

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
Chapter 1 [Reserved]

1-1 California Legal Forms--Transaction Guide Chapter 1

[Reserved]

Chapter 1[Reserved]



2 of 113 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS

1-1A California Legal Forms--Transaction Guide 1A.syn

§ 1A.syn Synopsis to Chapter 1A: ROLE OF COUNSEL IN STARTING A NEW BUSINESS

§ 1A.01 California Statutes

§ 1A.02 Federal Sources

[1] Statutes

[2] Regulations

§ 1A.03 Rules of Professional Conduct

[1] American Bar Association Model Rules of Professional Conduct

[2] California Rules of Professional Conduct

§ 1A.04 [Reserved]

§ 1A.05 Law Reviews and Periodicals

§ 1A.06 Annotations

§ 1A.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 1A.08-1A.09 [Reserved]

§ 1A.10 Advising Client on Business Start-Up Issues

[1] Ensuring That Client Makes Informed Decisions

[2] Specific Issues in Start-Up of New Business

[3] Need for Business Plan

[4] Advising Client Without Dictating Choices

§ 1A.11 Attorney's Relationship With Other Professionals

§ 1A.12 Collateral Work to be Performed by Attorney

§ 1A.13 Explaining Cost and Time Requirements to Client

[1] Analysis and Consultation

[2] Preparing Documents

[3] Fees for Collateral Work Performed by Attorney

§ 1A.14 Fee Agreements and Billing Statements

[1] Agreement at Outset of Relationship

[2] Written Fee Agreements

[3] Oral Fee Agreements

[4] Written Billing Statements

§ 1A.15 Referral Fees Prohibited

§ 1A.16 Limitation on Payment of Legal Fees by Someone Other Than Client

§ 1A.17 Continuing Nature of Representation

§§ 1A.18-1A.29 [Reserved]

§ 1A.30 Elements of Legal Malpractice Cause of Action

[1] Negligence Theory

[a] In General

[b] Duty of Attorney and Standard of Care

[c] "Error in Judgment" Rule

[2] Breach of Contract Theory

[3] Other Theories

§ 1A.31 Professional Responsibility Considerations

[1] Codes of Legal Ethics

[2] Relationship Between Malpractice and Ethics

§ 1A.32 Duty to Perform Competently

[1] In General

[2] Specialist Standard

[3] Duty to Refer

§ 1A.33 Identifying Conflicts of Interest

[1] Identifying the Client

[2] Representing the Business Entity

[a] Nature of Representation

[b] Disclosure Required When Constituents Also Represented

§ 1A.34 Representing Multiple Parties

[1] Duty to Identify Conflict

[2] Duty to Inform Client

[3] When Multiple Representation Is Inadvisable

[4] Choosing to Represent One Client

§ 1A.35 Conflicts Involving Prior Representation

§ 1A.36 Conflicts Involving Attorney in Other Roles

[1] Attorney as Investor

[2] Attorney as Corporate Agent, Director, or Officer

[3] Attorney as Witness

§ 1A.37 Minimizing Risk of Conflict of Interest

[1] Disclosure Letter Tailored to Specific Conflicts

[2] Conflict-Identification System

§ 1A.38 Prohibition on Attempts to Limit Malpractice Exposure

§§ 1A.39-1A.49 [Reserved]

§ 1A.50 Selection of Business Name

[1] Preliminary Considerations

[2] Name Restrictions

[a] Sole Proprietorship

[b] General and Limited Partnerships

[c] Limited Liability Partnership

[d] Corporation

[e] Limited Liability Company

§ 1A.51 Fictitious Business Name

[1] Who Must File

[2] "Fictitious Business Name" Defined

[a] Sole Proprietorship

[b] General Partnership

[c] Limited Partnership

[d] Limited Liability Partnership

[e] Corporation

[f] Limited Liability Company

[3] When to File

[4] Where to File

[5] Publication Requirement

[6] Penalties for Noncompliance

§ 1A.52 Trade Marks and Trade Names

[1] Relation to Business Name

[2] Registration of Trademarks and Trade Names

[a] Nature of Protection

[b] California Registration

[c] Federal Registration

§§ 1A.53-1A.99 [Reserved]

§ 1A.100 Client Interview

[1] Facts

[a] Natural Persons Participating in New Business

Scope

[b] Entities Participating in New Business

Scope

[c] Other Professionals Involved in Business Start-Up

Scope

[d] Business Activity

Scope

[2] Documents

Scope

§§ 1A.101-1A.109 [Reserved]

§ 1A.110 Scope of Work to Be Performed by Attorney

Scope

§ 1A.111 Collateral Work to be Performed by Attorney

Scope

§ 1A.112 Fees and Fee Agreements

Scope

§ 1A.113 Identifying Conflicts of Interest

Scope

§ 1A.114 Need for Fictitious Business Name Statement

Scope

§ 1A.115 Need for Trademark, Service Mark, or Trade Name Protection

Scope

§§ 1A.116-1A.129 [Reserved]

§ 1A.130 Filing Fictitious Business Name Statement

Scope

§ 1A.131 Registering Trademark or Service Mark

Scope

§§ 1A.132-1A.139 [Reserved]

§ 1A.140 Filing New Fictitious Business Name Statement on Change of Facts or Expiration of Previously-Filed Statement

Scope

§ 1A.141 Filing Statement of Abandonment of Fictitious Business Name

Scope

§ 1A.142 Filing Statement of Withdrawal by General Partner

Scope

§§ 1A.143-1A.199 [Reserved]

§ 1A.200 Engagement Letter

[1] Comment--Use of Form

[2] Form

Engagement Letter

§ 1A.201 Letter Advising Nonclients of Attorney's Limited Role

[1] Comment--Use of Form

[2] Form

Letter Advising Nonclients of Attorney's Limited Role

§ 1A.202 Closing Letter

[1] Comment--Use of Form

[2] Form

Closing Letter

§ 1A.203 Conflict Disclosure Letter and Consent

[1] Comment

[a] Use of Form

[b] Conflicts Between Clients and Former Clients

[c] Additional Disclosure and Consent if Potential Conflict Becomes Actual

[d] Obtaining Consent

[2] Form

Conflict Disclosure Letter and Consent

§ 1A.204 Letter Requesting Consent From Adverse Client

[1] Comment

[a] Use of Form

[b] When Consent Is Required

[2] Form

Letter Requesting Consent From Adverse Client

§ 1A.205 Fictitious Business Name Statement

[1] Comment

[a] Use of Form

[b] Who Must File

[c] Required Contents

[d] When to File

[e] Where to File; Forms to Be Furnished by County Clerk

[f] Execution and Publication Requirements

[g] Effect of Filing

[2] Form

Fictitious Business Name Statement

§ 1A.206 Privacy Notice

[1] Comment

[a] Use of Form

[b] Governing Law

[c] Scope of Privacy Protection

[d] "Nonpublic Personal Information" Defined

[e] "Financial Institutions" Defined

[f] Initial Privacy Notice Requirements

[g] Annual Privacy Notice Requirements

[h] "Clear and Conspicuous" Notice Requirements

[2] Form

Privacy Notice



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS

1-1A California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter covers the role of the attorney in starting a new business. It discusses the scope of the attorney's role; the attorney's relationship with other professionals such as accountants, insurance agents, and business consultants; and professional responsibility considerations. Although a complete discussion of legal ethics is outside the scope of this chapter, the following ethical issues are discussed: competent representation; association of specialists; confidentiality; conflicts of interest, including representing multiple parties, representing the business entity, the attorney as investor, officer, or director; and minimizing conflicts risks. Also covered is the selection of a business name and the filing of a fictitious business name statement. Trade names, trademarks, and service marks, as they relate to business names, are briefly discussed.

Forms include consents to legal services; letters requesting consents from adverse clients and from clients on conflict of interest issues; engagement, nonengagement, and closing letters; and a fictitious business name statement.

For detailed coverage of selecting a form of business entity and starting operations, refer to Ch. 1B, *Selecting Form of Business Entity* , Ch. 1C, *Regulation of Employers* , Ch. 1D, *Overview of Employee Benefits* , Ch. 1E, *Taxation of Businesses* , and Ch. 1F, *Insurance Considerations in Business Formation* . For further discussion of the considerations in selecting a business name, see Ch. 2, *Formation of Corporations* , Ch. 12A, *Professional Corporations* , Ch. 12C, *Limited Liability Companies* , Ch. 15, *General Partnerships* , Ch. 15A, *Formation of Limited Partnerships* , and Ch. 16C, *Limited Liability Partnerships* . Trade names, trademarks, and service marks are discussed in Ch. 103B, *Trademarks* .



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART I. RESEARCH GUIDE
A. Primary Sources

1-1A California Legal Forms--Transaction Guide § 1A.01

§ 1A.01 California Statutes

Special corporate name requirements. *Bus. & Prof. Code §§ 1804, 2285, 2415, 5536, 6171, 6738.*
Dental corporations. *Bus. & Prof. Code § 1804.*
Medical corporations. *Bus. & Prof. Code §§ 2285, 2415.*
Architectural corporations. *Bus. & Prof. Code § 5536.*
Law corporations. *Bus. & Prof. Code § 6171.*
Engineering corporations. *Bus. & Prof. Code § 6738.*

Regulation of attorneys. *Bus. & Prof. Code § 6000 et seq.*
Duties of attorney. *Bus. & Prof. Code § 6068.*
Fee for services; bills for services rendered. *Bus. & Prof. Code § 6148.*

Registration and protection of trademarks (Model State Trademark Law). *Bus. & Prof. Code § 14200 et seq.*
Service mark defined. *Bus. & Prof. Code § 14202(b).*
Trademark defined. *Bus. & Prof. Code § 14202(a).*
Trade name defined. *Bus. & Prof. Code § 14202(d).*
Common law rights. *Bus. & Prof. Code § 14259.*
Application for registration. *Bus. & Prof. Code § 14205 et seq.*
Priority of previously registered mark. *Bus. & Prof. Code § 14230(c)(6).*

Registration and protection of trademarks. *Bus. & Prof. Code § 14200 et seq.*
Service mark defined. *Bus. & Prof. Code § 14202(b).*
Trademark defined. *Bus. & Prof. Code § 14202(a).*
Trade name defined. *Bus. & Prof. Code § 14202(d).*
Common law rights. *Bus. & Prof. Code § 14259.*
Statutory requirement and application for registration. *Bus. & Prof. Code § 14205 et seq.*
Previously used marks. *Bus. & Prof. Code § 14230(c)(6).*

Tradenames and designations. *Bus. & Prof. Code § 14401 et seq.*
Presumption applicable to fictitious business name statement. *Bus. & Prof. Code § 14411 et seq.*
Notice that filing articles of incorporation does not itself authorize use of corporate name. *Bus. & Prof. Code § 14417*.
Effect of filing fictitious business name statement. *Bus. & Prof. Code § 14418*.

Fictitious business names. *Bus. & Prof. Code § 17900 et seq.*
Fictitious business name defined. *Bus. & Prof. Code § 17900(b)*.
Time for filing statement. *Bus. & Prof. Code § 17910*.
Fictitious business name statement requirements; form. *Bus. & Prof. Code § 17913*.
Filing. *Bus. & Prof. Code § 17915*.
What constitutes filing. *Bus. & Prof. Code § 17916*.
Publication; filing affidavit of publication. *Bus. & Prof. Code § 17917*.
Effect of failure to file. *Bus. & Prof. Code § 17918*.
Duration of statement; expiration. *Bus. & Prof. Code § 17920*.
Abandonment of fictitious name; filing statement. *Bus. & Prof. Code § 17922*.
Withdrawal from partnership; filing statement. *Bus. & Prof. Code § 17923*.
Forms to be furnished by county clerk. *Bus. & Prof. Code § 17924*.
Filing fees. *Bus. & Prof. Code § 17929*.

Statute of limitations: actions against attorney for wrongful act or omission, other than fraud. *Code Civ. Proc. § 340.6*.

Initiation of corporate existence; execution of articles. *Corp. Code § 200*.

Prohibited corporate names. *Corp. Code § 201 et seq.*
Reservation of name. *Corp. Code § 201*.
When certificate of insurance commissioner is required. *Corp. Code § 201.5*.

Articles of incorporation; required provisions. *Corp. Code § 202*.

Statement of dissolution of partnership. *Corp. Code § 16805*.

Limited partnership name. *Corp. Code §§ 15612* (CRLPA, repealed January 1, 2010), 15901.08 (ULPA '08).

Reservation of limited partnership name. *Corp. Code §§ 15613* (CRLPA, repealed January 1, 2010), 15901.13 (ULPA '08).

Formation of limited partnership; filing of certificate. *Corp. Code §§ 15621, 15712(b)(2)* (CRLPA, repealed January 1, 2010), 15902.01-15902.09 (ULPA '08).

Formation of limited liability company; filing of articles. *Corp. Code §§ 17050, 17051*.

Limited liability company name. *Corp. Code § 17052*.

Reservation of limited liability company name. *Corp. Code § 17053*.

Lawyer-client privilege in representation of joint clients. *Evid. Code § 962*.

Fictitious business name publication requirement. *Gov. Code § 6064*.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART I. RESEARCH GUIDE
A. Primary Sources

1-1A California Legal Forms--Transaction Guide § 1A.02

§ 1A.02 Federal Sources

[1] Statutes

Registration of federal trademarks. *15 U.S.C. § 1051*.

Trade name defined. *15 U.S.C § 1127*.

Corporate name restrictions: terms related to federal government. *18 U.S.C. § 709*.

Tax treatment of stock received in lieu of fees. *I.R.C. § 61(a)*.

Corporate name restrictions: terms and symbols related to Olympics. *36 U.S.C. § 380*.

[2] Regulations

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6 of 113 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART I. RESEARCH GUIDE
A. Primary Sources

1-1A California Legal Forms--Transaction Guide § 1A.03

§ 1A.03 Rules of Professional Conduct

[1] American Bar Association Model Rules of Professional Conduct

Competence. A.B.A. Model Rules Prof. Cond., Rule 1.1.

Scope of responsibility. A.B.A. Model Rules Prof. Cond., Rule 1.2.

Diligence. A.B.A. Model Rules Prof. Cond., Rule 1.3.

Communication. A.B.A. Model Rules Prof. Cond., Rule 1.4.

Fees. A.B.A. Model Rules Prof. Cond., Rule 1.5.

Confidentiality of information. A.B.A. Model Rules Prof. Cond., Rule 1.6.

Conflict of interest: general rule. A.B.A. Model RulesProf. Cond., Rule 1.7.

Conflict of interest: prohibited transactions. A.B.A. Model RulesProf. Cond., Rule 1.8.

Conflict of interest: former client. A.B.A. Model RulesProf. Cond., Rule 1.9.

[2] California Rules of Professional Conduct

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Failing to act competently. *Cal. Rules Prof. Cond., Rule 3-110.*

Avoiding adverse interests. *Cal. Rules Prof. Cond., Rule 3-300.*

Avoiding representation of adverse interests. *Cal. Rules Prof. Cond., Rule 3-310*.

Communication. *Cal. Rules Prof. Cond., Rule 3-500*.

Organization as client. *Cal. Rules Prof. Cond., Rule 3-600*.

Fees for legal services. *Cal. Rules Prof. Cond., Rule 4-200*.

Member as witness. *Cal. Rules Prof. Cond., Rule 5-210*.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART I. RESEARCH GUIDE
A. Primary Sources

1-1A California Legal Forms--Transaction Guide § 1A.04

[Reserved]

§ 1A.04[Reserved]



8 of 113 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1A California Legal Forms--Transaction Guide § 1A.05

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1A California Legal Forms--Transaction Guide § 1A.06

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1A California Legal Forms--Transaction Guide § 1A.07

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Ch. 1D, *Overview of Employee Benefits* .

Ch. 1E, *Taxation of Businesses* .

Ch. 1F, *Insurance Considerations in Business Formation* .

Ch. 2, *Formation of Corporations* .

Ch. 3, *Articles of Incorporation* .

Ch. 7, *Corporate Records and Reports* .

Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

Ch. 12, *Professional Corporations* .

Ch. 12C, *Limited Liability Companies* .

Ch. 15, *General Partnerships* .

Ch. 15A, *Formation of Limited Partnerships* .

Ch. 16C, *Limited Liability Partnerships* .

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1A California Legal Forms--Transaction Guide §§ 1A.08-1A.09

[Reserved]

§§ 1A.08[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
A. Role of Counsel

1-1A California Legal Forms--Transaction Guide § 1A.10

§ 1A.10 Advising Client on Business Start-Up Issues

[1] Ensuring That Client Makes Informed Decisions

When a new business is started, decisions must be made about the form of the enterprise and its structure, including management and control, financing, tax elections, employment relationships, and insurance coverage. If the client has made these decisions before consulting the attorney, the attorney should review the decisions with the client to ensure that the client has made informed decisions. The aspiring entrepreneur should be made aware that many new businesses fail. While external difficulties contribute to many failures, management experts generally agree that the inability to cope with these difficulties often results from management inexperience and a lack of knowledge and planning. Thus, one of the greatest services an attorney can perform in a business start-up is to provide the client with a checklist of typical issues to be resolved in selecting a form of business entity and in starting operations [*see [2], below*] and to emphasize the need for assistance to fill in any gap in expertise [*see [3], below*].

[2] Specific Issues in Start-Up of New Business

The additional chapters in this volume are designed to provide guidance in starting a new business. Chapter 1B, *Selecting Form of Business Entity* , outlines the various business forms available under California law and provides an overview of the tax and non-tax consequences of choosing a particular form. Chapter 1C, *Regulation of Employers*, discusses the scope, application, and requirements of laws regulating employers, including a discussion of licensing and registration requirements, environmental regulations, laws governing the hiring and promotion of employees, and the existence of the employer/employee relationship. Chapter 1D, *Overview of Employee Benefits,* discusses employee benefit programs and alternatives that businesses may want to offer their owners, participants, and employees. Chapter 1E, *Taxation of Businesses,* outlines various federal and California tax reporting and payment requirements that will arise for a new business, including income tax, withholding and employment tax, sales and use tax, and property tax considerations. Chapter 1F, *Insurance Considerations in Business Formation,* covers classes of insurance, types of policies, and insurance planning considerations for a new business.

[3] Need for Business Plan

A client who consults an attorney with respect to starting a business should already be knowledgeable about the type of business or business product, the nature of the market, and have a business plan, addressing specific goals and business objectives. Without such a plan, discussions of the appropriate form of business entity and other start-up considerations are futile. A client who does not yet have a business plan may wish to hire a business consultant, or seek the assistance of the Small Business Administration, which provides counseling, literature, and training workshops at its various offices throughout California. An attorney with a background in business management or business administration might also be able to help the client prepare a plan [*see § 1A.12*].

The financing considerations of a new business should be addressed by the business participants in consultation with a financial and tax advisor and a business banker. An attorney with financial, tax, or banking experience may wish to be involved in the decisions on business financing [*see § 1A.12*].

Other basic considerations should include the location and type of premises to be used for the business, significant assets to be purchased, private loans to be obtained, and any agreements to be entered into at the onset of the business venture.

[4] Advising Client Without Dictating Choices

Many of the issues for which an attorney is consulted in starting a new business do not have one correct answer. For example, even in cases where another organizational form appears preferable to the one traditionally used, the business owner may opt to use that form because he or she is "more comfortable" following tradition [*see* ch. 1B, *Selecting Form of Business Entity*]. In such circumstances, the attorney should be careful to fully inform the client of the legal ramifications of the client's choice, without dictating the client's choice.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewLegal EthicsClient RelationsEffective Representation



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
A. Role of Counsel

1-1A California Legal Forms--Transaction Guide § 1A.11

§ 1A.11 Attorney's Relationship With Other Professionals

As part of setting up a new business, the attorney typically collects information from the client and from other sources, analyzes the information, researches any problem areas, and advises the client regarding each major decision to be made. The attorney must work closely not only with the client, but also with the client's accountant or tax advisor, business consultant, insurance agent, lenders, and any key employees. It should be clearly established from the outset who will make or participate in making each decision in forming and structuring the new business. Even if someone else is primarily responsible for tax planning, the attorney should arrange to be kept informed of any tax decisions, since there is a close relationship between tax considerations and structuring the new business.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewLegal EthicsClient RelationsEffective Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
A. Role of Counsel

1-1A California Legal Forms--Transaction Guide § 1A.12

§ 1A.12 Collateral Work to be Performed by Attorney

The number of attorneys who practice simultaneously in law and in other fields, such as financial planning, is increasing, as is the number of interdisciplinary teams (including attorneys, accountants, financial planners, insurance, real estate and securities brokers) that provide the client with a full range of business planning services. The client may want the attorney to perform services that are incidental to getting the business started. Such services may include helping the client obtain business licenses, permits, and insurance, obtaining bonds, reviewing proposed leases or purchase contracts, preparing employment agreements or buy-sell agreements, applying for a federal and state employer identification numbers, preparing and filing a Subchapter S corporation election, obtaining a permit from the California Department of Corporations for issuing or offering shares or other securities, preparing an offering circular, selecting and obtaining a business name, or counseling participants regarding financing and the valuation of contributions to the business.

Whether the attorney performs collateral tasks or works as part of an interdisciplinary team, the responsibility for each task should be clearly established from the outset. For discussion of the attorney's obligation to consult or associate with a specialist when the attorney does not have the requisite level of skill to complete the work properly, refer to *§ 1A.32[2]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewLegal EthicsClient RelationsEffective Representation



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
A. Role of Counsel

1-1A California Legal Forms--Transaction Guide § 1A.13

§ 1A.13 Explaining Cost and Time Requirements to Client

[1] Analysis and Consultation

The most valuable service an attorney usually provides is to collect and analyze pertinent facts and to research any resulting issues necessary to working out a business structure that will achieve the most satisfying results for the client. This process can be time-consuming. For example, the attorney may have to analyze the tax and non-tax consequences of choosing a particular organizational form to determine which form provides the client the greatest overall benefits [*see* Ch. 1B, *Selecting Form of Business Entity*], or the attorney may have to evaluate alternate funding methods for a buy-sell agreement [*see* Ch. 1F, *Insurance Considerations*] or draft the agreement itself [*see*, Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*]. These issues will ordinarily be discussed with the client at the first meeting; both the attorney and the client should clearly understand the work to be performed and the resulting time and cost of that work. It is good business practice to send a follow-up letter confirming this understanding [*see § 1A.200*]. Written fee agreements are discussed in *§ 1A.14*.

[2] Preparing Documents

Many clients have misconceptions about how much time it takes to prepare customized documents, perhaps as a result of standardized forms and self-help handbooks. An occasional task may present no legal issues and can be routinely processed, using standardized forms, in a short period of time for a small fee; however, this is the exception rather than the rule. In most cases, preparing documents is a time-consuming and costly process.

[3] Fees for Collateral Work Performed by Attorney

The attorney and client should discuss at the first meeting which tasks the attorney will handle and which tasks the client will either handle directly or by retaining another professional to handle [*see §§ 1A.11, 1A.12*]. Any fees for additional work to be performed by the attorney should be discussed and agreed on in advance, so that there is no assumption on the part of the client that such ancillary fees are included in the consultation fees. For discussion of fees and fee agreements, refer to *§ 1A.14*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewLegal EthicsClient RelationsAttorney FeesFee AgreementsLegal EthicsClient RelationsEffective Representation



16 of 113 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
A. Role of Counsel

1-1A California Legal Forms--Transaction Guide § 1A.14

§ 1A.14 Fee Agreements and Billing Statements

[1] Agreement at Outset of Relationship

Fees and any special fee payment arrangements should be discussed and agreed upon at the onset of the attorney-client relationship: this reduces the likelihood of misunderstandings and future disagreements [*see Bus. & Prof. Code § 6148*]. It is good practice to summarize the arrangements in a written fee and representation agreement, even when not required by statute [*see [2], [3], below*] so as to clearly define the fee arrangement and the responsibilities of the attorney and client under the contract.

[2] Written Fee Agreements

A California attorney who represents a client on a noncontingency basis must have a written fee agreement with the client whenever it is reasonably foreseeable that the client's total expense, including fees, will exceed $1,000 [*Bus. & Prof. Code § 6148(a)*]. The fee agreement must include [*Bus. & Prof. Code § 6148(a)*]:

- The attorney's hourly rate and other standard rates;
- The general nature of the legal services to be provided to the client;
- The respective responsibilities of the attorney and the client under the agreement; and
- A disclosure statement if the attorney does not maintain errors and omissions insurance coverage in the amount prescribed by statute.

Additionally, a disclosure statement is required if the attorney does not maintain the errors and omission coverage required by the Business and Professions Code and has not filed with the State Bar an executed copy of a written agreement guaranteeing payment of all established claims for errors and omissions arising out of the attorney's practice of law in the amount specified by the Law Corporation Rules of the State Bar [*see* State Bar Law Corp. Rules, Rule IV(B)(1)]; or, if a law corporation, the attorney has not filed with the State Bar an executed copy of the written

agreement required pursuant to the Law Corporation Rules of the State Bar, Rule IV(B)(1)(a), (b), or (c).

If the attorney fails to comply with the statutory requirements, the fee agreement generally becomes voidable at the client's option [*Bus. & Prof. Code § 6148(c)*]. However, even if the agreement is voided by the client, the attorney is entitled to collect a "reasonable" fee [*Bus. & Prof. Code § 6148(c)*]. Refer to Ch. 86, *Agreements for Professional Services*, for sample written fee agreement forms. Sample forms approved by the State Bar of California Board of Governors may be obtained from the State Bar for a small fee.

[3] Oral Fee Agreements

Unless it is for a contingency fee [*see Bus. & Prof. Code § 6147*], an oral fee agreement is enforceable when one of the following applies:

- It is reasonably foreseeable that the client's total expense, including fees and costs, will not exceed $1,000 [*Bus. & Prof. Code § 6148(a)*];
- Foreseeable prejudice to the rights or interests of a client presents an emergency need for legal services or when a writing is otherwise impractical [*Bus. & Prof. Code § 6148(d)(1)*];
- The fee agreement is implied in fact by prior services of the same general nature rendered by the attorney and paid for by the client [*Bus. & Prof. Code § 6148(d)(2)*];
- The client, after full disclosure, makes a written waiver of the benefits of *Business and Professions Code Section 6148* [*Bus. & Prof. Code § 6148(d)(3)*];
- The client is a corporation [*Bus. & Prof. Code § 6148(d)(4)*].

[4] Written Billing Statements

Attorneys are required to provide their clients with written billing statements, clearly stating the method used to determine the attorney's fees [*Bus. & Prof. Code § 6148(b)*]. A client may demand such a statement at minimum intervals of 30 days; the attorney must provide a statement within 10 days after the demand [*Bus. & Prof. Code § 6148(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsAttorney FeesFee AgreementsLegal EthicsClient RelationsBilling & Collection



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
A. Role of Counsel

1-1A California Legal Forms--Transaction Guide § 1A.15

§ 1A.15 Referral Fees Prohibited

An attorney must not compensate any person or entity for a client referral [*Cal. Rules Prof. Cond., Rule 1-320(B)*]. If both the attorney and the referrer have an understanding that the attorney will direct the client's use of the referrer's services, that arrangement is a *prima facie* ethics violation [*see Cal. Rules Prof. Cond., Rule 1-320(B)*]. Further, fee splitting with non-lawyers is generally prohibited [*see Cal. Rules Prof. Cond., Rule 1-320(A)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAttorney FeesFee SplittingLegal EthicsProfessional ConductNonlawyers



18 of 113 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
A. Role of Counsel

1-1A California Legal Forms--Transaction Guide § 1A.16

§ 1A.16 Limitation on Payment of Legal Fees by Someone Other Than Client

An attorney must not accept compensation for representing a client from someone other than the client unless certain conditions are satisfied. First, the payment must not interfere with the attorney's independent professional judgment or the attorney-client relationship [*Cal. Rules Prof. Cond., Rule 3-310(F)*]. Second, the attorney must maintain the confidentiality of information related to the client's representation [*Cal. Rules Prof. Cond., Rule 3-310(F)*; *see Bus. and Prof. Code § 6068(e)*]. Finally, the attorney must obtain the client's informed, written consent [*Cal. Rules Prof. Cond., Rule 3-310(F)*]. For further discussion of fees and fee agreements, refer to *Section 1A.14.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAttorney FeesFee AgreementsLegal EthicsClient RelationsConfidentiality of InformationLegal EthicsClient RelationsConflicts of Interest



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
A. Role of Counsel

1-1A California Legal Forms--Transaction Guide § 1A.17

§ 1A.17 Continuing Nature of Representation

An attorney is required to keep clients reasonably informed of significant developments in matters with regard to which the attorney has agreed to provide legal services [*Bus. & Prof. Code § 6068(m)*]. There is not much litigation in this area and case law has yet to establish the extent of this duty. As a practical matter, the attorney should point out to the client the effect that any change in the client's personal life can have on business planning; for example, with regard to insurance considerations. It has been suggested that the attorney has a duty to contact the client after the initial representation is completed if the attorney promises to keep the client informed of future changes in the law relevant to the client or if the relationship between the attorney and client is such that the attorney should do so, as in the case of an attorney who is closely involved in a client's affairs on an ongoing basis.

Given the current uncertainty in the law, the attorney should deal explicitly with the scope of representation in either the engagement letter or the closing letter to the client [*see § 1A.202*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsEffective Representation



20 of 113 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
A. Role of Counsel

1-1A California Legal Forms--Transaction Guide §§ 1A.18-1A.29

[Reserved]

§§ 1A.18[Reserved]



21 of 113 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
B. Legal Malpractice and Ethical Considerations

1-1A California Legal Forms--Transaction Guide § 1A.30

§ 1A.30 Elements of Legal Malpractice Cause of Action

[1] Negligence Theory

[a] In General

California law treats legal malpractice claims in the same manner as other tort claims based on negligence by a professional [*see Bucquet v. Livingston (1976) 57 Cal. App. 3d 914, 921, 129 Cal. Rptr. 514]* . The key elements of a cause of action for legal malpractice are [*see Budd v. Nixen (1971) 6 Cal. 3d 195, 200, 98 Cal. Rptr. 849, 491 P.2d 433* ; *Bucquet v. Livingston (1976) 57 Cal. App. 3d 914, 920-921, 129 Cal. Rptr. 514]* :

- The attorney's duty to use such skill, prudence, and diligence as other members of the profession commonly possess and exercise;
- The attorney's breach of the duty by failing to perform with the requisite degree of skill;
- A proximate causal connection between the attorney's negligence and the injury; and
- Damage to the client.

For complete coverage of an attorney's liability for malpractice, see California Forms of Pleading and Practice, Ch. 76, *Attorney Professional Responsibility* (Matthew Bender).

[b] Duty of Attorney and Standard of Care

In performing professional services for a client, an attorney has the duty to have that degree of learning and skill ordinarily possessed by reputable attorneys practicing in the same or a similar locality and under similar circumstances [California Jury Instructions Civil: Book of Approved Jury Instructions (1986) §§ 6.37, 6.37.5; *see Lucas v. Hamm (1961) 56 Cal. 2d 583, 591, 15 Cal. Rptr. 821, 364 P.2d 685* ; *Ishmael v. Millington (1966) 241 Cal. App. 2d 520, 523, 50 Cal. Rptr. 592]* .

[c] "Error in Judgment" Rule

While the standard of care required of an attorney is high, it is not tantamount to perfection [*see Lucas v. Hamm (1961) 56 Cal. 2d 583, 591, 15 Cal. Rptr. 821, 364 P.2d 685]* . An attorney may be absolved from malpractice liability if, although mistaken, his or her opinion represents a reasonable exercise of informed judgment grounded on a professional evaluation of applicable legal principles. A claim of professional negligence cannot be founded on an error of judgment on a question of law [*Davis v. Damrell (1981) 119 Cal. App. 3d 883, 888, 174 Cal. Rptr. 257]* .

[2] Breach of Contract Theory

California courts have also held that in failing to exercise reasonable care, an attorney may be found to have breached an implied duty to exercise the reasonable skill, care, and diligence implied in the contract for services entered into between attorney and client [*see, e.g., Lucas v. Hamm (1961) 56 Cal. 2d 583, 591-592, 15 Cal. Rptr. 821, 364 P.2d 685]* . Although an attorney may agree to perform a particular task, thus creating an express contract [*see Lindner v. Eichel (1962) 232 N.Y.S.2d 240, 243 , aff'd, 233 N.Y.S.2d 238*], more commonly, an attorney impliedly agrees to act with ordinary professional skill [*see, e.g., Lucas v. Hamm (1961) 56 Cal. 2d 583, 591-592, 15 Cal. Rptr. 821, 364 P.2d 685]* . Thus, a plaintiff frequently pleads a malpractice action on the alternate theories of negligence and breach of contract.

[3] Other Theories

An attorney may be liable to a client on the theories of breach of fiduciary duty or fraud [*Day v. Rosenthal (1985) 170 Cal. App. 3d 1125, 1159, 217 Cal. Rptr. 89 , cert. denied, 475 U.S. 1048, 106 S. Ct. 1267, 89 L. Ed. 2d 576 (1986)]* . Intentional misrepresentations about the law and legal principles may give rise to fraud claims to the extent that a client justifiably relies on those statements [*see Day v. Rosenthal (1985) 170 Cal. App. 3d 1125, 1159-1160, 217 Cal. Rptr. 89* , cert. denied, *475 U.S. 1048, 106 S. Ct. 1267, 89 L. Ed. 2d 576 (1986)* ; *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz (1976) 57 Cal. App. 3d 104, 111, 128 Cal. Rptr. 901]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
TortsMalpractice & Professional LiabilityAttorneysTortsNegligenceDutyGeneral OverviewTortsNegligenceProofCustomProfessional CustomsTortsNegligenceStandards of CareSpecial CareHighly Skilled Professionals



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
B. Legal Malpractice and Ethical Considerations

1-1A California Legal Forms--Transaction Guide § 1A.31

§ 1A.31 Professional Responsibility Considerations

[1] Codes of Legal Ethics

Legal ethics for attorneys are codified in a number of places, including: The California Rules of Professional Conduct; the California Business and Professions Code [*Bus. & Prof. Code §§ 6000-6326*]; the American Bar Association Model Code of Professional Responsibility; and the American Bar Association Model Rules of Professional Conduct. Of particular interest to California attorneys are The California Rules of Professional Conduct, which were substantially revised effective May, 1989 and amended in September, 1992.

For complete coverage of an attorney's professional responsibilities, see California Forms of Pleading and Practice, Ch. 72, *Attorney Practice and Ethics* (Matthew Bender).

[2] Relationship Between Malpractice and Ethics

With increasing frequency, issues that have traditionally been considered "ethical" issues are making their way into the area of legal malpractice. Notwithstanding the disclaimer in both the California Rules of Professional Conduct and the American Bar Association Model Rules of Professional Responsibility that they are not "intended to create new civil causes of action" [*Cal. Rules Prof. Cond., Rule 1-100(A)*; *see Cal. Rules Prof. Cond., Rule 1-100,* discussion (member engaging in conduct contrary to rules does not automatically give rise to civil cause of action); A.B.A. Model Rules of Prof. Resp., amended 1991, scope, p. 9 (rules "not designed to be a basis for civil liability")], recent court decisions in malpractice suits have interpreted these standards as rules of law, rather than rules of conduct, compelling (rather than suggesting) the described conduct [*see Mirabito v. Liccardo (1992) 4 Cal. App. 4th 41, 45-46, 5 Cal. Rptr. 2d 571* (and cited antecedent cases)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsGeneral OverviewTortsMalpractice & Professional LiabilityAttorneys



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
B. Legal Malpractice and Ethical Considerations

1-1A California Legal Forms--Transaction Guide § 1A.32

§ 1A.32 Duty to Perform Competently

[1] In General

An attorney has the duty to perform legal services competently [*Cal. Rules Prof. Cond., Rule 3-110*; A.B.A. Model Rules Prof. Cond. (1983), Rules 1.1, 1.3]. Counseling a client on choice of business form, for example, can involve many areas of law, including not only corporation law, but also federal and state taxation law related to corporate, partnership and individual income taxation, estate planning, property law, contract law, and federal and state securities regulation. The attorney should become fully informed regarding the legal and procedural aspects of each task undertaken and should consult with an expert when appropriate [*see [2], below*].

[2] Specialist Standard

A general practitioner has the duty to refer a client to a specialist or to recommend the assistance of a specialist if a reasonably careful, skillful practitioner would do so under similar circumstances; alternatively, the general practitioner has the duty to perform with the knowledge, care, and skill required of a specialist under similar circumstances [*see Horne v. Peckham (1979) 97 Cal. App. 3d 404, 414, 158 Cal. Rptr. 714* ; *see also [3], below*]. A defense based on the argument that the attorney's conduct met the standard of care expected of a general practitioner when a specialist was required will not suffice in a legal malpractice case [*see Horne v. Peckham (1979) 97 Cal. App. 3d 404, 415, 158 Cal. Rptr. 714* ; *Wright v. Williams (1975) 47 Cal. App. 3d 802, 809-810, 121 Cal. Rptr. 194]* .

[3] Duty to Refer

If an attorney faces a problem requiring the expertise of a specialist, the attorney should associate such a specialist or refer the matter to a specialist [*see Horne v. Peckham (1979) 97 Cal. App. 3d 404, 414-415, 158 Cal. Rptr. 714]* . However, the attorney must exercise due care in referring to or associating another attorney: the attorney who decides to associate other counsel may be deemed liable to the extent that he or she does not adequately investigate the qualifications of the associated attorney [*Tormo v. Yormark (D.N.J. 1975) 398 F. Supp. 1159, 1171-1172* (attorney could be liable for negligent referral because he did not investigate qualifications of associated attorney who subsequently embezzled client's funds)]. Furthermore, if the client is referred to another attorney, the original attorney

must take care to warn the client of any deadline or other time-related exigencies [*see Miller v. Metzinger (1979) 91 Cal. App. 3d 31, 42, 154 Cal. Rptr. 22* (initially consulted attorney who referred client to specialist attorney could be liable for failure to warn client of eight-day deadline on statute of limitations)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsEffective RepresentationTortsMalpractice & Professional LiabilityAttorneysTortsNegligenceStandards of CareSpecial CareHighly Skilled Professionals



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
B. Legal Malpractice and Ethical Considerations

1-1A California Legal Forms--Transaction Guide § 1A.33

§ 1A.33 Identifying Conflicts of Interest

[1] Identifying the Client

An attorney who is asked to assist in the start-up of a new business must first ascertain which party the attorney represents: the entity itself, a single participant, some or all of the participants, or a combination of these parties. Unless the attorney chooses not to represent more than one party [*see § 1A.34[4]*], the initial conflict of interest disclosure letter should identify those represented [*see § 1A.203*].

[2] Representing the Business Entity

[a] Nature of Representation

In representing a business entity, the attorney representation must conform to the concept that the client is "the organization itself, acting through its highest authorized officer, employee, body, or constituent overseeing the particular engagement" [*Cal. Rules Prof. Cond., Rule 3-600(A)*; *see Meehan v. Hopps (1956) 144 Cal. App. 2d 284, 290, 301 P.2d 10* (attorney for corporation represents corporation and its shareholders and officers in their representative capacity; attorney does not represent corporation's officers personally)]. Whenever it becomes apparent that the entity's interests are or may become adverse to those of its directors, officers, employees, members, shareholders, or other constituents, the attorney must identify the client for whom the attorney is acting [*Cal. Rules Prof. Cond., Rule 3-600(D)*; *see* A.B.A. Model Rules Prof. Cond., Rule 1.13; *see also Johnson v. Superior Court (1995) 38 Cal. App. 4th 463, 477-478, 45 Cal. Rptr. 2d 312* (merely representing partnership does not constitute representing partners, since various factors must be considered in determining whether partnership's attorney has established attorney-client relationship with partners)].

[b] Disclosure Required When Constituents Also Represented

An attorney representing an entity may also represent its constituents, provided that the attorney makes a written disclosure to the client in accordance with The *California Rules of Professional Conduct 3-310(B)* and discloses his or her relationship to the entity [*Cal. Rules Prof. Cond., Rule 3-600(E)*]. Dual representation of clients whose interests

conflict is permitted, under certain circumstances, if the attorney obtains the written consent of each client [*Cal. Rules Prof. Cond., Rule 3-600(E)*; *see Pringle v. La Chapelle (1999) 73 Cal. App. 4th 1000, 1005-1007, 87 Cal. Rptr. 2d 90* (although attorney failed to follow *Rule 3-600(E)*, violation of rule does not automatically preclude attorney from obtaining fees)]. Caution should be exercised, however, in dual representation when an actual conflict of interest exists [*see § 1A.34[1]*]. Even without an actual conflict, under some circumstances, an attorney should not undertake multiple representation [*see § 1A.34[3]*]. For discussion of the conflict of interest issues that may arise once a new business is up and running if the attorney represents a client he or she represented during the business formation, refer to *§ 1A.34[3]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsGeneral OverviewLegal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsConflicts of Interest



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
B. Legal Malpractice and Ethical Considerations

1-1A California Legal Forms--Transaction Guide § 1A.34

§ 1A.34 Representing Multiple Parties

[1] Duty to Identify Conflict

In a business start-up, it is not uncommon for the parties to request that one attorney represent the entity itself, as well as the individual participants. Under the right circumstances, having one attorney represent all parties can result in a simpler, less expensive, and more harmonious transaction than if each party were represented by separate counsel. However, an attorney who is asked to represent multiple parties to a single transaction must first identify any actual or potential conflict and then determine whether the conflict may be waived. If the conflict may be waived, a suitable waiver must be obtained [*see Cal. Rules Prof. Cond., Rule 3-310(C)*; *see also § 1A.203*].

Although it appears, under the California Rules of Professional Conduct, that an attorney may represent clients with actual or potential conflicting interests, provided each client gives its informed, written consent [*Cal. Rules Prof. Cond., Rule 3-310(C)*], California courts have held that joint representation is not permitted in litigation, if an actual conflict exists [*see Klemm v. Superior Court (1977) 75 Cal. App. 3d 893, 898, 142 Cal. Rptr. 509]* . However, if the conflict is merely potential, then with full disclosure to and informed consent of all clients, there may be multiple representation at a hearing or trial [*Klemm v. Superior Court (1977) 75 Cal. App. 3d 893, 899, 142 Cal. Rptr. 509]* . Joint representation is also permitted, in a nonlitigation context, provided that all parties give their informed, written consent [*Klemm v. Superior Court (1977) 75 Cal. App. 3d 893, 898, 142 Cal. Rptr. 509]* .

[2] Duty to Inform Client

An attorney seeking to represent multiple parties must inform each client of the relevant circumstances and of the actual and foreseeable adverse consequences to the client [*Cal. Rules Prof. Cond., Rule 3-310(A)*]. Generally, an attorney must disclose, in understandable terms, all facts and circumstances that, in the judgment of an attorney of ordinary skill and capacity, will enable the client to make an intelligent decision on multiple representation [*Lysick v. Walcom (1968) 258 Cal. App. 2d 136, 147, 65 Cal. Rptr. 406* (decided before amendment of *Rule 3-310*)]. The attorney should caution the client that multiple representation limits the attorney-client communications privilege, because communications by one client to an attorney on issues that affect multiple representation are not privileged when the communication is offered in a civil action between those clients [*Evid. Code § 962*; *Wortham & Van Liew v. Superior Court (1987) 188*

Cal. App 3d 927, 933, 233 Cal. Rptr. 725] .

Even if the attorney identifies no current conflicts of interest, potential conflicts may exist because the parties' interest, often identical in a business start-up, may differ as the business progresses. The attorney must anticipate and disclose "any reasonably foreseeable adverse consequences" of representation of adverse interests [*Cal. Rules Prof. Cond., Rule 3-310(A)*]. Moreover, if the potential adversity becomes actual adversity, the attorney must obtain the further informed written consent of the client [*Cal. Rules Prof. Cond., Rule 3-310*, discussion]. Refer to *Section 1A.203 [2]* for an optional provision disclosing the possibility of a potential conflict when no actual conflict exists.

[3] When Multiple Representation Is Inadvisable

Even when the disclosure and consent requirements of the California Rules of Professional Conduct have been met [*see Cal. Rules Prof. Cond., Rule 3-310*], it may be inadvisable for an attorney to represent more than one party to the transaction. For example, unless the attorney is careful to distinguish between the business entity and its participants, the attorney risks representing the business inadequately. Furthermore, when multiple parties are involved, difficulties in communication and consensus may make multiple representation impractical. Also, if an actual conflict exists that is likely to be litigated, or if the participants' interests will likely conflict in the future, the attorney may be required (when an actual present conflict exists at hearing or at trial) to withdraw and may be disqualified from representing any of the parties, even if disclosure was made and consent properly obtained [*see Klemm v. Superior Court (1977) 75 Cal. App. 3d 893, 898, 142 Cal. Rptr. 509]* . Under these circumstances, both the client's and the attorney's best interests may dictate that the attorney avoid multiple representation.

[4] Choosing to Represent One Client

Attorneys sometimes choose to avoid potential or actual conflicts of interest, or the practical problems of multiple representation [*see [3], above*], by representing only one party to the transaction. In these circumstances, it is important to advise both the attorney's client and the other parties to the transaction that the attorney represents only a designated client and will not provide legal advice or services to the other parties. The attorney should also advise nonclients that they are free to retain independent counsel [*see § 1A.201*]. Written confirmation of the attorney's limited role and advice to nonclients to seek independent counsel will help protect both the attorney and nonclients from problems arising from uncertainty or misunderstandings about the attorney's role in the transaction.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsConflicts of Interest



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
B. Legal Malpractice and Ethical Considerations

1-1A California Legal Forms--Transaction Guide § 1A.35

§ 1A.35 Conflicts Involving Prior Representation

It is not uncommon for an attorney who represented a business or one of its participants in a business start-up to be asked to represent the business or some or all of the participants in another matter once the business is operational. In this situation, the attorney must fully disclose, in writing, to the current client any previous relationships (legal, business, financial, professional, or personal) that the attorney had with any party in the same matter, or any party affected by the resolution of the matter or by the attorney's representation [*Cal. Rules Prof. Cond., Rule 3-310(B)(2),(3)*]. "Full disclosure" means informing of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences of such representation to the client (or former client) [*Cal. Rules Prof. Cond., Rule 3-310(A)*].

The attorney must obtain the current client's written consent to representation despite the attorney's previous relationships [*Cal. Rules Prof. Cond., Rule 3-310(C)*]. This written disclosure of any previous relationships and the client's written consent are required, regardless of whether the interests of the current clients conflict with those of the parties with whom the attorney has had a relationship and whether the attorney has obtained confidential information related to the current representation [*see Cal. Rules Prof. Cond., Rule 3-310(B), (C)*]. The disclosure must be made to and the consent obtained from the clients to be currently represented, and not clients or former clients with whom the attorney has had a relationship [*Cal. Rules Prof. Cond., Rule 3-310(B)*], unless the proposed representation is (1) adverse to a current or a former client and relates to a matter for which the attorney has obtained confidential information [*see Cal. Rules Prof. Cond., Rule 3-310(E)*]; or (2) the prior relationships are with current clients [*see Cal. Rules Prof. Cond., Rule 3-310(B)*]. In these circumstances, the attorney must not only obtain the informed, written consent of the current client [*see Cal. Rules Prof. Cond., Rule 3-310(B)*], but also the informed, written consent of the former or current client whose interests are adverse to the anticipated representation [*Cal. Rules Prof. Cond., Rule 3-310(E)*]. "Informed consent" means the client's or former client's written agreement to the representation following written disclosure [*Cal. Rules Prof. Cond., Rule 3-310(A)*]. A failure to obtain consent may result in the attorney's disqualification in the event of litigation [*Civil Service Com. v. Superior Court (1984) 163 Cal. App. 3d 70, 82-83, 209 Cal. Rptr. 159]* , as well as possible disciplinary action or malpractice.

Whether a relationship exists between an individual and an attorney and what constitutes "representation" can be

difficult to define [*Civil Serv. Comm'n v. Superior Court (1984) 163 Cal. App. 3d 70, 76-77, 209 Cal. Rptr. 159]* , and a court may have to make that determination [*see Meehan v. Hopps (1956) 301 P.2d 10* (no relationship existed between corporate counsel and former president/principal stockholder); *but see Woods v. Superior Court (1983) 149 Cal. App. 3d 931, 936, 197 Cal. Rptr. 185* (corporate counsel for family-run business could not represent shareholder husband in marital dissolution action where corporation was primary focus of dispute)].

Refer to *§ 1A.204* for a sample disclosure letter addressing the issues raised by prior representation. Refer to *§ 1A.203* for a sample disclosure letter requesting consent to represent a party whose interests are adverse to those of a current or former client.

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureCounselDisqualificationsLegal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsConfidentiality of InformationLegal EthicsClient RelationsConflicts of Interest



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
B. Legal Malpractice and Ethical Considerations

1-1A California Legal Forms--Transaction Guide § 1A.36

§ 1A.36 Conflicts Involving Attorney in Other Roles

[1] Attorney as Investor

An attorney who represents clients in a start-up business venture may become an investor by accepting an interest in the venture in lieu of all or part of the attorney's fees or by simply making an investment in the client's business independent of any compensation received. An attorney who invests in a business venture with a client must comply with the following requirements [*Cal. Rules Prof. Cond., Rule 3-300*; *see* A.B.A. Model Rules Prof. Cond., Rule 1.8]:

- The terms of the transaction must be fair and reasonable to the client and fully disclosed in writing to the client in a reasonably understandable manner;

- The client must be advised in writing that the client may seek independent legal advice and be given a reasonable opportunity to do so; and

- The client must consent in writing to the transaction.

Although the advisability of investing in a client's business is outside the scope of this chapter, conflict of interest issues may be intensified in a dispute where the attorney is involved as both investor and counsel. If the attorney does decide to invest, the investment should be at the same price and on the same terms as other investors to help establish its fair and reasonable terms [*see Cal. Rules Prof. Cond., Rule 3-300(A)*]. As a practical matter, if an attorney is to receive a share in the business as compensation for services, it is advisable to bill the client at the attorney's regular rates and then, separately, to invest in the business at the same price and terms as the other investors. Moreover, an attorney who accepts stock in lieu of fees should bear in mind the tax consequences of such a transaction [*see I.R.C. § 61*; *Treas. Reg. § 1.61-2(d)(4)* (stock received as compensation taxed at fair market value at time of transfer)].

[2] Attorney as Corporate Agent, Director, or Officer

An attorney who files the articles of incorporation for a new corporation often serves as the initial agent for service of process [*see Corp. Code § 201(c)* (name and address of corporation's agent for service of process required in articles of

incorporation)], until another agent is appointed at the initial organizational meeting [*see* Chs. 2, *Formation of Corporations* , 3, *Articles of Incorporation*]; this service does not ordinarily raise conflict of interest issues. Additionally, attorneys are frequently asked to serve as directors or officers for a corporation for which they have done the incorporation work, and it is not unusual for an attorney to occupy the position of corporate secretary [*see* Ch. 7, *Corporate Records and Reports*].

Serving as an officer or director of a corporation can present several disadvantages to the attorney, however. It may increase the possibility of conflicts of interest [*see § 1A.33*]. It may result in the waiving of the attorney-client communication privilege [*see § 1A.34[2]*]. It may increase the attorney's malpractice exposure, either by establishing a higher standard of conduct for the attorney than for a non-attorney, or through the reliance of others on the attorney's statements as legal advice when those statements were not so intended. Further, if the attorney is compensated for acting as a corporate director or officer, the California Rules of Professional Conduct may require fairness to the client, full disclosure in writing, and the consent of the client in writing [*see Cal. Rules Prof. Cond., Rule 3-300*; A.B.A. Model Rules Prof. Cond., Rule 1.8; *see also [1], above*].

[3] Attorney as Witness

Even if the client's informed, written consent has been obtained, an attorney may decide not to represent a client if the attorney is likely to be called as a witness in any litigation in which there will be a jury [*see Cal. Rules Prof. Cond., Rule 5-210* (with limited exceptions, attorney cannot act as advocate before jury that will hear testimony from that attorney); *see also Cal. Rules Prof. Cond., Rule 5-210*, comment (rule inapplicable when attorney in advocate's firm will be witness)]. For example, an attorney who drafts a partnership agreement, or a corporate buy-sell agreement, might later be called as a witness in a dispute among the parties to the agreement to testify regarding the meaning of a section of the agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesFiduciary ResponsibilitiesDuty of LoyaltyCivil ProcedureCounselDisqualificationsEvidenceTestimonyCredibilityGeneral OverviewLegal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsConflicts of Interest



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
B. Legal Malpractice and Ethical Considerations

1-1A California Legal Forms--Transaction Guide § 1A.37

§ 1A.37 Minimizing Risk of Conflict of Interest

[1] Disclosure Letter Tailored to Specific Conflicts

To minimize the risk of conflict of interest, an attorney must abide by the California Rules of Professional Conduct. These rules generally require [*see Cal. Rules Prof. Cond., Rules 3-110-3-400* (Professional Relationship with Clients); *see also* §§ 1A.33-1A.36]:

- Fairness to the client;

- Full disclosure in writing of areas of actual or potential conflict among the parties, the potential risks associated with multiple representation, and the attorney's relationships to and representation of current as well as former clients whose interests are actually adverse to the proposed representation, or relate to a matter on which the attorney has obtained confidential information related to the representation; and

- The client's written consent.

In practice, a client's written consent to multiple representation is binding only if full disclosure of the relevant circumstances and actual and reasonably foreseeable adverse consequences have been made. Thus, to be effective, the disclosure letter must address the specific conflict issues of each representation. As a practical matter, the attorney should assume that a conflict disclosure letter and a signed consent form are necessary in a business start-up context, unless the attorney represents only one party to the venture. An attorney representing only one party should advise nonclients who are parties to the transaction that the attorney represents only a designated client [*see §§ 1A.34[4], 1A.201*]. Additionally, if the attorney represents the business entity, it is a good idea to obtain from the business a signed letter, listing the names of parties whose directions the attorney should follow.

[2] Conflict-Identification System

The attorney must have an adequate conflict-identification system, including, at a minimum, the names of clients and other parties to the transaction and the subject matter of the representation, to determine whether conflicts of interest

exist with current or former clients before the attorney undertakes any proposed representation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsGeneral OverviewLegal EthicsClient RelationsAppearance of ImproprietyLegal EthicsClient RelationsConflicts of Interest



29 of 113 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
B. Legal Malpractice and Ethical Considerations

1-1A California Legal Forms--Transaction Guide § 1A.38

§ 1A.38 Prohibition on Attempts to Limit Malpractice Exposure

An attorney must not contract with a client to prospectively limit the attorney's liability for malpractice [*Cal. Rules Prof. Cond., Rule 3-400(A)*]. Further, the attorney may settle a claim, or potential claim, for liability for malpractice only if the client is advised in writing that the client may seek independent legal counsel and is given a reasonable opportunity to do so [*Cal. Rules Prof. Cond., Rule 3-400(B)*]. The American Bar Association Model Rules of Professional Conduct also prohibit an attorney from prospectively limiting the attorney's liability unless the client is independently represented in the agreement or advised in writing that independent representation is appropriate [*see* A.B.A. Model Rules Prof. Cond., Rule 1-8(h)].

Legal Topics:

For related research and practice materials, see the following legal topics:
TortsMalpractice & Professional LiabilityAttorneys



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
B. Legal Malpractice and Ethical Considerations

1-1A California Legal Forms--Transaction Guide §§ 1A.39-1A.49

[Reserved]

§§ 1A.39[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
C. Business Name and Trademark

1-1A California Legal Forms--Transaction Guide § 1A.50

§ 1A.50 Selection of Business Name

[1] Preliminary Considerations

Before selecting a name, the client should be informed of any applicable statutory requirements, such as the filing of a fictitious name statement [*see Bus. & Prof. Code § 17910*; *see also § 1A.51*], a certificate of limited partnership [*see Corp. Code § 15902.01*; *see [2][b], below*; *see also* Ch. 16, *Formation of Limited Partnerships*], articles of incorporation [*see Corp. Code § 200*; *see [2][c], below*; *see also* Ch. 2, *Formation of Corporations*]; or articles of organization for a limited liability company [*see Corp. Code § 17051*; *see also* Ch. 12C, *Limited Liability Companies*].

Careful consideration should be given to choosing a name, since the name will symbolize the enterprise's good will, a major business asset. It can be expensive and aggravating for a new business to begin operations under a particular name only to be forced to change its name because it is the same or confusingly similar to a name used by another party.

The initial determination in selecting a name is whether the name is available. After it has been determined that the proposed name is available, the attorney and client should consider whether the name can be protected against infringing use by third parties, either as a fictitious business name [*see § 1A.51*] or as a registered trademark or service mark [*see § 1A.52*]. In situations when substantial amounts of money will be spent to develop goodwill in connection with a business name, it may be appropriate to register the trade name or trademark with the California Secretary of State and the United States Patent and Trademark Office [*see § 1A.52*]. For detailed coverage of the registration of trade names and trademarks, refer to Ch. 103B, *Trademarks.*

The client should be made aware that merely filing a fictitious business name, a limited liability partnership registration, a certificate of limited partnership, articles of incorporation, or articles of organization does not confer the right to use the selected name for all purposes. For example, a business entity may be the first to file to use a specified fictitious business name in a particular county. However, such a filing does not necessarily give the business the right to use that name as a trademark or trade name, because the first party to use a mark or name usually has superior rights, at least in a geographic area where the mark or name is used and known [*see Bus. & Prof. Code §§ 14230(c)(6), 14259* (registration of mark does not confer rights against prior users), *14417* (notification required to all new corps that filing of articles of

incorporation does not itself authorize use of corporate name in violation of other parties' previously acquired rights under other laws), *14418, 17910* (filing of fictitious business name statement does not itself authorize use of fictitious business name in violation of other parties' previously acquired rights under other laws); *Weatherford v. Eytchison (1949) 90 Cal. App. 2d 379, 384, 202 P.2d 1040]* .

[2] Name Restrictions

[a] Sole Proprietorship

A sole proprietor's choice of name is not regulated by statute. The client should be made aware, however, that there is no unrestricted right to use one's own name in business, if use of the name could cause confusion [*MacSweeney Enters. v. Tarantino (1965) 235 Cal. App. 2d 549, 560, 45 Cal. Rptr. 546]* .

[b] General and Limited Partnerships

A general partnership's choice of name is not regulated by the Uniform Partnership Act of 1994 [*Corp. Code § 16100 et seq.*]; thus, a general partnership may choose any name it wishes, although whether the name is available and can be protected are still important considerations.

Limited partnerships, however, are subject to a number of statutory restrictions on their choice of name. A limited partnership name, as set forth in the certificate of limited partnership, must meet the following requirements:

- It must end with the words "limited partnership" or the abbreviation "L.P." or "LP" [*Corp. Code § 15901.08(b)*].

- Unless otherwise authorized by the Secretary of State [*see Corp. Code § 15901.08(e)*], it must be distinguishable in the records of the Secretary of State from (1) the name of any limited partnership that has previously filed a certificate of limited partnership pursuant to *Corp. Code § 15902.01* or any foreign limited partnership registered pursuant to *Corp. Code § 15909.01*, and *(2)* each name reserved under *Corp. Code § 15901.09* [*Corp. Code § 15901.08(d)*].

- It may not contain the words "bank," "insurance," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." [*Corp. Code § 15901.08(g)*].

The name may contain the name of any partner [*Corp. Code § 15901.08(a)*].

The client should be advised that every limited partnership must file a certificate of limited partnership with the Secretary of State, and that a certificate will not be accepted for filing unless it complies with all the statutory requirements, including those related to the partnership name [*see Corp. Code § 15902.01(a)*].

For discussion of other means of protecting the partnership name, including trade name and trade or service mark protection, refer to *§ 1A.52* and to Ch. 103B, *Trademarks.* For a procedural guide to the reservation of a limited partnership name with the California Secretary of State, refer to Ch. 16, *Formation of Limited Partnerships.*

[c] Limited Liability Partnership

The name of a limited liability partnership (LLP) is restricted by statute. The last words or letters of the name of an LLP must be "Registered Limited Liability Partnership" or "Limited Liability Partnership" or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" [*Corp. Code § 16952*; *see Corp. Code § 16958(b)* (similar requirements for foreign LLPs)].

Clients should be advised that every California or foreign LLP must file a registration or application for registration with the Secretary of State, and that the registration or application will not be accepted for filing unless it complies with all statutory requirements, including those related to an LLP's name [*see Corp. Code §§ 16101(6), (8), 16951, 16953, 16959*]. For further discussion, consult Ch. 16C, *Limited Liability Partnerships* .

[d] Corporation

The Secretary of State will not file articles of incorporation bearing a name that is likely to mislead the public, or that is the same, or deceptively similar to, the actual or reserved name of a domestic corporation or a foreign corporation doing business within the state [*see Corp. Code § 201(b)*].

A corporate name may not include the words "bank," "trust," "trustee," or related words, unless approved [*see Corp. Code § 201(a)*]. Further, the name may not use the words "industrial loan company," "investment and loan company," "thrift company," or "thrift and loan company" unless authorized under the Indutrial Loan Law [*Fin. Code § 18104*; *see Fin. Code § 18100 et seq.*]. If the business of the corporation is to be an insurer, the Insurance Commissioner must first approve the name [*see Corp. Code § 201.5*]. Use of the word "cooperative" is restricted [*see Corp. Code § 12311*; *Food & Agric. Code § 54036*]. If the corporation is a close corporation, the name must include the word "corporation," "incorporated," "limited," or an abbreviation of one of these words [*Corp. Code § 202(a)*].

A corporation may be enjoined from the use of a name in violation of these rules, even though it has filed its articles of incorporation with the Secretary of State [*Corp. Code § 201(b)*]. Further, although acceptance of articles of incorporation by the Secretary of State implies that the corporate name does not conflict with that of other corporations registered or qualified to do business in California, the name may violate other parties' previously acquired rights under other laws [*see Bus. & Prof. Code § 14417*]. Conducting a thorough name search is the only way to ensure a name's availability [*see* Ch. 2, *Formation of Corporations ;* Ch. 103B, *Trademarks*].

Certain types of corporations have additional name requirements. These include dental corporations [*see Bus. & Prof. Code § 1804*], medical corporations [*see Bus. & Prof. Code §§ 2285, 2415*], architectural corporations [*see Bus. & Prof. Code § 5536*], engineering corporations [*see Bus. & Prof. Code § 6738*], and law corporations [*see Bus. & Prof. Code § 6171*]. For further discussion of name requirements of professional corporations, refer to Ch. 12, *Professional Corporations.*

The client should be advised that every corporation must file articles of incorporation with the Secretary of State, and that the articles will not be accepted for filing unless they comply with all the statutory requirements, including those related to the corporate name [*see Corp. Code §§ 201, 201.3, 201.5*].

Federal law also imposes name restrictions. The terms "national," "Federal," "United States," "reserve," "Deposit Insurance," and other terms associated with the federal government may not be used in corporate names [*see 18 U.S.C. § 709*]. In addition, use of words and symbols relating to the Olympics may not be used without the permission of the United States Olympic Committee [*see 36 U.S.C. § 380*].

For a complete list of words that may not be used in a corporate name, and additional information on the rules and restrictions applicable to corporate names, as well as a procedural guide to reserving the name with the California Secretary of State, see *Ch. 2, Formation of Corporations, §§ 2.13, 2.132*.

[e] Limited Liability Company

The name of a limited liability company must not be one that the Secretary of State determines to be likely to mislead the public, and must not be the same as, or resemble so closely as to tend to deceive, the name of an existing domestic or registered foreign limited liability company (without the other company's consent), or a name already reserved by a

limited liability company or a foreign limited liability company [*Corp. Code § 17052(c)*]. The name may contain the name of one or more of the limited liability company's members [*Corp. Code § 17052(b)*]. The last words of the name must be "limited liability company" or the abbreviation "LLC" or "L.L.C." [*Corp. Code § 17052(a)*]. The terms "limited" and "company" may be abbreviated to "Ltd." and "Co." respectively [*Corp. Code § 17052(a)*].

The terms "bank," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." may not be used in the name of a limited liability company, nor may the name contain "insurer," "insurance company," or any other words suggesting that the LLC is in the business of issuing insurance policies and assuming insurance risks [*Corp. Code § 17052(d)*]. In addition, the name of the limited liability company may not be indicative of a "professional service" [*see Bus. & Prof. Code § 13401(a)*], because professional limited liability companies are not authorized in California [*Corp. Code § 17375*; *see Corp. Code §§ 13401, 13401.3*].

The name of a limited liability company must be set forth in its articles of organization [*Corp. Code § 17052*].

An applicant may reserve an approved limited liability company name with the Secretary of State for 60 days, on payment of the required fee [*see Gov. Code § 12190(a)*]. The same person may not reserve the same name for consecutive 60-day periods, but may do so with breaks between 60-day periods [*Corp. Code § 17053*].

For a procedural guide to reserving the name with the California Secretary of State, see Ch. 12C, *Limited Liability Companies* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesGeneral OverviewBusiness & Corporate LawCorporate NamesFictitious NamesConducting Business Under Fictitious NamesBusiness & Corporate LawCorporate NamesFictitious NamesRegistration RequirementsBusiness & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporate NamesRequirementsTrademark LawProtection of RightsRegistrationGeneral OverviewTrademark LawProtection of RightsRegistrationFederal RegistrationTrademark LawSpecial MarksGeneral OverviewTrademark LawSpecial MarksService MarksGeneral OverviewTrademark LawSpecial MarksTrade NamesRegistration



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
C. Business Name and Trademark

1-1A California Legal Forms--Transaction Guide § 1A.51

§ 1A.51 Fictitious Business Name

[1] Who Must File

Every person who regularly transacts business in California for profit under a fictitious business name must file a fictitious business name statement [*Bus. & Prof. Code § 17910*; *see Bus. & Prof. Code § 17913* and 1A.205 (form)]. Model State Trademark Law [*Bus. & Prof. Code § 14200 et seq.*]. The statement is a public record identifying the type of business entity and the natural persons responsible for it. The filing requirement is not intended to confer any right or advantage on individuals or firms that fail to comply with the requirement; rather, it is designed to make available to the public the identities of persons doing business under the fictitious name [*Bus. & Prof. Code § 17900(a)(1)*]. A business entity doing business under the name appearing on its organizational documents on file with the Secretary of State is generally not subject to the fictitious business name filing requirement [*see Bus. & Prof. Code § 17900(b)(2)-(5)*; *see* [2], *below*].

Filing a fictitious business name statement does not create any rights superior to those of bona fide prior users of the name under common law, the federal Lanham Act [*see* U.S.C. § 1051 et seq.], the Model State Trademark Law [*see Bus. & Prof. Code § 14200 et seq.*], or the California Fictitious Business Name Act [*Bus. & Prof. Code § 17900 et seq.*; *see Bus. & Prof. Code § 14230(c)(6), 14259, 14417, 14418, 17913*]. Filing, however, establishes a rebuttable presumption of the exclusive right to use the fictitious business name as a trade name in the county of filing [Bus. & Prof. Code § 13311; *see Bus. & Prof. Code § 14415* (rebuttable presumption affects burden of producing evidence)].

[2] "Fictitious Business Name" Defined

[a] Sole Proprietorship

In the case of an individual, a name that does not include that individual's surname, or a name that suggests the existence of additional owners, is a fictitious business name [*Bus. & Prof. Code § 17900(b)(1)*].

A name suggests the existence of additional owners if it includes terms such as "Company," "& Company," "& Son," "& Sons," "& Associates," or "Brothers." However, words that describe the business being conducted, such as "Tom

Cooper Auto Service," do not fall in this category [*Bus. & Prof. Code § 17900(c)*].

[b] General Partnership

The name of a general partnership that does not include the surname of each partner, or a name that suggests the existence of additional owners, is a fictitious business name [*Bus. & Prof. Code § 17900(b)(2)*]. A name suggests the existence of additional owners if it includes terms such as "Company," "& Company," "& Son," "& Sons," "& Associates," or "Brothers" and the like, but not words that merely describe the business being conducted [*Bus. & Prof. Code § 17900(c)*].

[c] Limited Partnership

For a limited partnership, a fictitious business name is any name other than the name of the limited partnership on file with the Secretary of State [*Bus. & Prof. Code § 17900(b)(4)*].

[d] Limited Liability Partnership

Registered limited liability partnerships that have filed registrations, and foreign limited liability partnerships that have filed applications for registration [*see Corp. Code §§ 16953, 16959*], are specifically exempted from fictitious business name filing requirements [*Corp. Code § 16961*; *see Bus. & Prof. Code § 17900(b)(2)*]. All limited liability partnerships must register or apply for registration to establish the status of the partnership as a limited liability partnership [*see Corp. Code §§ 16101(6), (8), 16951, 16953, 16959*].

[e] Corporation

For a domestic or foreign corporation, a fictitious business name is any name other than the corporate name stated on the articles of incorporation on file with the Secretary of State [*Bus. & Prof. Code § 17900(b)(3)*]. A corporation may wish to conduct business under a fictitious name if, for example, the desired corporate name is unavailable, or if the corporation wishes to create a perceived local or regional connection with the name.

Use of a fictitious business name does not create a separate legal entity. For example, if a corporation is sued under its fictitious business name but appears and responds under its corporate name, the plaintiffs cannot continue proceedings against the corporation under its fictitious business name [*Pinkerton's, Inc. v. Superior Court (1996) 49 Cal. App. 4th 1342, 1347-1348, 57 Cal. Rptr. 2d 356* (plaintiffs could not obtain default judgment against fictitious business name as legally distinct entity after corporation responded to complaint in corporate name and obtained dismissal)].

[f] Limited Liability Company

For a limited liability company, a fictitious business name is any name other than the name stated in the articles of organization. For a foreign limited liability company that has filed an application for registration with the Secretary of State [*see Corp. Code § 17451*], a fictitious business name is any name other than the name on file with the Secretary of State [*Bus. & Prof. Code § 17900(b)(5)*; *see Bus. & Prof. Code § 17910.5*]

[3] When to File

A fictitious business name statement must be filed no later than 40 days after the entity begins to transact business for profit in California [*Bus. & Prof. Code § 17910(a)*]. Unless it expires earlier due to a change of facts [*Bus. & Prof. Code § 17920(b)*] or abandonment [*Bus. & Prof. Code § 17920(c)*], a statement expires at the end of five years from the date on which it was filed with the county clerk [*Bus. & Prof. Code § 17920(a)*]. A new statement must be filed on or before the expiration date [*Bus. & Prof. Code § 17910(b)*].

[4] Where to File

A business must file a fictitious business name statement with the clerk of the county in which it has its principal place of business in California [*Bus. & Prof. Code § 17915*]. If the entity has no such principal place of business, the statement must be filed with the clerk of Sacramento County. A person is not precluded from filing a fictitious business name statement in any other county as well, provided a statement is filed in the county of its principal place of business [*Bus. & Prof. Code § 17915*].

[5] Publication Requirement

A fictitious business name statement must be published within 30 days after filing with the county clerk [*Bus. & Prof. Code § 17917*]. It must appear in a newspaper of general circulation in the county where the fictitious business name statement was filed or, if none, in a newspaper of general circulation in an adjoining county [*Bus. & Prof. Code § 17917(a)*; *Gov. Code § 6064*]. If the business entity does not have a principal place of business in California, the statement must be published in a newspaper of general circulation in Sacramento county [*Bus. & Prof. Code § 17917(a)*]. The notice requirement is met by four publications at least five days apart in a newspaper regularly published at least once a week and circulated in the area where the entity will do business [*Gov. Code § 6064*].

No more than 30 days after the last publication, an affidavit of publication of the fictitious business name must be filed with the county clerk with whom the fictitious business name statement was filed [*Bus. & Prof. Code § 17917(d)*]. Many newspapers will provide a fictitious business name form, handle the filing and publication, and the filing of the affidavit, for a fee generally less than $50 [*see Bus. & Prof. Code § 17929* (filing fees)].

These publication requirements do not apply when a refiling is required because the prior statement has expired unless there has been a change in the information required in the expired statement, provided that the refiling is made within 40 days of the date the statement expired [*Bus. & Prof. Code § 17917(c)*].

[6] Penalties for Noncompliance

A party or entity doing business under a fictitious business name may not sue on a contract or transaction entered into using the fictitious name unless or until a fictitious business name statement has been filed [*Bus. & Prof. Code § 17918*]. However, before an action is finally dismissed on this ground, a plaintiff may cure this disability by filing the statement at any time before trial [*see Kadota Fig Asso. of Producers v. Case-Swayne Co. (1946) 167 P.2d 518*]. The opposing party is deemed to have waived the nonfiling unless it is raised by demurrer or answer [*see Code Civ. Proc. § 430.80*]. Furthermore, a business that should, but does not, file a fictitious business name statement loses the benefit of the rebuttable presumption of the exclusive right to use the name as a trade name [*see Bus. & Prof. Code §§ 14411-14416*; *see also [1], above*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesConducting Business Under Fictitious NamesBusiness & Corporate LawCorporate NamesFictitious NamesConsequences of NoncomplianceBusiness & Corporate LawCorporate NamesFictitious NamesRegistration Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
C. Business Name and Trademark

1-1A California Legal Forms--Transaction Guide § 1A.52

§ 1A.52 Trade Marks and Trade Names

[1] Relation to Business Name

A trademark or service mark is a word, name, symbol, or devise used by a business to identify its goods or services and to distinguish them from the goods or services of others [*15 U.S.C. § 1127*; *Bus. & Prof. Code § 14202(a), (b)*]. "Miller Cold Draft Light" is a trademark for a low-calorie beer, for example. A trade name identifies the business itself and distinguishes it from other businesses [*15 U.S.C. § 1127*; *Bus. & Prof. Code § 14202(d)*]. "Miller Brewing Company" is an example of a trade name. For detailed coverage of trademarks, service marks, and trade names, see Ch. 103B, *Trademarks* .

Courts have distinguished trade names from trademarks by identifying a trade name with the entire goodwill of a business and trade mark or service mark as the guarantee of the quality of particular goods or services offered by the business [*see Golden Door, Inc. v. Odisho (N.D. Cal. 1977) 437 F. Supp. 956, 966 , aff'd, 646 F.2d 347 (9th Cir. 1980)]* . The distinction between a trade name and a trade or service mark is often unclear, however, and the same name is frequently used for some or all purposes. For this reason, the laws applicable to the selection and use of trade or service marks are generally applicable to trade names, as well [*see Colvig v. KSFO (1964) 224 Cal. App. 2d 357, 368, 36 Cal. Rptr. 701* ; *see also North Carolina Dairy Foundation v. Foremost-McKesson, Inc. (1979) 92 Cal. App. 3d 98, 106-108, 154 Cal. Rptr. 794* (California and federal trademark statutes generally the same, each having codified common law principles; *New West Corp. v. NYM Co. (9th Cir. 1979) 595 F.2d 1194, 1201* (federal cases construing federal trade name and trademark law generally followed by state courts when construing state law)].

[2] Registration of Trademarks and Trade Names

[a] Nature of Protection

Trade names are generally protected in California by filing fictitious business name statements [*see Bus. & Prof. Code §§ 14411-14416, 17900-17930*; *see also § 1A.51[1]*]. This protection, however, is applicable only in the county where the fictitious business name statement is filed [*Bus. & Prof. Code § 14411*]. It is advisable, therefore, to file a statement in every county in which the entity does business.

If the name of a business is the same as, or closely resembles, the name of its product, the name may be protected under the state or federal trademark registration statutes [*see Bus. & Prof. Code §§ 14230(c)(6), 14259, 14417, 14418, 17913*. Note that this protection is based on use, rather than on the act of filing the fictitious business name statement, which does not confer rights against prior users of the same or a confusingly similar name [*see Weatherford v. Eytchison (1949) 90 Cal. App. 2d 379, 384, 202 P.2d 1040]* .

[b] California Registration

The Secretary of State's office is responsible for registering trade and service marks in California [*see Bus. & Prof. Code § 14205-14209* (application for registration requirements)]. On successful completion of the application process, the Secretary will issue a certificate of registration, which is admissible in evidence as competent and sufficient proof of the registration of the mark in any action or judicial proceeding in a California court [*Bus. & Prof. Code § 14215*].

The initial registration is effective for five years and may be renewed for successive five-year terms on application and payment of the required renewal fee within six months of the end of the expiring term [*Bus. & Prof. Code § 14217(a), (b)*; *see Gov. Code § 12193(c) (fee)*]. An registration that was in force on January 1, 2008 (the effective date of the Model State Trademark Law), continues in full force and effect for its unexpired term and may be renewed in accordance with the renewal procedure under the Model Act [*Bus. & Prof. Code § 14217(c)*]. All renewal applications, whether of registrations under the Model Act or prior law, must include (1) a verified statement that the mark has been and is still in use, and (2) a specimen showing actual use of the mark on, or in connection with, the goods or services with which the mark is associated [*Bus. & Prof. Code § 14217(d)*].

An application for renewal of registration of a trademark or a service mark (on an official Secretary of State form), together with the applicable fee, must be filed within the 6 months before the expiration of the 10-year term [*Bus. & Prof. Code § 14250*; *see Gov. Code § 12193(c) (fee)*].

[c] Federal Registration

The United States Patent and Trademark Office registers federal trademarks [*see 15 U.S.C § 1051* (sample application forms); *37 C.F.R. § 2.33* (statutory requirements); *see also* Ch. 103B, *Trademarks*].

For further discussion of tradename and trade marks, statutory requirements, and applications for registration, see Ch. 103B, *Trademarks* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesGeneral OverviewPatent LawU.S. Patent & Trademark Office ProceedingsFiling RequirementsGeneral OverviewTrademark LawProtection of RightsRegistrationGeneral OverviewTrademark LawProtection of RightsRegistrationFederal RegistrationTrademark LawSpecial MarksGeneral OverviewTrademark LawSpecial MarksService MarksGeneral OverviewTrademark LawSpecial MarksService MarksRegistrationTrademark LawSpecial MarksTrade NamesGeneral OverviewTrademark LawSpecial MarksTrade NamesRegistrationTrademark LawSubject MatterNamesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART II. LEGAL BACKGROUND
C. Business Name and Trademark

1-1A California Legal Forms--Transaction Guide §§ 1A.53-1A.99

[Reserved]

§§ 1A.53[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1A California Legal Forms--Transaction Guide § 1A.100

§ 1A.100 Client Interview

[1] Facts

[a] Natural Persons Participating in New Business

1. Name.

2. Residence address and telephone number.

3. Business address and telephone number.

4. Citizenship (United States citizen, resident alien, citizen of a country other than United States).

5. Tax identification numbers (social security number, employer identification number).

6. Marital status.

7. Age.

8. Educational background.

9. Business experience.

10. Gross and net income for last three years.

11. Estimated net worth.

12. Projected annual income.

13. Relationship to other participants.

14. Affiliations with other businesses.

15. Percentage interest in business.

[b] Entities Participating in New Business

1. Form of organization, if determined.

2. Personal and biographical information of persons responsible for management and control [*see [a], above*].

3. Tax identification number.

4. Tax year.

[c] Other Professionals Involved in Business Start-Up

1. Name.

2. Business address and telephone number.

3. Responsibilities.

[d] Business Activity

1. Principal activity.

2. Complete address, including county, of main office and any other offices or places of business.

3. Date business started, or date of anticipated start.

4. Significant assets to be purchased.

5. Total funds needed until business is self-sustaining or can be expected to attract new capital.

6. Conventional loans to be obtained.

7. Private loans to be obtained.

8. Significant agreements to be entered into at onset of business.

9. Party responsible for paying for legal work.

[2] Documents

1. Business plan.

2. Anticipated profit and loss statement and balance sheet for first year.

3. Current profit and loss statements and balance sheets, if existing business is being incorporated.

4. Existing contracts.

5. Copies of three years' prior income tax returns for participating individuals and business entities.

6. Copies of three years' prior income tax returns if existing business is being purchased, or change of form is contemplated.

7. Copies of tax projections for current year for participating individuals and business entities.

8. List of persons providing services for business and nature of services provided.

9. List of assets and value of those assets.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormationLegal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1A California Legal Forms--Transaction Guide §§ 1A.101-1A.109

[Reserved]

§§ 1A.101[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1A California Legal Forms--Transaction Guide § 1A.110

§ 1A.110 Scope of Work to Be Performed by Attorney

1. Determine tasks attorney will perform [*see § 1A.10*].

2. Determine whether consultation or association of specialist is required [*see § 1A.32*].

3. Determine any continuing representation [*see § 1A.17*].

NOTE:

As a practical matter, it has been suggested that the attorney has a duty to contact the client after the initial representation is completed if the attorney promises to keep the client informed of future changes in the law relevant to the client, or if the relationship between the attorney and client is such that the attorney should do so, as in the case of an attorney who is closely involved in a client's affairs on an ongoing basis.

There is not much litigation in this area, and case law has yet to establish the extent of this duty. Given this current uncertainty in the law, the attorney should deal explicitly with the scope of representation in either the engagement letter or the closing letter to the client [***see** § 1A.202*].

a. Will attorney promise to keep client informed of future changes in law relevant to client?

b. Is attorney-client relationship such that attorney should keep client so informed?

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1A California Legal Forms--Transaction Guide § 1A.111

§ 1A.111 Collateral Work to be Performed by Attorney

1. Determine whether attorney will perform tasks collateral to getting business started [*see § 1A.12*].

2. Determine fees for additional work [*see § 1A.114*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationLegal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1A California Legal Forms--Transaction Guide § 1A.112

§ 1A.112 Fees and Fee Agreements

NOTE:
It is good practice to summarize fees and any special fee payment arrangements in a written fee and representation agreement, even when not required by statute [***see** Bus. & Prof. Code § 6148*] so as to clearly define the fee arrangement and the responsibilities of the attorney and client under the contract.

1. Determine whether written fee agreement is required by statute [*see Bus. & Prof. Code § 6148(a), (d)*; *§ 1A.14*].

a. Will client's total expense likely exceed $1,000?

b. Will any of following exceptions apply [*see Bus. & Prof. Code § 6148(d)*]?
(1) Is there emergency need for legal services?

NOTE:
An oral fee agreement is enforceable if an emergency need for legal services exists or when a writing is otherwise impractical [*Bus. & Prof. Code § 6148(d)(1)*]. This situation is unlikely to arise in a business formation context.

(2) Is fee agreement implied in fact by prior course of dealing between attorney and client?

(3) Has client, after full disclosure, made written waiver of benefits of *Bus. and Prof. Code § 6148*?

(4) Is client a corporation?

2. Determine whether fees may be paid by someone other than client, if applicable.

a. Will such payment interfere with attorney's independent judgment [*see Cal. Rules Prof. Cond., Rule 3-310(F)*]?

b. Has attorney obtained client's informed, written consent [*see Cal. Rules Prof. Cond., Rule 3-310(F)*]?

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAttorney FeesFee Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1A California Legal Forms--Transaction Guide § 1A.113

§ 1A.113 Identifying Conflicts of Interest

1. Ascertain which party attorney represents.

NOTE:

An attorney representing an entity may also represent its constituents, provided that the attorney makes a written disclosure to the client in accordance with the *California Rules of Professional Conduct Rule 3-310(B)* and discloses his or her relationship to the entity [*Cal. Rules Prof. Cond., Rule 3-600(E)*]. Dual representation of clients whose interests conflict is permitted, under certain circumstances, if the attorney obtains the written consent of each client [*Cal. Rules Prof. Cond., Rule 3-600(E)*; ***see*** *Pringle v. La Chapelle (1999) 73 Cal. App. 4th 1000, 1005-1007, 87 Cal. Rptr. 2d 90* (although attorney failed to follow *Rule 3-600(E)*, violation of rule does not automatically preclude attorney from obtaining fees)]. Caution should be exercised, however, in dual representation when an actual conflict of interest exists [***see*** *§ 1A.34[1]*]. Even without an actual conflict, under some circumstances, an attorney should not undertake multiple representation [***see*** *§ 1A.34[3]*].

a. Will attorney represent business entity [*see § 1A.33 [2]*]?

b. Will attorney represent single participant?

c. Will attorney represent some or all of participants?

d. Will attorney represent a combination of situations described in (a) through (c), *above* [*see § 1A.33[2][b]*]?

2. Ascertain whether attorney represents clients with adverse interests [*see Cal. Rules Prof. Cond., Rule 3-310*; §§ 1A.33-1A.36].

a. Does attorney have legal, business, financial, professional, or personal relationship with party or witness in same matter?

b. Does attorney know (or reasonably should know) that:
(1) Attorney previously had legal, business, financial, professional, or personal relationship with party or witness in same matter; and

(2) Previous relationship will substantially affect attorney's representation?

c. Does (or did) attorney have legal, business, financial, professional, or personal relationship with party or entity that would be substantially affected by resolution of matter?

d. Does (or did) attorney have legal, business, financial, or professional interest in subject matter of representation?

e. Has attorney obtained confidential information related to representation from client or former client?

3. Ascertain whether attorney has provided written disclosure and obtained informed written consent from each client (or former client) whose interests actually or potentially conflict [*see Cal. Rules Prof. Cond., Rule 3-310*; §§ 1A.33-1A.35].

4. Ascertain whether attorney's other roles present conflict of interest issues [*see Cal. Rules Prof. Cond., Rule 3-300*; *see also § 1A.36*].

a. Will attorney invest in client's business [*see § 1A.36[1]*]?

b. Will attorney serve as corporate agent, director, or officer [*see § 1A.36[2]*]?

c. Is attorney likely to be called as witness in any litigation that includes jury [*see § 1A.36[3]*]?

5. Ascertain whether attorney has adequate conflict-identification system [*see § 1A.37[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsConfidentiality of InformationLegal EthicsClient RelationsConflicts of Interest



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1A California Legal Forms--Transaction Guide § 1A.114

§ 1A.114 Need for Fictitious Business Name Statement

1. If client is sole proprietor, determine whether business name adopted by client is "fictitious business name" for purpose of statute requiring filing of fictitious business name statement [*see Bus. & Prof. Code § 17900(b)(1)*].

a. Does name fail to include surname of owner; or

b. Does name suggest existence of additional owners?

NOTE:
A name suggesting the existence of additional owners is one that includes such terms as "Company," "& Company," "& Son," "Brothers," but not words merely describing the business being conducted [*Bus. & Prof. Code § 17900(c)*; *see § 1A.51[2][a]*]. A fictitious business name may not include the terms "Corporation," "Corp.," "Incorporated," or "Inc.," unless the entity is incorporated. Similarly, no fictitious business name may include the terms "Limited Liability Company," "LLC," or "LC" unless the entity is organized as a limited liability company. However, a person is not barred from using the complete words "Limited" or "Company," or their abbreviations, in the business name as long as that use does not imply that the person is a limited liability company [*Bus. & Prof. Code § 17910.5*].

2. If client is partnership or other association (other than limited partnership or limited liability partnership), determine whether business name adopted by client is "fictitious business name" for purpose of statute requiring filing of fictitious business name statement [*see Bus. & Prof. Code § 17900(b)(2)*]:

NOTE:
For limited partnerships that have filed with the Secretary of State [*see* Ch. 15A, *Formation of Limited*

Partnerships], a fictitious business name is any name other than the name of the limited partnership on file with the Secretary of State [*Bus. & Prof. Code § 17900(b)(4)*]. Registered limited liability partnerships that have filed registrations, and foreign limited liability partnerships that have filed applications for registration [*see Corp. Code §§ 16953, 16959*], are specifically exempted from fictitious business name filing requirements [*Corp. Code § 16961*[Deering's]; *see Bus. & Prof. Code § 17900(b)(2)*; *see also* Ch. 16C, *Limited Liability Partnerships]*.

a. Does name fail to include surname of each general partner; or

b. Does name suggest existence of additional owners [*see* P 1b NOTE, *above*]?

3. If client is domestic or foreign corporation, determine whether business name is "fictitious business name" for purpose of statute requiring filing of fictitious business name statement because business name differs from corporate name stated in articles of incorporation filed with Secretary of State [*see Bus. & Prof. Code § 17900(b)(3)*].

4. If client is limited liability company, determine whether business name is "fictitious business name" for purpose of statute requiring filing of fictitious business name statement because business name differs from name stated in articles of organization [*see Bus. & Prof. Code § 17900(b)(5)*].

5. If client is foreign limited liability company registered with Secretary of State, determine whether business name is "fictitious business name" for purpose of statute requiring filing of fictitious business name statement because business name differs from name on file with Secretary of State [*see Bus. & Prof. Code § 17900(b)(5)*].

6. Determine whether client's organization is exempt from filing requirements:

a. Is organization nonprofit corporation or association [*Bus. & Prof. Code § 17911*]?

b. Is organization real estate investment trust [*see Corp. Code § 23000*] with designation of agent on file [*see Bus. & Prof. Code § 17912*]?

7. If client proposes to use fictitious business name, determine whether all of following apply, requiring client to file fictitious business name statement [*see Bus. & Prof. Code § 17910*]:

a. Will client regularly transact business in California?

b. Will client transact business for profit?

c. Will client transact business using fictitious business name?

8. Determine if filing fictitious business name statement is prerequisite to right to maintain action on any contract or transaction.

a. Has client (or client's assignee) transacted business under fictitious business name without filing fictitious business name statement?

NOTE:
Neither a person who transacts business under a fictitious business name nor that person's assignee may sue on a contract or in connection with any transaction without filing a fictitious business name statement [***see*** *Bus. & Prof. Code § 17918*].

b. Has client in bankruptcy transacted business under fictitious business name without filing fictitious business name statement?

NOTE:
A fictitious business name statement may be filed by a trustee in bankruptcy at any time after bankruptcy when failure to do so would preclude maintenance of an action for sums due [***see*** *Bus. & Prof. Code § 17919(a)*].

c. Has conservatee, deceased, or partnership transacted business under fictitious business name without filing fictitious business name statement?

NOTE:
The conservator, executor, or administrator may file a fictitious business name statement if failure to do so would preclude the maintenance of an action to recover sums due the conservatee, the deceased, or the partnership of which the deceased was a member [***see*** *Bus. & Prof. Code § 17919(b)*].

d. Is client assignee or purchaser of business that previously transacted business under fictitious business name without filing fictitious business name statement?

NOTE:
The assignee or a purchaser of a business may file a fictitious business name statement if failure to do so would preclude maintenance of an action to recover sums due the assignee or purchaser by reason of assignment or sale [*Bus. & Prof. Code § 17919(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesConducting Business Under Fictitious NamesBusiness & Corporate LawCorporate NamesFictitious NamesRegistration Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1A California Legal Forms--Transaction Guide § 1A.115

§ 1A.115 Need for Trademark, Service Mark, or Trade Name Protection

NOTE:

Trademarks and service marks identify a particular line of products or services and may be registered with the California Secretary of State [***see*** *Bus. & Prof. Code §§ 14202(a), (b)*] and the United States Patent and Trademark Office [***see*** *15 U.S.C. § 1051* (sample application forms); *37 C.F.R. § 2.33* (statutory requirements)]. For further discussion and registration procedures, see Ch. 103B, ***Trademarks*** .

A trade name identifies the business, vocation, or occupation itself [***see*** *Bus. & Prof. Code § 14202(d)*; *15 U.S.C. § 1127*]. The filing of a fictitious business name statement establishes a rebuttable presumption (affecting the burden of producing evidence) that the registrant has the exclusive right to use the fictitious business name, as well as any confusingly similar name, as a trade name in the county where the statement is filed [*Bus. & Prof. Code § 14411*; ***see*** *Bus. & Prof. Code §§ 14412-14416*]. This presumption applies only if (1) the registrant is the first in the county to file a statement with that name, and (2) the registrant is actually engaged in a trade or business using the trade name [*Bus. & Prof. Code § 14411*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Trademark LawProtection of RightsRegistrationGeneral OverviewTrademark LawSpecial MarksGeneral OverviewTrademark LawSpecial MarksService MarksRegistrationTrademark LawSpecial MarksTrade NamesRegistration



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1A California Legal Forms--Transaction Guide §§ 1A.116-1A.129

[Reserved]

§§ 1A.116[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1A California Legal Forms--Transaction Guide § 1A.130

§ 1A.130 Filing Fictitious Business Name Statement

1. Obtain copies of fictitious business name statement forms from county clerk [*see Bus. & Prof. Code § 17924(a)*; *see also §§ 1A.51[4], 1A.205*].

NOTE:
The county clerk is required to furnish forms satisfying the statutory requirements of fictitious business name statements [***see*** *Bus. & Prof. Code § 17913(a)*] without charge [*Bus. & Prof. Code § 17924(a)*].

2. Complete form according to statutory requirements [*see Bus. & Prof. Code § 17913(b)*; *see also Bus. & Prof. Code § 17913(a)* (sample form)]:

a. Set forth fictitious business name or names of business ("registrant").

NOTE:
Only businesses operating at the same address and under the same ownership may be listed on the same statement [*Bus. & Prof. Code § 17913(b)(1)*].

b. Set forth street address and county of registrant's principal place of business, whether within or outside California.

c. Set forth registrant's name and address:

(1) If registrant is individual, insert full name and residence address.

(2) If registrants are husband and wife, insert full name and residence address of both spouses.

(3) If registrant is state or local registered domestic partnership, insert full name and residence address of each domestic partner.

(4) If registrant is general partnership, copartnership, joint venture, limited liability partnership, or unincorporated association other than partnership, insert full name and residence address of each general partner.

(5) If registrant is limited partnership, insert full name and residence address of each general partner.

(6) If registrant is trust, insert full name and residence address of each trustee.

(7) If registrant is corporation, insert:
(a) Name of corporation as set out in its articles of incorporation on file with Secretary of State.

(b) State of incorporation.

(8) If registrant is limited liability company, insert:

(a) Name of limited liability company as set forth in articles of organization on file with Secretary of State.

(b) State of organization.

d. Set forth legal nature or status of business by stating that business is:

(1) "An individual."

(2) "A general partnership."

(3) "A limited partnership."

(4) "A limited liability company."

(5) "An unincorporated association other than a partnership."

(6) "A corporation."

(7) "A business trust."

(8) "Copartners."

(9) "Husband and wife."

(10) "Joint venture."

(11) "State or local registered domestic partners."

(12) "A limited liability partnership."

e. Set forth date registrant began to transact business under fictitious business name listed.

NOTE:
If the registrant has not yet begun to transact business under the listed name, insert the statement "Not applicable" in the space provided on the form [*Bus. & Prof. Code § 17913(b)(5)*].

3. Have statement executed by:

NOTE:
The registrant must declare that all information contained in the fictitious business name statement is true and correct. A registrant who declares as true any material matter that he or she knows to be false is guilty of a misdemeanor [*Bus. & Prof. Code § 17913(a), (c)*].

a. Registrant [*see Bus. & Prof. Code § 17914*]:

(1) If registrant is individual, by that person.

(2) If registrants are husband and wife, by both spouses.

(3) If registrant is state or local registered domestic partnership, by one partner.

(4) If registrant is general partnership, limited partnership, limited liability partnership, copartnership, joint venture, or unincorporated association other than partnership, by general partner.

(5) If registrant is limited liability company, by manager or officer.

(6) If registrant is trust, by trustee.

(7) If registrant is corporation, by officer.

b. Trustee in bankruptcy at any time after bankruptcy when statement is prerequisite to action to recover sums due to debtor or bankruptcy estate or partnership of which debtor or bankruptcy estate was member [*see Bus. & Prof. Code § 17919(a)*; *see also § 1A.114*, 6b].

c. Conservator, executor, or administrator at any time after appointment of conservator or death of any individual or partner when necessary for that party to maintain action to recover sums due to conservatee or decedent or partnership of which decedent was member [*see Bus. & Prof. Code § 17919(b)*; *see also § 1A.114*, 6c].

d. Assignee or purchaser of business at any time after assignment or sale when necessary to maintain action to recover sums due to assignment or purchaser by reason of transaction [*see Bus. & Prof. Code § 17919(c)*].

4. File fictitious business name statement:

NOTE:
The presentation for filing of a fictitious business name statement in duplicate, with the required fees, and the county clerk's acceptance of the statement, constitute filing [*Bus. & Prof. Code § 17916*; ***see*** *Bus. & Prof. Code § 17929* (filing fees)].

a. File statement in duplicate with county clerk [*Bus. & Prof. Code §§ 17915, 17916*]:

(1) In county where business is located, if registrant has principal place of business in California.

(2) With clerk of Sacramento County, if registrant has no place of business in California.

(3) If desired, in any other county as long as statement has also been filed in county of principal place of business.

b. Accompany statement with filing fee [*see Bus. & Prof. Code § 17929*].

c. File original statement no later than 40 days from time registrant commences transaction of business for profit in California [*see Bus. & Prof. Code § 17910(a)*].

5. Publish fictitious business name statement [*Bus. & Prof. Code § 17917(a), (b)*; *Gov. Code § 6064*]:

a. Within 30 days after statement was filed with county clerk.

b. In newspaper of general circulation:

NOTE:
Subject to the following requirements, the newspaper selected for publication should be one that circulates in the area where the business is to be conducted [*Bus. & Prof. Code § 17917(b)*].

(1) In county where fictitious business name statement was filed.

(2) If no such newspaper exists in that county, in newspaper of general circulation in adjoining county.

(3) If registrant does not have place of business in California, in Sacramento County.

c. Once each week for four successive weeks.

NOTE:
Four publications in a weekly newspaper are sufficient [***see*** *Gov. Code § 6064*].

6. Have affidavit of publication prepared by newspaper in which publication occurred and file affidavit (or have newspaper file affidavit) [*see § 1A.51 [5]*]) with county clerk within 30 days after publication is completed [*Bus. & Prof. Code § 17917(d)*; *see Code Civ. Proc. §§ 2010, 2011, 2015.5*].

7. Advise business owners that no contract action may be maintained until required fictitious business name statement has been executed, filed, and published [*see Bus. & Prof. Code § 17918*].

8. Advise registrant to renew statement every five years on or before date of publication, and after any change in facts included in original statement [*see Bus. & Prof. Code §§ 17910(b)*, *17920*; *see also § 1A.140*].

9. Advise registrant to file abandonment of use of fictitious business name if registrant ceases to transact business in California under registered fictitious name [*see Bus. & Prof. Code § 17922*; *see also § 1A.141*].

10. If registrant is partnership, advise partners that on withdrawal of any partner, withdrawing partner should file statement of withdrawal from partnership operating under fictitious business name [*see Bus. & Prof. Code § 17923(a)*; *see also § 1A.142*].

NOTE:

The withdrawal of a general partner does not cause a fictitious business name statement to expire if the withdrawing partner files a statement of withdrawal and satisfies the publication requirements [*Bus. & Prof. Code § 17923(d)*; ***see*** *§ 1A.142*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesRegistration Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1A California Legal Forms--Transaction Guide § 1A.131

§ 1A.131 Registering Trademark or Service Mark

NOTE:

For details of trademark and service mark protection, and how to obtain that protection, see Ch. 103B, ***Trademarks*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Trademark LawSpecial MarksService MarksGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1A California Legal Forms--Transaction Guide §§ 1A.132-1A.139

[Reserved]

§§ 1A.132[Reserved]



47 of 113 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

1-1A California Legal Forms--Transaction Guide § 1A.140

§ 1A.140 Filing New Fictitious Business Name Statement on Change of Facts or Expiration of Previously-Filed Statement

1. Inform party that has previously-filed fictitious business name statement [see that new statement must be filed when [*see Bus. & Prof. Code §§ 17910(b), 17920(a), (b)*]:

a. Facts in previously-filed statement have changed.

NOTE:
A new statement must be filed within 40 days after any change in facts. Failure to do so will cause the previously-filed statement to expire. A change in the residence address of an individual, general partner, or trustee, however, will not cause the statement to expire [*Bus. & Prof. Code § 17910(b), 17920(b)*]. Also, a new statement need not be filed when a general partner withdraws from a partnership that is or has been regularly transacting business under a fictitious business name provided the general partner files and publishes a statement of withdrawal [*see Bus. & Prof. Code § 17923*; *see also § 1A.142*].

b. Previously-filed statement is due to expire.

NOTE:
A fictitious business name statement expires five years from the date it was filed with the county clerk [*Bus. & Prof. Code § 17920(a)*].

2. Prepare and file new statement [*see § 1A.130*].

NOTE:
The form and procedure for filing a new statement under these circumstances are the same as those for filing the original statement, except when the filing is due to expiration of the five-year period described

in 1.b., above, in which case no publication is required provided the new statement is filed within 40 days of the date the previously-filed statement expired [*Bus. & Prof. Code § 17917(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesRegistration Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

1-1A California Legal Forms--Transaction Guide § 1A.141

§ 1A.141 Filing Statement of Abandonment of Fictitious Business Name

NOTE:

A party that has filed a fictitious business name statement within the previous five years and ceases to do business under that name must file a statement of abandonment of use of that name [Bus. & Prof. Code § 179.22(a)].

1. Obtain form from county clerk [*see Bus. & Prof. Code § 17924(b)*].

2. Complete form [*see Bus. & Prof. Code § 17922(b)* (statutory requirements)].

3. Have form executed in same manner as fictitious business name statement [*Bus. & Prof. Code § 17922(a)*; *see § 1A.130*, P 3].

4. File statement in duplicate with clerk of county in which fictitious business name was filed [*Bus. & Prof. Code § 17922(a)*].

5. Publish statement in same manner as fictitious business name statement [*Bus. & Prof. Code § 17922(a)*; *see § 1A.130*, P 5].

6. Have affidavit of publication completed by publisher of newspaper in which statement was published [*Bus. & Prof. Code § 17922(a)*].

7. Have affidavit filed with county clerk after completion of publication [*Bus. & Prof. Code § 17922(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesConducting Business Under Fictitious NamesBusiness & Corporate LawCorporate NamesFictitious NamesRegistration Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

1-1A California Legal Forms--Transaction Guide § 1A.142

§ 1A.142 Filing Statement of Withdrawal by General Partner

NOTE:

If a general partner withdraws from a partnership that is or has been regularly transacting business under a fictitious business name, have the withdrawing general partner file a statement of withdrawal [***see*** *Bus. & Prof. Code § 17923*]

If a statement of withdrawal is properly completed, executed, filed, and published (when necessary), the withdrawal of a general partner does not cause a fictitious business name statement to expire [***see*** *Bus. & Prof. Code § 17923(d)*].

1. Obtain form from county clerk [*see Bus. & Prof. Code § 17924(b)*].

2. Complete form [*see Bus. & Prof. Code § 17923(b)* (statutory requirements)].

3. Have form executed by person filing statement in same manner as fictitious business name statement [*see Bus. & Prof. Code § 17923(a)*; *see § 1A.130*, P 3].

4. File statement in duplicate with clerk of county in which fictitious business name was filed [*see Bus. & Prof. Code § 17923(a)*].

5. Publish statement of withdrawal in same manner as fictitious business statement [*see Bus. & Prof. Code § 17923(c)*; *see also § 1A.130*, P 5].

6. File affidavit showing publication after completion of publication [*see Bus. & Prof. Code § 17923(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionWithdrawal



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

1-1A California Legal Forms--Transaction Guide §§ 1A.143-1A.199

[Reserved]

§§ 1A.143[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART IV. FORMS

1-1A California Legal Forms--Transaction Guide § 1A.200

§ 1A.200 Engagement Letter

[1] Comment--Use of Form

This form is an engagement letter, used to confirm that the attorney (or firm) will provide representation in a matter. Specifically, the form:

- Affirms the purposes for which the attorney was hired;
- Provides information on the firm's reporting procedures, billing procedures, and the attorney's expectations of the client;
- Explains the difference between fees and expenses and provides an estimate of fees and expenses;
- Lists the items the attorney will perform and the time frame involved, if possible;
- Lists the items the attorney was not hired to perform;
- Lists a contact person within the firm, as appropriate; and
- States in writing that the attorney does not guarantee the outcome of any matter.

The attorney should attach, or send under separate cover, a fee and representation agreement [*see* vol. 15, ch. 86, *Agreements for Professional Services*]. This letter is not a substitute for that agreement.

[2] Form

Engagement Letter

ENGAGEMENT LETTER

_____[*date*]
_____[*name of client*]
_____[*title*]
_____[*street address*]
_____[*city, state, zip*]

Re: Engagement letter
Dear _____ [*name of client*] :

The purpose of this letter is to confirm our conversation of _____[*date*], that _____[I *or* we] will represent you in _____[*describe matter*]. _____[I *or* We] will perform the following services: _____[*list services*].

You should be aware that _____[I *or* we] have *not* been engaged to provide the following services: _____[*list services outside scope of representation*].

Attached is an explanation of our billing and reporting procedures. _____[My *or* our] fee is _____[*specify, e.g.*, $200] per hour for services performed by the attorneys of this firm and _____[*specify, e.g.*, $125] per hour for services performed by _____[my *or* our] non-attorney staff. You will also be billed for our out-of-pocket expenses incurred on your behalf.

[*If an estimate of total cost will be included, add:*]

An estimate of total fees and expenses is provided below. Please keep in mind that this is an estimate only, and that, depending on the complexity of the matter and the time required to conclude it, actual costs may exceed this estimate. However, before proceeding to perform work that exceeds our total estimated costs, _____[I *or* we] will obtain your approval.

[*Itemize anticipated fees and expenses*]

[*Continue with the following:*]

Please be aware that nothing in our agreement or in _____[my *or* our] statements to you is a promise or guarantee about the outcome of this matter. _____[I *or* we] make no promises or guarantees. _____[My *or* our] comments about the outcome of this matter are expressions of opinion only.

[*If the firm wants to designate a primary contact, add:*]

Your primary contact for this matter will be _____[*name*]. If you have questions about your case, you should contact _____[him *or* her] directly.

[*Choose one of the following:*]

[*If the firm has designated a primary contact, use:*]

If you have any questions, please call _____[*name of primary contact*]. On behalf of the firm, _____[I am *or* we are] happy to represent you in this matter.

[*OR*]

[*If no primary contact has been designated, use:*]

If you have any questions, please call. On behalf of the firm, _____[I am *or* we are] happy to represent you in this matter.

[*Continue with the following:*]

Very truly yours,
_____ [*signature*]
[*typed name*]

[*Attach explanation of firm's billing and reporting procedures.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART IV. FORMS

1-1A California Legal Forms--Transaction Guide § 1A.201

§ 1A.201 Letter Advising Nonclients of Attorney's Limited Role

[1] Comment--Use of Form

This form is a letter that advises both the attorney's client and other parties to a transaction that the attorney represents only the attorney's client and does not represent, and will not provide legal services for, other parties.

Although the California Rules of Professional Conduct permit an attorney to represent multiple parties when specified requirements are satisfied [*see Cal. Rules Prof. Conduct, Rule 3-310*; *§ 1A.34*], an attorney often chooses to represent only one party [*see § 1A.34 [4]*]. Although this approach minimizes conflict of interest problems, problems can arise if the attorney fails to give written notice to nonclients that the attorney represents only a designated party to the transaction. Consequently, this letter should be sent by certified mail, return receipt requested.

The purpose of this letter is:

- To clarify the attorney's role to all parties to the transaction;
- To provide written notice of the attorney's role to nonclients, so that it will be difficult for them to claim that they did not understand this limited role; and
- To advise the nonclients to seek the advice of independent counsel.

This letter should not be confused with a letter declining employment when the nonclient's action may be affected by the statute of limitations. Refer to Ch. 86, *Agreements for Professional Services,* for a sample of this type of nonengagement or declination letter.

[2] Form

Letter Advising Nonclients of Attorney's Limited Role

LETTER ADVISING NONCLIENTS OF ATTORNEY'S LIMITED ROLE
_____[*date*]
_____[*name of client*]
_____[*title*]
_____[*street address*]
_____[*city, state, zip*]
[*For each nonclient, use:*]
_____[*name of nonclient*]
_____[*title*]
_____[*street address*]
_____[*city, state, zip*]

Re: Letter Advising of Attorney's Limited Role
Dear _____ [*names of all parties to transaction*] :

We met on _____[*date*] to discuss _____[*describe matter*]. This letter confirms the fact that _____[I *or* we] informed you that _____[I *or* we] will represent _____[*name of client*] individually in this matter. We will, therefore, not represent, or provide any legal services for, _____[*names of nonclients*].

This letter also confirms the fact that _____[I *or* we] advised _____[*nonclient's names*] to obtain separate counsel. If you have not already done so, _____[I *or* we] strongly encourage you to seek the advice of independent counsel in this matter.

_____[My *or* Our] decision to represent only one party in this matter is based on _____[my *or* our] ethical obligations as _____[an attorney *or* attorneys] and on the constraints imposed by the State Bar of California on the representation of multiple parties.

If you have any questions about this letter, please call.

Very truly yours,
_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsConflicts of Interest



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART IV. FORMS

1-1A California Legal Forms--Transaction Guide § 1A.202

§ 1A.202 Closing Letter

[1] Comment--Use of Form

This form is letter that establishes the end of the attorney-client relationship related to a particular representation [*see § 1A.17*]. At the close of a particular matter, a letter should be sent to the client, explaining that representation is complete. It will help the client to clearly understand that the attorney will provide no further services related to a particular matter and may help avoid attorney-client problems. It also helps to establish a date from which the statute of limitations runs for purposes of malpractice claims [*see Code Civ. Proc. § 340.6(a)(2)*].

If matters are still pending with regard to the subject matter of the representation, the attorney may wish to list deadlines for which the attorney is not responsible, but of which the client should be aware. If the attorney does so, he or she should make it clear that the list is for the client's information only and does not imply that the attorney has undertaken to complete any of the listed tasks.

For example, the attorney may counsel the client regarding the need to file a fictitious business name statement, and the client may chose to have someone other than the attorney file the statement. In that case, the attorney may want to inform the client in writing that the statement must be filed no later than 40 days from the time the registrant commences the transaction of business for profit in California [*see Bus. & Prof. Code § 17910(a)*].

The attorney should also return any documents belonging to the client with this letter. The letter should be sent by certified mail, return receipt requested, to document the close of the attorney-client relationship, as well to confirm the receipt of returned documents.

[2] Form

Closing Letter

CLOSING LETTER
_____[*date*]

_____[*name of client*]
_____[*title*]
_____[*street address*]
_____[*city, state, zip*]

Dear _____ [*name of client*] :

Thank you for the opportunity to represent you in _____[*describe matter*]. This letter confirms our _____[conversation *or* telephone conversation] of _____[*date*], in which we concluded that you would not need any further assistance in _____[*describe matter*], and that _____[my *or* our] representation with regard to this matter is now complete.

Although _____[I *or* we] attempt to keep _____[my *or* our] clients advised of significant changes in the law, _____[I *or* we] do *not* undertake this responsibility. Therefore, if it comes to your attention, through the news media or other sources, that there has been a change in the laws relating to _____[*describe matter in generic terms, e.g.,* partnership tax law], _____[I *or* we] recommend that you call for an appointment.

[*If matters are still pending, and attorney wishes to provide list of applicable deadlines, add:*]

Several matters are still pending with regard to _____[*describe matter*]. Although, based on our mutual agreement, _____[I *or* this firm] will not be performing any of these tasks, a list of applicable deadlines in included below for your convenience.

[*List deadlines*]

[*Continue with the following:*]

Please call if you have any questions, or if _____[I *or* we] can be of service in the future. Thank you, again, for allowing us to represent you in this matter.

Very truly yours,
_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsGeneral OverviewLegal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART IV. FORMS

1-1A California Legal Forms--Transaction Guide § 1A.203

§ 1A.203 Conflict Disclosure Letter and Consent

[1] Comment

[a] Use of Form

The form is a letter disclosing the presence of an actual or potential conflict of interest between an attorney's clients. The purpose of this letter is to (1) provide full and complete disclosure of actual and potential conflicts of interest if the attorney will represent multiple parties; and (2) secure each party's informed, written consent [*see Cal. Rules Prof. Cond., Rule 3-310*; *§ 1A.34*]. Also included are alternative provisions that address the issues of prior representation [*see [b], below*]. These provisions, accompanied by a complete discussion of all conflicts, actual and potential, should satisfy the disclosure requirements of the *California Rules of Professional Conduct, Rule 3-310*.

It is a mistake for the attorney to use a standard conflict letter that uses generalized disclosure language and does not specifically address the present and potential conflicts of each transaction. A client's written consent to multiple representation is binding only if the attorney discloses all facts and circumstances that will enable the client to make an informed decision on multiple representation [*see Cal. Rules Prof. Cond., Rule 3-310(A)*; *Lysick v. Walcom (1968) 258 Cal. App. 2d 136, 147, 65 Cal. Rptr. 406* (decided before amendment of *Rule 3-310*); *§ 1A.34[2]*].

[b] Conflicts Between Clients and Former Clients

Contemporaneous representation of clients with adverse interests is prohibited absent written disclosure and consent [*see Cal. Rules Prof. Cond., Rule 3-310*; *see also [a], above*; *§ 1A.34*]. Consecutive representation of clients is permitted if the attorney discloses, in writing, to the current client any previous relationships (legal, business, financial, professional, or personal) that the attorney had with any party in the same matter, or any party affected by the resolution of the matter or by the attorney's representation [*Cal. Rules Prof. Cond., Rule 3-310(B)(2), (3)*]; and if the attorney obtains the current client's written consent to representation despite the attorney's previous relationships [*Cal. Rules Prof. Cond., Rule 3-310(C)*; *see § 1A.35*].

This written disclosure of any previous relationships and the client's written consent are *in addition to* any disclosure and consent required when actual or potential conflicts of interest are presented by multiple representation, or when the

attorney has obtained confidential information related to the current representation [*see Cal. Rules Prof. Cond., Rule 3-310(B), (C), (E)*].

This disclosure must be made to and the consent obtained from clients to be currently represented, and not clients or former clients with whom the attorney has had a relationship [*Cal. Rules Prof. Cond., Rule 3-310(B)*], unless the proposed representation is (1) adverse to a current or a former client and relates to a matter for which the attorney has obtained confidential information [*see Cal. Rules Prof. Cond., Rule 3-310(E)*], or (2) the prior relationships are with current clients [*see Cal. Rules Prof. Cond., Rule 3-310(B)*]. In these circumstances, the attorney must not only obtain the informed, written consent of the current client [*see Cal. Rules Prof. Cond., Rule 3-310(B)*], but also the informed, written consent of the former or current client whose interests are adverse to the anticipated representation [*Cal. Rules Prof. Cond., Rule 3-310(E)*; *see § 1A.35*; *see also § 1A.204*].

[c] Additional Disclosure and Consent if Potential Conflict Becomes Actual

Even if the attorney identifies no current conflicts of interest, the attorney must anticipate potential future conflicts; the attorney is specifically required to disclose "any reasonably foreseeable adverse effects" of the representation of adverse interests [*see Cal. Rules Prof. Cond., Rule 3-310(A)*]. Moreover, an additional disclosure and consent to continued multiple representation is required if an actual conflict later arises between the parties [*Cal. Rules Prof. Cond., Rule 3-310(C)(2)*; *Cal. Rules Prof. Cond., Rule 3-310*, discussion; *see § 1A.34[1]*].

[d] Obtaining Consent

"Informed consent" means the client's or former client's written agreement to the representation following written disclosure [*Cal. Rules Prof. Cond., Rule 3-310(A)*]. A failure to obtain consent may result in the disqualification [*see Civil Serv. Comm'n v. Superior Court (1984) 163 Cal. App. 3d 70, 82-83, 209 Cal. Rptr. 159]* , disciplinary action, or malpractice.

When the attorney represents an entity and one or more of its constituents, the entity's informed written consent to multiple representation must be given by an individual or constituent other than the represented individual, or by the shareholders or entity's members [*Cal. Rules Prof. Cond., Rules 3-310, 3-600(E)*; *see Wortham & Van Liew v. Superior Court (1987) 188 Cal. App 3d 927, 933, 233 Cal Rptr. 725* (attorney represents all partners as to partnership business matters; therefore informed written consent of all partners must be obtained); *see also Pringle v. La Chapelle (1999) 73 Cal. App. 4th 1000, 1005-1007, 87 Cal. Rptr. 2d 90* (although attorney failed to follow *Rule 3-600(E)*, violation of rule does not automatically preclude attorney from obtaining fees)].

[2] Form

Conflict Disclosure Letter and Consent

CONFLICT DISCLOSURE LETTER AND CONSENT
_____[*date*]
[*For each client, use:*]
_____[*name of client*]
_____[*title*]
_____[*street address*]
_____[*city, state, zip*]

Re: Conflicts of Interest and Risks of Multiple Representation
Dear _____ [*name of client*] :

You have asked this firm to represent you in _____[*describe matter*].

Conflicts of Interest

[*Choose one of the following:*]

[*If actual conflicts exist, use:*]

This letter confirms our _____[conversation *or* telephone conversation] of _____[*date*], in which _____[I *or* we] advised you that _____[my *or* our] representation of you with regard to _____[*describe matter*] will create certain conflicts of interest because your individual interests and goals related to this matter differ, or may differ in the future, from the interests and goals of the [limited partnership *or* partnership *or* corporation *or* limited liability company] _____[and *or* or] the other participants.

_____[I *or* We] have identified the following existing conflicts of interest: _____[*specifically describe existing conflicts of interest*].

[*OR*]

[*If no actual conflicts exist, use:*]

This letter confirms our _____[conversation *or* telephone conversation] of _____[*date*], in which _____[I *or* we] advised you that _____[I *or* we] do not believe that _____[my *or* our] representation of you with regard to _____[*describe matter*] presents any actual conflicts of interest.

However, you should be aware that such representation may involve potential conflicts because your individual interests may differ, in the future, from the interests and goals of the _____[limited partnership *or* partnership *or* corporation *or* limited liability company] _____[and *or* or] the other participants.

_____[I *or* We] have identified what _____[I *or* we] reasonably believe to be potential conflicts of interest. These potential conflicts include: _____[*specifically describe potential conflicts of interest*].

[*If attorney has prior or continuing relationship with a party in this matter, or a party that would be substantially affected by the resolution of this matter, add:*]

This conflict of interest problem is complicated by the fact that _____[I *or* we] _____[have *or* had] the following type of relationship with _____[*name of party to transaction*]: _____[*describe attorney's previous or continuing (legal, business, financial, professional, or personal) relationship with the party to the transaction*].

[*If attorney represents current adverse client, add:*]

This conflict of interest problem is _____[further] complicated by the fact that _____[I *or* we] currently represent _____[*name of current adverse client*] in a matter that is adverse to your case. These matters are adverse because _____[*specify reason for conflict*].

[*Continue with the following:*]

As we discussed, _____[I *or* we] do not believe that _____[my *or* our] representation of you in _____[*describe matter*] would be affected by _____[my *or* our] _____[prior and *or* current] representation of _____[*name of party to matter with whom attorney has previous or current relationship or name of current adverse client*]. However, as we also discussed, _____[I am *or* we are] required by the State Bar of California to inform you of actual and potential conflicts of interest and of previous and current relationships that might substantially affect our representation of you in _____[*describe matter*], and to obtain your written consent to represent you despite any conflicts or previous and current adverse relationships.

Attached, as Exhibit A, is a complete copy of *Rule 3-310 of the California Rules of Professional Conduct*, which governs _____[my *or* our] representation of adverse interests.

In accordance with this rule, if you wish this firm to represent you with regard to _____[*describe matter*], you must sign and return a copy of this letter. By signing the consent at the end of the letter, you acknowledge that:

1. _____[I *or* We] have explained to you the actual and potential conflicts of interests associated with your representation in _____[*describe matter*]; and _____[I *or* we] have given you a copy of *Rule 3-310 of the California Rules of Professional Conduct.*

[*If attorney has prior or continuing relationship with a party in this matter, or a party that would be substantially affected by the resolution of this matter, add:*]

_____. You have been informed of the nature of this firm's _____[prior *or* continuing] relationship with _____[*name of party to transaction*].

[*If attorney represents current adverse client, add:*]

_____. You have been informed of this firm's present and continuing relationship with _____[*name of current adverse client*], whose interests are adverse to your interests in _____[*describe matter*].

[*Continue with the following:*]

_____. Despite the conflicts discussed above, you want this firm to represent you in the matter described above.

Risks of Multiple Representation

In some situations, for the sake of convenience or economy, parties may prefer to employ a single attorney. However, a single _____[attorney's *or* firm's] representation of multiple interests has significant risks, in addition

to the conflict of interest issues discussed above, which you should carefully consider.

For example, multiple representation may result in the loss of the attorney-client communications privilege because issues affecting multiple representation that are communicated to _____[me *or* a member of our firm] by one person may be disclosed to a jointly-represented client in a civil action between the parties.

Further, in the event of a dispute between the parties, _____[I *or* we] may not represent any one party without the written consent of all parties. Furthermore, under certain circumstances, _____[I *or* we] may be prevented from representing any of the parties, even with the consent of all parties.

In multiple representation, an attorney is more likely to balance the interests of all clients, in order to reach a consensus, rather than to aggressively represent a single person. Aggressive representation of a single person might result in "a better deal" for that person; and you may feel that you deserve "a better deal" because you have invested more time, money, or energy in this matter than have others.

Despite these additional risks of multiple representation, which _____[I *or* we] discussed with you in our _____[conversation *or* telephone conversation] of _____[*date*], you have informed us that you wish _____[me *or* us] to represent you and _____[*list names of other participants*] with regard to _____[*describe matter*] and that you do not wish to seek the advice of independent counsel.

Two copies of this letter and its attachment are enclosed. One copy is for your records. Please *review this letter carefully*, as it sets forth actual and potential conflicts of interest and other risks associated with multiple representation. If you have any questions about this letter or the consent, please contact _____[me *or* us] before signing the consent set forth below. In addition, you are free to consult with independent counsel regarding this letter or regarding any other matter related to this firm's representation of you in _____[*describe matter*].

Very truly yours,
_____ [*signature*]
_____ [*typed name*]

CONSENT

_____[*Name of attorney or name of firm*] has explained to the undersigned the nature and possible consequences of _____[actual *or* potential] conflicts of interest that exist with regard to the firm's representation of all parties in _____[*describe matter*].

[*If attorney has prior or continuing relationship with a party in this matter, or a party that would be substantially affected by the resolution of this matter, add:*]

_____[*Name of attorney or name of firm*] has informed the undersigned of the nature of this firm's _____[prior *or* continuing] relationship with _____[*name of party to transaction*].

[*If attorney represents current adverse client, add:*]

_____[*Name of attorney or name of firm*] has informed the undersigned of the nature of this firm's present and continuing relationship with _____[*name of current adverse client*], whose interests are

adverse to the undersigned's interests in the matter described above.

[*Continue with the following:*]

_____[*Name of attorney or name of firm*] has informed the undersigned that _____[he *or* she] may seek the advice of independent counsel regarding this letter or at any other time.

Despite the conflicts of interest and other risks of multiple representation described in this letter, the undersigned desires _____[*name of attorney or name of firm*] to represent _____[him *or* her] with regard to the matter described above.

[*For each client, use:*] _____[*date*]

_____[*signature*]
[*typed name of client*]

CC: _____[*names of other parties to the transaction to whom letter has been sent*]

EXHIBIT A

[*Attach copy of California Rules of Professional Conduct, Rule 3-310.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsConflicts of Interest



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART IV. FORMS

1-1A California Legal Forms--Transaction Guide § 1A.204

§ 1A.204 Letter Requesting Consent From Adverse Client

[1] Comment

[a] Use of Form

This form is a letter requesting consent to a conflict from an adverse client. The purpose of this letter is to make full disclosure of the circumstances surrounding a representation that is adverse to a present or former client, and to obtain that client's informed written consent to the representation despite the adversity. For discussion of the required extent of such disclosure, refer to *§ 1A.203[1][a]*.

[b] When Consent Is Required

If the proposed representation of parties is actually adverse to a client or former client and relates to a matter about which the attorney has obtained confidential information, in addition to the consent of the current client [*see Cal. Rules Prof. Cond., Rule 3-310(B)*; *§ 1A.203*], the attorney must also obtain the informed, written consent of the current or former client whose interests are now adverse [*Cal. Rules Prof. Cond., Rule 3-310(B),(E)*].

[2] Form

Letter Requesting Consent From Adverse Client

LETTER REQUESTING CONSENT FROM ADVERSE CLIENT
_____[*date*]
[*For each adverse client, use:*]
_____[*name of adverse client*]
_____[*title*]
_____[*street address*]
_____[*city, state, zip*]

Re: Proposed Representation of Adverse Interests

Dear _____ [*name of adverse client*] :

This letter confirms our _____[conversation *or* telephone conversation] of _____[*date*], in which _____[I *or* we] advised you that _____[I *or* the firm] has been requested to represent _____[*name of client*] with regard to _____[*briefly describe proposed representation*].

This firm _____[currently represents you *or* has represented you in the past] in _____[*describe matter*]. In the process of this representation, _____[I *or* we] received confidential information material to that representation.

_____[My *or* Our] representation of _____[*name of client whose proposed representation is adverse*] presents a conflict of interest because that client's interests are adverse to your interests in this proposed representation and because the proposed representation relates to a matter about which _____[I *or* we] received confidential information during the course of _____[my *or* our] representation of you in _____[*describe matter*].

When a proposed representation of parties is actually adverse to a client or former client and relates to a matter about which the attorney has obtained confidential information, the ethical rules of the State Bar of California require that the attorney obtain the written consent of the client or former client whose interests are adverse. A complete copy this rule (*Rule 3-310 of the California Rule of Professional Conduct*) is attached to this letter as Exhibit A.

In accordance with this rule and _____[my *or* our] ethical obligations, _____[I *or* we] must obtain your written consent to the proposed representation described above.

When we spoke on _____[*date*], you indicated that you did not object to _____[my *or* our] representation of _____[*name of client*] in _____[*briefly describe proposed representation*]. In that conversation, _____[I *or* we] also advised you that you are free to seek the advice of independent counsel on this proposed representation.

If, despite the conflict of interest presented by the proposed representation described above, you still wish to give your consent to that representation, please sign one of the two enclosed copies of this letter and return it to _____[me *or* us]. A second copy is enclosed for your files.

Before signing the consent set forth below, please *review this letter carefully*, as it sets forth conflicts of interest associated with the proposed adverse representation. If you have any questions about this letter or the consent, please contact _____[me *or* us] before signing the consent set forth below. In addition, you remain free to consult with independent counsel regarding any issue in this letter.

Very truly yours,
_____ [*signature*]
[*typed name*]

CONSENT

I have been advised that _____[*name of attorney or name of firm*] has been requested to represent _____[*name of client*] with regard to _____[*briefly describe proposed representation*].

I have been informed that this proposed representation of _____[*name of client whose proposed representation is adverse*] presents a conflict of interest because that client's interests are adverse to my interests in this proposed representation and because the proposed representation relates to a matter about which _____[*name of attorney or name of firm*] obtained confidential information material to the proposed representation during the course of my employment of _____[*name of attorney or name of firm*] in _____[*describe matter*]. I have also been given a copy of *Rule 3-310 of the California Rules of Professional Conduct*, which governs the representation of clients when actual or potential conflicts of interest exist.

I have been advised to seek the advice of independent counsel regarding the matter described above, if I so desire.

Nevertheless, despite the conflict of interest described in this letter, I consent to the representation of _____[*name of adverse client*] by _____[*name of attorney or name of firm*] with regard to the matter described above.

[*For each adverse client, use:*] _____[*date*]

_____[*signature*]
[*typed name of client*]

CC: _____[*names of other parties to the transaction to whom letter has been sent*]

EXHIBIT A

[*Attach copy of California Rules of Professional Conduct, Rule 3-310.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsConfidentiality of InformationLegal EthicsClient RelationsConflicts of Interest



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART IV. FORMS

1-1A California Legal Forms--Transaction Guide § 1A.205

§ 1A.205 Fictitious Business Name Statement

[1] Comment

[a] Use of Form

Because a form for a fictitious business name statement is filed with the county clerk of the county in which the registrant has his or her principal place of business, each county requires use of its own form. This is the form for use in San Francisco County. It is included here to give an example of the type of information that will be required in other counties in the state.

[b] Who Must File

Every person who regularly transacts business in California for profit under a fictitious business name must file a fictitious business name statement [*Bus. & Prof. Code § 17910*]. In general, a "fictitious business name" is (1) any name other than the surname of an individual owner, the surnames of all general partners, or the full name of a business entity, or (2) a name that suggests the existence of additional owners *Bus. & Prof. Code § 17900(b), (c)*; *see § 1A.51[1], [2]*]. Exclusions from this filing requirement are contained in the statutory definition of "fictitious business name" [*see Bus. & Prof. Code § 17900(b)*; *see also §§ 1A.51[1], [2], 1A.114*].

[c] Required Contents

The contents of the fictitious business name statement, as well as the form to be substantially followed, are set forth in the Business and Professions Code [*see Bus. & Prof. Code § 17913(a), (b)*].

In general, the registrant must provide:

- The fictitious business name;
- The registrant's business address;

- The full name and, when required, residence address of individuals, general partners, and trustees [*see Bus. & Prof. Code § 17913(b)(3)*];

- The nature of the business (i.e., type of business entity) chosen from statutory options [*see Bus. & Prof. Code § 17913(b)(4)*]; and

- The date the registrant first commenced business under the fictitious name, if applicable.

For detailed coverage of the contents of the statement, see *§ 1A.130*.

The registrant must declare that all information contained in the fictitious business name statement is true and correct. A registrant who declares as true any material matter that he or she knows to be false is guilty of a misdemeanor [*Bus. & Prof. Code § 17913(c)*].

In practice, each county must prepare a standard form, such as this form, that complies with the requirement of the statute [*see Bus. & Prof. Code § 17924*; *see also [e], below*].

[d] When to File

A fictitious business name statement must be filed no later than 40 days after the entity begins to transact business for profit in California [*Bus. & Prof. Code § 17910(a)*]. Unless it expires earlier due to a change of facts or the filing of a statement of abandonment, a statement expires at the end of five years from the date it was originally filed [*Bus. & Prof. Code § 17920*]. A change in the facts included in the original statement requires that a new statement be filed [*Bus. & Prof. § 17910(b)*; *see Bus. & Prof. Code § 17920(b)*].

[e] Where to File; Forms to Be Furnished by County Clerk

A fictitious business name statement must be filed with the clerk of the county in which the registrant has his or her principal place of business in California or, if there is no place of business in California, with the Sacramento County clerk. The registrant may also file a statement in another county as well [*Bus. & Prof. Code § 17915*]. Forms may be obtained from the county clerk of the appropriate county. The county clerk is required to furnish forms that satisfy the statutory requirements of fictitious business name statements [*see Bus. & Prof. Code § 17913(a)*], without charge [*Bus. & Prof. Code § 17924(a)*]. However, there is a fee for filing the form. A sample form from San Francisco County is reproduced in *[2], below*.

[f] Execution and Publication Requirements

For execution requirements, see *§ 1A.130*, Paragraph 3 [*see Bus. & Prof. Code §§ 17914, 17919*]. Publication requirements are discussed in *§ 1A.51[5]* [*see Bus. & Prof. Code § 17917*; *Gov. Code § 6064*].

[g] Effect of Filing

Using a fictitious business name does not create a separate legal entity. If a corporation is sued under its fictitious business name, but appears and responds under its corporate name, plaintiffs cannot continue the proceedings against the corporation under its fictitious business name. For example, plaintiffs who sued a corporation by its fictitious business name could not obtain a default judgment against the fictitious business name as a legally distinct entity after the corporation responded to the complaint in its corporate name and obtained a dismissal [*Pinkerton's, Inc. v. Superior Court (1996) 49 Cal. App. 4th 1342, 1347-1348, 57 Cal. Rptr. 2d 356*].

[2] Form

Fictitious Business Name Statement

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesRegistration Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1A ROLE OF COUNSEL IN STARTING A NEW BUSINESS
PART IV. FORMS

1-1A California Legal Forms--Transaction Guide § 1A.206

§ 1A.206 Privacy Notice

[1] Comment

[a] Use of Form

This form contains sample privacy policies and provisions for use by financial institutions, as that term is broadly defined under federal law [*see [e], below*], to comply with regulations governing the dissemination of consumers' nonpublic personal information [*see 16 C.F.R. § 313.1 et seq.*]. Primarily, the privacy policy must identify categories of information that the financial institution collects and the categories of information that the institution discloses [*see* 16 C.F.R. Pt. 313, Appendix A (sample clauses)]. This form contains several alternative sample privacy policy forms and provisions:

- First, a privacy notice that might be used by law firms, and can be adapted for use by financial planners and others receiving nonpublic personal information.
- Second, an alternative suited for an internet-based company.
- Third, clauses for use when the entity has affiliates.

These sample forms and provisions must be adapted to suit the individual privacy policies of persons and entities required to issue the notice.

[b] Governing Law

In 1999, Congress enacted legislation mandating that each financial institution has an affirmative and continuing obligation to respect the privacy of its customers and to protect the security and confidentiality of those customers' nonpublic personal information [*15 U.S.C. § 6801(a)*]. In general, a financial institution may not, directly or through any affiliate, disclose to a nonaffiliated third party any nonpublic personal information, unless the financial institution provides or has provided to the consumer a notice that complies with statutory requirements [*15 U.S.C. § 6802(a)*; *see 15 U.S.C. § 6803*]. A financial institution may not disclose nonpublic personal information to a nonaffiliated third party

unless (1) the institution clearly and conspicuously discloses to the consumer, in writing, in electronic form, or other permissible form that the information may be disclosed to the third party; (2) the consumer is given the opportunity, before the time that the information is initially disclosed, to direct that the information not be disclosed to the third party; and (3) the consumer is given an explanation of how the consumer can exercise that nondisclosure option [*15 U.S.C. § 6802(b)(1)*; *see 15 U.S.C. § 6802(b)(2)* (exception)].

Regulations issued in connection with this federal legislation, known as the Gramm-Leach-Bliley Act [*see 15 U.S.C. § 6801 et seq.*], require each "financial institution" to notify its individual clients annually of its privacy policy and its practices regarding disclosure of nonpublic personal information [*see 16 C.F.R. §§ 313.4, 313.5 et seq.*; *see [d], below*]. The term "financial institution" is broadly defined. Thus, for example, the scope of the privacy notice requirement may include law firms preparing tax returns, providing tax planning advice, or furnishing real estate settlement services [*see 16 C.F.R. § 313.1(b)*; *see also [e], below*].

The federal statutes and regulations are expressly not to be construed as superseding, altering, or affecting any statute, regulation, order, or interpretation in effect in any state, except to the extent that the state statute, regulation, order, or interpretation is inconsistent with federal law provisions, and then only to the extent of the inconsistency [*15 U.S.C. § 6807(a)*; *16 C.F.R. § 313.17(a)*]. A state statute, regulation, order, or interpretation is not inconsistent if the protection of the state statute, regulation, order, or interpretation affords any person is greater than the protection provided under federal law [*15 U.S.C. § 6807(b)*; *16 C.F.R. § 313.17(b)*].

[c] Scope of Privacy Protection

The privacy protections governing the treatment of nonpublic personal information about consumers by financial institutions (1) require financial institutions to provide notice to customers about its privacy policies and practices in specified circumstances; (2) describe the conditions under which a financial institution may disclose nonpublic personal information about consumers to nonaffiliated third parties; and (3) provide a method for consumers to prevent a financial institution from disclosing that information to most nonaffiliated third parties by "opting out" of that disclosure [*16 C.F.R. § 313.1(a)*; *see 16 C.F.R. § 313.7* (opt out procedures); *see also 16 C.F.R. § 313.13-313.15* (exceptions in to opt out procedures)]. These protections apply only to nonpublic personal information about individuals who obtain financial products or services primarily for personal, family or household purposes from financial institutions; they do not apply to information about companies or about individuals who obtain financial products or services for business, commercial, or agricultural purposes [*16 C.F.R. § 313.1(b)*].

These privacy protections also apply to "other persons," that is, third parties that are not financial institutions, but that receive nonpublic personal information from financial institutions with whom they are not affiliated [*16 C.F.R. § 313.1(b)*].

[d] "Nonpublic Personal Information" Defined

"Nonpublic personal information" is defined to mean the following [*16 C.F.R. § 313.1(n)(1)*; *see 16 C.F.R. § 313.1(o)* ("personally identifiable financial information" defined); *see also 16 C.F.R. § 313.1(p)* ("publicly available information" defined)]:

- Personally identifiable financial information; and

- Any list, description, or other grouping of consumers (and publicly available information pertaining to them) that is derived using any personally identifiable financial information that is not publicly available.

The term does not include publicly available information, except as included on any list, description, or other grouping

of consumers (and publicly available information pertaining to them) that is derived without using any personally identifiable financial information that is not publicly available [*16 C.F.R. § 313.1(n)(2)*; *see 16 C.F.R. § 313.1(n)(3)* (examples)].

[e] "Financial Institutions" Defined

"Financial institutions" include, but are not limited to, mortgage lenders, "pay day" lenders, finance companies, mortgage brokers, account servicers, check cashers, wire transferors, travel agencies operated in connection with financial services, collection agencies, credit counselors and other financial advisors, tax preparation firms, non-federally insured credit unions, and investment advisors that are not required to register with the Securities and Exchange Commission [*16 C.F.R. § 313.1(b)*]. The term "financial institution" also includes any institution whose business is engaging in financial activities described in *12 U.S.C. § 1843(k)*. An institution that is significantly engaged in financial activities is a financial institution [*16 C.F.R. § 313.3(k)(1)*]. Examples of financial institutions include the following [*16 C.F.R. § 313.3(k)(2)*]:

- Retailers that extend credit by issuing their own credit cards directly to consumers.
- Personal property or real estate appraisers.
- Automobile dealerships that, as a usual part of business, lease automobiles on a nonoperating basis for longer than 90 days, with respect to its leasing business.
- Career counselors that specialize in providing career counseling services to individuals currently employed by or recently displaced from a financial organization, individuals who are seeking employment with a financial organization, or individuals who are currently employed by or seeking placement with the finance, accounting, or audit departments of any company; businesses that print and sell checks for consumers.
- Businesses that regularly wire money to and from consumers.
- Check cashing businesses.
- Accountants or other tax preparation services in the business of completing income tax returns.
- Businesses that operate a travel agency in connection with financial services.
- Entities that provides real estate settlement services.
- Mortgage brokers.
- Investment advisory companies.
- Credit counseling services.

The term "financial institution is subject to numerous specific exclusions. For example, financial institution does not include the following [*16 C.F.R. § 313.3(k)(3)*; *see 16 C.F.R. § 313.3(k)(4)* (examples)]:

- Persons or entities with respect to any financial activity that is subject to the jurisdiction of the Commodity Futures Trading Commission under the Commodity Exchange Act [*see 7 U.S.C. 1 et seq.*].

- Institutions chartered by Congress specifically to engage in securitizations, secondary market sales (including sales of servicing rights) or similar transactions related to a transaction of a consumer, as long as the institutions do not sell or transfer nonpublic personal information to a nonaffiliated third party other than as permitted [*see 16 C.F.R. §§ 313.14, 313.15*].

- Entities that engage in financial activities but that are not significantly engaged in those financial activities.

[f] Initial Privacy Notice Requirements

Financial institutions must provide an initial, clear and conspicuous [*see [c], above*] privacy notice that accurately reflects their privacy policies and practices to the following [*16 C.F.R. § 313.4*]:

- New customers, no later than when the entity establishes a customer relationship [*16 C.F.R. § 313.4(a)(1)*; *but see 16 C.F.R. § 313.4(e)*].

- Consumers, before disclosing any nonpublic personal information about the consumer to any nonaffiliated third party [*16 C.F.R. § 313.4(a)(2)*; *but see 16 C.F.R. §§ 313.14, 313.15* ("opt out" provisions)].

- Existing customers.

However, an initial notice to consumers is not required if the entity will not disclose any nonpublic personal information about the consumer to any nonaffiliated third party, other than under the opt out provisions [*see 16 C.F.R. §§ 313.14, 313.15*] and the entity does not have a customer relationship with the consumer [*16 C.F.R. § 313.4(b)*]. A "customer relationship" is established when the entity and the consumer enter into a continuing relationship. With regard to loans, a "customer relationship" is established with a consumer when the entity originates a loan to the consumer for personal, family, or household purposes. If the servicing rights are subsequently transferred to another financial institution, the customer relationship transfers with the servicing rights [*16 C.F.R. § 313.4(c)(1), (2)*; *see 16 C.F.R. § 313.4(c)(3)* (examples)].

[g] Annual Privacy Notice Requirements

Financial institutions must provide a clear and conspicuous notice [*see [c], above*] to customers that accurately reflects the institution's privacy policies and practices not less than annually during the continuation of the customer relationship. Annually means at least once in any period of 12 consecutive months during which that relationship exists. The institution may define the 12-consecutive-month period, but the definition must be applied to the customer on a consistent basis [*16 C.F.R. § 313.5(a)(1)*; *see 16 C.F.R. § 313.5(a)(2)* (examples)]. Notice to former customers is not required [*16 C.F.R. § 313.5(b)*].

[h] "Clear and Conspicuous" Notice Requirements

A privacy notice is "clear and conspicuous" if the notice is reasonably understandable and designed to call attention to the nature and significance of the information in the notice [*16 C.F.R. § 313.3(b)(1)*]. A notice is "reasonably understandable" if it does all of the following [*16 C.F.R. § 313.3(b)(2)(i)*]:

- Presents the information in the notice in clear, concise sentences, paragraphs, and sections.

- Uses short explanatory sentences or bullet lists whenever possible.

- Uses definite, concrete, everyday words and active voice whenever possible.
- Avoids multiple negatives.
- Avoids legal and highly technical business terminology whenever possible.
- Avoids explanations that are imprecise and readily subject to different interpretations.

A notice is "designed to call attention to the nature and significance of the information in the notice" if it does the following [*16 C.F.R. § 313.3(b)(2)(ii)*]:

- Uses a plain-language heading to call attention to the notice.
- Uses a typeface and type size that are easy to read.
- Provides wide margins and ample line spacing.
- Uses boldface or italics for key words.
- Uses distinctive type size, style, and graphic devices, such as shading or sidebars if the notice is combined with other information.

If a privacy notice is provided on a web page, the notice should be designed to call attention to the nature and significance of the information in it. It should use text or visual cues to encourage scrolling down the page if necessary to view the entire notice, and ensure that other elements on the web site (such as text, graphics, hyperlinks, or sound) do not distract attention from the notice. In addition, either (1) the notice should be placed on a screen that consumers frequently access, such as a page on which transactions are conducted; or (2) a link should be placed on a screen that consumers frequently access, such as a page on which transactions are conducted, that connects directly to the notice and is labeled appropriately to convey the importance, nature, and relevance of the notice [*16 C.F.R. § 313.3(b)(2)(iii)*].

[2] Form

Privacy Notice

PRIVACY NOTICE

[*For law firms, use:*]

_____[*Name of firm*] is sending you the following notice:

_____[*Name of firm*] receives nonpublic personal information regarding its clients from the clients themselves and from other professionals hired by the clients, such as accountants, financial advisors, and insurance brokers. As required by California law and the ethical rules governing the conduct of attorneys, _____[*name of firm*] safeguards the confidentiality of all nonpublic client information and discloses this information to third parties only when the client expressly or implicitly (as in the case of exchanges of information with the client's other professional advisors) consents to the disclosure or when disclosure is legally compelled.

Within the firm, _____[*name of firm*] restricts access to nonpublic personal information about its clients to those employees who need that access to provide legal services to those clients. _____[*name of firm*] maintains physical, electronic, and procedural safeguards to protect the confidentiality of clients' and former

clients' nonpublic personal information.

_____[*Name of firm*] therefore does not disclose, and does not wish to reserve the right to disclose, nonpublic personal information about clients or former clients to anyone outside the firm, other than in the very limited circumstances described above.

[*OR, for internet companies, use:*]

_____[*Name of entity*] will collect, store, or use personally identifiable information, such as your name, address, telephone number, or e-mail address ("Your Information"), based on your voluntary submission to us. We will use Your Information to respond to requests you may make of us, and from time to time, we may use Your Information to better understand your needs and how we can improve our Web sites, products, and services. All such uses will comply with all applicable laws. We may also use Your Information to contact you. However, the submission of Your Information is only necessary if you choose to use or receive certain tools or services, such as _____[*specify*]. Any other information submitted by you in connection with these services or our websites that cannot be used to identify you ("Other Information") may be included in databases owned and maintained by _____[*name of entity*] or its agents. _____[*Name of entity*] retains all rights to these databases and the information contained in them.

Our Web sites, as do most internet sites, use Other Information and combine it with information that _____[*specify, e.g.*, tracks the number of visitors to our site, the number of visitors to each page of the site, and the domain names of our visitors' internet service providers]. However, no personally identifiable information is available or used in this process.

Some of our Web sites use "cookies," that is, pieces of information that the computer hosting the site assigns to your computer browser when you access a Web site. Cookies help ensure a more accurate analysis of site usage. For example, our site may set a cookie on your browser that keeps you from needing to remember and enter a password more than once during a visit to the site. Whenever cookies are used, _____[*name of entity*] will not collect personally identifiable information without your permission.

In addition, our Web sites have security measures in place, _____[*specify, e.g.*, including the use of industry standard secure socket layer encryption,] to protect the confidentiality of Your Information. However, your browser must support encryption protection to take advantage of this protection. These security measures also help us to honor your choices for the use of Your Information.

[*If web site contains links, add if desired:*]

For the convenience of our visitors, this Web site contains links to a number of sites that we believe may offer useful information. The policies and procedures we described here do not apply to those sites. _____[*Name of entity*] suggests contacting those sites directly for information on their privacy, security, data collection, and distribution policies.

[*Continue with the following:*]

_____[*Name of entity*] is committed to protecting the privacy of children. You should be aware that this site is not intended for, or designed to attract, children under the age of 13. We do not collect personally identifiable information from any person we actually know is a child under the age of 13.

_____[*Name of entity*] may update this Web site Privacy Policy from time to time. When the Policy is updated, the updated policy will be available on this page for your convenience.

[*For companies with affiliates, include:*]

To alert you to special offers and provide you with products and services that are specifically tailored to you and your needs, _____[*name of entity*] shares information with and among our affiliates on a confidential basis. Our affiliates are legally permitted to share any information about their transactions or experiences with you. Other information that you provide to us or that we obtain from third parties (such as credit bureaus) will not be shared if you _____[notify us *or* notify us in writing] that you do not want such information shared with our affiliates. You may send written notice to us at any time at the following address: _____[*specify mailing address*]. Please include identifying information such as your name and address as it appears on your account and your account identification. Please do not include any other correspondence with this notice.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawFederal ActsGramm-Leach-Bliley Act



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY

1-1B California Legal Forms--Transaction Guide 1B.syn

§ 1B.syn Synopsis to Chapter 1B: SELECTING FORM OF BUSINESS ENTITY

§ 1B.01 California Sources

[1] Statutes

[a] Close Corporation

[b] Corporations--In General

[c] Professional Corporation

[d] General Partnership

[e] Limited Partnership

[f] Limited Liability Partnership

[g] Limited Liability Company

[h] Miscellaneous

[2] Regulations

§ 1B.02 Federal Sources

[1] Statutes

[2] Regulations

[3] Revenue Rulings

[4] Revenue Procedures

[5] Other Federal Sources

§§ 1B.03-1B.04 [Reserved]

§ 1B.05 Law Reviews and Periodicals

§ 1B.06 Text References

[2] Additional Text References

§§ 1B.07-1B.09 [Reserved]

§ 1B.10 Sole Proprietorship

[1] Definition

[2] Salient Characteristics

[a] Extent of Personal Liability

[b] Availability of Capital

[c] Continuity of Existence

[d] Taxation

§ 1B.11 General Partnership

[1] Definition

[2] Salient Characteristics

[a] Management and Control

[b] Extent of Personal Liability

[c] Availability of Capital

[d] Continuity of Existence

[e] Taxation

§ 1B.12 Limited Partnership

[1] Definition

[2] Salient Characteristics

[a] Management and Control

[b] Extent of Personal Liability

[c] Availability of Capital

[d] Continuity of Existence

[e] Taxation

§ 1B.13 Limited Liability Company

[1] Definition

[2] Salient Characteristics

[a] Management and Control

[b] Extent of Personal Liability

[i] Members

[ii] Managers and Officers

[c] Availability of Capital

[d] Continuity of Existence

[e] Taxation

§ 1B.14 Joint Venture

[1] Definition Under State Law

[2] Definition for Tax Purposes

§ 1B.15 Other Noncorporate Forms

[1] Business Trust

[2] Unincorporated Associations

[3] Publicly Traded Partnership

[4] Small Business Investment Company

[5] Limited Liability Partnerships

[a] Definition

[b] Salient Characteristics

[i] Management and Control

[ii] Extent of Personal Liability

[iii] Taxation

§§ 1B.16-1B.29 [Reserved]

§ 1B.30 Overview of Corporate Form

[1] Definition

[2] Salient Characteristics

[a] In General

[b] Management and Control

[c] Extent of Personal Liability

[d] Availability of Capital

[e] Continuity of Existence

[f] Taxation

§ 1B.31 Types of Corporations

[1] General Business Corporations

[2] Professional Corporation

[a] Overview

[b] Professions Permitted to Incorporate

[3] Close Corporation

[4] Subchapter S Corporation

[5] Personal Services Corporation

[6] Nonprofit Corporation

[7] Cooperative Corporation

§§ 1B.32-1B.39 [Reserved]

§ 1B.40 Lawfulness of Business Activity

[1] Illegal Business Venture

[2] Business Forms Specified by Government Regulation

§ 1B.41 Management and Control

[1] Sole Proprietorship

[2] General Partnership

[3] Limited Partnership

[4] Limited Liability Company

[5] Corporation

§ 1B.42 Limitations on Liability

[1] In General

[2] Sole Proprietorship

[3] General Partnership

[4] Limited Partnership

[5] Limited Liability Company

[6] Corporation

[7] Close Corporation

[8] Professional Corporation

[9] Limited Liability Partnership

§ 1B.43 Availability of Capital

[1] In General

[2] Sole Proprietorship

[3] General Partnership

[4] Limited Partnership

[5] Limited Liability Company

[6] Corporation

§ 1B.44 Transferability of Interests

[1] Sole Proprietorship

[2] General Partnership

[3] Limited Partnership

[4] Limited Liability Company

[5] Corporation

§ 1B.45 Separate Legal Identity; Continuity of Existence

[1] Sole Proprietorship

[2] Partnership

[3] Limited Liability Company

[4] Corporation

§ 1B.46 Compliance With Securities Laws

[1] General Partnership

[2] Limited Partnership

[3] Limited Liability Company

[4] Corporation

§ 1B.47 Cost Considerations

§ 1B.48 Miscellaneous Considerations

[1] Traditional Forms for Certain Business Activities

[2] Complexity of Business

[3] Interstate Activity

[4] Compliance

§§ 1B.49-1B.59 [Reserved]

§ 1B.60 General Tax Considerations

§ 1B.61 Types of Business Organizations for Tax Purposes

§ 1B.62 Taxation of the Business Entity and its Owners or Investors

[1] Sole Proprietorship

[2] Partnership

[3] Limited Liability Company

[4] S Corporation

[5] C Corporations

§ 1B.63 Treatment of Income and Loss

[1] Choice of Business Form--In General

[2] Taxation of Income

[a] Sole Proprietorship

[b] Partnership

[c] Limited Liability Company

[d] S Corporation

[e] C Corporation

[i] Double Taxation

[ii] Penalty Taxes--In General

[iii] Penalty Tax on Personal Holding Company

[iv] Penalty Tax on Accumulated Earnings

[3] Deductibility of Losses

[a] Sole Proprietorship

[b] Partnership

[c] Limited Liability Company

[d] S Corporation

[e] C Corporation

§ 1B.64 Treatment of Capital Contributions

[1] In General

[2] Sole Proprietor

[3] Partnership and Limited Liability Company

[4] C Corporation

[5] S Corporation

§ 1B.65 Disposition of Business or Business Interest

[1] Sale

[a] In General

[b] Sole Proprietorship

[c] Partnership

[d] Limited Liability Company

[e] Corporation

[i] Sale of Stock

[ii] Distribution of Assets

[2] Retirement or Death

[a] In General

[b] Sole Proprietor

[c] Partnership

[i] In General

[ii] Treatment of Sale of Interest

[iii] Treatment as Liquidation of Partner's Interest

[iv] Treatment as Complete Liquidation of Partnership

[d] Limited Liability Company

[e] Corporation

§ 1B.66 Income Splitting

[1] In General

[2] Sole Proprietorship

[3] Partnership and Limited Liability Company

[4] C Corporation

[5] S Corporation

§ 1B.67 Deductibility of Start-up Expenses

[1] Sole Proprietorship

[2] Partnership, Limited Liability Company, and S Corporation

[3] Corporation

§ 1B.68 Other Tax Considerations

[1] Alternative Minimum Tax

[2] Choice of Tax Year

[3] Section 1244 Stock

[4] Fringe Benefits

[a] Retirement Plans

[b] Other Fringe Benefits

§§ 1B.69-1B.99 [Reserved]

§ 1B.100 Facts

Scope

§ 1B.101 Documents

Scope

§§ 1B.102-1B.109 [Reserved]

§ 1B.110 Ascertain Goals of Owners and Investors Affecting Choice of Business Form

[1] Determine Effects of Nontax Factors

Scope

[2] Determine Effect of Income Tax Factors

Scope

§ 1B.111 Determining Whether to Form Sole Proprietorship

Scope

§ 1B.112 Determining Whether to Form Partnership

Scope

§ 1B.113 Determine Whether to Form Limited Liability Company

Scope

§ 1B.114 Determine Whether to Form Corporation

Scope

§§ 1B.115-1B.199 [Reserved]

§ 1B.200 Client Letter Before Initial Meeting

[1] Comment

[a] Use of Form

[b] Fee and Representation Agreement

[2] FORM

Client Letter Before Initial Meeting

§ 1B.201 Client Letter Following Initial Meeting

[1] Comment--Use of Form

[2] FORM

Client Letter Following Initial Meeting

§ 1B.202 Follow-up Letter to Client if No Business Will Be Formed

[1] Comment--Use of Form

[2] FORM

Follow-up Letter to Client if No Business Will Be Formed

§ 1B.203 Client Letter if Business Will Be Formed

[1] Comment--Use of Form

[2] FORM

Client Letter if Business Will Be Formed

§ 1B.204 Table: Comparison of Business Forms: Nontax Attributes

[1] Comment

[a] Use of Form

[b] Use of Abbreviations

[2] FORM

Table: Comparison of Business Forms: Nontax Attributes

§ 1B.205 Table: Comparison of Business Forms: Tax Attributes

[1] Comment

[a] Use of Form

[b] Use of Abbreviations

[2] FORM

Table: Comparison of Business Forms: Tax Attributes

§ 1B.206 Table: Comparison of Business Forms: Availability of Fringe Benefits to Owners

[1] Comment

[a] Use of Form

[b] Use of Abbreviations

[2] FORM

Table: Comparison of Business Forms: Availability of Fringe Benefits to Owners

§ 1B.207 Table: Comparison of Business Forms: Startup Costs

[1] Comment

[a] Use of Form

[b] Nature and Complexity of Business Predominate Selection of Entity

[2] FORM

Table: Comparison of Business Forms: Startup Costs

§ 1B.208 Table: Comparison of Business Forms: Ongoing Filing Costs and Formalities

[1] Comment--Use of Form

[2] FORM

Table: Comparison of Business Forms: Ongoing Filing Costs and Formalities



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY

1-1B California Legal Forms--Transaction Guide Scope

Scope

Scope

When a client wants to start a new business or to change the form of an existing business, counsel's responsibility is to assist the client in choosing the most appropriate form for the business activity. This chapter outlines the various business forms available under California law and provides an overview of the nontax and tax consequences of choosing a particular form. It compares the advantages and disadvantages of the most common noncorporate and corporate forms of business organization, including the sole proprietorship, the general partnership, the limited partnership, the limited liability company, the for-profit corporation, the Subchapter S corporation, the closely held corporation, and the personal services corporation.

Forms of business organization for which a client would likely consult specialized counsel, such as nonprofit corporations, are not within the scope of this chapter. For a discussion of nonprofit corporations, see Ch. 13, *Nonprofit Corporations* . In addition, organizational forms subject to specialized government regulation, such as banks, insurance companies, and trust companies are not covered in this chapter.

The Transaction Guide provides a checklist of facts and documents to obtain and determinations to be made in choosing the most appropriate business form. Detailed procedures on how to form the chosen business entity are outside the scope of this chapter. For formation of general partnerships, see Ch. 15, Part A, *Formation of General Partnerships* . For formation of limited partnerships, see Ch. 15A, *Formation of Limited Partnerships* . For a discussion of general corporate formation, see Ch. 2, *Formation of Corporations* , Ch. 3, *Articles of Incorporation* , and Ch. 4, *Bylaws* . For formation of Subchapter S corporations, see Ch. 2B, *Electing Subchapter S Status* . For additional information about close corporations, see Ch. 8C, *Close Corporation Shareholder Agreements* . For formation of professional corporations, see Ch. 12A, *Professional Corporations ;* for formation of limited liability companies, see Ch. 12C, *Limited Liability Companies* . Formation of limited liability partnerships is covered in Ch. 16C, *Limited Liability Partnerships* .

For additional information relevant to starting a new business, see Ch. 1A, *Role of Counsel in Starting a New Business* , Ch. 1C, *Regulation of Employers* , Ch. 1D, *Overview of Employee Benefits* , Ch. 1E, *Taxation of Businesses* , and Ch. 1F, *Insurance Considerations in Business Formation* .

For additional discussion of business entities, see California Small Business Guide (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART I. RESEARCH GUIDE
A. Primary Sources

1-1B California Legal Forms--Transaction Guide § 1B.01

§ 1B.01 California Sources

[1] Statutes

[a] Close Corporation

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Written agreements between shareholders. *Corp. Code § 706*.

Mergers. *Corp. Code § 1111*.

Reorganizations. *Corp. Code § 1201*.

Dissolutions. *Corp. Code §§ 1800, 1904*.

[b] Corporations--In General

General provisions and definitions. *Corp. Code §§ 100-195*.

Corporate formation and bylaws. *Corp. Code §§ 200-213*.

Directors and management. *Corp. Code §§ 300-317*.

Shares. *Corp. Code §§ 400-423*.

Dividends. *Corp. Code §§ 500-510*.

Shareholders' meetings and consents. *Corp. Code §§ 600-605*.

Sales of assets. *Corp. Code §§ 1000-1002*.

Reorganizations. *Corp. Code §§ 1200, 1201*.

Records and reports. *Corp. Code §§ 1500, 1508*.

Dissolutions. *Corp. Code §§ 1800-1907*.

[c] Professional Corporation

Moscone-Knox Professional Corporation Act. *Corp. Code § 13400 et seq.*
Professional services defined. *Corp. Code § 13401(a)*.
Professional corporations defined. *Corp. Code § 13401(b)*.
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[d] General Partnership

Uniform Partnership Act of 1994 (UPA '94). *Corp. Code § 16100 et seq.*
Application of Act. *Corp. Code §§ 16111(a), (b),* 15722 (repealed January 1, 2010).
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Relations of partners to one another. *Corp. Code § 16401 et seq.*
Dissociation. *Corp. Code § 16601 et seq.*
Dissolution and winding up. *Corp. Code § 16801 et seq.*
Merger. *Corp. Code § 16901 et seq.*
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[e] Limited Partnership

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Formation: certificate of limited partnership. *Corp. Code § 15621*.
Admission of limited partners. *Corp. Code § 15631*.
Liability of limited partners. *Corp. Code §§ 15632(a), 15633*.
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General partners. *Corp. Code §§ 15641-15644*.

Distributions and withdrawals. *Corp. Code § 15661*.
Mergers; dissenting limited partners' rights. *Corp. Code §§ 15678.1-15679.14*.
Dissolutions. *Corp. Code § 15681*.

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Definitions. *Corp. Code § 15901.02*.
Formation. *Corp. Code § 15902.01 et seq.*
Limited partners. *Corp. Code § 15903.01 et seq.*
General partners. *Corp. Code § 15904.01 et seq.*
Contributions and distributions. *Corp. Code § 15905.01 et seq.*
Dissolution. *Corp. Code § 15908.01 et seq.*
Conversion and merger. *Corp. Code § 15911.01 et seq.*

[f] Limited Liability Partnership

Limited liability partnerships under Uniform Partnership Act of 1994. *Corp. Code § 16951 et seq.*
Name requirements. *Corp. Code § 16952*.
Registration. *Corp. Code § 16953*.
Amended registration. *Corp. Code § 16954*.
Application of Act; elections. *Corp. Code § 16955.5(a), (b)*.
Security requirements. *Corp. Code § 16956*.
Improper distributions. *Corp. Code § 16957*.
Foreign LLPs. *Corp. Code § 16958 et seq.*
Inapplicability of fictitious name filing requirements. *Corp. Code § 16961*.
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[g] Limited Liability Company

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Dissolution. *Corp. Code §§ 17350-17357*.
Mergers; dissenting limited partners' rights. *Corp. Code §§ 17550-17613*.
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Limited offering exemption. *Corp. Code § 25102(f)*.

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Corporation Income Tax. *Rev. & Tax. Code §§ 23501-23561*.

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART I. RESEARCH GUIDE
A. Primary Sources

1-1B California Legal Forms--Transaction Guide § 1B.02

§ 1B.02 Federal Sources

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Investment contract as security. *15 U.S.C. § 78c(a)(10)*.

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Gross income. *I.R.C. § 61*.

Fringe benefits. *I.R.C. § 132*.

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Definition of "substantial economic effect." *Treas. Reg. § 1.704-1(b)(2)(i)*.

Capitalization of syndication costs. *Treas. Reg. § 1.709-1*.

Regulations governing classification of entities for federal income tax purposes (effective January 1, 1997) *Treas. Reg. §§ 301.7701-1- 301.7701-3*.

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Limited offering exemption, up to $1 million. *17 C.F.R. § 230.504*.

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[4] Revenue Procedures

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART I. RESEARCH GUIDE
A. Primary Sources

1-1B California Legal Forms--Transaction Guide §§ 1B.03-1B.04

[Reserved]

§§ 1B.03[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1B California Legal Forms--Transaction Guide § 1B.05

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1B California Legal Forms--Transaction Guide § 1B.06

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Ch. 12A, *Professional Corporations*.

Ch. 12C, *Limited Liability Companies*.

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1B California Legal Forms--Transaction Guide §§ 1B.07-1B.09

[Reserved]

§§ 1B.07[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
A. Business Forms Available Under California Law
1. Noncorporate Forms

1-1B California Legal Forms--Transaction Guide § 1B.10

§ 1B.10 Sole Proprietorship

[1] Definition

A sole proprietorship is a form of business in which an individual carries on a for-profit business as the sole owner and decision-maker. The sole proprietorship is the simplest and least expensive form of business organization to form and to conduct from both a nontax and tax point of view. A sole proprietorship form appeals to individuals starting a business that is intended to remain small, does not involve great exposure to personal liability, and does not warrant the expense of incorporation nor the ongoing expense of corporate formalities. Professionals such as doctors, lawyers, and architects sometimes elect to function as sole proprietors during the early years of practice to avoid the expenses and formalities of incorporation.

Generally, a husband and wife can conduct business jointly and hold joint title to business assets in both names and still come within the definition of a sole proprietorship [*see Corp. Code § 16202(c)(1)*].

[2] Salient Characteristics

[a] Extent of Personal Liability

In a sole proprietorship, the owner is personally liable for the obligations and liabilities of the business, even in excess of the amount invested. Thus, not only are business assets vulnerable, assets personally owned by the sole proprietor are also subject to the risks of the business. Even with insurance, the possibility remains that liability may exceed available insurance coverage [*see* Ch. 1F, *Insurance Considerations in Business Formation*]. The extent of personal financial risk to the sole proprietor is usually a consideration if the sole proprietor owns assets in excess of those dedicated to the business or if the business uses hazardous materials, produces hazardous products, or is otherwise likely to lead to accidental injury to an employee or customer.

[b] Availability of Capital

The capital used in a sole proprietorship is limited to the personal funds of the owner and to the owner's ability to borrow. Here again, the sole proprietor is personally liable for repaying borrowed funds, even if money generated by the business itself is inadequate to do so.

[c] Continuity of Existence

For a sole proprietorship, continued existence depends on the legal competence and continued life of the owner. A sole proprietorship ceases to exist on either incapacity or death of the owner.

[d] Taxation

For tax purposes, the salient feature of a sole proprietorship is the taxability of business income and the deductibility of business losses on the proprietor's individual return [*I.R.C. §§ 61(a), 62(a)(1)*; *Rev. & Tax. Code §§ 17071, 17072*; *I.R.C. § 465(a), (b)* (at-risk limitation on deductibility of loss)].

For a more detailed discussion of the tax attributes of a sole proprietorship, see the portions of *§§ 1B.60- 1B.68* relating to sole proprietorships. For an enumeration of the advantages and disadvantages of conducting business as a sole proprietorship, see § 1B.102.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawSole Proprietorships



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
A. Business Forms Available Under California Law
1. Noncorporate Forms

1-1B California Legal Forms--Transaction Guide § 1B.11

§ 1B.11 General Partnership

[1] Definition

General partnerships formed under California law are governed by the Uniform Partnership Act of 1994 (UPA '94), which took effect on January 1, 1997 [*Corp. Code § 16100 et seq.*; *see Corp. Code § 16111*].

A general partnership is an association of two or more persons to carry on a business for profit as co-owners [*Corp. Code § 16101(9)*]. The term "person" includes individuals, partnerships, corporations, limited liability partnerships, limited liability companies, and other associations [*Corp. Code § 16101(13)*]. General partnerships may engage in every trade, occupation, or profession [*see Corp. Code § 16101(1), (9)*]. However, to engage in the banking business, a general partnership must be duly organized for that purpose [*Fin. Code § 102*].

If a dispute arises as to whether a particular group is actually a partnership, the determining factor is usually the existence of a partnership agreement, whether oral or written. However, the intentions of the parties to conduct the business as co-owners, with mutual right of control and with the right of each owner to share in the profits of the business, may also be shown by the surrounding circumstances [*Greene v. Brooks (1965) 235 Cal. App. 2d 161, 165-166, 45 Cal. Rptr. 99*]. For example, sharing business profits is presumptive evidence that the receiver is a partner in the business, unless profits are received in payment of a debt or as wages, rent, an annuity, a loan, or consideration for the sale of goodwill or other business property [*Corp. Code § 16202(c)(2), (3)*], or unless one of the exceptions of joint ownership exists [*Corp. Code § 16202(c)(1)*].

Although not as simple a form of business organization as the sole proprietorship, a general partnership is easier to organize than a limited partnership or a corporation and can provide a relatively simple arrangement regarding management and control, capital contributions, and the sharing of profits and losses.

For a more detailed discussion of the tax and nontax attributes of general partnerships, see *§§ 1B.40-1B.48* and *1B.60-1B.68* as they relate to general partnerships. For an enumeration of the advantages and disadvantages of

conducting business as a general partnership, see *§ 1B.111*. The formation, operation, and dissolution of general partnerships are discussed in greater detail in Ch. 15, *General Partnerships* .

[2] Salient Characteristics

[a] Management and Control

Each general partner is an agent for the partnership for the purpose of conducting its business. All partners are bound by any partner who acts within the scope of partnership business, unless the partner actually lacks the authority to act and the other party has knowledge of this fact [*Corp. Code § 16301(1)*].

[b] Extent of Personal Liability

Partners in a general partnership like sole proprietors (and unlike limited partners in a limited partnership and corporate shareholders) are personally liable, jointly and severally, for partnership debts, obligations, and liabilities [*Corp. Code § 16306(a)*; *see Corp. Code § 16305*; *see also Great Western Bank v. Kong (2001) 90 Cal. App. 4th 28, 31-33, 108 Cal. Rptr. 2d 266* (although under *Corp. Code § 16306(a)* all partners were jointly and severally liable for bank loan on real property, after foreclosure and entry of deficiency judgment, assignment of judgment to partnership and 11 of 12 partners extinguished the debt; the 11 partners could not acquire bank's right to collect balance of judgment from 12th partner, their co-obligor)]. A general partner's liability is not limited to that partner's percentage interest in the partnership, but extends to his or her other assets as well [*Corp. Code §§ 16305(a), 16306*]. However, some limited liability might be achieved if a partner is an entity, other than a natural person, with its own limited liability.

A judgment against a partnership is not by itself a judgment against a partner. A judgment against a partnership may not be satisfied from a partner's assets unless there is also a judgment against the partner [*Corp. Code § 16307(c)*]. However, a timely IRS assessment against a partnership for a tax debt for which the general partners were secondarily liable has been held sufficient to extend the statute of limitations for collection of the tax from the general partners. It was not necessary for the IRS to separately assess the general partners during the limitations period in order to extend the statute of limitations for collecting the tax from the general partners in a judicial proceeding [*United States v. Galletti (2004) 541 U.S. 114, 124 S. Ct. 1548, 158 L. Ed. 2d 279, 284-285* ; *see I.R.C. § 6502*].

[c] Availability of Capital

A partnership's ability to borrow, like that of a sole proprietorship, usually depends on the individual partners' creditworthiness and on the availability of business assets to serve as collateral. Partnership capital interests are generally not considered securities subject to regulation by federal and state securities law [*see 15 U.S.C. §§ 77a-77aa* (federal Securities Act of 1933); *Corp. Code §§ 25000-25706* (California Corporate Securities Law of 1968)].

[d] Continuity of Existence

Continuity of existence is more tenuous in a general partnership than in a corporation. Although the Uniform Partnership Act of 1994 [*Corp. Code § 16100 et seq.*] generally made it easier for general partnerships to continue after the "dissociation" [*see Corp. Code § 16601* (defining "dissociation")] (by death or otherwise) of a general partner, there are still circumstances under which a general partnership will dissolve unless the remaining partners take affirmative steps to continue it. In the case of a partnership at will, the partnership is disolved by the express will of at least half of the partners (other than wrongfully dissociating partners) to dissolve and wind up the partnership business [*Corp. Code § 16801(1)*]. In the case of a partnership for a definite term or particular undertaking, a partnership is dissolved when any of the following occur [*Corp. Code § 16801(2)*]:

- Ninety days after a partner's dissociation by death or otherwise, unless before that time a majority in interest of the partners (including partners who have rightfully dissociated) agree to continue the

partnership.

- The express will of the partners to wind up the partnership business.

- The expiration of the term or the completion of the undertaking.

- An event agreed to in the partnership agreement resulting in the winding up of the partnership business.

- An event that makes it unlawful for all or substantially all of the partnership business to be continued.

- A judicial determination that either (1) the economic purpose of the partnership is likely to be frustrated; (2) another partner has engaged in conduct relating to the partnership business that makes it not reasonably practicable to carry on the business in partnership with that partner; or (3) it is not otherwise reasonably practicable to carry on the partnership business in conformity with the partnership agreement.

- On application by a transferee of a partnership interest, a judicial determination that it is equitable to wind up the partnership business after the expiration of the term or completion of the undertaking, if the partnership was for a definite term of particular undertaking at the time of the transfer or entry of the charging order that gave rise to the transfer.

[e] Taxation

A general partnership is a separate tax-reporting entity for income tax purposes and must file an informational return that details income and deductions [*I.R.C. § 6031(a)*]. A general partnership is not a separate taxable entity [*I.R.C. § 701*]. Further, general partnerships (unlike limited partnerships, limited liability companies, and limited liability partnerships) need not pay a tax for the privilege of doing business in California [*Rev. & Tax. Code § 17851.5*; *see Rev. & Tax. Code § 23153*; *see also Rev. & Tax. Code §§ 17935, 17941, 17948*]. This tax is not deductible by any entity [*Rev. & Tax. Code § 17220(c)*].

Partnership income and losses flow through to the individual partners proportionately, as agreed, provided there is "substantial economic effect" to the agreement and subject to the amount of the adjusted basis of the partner's interest in the partnership [*I.R.C. § 704(a), (b)(2)*]. These items of income and loss are reflected on each partner's individual income tax return [*see I.R.C. §§ 701-761*].

State law that classifies an entity as a partnership is not controlling for income tax purposes [*Treas. Reg. § 301.7701-1(a)(1)*]. Classification of an entity as a partnership rather than a corporation for federal tax purposes formerly required a determination that the entity had fewer corporate than noncorporate characteristics, and required a potentially complicated analysis of whether or not the entity possessed one or more of four corporate characteristics on which the regulations based this determination. However, regulations effective January 1, 1997 [*Treas. Reg. §§ 301.7701-1-301.7701-3*] abolished this approach and instead permit most unincorporated entities to elect to be taxed as a corporation or as a partnership. Entities with only a single owner may elect to be classified as a single owner or to be disregarded as an entity separate from their owners *Treas. Reg. § 301.7701-3(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness &

Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionDeath & IncapacityBusiness & Corporate LawGeneral PartnershipsFormationElementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsPartnership Tax Returns (IRC sec. 6031)General Overview



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1-1B California Legal Forms--Transaction Guide § 1B.12

§ 1B.12 Limited Partnership

[1] Definition

A limited partnership is a partnership formed by two or more persons [*Corp. Code §§ 15611(z), 15901.02(y)*] that has one or more general partners and one or more limited partners (or their equivalents under another name) [*Corp. Code §§ 171.5, 15501*, 15611(n), (q), (r), 15901.02(m), (p), (q)]. A limited partnership is a hybrid form of business organization having some attributes of a general partnership and some attributes of a corporation; it provides a vehicle through which certain principals (limited partners) may avoid subjecting personal assets outside of their investment in the partnership to the claims of the partnership's creditors. A limited partner is a partner whose participation in management is limited by statute or agreement and, assuming that limitation is honored, whose liability is ordinarily limited to the assets contributed to the partnership and any obligations for subsequent contributions [*see Corp. Code §§ 15632, 15636*, 15666, 15903.02, 15903.03; *see also [2][b], below*]. A partnership agreement may specify classes of general and limited partners, and if so, the agreement must define the rights, powers, and duties of the classes relative to each other [*Corp. Code §§ 15631.5, 15645, 15903.07, 15904.09*].

The Uniform Limited Partnership Act of 2008 (ULPA '08), set forth in *Corp. Code §§ 15900-15912.07*, becomes operative on January 1, 2008 [*see Corp. Code § 15912.04*]. Existing provisions governing limited partnerships, *i.e.*, the Uniform Limited Partnership Act (ULPA) [*Corp. Code §§ 15501-15533*] and the California Revised Limited Partnership Act (CRLPA) [*Corp. Code §§ 15611-15723*], become inoperative and are repealed on January 1, 2010 [*see Corp. Code §§ 15534, 15724*]. Before that date, the new Act governs only [*see Corp. Code § 15912.06(a)*]:

- Limited partnerships formed on or after January 1, 2008; and
- Limited partnerships formed before January 1, 2008, which elect to be subject to the new Act.

On and after January 1, 2010, except as otherwise provided, the new Act will govern all limited partnerships [*see Corp. Code § 15912.06(b)*]. It will not affect any action commenced, proceeding brought, or right accrued before its operative

date [*see Corp. Code § 15912.07*; *see* Ch. 16, *Formation of Limited Partnerships*].

The formation and operation of a limited partnership, like a corporation or limited liability company, requires more formality than does the formation and operation of a general partnership. However, limited partnership formation requirements are minimal: a limited partnership must file a certificate of limited partnership with the Secretary of State and must have an oral or written partnership agreement [*Corp. Code §§ 15611(y), 15621(a),* 15901.02(z), 15902.01; *see* Ch. 16, *Formation of Limited Partnerships*]. These documents govern the business operations of the entity.

A limited partnership may be organized for any lawful purpose, and may engage in any lawful business activity (whether or not for profit) except the banking business, the business of issuing policies of insurance and assuming insurance risks, or the trust company business [*Corp. Code § 15901.04(b)*; *see Corp. Code § 15503*, *15616*]. Limited partnerships may merge into one limited partnership, or with or into other business entities, including corporations, general partnerships, limited liability companies, business trusts, or for-profit unincorporated associations [*Corp. Code §§ 15611(v)*, *15678.1*, 15901.02(u), 15911.02, *16901*, *23006*].

For a more detailed discussion of the tax and nontax attributes of a limited partnership, see *§§ 1B.40-1B.48* and *1B.60-1B.68* as they relate to limited partnerships. For an enumeration of the advantages and disadvantages of conducting business as an limited partnership, see *§ 1B.112*. The formation, operation, dissolution, and merger of limited partnerships are discussed in greater detail in Chs. 16-16B.

[2] Salient Characteristics

[a] Management and Control

A general partner in a limited partnership has exclusive management authority except as otherwise provided by law or the partnership agreement [*Corp. Code §§ 15643(a)*, 15904.06; *see Corp. Code § 15618*, 15901.10]. Limited partners may not participate in management without losing their limited liability [*Corp. Code § 15632*, 15903.03]. A general partner in a limited partnership has, by and large, the same rights and powers as a partner in a general partnership [*Corp. Code §§ 15509*, *15643(a)*, 15904.06]. However, a single general partner in a limited partnership may have more freedom of management and control than a partner in a general partnership simply because the other limited partners do not share in the decision-making process.

[b] Extent of Personal Liability

The liability of a general partner in a limited partnership is basically the same as that of a partner in a general partnership. The general partner in a limited partnership is personally liable for all partnership debts, obligations, and liabilities [*Corp. Code §§ 15509, 15643(b)*, 15904.04].

The liability of limited partners is ordinarily limited to their capital contributions, any commitments for future contributions, and, when partnership assets are insufficient to satisfy partnership liabilities, any distributions received from the partnership [*Corp. Code §§ 15632*, *15666*, 15903.13, 15905.09(b)]. However, this limited liability status may be lost if the proper formalities are not observed in the formation of the limited partnership. For example, limited liability is lost if the limited partner is named as a general partner in the certificate, or if the limited partner participates in the control of the business [*see Corp. Code §§ 15632*, *15903.03*].

[c] Availability of Capital

In addition to the sources of capital available to a general partnership, limited partners often personally guarantee loans or the limited partnership may sell limited partnership interests. These interests often appeal to investors because of the associated limited liability. However, the transfer of limited partnership interests is ordinarily restricted, sometimes making them somewhat less attractive as an investment than corporate shares. Limited partnership interests are

considered securities and are regulated by federal and state securities laws unless the securities qualify for an available exemption [*see 15 U.S.C. § 77c(a)*; *Corp. Code § 25102(f), (h)*].

[d] Continuity of Existence

Under the CRLPA, a limited partnership is dissolved and its affairs must be would up on the earliest of the following [*Corp. Code §§ 15642, 15681*]:

- The occurrence of an event specified in the agreement.
- The written consent of the general partners and a majority in interest of the limited partners.
- Unless otherwise provided in the partnership agreement, when a general partner ceases to be a general partner, unless (1) there is at least one other general partner and the remaining general partner (or all remaining general partners if more than one remains) continues the business of the limited partnership or (2) if no general partners remain, a majority in interest of the limited partners (or greater interest required by agreement) agree in writing to continue the business of the partnership and, within six months after the last remaining general partner has ceased to be a general partner, to admit one or more general partners.
- The entry of a decree of judicial dissolution.

Ordinarily, the death, incompetence [*Corp. Code § 15675*], or withdrawal of a limited partner [*Corp. Code § 15663*], or the sale or assignment [*Corp. Code § 15672*] of a limited partner interest does not dissolve the entity.

Under ULPA '08, a limited partnership has a perpetual duration [*Corp. Code § 15901.04(c)*; *see Corp. Code § 15912.06(c)* (exception for limited partnerships formed before January 1, 2008)].

A partnership is dissolved, and its activities must be wound up, only upon the occurrence of any of the following [*Corp. Code § 15908.01*]:

- The happening of an event specified in the partnership agreement.
- The consent of all general partners and of limited partners owning a majority of the rights to receive distributions as limited partners at the time the consent is to be effective.
- After the dissociation of a person as a general partner:
  - If the partnership has at least one remaining general partner, and a consent to dissolve the partnership is given within 90 days after the dissociation by partners owning a majority of the rights to receive distributions as partners at the time the consent is to be effective; or
  - If the partnership does not have a remaining general partner, the passage of 90 days after the dissociation, unless before the end of 90 days consent to continue the activities of the partnership and admit at least one general partner is given by limited partners owning a majority of the rights to receive distributions as limited partners at the time the consent is to be effective; and at least one person is admitted as a general partner in accordance with the consent.

- The passage of 90 days after the dissociation of the partnership's last limited partner, unless before the end of the period the limited partnership admits at least one limited partner.

Furthermore, on application by a partner, a court of competent jurisdiction may order dissolution of a partnership if it is not reasonably practicable to carry on its activities in conformity with the partnership agreement [*Corp. Code § 15908.02*].

For further discussion, see Ch. 16A, *Dissolution of Limited Partnerships* .

[e] Taxation

Like a general partnership, a limited partnership is a separate tax-reporting entity for federal and state income tax purposes and must file an informational return [*I.R.C. § 6031(a)*]. Neither a limited partnership nor a general partnership is a separate taxable entity [*I.R.C. § 701*], with one exception. At the time either entity files its state information return, a limited partnership must pay a tax for the privilege of doing business in California [*Rev. & Tax. Code §§ 17851.5, 17935*; *see Rev. & Tax. Code § 23153*]. This tax is not deductible by the entity [*Rev. & Tax. Code § 17220(c)*].

Partnership income flows through to the individual partners in proportion to each partner's interest [*I.R.C. § 702(a)*]. A partner who actively participates in partnership business may use partnership losses to offset income from other sources, up to the amount of the partner's capital investment, plus the partner's allocable share of recourse debt [*I.R.C. § 465(a)(1), (3)*]. However, for a limited partner, the deductibility of losses is restricted by the "passive activity" rules that generally limit the deductibility of such losses in a tax year to the amount of passive activity income for the year [*I.R.C. § 469(e)*]. Disallowed losses are carried forward to the next taxable year until the amount of passive income equals the available passive losses or until the disposition of the investment [*I.R.C. § 469(b), (g)*]. This restriction often limits the incentive to invest as a limited partner, since, ordinarily, the taxable income a client is seeking to reduce is income earned by the client's active participation as a wage earner or a business owner, which the passive loss of a limited partnership investment cannot be used to offset [*I.R.C. § 469(a)(1), (2)*].

As with general partnerships, state law that classifies an entity as a limited partnership is not controlling for income tax purposes [*Treas. Reg. § 301.7701-1(a)(1)*]. Classification of an entity as a partnership rather than a corporation for federal tax purposes formerly required a determination that the entity had fewer corporate than noncorporate characteristics, and required a potentially complicated analysis of whether or not the entity possessed one or more of four corporate characteristics on which the regulations based this determination. However, regulations effective January 1, 1997 [*Treas. Reg. §§ 301.7701-1- 301.7701-3*] abolished this approach and instead permit most unincorporated entities to elect to be taxed as a corporation or a partnership. Entities with only a single owner may elect to be classified as a single owner or to be disregarded as an entity separate from their owners [*Treas. Reg. § 301.7701-3(a)*].

California generally conforms to the federal entity classification rules under *Treas. Reg. § 301.7701-2* [*see Rev. & Tax. Code § 23038*; *see also* FTB *Notice 92-5*]. The classification of a business entity as an association taxable as a corporation is determined under FTB regulations, which must be consistent with the federal regulations in effect on January 1, 1997, that classify a business entity as a partnership or an association taxable as a corporation, or disregard the separate existence of the business entity [*Rev. & Tax. Code § 23038(b)(2)(B)(i)*]. The classification of an eligible business entity as a partnership or an association taxable as a corporation is the same as the classification of the entity for federal tax purposes; if the separate existence of the LLC is disregarded for federal tax purposes (for example, because the LLC has a single owner), the separate existence will be disregarded for California purposes [*Rev. & Tax. Code § 23038(b)(2)(B)(ii), (iii)*]. For more detailed discussion, see § 15A.70 in the Legal Background to Ch. 15A, *Formation of Limited Partnerships* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsDissolution & Winding UpBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsPartnership Tax Returns (IRC sec. 6031)General Overview



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1-1B California Legal Forms--Transaction Guide § 1B.13

§ 1B.13 Limited Liability Company

[1] Definition

A limited liability company (LLC) is a business entity that is essentially a hybrid of a corporation and partnership. An LLC is an entity having one or more members that is organized under the Beverly-Killea Limited Liability Company Act (Act) [*Corp. Code § 17000 et seq.*; *see Corp. Code §§ 17001(t), 17050(b)*]. The LLC form offers great flexibility: the Act is designed to assist the formation and operation of small, closely-held or operated business arrangements, but permits LLC structures that are attractive to larger, more complex business ventures. Areas in which the LLC structure are likely to be particularly useful include real estate, joint ventures (especially joint ventures with foreign partners and between corporations), high technology and venture capital, petroleum production, and theatrical investments.

A California LLC can have the income tax transparency of a partnership on both the state and federal level, avoiding the double taxation inherent in the use of a general corporation, without the restrictions imposed on S corporations, close corporations, and limited partnerships [*see [e], below*]. The use of a properly structured LLC can also limit the liability of its members, managers, and officers to their investments and commitments to invest in the LLC; this limited liability is similar to that enjoyed by corporate shareholders and limited partners, without the restrictions against management and control applicable to limited partners [*see [b], below*].

The formation and operation of an LLC is relatively simple. However, like a corporation or limited partnership, more formality in formation and operation is required than in either a general partnership or sole proprietorship. An LLC is formed by filing articles of organization with the Secretary of State, and must have an oral or written operating agreement [*Corp. Code § 17050*].

LLCs are prohibited from engaging in the banking business, the business of issuing policies of insurance and assuming insurance risks, or the trust company business [*Corp. Code § 17002(a)*; *but see Corp. Code § 17002(b)* (subsidiary LLC may operate as licensed health care service plan)]. In addition, LLCs may not perform professional services; professional services are those services that may only be lawfully rendered under a license, certificate, or registration

authorized by the Business and Professions Code, the Osteopathic Act, the Yacht and Ship Brokers Act, or the Chiropractic Action [Stats. 1994, ch. 1200, § 93; *Corp. Code §§ 13401(a), 13401.3*; *see § 1B.31[2][b]*].

For a more detailed discussion of the tax and nontax attributes of LLCs, see *§§ 1B.40-1B.48* and *1B.60-1B.68* as they relate to LLCs. For an enumeration of the advantages and disadvantages of conducting business as an LLC, see *§ 1B.113*. The formation, operation, dissolution, and merger of LLCs are discussed in greater detail in Ch. 12C, *Limited Liability Companies* .

[2] Salient Characteristics

[a] Management and Control

The management and control of an LLC is extremely flexible. An LLC may be managed by all of its members, or by one or more managers [*Corp. Code §§ 17150, 17151*]. The managers may be some or all of the members, but need not be members or natural persons [*Corp. Code § 17151(a), (c)*]. All that the statute requires is that if the LLC is to be managed by one or more managers, the articles of organization must contain a statement to that effect. Neither the names of the managers nor the number of managers need be specified in the articles, but if management is vested in only one manager, the articles must so state [*Corp. Code § 17151(b)*]. Even if the articles do not vest management in a manager or managers, the articles or operating agreement may restrict or enlarge the management rights and duties of any member or class of members [*Corp. Code § 17150*]. The articles of organization or the operating agreement may restrict or enlarge the management rights and duties of any members or classes of members [*Corp. Code § 17150*].

[b] Extent of Personal Liability

[i] Members

A member of an LLC ordinarily is not personally liable for any debt, obligation, or liability of the LLC arising in contract, tort, or otherwise solely by virtue of that membership [*Corp. Code § 17101(a)*]. However, an LLC member is subject to liability under the common law governing alter ego liability [*Corp. Code § 17101(b)*]. Further, a member may agree to be obligated personally for any or all of the LLC's debts, obligations, and liabilities, as long as the agreement to be obligated is set forth in the articles of organization or in a written operating agreement that specifically refers to the code section (*Corp. Code § 17101(e)*) authorizing liability [*Corp. Code § 17101(e)*]. Furthermore, a member is personally liable under a court judgment or for an obligation of the LLC under the same or similar circumstances, and to the same extent, as a corporate shareholder may be personally liable for a corporate obligation, except that the failure to hold meetings or to observe formalities pertaining to those meetings does not tend to establish personal liability for members if the articles of organization or operating agreement do not require meetings [*Corp. Code § 17101(b)*].

Members are personally liable for tortious conduct, and are also personally liable pursuant to the terms of any written guarantee or other contractual obligation (other than an operating agreement) entered into by the member [*Corp. Code § 17101(c)*]. In addition, personal liability may attach to a member who is responsible for filing returns or paying tax for any unpaid taxes (and any interest or penalties) if the member willfully fails to pay or cause to be paid any taxes due [*Rev. & Tax. Code § 6829(a), (b)*; *see Rev. & Tax. Code § 6829(d)* ("willful failure" defined)]. However, personal liability may be imposed only if the Franchise Tax Board can establish that (1) the LLC had included tax reimbursement in the selling price of, or added tax reimbursement to the selling price of, tangible personal property sold in the conduct of its business, or (2) the LLC consumed personal property and failed to pay the tax to the seller or has included use tax on the billing and collected the use tax or has issued a receipt for the use tax and failed to report and pay use tax [*Rev. & Tax. Code § 6829(c)*]. The Board of Equalization (BOE) may issue a deficiency determination against members responsible for nonpayment of an LLC's sales and use tax [*see Rev. & Tax. Code § 6829(e)*; *see also Rev. & Tax. Code §§ 6451 et seq., 6701 et seq.*]. The determination must be issued within the earlier of [*Rev. & Tax. Code § 6829(f)*]:

- Three years after the last day of the calendar month following the quarter period in which the BOE

obtains actual knowledge, through its audit activities, compliance activities, or written communication by the business, of the termination, dissolution, or abandonment of the entity; or

- Eight years after the last day of the calendar month following the quarterly period in which the entity was terminated, dissolved, or abandoned.

If the LLC files a notice of termination, dissolution, or abandonment of the entity with a state or local agency other than the BOE, that filing will not constitute actual knowledge of the BOE for purposes of timely issuance of a deficiency determination [*Rev. & Tax. Code § 6829(f)*].

Members are personally liable to the extent of any improper distribution received by a member (provided that the member had actual knowledge of facts indicating the impropriety of the distribution) [*Corp. Code § 17254(e)*]. Further, any member or manager voting for a distribution that violates the operating agreement or statute is personally liable for the amount of the distribution that exceeds the amount that could have properly been paid [*Corp. Code § 17255(a)*].

[ii] Managers and Officers

In general, managers and officers of an LLC are not personally liable for any debt, obligation, or liability of the LLC solely by virtue of that status [*Corp. Code § 17158 (a)*]. However, a manager may agree to be obligated personally for any or all of the LLC's debts, obligations, and liabilities if the agreement to be liable is set forth in the articles or a written operating agreement that specifically refers to the code section (*Corp. Code § 17158(b)*) authorizing liability [*Corp. Code § 17158(b)(1)*]. Furthermore, a manager may agree to be obligated pursuant to the terms of a written guarantee or other contractual obligation (other than an operating agreement) entered into by the manager [*Corp. Code § 17158(b)(2)*]. In addition, managers owe the same fiduciary duties to the LLC and its member as partners owe to a partnership and the other partners of that partnership, and may be held personally liable for any breach of that duty [*Corp. Code §§ 17153, 17155(a)*; *see Corp. Code § 17005(d)* (modification of fiduciary duty in written operating agreement)]. Managers are similarly liable for unpaid sales taxes [*Rev. & Tax. Code § 6829*; *see State Board of Equalization v. Wirick (2001) 93 Cal. App. 4th 411, 413, 419, 112 Cal. Rptr. 2d 919* (*Rev. & Tax. Code § 6829* applied to former chief financial officer of corporation, despite fact that he had resigned position over one year before corporation ceased business; because present tense in statute includes past tense, section covers former officers as well as those in charge when corporation ceases); *see also [i], above*], and for voting for an improper distribution [*Corp. Code § 17255*; *see Corp. Code §§ 17254, 17353*]. Although the liability of managers for tortious conduct is not mentioned in the Act, as is the liability of members [*Corp. Code § 17101(c)*], presumably managers would also be personally liable for tortious conduct. LLC managers may also be subject to fine or imprisonment for failure to warn employees of, or to abate, serious concealed workplace dangers [*Penal Code § 387*].

[c] Availability of Capital

The capital requirements of an LLC ordinarily are satisfied through equity contributions from its members. In addition, loans secured by LLC property or the personal guarantees of members are often used. Because liability can essentially be limited to the amount of the investment [*see [b], above*] and the availability of different classes of members to provide flexibility among investors [*see [a], above*], LLCs can be attractive to capital investors.

[d] Continuity of Existence

In general, an LLC does not have perpetual existence [*see Corp. Code §§ 17051(a)(2), 17350*]. For example, an LLC may be dissolved by the vote of a majority in interest of the members, or a greater percentage as specified in the articles of organization or written operating agreement [*Corp. Code § 17350(b)*]. Further, the articles may specify a time certain for, or events that cause, dissolution, in which case the LLC is dissolved as of the specified time or on the occurrence of the designated events [*Corp. Code §§ 17051(c)(3), (4), 17350(a)*]; these provisions are somewhat illusory because the

organizational documents may be amended. Finally, an LLC is dissolved on the entry of a decree of dissolution [*Corp. Code § 17350(c)*; *see Corp. Code § 17351*]. However, the importance of continuity of existence, or more accurately the lack thereof, has diminished since the liberalization of the federal entity classification rules. Effective January 1, 1997, partnership tax status is a matter of election rather than of counting corporate characteristics [*see Treas. Reg. §§ 301.7701-1- 301.7701-3*; *see also [e], below*].

[e] Taxation

Prior to 1997, the tax classification of an LLC--that is, whether the LLC was taxed as a corporation or as a partnership--was determined by weighing the number of corporate versus noncorporate characteristics possessed by the LLC [*see, e.g., Rev. Proc. 95-10* , § 4, *1995-1 C.B. 501* (now obsolete)]. These characteristics were (1) continuity of life; (2) centralized management; (3) limited liability for the obligations of the business; and (4) free transferability of interests. If partnership tax treatment was desired, it was important to structure the LLC so that at least some of these corporate characteristics were avoided.

This, however, is no longer the case. Under liberalized classification rules that took effect on January 1, 1997, an LLC with two or more members may elect to be taxed either as a corporation or as a partnership. An LLC with a single owner (i.e., a qualifying trust) may elect either to be taxed as a corporation or to be disregarded as an entity separate from its owner [*Treas. Reg. § 301.7701-3(a)*]. If an LLC does not make an election, it will be taxed as a partnership if it has two or more members, or will be disregarded as an entity separate from its owner if it has only one member [*Treas. Reg. § 301.7701-3(b)(1)*]. Note that existing LLCs that do not make an election will retain the classification that they would have claimed under the pre-1997 regulations [*Treas. Reg. § 301.7701-3(b)(3)*].

California generally conforms to the federal entity classification rules under *Treas. Reg. § 301.7701-2* [*see Rev. & Tax. Code § 23038*; *see also* FTB *Notice 92-5*]. The classification of a business entity as an association taxable as a corporation is determined under FTB regulations, which must be consistent with the federal regulations in effect on January 1, 1997, that classify a business entity as a partnership or an association taxable as a corporation, or disregard the separate existence of the business entity [*Rev. & Tax. Code § 23038(b)(2)(B)(i)*]. The classification of an eligible business entity as a partnership or an association taxable as a corporation is the same as the classification of the entity for federal tax purposes; if the separate existence of the LLC is disregarded for federal tax purposes (for example, because the LLC has a single owner), the separate existence will be disregarded for California purposes [*Rev. & Tax. Code § 23038(b)(2)(B)(ii), (iii)*]. However, if an eligible business entity was properly classified as an association taxable as a corporation for any income year beginning with the 60-month period preceding January 1, 1997, the entity continues to be an association taxable as a corporation until it elects to be classified the same as the entity is classified for federal purposes; this rule does not apply to any entity that was not doing business in California, did not derive income from California, and had no California resident owner during the 60-month period preceding January 1, 1997 [*Rev. & Tax. Code § 23038(b)(2)(C)*].

LLCs still are subject to the annual minimum franchise tax [*Rev. & Tax. Code §§ 17941, 23153, 23038(b)(2)(B)(iii)*] and must pay a graduated entity level fee based on total income from all sources reportable to California [*Rev. & Tax. Code §§ 17942* (fee applicable to income of $250,000 or more), *23038(b)(2)(B)(iii)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
A. Business Forms Available Under California Law
1. Noncorporate Forms

1-1B California Legal Forms--Transaction Guide § 1B.14

§ 1B.14 Joint Venture

[1] Definition Under State Law

A joint venture is similar to a partnership and there is little practical distinction between the two entities [*see Zeibak v. Nasser (1938) 12 Cal. 2d 1, 12, 82 P.2d 375]* .

A joint venture is like a partnership in that its members associate as co-owners of a business enterprise, agreeing to share profits and losses. However, a joint venture is usually formed for a transaction or a series of transactions, thus being more limited in both scope and duration, while a partnership ordinarily engages in a continuing business for an indefinite or fixed period of time [*Rickless v. Temple (1970) 4 Cal. App. 3d 869, 893, 84 Cal. Rptr. 828]* . This distinction is not ironclad as a partnership may be formed for a single business transaction and for a defined period of time [*see Kaufman-Brown Potato Co. v. Long (9th Cir. 1950) 182 F.2d 594, 599]* .

A joint venture, like a partnership, is formed under California law by an agreement between the parties, which may be oral or written, and may be implied from the acts as well as the statements of the participants [*Rickless v. Temple (1970) 4 Cal. App. 3d 869, 894, 84 Cal. Rptr. 828* ; *Nelson v. Abraham (1947) 29 Cal. 2d 745, 749, 177 P.2d 931* ; *see De Anza Enterprises v. Johnson (2002) 104 Cal. App. 4th 1307, 1314-1315, 128 Cal. Rptr. 2d 749* (litigation between joint venturers over buyout procedure set forth in written joint venture agreement)]. Whether a joint venture exists depends on the intention of the parties [*Rennick v. O.P.T.I.O.N. Care, Inc. (9th Cir. 1996) 77 F.3d 309, 317* ; *April Enterprises, Inc. v. KTTV and Metromedia, Inc. (1983) 147 Cal. App. 3d 805, 819, 195 Cal. Rptr. 421* ; *Universal Sales Corp. v. California Press Mfg. Co. (1942) 20 Cal. 2d 751, 704-765, 128 P. 2d 665]* .

There are three basic elements of a joint venture [*Orosco v. Sun-Diamond Corp. (1997) 51 Cal. App. 4th 1659, 1666, 60 Cal. Rptr. 2d 179* ; *580 Folsom Associates v. Prometheus Development Co. (1990) 223 Cal. App. 3d 1, 15-16, 272 Cal. Rptr. 227]* :

- The members must have joint control over the venture (even though they may delegate it);

- They must share the profits of the undertaking; and
- The members must each have an ownership interest in the enterprise.

Some courts have not upheld the authority of one joint venturer to bind the venture, and to impose liability on the other joint venturers, when the venture's undertaking is limited in scope and it would be inequitable to do so [*see Hayward's v. Nelson (1956) 143 Cal. App. 2d 807, 299 P.2d 1013]* . Other courts, however, have made no such distinction and have applied the mutual agency theory of a partnership to bind joint venturers [*see Smalley v. Baker (1968) 262 Cal. App. 2d 824, 69 Cal. Rptr. 521]* .

Thus, for practical purposes, there is no significant distinction between a joint venture and a partnership, except, perhaps, for that given it by tradition.

[2] Definition for Tax Purposes

A joint venture is defined for tax purposes as a joint transaction of two or more persons for the purpose of making a profit, without any "actual corporate or partnership designation" [*Tompkins v. Commissioner of Internal Revenue (1938) 97 F.2d 396, 398]* . The difference between a joint venture and a partnership is that the former relates to a single transaction, while the latter involves a general and continuing business of a particular kind [*Bartholomew v. Commissioner of Internal Revenue (1951) 186 F.2d 315, 317]* . However, because a joint venture is taxed as a partnership by both the federal and the state taxing authorities, there is no significant distinction between the two entities for tax purposes [*I.R.C. §§ 761(a), 7701(a)(2)*; *Treas. Reg. § 301.7701-3(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawJoint VenturesGeneral OverviewBusiness & Corporate LawJoint VenturesFormationBusiness & Corporate LawJoint VenturesManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
A. Business Forms Available Under California Law
1. Noncorporate Forms

1-1B California Legal Forms--Transaction Guide § 1B.15

§ 1B.15 Other Noncorporate Forms

[1] Business Trust

The Massachusetts or business trust is an unincorporated business entity in which the assets are held and managed by trustees for the benefit of holders of certificates of beneficial interest in the trust [*see Goldwater v. Oltman (1930) 210 Cal. 408, 292 P. 624]* . Beneficiaries of the trust ordinarily are not personally liable for the liabilities of the trust unless they exercise direct control over the assets or the trustees [*Goldwater v. Oltman (1930) 210 Cal. 408, 292 P. 624* ; *Bernesen v. Fish (1933) 135 Cal. App. 588, 28 P.2d 67]* ; the liability of a trustee of a business trust for trust obligations is substantially similar to that of a general partner in a limited partnership [*see Goldwater v. Oltman (1930) 210 Cal. 408, 292 P. 624]* .

A real estate investment trust (REIT) is a specialized form of business trust that is formed to own real property; this type of entity must comply with strict state and federal tax and securities laws [*see Corp. Code §§ 23000-23006*; *I.R.C. §§ 856-859*; *Rev. & Tax. Code § 24872*].

PRACTICE TIP:
Although available, business trusts are rarely used in California. Because of the complexities and uncertainties involved in the taxation, liability, and security aspects inherent in this form, a business trust (or REIT) should only be formed after cautious and exhaustive analysis of the goals of the client.

[2] Unincorporated Associations

Groups may be characterized as unincorporated associations. Unincorporated associations formed under California law include mutual benefit societies, labor unions, nonprofit associations, joint stock companies, and real estate investment trusts, among others [*see Corp. Code §§ 18020(a), 18035*; *see also Corp. Code § 18000 et seq.*]. Unincorporated associations vary in size, complexity, and sophistication. They may or may not employ legal counsel, and may or may not have written governing documents.

Although former law provided governance rules for certain particular types of unincorporated associations, such as general and limited partnerships or limited liability companies, there were virtually no general rules for the governance of unincorporated associations prior to 2006. Because members and officers were often unsure how to handle issues not addressed in the association's governing documents, and because the lack of structural guidance left the association subject to burdensome common law procedures, the Legislature enacted governance statutes for unincorporated associations. Effective January 1, *2006, the Corporations Code* provides statutory authority in the following areas [*see Corp. Code § 18300 et seq.*]:

- Member voting [*see Corp. Code § 18330*; *see also § 13A.33[2][d]*.
- Membership termination and suspension [*see Corp. Code §§ 18310, 18320*; *see also § 13A.33[3][a]*].
- Amending governing documents [*see Corp. Code §§ 18310, 18320*; *see also § 13A.34*].
- Merger [*see Corp. Code §§ 18350-18400*; *see also § 13A.39[2]*].
- Dissolution [*see Corp. Code §§ 18410*, 18411; *see also § 13A.39[3]*].

Many of these statutes provide default provisions in the event that the association's governing documents are silent. For example *Corp. Code § 18310*, which addresses the termination and suspension of membership, only applies when the unincorporated association's governing documents are silent. Other statutes, however, provide mandatory rules, either to guarantee minimal fairness [*see Corp. Code § 18320* (expulsion of members)] or to standardize relations with other organizations [*see Corp. Code § 18360 et seq.* (merger)]. These statutes are discussed in detail in Ch. 13A, *Nonprofit Associations* .

Unincorporated associations are liable for the debts and obligations of the association as if the association were a natural person [*Corp. Code § 18250*], except when a statute provides otherwise, as is the case for share owners of a real estate investment trust, if certain requirements are met [*Corp. Code §§ 23000-23002, 23004*].

[3] Publicly Traded Partnership

A publicly traded partnership is a partnership whose interests are traded on an established securities market or are readily tradable on a secondary market [*I.R.C. § 7704(b)*] and that derives less than 90 percent of its gross income from qualifying passive income, including interest, dividends, real property rents, and gain from the disposition of certain investment activities or assets [*I.R.C. § 7704(c), (d)*]. Publicly traded partnerships are taxed as corporations [*I.R.C. § 7704(a)*].

[4] Small Business Investment Company

A specialized small business investment company is a partnership or corporation that is licensed by the Small Business Administration [*see I.R.C. § 1044(c)(3)*]. This entity is analyzed in the same manner as partnerships or corporations with an additional consideration: individuals and regular business corporations (C rather than S corporations) may roll over a portion of any gain from the sale of publicly traded securities into specialized small business investment companies without recognition of gain [*I.R.C. § 1044*]. However, the entity must have been licensed in 1993; therefore, only an investment in an existing entity would qualify.

[5] Limited Liability Partnerships

[a] Definition

A "registered limited liability partnership" (a "registered LLP") is an association of two or more persons to carry on as co-owners a business for profit, other than a limited partnership, formed pursuant to an agreement governed by Article 10 of the Uniform Partnership Act of 1994 [*Corp. Code § 16951 et seq.*] that is registered under *Corp. Code § 16953* and satisfies one of the following requirements [*Corp. Code § 16101(8)*]:

- Each of its partners is either a "licensed person" (that is, a person duly licensed, authorized, or registered under the Business and Professions Code to practice architecture, public accountancy, or law, or lawfully able to render these services in California [*Corp. Code § 16101(7), (14)*]), or a person who is licensed or authorized to engage in the practice of architecture, public accounting, or law in a jurisdiction(s) other than California.

- The partnership is licensed under the laws of California to engage in the practice of architecture, public accountancy, or the practice of law.

- The partnership (1) is "related" to a registered LLP that practices public accountancy or, to the extent permitted by the California State Bar, practices law or is related to a foreign LLP; and (2) provides services related or complementary to the public accountancy or legal services provided by (or provides services or facilities to) that registered LLP or foreign LLP.

An LLP is a hybrid form of general partnership that can provide its partners with limitations on their personal liability without changing most other attributes of a general partnership. Thus, an LLP can combine the income tax transparency of partnerships on both the federal and California levels [*see [b][iii], below*], the management flexibility of general partnerships [*see [b][i], below*] and, with some significant limitations, limited liability for general partners akin to that of shareholders of business corporations [*see [b][ii], below*]. To secure the benefits of limited liability, an LLP must, on registration and at all times during which it transacts intrastate business in California, provide security for claims against it based on acts, errors, or omissions arising out of its practice of architecture, public accountancy, or law [*see Corp. Code § 16956*].

For further discussion of LLPs, see Ch. 16C, *Limited Liability Partnerships* .

[b] Salient Characteristics

[i] Management and Control

Each partner of a registered LLP (or foreign LLP that has applied for registration) is an agent for the partnership for the purpose of conducting partnership business. All partners are bound by any partner acting within the scope of partnership business unless the partner actually lacks the authority to act and the other party has knowledge of that fact [*Corp. Code § 16301(1)*].

[ii] Extent of Personal Liability

The LLP format can protect the personal assets of partners of architecture, public accountancy, and law firms from liability for obligations arising from acts, errors, or omissions arising out of the practice of architecture, public accountancy, or law ("malpractice") [*Corp. Code § 16306(c)*]. However, this shield does not affect a partner's liability to third parties for his or her own tortious conduct or malpractice [*Corp. Code § 16306(e)*].

For LLP partners to obtain limited liability, the LLP must comply with statutory security requirements totaling at least $100,000 per licensed person rendering professional services on behalf of the LLP, subject to an annual minimum and maximum total coverage. The minimum for all LLPs is $500,000 for LLPs with fewer than five licensed persons. The maximum for a public accountancy LLP and an architecture LLP is $5 million, and the maximum for a legal services

LLP is $7.5 million. Beginning January 1, 2008, the minimum for an architecture LLP is $1 million, and the maximum remains at $5 million [Corp. Code § 16956(a)(1), (2), (3)].

[iii] Taxation

An LLP retains its general partnership nature for tax purposes. It is a separate tax-reporting entity for income tax purposes and must file an informational return that details income and deductions [*I.R.C. § 6031(a)*]. However, the partnership itself is not a taxable entity [*I.R.C. § 701*], other than the required payment of the annual minimum franchise tax [*Rev. & Tax. Code §§ 17948-17948.2*]. Items of partnership income and losses flow through the partnership to the individual partners proportionately or as agreed, provided that there is substantial economic effect to the agreement and subject to the adjusted basis of the partner's interest in the partnership [*I.R.C. § 704(a), (b)(2)*]. For further discussion, see *§ 1B.11[2][e]* and Ch. 16C, *Limited Liability Partnerships* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawUnincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
A. Business Forms Available Under California Law
1. Noncorporate Forms

1-1B California Legal Forms--Transaction Guide §§ 1B.16-1B.29

[Reserved]

§§ 1B.16[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
A. Business Forms Available Under California Law
2. Corporate Forms

1-1B California Legal Forms--Transaction Guide § 1B.30

§ 1B.30 Overview of Corporate Form

[1] Definition

The corporation is the dominant form of business ownership today. California general business corporations are governed by the General Corporation law [*Corp. Code § 100 et seq.*]. A corporation is a distinct legal entity, existing apart and recognized separately from its owners or shareholders, and has all the powers of a natural person, including the rights to own property, sue in its corporate name, and make contracts [*Corp. Code § 207*]. Under California law, a corporation may be formed to engage in any business activity, subject to compliance with applicable laws [*Corp. Code § 206*]. The rights and obligations of the corporation, its directors, and its shareholders are clearly delineated by law but may be altered, within statutory limits, by agreement [*Corp. Code §§ 300-318, 600-605, 700-711*].

The formation and operation of a corporation, like a limited partnership, requires more formality than does the formation and operation of a sole proprietorship or a general partnership. A corporation is chartered by the state and may be formed only by filing articles of incorporation with the Secretary of State [*see Corp. Code §§ 200-210*]. Owners of a corporation ordinarily are issued shares, signifying their ownership interests [*see Corp. Code § 400*]. However, shareholders do not participate in the daily management of the corporation; their participation is limited to electing the corporate board of directors and voting on a limited number of significant transactions [*Corp. Code § 700(a)*]. A corporation is controlled by a board of directors, who have the discretion to appoint officers to manage the day-to-day business [*Corp. Code § 300(a)*].

[2] Salient Characteristics

[a] In General

Despite wide variations within the corporate form, all corporations share certain basic characteristics, including the following: (1) management and control by a board of directors and officers appointed at the board's discretion; (2) limited personal liability; (3) greater availability of capital than generally exists for noncorporate business forms; (4) perpetual life; and (5) taxation as a separate entity, unless the corporation has elected to be taxed under Subchapter S of

the Internal Revenue Code [*see [b]-[f], below*].

[b] Management and Control

A corporation is under the control of its board of directors and is managed either by the board or, as is usually the case, by officers appointed by the board [*Corp. Code § 300(a)*]. In publicly held corporations, whose stock is sold to the public at large, shareholders do not participate in corporate management [*Corp. Code § 700(a)*]. However, the purpose of a close corporation is to allow the shareholders to do just that, to participate in the day-to-day management of the corporation, without losing the protection of the corporate form [*see Corp. Code § 300(e)*].

[c] Extent of Personal Liability

The most significant feature of a corporation (as of a limited partnership or limited liability company) is its protection from personal liability. If properly formed and operating, a corporate shareholder's liability is limited to the amount of the investment in the corporation.

Further, because a corporation is a separate legal entity, its directors, officers, and employees ordinarily do not have any personal liability for the corporation's debts or other obligations [*see Corp. Code § 300(d)*]. Neither are they generally liable for the torts or criminal acts of one another, although directors, officers and other employees may be liable to the shareholders for a breach of their defined duties to the corporation [*see Corp. Code § 300*].

This limited liability protection distinguishes the corporate form from the sole proprietorship and from the general partnership (other than a limited liability partnership [*see § 1B.15[5]*]), and is similar to the protection from personal liability enjoyed by limited partners in a limited partnership. However, unlike shareholders, limited partners risk exposure to personal liability by participating in the management and control of the business [*Corp. Code §§ 15632(a), 15903.03*].

[d] Availability of Capital

Corporations generally provide the most flexible vehicle for obtaining capital. As with sole proprietorships and partnerships, financing is available through unsecured loans and loans based on the credit or personal guarantees of the directors, officers or shareholders or secured by the business's assets. In addition, capital is available through the sale of equity interests in the corporation. Because of limited liability for the debts and other obligations of the corporation, as well as the wide variety of types of capital interests, corporate shares often appeal to investors. As a practical matter, however, sale of securities is often limited to those offered by publicly held corporations (that is, corporations whose stock is sold to the public at large); and small or newly established corporations may be able to obtain financing only with the personal guarantees of their owners.

Like limited partnership interests, corporate securities are regulated by federal and state securities laws [*see Corp. Code §§ 25000-25706*; *see also 15 U.S.C. §§ 77a-77aa*], unless the securities qualify for an exemption [*15 U.S.C. § 77c(a)*; *Corp. Code § 25102(f), (h)*]. For a comprehensive discussion of corporate securities, see Chs. 6 through 6J.For a detailed guide to securities regulation, see Ch. 6, *Securities Regulation Issues* .

[e] Continuity of Existence

A corporation has perpetual existence, unless its articles of incorporation state otherwise [*Corp. Code § 200(c)*]. A corporation does not terminate on the death or change of identity of its shareholders, although the death of the sole shareholder of a professional corporation may, in effect, result in the practical, if not the legal, termination of the corporation.

[f] Taxation

A regular or general corporation is a separate tax paying entity for federal and state tax purposes [*I.R.C. § 11*; *Rev. & Tax. Code §§ 23038, 23151*], unlike sole proprietorships [*I.R.C. §§ 61(a), 62(a)(1)*], general and limited partnerships [*I.R.C. § 701*], most limited liability companies [*see I.R.C. § 701*], and Subchapter S corporations [*I.R.C. § 1361(b)*]. A regular corporation is referred to as a "C" corporation in the Internal Revenue Code, to distinguish it from an "S" corporation, a corporation that has elected to be taxed under Subchapter S of the Internal Revenue Code [*I.R.C. § 1361(a)*; *see I.R.C. §§ 1361-1366*]. See *§ 1B.31[4]* for a discussion of taxation of S corporations. A corporation formed under state law is a corporation for income tax purposes [*see Treas. Reg. § 301.7701-2(b)*]. California taxation of corporations generally conforms to federal taxation [*Rev. & Tax. Code § 23051.5*]. For a detailed discussion of corporate taxation, see Ch. 1E, *Taxation of Businesses* .

A C corporation is subject to a corporate tax rate schedule, which applies graduated rates that differ from the individual income tax rate schedule [*I.R.C. § 11(b)*]. However, certain personal service corporations are not eligible to use the graduated rates and are, instead, taxed at a flat rate [*I.R.C. §§ 11(b)(2), 448(d)(2)*; *see § 1B.31[5]*].

Corporations are subject to double taxation. A corporation's profit is taxed once to the corporation, and again when the after-tax profit is distributed to the shareholders as dividend income [*see I.R.C. §§ 301, 316*], unless the shareholder is a corporate entity eligible for the dividends-received deduction [*see I.R.C. §§ 243(a)(1), (b), (c), 248*]. Double taxation of dividends is less of a concern during years in which dividends are taxable at lower capital gains rates (generally tax years beginning after December 31, 2002, and before January 1, 2009), but still is a notable corporate characteristic [*I.R.C. § 1(h)(11)*; *see* Pub. Law No. 108-27, §§ 302(f)(1), 303 (effective date and sunset provisions for dividend taxation at capital gains rates)]. Corporate losses may be deducted from corporate income only by the corporation; such losses are not deductible by the shareholders on their individual income tax returns [*see I.R.C. § 11*]. A shareholder recognizes capital gain or loss on the sale of shares of stock or on the liquidation of the C corporation [*I.R.C. §§ 302, 331*].

For a more detailed discussion of the tax and nontax attributes of a regular corporation, see *§§ 1B.40 et seq. and 1B.60* et seq., relating to corporations. For an enumeration of the advantages and disadvantages of conducting business as a regular corporation, see § 1B.104.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeGeneral OverviewBusiness & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesPersonal Liability



74 of 113 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
A. Business Forms Available Under California Law
2. Corporate Forms

1-1B California Legal Forms--Transaction Guide § 1B.31

§ 1B.31 Types of Corporations

[1] General Business Corporations

A general corporation is a distinct entity that is recognized as a unique legal entity, separate from its directors, officers, and shareholders [*see Erkenbrecher v. Grant (1921) 187 Cal. 7, 200 P. 641]* . The rights and obligations of the corporation, its directors and officers, and its shareholders are established in the General Corporation Law [*see, e.g., Corp. Code §§ 300-317, 600-605, 700-710*]; within limits, these statutory rights and obligations may be altered by agreement [*see, e.g., Corp. Code §§ 300, 305, 307*].

Although corporations share key structural features, corporations vary widely depending on number of shareholders and the formalities with which they operate. The professional corporation, statutory close corporation, Subchapter S corporation, and personal services corporation are discussed more fully in *[2]-[7], below*. Certain corporate forms exist for tax purposes; these corporations are organized under the auspices of and are regulated by the taxing authorities. These forms include the personal service corporation and the Subchapter S corporation.

Corporate tax entities, like the personal service corporation and the S corporation, and the general business corporations formed under the California General Corporation Law are not necessarily mutually exclusive. Thus, a corporation may be both a close corporation and a Subchapter S corporation as long as it complies with the requirements for both categories [*see Corp. Code § 158* ("close corporation defined")]. Neither are the different forms of regular business corporations necessarily mutually exclusive. Most professional corporations with either one or a few shareholders will probably elect close corporation status, thereby allowing direct participation in the management of the corporation, without the usual corporate formalities.

[2] Professional Corporation

[a] Overview

A "professional corporation" is a regular business corporation that renders professional services in a single profession

under a certificate of registration issued by the governing board that regulates the profession [*see Corp. Code § 13401(a), (b)*; *but see Corp. Code § 13401.5* (allied professionals)]. "Professional services" are any services that may lawfully be rendered pursuant to a license, certificate, or registration authorized by the California Business and Professions Code, the Osteopathic Act, the Yacht and Ship Brokers Act, or the Chiropractic Act [*Corp. Code §§ 13401(a), 13401.3*; *see* Bus. & Prof. Code §§ 1000-1-1000-20; *see also [b], below*], although there are no longer any certification requirements for medical, osteopathic, dental, pharmacy, veterinary, architectural, registered nursing, behavioral sciences, speech-language pathology and audiology, or court reporter corporations [*see Corp. Code §§ 13401(b), 13402(a)*; *Bus. & Prof. Code § 2406*]. With these exceptions, a professional corporation must have its own certificate of registration to do business as a corporation [*Corp. Code § 13401(b)*; *see also Corp. Code § 13406(b)*].

Professional corporations are regulated by the General Corporation Act [*see Corp. Code §§ 100-2319*], except when it is inconsistent with the Moscone-Knox Professional Corporation Act [*Corp. Code §§ 13400-13410*], in which case the Professional Corporation Act governs [*Corp. Code § 13403*]. In addition, each profession is regulated by its own governing agency [*Corp. Code § 13404*]. For a detailed discussion of professional corporations, see Ch. 12A, *Professional Corporations* .

PRACTICE TIP:

Professional service providers may not avoid liability for professional negligence by incorporating [*see Corp. Code § 13410*]; if liability in areas other than professional negligence is a concern, incorporation still offers liability protection in addition to other benefits of incorporation [*see Bus. & Prof. Code § 6171*]. However, because most professional corporations do not require large amounts of capital, and ordinarily do not need to retain assets at the corporate level, incorporation may not be a particularly attractive alternative.

Many of the former tax incentives for incorporating have been largely eroded, including increased pension contributions and insurance benefits and use of a fiscal year other than a calendar year. In addition, if a professional corporation performs services for only one other entity, income may be reallocated between a taxpayer and the corporation [*see I.R.C. § 269A*].

[b] Professions Permitted to Incorporate

Currently, the following professions are permitted to incorporate under the Professional Corporations Act:

- Accounting [*see Bus. & Prof. Code §§ 5150-5157*].
- Acupuncture [*see Bus. & Prof. Code §§ 4977.2-4979*].
- Architecture [*see Bus. & Prof. Code §§ 5500-5590*].
- Audiology [*see Bus. & Prof. Code §§ 2536-2539*].
- Chiropractic [*see Bus. & Prof. Code §§ 1050-1058*].
- Clinical social work [*see* Bus. & Prof. Code §§ 4998-4998.6].
- Dental [*see Bus. & Prof. Code §§ 1701-1701.5, 1800-1808*].
- Law [*see Bus. & Prof. Code §§ 6160-6172*].
- Medical [*see Bus. & Prof. Code §§ 2500-2515, 6127.5*].

- Nursing [*see Bus. & Prof. Code §§ 2775-2781*].
- Osteopathic [*see Bus. & Prof. Code § 2099.5 et seq.*].
- Pharmacy [*see Bus. & Prof. Code § 4000 et seq.*].
- Physical therapy [*see Bus. & Prof. Code §§ 2690-2696*].
- Physicians' assistants [*see Bus. & Prof. Code §§ 3540-3546*].
- Podiatry [*see Bus. & Prof. Code §§ 2406-2412*].
- Psychological [*see Bus. & Prof. Code §§ 2907-2913*].
- Speech pathology [*see Bus. & Prof. Code §§ 2536-2537.5*].
- Services authorized by the Yacht and Ship Brokers Act [*see Harb. & Nav. Code § 700 et seq.*].

[3] Close Corporation

California has established a statutory entity referred to as a "close corporation." A close corporation is defined by statute as a corporation whose articles of incorporation contain (1) a provision that all the corporation's issued shares of all classes shall be held of record by not more than a specified number of persons, not exceeding 35; and (2) the statement "This corporation is a close corporation" [*Corp. Code § 158(a)*].

In general, close corporation business is managed in partnership-like manner, using procedures defined in its shareholder agreement, without the necessity of observing the corporate formalities related to meetings of shareholders or directors, as otherwise required by certain provisions of the General Corporation Code [*Corp. Code § 300(b)*]. Thus, the failure to observe such corporate formalities will not be considered a factor tending to establish that the shareholders have personal liability for corporate obligations [*Corp. Code § 300(e)*].

PRACTICE TIP:

A closely held corporation, unless it is qualified as a statutory close corporation under California law, is generally subject to the requirements that apply to general corporations [*see Corp. Code §§ 158, 300*].

[4] Subchapter S Corporation

An S corporation is a regular business corporation that has made an election to be taxed under Subchapter S of the Internal Revenue Code and, therefore, is treated as a partnership for most tax purposes [*see I.R.C. §§ 1361-1379*]. The Internal Revenue Code distinguishes between corporations that have made this election from those that have not, by referring to the former as "S" corporations and the latter as "C" corporations [*I.R.C. § 1361(a)*].

Like a partnership and unlike a regular C corporation, is not a separate taxpaying entity [*I.R.C. § 1363(a)*]. Most of the tax attributes of an S corporation (income, losses, deductions, and credits) are passed through, proportionately, to the shareholders, who report and pay any tax due on their individual income tax returns [*I.R.C. § 1366*]. Deductible losses are limited to the shareholder's basis in the stock, plus any loans made to the corporation [*I.R.C. § 1366(d)*]. As with partners, S corporation shareholders are limited by the at-risk and passive activity loss rules of the Internal Revenue Code [*see I.R.C. § 465(b)(1), (3)(at-risk)*; *see I.R.C. § 469(a)(2)* (passive loss)].

To qualify as an S corporation, the following requirements must be met:

- The number of shareholders must be no greater than 100 [*I.R.C. § 1361(b)(1)(A)*]. Husband and wife are ordinarily treated as one shareholder [*I.R.C. § 1361(c)(1)*]. Alternatively, taxpayers may elect to treat all members of the family as a single shareholder. "Members of the family" means a common ancestor, any lineal descendant of that common ancestor, and any spouse or former spouse of that common ancestor or lineal descendant [I.R.C. § 1361(c)(1)(A)(ii), (B), (D)].

- Shareholders must be individuals (excluding resident aliens [*I.R.C. § 1361(b)(1)(B), (C)*]), estates [*see I.R.C. § 1361(b)(1)(B), (c)(3)*], certain enumerated types of trusts [*see I.R.C. § 1361(b)(1)(B), (c)(2), (d), (e)*], qualified subchapter S subsidiaries [*see I.R.C. § 1361(b)(3)*], and certain exempt organizations [*I.R.C. § 1361(b)(1)(B)*; *see I.R.C. § 1361(c)(6)*].

- An S corporation must be a domestic corporation [*I.R.C. § 1361(b)(1)*].

- An S corporation may not be a financial institution that uses the reserve method of accounting for bad debts [*I.R.C. § 1361(b)(2)(A)*; *see I.R.C. § 585*]; an insurance company [*see I.R.C. § 1361(b)(2)(B)*]; a corporation that has elected special tax treatment and operates in Puerto Rico or other United States territorial possessions [*I.R.C. § 1361(b)(2)(C)*]; or a Domestic International Sales Corporation (DISC) or former DISC [*I.R.C. § 1361(b)(2)(D)*].

- An S corporation may not have more than one class of stock [*I.R.C. § 1361(b)(1)(D)*]. Neither differences in voting rights [*I.R.C. § 1361(c)(4)*] nor "straight debt" instruments create a second class of stock [*see I.R.C. § 1361(c)(5)(A)*].

All shareholders, including subsequent shareholders, are bound by the S corporation election [*I.R.C. § 1361(a)(1), (e)(2)*]. The election may be made at any time during the preceding taxable year or at any time during the taxable year and on or before the 15th day of the third month of the taxable year [*I.R.C. § 1362(b)(1), (2), (4)*; *see I.R.C. § 1362(b)(5)* (extension when Secretary determines reasonable cause for lack of timeliness)]. If the election is revoked [*see I.R.C. § 1362(d)(1)*] or terminated [*see I.R.C. § 1362(d)(2), (3)*; *but see I.R.C. § 1362(f)* (inadvertent invalid elections and terminations)], a corporation generally may not elect S corporation status again for a period of five years [*I.R.C. § 1362(g)*].

A corporation that has a valid election under *I.R.C. § 1362(a)* in effect for federal purposes will be an S corporation under California tax law [*Rev. & Tax. Code § 23801(a)*], and its shareholders will be shareholders of an S corporation without regard to whether the corporation is qualified to do business or is incorporated in California [*Rev. & Tax. Code § 23801(b)*].

California has generally adopted the federal tax treatment of S corporations, but with one substantial distinction [*see Rev. & Tax. Code § 23801*]. California S corporations are subjected to a modest tax on income (substantially less than that applicable to C corporations) and are subject to the annual minimum franchise tax [*Rev. & Tax. Code § 23802(b), (c)*; *see § 1B.62[4]*].

For a more detailed discussion of the taxation of S corporations, see Ch. 1E, *Taxation of Businesses* . For a discussion of the formation of S corporations, see Ch. 2B, *Electing Subchapter S Status* .

[5] Personal Services Corporation

A personal services corporation is defined by the Internal Revenue Code as a corporation that performs services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, when

substantially all the stock is held by current or retired employees or the estates of retired employees [*I.R.C. § 448(d)(2)*]. The taxable income of personal service corporations is taxed at a flat rate [*I.R.C. § 11(b)(2)*].

[6] Nonprofit Corporation

A nonprofit corporation is a business form that counsel may wish to consider in appropriate circumstances. A wide variety of businesses are organized as nonprofit corporations, subject to the general restriction that no profits may be distributed to members [*see Corp. Code §§ 5410, 9610, 7410-7414*]. Entities that are formed for specified nonprofit purposes may avoid state and federal taxation [*see Rev. & Tax. Code § 23701*; *see also I.R.C. § 501*]. In addition, these entities may qualify as exempt organizations; if an entity is exempt, contributions to that entity may be deductible as charitable donations [*see I.R.C. §§ 170, 501(c)(3)*; *see also Rev. & Tax. Code §§ 17201, 23701d, 24357 et seq.*]. The corporate form is typically used by nonprofit entities to protect principals from personal liability.

Nonprofit corporations are outside the scope of this chapter. For a detailed discussion of nonprofit corporations, see Ch. 13, *Nonprofit Corporations* .

[7] Cooperative Corporation

A cooperative corporation is a corporation that is organized and conducts its business primarily for the mutual benefit of its members as patrons of the corporation. Its earnings, savings, or benefits must be used for the general welfare of its members or equitably distributed to its members based on patronage, subject to various restrictions [*see Corp. Code § 12201*]. Cooperative corporations are regulated by the Consumer Cooperative Corporation Law [*Corp. Code §§ 12200-12704*; *see Food & Agric. Code § 54001 et seq.*].

Cooperative corporations are discussed in detail in Ch. 14, *Consumer Cooperative Corporations* and Ch. 14A, *Agricultural Nonprofit Cooperative Associations* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawCorporationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
A. Business Forms Available Under California Law
2. Corporate Forms

1-1B California Legal Forms--Transaction Guide §§ 1B.32-1B.39

[Reserved]

§§ 1B.32[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
B. Nontax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.40

§ 1B.40 Lawfulness of Business Activity

[1] Illegal Business Venture

The first and most basic question to consider is whether the proposed business venture may legally be conducted. Although problems of this nature are unlikely to arise with any frequency, the legality of the proposed business is an issue that should not be overlooked. Some businesses are clearly illegal, while other related businesses are not. For example, it is illegal to operate an escort service that engages in prostitution [*Penal Code § 266(f)*]; however, it is lawful to operate an escort service that does not engage in such activities. Further, a business venture that is legal, in principle, may be illegal if it does not observe certain restrictions--for example, it is illegal to lend money at usurious rates [Uncod. Meas. 1919-1 (Usury Law)].

[2] Business Forms Specified by Government Regulation

Most business ventures may be carried on in any of the organizational forms discussed in this chapter. However, a few activities are limited, by governmental regulation, either to a specified form or to a restricted choice of form. Banks, for example, may not operate as partnerships [*Corp. Code §§ 15616*, 15901.04] and must operate as corporations [*see Fin. Code § 102*]. A discussion of such specialized forms of doing business is beyond the scope of this chapter.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurpose



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
B. Nontax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.41

§ 1B.41 Management and Control

[1] Sole Proprietorship

In a sole proprietorship, all management and control rests in the proprietor-owner. The owner has the final responsibility for the decisions in the business, although he or she may delegate authority to employees.

[2] General Partnership

In a general partnership, all partners share equally in management and control, unless the partnership agreement contains contrary provisions [*Corp. Code § 16401(f)*]. Ordinarily, the general partnership form offers partners a wide variety of choices in dividing management responsibilities and allocating ownership percentages.

In actuality, centralization of management may be difficult because each general partner has the authority to bind the partnership when dealing with third parties [*Corp. Code §§ 16301, 16305, 16306*]. When partners disagree on matters arising in the ordinary course of business, a decision of the majority controls; however, certain decisions require the unanimous consent of all the partners, such as an act outside the ordinary course of business or an amendment to the partnership agreement [*Corp. Code § 16401(j)*]. Each partner is an agent of the partnership and has the authority to bind the partnership in the ordinary course of business, unless the partner does not have the authority to act for the partnership and the other party has knowledge of that fact [*Corp. Code § 16301(1)*]. Partners may reallocate this sharing of authority in the partnership agreement, by providing that a partner or selected partners manage partnership business or by restricting the authority of a particular partner or partners to act in certain ways [*see Corp. Code § 16303(a)(2)*]. An agreement to give management authority to one partner does not invalidate a partnership agreement [*Jacoby v. Feldman (1978) 81 Cal. App. 3d 432, 441, 146 Cal. Rptr. 334]* . An agreement to relinquish control is an exercise of the right of control over partnership business and does not destroy the community of interest required by a partnership [*Moulin v. Der Zakarian (1961) 191 Cal. App. 2d 184, 190, 12 Cal. Rptr. 572]* .

While providing more flexibility of management than a sole proprietorship, effective management of a partnership requires either the ability of all partners to work together or the actual acquiescence of the non-managing partners to the decisions of the managing partner.

[3] Limited Partnership

In a limited partnership, the general partners have the exclusive right to manage the business. As in a general partnership, management responsibilities may be divided in a variety of ways in the partnership agreement [*Corp. Code §§ 15643(a)*, 15904.06].

To maintain their limited liability protection, limited partners may not participate in the control of the business (management) [*Corp. Code §§ 15632(a)*, 15903.03(a)]. Their participation is limited to specific acts relating to basic issues of the partnership, such as dissolution or merger [*see Corp. Code §§ 15632(b), (c), 15636(f)*, 15903.03(b), (c), 15908.01(b), (c), 15911.03(b)]. In contrast to the restricted role of limited partners, LLC members may manage the LLC without fear of losing their limited liability.

[4] Limited Liability Company

A limited liability company may be managed by all of its members, or by one or more managers who may but need not be members [*Corp. Code §§ 17150, 17151*]. However, unless the articles of organization state than an LLC will be managed by one or more managers [*see Corp. Code §§ 17051(a), 17151(b)*], the business of the LLC is managed by all of its members absent any restriction or limitation in the articles or operating agreement [*Corp. Code § 17151(b)*]. If management is vested in the members, the members have the rights, duties, and obligations of managers [*Corp. Code § 17150*].

LLC members, much like corporate directors, may manage an LLC without forfeiting their limited liability. In contrast, if a limited partner participates in management, that partner loses his or her protective shield [*Corp. Code §§ 15632, 15636*, 15903.03]. Management and control rest with the partners of a general partnership; however, the liability of the general partners is unlimited and not restricted to their investments.

[5] Corporation

An advantage of incorporation is the centralized management that the form provides. Management and control in a corporation vary widely depending on the size of the corporation and the number of shareholders and their rights, as set forth in the incorporation documents. In general, in corporations with a large number of shareholders, ownership and management are separate. Shareholders delegate management and control by electing a board of directors [*Corp. Code § 301(a)*]; the board of directors then appoints officers to manage the day-to-day business and implement board policies [*Corp. Code §§ 301(a), 312(b)*]. Shareholder participation in decision making is generally limited to approving or disapproving major transactions affecting the life of the corporation [*Corp. Code § 700(a)*], including the merger or reorganization of the corporation [*Corp. Code §§ 1201, 1201.5, 1202*], the conversion of a corporation into a domestic other business entity [*see Corp. Code § 1151(a)*; *see also Corp. Code § 1150 et seq.*], the sale or other disposition of substantially all corporate assets [*Corp. Code § 1001*], the dissolution of the corporation [*Corp. Code §§ 1900, 1902*], the amendment of the articles of incorporation [*Corp. Code §§ 902-904*], and the removal of directors [*Corp. Code § 303*].

However, in a corporation with one or a few shareholders, such as a professional corporation, or in a close corporation [*see Corp. Code § 158*], management and control does not differ greatly from that of a sole proprietorship or a general partnership because ownership and management is the same. In a close corporation, shareholders, by agreement, may forego management by a board of directors and directly participate in the management of the business in its ordinary course, in a manner resembling that of a general partnership [*Corp. Code § 300(b)*].

Although in large corporations management is generally centralized and ownership separate, there are a variety of means of allocating control by using voting agreements [*Corp. Code § 706(a)*], voting trusts [*Corp. Code § 706(b)*], management contracts [*Corp. Code § 300(a)*], or shareholder agreements [*Corp. Code § 300(b), (c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesBusiness & Corporate LawSole Proprietorships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
B. Nontax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.42

§ 1B.42 Limitations on Liability

[1] In General

Limiting the liability of the principal or principals forming a business enterprise is usually a primary factor in selecting the form of business entity. In determining the importance of limited liability, counsel should evaluate the proposed business' potential to create liabilities that cannot be adequately provided for by insurance and the net worth and earning potential of the principals. If the likelihood that the business will generate uninsured liabilities is high, and if the principals have significant net worth and earning potential, the entity selected should provide the principals with maximum protection from the debts and obligations generated by the business.

[2] Sole Proprietorship

A sole proprietorship provides virtually no insulation to the principal from the losses generated by the business. The owner of a sole proprietorship has unlimited liability for the debts and obligations of the entity. It may be possible for a sole proprietor to limit liability to the assets of the business by contract, but barring such an arrangement, all assets, not just those dedicated to the business, are at risk. Although prudent business people will secure insurance to minimize the exposure of assets to unforeseen liabilities arising from daily operations or resulting from tort or contract obligations, the personal assets of a sole proprietor remain at risk if the claim exceeds the amount of insurance coverage, or if that coverage is deemed inapplicable [*see* Ch. 1F, *Insurance Considerations in Business Formation*]. In addition, all of the community property of a sole proprietor is liable for contract obligations incurred in the business during the marriage [*Fam. Code § 910*]. For practical purposes, the personal liability of the owner for the debts and other obligations of the business is of particular concern if the business engaged in is risky, or if the bulk of the owner's assets lie outside the business.

[3] General Partnership

General partnerships provide no insulation to the principals (partners) from losses generated by the business. In a general partnership, the partners are jointly and severally liable, without limitation, for the wrongful acts or omissions of any partner acting in the ordinary course of business, for the misapplication of money or property received from a third

person by the partnership, and for all other obligations of the partnership unless otherwise agreed by the claimant or provided by law [*Corp. Code §§ 16305, 16306*; *see Masoni v. Board of Trade of San Francisco (1953) 119 Cal. App. 2d 738, 743, 260 P.2d 205* ; *see also Reed v. Industrial Accident Commission (1937), 10 Cal. 2d 191, 192, 73 P.2d 1212* ; *Great Western Bank v. Kong (2001) 90 Cal. App. 4th 28, 31-33, 108 Cal. Rptr. 2d 266* (although under *Corp. Code § 16306(a)* all partners were jointly and severally liable for bank loan on real property, after foreclosure and entry of deficiency judgment, assignment of judgment to partnership and 11 of 12 partners extinguished the debt; the 11 partners could not acquire bank's right to collect balance of judgment from 12th partner, their co-obligor)]. A new partner in an existing partnership is not personally liable for any partnership obligation incurred before that partner's admission [*Corp. Code § 16306(b)*]. An inactive or secret partner may also be held liable for partnership debts and obligations [*see Gardiner v. Gaither (1958) 162 Cal. App. 2d 607, 329 P.2d 22* ; *see also Nels E. Nelson, Inc. v. Tarman (1958) 163 Cal. App. 2d 714, 329 P.2d 953]* .

PRACTICE TIP:

If the proposed business carries significant potential for liability exposure, counsel should advise the client to incorporate. Alternatively, combinations of entities (such as corporations and partnerships) may be used to achieve a measure of liability protection.

The termination of a partnership interest during a tax year does not relieve a partner of responsibility for partnership liabilities for the balance of the year if the partner personally guaranteed the debt [*Weiss v. Commissioner (11th Cir. 1992) 956 F.2d 242* ; *see Corp. Code §§ 15655*, 15905.02].

Further, since each partner is an agent of the partnership, he or she has the authority to bind the partnership with regard to acts in the ordinary course of business [*see Corp. Code § 16301(1)*], and all partners are jointly and severally liable for claims arising from those actions [*Corp. Code § 16306(a)*]. All partners may be held liable for the partnership's payroll taxes, including the nonpayment penalty, regardless of which partners are responsible for remitting the taxes [*see I.R.C. § 6672*]. However, a partner's authority may be restricted, in which case the partner is unable to bind the partnership provided that the third party knows of the lack of authority [*Corp. Code § 16301(1)*]. In addition, the partners' liabilities may be reallocated among partners by agreement with the claimant [see *Corp. Code § 16306(a)*].

[4] Limited Partnership

A general partner in a limited partnership has essentially unlimited liability for partnership debts and other obligations [*see Corp. Code § 15643, 15904.04*].

A limited partner in a properly formed limited partnership is liable for partnership debts and other obligations only up to the amount of any capital contribution [*Corp. Code §§ 15632(a)*, 15903.03]. However, the limited partner may lose the limited liability afforded by the limited partnership form under certain circumstances, such as if the limited partner is named as a general partner in the certificate or if the limited partner participates in the control of the business [*see Corp. Code § 15632, 15903.03*]. Additionally, a breach of fiduciary duty to the partnership may subject a limited partner to tort liability [*see Tri-Growth Centre City, Ltd. v. Silldorf, Burdman, Duignan & Eisenberg (1989) 216 Cal. App. 3d 1139, 265 Cal. Rptr. 330]* .

The termination of a partnership interest during a tax year does not relieve a partner of responsibility for partnership liabilities for the balance of the tear when the partner personally guaranteed the debt [*Weiss v. Commissioner (11th Cir. 1992) 956 F.2d 242]* ; further, a partner's death, disability, or other occurrence does not excuse the partner from any obligation to the limited partnership to contribute money or property to, or perform services for, the partnership [*see Corp. Code §§ 15655*, 15905.02].

[5] Limited Liability Company

The liability of members and managers of an LLC is similar to that of limited partners and corporate shareholders. LLC members and managers and limited partners of properly structured entities are ordinarily shielded from personal liability for company obligations [*see Corp. Code §§ 15632, 15903.03, 17101(a), 17158*; *see also [4], above*]. However, both may be liable under certain circumstances [*see, e.g., Corp. Code §§ 15632*, 15903.03, *17101(b), (c), 17153, 17158, 17254, 17255*; *see also §§ 1B.12[2][b], 1B.13[2][b]*].

Further, LLC members and shareholders may be personally liable if the entity is disregarded under the common law alter ego doctrine or if they personally guaranteed debts [*see Corp. Code § 17101(b), (e)*; *see also §§ 1B.13[2][b], 1B.30[2][c]*].

[6] Corporation

Of all organizational forms, corporations offer principals and shareholders the most protection from the liabilities of the business (assuming valid formation, compliance with formalities, and adequate capitalization) although its protection is not complete [*see Corp. Code §§ 300, 309, 409-414*]. Directors acting in good faith and in a manner that the director believes to be in the best interest of the corporation and its shareholders, exercising the care of an ordinarily prudent person in similar circumstances, is generally not liable for any alleged failure to discharge the duties of a director; officers are not liable for acts performed within their scope of authority [*Corp. Code § 309*; *see, e.g., FDIC v. Castetter (9th Cir. 1999) 184 F.3d 1040, 1044-1046* (nonofficer directors of federally insured national bank immunized by business judgment rule from liability for purely negligent acts)]. Similarly, shareholders of a corporation ordinarily are not personally liable for corporate debts and other obligations provided that the corporation is validly formed, complies with required formalities, and is adequately capitalized [*Corp. Code §§ 300, 309*]. As a separate entity, the corporation is liable for its own obligations [*see Corp. Code § 309(c)*]. For shareholders, the significance of this limited liability means the investor is at risk only for the amount of his or her investment. For directors, officers, and shareholders, this limited liability extends beyond contractual obligations to include protection for the torts and criminal acts of other employees and shareholders [*Corp. Code § 309*].

PRACTICE TIP:

The limited liability afforded by the corporate form may be of less practical value than anticipated, especially for closely held businesses: insurance is widely available and shareholders in newly formed small corporations are often required to personally guarantee the business's major undertakings. Further, tortious conduct ordinarily subjects an individual to liability [*U.S. Liability Ins. Co. v. Haidinger-Hayes, Inc. (1970) 1 Cal. 3d 586, 83 Cal. Rptr. 418, 463 P.2d 770]* .

Insulation from personal liability is not complete. Individuals who are employees of the corporation may have personal liability for certain types of taxes, such as payroll taxes that have been withheld from employees' salaries but not paid to the Internal Revenue Service [*I.R.C. §§ 6672, 7215*]. Individuals may be personally liable for corporate obligations if they have personally guaranteed such debts, as is often the case with small or newly established corporations [*Corp. Code § 506(a)*]. Directors and officers may also be personally liable for breach of duty to corporate creditors, the corporation itself, or its shareholders [*see Corp. Code §§ 309, 316(a)-(d)*; *see also Jones v. Ahmanson & Co. (1969) 1 Cal. 3d 93, 81 Cal. Rptr. 592, 460 P.2d 464* ; *GAB Business Services, Inc. v. Lindsey & Newsom Claim Services, Inc. (2000) 83 Cal. App. 4th 409, 423-424, 99 Cal. Rptr. 2d 665* (vice-president who used insider's knowledge of employees to recruit them into jobs with corporation's competitor was fiduciary of corporation as a matter of law; trial court's failure to instruct jury accordingly was prejudicial error); *Nelson v. Anderson (1999) 72 Cal. App. 4th 111, 124-126, 84 Cal. Rptr. 2d 753* (minority shareholder as individual had no standing to bring action for breach of fiduciary duty against majority shareholder, but should have brought derivative action on behalf of corporation when any obligations violated were duties owed directly and immediately to corporation)].

Finally, some situations exist in which the corporate veil is pierced (that is, the corporate entity disregarded) and personal liability imposed on the shareholders. This "alter ego" liability generally exists when there is a unity of interest

and ownership between the shareholders and the corporation, and it would violate the principles of equity not to disregard the corporate entity [*Erkenbrecher v. Grant (1921) 187 Cal. 7, 10, 13, 200 P. 641* ; *see, e.g., Playboy Enterprises, Inc. v. Welles (9th Cir. 2002) 279 F.3d 796, 806-807* (although unity of interest was established, no showing was made that fiction of separate existence of corporation would sanction fraud or promote injustice)]. Courts have considered a variety of factors in applying this equitable doctrine [*see Associated Vendors, Inc. v. Oakland Meat Co. (1962) 210 Cal. App. 2d 825, 26 Cal. Rptr. 806* (enumerating factors used in deciding whether to disregard corporate entity)], and increasingly have been willing to disregard the corporate entity when a subsidiary is merely a conduit of a parent [*see, e.g., United States v. Bestfoods (1998) 524 U.S. 51, 64-66, 118 S. Ct. 1876, 141 L.Ed. 2d 43* (parent corporation can be held liable as owner under CERCLA for subsidiary's actions in operating polluting facility if there are factors that would allow piercing corporate veil under general corporate law principles); *see also Laird v. Capital Cities/ABC Inc. (1998) 68 Cal. App. 4th 727, 742, 80 Cal. Rptr. 2d 454* (plaintiff failed to show specific manipulative conduct by parent toward subsidiary which relegated subsidiary to status of mere instrumentality, agency, conduit, or adjunct of parent)]. After successfully suing a corporation, a plaintiff may even attempt to join new defendants to be bound by the judgment, on the grounds that they are the alter ego of the corporation [*see, e.g., McClellan v. Northridge Park Townhome Owners Association, Inc. (2001) 89 Cal. App. 4th 746, 753-756, 107 Cal. Rptr. 2d 702* (successor corporation properly added as judgment debtor in addition to bankrupt predecessor, when substantial evidence supported conclusion that successor was mere continuation of predecessor; *but see Katzir's Floor and Home Design, Inc. v. M-MLS.com (9th Cir. 2004) 394 F.3d 1143, 1149-1151* (reversing amended judgment adding individual and new corporation as additional judgment debtor on grounds of alter ego and successor liability)].

The corporate veil may be pierced only by an adversary of the corporation, not by the corporation itself for its own benefit [*Disenos Artisticos E Indus. v. Costco Wholesale (9th Cir. 1996) 97 F.3d 377, 380* (corporation not entitled to establish and use its affiliates' separate legal existence for some purposes but have its own separate corporate existence disregarded for its own benefit against third parties); *see United Continental Tuna Corp. v. United States (9th Cir. 1977) 550 F.2d 569, 573]* , or by the shareholders for their own benefit [*Seretti v. Superior Nat. Ins. Co. (1999) 71 Cal. App. 4th 920, 931* (because shareholders of small, closely held corporation sought to pierce veil of their own corporation and substitute themselves in place of corporation as named insured under workers compensation policy, court held that shareholders' inability to maintain individual actions against corporation's workers' compensation carrier did not constitute type of "grave injustice" that justified ignoring corporation's separate existence)].

For an extensive discussion of the alter ego doctrine, see Ballantine & Sterling, California Corporation Laws, Ch. 14, *Litigation Involving Corporations and Shareholders* , §§ 295-300 (Matthew Bender).

[7] Close Corporation

A disregard for corporate formalities (such as required director meetings and properly documented board resolutions) has been a major factor in piercing the corporate veil [*see Associated Vendors, Inc. v. Oakland Meat Co. (1962) 210 Cal. App. 2d 825, 26 Cal. Rptr. 806]* . However, the purpose of a close corporation is to allow the shareholders to manage the corporation's business without observing corporate formalities related to director and shareholder meetings [*see Corp. Code § 300(e)*]. Thus, if the shareholders manage the corporation informally, according to the provisions of their shareholder agreement, the mere failure to observe corporate formalities will not be considered a factor tending to establish that shareholders have personal liability for corporate obligations [*Corp. Code § 300(e)*]. However, only those requirements related to board and shareholder meetings may be disregarded; other statutory requirements may not be ignored without risk of exposure to personal liability for corporate debts and other obligations [*see Corp. Code § 300(e)*].

The provisions of the General Corporation Law relating to close corporations [*Corp. Code §§ 158-300*] have not been the subject of much litigation, and case law does not establish the extent of that statutory protection. Therefore, it is desirable to observe corporate formalities or, at the very least, to carefully compare the possible adverse consequences of ignoring them to the advantages of informality of management. Close corporations are discussed in detail in Ch. 2,

Formation of Corporations , Ch. 3, *Articles of Incorporation* , and Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

[8] Professional Corporation

Shareholders of professional corporations have the same protection from personal liability as do shareholders of other corporations for acts or omissions unrelated to their professional practice [*Corp. Code § 13403*]. However, most regulatory agencies impose joint and several liability for malpractice [*see, e.g., Bus. & Prof. Code § 1057* (chiropractic corporations), *Bus. & Prof. Code § 2781* (nursing corporations)].

[9] Limited Liability Partnership

Assuming proper registration and compliance with all statutory requirements [*see Corp. Code § 16951 et seq.*], including security requirements [*see § 1B.15[5][b][ii]*], the liability of partners is similar to that of corporate shareholders or limited partners. The LLP structure protects the personal assets of partners of law and public accounting firms from liability for partnership debts and obligations, and most particularly from liability for obligations arising from other partners' acts, errors, or omissions arising out of practice of law or public accounting [*Corp. Code § 16306(c)*]. This shield does not affect a partner's liability to third parties for his or her own tortious conduct [*Corp. Code § 16306(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesPersonal LiabilityBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionPartnership LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesBusiness & Corporate LawSole Proprietorships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
B. Nontax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.43

§ 1B.43 Availability of Capital

[1] In General

Many sources of capital exist to finance the commencement and operation of a new business venture, including the following:

- Funding with equity or debt by the principal;
- Funding through equity investment by third parties;
- Fund through debt by third parties; and
- Any combination of the above.

PRACTICE TIP:
Whenever seeking passive equity capital, principals must consider whether the offering must be qualified under securities laws [*see Corp. Code § 25000 et seq.*; *see also* Ch. 6, *Securities Regulation Issues* ; Ch. 65, *Qualification of Securities*]. Passive equity investors should consider the restrictions governing passive activity losses and credits [*see I.R.C. § 469*; *see also* Ch. 1E, *Taxation of Businesses*].

[2] Sole Proprietorship

The availability of capital to a sole proprietorship is coincidental with that of its owner. The capital requirements can be met through self-funding or by loans from third parties; however, creditors often require sole proprietors to use their personal assets as security for credit. All of the equity in a proprietorship belongs to the owner.

[3] General Partnership

The availability of capital to a general partnership is not greatly different from that available to a sole proprietorship. A general partnership may obtain capital from the capital contributions of its partners and through secured and unsecured loans either from its partners or from third parties. Loans are usually available to a general partnership based on the credit standing of its partners, since general partners are jointly and severally liable for the debts of the partnership [*Corp. Code § 16306(a)*; *see also Reed v. Industrial Accident Commission (1937) 10 Cal. 2d 191, 73 P.2d 1212]* . Thus, as in a sole proprietorship, creditors often require partners to secure loans with their personal assets, if partnership assets do not provide sufficient collateral.

It is not unusual for a proposed partnership to exist in which only one partner (or a few partners) contributes capital and other partners provides services in the form of active involvement in the business. Whenever the equity partner plans to be inactive, counsel should evaluate the limited partnership form with the principals [*see [4], below*].

[4] Limited Partnership

Limited partnerships, like corporations and LLCs, are more advantageous vehicles for attracting capital than sole proprietorships and general partnerships. The sources of capital available to a limited partnership include the capital contributions of the general partners, unsecured loans, loans secured either by partnership assets or by the credit standing of the general partner, and the capital contributions of limited partners. The capital contributions of the limited partners may also increase the limited partnership's ability to borrow because partnership debts must be repaid before equity distributions can be made [*Corp. Code §§ 15684*, 15908.09].

Limited partnership interests often appeal to investors because of their limited liability [*see Corp. Code §§ 15632(a)*, 15903.03]; however, limited partnership interests have become somewhat less appealing to investors since the passage of the Tax Reform Act of 1986, which restricted the deductibility of passive losses by individuals in a year to the amount equal to passive income for the year [*I.R.C. § 469(e)*; *see* Ch. 1E, *Taxation of Businesses* ; *see also* Ch. 16, *Formation of Limited Partnerships*]. In addition, the transfer restrictions on limited partnership interests may deter some investors [*see Corp. Code §§ 15631, 15674*].

PRACTICE TIP:

When seeking passive equity capital, principals must always determine whether an offering must be qualified under securities laws [*see § 1B.46[2]*. Passive investors also must consider the restrictions regarding passive activity losses and credits [*see I.R.C. § 469*; *see also § 1B.63[2][b]*].

[5] Limited Liability Company

Limited liability companies, like corporations and limited partnerships, are more advantageous vehicles for attracting capital than sole proprietorships and general partnerships. The capital requirements of a limited liability company can be met in a variety of means similar to a corporation, including member contributions [*see Corp. Code §§ 17001(d), 17200(a)*] and loans secured by personal guarantees or by company property [*see Corp. Code §§ 17003, 17004*]. The availability of limited liability, the flexibility of the form, and, ordinarily, a single level of taxation may make limited liability companies an attractive investment opportunity.

PRACTICE TIP:

When seeking passive equity capital, principals must always determine whether an offering must be qualified under securities laws [*see § 1B.46[3]*]. Passive investors must also consider the restrictions regarding passive activity losses and credits [*see I.R.C. § 469*; *see also § 1B.63[2][c]*].

[6] Corporation

Corporations, like limited partnerships and LLCs, are extremely advantageous vehicles for attracting capital. A corporation's sources of capital include loans using the corporation's assets as collateral, loans based on the personal

guarantees of individual participants, and capital contributions of the shareholders. Because shareholders are ordinarily not liable for corporate debts [*see Corp. Code § 300*] and because the consequences and means of investing in shares of corporate stock are generally well understood, the purchase of corporate shares often appeals to investors. Furthermore, a variety of forms of shareholder's capital are available and provide flexibility, including various classes or series of stock, with different rights and priorities, as well as other warrants and a variety of debt instruments. For a comprehensive discussion of corporate securities, *see* Ch. 6, *Securities Regulation Issues* .

PRACTICE TIP:

For smaller or start-up corporations (as opposed to publicly held corporations), financing options may not differ greatly from those of limited partnerships. When seeking passive equity capital, principals must always determine whether an offering must be qualified under securities laws [*see § 1B.46[3]*]. Also, passive investors must consider the restrictions regarding passive activity losses and credits [*see I.R.C. § 469*; *see also § 1B.63[2][c]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawSole Proprietorships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
B. Nontax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.44

§ 1B.44 Transferability of Interests

[1] Sole Proprietorship

By its very nature, the interest in a sole proprietorship is freely transferable. The purchaser is likely to be third party obtained through advertising or a business broker. However, in practical terms, business assets may be encumbered by debts and, depending on the type of business, a purchaser may be difficult to find. If the need to sell the business is precipitated by an event such, as the disability or death of the proprietor, the business may have to be sold at a lower price because no mechanism exists to cover this contingency and no willing and able successor stands ready to take over the management (and liability) of the business.

PRACTICE TIP:

Counsel should advise clients determined to operate as sole proprietors to obtain adequate life and disability insurance coverage to ensure a measure of liquidity [*see* Ch. 1F, *Insurance Considerations in Business Formation*].

[2] General Partnership

General partnership interests are transferable with certain restrictions. Unless the partnership agreement provides otherwise, the rights of a general partner may not be transferred to another individual without the consent of all other partners [*Corp. Code § 16401(i)*]. The other general partners are ordinarily the most likely potential purchasers of a withdrawing partner's interest; if they are unwilling or unable to purchase that interest, the partnership may be forced to dissolve.

PRACTICE TIP:

Counsel should always include buy-sell provisions in the partnership agreement to cover the contingency of an unanticipated or forced sale of a general partner's interest. The agreement should also contain valuation provisions, such as formulas, an agreed value, or appraisal requirements. These provisions are likely to be examined when the partners are not on the best of terms. Therefore, counsel should consider the potential conflicts of interest that may be present in drafting these provisions [*see State Bar Rules of*

Prof. Conduct, Rule 3-310; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*].

A general partner's partnership interest may be assigned to a third party, but such an assignment gives the assignee the right to receive distributions of profits to which the assigning party would have been entitled, as well as the right to seek a judicial determination that it is equitable to wind up the partnership business [*Corp. Code § 16503(a), (b)*]. It does not give the assignee the rights of management and control, nor the rights to an accounting or to inspect partnership records [*Corp. Code § 16503(a)(2), (c), (d)*].

A merger involving a general partnership may also be a method of transferring or transforming an interest. A general partnership may merge with or into a general partnership. Further, general partnerships may merge with or into limited partnerships or limited liability companies [*Corp. Code § 16910(a)*; *see Corp. Code § 16901 et seq.*].

[3] Limited Partnership

Under the CRLPA, the transfer of a general partnership interest in a limited partnership is subject to restrictions similar to those applicable to the transfer of a general partnership interest in a general partnership [*Corp. Code §§ 15643, 15674, 16503*; *see [2], above*]. The admission of a new general partner requires the written consent of all remaining general partners, as well as the affirmative vote of a majority in interest of the limited partners [*Corp. Code §§ 15641, 15636(f), 15681(c)*]. The partnership agreement may prohibit a general partner from assigning or encumbering a partnership interest [*Corp. Code § 15672(c)*], and a general partner who assigns his or her interest may be removed by a majority in interest of the limited partners [*Corp. Code § 15674(d)*].

Unless restricted by the limited partnership agreement, limited partnership interests are freely transferable or assignable [*see Corp. Code §§ 15631, 15672*; *see also Corp. Code § 15618*]. Limited partnership interests are assignable in whole or in part, and the assignee has the same rights to receive distributions, allocations of income, loss, deductions, credits, and similar items as does the assignee of a general partnership interest [*Corp. Code § 15672*]. As with general partners in a general partnership, assignees of limited partners may not become limited partners unless the partnership agreement so provides or all general partners and a majority in interest of the limited partners consent [*Corp. Code § 15674(a)*]. Thus, assignees have limited rights to an accounting, limited access to financial records, and may not vote on partnership transactions [*Corp. Code § 15672*; *see Corp. Code § 15634*]. However, because the very nature of a limited partnership interest precludes participation in partnership management [*see Corp. Code § 15632(a)*], these restrictions may have little practical effect on the transferability of a limited partnership interest. Furthermore, assignees in partnerships with greater than 100 limited partners have complete access to partnership records [*Corp. Code § 15672*; *see Corp. Code § 15634*]. In addition, limited partnership interests in master limited partnerships, whose security interests are in the nature of corporate shares, are freely transferable [*see I.R.C. § 7704(b)*; *see also § 1B.15[3]*].

Under ULPA '08, the only interest of a partner that is transferable is the partner's transferable interest. A transferable interest (defined in *Corp. Code § 15901.02(ak)* as a partner's right to receive distributions) is personal property [*Corp. Code § 15907.01*]. This default provision, however, may be changed in a partnership agreement [*see Corp. Code § 15901.10*]. A transfer, in whole or in part, of a partner's transferable interest: (1) is permissible; (2) does not by itself cause the partner's dissociation or a dissolution and winding up of the limited partnership's activities; and (3) does not, as against the other partners or the partnership, entitle the transferee to participate in the management or conduct of the partnership's activities, to require access to information concerning the partnership's transactions except as otherwise described below, or to inspect or copy the required information or the partnership's other records or to exercise any other rights or powers of a partner interest [*Corp. Code § 15907.02(a)*]. A transferee has a right to receive, in accordance with the transfer, distributions to which the transferor would otherwise be entitled [*Corp. Code § 15907.02(b)*]. Upon transfer, the transferor retains the rights of a partner other than the interest in distributions transferred and retains all duties and obligations of a partner [*Corp. Code § 15907.02(h)*]. However, a transferee of a partnership interest may become a limited partner if and to the extent that the partnership agreement provides, or all general partners and a majority in interest of the limited partners consent [*Corp. Code § 15907.02(h)*]. A transferee that

becomes a partner with respect to a transferable interest is liable for the transferor's obligations under *Corp. Code §§ 15905.02* and *15905.09*, but is not obligated for liabilities unknown to the transferee at the time the transferee became a partner [*Corp. Code § 15907.02(g)*].

Since limited partnership interests are often issued under either the small or limited offering exemptions of the Corporate Securities Law of 1968 [*Corp. Code § 25102(f), (h)*], these limited partnership interests may be subject to transfer restrictions [*Corp. Code §§ 25102(f), (h), 25141*; *see* Ch. 6B, *California Limited Offering Exemptions* ; Ch. 6C, *California Small Offering Exemption*].

For further discussion, see Ch. 16, *Formation of Limited Partnerships* .

[4] Limited Liability Company

An economic interest [*see Corp. Code § 17001(n)*] in an LLC is freely assignable, in whole or in part, unless otherwise restricted by the articles of organization or the operating agreement [*Corp. Code § 17301(a)(1)*]. An assignment of an economic interest does not of itself dissolve an LLC or, except as set forth in the articles of organization or the operating agreement, entitle the assignee to vote and participate in the management and affairs of the LLC or to become or exercise any rights of a member [*Corp. Code § 17301(a)(2)*]; the assignment only entitles the assignee to receive, to the extent assigned, the economic benefits to which the assignor would have been entitled [*Corp. Code § 17301(a)(3)*]. Except to the extent assumed by agreement, an assignee has no liability to the LLC solely based on the assignment until the assignee becomes a member [*Corp. Code § 17301(b)*].

Members may only assign or transfer membership interests with the consent of a majority in interest of the members not transferring their interests [*Corp. Code § 17301(a)(1)*; *see Corp. Code § 17303*]. The assignment or transfer of amembership interest entitles the assignee to all of the rights and powers, as well as some of the obligations, of a member [*Corp. Code § 17303(a), (b)*].

For further discussion, see Ch. 12C, *Limited Liability Companies* .

[5] Corporation

A sale of a corporate business may occur through a sale of (1) the assets by the corporation or (2) the shares by the shareholders. Corporate shares are generally more freely transferable than are the interests of other business entities. However, free transferability of shares exists in practice only in the case of registered stock of publicly held corporations. The transfer of these shares, however, may be restricted to comply with securities laws [*see Corp. Code §§ 25000-25705*; *15 U.S.C. §§ 77a-77aa*] and is, of course, subject to market conditions.

The transfer of corporate shares is restricted in both close and professional corporations. In close corporations, transfer is usually restricted by written agreement [*see Corp. Code § 204(a)(3), (b)*]. In a professional corporation, transfer is restricted to the issuing corporation itself, or to persons licensed by the profession in which the corporation provides services [*Corp. Code §§ 13406, 13407*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersTransfers of InterestsBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsBusiness & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawSole Proprietorships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
B. Nontax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.45

§ 1B.45 Separate Legal Identity; Continuity of Existence

[1] Sole Proprietorship

A sole proprietorship does not have an identity apart from that of its owner, even if the individual is conducting the business under a fictitious name [*see Bus. & Prof. Code § 17900 et seq.*]. In a sole proprietorship, the owner has complete authority and responsibility for all business decisions, owns all of the business assets as an individual, and is subject to unlimited liability for the business's debts and pays taxes as an individual.

Continuity of existence is not an attribute of sole proprietorships. A sole proprietorship necessarily ceases to exist on the incapacity or death of its owner or the cessation of business [*see Morrissey v. Commissioner (1935) 296 U.S. 344, 56 S. Ct. 289, 80 L. Ed. 263]* .

An individual who might reasonably anticipate being subjected to the kind of racial discrimination that is proscribed by *42 U.S.C. § 1981*, which ensures equal rights to make and enforce contracts--"includ[ing] the making, performance, modification, and termination of contracts, and the enjoyment of all benefits, privileges, terms, and conditions of the contractual relationship"--should give that fact special consideration in selecting the form for doing business. If he or she elects to do business through a one-owner limited liability company or corporation [*see [3], [4], below*], then the protection of that statute could be lost becauseof the separate identity that the law attributes to a limited liability company or a corporation. The individual owner could not state a claim under the statute with respect to any contract made or sought by the company or corporation, even if there were proof that the company or corporation lost or failed to gain contractual benefits because of race-based animus toward the owner. Whether the company or corporation would have a claim under the statute in such a case remains undecided [*Domino's Pizza, Inc. v. McDonald (2006) 546 U.S. 470, 126 S. Ct. 1246, 1248, 1252, 163 L. Ed. 2d 1069]* .

[2] Partnership

The relationship between the business form and its partners is more attenuated than that of a sole proprietor to a sole proprietorship. For example, in a general partnership, all property contributed to or acquired by the partnership with partnership funds is the property of the partnership and is owned in the name of partnership [*Corp. Code §§ 16203,*

16204], and no partner has any individual right to that property absent agreement by the partners [*Corp. Code § 16401(g)*], whereas in a sole proprietorship, the owner has merely segregated assets and designated them as the property of the business while still holding legal title. Unlike a sole proprietorship, a partnership must file a separate, albeit informational, income tax return [*I.R.C. § 6031(a)*; *see also §§ 1B.11[2][e], 1B.12[2][e]*]. Further, limited partners are generally protected from any liability that exceeds the amount of their investment, stemming from partnership transactions [*Corp. Code §§ 15632(a)*, 15903.03].

Continuity of existence in a general partnership is uncertain. A general partnership can be dissolved on many grounds [*see Corp. Code § 16801*]. For further discussion, see *§ 1B.11[2][d]*.

A limited partnership shares some of the continuity characteristics of a general partnership and some of the continuity characteristics of a corporation, however, it is not as unstable as a general partnership or a sole proprietorship. For example, a limited partnership dissolves on the occurrence of an event specified in the partnership agreement, the consent of all the general partners and a majority in interest of the limited partners, and by judicial dissolution [*Corp. Code §§ 15642, 15681, 15682*, 15908.01, 15908.02]. However, neither the disposition of a limited partnership interest, nor the incapacity or death of a limited partner dissolves the partnership [*Corp. Code §§ 15672, 15675*, 15907.02(a), 15907.04]. For further discussion, see *§ 1B.12[2][d]*.

[3] Limited Liability Company

A limited liability company exists as a separate legal entity [*see Corp. Code § 17001(t)*] whose existence is independent of its members [*see Corp. Code § 17003*]. The existence of an LLC begins on the filing of the articles of organization with the Secretary of State [*Corp. Code § 17050(c)*].

An LLC, unlike a corporation, does not necessarily have perpetual existence [*see Corp. Code § 17350* (dissolution events); *see also § 1B.13[2][d]*]. For example, an LLC may be dissolved by the vote of a majority in interest of the members, or a greater percentage as specified in the articles of organization or written operating agreement [*Corp. Code § 17350(b)*], and the articles may specify a time certain for, or events that cause, dissolution of the LLC [*Corp. Code §§ 17051(c)(3), (4), 17350(a)*].

[4] Corporation

A corporation exists as a separate legal entity, whose existence is independent of that of its directors, officers, and shareholders [*Corp. Code § 200(c)*]. As a separate legal unit, a corporation has all the powers of a "natural person," including the rights to hold and to use property [*Corp. Code § 207(g)*], sue and be sued as an entity [*Corp. Code § 105*], and make contracts [*Corp. Code § 207(g)*]. However, likening a corporation's rights and powers to those of a natural person is confusing because a corporation's rights are not always coextensive with those of an individual [*see, e.g., First National Bank of Boston v. Bellotti (1978) 435 U.S. 765, 783-784, 98 S. Ct. 1407, 55 L. Ed. 2d 707* (corporations' *first amendment* rights broader than individuals); *see also Braswell v. United States (1988) 487 U.S. 99, 99, 108 S. Ct. 2284, 101 L. Ed. 2d 98* (*fifth amendment*)].

Corporations have a potentially unlimited duration. As a separate legal unit, a corporation's existence is not terminated by the withdrawal, death, or any other occurrence that might affect the directors, officers, or shareholders unless otherwise specified in its articles of incorporation [*Corp. Code § 200(c)*]. Although the death or unavailability of a key individual in a small corporation may make it practically impossible to continue the business, under other circumstances when the loss of one principal does not significantly alter the business, the corporate form with its perpetual life may be advantageous. However, the corporate form itself does not shield a corporation from actions taken to voluntarily or involuntarily dissolve or liquidate the corporation [*see Corp. Code §§ 1900-1907*; *see also Corp. Code §§ 1800-1809*].

In a close corporation, shareholders may bring about the dissolution of the corporation using methods not normally

available to shareholders with minority interests in regular corporations. The shareholder of a close corporation may file an action for dissolution no matter how many shares he or she owns [*Corp. Code § 1800(a), (b)*]; whereas in a regular corporation, at least one half of the directors or shareholders who own at least one third of the shares are required to file a petition for dissolution [*Corp. Code § 1800*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistenceBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionContinuationBusiness & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawSole Proprietorships



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
B. Nontax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.46

§ 1B.46 Compliance With Securities Laws

[1] General Partnership

A general partnership interest ordinarily is not deemed a security under the Corporate Securities Law of 1968 [*Corp. Code § 25019*; *see Corp. Code §§ 25000-25705*] or under the federal Securities Act of 1933 [*15 U.S.C. § 77b(a)(1)*; *see also 15 U.S.C. § 77a-77aa*]. However, under California law, if a partner is not actively involved in the business or if the sale of a partnership interest qualifies as an "investment contract," a general partnership interest may be a security subject to applicable security regulations [*Koch v. Hankins (9th Cir. 1991) 928 F.2d 1471, 1475-1476* ; *People v. Skelton (1980) 109 Cal. App. 3d 691, 713, 167 Cal. Rptr. 636 , cert. denied, 450 U.S. 917* ; *see Securities & Exchange Commission v. W.J. Howey, Co. (1946) 328 U.S. 293, 298-299* (definition of investment contract)].

All sales of partnership interests that are securities must meet federal registration and state qualification requirements, be eligible for a federal or state exemption, or not subject to qualification [*15 U.S.C. §§ 77c(a), 78c(a)(10)*; *Corp. Code §§ 25101-25105, 25110, 25120, 25130*].

[2] Limited Partnership

Because limited partners do not participate in the management and control of the business, a limited partnership interest ordinarily is deemed a security under state and federal regulations [*Corp. Code §§ 25000-25705*; *see Corp. Code § 25019* (definition of security); *see also People v. Woodson (1947) 78 Cal. App. 2d 132, 177 P.2d 586]* and by the federal Securities Act of 1933 [*15 U.S.C. §§ 77a-77aa*; *see 15 U.S.C. 77b(a)(1)* (definition of security); *see also SEC v. Murphy (9th Cir. 1980) 626 F.2d 633]* .

If a limited partnership interest is a security, it must be registered under the federal Securities Act of 1933 [*see 15 U.S.C. §§ 77a-77aa*] and qualified under the California Corporations Act of 1968 [*see Corp. Code §§ 25000-25705*], and other applicable acts in other states, as necessary, unless it is exempt from registration, or not subject to registration [*15 U.S.C. §§ 77c(a), 78c(a)(10)*] or qualification [*Corp. Code §§ 25101-25105, 25110, 25120, 25130*]. As a practical matter, all except very large limited partnership offerings normally are intentionally structured to take advantage of certain commonly used federal and state securities exemptions in order to avoid the more time-consuming and laborious

process of qualification or registration. The exemptions from registration under the federal Securities Act are numerous, the four most significant being the intrastate offerings exemption [*15 U.S.C. § 77c(a)(11)*], the limited offerings exemption for offerings up to $1 million [*17 C.F.R. § 230.504*], the limited offering exemption for offerings up to $5 million [*17 C.F.R. § 230.505*], and the private offering exemption [*17 C.F.R. § 230.506*]. For discussion of these exemptions, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* .

In California, certain issuer transactions involving 35 or fewer shareholders may be exempt under either the limited offering exemption [*see Corp. Code § 25102(f)*] or the small offering exemption [*see Corp. Code § 25102(h)*]. The limited offering exemption requires that (1) the sale of securities be limited to no more than 35 persons; (2) all purchasers have a preexisting personal or business relationship with the offeror; (3) each purchaser purchase for himself or herself, not for others; and (4) the offer and sale not be publicly advertised [*Corp. Code § 25102(f)*]. The criteria for a small offering exemption are more restricted than those of the limited offering exemption [*see Corp. Code § 25102(h)*]. For example, to be eligible to use the small offering exemption, a corporation may issue only one class of stock [*Corp. Code § 25102(h)*], whereas a limited offering exemption applies to almost any offer or sale of any security [*Corp. Code § 25102(f)*].

For discussion of some of the specific securities exemptions commonly relied on by limited partnerships in California, see Ch. 6B, *California Limited Offering Exemptions* , Ch. 6C, *California Small Offering Exemption* , and Ch. 6D, *California Qualified Purchaser Exemptions* .

[3] Limited Liability Company

Under California law, an LLC interest is included in the statutory definition of a security: the term "security" includes every interest in a LLC and any class or series of those interests (including any fractional or other interest in the LLC interest). A limited exception to this definition excludes a membership interest in an LLC in which the person claiming this exception can prove that all of the members are actively engaged in the management of the LLC. However, the statute provides that evidence that members vote or have the right to vote, to information concerning the business and affairs of the LLC, or to participate in management, does not establish, without more, that all members are actively engaged in the management of the LLC [*Corp. Code § 25019*]. As a practical matter, virtually all LLC interests are securities under California law and must be qualified unless exempt [*see [2], above*].

Under federal law, the determination of whether or not an interest is a security similarly involves an analysis of whether or not the interest holder actively participates in the business affairs of the issuing entity [*see 15 U.S.C. §§ 77b(a)(1), 78c(a)(10)* (investment contracts as securities)]. It is possible that a different result will be reached under state and federal law, such that an LLC interest may be a security for California purposes, but not for federal securities laws purposes.

[4] Corporation

The offer and sale of corporate stock are subject to the federal and state regulations discussed in *[1]* and *[2], above*. Also subject to securities law is the disclosure of investment information, as well as other activities related to making the offer [*see 15 U.S.C. §§ 77a-77aa*; *see also Corp. Code §§ 25000-25705*].

The offer and sale of stock in a small corporation usually will be tailored to assure that it meets one of several commonly used California exemptions from qualification [*see Corp. Code §§ 25102(f)* (limited offering exemption), *(h)* (small offering exemption), *(i)*, *(n)* (qualified purchaser exemptions)], and to comply with federal exemptions from registration under the federal securities laws. If the offer and sale does not qualify for one of the California exemptions, the offering will have to be "qualified" (approved for sale) before it can be offered or sold in California [*Corp. Code § 25110*]. For a general discussion of the California securities laws, see Ch. 6, *Securities Regulation Issues* . For discussion of some of the specific securities exemptions commonly relied on by nonpublic corporations in California,

see Ch. 6B, *California Limited Offering Exemptions* , Ch. 6C, *California Small Offering Exemption* , and Ch. 6D, *California Qualified Purchaser Exemptions* . Federal exemptions generally relied on by California nonpublic corporations are covered in Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* . Qualification of securities in California is discussed in Ch. 6H, *Qualification of Securities* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationPreincorporationGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsJoint Ventures & PartnershipsSecurities LawBlue Sky LawsSecurities RegistrationSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933DefinitionsSecurity



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
B. Nontax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.47

§ 1B.47 Cost Considerations

Although organizational costs are seldom determinative in choosing a business form, they may be a significant consideration for a small business and bear mentioning to all clients.

The costs of organizing and operating a business ordinarily depend more on the complexity of the business enterprise itself than on its form. However, some correlations between cost and form can be made. Generally, a sole proprietorship is the simplest and least costly to organize, because there are no formalities associated with the formation of this entity, which does not exist apart from its owner [*see* § 1B.25[1]].

A partnership is generally more expensive to organize than a corporation (although organizing a corporation may appear, at first, to be more complex than organizing a partnership because of the required statutory filings) simply because drawing up a partnership agreement, particularly a limited partnership agreement, is likely to be more time-consuming than preparing and filing standard corporate articles of incorporation and related forms. General partnerships must pay a fee for filing a statement of partnership [*Gov. Code § 12187(a)*], and limited partnerships must pay a fee for filing a certificate of limited partnership [*Gov. Code § 12188(b)*]. Limited partnerships and limited liability partnerships must pay an annual tax when they file their informational tax return [*Rev. & Tax. Code §§ 17851.5, 17935, 17948*; *see Rev. & Tax. Code §§ 23151, 23153*]. This tax is not deductible by the entity [*Rev. & Tax. Code § 17220(c)*].

Forming a limited liability company requires payment of a fee for filing the articles of organization [*Gov. Code § 12213*] and payment of an annual minimum franchise tax for the privilege of doing business in California [*Rev. & Tax. Code §§ 17941, 17942, 23151, 23153(d)*; *see § 1B.62[3]*].

Since limited partnership interests, LLC interests, and corporate shares ordinarily are considered securities [*Corp. Code § 25019*; *15 U.S.C. § 77b(a)(1)*], additional fees and expenses will be involved [*see Corp. Code §§ 25100, 25102(f), (h), 25608*; *see* Ch. 6, *Securities Regulation Issues*]. These expenses can range from minimal to very substantial depending on the available exemptions and other factors.

The costs of operating a business depend on the nature and complexity of the business venture and, thus, can vary

widely not only from one form to another but also within a single form. Costs associated with the formation, management and dissolution of a business, the possible need for specialized professional assistance, obtaining initial and additional capital and taxation should all be considered.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
B. Nontax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.48

§ 1B.48 Miscellaneous Considerations

[1] Traditional Forms for Certain Business Activities

Certain business activities have traditionally used certain forms. In those cases, consider the use of that form, since there is often a good reason behind a tradition. Even in cases when another organizational form appears preferable to the traditional one, consider the desire of the owner, who may be more comfortable using the traditional organizational form. For example, physicians in California have traditionally chosen to use a corporate form despite its lack of liability protection for malpractice [*see* § 1B.32[6]] and the possible tax disadvantages [*see I.R.C. § 11(b)(2)*; *see also* § 1B.104], while law firms in California have traditionally chosen to use the partnership form, despite the possible financial advantages of the using the corporate form.

[2] Complexity of Business

In general, the more complex a business, the more likely that the owners will select the corporate form. Several corporate characteristics, including the different levels of management and control, the continuity of existence of the business entity regardless of changes in organization or ownership, the availability of broader sources of capital, and the General Corporation Law often make the corporation the entity of choice for a complex business organization [*see § 1B.30[2]* for discussion of these characteristics].

In theory, a partnership's organization can be as complex as that of a corporation; however, the need to define its organizational structure and management and control in its partnership agreement and the tenuousness of its existence [*see* § 1B.35[2]], as well as other factors, tend to limit the use of the partnership form if the business is extremely complex.

A sole proprietorship is necessarily limited in its complexity by the fact that a single individual is responsible for its management and control [*see § 1B.10[1]*].

[3] Interstate Activity

A sole proprietorship may do business in states other than the state in which it was formed without formal qualification or registration of the business activity, since the business entity is not distinct from the person who owns it. Although qualification or registration is not required of the entity, a sole proprietorship may, nevertheless, be subject to licensing or other requirements.

A general partnership, like a sole proprietorship, generally is free from qualification and registration requirements, because it is considered to be an association of two or more persons to carry on a business as co-owners [*see* Uniform Partnership Act § 6(1); *see, e.g., Corp. Code § 16101(9)*]. However, like a sole proprietorship, a general partnership may be subject to licensing and other requirements.

A limited partnership is governed by the state statute and must comply with the statutory provisions of each jurisdiction in which it does business to protect the limited liability status of its limited partners. A limited partnership that does business in a foreign jurisdiction and ignores the statutes of that jurisdiction relating to limited partnerships risks exposing its limited partners to liability as general partners pursuant to the laws of the particular jurisdiction.

In general, before a limited liability partnership (LLP) may transact business in a state other than the one in which it is registered or otherwise organized, the LLP must apply for registration and comply with all statutory requirements [*see, e.g., Corp. Code § 16951 et seq.* (UPA '94)]. Under California law, a foreign LLP is governed by the law under which it is organized [*Corp. Code § 16958(a)(1)*].

In general, before a limited liability company (LLC) can carry on business in a state other than the one in which it is organized, it must register to do business as a foreign LLC [*see, e.g., Corp. Code §§ 17450-17457*]. Under California law, foreign LLCs are governed by the law under which they are organized [*Corp. Code § 17450(a)*].

In general, before a corporation can carry on business in a state other than the one in which it is incorporated, it must qualify to do business as a foreign corporation [*see, e.g., Corp. Code §§ 2101-2117.1*]. Qualification statutes vary from state to state, and although most require only a short form, payment of a qualification fee, and the designation of an agent for service of process within the state [*see, e.g., Corp. Code § 2101 et seq.*], these requirements make conducting business in foreign states as a corporation more burdensome than transacting business in foreign states as either a sole proprietorship or as a general partnership.

[4] Compliance

A sole proprietorship requires little in the way of compliance or housekeeping. Other than preparing and filing tax returns and filing and renewing any necessary fictitious business name statements [*Bus. & Prof. Code § 17900*], the recordkeeping requirements are the minimum necessary to adequately account for the operations of the business.

A general partnership, like a sole proprietorship, does not have statutory filing requirements other than informational tax returns and fictitious business name statements. However, as a practical matter, general partnerships must file a statement of partnership to obtain title insurance on real property owned by the partnership [*see Corp. Code §§ 16105, 16303*]. Further, the partnership agreement should require the preparation and retention of reports that must be provided to all of the general partners.

A limited partnership must file certificates of limited partnership at the appropriate time to protect the limited liability of the limited partners [*Corp. Code §§ 15621*, 15902.01; *see Corp. Code §§ 15622-15628, 15633*, 15902.01-15902.09, 15903.06]. If a limited partner discovers that the certificate has not been filed, that partner should cause an appropriate certificate to be signed and delivered to the Secretary of State for filing [*Corp. Code §§ 15633(a)*, 15903.06(a)]. The limited partnership agreement should identify the reports that will be provided to the limited partners by the general partners, and the time requirements for the preparation, retention, and distribution of those reports. Limited partners have to right to inspect and copy information required to be maintained by the partnership, and may be entitled to

additional information regarding the activities of the limited partnership [*see Corp. Code §§ 15615, 15634, 15901.11, 15903.04*; *see also* Ch. 16, *Formation of Limited Partnerships*].

Limited liability partnerships (LLPs) must comply with statutory filing requirements [*see, e.g., Corp. Code §§ 16953* (initial registration), *16954* (amended registration)] and continuously satisfy the statutory security requirements [*see Corp. Code § 16956*; *see also § 1B.15[5][b]*]. The failure to satisfy these requirements will result in the loss of the limited liability protection afforded by the LLP structure [*see Corp. Code §§ 16306(c)-(h), 16953* (UPA '94)]. For further discussion of LLPs, see Ch. 16C, *Limited Liability Partnerships* .

Limited liability companies (LLCs) must also comply with statutory recordkeeping and distribution requirements, which may involve considerable costs like that of a corporation. Statutory procedures for filing articles of organization and amendments [*see Corp. Code §§ 17050, 17054*] and biennial information statements [*see Corp. Code § 17060*] must be followed and filing fees paid to ensure limited liability [*see Gov. Code § 12190*]. LLCs must also maintain specified records of members and managers, and keep books and records as required by statute [*see Corp. Code § 17058*]. Meetings of members and managers must be noticed, conducted, and adjourned in the proper manner [*see Corp. Code § 17104*; *see* Ch. 12C, *Limited Liability Companies*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawSole Proprietorships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
B. Nontax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide §§ 1B.49-1B.59

[Reserved]

§§ 1B.49[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
C. Tax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.60

§ 1B.60 General Tax Considerations

The tax consequences of operating different forms of business will play an important role in selecting the appropriate form and can have a significant impact on business profits. The tax consequences of disposing of a business or of an owner's interest in a business can be significant, and the availability of and resulting tax consequences of fringe benefits will be influential. Although a complete discussion of the taxation of different forms of business is outside the scope of this chapter, the following income tax factors important to the determination of the most appropriate form for the business venture at hand will be considered:

- Types of business organizations for tax purposes.
- Taxation of the business entity and its owners or investors.
- Treatment of income and loss.
- Treatment of capital contributions.
- Disposition of the business or business interest.
- Income splitting.
- Other tax considerations, including the deductibility of start-up expenses; alternative minimum tax considerations; choice of tax year, *I.R.C. § 1244* stock; retirement plans and other fringe benefits.

The only effective way to evaluate whether organizing a business as a C corporation, as an S corporation, or as one of the noncorporate forms will produce an overall lower tax burden is to project the future income of the business venture and of its owners and investors (not limited to the activity under consideration) and make trial comparisons, taking into account the differences in tax rates and the possibility of double taxation.

For a more detailed discussion of the tax issues affecting various forms of business organization, including sales, property and local taxes, in addition to income taxes, see Ch. 1E, *Taxation of Businesses* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
C. Tax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.61

§ 1B.61 Types of Business Organizations for Tax Purposes

Federal law determines the classification of a business entity for tax purposes [*Treas. Reg. § 301.7701-1(a)*]. There are three basic categories into which business organizations fall for the purposes of taxation: trusts, partnerships, and corporations. Trusts refer to "ordinary trusts," which are arrangements formed for the protection and conservation of property and are not businesses conducted for profit [*see Treas. Reg. § 301.7701-4(a)*]. Partnerships include syndicates, groups, pools, joint ventures and other unincorporated associations that are not corporations, trusts, or estates for income tax purposes [*see I.R.C. § 761(a)*]. Corporations, for federal income tax purposes, include associations, joint stock companies, and insurance companies [*see I.R.C. § 7701(a)(3)*], as well as certain publicly traded partnerships [*see I.R.C. § 7704(a)*; *see also § 1B.15[3]*]. Finally, a sole proprietor pays income taxes on his or her sole proprietorship as an individual, rather than as a separate business entity [*see I.R.C. §§ 61(a), 62(a), 6017*]. This discussion will consider the following tax entities: individuals, partnerships, limited liability companies, and corporations.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsIncome Taxation of Estates, Trusts & BeneficiariesGeneral OverviewTax LawFederal Taxpayer GroupsIndividualsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
C. Tax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.62

§ 1B.62 Taxation of the Business Entity and its Owners or Investors

[1] Sole Proprietorship

A sole proprietor includes his or her profits (or losses) in personal income, and, in addition, pays a self employment tax, which is the self-employed person's social security tax [*I.R.C. §§ 61(a), 62(a)(1), 1401*].

[2] Partnership

A general or limited partnership, unlike a corporation, is not taxed as an entity separate from its owner [*I.R.C. § 701*]. It must file a separate, informational tax return on the basis of which the partners are taxed [*I.R.C. § 6031(a)*]. A partnership is merely a conduit, that "passes through" all partnership income, loss, gain, deductions, and credit items to its partners [*I.R.C. § 702(a)*]. Thus, the partners are taxed, as individuals, on their proportionate share of partnership profits, regardless of whether or not these profits are actually distributed [*see I.R.C. §§ 701-703*]. Partners are also permitted, as individuals, to deduct their share of partnership losses, subject to certain restrictions [*I.R.C. § 704(d)*].

Although neither a general, limited, or limited liability partnership is a separate taxable entity [*I.R.C. § 701*], limited and limited liability partnerships must pay a tax for the privilege of doing business in California when the entity files its state information return [*Rev. & Tax. Code §§ 17851.5, 17935, 17948*; *see Rev. & Tax. Code §§ 23151, 23153*]. Limited and limited liability partnerships must pay the tax when they are doing business in California and are required to file a California return, and, if they are not yet doing business, when they have executed, acknowledged, and filed with the Secretary of State [*Rev. & Tax. Code §§ 17935, 17948*; *see Rev. & Tax. Code §§ 17941, 23802(c)* (similar rule for LLCs and S corporations)]. This tax is not deductible by the entity [*Rev. & Tax. Code § 17220(c)*].

[3] Limited Liability Company

A limited liability company may elect to be taxed either as a corporation [*see [5], below*] or as a partnership [*see Treas. Reg. § 301.7701-3(a)*; *see also [2], above*]. California generally conforms to the federal entity classification rules under *Treas. Reg. § 301.7701-2* [*see Rev. & Tax. Code § 23038*; *see also* FTB *Notice 92-5*]. The classification of a business entity as an association taxable as a corporation is determined under FTB regulations, which must be consistent with the

federal regulations in effect on January 1, 1997, that classify a business entity as a partnership or an association taxable as a corporation, or disregard the separate existence of the business entity [*Rev. & Tax. Code § 23038(b)(2)(B)(i)*]. The classification of an eligible business entity as a partnership or an association taxable as a corporation is the same as the classification of the entity for federal tax purposes [*Rev. & Tax. Code § 23038(b)(2)(B)(ii)*]. However, if an eligible business entity was properly classified as an association taxable as a corporation for any income year beginning with the 60-month period preceding January 1, 1997, the entity continues to be an association taxable as a corporation until it elects to be classified the same as the entity is classified for federal purposes; this rule does not apply to any entity that was not doing business in California, did not derive income from California, and had no California resident owner during the 60-month period preceding January 1, 1997 [*Rev. & Tax. Code § 23038(b)(2)(C)*].

It is likely that most LLCs will seek partnership tax treatment, in which the LLC is merely a pass-through entity for tax purposes [*see § 1B.13*]. If an LLC elects to be taxed as a corporation, however, income will be taxed at the entity and member levels [*see Rev. & Tax. Code §§ 23038, 23151*; *see also [5], below*].

If the LLC elects to be taxed as a partnership, LLC income is not taxed at the entity level; rather, items of income, loss, gain, deductions, and credit pass through and are subject to taxation at the member level [*see Treas. Reg. § 301.7701-3*; *I.R.C. § 702(a)*]. However, an LLC classified as a partnership, like limited and limited liability partnerships and S corporations, must pay the annual minimum franchise tax [*Rev. & Tax. Code §§ 17851.5, 17935, 17941, 17948, 23151, 23153, 23802(c)*], unless the LLC is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* [*see Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; *see also I.R.C. § 501(c)(2), (25)* (title holding companies)].

LLCs subject to the franchise tax, LLCs taxed as partnerships as well as LLCs subject to corporate taxation, must also pay a graduated annual fee based on income of $250,000 or more from all sources requiring California reporting [*Rev. & Tax. Code § 17942*]. However, an LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax, and thus not subject to this annual fee [*see Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; *see also I.R.C. § 501(c)(2), (25)* (title holding companies)].

The LLC must file a separate, informational tax return with both the state and federal taxing authorities to report income, deductions, gains, losses, credits, and similar items [*Rev. & Tax. Code § 18633.5*; *see I.R.C. § 6031*; Treas. Reg. § 1.6031-1(a)]. The California return also establishes that the minimum franchise tax has been paid and whether or not any annual fee based on total income is due and payable [*Rev. & Tax. Code §§ 17941, 17942, 18633.5*]. For further discussion of LLC taxation, see Ch. 12C, *Limited Liability Companies* .

[4] S Corporation

Like partnerships and most LLCs [*see [2], [3], above*], an S corporation generally is not taxed at the corporate level, but passes through profits and losses to its owners, subject to various restrictions [*I.R.C. § 1363(a)*; *see I.R.C. §§ 1361-1379*; *see also §§ 1B.31[4], 1B.63[2][d]*]. S corporations are not subject to the alternative minimum tax [*Rev. & Tax. Code § 23400(b)*]. However, S corporations are subject to the annual minimum franchise tax [*Rev. & Tax. Code §§ 23151, 23153, 23802(c)*] and a 1.5 percent tax on net income at the corporate level [*Rev. & Tax. Code §§ 23800, 23802(b)*]. Corporations that incorporate or qualify to do business in California after January 1, 2000, are not subject to the minimum franchise tax for the first taxable year, unless the corporation reorganized solely to avoid payment of the minimum franchise tax [*Rev. & Tax. Code § 23153(f)* (exemption inapplicable to qualified Subchapter S subsidiaries)].

[5] C Corporations

C corporations; that is, corporations that have not elected to be taxed as S corporations [*I.R.C. § 1361(a)*], are subject to double taxation on income: the corporation pays a separate tax on earnings, and shareholders then pay a second tax on

dividends and appreciated property distributions [*I.R.C. §§ 1, 11, 61(a)(7), 301, 316*; *see I.R.C. § 1(h)(11)*; (federal taxation of qualified dividends at capital gains rates) *Rev. & Tax. Code §§ 23038, 23151, 23153* (annual minimum franchise tax); *see also § 1B.30[2][f]*]. However, corporations that incorporate or qualify to do business in California after January 1, 2000, are not subject to the minimum franchise tax for the first taxable year, unless the corporation reorganized solely to avoid payment of the minimum franchise tax [*Rev. & Tax. Code § 23153(f)(1), (3)*]. The use of the sole proprietorship, partnership, limited liability company, or S corporation form avoids the corporation's double taxation on business income.

The maximum corporate tax rate may or may not be less than the federal tax rate imposed on the individual shareholders. If it is lower, incorporation as a C corporation may be advantageous. The maximum individual tax rate is 35 percent after 2005 [*I.R.C. § 1(a)-(d), (i)(2)*]. In contrast, the maximum federal tax rate for taxable income between $75,000 and $10 million is 34 percent. For taxable income over $10 million, the maximum corporate tax rate is 35 percent [*I.R.C. § 11(b)(1)*]. An additional 5 percent tax is imposed on corporate taxable income exceeding $100,000, with an $11,750 cap on additional tax liability. This causes an effective tax rate of 39 percent on taxable income between $100,000 and $335,000. A 3 percent additional tax is imposed on corporate taxable income exceeding $15 million, with a $100,000 cap on additional tax liability. This causes an effective tax rate of 38 percent on corporate taxable income between $15 million and $18,333,333. Corporate taxable income over $18,333,333 is subject to a tax rate of 35 percent [*I.R.C. § 11(b)(1)*]. However, offsetting the potential tax rate advantage to incorporating, and ignoring the double taxation issue, is the differential in capital gain tax rates. The maximum individual rate applicable to capital gains (generally 15 percent [*I.R.C. § 1(h)(1)*, effective generally for tax years ending on or after 5/16/03 and before 2009; *see* Pub. Law No. 108-27, §§ 301, 303]) is significantly lower that the maximum individual and corporate tax rates. [*I.R.C. §§ 1(a)- (d), (h), (i)(2), 11*]. Corporations are not eligible for this special capital gains tax rate [*I.R.C. §§ 1(h), 11, 1201(a)*]. Therefore, if sizeable net capital gain is anticipated, the corporate form may be disadvantageous.

Personal service corporations are not eligible for the graduated federal corporate income tax rates. These corporations are taxable at a flat rate of 35 percent [*I.R.C. § 11(b)(2)*]. Thus, taxable income of a corporation that performs services in the fields of health, law, engineering, architecture, accounting, actuarial sciences, performing arts, or consulting is taxed at a flat 35 percent rate on all taxable income [*I.R.C. §§ 11(b)(2)*; *see I.R.C. § 448(d)(2)* (definition of qualified personal service corporation)].

Although there are many ways to minimize the effect of the double taxation of corporate income [*see § 1B.63[2][d]*], and there may remain some tax advantages to incorporating in order to split income between the corporation and its owners and, thus, pay a lesser amount of combined tax [*see § 1B.113*, P 3e], as well as nontax advantages, the double taxation and rate differentials have made the noncorporate forms of business organization, the sole proprietorship, the partnership, the LLC, or the S corporation, considerably more attractive.

The California state tax rate for corporations (excepting banks and financial corporations [*see Rev. & Tax. Code §§ 23181, 23183*]) is 8.84 percent [*Rev. & Tax. Code § 23151(e), (f)*]; the state tax rate for individuals is 9.3 percent [*Rev. & Tax. Code § 17041(a)(1)*; *but see Rev. & Tax. Code § 17041(a)(2)* (possible temporary additional rate component)]. However, because of the significantly higher federal tax rates, federal income tax considerations, rather than state, dominate the tax planning aspects of entity selection. California also imposes an alternative minimum tax (AMT) on corporations at the rate of 7 percent [*Rev. & Tax. Code §§ 23400, 23455-23459*] that generally follows the federal corporate AMT [*I.R.C. §§ 55-59*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsIndividualsGeneral OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
C. Tax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.63

§ 1B.63 Treatment of Income and Loss

[1] Choice of Business Form--In General

Every business anticipates making a profit; however, a loss may result from expenses exceeding income during the early years of the business or from a "paper" tax loss, a loss resulting from depreciation or other non-cash expenses [*see I.R.C. § 167*]. Even when businesses are profitable from year one, some businesses will be required to reinvest a substantial portion of their earnings, whereas other businesses will want to distribute a substantial portion of their earnings to their owners as is usually the case when the owner provides the business service.

The following subsections discuss the taxation of income and the deductibility of losses for sole proprietorships, partnerships, limited liability companies, S corporations, and C corporations. The differences in tax treatment may significantly affect the initial choice of business form.

[2] Taxation of Income

[a] Sole Proprietorship

In a sole proprietorship, the owner includes net business income in personal income and pays tax accordingly; the owner does not pay a separate income tax on the business' net profit [*I.R.C. §§ 61(a), 62(a)(1)*]. However, net profits of $400 or more are subject to a self-employed social security tax, which is calculated on and paid with the individual income tax form [*I.R.C. §§ 1401, 1402(b)(2), 6017*].

Business deductions that reduce business income must be ordinary and necessary business expenses; no other deductions are permitted [*see I.R.C. § 162*].

In actual practice, taxation of income of a sole proprietorship is essentially the same as the taxation of a partnership [*I.R.C. § 61(a)(2), (13)*]. A significant difference, however, is that partners in a partnership may allocate income (as well as gain, loss, deductions, and credits) in a percentage that differs from the partner's percentage of capital contributions, provided that there is substantial economic effect to the allocation [*I.R.C. § 704(a), (b)*; *Treas. Reg. 1.704-1(b)(2)(i)*]. In

contrast, a sole proprietor, as sole owner, must necessarily report all income (as well as gain, loss, deduction, or credit) on his or her individual income tax return [*I.R.C. §§ 61(a), 62(a)(1)*].

[b] Partnership

Because a partnership acts as a conduit, passing through items of income (as well as gain, loss, deductions, or credit) to its partners, an individual partner's income from the partnership is taxed according to the rules that govern the taxation of individuals [*I.R.C. § 701*; *see I.R.C. § 61(a)(13)*]. Further, some items, charitable contributions and investment interest and expense, for example, pass through directly to the individual partners without first being used in the computation of partnership income or loss [*I.R.C. § 702(a), (b)*]. Each partner must include his or her share of income (and other partnership items) on his or her individual return, regardless of whether the items, or their cash equivalent, are actually distributed to the partner [*I.R.C. §§ 702(a), 704(b)*].

Guaranteed payments made to a partner, as well as other income received, are considered to be self-employment income and are subject to self-employment tax [*I.R.C. § 1402(a)(5)(A), (B)*].

[c] Limited Liability Company

The principal advantage of an LLC taxed as a partnership over a corporation [*see [e], below*] is, that as a pass-through entity, LLCs avoid double taxation of income [*I.R.C. §§ 1, 11, 701*; *Rev. & Tax. Code §§ 23038, 23151*; *see [e], below*]. However, because of the possibly higher rates applicable to individuals, tax transparency may or may not be a significant benefit [*I.R.C. §§ 1, 11*; *see § 1B.62[5]*].

The principal advantage of an LLC taxed as a partnership over other pass-through entities, such as partnerships and S corporations, is that the profits and losses of the LLC can be reallocated among the members (or classes of members), within IRS restrictions, pursuant to the operating agreement. If the agreement does not provide to the contrary, profits and losses are allocated in proportion to the contributions of the members [*Corp. Code § 17202*]. In contrast, S corporation shareholders report a pro rata share, based on their shares, of the corporation's income and loss [*I.R.C. § 1366(a)*].

Similar to partners and S corporation shareholders who receive compensation for services, LLC members actively engaged in management must pay self-employment tax on the net amount exceeding $400 [*see I.R.C. §§ 1402, 6017*].

[d] S Corporation

The tax law governing the taxation of S corporation shareholders is generally the same as the law governing the taxation of partners, with regard to items of partnership income and loss. Each S corporation shareholder reports his or her proportionate share of income (as well as gain, loss, deduction, or credit) on his or her individual income tax returns [*I.R.C. § 1366(a)*]. In addition, like partners who receive guaranteed payments, S corporation shareholders who receive compensation in exchange for services, without being actual employees of the corporation, must pay self-employment tax on the net amount exceeding $400 [*see I.R.C. §§ 1402, 6017*; *see also Ding v. Commissioner (9th Cir. [T.C.] 1999) 200 F.3d 587, 588-590* (holding that S corporation pass-through losses are not properly included in determining self-employment tax liability)].

[e] C Corporation

[i] Double Taxation

The significant disadvantage of a corporation is its double taxation: the corporation pays income tax on its net income [*I.R.C. § 11(a)*]; its shareholders pay tax on the corporate dividends distributed to them [*I.R.C. §§ 1(h)(1), 61(a)(7), 301, 316*]. Double taxation of dividends is less of a concern during years in which dividends are taxable at lower capital

gains rates (generally tax years beginning after December 31, 2002, and before January 1, 2009), but still is a disadvantage to the corporate form if corporate earnings are distributed as dividends [*I.R.C. § 1(h)(11)*; *see* Pub. Law No. 108-27, §§ 302(f)(1), 303 (effective date and sunset provisions for dividend taxation at capital gains rates)]. There are various tax planning devices that might mitigate the impact of double taxation by reducing dividend distributions that are not deductible by the corporation [*I.R.C. §§ 301, 562*], and by making payments to shareholders which can be deducted by the corporation from its taxable income. These payments include deductible payments to shareholders as compensation [*I.R.C. § 162(a)(1)*], as rent [*I.R.C. § 162(a)(3)*], or as interest on loans from shareholders [*I.R.C. § 163(a)*]. In addition, organizing a corporation as a "thin corporation" with a maximum of debt and a minimum of equity can help reduce the impact of double taxation by allowing the corporation to deduct, as interest, the amounts distributed by the corporation with respect to its debt instruments, whereas distributions of profits would otherwise be nondeductible dividends [*see I.R.C. §§ 385, 301, 316*].

[ii] Penalty Taxes--In General

Because C corporations are subject to double taxation, one way to avoid the second tax on dividends at the shareholder level would be to retain, in the corporation, the amount that would otherwise have been paid out as dividends. To prevent this situation, penalty taxes, including the accumulated earning tax and the personal holding tax, have been imposed on corporations [*see United States v. Donruss Co. (1969) 393 U.S. 297, 89 S. Ct. 501, 21 L. Ed. 2d 495* ; *see also I.R.C. §§ 531, 532, 541*].

[iii] Penalty Tax on Personal Holding Company

A personal holding company is a closely held corporation in which five or fewer individuals own more than 50 percent of the corporation's outstanding stock [*I.R.C. § 542(a)(2)*] and at least 60 percent of the corporation's income comes from passive sources, such as dividends, interest, rents, royalties, annuities, and personal service contracts [*I.R.C. § 542(a)(1)*; *see I.R.C. § 543* (complete list of sources)]. A corporation that is classed as a personal holding company must pay a 15 percent penalty tax [*I.R.C. § 541*, effective for tax years beginning after 12/31/02 and before 1/1/09; *see* Pub. Law No. 108-27, §§ 302(f)(1), 303)]. For other tax years, the tax rate is the highest rate of tax imposed under *I.R.C. § 1(c)* [*I.R.C. § 541*, before amendment by Pub. Law No. 108-27]. The tax is imposed on undistributed personal holding company income, in addition to the other taxes [*I.R.C. § 541*].

[iv] Penalty Tax on Accumulated Earnings

The accumulated earnings tax [*I.R.C. §§ 531-537*] is another penalty tax imposed on corporations that accumulate earnings above their reasonable business needs for the purpose of avoiding the income tax imposed on shareholders if the earnings were distributed as dividends [*I.R.C. §§ 532(a), 533*; *see I.R.C. § 532(b)* (exceptions)]. The accumulated earnings tax will not be imposed until accumulated earnings exceed $250,000, or $150,000 for personal service corporations or corporations whose principal business is in the field of health, law, engineering, accounting, actuarial science, performing arts, or consulting [*I.R.C. § 535(c)(2)*]. The tax is seldom imposed on corporations that reinvest their earnings in the business, even if those reinvested earnings exceed the above-mentioned amounts [*I.R.C. § 537*; *Treas. Reg. §§ 1.537-1, 1.537-2*]. It is imposed, in practice, when liquid assets are not directly used in the business and when tax avoidance is one of the purposes for accumulating the assets [*Ivan Allen Co. v. United States (1975) 422 U.S. 617, 95 S. Ct. 2501, 45 L. Ed. 2d 435]* . The penalty tax, if imposed, is 15 percent [*I.R.C. § 531*, effective for tax years beginning after 12/31/02 and before 1/1/09; *see* Pub. Law No. 108-27, §§ 302(f)(1), 303)]. For other tax years, the tax rate is the highest rate of tax imposed under *I.R.C. § 1(c)* [*I.R.C. § 531*, before amendment by Pub. Law No. 108-27]. The tax is imposed on the corporation's accumulated taxable income [*I.R.C. § 531*].

[3] Deductibility of Losses

[a] Sole Proprietorship

The general rule is that a sole proprietor may deduct business losses from other income [*I.R.C. § 62(a)(1)*]. However, there are two notable restrictions. First, the sole proprietor may not deduct losses in an amount greater than he or she has at risk in the business [*see I.R.C. § 465*]. Generally, the at-risk rules allow an individual to deduct losses only to the extent of the amount at risk [*I.R.C. § 465(a)(1)*]. The amount at risk includes the business' contributed capital and the business owner's recourse liabilities [*I.R.C. § 465(b)(1)- (3)*]. The amount at risk that applies to real estate includes certain qualified nonrecourse financing, in addition to capital contributed and recourse liabilities [*I.R.C. § 465(b)(6)*]. Unallowed losses are, in most cases, allowed on disposition of the business [*see I.R.C. § 465*]. Second, the business venture must be engaged in for profit [*see I.R.C. §§ 183(c), 262*]. If the business activity is not pursued with a profit motive, the Internal Revenue Service may recharacterize it as a hobby, thereby limiting the activity's deductions to an amount not to exceed its income [*I.R.C. § 183(b)*; *see I.R.C. § 183* (hobby loss rules)].

[b] Partnership

A partner may deduct his or her share of partnership losses, should partnership operations result in a loss, from other income on his or her individual income tax return [*I.R.C. §§ 701, 702(a)(8)*]. However, losses are deductible only to the extent of the adjusted basis of the partner's interest at the end of the partnership year in which the loss occurs [*I.R.C. § 704(d)*]. Any unused loss is deductible in a year in which the partner's interest in basis is reestablished [*I.R.C. § 704(d)*]. In addition, a partner's ability to offset income from other sources is further limited by the passive loss rules [*see I.R.C. § 469*]. These rules generally restrict the use of losses from passive activities to offset income from passive activities, rather than income from wages. A passive activity is an activity involving a trade or business in which the taxpayer does not materially participate [*I.R.C. § 469(c)*]. Because a limited partner does not materially participate in the management and control of the business, a limited partner whose distributive share from the partnership results in a loss may not use this loss to offset his or her income from wages [*see I.R.C. § 469(c), (h)*].

[c] Limited Liability Company

Most limited liability companies will seek partnership tax treatment. Under partnership tax rules, LLC members may deduct their share of LLC losses from other income on his or her individual income tax return [*I.R.C. §§ 701, 702(a)(8)*], to the extent of the adjusted basis of the member's interest at the end of the year in which the loss occurs [*I.R.C. § 704(d)*]. Any unused loss is deductible in a year in which the member's interest in basis is reestablished [*I.R.C. § 704(d)*].

A member's ability to offset income from other sources may be further limited by the passive loss rules [*see I.R.C. § 469*], which generally restrict the use of losses from passive activities to offset income from passive activities, rather than income from wages. A passive activity is an activity involving a trade or business in which the taxpayer does not materially participate [*I.R.C. § 469(c)*]. If the member does not materially participate in the management and control of the business, a member whose distributive share from the partnership results in a loss may not use this loss to offset his or her income from wages [*see I.R.C. § 469(c), (h)*].

[d] S Corporation

S corporation shareholders may deduct losses from the business activity against their other income, subject to the passive loss limitations [*see I.R.C. § 469*] and the at-risk rules [*I.R.C. § 465(c)(3)(B)(ii)*]. However, the amount of deductible loss is also limited by the amount of the shareholder's adjusted basis in the S corporation's stock and the shareholder's adjusted basis of loans made to the corporation by the shareholder [*I.R.C. § 1367*]. As with partnerships, losses that are not deductible in a current year can be carried forward and deducted in any subsequent year in which the shareholder has an adequate adjusted basis in either shares or indebtedness [*I.R.C. § 1366(d)*].

The basis of an S corporation shareholder's interest is calculated in a significantly different way from that used by a partner to determine the basis of his or her partnership interest. Unlike a partner in a partnership, when an increase or

decrease of partnership liabilities results in a corresponding proportionate increase or decrease in the partner's basis in his or her partnership interest [*see I.R.C. § 752*], an S corporation shareholder may not include his or her share of corporate liabilities in basis, for determining the amount of deductible loss [*I.R.C. § 1366(d)*]; only loans from the shareholder to the corporation may be added to the shareholder's basis [*I.R.C. § 1366(d)(1)(B)*]. Therefore, S corporation shareholders who personally guarantee a bank loan to the corporation will not benefit by a proportionate increase in basis [*see I.R.C. § 1366(d)(1)(B)*], unless the lender relies primarily on the shareholder for repayment of the loan [*see Selfe v. United States (11th Cir. 1985) 778 F.2d 769*].

[e] C Corporation

In contrast to losses of partnerships and S corporations that pass through to owners, subject to certain limitations, losses of a C corporation do not pass through and are not deductible by the shareholders [*I.R.C. §§ 172, 1212*]. These losses may be carried forward as net operating losses, to be used by the corporation when it has a net profit [*I.R.C. § 172*]. Losses are also limited by the at risk rules, if the C corporation is a closely held corporation [*I.R.C. § 465(a)(2)*], and by the passive activity loss limitations, if the C corporation is a personal services corporation or a closely held corporation [*I.R.C. § 469(a)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsAccumulated Earnings Tax (IRC secs. 531-537)General OverviewTax LawFederal Taxpayer GroupsIndividualsBusiness Deductions (IRC secs. 62, 63, 162)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsComputation of Income & Loss (IRC secs. 1366, 1371-1375)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
C. Tax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.64

§ 1B.64 Treatment of Capital Contributions

[1] In General

Whether or not a transfer of property to a business is a taxable event, either at its formation or subsequently, is probably not the deciding factor in choice of form. However, an understanding of this aspect of the tax law is integral to making a well-informed choice of business entity.

[2] Sole Proprietor

In general, a sole proprietorship may be formed without tax consequences, because a sole proprietorship is not an entity distinct from its owner. Property may also be transferred without tax consequences to a sole proprietorship subsequent to formation for the same reason [*see I.R.C. § 62(a)(1)*]. However, it is a good idea for accounting and tax reporting purposes to distinguish assets that are dedicated to the business from assets used personally.

[3] Partnership and Limited Liability Company

A partnership or LLC may be formed with or without tax consequences, depending on whether a partner pr member exchanges property or services for a partnership interest [*see I.R.C. §§ 83, 721, 707*]. No gain or loss is recognized by the partner, member, or entity on the transfer of property to a partnership or LLC in exchange for a partnership or membership interest [*I.R.C. § 721(a)*], regardless of whether the property is contributed at the time of formation or at a later date [*I.R.C. § 721(a)*]. However, any deferred gain or loss on the property transferred is ultimately allocated to the contributing partner or member when gain or loss is recognized [*I.R.C. § 704(c)*].

Nonrecognition rules do not apply if a partner or member contributes property whose liabilities are assumed by the entity [*I.R.C. § 752*], or if a partner or member exchanges services for a partnership or membership interest (as opposed to a profits interest) [*I.R.C. §§ 83(a), 707(c)*; *see Rev. Proc. 93-27, 1993-2 C.B. 343* ; *see also Treas. Reg. § 1.721-1(b)(2)*]. If the liability on contributed property is assumed by the entity, the partner or member will recognize gain on the amount the liability assumed by the entity to the extent that it exceeds the adjusted basis in the property, because the transaction is treated as though the partner or member received a distribution of money from the entity [

I.R.C. §§ 731(a), 741]. If a partner or member exchanges services for an unrestricted capital interest in the partnership or LLC, the partner or member will be taxed on the fair market value of the partnership or membership interest at the time of receipt, and the entity will be treated as having made a guaranteed payment to the partner or member [*Treas. Reg. § 1.721-1(b)(2)*; *U.S. v. Frazell (5th Cir. 1964) 335 F.2d. 487 , cert. denied, 380 U.S. 961* ; *see also I.R.C. § 707(c)*]. If the partnership or membership interest received is nontransferable and is subject to substantial risk of forfeiture, the partner or member is not required to include any amount in income, until that interest either becomes transferable or is no longer subject to substantial risk of forfeiture, whichever happens first [*I.R.C. § 83(a)*]. Special rules govern the timing of a deduction for the partnership or LLC under these circumstances [*see I.R.C. § 83(h)*].

The basis of property contributed to a partnership or LLC in a nonrecognition transaction remains generally the same as if no transfer had been made with regard to unrealized appreciation or depreciation taken [*I.R.C. §§ 721, 723*]. A partner's or member's basis in a partnership or membership interest includes the adjusted basis of contributed property, the fair market value of services performed by the partner or member for the entityp, and the amount of money contributed [*I.R.C. § 722*].

Under certain circumstances, a partner or member may wish to recognize gain or loss at the time property is contributed to the entity. This may be accomplished by structuring the transfer as a sale [*see I.R.C. §§ 707, 1001*]. However, neither a partner nor a member is entitled to a loss deduction if the sale or exchange of property (other than an interest in a partnership) takes place between the entity and a person owning more than a 50 percent capital interest in the entity [*I.R.C. § 707(b)(1)*]. The advantage to a partnership or LLC that purchases property with a fair market value higher than its adjusted basis is that depreciation deductions will be greater than if it had received the same property in a nonrecognition transaction [*see I.R.C. § 167*; *cf. I.R.C. § 723* (basis of property contributed under *I.R.C. § 721(b)*)]. The partnership or LLC will ultimately recognize gain or loss when the property is sold or exchanged [*see I.R.C. §§ 1001(a), 1001(b)*; *see also I.R.C. § 704(c)*].

[4] C Corporation

Like a partnership or a limited liability company, a C corporation may be formed with or without tax consequences. However, because a corporation is a separate legal entity, the laws governing transfers to corporations are more complex than those governing transfers to partnerships and limited liability companies.

In general, a shareholder may transfer property to a C corporation in exchange for shares without tax consequences if property is transferred to the corporation only in exchange for stock and the corporation is controlled by 80 percent of the transferring shareholders immediately after the transaction [*I.R.C. § 351(a)*]. The usual result of this rule is that initial transfers to corporations are tax free, as are initial and subsequent contributions by the initial shareholders, although subsequent transfers by new shareholders are taxed unless they can bring the transaction within the nonrecognition rules [*I.R.C. § 351*]. The transfer of property by a shareholder to a corporation under *I.R.C. § 351* is generally a nontaxable transaction because the exchange is considered to be merely a change in form of investment [*I.R.C. § 351*]. However, if the contributing shareholder receives "boot," money, or other property from the corporation in addition to stock, the shareholder recognizes gain on that amount [*I.R.C. § 351(b)*].

The basis of stock received by a shareholder in exchange for property will be the same as the adjusted basis of the contributed property [*I.R.C. § 358(a)*]; the basis to the corporation of any property contributed by a shareholder is the adjusted basis of the property in the shareholder's hands at the time of contribution [*I.R.C. § 362(a)*].

Services performed by a shareholder in exchange for stock are not considered property [*I.R.C. § 351(d)(1)*]. Therefore, a shareholder who receives shares in exchange for services will recognize gain related to this transaction unless the shares are subject to substantial risk of forfeiture and to restrictions on transfer [*see I.R.C. §§ 83(b), 351(d)(1)*]. The corporation itself recognizes no gain if shares are exchanged for services; rather, the corporation may deduct the fair market value of the transferred shares as the equivalent of deductible salary expense [*I.R.C. § 162(a)*].

Under certain circumstances, a taxable corporate formation may be advantageous. This effect may be accomplished by selling the assets to the corporation, or by exchanging property and cash for shares. Under these circumstances, a shareholder recognizes gain or loss from the sale or exchange [*see I.R.C. § 1001*]. However, the corporation itself recognizes no gain or loss on an exchange of its own stock for money or other property [*I.R.C. § 1032(a)*]. This rule applies whether or not the exchange qualifies for nonrecognition treatment under *I.R.C. § 351* [*I.R.C. § 1032(a)*]. Although no gain or loss is recognized on the transfer of property to the corporation, gain or loss is recognized by the corporation on the disposition of the asset [*see I.R.C. § 1001*]. Similarly, gain or loss is also recognized by a shareholder when he or she disposes of the stock received in exchange for property [*see I.R.C. § 1001*].

Capital contributions made subsequent to formation, by either shareholders or nonshareholders, are excluded from the corporation's gross income [*I.R.C. § 118(a)*], provided that the contributions are not made in return for goods or services received [*Treas. Reg. § 1.118-1*]. For shareholders, capital contributions of cash results in increased adjusted basis equal to the stock received in exchange [*I.R.C. § 1012*]. Capital contributions of noncash property may result in gain to the shareholder on the exchange, unless the nonrecognition rules of *I.R.C. § 351* can be met [*see I.R.C. §§ 351, 1012*].

[5] S Corporation

Like a C corporation, an S corporation may be formed with or without tax consequences, under the rules that apply to C Corporations [*see I.R.C. § 351*; *see also [4], above*]. However, the effect of gain or loss recognized on the disposition of an asset by a corporation differs if the disposing corporation is an S corporation. Although the deferred gain is still taxed to the corporation [*see I.R.C. § 1001*], any gain in an S corporation is taxed directly to the shareholders, in proportion to their interests, thus relieving the contributing shareholder of bearing the entire tax burden [*see I.R.C. § 1367(a)(1)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Stock & Stock RightsTax LawFederal Taxpayer GroupsS CorporationsBasis (IRC secs. 1361, 1367)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
C. Tax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.65

§ 1B.65 Disposition of Business or Business Interest

[1] Sale

[a] In General

It is sometimes said that the best choice of entity is one that is easy to convert to another form of business or that can be disposed of in the least expensive manner. Although conversion and disposition issues are not usually concerns for the client when organizing a new business venture, they should play a significant role in determining the initial choice of form.

The tax differences related to dispositions of business assets and business interests for the different entities generally reflect the differences between pass-through entities and C corporations that pay a separate tax. Taxable dispositions of sole proprietorships, partnerships, LLCs, and S corporations generally result in a single tax [*I.R.C. §§ 61(a), 702, 705, 1366*], while taxable dispositions of a C corporation are taxed first at the corporate level, with the shareholder generally paying a tax on receipt of the distribution [*I.R.C. §§ 11(b), 61(a)(7), 301, 316*].

Furthermore, reorganization of a business is an area in which the corporate form (including both C and S corporations) may have important advantages over noncorporate forms. If a corporation is reorganized rather than liquidated, neither the old corporation nor its shareholders ordinarily recognize gain (unless boot is involved) [*see I.R.C. § 368*]. However, the bases of the assets of the old corporation, as well as other attributes, carry over to the new corporation [*I.R.C. § 362(a)*], generally at a value less than their fair market value, so that if the new corporation sells those assets, it will likely pay more in capital gains than it would had it purchased the assets at fair market value [*see I.R.C. § 1001*]. For the tax treatment of corporate reorganizations, see *I.R.C. §§ 351, 354, 361* and *368* [*I.R.C. §§ 351, 354, 361, 368*; *see* Ch. 11, *Merger and Acquisition Issues*].

[b] Sole Proprietorship

On the sale of a sole proprietorship, each business asset is treated separately, according to the nature of the asset. Thus, even if the entire business is sold for a single price, the price of the business must be allocated among its assets [

Williams v. McGowan (2d Cir. 1945) 152 F.2d 570] .

[c] Partnership

When an individual partner sells his or her partnership interest, the partner realizes capital gain or loss, subject to the restrictions of *I.R.C. § 751* [*I.R.C. § 741*]. Proceeds from the sale of unrealized receivables or inventory are treated as a noncapital asset [*I.R.C. § 751(c), (d)*] and, consequently, as ordinary income or ordinary loss [*I.R.C. § 751(c), (d)*]. The maximum individual tax rates for ordinary income are higher than the capital gains tax rate 15 percent [*I.R.C. § 1(h)(1)*, effective generally for tax years ending on or after 5/16/03 and before 2009; *see* Pub. Law No. 108-27, §§ 301, 303]. In addition, ordinary losses are not subject to the limitations that apply to capital losses [*I.R.C. §§ 1(a)- (d), (h), (i)(2), 165, 1211*]. However, a partner does not recognize any gain unless the money or property received exceeds the partner's basis in the partnership interest (or unless certain items of inventory or unrealized receivables are received, under the rules of *I.R.C. § 751*) [*I.R.C. §§ 731, 751*].

When a partnership is disposed of, the partnership pays no tax [*I.R.C. § 731(b)*]. Any gain or loss on disposition is taxed directly to the partners, whose partnership interests will be adjusted accordingly [*see I.R.C. §§ 701, 702*; *Treas. Reg. § 1.702-1*].

The disposition of a partnership may have no immediate tax consequences if it constitutes a transfer to a controlled corporation [*see I.R.C. § 351*]. However, such a transfer is a reorganization, rather than a disposition, only if the transferor-partners are in control of the corporation [*I.R.C. §§ 351(a), 368(c)*]. In addition, a partnership may merge or consolidate with another partnership without recognizing either gain or loss, if the transaction qualifies under *I.R.C. § 708* [*I.R.C. § 708*; *see Rev. Rul. 90-17, 1990-1 C.B. 119*]. For further discussion, see Ch. 15, Part C, *Conversion and Mergers ofGeneral Partnerships* .

[d] Limited Liability Company

Most LLCs will be structured as pass-through entities to take advantage of a single level of taxation under the partnership tax rules [*see [c], above*]. However, some LLCs will be unable to secure partnership-like taxation (and be taxed as an association taxables as a corporation) or for other reasons actively seek corporate tax treatment [*see [e], below*].

[e] Corporation

[i] Sale of Stock

Both C and S corporation shareholders ordinarily recognize capital gain or loss on the sale of their corporate stock [*I.R.C. § 1001*]. For tax years beginning before January 1, 2003 and after December 31, 2008, the shareholders of a collapsible corporation are taxed at ordinary income rates on their gain, rather than at capital gain rates [*I.R.C. § 341*, before repeal by Pub. Law No. 108-27].

A collapsible corporation is one formed for the construction, production, or purchase of property with a view to the sale or exchange of its stock, or the distribution of property to shareholders before the corporation realizes a substantial part of the income derived from the property [*I.R.C. § 341(b)(1)*]. For tax years beginning after December 31, 2002 and before January 1, 2009, the collapsible corporation rules are repealed, and do not apply [*see I.R.C. § 341*, before repeal by Pub. Law No. 108-27; Pub. Law No. 108-27, §§ 302(f)(1), 303 (effective date and sunset provisions for repeal of collapsible corporation rules)].

If S corporation stock is sold, the sale may precipitate the loss of S corporation status as of the date of the sale [*I.R.C. §§ 1361(b)(1)(B), 1362(c), (d)(2)*].

[ii] Distribution of Assets

A C corporation pays a corporate level tax on the distribution of appreciated assets to shareholders, whether or not the distribution results from a liquidation of the corporation. The amount of gain recognized is the same amount that would be recognized if the property had been sold to the distributee at its fair market value [*I.R.C. § 311(b)(1)*].

If a distribution of assets results from a complete liquidation, the amounts received by the shareholders are treated as in full payment in exchange for the stock [*see I.R.C. § 331*]. If assets are distributed in something other than a complete liquidation, shareholders recognize income to the extent that the fair market value of the distributed property constitutes a dividend plus any portion of the distribution that is not a dividend and that exceeds basis [*see I.R.C. §§ 301(a), (c), 316, 317*]. For taxable years beginning after December 31, 2002 and before January 1, 2009 [*see* Pub. Law No. 108-27, §§ 302(f)(1), 303 (uncodified effective date and sunset provision of dividends capital gains rate legislation)], qualified dividends received by individuals are subject to federal taxation at capital gains rates [*I.R.C. § 1(h)(11)*].

[2] Retirement or Death

[a] In General

The retirement or death of a partner or shareholder can have significant tax consequences. Tax considerations in the sale of the entity or of the business interests of its owner or investor are discussed in *[1], above*. The retirement or death of the business owner raises special issues.

[b] Sole Proprietor

In general, the assets of a sole proprietorship are distributed in accordance with the terms of the owner's will or under California's intestacy statute. The assets receive a "stepped up" basis to fair market value at the date of death [*I.R.C. § 1014*; for decedents dying after 2009, a modified carryover basis rule generally applies, so a step-up basis does not apply (*I.R.C. § 1022*)]. The sale of the business, or of any of its assets, generally results in capital gain or loss to the seller [*I.R.C. § 1001*].

[c] Partnership

[i] In General

Like a sole proprietorship, a partnership interest passes either under the partner's will or under California's intestacy statute unless the partnership agreement is drafted to prevent a testamentary transfer of a partnership interest. As with a sole proprietorship, the basis of a partnership interest is stepped up to fair market value as of the date of death [*I.R.C. § 1014*; for decedents dying after 2009, a modified carryover basis rule generally applies, so a step-up basis does not apply (*I.R.C. § 1022*)].

However, a partnership has much more flexibility in planning for the retirement or death of a partner than does either a sole proprietorship or a corporation. The death or retirement of a partner can be treated in one of three ways: (1) as a sale of the partner's interest [*see I.R.C. §§ 741, 742, 751*; *see also [1][c], above*]; (2) as the liquidation of the partner's interest [*see I.R.C. § 736*; *see also [iii], below*]; or (3) as a complete liquidation of the partnership [*see I.R.C. §§ 731, 732, 751*; *see also [iv], below*].

[ii] Treatment of Sale of Interest

On a partner's death, the basis of the deceased partner's interest is stepped up to fair market value [*I.R.C. § 1014*; for decedents dying after 2009, a modified carryover basis regime generally applies, so a step-up basis does not apply (*I.R.C. § 1022*)], while the decedent's share of partnership income or loss for the tax period ending with the partner's

death is taxable to the partner's estate or the party succeeding to the partner's interest [*see I.R.C. § 742*]. It is important to note that by planning to treat the death or retirement of a partner as a sale of that partner's interest, the partnership does not receive a deduction because the sale is a capital transaction between the partner or the partner's estate and a third party.

[iii] Treatment as Liquidation of Partner's Interest

The death or retirement of a partner may be treated as a complete liquidation of the partner's interest, which is then purchased by the partnership. Payments to a retiring partner or to a deceased partner's estate under these circumstances generally result in capital gain or loss to the partner unless *I.R.C. § 751* applies [*I.R.C. § 741*; *see I.R.C. § 751*]; these payments are not deductible by the partnership because they represent a distribution by the partnership to a partner or a partner's estate with regard to the partner's interest in partnership property [*see I.R.C. § 736*].

Payments made by the partnership to a retiring partner or to a deceased partner's estate in exchange for anything other than the partnership interest, such as for partnership goodwill or unrealized receivables, result in ordinary income to the receiving party and a deduction to the partnership [*I.R.C. § 736*; *Treas. Reg. 1.736-1(a)(4)*].

[iv] Treatment as Complete Liquidation of Partnership

In the complete liquidation of a partnership, a partner recognizes gain to the extent that any money distributed exceeds the partner's adjusted basis of the partnership interest [*I.R.C. § 731(a)(1)*]. Gain or loss is characterized as capital unless it results from unrealized receivables or inventory [*I.R.C. §§ 741, 751*]. Gain or loss is recognized on the sale of individual assets and is taxed directly to the partners and results in an adjustment of the basis of each partner's interest [*Williams v. McGowan (2d Cir. 1945) 152 F.2d 570* ; *I.R.C. §§ 741, 702, 705*; *Treas. Reg. §§ 1.702-1, 1.702-2*].

[d] Limited Liability Company

Most LLCs will be structured as pass-through entities to take advantage of a single level of taxation under the partnership tax rules. Therefore, the tax rules governing the effects of the retirement or death of a member are similar to those applicable to partnerships [*see [c], above*].

[e] Corporation

A shareholder wishing to dispose of stock may sell the shares to the remaining shareholders or to nonshareholders, or the corporation may redeem the shares. If the shares are redeemed, there must be an actual reduction in the shareholder's proportionate interest in the corporation for the redemption to receive capital gain treatment [*I.R.C. § 302(b)(1)*]. If the shareholder retains an interest in the corporation, the redemption may be treated as a dividend [*I.R.C. § 302(b)(1)*]. For taxable years beginning after December 31, 2002 and before January 1, 2009 [Pub. Law No. 108-27, §§ 302(f)(1), 303 (uncodified effective date and sunset provision of dividends capital gains rate legislation)], qualified dividends received by individuals are subject to federal taxation at capital gains rates [*I.R.C. § 1(h)(11)*]. Therefore, the treatment of a redemption distribution as a dividend will not trigger adverse federal tax consequences for those years, because it will be taxed at capital gains rates [*I.R.C. § 1(h)(1)(B), (C), (11)*]. The corporation itself will receive no deduction for the redemption [*see I.R.C. § 302(a)*].

If shares are sold, to either shareholders or nonshareholders, the transaction is governed by the general gain and loss recognition rules [*I.R.C. § 1001(c)*]. The corporation receives no deduction for shares purchased by its remaining shareholders.

If a shareholder dies, the basis of shares that pass either under a will or under the California intestacy statutes is stepped up to fair market value as of the date of death [*I.R.C. § 1014*; for decedents dying after 2009, a modified carryover basis regime generally applies, so a step-up basis does not apply (*I.R.C. § 1022*)]. A redemption of a deceased shareholder's

stock to pay estate taxes and funeral and administrative expenses ordinarily receives capital gains treatment [*I.R.C. § 303*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionDeath & IncapacityBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionWithdrawalBusiness & Corporate LawLimited Liability CompaniesDissolution & Winding UpTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Distributions of PropertyTax LawFederal Taxpayer GroupsS CorporationsDistributions (IRC secs. 1361, 1368)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
C. Tax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.66

§ 1B.66 Income Splitting

[1] In General

Income splitting may be accomplished not only between two taxpaying entities, such as a corporation and a shareholder [*see § 1B.113*, P (3)(e)], but also among family members. Income splitting among family members, particularly in partnerships, is a device that has spawned an enormous amount of litigation and has resulted in stringent Internal Revenue Code requirements [*see I.R.C. § 704(e)*; *Treas. Reg. § 1.704-1*].

[2] Sole Proprietorship

Income splitting in a sole proprietorship is possible only by employing a family member. Money is retained within the family unit while the sole proprietor receives the benefit of a deduction for salaries [*see I.R.C. § 162(a)*]. However, money paid in wages to another family member may be taxed to that family member, so that although the sole proprietor's net tax is lessened, the family member's tax liability will likely increase.

[3] Partnership and Limited Liability Company

Partnership or limited liability company income may be split among family members if certain requirements are met [*I.R.C. § 704(c), (e)*]. In general, a family member will be considered a legitimate partner or member if he or she owns a partnership or membership interest in an entity in which capital is a material income-producing factor [*I.R.C. § 704(e)(1)*]. This requirement eliminates the possibility of income splitting in most personal service businesses in which the owner provides the principal service of the business and capital is not an income-producing factor [*see Payton v. United States (5th Cir. 1970) 425 F.2d 1324 , cert. denied, 400 U.S. 957 (1970)]* .

A family member receiving a gift of a partnership or membership interest is taxed on his or her distributive share of partnership or LLC income according to the partnership or LLC operating agreement, except to the extent that (1) that share is determined without allowance of reasonable compensation for services rendered to the entity by the donor and (2) the portion of that share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital [*I.R.C. § 704(e)(2)*; *see also Treas. Reg. § 1.704-1(e)(3)(i)(a), (c)*].

If minor children are made partners or members, a fiduciary must be appointed unless the minor child is competent to manage property on a equal basis with adults [*see Treas. Reg. § 1.704-1(e)(2(viii)*]. In addition, following the Tax Reform Act of 1986 [Pub. L. No. 99-514] and the Tax Increase Prevention and Reconciliation Act of 2005 [Pub. L. No. 109-222], the unearned income of children under the age of 18 may be taxed at the parents' rates rather than the child's [I.R.C. § 1(g)(2)(A)], thereby reducing the incentive to shift income to children.

[4] C Corporation

In a corporation, income shifting may be accomplished simply by transferring stock ownership to other family members. However, the Internal Revenue Service can reapportion gross income, deductions, credits, or allowances among family members to prevent tax avoidance and to clearly reflect the income of any one of them [*I.R.C. § 482*]. This power and the assignment of income doctrine [*see Lucas v. Earl (1930) 281 U.S. 111, 50 S. Ct. 241, 74 L. Ed. 731* ; *Commissioner v. Giannini (9th Cir. 1942) 129 F.2d 638* ; *see also Rev. Rul. 88-38, 1988-1 C.B. 246*] serve to limit the use of the corporation as an income-splitting device.

[5] S Corporation

An S corporation may be used to shift income among family members through a bona fide transfer of shares. However, if an individual who is a family member of one or more of the shareholders of an S corporation renders services or provides capital without receiving reasonable compensation, the IRS may reallocate income, deductions, and other items to properly reflect the value of those services or capital [*see I.R.C. § 1366(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsAllocations of Basis (IRC secs. 704, 755)Tax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
C. Tax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.67

§ 1B.67 Deductibility of Start-up Expenses

[1] Sole Proprietorship

A sole proprietor may amortize start-up expenses over a period of not less than five years, provided a timely election is made [*I.R.C. § 195*]. Start-up expenses are those paid or incurred in connection with the investigation or creation of an active trade or business that would otherwise be deductible if paid or incurred in connection with the operation of an existing trade or business [*I.R.C. § 195(c)(1)*]. These include expenses to investigate starting a new business venture or acquiring an existing business; other costs incurred before the opening of the business, such as advertising, salaries paid to employees being trained, travel and other expenses incurred lining up prospective distributors, suppliers, and customers; and fees paid for consultants and similar services [Miscellaneous Revenue Act of 1980, *1980-2 C.B. 709, 712-713]* . A taxpayer who borrows money to start a sole proprietorship, or to buy assets such as machinery or equipment used in the business may deduct the interest as a business expense [*I.R.C. §§ 162, 163*].

[2] Partnership, Limited Liability Company, and S Corporation

Neither a partnership or its partners, a limited liability company or its members, nor an S corporation or its shareholders may deduct expenses incurred in the formation of the entity. A partnership, LLC, or S corporation may elect to amortize start-up expenses over a period of 180 months [*I.R.C. §§ 709(b), 1363(b)(3)*]. Start-up expenses that can be amortized are those that can be expected to benefit the entity throughout its existence [*see Treas. Reg. § 1.709-2* (examples of start-up expenses)].

Like start-up expenses, syndication costs incurred in connection with a limited partnership must be capitalized [*Treas. Reg. § 1.709-2(b)*]. However, unlike start-up expenses, syndication costs may not be amortized [*Treas. Reg. § 1.709-2(b)*]. Syndication costs are those connected with the issuing and marketing of interests in an entity, including brokerage and registration fees and the costs of the prospectus or placement memorandum [*Treas. Reg. § 1.709-2(b)*].

Interest paid on loans to purchase an interest in a pass-through entity such as a partnership, limited partnership, limited liability company, or S corporation must be allocated among the entity's assets using a reasonable method, such as a pro rata allocation based on the fair market value, book value, or adjusted basis of the assets (reduced by any debt of the S

corporation or shareholder that is allocated to those assets [*see 1989-1 C.B. 675, Notice 89-35* ; *see also* Temp. Treas. Reg. § 1.163-8T].

[3] Corporation

A corporation may elect to amortize its start-up expenses over a period of at least 180 months [*I.R.C. § 248*]. If no election is made, start-up expenses may be capitalized and are deductible at dissolution [*I.R.C. § 248*]. Syndication costs must be capitalized [*Treas. Reg. § 1.248-1(b)(3)*; *see [2], above*].

When a taxpayer borrows money to purchase stock, the interest expense connected with the debt is investment interest. Deductions of investment interest are limited to the taxpayer's net investment income for the year [*I.R.C. § 163(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesTax LawFederal Income Tax ComputationDeductions for Amortization, Depletion & DepreciationGeneral OverviewTax LawFederal Income Tax ComputationDeductions for Business ExpensesGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)EffectsTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Adjustments to Basis of Shareholder Stock



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
C. Tax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.68

§ 1B.68 Other Tax Considerations

[1] Alternative Minimum Tax

The differences in alternative minimum tax (AMT) adjustments for individuals, partners, LLC members, S corporation shareholders, and C corporations may result in a significant additional tax burden in choosing to do business as a C corporation. The AMT [*I.R.C. §§ 55-59*] is a tax imposed on both individuals and corporations on alternative minimum taxable income, or taxable income with both adjustments and additions of tax preference items [*I.R.C. § 55(b)(2)*]. Although the corporate AMT rate is 20 percent, or 6 to 8 percent lower than the individual alternative rate [*I.R.C. § 55(b)(1)*], a number of adjustments apply only to C corporations [*see I.R.C. § 56(c)(1), (g)*] and generally result in higher corporate alternative minimum taxes and may deter owners from choosing the C corporate form. If the corporate form is chosen, the AMT imposed on corporations makes advance tax planning essential.

California also imposes an AMT on individuals, corporations other than S corporations, and banks and financial corporations subject to the bank and corporation franchise tax [*Rev. & Tax. Code §§ 17062, 23400, 23455*].

[2] Choice of Tax Year

The tax year of a sole proprietorship is the same as the tax year of its proprietor because the proprietorship and the proprietor are one and the same taxpayer. Thus, no opportunity exists to shift income by adopting a different tax year for the business.

Partnerships, S corporations, and personal service corporations must adopt a calendar year as their tax year, unless they can show a business reason for a different year or unless they make a special election for a tax year with a deferral period and make required payments [*I.R.C. §§ 444* (election of tax year other than required year), *7519* (required payments); *see I.R.C. §§ 441(i)* (personal service corporations), *706(b)* (partnerships), *1378* (S corporations)]. Corporations that are neither S corporations nor personal service corporations may adopt any fiscal year [*see I.R.C. §§ 441, 444*]. The choice of a fiscal year may allow a corporation, by timing its payments to calendar year shareholders, to limit the amount that those shareholders must report in one year and defer the remainder of the income to a future year. However, accounting period requirements are complex and are written intentionally to minimize benefits arising from

shifting income from one calendar year to another [*see I.R.C. §§ 444(c), 7519*].

[3] Section 1244 Stock

Losses that result from the sale, exchange, or worthlessness of an investment, such as a limited partnership interest, LLC interest, or corporate securities, are generally capital losses that can be used by a noncorporate taxpayer to offset ordinary income only up to $3,000 per year [*I.R.C. § 1211(b)*]. However, small business corporations (those whose total equity capital does not exceed $1,000,000 [*I.R.C. § 1244(c)(1)(A)*]) may take advantage of *I.R.C. § 1244*, if they meet Section 1244 requirements [*see I.R.C. § 1244*]. Section 1244 provides that losses on stock may be deducted as ordinary losses of $50,000, or $100,000 on a joint return, per year [*I.R.C. § 1244(b)*], providing both protection for investors in a new small business and a possible tax benefit.

I.R.C. § 1244 is available to S corporations as well as to C corporations [*I.R.C. § 1371(a)*]. However, as a practical matter, the tax benefits for losses on Section 1244 stock for S corporation shareholders will likely be limited by the requirement that losses be deducted only to the extent of the shareholder's basis in the corporation [*see I.R.C. § 1367*].

[4] Fringe Benefits

[a] Retirement Plans

Following the Tax Equity and Fiscal Responsibility Act of 1987 [Pub. L. No. 97-248], the distinction between tax-qualifying retirement plans (Keoghs) available to noncorporate entities and S corporation shareholders and those available to corporations was practically eliminated [*see I.R.C. §§ 401-424*]. However, a few differences remain that make slightly better retirement benefits available to corporations than to noncorporate entities or to S corporation shareholders. For example, the maximum amount deductible as a retirement plan contribution by a noncorporate entity for a self-employed person is limited to that person's self-employment income, reduced by the amount contributed to qualified retirement plans [*I.R.C. § 404(a)(8)*]. There is no such restriction for persons who participate in corporate retirement plans. In addition, plans based on stock ownership, such as Employee Stock Ownership Plans [*I.R.C. § 409*], incentive stock options [*I.R.C. § 422*], stock bonus plans [*I.R.C. § 401(a)*], or cash or deferred arrangements [*I.R.C. § 401(k)*] are available only to corporations.

[b] Other Fringe Benefits

More fringe benefits are available through a C corporation than a sole proprietorship, partnership, LLC, or S corporation. A C corporation may provide life insurance up to $50,000 tax-free to employees under a group life insurance policy; in contrast, a sole proprietor, partner, or S corporation shareholder who owns more than 2 percent of the shares ("2 percent S corporation shareholder") who receives such a benefit must include its dollar value when reporting taxable income [*I.R.C. §§ 79, 1372*]. A C corporation generally may deduct premiums for medical plans, while corporate employees receive a tax-free payment or reimbursement of their medical expenses and tax-free payments from disability insurance if they become disabled [*I.R.C. § 105(b)*]. Sole proprietors, partners, LLC members, and 2 percent S corporation shareholders are specifically excluded from these benefits [*I.R.C. §§ 105(g), 401, 1372*]. However, self-employed individuals, including sole proprietors, general partners, LLC members, and 2 percent S corporation shareholders, may deduct a percentage of their payments for medical insurance for themselves, their spouse and dependents, not to exceed the earned income from the business for which the health insurance plan is set up [*see I.R.C. § 401(c)*; *see also I.R.C. § 162(l)*]. This deduction will not decrease the business owner's net income, as it is used to calculate self-employment tax [*I.R.C. § 162(l)(4)*]. Moreover, such a deduction is disallowed to any individual who is eligible to participate in any health plan provided by an employer of the individual or his or her spouse [*I.R.C. § 162(l)(2)(B)*]. A partnership may deduct premiums paid to a partner and an S corporation may deduct premiums paid to a two percent shareholder; the partner and shareholder would then be required to include the amount of premiums paid in income, but would be eligible to use the percentage deduction described above [*I.R.C. § 162(l)*].

Meals and lodging provided by a C or S corporation for the convenience of the employer are deductible by the corporation and tax-free to the employee, provided the employee is not a more than 2 percent S corporation shareholder. Partners and sole proprietors are excluded from these benefits [*I.R.C. §§ 119, 1372*; *Armstrong v. Phinney (5th Cir. 1968) 394 F.2d 661* (partnerships)].

Fringe benefits under educational assistance programs [*I.R.C. § 127*], dependent care assistance plans [*I.R.C. § 129*], and adoption assistance programs [*I.R.C. § 137*], as well as working condition [*I.R.C. § 132(a)(3), (d)*; *Treas. Reg. § 1.132-1(b)(2)*] and de minimis fringe benefits [*I.R.C. § 132(a)(4), (e)*] are available to corporate and noncorporate entities alike.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawSole Proprietorships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART II. LEGAL BACKGROUND
C. Tax Considerations in Choosing a Business Form

1-1B California Legal Forms--Transaction Guide §§ 1B.69-1B.99

[Reserved]

§§ 1B.69[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1B California Legal Forms--Transaction Guide § 1B.100

§ 1B.100 Facts

NOTE:
The initial client interview is a comprehensive fact finding conference. An extensive discussion of the client's plans (including any preliminary business plan and existing operation procedures) can provide critical information and understanding of the motives, requirements, and objectives of the client in the entity selection process.

1. Information regarding participants at formation.

a. Natural persons.
(1) Name.

(2) Resident address and telephone number.

(3) Business address and telephone number.

(4) Citizenship, e.g., United States citizen, resident alien, or citizen of country other than United States.

(5) Tax identification numbers, e.g., social security number or employer identification number.

(6) Marital status.

(7) Age.

(8) Educational background.

(9) Business experience within last five years.

(10) Other relevant business experience (financial acumen).

(11) Present occupation or employment.

(12) Gross and net income for last three years.

(13) Estimated net worth, including any expectancies (e.g., anticipated gifts or bequests).

(14) Projected annual income from sources outside business, plus any anticipated salary to be paid from business.

(15) Preexisting business or personal relationship with other participants.

(16) Affiliations with other proprietorships, partnerships, LLCs, or corporations.

(17) Percentage of business to be owned or controlled.

(18) Person responsible for paying for pre-formation work if:
(a) Business organization is formed.

(b) Business organization is not formed.

(19) Anticipated fringe benefits from business.

(20) Manner in which principals intend to deal with sales of interests of one or more principals (e.g., rights of first refusal, appraisals, etc.).

(21) Any desire to maintain confidentiality of ownership [*see § 1B.110[1]* P 6a NOTE].

b. Business entities.

(1) Form of organization.

(2) Personal and biographical information of persons responsible for management and control [*see* P a, *above*].

(3) Tax identification number(s).

(4) Tax year(s).

2. Information regarding additional participants after formation.

a. Number of additional participants.

NOTE:

To operate as a statutory close corporation, the corporation may not have more than 35 shareholders [*Corp. Code § 158(a)*]. To operate as an S corporation, the corporation may not have more than 100 shareholders [*I.R.C. § 1361(b)(1)(A)*; *Rev. & Tax. Code § 23800 et seq.*]. For purposes of determining the number of shareholders, husband and wife ordinarily count as one shareholder [*Corp. Code § 158(d)* (close corporation); *I.R.C. § 1361(c)(1)(A)(i)* (S corporation)]. Alternatively, taxpayers may elect to treat all members of the family as a single shareholder. "Members of the family" means a common ancestor, any lineal descendant of that common ancestor, and any spouse or former spouse of that common ancestor or lineal descendant [I.R.C. § 1361(c)(1)(A)(ii), (B), (D)]. To qualify for exemptions to qualification and registration requirements under the federal and state securities laws using the limited offering exemption or the small offering exemption, there may be no more than 35 shareholders [*Corp. Code § 25102(f)(1), (h)*].

b. Type of participants, e.g., natural persons or business entities.

NOTE:
Eligible shareholders in an S corporation include only individuals (but not resident aliens), estates, and certain trusts [*I.R.C. § 1361(b)(1)(B), (c)(2), (3), (d)*]. Violation of this rule results in automatic termination of Subchapter S status [*I.R.C. § 1362(b)(2)*].

c. Personal and biographical information of individual participants and pertinent information regarding business entities with ownership interests [*see* P 1a, b, *above*].

3. Information regarding the proposed business activity.

a. Principal and other business activities, including any limitations or restrictions on business or powers of proposed entity.

NOTE:
A few activities are limited, by governmental regulation, to a specified form or to a restricted choice of form. Banks, for example, may not operate as partnerships [*Corp. Code §§ 15616*, 15901.04], and must operate as corporations [*Fin. Code § 102*]. LLCs may not engage in the banking business, the business of issuing policies of insurance and assuming insurance risks, or the trust company business [*Corp. Code § 17002(a)*; ***but see*** *Corp. Code § 17002(b)* (subsidiary LLC may operate as licensed health care service plan)]

b. Proposed location and mailing address.

(1) Complete address, including county, of main office.

(2) Complete address, including county, of other office or places of business.

c. Proposed name of business.

d. Proposed starting date of business.

e. Potential risks in operating business.

f. Licensing requirements.

g. Projections for growth.

h. Potential that business will be sold in foreseeable future.

i. Necessity for protection of intellectual property (e.g., patents, copyrights, trade marks, or trade names).

j. Whether business will grant consumer credit.

k. Whether business will be successor in interest to any existing business and, if so, how to handle potential successor liability.

4. Information regarding financing proposed business activity.

a. Funds needed for organization, syndication, or start-up costs.

NOTE:

For tax purposes, organizational and start-up expenses must be capitalized and may be amortized over a period of 180 months [*I.R.C. §§ 195, 248, 709(b)*]. Syndication costs must be capitalized, but may not be amortized [*Treas. Reg. §§ 1.248-1(b)(3)(i), 1.709-2(b)*; ***see*** *§ 1B.67*].

b. Estimated funds needed for first year of operation.

c. Sources of funding and amount of funding available from each source.

(1) Capital contributions.

(a) Contributions of service in exchange for capital interest.

NOTE:

A requirement to perform future services is inadequate consideration for exchange of corporate shares [*Corp. Code § 409(a)(1)*] or a limited partnership interest [*Corp. Code §§ 15651*, 15905.01]. Special tax rules apply when a partner receives an unrestricted capital interest in a partnership in exchange for services [***see*** *§ 1B.64[3]*] and when a partner receives a profits interest in exchange for services; a "profits interest" is an interest that provides a share in future partnership profits or earnings, but does not provide for a share in the existing partnership assets [***see*** *I.R.C. § 721*; *Treas. Reg. § 1.721-1(b)(1)*]. If a member contributes services to an LLC classified as a partnership in exchange for a membership interest, that contribution is a taxable event for the member; the value of the LLC interest is taxable as compensation to the member [*Treas. Reg. § 1.721-1(b)(1)*; ***see*** *§ 1B.64[4]*]. For the consequences of exchanging services for corporate shares, see *I.R.C. § 351(d)(1)* and § 1B.64[5], [6].

(b) Contributions of property.

(i) Types of property (real property, personal property, tangible and intangible, e.g., goodwill).

(ii) Adjusted basis of property for tax purposes, if transferred by business owner or

investor.

(iii) Fair market value of property transferred.

(iv) Purchase price, if real or personal property will be purchased.

(v) Contracts and other liabilities assumed by transferees or buyers.

(c) Sale of business interests.

(2) Loans.

(a) From participants.

NOTE:
The exchange of property for corporate debt is a taxable transaction [***see*** *I.R.C. § 351*].

(b) From nonparticipants, such as institutional lenders or unaffiliated third parties.

NOTE:
Personal guarantees by participants are often required if the business is new or if the business has few assets.

(3) Debt versus equity.

(a) Total amount of cash to be contributed.

(b) Ratio of debt to equity.

NOTE:
For a corporation, debt has an advantage over equity because interest payments are deductible to the corporation [*I.R.C. § 163(a)*], while distributions of dividends on shareholder equity are not [*I.R.C. §§ 301*, *316*, *562*]. Further, repayment of debt generally has priority over repayment of equity. However, high debt and low equity in a corporation may cause the Internal Revenue Service to recharacterize the debt as equity, with adverse tax consequences to both the corporation and the shareholder [***see*** *I.R.C. § 385*]. Ordinarily, this is not a problem if the corporation borrows money from an institution or an unaffiliated third party.

(4) Anticipated earnings.

NOTE:
If the business is highly speculative, or there is another anticipated reason that it might fail, the corporate form may be advantageous. Directors, officers, and shareholders are not ordinarily responsible for corporate debts and other liabilities [*Corp. Code § 300*]. Similarly, limited partners and LLC members are not ordinarily liable for business debts in excess of their investments [*Corp. Code §§ 15632-15636*, *15643(b)*, 15903.03, *17101(a)*, *17158*].

If the requirements of *I.R.C. § 1244* are met in the issuance of corporate stock, investors may deduct, as ordinary losses, up to $50,000, or $100,000 on a joint return, per year for losses resulting from the sale, exchange, or worthlessness of an investment [*I.R.C. § 1244(b)*]. Otherwise, losses from the sale,

exchange, or worthlessness of stock is a capital loss, limited to maximum of $3,000 per year [*I.R.C. § 1211(b)(1)*; ***see*** *§ 1B.68*]. For a more detailed discussion of qualification requirements under *I.R.C. § 1244*, see Ch. 6H, ***Qualification of Securities*** .

If the business is expected to operate at a loss for the first few years, owners or investors may want to adopt the sole proprietorship, partnership, LLC, or S corporation form that allows them to take advantage of business losses by deducting those losses, subject to certain restrictions, on their personal income tax returns [*I.R.C. §§ 61(a)* (sole proprietorship), *701*, *702* (partnerships and LLCs), *1366* (S corporations); ***see*** *§ 1B.63[3]*].

d. Whether some form of preferential equity participation will be required by key employees, such as stock options.

5. Information related to the complexity of the business organization.

a. Number of participants [*see § 1B.100[1],* P 2].

b. Complexity of organization.

NOTE:

Although technically a partnership's organization can be as complex as the abilities of the drafter of the agreement, several corporate characteristics, including the different levels of management and control, the continuity of existence, the availability of broader sources of capital, and the General Corporation Law often make the corporation the form of choice for a complex business organization [***see*** *§ 1B.30[2]*]. The sole proprietorship is necessarily limited by the fact that a single person ultimately is responsible for its management and control [***see*** *§ 1B.10*].

6. Information related to management and control.

a. Relationship between owners and investors and managers or employees.

b. Owners or investors who will devote time to the business.

(1) Names.

(2) Amount of time to be devoted.

(3) Titles, powers, and duties, as well as any desired limitations.

(4) Qualifications.

(5) Compensation.

(6) Indemnification.

(7) Insurance.

c. Employees in addition to working owners/investors.

(1) Number.

(2) Titles, powers, and duties.

(3) Compensation.

d. Persons retained to provide specialized services.

(1) Accountant's name, address, and telephone number.

NOTE:
Counsel should involve the client's accountant in the early stages of the selection process. The accountant may be aware of significant facts that the client may fail to mention, and the accountant's input will likely be extremely valuable. If the accountant is not contacted until after the preliminary selection is made and the accountant's opinion differs, a significant delay may result and counsel and the accountant may assume adversarial roles to the detriment of the client.

(2) Banker's name, address, and telephone number.

(3) Insurance agent's name, address, and telephone number.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewLegal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1B California Legal Forms--Transaction Guide § 1B.101

§ 1B.101 Documents

1. Any business plan and any preorganization agreement, including agreements to make contributions.

2. Anticipated profit and loss statement and balance sheet for the first year.

3. Current profit and loss statements and balance sheets, if existing business is being incorporated.

4. Sales or purchase agreements for business or business assets, including any appraisals.

5. Documents of transfer, including deeds or other instruments.

6. Existing contracts, such as leases, franchises, supplier/distributor agreements, service agreements, labor contracts, or employment agreements that will be transferred to business.

7. Any fictitious business or trade name certificates already obtained by principals.

8. Copies of three years' prior financial statements or income tax returns for participating individuals and business entities.

9. Copies of three years' prior income tax returns if existing business is being purchased, or change of form is contemplated.

10. Copies of tax projections for the current year for participating individuals and business entities.

11. Copies of individual participants' wills and other estate planning documents.

12. Copies of participants' retirement plans.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawSole ProprietorshipsLegal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1B California Legal Forms--Transaction Guide §§ 1B.102-1B.109

[Reserved]

§§ 1B.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART III. TRANSACTION GUIDE
B. Preliminary Determinations to Selecting a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.110

§ 1B.110 Ascertain Goals of Owners and Investors Affecting Choice of Business Form

[1] Determine Effects of Nontax Factors

1. Determine type of management preferred (e.g., centralized management or management by all participants) [*see § 1B.41*].

NOTE:

In a general partnership, all partners are equally responsible for management and control [*Corp. Code § 16401(f)*], although partners sometimes allocate control in a partnership or designate a managing partner [*Corp. Code § 16401(j)*]. The less centralized the management, the more a partnership's effective management depends on all partners' willingness to work together. Corporate management and control is in the hands of directors, who, in turn have the power to appoint officers to manage the day-to-day business of the corporation [*Corp. Code §§ 301(a), 312(b)*]. Limited partnerships, which are managed by general partners [*Corp. Code §§ 15507* (ULPA), 15632 (CRLPA), repealed January 1, 2010; *Corp. Code 15903.03* (ULPA '08)], ordinarily have more centralized management than either general partnerships or corporations. LLCs may or may not have centralized management, depending on how they are structered [***see** § 1B.41[5]*].

2. Determine whether business owners and investors desire limited liability.

NOTE:

If limited liability is desired, the limited partnership, LLC, and corporate forms can be the more advantageous than the sole proprietorship or general partnership. See *§ 1B.42* for a discussion of limitations on liability.

a. Determine whether owners are unwilling to subject their personal assets to claims of business creditors.

b. Determine whether owners have particular assets they wish to protect from business liabilities.

c. Determine whether owners are unwilling to personally guarantee business debts.

d. Determine whether creditors will lend money to the business without personal guarantee of some or all of its owners.

e. Determine whether nature of the business makes bankruptcy likely.
(1) Is business highly speculative?

(2) Is business a user or producer of hazardous products?

(3) Is business one in which accidental injury to employee or customer is likely?

(4) Is business one that is likely to be subject to lawsuits?

f. Determine extent to which such risks are insurable.

g. Determine whether owners are engaged in other businesses or activities from which they wish to shield this business activity.

3. Determine whether owners desire continuity of existence for business [*see § 1B.45*].

a. Determine whether owners wish business to continue after death or withdrawal of one or more of original owners.

b. Determine if age or life expectancy of any owner is such that early retirement or death is likely.

c. Determine whether long-term financing will require continuity of existence of business organization.

4. Determine whether issuance of securities will be necessary to obtain required amount of capital for business [*see § 1B.46*].

5. Determine owner's desires regarding transferability of ownership interests.

NOTE:
The transferability of ownership interests is often disadvantageous for closely held corporations and for corporations that have elected Subchapter S status. Shareholders in closely held corporations generally want to be able to choose additional participants, since the business organization is likely to managed and controlled in a partnership-like manner [***see** § 1B.31 [3]*]. S corporations risk automatic termination if shares are transferred to ineligible shareholders [***see** I.R.C. §§ 1361(b)(1)(B), (c)(2), (3), 1362(f)*; ***see also** § 1B.31[3]*].

a. Determine whether original participants are willing to permit sale of shares to outsiders.

b. Determine if any participants will be temporary investors only, who will wish to withdraw or sell their interests.

c. Determine if additional investors will be required.

d. Determine if interests are marketable, if interests are transferable.

6. Determine whether participants are willing to be subject to any required government control.

a. Determine whether participants are willing to disclose their identity and make public personal financial information.

NOTE:

If participants desire anonymity, the sole proprietorship provides no protection because even if the owner does business under a fictitious name, the laws governing use of a fictitious name require disclosure of the names of the owners [*Bus. & Prof. Code §§ 17900-17930*]. Partners in a general partnership may ordinarily remain anonymous unless they are required to file a statement of partnership listing the name of each partner [***see*** *Corp. Code § 16303*]. The corporate form normally provides the most anonymity because there is no general requirement of disclosure of shareholder identity.However, the small offering exemption of the Corporate Securities Law requires disclosure of the names of individuals to whom shares will initially be issued [*Corp. Code § 25102(h)*]. General partners in limited partnerships must disclose their names and addresses on the certificate of limited partnership filed with the California Secretary of State [*Corp. Code § 25102(h)*]. Limited partners and LLC members, although necessarily disclosed on organizational documents may be subject to the same securities disclosure rules as are corporate shareholders [***see*** *Corp. Code § 25102(h)*].

b. Determine whether participants are willing to comply with securities law restrictions that may apply to soliciting business loans and investments and to offering securities [*see § 1B.46*].

c. Determine whether participants are willing to comply with procedures required to do business in other states.

7. Determine impact of expense and formalities of organizational form chosen.

a. Determine if participants are prepared for initial expense of incorporation or preparation of partnership or LLC documents [*see §§ 1B.11[1], 1B.12[1], 1B.13[1], 1B.30[1]*].

b. Determine if participants are prepared for costs of specialized services (e.g., attorneys and accountants) that increase with complexity of form chosen.

c. Determine participants' willingness to observe formalities related to operation of business [*see § 1B.48[4]*].

NOTE:

Individuals who participate in the management of a corporation and who are unwilling to observe corporate formalities, such as regular meetings, meeting notices, meeting minutes, financial reports, and inspection of records by directors and shareholders, and

unwilling to separate corporate from personal assets, risk losing the limited liability protection of the corporate form [***see** § 1B.30 [2]*], the primary advantage of incorporation. Although election of close corporation status may allow some of the corporate formalities to be ignored without loss of liability protection [*Corp. Code § 300(b)*], this issue has not been the subject of much litigation, and it may remain advantageous to observe corporate formalities (e.g., related to securities issues, election of officers and directors, and hiring of employees) even when not required by statute.

[2] Determine Effect of Income Tax Factors

1. Project income of proposed business over next three to five years.

2. Determine whether participants desire business income to be distributed or retained.

NOTE:

Neither the sole proprietorship, partnership, nor LLC forms offers participants the option of retaining income in the business entity. A sole proprietor is taxed on 100 percent of net income [*I.R.C. §§ 61(a), 62(a)(1)*], while each partner (or member of an LLC taxed as a partnership) must include his or her share of income (and other items) in personal income and pay tax accordingly, regardless of whether the items, or their cash equivalent, were actually distributed [*I.R.C. §§ 701, 702(a), 704(b)*]. Similar to partnerships, S corporation shareholders report their proportionate share of income on their individual tax returns [*I.R.C. § 1366(a)*]. Only the C corporation, which first pays a corporate level tax on its earnings [*I.R.C. § 11(b)*], may choose not to distribute its earnings to shareholders as dividends, under certain circumstances. However, corporations that retain their earnings risk a substantial penalty tax if earnings are accumulated above reasonable business needs for the purpose of avoiding the income tax imposed on shareholders [*I.R.C. §§ 531-537*; ***see** §§ 1B.63[2][e][3], 1B.113*].

3. Determine whether participants contemplate withdrawal of assets from business in near future.

NOTE:

It is much easier to withdraw assets from a sole proprietorship, an LLC, or a partnership with no or minimal tax consequences than it is to withdraw assets from a corporation. No gain or loss is recognized on the withdrawal of assets from a sole proprietorship, although recapture of tax advantages (e.g., accelerated depreciation) may be required [*I.R.C. §§ 1245, 1250*; ***see** I.R.C. §§ 168, 179*]. Similarly, withdrawal of assets from a partnership or LLC usually results in a recapture of tax advantages [*I.R.C. §§ 1245, 1250*; ***see, e.g.,** I.R.C. §§ 168, 179*], with a limited recognition of gain or loss, if any [***see** I.R.C. § 751*; *Treas. Reg. § 1.751-1*]. However, both C and S corporations must fully recognize gain on the distribution of appreciated assets [*I.R.C. §§ 301, 311(b), 1371(a)*]. Moreover, the receipt of the asset is generally a taxable event to the receiving C corporation shareholder [***see** I.R.C. §§ 61, 301, 316*].

4. Determine what fringe benefits are desired by participants [*see § 1B.68[4]*].

5. Determine importance of retirement plans to participants.

NOTE:

Today, few differences exist between the retirement plans available to corporations and to those who are self-employed or are the employees of noncorporate businesses. However, a C corporation may still provide somewhat better retirement benefits than those available to noncorporate entities or to S corporation shareholders [***see** § 1B.68[4][a]*].

6. Determine probability that business will become insolvent [*see § 1B.68[3]* for a discussion of *I.R.C. § 1244* stock].

7. Determine probability that business will operate at loss.

NOTE:

If the business is expected to operate at a loss for the first few years, the sole proprietorship, partnership, LLC, or S corporation forms may permit concurrent deduction of the owner's proportionate share of losses on his or her individual income tax returns [*I.R.C. §§ 61(a)* (sole proprietorship), *701*, *702* (partnership), *1366* (S corporation); ***see** § 1B.63 [3]*]. C corporation losses are not passed through to the shareholders, but remain at the corporate level and may be used to reduce corporate income in later years, when the corporation has a profit [*I.R.C. § 172*].

8. Determine which form will provide greatest tax advantages for both business and each participant, based on:

a. The above facts [*see* PP 1-7, *above*].

b. Taxable income of participants from other sources.

c. Projected tax brackets of participants and business entity, if corporate form is being considered.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawSole Proprietorships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART III. TRANSACTION GUIDE
B. Preliminary Determinations to Selecting a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.111

§ 1B.111 Determining Whether to Form Sole Proprietorship

1. Consider advantages of doing business as sole proprietorship, including:

a. Owner's right to receive all profits of business.

b. Owner's ability to make decisions and take action without delay or formalities, such as meetings and consent of board of directors or partners.

c. Minimal legal formalities and costs involved in setting up business.

d. Minimal regulatory and reporting requirements related to conducting business.

e. Owner's freedom from obligations created by any person not appointed as agent for owner.

NOTE:
The risk of being subject to obligations created by others is inherent in powers invested in a partnership or in a corporation. However, in a corporation, LLC, or a limited partnership, individual liability may be limited to the amount of the individual's capital investment [***see*** *§ 1B.42*].

f. Freedom to carry on business in other states without qualification or registration requirements.

NOTE:
For a discussion of fictitious business name requirements, see Chapter 1A, ***Role of Counsel in Starting a New Business*** .

g. Business' ability to obtain credit not only to extent justified by financial condition of enterprise, but also to extent warranted by owner's individual resources and credit standing.

NOTE:

The capital of a sole proprietorship generally consists of the o- wner's funds, business credit, and loans. Many commercial lenders will not lend funds to a sole proprietorship unless the owner has contributed at least half of the funds required for the business. If the owner is unable to contribute at least half of the necessary funds, consideration should be given to other methods of raising capital, such as seeking investment by partners.

h. Withdrawal of assets from business with minimal tax consequences [*see § 1B.110* PP 2, 3].

2. Consider disadvantages of doing business as sole proprietorship, including[*see § 1B.10[2]*]:

a. Need for owner personally to make every business decision and take every action unless owner appoints agents with appropriate authority.

b. Owner's unlimited personal liability for all obligations of business.

c. Limitations on business' initial and expansion capital, based on owner's resources and credit standing.

d. Possible difficulty in sale of business.

NOTE:

Because the primary asset of a sole proprietorship is often its owner, the business may be difficult to sell. Even if a market exists for the business, it is often difficult to value and sell intangible as sets, such as goodwill, which are usually tied to the personality and abilities of the sole proprietor.

e. Termination of business on owner's death or incapacity.

f. Owner's limited opportunity to take advantage of deferred compensation arrangements and certain other benefits available to corporate employees [*see § 1B.68[4]*].

3. Consider income tax consequences of doing business as sole proprietorship, including:

a. Treatment of business profit or loss as owner's personal income or loss [*I.R.C. § 61(a)*].

b. Avoidance of double taxation that can occur if corporate form of business is used [*see § 1B.114* P 3d].

c. Possibility of recognition of substantial ordinary income or loss on sale of sole proprietorship [*see Williams v. McGowan (2d Cir. 1945) 152 F.2d 570]* .

NOTE:

A withdrawing partner or shareholder usually realizes capital gain or loss [*I.R.C. § 61(a)*]. When a sole proprietor sells, the gain or loss on the sale of each asset is treated as capital or ordinary, depending on the nature of the asset [***see*** *Williams v. McGowan (2d Cir. 1945) 152 F.2d 570]* .

d. Inability to step up basis of property that has appreciated in value in order to increase depreciation

deductions [*see I.R.C. §§ 707(a), 722, 1012*].

e. Deductibility of business losses and expenses from owner's income from other sources [*I.R.C. §§ 162, 165*; *see I.R.C. § 469* (passive loss limitations); *see also § 1B.63[3][a]*].

f. Limitations on deductibility of pension plans and employee benefits [*see § 1B.68[4]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesConducting Business Under Fictitious NamesBusiness & Corporate LawSole Proprietorships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART III. TRANSACTION GUIDE
B. Preliminary Determinations to Selecting a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.112

§ 1B.112 Determining Whether to Form Partnership

NOTE:
As used throughout this section, "partners" refers to general partners in a general partnership and general partners in a limited partnership [***see** §§ 1B.11, 1B.12*]. For detailed coverage of partnerships and their formation, see Ch. 15, Part A, ***Formation of General Partnerships*** **,** and Ch. 16, ***Formation of Limited Partnerships***.

1. Consider advantages of doing business as a partnership, including:

a. Partners ability to participate in management of partnership business [*Corp. Code §§ 15904.06, 16401*].

NOTE:
The partnership agreement may restrict the management rights of the partners [*Corp. Code § 16401(f), (j)*]. The combined talents of the partners can broaden the firm's basis for business judgments and operations, enabling it to operate on a wider scope than a sole proprietorship. The distribution of responsibilities among the partners can permit specialization and closer attention to details.

b. Greater availability of capital than in sole proprietorship [*see § 1B.43[3]* (general partnerships), *[4]* (limited partnerships)].

c. Ability to share risks and losses.

d. Relatively inexpensive organizational costs [*but see* P 2e, *below*.].

NOTE:

General partnerships must pay a fee for filing a statement of partnership [*Gov. Code § 12187(a)*; ***see*** *§ 1B.47*], and limited partnerships must pay a fee for filing a certificate of limited partnership [*Gov. Code § 12188(b)*]. In addition, limited and limited liability partnerships must pay an annual minimum franchise tax [*Rev. & Tax. Code §§ 17935* (limited), *17948-17948.2* (limited liability)].

2. Consider disadvantages of doing business as partnership, including:

a. Possible difficulty of obtaining consensus of partners regarding management of business.

b. Individual partners' inability to use partnership property for any purpose other than partnership business [*Corp. Code §§ 16203, 16204, 16401*].

c. Each partner's personal liability (regardless of initial capital contribution to partnership) for other partners' wrongful acts and breaches of trust and for all debts and obligations of partnership [*Corp. Code §§ 16305, 16306* (general partnerships); *Corp. Code § 15904.04* (limited partnerships)].

NOTE:

In a limited partnership, the limited partners' liability is ordinarily limited to their capital contributions [*Corp. Code § 15903.03*].

d. Restricted transferability of partnership interest [*see Corp. Code §§ 16401(i), 16503* (general partnerships); *Corp. Code §§ 15907.01 et seq.* (limited partnerships)].

NOTE:

By statute, a person may become a partner only with the consent of the other partners [*Corp. Code § 16401(i)*; ***see*** *Corp. Code § 16503(a), (d)* (transferrable interest freely transferred)]. Further, as a practical matter, the possibility of personal liability that attaches to a general partnership interest limits the market of potential transferees [***see*** *Corp. Code §§ 16305, 16306*]. Limited partnership interests are subject to transfer restrictions [***see*** *Corp. Code §§ 15907.01, 15907.02*]. However, the restrictions have little practical effect on the transferability of the interests [***see*** *Corp. Code §§ 15907.02*; ***see also*** *§ 1B.44[3]*].

e. Substantial expense involved in preparation of partnership agreement.

NOTE:

A general partnership agreement should be in writing, although this is not a statutory requirement. Similarly, a limited partnership should have a written agreement, although it is not required by statute [***see*** *Corp. Code § 15902.01*]. Further, a general partnership must file a fictitious business name statement if the partnership name does not include each partner's name [*Bus. & Prof. Code § 17900(b)(2)*], or if it implies the existence of additional partners [*Bus. & Prof. Code § 17900(c)*]. A limited partnership must file a fictitious business name statement if it uses any name other than the name on the certificate of limited partnership filed with the Secretary of State [*Bus. & Prof. Code § 17900(b)(4)*]; see *Corp. Code § 15621(a)* (certificate of limited partnership)].

f. Limited duration of partnership.

NOTE:

Ordinarily a partnership dissolves on the occurrence of events specified in the partnership

agreement or by statute [***see*** *Corp. Code § 16801* (general partnerships); *Corp. Code § 15681, 15908.01* (limited partnerships). However, the dissolution of a general partnership need not result in the winding up of partnership affairs. For example, dissolution by the death or withdrawal of a partner does not preclude the remaining partners from carrying on the business, with or without new partners, pursuant to an agreement among the partners, or as provided by statute [***see*** *Corp. Code §§ 16801(1), 16802(b)*; *Prob. Code § 9762*]. Limited partnerships formed under the ULPA '08 have perpetual duration [*Corp. Code § 15901.04(c)*]. This default provision, however, may be changed in a partnership agreement to specify a different duration. [*See Corp. Code § 15901.10*; *see* Ch. 16, *Formation of Limited Partnerships*].

g. Necessity of complying with federal and state regulation of securities.

NOTE:

Although a general partnership interest ordinarily is not considered a security, a limited partnership interest is usually a security under state and federal regulations [***see*** *Corp. Code § 25019*; ***see also*** *15 U.S.C. § 77b(a)(1)* (definition of security)].

3. Consider income tax consequences of doing business as a partnership, including:

a. Each partner's liability for tax on distributive share of partnership income, whether or not income is distributed [*I.R.C. §§ 701, 702, 704*].

b. Partners' ability to allocate income, deductions, credits, gain, and losses in proportions other than their capital interests [*I.R.C. § 704(a), (b)*; *see also Treas. Reg. § 1.704-1(b)(2)(i)*].

NOTE:

If the partnership distributes contributed property within seven years of contribution, the contributing partner recognizes gain or loss [***see*** *I.R.C. § 704(c)*].

c. Each partner's ability to deduct share of partnership loss from personal income to extent of partner's basis in partnership [*I.R.C. § 704(d)*; *see I.R.C. § 165*].

d. Partner's ability to increase basis in appreciated property (for purpose of increased depreciation deductions) by selling property to partnership [*see I.R.C. §§ 707(a), 722, 1012*].

NOTE:

The partner will recognize gain on the profit from the sale of appreciated assets [***see*** *I.R.C. §§ 707(a), 1012, 1239*].

e. Family income-splitting opportunities [*see I.R.C. § 704(e)*; *see also § 1B.66[3]*].

f. Greater flexibility in planning for the disposition of business interest at retirement or death than either sole proprietorship or corporation [*see § 1B.65[2][c]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties &

LiabilitiesGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART III. TRANSACTION GUIDE
B. Preliminary Determinations to Selecting a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.113

§ 1B.113 Determine Whether to Form Limited Liability Company

1. Consider advantages of doing business as LLC, including [*see § 1B.13[2]*]:

NOTE:

LLCs are prohibited from engaging in the banking business, the business of issuing policies of insurance and assuming insurance risks, or the trust company business as well as from providing professional services [*Corp. Code §§ 17002(a), 17375*]. However, LLCs may operate as licensed health care service plans if they are subsidiaries of licensed health care service plans and are established to serve an existing line of business of the parent [*Corp. Code § 17002(b)*].

a. Members ability to participate in management of LLC business.

NOTE:

LLC management and governance ordinarily are more flexible than that permitted in corporations. An LLC may be managed by all its members or by managers, who may but need not be members [*Corp. Code §§ 17150, 17151*]. The combined talents of the members can broaden the firm's basis for business judgments and operations, permitting specialization and enabling it to operate on a wider scope than a sole proprietorship. Unlike limited partners who participate in the management and control of the partnership, LLC members and managers do not forfeit their limited liability protection by participating in the management of the LLC [*Corp. Code §§ 15632, 15903.03, 15643(b), 17101(a), 17158*].

b. Greater availability of capital than in sole proprietorship [*see § 1B.43[5]*].

c. Ability to share risks and losses.

d. Ability to limit losses to investment.

NOTE:

In general, members of LLCs and limited partners, like corporate shareholders, are shielded from personal liability for company obligations [*Corp. Code §§ 15632-15636, 15643(b), 17101(a), (b), 17158*; ***see*** *People v. Clauson (1964) 231 Cal. App. 2d 374, 41 Cal. Rptr. 691* ; ***see also*** *§ 1B.13[2][b],* P 2c, ***below***].

e. Relatively limited formation costs [*but see* P 2e, *below*].

NOTE:

LLCs must pay a fee for filing the articles of organization [*Gov. Code § 12190(b)*], an annual minimum tax [*Rev. & Tax. Code § 17941*; ***see*** *Rev. & Tax. Code § 23153*; ***see also*** *Rev. & Tax. Code § 17220* (tax not deductible)], and a graduated fee based on income of $250,000 or more [*Rev. & Tax. Code § 17942*]. However, LLCs that are exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that are not taxed as a corporation for California tax purposes are not subject to the annual minimum tax or the graduated fee [***see*** *Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; ***see also*** *I.R.C. § 501(c)(2), (25)* (title holding companies)].

2. Consider disadvantages of doing business as LLC, including:

a. Possible difficulty of obtaining consensus of LLC members (or managers) regarding management of business.

b. Individual members' inability to use LLC property for any purpose other than LLC business [*see Corp. Code § 17003*].

c. Each member's personal liability (regardless of initial capital contribution) for tortious conduct, improper distributions, failure to pay taxes, and other acts that might result in shareholder liability, including under the alter ego doctrine [*Corp Code §§ 17101(a)- (c), 17254, 17255*; *Rev. & Tax. Code § 6829* (responsible members)].

NOTE:

In an LLC, the members liability is ordinarily to their capital contributions [*Corp. Code § 17101(a)*].

d. Restricted transferability of membership interest [*see Corp. Code §§ 17301(a), 17303(a)*; *see also § 1B.44[4]*].

NOTE:

LLC members may freely assign or encumber their economic interests [***see*** *Corp. Code §§ 17001(n), 17301(a), 17303(a)*]. An LLC operating agreement may provide for unrestricted transferability of membership interests.

e. Substantial expense involved in preparation of LLC operating agreement.

f. Limited duration of LLC [*see § 1B.45[3]*].

g. Relative newness of entity in California and limited case law.

3. Consider income tax consequences of doing business as an LLC, including:

a. If desired, single level of taxation, with profits and losses reported at member level [*see Treas. Reg. § 301.7701-3(a)*; *see also § 1B.13[2][e]*].

NOTE:
Under entity classification regulations that took effect on January 1, 1997, an LLC with two or more members may elect to be taxed either as a partnership or as a corporation. An LLC with only one owner can elect to be disregarded as an entity separate from the owner [*Treas. Reg. § 301.7701-3(a)*].

b. Flexibility in allocating income, deductions, credits, gains, and losses according to agreement, not necessarily on basis of capital interests [*I.R.C. § 704(a), (b)*; *Corp. Code § 17202*; *see § 1B.13 [2][e]*; *see also Treas. Reg. § 1.704-1(b)(2)(i)*].

c. Each member's liability for tax on distributive share of LLC income, whether or not income is distributed [*I.R.C. §§ 701, 702, 704*].

d. Each member's ability to deduct share of LLC loss from personal income to extent of member's basis [*I.R.C. § 704(d)*; *see I.R.C. § 165*].

e. Member's ability to increase basis in appreciated property (for purpose of increased depreciation deductions) by selling property to LLC [*see I.R.C. §§ 707(a), 722, 1012*].

NOTE:
The member will recognize gain on the profit from the sale of appreciated assets [***see*** *I.R.C. §§ 707(a), 1012, 1239*].

f. Family income-splitting opportunities [*see I.R.C. § 704(e)*; *see also § 1B.66[3]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART III. TRANSACTION GUIDE
B. Preliminary Determinations to Selecting a Business Form

1-1B California Legal Forms--Transaction Guide § 1B.114

§ 1B.114 Determine Whether to Form Corporation

1. Consider advantages of doing business as a corporation, including [*see §§ 1B.30, 1B.31*]:

a. Ability to spread risk over large number of investors.

b. Ability to raise large amounts of capital by selling corporate stock.

c. Ability to offer key employees ownership interests through shares in the corporation.

d. Centralized business management under board of directors unless otherwise provided in incorporation documents [*Corp. Code § 300(a)*; *see Corp. Code § 312(b)*].

e. Limited liability of shareholders for debts of the corporation [*see § 1B.42[5]-[7]*].

f. Continuity of existence of business entity [*Corp. Code § 200(c)*; *see § 1B.45[4]*].

g. Free transferability of ownership interests, unless restricted by certificate of incorporation, bylaws, or shareholder agreement [*Corp. Code § 204(a)(2), (b)*; *see Corp. Code §§ 404-406*].

NOTE:
In close corporations, transfer is usually restricted by written agreement [*Corp. Code § 204(a)(3), (b)*]. In professional corporations, ownership of shares is restricted to the issuing corporation or to persons licensed by the profession in which the corporation provides services [*Corp. Code §§ 13406, 13407*]. In either case, transfer is practically restricted by the availability of an actual market for the shares.

h. Family income splitting opportunities [*see § 1B.66[4]*].

i. Potentially better market for ownership interests than for sole proprietorships, general or limited partnerships, or LLCs.

NOTE:

Sale of corporate stock is widely understood. This comfort level may encourage investors to purchase corporate shares rather than partnership or LLC interests. However, an unknown corporation, despite its form, may not be able to attract investors.

j. Potentially better image for marketing and credit purposes.

2. Consider disadvantages of doing business as a corporation, including:

a. Substantial legal formalities and expense of forming corporation, including filing certificate of incorporation [*see Corp. Code §§ 200-201.5*] and adoption of bylaws [*see Corp. Code §§ 211-213*].

NOTE:

For a discussion of corporate formation, see Ch. 2, ***Formation of Corporations*** , Ch. 2B, ***Electing Subchapter S Status*** , Ch. 3, ***Articles of Incorporation*** , Ch. 4, ***Bylaws*** , and Ch. 12A, ***Professional Corporations*** .

b. Substantial formalities in running business, including meetings of shareholders [*see Corp. Code §§ 600-604*] and directors [*see Corp. Code §§ 300-317*], keeping corporate records and filing annual reports [*see Corp. Code §§ 1500-1509*], unless corporation is close corporation [*see Corp. Code § 300(b)*].

NOTE:

For a discussion of shareholders meetings, see Ch. 8A, ***Shareholders' Meetings, Voting, and Agreements*** . Corporate records and reports are discussed in Ch. 7, ***Corporate Records and Reports*** .

c. Expense and formalities required to do business in other states.

d. Necessity of complying with federal and state regulation of securities issued by corporation [*see § 1B.46[4]*; *see also* Ch. 6, *Securities Regulation Issues*].

3. Consider income tax consequences of doing business as a corporation, including:

a. Treatment of anticipated business income that will be derived from dividends, interest, rents, royalties, and personal service contracts.

NOTE:

If 60 percent or more of a corporation's income is from these sources, and if more than 50 percent of the corporate stock is owned by five or fewer persons, then the corporation may be classed as a personal holding company and the undistributed income will be taxed a 15-percent rate, effective for tax years beginning after December 31, 2002 and before January 1, 2009 [*I.R.C. §§ 541, 542(a)(1)*; for tax years beginning before 1/1/03 and after 12/31/08, the tax rate is the highest rate of tax imposed under *I.R.C. § 1(c)* (*I.R.C. § 541*, before amendment by Pub. Law No. 108-27, §§ 302(f)(1), 303); ***see*** *I.R.C. §§ 543, 545*; ***see also*** *§ 1B.63[2][e][ii]*].

b. Treatment of income that corporation will retain.

NOTE:

Once a corporation has accumulated income of $250,000 over the entire period of its existence, any additional accumulated income must be justified to the Internal Revenue Service as an accumulation necessary for the reasonable needs of the business, or an additional 15-percent tax will be imposed on the corporation's accumulated income in that year, effective for tax years beginning after December 31, 2002 and before January 1, 2009 [*I.R.C. §§ 531, 535*; for tax years beginning before 1/1/03 and after 12/31/08, the tax rate is the highest rate of tax imposed under *I.R.C. § 1(c)* (*I.R.C. § 531*, before amendment by Pub. Law No. 108-27, §§ 302(f)(1), 303); ***see*** *I.R.C. §§ 531-537*]. Certain corporations, including health, law, engineering, architectural, actuarial science, performing arts, and consulting corporations, may only accumulate up to $150,000 of income [*I.R.C. § 535(c)(2)(B)*; ***see also*** *§ 1B.63[2][e][iii]*].

c. Treatment of loans made by participant to business.

NOTE:

Restructuring shareholder investments as loans rather than as capital contributions is one way to minimize the double tax on corporate income. Interest payments made by the corporation to its shareholders are taxable to the recipient [*I.R.C. § 61(a)(4)*] and deductible to the business entity [*I.R.C. § 163(a)*]. However, if the IRS determines an interest payment to be a disguised dividend, or the ratio of debt to equity or capital investment is too high, the IRS may reclassify the corporation's debt as a contribution of capital and recharacterize the interest payments as nondeductible dividends [***see*** *I.R.C. § 385*].

d. Tax rate differentials between individuals and corporations, and double taxation of income first taxed as income received by corporation and taxed again when received by shareholders as dividends [*see § 1B.63[2][e][i]*].

NOTE:

The maximum individual tax rate is 39.1 percent for 2001, 38.6 percent for 2002, and 35 percent after 2002 [*I.R.C. § 1(a)-(d), (i)(2)*]. In contrast, the maximum federal corporate tax rate for taxable income between $75,000 and $10 million is 34 percent. For taxable income over $10 million, the maximum corporate tax rate is 35 percent [*I.R.C. § 11(b)*]. An additional 5 percent tax is imposed on corporate taxable income exceeding $100,000, with an $11,750 cap on additional tax liability. This causes an effective tax rate of 39 percent on taxable income between $100,000 and $335,000. A 3 percent additional tax is imposed on corporate taxable income exceeding $15 million, with a $100,000 cap on additional tax liability. This causes an effective tax rate of 38 percent on corporate taxable income between $15 million and $18,333,333. Corporate taxable income over $18,333,333 is subject to a tax rate of 35 percent [*I.R.C. § 11(b)(1)*]. Personal service corporations are subject to a flat tax rate of 35 percent on all taxable income [*I.R.C. § 11(b)(2)*]. Corporations are not eligible for the relatively low capital gains rates (generally 15 percent) that individuals have [*I.R.C. §§ 1, (h)(1)(C), 1201(a)*; the 15-percent maximum capital gains rates for individuals is effective generally for tax years ending on or after 5/16/03 and before 2009 (*I.R.C. § 1(h)(1)*; ***see*** Pub. Law No. 108-27, §§ 301, 303)].

If double taxation of corporate income will seriously affect profitability of corporation, consider having corporation: (1) eliminate the double tax by electing Subchapter S status [***see*** *§ 1B.31[4]*]; or (2) minimize the double taxation by making payments to shareholders that can be deducted by the corporation from its taxable earnings, such as in the form of compensation [***see*** *§ 1B.63[2][e]*].

e. Treatment of salaries that will be paid to owners of business.

(1) Determine whether desired salaries are reasonable [*see Treas. Reg. § 1.162-8*].

NOTE:
A corporation that intends to distribute most of its income as salaries and fringe benefits should be concerned that those amounts be reasonable. Although reasonable salaries are deductible business expenses [*I.R.C. § 162(a)(1)*], unreasonably high salaries may be recharacterized by the Internal Revenue Service as dividend distributions [*Treas. Reg. §§ 1.162-7, 1.162-8*]. Factors that determine the reasonableness of salaries include: the employee's qualifications; the employee's position; the amount of time spent working for the corporation; the size and complexity of the business; salaries paid for comparable positions by comparable corporations; and the amount of compensation paid to the employee in previous years [***see*** *Elliotts, Inc. v. Commissioner (9th Cir. 1983) 716 F.2d 1241 ; Kennedy v. C.I.R. (6th Cir. 1982) 671 F.2d 167, 173, 174]* .

(2) Determine amount of compensation to shareholder employee providing maximum tax advantage.

NOTE:
Income-splitting possibilities exist between the corporation and its shareholder employees. Trial computations should be made to determine the level of salaries that will yield the lowest overall tax burden for both the corporation and the shareholder. Although income splitting may provide a major tax advantage, the possibility exists that compensation may be recharacterized as a dividend distribution, resulting in an increased tax liability to the corporation [*Treas. Reg. §§ 1.162-7, 1.162-8*]. Further, a negligence penalty may be imposed if the corporation's underpayment of tax is due to negligence or intentional disregard (not fraud) of the Treasury Regulations [***see*** *I.R.C. § 6653(a)*].

f. Choice of fiscal year.

g. Ability to deduct losses against passive income unless corporation is closely held, personal service, or S corporation [*I.R.C. § 469(a)(2)*].

h. Taxation on distribution of appreciated assets [*see § 1B.110[2]*].

i. Treatment of corporation, if collapsible [*see I.R.C. § 341*, temporarily repealed, effective for tax years beginning after December 31, 2002, and before January 1, 2009 (Pub. Law No. 108-27, §§ 302(e)(4)(A), 302(f)(1), 303); *see also § 1B.65[1][e]*].

j. Conducting business through more than one corporation.

NOTE:
Multiple corporations might be warranted if it is contemplated that a part of the business will be disposed of in the future. By initially forming multiple corporations, the exacting requirements of statutory

spin-off provision [***see*** *I.R.C. § 346*] and spin-off [***see*** *I.R.C. § 355*] may be avoided at the time of disposal.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART III. TRANSACTION GUIDE
B. Preliminary Determinations to Selecting a Business Form

1-1B California Legal Forms--Transaction Guide §§ 1B.115-1B.199

[Reserved]

§§ 1B.115[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART IV. FORMS

1-1B California Legal Forms--Transaction Guide § 1B.200

§ 1B.200 Client Letter Before Initial Meeting

[1] Comment

[a] Use of Form

Before the initial meeting with the client, the attorney will want to obtain enough information to determine the scope of the work to be done and any preliminary decisions to be made. Although a client may approach the attorney to prepare a partnership agreement or LLC articles of organization, or to file incorporation documents, other options in choice of form should be considered to ensure that the client makes an informed decision.

At the initial meeting, the attorney will want to have additional, specific information to estimate the time required to perform the legal and factual research and analysis. However, complicated or lengthy questionnaires tend to discourage clients and frequently result in canceled appointments because the client is "unprepared." The letter that follows is composed with that in mind. If a more detailed set of questions is appropriate before the initial meeting, the attorney should incorporate relevant facts and documents from the Client Interview in this Transaction Guide [*see §§ 1B.100, 1B.101*].

[b] Fee and Representation Agreement

Mention is made of this agreement in the first paragraph of the form below. For sample forms, see Volume 15, Chapter 86, *Agreements for Professional Services* .

[2] FORM

Client Letter Before Initial Meeting

_____[*date*]
_____[*client's name and address*]

Re: Choice of Business Form

Dear _____ [*client's name*]:

In preparation for our initial meeting, regarding the choice of business form for your proposed business, I have _____[sent you under separate cover *or* enclosed] a fee and representation agreement outlining our mutual obligations.

The purpose of this letter is to provide you with a short list of the documents and information that you should bring to our initial meeting. This is a suggested list only. If you believe other items would be useful, please bring those as well. If you are unable to obtain everything on the list, bring what you have available.

Information:

1. Names and telephone numbers of people who will likely be key to the business (including owners, managers, investors, accountants, bankers, etc.).

2. An estimate of the amount of money needed to get the business up and running.

3. An estimate of the amount of money required by the business until the business itself becomes profitable.

4. Sources of funding (including amounts to be contributed by business owners, loans from owners to business, other loans, etc.)

Documents:

1. Three years' prior federal income tax returns for likely participants in business venture, including individuals and any business entities.

2. Copies of participants' retirement plans or summaries of plan benefits.

3. Copy of any business plan.

4. Projected profit and loss statements and balance sheet for the proposed business, if available.

5. Any existing agreements that the participants plan to sign when the business is formed.

I look forward to meeting with you on _____[*date*] at _____[*time*] at _____[*location*] to discuss the formation of your business. Please do not hesitate to call if you have questions.

Very truly yours,
_____ [*signature of attorney*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsAttorney FeesFee Agreements



106 of 113 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART IV. FORMS

1-1B California Legal Forms--Transaction Guide § 1B.201

§ 1B.201 Client Letter Following Initial Meeting

[1] Comment--Use of Form

The letter to a client following an initial meeting serves two purposes. First, it reiterates the tasks that the attorney will perform, reminding the client of the extent of the work involved; if there are tasks that the client has agreed that the attorney will not perform, for example such as contacting a tax professional, tasks not to be performed should also be outlined. Second, if the attorney is awaiting additional materials, it provides the client with a complete list of the additional information or documents that he or she must provide, putting the client on notice that work cannot be completed without those items.

[2] FORM

Client Letter Following Initial Meeting

_____[*date*]
_____[*client's name and address*]

Dear _____ [*client*]:

In our meeting on _____[*date*], we agreed that I would perform the research and analysis necessary to determine the most appropriate form for your proposed business venture. This will include _____[*e.g.*, (1) trial computations to determine which form provides the lowest overall tax burden; (2) research regarding applicable securities law restrictions; etc.].

[*If client agreed to provide additional information, use:*]

We also agreed that you would provide me with the following _____[information *or* documents *or* information and documents]: _____[*list information and documents*].

I look forward to receiving your information as soon as possible, so that I can complete the work we discussed. I will telephone you to confirm receipt of your materials and to schedule a date for our follow-up discussion.

[*OR*]

[*If client will not provide any additional information, use:*]

I look forward to seeing you on _____[*date*], _____[*time*], _____[*location*] to discuss the results of this research.

Very truly yours,
_____ [*signature of attorney*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting Representation

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART IV. FORMS

1-1B California Legal Forms--Transaction Guide § 1B.202

§ 1B.202 Follow-up Letter to Client if No Business Will Be Formed

[1] Comment--Use of Form

If the client decides not to form a business at the time of the meeting, or at sometime thereafter, a follow-up letter to the client establishes the end of the attorney-client relationship related to that particular representation. This letter will help establish a date from which the statute of limitations runs for purposes of malpractice claims [*see Code Civ. Proc. § 340.6(a)(2)*].

If the client has provided the attorney with documents, the attorney should return them to the client along with this letter. The attorney should send the letter certified or registered mail, to document the close of the attorney-client relationship, if need be, as well to establish that any returned documents have been received.

[2] FORM

Follow-up Letter to Client if No Business Will Be Formed

_____[*date*]
_____[*client's name and address*]

Dear _____ [*client*]:

This letter will confirm our _____[office *or* telephone] conversation of _____[*date*], in which we concluded that you would not be forming your proposed business venture.

If you decide to pursue this matter, please feel free to consult us again. However, currently, we consider the matter closed.

We appreciate your confidence and having had the opportunity to be of service. Please call if you have any questions, or of we can be of service in the future.

Very truly yours,
_____ [*signature of attorney*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsEffective Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART IV. FORMS

1-1B California Legal Forms--Transaction Guide § 1B.203

§ 1B.203 Client Letter if Business Will Be Formed

[1] Comment--Use of Form

This form is a letter that should be sent to a client when, after consultation, the client has selected a form of business entity. The letter documents for the attorney, and clarifies for the client, the consequences of choosing a particular form. Counsel should consider identifying any particular disadvantages of the chosen form of entity. The letter contains optional paragraphs for use when the selection of entity is the final task or when the attorney will continue determinations.

[2] FORM

Client Letter if Business Will Be Formed

_____[*date*]
_____[*client's name and address*]

Dear _____ [*client*]:

This letter confirms our conversation of _____[*date*], in which we concluded that the _____[*specify selected business form, e.g.,* sole proprietorship, general partnership, limited partnership, limited liability company, corporation, or Subchapter S corporation] is the most appropriate form to use to carry on _____[your proposed business *or name of business to be formed*].

As we discussed, the use of this form has the following advantages: _____[*specify advantages*].

As we also discussed, this form has the following disadvantages: _____[*specify disadvantages*].

[*If attorney wishes to highlight significant disadvantages of the chosen form, add:*]

In the case of _____[your business venture *or name of business*], you should be particularly aware of the possible adverse consequences of _____[*e.g.*, unlimited personal liability *or* double taxation *or* the ability to be bound by the authority of others]. If you have any questions about our discussion(s), please do not hesitate to call.

[*If organizational work is to be done, add:*]

I look forward to beginning work on the actual formation of _____[your business *or name of proposed business*]. We appreciate your confidence and having the opportunity to serve you.

[*OR*]

[*If attorney's work is complete, add:*]

This letter also confirms our _____[office *or* telephone] conversation on _____[*date*], in which we agreed that, having assisted you in your choice of business form, our work on this matter is now finished.

We appreciate your confidence and having had the opportunity to serve you. If we can be of assistance in the future, please do not hesitate to call.

[*Continue with the following:*]

Very truly yours,
_____ [*signature of attorney*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsEffective Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART IV. FORMS

1-1B California Legal Forms--Transaction Guide § 1B.204

§ 1B.204 Table: Comparison of Business Forms: Nontax Attributes

[1] Comment

[a] Use of Form

This table provides a summary comparison of the significant nontax characteristics of the sole proprietorship, general partnership, limited partnership, limited liability company, and corporation.

This form may be used as a summary reminder subsequent to performing the research necessary to choose the appropriate business form; or it may be consulted, for an overview, before beginning that research.

For a detailed comparison of business forms, see *Sections 1B.10 through 1B.31*, which identify and define the different forms of business organization; Sections 1B.20 through *1B.48*, which identify the non-tax advantages and disadvantages of the different forms; and *Sections 1B.60* through *68*, which identify the tax advantages and disadvantages of the different forms.

[b] Use of Abbreviations

The following abbreviations are used in this form: sole proprietorship (SP), general partnership (GP), limited partnership (LP), limited liability company (LLC), corporation (corp.), S corporation (S corp.), and shareholder (SH).

[2] FORM

Table: Comparison of Business Forms: Nontax Attributes

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral

PartnershipsFormationElementsBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawSole Proprietorships

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART IV. FORMS

1-1B California Legal Forms--Transaction Guide § 1B.205

§ 1B.205 Table: Comparison of Business Forms: Tax Attributes

[1] Comment

[a] Use of Form

This table provides a summary comparison of the significant tax attributes of the sole proprietorship, general partnership, corporation, limited liability company, and S corporation. Tax characteristics of limited partnerships that vary from those of general partnerships are noted as well.

This form may be used as a summary reminder subsequent to performing the research necessary to choose the appropriate business form; or it may be consulted, for an overview, before beginning that research.

For a detailed comparison of business forms, see *Sections 1B.10 through 1B.31*, which identify and define the different forms of business organization; *Sections 1B.40* through *1B.48*, which identify the non-tax advantages and disadvantages of the different forms; and *Sections 1B.60* through *68*, which identify the tax advantages and disadvantages of the different forms.

[b] Use of Abbreviations

The following abbreviations are used in this form: sole proprietorship (SP), general partnership (GP), limited partnership (LP), limited liability company (LLC), corporation (corp.), S corporation (S corp.), and shareholder (SH).

[2] FORM

Table: Comparison of Business Forms: Tax Attributes

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationElementsBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawSole Proprietorships

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART IV. FORMS

1-1B California Legal Forms--Transaction Guide § 1B.206

§ 1B.206 Table: Comparison of Business Forms: Availability of Fringe Benefits to Owners

[1] Comment

[a] Use of Form

This table provides a summary comparison of the significant fringe benefits available to the sole proprietorship, general partnership, corporation, and S corporation. Available benefits are those that are deductible to the business and not taxed on receipt to the owner-employee. Limited partners are not, by their very nature, owner-employees and are not eligible for these benefits.

In a small corporation, whose owners will be employees, there is a significant tax advantage to paying out most of the business's earnings as salaries and fringe benefits. The corporation receives a deduction for these payments, provided that they are reasonable [*see I.R.C. § 162(a)(1)*; *Treas. Reg. § 1.162-8*], which mitigates the impact of double taxation which arises if distributions are made to shareholders in the form of dividends. Further, certain fringe benefits received are excluded from the owner-employee's income [*see § 1B.68 [4]*]. Although more, and somewhat better, fringe benefits are available through corporate entities than noncorporate entities, most prospective business owners will want to know the extent of tax deductible benefits available for them, whatever form they chose.

For a general discussion of the fringe benefits available to each business form, see *§ 1B.68[4]*.

[b] Use of Abbreviations

The following abbreviations are used in this form: sole proprietorship (SP), general partnership (GP), limited partnership (LP), corporation (corp.), S corporation (S corp.), shareholder (SH).

[2] FORM

Table: Comparison of Business Forms: Availability of Fringe Benefits to Owners

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationElementsBusiness & Corporate LawSole Proprietorships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART IV. FORMS

1-1B California Legal Forms--Transaction Guide § 1B.207

§ 1B.207 Table: Comparison of Business Forms: Startup Costs

[1] Comment

[a] Use of Form

This table provides a summary comparison of the significant startup costs of sole proprietorships, general partnerships, limited partnerships, limited liability companies, corporations, and limited liability partnerships. This form may be used as a summary reminder after performing the research necessary to choose the appropriate business form, or it may be consulted as an overview of startup costs before beginning that research.

Startup costs include document preparation, filing fees, licensing, and the like. Filing fees for noncorporate entities are ordinarily the same, and licensing fees tend to apply without regard to the type of business entity. However, the cost of preparing the organizational documents can vary widely depending on the nature and structural complexity of the business [*see [b], below*].

A table comparing ongoing operating costs for different types of entities is *set forth in § 1B.208*. For a detailed comparison of business forms, see *§§ 1B.10-1B.31*, which identify and define the different forms of business organization; §§ 1B.20-1B.48, which identify the non-tax advantages and disadvantages of the different forms; and §§ 1B.60-1B.68, which identify the tax advantages and disadvantages of the different forms. Tables comparing tax and nontax attributes and tax benefits of various business entities are *set forth in §§ 1B.204-1B.206*. More specific information as to filing requirements and startup costs may be found in the individual chapters dealing with the selected entity.

[b] Nature and Complexity of Business Predominate Selection of Entity

In general, the nature and complexity of the proposed business determines the expense of organizing as a particular business entity rather than the applicable filing fees. If the parties forming a business entity wish to limit their liability, the resulting entity (corporation, limited liability company, or limited partnership) is subject to more statutory requirements and formalities than entities (such as general partnerships) that are fully liable. For example, although a corporation is relatively inexpensive to form, it must make more detailed annual filings, hold noticed meetings at least

annually, and maintain minutes and records to maintain its liability shield. In addition, the operating document of an entity with limited liability (limited partnership agreement, operating agreement, or bylaws) will likely be more complicated (and more expensive) to prepare. However, if the parties decide to form a large general partnership, the partnership agreement must be detailed enough to comprehensively handle all aspects of the partners' relations and can be extremely expensive to prepare.

Special considerations related to family business entities may make the organization and operation of these businesses more expensive. Such an organizational agreement incorporates estate planning objectives and a succession plan and is highly individualized. For further discussion, see Ch. 68A, *Using Family Partnerships and Other Business Entities in Estate Planning* .

[2] FORM

Table: Comparison of Business Forms: Startup Costs

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawSole Proprietorships

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113 of 113 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1B SELECTING FORM OF BUSINESS ENTITY
PART IV. FORMS

1-1B California Legal Forms--Transaction Guide § 1B.208

§ 1B.208 Table: Comparison of Business Forms: Ongoing Filing Costs and Formalities

[1] Comment--Use of Form

This table provides a summary comparison of the ongoing filing costs of sole proprietorships, general partnerships, limited partnerships, limited liability companies, corporations, and limited liability partnerships, as well as a comparison of the minimum ongoing formalities for such entities that are required by statute. This form may be used as a summary reminder after performing the research necessary to choose the appropriate business form, or it may be consulted as an overview of potential operational costs before beginning that research.

Ongoing annual costs include annual informational statements, as well as compliance with other requirements applicable to the particular entity, such as noticed meetings. It is important to analyze potential annual costs when selecting the business form.

A table comparing startup costs for different types of entities is set forth in*§ 1B.207*. For a detailed comparison of business forms, see *§§ 1B.10-1B.31*, which identify and define the different forms of business organization; §§ 1B.20-1B.48, which identify the non-tax advantages and disadvantages of the different forms; and §§ 1B.60-1B.68, which identify the tax advantages and disadvantages of the different forms. Tables comparing tax and nontax attributes and tax benefits of various business entities are *set forth in §§ 1B.204-1B.206*. More specific information as to filing requirements and startup costs may be found in the individual chapters dealing with the selected entity.

[2] FORM

Table: Comparison of Business Forms: Ongoing Filing Costs and Formalities

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesGeneral

OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesBusiness & Corporate LawSole Proprietorships



1 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS

1-1C California Legal Forms--Transaction Guide 1C.syn

§ 1C.syn Synopsis to Chapter 1C: REGULATION OF EMPLOYERS

§ 1C.01 California Sources

[1] California Constitution

[2] Statutes

[3] Regulations

[4] Attorney General Opinions

§ 1C.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 1C.03-1C.04 [Reserved]

§ 1C.05 Law Reviews and Periodicals

§ 1C.06 Annotations

§ 1C.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§ 1C.08 Pamphlets

§ 1C.09 [Reserved]

§ 1C.10 California Equal Employment Opportunity Law

[1] California Fair Employment and Housing Act

[a] Prohibition on Discrimination

[b] Application of FEHA

[2] California Equal Pay Act

[3] Unruh Civil Rights Act

[4] Ralph Civil Rights Act

[5] Prohibition Against Discrimination in State-Funded Programs

[6] Prohibition Against Discrimination Based on Sexual Orientation

[7] California Constitution

[8] Disability Protections

§ 1C.11 Federal Equal Employment Opportunity Law

[1] Title VII of Civil Rights Act of 1964

[a] Discrimination in Employment Prohibited

[b] Discrimination in Employment Advertising Prohibited

[c] Employers Covered

[d] Exceptions to Application of Title VII

[2] Age Discrimination in Employment Act

[a] Prohibition on Age Discrimination

[b] Employers Covered

[3] Equal Pay Act of 1963

[4] Americans With Disabilities Act of 1990

[a] Prohibition on Discrimination

[b] Employers Covered

[c] Permissible Examinations

[5] Rehabilitation Act of 1973

[a] Contracts With Federal Government

[b] Financial Assistance From Federal Government

[6] Veterans' Programs

[a] Vietnam Era Veterans' Readjustment Assistance Act

[b] Veteran's Reemployment Rights Act

[7] Civil Rights Act of 1866

[8] Title VI of Civil Rights Act of 1964

[9] Immigration Reform and Control Act

§ 1C.12 Employment Contracts

[1] "Contract of Employment" Defined

[2] Statute of Frauds

[3] Written Contracts

[a] Use of Written Contract

[b] When Written Contract Is Required

[4] Oral Contracts

[5] Enforcement of Employment Contracts

§ 1C.13 Sexual Harassment in the Workplace

[1] Types of Sexual Harassment

[a] In General

[b] "Hostile Environment" Harassment

[c] "Quid Pro Quo" Harassment

[2] Guidelines on Discrimination Because of Sex

[3] Employer Liability for Sexual Harassment

[a] Basis of Liability

[b] Standard of Behavior

[c] Prevention and Correction of Sexual Harassment

§§ 1C.14-1C.19 [Reserved]

§ 1C.20 Constitutional Protection of Privacy

[1] California Constitution

[a] In General

[b] Permissible Intrusion Into Privacy

[2] Federal Constitution

§ 1C.21 Protection of Particular Privacy Issues

[1] Arrest Record Not Resulting in Conviction

[2] Fair Employment and Housing Act Privacy Protection

[a] In General

[b] Sex

[c] Pregnancy

[d] Marital Status

[e] Religion

[f] Age

[g] Physical Disability

[h] Medical Examination

[3] AIDS Test

[4] Drug Test

[a] In General

[b] Application of Hill Balancing Test

[c] Elements of Cause of Action

[d] Application to Employment Setting

[e] Federally Mandated Drug Testing

[5] Alcohol Test

[6] Polygraph Test

[7] Eavesdropping and Wiretapping

[8] Investigative Report

[9] Credit Report

[10] Determination of Unauthorized Alien Status

[11] Leave Related to Domestic Violence

§§ 1C.22-1C.29 [Reserved]

§ 1C.30 Grounds for Termination

[1] In General

[2] Termination of Employment for Specified Term

[3] Termination of Employment Without Specified Term (Employment at Will)

[4] Statutory Exceptions to Employment at Will

[5] Judicial Exceptions to Employment at Will

[a] Wrongful Termination in Violation of Public Policy

[b] Agreement to Terminate for "Good Cause Only"

[c] Termination in Violation of Covenant of Good Faith

§ 1C.31 Notification Required by Worker Adjustment and Retraining Notification Act

§ 1C.32 Payment Obligation on Termination

[1] Time of Payment

[2] Place of Payment

[3] Vested Vacation Pay

§ 1C.33 Prohibition on Retaliatory Termination or Discipline

[1] California Law

[a] Job Discrimination

[b] Violation of Statute or Regulation

[c] Injury and Illness Prevention Program

[d] Safety or Health Violations

[2] Federal Law

§§ 1C.34-1C.39 [Reserved]

§ 1C.40 Obligations for State Tax Purposes

[1] In General

[2] Income Tax

[3] Unemployment Insurance

[a] Purpose

[b] Duty to Withhold and Contribute

[c] "Employer" and "Employee" Defined

[4] Disability Insurance

[5] Employment Training Tax

[6] Workers' Compensation

[a] Basis of Liability

[b] Exclusive Remedy

[c] Duty to Insure

[d] Parties Covered

[7] Registration With California Employment Development Department

§ 1C.41 Obligations for Federal Tax Purposes

[1] In General

[2] Income Tax

[3] Social Security and Medicare Tax

[a] Duty to Withhold

[b] Definitions

[4] Unemployment Tax

[5] Federal Employer Identification Number

§§ 1C.42-1C.49 [Reserved]

§ 1C.50 Applicability of California Governing Law

[1] Labor Code

[2] Industrial Welfare Commission Orders

§ 1C.51 Applicability of Federal Fair Labor Standards Act

[1] Extent of Coverage

[2] Nonwaivability

§ 1C.52 Minimum Wage Requirements

[1] California Law

[a] In General

[b] Credits Against Minimum Wage

[c] Prevailing Wage Requirement for Public Works

[2] Federal Law

[a] In General

[b] Credits Against Minimum Wage

§ 1C.53 Equal Pay Rates for All Employees

§ 1C.54 Overtime Compensation

[1] California Law

[a] "Workday" and "Workweek" Defined

[b] When Overtime Is Owed

[c] Exceptions to Overtime Regulations

[d] Employees Exempted From Overtime Regulations

[e] Alternative Work Schedules

[2] Federal Law

[a] "Workweek" as Measure of Overtime

[b] Employees Covered

[c] Employees Exempted

§ 1C.55 Regulation of Hours

[1] State Law

[a] Restriction on Hours Worked

[b] Meal and Rest Periods

[c] One Day's Rest in Seven

[d] Minors

[e] Use of Paid Vacation Time

[2] Federal Law

§ 1C.56 Time and Place of Payment of Wages

[1] During Employment

[a] In General

[b] Agricultural and Domestic Workers

[c] Notice of Time and Place of Payment

[d] Prohibitions on Repayment

[e] Itemized Payroll Statement

[f] Deductions, Assignments, and Garnishments

[2] On Discharge or Quitting

§ 1C.57 Form of Payment

[1] California Law

[2] Federal Law

§ 1C.58 Workplace Posting Requirements

[1] California Law

[2] Federal Law

§ 1C.59 Workplace Recordkeeping Requirements

[1] California Law

[a] In General

[b] Employee Inspection of Records

[c] Other Records

[2] Federal Law

§ 1C.60 Employing Minors Under California Law

[1] In General

[2] Permits to Employ Minors

[3] Hours of Employment

[4] Minimum Wage

[5] Prohibited Occupations

[a] Minors Under 18

[b] Minors Under 16

[c] Minors Under 12

[6] Labor Commissioner's Permission Required for Certain Occupations

§ 1C.61 Employing Minors Under Federal Law

[1] Prohibition on Oppressive Child Labor

[2] Exemptions From Fair Labor Standards Act

[3] Hours of Employment

[4] Minimum Wage

[5] Permits to Employ Minors

§ 1C.62 Relations With Organized Employees

[1] Federal Labor Management Relations Act

[a] Employees' Right to Organize

[b] Unfair Labor Practice

[c] Restriction on Payments

[d] Duty to Cooperate

[2] California Alatorre-Zenovich-Dunlap-Berman Agricultural Labor Relations Act of 1975

[a] Applicability

[b] Employees' Right to Organize

[c] Unfair Labor Practice

[d] Restriction on Payments

[3] Solicitation of Employees During Labor Dispute

[4] Use of Professional Strikebreakers

§ 1C.63 Miscellaneous Obligations

[1] Family Care and Medical Leave

[2] Pregnancy Leave

[3] Uniforms, Tools, and Equipment

[4] Jury Duty and Court Appearances

[5] Leave to Vote

[6] Volunteer Firefighter, Reserve Peace Officer, and Emergency Rescue Personnel Duty

[7] Employee Literacy Assistance

[8] Drug-Free Workplace

[9] Sanitation Requirements

[10] Leave Related to Domestic Violence

§§ 1C.64-1C.69 [Reserved]

§ 1C.70 Hazardous Substances Information and Training Act

[1] Applicability of Act

[2] Duty of Manufacturer to Prepare MSDS

[3] Duty of Employer to Provide Information About Toxic or Harmful Substances

§ 1C.71 Regulation of Employee Contact With Asbestos

[1] Duties of Employer Engaged in Asbestos-Related Work

[2] Notice to Employees of Presence of Asbestos

§ 1C.72 Regulation of Employee Contact With Pesticides

§ 1C.73 Occupational Carcinogens Control Act

§ 1C.74 Safe Drinking Water and Toxic Enforcement Act (Proposition 65)

[1] Prohibition on Discharging Harmful Chemicals

[2] Prohibition on Exposing Persons to Hazardous Chemicals

[3] List of Covered Chemicals

[4] Application of Act

§ 1C.75 Federal Hazardous Communication Standard

[1] In General

[2] Duty of Employer

§§ 1C.76-1C.79 [Reserved]

§ 1C.80 Governing Law

[1] California Occupational Safety and Health Act

[a] Purpose

[b] Enforcement

[2] Federal Occupational Safety and Health Act

[a] In General

[b] Duties of Employer and Employee

[c] State Plan

[d] Recordkeeping

[e] Enforcement

§ 1C.81 General Safety and Health Duties of Employer

[1] Employer's Duty to Maintain Safe and Healthy Employment

[2] Variance From Standards

[a] Temporary Variance

[b] Permanent Variance

[3] Duty to Furnish Safety Devices and Procedures

[4] Duty to Monitor for Hazardous Conditions

[5] Duty to Comply With Safety Orders

[6] Duty to Provide Safety Information to Employees

§ 1C.82 Duty to Implement Injury and Illness Prevention Program

[1] In General

[2] Duty to Train Employees

[3] Communication and Records

[4] Exceptions for Small Businesses

§ 1C.83 Duty to Implement Emergency Plans

[1] Emergency Action Plan

[2] Fire Prevention Plan

§ 1C.84 Duty to File Report of Injury or Illness

[1] California Law

[2] Federal Law

§ 1C.85 Duty to Maintain Log and Summary of Injuries and Illnesses

[1] In General

[2] Exemptions

§ 1C.86 Duty to Provide Medical Examinations

§ 1C.87 Duty to Obtain Permits

[1] Employment Involving Substantial Risk of Injury

[2] Asbestos-Related Work

[3] Posting of Permit

§ 1C.88 Duty to Notify of Concealed Dangers

§ 1C.89 Duty to Provide Access to Employees With Disabilities

[1] Under Fair Employment and Housing Act

[2] Under Americans With Disabilities Act

§ 1C.90 Duty Regarding Agricultural Workers

§§ 1C.91-1C.99 [Reserved]

§ 1C.100 Hiring Employees

[1] Facts

Scope

[2] Documents

Scope

§ 1C.101 Employee Programs and Benefits

[1] Facts

Scope

[2] Documents

Scope

§ 1C.102 Employment Taxes

[1] Facts

Scope

[2] Documents

Scope

§ 1C.103 Wages and Hours

[1] Facts

Scope

[2] Documents

Scope

§ 1C.104 Environmental, Safety, Health, and Access Regulations

[1] Facts

Scope

[2] Documents

Scope

§§ 1C.105-1C.109 [Reserved]

§ 1C.110 Determinations Relating to Hiring and Use of Employees

Scope

§ 1C.111 Determinations Relating to Required Registration and Permits

Scope

§ 1C.112 Determinations Relating to Environmental, Safety, and Access Regulations

Scope

§§ 1C.113-1C.119 [Reserved]

§ 1C.120 Procedural Guide to Hiring Employees

Scope

§ 1C.121 Procedural Guide Regarding Employee Insurance and Taxes

Scope

§ 1C.122 Procedural Guide Regarding Wages and Hours

[1] Payment of Wages

Scope

[2] Regulation of Hours

Scope

§ 1C.123 Procedural Guide to Employee Notices and Recordkeeping

[1] Posting Employee Notices

Scope

[2] Maintaining Employee Records

Scope

§ 1C.124 Procedural Guide to Complying With Occupational Safety and Health Standards

Scope

§ 1C.125 Procedural Guide to Miscellaneous Employment Duties

Scope

§ 1C.126 Procedural Guide to Relations With Unions

Scope

§§ 1C.127-1C.139 [Reserved]

§ 1C.140 Drafting Guide to Employee Manual

Scope

§§ 1C.141-1C.199 [Reserved]

§ 1C.200 Letter to Client Containing Pre-employment Checklist

[1] Comment

[a] Use of Form

[b] General Prohibition on Discrimination

[c] Prohibition on Discrimination in Advertising

[d] Race Discrimination

[e] Religious Discrimination

[f] Sex Discrimination

[g] National Origin Discrimination

[h] Citizenship

[i] Family Status Discrimination

[j] Perceived Sexual Orientation Discrimination

[k] Age Discrimination

[l] Disability Discrimination

[m] Height and Weight Discrimination

[n] Veteran Status Discrimination

[o] Language Discrimination

[p] Use of Subjective Criteria

[q] Legality of Specific Inquiries

[i] Education

[ii] Job Experience

[iii] Investigative Reports

[iv] Credit Reports

[v] Arrests or Detentions

[vi] Disabilities

[vii] Fingerprints and Photographs

[viii] Age

[r] Tests and Examinations

[i] Ability Test

[ii] Medical Examination

[iii] HIV Test

[iv] Drug Test

[v] Alcohol Test

[vi] Lie Detector Test

[2] FORM

Letter to Client Containing Pre-employment Checklist

§ 1C.201 Letter Offering Employment

[1] Comment

[a] Use of Form

[b] Employment at Will

[2] FORM

Letter Offering Employment

§ 1C.202 Letter to Client Containing List of Required Employer Tax Forms

[1] Comment--Use of Form

[2] FORM

Letter to Client Containing List of Required Employer Tax Forms

§ 1C.203 Letter to Client Containing List of Recordkeeping Requirements Related to California and Federal Taxes

[1] Comment--Use of Form

[2] FORM

Letter to Client Containing List of Recordkeeping Requirements Related to California and Federal Taxes

§ 1C.204 Letter to Client Containing Procedural Guide to Employee Taxes

[1] Comment

[a] Use of Form

[b] Duty to Withhold and Pay Employment Taxes

[i] California Law

[ii] Federal Law

[2] FORM

Letter to Client Containing Procedural Guide to Employee Taxes

§ 1C.205 Letter to Client Containing List of Required Employee Notices to be Posted

[1] Comment

[a] Use of Form

[b] Equal Employment Opportunity Notices

[c] Fair Labor Standards Act Notice

[d] Poster on Sexual Discrimination

[e] Notice of Right to Request Family Care and Medical Leave

[f] Wage Orders

[g] Workers' Compensation

[h] OSHA Notices

[i] Notice of Payday

[j] Notice of Time Off to Vote

[k] Polygraph Act Notice

[l] Rate of Pay for Farm Employees

[m] Talent Agency Provisions

[n] Asbestos-Related Work

[2] FORM

Letter to Client Containing List of Required Employee Notices to be Posted

§ 1C.206 Letter to Client Regarding Occupational Safety and Health Regulations

[1] Comment

[a] Use of Form

[b] Scope of Federal OSHA

[c] State Plan Under Federal OSHA

[d] Federal OSHA Recordkeeping Requirements

[e] Scope of Cal/OSHA

[f] Cal/OSHA Recordkeeping Requirements

[i] Reports of Occupational Injuries and Illnesses

[ii] Records Relating to Injury and Illness Prevention Program

[iii] Cal/OSHA Notice

[iv] Posting of Citations

[2] FORM

Letter to Client Regarding Occupational Safety and Health Regulations

§§ 1C.207-1C.219 [Reserved]

§ 1C.220 Sample Policy on Sexual Harassment

[1] Comment

[a] Use of Form

[b] Sexual Harassment Defined

[c] Types of Sexual Harassment

[i] "Hostile Environment" Harassment

[ii] "Quid Pro Quo" Harassment

[d] Standard of Behavior

[e] Liability for Sexual Harassment

[f] Prevention and Correction of Sexual Harassment

[g] Poster and Information Sheet

[2] FORM

Sample Policy on Sexual Harassment

§ 1C.221 Sample Injury and Illness Prevention Program

[1] Comment

[a] Use of Form

[b] Contents of Written Program

[c] When Program Must be Written

[d] Application of Program

[e] Required Records

[f] Safety and Health Committee

[g] Grandfather Provision

[h] Insurers' Review of Program

[2] FORM

Sample Injury and Illness Prevention Program

§§ 1C.222-1C.229 [Reserved]

§ 1C.230 Notice to Employees of Time and Place of Payment of Wages

[1] Comment

[a] Use of Form

[b] Frequency of Payment

[2] FORM

Notice to Employees of Time and Place of Payment of Wages

§ 1C.231 Notice of Employee's Right to Take Time Off to Vote

[1] Comment

[a] Use of Form

[b] Employee's Right to Take Time Off to Vote

[2] FORM

Notice of Employee's Right to Take Time Off to Vote

§ 1C.232 Notice to Employee as to Change in Relationship

[1] Comment--Use of Form

[2] FORM

Notice to Employee of Change in Employment Relationship

§ 1C.233 Notice of Right to Request Family Care and Medical Leave (CFRA Leave) and Pregnancy Disability Leave

[1] Comment

[a] Use of Form

[b] Right to Family Care and Medical Leave

[c] Employee Status During Leave

[d] Permitted Refusal to Reinstate

[2] FORM

Notice of Right to Request Family Care and Medical Leave (CFRA Leave) and Pregnancy Disability Leave

§ 1C.234 Notice to Employees of Prohibition on Illegal Drug Use

[1] Comment

[a] Use of Form

[b] Requirement to Operate Drug-Free Workplace

[c] Penalty for Failure to Certify Drug-Free Workplace

[d] Federal Drug-Free Workplace Requirement

[2] FORM

Notice to Employees of Prohibition on Illegal Drug Use



2 of 170 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS

1-1C California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter is an overview of the variety of California and federal laws and programs that regulate employers in their relations with employees. The chapter is intended to assist the practitioner in advising the owner of a new business about the obligations the law imposes on an employer. This chapter contains many cross references to other California Legal Forms chapters, other Matthew Bender publications, and government publications where the practitioner may find more detailed coverage of a topic.

The Legal Background covers the employer's obligations regarding hiring and equal employment opportunity, employee and applicant privacy, wage and hour laws, safety and health laws, employment contracts, child labor laws, employee insurance and tax obligations, and employee termination. The Transaction Guide contains a variety of checklists and procedural guides to assist the practitioner in advising the client concerning an employer's obligations.

The Forms section contains a number of letters drafted as checklists or procedural reminders that the practitioner can send to the client on a variety of matters. In addition, certain employee notices are included, as are sample forms of employment agreements, injury and illness prevention programs, and a policy on sexual harassment.

For discussion of the lawyer's role in advising the new business owner, see Ch. 1A, *Role of Counsel in Starting a New Business* . To assist in determining the proper type of business to form, see Ch. 1B, *Selecting Form of Business Entity* . Employee benefits, including workers' compensation, are discussed in Ch. 1D, *Overview of Employee Benefits* . For discussion of employment taxation and insurance topics, see Ch. 1E, *Taxation of Businesses* , and Ch. 1F, *Insurance Considerations in Business Formation* .

For coverage of employment contracts, see Ch. 85, *Employment Agreements* . To assist in making a determination whether to operate the business with employees or independent contractors, see Ch. 84, *Independent Contractors* . Agreements for professional services are covered in Ch. 86, *Agreements for Professional Services* . Specialized entertainment contracts are discussed in Ch. 87, *Entertainment Contracts* . For detailed coverage of employer obligations, see Wilcox, California Employment Law (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART I. RESEARCH GUIDE
A. Primary Sources

1-1C California Legal Forms--Transaction Guide § 1C.01

§ 1C.01 California Sources

[1] California Constitution

Inalienable right to privacy. *Cal. Const. art. I, § 1*.

Prohibition on employment discrimination. *Cal. Const. art. I, § 8*.

[2] Statutes

Unruh Civil Rights Act. *Civ. Code § 51*.

Ralph Civil Rights Act. *Civ. Code §§ 51.7, 52*.

Equal access for individuals with disabilities; guide dogs. *Civ. Code §§ 54-54.3*.

Statute of frauds. *Civ. Code § 1624(a)*.

Modification of written contract. *Civ. Code § 1698*.

Prohibition on specific enforcement of employment contracts. *Civ. Code § 3390*.

Permit to employ minor. *Educ. Code §§ 49160-49162*.

Time off work to vote. *Elec. Code §§ 14350, 14351*.

Fair Employment and Housing Act (FEHA). *Gov. Code §§ 12900-12996*.

Application of FEHA. *Gov. Code §§ 12926(d), 12940(j)(4)(A)*.

Prohibition on employment discrimination. *Gov. Code §§ 12940, 12941, 12945*.

Pregnancy leave. *Gov. Code § 12945(b)(2)*.

Family care leave. *Gov. Code § 12945.2*.

Prohibition on use of HIV test results to determine suitability for employment. *Health & Safety Code § 120980(f)*.

Safe Drinking Water and Toxic Enforcement Act (Proposition 65). *Health & Safety Code §§ 25249.5-25249.13*.

Obligations regarding compensation and working conditions. *Lab. Code §§ 200-272*.

Time off work for jury duty and court appearances. *Lab. Code § 230*.

Time off work to serve as volunteer firefighter. *Gov. Code § 50952(p)*

Prohibition on seeking information about arrest or detention that did not result in conviction. *Lab. Code § 432.7*.

Regulation of working hours. *Lab. Code § 510 et seq.*

Assistance to employees with literacy problems. *Lab. Code §§ 1040-1044*.

Prohibition on retaliation against employee for disclosing violation of law. *Lab. Code § 1102.5*.

Alatorre-Zenovich-Dunlap-Berman Agricultural Labor Relations Act of 1975. *Lab. Code §§ 1140-1166.3*.

Obligations regarding wages, hours, and working conditions. *Lab. Code §§ 1171-1205*.

Equal Pay Act. *Lab. Code § 1197.5*.

Prevailing wage requirement for public works. *Lab. Code §§ 1770, 1771, 1773*.

Regulation of employment of minors. *Lab. Code §§ 1390-1399*.

Maintaining workplace in sanitary and healthful condition. *Lab. Code § 2260 et seq.*

Written employment contracts. *Lab. Code §§ 2750-2752*.

General obligations of employer. *Lab. Code §§ 2800-2806*.

Unenforceability of employment contract against employee beyond seven years from beginning of service. *Lab. Code § 2855*.

Termination of employment. *Lab. Code §§ 2920-2929*.

Workers' Compensation Act. *Lab. Code § 3200 et seq.*

California Occupational Safety and Health Act of 1973 (Cal/OSHA). *Lab. Code §§ 6300-9061*.

Hazardous Substances Information and Training Act. *Lab. Code § 6360 et seq.*

Responsibilities and duties of employers. *Lab. Code §§ 6400-6413.5*.

Injury and illness prevention program. *Lab. Code § 6401.7*.

Duty to maintain records of occupational injuries and illnesses. *Lab. Code §§ 6409-6410*.

Occupational Carcinogens Control Act of 1976. *Lab. Code § 9000 et seq.*

Criminal liability for failing to warn employees of concealed danger. *Penal Code § 387*.

Duty to withhold and contribute disability and unemployment tax contribution from employee wages. *Unemp. Ins. Code §§ 976, 977, 986, 1110, 2602*.

Duty to contribute to Employment Training Fund. *Unemp. Ins. Code §§ 976.6, 1610-1612*.

Requirement that employer register with Employment Development Department. *Unemp. Ins. Code § 1086*.

Duty to withhold and contribute income tax from employee wages. *Unemp. Ins. Code § 13020(a)*.

[3] Regulations

Fair Housing and Employment Act regulations. *2 Cal. Code Reg. § 7285.0 et seq.*

Cal/OSHA regulations. *8 Cal. Code Reg. § 330 et seq.*

Safety orders for specific trades, industries, and occupations. *8 Cal. Code Reg. §§ 450 et seq., 6248 et seq.*

General industry safety orders. *8 Cal. Code Reg. § 3200 et seq.*

Injury and illness prevention program. *8 Cal. Code Reg. § 3203*.

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART I. RESEARCH GUIDE
A. Primary Sources

1-1C California Legal Forms--Transaction Guide § 1C.02

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5 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART I. RESEARCH GUIDE
A. Primary Sources

1-1C California Legal Forms--Transaction Guide §§ 1C.03-1C.04

[Reserved]

§§ 1C.03[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1C California Legal Forms--Transaction Guide § 1C.05

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1C California Legal Forms--Transaction Guide § 1C.06

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1C California Legal Forms--Transaction Guide § 1C.07

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1C California Legal Forms--Transaction Guide § 1C.08

§ 1C.08 Pamphlets

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1C California Legal Forms--Transaction Guide § 1C.09

[Reserved]

§ 1C.09[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
1. Hiring and Retaining Employees

1-1C California Legal Forms--Transaction Guide § 1C.10

§ 1C.10 California Equal Employment Opportunity Law

[1] California Fair Employment and Housing Act

[a] Prohibition on Discrimination

The California Fair Employment and Housing Act (FEHA) [*see Gov. Code §§ 12900-12996*; *see also 2 Cal. Code Reg. §§ 7285.0-8504*] makes it an unlawful employment practice for an employer to discriminate because of race, religious creed, color, national origin, ancestry, physical disability, mental disability, medical condition, marital status, sex, age, or sexual orientation [*Gov. Code § 12940(a)*], or pregnancy, childbirth, or related medical condition [*Gov. Code § 12945(a)*]. It is also an unlawful employment practice to print or circulate any publication, or make any non-job-related inquiry, that expresses a limitation, specification, or discrimination about one of these classifications [*Gov. Code § 12940(d)*].

With regard to age discrimination, nothing in the FEHA prohibits an employer from refusing to employ an individual because of his or her age if the law compels or provides for that refusal. Promotions within the existing staff, hiring or promotion on the basis of experience and training, rehiring on the basis of seniority and prior service with the employer, or hiring under an established recruiting program from high schools, colleges, universities, or trade schools do not, in and of themselves, constitute unlawful employment practices [*Gov. Code § 12940(a)(5)*]. Further, an employer or employment agency is not barred from inquiring into the age of an applicant, or from specifying age limitations, when the law compels or provides for that action [*Gov. Code § 12940(d)*].

In addition, it is an unlawful employment practice to deny a person rights created by the Unruh and Ralph Civil Rights Acts [*Gov. Code § 12948*; *see Civ. Code §§ 51*, *51.7*; *see also* [3], [4], *below*]. Further, individuals with disabilities or medical conditions are entitled to the same rights as the general public with regard to the use of and access to streets, sidewalks, public buildings, medical facilities, and other public places [*Civ. Code §§ 54*, *54.1*]. A violation of the Americans With Disabilities Act also constitutes a violation of California's full and equal access law [*Civ. Code § 54.1(d)*] and is an unfair employment practice [*Gov. Code § 12948*]. Individuals with disabilities are entitled to be accompanied by a trained dog in these places [*Civ. Code § 54.2*]. Any person, firm, or corporation that interferes with

these rights is liable for damages and attorneys' fees [*Civ. Code § 54.3(a)*]. Any aggrieved person may file a verified complaint with the Department of Fair Employment and Housing (FEHA) [*Civ. Code § 54.3(b)*; *see Gov. Code § 12948*; *see also* [b], *below*]. The FEHA specifically incorporates portions of the federal Americans With Disabilities Act of 1990 [*see, e.g., Gov. Code § 12940(d)*; *see 42 U.S.C. §§ 12101-12213*; *see also § 1C.11[4]*].

It is also an unlawful business practice under the FEHA for a business establishment to discriminate against, boycott or blacklist, or refuse to buy from, contract with, sell to, or trade with any person, firm, organization, or other business entity in California because of the race, creed, religion, color, national origin, sex, disability, or medical condition of the person or of the person's partners, members, stockholders, directors, officers, managers, superintendents, agents, employees, business associates, suppliers, or customers. Similarly, it is an unlawful business practice to take any of the above actions based on the perception that the person has one or more of these characteristics, or because the person is associated with a person who has (or is perceived to have) any of these characteristics [*Gov. Code § 12948*; *Civ. Code § 51.5*]. The FEHA is authorized to receive, investigate, and conciliate complaints alleging violations of this prohibition [*Gov. Code § 12930(f)(2)*].

An employer may refuse to hire, or may discharge, a person with a physical or mental disability or a person with a medical condition, if the person is unable to perform his or her duties in a safe manner because of the condition [*Gov. Code § 12940(a)(1), (2)*]. However, when the employer becomes aware that an applicant or employee might have a pertinent disability, the employer has a duty to engage in a timely, good faith, interactive process with the applicant or employee to determine effective reasonable accommodations, if any, in response to a request for reasonable accommodation by the applicant or employee [Gov. Code § 12940(n); Gelfo v. Lockheed Martin Corp. (2006) 140 Cal. App. 4th 34, 61, 43 Cal. Rptr. 3d 874]. In addition, discrimination exceptions are made for bona fide occupational qualifications [*Gov. Code § 12940*].

The duty of an employer under the FEHA to provide reasonable accommodation for a disabled employee does not obligate the employer to convert a temporary light-duty position (in which a temporarily disabled employee might have been placed until the passing of the disability) into a permanent one (in which such an employee might wish to be placed on discovering that the disability will be permanent) when doing so would, in effect, require creating a new position [*Raine v. City of Burbank (2006) 135 Cal. App. 4th 1215, 1223, 37 Cal. Rptr. 3d 899]* .

[b] Application of FEHA

The FEHA applies to (1) a person who regularly employs five or more persons, (2) a person acting directly or indirectly as an agent of an employer, (3) the State of California, (4) political or civil subdivisions of the State of California, and (5) cities [*Gov. Code § 12926(d)*]. However, for purposes of the prohibition against harassment, an "employer" is any person regularly employing one or more persons, regularly receiving the services of one or more persons providing services pursuant to a contract, or any person directly or indirectly acting as an agent of an employer [*Gov. Code § 12940(j)(4)(A)*]. The term "employer" does not apply to religious associations or corporations not organized for private profit [*Gov. Code § 12926(d), (h)(3)(B)*].

[2] California Equal Pay Act

An employer may not discriminate in paying wages solely on the basis of the sex of the employee. However, an employer may pay different rates under a seniority system, merit system, or system that measures quantity or quality of production, or on a differential based on any bona fide factor other than sex [*Lab. Code § 1197.5(a)*].

[3] Unruh Civil Rights Act

The Unruh Civil Rights Act [*see Civ. Code § 51(a)*] provides that all persons in California are free and equal, and regardless of sex, race, color, religion, ancestry, national origin, disability, medical conditions, marital status, or sexual

orientation are entitled to the full and equal accommodations, advantages, facilities, privileges, and services of all business establishments [*Civ. Code § 51(b)*; *see Civ. Code § 51(e)* (definitions)]. The protections of the Unruh Act also extend to discrimination against individuals on the basis of sexual orientation [*Beaty v. Truck Ins. Exchange (1992) 6 Cal. App. 4th 1455, 1460, 8 Cal. Rptr. 2d 593* ; *Rolon v. Kulwitzky (1984) 153 Cal. App. 3d 289, 292, 200 Cal. Rptr. 217* ; *Curran v. Mount Diablo Council of the Boy Scouts (1983) 147 Cal. App. 3d 712, 195 Cal. Rptr. 325]* . In spite of this broad language, the California Supreme Court has determined that the Unruh Act does not apply to employment discrimination; instead, employment discrimination is governed solely by the FEHA [*Alcorn v. Anbro Engineering, Inc. (1970) 2 Cal. 3d 493, 500, 86 Cal. Rptr. 88, 468 P.2d 216]* . However, under the FEHA, it is an unlawful employment practice to deny, or to aid, incite, or conspire in the denial of, the rights created by the Unruh Civil Rights Act [*Gov. Code § 12948*].

[4] Ralph Civil Rights Act

The Ralph Civil Rights Act [*see Civ. Code §§ 51.7, 52*] provides that all persons in California have the right to be free from violence, or intimidation by threat of violence, committed against them or their property because of their political affiliation, on account of any characteristic listed or defined in *Civ. Code § 51(b)* or *(e)* [*see* [3], *above*], their position in a labor dispute, or because another person perceives them to have one or more of those characteristics [*Civ. Code § 51.7(a)*]. *Civ. Code § 51.7* does not apply to statements concerning positions in a labor dispute that are made during the course of otherwise lawful labor picketing [*Civ. Code § 51.7(b)*].

It is an unlawful employment practice to deny, or to aid, incite, or conspire in the denial of, the rights created by *Civ. Code § 51.7* [*Gov. Code § 12948*].

[5] Prohibition Against Discrimination in State-Funded Programs

No one may unlawfully discriminate or deny full and equal access to benefits to a person on the basis of race, national origin, ethnic group identification, religion, age, sex, sexual orientation, color, or physical or mental disability under a program or activity that is conducted, operated, or administered by the state or by any state agency, funded directly by the state, or that receives any state financial assistance [*Gov. Code § 11135(a), (c)*; *see Gov. Code § 11135(b)*; *see also Gov. Code § 12926*]. This ban on discrimination extends to California state universities [*Gov. Code §§ 11000, 11135(a)*].

The California Legislature has expressly found and declared that the ability to use electronic or information technology is often an essential function for successful employment in the current workforce [*Gov. Code § 11135(d)(1)*]. To improve the accessability of existing technology and increase the successful employment of individuals with disabilities, particularly those with visual and hearing impairments, state governmental entities must comply with the accessability requirements of Section 508 of the Rehabilitation Act [*see 29 U.S.C. § 794d*] and its implementing regulations [*see* 26 C.F.R. Part 1194] in developing, procuring, maintaining, or using electronic or information technology either indirectly or through the use of state funds by other entities [*Gov. Code § 11135(d)(2)*]. Further, any entity that contracts with a state or local entity subject to *Gov. Code § 11135* for the provision of electronic or information technology, or for the provision of related services, must agree to respond to and resolve any complaint regarding the assessability of its products or services that is brought to the attention of the entity [*Gov. Code § 11135(d)(3)*].

[6] Prohibition Against Discrimination Based on Sexual Orientation

The FEHA expressly prohibits discrimination and harassment based on sexual orientation, which is defined to include heterosexuality, homosexuality, and bisexuality [*Gov. Code §§ 12926(q), 12940(a), (j)*]. Under California law, the FEHA occupies the field of employment discrimination and preempts local ordinances prohibiting sexual orientation discrimination in employment [*Delaney v. Superior Fast Freight (1993) 14 Cal. App. 4th 590, 596-598, 18 Cal. Rptr.*

2d 33 ; *see Gov. Code § 12993(c)*]. Although this prohibition does not generally apply to religious associations and corporations not organized for profit [*Gov. Code §§ 12926(d), 12926.2, 12940(j)(4)(B)*], the prohibition against harassment generally applies to (1) employees of a religious corporation or association to perform nonreligious duties at a health care facility operated for the provision of health care that is not restricted to adherents of that religion [*Gov. Code §§ 12926(j)(4)(B), 12926.2(c)*], and (2) employees of a nonprofit public benefit corporation formed by or affiliated with a particular religion that operates an educational institution as its sole or primary activity, except that the employer may restrict employment and promotion to individuals of a particular religion [*Gov. Code § 12926.2(f)*].

[7] California Constitution

A person may not be disqualified from entering or pursuing a business, profession, vocation, or employment because of sex, race, creed, color, or national or ethnic origin [*Cal. Const. art. I, § 8*]. Article I, Section 8 reflects a fundamental public policy against discrimination in employment, whether public or private [*Rojo v. Kliger (1990) 52 Cal. 3d 65, 90, 276 Cal. Rptr. 130, 801 P.2d 373]* .

[8] Disability Protections

With respect to disabilities, California provides protections that are independent of the federal Americans With Disabilities Act of 1990 [*Gov. Code § 12926.1(a), (d)*; *see § 1C.11[4]*]. Although the subsequently enacted federal Act provides a floor of protection, California law has always afforded additional protections [*Gov. Code § 12926.1(a)*]. For example, California defines physical and mental disabilities to require a "limitation" on a major life activity, but does not require a "substantial limitation" as does federal law [*Gov. Code § 12926.1(c)*].

PRACTICE TIP:

This legislative pronouncement is particularly important for two reasons. First, California law provides significantly more protection than federal law [*see Gov. Code § 12926.1*]. Second, the United States Supreme Court has held that Congress exceeded its authority and invalidly abrogated state sovereign immunity when it imposed Title I of the federal Americans With Disabilities Act of 1990 [*see § 1C.11[4]*] on states. Thus, suits in federal court by state employees to recover money damages based on a state's failure to comply with Title I of the ADA are barred by the *Eleventh Amendment* [*Board of Trustees of Univ. of Alabama v. Garrett (2001) 531 U.S. 356, 121 S. Ct. 955, 148 L. Ed. 2d 866]* . *Commentary by publisher's editorial staff.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil Rights LawContractual Relations & HousingFair Housing RightsRacial DiscriminationLabor & Employment LawDiscriminationActionable DiscriminationLabor & Employment LawDiscriminationAge DiscriminationCoverage & DefinitionsGeneral OverviewLabor & Employment LawDiscriminationDisability DiscriminationGeneral OverviewLabor & Employment LawDiscriminationDisability DiscriminationCoverage & DefinitionsGeneral OverviewLabor & Employment LawDiscriminationGender & Sex DiscriminationGeneral OverviewLabor & Employment LawDiscriminationGender & Sex DiscriminationCoverage & DefinitionsPregnancy & Parental RightsLabor & Employment LawDiscriminationGender & Sex DiscriminationCoverage & DefinitionsSexual OrientationLabor & Employment LawDiscriminationNational Origin DiscriminationGeneral OverviewLabor & Employment LawDiscriminationNational Origin DiscriminationEmployment PracticesFailures to Hire



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
1. Hiring and Retaining Employees

1-1C California Legal Forms--Transaction Guide § 1C.11

§ 1C.11 Federal Equal Employment Opportunity Law

[1] Title VII of Civil Rights Act of 1964

[a] Discrimination in Employment Prohibited

Under Title VII of the Civil Rights Act of 1964 [*see 42 U.S.C. §§ 2000e-2000e-17*], it is an unlawful employment practice for an employer to discriminate against an individual because of the individual's race, color, religion, sex, or national origin. Unlawful actions include failing or refusing to hire a person, discharging a person, or otherwise discriminating with respect to compensation, terms, conditions, or privileges of employment [*42 U.S.C. § 2000e-2(a)*; *see 29 C.F.R. §§ 1604.1-1604.11* (sex discrimination), 1605.1-1605.3 (religious discrimination), 1606.1-1606.8 (national-origin discrimination)].

It is unlawful sex discrimination under Title VII to adopt a "fetal protection" policy that excludes pregnant women from hazardous jobs unless the employer can prove that sex is a bona fide occupational qualification [*Auto. Workers v. Johnson Controls (1991) 499 U.S. 187, 111 S. Ct. 1196, 113 L. Ed. 2d 158, 174]* .

[b] Discrimination in Employment Advertising Prohibited

It is an unlawful employment practice to publish a notice or advertisement relating to employment indicating a preference, limitation, specification, or discrimination based on race, color, religion, sex, or national origin. However, a notice or advertisement may indicate a preference, limitation, specification, or discrimination based on religion, sex, or national origin when that classification is a bona fide occupational qualification [*42 U.S.C. § 2000e-3(b)*].

[c] Employers Covered

The term "employer" means a person engaged in an industry affecting commerce who has or had 15 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year [*42 U.S.C. § 2000e(b)*; *Arbaugh v. Y & H Corp. (2006) 546 U.S. 500, 126 S. Ct. 1235, 1238, 163 L. Ed. 2d 1097* (employee

asserting violation of Title VII must allege and prove that 15-or-more-employees requirement was met, and this is merely one element of employee's claim, rather than test of subject matter jurisdiction; therefore, employer is obliged to make timely challenge if that threshold requirement is not pleaded or proved)]. "Commerce" means trade, traffic, commerce, transportation, transmission, or communication among states [*42 U.S.C. § 2000e(g)*]. Virtually all business and employment "affects commerce" [*see NLRB v. Reliance Fuel Oil Corp. (1963) 371 U.S. 224, 226-227, 83 S. Ct. 312, 9 L. Ed. 2d 279* (commerce includes activities that in isolation might be deemed merely local but in interconnections of business across state lines, affect interstate commerce)].

[d] Exceptions to Application of Title VII

Title VII's prohibitions do not apply to employment outside the United States, or to a religious corporation, association, educational institution, or society with respect to employing individuals of a particular religion to perform work connected with carrying on the employer's activities [*42 U.S.C. § 2000e-1(a)*].

Title VII does not affect state law other than a law that purports to require or permit an act that would be unlawful under Title VII [*42 U.S.C. § 2000e-7*].

[2] Age Discrimination in Employment Act

[a] Prohibition on Age Discrimination

The Age Discrimination in Employment Act (ADEA) [*see 29 U.S.C. §§ 621-634*; *29 C.F.R. §§ 1625.1-1625.13, 1626.1*-1626.19] makes it unlawful for an employer to fail or refuse to hire, to discharge, or to otherwise discriminate against an individual with respect to his or her compensation, terms, conditions, or privileges of employment, because of the individual's age [*29 U.S.C. § 623(a)*]. This prohibition on age discrimination is intended to protect individuals who are at least 40 years of age [*29 U.S.C. § 631(a)*]. It is also unlawful to advertise in a way that indicates a preference, limitation, specification, or discrimination based on age [*see 29 U.S.C. § 631(e)*].

[b] Employers Covered

Under the ADEA, an "employer" is a person engaged in industry affecting commerce who has or had 20 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year [*29 U.S.C. § 630(b)*]. "Commerce" means trade, traffic, commerce, transportation, transmission, or communication among states [*29 U.S.C. § 630(g)*]. Virtually all business and employment "affects commerce" [*see NLRB v. Reliance Fuel Oil Corp. (1963) 371 U.S. 224, 226-227, 83 S. Ct. 312, 9 L. Ed. 2d 279* (commerce includes activities that in isolation might be deemed merely local but in interconnections of business across state lines, affect interstate commerce)].

The Supreme Court has held that the ADEA does not validly abrogate state sovereign immunity. Therefore, the ADEA cannot be applied to states and state agencies and does not authorize a suit against state employers in federal court without the state's consent [*Kimel v. Florida Bd. of Regents (2000) 528 U.S. 62, 120 S. Ct. 631, 634, 145 L. Ed. 2d 522]* .

[3] Equal Pay Act of 1963

Under the Equal Pay Act of 1963 [*see 29 U.S.C. § 206(d)*], an employer may not discriminate between employees on the basis of sex in the payment of wages. The Act prohibits paying wages to employees at a rate less than wages paid to employees of the opposite sex for equal work on jobs the performance of which requires equal skill, effort, and responsibility, performed under similar working conditions. Exceptions exist for payments made under a seniority system, a merit system, a system that measures earnings by quantity or quality of production, or a differential based on a factor other than sex [*29 U.S.C. § 206(d)(1)*; *see 29 C.F.R. §§ 1620.1-1620.34, 1621.1*-1621.4].

[4] Americans With Disabilities Act of 1990

[a] Prohibition on Discrimination

The Americans With Disabilities Act of 1990 (ADA) [*see 42 U.S.C. §§ 12101-12213*] provides that no covered entity [*see* [b], *below*] may discriminate against a qualified individual with a disability [*see 42 U.S.C. § 12131(2)* ("qualified individual with a disability" defined)] because of the disability with regard to job application procedures, hiring, advancement, discharge, compensation, job training, or other terms, conditions, and privileges for employment [*42 U.S.C. § 12112(a)*]. Further, except as provided in § 1C.11[4][c], an employer may not require a medical examination, and may not inquire of the employee, to determine whether the applicant has a disability or the nature and severity of the disability [*42 U.S.C. § 12112(d)(4)(A)*].

[b] Employers Covered

The ADA applies to "covered entities," which includes employers, employment agencies, labor organizations, and joint labor-management committees. An "employer" is a person engaged in an industry affecting commerce (or the person's agent) who has or had 15 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year [*42 U.S.C. § 12111(5)(A)*]. Virtually all business and employment "affects commerce" [*see NLRB v. Reliance Fuel Oil Corp. (1963) 371 U.S. 224, 226-227, 83 S. Ct. 312, 9 L. Ed. 2d 279* (commerce includes activities that in isolation might be deemed merely local but in interconnections of business across state lines, affect interstate commerce)].

PRACTICE TIP:

The United States Supreme Court has held that Congress exceeded its authority and invalidly abrogated state sovereign immunity when it imposed Title I of the federal Americans With Disabilities Act of 1990 [*see § 1C.11[4]*] on states. Thus, suits in federal court by state employees to recover money damages based on a state's failure to comply with Title I of the ADA are barred by the *Eleventh Amendment* [*Board of Trustees of Univ. of Alabama v. Garrett (2001) 531 U.S. 356, 121 S. Ct. 955, 148 L. Ed. 2d 866]* . For discussion of California's disability protections and their independence from the federal ADA [*see Gov. Code § 12926.1*], see *§ 1C.10[8]. Commentary by Publisher's Editorial Staff.*

[c] Permissible Examinations

An employer may require a pre-employment examination to determine an applicant's ability to perform job-relatedfunctions [*42 U.S.C. § 12112(d)(2)(B)*]. In addition, an employer may require a medical examination after an offer of employment has been made, and may condition the offer on the results of the examination if (1) all entering employees take the examination regardless of disability, (2) information obtained is handled properly, and (3) the results of the examination are used only in accordance with the ADA [*42 U.S.C. § 12112(d)(3)*].

[5] Rehabilitation Act of 1973

[a] Contracts With Federal Government

Any contract in excess of $2,500 entered into by the federal government for personal property and nonpersonal services for the United States must contain a provision requiring that, in employing persons to carry out the contract, the party contracting with the United States take affirmative action to employ and advance qualified individuals with handicaps [*29 U.S.C. § 793(a)*; *see 29 U.S.C. § 706(8)* ("individual with handicaps" defined)].

[b] Financial Assistance From Federal Government

An otherwise qualified individual with handicaps [*see 29 U.S.C. § 706(8)* ("individual with handicaps" defined)] may

not, solely because of his or her handicap, be excluded from participating in, be denied the benefits of, or be subjected to discrimination under, any program or activity receiving federal financial assistance or any activity conducted by an Executive agency or the Postal Service [*29 U.S.C. § 794(a)*].

[6] Veterans' Programs

[a] Vietnam Era Veterans' Readjustment Assistance Act

The Vietnam Era Veterans' Readjustment Assistance Act [*see 38 U.S.C. §§ 4211-4214*] provides that any contract for $10,000 or more entered into by the federal government for procuring personal property and non-personal services for the United States must contain a provision requiring the party contracting with the United States to take affirmative action to employ and advance qualified special disabled veterans and veterans of the Vietnam era. However, the contractor may exclude openings for executive and top management, positions that will be filled from within the contractor's organization, and positions lasting three days or less [*38 U.S.C. § 4212(a)*; *see 38 U.S.C. §§ 101(29), 4211(1)(A), (2)(A)* (definitions)].

[b] Veteran's Reemployment Rights Act

The Veterans' Reemployment Rights Act [*see 38 U.S.C. §§ 2021-2027*] provides for leaves of absence, reemployment, and full pay and seniority rights for persons who enlist in, are called up to, or are inducted into the armed forces, and who apply for reemployment with an employer after an honorable discharge [*see 38 U.S.C. §§ 2021*, 2024]. An "employer" is a person engaged in an industry affecting commerce (or the person's agent) who has or had 15 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year [38 U.S.C. § 2027(c)(1)]. Virtually all business and employment "affects commerce" [*see NLRB v. Reliance Fuel Oil Corp. (1963) 371 U.S. 224, 226-227, 83 S. Ct. 312, 9 L. Ed. 2d 279* (commerce includes activities that in isolation might be deemed merely local but in interconnections of business across state lines, affect interstate commerce)].

[7] Civil Rights Act of 1866

The Civil Rights Act of 1866 provides that, among other rights, all persons within the jurisdiction of the United States have the same right in every state and territory to make and enforce contracts as is enjoyed by white citizens [*42 U.S.C. § 1981(a)*]. "Make and enforce contracts" includes the making, performance, modification, and termination of contracts, and the enjoyment of all benefits, privileges, terms, and conditions of the contractual relationship [*42 U.S.C. § 1981(b)*]. Section 1981 applies to impairment of contracts by nongovernmental discrimination [*42 U.S.C. § 1981(c)*], providing a remedy to racial discrimination in private employment contracts [*see Runyon v. McCrary (1976) 427 U.S. 160, 172, 96 S. Ct. 2586, 49 L. Ed. 2d 415]* .

[8] Title VI of Civil Rights Act of 1964

Under Title VI of the Civil Rights Act of 1964 [*see 42 U.S.C. §§ 2000d-2000d-4*; *29 C.F.R. §§ 1691.1-1691.13*], no person in the United States may be subjected to discrimination on the ground of race, color, or national origin under a program or activity receiving federal financial assistance [*42 U.S.C. § 2000d*; *see 42 U.S.C. § 2000d-4a* ("program or activity" defined)]. This prohibition is intended to apply only when a primary objective of the federal assistance is to provide employment [*42 U.S.C. § 2000d-3*].

[9] Immigration Reform and Control Act

In addition to regulating the employment of unauthorized aliens, the Immigration Reform and Control Act (IRCA) [*see 8 U.S.C. §§ 1324a, 1324b*] makes it an unfair immigration-related employment practice for a person or entity to discriminate against an individual (other than an unauthorized alien) in employment because of the individual's national origin or, for a protected individual, because of the individual's citizenship status [*8 U.S.C. § 1324b(a)(1)*; *see 8 U.S.C.*

§ 1324b(a)(3) ("protected individual" defined)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil Rights LawCivil Rights ActsCivil Rights Act of 1964Civil Rights LawContractual Relations & HousingEqual Rights Under the Law (sec. 1981)General OverviewCivil Rights LawProtection of Disabled PersonsRehabilitation ActGeneral OverviewLabor & Employment LawDiscriminationAge DiscriminationCoverage & DefinitionsGeneral OverviewLabor & Employment LawDiscriminationTitle VII of the Civil Rights Act of 1964Coverage & DefinitionsGeneral OverviewLabor & Employment LawEqual PayEqual Pay ActGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
1. Hiring and Retaining Employees

1-1C California Legal Forms--Transaction Guide § 1C.12

§ 1C.12 Employment Contracts

[1] "Contract of Employment" Defined

A "contract of employment" is a contract by which an employer engages an employee to do something for the benefit of the employer or a third person [*Lab. Code § 2750*]. For further discussion of employment agreements, see Ch. 85, *Employment Contracts* .

[2] Statute of Frauds

Under the statute of frauds, any agreement that by its terms is not to be performed within a year from its making must be in writing to be valid [*Civ. Code § 1624(a)*]. This requires any employment contract that will not be fully performed in one year from the date of the contract to be memorialized by some writing to be valid. An oral contract to employ someone as long as he or she does a satisfactory job is not made unenforceable by the statute of frauds, because it could theoretically be performed in less than a year by the termination of the employee for an unsatisfactory job within the year [*Foley v. Interactive Data Corp. (1988) 47 Cal. 3d 654, 675, 254 Cal. Rptr. 211, 765 P.2d 373* ; *see* [4], *below* (oral contracts)].

[3] Written Contracts

[a] Use of Written Contract

Written contracts are generally used to make clear an employee's responsibilities and to establish the standard for termination if the employee does not fulfill the expectations of the employer. Provisions in written employment contracts should be specific and complete; courts will not supply terms about which the contract is silent [*Hillsman v. Sutter Community Hospitals (1984) 153 Cal. App. 3d 743, 754, 200 Cal. Rptr. 605]* . A written contract may be modified by a subsequent written contract, or by an oral agreement supported by new consideration [*Civ. Code § 1698*].

[b] When Written Contract Is Required

Contracts of employment must be in writing in the following situations:

- When an employer with no permanent and fixed place of business enters into an employment contract with an employee for services to be rendered in California, and the contemplated method of payment will include commissions [*Lab. Code § 2751*].

- When an employee's contract with the employer requires the employee to render services of unique or special value to the employer, and the employer wishes to be able to obtain injunctive relief [*Civ. Code § 3423(e)*].

[4] Oral Contracts

An employer and employee may agree orally that the employee will not be terminated except for cause or other specified condition, resulting in an oral employment contract [*Rabago-Alvarez v. Dart Industries, Inc. (1976) 55 Cal. App. 3d 91, 96, 127 Cal. Rptr. 222* ; *see* [2], *above* (oral contracts to perform satisfactory job are outside scope of statute of frauds)].

[5] Enforcement of Employment Contracts

An obligation to render personal service or to employ someone in personal service (that is, an employment contract) cannot be specifically enforced [*Civ. Code § 3390*; *but see Herman v. County of Los Angeles (2002) 98 Cal. App. 4th 484, 488-489, 119 Cal. Rptr. 2d 691* (finding statute inapplicable to contract providing for transfer of county police officers to sheriff's department)]. Therefore, an aggrieved employer must resort to an action for monetary damages in a contract dispute with an employee.

With limited exceptions, a contract to render service may not be enforced against the employee beyond seven years from the beginning of service under the contract [*Lab. Code § 2855(a)*; *see Lab. Code § 2855(b)* (exceptions)]. In addition, courts will not enforce an employment contract in which the employee agrees to perform an illegal act [*Foley v. Interactive Data Corp. (1988) 47 Cal. 3d 654, 667 n.7, 254 Cal. Rptr. 211, 765 P.2d 373]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEmployment RelationshipsEmployment ContractsGeneral OverviewLabor & Employment LawEmployment RelationshipsEmployment ContractsFormationLabor & Employment LawEmployment RelationshipsEmployment ContractsInterpretationLabor & Employment LawEmployment RelationshipsEmployment ContractsStatutes of Frauds



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
1. Hiring and Retaining Employees

1-1C California Legal Forms--Transaction Guide § 1C.13

§ 1C.13 Sexual Harassment in the Workplace

[1] Types of Sexual Harassment

[a] In General

Sexual harassment is an illegal form of sex discrimination [*see Meritor Savings Bank v. Vinson (1986) 477 U.S. 57, 73, 106 S. Ct. 2399, 91 L. Ed. 2d 49* ; *see also Gov. Code § 12940(j)(1), (4)(C)*]. Forms of sexual harassment include verbal, physical, and visual harassment, as well as unwanted sexual advances [*2 Cal. Code Reg. § 7291.1(f)(1)*; *see 2 Cal. Code Reg. § 7287.6(b)*; *see also* [b], [c], *below*].

Under *Gov. Code § 12940(h)*, a cause of action for sexual harassment may be stated by a member of the same sex as the harasser, whether based on the quid pro quo theory, the hostile environment theory, or a hybrid of both theories [*Mogilefsky v. Superior Court (1993) 20 Cal. App. 4th 1409, 1418, 26 Cal. Rptr. 2d 116* ; *see Oncale v. Sundowner Offshore Servs., Inc. (1998) 523 U.S. 75, 118 S. Ct. 998, 140 L. Ed. 2d 201* (upholding principle of same sex harassment without requirement of homosexual harasser); *see also* [b], [c], *below*].

[b] "Hostile Environment" Harassment

"Hostile environment" sexual harassment exists when an employee can show (1) that he or she was subjected to sexual advances, requests for sexual favors, or other verbal or physical conduct of a sexual nature; (2) that the conduct was unwelcome; and (3) that the conduct was sufficiently severe or pervasive to alter the conditions of the victim's employment and create an abusive working environment [*Ellison v. Brady (9th Cir. 1991) 924 F.2d 872, 875-876* ; *see Meritor Savings Bank v. Vinson (1986) 477 U.S. 57, 106 S. Ct. 2399, 91 L. Ed. 2d 49* ; *see also Faragher v. City of Boca Raton (1998) 524 U.S. 775, 118 S. Ct. 2275, 141 L. Ed. 2d 662, 689]* . As long as the environment would reasonably be perceived, and is perceived, as hostile or abusive, there is no need for it also to be psychologically injurious [*Harris v. Forklift Systems, Inc. (1993) 510 U.S. 17, 114 S. Ct. 367, 126 L. Ed. 2d 295, 302]* .

[c] "Quid Pro Quo" Harassment

"Quid pro quo" sexual harassment occurs when the employer or a superior employee makes a subordinate employee submit to sexual conduct as a condition of employment benefits [*Fisher v. San Pedro Peninsula Hospital (1989) 214 Cal. App. 3d 590, 607, 262 Cal. Rptr. 842* ; *see Burlington Industries, Inc. v. Ellerth (1998) 524 U.S. 742, 118 S. Ct. 2257, 141 L. Ed. 2d 633, 652-653* ; *see also Hicks v. Gates Rubber Co. (10th Cir. 1987) 833 F.2d 1406]* .

[2] Guidelines on Discrimination Because of Sex

The Equal Employment Opportunity Commission has adopted Guidelines on Discrimination Because of Sex [*see 29 C.F.R. §§ 1604.1-1604.11*], which provide specific guidelines defining sexual harassment, listing circumstances in which employers are liable for sexual harassment, and offering suggestions on preventing sexual harassment in the workplace [*see 29 C.F.R. § 1604.11*].

[3] Employer Liability for Sexual Harassment

[a] Basis of Liability

Sexual harassment is illegal sex discrimination under Title VII of the Civil Rights Act of 1964 [*Meritor Savings Bank v. Vinson (1986) 477 U.S. 57, 73, 106 S. Ct. 2399, 91 L. Ed. 2d 49* ; *see 42 U.S.C. §§ 2000e-2000e-17*]. Under the Fair Employment and Housing Act (FEHA) and its regulations [*see Gov. Code §§ 12900-12996*; *2 Cal. Code Reg. §§ 7285.0-8504*], any form of harassment, including sexual harassment, is unlawful [*Gov. Code § 12940(j)(1)*]. Under FEHA, harassment is generally concerned with the message conveyed to an employee, and therefore with the social environment of the workplace, while discrimination is concerned with explicit changes in the terms or conditions of employment [*compare Gov. Code § 12940(j)(1)* (making it unlawful for employer "to harass" employee on basis of protected classification) *with Gov. Code § 12940(a)* (making it unlawful for employer "to discriminate [against employee] in compensation or in terms, conditions, or privileges of employment" on basis of protected classification)]. However, although harassment and discrimination are separate wrongs, they are sometimes closely interrelated and even overlapping. Thus, if the hostile message that constitutes the harassment is conveyed through official employment actions, those actions can give rise to a discrimination claim as well as a harassment claim [*Roby v. McKesson Corp., 47 Cal. 4th 686, at 707-709 (Cal. 2009)* ("[I]n analyzing the sufficiency of evidence in support of a harassment claim, there is no basis for excluding evidence of biased personnel management actions so long as that evidence is relevant to prove the communication of a hostile message.")].

If an employer or the employer's agent or supervisor sexually harasses an employee, job applicant, or person providing services pursuant to a contract [*see Gov. Code § 12920(h)(4)*], the employer is strictly liable for the harassment [*Kelly-Zurian v. Wohl Shoe Co. (1994) 22 Cal. App. 4th 397, 415, 27 Cal. Rptr. 2d 457* ; *Gov. Code §§ 12926(d), 12940(h)(1)*; *see 2 Cal. Code Reg. § 7287.6(b)(2)*].

An employer may also be liable for sexual harassment in the workplace due to the harassment of one employee by another employee who is not an agent or supervisor. Liability for an employee's act may be imputed to the employer if the entity, its agents, or supervisors knows or should have known of the misconduct and fails to take immediate and appropriate corrective action [*Gov. Code § 12940(j)(1)*].

An employer may also be responsible for the acts of nonemployees with respect to sexual harassment of employees, applicants, or persons providing services pursuant to a contract in the workplace. Liability will be imputed if the employer, its agents, or its supervisors knows or should have known of the misconduct and fails to take immediate and appropriate corrective action. In reviewing cases involving the acts of nonemployees, the extent of the employer's control and any other legal responsibility that the employer may have with respect to the misconduct must be considered [*Gov. Code § 12940(j)(1)*].

An employer must take all reasonable steps to prevent the occurrence of harassment [*Gov. Code § 12940(j)(1), (k)*; *2 Cal. Code Reg. § 7287.6(b)(3)*; *see Ellison v. Brady (9th Cir. 1991) 924 F.2d 872, 881* ; *see also* [c], *below*]. Loss of tangible job benefits is not necessary to establish harassment [*Gov. Code § 12940(j)(1)*].

[b] Standard of Behavior

Sexual harassment cases are examined from the viewpoint of the victim (the "reasonable victim" standard). This means courts will apply the perspective of the reasonable woman in cases of sexual harassment against a woman, and the perspective of the reasonable man in cases of sexual harassment against a man [*see Ellison v. Brady (9th Cir. 1991) 924 F.2d 872, 879-880]* . The focus of a cause of action for sexual harassment is whether the victim has been subjected to sexual harassment, not what motivated the harasser [*Mogilefsky v. Superior Court (1993) 20 Cal. App. 4th 1409, 1418, 26 Cal. Rptr. 2d 116]* .

[c] Prevention and Correction of Sexual Harassment

Employers must take all reasonable steps to prevent sexual harassment from occurring, and, if it does occur, must take immediate appropriate corrective action [*Gov. Code § 12940(j), (k)*]. Remedies should be reasonably calculated to end the sexual harassment. This may include transferring, suspending, or terminating the harassing employee. In addition, employers should educate all their employees about sexual harassment, making sure employees know that such conduct is unlawful [*Ellison v. Brady (9th Cir. 1991) 924 F.2d 872, 882-883]* . For an illustrative sexual harassment policy that may be included in an employee manual, see *§ 1C.220*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawDiscriminationHarassmentSexual HarassmentBurdens of ProofGeneral OverviewLabor & Employment LawDiscriminationHarassmentSexual HarassmentBurdens of ProofObjective & Subjective StandardsLabor & Employment LawDiscriminationHarassmentSexual HarassmentDefenses & ExceptionsAntiharassment PolicyLabor & Employment LawDiscriminationHarassmentSexual HarassmentEmployer LiabilityCoworkersLabor & Employment LawDiscriminationHarassmentSexual HarassmentEmployer LiabilitySupervisorsLabor & Employment LawDiscriminationHarassmentSexual HarassmentHostile Work EnvironmentLabor & Employment LawDiscriminationHarassmentSexual HarassmentQuid Pro QuoLabor & Employment LawDiscriminationHarassmentSexual HarassmentRemediesGeneral Overview



15 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
1. Hiring and Retaining Employees

1-1C California Legal Forms--Transaction Guide §§ 1C.14-1C.19

[Reserved]

§§ 1C.14[Reserved]



16 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
2. Privacy Considerations of Applicants and Employees

1-1C California Legal Forms--Transaction Guide § 1C.20

§ 1C.20 Constitutional Protection of Privacy

[1] California Constitution

[a] In General

Under the California Constitution, privacy is an inalienable right [*Cal. Const. art. I, § 1*]. The right of privacy applies to private businesses as well as government entities, and prevents them from collecting and stockpiling unnecessary information, and from misusing information gathered for one purpose to serve other purposes, or to embarrass [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 20-21, 26 Cal. Rptr. 2d 834, 865 P.2d 633* ; *see Wilkinson v. Times Mirror Corp. (1989) 215 Cal. App. 3d 1034, 1040-1044, 264 Cal. Rptr. 194]* . The right of privacy has been applied to medical records, private investigations, student records, arrest records, financial records, and drug and alcohol testing [*see* Wilcox, California Employment Law, Ch. 50, *Limitations on Employer Collection of Private Information About Employees* (Matthew Bender); *see also § 1C.21*].

[b] Permissible Intrusion Into Privacy

Many inquiries and test procedures constitute intrusions into privacy. However, the constitutional right to privacy does not prohibit all incursions into individual privacy. A violation of the right to privacy may be justified by a competing interest. Legitimate interests derive from the legally authorized and socially beneficial activities of government and private entities. Their relative importance is determined by their proximity to the central functions of a particular enterprise. Conduct alleged to be an invasion of privacy is to be evaluated based on the extent to which it furthers legitimate and important competing interests [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 38, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* .

[2] Federal Constitution

The Federal Constitution provides several privacy protections relevant to the employment field. For example, the *First Amendment* protects the rights of free speech and free association, the *Fourth Amendment* protects the right to be free of

unreasonable search and seizure, and the *Fifth Amendment* prohibits compulsory self-incrimination [*see U.S. Const., amends. I, IV, V*]. In addition, the United States Supreme Court has found in the *Bill of Rights* "zones of privacy" emanating from the "penumbras" of specific constitutional guarantees [*see Griswold v. Connecticut (1965) 381 U.S. 479, 484, 85 S. Ct. 1678, 14 L. Ed. 2d 510]* .

Because the *Bill of Rights* applies only to government conduct, these protections generally are applicable only to government entities. However, they are also applicable to private employers, but only when the practice is compelled by the government and the industry is subject to significant government regulation, converting the private conduct into state action [*see Skinner v. Railway Labor Executives' Ass'n (1989) 489 U.S. 602, 614-618, 109 S. Ct. 1402, 103 L. Ed. 2d 639]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Constitutional LawBill of RightsFundamental FreedomsFreedom of SpeechScope of FreedomConstitutional LawBill of RightsFundamental RightsGeneral OverviewConstitutional LawBill of RightsFundamental RightsUnenumerated RightsLabor & Employment LawEmployee PrivacyConstitutional Protections



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
2. Privacy Considerations of Applicants and Employees

1-1C California Legal Forms--Transaction Guide § 1C.21

§ 1C.21 Protection of Particular Privacy Issues

[1] Arrest Record Not Resulting in Conviction

In general, an employer may not ask an applicant to disclose information concerning an arrest or detention that did not result in conviction, or information concerning participation in a diversion program [*Lab. Code § 432.7(a)*]. The information may be sought from persons seeking employment, or already employed, as peace officers [*Lab. Code § 432.7(e)*], and from applicants for employment at a health facility in a position involving access to patients, drugs, or medication [*Lab. Code § 432.7(f)*].

[2] Fair Employment and Housing Act Privacy Protection

[a] In General

The Fair Employment and Housing Act (FEHA) [*see Gov. Code § 12900 et seq.*] and its implementing regulations [*see 2 Cal. Code Reg. §§ 7285.0-8504*] generally prohibit an employer from discriminating against employees on a number of prohibited bases [*see Gov. Code § 12940(a)*; *see also § 1C.10[1][a]*]. As a part of this prohibition on discrimination, the Act provides employees with a variety of privacy protections.

[b] Sex

Except for recordkeeping and other limited purposes, an employer may not ask the sex of a job applicant on an application or questionnaire. After an individual is hired, the employer may record his or her sex for legitimate personnel purposes [*2 Cal. Code Reg. § 7290.9(b)(2)*].

[c] Pregnancy

An employer may not ask questions regarding childbearing, pregnancy, birth control, or familial responsibilities unless they relate to specific and relevant working conditions of the job in question [*2 Cal. Code Reg. § 7290.9(b)(3)*].

[d] Marital Status

An employer may not ask applicants to disclose marital status as part of a pre-employment inquiry, but may ask for any former names used, to check past work records [*2 Cal. Code Reg. § 7292.4(a), (b)*]. An employer may also ask if the applicant has a spouse who is currently employed by the employer, but the employer may not use this information in the employment decision [*2 Cal. Code Reg. § 7292.4(c)*].

[e] Religion

An employer may not ask questions regarding an applicant's availability for work on weekends or evenings as a pretext for ascertaining his or her religious creed. In addition, this type of inquiry may not be used to evade the requirement of reasonable accommodation of an employee's religion [*see 2 Cal. Code Reg. § 7293.3* ("reasonable accommodation" defined)]. Availability inquiries are permissible when reasonably related to the requirements of the job in question [*2 Cal. Code Reg. § 7293.4*].

[f] Age

Discrimination on the basis of age in hiring or employment is an unlawful employment practice [*Gov. Code § 12940(a)*]. Further, it is an unlawful employment practice to make any non-job related inquiry of an applicant that expresses any limitation, specification, or discrimination as to age. However, an employer or employment agency is not barred from inquiring into the age of an applicant, or from specifying age limitations, when the law compels or provides for that action [*Gov. Code § 12940(d)*].

[g] Physical Disability

Under state law, an employer may not ask general questions about physical condition in an application, in a pre-employment questionnaire, or in the course of the selection process [*2 Cal. Code Reg. § 7294.0(b)(2)*]. However, it is permissible to ask questions concerning an applicant's physical fitness, medical or physical condition, or medical history, if the inquiry is directly related or pertinent to the position in question, or directly related to a determination of whether or not the applicant would endanger his or her health or safety or the health or safety of others [*see 2 Cal. Code Reg. § 7294.0(b)(3)*].

In addition, under the federal Americans With Disabilities Act of 1990 [*see 42 U.S.C. §§ 12101-12213*], an employer may not ask a job applicant if he or she is an individual with a disability, or inquire about the nature or severity of the disability. However, an employer may make pre-employment inquiries into the ability of an applicant to perform job-related functions [*42 U.S.C. § 12112(c)(2)*].

[h] Medical Examination

An employer may make a pre-employment inquiry regarding physical fitness, medical condition, physical condition, or medical history of an applicant only if that inquiry is directly related and pertinent to the position the applicant is applying for or is directly related to a determination of whether the applicant would endanger his or her health and safety or the health and safety of others [*2 Cal. Code Reg. § 7287.3(b)(1)*; *see Gov. Code § 12940(d)*]. An employer who does receive medical information must establish procedures to ensure the confidentiality of the information, and to protect it from unauthorized use and disclosure [*Civ. Code § 56.20(a)*]. It is unlawful age discrimination to require an applicant over 40 to meet higher physical or medical standards than younger applicants for the same job [*2 Cal. Code Reg. § 7295.6(c)*].

In general, an employer or employment agency may not require any medical or psychological examination of any job applicant, make any medical or psychological inquiry of an applicant, make any inquiry into whether an applicant has a physical or mental disability or medical condition, or make any inquiry into the nature or severity of a physical or

mental disability or medical condition [*Gov. Code § 12940(e)(1)*]. However, an employer or employment agency may inquire into the applicant's ability to perform job-related functions and may respond to an applicant's request for reasonable accommodation [*Gov. Code § 12940(e)(2)*]. Further, an employer or employment agency may require a medical or psychological examination or make a medical or psychological inquiry after making a job offer but before the commencement of employment duties, provided that (1) the examination or inquiry is job-related and consistent with business necessity and (2) all entering employees in the same job classification are subject to the same examination or inquiry [*Gov. Code § 12940(e)(3)*]. Similarly, an employer or employment agency is generally prohibited from requiring any medical or psychological examination of an employee, making any medical or psychological inquiry of an employee, making any inquiry into whether an employee has a physical or mental disability or medical condition, or making any inquiry into the nature or severity of a physical or mental disability or medical condition [*Gov. Code § 12940(f)(1)*]. However, an employer or employment agency may require examinations or inquiries that it can show to be job-related and consistent with business necessity. In addition, an employer or employment agency may conduct voluntary medical examinations, including voluntary medical histories, that are part of an employee health program that is available to employees at that worksite [*Gov. Code § 12940(f)(2)*].

Under federal law, an employer may require a medical examination after an offer of employment has been made to a job applicant, and may condition an offer of employment on the results of the examination if (1) all entering employees are subject to the examination, regardless of disability, (2) information obtained is treated as a confidential medical record (with limited exceptions), and (3) the results of the test are used only as specified in the ADA [*42 U.S.C. § 12112(c)(3)*; *see § 1C.11[4]*].

[3] AIDS Test

The results of an HIV test [*see Health & Safety Code § 120775(c)*] that identifies or provides identifying characteristics of the person to whom the test results apply may not be used to determine suitability for employment [*Health & Safety Code § 120980(f)*; *see Health & Safety Code § 121115* (fact of person's participation in AIDS research study may not be used to determine employability)]. In addition, the disclosure of HIV positive status may be entitled to privacy protection under *Article I, Section 1, of the California Constitution*, when there is improper use of information properly obtained [*Urbaniak v. Newton (1991) 226 Cal. App. 3d 1128, 1140, 277 Cal. Rptr. 354]* .

[4] Drug Test

[a] In General

Apparently in reaction to concern over the economic, societal, and safety problems associated with drug abuse in general and drug use in the workplace, some employers have instituted drug testing programs. These programs vary in scope and procedure, and may apply to job applicants as well as current employees. There are currently no federal or state statutes that directly prohibit private employers from requiring applicants or employees to submit to drug testing. The California Supreme Court has determined that in many instances, drug testing of employees and applicants is acceptable [*see* [b], *below*]. For further discussion of the policy issues surrounding drug testing, see Wilcox, California Employment Law, Ch. 50, *Limitations of Employer Collection of Private Information About Employees* (Matthew Bender).

[b] Application of *Hill* Balancing Test

With regard to the right of privacy under the California Constitution [*see Cal. Const. art. I, § 1*; *see also § 1C.20 [1]*], the California Supreme Court applied a "balancing test" standard to hold that the National Collegiate Athletic Association's drug testing program did not violate the privacy rights of student athletes [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 57, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* . This defense is less rigorous than the compelling interest defense, whose application the Court limited to cases involving obvious government action impacting freedom of expression and association or an obvious invasion of an interest fundamental to personal

autonomy [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 34, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* .

This "competing interest" defense involves the use of a balancing test that compares the specifically identified privacy interests of the plaintiff with legitimate, competing, and countervailing nonprivacy interests asserted by the defendant [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 37, 26 Cal. Rptr. 2d 834, 865 P.2d 633* (applying this test to NCAA drug testing program for student athletes and finding no violation)]. If the interests asserted by the defendant justify the invasion of privacy, the intrusion does not violate the California Constitution. The relative importance of an asserted interest depends on its proximity to the central functions of a particular public or private enterprise [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 38, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* .

The plaintiff may rebut the assertion of a competing interest by showing that there are feasible and effective alternatives to the defendant's conduct that would have a lesser impact on privacy interests [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 40, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* .

[c] Elements of Cause of Action

The California Supreme Court has set forth three essential elements for a cause of action for invasion of the state constitutional right of privacy [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 39-40, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* :

- A legally protected privacy interest.
- A reasonable expectation of privacy.
- A serious invasion of the privacy interest.

The plaintiff in an invasion of privacy case has the burden of establishing each element [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 39, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* .

[d] Application to Employment Setting

The California Supreme Court declined to pass judgment on the legality of blanket or random drug test programs for employees or job applicants [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 54, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* . However, the Court indicated that the same "competing interest" standard will apply to determine under what circumstances it is permissible to use drug testing in order to maintain a workplace free of substance abuse. The result will depend on the public interest, the employer's special interests, and the employees' reasonable expectations of privacy in a particular employment setting [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 55-56 n.20, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* . Pre-*Hill* cases addressing drug testing issues in an employment context must be reexamined to determine whether they are consistent with the elements and standards announced in *Hill*. The Supreme Court offered no analysis of the continuing vitality of these decisions, except by noting that at least one appellate court had erroneously applied the compelling interest standard [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 55-56 n.20, 26 Cal. Rptr. 2d 834, 865 P.2d 633 citing Luck v. Southern Pacific Transportation Co. (1990) 218 Cal. App. 3d 1, 267 Cal. Rptr. 618* (drug testing based on safety considerations unconstitutional when applied to nonsafety employee)].

Hill culminates a trend that makes it clear that "not every act which has some impact on personal privacy invokes the protections of the state's Constitution and requires such justification" [*Wilkinson v. Times Mirror Corp. (1989) 215 Cal. App. 3d 1034, 1046-1048, 264 Cal. Rptr. 194]* . The California Supreme Court has made it clear that the *Hill* standard will apply to future claims for invasion of the state constitutional right to privacy. The Court offered no

analysis on the continuing vitality of cases decided before *Hill* [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 55-56 n.20, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* , and accordingly, those cases should be followed with caution. However, it is safe to conclude that if a properly planned and administered drug testing program is adopted, and used for applicants or employees in jobs that relate to safety, security, or other sensitive issues, it is likely that the program will be valid.

[e] Federally Mandated Drug Testing

Federal regulations require employers in industries in which safety is a primary consideration, such as airlines and railroads to conduct pre-employment drug tests for certain classes of job applicants [*see 14 C.F.R. §§ 120.7(f), 120.35, 120.109(a), 120.101 et seq.* (airlines); *49 C.F.R. §§ 219.501-219.505* (railroads)].

In addition, federal regulations require drug testing of certain airline employees [*14 C.F.R. §§ 120.35, 120.101 et seq.* (airlines)] and railroad employees [*49 C.F.R. §§ 219.601-219.605*]. For further discussion, see Wilcox, California Employment Law, Ch. 50, *Limitations of Employer Collection of Private Information About Employees* (Matthew Bender).

[5] Alcohol Test

The privacy issues surrounding alcohol tests are similar to those in drug tests [*see* [4], *above*]. Alcohol tests are usually less intrusive than drug tests, and generally do not test for any substance but alcohol. For these reasons, alcohol tests are even more likely to be valid under a privacy challenge than drug tests. Federal regulations authorize employers in safety-sensitive industries, such as railroads, to conduct alcohol tests after an accident or for cause [*see, e.g., 49 C.F.R. §§ 219.201-219.213* (post-accident), 219.301-219.309 (for cause)]. For further discussion, see Wilcox, California Employment Law, Ch. 50, *Limitations of Employer Collection of Private Information About Employees* (Matthew Bender).

[6] Polygraph Test

An employer may not demand or require that a job applicant take a polygraph or lie detector test as a condition of employment [*Lab. Code § 432.2(a)*]. The federal Employee Polygraph Protection Act of 1988 provides similar protections for private employees [*see 29 U.S.C. §§ 2001-2009; 29 C.F.R. §§ 801.1-801.75*].

[7] Eavesdropping and Wiretapping

It is unlawful for any person, including an employer, to use certain eavesdropping, wiretapping, and other surveillance techniques to invade private communications without the consent of the parties to the communication [*see Penal Code §§ 630-637.5*]. Similarly, it is an infraction for an employer, other than the federal government, to make audio or videotape recordings of employees in restrooms, locker rooms, or other rooms designated by employers for changing clothes [*Lab. Code § 435*].

In one case involving an employer's video surveillance of an office used by employees, the California Supreme Court found that the employees had a reasonable expectation under widely held social norms that their employer would not install video equipment capable of monitoring and recording their activities--personal and work-related--behind closed doors without their knowledge or consent. Under the circumstances of that case, however, the intrusion was not sufficiently serious to constitute a privacy violation. Any actual surveillance was drastically limited in nature and scope (no audio, not operated during business hours), exempting plaintiffs from its reach, and the defendants were motivated by strong countervailing concerns, which included providing a wholesome environment for the abused children in their care and avoiding legal liability [*Hernandez v. Hillsides, Inc. (2009) 47 Cal. 4th 272, 286-300, 97 Cal. Rptr. 3d 274, 211 P.3d 1063]* .

[8] Investigative Report

An employer may use an investigative consumer report for employment purposes. If the report is sought for employment purposes other than suspicion of wrongdoing or misconduct by the subject of the investigation, the person seeking the investigative consumer report may procure the report (or cause the report to be made) only if all the following apply [*Civ. Code § 1786.16(a)(2)*]:

- The person procuring or causing the report to be made has a permissible purpose [*see Civ. Code § 1786.12*].
- The person procuring or causing the report to be made provides a clear and conspicuous disclosure in writing to the consumer at any time before the report is procured or caused to be made in a document consisting solely of the disclosure. The disclosure document must do all of the following:
  - State that an investigative report may be obtained.
  - Identify the permissible purpose of the report.
  - State that the disclosure may include information on the consumer's character, general reputation, personal characteristics, and mode of living.
  - Identify the name, address, and telephone number of the investigative consumer reporting agency conducting the investigation.
  - Notify the consumer of the nature and scope of the investigation requested, including a summary of *Civ. Code § 1786.22*.
- The consumer has given written authorization for the procurement of the report.

The person procuring or causing the report to be made must certify to the reporting agency that he or she has made the applicable requisite disclosures and will comply with *Civ. Code § 1786.16(b)* [*Civ. Code § 1786.16(a)(4), (b)*]. Further, the person procuring or causing the report to be prepared must agree to provide a copy of the report as provided in *Civ. Code § 1786.16(b)* [*Civ. Code § 1786.16(a)(5), (b)*]. *Civ. Code § 1786.16(b)* requires that any person requesting an investigative report provide the subject of the investigation (the consumer) a means by which the consumer may indicate on a written form, by means of a box to check, that the consumer wishes to receive a copy of any report prepared. If the consumer wishes to receive a copy, the recipient of the report (typically the employer) must send a copy to the consumer within three business days of the date that the report is provided to the recipient. The recipient may contract with another entity to send a copy to the consumer. The notice to request the report may be contained in either the disclosure form or a separate consent form. The copy of the report must contain the name, address, and telephone number of the person who issued the report and how to contact them [*Civ. Code § 1786.16(b)(1)*]. In addition, the person requesting the report must comply with *Civ. Code § 1786.40* if the taking of an adverse action is a consideration [*Civ. Code § 1786.16(b)(2)*].

These restrictions and requirements [*see Civ. Code § 1786.16(a), (b)*] do not apply to an investigative consumer report procured or caused to be prepared by an employer when the report is sought for employment purposes due to the employer's suspicion of wrongdoing or misconduct by the subject of the investigation [*Civ. Code § 1786.16(c)*]. Finally, certain items of information may not be included in the report [*see Civ. Code § 1786.18*].

[9] Credit Report

Under the Consumer Credit Reporting Agencies Act [*see Civ. Code §§ 1785.1-1785.35*], an employer may obtain a consumer credit report from a consumer credit reporting agency if it intends to use the information for employment purposes [*Civ. Code § 1785.11(a)(3)(B)*]. Before requesting a report, the employer must give written notice to the applicant of the report, and provide a mechanism for the applicant to request and receive a copy of the report at no charge [*Civ. Code § 1785.20*.5(a)]. The federal Fair Credit Reporting Act imposes similar requirements on employers who use credit reports in making employment decisions [*see 15 U.S.C. §§ 1681-1681t*].

[10] Determination of Unauthorized Alien Status

Under the Immigration Reform and Control Act (IRCA) [*see 8 U.S.C. §§ 1324a, 1324b*], it is unlawful to hire an alien for employment in the United States knowing the alien is an unauthorized alien or without requiring proof of eligibility for employment [*8 U.S.C. § 1324a(a)(1), (b)*]. It is also unlawful to continue to employ an alien knowing he or she is not authorized to be employed [*8 U.S.C. § 1324a(a)(2)*]. For a list of the documents that satisfy the proof of eligibility for employment requirement, see *§ 1C.100[2],* Paragraph 4.

[11] Leave Related to Domestic Violence

When an employee requests leave to handle matters related to domestic violence, the employer must maintain the confidentiality of the employee to the extent allowed by law [*Lab. Code §§ 230(d)(3), 230.1(b)(3)* (employers with 25 or more employees)]. For further discussion, see *§ 1C.63[4]* and *[10], below*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEmployee PrivacyMedical & Related ExaminationsLabor & Employment LawEmployee PrivacyPrivacy ActGeneral OverviewLabor & Employment LawPreemployment Practices



18 of 170 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
2. Privacy Considerations of Applicants and Employees

1-1C California Legal Forms--Transaction Guide §§ 1C.22-1C.29

[Reserved]

§§ 1C.22[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
3. Terminating Employees

1-1C California Legal Forms--Transaction Guide § 1C.30

§ 1C.30 Grounds for Termination

[1] In General

Every employment is terminated by (1) expiration of its appointed term, (2) extinction of its subject, (3) death of the employee, or (4) the employee's legal incapacity to act as an employee [*Lab. Code § 2920*]. Absent a contract, every employment is at will, and the employee can be fired with or without cause. However, the presumption of employment at will may be superseded by a contract limiting the employer's right to discharge the employee [*Foley v. Interactive Data Corp. (1988) 47 Cal. 3d 654, 665, 254 Cal. Rptr. 211, 765 P.2d 373]* . For further discussion of employment at will, and exceptions to the at-will doctrine, see [3] through [5], *below*.

[2] Termination of Employment for Specified Term

Employment for a specified term may be terminated at any time by the employer for (1) willful breach of duty bythe employee in the course of his or her employment, (2) habitual neglect of duty, or (3) continued incapacity to perform [*Lab. Code § 2924*]. An employee may terminate employment for a specified term for willful or permanent breach of the obligations of the employer to him or her as an employee [*Lab. Code § 2925*]. Employment for a "specified term" means employment for a period greater than one month [*Lab. Code § 2922*].

[3] Termination of Employment Without Specified Term (Employment at Will)

If an employment has no specified term, it may be terminated at the will of either party on notice to the other party [*Lab. Code § 2922*]. This is commonly known as "employment at will" or the "at-will doctrine." An employee not employed for a specified term who quits or is dismissed by the employer is entitled to compensation for services rendered up to the time of dismissal [*Lab. Code § 2926*].

[4] Statutory Exceptions to Employment at Will

There are many federal and California statutory exceptions to the at-will doctrine. The broadest is Title VII of the Civil

Rights Act of 1964, which prohibits employment discrimination on a variety of bases [*see 42 U.S.C. § 2000e-2(a)*]. The primary California statute is the Fair Employment and Housing Act, which generally prohibits employment discrimination on the same bases as federal Title VII [*see Gov. Code § 12940* (FEHA also bars discrimination and harassment based on sexual orientation)]. For discussion of the many statutory exceptions to the at-will doctrine and an employer's liability for wrongful termination, see Wilcox, California Employment Law, Ch. 60, *Liability for Wrongful Termination and Discipline* (Matthew Bender).

[5] Judicial Exceptions to Employment at Will

[a] Wrongful Termination in Violation of Public Policy

The California Supreme Court first held in 1980 that a discharged employee may bring a tort action against his or her employer if the discharge violated fundamental principles of public policy [*Tameny v. Atlantic Richfield Co. (1980) 27 Cal. 3d 167, 172, 164 Cal. Rptr. 839, 610 P.2d 1330]* . In this case, the employer violated public policy by firing the employee for refusing to participate in an illegal scheme to fix gasoline prices [*Tameny v. Atlantic Richfield Co. (1980) 27 Cal. 3d 167, 170, 164 Cal. Rptr. 839, 610 P.2d 1330]* . The discharge must be against public policy and must affect a duty that inures to the benefit of the public at large, rather than to a particular employer or employee [*Foley v. Interactive Data (1988) 47 Cal. 3d 654, 669, 254 Cal. Rptr. 211, 765 P.2d 373]* . A wrongful termination action based on violation of public policy must derive from constitutional or statutory authority [*Gantt v. Sentry Insurance (1992) 1 Cal. 4th 1083, 1095, 4 Cal. Rptr. 2d 874, 824 P.2d 680]* . For discussion of the sources of public policy, see Wilcox, California Employment Law, Ch. 60, *Liability for Wrongful Termination and Discipline* (Matthew Bender).

[b] Agreement to Terminate for "Good Cause Only"

Another exception provides that an employee may not be terminated without cause if the employer has represented by oral or written agreement that the employee will be terminated "for good cause only" [*see* Pugh v. See's *Candies, Inc. (1981) 116 Cal. App. 3d 311, 171 Cal. Rptr. 917]* . "Good cause" generally refers to a fair and honest cause or reason, regulated by good faith on the part of the party exercising the power [Pugh v. See's *Candies, Inc. (1981) 116 Cal. App. 3d 311, 330, 171 Cal. Rptr. 917]* . A contract is terminable "for good cause only" if either (1) the contract was supported by consideration independent of the services to be performed by the employee for the employer, or (2) the parties agreed that the employee would be terminated only for cause [Pugh v. See's *Candies, Inc. (1981) 116 Cal. App. 3d 311, 326, 171 Cal. Rptr. 917]* .

[c] Termination in Violation of Covenant of Good Faith

The third judicial exception to the at-will doctrine is breach of the implied covenant of good faith and fair dealing. As in other contracts, employment contracts impose on each party a duty of good faith and fair dealing in the performance and enforcement of the contract [*Foley v. Interactive Data Corp. (1988) 47 Cal. 3d 654, 683, 254 Cal. Rptr. 211, 765 P.2d 373]* . This duty of good faith protects the parties' right to receive the benefit of their agreement, and breach of the duty may result in contract damages. However, the duty does not create an agreement to terminate only for good cause in an at-will employment relationship [*Foley v. Interactive Data Corp. (1988) 47 Cal. 3d 654, 698 n.39, 254 Cal. Rptr. 211, 765 P.2d 373]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEmployment RelationshipsAt-Will EmploymentDuration of EmploymentLabor & Employment LawEmployment RelationshipsAt-Will EmploymentExceptionsPublic PolicyLabor & Employment LawEmployment RelationshipsEmployment ContractsConditions & TermsDischargesLabor & Employment LawWrongful TerminationDefensesEmployee Misconduct



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
3. Terminating Employees

1-1C California Legal Forms--Transaction Guide § 1C.31

§ 1C.31 Notification Required by Worker Adjustment and Retraining Notification Act

The Worker Adjustment and Retraining Notification Act [*see 29 U.S.C. § 2101 et seq.*] (sometimes called the WWARN Act) imposes a duty on employers to notify employees of plant closings or mass layoffs [*see 29 U.S.C. § 2102*]. The Act applies to employers of 100 or more employees [*see 29 U.S.C. § 2101(a)(1)*]. In general, the Act requires employers to give written notification to representatives or employees at least 60 days before a plant closing or mass layoff, if it will result in the loss of employment for at least 50 full-time employees at a single site of employment [*29 U.S.C. § 2102(a)*; *see 29 U.S.C. § 2101(a)(2),(3)* ("plant closing" and "mass layoff" defined); *20 C.F.R. § 639.3(I)* ("single site of employment" defined); *Bader v. Northern Line Layers, Inc. (9th Cir. 2007) 503 F.3d 813* , (application of those definitions to layoffs of construction workers at numerous job sites distant from each other, where fewer than 50 were employed at each site; WARN Act did not require notification)].

Employers may give less than 60 days notice in certain unusual circumstances [*see 29 U.S.C. § 2102(b)*]. An employer is not required to give notice if the closing or layoff is due to the completion of a particular project and employees were hired with the understanding that employment was of a limited duration, or if the closing or layoff is due to a strike or lockout not intended to evade the notice requirements [*see 29 U.S.C. § 2103*]. The Act also "plainly does not apply to a government-ordered mass layoff" [*Deveraturda v. Globe Aviation Sec. Servs. (9th Cir. 2006) 454 F.3d 1043, 1049* (worker who was laid off as result of federalization of airport security and assumption by government of responsibility for aviation screening services at airport had no claim against employer for failing to give 60 days notice under Act)].

A California law having the same title imposes a similar notification requirement but applies to somewhat smaller employers [*see generally Lab. Code § 1400 et seq.*]. Note that because the law defines a mass layoff in terms of 50 or more employees losing their positions with the employer [*Lab. Code § 1400(c), (d)*], there would be no mass layoff in the case of a transfer of a business that includes a transfer of the employees. In that case, the employees would not be losing their positions but would merely be exchanging the former employer for a new employer. Therefore, the former employer would have no duty to give the notice specified in the law, even if not all of the existing employees were transferred (as long as fewer than 50 were laid off in the process) [*MacIsaac v. Waste Management Collection & Recycling, Inc. (2005) 134 Cal. App. 4th 1076, 1086-1087, 36 Cal. Rptr. 3d 650]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWorker Adjustment & Retraining Notification ActGeneral OverviewLabor & Employment LawWorker Adjustment & Retraining Notification ActCoverage & DefinitionsGeneral OverviewLabor & Employment LawWorker Adjustment & Retraining Notification ActCoverage & DefinitionsMass Layoffs



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
3. Terminating Employees

1-1C California Legal Forms--Transaction Guide § 1C.32

§ 1C.32 Payment Obligation on Termination

[1] Time of Payment

If an employer discharges an employee, the wages earned and unpaid on discharge are due and payable immediately. An employer who lays off seasonal workers must make payment within a reasonable time, which cannot exceed 72 hours [*Lab. Code § 201(a)*]. A state employer will be deemed to have made an immediate payment of wages for any unused or accumulated vacation, annual leave, holiday leave, or time off to which the employee is entitled by previous overtime work when compensating time off was given by the appointing power, if the employee submitted a written election to the appointing power authorizing the state employer to tender payment for any or all leave to be contributed on a pretax basis to the employee's account in a state-sponsored supplemental retirement plan [*Lab. Code § 201(b)*; *see I.R.C. §§ 401(k), 403(b), 457*]. The employee's election must be submitted at least five days before the final day of employment. The contribution to the plan account must be made no later than 45 days after discharge [*Lab. Code § 201(b)*]. Further, a discharged employee of a state employer may submit, at least five days before the final day of employment, a written election authorizing the deferral of payment into the next calendar year of any unused or accumulated vacation, annual leave, holiday leave, or compensatory time. However, only that portion of leave that extends past the November pay period may be deferred into the next calendar year. These payments must be tendered no later than February 1 of the year after the employee's last day of employment [*Lab. Code § 201(c)*]. Nothing in these deferral provisions is intended to authorize contributions in excess of the annual deferral limits imposed by state and federal law or the provisions of the supplemental retirement plan itself [*Lab. Code § 201(b), (c)*].

An employer effectuates a discharge within the contemplation of *Lab. Code § 201* not only when the employer fires an employee, but also when the employer releases an employee on the employee's completion of the particular job assignment or time duration for which he or she was hired [*Smith v. Superior Court (2006) 39 Cal. 4th 77, 90, 45 Cal. Rptr. 3d 394, 137 P.3d 218* (person whom employer hired to perform one day of work was entitled to receive wages immediately after completing that employment)].

An employee not employed under a written contract for a definite period who quits must be paid within 72 hours of

quitting. If the employee gives at least 72 hours notice of the intention to quit, he or she is entitled to be paid at the time of quitting [*Lab. Code § 202(a)*]. A state employer will be deemed to have made an immediate payment of wages for any unused or accumulated vacation, annual leave, holiday leave, sick leave to which the employee is otherwise entitled due to a disability retirement, or time off to which the employee is entitled by previous overtime work when compensating time off was given by the appointing power, if the employee submitted a written election to the appointing power authorizing the state employer to tender payment for any or all leave to be contributed on a pretax basis to the employee's account in a state-sponsored supplemental retirement plan, provided that the plan permits these contributions [*Lab. Code § 202(b)*; *see I.R.C. §§ 401(k), 403(b), 457*]. The employee's election must be submitted at least five days before the final day of employment. The contribution to the plan account must be made no later than 45 days after the last day of employment [*Lab. Code § 202(b)*]. Further, when a state employee quits, retires, or retires based on disability, the employee may submit, at least five days before the final day of employment, a written election authorizing the deferral of payment into the next calendar year of any unused or accumulated vacation, annual leave, holiday leave, sick leave, retirement, or compensatory time. However, only that portion of leave that extends past the November pay period may be deferred into the next calendar year. These payments must be tendered no later than February 1 of the year after the employee's last day of employment [*Lab. Code § 202(c)*]. Nothing in these deferral provisions is intended to authorize contributions in excess of the annual deferral limits imposed by state and federal law or the provisions of the supplemental retirement plan itself [*Lab. Code § 202(b), (c)*].

The requirement that earned, unpaid wages be paid on termination or resignation [*Lab. Code §§ 201, 202*] is not violated by an employee incentive compensation plan under which employees can elect to receive, in lieu of a portion of their compensation, shares of company stock with restricted rights during a vesting period, with forfeiture of the restricted stock on an employee's resignation or termination for cause before the stock fully vests [*Schachter v. Citigroup, Inc. (2009) 47 Cal. 4th 610, 618-623, 101 Cal. Rptr. 3d 2, 9-13, 218 P.3d 262, 268-271* (because restricted stock had value--immediately exercisable voting and dividend rights, and contingent rights of full ownership--employee's bargained-for wages had been paid in full, and forfeiture of unvested shares did not constitute denial of compensation)].

[2] Place of Payment

A discharged employee must be paid at the place of discharge. An employee who quits must be paid at the office or agency of the employer in the county where the employer worked [*Lab. Code § 208*].

[3] Vested Vacation Pay

Unless otherwise provided by a collective bargaining agreement, whenever an employer or employment contract provides for paid vacations, and an employee is terminated without having taken off vested vacation time, all vested vacation time must be paid as wages at the employee's final rate of pay. An employer's policy or employment contract may not provide for forfeiture of vested vacation time on termination [*Lab. Code § 227.3*; *see* Owen v. Macy's, Inc., (2009) 175 Cal. App. 4th 462, 468, 96 Cal. Rptr. 3d 70 (*Lab. Code § 227.3* does not require that employer provide its employees with any paid vacation at all; rather, statute imposes certain requirements "whenever" employer provides vacation benefits)]. The right to paid vacation vests as labor is rendered [*Suastez v. Plastic Dress-Up Co. (1982) 31 Cal. 3d 774, 784, 183 Cal. Rptr. 846, 647 P.2d 122]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsCoverage & DefinitionsGeneral OverviewLabor & Employment LawWage & Hour LawsCoverage & DefinitionsHoliday, Sick & Vacation Pay



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
3. Terminating Employees

1-1C California Legal Forms--Transaction Guide § 1C.33

§ 1C.33 Prohibition on Retaliatory Termination or Discipline

[1] California Law

[a] Job Discrimination

An employer may not discharge, expel, or otherwise discriminate against a person because he or she has opposed any forbidden employment practices or filed a complaint, or testified or assisted in a proceeding, relating to unlawful employment discrimination [*Gov. Code § 12940(h)*].

[b] Violation of Statute or Regulation

An employer may not prevent an employee from disclosing information to a government agency or law enforcement agency, when the employee has reasonable cause to believe the information discloses a violation of a state or federal statute, or a violation or noncompliance with a state or federal rule or regulation [*Lab. Code § 1102.5(a)*; *see Lab. Code §§ 1102.6-1102.7*; *see also Lab. Code § 1102.8* (posting requirements)]. Further, the employer may not retaliate against an employee for making such a disclosure [*Lab. Code § 1102.5(b)*; *see Lab. Code § 1102.5(e)*; *but see Lab. Code § 1102.5(g)* (rule generally inapplicable to disclosure of privileged information)] or for refusing to participate in an activity that would result in a violation of state or federal statute (or violation or noncompliance with a state or federal rule or regulation) [*Lab. Code § 1102.5(c)*]. Retaliation for an employee's exercise of these rights [*Lab. Code § 1102.5(a)-(c)*] in any former employment is similarly prohibited [*Lab. Code § 1102.5(d)*].

In addition to other penalties, an employer that is a corporation or limited liability company is liable for a civil penalty for violating these prohibitions [*Lab. Code § 1102.5(f)*].

[c] Injury and Illness Prevention Program

Every employer must develop an injury and illness prevention program [*see § 1C.82*], which must include, among other things, a provision designed to encourage employees to inform the employer of health and safety hazards at the worksite

without fear of reprisal by the employer [*Lab. Code § 6401.7(a)(5)*].

[d] Safety or Health Violations

Under Cal/OSHA, an employer may not discharge or discriminate against an employee because he or she has done any of the following [*Lab. Code § 6310(a)*]:

- Made a complaint about employee safety or health to the Division of Occupational Safety and Health, to another agency, to the employer, or to an employee representative.
- Instituted a proceeding relating to the employee's rights.
- Testified (or is about to testify) in a proceeding relating to the rights of the employee or another employee.
- Participated in an occupational safety and health committee established under an illness and injury prevention program [*see* Lab. Code § 6301.7].

An employee discharged, threatened with discharge, demoted, suspended, or otherwise discriminated against for doing any of these things must be reinstated and reimbursed for lost wages and work benefits caused by the acts of the employer [*Lab. Code § 6310(b)*].

In addition, it is unlawful to lay off or discharge an employee for refusing to perform work that would cause a violation of an occupational safety or health statute, standard, or order, if the violation would create a real and apparent hazard to the employee or his or her fellow workers [*Lab. Code § 6311*].

[2] Federal Law

Under Title VII of the Civil Rights Act of 1964 [*see 42 U.S.C. §§ 2000e-2000e-17*], it is an unlawful employment practice for an employer to discriminate against an employee or applicant for opposing an unlawful employment practice or for making a charge, testifying, assisting, or participating in an investigation, proceeding, or hearing under Title VII [*42 U.S.C. § 2000e-3(a)*]. This protection extends not only to an employee who reports discrimination on his or her own initiative but also to an employee who speaks out about discrimination in answering questions during an employer's internal investigation [Crawford v. Metro. Gov't (2009) ___ U.S. ___, 129 S. Ct. 846, 172 L. Ed. 2d 650, 656-658 (employee can "oppose" employer's unlawful practice for purposes of *42 U.S.C. § 2000e-3(a)* simply by disclosing that practice)]. This anti-retaliation provision does not confine the actions and harms it forbids to those that are related to employment or occur at the workplace. The provision covers only those employer actions that would have been materially adverse to a reasonable employee or job applicant. That means that the employer's actions must be harmful to the point that they could dissuade a reasonable worker from making or supporting a charge of discrimination [*Burlington N. & Santa Fe Ry. v. White (2006) 548 U.S. 53, 57, 126 S. Ct. 2405, 2409, 165 L. Ed. 2d 345, 353]* .

Under the Age Discrimination in Employment Act (ADEA) [*see 29 U.S.C. §§ 621-634*], it is unlawful for an employer to discriminate against an employee or applicant for opposing an unlawful practice or for making a charge, testifying, assisting, or participating in an age discrimination action under the ADEA [*29 U.S.C. § 623(d)*].

An employee who reports employer violations of the Occupational Safety and Health Act (OSHA) [*see 29 U.S.C. §§ 651-678*] is protected from retaliatory action by the employer [*29 U.S.C. § 660(c); see 29 C.F.R. §§ 1977.1-1977.23*]. For further discussion of OSHA, see *§ 1C.80[2]*.

An employee who reports employer violations of certainenvironmental protection statutes is protected from retaliatory

action by the employer [*29 C.F.R. § 24.2*; *see 29 C.F.R. §§ 24.1-24.9*]. For further discussion of environmental protections as they relate to the workplace, see *§ 1C.81*.

It is unlawful for a defense contractor to discharge, demote, or otherwise discriminate against an employee because the employee disclosed to a government official what he or she reasonably believed was evidence of a substantial violation of a federal law or regulation [*10 U.S.C. § 2409*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawDiscriminationRetaliationElementsAdverse Employment ActionsLabor & Employment LawDiscriminationRetaliationElementsProtected ActivitiesLabor & Employment LawDiscriminationRetaliationStatutory ApplicationFair Labor Standards ActLabor & Employment LawOccupational Safety & HealthDuties & RightsLabor & Employment LawWrongful TerminationWhistleblower Protection ActCoverage & DefinitionsProtected Activities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
A. Hiring and Terminating Employees
3. Terminating Employees

1-1C California Legal Forms--Transaction Guide §§ 1C.34-1C.39

[Reserved]

§§ 1C.34[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
1. Tax and Insurance Obligations

1-1C California Legal Forms--Transaction Guide § 1C.40

§ 1C.40 Obligations for State Tax Purposes

[1] In General

State tax and insurance law requires an employer to withhold, pay, and account for a variety of taxes from employees' wages, including unemployment insurance, workers' compensation insurance, state disability insurance, and income tax. This section discusses the basic obligations that an employer should be made aware of. For further discussion of state taxes related to the employer-employee relationship, see Ch. 1D, *Overview of Employee Benefits* , and Ch. 1E, *Taxation of Businesses* .

[2] Income Tax

Every employer who pays wages to a resident employee within or outside California, or to a nonresident employee for services performed within California, must deduct and withhold income tax from those wages [*Unemp. Ins. Code § 13020(a)*; *see Rev. & Tax. Code § 17041* (rate of income tax)]. An "employer" is an individual, person, corporation, association, partnership, or limited liability company (or agent of any of these) doing business in California, deriving income from sources within California, or otherwise subject to California law, that pays wages to employees for services performed within California [*Unemp. Ins. Code § 13005(a)*]. For purposes of withholding state income tax, an "employee" is a resident individual who receives remuneration for services performed within or outside California, or a nonresident individual who receives remuneration for services performed within California. "Employee" also includes an officer of a corporation [*Unemp. Ins. Code § 13004*].

[3] Unemployment Insurance

[a] Purpose

The unemployment insurance scheme was enacted by the Legislature as a mandatory means of setting aside funds to be used to provide benefits for persons unemployed through no fault of their own, and to reduce involuntary unemployment and the suffering caused by unemployment [*Unemp. Ins. Code § 100*].

[b] Duty to Withhold and Contribute

Unemployment insurance is based on "employment," which is service, including service in interstate commerce, performed by an employee for wages or under any contract of hire [*Unemp. Ins. Code § 601*]. Wages are the basis of contribution in the unemployment insurance system. "Wages" means all remuneration payable to an employee for personal services, including commissions, bonuses, the reasonable cash value of all remuneration payable in a medium other than cash [*Unemp. Ins. Code § 926*], and certain tips [*see Unemp. Ins. Code § 927*].

The employer must pay its unemployment contribution based on a payroll calculation [*see Unemp. Ins. Code § 977*]; the employer may not deduct the contribution from employees' wages [*see Unemp. Ins. Code § 976*]. The employer's unemployment contribution must be transmitted to the Unemployment Fund on a prescribed schedule [*see Unemp. Ins. Code §§ 986, 1110*]. For further discussion of theunemployment insurance structure, see Wilcox, California Employment Law, Ch. 80, *Unemployment and State Disability Insurance* (Matthew Bender).

[c] "Employer" and "Employee" Defined

An "employer" is any employing unit that, for some portion of a day, has within the current or had within the preceding calendar year in employment one or more employees, and pays wages for employment in excess of $100 during any calendar quarter [*Unemp. Ins. Code § 675*; *see Unemp. Ins. Code § 135* ("employing unit" defined)].

An "employee" is (1) an officer of a corporation, (2) an individual who, under common law rules for determining the employer-employee relationship, has the status of an employee, and (3) any other individual who performs services for remuneration for any employing unit [*Unemp. Ins. Code § 621*]. The term also includes an individual who performs service in an artistic or literary capacity pursuant to a collective bargaining agreement [*see Unemp. Ins. Code § 601.5*], and one who creates a specially ordered or commissioned work of authorship when the parties agree in a signed writing that the work will be considered a work for hire as defined in *17 U.S.C § 101* [*see Unemp. Ins. Code § 686*].

[4] Disability Insurance

The purpose of disability insurance is to compensate for the wage loss sustained by individuals unemployed because of sickness or injury [*Unemp. Ins. Code § 2601*]. In general, the duties of an employer relating to disability insurance are the same as those relating to unemployment insurance [*see* [3], *above*]. However, the employer makes no disability contribution of its own; only employees contribute to the Disability Fund [*see Unemp. Ins. Code § 2603(a)*]. The employer's duty is to calculate and withhold workercontributions and transmit them to the Disability Fund on a prescribed schedule [*see Unemp. Ins. Code §§ 986, 1110*]. For further discussion of disability insurance, see Wilcox, California Employment Law, Ch. 80, *Unemployment and State Disability Insurance* (Matthew Bender).

The terms "employer" and "employee" have the same meaning for disability insurance purposes as for unemployment insurance purposes [*Unemp. Ins. Code § 2602(a)*; *see Unemp. Ins. Code § 621*; *see also* [3][c], *above*].

As an alternative to the withholding of employees' wages and contributing to the state disability fund, an employer, a majority of the employer's employees, or both, may apply for Employment Development Department approval of a voluntary plan for the payment of disability benefits [*see Unemp. Ins. Code § 3251*]. If the plan is approved, the employer and employees are not liable for the worker disability contribution [*see Unemp. Ins. Code § 3252*].

[5] Employment Training Tax

Most employers must contribute to the Employment Training Fund by making payments based on a percentage of wages paid [*Unemp. Ins. Code § 976.6*; *see Unemp. Ins. Code §§ 1610-1612*]. The purpose of the Fund is to help establish an employment training program that will foster job creation, minimize unemployment costs, and meet

employers' needs for skilled workers. These goals will be accomplished by providing skills training to unemployment insurance claimants, people who have recently exhausted their unemployment insurance and remain unemployed, and potentially displaced workers who would otherwise become unemployment insurance claimants [*Unemp. Ins. Code §§ 1611, 10200, 10201(b)*].

[6] Workers' Compensation

[a] Basis of Liability

The California Workers' Compensation Act [*see Lab. Code §§ 3201-4855*] assures compensation to employees for harm arising within the course and scope of their employment [*Shields v. County of San Diego (1984) 155 Cal. App. 3d 103, 112, 202 Cal. Rptr. 30]* . An employer is liable, without regard to negligence, for an injury sustained by an employee causing disability or death, and that arises out of and in the course of employment [*Lab. Code § 3600*]. Liability is based not on an act or omission of the employer, but because of the employment relationship, and because the injury arises out of and in the course of that employment. The employer's duty arises solely from the employment relationship [*Shields v. County of San Diego (1984) 155 Cal. App. 3d 103, 112, 202 Cal. Rptr. 30]* . For further discussion of workers' compensation, see Ch. 1D, *Employee Benefits* .

[b] Exclusive Remedy

Workers' compensation is the exclusive remedy for employees injured or killed on the job [*Lab. Code § 3602(a)*]. However, if the employer fails to secure payment of workers' compensation, an injured employee or his or her dependents may sue the employer for damages [*Lab. Code § 3706*]. The employer may also be liable for an employee's injury or death caused by the employer's knowing removal or failure to install certain types of safety guards [*see Lab. Code § 4558(b)*].

[c] Duty to Insure

Every private employer in California must provide for the payment of compensation by securing (1) liability insurance from an insurer authorized to write workers' compensation insurance, or (2) a certificate of consent to self-insure from the Director of Industrial Relations, which may be obtained by satisfying the Director of the employer's ability to self-insure and pay any necessary compensation [*see Lab. Code § 3700(a), (b)*].

[d] Parties Covered

Liability for workers' compensation arises only in an employer-employee relationship [*see Lab. Code § 3600(a)*]. For workers' compensation purposes, the term "employer" includes a governmental agency, a quasi-public corporation, every person who has a natural person in service, and the legal representative of a deceased employer [*Lab. Code § 3300*]. The term "employee" means every person in the service of an employer under any appointment or contract of hire or apprenticeship, express or implied, oral or written, regardless of whether lawfully or unlawfully employed [*Lab. Code § 3351*]. Persons holding jobs in many specific occupations are defined as employees [*see Lab. Code §§ 3351-3370*].

[7] Registration With California Employment Development Department

Every employing unit must register with the Employment Development Department (EDD) on a prescribed form within 15 days after becoming an employer [*Unemp. Ins. Code § 1086*; *see Unemp. Ins. Code § 135* ("employing unit" defined)]. An "employer" is an employing unit that for some portion of a day, within the current or past calendar year, has employed one or more employees and paid wages for employment in excess of $100 during any calendar quarter [*Unemp. Ins. Code § 675*].

Form DE-1 is the required registration form for all employers, and is available from any EDD employment tax district office. An employer must deliver the registration to the EDD or to an officer or employee of the State Board of Equalization who is authorized to (1) accept applications for seller's permits, (2) register retailers, (3) accept applications for licenses to operate commercial vehicles, or (4) issue licenses to operate commercial vehicles [*Unemp. Ins. Code § 1087*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawDisability & Unemployment InsuranceDisability BenefitsCoverage & DefinitionsGeneral OverviewLabor & Employment LawDisability & Unemployment InsuranceUnemployment CompensationCoverage & DefinitionsTax LawState & Local TaxesAdministration & ProceedingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
1. Tax and Insurance Obligations

1-1C California Legal Forms--Transaction Guide § 1C.41

§ 1C.41 Obligations for Federal Tax Purposes

[1] In General

Federal law requires an employer to withhold, pay, and account for income tax, Federal Insurance Contribution Act (FICA) tax (Social Security), and Federal Unemployment Tax Act (FUTA) tax. This section discusses the basic obligations that an employer should be made aware of. For further discussion of federal taxes related to the employer-employee relationship, see Ch. 1D, *Overview of Employee Benefits* , and Ch. 1E, *Taxation of Businesses* .

[2] Income Tax

In general, every employer paying wages must deduct and withhold income taxes on those wages by specified methods [*I.R.C. § 3402(a)*; *see I.R.C. § 3402(b)* (percentage method), (c) (wage-bracket method), (h) (alternative methods); *see also* Treas. Reg. §§ 1.6071, 1.6151, 1.6302 (procedure for collection and payment)]. In general, "wages" means all remuneration for services performed by an employee for his or her employer, including the cash value of all remuneration (including benefits) paid in a medium other than cash [*I.R.C. § 3401(a)*]. An "employer" is a person for whom an individual performs or performed any service, of whatever nature, as the employee of the person. However, if the person for whom the individual performs or performed the services does not have control of the payment of wages for the services, the employer is the person having control of the payment of wages [*I.R.C. § 3401(d)(1)*].

[3] Social Security and Medicare Tax

[a] Duty to Withhold

Under the Federal Insurance Contribution Act (FICA) [*see I.R.C. §§ 3101-3128*], taxpayers' wages are subject to a Social Security and Medicare tax at a statutory rate, based on employment [*see I.R.C. § 3101*]. The employer of a covered taxpayer must collect the tax by deducting it from the taxpayer employee's wages when paid [*I.R.C. § 3102(a)*; *see* Treas. Reg. §§ 1.6071, 1.6151, 1.6302 (procedure for collection and payment)]. An employer required to deduct Social Security and Medicare tax is liable to pay the tax, and must be indemnified for amounts paid [*I.R.C. § 3102(b)*].

In addition, the employer must itself pay a separate Social Security and Medicare contribution based on amount of wages paid to employees [*see I.R.C. § 3111*].

[b] Definitions

In general, "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in a medium other than cash [*I.R.C. § 3121(a)*]. "Employment" means any service performed (1) by an employee for his or her employer, regardless of citizenship or residence, within the United States or outside the United States in connection with American vessels or aircraft, or (2) outside the United States by a United States citizen for an American employer [*I.R.C. § 3121(b)*]. The term "employee" includes (1) an officer of a corporation; (2) an individual who, under common law rules for determining the employer-employee relationship, is an employee; and (3) an individual who performs services for remuneration as a driver, insurance salesperson, home worker, or traveling salesperson [*I.R.C. § 3121(d)*].

[4] Unemployment Tax

The Federal Unemployment Tax Act (FUTA) [*see I.R.C. §§ 3301-3311*] imposes an unemployment tax on every employer [*see I.R.C. § 3306(a)* ("employer" defined)] based on a percentage of wages paid with respect to employment during the calendar year [*I.R.C. § 3301*]. Taxpayers receive credit for their federal unemployment tax liability for contributions made to a certified state unemployment compensation fund that meets federal guidelines [*I.R.C. § 3302(a)(1)*; *see I.R.C. § 3304* (certification of state program)]. The California unemployment insurance scheme meets the federal guidelines [*see City of Sacramento v. State of California (1984) 156 Cal. App. 3d 182, 189, 195, 203 Cal. Rptr. 258]* . However, because the federal unemployment tax rate is higher than the maximum state unemployment tax rate [*see I.R.C. § 3301(1)*; *Unemp. Ins. Code § 977*], employers must still make a federal tax contribution [*see* Tax Guide for Small Businesses (IRS Pub. 334)].

[5] Federal Employer Identification Number

With limited exceptions, every employer that employs one or more individuals for wages that are subject to Federal Insurance Contribution Act (FICA) tax (Social Security) or income withholding tax [*see I.R.C. § 3402*] must apply for an employer identification number [*Treas. Reg. § 31.6011(b)-1(a)(1)(ii)*; *see Treas. Reg. § 301.6109-1(a)(1)* ("employer identification number" defined)]. To apply for an identification number, the employer must complete IRS Form SS-4 and attach any supplementary statement. The form is available from any IRS office or Social Security Administration office [*Treas. Reg. §§ 31.6011(b)-1(a)(1)(iii)*, 301.6109-1(d)(2)].

An employer who employs only domestic workers in a private home may be assigned an employer identification number without having to apply on Form SS-4 [*Treas. Reg. § 31.6011(b)-1(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FICA DeductionsTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FUTA Rate of TaxTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)Income Tax Collected at SourceTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)Liability for Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
1. Tax and Insurance Obligations

1-1C California Legal Forms--Transaction Guide §§ 1C.42-1C.49

[Reserved]

§§ 1C.42[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.50

§ 1C.50 Applicability of California Governing Law

[1] Labor Code

The Labor Code imposes wage, hour, and working condition restrictions on employers [*see Lab. Code §§ 1171-1205*]. These provisions apply to men,women, and minors employed in any occupation, trade, or industry, regardless of the measure of compensation. However, these Labor Code provisions do not apply to outside salespersons or any individual participating in a national service program pursuant to *42 U.S.C. § 12571*, provided that the nonprofit entity using the individual's service informs the individual of any requirement to work more than 8 hours per day or 40 hours per week and provides an opportunity to opt out of the service program [*Lab. Code § 1171*].

The Labor Code does not define "employer" in the context of the provisions governing wages, hours, and working conditions. Therefore, the common law test of employment is to be applied. Neither the Fair Labor Standards Act nor cases construing and applying it would be relevant to a determination of who is the employer in a specific case, nor can effect be given to a definition of "employer" in a wage order by the Industrial Welfare Commission insofar as that definition expands the class of persons who are employers under the common law test. Following the common law, corporate agents acting within the scope of their agency (such as the CEO and other officers) are not personally liable for the corporation's failure to pay employees' wages [*Reynolds v. Bement (2005) 36 Cal. 4th 1075, 1086-1087, 32 Cal. Rptr. 3d 483, 116 P.3d 1162]* unless it can be shown on the alter ego theory that the corporation and a particular officer (such as the CEO) are one and the same person [*see Jones v. Gregory (2006) 137 Cal. App. 4th 798, 811, 40 Cal. Rptr. 3d 581* (relying on *Reynolds* to reverse judgment against CEO in Labor Commissioner's suit to recover unpaid wages for corporation's employees, but remanding with instruction to consider whether liability could rest on alter ego theory)].

[2] Industrial Welfare Commission Orders

The Industrial Welfare Commission is authorized to adopt, amend, or rescind orders concerning wages, hours, and working conditions for any occupation, trade, or industry in California [*Lab. Code § 1173*]. Accordingly, the Commission has adopted orders regulating a variety of fields [*see 8 Cal. Code Reg. §§ 11010-11160*]. In addition, the

Commission has adopted a general minimum wage order, which applies to all employees in California except government employees, outside salespersons, and certain family members of an employer [*see 8 Cal. Code Reg. § 11000*].

The Commission's orders are not enforceable, however, to the extent that they exceed the Commission's authority [*Bearden v. U.S. Borax, Inc. (2006) 138 Cal. App. 4th 429, 440, 41 Cal. Rptr. 3d 482* (Commission exceeded its authority when it issued order exempting certain employees from statutory meal period requirements if employees were covered by qualifying collective bargaining agreements)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsAdministrative Proceedings & RemediesGeneral OverviewLabor & Employment LawWage & Hour LawsCoverage & DefinitionsGeneral OverviewLabor & Employment LawWage & Hour LawsCoverage & DefinitionsEmployers



28 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.51

§ 1C.51 Applicability of Federal Fair Labor Standards Act

[1] Extent of Coverage

The federal Fair Labor Standards Act (FLSA) [*see 29 U.S.C. §§ 201-219*] sets standards for minimum wages [*see 29 U.S.C. § 206*] and maximum hours of regular employment and overtime pay [*see 29 U.S.C. § 207*]. The FLSA also restricts the use of child labor in interstate commerce [*see 29 U.S.C. § 212*] and prohibits discrimination based on sex [*see 29 U.S.C. § 206(d)*].

In general, the FLSA applies to employees who are (1) engaged in commerce or in the production of goods for commerce, or (2) employed in an enterprise engaged in commerce or in the production of goods for commerce [*see 29 U.S.C. §§ 206(a), 207(a), 212(a)*]. The FLSA applies to employees within the United States and its territories [*see 29 U.S.C. § 213(f)*]. For further discussion of the employees covered by the FLSA, see Wilcox, California Employment Law, Ch. 1, *Overview of Wage and Hour Laws* (Matthew Bender).

The United States Supreme Court has held that the enforcement provisions of the FLSA do not authorize a suit against state employers in federal or state court without the state's consent [*Seminole Tribe v. Florida (1996) 517 U.S. 44, 47, 116 S. Ct. 1114, 134 L. Ed. 2d 252* (federal court); *Alden v. Maine (1999) 527 U.S. 706, 119 S. Ct. 2240, 2246, 144 L. Ed. 2d 636* (state court)].

[2] Nonwaivability

An employee cannot waive his or her right to minimum wage and overtime pay [*Barrentine v. Arkansas-Best Freight System (1981) 450 U.S. 728, 740, 101 S. Ct. 1437, 67 L. Ed. 2d 641]* . Accordingly, the rights guaranteed by the FLSA cannot be bargained away in a written contract [*Brooklyn Savings Bank v. O'Neil (1945) 324 U.S. 697, 706-707, 65 S. Ct. 895, 89 L. Ed. 1296]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsChild LaborLabor & Employment LawWage & Hour LawsCoverage & DefinitionsEmployeesLabor & Employment LawWage & Hour LawsCoverage & DefinitionsEmployersLabor & Employment LawWage & Hour LawsCoverage & DefinitionsEnterprise CoverageLabor & Employment LawWage & Hour LawsCoverage & DefinitionsMinimum WageLabor & Employment LawWage & Hour LawsCoverage & DefinitionsOvertime & Work Period



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.52

§ 1C.52 Minimum Wage Requirements

[1] California Law

[a] In General

In general, every employer must pay to each nonexempt employee wages of not less than $6.75 per hour for all hours worked [*8 Cal. Code Reg. § 11000(2), 11010(4)(A)* (manufacturing industry), 11030(4) (canning, freezing, and preserving industry), 11040(4) (professional, technical, clerical, mechanical, and similar occupations); *see* Industrial Welfare Commission Minimum Wage Order MW-2001]. This language expresses the legislative intent to ensure that employees are compensated at the minimum wage for each hour worked [*Armenta v. Osmose, Inc. (2005) 135 Cal. App. 4th 314, 323, 37 Cal. Rptr. 3d 460* (averaging method used by federal courts for assessing violation of federal minimum wage law does not apply under California law; employer violated minimum wage law by failing or refusing to pay for what employer characterized as nonproductive time: on-the-job driving time and time spent by foremen processing paperwork)]. It is unlawful to pay employees a wage less than the minimum wage [*Lab. Code § 1197*]. Any employee receiving less than the legal minimum wage is entitled to recover the unpaid balance of the full amount owed, including interest, plus reasonable attorney's fees and costs of suit [*Lab. Code § 1194(a)*]. Punitive damages are not available, however [*see Brewer v. Premier Golf Props. (2008) 168 Cal. App. 4th 1243, 1252, 86 Cal. Rptr. 3d 225* ("[P]unitive damages are not recoverable when liability is premised solely on the employer's violation of the Labor Code statutes that regulate meal and rest breaks, pay stubs, and minimum wage laws.")].

The California minimum wage law reveals a clear legislative intent to protect the minimum wage rights of California employees to a greater extent than under federal law [*see generally § 1C.52[2][a]*]. California employees are allowed a higher minimum wage than the federal statutes allow. Federal law allows a subminimum wage to be paid to new hires under 20 years of age for the first 90 days of employment [*29 U.S.C. § 206(g)(1)*]. In contrast, California law limits the subminimum wage to the first 160 hours (approximately 20 days) [*8 Cal. Code Reg. §§ 11010-11150*]. In addition, an employer may pay student learners in vocational training programs 75 percent of the minimum wage under federal law [*29 C.F.R. § 520.200 et seq.*], whereas California law increases that amount to not less than 85 percent of the minimum wage [*8 Cal. Code Reg. §§ 11010-11050*]. Finally, federal law gives employers a tip credit for employees earning tips [

29 U.S.C. § 203(m); *29 C.F.R. § 531.50*]. California law expressly forbids a tip credit, and employees must receive the full minimum wage [*Lab. Code § 351*]. All of these examples demonstrate that California law provides greater protections to minimum wage employees [*Armenta v. Osmose, Inc. (2005) 135 Cal. App. 4th 314, 324, 37 Cal. Rptr. 3d 460]* .

The minimum wage requirement does not apply to persons employed in administrative, executive, or professional capacities [*see, e.g., 8 Cal. Code Reg. § 11010(1)(A)* (manufacturing industry)], outside salespersons, or the parents, spouse, children, or legally adopted children of an employer [*8 Cal. Code Reg. § 11000(1)*]. In certain situations an employer may pay learner employees a subminimum wage [*see, e.g., 8 Cal. Code Reg. § 11010(4)* (manufacturing industry)].

Special rules apply to split-shift and reporting-time pay [*see, e.g., 8 Cal. Code Reg. § 11010(4)(C), (5)(A)* (manufacturing industry)].

[b] Credits Against Minimum Wage

The value of meals and lodging provided by an employer to an employee may be credited against the minimum wage obligation if the parties have a voluntary written agreement. No more than specified maximum amounts may be credited in a given period [*8 Cal. Code Reg. § 11000(3)*]. Tips received by an employee are the employee's property and may not be used by the employer as a credit against the minimum wage obligation [*Henning v. Industrial Welfare Com. (1988) 46 Cal. 3d 1262, 1278, 252 Cal. Rptr. 278, 762 P.2d 442]* . In addition, the value of uniforms, tools, and equipment furnished by the employer are not treated as a wage credit [*see, e.g., 8 Cal. Code Reg. § 11010(4), (9)* (manufacturing industry)].

[c] Prevailing Wage Requirement for Public Works

Workers employed under contract on most public works of more than $1,000 must be paid the general prevailing wage as determined by the director of the Department of Industrial Relations [*Lab. Code §§ 1770, 1771*; *see Lab. Code § 1773* (method of determining general prevailing wage)]. An awarding body need not require the payment of the general prevailing wage on certain small public works projects if the awarding body elects to meet certain requirements with regard to all public works project under its authority, including payment of a fee to the Department of Industrial Relations for the enforcement of prevailing wage obligations [*see Lab. Code § 1771.55*; *see also Lab. Code § 1771.5* (awarding body need not specify payment of prevailing wage in certain small public works contracts awarded before adoption of fee and regulations implementing *Lab. Code § 1771.55*, if awarding body has its own labor compliance program)]. However, other wage requirements may nevertheless apply. For example, every apprentice employed on public works must be paid the prevailing rate of per diem wages for apprentices in the trade to which he or she is registered [*Lab. Code § 1777.5(b)*].

[2] Federal Law

[a] In General

The federal minimum wage must be paid to every nonexempt employee who in any workweek (1) is engaged in commerce or in the production of goods for commerce, or (2) is employed in an enterprise engaged in commerce or in the production of goods for commerce [*29 U.S.C. § 206(a)*].

The federal minimum wage requirement does not apply to a variety of exempted occupations, including persons employed in bona fide executive, administrative, or professional capacities, and outside salespersons [*29 U.S.C. § 213(a)(1)*; *see 29 C.F.R. §§ 541.1-541.5* (definitions); *see also 29 U.S.C. §§ 213(a)* (exemptions), 251-262 (Portal-to-Portal Act exemptions)]. A subminimum wage may be paid to learners, apprentices, messengers, students, and handicapped workers [*see 29 U.S.C. § 214(a)-(c)*].

The minimum wage provisions of federal law differ significantly from California's minimum wage law [*see generally § 1C.52[1][a]*]. In particular, as noted above, federal law requires payment of a minimum wage to employees who "in any work week" are engaged in commerce [*29 U.S.C. § 206(a)*]. *Lab. Code § 1194(a)*, on the other hand, provides that any employee receiving "less than the legal minimum wage" is entitled to recover the unpaid balance of the "full amount" owed. Regulations require payment of the minimum wage "for all hours worked" [*e.g., 8 Cal. Code Reg. § 11010(4)(A)*]. This language expresses the legislative intent to ensure that employees are compensated at the minimum wage for each hour worked. The averaging method used by the federal courts for assessing a violation of the federal minimum wage law does not apply under California law [*Armenta v. Osmose, Inc. (2005) 135 Cal. App. 4th 314, 323, 37 Cal. Rptr. 3d 460]* .

[b] Credits Against Minimum Wage

"Wages" paid to an employee include the reasonable cost to the employer of furnishing the employee with board, lodging, or other facilities if they are customarily furnished by the employer. For an employee who receives tips, the amount paid to the employee by the employer is deemed to be increased by the tips in an amount determined by the employer, but not above a specified percentage or the value of tips actually received [*29 U.S.C. § 203(m)*]. An employer may not treat the cost of provided uniforms and tools as wages for purposes of meeting minimum wage obligations [*29 C.F.R. §§ 531.3(d)(2), 531.32(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEqual PayEqual Pay ActGeneral OverviewLabor & Employment LawEqual PayFederal & State InterrelationshipsLabor & Employment LawWage & Hour LawsCoverage & DefinitionsMinimum WageLabor & Employment LawWage & Hour LawsCoverage & DefinitionsPrevailing Wages



30 of 170 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.53

§ 1C.53 Equal Pay Rates for All Employees

An employer may not pay an employee at wage rates less than the rates paid to employees of the opposite sex in the same establishment for equal work on jobs the performance of which requires equal skill, effort, and responsibility, performed under similar working conditions. Exceptions exist for payments made under a seniority system, a merit system, a system that measures earnings by quantity or quality of production, or a differential based on a factor other than sex [*Lab. Code § 1197.5*; *29 U.S.C. § 206(d)(1)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.54

§ 1C.54 Overtime Compensation

[1] California Law

[a] "Workday" and "Workweek" Defined

California overtime pay provisions are based on "workday" and "workweek" time periods. A "workday" is any consecutive 24 hours beginning at the same time each calendar day. A "workweek" is any seven consecutive days, starting with the same calendar day each week. A workweek is also described as a fixed and regularly recurring period of 168 hours, that is, seven 24-hour periods [*see, e.g., 8 Cal. Code Reg. § 11010(2)(P), (Q)* (manufacturing industry)].

[b] When Overtime Is Owed

Overtime regulations vary according to industry [*see 8 Cal. Code Reg. §§ 11010-11500*]. However, under a typical scheme, employees over 18 years of age, and employees 16 and 17 years of age who are not required to attend school and are not otherwise prohibited by law from engaging in the target work, may not be employed more than 8 hours in any workday or more than 40 hours in any workweek unless the employee receives one and one-half times the employee's regular rate of pay for all hours worked over 40 in the workweek. It is permissible to work more than 8 hours in any workday or more than 6 days in any workweek if the employee is compensated for that overtime at not less than the following [*see, e.g., 8 Cal. Code Reg. § 11010(3)(A)* (manufacturing industry)]:

- One and one-half times the employee's regular rate of pay for all hours worked in excess of 8 hours up to and including 12 hours in any workday, and for the first 8 hours worked on the seventh day of work; and

- Double the employee's regular rate of pay for all hours worked in excess of 12 in any workday and for all hours worked in excess of 8 hours on the seventh day in any workweek.

If the employment agreement entitles an employee to a premium rate of pay, which exceeds the regular rate, for

working on a specified day such as a holiday, and the employee works more than 8 hours on such a day, the law does not require the employer to pay one and one-half times (or, for more than 12 hours, double) that premium rate. The law requires only that the employer must pay the legal multiple of the regular rate [*Advanced-Tech Sec. Servs., Inc. v. Superior Court (2008) 163 Cal. App. 4th 700, 702, 77 Cal. Rptr. 3d 757* (employee whose contract entitled her to 1.5 times regular pay for work on holidays was not entitled to apply legal multiple to her contract premium rate so as to claim 2.25 times regular pay for overtime on holidays but instead was limited to claiming legal multiple of regular rate)].

[c] Exceptions to Overtime Regulations

Different overtime regulations apply to minors [*see Lab. Code § 1391*; *see also § 1C.60[4]*], agricultural workers [*see 8 Cal. Code Reg. § 11140(3)*], horseracing employees [*see Lab. Code § 1182.10*], and motion picture industry employees [*see 8 Cal. Code Reg. § 11120(3)*].

[d] Employees Exempted From Overtime Regulations

Under California law, certain types of employees are exempt from the overtime pay provisions, including the following:

- Persons employed in administrative, executive, or professional capacities [*see, e.g., 8 Cal. Code Reg. § 11010(1)(A)* (manufacturing industry)].

- Outside salespersons [*see Lab. Code § 1171*].

- Individuals participating in a national service program pursuant to *42 U.S.C. § 12571*, provided that the nonprofit entity using the individual's service informs the individual of any requirement to work more than 8 hours per day or 40 hours per week and provides an opportunity to opt out of the service program [*see Lab. Code § 1171*].

- Certain members of the employer's family [*see 8 Cal. Code Reg. § 11000(1)*].

- Employees covered by a valid collective bargaining agreement if the agreement expressly provides for wages, hours of work, and working conditions of the employees and the agreement provides premium wage rates for all overtime hours worked and a regular hourly rate of pay for those employees of not less than 30 percent more than the state minimum wage [*see, e.g., 8 Cal. Code Reg. § 11010(3)(H)* (manufacturing industry)].

For further coverage of occupations not subject to standard overtime regulations, see California Employment Law, Ch. 3, *Overtime Compensation and Regulation of Hours Worked* (Matthew Bender).

[e] Alternative Work Schedules

On the proposal of their employer, employees may adopt a regularly scheduled alternative workweek that authorizes work by the affected employees for no longer than 10 hours a day within a 40-hour workweek without the payment to the affected employees of an overtime rate of compensation [*Lab. Code § 511(a)*]. An alternative workweek schedule will be deemed adopted only if it receives approval in a secret-ballot election by at least two thirds of affected employees in a readily identifiable work unit [*Lab. Code § 511(a)*; *see Lab. Code § 511(i)* ("work unit" includes division, department, job classification, shift, separate physical location, or recognized subdivision thereof, and may consist of individual employee as long as criteria for identifiable work unit are met); *see also Lab. Code § 511(e)* (employer must report results of election to Division of Labor Statistics and Research within 30 days after results are final)]. The regularly scheduled alternative workweek proposed by an employer may be a single work schedule that

would become the standard schedule for workers in the work unit, or it may be a menu of work-schedule options, from which each employee in the unit would be entitled to choose. A menu of work-schedule options may include a regular schedule of 8-hour days that is subject to the usual overtime requirements for such a schedule [*Lab. Code § 511(a)*; *see Lab. Code § 510(a)* (overtime compensation requirements)]. Employees who adopt a menu of work-schedule options may, with employer consent, move from one schedule option to another on a weekly basis [*Lab. Code § 511(a)*].

An affected employee working longer than 8 hours but not more than 12 hours in a day pursuant to an alternative workweek schedule must be paid an overtime rate of compensation of no less than one and a half times the regular rate of pay of the employee for any work in excess of the regularly scheduled hours established by the alternative workweek agreement and for any work in excess of 40 hours a week [*Lab. Code § 511(b)*]. An overtime rate of compensation of no less than double the regular rate of pay of the employee must be paid for any work in excess of 12 hours a day and for any work in excess of 8 hours on those days worked beyond the regularly scheduled workdays established by the alternative workweek agreement [*Lab. Code § 511(b)*]. An employer is not required to combine more than one rate of overtime compensation in order to calculate the amount to be paid to an employee for any hour of overtime work [*Lab. Code § 511(b)*].

An employer must not reduce an employee's regular rate of hourly pay as a result of the adoption, repeal, or nullification of an alternative workweek schedule [*Lab. Code § 511(c)*].

An employer must make a reasonable effort to find a work schedule not exceeding 8 hours in a workday to accommodate any affected employee who was eligible to vote on an alternative-workweek election, or who was hired after the election, and who is unable to work the alternative schedule hours established as the result of that election [*Lab. Code § 511(d)*]. Also, an employer must explore any available reasonable alternative means of accommodating the religious belief or observance of an affected employee that conflicts with an adopted alternative workweek schedule [*Lab. Code § 511(d)*; *see Gov. Code § 12940(j)*].

[2] Federal Law

[a] "Workweek" as Measure of Overtime

An employer must pay covered employees [*see* [b], *below*] at a rate of one and one-half times their regular rate of pay for all hours in excess of 40 worked in a workweek [*29 U.S.C. § 207(a)(1)*]. A "workweek" is a fixed and regularly recurring period of 168 hours, that is, seven consecutive 24-hour periods. It need not coincide with the calendar week. Workweeks may be set for whole plants or establishments, or may be set for individual employees [*29 C.F.R. § 778.105*].

[b] Employees Covered

The federal overtime compensation provisions apply to an employee who in any workweek (1) is engaged in commerce or in the production of goods for commerce, or (2) is employed in an enterprise engaged in commerce or in the production of goods for commerce [*29 U.S.C. § 207(a)(1)*]. Special overtime rules apply to employees whose work necessitates irregular hours, employees employed at piece rates, retail or service establishment employees, hospital employees, domestic service employees, tobacco industry employees, and certain railway and bus company employees [*see 29 U.S.C. § 207(f)-(n)*].

[c] Employees Exempted

A variety of employees are exempt from the overtime pay provisions of the FLSA, including the following:

- Persons employed in bona fide executive, administrative, or professional capacities [*29 U.S.C. § 213(a)(1)*; *see 29 C.F.R. §§ 541.1-541.4* (definitions)].

- Outside salespersons [*29 U.S.C. § 213(a)(1)*; *see* 29 C.F.R. § 541.5 (definition)].

- Employees covered by a collective bargaining agreement [*see 29 U.S.C. § 207(b)(1), (2)*].

(4) Employees in the transportation industry, including employees of motor carriers, railroads, air carriers, and shipping companies [*29 U.S.C. § 213(b)(1)-(3), (6)*].

Many other exemptions exist [*see 29 U.S.C. § 213(b)*; *see also 29 U.S.C. §§ 251-262* (Portal-to-Portal Act exemptions)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsDefenses & ExemptionsGeneral OverviewLabor & Employment LawWage & Hour LawsDefenses & ExemptionsExecutives & Professional EmployeesLabor & Employment LawWage & Hour LawsDefenses & ExemptionsTransportation Industries



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.55

§ 1C.55 Regulation of Hours

[1] State Law

[a] Restriction on Hours Worked

Employees in occupations such as canning, freezing, preserving, and handling agricultural products, are limited to working 72 hours in a period of seven consecutive days, after which they must be given a 24-hour period off duty [*see 8 Cal. Code Reg. §§ 11030(3)(A)(2), 11080(3)(A)(2)*]. Persons employed in technical, clerical, mechanical, and similar occupations may not be terminated for refusing to work more than 72 hours in a workweek [*8 Cal. Code Reg. § 11040(3)(L)*]. Special hours restrictions apply to employees of railroads, lumber businesses, smelters, and pharmacies [*see Lab. Code §§ 600-856*].

Generally, these hour restrictions do not apply to persons employed in administrative, executive, or professional capacities, and persons employed as outside salespersons [*see, e.g., 8 Cal. Code Reg. § 11030(1)(A)*].

[b] Meal and Rest Periods

An employer may not employ a nonexempt employee for a work period of more than five hours without a meal period of 30 minutes. However, the employer and employee may agree to waive the meal period when the work period is notlonger than six hours [*see, e.g., 8 Cal. Code Reg. § 11030(11)*]. Employers must also allow nonexempt employees to take rest periods, which should generally be in the middle of work periods. The rest period time is determined at a rate of 10 minutes per four hours worked. Rest periods are not required for employees whose total daily work time is less than three and one-half hours [*see, e.g., 8 Cal. Code Reg. § 11030(12)*].

These meal and rest regulations do not apply to persons employed in administrative, executive, or professional capacities, and persons employed as outside salespersons [*see, e.g., 8 Cal. Code Reg. § 11030(1)(A)*].

[c] One Day's Rest in Seven

Most employees engaged in an occupation of labor are entitled to one day's rest in seven [*Lab. Code § 551*; *see Lab. Code § 550* ("day's rest" defined)], and no employer of labor may cause his or her employees to work more than six days in seven [*Lab. Code § 552*]. However, this prohibition does not apply in the following situations [*Lab. Code §§ 554, 555*]:

- In emergencies or to work performed in the protection of life or property from loss or destruction.
- To common carriers engaged in or connected with the movement of trains.
- To agricultural work or the care of animals.
- Under a collective bargaining agreement.
- When the chief of the Division of Labor Standards Enforcement determines that hardship will result.
- To any employee whose total hours of employment do not exceed 30 in a week or 6 in a day.

[d] Minors

Special rules control the hours of employment of minors [*see Lab. Code §§ 1391.1-1399*]. For a general discussion of the law relating to the employment of minors, see *§§ 1C.60, 1C.61*.

[e] Use of Paid Vacation Time

Case law establishes that paid vacation time is the functional equivalent of wages for services performed [*Suastez v. Plastic Dress-Up Co. (1982) 31 Cal. 3d 774, 779, 183 Cal. Rptr. 846, 647 P.2d 122]* , and that view is reflected in statutes [*see, e.g., Lab. Code § 227.3* (accrued unused paid vacation time must be paid as wages to terminated employee); *see also* Owen v. Macy's, Inc. (2009) 175 Cal. App. 4th 462, 468, 96 Cal. Rptr. 3d 70 (*Lab. Code § 227.3* does not require that employer provide its employees with any paid vacation at all; rather, statute imposes certain requirements "whenever" employer provides vacation benefits); § 1C.32[3]]. However, this does not limit the employer's right to control the scheduling of employees' absences for vacation [*see Suastez v. Plastic Dress-Up Co. (1982) 31 Cal. 3d 774, 778-779 n. 7, 183 Cal. Rptr. 846, 647 P.2d 122]* . Moreover, the employer may require that an exempt employee [*see generally § 1C.54[1][d]*] who is absent from work for four or more hours in a single day must count that as a paid vacation day (as long as the employee has any unused paid vacation days) [*Conley v. Pacific Gas & Elec. Co. (2005) 131 Cal. App. 4th 260, 270, 31 Cal. Rptr. 3d 719]* .

[2] Federal Law

The Fair Labor Standards Act (FLSA) [*see 29 U.S.C. §§ 201-219*] contains no absolute limitation on the number of hours an employee may work in a workweek, as long as the employer pays the required overtime compensation [*see 29 U.S.C. § 207*]. However, the FLSA does not relieve an employer from any obligations imposed by contract or by other federal or state law [*29 C.F.R. § 778.102*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsChild LaborLabor & Employment LawWage & Hour LawsCoverage & DefinitionsHoliday, Sick & Vacation PayLabor & Employment LawWage & Hour LawsCoverage & DefinitionsOvertime & Work Period



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.56

§ 1C.56 Time and Place of Payment of Wages

[1] During Employment

[a] In General

Regular wages earned by most persons in employment are due and payable twice during each calendar month, on days designated in advance by the employer as regular paydays. Wages paid weekly, biweekly, or semimonthly satisfy this requirement. Wages earned for labor in excess of the normal work period must be paid no later than the payday for the next regular payroll period [*Lab. Code § 204*]. Wages of striking employees must be paid on the next regular payday without abatement or reduction [*Lab. Code § 209*]. Gratuities received by an employee are deemed to be the employee's sole property, and the employer may not collect, take, or receive any part of them. The employer must remit gratuities paid by credit card no later than the next regular payday following the date on which the patron authorized the credit card payment, without any deductions for any credit card processing fees or costs that may be charged to the employer [*Lab. Code § 351*]. Salaries of executive, administrative, and professional employees of employers covered by the FLSA, and commission employees of vehicle dealers may be paid once a month [*Lab. Code §§ 204.1, 204.2*; *see 29 U.S.C. § 213(a)(1)* (FLSA)].

[b] Agricultural and Domestic Workers

The wages of employees in agricultural, viticultural, and horticultural pursuits, in poultry and stock raising, and in domestic service who are provided board and lodging by their employers are due and payable once a month on a day designated in advance by the employer as the regular payday [*Lab. Code § 205*].

[c] Notice of Time and Place of Payment

Employers must keep posted conspicuously a notice specifying the regular paydays and the time and place of payment. The notice must be posted at the place of work, if practicable. Otherwise, the notice must be posted in another location where it can be seen as employees come or go to their places of work, or at the office or nearest agency for payment

kept by the employer [*Lab. Code § 207*]. For a form for this notice, see *§ 1C.230*.

[d] Prohibitions on Repayment

An employer may not collect or receive from an employee any part of wages already paid by the employer to the employee [*Lab. Code § 221*].

[e] Itemized Payroll Statement

At the time of each payment of wages, or semimonthly, the employer must give each employee an accurate itemized wage statement showing information pertaining to that pay period [*Lab. Code § 226(a)*].

[f] Deductions, Assignments, and Garnishments

An employer may withhold or divert a portion of an employee's wages (1) when required or empowered to do so by state or federal law, (2) when a deduction is authorized by the employee, or (3) when a deduction is authorized by a collective bargaining or wage agreement [*Lab. Code § 224*]. Wage assignments that meet the statutory requirements may also be made by employers [*see Fam. Code §§ 5200-5290* (child and spousal support); *Prob. Code § 3088* (support of conservatee); *Lab. Code § 300* (other assignments)]. Similarly, wage garnishments must be honored if proper [*see Code Civ. Proc. §§ 706.010-706.154* (Wage Garnishment Law)].

[2] On Discharge or Quitting

Special provisions govern the time, place, and manner of payment of wages for employees who quit or are discharged [*see Lab. Code §§ 201-203, 208*]. For discussion of these provisions, see *§ 1C.32*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Family LawChild SupportObligationsEnforcementGarnishmentsFamily LawMarital Termination & Spousal SupportSpousal SupportEnforcementGarnishmentsLabor & Employment LawWage & Hour LawsAssignments, Deductions & GarnishmentsLabor & Employment LawWage & Hour LawsWage Payments



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.57

§ 1C.57 Form of Payment

[1] California Law

Employers may not issue any of the following in payment of wages due, wages to become due, or as an advance on wages to be earned: (1) an order, check, draft, note, memorandum, or other acknowledgment of indebtedness unless it is negotiable and payable in cash on demand without discount at an established place of business in California; or (2) scrip, coupon, cards, or other redeemable thing, in merchandise, or purporting to be payable or redeemable other than in money [*Lab. Code § 212*; *see Lab. Code § 213* (exceptions)].

[2] Federal Law

Under the Fair Labor Standards Act [*see 29 U.S.C. §§ 201-219*], payment for wages, including overtime, must be made in cash or by negotiable instruments, payable at par. In some circumstances, wages may also be paid in the form of board, lodging, other facilities, and tips [*see 29 C.F.R. § 531.27*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsWage Payments



35 of 170 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.58

§ 1C.58 Workplace Posting Requirements

[1] California Law

Employers must post a variety of employee notices, including the following, as appropriate:

- A notice of the time and place of payment of wages [*see Lab. Code § 207*].
- Wage orders relevant to the employer's occupation or industry [*see Lab. Code § 1183*].
- The rate of compensation to be paid by farm labor contractors [*see Lab. Code § 1695(7)*].
- The Labor Code talent agency provisions for talent agency employers [*see Lab. Code § 1700.28*].
- A notice of employees' right to take time off work to vote [*see Elec. Code §§ 14350, 14351*].

[2] Federal Law

An employer who employs persons subject to the Fair Labor Standards Act (FLSA) [*see 29 U.S.C. §§ 201-219*] minimum wage requirement must post a notice that explains the provisions of the FLSA. If employees are exempted from overtime regulations, the employer must add a notation that the employees are exempt from overtime regulations [*29 C.F.R. § 516.4*]. Employers must also post a notice containing pertinent provisions of Title VII of the Civil Rights Act of 1964 [*42 U.S.C. § 2000e-10(a)*; *see 42 U.S.C. §§ 2000e-2000e-17*]. Special posting requirements apply to employers who pay subminimum wage [*see, e.g.,* 29 C.F.R. § 522.6(d) (learner certificate)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsGeneral OverviewLabor & Employment LawWage & Hour

LawsAdministrative Proceedings & RemediesGeneral OverviewLabor & Employment LawWage & Hour LawsStatutory ApplicationTitle VII of the Civil Rights Act of 1964Labor & Employment LawWage & Hour LawsWage Payments



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.59

§ 1C.59 Workplace Recordkeeping Requirements

[1] California Law

[a] In General

Employers must keep records showing the names and addresses of all employees, and the ages of all minor employees. Complete payroll records must be kept in California for not less than three years [*Lab. Code § 1174(c), (d)*; *see, e.g., 8 Cal. Code Reg. § 11010(7)* (payroll record regulations for manufacturing industry)]. In addition, employers must furnish employees with accurate itemized statements of wages and deductions and maintain a copy of the statement, or a record of the deductions, on file at the place of employment or at a central location within California for at least three years [*Lab. Code § 226(a)*].

Employers of minors under 18 years of age must keepemployment permits on file during the minors' employment [*Educ. Code § 49161*]. Under the Fair Employment and Housing Act (FEHA) [*see Gov. Code §§ 12900-12996*], employers must prepare and maintain records regarding applicants and employees, including "California Employer Information Reports," and records regarding the race, sex, and national origin of job applicants [*see 2 Cal. Code Reg. § 7287.0*].

[b] Employee Inspection of Records

Employers must allow employees to inspect their personnel files on request, at reasonable intervals [*see Lab. Code § 1198.5*]. Special rules require disclosure on request of certain reports used by employers in evaluating applicants [*see, e.g., Civ. Code § 1785.20*.5(a) (credit report)]. Some confidential information is subject to special protection [*see, e.g., Health & Safety Code § 120980* (results of HIV test)]. For discussion of the collection, use, and disclosure of private information about applicants and employees, see California Employment Law, Ch. 50, *Limitations on Employer Collection of Private Information About Employees*, and Ch. 51, *Use and Disclosure of Private Information About Employees* (Matthew Bender).

Employers required to keep and disclose itemized wage and deduction information [*Lab. Code § 226(b)*; *see* [a], *above*] must afford current and former employees the right to inspect or copy the records pertaining to that employee on reasonable request to the employer [*Lab. Code § 226(b)*; *but see Lab. Code § 226(d), (h)* (exceptions)]. Employers may take reasonable steps to ensure the identity of the employee and may charge the actual costs of reproduction to the employee [*Lab. Code § 226(b)*]. An employer must comply with an inspection or copy request as soon as practicable, but no later than 21 days from the date of the request [*Lab. Code § 226(c)*]. An employer's failure to comply with the inspection requirement is subject to penalty, injunctive relief, and damages if the failure is knowing and intentional [*Lab. Code § 226(e), (f), (g)*].

[c] Other Records

A variety of records and notices are required under the state income tax, workers' compensation, and unemployment and disability compensation systems. For discussion of these requirements, see Ch. 1D, *Overview of Employee Benefits* , and Ch. 1E, *Taxation of Businesses* .

[2] Federal Law

Employers subject to the FLSA must prepare and preserve employee records that include information about each employee and his or her occupation, wages, hours, working conditions, and pay periods [*29 U.S.C. § 211(c)*; *see 29 C.F.R. § 516.2*]. Most records must be preserved for at least three years [*29 C.F.R. § 516.5*]. Different recordkeeping regulations apply to particular groups of employees [*see 29 C.F.R. §§ 516.3*, *516.11*-516.33].

A variety of records and notices are required under the federal income tax and unemployment insurance systems. For discussion of these requirements, see Ch. 1E, *Taxation of Businesses* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEmployee PrivacyDisclosure of Employee InformationPersonnel FilesLabor & Employment LawWage & Hour LawsRecordkeeping Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.60

§ 1C.60 Employing Minors Under California Law

[1] In General

Other than age restrictions, occupation restrictions, and hours and conditions of employment, an employer must generally treat minor employees in the same manner as other employees. The Division of Labor Standards Enforcement has promulgated regulations that specify special restrictions on the types of occupations minors may engage in, set limits on minors' work hours, and specify enforcement procedures [*see 8 Cal. Code Reg. §§ 11701-11784*].

A "minor" is any person under 18 years of age who is required to attend school under the Education Code and any person under the age of six years [*Lab. Code § 1286(c)*; *see Educ. Code §§ 48200, 48400*]. A person under 18 years who is not required to attend school solely because that person is a nonresident of California is still a minor [*Lab. Code § 1286(c)*].

[2] Permits to Employ Minors

In general, an employer wishing to employ a minor under the age of 18 must obtain a permit to employ from the proper educational officers [*Educ. Code § 49160*; *see Educ. Code §§ 49110, 49110.1* (persons authorized to issue permits)]. An employer of a minor under 18 must keep all employment permits on file during the minor's term of employment [Lab. Code § 1299; *Educ. Code § 49161*]. To apply for a permit to employ, the employer must send a written notification of the intent to employ the minor to the officer authorized to issue an employment permit [*Educ. Code § 49162*]. The employer must use Department of Education Form B1-1 to request the work permit, and as a statement of intent to employ the minor. Form B1-1 is available from the school district in which the minor is enrolled. A work permit may be issued by the superintendent of the school district in which the minor resides; the chief executive officer or person holding the equivalent position in a charter school that the minor attends; certain persons authorized by the district superintendent or charter school's chief executive officer; the county superintendent of schools, or a person authorized by the county superintendent, if the minor does not reside within a school district or attend a charter school; or the principal, or administrator designated by the principal, of the public or private school that the minor attends [*Educ. Code §§ 49110(b), 49110.1*]. A work permit is issued on Department of Education Form B1-4.

Special permits must be obtained from the Labor Commissioner for minors employed in the entertainment industry [*see Lab. Code § 1308.5*; *see also 8 Cal. Code Reg. § 11751*].

[3] Hours of Employment

With limited exceptions (such as minors employed to deliver newspapers to consumers [*see Lab. Code § 1391(d)*]), minors may not be employed more than the following hours [*Lab. Code § 1391(a)*]:

- For minors 15 years of age and under, no more than eight hours in one day of 24 hours or more than 40 hours in one week. In addition, these minors may not work before 7:00 A.M. or after 7:00 P.M., except from June 1 to Labor Day, when they may work until 9:00 P.M. However, while school is in session no employer may employ a minor 14 or 15 years of age for more than 3 hours in any school day or more than 18 hours in any week, or during school hours, except that a minor enrolled in and employed pursuant to a school-supervised and school-administered work experience and career exploration program may be employed for no more than 23 hours, any portion of which may be during school hours [*see Educ. Code § 49116(a)*].

- For minors 16 and 17 years of age, no more than eight hours in one day of 24 hours or more than 48 hours in one week. In addition, these minors may not work before 5:00 A.M. or after 10:00 P.M. on any day preceding a schoolday, except during an evening preceding a non-schoolday, when they may work until 12:30 A.M. of the non-schoolday. However, while school is in session no employer may employ a minor 16 or 17 years of age for more than 4 hours in any school day except if the minor (1) is employed in personal attendant occupations [*see 8 Cal. Code Reg. § 11150*], school-approved work experience, or cooperative vocational education programs or (2) has been issued a work permit [*Educ. Code § 49112(c)*; *see* [2], *above*] and is employed in accordance with that permit [*Lab. Code § 1391(a)(4)*; *see Educ. Code § 49116(b)*].

A "schoolday" is a day that a minor is required to attend school for 240 minutes or more [*Lab. Code § 1391(b)*].

Hours of employment restrictions are different for minors employed as messengers [*see Lab. Code § 1297*], minors employed in the entertainment industry [*see Lab. Code § 1308.7*], and minors engaged in agricultural, horticultural, viticultural, and domestic labor [*see Lab. Code § 1394*].

[4] Minimum Wage

Ordinarily, a California employer must pay each employee not less than the minimum wage [*see 8 Cal. Code Reg. § 11000*]. However, under wage orders for individual industries, minors may be paid not less than 85 percent of the minimum wage, rounded to the nearest nickel, provided that the number of minors employed at the lower rate does not exceed 25 percent of the persons regularly employed in the establishment. An employer of fewer than 10 persons may employ three minors at the lower rate. A "minor" for the purposes of wage orders is any person under 18 years of age [*see 8 Cal. Code Reg. §§ 11010-11150* (wage orders)].

[5] Prohibited Occupations

[a] Minors Under 18

It is a misdemeanor to employ or cause a minor under 18 years of age to engage in an obscene, indecent, or immoral exhibition or practice [*Lab. Code § 1308(a)(3)*].

[b] Minors Under 16

Minors under 16 years of age may not work in a variety of occupations, including the following:

- Manufacturing [*see Lab. Code §§ 1290, 1293*].
- Door-to-door selling more than 50 miles from the minor's residence [*see Lab. Code § 1308.1*].
- Transportation [*see Lab. Code § 1294*].
- Work involving hazardous acids, dyes, or gases [*see Lab. Code § 1294*].
- Messenger [*see Lab. Code § 1297*].
- Street occupations [*see Lab. Code § 1298*].
- Other dangerous or injurious occupations [*see Lab. Code § 1294*].

Additional occupations are prohibited to minors under 16 years of age [*see 8 Cal. Code Reg. §§ 11701-11704, 11706, 11707*]. Furthermore, it is a misdemeanor for an employer to employ or cause a minor under 16 years of age to engage in certain injurious businesses, exhibitions, vocations, performing jobs such as singing or rope walking, or mendicant or wandering businesses [*Lab. Code § 1308(a)(1), (2), (4)*; *but see Lab. Code § 1308(b)* (exceptions)].

[c] Minors Under 12

No minor under 12 years of age may work in an "agricultural zone of danger," which includes work involving moving equipment, unprotected chemicals, or unprotected water hazards [*see Lab. Code § 1293.1*].

[6] Labor Commissioner's Permission Required for Certain Occupations

The consent of the Labor Commissioner is required for minors to work in certain occupations, such as acting, performing music, and modeling [*see Lab. Code §§ 1308.5, 1308.6*; *see also 8 Cal. Code Reg. §§ 11750-11765* (entertainment industry regulations)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsChild Labor



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.61

§ 1C.61 Employing Minors Under Federal Law

[1] Prohibition on Oppressive Child Labor

No employer may employ any oppressive child labor in commerce or in the production of goods for commerce, or in any enterprise engaged in commerce or the production of goods for commerce [*29 U.S.C. § 212(c)*; *see 29 U.S.C. § 203(b)* ("commerce" defined); *see also NLRB v. Reliance Fuel Oil Corp. (1963) 371 U.S. 224, 226-227, 83 S. Ct. 312, 9 L. Ed. 2d 279* (commerce includes activities that in isolation might bedeemed merely local but in interconnections of business across state lines, affect interstate commerce)].

"Oppressive child labor" is a condition of employment under which (1) an employee under 16 years of age is employed in any occupation (with limited exceptions) or (2) an employee between 16 and 18 years of age is employed in an occupation that the Secretary of Labor determines is hazardous for children between these ages or detrimental to their health or well-being [*29 U.S.C. § 203(l)*; *see 29 C.F.R. §§ 570.50-570.72* (hazardous occupation regulations)]. For minors between 14 and 16 years of age, a variety of occupations are deemed not to be oppressive child labor [*see 29 C.F.R. §§ 570.31-570.38*].

[2] Exemptions From Fair Labor Standards Act

Certain types of employment are exempt from the child labor provisions of the Fair Labor Standards Act (FLSA) [*see 29 U.S.C. §§ 201-219*], including employment by parents [*see 29 U.S.C. § 203(l)(1)*], employment in agriculture [*see 29 U.S.C. § 213(c)(1), (2), (4)*; *29 C.F.R. §§ 570.123, 575.1*-575.9], employment in acting and performing [*see 29 U.S.C. § 213(c)(3)*; *29 C.F.R. § 570.125*], and employment in newspaper delivery and wreathmaking [*see 29 U.S.C. § 213(d)*; *29 C.F.R. § 570.124*].

[3] Hours of Employment

Employers are generally subject to the provisions of the FLSA concerning the working hours of minors, including the payment of overtime [*29 C.F.R. § 570.103(a)*; *see 29 U.S.C. § 207*]. However, the Secretary of Labor has promulgated

hours restrictions for minors between ages 14 and 16 engaged in certain occupations [*29 C.F.R. § 570.35*; *see 29 C.F.R. §§ 570.33*, *570.34* (occupations)]. For further discussion, see Wilcox, California Employment Law, Ch. 6, *Child Labor Laws* (Matthew Bender).

[4] Minimum Wage

Federal law contains no special provision allowing an employer to pay a minor less than the federal minimum wage [*29 C.F.R. § 570.103(a)*; *see 29 U.S.C. § 206*]. However, a subminimum wage may be paid to a minor who is a learner, apprentice, messenger, or student [*see 29 U.S.C. § 214(a), (b)*; *see also 29 C.F.R. §§ 519.1-519.20* (student), 520.1-520.11 (student-learner), 521.1-521.11 (apprentice)].

[5] Permits to Employ Minors

To protect itself from an unwitting violation of oppressive-child-labor laws [*see* [1], *above*], a business employing minors must have on file an unexpired proof of age certifying that each minor is above the oppressive child-labor age for the occupation in which the minor is employed [*29 C.F.R. § 570.5(a)*; *see 29 C.F.R. § 570.2* (minimum age standards)]. Two types of forms satisfy this requirement: (1) federal certificates of age, and (2) state age, employment, or working certificates or permits, issued by a state agency approved by the administrator of the Wage and Hour Division [*29 C.F.R. § 570.5(b)*; *see 29 C.F.R. §§ 570.6-570.12*]. California certificates and permits satisfy the federal requirement [*29 C.F.R. § 570.9(a)*]. For further discussion of permits to employ minors, see *§ 1C.60[2]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsChild Labor



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.62

§ 1C.62 Relations With Organized Employees

[1] Federal Labor Management Relations Act

[a] Employees' Right to Organize

Under the federal Labor Management Relations Act of 1947 [*see 29 U.S.C. 141-187*], employees have the right to self-organization, to form, join, or assist labor unions, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid and protection [*29 U.S.C. § 157*]. Representatives chosen for the purposes of collective bargaining by the majority of employees in a unit are the exclusive representatives of all the employees in the unit [*29 U.S.C. § 159(a)*].

[b] Unfair Labor Practice

It is an unfair labor practice for an employer to do any of the following [*29 U.S.C. § 158*; *see 29 U.S.C. § 152(2)* ("employer" defined)]:

- Interfere with employees in the exercise of their right to organize [*see 29 U.S.C. § 157*].
- Dominate or interfere with the formation or administration of a labor organization.
- Discriminate regarding hiring, advancement, terms, or conditions of employment to encourage or discourage membership in a labor organization.
- Discharge or otherwise discriminate against an employee because he or she filed charges or gave testimony related to a labor organization.
- Refuse to bargain collectively with the employees' representatives [*see 29 U.S.C. § 159(a)*].

The National Labor Relations Board may prevent any person from engaging in an unfair labor practice affecting commerce [*29 U.S.C. § 160(a)*; *see 29 U.S.C. § 152(6)* ("commerce" defined)]. Virtually all business and employment "affects commerce" [*see NLRB v. Reliance Fuel Oil Corp. (1963) 371 U.S. 224, 226-227, 83 S. Ct. 312, 9 L. Ed. 2d 279* (commerce includes activities that in isolation might be deemed merely local but in interconnections of business across state lines, affect interstate commerce)].

[c] Restriction on Payments

It is unlawful for an employer or association of employers to pay, lend, or deliver money or other thing of value, or to agree to pay, lend, or deliver money or other thing of value to a labor organization, to its representatives or officers, or to an employee (in excess of his or her normal compensation) for purposes of influence [*29 U.S.C. § 186(a)*].

[d] Duty to Cooperate

Employers and employees and their representatives must make reasonable efforts to make and maintain agreements concerning pay, hours, and conditions of employment, and to participate in conferences and meetings when disputes arise [*29 U.S.C. § 174(a)*].

[2] California Alatorre-Zenovich-Dunlap-Berman Agricultural Labor Relations Act of 1975

[a] Applicability

The Alatorre-Zenovich-Dunlap-Berman Agricultural Labor Relations Act of 1975 (Act) [*see Lab. Code §§ 1140-1166.3*; *see also 8 Cal. Code Reg. §§ 20100-21200*] applies to "agricultural employers," which includes any person acting directly or indirectly in the interest of an employer in relation to an agricultural employee, an individual grower, corporate grower, cooperative grower, or various agricultural associations, groups, and cooperatives [*Lab. Code § 1140.4(c)*].

[b] Employees' Right to Organize

Under the Act, employees have the right to self-organization, to form, join, or assist labor unions, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid and protection [*Lab. Code § 1152*; *see Lab. Code § 1140.4(b)* "employee" defined)]. Representatives chosen for the purposes of collective bargaining by the majority of employees in a unit are the exclusive representatives of all the employees in the unit [*Lab. Code § 1156*].

[c] Unfair Labor Practice

It is an unfair labor practice for an agricultural employer to do any of the following [*Lab. Code § 1153*]:

- Interfere with agricultural employees in the exercise of their right to organize [*see Lab. Code § 1152*].
- Dominate or interfere with the formation or administration of a labor organization.
- Contribute financial or other support to a labor organization.
- Discriminate regarding hiring, advancement, terms, or conditions of employment to encourage or discourage membership in a labor organization.
- Discharge or otherwise discriminate against an agricultural employee because he or she filed charges

or gave testimony in relation to an agricultural labor organization.

- Refuse to bargain collectively with a certified labor organization [*see Lab. Code §§ 1156-1159*].

- Recognize, bargain with, or sign a collective-bargaining agreement with an uncertified labor organization.

The Agricultural Labor Relations Board may prevent any person from engaging in an unfair labor practice [*Lab. Code § 1160*].

[d] Restriction on Payments

It is unlawful for an agricultural employer or association of agricultural employers to pay, lend, or deliver money or other thing of value to a labor organization, to its representatives or officers, or to anemployee (in excess of his or her normal compensation) for purposes of influence [*Lab. Code § 1155.4*].

[3] Solicitation of Employees During Labor Dispute

An advertisement seeking employees to work while a strike, lockout, or other trade dispute is in progress must plainly and explicitly mention that the dispute exists. The advertisement must also state the name of the person placing the ad and the name of the person responsible for the ad, if different from the name of the person placing the ad [*Lab. Code § 973*].

[4] Use of Professional Strikebreakers

It is unlawful for an employer willingly and knowingly to use professional strikebreakers to replace employees involved in a strike or lockout at a place of business [*Lab. Code § 1134*; *see Lab. Code § 1133* ("professional strikebreaker" defined)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawCollective Bargaining & Labor RelationsRight to OrganizeLabor & Employment LawCollective Bargaining & Labor RelationsStrikes & Work StoppagesLabor & Employment LawCollective Bargaining & Labor RelationsUnfair Labor PracticesGeneral OverviewLabor & Employment LawCollective Bargaining & Labor RelationsUnfair Labor PracticesStrikes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide § 1C.63

§ 1C.63 Miscellaneous Obligations

[1] Family Care and Medical Leave

In general, employers of 50 or more employees must allow employees with more than 12 months of service to take a total of 12 weeks for family care or medical leave during any 12-month period [*Gov. Code § 12945.2(a)*]. Family care and medical leave may be taken (1) for the birth of a child, for the placement of a child with an employee in connection with adoption or foster care, or for the serious health condition of a child; (2) to care for a parent or spouse who has a serious health condition; or (3) because of an employee's own serious health condition (except for disability on account of pregnancy, childbirth, or related medical conditions) that makes the employee unable to perform the functions of his or her job [*Gov. Code § 12945.2(c)(3)*]. In some instances, an employee must first use accrued vacation time or sick leave before taking family care and medical leave [*see Gov. Code § 12945.2(e)*].

The employer must provide notice to the employees of their right to request family care and medical leave [*2 Cal. Code Reg. § 7297.9*; *see § 1C.205[1][e]*]. Failure to provide the notice could leave the employer in a weak defensive position if an employee sues for violation of the employee's statutory leave rights [*see*, e.g., *Faust v. California Portland Cement Co. (2007) 150 Cal. App. 4th 864, 881, 58 Cal. Rptr. 3d 729* (holding that lower court's finding of summary judgment for employer was erroneous)].

During family care and medical leave, the employee retains full employment status, including seniority [*Gov. Code § 12945.2(g)*], and is entitled to participate in employee health care and benefit plans [*Gov. Code § 12945.2(f)*]. However, the employee may be required to reimburse the employer for the cost of coverage [*Gov. Code § 12945.2(f)*]. The employer must guarantee an employee the same or a comparable position on returning [*Gov. Code § 12945.2(a)*].

An employer may refuse to reinstate an employee returning from leave to the same or a comparable position if all of the following apply [*Gov. Code § 12945.2(r)(1)*]:

- The employee is a salaried employee who is among the highest paid 10 percent of employees in a

defined geographic area.

- The refusal is necessary to prevent substantial and grievous economic injury to the operations of the employer.

- The employer notifies the employee of the intent to refuse reinstatement at the time the employer determines the refusal is necessary.

It is an unlawful employment practice for an employer to refuse to hire, or to discharge, fine, suspend, expel, or discriminate against an employee for exercising the right to family care and medical leave [*Gov. Code § 12945.2(l)(1)*].

Similar federal coverage is provided by the Family and Medical Leave Act of 1993 (FMLA) [*see 29 U.S.C. § 2601 et seq.*]. However, although the Ninth Circuit has not addressed the issue, the prevailing view among the other circuit courts is that the FMLA is an invalid abrogation of state sovereign immunity and therefore does not apply to state employers and employers determined to be arms of the state [*see, e.g., Hodgens v. General Dynamics Corp. (1st Cir. 1998) 144 F.3d 151, 159* ; *Hale v. Mann (2d Cir. 2000) 219 F.3d 61, 67-69* ; *see also* Moore's Federal Practice, Ch. 123, *Access to Courts : Eleventh Amendment and State Sovereign Immunity* (Matthew Bender 3d ed.)] Nevertheless, California regulations incorporate by reference the federal regulations interpreting the FMLA, to the extent that they are not inconsistent with California law [*see 2 Cal. Code Reg. § 7297.10*; *Pang v. Beverly Hosp., Inc. (2000) 79 Cal. App. 4th 986, 993, 94 Cal. Rptr. 2d 643]* .

[2] Pregnancy Leave

An employer must allow a female employee disabled by pregnancy, childbirth, or related conditions to take a leave for a reasonable time not exceeding four months and thereafter return to work [*Gov. Code § 12945(a)*]. The employee may use accrued vacation leave during this period. The employer may require the employee to give reasonable notice of the date the leave will begin, and the estimated duration of the leave [*Gov. Code § 12945(a)*].

An employer who has a policy, practice, or collective bargaining agreement requiring or authorizing the transfer of temporarily disabled employees to less strenuous or hazardous positions for the duration of the disability must transfer a pregnant female employee who requests such a transfer [*Gov. Code § 12945(b)(2)*]. Every employer must temporarily transfer a pregnant female employee to a less strenuous or less hazardous position for the duration of her pregnancy if, on the advice of her physician, she requests such a transfer, and the transfer can be reasonably accommodated [*Gov. Code § 12945(b)(3)*].

[3] Uniforms, Tools, and Equipment

If an employer requires employees to wear uniforms as a condition of employment, the employer must provide and maintain the uniforms. When tools or equipment are required by the employer or are necessary for the performance of a job, the employer must provide and maintain them; however, employees who earn wages at least two times the minimum wage may be required to provide and maintain hand tools and equipment customarily required by the trade or craft [*see, e.g., 8 Cal. Code Reg. § 11010(9)(A), (1)* (manufacturing industry)]. The employer may require a reasonable deposit as security for the return of items furnished by the employer, provided that the employer issues a receipt to the employee for the deposit [*see* 8 Cal. Code Reg. § 11019(9)(C)].

[4] Jury Duty and Court Appearances

An employer may not discharge or discriminate against an employee for taking time off to serve as required by law on an inquest jury or trial jury, provided that the employee gives reasonable notice to the employer before taking the time off [*Lab. Code § 230(a)*]. Similarly, an employer may not discharge, discriminate, or retaliate against an employee,

including a crime victim, for taking time off to appear in court to comply with a subpoena or other court order as a witness in any judicial proceeding [*Lab. Code § 230(b)*]. Further, no employer may discharge or discriminate or retaliate against an employee who is a victim of domestic violence [*see Fam. Code § 6211*] or sexual assault [*see Lab. Code § 230(h)(2)*] for taking time off to obtain or attempt to obtain any relief to help ensure the health, safety, or welfare of the violence victim or his or her children; for this purpose, the employee must give the employer reasonable advance notice of the intention to take time off unless advance notice is not feasible [*Lab. Code § 230(c), (d)*; *see* [10], *below*].

Employees may use vacation, personal leave, or compensatory time off for these purposes, and this entitlement may not be diminished by a collective bargaining agreement [*Lab. Code § 230(g)*]. Remedies include reinstatement, reimbursement for lost wages and benefits, and a one-year filing period for filing a complaint with the Division of Labor Standards Enforcement [*Lab. Code § 230(e), (f)*; *see Lab. Code § 230(e)* (willful refusal to restore employee is misdemeanor)].

[5] Leave to Vote

If a voter does not have sufficient time outside of working hours to vote at a statewide election, the voter may take off enough working time that, when added to the voting time available outside of working hours, will enable the voter to vote. No more than two hours may be taken off without loss of pay [*Elec. Code § 14350*]. Not less than 10 days before each statewide election, employers must post a notice setting forth the employees' right to take time off work to vote [*Elec. Code § 14351*; *see Elec. Code § 14350*; *see also § 1C.231* (form for notice)].

[6] Volunteer Firefighter, Reserve Peace Officer, and Emergency Rescue Personnel Duty

An employer may not discharge or discriminate against an employee for taking time off work to perform emergency duty as a volunteer firefighter [*see Lab. Code § 230.3(d)(1)*; *Gov. Code § 50952(p)*], a reserve peace officer, or emergency rescue personnel [*Lab. Code § 230.3(a)*; *see Lab. Code § 230.3(d)(2)*; *Health & Safety Code § 1799.107(e)*]. This prohibition does not apply to any public safety agency or emergency medical services provider if the employer determines that the employee's absence would hinder the availability of public safety or emergency medical services [*Lab. Code § 230.3(c)*].

[7] Employee Literacy Assistance

Every private employer regularly employing 25 or more employees must reasonably accommodate and assist any employee who reveals a literacy problem and requests employer assistance in enrolling in an adult literacy education program, provided the reasonable accommodation does not impose an undue hardship on the employer [*Lab. Code § 1041(a)*]. "Employer assistance" includes providing the employee with the location of the program or arranging for a literacy education provider to visit the jobsite [*Lab. Code § 1041(b)*]. Employers must make reasonable efforts to safeguard the privacy of employees who reveal literacy problems [*Lab. Code § 1042*], and may not terminate such employees who are otherwise preforming their work satisfactorily [*Lab. Code § 1044*]. Employers do not have to give employees time off with pay to participate in a literacy education program [*Lab. Code § 1043*].

[8] Drug-Free Workplace

A business awarded a contract or grant from a state agency for procuring property or services must certify to the agency that it will provide a drug-free workplace. To meet this requirement, a business must (1) publish a statement notifying employees that unlawful manufacture, distribution, dispensation, possession, or use of a controlled substance is prohibited in the person's or organization's workplace and specifying the actions that will be taken against employees for violations; (2) establish a drug-free awareness program; (3) require that each employee be given a copy of the statement concerning unlawful use of controlled substances; and (4) require that each employee, as a condition of employment, agree to abide by the terms of the statement [*Gov. Code § 8355(a)*]. This certification requirement does

not apply to credit card purchases of goods of $2,500 or less [*Gov. Code § 8355(b)(1)*; *see Gov. Code § 8355(b)(2)* (annual exemption limited to $7,500 per company)]. A similar federal program applies to contracts for the procurement of property or services for $25,000 or more from any federal agency [*see 41 U.S.C. §§ 701-707*].

[9] Sanitation Requirements

Employers must keep business establishments clean, maintain restrooms for employees [*Lab. Code § 2350*], and furnish free drinking water to employees [*Lab. Code § 2441(a)*]. Factories, shops, and businesses in which power machinery is used for manufacturing purposes must maintain medical supplies on the premises [*Lab. Code § 2440*]. Special sanitation requirements apply to theaters, foundries, metal shops, and factories [*see Lab. Code §§ 2260-2355*].

[10] Leave Related to Domestic Violence

Employers may not discharge, discriminate, or retaliate against an employee who is a victim of domestic violence [*see Fam. Code § 6211*] for taking time off from work to seek judicial relief [*see* [4], *above*] or to help ensure the health, safety, or welfare of a domestic violence victim or his or her child [*Lab. Code § 230(c)*]. Further, the employer must maintain the confidentiality of any employee requesting leave to the extent allowed by law [*Lab. Code § 230(d)(3)*]. If feasible, the employee must give the employer reasonable advance notice of the employee's intention to take time off [*Lab. Code § 230(d)(1)*]. However, the employer may not take any action against the employee based on an unscheduled absence if the employee provides certification to the employer within a reasonable time after the absence [*Lab. Code § 230(d)(2)*]. Employees may use vacation, personal leave, or compensatory time off for this purpose, and this entitlement may not be diminished by a collective bargaining agreement [*Lab. Code § 230(g)*]. Remedies include reinstatement, reimbursement for lost wages and benefits, and a one-year filing period for filing a complaint with the Division of Labor Standards Enforcement [*Lab. Code § 230(e), (f)*; *see Lab. Code § 230(e)* (willful refusal to restore employee is misdemeanor)].

In addition, employers with 25 or more employees may not discharge, discriminate, or retaliate against an employee who is a victim of domestic violence [*see Fam. Code § 6211*] for taking time off from work to attend to any of the following [*Lab. Code § 230.1(a)*]:

- To seek medical attention for injuries caused by domestic violence.
- To obtain services from a domestic violence shelter, program, or rape crisis center.
- To obtain psychological counseling related to an experience of domestic violence.
- To participate in safety planning and take other actions to increase safety from future domestic violence, including temporary or permanent relocation.

The advance notice and confidentiality requirements discussed above apply in this context, as well as the available remedies [*Lab. Code § 230.1(b)-(e)*]. However, an employee may not take unpaid leave for these purposes that exceeds the unpaid leave time allowed under, or is in addition to the unpaid leave time permitted by, the federal Family and Medical Leave Act of 1993 [*Lab. Code § 230.1(f)*; *see* 29 U.S.C. § 2606 et seq.; *see also* [1], *above*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawGeneral OverviewLabor & Employment LawLeaves of AbsenceGeneral OverviewLabor & Employment LawLeaves of AbsenceFamily & Medical Leave ActCoverage & DefinitionsGeneral OverviewLabor & Employment LawLeaves of AbsenceFamily & Medical Leave ActCoverage & DefinitionsAdoption & MaternityLabor

& Employment LawLeaves of AbsenceShort-Term Leave



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
B. Obligations Arising From Employer-Employee Relationship
2. Working Conditions and Compensation

1-1C California Legal Forms--Transaction Guide §§ 1C.64-1C.69

[Reserved]

§§ 1C.64[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
1. Regulation of Hazardous Substances

1-1C California Legal Forms--Transaction Guide § 1C.70

§ 1C.70 Hazardous Substances Information and Training Act

[1] Applicability of Act

The Hazardous Substances Information and Training Act (Act) [*see Lab. Code §§ 6360-6399.7*] was enacted to ensure the transmission of necessary information to employees regarding the properties and potential hazards of hazardous substances in the workplace [*Lab. Code § 6361(b)*]. The provisions of the Act apply to (1) all employers who use hazardous substances in California, (2) any person who sells a hazardous substance to an employer in California, and (3) any manufacturer who produces or sells hazardous substances in California. The Act covers hazardous substances that are present in the workplace as a result of workplace operations, in a mannerthat employees may be exposed to them under normal work conditions or in reasonably foreseeable emergencies resulting from workplace operations [*Lab. Code § 6362*].

Hazardous substances subject to the Act are compiled in a list prepared by the director of the Division of Occupational Safety and Health (DOSH) [*Lab. Code § 6380*; *see 8 Cal. Code Reg. § 339* (hazardous substances list)].

[2] Duty of Manufacturer to Prepare MSDS

Manufacturers of listed hazardous substances must prepare and provide direct purchasers of substances with a Material Data Safety Sheet (MSDS) setting forth the name, other designations, hazards, risks, handling procedures, and emergency procedures associated with that hazardous substance [*Lab. Code §§ 6390, 6391*]. The preparer of an MSDS must provide a copy to the Department of Industrial Relations [*Lab. Code § 6394*]. Manufacturers, importers, distributors, and employers must label containers of hazardous waste in a manner consistent with California standards and the federal Hazard Communication Standard [*Lab. Code § 6390.5*; *see 8 Cal. Code Reg. § 5194*; *29 C.F.R. § 1910.1200*].

[3] Duty of Employer to Provide Information About Toxic or Harmful Substances

An MSDS for each hazardous substance in the workplace must be available to all employees, bargaining units, and

employees' physicians [*Lab. Code § 6398(a)*]. Employers must furnish employees who may be exposed to a hazardous substance with information about the contents of the MSDS for the hazardous substance or with equivalent information, either in written form or through a training program [*Lab. Code § 6398(b)*]. Employers must make provision to inform employees of their rights under this Act [*Lab. Code § 6398(c)*].

Employers must also notify an employee who has been or is being exposed to toxic materials or harmful physicalagents in excessive amounts, and must inform the employee of corrective action being taken [*Lab. Code § 6408(e)*]. In addition, employers must allow employees or their representatives access to accurate records of employee exposures to potentially toxic materials or harmful physical agents [*Lab. Code § 6408(d)*].

Employers may not retaliate against employees for being involved in a proceeding relating to hazardous substances, or for exercising a right afforded by this Act [*Lab. Code § 6399.7*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthCompliance & DefensesLabor & Employment LawOccupational Safety & HealthDuties & Rights



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
1. Regulation of Hazardous Substances

1-1C California Legal Forms--Transaction Guide § 1C.71

§ 1C.71 Regulation of Employee Contact With Asbestos

[1] Duties of Employer Engaged in Asbestos-Related Work

An employer or contractor engaged in asbestos-related work [*see Lab. Code § 6501.8(a)* ("asbestos-related work" defined) that involves 100 square feet or more of surface area of asbestos-containing material must register with the Division of Occupational Safety and Health (DOSH) [*Lab. Code § 6501.5*; *see 8 Cal. Code Reg. §§ 341.6-341.14* (registration regulations)]. The employer or contractor must meet certain criteria and must provide DOSH with requested information about the work [*see Lab. Code § 6501.5(b)*]. DOSH will grant registration if it is satisfied that the employer or contractor will provide a safe and healthful place of employment. The employer or contractor must post a copy of the registration and warning signs at the work location [*Lab. Code § 6501.5*]. In all asbestos-handling jobs, a safety conference must be held before the start of actual work [*Lab. Code §§ 6503, 6503.5*].

In addition, the employer or contractor must do all of the following [*Lab. Code § 6501.5(a)*]:

(1) Provide health insurance coverage for medical examinations and monitoring for employees.

(2) Maintain workers' compensation insurance for employees or provide a trust account for each employee.

(3) Train and certify employees to work with asbestos [*see 8 Cal. Code Reg. §§ 1529, 5208*].

(4) Provide the equipment necessary to safely perform asbestos-related work.

If the employer is a contractor, the contractor must be certified by the Contractors' State License Board [*Lab. Code § 6501.5(a)(1)*; *see Bus. & Prof. Code §§ 7058.5, 7058.6*].

Employers, contractors, and owners of commercial or industrial buildings who engage in or contract for asbestos-related

work must make a good faith effort to determine if asbestos is present before the work begins. For asbestos-related work on a building or structure built before 1978, the employer must first ask the owner if asbestos is present [*Lab. Code § 6501.9*].

[2] Notice to Employees of Presence of Asbestos

The owner of a building constructed before 1979 who knows that the building contains asbestos-containing construction materials must provide a notice containing all the following elements to employees in the building [*Health & Safety Code § 25915(a)*; *see* Health & Safety Code §§ 25918.3-25919.6 (definitions)]:

> (1) Information relating to any asbestos survey known to the owner to have been conducted on the building.
>
> (2) Specific locations in the building known to the owner or identified in the survey where asbestos-containing materials are present.
>
> (3) Procedures and handling restrictions necessary to prevent and minimize disturbance, release, and exposure of asbestos.
>
> (4) A summary of the results of any analysis or monitoring done for asbestos [*see 8 Cal. Code Reg. § 5208*].
>
> (5) Potential health risks or impacts that may result from exposure to the asbestos in the building.

This notice must be provided to each employee in writing annually [*Health & Safety Code § 25915.2(a)*].

Instead of providing the preceding notice to employees, the owner may prepare an asbestos management plan [*see Health & Safety Code §§ 25915(a), 25915.1*]. The plan must contain the items specified in (1)-(5), above, but need not be given to employees. If a plan is prepared, an abbreviated notice must be given to employees stating the specific location of asbestos in the building, and informing employees of the existence and availability of the plan and a description of its contents [*see Health & Safety Code § 25915(a)*].

If construction, maintenance, or remodeling is conducted in an area of the building where employees might come in contact with asbestos, the owner must post a prescribed warning sign [*see Health & Safety Code § 25916*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Environmental LawHazardous Wastes & Toxic SubstancesAsbestosWork Practice StandardsLabor & Employment LawOccupational Safety & HealthDuties & RightsLabor & Employment LawOccupational Safety & HealthIndustry Standards



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
1. Regulation of Hazardous Substances

1-1C California Legal Forms--Transaction Guide § 1C.72

§ 1C.72 Regulation of Employee Contact With Pesticides

The Director of Food and Agriculture is authorized to adopt regulations to provide for the safe use of pesticides and safe working conditions for farmworkers, pesticide applicators, and other persons working with or around pesticides [*Food & Agric. Code §§ 407, 12980, 12981*]. Accordingly, the Director has adopted pesticide regulations imposing a number of safety requirements on employers. Employers must have a written training program for employees who handle minimal-exposure pesticides, must keep records about training, and must post safety information [*3 Cal. Code Reg. § 6724*; *see 3 Cal. Code Reg. §§ 6790-6793* (minimal-exposure pesticides)]. Employers must provide for emergency medical care in advance, and provide for medical supervision of employees [*3 Cal. Code Reg. §§ 6726, 6728*]. Employees working with certain pesticides must work in groups or must make periodic contact with another person [*3 Cal. Code Reg. § 6730*]. Employers must provide areas for employees to change their clothes and must provide employees with wash facilities and clean work clothing [*3 Cal. Code Reg.§§ 6732-6736*]. In addition, employers must provide safety equipment and adequate lighting, and must maintain appropriate equipment for working with pesticides in a safe condition [*3 Cal. Code Reg. §§ 6738-6746*].

Employers are subject to additional regulations relating to the safety of field workers [*see 3 Cal. Code Reg. §§ 6760-6778*] and the use of fumigants [*see 3 Cal. Code Reg. §§ 6780-6784*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Environmental LawHazardous Wastes & Toxic SubstancesPesticidesGovernmentsAgriculture & FoodPest & Disease Control



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
1. Regulation of Hazardous Substances

1-1C California Legal Forms--Transaction Guide § 1C.73

§ 1C.73 Occupational Carcinogens Control Act

Under the Occupational Carcinogens Control Act of 1976 [*see Lab. Code §§ 9000-9061*], employers must observe certain safety standards regarding the use and handling of carcinogens [*Lab. Code § 9021*; *see 8 Cal. Code Reg. §§ 5208-5210* (standards)]. In addition to providing a safe work environment for employees, employers must report releases of potentially hazardous amounts of carcinogens [*see Lab. Code § 9030*], and provide medical examinations and monitoring for affected employees [*see Lab. Code § 9040*]. Employers also must post copies of reports of releases of potentially hazardous amounts of carcinogens at each location of the release [*Lab. Code § 9031*].

For purposes of the Act, an "employer" is a governmental agency, a person that has a natural person in service, or the legal representative of a deceased employer [*Lab. Code § 9006*]. An "affected employee" is an employee who, as part of his or her employment, is involved in the use of a carcinogen [*see Lab. Code § 9009* ("use" defined)], or an employee who has a substantial probability of becoming involved in the use of a carcinogen in employment [*Lab. Code § 9003*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
1. Regulation of Hazardous Substances

1-1C California Legal Forms--Transaction Guide § 1C.74

§ 1C.74 Safe Drinking Water and Toxic Enforcement Act (Proposition 65)

[1] Prohibition on Discharging Harmful Chemicals

The Safe Drinking Water and Toxic Enforcement Act (commonly known as Proposition 65) [*see Health & Safety Code §§ 25249.5-25249.13*; *see also 27 Cal. Code Reg. § 25102 et seq.*] generally prohibits any person in the course of doing business from knowingly discharging or releasing a chemical known to the State of California to cause cancer or reproductive toxicity into water, or into or onto land where the chemical passes or will probably pass into a source of drinking water [*Health & Safety Code § 25249.5*].

[2] Prohibition on Exposing Persons to Hazardous Chemicals

No person in the course of doing business may knowingly and intentionally expose another person to one of these chemicals without first giving the person clear and reasonable warning [*Health & Safety Code § 25249.6*; *see* 22 Cal. Code Reg. § 12601(c) (manner of occupational exposure warnings)]. Warnings need not be separately given to each exposed person, but may be provided by general methods such as labels on products, posting of notices, and published warnings [*Health & Safety Code § 25249.11(f)*]. Warnings need not be posted when a federal law governing warning preempts state law, and when the person responsible for the exposure can show the exposure poses no significant threat [*Health & Safety Code § 25249.10(a), (c)*].

[3] List of Covered Chemicals

Proposition 65 applies to chemicals included on a list published by the governor [*see 27 Cal. Code Reg. § 27001(b)* (list of chemicals)]. At a minimum, this list must include the hazardous substances contained in listings referred to in *Labor Code Section 6382(b)* and *(d)* [*Health & Safety Code § 25249.8(a)*; *see 8 Cal. Code Reg. § 339* ("Governor's List"); *29 C.F.R. § 1910.1200* (federal Hazard Communication Standard)].

[4] Application of Act

The prohibitions imposed by Proposition 65 apply only to a "person in the course of doing business." They do not apply to government employers or persons employing fewer than 10 employees [*see Health & Safety Code § 25249.11(b)*]. For purposes of Proposition 65, a "person" is an individual, trust, firm, joint stock company, corporation, company, partnership, or association [*Health & Safety Code § 25249.11(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Environmental LawHazardous Wastes & Toxic SubstancesToxic SubstancesEnvironmental LawWater QualityGeneral OverviewEnvironmental LawWater QualityClean Water ActCoverage & DefinitionsDischarges



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
1. Regulation of Hazardous Substances

1-1C California Legal Forms--Transaction Guide § 1C.75

§ 1C.75 Federal Hazardous Communication Standard

[1] In General

The federal Hazardous Communication Standard [*see 29 C.F.R. § 1910.1200*] imposes obligations on employers in connection with the production and use of hazardous substances. Under the Standard, an "employer" is a person engaged in a business where chemicals are used, distributed, or produced for use or distribution. The term includes contractors and subcontractors. An "employee" is a worker who may be exposed to hazardous chemicals under normal operating conditions or in foreseeable emergencies. Workers who encounter hazardous chemicals only in non-routine, isolated situations, such as office workers, are not covered [*29 C.F.R. § 1910.1200(c)*].

[2] Duty of Employer

The Standard imposes on employers the following obligations:

(1) Developing a written hazard communication program, which must cover labels and other warnings, Material Safety Data Sheets (MSDS) and employee training [*29 C.F.R. § 1910.1200(e)*].

(2) Providing employee training and information about hazardous chemicals in their work area [*29 C.F.R. § 1910.1200(h)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Environmental LawHazardous Wastes & Toxic SubstancesEmergency Planning & Community Right to KnowLabor & Employment LawOccupational Safety & HealthGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
1. Regulation of Hazardous Substances

1-1C California Legal Forms--Transaction Guide §§ 1C.76-1C.79

[Reserved]

§§ 1C.76[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
2. Safety, Health, and Access Regulations

1-1C California Legal Forms--Transaction Guide § 1C.80

§ 1C.80 Governing Law

[1] California Occupational Safety and Health Act

[a] Purpose

The California Occupational Safety and Health Act of 1973 (Cal/OSHA) [*see Lab. Code §§ 6300-9061*] was enacted to assure working Californians safe and healthful working conditions by authorizing the enforcement of effective standards, by assisting and encouraging employers in maintaining safe and healthful working conditions, and by providing research, information, education, training, and enforcement in the area of occupational safety and health [*Lab. Code § 6300*]. Enacted as a state plan to take full responsibility for enforcing federal OSHA safety and health standards, Cal/OSHA was granted final approval by the Secretary of Labor in 1977. Because it has federal approval, Cal/OSHA is the sole mechanism for enforcing occupational safety and health laws in California [*see 29 U.S.C. § 667(b)*], with the exception of occupational fields reserved to concurrent state and federal jurisdiction, and to purely federal jurisdiction, such as maritime activity, some railroad activity, employment by the federal government, and others [*see* K. Wilcox, California Employment Law, Ch. 21, *Occupational Safety and Health Regulation* (Matthew Bender)].

[b] Enforcement

Cal/OSHA requirements are implemented by occupational safety laws for certain specific industries [*see Lab. Code §§ 6800-9061*] and safety and health standards for most industries [*see 8 Cal. Code Reg. §§ 450-8618*]. The Division of Occupational Safety and Health (DOSH) has jurisdiction over all employment in California, and has the power toenforce and administer laws, standards, and orders relating to occupational safety and health [*Lab. Code § 6307*]. Employers are subject to civil and criminal penalties for failing to comply with standards, orders, or any other occupational safety and health provisions [*see Lab. Code §§ 6423-6436*].

[2] Federal Occupational Safety and Health Act

[a] In General

The federal Occupational Safety and Health Act of 1970 (OSHA) [*see 29 U.S.C. §§ 651-678*] was enacted to assure working people safe and healthful working conditions, and to preserve human resources [*29 U.S.C. § 651(b)*]. The Act applies to employment within the states, the District of Columbia, and certain other areas [*see 29 U.S.C. § 653(a)*]. It regulates each "employer," defined as a person engaged in a business affecting commerce who has employees [*29 U.S.C. § 652(5)*]. An "employee" is an employee of an employer who is engaged in a business of his or her employer that affects commerce [*29 U.S.C. § 652(6)*]. By using the phrase "affects commerce," Congress intended the scope of OSHA to be as broad as the Commerce Clause allows [Godwin v. Occupational Saf. & Health Rev. Com'n (9th Cir. [Cal.] 1976) *540 F.2d 1013, 1015* ; *see Wickard v. Filburn (1942) 317 U.S. 111, 127-128, 63 S. Ct. 82, 87 L. Ed. 122* (trivial contribution to commerce enough to be subject to federal regulation)]. Consequently, because virtually all business "affects commerce," all employers are subject to OSHA.

[b] Duties of Employer and Employee

An employer subject to OSHA must do both of the following [*29 U.S.C. § 654(a)*]:

(1) Furnish each employee with employment and a place of employment free from recognized hazards that cause or are likely to cause death or serious injury.

(2) Comply with OSHA's occupational safety and health standards [*see 29 U.S.C. § 655* (promulgation of standards)].

Each employee must comply with OSHA's occupational safety and health standards, and all rules, regulations, and orders applicable to the employee's actions and conduct [*29 U.S.C. § 654(b)*].

[c] State Plan

OSHA does not prevent a state from adopting its own occupational safety and health plan. The state plan may simply regulate areas outside the scope of OSHA's standards, or may take responsibility for the enforcement of all OSHA standards if (1) the plan provides standards at least as effective as OSHA's standards, and (2) the state plan is approved by the Secretary of Labor [*see 29 U.S.C. § 667(a)-(c)*]. California's state plan was granted final approval in 1977 [*see* K. Wilcox, California Environmental Law, Ch. 21, *Occupational Safety and Health Regulation* (Matthew Bender)].

[d] Recordkeeping

Employers must make, keep, and make available records of the employer's activities relating to occupational safety and health [*29 U.S.C. § 657(c)*]. This includes maintaining a log and summary of occupational injuries and illnesses on a prescribed form [*see 29 C.F.R. §§ 1904.2, 1904.5, 1904.6*], and reporting to OSHA about employment accidents in which an employee is killed or in which five or more employees are hospitalized [*see 29 C.F.R. § 1904.8*]. Employers may be required to complete an annual survey of occupational injuries and illnesses [*see* 29 C.F.R. § 1904.21].

However, employers with no more than 10 employees and employers in low-risk industries are generally exempt from regular recordkeeping requirements [*see* 29 C.F.R. §§ 1904.15, 1904.16]. Employers engaged inphysically dispersed operations are subject to different recordkeeping requirements [*see* 29 C.F.R. § 1904.14]. However, these employers still must comply with OSHA safety standards, display OSHA posters, and report fatal or other serious accidents. Employers must comply with these federal recordkeeping regulations even though Cal/OSHA has full responsibility for enforcing federal OSHA standards [*see Lab. Code § 6410*].

Exempt employers may be required to maintain records for one year if selected by the Bureau of Labor Statistics (BLS) to participate in a survey of occupational injuries and illnesses [29 C.F.R. §§ 1904.15(b), 1904.16(b), 1904.21].

[e] Enforcement

A key part of OSHA's structure for maintaining safe employee work environments is the authority of the Secretary of Labor to establish and enforce occupational safety and health standards, national consensus standards, and other federal standards [*see 29 U.S.C. § 655(a)*; *29 C.F.R. §§ 1910.1-1910.441* (occupational safety and health standards)]. To enforce these standards, the Secretary may conduct inspections and investigations, examine records, issue citations, assess penalties, and seek restraining orders [*see 29 U.S.C. §§ 657-659, 662*]. An employer who violates OSHA's requirements or fails to correct a cited violation is subject to civil and criminal penalties [*see 29 U.S.C. § 666*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthCompliance & DefensesLabor & Employment LawOccupational Safety & HealthDuties & RightsLabor & Employment LawOccupational Safety & HealthIndustry StandardsLabor & Employment LawPosting & Recordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
2. Safety, Health, and Access Regulations

1-1C California Legal Forms--Transaction Guide § 1C.81

§ 1C.81 General Safety and Health Duties of Employer

[1] Employer's Duty to Maintain Safe and Healthy Employment

Under Cal/OSHA, every employer's general duty is to furnish employment and a place of employment that are safe and healthful for employees [*Lab. Code § 6400*]. An employer may not require or permit an employee to be in a place of employment that is not safe and healthful[*Lab. Code § 6402*]. In addition, an employer may not occupy, maintain, construct, or cause the construction of a place of employment that is not safe and healthful [*Lab. Code §§ 6404, 6405*]. In the context of employment, the terms "safe," "safety," and "health" mean the freedom from danger to employees' life, safety, and health that the nature of the employment reasonably permits [*Lab. Code § 6306(a)*].

Both employers and employees must comply with all occupational safety and health standards, *Health and Safety Code Section 25910* relating to asbestos spraying, and all applicable Cal/OSHA rules, regulations, and orders [*Lab. Code § 6407*]. However, the employer has the primary responsibility for the safety of the employee [*Bendix Forest Products Corp. v. Division of Occupational Saf. & Health (1979) 25 Cal. 3d 465, 470-471, 158 Cal. Rptr. 882, 600 P.2d 1339]* .

[2] Variance From Standards

[a] Temporary Variance

An employer may apply to DOSH for a temporary order granting a variance from an occupational safety and health standard. DOSH will grant the order if the employer completes the mandatory application [*see Lab. Code § 6451*] and establishes all of the following [*Lab. Code § 6450(a)*]:

(1) The employer is unable to comply with the standard because of unavailability of personnel or materials and equipment needed to comply, or because complying facilities cannot be completed in time.

(2) The employer is taking all available steps to safeguard employees against the hazards covered by the standard.

(3) The employer has an effective program for complying with the standard as quickly as practicable.

[b] Permanent Variance

An employer may apply to the Occupational Safety and Health Standards Board for a permanent variance from an occupational safety and health standard or order by showing that an alternate program, method, practice, means, device, or process will provide equal or superior safety for employees as the standard or order [*Lab. Code § 143(a)*]. If the board determines that the variance proposed by the employer will provide conditions as safe and healthful as the standard or order, it will issue the variance. The variance will specify the conditions the employer must maintain, and the practices, means, methods, operations, and processes that he or she must adopt and utilize, to the extent that they differ from the standard or order in question [*Lab. Code § 143(b)*].

[3] Duty to Furnish Safety Devices and Procedures

Employers must furnish and use safety devices and safeguards. They must also adopt and employ practices, means, methods, operations, and processes that are reasonably adequate to render the employment and place of employment safe and healthful. In addition, employers must do everything else reasonably necessary to protect the life, safety, and health of employees [*Lab. Code § 6401*; *see Lab. Code § 6403*]. It is unlawful for anyone to remove, displace, damage, destroy, or interfere with the use of safety devices, safeguards, safety notices, or warnings [*see Lab. Code § 6406*]. The terms "safety device" and "safeguard" are given broad interpretations in order to include any practicable method of mitigating or preventing a specific danger [*Lab. Code § 6306(b)*]. The employer's duty to furnish safety devices requires the employer to pay for any necessary safety equipment [*Bendix Forest Products Corp. v. Division of Occupational Saf. & Health (1979) 25 Cal. 3d 465, 473, 158 Cal. Rptr. 882, 600 P.2d 1339]* .

Safety and health regulations that cover all employees have been promulgated relating to the design and use of specific personal safety devices and safeguards, including body, head, eye, face, hand, and foot protection, jewelry,safety belts, life rings, electric shock protection, medical services, and cleaning of protectors [*see 8 Cal. Code Reg. §§ 3380-3400*]. When safety devices or safeguards are used, they must be of an acceptable type and design, and must comply with standards approved by a recognized authority [*8 Cal. Code Reg. § 3380(a)*].

[4] Duty to Monitor for Hazardous Conditions

Whenever it is reasonable to expect that employees may be exposed to concentrations of airborne contaminants above certain prescribed levels, an employer must monitor the work environment so that exposure to employees can be measured or calculated [*8 Cal. Code Reg. § 5155(e)(1)*; *see 8 Cal. Code Reg. § 5155(c)* (exposure limits)]. If exposures to contaminants are found or are expected to exceed allowable levels, the employer must take measures to control the harmful exposures [*8 Cal. Code Reg. § 5155(e)(2)*; *see 8 Cal. Code Reg. § 5141* (types of controls)].

In addition, employers must monitor existing conditions and take action to safeguard employees or prevent them from being exposed to confined space, asbestos, vinyl chloride, and other hazards [*see 8 Cal. Code Reg. §§ 5156-5158, 5208(g), 5210(d)*].

[5] Duty to Comply With Safety Orders

As part of the duty to provide employees with a safe working environment [*see Lab. Code § 6400*], employers must comply with safety orders regarding the design, construction, installation, and maintenance of guardrails, elevated walkways, wall and floor openings, service pits, handrails, exits, exit signs, ramps, stairways, and doors [*see 8 Cal. Code Reg. §§ 3209-3235*].

[6] Duty to Provide Safety Information to Employees

Employers must provide safety information to employees by doing all of the following [*Lab. Code § 6408*]:

(1) Posting information regarding protections and obligations of employees under occupational safety and health laws, including the Cal/OSHA Notice of Employee Protections and Obligations entitled "Safety and Health Protection on the Job" [*see 8 Cal. Code Reg. § 340*].

(2) Prominently posting citations at or near each place a violation referred to in the citation occurred [*see Lab. Code §§ 6317, 6318*].

(3) Providing an opportunity for employees or their representatives to observe monitoring or measuring of employee exposure to hazards [*see Lab. Code § 142.3*].

(4) Allowing access by employees or their representatives to records of employee exposures to potentially toxic materials or harmful physical agents [*see 8 Cal. Code Reg. § 3204*].

(5) Notifying an employee who has been or is being exposed to toxic materials or harmful physical agents, and informing the employee of any corrective action being taken.

(6) Posting telephone numbers to be called in an emergency [*see 8 Cal. Code Reg. § 1512(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthCompliance & DefensesLabor & Employment LawOccupational Safety & HealthDuties & RightsLabor & Employment LawPosting & Recordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
2. Safety, Health, and Access Regulations

1-1C California Legal Forms--Transaction Guide § 1C.82

§ 1C.82 Duty to Implement Injury and Illness Prevention Program

[1] In General

Every employer must establish, implement, and maintain an effective injury and illness prevention program. For most employers, the entire program must be in writing, must contain specified elements [*Lab. Code § 6401.7(a)*; *see 8 Cal. Code Reg. § 3203(a)* (general regulations); *see also 8 Cal. Code Reg. §§ 1509, 6507, 6760, 8350, 8406* (specific industry regulations)], and must identify a person or group responsible for implementing the program [*Lab. Code § 6401.7(a)(1)*]. Certain employers of fewer than 20 employees have a modified recordkeeping requirement [*see Lab. Code § 6401.7(e)(2)*]. The employer has a duty to conduct its own inspections of the premises [*see Lab. Code § 6401.7(a)(2)*], and must correct unsafe and unhealthy conditions and work practices in a timely manner [*Lab. Code § 6401.7(b)*].

For a sample written injury and illness prevention program, see *Section 1C.221*. For a complete discussion of injury and illness prevention programs, see K. Wilcox, California Employment Law, Chapter 21, *Occupational Safety and Health Regulation* (Matthew Bender).

[2] Duty to Train Employees

The employer must give program training to all existing employees, all new employees, and all employees given new job assignments. Employees must also be trained when changes to the work environment present new hazards and when new or previously unrecognized hazards arise [*Lab. Code § 6401.7(c)*]. The training program must be designed to instruct employees in general safe and healthy work practices, and to provide specific instructions about hazards specific to each employee's job assignment [*Lab. Code § 6401.7(a)(4)*].

Licensed contractors may use approved occupational safety and health training programs to fulfill a portion of their employee training requirement [*see Lab. Code § 6401.7(c)*].

[3] Communication and Records

The employer must have a system for communicating about occupational safety and health matters with all affected employees in a form they can readily understand [*8 Cal. Code Reg. § 3203(a)(3)*], and a system for ensuring that employees comply with safe and healthy work practices, which may include disciplinary action [*Lab. Code § 6401.7(a)(6)*]. In addition, the employer must keep records regarding the program [*Lab. Code § 6401.7(d)*], including records of inspections to identify unsafe conditions and work practices, and documentation of safety and health training [*see 8 Cal. Code Reg. § 3203(b)*].

Licensed contractors may use records relating to approved occupational safety and health training programs to fulfill a portion of their recordkeeping requirements [*see Lab. Code § 6401.7(d)*].

[4] Exceptions for Small Businesses

The implementing regulations exempt employers of fewer than 10 employees from some documentation requirements [*see 8 Cal. Code Reg. § 3203(a)(3), (b)(1), (2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthBurdens of ProofLabor & Employment LawOccupational Safety & HealthCompliance & DefensesLabor & Employment LawOccupational Safety & HealthDuties & RightsLabor & Employment LawPosting & Recordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
2. Safety, Health, and Access Regulations

1-1C California Legal Forms--Transaction Guide § 1C.83

§ 1C.83 Duty to Implement Emergency Plans

[1] Emergency Action Plan

Every employer must provide an emergency action plan. The plan must cover the actions the employer and employees must take to ensure employee safety in a fire or other emergency, and, for most employers, must be in writing [*8 Cal. Code Reg. § 3220(a)*; *see 8 Cal. Code Reg. § 3220(e)(3)* (employer with 10 or fewer employees may use oral plan)]. The plan must include, at a minimum, all of the following elements [*8 Cal. Code Reg. § 3220(b)*]:

(1) Emergency escape procedures and emergency escape route assignments.

(2) Procedures for employees who remain behind to operate critical plant operations before they evacuate.

(3) Procedures to account for all employees after the evacuation is completed.

(4) Rescue and medical duties for employees who will perform those duties.

(5) The preferred means of reporting fires and other emergencies.

(6) Who an employee can contact for more information or explanation of duties under the plan.

The employer must keep the written plan at the workplace, and must make it available for employees to read [*8 Cal. Code Reg. § 3220(e)(3)*].

The employer must establish in the program the types of evacuation to be used in emergency situations [*8 Cal. Code Reg. § 3220(d)*], and must establish a complying employee alarm system [*8 Cal. Code Reg. § 3220(c)*; *see 8 Cal. Code Reg. § 6184*]. Before the program is implemented, the employer must provide appropriate program training to all

employees [*see 8 Cal. Code Reg. § 3220(e)*].

[2] Fire Prevention Plan

Every employer must provide a fire prevention plan. Except for employers with 10 or fewer employees, the plan must be in writing [*8 Cal. Code Reg. § 3221(a)*; *see 8 Cal. Code Reg. § 3221(d)(2)* (employer with 10 or fewer employees may use oral plan)]. The plan must include, at a minimum, all of the following elements [*8 Cal. Code Reg. § 3221(b)*]:

> (1) Potential fire hazards and their proper handling and storage procedures, potential ignition sources and their control procedures, and the type of fire protection equipment or systems that can control a fire involving fire hazards or ignition sources.
>
> (2) Names or regular job titles of those responsible for maintaining equipment and systems installed to prevent or control ignitions or fires.
>
> (3) Names or regular job titles of those responsible for controlling the accumulation of flammable or combustible waste materials.

The employer must keep the written plan at the workplace, and must make it available for employees to read [*8 Cal. Code Reg. § 3221(d)(2)*].

The employer must control the accumulation offlammable and combustible waste materials and residues so that they do not contribute to a fire emergency [*8 Cal. Code Reg. § 3221(c)*], and must maintain equipment and systems installed in the workplace to prevent the accidental ignition of combustible materials [*8 Cal. Code Reg. § 3221(e)*]. Employees must be informed of fire hazards to which they are exposed, and must receive appropriate training in the program [*see 8 Cal. Code Reg. § 3221(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthDuties & RightsLabor & Employment LawPosting & Recordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
2. Safety, Health, and Access Regulations

1-1C California Legal Forms--Transaction Guide § 1C.84

§ 1C.84 Duty to File Report of Injury or Illness

[1] California Law

An employer must file a complete report with the Division of Labor Statistics and Research (DLSR) or with the employer's insurer of every occupational injury or illness [*see Lab. Code § 6409*] to an employee that results in lost time beyond the date of the injury or illness, or that requires medical attention beyond first aid. This reporting requirement applies to each injury and illness that has, or is alleged to have, arisen out of and in the course of employment. The report must be filed within five days after the employer learns of the injury or illness. If the employee subsequently dies as a result of the reported injury or illness, the employer must file an amended report [*Lab. Code § 6409.1(a)*]. These reports must be filed in a manner and on a form prescribed by regulation [*Lab. Code § 6410*; *see 8 Cal. Code Reg. §§ 14000-14005*].

NOTE:

The report requirement imposed by *Labor Code Section 6409.1(a)* has been amended with a delayed effective date to require the insured employer to file the report with the insurer (on a Division of Workers' Compensation form prescribed for that purpose) within five days after the employer obtains knowledge of the injury or illness. A self-insured employer, the state, or the insurer of an insured employer also must file the report in an electronic form to be prescribed [*Lab. Code § 6409.1(a)* as amended by Stats. 2008, ch. 740, § 1]. These changes are effective on the effective date of implementing regulations to be adopted by the Department of Workers' Compensation, provided those regulations specify a transition period of no less than 180 days and no more than 545 days in which the employer or insurer may continue to comply with Section 6409.1 in its pre-amendment form [Stats. 2008, ch. 740, § 3].

In any case involving a serious injury or illness [*see 8 Cal. Code Reg. § 330(h)* ("serious injury or illness" defined)] or death, the employer must immediately report to the Division of Occupational Safety and Health by telephone or telegraph in addition to filing a report [*Lab. Code § 6409.1(b)*; *see 8 Cal. Code Reg. § 342*].

[2] Federal Law

Even though Cal/OSHA is responsible for enforcingfederal OSHA standards in California [*see § 1C.80 [1]*], employers must still maintain any records and file any reports with the Secretary of Labor that are required by the federal Occupational Safety and Health Act [*Lab. Code § 6410*; *see 29 U.S.C. § 657*; *29 C.F.R. §§ 1904.1-1904.22*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthDuties & RightsLabor & Employment LawPosting & Recordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
2. Safety, Health, and Access Regulations

1-1C California Legal Forms--Transaction Guide § 1C.85

§ 1C.85 Duty to Maintain Log and Summary of Injuries and Illnesses

[1] In General

With the exemptions listed in [2], *below*, every private employer must maintain a log on a prescribed form of all recordable occupational injuries and illnesses for each establishment, and enter each recordable occupational injury and illness on the log as soon as practicable within seven days after learning that the injury or illness has occurred[*8 Cal. Code Reg. § 14300.29(b)(3)*; *see 8 Cal. Code Reg. § 14300.4-14300.11* (recording criteria)]. In addition, employers must complete an incident report for each injury or illness reported in the log, and an annual summary of all injuries and illnesses [*8 Cal. Code Reg. § 14300.29(a)*; *see 8 Cal. Code Reg. § 14300.29(b)(2)*]. A separate log must be maintained for each establishment of a business [*8 Cal. Code Reg. § 14300.30*]. For recordkeeping purposes, the term "establishment" includes each "single physical location" where business is conducted or services or operations are performed, and each "distinctly separate activity" at a single physical location [*8 Cal. Code Reg. § 14300.6*].

Logs, summaries, and supplementary records must be established on a calendar-year basis [*see 8 Cal. Code Reg. § 14300.32(a)*], and must be maintained for five years after the end of the year to which they relate [*see 8 Cal. Code Reg. §§ 14300.33(a), 14300.44*]. The summary must be posted in a customary posting place for employee notices [*see 8 Cal. Code Reg. § 14300.32(a)(4), (b)(5), (6)*; *see also 8 Cal. Code Reg. § 14300.43* (transition rules)]. Logs and summaries must be available for examination and copying by employees, former employees, and employee representatives [*see 8 Cal. Code Reg. § 14300.35(a)(2), (b)*]. The employer must also make the logs, summaries, and supplementary records available for inspection and copying by officials [*see 8 Cal. Code Reg. § 14300.40*].

Employers may be required to complete an annual survey of occupational injuries and illnesses [*see 8 Cal. Code Reg. § 14300.41*].

Employers engage in physically dispersed operations are subject to special recordkeeping requirements [*see 8 Cal. Code Reg. § 14300.30*].

[2] Exemptions

Employers of no more than 10 employees in a calendar year and employers classified in the retail, service, finance, insurance, or real estate industries listed in *8 Cal. Code Reg. § 14300.2* are exempt from regular recordkeeping requirements [*see 8 Cal. Code Reg. §§ 14300.1(a), 14300.2(a)*]. These exemptions do not relieve the employers of their reporting obligations [*8 Cal. Code Reg. §§ 14300.1(a), 14300.2(a)*].

Employers subject to the federal Mine Safety and Health Act [*see 30 U.S.C. § 801 et seq.*] are not required to comply with these recordkeeping requirements if compliance would duplicate requirements under the Act [*8 Cal. Code Reg. § 14300.47*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Workers' Compensation & SSDIPosting & Recordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
2. Safety, Health, and Access Regulations

1-1C California Legal Forms--Transaction Guide § 1C.86

§ 1C.86 Duty to Provide Medical Examinations

Employers using carcinogens must provide medical examinations for affected employees when required [*Lab. Code § 9040*; *see 8 Cal. Code Reg. §§ 450-8618* (standards)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthDuties & Rights



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
2. Safety, Health, and Access Regulations

1-1C California Legal Forms--Transaction Guide § 1C.87

§ 1C.87 Duty to Obtain Permits

[1] Employment Involving Substantial Risk of Injury

For employments or places of employment that involve a substantial risk of injury, the employer must first obtain a permit from the Division of Occupational Safety and Health before any work can be done. Permits must be obtained for the following types of work [*Lab. Code § 6500*]:

(1) The construction of trenches or excavations at least five feet deep into which a person is required to descend.

(2) The construction of a building, structure, falsework, or scaffold more than three stories high, or the equivalent height.

(3) The demolition of a building, structure, falsework, or scaffold more than three stories high, or the equivalent height.

(4) The underground use of diesel engines for work in mines and tunnels.

The application must contain sufficient information for DOSH to evaluate the safety of the employment or place of employment, and must contain a provision stating that the employer knows the applicable occupational safety and health standards and orders and will comply with them [*Lab. Code § 6501*; *see 8 Cal. Code Reg. §§ 341-341.5* (permit regulations)].

[2] Asbestos-Related Work

An employer engaged in asbestos-related work [*see Lab. Code § 6501.8(a)* ("asbestos-related work" defined)] that involves 100 square feet or more of surface area of asbestos-containing material must register with DOSH. The employer must meet certain criteria and must provide DOSH with requested information about the asbestos-related

work. DOSH will approve the permit if it is satisfied the employer will provide a safe and healthful place of employment. In addition to obtaining the permit, the employer must post warning signs at the work location [*Lab. Code § 6501.5(c)*]. For further discussion of the regulation of asbestos-related work, see *Section 1C.71*.

[3] Posting of Permit

An employer issued a permit for work involving a substantial risk of injury must post copies of the permit [*Lab. Code § 6504*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Environmental LawHazardous Wastes & Toxic SubstancesAsbestosWork Practice StandardsLabor & Employment LawOccupational Safety & HealthDuties & Rights



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
2. Safety, Health, and Access Regulations

1-1C California Legal Forms--Transaction Guide § 1C.88

§ 1C.88 Duty to Notify of Concealed Dangers

A corporation or manager who knows of a seriousconcealed danger subject to regulation by certain government agencies must, within 15 days after learning of the danger (or immediately if there is imminent risk of great bodily harm or death), do both of the following [*Penal Code § 387(a)*]:

(1) Inform the Division of Occupational Safety and Health (DOSH) of the condition.

(2) Warn its affected employees of the condition.

The term "serious concealed danger" means a product or business practice that, in normal or foreseeable use, creates a substantial probability of death, great bodily harm, or serious exposure to an individual, where the danger is not readily apparent to the individual likely to be exposed to the danger [*Penal Code § 387(b)(4)*].

Notice to DOSH and the employees must be in writing unless the corporation or manager has actual knowledge that DOSH and the employees have been notified. Disclosure need not be made if the hazard is corrected within the time prescribed for reporting [*Penal Code § 387(a)(2)(A), (B)*]. A corporation or manager failing to comply with this provision is subject to fine and imprisonment [*Penal Code § 387(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthDuties & Rights



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
2. Safety, Health, and Access Regulations

1-1C California Legal Forms--Transaction Guide § 1C.89

§ 1C.89 Duty to Provide Access to Employees With Disabilities

[1] Under Fair Employment and Housing Act

Under the Fair Employment and Housing Act [*see Gov. Code §§ 12900-12996*], it is an unlawful employment practice to discriminate against a person because of the person's physical disability [*Gov. Code § 12940(a)*]. To avoid a charge of discrimination, an employer must make reasonable accommodation to the physical disability of a disabled person if the employer knows of the disability, by methods such as making facilities readily accessible to and usable by disabled persons, and making structural alterations to buildings and grounds [*2 Cal. Code Reg. § 7293.9(a)(1), (3)*]. It is not unlawful employment discrimination,however, for an employer to refuse to make an accommodation for an employee with a physical disability that would cause the employer undue hardship [*Gov. Code § 12994*; *see 2 Cal. Code Reg. § 7293.9(b)*].

[2] Under Americans With Disabilities Act

In addition to prohibiting employer discrimination against an individual with a disability [*see 42 U.S.C. § 12113*], the Americans With Disabilities Act of 1990 (ADA) [*see 42 U.S.C. §§ 12101-12213*] requires that commercial facilities constructed for first occupancy after January 1, 1993, and existing facilities altered after January 26, 1992, be readily accessible to individuals with disabilities [*see 42 U.S.C. §§ 12182(a), 12183(a)*]. "Commercial facilities" are facilities that are intended for nonresidential use and whose operation will affect commerce [*42 U.S.C. § 12181(2)*; *see 42 U.S.C. § 12181(1)* ("commerce" defined)]. The implementing regulations [*see 28 C.F.R. §§ 36.101-36.608*] require commercial facilities to be designed, constructed, and altered in compliance with federal accessibility standards [*28 C.F.R. § 36.101*]. Specific accessibility guidelines are set forth in the ADA Accessibility Guidelines for Buildings and Facilities [*see* 28 C.F.R. pt. 36, app. A].

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil Rights LawProtection of Disabled PersonsAmericans With Disabilities ActAccommodation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
2. Safety, Health, and Access Regulations

1-1C California Legal Forms--Transaction Guide § 1C.90

§ 1C.90 Duty Regarding Agricultural Workers

The Migrant and Seasonal Agricultural Worker Protection Act [*see 29 U.S.C. §§ 1801-1872*] regulates the hiring and treatment of certain types of agricultural workers. Farm labor contractors must register with the Secretary of Labor [*29 U.S.C. § 1811(a)*; *see 29 U.S.C. § 1802* (definitions)], and may not knowingly recruit, hire, or employ unlawful aliens [*see 29 U.S.C. § 1816*].

Farm labor contractors, agricultural employers, andagricultural associations must provide employment information to workers, and must keep records regarding their workers [*see 29 U.S.C. §§ 1821*, *1831*]. In addition, contractors, employers, and associations must pay their employees' wages when due, must not require workers to purchase goods or services solely from the contractor, employer, or association, and must not violate the terms of any working arrangement [*see 29 U.S.C. §§ 1822*, *1832*].

It is unlawful to discriminate against an agricultural worker for filing a complaint or instituting a proceeding relating to migrant or seasonal workers [*29 U.S.C. § 1855(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsCoverage & DefinitionsEmploy



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART II. LEGAL BACKGROUND
C. Environmental, Safety, Health, and Access Regulations
2. Safety, Health, and Access Regulations

1-1C California Legal Forms--Transaction Guide §§ 1C.91-1C.99

[Reserved]

§§ 1C.91[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1C California Legal Forms--Transaction Guide § 1C.100

§ 1C.100 Hiring Employees

[1] Facts

1. Type of business, including description of all activities to be engaged in.

2. Location of business.

3. Whether employees or independent contractors will be used [*see* vol. 15, Ch. 84, *Independent Contractors*].

4. Total number of employees to be hired.

5. Number and type of positions to be filled, such as:

a. Executives.

b. Supervisors.

c. Production or office staff.

d. Sales staff.

e. Support staff.

6. Minimum qualifications for each position, including objective criteria, such as:

a. Professionals are properly licensed (for example, lawyers have successfully passed

state bar exam).

b. Employees in safety-sensitive industries have passed physical examinations and drug tests (for example, railroad employees have passed federal pre-employment drug test).

7. Age of any minors to be employed.

[2] Documents

NOTE:
The following documents are those typically used in the process of hiring employees. Depending on the individual employee, certain documents may not be required.

1. Advertisement for jobs.

2. Employment application form.

3. Employee's resume or other supporting documentation.

4. Document proving prospective employee is not unauthorized alien [*see 8 U.S.C. § 1324a(b)(1)*].

NOTE:
For a list of these documents, see *Section 1C.110*, Paragraph 4.

5. If employee is minor:

a. Age certificate; or

b. Permit to employ.

6. Results of pre-employment test, such as:

a. Job skill test.

b. Physical examination.

c. Drug test.

7. Employment agreement, if desired [*see* vol. 15, Ch. 85, *Employment Agreements*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEmployee PrivacyAlcohol & Drug TestingLabor & Employment LawPreemployment Practices



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1C California Legal Forms--Transaction Guide § 1C.101

§ 1C.101 Employee Programs and Benefits

[1] Facts

NOTE:
This list is intended to alert employers to the types of plans they may provide for employees. For a complete discussion of these types of plans, see Chapter 1D, ***Overview of Employee Benefits*** .

1. Insurance coverage for employees:

    a. Medical coverage.

    b. Dental coverage.

    c. Vision care.

    d. Prescription coverage.

2. Long-term disability coverage.

3. Pension or retirement plan.

4. Profit-sharing plan.

5. Employee stock ownership plan.

6. Employee savings plan.

7. Tuition aid and scholarship plans.

8. Substance abuse program.

9. Family counseling.

10. Emergency psychological assistance.

[2] Documents

1. Medical plan policy, including policies for:

    a. Dental coverage.

    b. Vision care.

    c. Prescription coverage.

2. Text of pension or profit-sharing plan.

3. Text of retirement plan.

4. Text of long-term disability plan.

5. Text of employee stock ownership plan.

6. Text of employee savings plan.

7. Text of employee assistance plans, such as:

    a. Substance abuse program.

    b. Family counseling program.

    c. Emergency psychological assistance.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansGeneral OverviewPensions & Benefits LawEmployee Benefit PlansDefined Contribution PlansPensions & Benefits LawEmployee Benefit PlansPension Benefit PlansPensions & Benefits LawEmployee Benefit PlansWelfare Benefit Plans



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1C California Legal Forms--Transaction Guide § 1C.102

§ 1C.102 Employment Taxes

[1] Facts

NOTE:
For a discussion of employment taxes, see Chapter 1E, ***Taxation of Businesses*** . For a discussion of workers' compensation and state unemployment compensation, see Chapter 1D, ***Overview of Employee Benefits*** .

1. Number of employees.

2. Amount of wages paid to each employee.

3. Amount of withholding from each employee's wages for:

    a. Income tax.

    b. Social Security and Medicare taxes.

    c. Disability insurance tax.

4. Amount of employer contribution for:

    a. Unemployment insurance tax.

    b. Social Security and Medicare taxes.

    c. Employment training tax.

5. Premium for workers' compensation insurance.

[2] Documents

NOTE:
The forms listed below are the tax forms generally necessary to file required California and federal employee income, unemployment insurance, disability insurance, and employment training taxes. In general, state forms are available from the Employment Development Department (EDD), and federal forms are available from the Internal Revenue Service (IRS). For discussion of the use of these forms, see Employment Development Department Booklet DE 44, California Employer's Guide, available from any employment tax district office of the Employment Development Department, and IRS Circular E, Employer's Tax Guide, available from any IRS office. For a general discussion of employment taxes and compensation programs, see Chapters 1D, ***Overview of Employee Benefits*** , and 1E, ***Taxation of Businesses*** .

1. Tax deposit coupon:

a. California--EDD Form DE 88.

b. Federal--Treasury Dep't Form FTD 501 or FTD 511.

2. Quarterly contribution return:

a. California--EDD Form DE 3DP.

b. Federal:
(1) Income, Social Security, and Medicare Tax--IRS Form 941

(2) Unemployment--IRS Form 940.

3. Reconciliation of income tax withheld and transmittal of IRS Forms W-2 and 1099-R:

a. California--EDD Form DE 43.

b. Federal--IRS Form W-3.

4. Combined federal/state wage and tax statement--IRS Form W-2.

5. Statement for distribution from pensions, annuities, retirement or profit-sharing plans, IRAs, and insurance contracts--IRS Form 1099-R.

6. Employer registration:

a. California--EDD Form DE 1.

b. Federal--IRS Form SS-4.

7. Employee's withholding allowance certificate:

a. California--EDD Form DE 4.

b. Federal--IRS Form W-4.

8. Withholding exemption certificate:

a. California--EDD Form DE 4.

b. Federal--IRS Form W-4.

9. Withholding certificate for pension or annuity payments:

a. California--EDD Form DE 4P.

b. Federal--IRS Form W-4P.

10. Request for state income tax withholding from sick pay:

a. California--EDD Form DE 4S.

b. Federal--IRS Form W-4S.

11. Annual return for income tax withheld on nonpayroll items, such as pensions, annuities, IRAs, military retirement, gambling winnings, and backup withholding: IRS Form 945.

12. California report of new employees: EDD Form DE 34.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)General OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FICA DeductionsTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FUTA Rate of TaxTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)Income Tax Collected at SourceTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)Liability for Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1C California Legal Forms--Transaction Guide § 1C.103

§ 1C.103 Wages and Hours

NOTE:
For discussion of California and federal wage and hour restrictions, see *Sections 1C.50 through 1C.63*.

[1] Facts

1. Type of business.

2. Industrial Welfare Commission (IWC) wage orders that apply to particular occupation, trade, or industry.

3. Whether business is subject to Fair Labor Standards Act (FLSA) because employees are:

a. Engaged in commerce or in production of goods for commerce; or

b. Employed in enterprise engaged in commerce or production of goods for commerce.

4. If minors are employed:

a. Age of each minor.

b. Hours minors will work.

c. Task(s) minors will perform.

5. Whether overtime pay is required by employees' work schedule.

6. Whether employment is on public works project, requiring employer to pay prevailing wage.

7. Required days off, meal periods, and breaks.

8. Time, place, and form of wage payment.

[2] Documents

1. Employee notices to be posted:

a. Payday notice [*see § 1C.230*].

b. Wage orders relating to occupation, trade, or industry [*see 8 Cal. Code Reg. §§ 11010-11150*].

c. Workers' compensation information:
(1) Certificate of consent to self-insure [*see Lab. Code § 3550(a)*; *8 Cal. Code Reg. § 15350.2*]; or

(2) Notice of workers' compensation insurance carrier [*see Lab. Code § 3550(a)*; *8 Cal. Code Reg. § 15565*].

d. Notice of employees' right to take time off work to vote [*see § 1C.231*].

e. Federal Equal Employment Opportunity Commission discrimination information [*see 29 C.F.R. §§ 1601.30* (Title VII and ADA), 1627.10 (ADEA)].

f. Wage and hours information for businesses covered by minimum wage provisions of Fair Labor Standards Act [*see 29 C.F.R. § 516.4*].

g. Federal polygraph test information [*see 29 C.F.R. § 801.6*].

2. Age certificate or work permit for each minor [*see 29 C.F.R. § 570.5(b)*].

3. California and federal drug-free workplace statement, for recipients of contracts or grants [*see § 1C.234*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawPosting & RecordkeepingLabor & Employment LawWage & Hour LawsRecordkeeping RequirementsLabor & Employment LawWage & Hour LawsWage PaymentsWorkers' Compensation & SSDIPosting & Recordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1C California Legal Forms--Transaction Guide § 1C.104

§ 1C.104 Environmental, Safety, Health, and Access Regulations

[1] Facts

1. Known presence of any of following on premises:

    a. Asbestos.

    b. Hazardous waste.

    c. Other hazardous materials.

2. Types of materials and substances employees come in contact with in performing jobs.

3. Emergency access to building.

4. Safe and proper stairs, walkways, ladders, doors, and other access ways in building.

5. Necessary access in building and other facilities for employees with disabilities [*see § 1C.89* (FEHA and ADA)].

[2] Documents

1. Written injury and illness prevention program [*see § 1C.221*].

2. Written emergency action plan and fire prevention plan [*see § 1C.83*].

3. Proposition 65 warning [*see § 1C.74*].

4. Material Safety Data Sheets (MSDS) for hazardous substances in workplace [*see § 1C.70*].

5. Federal OSHA information [*see 29 C.F.R. § 1903.2(a)(1)*].

6. Cal/OSHA posters and safety orders [*see 8 Cal. Code Reg. §§ 340, 3204(g)*]:

a. "Safety and Health Protection on the Job."

b. "Access to Medical and Exposure Records."

7. Listing of telephone numbers to be called in emergencies [*see 8 Cal. Code Reg. § 1512(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthGeneral OverviewLabor & Employment LawPosting & Recordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1C California Legal Forms--Transaction Guide §§ 1C.105-1C.109

[Reserved]

§§ 1C.105[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1C California Legal Forms--Transaction Guide § 1C.110

§ 1C.110 Determinations Relating to Hiring and Use of Employees

1. Determine whether client wishes to operate business using employees or independent contractors by considering all of following:

NOTE:
A variety of considerations must be taken into account in determining whether to use independent contractors or employees. For discussion of these considerations, see Volume 15, Chapter 84, ***Independent Contractors***. If the business owner chooses to use only independent contractors, most of the regulations on employers in this chapter will not apply.

a. Determine whether work to be performed requires extensive supervision.

b. Determine degree of control employer wishes to maintain over workers.

c. Determine whether type of business is better suited to use of employees or to use of independent contractors.

NOTE:
For a list of types of services that are commonly performed by independent contractors, see Volume 15, Chapter 84, ***Independent Contractors***.

d. Determine relative cost of use of employees and independent contractors.

2. Determine number, type, and qualifications of employees client wishes to use.

3. Determine whether employees sought will be members of labor union or other organized labor group:

NOTE:

Businesses employing organized employees are subject to the Labor Management Relations Act [***see*** *29 U.S.C. §§ 141-187*] if the business affects interstate commerce. Virtually all business activity "affects interstate commerce" [***see*** *NLRB v. Reliance Fuel Oil Corp. (1963) 371 U.S. 224, 226-227, 83 S. Ct. 312, 9 L. Ed. 2d 279]* . Employers of organized agricultural labor have collective bargaining obligations under the California Agricultural Labor Relations Act [***see*** *Lab. Code §§ 1140-1166.3*; ***see also*** *8 Cal. Code Reg. §§ 20100-21200*].

a. Are employees in employer's locale and type of business generally unionized?

b. Can employer obtain sufficiently skilled non-union labor at reduced cost?

c. Is use of union labor desirable or required?

d. Is employer willing to bargain and deal fairly with union labor?

4. Determine whether prospective employee can prove he or she is not unauthorized alien by producing any of following [*8 U.S.C. § 1324a(a)(1), (b)(1)*]:

NOTE:

It is unlawful to hire an alien for employment in the United States knowing the alien is an unauthorized alien, or without requiring proof of eligiblity for employment [*8 U.S.C. § 1324a(a)(1), (b)*]. It is also unlawful to continue to employ an alien knowing he or she is not authorized to be employed [*8 U.S.C. § 1324a(a)(2)*].

a. United States passport.

b. Certificate of United States citizenship.

c. Certificate of naturalization.

d. Unexpired foreign passport, if it has unexpired endorsement of Attorney General authorizing employment.

e. Resident alien card or other alien registration card if card sets forth:

(1) Photograph or other identifying information.

(2) Evidence of authorization of employment in United States.

f. One document specified in (1), *below*, and one document specified in (2), *below*:

(1) Social security account number card, certificate of birth in United States, certificate of birth showing United States citizenship, or other document showing employment authorization; and

(2) Driver's license or other state identification card containing photograph, or, for persons under 16 years of age, other documentation of personal identity.

5. If minors are to be employed, advise client to:

a. Determine that each minor is of legal age to perform particular job.

b. Determine that each minor has age certificate or permit to employ.

NOTE:
California and federal law require an employer to obtain an age certificate or permit to employ for minors under 18 years of age in certain jobs. For further discussion, see *§§ 1C.60[2], 1C.61[5]*.

6. Determine whether client requires or wishes written employment contract.

NOTE:
The statute of frauds requires that certain contracts must be in writing to be valid [***see** Civ. Code § 1624*]. For discussion of the statute of frauds and the desirability and use of written employment agreements, see Ch. 85, ***Employment Agreements*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Immigration LawDuties & Rights of AliensEmploymentLabor & Employment LawEmployment RelationshipsAt-Will EmploymentEmployeesLabor & Employment LawEmployment RelationshipsIndependent ContractorsLabor & Employment LawPreemployment PracticesLabor & Employment LawWage & Hour LawsChild Labor



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1C California Legal Forms--Transaction Guide § 1C.111

§ 1C.111 Determinations Relating to Required Registration and Permits

1. Determine whether business must obtain federal employer identification number because it does both of the following [*Treas. Reg. § 31.6011(b)-1(a)(1)(ii)*]:

NOTE:
To apply for an identification number, complete IRS Form SS-4 and attach any required supplementary statement. The form is available from any IRS office or Social Security Administration office [*Treas. Reg. §§ 31.6011(b)-1(a)(1)(iii),* 301.6109-1(d)(2)].

a. Employs one or more individuals.

b. Pays wages that are subject to:
(1) Federal Insurance Contributions Act (Social Security and Medicare); or

(2) Income tax withholding [*see I.R.C. § 3402*].

2. Determine whether business must register with California Employment Development Department (EDD) because it has done both of following for any portion of day within current or past calendar year [*Unemp. Ins. Code §§ 135, 675, 1086(a)*]:

NOTE:
To apply for an identification number, complete EDD Form DE-1. The form is available from EDD employment tax district offices.

a. Employed one or more employees.

b. Paid wages for employment in excess of $100 during any calendar quarter.

3. Determine whether business will employ minors, requiring it to:

NOTE:
For discussion of the employment of minors and when child work permits must be obtained, see California Employment Law, Ch. 6, ***Child Labor Laws*** (Matthew Bender).

a. Obtain permit to employ from appropriate county, school-district, or charter-school official, or from principal or other designated administrator of school attended by minor [*see Educ. Code § 49110*; *see* also *§ 1C.60[2]*].

b. Register with Department of Education [*see Educ. Code §§ 49160, 49162, 49163*].

c. Keep on file one of following [*see 29 C.F.R. §§ 570.5(b), 570.9(a)*]:

(1) Federal certificate of age, issued by person authorized by Administrator of Wage and Hour Division of Department of Labor.

(2) State certificate, issued by, or under supervision of, state agency.

NOTE:
To protect itself from an unwitting violation of oppressive child labor laws, a business employing minors must have on file an unexpired proof of age [*29 C.F.R. § 570.5(a)*; ***see*** *29 U.S.C. § 203(l)* ("oppressive child labor" defined)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1C California Legal Forms--Transaction Guide § 1C.112

§ 1C.112 Determinations Relating to Environmental, Safety, and Access Regulations

NOTE:
For discussion of employee safety and health, see *§§ 1C.80 through 1C.90*. For discussion of an employer's responsibilities regarding hazardous substances, see *§§ 1C.70 through 1C.75*. For discussion of an employer's duty to provide reasonable access to employees with disabilities, see *§ 1C.89*.

1. Determine whether hazardous substances exist on premises that pose health risk to employees:

   a. Hazardous waste.

   b. Asbestos.

   c. Pesticides.

   d. Other hazardous substances.

2. Determine whether unsafe condition exists on premises that could harm employees:

   a. Machinery without proper guards, switches, and other emergency equipment.

   b. Stairways, catwalks, and other accessways without railings or other safety features.

   c. Inadequate, improperly marked, or blocked emergency exits.

   d. Cluttered aisles and doorways.

3. Determine whether condition exists limiting access of employees with disabilities:

a. Stairways, aisles, doors, facilities, and rooms that inhibit access of wheelchair user.

b. Stairway, walkway, and other obstructions that inhibit access of vision-impaired employees.

4. Determine whether heating and air conditioning system has condition that will affect employees sensitive to airborne contaminants.

5. Determine whether all applicable safety orders and other safety and health regulations have been complied with.

6. Determine whether all required safety and health notices, warnings, and citations have been posted.

7. Determine whether procedures for documenting and reporting occupational injuries and illnesses are being complied with.

8. Determine whether procedures for discovering and abating unsafe work conditions and practices are being complied with.

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthGeneral OverviewLabor & Employment LawPosting & RecordkeepingWorkers' Compensation & SSDIPosting & Recordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1C California Legal Forms--Transaction Guide §§ 1C.113-1C.119

[Reserved]

§§ 1C.113[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1C California Legal Forms--Transaction Guide § 1C.120

§ 1C.120 Procedural Guide to Hiring Employees

1. Confirm with client type and number of positions to be filled.

2. Establish time and place of interviews.

3. Advertise positions available:

a. For non-specialized employment, in:
(1) Local newspaper of wide circulation.

(2) Job offices of local high schools and colleges.

(3) Employment agency.

(4) Employment Development Department office.

b. For specialized employment, in:

(1) Industry publications.

(2) Applicable college departments.

c. Do not advertise employment in manner that indicates preference, limitation, specification, or discrimination based on following categories [*42 U.S.C. § 2000e-3(b)*]:

(1) Race.

(2) Color.

(3) Religion.

(4) Sex.

(5) National origin.

(6) Age.

NOTE:
An advertisement may include a preference, limitation, specification, or discrimination based on religion, sex, or national origin if the category is a bona fide occupational qualification (BFOQ) [*42 U.S.C. § 2000e-3(b)*]. However, BFOQ determinations are intended to have a limited scope and application, and are to be narrowly construed [***see, e.g.,*** *29 C.F.R. §§ 1606.4* (national origin discrimination), 1625.6 (age discrimination)].

d. Do not advertise in manner that expresses, directly or indirectly, any limitation, specification, or discrimination based on following categories [*Gov. Code § 12940(d)*]:

(1) Race.

(2) Religious creed.

(3) Color.

(4) National origin.

(5) Ancestry.

(6) Physical disability.

(7) Mental disability.

(8) Medical condition.

(9) Marital status.

(10) Sex.

(11) Age.

NOTE:
Nothing in California's FEHA bars an employer or employment agency from inquiring into the age of an applicant, or from specifying age limitations, when the law compels or provides for that action [*Gov. Code § 12940(d)*].

(12) Sexual orientation.

4. Advise client to limit pre-employment inquiries to relevant areas:

a. Citizenship or authorized alien status [*see 8 U.S.C. § 1324a*].

NOTE:

The employer must attest on a verification form that it has verified that the individual is not an unauthorized alien by examining the required document [***see** 8 U.S.C. § 1324a(b)(1)(B)-(D)*]. Verification is satisfied if a document reasonably appears on its face to be genuine [*8 U.S.C. § 1324a(b)(1)(A)*]. The employer must retain the verification form for a specified period and make it available to federal officials on request [***see** 8 U.S.C. § 1324a(b)(3)*].

b. Age, within certain limits.

NOTE:

It is unlawful for an employer to discriminate on the basis of age for individuals who are over 40 years of age [*29 U.S.C. §§ 623(a), 631(a)*]. However, requests for age or date of birth do not violate the ADEA if made for a proper purpose. Employers who request age or date of birth should provide a notice on applications stating that the ADEA prohibits age discrimination [***see** 29 C.F.R. § 1625.5*].

Nothing in California's FEHA bars an employer or employment agency from inquiring into the age of an applicant, or from specifying age limitations, when the law compels or provides for that action [*Gov. Code § 12940(d)*].

c. Education.

NOTE:

An employer may inquire about education as long as it bears a demonstrable relationship to successful job performance [*Griggs v. Duke Power Co. (1971) 401 U.S. 424, 431, 91 S. Ct. 849, 28 L. Ed. 2d 158]* .

d. Job experience.

NOTE:

Employers may inquire about past job experience if it is indicative of important aspects of performance on the job for which applicants are to be evaluated. Employers who consider past work experience must also consider unpaid or volunteer work experience [***see** 2 Cal. Code Reg. § 7291.0(d)*].

e. Height, weight, and physical ability.

NOTE:

An employer may impose height, weight, and strength standards if they are necessary for the requirements of the job [***see*** Blake v. City of Los Angeles (9th Cir. [Cal.] 1979) *595 F.2d 1367, 1375* , ***cert. denied***, *446 U.S. 928, 100 S. Ct. 1865, 64 L. Ed. 2d 281 (1980)]* . However, standards that have a discriminatory impact are invalid unless the employer can show a "business necessity" for the standards [***see** Blake v. City of Los Angeles (9th Cir. 1979) 595 F.2d 1367, 1376* , ***cert. denied***, *446 U.S. 928, 100 S. Ct. 1865, 64 L. Ed. 2d 281 (1980)]* .

f. Veteran status.

NOTE:

Title VII expressly authorizes special rights and preferences for veterans [***see*** *42 U.S.C. § 2000e-11*].

Nothing in California's FEHA bar against discrimination on account of sex affects an employer's right to use veteran status as a factor in employee selection or to give special consideration to Vietnam era veterans [*Gov. Code § 12940(a)(4)*].

g. Investigative report.

NOTE:

An employer may use an investigative consumer report for employment purposes. If the report is sought for employment purposes other than suspicion of wrongdoing by the subject of the investigation, the person procuring or causing the report to be made must (1) have a permissible purpose [***see*** *Civ. Code § 1786.12*]; and (2) provide a clear and conspicuous disclosure in writing to the consumer before the report is procured or caused to be made, in a document consisting solely of the disclosure, as required by statute. In addition, the consumer must give written authorization for the procurement of the report [*Civ. Code § 1786.16(a)(2), (c)*]. For further discussion, see *§ 1C.21[8]*.

h. Credit report.

NOTE:

An employer may obtain a consumer credit report from a consumer credit reporting agency if it intends to use the information for employment purposes [*Civ. Code § 1785.11(a)(3)(B)*; ***see*** *15 U.S.C. §§ 1681-1681t* (Fair Credit Reporting Act of 1970)]. Before requesting a report, the employer must give written notice to the applicant of the report, and provide a means for the applicant to receive a copy of the report [*Civ. Code § 1785.20*.5(a)].

i. Fingerprints and photographs.

NOTE:

An employer may take fingerprints and photographs of applicants and employees for the employer's own use [10 Ops. Atty. Gen. 19, 21 (1947)]. An employer who requires fingerprints or photographs as a condition of employment may not give them to any other person when they could be used to the applicant's or employee's detriment [*Lab. Code § 1051*]. Fingerprints are required of persons employed in a number of regulated professions [***see, e.g.,*** *Bus. & Prof. Code §§ 7525.1* (private investigators), 7546 (security guards)].

Special rules regarding fingerprints apply to employees of banks and savings and loan associations and persons involved in the trading of securities [***see*** *15 U.S.C. § 78q(f)(2)*].

j. Subjective criteria, such as [*Frausto v. Legal Aid Soc. of San Diego, Inc. (9th Cir. 1977) 563 F.2d 1324, 1325-1326]* :

NOTE:

While the use of subjective criteria in making employment decisions is not per se illegal, to the extent the criteria reflect subconscious stereotypes and prejudices, they may be unlawful as disparate impact discrimination [*Watson v. Fort Worth Bank and Trust (1988) 487 U.S. 977, 990-991, 108 S. Ct. 2777, 101 L. Ed. 2d 827]* .

(1) Stable employment history.

(2) Professional reputation.

(3) Ability to get along with others.

(4) General demeanor.

5. Advise client to consider other relevant factors:

a. Fluency in English.

NOTE:
Denying employment because of a foreign accent or inability to communicate well in English may constitute national origin discrimination [***see*** *29 C.F.R. § 1606.6(b)(1)*].

b. Personal appearance and dress.

NOTE:
A private employer may require male and female employees to adhere to different standards of dress and appearance without violating Title VII [*Baker v. California Land Title Company (9th Cir. 1974) 507 F.2d 895, 898* , ***cert. denied***, *422 U.S. 1046, 95 S. Ct. 2664, 45 L. Ed. 2d 699 (1975)* ; ***see*** *42 U.S.C. § 2000e-2(a)*].

6. Notify client of restrictions and prohibitions governing inquiries into following topics:

NOTE:
It is an unlawful employment practice for an employer to discriminate against an individual because of his or her race, color, religion, sex, or national origin [***see*** *42 U.S.C. § 2000e-2(a)*]. Inquiries based on these categories are unlawful unless they come within one of the limited exceptions discussed below.

The Fair Housing and Employment Act prohibits any non-job related inquiry that expresses any limitation, specification, or discrimination concerning race, religious creed, color, national origin, ancestry, physical or mental disability, medical condition, marital status, sex, age, or sexual orientation [***see*** *Gov. Code § 12940(a), (d)*].

For a detailed discussion of federal and state law relating to employment discrimination, see California Employment Law, Ch. 41, ***Substantive Requirements Under Equal Employment Opportunity Laws*** (Matthew Bender).

a. Race, color, or national origin [*see 42 U.S.C. § 2000e-2*; *see also Gov. Code § 12940(a), (d)*].

NOTE:
Title VII and the Fair Housing and Employment Act prohibit employment discrimination

based on national origin, race, and color [***see*** *42 U.S.C. § 2000e-2*; *Gov. Code § 12940(a)*]. "National origin" refers to the country where a person was born, or the country from which his or her ancestors came [*Espinoza v. Farah Mfg. Co. (1973) 414 U.S. 86, 88, 94 S. Ct. 334, 38 L. Ed. 2d 287]* . While "race" has not been defined under Title VII, in the context of *42 U.S.C. § 1981*, the Supreme Court determined that "race" means identifiable classes of persons who are subjected to intentional discrimination solely because of their ancestry or ethnic characteristics [*Saint Francis College v. Al-Khazraji (1987) 481 U.S. 604, 613, 107 S. Ct. 2022, 95 L. Ed. 2d 582]* .

b. Sex.

NOTE:

A pre-employment inquiry that expresses any limitation, specification, or discrimination based on sex is unlawful unless based on a bona fide occupational qualification. However, an employer may inquire as to the sex of the applicant in good faith for a nondiscriminatory purpose [*29 C.F.R. § 1604.7*; ***see*** *42 U.S.C. § 2000e-2*].

Under California's FEHA, a pre-employment inquiry that directly or indirectly expresses any limitation, specification, or discrimination on the basis of sex is unlawful unless based on a bona fide occupational qualification or on applicable federal or state security regulations [*Gov. Code § 12940(a), (d)*]. However, nothing in the bar against discrimination on account of sex affects an employer's right to use veteran status as a factor in employee selection or to give special consideration to Vietnam era veterans [*Gov. Code § 12940(a)(4)*].

c. Religion.

NOTE:

An employer may not inquire into a job applicant's religious practices unless the employer can show the inquiry has no exclusionary effect, and the inquiry is justified by business necessity [*29 C.F.R. § 1605.3(b)(2)*; ***see*** *42 U.S.C. § 2000e-2*; ***see also*** *Gov. Code § 12940(a), (d)*].

d. Information concerning arrests.

NOTE:

In general, an employer may not ask an applicant to disclose information concerning an arrest or detention that did not result in conviction, or information concerning participation in a diversion program [*Lab. Code § 432.7(a)*]. However, this information may be sought from persons seeking employment, or already employed, as peace officers [*Lab. Code § 432.7(e)*], or from applicants for employment at a health facility in a position involving access to patients, drugs, or medication [*Lab. Code § 432.7(f)*].

e. Marital or family status.

NOTE:

Generally, selection of applicants based on marital status or pregnancy or related medical conditions is unlawful sex discrimination [***see*** *42 U.S.C. § 2000e(k)*]. Employers may not ask applicants to disclose marital status, but may ask for any former names used to check past work records [***see*** *Gov. Code § 12940(a), (d)*; ***see also*** *2 Cal. Code Reg. § 7292.4(a), (b)*].

f. Pregnancy.

NOTE:

An employer may not ask questions regarding pregnancy, birth control, or family responsibilities unless they relate to specific and relevant working conditions of a particular job [*2 Cal. Code Reg. § 7290.9(b)(3)*].

g. Physical or mental disability or medical condition.

NOTE:

An employer may not ask a job applicant if he or she is an individual with a physical or mental disability or medical condition, or inquire about the nature or severity of the disability. However, an employer may make pre-employment inquiries into the ability or condition of an applicant to perform job-related functions [*42 U.S.C. § 12112(c)(2)*; ***see*** *Gov. Code § 12940(d), (e)*; ***see also*** *2 Cal. Code Reg. § 7294.0(b)(3)*]. For restrictions applicable to examinations and tests, see P 7, ***below***.

h. Perceived sexual orientation.

NOTE:

The FEHA expressly prohibits discrimination and harassment based on sexual orientation, which is defined to include heterosexuality, homosexuality, and bisexuality [*Gov. Code §§ 12926(q), 12940(a), (j)*]. Under California law, the FEHA occupies the field of employment discrimination and preempts local ordinances prohibiting sexual orientation discrimination in employment [*Delaney v. Superior Fast Freight (1993) 14 Cal. App. 4th 590, 596-598, 18 Cal. Rptr. 2d 33* ; ***see*** *Gov. Code § 12993(c)*].

i. Age.

NOTE:

The FEHA expressly bars discrimination based on age [*Gov. Code § 12940(a), (d)*]. However, an employer or employment agency is not barred from inquiring into the age of an applicant, or from specifying age limitations, when the law compels or provides for that action [*Gov. Code § 12940(d)*].

7. Advise client to conduct following examinations and tests, if desired:

a. Ability test to determine applicant's qualification for duties of job.

NOTE:

It is not an unlawful employment practice to give and act on the results of a professionally developed ability test, provided that the test, its administration, or the action on its results is not designed, intended, or used to improperly discriminate [*42 U.S.C. § 2000e-2(h)*]. However, an employer may not use an employment test that screens out individuals or classes with disabilities unless the test is shown to be job-related for the position in question and is consistent with business necessity [*42 U.S.C. § 12112(b)(6)*].

Under Title VII, before an employer can discard test results to avoid a disparate impact on minority candidates--an act that would itself constitute intentional race-based discrimination against those who did well on the test--the employer must have a strong

basis in evidence to believe it will be subject to disparate-impact liability if it fails to take the race-conscious, discriminatory action of discarding the test results [*Ricci v. DeStefano (2009) 129 S. Ct. 2658, 174 L. Ed. 2d 490, 507-511, 2009 U.S. LEXIS 4945* (adopting "strong-basis-in-evidence" standard to resolve conflict between disparate-treatment and disparate-impact provisions of Title VII); *see 42 U.S.C. § 2000e-2(a)(1)* (prohibition of disparate treatment); *42 U.S.C. § 2000e-2(k)* (prohibition of disparate impact)].

b. Medical examination to determine applicant's physical ability to perform job.

NOTE:

An employer may require a medical examination after an offer of employment has been made to a job applicant, and may condition an offer of employment on the results of the examination, if (1) all entering employees are subject to the examination, regardless of disability, (2) information obtained is treated as a confidential medical record with limited exceptions, and (3) the results of the test are used only as specified in the ADA [*42 U.S.C. § 12112(c)(3)*].

The FEHA allows employers to obtain information about a job applicant's physical condition if the inquiry relates directly to (1) the position the applicant is applying for, or (2) a determination of whether the applicant can safely perform the job [***see** Gov. Code § 12940(d),(e)*]. Specifically, an employer or employment agency may inquire into the applicant's ability to perform job-related functions and may respond to an applicant's request for reasonable accommodation [*Gov. Code § 12940(e)(2)*]. Further, an employer or employment agency may require a medical or psychological examination or make a medical or psychological inquiry after making a job offer but before the commencement of employment duties, provided that (1) the examination or inquiry is job-related and consistent with business necessity, and (2) all entering employees in the same job classification are subject to the same examination or inquiry [*Gov. Code § 12940(e)(3)*].

c. Drug test.

NOTE:

Under a balancing test announced by the California Supreme Court, pre-employment drug testing will be valid if a "competing interest" standard can be met. The result will depend on the public interest, the employer's special interests, and the applicants' reasonable expectations of privacy in a particular employment setting [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 55-56 n.20, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* . A properly planned and administered drug testing program for applicants for jobs that relate to safety, security, or other sensitive issues is likely to be valid.

For specific jobs where safety is paramount, such as airline and railroad operations workers, pre-employment drug testing is mandated by federal law [***see, e.g.,** 14 C.F.R. §§ 120.7(f), 120.35, 120.109(a), 120.101 et seq.* (airlines); *49 C.F.R. §§ 219.501-219.505* (railroads)]. For further discussion, see *§ 1C.21[4]* and California Employment Law, Ch. 41, ***Substantive Requirements Under Equal Employment Opportunity Laws***, and Ch. 50, ***Limitations of Employer Collection of Private Information About Employees*** (Matthew Bender).

d. Alcohol test.

NOTE:

The privacy issues surrounding alcohol tests are similar to those in drug tests [***see*** P c, ***above***; ***see also*** California Employment Law, Ch. 50, ***Limitations on Employer Collection of Private Information About Employees*** (Matthew Bender)].

8. Notify client of prohibitions or limitations relating to following pre-employment tests:

a. AIDS test.

NOTE:

The results of an HIV test [***see*** *Health & Safety Code § 120775(c)*] that identifies or provides identifying characteristics of the person to whom the test results apply may not be used in any instance for the determination of suitability for employment [*Health & Safety Code § 120980(f)*; ***see*** *Health & Safety Code § 121115* (fact of person's participation in AIDS research study may not be used to determine employability)]. The disclosure of HIV positive status may be entitled to privacy protection under *Article I, Section 1, of the California Constitution* [*Urbaniak v. Newton (1991) 226 Cal. App. 3d 1128, 1140, 277 Cal. Rptr. 354]* .

b. Polygraph test.

NOTE:

An employer may not demand or require that a job applicant take a polygraph, lie detector, or similar test as a condition of employment [*Lab. Code § 432.2(a)*; ***see*** *29 U.S.C. §§ 2001-2009*].

9. Advise client to draft and execute employment agreement, if desired by client or employee, or required by employment relationship.

a. If employment agreement is any of following, advise client that it must be in writing:

NOTE:

The statute of frauds requires that certain contracts must be in writing to be valid [***see*** *Civ. Code § 1624*]. For discussion of the statute of frauds and the desirability and use of written employment agreements, see Ch. 85, ***Employment Agreements*** .

(1) Agreement that by its terms is not to be performed within a year from making [*Civ. Code § 1624(a)*].

(2) Agreement employing or authorizing agent, broker, or other person to purchase or sell real estate, lease real estate for longer than a year, or to procure, introduce, or find purchaser or seller of real estate or lessee or lessor of real estate where lease is for longer than a year [*Civ. Code § 1624(d)*].

NOTE:

For extensive coverage of listing agreements, see Ch. 21, ***Agreements With Brokers and Agents*** .

(3) Agreement between employee and employer with no permanent and fixed place of business for services to be rendered in California, and contemplated method of payment includes commissions [*Lab.*

Code § 2751].

(4) Agreement between employee and employer that requires employee to render unique or special services, and employer wishes to be able to obtain injunctive relief [*Civ. Code § 3423(e)*].

b. Advise client not to require applicant to agree to illegal term or condition in employment contract.

NOTE:

An employer may not require an employee to agree, in a written employment contract, to a term or condition the employer knows is against the law [*Lab. Code § 432.5*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEmployment RelationshipsGeneral OverviewLabor & Employment LawPreemployment Practices



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1C California Legal Forms--Transaction Guide § 1C.121

§ 1C.121 Procedural Guide Regarding Employee Insurance and Taxes

NOTE:
For a complete discussion of an employer's rights and obligations regarding unemployment insurance, workers' compensation, disability insurance, and income tax, see Ch. 1D, ***Overview of Employee Benefits*** , and Ch. 1E, ***Taxation of Businesses*** .

1. Advise client to withhold, pay, and account for the following state taxes:

a. Income tax contributions withheld from employees' wages.

NOTE:
Every employer who pays wages to a resident employee within or outside California, or to a nonresident employee for services performed within California, must deduct and withhold income tax from those wages [*Unemp. Ins. Code § 13020(a)*; ***see*** *Rev. & Tax. Code § 17041* (rate of income tax)].

b. Disability insurance contribution withheld from employees' wages.

NOTE:
An employer must withhold worker disability contributions and transmit them to the Disability Fund [***see*** *Unemp. Ins. Code § 986*].

c. Employer's unemployment tax contribution.

NOTE:
An employer must calculate and transmit its unemployment contribution to the Unemployment Fund; it may not meet its obligations by making deductions from

employees' wages [***see*** *Unemp. Ins. Code §§ 976, 986*].

d. Employer's employment training tax contribution.

NOTE:
Employers must calculate and pay an employment training tax to the Employment Training Fund [***see*** *Unemp. Ins. Code §§ 976.6, 1610*].

2. Advise client to provide for workers' compensation by securing [*see Lab. Code § 3700(a), (b)*]:

a. Workers' compensation policy from authorized insurer; or

b. Certificate of consent to self-insure from Director of Industrial Relations.

3. Advise client to withhold, pay, and account for following federal taxes:

a. Income tax withheld from employees' wages.

NOTE:
An employer paying wages must deduct and withhold income taxes on those wages by specified methods [*I.R.C. § 3402(a)*; ***see*** *I.R.C. § 3402(b)* (percentage method), (c) (wage-bracket method), (h) (alternative methods); ***see also*** Treas. Reg. §§ 1.6071, 1.6151, 1.6302 (procedure for collection and payment)].

b. Social Security and Medicare tax withheld from employees' wages.

c. Employer's separate Social Security and Medicare contribution.

NOTE:
An employer of a taxpayer must collect Social Security and Medicare tax by deducting it from the employee's wages when paid [*I.R.C. § 3102(a)*; ***see*** *I.R.C. § 3101* (rate of tax)]. An employer must also pay its own Social Security and Medicare contribution based on amount of wages paid to employees [***see*** *I.R.C. § 3111*].

d. Any additional unemployment tax contribution necessary to meet federal amounts due to insufficient state unemployment tax withholding.

NOTE:
Although the Federal Unemployment Tax Act imposes an unemployment tax on every employer based on a percentage of wages paid [*I.R.C. § 3301*], taxpayers receive credit for their federal unemployment tax liability for contributions made to a certified state unemployment compensation fund that meets federal guidelines [*I.R.C. § 3302(a)(1)*; ***see*** *I.R.C. § 3304* (certification of state program)]. The California unemployment insurance scheme meets the federal guidelines [***see*** *City of Sacramento v. State of California (1984) 156 Cal. App. 3d 182, 189, 195, 203 Cal. Rptr. 258]* . However, because the federal unemployment tax rate is higher than the maximum state unemployment tax rate [***see*** *I.R.C. § 3301(1)*; *Unemp. Ins. Code § 977*], employers must still make a federal tax contribution [***see*** IRS Pub. 334, Tax Guide for Small Businesses].

An employer [***see*** *I.R.C. § 3306(a)*] is liable for federal unemployment tax even if he or she is not subject to a state unemployment compensation law [*Treas. Reg. § 31.3301-1*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)General OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FICA Rate of TaxTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FUTA CreditsTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FUTA Rate of TaxTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)Income Tax Collected at SourceTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)Liability for Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1C California Legal Forms--Transaction Guide § 1C.122

§ 1C.122 Procedural Guide Regarding Wages and Hours

[1] Payment of Wages

1. Advise client to pay employees in following manner:

a. Pay nonexempt employees at least minimum hourly wage [*8 Cal. Code Reg. § 11000(2)*; *29 U.S.C. § 206(a)*].

NOTE:
Employers may pay certain employees, such as learners, a subminimum wage [***see*** *8 Cal. Code Reg. § 11010(4)* (manufacturing industry); ***see also*** *§ 1C.52[1][a]*].

b. Do not deduct value of meals and lodging without prior voluntary written agreement [*8 Cal. Code Reg. § 11000(3)*].

c. Do not deduct value of tips received by employee [*Henning v. Industrial Welfare Com. (1988) 46 Cal. 3d 1262, 1278, 252 Cal. Rptr. 278, 762 P.2d 442]* .

d. Do not deduct value of uniforms, tools, and equipment furnished [*see, e.g., 8 Cal. Code Reg. § 11010(4), (9)* (manufacturing industry)].

2. Advise client to pay all employees, regardless of sex, same rate for equal work on jobs requiring equal skill, effort, and responsibility, performed under similar working conditions [*Lab. Code § 1197.5*; *29 U.S.C. § 206(d)(1)*].

3. Advise client to pay following overtime rates, when applicable [*see, e.g., 8 Cal. Code Reg. § 11010(3)(A)* (manufacturing industry); *see 29 U.S.C. § 207(a)(1)* (overtime pay for more than 40 hours worked in workweek)]:

NOTE:
Many types of employees are exempt from overtime pay requirements [***see*** *§ 1C.54[1][d], [2][c]*].

a. One and one-half times employee's regular rate for all hours worked in excess of 8 hours up to and including 12 hours in any workday, and for first 8 hours worked on seventh day of work.

b. Double employee's regular rate of pay for all hours worked in excess of 12 in any workday and for all hours worked in excess of 8 hours on seventh day in any workweek.

4. If client is employer under contract for public works project over $1,000, advise client to pay general prevailing wage [*Lab. Code § 1771*].

NOTE:
The director of the Department of Industrial Relations determines the general prevailing wage [***see*** *Lab. Code §§ 1770, 1773*].

5. Advise client to pay regular wages weekly, biweekly, or semimonthly, on days designated in advance [*Lab. Code § 204*].

NOTE:
Salaries of executive, administrative, and professional employees of employers covered by the FLSA, and commission employees of vehicle dealers, may be paid once a month [*Lab. Code §§ 204.1, 204.2*; ***see*** *29 U.S.C. § 213(a)(1)* (FLSA)].

6. Advise client to pay wages earned for labor in excess of the normal work period no later than next regular payday [*Lab. Code § 204*].

7. Advise client not to collect or receive any part of wages already paid [*Lab. Code § 221*].

8. Advise client not to pay wages in any of following ways [*Lab. Code § 212*]:

a. By order, check, draft, note, memorandum, or other acknowledgment of indebtedness, unless it is all of following:

(1) Negotiable.

(2) Payable in cash on demand.

(3) Without discount.

(4) Payable at established place of business in California.

b. By scrip, coupon, cards, or other redeemable thing, in merchandise, or purporting to be payable or redeemable other than in money.

9. For employees covered by FLSA, advise client to make payment for regular and overtime wages in one of following ways [*29 C.F.R. § 531.27(a)*]:

a. In cash.

b. By negotiable instruments, payable at par.

NOTE:
In some circumstances, wages may also be paid in the form of board, lodging, other facilities, and tips [***see*** *29 C.F.R. § 531.27*].

10. Advise client that on payday, or at least semimonthly, client must give employee accurate itemized wage statement showing information pertaining to that pay period [*Lab. Code § 226(a)*].

11. Advise client that, if required or empowered to do so, client may make following reductions from wages:

a. State or federal deductions [*Lab. Code § 224*].

b. Wage assignments [*see Fam. Code §§ 5200-5295* (child and spousal support); *Prob. Code § 3088* (support of conservatee); *Lab. Code § 300* (other assignments)].

c. Wage garnishments [*see Code Civ. Proc. §§ 706.010-706.154*].

12. For discharged employee, advise client to pay wages immediately at place of discharge [*Lab. Code § 201(a)*].

NOTE:
For discussion of the situations in which an employer or employee may lawfully terminate employment, see *§ 1C.30*. For discussion of a state employer's payment obligations, see *§ 1C.32[1]*.

13. For employee who quits, advise client to pay wages within 72 hours of quitting at office or agency of employer in county where employee worked [*Lab. Code §§ 202(a), 208*].

NOTE:
If an employee gives at least 72 hours' notice of the intention to quit, he or she is entitled to be paid at the time of quitting [*Lab. Code § 202(a)*. For discussion of a state employer's payment obligations, see *§ 1C.32[1]*.].

14. For employee who quits or is discharged, advise client to pay for all unused vested vacation time at employee's final rate of pay [*Lab. Code § 227.3*].

[2] Regulation of Hours

1. For employees in following regulated occupations, advise client to limit work to 72 hours in seven-day period [*see 8 Cal. Code Reg. §§ 11030(3)(A)(2), 11080(3)(A)(2)*]:

a. Canning, freezing, and preserving.

b. Certain industries handling products after harvest.

2. For employees in professional technical, clerical, mechanical, and similar occupations, advise client not to terminate for employee's refusal to work more than 72 hours in workweek [*see 8 Cal. Code Reg. § 11040(3)(L)*].

3. Advise client to give nonexempt employees following break periods [*see 8 Cal. Code Reg. § 11030(11), (12)*]:

a. Thirty-minute meal period if employed more than five hours.

NOTE:
This rule does not apply if a work period of not more than six hours will complete the day's work and the employer and the employee mutually consent to waive the meal period. Unless the employee is relieved of all duty during the 30-minute period, the meal will be deemed an "on duty" meal period and count as time worked. "On duty" meal periods are only permitted when the nature of the work prevents an employee from being relieved of all duty and the parties agree in writing to an on-the-job paid meal period. This agreement must provide that the employee may, in writing, revoke the agreement at any time [*8 Cal. Code Reg. § 11040(11)(A)*; ***see*** *8 Cal. Code Reg. § 11040(11)(B)* (penalty)].

b. Ten-minute rest period for each four hours worked.

4. Advise client not to require employees engaged in occupation of labor to work more than six days in seven [*Lab. Code § 552*].

5. Advise client to employ minors in accordance with following hours restrictions [*Lab. Code § 1391(a)*; *see Lab. Code § 1391(c)* (penalties)]:

NOTE:
The hours restrictions do not apply to minors employed to deliver newspapers to consumers [***see*** *Lab. Code § 1391(d)*; ***see*** *Educ. Code § 49116(d)*]. The federal Fair Labor Standards Act also limits the employment of minors. For discussion, see *Section 1C.61*.

a. For minors 15 and under [*Lab. Code § 1391(a)(1)*]:

NOTE:
Notwithstanding the following restrictions, while school is in session no employer may employ a minor 14 or 15 years of age for more than 3 hours in any school day or more than 18 hours in any week, or during school hours, except that a minor enrolled in and employed pursuant to a school-supervised and school-administered work experience and career exploration program may be employed for no more than 23 hours, any portion of which may be during school hours [*Lab. Code § 1391(a)(2)*; ***see*** *Educ. Code § 49116(a)*].

(1) No more than 8 hours in one day or 40 hours in one week.

(2) Not before 7:00 A.M. or after 7:00 P.M.

NOTE:
Minors 15 years of age and under may work until 9:00 P.M. between June 1 and Labor Day [*Lab. Code § 1391(a)(1)*].

b. For minors 16 and 17 [*Lab. Code § 1391(a)(3)*]:

NOTE:

Notwithstanding the following restrictions, while school is in session no employer may employ a minor 16 or 17 years of age for more than 4 hours in any school day except if the minor (1) is employed in personal attendant occupations [***see*** *8 Cal. Code Reg. § 11150*], school-approved work experience, or cooperative vocational education programs or (2) has been issued a work permit [*Educ. Code § 49112(c)*] and is employed in accordance with that permit [*Lab. Code § 1391(a)(4)*; ***see*** *Educ. Code § 49116(b)*].

(1) No more than 8 hours in one day or 48 hours in one week.

(2) Not before 5:00 A.M. or after 10:00 P.M.

NOTE:

During an evening preceding a non-schoolday, minors 16 and 17 years of age may work until 12:30 A.M. of the non-schoolday [*Lab. Code § 1391(a)(3)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsCoverage & DefinitionsGeneral OverviewLabor & Employment LawWage & Hour LawsDefenses & ExemptionsGeneral OverviewLabor & Employment LawWage & Hour LawsDefenses & ExemptionsExecutives & Professional EmployeesLabor & Employment LawWage & Hour LawsRecordkeeping RequirementsLabor & Employment LawWage & Hour LawsWage Payments



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1C California Legal Forms--Transaction Guide § 1C.123

§ 1C.123 Procedural Guide to Employee Notices and Recordkeeping

[1] Posting Employee Notices

NOTE:
The attorney should advise the client to obtain and post all of the following notices and posters. If the client wishes, the attorney can obtain the notices from the appropriate state and federal agencies.

1. Post notice of time and place of payment of wages [*Lab. Code § 207*; *see § 1C.230*].

2. For employers subject to FLSA, post notice explaining provisions of FLSA [*29 C.F.R. § 516.4*].

3. For employers with employees exempt from overtime pay, add legible notation to FLSA notice stating that they are exempt [*29 C.F.R. § 516.4*].

4. Post notice containing pertinent provisions of Title VII [*42 U.S.C. § 2000e-10(a)*].

5. Post wage orders relevant to employer's occupation or industry [*Lab. Code § 1183*; *see 8 Cal. Code Reg. §§ 11010-11150* (wage orders)].

6. Post Cal/OSHA notices relating to occupational safety and health [*see 8 Cal. Code Reg. §§ 340, 3204(g)*].

7. Post Department of Fair Employment and Housing poster on discrimination in employment that includes information about or regarding sexual harassment [*see Gov. Code § 12950(a)*].

8. For employers with 50 or more employees, post notice concerning employee's right to request family care and medical leave [*see 2 Cal. Code Reg. § 7297.8*; *see also § 1C.233*].

9. If required to maintain workers' compensation insurance [*see 8 Cal. Code Reg. §§ 15350.1, 15565*]:

a. Post notice stating name of workers' compensation insurance carrier; or

b. If employer is self-insured, post:
(1) Notice stating that employer is self-insured; and

(2) Certificate of Consent to Self-Insure.

10. Post notice containing telephone numbers of emergency services [*see 8 Cal. Code Reg. § 1512(e)*].

11. Not less than 10 days before statewide election, post notice of employee's right to take time off to vote, if necessary [*Elec. Code §§ 14350, 14351*; *see § 1C.231*].

12. Notice listing employees' rights and responsibilities under whistleblower laws, including telephone number of whistleblower hotline, in lettering larger than size 14 pica type [*Lab. Code § 1102.8(a)*; *see Lab. Code § 1102.7*; *see also § 1C.33[1][b]*].

13. For farm labor contractors, display rate of compensation paid to employees in both English and Spanish, in required typesize [*Lab. Code § 1695(7)*]:

a. At site where work is to be performed.

b. On all vehicles used to transport employees.

14. For talent agencies, post printed copy of Labor Code talent agent provisions in conspicuous place in office [*see Lab. Code § 1700.28*].

[2] Maintaining Employee Records

NOTE:
The recordkeeping rules presented here are those required by California law. Similar regulations apply to employers subject to the FLSA [***see*** *29 U.S.C. § 211(c)*; *29 C.F.R. § 516.2*].

For discussion of recordkeeping relating to workers' compensation, unemployment insurance, disability insurance, and income taxes, see Ch. 1D, ***Overview of Employee Benefits*** , and Ch. 1E, ***Taxation of Businesses*** .

1. Advise client to retain following information for employees in California for at least three years [*see 8 Cal. Code Reg. § 11010(7)*; *Lab. Code § 1174*]:

a. Name, home address, occupation, and social security number.

b. Birthdate, if under 18, and designation as minor.

c. Payroll/time records showing following:

NOTE:
Payroll records must be kept for not less than two years at a central location in California or at the plants or establishments at which the employees are employed [*Lab. Code § 1174*].

(1) Hours worked daily by and wages paid to employees employed at respective plants or establishments.

(2) Number of piece-rate units earned by and any applicable piece rate paid to employees employed at respective plants or establishments.

(3) Time records showing beginning and ending work hours, meal periods, split shifts, and total daily hours worked.

d. Total wages paid each payroll period.

e. Total hours worked each payroll period and applicable rates of pay.

f. Incentive plan formula, if any.

2. Advise client to give employee accurate itemized statement showing gross wages, deductions, work period dates, and other information on semimonthly basis or at time of payment [*8 Cal. Code Reg. § 11010(7)*; *Lab. Code § 226*].

NOTE:
Employers required to keep and disclose this information must afford current and former employees the right to inspect or copy the records pertaining to that employee on reasonable request to the employer [*Lab. Code § 226(b)*; ***but see*** *Lab. Code § 226(d), (h)* (exceptions)]. Employers may take reasonable steps to ensure the identity of the employee and may charge the actual costs of reproduction to the employee [*Lab. Code § 226(b)*]. An employer must comply with an inspection or copy request as soon as practicable, but no later than 21 days from the date of the request [*Lab. Code § 226(c)*]. An employer's failure to comply with the inspection requirement is subject to penalty, injunctive relief, and damages if the failure is knowing and intentional [*Lab. Code § 226(e), (f), (g)*].

3. For employer of minor under 18 years of age, advise client to keep employment permit on file during minor's employment [*Educ. Code § 49161*].

4. Advise client to allow employees to inspect their personnel files on request, at reasonable intervals [*see Lab. Code § 1198.5*].

NOTE:
Special rules require disclosure on request of certain reports used by employers in evaluating applicants [***see, e.g.,*** *Civ. Code § 1785.20*.5(a) (credit report)]. Some confidential information is subject to special protection [***see, e.g.,*** *Health & Safety Code § 120980* (results of HIV test)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawPosting & Recordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1C California Legal Forms--Transaction Guide § 1C.124

§ 1C.124 Procedural Guide to Complying With Occupational Safety and Health Standards

1. Advise client to comply with Cal/OSHA safety and health laws, standards, and orders [*see Lab. Code §§ 6300-9061*; *8 Cal. Code Reg. §§ 450-8618, 11010-11050*], including basic requirements to:

a. Furnish safe and healthful employment for all employees [*see Lab. Code § 6400*].

b. Provide safety information to employees [*see Lab. Code § 6408*].

c. Furnish necessary safety devices and procedures to employees [*see Lab. Code § 6401*].

d. Regularly monitor work environment for hazardous conditions [*see 8 Cal. Code Reg. §§ 5155, 5158, 5208, 5210*].

NOTE:
For further discussion of the basic responsibilities of the employer regarding employee safety and health, see *§§ 1C.80-1C.90*.

2. Assist client in developing and implementing written injury and illness prevention program [*see Lab. Code § 6401.7*; *8 Cal. Code Reg. § 3203*].

NOTE:
For a sample injury and illness prevention program, see *§ 1C.221*.

3. Assist client in developing and implementing following emergency plans:

a. Emergency action plan [*see 8 Cal. Code Reg. § 3220(a)*; *see also § 1C.83[1]*].

b. Fire prevention plan [*see 8 Cal. Code Reg. § 3221(a)*; *see also § 1C.83[2]*].

4. Advise client to prepare and file all required reports of occupational injuries and illnesses [*see Lab. Code § 6409*; *see also § 1C.84*].

5. Advise client to maintain log, annual summary, and supplementary record of occupational injuries and illnesses [*see 8 Cal. Code Reg. §§ 14300.4-14300.33*].

NOTE:
For discussion of the documentation procedures regarding occupational injuries and illnesses, see *§ 1C.85*.

6. Advise client to post all required employee safety and health notices and posters [*see § 1C.123*].

NOTE:
For a list of employee notices an employer must post, see *§ 1C.104[2]*.

7. Advise client to post Proposition 65 warning if chemicals are present known to State of California to cause cancer or reproductive toxicity [*see Health & Safety Code § 25249.5*; *see also §§ 1C.73, 1C.74*].

8. For employer who produces and uses hazardous substances, assist client in developing written hazard communication system [*see 29 C.F.R. § 1910.1200*; *see also § 1C.75*].

9. If hazardous substances exist on premises [*see § 1C.112*, P 1], advise client to arrange for cleanup.

10. Advise client to train employees about handling hazardous substances [*see Lab. Code §§ 6360-6399.7*; *see also § 1C.70[3]*].

11. Advise client to make Material Data Safety Sheets (MSDS) available to employees who may come in contact with hazardous substances [*see Lab. Code § 6398*; *see also § 1C.70[2]*].

12. Advise client to train employees who will come in contact with asbestos about the handling of asbestos [*see 8 Cal. Code Reg. §§ 1529, 1530*; *see also § 1C.71[1]*].

13. Advise client to notify employees of the presence of asbestos [*see Health & Safety Code § 25915*; *see also § 1C.71[2]*].

14. Advise client to train employees about the use and handling of pesticides [*see 3 Cal. Code Reg. § 6724*; *see also § 1C.72*].

15. Advise client to observe safety procedures in use and handling of carcinogens [*see Lab. Code § 9021*; *8 Cal. Code Reg. §§ 5208-5210*; *see also § 1C.73*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthGeneral OverviewLabor & Employment LawOccupational Safety & HealthCompliance & Defenses



76 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1C California Legal Forms--Transaction Guide § 1C.125

§ 1C.125 Procedural Guide to Miscellaneous Employment Duties

1. If employees are required to wear uniforms, advise client to provide and maintain uniforms [*see, e.g., 8 Cal. Code Reg. § 11010(9)*].

2. Advise client to provide and maintain any tools or equipment required or necessary for performance of job [*see, e.g., 8 Cal. Code Reg. § 11010(9)*].

NOTE:
An employer may require employees who earn wages at least two times the minimum wage to provide and maintain hand tools and equipment customarily required by the trade or craft [***see, e.g.,*** *8 Cal. Code Reg. § 11010(9)* (manufacturing industry)].

3. Advise client not to discharge or discriminate against employee for taking time off work to serve on jury, to appear in court as witness, or, if employee is domestic violence or sexual assault [*see Lab. Code § 230(h)(2)*] victim, to obtain any relief to help ensure health, safety, or welfare of employee or his or her children [*Lab. Code § 230(a)-(c)*; *see Fam. Code § 6211* (domestic violence); *see also Lab. Code § 230(h)(2)* (sexual assault)].

NOTE:
An employer may not discharge or discriminate against an employee for taking time off to serve as required by law on an inquest jury or trial jury, provided that the employee gives reasonable notice to the employer before taking the time off [*Lab. Code § 230(a)*]. Similarly, an employer may not discharge or discriminate or retaliate against an employee, including a crime victim, for taking time off to appear in court to comply with a subpoena or other court order as a witness in any judicial proceeding [*Lab. Code § 230(b)*]. Further, no employer may discharge or discriminate or retaliate against an employee who is a victim of domestic violence [***see*** *Fam. Code § 6211*] or sexual assault [

see *Lab. Code § 230(h)(2)*] for taking time off to obtain or attempt to obtain any relief to help ensure the health, safety, or welfare of the employee or his or her children [*Lab. Code § 230(c)*].

In addition, an employer with 25 or more employees may not discharge, discriminate, or retaliate against an employee who is a victim of domestic violence or sexual assault from taking time off of work to seek medical attention for injuries caused by domestic violence or sexual assault, to obtain services or psychological counseling, or to participate in safety planning or otherwise increase safety, including temporary or permanent relocation [*Lab. Code § 230.1(a)*].

For these purposes, the employee must give the employer reasonable advance notice of the employee's intention to take time off unless that notice is not feasible [*Lab. Code §§ 230(d)(1), 230.1(b)(1)*]. However, the employer may not take any action against the employee based on an unscheduled absence if the employee provides certification to the employer within a reasonable time after the absence [*Lab. Code §§ 230(d)(2), 230.1(b)(2)*]. Employees may use vacation, personal leave, or compensatory time off for these purposes, and this entitlement may not be diminished by a collective bargaining agreement [*Lab. Code §§ 230(g), 230.1(e)*]. Remedies include reinstatement, reimbursement for lost wages and benefits, and a one-year filing period for filing a complaint with the Division of Labor Standards Enforcement [*Lab. Code §§ 230(e), (f), 230.1(c), (d)*; ***see*** *Lab. Code §§ 230(e), 230.1(c)* (willful refusal to restore employee is misdemeanor)].

4. If employee does not have sufficient time outside working hours to vote in statewide election, advise client to allow employee to take off enough working time to vote [*Elec. Code § 14350*].

5. Advise client not to discharge or discriminate against employee for taking time off work to perform emergency duty as volunteer firefighter, reserve peace officer, or emergency rescue personnel [*Lab. Code § 230.3(a), (b)*; *see Lab. Code § 230.3(d)* (definitions); *Gov. Code § 50952(p)*(definition); *Health & Safety Code § 1799.107(e)* (definition)]. [*Lab. Code § 230.3(a)*].

NOTE:

This prohibition against discrimination does not apply to any public safety agency or emergency medical services provider if the employer determines that the employee's absence would hinder the availability of public safety or emergency medical services [*Lab. Code § 230.3(c)*].

6. If business has 25 or more employees, advise client to accommodate and assist any employee who reveals literacy problem, if this does not involve undue hardship to employer [*Lab. Code § 1041*].

7. If business is awarded certain state or federal agency contracts, advise client to certify to agency that employer will provide drug-free workplace [*see Gov. Code § 8355*; *41 U.S.C. §§ 701-707*].

8. Advise client to comply with following sanitation requirements:

a. Keep business establishment clean [*Lab. Code § 2350*].

b. Maintain restroom for employees [*Lab. Code § 2350*].

c. Furnish free drinking water for employees [*Lab. Code § 2441(a)*].

NOTE:
Special sanitation requirements apply to theaters, foundries, metal shops, and factories [***see*** *Lab. Code §§ 2260-2355*].

9. If business is factory, shop, or business in which power machinery is used for manufacturing purposes, advise client to maintain medical supplies on premises [*Lab. Code § 2440*].

10. Advise client to provide reasonable access for employees with disabilities [*2 Cal. Code Reg. § 7293.9*; *42 U.S.C. §§ 12182, 12183*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawLeaves of AbsenceGeneral OverviewLabor & Employment LawPosting & Recordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1C California Legal Forms--Transaction Guide § 1C.126

§ 1C.126 Procedural Guide to Relations With Unions

1. Advise client to investigate advantages of joining employer bargaining association, such as retail merchants' association.

2. Advise compliance with requirements of Labor Management Relations Act [*see 29 U.S.C. §§ 141-187*] or Agricultural Labor Relations Act [*see Lab. Code §§ 1140-1166.3*], including prohibition on all of following:

NOTE:

It is an unfair labor practice under both the federal Labor Management Relations Act and the California Agricultural Labor Relations Act for an employer to do any of the following acts regarding employees in labor organizations [***see*** *29 U.S.C. § 158*; *Lab. Code § 1153*]. For further discussion of dealings with union employees, see *§ 1C.62*.

a. Interfering with employees in exercise of their right to organize.

b. Dominating or interfering with formation or administration of labor organization.

c. Discriminating regarding hiring, advancement, terms, or conditions of employment to encourage or discourage membership in labor organization.

d. Discharging or otherwise discriminating against employee because he or she filed charges or gave testimony related to labor organization.

e. Refusing to bargain collectively with employees' representatives.

3. Advise client not to pay, lend, or deliver money or other thing of value to labor organization, to its representatives or officers, or to employee for purposes of influence [*see 29 U.S.C. § 186(a)*; *Lab. Code § 1155.4*].

4. Assist client in negotiating labor contract with union representatives.

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawCollective Bargaining & Labor RelationsDiscipline, Layoff & TerminationLabor & Employment LawCollective Bargaining & Labor RelationsRight to OrganizeLabor & Employment LawCollective Bargaining & Labor RelationsUnfair Labor PracticesGeneral OverviewLabor & Employment LawCollective Bargaining & Labor RelationsUnfair Labor PracticesRefusals to Bargain



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1C California Legal Forms--Transaction Guide §§ 1C.127-1C.139

[Reserved]

§§ 1C.127[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
D. Drafting Guide

1-1C California Legal Forms--Transaction Guide § 1C.140

§ 1C.140 Drafting Guide to Employee Manual

NOTE:

While the use of an employee manual is not mandated by state or federal law, an employee manual can be an important part of an employer's training, communication, and discipline system. By gathering important employee information into one publication and requiring each employee to read the manual, the employer has some assurance that employees will be aware of company policy, procedures, and safety and health rules contained in the manual. In addition, the inclusion of certain other recommended elements, such as a sexual harassment policy [***see*** *§ 1C.220* (sample policy on sexual harassment)], in an employee manual will help to provide a more collegial and productive workplace. In the event of a charge or complaint, such as a sexual harassment complaint, an employer may be able to avoid liability by showing it took all reasonable steps to prevent harassment, including training employees and publishing the policy on sexual harassment in the employee manual [***see*** *§ 1C.13 [3]* (discussion of employer liability for sexual harassment in the workplace)].

Employee manuals are also a convenient location in which to compile mandatory safety and health information, such as an injury and illness prevention program [***see*** *§ 1C.221* (sample injury and illness prevention program)]. By including such information in an employee manual, an employer is more assured that each employee has been exposed to the information.

The attorney should advise the employer to include the following elements, as appropriate, in a printed employee manual, distributed to all employees, and revised periodically as necessary.

1. General information about company, including:

a. Nature of company's business.

b. Company history.

c. Organization of company staff.

d. Chain of communication.

e. Procedure for obtaining services and information.

2. Company policies and practices:

a. Flexible work hours.

b. Overtime compensation.

c. "Comp time" (time off in lieu of overtime compensation).

d. Meal allowance.

e. Shift differential.

f. Tips.

NOTE:

There are legal implications for the employer's policy on tips. No employer or agent may collect, take, or receive any gratuity, or any part of any gratuity, that is paid or given to, or left for, an employee by a patron. Employers may not impose wage deductions based on received tips. Every gratuity is the sole property of the employee or employees to whom it was paid or given or for whom it was left. An employee's rights respecting tips extend to tips paid by credit cards [*Lab. Code § 351*]. These legal rules are intended not only to prevent fraud on the public but also to ensure that employees, exclusively, will receive the full benefit of gratuities that patrons intend for the sole benefit of the employees who serve them. In other words, the law protects employees from employers who would use their positions to unfairly command a share of the employees' tips. However, low-level supervisory employees, whether or not they could be the employer's agents in this context, are not necessarily precluded from sharing in tips. An employer can lawfully have a policy that those supervisory employees will share in tips, along with employees whom they supervise in serving patrons, as long as the employer makes that policy clearly known to patrons [*Chau v. Starbucks Corp. (2009) 174 Cal. App. 4th 688, 696-697, 94 Cal. Rptr. 3d 593* (employer's policy permitting shift supervisors to share in tip proceeds that coffee-bar patrons left in collective-tip box near cash register did not violate *Lab. Code § 351* because it was clear to patrons that tips left in that box were for all employees providing service, meaning both baristas and shift supervisors; moreover, employer's policy precluded store managers and assistant managers from sharing in collective tips)].

g. Tools and uniforms.

h. Nepotism.

i. Garnishments.

j. On-the-job accidents.

k. Job posting.

l. Pre-employment physical examination.

m. Employment policy regarding:

(1) Hiring practices and procedures.

(2) Equal employment opportunity.

(3) Sexual harassment.

(4) Sex discrimination.

(5) Racial discrimination.

(6) Other forms of discrimination.

n. Dealings with organized labor.

o. Smoking policy.

p. Alcohol and drug-abuse policy.

q. Problem-handling policy.

r. Disciplinary procedures.

s. Solicitation policy.

t. Leaving the company.

3. Company programs:

a. Salary administration program.

(1) Setting job salaries.

(2) Salary increases:
(a) Years of service.

(b) Merit.

(c) Promotion.

b. Periodic job evaluations.

c. Job descriptions.

d. Performance appraisals.

e. Promotion policy.

f. Job posting.

g. Retirement program.

h. Employee stock ownership program.

i. Employee savings plan.

j. Tuition aid program.

k. Scholarship program.

l. Service awards.

m. Transportation assistance, such as:

(1) Sale or subsidy of transit tickets.

(2) Providing or subsidizing parking.

(3) Organizing ridesharing, carpooling, and vanpooling.

n. Banking services, such as:

(1) Direct paycheck deposit.

(2) Savings plan.

(3) Savings bond deductions.

o. Employee newsletters and information.

p. Community assistance programs.

q. Special activities.

4. Time off work:

a. Company holidays.

b. Floating holidays.

c. Vacation.

d. Sick leave.

e. Personal business.

f. Disability leave.

g. Family care and medical leave.

h. Funeral leave.

i. Military leave.

j. Jury duty.

k. Time off to vote.

l. Leave of absence.

5. Administration of benefits, including:

a. Medical insurance coverage.

b. Health maintenance organizations.

c. Prescription program.

d. Dental program.

e. Vision care program.

f. Employee assistance program, including:

(1) Family counseling.

(2) Substance abuse counseling.

(3) Crisis counseling.

g. Group life insurance.

h. Accidental death and dismemberment insurance.

i. Business travel insurance.

j. Long-term disability insurance.

k. Government benefits programs, such as:

(1) Disability insurance.

(2) Unemployment insurance.

(3) Social security.

l. Severance pay.

6. Information about time reporting, including:

a. How to complete and file time reports.

b. When to file time reports.

7. Company communications structure, including:

a. Person employee reports to.

b. Mail room organization, including:

(1) Mail delivery system.

(2) Shipments.

c. Telephone system.

d. Electronic communications system.

e. Employee suggestion program.

f. Employee bulletin boards.

g. Employee newsletters and other publications.

h. Grievance procedure.

8. Information about work environment, including:

a. General rules:

(1) Breaks and meal periods.

(2) Location of break area.

(3) Smoking and eating policy.

(4) Security policy:
(a) External security, including intruders.

(b) Internal security, including locking doors, closets, cabinets, desks, machines, and computers.

(5) Location of supplies and materials.

(6) Location of employee notices.

b. Office work environment:

(1) Computer workstations.

(2) Supplies.

(3) Support services, such as photocopying, faxing, and repairs.

c. Industrial locations:

(1) Operation of machines.

(2) Cleaning procedures.

d. Off-site locations:

(1) Where to report for work.

(2) Communications at site.

(3) Travel arrangements.

(4) Use of company vehicles.

e. Sales representatives:

(1) Filing of reports.

(2) Communications with supervisor.

(2) Reimbursement for expenses.

(3) Travel arrangements.

9. Safety and health information, including:

NOTE:
For a general discussion of safety and health regulations, see *Sections 1C.70 through 1C.90*.

a. First aid supplies and procedures.

b. Emergencies:

(1) Emergency action plan.

(2) Fire prevention plan.

NOTE:
For discussion of emergency action plans and fire prevention plans, see *Section 1C.83*.

(3) Earthquake preparedness plan.

c. Injury and illness prevention program.

NOTE:
For discussion of injury and illness prevention programs, see *Section 1C.82*. For a form of sample injury and illness prevention program, see *Section 1C.221*.

d. Company safety and health policy and rules.

e. Nearby medical facilities.

f. Emergency telephone numbers.

g. Accidents on the job.

h. Video display terminal health.

i. Industrial machine safety.

j. Hazardous material safety.

k. Safety in construction and maintenance work.

l. Heating and air conditioning system.

m. Safe driving practices.

10. Employee activities and committees:

a. Travel and entertainment expenses.

b. Employee award programs:

(1) Service awards.

(2) Performance awards.

(3) Suggestion awards.

c. Employee committees:

(1) Grievance committee.

(2) Suggestion committee.

(3) Safety committee.

(4) Committee on sexual harassment.

(5) Special events committee.

11. Producing and protecting company product:

a. Production process.

b. Distribution process.

c. Protection of proprietary information, including:

(1) Copyrights.

(2) Patents.

(3) Trademarks.

(4) Trade secrets.

(5) Supplier lists.

(6) Customer lists.

d. Policy on employee inventions and other creations.

e. Security procedures.

12. Human resources department.

a. Overview of department.

b. Organization of department.

c. List of department services.

13. List of all company job descriptions and pay scales.

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEmployment RelationshipsAt-Will EmploymentExceptionsExpress ContractsLabor & Employment LawEmployment RelationshipsAt-Will EmploymentExceptionsImplied ContractsLabor & Employment LawEmployment RelationshipsEmployment ContractsInterpretationLabor & Employment LawLeaves of AbsenceFamily & Medical Leave ActPosting & RecordkeepingLabor & Employment LawWrongful TerminationBreach of ContractEmployer Handbooks



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART III. TRANSACTION GUIDE
D. Drafting Guide

1-1C California Legal Forms--Transaction Guide §§ 1C.141-1C.199

[Reserved]

§§ 1C.141[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
A. Client Letters

1-1C California Legal Forms--Transaction Guide § 1C.200

§ 1C.200 Letter to Client Containing Pre-employment Checklist

[1] Comment

[a] Use of Form

This form is a letter to be sent to the client, containing a checklist of factors relating to employment law the employer should consider in hiring employees. These factors range from considerations in advertising job openings, to procedural protections to prevent unlawful discrimination or improper inquiry in hiring. The remainder of this comment presents background discussion of the legality of inquiry and investigation into a variety of areas.

[b] General Prohibition on Discrimination

Under federal law, it is an unlawful employment practice for an employer to discriminate against an individual because of his or her race, color, religion, sex, or national origin [*see 42 U.S.C. § 2000e-2(a)*]. In addition, the California Fair Employment and Housing Act (FEHA) [*see Gov. Code §§ 12900-12996*; *see also 2 Cal. Code Reg. §§ 7285.0-8504*] makes it an unlawful employment practice for an employer to discriminate because of race, religious creed, color, national origin, ancestry, physical handicap, mental condition, marital status, sex, age, sexual orientation [*Gov. Code § 12940(a)*], or pregnancy, childbirth, or related medical condition [*Gov. Code § 12945(a)*]. Inquiries based on these categories are unlawful unless they come within one of the limited exceptions.

The FEHA also prohibits any non-job-related inquiry that expresses any limitation, specification, or discrimination concerning race, religious creed, color, national origin, ancestry, physical or mental disability, medical condition, marital status, sex, age, or sexual orientation [*see Gov. Code § 12940(d), (e)*; *see also § 1C.10*]. For a detailed discussion of federal and state law relating to employment discrimination, see California Employment Law, Ch. 41, *Substantive Requirements Under Equal Employment Opportunity Laws* (Matthew Bender).

[c] Prohibition on Discrimination in Advertising

It is unlawful to indicate a preference, limitation, specification, or discrimination based on race, color, religion, sex, or

national origin in advertising relating to employment. However, an employer may indicate a preference, limitation, specification, or discrimination based on religion, sex, or national origin if the category is a bona fide occupational qualification (BFOQ) [*42 U.S.C. § 2000e-3(b)*]. BFOQ determinations are intended to have a limited scope and application, and are to be narrowly construed [*see, e.g., 29 C.F.R. §§ 1606.4* (national origin discrimination), 1625.6 (age discrimination)].

[d] Race Discrimination

Title VII and the FEHA prohibit employment discrimination based on race or color [*see 42 U.S.C. § 2000e-2*; *Gov. Code § 12940(a)*]. While "race" does not seem to have been defined under Title VII, in the context of the Civil Rights Act of 1866 [*see 42 U.S.C. § 1981*], the Supreme Court determined that "race" means identifiable classes of persons who are subjected to intentional discrimination solely because of their ancestry or ethnic characteristics [*Saint Francis College v. Al-Khazraji (1987) 481 U.S. 604, 613, 107 S. Ct. 2022, 95 L. Ed. 2d 582]* .

[e] Religious Discrimination

An employer may not inquire into a job applicant's religious practices unless the employer can show the inquiry has no exclusionary effect, and the inquiry is justified by business necessity [*29 C.F.R. § 1605.3(b)(2)*; *see 42 U.S.C. § 2000e-2*; *see also Gov. Code § 12940(a)*].

[f] Sex Discrimination

A pre-employment inquiry that expresses any limitation, specification, or discrimination based on sex is unlawful unless based on a bona fide occupational qualification. However, an employer may inquire as to the sex of the applicant in good faith for a nondiscriminatory purpose [*29 C.F.R. § 1604.7*; *see 42 U.S.C. § 2000e-2*; *see also Gov. Code § 12940(a)*].

A private employer may require male and female employees to adhere to different standards of dress and appearance without violating Title VII [*Baker v. California Land Title Company (9th Cir. 1974) 507 F.2d 895, 898 , cert. denied, 422 U.S. 1046, 95 S. Ct. 2664, 45 L. Ed. 2d 699 (1975)* ; *see 42 U.S.C. § 2000e-2(a)*].

[g] National Origin Discrimination

Title VII and the FEHA prohibit employment discrimination based on national origin [*see 42 U.S.C. § 2000e-2*; *Gov. Code § 12940(a)*]. "National origin" refers to the country where a person was born, or the country from which his or her ancestors came [*Espinoza v. Farah Mfg. Co. (1973) 414 U.S. 86, 88, 94 S. Ct. 334, 38 L. Ed. 2d 287]* .

[h] Citizenship

An employer must attest on a prescribed form that it has verified that the a prospective employee is not an unauthorized alien by having examined certain acceptable documentation [*see 8 U.S.C. § 1324a(b)(1)*; *see also § 1C.110*, P 4 (list of acceptable documents)].

[i] Family Status Discrimination

Generally, selection of applicants based on marital status or pregnancy or related medical conditions is unlawful sex discrimination [*see 42 U.S.C. § 2000e(k)*]. Employers may not ask applicants to disclose marital status, but may ask for any former names used to check past work records [*2 Cal. Code Reg. § 7292.4(a), (b)*].

An employer may not ask questions regarding pregnancy, birth control, or family responsibilities unless they relate to specific and relevant working conditions of a particular job [*2 Cal. Code Reg. § 7290.9(b)(3)*].

[j] Perceived Sexual Orientation Discrimination

The FEHA expressly prohibits discrimination and harassment based on sexual orientation, which is defined to include heterosexuality, homosexuality, and bisexuality [*Gov. Code §§ 12926(q), 12940(a), (j)*]. Under California law, the FEHA occupies the field of employment discrimination and preempts local ordinances prohibiting sexual orientation discrimination in employment [Delaney v. Superior Fast Freight (1993) 14 Cal. App. 4th 590, 596-598, 18 Cal. Rptr. 2d 33 ; *see Gov. Code § 12993(c)*]. However, the prohibition does not apply religious associations and corporations not organized for profit [*Gov. Code §§ 12926(d), 12940(j)(4)(B)*].

[k] Age Discrimination

It is unlawful for an employer to discriminate on the basis of age for individuals who are over 40 years of age [*29 U.S.C. §§ 623(a), 631(a)*]. However, requests for age or date of birth do not violate the Age Discrimination in Employment Act (ADEA) if made for a proper purpose. Employers who request age or date of birth should provide a notice on applications stating that the ADEA prohibits age discrimination [*see 29 C.F.R. § 1625.5*]. For further discussion, see *§ 1C.11[2]*.

The FEHA expressly prohibits discrimination on the basis of age [*Gov. Code § 12940(a)*]. However, nothing in the FEHA prohibits an employer from refusing to employ an individual because of his or her age if the law compels or provides for that refusal. Promotions within the existing staff, hiring or promotion on the basis of experience and training, rehiring on the basis of seniority and prior service with the employer, or hiring under an established recruiting program from high schools, colleges, universities, or trade schools do not, in and of themselves, constitute unlawful employment practices [*Gov. Code § 12940(a)(5)*]. Further, an employer or employment agency is not barred from inquiring into the age of an applicant, or from specifying age limitations, when the law compels or provides for that action [*Gov. Code § 12940(d)*].

[l] Disability Discrimination

Under the Americans With Disabilities Act, an employer may not discriminate regarding employment against a qualified person with a disability because of the disability [*see 42 U.S.C. § 12112(a)*]. However, an employer may make pre-employment inquiries into the ability of an applicant to perform job-related functions [*42 U.S.C. § 12112(d)(2)(B)*]. For further discussion, see *§ 1C.10[8]* (California law) and § 1C.11[4] (federal law).

[m] Height and Weight Discrimination

An employer may impose height, weight, and strength standards if they are necessary for the requirements of the job [*see Blake v. City of Los Angeles (9th Cir. 1979) 595 F.2d 1367, 1375 , cert. denied, 446 U.S. 928, 100 S. Ct. 1865, 64 L. Ed. 2d 281 (1980)]* . However, standards that have a discriminatory impact are invalid unless the employer can show a "business necessity" for the standards [*see Blake v. City of Los Angeles (9th Cir. 1979) 595 F.2d 1367, 1376 , cert. denied, 446 U.S. 928, 100 S. Ct. 1865, 64 L. Ed. 2d 281 (1980)]* .

[n] Veteran Status Discrimination

Title VII expressly authorizes special employment rights and preferences for veterans [*see 42 U.S.C. § 2000e-11*].

[o] Language Discrimination

Denying employment because of a foreign accent or inability to communicate well in English may constitute national origin discrimination [*29 C.F.R. § 1606.6(b)(1)*].

[p] Use of Subjective Criteria

While the use of subjective criteria in making employment decisions is not per se illegal, to the extent the criteria reflect subconscious stereotypes and prejudices, they may be unlawful as disparate impact discrimination [*Watson v. Fort Worth Bank and Trust (1988) 487 U.S. 977, 990-991, 108 S. Ct. 2777, 101 L. Ed. 2d 827]* .

[q] Legality of Specific Inquiries

[i] Education

An employer may inquire about education as long as it bears a demonstrable relationship to successful job performance [*Griggs v. Duke Power Co. (1971) 401 U.S. 424, 431, 91 S. Ct. 849, 28 L. Ed. 2d 158]* .

[ii] Job Experience

Employers may inquire about past job experience if it is indicative of important aspects of performance on the job for which applicants are to be evaluated [29 C.F.R. § 1607.5B]. Employers who consider past work experience must also consider unpaid or volunteer work experience [*2 Cal. Code Reg. § 7291.0(d)*].

[iii] Investigative Reports

An employer may use an investigative consumer report for employment purposes. If the report is sought for employment purposes other than suspicion of wrongdoing by the subject of the investigation, the person procuring or causing the report to be made must (1) have a permissible purpose [*see Civ. Code § 1786.12*]; and (2) provide a clear and conspicuous disclosure in writing to the consumer before the report is procured or caused to be made, in a document consisting solely of the disclosure, as required by statute. In addition, the consumer must give written authorization for the procurement of the report [*Civ. Code § 1786.16(a)(2)*]. For further discussion, see *§ 1C.21[8]*.

[iv] Credit Reports

An employer may obtain a consumer credit report from a consumer credit reporting agency if it intends to use the information for employment purposes [*Civ. Code § 1785.11(a)(3)(B)*; *see 15 U.S.C. §§ 1681-1681t* (Fair Credit Reporting Act of 1970)]. Before requesting a report, the employer must give written notice to the applicant of the report, and provide a means for the applicant to receive a copy of the report [*Civ. Code § 1785.20*.5(a)].

[v] Arrests or Detentions

In general, an employer may not ask an applicant to disclose information concerning an arrest or detention that did not result in conviction, or informationconcerning participation in a diversion program [*Lab. Code § 432.7(a)*]. This information can be sought from persons already employed as peace officers or for positions in the Department of Justice or other criminal justice agencies [*Lab. Code § 432.7(e)*].

[vi] Disabilities

An employer may not ask a job applicant if he or she is an individual with a mental or physical disability or medical condition, or inquire about the nature or severity of the disability or condition. However, an employer may make pre-employment inquiries into the ability of an applicant to perform job-related functions [*42 U.S.C. § 12112(d)(2)*; *see Gov. Code § 12940(a), (d), (e)*; *see also 2 Cal. Code Reg. § 7294.0(b)*]. For further discussion, see *§ 1C.10[8]* (California law) and § 1C.11[4] (federal law).

[vii] Fingerprints and Photographs

An employer may take fingerprints and photographs of applicants and employees for the employer's own use [10 Ops. Atty. Gen. 19, 21 (1947)]. An employer who requires fingerprints or photographs as a condition of employment may not give them to any other person when they could be used to the applicant's or employee's detriment [*Lab. Code § 1051*]. Fingerprints are required of persons employed in a number of regulated professions [*see, e.g., Bus. & Prof. Code §§ 7525.1* (private investigators), 7546 (security guards)].

[viii] Age

Under California law, it is not an unlawful employment practice to inquire into a job applicant's age, or to specify age limitations, when the law compels or provides for that action [*Gov. Code § 12940(d)*].

[r] Tests and Examinations

[i] Ability Test

It is not an unlawful employment practice to give and act on the results of a professionally developed ability test, provided that the test, its administration, or the action on its results is not designed, intended, or used to improperly discriminate [*42 U.S.C. § 2000e-2(h)*]. However, an employer may not use an employment test that screens out individuals or classes with disabilities unless the test is shown to be job-related for the position in question and is consistent with business necessity [*42 U.S.C. § 12112(b)(6)*].

Under Title VII, before an employer can discard test results to avoid a disparate impact on minority candidates--an act that would itself constitute intentional race-based discrimination against those who did well on the test--the employer must have a strong basis in evidence to believe it will be subject to disparate-impact liability if it fails to take the race-conscious, discriminatory action of discarding the test results [*Ricci v. DeStefano (2009) 129 S. Ct. 2658, 174 L. Ed. 2d 490, 507-511, 2009 U.S. LEXIS 4945* (adopting "strong-basis-in-evidence" standard to resolve conflict between disparate-treatment and disparate-impact provisions of Title VII); *see 42 U.S.C. § 2000e-2(a)(1)* (prohibition of disparate treatment); *42 U.S.C. § 2000e-2(k)*(prohibition of disparate impact)].

[ii] Medical Examination

An employer may require a medical examination after an offer of employment has been made to a job applicant, and may condition an offer of employment on the results of the examination if (1) all entering employees are subject to the examination, regardless of disability; (2) information obtained is treated as a confidential medical record with limited exceptions; and (3) the results of the test are used only as specified in the Americans With Disabilities Act [*42 U.S.C. § 12112(c)(3)*].

The FEHA allows employers, in connection with prospective employment, to obtain information about the applicant's physical or mental disability or medical condition if the inquiry relates to a position the applicant is applying for, or to a determination of whether the applicant can safely perform the job [*see Gov. Code § 12940(d), (e)*]. Specifically, an employer or employment agency may inquire into the applicant's ability to perform job-related functions and may respond to an applicant's request for reasonable accommodation [*Gov. Code § 12940(e)(2)*]. Further, an employer or employment agency may require a medical or psychological examination or make a medical or psychological inquiry after making a job offer but before the commencement of employment duties, provided that (1) the examination or inquiry is job-related and consistent with business necessity, and (2) all entering employees in the same job classification are subject to the same examination or inquiry [*Gov. Code § 12940(e)(3)*]. For further discussion, see *§ 1C.21[2][h]*.

[iii] HIV Test

The results of an HIV test [*see Health & Safety Code § 120775(c)*], which identifies or provides identifying

characteristics of the person to whom the test results apply, may not be used in any instance for the determination of suitability for employment [*Health & Safety Code § 120980(f)*; *see Health & Safety Code § 121115* (fact of person's participation in AIDS research study may not be used to determine employability)]. Note that the disclosure of HIV positive status may be entitled to privacy protection under *California Constitution Article I, Section 1* [*Urbaniak v. Newton (1991) 226 Cal. App. 3d 1128, 1140, 277 Cal. Rptr. 354]* .

[iv] Drug Test

Under a balancing test announced by the California Supreme Court, pre-employment drug testing will be valid if a "competing interest" standard can be met. The result will depend on the public interest, the employer's special interests, and the applicants' reasonable expectations of privacy in a particular employment setting [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 55-56 n.20, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* . This "competing interest" defense involves the use of a balancing test that compares the specifically identified privacy interests of the plaintiff with legitimate, competing, and countervailing nonprivacy interests asserted by the defendant [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 38, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* . If the interests asserted by the defendant justify the invasion of privacy, the intrusion does not violate the California Constitution. The relative importance of an asserted interest depends on its proximity to the central functions of a particular public or private enterprise [*Hill v. National Collegiate Athletic Assn. (1994) 7 Cal. 4th 1, 40, 26 Cal. Rptr. 2d 834, 865 P.2d 633]* . If a properly planned and administered drug testing program is adopted, and used for applicants for jobs that relate to safety, security, or other sensitive issues, it is likely that the program will be valid.

For specific jobs in which safety is paramount, such as airline and railroad operations workers, pre-employment drug testing is mandated by federal law [*see, e.g., 14 C.F.R. §§ 120.7(f), 120.35, 120.109(a), 120.101 et seq.* (airlines); *49 C.F.R. §§ 219.501-219.505* (railroads)]. For further discussion, see *§ 1C.21[4]* and California Employment Law, Ch. 41, *Substantive Requirements Under Equal Employment Opportunity Laws*, and Ch. 50, *Limitations of Employer Collection of Private Information About Employees* (Matthew Bender).

[v] Alcohol Test

The privacy issues surrounding alcohol tests are similar to those in drug tests [*see* [iv], *above*]. Alcohol tests are usually less intrusive than drug tests, and generally do not test for any substance other than alcohol. For these reasons, alcohol tests are even more likely to withstand a privacy challenge than drug tests [*see* California Employment Law, Ch. 50, *Limitations on Employer Collection of Private Information About Employees* (Matthew Bender)].

[vi] Lie Detector Test

An employer may not demand or require that a job applicant take a polygraph, lie detector, or similar test as a condition of employment [*Lab. Code § 432.2(a)*; *see 29 U.S.C. §§ 2001-2009* (Employee Polygraph Protection Act of 1988)].

[2] FORM

Letter to Client Containing Pre-employment Checklist

_____ [*date*]

Dear _____ [*name of client*] :

This letter is a checklist of procedures you can refer to in the hiring of employees for _____[*name of business*]. By following the procedures set out in this letter, you should be able to hire capable employees in a legal and efficient manner.

1. Determine the number and type of job positions you intend to fill.

2. Establish the time and place for interviews with applicants.

3. Advertise the positions that are available, as follows:

a. For non-specialized employment, advertise in:
(1) A local newspaper of wide circulation.

(2) Job offices of local schools.

(3) An employment agency.

(4) Any Employment Development Department office.

b. For specialized employment, advertise in industry publications of desired circulation.

c. Do not advertise in a manner that indicates a preference, limitation, specification, or discrimination based on any of the following prohibited classifications:

(1) Race.

(2) Color.

(3) Religion.

(4) Sex.

(5) National origin.

(6) Age, unless the law provides for or compels that action [*see Gov. Code § 12940(d)*].

4. Limit your pre-employment inquiries to the following permissible areas:

a. Citizenship or authorized alien status.

b. Education.

c. Job experience.

d. Height, weight, and physical ability (if related to the requirements of the job).

e. Veteran status.

f. An investigative report.

g. A credit report.

h. Fingerprints and photographs.

i. Relevant and nondiscriminatory subjective criteria, such as:

(1) A stable employment history.

(2) The applicant's professional reputation.

(3) The applicant's ability to get along with other employees.

(4) The general demeanor of the applicant.

5. Consider other relevant factors, including:

a. Fluency in English if it is related to job performance.

b. Personal appearance and dress.

6. Do not inquire into areas unrelated to job performance, such as:

a. Race, color, or national origin.

b. Sex.

c. Religion.

d. Information concerning criminal arrests.

e. Marital or family status.

f. Pregnancy.

g. Physical handicap or disability unrelated to duties of job.

h. Perceived sexual orientation.

7. Conduct the following examinations and tests, if desired:

a. Ability test to determine applicant's qualification for the duties of the job.

b. Medical examination to determine applicant's physical ability to perform the job.

c. Drug and alcohol test for position in which there is concern for safety, security, or other sensitive issues, or when required by federal law for certain jobs in the transportation industry.

The law in California concerning pre-employment drug testing is in a state of flux. However, a properly planned and administered drug test for a job in which safety, security, or another sensitive issue is paramount should present no legal problem.

8. Do not conduct the following invalid or uncertain tests:

a. HIV test.

b. Polygraph test.

If you have questions about advertising job openings or interviewing or testing applicants, do not hesitate to contact me.

_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawPreemployment Practices



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
A. Client Letters

1-1C California Legal Forms--Transaction Guide § 1C.201

§ 1C.201 Letter Offering Employment

[1] Comment

[a] Use of Form

This form is a letter offering employment. The attorney should provide a basic form letter modeled on this form for the client to send to a job applicant to make an offer of employment. While the use of an employment letter is not mandatory, it can help to establish the understanding of the employee and employer about the conditions of employment. Having a clear written understanding helps to prevent future problems concerning the duties of the job offered, salary, starting date, and permissible reasons for termination. Offer letters are typically used for highly paid and executive employees, but can be used for any job offer.

This form contains optional text that may be included if the employer wishes to make clear that the offer is for employment at will [*see* [b], *below*].

[b] Employment at Will

Employment having no specified term ("at-will" employment) may be terminated at the will of either party on notice to the other [*Lab. Code § 2922*]. In an at-will employment relationship, the employer has the privilege to discharge the employee with or without cause [*Crain v. Burroughs Corp. (C.D. Cal. 1983) 560 F. Supp. 849, 853]* , subject to limitations based on public policy and implied covenants [*see Shapiro v. Wells Fargo Realty Advisors (1984) 152 Cal. App. 3d 467, 475-476, 199 Cal. Rptr. 613]* . The at-will clause may be included in the letter to remove any uncertainty about the nature of the employment. By signing and returning the letter, the employee will have agreed in an enforceable contract to at-will employment. This at-will clause would supersede any language to the contrary in employee manuals or other company literature [*see Crain v. Burroughs Corp. (C.D. Cal. 1983) 560 F. Supp. 849, 852]* .

For discussion of at-will employment and the exceptions to at-will employment that prohibit termination on certain bases, see *§ 1C.30*.

[2] FORM

Letter Offering Employment

_____ [*date*]

Dear _____ [*name of applicant*] :

Thank you for taking the time to talk with _____[*names of interviewers*] on _____[*date*] about employment with _____[*name of company*]. Based on the interview, your application and resume [*add if applicable*:, and your test scores], we would like to offer you the position of _____[*name of position*], at a salary of $ _____ per _____[*period*]. It was our understanding from the interview that if you accept this position, you will be able to begin work on _____[*date*].

To accept this position, please sign and date the Acceptance of Offer of Employment below and return it in the enclosed envelope by _____[*date*]. If you have any questions, do not hesitate to call me at _____[*telephone number*].

Sincerely,
_____ [*signature*]
[*typed name*]
[*title*]

Acceptance of Offer of Employment

I accept this offer of employment on _____[*date*]. [*If employment is at will, add*: In consideration of employment by _____ (*name of company*), I agree to abide by all company rules and policies. I also agree that my employment is strictly at will, and that the company or I may terminate my employment at any time with or without cause. Inaddition, I understand that no representative of the company other than _____ (*e.g.*, the President) has the authority to enter into an agreement with me for employment for a specific period, or for employment subject to any other conditions.]

_____ [*signature of prospective employee*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEmployment RelationshipsAt-Will EmploymentGeneral OverviewLabor & Employment LawEmployment RelationshipsEmployment ContractsConditions & TermsDischargesLabor & Employment LawEmployment RelationshipsEmployment ContractsConditions & TermsDuration of EmploymentGeneral OverviewLabor & Employment LawEmployment RelationshipsEmployment ContractsFormationLabor & Employment LawPreemployment Practices



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
A. Client Letters

1-1C California Legal Forms--Transaction Guide § 1C.202

§ 1C.202 Letter to Client Containing List of Required Employer Tax Forms

[1] Comment--Use of Form

This form is a client letter the attorney should send to alert the client to the various official employment-related forms that must be obtained and filed by the employer, or provided to the employee. For discussion of the employer's obligation to register with the Employment Development Department (EDD) and the Internal Revenue Service (IRS), and to withhold and pay income, unemployment, disability, and other taxes, see *Sections 1C.40* and *1C.41*. For more information about the use of these forms, see California Employer's Guide, EDD Publication DE 44, and Circular E, Employer's Tax Guide, IRS Publication 15.

[2] FORM

Letter to Client Containing List of Required Employer Tax Forms

_____ [*date*]

Dear _____ [*name of client*] :

This letter contains a list of forms you will need to use regarding payment and reporting of California and federal taxes. All these forms are official forms, and should be obtained from and filed with the government agencies mentioned. In some cases, as mentioned below, the California and federal authorities each require separate forms. In other cases, the same form can be used for both. In still other cases, use of the California form is optional, and the federal form may be used for both California and federal purposes, if desired. Please be sure to follow the use and filing requirements exactly. Two helpful publications you should obtain are the California Employer's Guide, Publication DE 44, available from any employment tax district office of the Employment Development Department (EDD), and Circular E, Employer's Tax Guide, IRS Publication 15, available from any IRS office.

1. Use California EDD Form DE-1 to register as an employer with the EDD. Use federal IRS Form SS-4

to apply for a federal employer identification number with the IRS.

2. When hiring new employees, or when employees return from layoff, furlough, separation, leave of absence, or termination, use EDD Form DE 34 to report the names and social securities numbers of the employees to the EDD within 30 days of hiring.

3. Use the tax deposit coupon, California EDD Form DE 88, to make required monthly or semi-weekly deposits for employees' disability insurance and income tax contributions with the EDD. Use federal Treasury Department Form FTD 501 or FTD 511 to deposit the equivalent federal contribution with the IRS.

4. Use the quarterly contribution return, California EDD Form DE 3DP, to make required quarterly payments for employees' income tax and disability tax, and to deposit the employer's unemployment tax and employment training tax contributions with the EDD. Use federal IRS Form 941 to make the contribution for federal income tax and Social Security and Medicare tax withheld. Use federal IRS Form 940 to make the contribution for federal unemployment tax. Use federal IRS Form 945 as the annual return of nonpayroll income tax withholding.

5. Use the reconciliation of income tax withheld, California EDD Form DE 43, to reconcile the amount of California income tax withheld as reported on IRS Forms W-2 and 1099-R, with the total amount withheld and reported on the contribution returns, including any adjustments, and submit the form to the EDD. Use federal IRS Form W-3 to make the federal reconciliation with the Social Security Administration.

6. Provide federal IRS Form W-2 as a wage and tax statement for each employee to file with both the IRS and the California Franchise Tax Board (FTB).

7. Provide federal IRS Form 1099-R as an employee statement for distributions from pensions, annuities, retirement or profit-sharing plans, IRAs, and insurance contracts, for each employee to file with both the IRS and the FTB.

8. Provide the employee's withholding allowance certificate, California EDD Form DE 4, for employees to specify their California rate of income tax withholding. Provide federal IRS Form W-4 for employees to specify their federal rate of income tax withholding. If desired, employees can use federal IRS Form W-4 for both California and federal purposes, and not file a separate EDD Form DE 4. Either of these forms can also be used by the employee as a withholding exemption certificate.

9. Provide the employee's withholding allowance certificate for pension or annuity payments, California EDD Form DE 4P, for employees to specify their California rate of income tax withholding for pension or annuity payments. Provide federal IRS Form W-4P for employees to specify their federal rate of income tax withholding for pension or annuity payments. If desired, employees can use federal IRS Form W-4P for both IRS and FTB purposes, and not file a separate EDD Form DE 4P.

10. Provide the request for state income tax withholding from sick pay, California EDD Form DE 4S, for employees to request that state income tax be withheld from sick pay paid by a third party, such as an insurance company. Provide federal IRS Form W-4S for employees to request that federal income tax be withheld from sick pay paid by a third party. If desired, employees can use federal IRS Form W-4S for both IRS and FTB purposes, and not file a separate EDD Form DE 4S. These forms are used to provide for withholding of income tax from sick pay paid by third parties only, because sick pay paid by the employer will automatically have income tax withheld.

If you have questions about the use, completion, or availability of any of these forms, do not hesitate to contact me.

_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawPosting & RecordkeepingTax LawFederal Tax Administration & ProcedureGeneral OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)General OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)Liability for Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
A. Client Letters

1-1C California Legal Forms--Transaction Guide § 1C.203

§ 1C.203 Letter to Client Containing List of Recordkeeping Requirements Related to California and Federal Taxes

[1] Comment--Use of Form

This form is a client letter the attorney should send to alert the client to the requirements to keep certain employee records relating to California and federal income tax, unemployment tax, and other miscellaneous taxes. For a discussion of the obligation to retain records relating to employment taxes, see Chapters 1D, *Overview of Employee Benefits* , and 1E, *Taxation of Businesses* . In addition, two useful resource relating to the reporting of federal employment taxes are IRS Publications 334, Tax Guide for Small Business, and 937, Business Reporting. For more California employment tax information, see EDD Publication DE 44, California Employer's Guide.

[2] FORM

Letter to Client Containing List of Recordkeeping Requirements Related to California and Federal Taxes

_____ [*date*]

Dear _____ [*name of client*] :

This letter contains a list of records you must keep in your capacity as an employer. These records relate to California and federal recordkeeping requirements applicable to income tax, disability tax, unemployment tax, and other taxes. Both California and federal records must be retained for at least four years after the return period to which the records relate or the date the tax is paid, whichever is later. Note that even if you believe you are not subject to the California Unemployment Insurance Code provisions, or are engaged only in exempt employment, you must still retain employment records for at least four years.

As a general rule, your records need not be in any particular form. However, in some cases (described below) official forms must be filed or retained. You may use anyrecordkeeping system you like, as long as it provides a true and

accurate record of the required information. A precise and organized system is recommended, because you must have ready access to the information if you are audited by a state or federal agency.

California Tax Records:

1. Money wages paid (including reported tips), the dates and amounts of payment, and the period covered.

2. For each employee hired:

a. Name.

b. Social security number.

c. Date hired.

d. Date of release, lay off, or leave of absence.

e. Occupation.

f. Place of work.

3. For each employee receiving pay for personal injury or sick leave:

a. Period of personal injury or sick leave.

b. Amount and weekly rate of personal injury or sick leave pay.

c. Whether payment was made by you or a third-party insurer.

4. Fair market value of in-kind wages provided to employees.

5. Fair market value of meals and lodging provided to employees.

6. Fair market value of fringe benefits provided to employees.

7. Special payments (such as annual bonuses or gifts), the nature of each such payment, and the period of payment covered by the payment.

8. Amounts and dates of payments under pension and annuity plans, and copies of the plans and agreements themselves.

9. The amounts withheld from employee wages.

10. Any other information required to be shown on the unemployment and disability tax return, and the amount of the tax (Employment Development Department (EDD) Form DE 3DP).

11. Dates and amounts of all tax deposits made to EDD.

12. Copies of employees' withholding allowance certificate (IRS Form W-4 or EDD Form DE 4).

13. Any agreement between you and the employee on IRS Form W-4 or EDD Form DE 4 for the voluntary withholding of additional amounts of tax.

14. Copies of yearly statement of wages (IRS Form W-2) provided to each employee.

15. Copies of past employment tax returns filed.

16. EDD account number (EDD Form DE-1).

Federal Income Tax Records:

1. Each employee's name, address, and social security number.

2. The total amount and date of each wage payment and the period of time the payment covers.

3. The amount subject to withholding for each wage payment.

4. The amount of withholding tax collected on each payment and the date it was collected.

5. The reason why the taxable amount is less than the total amount, if they differ.

6. Copies of any statements furnished by employees relating to nonresident alien status.

7. The fair market value and date of each payment of noncash compensation made to a retail commission salesperson, if no income tax was withheld.

8. Information about the amount of each payment for wage continuation plans.

9. The withholding allowance certificate (IRS Form W-4) filed by each employee.

10. Any agreement between you and the employee on IRS Form W-4 for the voluntary withholding of additional amounts of tax.

11. The yearly statement of wages (IRS Form W-2) provided to each employee.

12. The dates in each calendar quarter on which the employee worked for you other than in the course of your trade or business, and the amount paid for that nonbusiness work.

13. Copies of statements furnished by employees reporting tips received in their work, unless the information shown on the statements appears in another item on this list.

14. Requests by employees to have the tax withheld figured on the basis of their individual cumulative wages.

Federal Social Security and Medicare Tax Records:

1. The amount of each wage payment subject to social security tax.

2. The amount of each wage payment subject to Medicare tax.

3. The amount of social security and Medicare taxes collected for each payment and the date collected.

4. The reason why the total wage payment is more than the taxable amount, if they differ.

Federal Unemployment Tax Records:

1. The total amount paid to your employees during the calendar year.

2. The amount of compensation subject to the unemployment tax, and why it differs from the total compensation, if they differ.

3. The amount you paid into the California Unemployment Fund.

4. Any other information required to be shown on the unemployment tax return, and the amount of the tax.

Federal Earned Income Credit Records:

1. Copies of each employee's IRS Form W-5.

2. Amounts and dates of all wage payments and advance earned income credit payments.

3. Dates of each employee's employment.

Miscellaneous Federal Records:

1. Employer identification number (IRS Form SS-4).

2. Copies of all tax returns filed.

3. Dates and amounts of all tax deposits made.

If you have questions about any of these recordkeeping requirements, do not hesitate to contact me.

_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawPosting & RecordkeepingLabor & Employment LawWage & Hour LawsRecordkeeping RequirementsTax LawFederal Tax Administration & ProcedureAdministrationIdentification Numbers & Information Returns (IRC secs. 6031-6065)Tip ReportingTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesGeneral OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates &

Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)General OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FICA DeductionsTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FUTA CreditsTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FUTA Rate of TaxTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)Liability for Tax



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
A. Client Letters

1-1C California Legal Forms--Transaction Guide § 1C.204

§ 1C.204 Letter to Client Containing Procedural Guide to Employee Taxes

[1] Comment

[a] Use of Form

This form is a client letter the attorney should send to the client to give an overview of the procedures governing the withholding and payment of California and federal employee taxes. For further discussion of the California procedures, see EDD Publication DE 44, California Employer's Guide. For further discussion of the federal procedures, see IRS Circular E, Employer's Tax Guide (IRS Publication 15).

[b] Duty to Withhold and Pay Employment Taxes

[i] California Law

Under California law, employers must (1) deduct, withhold, and contribute income tax from employees' wages [*see Unemp. Ins. Code § 13020(a)*]; (2) make their own separate unemployment tax payment without deducting it from employees' wages [*see Unemp. Ins. Code §§ 976, 977*]; (3) deduct, withhold, and contribute employees' disability contributions [*see Unemp. Ins. Code § 2602(a)*]; and (4) make their own contribution to the Employment Training Fund [*see Unemp. Ins. Code § 976.6*; *see also Unemp. Ins. Code §§ 1610-1612*]. For further discussion of the duty to deduct and withhold these taxes, see Chapters 1D, *Overview of Employee Benefits* , and 1E, *Taxation of Businesses* .

[ii] Federal Law

Under federal law, employers must (1) deduct, withhold, and contribute income taxes from employees' wages [*see I.R.C. § 3402(a)*]; (2) deduct and pay Social Security and Medicare tax from employees'wages [*see I.R.C. § 3102(a), (b)*] along with a separate Social Security and Medicare contribution of their own [*see I.R.C. § 3111*]; and (3) make their own contribution for the federal unemployment tax [*see I.R.C. § 3301*]. For further discussion of the duty to deduct and withhold these taxes, see Chapters 1D, *Employee Benefits* , and 1E, *Taxation of Businesses* .

[2] FORM

Letter to Client Containing Procedural Guide to Employee Taxes

_____ [*date*]

Dear _____ [*name of client*] :

This letter contains a list of the steps you must take for the withholding and payment of California income, disability, unemployment, and employment training taxes, and federal income, social security, and unemployment taxes. The items below present an overview of the steps necessary to comply with withholding and filing requirements. For further discussion of the employer's duty to withhold and contribute California taxes, see EDD Publication DE 44, California Employer's Guide. For further discussion of the employer's duty to withhold and contribute federal taxes, see IRS Circular E, Employer's Tax Guide (IRS Publication 15).

California:

1. Determine that you have employees, not independent contractors.

2. Obtain California EDD account number by completing and filing EDD Form DE 1.

3. Record each employee's name and social security number. If an employee does not have a social security number, have him or her obtain one by completing IRS Form SS-5 and filing it with the Social Security Administration.

4. When you hire a new employee, or an employee returns from a layoff, furlough, separation, leave of absence, or termination, file EDD Form DE 34 or its equivalent within 30 days with the EDD.

5. Record and retain payroll information for each employee, including amount of wages, dates paid and period covered, any special payments, and amounts withheld for income and disability taxes.

6. Determine total amount of taxable wages. This includes salary, wages, commissions, tips, bonuses, in-kind payments such as meals and lodging, and other forms of compensation.

7. Obtain IRS Form W-4 or EDD Form DE 4 from each employee to determine how much income tax to withhold.

8. Determine income tax withholding, taking into account:

a. Wages paid.

b. Marital status.

c. Withholding allowances.

d. Voluntary additional withholding.

e. Exemption from withholding because employee had no income tax liability in previous year.

9. Figure income and disability tax withholding [*see* EDD Publication DE 44, California Employer's Guide].

10. Withhold income and disability taxes from employees' wages, pensions, and annuities.

11. Deposit withheld taxes with EDD on one of the following bases [*see* EDD Form DE 88ALL]:

a. Semi-weekly.

b. Monthly.

c. Quarterly.

12. Determine your own unemployment insurance tax and employment training tax contributions.

13. File the quarterly return of withheld income tax, disability tax, unemployment tax, and employment training tax with the EDD [*see* EDD Form DE 3DP].

Federal

1. Determine that you have employees, not independent contractors.

2. Obtain federal employer identification number by completing and filing IRS Form SS-4.

3. Record each employee's name and social security number. If an employee does not have a social security number, have him or her obtain one by completing IRS Form SS-5 and filing it with the Social Security Administration.

4. Determine total amount of taxable wages. This includes cash, most tips, bonuses, the fair market value of goods, lodging, meals, and all other forms of compensation.

5. Determine payroll period.

6. Obtain IRS Form W-4 from each employee to determine how much income tax to withhold.

7. Determine income tax withholding, taking into account:

a. Wages paid.

b. Marital status.

c. Withholding allowances.

d. Voluntary additional withholding.

e. Exemption from withholding because employee had no income tax liability in previous year.

8. Figure income, social security, and Medicare tax withholding, using applicable method [*see* IRS Circular E, Employer's Tax Guide (IRS Publication 15)].

9. Withhold taxes from wages, pensions, and annuities.

10. Deposit taxes with authorized depositary, such as IRS or Federal Reserve Bank.

11. File the quarterly return of withheld income tax, social security tax, and Medicare tax with the IRS [*see* IRS Form 941].

12. Determine your Federal Unemployment Tax contribution and file the Federal Unemployment Tax return with the IRS [*see* IRS Form 940].

13. Report withheld taxes to the Social Security Administration, using Copy A of each IRS Form W-2 and each IRS Form 1099-R.

14. Report annually nonpayroll income tax withholding, such as pensions, annuities, IRAs, military retirement, gambling winnings, and backup withholding, using IRS Form 945.

15. Report yearly earnings and taxes withheld to each employee on IRS Form W-2 by January 31 of the following tax year.

If you have questions about any of these procedural steps, do not hesitate to contact me.

_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawPosting & RecordkeepingLabor & Employment LawWage & Hour LawsRecordkeeping RequirementsTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)General OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FICA DeductionsTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)Income Tax Collected at Source



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
A. Client Letters

1-1C California Legal Forms--Transaction Guide § 1C.205

§ 1C.205 Letter to Client Containing List of Required Employee Notices to be Posted

[1] Comment

[a] Use of Form

This form is a letter the attorney should send to the client to alert the client to the various employee notices that employers must post in the workplace. In general, all of these notices must be posted prominently in a conspicuous place where employees, applicants, and union representatives can easily read them.

[b] Equal Employment Opportunity Notices

Employers subject to Title VII of the Civil Rights Act of 1964 [*see 42 U.S.C. §§ 2000e-2000e-17*] or the Americans With Disabilities Act (ADA) [*see 42 U.S.C. §§ 12101-12213*] must post notices describing applicable provisions of Title VII and the ADA [*see 29 C.F.R. § 1601.30*]. Employers subject to the Age Discrimination in Employment Act (ADEA) must post a notice pertaining to the applicability of the ADEA [*see 29 C.F.R. § 1627.10*]. All of these notices must be posted prominently in a conspicuous place where they can readily be observed by employees and applicants. For further discussion of equal employment opportunity laws, see *§§ 1C.10* and *1C.11*.

[c] Fair Labor Standards Act Notice

An employer who employs persons subject to the Fair Labor Standards Act (FLSA) minimum wage requirement [*see § 1C.52 [2]*] must post a notice that explains the provisions of the FLSA. If employees are exempted from overtime regulations, the employer must add a notation regarding the exemption [*29 C.F.R. § 516.4*].

Special posting requirements apply to employers whopay subminimum wages [*see, e.g.*, 29 C.F.R. § 522.6(d) (learner certificate)].

[d] Poster on Sexual Discrimination

Every employer must obtain from the Department of Fair Employment and Housing its poster on discrimination in employment that includes information relating to the illegality of sexual harassment. The poster must be posted in a prominent and accessible location in the workplace [*Gov. Code § 12950(a)*].

[e] Notice of Right to Request Family Care and Medical Leave

Every employer of 50 or more employees must provide notice to their employees of the right to request family care and medical leave. The official notice or a comparable employer-drafted notice must be posted in a conspicuous place or places where employees tend to congregate [*2 Cal. Code Reg. § 7297.8(a)*]. Employers may also give a copy of this notice to each employee *2 Cal. Code Reg. § 7297.8*]. For a form for giving notice of the right to family care and medical leave, see *§ 1C.233*. This form assumes that the attorney will provide the employer with a copy of the sample notice.

[f] Wage Orders

Each employer must post all wage orders regulating the employer's occupation, trade, or industry [*Lab. Code § 1183*; *see 8 Cal. Code Reg. §§ 11010-11150* (wage orders)]. For further discussion of wage orders, see *§ 1C.50*.

[g] Workers' Compensation

Every employer required to maintain workers' compensation insurance must keep posted a notice that states the name of the current workers' compensation insurance carrier, or that the employer is self-insured [*see 8 Cal. Code Reg. § 15565*]. The employer must post the notice in a conspicuous place frequented by employees, where they may easily read it during work hours [*Lab. Code § 3550(a)*]. The form and content of this notice will be prescribed by the administrative director of the Division of Workers' Compensation and must be easily understandable and advise employees that all injuries should be reported to their employer. If there are Spanish-speaking employees, the notice must be posted in both English and Spanish [*Lab. Code § 3550(d)*; *see Lab. Code § 3550(f)* (notice will be made available to self-insured employers and insurers)]. An employer's failure to post this notice automatically permits an employee to be treated by his or her personal physician with respect to any injury occurring during that failure [*Lab. Code § 3550(e)*]. If the employer is self-insured, the employer must also post the Certificate of Consent to Self-Insure [*8 Cal. Code Reg. § 15350.1*]. For further discussion of workers' compensation insurance, see Ch. 1D, *Employee Benefits* .

[h] OSHA Notices

Employers must post notices furnished by federal OSHA and Cal/OSHA informing employees about the protections and obligations provided by occupational safety and health laws [*see 8 Cal. Code Reg. § 340*; *29 C.F.R. § 1903.2(a)(1)*]. In addition, when required, the annual survey must be certified by a company executive [*see 8 Cal. Code Reg. § 14300.32(b)(3), (4)*] and posted in a conspicuous location where other employee notices are customarily posted [*see 8 Cal. Code Reg. § 14300.32(b)(5), (6)*; *see also 29 C.F.R. § 1904.5*]. The report must remain posted from no later than the first day of February of the year following the reporting year until April 30 of that year [*see 8 Cal. Code Reg. § 14300.32(b)(5), (6)*].

Employers must post a notice informing employees of their right to inspect and copy medical records and records of exposure to toxic substances [*see 8 Cal. Code Reg. § 3204(g)*]. A listing of telephone numbers to be called in emergencies must also be posted [*see 8 Cal. Code Reg. § 1512(e)*]. If an employer is issued a citation for violating an occupational safety and health law, the citation must be prominently posted at or near each place a violation referred to in the citation occurred [*see Lab. Code §§ 6317, 6318*]. For further discussion of occupational safety and health laws, see *§§ 1C.80-1C.90*.

[i] Notice of Payday

Every employer must post a notice specifying employees' regular paydays and the time and place of payment. The

employer must post the notice at the place of work, if practicable. Otherwise, the notice must be posted in another location where it can be seen as employees come or go to their places of work, or at theoffice or nearest agency for payment kept by the employer [*Lab. Code § 207*]. For a form for notice of payday, see *§ 1C.230*. This form assumes that the attorney will provide the employer with a copy of the sample notice.

[j] Notice of Time Off to Vote

Not less than 10 days before each statewide election, every employer must post a notice setting forth the employees' right to take time off work to vote. The notice must be posted at the place of work, if practicable, or otherwise where it can be seen by employees as they come and go to their place of work. The notice must set forth the provisions of *Elec. Code § 14350* [*Elec. Code § 14351*]. For a form for notice of employee's right to take time off to vote, see *§ 1C.231*. This form assumes that the attorney will provide the employer with a copy of the sample notice.

[k] Polygraph Act Notice

Employers subject to the federal Employee Polygraph Protection Act [*29 U.S.C. §§ 2001-2009*; *see 29 C.F.R. § 801.3(a)* (virtually all employers are subject to the Act)] must post a notice explaining the provisions of the Act. The notice must be posted in a prominent and conspicuous place where it can be seen by employees and applicants [*29 C.F.R. § 801.6*].

[l] Rate of Pay for Farm Employees

Farm labor contractors must display the rate of compensation to be paid to employees at the site where work is to be performed and on all vehicles used to transport employees. This notice must be displayed prominently, and must be printed in both English and Spanish [*Lab. Code § 1695(7)*].

[m] Talent Agency Provisions

Talent agencies must post in a conspicuous place in their offices a printed copy of the Labor Code talent agency provisions and other statutes as specified by the Labor Commissioner [*Lab. Code § 1700.28*; *see Lab. Code §§ 1700-1700.47*]. For further discussion of the regulation of talent agencies, see Ch. 87, *Entertainment Contracts* .

[n] Asbestos-Related Work

An employer engaged in asbestos-related work [*see Lab. Code § 6501.8* ("asbestos-related work" defined)] must register with Division of Occupational Safety and Health to engage in asbestos-related work [*Lab. Code §§ 6501.5, 6502*]. The employer must post the registration on the jobsite beside the Cal/OSHA safety and health poster [*Lab. Code §§ 6501.5(d), 6504*]. In addition, the employer must post a sign warning of the danger of asbestos [*Lab. Code § 6501.5(c)*].

[2] FORM

Letter to Client Containing List of Required Employee Notices to be Posted

_____ [*date*]

Dear _____ [*name of client*] :

This letter is to alert you to the variety of employee information notices and posters you must post in your role as employer. These notices relate to a variety of subjects, including taxes, wages, occupational safety and health, equal

employment opportunity, and notices of paydays and the employee's right to take time off work to vote. I have also included mention of some special notices relating to your business. You must comply with these posting requirements. Employers who fail to do so are subject to civil and criminal penalties.

A number of federal laws prohibit unlawful job discrimination. If you employ at least 15 employees, you are subject to Title VII of the federal Civil Rights Act of 1964. If you employ at least 25 employees, you aresubject to the Americans With Disabilities Act. After July 26, 1994, that number will drop to 15 employees. If you employ at least 25 employees, you are also subject to the Age Discrimination in Employment Act. Depending on which of these acts applies to your business, you must post notices describing applicable provisions of these anti-discrimination laws. These notices must be posted prominently in a conspicuous place where they can readily be observed by employees and job applicants. The notices are available from the federal Equal Employment Opportunity Commission.

If you employ persons subject to the federal Fair Labor Standards Act (FLSA) minimum-wage requirement, you must post a notice that explains the provisions of the FLSA. Virtually all employees are covered by the FLSA. In addition, if you have employees who are exempt from overtime pay, such as professionals, executives, and outside salespersons, you must add a notation that the employees are exempt from overtime regulations. This notice is available from the Wage and Hour Division of the U.S. Department of Labor.

If you pay authorized subminimum wages to employees such as apprentices, learners, and messengers, you must post a copy of the particular certificate applicable to that type of subminimum wage employee. Certificates are issued by the administrator of the Wage and Hour Division of the U.S. Department of Labor.

You must obtain from the California Department of Fair Employment and Housing its poster on discrimination in employment that includes information relating to the illegality of sexual harassment. You must place the poster in a prominent and accessible location in the workplace

If you have 50 or more employees, you must post a notice informing your employees of the right to request family care and medical leave. The notice must be posted in a conspicuous place where employees tend to congregate. You may post either the official notice (which I have provided), or may draft and post your own notice, as long as it accurately reflects your company leave policy and California law.

You must post any California wage order that regulatesyour particular occupation, trade, or industry. The wage order applicable to your business is _____[*specify number and name of wage order, e.g.,* Order No. 11-80, Broadcasting Industry]. Copies of these wage orders are available from the California Industrial Welfare Commission.

Because you have employees, you must maintain workers' compensation insurance for them, and must post either a notice that states the name of your workers' compensation insurance carrier, or a notice that you are self-insured. The notice must be in a conspicuous place frequented by employees, where they may easily read it during work hours. If you are self-insured, you must also post the Certificate of Consent to Self-Insure, provided by the California Labor Commissioner.

Regarding occupational safety and health, you must post the federal OSHA safety and health poster and the Cal/OSHA poster entitled "Safety and Health Protection on the Job," which inform employees about the protections and obligations provided by occupational safety and health laws. These posters are available from federal OSHA and Cal/OSHA. In addition, you must post the Cal/OSHA poster entitled "Access to Medical and Exposure Records," which informs employees of their right to see and copy various records relating to exposure to toxic substances. You are also required to post a listing of telephone numbers to be called in emergencies, such as ambulances, police, the fire department, and Cal/OSHA.

If you are issued a citation for violating an occupational safety and health law, you must post the citation prominently at

or near each place a violation referred to in the citation occurred. You must keep the citation posted for three days or until you correct the unsafe condition, whichever is longer.

[*Add if employer is required to keep OSHA records*: You must also post the annual summary of occupational injuries and illnesses in a conspicuous place where employee notices are customarily posted. This summary is created from the log of occupational injuries and illnesses you must maintain on Form OSHA No. 200.]

You must post a notice specifying the employees'regular paydays and the time and place of payment. You must post this notice at the place of work, if practicable. Otherwise, it must be posted where it can be seen as employees come or go to their places of work, or at your office or nearest agency for payment. I have included a copy of a sample notice for you to use.

Not less than 10 days before each statewide election, you must post a notice setting forth the employee's right to take time off work to vote. The notice must be posted at the place of work, if practicable. Otherwise, it must be posted where it can be seen by employees as they come and go to their place of work. The notice must include certain required information. I have included a copy of a sample notice for you to use.

Under the requirements of the federal Employee Polygraph Protection Act, you must post a notice explaining the provisions of the Act. The notice must be posted in a prominent and conspicuous place where it can be seen by employees and applicants. Copies of the notice may be obtained from the Wage and Hour Division of the U.S. Department of Labor.

[*Add for farm labor contractor*: You must display a notice stating the rate of compensation to be paid to employees at the site where work is to be performed and on all vehicles used to transport employees. The notice must be displayed prominently, and must be printed in both English and Spanish in a specified type size.]

[*Add for talent agency*: You must post in a conspicuous place in your office a printed copy of the Labor Code talent agency provisions and other statutes as specified by the Labor Commissioner. The notice is available from the office of the California Labor Commissioner.]

[*Add for employer engaged in asbestos-related work*: You must post your registration to perform asbestos-related work on the jobsite beside the Cal/OSHA safety and health poster. You must also post a sign warning of the danger of asbestos.]

If you have questions about complying with any of these posting requirements, or need further assistance inobtaining or drafting the notices, do not hesitate to contact me.

_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawPosting & RecordkeepingLabor & Employment LawWage & Hour LawsRecordkeeping Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
A. Client Letters

1-1C California Legal Forms--Transaction Guide § 1C.206

§ 1C.206 Letter to Client Regarding Occupational Safety and Health Regulations

[1] Comment

[a] Use of Form

This form is a letter the attorney should send to the client to alert the client to the procedural and recordkeeping requirements of federal and state occupational safety and health laws. For further discussion of occupational safety and health laws, see *§§ 1C.80-1C.90*, and California Employment Law, Ch. 21, *Occupational Safety and Health Regulation* (Matthew Bender).

This letter assumes that the attorney will have copies of appropriate occupational safety and health laws and safety orders to provide to the employer.

[b] Scope of Federal OSHA

The federal Occupational Safety and Health Act of 1970 (OSHA) [*see 29 U.S.C. §§ 651-678*] was enacted to assure working people safe and healthful working conditions, and to preserve human resources [*29 U.S.C. § 651(b)*]. The Act applies to employment within the states, the District of Columbia, and certain other areas [*see 29 U.S.C. § 653(a)*]. It regulates each "employer," defined as a person engaged in a business affecting commerce who has employees [*29 U.S.C. § 652(5)*]. An "employee" is an employee of an employer who is engaged in a business of his or her employer that affects commerce [*29 U.S.C. § 652(6)*]. By use of the phrase "affecting commerce," Congress intended the scope of OSHA to be as broad as the Commerce Clause allows [Godwin v. Occupational Saf. & Health Rev. Com'n (9th Cir. [Cal.] 1976) *540 F.2d 1013, 1015* ; *see Wickard v. Filburn (1942) 317 U.S. 111, 127-128, 63 S. Ct. 82, 87 L. Ed. 122* (trivial contribution to commerce enough to be subjectto federal regulation)].

[c] State Plan Under Federal OSHA

Federal OSHA does not prevent a state from adopting its own occupational safety and health plan. The state plan may simply regulate areas outside the scope of OSHA's standards, or may take responsibility for the enforcement of all

OSHA standards if (1) the plan provides standards at least as effective as OSHA's standards, and (2) the state plan is approved by the Secretary of Labor [*see 29 U.S.C. § 667(a)-(c)*]. California's state plan [*see* [e], *below*] was granted approval for full responsibility in 1977 [*see* California Employment Law, Ch. 21, *Occupational Safety and Health Regulation* (Matthew Bender)].

[d] Federal OSHA Recordkeeping Requirements

Employers must make, keep, and make available records of the employer's activities relating to occupational safety and health [*29 U.S.C. § 657(c)*]. This requires employers to maintain a log and annual summary of all recordable occupational injuries or illnesses on Form OSHA No. 200 or an equivalent. Entries must be made within six working days after the employer learns of a recordable injury or illness [*29 C.F.R. § 1904.2*]. Employers must post the annual summary in a conspicuous place for employees to read [*29 C.F.R. §§ 1903.2(a)(1), 1904.5*]. Employers must also maintain a supplementary record of each injury or illness on Form OSHA No. 101 or an alternative acceptable form that gives details of the occurrence [*29 C.F.R. § 1904.4*]. All of these records must be retained for five years following the end of the year to which they relate [*29 C.F.R. § 1904.5*]. Federal recordkeeping requirements regarding injuries and illnesses are satisfied if the employer complies with California recordkeeping requirements [*see* California Employment Law, Ch. 21, *Occupational Safety and Health Regulation* (Matthew Bender); *see also* [f], *below*].

In addition, employers must report to OSHA about employment accidents in which an employee is killed or in which five or more employees are hospitalized [*see 29 C.F.R. § 1904.8*]. Employers with no more than 10 employees, employers engaged in physically dispersed operations, and employers in specified industries may follow simpler recordkeeping requirements, but still must comply with OSHA standards, display OSHA posters, and report fatal or and other serious accidents [*see* 29 C.F.R. §§ 1904.14-1904.16].

Even though Cal/OSHA has responsibility for enforcing federal OSHA standards in California [*see § 1C.80*], employers must still maintain any records and file any reports with the Secretary of Labor that are required by federal OSHA [*Lab. Code § 6410*; *see 29 U.S.C. § 657*; *29 C.F.R. §§ 1904.1-1904.22*].

[e] Scope of Cal/OSHA

The California Occupational Safety and Health Act of 1973 (Cal/OSHA) [*see Lab. Code §§ 6300-9061*] regulates the work environment to assure employees safe and healthful working conditions by authorizing the enforcement of effective standards, by assisting and encouraging employers in maintaining safe and healthful working conditions, and by providing research, information, education, training, and enforcement in the area of occupational safety and health [*Lab. Code § 6300*]. Cal/OSHA was enacted as a state plan to take full responsibility for enforcing federal OSHA safety and health standards, and is the mechanism for enforcing all occupational safety and health laws in California [*see 29 U.S.C. § 667(b)*], with limited exceptions.

[f] Cal/OSHA Recordkeeping Requirements

[i] Reports of Occupational Injuries and Illnesses

Most private employers must maintain a log and summary of all recordable occupational injuries and illnesses for each establishment on prescribed forms. Each recordable occupational injury and illness must be entered on the log as soon as practicable, within seven days after learning that the injury or illness occurred [*8 Cal. Code Reg. § 14300.29(b)(3)*; *see 8 Cal. Code Reg. § 14300.4-14300.11* (recording criteria)]. In addition, employers must complete an incident report for each injury or illness reported in the log, and an annual summary of all injuries and illnesses [*8 Cal. Code Reg. § 14300.29(a)*; *see 8 Cal. Code Reg. § 14300.29(b)(2)*]. A separate log must be maintained for each establishment of a business [*8 Cal. Code Reg. § 14300.30*; *see 8 Cal. Code Reg. § 14300.6* ("establishment" defined); *see also § 1C.85*].

Logs, summaries, and supplementary records must be established on a calendar-year basis [*see 8 Cal. Code Reg. §*

14300.32(a)], and must be maintained for five years after the end of the year to which they relate [*see 8 Cal. Code Reg. §§ 14300.33(a), 14300.44*]. Logs and summaries must be available for examination and copying by employees, former employees, and employee representatives [*see 8 Cal. Code Reg. § 14300.35(a)(2), (b)*]. The employer must also make the logs, summaries, and supplementary records available for inspection and copying by officials [*see 8 Cal. Code Reg. § 14300.40*].

Employers of no more than 10 employees in a calendar year and employers classified in the retail, service, finance, insurance, or real estate industries listed in *8 Cal. Code Reg. § 14300.2* are exempt from regular recordkeeping requirements [*see 8 Cal. Code Reg. §§ 14300.1(a), 14300.2(a)*]. These exemptions do not relieve the employers of their reporting obligations [*8 Cal. Code Reg. §§ 14300.1(a), 14300.2(a)*]. Employers subject to the federal Mine Safety and Health Act [*see 30 U.S.C. § 801 et seq.*] are not required to comply with these recordkeeping requirements if compliance would duplicate requirements under the Act [*8 Cal. Code Reg. § 14300.47*].

In addition, an employer must file a complete report with DLSR or with the employer's insurer of every occupational injury or illness [*see* Lab. Code § 6409 ("occupational injury or illness" defined)] to an employee that results in lost time beyond the date of the injury or illness, or that requires medical attention beyond first aid. This reporting requirement applies to each injury and illness that has, or is alleged to have, arisen out of and in the course of employment. The report must be filed within five days after the employer learns of the injury or illness. If the employee subsequently dies as a result of the reported injury or illness, the employer must file an amended report [*Lab. Code § 6409.1(a)*].

NOTE:

The report requirement imposed by *Labor Code Section 6409.1(a)* has been amended with a delayed effective date to require the insured employer to file the report with the insurer (on a Division of Workers' Compensation form prescribed for that purpose) within five days after the employer obtains knowledge of the injury or illness. A self-insured employer, the state, or the insurer of an insured employer also must file the report in an electronic form to be prescribed [*Lab. Code § 6409.1(a)* as amended by Stats. 2008, ch. 740, § 1]. These changes are effective on the effective date of implementing regulations to be adopted by the Department of Workers' Compensation, provided those regulations specify a transition period of no less than 180 days and no more than 545 days in which the employer or insurer may continue to comply with Section 6409.1 in its pre-amendment form [Stats. 2008, ch. 740, § 3].

In any case involving a serious injury or illness [*see 8 Cal. Code Reg. § 330(h)* ("serious injury or illness" defined)] or death, the employer must immediately report to the Division of Occupational Safety and Health (DOSH) by telephone or telegraph in addition to filing a report [Lab. Code. § 6409.1(b); *see 8 Cal. Code Reg. § 342*.].

Employers may be required to complete an annual survey of occupational injuries and illnesses [*see 8 Cal. Code Reg. §§ 14300.32, 14300.41*]. When required, the annual survey must be certified by a company executive [*see 8 Cal. Code Reg. § 14300.32(b)(3), (4)*] and posted in a conspicuous location where other employee notices are customarily posted. The report must remain posted from no later than the first day of February of the year following the reporting year until April 30 of that year [*see 8 Cal. Code Reg. § 14300.32(b)(5), (6)*].

For complete instructions on occupational safety and health recordkeeping, see the U.S. Department of Labor, Bureau of Labor Statistics, publication "Recordkeeping Guidelines for Occupational Injuries and Illnesses." While this publication relates specifically to federal OSHA records, most Cal/OSHA recordkeeping is identical to federal, and this publication is provided by the California Division of Labor Statistics and Research in response to inquiries about Cal/OSHA recordkeeping.

[ii] Records Relating to Injury and Illness Prevention Program

Employers must also keep records regarding the mandatory injury and illness prevention program [*Lab. Code § 6401.7(d)*; *see § 1C.82*]. Required records include a written program, records of inspections to identify unsafe conditions and work practices, and documentation of safety and health training. Records must be maintained for at least one year [*see 8 Cal. Code Reg. § 3203(a), (b)*]. For a sample written injury and illness prevention program, see *§ 1C.221*.

[iii] Cal/OSHA Notice

Every employer must post at least one copy of the Cal/OSHA Notice of Employee Protections and Obligations entitled "Safety and Health Protection on the Job" in a conspicuous place where employee notices are customarily posted. The employer must take steps to ensure that the notice is not altered, defaced, or covered by other material. An employer who fails to post the notice is subject to fine [*8 Cal. Code Reg. § 340*].

In addition, employers must post a notice informing employees of their right to inspect and copy medical records and records of toxic exposure [*see 8 Cal. Code Reg. § 3204(g)*].

[iv] Posting of Citations

Employers must prominently post citations and special orders and actions [*see Lab. Code §§ 6308, 6317*] at or near each place a violation referred to in the citation, order, or action occurred. The employer must maintain the posting for three working days, or until the unsafe condition is abated, whichever is longer. Similar notices must be posted following the abatement of a serious violation, and following the investigation of an industrial accident or occupational illness [*Lab. Code § 6318*; *see 8 Cal. Code Reg. § 332.4*].

[2] FORM

Letter to Client Regarding Occupational Safety and Health Regulations

_____ [*date*]

Dear _____ [*name of client*] :

This letter is to alert you to the procedural and recordkeeping requirements imposed by federal and California occupational safety and health laws. These laws are intended to ensure that employees have a safe and healthy work environment by regulating the facilities, practices, safeguards, materials, and substances that employees use and come in contact with in performing their jobs. Compliance with applicable parts of the laws is mandatory; violators are subject to civil and criminal penalties.

First, determine that your business is subject to federal OSHA and Cal/OSHA. Virtually all private employers in California are subject to both the federal and California acts. Because Cal/OSHA has full responsibility for enforcing the federal and California occupational safety and health law, this letter will list only the appropriate Cal/OSHA forms, which fulfill both the federal and California OSHA recordkeeping requirements. However, for some forms, such as Log 200, the annual summary of occupational injuries and illnesses, use of either the California or federal form is permissible.

Almost all businesses are required to comply with Cal/OSHA safety standards, display the Cal/OSHA employee safety poster, and report to Cal/OSHA within 48 hours an accident that results in one or more fatalities or the hospitalization of five or more employees.

Businesses in high-risk industries and establishments with 11 or more employees must also comply with Cal/OSHA recordkeeping requirements. Many types of businesses, such as retail stores, banks, insurance companies, other low-risk industries, and employers with 10 or fewer employees are either exempt from keeping Cal/OSHA records or may keep simplified records. Even if your business is exempt from Cal/OSHA recordkeeping, you must still comply with Cal/OSHA safety standards, display the Cal/OSHA poster, and report serious accidents to Cal/OSHA.

Once you have determined that your business is subject to federal OSHA and Cal/OSHA, display all required safety and health information posters, including the federal OSHA poster and the Cal/OSHA notices entitled "Safety and Health Protection on the Job" and "Access to Medical and Exposure Records."

The most important aspect of Cal/OSHA law is the enforcement of safety standards and safety orders pertaining to all employees and employees in specific industries. You must comply with all safety orders that relate to your business, including all occupational safety and health laws, standards for industries and materials, general orders covering subjects such as airborne contaminants and employee safety devices and safeguards, and specific orders relating to a particular business or industry. I will enclose copies of the laws and general and specific orders that regulate your business. Please review them carefully and contact me if you have any questions.

If an injury or illness occurs on the job, determine whether it is a recordable occupational injury or illness. An occupational injury or illness is recordable if it (1) results in a fatality; (2) results in lost workdays; (3) results in transfer to another job or termination of employment; (4) requires medical treatment other than first aid; or (5) results in loss of consciousness or restriction of work or motion.

If the occupational injury or illness is recordable, complete Cal/OSHA Log 200 and DLSR Form 5020 or their suitable equivalents. Cal/OSHA Log 200 is a log and summary of occupational injuries and illnesses. This form gathers information about the incident, including the name of the employee, extent of the injury or illness, and details about the circumstances of the injury or illness. You must make the entry in the log within six working days of learning of the injury or illness. In addition, you must prepare an annual summary on Cal/OSHA Log 200 for each establishment, based on information in the log. The annual summary must be posted in a conspicuous place where employee notices are posted. Federal OSHA Form 200 is an acceptable substitute for Cal/OSHA Log 200.

DLSR Form 5020 is a supplementary record of occupational injuries and illnesses. You must complete a supplementary record for every injury or illness on the log. The supplementary record gathers in greater detail than the log information about the circumstances, causes, and results of the injury or illness. Federal OSHA Form 101 is an acceptable substitute for DLSR Form 5020.

You must maintain separate records for each "establishment" covered by Cal/OSHA. This requires keeping separate injury and illness records for the employees of each physical location where business is conducted or operations are performed, such as a factory, restaurant, store, or other individual business. In addition, you must maintain separate records for each "distinctly separate activity" performed at each physical location. This requires separate records for employees of each fundamentally different part of your operation, such as manufacturing and bookkeeping. If you have employees who do not work at a fixed location, you may retain records for them at a field office or mobile operations base, or at an established central location, such as a personnel office.

You must maintain all of these records in each establishment for at least five calendar years following the end of the year to which the records relate. In addition, you must make the records available for inspection and copying on the request of state and federal officials, employees, former employees, and employee representatives.

If an injury or illness results in lost work time beyond the date of the injury, or if the employee requires medical attention beyond first aid, you must report the incident to the California Division of Labor and Statistics Research or your workers' compensation insurer within five days of learning of the accident. If the employee subsequently dies as a

result of the reported injury or illness, you must file an amended report. In any case involving a serious injury or illness or death, you must immediately report to the California Department of Occupational Safety and Health by telephone or telegraph in addition to filing a report. A "serious injury or illness" is one in which an employee is hospitalized for more than 24 hours other than for medical observation, or one in which an employee suffers the loss of any member of the body or a serious degree of permanent disfigurement.

If the employment injury or illness results in the death of an employee or the hospitalization of five ormore employees, you must also report either orally or in writing within 48 hours to the nearest office of the Area Director of federal OSHA.

[*Add if business employs 20 or more employees*: You must keep a written copy of your injury and illness prevention program, and must also keep records of your steps to implement and maintain the plan.]

If you have questions about complying with any of the provisions of federal OSHA or Cal/OSHA, or need any help in maintaining any of the required records, do not hesitate to contact me.

_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthCompliance & DefensesLabor & Employment LawOccupational Safety & HealthDuties & RightsLabor & Employment LawPosting & Recordkeeping



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
A. Client Letters

1-1C California Legal Forms--Transaction Guide §§ 1C.207-1C.219

[Reserved]

§§ 1C.207[Reserved]



89 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
B. Policies and Programs

1-1C California Legal Forms--Transaction Guide § 1C.220

§ 1C.220 Sample Policy on Sexual Harassment

[1] Comment

[a] Use of Form

This form is a sample company policy on sexual harassment. Because sexual harassment is illegal [*see* [b], *below*], an employer should adopt a policy of this type to help prevent sexual harassment in the workplace, for which the employer can be held liable [*see* [e], *below*].

This policy can be presented to employees in a number of ways. It can be incorporated into the company's employee manual, given to each employee during initial orientation or training, or distributed to employees in training sessions about harassment to raise employee awareness of sexual and other types of workplace harassment. This form is based on the model policy on sexual harassment produced by the Bar Association of San Francisco in conjunction with the California Women Lawyers. Copies of the sample policy and policy guidelines may be obtained from the Bar Association of San Francisco.

[b] Sexual Harassment Defined

Sexual harassment is a form of illegal sex discrimination under federal Title VII of the Civil Rights Act of 1866 [*see Meritor Savings Bank v. Vinson (1986) 477 U.S. 57, 73, 106 S. Ct. 2399, 91 L. Ed. 2d 49* ; *see also § 1C.11[1]* (discussion of Title VII)]. It is also illegal under the Fair Employment and Housing Act [*Gov. Code § 12940(a), (j), (k)*]. Under *Gov. Code § 12940(j)*, a cause of action for sexual harassment may be stated by a member of the same sex as the harasser, whether based on the quid pro quo theory of the hostile environment theory, or a hybrid of both theories [*Mogilefsky v. Superior Court (1993) 20 Cal. App. 4th 1409, 1418, 26 Cal. Rptr. 2d 116]* . Sexual harassment can take the form of verbal, physical, and visual harassment, as well as unwanted sexual advances [*2 Cal. Code Reg. § 7291.1(f)(1)*]. Harassment includes, but is not limited to, all of the following [*2 Cal. Code Reg. § 7287.6(b)(1)*]:

- Verbal harassment, such as epithets, derogatory comments, or slurs.

- Physical harassment, such as assault, impeding or blocking movement, or any physical interference with normal work or movement, when directed at an individual.

- Visual harassment, such as derogatory posters, cartoons, or drawings.

- Sexual favors, such as unwanted sexual advances that condition an employment benefit on an exchange of sexual favors.

For an expanded definition of sexual harassment, see Department of Fair Employment and Housing brochure DFEH-185.

Courts and the Equal Employment Opportunity Commission have recognized two major types of sexual harassment [*see* [c], *below*].

[c] Types of Sexual Harassment

[i] "Hostile Environment" Harassment

"Hostile environment" sexual harassment is harassment that has the purpose or effect of unreasonably interfering with an employee's work performance, or of creating an intimidating, hostile, or offensive working environment [*see 29 C.F.R. § 1604.11(a)*]. To prove that hostile environment sexual harassment has occurred, an employee must show (1) that he or she was subjected to sexual advances, requests for sexual favors, or other verbal or physical conduct of a sexual nature, (2) that the conduct was unwelcome, and (3) that the conduct was sufficiently severe or pervasive to alter the conditions of the victim's employment and create an abusive working environment [*Ellison v. Brady (9th Cir. 1991) 924 F.2d 872, 875-876* ; *see Meritor Savings Bank v. Vinson (1986) 477 U.S. 57, 106 S. Ct. 2399, 91 L. Ed. 2d 49]* . It is the harasser's conduct that must be pervasive or severe, and not the extent of alteration in the conditions of employment [*Ellison v. Brady (9th Cir. 1991) 924 F.2d 872, 878]* . As long as the environment would reasonably be perceived, and is perceived, as hostile or abusive, there is no need for it also to be psychologically injurious [*Harris v. Forklift Systems, Inc. (1993) 510 U.S. 17, 114 S. Ct. 367, 126 L. Ed. 2d 295, 302]* .

In some situations, the mere presence of an employee who has engaged in particularly severe or pervasive harassment can create a hostile environment [*Ellison v. Brady (9th Cir. 1991) 924 F.2d 872, 883]* .

[ii] "Quid Pro Quo" Harassment

"Quid pro quo" sexual harassment occurs when the employer or a superior employee makes a subordinate employee submit to sexual conduct as a condition of employment benefits [*Fisher v. San Pedro Peninsula Hospital (1989) 214 Cal. App. 3d 590, 607, 262 Cal. Rptr. 842* ; *see Hicks v. Gates Rubber Co. (10th Cir. 1987) 833 F.2d 1406]* . "Quid pro quo" harassment also occurs when submission to or rejection of sexual conduct by an employee is used by a superior as the basis for making employment decisions that affect the employee [*see 29 C.F.R. § 1604.11(a)*].

[d] Standard of Behavior

Sexual harassment cases are examined from the viewpoint of the victim of harassment (the "reasonable victim" standard). This means courts will apply the perspective of the reasonable woman in cases of sexual harassment against a woman, and the perspective of the reasonable man in cases of sexual harassment against a man [*see Ellison v. Brady (9th Cir. 1991) 924 F.2d 872, 879-880]* . The focus of a cause of action forsexual harassment is whether the victim has been subjected to sexual harassment, not what motivated the harasser [*Mogilefsky v. Superior Court (1993) 20 Cal. App. 4th 1409, 1418, 26 Cal. Rptr. 2d 116]* .

[e] Liability for Sexual Harassment

As mentioned under [b], *above*, sexual harassment is illegal sex discrimination under Title VII [*see Meritor Savings Bank v. Vinson (1986) 477 U.S. 57, 73, 106 S. Ct. 2399, 91 L. Ed. 2d 49]* . It is also unlawful under the Fair Employment and Housing Act [*Gov. Code § 12940(j)*].

If an employer or the employer's agent or supervisor sexually harasses an employee, job applicant, or person providing services pursuant to a contract [*see Gov. Code § 12920(j)(5)*], the employer is strictly liable for the harassment *see Burlington Indus., Inc. v. Ellerth (1998) 524 U.S. 742, 118 S. Ct. 2257, 2270, 141 L. Ed. 2d 633* (tangible employment decision); [*Kelly-Zurian v. Wohl Shoe Co. (1994) 22 Cal. App. 4th 397, 415, 27 Cal. Rptr. 2d 457* ; *Gov. Code §§ 12926(d), 12940(j)(1)*; *see 2 Cal. Code Reg. § 7287.6(b)(2)*].

An employer may also be liable for sexual harassment in the workplace due to the harassment of one employee by another employee who is not an agent or supervisor. Liability for an employee's act in this situation may be imputed to the employer if entity, its agents, or supervisors knows or should have known of the misconduct and fails to take immediate and appropriate corrective action. An employer must take all reasonable steps to prevent the occurrence of harassment [*Gov. Code § 12940(j), (k)*; *Ellison v. Brady (9th Cir. 1991) 924 F.2d 872, 881* ; *see 2 Cal. Code Reg. § 7287.6(b)(3)*]. Loss of tangible job benefits is not necessary to establish harassment [*Gov. Code § 12940(j)(1)*]. However, an employer will not be vicariously liable for an actionable hostile environment if the employer can plead and prove a two-part affirmative defense: first, that the employer exercised reasonable care to prevent and promptly correct any sexually harassing behavior, and second, that the employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer [*Burlington Indus. v. Ellerth (1998) 524 U.S. 742, 118 S. Ct. 2257, 2270, 141 L. Ed. 2d 633* ; *Faragher v. City of Boca Raton (1998) 524 U.S. 775, 118 S. Ct. 2275, 2292-2293, 141 L. Ed. 2d 662* ; *e.g., Hardage v. CBS Broad. Inc. (9th Cir. 2005) 427 F.3d 1177, 1183-1188* (employer successfully asserted Ellerth/Faragher defense)]. For discussion of the Ellerth/Faragher defense, see California Forms of Pleading and Practice, Ch. 115, *Civil Rights: Employment Discrimination* (Matthew Bender).

An employee of an entity covered by the FEHA is personally liable for any prohibited harassment by that employee, regardless of whether the employer knows or should have known of the conduct and fails to take immediate and appropriate corrective action [*Gov. Code § 12940(j)(3)*].

An employer may also be responsible for the acts of nonemployees with respect to sexual harassment of employees, applicants, or persons providing services pursuant to a contract in the workplace. Liability will be imputed if the employer, its agents, or its supervisors knows or should have known of the misconduct and fails to take immediate and appropriate corrective action. In reviewing cases involving the acts of nonemployees, the extent of the employer's control and any other legal responsibility that the employer may have with respect to the misconduct must be considered [*Gov. Code § 12940(j)(1)*].

[f] Prevention and Correction of Sexual Harassment

Employers must take all reasonable steps to prevent sexual harassment from occurring, and, if it does occur, must take appropriate corrective action [*Gov. Code § 12940(j)*]. Remedies should be reasonably calculated to end the sexual harassment. Possible remedies may include transferring, suspending, or terminating the harassing employee. In addition, employers should educate all their employees about sexual harassment, making sure employees know that sexual harassment is unlawful [*Ellison v. Brady (9th Cir. 1991) 924 F.2d 872, 882-883]* .

By adopting a policy on sexual harassment, distributing the policy to employees, and conducting employee training about sexual harassment, an employer should be able to prevent most forms of sexual harassment from occurring. However, if sexual harassment should occur despite an employer's best efforts, the employer may be able to defend itself by showing that it took all reasonable steps to prevent harassment by adopting an effective comprehensive policy and making employees aware of the policy and of the illegality of sexual harassment [*see* [e], *above*].

[g] Poster and Information Sheet

In addition to the responsibilities set forth in *Gov. Code § 12940(j)* and *(k)*, every employer must comply with both of the following [*Gov. Code § 12950(a), (b)*]:

- Obtain from the Department of Fair Employment and Housing its poster on discrimination in employment that includes information relating to the illegality of sexual harassment. The poster must be posted in a prominent and accessible location in the workplace.

- Obtain from the Department of Fair Employment and Housing its information sheet on sexual harassment (Brochure DFEH-185). The information sheet must be distributed to each of its employees, unless the employer provides its own equivalent information to the official information sheet. The information sheet must be delivered in a manner that ensures distribution to each employee, such as with paychecks [*see Gov. Code § 12950(c)*].

If the employer chooses to produce its own information sheet on sexual harassment, it must contain equivalent information to the official information sheet. It must contain, at a minimum, the following:

- The illegality of sexual harassment.

- The definition of sexual harassment under applicable state and federal law.

- A description of sexual harassment, using examples.

- The internal complaint process of the employer available to the employee.

- The legal remedies and complaint process available through the Department of Fair Employment and Housing and the Fair Employment and Housing Commission.

- Directions on how to contact the Department and the Commission.

- The protection against retaliation provided by *2 Cal. Code Reg. § 7287.8*.

This form assumes that the employer will distribute Brochure DFEH-185 to all employees, rather than drafting an equivalent information sheet.

[2] FORM

Sample Policy on Sexual Harassment

POLICY ON SEXUAL HARASSMENT

Statement of Company Policy

_____[*Company name*] is proud of its tradition of a collegial work environment in which everyone is treated with respect and dignity. Each person has the right to work in a professional atmosphere that promotes equal opportunities and prohibits discriminatory practices, including sexual harassment. At _____[*company name*], sexual harassment, whether verbal, physical, or environmental, is unacceptable and will not be tolerated.

"Sexual Harassment" Defined

For purposes of this policy, "sexual harassment" is defined as unwelcome or unwanted advances, requests for sexual favors, and any other verbal, visual, or physical conduct of a sexual nature when either:

(1) Submission to or rejection of this conduct by a person is used as a factor in decisions affecting hiring, evaluation, retention, promotion, or other aspects of employment; or

(2) This conduct substantially interferes with a person's employment or creates an intimidating, hostile, or offensive work environment.

Examples of sexual harassment include, but are not limited to, the following:

(1) Unwanted sexual advances.

(2) Demands for sexual favors in exchange for favorable treatment or continued employment.

(3) Threats and demands to submit to sexual requests to obtain or retain any employment benefit.

(4) Verbal conduct such as (a) epithets, derogatory or obscene comments, slurs, or sexual invitations; (b) sexual jokes or propositions, (c) suggestive, insulting, or obscene comments or gestures; or (d) other verbal abuse of a sexual nature. "Verbal" conduct includes both oral and written communication.

(5) Graphic verbal commentary about a person's body, sexual prowess, or sexual deficiencies.

(6) Flirtations, advances, leering, whistling, touching, pinching, assault, coerced sexual acts, or the blocking of normal movements.

(7) Visual conduct such as derogatory or sexual posters, photographs, cartoons, drawings, gestures, or other displays in the workplace of sexually suggestive objects or pictures.

(8) Conduct or comments consistently targeted at only one gender, even if the content is not sexual.

(9) Retaliation for having reported or threatened to report sexual harassment.

This behavior is unacceptable in the workplace itself and in other work-related settings such as business trips, court appearances, training sessions, seminars, symposia, and business-related social events. In evaluating behavior, the standard to be applied is that of a reasonable victim of the same gender as the victim.

Dissemination of Policy

This policy will be disseminated to all employees, and its existence will be announced in a prominent place by the company. A copy of this policy will be posted _____[*specify location, e.g.*, on the employee notices bulletin board in the Human Resources office]. All supervisors are responsible for knowing of the policy's existence, of its substance, and of their responsibility for its implementation. The _____[*name of person, e.g.*, Director of Human Resources] will be available to answer all questions about the policy and its implementation.

The company will post the Department of Fair Employment and Housing poster concerning employment discrimination

_____[*specify location, e.g.,* on the employee notices bulletin board in the Human Resources office]. Employees are encouraged to read the poster.

In addition, Department of Fair Employment and Housing Brochure DFEH-185, "Sexual Harassment Is Forbidden by Law," will be distributed to all employees. Each employee must read this information sheet and sign and return a receipt to the Human Resources office stating that he or she has received and read the information sheet.

Individuals Covered by the Policy

This policy covers every person in the workplace, including _____[*list all job titles covered by policy*]. _____[*Company name*] will not tolerate, condone, or allow sexual harassment, whether engaged in by employees or non-employees who conduct business with _____[*company name*]. _____[*Company name*] encourages reporting of all incidents of sexual harassment, regardless of who the offender may be, or the offender's relationship to the company.

Committee on Sexual Harassment

The _____[*e.g.,* Director of Human Resources] will form a Committee on Sexual Harassment. The duties of the committee are to receive sexual harassment complaints, investigate incidents of sexual harassment, recommend action after determining that sexual harassment has occurred, and ensure that the company maintains an effective policy on sexual harassment. Committee members will receive special training in dealing with sexual harassment complaints.

The committee will be composed of _____[*e.g.,* six members, three male and three female]. Committee members are chosen by _____[*describe method of choosing members, e.g.,* agreement of the Director of Human Resources and the President]. The following are the current members of the Committee on Sexual Harassment:

Name of Committee Member	Title
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

Reporting a Complaint

While _____[*company name*] encourages people who believe they are being harassed to firmly and promptly notify the offender that his or her behavior is unwelcome, the company also recognizes that power and statusdisparities between an alleged harasser and a target may make a confrontation impossible. In the event that informal, direct communication between the people involved is either ineffective or impossible, the following steps should be followed to report a sexual harassment complaint.

1. Notification of Appropriate Staff

People who believe they have been subjected to sexual harassment should report the incident to any member of the Committee on Sexual Harassment, listed above.

A person also may choose to report the complaint to his or her supervisor. If the supervisor successfully resolves the complaint in an informal manner to the complainant's satisfaction, the supervisor must file a confidential report to _____[*specify designated person, e.g.*, the Director of Human Resources] about the complaint and resolution so that the company will be aware of any pattern of harassment by a particular person and also will be aware of all complaints of sexual harassment on a company-wide basis. If the supervisor does not successfully resolve the complaint in an informal manner, a written report must be made to _____[*specify designated person, e.g.*, the Director of Human Resources] within one work day. A supervisor who has not had special training in dealing with sexual harassment complaints is strongly encouraged to consult a trained member of the Committee on Sexual Harassment before taking any action.

2. Description of Misconduct

An accurate record of objectionable behavior or misconduct is needed to resolve a formal complaint of sexual harassment.

Oral reports of sexual harassment must be put in writing either by the complainant or by the person designated to receive complaints, and must be signed by the complainant. Employees who believe they have been or currently are being harassed should maintain a record of objectionable conduct to effectively prepare and substantiate their allegations.

While _____[*company name*] encourages employees to keep written notes to accurately record offensive conduct or behavior, the company hereby notifies all employees that, in the event a lawsuit develops from the reported incident, the complainant's written notes might not be considered privileged or confidential information, and might have to be turned over to the company's attorneys for review.

3. Timeframe for Reporting Complaint

_____[*Company name*] encourages a prompt reporting of complaints so that rapid response and appropriate action can be taken. This policy not only aids the complainant, but also helps to maintain an environment free from discrimination for all employees. Employees should also be aware of the time limits imposed by local, state, and federal governmental agencies for the filing of complaints of harassment or discrimination. These time limits are posted on the official notices that are prominently displayed _____[*specify location, e.g.*, on the employee notices bulletin board in the Human Resources office].

Investigating the Complaint

1. Confidentiality

Any allegation of sexual harassment brought to the attention of the Committee on Sexual Harassment will be promptly investigated. Confidentiality will be maintained throughout the investigatory process to the extent practical and appropriate under the circumstances.

2. Identification of Investigators

Complaints will be investigated and resolved by the Committee on Sexual Harassment. In addition, the following people may participate in reviewing the investigation and outcome: _____[*specify other persons who may participate, e.g.*, the Director ofHuman Resources and the President].

3. Investigation Process

In pursuing the investigation, the investigator will try to take the wishes of the complainant into consideration, but will thoroughly investigate the matter, keeping the complainant informed as to the status of the investigation. For a complete investigation, the investigator must do at least all of the following:

a. Confirm the name and position of the complainant.

b. Identify the alleged harasser.

c. Thoroughly ascertain all facts that explain what happened by questioning the complainant and the alleged harasser. The investigator should question the parties separately, and should ask all questions in a non-judgmental manner.

d. Determine the frequency and type of alleged harassment and, if possible, the dates and locations where alleged harassment occurred.

e. Find out if there were witnesses who observed the alleged harassment. If there were witnesses, the investigator should take a statement from each witness.

f. Ask the complainant how he or she responded to the alleged harassment.

g. Develop a thorough understanding of the professional relationship, degree of control, and amount of interaction between the alleged harasser and the complainant. For example, the investigator might want to find out whether the alleged harasser controls the compensation, terms of employment, benefits, or promotion of the complainant, or whether the parties involved work in close proximity to each other.

h. Determine whether the alleged harasser has carried out any threats or promises directed at the complainant.

i. Determine whether the complainant knows of or suspects that there are other employees who have been harassed by the alleged harasser.

j. Determine if the complainant has informed a supervisor or other manager of the incident. If the complainant has informed a supervisor or other manager, determine what response the complainant received from each person.

k. Ask the complainant what action he or she would like the company to take as a consequence of the harassment.

l. When first interviewing the alleged harasser, remind him or her of the company's policy that prohibits retaliation against an employee for making a complaint of sexual harassment.

Resolving the Complaint

To minimize as much as possible the damage to the company, to the complainant, and to the alleged harasser, _____[*company name*] will complete the investigation of a sexual harassment complaint and will communicate its findings and intended actions to the complainant and alleged harasser as quickly as possible.

If the investigator, together with the Committee on Sexual Harassment, finds that sexual harassment has occurred, the harasser will be subject to appropriate disciplinary procedures, as listed below. The complainant will be informed of the disciplinary action taken.

If the investigator, together with the Committee on Sexual Harassment, determines that no sexual harassment has occurred, this finding will be communicated to the complainant in an appropriately sensitive manner. The alleged harasser will also be informed of this finding.

If the investigator, together with the Committee on Sexual Harassment, is unable to determine whether sexual harassment occurred, this finding will be communicated to the complainant and the alleged harasser, and the matter will be recorded as unresolved. Both the complainant and the alleged harasser will be informed again of the procedures set forth in this Policy on Sexual Harassment, including the appeal process contained below.

If a resolution satisfactory to both parties cannot be reached based on the initial investigation, the matterwill be referred to _____[*specify appropriate person or group, e.g.,* the President *or* the Human Resources Committee]. For further discussion, see "Appeals Process," below.

1. Sanctions

Persons found to have engaged in misconduct constituting sexual harassment will be severely disciplined, up to and including termination. Appropriate sanctions will be determined by _____[*specify appropriate person or group, e.g.,* the Director of Human Resources *or* the Committee on Sexual Harassment]. In addressing incidents of sexual harassment, the company's response at a minimum must include reprimanding the harasser and preparing a written record of the reprimand. Additional action may include referral to counseling, withholding of a promotion, reassignment, temporary suspension without pay, financial penalties, or termination.

This policy is intended to protect all employees from harassment in any way associated with the workplace or work environment, regardless of who the harasser is.

Although the company's ability to discipline a non-employee harasser (for example, a delivery person or a client) may be limited by the degree of control, if any, that the company has over the alleged harasser, any employee who has been subjected to sexual harassment should file a complaint and be assured that action will be taken. Such action may include ceasing business relations with a client or supplier, reporting a client contact or representative to his or her employer, reporting a public official to the appropriate agency, or other appropriate action to protect employees.

2. Appeal Process

If any party directly involved in a sexual harassment investigation is dissatisfied with the outcome or resolution of the investigation, that person has the right to appeal the decision. The dissatisfied person should submit his or her written comments in a timely manner to _____[*specify appropriate person or group, e.g.,* the President *or* the Human Resources Committee].

Maintaining a Written Record of the Complaint

The company will maintain a complete written record of each complaint and the manner in which it was investigated and resolved. Written records will be maintained in a confidential manner _____[*specify location of records, e.g.,* in the office of the Director of Human Resources].

Written records will be maintained for five years from the date of resolution unless new circumstances dictate that the

file should be kept for a longer period of time.

Protection Against Retaliation

_____[*Company name*] will not retaliate in any way against an employee who makes a complaint of sexual harassment or against a participant in the investigation of sexual harassment. Similarly, the company will not allow any employee to retaliate in any way against an employee who makes a complaint of sexual harassment or against a participant in the investigation of sexual harassment. Retaliation is a serious violation of this Policy on Sexual Harassment and should be reported immediately. Any person found to have retaliated against another person for reporting sexual harassment or for participating in an investigation of sexual harassment will be subject to the same disciplinary action provided for sexual harassment offenders. For further discussion of these disciplinary procedures, see "Resolving the Complaint," above.

Formal Legal Proceedings

The procedures described in this policy apply to internal complaints of sexual harassment. Differentprocedures apply after a formal governmental administrative charge or civil lawsuit is filed. If any employee receives such a charge or complaint, he or she should deliver it to _____[*specify person to whom charge or complaint should be delivered, e.g.*, the Director of Human Resources] immediately. All responses to formal charges or complaints will be made through _____[*specify person or department, e.g.*, the Director of Human Resources].

Retaliation against any person who files a formal charge or complaint of sexual harassment is prohibited, and is grounds for the same disciplinary action provided for sexual harassment offenders, up to and including termination. For further discussion of these disciplinary procedures, see "Resolving the Complaint," above.

Conclusion

_____[*Company name*] has developed this Policy on Sexual Harassment to ensure that all its employees, supervisors, and executives can work in an environment free from sexual harassment. The company will make every effort to ensure that all its personnel are familiar with the policy and know that any complaint received will be thoroughly investigated and appropriately resolved.
_____ Dated:

_____ [*company name*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawDiscriminationHarassmentSexual HarassmentGeneral OverviewLabor & Employment LawDiscriminationHarassmentSexual HarassmentCorrection & PreventionLabor & Employment LawDiscriminationHarassmentSexual HarassmentDefenses & ExceptionsAntiharassment PolicyLabor & Employment LawPosting & Recordkeeping



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
B. Policies and Programs

1-1C California Legal Forms--Transaction Guide § 1C.221

§ 1C.221 Sample Injury and Illness Prevention Program

[1] Comment

[a] Use of Form

This form is a sample written injury and illness prevention program. Every employer must establish, implement, and maintain an effective injury and illness prevention program [*Lab. Code § 6401.7(a)*; *see 8 Cal. Code Reg. § 3203* (regulation)]. The employer must correct unsafe and unhealthy conditions and work practices in the workplace, must train employees in the injury and illness prevention program, and must keep certain records pertaining to the program [*Lab. Code § 6401.7(b)-(d)*]. With limited exceptions [*see* [c], *below*], the injury and illness prevention program must be in writing, and must contain specified elements [*Lab. Code § 6401.7(a)*; *see 8 Cal. Code Reg. § 3203(a)* (regulation); *see also* [b], *below* (required elements)].

This form contains all of the elements required to be included in the written program. It has been drafted as a sample with blanks that elicit particular information, and can be revised to suit a variety of businesses or industries. The form contains parts discussing company safety and health policy, the company organization, and inspection, evaluation, and investigation procedures. The form also contains a number of separate forms for use with the program, including a notice to employees of the program, job hazard evaluation form, workplace inspection form, accident report form, safety committee forms, and various forms relating to employee training. All of these forms can be modified to suit a particular business or industry.

The Division of Occupational Safety and Health (DOSH) has prepared several model injury and illness prevention programs for different employment situations [*see Lab. Code § 6401.7(j)(1), (3)*]. In addition, DOSH has produced a booklet entitled "Guide to Developing Your Workplace Injury & Illness Prevention Program." These publications can be obtained by contacting any DOSH office.

[b] Contents of Written Program

The injury and illness prevention program must satisfy the following requirements [*8 Cal. Code Reg. § 3203(a)*; *see*

Lab. Code § 6401.7(a)]:

(1) Identify the person or persons with the authority and responsibility for implementing the program.

(2) Include a system for ensuring that employees comply with safe and healthy work practices. Methods of substantially complying with this provision include recognition of employees who follow safe and healthful work practices, training and retraining programs, disciplinary action, or any other means that ensures employee compliance with safe and healthful work practices.

(3) Include a system for communicating in a readily understandable manner with affected employees on matters relating to occupational safety and health, including provisions designed to encourage employees to inform the employer of hazards at the worksite without fear of reprisal. Methods of complying with this provision include meetings, training programs, posted information, written communications, a system of anonymous notification by employees about hazards, safety and health committees, or other means that ensure communication with employees. If an employee can read only a language other than English, communications must be in that language. If an employee cannot read any language, communications must be oral. Employers with fewer than 10 employees may communicate information to employees orally.

(4) Include procedures for identifying and evaluating workplace hazards, including scheduled periodic inspections to identify unsafe conditions and work practices. Inspections must be made to identify and evaluate hazards (a) when the program is first established, (b) when new substances, processes, procedures, or equipment are introduced to the workplace that represent new occupational safety and health hazards, and (c) when the employer becomes aware of a new or previously unrecognized hazard.

(5) Include a procedure to investigate occupational safety and illness.

(6) Include methods and procedures for correcting unsafe or unhealthy conditions, work practices, and work procedures in a timely manner based on the severity of the hazard. This requires correcting unsafe and unhealthy situations when observed or discovered. When an imminent hazard exists that cannot be immediately corrected without endangering employees and property, the employer must remove all exposed personnel from the area except those necessary to correct the condition. Employees correcting the hazardous condition must be provided with necessary safeguards.

(7) Provide for training and instruction, as follows: (a) when the program is first established; (b) to all new employees; (c) to employees given new job assignments; (d) when new substances, processes, procedures, or equipment are introduced to the workplace and represent a new hazard; (e) when the employer becomes aware of a new or previously unrecognized hazard; and (f) for supervisors, to familiarize them with the safety and health hazards to which employees under their immediate direction and control may be exposed. Employers in the construction industry required to be licensed as contractors [*see Bus & Prof. Code §§ 7000-7189.7*] may use employee training provided by an approved occupational safety and health training program to comply with portions of the training requirement [*Lab. Code § 6401.7(d)*].

[c] When Program Must be Written

As mentioned in [a], *above,* for most employers, the entire injury and illness prevention program must be in writing [*Lab. Code § 6401.7(a)*; *see 8 Cal. Code Reg. § 3203(a)*]. However, certain employers with fewer than 20 employees need keep written documentation of only portions of the program. Exempted employers are those in industries (1) that are not on a designated list of high hazard industries and that meet certain employee experience criteria, or (2) that are

on a designated list of low hazard industries [*Lab. Code § 6401.7(e)(2)*; *see Lab. Code §§ 6314.1, 6401.7(e)(3), (4), (j)(2)* (industry lists)].

[d] Application of Program

The program must cover all the employer's employees and all other workers the employer controls or directs and directly supervises on the job, to the extent those workers are exposed to specific hazards at the worksite and in the job assignment [*Lab. Code § 6401.7(h)*].

[e] Required Records

Employers must keep records of the steps taken to implement the program [*Lab. Code § 6401.7(d)*]. Records the employer must keep include the following [*8 Cal. Code Reg. § 3203(b)*]:

(1) Records of scheduled and periodic inspections to identify unsafe conditions and work practices [*see 8 Cal. Code Reg. § 3203(a)(4)*], including the persons conducting the inspections, the unsafe conditions and work practices identified, and the actions taken to correct the unsafe conditions and work practices.

(2) Documentation of safety and health training for each employee [*see 8 Cal. Code Reg. § 3203(a)(7)*], including the employee's name or other identification, training dates, type of training, and training provider.

The employer must maintain these documents for at least one year [*8 Cal. Code Reg. § 3203(b)(1), (2)*]. This form includes records to document safety inspections [*see* [2], *below*, app. E] and employee training [*see* [2], *below*, apps. J, K].

Employers of fewer than 10 employees can substantially comply with the documentation requirement by maintaining a log of instructions given to each employee about the hazards unique to the employee's job assignment when hired or when reassigned [*8 Cal. Code Reg. § 3203(b)(2)*]. Employers in the construction industry required to be licensed as contractors [*see Bus. & Prof. Code §§ 7000-7189.7*] may use records relating to employeetraining provided by an approved occupational safety and health training program to comply with portions of the recordkeeping requirement [*Lab. Code § 6401.7(d)*]. Certain public employers do not need to keep records of steps taken to implement and maintain the injury and illness prevention program [*Lab. Code § 6401.7(k)*; *see Lab. Code § 6401.7(d)*].

[f] Safety and Health Committee

To fulfill the communication requirement [*see* Item (3) in [b], *above*], an employer's injury and illness prevention program may include an occupational safety and health committee composed of labor and management [*8 Cal. Code Reg. § 3203(c)*; *see Lab. Code § 6401.7(f)*]. Employers who use a labor/management safety and health committee to comply with the communication requirement [*see 8 Cal. Code Reg. § 3203(a)(3)*] are presumed to have substantially complied with the requirement if the committee does all of the following [*8 Cal. Code Reg. § 3203(c)*]:

(1) Meets regularly, but not less often than quarterly.

(2) Prepares and makes available to affected employees written records of the safety and health issues discussed at the committee meetings. The committee must maintain these records for at least one year and for review by the Division of Occupational Safety and Health (DOSH) on request.

(3) Reviews results of the periodic, scheduled worksite inspections.

(4) Reviews investigations of occupational accidents and causes of incidents resulting in occupational injury, occupational illness, or exposure to hazardous substances. When appropriate, the committee may submit suggestions to management for the prevention of future similar incidents.

(5) Reviews investigations of alleged hazardous conditions brought to the attention of any committee member. When necessary, the committee may conduct its own inspection and investigation to assist in remedial solutions.

(6) Submits recommendations to assist in evaluating employee safety suggestions.

(7) On request from DOSH, verifies corrective action taken by the employer to abate DOSH citations.

This form provides for a joint management/labor safety committee, and includes specific forms for use by the committee [*see* [2], *below*, apps. H, I].

[g] Grandfather Provision

An employer that had a written injury and illness prevention program in place on July 1, 1991, that complied with the pre-January 1, 1991 requirements of *Title 8, Section 3203 of the California Code of Regulations*, is exempt from certain requirements of current Section 3203 [*8 Cal. Code Reg. § 3203(a)(4)(A), (7)(A)*].

[h] Insurers' Review of Program

Workers compensation insurers must conduct a review, and make a written review, of the injury and illness prevention program of each of its insureds within four months of the commencement of the initial insurance policy term. The review will determine whether the insured has implemented all of the required components of the program and will evaluate their effectiveness. The review must also evaluate the training component of the program. The written report must specify the findings of the review and all recommended changes deemed necessary to make the program effective. This review must be conducted by an independent licensed California professional engineer, certified safety professional, or a certified industrial hygienist [*Lab. Code § 6401.7(l)*].

[2] FORM

Sample Injury and Illness Prevention Program

INJURY AND ILLNESS PREVENTION PROGRAM

_____ [*Company name*]

INTRODUCTION

In October 1989, California Senate Bill 198 was passed, requiring every employer to establish, implement, and maintain an injury and illness prevention program by July 1, 1991. SB 198 specified that the program had to be in writing, and had to include, but not be limited to, the following elements:

(1) Identification of the person or persons responsible for implementing the program.

(2) The employer's system for identifying and evaluating workplace hazards, including scheduled periodic inspections to identify unsafe conditions and work practices.

(3) The employer's methods and procedures for correcting unsafe or unhealthful conditions and work practices in a timely manner.

(4) An occupational safety and health training program designed to instruct employees in general safe and healthy work practices and to provide specific instructions about the hazards specific to each employee's job assignment.

(5) The employer's system for communicating with employees about occupational safety and health matters, including provisions designed to encourage employees to inform the employer of hazards at the work site without fear of reprisal.

(6) The employer's system for ensuring that employees comply with safe and healthy work practices, which may include disciplinary action.

(7) The employer's procedure for investigating accidents that occur in the workplace.

_____[*Company name*] has adopted this Injury and Illness Prevention Program to comply with the requirements of California law and to reinforce the efforts of management and employees toward achieving the company's goal of having a workplace free of injury and illness. While _____[*company name*] believes this Program meets and exceeds the requirements of *California Labor Code Section 6401.7* and *Title 8, Section 3203 of the California Code of Regulations*, meeting the statutory standard is secondary to our main purpose of preventing injuries and illnesses in the workplace.

This Program will be periodically revised as the need arises to comply with changes in the law and, most important, to respond to changes and new hazards in the workplace so that we may continue to provide a safe and healthful work environment for all our employees.

I. POLICY

It is the policy of _____[*company name*] to have a safe and healthful workplace. That is the primary consideration in the operation of the company. To achieve that goal, we have implemented this Injury and Illness Prevention Program.

Members of management are expected to do everythingwithin their control to assure a safe and healthful work environment, and always to comply with federal, state, and local safety and health regulations.

Employees are expected to obey safety and health rules, follow established safe work practices, and exercise caution and good judgment in all their work activities.

All employees are expected to report immediately any unsafe conditions to their supervisors. Employees at all levels of our organization who are responsible for correcting unsafe conditions should do so.

Working together, we can succeed in having a safe, healthful, and profitable workplace from which we all can benefit.

II. ORGANIZATION

Identification of Company

Name of Company: _____

Address: _____

City: _____

State: _____

Zip Code: _____

Telephone Number: _____

Main Business Activity: _____

Company Structure

Printed below is a chart of our organization as it relates to the Injury and Illness Prevention Program. The chart shows the reporting relationships and flow of communications under the Program. An outline of the responsibilities of each position is presented on the following pages.

Click here to view image.

Responsible Person

Name: _____

Title: _____

The "Responsible Person" has the ultimate responsibility and authority for implementing this Injury and Illness Prevention Program, as required by law. The duties of the Responsible Person are to:

(1) Set safety and health policy.

(2) Assign responsibility and accountability for particular parts of the Program to individuals and the Safety Committee.

(3) Review and evaluate the effectiveness of the Program.

(4) Provide active leadership by participation, example, and a demonstrated interest in the Program.

Safety Director

Name: _____

Title: _____

The "Safety Director" has the responsibility and authority for the day-to-day implementation and operation of the Injury and Illness Prevention Program. The following is a partial list of the duties and responsibilities of the Safety Director. These duties and responsibilities may be added to or changed in the futureas conditions require. The Safety Director must perform the following tasks:

(1) Understand the requirements of *California Labor Code Section 6401.7, Title 8, Section 3203, of the California Code of Regulations*, and other safety regulations that may apply to the work that _____ [*company name*] performs.

(2) Ensure that safety and health hazards have been identified for each job description (see Appendix D).

(3) Ensure that regular inspections are conducted to identify and control job-related hazards (see Appendix E).

(4) Ensure that new employees are provided with general and specific safety training covering expected job hazards before beginning their assignments (see Appendixes J, K).

(5) Ensure that current employees receive training on newly identified job hazards.

(6) Ensure that reassigned employees receive appropriate safety training covering general and specific job hazards at their new assignments.

(7) Ensure that all employees receive on-going safety updates of both general and specific job hazards.

(8) Ensure that all job-related injuries and illnesses are reported and investigated according to company safety policy (see Appendix G).

(9) Ensure that all reported near-miss accidents are investigated and that appropriate corrective action is taken.

(10) Ensure that supervisors are familiar with the safety and health hazards to which their employees are exposed.

(11) Ensure that there is a communication system that provides employees with understandable information on safety and health matters (see Appendix A).

(12) Ensure that employees are encouraged to report workplace hazards and that employees understand that they may do so without fear of reprisal (see Appendix L).

(13) Ensure that proper safety and health documentation is maintained.

(14) Ensure that all safety and health training records will be maintained for three years.

(15) Ensure that federal, state, and local safety and health laws are complied with.

(16) Ensure that company safety and health policy is complied with.

(17) Assume direct responsibility for the safety and health training of each employee until assigned to the responsibility of a supervisor.

Safety Committee

Name of Committee Member	Title
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

The implementing regulations provide that a company may meet the communication requirement of its injury and illness prevention program through the use of a joint management/labor safety and health committee. _____[*Company name*]'s Safety Committee is made up of _____[*number, e.g.,* six] members, _____[*number, e.g.,* three] from management and _____[*number, e.g.,* three] from the non-management labor force. The Safety Director must always be a member, and is the chairperson of the Committee. The Committee will hold regular quarterly meetings, and other special meetings as are deemed necessary by the Committee or the Safety Director.

The responsibilities of the members of the Safety Committee are to do the following:

(1) Participate in all regular and special meetings of the Committee.

(2) Provide written accounts of Committee proceedings to employees (see Appendix H).

(3) Participate in and review results of periodic scheduled safety and health inspections.

(4) Participate in the investigation and analysis of accidents involving injury or illness.

(5) Review the potential safety or health hazards of all new processes, methods, machines, tools, or materials introduced into the workplace.

(6) Serve as a conduit for communications between employees and management, investigating any allegations of hazardous conditions brought to a Committee member's attention.

(7) Submit recommendations to help in evaluating employee safety and health suggestions.

(8) Verify action taken by employer to abate citations, on the request of the Department of Occupational Safety and Health.

Supervisors

As members of management, supervisors are expected to comply fully with the Program, communicate with their employees about the Program, and ensure that the work area they are responsible for is safe and healthful. Supervisors have the responsibility for safety and health education of employees once they are assigned to specific jobs. The

supervisors' responsibilities are to do the following:

(1) Keep informed about safety and health regulations affecting operations they supervise.

(2) Make sure that each of their employees has the ability and knowledge to safely complete each task he or she is assigned.

(3) Make sure that each of their employees receives orientation training and job-specific safety and health training (see Appendixes J, K).

(4) Make sure that machines, equipment, and tools for which they are responsible are maintained in safe operating condition.

(5) Make sure their employees follow all safety and health regulations and work practices, including using all required safeguards and personal safety equipment.

(6) Investigate accidents and identify the corrective action necessary to prevent similar future accidents from occurring (see Appendix G).

(7) Report to the Safety Director immediately any unsafe or unhealthful condition that the supervisor cannot correct.

Employees

Employees have important responsibilities under the Injury and Illness Prevention Program. Employees are expected to observe safe work habits and practices. They must obey all company safety rules (see Appendices B, C) and all federal, state, and local safety and health regulations. Employees should regularly inspect their work areas for unsafe or unhealthful conditions and (1) correct any such conditions, if possible, or (2) report any such conditions they cannot correct to their supervisors. In addition, employees are encouraged to report conditions they believe to be unsafe or unhealthful to their supervisor, the Safety Director, or the Safety Committee. This can be done anonymously by use of the Employee Safety and Health Hazard Reporting Form (see Appendix L).

In addition, employees have important rights under the Program. This includes the right to report unsafe and unhealthful conditions without fear of reprisal, and the right to review the written Program. A copy of the Program is available at _____[*specify location, e.g.,* the office of the Safety Director].

Suggestion Box

The safety and health suggestion box is intended to provide a means for employees to make safety and health suggestions to the company anonymously without fear of reprisal or discrimination. Employees may use the Employee Safety and Health Hazard Reporting Form (see Appendix L) to make suggestions. The Safety Director monitors the box, and delivers suggestions to the SafetyCommittee. The Committee responds to affected employees and the employee making the suggestion, if known.

III. OCCUPATIONAL SAFETY AND HEALTH HAZARDS

Identification of Hazards

_____[*Company name*] will conduct the following activities to identify, evaluate, correct, and prevent occupational safety and health hazards:

(1) Conduct scheduled and periodic inspections of employees' work areas, work practices, and work procedures (see Appendix E). Inspections will be conducted according to _____ [*company name*]'s safety policy guidelines (see Appendix B) and applicable departmental guidelines.

(2) List defects and hazards found in any inspection and any corrective action taken.

(3) Document the corrective action taken.

(4) Investigate all on-the-job accidents, injuries, and illnesses as well as near-miss accidents (see Appendix G). Investigations will be conducted according to _____ [*company name*]'s safety policy guidelines (see Appendix B) and applicable departmental guidelines.

(5) Periodically conduct job-hazard evaluations for each job in the company (see Appendix D).

(6) Evaluate job hazards reported by employees (see Appendix L).

(7) Review the Log of Occupational Injuries and Illnesses (Cal/OSHA Log 200).

(8) Review general information (including general Safety Orders and Material Data Safety Sheets for any chemicals in the workplace) to identify potential occupational safety and health hazards.

(9) Review appropriate industry-specific Safety Orders and General Industry Safety Orders contained in Title 8 of the California Code of Regulations relating to the type of work being done. Orders relating to the type of work done at _____ [*company name*] are listed below:

_____[*list relevant safety orders, e.g.,* Sections 3575-3583, Abrasive Wheels].

These safety orders are available for review by contacting _____[*name*], _____[*title*], at _____[*telephone number*].

Job Hazard Evaluations

_____[*Company name*] will conduct evaluations of the hazards likely to be encountered in all jobs in the company by using the Job Hazard Evaluation Form (see Appendix D). Initially, all jobs will be evaluated. Once all jobs have been evaluated, jobs that warrant future evaluation for new or previously unrecognized hazards will be reevaluated on a regular schedule. Following is a hazard evaluation schedule for all job titles:

(1) Job Title: _____
General Work Area: _____
Description of Duties:_____
Frequency of Evaluation:_____

(2) Job Title: _____
General Work Area: _____

Description of Duties: _____
Frequency of Evaluation: _____

(3) Job Title: _____
General Work Area: _____
Description of Duties: _____
Frequency of Evaluation: _____

Documentation of Hazards

_____[*Company name*] intends to provide complete documentation of all aspects of the Injury and Illness Prevention Program. The company documents identified occupational safety and health hazards in thefollowing ways:

(1) Preparation of hazard evaluation forms for each job position (see Appendix D).

(2) Preparation of documented summary and analysis of on-the-job injury, illness, and near-miss accident reports (see Appendix G).

(3) Preparation of documented summary and analysis of accident investigation recommendations to prevent recurrence.

(4) Preparation of documentation based on observation of work procedures and work practices.

(5) Review and documentation of employees' oral and written comments and suggestions about workplace safety and health.

(6) Maintenance and review of the Log of Occupational Injuries and Illnesses (Cal/OSHA Log 200).

(7) Preparation of annual summary of Log of Occupational Injuries and Illnesses (Cal/OSHA Log 200).

(8) Preparation and filing of Employer's Reports of Occupational Injury or Illness (Division of Labor Statistics and Research Form No. 5020) with _____ [*name of workers' compensation insurance provider or administrator*] within 48 hours of the time we receive notice of an injury or illness that results in lost work time or requires medical attention beyond first aid.

(9) Maintenance of a separate file within the company of all reports of injuries, illnesses, and unusual occurrences.

(10) Maintenance in each employee's file of all records relating to occupational safety and health concerning that employee.

This documentation is carried out by supervisors, the Safety Director, and the Safety Committee. The records are maintained in _____[*describe location, e.g.*, the office of the Safety Director]. The Safety Director is responsible for ensuring that all of these records and documents are properly maintained for the required period.

Accident Investigation

_____[*Company name*] investigates every accident to determine what caused the accident, so that the company can take remedial action to prevent similar accidents from occurring in the future. Accident investigations are not made to fix blame for the accident on an employee.

It is company policy to investigate all accidents that result in injury, illness, or lost work time. In addition, we may investigate accidents involving only property damage, near-miss incidents, and other potentially hazardous unusual occurrences.

Because a supervisor is directly responsible for work conditions and work practices, the supervisor of an affected employee has primary responsibility for the accident investigation. The supervisor should conduct the investigation as soon as possible after the accident, using the Report of Accident (see Appendix G). The Safety Committee and the Safety Director will assist in the investigation, and may conduct additional investigations as are deemed necessary.

Safe Working Conditions

It is the policy of _____[*company name*] to provide safe working conditions for all employees. The company documents and communicates a wide range of information concerning safe working conditions, safe work practices, and regulations regarding the maintenance and use of protective equipment to employees. The Safety Director is responsible for ensuring that proper documentation, communication, and training is provided to all employees.

Documentation provided to employees includes the following:

(1) _____ [*Company name*] safety policy and general safety rules (see Appendix B).

(2) Department-specific safety rules (see Appendix C).

(3) Copies of applicable specific industry orders and General Industry Safety Orders applicable to _____ [*company name*]'s type of business.

(4) Documentation of training for general and specific job hazards (see Appendixes J, K). Copies of training records are given to the employee and retained in the Safety Director's files.

(5) _____ [*List other relevant resources, e.g.,* Company motor vehicle safety policy].

Safety and health rules and regulations are communicated to employees in the following manner:

(1) Training on the portions of the company safety policy and rules that outline safe work conditions, safe work practices, and use of protective equipment.

(2) Training on other relevant safety requirements.

(3) Additional training for newly-discovered hazards.

(4) Additional training for reassigned employees.

(5) Posting of federal, state, local, and company safety rules and regulations.

(6) Discussing safety rules and regulations in meetings.

(7) Providing employees with all relevant safety rules and policies.

In addition to the information provided to employees by the company, it is essential that the company be receptive to observations and suggestion of employees concerning workplace safety and health. In order to ensure the proper flow of communications, the Safety Director will provide for two-way communication in all of the following ways:

(1) Publishing and distributing the minutes of Safety Committee meetings (see Appendix H).

(2) Publishing and distributing safety newsletters.

(3) Displaying safety posters.

(4) Conducting safety meetings.

(5) Using safety recognition and incentive programs.

(6) Establishing an anonymous safety suggestion box system for employees to use to inform the company of safety and health hazards without fear of reprisal (see Appendix L).

IV. SAFETY INSPECTIONS

Policy on Inspections

It is the policy of _____[*company name*] to conduct and document periodic safety and health inspections to verify compliance with company policy, to identify new and previously unrecognized workplace hazards, and to investigate accidents, occupational injuries and illnesses, and unusual occurrences.

To implement this policy concerning investigations, the Safety Director will ensure that the following occur:

(1) Workplace safety inspections are carried out as often as needed to maintain a safe and healthful work environment (see Appendix E).

(2) Unsafe or unhealthy work practices or work conditions are corrected in a timely manner based on the severity of the hazard.

(3) Inspection procedures are implemented whenever potentially hazardous new substances, processes, procedures, or equipment are introduced into the workplace.

(4) Inspection procedures are implemented whenever previously unrecognized hazards are reported.

The Safety Director will ensure that the following areas are inspected at least as frequently as indicated below, and that these inspections are conducted and documented in accordance with company safety policy (see Appendix E):

(1) Job Area/Equipment Type: _____ [*specify, e.g.,* Administration office].
Frequency: _____ [*specify, e.g.,* Every six months].

(2) Job Area/Equipment Type: _____ [*specify, e.g.*, Loading dock].
Frequency: _____ [*specify, e.g.*, Monthly].

(3) Job Area/Equipment Type: _____ [*specify, e.g.*, Machine shop].
Frequency: _____ [*specify, e.g.*, Weekly].

In addition, the Safety Director must also ensure that the following inspection is conducted by employees in accordance with company safety policy:

(1) Job Area/Equipment Type: _____ [Ladders]
Frequency: _____ [*specify, e.g.*, Before each use]

Inspections and investigations are to be performed as soon as practicable after the Safety Director learns of an accident, injury, illness, near-miss, or unusual occurrence.

Standard company inspections reports are to be used to document inspections (see Appendix E). The Safety Director will ensure that inspection documents are maintained for three years. Theses forms are maintained at _____[*specify location, e.g.*, the office of the Safety Director].

Standards for Inspections

To maintain a safe and healthful workplace, we need to have a way to identify hazards in the workplace. Recognizing that unsafe work practices generally cause at least as many accidents as unsafe conditions do, we intend to focus on both of these areas to make a safer and healthier workplace.

Our primary tool for identifying unsafe and unhealthful conditions and practices in the workplace is the workplace inspection (see Appendix E). Some of the criteria we use for these inspections include the following:

(1) Violations of company safety rules.

(2) Unsafe use or storage of chemicals, including flammables.

(3) Unsafe use or storage of materials.

(4) Improper use of any tool, machine, or equipment.

(5) Obvious violations of good housekeeping practices.

(6) Failure to use safeguards or personal safety equipment.

(7) Any other deviation from accepted safe work practices.

Safety Director's Responsibilities

The Safety Director, with members of the Safety Committee, will conduct an inspection of the workplace before each quarterly Safety Committee meeting. The purpose of this inspection is to have a team composed of management and

employees inspect the workplace on a regular and frequent basis, looking for both unsafe physical conditions of the workplace as well as unsafe job practices or acts of employees.

The inspection findings will be documented on the Safety Inspection Report (see Appendix E). Copies of these reports will be attached to copies of the minutes of the Safety Committee meeting and filed with the Safety Director.

Supervisors' Responsibilities

All supervisors are responsible for routinely inspecting their area of responsibility, including their own and their employees' work areas. When possible in relatively simple situations, supervisors should correct unsafe and unhealthful conditions and work practices. If corrections cannot be made by the supervisor, the supervisor is responsible for ensuring that corrections are completed by the person assigned the task of taking the corrective action.

In more complicated situations, the supervisor will need to make a more in-depth analysis of the hazards or potential hazards. These situations include tasks known to have caused accidents in the past, or conditions that continue to cause accidents despite remedial action. More in-depth analysis is also required when the supervisor is conducting an accident investigation. In all these situations, the supervisor should focus on the specific condition, hazard, or practice that caused or contributedto the accident.

Employees' Responsibilities

All employees are responsible for inspecting their workplaces on a daily basis. Employees must promptly report unsafe or unhealthful conditions to their supervisors unless they have the ability and authority to correct the condition themselves.

Special Hazards

In addition to the other duties specified above, the Safety Director will conduct periodic inspections of work areas, equipment, and practices presenting special workplace hazards, such as _____[*list unusual hazards, e.g.*, inspection of all VDT workstations (see Appendix F) *or* inspection of the welding shop]. In addition, to help in analyzing the causes of injuries and illnesses, the Safety Director will make regular and frequent reviews of the Cal/OSHA log of occupational injuries and illnesses and the reports of occupational injury or illness sent to _____[*name of workers' compensation insurance provider*].

V. EMPLOYEE TRAINING

Goals of Employee Training

_____[*Company name*] provides safety and health training for employees in all situations in which training would result in a safer and healthier workplace. The Safety Director will ensure that employee training accomplishes the following:

(1) Addresses general safety and health work practices and procedures.

(2) Provides instruction about specific job hazards.

(3) Is given to all employees when the Program is first established.

(4) Is given to all new employees before they begin working at jobs that expose them to safety and health hazards for which they have not received training.

(5) Is provided to all employees reassigned to jobs for which sufficient training has not already been provided.

(6) Addresses new hazards caused by new substances, processes, procedures, or equipment.

(7) Occurs when the employer is informed of a new or previously unrecognized hazard.

(8) Is given to supervisors to familiarize them with the safety and health hazards to which their employees may be exposed.

(9) Is provided following an accident, if the accident investigation shows that additional training is needed.

(10) Is provided following an unusual occurrence, if an investigation shows that additional training is needed.

(11) Includes an annual "refresher" course.

The Safety Director will work in close cooperation with supervisors to ensure that each new or reassigned employee receives safety orientation training and job-specific safety and health training. After an employee is assigned to a specific job, the supervisor takes on the responsibility for safety and education.

The Safety Director will also ensure that employee training includes the following specific information:

(1) Hazard communication (see *Title 8, Section 5194 of the California Code of Regulations*).

(2) Emergency action plan (see *Title 8, Section 3220 of the California Code of Regulations*).

(3) Fire prevention plan (see *Title 8, Section 3221 of the California Code of Regulations*).

(4) Any other safety order or General Industry Safety Order pertaining to the particular job (see Title 8 of the California Code of Regulations).

(5) _____ [*Company name*] safety policies pertaining to the particular job.

Training Documentation

Training documentation will be prepared for each new or reassigned employee. Training records will contain the following:

(1) The employee's name.

(2) Training dates.

(3) Subjects and types of training.

(4) Name of training provider.

(5) Copies of materials used.

Training records are provided to employees and maintained at _____[*specify location, e.g.,* the office of the Safety Director] for three years.

VI. COMMUNICATIONS WITH EMPLOYEES

Safety Director's Responsibilities

_____[*Company name*] maintains effective communication with its employees. The Safety Director will take the following steps to ensure that lines of communication with employees are maintained:

(1) Requiring supervisors to inform employees of the job hazards to which they are exposed.

(2) Asking employees to inform the company of any hazards they are exposed to or unsafe or unhealthy conditions they perceive.

(3) Establishing a system by which employees can inform the company of hazards without fear of reprisal (for example, an anonymous safety suggestion box).

(4) Informing employees that they have the right to review the written Injury and Illness Prevention Program, and that they have certain rights and responsibilities under the Program.

(5) Implementing employee recognition and incentive programs.

(6) Using appropriate corrective action steps, including discipline, for failure to comply with company safety and health policies and practices.

(7) Informing employees that they are not subject to discipline or discrimination for advising the company of job hazards.

Methods of Communication

The following methods are used to convey safety information to employees:

(1) Group meetings.

(2) Group training.

(3) Individual training.

(4) Individual discussions.

(5) Safety and health posters.

(6) Safety and health newsletters and memos.

(7) Printed company safety policies and rules.

(8) The Notice to Employees contained in this Program (see Appendix A).

For a chart outlining the flow of communications under the Program, see Part II, ORGANIZATION.

VII. DISCIPLINE

Employee Discipline

California law requires that our Illness and Injury Prevention Program include a system for ensuring that employees comply with safe and healthy work practices, which may include disciplinary action. All employees, including supervisors and executives, are expected to abide by federal, state, local, and company safety and health regulations. Failure to do so may result in oral or written reprimands, suspension, or termination, depending on the severity of the misconduct and the circumstances. Any disciplinary measures taken will follow regular company procedure.

Fair and Equitable Enforcement

This disciplinary policy will be enforced fairly and equally against all employees, without exception. Supervisors and executives should ensure that employees understand safety and health regulations, and also understand the consequences of failing to comply with these regulations.

VIII. RECORDKEEPING

Maintenance of Written Records

_____[*Company name*] will maintain all written records relating to employee safety and health under this Injury and Illness Prevention Program for three years from creation of the record. Records are kept at _____[*specify location, e.g.*, the office of the Safety Director].

IX. APPROVAL

Presentation of Program

As the Safety Director, I state that I have developed this Injury and Illness Prevention Program, and that I believe it fulfills the requirements of *California Labor Code Section 6401.7* and *Title 8, Section 3203, of the California Code of Regulations.*

Date: _____

_____ [*signature*]
[*typed name*]

[*title*]

Approval and Implementation of Program

As the Responsible Person, I state that I have reviewed and approved this Injury and Illness Prevention Program, and that I am responsible for its implementation.

Date: _____

_____ [*signature*]
[*typed name*]
[*title*]

APPENDIX A

**[Post this notice conspicuously
where other employee notices are posted:]**

NOTICE TO EMPLOYEES OF
INJURY AND ILLNESS PREVENTION PROGRAM

_____[*Company name*] has complied with the requirements of *California Labor Code Section 6401.7* and *Title 8, Section 3203, of the California Code of Regulations* by implementing an Injury and Illness Prevention Program. A copy of the Program is available for your review at _____[*specify location, e.g.*, the office of the Safety Director].

The rights of the employees under the Program include the following:

(1) To be continuously advised of all relevant safety and health hazards in their working environment.

(2) To receive training concerning safe work practices, safe work procedures, and the use of personal protective equipment.

(3) To make safety and health suggestions without fear of reprisal.

The responsibilities of the employees under the Program include the following:

(1) To understand and use safe work practices and safe work procedures in the performance of their jobs.

(2) To comply with all federal, state, local, and company safety and health rules and regulations.

(3) To report all unsafe and unhealthy work practices and work conditions to their supervisors.

(4) To report all accidents, injuries, illnesses, near-misses, and unusual occurrences to their supervisors.

An employee's failure to comply with these obligationsmay result in disciplinary action. Disciplinary action includes oral and written warnings, suspension, and termination.

_____[*Company name*] will conduct periodic inspections of the workplace to identify unsafe work practices and unsafe working conditions.

If you have any questions about this Program, please contact your supervisor or the Safety Director.

Date: _____

_____ [*signature of safety director*]
[*typed name*]
[*title*]

APPENDIX B

[Give this notice to each employee:]

COMPANY SAFETY AND HEALTH POLICY
AND GENERAL SAFETY RULES

Policy

It is the policy of _____[*company name*] to have a safe and healthful workplace. That is the primary consideration in the operation of _____[*company name*]. To achieve that goal, we have implemented an Injury and Illness Prevention Program.

Members of management are expected to do everything within their control to assure a safe work environment, and always to comply with federal, state, and local safety regulations.

Employees are expected to obey safety rules, follow established safe work practices, and exercise caution in all their work activities.

All employees are expected to report immediately any unsafe conditions to their supervisors. Employees at all levels of our organization who are responsible for correcting unsafe conditions should do so.

Working together, we can succeed in having a safe, healthful, and profitable workplace from which we can all benefit.

General Safety Rules

Certain basic principles of safety are so important they can only be expressed as rules. These safety rules are a basic part of our Injury and Illness Prevention Program, and are also part of our disciplinary procedures.

Employees must know and follow these general safety rules. In addition, employees must know and follow safety rules

specific to their particular job, provided to them by their supervisors. Any employee violating a general orspecific safety rule is subject to discipline or termination. Supervisory and management staff must also know and follow the rules, and must enforce them.

These are the basic safety rules:

(1) Immediately report any injury to your supervisor.

(2) Immediately report all unsafe procedures or unhealthful conditions in the workplace, including defective, broken, or malfunctioning tools, machines, or equipment to your supervisor.

(3) Follow all established safe job procedures.

(4) Any changes in regular job procedures require the prior approval of your immediate supervisor.

(5) If unsure of how to operate a machine, use a tool, or perform any assigned task, contact your supervisor before proceeding.

(6) Use only the proper tool for the job. If the proper tool is not available, get help from your supervisor before doing the job. Do not use defective, broken, or malfunctioning tools, machines, or equipment.

(7) Do not remove or disable a guard or safety device on any machine or tool.

(8) Always wear or use personal protective equipment in any area for which it has been issued.

(9) Get help in lifting any item that is so bulky, awkward, or heavy that you feel you cannot lift it safely alone.

(10) If a repetitive task causes you discomfort, or you feel it is unsafe or unhealthful, report it to your supervisor immediately.

(11) Do not use, sell, or possess alcoholic beverages or illegal drugs anywhere in the workplace.

(12) _____ [*List other desired safety rules pertaining to employer's trade or occupation*].

APPENDIX C

[Give this notice to each employee
in the affected department:]

_____ [*specify, e.g.,* MACHINING] DEPARTMENT SAFETY RULES

These safety rules specific to your department are a part of our Injury and Illness Prevention Program, and are also part of our disciplinary procedures.

Employees must know and follow these specific safety rules. Any employee violating a specific safety rule is subject to

discipline or termination. Supervisory and management staff must also know and follow the rules, and must enforce them.

These are the safety rules specific to your department: _____ [*list department-specific safety rules, e.g.,*

(1) Do not smoke while at your work area or at any other time while on the job.

(2) Do not bring food or drink into your work area.

(3) Keep your machine and the area around it clean and dry.

(4) When operating your machine, wear all required safety equipment, including safety glasses, earplugs, gloves, and apron.

(5) Before using your machine each day, inspect it to make sure it is in correct working order and all safeguards are in place.

(6) Before you leave for a break and at the end of the day, make sure your machine is turned off.

(7) Do not allow your machine to operate while you are away from it.

(8) Turn off and lock your machine before adjusting or cleaning it.

(9) If your machine malfunctions, stop it immediately and notify your supervisor.

(10) In the event of a fire or other emergency, stop your machine, notify your supervisor or sound the alarm, and proceed quickly and calmly to the nearest emergency exit.]

APPENDIX D

JOB HAZARD EVALUATION FORM

This form is used to evaluate the hazards of any particular job in the company. The evaluator should use this form to describe the duties of the job, note potential hazards of the job, and suggest remedial action to correct the hazards. The evaluator should also research and list any safety orders that pertain to the job.

Name of Evaluator: Date of Evaluation: _____

_____

Department: _____[*specify, e.g.,* Field Operations]

Job Class or Work Area: _____[*specify, e.g.,* Transformer Installer]

Description of Job Tasks: _____ [*describe particular tasks related to job, e.g.,*

(1) Installs, connects, and troubleshoots large electrical transforming equipment.

(2) Generally works outdoors.

(3) Works in a variety of locations.

(4) Does heavy lifting.

(5) Uses hand tools, power tools, and heavy equipment.

(6) Operates motor vehicles.]

Potential Hazards Related to Job Tasks: _____ [*describe particular haxards related to job, e.g.,*

(1) Chemical hazards.

(2) Possibility of slipping, falling, or tripping.

(3) Driving hazards.

(4) Possibility of back injuries.

(5) Ladder hazards.

(6) Possibility of electric shock.

(7) Weather and temperature hazards.]

Suggested Remedial Action: _____ [*describe any suggested remedial action, e.g.,*

(1) Provide sufficient general and job-specific safety training.

(2) Provide safety manuals.

(3) Provide copies of relevant safety orders.

(4) Provide instruction in proper use of tools and equipment.

(5) Ensure that all tools and equipment are in safe working condition.

(6) Provide driver training.

(7) Require reporting of all unsafe conditions.

(8) Report all injuries and illnesses.]

Safety Orders Related to This Job: _____ [*list safety orders, e.g.,*

(1) Section 1502, Application of Orders.

(2) Sections 1509-1527, General.

(3) Sections 1693-1707, Tools and Equipment.

(4) Sections 3380-3400, Safety Devices and Safeguards.

(5) Sections 3649-3666, Industrial Trucks.]

APPENDIX E

SAFETY INSPECTION CHECKLIST

This form is to be used to conduct a safety inspection of a particular department. It is based on the company's general safety and health rules and on specific safety rules for this department. Part A is a list of items the inspector should be sure to check. However, the inspector should also look for any unsafe practices and conditions, note them, and suggest remedial action in Part B.

Name of Inspector: Date of Inspection: _____

_____

Department: _____[*specify, e.g.*, Machining Department]

Part A

Unsafe Practices

☐ Improper lifting techniques.

☐ Running in aisles or on stairs.

☐ Cleaning machine without first shutting it off.

☐ Leaving machine without shutting it off.

☐ Smoking near machine.

Housekeeping

☐ Machine and work area.

- ☐ Tool room.
- ☐ Aisles, stairs, and floors.
- ☐ Washrooms and locker rooms.
- ☐ Light and ventilation.
- ☐ Waste disposal.
- ☐ Cleaning supplies and equipment.

First Aid

- ☐ First aid kits.
- ☐ Stretchers and blankets.
- ☐ Emergency shower.
- ☐ Hazardous material kit.

Fire Protection

- ☐ Fire alarm system.
- ☐ Fire extinguishing equipment.
- ☐ Standpipes, hoses, sprinkler heads, and valves.
- ☐ Exits, stairs, and signs.
- ☐ Proper storage of flammable materials.

Miscellaneous

- ☐ Safety and health posters.

☐ Material Safety Data Sheets.

☐ New processes, chemicals, and materials.

☐ Dust, vapor, and fumes.

☐ Ladders and furniture.

Part B

Date

Unsafe Condition or Practice Observed	Recommended Action	Action Taken
_____	_____	_____
_____	_____	_____
_____	_____	_____

_____ [*signature of inspector*]
[*typed name*]
[*title*]

APPENDIX F

VDT INSPECTION CHECKLIST

This form is used to conduct a safety and health inspection of an employee's video display terminal (VDT) workstation. Because the widespread use of VDTs has been linked to increased work-related injuries and illnesses, this inspection is intended to detect and solve common problems before they can adversely affect employees. This form is based on the company's general and specific safety rules relating to the use of VDTs.

Name of Inspector: Date of Inspection: _____
_____

Operator: _____[*specify, e.g.*, Legal Secretary John Jones]

Workstation Location: _____

Type of Computer: _____

VDT Monitor

Is the VDT screen clean?

Has glare been eliminated by a glare screen, glare hood, proper office lighting, and the use of window shades?

Is the monitor positioned against a non-reflective background?

Is the monitor positioned perpendicular to any windows?

Is the monitor a comfortable distance from the operator (approximately 18 to 30 inches)?

Is the top of the monitor below (approximately 10 to 20 inches) the operator's line of sight?

Can the monitor be tilted or otherwise adjusted?

Are the brightness and contrast of the monitor adjusted properly?

Does the operator know how to adjust the monitor?

Can cooling air circulate around the monitor?

Keyboard and CPU

Can the height of the keyboard be adjusted to suit the operator?

Is the keyboard at the proper height (so that the home keys are level with the fingers when the arms are horizontal)?

Is the keyboard in a pull-out drawer?

Does the keyboard include a wrist rest?

Is the CPU placed properly?

Workstation

Are the workstation surfaces adjustable for height?

Does the operator know how to adjust the workstation?

Is there a document holder at a comfortable position?

Is the document holder properly lit?

Are work surfaces clean, uncluttered, and non-reflective?

Is there sufficient leg clearance from the floor to the bottom of the workstation (at least 25 inches)?

If the operator needs one, is a footrest in use or available?

Are the telephone and similar devices placed properly to avoid injuries?

If the operator needs one, is a headset in use or available?

Are cords placed out of the way?

Chair

Does the operator have an ergonomically correct adjustable chair?

Is the chair adjusted properly?

Does the operator know how to adjust the chair?

_____ [*signature of inspector*]
[*typed name*]
[*title*]

APPENDIX G

REPORT OF ACCIDENT

To prevent accidents, we need to know how and why they occur. This form gathers information about the results and causes of accidents. Supervisors and Safety Committee members investigating accidents should fill out this form as completely and accurately as possible. The investigation should be completed as soon as possible after an accident.

Name of Investigator/Supervisor: _____ Date: _____

Injured Employee's Name: _____

Employee's Department: _____

Employee's Job Title: _____

Employee's Work Location: _____

Date and Time of Injury: _____

Date Employer Was Notifed of Injury: _____

Location on Premises Where Accident Occurred: _____

Names of Witnesses to Accident (attach statements): _____

Describe the Injury and the Parts of the Body Affected: _____

State What Specific Task Employee Was Doing When Injured: _____

Describe the Events, Procedures, Conditions, Tools, and Equipment That Contributed to the Accident:

_____

If Known, State the Primary Cause of the Accident: _____

State Which, if any, Safety Rule Violations Contributed to the Accident: _____

Check All Boxes That Apply:

Building and Working Conditions

- ☐ Workplace design.
- ☐ Layout of equipment.
- ☐ Unsafe processes.
- ☐ Poor ventilation.
- ☐ Poor sanitation or hygiene.
- ☐ Poor lighting.
- ☐ Excessive noise.
- ☐ Design of floors, platforms, aisles, or stairs.

Housekeeping

- ☐ Improperly stored or piled supplies or materials.
- ☐ Congestion.

Equipment and Physical Hazards

- ☐ Defective tools.
- ☐ Defective machines.
- ☐ Defective materials.

Instruction and Training

- ☐ No employee training.
- ☐ Incomplete employee training.
- ☐ Erroneous employee training.
- ☐ Failure to follow directions.
- ☐ Operating without authority.
- ☐ Inexperience.
- ☐ Employee untrained in procedure.
- ☐ Incorrect use of tool or equipment.
- ☐ Poor judgment.
- ☐ Improper lifting.
- ☐ Excessive lifting.

Discipline

- ☐ Violation of safety rule.
- ☐ Roughhousing or horseplay.
- ☐ Use of alcohol or illegal drugs.

Clothing

- ☐ Clothing or footwear unsuitable.

State What Changes Can be Made to Prevent This Type of Accident From Occurring in the Future:
_____

State What Type of New Safety Rule Will Prevent This Type of Accident From Occurring in the Future: _____

State Which Inspection and Training Procedures Need to be Changed to Prevent This Type of Accident From Occurring in the Future: _____

Approximate Date Condition or Procedure Will be Corrected: _____

_____ [*signature of inspector/supervisor*]
[*typed name*]
[*title*]

APPENDIX H

MINUTES OF SAFETY COMMITTEE MEETING

This form is to be used as a record of the minutes of meetings of the Safety Committee. The minutes should be taken by the Secretary of the Committee, and should be approved by the Committee Chairperson. These minutes should be posted where other employee notices are located for employees to read.

The Safety Committee holds regular meetings quarterly, and special meetings as called by the Committee or the Safety Director.

Date of Meeting: _____

Date of Next Meeting: _____

Agenda

(1) Information About Committee Members:

Name: _____ ☐ Present ☐ Absent
Name: _____ ☐ Present ☐ Absent
Name: _____ ☐ Present ☐ Absent
Name: _____ ☐ Present ☐ Absent

Name: _____ _____ ___ ☐ Present ☐ Absent

Name: _____ _____ ___ ☐ Present ☐ Absent

☐ Present ☐ Absent

Voting Information:

Issue: _____ _____ ___ Vote Breakdown: _____ _____ ___

Issue: _____ _____ ___ Vote Breakdown: _____ _____ ___

Issue: _____ _____ ___ Vote Breakdown: _____ _____ ___

(2) List and discuss injuries and illnesses since last meeting and any corrective action taken:

Injury/Illness: _____ _____ ___

Action: _____

Injury/Illness: _____ _____ ___

Action: _____

Injury/Illness: _____ _____ ___

Action: _____

(3) List and discuss corrective recommendations completed since last meeting:

Recommendations Completed: _____ _____ ___

Recommendations Completed: _____ _____ ___

Recommendations Completed: _____ _____ ___

(4) List corrective recommendations still pending and status of each:

Status of Recom-

mendations Pending: _____ _____ ___

Status of Recommendations Pending: _____ _____ ___

Status of Recommendations Pending: _____ _____ ___

(5) Review and discuss accident reports, accident investigations, and reports of alleged hazardous conditions:

Reports, Investigations, and Conditions: _____ _____ ___

Reports, Investigations, and Conditions: _____ _____ ___

Reports, Investigations, and Conditions:

_____
_____
___

(6) List and discuss new recommendations, procedures, policies, and rules, and member to whom assigned:

Item:
_____
_____
___ Committee Member:
_____
_____
___

Item:
_____
_____
___ Committee Member:
_____
_____
___

Item:
_____
_____
___ Committee Member:
_____
_____
___

(7) Review, discuss, and make recommendations based on employee suggestions.

Suggestion:
_____
_____
___ Recommendation:
_____
_____

___ Suggestion: _____ _____

___ Recommendation: _____ _____

___ Suggestion: _____ _____

___ Recommendation: _____ _____

___

(8) Discuss training and educational activities.

Activity: _____ _____

___ Activity: _____ _____

___ Activity: _____ _____

___

I recorded these Minutes and state that they accurately reflect the business of the _____[regular *or* special] Safety Committee meeting held on _____[*date*]

_____ [*signature of secretary*]
[*typed name*]
Secretary

I approve the Minutes as recorded.

_____ [*signature of safety director*]

[*typed name*]
Safety Director

APPENDIX I

REPORT OF STATUS OF SAFETY COMMITTEE ACTION

This form is to be used by the Safety Committee to track Committee action, including investigations, inquiries, suggestions, and recommendations. This form should be maintained by the Secretary of the Committee, and should be updated at every regular and special meeting of the Safety Committee.

Action No. _____

Description of Action: _____[*specify, e.g.,* Evaluating employee suggestion to try new type of safety glasses]

Action Assigned to: _____[*name of committee member*]

Date Assigned: _____

Target Completion Date: _____

Date Completed: _____

Status Update: _____[*specify, e.g.,* Awaiting purchase authorization for glasses to use in test period]

APPENDIX J

INDIVIDUAL EMPLOYEE SAFETY ORIENTATION CHECKLIST

This form is used to document the safety orientation of a new employee or of an employee assigned to a new job. The supervisor should prepare this form for use during a discussion of the safety and health rules and policies relevant to the employee's job. Both the supervisor and the employee should sign the form. It should be retained in the employee's file and in the Safety Director's records for the Program.

Employee's Name: _____ Date Hired or Reassigned: _____

Department: _____

Job Title: _____

Past Work Experience Relevant to Safety and Health in This Job: _____

The following checked items have been discussed with the employee. Include comments beside relevant items, if desired.

☐ Company safety policies and programs.

☐ General safety rules.

☐ Specific safety rules that relate to employee's job.

☐ Disciplinary procedures for enforcing company safety policy, programs, and rules.

☐ Method for reporting injuries and illnesses.

☐ Method for reporting unsafe or unhealthy conditions and practices.

☐ Employee's right to ask questions about company safety policy and rules.

☐ Anonymous safety suggestion system.

☐ Review of fire and emergency evacuation plan.

☐ Location and use of fire extinguishers.

☐ Location and use of first aid kit.

☐ Safe work clothing.

☐ Importance of proper housekeeping.

☐ Hazard Communication Program, including Material Safety Data Sheets (MSDS).

☐ Special hazards of employee's job.

☐ Proper lifting procedures.

☐ VDT safety (for office workers using VDTs).

☐ Additional training required: _____ [*specify*].

I discussed each of the checked safety and health items above with _____[*name of employee*] on _____[*date*].

_____ [*signature of supervisor*]
[*typed name*]
Supervisor

I discussed each of the checked safety and health items above with my supervisor on _____[*date*], and I understand the importance of each item. I also understand that I may be subject to disciplinary action for failure to comply with company safety rules and regulations.

_____ [*signature of employee*]
[*typed name*]
Employee

APPENDIX K

GROUP EMPLOYEE SAFETY TRAINING LOG

This form is a roster used to document safety training for a group of employees. This form can be used for training of new employees, training of existing employees for newly recognized hazards, or annual refresher training. The training instructor should prepare this form before the training and have it available for employees to sign at the training session. Copies of this form should be retained in the attending employees' files and in the Safety Director's records for the Program.

Instructor: _____ Date: _____

Subjects Covered:

_____

Training Aids Used:

_____

Materials Distributed:

_____

Job Titles or Work Areas Covered:

_____

Attendees

I have attended this training session and understand the importance of the subjects discussed.

Printed Name	Signature
_____	_____
_____	_____
_____	_____

APPENDIX L

EMPLOYEE SAFETY AND HEALTH HAZARD
REPORTING FORM

As part of our Illness and Injury Prevention Program, this form is provided to allow employees to report safety and health concerns to management. We encourage and appreciate reports of unsafe or unhealthy working conditions or work practices. By providing this information, you are helping to prevent work-related injuries and illnesses.

The company will investigate all reports and address all questions raised by employees. We will respond to the employees affected and to the employee who submitted the form, if the form was signed.

Consistent with company policy and California law, no reprisal or disciplinary action will be taken against an employee who provides information or presents a suggestion relating to workplace safety and health.

Description of unsafe condition or practice: _____.

Cause of unsafe condition or practice: _____.

Suggestion for improvement: _____.

Employee's name (optional): _____.

Department: _____.

Date: _____.

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawOccupational Safety & HealthCompliance & DefensesLabor & Employment LawPosting & RecordkeepingWorkers' Compensation & SSDIPosting & Recordkeeping



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
B. Policies and Programs

1-1C California Legal Forms--Transaction Guide §§ 1C.222-1C.229

[Reserved]

§§ 1C.222[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
C. Employee Notices

1-1C California Legal Forms--Transaction Guide § 1C.230

§ 1C.230 Notice to Employees of Time and Place of Payment of Wages

[1] Comment

[a] Use of Form

This form is a notice to be posted by an employer notifying employees of regular paydays. Employers must keep posted conspicuously a notice specifying the regular paydays and the time and place of payment. The notice must be posted at the place of work, if practicable. Otherwise, the notice must be posted in another location where it can be seen as employees come or go to their places of work, or at the office or nearest agency for payment kept by the employer [*Lab. Code § 207*].

[b] Frequency of Payment

With limited exceptions [*see Lab. Code §§ 201, 202, 204.1, 204.2* (exceptions)], regular wages earned by most persons in employment are due and payable twice during each calendar month, on days designated in advance by the employer as regular paydays. Wages paid weekly, biweekly, or semimonthly satisfy this requirement [*Lab. Code § 204*].

Wages earned for labor in excess of the normal work period must be paid no later than the payday for the next regular payroll period [*Lab. Code § 204*]. Salaries of executive, administrative, and professional employees of employers covered by the FLSA, and commission employees of vehicle dealers, may be paid once a month [*Lab. Code §§ 204, 204.1, 204.2*; *see 29 U.S.C. § 213(a)(1)* (FLSA)].

[2] FORM

Notice to Employees of Time and Place of Payment of Wages

PAYDAY NOTICE

Regular paydays for employees of _____[*name of business*] are _____[*specify*

regular payday, e.g., biweekly on Thursday]. Pay is distributed _____[*specify time and place of pay distribution, e.g.,* by delivering checks to employees at their work locations between 9:00 and 10:00 A.M. Employees who are not at their work locations during this period may claim their checks at the Human Resources office after 10:30 A.M.]

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawPosting & RecordkeepingLabor & Employment LawWage & Hour LawsRecordkeeping RequirementsLabor & Employment LawWage & Hour LawsWage Payments



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
C. Employee Notices

1-1C California Legal Forms--Transaction Guide § 1C.231

§ 1C.231 Notice of Employee's Right to Take Time Off to Vote

[1] Comment

[a] Use of Form

This form is a notice to be posted by an employer notifying employees of their right to take time off work, if necessary, to vote. Not less than 10 days before each statewide election, every employer must post a notice setting forth the employees' right to take time off work to vote. The notice must be posted at the place of work, if practicable, or otherwise where it can be seen by employees as they come and go to their place of work. The notice must set forth the provisions of *Election Code Section 14350* [*Elec. Code § 14351*].

[b] Employee's Right to Take Time Off to Vote

If a voter does not have sufficient time outside of working hours to vote at a statewide election, the voter may, without loss of pay, take off enough working time that, when added to the voting time available outside of working hours, will enable the voter to vote. No more than two hours may be taken off without loss of pay [*Elec. Code § 14350*].

The time off for voting must be at the beginning or ending of a regular shift, whichever allows the most free time for voting and the least time off work, unless the employer and employee agree otherwise. If, on the third working day before the day of the election, the employee knows or should know that he or she will need to take time off to vote, the employee must give the employer at least two working days' notice of the desire to take time off to vote [*Elec. Code § 14350*].

[2] FORM

Notice of Employee's Right to Take Time Off to Vote

NOTICE TO EMPLOYEES OF TIME OFF FOR VOTING

If you do not have enough time outside of working hours to vote at a statewide election, you may, without loss of pay, take off enough working time that, when added to the voting time available outside of working hours, will enable you to vote. You may take no more than two hours off without loss of pay.

You must take the time off to vote at the beginning or ending of your regular shift, whichever allows the most free time for voting and the least time off work, unless you and _____[*name of employer*] agree otherwise. To arrange to take time off to vote other than at the beginning or ending of your regular shift, _____[*specify method of arranging other time off to vote, e.g.,* contact your supervisor]. If, on the third working day before the day of the election, you believe that you will need time off to vote, give _____[*name of employer*] at least two working days' notice that you wish to take time off to vote.

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawLeaves of AbsenceGeneral OverviewLabor & Employment LawPosting & Recordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
C. Employee Notices

1-1C California Legal Forms--Transaction Guide § 1C.232

§ 1C.232 Notice to Employee as to Change in Relationship

[1] Comment--Use of Form

This form is a notice to an employee that he or she has been discharged, fired, or laid off, or is on a leave of absence. An employer must immediately notify an employee of any change in relationship between the employer and the employee [*Unemp. Ins. Code § 1089*]. The changes in relationship that require notification are discharge, layoff, or leave of absence. An employer does not need to give an employee notice of the employee voluntarily quitting, of a promotion or demotion, of a change in work assignment or work location, or of a cessation of work due to a trade dispute. No particular form of this notice is required, but a notice in substantially the following form meets the notice requirement [*see* EDD Publication DE 44, California Employer's Guide].

[2] FORM

Notice to Employee of Change in Employment Relationship

NOTICE TO EMPLOYEE AS TO CHANGE IN RELATIONSHIP

Employee's Name: _____

Employee's Social Security Number: _____

This notice, pursuant to *Unemployment Insurance Code Section 1089*, is to inform you that you were _____[laid off *or* discharged on *or* on leave of absence starting] _____[*date*].

_____ [*name of employer*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEmployment RelationshipsGeneral OverviewLabor & Employment LawEmployment RelationshipsAt-Will EmploymentGeneral OverviewLabor & Employment LawEmployment RelationshipsAt-Will EmploymentDuration of EmploymentLabor & Employment LawEmployment RelationshipsEmployment ContractsConditions & TermsDischargesLabor & Employment LawLeaves of AbsenceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
C. Employee Notices

1-1C California Legal Forms--Transaction Guide § 1C.233

§ 1C.233 Notice of Right to Request Family Care and Medical Leave (CFRA Leave) and Pregnancy Disability Leave

[1] Comment

[a] Use of Form

This form is an official notice employers must display to their employees concerning the right to request family care and medical leave [*see* [b], *below*]. This notice must be posted in a conspicuous place or places where employees tend to congregate [*2 Cal. Code Reg. § 7297.9(a)*]. Employers may also give a copy of this notice to each employee [*2 Cal. Code Reg. § 7297.9(b)*]. The employer may include both family care and medical leave (CFRA leave) and pregnancy disability leave in a single notice [*2 Cal. Code Reg. § 7297.9(a)*].

If an employer publishes an employee handbook that describes the kinds of personal or disability leaves available, a description of family care and medical leave must be included in the next edition of the handbook [*2 Cal. Code Reg. § 7297.9(a)*]. If an employer's workforce contains 10 percent or more of employees who speak a language other than English as their primary language, the employer must translate this notice into the languages spoken by those groups [*2 Cal. Code Reg. § 7297.9(c)*].

The official notice contains only the minimum requirements of the Family Rights Act of 1993 and of the employer's obligation to provide pregnancy disability leave. Employers may provide the notice set forth in the regulations, or may draft their own notice. In either case, the notice must accurately reflect the employer's leave policy [*2 Cal. Code Reg. § 7297.9(d)*]. This form is based on the official notice. However, the official notice set forth in the regulations [*see 2 Cal. Code Reg. § 7297.9*] has not yet been revised to reflect the 1993 statutory changes to the Family Rights Act of 1991. This form has been altered to reflect those statutory changes, and does not, therefore, exactly match the regulatory form.

[b] Right to Family Care and Medical Leave

In general, employers of 50 or more employees must allow employees with more than 12 months of service to take a total of 12 weeks for family care or medical leave during any 12-month period [*Gov. Code § 12945.2(a)*]. Family care

and medical leave may be taken (1) for the birth of a child, for the placement of a child with an employee in connection with adoption or foster care, or for the serious health condition of a child; (2) to care for a parent or spouse who has a serious health condition; or (3) because of an employee's own serious health condition (except for disability on account of pregnancy, childbirth, or related medical conditions) that makes the employee unable to perform the functions of his or her job [*Gov. Code § 12945.2(c)(3)*]. In some instances, an employee must first use accrued vacation time or sick leave before taking family care and medical leave [*see Gov. Code § 12945.2(e)*].

It is an unlawful employment practice for an employer to refuse to hire, or to discharge, fine, suspend, expel, or discriminate against an employee for exercising the right to family care and medical leave [*Gov. Code § 12945.2(l)(1)*].

Similar federal coverage is provided by the Family and Medical Leave Act of 1993 [*see 29 U.S.C. §§ 2601-2654*].

[c] Employee Status During Leave

During family care and medical leave, the employee retains full employment status, including seniority [*Gov. Code § 12945.2(g)*], and is entitled to participate in employee health care and benefit plans [*Gov. Code § 12945.2(f)*]. However, the employee may be required to reimburse the employer for the cost of coverage [*Gov. Code § 12945.2(f)*]. With limited exceptions [*see* [d], *below*], the employer must guarantee an employee the same or a comparable position on returning [*Gov. Code § 12945.2(a)*].

[d] Permitted Refusal to Reinstate

An employer may refuse to reinstate an employeereturning from leave to the same or a comparable position if all of the following apply [*Gov. Code § 12945.2(r)(1)*]:

(1) The employee is a salaried employee who is among the highest paid 10 percent of employees in a defined geographic area.

(2) The refusal is necessary to prevent substantial and grievous economic injury to the operations of the employer.

(3) The employer notifies the employee of the intent to refuse reinstatement at the time the employer determines the refusal is necessary.

[2] FORM

Notice of Right to Request Family Care and Medical Leave (CFRA Leave) and Pregnancy Disability Leave

FAMILY CARE AND MEDICAL LEAVE (CFRA LEAVE) AND PREGNANCY DISABILITY LEAVE

Under the California Family Rights Act of 1993 (CFRA), if you have more than 12 months of service with us and have worked at least 1,250 hours in the 12-month period before the date you want to begin your leave, you may have a right to an unpaid family care or medical leave (CFRA leave). This leave may be up to 12 work weeks in a 12-month period for the birth, adoption, or foster care placement of your child or for your own serious health condition or that of your child, parent, or spouse.

Even if you are not eligible for CFRA leave, if you are disabled by pregnancy, childbirth, or related medical conditions, you are entitled to take a pregnancy disability leave of up to four months, depending on your period(s)of actual disability. If you are CFRA-eligible, you have certain rights to take BOTH a pregnancy disability leave and a CFRA leave for reason of the birth of your child. Both leaves contain a guarantee of reinstatement to the same or to a comparable position at the end of the leave, subject to any defense allowed under the law.

If possible, you must provide at least 30 days advance notice for foreseeable events (such as the expected birth of a child or a planned medical treatment for yourself or a family member). For events that are unforeseeable, we need you to notify us, at least verbally, as soon as you learn of the need for the leave. Failure to comply with these notice rules is grounds for, and may result in, denial or deferral of the requested leave until you comply with this notice policy.

We may require certification from your health care provider before allowing you a leave for pregnancy or for your own serious health condition or certification from the health care provider of your child, parent, or spouse who has a serious health condition before allowing you a leave to take care of that family member. When medically necessary, leave may be taken on an intermittent or reduced work schedule.

If you are taking a leave for the birth, adoption, or foster care placement of a child, the basic minimum duration of the leave is two weeks and you must conclude the leave within one year of the birth or placement for adoption or foster care.

Taking a family care or pregnancy leave may impact certain of your benefits and your seniority date.

If you want more information regarding your eligibility for a leave and/or the impact of the leave on your benefits, please contact _____[*title of contact person, e.g.,* the Director of Human Resources].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawLeaves of AbsenceFamily & Medical Leave ActCoverage & DefinitionsAdoption & MaternityLabor & Employment LawLeaves of AbsenceFamily & Medical Leave ActCoverage & DefinitionsDenials & RequestsLabor & Employment LawLeaves of AbsenceFamily & Medical Leave ActCoverage & DefinitionsEmployeesLabor & Employment LawLeaves of AbsenceFamily & Medical Leave ActCoverage & DefinitionsRestoration of Job & BenefitsLabor & Employment LawLeaves of AbsenceFamily & Medical Leave ActCoverage & DefinitionsSerious Health ConditionsLabor & Employment LawLeaves of AbsenceFamily & Medical Leave ActPosting & Recordkeeping



96 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1C REGULATION OF EMPLOYERS
PART IV. FORMS
C. Employee Notices

1-1C California Legal Forms--Transaction Guide § 1C.234

§ 1C.234 Notice to Employees of Prohibition on Illegal Drug Use

[1] Comment

[a] Use of Form

This form is a statement employers must give to their employees notifying them that illegal drug use on the premises is prohibited. The statement must be given to employees in a business that is awarded a contract or grant from a state agency for procuring property or services [*see Gov. Code § 8355(a)*]. However, this requirement that employers must certify a drug-free workplace [*see* [b], *below*] does not apply to credit card purchases of goods of $2,500 or less [*Gov. Code § 8355(b)(1)*; *see Gov. Code § 8355(b)(2)* (annual exemption limited to $7,500 per company)].

[b] Requirement to Operate Drug-Free Workplace

Under the Drug-Free Workplace Act of 1990 [*see Gov. Code §§ 8350-8357*], every person or organization awarded a contract or grant from a state agency for procuring property or services must certify to the agency that it will provide a drug-free workplace. To meet this requirement, the business must do all of the following [*Gov. Code § 8355(a)*]:

(1) Publish a statement notifying employees that the unlawful manufacture, distribution, dispensation, possession, or use of a controlled substance is prohibited in the workplace, and specifying the actions that will be taken against the employee for violation of the prohibition [*see Gov. Code § 8351(c)*; *21 U.S.C. § 812* ("controlled substance" defined)].

(2) Establish a drug-free awareness program to inform employees about (a) the dangers of drug abuse in the workplace, (b) the business's policy of maintaining a drug-free workplace, (c) any available drug counseling, rehabilitation, and employee assistance programs, and (d) the penalties that may be imposed on an employee for drug abuse violations.

(3) Require that each employee engaged in the performance of the contract or grant be given a copy of the statement concerning unlawful use of controlled substances, and that, as a condition of employment

on the contract or grant, the employee agree to abide by the terms of the statement.

[c] Penalty for Failure to Certify Drug-Free Workplace

Payment under a contract or grant awarded by a state agency may be suspended, or the contract or grant may be terminated, if the agency determines that the contractor or grantee made false certifications under *Government Code Section 8355* or failed to follow the requirements for establishing a drug-free workplace [*Gov. Code § 8356(a)*; *see Gov. Code § 8355(a)*].

[d] Federal Drug-Free Workplace Requirement

A similar federal program applies to grants and to contracts for the procurement of property or services for $25,000 or more from a federal agency [*see 41 U.S.C. §§ 701-707*]. The federal program differs from the state program by requiring employees to notify the employer, no later than five days after the conviction, of a criminal drug statute conviction for a violation occurring in the workplace [*41 U.S.C. §§ 701(a)(1)(D)(ii)* (contracts), 702(a)(1)(D)(ii) (grants)]. The federal program also requires employers to take action against employees convicted of drug offenses in the workplace [*see 41 U.S.C. § 703*]. This form can be modified to satisfy the federal program by including the optional language in the employee agreement portion of the form.

[2] FORM

Notice to Employees of Prohibition on Illegal Drug Use

NOTICE OF DRUG-FREE WORKPLACE

The unlawful manufacture, distribution, dispensation, possession, or use of a controlled substance by any person is prohibited _____[*specify workplace, e.g.*, in the building, on the premises, and any time while in the service, of XYZ Manufacturing Company]. Prohibited controlled substances are those listed in Schedules I through V of *Title 21, Section 812, of the United States Code*. A list of these prohibited controlled substances is on file at the Human Resources office for your review.

If you violate this prohibition, _____[*name of employer*] may take the following action: _____[*specify action to be taken, e.g.*, For the first violation, you will be enrolled in, and must participate in and successfully complete, a drug treatment program. In addition, a disciplinary letter will be placed in your personnel file. If you fail to complete the drug treatment program, your employment will be terminated. For any subsequent violation of this prohibition on illegal drug use, your employment will be terminated immediately].

AGREEMENT TO TERMS BY EMPLOYEE

As a condition of employment, I agree to abide by the terms of this statement [*add for federal program:* and agree to notify _____ (*name of employer*), no later than five days after the conviction, of a criminal drug statute conviction for a violation occurring in the workplace].
Dated: _____

EMPLOYEE
_____[*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEmployment RelationshipsEmployment ContractsConditions & TermsGeneral OverviewLabor & Employment LawPosting & RecordkeepingLabor & Employment LawPreemployment Practices



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS

1-1D California Legal Forms--Transaction Guide 1D.syn

§ 1D.syn Synopsis to Chapter 1D: OVERVIEW OF EMPLOYEE BENEFITS

§ 1D.01 California Statutes

§ 1D.02 Federal Sources

[1] Statutes

[2] Regulations

[3] Revenue Rulings

[4] Revenue Procedures

[5] Letter Rulings

§§ 1D.03-1D.04 [Reserved]

§ 1D.05 Law Reviews and Periodicals

§ 1D.06 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 1D.07-1D.09 [Reserved]

§ 1D.10 Who Should be Compensated

[1] Practical Considerations

[2] Non-Discrimination Provisions

§ 1D.11 Present Compensation and Benefit Plans--In General

§ 1D.12 Current Cash Compensation

§ 1D.13 Current Equity Interest in Business

§ 1D.14 Fringe Benefits

§ 1D.15 Deferred Compensation and Benefit Plans--In General

§ 1D.16 Deferred Compensation

§ 1D.17 Future Equity Interest in Business

§ 1D.18 Retirement Plans

[1] Generic Types

[2] Qualified Retirement Plans

[3] Non-Qualified Retirement Plans

§ 1D.19 Effect of Business Form on Benefits Selection

[1] General Effect on Benefits Selection

[2] Pension Plans

[3] Stock-Based Plans

[4] Restrictions on Specified Fringe Benefits Available to Sole Proprietorships, Partnerships, Limited Liability Companies, and S Corporations

§ 1D.20 California Taxation of Employee Benefit Plans

§§ 1D.21-1D.29 [Reserved]

§ 1D.30 "Fringe Benefits" Defined

§ 1D.31 Group Term Life Insurance

[1] Life Insurance Benefits--In General

[2] Qualification Requirements

[a] "Group Term Life Insurance" Defined

[b] General Death Benefit

[c] "Group of Employees" Defined

[d] "Employee" Defined

[e] "Policy Carried Directly or Indirectly" Defined

[f] Non-Discrimination Requirements

[g] Plans Covering Fewer Than 10 Employees

[3] Taxation of Group Life Insurance Premiums

[a] Exclusion by Employee

[b] Deduction by Employer

[4] Taxation of Death Benefits

[a] Income Taxes

[b] Estate Taxes

§ 1D.32 [Reserved]

§ 1D.33 Accident and Health Benefits

[1] In General

[2] Taxation of Accident and Health Plans

[a] Exclusion of Employer Contributions by Employee

[b] Exclusion of Benefits by Employee

[c] Deduction by Employer

[d] Self-Employed Individuals Not Employees

[3] Non-discrimination Rules

§ 1D.34 Requirements for Continuation of Coverage Under Group Health Plans

§ 1D.35 Cafeteria Plans

[1] "Cafeteria Plan" Defined

[2] "Employee" Defined

[3] Tax Aspects; Non-Discrimination Requirements

[4] Available Benefits

§ 1D.36 Miscellaneous Fringe Benefits

§ 1D.37 Dependent Care Assistance Programs

[1] Definitions

[2] Income Taxation of Dependent Care Assistance Programs

[a] Exclusion by Employee

[b] Tax Withholding by Employer

[3] "Employee" Defined

[4] Requirements for Qualification

§ 1D.38 Employer-Provided Educational Assistance

§ 1D.39 Internal Revenue Code Section 132 Benefits

[1] In General

[2] No-Additional-Cost Services

[3] Qualified Employee Discounts

[4] Working Condition Fringes

[5] De Minimis Fringe Benefits

[6] Qualified Transportation Fringe Benefit

[7] Qualified Moving Expense Reimbursement

[8] Qualified Retirement Planning Services

§ 1D.40 Adoption Assistance Programs

§ 1D.41 Additional Requirements for Welfare and Fringe Benefit Plans

§§ 1D.41-1D.49 [Reserved]

§ 1D.50 Structure of Qualified Retirement Plans

§ 1D.51 Tax Aspects of Qualified Retirement Plans--In General

§ 1D.52 ERISA Aspects of Qualified Retirement Plans

[1] Enforcement

[2] Fiduciary Standards

[3] Prohibited Transactions

[4] Preemption of State Law

[5] Private Lawsuits Permitted

§ 1D.53 Applicability of Securities Laws

§ 1D.54 Other Federal Limitations on Employee Compensation and Retirement Plans

§ 1D.55 Generic Types of Qualified Retirement Plans

§ 1D.56 Defined Benefit Plans

[1] "Defined Benefit Plan" Defined

[2] Limited Annual Deduction

[3] Actuarially Determined Contributions; Risk of Investment Performance on Employer

[4] Pension Benefit Guaranty Corporation

[5] Types of Defined Benefit Plans

§ 1D.57 Defined Contribution Plans

[1] "Defined Contribution Plan" Defined

[2] Risk of Investment Performance on Participant

[3] Types of Defined Contribution Plans

§ 1D.58 Profit-Sharing Plans

§ 1D.59 Money Purchase Pension Plans

§ 1D.60 Cash or Deferred Plans

§ 1D.61 Qualified Stock Bonus Plans; Employee Stock Ownership Plans

§ 1D.62 Simplified Employee Pensions

§ 1D.63 SIMPLE Retirement Plans

§ 1D.64 Credit for Small Employer Pension Plan Start-Up Costs

§§ 1D.65-1D.69 [Reserved]

§ 1D.70 Tax and ERISA Aspects of Non-Qualified Plans--In General

§ 1D.71 Structure of Non-Qualified Plans

§ 1D.72 Rabbi Trusts

§§ 1D.73-1D.79 [Reserved]

§ 1D.80 Basic Types of Stock-Based Plans

§ 1D.81 Non-Qualified Stock Plans

[1] In General

[2] Non-Qualified Stock Options

[3] Tax Treatment of Non-Qualified Stock Plans Under Internal Revenue Code Section 83

§ 1D.82 Qualified Stock Plans

[1] In General

[2] Incentive Stock Options

§ 1D.83 Stock Appreciation Rights

§§ 1D.84-1D.89 [Reserved]

§ 1D.90 Workers' Compensation Insurance

§ 1D.91 Unemployment and State Disability Insurance

§§ 1D.92-1D.99 [Reserved]

§ 1D.100 Facts

[1] Information About Natural Persons Who Are Owners of New Business

Scope

[2] Information About Organizations That Own or Are Owned by New Business

Scope

[3] Information About Business

Scope

[4] Types of Professional Advisors Involved in Business

Scope

[5] Information About Professional Advisors Involved in Business

Scope

[6] Information About Employees of Business

Scope

[7] Information About Present Employee Benefit Programs

Scope

§ 1D.101 Documents

Scope

§§ 1D.102-1D.109 [Reserved]

§ 1D.110 Scope of Work to be Performed by Attorney

Scope

§ 1D.111 Business's Objectives in Providing Retirement Plans

Scope

§ 1D.112 Business's Objectives in Providing Compensation Plans Other Than Retirement Plans

Scope

§ 1D.113 Checklist of Types of Benefit Plans

Scope

§ 1D.114 Checklist of Basic Requirements for Retirement Plan Qualification

Scope

§§ 1D.115-1D.199 [Reserved]

§ 1D.200 Client Letter Before Initial Meeting

[1] Comment

[a] Use of Form

[b] Fee and Representation Agreement

[2] FORM

Client Letter Before Initial Meeting

§ 1D.201 Client Letter Following Initial Meeting

[1] Comment--Use of Form

[2] FORM

Client Letter Following Initial Meeting

§ 1D.202 Client Letter if Attorney Is to Perform No Further Work

[1] Comment--Use of Form

[2] FORM

Client Letter if Attorney Is to Perform No Further Work

§ 1D.203 Client Letter if Attorney Recommends Specific Employee Benefit Plans

[1] Comment--Use of Form

[2] FORM

Client Letter if Attorney Recommends Specific Employee Benefit Plans



98 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS

1-1D California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter discusses tax-qualified employee benefit plans and non-qualified benefit alternatives a new business may offer its directors, officers, partners, owners, and employees. The chapter provides a brief overview of the types of employee benefits available, touching on their advantages and disadvantages from a tax and business standpoint.

The coverage is intended to allow an attorney setting up a new business to advise the business owner about the types of benefits that may be suitable for the employees for the business. The focus of this chapter is on the selection of employee benefits, rather than on setting up the benefit plan. The detailed steps in setting up a plan, particularly a deferred compensation plan, are highly technical and beyond the scope of this chapter. If the attorney does not have experience in this specialized area, he or she should associate someone who does.

The chapter discusses the types of benefits that may be provided by corporations, partnerships, limited liability companies, and sole proprietorships and highlights the disparate tax treatment of specific benefits. It covers specified fringe benefits, including group term life insurance, accident and health benefits, dependent care assistance programs, employer-provided educational assistance, cafeteria plans, and miscellaneous statutory fringe benefits. Although a complete discussion of pension plans is outside the scope of this chapter, the following types of plans are discussed from the perspective of benefits selection: defined benefit plans; defined contribution plans, including profit-sharing plans, money purchase pension plans, cash or deferred plans; and simplified employee pensions. Also covered are deferred compensation plans, including stock bonus plans, employee stock ownership plans and stock option plans. State unemployment compensation and workers' compensation insurance are briefly discussed.

As used in this chapter, "employee benefit plan" has a broader meaning than the term as defined in the Employment Retirement Income Security Act of 1974 (ERISA) and includes any arrangement under which an employer provides cash compensation or other benefits to its employees or to their beneficiaries.

Benefit plans for specialized types of entities, such as non-profit corporations and associations, including voluntary employees' beneficiary associations, are beyond the scope of this chapter. For further discussion of non-profit corporations and associations, refer to Ch. 13, *Nonprofit Corporations* .

For further discussion of fringe benefits, employee incentives, profit-sharing plans, stock bonus and stock option plans,

as well as forms providing for these benefits, refer to Volume 15, Chapter 85, *Employment Agreements,* and Bacon, Prater & Tucker, Employee Benefits Guide(Matthew Bender). Keogh plans are covered in Volume 3A, Chapter 12A, *Professional Corporations.* Life, accident, health, disability insurance, and workers' compensation are discussed in Chapter 1F, *Insurance Considerations* , and in California Insurance Law and Practice(Matthew Bender).

Defined contribution plans are covered in greater detail in C. Scudere, Pension and Profit-sharing Plans Compliance Guide(Matthew Bender); H. Frutkin, Pension and Profit-sharing Plans: Forms and Practice(Matthew Bender); and Rabkin and Johnson, Current Legal Forms with Tax Analysis, Volume 5A, Chapter 13, *Pension Plans and Other Exempt Employees' Plans* (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART I. RESEARCH GUIDE
A. Primary Sources

1-1D California Legal Forms--Transaction Guide § 1D.01

§ 1D.01 California Statutes

Worker performing certain construction/trade services presumed to be employee. *Lab. Code § 2750.5*.

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When individual deemed unemployed. *Unemp. Ins. Code §§ 1251, 1252*.

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART I. RESEARCH GUIDE
A. Primary Sources

1-1D California Legal Forms--Transaction Guide § 1D.02

§ 1D.02 Federal Sources

[1] Statutes

Employment Retirement Income Security Act of 1974 (ERISA)

Definitions. *29 U.S.C. § 1002*.

Coverage. *29 U.S.C. § 1003*.

Reporting and disclosure. *29 U.S.C. §§ 1021-1031*.

Participation and vesting. *29 U.S.C. §§ 1051-1061*.

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Administration and enforcement. *29 U.S.C. §§ 1131-1145*.

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Internal Revenue Code

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Annuities. *I.R.C. § 72*.

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Amounts received under accident and health plans. *I.R.C. § 105*.

Contributions by employer to accident and health plans. *I.R.C. § 106*.

Cafeteria plans. *I.R.C. § 125*.

Educational assistance programs. *I.R.C. § 127*.

Dependent care assistance programs. *I.R.C. § 129*.

Certain fringe benefits. *I.R.C. § 132*.

"Dependent" defined. *I.R.C. § 152*.

Trade or business expenses. *I.R.C. § 162*.

Qualified pension, profit-sharing, and stock bonus plans. *I.R.C. § 401*.

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Special rules for top-heavy plans. *I.R.C. § 416*.

Incentive stock options. *I.R.C. § 422*.

Employee stock purchase plans. *I.R.C. § 423*.

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Employer deduction in property transfer to employee. *Treas. Reg. § 1.83-6*.

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Taxation of employer contributions to accident and health plans. *Treas. Reg. § 1.106-1*.

Cafeteria plan; questions and answers. Temp. Treas. Reg. § 1.125-2T.

Exclusion from gross income of certain fringe benefits; "employee" defined. *Treas. Reg. § 1.132-1*.

No additional cost services. *Treas. Reg. 1.132-2*.

Working condition fringes. *Treas. Reg. § 1.132-5*.

Compensation for personal services. *Treas. Reg. § 1.162-7*.

Employee bonuses. *Treas. Reg. § 1.162-9*

Certain employee benefits. *Treas. Reg. § 1.162-10*.

Pension, profit-sharing, stock bonus plans, definitions. *Treas. Reg. § 1.401-0*.

Profit-sharing plan, definite formula for benefits. *Treas. Reg. §§ 1.401-1*, 1.401-3.

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Constructive receipt of income. *Treas. Reg. § 1.451-2*.

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"Employee" and "employer-employee relationship" defined. *Treas. Reg. § 31.3401(c)-1*.

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Rules on social security integration. *Rev. Rul. 71-446, 1971-2 C.B. 187* .

Incidents of ownership defined. *Rev. Rul. 71-463, 1971-2 C.B. 333* .

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[4] Revenue Procedures

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART I. RESEARCH GUIDE
A. Primary Sources

1-1D California Legal Forms--Transaction Guide §§ 1D.03-1D.04

[Reserved]

§§ 1D.03[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1D California Legal Forms--Transaction Guide § 1D.05

§ 1D.05 Law Reviews and Periodicals

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1D California Legal Forms--Transaction Guide § 1D.06

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Ch. 1F, *Insurance Considerations*.
Ch. 2, *Formation of Corporations*.
Ch. 2B, *Electing Subchapter S Status*.
Ch. 5, *Director's Meetings, Actions, and Resolutions*.
Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*.
Ch. 8C, *Close Corporation Shareholder Agreements*.
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1D California Legal Forms--Transaction Guide §§ 1D.07-1D.09

[Reserved]

§§ 1D.07[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
A. Preliminary Considerations in Selecting Employee Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.10

§ 1D.10 Who Should be Compensated

[1] Practical Considerations

Assisting the owner of a new business in the selection of appropriate types of employee benefit plans begins by determining which employees the owner wants to compensate. The target group might include owner-employees, key employees, salaried employees, union and non-union employees, salespersons, employees of a particular division, or all employees [*see [2], below*]. The group may vary in size from a single sole proprietor or sole shareholder of a corporation, to all employees of a publicly-held corporation.

Often, the owner will wish to compensate several groups, but with unequal benefits to each group. Counsel should discuss with the owner the different categories of employees, the owner's objectives (the hiring and retention of key employees, for example) and the types of benefit plans available, including present and future compensation and fringe benefits, including retirement plans, and the tax implications of each type of plan. A discussion of the advantages and disadvantages of employee benefit plans should also take into account, when appropriate, the psychological impact of the plans. For example, a plan to attract key employees may include the opportunity to own some of the business, while lower-paid employees may prefer increased cash compensation (higher salary or bonuses) to an ownership interest in the business.

[2] Non-Discrimination Provisions

When considering which employees to include in a particular benefit plan, the attorney and business owner should keep in mind that, under federal tax law, certain types of plans have non-discrimination requirements that must be complied with if the tax benefits of the plan are to be realized. This generally means that, for the business to obtain the full tax benefit from an offered plan, the plan must be made available to most or all employees, not just highly-compensated or key employees. This requires that the business owner surrender some or all discretion regarding which employees will receive benefits.

Programs that are subject to non-discrimination provisions include group life insurance plans [*see § 1D.31[2][f]*], accident and health benefit plans [*see § 1D.33 [3]*], and cafeteria plans [*see § 1D.35[3]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
A. Preliminary Considerations in Selecting Employee Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.11

§ 1D.11 Present Compensation and Benefit Plans--In General

A business owner can provide current compensation to its employees through (1) direct cash compensation; (2) an equity interest in the business; and (3) fringe benefits. The net economic value of these different methods of compensation to the employee and the business owner depends in part on their respective tax consequences. For example, from a tax point of view, statutory fringe benefits may be the best way for a business to provide benefits to its owners or employees. If properly structured, such plans provide benefits that are not taxable to the employee, while the costs of the benefits are deductible business expenses [*see § 1D.14*]. A fringe benefit that does not result in taxable income to the employee is more valuable to the employee than an equivalent taxable amount of compensation, if the employee were to purchase the same benefit with after-tax dollars. Consequently, the employer may derive a double benefit if, in addition to deducting the cost of the benefit, it is also able to pay the employee slightly less direct cash compensation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEmployment RelationshipsGeneral OverviewPensions & Benefits LawEmployee Benefit PlansGeneral OverviewPensions & Benefits LawEmployee Benefit PlansEmployee Stock Ownership PlansTax LawFederal Income Tax ComputationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
A. Preliminary Considerations in Selecting Employee Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.12

§ 1D.12 Current Cash Compensation

Current cash compensation is the traditional means of hiring and retaining key or desired employees. Reasonable compensation paid by an employer to an employee for services actually rendered is generally treated as an ordinary and necessary cost of doing business [*I.R.C. § 162(a)*; *Treas. Reg. §§ 1.162-7*, *1.162-9*, *1.162-10*]. As such, it is deductible by the business [*I.R.C. § 162(a)*] and includable in the employee's taxable income [*I.R.C. § 61(a)*; *Treas. Reg. § 1.61-2(a)(1)*].

However, current cash compensation has none of the attractive tax features for the employee of fringe benefits [*see § 1D.14*], an equity interest in the business [*see § 1D.13*], or certain deferred benefits [*see §§ 1D.15-1D.18*]. Most alternative methods of employee compensation have arisen to allow employees to pay lower taxes in the year the benefit is received or to defer taxes until a later year.

From the owner's viewpoint, the deductibility of direct cash compensation and the low administrative costs of the benefit are advantageous. However, other factors, such as the high current income tax rate for highly compensated employees, their desire to own an interest in the business, the general desire of employees for health and life insurance, as well as for retirement benefits, may make other methods of compensation more cost effective for the employer than increased wages as a means of hiring and retaining desired employees.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansEmployee Stock Ownership PlansTax LawFederal Income Tax ComputationGeneral OverviewTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsGeneral OverviewTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)General OverviewTax LawFederal Income Tax ComputationDeductions for Business ExpensesBusiness, Entertainment & Trade Expenses (IRC secs. 162, 274)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
A. Preliminary Considerations in Selecting Employee Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.13

§ 1D.13 Current Equity Interest in Business

Some business owners are unwilling to transfer any interest in the business; others may view the transfer as an incentive for retention of desired employees or improved employee performance. The trend in new service and high-tech companies is generally toward some form of equity-based compensation.

Property transfers may be made by an unincorporated business; they are most often made by a corporation in the context of a transfer of its stock. The type of economic benefit that a property or ownership interest provides depends largely on whether money is being accumulated in the business or distributed to the owners at regular intervals. For example, an ownership interest in a (profitable) partnership that distributes most of its income annually will result in an increase in income for the new partner, although there will be little increase in the value of the partnership interest itself. An ownership interest in a (profitable) corporation that does not declare any, or minimal, dividends, however, will result in no current increased cash income to the employee, but may substantially increase the employee's net worth over several years.

No income tax deduction may be taken by the business until the recipient recognizes taxable income (normally in the year the transfer is made) [*see I.R.C. § 83*]. The present and future taxation of the employee and the employer-entity on property transfers is further discussed in *§ 1D.82[2]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansEmployee Stock Ownership PlansPensions & Benefits LawEmployee Benefit PlansProfit-Sharing Plans



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
A. Preliminary Considerations in Selecting Employee Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.14

§ 1D.14 Fringe Benefits

Expenditures made by a business as fringe benefits for its employees are especially advantageous from a tax point of view. They are deductible as business expenses, but are not taxable to the employees who benefit from the expenditures [*see I.R.C. §§ 61(a), 72, 79, 104, 105, 106, 119, 125, 127, 129, 132, 137*].

Health and disability insurance is an increasingly coveted benefit. Generally, a business can obtain health and disability coverage for its employees at a substantially lower rate that the employees could obtain individually, so that net advantage to employees of this benefit is typically far greater than if they were to receive, as increased cash compensation, the amount spent by the business for premiums. Thus, the employer may either pay the employee less in direct cash compensation, allowing the tax benefits from the health plan to make up the difference; or pay the employee the same total compensation, part of which is excludable under *I.R.C. § 105*, with the employee realizing a greater net (that is, after-tax) benefit than if he or she had received the equivalent amount as direct cash compensation. Further, the cost to a business of establishing and administering a health insurance plan through an insurance company is not significant. Health and other fringe benefit plans are further discussed in *§§ 1D.30-1D.40*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansDefined Benefit PlansPensions & Benefits LawEmployee Benefit PlansDefined Contribution PlansPensions & Benefits LawEmployee Benefit PlansEmployee Stock Ownership PlansPensions & Benefits LawEmployee Benefit PlansPension Benefit Plans



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
A. Preliminary Considerations in Selecting Employee Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.15

§ 1D.15 Deferred Compensation and Benefit Plans--In General

A business owner can provide future compensation to its employees through (1) deferred compensation arrangements; (2) an equity interest in the business; and (3) contributions to retirement plans. These deferred benefits are discussed in *§§ 1D.16-1D.18* as illustrations of the flexibility a business has in developing employee benefit plans. Deferred benefit plans, including qualified retirement plans, non-qualified alternatives, and stock-based plans, are discussed in detail in *§§ 1D.50-1D.82*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansDefined Contribution PlansTax LawFederal Income Tax ComputationRetirement PlansDefined Contribution Plans (IRC secs. 414-415)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
A. Preliminary Considerations in Selecting Employee Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.16

§ 1D.16 Deferred Compensation

For purposes of this section, the term "deferred compensation arrangement" refers to an informal, nonqualified arrangement whereby the employer and employee agree that a portion of an employee's income earned in one year will not be paid until a later year. This is distinguished from other types of deferred compensation arrangements, such as traditional pension plans and 401(k) plans [*see §§ 1D.17, 1D.60*].

Deferred compensation arrangements shift compensation income on which an employee would otherwise incur tax in one year to a later year. This is accomplished by having the employer and employee agree to defer payment of compensation for services to be rendered in an upcoming tax period to a later tax year. The employer then takes its deduction, and the employee includes the payment as income, when the payment occurs [*I.R.C. § 404(a)(5)*].

A primary advantage of a deferred compensation arrangement from the employer's point of view is that the arrangement is exempt from ERISA's cumbersome requirements. The employer therefore has more discretion and flexibility in determining participants, contributions, and benefits in the plan. In addition, depending on the tax rate of the shareholders and the corporation, there may be a tax rate advantage in retaining the compensation in the corporation until later years. This latter advantage is less likely to occur after 2002, when the maximum individual tax rates dropped to 35 percent [*I.R.C. §§ 1(a)-(d), (i)(2), 11(b)*]. The cost of administering this type of plan ordinarily is minimal; individual agreements, rather than formal plans, may be used, and shareholder approval is not required [*see, e.g., Rev. Rul. 60-31, 1960-1 C.B. 174*]. A deferred compensation plan also allows an employer to delay paying for services rendered, thus effectively reducing the cost of the employee's compensation.

The main advantage from the employee point of view is the deferral of income into a year (such as after retirement) when the employee may have less income and be in a lower tax rate [*see I.R.C. § 1(a)-(d), (i)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsWage PaymentsTax LawFederal Income Tax

ComputationCompensation & Welfare BenefitsTips, Wages & Other Compensation (IRC secs. 61, 3121, 3231)Wages



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
A. Preliminary Considerations in Selecting Employee Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.17

§ 1D.17 Future Equity Interest in Business

A future equity interest in an incorporated business might take the form of an incentive stock option, a phantom stock plan, or stock appreciation rights, or an agreement to give stock options, phantom shares, or appreciation rights. A future equity interest in a unincorporated business might take the form of an agreement regarding a future partnership or limited liability company. The non-tax implications of transferring a future equity interest in the business are quite similar to those related to the transfer of a present interest [*see § 1D.13*]. The differences in the tax treatment of the transfer of a present and a future interest are discussed in *§ 1D.81[3]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsStock Options (IRC secs. 421-424)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
A. Preliminary Considerations in Selecting Employee Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.18

§ 1D.18 Retirement Plans

[1] Generic Types

Retirement plans are the most common type of deferred benefit. There are two generic types of retirement plans: qualified and non-qualified. Qualified plans are those that meet specific statutory requirements [*see I.R.C. §§ 401-418E*], generally provide employees with non-taxable or tax-favored benefits [*see e.g., I.R.C. §§ 402(a), 403(a)(1)*], and permit employers to deduct their plan contribution in the year in which it is made [*I.R.C. § 404*; *see [2], below*]. Non-qualified plans do not offer the tax advantages of qualified plans; however, in many instances, employers may find non-qualified arrangements to be preferable [*see [3], below*].

[2] Qualified Retirement Plans

A qualified plan is one that satisfies the requirements of *I.R.C. § 401(a)*: pension, annuity, profit-sharing, and stock bonus plans, including employee stock ownership plans (ESOPS) [*Treas. Reg. § 1.401-0*; *see I.R.C. §§ 401-418E*]. These detailed requirements (related to funding and benefits, coverage, vesting, top-heaviness, multiple employers, distributions, and reporting and disclosure) must be met for the employer and participants to obtain favorable tax treatment. The tax advantages include, for example, the deduction of contributions by the employer in the year the contribution is made [*I.R.C. § 404*], deferral of tax to the participants until the income is received [*I.R.C. §§ 402(a), 403(a)(1)*], and tax-free accumulation of plan contributions [*I.R.C. § 501(a)*]. The tax treatment of qualified retirement plans and retirement plan benefits is discussed more fully in *§ 1D.51*.

Because tax savings is usually the key feature of any retirement plan, qualified plans are generally more desirable than non-qualified plans. However, non-qualified plans, which permit employers to arbitrarily select plan participants, may be used to achieve important non-tax objectives of the employer and employee, such as improving employee incentive through equity ownership in the business [*see [3], below*].

The primary disadvantage of qualified plans is the substantial costs associated with drafting a plan and related trust agreement that meet the complicated requirements of the Internal Revenue Code and Employee Retirement Income Security Act of 1974 (ERISA) [*see I.R.C. §§ 401-418E, 501(a)*; *29 U.S.C. §§ 1081-1086*] and obtaining a qualification

letter from the Internal Revenue Service [*see Rev. Proc. 80-30, 1980-1 C.B. 685* (although customary to obtain advance ruling from IRS, favorable determination letter on qualification not required as condition for obtaining plan or trust benefits)]. Continuing costs include the administrative expense of handling the trust's funds and filing various required reports. Another substantial continuing cost arises if the employer wants to make disproportionately large contributions on behalf of a small number of highly paid employees, who make up a small percentage of the total number of employees. In these circumstances, the employer will have to contribute additional money on behalf of all eligible employees, to avoid complex non-discrimination rules requiring that the actual deferral percentage for highly paid employees not exceed a permitted ratio to the percentage for other eligible employees [*see I.R.C. § 401(a)(4)*; *Treas. Reg. §§ 1.401-1, 1.401(b)-1*]. Of course, this problem is minimized if the highly paid employees for whom the employer wishes to make disproportionate contributions make up the majority of the plan's eligible participants.

[3] Non-Qualified Retirement Plans

A non-qualified retirement plan is one that does not meet the requirements of *I.R.C. § 401(a)* and related provisions, and thus does not offer the tax advantages of a qualified plan [*see I.R.C. §§ 401-418E*]. If a retirement plan is not qualified, an employer's deduction for a compensation expense is generally linked to the time an employee includes the compensation in income [*see I.R.C. § 83(h)*]. In addition, the earnings from a non-qualified plan generally are not exempt from tax [*see I.R.C. § 501(a)*].

Although less advantageous from a tax point of view,non-qualified plans typically do not require the non-discriminatory coverage of employees required by qualified plans, and therefore may require lower total employer contributions, since the employer may chose to benefit only a select group of employees, typically management or highly compensated employees. Further, except for certain reporting and disclosure requirements, non-qualified plans are generally exempt from the provisions of ERISA [*29 U.S.C. §§ 1051(2), 1081(a)(3), 1101(a)(1)*]. Thus, many non-qualified plans may be established, funded, and administered less expensively than qualified plans, although the costs may vary significantly depending on the tax treatment of contributions and benefits, the total number of covered participants, and whether the plan is funded with current or future contributions. Obviously, when a less-expensive non-qualified alternative can satisfy the employer's objectives, use of a qualified plan is not recommended.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansGeneral OverviewTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsGeneral OverviewTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsCafeteria Plans (IRC sec. 125)Tax LawFederal Income Tax ComputationRetirement PlansGeneral OverviewTax LawFederal Income Tax ComputationRetirement PlansQualified Plans (IRC secs. 401, 410-412)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
A. Preliminary Considerations in Selecting Employee Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.19

§ 1D.19 Effect of Business Form on Benefits Selection

[1] General Effect on Benefits Selection

The employer's form of business is no longer a major factor in benefits selection, although whether a business is incorporated or unincorporated retains some tax significance, mostly for owners who are also employees of the business [*see, e.g., [4], below*]. Indeed, although a corporation can, in certain circumstances, offer a wider variety of types of compensation and fringe benefits than a sole proprietorship, partnership, or limited liability company, these fringe benefits may be subject to non-discrimination rules and other restrictions against plans that primarily benefit certain corporate officers and owners [*see I.R.C. § 416*; *Treas. Reg. § 1.416-1*]. In addition, S corporations [*see I.R.C. §§ 1361* ("S corporation" defined), *1362* (S corporation election)] are treated in the same manner as partnerships for the purpose of many employee fringe benefits and, as such, are given less favorable tax treatment than C corporations [*I.R.C. § 1372*; *see [4], below*].

The advantages and disadvantages of operating a business as a corporation, partnership, limited liability company, or sole proprietorship are discussed in Ch. 1B, *Selecting Form of Business Entity* . Ch 2B, *Electing Subchapter S Status* , covers the procedures to be used by a small business corporation in electing (or terminating) Subchapter S status.

[2] Pension Plans

Both corporate and non-corporate pension plans are subject to the same limitation on deductibility of contributions [*see, e.g., I.R.C. § 415(b)* (annual benefit for defined benefit plan limited to lesser of $160,000 ($90,000 for years ending on or before December 31, 2001) or 100 percent of participant's average compensation for high three years)].

Nonetheless, some corporate advantages remain: Self-employed retirement plans, commonly called Keogh plans (either defined-benefit or defined-contribution plans), for example, are still subject to certain restrictions that do not apply to the plans of C corporations. These restrictions include the fact that a loan between the qualified plan of an unincorporated entity and a sole proprietor or partner (with a 10-percent or more ownership interest) is a prohibited transaction, subject to penalty taxes [*see I.R.C. § 4975(d)(1)*; *29 U.S.C. § 1108(b)(1)* (exceptions for loans to disqualified persons or parties in interest does not apply to owner-employees); *see also I.R.C. § 401(c)(3)*

("owner-employee" defined)]. Furthermore, the maximum deductible retirement plan contribution made by an unincorporated entity on behalf of a self-employed individual is limited to that individual's net self-employment income (which has already been reduced by one half of the self-employment tax [*see I.R.C. § 1402(a)* ("net earnings from self-employment" defined)], further reduced by the deduction for contributions to a qualified retirement plan [*I.R.C. § 404(a)(8)(B)*; *see I.R.C. §§ 401(c)(2)* ("earned income" defined), *404(a)(8)(B)*]. This restriction, which does not apply to participants in corporate plans, effectively reduces the amount that the self-employed individual may contribute to a qualified plan. This is because it reduces the amount that is considered 100 percent of the participant's compensation for purposes of the defined benefit or defined contribution limitation [*see I.R.C. § 415(b)(1), (c)(1)*]. It should be noted that S corporation pass-through income, may not be net earnings from self-employment for purposes of shareholder Keogh plan deductions [*see Durando v. United States (9th Cir. 1995) 70 F.3d 548, 553* (citing I.R.C. provisions authorizing partners and sole proprietors, but not S corporation shareholders, to deduct contributions)].

[3] Stock-Based Plans

The difference between a corporation and a sole proprietorship, partnership, or limited liability company is significant with respect to stock-based plans, which, by their nature, can be implemented only by a corporation. A corporation may use a variety of approaches to utilize its own stock as a form of employee compensation. Such plans include, among others, qualified stock bonus and employee stock ownership plans [*see I.R.C. § 409*; *see also § 1D.61*], qualified stock plans and incentive stock options [*I.R.C. §§ 401(a), 421, 422*; *see also § 1D.82*], non-qualified stock plans and stock options [*see I.R.C. § 83*; *see also § 1D.81*], cash or deferred arrangements that may be part of a stock bonus plan [*see I.R.C. § 401(k)*; *see also § 1D.60*] and stock appreciation rights [*see, e.g., Rev. Rul. 80-300, 1980-2 C.B. 165* ; *see also § 1D.113*].

[4] Restrictions on Specified Fringe Benefits Available to Sole Proprietorships, Partnerships, Limited Liability Companies, and S Corporations

Sole proprietors, partners, and 2-percent shareholders of S corporations [*see I.R.C. § 1372(b)* "2-percent shareholder" defined)] have been denied employee-related tax exclusions for: (1) group term life insurance [*Treas. Reg. §§ 1.79-0, 31.3401(c)-1*; *see § 1D.31*]; (2) employee death benefits [*Treas. Reg. § 1.101-2(f)*; *see § 1D.32*]; (3) accident and health plans [*I.R.C. § 105(g)*; *Rev. Rul. 69-144, 1969-1 C.B. 115* ; *Rev. Rul. 56-326, 1956-2 C.B. 100* ; *see § 1D.33*]; and (4) meals and lodging benefits [*Wilson v. United States (Ct. Cl. 1967) 376 F.2d 280, 296-297]* . This is because these persons are not considered "employees" for purposes of these categories of fringe benefits [*Treas. Reg. §§ 1.79-0, 1.101-2(f), 31.3401(c)-1*; *I.R.C. § 1372*]. A member of a limited liability company that is taxed as a partnership presumably also would not be considered an "employee" [*see* Ch. 12C, *Limited Liability Companies*]. Shareholder-employees of C corporations, however, are considered to be employees, even if they hold a controlling interest in their corporations [*Treas. Reg. §§ 1.79-0, 1.101-2(f), 31.3401(c)-1*; *I.R.C. § 1372*]. Furthermore, S corporation pass-through income has been held not to constitute net earnings from self-employment for purposes of shareholder Keogh plan deductions [*Durando v. United States (9th Cir. 1995) 70 F.3d 548, 553]* .

Employees of sole proprietorships, partnerships, limited liability companies, or S corporations, however, may receive the qualified fringe benefits enumerated above on tax-free basis [*I.R.C. §§ 79(b)(1), (3), 1372(a)*; *Treas. Reg. § 1.79-0*; *Rev. Rul. 68-577, 1968-2 C.B. 50*]. Further, S corporation shareholders "employed" by their corporation, and partners who "perform services" for their partnerships, are considered employees for purposes of certain miscellaneous statutory fringe benefits, including the following [*Treas. Reg. § 1.132-1(b)*]: (1) no-additional-cost benefits [*see § 1D.39[2]*]; (2) qualified employee discounts [*see § 1D.39[3]*]; (3) working condition fringe benefits [*see § 1D.39[4]*]; and (4) *de minimis* fringe benefits [*see § 1D.39[5]*]. Presumably, this also applies to members who "perform services" for their limited liability companies [*see* Ch. 12C, *Limited Liability Companies*]. Otherwise, partners and S corporation owners who are not employees generally may not participate on a tax-free basis in fringe benefit programs set up for their employees.

Furthermore, a partner may not achieve employee status through the use of guaranteed payments [*Treas. Reg. § 1.707-1(c)*; *see I.R.C. § 707(c)* ("guaranteed payments" defined)] despite the fact that guaranteed payments are taxed as salary or other ordinary income compensation to the partner [*I.R.C. § 162(a)(1)*; *Treas. Reg. § 1.162-7*] and allowed as business deductions to the partnership, provided they meet the general deductibility tests of the Internal Revenue Code [*I.R.C. § 707(c)*; *Treas. Reg. § 1.707-1(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansGeneral OverviewPensions & Benefits LawEmployee Benefit PlansPension Benefit PlansTax LawFederal Income Tax ComputationRetirement PlansGeneral OverviewTax LawFederal Income Tax ComputationRetirement PlansNondiscrimination Rules (IRC sec. 401)Tax LawFederal Income Tax ComputationRetirement PlansQualified Plans (IRC secs. 401, 410-412)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
A. Preliminary Considerations in Selecting Employee Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.20

§ 1D.20 California Taxation of Employee Benefit Plans

California law on the taxation of employee benefit plans conforms to federal law [*Rev. & Tax. Code § 17024.5(a)(1)*], unless otherwise noted.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansGeneral OverviewTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
A. Preliminary Considerations in Selecting Employee Benefit Plans

1-1D California Legal Forms--Transaction Guide §§ 1D.21-1D.29

[Reserved]

§§ 1D.21[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.30

§ 1D.30 "Fringe Benefits" Defined

Although the phrase "fringe benefits" is often used as a catch-all to refer to any form of employee compensation other than direct cash compensation, such as sickness, accident, hospitalization, medical expenses, recreational, welfare, and similar benefit plans [*see Treas. Reg. § 1.162-10*], "fringe benefits" is used in this chapter to mean "specified fringe benefit plans" as defined in the Internal Revenue Code. These plans include any plan under *I.R.C. §§ 79* (group term life insurance), *105* (amounts received under accident and health plans), *106* (employer contributions to accident and health plans), *125* (cafeteria plans), *127* (educational assistance programs), *129* (dependent care assistance programs), and *137* (qualified adoption assistance programs) [*I.R.C. § 6039D(d)(1)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansGeneral OverviewPensions & Benefits LawEmployee Benefit PlansCafeteria PlansTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.31

§ 1D.31 Group Term Life Insurance

[1] Life Insurance Benefits--In General

Life insurance pays a specified amount of money to a beneficiary if the insured dies while the policy is in effect. If the insured is a participating employee, that amount is frequently referred to as a death benefit.

There are two main categories of life insurance. The first, "whole life insurance," is payable whenever the insured's death occurs; its premiums are payable in a lump sum ("single premium life"), for a specified period of time ("limited payment life"), or for life ("ordinary life").

The second, "term life insurance," is payable only if the insured dies within a specified period. To qualify for the tax exemption, insurance provided under a group term life insurance plan must be term (not whole life) insurance, as its name indicates, and must meet certain other statutory requirements discussed below [*Treas. Reg. § 1.79-1(a)*; *see [2], below*]. However, an exception to the term insurance requirement is made when the policy specifies the portion of the premium allocated to term insurance, and the employer pays only that portion [*Treas. Reg. § 1.79-1(b)(1)(i)*; *see Rev. Rul. 71-360, 1971-2 C.B. 87* ; *Rev. Rul. 75-91, 1975-1 C.B. 39* (employee pays portion of premium attributable to factors other than term life insurance)].

For further discussion of types of life insurance, see Ch. 1F, *Insurance Considerations* , and California Insurance Law and Practice, Ch. 20, *Nature and Types of Life Insurance* (Matthew Bender).

[2] Qualification Requirements

[a] "Group Term Life Insurance" Defined

Group term life insurance is life insurance coverage that satisfies the following conditions [*Treas. Reg. § 1.79-1(a)*]:

- Provides general death benefits only, excludable from the beneficiary's gross income under *I.R.C. § 101(a)*; [*but see Treas. Reg. § 1.79-3(f)* (provision of other benefits); *see also [b], below*].

- Is provided to a group of employees on the basis of factors that preclude individual selection [*see Treas. Reg. § 1.79-0(c)*; *see also [c], [d], below*];

- Is provided under a policy carried directly or indirectly by the employer [*see [e], below*]; and

- Determines the amount of insurance available to each employee under a formula that precludes individual selection. The plan's coverage formula may be based on factors such as age, years of service, compensation, or employee position [*Treas. Reg. § 1.79-1(a)(4)*]. Additional non-discrimination requirements, however, apply to key employees [*see [f], below*].

[b] General Death Benefit

To qualify for the income tax exclusion under *I.R.C. § 79*, the policy must provide a general death benefit excludable under *I.R.C. § 101(a)* [*Treas. Reg. § 1.79-1(a)(1)*]. Many types of insurance, such as travel insurance and accident and health insurance, do not provide a general death benefit. These types of insurance, as well as insurance provided on the spouse of the employee, do not qualify for this tax exclusion [*Treas. Reg. § 1.79-1(f)(2), (3)*]. However, an employer's contributions to these types of insurance may be excludable under another statute. For example, the gross income of an employee does not include employer-provided coverage under an accident or health plan [*I.R.C. § 106*].

[c] "Group of Employees" Defined

For purposes of group term life insurance, a "group of employees" must include all the employees of the employer or a class or classes of employees that preclude individual selection [*Treas. Reg. § 1.79-0(b)*]. The group may be based on factors such as age, marital status, or factors related to employment [*Treas. Reg. § 1.79-0(b)*]. "Factors related to employment" include union membership, types of duties performed, compensation received, and length of employment [*Treas. Reg. § 1.79-0(b)*]. Participation in a pension or profit-sharing plan, stock bonus plan, or accident or health insurance plan are factors considered related to employment, even if employee contributions to the plan are required [*Treas. Reg. § 1.79-0(b)*]. Stock ownership is not a factor related to employment; however, participation in an employer's stock bonus plan is such a factor [*Treas. Reg. § 1.79-0(b)*].

[d] "Employee" Defined

For purposes of group term life insurance, "employee" does not include a self-employed individual, that is, a sole proprietor, partner, or 2-percent S corporation shareholder [*Treas. Reg. § 1.79-0(b)*; *see I.R.C. § 1372(a)*]. It does, however, include employees of those entities [*I.R.C. § 79(b)(1), (3)*; *Treas. Reg. § 1.79-0(b)*; *Rev. Rul. 68-577, 1968-2 C.B. 50*]. A member of a limited liability company that is taxed as a partnership would presumably also not be considered an "employee" [*see* Ch. 12C, *Limited Liability Companies*]. Thus, this tax-favored benefit is available to C corporation employees, including shareholder employees as well as non-owner employees, employees of sole proprietorships, partnerships, limited liability companies, and S corporations, as well as their retired employees, with the exception of disability retirees [*I.R.C. § 79(b)(1), (e)*; *Treas. Reg. § 1.79-0(b)*].

[e] "Policy Carried Directly or Indirectly" Defined

A policy is carried directly or indirectly by the employer if (1) the employer pays any part of the insurance directly or through another person; or (2) an employer maintains a contributory plan and charges at least one employee more than the cost of the insurance and at least one employee less than the cost of the insurance [*Treas. Reg. § 1.79-0*; *see Treas. Reg. § 1.79-3(d)(2)* (table determining cost)].

[f] Non-Discrimination Requirements

The non-discrimination requirements are designed to prevent favorable treatment of key employees [*see I.R.C. § 79(d)*; *see also I.R.C. § 416(i)(1)* ("key employee" defined)]. However, failure to satisfy these requirements affects only the tax treatment of key employees; it does not effect the favorable tax treatment afforded lower-paid employees [*I.R.C. § 79(d)*1); *see [3], below*].

A non-discrimination eligibility provision requires the following [*I.R.C. § 79(d)(3)(A)*]:

- The plan benefit 70 percent of all employees;
- At least 85 percent of participants not be key employees;
- The plan's eligibility classification be found by the Internal Revenue Service not to discriminate in favor of key employees; or
- The plan be part of a cafeteria plan that satisfies the eligibility requirements for cafeteria plans under *I.R.C. § 125* [*see § 1D.35*].

Certain employees, however, are excluded from these requirements, including the following [*I.R.C. § 79(d)(3)(B)*]:

- Employees who have not completed three years of service;
- Part-time or seasonal employees;
- Employees not covered by the plan but covered by a collective bargaining agreement, if group term life insurance benefits were the subject of good faith bargaining between employee representatives and employer or employers; and
- Employees who are non-resident aliens with no United States earned income.

A non-discrimination benefits provision requires that all benefits available to key employees be available to all other participants [*I.R.C. § 79(d)(4)*], except that life insurance benefits bearing a uniform relationship to compensation are not discriminatory [*I.R.C. § 79(d)(5)*]. Further, different level of benefits may be provided for present and former employees, without being discriminatory [*I.R.C. § 79(d)(8)*].

[g] Plans Covering Fewer Than 10 Employees

In order for the tax exemption to apply [*see [3], below*], the plan generally must cover at least 10 employees [*Treas. Reg. § 1.79-1(c)(1)*]. If the covered group consists of fewer than 10 employees, special rules apply. Insurance must be provided for all full-time employees, and the insurance coverage provided must be computed based either as a uniform percentage of the employee's salary or according to coverage brackets established by the insurer [*Treas. Reg. § 1.79-1(c)(2)*].

[3] Taxation of Group Life Insurance Premiums

[a] Exclusion by Employee

Up to $50,000 of group term life insurance coverage may be provided to the employee without the employee being taxed on the premiums the employer paid for this benefit [*I.R.C. § 79(a)*; *see [b], below*]. To the extent that the insurance exceeds $50,000, the excess is includable in the employee's taxable income and is subject to social security and medicare taxes [*I.R.C. § 3121(a)(2)(C)*; *see I.R.C. § 3111(a), (b)* (social security and medicare taxes)]. It is not

subject, however, to federal unemployment tax or withholding [*I.R.C. §§ 3401(a)(14), 3306(b)(2)*]. Moreover, the amount of the employee's taxable income for the excess coverage is determined by using the Uniform Premium Table (UPT) found in the Treasury Regulations, which usually values the cost of the coverage at less than its actual cost [*see Treas. Reg. § 1.79-3(d)(2)*]. Thus, a qualified group term life insurance plan offers the employee two main advantages: an exclusion from income of the premiums paid by the employer for the first $50,000 of coverage and favorable tax treatment with respect to amounts paid for coverage in excess of $50,000.

Refer to *[4], below*, for a discussion of taxation of death benefits.

[b] Deduction by Employer

Premiums paid by an employer for group term life insurance coverage qualify as ordinary and necessary business expenses and may be deducted by the employer if they are both reasonable in amount and paid for services actually rendered [*I.R.C. § 162(a)(1)*; *see I.R.C. § 212*]. However, no deduction is allowed for premiums paid on a life insurance policy or endowment or annuity contract, if the employer is directly or indirectly a beneficiary under the policy or contract [*I.R.C. § 264(a)(1)*; *see I.R.C. § 79(b)(2)*]. "Key employee" insurance, commonly purchased by an employer to covers its own losses in the event of the death of a key employee, is an example of this type of non-deductible insurance.

[4] Taxation of Death Benefits

[a] Income Taxes

On the death of an employee covered under a group term plan, life insurance proceeds generally will not be included in the recipient's taxable income [*I.R.C. § 101(a)(1)*]. This rule, however, is subject to limitations, primarily in the case of "transfers for value" [*I.R.C. § 101(a)(2)*]. For further discussion of the income taxation of life insurance proceeds, see Ch. 1F, *Insurance Considerations* , and California Insurance Law and Practice, Ch. 71, *Life Insurance Considerations in Personal and Estate Planning* (Matthew Bender).

[b] Estate Taxes

The value of the death benefits is includable in the employee's gross estate for estate tax purposes unless (1) the benefits are paid to a beneficiary other than the executor or estate of the employee, and (2) the employee possess no incidents of ownership with respect to the policy at the time of his or her death [*I.R.C. § 2042*]. "Incidents of ownership" broadly includes the right of the insured or the insured's estate to economic benefits under the policy, or to a greater than 5-percent reversionary interest in the value of the policy, and can include the power to change beneficiaries, to assign the policy or to revoke an assignment, to surrender or to cancel the policy, or to borrow against the policy [*see I.R.C. § 2042(2)*; *Treas. Reg. § 20.2042-1(c)(2),(6)*; *Rev. Rul. 71-463, 1971-2 C.B. 333*]. For further discussion of the estate taxation of life insurance proceeds, see Ch. 1F, *Insurance Considerations* , and California Insurance Law and Practice, Ch. 71, *Life Insurance Considerations in Personal and Estate Planning* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansCafeteria PlansTax LawFederal Estate & Gift TaxesTaxable PropertyLife Insurance (IRC sec. 2042)Incidents of OwnershipTax LawFederal Estate & Gift TaxesTaxable PropertyLife Insurance (IRC sec. 2042)Proceeds Receivable by ExecutorsTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsLife Insurance (IRC sec. 79)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.32

[Reserved]

§ 1D.32[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.33

§ 1D.33 Accident and Health Benefits

[1] In General

An accident and health plan established by an employer for the benefit of its employees is another type of fringe benefit potentially excludable from the employee's taxable income. When properly used, accident and health plans can provide substantial tax benefits to employees, and may be advantageous to employers as well [*see [2], below*; *§ 1D.14*].

Accident and health benefits include such generic types of insurance as accident insurance, medical insurance, disability income insurance, and accidental death and dismemberment insurance.

A qualified plan may take one of two forms: a funded medical and hospital "insurance" plan, in which the employer purchases insurance and the insurance proceeds are used to pay medical expenses incurred by the employee, the employee's spouse, or dependents; or a "medical expense reimbursement" plan, in which the employer contributes funds to a separate trust or account used to reimburse employees directly for accident and health expenses that they and their spouses or dependents incur [*Treas. Reg. § 1.106-1*].

[2] Taxation of Accident and Health Plans

[a] Exclusion of Employer Contributions by Employee

An employee's gross income does not include the value of employer contributions to accident and health plans [*I.R.C. § 106*; *Treas. Reg. § 1.106-1*]. If the employer funds its accident and health plan with insurance (or some other funding vehicle), that funding will not result in taxable income to its employees [*see I.R.C. § 106*; *Treas. Reg. § 1.106-1*; *P.L.R. 8411064* (employer contributions to accident and health plans are not employee income, whether plan is insured or otherwise)].

[b] Exclusion of Benefits by Employee

An employee's gross income does not include amounts paid directly or indirectly to the employee through an accident

and health plan for medical care expenses incurred by the employee, the employee's spouse, or dependents, except to the extent that the employee has previously deducted those expenses [*I.R.C. § 105(b)*; *see I.R.C. §§ 152* (dependent defined), *213(d)* (medical care defined)]. Also excluded from an employee's gross income are amounts constituting payment for permanent loss, or loss of use of a body member or function, or permanent disfigurement of the employee, the employee's spouse, or dependents, when the amount is dependent on the nature of the injury and not on the length of absence from work [*I.R.C. § 105(c)*; *see Treas. Reg. § 1.105-3* ("permanent disfigurement" defined)]. Disability and wage continuation pension benefits generally are no longer excluded from income [Social Security Amendments Act of 1983, Pub. L. No. 98-21, 122(b) (repealing *I.R.C. § 105(d)* for tax years beginning after 1983)]. For purposes of the tax exclusion, the benefits may be insured or self-insured and an employer, fund, employee association, or insurer may pay them under the plan [*I.R.C. § 105(e)*; *Treas. Reg. § 1.105-1(b)*].

[c] Deduction by Employer

Payments made by an employer to an accident or health plan are deductible as ordinary and necessary business expenses by the employer as long as they constitute reasonable compensation to the employee, taking into account all of the compensation paid by the employer to the employee [*I.R.C. § 162*; *see I.R.C. § 212*].

[d] Self-Employed Individuals Not Employees

Self-employed individuals (sole proprietors, partners, and 2-percent S corporation shareholders) do not qualify for the tax exemption under *Internal Revenue Code Sections 105* and *106*, with regard to amounts paid for themselves, because they are not considered "employees" for purposes of the statute [*I.R.C. §§ 105(g), 1372(a)*; *Treas. Reg. § 1.105-1(a)*; *see § 1D.31*]. A member of a limited liability company that is taxed as a partnership presumably would also be considered self-employed [*see* vol. 4, Ch. 12C, *Limited Liability Companies*].

[3] Non-discrimination Rules

There are no statutory non-discrimination rules for health and accident plans that provide benefits solely through insurance [*see* former *I.R.C. § 89*; Pub. L. No. 101-140, § 202(a), (c)]. Thus, such plans can discriminate in favor of highly compensated employees or self-employed individuals. However, the non-discrimination rules applicable to self-insured medical reimbursement plans provide that there will be no exclusion for benefits paid to highly compensated individuals that discriminate in their favor as to benefits or eligibility [*I.R.C. § 105(h)(1)*; *see I.R.C. § 105(h)(5)*].

A "self-insured medical" reimbursement plan is an employer plan that reimburses employees for medical expenses for which reimbursement is not provided under a policy of accident and health insurance [*I.R.C. § 105(h)(6)*]. Certain other plans issued by a licensed insurance company that do not shift the risk to the insurer are also considered self-insured plans and, as such, are subject to the non-discrimination rules discussed above [*see Treas. Reg. § 1.105-11(b)(1)(ii)*].

The non-discrimination benefits rules require that all benefits provided for highly compensated participants be provided to all other participants [*I.R.C. § 105(h)(4)*]. All reimbursements received by highly compensated individuals that do not meet this requirement are "excess reimbursements" and must be included in the recipient's gross income [*I.R.C. § 105(h)(7)*; *see I.R.C. § 105(h)(7)(A)* (excessive reimbursements defined for non-discrimination benefit rules)].

The non-discrimination eligibility rules require that [*I.R.C. § 105(h)(3)(A)*]:

- The plan benefit at least 70 percent of all employees, or at least 80 percent, if at least 70 percent are eligible to benefit under the plan; or

- The plan's eligibility classification be found by the Internal Revenue Service not to discriminate in

favor of highly compensated individuals.

Certain employees, however, are excluded from these requirements, including all of the following [*I.R.C. § 105(h)(3)(B)*]:

- Employees who have not completed three years of service;
- Employees under the age of 25;
- Part-time or seasonal employees;
- Employees not covered by the plan but covered by a collective bargaining agreement, if the accident or health benefits were the subject of good faith bargaining between employee representatives and employer or employers; and
- Employees who are non-resident aliens with no United States earned income.

If the eligibility requirements are not met, highly compensated individuals must include in their gross income all "excessive reimbursements" [*I.R.C. § 105(h)(1); see I.R.C. § 105(h)(7)(B)* (excess reimbursements defined for non-discrimination eligibility rules)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansCafeteria PlansPensions & Benefits LawEmployee Benefit PlansWelfare Benefit PlansTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsCafeteria Plans (IRC sec. 125)Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsDeath Benefits (IRC sec. 101)Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsDisability Payments (IRC secs. 104-106)Accident & Health Insurance



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.34

§ 1D.34 Requirements for Continuation of Coverage Under Group Health Plans

Under federal law, an employer with more than 20 employees that offers a group health plan must make continuation coverage under the plan available to its employees, under specified terms, on the occurrence of a qualifying event [*I.R.C. § 4980B*; *29 U.S.C. §§ 1161-1169*; *42 U.S.C. §§ 300bb-1-300bb-8*; *see I.R.C. § 4980B(f)(3)*; *29 U.S.C. § 1163*; *42 U.S.C. § 300bb-3* ("qualifying event" defined)]. This type of coverage is commonly called COBRA continuation coverage [*see* Consolidated Omnibus Budget Reconciliation Act of 1985, §§ 10001-10003, Pub. L. No. 99-272].

The continuation coverage must consist of coverage that, at the time the coverage is provided, is identical to the coverage provided under the plan to similarly situated beneficiaries to whom a qualifying event has not occurred [*I.R.C. § 4980B(f)(2)(A)* (if plan coverage is modified for any group of similarly situated beneficiaries, coverage must also be modified for qualified beneficiaries); *29 U.S.C. § 1162(1)*; *42 U.S.C. § 300bb-2(1)*].

The continuation coverage must generally last 36 months after the date of the qualifying event, unless the qualifying event is the termination of the employee, in which case the coverage need last only 18 months [*I.R.C. § 4980B(f)(2)(B)*; *29 U.S.C. § 1162(2)*; *42 U.S.C. § 300bb-2(2)*; *see I.R.C. § 4980B(f)(2)(B)(v)*; *29 U.S.C. § 1162(2)(A)* (rules governing covered employees entitled to Medicare for plan years after 1989)].

The plan may require the payment of a premium for any period of continuation coverage. However, the premium may not exceed 102 percent of the premium otherwise applicable under the plan, and the payor may elect to pay the premiums in monthly installments [*I.R.C. § 4980B(f)(2)(C)*; *29 U.S.C. § 1162(3)*; *42 U.S.C. § 300bb-2(3)*]. Further, the continuation coverage must not be conditioned on, or discriminate on the basis of the lack of, evidence of insurability [*I.R.C. § 4980B(f)(2)(D)*; *29 U.S.C. § 1162(4)*; *42 U.S.C. § 300bb-2(4)*].

If the employer's group health plan does not comply with the federal requirements with respect to any qualifying beneficiary [*see I.R.C. § 4980B(f)*], a penalty tax will be imposed on the employer or, in the case of a multiemployer plan, on the plan [*I.R.C. § 4980B(a), (e)*; *see I.R.C. § 4980B(d)(2), (3)* (exceptions for governmental and church plans); *see also I.R.C. § 414(d)* ("governmental plans" defined), *(e)* ("church plans" defined)]. Further, group health plans maintained by any state receiving funds from the Public Health Services Act [*42 U.S.C. §§ 201 et seq.*], or by any of its

political subdivisions, agencies, or instrumentalities, must provide continuation coverage that satisfies the federal requirements [*see 42 U.S.C. §§ 300bb-1-300bb-8*]. Thus, although California insurance law does not mandate the continuation of coverage benefit [*see Ins. Code § 12692(h)*], employers purchasing group health policies for their employees must require that the policy contain this benefit as a result of the federal requirements [*see 42 U.S.C. §§ 300bb-1-300bb-8*].

For further discussion of continuation requirements, refer to California Insurance Law and Practice, Volume 2, Chapter 26, *The Health and Disability Contract* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawConsolidated Omnibus Budget Reconciliation Act (COBRA)ContinuationPensions & Benefits LawConsolidated Omnibus Budget Reconciliation Act (COBRA)CoveragePensions & Benefits LawConsolidated Omnibus Budget Reconciliation Act (COBRA)PremiumsPensions & Benefits LawConsolidated Omnibus Budget Reconciliation Act (COBRA)Qualifying Event



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.35

§ 1D.35 Cafeteria Plans

[1] "Cafeteria Plan" Defined

A "cafeteria plan" is a written plan that allows employees to choose between receiving additional cash compensation or having a corresponding amount go towards a nontaxable fringe benefit or combination of benefits [*see I.R.C. § 125*]. The cafeteria plan does not itself create the nontaxable benefits; it merely allows the employee to make the choice among various benefits, if the employee does not opt to receive taxable cash compensation [*see [3], below*]. Cafeteria plans have become an increasingly popular means of offering employee benefits, as a result of the flexibility they provide employees in determining, for themselves, the type and combination of compensation they will receive.

[2] "Employee" Defined

For purposes of cafeteria plans, the term "employee" includes present and former employees but not self-employed individuals [*see I.R.C. § 125(b)(2)*]. As a result, sole proprietors, partners, and 2-percent shareholders are unable to avail themselves of this tax exemption, since they are not considered employees [*see § 1D.19[4]*]. A member of a limited liability company that is taxed as a partnership presumably would also be considered self-employed and, hence, not an employee [*see* Ch. 12C, *Limited Liability Companies*].

[3] Tax Aspects; Non-Discrimination Requirements

If the employee elects to receive cash benefits, that compensation is deductible by the business [*I.R.C. § 162(a)*; *Treas. Reg. §§ 1.162-7, 1.162-9, 1.162-10*] and includable in the gross income of the employee in the tax year the compensation is actually or constructively received [*I.R.C. § 61(a)*; *Treas. Reg. § 1.61-2(a)(1)*]. Constructive receipt occurs when compensation is or becomes available without "substantial limitations or restrictions" [*Treas. Reg. § 1.451-2(a)*]. However, the statute governing cafeteria plans creates an important exception to the doctrine of constructive receipt and allows the taxpayer to choose an alternative nontaxable fringe benefit instead of receiving addition cash compensation (taxable income) [*see I.R.C. § 125(a)*].

If the plan fails to meet certain statutory non-discrimination requirements [*see I.R.C. § 125(g)*], however, highly

compensated employees or key employees electing a normally tax-exempt benefit under the plan must include the value of the benefit in income [*I.R.C. § 125(b)(1), (2)*; *see I.R.C. § 414(q)* ("highly compensated employee" defined)].

[4] Available Benefits

Qualified benefits, that is, benefits eligible for the tax exemption, include [*I.R.C. § 125(f)*; *see* Temp. Treas. Reg. § 1.125-2T]:

- Group term life insurance [*I.R.C. § 79*; *see § 1D.31*].
- Accident and health coverage [*I.R.C. §§ 105, 106*; *see § 1D.33*].
- Dependent care assistance [*I.R.C. § 129*; *see § 1D.37*].
- Cash or deferred plans [*I.R.C. § 401(k)*; *see § 1D.60*].
- Other statutory fringe benefits expressly excluded from the gross income of an employee, excluding the following [*I.R.C. § 125(f)*; Temp. Treas. Reg. § 1.125-2T]: scholarships and tuition reduction programs [*I.R.C. § 117*]; educational assistance programs [*I.R.C. § 127*; *see § 1D.38*]; and miscellaneous fringe benefits specified by *I.R.C. § 132* [*I.R.C. § 132*; *see § 1D.39*]. Also specifically excluded are deferred compensation plans, with the exception of cash or deferred arrangements [*I.R.C. § 125(d)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansCafeteria PlansTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsCafeteria Plans (IRC sec. 125)



123 of 170 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.36

§ 1D.36 Miscellaneous Fringe Benefits

Specific statutory fringe benefit programs allow employees to exclude certain employer- provided benefits from gross income. These include certain amounts received under cafeteria plans [*I.R.C. § 125*], educational assistance payments [*I.R.C. § 127*], dependent care assistance payments [*I.R.C. § 129*], and adoption assistance payments [*I.R.C. § 137*]. *I.R.C. § 132* also allows an exclusion for a variety of non- statutory fringe benefits. (qualified transportation)]. Further, *I.R.C. § 132* has restricted the use of non-statutory fringe benefits by adopting new statutory standards [*see § 1D.39*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansCafeteria PlansPensions & Benefits LawEmployee Benefit PlansWelfare Benefit PlansTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.37

§ 1D.37 Dependent Care Assistance Programs

[1] Definitions

A dependent care assistance program is another employee fringe benefit given preferential tax treatment [*see I.R.C. § 129*]. Under the program, an employer may either reimburse the employee or directly pay for expenses incurred by the employee for dependent care assistance [*see I.R.C. § 129(e)(1)*]. "Dependent care assistance expenses" are those that would qualify as employment-related expenses under *I.R.C. § 21(b)(2)* [*I.R.C. § 129(e)(1)*]. These are expenses for household or dependent care services for the care of one or more qualifying individuals necessary for the gainful employment of the employee [*I.R.C. § 21(b)(2)*]. A "qualifying individual" is a dependent of the taxpayer who is under the age of 13 and who has the same principal place of abode as the taxpayer for more than one-half of the taxable year or the spouse or a dependent of the taxpayer who is physically or mentally incapable of caring for himself or herself [*I.R.C. § 21(b)(1)*; *see I.R.C. § 151(c)* (additional personal exemption for dependents)].

[2] Income Taxation of Dependent Care Assistance Programs

[a] Exclusion by Employee

The first $5,000 (or $2,500 for a married person filing separately) in value of qualifying payments or services is excluded from the taxable income of the employee benefitting from the program [*I.R.C. § 129(a)(1), (2)*], subject to the following limitations. To be excluded from the employee's taxable income, payments by the employer may not exceed the employee's earned income during the taxable year, or, if the employee is married, they may not exceed the earned income of the employee's spouse, if less [*I.R.C. § 129(b)*]. This limitation effectively precludes married taxpayers from taking advantage of the program if either spouse is not employed, unless the unemployed spouse is a full-time student or incapable of taking care of himself or herself [*I.R.C. § 129(b)(2)*]. Further, payments by the employer are not excludable from income to the extent that they are paid to an individual under the age of 19, or to a dependent or spouse of the employee [*I.R.C. § 129(c)*].

Amounts excluded from the gross income of the employee cannot be deducted by the employee, or claimed as a credit under any other section of the Internal Revenue Code [*I.R.C. § 129(e)(7)*]. However, the exclusion from income of the

employer's payments generally is more beneficial than the tax credit for dependent care services available under *I.R.C. § 21* [*see I.R.C. § 21(a)* (calculation of allowable credit)].

[b] Tax Withholding by Employer

Excludable employer contributions to, and benefits under, dependent care assistance programs and qualified military benefits are exempt from social security and medicare taxes, federal unemployment taxes, and federal income tax withholding [*I.R.C. §§ 3121(a)(18), 3306(b)(13), 3401(a)(18)*].

[3] "Employee" Defined

An "employee," for purposes of dependent care assistance programs, includes self-employed persons [*I.R.C. § 129(e)(3)*]. Thus, although there are restrictions on benefits payable to owners and shareholders [*see I.R.C. § 129(d)*; *see also [4], below*], unlike most statutory fringe benefit plans, owners of unincorporated businesses are eligible for benefits under dependent care assistance programs. However, self-employed persons, who are not eligible to participate in cafeteria plans [*see § 1D.35[2]*], will not be able to participate in a dependent care assistance programs funded by salary contributions under such plans.

[4] Requirements for Qualification

To qualify for preferential tax treatment, a dependent care assistance program must be a separate written plan of the employer for the exclusive benefit of its employees [*I.R.C. § 129(d)(1)*]. The program must satisfy various requirements designed to prevent discrimination in favor of highly compensated employees [*see I.R.C. § 129(d)(2)*]. It must benefit employees who qualify under a classification set up by the employer and found by the Internal Revenue Service not to be discriminatory in favor of employees who are highly compensated or their dependents [*I.R.C. § 129(d)(3)*; *see I.R.C. § 129(d)(9)* (excluded employees)]. In addition, plan contributions and benefits must not discriminate in favor of highly compensated employees [*I.R.C. § 129(d)(2)*]. Further, shareholders or owners (or their spouses or dependents) who, on any day of the year, own more than 5 percent of the stock or the capital or profits interest of the business, may not receive more than 25 percent of the amounts paid or incurred by the business for dependent care assistance during the year [*I.R.C. § 129(d)(4)*]. Average benefits provided to employees who are not highly compensated employees must be at least 55 percent of the average benefits provided to highly compensated employees [*I.R.C. § 129(d)(8)(A)*], except that, in the case of benefits provided through a salary reduction agreement, a plan may disregard any employees whose compensation is less than $25,000 [*I.R.C. § 129(d)(8)(B)*; *see I.R.C. §§ 414(q)(4), 415(c)(3)* (for this purpose, "compensation" includes amounts contributed to cafeteria plans and cash or deferred plans)].

The plan is not required to be pre-funded by the employer [*I.R.C. § 129(d)(5)*].

If the plan fails to meet the qualification requirements discussed above, the income exclusion will be eliminated only for highly compensated employees [*I.R.C. § 129(d)(1)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansCafeteria PlansTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsCafeteria Plans (IRC sec. 125)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.38

§ 1D.38 Employer-Provided Educational Assistance

An educational or training expense may be excludable from income if it is a working condition fringe [*see I.R.C. § 132(d), (j)(8)*; *see also § 1D.39[4]*]. Thus, employer-paid, job-related education is excludable from the employee's income (and deductible by the employer), if properly substantiated [*see I.R.C. § 162*]. Further, job-related educational expenses may be excluded as a working condition fringe by self-employed individuals (including sole proprietors, partners and 2-percent S corporation shareholders), as well as common-law employees [*see I.R.C. § 132(d)*]. A member of a limited liability company that is taxed as a partnership would presumably also be considered self-employed [*see* Ch. 12C, *Limited Liability Companies*].

The maximum annual exclusion for an individual is $5,250 [*I.R.C. § 127(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)Working Condition Fringe



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.39

§ 1D.39 Internal Revenue Code Section 132 Benefits

[1] In General

The following types of miscellaneous fringe benefits are excluded from the income of the benefitted employee and are deductible by the employer [*I.R.C. § 132(a)*; *see Treas. Reg. § 1.162-10*]:

- No-additional-cost services [*see [2], below*].
- Qualified employee discounts [*see [3], below*].
- Working condition fringes [*see [4], below*].
- *De minimis* fringes [*see [5], below*].
- Qualified transportation fringes [*see [6], below*].
- Qualified moving expense reimbursement [*see [7], below*].
- Qualified retirement planning services [*see [8], below*].

[2] No-Additional-Cost Services

"No-additional-cost services" are services provided by the employer to the employee (1) that the employer offers for sale to customers in the ordinary course of the business in which the employee works, and (2) for which the employer incurs no substantial additional costs, including foregone revenue and lost productive time, in providing to the employee [*I.R.C. § 132(b)*; *see Treas. Reg. § 1.132-2(a)(5)*]. For purposes of the exclusion for no-additional-cost services, an "employee" includes a self-employed individual [*Treas. Reg. § 1.132-1(b)(1)*; *see I.R.C. § 401(c)(1)* ("self-employed individual" defined)]. Employers may additionally extend no-additional-cost services on a tax-free basis to spouses and dependent children of employees and to retired and disabled employees and surviving spouses of deceased employees [

I.R.C. § 132(h)(1), (2); *see I.R.C. § 132(h)(3)* (special rule for parents in case of air transportation)].

Examples of no-additional-cost services include free air travel provided to airline employees on a stand-by basis, and free room accommodations provided to hotel employees [*Treas. Reg. § 1.132-2(c)*].

The exclusion from income applies to owners, officers, or other highly compensated employees only if the services are available on a non-discriminatory basis [*I.R.C. § 132(j)(1)*]. However, if the non-discrimination requirement is not met, employees who are not highly compensated nevertheless retain their tax exemption [*I.R.C. § 132(j)(1)*; *see I.R.C. § 414(q)* (highly compensated employee defined)].

[3] Qualified Employee Discounts

"Qualified employee discounts" are discounts to employees on property (other than real property and property of a kind commonly held for investment) or services normally offered for sale in the employer's lines of business [*I.R.C. § 132(c)(1),(4)*]. The amount of the exemption for property may not exceed the normal gross profit percentage on sales to customers [*I.R.C. § 132(c)(1)(A)*]; the amount of the exemption for services may not exceed 20 percent of the sales price to customers [*I.R.C. § 132(c)(1)(B)*]. Discounts in excess of these limitations are taxable to the employee [*see I.R.C. § 132(a)*].

For purposes of the exclusion for qualified employee discounts, an "employee" includes a self-employed individual [*Treas. Reg. § 1.132-1(b)(1)*; *see I.R.C. § 401(c)(1)* ("self-employed individual" defined)]. Employers may extend qualified employee discounts on a tax-free basis to spouses and dependent children of employees and to retired and disabled employees and surviving spouses of deceased employees [*I.R.C. § 132(h)(1), (2)*].

As an example of a qualified employee discount, a department store might allow its employees to purchase items at a discount, provided that the discount does not exceed the limitations discussed above.

A qualified employee discount is subject to the same non-discrimination rules applied to no-additional cost fringes [*I.R.C. § 132(j)(1)*; *see § 1D.39[2]*].

[4] Working Condition Fringes

"Working condition fringes" include any property or services provided to an employee, to the extent that if the employee paid for the property or services, they would be deductible to the employee as a trade or business expense, or as depreciation [*I.R.C. § 132(d)*; *see I.R.C. § 162* (trade or business expenses), *167* (depreciation)]. Items relating to another trade or business of the employee do not qualify for the exemption and are taxable to the employee [*Treas. Reg. § 1.132-5(a)(2)*].

Unlike no-additional-cost services and qualified employee discounts [*see § 1D.39[1], [2]*], working condition fringes are not subject to anti-discrimination rules [*see I.R.C. § 132(j)(1)*] and therefore may be offered to only a select group of employees. For purposes of the exclusion for working condition fringes, the term "employee" includes a self-employed individual [*Treas. Reg. § 1.132-1(b)(2)*; *see I.R.C. § 401(c)(1)* ("self-employed individual" defined)].

An example of a working condition fringe is the use of a company car. Thus, employees who use company cars only for business or whose personal use is *de minimis* are not required to include the value of the use in their income [*see I.R.C. § 274(i)*]. Personal use of a company car that is not *de minimis*, however, must be included in the employee's taxable income [*see I.R.C. § 274(i)*; *see also Treas. Reg. § 1.132-5(b)* (calculation of value of personal use)].

[5] *De Minimis* Fringe Benefits

A "*de minimis* fringe benefit" is any property or service the value of which is so small as to make accounting for it unreasonable or administratively impractical [*I.R.C. § 132(e)(1)*]. Specifically included are eating facilities on or near the employer's business premises, provided that the revenue derived from the facility normally covers its operating costs [*I.R.C. § 132(e)(2)*]. However, such an eating facility will not qualify as a *de minimis* fringe benefit if access is available only to highly compensated employees [*I.R.C. § 132(e)(2)*; *see I.R.C. § 414(q)* ("highly compensated employee" defined)].

For purposes of the exclusion for *de minimis* fringe benefits, "employee" includes a self-employed individual [*Treas. Reg. § 1.132-1(b)(4)* ("any recipient" of a *de minimis* benefit); *see I.R.C. § 401(c)(1)* ("self-employed individual" defined)].

Besides the eating facilities mentioned above, examples of *de minimis* fringe benefits include the value of office parties, infrequent personal use of office equipment such as photocopiers, or nominally valued Christmas gifts [*Treas. Reg. § 1.132-6*].

The value of on-premises gyms and other athletic facilities is separately enumerated as exempt from an employee's gross income [*I.R.C. § 132(j)(4)(A)*; *see Treas. Reg. § 1.132-1(b)(3)* ("employee" defined for this purpose)].

[6] Qualified Transportation Fringe Benefit

A "qualified transportation fringe" includes (1) transportation in a commuter highway vehicle between the employee's home and place of employment; (2) any transit pass; (3) qualified parking; and (4) any qualified bicycle commuting reimbursement [*I.R.C. § 132(f)(1)*; *see I.R.C. § 132(f)(5)* (definitions)]. The amount of qualified transportation fringe that may be excluded from the employee's gross income is limited to $60 per month for transportation in a commuter highway vehicle and any transit pass, and $155 per month in the case of qualified parking [*I.R.C. § 132(f)(2)*]. These amounts are subject to inflation adjustments [*I.R.C. § 132(f)(6)*]. For 2002, the maximum exclusion for transportation in a commuter highway vehicle and transit pass is $100, and the monthly limit for parking is $185 [*Rev. Proc. 2001-59* , § 3.09, *2001-52 I.R.B. 623*]. For purposes of the qualified transportation fringe benefit, the term "employee" does not include a self-employed individual [*I.R.C. § 132(f)(5)(E)*; *see I.R.C. § 401(c)(1)* ("self-employed individual" defined)].

[7] Qualified Moving Expense Reimbursement

Employer reimbursements of deductible moving expenses are excluded from employees' income, effective for benefits provided after December 31, 1993 [*I.R.C. § 132(g)*; *see I.R.C. § 217* (deductible moving expenses)]. It is unclear whether this deduction applies to self-employed individuals, including partners and 2-percent S corporation shareholders. As noted above, the Treasury Regulations treat self-employed individuals as employees for purposes of no-additional cost services, qualified employee discounts, working condition fringes, and *de minimis* fringes [*Treas. Reg. § 1.132-1(a)-(d)*], while the Internal Revenue Code specifically excludes self-employed individuals from the definition of employee for purposes of qualified transportation fringes [*I.R.C. § 132(f)(5)(E)*; *see I.R.C. § 401(c)(1)* (self-employed individual defined)].

[8] Qualified Retirement Planning Services

Qualified retirement planning services provided to employees and their spouses by an employer maintaining a qualified plan are excludable from gross income [*I.R.C. § 132(a)(7), (m)*, effective for years beginning after December 31, 2001]. The exclusion does not apply with respect to highly compensated employees unless the services are available on substantially the same terms to each member of the group of employees normally provided education and information regarding the employer's qualified plan [*I.R.C. § 132(m)(2)*]. "Qualified retirement planning services" include any retirement planning advice and information [*I.R.C. § 132(m)(1)*].

The exclusion is not limited to information regarding the qualified plan, and, thus, for example, applies to advice and information regarding retirement income planning for employees and their spouses and how the employer's plan fits into their overall retirement income plan. Conference reports indicate that the exclusion does not apply to services that may be related to retirement planning, such as tax preparation, accounting, legal or brokerage services. It is intended that the treatment of retirement advice provided in a nondiscriminatory manner will be clarified. It is intended that the Secretary, in determining the application of the exclusion to highly compensated employees, may permit employers to take into consideration employee circumstances other than compensation and position in providing advice to classifications of employees. Thus, for example, the Secretary may permit employers to limit certain advice to individuals nearing retirement age under the plan [Conference Committee report to Pub. L. No. 107-16, § 665].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawGeneral OverviewTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)General OverviewTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)De Minimis FringeTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)No-Additional-Cost Service ExclusionTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)Working Condition Fringe



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.40

§ 1D.40 Adoption Assistance Programs

Employees may exclude from gross income amounts paid or expenses incurred by an employer for qualified adoption expenses in connection with the adoption of a child by the employee. To be excludable, the amounts must be furnished pursuant to an adoption assistance program [*I.R.C. § 137(a)(1)*]. The maximum amount excludable with respect to any adoption generally is $10,000 per eligible child, for tax years beginning after December 31, 2001 [*I.R.C. § 137(b)(1)*; the $10,000 amount is adjusted for inflation after 2002 (*I.R.C. § 137(f)*)]. For taxable years beginning after 2002, the amount of adoption expenses taken into account in determining the exclusion in the case of a special needs adoption is increased by the excess (if any) of $10,000 over the aggregate qualified adoption expenses with respect to the adoption for the taxable year the adoption becomes final and all prior taxable years. Thus, for an adoption of a child with special needs which becomes final during a taxable year, a $10,000 exclusion is permitted even if the aggregate qualified adoption expenses for the adoption are less than that amount [*I.R.C. § 137(a)(2)*]. For tax years beginning before January 1, 2002, the maximum exclusion is $5,000 ($6,000 for a child with special needs) [*I.R.C. § 137(b)(1)*, before amendment by Pub. L. No. 107-16]. The amount excludable must be reduced (but not below zero) if the taxpayer's adjusted gross income exceeds $150,000 ($75,000 for tax years beginning before January 1, 2002). The amount of the reduction is determined according to the ratio that the taxpayer's adjusted gross income in excess of $150,000 ($75,000 for tax years beginning before January 1, 2002) bears to $40,000 [*I.R.C. § 137(b)(2)*; the $150,000 amount is adjusted for inflation after 2002 (*I.R.C. § 137(f)*)].

For all adoptions in tax years beginning before 2003, only amounts paid for "qualified adoption expenses" are eligible for the exclusion [*I.R.C. § 137(a)*, before amendment by Pub. L. No. 107-16]. For tax years beginning after 2002, an exclusion of up to $10,000 is available for special needs adoptions regardless of whether the taxpayer has qualified adoption expenses [*I.R.C. § 137(a)(2)*]. "Qualified adoption expenses" include reasonable and necessary adoption fees, court costs, attorney fees, and other costs directly related to the adoption [*I.R.C. §§ 23(d)(1), 137(d)*]. Qualified adoption expenses, however, do not include costs of adopting a spouse's child or expenses that are reimbursed under an employer program or otherwise [*I.R.C. §§ 23(d)(1)(C), (D), 137(d)*]. Amounts paid for expenses incurred for foreign adoptions are excludable from gross income only if the adoption becomes final [*I.R.C. §§ 23(e), 137(e)*]. Taxpayers may also be eligible to claim a credit for qualified adoption expenses [*I.R.C. § 23*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Family LawAdoptionExpensesPensions & Benefits LawEmployee Benefit PlansWelfare Benefit PlansTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsCafeteria Plans (IRC sec. 125)Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide § 1D.41

§ 1D.41 Additional Requirements for Welfare and Fringe Benefit Plans

In addition to the specific requirements discussed above in relation to particular fringe benefit plans, both the Internal Revenue Code and ERISA impose additional requirements of a more general nature.

Many of these plans, such as life insurance and health and disability plans, are "welfare benefit plans," as defined in ERISA [*see 29 U.S.C. § 1002(1)*]. As such, they are covered by ERISA's information and reporting requirements [*29 U.S.C. § 1081 et seq.*], fiduciary duties and trust requirements [*29 U.S.C. § 1101 et seq.*], and reporting and enforcement requirements [*29 U.S.C. § 1131 et seq.*]. For additional coverage of ERISA, see *§ 1D.52* and Bacon, Prater & Tucker, Employee Benefits Guide(Matthew Bender).

In addition, certain fringe benefit plans are now required to meet annual reporting requirements under the Internal Revenue Code. These plans include the following [*I.R.C. § 6039D(a), (d)*]:

- Group-term life insurance purchased for employees [*I.R.C. § 79*].
- Accident and health plans [*I.R.C. §§ 105, 106*].
- Cafeteria plans [*I.R.C. § 125*].
- Educational assistance programs [*I.R.C. § 127*].
- Dependent care assistance programs [*I.R.C. § 129*].
- Qualified adoption assistance programs [*I.R.C. § 137*; *see § 1D.40* for discussion].

The IRS, however, has suspended filing requirements under *I.R.C. § 6039D* for fringe benefit cafeteria plans, educational assistance programs, and adoption assistance programs [*2002-16 I.R.B. 785, Notice 2002-24* ; *see I.R.C. §§ 125, 127, 137*].

An employer maintaining any of these plans must also keep records that meet applicable substantiation requirements [*I.R.C. § 6039D(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Retirement Income Security Act (ERISA)Disclosure, Notice & ReportingAnnual ReportsTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsCafeteria Plans (IRC sec. 125)Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsDisability Payments (IRC secs. 104-106)Accident & Health InsuranceTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)General OverviewTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsLife Insurance (IRC sec. 79)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
B. Fringe Benefit Plans

1-1D California Legal Forms--Transaction Guide §§ 1D.41-1D.49

[Reserved]

§§ 1D.41[Reserved]



130 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.50

§ 1D.50 Structure of Qualified Retirement Plans

Qualified retirement plans, that is, pension, profit-sharing, and stock bonus plans (and other assorted plans) meeting the requirements of *I.R.C. § 401(a)*, are probably the most important tax planning device available to a small business and its owners and employees. Although qualified retirement plans, unlike fringe benefits, eventually result in taxable income to their participants (deferred until distribution) [*see I.R.C. § 402(a)*], they also provide the employer and the participants, and the participants' beneficiaries with income tax advantages of a magnitude that is otherwise unobtainable. The tax aspects of qualified plans, which are generally similar with respect to the employer, the employee, and the plan's trust, are discussed in *§ 1D.51*.

All qualified plans operate in a similar manner. The employer makes contributions on behalf of the employees who are plan participants [*see I.R.C. § 404(a)*]. The plan may also allow or require contributions from its participants [*see Rev. Rul. 80-306, 1980-2 C.B. 131* (plan qualified even though all contributions came from employees); *I.R.C. § 401(k)(2)(A)* (employees may elect to take salary reduction or forgo increase and have employer contribute difference to profit sharing or stock bonus plan); *Rev. Rul. 72-349, 1972-2 C.B. 219* ; *Rev. Rul. 70-658, 1970-2 C.B. 86* (mandatory contributions may be required as condition of plan participation)]. Contributions are made to a trust fund or custodial account or invested in annuity contracts issued by insurance companies [*29 U.S.C. § 1103(a), (b)*], where the funds are accumulated for the benefit of plan participants [*see I.R.C. § 401(a)(1)*]. Funds are normally distributed to the participants either at the participants' normal retirement age, as defined in the plan, or at another authorized payout, such as termination of service with the employer [*see I.R.C. § 401(a)(14)*]. Although distribution of funds varies depending on the type of plan and its individual provisions, funds are generally distributed as a lump-sum payment, as an installment payment over a defined period of years, or as an annuity providing payment over the participant's lifetime or the lifetime of the participant's spouse as well [*see I.R.C. § 401(a)(9)(A)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansEmployee Stock Ownership PlansPensions & Benefits LawEmployee Benefit PlansPension Benefit PlansPensions & Benefits LawEmployee Benefit PlansProfit-Sharing PlansTax

LawFederal Income Tax ComputationRetirement PlansQualified Plans (IRC secs. 401, 410-412)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.51

§ 1D.51 Tax Aspects of Qualified Retirement Plans--In General

A number of significant tax benefits are available for qualified retirement plans. Contributions made by the employer to qualified plans are deductible (within certain limits) by the employer [*I.R.C. § 404(a)*]. However, taxation of income received by the plan's participants or their beneficiaries is deferred until the funds are actually distributed, generally at retirement [*I.R.C. §§ 402(a), 403(a)*; *see Treas. Reg. §§ 1.83-3(e), 1.83-8(a)* (absent statutory exception, plan payments ordinarily generate current funded benefit on which employee accrues current tax liability)]. Further, income received by the participant or by the participant's beneficiaries may be eligible for favorable tax treatment, if the amount qualifies as a lump-sum distribution [*see I.R.C. § 402(d)*]. Even when distributions are made in the form of an annuity over the participant's expected remaining life, distributions made during retirement years are likely to be taxed at a lower rate than if they had been included in the employee's taxable income at the time of contribution, assuming a lower income during retirement.

Earnings under qualified plans accumulate tax-free until they are distributed to the plan's participants or their beneficiaries [*I.R.C. § 501(a)*]. This tax benefit is twofold. First, the tax-free accumulation of plan earnings can be substantial over a short period of time. Second, under a non-qualified plan, the participant may be currently taxed on the trust's earnings, which, when added to the participant's other taxable income may push the participant in a higher tax bracket and result in the participant's being taxed at a higher rate.

No distinction is made in this discussion between corporate and noncorporate employers because the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) [Pub. L. No. 97-248] eliminated most of the advantages formerly enjoyed by corporate plans and brought plan treatment for noncorporate entities into general parity with that of corporations [*see I.R.C. §§ 402, 404; see also § 1D.19[1], [2]*].

PRACTICE TIP:

The tax-favored treatment of qualified plans tends to encourage their use. However, in some circumstances, businesses will find non-qualified approaches to employee compensation to be preferable. For example, although an incentive stock option allows the employee to defer tax on the receipt and exercise of a qualifying option, the employer gets no offsetting current deduction [*see I.R.C. § 421(a)(2)*

; *see also § 1D.82[2]*]. However, through a properly structured non-qualified stock option and special employee election to pay current tax [*see I.R.C. § 83(b)(2)*; *Treas. Reg. § 1.83-6(a)(1)* (employer takes deduction in same year employee reports amount in income)], both employer and employee may come out ahead by using a non-qualified option [*see § 1D.81[3]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationRetirement PlansQualified Plans (IRC secs. 401, 410-412)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.52

§ 1D.52 ERISA Aspects of Qualified Retirement Plans

[1] Enforcement

The Employee Retirement Income Security Act of 1974 (ERISA) is a complex body of statutory and regulatory standards imposed on most qualified welfare benefit and pension plans. ERISA spans both the Internal Revenue Code [*I.R.C. § 401 et seq.*] and federal labor statutes [*29 U.S.C. § 1001 et seq.*]. The Internal Revenue Service generally enforces the tax law aspects of ERISA, while the Department of Labor enforces those aspects of ERISA related to the management of plan funds, the fiduciary responsibilities of plan administrators, and participant's rights. For example, when a plan fiduciary causes a plan to participate in a "prohibited transaction," the Department of Labor will be concerned with the breaches of fiduciary obligation incident to participation in the prohibited transaction [*29 U.S.C. § 1132*; *see 29 U.S.C. § 1106* (prohibited transactions); *see also § 1D.52[3]*], while the Internal Revenue Service will primarily be involved in the collection of any excise taxes that may be imposed in the prohibited transaction [*see I.R.C. § 4975*].

[2] Fiduciary Standards

A plan fiduciary must discharge its duties as would a "prudent man." That is, the fiduciary must act with the care, skill, prudence, and diligence that a prudent man acting in a like capacity and familiar with such matters would use [*29 U.S.C. § 1104(a)(1)(B)*]. If a plan fiduciary fails to discharge all of its duties according to the prudent man standard, a plan fiduciary is subject to potential personal liability to the plan, its participants, or both [*29 U.S.C. § 1104(a)(1)(A)*].

A plan fiduciary must discharge its duties solely in the interests of plan participants and their beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses related to plan administration, or liability may result [*29 U.S.C. § 1104(a)(1)(A)*]. Furthermore, in certain circumstances, a plan fiduciary will be liable for breaches of fiduciary duty committed by another plan fiduciary [*29 U.S.C. § 1105(a)*]. Therefore, company officers and a corporation's directors generally ought not be plan fiduciaries, so that a conflict of interest cannot arise.

[3] Prohibited Transactions

A plan fiduciary who enters into a prohibited transaction breaches his or her fiduciary obligation [*29 U.S.C. § 1109(a)*]. The following acts are prohibited transactions under both ERISA and the Internal Revenue Code [*29 U.S.C. § 1106*; *see I.R.C. § 4975(c)*]:

- The sale, exchange, or lease between the plan and certain related individuals or entities ("parties in interest") [*29 U.S.C. § 1106(a)(1)*; *I.R.C. § 4975(c)(1)(A)*; *see 29 U.S.C. § 1002(14)* ("party in interest" defined); *I.R.C. § 4975(c)(2)* (I.R.C. uses "disqualified person" in place of Title 29's "party in interest"); *but see* I.R.C. § 4975(d)(22), (23) (exemptions)].

- The loan or extension of credit between a plan and a party in interest [*29 U.S.C. §§ 1106(a)(1)(B), 1108(b)(d)*; *I.R.C. § 4975(c)(1)(B)*; *but see* I.R.C. § 4975(d)(1), (23) (exemptions)].

- Furnishing of goods, services, or facilities between a plan and a party in interest [*29 U.S.C. §§ 1106(a)(1)(C), 1108(b)(2)* (exceptions); *I.R.C. § 4975(c)(1)(C)*; *but see* I.R.C. § 4975(d)(2), (23) (exemptions)].

- The transfer to, or use by or for the benefit of, a party in interest of any income or assets of the plan [*29 U.S.C. § 1106(a)(1)(D), (b)(1)*; *I.R.C. § 4975(c)(1)(D),(E)*; *but see* I.R.C. § 4975(d)(23) (exemption)].

- Acquisition, on behalf of the plan, of employer securities or employer real property in violation of specified limitations [*29 U.S.C. § 1106(a)(1)(E)*; *see 29 U.S.C. § 1107* (allowable percentages and exceptions)].

In addition, a fiduciary is prohibited from acts of self-dealing, receiving payoffs, or participating in any transaction in which the fiduciary has a conflict of interest with the plan or its participants [*29 U.S.C. § 1106(b)*].

Certain transactions are exempted from the prohibited transaction rules [*see 29 U.S.C. § 1108(b)*]. In addition, the Department of Labor may exempt specific transactions, or classes of transactions, from ERISA's prohibited transactions rules [*29 U.S.C. § 1108(a)*].

[4] Preemption of State Law

With limited exceptions [*see 29 U.S.C. § 1144(b)*], ERISA preempts state law relating to employee benefits. This means that, in general, an employee's exclusive remedy for complaints regarding employee benefits is through ERISA's scheme [*29 U.S.C. § 1144(a)*; *see Pilot Life Ins. Co. v. Dedeaux (1987) 481 U.S. 41, 107 S. Ct. 1549, 95 L. Ed. 2d 39, 54* ; *see also § 1D.52[5]*].

[5] Private Lawsuits Permitted

The Secretary of Labor may sue on behalf of plan participants for reimbursement to the plan and to enforce any other provision of ERISA [*29 U.S.C. § 1132(a)(2)*, (4)-(6)]. A participant or a participant's beneficiary may also bring a suit in the event a plan fiduciary breaches a fiduciary duty [*29 U.S.C. § 1132(a)(1)*; *see* Poore v. Simpson Paper Co. (9th Cir. 2009) 566 F.3d 922, 925 (former employee meets ERISA definition of "participant" by having reasonable expectation of returning to covered employment or having colorable claim to vested benefits); *Vaughn v. Bay Envtl. Mgmt., Inc. (9th Cir. 2008) 544 F.3d 1008, 1009* (former employee who received full distribution of account balance under defined contribution pension plan had standing as plan participant to file suit under ERISA); *see also Simon v. Hartford Life & Acc. Ins. Co. (9th Cir. 2008) 546 F.3d 661, 663* (plan participant suing pro se may not prosecute claims on behalf of plan but may sue only on own individual claim)]. In addition, participants may sue to recover benefits due

under the plan, to enforce their rights under the plan, to clarify their rights to future benefits under the plan, or to enjoin any act that violates any provision of ERISA or the plan [*29 U.S.C. § 1132(a)(1)(B)*; *see generally Marin Gen. Hosp. v. Modesto & Empire Traction Co. (9th Cir. 2009) 581 F.3d 941, 946* (state-law causes of action coming within scope of *29 U.S.C. § 1132(a)(1)(B)* are completely pre-empted; state-law cause of action comes within scope of that statute if plaintiff's claim could have been brought under it at some point in time and if there is no other independent legal duty that is implicated by defendant's actions)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Retirement Income Security Act (ERISA)Civil Claims & RemediesCauses of ActionGeneral OverviewPensions & Benefits LawEmployee Retirement Income Security Act (ERISA)Federal PreemptionState LawsPensions & Benefits LawEmployee Retirement Income Security Act (ERISA)FiduciariesFiduciary ResponsibilitiesPrudencePensions & Benefits LawEmployee Retirement Income Security Act (ERISA)Prohibited TransactionsGeneral OverviewTax LawFederal Income Tax ComputationRetirement PlansQualified Plans (IRC secs. 401, 410-412)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.53

§ 1D.53 Applicability of Securities Laws

The possibility that interests in a plan may be deemed securities subject to registration or qualification under federal or state securities laws should be considered when a plan is being selected.

Any interest in an employee's qualified pension plan [*see § 1D.18[2]*], including a pension, profit-sharing, stock bonus, or similar qualified plan, is exempt from qualification (approval) by the California Department of Corporations [*Corp. Code § 25100(n)*]. In addition, securities may be sold without qualification to a pension and profit-sharing trust, other than (1) a pension or profit-sharing trust of the insurer; (2) a self-employed individual retirement plan; or (3) an individual retirement account, if the trust provides an investment letter containing specific representations [*Corp. Code § 25102(i)*]. In addition, an issuer (or an affiliate of the issuer) may, without qualification, contribute any stock, or cash for the purchase of the issuer's stock, to a qualified pension, profit-sharing, or stock bonus plan, including an employee stock ownership plan, for the issuer's employees, its parent, or its subsidiaries, provided that the employees are not required or permitted to contribute to the plan [*Corp. Code § 25102(m)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansEmployee Stock Ownership PlansPensions & Benefits LawEmployee Benefit PlansProfit-Sharing PlansSecurities LawAdditional Offerings & the Securities Exchange Act of 1934Registration RequirementsSecurities LawBlue Sky LawsSecurities Registration



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.54

§ 1D.54 Other Federal Limitations on Employee Compensation and Retirement Plans

A number of other federal statutes and regulations apply to employee compensation and retirement plans. These include:

- The Fair Labor Standards Act of 1938 [*29 U.S.C. § 201 et seq.*] sets a minimum and overtime wage for covered employees; and the Equal Pay Act of 1963 [*29 U.S.C. § 206*], an amendment to that Act, requires equal pay between sexes for equal work.

- Title VII of the Civil Rights Act of 1964 [*42 U.S.C. § 2000e et seq.*] prohibits discrimination in employment practices based on race or sex. The United States Supreme Court has held that a pension plan requiring greater contributions by women (because of their longer life expectancy) than by men was discriminatory in violation of Title VII of the Civil Rights Act [*Los Angeles, Dep't of Water & Power v. Manhart (1978) 435 U.S. 702, 711, 98 S. Ct. 1370, 55 L. Ed. 2d 657]* . As a result of *Manhart* and ensuing decisions [*see, e.g., Arizona Governing Committee for Tax Deferred Annuity and Deferred Compensation Plans (1983) 463 U.S. 1073, 1089-1090, 103 S. Ct. 3492, 77 L. Ed. 2d 1236]* , pension plans now generally use gender neutral tables, which combine male and female life expectancies.

- The Pregnancy Discrimination Act [*42 U.S.C. § 2000e(k)*] (an amendment to the Civil Rights Act of 1964) provides that any discrimination based on a woman's pregnancy is discrimination based on gender. The protection against discrimination in employment applies to men as well as to women. Thus, discrimination in coverage afforded wives of men who are employees is also discrimination against those men [*Newport News Shipbldg. & Dry Dock v. EEOC (1983) 462 U.S. 669, 684, 103 S. Ct. 2622, 77 L. Ed. 2d 89* ; *see Hulteen v. AT&T Corp. (9th Cir. 2006) 441 F.3d 653, 664* (Pregnancy Discrimination Act could not be applied retroactively either to invalidate company's accounting scheme for pregnancy leaves that was in place before enactment or to create current violation of Title VII of Civil Rights Act merely because that pre-enactment accounting scheme underlay current disparity in employees' benefits)].

- The Age Discrimination in Employment Act of 1967 [*29 U.S.C. § 621 et seq.*] prohibits discrimination in the employment of individuals age 40 and older, except when age is a bona fide occupational qualification [*29 U.S.C. § 623(i)*]. For example, group retirement plans for plan years beginning after 1987 must continue to accrue benefits on behalf of all participants [*29 U.S.C. § 623(i)*; *see I.R.C. §§ 410(a)(2), 411(b)(1)(H)* (similar participation and accrual requirements)]. Further, defined benefit plans may not cease or reduce the rate of accrual under the plan on account of age [*29 U.S.C. § 623(i)*; *I.R.C. § 411(b)(1)(H)*].

- The Military Selective Service Act [*50 U.S.C. App. § 451 et seq.*] and the Veterans Reemployment Rights Act [*38 U.S.C. §§ 2021 et seq.*] give veterans certain re-employment rights, seniority, and the right to continued participation in employee benefit programs [*see e.g., 38 U.S.C. § 2021*]. The Military Selective Service Act may also require the accrual of benefits under a pension plan [*see Alabama Power Co. v. Davis (1977) 431 U.S. 581, 594, 97 S. Ct. 2002, 52 L. Ed. 2d 595]* .

Except for this overview, the federal statutes enumerated above are outside the scope of this chapter. For a more detailed listing of these statutes, see *§ 1D.11*; see also Ch. 1C, *Regulation of Employers* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawWage & Hour LawsCoverage & DefinitionsMinimum WageLabor & Employment LawWage & Hour LawsCoverage & DefinitionsOvertime & Work PeriodLabor & Employment LawWage & Hour LawsStatutory ApplicationTitle VII of the Civil Rights Act of 1964Pensions & Benefits LawEmployee Benefit PlansGeneral OverviewTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.55

§ 1D.55 Generic Types of Qualified Retirement Plans

Although qualified plans encompass a variety of types, including pension, profit-sharing, stock bonus, employee stock ownership, and assorted other plans, ERISA and the Internal Revenue Code have divided qualified plans into two basic categories: defined benefit plans [*see § 1D.56*] and defined contribution plans [*see § 1D.57*]. Although both generic types are subject to the same basic qualification rules [*see I.R.C. §§ 401-418E*; *see also § 1D.114*], special rules apply to each type of plan, and these rules may determine the employer's choice of plan type.

PRACTICE TIP:

The most important part of a retirement plan for an owner employed in the business may be the business's assets and the owner's non-business income, which will presumably remain after retirement. If there are sufficient assets to support a comfortable retirement, a complex retirement plan may be a waste of money. A business owner with substantial assets may be primarily concerned about estate planning, so that the majority of his or her assets pass to the family. In that case, individual estate planning, only incidentally involving the individual's business, may be the appropriate approach.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationRetirement PlansGeneral OverviewTax LawFederal Income Tax ComputationRetirement PlansQualified Plans (IRC secs. 401, 410-412)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.56

§ 1D.56 Defined Benefit Plans

[1] "Defined Benefit Plan" Defined

A "defined benefit plan" is any plan that is not a defined contribution plan [*29 U.S.C. § 1002(35)*; *I.R.C. § 414(j)*; *see I.R.C. § 414(i)* ("defined contribution plan" defined; *see also § 1D.57 [1]*]. The distinctive characteristic of a defined benefit plan is that the participant's benefit amount is defined in advance [*Treas. Reg. § 1.401-1(b)(1)(i)*]. These plans pay a stated periodic (usually monthly) benefit on the employee's retirement (or earlier authorized payout) [*Treas. Reg. § 1.401-1(b)(2)(i)*]. Benefits are paid from the general assets of the trust or annuity; participants do not have individual accounts [*29 U.S.C. § 1002(35)*]. The benefits may be based on length of service, compensation, and other relevant factors [*Treas. Reg. § 1.401-1(b)(2)(i)*]. The employer contributes the amounts necessary to fund the defined benefits [*see I.R.C. § 412* (minimum funding standard); *see also § 1D.56[2]*].

[2] Limited Annual Deduction

The employer's annual allowable deduction is generally the amount necessary to fund an annual benefit of the lesser of $160,000 ($90,000 for years ending on or before December 31, 2001), subject to certain inflation adjustments as tied to social security benefits, or 100 percent of the participant's average compensation for his or her high three years [*I.R.C. § 415(b)(1)*; *see I.R.C. § 415(b)(2)* (adjustments), (3) (average compensation for high three years defined)]. These dollar limitations are reduced for participants with fewer than 10 years of service [*I.R.C. § 415(b)(5)*]. Other adjustments are made to the dollar limitations if the benefits begin before or after the social security retirement age [*I.R.C. § 415(b)(2)(C), (D)*]. A defined benefit plan is subject to the minimum funding standard defined in the Internal Revenue Code [*see I.R.C. § 412(a)*]; and the employer's deduction for plan contribution may not exceed the full funding limitation set forth in the Internal Revenue Code [*I.R.C. § 404(a)(1)(A),(B)*; *see I.R.C. § 412(c)(7)* ("full funding limitation" defined)].

[3] Actuarially Determined Contributions; Risk of Investment Performance on Employer

An enrolled actuary must be hired to calculate the amount the employer must contribute annually and supervise the preparation of actuarial statements and reports [*29 U.S.C. § 1023(a)(4)*; *see 29 U.S.C. § 1242* (requirements for enrolled

actuaries)]. In determining the amount of an employer's annual contribution, the actuary assumes that the plan assets will generate a specified rate of return. Consequently, if the plan's actual investment performance does not meet the actuary's return assumption, the employer will be required to make greater contributions in the future, to make up for the investment shortfall [*see I.R.C. § 412(a)* (minimum funding standard), *(c)(11)* (liability for contributions)]. Conversely, if the rate of return on the plan's investments exceeds the actuary's return assumptions, the employer will be required to make a smaller contribution than would otherwise be necessary [*see I.R.C. § 412(a)* (minimum funding standard), *(c)(11)* (liability for contributions)].

Employees (and unions) historically have favored defined benefit plans for two reasons. First, the employer must make plan contributions without regard to its profits [*see Treas. Reg. § 1.401-1(b)(1)(i)*]. Second, the employer, rather than the plan's participants, must bear the risk of the plan's investment performance, because the employer will be responsible for making up any shortfall in the assumed rate of return [*see I.R.C. § 412*].

[4] Pension Benefit Guaranty Corporation

Another distinguishing feature of a defined benefit plan is that it is normally subject to a plan termination insurance operated by the Pension Benefit Guaranty Corporation (PBGC), a separate government agency [*see 29 U.S.C. § 1302*]. The plan administrator is required to pay annual insurance premiums to the PBGC [*29 U.S.C. § 1306(a)(1)*] and file a notice of a reportable event if (1) the plan fails to meet minimum funding standards [*see I.R.C. § 412*]; (2) the plan is amended to decrease the benefit payable to any participant; or (3) another specified occasion or event occurs [*29 U.S.C. § 1343(b)*].

[5] Types of Defined Benefit Plans

Typical types of defined benefit plans include (1) a pension plan that provides a monthly benefit to the participant, payable from an employer-sponsored pension trust, or (2) an annuity plan, under which the benefit is payable from an annuity purchased from an insurance company with plan contributions [*Treas. Reg. § 1.404(a)-3(a)*]. Special types include multi-employer plans [*see I.R.C. § 414(f)*].

PRACTICE TIP:

The biggest cost of a qualified retirement plan, compared to a non-qualified plan, is the employer's required contributions for all employees, not just key employees, to avoid discrimination in coverage or benefits in favor of highly compensated employees [*see I.R.C. § 401(a)(4)*; *see also I.R.C. § 410(a)(1)* (exclusions)]; these contributions for all employees may be greater than the employer would choose to make. Of course, when a high percentage of the payroll goes to the highly compensated employees, the additional cost of benefiting the other employees as well will be less significant.

Of the qualified retirement plans, benefits under a defined benefit pension plan may be desirable if employees are older, because benefits can be provided in a short period of time [*see Rev. Rul. 74-385, 1974-2 C.B. 130* (flat benefits may be provided without regard to years of service)]. On the other hand, a defined contribution plan may be more appropriate if employees are younger, since plan contributions that accumulate tax-free for a period of 20 or 30 years will provide greater benefits than the flat benefits of a defined pension plan.

The best combination of plans depends on a variety of factors, including the employees' ages, the plan's earnings, plan contribution requirements and the deductibility of employer contributions under the plan [*see I.R.C. § 404*], and plan administration costs. If the employer's goal is to maximize retirement benefits for all employees, without regard to contribution requirement and plan administration expenses, it might consider combining a profit-sharing or money purchase plan with a defined benefit pension plan. An employer concerned with contribution requirements and plan expense, on the other hand, can reduce

these problems and still maximize employee benefits by adopting a profit-sharing plan, which may be a cash or deferred plan [*see § 1D.60*], and a money-purchase plan [*see § 1D.59*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansDefined Benefit PlansPensions & Benefits LawU.S. Pension Benefit Guaranty CorporationTax LawFederal Income Tax ComputationRetirement PlansDefined Benefit & Hybrid Plans (IRC secs. 411, 414, 415)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.57

§ 1D.57 Defined Contribution Plans

[1] "Defined Contribution Plan" Defined

Unlike a defined benefit plan, a "defined contribution plan" provides an individual account for each participant in the plan and pays benefits based solely on contributions to a participant's account and any income, expenses, gains, and losses, and any forfeitures of other participants accounts allocated to the participant's account [*29 U.S.C. § 1002(34)*; *I.R.C. § 414(i)*]. The plan need not specify a precise dollar amount to be contributed each year. It must merely set forth a general formula to be used in determining contributions [*see Lincoln Electric Co. Employer's Profit Sharing Trust v. Commissioner (6th Cir. 1951) 190 F.2d 326, 328-329]* . For example, a defined contribution plan provision is sufficient if it states that each year, the board of directors or the partnership will vote (at its discretion) to make an annual contribution to the plan of between zero and 20 percent of the entity's total yearly net profit. Consequently, under defined contribution plans, participants are not promised a specific retirement benefit, but are entitled only to the benefit that can be provided from their accounts, when the accounts are distributed.

[2] Risk of Investment Performance on Participant

Once the employer has made the required contribution to a defined contribution plan, it usually has no further responsibility to the plan or its participants (except for ERISA's fiduciary requirements) [*see I.R.C. § 414(i)*; *29 U.S.C. § 1081 et seq.*] regarding the growth of the plans assets. Thus, unlike a defined benefit plan, defined contribution plans put the investment risk on the plan's participants, rather than on the employer.

[3] Types of Defined Contribution Plans

There are several types of defined contribution plans. The most common are:

- Profit-sharing plans [*see § 1D.58*].
- Money purchase plans [*see § 1D.59*].

- Cash or deferred arrangements [*see § 1D.60*].
- Stock bonus plans and employee stock ownership plans [*see § 1D.61*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansDefined Contribution PlansPensions & Benefits LawEmployee Benefit PlansEmployee Stock Ownership PlansPensions & Benefits LawEmployee Benefit PlansProfit-Sharing PlansTax LawFederal Income Tax ComputationRetirement PlansDefined Contribution Plans (IRC secs. 414-415)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.58

§ 1D.58 Profit-Sharing Plans

A "profit-sharing plan" is categorized by ERISA as a defined contribution plan [*29 U.S.C. § 1002(34)*]. This type of plan is designed primarily to provide employees with an interest in the business's profits. However, it also often provides retirement benefits [*Treas. Reg. § 1.401-1(b)(1)(i), (ii)*].

The amount the employee or its beneficiary receives under the plan must be determined by a definite, predetermined formula for allocating employer contributions made to the plan among participants (in proportion to each participant's compensation, for example) and for distributing funds accumulated under the plan after a stated period of time or on the occurrence of a specified event, such as illness, hardship, disability, retirement, death, or termination of employment [*Treas. Reg. §§ 1.401-1(b)(1)(ii), 1.401-3(c)*].

The amount of employer contributions to a profit-sharing plan can, but need not be, made from profits [*I.R.C. § 401(a)(27)*] and is determined either at the employer's discretion, subject to certain limitations, or according to formula [*Treas. Reg. §§ 1.401-1(b)(1)(ii), 1.401-3, 1.401-4*; *see I.R.C. § 404(a)(3)* (limitations)]. Contributions may range from a minimum of zero to a maximum deductible contribution of the greater of the employer's required 401(k)(11) annual contribution or 25 percent (15 percent, for years beginning before January 1, 2002) of the participant's compensation [*I.R.C. § 404(a)(3)(A)*]. Thus, profit-sharing plans are not subject to the minimum funding standards of *I.R.C. § 412* [*see I.R.C. § 401(a)(27)*].

A profit-sharing plan may be an appropriate choice if the employer wants the flexibility to make contributions at its discretion. However, the funding of adequate retirement benefits for older employees may be difficult to achieve under this type of plan.

For forms for employee profit-sharing plans and other employee benefit plans, see Rabkin & Johnson, Current Legal Forms with Tax Analysis (Matthew Bender), Ch. 13, *Pension Plans and Other Exempt Employees' Plans* , and Ch.14, *Stock Options and Other Incentive Plans* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansProfit-Sharing PlansTax LawFederal Income Tax ComputationRetirement PlansDefined Contribution Plans (IRC secs. 414-415)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.59

§ 1D.59 Money Purchase Pension Plans

A "money purchase plan" is a defined contribution plan under ERISA [*29 U.S.C. § 1002(34)*]. In this type of plan, amounts are contributed according to a specified formula, usually stated in terms of participants' compensation (for example, 10 percent of all participants' compensation for the year), and funds accumulated in a participant's account at payout are used to purchase a then-commercially available annuity for the participant [*Treas. Reg. § 1.401-1(b)(1)(i)*].

A money purchase plan is similar, in most respects, to a profit-sharing plan, except with regard to the dollar limitation on the deductibility of contributions [*see I.R.C. §§ 404(a)(3)* (greater of employer's required 401(k)(11) contribution or 25 percent (15 percent, for years beginning before January 1, 2002) of compensation for profit sharing plans), *415(c)(1)* (the lesser of $40,000 or 100 percent (for years beginning on or before December 31, 2001, $30,000 or 25 percent) of employee compensation for money purchase pension plans)]. However, unlike most profit-sharing plans, a money purchase plan requires the employer to contribute a fixed amount each year, whether or not the employer has a profit [*see Treas. Reg. § 1.401-1(b)(1)(i)*]. In addition, the minimum funding standards for qualified retirement plans apply [*I.R.C. § 412(a)*].

Unlike a profit-sharing plan, a money purchase plan is required to distribute benefits to participants in certain forms mandated by the Internal Revenue Code (joint and survivor annuities and pre-retirement death benefits for survivors of participants), unless the participant and his or her spouse properly elect otherwise [*see 29 U.S.C. § 1055(a), (b)*; *I.R.C. §§ 401(a)(11), 417*]. The complexities of joint and survivor annuities and pre-retirement annuity forms, as well as the requirement that an employer contribute to a money purchase plan regardless of profits, may make this type of plan less attractive to an employer than the profit-sharing plan, which has neither of these limitations.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansDefined Contribution PlansTax LawFederal Income Tax ComputationRetirement PlansGeneral OverviewTax LawFederal Income Tax ComputationRetirement PlansTax-Sheltered Annuities (IRC sec. 403)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.60

§ 1D.60 Cash or Deferred Plans

A "cash or deferred plan" (commonly known as a CODA or a 401(k) plan) is a plan permitting the employee to choose between current taxable cash compensation and a non-taxable contribution made by the employer to a qualified profit-sharing or stock bonus plan maintained by the employer [*I.R.C. § 401(k)(2)(A)*]. These plans are supplements to profit-sharing and stock bonus plans. Therefore, if the employer has neither of the latter types of plans, this arrangement is not available [*see I.R.C. § 401(k)(2)(A)*].

A 401(k) plan may be a bonus plan, under which the employer declares year-end bonuses for employees, giving them the choice of receiving the bonus in cash or having the bonus amount contributed to a qualified plan. Under this type of plan, the employer has little obligation beyond having the underlying profit-sharing or stock bonus plan in place [*see Treas. Reg. § 1.401(k)-1(a)(3)*].

A 401(k) plan may also be a salary reduction plan, under which a contribution to the plan will be made only if the employee elects to take a salary reduction, or to forego a salary increase, and have the difference contributed to an employer profit-sharing or stock bonus plan. This is commonly accomplished by periodic employee contributions or withholding from the employee's paycheck [*see Treas. Reg. § 1.401(k)-1(a)(3)*].

The tax treatment of a 401(k) plan depends on the employee's election. If the employee elects a current cash payment, it is includable in the employee's taxable income and is deductible by the employer, provided it is reasonable in amount and meets the other requirements for deductibility [*I.R.C. §§ 61(a)(1), 162(a)(1); Treas. Reg. §§ 1.61-2(a)(1), 1.162-1(a)*]. If the employee instead elects to have a contribution made to a profit-sharing or stock bonus plan, the contribution is treated as an employer contribution [*Treas. Reg. § 1.402(a)-1(d)*] and, as such, is currently deductible by the employer, while not being currently taxed to the employee [*I.R.C. §§ 401(k), 404(a)*]. The employee (or the employee's beneficiary) is taxed on the contributions when they are distributed [*I.R.C. § 402(a)*].

In addition to the general non-discrimination restriction imposed on qualified plans, special non-discrimination rules apply to 401(k) plans. These rules bar highly compensated employees from contributing a significantly higher percentage of compensation than lower-paid employees [*I.R.C. §§ 401(k)(3), 414(q); see I.R.C. §§ 401(a)(4), 410(b)*

(anti-discrimination and participation requirements)].

Often, 401(k) plans provide for matching (or partially matching) contributions to be made by the employer, if the employee has elected to have a percentage of his or her compensation contributed to an employer profit-sharing or stock bonus plan [*Treas. Reg. § 1.401(k)-1(g)(9)*].

The principal advantage of a 401(k) plan to an employee is that it generally permits the employee to make choices each year regarding the amount of compensation the employee will currently receive, and pay taxes on, in that year. Its principal disadvantage is that its maximum elective deferral is capped at a low level. The maximum dollar limit on annual elective deferrals under Section 401(k) plans is $10,500 in 2000 and 2001 [*I.R.C. § 402(g)(1),(5)*, before amendment by Pub Law 107-16; *2000-52 I.R.B. 600, Notice 2000-66* ; *1999-2 C.B. 638, Notice 99-55*], $11,000 in 2002, $12,000 in 2003, $13,000 in 2004, $14,000 in 2005, and $15,000 in 2006 [*I.R.C. § 402(g)(1),(2)*]. Cost-of-living increases in $500 increments are made thereafter [*I.R.C. § 402(g)(4)*]. Limited catch-up contributions to 401(k) plans are permitted for individuals aged 50 and over [*I.R.C. § 414(v)*]. This limitation and the special anti-discrimination rules make it difficult to use these plans to compensate highly paid plan participants [*see I.R.C. § 402(g)*]. The primary advantage of a 401(k) plan to an employer is that the employer's plan cost may be low because the plan is substantially funded with deferred compensation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansDefined Contribution PlansTax LawFederal Income Tax ComputationRetirement PlansContributions (IRC secs. 401-404A, 406-408A, 410-420)Tax LawFederal Income Tax ComputationRetirement PlansDefined Contribution Plans (IRC secs. 414-415)Tax LawFederal Income Tax ComputationRetirement PlansNondiscrimination Rules (IRC sec. 401)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.61

§ 1D.61 Qualified Stock Bonus Plans; Employee Stock Ownership Plans

A "qualified stock bonus plan" is a plan providing benefits similar to a profit-sharing plan [*see § 1D.58*], but benefits are generally in the form of employer stock [*Treas. Reg. § 1.401-1(b)(1)(iii)*]. A stock bonus plan must meet the same requirements related to the allocation and distribution of stock to employees as a profit-sharing plan [*Treas. Reg. § 1.401-1(b)(1)(iii)*].

An "employee stock ownership plan" (commonly referred to as an ESOP) is a stock bonus plan, or a combination stock bonus plan and money purchase plan [*see § 1D.59*] that invests primarily in the employer's own stock and meets other qualifying requirements of the Internal Revenue Code [*29 U.S.C. § 1107(d)(6)*; *I.R.C. § 4975(e)(7)(A)*; *Treas. Reg. § 54.4975-11(a)*; *see I.R.C. §§ 409(h)* (additional requirements), *(p)*, *4979A(a)(3)*, *(4)* (special rules apply regarding prohibited allocations of stock by S corporation ESOPs, effective with respect to plan years beginning after December 31, 2004)].

The distinction between a stock bonus plan and an ESOP can be important because ESOPs are exempt from prohibitions on certain types of transactions that apply to stock bonus plans as well as other qualified plans. First, an ESOP may invest exclusively in the employer's own securities and need not diversify its holdings, as must other types of qualified employee plans [*see 29 U.S.C. §§ 1107(a)(2)*, *1108(e)* (plan investment in employer's stock or real estate generally not permitted to exceed 10 percent of trust's assets, unless plan is ESOP, or other individual account plan--profit sharing or money purchase plan--specifying higher allowable holding of employer stock)]. Second, an ESOP may borrow the money to purchase the securities from a party in interest [*29 U.S.C. § 1108(b)(3)*; *I.R.C. § 4975(d)(3)*] or from banks, insurance companies, or other commercial lenders [*see I.R.C. § 133*]. Thus, outside leveraging (that is, borrowing to acquire employer securities) is available to finance the stock purchase.

Although originally viewed as a vehicle to enhance employee incentives through an equity interest in the business, ESOPs serve a variety of corporate purposes. For example, the employer's ability to leverage enables the employer to use the ESOP to raise needed capital from the sale of its own stock, with the additional tax benefit of deductions on principal and dividend payments, as well as interest payments [*see I.R.C. § 404(a)(9)(A)*, *(B)*, *(k)*]. An employer wanting to raise capital might establish an ESOP that borrows money from a bank, with the employer guaranteeing the

loan. The ESOP would then use the loan proceeds to purchase the securities from the employer; the employer would use the money from the sale of securities as needed (for working capital or capital improvements, for example). The employer would make tax deductible contributions to the ESOP to enable the ESOP to meet its debt service payments [*see I.R.C. § 404(a)(3)(A)*], while the bank would receive a partial exclusion from income for the interest income it receives on the ESOP loan [*see I.R.C. § 133*]. As a further example, an ESOP might be used to provide cash to buy out a deceased or retiring shareholder.

From the employee's perspective, the greatest advantage of an ESOP is that the employee receives stock rights without being personally at risk for the cost of the stock. Further, these rights are not taxable to the employee until they are distributed, generally at retirement or termination of service [*I.R.C. § 402(a)*; *see I.R.C. § 409(o)(1)* (timing of distributions)]. In addition, if the distribution is a lump-sum distribution, it may be eligible for favored tax treatment [*see I.R.C. § 402(e)(4)(D)*]. Similar to other qualified plans, tax on appreciation of the stock while held by the trust is deferred until the employee sells or otherwise disposes of the stock in a taxable transaction [*I.R.C. § 402(a)*].

Other qualified stock plans, including incentive stock options (ISOs) and employee stock purchase plans, are *covered in §§ 1D.82[2]* and *1D.113*, respectively.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansEmployee Stock Ownership PlansTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsStock Options (IRC secs. 421-424)Tax LawFederal Income Tax ComputationRetirement PlansEmployee Stock Ownership Plans (ESOPs) (IRC sec. 409)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.62

§ 1D.62 Simplified Employee Pensions

A simplified employee pension (SEP) combines the features of an IRA [*I.R.C. § 408*] and a defined contribution plan [*see § 1D.57*]. Under a SEP, the employer establishes IRAs for employees and makes annual contributions to those accounts [*I.R.C. § 408(k)*]. To qualify for tax-favored treatment, a SEP may not discriminate in favor of certain officers and highly compensated individuals [*I.R.C. § 408(k)(3)(A)*; *see I.R.C. § 408(k)(2)* (participation requirements)].

Employer contributions to a SEP may be made for a taxable year at any time before the due date (including extensions) for filing the return for that year [*I.R.C. § 404(h)(1)(B)*]. The amount deductible cannot exceed 25 percent (15 percent for years beginning before January 1, 2002) of the compensation paid to the employee during the calendar year. Any excess contributed over the amount deductible may be carried over and deducted in later taxable years, subject to the same percentage limitation [*I.R.C. § 404(h)(1)(C)*]. Any amount deducted by an employer for SEP contributions reduce the amounts deductible for contributions to plans subject to limits on deductible contributions under *I.R.C. § 404(a)(3)(A)* (i.e., stock bonus or profit-sharing plans and certain money purchase plans) [*I.R.C. § 404(h)(2)*].

In addition, employer contributions must bear a uniform relationship to the first $200,000 ($150,000 for years beginning before January 1, 2002) of each employee's compensation [*I.R.C. § 408(k)(3)(C)*; *see I.R.C. § 401(l)* (adjustments to compensation taken into account)]. If specified requirements are met, SEPs are further allowed to include a voluntary salary reduction arrangement, similar to a 401(k) plan [*I.R.C. § 408(k)(6)* (employee election); *see § 1D.60*]. Limited catch-up contributions to SEPs are permitted for individuals aged 50 and over [*I.R.C. § 414(v)*].

Under a qualified plan, the employer receives a current deduction for contributions made to separate IRAs for each covered employee [*I.R.C. §§ 162, 408(k)*]. In general, employer contributions to a SEP are not treated as made available to an employee or as employee contributions [*I.R.C. § 402(h)(1)(A)*]. In addition, employer contributions made pursuant to a salary reduction arrangement [*see I.R.C. § 408(k)(6)*], are not treated as distributed or made available or as contributions made by the employee merely because the SEP provides for a salary reduction arrangement election [*I.R.C. § 402(h)(1)(B)*]. Employer contributions are treated as distributed and made available to the employee or as contributions made by the employee, however, to the extent those contributions exceed the lesser of 25 percent (15 percent, for tax years beginning before January 1, 2002) of the employee's compensation, or the limitation in effect

under *I.R.C. § 415(c)(1)(A)* ($40,000, for tax years beginning after December 31, 2001) [*I.R.C. §§ 402(h)(2), 415(c)(1)(A)*; the $40,000 limitation is subject to cost-of-living adjustments (*I.R.C. § 415(d)(1)(C)*)]. Any amount paid or distributed from a SEP must be included in gross income by the payee or distributee [*I.R.C. §§ 402(h)(3), 408(d)*].

From the employee's perspective, SEPs are preferable to IRAs because their contribution limits are significantly higher [*I.R.C. §§ 408(j), 415(c)(1)*]. From the employer's perspective, the primary advantage of a SEP is its simplicity and low administrative cost.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansIndividual Retirement AccountsPensions & Benefits LawEmployee Benefit PlansSimplified Employee Pension PlansTax LawFederal Income Tax ComputationRetirement PlansDefined Contribution Plans (IRC secs. 414-415)Tax LawFederal Income Tax ComputationRetirement PlansSEPs, SIMPLEs & Keoghs (IRC secs. 402, 404, 408)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.63

§ 1D.63 SIMPLE Retirement Plans

A Savings Incentive Match Plan for Employees (SIMPLE) plan may be established by an employer with no more than 100 employees [*I.R.C. § 408(p)*]. A SIMPLE plan may be set up as an IRA or a cash or deferred arrangement [*I.R.C. §§ 408(p), 7701(a)(37)*]. Employer contributions to a SIMPLE plan are deductible in the tax year of the employer with or within which the calendar year for which the contributions were made ends. Contributions are treated as made for a taxable year if they are made on account of the taxable year and are made not later than the due date for the return for that year (including extensions) [*I.R.C. § 404(m)(2)*]. Employees generally are not taxed on the contributions until they are distributed [*I.R.C. §§ 72, 402(h)(1), (3), (k), 403*].

A SIMPLE plan is an individual retirement plan under which the only contributions allowed are those made under a qualified salary reduction arrangement [*I.R.C. § 408(p)(1)(B), (2)*]. The qualified salary reduction arrangement of the SIMPLE plan generally must be the only plan of the employer [*I.R.C. § 408(p)(2)(D)* (exception for collectively bargained employees)]. A qualified salary reduction arrangement is a written arrangement under which an eligible employee elects to have the employer make payments as elective employer contributions to a SIMPLE retirement account on behalf of the employee or to the employee directly in cash. The amount that an employee may elect must be specified as a percentage of compensation. The amount may not exceed $7,000 in 2002, $8,000 in 2003, $9,000 in 2004, and $10,000 in 2005 and thereafter, subject to cost-of-living adjustments [*I.R.C. § 408(p)(2)(A)(ii), (E)(i), (ii)*] For 2001, the maximum was $6,500 [*2000-52 I.R.B. 600, Notice 2000-66*]. Limited catch-up contributions to SIMPLE plans are permitted for individuals aged 50 and over [*I.R.C. § 414(v)(2)(B)(ii)*].

The employer must make a timely matching contribution or nonelective contribution [*I.R.C. § 408(p)(2)(A)(iii), (5)(A)*]. Under the matching contribution alternative, the employer must generally match the employee's contribution up to three percent of the employee's compensation for the year [*I.R.C. § 408(p)(2)(A)(iii), (C)(ii)(I)*]. An employer may elect, however, to apply a lower matching percentage (not less than one percent) for all eligible employees for a given year [*I.R.C. § 408(p)(2)(C)(ii)(II)*]. In lieu of the matching contribution, an employer may instead elect to make a nonelective contribution of two percent of the compensation for each eligible employee with at least $5,000 compensation from the employer for that year. The compensation limit of *I.R.C. § 401(a)(17)* applies to the contribution [*I.R.C. § 408(p)(2)(B)*].

In the case of a SIMPLE IRA, the limitation that otherwise applies to IRAs [*see I.R.C. § 408(a), (b)(2)*] is increased to the limits in effect for contributions made under a qualified salary reduction arrangement. This includes employee elective contributions and required employer contributions [*I.R.C. § 408(p)(8)*].

A SIMPLE plan must meet statutory vesting, participation, and administrative requirements [*I.R.C. § 408(p)(1)(A), (3), (4), (5)*]. Amounts in a SIMPLE plan account may be rolled over to another SIMPLE plan account, or, if the individual has participated in the SIMPLE plan for at least two years, to an IRA or eligible retirement plan. The amount that can be rolled over into an eligible retirement plan cannot exceed the portion of the amount received that is includable in gross income without regard to the rollover rules. This restriction does not apply to rollovers to an IRA [*I.R.C. § 408(d)(3)(A), (G)*]. An eligible retirement plan includes a qualified plan, a *Section 403(a)* annuity plan [*see I.R.C. § 403(a)*], a *Section 403(b)* annuity contract [*see I.R.C. § 403(b)*], or a governmental *Section 457* plan [*I.R.C. § 402(c)(8)(B)*; *see I.R.C. § 457*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationRetirement PlansContributions (IRC secs. 401-404A, 406-408A, 410-420)Tax LawFederal Income Tax ComputationRetirement PlansIndividual Retirement Plans (IRC secs. 219, 403, 408-408A)Tax LawFederal Income Tax ComputationRetirement PlansSEPs, SIMPLEs & Keoghs (IRC secs. 402, 404, 408)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide § 1D.64

§ 1D.64 Credit for Small Employer Pension Plan Start-Up Costs

A nonrefundable income tax credit is available for 50 percent of the administrative and retirement-related education expenses for any small business that adopts a new qualified defined benefit or defined contribution plan (including a section 401(k) plan), SIMPLE plan, or simplified employee pension ("SEP") [*I.R.C. §§ 45E(a), (d)(1), 4972(d)(1),* effective for costs paid or incurred in taxable years beginning after December 31, 2001, with respect to plans established after that date]. The credit applies to 50 percent of the first $1,000 in establishment and administration costs and costs to educate employees about the plan for each of the first three years of the plan. Thus, the maximum credit per year is $500 [*I.R.C. § 45E(b)*]. The credit is available to an employer that did not employ, in the preceding year, more than 100 employees with compensation in excess of $5,000 [*I.R.C. § 45E(c)(1), 408(p)(2)(C)(i)*].

An employer cannot claim the credit if, during the 3 years before the first year in which the credit is otherwise available, the employer (or a member of any controlled group of the employer) or a predecessor of either established or maintained a qualified employer plan to which contributions were made, or benefits were accrued, for substantially the same employees as are in the plan for which the credit would be claimed [*I.R.C. § 45E(c)(2)*]. In order for plan costs to be eligible for the credit, the plan must cover at least one non-highly compensated employee [*I.R.C. § 45E(d)(1)(B)*]. The credit is a general business credit, but it cannot be carried back to years beginning before January 1, 2002 [*I.R.C. § 39(d)(10)*]. Any unused portion of the credit may be deducted in the following year [*I.R.C. § 196(a), (c)(10)*]. The 50 percent of qualifying expenses that are effectively offset by the tax credit are not deductible [*I.R.C. § 45E(e)(2)*]. The other 50 percent of the qualifying expenses (and other expenses) are generally by an employer as ordinary and necessary expenses in carrying on a trade or business [*I.R.C. § 162(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansSimplified Employee Pension PlansTax LawFederal Income Tax ComputationRetirement PlansSEPs, SIMPLEs & Keoghs (IRC secs. 402, 404, 408)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
C. Qualified Retirement Plans

1-1D California Legal Forms--Transaction Guide §§ 1D.65-1D.69

[Reserved]

§§ 1D.65[Reserved]



146 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
D. Non-Qualified Deferred Compensation Plans

1-1D California Legal Forms--Transaction Guide § 1D.70

§ 1D.70 Tax and ERISA Aspects of Non-Qualified Plans--In General

In contrast to a qualified plan, under a non-qualified plan, the employer does not receive a deduction until the employee includes the benefit in income, even if the employer uses the accrual method of accounting [*I.R.C. § 404(a)(5)*]. The tax objective of the employee in a non-qualified deferred compensation plan is to avoid paying tax on non-qualified plan benefits until the funds are actually paid to the employee [*see Rev. Rul. 60-31, 1960-1 C.B. 174* (discussion of year in which compensation paid under different types of deferred compensation plans will be deemed received by employee); *see also Rev. Rul. 70-435* (modifying example (5) of *Rev. Rul. 60-31*)]. To achieve deferral, a common approach is to structure the plan to take advantage of *I.R.C. § 83*. This provision generally defers tax on employee compensation that is received subject to a substantial risk of forfeiture or transfer restrictions on the employee's ability to transfer the item free of a risk of forfeiture, until the time that the risk or restriction lapses [*see I.R.C. § 83*; *see also § 1D.81[3]*].

Except for certain reporting and disclosure requirements, unfunded plans maintained primarily to provide deferred compensation to a select group of employees (usually management or highly compensated employees) are generally exempt from the provisions of ERISA [*29 U.S.C. §§ 1051(2), 1081(a)(3), 1101(a)(1)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Retirement Income Security Act (ERISA)Disclosure, Notice & ReportingExemptionsTax LawFederal Income Tax ComputationRetirement PlansGeneral OverviewTax LawFederal Income Tax ComputationRetirement PlansQualified Plans (IRC secs. 401, 410-412)Tax LawFederal Income Tax ComputationTax AccountingAccrual Method (IRC secs. 446, 447, 451, 461, 467)General Overview



147 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
D. Non-Qualified Deferred Compensation Plans

1-1D California Legal Forms--Transaction Guide § 1D.71

§ 1D.71 Structure of Non-Qualified Plans

A non-qualified deferred compensation plan generally takes one of two general forms. The first is an unfunded promise to pay, under which the employer promises to pay the employee a portion of the compensation the employee would otherwise receive in an upcoming tax period, but at a specified future date or dates [*see § 1D.16*]. Under an unfunded deferred compensation plan, the employee is put in the position of being a general creditor of the employer. Specific property cannot be set aside in the employee's name; therefore, a separate irrevocable trust fund, escrow account, or other irrevocable funding vehicle is not permitted [*see Rev. Proc. 71-19, 1971-1 C.B. 698*].

The second form is a funded deferred compensation arrangement, in which the employer irrevocably contributes the deferred compensation to a separate funding vehicle, such as a trust, escrow account, or annuity [*see Treas. Reg. §§ 1.83-3(e), 1.451-2(a)*]. If a trust is used, the trust then holds and invests the contributed funds until the funds are paid out to the employee [*see I.R.C. § 83(a)*; *see also I.R.C. § 402(b)* (*I.R.C. § 83* generally governs taxability of employer contributions made to unqualified trust)]. The obvious advantage of a funded arrangement to the employee is that the funds are irrevocably committed for the promised future payment, and the employee need not rely on the employer's mere promise to pay.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansGeneral OverviewTax LawFederal Income Tax ComputationRetirement PlansDistributions (IRC secs. 402-403)Tax LawFederal Income Tax ComputationRetirement PlansTax-Sheltered Annuities (IRC sec. 403)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
D. Non-Qualified Deferred Compensation Plans

1-1D California Legal Forms--Transaction Guide § 1D.72

§ 1D.72 Rabbi Trusts

An alternative approach employs both the unfunded and funded plan formats and places the contributed amounts in an irrevocable trust subject to the claims of the general creditors of the employee. One of the first rulings to uphold the deferral effects of such a trust involved an irrevocable trust established for the benefit of a rabbi [*P.L.R. 8113017*]. As a result, such trusts are commonly called "rabbi trusts." As long as the trust corpus and income remain the employer's property, taxable to the employer and subject to the claims of its creditors in case of insolvency, and certain other conditions are met [*see I.R.C. §§ 671-679*], the Internal Revenue Service has taken the position that the interest in the trust, although otherwise vested in the employee, is not taxable to the employee [*see P.L.R. 8727028*]. Consequently, taxation can be deferred by the employee until the funds are distributed.

This area of law is as yet unsettled, with little case law and few formal rulings by the Internal Revenue Service. Therefore, caution should be exercised in drafting a rabbi trust to ensure that the interest in the trust will not result in current taxation to the employee.

Legal Topics:

For related research and practice materials, see the following legal topics:
Estate, Gift & Trust LawTrustsIrrevocable Living TrustsTax LawFederal Income Tax ComputationRetirement PlansDistributions (IRC secs. 402-403)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
D. Non-Qualified Deferred Compensation Plans

1-1D California Legal Forms--Transaction Guide §§ 1D.73-1D.79

[Reserved]

§§ 1D.73[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
E. Stock-Based Plans

1-1D California Legal Forms--Transaction Guide § 1D.80

§ 1D.80 Basic Types of Stock-Based Plans

Although stock-based plans encompass an almost limitless variety of types, stock plans and stock option plans can be divided into two basic categories: non-qualified plans [*see § 1D.81*] and qualified plans [*see § 1D.82*]. The tax treatment of non-qualified stock option and stock plans is generally determined under *I.R.C. § 83* [*see § 1D.81[3]*]; the tax treatment of qualified stock option (that is, incentive stock option) and stock plans is generally determined under *I.R.C. §§ 421* and *422* [*see § 1D.82*].

PRACTICE TIP:

Like an incentive stock option [*see § 1D.82[2]*], an employee stock purchase plan provides tax-favored benefits to employees: it defers recognition of gain on the employee's exercise of the option until the employee actually sells or exchanges the stock acquired under the option [*I.R.C. § 423(a)*]. Provided that the disposition occurs at least two years after the date the option is granted, and the employee has held the stock at least six months after exercising the option, any profit will be taxed as long-term gain [*I.R.C. § 423(a)*; *but see I.R.C. § 423(c)* (special rule when option price less than fair market value of shares when option granted)]. Unlike an ISO, the granting of options to purchase employer stock may not discriminate in favor of key employees [*I.R.C. § 423(b)(4), (5)*].

Securities problems inevitably associated with issuing shares of stock to a large number of employees will probably discourage all but corporations that already have an established market for their stock from establishing a employee stock purchase plan. A non-qualified stock option or direct transfer of stock can be used to achieve the same general result of providing corporate shares to employees as a general benefit of employment.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsStock Options (IRC secs. 421-424)Tax LawFederal Income Tax ComputationRetirement PlansNondiscrimination Rules (IRC sec. 401)Tax LawFederal Income Tax ComputationRetirement PlansQualified Plans (IRC secs. 401, 410-412)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
E. Stock-Based Plans

1-1D California Legal Forms--Transaction Guide § 1D.81

§ 1D.81 Non-Qualified Stock Plans

[1] In General

Unlike a qualified stock plan, which must be made available to a broad group of employees [*see § 1D.82*], a non-qualified stock plan may be provided for just key employees; use of a non-qualified plan is generally aimed at retaining key personnel. Further, because a non-qualified plan is not subject to special statutory requirements, it has greater flexibility in the way in which stock may be made available to the employee. A variety of approaches, in addition to the direct transfer of stock, may be used to provide the corporation's stock as a form of compensation to its employees. Formats discussed below include non-qualified stock options [*see [2], below*] and stock appreciation rights [*see § 1D.113*].

[2] Non-Qualified Stock Options

Like any other stock option, a non-qualified stock option is a type of employee benefit in which the employee is granted the right to purchase stock in the employee's (corporate) employer at a predetermined (and often discounted) price for a specified period of time. However, unlike a qualified stock option, a non-qualified option is structured in a manner that does not meet any special statutory requirements under the Internal Revenue Code [*see I.R.C. § 422* (incentive stock options); *see also I.R.C. § 421(b)* (disqualifying disposition of ISO)]. Consequently, non-qualified stock options may be offered to a select group of employees, may be granted to different groups of employees on varying terms, may be offered for substantially less than market price, or may be exercised at any time. None of these terms is available for an ISO [*see I.R.C. §§ 421-422*; *§ 1D.82[2]*].

A non-qualified option is not taxable to the employee when granted, with limited exceptions that are seldom applicable to stock options in non-publicly traded corporations [*see I.R.C. § 83(e)*; *Treas. Reg. §§ 1.83-3(a)(2)*, 1.183-7(a),(b)]. On exercise of the non-qualified option, the employee recognizes income equal to the spread between the option exercise price and the fair market value, except that (1) if the shares are nontransferable or subject to forfeiture, the employee is taxed at the time the shares become transferable or the forfeiture provision lapses; or (2) if the company is publicly traded and the employee is an officer or director, the taxable event occurs six months after exercise or, if later, when the stock is transferable or any applicable forfeiture lapses [*I.R.C. § 83(a)-(c)*]. Generally, the employer receives a tax

deduction, equal to the amount of the gain to the individual, when the employee recognizes income [*I.R.C. § 83(h)*]. However, since the employee recognizes income on exercise, or vesting [*see I.R.C. § 83(a)*], this recognition may result in a cash flow problem, since the employee will need money to pay both the exercise price of the stock and the tax.

For several years after the Tax Reform Act of 1986 [Pub. L. No. 99-514, Act § 301(a) (repealing former *I.R.C. § 1202*, relating to exclusion of long term capital gains)], there was only a small advantage for capital gains treatment [*see* former *I.R.C. § 1(b)*], and as a consequence, many corporate employers favored non-qualified stock options, coupled with a *Section 83(b)* election [*see [3], below*] over qualified stock plans. With the rate differential between capital gains and ordinary income once again substantial enough to give capital gains treatment a significant advantage [*see I.R.C. § 1(a)-(d), (h), (i)(2)*; *Rev. & Tax. Code § 18151*], employers tend to favor qualified options over nonstatutory options.

[3] Tax Treatment of Non-Qualified Stock Plans Under Internal Revenue Code Section 83

I.R.C. § 83 generally applies any time property is transferred, in connection with services, to any person other than the person for whom the services are performed (usually, the employer) [*I.R.C. § 83(a)*]. It does not apply, however, to incentive stock options, employee stock purchase plans, or the transfer and exercise of certain stock options [*I.R.C. §§ 83(e), 421*; *see I.R.C. §§ 422* (incentive stock options), *423* (employee stock purchase plans)].

The timing and amount of the employer's deduction under *I.R.C. § 83* is linked to the time the employee is required to include the property (that is, usually, the stock) in income and to the amount of taxable income the employee is required to include [*I.R.C. § 83(h)*]. The employee will recognize income with respect to the property transferred on the earlier of the time the employee's rights in the restricted property (1) become transferable, or (2) are no longer subject to a substantial risk of forfeiture [*I.R.C. § 83(a)*; *see Treas. Reg. § 1.83-3(c)(1)* ("substantial risk of forfeiture" defined)]. The employee will be required to include in income the fair market value of the transferred property (determined without taking into consideration any restrictions on transferability, except restrictions that never lapse), minus any amount paid by the employee for the property [*I.R.C. § 83(a)*]. The value of the property is determined at the time it is included in income, and is taxed at ordinary income rates [*see I.R.C. § 83(a)*].

However, if the employee makes an election under *I.R.C. § 83(b)*, the employee will be taxed in the year the property is transferred (instead of the time the restrictions on the property lapse) [*I.R.C. § 83(b)*]. Thus, if the current price of the property (stock) is low and it is likely to appreciate substantially in value, it may be wise for the employee to make this election to avoid having to pay tax on the property's appreciation at the time the property is transferred [*see I.R.C. § 83(a)*]. For example, 100 shares of non-transferable stock, having a value of $10 per share, might be issued to the employee, subject to the restriction that the shares will be forfeited if the employee terminates employment within five years. Five years later, the fair market value of the shares is $50 per share. If the employee does not make an *I.R.C. § 83(b)* election, the employee will have $5,000 of ordinary income in year five [*see I.R.C. § 83(a)*] and the employer will receive a $5,000 compensation deduction [*see I.R.C. § 83(h)*]. If the employee does make the election, the employee will have $1,000 of ordinary income in the year in which the stock was transferred [*see I.R.C. § 83(b)*] and the employer will be entitled to a $1,000 compensation deduction for the same year [*see I.R.C. § 83(h)*]. Further, the employee will have no additional income when the forfeiture restriction lapses at the end of year five [*see I.R.C. § 83(b)*]. However, the employee will pay capital gain tax if the shares are later sold for a gain over the employee's $1,000 basis [*see I.R.C. §§ 1001(a), 1221, 1222*].

There are two disadvantages to making the election. First, the employee must recognize some income in the year of the transfer. Second, if the property is subsequently forfeited or sold in an arm's length transaction before the time the transfer of the property from the employer becomes complete, any loss recognized by the employee is limited to the amount, if any, paid for the property, minus any amount realized on the forfeiture or sale [*Treas. Reg. § 1.83-2(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsStock Options (IRC secs. 421-424)Tax LawFederal Income Tax ComputationRetirement PlansGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
E. Stock-Based Plans

1-1D California Legal Forms--Transaction Guide § 1D.82

§ 1D.82 Qualified Stock Plans

[1] In General

"Qualified stock plans" are arrangements under which options to purchase stock in the employer corporation are granted to employees, with potentially more favorable tax treatment than is available under non-qualified options. The tax treatment of qualified stock options generally provides that the employee has no income on the receipt or exercise of the option [*see I.R.C. § 421(a)*]. As a result, the employee is taxed at the capital gains rate, when the shares acquired by the exercise of the option are sold [*see I.R.C. § 421(a)*; *but see I.R.C. §§ 56(b)(3)* (amount by which fair market value of stock at time of exercise exceeds option price is tax preference item for purposes of individual alternative minimum tax), *422(c)(2)* (exception to minimum alternative tax); *see also I.R.C. § 421(a)(2)* (no offsetting deduction for employer for value of option or stock acquired by employee when exercising option)].

Further, if holding period requirements are met, the difference between the exercise price of the option and the price of the stock on disposition will be classified as long-term capital gain [*see I.R.C. §§ 1221, 1222*]. For several years after the Tax Reform Act of 1986, [Pub. L. No. 99-514], there was only a small tax advantage for capital gain treatment [*see* former *I.R.C. § 1(b)*]. Enactment of the Revenue Reconciliation Act of 1993 [Pub. L. No. 103-66] has once again made the rate differential between capital gains and ordinary income substantial enough to give capital gains treatment a significant advantage [*see I.R.C. § 1(a)-(d), (h), (i)(2)*; *Rev. & Tax. Code § 18151*].

There are currently only two qualified stock option plans: incentive stock options [*see I.R.C. § 422*; *see also [2], below*] and employee stock purchase plans [*see I.R.C. § 423*; *see also § 1D.113*].

[2] Incentive Stock Options

If the statutory requirements of an incentive stock option are met [*see I.R.C. § 422(b)*], a corporation may make available to its employees, on a discriminatory basis [*but see I.R.C. § 422(b)(6)*], stock options that may be exercised with no immediate tax consequences to the employee and that qualify for capital gains treatment when sold [*see I.R.C. § 421(a)*; *see also [1], above*]. However, this somewhat favorable tax treatment is available to an employee only (1) if the employee does not dispose of the shares within two years from the date the option was granted or within one year from

the date the employee exercised the option, and (2) if the individual remains an employee of the granting corporation (or its parent or subsidiary) continuously from the date the option was granted until three months before the option is exercised [*I.R.C. § 422(a)*].

The transferor corporation receives no deduction for the transferred shares [*I.R.C. § 421(a)(2)*], and no amount other than the price paid under the option is received by the corporation for the shares transferred [*I.R.C. § 421(a)(3)*]. Instead, any income realization is deferred until the employee disposes of the stock received from the option. Tax-free exercise of the option relieves the employee from financing a tax payment in addition to the exercise price [Colvin, *Qualified "Incentive Stock Options" Under the New Law: Requirements and Advantages, 55 J. Tax'n 202 (1981)*].

For further discussion of incentive stock options, see Ch. 85, *Employment Agreements* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansEmployee Stock Ownership PlansTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsStock Options (IRC secs. 421-424)Tax LawFederal Income Tax ComputationRetirement PlansEmployee Stock Ownership Plans (ESOPs) (IRC sec. 409)Tax LawFederal Income Tax ComputationRetirement PlansQualified Plans (IRC secs. 401, 410-412)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
E. Stock-Based Plans

1-1D California Legal Forms--Transaction Guide § 1D.83

§ 1D.83 Stock Appreciation Rights

Stock appreciation rights (SARs) are cash options entitling the employee to an amount of cash measured by the value of the employer's stock at the date of the award. SARs are generally granted in connection with the grant of a stock option, either qualified or non-qualified. A SAR is not taxable to the employee (or deductible by the employer) when first granted [*I.R.C. § 404(a)(5)*; *Treas. Reg. §§ 1.404(a)-12(b), 1.83-3(e)*; *Rev. Rul. 80-300, 1980-2 C.B. 165*]. Rather, it is taxable to the employee as compensation (ordinary income) when the cash payment is received by the employee [*I.R.C. § 83(a)*; *Treas. Reg. § 1.83-1(a)*; *Rev. Rul. 80-300, 1980-2 C.B. 165*]. If a SAR is exercised at the same time as the stock option, the employee will have the funds to purchase the stock or will have cash, if he or she decides not to make the purchase. SARs also allow employees to share in the appreciation of the employers stock, without requiring any initial cash layout (either to purchase the right or to pay taxes on it), and without diluting the stock ownership of existing shareholders.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansGeneral OverviewPensions & Benefits LawEmployee Benefit PlansEmployee Stock Ownership PlansTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsStock Options (IRC secs. 421-424)Tax LawFederal Income Tax ComputationRetirement PlansContributions (IRC secs. 401-404A, 406-408A, 410-420)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
E. Stock-Based Plans

1-1D California Legal Forms--Transaction Guide §§ 1D.84-1D.89

[Reserved]

§§ 1D.84[Reserved]



155 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
F. California Labor Laws

1-1D California Legal Forms--Transaction Guide § 1D.90

§ 1D.90 Workers' Compensation Insurance

With few exceptions, California employers are subject to workers' compensation laws [*Lab. Code §§ 3300* ("employer" defined), *3301* (exclusions), *3351*]. These laws impose liability for work-related accidents, regardless of any negligence on the part of the employer or employee [*Cal. Const. art. XIV, § 4*; *Lab. Code § 3600*], and provide a schedule of benefits, including indemnity for disability, medical expenses, hospital expenses, ancillary treatment, vocational rehabilitation, death benefits and burial allowances [*see Lab. Code § 3207*] to be paid to the injured employee or the employee's dependents or heirs [*see Lab. Code §§ 4700-4709*].

Coverage is based on defined employment relationships. That is, an injured worker must be an "employee" who is entitled to workers' compensation coverage for an injury occurring in the course of specified employment [*Lab. Code §§ 3350-3369*; *In-Home Supportive Services v. Workers' Comp. Appeals Bd. (1984) 152 Cal. App. 3d 720, 727, 199 Cal. Rptr. 697]* . One person rendering a service for another establishes a presumption of an employer-employee relationship, absent a showing that the relationship is one of principal and independent contractor [*Lab. Code § 3357*; *Germann v. Workers' Comp. Appeals Bd. (1981) 123 Cal. App. 3d 776, 783, 176 Cal. Rptr. 868* ; *see Lab. Code §§ 3353* ("independent contractor" defined), *3352, 3352.94* (additional persons excluded from definition of "employee")].

An employer subject to workers' compensation laws must secure payment of compensation by carrying workers' compensation insurance or by obtaining a permit to self-insure [*Lab. Code §§ 3700, 3711*; *see Royal Globe Ins. Co. v. Workers' Comp. Appeals Bd. (1978) 84 Cal. App. 3d 287, 292 n.4, 148 Cal. Rptr. 325* ; *43 Cal. Comp. Cases 895]* .

Worker's compensation is discussed in greater detail in Ch. 1C, *Regulation of Employers* , and Ch. 1E, *Insurance Considerations* and in California Insurance Law and Practice, Ch. 42, *Workers' Compensation Insurance* (Matthew Bender). For detailed coverage of this topic, see California Law of Employee Injuries and WORKERS' Compensation(Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:

Workers' Compensation & SSDICoverageGeneral Overview



156 of 170 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
F. California Labor Laws

1-1D California Legal Forms--Transaction Guide § 1D.91

§ 1D.91 Unemployment and State Disability Insurance

Most California employers that pay $100 or more in wages in any calendar quarter and have employed one or more employees in the current or preceding calendar year are subject to the California Unemployment Insurance Code [*Unemp. Ins. Code § 675*; *see Unemp. Ins. Code §§ 676-687.2* (subject employers)]. The Unemployment Insurance Code governs both unemployment and disability benefits.

California's unemployment insurance program provides benefits to unemployed workers who have lost their jobs and who meet certain qualifications [*Unemp. Ins. Code § 1251*; *see Unemp. Ins. Code § 1252* (when individual is deemed unemployed)]. Unemployment benefits are funded by employer contributions based on a percentage of the employer's payroll for the year [*see Unemp. Ins. Code § 977* (contributions rate schedules)].

California's disability insurance program provides benefits to eligible workers experiencing a loss of wages when they are unable to perform their usual work because of their own sickness or injury; the sickness or injury of a family member; or the birth, adoption, or foster care placement of a new child [*see Unemp. Ins. Code § 2601* (statutes to be liberally construed to mitigate burdens falling on unemployed worker or family)]. Work-related injuries are covered by workers' compensation laws [*see § 1D.90*]. Disability benefits are funded by withholding from employees' wages [*Unemp. Ins. Code § 3252*]. Unlike unemployment insurance, which requires mandatory participation by subject employers [*see Unemp. Ins. Code §§ 675-687.2*], the employer may choose private disability insurance coverage under a state-approved voluntary disability plan [*Unemp. Ins. Code § 3252(a)*]. Employees covered under such a private plan are not required to pay tax to the state [*Unemp. Ins. Code § 3252(a)*].

Coverage and requirements for state disability and unemployment insurance are set forth in the *California Employer's Guide*, prepared by the California Employment Development Department. For further discussion of disability insurance in general, see California Insurance Law and Practice, Ch. 25, *Nature and Types of Disability Insurance* , and Ch. 30, *Group Life and Disability Insurance* (Matthew Bender). See also California Employment Law, Ch. 80, *Unemployment and State Disability Insurance* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawDisability & Unemployment InsuranceUnemployment CompensationBenefit Entitlements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART II. LEGAL BACKGROUND
F. California Labor Laws

1-1D California Legal Forms--Transaction Guide §§ 1D.92-1D.99

[Reserved]

§§ 1D.92[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1D California Legal Forms--Transaction Guide § 1D.100

§ 1D.100 Facts

[1] Information About Natural Persons Who Are Owners of New Business

1. Name.

2. Residence address and telephone number.

3. Business address and telephone number.

4. Citizenship (e.g., U.S. citizen, resident alien, citizen of a country other than the United States).

5. Tax identification numbers (social security number, employer identification number).

6. Marital status.

7. Age.

8. Educational background.

9. Business experience.

10. Gross and net income for last three years.

11. Estimated net worth.

12. Projected annual income.

13. Relationship to other participants.

14. Affiliations with other businesses.

15. Percentage interest in business.

[2] Information About Organizations That Own or Are Owned by New Business

1. Organizations that own, directly or indirectly, percentage of business.

2. Percentage of business owned by each organization.

3. Organizations owned, directly or indirectly, by the business.

4. Percentage of organizations owned by business.

5. Form of organization.

6. Personal and biographical information of persons responsible for management and control [*see* [1], *above*].

7. Tax identification number.

8. Tax year.

9. Accounting method.

[3] Information About Business

1. Name of business.

2. Complete address, including county, of main office and any other offices or places of business.

3. Date business started or date of anticipated start.

4. Principal activity (e.g., manufacturing, sales, professional services).

5. Business's federal and state tax identification numbers.

6. Form of business.

7. If incorporated:

    a. Date of incorporation.

    b. State of incorporation.

c. Type of corporation for tax purposes (i.e., C or S corporation).

d. Type of corporation for holding purposes (i.e., publicly or privately held).

8. If partnership:

a. Date of partnership formed.

b. Date certificate filed, if limited partnership.

9. If limited liability company:

a. Date of organization.

b. State of organization.

10. Projected gross and net income for current year.

11. Projected gross and net income for next three years, if available.

[4] Types of Professional Advisors Involved in Business

1. Attorney.

2. Accountant.

3. Actuary.

4. Insurance advisor.

5. Trustees, or proposed trustees, of retirement plans.

6. Custodians, or proposed custodians, of retirement funds, if not trustee.

7. Retirement plan administrator, or proposed administrator.

8. Professional investment manager, or proposed manager.

9. Life insurance agent, or proposed agent.

10. ERISA fiduciary liability insurance agent or carrier, or proposed agent or carrier.

[5] Information About Professional Advisors Involved in Business

1. Name.

2. Business address and telephone number.

3. Capacity.

4. Responsibilities.

[6] Information About Employees of Business

1. Total number of employees.

2. Total number of owner-employees.

3. Percentage of business owned by owner-employees.

4. Number of employees who are:

    a. Salaried.

    b. Commission.

    c. Hourly.

    d. Union.

    e. Under age 21.

    f. Over age 55.

    g. Over age 65.

    h. Non-resident aliens.

5. Special compensation programs for key employees.

[7] Information About Present Employee Benefit Programs

1. Types of benefit programs.

2. Number of employees covered by each plan.

3. Names of covered employees.

4. Names of plans.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawGeneral

PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawSole Proprietorships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1D California Legal Forms--Transaction Guide § 1D.101

§ 1D.101 Documents

1. Business plan.

2. Balance sheet.

3. Current or projected profit and loss statements.

4. Existing contracts.

5. Copies of prior federal income tax returns from last three years for participating individuals and business entities.

6. Copies of prior income tax returns from last three years, if existing business is being purchased or change in form is contemplated.

7. Copies of tax projections for current year for participating individuals and business entities.

8. Copies of plan summaries for any existing benefit plans.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawSole Proprietorships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1D California Legal Forms--Transaction Guide §§ 1D.102-1D.109

[Reserved]

§§ 1D.102[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1D California Legal Forms--Transaction Guide § 1D.110

§ 1D.110 Scope of Work to be Performed by Attorney

1. Determine tasks attorney will perform, including:

NOTE:

The focus of this chapter is on the selection of employee benefits, rather than on setting up the benefit plan. The detailed steps in setting up a plan, particularly a deferred compensation plan, are highly technical and beyond the scope of this chapter. It is anticipated that the attorney will associate with a professional specializing in employee benefit plans before recommending the adoption of any particular benefits.

Counsel should refer to the Scope and Research Guide of this chapter for additional references to aid in making these determinations.

a. Contacting employee benefits professional.

b. Associating specialist counsel, if necessary.

c. Researching applicable tax and labor law.

d. Making recommendations based on research.

e. Drafting and reviewing letters and agreements.

2. Determine at which point employee benefits professional should be contacted to make determinations and recommendations.

3. Determine whether consultation or association of specialist is appropriate [*see § 1D.100[1][d]*].

NOTE:

For discussion of when an attorney must associate a specialist, refer to Ch. 1A, ***Role of Counsel in Starting a New Business.***

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsEffective RepresentationPensions & Benefits LawEmployee Benefit PlansGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1D California Legal Forms--Transaction Guide § 1D.111

§ 1D.111 Business's Objectives in Providing Retirement Plans

NOTE:

The selection of any retirement plan depends on the client's objectives, the types and numbers of its employees, and the legal requirements with which each type of plan must comply. One plan may not satisfy all the client's objectives. In that case, the business may require more than one plan, or the client may have to choose the single plan that best meets its objectives. In addition, the expectation of employees may influence the choice of plan. Today, most large manufacturing employers maintain traditional types of pension plans (e.g., defined pension benefit plans) because the employee market place demands it. The trend in new service and high-tech companies, however, is toward qualified salary-deferral plans and some form of non-qualified equity-based compensation.

1. Determine client's financial and tax objectives regarding any pension and profit-sharing plans, which may include:

a. Flexibility in determining amount of annual employer contributions.

NOTE:

Annual contributions to non-qualified plans are not subject to statutory restrictions. However, the amount an employer needs to contribute per covered employee may be higher in a non-qualified plan than in a qualified plan (to provide the same amount of benefits to the employee on retirement) because the net cost to the employer of a non-qualified plan is generally greater since the plan enjoys no tax advantages.

Of the qualified retirement plans, profit-sharing plans are the most flexible with respect to annual contributions [***see*** § 1B.58; ***see also*** *I.R.C. § 404(a)(3)(A)*], and defined benefit pension plans are the least flexible [***see*** § 1B.56; ***see also*** *I.R.C. § 412*].

b. Minimizing administrative costs of plan.

NOTE:

The primary disadvantage of a qualified plan (compared to a non-qualified plan) is its substantial design and administration costs, the result of having to comply with the complex requirements of both the Internal Revenue Code and ERISA. Unless a prototype or master plan is used, the costs of drafting a plan and obtaining a qualification letter from the Internal Revenue Service are significant. Similarly, continuing administration costs are higher for qualified than for non-qualified plans because of the expense of managing the funds and filing internal and governmental reports.

Of the qualified plans, administrative costs are generally higher for defined benefit pension plans than for profit-sharing plans or money purchase plans because the defined pension benefit plans not only require the services of an actuary to design the plan, but also require an actuary's continuing services to calculate annual contributions and provide a portion of the plan's required annual report [***see*** *29 U.S.C. § 1023(a)(4)*; ***see also*** *29 U.S.C. § 1242* (requirements for enrolled actuaries)], whereas the employer's accountant can often maintain a profit-sharing or money purchase plan.

c. Avoiding payment of pension benefit guarantee insurance.

NOTE:

Most qualified defined pension benefit plans are subject to Pension Benefit Guaranty Corporation (PBCG) insurance coverage requirements [*29 U.S.C. § 1321(a)(1)*]. Exceptions include plans exclusively for more than 10-percent owners [*29 U.S.C. § 1321(b)(9)*], plans of professional service employers that never have more than 25 active participants [*29 U.S.C. § 1321(b)(13)*], and certain other plans [***see*** *29 U.S.C. § 1321(b)*].

d. Avoiding requirement of employer to continue to fund terminated plan.

NOTE:

Defined pension benefit plans are generally subject to the PBGC's plan termination insurance program, where an employer is liable, up to 30 percent of the employer's net worth, if its plan terminates with assets insufficient to pay vested benefits [***see*** *29 U.S.C. § 1362(b)*].

e. Maximizing business's current income tax deductions.

NOTE:

The tax-favored treatment of qualified plans generally encourages their use [***see, e.g.,*** *I.R.C. §§ 402-404*]. However, in some circumstances, businesses will find non-qualified approaches to employee compensation to be preferable. For further discussion, see *§ 1D.51*, Practice Tip.

f. Maximizing income tax benefits for employees [*see § 1D.51*].

g. Reducing estate (and gift) taxes of owner-employees.

NOTE:

For further discussion, see *§ 1D.55*, Practice Tip.

2. Determine which group of employees employer wants to benefit.

NOTE:

For a discussion of considerations in deciding which group of employees to compensate, see *§ 1D.56[5]*,

Practice Tip.

3. Determine other retirement objectives of employer, including:

a. Providing predictable retirement benefits.

NOTE:

The basic retirement benefits from a defined benefit pension plan are fixed by formula, without regard to the plan's investment performance or the business' profits [*I.R.C. § 412*]. Further, certain benefits are required to be insured by the PBGC [*29 U.S.C. § 1321(a)(1)*]. Conversely, the quality of the plan's investments in a profit-sharing plan, or a cash-deferred plan directly affect the amount of plan benefits because the benefits are linked to the plan's investment performance [***see** I.R.C. § 414(i)*]. For example, if the plan's investments are in common stock and the value of the stock is down at the time or retirement, benefits may be less than anticipated.

b. Encouraging employees to save for retirement.

NOTE:

A defined pension benefit plan generally does not provide for either voluntary or mandatory employee contributions; contributions are made each year by the employer [***see** I.R.C. § 412*]. By contrast, under a cash or deferred plan, employees may reduce their income from wages by making pre-tax contributions of a portion of their compensation. The maximum dollar limit on annual elective deferrals under cash or deferred plans is $10,500 in 2000 and 2001 [*I.R.C. § 402(g)(1),(5)*, before amendment by Pub Law 107-16; *2000-52 I.R.B. 600, Notice 2000-66* ; *1999-2 C.B. 638, Notice 99-55*], $11,000 in 2002, $12,000 in 2003, $13,000 in 2004, $14,000 in 2005, $15,000 in 2006 [*I.R.C. § 402(g)(1),(2)*]. Cost-of-living increases in $500 increments are made thereafter [*I.R.C. § 402(g)(4)*]. Elective deferral contributions are not subject to the deduction limits that apply to stock bonus or profit-sharing plans, to combination defined contribution and defined benefit plans, or to SEPs [*I.R.C. § 404(n)*, effective for years beginning after December 31, 2001]. In addition, the application of a deduction limitation to any other employer contribution to a qualified stock bonus or profit-sharing plan [***see** I.R.C. § 404(a)(3)*] does not take into account elective deferral contributions [*I.R.C. § 404(n)*, effective for years beginning after 12/31/01].

Anti-discrimination requirements also apply to cash or deferred plans [*I.R.C. § 401(k)(3)* (discrimination tests may limit amount most highly compensated plan participants may defer)]. Often, cash or deferred plans also allow a participant to make after-tax contributions [***see** I.R.C. § 401(m)(2)* (contribution limitations)]. Under a profit-sharing plan, both voluntary and mandatory employee (nondeductible) contributions may be made [***see** I.R.C. § 401(k)* (voluntary contributions); ***see also** I.R.C. § 411(c)(2)*) (non-contributory retirement plan)].

c. Integrating plan benefits with social security.

NOTE:

Contributions to certain plans or benefits paid from them may be integrated with social security [*I.R.C. § 401(a)(5), (l)*]. Under an integrated plan, participants can expect to receive social security benefits, or certain other state and federal benefits, in addition to

their benefits under the plan itself. By integrating a retirement plan with social security, the cost of benefits to lower-paid employees can be reduced because the plan may exclude employees whose entire benefits are covered by social security, without being considered discriminatory [***see*** *I.R.C. §§ 401(l), 3101(a)*; *Rev. Rul. 84-45, 1984-1 C.B. 115* (limitation on offset of contribution by social security under defined contribution plan)]. In addition, an integrated plan may favor more highly compensated employees without being considered discriminatory because plan contributions or benefits may be based on compensation not covered by social security [***see*** *I.R.C. § 401(a)(5)*; *Rev. Rul. 84-45, 1984-1 C.B. 115*]. Detailed rules on social security integration have been issued by the Internal Revenue Service [***see*** *Rev. Rul. 78-92, 1978-1 C.B. 118* ; *Rev. Rul. 71-446, 1971-2 C.B. 187*].

The cash or deferred plan, however, does not allow integration with social security because of it must comply with special anti-discrimination rules [***see*** *I.R.C. § 401(k)(3)*].

4. Determine additional non-retirement objectives of employer, including:

a. Providing benefits payable before retirement or termination of employment.

NOTE:

Profit-sharing plans may distribute benefits before an employee's retirement or termination on the occurrence of specified events, such as lapse of time or financial hardship; however, defined benefit and defined contribution pension plans may not make such distributions [***see*** *Rev. Rul. 73-553, 1973-2 C.B. 130*]. Cash or deferred plans may not allow in-service withdrawals before a participant reaches age 591/2, unless there is disability or financial hardship [***see*** *I.R.C. § 401(k)(2)(B)*].

b. Providing benefits on disability.

NOTE:

Profit-sharing plans may provide full-vesting on disability [*Treas. Reg. § 1.401-1(b)(1)(ii)*]; distributions are made on termination of employment [*Treas. Reg. § 1.401-1(b)(1)(ii)*]. Early withdrawals may also be allowed because of illness [*Treas. Reg. § 1.401-1(b)(1)(ii)*]. Cash or deferred plans may also provide full-vesting on disability [*I.R.C. § 401(k)(2)(B)*], except that distributions made on termination of employment must be based on financial hardship [*Treas. Reg. § 1.401-1(d)(2)*]. Defined benefit plans may provide full vesting on disability [*I.R.C. § 411(a)(9)*]; actuarially reduced benefits are payable on disability [***see*** *I.R.C. § 411(a)(3)*; *Treas. Reg. § 1.411(a)-7(d)(6)(i)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansGeneral OverviewPensions & Benefits LawEmployee Benefit PlansPension Benefit PlansPensions & Benefits LawEmployee Benefit PlansProfit-Sharing Plans



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1D California Legal Forms--Transaction Guide § 1D.112

§ 1D.112 Business's Objectives in Providing Compensation Plans Other Than Retirement Plans

NOTE:
As with retirement plans [***see** § 1D.111*], the selection of any compensation or benefit plan depends on the client's objectives, the types and numbers of its employees, and the legal requirements with which each type of plan must comply.

1. Determine reasons client wants to benefit employees:

a. Retain key employees.

NOTE:
Benefit plans that defer compensation or provide an equity interest in the business may be most effective for key employees [***see** §§ 1D.13*, *1D.16*, *1D.17*].

b. Reward key employees for past performance.

NOTE:
If an employer wants to reward key employees for past services, compensation (such as direct cash compensation) that does not tie the employee to the job may be more appropriate [***see** § 1D.12*].

2. Determine client's financial and tax objectives regarding compensation and benefit plans, which may include:

a. Minimizing administrative costs of plan.

b. Maximizing business' current income tax deductions.

c. Maximizing income tax benefits for employees.

NOTE:
For further coverage of these considerations, see *§ 1D.111*.

3. Determine which group of employees employer wants to benefit.

NOTE:
For further coverage of these considerations, see *§ 1D.111*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1D California Legal Forms--Transaction Guide § 1D.113

§ 1D.113 Checklist of Types of Benefit Plans

1. Based on client's objectives [*see § 1D.112*], determine appropriateness of any of following benefit plans:

a. Group life insurance [*see § 1D.31*].

b. Life insurance, other than group life.

NOTE:
An employer may want to provide life insurance coverage to some or all of its employees. Group term life insurance is discussed in *§ 1D.31*. Other types of life insurance plans that the employer may want to consider include "key employee" and split dollar insurance. For further discussion of these programs, **see** California Insurance Law and Practice, Ch. 20, ***Nature and Types of Life Insurance*** (Matthew Bender).

c. Accident, health, and disability plans [*see § 1D.33*].

d. Dependent care assistance program [*see § 1D.37*].

e. Educational assistance program [*see § 1D.38*].

f. Cafeteria plans [*see § 1D.35*].

g. Adoption assistance programs [*see § 1D.40*].

h. Qualified pension plan [*see §§ 1D.50-1D.61*].

i. Qualified profit-sharing plan [*see § 1D.58*].

j. Qualified stock bonus plan [*see § 1D.61*].

k. Employee stock ownership plan (ESOP) [*see § 1D.61*].

l. Incentive stock options (ISOs) [*see § 1D.82[2]*].

m. Employee stock purchase plan.

NOTE:
For discussion of the tax benefits of employee stock purchase plans, see *§ 1D.80*, Practice Tip.

n. Non-qualified stock or stock option plan [*see § 1D.81*].

o. Non-qualified deferred compensation plan or excess benefit plan.

NOTE:
Use of a deferred compensation arrangement to supplement a qualified pension plan is commonly referred to as an "excess benefits plan" [***see*** *29 U.S.C. § 1002(36)* ("excess benefits plan" defined)].

p. Stock appreciation rights.

NOTE:
For coverage of stock appreciation rights (SARs), see *§ 1D.83*.

q. Individual retirement accounts.

NOTE:
Employees who are not covered by a qualified retirement plan [***see*** *§§ 1D.50-1D.61*] may establish individual retirement accounts (IRAs) for themselves and their spouses, provided certain statutory requirements are met [***see*** *I.R.C. §§ 408, 219*].

r. Simplified employee pension.

NOTE:
For coverage of simplified employee pensions (SEPs), see *§ 1D.62*.

2. Determine availability of benefits based on employer's form of business.

NOTE:
Restrictions limit the benefits available to self-employed persons and to 2-percent shareholder of S corporations [***see*** *§ 1D.19*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansGeneral OverviewPensions & Benefits LawEmployee Benefit PlansCafeteria PlansPensions & Benefits LawEmployee Benefit PlansDefined Benefit PlansPensions & Benefits LawEmployee Benefit PlansDefined Contribution PlansPensions & Benefits LawEmployee Benefit PlansIndividual Retirement AccountsPensions & Benefits LawEmployee Benefit PlansPension Benefit PlansPensions & Benefits

LawEmployee Benefit PlansSimplified Employee Pension PlansTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsStock Options (IRC secs. 421-424)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1D California Legal Forms--Transaction Guide § 1D.114

§ 1D.114 Checklist of Basic Requirements for Retirement Plan Qualification

NOTE:

For a retirement plan to be qualified, that is, subject to favorable tax treatment, a number of statutory and regulatory requirements must be met. Defined benefit plans and defined contribution plans are subject to the same basic qualification rules [*I.R.C. § 401(a)*; ***see*** *I.R.C. §§ 401-418E* (qualification rules)]. The basic requirements are summarized below. Although this chapter discusses the ***selection*** of employee benefits and does not cover the steps necessary to secure such benefits, the following summary is included to provide the attorney with a general understanding of the extent of qualification requirements. This list is not exhaustive. For further discussion of qualification requirements, see, Pension and Profit-Sharing Plans Compliance Guide(Matthew Bender), and Frutkin, Pension and Profit-Sharing Plans: Forms and Practice(Matthew Bender).

1. Plan must be definite written plan communicated to employees [*I.R.C. § 401(a)*; *Treas. Reg. § 1.401-1(a)(2)*].

2. Plan must name at least one fiduciary responsible for plan management and administration [*29 U.S.C. § 1102(1)*].

3. Summary plan description must be given to each employee and beneficiary receiving benefits [*29 U.S.C. §§ 1021(a)(1), 1025(a)*].

4. Plan assets must generally be held in trust, under written trust agreement, or invested in annuities issued by insurance companies [*29 U.S.C. § 1103(a)*; *see 29 U.S.C. § 1103(b)* (exceptions)].

5. Plan must be for exclusive benefit of employees and their beneficiaries [*Treas. Reg. § 1.401-1(b)(4)*].

6. Plan must meet minimum participation standards and vesting requirements [*I.R.C. § 401(a)(3)*; *Treas. Reg. § 1.401-1(a)(3)*; *see I.R.C. § 410* (standards defined)].

7. Plan must not discriminate in favor of highly compensated individuals [*I.R.C. § 401(a)(4)*; *see I.R.C. § 414(q)* ("highly compensated individual" defined)].

8. Plan must take into account compensation limits in determining amount of employee benefits [*I.R.C. § 401(a)(17)*].

9. Plan must contain specified distribution requirements [*I.R.C. § 401(a)(9)*].

10. Plan must contain special requirements that will take effect if plan becomes "top-heavy," providing for faster vesting and better benefits for lower-paid employees [*I.R.C. § 401(a)(10)*; *see I.R.C. § 416(g)* ("top-heavy plan" defined)].

11. Plan should submit application for letter of determination to Internal Revenue Service.

NOTE:

Although not required, it is prudent (and customary) to seek a letter of determination from the Internal Revenue Service, stating that the proposed plan meets the qualification requirements of *Internal Revenue Code Sections 401(a)* and *501(a)*, and related provisions. The application for the letter of determination is made using IRS Form 5300 (defined benefit plan) or Form 5301 (defined contribution plan).

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawEmployee Benefit PlansGeneral OverviewPensions & Benefits LawEmployee Benefit PlansCafeteria PlansPensions & Benefits LawEmployee Benefit PlansDefined Contribution PlansPensions & Benefits LawEmployee Benefit PlansPension Benefit PlansTax LawFederal Income Tax ComputationRetirement PlansContributions (IRC secs. 401-404A, 406-408A, 410-420)Tax LawFederal Income Tax ComputationRetirement PlansDefined Contribution Plans (IRC secs. 414-415)Tax LawFederal Income Tax ComputationRetirement PlansDetermination LettersTax LawFederal Income Tax ComputationRetirement PlansNondiscrimination Rules (IRC sec. 401)Tax LawFederal Income Tax ComputationRetirement PlansQualified Plans (IRC secs. 401, 410-412)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1D California Legal Forms--Transaction Guide §§ 1D.115-1D.199

[Reserved]

§§ 1D.115[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART IV. FORMS

1-1D California Legal Forms--Transaction Guide § 1D.200

§ 1D.200 Client Letter Before Initial Meeting

[1] Comment

[a] Use of Form

This form is a letter to a client, for use before an initial meeting regarding employee benefits, to gather information the attorney will use in determining the scope of the work to be done and any preliminary decisions to be made.

At the initial meeting, the attorney will want to have additional, specific information to estimate the time required to perform the legal research and factual analysis. However, complicated or lengthy questionnaires tend to discourage clients and frequently result in cancelled appointments because the client is "unprepared." This form is composed with that in mind. If a more detailed set of questions is appropriate before the initial meeting, counsel should incorporate relevant facts and documents from the checklists in *Sections 1D.100* and *1D.101*.

[b] Fee and Representation Agreement

The first paragraph of this form refers to a fee and representation agreement. For coverage of fee and representation agreements, see Chapter 1A, *Role of Counsel in Starting a New Business* . For sample forms, see Volume 15, Chapter 86, *Agreements for Professional Services*, Part A.

[2] FORM

Client Letter Before Initial Meeting

_____[*date*]
_____[*name*]
_____[*title*]
_____[*street address*]
_____[*city, state, zip*]

Re: Selection of Employee Benefits
Dear _____ [*name of client*] :

In preparation for our initial meeting regarding the selection of employee benefits for your _____[business *or* proposed business], I have _____[sent under separate cover *or* enclosed] a fee and representation agreement outlining our mutual obligations.

The purpose of this letter is to provide you with a short list of the documents and information to bring to our meeting. This is a suggested list only. If you believe other items would be useful, include those as well. If you are unable to obtain everything on the list, bring what you have.

Information

1. Names and telephone numbers of business participants.

2. Names and telephone numbers of the following individuals:

    a. Business's accountant.

    b. Actuary.

    c. Trustees, or proposed trustees, of retirement plans.

    d. Custodians, or proposed custodians of retirement funds, if not trustee.

    e. Retirement plan administrator, or proposed administrator.

    f. Professional investment manager, or proposed manager.

    g. Life insurance agent, or proposed agent.

    h. ERISA fiduciary liability insurance agent or carrier, or proposed agent or carrier.

3. Information about present employee benefit programs (e.g., union retirement plans), if any.

    a. Types of benefit programs.

    b. Number of employees covered by each plan.

    c. Names of covered employees.

    d. Names of plans.

[*Choose one of the following set of questions:*]

[*If business entity is a corporation, use:*]

4. Name and address of corporation.

5. Date of incorporation.

6. Tax year of corporation.

7. Type of corporation.

[*If business entity is a partnership, use:*]

4. Name and address of partnership.

5. Date partnership was or will be formed.

6. Tax year of partnership.

7. Type of partnership.

[*If business entity is a limited liability company, use:*]

4. Name and address of limited liability company.

5. Date of organization.

6. Tax year of limited liability company.

[*If business entity is a sole proprietorship, use:*]

4. Name and address of sole proprietorship.

5. Date proprietorship was or will be formed.

6. Tax year of proprietorship, if different from tax year of owner.

[*If any participants are employees of the business, continue with the following:*]

_ [7 *or* 8]. Position or title of participants who are employees of the business.

[*Continue with the following:*]

_ [8 *or* 9]. Estate plan or plans for business interests.

_ [8 *or* 9]. Nature of business.

Documents

1. _____ [Articles of incorporation *or* Partnership agreement *or* Articles of organization].

2. Any buy-sell agreements.

3. Most recent financial statement.

4. Most recent tax return.

5. Fringe benefit plans and agreements.

6. Insurance policies of:

a. Individual participants.

b. Business.

[*Continue with the following:*]

I look forward to meeting with you on _____[*date*] at _____[*time*] at _____[*location*] to discuss the employee benefits needs of your _____[business *or* proposed business venture]. Do not hesitate to call if you have questions.

Very truly yours,

_____
[*signature*]
[*typed name*]
_____ [*street address*]
_____ [*city, state, zip*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsEffective RepresentationPensions & Benefits LawEmployee Benefit PlansGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART IV. FORMS

1-1D California Legal Forms--Transaction Guide § 1D.201

§ 1D.201 Client Letter Following Initial Meeting

[1] Comment--Use of Form

This form is a follow-up letter to an initial meeting at which employee benefits considerations for a new business were discussed.

This letter serves two purposes. First, it reiterates the tasks the attorney will perform, reminding the client of the extent of work involved. The letter provides optional text for use if the attorney will work in consultation with an employee benefits specialist.

Second, if the attorney is awaiting additional materials from the client, it provides the client with a complete list of the information or documents that he or she must provide and puts the client on notice that work cannot be completed without those items.

[2] FORM

Client Letter Following Initial Meeting

_____[*date*]
_____[*name*]
_____[*title*]
_____[*street address*]
_____[*city, state, zip*]

Dear _____ [*name of client*] :

In our meeting of _____[*date*], we agreed that I would perform the research and analysis necessary to determine the advisable types of employee fringe benefits, including retirement plans, for your _____[business *or* proposed business venture]. This will include _____[*specify, e.g.*,

comparing the cost (including the tax consequences) of qualified versus non-qualified retirement plans, determining the feasibility of establishing a statutory stock based plan, and performing the research necessary to determine whether workers are employees or independent contractors for purposes of workers' compensation]. [*Add if applicable:* I will perform this research and analysis in consultation with _____ (*name*), an employee benefits specialist.]

[*If client is to provide additional information, use:*]

We also agreed that you would provide me with the following: _____[*list information and documents*].

I look forward to receiving this information as soon as possible, so that I can complete the work we discussed. I will telephone you to confirm receipt of your materials and to schedule a date for our follow-up discussion.

[*If client is not to provide additional information, use:*]

I look forward to seeing you on _____[*date*] at _____[*time*] at _____[*location*] to discuss the results of this research.

[*Continue with the following:*]

Very truly yours,
_____ [*signature*]
[*typed name*]
_____ [*street address*]
_____ [*city, state, zip*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsEffective RepresentationPensions & Benefits LawEmployee Benefit PlansGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART IV. FORMS

1-1D California Legal Forms--Transaction Guide § 1D.202

§ 1D.202 Client Letter if Attorney Is to Perform No Further Work

[1] Comment--Use of Form

This form is a follow-up letter to a meeting at which employee benefits considerations for a new business were discussed, stating that no further work will be done.

If no research or analysis is to be performed regarding the business's employee benefits needs, a follow-up letter to the client establishes the end of the attorney-client relationship related to this particular representation. This letter helps establish a date from which the statute of limitations runs for purposes of malpractice claims [*see Code Civ. Proc. § 340.6(a)(2)*].

The attorney should return any documents belonging to the client with this letter. The letter should be sent certified or registered mail, to document the close of the attorney-client relationship, as well to confirm the receipt of returned documents.

[2] FORM

Client Letter if Attorney Is to Perform No Further Work

_____[*date*]
_____[*name*]
_____[*title*]
_____[*street address*]
_____[*city, state, zip*]

Dear _____ [*name of client*] :

This letter will confirm our _____[conversation *or* telephone conversation] of _____[*date*], in which we concluded that you would not need any further assistance in evaluating the

employee benefit needs of your _____[business *or* proposed business venture].

If you decide to pursue this matter, please feel free to consult _____[me *or* us] again. However, currently, _____[I *or* we] consider the matter closed.

Please call if you have any questions, or of _____[I *or* we] can be of service in the future.

Very truly yours,
_____ [*signature*]
[*typed name*]
_____ [*street address*]
_____ [*city, state, zip*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsEffective RepresentationPensions & Benefits LawEmployee Benefit PlansGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1D OVERVIEW OF EMPLOYEE BENEFITS
PART IV. FORMS

1-1D California Legal Forms--Transaction Guide § 1D.203

§ 1D.203 Client Letter if Attorney Recommends Specific Employee Benefit Plans

[1] Comment--Use of Form

This form is a letter that documents for the attorney, and clarifies for the client, recommended types of employee benefits coverage for a new business. This recommendation should be made in consultation with an employee benefits specialist.

[2] FORM

Client Letter if Attorney Recommends Specific Employee Benefit Plans

_____[*date*]
_____[*name*]
_____[*title*]
_____[*street address*]
_____[*city, state, zip*]

Dear _____ [*name of client*] :

This letter will confirm our _____[conversation *or* telephone conversation] of _____[*date*], in which we concluded that the following employee benefits coverage is advisable for your business: _____[*list applicable coverages*].

[*If a qualified plan is recommended over a non-qualified alt ernative, use:*]

As we discussed, use of a qualified _____[*describe type of plan, e.g,* money purchase plan, incentive stock option] has the following advantages: _____[*list advantages*].

As we also discussed, it has the following disadvantages: _____[*list disadvantages*].

Once you have selected the appropriate plan, it is important to take the appropriate steps to secure coverage. top

[*Choose one of the following paragraphs:*]

[*If attorney is to perform additional work, use:*]

I look forward to _____[*specify work to be done, e.g.,* drafting the trust agreement, selecting the trustee, arranging for a plan administrator, arranging for an investment committee or an individual who will handle plan investments, obtaining a bond for each individual who will handle plan assets, and filing a qualification letter with the Internal Revenue Service].

[*If attorney's work is complete, use:*]

This letter will also confirm our _____[conversation *or* telephone conversation] of _____[*date*], in which we agreed that, having assisted you in evaluating the employee benefit needs of your _____[business *or* proposed business venture], _____[my *or* our] work on this matter is now finished.

[*Continue with the following:*]

_____[I *or* We] appreciate your confidence and having had the opportunity to serve you. If _____[I *or* We] can be of assistance in the future, please do not hesitate to call.

Very truly yours,
_____ [*signature*]
[*typed name*]
_____ [*street address*]
_____ [*city, state, zip*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsEffective RepresentationPensions & Benefits LawEmployee Benefit PlansGeneral Overview



1 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES

1-1E California Legal Forms--Transaction Guide 1E.syn

§ 1E.syn Synopsis to Chapter 1E: TAXATION OF BUSINESSES

§ 1E.01 California Sources

[1] Constitution

[2] Statutes

[3] Regulations

§ 1E.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 1E.03-1E.04 [Reserved]

§ 1E.05 Law Reviews and Periodicals

§ 1E.06 Text References

[1] Matthew Bender Sources

[2] Additional Text References

[3] Pamphlets

§§ 1E.07-1E.09 [Reserved]

§ 1E.10 Taxation of Sole Proprietorship

[1] In General

[2] Deductibility of Losses

[3] Self-Employment Tax

[4] Alternative Minimum Tax (AMT) on Individuals

[5] Estimated Tax Payments

§ 1E.11 Taxation of Partnership

[1] Filing of Informational Return

[2] Statement to Partners on Schedule K-1

[3] Tax Matters Partner (TMP)

[a] Designation of TMP

[b] Duty of TMP to Inform Partners

[c] Duty of TMP to Inform IRS

[d] When Action of TMP Binds Partnership and Partners

[4] Partnership Level Treatment of Partnership Items

[5] Inconsistent Reporting by Partner

§ 1E.12 Taxation of Corporation

[1] Filing Requirements

[a] C Corporation

[b] S Corporation

[c] First Tax Return

[2] Corporate Income Tax Rate

[3] Other Initial Filings

[4] Recordkeeping and Record Retention

[5] Estimated Tax Payments

[6] Alternative Minimum Tax (AMT) on Corporations

§ 1E.13 Taxation of Limited Liability Company

[1] Freedom to Choose Type of Tax Treatment

[2] Treatment as Partnership for Income Tax Purposes

[a] Advantage of Partnership Tax Treatment

[b] California Tax Treatment

[c] Tax Matters Member

[3] Limited Liability Company as Accounting Entity for Income Taxation of Members

[4] Income Taxation of Members of Limited Liability Company

[5] Requirement to File Federal Tax Return

§§ 1E.14-1E.19 [Reserved]

§ 1E.20 Federal Income Tax Withholding

[1] In General

[2] Definitions for Federal Income Tax Withholding Purposes

[a] Employer

[b] Employee

[c] Wages

§ 1E.21 Federal Employment Taxes

[1] In General

[2] Types of Federal Employment Taxes

[a] FICA Taxes

[b] FUTA Taxes

[3] Definitions for Federal Employment Tax Purposes

[a] Employer

[b] Employee

[c] Wages

§ 1E.22 Reporting of Federal Withholding and Employment Taxes

[1] IRS Form 941 (Employer's Quarterly Federal Tax Return)

[2] IRS Form W-2 (Wage and Tax Statement)

[3] IRS Form 940 (Employer's Annual Federal Unemployment (FUTA) Tax Return)

§ 1E.23 Payment by Deposit of Federal Withholding and Employment Taxes

§ 1E.24 Other Federal Reporting Requirements

[1] Report of Payment to Independent Contractor

[2] Report of Cash Receipts Exceeding $10,000

§§ 1E.25-1E.49 [Reserved]

§ 1E.50 Taxation of Sole Proprietorship

§ 1E.51 Taxation of Partnership

[1] Partnership Return

[2] Franchise Tax on Limited Partnerships

[3] Withholding Tax on Distributions to Partners

[a] Withholding Based on Partner's Status

[i] Resident Partners

[ii] Nonresident Domestic Partners

[iii] Foreign Partners

[b] Withholding Returns and Payment

§ 1E.52 Taxation of Corporations

[1] Types of Tax Imposed on Corporations

[a] Franchise Tax

[b] Corporate Income Tax

[c] Corporate Alternative Minimum Tax

[2] Returns and Payment

[3] Estimated Tax Payments

§ 1E.53 Taxation of Limited Liability Companies

[1] Partnership Tax Treatment

[2] Franchise Tax

[3] Fee Based on Income

[4] Requirement to File California Tax Return

[5] Requirement to Provide Tax Information to Members

§ 1E.54 Other State Tax Reporting Requirements

[1] Report of Payment to Independent Contractor

[2] Report of Cash Receipts Exceeding $10,000

§§ 1E.55-1E.59 [Reserved]

§ 1E.60 Imposition of Sales Tax

[1] In General

[2] Retail Sales

[3] Tangible Personal Property

§ 1E.61 Sales Tax Reimbursement

§ 1E.62 Measure and Rate of Sales Tax

[1] Gross Receipts as Measure of Tax

[2] Rate of Tax

§ 1E.63 Imposition of Use Tax

[1] In General

[2] Collection of Use Tax by Retailer

§ 1E.64 Exemption From Sales and Use Tax

[1] In General

[2] Exemptions From Sales Tax

[3] Exemptions From Use Tax

§ 1E.65 SBE Seller's Permit

§ 1E.66 Returns and Payment of Sales and Use Taxes

§§ 1E.67-1E.69 [Reserved]

§ 1E.70 Real and Personal Property Taxes

[1] Constitutional Authorization and Limitation

[2] Real Property Subject to Taxation

[3] Personal Property Subject to Taxation

[a] In General

[b] Business Inventory Exemption

§ 1E.71 Annual Informational Statement

§ 1E.72 Payment of Property Tax

§ 1E.73 Change of Ownership Statements

[1] Real Property Transfers

[2] Changes in Control of Partnership or Other Legal Entity

§§ 1E.74-1E.79 [Reserved]

§ 1E.80 State Income Tax Withholding

[1] Amount of Withholding

[2] Definitions for Income Tax Withholding Purposes

[a] Employer

[b] Employee

[c] Wages

§ 1E.81 Types of State Employment Taxes

[1] Unemployment Tax

[2] Disability Tax Withholding

[3] Training Taxes

§ 1E.82 Definitions for Employment Tax Purposes

[1] Employment

[a] Covered Services

[b] Excluded Services

[2] Employer

[3] Employee

[4] Wages

§ 1E.83 Reporting and Payment of State Withholding and Employment Taxes

[1] In General

[2] EDD Form DE-3

[3] EDD Form DE-43

§§ 1E.84-1E.99 [Reserved]

§ 1E.100 Facts

Scope

§ 1E.101 Documents

Scope

§§ 1E.102-1E.109 [Reserved]

§ 1E.110 Classification of Worker as Employee or Independent Contractor

Scope

§ 1E.111 Determination If Business Involves Retail Sales Subject to Sales Tax

Scope

§ 1E.112 Checklist of Miscellaneous Taxes

Scope

§§ 1E.113-1E.119 [Reserved]

§ 1E.120 Withholding of Income and Employment Taxes

Scope

§ 1E.121 State Sales and Property Tax Considerations

[1] Collection of Sales Tax

Scope

[2] Property Tax Base and Statements

Scope

§ 1E.122 Partnership Considerations

[1] Partnership-Level Treatment

Scope

[2] Designation of Tax-Matters Partner and Other Elections

Scope

§ 1E.123 Corporate Considerations

Scope

§ 1E.124 Limited Liability Company Considerations

[1] Choosing Type of Tax Treatment

Scope

[2] Limited Liability Company-Level Treatment

Scope

[3] Designation of Tax Matters Member and Other Elections

Scope

§§ 1E.125-1E.129 [Reserved]

§ 1E.130 Record Retention

Scope

§§ 1E.131-1E.199 [Reserved]

§ 1E.200 Client Letter Prior to Initial Meeting

[1] Comment--Use of Form

[2] Form

Client Letter Prior to Initial Meeting

§ 1E.201 Client Letter Following Initial Meeting If Attorney Is Retained

[1] Comment--Use of Form

[2] Form

Client Letter Following Initial Meeting If Attorney Is Retained

§ 1E.202 Client Letter If Attorney Is Not Retained

[1] Comment--Use of Form

[2] Form

Client Letter If Attorney Is Not Retained



2 of 192 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES

1-1E California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter outlines various federal and California tax reporting and payment requirements that will arise for a new business. The coverage focuses on the following tax factors: (1) basic federal and state income tax reporting and payment requirements for sole proprietorships, partnerships, corporations, and limited liability companies; (2) federal and state withholding and employment taxes; (3) sales and use tax considerations; and (4) property tax reporting and payment. The Practice Guide provides a checklist of facts and documents to obtain and determinations to be made in advising the client on initial tax matters.

For discussion of tax considerations involving nonprofit corporations, see Ch. 13, *Nonprofit Corporations* , and Ch. 13B, *Tax-Exempt Status for Nonprofit Entities* . For coverage of special tax problems of multijurisdictional taxpayers, that is, corporations conducting business both inside and outside California, see Ballantine & Sterling, California Corporation Laws, Ch. 22, *Franchise and Income Taxes* (Matthew Bender).

Tax issues involving organizational forms that are subject to specialized government regulation, such as banks and insurance and trust companies, are beyond the scope of this chapter. For coverage of those complex issues, see Taxation of Financial Institutions(Matthew Bender) and Antes, Griffith, et. al., Federal Income Taxation of Life Insurance Companies(Matthew Bender).

For coverage of tax and other considerations involved in selecting the most appropriate form of entity for a new business, see Ch. 1B, *Selecting Form of Business Entity* . For a discussion of the range of laws that govern the establishment and operation of a business, see Ch. 1C, *Regulation of Employers* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART I. RESEARCH GUIDE
A. Primary Sources

1-1E California Legal Forms--Transaction Guide § 1E.01

§ 1E.01 California Sources

[1] Constitution

Taxation of property. Cal. Const. art. XIII.

Proposition 13. Cal. Const. art. XIIIA.

[2] Statutes

Property taxation. *Rev. & Tax. Code § 50 et seq.*

Purchase or transfer of ownership interests in legal entities. *Rev. & Tax. Code § 64*.

Definitions. *Rev. & Tax. Code §§ 103-136*.

Taxable and exempt property. *Rev. & Tax. Code §§ 201-236*.

Business inventory exemption. *Rev. & Tax. Code § 219*.

Assessments. *Rev. & Tax. Code §§ 404, 405*.

Property statements. *Rev. & Tax. Code §§ 441-452*.

Change in ownership reporting. *Rev. & Tax. Code §§ 480-485*.

Collection. *Rev. & Tax. Code §§ 2601-2636*.

Due dates and payment. *Rev. & Tax. Code §§ 2605-2607*.

Delinquency dates. *Rev. & Tax. Code §§ 2617, 2618*.

Collection on unsecured roll, due and delinquency dates. *Rev. & Tax. Code §§ 2901, 2922(a)*.

Sales and use taxes. *Rev. & Tax. Code § 6001 et seq.*

Definitions. *Rev. & Tax. Code §§ 6001-6024*.

Retail sale. *Rev. & Tax. Code § 6007*.

Gross receipts. *Rev. & Tax. Code § 6012*.

Retailer. *Rev. & Tax. Code §§ 6015, 6019*.

Tangible personal property. *Rev. & Tax. Code § 6016*.

Imposition of sales tax. *Rev. & Tax. Code §§ 6051-6052*.

Seller's permit. *Rev. & Tax. Code §§ 6066-6074*.

Gross receipts presumed taxable. *Rev. & Tax. Code § 6091*.

Resale certificate. *Rev. & Tax. Code § 6093*.

Use tax. *Rev. & Tax. Code §§ 6201-6207*.

Exemptions from sales and use tax. *Rev. & Tax. Code §§ 6351-6380*.

Exemptions from sales tax. *Rev. & Tax. Code §§ 6381-6396*.

Exemptions from use tax. *Rev. & Tax. Code §§ 6401-6410*.

Returns and payment. *Rev. & Tax. Code § 6451-6459*.

Prepayment. *Rev. & Tax. Code §§ 6470-6479*.

Security for seller's permit. *Rev. & Tax. Code § 6701*.

Violations. *Rev. & Tax. Code §§ 7152-7156*.

Personal income tax. *Rev. & Tax. Code § 17001 et seq.*

Federal election proper election for California tax purposes. *Rev. & Tax. Code § 17024.5(e)(1)*.

Alternative minimum tax. *Rev. & Tax. Code § 17062*.

Gross income, adjusted gross income defined. *Rev. & Tax. Code §§ 17071, 17072*.

Income taxation of partners and partnerships. *Rev. & Tax. Code §§ 17851-17858*.

Tax on limited partnerships. *Rev. & Tax. Code § 17935*.

Returns on magnetic media. *Rev. & Tax. Code § 18409*.

Filing dates. *Rev. & Tax. Code § 18566*.

Returns, time of filing and content. *Rev. & Tax. Code § 18601*.

Report of payment to independent contractor. *Rev. & Tax. Code § 18631(c)(5)*.

Withholding. *Rev. & Tax. Code §§ 18662-18677*.

Payments. *Rev. & Tax. Code §§ 19001-19010*.

Method of payment. *Rev. & Tax. Code § 19005*.

Estimated tax. *Rev. & Tax. Code §§ 19023-19027*.

Payment by electronic funds transfer. *Rev. & Tax. Code § 19029*.

Bank and corporation tax law. *Rev. & Tax. Code § 23001 et seq.*

Bank and corporation franchise tax. *Rev. & Tax. Code §§ 23101-23459*.

Activities excluded. *Rev. & Tax. Code § 23101.5*.

Franchise tax rate for general corporations. *Rev. & Tax. Code § 23151*.

Minimum franchise tax. *Rev. & Tax. Code § 23153*.

Alternative minimum tax. *Rev. & Tax. Code §§ 23400-23459*.

Corporate income tax. *Rev. & Tax. Code § 23501 et seq.*

Offset of franchise tax. *Rev. & Tax. Code § 23503*.

S corporation tax treatment. *Rev. & Tax. Code §§ 23800-23811*.

Unemployment compensation. *Unemp. Ins. Code § 100 et seq.*

Employing unit defined. *Unemp. Ins. Code § 135*.

Employment covered. *Unemp. Ins. Code §§ 601-611*.

Employee covered. *Unemp. Ins. Code § 621.5*.

Services excluded. *Unemp. Ins. Code §§ 629-656*.

Wages defined. *Unemp. Ins. Code § 940*.

Contribution rates. *Unemp. Ins. Code § 976-994*.

Records, reports, and contribution payments. *Unemp. Ins. Code §§ 1085-1098*.

Due and delinquent dates of contributions. *Unemp. Ins. Code § 1110*.

Disability compensation. *Unemp. Ins. Code §§ 2601-3272*.

Withholding tax on wages. *Unemp. Ins. Code §§ 13000-13101*.

Definitions. *Unemp. Ins. Code §§ 13004-13009*.

Withholding and payment of tax. *Unemp. Ins. Code §§ 13020-13031*.

Amount. *Unemp. Ins. Code § 13020*.

Return. *Unemp. Ins. Code § 13021*.

Withholding exemption certificate. *Unemp. Ins. Code § 13026*.

Computation of withholding exemptions. *Unemp. Ins. Code § 13040*.

Reports, returns, and statements. *Unemp. Ins. Code §§ 13050-13058*.

[3] Regulations

Fixtures defined. *18 Cal. Code Reg. § 122.5*.

List of land and improvements. *18 Cal. Code Reg. § 124*.

Business inventory exemption. *18 Cal. Code Reg. § 133*.

Service enterprises. *18 Cal. Code Reg. § 1501*.

Payment and collection of use tax. *18 Cal. Code Reg. §§ 1684-1686*.

Withholding on distributions to partners. *18 Cal. Code Reg. §§ 18805-1-18805-8*.

Unemployment and disability compensation, required work records. 22 Cal. Code Reg. § 1085-2.

Unemployment and disability compensation, filing of returns and payment of tax. 22 Cal. Code Reg. § 1088-1(a).

Withholding tax on wages, employee defined. 22 Cal. Code Reg. § 4304-1.

Wages, exclusions from wages. 22 Cal. Code Reg. §§ 4309-1, *4309-2*.

Withholding exemption certificate. 22 Cal. Code Reg. § 4340-1.

Statement for employees. 22 Cal. Code Reg. § 4350- 1.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART I. RESEARCH GUIDE
A. Primary Sources

1-1E California Legal Forms--Transaction Guide § 1E.02

§ 1E.02 Federal Sources

[1] Statutes

Tax rates, individuals. *I.R.C. § 1*.

Tax rates, corporations. *I.R.C. § 11*.

Income taxation of corporations, cross-references. *I.R.C. § 12*.

Alternative minimum tax. *I.R.C. §§ 55-59*.

Environmental tax. *I.R.C. § 59A*.

Gross income defined. *I.R.C. § 61*.

Adjusted gross income defined. *I.R.C. § 62*.

Fringe benefits. *I.R.C. § 132*.

Trade or business expenses. *I.R.C. § 162*.

Hobby loss rules. *I.R.C. § 183*.

Start-up expenditures. *I.R.C. § 195*.

At-risk rules. *I.R.C. § 465*.

Income taxation of partners and partnership. *I.R.C. §§ 701-761*.

Tax treatment of partnership. *I.R.C. § 701*.

Income and credits of partner. *I.R.C. § 702*.

Alternative tax for corporations. *I.R.C. § 1201*.

Income taxation of S corporations. *I.R.C. §§ 1361-1379*.

Tax on self-employment income. *I.R.C. §§ 1401-1403*.

Federal Insurance Contributions Act (FICA). *I.R.C. §§ 3101-3128*.
Rate of tax. *I.R.C. § 3101*.
Deduction of tax from wages. *I.R.C. § 3102*.
Rate of tax. *I.R.C. § 3111*.
Definitions. *I.R.C. § 3121*.

Federal Unemployment Tax Act (FUTA). *I.R.C. §§ 3301-3311*.
Rate of tax. *I.R.C. § 3301*.
Credits against tax. *I.R.C. § 3302*.
Definitions. *I.R.C. § 3306*.

Income tax withholding. *I.R.C. §§ 3401-3406*.

Collection at source. *I.R.C. §§ 3402*.

Requirement of records, statements, returns. *I.R.C. § 6001*.

Income tax returns. *I.R.C. § 6012*.

Self-employment tax returns. *I.R.C. § 6017*.

Partnership informational return. *I.R.C. § 6031*.

S corporation return. *I.R.C. § 6037*.

Return for payment to independent contractor. *I.R.C. § 6041A*.

Return related to cash received in business. *I.R.C. § 6050I(a)*.

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Failure to pay estimated tax. *I.R.C. §§ 6654, 6655*.

Failure to file information return. *I.R.C. § 6721(e)(2)*.

Willful failure to file, supply information, or pay tax. *I.R.C. § 7203*.

[2] Regulations

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Accounting period. Temp. Treas. Reg. § 1.441-1T.

General rule for methods of accounting. *Treas. Reg. § 1.446-1*.

Partnership taxation. *Treas. Reg. §§ 1.702-1, 1.702-2*.

Wages defined for withholding. *Treas. Reg. § 31.3401(a)-1*.

Employee defined for withholding. *Treas. Reg. § 31.3401(c)-1*.

Records. *Treas. Reg. § 1.6001-1*.

Returns. *Treas. Reg. §§ 1.6011-1, 31.6011(a)-4, 31.6011(a)-6*.

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Partnership returns. Treas. Reg. § 1.6031-1.

Statements to partners. Temp. Treas. Reg. § 1.6031(b)-1T.

S corporation return. *Treas. Reg. § 1.6037-1*.

Return relating to cash received in business. *Treas. Reg. § 1.6050I-1*.

Statements for employees. *Treas. Reg. §§ 31.6051-1, 31.6051-2*.

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Tax matters partner. Temp. Treas. Reg. §§ 301.6223(g)-1T, 301.6224(c)-1T, 301.6227(b)-1T, 301.6231(a)(7)-1T.

Tax deposit rules for amounts withheld. *Treas. Reg. § 31.6302-1*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART I. RESEARCH GUIDE
A. Primary Sources

1-1E California Legal Forms--Transaction Guide §§ 1E.03-1E.04

[Reserved]

§§ 1E.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1E California Legal Forms--Transaction Guide § 1E.05

§ 1E.05 Law Reviews and Periodicals

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1E California Legal Forms--Transaction Guide § 1E.06

§ 1E.06 Text References

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Ch. 23, *Tax Planning for the Closely Held Corporation*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1E California Legal Forms--Transaction Guide §§ 1E.07-1E.09

[Reserved]

§§ 1E.07[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
A. Federal Taxes
1. Income Taxes

1-1E California Legal Forms--Transaction Guide § 1E.10

§ 1E.10 Taxation of Sole Proprietorship

[1] In General

A sole proprietor's profits (or losses) are computed on Schedule C of IRS Form 1040 and included in personal income: there is no separate income tax on the business's net profit [*see I.R.C. §§ 61(a), 62(a)(1)*]. The sole proprietor pays income taxes on the sole proprietorship as an individual, not as a separate business entity [*see I.R.C. §§ 61(a), 62(a), 6012(a)*]. The tax year of a sole proprietorship is the same as the tax year of its proprietor,because the proprietorship and the proprietor are one and the same taxpayer. Business deductions which reduce business income must be "ordinary and necessary" business expenses; no other deductions are permitted [*see I.R.C. § 162*]. The taxpayer may elect to amortize start-up expenses over a period of not less than five years [*see I.R.C. § 195*]; if this election is not made, the start-up expenses are not deductible because they are not incurred in carrying on a trade or business [*see I.R.C. §§ 162(a), 195(a)*]. For accounting and tax reporting purposes, assets dedicated to the business should be distinguished from assets used personally.

[2] Deductibility of Losses

A sole proprietor may generally deduct business losses from other income [*I.R.C. § 62(a)(1)*]; provided, however, that those losses may not be deducted in amount greater than the amount that is "at risk" in the business [*see I.R.C. § 465*] and the business venture must be engaged in for profit [*see I.R.C. §§ 162, 183*]. The amount at risk includes the contributed capital and the sole proprietor's recourse liabilities [*I.R.C. § 465(b)(1)-(3)*; *see I.R.C. § 465(b)(6)* (amount at risk for real estate also includes certain qualified nonrecourse financing)]. Unallowed losses will usually be allowed upon disposition of the business [*see I.R.C. § 465*]. A business activity not pursued with a profit motive may be recharacterized by the IRS as a hobby: the activity's deductions are then limited to an amount not to exceed its income [*I.R.C. § 183*].

[3] Self-Employment Tax

If a sole proprietor has a net profit of $400 or more, the amount of the profit is subject to a self-employment tax that

finances social security benefits; the self-employment tax is calculated on Schedule SE which is attached to IRS Form 1040 (Individual U.S. Income Tax Return) [*see I.R.C. §§ 1401, 1402(b), 6017*; *Treas. Reg. § 1.6017-1(a)(1)*]. The self-employment tax is added to the income tax liability and paid with it [*see* IRS Form 1040, Instr.].

[4] Alternative Minimum Tax (AMT) on Individuals

The alternative minimum tax (AMT) is imposed when the amount of AMT exceeds the individual's regular tax for the taxable year [*I.R.C. § 55(a)*]; it is imposed on an individual's alternative minimum taxable income, reduced by the exemption amount [*I.R.C. § 55(b)(2)* (alternative minimum taxable income); *see I.R.C. § 55(d)(1), (3)* (exemption amount and phase out)]. Alternative minimum taxable income is calculated by making certain adjustments to regular taxable income [*I.R.C. §§ 55(b)(2)(A), 56, 58*], and increasing it by the amount of certain items of tax preference [*I.R.C. §§ 55(b)(2)(B), 57*]. The individual alternative minimum tax rate is 26 percent up to $175,000, and 28 percent above that amount [*I.R.C. § 55(b)(1)(A)*].

[5] Estimated Tax Payments

An individual taxpayer is generally required to make quarterly estimated tax payments if the current year's estimated tax liability is at least $500 and withholding will not be at least 90 percent of the current year's tax or 100 percent of the prior year's tax [*see I.R.C. § 6654(d)(1)(B), (e)*]. The estimated tax payment is enclosed with IRS Form 1040-ES.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawSole ProprietorshipsTax LawFederal Taxpayer GroupsIndividualsBusiness Deductions (IRC secs. 62, 63, 162)General OverviewTax LawFederal Taxpayer GroupsIndividualsEstimated Taxes (IRC secs. 6315, 6654)Income Tax PaymentsTax LawFederal Taxpayer GroupsIndividualsSelf-Employment (IRC secs. 164, 1401-1403, 6017)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
A. Federal Taxes
1. Income Taxes

1-1E California Legal Forms--Transaction Guide § 1E.11

§ 1E.11 Taxation of Partnership

[1] Filing of Informational Return

A partnership is not itself a taxpaying entity; it is a conduit of income, gain, loss, deductions, and credits to the individual partners [*see I.R.C. §§ 701, 702(a)*]. A partnership need not adopt the same tax year as its partners, however, nor is it required to share the same accounting method [*I.R.C. §§ 703, 706*]. A partnership, with some exceptions, must file an informational return on IRS Form 1065 (U.S. Partnership Return of Income) [*I.R.C. § 6031(a)*; Treas. Reg. § 1.6031-1(a)(1)]. This return reports partnership income and deductions and the partners' names, addresses, and distributive shares, as well as other information required by the IRS [*I.R.C. § 6031(a)*]. The partnership must file its first return for the first taxable year in which the partnership has income or has a deductible expense [Treas. Reg. § 1.6031-1(a)(1)]. Generally, the return is due by the fifteenth day of the fourth month after the close of the partnership's taxable year [Treas. Reg. § 1.6031-1(e)(2)].

In addition, the partnership entity must annually pay the minimum franchise tax for the privilege of doing business in California [*Rev. & Tax. Code § 17851.5*; *see § 1E.51[2]*].

[2] Statement to Partners on Schedule K-1

On or before the day the partnership return must be filed, the partnership must provide to each partner (and each person holding an interest in the partnership as a nominee for another at any time during the taxable year) a statement showing that partner's distributive share of income, gains, losses, deductions, and credits [*see I.R.C. § 6031(b)*; *see also* Temp. Treas. Reg. § 1.6031(b)-1T(a)(1), (3)]. In the case of an electing large partnership [*see I.R.C. § 775*], this information must be furnished on or before the first March 15 following the close of the taxable year [*I.R.C. § 6031(b)*]. This statement is made on Schedule K-1 (Partner's Share of Income, Deductions, Credits, Etc.). The partners report the items from the Schedule K-1 on the partners' individual returns consistent with the treatment of the items on the partnership return [*I.R.C. § 6222(a)*]; however, a partner's return may treat items inconsistently if a statement is filed with the IRS identifying the inconsistently treated items [*I.R.C. § 6222(b)(1)*; *see [5], below*].

[3] Tax Matters Partner (TMP)

[a] Designation of TMP

The partnership designates a tax-matters partner (TMP) to represent it; the TMP has notification responsibilities to the partners and the IRS and the actions of the TMP may bind the partnership and certain partners [*I.R.C. § 6231(a)(7)*; *see [b]-[d], below*]. A partner is eligible to be the TMP for a taxable year if either the partner was a general partner at some time during that year or is a general partner when the designation is made [*Treas. Reg. § 301.6231(a)(7)-1(b)*].

If the partnership fails to designate a TMP, ordinarily the general partner with the largest interest in partnership profits at the close of the taxable year automatically becomes the TMP. If the partnership has more than one such partner, the first such partner alphabetically is designated the TMP [*I.R.C. § 6231(a)(7)(B)*; *Treas. Reg. § 301.6231(a)(7)-1(m)(2)*]. If the partnership has not designated a tax matters partner and it is impracticable [*see Treas. Reg. § 301.6231(a)(7)-1(o)* (determination of impracticability)] to apply the largest-profits-interest rule, the Commissioner will select a tax matters partner [*I.R.C. § 6231(a)(7)*; *Treas. Reg. § 301.6231(a)(7)-1(n), (p)*]. Within 30 days of that selection, the Secretary must notify all partners entitled to notice [*see I.R.C. § 6223(a)*] of the name and address of the selected TMP [*I.R.C. § 6231(a)(7)*; *see Treas. Reg. § 301.6231(a)(7)-1(r)*].

[b] Duty of TMP to Inform Partners

With some exceptions, the TMP must notify all partners by forwarding copies of the IRS notice that a partnership- level proceeding is beginning or that a final partnership administrative adjustment has been issued [Temp. Treas. Reg. § 301.6223(g)-1T(a)]. The TMP is also generally required to inform all partners of the following within 30 days [Temp. Treas. Reg. § 301.6223(g)-1T(b)(1)]:

- A closing conference with an examining agent;
- Any proposed adjustments, rights of appeal, and requirements for filing a protest;
- The time and place of an appeal conference;
- IRS acceptance of a settlement offer;
- A consent to extension of the period of limitation for all partners;
- The filing of a request for administrative adjustment on behalf of the partnership;
- The filing of a petition for judicial review;
- The filing of a notice of appeal regarding a judicial determination; or
- A final judicial redetermination.

[c] Duty of TMP to Inform IRS

On receiving notice of a partnership-level proceeding for a partnership year, the TMP is required to furnish the IRS with the name, address, profits interest, and taxpayer identification number of each person who was a partner at any time during the year if that information is not on the partnership return [*I.R.C. § 6230(e)*; Temp. Treas. Reg. § 301.6230(e)-1T(a)]. The TMP must also provide the IRS with revised or additional information upon discovery that information on the partnership return or otherwise furnished to the IRS is incorrect or incomplete [*I.R.C. § 6230(e)*;

Temp. Treas. Reg. § 301.6230(e)-1T(b)].

[d] When Action of TMP Binds Partnership and Partners

The partnership and certain partners are bound by the action of the TMP when the TMP extends the period of limitation for assessing tax on any partnership item or affected item for all partners [*I.R.C. § 6229(b)(1)(B)*]. Lacking a showing of fraud, malfeasance, or misrepresentation of fact, the partnership and certain partners will be bound by a settlement agreement entered into with the IRS by the TMP that expressly binds all partners other than notice partners or those that expressly deny the settlement authority of the TMP in a statement filed with the IRS at least 30 days before the agreement is reached [*I.R.C. § 6224(c)(3)*; Temp. Treas. Reg. § 301.6224(c)-1T(a)]. The partnership and partners are bound when the TMP files a request for administrative adjustment and asks that it serve as a substitute for treatment of partnership items on the partnership return [*I.R.C. § 6227(c)*; Temp. Treas. Reg. § 301.6227(c)-1T(a)] as well as when the TMP files a petition for judicial review of a final partnership administrative adjustment during the first 90 days after the IRS mails it or appeals a court decision regarding such an adjustment [*I.R.C. § 6226(a), (g)*].

[4] Partnership Level Treatment of Partnership Items

When a partner reports an item consistently with the partnership, the tax treatment of that partnership item is determined at the partnership level although any resulting tax liability is imposed individually on each partner [*see I.R.C. §§ 6221-6232*; Temp. Treas. Reg. § 301.6221-1T(a)]. Instead of proceeding with individual partner audits, the IRS generally can change that treatment only through a partnership-level proceeding [Temp. Treas. Reg. § 301.6221-1T(a)]. Unless the dispute is resolved during the proceeding, at the conclusion of the partnership-level proceeding the IRS issues a final partnership administrative adjustment (FPAA) containing its determination of the questionable partnership items [*see I.R.C. § 6223(a)*]. The TMP and other partners are then entitled to pursue judicial review [*I.R.C. § 6228*]. The partnership-level procedures do not apply to a partnership that elects not to be treated as a partnership [*see* Treas. Reg. § 1.6031-1(b)(1)] and a small partnership is exempt from the procedures if certain conditions are met and, therefore, must elect partnership-level treatment if it is desired [*I.R.C. § 6231(a)(1)(B)*; *see § 1E.122[1]*, Paragraph 3].

[5] Inconsistent Reporting by Partner

If a partner reports a partnership item inconsistently, the IRS may change the treatment to make it conform to the partnership's treatment of the item and can make an automatic computational adjustment of the partner's tax liability [*I.R.C. § 6222(c)*; Temp. Treas. Reg. § 301.6222(b)-2T(a)]. However, if the partner files a statement notifying the IRS of the inconsistent item [*see I.R.C. § 6222(b)*], the IRS must either conduct a partnership-level proceeding to determine proper treatment or classify all partnership items for the year as nonpartnership items not subject to partnership-level procedure [Temp. Treas. Reg. § 301.6222(b)-2T(a)]. If the inconsistency results from incorrect information received by the partner from the partnership, the partner may be treated as if a timely notification of the inconsistency were made [*I.R.C. § 6222(b)(2)*; Temp. Treas. Reg. § 301.6222(b)-3T(a)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partner Income & CreditsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsPartnership Tax Returns (IRC sec. 6031)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsPartnership Tax Returns (IRC sec. 6031)Information Returns



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
A. Federal Taxes
1. Income Taxes

1-1E California Legal Forms--Transaction Guide § 1E.12

§ 1E.12 Taxation of Corporation

[1] Filing Requirements

[a] C Corporation

The C corporation is a separate tax-paying entity [*see I.R.C. § 11(a)*]; it must, with few exceptions, file an income tax return, whether or not it has taxable income and regardless of the amount of its gross income [*I.R.C. § 6012(a)(2)*; *see I.R.C. §§ 6037(a)* (S corporation return), *6038A* (additional requirements for foreign owned corporations)]. The return is filed on IRS Form 1120 (U.S. Corporation Income Tax Return) or on a specialized version of that form. The return is due on the 15th day of the third month following the close of the corporation's taxable year [*I.R.C. § 6072(b)*]. Failure to file by the due date or extended due date can subject the corporation to penalties, as can failure to pay all of the tax that is shown to be due on the return when the return is filed [*see I.R.C. § 6651(a)*]. Penalties for failure to file can also be assessed against a corporation that files an insufficient return [*see I.R.C. §§ 6651*, *7203*; *Treas. Reg. § 1.6011-1(b)*].

[b] S Corporation

An S corporation is not a separate tax-paying entity; income, gain, loss, deductions, and credits are taxed to the shareholders [*see I.R.C. § 1363*]. Therefore, like a partnership, an S corporation must file an informational return [*I.R.C. § 6037(a)*]. The return is filed on IRS Form 1120-S. Any person who was a shareholder during the taxable year must be given a copy of the information shown on the return [*I.R.C. § 6037(b)*]. The information for the taxable year that is required by the return includes [*I.R.C. § 6037(a)*; *Treas. Reg. § 1.6037-1(a)*]: items of gross income; deductions; each shareholder's name, address, and stock holding; and the amount and date of any distributions to shareholders. The return must be filed on or before the 15th day of the third month following the close of the corporation's taxable year [*Treas. Reg. § 1.6037-1(b)*].

[c] First Tax Return

The corporation may adopt any permissible method of accounting for computing taxable income when filing its first

return [*Treas. Reg. § 1.446-1(e)(1)*]; the selected accounting method may not be changed unless the law changes or the corporation gets permission to change from the IRS [*I.R.C. § 446(e)*; *Treas. Reg. § 1.446-1(e)(2)*]. The original tax return must contain the selection of the tax year of the corporation [Temp. Treas. Reg. § 1.441-1T(b)(2)], as well as a statement of the assets received in incorporation [*Treas. Reg. § 1.351-3(b)*.

[2] Corporate Income Tax Rate

The first $50,000 of taxable income is taxed at a rate of 15 percent, the next $25,000 is taxed at a rate of 25 percent, and the balance up to $10 million is taxed at a rate of 34 percent. Taxable income exceeding $10 million is taxed at the rate of 35 percent [*I.R.C. § 11(b)*]. There is also a surtax of 5 percent on taxable income exceeding $100,000 (up to $11,750) and another 3-percent surtax on taxable income exceeding $15 million (up to $100,000) [*see I.R.C. § 11(b)*].

[3] Other Initial Filings

The corporation must obtain an employer identification number by filing IRS Form SS-4 (Application for Employer Identification Number) with the IRS [*see I.R.C. § 6109*]. An S corporation election must be filed on or before the fifteenth day of the third month of the corporation's current fiscal year to be effective for that year; an election may be made at any time during the year for the next succeeding taxable year [*I.R.C. § 1362(b)(1)*]. The election of S corporation status is usually made on IRS Form 2553 (Election by Small Business Corporation) [*see I.R.C. § 1362(a)*; *Treas. Reg. § 1.1362-6(a)(2)*]. Any tax shelter organizer must register the tax shelter no later than the day on which the first offering for sale of interests in the tax shelter occurs; registration is accomplished by filing IRS Form 8264 (Application for Registration of a Tax Shelter) with the IRS [*I.R.C. § 6111(a)(1)*; Temp. Treas. Reg. § 301.6111-1T, Q & A 1].

[4] Recordkeeping and Record Retention

The corporation must set up permanent records sufficient to establish the amount of gross income, deductions, credits, or other matters that are required to be shown on any tax return or information return [*I.R.C. § 6001*; *Treas. Reg. § 1.6001-1(a)*; *see Treas. Reg. § 1.446-1(a)(4)*]. The complex and varied recordkeeping requirements for corporate financial statements, federal and state regular income tax, federal alternative minimum tax, and federal earnings and profit calculations mandate obtaining professional help from a certified public accountant or other accounting or tax professional. Books and records should be retained as long as the contents may become material in the administration of any internal revenue law [*Treas. Reg. § 1.6001-1(e)*; *see § 1E.130*].

[5] Estimated Tax Payments

All C corporations are generally required to make quarterly payments of estimated tax for each taxable year; "tax" means the sum of the regular corporate income tax [*see I.R.C. §§ 11* (income tax), *801* (tax on life insurance companies), *1201(a)* (alternative tax on capital gains)], the corporate alternative minimum tax [*see I.R.C. § 55*], the environmental tax [*see I.R.C. § 59A*], and the tax imposed on transportation income of foreign corporations [*see I.R.C. § 887*], as reduced by any allowable credits and overpayments [*I.R.C. § 6655(g)(1)*]. S corporations must also make estimated tax payments with respect to anticipated federal tax liability attributable to certain types of income [*I.R.C. § 6655(g)(4)*; *see I.R.C. §§ 1374(a)* (built-in gains), *1375(a)* (excess net passive investment income)]; the requirements are generally the same as those for C corporations but there are differences [*see, e.g., I.R.C. § 6655(g)(4)(B)* (prior year safe harbor)]. Failure to pay, or underpayment, subjects the corporation to a penalty [*I.R.C. § 6655(a)*]. The penalty is calculated by applying the applicable corporate underpayment rate to the amount of each quarterly underpayment for the entire underpayment period [*I.R.C. § 6655*; *see I.R.C. § 6621(a)(2)* (corporate underpayment rate)]; no penalty is imposed if the amount of tax due for the year is less than $500 [*I.R.C. § 6655(f)*].

The amount of the corporation's estimated tax is calculated on IRS worksheet Form 1120-W (Corporation Estimated Tax); this form is not filed with the IRS [*see* IRS Form 1120-W, Instr.]. Estimated taxes are paid to an authorized

commercial bank depository with IRS Form 8109 (Federal Tax Deposit Coupon Book) [*see* IRS Form 8109, Instr.].

The IRS usually sends IRS Form 8109 to the taxpayer automatically when an application is made for an employer identification number [*see Treas. Reg. § 31.6302-1(i)(4)*]; IRS Form 4417-A (Request for Federal Tax Deposit Forms) also may be used to request IRS Form 8109 [*see* IRS Form 4417-A, Instr.].

[6] Alternative Minimum Tax (AMT) on Corporations

Corporations are subject to an alternative minimum tax (AMT) imposed on "alternative minimum taxable income" when the AMT would result in a higher amount of tax than the regular income tax [*see I.R.C. § 55*]. The AMT for corporations is imposed at a rate of 20 percent [*I.R.C. § 55(b)(1)(B)*] on alternative minimum taxable income reduced by the exemption amount of $40,000 [*I.R.C. § 55(d)(2)* and the alternative minimum tax foreign credit [*I.R.C. § 55(b)(1)(B)*]. The exemption amount is reduced by 25 cents for each $1 of alternative minimum taxable income that exceeds $150,000 [*I.R.C. § 55(d)(3)(A)*]. Alternative minimum taxable income is calculated by both making adjustments to regular taxable income [*see I.R.C. §§ 56, 58*] and adding items of tax preference to it [*I.R.C. § 55(b)(2)*; *see I.R.C. § 57*].

Effective for tax years beginning after 1997, small corporations are exempt from the alternative minimum tax. Specifically, a corporation's tentative minimum tax is zero for any taxable year if (1) the corporation met the $5 million gross receipts test [*see I.R.C. § 448(c)*] for its first taxable year beginning after December 31, 1996, and (2) the corporation would meet that test for the taxable year and all prior taxable years beginning after the first taxable year if the test were applied by substituting $7.5 million [*I.R.C. § 55(e)*].

For more detailed discussion of the alternative minimum tax, see *California Small Business Guide, Ch. 2, Preincorporation Tax Considerations, § 2.02[6]* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationAlternative Minimum Tax (IRC secs. 55-59)Tax LawFederal Income Tax ComputationTax AccountingGeneral OverviewTax LawFederal Income Tax ComputationTax AccountingTaxable Year (IRC secs. 441-444)DefinitionsTax LawFederal Tax Administration & ProcedureAdministrationIdentification Numbers & Information Returns (IRC secs. 6031-6065)General OverviewTax LawFederal Tax Administration & ProcedureAdministrationIdentification Numbers & Information Returns (IRC secs. 6031-6065)S Corporation ReturnsTax LawFederal Tax Administration & ProcedureAdministrationTax Payment & Tax Return Requirements (IRC secs. 6071-6091, 6151-6167)General OverviewTax LawFederal Taxpayer GroupsC CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsTax Accounting (IRC secs. 701-703, 706)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
A. Federal Taxes
1. Income Taxes

1-1E California Legal Forms--Transaction Guide § 1E.13

§ 1E.13 Taxation of Limited Liability Company

[1] Freedom to Choose Type of Tax Treatment

For income tax purposes, a limited liability company (LLC) may elect to be taxed as a corporation or as a partnership [*Treas. Reg. § 301.7701-3(a)*]. It seems likely that most LLCs will choose partnership tax treatment, in which the LLC is merely a pass-through tax entity, and the members pay tax on any LLC income.

Prior to 1997, the tax classification of an LLC was determined by weighing the number of corporate versus noncorporate characteristics possessed by the LLC [*see, e.g., Rev. Proc. 95-10* , § 4, *1995-1 C.B. 501* (now obsolete)]. These characteristics were (1) continuity of life; (2) centralized management; (3) limited liability for the obligations of the business; and (4) free transferability of interests. If partnership tax treatment was desired, it was important to structure the LLC so that at least some of these corporate characteristics were avoided.

This, however, is no longer the case. Under liberalized classification rules that took effect on January 1, 1997, an LLC with two or more members may elect to be taxed either as a corporation or as a partnership. An LLC with a single owner (i.e., a qualifying trust) may elect either to be taxed as a corporation or to be disregarded as an entity separate from its owner [*Treas. Reg. § 301.7701-3(a)*]. If an LLC does not make an election, it will be taxed as a partnership if it has two or more members, or will be disregarded as an entity separate from its owner if it has only one member [*Treas. Reg. § 301.7701-3(b)(1)*]. Note that existing LLCs that do not make an election will retain the classification that they would have claimed under the pre-1997 regulations if (1) the LLC had a reasonable basis for its claimed classification, (2) the LLC and all its members recognized the federal tax consequences of any change in the entity's classification within the 60 months before January 1, 1997, and (3) neither the LLC nor any member was notified in writing on or before May 8, 1996, that the classification of the entity was under examination [*Treas. Reg. § 301.7701-3(b)(3), (n)(2)*].

For California tax purposes, tax determinations regarding LLCs will be consistent with IRS determinations [Corp. Code § 23038(b)(ii); FTB *Notice 92-5*]. LLCs are subject to the annual minimum franchise tax [*Rev. & Tax. Code §§ 17941, 23153*] and must pay a graduated entity level fee based on total income from all sources reportable to California [*Rev. &*

Tax. Code § 17942 (fee applicable to income of $250,000 or more)]. However, LLCs that are exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that are not taxed as a corporation for California tax purposes are not subject to the annual minimum tax or the graduated fee [*see Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; *see also I.R.C. § 501(c)(2), (25)* (title holding companies)].

[2] Treatment as Partnership for Income Tax Purposes

[a] Advantage of Partnership Tax Treatment

If desired, an LLC will receive pass-through income tax treatment essentially like that of a partnership. Partnership income is taxed only once, at the partner level, not the partnership level. Partnership tax treatment avoids the double taxation attributable to corporations that are not S corporations; that is, taxation once on the corporate earnings and again on shareholders' dividends. It also allows other tax benefits as contrasted not only with corporations but also, in a few respects, with partnerships.

[b] California Tax Treatment

California generally conforms to the federal entity classification rules under *Treas. Reg. § 301.7701-2* [*see Rev. & Tax. Code § 23038*; *see also* FTB *Notice 92-5*]. The classification of a business entity as an association taxable as a corporation is determined under FTB regulations, which must be consistent with the federal regulations in effect on January 1, 1997, that classify a business entity as a partnership or an association taxable as a corporation, or disregard the separate existence of the business entity [*Rev. & Tax. Code § 23038(b)(2)(B)(i)*]. The classification of an eligible business entity as a partnership or an association taxable as a corporation is the same as the classification of the entity for federal tax purposes; if the separate existence of the LLC is disregarded for federal tax purposes (for example, because the LLC has a single owner), the separate existence will be disregarded for California purposes [*Rev. & Tax. Code § 23038(b)(2)(B)(ii), (iii)*]. However, if an eligible business entity was properly classified as an association taxable as a corporation for any income year beginning with the 60-month period preceding January 1, 1997, the entity continues to be an association taxable as a corporation until it elects to be classified the same as the entity is classified for federal purposes; this rule does not apply to any entity that was not doing business in California, did not derive income from California, and had no California resident owner during the 60-month period preceding January 1, 1997 [*Rev. & Tax. Code § 23038(b)(2)(C)*].

[c] Tax Matters Member

Under federal partnership taxation law, a partnership must have a "tax matters partner" (TMP) to act as a liaison between the partnership and the IRS on tax issues [*see I.R.C. § 6231(a)(7)*; *see also Treas. Reg. § 301.6231(a)(7)-1*]. Among other responsibilities, the TMP gives notice to the other partners of tax proceedings, makes tax decisions that bind the other partners, and petitions the IRS for readjustments [*see I.R.C. §§ 6223(g), 6224(c)(3), 6226(a)*; *§ 1E.11[3]*].

The TMP of a partnership is either (1) the general partner designated as the tax matters partner, or (2) if no such partner is designated, the general partner having the largest profits interest in the partnership at the close of the taxable year. If there is more than one such partner, the first such partner alphabetically is the TMP [*I.R.C. § 6231(a)(7)*]. If the partnership has not designated a tax matters partner and it is impracticable [*see Treas. Reg. § 301.6231(a)(7)-1(o)* (determination of impracticability)] to apply the largest-profits-interest rule, the Commissioner will select a tax matters partner [*I.R.C. § 6231(a)(7)*; *Treas. Reg. § 301.6231(a)(7)-1(n), (p)*]. Within 30 days of that selection, the Secretary must notify all partners entitled to notice [*see I.R.C. § 6223(a)*] of the name and address of the selected TMP [*I.R.C. § 6231(a)(7)*; *see Treas. Reg. § 301.6231(a)(7)-1(r)*]. The person designated as TMP must be, or have been, a general partner during the taxable period in question [*Treas. Reg. § 301.6231(a)(7)-1(b)(1)*; *§ 1E.11[3][a]*].

Following from the partnership tax laws, an LLC taxed as a partnership presumably must have a "tax matters member,"

whose responsibilities would be similar to those of a tax matters partner. An LLC may wish to designate a tax matters member in its operating agreement rather than risk having the IRS choose one.

[3] Limited Liability Company as Accounting Entity for Income Taxation of Members

If an LLC is taxed as a partnership for federal and California income tax purposes [*see [1], above*], it will be taxed under the partnership taxation statutes and regulations. The basic premise of Subchapter K (partnership provisions) of the Internal Revenue Code (applicable to qualifying LLCs) [*see I.R.C. § 701* et seq.] is that the LLC is merely an accounting entity for determining items of income and loss that are to be allocated to individual taxpayers (the members of the LLC). The members of the LLC, not the LLC itself, are liable for tax on any LLC income [*see I.R.C. § 701*; *see also [4], below*].

Though an LLC is not treated as a tax-paying entity, it does make its own elections related to accounting, including choosing a taxable year, which generally must be the same as that of its principal members [*see I.R.C. §§ 703(b), 706*]. The Internal Revenue Code provides methods for determining the taxable year of an LLC [*see I.R.C. §§ 444, 706(b)*].

For California purposes, taxation of LLCs treated as partnerships is generally determined in accordance with Subchapter K of the Internal Revenue Code [*Rev. & Tax. Code § 17851*; *see I.R.C. § 701* et seq.]. However, there are certain California modifications [*see Rev. & Tax. Code § 17853 et seq.*].

[4] Income Taxation of Members of Limited Liability Company

If taxed as a partnership, an LLC is not a federal income taxpayer. Instead, the members, not the LLC, are taxed on income earned by the LLC [*I.R.C. § 701*]. The main purpose of partnership income tax law [*see I.R.C. § 701* et seq.] is to allocate income and loss (and certain other items) to the members for use in preparing their individual tax returns. Another chief purpose is to determine the tax consequences of members' contribution of assets to the LLC.

For further coverage of LLC taxation, see Ch. 12C, *Limited Liability Companies* . For detailed coverage of the taxation of partnerships and partners, see Ballantine & Sterling, California Corporation Laws, Ch. 26, *Income Taxation of Partnerships* (Matthew Bender).

[5] Requirement to File Federal Tax Return

An LLC classified as a partnership for federal tax purposes must file a partnership return [*see* Treas. Reg. § 1.6031-1(a)], as well as related schedules and other forms. For a procedural guide to completing and filing federal LLC tax forms, see Ch. 12C, *Limited Liability Companies* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Tax Administration & ProcedureAdministrationTax Payment & Tax Return Requirements (IRC secs. 6071-6091, 6151-6167)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral OverviewTax LawState & Local TaxesIncome TaxPartnerships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
A. Federal Taxes
1. Income Taxes

1-1E California Legal Forms--Transaction Guide §§ 1E.14-1E.19

[Reserved]

§§ 1E.14[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
A. Federal Taxes
2. Federal Withholding and Employment Taxes

1-1E California Legal Forms--Transaction Guide § 1E.20

§ 1E.20 Federal Income Tax Withholding

[1] In General

Federal income taxes must be withheld by employers from employees' wages and paid to the IRS; the annual tax liability of the employee determines the amount withheld [*see I.R.C. §§ 3401-3403*]. Income tax withholding applies only to "covered employment"; however, covered employment includes all but employment specifically excluded by statute such as that of certain agricultural workers [*see I.R.C. §§ 3401(a)(2), 3121(a)(8)*], crew members on small fishing boats [*see I.R.C. §§ 3401(a)(17), 3121(b)(20)*], and minors delivering newspapers [*see I.R.C. §§ 3401(a)(10)(A), 3121(b)(14)(A)*].

[2] Definitions for Federal Income Tax Withholding Purposes

[a] Employer

An "employer" is the one for whom an individual performs services as an employee [*I.R.C. § 3401(d)*]. The employer is the one who controls payment of wages [*I.R.C. § 3401(d)(1)*].

[b] Employee

An individual is an "employee" if the individual is either a corporate officer or a common law employee [*I.R.C. § 3401(c)*; *Treas. Reg. § 31.3401(c)-1*]. An individual generally is a common law employee if the person for whom services are performed has the right to control and direct the performance, not only as to the result to be accomplished, but also as to the details and means by which that result is accomplished [*Treas. Reg. § 31.3401(c)-1(b)*]. In doubtful cases, the facts will be examined to determine whether or not an employer-employee relationship exists [*Treas. Reg. § 31.3401(c)-1(d)*]; and, if that relationship is found to exist, the designation of the employee by the parties as something else, such as an independent contractor, is immaterial [*Treas. Reg. § 31.3401(c)-1(e)*]. If the individual performing services is not a common law employee, that individual is an independent contractor [*see § 1E.110* (classification of worker as employee or independent contractor)].

[c] Wages

"Wages" are all remuneration for services performed by an employee for the employer, and include the cash value of any remuneration paid in any medium other than cash, unless specifically excluded by statute [*I.R.C. § 3401(a)*]. The name given to the remuneration for services is immaterial: salaries, fees, bonuses, and commissions are wages if paid as compensation for services by the employee for the employer [*Treas. Reg. § 31.3401(a)-1(a)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsTips, Wages & Other Compensation (IRC secs. 61, 3121, 3231)WagesTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FICA DeductionsTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FUTA Rate of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
A. Federal Taxes
2. Federal Withholding and Employment Taxes

1-1E California Legal Forms--Transaction Guide § 1E.21

§ 1E.21 Federal Employment Taxes

[1] In General

Two kinds of federal employment taxes are computed as a percentage of employees' wages up to a maximum wage base: FICA (social security and medicare) taxes and FUTA (federal unemployment) taxes [*see I.R.C. §§ 3111, 3121(a)(1), (2), 3301, 3306(b)(1)*]. FICA taxes are imposed equally on both the employer and employee [*I.R.C. §§ 3101, 3111*]; the employer must withhold FICA taxes from the employee's wages and pay that amount to the IRS along with the employer's payment [*I.R.C. § 3102*]. FUTA taxes are imposed on the employer [*see I.R.C. § 3301*]. Both kinds of tax apply only to covered employment which includes just about all employment except for some specific statutory exceptions [*see, e.g., I.R.C. § 3121(a)(7)(C)* (casual labor), *(b)(20)* (fishermen receiving share of catch as compensation)].

[2] Types of Federal Employment Taxes

[a] FICA Taxes

The FICA (Federal Insurance Contribution Act) tax consists of the social security tax and the medicare tax [*see I.R.C. § 3111(a)* (social security tax), (b) (medicare tax)]. The tax is calculated as a percentage of wages up to a specified maximum known as the "contribution base" [*see I.R.C. §§ 3101(a), (b), 3111(a), (b)*]. The social security tax rate is 6.2 percent [*I.R.C. §§ 3101(a), 3111(a)*]. and the medicare tax rate is 1.45 percent [*I.R.C. §§ 3101(b), 3111(b)*]. Each employee must contribute an amount that matches the employer's FICA tax obligation for that employee; the employer must collect the employee contributions and deposit them for each employee's benefit [*I.R.C. §§ 3101, 3102*]. A sole proprietor is subject to self-employment tax in place of FICA taxes on employees [*see I.R.C. §§ 1401, 1402; § 1E.10 [3]*].

[b] FUTA Taxes

The unemployment tax is imposed only on employers [*I.R.C. § 3301; Treas. Reg. § 31.3301-1(a)*]. The tax rate is 6.2

percent of the first $7,000 in wages paid to an employee [*I.R.C. §§ 3301(1), 3306(b)(1)*]. However, if an employer contributes to an approved state unemployment compensation plan, this contribution operates as a credit against the FUTA tax [*I.R.C. § 3302*].

[3] Definitions for Federal Employment Tax Purposes

[a] Employer

For FICA tax purposes, the definition of employer is generally the same as for income tax withholding [*see § 1E.20[2][a], above*]. For FUTA tax purposes, an employer is one who either paid wages of $1,500 or more during any calendar quarter or had at least one individual as an employee for some part of a day in each of 20 different calendar weeks [*I.R.C. § 3306(a)(1)*; *but see I.R.C. § 3306(a)(2)* (agricultural labor), *(3)*(domestic service)].

[b] Employee

For both FICA and FUTA tax purposes, employees include corporate officers, common law employees, and statutory employees [*I.R.C. § 3121(d)*]. A common law employee is the same for FICA and FUTA purposes as for income tax withholding [*see § 1E.20[2][b], above*]. Statutory employees for FICA and FUTA tax purposes include the following [*I.R.C. § 3121(d)(3)*]:

- Agent-drivers or commission-drivers engaged in distributing meat, vegetable, or bakery products, beverages other than milk, or laundry or dry cleaning services;
- Full-time life insurance salespersons;
- Home workers performing work, according to the specifications of the person for whom the work is performed, on materials furnished by that person that must be returned to that person; and
- Traveling or city salespersons engaged full-time in soliciting on behalf of and transmitting to a principal orders from sellers for merchandise for resale or supplies.

However, home workers and full-time life insurance salespersons are not included for FUTA tax purposes unless certain specific circumstances apply [*see I.R.C. § 3306(i)*].

[c] Wages

The definition of wages for FICA and FUTA tax purposes is substantially the same as for income tax withholding purposes [*cf. I.R.C. §§ 3121(a), 3306(b)*; *see § 1E.20[2][c]*]. Wages includes all remuneration for employment, including the cash value of benefits or other remuneration paid by a medium other than cash, unless specifically excluded by statute [*I.R.C. § 3121(a)*; *see I.R.C. §§ 3306(b)(1)-(16)* (exclusions from FUTA wages), *3121(a)(1)-(21)*(exclusions from FICA wages)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsTips, Wages & Other Compensation (IRC secs. 61, 3121, 3231)WagesTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)DefinitionsTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FICA DeductionsTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FUTA Rate of

TaxTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)Self-Employment Contributions ActTax LawFederal Taxpayer GroupsIndividualsSelf-Employment (IRC secs. 164, 1401-1403, 6017)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
A. Federal Taxes
2. Federal Withholding and Employment Taxes

1-1E California Legal Forms--Transaction Guide § 1E.22

§ 1E.22 Reporting of Federal Withholding and Employment Taxes

[1] IRS Form 941 (Employer's Quarterly Federal Tax Return)

Each quarter, starting with the quarter in which taxes are first withheld, the employer must file a report of income taxes withheld from employee wages and employer and employee portions of social security and medicare taxes [*see Treas. Reg. § 31.6011(a)-4*; IRS Form 941, Instr.]. The report is filed on IRS Form 941 (Employer's Quarterly Federal Tax Return) except in limited cases including [*see Treas. Reg. §§ 31.6011(a)-4(a)(1)*--(3), 31.6011(a)-4T(a)(4)]:

- An employer that only withholds income tax [*see* IRS Form 941-E (Quarterly Return of Withheld Federal Income Tax and Hospital Insurance Tax)].

- Certain employers of household workers [*see* IRS Form 942 (Employer's Quarterly Tax Return for Household Employees (for Social Security and Withholding Income Tax))].

- Certain employers of agricultural workers [*see* IRS Form 943 (Employer's Annual Tax Return for Agricultural Employees (for Social Security Taxes and Withheld Income Tax))].

- An employer that has been notified in writing by the IRS that it qualifies for the Employers' Annual Federal Tax Program and therefore must file IRS Form 944 (Employer's ANNUAL Federal Tax Return) instead of IRS Form 941.

The employer must continue to file IRS Form 941 for each calendar quarter, whether or not wages are paid in that quarter, until the employer makes a final return [*Treas. Reg. § 31.6011(a)-4*].

[2] IRS Form W-2 (Wage and Tax Statement)

Employers must report each employee's amount of wages, withholding, and deductions to the employee and to the Social Security Administration [*I.R.C. § 6051*; *Treas. Reg. §§ 31.6051-1(a)(1), 31.6051-2*]. The report is made on IRS

Form W-2 (Wage and Tax Statement) and sent to the government using IRS Form W-3 (Transmittal of Income and Tax Statement) [*see I.R.C. § 6051*; *Treas. Reg. § 31.6051-2*].

[3] IRS Form 940 (Employer's Annual Federal Unemployment (FUTA) Tax Return)

FUTA taxes are reported on IRS Form 940 (Employer's Annual Federal Unemployment (FUTA) Tax Return) on a calendar year basis [*see* IRS Form 940, Instr.]. The form is due January 31, unless the employer makes a full deposit of the FUTA taxes due, in which case the deadline for filing is February 10 [*see* IRS Form 940, Instr.; *Treas. Reg. § 31.6011(a)-4*]. The employer must continue to file IRS Form 940 for each year, whether or not wages are paid in that year, until the employer makes a final return [*see Treas. Reg. § 31.6011(a)-6(a)(3)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesCollection (IRC secs. 6301-6317)Methods & TimingTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)General OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FICA DeductionsTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FUTA Rate of Tax



17 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
A. Federal Taxes
2. Federal Withholding and Employment Taxes

1-1E California Legal Forms--Transaction Guide § 1E.23

§ 1E.23 Payment by Deposit of Federal Withholding and Employment Taxes

The employer has a duty to deposit income tax withheld from employees' wages at an authorized depository [*see I.R.C. §§ 3402(a)(1), 6302(c)*]. FICA and FUTA taxes must also be paid by deposit [*see I.R.C. § 6302(c)*; *Treas. Reg. § 31.6302-1(e)*]. The deposits are made with IRS Form 8109 (Federal Deposit Coupon Book) [*Treas. Reg. § 31.6302-1(i)(3)*]. Generally, deposits must be made either monthly or semi-weekly based on an annual determination of the aggregate amount of employment taxes (including withheld income tax) reported by the employer in the "lookback period," which is the 12-month period ending on June 30 of the preceding calendar year [*Treas. Reg. § 31.6302-1(a), (b)*]. An employer is a monthly depositor for the calendar year if the amount of taxes reported for the lookback period is $50,000 or less; if the amount exceeds $50,000, the employer is a semi-weekly depositor [*Treas. Reg. § 31.6302-1(b)(2), (3)*]. Special rules apply when an employer has accumulated $100,000 or more of employment taxes [*Treas. Reg. § 31.6302-1(c)(3)*]. The employer's tax account is identified by the employer identification number previously obtained from the IRS [*see Treas. Reg. § 31.6011(b)-1*; *see also § 1E.10*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsTips, Wages & Other Compensation (IRC secs. 61, 3121, 3231)WagesTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)General OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)Liability for Tax



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
A. Federal Taxes
2. Federal Withholding and Employment Taxes

1-1E California Legal Forms--Transaction Guide § 1E.24

§ 1E.24 Other Federal Reporting Requirements

[1] Report of Payment to Independent Contractor

The business must generally report payments over $600 per year made to any independent contractor [*I.R.C. § 6041A*]. An "independent contractor" performs work or services for the business, is paid by the business, but is not an employee of the business [*Treas. Reg. § 31.3401(c)-1*]. The report is usually made on IRS Form 1099 MISC (Miscellaneous Income) with the IRS Form 1096 (Annual Summary and Transmittal of U.S. Information Returns) transmittal form enclosed [*see* IRS Form 1099 MISC, Instr.].

[2] Report of Cash Receipts Exceeding $10,000

If more than $10,000 in cash in one transaction or in two or more related transactions is received in the course of trade or business, an information return must be filed with the IRS on IRS Form 8300 (Report of Cash Payments Over $10,000 Received in a Trade or Business) [*I.R.C. § 6050I(a)*]. The return is due by the 15[th] day after the cash is received [*Treas. Reg. § 1.6050I-1(e)*]. The penalty for intentional disregard of the reporting requirement is the greater of $25,000 or the amount of cash received in the transaction (up to $100,000) [*I.R.C. § 6721(e)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationTax AccountingGeneral OverviewTax LawFederal Tax Administration & ProcedureAdministrationIdentification Numbers & Information Returns (IRC secs. 6031-6065)Information at SourceTax LawFederal Tax Administration & ProcedureAdministrationIdentification Numbers & Information Returns (IRC secs. 6031-6065)Returns for Cash Received in Trade & Business



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
A. Federal Taxes
2. Federal Withholding and Employment Taxes

1-1E California Legal Forms--Transaction Guide §§ 1E.25-1E.49

[Reserved]

§§ 1E.25[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
1. State Income Taxes

1-1E California Legal Forms--Transaction Guide § 1E.50

§ 1E.50 Taxation of Sole Proprietorship

As for federal income tax purposes, the taxability of business income and the deductibility of business losses are determined on the sole proprietor's individual return [*see Rev. & Tax. Code §§ 17071, 17072*]. California also imposes an alternative minimum tax on individuals [*see Rev. & Tax. Code § 17062*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawSole ProprietorshipsTax LawFederal Taxpayer GroupsIndividualsGeneral OverviewTax LawState & Local TaxesMinimum Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
1. State Income Taxes

1-1E California Legal Forms--Transaction Guide § 1E.51

§ 1E.51 Taxation of Partnership

[1] Partnership Return

Every partnership that engages in a trade or business in California or that has income from California sources must file an informational California partnership return on FTB Form 565 (Partnership Return of Income) for each taxable year stating specifically the items of gross income and deductions [*Rev. & Tax. Code § 18633(a)(1)* (partnerships), *(2)* (limited partnerships)]. The return also must include the names, addresses, and taxpayer identification numbers of the partners, whether they are residents or nonresidents, and the amount of their distributive shares [*Rev. & Tax. Code § 18633(a)*]. An election, such as partnership tax year or method of depreciation, properly made for federal tax purposes is deemed a proper election for California tax purposes [*Rev. & Tax. Code § 17024.5(e)(1)*]; a separate election to obtain other tax treatment for California purposes may be filed, but only when that election is expressly authorized by statute or regulation [*see Rev. & Tax. Code § 17024.5(e)(3)*]. The return is due by the 15[th] day of the fourth month following the close of the partnership's taxable year [*Rev. & Tax. Code § 18633(a)*]. The partnership must supply a copy of the return to each partner, as well as any person who holds an interest as a nominee for another at any time during the taxable year, on or before the day the return is due [*Rev. & Tax. Code § 18633(b)*].

[2] Franchise Tax on Limited Partnerships

Any limited partnership doing business in California, and required to file a FTB Form 565 return in California, is subject to the minimum franchise tax for the privilege of doing business in California [*Rev. & Tax. Code § 17935(a)*; *see Rev. & Tax. Code § 23153* (minimum franchise tax)]. A limited partnership is any partnership formed by two or more persons under the laws of California or any other jurisdiction and having one or more general partners and one or more limited partners [*Rev. & Tax. Code § 17935(d)*]. The amount of the minimum franchise tax imposed on partnerships is equal to the amount of that tax imposed on corporations [*Rev. & Tax. Code §§ 17935(a), 23153*].

[3] Withholding Tax on Distributions to Partners

[a] Withholding Based on Partner's Status

[i] Resident Partners

The partnership is not required to withhold on distributions made to a California resident partner if that partner has filed an exemption certificate with the FTB [18 Cal. Code Reg. § 18805-7(a)]. This certificate is FTB Form 590 (Withholding Exemption Certificate).

[ii] Nonresident Domestic Partners

After notification by the FTB, a partnership engaged in a trade or business in California or with income from California sources must withhold at a rate of 7 percent on all distributions of income to domestic nonresident partners [*see Rev. & Tax. Code §§ 18622, 18668*; 18 Cal. Code Reg. §§ 18662-1, *18662-2, 18662-3(a), 18662-11*; FTB *Notice 90-5 (Aug 20, 1990)*]. A domestic nonresident partner is an individual who is a U.S. citizen or resident who does not reside in California; a domestic nonresident partnership, estate, or trust; or a U.S. corporation without a permanent place of business in California and not qualified to do business in California [*see* 18 Cal. Code Reg. §§ 18662-1, *18662-11*; FTB *Notice 90-5 (Aug 20, 1990)*]. The partnership is not required to withhold until total distributions to the same domestic nonresident partner exceed $1,500 in cash and property during a calendar year [18 Cal. Code Reg. § 18662-1].

[iii] Foreign Partners

Any partnership that has taxable income derived from California sources that is effectively connected to a U.S. trade or business is also required to withhold on the portion of that California income allocable to a foreign partner [*Rev. & Tax. Code § 18666*]. The federal guidelines and rules for withholding under these circumstances are directly applicable for California purposes [*see Rev. & Tax. Code § 17024.5*; *Rev. Proc. 89-31, 1989-1 C.B. 895* (federal withholding requirements)].

[b] Withholding Returns and Payment

FTB Form 598-A (Partnership Withholding Tax Payment), along with the amount withheld, must be sent to the FTB within 20 days following the last day of the month that the total amount withheld from all sources exceeds $2,500 [18 Cal. Code Reg. § 18805-8]. By January 31 of the year following the taxable year in question, the partnership must file both FTB Form 598 (Annual Return for Tax Withheld on Foreign and Domestic Nonresident Partners) which reports the total partnership withholding and FTB Form 598-B (Report of Tax Withheld on Foreign and Domestic Nonresident Partners) which reports income, distributions, and tax payments to each nonresident domestic partner [FTB *Notice 90-5 (Aug 20, 1990)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Tax Administration & ProcedureAdministrationIdentification Numbers & Information Returns (IRC secs. 6031-6065)Partnership Income ReturnsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsPartnership Tax Returns (IRC sec. 6031)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsPartnership Tax Returns (IRC sec. 6031)Information ReturnsTax LawState & Local TaxesFranchise TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
1. State Income Taxes

1-1E California Legal Forms--Transaction Guide § 1E.52

§ 1E.52 Taxation of Corporations

[1] Types of Tax Imposed on Corporations

[a] Franchise Tax

A corporation, other than a bank or an expressly exempt corporation, must pay an annual franchise tax to California for the privilege of doing business in California [*Rev. & Tax. Code § 23151*; *see Rev. & Tax. Code § 23101.5* (activities excluded from franchise tax)]. For taxable years beginning on or before December 31, 2010, "doing business in California" means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit [*Rev. & Tax. Code § 23101(a)*]. For taxable years beginning on or after January 1, 2011, a taxpayer is "doing business in California" if any of the following conditions has been satisfied [*Rev. & Tax. Code § 23101(b)*]:

1. The taxpayer is organized or commercially domiciled in California;

2. The taxpayer's sales in California for the taxable year exceed the lesser of $500,000 or 25 percent of the taxpayer's total sales [*see Rev. & Tax. Code §§ 25101(b)(2), 25120(e), (f)* (determination of "sales")];

3. The taxpayer's real property and tangible personal property in California exceed the lesser of $50,000 or 25 percent of the taxpayer's total real property and tangible personal property [*see Rev. & Tax. Code § 25101(b)(3)* (determination of property value)]; or

4. The amount the taxpayer paid in California for compensation exceeds the lesser of $50,000 or 25 percent of the total compensation paid by the taxpayer [*see Rev. & Tax. Code §§ 23101(b)(4), 25133, 25137* (rules for determining compensation)].

The amounts described in 2.-4., above, are subject to annual revision [*see Rev. & Tax. Code § 23101(c)*]. The taxpayer's sales, property, and payroll include the taxpayer's pro rata or distributive share of a partnership or S corporation [*Rev. & Tax. Code § 23101(d)*].

The franchise tax is based on the corporation's net income for that taxable year and is imposed on general corporations at the rate of 8.84 percent [*Rev. & Tax. Code § 23151(a), (e), (f)*; *see Rev. & Tax. Code § 23181* (rate for banks and financial corporations)]. The franchise tax is imposed on S corporations at the rate of 1.5 percent [*Rev. & Tax. Code § 23802(b)(1)*].

With limited exceptions, a minimum franchise tax is imposed on corporations until the later of either (1) the effective date of dissolution or withdrawal, or (2) the date the corporation ceases to do business in California [*Rev. & Tax. Code §§ 23153(a), (d)(1), 23181*]. The minimum franchise tax is imposed on S corporations [*Rev. & Tax. Code §§ 23153, 23802(c)*]. However, corporations that incorporate or qualify to do business in California after January 1, 2000, are not subject to the minimum franchise tax for the first taxable year, unless the corporation reorganized solely to avoid payment of the minimum franchise tax [*Rev. & Tax. Code § 23153(f)(1), (3)*; *see Rev. & Tax. Code § 23153(f)(2)* (exemption inapplicable to qualified Subchapter S subsidiaries)].

[b] Corporate Income Tax

A corporate income tax is imposed on foreign corporations at the same rate as the franchise tax [*Rev. & Tax. Code § 23501*]. The corporate income tax is imposed on S corporations at the rate of 1.5 percent [*Rev. & Tax. Code § 23802(b)(1)*]. The tax is imposed on net income derived from sources within California, except to the extent that such income is subject to the franchise tax [*Rev. & Tax. Code § 23501*]; taxes paid under the franchise tax may be offset against amounts owing under the income tax [*Rev. & Tax. Code § 23503*]. See Ballantine & Sterling, California Corporation Laws, Ch. 22, *Corporate Franchise and Income Taxes in California* (Matthew Bender), for a discussion of the special tax problems of multijurisdictional taxpayers.

[c] Corporate Alternative Minimum Tax

California's alternative minimum tax (AMT) is imposed on corporations at the rate of 7 percent applied to the amount of a corporation's alternative minimum taxable income as exceeds the exemption amount [*Rev. & Tax. Code §§ 23400, 23455*]; a higher rate may be applied to banks [*Rev. & Tax. Code § 23455(a)(4)*]. The California AMT does not apply to California S corporations [*Rev. & Tax. Code § 23400(b)*]. If a corporation's California AMT exceeds the corporation's regular tax liability, that excess is payable in addition to the regular tax [*Rev. & Tax. Code §§ 23400, 23455*]; "regular tax" is the California franchise tax, corporate income tax, or tax on unrelated business income of exempt organizations [*Rev. & Tax. Code § 23455(c)*]. With some modifications, California has incorporated by reference federal AMT provisions [*Rev. & Tax. Code §§ 17024.5(a)(1), 23051.5(a), 23400(a)*; *see I.R.C. §§ 55-57*(federal AMT); *Rev. & Tax. Code §§ 23453-23459* (California modifications)].

[2] Returns and Payment

Returns must be filed on the form prescribed by the FTB within two months and 15 days after the close of the corporation's taxable year [*Rev. & Tax. Code § 18601(a)*; *see Rev. & Tax. Code § 18409* (returns on magnetic media or in other machine-readable form)]. The tax must be paid no later than the time set for filing of the return [*Rev. & Tax. Code § 19001*; *see Rev. & Tax. Code § 19021* (special rules for banks and financial corporations)]. Extensions for filing, of up to seven months, may be permitted by the FTB; the filing extension does not extend the time for payment [*Rev. & Tax. Code §§ 18604, 19001*].

Unless payment by electronic funds transfer is required [*see Rev. & Tax. Code § 19011*], payment made be made by check or, with FTB approval, in the form of a credit account number and authorization to draw on the specified account [*Rev. & Tax. Code § 19005*]. A taxpayer may request permission to make payment by electronic funds transfer [*Rev. & Tax. Code § 19011(a)(3)*].

[3] Estimated Tax Payments

All corporations within California must make estimated tax payments during the tax year in an amount based on estimated income, including tax preference income, for the period [*see Rev. & Tax. Code §§ 19023-19026.2*]. Penalties are imposed for the underpayment of estimated tax [*see Rev. & Tax. Code §§ 19142-19149*]. Estimated tax payments are made in four installments due on or before the 15th day of the fourth, sixth, ninth, and 12th months of the tax year [*Rev. & Tax. Code § 19025(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxGeneral OverviewBusiness & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsFinanceFranchise TaxComputationTax LawFederal Income Tax ComputationGeneral OverviewTax LawFederal Income Tax ComputationAlternative Minimum Tax (IRC secs. 55-59)Tax LawFederal Taxpayer GroupsS CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)EffectsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
1. State Income Taxes

1-1E California Legal Forms--Transaction Guide § 1E.53

§ 1E.53 Taxation of Limited Liability Companies

[1] Partnership Tax Treatment

For California purposes, taxation of LLCs treated as partnerships is generally determined in accordance with Subchapter K of the Internal Revenue Code [*Rev. & Tax. Code § 17851*; *see I.R.C. § 701 et seq.*]. However, there are certain California modifications [*see Rev. & Tax. Code § 17853 et seq.*; *see also Rev. & Tax. Code § 17941 et seq.*].

[2] Franchise Tax

In general, every LLC that is doing business in California and that is required to file a California tax return [*see Rev. & Tax. Code § 18633.5*] must pay an annual minimum franchise tax of $800 for the privilege of doing business in California [*Rev. & Tax. Code §§ 17941(a), 23153(d)(1)*]. In addition to LLCs that are doing business in California (and are therefore subject to the franchise tax), all other LLCs must pay this tax annually if articles of organization have been accepted for filing, or a certificate of registration has been issued, by the Secretary of State's office. The tax must be paid for each taxable year (or partial taxable year) until a certificate of cancellation of articles of organization (domestic LLCs) or a certificate of cancellation of registration (foreign LLCs) is filed with the Secretary of State on behalf of the LLC [*Rev. & Tax. Code § 17941(b)(1)*]. However, an LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax [*see Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; *see also I.R.C. § 501(c)(2), (25)* (title holding companies)].

PRACTICE TIP:

An LLC treated as a partnership must pay the annual minimum franchise tax on or before the 15th day of the fourth month after filing with the Secretary of State [*Rev. & Tax. Code § 17941(c)*]; the FTB will send a tax notice to the LLC and the tax is paid directly to the FTB. Alternatively, an LLC may be taxed as a corporation; if the LLC will receive corporate tax treatment, the annual minimum franchise tax is payable to the Secretary of State on the filing of articles of organization or an application for registration.

If an LLC files a return that is designated as its final return, the FTB will notify the LLC that the annual tax is due annually until a certificate of cancellation is filed [*Rev. & Tax. Code § 17941(b)(2)*; *see Corp. Code §§ 17455*].

[3] Fee Based on Income

In addition to the minimum franchise tax [*see* [2], *above*], every LLC or foreign LLC subject to the minimum franchise tax [*see Rev. & Tax Code § 17941*] must also pay a graduated annual fee based on its total income of $250,000 or more from all sources derived from or attributable to California for the taxable year [*Rev. & Tax Code § 17942(a), (b)*; *see Rev. & Tax. Code § 17942(b)(1)* ("total income derived from or attributable to" defined)].However, an LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax, and thus not subject to this annual fee [*see Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; *see also I.R.C. § 501(c)(2), (25)* (title holding companies)].

Special income determination provisions apply to commonly controlled LLCs [*see Rev. & Tax. Code § 17942(b)(2)*]. This fee is due and payable on the date the LLC is required to file its tax return [*Rev. & Tax. Code § 17942(c)*; *see Rev. & Tax. Code § 18633.5(a)*; *but see Rev. & Tax. Code § 17942(d)* and Stats. 2008 First Extra Session, ch. 1, § 8 (applicable for taxable years beginning after January 1, 2009)]. For further discussion, see [4], *below* and Ch. 12C, *Limited Liability Companies*.

[4] Requirement to File California Tax Return

Every LLC or foreign LLC classified as a partnership for California tax purposes that is doing business in California, organized in California, or registered with the Secretary of State is required to file a California tax return [*Rev. & Tax. Code § 18633.5(a)*]. The return is used to report income, deductions, gains, losses, and the like from the operation of an LLC [*see Rev. & Tax. Code § 18633.5(a)*]. An LLC classified as a corporation must file a corporate tax return [*see Rev. & Tax. Code § 18633.5(h)*; *see also* Instructions for Form 568, p. 3]. For coverage of filing deadlines and other information and illustrations of California tax forms applicable to LLCs, see Ch. 12C, *Limited Liability Companies* .

[5] Requirement to Provide Tax Information to Members

Every LLC required to file a California tax return [*see Rev. & Tax. Code § 18633.5(a)*] for any taxable year must furnish to each person who holds an interest in the LLC a copy of the information required to be shown on the tax return [*Rev. & Tax. Code § 18633.5(b)*]. This may include copies of California Form 568, federal Form 1065, and related schedules and attachments.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewTax LawFederal Tax Administration & ProcedureAdministrationIdentification Numbers & Information Returns (IRC secs. 6031-6065)Partnership Income ReturnsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral OverviewTax LawState & Local TaxesFranchise TaxGeneral OverviewTax LawState & Local TaxesFranchise TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
1. State Income Taxes

1-1E California Legal Forms--Transaction Guide § 1E.54

§ 1E.54 Other State Tax Reporting Requirements

[1] Report of Payment to Independent Contractor

The business generally must report payments over $600 per year made to any independent contractor [*see I.R.C. § 6041A*; *§ 1E.24*]. The Franchise Tax Board may require the filing of the federal information return with the FTB as required by forms and instructions [*Rev. & Tax. Code § 18631(b), (c)(5)*]. A statement must also be furnished to the person providing the services [*Rev. & Tax. Code § 18638*].

[2] Report of Cash Receipts Exceeding $10,000

If the filing of a federal information relating to cash received in a trade or business is required [*see I.R.C. § 6050I*], the Franchise Tax Board may require the filing of that federal informational return with the FTB as required by forms and instructions [*Rev. & Tax. Code § 18631(b), (c)(10)*]. The penalty for failure to file a copy of the return with the FTB is the same as the federal penalty [*Rev. & Tax. Code § 19183(a)*; *see I.R.C. § 6721* (federal penalty)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationTax AccountingGeneral OverviewTax LawFederal Tax Administration & ProcedureAdministrationIdentification Numbers & Information Returns (IRC secs. 6031-6065)General OverviewTax LawState & Local TaxesAdministration & ProceedingsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
1. State Income Taxes

1-1E California Legal Forms--Transaction Guide §§ 1E.55-1E.59

[Reserved]

§§ 1E.55[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
2. Sales and Use Tax

1-1E California Legal Forms--Transaction Guide § 1E.60

§ 1E.60 Imposition of Sales Tax

[1] In General

Sales tax is imposed on retail sales of tangible personal property unless an exemption applies [*Rev. & Tax. Code § 6051*]. A sales tax permit must be obtained for any retailing business [*see Rev. & Tax. Code § 6071*]. Any seller who makes more than two retail sales of tangible personal property in any 12-month period is a retailer responsible for paying sales tax [*see Rev. & Tax. Code §§ 6051, 6015(a)(1), 6019*], as is any person engaged in the business of either making retail sales of tangible personal property at auction or making sales for storage, use, or other consumption [*Rev. & Tax. Code § 6015(a)(2)*]. Sales taxes must then be collected at the proper rate for the county in which the business is run and remitted to the State Board of Equalization (SBE) [*see Rev. & Tax. Code § 6051*].

[2] Retail Sales

Only retail sales are subject to sales tax. A "retail sale" is a sale of tangible personal property for any purpose other than resale in the regular course of business [*Rev. & Tax. Code § 6007*; *see Modern Paint and Body Supply, Inc. v. State Board of Equalization (2001) 87 Cal. App. 4th 703, 711, 104 Cal. Rptr. 2d 784* (sales of supplies to auto body repair shops were not sales for resale under *18 Cal. Code Reg. § 1546* and thus were subject to sales tax)]. If the purpose of the purchaser is resale, a resale certificate must be obtained from the purchaser to ensure that the transaction is treated as a nontaxable sale for resale [*Rev. & Tax. Code § 6091*]. The resale certificate must be signed by the purchaser and state the purchaser's name and address, the number of the purchaser's seller's permit, and the general character of the tangible personal property sold by the purchaser in the regular course of business [*Rev. & Tax. Code § 6093*].

[3] Tangible Personal Property

Sales tax does not apply to the sale of real property or intangible property [*see Rev. & Tax. Code § 6051*]. Sales tax only applies to sales of tangible personal property which is defined as property that can be seen, weighed, measured, felt, or touched, or is perceptible to the senses in any other manner [*Rev. & Tax. Code § 6016*]. A service is not a sale of tangible personal property and is not subject to sales tax and any transfer of tangible personal property merely incidental

to the performance of a service is not subject to tax; however, if the service provider also sells tangible personal property that sale itself is subject to the tax [*see 18 Cal. Code Reg. § 1501*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesSales TaxDefinitionsTax LawState & Local TaxesSales TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
2. Sales and Use Tax

1-1E California Legal Forms--Transaction Guide § 1E.61

§ 1E.61 Sales Tax Reimbursement

The retailer is responsible for paying the sales tax [*see Rev. & Tax. Code § 6051*]. However, the retailer is entitled to collect sales tax reimbursement from consumers if one of the following conditions applies [*Civ. Code § 1656.1(a)*; *18 Cal. Code Reg. § 1700(a)(2)*]:

- The sales agreement provides for reimbursement;
- The amount of reimbursement is shown on the sales receipt or other proof of sale; or
- The retailer posts in a visible location on the premises, or includes on price tags or advertisements, a notice that sales tax reimbursement is added to the sale price of all items.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesSales TaxImposition of Tax



28 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
2. Sales and Use Tax

1-1E California Legal Forms--Transaction Guide § 1E.62

§ 1E.62 Measure and Rate of Sales Tax

[1] Gross Receipts as Measure of Tax

The sales tax is determined by the gross receipts from sales subject to the tax [*Rev. & Tax. Code § 6051*]. "Gross receipts" are equal to the total amount of the sale, rental, or lease price received for an item of property, valued in money, whether the price is received in money or another form of compensation [*Rev. & Tax. Code § 6012(a)*]. No deduction from gross receipts may be made for the cost of the property sold, materials, labor, interest, losses, other expenses, or transportation of the property prior to the sale [*Rev. & Tax. Code § 6012(a)*]. Gross receipts specifically do not include cash discounts taken on sales, refunds to consumers for property returned, the price received for labor or services used in the installation of property sold, various taxes, and separately stated transportation charges [*Rev. & Tax. Code § 6012(c)*; *see Preston v. State Board of Equalization (2001) 25 Cal. 4th 197, 221, 105 Cal. Rptr. 2d 407, 19 P. 3d 1148* (agreements for transfers of intangible property--consisting of copyrights in artwork--constituted technology transfer agreements under *Rev. & Tax. Code §§ 6011(c)(10), 6012(c)(10),* which applied retroactively to exclude copyright transfers from sales tax)].

[2] Rate of Tax

The California state sales tax is 6 percent [*Rev. & Tax. Code §§ 6051, 6051.1*; *see Rev. & Tax. Code §§ 6051.2(a), 6051.3* (additional rates)]. In addition, every county in California has adopted a county and local sales tax at the maximum permitted rate of 1.25 percent; therefore, the combined state, county, and local rate is 7.25 percent [*see Rev. & Tax. Code §§ 6051, 6051.2(a), 6051.3, 7202(a)*]. Certain districts, such as transit districts, are also authorized to impose a transactions tax equal to 0.25 or 0.5 percent which must be imposed county-wide; generally, the combined maximum rate of these district taxes cannot exceed 2 percent in the county [*see Rev. & Tax. Code §§ 7251.1, 7261(a), 7262, 7285*]. The imposition of the state, county, and district taxes results in a sales tax varying by county from 7.25 percent to 8.25 percent [*see Rev. & Tax. Code §§ 7202(a), 7203, 7261(a), 7262*; SBE News Release (NR 3-S, Jan. 13, 1992); SBE News Release (NR 2-D, Jan. 10, 1992); SBE News Release (NR 44-G, July 1, 1991)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesSales TaxGeneral OverviewTax LawState & Local TaxesSales TaxImposition of Tax



29 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
2. Sales and Use Tax

1-1E California Legal Forms--Transaction Guide § 1E.63

§ 1E.63 Imposition of Use Tax

[1] In General

California imposes a use tax at a rate of 6 percent on the storage, use, or other consumption in California of tangible personal property purchased from a retailer regardless of whether the retailer is located inside California or outside of California [*Rev. & Tax. Code §§ 6201, 6201.2-6201.4*; *see Rev. & Tax. Code §§ 6051, 6202*; *see also Yamaha Corp. v. State Board of Equalization (1999) 73 Cal. App. 4th 338, 364-365, 86 Cal. Rptr. 2d 362* (interpreting *Rev. & Tax. Code § 6009.1*, which contains exclusions from definition of "storage" and "use" and, thus, from tax imposed by *Rev. & Tax Code § 6201*)]. Use tax is calculated as a percentage of the sales price of the property and applies when sales tax has not been paid previously on the transfer of the property [*Rev. & Tax. Code §§ 6201, 6202, 6401*].

[2] Collection of Use Tax by Retailer

The purchaser of the property subject to use tax is liable for the payment of the tax and must pay it to the person from whom the property is purchased or leased if that person has a seller's permit or a Certificate of Registration--Use Tax [*Rev. & Tax. Code §§ 6202, 6203*; *18 Cal. Code Reg. § 1685(1)*]. The liability is extinguished if the purchaser obtains a receipt for the tax from the retailer [*Rev. & Tax. Code §§ 6202, 6203*]. A retailer engaged in business in California is required to collect use tax tendered by a purchaser, give a receipt to the purchaser, and forward all use taxes collected to the SBE [*Rev. & Tax. Code § 6203*; *18 Cal. Code Reg. §§ 1684(d), 1686*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesUse TaxGeneral OverviewTax LawState & Local TaxesUse TaxImposition of Tax



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
2. Sales and Use Tax

1-1E California Legal Forms--Transaction Guide § 1E.64

§ 1E.64 Exemption From Sales and Use Tax

[1] In General

California is prohibited from taxing certain items, such as imports or exports, under the Constitution of the United States, the laws of the United States, and/or the Constitution of California [*see Rev. & Tax. Code § 6352*]. Certain items have been specifically exempted from both sales and use tax [*see Rev. & Tax. Code §§ 6351-6380* (miscellaneous exemptions from sales and use taxes)]. Examples include works of art and museum pieces for public display [*see Rev. & Tax. Code §§ 6365, 6366.3*; *18 Cal. Code Reg. § 1586*]; living animals ordinarily constituting food for human consumption, together with their feed [*see Rev. & Tax. Code § 6358(a), (b)*; *18 Cal. Code Reg. § 1587(a), (b)*]; and returnable containers [*see 18 Cal. Code Reg. § 1589*].

[2] Exemptions From Sales Tax

Certain transactions are specifically exempted from California sales tax [*see Rev. & Tax. Code §§ 6381-6396* (miscellaneous exemptions from sales tax)]. For example, sales made to the U.S. government and the American National Red Cross are exempt from sales tax [*Rev. & Tax. Code § 6381*]; also exempt are interstate shipments of tangible personal property if the sales contract requires the property to be shipped to a site outside California and the retailer does ship the property to a site outside California [*Rev. & Tax. Code § 6396*; *18 Cal. Code Reg. § 1620(a)(3)(B)*].

[3] Exemptions From Use Tax

Any use tax liability is extinguished if sales tax is paid on a sale [*Rev. & Tax. Code § 6401*]. Use tax also does not apply to property purchased from the U.S. government [*Rev. & Tax. Code § 6402*], property donated by a retailer to a charitable organization [*Rev. & Tax. Code § 6403*], or property loaned by a retailer to an educational institution for use in an educational program [*Rev. & Tax. Code § 6404*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesSales TaxExemptionsTax LawState & Local TaxesUse TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
2. Sales and Use Tax

1-1E California Legal Forms--Transaction Guide § 1E.65

§ 1E.65 SBE Seller's Permit

Every person engaged in business in California as a seller of tangible personal property must obtain a seller's permit for each business location from the SBE [*Rev. & Tax. Code §§ 6066(a), 6067, 6071*]; the permit must be displayed conspicuously on the premises for which it is issued [*Rev. & Tax. Code § 6067*]. The application for a seller's permit must be made on the prescribed SBE form and be authenticated in a form or pursuant to methods prescribed by the SBE [*Rev. & Tax. Code § 6066(a)*]. The application may be filed using electronic media, as prescribed; "electronic media" includes but is not limited to computer modem, magnetic media, optical disk, facsimile machine, or telephone [*Rev. & Tax. Code § 6066(b), (c)*]. The SBE will grant and issue the permit if the applicant has complied with the application requirements and posted any security required to ensure compliance with sales and use tax law [*Rev. & Tax. Code § 6067*; *see Rev. & Tax. Code § 6701*]. The SBE may require an applicant or holder of a seller's permit to post security to ensure that the permit holder will pay the tax when due [*see Rev. & Tax. Code § 6701*]. Any person who engages in business without a permit or who knowingly fails to obtain a permit before the first tax return is due is subject to substantial penalties [*Rev. & Tax. Code §§ 6071, 7153, 7153.5, 7155*]. A retailer not engaged in business within the state but selling tangible personal property for storage, use, or other consumption in California (property subject to use tax) must also register with the SBE and obtain a Certificate of Registration--Use Tax [*Rev. & Tax. Code § 6226*; *18 Cal. Code Reg. § 1684(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesSales TaxGeneral OverviewTax LawState & Local TaxesUse TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
2. Sales and Use Tax

1-1E California Legal Forms--Transaction Guide § 1E.66

§ 1E.66 Returns and Payment of Sales and Use Taxes

Sales and use tax returns must be filed on or before the last day of the month following each quarterly period of three months [*Rev. & Tax. Code § 6452(a)*]. Returns must be made in the form required by the SBE, which may include electronic media; returns must be authenticated in a form or pursuant to methods that may be prescribed by the SBE [*Rev. & Tax. Code § 6452(a)*]. The taxes are due and payable when the return is filed and must accompany the return [*Rev. & Tax. Code §§ 6451, 6454*; *see Rev. & Tax. Code §§ 6479.3-6479.5* (payment by electronic funds transfer)]. If the taxpayer's estimated tax liability averages $50,000 or more per month, the SBE may require the taxpayer to make prepayments [*see Rev. & Tax. Code §§ 6470-6479*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesSales TaxGeneral OverviewTax LawState & Local TaxesSales TaxImposition of TaxTax LawState & Local TaxesUse TaxGeneral OverviewTax LawState & Local TaxesUse TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
2. Sales and Use Tax

1-1E California Legal Forms--Transaction Guide §§ 1E.67-1E.69

[Reserved]

§§ 1E.67[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
3. Property Taxes

1-1E California Legal Forms--Transaction Guide § 1E.70

§ 1E.70 Real and Personal Property Taxes

[1] Constitutional Authorization and Limitation

The California Constitution authorizes taxation of real and personal property [*Cal. Const. art. XIII, § 1*]. Real property exemptions from taxation are provided by constitutional provision [*see Cal. Const. art. XIII, §§ 3, 4*]; the Legislature may exempt personal property by a two-thirds vote of both houses [*Cal. Const. art. XIII, § 2*]. In addition, the tax rates differ and delinquency dates may differ for real property and personal property taxes [*see Cal. Const. art. XIII, § 12*; *Rev. & Tax. Code §§ 2605-2607, 2701, 2702, 2901, 2905*].

Proposition 13 limits the maximum tax rate applicable to real property to 1 percent of the full cash value of the property [*Cal. Const. art. XIIIA, § 1(a)*]. However, exceptions are made for ad valorem taxes and special assessments to pay interest and redemption charges on certain indebtedness approved by voters [*Cal. Const. art. XIIIA, § 1(b)*]. The full cash value of real property is its fair market value as of March 1, 1975, unless that property is purchased, is newly constructed, or changes ownership after that date [*Cal. Const. art. XIIIA, § 2(a)*; *Rev. & Tax. Code § 110.1(a)*].

[2] Real Property Subject to Taxation

Real property includes (1) possession or ownership of land; (2) mining, mineral, quarry, and timber rights; and improvements, including all buildings, structures, fixtures, and (3) fences erected on or affixed to the land, and all trees and vines not of natural growth and not exempt from taxation, except date palms under eight years of age [*Rev. & Tax. Code §§ 104, 105*]. A fixture is an item of tangible personal property that has become real property because of both the fixture's physical or constructive annexation to real property and the taxpayer's intent that the fixture remain annexed indefinitely [*Rev. & Tax. Code § 105*; *18 Cal. Code Reg. § 122.5*]. A list of what constitutes land and improvements has been promulgated by the State Board of Equalization (SBE) [*see 18 Cal. Code Reg. § 124*]. Generally, real property owned by state and local governments, schools, and real property used for religious, hospital, or charitable purposes is exempt from taxation [*see Cal. Const. art. XIII, §§ 3, 4*].

[3] Personal Property Subject to Taxation

[a] In General

Personal property is all property except real estate, including tangible personal property, shares of capital stock, evidences of indebtedness, and any legal or equitable interest not otherwise exempt from taxation [*Cal. Const. art. XIII, § 2*; *Rev. & Tax. Code § 106*]. Shares of capital stock and evidences of indebtedness have been specifically exempted from taxation by the Legislature [*Rev. & Tax. Code § 212*]. Tangible personal property is all personal property that may be seen, weighed, measured, felt, touched, or perceived by the senses in any other manner [*18 Cal. Code Reg. § 123*]. Certain tangible personal property is specifically exempted from taxation, including (1) property used for religious, hospital, scientific, or charitable purposes [*see Rev. & Tax. Code § 214*] and (2) cargo containers used in ocean commerce [*Rev. & Tax. Code § 232*].

[b] Business Inventory Exemption

The significant exemption for California businesses, however, is the business inventory exemption from property tax [*Rev. & Tax. Code § 219*; *see Rev. & Tax. Code § 129* (definition)]. Business inventory is property held for sale or lease in the ordinary course of business, whether raw materials, work in progress, or finished goods [*Rev. & Tax. Code § 129*; *see 18 Cal. Code Reg. § 133*; *see also Transworld Systems, Inc. v. County of Sonoma (2000) 78 Cal. App. 4th 713, 716-718, 93 Cal. Rptr. 2d 165* (holding that form letters that collection service sent to debtors qualified as exempt business inventory of a nonprofessional service under *Rev. & Tax. Code § 129* and related regulation)]. Examples of property not a part of business inventory and subject to taxation as personal property include all of the following [*18 Cal. Code Reg. § 133(b)(1), (c)*]:

- Office supplies, furniture, machinery, and equipment;
- Manufacturing equipment, machinery, and supplies; and
- Property held in connection with a profession that is primarily a service activity, such as medicine, law, architecture, or accounting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesPersonal Property TaxExempt PropertyGeneral OverviewTax LawState & Local TaxesPersonal Property TaxExempt PropertyLimitationsTax LawState & Local TaxesReal Property TaxGeneral Overview



35 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
3. Property Taxes

1-1E California Legal Forms--Transaction Guide § 1E.71

§ 1E.71 Annual Informational Statement

The business must determine its taxable base for property tax purposes and determine the method for reporting the property to the assessor. A business owning taxable personal property with an aggregate cost of $100,000 or more must file an annual statement with the appropriate county assessor; any property owner may be asked to file such a statement [*Rev. & Tax. Code § 441*]. The SBE prescribes the form for reporting property [*see Rev. & Tax. Code § 452*]. The statement must set forth all of the following:

- All taxable property owned, claimed, possessed, controlled, or managed by the person filing [*Rev. & Tax. Code § 442*];

- A complete legal description or a description that geographically locates the property owned by the person filing [*Rev. & Tax. Code § 456*]; and

- Descriptions of the property in sufficient detail, including cost if known or available to the person filing [*Rev. & Tax. Code § 445*].

The annual statement must be filed between the lien date (March 1) and 5 P.M. on April 1 [*Rev. & Tax. Code § 441(a), (b); see § 1E.121[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesAdministration & ProceedingsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
3. Property Taxes

1-1E California Legal Forms--Transaction Guide § 1E.72

§ 1E.72 Payment of Property Tax

The assessor of the county in which the property is located assesses all taxable real and personal property in the county and prepares the assessment roll [*Rev. & Tax. Code §§ 404, 405, 601*]. Taxes are assessed on the unsecured roll as of July 31, and are delinquent if not paid by August 31 at 5 p.m. or the close of business, whichever is later [*Rev. & Tax. Code §§ 2901, 2922(a)*]. The unsecured roll consists of all property not on the secured roll; that is, all taxable personal property and some possessory interests in real property [*Rev. & Tax. Code §§ 109, 134*].

The secured roll includes all real property and all fixtures [*see Rev. & Tax. Code §§ 105, 107, 109*]. Taxes on the secured roll may be paid in two installments, but the second installment may be paid separately only if the first was paid on time [*see Rev. & Tax. Code § 2607*]. The first installment is due and payable November 1 and consists of half the real property taxes and all of the personal property (fixtures) taxes on the secured role, provided that a county can elect to collect only half of the taxes on personal property [*Rev. & Tax. Code §§ 2605, 2700*]. The first installment becomes delinquent on December 10 at 5 p.m. or the close of business, whichever is later [*Rev. & Tax. Code § 2617*]. The second installment is due and payable February 1 and is delinquent if not paid by April 10 at 5 p.m. or the close of business, whichever is later [*Rev. & Tax. Code §§ 2606, 2618*]. However, the entire tax on real property may be paid when the first installment is due and payable [*Rev. & Tax. Code § 2607*].

Legal Topics:

For related research and practice materials, see the following legal topics:
GovernmentsLocal GovernmentsFinanceTax LawState & Local TaxesAdministration & ProceedingsCollectionTax LawState & Local TaxesPersonal Property TaxGeneral OverviewTax LawState & Local TaxesReal Property TaxCollectionMethods & Timing



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
3. Property Taxes

1-1E California Legal Forms--Transaction Guide § 1E.73

§ 1E.73 Change of Ownership Statements

[1] Real Property Transfers

A transferee of real property may file a preliminary change of ownership report concurrently with the recording of any documents evidencing the transfer [*Rev. & Tax. Code § 480.3*]. The transferee must also file a formal change of ownership statement when the change of ownership occurs [*Rev. & Tax. Code § 480(a)*]. The change of ownership statement must set forth a description of the property, the names of the parties to the transaction, the date and terms of the transaction, and the amount and type of any consideration paid for the property [*Rev. & Tax. Code § 480(c)*].

[2] Changes in Control of Partnership or Other Legal Entity

After a change in control of any corporation, partnership, limited liability company, or other legal entity, the person or entity acquiring ownership control of the entity must file a change of ownership statement [*see Rev. & Tax. Code § 64(c), (d)*]. The statement must be on the prescribed form and filed with the SBE in Sacramento within 45 days from the date of the change [*Rev. & Tax. Code §§ 480.1(a), (b), 480.2(a), (b)*]. The SBE may request a statement or inspect documents at any time to determine whether a change in ownership has occurred [*see Rev. & Tax. Code §§ 480.1(e), 480.2(e)*]. The statement must describe the property owner by the entity, name the parties to the transaction, state the date on which ownership or control was acquired, and list all counties in which property is owned by the entity; if ownership has changed, the original co-owners before the transaction must also be listed [*Rev. & Tax. Code §§ 480.1(a), (b), 480.2(a), (b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral OverviewReal Property LawOwnership & TransferGeneral OverviewReal Property LawPriorities & RecordingRecording Acts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
3. Property Taxes

1-1E California Legal Forms--Transaction Guide §§ 1E.74-1E.79

[Reserved]

§§ 1E.74[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
4. State Withholding and Employment Taxes

1-1E California Legal Forms--Transaction Guide § 1E.80

§ 1E.80 State Income Tax Withholding

[1] Amount of Withholding

The employer must withhold state income taxes from an employee's wages in an amount dependent on the annual tax liability of the employee and pay the amount withheld on a quarterly basis to the California Employment Development Department (EDD) [*Unemp. Ins. Code § 13021*; *see Unemp. Ins. Code §§ 13020-13077*]. The FTB prescribes the amount of withholding and prepares withholding tables that the employer must use to compute the amount of tax to be withheld [*Unemp. Ins. Code § 13020*]. The employee must file a withholding exemption certificate with the employer before the date that employment begins; the certificate may be the federal withholding certificate (IRS Form W-4), the state withholding certificate (EDD Form DE-4), or a substantially similar form [*Unemp. Ins. Code § 13040*; 22 Cal. Code Reg. § 4340-1(a)]. No withholding is required for an employee who provides a withholding exemption certificate that states that the employee (1) incurred no liability for federal income tax purposes for the preceding taxable year and (2) anticipates no federal income tax liability for the current year [*Unemp. Ins. Code § 13026*; 22 Cal. Code Reg. § 4340-1(f)].

For California resident employees receiving wages subject to personal income tax withholding in both California and another state, the employer must reduce the California withholding by the amount of the deduction required by the other state [22 Cal. Code Reg. § 4320-1].

[2] Definitions for Income Tax Withholding Purposes

[a] Employer

In general, an employer is any person or entity doing business within California, deriving income from sources within the state, or otherwise subject to state law, making payments of wages to employees for services performed within the state [*Unemp. Ins. Code § 13005(a)*]. If a person or entity falls within this definition of employer but does not have control over the payment of wages for services, the person or entity with that control is the employer whether or not that person or entity is otherwise subject to California jurisdiction [*Unemp. Ins. Code § 13005(b)*].

[b] Employee

A California resident or nonresident receiving remuneration for services performed inside the state is an employee, as is a California resident receiving remuneration for services performed outside the state [*Unemp. Ins. Code § 13004*]. Certain construction workers are statutory employees for income tax withholding purposes [*Unemp. Ins. Code § 13004.5*].

In distinguishing employees from independent contractors, common law rules apply in determining the existence of an employer-employee relationship [22 Cal. Code Reg. § 4304-1]. The right of the principal to control the manner and means of accomplishing a desired result is the most significant factor in making this determination [22 Cal. Code Reg. § 4304-1]. An employer-employee relationship is indicated if the principal has the authority to exercise complete control, whether or not it is exercised over all details [22 Cal. Code Reg. § 4304-1]. The principal's right to discharge at will is another indication that control exists [22 Cal. Code Reg. § 4304-1]. Regulations enumerate other indications of the right to control [*see* 22 Cal. Code Reg. § 4304-1].

[c] Wages

For income tax withholding purposes, unless specifically excepted by statute, wages generally include all remuneration for services performed by an employee for an employer, including the cash value of all noncash remuneration received by the employee [*Unemp. Ins. Code § 13009*; 22 Cal. Code Reg. §§ 4309-1, *4309-2*]. Some remuneration is not subject to withholding because of a specific statutory exclusion either from withholding requirements [*see, e.g., Unemp. Ins. Code § 13025* (noncash remuneration paid to retail commission salesperson ordinarily only paid cash commission)] or from the definition of wages [*see Unemp. Ins. Code § 13009(a)-(r)* (exclusions); 22 Cal. Code Reg. § 4309-2 (exclusions)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesAdministration & ProceedingsCollectionTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
4. State Withholding and Employment Taxes

1-1E California Legal Forms--Transaction Guide § 1E.81

§ 1E.81 Types of State Employment Taxes

[1] Unemployment Tax

Unemployment taxes are an obligation of the employer and are not deducted or withheld from employee wages [*Unemp. Ins. Code § 976*]. The EDD assigns each employer a contribution rate based on the amount in the employer's reserve account [*Unemp. Ins. Code § 977*]; the usual rate is 3.4 percent [*see Unemp. Ins. Code § 982*]. The EDD notifies the employer of its contribution rate on or before January 10 of each year [*Unemp. Ins. Code § 979*]. The tax is imposed on the first $7,000 of an employee's wages [*Unemp. Ins. Code § 930*]; therefore, the amount paid by the employer is generally $238 ($7,000 x 3.4 percent).

[2] Disability Tax Withholding

Disability taxes must be withheld from employees' wages [*Unemp. Ins. Code § 986*]. The tax rate is not more than 1.3 percent or less than 0.1 percent of wages and depends on the disability fund balance [*Unemp. Ins. Code §§ 984(a)(3), 2604*]; the amount of wages subject to tax also varies [*Unemp. Ins. Code § 985*]. The EDD publishes the rates for the upcoming year on or before November 30 of each calendar year [*Unemp. Ins. Code § 984(b)*].

[3] Training Taxes

If the employer has a positive unemployment fund balance in its reserve account, it must also pay training tax [*Unemp. Ins. Code § 976.6*]. The tax rate is 0.1 percent of wages and the tax is collected along with unemployment taxes [*Unemp. Ins. Code § 976.6*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawDisability & Unemployment InsuranceDisability BenefitsCoverage & DefinitionsGeneral OverviewLabor & Employment LawDisability & Unemployment InsuranceUnemployment CompensationCoverage &

DefinitionsTax LawState & Local TaxesGeneral Overview



41 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
4. State Withholding and Employment Taxes

1-1E California Legal Forms--Transaction Guide § 1E.82

§ 1E.82 Definitions for Employment Tax Purposes

[1] Employment

[a] Covered Services

Employment is defined as services, including services in interstate commerce, performed by an employee for wages or under any contract of hire, written or oral, express or implied [*Unemp. Ins. Code § 601*]; however, for disability tax purposes this definition is modified regarding domestic services [*see Unemp. Ins. Code §§ 629, 639, 2606.5*]. Employment includes services performed entirely within California [*Unemp. Ins. Code § 603(a)*]; service performed both within and outside of California is included if the service is localized in California [*see Unemp. Ins. Code § 602(a)*]. Service is localized in California if any service performed outside of California is incidental to that performed within the state [*Unemp. Ins. Code § 603(b)*]. The following services not localized in California will be deemed employment for California employment tax purposes:

- Service partly performed in California if either the base of operations is located in California or there is no base of operations and the service is directed or controlled from California [*Unemp. Ins. Code § 602(b)*].

- Service performed in other states or Canada that is directed or controlled in California and is not covered by the unemployment compensation law of another state or Canada [*Unemp. Ins. Code § 603.5*].

- Service of a California resident if the base of operation or place from which the service is directed or controlled is not in any state where any part of the service is performed [*Unemp. Ins. Code § 602(b)*].

- Service performed on or in connection with American vessels or aircraft operating entirely or partly within the United States if the employer has certain connections with California [*Unemp. Ins. Code § 609*].

- Service performed outside of the United States or Canada by a U.S. citizen for an American employer if the employer has certain connections with California [*Unemp. Ins. Code § 610*].

[b] Excluded Services

Certain services are specifically excluded by statute from the definition of employment [*see Unemp. Ins. Code §§ 629-656*]. Certain services excluded from the definition of employment for FUTA tax purposes are also excluded for California unemployment tax purposes [*Unemp. Ins. Code § 638*; *see I.R.C. § 3306(c)* (FUTA exclusions)].

[2] Employer

An employer is an employing unit that had in its employment one or more employees for some portion of a day within the current or preceding calendar year and pays wages for employment in excess of $100 during any calendar quarter [*Unemp. Ins. Code § 675*]. An employing unit is an individual or organization employing one or more individuals performing services for it within the state [*Unemp. Ins. Code § 135*].

[3] Employee

For employment tax purposes, employees include corporate officers [*Unemp. Ins. Code § 621(a)*], statutory employees [*Unemp. Ins. Code § 621(c)*; *see also Unemp. Ins. Code § 621.5* (statutory employee status of certain construction workers)], and common law employees [*Unemp. Ins. Code § 621(b)*; *see* 22 Cal. Code Reg. § 4304-1]. The same rules apply in determining common law employee status for employment tax purposes as for income tax withholding purposes [*see § 1E.80[2][b]*]. An individual is a statutory employee if the individual performs certain services for any employing unit [*see [2], above*] under a contract of service that contemplates that substantially all of those services will be performed personally by the individual [*Unemp. Ins. Code § 621(c)*]; however, the individual is not a statutory employee if the services are a single transaction or the individual has a substantial investment in the facilities, except transportation facilities, used in connection with the services [*Unemp. Ins. Code § 621(c)(2)*]. The statute includes the services of the following [*Unemp. Ins. Code § 621(c)(1)*]:

- A driver distributing meat, vegetable, fruit, or bakery products, beverages other than milk, or laundry or dry cleaning services;

- A traveling or city salesperson soliciting orders from wholesalers, retailers, contractors, hotel and restaurant operators, or similar establishments, in certain cases; or

- A home worker performing work according to the specifications of the employing unit.

[4] Wages

For employment tax purposes, wages are all remuneration payable to an employee for personal services, whether by private agreement, consent, or force of statute, including commissions and bonuses, and generally include the reasonable cash value of any remuneration paid in a medium other than cash [*Unemp. Ins. Code § 926*; *see Unemp. Ins. Code § 936*]. Certain payments are specifically excluded from the definition of wages [*see Unemp. Ins. Code §§ 938.5* (duty and training payments to National Guard and reserve), *939* (exclusions similar to FUTA exclusions); 22 Cal. Code Reg. § 926-2 (exclusions by regulation)]. Wages up to $7,000 paid to any individual employee by an employer during a calendar year are subject to the payment and withholding of employment taxes [*Unemp. Ins. Code § 930*; *see Unemp. Ins. Code §§ 930.1* (ceiling when unemployment compensation law of other state applies), *930.5* (ceiling when employer acquires business of other employer)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawDisability & Unemployment InsuranceUnemployment CompensationCoverage & DefinitionsLabor & Employment LawEmployment RelationshipsAt-Will EmploymentEmployeesLabor & Employment LawEmployment RelationshipsAt-Will EmploymentEmployersTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)General Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
4. State Withholding and Employment Taxes

1-1E California Legal Forms--Transaction Guide § 1E.83

§ 1E.83 Reporting and Payment of State Withholding and Employment Taxes

[1] In General

An employing unit must register with the EDD within 15 days after it becomes an employer [*Unemp. Ins. Code § 1086*]. Registration is accomplished by completing and sending to the EDD Registration Form DE-1; the EDD will then assign the employer an account number [*see Unemp. Ins. Code §§ 13056, 13057*]. Each employer must keep an accurate record for each worker indicating the covered pay period, each worker's name, social security number, and status, and the remuneration paid to each worker [*Unemp. Ins. Code § 1085*; 22 Cal. Code Reg. § 1085-2 (recordkeeping requirements)]. Records should generally be kept for four years [22 Cal. Code Reg. § 1085-2(c)]. All payments must be mailed directly to the EDD in Sacramento [*see Unemp. Ins. Code § 13021(c)*].

[2] EDD Form DE-3

With some exceptions, quarterly returns on EDD Form DE-3 must be filed to report the total amount of personal income tax and disability tax withheld and the total amount of unemployment and training taxes due for the quarter [*Unemp. Ins. Code §§ 1088, 1110, 13021*; 22 Cal. Code Reg. § 1088-1(a)]. The return must be filed even if no wages are paid during the quarter, is due on or before the last day of the month following the close of the quarter, and must be accompanied by payment of any tax due [*Unemp. Ins. Code § 13021(a)*]. When an employer is required to deposit federal taxes [*see § 1E.23*], and the accumulated amount of state income tax withheld exceeds $500, the employer is required to remit the state tax pursuant to the rules applicable to federal income tax [*Unemp. Ins. Code § 13021(c)(1)*; *but see Unemp. Ins. Code § 13021(c)(2)* (amount subject to adjustment after January 1, 1996)]. Employers qualifying as semi-weekly depositors under federal rules [*see § 1E.23*] must make payments by electronic funds transfer [*Unemp. Ins. Code § 13021(d)(2)*]. An employer not otherwise required to make a payment before the filing of the quarterly return, becomes liable for remittance when the cumulative tax withheld is $350 or more [*see Unemp. Ins. Code § 13021(h)*; *see Unemp. Ins. Code § 13021(c)*].

[3] EDD Form DE-43

The employer must furnish each employee with an annual statement specifying, among other items, total wages paid that are subject to the personal income tax [*see Unemp. Ins. Code § 13009.5*], amounts deducted and withheld [*see Unemp. Ins. Code § 13020*], the total amount of worker contributions [*see Unemp. Ins. Code §§ 986, 3260*], and the total amount of elective deferrals [*see I.R.C. § 402(g)(3)*] and deferred compensation [*see Unemp. Ins. Code § 13050(a)*; *see I.R.C. § 457*]. The statement is made on IRS Form W-2 [*see Unemp. Ins. Code § 13050*; 22 Cal. Code Reg. § 4350-1(b); *see also § 1E.22[2]*]. The employer must file an annual report of total personal income tax withheld for the year with the EDD on Form DE-43 (Annual Reconciliation of Personal Income Tax Withheld and Transmittal of W-2, W-2C, W-2P, and 1099R Forms).

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawDisability & Unemployment InsuranceUnemployment CompensationCoverage & DefinitionsLabor & Employment LawWage & Hour LawsRecordkeeping RequirementsTax LawState & Local TaxesAdministration & ProceedingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART II. LEGAL BACKGROUND
B. State Taxes
4. State Withholding and Employment Taxes

1-1E California Legal Forms--Transaction Guide §§ 1E.84-1E.99

[Reserved]

§§ 1E.84[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1E California Legal Forms--Transaction Guide § 1E.100

§ 1E.100 Facts

1. Information regarding natural persons participating in new business.

a. Name.

b. Residence address and telephone number(s).

c. Business address and telephone number(s).

d. Citizenship (U.S citizen, resident alien, citizen of a country other than the United States).

e. Tax identification numbers (social security number, employer identification number).

f. Marital status.

g. Age.

h. Educational background.

i. Business experience.

j. Gross and net income for last three years.

k. Estimated net worth.

l. Projected annual income.

m. Relationship to other participants.

n. Affiliations with other businesses.

o. Percentage interest in business.

2. Information regarding entities participating in new business.

a. Form of organization.

b. Personal and biographical information of persons responsible for management and control [*see* P 1, *above*].

c. Tax identification number.

d. Tax year.

3. Person responsible for paying for legal work.

4. Information regarding business activity.

a. Principal activity.

b. Complete address, including county, of main office and any other offices or places of business.

c. Date business started.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Tax Administration & ProcedureAudits & InvestigationsDisclosure of Information (IRC secs. 6103-6104, 6108-6110, 6713, 7213, 7216, 7431, 7435)Identifying NumbersTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)General OverviewTax LawState & Local TaxesAdministration & ProceedingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1E California Legal Forms--Transaction Guide § 1E.101

§ 1E.101 Documents

1. Business plan.

2. Anticipated profit and loss statement and balance sheet for first year.

3. Current profit and loss statements and balance sheets, if existing business is being incorporated.

4. Existing contracts.

5. Copies of three years' prior income tax returns for participating individuals and business entities.

6. Copies of three years' prior income tax returns if existing business is being purchased, or change of form is contemplated.

7. Copies of tax projections for current year for participating individuals and business entities.

8. List of persons providing services for business and nature of services provided.

9. List of assets and value of those assets for property tax purposes.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesGeneral

OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawSole Proprietorships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1E California Legal Forms--Transaction Guide §§ 1E.102-1E.109

[Reserved]

§§ 1E.102[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1E California Legal Forms--Transaction Guide § 1E.110

§ 1E.110 Classification of Worker as Employee or Independent Contractor

1. Classify worker as employee or independent contractor.

NOTE:

If a worker is misclassified as an independent contractor, the employer is potentially liable for unpaid employment taxes, interest, and penalties [***see*** *I.R.C. § 6501(a)* (three-year statute of limitations for assessment from date return filed)].

2. Ascertain whether worker falls within safe harbor for those historically classified as independent contractors by answering following three questions affirmatively [Pub. L. No. 95-600, 95th Cong., 2d Sess., § 530 (Nov. 6, 1978); Pub. L. No. 97-248, 97th Cong., 2d Sess., § 269(e) (Sept. 3, 1982)].

a. Has employer consistently not treated worker as common law employee for any period beginning after 1977?

b. Has employer filed all federal tax returns?

c. Does employer have reasonable basis for not treating worker as employee?

NOTE:

A reasonable basis exists if an employer's treatment of a worker is based on any of following [Pub. L. No. 95-600, 95th Cong., 2d Sess., § 530 (Nov. 6, 1978); Pub. L. No. 97-248, 97th Cong., 2d Sess., § 269(e) (Sept. 3, 1982)]: precedent, including judicial precedent, published rulings, technical advice, or letter ruling issued to employer; past IRS audit of employer in which no worker in substantially similar position could have been reclassified as employee; or longstanding practice of significant segment of industry.

3. If worker does not fall within safe harbor, determine how many of the following factors exist:

NOTE:
The more factors that exist, the more likely IRS will classify worker as common law employee [*Rev. Rul. 87-41, 1987-1 C.B. 296*].

a. Employer instructs worker how to complete task.

b. Employer trains worker.

c. Worker's services are integrated into employer's business.

d. Worker renders services personally.

e. Worker may not hire, supervise, or pay assistants.

f. Worker and employer have continuing relationship.

g. Worker's hours are set.

h. Full-time work is required.

i. Worker works on employer's premises.

j. Employer sets order or sequence of work completion.

k. Worker reports regularly to employer orally or in writing.

l. Worker paid hourly, weekly, or monthly salary.

m. Employer pays worker's business and travel expenses.

n. Employer furnishes worker's tools or materials.

o. Worker does not have significant investment in facilities.

p. Worker has no potential to realize significant profit or loss.

q. Worker does not work for others simultaneously.

r. Worker does not make services available to general public.

s. Employer has right to discharge worker.

t. Worker has right to terminate relationship.

4. Determine whether client should apply for IRS determination of worker status by filing IRS Form SS-8; if yes, obtain information concerning one worker as representative of class.

NOTE:

A ruling made for a representative worker will apply to the status of other workers in the same class if the facts do not differ substantially [***see*** IRS Form SS-8, Instr.].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawEmployment RelationshipsAt-Will EmploymentEmployeesLabor & Employment LawEmployment RelationshipsIndependent Contractors



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1E California Legal Forms--Transaction Guide § 1E.111

§ 1E.111 Determination If Business Involves Retail Sales Subject to Sales Tax

1. Determine whether business activity involves "sale" of tangible personal property.

NOTE:

A sale occurs when a transfer of title or possession to tangible personal property is coupled with consideration [***see*** *Rev. & Tax. Code § 6006(a)*; ***see*** *§ 1E.60[2], [3]*]. Certain activities are classified as sales by statute [***see*** *Rev. & Tax. Code § 6006(b)-(g)*] and others are specifically excepted [***see*** *Rev. & Tax. Code §§ 6010.3-6010.50*]. While a lease of tangible personal property for consideration is generally a sale for sales tax purposes, certain leases have been excepted by statute [***see*** *Rev. & Tax. Code § 6006(g)*; ***see also*** *Preston v. State Board of Equalization (2001) 25 Cal. 4th 197, 211, 105 Cal. Rptr. 2d 407, 19 P. 3d 1148* (temporary transfers of tangible artwork were determined to be taxable transfers of tangible property; because agreements transferred artwork for use in manufacturing process performed outside taxpayer's premises, they fell within statutory definition of taxable lease)].

a. Is transfer of title or possession coupled with consideration?

b. Is activity classified as sale by statute or specifically excepted?

c. If activity involves leasing of tangible personal property for consideration, is it excluded from sale by statute?

d. Is client primarily engaged in business of rendering services?

NOTE:

Service providers are generally considered to be consumers of tangible personal property, not retailers; whether a transfer of property is merely incidental to a provision of service depends on the true object of the contract [*18 Cal. Code Reg. § 1501*].

2. If activity is a sale, is it at "retail"?

NOTE:

Only retail sales are subject to sales tax [*Rev. & Tax. Code § 6051*]. A retail sale is a sale for any purpose other than resale in the regular course of business [*Rev. & Tax. Code § 6007*; ***see*** *Modern Paint and Body Supply, Inc. v. State Board of Equalization (2001) 87 Cal. App. 4th 703, 711, 104 Cal. Rptr. 2d 784* (sales of supplies to auto body repair shops were not sales for resale under *18 Cal. Code Reg. § 1546* and thus were subject to sales tax)].

3. If sale is at retail, does client qualify as retailer responsible for payment of tax?

NOTE:

The retailer making the sale is responsible for paying the sales tax [*Rev. & Tax. Code § 6051*; ***see*** *§ 1E.60[1]*].

4. Is transaction exempted from sales and/or use tax [*see § 1E.64*]?

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesPersonal Property TaxTangible PropertyImposition of TaxTax LawState & Local TaxesSales TaxDefinitionsTax LawState & Local TaxesSales TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1E California Legal Forms--Transaction Guide § 1E.112

§ 1E.112 Checklist of Miscellaneous Taxes

1. Determine whether business activities involve any of the following areas of taxation:

a. Motor Vehicle Fuel License Tax [*Rev. & Tax. Code § 7301 et seq.*].

b. Use Fuel Tax [*Rev. & Tax. Code § 8601 et seq.*].

c. Local Motor Vehicle Fuel Tax [*Rev. & Tax. Code § 9501 et seq.*].

d. Vehicle License Fee [*Rev. & Tax. Code § 10701 et seq.*].

e. Private Railroad Car Tax [*Rev. & Tax. Code § 11201 et seq.*].

f. Documentary Transfer Tax [*Rev. & Tax. Code § 11901 et seq.*].

g. Insurance Tax [*Rev. & Tax. Code § 12001 et seq.*].

h. Cigarette and Tobacco Products Tax [*Rev. & Tax. Code § 30001 et seq.*].

i. Alcoholic Beverage Tax [*Rev. & Tax. Code § 32001 et seq.*].

j. Rapid Transit Planning [*Rev. & Tax. Code § 36000 et seq.*].

k. Timber Yield Tax [*Rev. & Tax. Code § 38101 et seq.*].

l. Energy Resources Surcharge [*Rev. & Tax. Code § 40001 et seq.*].

m. Emergency Telephone Users Surcharge [*Rev. & Tax. Code § 41001 et seq.*].

n. Hazardous Substances Tax [*Rev. & Tax. Code § 43001 et seq.*].

2. Determine whether business is subject to any city business license tax.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesAdministration & ProceedingsGeneral OverviewTax LawState & Local TaxesAdministration & ProceedingsCollectionTax LawState & Local TaxesAlcohol & Tobacco Products TaxGeneral OverviewTax LawState & Local TaxesAlcohol & Tobacco Products TaxAlcohol TaxGeneral OverviewTax LawState & Local TaxesPublic Utilities TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

1-1E California Legal Forms--Transaction Guide §§ 1E.113-1E.119

[Reserved]

§§ 1E.113[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1E California Legal Forms--Transaction Guide § 1E.120

§ 1E.120 Withholding of Income and Employment Taxes

1. Advise employer to obtain Employer's Tax Guide (IRS Publication 15, Circular E).

NOTE:

The Employer's Tax Guide is available free of charge from any IRS office. It contains instructions for completing and filing quarterly returns and other required reports, and for paying or depositing withheld income taxes and employer and employee FICA taxes. It also contains tables showing how different kinds of wages and employees are to be treated for income, FICA, and FUTA tax purposes, and amounts to be withheld from wages paid weekly, biweekly, semimonthly, monthly, or otherwise.

2. Advise client to apply for:

a. Federal employer identification number using IRS Form SS-4.

NOTE:

A business must obtain a federal employer identification number if on any day it employs one or more persons for wages subject to income tax withholding or FICA taxes [*I.R.C. § 6011(b)*; *Treas. Reg. § 31.6011(b)-1(a)(1)(ii)*]. Corporations and partnerships must obtain a number regardless of whether they are employers [***see*** *Treas. Reg. § 301.6109-1(b)*]. Form SS-4 is available from any IRS or Social Security office [***see*** *Treas. Reg. § 31.6011(b)-1(a)(1)(iii)*]; complete, execute, and file form according to instructions printed on reverse side of form.

b. Identifying number from EDD.

NOTE:

A business must register with EDD within 15 days after it becomes an employer [*Unemp. Ins. Code § 1086*] by completing and mailing to EDD Registration Form DE-1. After the form is submitted, EDD will assign an eight-digit account number to the employer [***see*** *Unemp. Ins. Code §§ 13056, 13057*].

3. Advise client to include federal employer identification number in all returns, statements, or documents filed for federal income tax, FICA, or FUTA purposes [*I.R.C. § 6109(a)(1)*; *Treas. Reg. § 301.6109-1(a), (b)*].

NOTE:

A $5 penalty is imposed for each failure by an employer to include the federal employer identification number on any return, statement, or document filed with IRS [Treas. Reg. § 301.6676-1(a)].

4. Advise client to perform following procedures when employees are hired:

a. Have each employee complete, sign, and date employee's withholding allowance certificate (IRS Form W-4) [*Treas. Reg. §§ 31.3402(f)(1)-1, 31.3402(f)(2)-1, 31.3402(f)(5)-1*].

b. Obtain each new employee's social security number and include in payroll records [*Treas. Reg. § 31.6011(b)-2(c)(1)*].

c. If employee does not have social security number, inform employee of his or her duty to apply to Social Security Administration for social security card and number (Social Security Administration Form SS-5) [*Treas. Reg. § 31.6011(b)-2(c)(2)*].

5. Advise client to perform following procedures when paying wages:

a. Withhold amount specified on applicable income tax withholding rate table in Employer's Tax Guide (IRS Pub. 15, Circular E) [*see I.R.C. § 3402*; *Treas. Reg. § 31.3402(c)-1(a)(1)*].

b. Withhold FICA taxes specified by statute until sum specified by statute has been earned by employee [*see I.R.C. §§ 3101, 3121(a)(1)*].

c. Withhold amount specified on FTB income tax withholding table [*Rev. & Tax. Code § 18663(a)*].

6. Advise client that, during tax year, quarterly return of income tax withheld (IRS Form 941) must be filed within one month after end of each calendar quarter, unless monthly returns are required by IRS [*Treas. Reg. §§ 31.6011(a)-4(a)(1), 31.6011(a)-5, 31.6071(a)-1(a)(1)*].

7. Determine whether de minimis rule allowing quarterly payment applies to client.

NOTE:

If the total amount of accumulated employment taxes for a quarter is less than $2500 and the amount is fully deposited or remitted with a timely filed quarterly return, the amount deposited or remitted is deemed timely [*Treas. Reg. § 31.6302-1(f)(4)*; ***see*** Treas. Reg. § 31.6302-1T(f)(4)].

8. Classify client as either a monthly or semi-weekly depositor for federal employment tax purposes.

NOTE:

While employers must generally deposit employment taxes monthly or semi-weekly, an overriding exception to the rule exists when an employer has accumulated $100,000 or more of employment taxes,

in which case taxes must be deposited by the close of the next banking day [*Treas. Reg. § 31.6302-1(a), (c)(3)*].

a. Determine aggregate amount of employment taxes reported by client for "lookback period" on quarterly returns (IRS Form 941) filed during four quarters constituting period [Treas. Reg. § 31.6302-1T(b)(4)].

NOTE:
The lookback period for each calendar year is the 12-month period ending preceding June 30; if the client is a new employer, the client will be treated as having employment tax liabilities of zero for any calendar quarter during which the client did not exist [Treas. Reg. § 31.6302-1T(b)(4)].

b. If aggregate amount of employment taxes for lookback period is $50,000 or less, client is monthly depositor for entire calendar year unless subject to special $100,000 rule [*Treas. Reg. § 31.6302-1(b)(2)*].

NOTE:
Monthly depositors must deposit employment taxes accumulated during the calendar month in an authorized financial institution on or before the 15th day of the following month, or if the 15th is not a banking day, on the first banking day thereafter [*Treas. Reg. § 31.6302-1(c)(1), (4)*; *but see Treas. Reg. § 31.6302-1(c)(7)* (exception for employers making interest-free adjustments)].

c. If aggregate amount of employment taxes for lookback period exceeds $50,000, client is semi-weekly depositor for entire calendar year [*Treas. Reg. § 31.6302-1(b)(3)*].

NOTE:
Semi-weekly depositors must deposit employment taxes in an authorized financial institution generally as follows: taxes accumulated on Wednesday, Thursday, and/or Friday must be deposited on or before the following Wednesday; taxes accumulated on Saturday, Sunday, Monday, and/or Tuesday must be deposited on or before the following Friday [*Treas. Reg. § 31.6302-1(c)(2)*; *but see Treas. Reg. § 31.6302-1(c)(7)* (exception for employers making interest-free adjustments)].

9. Advise client of time and manner of deposit of federal employment taxes, as follows [*Treas. Reg. § 31.6302-1(i)(1), (3)*]:

a. Deposit of employment taxes must be made separately from any other deposit.

b. Deposit of employment taxes in one calendar quarter must be made separately from deposit for another calendar quarter.

c. Each deposit must be accompanied by an FTD coupon (IRS Form 8109).

NOTE:
The client should receive FTD coupon books after receiving an employer identification number. If a deposit must be made before receipt of the coupon books, request coupon books from the local IRS office by furnishing the business name, employer identification number, address where books are to be sent, and number of books requested [*Treas. Reg. § 31.6302-1(h)(4)*].

10. Advise client that, during tax year, quarterly return of income and disability tax withheld and unemployment and training tax due (Form DE-3) must be filed with the EDD on or before the last day of the month following the close of the quarter, unless monthly returns are required [*see Unemp. Ins. Code §§ 1088, 1110, 13021*; 22 Cal. Code Reg. § 1088-1(a)].

11. On or before January 31 of each year, or within 30 days after last payment of wages to terminated employee, have client furnish each employee IRS Form W-2 showing wages paid and taxes withheld during preceding calendar year [*I.R.C. § 6051*; *Treas. Reg. § 31.6051-1*; 22 Cal. Code Reg. § 4350-1].

12. On or before last day of February of each year, have client file transmittal of income and tax statement (IRS Form W-3) with IRS office where quarterly returns are filed, together with copies of all W-2 Forms [*Treas. Reg. §§ 31.6051-2, 31.6071(a)-1(a)*].

13. On or before February 28 of each year, have client file Form DE-43 (Annual Reconciliation of Personal Income Tax and Transmittal of W-2, W-2C, W-2P, and 1099R Forms) with EDD [*see Unemp. Ins. Code §§ 13050*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)General OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesEstimates & Withholding (IRC secs. 3101-3102, 3301-3310, 3401-3406, 6315, 6654-6655)FICA DeductionsTax LawState & Local TaxesAdministration & ProceedingsGeneral OverviewTax LawState & Local TaxesAdministration & ProceedingsCollectionTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsGeneral OverviewTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1E California Legal Forms--Transaction Guide § 1E.121

§ 1E.121 State Sales and Property Tax Considerations

[1] Collection of Sales Tax

1. Advise client to obtain seller's permit for each business location [*Rev. & Tax. Code § 6066*] by making application on SBE form and posting security bond, if required [*Rev. & Tax. Code § 6067*].

2. Advise client to conspicuously display seller's permit in each business location [*Rev. & Tax. Code § 6067*].

3. Advise client of responsibility of collecting sales tax [*see § 1E.111*] and that sales tax reimbursement can be collected from consumers only if one of following applies [*Civ. Code § 1656.1(a)*; *18 Cal. Code Reg. § 1700(a)(2)*]:

a. Sales agreement provides for reimbursement.

b. Amount of sales tax reimbursement is shown on sales receipt or other proof of sale.

c. Notice that sales tax reimbursement is added to sale price of all items is either:
(1) Posted in visible location on premises; or

(2) Included on price tags or advertisements.

NOTE:
The following notices raise the presumption that sales price includes sales tax reimbursement: "All prices of taxable items include sales tax reimbursement computed to the nearest mill" and "The price of this item includes sales tax reimbursement computed to the nearest mill" [*Civ. Code § 1656.1(b)*; *18 Cal. Code Reg. § 1700(a)(2)(C)*].

4. Advise client that liability for collection of sales tax is extinguished if purchaser provides resale certificate under the following conditions:

NOTE:
If a purchaser intends to resell purchased property in the regular course of business, the sale is not subject to sales tax; however, the client is still liable for collecting tax unless the purchaser timely provides a valid resale certificate [*18 Cal. Code Reg. § 1668(a)*].

a. Resale certificate must be "timely."

NOTE:
A resale certificate is timely if it is provided before the seller bills the purchaser for the property, at any time within the seller's normal billing and payment cycle, or at any time at or before delivery of the property to the purchaser [*18 Cal. Code Reg. § 1668(a)*].

b. Resale certificate must contain all of following [*18 Cal. Code Reg. § 1668(b)(1)*]:

NOTE:
minimum form that will be regarded as a resale certificate. However, to preclude potential controversy, the seller should timely obtain from the purchaser a certificate substantially in the form shown in Appendix A of *18 Cal. Code Reg. § 1668*. If a purchaser operates an auto body repair and/or paint business, a specific resale certificate in substantially the same form as shown in Appendix B of *18 Cal. Code Reg. § 1668* [*18 Cal. Code Reg. § 1668(b)(2)*].

(1) Signature of purchaser, purchaser's employee, or authorized representative of purchaser.

(2) Purchaser's name and address.

(3) Purchaser's seller's permit number.

NOTE:
If the purchaser is not required to hold a permit because the purchaser sells only property of a kind the retail sale of which is not taxable (such as food products for human consumption) or because the purchaser makes no sales in California, the purchaser must include on the certificate a sufficient explanation as to the reason the purchaser is not required to hold a California seller's permit in lieu of a seller's permit number [*18 Cal. Code Reg. § 1668(b)(1)(C)*].

(4) Statement that described property is purchased "for resale."

NOTE:
The document must contain the phrase "for resale." The use of phrases such as "nontaxable," "exempt," or similar terminology is not acceptable. The property to be purchased under the certificate must be described either by an itemized list of the particular property to be purchased for resale, or by a general description of the kind of property to be purchased for resale [*18 Cal. Code Reg. § 1668(b)(1)(D)*].

(5) Date of execution.

5. Advise client that, if audited, failure to timely obtain valid resale certificate means client will only be relieved of liability for sales tax upon presentation of satisfactory evidence of one of following [*18 Cal. Code Reg. § 1668(e)*]:

a. Property is actually resold in purchaser's regular course of business.

b. Property is being held for resale by purchaser and has not been put to taxable use.

c. Property has been used or consumed by purchaser and

(1) Tax was reported directly to Board by purchaser on purchaser's sales and use tax return; or

(2) Tax was paid to Board by purchaser pursuant to assessment against or audit of purchaser developed either on actual basis or test basis.

[2] Property Tax Base and Statements

1. Determine taxable base of business for property tax purposes, examining the following:

a. Available exemptions.

b. Whether or not property is assessed to business and timing of assessment.

c. Whether property is subject to jurisdiction of particular county.

d. Whether start of business has caused change of ownership.

NOTE:
A change in ownership of real property results in a reassessment at full cash value on the date that the change of ownership occurs [***see*** *Cal. Const. art. XIIIA, § 2(a)*; *Rev. & Tax. Code § 110.1(a)*]. A transfer from an individual to a legal entity such as a partnership is treated as a change of ownership [***see*** *Rev. & Tax. Code § 61(j)*], as is a transfer of property between entities [***see*** *18 Cal. Code Reg. § 462.180(a)*]. However, no change of ownership occurs if the transfer results only in a change in method of holding title and proportional interests in the transferred property are exactly the same before and after transfer [*Rev. & Tax. Code § 62(a)*; *18 Cal. Code Reg. § 462.001(b)*].

e. What valuation of real property should be.

NOTE:
All property is valued for assessment at full cash or fair market value, which is defined as the amount of cash or its equivalent that the property would bring if (1) offered for sale in the open market; (2) both the buyer and seller were knowledgeable about the property's uses and purposes, including restrictions on its use; and (3) neither party could take advantage of exigencies of the other [*Rev. & Tax. Code §§ 110, 402.1*].

f. What valuation of tangible personal property should be.

NOTE:

When appraising tangible personal property, the assessor will give recognition to the trade level at which the property is situated and to the principle that property values normally increase as the property progresses through production and distribution channels to its ordinary maximum value at the consumer level [*18 Cal. Code Reg. § 10(a)*; ***see*** *18 Cal. Code Reg. § 10(b)-(f)*].

2. Determine whether business owns taxable personal property with aggregate cost of $100,000 or more [*Rev. & Tax. Code § 441*].

a. If so, advise client that informational statements must be filed annually with the assessor of each county in which the business has property [*see § 1E.71*].

b. If property subject to tax has full cash value under $200,000, short-form property statement may be used [*see 18 Cal. Code Reg. § 171(d)*].

3. If annual statement is required, advise client to prepare current property statement and review it for accuracy; statement will have to be amended to reflect any acquisitions or dispositions before applicable lien date.

NOTE:

The taxpayer, a partner, or an agent must sign the statement under penalty of perjury [*Rev. & Tax. Code § 441(b)*; *18 Cal. Code Reg. § 172(c)*]. If the statement is signed by an agent or employee other than a licensed attorney, certified public accountant, public accountant, or duly appointed fiduciary, the taxpayer's written authorization must be filed with the assessor [*18 Cal. Code Reg. § 172(a)*].

A filed property statement may be amended without penalty until May 31 of the applicable year for errors and omissions that are not the result of willful intent to make an erroneous report [*Rev. & Tax. Code § 441(i)*; ***see*** *Rev. & Tax. Code § 463* (penalty)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesAdministration & ProceedingsCollectionTax LawState & Local TaxesPersonal Property TaxGeneral OverviewTax LawState & Local TaxesReal Property TaxAssessment & ValuationAssessment Methods & TimingTax LawState & Local TaxesReal Property TaxAssessment & ValuationValuationTax LawState & Local TaxesSales TaxImposition of Tax



53 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1E California Legal Forms--Transaction Guide § 1E.122

§ 1E.122 Partnership Considerations

[1] Partnership-Level Treatment

1. Advise client that partnership-level procedure rules require that each partner report partnership items (and the applicability of any penalty, addition to tax, or additional amount relating to an adjustment to a partnership item) consistently with partnership's treatment unless IRS is notified of inconsistency and that all controversies about treatment are determined at partnership-level proceedings [*I.R.C. §§ 6221, 6222, 6231(a)(3)*].

2. Advise client that following are partnership items:

a. Income, gains, losses, deductions, and credits; nondeductible expenditures; tax-preference items for any partner [*see I.R.C. § 57*]; tax-exempt income; and partnership liabilities [*Treas. Reg. § 301.6231(a)(3)-1(a)(1)(i)-(v)*].

b. Other items regarding partnership assets, investments, transactions, and operations needed to compute investment tax credit or recapture, oil well and gas well depletion, amounts at-risk in partnership activities, or ordinary income or loss attributable to partnership unrealized receivables and inventory [*Treas. Reg. § 301.6231(a)(3)-1(a)(1)(vi)*].

c. Guaranteed payments [*Treas. Reg. § 301.6231(a)(3)-1(a)(2)*; *see I.R.C. § 707(c)*].

d. Items and issues relating to contributions to partnership, including character of amount received; amount of money contributed; applicability of investment company rules to contribution; and partnership's basis in contributed property [*Treas. Reg. § 301.6231(a)(3)-1(a)(4), (c)(2)*].

e. Items and issues relating to distributions from partnership, including character of amount transferred; amount of money distributed; partnership's basis in distributed property; and character of distributed property as, for example, inventory or capital asset [*Treas. Reg. § 301.6231(a)(3)-1(a)(4), (c)(3)*].

f. Items and issues relating to transactions between partnership and partner not acting in capacity as partner, including amount transferred to partner; character of transferred amount; and each partner's percentage interest in partnership capital and profits [*Treas. Reg. § 301.6231(a)(3)-1(a)(4), (c)(4)*].

g. Accounting practices, including method of accounting; taxable year; and inventory method [*Treas. Reg. § 301.6231(a)(3)-1(b)*].

3. Determine whether partnership meets following conditions of "small partnership" and is exempt from partnership-level procedural rules [*I.R.C. § 6231(a)(1)(B)*]:

a. There are no more than 10 partners at any one time during year.

NOTE:
Spouses and their estates are counted as one partner [*I.R.C. § 6231(a)(1)(B)(i)*].

b. All partners are natural persons or estates.

NOTE:
The partnership cannot have, at any time during the year, any "pass-through" partners which include another partnership, estate, trust, S corporation, or nominee [*I.R.C. § 6231(a)(9)*; Temp. Treas. Reg. § 301.6231(a)(1)-1T(a)(2)].

c. No partner is a nonresident alien at any time during year.

d. At any time during year, each partner's share of following partnership items is the same as that partner's share of every other item: items of income, gain, loss, deduction, or credit; nondeductible expenditures; tax preference items; and tax-exempt income.

4. If partnership is "small partnership" and exempt from partnership-level procedure rules, determine whether partnership should elect to be subject to those rules [*see I.R.C. § 6231(a)(1)(B)(ii)*].

NOTE:
Election is made by attaching a statement to the partnership return for the taxable year for which the election is to be effective; the statement must refer to the election under *I.R.C. § 6231(a)(1)(B)(ii)* and is signed by all persons who were partners during the year [Temp. Treas. Reg. § 301.6231(a)(1)-1T(b)(2)].

[2] Designation of Tax-Matters Partner and Other Elections

1. Advise client to select tax-matters partner (TMP) and alternate TMP, if desired [*see Treas. Reg. § 301.6231(a)(7)-1(a)*].

2. Determine whether selected partner meets following conditions of eligibility to be TMP for taxable

year:

a. Was designee general partner at some time during that year or when designation is made [*Treas. Reg. § 301.6231(a)(7)-1(b)(1)*]?

b. Was designee U.S. person for taxable year [*see Treas. Reg. § 301.6231(a)(7)-1(b)(2)*]?

NOTE:
If a U.S. person is eligible to be TMP for a year, a non-U.S. person may not be designated TMP without the consent of the IRS [*Treas. Reg. § 301.6231(a)(7)-1(b)(2)*].

3. Advise client that elections will have to be made at partnership level concerning partnership accounting methods, tax year, method of depreciation, and any adjustment of basis of partnership property [*see I.R.C. § 703(b)*].

NOTE:
An election properly made for federal tax purposes is deemed a proper election for California tax purposes [*Rev. & Tax. Code § 17024.5(e)*]; a separate election to obtain other tax treatment for California purposes may be filed, but only when that election is expressly authorized by statute or regulation [***see*** *Rev. & Tax. Code § 17024.5(e)(3)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsContributions to Partnerships (IRC secs. 721-724)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsDistributions by Partnerships (IRC secs. 731-737)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsPartnership Tax Returns (IRC sec. 6031)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsPartnership Tax Returns (IRC sec. 6031)Information ReturnsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsTransactions Between Partner & Partnership (IRC sec. 707)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1E California Legal Forms--Transaction Guide § 1E.123

§ 1E.123 Corporate Considerations

1. Advise corporate client concerning election to be treated as S corporation [*see I.R.C. § 1362(a)*; *see also* Ch. 2B, *Electing Subchapter S Status*].

NOTE:
This election is made on IRS Form 2553 and is filed separately from annual return.

2. Advise corporate client of depreciation options and election under Accelerated Cost Recovery System (ACRS) [*see I.R.C. § 168*].

NOTE:
This election is made on IRS Form 4562 (Depreciation and Amortization) and is made with the annual return.

3. Advise corporate client of selection of original tax year.

NOTE:
This election is made on original annual return [Temp. Treas. Reg. § 1.441-1T(b)(2)]. Corporations which are neither S corporations nor personal service corporations may adopt any fiscal year [***see*** *I.R.C. §§ 441, 444*].

4. Advise corporate client concerning adoption of accounting method.

NOTE:
Corporation may adopt any permissible method on original return; once method is selected, that method must be used unless law changes or permission to change is obtained from IRS [Temp. Treas. Reg. § 1.441-1T(b)(3)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1E California Legal Forms--Transaction Guide § 1E.124

§ 1E.124 Limited Liability Company Considerations

[1] Choosing Type of Tax Treatment

1. Determine whether to be taxed as:

a. Partnership; or

b. Corporation.

NOTE:
For issues to consider in determining whether an LLC should be taxed as a corporation or as a partnership, see Ch. 12C, ***Limited Liability Companies*** .

2. If LLC will be taxed as corporation, file election to be taxed as corporation, and comply with corporate tax requirements [*see § 1E.123*].

NOTE:
Under tax classification rules effective January 1, 1997, an LLC may elect to be taxed either as a corporation or as a partnership [*Treas. Reg. § 301.7701-3(a)(1)*]. Unless it affirmatively elects to be classified as a corporation, it will be classified as a partnership if it has two or more members, or disregarded as an entity separate from its owner if it has only one owner [*Treas. Reg. § 301.7701-3(b)*].

An election is made by attaching a copy of IRS Form 8832 to its federal tax or information return for the year in question [***see*** *Treas. Reg. § 301.7701-3(c)* (procedure for making election)].

3. If LLC will be taxed as partnership, comply with partnership tax requirements [*see [2], [3], below*].

NOTE:

For a brief discussion of federal taxation of LLCs, see *§ 1E.13*. For extensive coverage of LLCs, see Ch. 12C, ***Limited Liability Companies*** , and Ballantine & Sterling, California Corporation Laws, Ch. 27, ***Limited Liability Companies*** (Matthew Bender).

[2] Limited Liability Company-Level Treatment

NOTE:

The remainder of this section is drafted with the assumption that the limited liability company (LLC) will receive federal partnership-like income tax treatment. If this is the case, the LLC will be subject to partnership income tax law, and will be treated just as a partnership would. If the LLC will receive federal corporate tax treatment, see *Section 1E.123*.

1. Advise client that LLC-level procedure rules require that each member report member items (and the applicability of any penalty, addition to tax, or additional amount relating to an adjustment to a partnership item) consistently with LLC's treatment unless IRS is notified of inconsistency and that all controversies about treatment are determined at LLC-level proceedings [*I.R.C. §§ 6221, 6222, 6231(a)(3)*].

2. Advise client that following are LLC items:

a. Income, gains, losses, deductions, and credits; nondeductible expenditures; tax-preference items for any member [*see I.R.C. § 57*]; tax-exempt income; and, LLC liabilities [*Treas. Reg. § 301.6231(a)(3)-1(a)(1)(i)-(v)*].

b. Other items regarding LLC assets, investments, transactions, and operations needed to compute investment tax credit or recapture, oil well and gas well depletion, amounts at-risk in LLC activities, or ordinary income or loss attributable to LLC unrealized receivables and inventory [*Treas. Reg. § 301.6231(a)(3)-1(a)(1)(vi)*].

c. Guaranteed payments [*Treas. Reg. § 301.6231(a)(3)-1(a)(2)*; *see I.R.C. § 707(c)*].

d. Items and issues relating to contributions to LLC, including character of amount received; amount of money contributed; applicability of investment-company rules to contribution; and LLC's basis in contributed property [*Treas. Reg. § 301.6231(a)(3)-1(a)(4), (c)(2)*].

e. Items and issues relating to distributions from LLC, including character of amount transferred; amount of money distributed; LLC's basis in distributed property; and character of distributed property as, for example, inventory or capital asset [*Treas. Reg. § 301.6231(a)(3)-1(a)(4), (c)(3)*].

f. Items and issues relating to transactions between LLC and member not acting in capacity as member, including amount transferred to member; character of transferred amount; and each member's percentage interest in LLC capital and profits [*Treas. Reg. § 301.6231(a)(3)-1(a)(4), (c)(4)*].

g. Accounting practices, including method of accounting; taxable year; and inventory method [*Treas. Reg. § 301.6231(a)(3)-1(b)*].

[3] Designation of Tax Matters Member and Other Elections

1. Advise client to select tax matters member and alternate, if desired [*see Treas. Reg. § 301.6231(a)(7)-1(a)*].

2. Determine whether selected member meets following conditions of eligibility for taxable year:

a. Was designee member at some time during that year or when designation is made [*Treas. Reg. § 301.6231(a)(7)-1(b)(1)*]?

b. Was designee U.S. person for taxable year [*see Treas. Reg. § 301.6231(a)(7)-1(b)(2)*]?

NOTE:
If a U.S. person is eligible to be tax matters member for the year, a non-U.S. person may not be designated the without consent of the IRS [*Treas. Reg. § 301.6231(a)(7)-1(b)(2)*].

3. Advise client that elections will have to be made at LLC level concerning LLC accounting methods, tax year, method of depreciation, and any adjustment of basis of LLC property [*see I.R.C. § 703(b)*].

NOTE:
An election properly made for federal tax purposes is deemed a proper election for California tax purposes [*Rev. & Tax. Code § 17024.5(e)*]; a separate election to obtain other tax treatment for California purposes may be filed, but only when that election is expressly authorized by statute or regulation [***see*** *Rev. & Tax. Code § 17024.5(e)(3)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
C. Procedural Guide

1-1E California Legal Forms--Transaction Guide §§ 1E.125-1E.129

[Reserved]

§§ 1E.125[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

1-1E California Legal Forms--Transaction Guide § 1E.130

§ 1E.130 Record Retention

1. Advise client and accountant to establish system for keeping records of:

    a. Cash receipts.

    b. Cash disbursements.

    c. Sales.

    d. Purchases.

    e. Wages paid.

    f. Equipment leased.

    g. Inventory.

    h. Accounts receivable.

    i. Accounts payable.

2. Have client set up system for retaining records for indicated periods:

NOTE:

Retain the following records for general or historical reference and to substantiate information on balance sheets and tax returns. Consider the statute of limitations with respect to assessment of income tax deficiencies in determining how long to retain the records. The statute of limitations for assessing

additional income taxes is generally three years from the due date of the return (absent false return, willful attempt to evade tax, no return, or extension by agreement) [*I.R.C. § 6501(a), (c)*]. The statute of limitations for assessing additional income taxes is six years from the date of the return if gross income is omitted in amount equal to or greater than 25 percent of the gross income reported on the return [*I.R.C. § 6501(e)*]. If no return is filed or a fraudulent return is filed, there is no statute of limitations [*I.R.C. § 6501(c)*].

The following guidelines are based on data provided by the Guide to Record Retention Requirements, published by the Government Printing Office, Washington, D.C. 20401. Because the statute of limitations runs from the due date of the return, as a general rule retain the records at least six months longer than number of years given below.

a. Accounting records.

(1) Bank statements--six years.

(2) Deposit slips--six years.

(3) Payroll time cards--six years.

(4) Cancelled dividend checks--six years.

(5) Expense reports--six years.

(6) Accounts payable and receivable and other subsidiary ledgers--six years.

(7) Monthly trial balances--six years.

(8) Cancelled general and payroll checks other than those viewed as important corporate records--eight years.

(9) Payment vouchers--eight years.

(10) Audit reports--permanently.

(11) General ledgers and journals--permanently.

b. Business operation records.

(1) Tax records, including returns and working papers--permanently.

(2) Checks given in payment of taxes, for property, and on major contracts--permanently.

(3) Contracts--permanently.

(4) Copyright, trademark registration, and patent records--permanently.

(5) Labor contracts (collective bargaining and employment)--permanently.

(6) Legal and tax correspondence--permanently.

c. Personnel records.

(1) Withholding tax statements--six years.

(2) Paycheck deduction records--six years.

(3) Retirement and related papers--permanently.

(4) Pension records--permanently.

d. Purchase and sales records.

(1) Purchase orders--four years.

(2) Requisitions--six years.

(3) Sales contracts and invoices--six years.

(4) Exemption and resale certificates--four years following completion of last sale covered by certificate.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesGovernmentsLegislationStatutes of LimitationsTime LimitationsLabor & Employment LawWage & Hour LawsRecordkeeping RequirementsTax LawFederal Tax Administration & ProcedureAdministrationTax Payment & Tax Return Requirements (IRC secs. 6071-6091, 6151-6167)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

1-1E California Legal Forms--Transaction Guide §§ 1E.131-1E.199

[Reserved]

§§ 1E.131[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART IV. FORMS

1-1E California Legal Forms--Transaction Guide § 1E.200

§ 1E.200 Client Letter Prior to Initial Meeting

[1] Comment--Use of Form

Prior to the initial meeting with the client, the attorney will need enough information to determine the scope of the work to be done and any preliminary decisions to be made. This letter is used to obtain that information. Complicated or lengthy questionnaires tend to discourage clients and may result in cancelled appointments because the client is "unprepared." This letter is composed with that in mind. If a more detailed set of questions is appropriate before the initial meeting, the attorney should incorporate relevant facts and documents from the client interview [*see 1E.10*]. The first paragraph of this letter mentions a fee and representation agreement. For sample forms, see Volume 15, Chapter 86, *Agreements for Professional Services*.

[2] Form

Client Letter Prior to Initial Meeting

_____[*date*]
_____[*client's name*]
_____[*client's address*]

Re: Tax considerations for new business
Dear _____ [*client's name*] :

In preparation for our initial meeting, regarding tax considerations for your new business, I have [sent you under separate cover *or* enclosed] a fee and representation agreement outlining our mutual obligations.

The purpose of this letter is to provide you with a short list of information and documents that you should bring to our initial meeting. This is a suggested list only. If you believe other items would be useful, include those as well. If you are unable to obtain everything on the list, bring what you have available.

Information:

1. Names and telephone numbers of people who are key to the business (including owners, managers, accountant, banker, etc.).

2. Sources of funding (including amounts contributed by business owners, loans from owners to business, other loans, etc.)

Documents:

1. Three years' prior federal income tax returns for participants (both individuals and business entities, if any).

2. List of assets, stating value of each asset and source of value determination.

3. Projected profit and loss statements and balance sheet for the business, if available.

4. Any agreements signed at the time the business was formed, or subsequently.

I look forward to meeting with you on _____[*date*] at _____[*time*] at _____[*location*] to discuss your business. Do not hesitate to call if you have questions.

Very truly yours,
_____ [*signature of attorney*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsAttorney FeesFee Agreements



60 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART IV. FORMS

1-1E California Legal Forms--Transaction Guide § 1E.201

§ 1E.201 Client Letter Following Initial Meeting If Attorney Is Retained

[1] Comment--Use of Form

The client letter following the initial meeting reiterates the tasks the attorney will perform, reminding the client of the extent of the work involved. If the attorney is awaiting additional materials, the letter also provides the client with a complete list of the additional information or documents that must be provided and notifies the client that work cannot be completed without those items.

[2] Form

Client Letter Following Initial Meeting If Attorney Is Retained

_____[*date*]
_____[*client's name*]
_____[*client's address*]

Dear _____ [*client's name*] :

In our meeting on _____[*date*], we agreed that I would _____[*specify tasks to be performed*].

[*If client is to provide additional information:*]

We also agreed that you would provide me with the following: _____[*list of information and documents*].

I look forward to receiving your information as soon as possible, so that I can complete the work we discussed. I will telephone you to confirm receipt of your materials and to schedule a date for our follow-up discussion.

[*If client is not to provide any additional information:*]

I look forward to seeing you at _____[*time*] on _____[*date*], at _____[*location*] to discuss the results of this research.

[*Continue with the following:*]

Very truly yours,
_____ [*signature of attorney*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsEffective Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1E TAXATION OF BUSINESSES
PART IV. FORMS

1-1E California Legal Forms--Transaction Guide § 1E.202

§ 1E.202 Client Letter If Attorney Is Not Retained

[1] Comment--Use of Form

If the attorney is not retained, a follow-up letter to the client establishes the end of the attorney-client relationship related to that particular representation. This letter will help establish a date from which the statute of limitations runs for purposes of malpractice claims [*see Code Civ. Proc. § 340.6(a)(2)*].

If the client has provided the attorney with documents, they should be returned to the client along with this letter. The letter should be sent by certified or registered mail to document the close of the attorney-client relationship and confirm the client's receipt of any returned documents.

[2] Form

Client Letter If Attorney Is Not Retained

_____[*date*]
_____[*client's name*]
_____[*client's address*]

Dear _____ [*client's name*] :

This letter will confirm our _____[telephone conversation *or* conversation] of _____[*date*], in which we concluded that you would not be retaining my services for your new business venture.

If you decide to pursue this matter, please feel free to consult me again. However, currently, I consider the matter closed.

[*If documents are returned, add*:]

Enclosed please find the following documents which I am returning to you: _____[*list of documents*].

I appreciate your confidence and having had the opportunity to be of service. Please call if you have any questions, or if I can be of service in the future.

Very truly yours,
_____ [*signature of attorney*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION

1-1F California Legal Forms--Transaction Guide 1F.syn

AUTHOR: Reviewed by Pam Boc

§ 1F.syn Synopsis to Chapter 1F: INSURANCE CONSIDERATIONS IN BUSINESS FORMATION

§ 1F.01 California Sources

[1] Statutes

[2] Regulations

§ 1F.02 Federal Sources

[1] Internal Revenue Code

[2] Treasury Regulations

§§ 1F.03-1F.04 [Reserved]

§ 1F.05 Law Reviews and Periodicals

§ 1F.06 Annotations

§ 1F.07 Text References

§ 1F.08 Insurance Company Rating Guides

§ 1F.09 [Reserved]

§ 1F.10 Nature of Insurance

[1] Attorney's Role in Making Insurance Recommendations

[2] Insurance Defined

[3] Purpose of Insurance

[4] Categories of Insurance

§ 1F.11 Governing Law

§ 1F.12 Insurance Contract

[1] Formation of Insurance Contract

[2] Required Contents

[3] Oral Contracts

[4] Written Contracts

§ 1F.13 Types of Policies

[1] Open and Valued Policies Distinguished

[2] Running Policies

[3] Specific and Floater Policies Distinguished

[4] Master Policies and Individual Certificates of Insurance

§ 1F.14 Premiums

[1] Payment of Premium

[2] Return of Premium

[a] Right to Return

[b] Conditions of Return

[3] Life Insurance Policies: Special Premium Considerations

[a] Cash Surrender Value

[b] Waiver of Premium

[4] Forfeiture of Policy for Nonpayment

§ 1F.15 Coverage

[1] Commencement of Coverage

[a] In General

[b] Under Oral Binder

[2] Limitations on Coverage

[a] In General

[b] Distinguished From Warranties and Conditions

[i] Warranties and Conditions Defined

[ii] Classification of Clause as Limitation or as Warranty or Condition

[c] Consequences of Classifying Clause as Limitation or as Warranty or Condition

[i] Avoidance of Policy Due to Breach of Warranty or Condition

[ii] Application of Waiver and Estoppel to Breach of Warranty or Condition

[iii] Limitation on Defense of Warranty or Condition

[3] Effect of Agent's or Company's Representations

§ 1F.16 Rescission

[1] Grounds for Rescission

[2] Time for Rescission

[3] Availability of Damages for Fraud

§ 1F.17 Cancellation by Mutual Agreement

§ 1F.18 Cancellation by Insured

§ 1F.19 Cancellation by Insurer--In General

[1] Covenant of Good Faith and Fair Dealing

[2] Notice to Insured

[a] General Requirements

[b] Notice of Cancellation of Commercial Policy

[3] Refund Upon Cancellation

§ 1F.20 Cancellation by Insurer of Individual Property and Liability Policies

§ 1F.21 Cancellation by Insurer of Commercial Property and Liability Policies

§ 1F.22 Nonrenewal by Insurer

[1] Individual Policies

[2] Commercial Policies

§ 1F.23 Insurer's Duty to Defend

[1] In General

[2] Scope of Duty to Defend

§ 1F.24 Insurer's Obligation to Provide Independent Counsel

[1] In General

[2] Statutory Duties

[a] Insurer's Duty to Appoint Independent Counsel

[b] Duty of Appointed Independent Counsel

[3] Existence of Conflict of Interest

§§ 1F.25-1F.29 [Reserved]

§ 1F.30 Life Insurance Defined

§ 1F.31 Purpose of Life Insurance

§ 1F.32 Basic Elements of Life Insurance

[1] In General

[2] Insurable Interest

[a] Requirement for Valid Insurance Contract

[b] Statutory Definition

[c] Insurable Interest of Employer

[3] Shifting of Loss

[4] Insurable Risk

§ 1F.33 Term Life Insurance

§ 1F.34 Whole Life Insurance

§ 1F.35 Life Insurance for Business Purposes

[1] General Uses

[2] Corporation Life Insurance

[3] Partnership Life Insurance

§ 1F.36 Disability and Health Insurance

[1] Definition

[2] Classification of Disability Insurance by Types of Benefits

§§ 1F.37-1F.49 [Reserved]

§ 1F.50 Property and Liability Insurance--In General

[1] Distinguished

[2] Governing Law

§ 1F.51 Property Insurance

[1] Personal and Commercial Lines Distinguished

[2] Open and Valued Policies Distinguished

[3] Subject Matter of Property Insurance

[a] In General

[b] Specific Categories of Property

[i] Real Property

[ii] Boiler and Machinery

[iii] Automobile

[iv] Marine

[v] Aircraft

§ 1F.52 Liability Insurance

[1] Types of Liability Insurance--In General

[2] Forms of Commercial Liability Insurance Policies

[a] Individual Policies

[b] Business General Liability Policies

[c] Package Policies

[3] Professional Liability Insurance

[4] Protection Against Attorney's Fees and Related Costs

§§ 1F.53-1F.59 [Reserved]

§ 1F.60 General Insurance Considerations in Business Planning

§ 1F.61 Directors and Officers Insurance

[1] Governing Law

[2] Authority of Corporations to Procure Coverage; Power of Corporation to Limit Liability

[3] Availability of Insurance Coverage

[4] Forms of Coverage

[a] In General

[b] Directors and Officers Liability Coverage

[c] Corporate Reimbursement Coverage

[5] Coverage Under Other Insurance Policies

[6] Only "Claims Made" Coverage Available

[7] Extended Coverage

§ 1F.62 Key Employee Life and Disability Insurance

[1] In General

[2] Tax Considerations

[a] Taxation of Premiums

[i] Deduction by Employer

[ii] Taxable to Key Employee

[b] Taxation of Policy Proceeds

[c] Alternative Minimum Tax Considerations for C Corporations

[d] Taxation of Accidental Death or Disability Feature

§ 1F.63 Life Insurance Funded Buy-Sell Agreement

[1] Types of Buy-Sell Agreements

[2] Advantages of Buy-Sell Agreements

[3] Cost of Insurance

[4] Alternate Insurance Possibilities

[5] Adequate Amount and Appropriate Life Insurance Product for Funding

[a] Amount

[b] Type of Life Insurance Product

[6] Importance of Funding Agreement Through Purchase of Insurance

§ 1F.64 Taxation of Corporate Buy-Sell Agreements Funded by Life Insurance

[1] Taxation of Premiums

[2] Taxation of Policy Proceeds

[3] Accumulated Earnings Tax

[4] Estate Taxation of Policy Proceeds

[a] In General

[b] Incidents of Ownership

[c] Valuation of Shares

§ 1F.65 Taxation of Shareholder Cross-Purchase Agreement Funded by Life Insurance

[1] Taxation of Premiums

[2] Taxation of Policy Proceeds

[3] Estate Taxation of Policy Proceeds

§ 1F.66 Taxation of Partnership Buy-Sell Agreement

[1] Taxation of Premiums and Proceeds

[2] Effect of Policy Proceeds on Tax Basis of Partnership Interest

[3] Estate Taxation of Policy Proceeds

§ 1F.67 Insurance Coverage for Actions Against Dissolved Corporation and its Shareholders

§ 1F.68 Business Interruption Insurance

[1] Individual Income Protection

[2] Business Protection Coverage

§ 1F.69 Professional Liability Insurance

[1] Special Characteristics of Professional Liability Policies

[2] Liability and Indemnity Policies Distinguished

[3] Coverage of Defense Expenses Under Liability Policies

[4] Claims Made Coverage Compared to Occurrence Coverage

§ 1F.70 Workers' Compensation Insurance

[1] In General

[2] Obtaining Insurance

[3] Consequences of Misclassification and Failure to Carry Insurance

[4] Liability to Independent Contractors

§§ 1F.71-1F.99 [Reserved]

§ 1F.100 Facts

[1] Information Regarding Individuals Participating in New Business

Scope

[2] Information Regarding Corporation

Scope

[3] Information Regarding Shareholders

Scope

[4] Information Regarding Partnership

Scope

[5] Information Regarding Partners

Scope

[6] Information Regarding Limited Liability Company

Scope

[7] Information Regarding Members

Scope

[8] Information Regarding Sole Proprietorship

Scope

§ 1F.101 Documents

[1] Corporation

Scope

[2] Partnership

Scope

[3] Limited Liability Company

Scope

[4] Sole Proprietorship

Scope

[5] Individual Participants

Scope

§§ 1F.102-1F.109 [Reserved]

§ 1F.110 Property Insurance

Scope

§ 1F.111 General Liability Insurance

Scope

§ 1F.112 Directors and Officers Insurance

Scope

§ 1F.113 Professional Liability Insurance

Scope

§ 1F.114 Liability Insurance Coverage for Actions Against Dissolved Corporations and Their Shareholders

Scope

§ 1F.115 Life and Disability Insurance

Scope

§ 1F.116 Life Insurance Funded Buy-Sell Agreement

Scope

§ 1F.117 Business Interruption Insurance

Scope

§ 1F.118 Workers' Compensation Insurance

Scope

§§ 1F.119-1F.199 [Reserved]

§ 1F.200 Client Letter Prior to Initial Meeting

[1] Comment

[a] Use of Form

[b] Fee and Representation Agreement

[2] Form

Client Letter Prior to Initial Meeting

§ 1F.201 Client Letter Following Initial Meeting

[1] Comment--Use of Form

[2] Form

Client Letter Following Initial Meeting

§ 1F.202 Client Letter If Attorney is to Perform No Further Work

[1] Comment--Use of Form

[2] Form

Client Letter If Attorney is to Perform No Further Work

§ 1F.203 Client Letter If Attorney Recommends Insurance Coverage

[1] Comment--Use of Form

[2] Form

Client Letter If Attorney Recommends Insurance Coverage

§ 1F.204 Checklist for Selecting Insurance Policy

[1] Comment--Use of Form

[2] Form

Checklist for Selecting Insurance Policy

§ 1F.205 Business General Liability Policy

[1] Comment

[a] Use of Form

[b] Importance of Business General Liability Policy

[c] Claims Made Coverage and Occurrence Coverage

[2] Form

Business General Liability Policy

Reviewed by Pam Bocn*

FOOTNOTES:
(n2)Footnote *. Ms. Boc is an assistant vice president and broker at Rollins Hudig Hall in San Francisco.



63 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION

1-1F California Legal Forms--Transaction Guide Scope

AUTHOR: Reviewed by Pam Boc

Scope

Reviewed by Pam Bocn* Scope

This chapter outlines insurance considerations that will arise for a new business. It is intended to assist the attorney who is advising persons involved in starting a new business. The chapter is intended to point out areas of concern to the owners of the business; it is not meant as a complete guide to business insurance. In addition, this chapter is drafted with the assumption that an insurance professional will be involved in advising the business owners on insurance matters.

Although a complete discussion of insurance law is beyond the scope of this chapter, the following insurance issues are discussed:

- The purpose and feasibility of insurance;
- Insurance premiums and coverage;
- Rescission, cancellation, and nonrenewal of policies;
- The insurer's duty to defend;
- Categories of insurance, including life, health, disability, workers' compensation, property, and liability insurance;
- Insurance planning considerations for a new business.

The Transaction Guide is designed to aid the attorney in determining appropriate types of insurance coverage. Forms include client letters and a checklist for determining the appropriate type of insurance policy.

For detailed coverage of California insurance law, refer to California Insurance Law and Practice (Matthew Bender).

For further discussion of the life insurance considerations in estate planning, see Ch. 60, *Estate Planning* . For discussion of limitations on liability based on choice of business entity, see Ch. 1B, *Selecting Form of Business Entity* .

FOOTNOTES:
(n3)Footnote *. Ms. Boc is an assistant vice president and broker at Rollins Hudig Hall in San Francisco.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART I. RESEARCH GUIDE
A. Primary Sources

1-1F California Legal Forms--Transaction Guide § 1F.01

AUTHOR: Reviewed by Pam Boc

§ 1F.01 California Sources

[1] Statutes

General rules governing interpretation of contracts. *Civ. Code §§ 1635-1662*.

Indemnification. *Civ. Code § 2778*.

Conflict of interest; insurer's obligation to appoint independent counsel. *Civ. Code § 2860*.

Service by mail. *Code Civ. Proc. § 1013(a)*.

Close corporation defined. *Corp. Code § 158*.

Indemnification of corporate agents in articles of incorporation; exceptions. *Corp. Code § 204(a)(10), (11)*.

Authority of corporations to procure liability coverage for corporate agents; circumstances under which corporation may or must indemnify agent. *Corp. Code § 317*.

General rules governing insurance. *Ins. Code §§ 100-1877.5*.

Life insurance defined. *Ins. Code § 101*.

Disability insurance defined. *Ins. Code § 106*.

Types of liability insurance. *Ins. Code § 108*.

Types of commercial property insurance. *Ins. Code §§ 111-120*.

Insurable interest generally. *Ins. Code § 280*.

Provisions regarding insurance policies. *Ins. Code §§ 380-460*.

Provisions regarding insurance premiums. *Ins. Code §§ 480-520*.

Rescission. *Ins. Code §§ 650, 651*.

Cancellation or failure to renew. *Ins. Code §§ 660-679.6*.

Unfair Claims Practices Act. *Ins. Code §§ 790-790.10*.

McBride-Grunsky Insurance Regulatory Act. *Ins. Code §§ 1851-1860.3*.

Reduction and control of insurance rates (Proposition 103). *Ins. Code §§ 1861.01-1861.14*.

Classes of insurance. *Ins. Code §§ 1880-12764*.

Marine insurance contracts. *Ins. Code § 1880*.

Fire insurance contracts. *Ins. Code § 2030*.

Life and disability insurance contracts. *Ins. Code § 10110*.

Group life policies. *Ins. Code § 10200*.

Liability, workers' compensation and common carrier liability insurance--general regulations. *Ins. Code § 11550*.

Workers' compensation policies--definitions. *Ins. Code § 11630*.

Rules governing the insurance commissioner. *Ins. Code §§ 12900-13601*.

Rules governing the insurance adjusters. *Ins. Code §§ 14000-15062*.

Worker performing certain construction/trade services presumed to be employee. *Lab. Code § 2750.5*.

Employers subject to workers' compensation laws. *Lab. Code §§ 3300, 3351*.

Employer defined. *Lab. Code § 3300*.

Exclusions. *Lab. Code § 3301*.

Additional persons excluded from definition of employee. *Lab. Code §§ 3352, 3352.94*.

Independent contractor defined. *Lab. Code § 3353*.

Employee defined. *Lab. Code § 3357*.

Workers' compensation or permit to self-insure required of subject employers. *Lab. Code §§ 3700, 3711*.

Workers' compensation coverage for workers not included in definition of employee. *Lab. Code § 4150*.

Compulsory, non-occupation disability law, funded through withholding. *Unemp. Ins. Code §§ 13040-13043*.

Automobile insurance or other evidence of financial responsibility required. *Veh. Code § 16020*.

[2] Regulations

Reporting, auditing requirements for self-insured workers' compensation. *8 Cal. Code Reg. §§ 15250-15406*.

Loss of time (disability benefits). *10 Cal. Code Reg. §§ 2220.24, 2540.5*.

Unfair claims settlement practices. *10 Cal. Code Reg. §§ 2695.1-2695.17*.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART I. RESEARCH GUIDE
A. Primary Sources

1-1F California Legal Forms--Transaction Guide § 1F.02

AUTHOR: Reviewed by Pam Boc

§ 1F.02 Federal Sources

[1] Internal Revenue Code

Alternative minimum tax. *I.R.C. §§ 55-58*.

Group life insurance--anti-discrimination tests. *I.R.C. § 79(d)*.

Taxation of life insurance proceeds. *I.R.C. § 101(a)*.

Taxation of disability policy benefits. *I.R.C. § 105(c)*.

Taxation of life insurance premiums. *I.R.C. § 264(a)*.

Accumulated earning tax. *I.R.C. § 531*.

Effect of life insurance proceeds on partnership basis. *I.R.C. § 705(a)*.

Alternative tax for corporations. *I.R.C. § 1201*.

Subchapter S corporation defined. *I.R.C. § 1362(a)*.

Inclusion of value of decedent's stock or partnership interest in decedent's gross estate. *I.R.C. § 2031*.

Estate taxation of life insurance proceeds. *I.R.C. § 2042*.

Valuation of shares for estate tax purposes. *I.R.C. § 2703*.

[2] Treasury Regulations

Taxation of life insurance proceeds. *Treas. Reg. § 1.101-1(a)*.

Taxation of life insurance premiums. *Treas. Reg. § 1.264-1(a)*.

Inclusion of value of decedent's stock or partnership interest in decedent's gross estate. *Treas. Reg. § 20.2031-2(h)*.

Valuation of shares (requirements). *Treas. Reg. §§ 20.2031-2, 20.2031-3, 25.2703-1*.

Incidents of ownership. *Treas. Reg. § 20.2042-1(c)(2)*.

Estate taxation of life insurance proceeds. *Treas. Reg. § 20.2042-1(c)(6)*.



66 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART I. RESEARCH GUIDE
A. Primary Sources

1-1F California Legal Forms--Transaction Guide §§ 1F.03-1F.04

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[Reserved]

§§ 1F.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1F California Legal Forms--Transaction Guide § 1F.05

AUTHOR: Reviewed by Pam Boc

§ 1F.05 Law Reviews and Periodicals

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1F California Legal Forms--Transaction Guide § 1F.06

AUTHOR: Reviewed by Pam Boc

§ 1F.06 Annotations

Annot., What Constitutes Waiver by Insured or Insured's Agent of Required Notice of Cancellation of Insurance Policy, 86 A.L.R.4th 886 .

Annot., Duty of Insurer to Pay for Independent Counsel When Conflict of Interest Exists Between Insured and Insurer, 50 A.L.R.4th 932.

Annot., Doctrine of Estoppel or Waiver to Bring Within Coverage of Insurance Policy Risks Not Covered by its Terms or Expressly Excluded Therefrom, 1 A.L.R.3d 1139 .

Annot., Insurance Company Bound by Greater Coverage in Earlier Policy Where Renewal Policy Is Issued Without Calling to Insured's Attention Reduction in Policy Coverage, 91 A.L.R.2d 546 .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1F California Legal Forms--Transaction Guide § 1F.07

AUTHOR: Reviewed by Pam Boc

§ 1F.07 Text References

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Ch. 6, *Management: Duties and Liabilities of Directors and Controlling Shareholders*.
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California Legal Forms (Matthew Bender).
Ch. 1A, *Role of Counsel in Starting a New Business*
Ch. 1B, *Selecting Form of Business Entity* .
Ch. 1D, *Overview of Employee Benefits* .
Ch. 1E, *Taxation of Businesses* .
Ch. 2B, *Electing Subchapter S Status* .
Ch. 8C, *Buy-Sell Agreements* .
Ch. 12A, *Professional Corporations* .
Ch. 12C, *Limited Liability Companies* .
Ch. 15, *General Partnerships* .
Ch. 15A, *Formation of Limited Partnerships* .
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1F California Legal Forms--Transaction Guide § 1F.08

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§ 1F.08 Insurance Company Rating Guides

A.M. Best's Insurance Company Rating Guide.

Standard and Poors Insurance Digest.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART I. RESEARCH GUIDE
B. Secondary Sources

1-1F California Legal Forms--Transaction Guide § 1F.09

AUTHOR: Reviewed by Pam Boc

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§ 1F.09[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.10

AUTHOR: Reviewed by Pam Boc

§ 1F.10 Nature of Insurance

[1] Attorney's Role in Making Insurance Recommendations

This chapter provides an overview of the many insurance considerations that will arise for a new business. It is intended to assist the attorney who is advising persons starting a new business. The purpose of this chapter is to point out areas of concern to the owners of the business; it is not meant as a complete guide to business insurance. This chapter is drafted with the assumption that an insurance professional will be involved in advising the business owners on insurance matters and in obtaining insurance coverage. The attorney's role is to ensure that the business owners are aware of the many concerns listed in this chapter, and to ensure that the owners have competent assistance so that they can make informed decisions regarding insurance.

[2] Insurance Defined

"Insurance" is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event [*Ins. Code § 22*]. This statutory definition reflects the common understanding of insurance, which has been further defined as an agreement by which one person, for consideration, promises to pay money or its equivalent or to perform some act of value to another on the destruction, death, loss, or injury of someone or something by specified perils [*California Physicians' Service v. Garrison (1946) 28 Cal. 2d 790, 803-804, 172 P.2d 4* ; *see Fraser-Yamor Agency, Inc. v. County of Del Norte (1977) 68 Cal. App. 3d 201, 213, 137 Cal. Rptr. 118]* . Two basic elements distinguish insurance contracts from other contracts. First, there must be a risk of loss to which one party may be subjected by contingent or future events, and second, there must be a legally binding arrangement by which another party assumes the risk [*California Physicians' Service v. Garrison (1946) 28 Cal. 2d 790, 804, 172 P.2d 4 , quoting Jordan v. Group Health Ass'n (D.C. Cir. 1939) 107 F.2d 239, 245]* .

[3] Purpose of Insurance

The purpose of insurance is to reduce uncertainty by transferring the risk of a loss from the insured to the insurer [*see*

California Physicians' Service v. Garrison (1946) 28 Cal. 2d 790, 804, 172 P.2d 4] . The policyholder pays a premium (representing a proportional share of losses) in return for the insurer's promise to pay the policyholder's losses according to the terms of the policy [*California Physicians' Service v. Garrison (1946) 28 Cal. 2d 790, 803-804, 172 P.2d 4* ; *see Fraser-Yamor Agency, Inc. v. County of Del Norte (1977) 68 Cal. App. 3d 201, 213, 137 Cal. Rptr. 118]* . Based on experience with losses for given classes of risks, insurance companies establish appropriate rates per unit of exposure. Through these premiums they equitably redistribute the burden of losses among their policyholders. From the policyholder's standpoint, this redistribution can be considered either as the transfer of risk to a professional risk bearer or, alternatively, as the substitution of a certain, but small, loss for an uncertain, but potentially large, loss. For further discussion of the purpose of insurance, refer to California Insurance Law and Practice, Volume 3, Chapter 41, *Liability Insurance in General* (Matthew Bender).

[4] Categories of Insurance

Historically, insurers in the United States were limited by statute to writing insurance in only one of three categories: life insurance, fire and marine insurance, or casualty insurance. Although these restrictions have been abrogated by legislation in all states, so that any insurer (except a life insurer, title insurer, or mortgage guarantor or insurer) may now conduct business in all lines of insurance, these separate categories of insurance are preserved in the statutory and common law principles that apply uniquely to each category. For discussion of the characteristics of each category of insurance, refer to Sections 1F.30 through 1F.52.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.11

AUTHOR: Reviewed by Pam Boc

§ 1F.11 Governing Law

Insurance contracts are a specialized form of contract. As contracts, they are subject to the general rules pertaining to the interpretation of contracts [*Civ. Code §§ 1635-1662*; *see Crane v. State Farm Fire. & Cas. Co. (1971) 5 Cal. 3d 112, 115, 95 Cal. Rptr. 513, 485 P.2d 1129]* . In addition, they are subject to the Insurance Code [*Ins. Code §§ 1-15062*], its regulatory acts, and judicial interpretations. The Insurance Code contains four divisions: general rules governing insurance [*Ins. Code §§ 100-1877.5*], classes of insurance [*Ins. Code §§ 1880-12764*], the insurance commissioner [*Ins. Code §§ 12900-13601*], and insurance adjusters [*Ins. Code §§ 14000-15062*]. For further discussion of the Insurance Code, refer to California Insurance Law and Practice, Volume 1, Chapter 1, *Overview of California Insurance Law* (Matthew Bender).

The insurance industry is regulated by the McBride-Grunsky Insurance Regulatory Act [*Ins. Code §§ 1851-1860.3*], which established rate restrictions, reporting requirements, and procedural rules for hearings and review. In 1988, Proposition 103 repealed the rate-making provisions of the McBride-Grunsky Act, but left its enforcement provisions in place [*see* Proposition 103, § 7 (November 8, 1988)]. California thereby became a "prior approval" state, requiring the insurance commissioner to approve any rate changes before their adoption and use [*Ins. Code § 1861.05(b)*]. Proposition 103 also repealed the insurance industry's limited exemption from antitrust and other business laws [*Ins. Code § 1861.03(a)*; *see* former Ins. Code §§ 1853, *1853.6*, 1853.7; *see also Bus. & Prof. Code §§ 16600-17930*]. For further discussion, refer to California Insurance Law and Practice, Volume 1, Chapter 4, *Insurance Carrier Operations* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsPolicy InterpretationGeneral OverviewInsurance LawIndustry RegulationState Insurance Commissioners & DepartmentsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.12

AUTHOR: Reviewed by Pam Boc

§ 1F.12 Insurance Contract

[1] Formation of Insurance Contract

A written instrument that contains an insurance contract is called a "policy" [*Ins. Code § 380*], and represents the final settlement of the respective obligations of the insurer and insured [*Estate of Richartz (1955) 45 Cal. 2d 292, 294-295, 288 P.2d 857]* . The parties may contract for insurance coverage as they please, provided they do not violate the law or public policy [*Linnastruth v. Mut. Benefit etc. Assn. (1943) 22 Cal. 2d 216, 218, 137 P.2d 833]* .

The first step in negotiating an insurance policy is the completion of an application by the prospective insured. The insurer may then accept the application on its terms, reject the application for any reason, even if the reason seems arbitrary [*K.C. Working Chem. Co. v. Eureka-Sec. Ins. Co. (1947) 82 Cal. App. 2d 120, 131, 185 P.2d 832* ; *but see Ins. Code §§ 679.70-679.73, 11628* (prohibiting discrimination in issuance)], or make changes or additions to the policy before forwarding it to the insured. If changes or additions are made, the modified policy is a counteroffer. Accordingly, after a counteroffer, there is a contract only when the new policy terms are accepted by the prospective insured [*see Linnastruth v. Mut. Benefit etc. Assn. (1943) 22 Cal. 2d 216, 218, 137 P.2d 833* (formation of insurance contract requires meeting of minds)]. However, unless principles of estoppel or waiver can be invoked, retention of the modified contract will be deemed an acceptance by the insured, and the insured will be presumed to have read the policy and to know its contents [*Burch v. Hartford Fire Ins. Co. (1927) 85 Cal. App. 542, 554, 259 P. 1108*]. The existence of a contract is a question of law, rather than of fact. A lower court finding that a contract has been formed will not limit the scope of review at the appellate level [*Employers Casualty Co. v. Northwestern Nat. Ins. Group (1980) 109 Cal. App. 3d 462, 473, 167 Cal. Rptr. 296]* .

[2] Required Contents

Every insurance policy must specify all of the following [*Ins. Code § 381*]:

- The parties between whom the contract is made;

- The property or life insured;
- The interest of the insured in the property insured;
- The risks insured against;
- The period the insurance is to cover; and
- A statement of the premium, or if the exact insurance premium is determinable only on the termination of the contract, a statement of the basis and the rates on which the final premium is to be determined and paid.

[3] Oral Contracts

Oral insurance contracts are used to provide immediate temporary insurance until a written binder can be issued, to renew existing policies, and to transfer existing insurance from one location to another [*Parlier Fruit Co. v. Fireman's etc. Ins. Co. (1957) 151 Cal. App. 2d 6, 19, 311 P.2d 62* ; *see Ins. Code § 382.5(a)* ("binder" defined); *see also [4], below*]. Oral insurance contracts are enforceable if they can be performed within one year [*see Stanley v. Columbia Casualty Co. (1943) 63 Cal. App. 2d 724, 731-732, 147 P.2d 627* (adoption of insurance code did not abolish oral contracts); *Farnum v. Phenix Ins. Co. (1890) 83 Cal. 246, 261, 23 P. 869* (oral contract not enforceable if statute of fraud applies)], if there is clear and convincing proof that an oral contract was entered into and that each party understands the contract in the same light, regarding the same subject matter [*K.C. Working C. Co. v. Eureka-Sec. Ins. Co. (1947) 82 Cal. App. 2d 120, 130, 185 P.2d 832]* , and if the terms of the contract are definite and certain [*K.C. Working Chem. Co. v. Eureka-Sec. Ins. Co. (1947) 82 Cal. App. 2d 120, 130, 185 P.2d 832]* .

Oral binders may be effected on behalf of an insurer by an agent possessing authority to bind the company by contracts of insurance in general [*Granco Steel, Inc. v. Workmen's Comp. App. Bd. (1968) 68 Cal. 2d 191, 197, 65 Cal. Rptr. 287, 436 P.2d 287]* .

[4] Written Contracts

Written insurance contracts may take one of two forms. They may be either the preliminary contract, usually referred to as a "binder," which temporarily obliges the insurer to provide coverage pending issuance of the insurance policy [*see Ins. Code § 382.5(a)*], or the final contract or policy itself [*Parlier Fruit Co. v. Fireman's etc. Ins. Co. (1957) 151 Cal. App. 2d 6, 20, 311 P.2d 62]* . For further discussion of written binders, refer to California Insurance Law and Practice, Ch. 9, *Issuance of Insurance Policies* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsContract FormationGeneral OverviewInsurance LawClaims & ContractsContract FormationApplicationsInsurance LawClaims & ContractsContract FormationOral ContractsInsurance LawClaims & ContractsContract FormationPolicy Delivery



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.13

AUTHOR: Reviewed by Pam Boc

§ 1F.13 Types of Policies

[1] Open and Valued Policies Distinguished

An insurance policy may be either open or valued [*see Ins. Code § 410*]. An "open" policy does not state the value of the subject matter; that amount is left to be ascertained in case of loss [*Ins. Code § 411*]. A "valued" policy provides that the insured property will be valued at a specified sum [*Ins. Code § 412*] and that the insured property is worth the amount for which it is insured [*see Solomon v. Federal Ins. Co. (1917) 176 Cal. 133, 136, 167 P. 859]* .

[2] Running Policies

A "running" policy contemplates successive insurances; it provides that the object of the policy may be defined from time to time by additional statements or endorsements, particularly with regard to the subject of insurance [*Ins. Code § 413*].

[3] Specific and Floater Policies Distinguished

An insurance policy may be either specific or a floater. A "specific" policy covers property at a specific location in a specific amount for a specific premium [*Gillies v. Michigan Millers etc. Ins. Co. (1950) 98 Cal. App. 2d 743, 747, 221 P.2d 272]* . A "floater" policy is issued when the amount of merchandise insured fluctuates from day to day, when the merchant intends to move the stock from one location to another, or when the merchant operates more than one establishment [*Gillies v. Michigan Millers etc. Ins. Co. (1950) 98 Cal. App. 2d 743, 747, 221 P.2d 272]* . If there is a loss, the insured will receive the actual cash value of the damaged property covered by the floater policy [*Gillies v. Michigan Millers etc. Ins. Co. (1950) 98 Cal. App. 2d 743, 747, 221 P.2d 272* ; *see also Olson v. Standard Marine Ins. Co. (1952) 109 Cal. App. 2d 130, 132, 240 P.2d 379]* . Floater policies are generally used to insure unscheduled personal property.

[4] Master Policies and Individual Certificates of Insurance

In some situations, such as group life or disability insurance, an insurer may issue a master policy to the employer or franchisor. The insurer then issues certificates of insurance to the individual insureds. If a certificate is issued in lieu of the actual policy, the certificate must include, among other things, substantially the following statement: "This certificate or verification of insurance is not an insurance policy and does not amend, extend or alter the coverage afforded by the policies listed herein. Notwithstanding any requirement, term, or condition of any contract or other document with respect to which this certificate or verification of insurance may be issued or may pertain, the insurance afforded by the policies described herein is subject to all the terms, exclusions and conditions of such policies" [*Ins. Code § 384(a)*; *see Ins. Code § 384(b)* (requirement inapplicable to surplus line broker certificate)].

This statutory notice may obviate the common law rule that, if the terms of the policy as stated on the certificates differ from the terms of the master policy, the terms of the certificate are controlling [*Humphrey v. Equitable Life Assur. Soc. (1967) 67 Cal. 2d 527, 534, 63 Cal. Rptr. 50, 432 P.2d 746* ; *Evans v. Holly Corp. (1971) 15 Cal. App. 3d 1020, 1023, 93 Cal. Rptr. 712]* , because the decisions establishing that rule preceded enactment of *Ins. Code § 384* in 1978. However, if the certificate terms differ materially from the master policy terms, an insured may have a cause of action for fraud, estoppel, or waiver, that may permit the insured to rescind the contract or to recover damages for fraud [*see §§ 1F.15[2], 1F.16 [3]*; *see also Ins. Code §§ 331* (concealment), *359* (false representations)]. Further, because standardized insurance contracts are generally treated as contracts of adhesion [*see Gray v. Zurich Insurance Co. (1966) 65 Cal. 2d 263, 269-270, 54 Cal. Rptr. 104, 419 P.2d 168]* , it is well-established that exceptions and limitations on coverage that the insured could reasonably expect must be called to the insured's attention, clearly and plainly, before the exclusions will be interpreted to relieve the insurer of liability or performance [*Interinsurance Exchange v. Velji (1975) 44 Cal. App. 3d 310, 318, 118 Cal. Rptr. 596]* . The general statutory notice provided by *Ins. Code § 384* would seem to fall short of this disclosure requirement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceGeneral OverviewInsurance LawClaims & ContractsGeneral OverviewInsurance LawGroup PoliciesMultiple Documents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.14

AUTHOR: Reviewed by Pam Boc

§ 1F.14 Premiums

[1] Payment of Premium

Provided that an insurance contract has been entered into, an insurer is entitled to payment of the premium as soon as the subject matter insured is exposed to the risk insured against [*Ins. Code § 480*]. Payment of the premium is not a condition precedent to the operation of the policy or to any recovery on it, even if the policy identifies the premium as consideration for coverage [*Raulet v. Northwestern etc. Ins. Co. (1910) 157 Cal. 213, 224, 107 P. 292]* . However, if a time is prescribed for payment of the premium, it must be paid by that time [*Thomas v. Northwestern etc. Ins. Co. (1904) 142 Cal. 79, 82, 75 P. 665* ; *see Northey v. Bankers' Life Asso. (1895) 110 Cal. 547, 550, 42 P. 1079* (if no date prescribed within specified month for payment, premium presumed payable on last day of specified month)].

An acknowledgment in the policy of receipt of a premium is conclusive evidence of its payment for the purpose of making the policy binding [*Ins. Code § 484*]. The acknowledgment has been held to be a "solemn admission" that estops the insurer from contesting the policy for nonpayment of premium [*Masson v. New England Mut. Life Ins. Co. (1927) 85 Cal. App. 633, 641*]. However, the acknowledgment does not prevent cancellation for nonpayment of a premium if a cancellation right is reserved to the issuer of the policy [*Ins. Code § 484*].

[2] Return of Premium

[a] Right to Return

Unless the policy provides otherwise, if the risk insured against has existed, and the insurer has been liable for any period of time, no matter how short, the insured is not entitled to a return of the premium relating to that particular risk except under the certain specified circumstances described below.

An insured will be entitled to a return of the premium when the contract is voidable because of the fraud or misrepresentation of an insurer or because of facts unknown to the insured without fault on the part of the insured [*Ins.*

Code § 483(a), (b)]. An insured is also entitled to a return of premium when, by any default of the insured other than actual fraud, the insurer "did not incur any liability" under the policy [*Ins. Code § 483(c)*]; this presumably refers to a situation where the insured fails to comply with some condition precedent to coverage taking effect. These provisions are specifically applicable to both life insurance and annuity policies [*see Equitable Life Etc. Soc. v. Johnson (1942) 53 Cal. App. 2d 49, 127 P.2d 95* (construing former Civ. Code § 2619, now *Ins. Code § 483*)].

[b] Conditions of Return

Unless otherwise provided in the policy, the insured is entitled to a return of the premium if the policy is canceled, rejected, surrendered, or rescinded [*Ins. Code § 481(a)*; *but see Ins. Code § 481(c)* (exception for ocean marine insurance)]. Under these circumstances, the insured is entitled to return of the whole premium if the insurer has not been exposed to any risk of loss; if the policy has been made for a definite period of time and the insured surrenders the policy earlier, the insured is entitled to a short rate cancellation, unless the insured shows that coverage has been placed elsewhere for the same period. The provisions of *Insurance Code Section 482* with regard to the exposure of the insurer to risk apply only to that portion of the policy term that has expired [*Ins. Code § 481(a)*].

[3] Life Insurance Policies: Special Premium Considerations

[a] Cash Surrender Value

If an insured surrenders a life insurance policy to the insurer for its cash surrender value, the insurer's liability for the risk covered in the policy is terminated [*Jensen v. Allstate Ins. Co. (1973) 32 Cal. App. 3d 789, 793-794, 108 Cal. Rptr. 498* ; *see Jennings v. Prudential Ins. Co. (1975) 48 Cal. App. 3d 8, 17, 121 Cal. Rptr. 125* (*Ins. Code § 481* inapplicable after receipt of policy's cash surrender value)].

[b] Waiver of Premium

"Waiver of premium" coverage is offered by life insurance companies for an additional premium. With this coverage, in the event the insured becomes disabled, future premiums on the policy are automatically waived by the insurer, and the life insurance remains in effect [*Boogaert v. Occidental Life Ins. Co, (1983) 150 Cal. App. 3d 875, 878-880, 198 Cal. Rptr. 357]* . The premiums waived due to the disability of the insured are ordinarily exempt from taxation as "amounts received through accident and health insurance as compensation for personal injuries or sickness" [*I.R.C. § 104(a)(3)*].

[4] Forfeiture of Policy for Nonpayment

Forfeiture for nonpayment of premiums has been held to be a necessary means for insurers to protect themselves [*Methvin v. Fidelity Mut. Life Asso. (1900) 129 Cal. 251, 258, 61 P. 1112]* . On the other hand, because insurance contracts are generally held to be contracts of adhesion [*see, e.g., Gray v. Zurich Insurance Co. (1966) 65 Cal. 2d 263, 269, 54 Cal. Rptr. 104, 419 P.2d 168]* , or are implicitly treated as adhesion contracts [*Ponder v. Blue Cross of Southern California (1983) 145 Cal. App. 3d 709, 719, 193 Cal. Rptr. 632* ; *see, e.g., Crane v. State Farm Fire & Cas. Co. (1971) 5 Cal. 3d 112, 115, 95 Cal. Rptr. 513, 485 P.2d 1129]* , it is well established that forfeitures, which are generally not favored, are particularly scrutinized in the insurance context. A forfeiture will be permitted only when expressed in clear and unmistakable terms [*Bittinger v. New York Life Ins. Co. (1941) 17 Cal. 2d 834, 840-841, 112 P.2d 621]* . The court will come to the aid of the insured if, by any reasonable construction, the forfeiture can be avoided, and will likely construe the grace period liberally to save the policy from lapsing immediately [*Bittinger v. New York Life Ins. Co. (1941) 17 Cal. 2d 834, 841-842, 112 P.2d 621]* . Special nonforfeiture provisions, known as the Standard Nonforfeiture Law for Life Insurance [*Ins. Code § 10159.1 et seq.*], apply to life insurance policies. For discussion, see California Insurance Law and Practice, Ch. 21, *The Life Insurance Contract* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsPremiumsGeneral OverviewInsurance LawClaims & ContractsPremiumsForfeituresInsurance LawClaims & ContractsPremiumsRefundsInsurance LawLife InsuranceCash Surrender Value



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.15

AUTHOR: Reviewed by Pam Boc

§ 1F.15 Coverage

[1] Commencement of Coverage

[a] In General

When an applicant for insurance pays a prescribed premium and the binder states that the insurance applied for is effective from the date of the application on payment of the premium and company satisfaction of insurability, it is deemed that the parties intended the insurance to be effective immediately, subject to termination on the condition subsequent that the applicant is not insurable [*Thompson v. Occidental Life Ins. Co. (1973) 9 Cal. 3d 904, 911, 109 Cal. Rptr. 473, 513 P.2d 353]* . When an insurer has received an application and the premium and then decides to reject the application, the insurance contract immediately created on receipt of the application and premium is not terminated until the insurer has actually rejected the application and refunded the premium [*Smith v. Westland Life Ins. Co. (1975) 15 Cal. 3d 111, 121, 123 Cal. Rptr. 649, 539 P.2d 433]* .

[b] Under Oral Binder

If an authorized insurance agent orally accepts a risk under an oral binder [*see § 1F.12 [3]*], promising to deliver the written policy later, the insurance is effective immediately and the parol contract continues in force under the written policy is delivered and supersedes it [*Kazanteno v. California-Western States Life Ins. Co. (1955) 137 Cal. App. 2d 361, 370, 290 P.2d 332]* . If a loss occurs before the written policy is issued, the insurer is nonetheless liable [*Spott Electrical Co. v. Industrial Indem. Co. (1973) 30 Cal. App. 3d 797, 805, 106 Cal. Rptr. 710]* . An oral agreement for insurance is not rendered invalid just because more information is required before a policy can be written [*Parlier Fruit Co. v. Fireman's etc. Ins. Co. (1957) 151 Cal. App. 2d 6, 23, 311 P.2d 62]* .

[2] Limitations on Coverage

[a] In General

Typically, in addition to limiting the risk of liability on an insurance policy by including conditions or warranties [*see [b], below*], insurers include clauses that limit the coverage otherwise stated in the policy. These limitations may include limitations on the subject matter of the policy, on the types of hazards insured against, on the proceeds payable on the policy, and on the period of coverage. However, the extent of coverage is that which an ordinary layperson may reasonably expect [*Wernecke v. Pacific Fidelity Life Ins. Co. (1965) 238 Cal. App. 2d 884, 887, 48 Cal. Rptr. 251]* . Further, unless any limitations are brought to the attention of the insured, the coverage provided will be determined according to the ordinary layperson's expectations [*Young v. Metropolitan Life Ins. Co. (1969) 272 Cal. App. 2d 453, 460-461, 77 Cal. Rptr. 382* ; *see State Farm Mut. Auto Ins. Co. v. Khoe (9th Cir. 1989) 884 F.2d 401, 407]* .

Narrowly defining, or failing to define, a crucial word or phrase in a policy, especially a policy that is truly negotiated and is drafted specifically for the insured, could turn out to create implicit limitations on coverage or on the insurer's duty under the policy, which the insured might not have anticipated. For instance, if the insurer is bound to defend "any suit or action," then in the absence of a controlling definition, a court could find that the duty to defend does not extend to administrative proceedings [*Lockheed Martin Corp. v. Continental Ins. Co. (2005) 134 Cal. App. 4th 187, 198-200, 35 Cal. Rptr. 3d 799* (insurer was not required to defend insured in administrative proceedings that had not ripened into lawsuits filed in court; in addition, coverage for damages resulting from "accident" did not extend to liability for effects of pollution that occurred and increased gradually, and coverage for "personal injury" liability as defined in policy could not be extended to pollution-based liability), *disapproved on other grounds, State v. Allstate Ins. Co. (2009) 45 Cal. 4th 1008, 1036 n.11*].

[b] Distinguished From Warranties and Conditions

[i] Warranties and Conditions Defined

A factual statement in a policy regarding the person or thing insured, or the risk insured against, is an express warranty that the fact is true [*Ins. Code § 441*]. Further, any statement in a policy that imports that there is an intention to do or not to do something that materially affects the risk insured against is a warranty [*Ins. Code § 445*]. No particular form of words need be used to create an express warranty [*Ins. Code § 442*]. Contracts of insurance are governed and interpreted by the same rules that ordinarily apply to other contracts [*see Civ. Code § 1635 et seq.*]. In contract law, a "condition" is an act or event, which occurrence or non-occurrence creates or extinguishes a legal duty [Restatement (Second) of Contracts, § 230]. The failure of a condition gives the promissor a legal justification for refusing to perform his or her promise, and, thus, may provide a defense to the promissor in an action by the promisee for non-performance of the promise [Restatement (Second) of Contracts, § 230].

[ii] Classification of Clause as Limitation or as Warranty or Condition

Whether a particular clause in a policy is a warranty or condition or a limitation on coverage depends on whether the circumstance that is the subject of the clause is discoverable by the insurer by investigation at the policy's inception. If the circumstance is discoverable, it is classified as a warranty or condition [*Simpson v. Phoenix Mutual Life Insurance Co. (1969) 24 N.Y.2d 262, 247 N.E.2d 655, 658]* . If the circumstance is not discoverable by the insurer at the inception of the policy, it is to be classified as a limitation on coverage [*Simpson v. Phoenix Mutual Life Insurance Co. (1969) 24 N.Y.2d 262, 247 N.E.2d 655, 658* ; *see Metropolitan Life Ins. Co. v. Conway (1930) 252 N.Y. 449, 169 N.E. 642, 642-643* (summary of decisions in other jurisdictions)].

[c] Consequences of Classifying Clause as Limitation or as Warranty or Condition

[i] Avoidance of Policy Due to Breach of Warranty or Condition

The major distinction between a limitation on coverage and a warranty or condition is that the violation of a material warranty or any other material provision or condition of the policy on the part of either party entitles the other to rescind

[*Ins. Code § 447*; *see Kleiber M.T. Co. v. International I. Co. (1930) 106 Cal. App. 709, 721-724, 289 P. 865* (breach of immaterial provision will not avoid policy unless policy so states)]. Thus, breach of a material warranty or condition not only provides the insurer a defense against payment of proceeds, but avoids the policy itself [*Gilmore v. Eureka Casualty Co. (1932) 123 Cal. App. 20, 27, 10 P.2d 810]* . On the other hand, an act or event that falls outside of coverage because of a limitation on or exception to coverage does not have any affect on the voidability of the contract; the insurer is merely not liable for any loss due to that occurrence [*Cravens, Dargan & Co. v. Pacific Indem. Co. (1972) 29 Cal. App. 3d 594, 598-601, 105 Cal. Rptr. 607]* .

[ii] Application of Waiver and Estoppel to Breach of Warranty or Condition

A second distinction between a limitation on coverage and a warranty or condition is that, under certain circumstances, a court will hold that an insurer has waived or is estopped to claim the right to defend or rescind on the basis of a breach of warranty or condition or a misrepresentation, in which case the insurer remains liable under the policy [*see, e.g., McLaughlin v. Connecticut General Life Ins. Co. (1983) 565 F. Supp. 434, 451* (insurer relying on specific grounds for denying claim waives right to rely in subsequent litigation on any other grounds that reasonable investigation would have uncovered)]. As a general rule, however, a court will not expand coverage beyond that specified in the contract by application of the doctrine of waiver or estoppel [*Aetna Casualty & Surety Co. v. Richmond (1977) 76 Cal. App. 3d 645, 652-653, 143 Cal. Rptr. 75* (estoppel); *but see Miller v. Elite Ins. Co. (1980) 100 Cal. App. 3d 739, 753-754, 161 Cal. Rptr. 322* (unconditional defense of action against insured constitutes a waiver of policy's terms and estops insurer from asserting those grounds)].

[iii] Limitation on Defense of Warranty or Condition

A third distinction between a limitation on coverage and a warranty or condition is that the statutes that commonly limit the defenses of warranties and conditions do not apply to limitations on coverage [*see Ins. Code §§ 447-449*].

[3] Effect of Agent's or Company's Representations

An agent's or company's representations will not defeat an applicant's reasonable expectations of coverage [*Young v. Metropolitan Life Ins. Co. (1969) 272 Cal. App. 2d 453, 460, 77 Cal. Rptr. 382* (unambiguous limitation of liability in conditional receipt held ineffective when not called to applicant's attention); *Slobojan v. Western Travelers Life Ins. Co. (1969) 70 Cal. 2d 432, 441, 74 Cal. Rptr. 895, 450 P.2d 271* (agent's explanation that there were conditions precedent to coverage ineffective when applicant's expectation of coverage arose from subsequent payment of premium)]. Further, an agent's or company's representations are often held to give rise to an insured's expectations of coverage [*see Logan v. John Hancock Mut. Life Ins. Co. (1974) 41 Cal. App. 3d 988, 116 Cal. Rptr. 528]* . In the absence of constructive or actual notice to the insured of any limitations on the agent's authority, a general agent may bind the insurance company by acts, agreements, or representations that are within the ordinary scope and limits of the insurance business entrusted to him or her, although they are in violation of private restrictions [*Skyways Aircraft Ferrying Service, Inc. v. Stanton (1966) 242 Cal. App. 2d 272, 280-281, 51 Cal. Rptr. 352* ; quoting *Cronin v. Coyle (1935) 6 Cal. App. 2d 205, 212-213, 44 P.2d 385]* . A general agent is one who has all the powers of the principal, except as limited by the company to whatever seems expedient [*see Skyways Aircraft Ferrying Service, Inc. v. Stanton (1966) 242 Cal. App. 2d 272, 280, 51 Cal. Rptr. 352* ; quoting *Cronin v. Coyle (1935) 6 Cal. App. 2d 205, 212-213, 44 P.2d 385]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsBindersInsurance LawClaims & ContractsContract FormationGeneral OverviewInsurance LawClaims & ContractsContract FormationOffer & AcceptanceInsurance LawClaims & ContractsEstoppel & WaiverMisrepresentations



78 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.16

AUTHOR: Reviewed by Pam Boc

§ 1F.16 Rescission

[1] Grounds for Rescission

Rescission is an equitable remedy that restores the parties to their former positions as of the time the contract was made [*Fireman's Fund American Ins. Co. v. Escobedo (1978) 80 Cal. App. 3d 610, 619, 145 Cal. Rptr. 785]* . Misrepresentation or concealment of a fact material to the risk insured against is grounds for rescission; an actual intent to deceive need not be shown [*Thompson v. Occidental Life Ins. Co. (1973) 9 Cal. 3d 904, 916, 109 Cal. Rptr. 473, 513 P.2d 353]* . No right to avoid or rescind a policy arises from a violation of a policy provision by the insured unless the provision materially affects the risk or the policy specifically states that the breach will avoid the policy [*Victoria S.S. Co. v. Western Assur. Co. (1914) 167 Cal. 348, 357, 139 P. 807]* ; this rule applies if the affected provision is characterized as a warranty [*Los Angeles Mut. Ins. Co. v. Cawog (1973) 30 Cal. App. 3d 378, 383, 106 Cal. Rptr. 307]* . Any of the grounds for rescission found in the Civil Code [*see Civ. Code § 1689*] may be used to avoid the policy [*DeCampos v. State Comp. Ins. Fund (1954) 122 Cal. App. 2d 519, 529, 265 P.2d 617* ; *Cole v. Calaway (1956) 140 Cal. App. 2d 340, 347-348, 295 P.2d 84]* . Rescission will apply to all insureds under the policy, including additional insureds, unless the contract provides otherwise [*Ins. Code § 650*; *see Civil Service Employees Ins. Co. v. Blake (1966) 245 Cal. App. 2d 196, 202, 53 Cal. Rptr. 701* (insurer entitled to rescind auto policy obtained through fraud, breach of warranty, or material misrepresentation, notwithstanding any rights of third parties injured by the acts of insured occurring before rescission)].

[2] Time for Rescission

An insurer is permitted to exercise any right to rescission at any time before the commencement of an action on the contract [*see Ins. Code § 650*; *see also Ins. Code § 651* (insured's right to notice of grounds for rescission under automobile liability contracts)].

[3] Availability of Damages for Fraud

Rescission is not an exclusive remedy. Intentional concealment of material facts or false representations made in reference to material facts, with the intent to mislead the insurer, constitutes fraud [*DeCampos v. State Comp. Ins. Fund (1954) 122 Cal. App. 2d 519, 527, 265 P.2d 617]* . A defrauded party, induced by false representations to execute a contract, may rescind the contract, or affirm the contract and recover damages for the fraud, or use concealment and misrepresentation as a defense to any action on the policy by the insured [*DeCampos v. State Comp. Ins. Fund (1954) 122 Cal. App. 2d 519, 527, 265 P.2d 617]* .

An action for damages rests on the theory that the contract is still in force; the insurer will not lose the right to damages if it ineffectually seeks to disaffirm the contract. While the remedies for rescission and damages are inconsistent, in seeking rescission, damages may be prayed for in the event the court disallows the rescission [*Davis v. Rite--Lite Sales Co. (1937) 8 Cal. 2d 675, 678-679, 67 P.2d 1039* ; *DeCampos v. State Comp. Ins. Fund (1954) 122 Cal. App. 2d 519, 527, 265 P.2d 617]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawRemediesRescission & RedhibitionGeneral OverviewInsurance LawClaims & ContractsCancellation & NonrenewalGeneral OverviewInsurance LawClaims & ContractsCancellation & NonrenewalMaterial Misrepresentation



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.17

AUTHOR: Reviewed by Pam Boc

§ 1F.17 Cancellation by Mutual Agreement

An insurance contract may be cancelled either pursuant to its terms or by the mutual consent of the parties. If the policy is terminated by mutual agreement, it may be cancelled without reference to the express terms of the policy [*Glens Falls Ins. Co. v. Founders' Ins. Co. (1962) 209 Cal. App. 2d 157, 165, 25 Cal. Rptr. 753]* . A mutual agreement to cancel may be either express or implied, depending on the circumstances of the case [*Glens Falls Ins. Co. v. Founders' Ins. Co. (1962) 209 Cal. App. 2d 157, 168, 25 Cal. Rptr. 753]* ; however, mere return of a policy to the company does not necessarily mean there has been a cancellation by mutual agreement or by request of the insured [*Emery v. Pacific Employers Ins. Co. (1937) 8 Cal. 2d 663, 670-671, 67 P.2d 1046]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsCancellation & NonrenewalGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.18

AUTHOR: Reviewed by Pam Boc

§ 1F.18 Cancellation by Insured

To cancel an insurance policy, the insured need only communicate a definite and unconditional request for cancellation to the insurer [*Glens Falls Ins. Co. v. Founders' Ins. Co. (1962) 209 Cal. App. 2d 157, 165, 25 Cal. Rptr. 753]* . Although an insured may cancel an insurance policy at any time, the request for cancellation must be unequivocal and absolute [*Glens Falls Ins. Co. v. Founders' Ins. Co. (1962) 209 Cal. App. 2d 157, 165, 25 Cal. Rptr. 753]* . The request must indicate a present intention to cancel; an expression of intent to cancel the policy at some time in the future will not result in a cancellation [*Glens Falls Ins. Co. v. Founders' Ins. Co. (1962) 209 Cal. App. 2d 157, 165, 25 Cal. Rptr. 753]* . The request must also be actually communicated to the insurer [*Glens Falls Ins. Co. v. Founders' Ins. Co. (1962) 209 Cal. App. 2d 157, 165-167, 25 Cal. Rptr. 753]* .

Cancellation of an existing policy will not occur merely because the insured obtains substitute insurance with the intent to replace existing insurance. The insured may either retain the second policy as additional insurance or cancel the earlier policy. The insurer may not cancel a policy simply because the insured procures substitute insurance, although the later policy may be substituted for the former with mutual consent [*Glens Falls Ins. Co. v. Founders' Ins. Co. (1962) 209 Cal. App. 2d 157, 169-170, 25 Cal. Rptr. 753* ; *Apparel Mfrs' Supply Co. v. National Auto & Cas. Ins. Co. (1961) 189 Cal. App. 2d 443, 459, 11 Cal. Rptr. 380]* .

In the absence of a clear provision to the contrary, the insured generally need not give the insurer formal written notice of cancellation or surrender the policy to the insurer [*see Glens Falls Ins. Co. v. Founders' Ins. Co. (1962) 209 Cal. App. 2d 157, 165-168, 25 Cal. Rptr. 753]* . However, when the policy contains an unambiguous provision requiring the insured to take a specific action as a condition precedent to the cancellation of the policy, that provision will be enforced [*Pacific National Ins. Co. v. Webster (1985) 174 Cal. App. 3d 779, 782, 220 Cal. Rptr. 274]* .

Legal Topics:

For related research and practice materials, see the following legal topics:

Insurance LawClaims & ContractsCancellation & NonrenewalNotice RequirementsInsurance LawMotor Vehicle InsuranceCancellation & RenewalAcquisition of New Policy



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.19

AUTHOR: Reviewed by Pam Boc

§ 1F.19 Cancellation by Insurer--In General

[1] Covenant of Good Faith and Fair Dealing

In addition to any applicable statutory limitations on cancellation of policies [*see [2], below, §§ 1F.20, 1F.21*], insurers are bound by the covenant of good faith and fair dealing in cancellation matters [*Spindle v. Travelers Ins. Companies (1977) 66 Cal. App. 3d 951, 957-958, 136 Cal. Rptr. 404]* . For discussion of this covenant, see California Insurance Law and Practice, Ch. 13, *Claims Handling and the Duty of Good Faith* (Matthew Bender).

[2] Notice to Insured

[a] General Requirements

Insurance contracts typically have a provision for cancellation that requires notice to the insured before the cancellation is effective. For example, under a standard form fire insurance policy, the insurer may cancel the policy by giving 20 days written notice to the insured [*see Ins. Code § 2071*]. If there is a provision for notice of cancellation in the policy, the insurer must strictly comply with its terms in order to effect a cancellation [*Naify v. Pacific Indemnity Co. (1938) 11 Cal. 2d 5, 10, 76 P.2d 663]* . The policy is cancelled as of the specific date the notice is properly mailed, regardless of whether it is received [*Jensen v. Traders & General Ins. Co. (1959) 52 Cal. 2d 786, 798, 345 P.2d 1]* . Notice of cancellation to the insured's agent is not notice of cancellation to the insured unless that notice is actually communicated to the insured [*Emery v. Pacific Employers Ins. Co. (1937) 8 Cal. 2d 663, 672, 67 P.2d 1046]* .

[b] Notice of Cancellation of Commercial Policy

A notice of cancellation of a commercial policy must be in writing and must be delivered or mailed to the producer of record (provided the producer is not an employee of the named insured) and to the named insured at the mailing address as shown on the policy [*Ins. Code § 677.2(b)*; *see Code Civ. Proc. § 1013(a)* (service by mail)]. It must state the reason for and the effective date of the cancellation [*Ins. Code § 677.2(b)*]. In most cases, the notice must be given at least 30

days before the effective date of the cancellation [*Ins. Code § 677.2(c)*]. However, when cancellation is for nonpayment of premiums or for fraud, the notice must be given no less than 10 days before the effective date of cancellation [*Ins. Code § 677.2(c)*]. Notice of a proposed cancellation issued pursuant to *Ins. Code § 676.2(d)* [*see § 1F.21*] before the Insurance Commissioner has issued a finding will be considered timely if it is given no less than 30 days before the effective date of cancellation and if it states that cancellation will be effective only on the commissioner's approval [*Ins. Code § 677.2(c)*].

[3] Refund Upon Cancellation

Cancellation may be either flat or pro rata. With a flat cancellation, no refund is made. With a pro rata cancellation, the insurance company may demand payment by the insured of the pro rata portion of the premium for the time the policy was in effect, if credit was extended to the insured [*see Ins. Code § 673(g)*]. If the premium has been paid beyond the date of cancellation, the insured is entitled to a pro rata return of premium [*see Jensen v. Traders & General Ins. Co. (1959) 52 Cal. 2d 786, 799, 345 P.2d 1]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsCancellation & NonrenewalGeneral OverviewInsurance LawClaims & ContractsCancellation & NonrenewalNotice RequirementsInsurance LawClaims & ContractsCancellation & NonrenewalRefund of PremiumsInsurance LawClaims & ContractsGood Faith & Fair DealingGeneral OverviewInsurance LawClaims & ContractsPremiumsRefunds



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.20

AUTHOR: Reviewed by Pam Boc

§ 1F.20 Cancellation by Insurer of Individual Property and Liability Policies

The Robbins Brown Insurance Consumer Reform Act [*Ins. Code §§ 675-679.6*] governs the cancellation, as well as the nonrenewal [*see § 1F.22*], of commercial and individual property/liability policies covering individual risks (other than automobile and workers' compensation insurance). These individual property and liability policies insure against the following contingencies [Ins. Code § 675a]:

- Loss or damage to real property that is used predominantly for residential purposes and that consists of not more than four units;

- Loss of or damage to personal property in which natural persons resident in the real property described in (1), *above*, have an insurable interest, except personal property used in a commercial or industrial enterprise; and

- Legal liability of a natural person for loss of, damage to, or injury to persons or property, but not including policies primarily insuring risks arising from the conduct of a commercial or industrial enterprise.

Cancellation of individual property and liability policies may be relevant to a new business if that business involves renting out four or fewer residential rental units. After an individual policy covered by the Robbins Brown Act has been in effect for 60 days, or effective immediately, if the policy is a renewal, cancellation of the policy by the insurer will be effective only if it is based on the occurrence of one or more of the following events [*Ins. Code § 676(a)- (e)*]:

- Nonpayment of premium, including nonpayment of additional premiums, justified by a physical change in the insured property to a change in its occupancy or use;

- Conviction of the named insured of a crime having as one of its necessary elements an act increasing

any hazard insured against;

- Discovery of fraud or material misrepresentation by either (a) the insured or his or her representative in obtaining insurance; or (b) the named insured or his or her representative in pursuing a claim under the policy;

- Discovery of grossly negligent acts or omissions by the insured or his or her representative substantially increasing any of the hazards insured against; and

- Physical changes in the insured property that result in its becoming uninsurable [*see Ins. Code § 678.5* (special rule relating to corrosive soil conditions)].

Special restrictions apply to the cancellation of automobile insurance policies; for discussion of those restrictions, refer to California Insurance Law and Practice, Ch. 50 *Automobile Insurance* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsCancellation & NonrenewalGeneral OverviewInsurance LawClaims & ContractsCancellation & NonrenewalMaterial MisrepresentationInsurance LawClaims & ContractsCancellation & NonrenewalNotice Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.21

AUTHOR: Reviewed by Pam Boc

§ 1F.21 Cancellation by Insurer of Commercial Property and Liability Policies

For purposes of cancellation, "commercial insurance policies" includes commercial multi-peril, commercial property, commercial liability, commercial special multi-peril, errors and omissions liability, professional liability insurance, and any other insurance not specifically excluded by *Ins. Code § 675.5(d)* and that covers any of the following contingencies [*Ins. Code § 675.5(b)(1)- (3)*]:

- Loss or damage to real property used or owned in a commercial or industrial enterprise;

- Loss of or damage to personal property, except personally owned motor vehicles, used in a commercial or industrial enterprise; and

- Legal liability of any person for loss of or damage to property, or injury to persons arising from the conduct of a commercial or industrial enterprise (including a business operated for profit, a professional practice, a nonprofit organization, or a governmental entity).

After a commercial property and liability policy has been in effect for more than 60 days, or effective immediately, if the policy is a renewal, cancellation of the policy by the insurer will be effective only if it is based on one or more of the following events occurring after the date of the policy [*Ins. Code § 676.2(b)*]:

- Nonpayment of premium, including any payment due on a prior policy issued by the insurer and due during the current policy term covering the same risks;

- A judgment by a court or administrative tribunal that the named insured has violated any California or federal law having as one of its necessary elements an act that materially increases any of the risks insured against;

- Discovery of fraud or material misrepresentation by either the named insured or his or her representative in either obtaining insurance or in pursuing a claim under the policy;

- Discovery of willful or grossly negligent acts or omissions, or violation of state laws or regulations establishing safety standards, that materially increase any of the risks insured against;

- Failure by the named insured or his or her representative to implement reasonable loss control requirements that were agreed upon by the insured as a condition of policy issuance or were conditions precedent to the use by the insurer of a particular rate or rating plan, if the failure materially increases any of the risks insured against;

- A determination by the insurance commissioner that loss of or changes to the insurer's reinsurance covering all or part of the risk would threaten the financial integrity or solvency of the insurer;

- A determination by the insurance commissioner that a continuation of policy coverage would place the insurer in violation of California law or the law of the insurer's domicile, or that continuation of coverage would threaten the insurer's solvency; and

- A change by the named insured or his or her representative in the activities or property of the insured enterprise that results in a materially increased risk, or a materially changed risk, unless the added, increased, or changed risk is included in the policy.

In addition to the grounds discussed above, additional grounds exist for cancellation of a commercial umbrella liability insurance policy, commercial excess liability insurance policy, or commercial excess property insurance policy [*see Ins. Code § 676.6(c)*; *see also Ins. Code § 676.6(b)(1)* ("commercial umbrella liability insurance policy" defined), *(2)* ("excess liability insurance policy" defined), *(3)* ("excess property insurance policy" defined)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsCancellation & NonrenewalGeneral OverviewInsurance LawClaims & ContractsCancellation & NonrenewalMaterial MisrepresentationInsurance LawClaims & ContractsCancellation & NonrenewalNonpayment of Premiums



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.22

AUTHOR: Reviewed by Pam Boc

§ 1F.22 Nonrenewal by Insurer

[1] Individual Policies

At least 45 days before the expiration of the policy period, an insurer must mail or deliver to the named insured at the address shown on either of the following [*Ins. Code § 678(a)*; *see Ins. Code §§ 675, 678(d)*]:

- An offer to renew the policy, contingent on the payment of the premium as stated in the offer, setting forth both of the following:
  - Any reduction of limits or elimination of coverage.
  - The telephone number of the insurer's representatives who handle consumer inquiries or complaints, displayed prominently in a font size consistent with the other text of the renewal offer.
- A notice of the nonrenewal of the policy, stating all of the following:
  - The reason(s) for nonrenewal.
  - The telephone number of the insurer's representatives who handle consumer inquiries or complaints, displayed prominently in a font size consistent with the other text of the notice.
  - A brief statement indicating that if the consumer has contacted the insurer to discuss the nonrenewal and remains unsatisfied, the consumer may have the matter reviewed by the Insurance Department.

- The telephone number of the unit within the Department that responds to consumer inquiries or complaints.

If the insurer fails to give the named insured either an offer of renewal or a notice of nonrenewal, the existing policy will remain in effect with no change in terms or conditions for 45 days from the date that either the offer to renew or the notice of nonrenewal is delivered or mailed to the named insured [*Ins. Code § 678(b)*]. The insurer must inform the named insured of this fact along with the offer to renew or the notice of nonrenewal [*Ins. Code § 678(b)*]. Any policy written for a term of less than one year is considered as if written for a term of one year. Any policy written for a term of longer than one year, as well as any policy with no fixed expiration date, is considered as if written for successive policy periods or terms of one year [*Ins. Code § 678(c)*].

In general, insurers may not to refuse to renew individual property and liability policies (other than automobile insurance and workers' compensation insurance policies) [*Ins. Code § 675(a)*; *see § 1F.20*] solely on the basis that a claim is pending under the policy. However, this bar does not apply to claims made under coverage for loss or damage caused by earthquake [*Ins. Code § 675(a)*; *see Ins. Code §§ 10081 et seq., 10089.5 et seq.*]. Special restrictions apply to the nonrenewal of automobile insurance policies [*see Ins. Code § 1861.03(c)*]. For discussion of those restrictions, refer to California Insurance Law and Practice, Ch. 50, *Automobile Insurance* (Matthew Bender).

[2] Commercial Policies

Any notice of nonrenewal of a commercial insurance policy, commercial umbrella liability insurance policy, commercial excess liability insurance policy, or commercial excess property insurance policy must be in writing and delivered or mailed to the producer of record and to the named insured at the mailing address shown on the policy [*Ins. Code § 678.1(b)*; *see Ins. Code § 676.6(b)(1)- (3)* (commercial umbrella liability insurance, excess liability insurance, and excess property insurance policies defined); *Code Civ. Proc. § 1013(a)* (service by mail)].

If the insurer does not intend to renew the policy or intends to condition renewal on a reduction of limits, elimination of coverages, increase in deductibles, or increase of more than 25 percent of the rate on which the premium is based, it must provide the insured with a notice of nonrenewal [*Ins. Code § 678.1(c)*]. That notice must state the grounds on which the nonrenewal is based and must be given to the insured at least 45 days, but not more than 120 days, before the end of the policy period [*Ins. Code § 678.1(c)*]. However, if the aggregate premium of the policy holder is $10,000 or less, the notice must be provided at least 60 days but not more than 120 days in advance of the policy period [*Ins. Code § 678.1(c)*]. With respect to commercial umbrella liability insurance policies, commercial excess liability insurance policies, or commercial excess property insurance policies, an insurer may also condition renewal on requirements relating to the underlying policy or policies [*see Ins. Code § 678.1(e)*].

If the insurer fails to give timely notice of nonrenewal, the policy will be continued, with no changes in its terms or conditions, for 60 days after the insurer gives notice [*Ins. Code § 678.1(d)*]. For this purpose, "terms and conditions" includes, but is not limited to, a reduction in coverage limits, elimination of coverages, or an increase in deductibles [*Ins. Code § 678.1(f)(6)*].

Under certain circumstances, the insurer is not required to provide the insured with a notice of renewal of a commercial policy, including a commercial umbrella liability insurance policy, commercial excess liability insurance policy, or commercial excess property insurance policy [*see Ins. Code § 678.1(f)*; *see also Ins. Code § 676.6(b)(1)- (3)* (commercial umbrella liability insurance, excess liability insurance, or excess property insurance policies defined)]. A notice need not be sent [*Ins. Code § 678.1(f)*]:

- On the transfer or renewal of a policy between insurers that are members of the same insurance group when no change is made to the terms, conditions, or rates on which the premium is based;

- If the policy was extended for 90 days or less and the notice required by statute was provided before the extension [*see Ins. Code § 678.1(c)* (notice requirement)];

- If the policy is for a period of no more than 60 days, and the insured is notified at the time of issuance that it may not be renewed; or

- If the named insured requests a change in the terms, conditions, or risks covered by the policy within 60 days before the end of the policy period.

Further, a nonrenewal notice is not required if the insured has made an offer to the insured, within 45 to 120 days before the end of the policy period, to renew the policy under changed terms and conditions or at a changed premium rate [*Ins. Code §§ 676.6(d)(6), 678.1(f)(6)*; *see Ins. Code § 678.1(c)* (notice requirement)].

When an insured receives a notice of nonrenewal, the insured, or the agent or broker of record on the nonrenewed policy, may file a written request seeking an explanation. Within 15 business days of receiving the request, the insurer must provide a premium and loss history report for the shorter of (1) the account's tenure or (2) the past three years, as well as a report of any loss experience during the current policy year [*Ins. Code § 678.1* (requirement inapplicable to professional liability insurance)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsCancellation & NonrenewalGeneral OverviewInsurance LawClaims & ContractsCancellation & NonrenewalNotice RequirementsInsurance LawMotor Vehicle InsuranceCancellation & RenewalNotice RequirementsGeneral OverviewInsurance LawMotor Vehicle InsuranceCancellation & RenewalStatutory Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.23

AUTHOR: Reviewed by Pam Boc

§ 1F.23 Insurer's Duty to Defend

[1] In General

An insurer's duty to defend is a contractual duty arising from the express language of the policy [*Larraburu Bros., Inc. v. Royal Indem. Co. (9th Cir. 1979) 604 F.2d 1208, 1214-1215]* . As a contractual duty, it is not unconditional (as is the implied covenant of good faith and fair dealing) [*see* California Insurance Law and Practice, Ch. 13, *Claims Handling and the Duty of Good Faith* (Matthew Bender)]. For example, the duty to defend does not arise until the insurer receives actual notice of an action against the insured [*California Shoppers, Inc. v. Royal Globe Ins. Co. (1985) 175 Cal. App. 3d 1, 58, 221 Cal. Rptr. 171* (insurer did not breach implied covenant in failing to defend when it never received actual notice of lawsuit; however, insurer remained contractually liable to pay insured's defense costs); *see Foster-Gardner, Inc. v. National Union Fire Ins. Co. (1998) 18 Cal. 4th 857, 879-880, 77 Cal. Rptr. 2d 107, 959 P.2d 265* (EPA order requiring business to remediate pollution did not initiate "suit" within meaning of insurance policies and thus did not give rise to insurers' duty to defend; use of term "suit" in policies was not ambiguous, as reasonable interpretation of term is "lawsuit" and construction that included precomplaint notices was not reasonable)]. However, wrongful refusal to defend (that is, unreasonable withholding of defense benefits without good cause) can contribute to a breach of the implied covenant [*see, e.g., California Shoppers, Inc. v. Royal Globe Ins. Co. (1985) 175 Cal. App. 3d 1, 57-58, 221 Cal. Rptr. 171]* .

Insurance policies may not expressly provide or be construed to provide any duty to defend any claim in any criminal action or proceeding or in any action or proceeding brought pursuant to the Unfair Competition Act [*see Bus. & Prof. Code §§ 17200-17209*] or the Business and Professions Code provisions governing false advertising [*see Bus. & Prof. Code §§ 17500-17509*] in which the recovery of a fine, penalty, or restitution is sought by the Attorney General, any district attorney, any city prosecutor, or any county counsel [*Ins. Code § 533.5(b)*; *see Ins. Code § 533.5(c)* ("duty to defend" for purposes of this section defined)].

[2] Scope of Duty to Defend

An insurer is obliged to provide a defense to a lawsuit when the insurer learns (or reasonably should have learned) of facts from any source that give rise to the potential that the insured will be held liable for damages covered under its policy [*Gray v. Zurich Ins. Co. (1966) 65 Cal. 2d 263, 276-277, 54 Cal. Rptr. 104, 419 P.2d 168* ; *Truck Ins. Exchange v. Bennett (1997) 53 Cal. App. 4th 75, 81, 61 Cal. Rptr. 2d 497* (duty to defend measured by nature and kinds of risk covered by policy); *CNA Casualty Co. of California v. Seabord Surety Co. (1986) 176 Cal. App. 3d 598, 606, 222 Cal. Rptr. 276* (enumerating cases)]. However, an insurer has no duty to defend an insured when there is no potential for liability under the policy [*Fire Ins. Exchange v. Jiminez (1986) 184 Cal. App. 3d 437, 441, 229 Cal. Rptr. 83* ; *see California Ins. Guarantee Assn. v. Wood (1990) 217 Cal. App. 3d 944, 948, 266 Cal. Rptr. 250* (duty to defend is dependent on policy, not whether cause of action is valid)]. For example, a corporation's insurer had no duty under a comprehensive general liability (CGL) policy to defend a minority shareholder who sued the corporation after being ousted as president and as a corporate employee, but who remained a director after leaving the corporation's employment to work elsewhere, against a defamation counterclaim filed by the corporation and the controlling shareholder, when the plaintiff was sued as an individual and offered no evidence to support his claim that he was acting in his capacity as a director when he allegedly defamed the corporation [*Lomes v. Hartford Financial Services Group, Inc. (2001) 88 Cal. App. 4th 127, 132-135, 105 Cal. Rptr. 2d 471]* .

Although the duty to defend is limited by the nature and kind of risk assumed by the insurance policy [*Gray v. Zurich Ins Co. (1966) 65 Cal. 2d 263, 275, 54 Cal. Rptr. 104, 419 P.2d 168* ; *Giddings v. Industrial Indemnity Co. (1980) 112 Cal. App. 3d 213, 218, 169 Cal. Rptr. 278]* , it is broader than, as well as independent of, the duty to indemnify [*Fire Ins. Exchange v. Abbott (1988) 204 Cal. App. 3d 1012, 1029, 251 Cal. Rptr. 620]* . Thus, even though the insurer ultimately might not be obliged to pay any indemnity (if the only claims proven are based on excluded conduct), it still has a duty to defend [*Gray v. Zurich Ins Co. (1966) 65 Cal. 2d 263, 268, 271-272, 54 Cal. Rptr. 104, 419 P.2d 168* ; *see State Farm Mutual Auto. Ins. Co. v. Allstate Ins. Co. (1970) 9 Cal. App. 3d 508, 530, 88 Cal. Rptr. 246* (duty to defend is independent of ultimate question of coverage)].

If some of the allegations against the insured are covered under the policy and some are not, the insurer is ordinarily required to defend the entire action [*Hogan v. Midland National Ins. Co. (1970) 3 Cal. 3d 553, 563, 91 Cal. Rptr. 153, 476 P.2d 825]* . However, an insurer may not be obliged to pay for all defense costs if it can demonstrate the allocability of defense costs between covered and noncovered claims [*see Hogan v. Midland National Ins. Co. (1970) 3 Cal. 3d 553, 564, 91 Cal. Rptr.153, 476 P.2d 825* (insurer, having breached duty to defend, required to produce undeniable evidence of allocability of expenses to noncovered claims before it could avoid liability for such expenses); *Okada v. MGIC Indem. Corp. (9th Cir. 1986) 823 F.2d 276, 283* (when covered claims readily distinguished from noncovered claims, allocation may be made either early in case or once lawsuit against insured concluded)]. The rule that an insurer must defend an entire action if some of the allegations are potentially covered under the policy and others are not [*see Hogan v. Midland National Ins. Co. (1970) 3 Cal. 3d 553, 563-564, 91 Cal. Rptr. 153, 476 P.2d 825]* does not apply when there is a potentially covered claim in a cross-complaint but not in the underlying action; in this case, the insurer has a duty to defend the cross-complaint from the time the insurer learned of the potentially covered claim, but no duty to defend the entire action [*Westfield Ins. Co. v. TWT, Inc. (N.D. Cal. 1989) 723 F. Supp. 492, 496-497* ; *see California Union Ins. Co. v. Club Aquarius (1980) 113 Cal. App. 3d 243, 247-248, 169 Cal. Rptr. 685* (insurer excused from defending damages portion of lawsuit after determination that insured had no covered liability under policy)]. The scope of the duty to defend may also include, at least under some circumstances, a duty to appeal an adverse judgment when there are reasonable grounds to do so [*see Jenkins v. Insurance Co. of North America (1990) 220 Cal. App. 3d 1481, 1488-1492, 272 Cal. Rptr. 7]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceDirectors & Officers Liability InsuranceObligationsDefenseInsurance LawClaims & ContractsGood Faith & Fair DealingDuty to Defend



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide § 1F.24

AUTHOR: Reviewed by Pam Boc

§ 1F.24 Insurer's Obligation to Provide Independent Counsel

[1] In General

The language of a liability policy typically reserves control of the defense to the insurer. The insurer ordinarily selects defense counsel for the insured and controls the defense, pursuant to policy terms stating that the insurer has the right and/or duty to defend claims on the insured's behalf. However, the existence of a conflict of interest between the interests of the insurer and the interests of the insured requires that the insurer relinquish control of the defense to the insured and allow the insured to select its own counsel [*San Diego Navy Federal Credit Union v. Cumis Ins. Society, Inc. (1984) 162 Cal. App. 3d 358, 375, 208 Cal. Rptr. 494]* . Such a conflict arises when an insurer reserves its rights to contest coverage, and the determination of whether coverage exists is a question of fact to be resolved in the underlying lawsuit; it is based on the presumption that a defense attorney, hired by the insurer to defend the insured, is unable to represent the divergent interests of the joint clients [*San Diego Navy Federal Credit Union v. Cumis Ins. Society, Inc. (1984) 162 Cal. App. 3d 358, 375, 208 Cal. Rptr. 494]* .

[2] Statutory Duties

[a] Insurer's Duty to Appoint Independent Counsel

The requirements set forth in *[1], above*, with some additional controls, have been codified in the California Civil Code [*see Civ. Code § 2860*]. Under the statute, if the provisions of an insurance policy impose a duty to defend on an insurer, and a conflict of interest arises that creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer must provide independent counsel to represent the insured, unless the insured expressly waives the right to independent counsel [*Civ. Code § 2860(a)*]. Any waiver of the conflict must be in writing and in the form required by statute [*Civ. Code § 2860(a)*].

[b] Duty of Appointed Independent Counsel

When an insured selects independent counsel, the insured and its counsel have a duty to disclose to the insurer all information concerning the action, except privileged materials relevant to coverage disputes [*Civ. Code § 2860(d)*]. In addition, independent counsel must inform and consult with the insurer in a timely manner on all matters related to the action [*Civ. Code § 2860(d)*]. When the insured selects independent counsel, both the counsel for the insured and counsel for the insurer must be allowed to participate in all aspects of the litigation [*Civ. Code § 2860(f)*]. Further, counsel must cooperate fully in the exchange of information that is consistent with each counsel's ethical and legal obligations to the insured [*Civ. Code § 2860(f)*; *see* Model Code of Ethical Considerations, Rules 5-14-5-17]. However, communications between the insurer's counsel and the insurance adjuster are privileged from disclosure to the insured [*State Farm Fire & Casualty Co. v. Superior Court (1989) 216 Cal. App. 3d 1222, 1228, 265 Cal. Rptr. 372]* .

[3] Existence of Conflict of Interest

A conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage [*Civ. Code § 2860(b)*]. No conflict of interest may be deemed to exist as to allegations of punitive damages [*Civ. Code § 2860(b*); *Zieman Mfg. Co. v. St. Paul Fire & Marine Ins. Co. (9th Cir. 1983) 724 F.2d 1343, 1346]* , or be deemed to exist solely because an insured is sued for an amount in excess of the insurance policy limits [*Civ. Code § 2860(b)*; *see Foremost Ins. Co. v. Wilks (1988) 206 Cal. App. 3d 251, 262-262, 253 Cal. Rptr. 596]* .

Further, a conflict does not arise in every instance when the insurer reserves the right to contest coverage [*Civ. Code § 2860(b)*]. However, when an insurer reserves its right on a particular coverage issue, and the outcome of that issue can be controlled by the counsel retained by the insurer to handle the defense of the claim, a conflict of interest may exist [*Civ. Code § 2860(b)*]. It has been held that no conflict exists if the resolution of the coverage dispute does not depend on the determination of facts at issue in the claim against the insured [*McGee v. Superior Court (1985) 176 Cal. App. 3d 221, 226-227, 221 Cal. Rptr. 421]* . However, in other circumstances a conflict may arise because the insurer is not economically motivated to vigorously defend the insured [*see Previews, Inc. v. California Union Ins. Co. (9th Cir. 1981) 640 F.2d 1026, 1028]* .

For further discussion of the insurer's obligation to provide independent counsel when a conflict of interest exists, refer to California Insurance Law and Practice, Ch. 13, *Claims Handling and the Duty of Good Faith* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsReservation of RightsIndependent Counsel



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
A. Overview of Insurance Issues

1-1F California Legal Forms--Transaction Guide §§ 1F.25-1F.29

AUTHOR: Reviewed by Pam Boc

[Reserved]

§§ 1F.25[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
B. Categories of Insurance
1 Life, Disability, and Health Insurance

1-1F California Legal Forms--Transaction Guide § 1F.30

AUTHOR: Reviewed by Pam Boc

§ 1F.30 Life Insurance Defined

Life insurance is "insurance upon the lives of persons or appertaining thereto, and the granting, purchasing, or disposing of annuities" [*Ins. Code § 101*]. Life insurance is essentially a contract whereby the insurer, for a stipulated consideration (a premium), agrees to make a specified payment on the death of the insured person. Any person other than a public enemy may be insured [*Ins. Code § 151*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawLife InsuranceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
B. Categories of Insurance
1 Life, Disability, and Health Insurance

1-1F California Legal Forms--Transaction Guide § 1F.31

AUTHOR: Reviewed by Pam Boc

§ 1F.31 Purpose of Life Insurance

The basic purpose of life insurance is to protect against the risks of premature death. However, life insurance can serve not only a protective function but, with certain types of policies, a savings function as well. In its protective function, life insurance provides funds for estate purposes, income for family members after the death of the insured, and income for special needs such as payment of a mortgage or protection of a business from loss [*see § 1F.35*]. In its savings function, certain life insurance products allow individuals to accumulate savings and permit the policyholder to borrow against those savings or to obtain the cash surrender value of the policy.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawLife InsuranceCash Surrender Value



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
B. Categories of Insurance
1 Life, Disability, and Health Insurance

1-1F California Legal Forms--Transaction Guide § 1F.32

AUTHOR: Reviewed by Pam Boc

§ 1F.32 Basic Elements of Life Insurance

[1] In General

The three basic elements of a life insurance contract are (1) an insurable interest [*see Ins. Code §§ 280-287, 10110, 10110.2*]; (2) shifting of loss [*see Helvering v. Le Gierse (1941) 312 U.S. 531, 539, 61 S. Ct. 646, 85 L. Ed. 996]* ; and, (3) an insurable risk [*California Physicians' Service v. Garrison (1946) 28 Cal. 2d 790, 803-804, 172 P.2d 4]* .

[2] Insurable Interest

[a] Requirement for Valid Insurance Contract

If the insured has no insurable interest, the contract is void [*Ins. Code §§ 280, 10110.1(e)*; *see Osborne v. Security Insurance Co. (1957) 155 Cal. App. 2d 201, 205, 318 P.2d 94]* . An insurable interest must exist at the time the life (or disability) insurance becomes effective [*Ins. Code § 10110.1(g)*]. However, it is only required to exist at the time of application, not at the time the loss actually occurs [*Ins. Code § 10110.1(g)*; *see Shaw v. Board of Administration (1952) 109 Cal. App. 2d 770, 774, 241 P.2d 635* (beneficiary designation, if valid at contract's inception, remains valid even if insurable interest ceases, unless contract provides otherwise)].

[b] Statutory Definition

An "insurable interest," for both life and disability insurance purposes, is an interest based on a reasonable expectation of pecuniary advantage through the continued life, health, or bodily safety of another person, and consequent loss by reason of that person's death or disability, or, in the case of closely related individuals, a substantial interest engendered by love and affection [*Ins. Code § 10110.1(a)*]. This statutory definition, however, is not to be interpreted to define all instances in which an insurable interest exists [*Ins. Code § 10110.1(i)*].

With respect to life and disability insurance contracts, every person has an insurable interest in the life and health of [*Ins. Code § 10110*]:

- Himself or herself [*see Ins. Code § 10110.1(b)*; *Mayfield v. Fidelity & Casualty Co. (1936) 16 Cal. App. 2d 611, 621, 61 P.2d 83]* ;

- Any person on whom he or she depends wholly or in part for education or support [*see Rudell v. Board of Administration (1937) 8 Cal. 2d 600, 602, 66 P.2d 1203* (determination of dependency is question of fact)];

- Any person under a legal obligation to him or her for the payment of money or respecting property or services, of which death or illness might delay or prevent performance [*see Curtiss v. Aetna Life Ins. Co. (1891) 90 Cal. 245, 249-251, 27 P. 211* (assignee of creditor has insurable interest)]; and

- Any person upon whose life any estate or interest vested in him or her depends.

In a move to control possible abuses in the life settlement industry, legislation has been enacted to the effect that trusts and special purpose entities that are used to apply for and initiate the issuance of insurance policies for investors, when one or more beneficiaries of those trusts or entities do not have an insurable interest in the insured's life, violate the insurable interest laws and the prohibition against wagering on life [*Ins. Code § 10110.1(d)*]. Furthermore, any device, scheme, or artifice designed to give the appearance of an insurable interest when there is no legitimate insurable interest violates the insurable interest laws [*Ins. Code § 10110.1(e)*].

[c] Insurable Interest of Employer

In general, an employer has an insurable interest in the life or physical or mental ability of any of its directors, officers, or employees (or in the same class of persons of any subsidiary), or any other person whose death or physical or mental disability might cause financial loss to the employer [*Ins. Code § 10110.1(c)*]. An employer also has an insurable interest pursuant to specified contracts with shareholders, or relating to compensation agreements obligating the employer as guarantor or surety on the life of the principal obligor [*Ins. Code § 10110.1(c)*]. An employer's trustee or the trustee of a pension, welfare benefit plan, or trust established by an employer providing life, health, disability, retirement or similar benefits to employees and retired employees, and acting in a fiduciary capacity with respect to those persons and their dependents and beneficiaries, has an insurable interest in those employees and retired employees [*Ins. Code § 10110.1(c)*]. The employer must obtain the written consent of the individual being insured [*Ins. Code § 10110.1(c)*; *see Ins. Code § 10110.1(h)* (qualified charitable organizations may ignore insurable interest requirement, if insured consents to issuance of insurance); *see also Rev. & Tax Code § 214* ("qualified charity" defined)].

Effective January 1, 2004, an insurer may not issue or deliver a corporate-owned life insurance policy, other than a policy insuring the life of a current or former exempt employee [*Ins. Code § 10110.4(a), (c)* ("exempt employee" is administrative, executive, or professional employee who is exempt under *Lab. Code § 515*)]. A "corporate-owned life insurance policy" is a life insurance policy that is purchased by a California employer that designates the employer as beneficiary and insures the life of a California resident who is a current or former employee of the employer [*Ins. Code § 10110.4(b)*]. A corporate-owned life insurance policy purchased on or after January 1, 2004, is void [*Ins. Code § 10110.4(e)(1)*].

In general, it is a violation of public policy for a California employer to purchase or hold a corporate-owned life insurance policy [*Ins. Code § 10110.4(d)*]. Further, a corporate-owned life insurance policy purchased before January 1,

2004, ordinarily becomes void on the next premium payment date or January 1, 2009, but no later than January 1, 2010 [*Ins. Code § 10110.4(e)(2)*]. However, policies purchased before January 1, 2004, that insure the life of a current or former nonexempt employee continue in force, provided that no further premium payments are made after that date [*Ins. Code § 10110.4(f)*].

PRACTICE TIP:

If an employer purchases a policy insuring the life of a current or former nonexempt employee before January 1, 2004, and holds the policy after that date, the employer must make specified written disclosures to the employee with 90 days of that date [*Ins. Code § 10110.4(f)*; *see Ins. Code § 10110.4(g)*].

[3] Shifting of Loss

Insurance involves risk shifting and risk distributing; these elements are essential to a life insurance contract [*Helvering v. Le Gierse (1941) 312 U.S. 531, 539, 61 S. Ct. 646, 85 L. Ed. 996]* . Insurance furnishes protection and provides an economic advantage by loss sharing: by sharing losses, the cost to each person decreases and, therefore, becomes bearable [*see Metropolitan Life Ins. Co. v. State Board of Equalization (1982) 32 Cal. 3d 649, 654, 186 Cal. Rptr. 578, 652 P.2d 426]* .

[4] Insurable Risk

The general characteristics of insurable risk are that (1) the risk must be common to large numbers of people in order to accurately predict outcomes and accurately determine rates; (2) the loss must be definite; (3) the loss to the individual must be unexpected; (4) the risk should not present exposure to catastrophic loss; (5) the loss must be serious; (6) the chance of loss must be calculable; and (7) the cost must be reasonable [*California Physicians' Service v. Garrison (1946) 28 Cal. 2d 790, 803-804, 172 P.2d 4* ; *see Fraser-Yamor Agency, Inc. v. County of Del Norte (1977) 68 Cal. App. 3d 201, 213, 137 Cal. Rptr. 118* ; *Pfeiffer v. General Ins. Corp. (N.D. Cal. 1960) 185 F. Supp. 605, 608* ; *Harman v. American Casualty Co. (S.D. Cal. 1957) 155 F. Supp. 612, 614]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawLife InsuranceGeneral OverviewInsurance LawLife InsuranceInsurable InterestsGeneral OverviewInsurance LawLife InsuranceInsurable InterestsEmployers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
B. Categories of Insurance
1 Life, Disability, and Health Insurance

1-1F California Legal Forms--Transaction Guide § 1F.33

AUTHOR: Reviewed by Pam Boc

§ 1F.33 Term Life Insurance

Term life insurance is insurance that is in effect for a specified term of years and automatically expires at the end of the term, unless renewed. Term insurance has no cash surrender value, loan value, or any value except in the event of the death of the insured during the term. It can be terminated simply by nonpayment of premiums.

Term insurance provides financial protection for a minimum premium, but only for a limited period of time. Term insurance provides only temporary protection and provides no savings feature. Moreover, if the insured survives the initial term and obtains renewals, the substantial increases in premium rates for renewals as the insured increases in age can cause the total premiums to exceed the amount the insured would have paid had he or she originally purchased a whole life policy. For discussion of the types of term insurance, refer to California Insurance Law and Practice, Ch. 20, *Nature and Types of Life Insurance* (Matthew Bender). For coverage of whole life insurance, see *§ 1F.34*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawLife InsuranceTerm Policies



92 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
B. Categories of Insurance
1 Life, Disability, and Health Insurance

1-1F California Legal Forms--Transaction Guide § 1F.34

AUTHOR: Reviewed by Pam Boc

§ 1F.34 Whole Life Insurance

Whole life insurance provides permanent protection with an investment or savings element. It allows the insured to accumulate a savings fund, without sacrificing protection against premature death. Whole life premiums are larger than term premiums; this difference creates the cash surrender value of the policy. Whole life does not allow maximum benefit for temporary protection or protection that decreases over time. However, without paying the cost of additional whole life insurance, an insured may be able to add to a whole life policy a less expensive term insurance policy for the period during which the insured needs increased protection. For example, the insured may need increased protection before a mortgage is paid off or before the insured's children leave home. Various types of whole life policies are discussed in California Insurance Law and Practice, Ch. 20, *Nature and Types of Life Insurance* (Matthew Bender). For coverage of term life insurance, see *§ 1F.33*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawLife InsuranceCash Surrender ValueInsurance LawLife InsuranceWhole Life Coverage



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
B. Categories of Insurance
1 Life, Disability, and Health Insurance

1-1F California Legal Forms--Transaction Guide § 1F.35

AUTHOR: Reviewed by Pam Boc

§ 1F.35 Life Insurance for Business Purposes

[1] General Uses

Corporation and partnership life insurance are generally used to liquidate the interest of a deceased stockholder or partner, establish credit, create reserves for the business, fund arrangements for deferred compensation, pension, and/or profit sharing, and fund the payment of death benefits and salary continuance to a deceased employee's surviving spouse or heirs by the business. Life insurance for the benefit of a sole proprietor is generally used to indemnify his or her estate against loss resulting from a forced sale of the business following the owner's death, provide heirs with necessary cash to carry on the business, establish credit during the sole proprietor's lifetime, provide retirement income for the sole proprietor, and provide immediate cash for estate settlement requirements without encumbering or jeopardizing the financial status of the business. For more detailed discussion of the use of life insurance in business planning, including tax considerations, see *§§ 1F.62 through 1F.66*.

[2] Corporation Life Insurance

Corporation life insurance is insurance placed on the lives of stockholders of small corporations; it funds an agreement to purchase or redeem a stockholder's shares on his or her death or retirement. If the corporation as an "entity" is a party to the stock redemption agreement, it will be the owner and beneficiary of policies on the lives of its stockholders. On the death, and often on the retirement, of a stockholder, the benefits or values payable to the corporation provide the necessary surplus to allow the corporation to redeem its shares.

Alternatively, the stockholders may execute a "cross-purchase" buy-sell agreement, under which each stockholder funds his or her own agreement to purchase shares from a retiring stockholder or a deceased stockholder's estate by the purchase of an insurance policy on the life of every other stockholder. The participation of more than two or three stockholders makes the number of policies required for this type of arrangement impractical; a stock redemption agreement would be the practical solution if a greater number of shareholders are involved.

For more detailed treatment of the use of life insurance in connection with corporate buy-sell agreements, see *§§ 1F.63 through 1F.65*.

[3] Partnership Life Insurance

Partnership life insurance is similar to corporation life insurance: insurance is purchased by the partnership, or by the partners, on the lives of one or more of the partners. Under the "entity" arrangement, the proceeds of the policies are payable to the partnership to fund the redemption of the deceased or retiring partner's interest. They are paid to the surviving partner or partners when they are used to fund a buy-out by those partners of a deceased or retiring partner's interest in the partnership.

Partnership life insurance may also be purchased under a cross purchase agreement wherein the partners, as individuals, agree to purchase the interest of the deceased partner and to fund the agreement and agree to purchase insurance on the lives of the others. Those who purchase the policies are both the owners and beneficiaries of the policies. The precise method used may have important tax consequences that must be considered before entering into such an arrangement. For further discussion of the use of life insurance in partnership buy-sell agreements, see *§§ 1F.63* and *1F.66*.

This type of life insurance arrangement could also be established for the members of a limited liability company. For coverage of limited liability companies, see Ch. 12C, *Limited Liability Companies* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawLife InsuranceGeneral OverviewInsurance LawLife InsuranceInsurable InterestsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
B. Categories of Insurance
1 Life, Disability, and Health Insurance

1-1F California Legal Forms--Transaction Guide § 1F.36

AUTHOR: Reviewed by Pam Boc

§ 1F.36 Disability and Health Insurance

[1] Definition

Disability insurance is broadly defined to include insurance appertaining to injury, disablement, or death resulting to the insured from accidents, and appertaining to disablements resulting to the insured from sickness [*Ins. Code § 106(a)*]. "Health insurance," for statutes that became effective on or after January 1, 2002, means an individual or group disability insurance policy that provides coverage for hospital, medical, and surgical benefits. However, the term excludes specific types of insurance, such as accidental death and accidental death and dismemberment policies, disability insurance (including hospital indemnity, accident only, and specified disease insurance that pays benefits on a fixed benefit, cash payment only basis), and insurance arising out of worker's compensation or similar law [*Ins. Code § 106(b)*]."Specialized health insurance policy," in statutes that became effective on or after January 1, 2008, means a policy of health insurance for covered benefits in a single specialized area of health care, including dental-only, vision-only, and behavioral health-only policies [*Ins. Code § 106(c)*]. The term "policy of accident and sickness insurance" is defined only by reference to the general definition of disability insurance [*Ins. Code § 10275*]. Thus, in California, a disability policy is essentially synonymous with a policy of accident and sickness insurance [*see* Ins. Bull. 72-15]. The Insurance Code also uses the term "accident and health policies," but without a separate definition; it appears that this term is simply an alternative phrase for "accident and sickness policies" [*see, e.g., Ins. Code § 10276*].

[2] Classification of Disability Insurance by Types of Benefits

In addition to classifying disability polices based on the statutory definition of disability insurance [*see Ins. Code §§ 779.2(2)* (credit disability insurance), *10270.1* (tuition refund insurance), *10270.2* (blanket disability insurance), *10270.5*, *10270.505*, *10270.57*, *10270.63* (group disability insurance), *10270.7* (family expense disability insurance), *10270.97* (selected group disability insurance), *10295* (transportation ticket insurance)], disability polices can also be distinguished based on the types of benefits offered, or the types of hazards covered, in the event of the insured's injury or sickness. Two of the statutory types of disability insurance are based on this type of distinction: credit disability

insurance pays benefits based on the indebtedness of the insured, and tuition disability insurance pays benefits based on forfeited tuition and fees.

The most common type of disability benefit is a medical or health policy that provides indemnification based on the insured's medical costs in the event of an accident or sickness. The exact nature of the medical coverage is subject to considerable variation and ranges from coverage for a particular dread disease [*see Ins. Code § 10291.5(b)(11)*] to comprehensive hospitalization and physician coverage [*see Ins. Code § 10176*]. Medical coverage may also be limited to benefits provided by one type of medical practitioner, such as a dental care policy [*see Ins. Code § 10176*], or provide special limited benefits, such as a medicare supplement policy [*see Ins. Code § 10192.1 et. seq.*]. Disability policies may also provide benefits based on the insured's loss of earnings during his or her disability [*see § 1F.68[1]*]. Accidental death and dismemberment insurance is a common form of disability policy providing lump sum payments in the event of accidental death or certain dismemberments [*see 10 Cal. Code Reg. §§ 2220.12-2220.14*].

For detailed discussion of types of disability coverage, refer to California Insurance Law and Practice, Ch. 25, *Nature and Types of Disability Insurance* , and Ch. 31, *Credit Life and Disability Insurance* (Matthew Bender). For discussion of the health and disability insurance contract and an analysis of disability policies, see California Insurance Law and Practice, Ch. 26, *The Health and Disability Insurance Contract* (Matthew Bender). Health insurance as an employee benefit is covered in Ch. 1D, *Overview of Employee Benefits* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Healthcare LawInsuranceGeneral OverviewHealthcare LawInsuranceCoverageGeneral OverviewHealthcare LawInsuranceReimbursementGeneral OverviewInsurance LawDisability InsuranceGeneral OverviewInsurance LawDisability InsuranceInsurability



95 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
B. Categories of Insurance
1 Life, Disability, and Health Insurance

1-1F California Legal Forms--Transaction Guide §§ 1F.37-1F.49

AUTHOR: Reviewed by Pam Boc

[Reserved]

§§ 1F.37[Reserved]



96 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
B. Categories of Insurance
2. Property and Liability Insurance

1-1F California Legal Forms--Transaction Guide § 1F.50

AUTHOR: Reviewed by Pam Boc

§ 1F.50 Property and Liability Insurance--In General

[1] Distinguished

By its policy, the property insurer promises to pay the value of the loss incurred by the insured in the event that a certain type of loss occurs within a specified period. By its policy, the liability insurer promises to pay, on the insured's behalf, any damages (within the policy limits) that may be legally assessed against the insured and promises to provide the insured with a defense against suits seeking damages resulting from actual or potential liability within the scope of policy coverage. Liability insurance provides indemnity for liability for damages to the person or property of others; property insurance provides for the indemnification of an insured for property damaged or destroyed to the extent of the insured's insurable interest. In liability insurance, the essence of the contract is that the event insured against will not happen; in property insurance, the contract provides indemnity for the consequences of the event if it should happen [*Gribaldo, Jacobs, Jones & Associates v. Agrippina Versicherunges A.G. (1970) 3 Cal. 3d 434, 446, 91 Cal. Rptr. 6, 476 P.2d 406]* .

[2] Governing Law

In general, property and liability insurance polices are covered by the Insurance Code in general and the consumer protection provisions of Proposition 103 [*Ins. Code §§ 1861.01-1861.14*], including the prohibition against excessive, inadequate, or unfairly discriminatory rates [*see Ins. Code § 1861.05(a)*], and the requirement of prior approval of rate changes [*see Ins. Code §§ 1861.01(c), 1861.05(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawGeneral Liability InsuranceGeneral OverviewInsurance LawGeneral Liability InsuranceObligationsDefenseInsurance LawProperty InsuranceGeneral OverviewInsurance LawProperty

InsuranceInsurable InterestsInsurance LawProperty InsuranceObligationsDefense



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
B. Categories of Insurance
2. Property and Liability Insurance

1-1F California Legal Forms--Transaction Guide § 1F.51

AUTHOR: Reviewed by Pam Boc

§ 1F.51 Property Insurance

[1] Personal and Commercial Lines Distinguished

In addition to personal property insurance, commercial policies are available that can protect against loss of rental value, business interruption, extra expense, builder's risk, damage to boilers and machinery, damage to crops, bailee's risks, and default by mortgages [*see Ins. Code §§ 111-120*]. Business interruption insurance is discussed in *Section 1F.68*.

[2] Open and Valued Policies Distinguished

A property insurance policy may be either open or valued. An open policy is one in which the value of the property to be insured is not agreed on, but is left to be ascertained in case of loss [*Ins. Code § 411*]. A valued policy is a policy that expresses on its face an agreement that the thing insured is valued at a specific sum [*Ins. Code § 412*]. Most property insurance polices are open; the extent of the insurer's liability is subject to appraisal after a loss has occurred. Fire and automobile policies, for example, provide for a means of determining the damage to the insured's house or car after the loss. A valued policy is sometimes available for theft coverage when the value of the property can be determined with certainty before the loss.

[3] Subject Matter of Property Insurance

[a] In General

If there is an insurable interest [*see Ins. Code § 281* ("insurable interest" defined)], the loss or damage to any property may be insured against, except where prohibited by public policy [*see Faris v. American Nat. Assur. Co. (1919) 44 Cal. App. 48, 54-55, 185 P. 1035]* . A property insurance contract of indemnity indemnifies the insured for the actual loss or damage arising from a contingent or unknown event [*see Vyn v. Northwest Casualty Co. (1956) 47 Cal. 2d 89, 94, 301 P.2d 869* (insuring loss for event known to both insurer and insured is void)]. Before indemnification will be

made, an actual loss must be suffered.

Property subject to a policy of insurance need not be in existence at the time a contract of insurance is entered into. For example, a building to be constructed, a merchant's inventory to be delivered in the future, or crops to be harvested at a future date may all be subjects of contracts of insurance. An insurable interest in property may consist of an inchoate interest founded on an existing interest, or an expectancy coupled with an existing interest in which the expectancy arises [*Ins. Code § 282*]. Intangibles, such as lost rental income, profits from crops that have been damaged or destroyed, and anticipated profits from construction of a building may be subject to insurance [*see Ins. Code § 282*].

[b] Specific Categories of Property

[i] Real Property

Fire is the primary risk to buildings and other real property; accordingly, insurance on real property typically focuses on fire coverage. In addition to fire, however, most policies insure against the risk of loss from phenomena such as windstorms, lightning, aircraft, riots, explosion, and smoke [*see Ins. Code § 2071* (California Standard Form Fire Insurance Policy)]. Earthquake and flood insurance are automatically excluded, and must be purchased separately. Currently, earthquake and flood insurance are expensive and difficult to obtain.

[ii] Boiler and Machinery

Boiler and machinery insurance includes insurance against loss of property or damage from explosions of or related to boilers, tanks, pipes, pressure vessels, and apparatus connected to or operated by them [*Ins. Code § 111*].

[iii] Automobile

Automobile insurance constitutes the largest volume of insurance covering a particular risk. Some type of automobile insurance (or a bond) must be carried by every new business that uses automobiles, because since 1975, California drivers have been required to carry insurance or maintain some form of financial responsibility to protect others from their possible negligence [*Veh. Code § 16020(a)*]. Automobile insurance is discussed in detail in California Insurance Law and Practice, Volume 3, Chapter 50, *Automobile Insurance* (Matthew Bender).

[iv] Marine

Marine insurance includes loss or damage to vessels and craft, aircraft, automobiles, and vehicles of any kind, as well as goods, freights, cargos, merchandise, effects, disbursements, profits, holdings, securities, choses in action, evidence of debt, valuable papers, which loss or damage results from any risks of perils of navigation, transit, or transportation, while being assembled, packed, or prepared for shipment [*see Ins. Code § 103(a)*]. "Inland marine" insurance affords coverage for transportation as well as cargo [*see Ins. Code § 103(a)*; *see also Ins. Code § 1851(c)* (inland marine insurance defined for rating purposes)]. Insurance against loss of or damage to precious stones, jewels, jewelry, gold, silver, and other precious gems and metals, whether used in business, trade, or otherwise, and whether in the course of transportation or otherwise, is included in the statutory definition of marine insurance [*see Ins. Code § 103(c)*]. Marine insurance policies should be obtained, as appropriate, by any new business. For detailed discussion of kinds of marine insurance and the substantive law applicable to such insurance, refer to California Insurance Law and Practice, Volume 3, Chapter 44, *Marine Insurance* (Matthew Bender).

[v] Aircraft

Aircraft property damage policies are generally known as "hull policies." Aircraft property insurance is a specialized line because of the high exposure; the larger airlines are generally covered by pools of insurers. For discussion of hull policies and related matters, refer to California Insurance Law and Practice, Volume 3, Chapter 45, *Aviation Insurance*

(Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceBusiness Interruption InsuranceGeneral OverviewInsurance LawBusiness InsuranceMarine InsuranceGeneral OverviewInsurance LawProperty InsuranceCoverageGeneral OverviewInsurance LawProperty InsuranceCoverageCrop InsuranceInsurance LawProperty InsuranceCoverageExplosionsInsurance LawProperty InsuranceCoverageFarm & Ranch InsuranceInsurance LawProperty InsuranceCoverageHurricanes & TornadoesInsurance LawProperty InsuranceCoverageNatural PhenomenaInsurance LawProperty InsuranceCoveragePersonal PropertyInsurance LawProperty InsuranceCoverageReal PropertyGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
B. Categories of Insurance
2. Property and Liability Insurance

1-1F California Legal Forms--Transaction Guide § 1F.52

AUTHOR: Reviewed by Pam Boc

§ 1F.52 Liability Insurance

[1] Types of Liability Insurance--In General

By industry practice, liability contracts fall within three major categories: employer's liability and workers' compensation, automobile liability, and public liability [*see Ins. Code § 108* (types of liability insurance defined)]. Workers' compensation insurance, as it relates to planning for a new business, is discussed in *Section 1F.70*. Automobile insurance is discussed in detail in California Insurance Law and Practice, Volume 3, Chapter 50, *Automobile Insurance* (Matthew Bender). Public liability insurance (also called "general liability" insurance) includes all forms of liability insurance except employer's liability or workers' compensation or automobile insurance. Public liability insurance is further classified according to the nature of the activity creating liability into three categories: personal liability insurance to protect the insured against financial losses that arise from personal, nonbusiness acts; commercial liability insurance; and, professional liability insurance.

[2] Forms of Commercial Liability Insurance Policies

[a] Individual Policies

Individual policies may be issued in the following forms: Premises and Operations policies, Completed Operations and Product Liability policies, Contractual (designated contracts) policies, Owner's and Contractor's Protective Liability policies, and Storekeeper's Liability policies. These policies are designed to afford coverage for liability arising out of the business premises and most of the business operations of the insured.

[b] Business General Liability Policies

The Business General Liability policy (formerly known as the Comprehensive General Liability or Commercial General Liability (CGL) policy) [*see* California Insurance Law and Practice, vol. 3, Ch. 49, *Business General Liability Policies*

, § 49.01 n.1 (Matthew Bender)] combines protection for five hazards that were previously covered only by separate policies. These are hazards related to or arising out of premises and operations, elevators, owner's and contractor's protective liability (acts and omissions with respect to supervising independent contractors), completed operations, and product liability.

Virtually every business that is conducted out of physical premises will want to obtain a business general liability policy before beginning operations. For detailed coverage of these types of policies, refer to California Insurance Law and Practice, Volume 3, Chapter 49, *Business General Liability Policies* (Matthew Bender).

[c] Package Policies

A third type of business liability coverage is available in the form of "package" policies or "multiple line contracts." A "package policy" combines two or more basic forms of insurance coverage in a single insurance contract. A "multiple line contract" is a single policy that includes coverage from traditional fire and casualty lines. In the liability insurance context, the two terms are synonymous. A business that acquires a package policy can obtain insurance protection for its commercial property as well as its liability exposure.

[3] Professional Liability Insurance

For liability insurance purposes, a "professional" is a person who possesses the special knowledge or skill necessary to render a professional service. Professionals are required, first, to exercise reasonable care in what they do and, second, to possess a minimum standard of knowledge and ability [Prosser & Keeton on the Law of Torts (5th ed. 1971) § 32]. A professional who lacks requisite skill and learning, or who does not perform his or her services in accordance with appropriate standards of conduct, may be subject to tort liability [*see Northern Insurance Co. v. Superior Court (1979) 91 Cal. App. 3d 541, 544, 154 Cal. Rptr. 198]* . Persons who face exposure for potential professional tort liability include, among others, architects, accountants, attorneys, engineers, insurance agents, medical personnel, notaries public, and real estate brokers.

Because basic liability insurance policies do not provide coverage for claims based on acts or omissions arising from the rendition of personal services, professional liability policies may be an important part of a professional's insurance program. For further discussion of professional liability coverage, refer to *Section 1F.69*.

[4] Protection Against Attorney's Fees and Related Costs

Whether or not liability is ultimately imposed on an insured, the insured may find it necessary to pay attorney's fees and costs related to a particular claim or suit. Most liability insurance policies afford protection against these losses as well as against the ultimate imposition of legal liability.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawGeneral Liability InsuranceCoverageGeneral OverviewInsurance LawGeneral Liability InsuranceObligationsDefenseInsurance LawGeneral Liability InsurancePersons InsuredGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
B. Categories of Insurance
2. Property and Liability Insurance

1-1F California Legal Forms--Transaction Guide §§ 1F.53-1F.59

AUTHOR: Reviewed by Pam Boc

[Reserved]

§§ 1F.53[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
C. Insurance Planning

1-1F California Legal Forms--Transaction Guide § 1F.60

AUTHOR: Reviewed by Pam Boc

§ 1F.60 General Insurance Considerations in Business Planning

In most cases, a new business should obtain insurance to cover anticipated contingencies, to protect the individual participants of the business from personal liability, and to protect the business's assets and any retained earnings. Appropriate coverage depends on the nature of the business and its available capital and may include general liability policies, including fire, theft, casualty and auto insurance [*see § 1F.52 [2]*], director and officer insurance [*see § 1F.61*], key personnel life and disability insurance [*see § 1F.62*], insurance to fund a business buy-sell agreement [*see § 1F.63*], business interruption insurance [*see § 1F.68*], and workers' compensation insurance [*see § 1F.70*]. For professionals, malpractice insurance may be important [*see § 1F.69*].

For discussion of insurance coverage, including health, group life, disability insurance, and various kinds of pension plans, as part of an employee benefits package, refer to Chapter 1D, *Overview of Employee Benefits*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceGeneral OverviewInsurance LawGeneral Liability InsuranceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
C. Insurance Planning

1-1F California Legal Forms--Transaction Guide § 1F.61

AUTHOR: Reviewed by Pam Boc

§ 1F.61 Directors and Officers Insurance

[1] Governing Law

In general, directors and officers liability insurance policies are covered by the Insurance Code in general and the consumer protection provisions of Proposition 103 [*Ins. Code §§ 1861.01-1861.14*], including the requirement for prior approval of rate changes [*see Ins. Code §§ 1861.01(c), 1861.05(b)*]. For further discussion of the insurance code provisions pertaining to insurer operations, refer to California Insurance Law and Practice, Volume 1, Chapter 4, *Insurance Carrier Operations* (Matthew Bender).

[2] Authority of Corporations to Procure Coverage; Power of Corporation to Limit Liability

Corporations have the power to purchase and maintain insurance on behalf of any agent of the corporation against any liability asserted against or incurred by the agent in that capacity, regardless of whether the corporation would otherwise have the power to indemnify the agent against that liability under *Corporation Code Section 317* (which generally specifies the circumstances under which a corporation may or must indemnify its agent) [*Corp. Code § 317(i)*]. This type of insurance coverage could apply to directors and officers, employees, and other agents.

Concomitantly, the corporation may provide in its articles of incorporation for indemnification of its agents, for breach of duty to the corporation and its shareholders, in an amount in excess of that specifically permitted by *Corporation Code Section 317* [*Corp. Code § 204(a)(11)*]. This right, however, is subject to a number of important exceptions [*see Corp. Code § 204(a)(10)*]. A complete discussion of the liability of corporate directors, the extent of permissible indemnity, and the limitation of directors' liability in the articles of incorporation is beyond the scope of this chapter. For detailed treatment of these subjects, refer to Ballantine Sterling, California Corporation Laws, Volume 1, Chapters 3, *Formation of Corporations* , and 6, *Management: Duties and Liabilities of Directors and Controlling Shareholders.*

[3] Availability of Insurance Coverage

Recently, the cost of directors and officers insurance has increased as its availability has decreased. The amendment of the Corporations Code to permit a corporation to limit the personal liability of directors for monetary damages in derivative actions and to expand its ability to indemnify them [*see Corp. Code §§ 204, 204.5, 309(c)*; *see also [2], above*] should lessen the potential exposure of the corporation and its directors to shareholders claims and reduce the insurance coverage required to adequately protect directors. However, insurance is still needed in circumstances where indemnification is unavailable, either legally [*see Corp. Code § 204(a)(10)*] or because a corporation is unable (for example, because the corporation is insolvent) or unwilling to indemnify its directors and officers.

The need for insurance has led corporations that cannot obtain or afford directors and officers insurance to self-insure. Self-insurance programs, in which a corporation owns all or a portion of the shares of the company issuing the insurance, are permitted if those self-insurance programs are either limited to providing indemnification to the extent otherwise permitted [*see Corp. Code § 317(i)(1)*] or are designed to assure that the claims processing will not be subject to the direct control of the corporation purchasing the policy and are subject to some manner of risk sharing between the issuer and purchaser of the policy and some unaffiliated person or persons [*see Corp. Code § 317(i)(2)*].

[4] Forms of Coverage

[a] In General

There are two basic forms of insurance coverage for the acts of officers and directors. The first, referred to as "directors and officers liability," directly insures the director or officer for a loss caused by his or her wrongful acts or omissions. The second, referred to as "corporate reimbursement" or "corporate indemnification," provides coverage to the corporation if the corporation has entered into agreements to indemnify its officers or directors for its negligent acts. Although these two coverages may be written separately, it is not unusual for them to be combined into a single policy. Other forms of specialized coverage are also available, including, for example, coverage for directors who serve on boards of condominium associations or nonprofit organizations.

[b] Directors and Officers Liability Coverage

A typical policy providing director and officer liability coverage insures every person who is, was, or may, in the future, be a director or officer of the corporation from all loss arising from any claim during the policy period for which the director or officer is legally obliged to pay by reason of a wrongful act. "Wrongful act" is commonly defined to mean any breach of duty, neglect, actual or alleged error, misstatement, or misleading statement by directors or officers in the discharge of their duties solely in their capacity as directors or officers.

Under California law, the "business judgment rule" provides that when a director acts in good faith and reasonably believes that his or her actions are in the best interests of the corporation, liability will not be imposed, even though the director's failure to act may have resulted in financial loss to the corporation [*Corp. Code § 309*; *Gaillard v. Natomas Co. (1989) 208 Cal. App. 3d 1250, 1263, 256 Cal. Rptr. 702 , disapproved on other ground, Grosset v. Wenaas (2008) 42 Cal. 4th 1100, 1119 n.16, 72 Cal. Rptr. 3d 129, 175 P.3d 1184]* . For example, this rule has been held to immunize the directors of a federally insured national bank from liability for purely negligent acts [*see FDIC v. Castetter (9th Cir. 1999) 184 F.3d 1040, 1044-1046* (nonofficer directors entitled to rely on company employees and advisors without duty of further inquiry, absent special circumstances)]. However, liability will be imposed for failure to exercise the proper care, skill, and diligence in the management of the corporation's affairs, as opposed to mere mistakes and errors in judgment [*see Burt v. Irvine Co. (1965) 237 Cal. App. 2d 828, 852, 47 Cal. Rptr. 392]* .

In performing his or her duties, a director is entitled to rely on information, opinions, reports, and statements prepared by officers, employees, counsel, independent accountants, or committees of the board of directors on which the director does not serve, provided that the director believes the persons to be reliable and competent [*Corp. Code § 309(b)(1)*]. For additional discussion of the business judgment rule and the grounds for liability of corporate directors and officers,

refer to Ballantine & Sterling, California Corporation Laws, Ch. 6, *Management: Duties and Liabilities of Directors and Controlling Shareholders* , and Ch. 14, *Litigation Involving Corporations and Shareholders* (Matthew Bender).

For further coverage of directors and officers insurance, see California Insurance Law and Practice, Ch. 43, *Directors and Officers Insurance* (Matthew Bender).

[c] Corporate Reimbursement Coverage

In order to attract capable outside directors, corporations frequently agree to indemnify their directors for any loss they may incur as a result of their negligence. Corporate reimbursement coverage (also known as corporate indemnification coverage) protects the corporation if it has entered into an agreement to indemnify its directors and officers for their wrongful acts.

[5] Coverage Under Other Insurance Policies

Typically, the general liability policies of the corporation or of the individual officer or director do not cover the indemnification of an officer or director, although the terms of individual insurance policies vary and each must be examined to determine what acts are covered. Similarly, an individual's homeowner's policy will not provide reimbursement for losses suffered by an individual acting in the capacity of an officer or director. For discussion of general liability policies, see *§ 1F.52*.

[6] Only "Claims Made" Coverage Available

All directors and officers policies are written on a "claims made" basis, which provides coverage for those claims reported to the insurer during the policy period. If a claim is not made until after the policy period has expired, the insurer has no liability [*Chamberlin v. Smith (1977) 72 Cal. App. 3d 835, 846, 140 Cal. Rptr. 493]* . Thus, a claims made policy usually covers liabilities based on errors and omissions taking place prior to the policy period. The outmoded "occurrence" policy provided coverage for acts or omissions that took place during the policy period, regardless of when the claim was made [*VTN Consolidated, Inc. v. Northbrook Ins. Co. (1979) 92 Cal. App. 3d 888, 891, 155 Cal. Rptr. 172* ; *Chamberlin v. Smith (1977) 72 Cal. App. 3d 835, 845 n.5, 140 Cal. Rptr. 493]* . Because coverage on a "claims made" basis is determined by the period in which the claim is presented rather than when the alleged wrongful act occurred, it is important for directors and officers to arrange for "tail coverage" (coverage after the director or officer leaves the corporation) or extended coverage [*see [7], below*].

[7] Extended Coverage

Directors and officers insurance policies often contain provisions for extended coverage (generally no longer than 12 months) in the event that the insurer cancels or refuses to renew the policy. It has been held that renewal terms may be so burdensome as to constitute a de facto refusal to renew [*Kemmerer Eng. Co. v. Continental Cas. Co (1967) 253 Cal. App. 2d 188, 190, 61 Cal. Rptr. 94]* . In an attempt to limit this result, some policies provide that an offer of renewal on different terms from those contained in the expired policy will not constitute nonrenewal.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesIndemnificationInsurance LawBusiness InsuranceDirectors & Officers Liability InsuranceGeneral OverviewInsurance LawBusiness InsuranceDirectors & Officers Liability InsuranceCoverageGeneral OverviewInsurance LawBusiness InsuranceDirectors & Officers Liability InsuranceCoveragePersons Insured



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
C. Insurance Planning

1-1F California Legal Forms--Transaction Guide § 1F.62

AUTHOR: Reviewed by Pam Boc

§ 1F.62 Key Employee Life and Disability Insurance

[1] In General

Key employee insurance is insurance on the life of the owner of a business or on the life of an employee who performs a crucial role in the employer's business. The insurance is purchased and owned by the business; its purpose is to compensate the business for the loss created by the death of the owner or a key employee. Examples of this type of loss include payment to an executive search firm to find a replacement or cash flow problems during the time it takes for the business to reestablish its goodwill. It is usually obtained for corporate officers, top sales representatives, or any person on whom the business is clearly dependent for its success [*Boldemann Chocolate Co. v. Price (1936) 5 Cal. 2d 200, 202, 53 P.2d 946* ; *Penn Mut. Life Insurance Co. v. Bank of America etc. Assn. (1936) 5 Cal. 2d 288, 297, 54 P.2d 453]* . The purchase of this type of insurance is regarded as a proper use of corporate funds, no less important than insuring the buildings, machinery, and automobiles belonging to the business [*Emeloid Co. v. Commissioner of Internal Revenue (3d Cir. 1951) 189 F.2d 230, 233]* .

[2] Tax Considerations

[a] Taxation of Premiums

[i] Deduction by Employer

As a general rule, a business cannot deduct the payment of life insurance premiums for federal income tax purposes (despite the fact they would otherwise be deductible as trade or business expenses) if the business is, directly or indirectly, a beneficiary of the life insurance policy [*I.R.C. § 264(a)(1)*; *see Treas. Reg. § 1.264-1(a)*]. Ordinarily, the employer (or owner, if a sole proprietorship) is both the owner and the beneficiary of an insurance policy on the life of a key employee; therefore, no deduction is allowed for premium payments [*see I.R.C. § 264(a)(1)*]. Further, premiums may not be deducted when the payor is an indirect beneficiary, even if the payor is not the named beneficiary [*I.R.C. § 264(a)(1)*; *Rev. Rul. 70-148, 1970-1 C.B. 60*], nor may they be deducted when the payor has a contractual right to

assign the policy, an exclusive right to surrender the policy, or a right to change the beneficiary [*Brock v. Commissioner (1982) 44 T.C.M. 128, 143, T.C. Memo. 1982-335]* .

[ii] Taxable to Key Employee

Whether or not the premiums are taxable dividends to the key employee depends on the extent of the economic benefit to that employee [*see Casale v. Commissioner (2d Cir. 1957) 247 F.2d 440, 442* (holding that premiums were not taxable dividends to employee, despite fact that policy, at maturity, was to provide annuity to employee, when corporation was both owner and beneficiary of policy and policy was treated as corporate asset, reachable by creditors)].

[b] Taxation of Policy Proceeds

Life insurance policy proceeds, if paid by reason of the insured's death, are excluded from the gross income of the recipient [*I.R.C. § 101(a)(1)*; *Treas. Reg. § 1.101-1(a)*; *United States v. Supplee-Biddle Hardware Co. (1924) 265 U.S. 189, 194, 44 S. Ct. 546, 68 L. Ed. 970]* . The exclusion from gross income applies whether payment is made to the estate of the insured or is made to any beneficiary, whether an individual, a corporation, or a partnership; the exclusion applies whether the payment is made directly to the beneficiary or in trust [*Rev. Rul. 71-79, 1971-1 C.B. 112*].

If payment is made to the business entity as beneficiary and, pursuant to a contractual agreement, the business entity then pays all or part of the proceeds to a further recipient (the insured's spouse, for example), the proceeds remain tax free to the business entity [*I.R.C. § 101(a)(1)*] but will probably be taxable to the ultimate recipient as a dividend [*Rev. Rul. 71-79, 1971-1 C.B. 112*] or as compensation [*Essenfeld v. C.I.R. (2d Cir. 1962) 311 F.2d 208, 209]* .

[c] Alternative Minimum Tax Considerations for C Corporations

Receipt of life insurance proceeds may subject the corporation to the alternative minimum tax (AMT) [*I.R.C. § 55*]. Therefore, tax planning should be done with this risk in mind. The AMT for corporations is similar to the AMT for individuals. Nevertheless, although the corporate rate is less than those applicable to individuals, many income adjustments that apply solely to corporations may increase their alternative minimum tax [*see I.R.C. §§ 55(b), 56(c), (g)*; *see also I.R.C. § 56(g)(6)* (adjustments inapplicable to specified entities, e.g., S corporations)]. The tax is imposed on the amount by which the alternative minimum taxable income [*I.R.C. § 55(b)(2)*] exceeds the exemption amount, reduced by the alternative minimum tax foreign tax credit [*I.R.C. § 55(b)(1)*]. However, small corporations are exempt from the alternative minimum tax [*I.R.C. § 55(e)*]. For further discussion of the alternative minimum tax, see Ch. 1E, *Taxation of Businesses* ; see also California Small Business Guide, Ch. 1, *Factors in Selecting the Proper Business Entity* , Ch. 2, *Preincorporation Tax Considerations* , and Ch. 22, *California Tax Reporting and Payment Requirements* (Matthew Bender).

[d] Taxation of Accidental Death or Disability Feature

Key employee life insurance frequently contains an accidental death or disability feature. The proceeds of the accidental death benefit will be tax free [*I.R.C. § 101*]. The amounts paid for premiums for the disability feature will, consequently, not be deductible by the business entity because they are expenses related to the generation of tax-exempt income [*see I.R.C. § 265(a)*; *Rev. Rul. 66-262, 1966-2 C.B. 105*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceBusiness Interruption InsurancePurposeInsurance LawDisability InsuranceInsurable InterestsInsurance LawLife InsuranceBeneficiariesGeneral OverviewInsurance LawLife InsuranceInsurable InterestsEmployersTax LawFederal Income Tax ComputationAlternative Minimum Tax (IRC secs. 55-59)Tax LawFederal Taxpayer GroupsIncome Taxation of Estates, Trusts & BeneficiariesTaxation of Beneficiaries (IRC secs.

661-668, 691-692)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
C. Insurance Planning

1-1F California Legal Forms--Transaction Guide § 1F.63

AUTHOR: Reviewed by Pam Boc

§ 1F.63 Life Insurance Funded Buy-Sell Agreement

[1] Types of Buy-Sell Agreements

There are two principal types of business buy-sell agreements. The first type is the stock or partnership interest redemption or "entity-purchase" plan. Under this type of plan, a corporation redeems or purchases a shareholder's stock on the death of the shareholder, and a partnership redeems or purchases the partnership interest on the death of a partner. The second type is the stock or partnership interest purchase agreement or "cross purchase" plan. Under this type of plan, the decedent's stock or partnership interest is purchased directly from the decedent's estate by the surviving shareholders or partners in proportion to their existing ownership interests. Either of these types of plans could also be used by a limited liability company.

For discussion of the contents of a stock redemption agreement and a stock purchase agreement, refer to California Insurance Law and Practice, Volume 4, Chapter 70, *Insurance Considerations in Business Planning* (Matthew Bender). For detailed discussion of the provisions in corporate buy-sell agreements, refer to Cavitch, Business Organizations, Volume 7, Chapter 148, *Stock Buy-Out Agreements* (Matthew Bender).

If life insurance is used to fund a cross-purchase agreement, each shareholder or partner must obtain a life insurance policy on the life of every other shareholder or partner in an amount sufficient to fund his or her proportionate obligation to purchase the shares or interests from the decedent's estate. When there are more than a few shareholders or partners, this type of agreement is not advisable because it requires having numerous insurance policies, because of the increased administrative costs related to the policies themselves, and because of the increased complexity and legal cost of an insurance-funded cross-purchase.

[2] Advantages of Buy-Sell Agreements

A life insurance buy-sell agreement offers a number of advantages to a business. Life insurance can ensure the continuity of the business by providing the funding for the transfer of management and allowing the principals to select,

in advance, the purchaser of their business interests. This is particularly important when the proprietors of a family business or a closely held corporation have invested their working lives and, likely, their personal assets in the venture. Buying out a deceased owner with life insurance proceeds further allows the business to fund a buyout without depleting the business's capital, requiring the sale of business assets, or forcing the business to borrow to fund the buyout when its credit is needed for business operations.

Assuring the continuity of management may also provide present credit advantages and a sense of security to key employees. Additionally, life insurance may enable a key employee to purchase the business from the sole owner's estate, if, for example, the employee obtains a life insurance policy on the owner's life and uses the proceeds to buy the business. Such an arrangement may benefit both the employee, who is able to purchase a business in which he or she is already involved, and the owner's estate and its beneficiaries, since a business owned by one person,whether or not incorporated, is often difficult to sell. A complete discussion of this type of arrangement is beyond the scope of this chapter. For a discussion of estate planning considerations in the use of life insurance, refer to Volume 11, Chapter 60, *Estate Planning.*

[3] Cost of Insurance

The cost of using life insurance to fund a buy-sell agreement must be compared with the cost of borrowing money or using the business's own capital. There are many assumptions to be made in this comparison, including the future value of the business, its future need for capital, future interest rates, and the length of life of the insureds. The uninsurability of any of the owners of the business or the increased cost of insuring an owner with medical problems may rule out funding a buy-sell agreement with life insurance. In either case, alternate insurance possibilities [*see [4], below*], as well as other funding methods, should be considered.

[4] Alternate Insurance Possibilities

Alternate insurance possibilities include the use of "guaranteed issue" life insurance, which may obtained without regard to the insured's health, group life insurance that includes "guaranteed issue" insurance, or the transfer of the policy owner's personal life insurance policy to the business to fund the buy-sell agreement. However, each alternative has a possible disadvantage to consider.

With "guarantee issue" insurance, the coverage is often limited. With group life insurance, to cover an otherwise uninsurable partner or shareholder may require insuring all employees for a large amount or risk failing to meet the Internal Revenue Service's antidiscrimination tests to qualify as group insurance [*see I.R.C. § 79(d)*]. Finally, an uninsurable person may be unwilling to transfer a personally-owned policy to the business and, if such a sale or transfer does occur, the policy should not be transfered or sold to a corporation without careful consideration of the transfer-for-value tax rule [*see I.R.C. § 101(a)(2)(B)*].

[5] Adequate Amount and Appropriate Life Insurance Product for Funding

[a] Amount

The simplest way to assure adequate liquid capital to finance the purchase of a business interest under a buy-sell agreement is to obtain life insurance in an amount equal to the value of the interest to be redeemed or purchased. For discussion of valuation methods, refer to Volume 3, Chapter 8, *Shareholders' Meetings, Voting, and Agreements.*

[b] Type of Life Insurance Product

Many types of life insurance products may be used to fund the agreement. The correct vehicle for funding a buy-sell agreement should be selected in consultation with a life insurance agent. The type chosen will depend primarily on the length of time a buy-sell agreement is to be in effect and the cost of premiums. For example, if the existence of the

business is deemed perpetual, the cost of maintaining term insurance on older individuals may not be cost effective, if not actually prohibitive. Permanent insurance, also referred to as whole life, straight life, ordinary life, universal life, or executive protection, provides a level premium, with increasing cash surrender values.

All permanent insurance has a buildup of cash value; term insurance has no cash value or equity buildup. Because of the cash buildup in permanent insurance, its premiums can be substantially reduced after a specified period, possibly to the point where the permanent insurance will be less expensive than term insurance in the later years of the policy. In addition, permanent insurance has special features, such as the cash equity buildup mentioned above, tax-free cash borrowing (under most circumstances), with favorable interest rates, the ability to cash in the policy if the business is in serious need, and may include an option to convert the equity portion of the policy to an annuity. For further discussion of the features of term and permanent insurance, refer to *Sections 1F.33* and *1F.34.*

[6] Importance of Funding Agreement Through Purchase of Insurance

Regardless of the type of buy-sell agreement chosen or the product selected for funding, the attorney should ensure the client does, in fact, purchase the insurance. The most frequent flaw found in businesses with buy-sell agreements is the lack of insurance coverage to fund the buy-out. Failure to take the time to establish that the client has actually funded the agreement may subject the client to the worst of both worlds: a mandatory buy-out with a contractually-obliged buyer and seller at a crucial juncture in the life of the business, with no funds available to carry out the agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersTransfers of InterestsInsurance LawLife InsuranceBeneficiariesGeneral OverviewInsurance LawLife InsuranceInsurable InterestsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
C. Insurance Planning

1-1F California Legal Forms--Transaction Guide § 1F.64

AUTHOR: Reviewed by Pam Boc

§ 1F.64 Taxation of Corporate Buy-Sell Agreements Funded by Life Insurance

[1] Taxation of Premiums

A corporation may not deduct the payment of insurance premiums for federal income tax purposes if the corporation is, directly or indirectly, a beneficiary of the life insurance policy [*I.R.C. § 264(a)(1)*]. A policy used to fund a corporate buy-sell agreement is considered to be for the corporation's benefit because the proceeds are used to acquire a capital asset, the corporation's stock [*Rev. Rul. 70-117, 1970-1 C.B. 30*]. Premiums paid by the corporation are not taxed to the shareholders, unless the shareholders own the policy [*Rev. Rul. 59-184, 1959-1 C.B. 65* ; *Paramount-Richards Theatres, Inc. v. Commissioner (5th Cir. 1946) 153 F.2d 602]* . In that case, the premiums are treated as a dividend distribution to the shareholder and are taxable as ordinary income [*Rev. Rul. 59-184, 1959-1 C.B. 65*].

[2] Taxation of Policy Proceeds

A corporation is generally not taxed on insurance proceeds it receives on the death of a shareholder [*I.R.C. § 101(a)(1)*]; this is true whether the proceeds are paid to the corporation, which then purchases the decedent's shares, or the proceeds are paid directly to the shareholder's estate to satisfy the corporation's obligation to purchase the decedent' shares [*Mushro v. Commissioner (1968) 50 T.C. 43* , *nonacq.* 1970-2 C.B. xxii]. However, caution should be exercised because the Commissioner has not acquiesced to *Mushro*; the better plan is to have the proceeds under a corporate buy-sell agreement paid directly to the owner of policy, rather than to the insured's estate. Life insurance proceeds received by the corporation may be subject to the corporate alternative minimum tax [*I.R.C. § 55*; *see § 1F.62[2][c]*]. The increased value of the shareholders' shares resulting from the corporation's purchase of the decedent's shares is not taxed to the surviving shareholders as a constructive dividend so long as the corporation is not satisfying the obligation of the shareholders to purchase the shares from the decedent's estate [*Rev. Rul. 58-614, 1958-2 C.B. 920*].

[3] Accumulated Earnings Tax

Life insurance may subject the corporation to the accumulated earnings tax. The accumulated earnings tax is a penalty

tax imposed on corporations that accumulate earnings above their reasonable business need for the purpose of avoiding the income tax that would be imposed on shareholders if the earning were distributed as dividends [*see I.R.C. § 531*].

Although many practitioners believe that life insurance ownership will seldom present an accumulated earnings problem, a corporation that owns life insurance policies with large cash surrender values should keep this risk in mind in its tax planning [*see Lamark Shipping Agency, Inc., v. Commissioner, T.C. Memo 1981-284* (accumulating funds to buy out corporate shareholder justifiable as furthering corporate purpose in appropriate circumstances); *Mountain State Steel Foundries, Inc. v. Commissioner (4th Cir. 1960) 284 F.2d 737* (life insurance funds justifiable if buy-sell agreement necessary to avoid shareholder disputes); *but see Pelton Steel Casting v. Commissioner (7th Cir. 1958) 251 F.2d 278* (corporation improperly accumulated earnings to redeem 80 percent ofshares to prevent sale to outsider); *Boshwit Bros., T.C. Memo 1982-156* (reasonable business need to redeem majority shareholder's interest to continue family ownership not established absent formal, written redemption plan); *Cadillac Textiles, Inc., T.C. Memo 1975-46* (reasonable business need not established absent specific, definite, feasible plan for redemption)]. For further discussion of the corporate accumulated earnings tax, refer to Chapters 1E, *Taxation of Businesses*, and 1B, *Selecting Form of Business Entity*. For detailed discussion of this subject, refer to Mertens & Paul, The Law of Federal Income Taxation, Volume 10, Chapter 39, *Accumulated Earnings Tax* (revised ed. 1989).

[4] Estate Taxation of Policy Proceeds

[a] In General

Life insurance proceeds are not includable in the decedent's estate, regardless of whether the proceeds are paid to the corporation or to the decedent's estate, if they are paid under a bona fide stock purchase agreement [*I.R.C. § 2042*; *Treas. Reg. § 20.2042-1(c)(6)*]. The stock's value is includable in the decedent's gross estate for estate tax purposes [*I.R.C. § 2031*; *Treas. Reg. § 20.2031-2(h)*]. However, if the decedent possesses "incidents of ownership" in the insurance policy, the policy proceeds are included in the decedent's gross estate for estate tax purposes [*I.R.C. § 2042(2)*; *see [b], below*]. Caution should be exercised to avoid double taxation of the insurance proceeds (that is, the inclusion of both the full value of the stock and the insurance proceeds in the decedent's gross estate) by ensuring that a shareholder does not have any incidents of ownership in an insurance policy held by the corporation on the shareholder's life [*see I.R.C. § 2042(2)*].

[b] Incidents of Ownership

Incidents of ownership can include the power to change beneficiaries, to assign the policy or to revoke an assignment, to surrender or to cancel the policy, or to borrow against the policy [*Treas. Reg. § 20.2042-1(c)(2)*; *Chase National Bank v. United States (1929) 278 U.S. 327, 334-338, 49 S. Ct. 126, 73 L. Ed. 405* ; *Estate of Riefberg v. Comm., T.C. Memo 1982-70]* . A controlling shareholder possesses incidents of ownership if he or she has the ability to control an insurance policy owned by a corporation [*I.R.C. § 2042*; *Treas. Reg. § 20.2042-1(c)*]. In this case, a controlling shareholder's incidents of ownership result in both the stock's value and the insurance proceeds being included in his or her gross estate for estate tax purposes [*see I.R.C. §§ 2031, 2042*]. However, if the corporation is the beneficiary of any portion of the proceeds on the life of the controlling shareholder, that portion of the proceeds will not be included in the decedent's gross estate [*see I.R.C. § 2042*], but will be a factor in valuing the shares for estate tax purposes [*Treas. Reg. § 20.2042-1(c)(6)*; *see I.R.C. § 2031*]. The proceeds, however, must be payable to the corporation or to a third party for a valid corporate purpose; this regulation does not apply if the proceeds are payable to the decedent's estate or to a trustee [*Treas. Reg. § 20.2042-1(c)(6)*].

The Internal Revenue Service has argued that when insurance policy proceeds are payable to the deceased shareholder's estate to purchase the decedent's shares or when the shareholder possesses incidents of ownership in the policy, both the insurance proceeds and the value of the shares must be included in the decedent's gross estate for estate tax purposes. However, the Tax Court has rejected this position if the insurance proceeds must be credited against the shares'

purchase price under the buy-sell agreement [*Tompkins v. Commissioner (1949) 13 T.C. 1054 , acq., 1950-1 C.B. 5*].

[c] Valuation of Shares

The risk of double taxation of insurance proceeds also exists if the buy-sell agreement does not set a value on the shares that will be accepted by the Internal Revenue Service for estate tax purposes. In this case, the estate may be subject to a higher estate tax valuation than the amount actually paid for the shares [*see I.R.C. § 2703*]. This problem may be avoided by ensuring that the value of shares set by the buy-sell agreement will be accepted by the Internal Revenue Service for estate tax purposes [*see I.R.C. § 2703(b)*; *Treas. Reg. §§ 20.2031-2,* 20.231-3, *25.2703-1* (requirements)]. A detailed discussion of valuation methods for buy-sell agreements is outside the scope of this chapter. For further discussion, refer to Volume 3, Chapter 8, *Shareholders' Meetings, Voting, and Agreements.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawLife InsuranceBeneficiariesGeneral OverviewInsurance LawLife InsuranceInsurable InterestsGeneral OverviewTax LawFederal Estate & Gift TaxesTaxable PropertyLife Insurance (IRC sec. 2042)General OverviewTax LawFederal Estate & Gift TaxesTaxable PropertyLife Insurance (IRC sec. 2042)Incidents of OwnershipTax LawFederal Income Tax ComputationUnearned IncomeDividendsTax LawFederal Taxpayer GroupsC CorporationsAccumulated Earnings Tax (IRC secs. 531-537)Accumulated Taxable IncomeTax LawFederal Taxpayer GroupsC CorporationsAccumulated Earnings Tax (IRC secs. 531-537)Imposition of Taxes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
C. Insurance Planning

1-1F California Legal Forms--Transaction Guide § 1F.65

AUTHOR: Reviewed by Pam Boc

§ 1F.65 Taxation of Shareholder Cross-Purchase Agreement Funded by Life Insurance

[1] Taxation of Premiums

The premiums on life insurance policies funding a shareholder cross-purchase agreement (ordinarily paid by the shareholders who own the policies) are not deductible for income tax purposes [*I.R.C. § 264(a)*]. If the corporation pays the premiums on the life insurance, the payments are dividends to the shareholder who owns the policy and, as such, are taxable to the shareholder and not deductible by the corporation [*see I.R.C. §§ 61(a)(7), 301, 316*; *Young v. Commissioner, T.C. Memo 1995-379* ; *Lynch v. Commissioner, T.C. Memo 1983-173]* . Split dollar insurance, in which the corporation pays a portion of the premium and the shareholder pays the remainder, is an option to consider to reduce the cost to the shareholders of funding a cross-purchase agreement. Here, too, the portion of the premium paid by the corporation may be treated as a constructive dividend to the shareholder [*Johnson v. Commissioner (1980) 74 T.C.1316]* . For further discussion of split dollar insurance, see California Insurance Law and Practice, Ch. 70, *Insurance Considerations in Business Planning* (Matthew Bender).

[2] Taxation of Policy Proceeds

Insurance proceeds received by a shareholder to fund a cross-purchase agreement are not taxable income to the shareholder, unless there was a previous transfer to the shareholder for valuable consideration [*I.R.C. § 101(a)(2)*]. If insurance policies held by a deceased shareholder are transfered to the remaining shareholders for valuable consideration, the policy proceeds are taxable to the extent they exceed the consideration, premiums, and other amounts subsequently paid by the transferee shareholder [*I.R.C. § 101(a)(2)* ("other amounts" includes interest paid or accrued by transferee on debt with respect to contract when not allowable as deduction)].

If the corporation pays the premiums, receives the proceeds, and distributes them to the remaining shareholders to satisfy their obligation to purchase the shares under the cross-purchase agreement, under certain circumstances, the distribution may be taxable as a dividend [*Rev. Rul. 61-134, 1961-2 C.B. 250* ; *see Golden v. Commissioner (3d Cir. 1940) 113 F.2d 590]* . In addition, if the corporation receives the insurance proceeds and directly purchases the

decedent's shares in satisfaction of the remaining shareholders' obligations under the agreement, the amount used to satisfy each shareholder's obligation may be taxable to the shareholder as a dividend [*Wall v. United States (4th Cir. 1947) 164 F.2d 462]* . However, if the purchase is not made in satisfaction of any obligation of the remaining shareholders', the corporation's use of life insurance proceeds to purchase the shares of a deceased shareholder does not result in taxable income to the remaining shareholders, nor does it result in taxable income as a result of the increase in value of the remaining shareholder's shares [*Holsey v. Commissioner (3d Cir. 1958) 258 F.2d 865]* .

For discussion of the tax issues that may arise if the insured's estate is designated as the beneficiary of the policy under a cross-purchase agreement, see *§ 1F.64[2]*.

[3] Estate Taxation of Policy Proceeds

If a remaining shareholder who owns the policy is the policy's beneficiary, the policy proceeds are not included in the deceased shareholder's gross estate for estate tax purposes, whether they are paid directly to the insured's estate or to a trustee [*I.R.C. § 2042(2)*]. Although the value of the stock is included in the decedent's gross estate, it will not be increased by the policy proceeds to the extent that the proceeds do not exceed the value of the shares [*see I.R.C. § 2031*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsPremiumsGeneral OverviewTax LawFederal Estate & Gift TaxesTaxable PropertyLife Insurance (IRC sec. 2042)General OverviewTax LawFederal Estate & Gift TaxesTaxable PropertyLife Insurance (IRC sec. 2042)Proceeds Receivable by ExecutorsTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsLife Insurance (IRC sec. 79)Tax LawFederal Income Tax ComputationTaxable Income (IRC sec. 63)Tax LawFederal Taxpayer GroupsC CorporationsDividends (IRC secs. 316, 561-565)Tax LawState & Local TaxesEstate & Gift TaxGross Estate



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
C. Insurance Planning

1-1F California Legal Forms--Transaction Guide § 1F.66

AUTHOR: Reviewed by Pam Boc

§ 1F.66 Taxation of Partnership Buy-Sell Agreement

[1] Taxation of Premiums and Proceeds

Life insurance premiums used to fund either type of buy-sell agreement (a cross-purchase agreement among individual partners or an agreement by the partnership to purchase the interest of a deceased partner) are not deductible for income tax purposes, whether the partners pay the premiums or the partnership owns the policy and pays the premiums [*I.R.C. § 264(a)(1)*]. Insurance proceeds from a life insurance policy on a deceased partner are tax free, regardless of whether they are received by the partnership or the surviving partner or partners [*I.R.C. § 101(a)(2)(B)*].

[2] Effect of Policy Proceeds on Tax Basis of Partnership Interest

Under a cross-purchase agreement, the bases of the surviving partners interests will be increased by the amount of life insurance proceeds paid for the interest of the deceased partner [*see Mushro v. Commissioner (1968) 50 T.C. 43 , nonacq.* 1970-2 C.B. xxii]. The same result also occurs if the partnership purchases the deceased partner's interest under an entity purchase agreement. The basis of a partnership interest is increased by a partner's distributive share of tax-exempt income when the proceeds are received by the partnership from a life insurance policy on the death of a partner [*I.R.C. § 705(a)(1)(B)*]. Therefore, the bases of the partnership interests of the remaining partners are increased by the amount of the proceeds received by the partnership.

[3] Estate Taxation of Policy Proceeds

Life insurance proceeds are not includable in the deceased partner's estate for estate tax purposes, unless the partner had "incidents of ownership" [*I.R.C. § 2042(2)*; *see § 1F.64[4][b]*], or the proceeds are payable to the estate [*I.R.C. § 2042(1)*]. However, the value of the partnership interest, as well as the value of any life insurance policies owned by the deceased partner on the lives of the remaining partners, is includable in the deceased partner's gross estate for estate tax purposes [*I.R.C. § 2031(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersTransfers of InterestsTax LawFederal Estate & Gift TaxesTaxable PropertyLife Insurance (IRC sec. 2042)General OverviewTax LawFederal Estate & Gift TaxesTaxable PropertyLife Insurance (IRC sec. 2042)Incidents of OwnershipTax LawFederal Taxpayer GroupsIndividualsAnnuities & Life Insurance (IRC sec. 72)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsBasis (IRC secs. 704, 705, 722-724, 731-735, 737, 742, 751, 754, 755)Partner Interests



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
C. Insurance Planning

1-1F California Legal Forms--Transaction Guide § 1F.67

AUTHOR: Reviewed by Pam Boc

§ 1F.67 Insurance Coverage for Actions Against Dissolved Corporation and its Shareholders

Consideration should be given to purchasing insurance to cover potential claims against the shareholders of a dissolved corporation. The shareholders may have liability in that causes of action against a dissolved corporation arising before or after the dissolution of the corporation may be enforced against shareholders of the dissolved corporation, if any of the assets of the dissolved corporation have been distributed to them, to the extent of the lesser of their pro rata share of the claim or of the corporate assets distributed to them, in addition to enforcement against the dissolved corporation to the extent of any undistributed assets [*Corp. Code § 2011(a)*; *Penasquitos, Inc. v. Superior Court (1991) 53 Cal. 3d 1180, 1188-1191, 283 Cal. Rptr. 135, 812 P.2d 154* ; *see Corp. Code § 2010* ("dissolved corporation" defined)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesPersonal LiabilityInsurance LawBusiness InsuranceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
C. Insurance Planning

1-1F California Legal Forms--Transaction Guide § 1F.68

AUTHOR: Reviewed by Pam Boc

§ 1F.68 Business Interruption Insurance

[1] Individual Income Protection

Disability income protection, also referred to as a "loss of time" benefit [*see 10 Cal. Code Reg. § 2220.24*], provides benefits to replace lost income resulting from the insured's inability to perform a designated occupation or specified activities due to a covered accident or illness [*10 Cal. Code Reg. § 2540.5(g)*]. Benefits are ordinarily a fixed amount per day of disability and are based on the insured's income level. Because policy benefits are, generally, not subject to income tax [*see I.R.C. § 105(c)*], policy limits are usually 40 to 75 percent of the insured's normal income.

Income protection policies may be written on an individual or group basis and generally have an elimination period. They are sometimes categorized as occupational or non-occupational, depending on whether the risks insured against include non-occupational accidents and sickness. Polices may also be short term or long term. Short term policies generally provide benefits for a designated number of weeks, usually less than one year, while long term policies may provide benefits for a number of years or until age 65.

Because California has a compulsory, non-occupational disability law funded through a payroll tax and covering most employees [*see Unemp. Ins. Code §§ 13040-13043* (withholding)], the use of income protection coverage is probably less common in California than in states without that type of law. However, income protection coverage is an important consideration for small business owners (whether or not incorporated).

[2] Business Protection Coverage

Business protection coverage includes a number of specialized disability policies. Business overhead insurance is an extension of income protection type coverage. It provides funds to a self-employed business person to cover overhead expenses of a business while the owner is disabled. Benefits are generally measured by the actual overhead incurred during the coverage period, including all regular expenses of the business, except the owner's compensation, cost of capital goods, and payment of principal on any indebtedness. Policies offering business protection coverage are limited

to a specific time period and usually have an elimination period provision.

A business buy-out policy, often combined with life coverage, provides funds to a corporation or partnership to buy back the interests of a permanently disabled shareholder or partner pursuant to a buy-sell agreement. Business buy-sell agreements are discussed in greater detail in *Section 1F.63*. Other forms of business protection disability policies tailored to particular types of businesses are also available. For example, "cast" insurance is used in the entertainment industry to protect against the disabilities of key cast members of television, film, and theater productions [*see 6 Ops. Cal. Atty. Gen. 33 (1945)]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsClaims Made PoliciesExtended Coverage



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
C. Insurance Planning

1-1F California Legal Forms--Transaction Guide § 1F.69

AUTHOR: Reviewed by Pam Boc

§ 1F.69 Professional Liability Insurance

[1] Special Characteristics of Professional Liability Policies

Professional liability insurance protects professionals from claims based on acts, errors, or omissions in the performance of professional services for others [*see Northern Insurance Co. v. Superior Court (1979) 91 Cal. App. 3d 541, 544, 154 Cal. Rptr. 198* (nature of professional services); *Transamerica Ins. Co. v. Keown (D.N.J. 1979) 472 F. Supp. 306, 310* (problem of professional services rendered for others)]. This insurance complements, rather than serves as a substitute for, a professional's coverage under other policies. While professional liability policies exclude coverage for personal injury and property damage, comprehensive liability policies cover such losses but exclude coverage for acts, errors, or omissions in the performance of professional services. For discussion of general liability policies, refer to *Section 1F.52*.

[2] Liability and Indemnity Policies Distinguished

Most errors and omissions policies available to professionals provide liability rather than indemnification insurance. Pursuant to many professional liability policies, the insurer will "pay on behalf of the insured all sums which the insured becomes legally obliged to pay as damages" because of an act, error, or omission in the performance of professional services; thus, the insured's duty to pay arises when the insured becomes liable [*see § 1F.50[1]*].

Indemnification policies, on the other hand, require the insured to pay the claim and any defense costs, if covered [*see Gribaldo, Jacobs, Jones Associates v. Agrippina Versicherunges A.G. (1970) 3 Cal. 3d 434, 448, 91 Cal. Rptr. 6, 476 P.2d 406]* , before any indemnification by the insurer. Indemnification is reimbursement of moneys paid out [*Civ. Code § 2778*]. Only a few insurers continue to provide indemnification policies covering professional liability.

[3] Coverage of Defense Expenses Under Liability Policies

In general, liability policies will pay either damages or losses on behalf of the insured. "Loss" includes the amounts paid

to the claimants as well as the costs and expenses involved in the defense of the claim. Typical policy language defines "loss" as any amount an insured is obligated to pay with respect to his or her legal liability, whether actual or asserted, for a [defined] wrongful act, and subject to the applicable limits and conditions of this policy, including damages, judgments, settlements, costs, charges, and expenses incurred in the defense of actions, suit or proceedings and appeals therefrom.

In contrast, the term "damages" refers to payment to the claimant and excludes defense costs and expenses. Typical policy language defines "damages" as a monetary judgment or settlement or compensatory damages that the insured is legally obliged to pay in excess of the deductible. However, these different definitions have little practical significance because policies that use the term "damages" either separately define covered "claim expenses" or provide for payment of costs and expenses under limits of liability.

Of great practical significance, however, is the fact that, under most current policies, coverage limits include defense costs. Therefore, the maximum monetary value of any claim the client may face should be realistically evaluated and policy limits chosen accordingly [*see § 1F.113*].

[4] Claims Made Coverage Compared to Occurrence Coverage

Most professional liability policies are written on a"claims made" basis, which provides coverage for those claims reported to an insurer during the policy period. If a claim is not made until after the policy period has expired, the insurer has no liability [*Chamberlin v. Smith (1977) 72 Cal. App. 3d 835, 846, 140 Cal. Rptr. 493* ; *VTN Consolidated, Inc. v. Northbrook Ins. Co. (1979) 92 Cal. App. 3d 888, 891-892, 155 Cal. Rptr. 172]* . A claims made policy, therefore, usually covers liabilities based on errors or omissions taking place before the policy period. Some claims made policies give the insured the right to purchase extended reporting period coverage after expiration of the policy. Thus, a professional who retires could still be covered for malpractice claims based on the period when he or she was in practice, without having full coverage.

In contrast, an "occurrence" policy provides coverage for acts or omissions that take place during the policy period, regardless of when the claim is made [*VTN Consolidated, Inc. v. Northbrook Ins. Co. (1979) 92 Cal. App. 3d 888, 891, 155 Cal. Rptr. 172* ; *Chamberlin v. Smith (1977) 72 Cal. App. 3d 835, 845 n.5, 140 Cal. Rptr. 493]* . A professional liability policy rarely combines claims made and occurrence policies.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawGeneral Liability InsuranceObligationsIndemnificationInsurance LawMalpractice InsuranceGeneral OverviewInsurance LawMalpractice InsuranceClaims Made & Occurrence PoliciesInsurance LawMalpractice InsuranceErrors & Omissions Policies



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
C. Insurance Planning

1-1F California Legal Forms--Transaction Guide § 1F.70

AUTHOR: Reviewed by Pam Boc

§ 1F.70 Workers' Compensation Insurance

[1] In General

Workers' compensation laws impose liability for work-related accidents, regardless of any negligence on the part of the employer or employee [*Cal. Const. art. XIV, § 4*; *Lab. Code § 3600*], and provide a schedule of benefits, including indemnity for disability, medical expenses, hospital expenses, ancillary treatment, vocational rehabilitation, death benefits, and burial allowances [*see Lab. Code § 3207*] to be paid to the injured employee or the employee's dependents or heirs [*see Lab. Code §§ 4700-4709*].

With few exceptions, all California employers are subject to the workers' compensation laws [*Lab. Code §§ 3300, 3351*]. Coverage is based on defined employment relationships; that is, an injured worker must be an "employee" who is entitled to workers' compensation coverage for an injury occurring in the course of specified employment [*Lab. Code §§ 3350-3369*; *In-Home Supportive Services V. Workers' Comp. Appeals Bd. (1984) 152 Cal. App. 3d 720, 727, 199 Cal. Rptr. 697, 49 Cal. Comp. Cases 177]* . A person rendering a service for another establishes a presumption of an employer-employee relationship, absent a showing that the relationship is one of principal and independent contractor [*Lab. Code § 3357*; *Germann v. Workers' Comp. Appeals Bd. (1981) 123 Cal. App. 3d 776, 783, 176 Cal. Rptr. 868, 46 Cal. Comp. Cases 1062* ; *see Lab. Code § 3353* ("independent contractor" defined); *see also Lab. Code §§ 3352, 3352.94* (additional persons excluded from the definition of "employee"); *§ 1F.118*].

An employer subject to workers' compensation laws [*see Lab. Code §§ 3300* ("employer" defined), *3301* (exclusions)] must secure payment of compensation by carrying workers' compensation insurance or by obtaining a permit to self-insure [*Lab. Code §§ 3700, 3711*; *see Royal Globe Ins. Co. v. Workers' Comp. Appeals Bd. (1978) 84 Cal. App. 3d 287, 292 n.4, 148 Cal. Rptr. 325* ; *43 Cal. Comp. Cases 895]* .

[2] Obtaining Insurance

Insurance may be obtained privately or though the state's own insurance fund, the State Compensation Insurance Fund

(SCIF) [*see Lab. Code § 3211*]. Any employer may opt for self-insurance by applying for that status to the California Department of Industrial Relations, while demonstrating the ability to pay compensation to workers if it should be necessary [*see Lab. Code § 3701* (security bond required)]. Continued ability to self-insure is guaranteed by mandating compliance with various reporting and auditing requirements [*see 8 Cal. Code Reg. §§ 15250-15406*].

An employer choosing not to self-insure may obtain private insurance from any number of carriers or from the SCIF [*Lab. Code § 56*].

[3] Consequences of Misclassification and Failure to Carry Insurance

If a worker has been misclassified as an independent contractor, and the employer has not provided workers' compensation for the worker, the employer may be held liable for civil tort liability both to the worker [*Lab. Code § 3706*] and to third parties who are injured as a result of negligent acts of the misclassified worker in the course and scope of employment. Further, employers who receive contributions from employees to cover any part of the cost of workers' compensation coverage may be found guilty of a misdemeanor [*Lab. Code § 3751*].

Failure to carry workers' compensation insurance or to obtain a certificate of self-insurance is a misdemeanor [*Lab. Code §§ 3700.5, 3710.2*]. Further, employers who do not comply with this requirement may subject themselves to fine and imprisonment [*Lab. Code §§ 3710.2, 3722*], a suit for civil damages [*Lab. Code § 3706*; *see Lab. Code §§ 3708, 3709*], and a claim filed by the injured employee with the California Workers' Compensation Appeals Board, in addition to any civil action the injured employee might file [*Lab. Code § 3715(a)*].

An employer may also provide workers' compensation coverage to workers not included in the definition of employee if both parties agree to do so [*see Lab. Code § 4150*]. Although such coverage may protect an employer from liability for civil tort suits from misclassified independent contractors, it may also serve as an indication of employment status in other contexts. Thus, caution should be exercised in making a determination to provide workers' compensation coverage for independent contractors.

For a detailed discussion of workers' compensation insurance, refer to California Insurance Law and Practice, Volume 3, Chapter 42, *Workers' Compensation Insurance* (Matthew Bender).

[4] Liability to Independent Contractors

Although a principal is not generally liable to an independent contractor or to the contractor's employees, there are two major exceptions to this rule. The first exception imposes liability for injuries that could have been prevented, if the services contracted for are likely to cause a particular risk of harm unless special precautions are taken [*see Widman v. Rossmoor Sanitation, Inc. (1971) 19 Cal. App. 3d 734, 744-745, 97 Cal. Rptr. 52]* . The second exception imposes liability when the principal maintains some degree of control over the premises, provides equipment that malfunctions and causes injury, actively interferes with the work during performance and causes injury, or when the work being performed constitutes a nuisance [*McDonald v. Shell Oil Co. (1955) 44 Cal. 2d 785, 791, 285 P.2d 902]* . For discussion of liability coverage, other than workers' compensation, refer to *Section 1F.52[1], [2]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Workers' Compensation & SSDIGeneral OverviewWorkers' Compensation & SSDICoverageGeneral OverviewWorkers' Compensation & SSDICoverageEmployment RelationshipsContractors



111 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART II. LEGAL BACKGROUND
C. Insurance Planning

1-1F California Legal Forms--Transaction Guide §§ 1F.71-1F.99

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[Reserved]

§§ 1F.71[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1F California Legal Forms--Transaction Guide § 1F.100

AUTHOR: Reviewed by Pam Boc

§ 1F.100 Facts

[1] Information Regarding Individuals Participating in New Business

NOTE:

Facts and documents obtained from the client aid the insurance agent and attorney in determining appropriate types and amounts of insurance coverage. This section is drafted with the assumption that the appropriate insurance will be selected in consultation with an insurance agent. The attorney's role is to ensure that all the relevant facts and documents have been obtained, and that the client has considered the business and tax consequences of these insurance decisions.

1. Name.

2. Residence address and telephone number.

3. Business address and telephone number.

4. Tax identification numbers (social security number; employer identification number).

5. Citizenship and, if an alien, United States residency status.

6. Marital status.

7. Age.

8. Gross and net income for last three years.

9. Estimated net worth.

10. Projected annual income.

11. Relationship to other participants.

12. Affiliations with other businesses.

13. Percentage interest in business.

14. Types and amounts of insurance policies held individually.

15. Whether participant has been denied insurance coverage; if so:

a. Type of coverage denied.

b. Reason for denial.

c. Date of denial.

16. Estate plan.

[2] Information Regarding Corporation

1. Name and address of corporation.

2. Date of incorporation.

3. Tax year of corporation.

4. Type of corporation [*see Corp. Code § 162*]:

NOTE:
The type and size of the corporation will affect the appropriate types and amounts of insurance [***see, e.g., § 1F.61*** (directors and officers insurance), *1F.67* (dissolved corporation)]. For a discussion of limitations on liability based on the corporate form, refer to Chapter 1B, ***Selecting Form of Business Entity.***

a. Publicly held corporation: one in which shares of stock have been advertised and sold to public at large.

b. Closely held corporation: one in which shares of stock are sold privately (that is, without the use of advertising) to relatively small number of shareholders.

c. Close corporation: one in which [*Corp. Code §§ 158, 300*]:

- Shares of stock are sold privately;

- There are no more than 35 shareholders;
- Close corporation election is made in articles of incorporation;
- There is shareholder agreement modifying the usual powers of the board of directors; and
- Close corporation legend is printed on stock certificate [*see Corp. Code § 418(c)*].

5. Whether the corporation is a professional corporation.

NOTE:

A "professional corporation" is a regular business corporation that renders professional services in a single profession under a certificate of registration issued by the governing board that regulates the profession and designates itself as such [***see*** *Corp. Code § 13401(b)*; ***but see*** *Corp. Code § 13401.5* (allied professionals)]. "Professional services" are any services that may lawfully be rendered pursuant to a license or certificate of registration authorized by the Business and Professions Code, the Osteopathic Act, the Yacht and Ship Brokers Act, or the Chiropractic Act [*Corp. Code §§ 13401(a), 13401.3*; ***see*** Bus. & Prof. Code §§ 1000-1-1000-20]. However, there is no longer any certification requirement for medical, osteopathic, dental, pharmacy, veterinary, architectural, registered nursing, optometry, behavioral sciences, speech-language pathology and audiology, or court reporter corporations [***see*** *Corp. Code §§ 13401(b), 13402(a)*; *Bus. & Prof. Code § 2406*]. For further discussion and coverage of professions that must be licensed or registered, see Ch. 12A, ***Professional Corporations*** **.**

For professional corporations, professional liability insurance is an important consideration [***see*** *§ 1F.69*].

6. Whether corporation has elected Subchapter S status.

NOTE:

A small business corporation may elect to be an S corporation [*I.R.C. § 1362(a)*]. Unlike a C corporation, which is a separate tax-paying entity [***see*** *I.R.C. § 11*], an S corporation is generally treated as a conduit of income, loss, deductions, and credits to shareholders [***see*** *I.R.C. §§ 1363, 1366*]. For discussion of the advisability of electing to be an S corporation, see Ch. 1B, ***Selecting Form of Business Entity*** . For discussion of the procedures to be used in electing or terminating Subchapter S status, see Ch. 2B, ***Electing Subchapter S Status*** **.**

Whether or not a corporation has elected S corporation status will affect the determination of the tax impact of a life insurance funded buy-sell agreement [***see*** *§§ 1F.64*, *1F.65*].

7. Employer identification number.

8. Type of business.

9. Business insurance coverage, if any.

[3] Information Regarding Shareholders

1. Names and addresses of shareholders:

    a. Individual shareholders and spouses.

    b. Entities.

2. Capacity in which individual holds shares:

    a. Owner.

    b. Trustee.

    c. Executor or administrator.

    d. Guardian.

    e. Custodian under Uniform Transfers to Minors Act [*see* Ch. 60A, *Gifts*].

3. Basis of shareholder's stock.

4. Tax identification number.

5. Tax year.

6. If shareholder is individual, personal and financial information enumerated in *[1], above.*

7. If shareholder is employee of corporation:

    a. Position or title.

    b. Fringe benefits, including:
    (1) Pensions.

    (2) Stock options.

    (3) Profit sharing.

    (4) Current insurance coverage.

8. Estate plans for shares.

NOTE:
An estate plan may affect a buy-sell agreement [***see §§ 1F.63-1F.66***].

[4] Information Regarding Partnership

1. Name and address of partnership.

2. Date of partnership formed.

3. Tax year of partnership.

4. Type of partnership:

NOTE:
The type of liability protection provided by the partnership form may be a consideration in insurance planning. For further discussion of limits on liability in general and limited partnerships, see Ch. 1B, ***Selecting Form of Business Entity*** .

a. General partnership.

NOTE:
A general partnership is an association of two or more persons to carry on, as co-owners, a business for profit [*Corp. Code § 16101(9)*]. Partners in a general partnership are personally liable, jointly and severally, for all partnership obligations [*Corp. Code § 16306(a)*; ***see*** *Corp. Code § 16305* (partnership liability)]. A general partner's liability is not limited to the partner's percentage interest in the partnership, but extends to the partner's other assets as well [***see*** *Corp. Code § 16306(a)*]. For further coverage of general partnerships, see Ch. 15, Part A, ***Formation of General Partnerships*** .

b. Limited partnership.

NOTE:
A limited partnership is a partnership having one or more general partners and one or more limited partners [*Corp. Code §§ 15501*, 15611(r)(repealed January 1, 2010); *Corp. Code 15901.02(q)* (ULPA '08)]. A general partner in a limited partnership has, by and large, the same liability as a partner in a general partnership [*Corp. Code §§ 15509*, 15643 (repealed January 1, 2010); *see Corp. Code 15904.04* (ULPA '08)]. A limited partner is a partner whose participation in management is limited by statute or agreement and whose liability is ordinarily limited to the amount of its investment [***see*** *Corp. Code §§ 15632*, 15666 (repealed January 1, 2010); *Corp. Code 15903.03* (ULPA '08)]. For further coverage of limited partnerships, see Ch. 16, ***Formation of Limited Partnerships*** .

c. Limited liability partnership.

NOTE:
A registered limited liability partnership is an association of two or more persons to carry on a business as co-owners, other than a limited partnership, formed pursuant to an agreement (1) in which each partner and the partnership is licensed, authorized, or registered to provide architecture, public accountancy, or legal services, or (2) that is related to a registered limited liability partnership that practices public accountancy or, to the extent permitted by the State Bar, practices law or is related to a foreign limited liability partnership and provides complementary or related services or provides services or facilities to that registered limited liability partnership [*Corp. Code § 16101(6)- (9), (14)*]. To secure the benefits of limited liability, the partnership must satisfy all applicable statutory requirements, including a security requirement [*Corp. Code §§ 16306(c), 16501 et seq.*]. One method of satisfying the security requirement is for the partnership to maintain statutorily specified amounts of malpractice insurance [***see*** Corp. Code § 16596].

For further discussion, see Ch. 16C, ***Limited Liability Partnerships*** .

5. Partnership identification number.

6. Type of business partnership.

7. Business insurance coverage, if any.

[5] Information Regarding Partners

1. Names and addresses of partners:

a. Individual partners and spouses.

b. Entities.

2. Capacity in which individual holds partnership interest:

a. Owner.

b. Trustee.

c. Executor or administrator.

d. Guardian.

e. Custodian under Uniform Transfers to Minors Act [*see* Ch. 60A, *Gifts*].

3. Basis of partner's interest.

4. Tax identification number.

5. If partner is individual, personal and financial information enumerated in *[1], above.*

6. If partner is employee of partnership:

a. Position or title.

b. Fringe benefits, including:
(1) Pensions.

(2) Stock options.

(3) Profit sharing.

(4) Current insurance coverage.

7. Estate plans for partnership interests.

NOTE:
An estate plan may affect a partnership buy-sell agreement [***see §§ 1F.63, 1F.66***].

[6] Information Regarding Limited Liability Company

NOTE:
For coverage of limited liability companies, see Ch. 12C, ***Limited Liability Companies*** .

1. Name and address of limited liability company (LLC).

2. Date of organization.

3. Tax year of LLC.

4. Employer identification number.

5. Type of business.

6. Business insurance coverage, if any.

[7] Information Regarding Members

1. Names and addresses of members:

    a. Individual members and spouses.

    b. Entities.

2. Capacity in which individual holds LLC interest:

    a. Owner.

    b. Trustee.

    c. Executor or administrator.

    d. Guardian.

    e. Custodian under Uniform Transfers to Minors Act [*see* vol. 11, Ch. 60A, *Gifts*].

3. Basis of member's interest.

4. Tax identification number.

5. If member is individual, personal and financial information enumerated in *[1], above.*

6. If member is employee of LLC:

a. Position or title.

b. Fringe benefits, including:
(1) Pensions.

(2) Stock options.

(3) Profit sharing.

(4) Current insurance coverage.

7. Estate plans for LLC interests.

[8] Information Regarding Sole Proprietorship

1. Name and address of business.

2. Date proprietorship formed.

3. Tax year of proprietorship, if different from that of owner.

4. Type of business.

5. Position or title of owner.

6. Fringe benefits, including:

a. Pensions.

b. Profit sharing.

c. Insurance coverage.

7. Business insurance coverage, if any.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceGeneral OverviewLegal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsEffective Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1F California Legal Forms--Transaction Guide § 1F.101

AUTHOR: Reviewed by Pam Boc

§ 1F.101 Documents

[1] Corporation

1. Articles of incorporation.

2. Bylaws.

3. Most recent income tax return.

4. Shareholder list.

5. Most recent financial statement.

6. Annual report.

7. Fringe benefit plans and agreements.

8. Any instrument under which corporation's stock is held, including:

a. Trust instruments for trusts holding corporation's shares.

b. Will under which any deceased shareholder's S corporation stock is held by estate.

c. Bankruptcy court order under which bankrupt shareholder's stock is held by bankrupt's estate.

d. Court order for guardianship.

9. Any corporate buy-sell agreement.

10. Any buy-sell agreement between any shareholder and any member of shareholder's family.

11. Insurance policies.

[2] Partnership

1. Partnership agreement.

2. Any partnership buy-sell agreement, if not included in partnership agreement.

3. Most recent income tax return.

4. Most recent financial statement.

5. Fringe benefit plans and agreements.

6. Any instrument under which partnership's interests are held.

7. Any buy-sell agreement between any partner and any member of partner's family.

8. Insurance policies.

[3] Limited Liability Company

1. Articles of organization.

2. Operating agreement.

3. Most recent income tax return.

4. List of members.

5. Most recent financial statement.

6. Annual report.

7. Fringe benefit plans and agreements.

8. Any instrument under which LLC membership interests are held.

9. Any buy-sell agreement between any member and any member of member's family.

10. Insurance policies.

[4] Sole Proprietorship

1. Most recent income tax return.

2. Most recent financial statement.

3. Fringe benefit plans and agreements.

4. Any buy-sell agreement.

[5] Individual Participants

1. Most recent income tax return.

2. Estate planning documents, including wills and/or trusts.

3. Insurance policies.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceGeneral OverviewLegal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsEffective Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

1-1F California Legal Forms--Transaction Guide §§ 1F.102-1F.109

AUTHOR: Reviewed by Pam Boc

[Reserved]

§§ 1F.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations in Selecting Appropriate Insurance Coverage

1-1F California Legal Forms--Transaction Guide § 1F.110

AUTHOR: Reviewed by Pam Boc

§ 1F.110 Property Insurance

NOTE:
Property insurance policies, including real property, boiler and machinery, transportation, and personal property insurance, should be obtained, as applicable, by any new business. This section is drafted with the assumption that the appropriate insurance will be selected in consultation with an insurance agent. The attorney's role is to ensure that all the relevant facts and documents have been obtained, and that the client has considered the business and tax consequences of these insurance decisions.

1. Ascertain whether business will require property insurance:

a. Will business own real property, either structures or crops?

b. Will business own or lease and operate automobiles, vessels, or aircraft?

c. Will business require transportation of product?

d. Will business require special property insurance, such as protection against loss of rental value, extra expense, builder's risk, damage to boilers and machinery, damage to crops, bailee's risks, or default by mortgagees?

2. Ascertain adequate amount of property insurance coverage based on nature of business and its available capital.

NOTE:
In making this determination, counsel should consult with the business's owners, accountant, and

insurance agent.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceGeneral OverviewInsurance LawBusiness InsuranceAviation InsurancePropertyInsurance LawBusiness InsuranceMarine InsuranceGeneral OverviewInsurance LawProperty InsuranceGeneral OverviewInsurance LawProperty InsuranceCoverageGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations in Selecting Appropriate Insurance Coverage

1-1F California Legal Forms--Transaction Guide § 1F.111

AUTHOR: Reviewed by Pam Boc

§ 1F.111 General Liability Insurance

1. Ascertain whether business will require general liability insurance.

NOTE:
Individual liability policies may be issued in many different forms. A common form is the Business General Liability policy, which provides protection for hazards related to or arising from (1) premises and operations; (2) elevators; (3) owner's and contractor's protective (acts and omissions with respect to supervising independent contractors); (4) completed operations; and (5) product liability. For further discussion of business general liability policies, refer to *Section 1F.52* and California Insurance Law and Practice, Volume 3, Chapter 49, ***Business General Liability Policies*** (Matthew Bender).

a. Is there a risk of injury related to business premises or elevators?

b. Is there a risk of injury from business operations?

c. Is there potential liability with respect to use of independent contractors?

d. Is there potential liability related to particular contracts?

2. Ascertain whether nature of business itself is likely to lead to liability.

NOTE:
Certain types of businesses, such as restaurants, private schools, and health clubs, have a

potentially high risk of tort liability. Many owners find incorporation a benefit under such circumstances. However, since incorporation will not always protect the participants from personal liability [***see*** Ch. 1B, ***Selecting Form of Business Entity***], liability insurance coverage should be considered.

Professionals will also often incorporate to avoid personal liability [***see*** vol. 3A, Ch. 12A, ***Professional Corporations*** (list of professions permitted professional corporation status)]. Shareholders of professional corporations have the same protection from personal liability as do shareholders of other corporations for acts and omissions unrelated to their professional practice [*Corp. Code § 13403*]. Most regulatory agencies, however, impose joint and several liability for malpractice [***see, e.g.,*** *Bus. & Prof. Code §§ 1057* (chiropractic corporations), *2781* (nursing corporations)]. Thus, for professionals, whether incorporated or not, malpractice insurance is an important consideration [***see*** *§§ 1F.69, 1F.113*].

In addition, director liability insurance may be necessary in order to attract qualified outside directors [***see*** *§§ 1F.61, 1F.112*].

a. Is business highly speculative?

b. Is business user or producer of hazardous products [*see* California Insurance Law and Practice, Volume 3, Chapter 47, *Products Liability Insurance* (Matthew Bender)]?

c. Is business one in which accidental injury to employee or customer is likely?

d. Is business one which is likely to be subject to lawsuits?

e. Is business professional business in which malpractice may occur?

3. Determine extent risks are insurable.

4. Ascertain adequate amount of coverage based on nature of risks and business's available capital.

NOTE:
In making this determination, counsel should consult with the business's owners, accountant, and insurance agent.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawGeneral Liability InsuranceCoverageGeneral OverviewInsurance LawGeneral Liability InsuranceCoverageAccidentsInsurance LawGeneral Liability InsuranceCoverageCompleted OperationsInsurance LawGeneral Liability InsuranceCoverageProducts & WorkmanshipInsurance LawGeneral Liability InsurancePersons InsuredGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations in Selecting Appropriate Insurance Coverage

1-1F California Legal Forms--Transaction Guide § 1F.112

AUTHOR: Reviewed by Pam Boc

§ 1F.112 Directors and Officers Insurance

NOTE:

Corporation Code Section 317(i) allows corporations to maintain insurance on behalf of an agent of the corporation (including directors and officers) against liability asserted against or incurred by the agent in that capacity, regardless of whether the corporation would otherwise have the power to indemnify the agent under *Corporation Code Section 317* [*Corp. Code § 317(i)*; ***see*** *§ 1F.61*]. The corporation may also provide in its articles of incorporation for indemnification of its agents, in excess of that specifically permitted by *Corporation Code Section 317*, for breach of duty to the corporation and its shareholders [*Corp. Code § 204(a)(11)*].

For further discussion of the liability of corporate directors, the extent of permissible indemnity, and the limitation of directors' liability in the articles of incorporation, refer to Ballantine Sterling, California Corporation Laws, Volume 1, Chapters 3, ***Formation of Corporations*** and 6, ***Management: Duties and Liabilities of Directors and Controlling Shareholders.***

1. Ascertain whether directors and officers insurance is advisable:

    a. As practical matter, will it be necessary in order to attract qualified outside directors?

    b. Can corporation obtain and afford such insurance [*see § 1F.61[3]*]?

    c. Can corporation self-insure, if necessary [*see § 1F.61[3]*]?

2. Ascertain appropriate form of coverage.

NOTE:

There are two basic forms of insurance coverage for the acts of officers and directors. "Directors and officers liability" directly insures the officer or director for a loss caused by his or her wrongful acts or omissions. "Corporate reimbursement" or "corporate indemnification" provides coverage to the corporation if the corporation has entered into agreements to indemnify its officers or directors for its negligent acts. Although these two coverages may be written separately, it is not unusual for them to be combined into a single policy.

a. Has corporation agreed to indemnify its directors and officers?

NOTE:

Depending on the requirements of the corporation, it may purchase either or both of the two basic policy types. If a corporation has not entered into an agreement to indemnify its officers or directors, it will have no need for corporate reimbursement coverage.

b. Will corporation need to purchase specialized coverage based on nature of business or nonprofit form?

c. Is coverage available under other policies?

NOTE:

Typically, the general liability policies of the corporation or of the individual officer or director do not cover the indemnification of an officer or director. The terms of the individual policies vary, however, and must be examined to determine what acts are covered.

3. Ascertain adequate amount of coverage (including extended coverage) based on nature of risks and business's available capital [*see § 1F.61[7]*].

NOTE:

In making this determination, counsel should consult with the business's owners, accountant, and insurance agent.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceDirectors & Officers Liability InsuranceCoveragePersons InsuredInsurance LawBusiness InsuranceDirectors & Officers Liability InsuranceCoverageWrongful ActsInsurance LawBusiness InsuranceDirectors & Officers Liability InsuranceObligationsIndemnification



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations in Selecting Appropriate Insurance Coverage

1-1F California Legal Forms--Transaction Guide § 1F.113

AUTHOR: Reviewed by Pam Boc

§ 1F.113 Professional Liability Insurance

NOTE:

Professional liability insurance protects professionals from claims based on acts, errors, or omissions in the performance of professional services for others [***see*** *Northern Insurance Co. v. Superior Court (1979) 91 Cal. App. 3d 541, 154 Cal. Rptr. 198* (examining nature of professional services)]. This insurance complements, rather than serves as a substitute for, a professional's coverage under other policies. While professional liability policies exclude coverage for personal injury and property damage, business general liability policies cover such losses but exclude coverage for acts, errors, or omissions in the performance of professional services [***see*** *§ 1F.52*]. Before going into business, a professional should seriously consider obtaining professional liability coverage. For further discussion, see *Sections 1F.52[3]* and *1F.69*.

1. Ascertain whether professional liability coverage (including prior acts and/or extended coverage) is advisable [*see § 1F.69*].

2. Determine appropriate type of coverage:

a. "Claims made" coverage.

NOTE:

Most professional liability policies are written on a "claims made" basis, which provides coverage for claims reported to an insurer during the policy period [*Chamberlin v. Smith (1977) 72 Cal. App. 3d 835, 846, 140 Cal. Rptr. 493]* . A claims made policy usually covers liabilities based on errors or omissions taking place before the policy period [***see*** *§ 1F.69[4]*].

b. "Occurrence" coverage.

NOTE:

An "occurrence" policy provides coverage for acts or omissions that take place during the policy period, regardless of when the claim is made [*VTN Consolidated, Inc. v. Northbrook Ins. Co. (1979) 92 Cal. App. 3d 888, 891, 155 Cal. Rptr. 172]* . Occurrence policies are rarely written; if available, coverage is expensive [***see** § 1F.69[4]*].

3. Ascertain adequate amount of coverage (including prior acts and/or extended coverage) based on nature of risks and business's available capital.

NOTE:

In making this determination, counsel should consult with the business's owners, accountant, and insurance agent.

a. Is policy "wasting" policy?

NOTE:

A "wasting policy" is one in which the policy limits are reduced by both the costs of defense and the cost of any liability. Caution should be exercised to ensure that the policy limits are high enough to cover defense costs as well as any liability incurred.

b. Does insurance company's proposed settlement agreement limit dollar amount of insurance coverage if professional refuses to consent to settlement?

NOTE:

Caution should be exercised regarding policies that permit the insurance company to limit its coverage to the amount of a proposed settlement, if the insured withholds its consent to that settlement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawMalpractice InsuranceGeneral OverviewInsurance LawMalpractice InsuranceClaims Made & Occurrence PoliciesInsurance LawMalpractice InsuranceDefense ObligationsInsurance LawMalpractice InsuranceErrors & Omissions Policies



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations in Selecting Appropriate Insurance Coverage

1-1F California Legal Forms--Transaction Guide § 1F.114

AUTHOR: Reviewed by Pam Boc

§ 1F.114 Liability Insurance Coverage for Actions Against Dissolved Corporations and Their Shareholders

NOTE:

Causes of action against a dissolved corporation arising before or after the dissolution of the corporation may be enforced against (1) the dissolved corporation to the extent of any undistributed assets, and (2) shareholders of the dissolved corporation, if any of the assets of the dissolved corporation have been distributed to them [*Corp. Code § 2011(a)*; *Penasquitos, Inc. v. Superior Court (1991) 53 Cal. 3d 1180, 1188-1191, 283 Cal. Rptr. 135, 812 P.2d 154* ; ***see*** *Corp. Code § 2010* (dissolved corporation defined)]. Consideration, therefore, should be given to purchasing insurance to cover potential claims against the shareholders of a dissolved corporation.

1. Ascertain whether coverage for actions against dissolved corporation and its shareholders is advisable.

2. Ascertain adequate amount of coverage based on nature of risks and business's available capital.

NOTE:

In making this determination, counsel should consult with the business's owners, accountant, and insurance agent.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesPersonal LiabilityInsurance LawBusiness InsuranceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations in Selecting Appropriate Insurance Coverage

1-1F California Legal Forms--Transaction Guide § 1F.115

AUTHOR: Reviewed by Pam Boc

§ 1F.115 Life and Disability Insurance

1. Ascertain whether key employee life and disability insurance is advisable.

NOTE:
The purpose of key employee life insurance is to compensate the business for the loss created by the death of the owner or key employee. Key employee insurance is usually obtained for corporate officers, top sales representatives, or any person on whom the business is clearly dependent for its success [*Boldemann Chocolate Co. v. Price (1936) 5 Cal. 2d 200, 202, 53 P.2d 946]* . Such insurance frequently contains an accidental death or disability feature. For further discussion of key employee insurance, refer to *Section 1F.62*.

2. Determine tax consequences to business of its payment of key employee life premiums and its receipt of policy proceeds [*see § 1F.62[2]*].

3. Ascertain additional needs of corporation or partnership that may be met by life insurance:

a. Will entity need to liquidate interest of deceased shareholder, partner, or member?

b. Will entity need to establish credit?

c. Will entity need to create reserves for business?

d. Will entity need to fund deferred compensation arrangements?

e. Will entity need to fund pension and profit sharing arrangements?

4. Ascertain additional benefits of life insurance to sole proprietor:

a. Will sole proprietor need to indemnify his or her estate against loss resulting from forced sale of business after owner's death?

b. Will sole proprietor need to provide heirs with necessary cash to carry on business?

c. Will sole proprietor need to establish credit during his or her lifetime?

d. Will sole proprietor need to provide for his or her retirement?

e. Will sole proprietor need to provide immediate cash for estate settlement purposes without encumbering or jeopardizing business's financial status?

5. Advise client to determine whether life insurance is appropriate vehicle to accomplish needs enumerated in Paragraph 4, *above*.

NOTE:
In making this determination, counsel should consult with the business's owners, accountant, and insurance agent.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceGeneral OverviewInsurance LawDisability InsuranceInsurable InterestsInsurance LawLife InsuranceInsurable InterestsGeneral OverviewInsurance LawLife InsuranceInsurable InterestsEmployers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations in Selecting Appropriate Insurance Coverage

1-1F California Legal Forms--Transaction Guide § 1F.116

AUTHOR: Reviewed by Pam Boc

§ 1F.116 Life Insurance Funded Buy-Sell Agreement

NOTE:
Whether life insurance should be used to fund a buy-sell agreement depends on the nature of the business, the owners' objectives, the purchase price of the interests, and the cost of life insurance. The cost of life insurance, including its tax consequences, must be compared with the cost of alternate insurance [***see*** *§ 1F.63 [4]*] and other funding methods, such as borrowing or an installment purchase using the business's own capital.

1. Ascertain whether buy-sell agreement is advisable.

NOTE:
A buy-sell agreement can ensure the continuity of a business by providing funds for the transfer of management; it allows the principals to select, in advance, the purchaser of their business interests. This is particularly important when the owners of a family business have invested their working lives and, likely, their personal assets in the venture. For further discussion of advantages of a buy-sell agreement, refer to *Section 1F.63[2]*.

2. If buy-sell agreement is advisable, determine appropriate type:

a. Entity-purchase plan.

NOTE:
The stock, partnership interest, or LLC interest redemption or "entity-purchase" plan provides that, on a shareholder's, partner's, or member's death, the shareholder's stock, partnership interest, or LLC interest is redeemed or purchased by the business entity (the

corporation or partnership) [***see** § 1F.63[1]*].

b. Cross-purchase plan.

NOTE:

The stock, partnership interest, or LLC interest purchase agreement or "cross-purchase" plan provides that the decedent's stock, partnership interest, or LLC interest is purchased directly from the decedent's estate by the surviving shareholders, partners, or members in proportion to their existing ownership interests [***see** § 1F.63[1]*].

If life insurance is used to fund a cross-purchase agreement, each shareholder, partner, or member must obtain a life insurance policy on the life of every other shareholder, partner, or member in an amount sufficient to fund his or her proportionate obligation to purchase the shares or interests from the decedent's estate. This type of agreement can be disadvantageous when there are more than a few shareholders, partners, or members, not only because having numerous insurance policies can be cumbersome, but because of the increased administrative costs related to the policies themselves and the increased complexity and legal cost of an insurance-funded cross-purchase.

3. Determine appropriate amount of funding.

NOTE:

The simplest way to assure adequate capital to finance the purchase of a business interest under a buy-sell agreement is to obtain life insurance in an amount equal to the value of the interest to be redeemed or purchased. For discussion of valuation methods, refer Volume 3, Chapter 8, ***Shareholders' Meetings, Voting, and Agreements.***

4. Determine type of insurance for funding:

NOTE:

The correct vehicle for funding a buy-sell agreement should be selected in consultation with a life insurance agent. For discussion of the types of life insurance products that may be used to fund the agreement, refer to *Section 1F.63[5][b]*.

a. How long will buy-sell agreement be in effect?

b. What is comparative cost of premiums for term and permanent insurance?

5. Ascertain income tax consequences of buy-sell agreement funded by life insurance to: decedent, surviving shareholders, partners, or members, and business entity.

a. How will premiums be taxed?

NOTE:

For discussion of taxation of life insurance premiums, refer to *Sections 1F.64[1]* (taxation of premiums for corporate buy-sell agreements), *1F.65[1]* (taxation of premiums for shareholder cross-purchase agreements), and *1F.66[1]* (taxation of premiums for partnership buy-sell agreements).

b. How will policy proceeds be taxed?

NOTE:

For discussion of taxation of policy proceeds, refer to *Sections 1F.64[2]* (taxation of policy proceeds of corporate buy-sell agreements), *1F.65[2]* (taxation of policy proceeds of shareholder cross-purchase agreements), and *1F.66[1]* (taxation of policy proceeds of partnership buy-sell agreements).

6. Ascertain estate tax consequences of buy-sell agreement funded by life insurance to: decedent, surviving shareholders, partners, or members, and business entity.

NOTE:

For discussion of estate taxation of policy proceeds, refer to Sections *1F.64[4]* (estate taxation of policy proceeds of corporate buy-sell agreements), *1F.65[3]* (estate taxation of policy proceeds of shareholder cross-purchase agreements), and *1F.66[3]* (estate taxation of policy proceeds of partnership buy-sell agreements). For discussion of the complex issues in estate taxation for closely held corporations, refer to California Small Business Guide, Volume 3, Chapter 42, ***Estate Planning for Shareholders*** (Matthew Bender). For discussion of partnership taxation, refer to Willis, Pennell & Postwaite, Partnership Taxation, (4th ed. 1993).

7. If any owner is uninsurable, determine whether alternate insurance may be obtained to fund buy-sell agreement [*see § 1F.63[4]*].

a. Is "guaranteed issue" life insurance obtainable?

b. Is group life insurance that includes "guaranteed issue" insurance obtainable?

c. Is uninsurable owner willing to transfer personal life insurance policy to business to fund agreement?

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersTransfers of InterestsBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsInsurance LawLife InsuranceInsurable InterestsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations in Selecting Appropriate Insurance Coverage

1-1F California Legal Forms--Transaction Guide § 1F.117

AUTHOR: Reviewed by Pam Boc

§ 1F.117 Business Interruption Insurance

NOTE:
Business interruption insurance includes disability income protection coverage, or "loss of time benefit" [***see*** PP 1-2, ***below***] and business protection coverage, including business overhead protection, specialized disability protection for persons in specific industries (e.g., "cast" insurance [***see*** PP 3-4, ***below***], as well as business buy-out policies [***see § 1F.116***].

1. Ascertain whether disability income protection ("loss of time" benefit [*see 10 Cal. Code Reg. § 2220.24*] is required:

a. Will California's compulsory, nonoccupational disability insurance [*see Unemp. Ins. Code §§ 13040-13043* (withholding)] provide adequate coverage?

b. Will business owner require additional benefits to replace lost income resulting from his or her inability to perform a designated occupation or specified activities [*see § 1F.63[1]*]?

2. If additional disability income protection is desired, ascertain adequate amount of coverage based on nature of risks and business's available capital.

NOTE:
In making this determination, counsel should consult with the business's owners, accountant, and insurance agent.

3. Ascertain whether business overhead protection is advisable [*see § 1F.68[2]*].

4. Ascertain whether any specialized form of disability protection (e.g., "cast" protection) is advisable [*see § 1F.68[2]*].

5. Ascertain adequate amount of business protection coverage based on nature of risks and business's available capital.

NOTE:
In making this determination, counsel should consult with the business's owners, accountant, and insurance agent.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceBusiness Interruption InsuranceComputation of LossesInsurance LawBusiness InsuranceBusiness Interruption InsurancePremises & OperationInsurance LawBusiness InsuranceBusiness Interruption InsurancePurpose



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations in Selecting Appropriate Insurance Coverage

1-1F California Legal Forms--Transaction Guide § 1F.118

AUTHOR: Reviewed by Pam Boc

§ 1F.118 Workers' Compensation Insurance

NOTE:
Workers' compensation insurance compensate employees who have been injured in the course and scope of their employment, without regard to fault [*Lab. Code § 3200 et seq.*]. In exchange, injured employees are barred, in most cases, from bringing a civil suit against the employer [*Lab. Code § 3602*]. Most California employers must provide workers' compensation coverage [*Lab. Code §§ 3300, 3351*; ***see*** Lab. Code §§ 2270.5, *3352, 3352.94, 3353* (exclusions)]. For detailed discussion of workers' compensation insurance, including covered employees, exclusions, employer responsibilities, and types of coverage, refer to California Insurance Law and Practice, Volume 3, Chapter 42, ***Workers' Compensation Insurance*** (Matthew Bender).

1. Ascertain whether employer is subject to workers' compensation laws, because employer is one of following [*Lab. Code § 3300*]:

a. State government, state agency, or other public agency.

b. Person that has natural person in its service.

c. Legal representative of deceased employer.

NOTE:
Certain groups are excluded from the definition of "employer" [***see*** *Lab. Code § 3301*].

2. Determine if worker is "employee" because worker is person in service of employer [*see* [1], *above*] under any appointment or contract for hire or apprenticeship, express or implied, oral or written, whether lawfully or unlawfully

employed [*Lab. Code § 3351*].

NOTE:

Workers' compensation coverage is based on defined employment relationships: an injured worker must be an "employee" to be entitled to worker's compensation coverage for an injury occurring in the course and scope of employment [*Lab. Code §§ 3350-3370*; *In-Home Supportive Services v. Workers' Compensation Appeals Bd. (1984) 152 Cal. App. 3d 720, 727, 199 Cal. Rptr. 697, 49 Cal. Comp. Cases 177]* . A person rendering services for another, other than an independent contractor, or unless expressly excluded under workers' compensation laws, is presumed to be an employee [*Lab. Code § 3357*; *Laeng v. Workmen's Comp. Appeals Bd. (1972) 6 Cal. 3d 771, 777, 100 Cal. Rptr. 377, 494 P.2d 1, 37 Cal. Comp. Cases 185]* .

3. Determine if worker is "independent contractor":

NOTE:

An independent contractor is any person who renders service for a specified recompense for a specified result only, and not regarding the means by which it is accomplished [*Lab. Code § 3353*; ***see*** *S.G. Borello & Sons, Inc. v. Department of Industrial Relations (1989) 48 Cal. 3d 341, 349, 256 Cal. Rptr. 543, 769 P.2d 399, 54 Cal. Comp. Cases 80]* .

For coverage of independent contractors, see Volume 15, Chapter 84, ***Independent Contractors*** .

a. Does worker hold a valid contractor's license?

NOTE:

The Labor Code creates a rebuttable presumption that a worker performing certain construction or trade services for which a license is required [***see*** *Bus. & Prof. Code §§ 7000-7173*], or performing such services for a person required to obtain such a license, is an employee rather than an independent contractor [***see*** *Lab. Code § 2750.5*; *State Compensation Ins. Fund v. Workers' Comp. Appeals Bd. (1985) 40 Cal. 3d 5, 219 Cal. Rptr. 13, 706 P.2d 1146* (*Labor Code § 2750.5* specifically applicable to workers' compensation cases)].

To rebut the presumption of employee status, the individual must have a valid contractor's license [***see*** *Lab. Code § 2750.5*. Thus, a worker who does not have such a license cannot assert independent contractor status. Statutory factors [***see*** *Lab. Code § 2750.5*; PP b--d, 4, ***below***] and case law [***see*** P 5, ***below***] evidencing the right to control the services rendered also determine independent contractor status.

b. Does worker have right to control and discretion as to services performed?

c. Is worker customarily engaged in independently established business?

d. Is worker's independent contractor status bona fide and not subterfuge to avoid employee status?

4. To determine whether independent contractor status is bona fide, ascertain how many of following statutory factors exist.

NOTE:

A bona fide independent contractor status is evidenced by the cumulative presence of the factors

enumerated in Paragraphs a--k, ***below*** [***see*** *Lab. Code § 2750.5*].

a. Does worker have substantial investment, other than personal services, in business?

b. Does worker hold himself or herself out to be in business?

c. Does worker bargain for contract to complete specific project for compensation rather than by time?

d. Does worker control time and place work is performed?

e. Does worker supply his or her own tools or instrumentalities, other than those customarily provided by employer?

f. Does worker hire employees?

g. Does worker perform work not ordinarily in course of principal's work?

h. Does worker perform work requiring a particular skill?

i. Does worker hold a license under Business and Professions Code?

j. Do parties intend work relationship to be that of independent contractor?

k. Does termination of relationship give rise to action for breach of contract?

5. Determine how many of following common law factors exist [*see S.G. Borello & Sons, Inc. v. Department of Industrial Relations (1989) 48 Cal. 3d 341, 350-351, 354, 256 Cal. Rptr. 543, 769 P.2d 399, 54 Cal. Comp. Cases 80* ; *see also* vol. 15, Ch. 84, *Independent Contractors*].

NOTE:

The following common law factors, traditionally applied by the Workers' Compensation Appeals Board, are not applied mechanically as separate tests; rather, their weight often depends on particular combinations [***see*** *S.G. Borello & Sons, Inc. v. Department of Industrial Relations (1989) 48 Cal. 3d 341, 350-351, 354, 256 Cal. Rptr. 543, 769 P.2d 399, 54 Cal. Comp. Cases 80]* . ***Borello*** requires that the test of independent contractor, for purposes of workers' compensation, be applied in keeping with the protective purposes of the legislation [*S.G. Borello & Sons, Inc. v. Department of Industrial Relations (1989) 48 Cal. 3d 341, 358-359, 256 Cal. Rptr. 543, 769 P.2d 399, 54 Cal. Comp. Cases 80* ; ***see*** *Rinaldi v. Workers' Compensation Appeals Bd. (1991) 278 Cal. Rptr. 105* (crew member of farm labor contractor held to be employee for purposes of workers' compensation); *Yellow Cab Coop., Inc. v. Workers' Compensation Appeals Bd. (1991) 226 Cal. App. 3d 1288, 1300-1302, 277 Cal. Rptr. 434* (cab driver held to be employee of taxi company for purposes of workers' compensation; ***but see*** *Torres v. Reardon (1992) 3 Cal. App. 4th 831, 837-838, 5 Cal. Rptr. 2d 52* (gardener held to be independent contractor for purposes of workers' compensation)].

a. Does worker have right to control manner and performance of work?

NOTE:

Although the worker may exercise some limited control, if the employer has ultimate

control of the manner and performance of the work, employee status is indicated.

b. Does worker control time work begins and ends?

NOTE:
If not, employee status may be indicated.

c. Does worker have a monetary investment in his or her work.

NOTE:
If not, employee status may be indicated.

d. Does worker supply his or her own tools, instrumentalities and place of work.

NOTE:
If not, employee status may be indicated.

e. Does worker have license to perform work?

NOTE:
If not, employee status may be indicated.

f. Can worker terminate employment relationship at will?

NOTE:
If so, employee status may be indicated.

g. Was worker hired for indefinite period of time?

NOTE:
If so, employee status may be indicated.

h. Is worker paid by time (hour, week, month, or year), or by job?

NOTE:
If worker is paid by time, employee status may be indicated.

i. Is worker engaged in distinct occupation or business?

NOTE:
If not, employee status may be indicated.

j. Is worker supervised in performance of his or her work?

NOTE:
If so, employee status may be indicated.

k. Do parties believe they are creating principal-independent contractor relationship?

NOTE:
If so, independent contractor status may be indicated.

l. Do services rendered require great deal of skill?

NOTE:
If so, independent contractor status may be indicated.

Legal Topics:

For related research and practice materials, see the following legal topics:
Workers' Compensation & SSDIAdministrative ProceedingsBurdens of ProofWorkers' Compensation & SSDICoverageGeneral OverviewWorkers' Compensation & SSDICoverageEmployment RelationshipsContractorsWorkers' Compensation & SSDICoverageEmployment RelationshipsEmployees



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations in Selecting Appropriate Insurance Coverage

1-1F California Legal Forms--Transaction Guide §§ 1F.119-1F.199

AUTHOR: Reviewed by Pam Boc

[Reserved]

§§ 1F.119[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART IV. FORMS

1-1F California Legal Forms--Transaction Guide § 1F.200

AUTHOR: Reviewed by Pam Boc

§ 1F.200 Client Letter Prior to Initial Meeting

[1] Comment

[a] Use of Form

This form is a letter to a client requesting insurance and business information to be used at the initial meeting with the client about obtaining business insurance. Before the initial meeting with the client, the attorney will want to obtain enough information to determine the scope of the work to be done and any preliminary decisions to be made.

At the initial meeting, the attorney will want to have additional, specific information to estimate the time required to perform the legal research and factual analysis. However, complicated or lengthy questionnaires tend to discourage clients and frequently result in cancelled appointments because the client is "unprepared." This letter is composed with that in mind. If a more detailed set of questions is appropriate before the initial meeting, counsel should incorporate relevant facts and documents from *Section 1F.100*.

[b] Fee and Representation Agreement

Mention is made of a fee and representation agreement in the first paragraph of the form below. For sample forms, refer to Volume 15, Chapter 86, *Agreements for Professional Services* .

[2] Form

Client Letter Prior to Initial Meeting

_____[*date*]
_____[*name*]
_____ [*title*]
_____ [*street address*]

_____ [*city, state, zip*]

Re: Insurance Considerations
Dear _____ [*name of client*]:

In preparation for our initial meeting regarding the insurance needs of your _____ [business *or* proposed business], I have _____ [sent under separate cover *or* enclosed] a fee and representation agreement outlining our mutual obligations.

This letter is to provide you with a short list of the documents and information to bring to our meeting. This is a suggested list only. If you believe other items would be useful, include those as well. If you are unable to obtain everything on the list, bring what you have.

Information

1. Names and telephone numbers of business participants.

2. Names and telephone numbers of business's insurance agent and accountant.

3. Types of insurance policies held individually by business participants.

4. Types of insurance policies held by business, if any.

5. Whether any business participant has been denied insurance coverage. If so:

    a. Type of coverage denied.

    b. Reason for denial.

    c. Date of denial.

    [*Choose one of the following set of questions:*]

    [*If business entity is a corporation, use:*]

6. Name and address of corporation.

7. Date of incorporation.

8. Tax year of corporation.

9. Type of corporation.

[*If business entity is a partnership, use:*]

6. Name and address of partnership.

7. Date of partnership was or will be formed.

8. Tax year of partnership.

9. Type of partnership.

[*If business entity is a limited liability company, use:*]

6. Name and address of limited liability company.

7. Date of organization.

8. Tax year of limited liability company.

[*If business entity is a sole proprietorship, use:*]

6. Name and address of sole proprietorship.

7. Date proprietorship was or will be formed.

8. Tax year of proprietorship, if different from owner.

[*If any participants are employees of the business, use:*]

6. Position or title of participants who are employees of the business.

7. Fringe benefits, including:

a. Pensions.

b. Stock options.

c. Profit sharing.

d. Current insurance coverage.

[*Continue with the following:*]

_ . Estate plan or plans for business interests.

_ . Nature of business.

Documents

1.

_____ [Articles of incorporation *or* Partnership agreement *or* Articles of organization].

2. Any buy-sell agreements.

3. Most recent financial statement.

4. Most recent tax return.

5. Fringe benefit plans and agreements.

6. Insurance policies of:

a. Individual participants.

b. Business.

7. Estate planning documents, including wills and/or trusts.

[*Add if applicable:*]

Please ensure that_____[*name*], your insurance agent, and_____[*name*], your accountant, are able to attend this meeting.

[*Continue with the following:*]

I look forward to meeting with you on_____[*date*] at_____[*time*] at _____ [*location*] to discuss the insurance needs of your _____ [business *or* proposed business venture]. Do not hesitate to call if you have questions.

Very truly yours,

_____ [*signature*]

[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceGeneral OverviewLegal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsAttorney FeesFee Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART IV. FORMS

1-1F California Legal Forms--Transaction Guide § 1F.201

AUTHOR: Reviewed by Pam Boc

§ 1F.201 Client Letter Following Initial Meeting

[1] Comment--Use of Form

This form is a follow-up letter to an initial meeting at which insurance considerations for a new business were discussed.

This letter serves two purposes. First, it reiterates the tasks the attorney will perform, reminding the client of the extent of work involved. The letter provides optional text for use if the attorney will work in consultation with the business's insurance agent and accountant.

Second, if the attorney is awaiting additional materials from the client, it provides the client with a complete list of the information or documents that he or she must provide and puts the client on notice that work cannot be completed without those items.

[2] Form

Client Letter Following Initial Meeting

_____[*date*]
_____[*name*]
_____ [*title*]
_____ [*street address*]
_____ [*city, state, zip*]

Dear _____ [*name of client*]:

In our meeting of_____[*date*], we agreed that I would perform the research and analysis necessary to

determine the advisable types of insurance coverage for your _____ [business *or* proposed business venture]. This will include _____ [*specify, e.g.,* comparing the cost (including the tax consequences) of life insurance funding for a buy-sell agreement with the cost of alternative insurance and other funding methods; determining the feasibility of a self-insurance program for directors and officers liability insurance; and researching whether workers will be considered employees or independent contractors for purposes of workers' compensation]. [*Add if applicable:* I will perform this research and analysis in consultation with your insurance agent, _____ (*name*), and accountant, _____ (*name*)].

[*If client is to provide additional information, use:*]

We also agreed that you would provide me with the following: _____ [*list information and documents*].

I look forward to receiving this information as soon as possible, so that I can complete the work we discussed. I will telephone you to confirm receipt of your materials and to schedule a date for our follow-up discussion.

[*If client is not to provide additional information, use:*]

I look forward to seeing you on_____[*date*] at _____ [*time of day*] at _____ [*location*] to discuss the results of this research.

[*Continue with the following:*]

Very truly yours,

_____ [*signature*]

[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceGeneral OverviewLegal EthicsClient RelationsEffective Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART IV. FORMS

1-1F California Legal Forms--Transaction Guide § 1F.202

AUTHOR: Reviewed by Pam Boc

§ 1F.202 Client Letter If Attorney is to Perform No Further Work

[1] Comment--Use of Form

This form is a follow-up letter to a meeting at which insurance considerations for a new business were discussed, stating that no further work will be done.

If no research or analysis is to be performed regarding a business's insurance needs, a follow-up letter to the client establishes the end of the attorney-client relationship related to this particular representation. This letter helps establish a date from which the statute of limitations runs for purposes of malpractice claims [*see Code Civ. Proc. § 340.6(a)(2)*].

The attorney should return any documents belonging to the client with this letter. The letter should be sent certified or registered mail, to document the close of the attorney-client relationship, as well to confirm the receipt of returned documents.

[2] Form

Client Letter If Attorney is to Perform No Further Work

_____[*date*]
_____[*name*]
_____ [*title*]
_____ [*street address*]
_____ [*city, state, zip*]

Dear _____ [*name of client*]:

This letter will confirm our _____ [conversation *or* telephone conversation]

of_____[*date*], in which we concluded that you would not need any further assistance in evaluating the insurance needs of your _____ [business *or* proposed business venture].

If you decide to pursue this matter, please feel free to consult _____ [me *or* us] again. However, currently, _____ [I *or* we] consider the matter closed.

Please call if you have any questions, or if _____ [I *or* we] can be of service in the future.

Very truly yours,

_____ [*signature*]

_____ [*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART IV. FORMS

1-1F California Legal Forms--Transaction Guide § 1F.203

AUTHOR: Reviewed by Pam Boc

§ 1F.203 Client Letter If Attorney Recommends Insurance Coverage

[1] Comment--Use of Form

This form is a letter that documents for the attorney, and clarifies for the client, recommended types of insurance coverage for a new business. This letter should be prepared in consultation with the business's insurance agent, and if necessary, accountant.

[2] Form

Client Letter If Attorney Recommends Insurance Coverage

_____[*date*]
_____[*name*]
_____ [*title*]
_____ [*street address*]
_____ [*city, state, zip*]

Dear _____ [*name of client*]:

This letter will confirm our _____ [conversation *or* telephone conversation] of_____[*date*], in which we concluded that the following insurance coverage is advisable for your business: _____ [*list applicable coverages*].

[*If life insurance is to be used to fund a buy-sell agreement, use:*]

As we discussed, use of life insurance to fund a buy- sell agreement has the following advantages:

_____ [*list advantages*].

As we also discussed, it has the following disadvantages: _____ [*list disadvantages*].

It is important to meet with your insurance agent to choose and purchase the appropriate insurance policies to fund the agreement.

[*Choose one of the following paragraphs:*]

[*If attorney is to perform additional work, use:*]

I look forward to _____ [*specify work to be done, e.g.*, drafting the buy-sell agreement for your business].

[*If attorney's work is complete, use:*]

This letter will also confirm our _____ [conversation *or* telephone conversation] of_____[*date*], in which we agreed that, having assisted you in evaluating the insurance needs of your _____ [business *or* proposed business venture], _____ [my *or* our] work on this matter is now finished.

[*Continue with the following:*]

_____ [I *or* We] appreciate your confidence and having had the opportunity to serve you. If [I *or* we] can be of assistance in the future, please do not hesitate to call.

Very truly yours,

_____ [*signature*]

_____ [*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceGeneral OverviewLegal EthicsClient RelationsEffective Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART IV. FORMS

1-1F California Legal Forms--Transaction Guide § 1F.204

AUTHOR: Reviewed by Pam Boc

§ 1F.204 Checklist for Selecting Insurance Policy

[1] Comment--Use of Form

This form is a checklist that provides the attorney with a list of items to consider in helping to select the insurance policy itself, including policy limits, deductibles, coverage (including prior acts and extended reporting coverage), exclusions, notice and reporting provisions, and defense and settlement provisions. It also includes checklists regarding the application itself and the insurer's reliability. This checklist should be used in consultation with the business's insurance agent and accountant in selecting appropriate insurance coverage for a new business.

The attorney should review this checklist with the client before the client actually contacts his or her insurance agent to select the actual policies to satisfy the insurance needs of the business.

[2] Form

Checklist for Selecting Insurance Policy

Policy Limits

1. Property Insurance: Are the proposed per-claim limits and aggregate policy limits sufficient to protect the insured property?

2. Life, Health and Disability Insurance: Are the policy limits sufficient to provide adequate protection or to finance the purchase of business interests under a buy-sell agreement?

3. Liability Insurance: Are the proposed per-claim limits sufficient to cover likely financial exposure for a single claim?

4. Liability Insurance: Are the proposed aggregate limits of liability sufficient to protect the client's

assets, other business participants' assets, and the business's collective assets?

5. Liability Insurance: If the policy limits include defense costs, are the proposed policy limits sufficient to cover both the client's potential liability and his or her defense costs?

Policy Deductibles

1. Is the client willing and financially able to pay the amount of the proposed deductible in exchange for a reduction in premiums costs?

2. Are the policy limits in excess of, or includable in, the deductible?

Policy Coverage

1. Liability Insurance: Does the policy provide coverage for the business's employees?

2. Liability Insurance: Does the policy provide coverage for the client's potential vicarious liability for independent contractors or agents?

3. Liability Insurance: Does the policy provide coverage for employees hired during the policy period? Are there any conditions, limitations, or additional premiums for new employees?

4. Liability Insurance: Does the policy provide coverage on a claims made or an occurrence basis, or a combination thereof [*see § 1F.69 [4]*]?

5. Liability Insurance: Does the policy provide for a defense to malicious prosecution or defamation?

6. Directors and Officers Liability Insurance: Does the policy provide for directors and officers liability coverage, corporate reimbursement or indemnification coverage, or both [*see § 1F.61[4]*]?

7. Property Insurance: Is the policy open or valued [*see § 1F.51[2]*]?

8. Property Insurance: In addition to insuring the business's tangible property, has the client considered insuring intangibles, such as lost rental income, lost profits from damaged or destroyed crops, or anticipated profits from the construction of a building [*see § 1F.51[3]*?

9. Life Insurance: Does the client understand the advantages and disadvantages of term versus permanent insurance [*see §§ 1F.33, 1F.34*]?

10. Disability Insurance: In addition to personal disability insurance (such as income protection coverage), would the client benefit from, and can the client afford, business overhead insurance [*see § 1F.68[2]*]?

Prior Acts and Extended Reporting Options

1. Liability Insurance: Is the prior acts or extended reporting ("tail") coverage long enough to meet the client's needs?

2. Liability Insurance: Is the extended reporting option available if the client, rather than the insurance company, elects to cancel or not renew the policy?

3. Liability Insurance: Does the extended reporting option cover retired or otherwise non-practicing individuals?

Exclusions

1. What is the scope of the policy exclusions?

2. Does the policy exclude coverage for claims that are likely to arise from the client's business?

3. Does the policy have a territorial exclusion? (Is the coverage world-wide? Does the policy require that a claim or lawsuit be brought in the United States to trigger coverage?)

4. Professional Liability Insurance: Does the policy provide coverage for claims unrelated to the client's area of practice?

5. Is there another way to obtain excluded coverage (by way of endorsement, for example)?

6. If such coverage is available by endorsement, can the client narrow the policy coverage by way of endorsement and, thus, reduce the policy's premium?

Settlement and Defense Provisions

1. Is the client's consent required before the insurance company can settle a claim against the client?

2. Does the policy permit the client to participate in the selection of counsel? Is so, will the insurer allow the client to select only from among a list of specified attorneys?

3. Liability Insurance: does the policy provide coverage for actions against governmental or regulatory agencies?

Notice and Reporting Provisions

1. What is the period of cancellation by the insurance company [*see § 1F.19*]?

2. What are the insurer's notice requirements for cancellation or non-renewal [*see §§ 1F.19, 1F.22*]?

3. When must the insured give notice of cancellation [*see § 1F.18*]?

4. When must the insured give notice to the insurer of a claim?

The Insurance Application

1. Is the client aware that he or she must provide complete and accurate responses to every question on the insurance application?

2. Liability Insurance: Has the client disclosed circumstances that may give rise to claim?

3. Liability Insurance: If the client is changing insurers, has the client notified its present insurer of circumstances that may give rise to a claim?

Other Insurance Coverage

1. Has the client reviewed its existing insurance coverage to determine if there is any duplication of coverage among different policies?

The Insurer's Reliability

1. How long has the insurer been writing insurance in the United States and in California?

NOTE:

The California Department of Insurance will provide, on request, information on (1) whether an insurer is licensed to write insurance in California, (2) how long an insurer has been writing insurance in California, and (3) relative number of claims against an insurer compared to other insurers.

2. In what states is the insurer admitted? How long has the insurer been writing insurance in those states?

NOTE:

New York has the most stringent insurance regulations in the United States. Since New York enacted its Insurance Law of 1909, no insurance company licensed in New York is known to have gone bankrupt. Therefore, the client may want to consider obtaining an insurance policy from a company licensed to do business in New York.

3. Is the insurer financially sound?

NOTE:

Factors to consider include the insurer's Best Company rating (A+ preferred), Moody's, and Standard and Poor's claims-paying rates (AAA or AAA preferred); its reinsurance ratings; its capitalization; its current financial position and operating history; and the percentage of investment grade securities in the insurer's portfolio (if a whole life contract is being considered).

The insurer's performance can be determined by consulting *A.M. Best's Insurance Company Rating Guide*), an annual publication that summarizes certain financial, operating, and underwriting information about a large number of insurers, or *Standard and Poors Insurance Digest*, a quarterly publication that summarizes the rates and claim-paying abilities of some insurers.

4. What is the insurer's reputation for claims handling?

5. What is the insurer's reputation for underwriting flexibility?

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceGeneral OverviewLegal EthicsClient RelationsEffective Representation



130 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 1F INSURANCE CONSIDERATIONS IN BUSINESS FORMATION
PART IV. FORMS

1-1F California Legal Forms--Transaction Guide § 1F.205

AUTHOR: Reviewed by Pam Boc

§ 1F.205 Business General Liability Policy

[1] Comment

[a] Use of Form

This form is an illustration of a standard form of business general liability insurance policy, issued by the Insurance Services Office (ISO). It is reproduced here to give the attorney and client an idea of the provisions typically contained in a business liability policy.

For illustrations of other business general liability policies and extensive coverage of these policies, see California Insurance Law and Practice, Volume 3, Chapter 49, *Business General Liability Policies* (Matthew Bender).

[b] Importance of Business General Liability Policy

The general liability policy is the basic coverage used by a business to protect itself against claims by third parties. The function of this policy is to protect the business against loss arising out of legal liability to others for bodily injury or property damage. This type of policy does not negate the requirement to carry other mandatory or recommended types of insurance, including workers' compensation insurance, malpractice insurance, and directors and officers liability insurance [*see* California Insurance Law and Practice, vol. 3, Ch. 49, *Business General Liability Policies* , § 49.02 (Matthew Bender)].

For further coverage of commercial liability insurance, see *Section 1F.52[2]*.

[c] Claims Made Coverage and Occurrence Coverage

Standard general liability policies are printed in both "claims made" versions and "occurrence" versions. A claims made policy provides coverage for those claims reported to an insurer during the policy period. If a claim is not made until after the policy period has expired, the insurer has no liability [*Chamberlin v. Smith (1977) 72 Cal. App. 3d 835, 846,*

140 Cal. Rptr. 493] . An occurrence policy provides coverage for acts or omissions that take place during the policy period, regardless of when the claim is made [*VTN Consolidated, Inc. v. Northbrook Ins. Co. (1979) 92 Cal. App. 3d 888, 891, 155 Cal. Rptr. 172]* . For further discussion of the differences between these two types of coverage, see *Section 1F.69[4]*.

[2] Form

Business General Liability Policy

Please see Original Source or contact Editorial Support for assistance.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawClaims & ContractsClaims Made PoliciesCoverageInsurance LawClaims & ContractsClaims Made PoliciesOccurrence PoliciesInsurance LawGeneral Liability InsuranceGeneral OverviewInsurance LawGeneral Liability InsuranceCoverageGeneral OverviewInsurance LawGeneral Liability InsuranceOccurrences



131 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS

2-2 California Legal Forms--Transaction Guide 2.syn

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.syn Synopsis to Chapter 2: FORMATION OF CORPORATIONS

§ 2.01 California Sources

[1] Statutes

[2] Regulations

§ 2.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 2.03-2.04 [Reserved]

§ 2.05 Law Reviews and Periodicals

§ 2.06 Annotations

§ 2.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 2.08-2.09 [Reserved]

§ 2.10 Planning and Forming Corporation

[1] In General

[2] Consequences of Improper Incorporation

§ 2.11 Number and Sophistication of Incorporators or Investors

§ 2.12 Where to Incorporate

§ 2.13 Name of Corporation

[1] Choosing Corporate Name

[a] In General

[b] Restrictions on Corporate Names

[2] Reserving Corporate Name

[a] In General

[b] Checking Availability of Corporate Name

[c] Reserving Corporate Name

§ 2.14 Using a Fictitious Business Name

§ 2.15 Deciding Whether to Form Close Corporation

§ 2.16 Determining Purpose of Corporation

§ 2.17 Designating Initial Agent for Service of Process

§ 2.18 Capital Structure of Corporation

§§ 2.19-2.29 [Reserved]

§ 2.30 Using Incorporators and Promoters

[1] Incorporators

[2] Promoters

[a] Definition

[b] Fiduciary Duty of Promoter

[c] Liability of Promoter for Violation of Fiduciary Duty

[d] Promoter Compensation

§ 2.31 Preincorporation Agreements

§ 2.32 Subscription Agreements

[1] Overview

[2] Subscription Agreement Is a Security

[a] Need to Comply with Securities Laws

[b] Exemptions from Qualification in California

[c] Exemptions from Federal Registration

[d] Timing Considerations

[3] Preincorporation Subscription Agreements Not Binding

[4] Mandatory Use of Subscription Agreements in Connection With Impound Condition

§ 2.33 Preincorporation Agreements With Third Parties

[1] Overview

[2] Contract in Incorporator's Name Only

[3] Contracts Made on Behalf of Proposed Corporation

[4] Agreement Constituting Continuing Offer by Third Party

§§ 2.34-2.99 [Reserved]

§ 2.100 Facts

[1] Incorporators and Promoters

Scope

[2] Proposed Corporation

Scope

[3] Agent for Service of Process

[4] Financing for Proposed Corporation

Scope

[5] Future Shareholders

Scope

[6] Future Directors

Scope

[7] Future Officers and Employees

Scope

§ 2.101 Documents

Scope

§§ 2.102-2.109 [Reserved]

§ 2.110 Choosing Place of Incorporation

Scope

§ 2.111 Determining Whether to Form More Than One Corporation

Scope

§ 2.112 Determining Whether to Form Close Corporation

Scope

§ 2.113 Determining Effect of Income Taxation

Scope

§ 2.114 Determining Effect of Other Taxes

Scope

§ 2.115 Determining Organization of Corporation

Scope

§ 2.116 Determinations Related to Subscriptions and Subscription Agreements

Scope

§ 2.117 Determinations Related to Preincorporation Agreements

Scope

§ 2.118 Checklist of Incorporation Expenses

Scope

§§ 2.119-2.129 [Reserved]

§ 2.130 Planning Formation of Corporation

[1] Scheduling Formation of Corporation

Scope

[2] Corporate Formation Process

Scope

[3] Post-Incorporation Process

Scope

§ 2.131 Forming a Close Corporation

Scope

§ 2.132 Selecting and Reserving Corporate Name

[1] Selecting Proposed and Alternative Names

Scope

[2] Reserving Proposed Corporate Name

Scope

§ 2.133 Procedures Relating to Preincorporation Agreements

[1] Using Preincorporation Subscriptions (Offers But Not Sales of Securities)

Scope

[2] Using Subscription Agreement After Incorporation

Scope

[3] Using Preincorporation Contracts With Third Parties

Scope

§§ 2.134-2.139 [Reserved]

§ 2.140 Preincorporation Agreement Among Principals

Scope

§ 2.141 Preincorporation Contracts With Third Parties

Scope

§§ 2.142-2.199 [Reserved]

§ 2.200 Preincorporation Checklist

[1] Comment--Use of Form

[2] Form

Preincorporation Checklist

§ 2.200A Name Availability Inquiry Letter-Official Form

[1] Comment--Use of Form

[2] FORM

§ 2.201 Request for Reservation of Corporate Name--Official Form

[1] Comment--Use of Form

[2] Form

Request for Reservation of Corporate Name--Official Form

§ 2.202 Incorporators' Action Perfecting Corporation

[1] Comment

[a] Use of Form

[b] Authority for Action by Incorporators

[2] Form

Incorporators' Action Perfecting Corporation

§§ 2.203-2.209 [Reserved]

§ 2.210 Preincorporation Subscription Agreement With No Public Offering

[1] Comment

[a] Use of Form

[b] Contents of Subscription Agreements

[c] Nature of Subscription Agreements and Obligations of Subscribers

[d] Compliance With California Nonpublic Offering Requirements

[e] Limited Offering Exemption

[f] Small Offering Exemption

[g] Qualified Purchaser Offering Exemption

[h] Nonpublic Offers

[i] Exemption From Federal Securities Regulation

[j] Rule 144

[2] Form

Preincorporation Subscription Agreement With No Public Offering

§ 2.211 Subscription Agreement Provisions for Impound Condition

[1] Comment

[a] Use of Form

[b] Subscription Agreement Required

[c] Contents of Agreement

[d] Delivery of Copies

[2] Form

Subscription Agreement Provisions for Impound Condition

§ 2.212 Agreement Between Incorporators and Promoter for Solicitation of Subscriptions

[1] Comment

[a] Use of Form

[b] Characterization of Promoter as "Agent"

[c] Nature of Compensation

[d] Status of Agreement Under Securities Law

[e] Time for Performance

[2] Form

Agreement Between Incorporators and Promoter for Solicitation of Subscriptions

§ 2.213 Purchaser Questionnaire

[1] Comment--Use of Form

[2] Form

Purchaser Questionnaire

§§ 2.214-2.219 [Reserved]

§ 2.220 Agreement Between Incorporators and Organizer-Manager

[1] Comment

[a] Use of Form

[b] Enforceability of Preincorporation Agreement

[c] Issuance of Promotional Securities

[2] Form

Agreement Between Incorporators and Organizer-Manager

§§ 2.221-2.229 [Reserved]

§ 2.230 Preincorporation Agreement to Incorporate

[1] Comment

[a] Use of Form

[b] Contents of Agreement

[2] Form

Preincorporation Agreement to Incorporate

§§ 2.231-2.239 [Reserved]

§ 2.240 Agreement Indemnifying Director, Officer, or Agent

[1] Comment

[a] Use of Form

[b] Limitation or Elimination of Director's Liability

[c] Limitation or Elimination of Agent's Liability

[d] Attorneys' Fees to Prevailing Party in Enforcement Proceeding

[2] Form

Agreement Indemnifying Director, Officer, or Agent

§§ 2.241-2.249 [Reserved]

§ 2.250 Attorney Letter Advising Client Regarding Post-Incorporation Matters

[1] Comment--Use of Form

[2] Form

Attorney Letter Advising Client Regarding Post-Incorporation Matters

Marilyn E. Minger, Practice Consultantn*

FOOTNOTES:

(n5)Footnote *. Marilyn E. Minger is a sole practitioner in Oakland, California, specializing in business law, personal injury, bankruptcy, and probate. Ms. Minger formerly worked for Heller, Ehrman, White & McAuliffe and Pettit & Martin in San Francisco, where she practiced corporate law.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS

2-2 California Legal Forms--Transaction Guide Scope

AUTHOR: Marilyn E. Minger, Practice Consultant

Scope

Marilyn E. Minger, Practice Consultantn* Scope

This chapter sets forth the considerations and steps involved in planning and forming a corporation. It covers various issues and decisions involved in forming a corporation, and provides procedures and forms used in the corporate formation process. The chapter also discusses the use of preincorporation agreements to incorporate, preincorporation subscription agreements, and preincorporation agreements with third parties.

The Legal Background covers the legal and formal considerations in corporate formation, and the use of various types of preincorporation agreements. The Transaction Guide includes checklists of the relevant facts and documents to obtain from clients planning to form a corporation, the preliminary determinations to make at the preincorporation planning stage, procedural guides to the selection and reservation of a corporate name, preincorporation agreements, planning for incorporation, and planning for the formation of a close corporation. It also includes guides for drafting preincorporation agreements and lists procedures related and subsequent to the execution of preincorporation subscription agreements and contracts between the incorporators and third parties.

The forms section provides various forms related to preincorporation planning and actions, including an incorporation checklist, a request to reserve a corporate name, and a resolution perfecting the corporation. Subscription agreements, an investor questionnaire, a preincorporation agreement to incorporate, and an indemnity agreement are also included.

For a guide to the determinations that any new business, corporate or noncorporate, must make before beginning operations, see Chs. 1A through 1F. For a guide to the considerations involved in determining whether to incorporate or to conduct business in some form other than the corporate form, see Ch. 1B, *Selecting Form of Business Entity* . The steps that must be taken to incorporate a going business such as a partnership or sole proprietorship are detailed in Ch. 2A, *Incorporating a Going Business* .

FOOTNOTES:
(n6)Footnote *. Marilyn E. Minger is a sole practitioner in Oakland, California, specializing in business law, personal injury, bankruptcy, and probate. Ms. Minger formerly worked for Heller, Ehrman, White & McAuliffe and Pettit & Martin in San Francisco, where she practiced corporate law.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

2-2 California Legal Forms--Transaction Guide § 2.01

AUTHOR: Marilyn E. Minger, Practice Consultant

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Incorporation of unincorporated association. *Corp. Code § 200.5*.

Corporate names and reservation. *Corp. Code § 201*.

Required and optional provisions in articles of incorporation. *Corp. Code §§ 202, 204*.

Corporate powers. *Corp. Code § 207*.

Action by incorporators in lieu of initial directors. *Corp. Code § 210*.

Provisions pertaining to directors and management. *Corp. Code §§ 211-213*.

Provisions pertaining to bylaws. *Corp. Code §§ 300-317*.

Issuance of shares. *Corp. Code §§ 400, 401*.

Options to subscribe for corporate shares. *Corp. Code § 404*.

Consideration for issuance of shares. *Corp. Code § 409*.

Liability of subscribers to corporation for shares. *Corp. Code § 410*.

Shareholders' meetings. *Corp. Code §§ 600-605*.

Record and reports. *Corp. Code §§ 1500-1502*.

Criminal liability for signing fictitious name to subscription agreement. *Corp. Code §§ 2252, 2260*.

Preincorporation subscription agreement not involving a public offering. *Corp. Code § 25102(a)*.

Preincorporation subscription agreements involving a public offering. *Corp. Code § 25102(c)*.

Small offering exemption from securities qualification requirement. *Corp. Code § 25102(h)*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

2-2 California Legal Forms--Transaction Guide § 2.02

AUTHOR: Marilyn E. Minger, Practice Consultant

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Subchapter S corporation. I.R.C. §§ 1361-1378.

[2] Regulations

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

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AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 2.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART I. RESEARCH GUIDE
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2-2 California Legal Forms--Transaction Guide § 2.05

AUTHOR: Marilyn E. Minger, Practice Consultant

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-2 California Legal Forms--Transaction Guide § 2.06

AUTHOR: Marilyn E. Minger, Practice Consultant

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-2 California Legal Forms--Transaction Guide § 2.07

AUTHOR: Marilyn E. Minger, Practice Consultant

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Ch. 2B, *Electing Subchapter S Status*.

Ch. 3, *Articles of Incorporation*.

Ch. 4, *Bylaws*.

Ch. 5, *Directors' Meetings, Actions, and Resolutions*.

Ch. 6, *Securities Regulation Issues*.

Ch. 6I, *Issuance of Equity Securities*.

Ch. 6J, *Issuance of Debt Securities*.

Ch. 7, *Corporate Records and Reports*.

Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*.

Ch. 8B, *Voting Agreements and Voting Trusts*.

Ch. 8C, *Close Corporation Shareholder Agreements*.

Ch. 8D, *Buy-Sell Agreements*.

Ch. 12A, *Professional Corporations*.

Ch. 12B, *Foreign Corporations and Associations*.

Ch. 13, *Nonprofit Corporations*.

Ch. 14, *Consumer Cooperative Corporations*.

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Ch. 55, *The Promoter's Relationship With the Corporation to Be Formed*.

Ch. 56, *Preincorporation Transactions With Third Parties*.

Ch. 61, *Where to Incorporate*.

Ch. 62, *Conditions Precedent to and Mechanics of Forming and Starting a Corporation on a Going Basis*.

Ch. 68, *How Corporations Are Taxed*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-2 California Legal Forms--Transaction Guide §§ 2.08-2.09

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[Reserved]

§§ 2.08[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
A. Considerations and Steps Involved in Formation of Corporation

2-2 California Legal Forms--Transaction Guide § 2.10

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.10 Planning and Forming Corporation

[1] In General

This chapter is for use in the corporate planning and formation process once the decision has been made to form a corporation under the General Corporation Law [*see Corp. Code § 100*]. For a discussion of issues to consider in deciding whether to incorporate, see Ballantine & Sterling, California Corporation Laws, Ch. 2, *Choice of Form of Doing Business* . This chapter is not for use with nonprofit corporations [*see* Ch. 13, *Nonprofit Corporations*], cooperative corporations [*see* Ch. 14, *Consumer Cooperative Corporations* and Ch. 14A, *Agricultural Nonprofit Cooperative Associations*], or statutory close corporations [*see* California Small Business Guide (Matthew Bender)].

After the decision to incorporate has been made, the principals must:

- Decide where to incorporate [*see § 2.110*].
- Choose a corporate name [*see § 2.132*].
- Determine an appropriate purpose clause for the articles of incorporation [*see § 2.16*].
- Choose an initial agent for service of process [*see § 2.17*].
- Determine the identity, role and compensation of the incorporator or incorporators [*see § 2.30*].
- Determine whether to use and how to compensate a promoter or promoters [*see § 2.30*].
- Determine the corporate capital structure [*see § 2.18*].

- Determine the use and form of any preincorporation agreements, including agreements among shareholders, subscription agreements and preincorporation contracts with third parties [*see §§ 2.31-2.33*].

Generally, these decisions and determinations must be made before the articles of incorporation are filed. For discussion of preparing the articles of incorporation, see Ch. 3, *Articles of Incorporation* . For discussion of preparing bylaws, see Ch. 4, *Bylaws* .

Many organizational tasks will be carried out at the first, or organizational, meeting of the board of directors. For discussion of the procedure for this meeting and the issues to be covered, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* . The corporation also must make various decisions regarding accounting, including choosing an accounting period and an accounting method [*see § 2.115*, P 10, 11]. For more detailed coverage of bookkeeping, recordkeeping, and other filing and record requirements, see Ch. 7, *Corporate Records and Reports* . Requirements relating to shareholders are covered in Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

The procedures involved in incorporating a going business are covered in Ch. 2A, *Incorporating a Going Business* . For coverage of electing Subchapter S status, see Ch. 2B, *Electing Subchapter S Status* .

[2] Consequences of Improper Incorporation

Substantial compliance with the statutory requirements for incorporation will result in a *de jure* corporation, that is, a valid and operating corporation. If there is a failure to comply with all technical incorporation requirements, a *de facto* corporation may be created. A *de facto* corporation is created when there is:

- A law under which a corporation can be organized;
- A good faith attempt to organize the corporation under that law; and
- Actual use of the corporate powers.

A *de facto* corporation is entitled to act as any other corporation unless it is dissolved in an action brought by the Attorney General [*Westlake Park Inv. Co. v. Jordan (1926) 198 Cal. 609, 614, 618, 246 P. 807]* .

A complete failure to comply with incorporation requirements or a failure to follow corporate formalities [*see § 2.115*] can result in a finding that no corporation exists. In this situation, the limitation of liability for the shareholders will not be available, and the principals may be personally liable for the debts of the corporation [*see, e.g.,* *Minton v. Cavaney (1961) 56 Cal. 2d 576, 15 Cal. Rptr. 641, 364 P.2d 473]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeGeneral OverviewBusiness & Corporate LawCorporationsFormationPlace of IncorporationGeneral OverviewBusiness & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesPersonal LiabilityBusiness & Corporate LawCorporationsFormationDe Facto CorporationsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
A. Considerations and Steps Involved in Formation of Corporation

2-2 California Legal Forms--Transaction Guide § 2.11

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.11 Number and Sophistication of Incorporators or Investors

When a small number of principals with close business or personal relationships form a corporation, they may not see the need to commit their agreements to writing, though it is always a good idea to do so. As the number of investors or the amount of investment increases, however, written agreements and commitments with and by principals, shareholders and investors become essential.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
A. Considerations and Steps Involved in Formation of Corporation

2-2 California Legal Forms--Transaction Guide § 2.12

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.12 Where to Incorporate

After deciding to incorporate, the next key decision is deciding where to incorporate. A corporation may be incorporated in California and conduct business in California as a domestic corporation, or may incorporate elsewhere (such as Delaware or Nevada) and conduct business in California as a foreign corporation. Foreign corporations conducting business in California are subject to varying amounts of regulation, depending on the extent of the activities in the state and the residence of its shareholders [*see Corp. Code §§ 2101-2117.1*]. For further discussion, see Ch. 12B, *Foreign Corporations and Associations* .

In general, if the majority of the corporation's business will be conducted in California, there may be an advantage to incorporating in California based on weighing various factors, such as the costs of incorporation, tax considerations, jurisdictional issues, and the extent of regulation of the corporation. Incorporation elsewhere may be more appropriate, however, in some instances, such as when the business is a regional subsidiary of a national corporation. For a list of factors to consider in determining whether to incorporate in California or elsewhere, see *§ 2.110*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawCorporationsFormationPlace of IncorporationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
A. Considerations and Steps Involved in Formation of Corporation

2-2 California Legal Forms--Transaction Guide § 2.13

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.13 Name of Corporation

[1] Choosing Corporate Name

[a] In General

Prior to filing the articles of incorporation, a name must be chosen for the corporation. Generally, the principals select the corporate name on the basis of business and personal factors. The availability of the proposed name and alternate names should be checked with the Corporate Name Availability Unit of the office of the Secretary of State prior to submitting the articles of incorporation for filing. If it is anticipated that the corporation will conduct business in other states, the availability of the proposed name also should be checked in those states.

For a checklist to assist in choosing a corporate name, see *§ 2.132[1]*.

[b] Restrictions on Corporate Names

The Secretary of State will not file articles of incorporation bearing a name that is likely to mislead the public, or that is the same as, or resembles so closely as to tend to deceive, the actual or reserved name of a domestic corporation or a foreign corporation operating within California in compliance with California law [*see Corp. Code § 201(b)*].

Some additional restrictions on corporate names are as follows:

- The name of a corporation may not include the words "bank," "trust," "trustee," or related words unless approved by the Commissioner of Financial Institutions [*see Corp. Code § 201(a)*].

- If the business of the corporation is to be an insurer, the Insurance Commissioner must first approve the name [*see Corp. Code § 201.5*].

- Use of the word "cooperative" is restricted [*see Corp. Code § 12311(b)*; *Food & Agric. Code § 54036*].

- If the corporation is a close corporation pursuant to *Corp. Code § 158*, the name must include the word "corporation," "incorporated," "limited," or an abbreviation of one of these [*Corp. Code § 202(a)*].

Certain types of corporations have additional name requirements. These include dental corporations [*see Bus. & Prof. Code § 1804*], medical corporations [*see Bus. & Prof. Code §§ 2285, 2415*], architectural corporations [*see Bus. & Prof. Code § 5536*], engineering corporations [*see Bus. & Prof. Code § 6738*], and law corporations [*see Bus. & Prof. Code § 6171*].

Federal law also imposes name restrictions. The terms "national," "Federal," "United States," "reserve," "Deposit Insurance," and other terms associated with the federal government may not be used in corporate names [*see 18 U.S.C. § 709*]. In addition, use of words and symbols relating to the Olympics may not be used without permission of the United States Olympic Committee [*see 36 U.S.C. § 380*].

For a detailed list of terms and words that may not be used in a corporate name, see *§ 2.132[1]*.

The Secretary of State's office has made available online general information on name availability [*see* http://www.sos.ca.gov/business/corp/corp_naav2.htm#geninfo].

[2] Reserving Corporate Name

[a] In General

A corporate name may be reserved through the Corporate Name Availability Unit of the office of the Secretary of State for a period of 60 days upon payment of the applicable fee [*Corp. Code § 201(c)*; *see Gov. Code § 12186(a) (fee)*]. The same name (or a similar one) may not be reserved by the same applicant or on behalf of the same person, partnerships, firm, or corporation for additional 60-day periods over the course of a business day, between reservation periods [*Corp. Code § 201(c)*]. For a procedural guide to checking and reserving a corporate name, see *§ 2.132[2]*.

[b] Checking Availability of Corporate Name

The availability of a corporate name may be checked with the Secretary of State's office in the following ways [*see* Secretary of State's website at http://www.sos.ca.gov/business/corp/corp_naav2.htm#resv]:

- **By mail.** Completing and mailing a Name Availability Inquiry Letter to the Secretary of State's office in Sacramento. [*see § 2.200A* (form) (no fee)].

- **Through prepaid account.** A Prepaid Priority Account may be established with the office of the Secretary of State whereby the holder may telephone the office of the Secretary of State via priority telephone lines to check on the availability of a corporate name. For each such request the caller's account is debited $4.

Email and online inquiries are not currently available.

Checking the availability of a corporate name does not reserve, or confer any rights to, the name; nor does it have any binding effect on the Secretary of State.

[c] Reserving Corporate Name

A corporate name may be reserved for 60 days as follows [*see* Secretary of State's website at http://www.sos.ca.gov/business/corp/corp_naav2.htm#resv]:

- **By written request.** A completed Name Reservation Request form [*see § 2.201* (information and form)] accompanied by a stamped, self-addressed envelope, may be mailed to the Secretary's Sacramento office. The completed form must be accompanied by a $10 fee.

- **In Person (Over the Counter).** A corporate name may be reserved by submitting a completed Name Reservation Request form [*see § 2.201* (information and form)] in person either at the main office of the Secretary of State in Sacramento or at one of the Secretary's offices in Fresno, Los Angeles, San Diego, or San Francisco. In addition to the $10 per name reservation fee, a $10 special handling fee per reserved name must be remitted separately and will be retained whether the proposed name is accepted or denied for reservation [*see 2 Cal. Code Reg. § 21903(b)(3), (c)(3)* (fees)].

- **By Prepaid Account.** A prepaid account may be established with the office of the Secretary of State whereby the holder may telephone the office of the Secretary of State via priority telephone lines to reserve a corporate name. For each such reservation the caller's account will be debited $10 plus $4 per name if the availability of potential names is checked [*see 2 Cal. Code Reg. § 21903(b)(3), (c)(3)* (fees)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesGeneral OverviewBusiness & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawCorporate NamesFictitious NamesRegistration Requirements



144 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
A. Considerations and Steps Involved in Formation of Corporation

2-2 California Legal Forms--Transaction Guide § 2.14

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.14 Using a Fictitious Business Name

A corporation may wish to conduct business under a fictitious business name if, for example, the desired corporate name is unavailable but use of the name would not otherwise create problems, or if the corporation wishes to create a perceived local or regional connection with the name. When used by a corporation, a "fictitious business name" is any name other than the corporate name stated in the articles of incorporation [*Bus. & Prof. Code § 17900(b)(3)*].

If a corporation intends to regularly transact business for profit in California under a fictitious business name, it must file a fictitious business name statement with the clerk of the county in which it has its principal place of business [*Bus. & Prof. Code §§ 17910, 17915*; *see Bus. & Prof. Code § 17913* (form for fictitious business name statement)]. The statement must be signed by an officer of the corporation [*Bus. & Prof. Code § 17914*].

For further discussion and a fictitious business name statement, see Ch. 1A, *Role of Counsel in Starting a New Business* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesRegistration RequirementsBusiness & Corporate LawCorporate NamesFictitious NamesConducting Business Under Fictitious Names



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
A. Considerations and Steps Involved in Formation of Corporation

2-2 California Legal Forms--Transaction Guide § 2.15

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.15 Deciding Whether to Form Close Corporation

Before incorporating, the incorporators will want to determine whether or not to incorporate as a close corporation. A "close corporation" in California is one whose articles of incorporation contain, in addition to the provisions required by *Corp. Code § 202* [discussed in *§ 2.16* et seq.], the following provisions [*Corp. Code § 158(a)*]:

- All of the corporation's issued shares of all classes will be held of record by not more than a specified number of persons, not greater than 35; and

- "This corporation is a close corporation."

Close corporation status may be desirable if the principals wish to operate the corporation as if it were a partnership, or if they wish to avoid certain corporate formalities [*see § 2.112*].

Close corporation status may be elected at the time of the corporation's initial incorporation, or a corporation may attain close corporation status by later amendment of the articles of incorporation [*Corp. Code § 158(b)*]. If shares have been issued prior to conversion to close corporation status, the articles may be amended to include close corporation provisions only after the affirmative vote of all of the issued and outstanding shares of all classes [*Corp. Code § 158(b)*]. Close corporation status may be canceled by amending the articles of incorporation after appropriate approval by the shareholders [*see Corp. Code § 158(c)*].

For a list of factors to consider in determining whether to adopt close corporation status, see *§ 2.112*. For a procedural guide to forming a close corporation, see *§ 2.131*. For more detailed discussion of close corporations, see Ballantine & Sterling, California Corporation Laws, Ch. 4, *Close Corporations* , and California Small Business Guide (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawClosely Held CorporationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
A. Considerations and Steps Involved in Formation of Corporation

2-2 California Legal Forms--Transaction Guide § 2.16

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.16 Determining Purpose of Corporation

The articles of incorporation must include a statement concerning the purpose of the corporation [*Corp. Code § 202(b)*]. The purpose of a corporation may be to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law (with certain exceptions) [*see Corp. Code § 202(b)(1)(i)*], or may be specifically tailored to the profession in which the corporation will engage [*see Corp. Code § 202(b)(1)(ii)*]. Corporations in particular businesses, such as banking and insurance, must comply with additional purpose-clause requirements [*see Corp. Code § 202(b)(2), (3)*]. Similarly, if the corporation is intended to be a professional corporation, the articles must also contain a statement to that effect [*Corp. Code § 202(b)(4)*; *see Corp. Code § 13404* (content); *see also* Ch. 12A, *Professional Corporations*].

PRACTICE TIP:

Generally the articles of incorporation of corporations organized under the General Corporation Law state that the purpose of the corporation is to engage in any lawful act or activity. There is no advantage to be gained from limiting the purpose of the corporation, and a broad purpose statement allows the corporation to engage in different types of business without first having to amend its articles of incorporation. For examples of various purpose clauses, see Ch. 3, *Articles of Incorporation* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurposeBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
A. Considerations and Steps Involved in Formation of Corporation

2-2 California Legal Forms--Transaction Guide § 2.17

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.17 Designating Initial Agent for Service of Process

A corporation's articles of incorporation must set forth the name of the corporation's initial agent for service of process [*Corp. Code § 202(c)*]. The agent must be either a natural person residing in California or a corporation that has complied with *Corp. Code § 1505(b)* and whose capacity to act as an agent has not terminated [*Corp. Code §§ 202(c), 1502(b)*].

When designating an individual as the agent, the complete address, not a post office box, of the agent must be stated. When designating a corporation as agent, the address should not be stated [Office of Secretary of State, State of California, Guide to Corporate Filings 44-45 (1995-1996 ed.)].

For a complete set of articles of incorporation, including a clause appointing an agent for service of process, see Ch. 3, *Articles of Incorporation* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
A. Considerations and Steps Involved in Formation of Corporation

2-2 California Legal Forms--Transaction Guide § 2.18

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.18 Capital Structure of Corporation

In order to carry on its business, a corporation needs to acquire certain assets and services. The principals must determine what assets and services are needed and how the corporation will pay for those assets and services. Generally, assets and services may be acquired either in exchange for securities of the corporation, on credit or for cash. If the assets and services are going to be acquired for cash, the principals must determine how the corporation is going to generate the cash. Generally, cash can be generated by selling shares of the corporation [*see* Ch. 6I, *Issuance of Equity Securities*], selling debt securities of the corporation [*see* Ch. 6J, *Issuance of Debt Securities*] or borrowing.

Consequently, the principals must determine the classes of shares, the number of shares to be authorized, the rights attendant to those shares, the number of shares to be issued, and the par value of the shares.

If the corporation is authorized to issue only one class of shares, the total number of shares that the corporation is authorized to issue must be set forth in the articles of incorporation [*Corp. Code § 202(d)*]. If the corporation is authorized to issue more than one class of shares, or if any class of shares is to have more than one series, the articles of incorporation must either (1) fix the authorized number of shares in that class or series and the rights, preferences and privileges of the respective classes or series, or (2) authorize the board, within any limits stated, to determine or alter the number and rights, preferences and privileges of any class or series of wholly unissued shares [*Corp. Code § 202(e)*].

If the rights, preferences, privileges and restrictions of any class or series of shares are not set forth in the articles of incorporation, the board, if authorized by the articles, may pass a resolution and file it with the Secretary of State in a Certificate of Designation setting forth the number of shares of a class or series, and the rights, preferences and privileges attached to that class or series, if no such shares have been issued [*Corp. Code § 401*; *see also § 2.130[3]*P*[6]*.

For further discussion of capital structure and issuance of securities, see Ch. 6, *Securities Regulation Issues* , and Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
A. Considerations and Steps Involved in Formation of Corporation

2-2 California Legal Forms--Transaction Guide §§ 2.19-2.29

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[Reserved]

§§ 2.19[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
B. Preincorporation Agreements and Activities

2-2 California Legal Forms--Transaction Guide § 2.30

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.30 Using Incorporators and Promoters

[1] Incorporators

The person or persons who perform the initial acts to establish the corporate identity of the corporation, such as preparing and filing the articles of incorporation, are the incorporators of the corporation. If initial directors are not named in the articles of incorporation, each incorporator must sign and acknowledge the original articles of incorporation [*see Corp. Code § 200(b)*]. An incorporator may be a natural person, a partnership, an association, or a corporation [*see Corp. Code § 200(a)*].

The incorporator or incorporators may be principals with an interest in the corporation, or may be an attorney, paralegal or other person hired to perform the mechanics of establishing the corporation.

[2] Promoters

[a] Definition

A "promoter" is a person who brings about the incorporation and organization of a corporation. He or she is the person who brings together the people who become interested in the enterprise, aids in procuring subscriptions, and sets in motion the machinery leading to formation of the corporation itself, or who takes part in the acts that lead to formation of a corporation [*see Dickerman v. Northern Trust Co. (1900) 176 U.S. 181, 203-204, 20 S. Ct. 311, 44 L. Ed. 423* ; *see also MacDonald v. Arrowhead Hot Springs Co. (1931) 114 Cal. App. 496, 500, 300 P. 105]* .

Promoters may be persons with an interest in the new corporation or they may be hired by the principals to assist in obtaining subscriptions to buy stock in the new corporation.

For further discussion of promoters, see Ballantine & Sterling, California Corporation Laws, Ch. 3, *Formation of Corporations* (Matthew Bender).

[b] Fiduciary Duty of Promoter

A promoter owes a fiduciary duty to:

- Persons whom the promoter solicits to become a subscriber to shares of the new corporation [*California-Calaveras Min. Co. v. Walls (1915) 170 Cal. 285, 298-299, 149 P. 595]* ;
- The corporation [*Burbank v. Dennis (1894) 101 Cal. 90, 97, 35 P. 444]* ; and
- Co-promoters [*Bellus v. Peters (1913) 165 Cal. 112, 116, 130 P. 1186]* .

[c] Liability of Promoter for Violation of Fiduciary Duty

If a promoter violates his, her, or its fiduciary duty, transactions induced by the promoter may be set aside and the promoter will be liable for the losses suffered by the other party [*see Lance v. Forsberg (1951) 106 Cal. App. 2d 226, 231, 234 P.2d 662* ; *Lomita Land and Water Co. v. Robinson (1908) 154 Cal. 36, 45, 97 P. 10]* . Co-promoters who perpetrate a fraud on the corporation are joint tortfeasors, and are jointly and severally liable [*Lomita Land and Water Co. v. Robinson (1908) 154 Cal. 36, 46, 97 P. 10]* .

Promoters may also be subject to criminal liability for certain fraudulent acts regarding stock subscriptions [*see Corp. Code §§ 2251, 2252*].

[d] Promoter Compensation

A corporation may legally reimburse a promoter for preincorporation services and the organizational expenses incurred before incorporation. Compensation may be given in the form of:

- Shares of the corporation [*see Corp. Code § 409(a)(1)*; *see also Nakashima v. Muth (1970) 10 Cal. App. 3d 966, 969, 89 Cal. Rptr. 495]* ;
- Money [*see McSherry v. The Market Corporation (1933) 129 Cal. App. 330, 332, 18 P.2d 776]* ;
- A contract for employment [*see Trumbo v. Bank of Berkeley (1947) 77 Cal. App. 2d 704, 709, 176 P.2d 376]* ; or
- Any combination of the above [*see Weinstock v. L.A. Carpet, Inc. (1965) 234 Cal. App. 2d 809, 811, 44 Cal. Rptr. 852]* .

PRACTICE TIP:
An agreement between the incorporators and a promoter may be enforced against the corporation and, as a matter of good practice, such an agreement should clearly specify the amount to be paid to the promoter and the method by which payment will be made [*see Chater v. San Francisco Sugar Refining Co. (1861) 19 Cal. 219, 246* ; *see also § 2.220[1][b]*]. *Commentary by Marilyn E. Minger.*

For further discussion of compensation of promoters and reimbursement for preincorporation services and expenses, see Cavitch, BUSINESS ORGANIZATIONS, Ch. 55, *The Promoter's Relationship With the Corporation to Be Formed* (Matthew Bender), and Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 3, *Formation of Corporations* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
B. Preincorporation Agreements and Activities

2-2 California Legal Forms--Transaction Guide § 2.31

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.31 Preincorporation Agreements

A preincorporation agreement is a contract entered into by the persons who intend to organize a corporation and become its initial shareholders. It sets forth their rights and liabilities as among themselves, rather than between themselves and the corporation.

A preincorporation agreement is certainly desirable for persons who do not have a well-established business relationship, especially when substantial funding will be required to launch the business or the preincorporation activities are very complex, but is also useful when the principals are all members of the same family or close friends or business associates. A properly drafted preincorporation agreement can prevent later dissension or litigation. Moreover, it is useful to include the bargain of the parties in the preincorporation agreement in order to ensure contractual liability if one of the principals seeks to avoid incorporation. In addition, when subscriptions are to be sought from third parties, the preincorporation agreement may be the only document that the subscribers can rely on as evidence of what they can expect from their subscription.

Preincorporation agreements may address the following:

- **Parties' roles.** Define the parties' role and compensation as promoters.

- **Employment.** Spell out any employment commitments to the parties and the terms of the employment [*see § 2.220*].

- **Future funding.** Set forth the obligations each person has to contribute future funding, the proportion of the funding that each will contribute, and the method by which the investments will be made, whether by stock purchase, loans, or outright contribution.

- **Stock transfer.** Spell out restrictions on stock transfer. These restrictions may be spelled out in the

articles of incorporation, bylaws or in post-incorporation shareholders' agreements. However, it may be prudent, and even required by some or all of the principals, to have these restrictions specified in writing before incorporation.

- **Trade secret protection.** Protect or provide for the contribution of a trade secret or processor other asset to be contributed to the business.

- **Other agreements.** Place in writing any part of the bargain between the principals that would not, in the ordinary course of business, be contained in the articles, the bylaws, or the written actions or resolutions of the directors or shareholders.

For a guide to drafting a preincorporation agreement, see *§ 2.140*. A preincorporation agreement to incorporate is set forth in *§ 2.230*. For further discussion of preincorporation agreements, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 3, *Formation of Corporations* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
B. Preincorporation Agreements and Activities

2-2 California Legal Forms--Transaction Guide § 2.32

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.32 Subscription Agreements

[1] Overview

A subscription agreement is an agreement to take stock in a corporation [*see Brown v. North Ventura Road Dev. Co. (1963) 216 Cal. App. 2d 227, 233, 30 Cal. Rptr. 568]* . Subscription agreements are most frequently used in connection with offerings made to individuals who have no preexisting business or personal ties with the promoters. Use of a subscription agreement is mandatory when the Commissioner of Corporations imposes an impound condition on an offering of securities [*10 Cal. Code Reg. § 260.141.22(a)*].

Because preincorporation agreements are not binding on a corporation until after it has been formed and has accepted the agreements made on its behalf prior to incorporation [*see* [3], *below*], it is probably more advantageous, especially in the case of large offerings, to form the corporation (by filing the articles of incorporation) before soliciting any subscriptions for shares. This enables the corporation to accept subscriptions immediately on receipt.

[2] Subscription Agreement Is a Security

[a] Need to Comply with Securities Laws

A subscription agreement is a "security" under the Corporate Securities Law [*Corp. Code § 25019*] and under the Securities Act of 1933 [*15 U.S.C. § 77b(a)(1)*]. Offers of securities (that is, attempts or offers to dispose of, or solicitation of offers to buy securities [*Corp. Code § 25017(b)*; *15 U.S.C. § 77b(a)(3)*]) must be qualified under California law and registered under federal law unless they are specifically exempted or are not subject to qualification [*Corp. Code § 25110*; *15 U.S.C. § 77e*]. In addition, if securities are being offered to persons who are residents of states other than California, the securities laws of those states should be reviewed and complied with.

PRACTICE TIP:
Exemptions from registration and qualification under securities laws often turn on the financial status of

some if not all of the purchasers. When they do, an issuer must know the financial status of potential investors and should require each investor to complete an investor questionnaire such as the one set out in *§ 2.213*. *Commentary by Marilyn E. Minger*.

[b] Exemptions from Qualification in California

The solicitation of subscriptions incident to the formation of a corporation for which the number of shareholders will be limited may be exempt from qualification in California under the following exemptions:

- Small offering exemption [*see Corp. Code § 25102(h)*; *see also* Ch. 6C, *California Small Offering Exemption*];
- Limited offering exemption [*see Corp. Code § 25102(f)*; *see also* Ch. 6B, *California Limited Offering Exemptions*]; or
- Qualified purchaser offering exemption [*see Corp. Code § 25102(n)*; *see* Ch. 6D, *California Qualified Purchaser Exemptions*].

In addition, *Corp. Code § 25102(a)* exempts nonpublic offers, but not sales, from qualification if the offer contains language required by statute and if no consideration for the securities is paid or received until the securities are issued under a permit [*Corp. Code § 25102(a)*]. See *§ 2.210* for further discussion.

[c] Exemptions from Federal Registration

The solicitation of subscriptions incident to the formation of a corporation for which the number of shareholders will be limited may be exempt from registration under federal law pursuant to the following exemptions:

- Intrastate offering exemption [*15 U.S.C. § 77c(a)(11)*];
- Private offering exemption [*15 U.S.C. § 77d(2)*];
- Limited and private offerings under Regulation D [*17 C.F.R. §§ 230.501-230.508*]; or
- Exemption for offers and sales solely to accredited investors as defined in *15 U.S.C. § 77b(a)(15)* and *17 C.F.R. § 230.215* [*15 U.S.C. § 77d(6)*].

[d] Timing Considerations

If the offer of securities does not qualify for an exemption, the principals must determine at what stage in the process they need to qualify or register the securities. Three stages in the financial planning of a corporation can be identified along a continuum as follows:

- Preliminary business discussions between principals and potential investors regarding whether to organize, how to organize, and whether there is any prospect of financial assistance from possible investors;
- Offers to sell securities, or solicitation of offers to buy securities; and
- The actual sale of securities.

Qualification and registration may not be required for the exchange of views or preliminary discussions before a fixed plan of operation and financing has been determined [*see B.C. Turf & Country Club v. Daugherty (1949) 94 Cal. App. 2d 320, 329-331, 210 P.2d 760]* . However, further discussions could be interpreted as offers of securities and may be subject to qualification and registration requirements.

For a more detailed discussion of the qualification and registration of securities, see Ch. 6, *Securities Regulation Issues* , and Ch. 6H, *Qualification of Securities* . For additional discussion, see Marsh and Volk, Practice Under the California Securities Laws (Matthew Bender). For further discussion of the small offering and limited offering exemptions, see Ch. 6B, *California Limited Offering Exemptions* , and Ch. 6C, *California Small Offering Exemption* . For further discussion of securities laws, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 10, *Transfer and Registration of Securities* (Matthew Bender).

[3] Preincorporation Subscription Agreements Not Binding

Generally a preincorporation subscription constitutes merely a continuing offer to purchase stock in a corporation, and is not binding on the corporation until the corporation is formed and accepts the offer [*see Marysville etc. Co. v. Johnson (1892) 93 Cal. 538, 546, 29 P. 126* ; *see also Hoppe v. Rittenhouse (9th Cir. 1960) 279 F.2d 3, 8]* . Consequently, a subscription may be withdrawn at any time before the proposed corporation is formed and takes some action to accept the offer. Thus, the principals should be advised of the need to have the agreements accepted immediately after formation of the corporation by resolution of the board of directors.

For further discussion of subscription agreement, see Cavitch, BUSINESS ORGANIZATIONS, Ch. 86, *Stock Subscriptions* (Matthew Bender).

[4] Mandatory Use of Subscription Agreements in Connection With Impound Condition

In certain securities offerings the Commissioner of Corporations will require that funds received pursuant to the offering be placed in an escrow account until all funds necessary to finance the proposed undertaking are received by the offerors [*10 Cal. Code Reg. §§ 260.141.20, 260.141.21*]. When such an impound condition is imposed on an offering, the use of a subscription agreement is mandatory [*10 Cal. Code Reg. § 260.141.22(a)*]. The form of the subscription agreement must be approved by the Commissioner, and must contain certain specified information [*10 Cal. Code Reg. § 260.141.22*].

When an impound condition has been imposed, the issuer may not issue any certificates or other evidence of securities until the impound condition has been satisfied and the impound funds have been released to the issuer. All checks must be made payable to the depositary or to a licensed broker-dealer as the selling agent. All funds received from the sale, including any amounts allowed as selling expenses, must be placed in a separate escrow account with an approved depositary within 48 hours of receipt [*10 Cal. Code Reg. §§ 260.141.21, 260.141.23(a)*]. Normally the depositary will be a national bank located in California or a California bank [*10 Cal. Code Reg. § 260.141.23(a)*; *see* 10 Cal. Code Reg. § 260.140.23(b) (contents of application for approval of depositary and minimum contents of agreement between issuer and depositary)].

The Commissioner will authorize the depositary to release the impound funds to the issuer when the full amount of impound funds specified in the impound condition has been deposited and any other conditions to the release have been satisfied, unless there have been changes in the plan of operation or in other circumstances that would render the impound funds inadequate, or circumstances have changed so that the Commissioner could no longer find that the sale would be fair, just, and equitable [*10 Cal. Code Reg. § 260.141.24(a)*; *see 10 Cal. Code Reg. § 260.141.24(b)* (contents of application by issuer to release impound funds)]. The Commissioner may approve a partial release of impound funds in unusual cases [*see 10 Cal. Code Reg. § 260.141.24(d)*].

If the specified amount of impound funds has not been obtained as of the date specified in the impound condition, or on the earlier issuance of a stop order or an order suspending or revoking the qualification permit, the Commissioner will issue an order directing the depositary to return to each subscriber the amount of each subscriber's payment [*10 Cal. Code Reg. § 260.141.25(a)*]. Extensions of time may be granted in unusual cases [*see 10 Cal. Code Reg. § 260.141.25(b)*].

The Commissioner has discretion to grant variances from these requirements. An issuer that desires a variance must submit a verified request for variance [*see 10 Cal. Code Reg. § 260.141.27*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawExemptions From RegistrationIntrastate Offerings & RecapitalizationsSecurities LawExemptions From RegistrationSmall Issue ExemptionsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscriber RightsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscription AgreementsSecurities LawAdditional Offerings & the Securities Exchange Act of 1934Registration RequirementsSecurities LawBlue Sky LawsSecurities Exempt From RegistrationSecurities LawExemptions From RegistrationExempt TransactionsRegulation D Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
B. Preincorporation Agreements and Activities

2-2 California Legal Forms--Transaction Guide § 2.33

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.33 Preincorporation Agreements With Third Parties

[1] Overview

In the preincorporation planning stage, the incorporators may have occasion to enter into agreements with third parties for services to be performed for or on behalf of the corporation before or after its incorporation. These agreements include contracts for financing, subscriptions to shares, the acquisition or lease of property, the acquisition of patents, copyrights, or trade secrets, and the employment of key personnel.

The promoter forming the contract on behalf of the corporation may have varying degrees of liability depending on his or her role in the contract.

[2] Contract in Incorporator's Name Only

When the contract is entered into by an incorporator in his or her own name (whether that person is a principal or a professional hired by the principals) without reference to a contemplated corporation, the incorporator will be personally liable on the contract, as in normal contract situations [*see Shell Oil Co. v. Hanchett (1936) 18 Cal. App. 2d 240, 243, 63 P.2d 338]* . Such a contract should allow for assignment of the contract by the incorporator to the corporation.

The corporation, when it is established, may assume liability of the contract by ratifying or adopting the obligation. In the absence of a novation, however, the incorporator is not necessarily relieved of his or her obligation under the contract [*see Berk v. Twentynine Palms Ranchos, Inc. (1962) 201 Cal. App. 2d 625, 635, 20 Cal. Rptr. 144* ; *Biggart v. Lewis (1920) 183 Cal. 660, 667, 192 P. 437]* . Accordingly, this type of contract should be avoided by the incorporator if possible. Third parties, however, may insist on this kind of arrangement.

[3] Contracts Made on Behalf of Proposed Corporation

An incorporator may contract with a third party in the incorporator's name but with the express stipulation or disclosure that the incorporator is acting on behalf of the proposed corporation and that the corporation is to perform the contract. Because the corporation is not in existence at the time the agreement is entered into, however, it may not become bound or liable thereunder unless it ratifies the agreement either expressly or impliedly by performance or willful and knowing acceptance of its benefits. Conversely, the incorporator may be held personally liable even if the proposed corporation is actually incorporated and then adopts the agreement [*see Shell Oil Co. v. Hanchett (1936) 18 Cal. App. 2d 240, 243, 63 P.2d 338]* . This liability may be negated by novation, but it should also be addressed by express limitations set forth in the contract.

[4] Agreement Constituting Continuing Offer by Third Party

The incorporator may enter into an agreement in the name of the corporation without actually becoming a party to the contract. In this type of contract, it is made entirely clear that the corporation, if and when it is formed, will be solely responsible for performance under the contract. Such agreements may be treated as continuing offers that do not ripen into a legally binding contract until accepted by the corporation after its incorporation. The incorporator can avoid being bound under this type of contract if the corporation, when formed, will have power to ratify or adopt it [*see MacDonald v. Arrowhead Hot Springs Co. (1931) 114 Cal. App. 496, 501, 300 P. 105]* . In the preincorporation planning stage, therefore, the incorporators should use this type of contract whenever possible.

There is often a problem of establishing that the incorporator intended, and the other contracting party understood and agreed, that the incorporator was not to be personally liable on the contract, but that only the future corporation was to be bound, if and when it came into existence. In preincorporation transactions, the corporation is not in existence and thus is not and cannot be an original party to the contract even if the incorporator purports to act in the name of the nonexistent corporation. Thus, the incorporators should be advised to make clear in the written contract itself that the contracting party is fully aware that only the future corporation will be liable and then only after it ratifies or adopts the contract.

In the majority of situations, the corporation's board of directors will assume liability by taking some positive action, whether by accepting the benefits of the contract and impliedly ratifying it, by adopting or ratifying it through novation, or by accepting the continuing offer embodied in the agreement [*see, e.g., Biggart v. Lewis (1920) 183 Cal. 660, 667, 192 P. 437]* . However, in the planning stage, the incorporators should assure such a result by assuring their control over the corporation through the distribution of voting stock among themselves.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



154 of 192 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART II. LEGAL BACKGROUND
B. Preincorporation Agreements and Activities

2-2 California Legal Forms--Transaction Guide §§ 2.34-2.99

AUTHOR: Marilyn E. Minger, Practice Consultant

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§§ 2.34[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
A. Facts and Documents

2-2 California Legal Forms--Transaction Guide § 2.100

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.100 Facts

[1] Incorporators and Promoters

1. Name, address, telephone number, and background of each principal or incorporator [*see* [5], [6], *below*].

2. Name, address, telephone number, and background of each person performing promotion work.

NOTE:

Promotion work includes the procurement of preincorporation subscriptions and the work done in forming a corporation [***see*** *Dickerman v. Northern Trust Company (1900) 176 U.S. 181, 203-204, 20 S. Ct. 311, 44 L. Ed. 423* ; ***see also*** *MacDonald v. Arrowhead Hot Springs Co. (1931) 114 Cal. App. 496, 500, 300 P. 105]* .

3. Persons responsible for paying for promotion work if:

a. Corporation is formed;

b. Corporation is not formed; or

c. Corporation refuses to compensate promoter.

[2] Proposed Corporation

1. Proposed name for corporation and three alternative names.

NOTE:
For a discussion of the steps involved in the selection and reservation of a corporate name, see *§ 2.132*. For a form for a request to reserve a corporate name, see *§ 2.201*.

2. Additional fictitious business names (that is, names other than exact corporate name) under which corporation will do business in California, and counties where business will be transacted under those names.

NOTE:
For further discussion of fictitious business names, see *§ 2.14*. For illustration of the forms to use to file a fictitious business name statement, see Ch. 1A, ***Role of Counsel in Starting a New Business*** .

3. Location of proposed corporation:

a. Address, including county, and telephone number of principal executive office.

b. Address, including state and/or county, and telephone number of each other office or place where business is to be conducted.

4. Operation of proposed corporation:

a. General proposed method of doing business or principal types of business to be conducted.

b. Related activities of corporation.

c. Type of activities to be conducted in each office or place of business where business is to be conducted.

d. Initial operating capital requirements of corporation (that is, for first six to 12 months).

e. Estimated amount and sources of income for first year.

f. Federal, state, and local business licenses or registrations required.

g. Number of employees proposed for each location.

h. Officer or employee in charge of each location.

5. Description and location of real property that will be owned by corporation.

6. Description and location of premises to be leased, term of lease, and name and address of lessor.

7. Description, value, and tax basis of major assets owned or to be acquired.

8. Name, address, and telephone number of accountant.

9. Name, address, and telephone number of insurance carriers and brokers.

10. Name and address of each bank, and name of bank officer or employee dealt with.

11. Accounting year proposed (that is, calendar year or other).

12. Accounting method to be used (that is, cash or accrual).

13. Date that principals desire business to commence in corporate form.

14. Date proposed for transfer of assets of going business to corporation [*see* Ch. 2A, *Incorporating a Going Business*].

[3] Agent for Service of Process

Name and address of initial agent for service of process.

PRACTICE TIP:

There are corporate agents that will act as an agent for a nominal fee. Use of a corporate agent assures the corporation of continuity in this area. Corporate agents often provide other services useful to corporations, including maintaining corporate filings with the Secretary of State. *Commentary by Marilyn E. Minger.*

[4] Financing for Proposed Corporation

1. Sources from which required funds will be obtained and amount to be obtained from each source:

a. Sale of common stock [*see* Ch. 6I, *Issuance of Equity Securities*].

b. Sale of preferred stock [*see* Ch. 6I, *Issuance of Equity Securities*].

c. Sale of debt securities [*see* Ch. 6J, *Issuance of Debt Securities*].

d. Loans or other contributions to capital.

e. Other sources.

2. For each type of security (debt or equity) to be sold:

a. Description of security.

b. Number authorized.

c. Number to be sold.

d. Number of holders.

e. Sale price of each security.

f. Date of first issuance.

3. If shares are to be offered to others than original incorporators, names or description of class of persons to whom shares are to be offered.

4. Method proposed for sale of securities:

a. Advertising, including:
(1) Type of medium.

(2) Contents of advertising.

(3) Time for commencing advertising.

b. Subscription agreements, oral or written, obtained through personal contact with proposed security purchaser, including:

(1) Time of contact.

(2) Person, or persons, who are to solicit subscriptions for shares.

c. Use of underwriters, brokers, or salespersons.

d. Total estimated selling expenses.

5. Consideration other than cash to be received for securities:

a. Description and value of real property.

b. Description and value of personal property, tangible and intangible.

c. Description of services to be rendered.

d. Cancellation of indebtedness.

[5] Future Shareholders

1. Proposed number of security holders in each of following classifications:

a. Common shareholders.

b. Preferred shareholders.

c. Bondholders.

d. Debenture holders.

2. Qualifications of shareholders to be imposed by articles or bylaws.

3. Personal information for each shareholder, if offering is private:

NOTE:
For a questionnaire to present to potential investors to obtain the following information, see *§ 2.213*.

a. Name.

b. Social Security Number or Tax I.D. Number

c. Principal residence address and telephone number.

d. Business address and telephone number.

e. Date of birth.

f. Principal occupation.

g. Employment and other positions held in the last five years.

h. Annual income, individually or jointly with spouse, for last two years plus estimate for current year.

i. Net worth, individually or jointly with spouse.

j. Educational background.

k. Business experience.

l. Previous investments in "start-up" corporations, marketable securities, securities with limited marketability.

m. Use of accountants, lawyers or other experts in evaluating this and previous investments.

n. Relationship by blood, marriage, business, or close friendship with officers, directors, or other shareholders.

o. Position with corporation, services to be performed for corporation, and salary to be paid.

p. Number and description of securities to be purchased.

q. Description and value of consideration to be paid for securities cash, property, or services.

r. Whether investor can afford to lose this investment; whether it is more than 10 percent of investor's net worth.

s. Date and method of obtaining agreement to subscribe.

4. Meetings and voting:

a. Time and place of annual shareholders' meeting.

b. Type of bylaws to be adopted by shareholders, if any.

c. Notice of annual meeting to be required or dispensed with.

d. Restrictions on transfer of shares to be included in articles of incorporation, bylaws, or shareholders' agreement.

[6] Future Directors

1. Number of directors planned or desired:

a. Definite number with minimum of three.

NOTE:
Corporations may have one or two directors if there are, respectively, one or two shareholders [*Corp. Code § 212(a)*].

b. Indefinite number with minimum of three.

NOTE:
An odd number of voting directors is desirable to avoid tie votes. If the bylaws are to provide for an even number of directors with a director as nonvoting chairperson (except in case of ties), that result would be achieved.

2. Qualifications of directors to be imposed by articles or bylaws.

3. Compensation to be fixed by articles or bylaws.

4. Use of indemnity agreements.

5. Personal and biographical information regarding proposed directors if shares of corporation will have to be qualified with the Commissioner of Corporations:

a. Name.

b. Residence address and telephone number.

c. Business address and telephone number.

d. Date of birth.

e. Educational background, including degrees and areas of specialization.

f. Present occupation.

g. Estimated annual income and net worth.

h. Business experience within the past five years, including names and addresses of employers and periods of employment.

i. Fiduciary experience, including names, addresses, and descriptions of all companies, foundations, and trusts for which person has served in a fiduciary capacity.

j. Refusals, if any, of insurance or bonding companies to issue surety or fidelity bond to or covering proposed director.

k. Criminal convictions, if any.

l. Compensation proposed for services as director, including salary or expenses.

m. Other offices to be held with corporation and salary to be paid for such services.

n. Number and type of securities to be purchased.

o. Description and value of consideration to be paid for securities cash, property, or services.

6. Meetings and voting:

a. Time, date, and place proposed for regular directors' meetings.

b. Time, date, and place of first meeting of directors after filing of articles.

c. Number to be required for quorum of directors (more or less than majority but not less than one third of the authorized number of directors nor less than two directors [*Corp. Code §§ 204(a)(5), 307(a)(7)*]).

d. Number of directors to be required for board action at meeting at which quorum is present (majority or more [*see Corp. Code §§ 204(a)(5), 307(a)(8)*]).

e. Notices of regular meetings to be required or dispensed with.

f. Action without meeting to be authorized by articles or bylaws.

[7] Future Officers and Employees

1. Proposed number of employees.

2. Estimated amount of monthly payroll.

3. Titles of officers to be appointed at first directors' meeting.

4. Description of duties.

5. Compensation of officers.

6. Use of confidentiality agreements.

7. Personal and biographical information for each officer:

a. Name.

b. Residence address and telephone number.

c. Titles of offices to be held.

d. Status as director.

e. Status as shareholder.

f. Business experience for past five years.

g. Relationship with other officers, directors, and shareholders.

8. Unions to be negotiated with.

9. Fringe benefits:

a. Stock purchase plans.

b. Pension or profit-sharing plans.

c. Group insurance, including hospitalization and other medical benefits.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsFormationPlace of IncorporationGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
A. Facts and Documents

2-2 California Legal Forms--Transaction Guide § 2.101

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.101 Documents

1. Written statement, in form of budget, setting forth:

NOTE:
This type of information will be needed in applying for a permit from the Commissioner of Corporations to sell the corporation's securities [***see*** Ch. 6, ***Securities Regulation Issues***].

a. Use proposed for proceeds from sale of securities, including all expenditures to be made or incurred.

b. Total projected financing requirements of corporation for six months, or, if proposed plan of operation requires initial financing for longer period, then for that longer period.

c. Statement setting forth sources of all required funds other than from sale of securities, including any proposed loans or contributions to capital.

2. Pro forma profit and loss statement and balance sheet (or latest profit and loss statement and balance sheet if going business is being incorporated).

NOTE:
For the special procedures involved in incorporating a going business, see Ch. 2A, ***Incorporating a Going Business*** .

3. Copies of any prospectus or advertising to be used in connection with offers or sale and issuance of securities.

4. Any preincorporation agreements among principals or with promoters.

5. All preincorporation subscription agreements.

6. Any proposed post-incorporation:

a. Subscription agreements.

b. Shareholders' agreements.

7. Any contracts, franchises, or leases that will be assigned to or assumed by corporation.

8. Copies of pension, Keogh, IRA, or other retirement plan documents relating to each principal.

9. Copy of any pertinent buy-sell agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationPreincorporationGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
A. Facts and Documents

2-2 California Legal Forms--Transaction Guide §§ 2.102-2.109

AUTHOR: Marilyn E. Minger, Practice Consultant

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§§ 2.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2 California Legal Forms--Transaction Guide § 2.110

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.110 Choosing Place of Incorporation

NOTE:
For an extended analysis of the factors involved in deciding where to incorporate, see Cavitch, Business Organizations With Tax Planning, ch. 61, ***Where to Incorporate*** (Matthew Bender).

1. Will proposed corporation be conducted as purely local intrastate business?

NOTE:
If the principal business of the corporation will be conducted in California and the shareholders will be California residents, there is generally no advantage to be gained by incorporating in another state such as Nevada or Delaware, when weighed against the inconvenience of maintaining an out-of-state office and the additional expenses involved.

A foreign corporation that wishes to conduct intrastate business in California must first qualify with the Secretary of State [***see*** *Corp. Code § 2105(a)*]. Qualification may involve significant costs and taxation [***see*** Ch. 12B, ***Foreign Corporations and Associations***].

2. In which state will corporation's principal place of business be located?

3. In what state does corporation contemplate that it will derive most of its income?

NOTE:
A foreign corporation is subject to California taxation on its net income from sources within California, regardless of whether it is qualified or otherwise doing business in the state [*Rev. & Tax. Code § 23501(a)*].

4. Have jurisdictional issues been considered?

NOTE:

A California corporation that transacts purely intrastate business will be subject to jurisdiction only in California. A foreign corporation qualified to do business in California will be subject to jurisdiction in both the home state and in California [***see*** *Corp. Code § 2105(a)(5)*; ***see also*** *Code Civ. Proc. § 410.10* (Judicial Council Comment)]. This may be inconvenient, and, in some cases, may affect federal diversity jurisdiction [***see*** california Forms of Pleading and Practice, ch. 265, ***Federal Courts: Jurisdiction and Removal*** (Matthew Bender)].

5. Are principals willing to bear extra costs of incorporating in another state?

a. Fee for filing statement and designation on qualifying to do business in California [*see Gov. Code § 12186(e), (f)*].

b. California franchise taxes identical to those imposed on domestic corporations [*see Rev. & Tax. Code § 23151 et seq.*].

c. Possibility of franchise or income taxes in state of its incorporation.

6. What is effect of state restrictions on issuance of securities?

NOTE:

Any sale or offer of securities in California is subject to the Corporate Securities Law unless expressly exempted or not subject to qualification [*Corp. Code § 25110*].

7. What is effect of state restrictions on capital structure of proposed corporation?

NOTE:

While other states may impose restrictions on a corporation's capital structure, California has no outright restrictions on the capital structure of a corporation except in the case of a close corporation, which is limited to 35 shareholders [***see*** *Corp. Code § 158(a)*].

The only statutory requirement bearing on a California corporation's capital structure is that if the corporation is authorized to issue only one class of shares, the total number of authorized shares must appear in the articles of incorporation [*Corp. Code § 202(d)*]. If more than one class or more than one series in a class are authorized, the articles may either [*Corp. Code § 202(e)*]:

- Specify the particulars of the additional classes or series, including the rights, preferences and privileges; or

- Authorize the board to designate the particulars.

The board must make its designation prior to the issuance of any shares in the class or series [*Corp. Code § 202(e)*; ***see*** *Corp. Code § 401*; ***see also*** *§ 2.18*].

8. What is effect of state law governing shareholders' rights, powers, and liabilities:

a. Voting trusts [*see Corp. Code §§ 605(b), 1600*].

NOTE:
For discussion of voting trusts and voting trust agreements under California law, see Ch. 8B, ***Voting Agreements and Voting Trusts*** .

b. Cumulative voting [*see Corp. Code §§ 204(a), 303(a), 708*].

NOTE:
Some states do not permit cumulative voting. For most California corporations cumulate voting (casting a number of votes equal to the number of shares held multiplied by the number of directors to be elected, for one or more director candidates) must be allowed if requested by the shareholder [***see*** *Corp. Code § 708*]. For discussion, see Ch. 8A, ***Shareholders' Meetings, Voting, and Agreements*** . Corporations with shares listed on the New York or American Stock Exchanges and certain other large corporations may amend their articles or bylaws to eliminate cumulative voting [*Corp. Code § 301.5*; ***see*** *Corp. Code § 708*]. For further discussion, see Ch. 8A, ***Shareholders' Meetings, Voting, and Agreements*** .

c. Preemptive rights [*see Corp. Code § 204(a)(2)*].

NOTE:
A preemptive right is the right of a shareholder to subscribe to future issues of shares [***see*** *Corp. Code § 204(a)(2)*]. For discussion, see Ch. 3, ***Articles of Incorporation*** .

d. Right to inspect records [*see Corp. Code §§ 1600, 1601*].

NOTE:
Although most states grant shareholders the right to inspect corporate records, those rights should be compared to the rights granted under California law [***see*** *Corp. Code §§ 1600, 1601*; ***see also*** Ch. 7, ***Corporate Records and Reports***].

e. Rights relative to derivative suits [*see Corp. Code §§ 208(a), 800*].

NOTE:
California law permits shareholders of both domestic and foreign corporations to assert a claim for alleged wrongdoing to the corporation on its behalf, subject to certain specific procedural limitations [***see*** *Corp. Code §§ 208(a), 800*]. The rights granted under California law should be compared to those granted to shareholders under the law of any other jurisdiction in which incorporation is being considered.

f. Liability for unpaid stock subscriptions [***see*** *§ 2.32[3]*].

9. What is effect of state law governing directors' powers and liabilities [*see* Ch. 5, *Directors' Meetings, Actions, and Resolutions*]?

a. Classification of directors.

b. Minimum number of directors required.

c. Quorum provisions.

d. Action permitted without meeting.

e. Provisions for executive committees and their powers.

f. Fiduciary duty of directors.

g. Liability of directors.

h. Indemnification of directors.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFormationPlace of IncorporationGeneral OverviewBusiness & Corporate LawCorporationsFormationPlace of IncorporationPrincipal OfficeBusiness & Corporate LawCorporationsFormationPlace of IncorporationResidence



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2 California Legal Forms--Transaction Guide § 2.111

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.111 Determining Whether to Form More Than One Corporation

NOTE:

In view of the graduated tax rate structure applicable to a corporation's taxable income [***see*** *I.R.C. § 11(b)*; ***see also*** *§ 2.113*, P 9c], if the corporation's business, and therefore its income, can be divided between two or more corporations, a considerable income tax saving could be achieved. For example, a single corporation with a taxable income of $200,000 will pay more income tax than two corporations that divide a like amount of taxable income.

However, if the corporations constitute a "controlled group of corporations" [***see*** *I.R.C. § 1563(a)*], the controlled group is limited to a total of only $50,000 of taxable income in the first bracket, $25,000 in the second bracket, and $9,925,000 in the third bracket [*I.R.C. §§ 11(b)(1), 1561*]. These amounts must be divided equally among the members of the controlled group unless they consent to an apportionment plan providing for an unequal allocation [*I.R.C. § 1561*]. For example, if there are two members of a controlled group and if no plan for unequal apportionment is adopted, each component member will be subject to tax at a rate of 15 percent of its first $25,000 of taxable income, 25 percent of its next $12,500, 34 percent of its next $4,962,500, and 35 percent of any income exceeding $5,000,000. For two controlled corporations each with apportioned taxable income over $50,000, the tax is increased by the lesser of (1) 5 percent of any income exceeding $50,000 or (2) $5,875. For two controlled corporations each with apportioned taxable income over $7,500,000, the tax is increased by the lesser of (1) 3 percent of any income exceeding $50,000 or (2) $50,000 [*I.R.C. §§ 11(b)(1), 1561*]. Note, however, that a qualified personal service corporation [***see*** *I.R.C. § 448(d)(2)* (definition)] is subject to a 35 percent tax rate on all taxable income [*I.R.C. § 11(b)(2)*; ***see*** *§ 2.113*, P 9c].

Although several tests must be met before corporations are subject to controlled group treatment, the threshold issue is whether either a single parent corporation or five or fewer individuals, estates, or trusts own either 80 percent of the combined voting power of all voting stock in each corporation or 80 percent

of the total value of shares of all classes of stock in each corporation [***see*** *I.R.C. § 1563(a)*; ***see also*** *United States v. Vogel Fertilizer Co. (1982) 455 U.S. 16, 102 S. Ct. 821, 70 L. Ed. 2d 792]* . Stock ownership can be actual or constructive [*I.R.C. § 1563(d), (e)*]. Only in the relatively rare instances in which brother-sister corporations (so distinguished from parent-subsidiary corporations) are owned by a substantial number of shareholders in significantly different proportions will the definition of a "controlled group" be broken, and the possibility of obtaining the major tax advantages be available.

For examination of the lure and pitfalls of multiple corporations, see Cavitch, Tax Planning for Corporations and Shareholders, Ch. 1 (Matthew Bender), and Cavitch, Business Organizations, Ch. 74, ***The Lure and the Pitfalls of Multiple Corporations*** (Matthew Bender).

1. Is there business purpose, other than reducing income taxes, for having business conducted by more than one corporation?

NOTE:

If the taxpayer cannot establish that tax avoidance was not a major or principal purpose for forming more than one corporation, the benefits of the graduated corporate tax rates will be denied and the income of the other corporations will be taxed at the highest corporate rate [***see*** *I.R.C. §§ 269, 1551*].

There are business reasons for using multiple corporations. For example, such a scheme could allow the taking of separate tax elections for a business that would otherwise have been limited to a single election. Thus, separate elections under Subchapter S or Section 1244 could be made for different parts of the business according to the particular needs of each part or different accounting periods or methods could be chosen for each part.

Multiple corporations might also be warranted if it is contemplated that a part of the business will be disposed of in the future. By the initial formation of multiple corporations, avoidance of the exacting requirements of the Internal Revenue Code provisions regarding partial liquidation [*see I.R.C. § 346*] and spin-off [***see*** *I.R.C. § 355*] may be avoided at the time of disposal.

2. Is there natural basis for division of business?

a. Separation of ownership of property from hazards of operation?

b. Horizontal division for different products or geographical areas?

c. Functional division, for example, sales and manufacturing operations?

3. Is sale or liquidation of one corporation out of group in foreseeable future probable or desirable?

NOTE:

When multiple corporations are formed to operate different portions of a business, one portion of the business, being a separate corporation, can be liquidated or sold at capital gain rates more readily than would be possible if all portions of the business were operated by the same corporation and a "spin-off" were necessary [***see*** *I.R.C. §§ 1(h),* 331-338, *355, 1001, 1222*; ***see also*** Cavitch, Business Organizations, Ch. 74, ***The Lure***

and the Pitfalls of Multiple Corporations (Matthew Bender)].

4. Will income from one corporation in group be required for use by another portion of business?

NOTE:

Operating various portions of a business as separate corporations seriously limits the ease of transferring working funds from one portion of the business to another. Transfers of cash from one corporation to another may be vulnerable to attack by the IRS as constituting constructive dividends to the shareholders who are common to the corporations [***see*** Cavitch, Business Organizations, Ch. 74, ***The Lure and the Pitfalls of Multiple Corporations*** (Matthew Bender)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationPreincorporationGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsConsolidated Returns & Liability (IRC secs. 1501-1504, 1551-1552, 1561-1563)General OverviewBusiness & Corporate LawCorporationsFormationGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsConsolidated Returns & Liability (IRC secs. 1501-1504, 1551-1552, 1561-1563)Computation & Payment of Taxes



160 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2 California Legal Forms--Transaction Guide § 2.112

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.112 Determining Whether to Form Close Corporation

NOTE:

A "close corporation" is a corporation whose articles of incorporation, in addition to other required provisions [***see*** *Corp. Code § 202*], contain the following: (1) a provision that all of the corporation's issued shares of all classes shall be held of record by not more than a specified number of persons, not exceeding 35, and (2) the statement "This corporation is a close corporation" [*Corp. Code § 158(a)*]. For other discussions relating to close corporations, see Ch. 3, ***Articles of Incorporation*** , and Ch. 8A, ***Shareholders' Meetings, Voting, and Agreements*** . Additional detailed coverage is found in CALIFORNIA SMALL BUSINESS GUIDE (Matthew Bender).

1. Consider adopting close corporation status if:

NOTE:

For a detailed discussion of the situations in which close corporation status is desirable, see Ballantine & Sterling, California Corporation Laws, Ch. 4, ***Close Corporations*** (Matthew Bender). For additional coverage, see CALIFORNIA SMALL BUSINESS GUIDE (Matthew Bender).

a. Business is likely to be managed and controlled in partnership-like manner.

b. Owners wish to avoid normal corporate formalities relating to corporate actions and meetings of shareholders and directors.

NOTE:

The failure of a close corporation to observe corporate formalities relating to meetings of directors or shareholders in connection with the management of its affairs, pursuant to a statutory shareholder's agreement [***see*** *Corp. Code § 300(b)*], will not be considered a factor tending to establish that the shareholders have personal liability for corporate obligations [*Corp. Code § 300(e)*].

c. Owners anticipate use of shareholders' agreement [*see Corp. Code §§ 186, 300(b)*; *see also* Ch. 8C, *Close Corporation Shareholder Agreements*] to regulate:

(1) Management of business.

(2) Division of profits.

(3) Distribution of assets on liquidation.

(4) Other matters ordinarily the responsibility of and under control of board of directors.

d. Owners wish to further and protect minority shareholders' interests by avoiding potential abuses such as:

(1) Excessive compensation taken by majority shareholders.

(2) Sale or alienation of all or substantially all of corporation's assets.

(3) Unreasonable dividend policy.

(4) Fraud, abuse of authority, or mismanagement.

(5) Criminal activity.

2. Avoid close corporation status if corporation has or reasonably anticipates having extraordinarily great capital needs.

3. Close corporation status is unavailable if corporation has more than 35 shareholders [*see Corp. Code § 158(a), (d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawClosely Held CorporationsFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2 California Legal Forms--Transaction Guide § 2.113

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.113 Determining Effect of Income Taxation

NOTE:

When the double taxation of corporate income (that is, a tax on the corporation's earnings and a second tax on the profits when distributed to the shareholders as dividends) will result in unfavorable tax consequences, the principals may decide to do business as partners or even to continue in business as individuals. On the other hand, they may choose to incorporate and, if the corporation can be classed as a "small business corporation" [***see*** *I.R.C. § 1361*], elect to have it treated as an S corporation [***see*** *I.R.C. § 1361* et seq.]. In that case, the corporation would be subject to only minimal income taxation and the shareholders would be taxed as if they were partners in a partnership. For discussion and relevant procedures, see Ch. 2B, ***Electing Subchapter S Status*** .

1. Will assets other than cash be contributed to corporation?

NOTE:

No gain or loss is recognized if property is transferred to a corporation solely in exchange for stock or securities in that corporation, and immediately after the exchange the persons who made the transfer are in control of the corporation [*I.R.C. § 351(a)*]. "Control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation [*I.R.C. § 368(c)*]. For further discussion, see Ch. 2A, ***Incorporating a Going Business*** .

2. What is corporation's anticipated income for next three to five years?

3. What percent of corporate income is likely to be derived from dividends, interest, royalties, annuities,

and rent, that is, will corporation be classified as personal holding company subject to penalty federal taxation on undistributed income [***see*** I.R.C. §§ 541-547]?

NOTE:

If 60 percent or more of the corporate income is from these sources, and if 50 percent of the corporate stock is owned by five or fewer persons [***see*** *I.R.C. § 542*], then the corporation may be classed as a personal holding company and the undistributed income will be subject to a 15 percent tax [*I.R.C. § 541*, effective for tax years beginning after 12/31/02 and before 1/1/09; for other tax years, the tax rate is the highest rate of tax imposed under *I.R.C. § 1(c)* (***see*** Pub. Law No. 108-27, §§ 302(f)(1), 303)].

4. What proportion of corporate income will be distributed to shareholders as dividends?

NOTE:

Dividends are not deductible by the corporation in determining its income tax liability, and they are taxable income to the recipients; therefore, double taxation applies to the income distributed as dividends [***see*** *I.R.C. §§ 1(h)(11), 162, 301(a), (c)(1), 316(a)*; ***see also*** Pub. Law No. 108-27, §§ 302(f)(1), 303 (uncodified effective date and sunset provision of dividends capital gains rate legislation)]. If a liberal dividend policy is to be adopted and the consequent double taxation would create a serious tax disadvantage, the principals should be advised to consider election of Subchapter S status, which would enable the corporation to be taxed in substantially the same manner as a partnership [***see*** *I.R.C. § 1361* et seq.; ***see also*** Ch. 2B, ***Electing Subchapter S Status***].

5. What salaries will be paid to principals after incorporation if they are to hold office in management of corporation?

a. Are proposed salaries reasonable?

NOTE:

Reasonable salaries are deductible business expenses to the corporation; however, unreasonably large salaries will be considered as nondeductible dividend distributions [***see*** *Treas. Reg. § 1.162-8*]. Some of the factors to be considered in determining the reasonableness of salaries are: the employee's qualifications; the nature, extent, and scope of the employee's work; the size and complexities of the business; a comparison of salaries paid with the corporation's gross and net income; the prevailing rates of compensation for comparable positions in comparable concerns; the salary policy of the corporation as to all employees; in the case of small corporations with a limited number of officers, the amount of compensation paid to the particular employee in previous years; the success of the employee's efforts; profitability of the business; absence of the types of fringe benefits usually available to executives of other corporations of similar size; unusual capabilities of the employee; and bonuses not paid in the same ratio as stock holdings [***see*** *Elliotts, Inc. v. C.I.R. (9th Cir. 1983) 716 F.2d 1241* ; *Kennedy v. C.I.R. (6th Cir. 1982) 671 F.2d 167, 173, 174]* .

b. What are optimum salary ranges?

NOTE:

A major tax advantage of incorporating may occur because of the splitting of income between a corporation and the principals who will be paid salaries after incorporation. For each level of business income, there is a certain range of salary that gives the maximum

tax advantage. This must be calculated by trial computations taking into consideration anticipated income and the respective tax brackets of the corporation [***see*** P 9c NOTE, ***below***] and the principals.

6. What fringe benefits will be available to principals following incorporation?

NOTE:

If a shareholder is an employee of the corporation, fringe benefits, such as qualified pension and profit-sharing plans, group insurance, and medical expense reimbursement plans, are currently deductible by the corporation and not taxable to the shareholder until the amounts are actually distributed [***see*** *I.R.C. §§ 72, 83, 402, 404*; ***see also*** Ch. 1D, ***Overview of Employee Benefits*** ; Cavitch, Business Organizations, Chs. 131, ***Bonanza of Qualified Pension and Profit-Sharing Plans*** , 132, ***Establishing a Qualified Pension or Profit-Sharing Plan*** (Matthew Bender)].

7. How much income is likely to be retained by corporation?

NOTE:

Once the corporation has accumulated income of $250,000 over the entire period of its existence ($150,000 in the case of certain personal service corporations) [***see*** *I.R.C. § 535(c)*], any additional accumulated income must be justified to the Internal Revenue Service as an accumulation necessary for the reasonable needs of the business, or it will be subject to a 15 percent additional tax [*I.R.C. § 531*, effective for tax years beginning after 12/31/02 and before 1/1/09 (***see*** Pub. Law No. 108-27, §§ 302(f)(1), 303); for other tax years, the tax rate is the highest rate of tax imposed under *I.R.C. § 1(c)* (*I.R.C. § 531*, before amendment by Pub. Law No. 108-27); ***see*** *I.R.C. §§ 531*-537]; ***see also*** Cavitch, Business Organizations, Ch. 70, ***Improper Accumulation of Earnings*** (Matthew Bender)]. Corporate officers and employees who willfully fail to pay any tax due or willfully attempt to evade or defeat any tax due are liable, in addition to other penalties, for a penalty of 50 percent of the total amount of the underpayment of tax [*I.R.C. § 6653*; ***see*** *I.R.C. § 6671(b)*].

Any corporate planning must also take into account the fact that listed and readily marketable securities owned by a corporation and purchased out of its earnings and profits are to be valued at their net liquidation value, rather than their cost, in determining whether a corporation has incurred liability on its current earnings for the accumulated earnings tax [*Ivan Allen Co. v. United States (1975) 422 U.S. 617, 629-630, 95 S. Ct. 2501, 45 L. Ed. 2d 435]* . This factor may force corporations to reorganize their tax planning since it is contrary to standard accounting practices and the tax practices of many corporations.

8. Do principals intend to make loans to corporation and, if so, would those loans be viewed by IRS as bona fide debt with deductibility of payments rather than as equity with treatment of payments as nondeductible dividends, applying statutory factors listed in (a) through (f), below [*I.R.C. § 385*]?

NOTE:

If the corporation is indebted to a shareholder, any repayment of principal is not taxable to the shareholder. However, interest payments on shareholder loans are taxable to the shareholder [***see*** *I.R.C. § 61(a)(4)*] and deductible by the corporation [*I.R.C. § 163(a)*]. Therefore, if it is contemplated that funds are to be withdrawn from the corporation in the future, the possibility of the owner lending funds to the corporation at the time of incorporation should be considered.

One drawback to such a plan is that if the ratio of debt to outstanding stock is too high, resulting in "thin incorporation," or if it is questionable whether the debt is bona fide, the IRS can reclassify the transaction

as a contribution to capital, rather than a loan, and determine that the repayment of the "loan" is, in effect, a payment of a dividend [***see*** *I.R.C. § 385(a)*]. A variety of factors is used to determine whether a debtor-creditor or corporation-shareholder relationship exists [***see*** *I.R.C. § 385(b)*]. The characterization by the issuer of the interest in the corporation as stock or indebtedness is binding on the issuer and all holders of the interest, but not on the IRS [*I.R.C. § 385(c)*].

For further discussion, see Cavitch, Business Organizations, Ch. 71, ***How to Obtain Significant Advantages Through Mixed Debt and Equity Shareholder Financing; Thin Corporations*** (Matthew Bender).

a. Is there written unconditional promise to pay on demand or on specified date a sum certain in money in return for adequate consideration in money or money's worth, and to pay fixed rate of interest?

b. Is there subordination to or preference over any indebtedness of corporation?

c. What is corporation's ratio of debt to equity?

d. Is there convertibility into stock of corporation?

e. What is relationship between holdings of stock in corporation and holdings of interest in question?

f. Is proposed loan reasonable in comparison to what would be commercially reasonable to independent lender in arm's length transaction?

9. Will incorporation yield income tax advantages for corporation and each principal, based on:

a. All factors previously listed [*see* PP 1-8, *above*]?

NOTE:

In general, with proper planning, there is no immediate tax disadvantage to incorporating a business with a substantial income, and there may be considerable tax saving. Since generalizations concerning the tax advantages and disadvantages of incorporating are not always accurate, it is necessary to make trial computations based on projected future income and various other factors to determine whether there will, in fact, be a tax saving or a tax loss by incorporating, and the extent of the saving or loss. The facts listed below are those that will have to be known to make such a determination.

b. Income of owners from other sources?

c. Anticipated tax brackets applicable to corporation and its principals?

NOTE:

Corporate income tax rates are imposed in three brackets: 15 percent on the first $50,000 of taxable income, 25 percent on taxable income between $50,000 and $75,000, 34 percent on taxable income between $75,000 and $10,000,000, and 35 percent on the balance above $10,000,000. In addition, if the corporation's taxable income exceeds $100,000, the amount of tax is increased by the lesser of (1) 5 percent of the excess, or (2) $11,750. If the corporation's taxable income exceeds $15,000,000, the amount of the tax is increased by the lesser of (1) 3 percent of the excess, or (2) $ 100,000 [*I.R.C. § 11(b)(1)*].

However, a qualified personal service corporation [***see*** *I.R.C. § 448(d)(2)* (corporation providing health, law, engineering, architecture, or other professional services in which stock is held by employees providing those services)] is subject to a 35 percent tax rate on all taxable income [*I.R.C. § 11(b)(2)*].

Corporate dividends are income to the shareholders [***see*** *I.R.C. §§ 301*-307, 316; ***see also*** Ch. 9, ***Dividends, Reacquisitions of Shares, and Assessments***]. For taxable years beginning after December 31, 2002 and before January 1, 2009 [Pub. Law No. 108-27, §§ 302(f)(1), 303 (uncodified effective date and sunset provision of dividends capital gains rate legislation)], qualified dividends received by individuals are subject to taxation at a maximum 15 percent capital gains rate [*I.R.C. § 1(h)(11)*]. For other years, they are taxable at the significantly higher maximum regular tax rates for individuals [*I.R.C. § 1(a)-(d), (i)(2)*].

10. What are probabilities that business will operate at loss and become insolvent?

NOTE:

When the business owners are forced to liquidate a business and sell it as a loss, the loss will be a capital loss, which is seldom as beneficial as an ordinary loss. This capital loss can be converted into an ordinary loss if the stock issued to the shareholders qualifies under *I.R.C. § 1244*. Most small businesses can qualify under this code section; for a discussion of qualification requirements under *I.R.C. § 1244*, see the Legal Background to Ch. 6I, ***Issuance of Equity Securities***, § 6I. 21, and Cavitch, Business Organizations, Ch. 73, ***Ordinary Loss Deductions on Stock of Small Corporate Ventures*** (Matthew Bender).

11. Do principals have any intent to liquidate corporation in near future?

NOTE:

If the corporation is formed for the construction, production, or purchase of property with a view to the sale or exchange of its stock, or distribution of the property to the shareholders before the corporation realizes a substantial part of the income derived from the property, the corporation may be classified as a "collapsible corporation" and the owners will be taxed at ordinary income tax rates on their gain, rather than at capital gains rates [*I.R.C. § 341*, before repeal by Pub. Law No. 108-27; ***see*** Pub. Law No. 108-27, §§ 302(f)(1), 303 (effective date and sunset provisions for repeal of collapsible corporation rules); ***see*** Cavitch, Business Organizations, Ch. 194, ***Avoiding Collapsible Corporation Treatment*** (Matthew Bender)]. The rules for determining the status of a corporation as collapsible or noncollapsible are very complicated, and if one reason for incorporating a business is to obtain capital gains rates on the sale of the stock or on liquidation of the corporation, a close study should be made to see if the corporation will be considered collapsible [***see*** *I.R.C. § 341*, before repeal by Pub. Law No. 108-27; ***see also*** Pub. Law No. 108-27, §§ 302(f)(1), 303 (effective date and sunset provisions for repeal of collapsible corporation rules)]. Fortunately, for tax years beginning after December 31, 2002 and before January 1, 2009, the collapsible corporation rules have been repealed, and do not apply [***see*** Pub. Law No. 108-27, §§ 302(f)(1), 303 (effective date and sunset provisions for repeal of collapsible corporation rules)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsTax Accounting (IRC secs. 701-703, 706)General OverviewTax LawFederal Taxpayer

GroupsS CorporationsComputation of Income & Loss (IRC secs. 1366, 1371-1375)Tax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partners Subject to TaxTax LawFederal Taxpayer GroupsC CorporationsPersonal Holding Companies (IRC secs. 541-558)Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2 California Legal Forms--Transaction Guide § 2.114

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.114 Determining Effect of Other Taxes

1. Will transfers of personal property to corporation subject corporation to state sales tax?

NOTE:
Transfer of personal property to the corporation for consideration other than stock may be considered a taxable sale [***see*** *18 Cal. Code Reg. § 1595(b)(4)*]. However, various exemptions apply, such as the transfer of 80 percent or more of all tangible personal property used in a business when 80 percent or more of the real or ultimate ownership of the property is substantially the same after the transfer [***see*** *18 Cal. Code Reg. § 1595(b)(2)*].

2. Will real property transferred to corporation be reassessed on transfer?

NOTE:
Whenever real property is subject to a change in ownership, its value is reassessed for property tax purposes [*Rev. & Tax. Code § 75.10(a)*; ***see*** *Rev. & Tax. Code § 110.1(a)(2)*]. Transfer of an interest in real property is a "change in ownership" that causes a reassessment of the property [*Rev. & Tax. Code § 60*]. However, a transfer between and individual an a corporation that results solely in a change in the method of holding title, with no change in proportional ownership interests, is not a "change in ownership" [*Rev. & Tax. Code § 62(a)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:

Tax LawState & Local TaxesReal Property TaxAssessment & ValuationGeneral OverviewBusiness & Corporate LawCorporationsFormationGeneral OverviewTax LawState & Local TaxesSales TaxImposition of TaxTax LawState & Local TaxesSales TaxExemptionsTax LawState & Local TaxesReal Property TaxAssessment & ValuationAssessment Methods & Timing



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2 California Legal Forms--Transaction Guide § 2.115

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.115 Determining Organization of Corporation

1. Who is to perform functions preliminary to organization and formation of corporation?

    a. Same person acting as incorporator, promoter, and person responsible for subscriptions.

    b. Different persons acting as incorporator, promoter, and subscription agent.

2. What compensation, if any, is to be paid for work performed in those functions?

3. How will incorporator, promoter, and subscription agent be compensated?

    a. Cash, stock, employment.

    b. Will preincorporation agreement among principals assuring agents control of proposed corporation and, thus, payment after formation.

4. What is desired initial capital structure (for inclusion in articles of incorporation)?

NOTE:

The chief advantage of equity financing is that it may be easier to obtain than commercial financing because a new corporation has no earnings history. In addition, equity financing involves no assumption of a fixed obligation, requiring payments. A chief disadvantage of equity financing is that it forces the organizers to give up a portion of their equity, and therefore their control, of the corporation. For further discussion, see Ballantine & Sterling, California Corporation Laws, Ch. 3, ***Formation of Corporations***

(Matthew Bender).

a. Classes of stock.

NOTE:
To qualify for the small offering exemption from California securities laws, there must be only one class of shares [***see*** *Corp. Code § 25102(h)*]. For further discussion of the small offering exemption, see Ch. 6C, ***California Small Offering Exemption*** .

b. Number of shares.

c. Par value.

NOTE:
There is no longer a requirement to establish par value of stock in a California corporation. However, if desired, a statement concerning par value may included in the articles of incorporation [***see*** *Corp. Code § 204(d)*]. For purposes of determining taxes or fees based upon the capitalization of a corporation, shares are deemed to have a par value of $1 [*Corp. Code § 205*]. If a requirement applicable to a particular corporation requires shares to have a par value, the board of directors of the corporation may determine a par value [*Corp. Code § 205*].

For further discussion of par value, see *Ch. 6I, **Issuance of Equity Securities**, § 6I.19.*

d. Rights, preferences, privileges, and restrictions of preferred shares.

NOTE:
"Preferred shares" are shares other than common shares [*Corp. Code § 176*]. "Common shares" are shares that have no preference over any other shares as to distribution of assets on liquidation or payment of dividends [*Corp. Code § 159*]. For further discussion, see Ch. 6, ***Securities Regulation Issues*** , Part A.

e. Preemptive rights.

NOTE:
Preemptive rights give shareholders the right to subscribe to future stock issuances on a proportional basis. Provision for preemptive rights may be included in the articles of incorporation [***see*** *Corp. Code § 204(a)(2)*].

5. What other forms of financing are contemplated?

a. Debt financing:

(1) Commercial loans.

NOTE:
Debt financing has several advantages compared to equity financing. It allows the organizers to retain control of the corporation, interest paid on the debt is tax deductible, and the cost of debt securities is generally less than the cost of equity securities. On the other hand, debt financing imposes a greater risk because of the assumption of a fixed obligation, and a new corporation with no earnings history may be unable to obtain debt

financing. For further discussion, see Ballantine & Sterling, California Corporation Laws, Ch. 3, ***Formation of Corporations*** (Matthew Bender).

(2) Personal loans from:

(a) Family.

(b) Friends.

(c) Other private individuals.

(3) SBA loans.

NOTE:
The Small Business Administration provides a variety of types of financial assistance to small businesses.

b. Venture capital.

NOTE:
For discussion of the advantages and disadvantages of using venture capital, see Ballantine & Sterling, California Corporation Laws, Ch. 3, ***Formation of Corporations*** (Matthew Bender).

c. SBIC capital.

NOTE:
Small Business Investment Companies provide equity capital and long term loans to small businesses.

6. Will noncash assets be contributed, such as:

a. Services.

b. Property.

NOTE:
Various tax consequences must be considered regarding the contribution of real and personal property. For example, no gain or loss is recognized if property is transferred to a corporation solely in exchange for stock or securities in that corporation, and immediately after the exchange the persons who made the transfer are in control of the corporation [***see*** *I.R.C. § 351*; ***see also*** Ch. 2A, ***Incorporating a Going Business***].

7. To avoid personal liability for principals, officers, directors, and shareholders, has corporation been structured and operated properly?

NOTE:
The phrases "alter ego doctrine" and "disregarding the corporate entity" refer to situations involving abuse of the corporate privilege, in which the separate corporate identity is disregarded to allow personal liability when it would be inequitable not to do so [*Minton v. Cavaney (1961) 56 Cal. 2d 576, 579-580, 15 Cal. Rptr. 641, 364 P.2d 473]* . For application of the alter ego doctrine, two requirements must be met: (1) there must be such unity of interest and ownership that the separate personalities of the

corporation and the individual no longer exist, and (2) if the acts are treated as those of the corporation alone, an inequitable result will follow [*Automotriz etc. De California v. Resnick (1957) 47 Cal. 2d 792, 796, 306 P.2d 1* ; ***see*** *Commodity Futures Trading Commission v. Topworth (9th Cir. 2000) 205 F.3d 1107, 1112-1113* (extreme undercapitalization found)].

Many different improper acts may result in application of the alter ego doctrine [***see*** *Associated Vendors, Inc. v. Oakland Meat Co. (1962) 210 Cal. App. 2d 825, 838-840, 26 Cal. Rptr. 806]* .

a. Adequately capitalize corporation.

NOTE:

If a corporation is grossly undercapitalized, the corporate identity may be disregarded, and the principals may be held liable for the debts of the corporation [*Minton v. Cavaney (1961) 56 Cal. 2d 576, 579, 15 Cal. Rptr. 641, 364 P.2d 473]* .

b. Observe corporate formalities, such as:

NOTE:

Failing to hold meetings and other disregard for corporate formalities may result in application of the alter ego doctrine, resulting in shareholders being personally liable for the debts of the corporation [*Temple v. Bodega Bay Fisheries, Inc. (1960) 180 Cal. App. 2d 279, 282, 4 Cal. Rptr. 300]* . However, if fraud is present, principals may be personally liable even if all the corporate formalities have been observed [***see*** *Wyatt v. Union Mortg. Co. (1979) 24 Cal. 3d 773, 785, 157 Cal. Rptr. 392, 598 P.2d 45]* .

(1) Holding annual shareholders' meetings.

(2) Holding annual directors' meetings.

(3) Maintaining corporate records.

c. Comply with securities laws.

d. Avoid making personal guaranties in corporate documents.

NOTE:

If the equitable owners guarantee debts of the corporation or hold themselves out as personally liable for those debts, the corporate entity may be disregarded for the purpose of determining liability [*Minton v. Cavaney (1961) 56 Cal. 2d 576, 579, 15 Cal. Rptr. 641, 364 P.2d 473]* .

e. Execute documents in name of corporation, not individual.

f. Keep corporate finances separate from individual finances.

NOTE:

Failure to adequate segregate personal and corporate finances may result in application of the alter ego doctrine [*Minton v. Cavaney (1961) 56 Cal. 2d 576, 579, 15 Cal. Rptr. 641, 364 P.2d 473]* .

g. Maintain adequate liability insurance.

NOTE:

The corporation should maintain adequate general liability insurance, fire and casualty insurance, key-personnel life and disability insurance, business interruption insurance, and workers' compensation insurance. For detailed coverage of business insurance, see Ch. 1F, ***Insurance Considerations in Business Formation*** , and California Insurance Law and Practice (Matthew Bender).

8. Has provision been made for proper management and control?

a. Power of directors to choose officers and exercise control over management of corporation.

b. Power of officers to direct day-to-day operations of business of corporation, including hiring and firing employees.

c. Rights of shareholders to elect directors.

d. Control rights of creditors.

NOTE:

California corporation law affords considerable flexibility in determining how the corporation will be managed and controlled [***see*** *Corp. Code § 100 et seq.*]. The structure of the corporation will be set forth in the articles of incorporation and the bylaws. For further discussion, see Ch. 3, ***Articles of Incorporation*** , and Ch. 4, ***Bylaws*** .

9. Have securities laws of federal government, California and other states where securities will be offered been complied with before offering, selling or issuing securities [*see Corp. Code § 25000 et seq.*; *15 U.S.C. § 77a et seq.*]?

NOTE:

For discussion of securities regulation, see Ch. 6, ***Securities Regulation Issues*** .

10. Which accounting period will be used?

a. Calendar year basis.

b. Fiscal year basis.

NOTE:

In general, a corporation may use either of these accounting periods [***see*** *I.R.C. § 441(b)*]. If a corporation keeps no books or has no accounting period, it must use the calendar year as its taxable year [*I.R.C. § 441(g)*]. Personal service corporations generally must use the calendar year [***see*** *I.R.C. § 441(i)*]. However, personal service corporations and S corporations may elect to have a taxable year other than the required taxable year [*I.R.C. § 444(a)*].

11. Which accounting method will be used [***see*** *I.R.C. § 446(c)*]?

a. Cash method.

b. Accrual method.

c. Other method permitted by Internal Revenue Code.

NOTE:

Accounting must be done by the method that most clearly reflects income [*I.R.C. § 446(b)*]. In general, C corporations may not use the cash method [*I.R.C. § 448(a)*]. C corporations conducting a farming business, qualified personal service corporations, and corporations that meet a $5 million gross receipts test, however, may use the cash method [*I.R.C. § 448(b), (c)*]. In addition, under a special small business exception, the IRS allows certain taxpayers with average annual gross receipts of $10 million or less to use the cash method of accounting [*Rev. Proc. 2002-28, 2002-1 C.B. 815*].

12. Restrictions on share transfers.

NOTE:

The corporation may wish to ensure continuity in the management of the corporation by controlling the transfer of shares. This can be done by the use of a shareholders agreement or a buy-sell agreement, which is a contract between the corporation and the shareholders describing the terms under which the shareholders may or must sell their shares. A buy-sell agreement can ensure the continuation of the corporation regardless of the death of a participant, prevent "outsiders" from taking corporate shares, and enable shareholders to sell their shares for a fair price despite the lack of a public market. For further discussion, see Ch. 8D, ***Buy-Sell Agreements*** .

13. Fringe benefits and pension plans.

NOTE:

In this area, the attorney will need to work with the principals to determine what types of benefits and plans shareholder/employees desire. Structured pension plans may enjoy favorable tax treatment. For example, the corporation may be entitled to an immediate tax deduction for its current contribution to a plan [***see*** *I.R.C. § 404*], and the employee may not be taxed on the contribution [***see*** *I.R.C. § 402*]. For further discussion, see Young, Pension and Profit Sharing Plans (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawBlue Sky LawsSecurities Exempt From RegistrationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2 California Legal Forms--Transaction Guide § 2.116

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.116 Determinations Related to Subscriptions and Subscription Agreements

1. At what point will subscriptions be solicited?

a. Before formation of corporation; or

b. After articles of incorporation have been filed.

NOTE:
Because preincorporation agreements are not binding in California until after the corporation has been formed and has accepted the subscriptions [***see § 2.32[3]***], it will probably be more advantageous, especially in the case of large offerings, to form the corporation before soliciting any subscriptions for shares. This enables the corporation to accept subscriptions immediately on receipt.

2. Do advantages of using written agreement outweigh disadvantages?

a. Advantages:

(1) Assist in establishing availability of exemption from registration or qualification under state or federal securities laws.

(2) Create business record that may be used in evidence if litigation arises.

(3) Assist in corporate recordkeeping.

b. Disadvantages:

(1) Possible costs and expenses involved.

(2) Possible delay involved resulting from subscriptions for predetermined amount of capital.

(3) Cost and delay involved in obtaining any required permit from Commissioner of Corporations.

3. Will imposition of impound condition require use of subscription agreements [*see 10 Cal. Code Reg. § 260.141.22*]?

NOTE:

The Commissioner will require that a subscription agreement be delivered to each subscriber whenever the Commissioner imposes an impound requirement in connection with the sale of securities [*10 Cal. Code Reg. § 260.141.22(a)*]. An impound condition normally will be imposed if the securities are not firmly underwritten and if the Commissioner determines that a specific minimum amount of funds is necessary to finance the proposed undertaking as described in the application and that it is inadvisable for the issuer to expend any of the proceeds from the sale of the securities prior to receiving that minimum amount [*10 Cal. Code Reg. § 260.141.20*]. For additional discussion, see *§ 2.32[4]*.

4. If subscription agreement is needed, what type of agreement [*see § 2.210*]?

a. Agreement with small number of original incorporators (nonpublic offering).

b. Agreement with large number of investors (public offering).

5. What consideration will be required in agreement for sale of shares contemplated therein [*see Corp. Code § 409(a)*]:

a. Cash:

(1) Lump sum payment.

(2) Payment in installments [*see* 10 Cal. Code Reg. § 240.141.22(b)].

b. Services rendered (including services rendered in formation of corporation).

c. Cancellation of debts or securities.

d. Tangible property.

e. Intangibles, such as patents, trademarks, or copyrights, actually transferred.

6. In what states will potential subscribers be solicited?

NOTE:

State blue-sky or federal securities regulations may apply to both promotional methods and registration of the securities. These regulations should be carefully considered to determine whether or not the particular transactions are exempt from registration requirements or whether strict compliance with applicable procedures is necessary [***see*** generally Ch. 6, ***Securities Regulation Issues***]. Solicitation of

subscribers outside California may eliminate use of federal "intrastate exemption" from registration under the Securities Act of 1933 [***see*** *15 U.S.C. § 77c(a)(11)*; *17 C.F.R. § 230.147*; ***see also*** Ch. 6A, ***Federal Securities Exemptions for California Nonpublic Corporations*** , for discussion of commonly used exemptions from the federal securities laws].

7. What is appropriate time and place to arrange for payment of subscriptions?

NOTE:

Subscribers are liable to the corporation for the full consideration agreed on. The full amount must be paid when the securities are issued unless they are issued as "partly paid" [***see*** *Corp. Code §§ 409(d), 410*]. If an impound condition has been imposed and the securities are to be paid for in installments, each subscriber must be given a receipt meeting specified requirements. For discussion see Ch. 6, ***Securities Regulation Issues*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscriber RightsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscription AgreementsSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt Classes of SecuritiesSecurities LawBlue Sky LawsSecurities Exempt From RegistrationSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933Registration of SecuritiesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2 California Legal Forms--Transaction Guide § 2.117

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.117 Determinations Related to Preincorporation Agreements

1. Is there need for preincorporation agreement between principals in view of following factors:

   a. Whether personal and business relationships of principals are close enough to dispense with formal contract.

   b. Whether danger that disputes will arise among principals over creation of corporation is sufficient to justify written agreement.

   c. Number of prospective shareholders involved.

2. What type or types of preincorporation agreement might be appropriate?

   a. Preincorporation agreement among partners [*see § 2.230*].

   b. Preincorporation agreement with selling agent [*see § 2.212*].

   c. Preincorporation agreement with single organizer-manager [*see § 2.220*].

3. Is there need to protect or provide for any of following?

   a. Investments of time, money, materials, or goodwill of going business.

   b. Trade secrets.

c. Secret processes.

d. Services or expertise.

e. Share transfer restrictions.

4. What provisions should be included in preincorporation agreement?

a. Amount of initial capital that will be contributed by each principal, whether in cash, property, or intangibles, such as goodwill of going business contributed as property.

b. Amount of capital to be borrowed:
(1) From whom to be raised.

(2) Method of raising additional capital.

c. Title or position and duties and authority of each principal, assuming each will actively participate in affairs of proposed corporation.

d. Compensation to be paid for services rendered before or after incorporation.

e. Restrictions on stock transfer.

f. Buy-sell agreement.

g. Dissension or deadlock relief.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationPreincorporationTransactions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2 California Legal Forms--Transaction Guide § 2.118

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§ 2.118 Checklist of Incorporation Expenses

NOTE:

Incidental expenses not usually paid through an attorney's office are not included in this schedule of costs. For items that vary, the approximate range has been given or the method for determining the amount is suggested.

1. What amount is due to Franchise Tax Board for prepayment of minimum annual franchise tax?

NOTE:

For the first taxable year beginning on or after January 1, 2000, the tax imposed is the sum of (1) a tax according to or measured by net income, to be computed at the rate of 8.84 percent on the basis of net income for the next preceding income year, but not less than the minimum annual tax, and (2) a tax according to or measured by net income, to be computed at the rate of 8.84 percent on the basis of net income for the first taxable year beginning on or after January 1, 2000, but not less than the minimum annual tax [*Rev. & Tax. Code § 23151(f)(1)*; ***see*** *Rev. & Tax. Code § 23153* (minimum tax)]. For other taxable years beginning on or after January 1, 2000, the tax imposed is a tax according to or measured by net income, to be computed at the rate of 8.84 percent on the basis of the net income for that taxable year, but not less than the minimum annual tax [*Rev. & Tax. Code § 23151(f)(2)*].

2. What amounts are due to Secretary of State?

a. Reservation of corporate name.

NOTE:

The fee for reserving a corporate name is $10. When reserving over the counter in the Sacramento office or a branch office of the Secretary of State, there is an additional special handling fee of $10 per name. Separate checks should be written for the reservation fee and the special handling fee because the special handling fee will be retained even if the name cannot be reserved [*Gov. Code § 12186(a)*; ***see*** http://www.sos.ca.gov/business/corp/pdf/naavreservform.pdf]. A preliminary check of the availability of a corporate name can be made by mailing a name availability inquiry letter to the Secretary of State's office in Sacramento [***see*** http://www.sos.ca.gov/business/corp/corp_naav2.htm#avail].

b. Filing articles of incorporation.

NOTE:

The fee for filing articles of incorporation is $100 [*Gov. Code § 12186(c)*]. The fee for affixing the certificate and seal of state is $5 [*Gov. Code § 12183*]. Additional fees may be charged for copying, preclearance of documents, and special handling [***see*** *Gov. Code § 12182*].

3. What costs are likely for stationery or printing of minute book, share certificates, and for corporate seal?

NOTE:

These items will depend on the type desired; the costs can range from $25 to $50 and up. Individuals who have successfully reserved a proposed corporate name should not invest in corporate seals, stationary, signs, and the like based on that name reservation. The entity is not yet created to act as a corporation until appropriate documents have been filed. Further, the name reservation does not mean that the name style will be acceptable for the specific type of document being filed.

4. What fees are likely to be required by Commissioner of Corporations?

a. Fee for filing notice of sale of shares exempt from qualification [*Corp. Code § 25608(c), (x)*].

NOTE:

The fee for filing the notice of sale under a small offering or limited offering exemption [***see*** *Corp. Code § 25102(f)(4), (h)(5)*] is based on the value of the securities proposed to be sold in the transaction [*Corp. Code § 25608(c)*; ***see*** *Corp. Code § 25608(g)(1)* (valuation of securities)]. The filing fee ranges from $25 to $300, depending on the value of the securities [***see*** *Corp. Code § 25608(c)*]. The fee for filing the notice of sale under a qualified purchaser offering exemption [***see*** *Corp. Code § 25102(n)*] is $600 [*Corp. Code § 25608(x)*]. An additional fee is due for failure to file a timely notice [***see*** *Corp. Code §§ 25102(f)(4), 25110*].

b. Fee for filing application for qualification of shares if qualification is by permit under *Corp. Code § 25113*.

NOTE:

The fee for filing an application for qualification by permit [***see*** *Corp. Code § 25113*] is $200, plus one fifth of 1 percent of the aggregate value of the securities sought to be sold in California, up to a maximum aggregate fee of $2,500 [*Corp. Code § 25608(e)*].

The fee for filing a small company application for qualification by permit is $2,500.

However, if the actual costs of processing the small company application exceed the filing fee, an additional fee, based on the actual costs of processing, will be charged, but not to exceed $1,000 [*Corp. Code § 25608(e)*].

5. What are likely attorneys' fees?

NOTE:

For an agreement between a client and an attorney who will form a corporation for the client, see *Ch. 86A, **Agreements for Legal Services**, § 86A.231*. Conflict of interest issues are discussed in Ch. 1A, ***Role of Counsel in Starting a New Business*** .

a. Drafting preincorporation agreements to incorporate.

b. Drafting subscription agreements.

c. Drafting and filing:

(1) Articles of incorporation.

(2) Applications for securities permits.

(3) Notices of issuance of offers for securities and issuance of securities.

(4) Bulk transfer or other notices to creditors.

(5) Bills of sale, assignments of leases, assignments of contracts, novations, and other relevant property transfer documents.

(6) Abandonment of any current fictitious name statement and filing of any necessary fictitious name statement for corporation.

(7) Resolutions for adoption at first meeting of corporate directors.

d. Obtaining assignment of right to use corporate name from existing business, if necessary, and reserving name for corporation.

e. Protecting corporate name, trade name, trademark, or service mark.

f. Obtaining assignment of copyrights, if necessary.

g. Establishing corporate fringe benefit program.

h. Reviewing and modifying wills of corporation's principals.

6. What other costs should be anticipated?

a. Fee payable to Commissioner of Corporations if public offering is involved and negotiating permit is required with respect to preincorporation agreements and subscriptions.

NOTE:
The fee is $50 [***see*** *Corp. Code §§ 25102(c), 25608(b)*].

b. Licensing fees.

NOTE:
The Secretary of State does not license corporations. To determine licensing requirements, consult with the Department of Consumer Affairs, the city and/or county where the principal place of business is located, and/or the state agency with jurisdiction over the business [Secretary of States' information packet].

c. Costs of incorporating going business:

(1) Notice of intended transfer to corporation:
(a) County recorder's recording fee [*see Gov. Code § 27361(a)*].

(b) Charges of newspaper for publishing notice.

NOTE:
These charges may range from $25 to $50 or more, depending on the locality or the publication.

(2) Notice of termination of prior unincorporated business.

(a) Charges of newspaper for publishing notice.

(b) Cost of mailing notice to known suppliers and creditors of unincorporated business.

NOTE:
Costs of mailing the notice will depend on the number of copies mailed and the manner in which they are sent, whether first class or certified mail.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersBusiness & Corporate LawCorporate NamesGeneral OverviewTax LawState & Local TaxesFranchise TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2 California Legal Forms--Transaction Guide §§ 2.119-2.129

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 2.119[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

2-2 California Legal Forms--Transaction Guide § 2.130

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.130 Planning Formation of Corporation

NOTE:

This section lists the steps in the formation of a corporation that must be anticipated or acted on in the preincorporation planning stage for any corporation. The preincorporation planning peculiar to the formation of a close corporation is covered in *§ 2.131*.

A corporation is "formed" when its articles of incorporation are executed by one or more natural persons, partnerships, associations, or corporations, and filed in the office of the Secretary of State [***see*** *Corp. Code §§ 169, 200(c)*]. The procedures involved in this formative step are set forth in detail in Ch. 3, ***Articles of Incorporation***.

For additional materials on the incorporation of a going business, see Ch. 2A, ***Incorporating a Going Business*** .

[1] Scheduling Formation of Corporation

NOTE:

To establish a timetable for the process of incorporation, it is necessary to work backward from the final event, which is the commencement of business.

1. Select date on which corporation is to commence transacting business, based on following factors:

a. Allowance of sufficient time to obtain necessary business licenses, property, equipment, and supplies, and to make other business preparations.

b. Practical business considerations, such as market fluctuations and business seasons.

c. Amount of income that may be earned between time corporation commences business and end of its first taxable or fiscal year.

NOTE:
The corporation's income for tax purposes will be reported on the basis of its fiscal year [*I.R.C. § 441*], and the first income tax return of the corporation will reflect its income for the short period between the time it came into existence and the date when its fiscal year would normally end [*I.R.C. § 443(a)(2)*]. Thus, a corporation that has the calendar year as its fiscal year and was organized on August 1, 2004, must file its first income tax return by March 15, 2005, reporting its income from August 1, 2004, to December 31, 2004 [***see*** *Treas. Reg. § 1.443-1(a)(2)*]. Because the federal corporate tax rate structure is graduated (that is, the tax rate increases as taxable income increases), the date the corporation is to commence business should be set, all factors being equal, at a time that would minimize its income during the short period covered by its first income tax return. For example, it may be preferable that the taxable income of the corporation not exceed $50,000 during the short period, because the corporate tax rate is only 15 percent on the first $50,000 of taxable income [*I.R.C. § 11(b)*].

d. If going business is being incorporated, date when income of business may be most advantageously shifted from individual owners to corporation.

NOTE:
For further discussion, see Ch. 2A, ***Incorporating a Going Business*** .

2. Select date for corporation to issue its shares:

a. If corporation is to conduct new business, it should ordinarily issue its shares before time it is to commence transacting that business.

NOTE:
Although the execution of contracts, leases, and the commission of other acts necessary to prepare the corporation to commence business may be undertaken by the incorporators or promoters before the corporation is fully organized, they may have problems in securing binding commitments without incurring personal liability [***see*** *§ 2.33*]. When these obligations are incurred after the corporation is formed, but before it has issued shares, the incorporators may be personally liable for these obligations [***see*** *Automotriz etc. De California v. Resnick (1957) 47 Cal. 2d 792, 306 P.2d 1]* .

b. If going business is being incorporated, corporation should issue its shares when the business is transferred to it, usually on same day it intends to commence operation of that business in corporate form.

3. Select estimated date for issuance of permit for preincorporation subscription agreements by Commissioner of Corporations, if one must be obtained.

NOTE:
Although the Commissioner's office may be able to process the average application and issue a permit within four days after the application is filed with it, an examination of permits actually issued indicates that there is normally a period of two to four weeks between the date the application is filed and the date

the permit is issued.

If a going business is being incorporated and a notice of bulk sale will be required [***see*** *Com. Code §§ 6102(a)(3), 6103(a)*], sufficient time should be allowed between the date of issuance of the permit and the date that shares are actually to be issued by the corporation to allow for the necessary filing of the notice of sale at least 12 business days before the business is transferred to the corporation, and for the publication of that notice at least 12 business days before the date of sale [***see*** *Com. Code § 6105(b)*; ***see also*** Ch. 2A, ***Incorporating a Going Business***].

4. Determine date for reservation of corporate name:

a. Select date for filing articles of incorporation.

NOTE:
Corporate existence begins on the date the articles are filed by the Secretary of State [*Corp. Code § 200(c)*]. Sufficient time should be allowed between this date and the date the corporation intends to commence business to make all the necessary business and financial arrangements, including the issuance of shares. The actual process of incorporation is covered in [2], ***below***. The procedure for filing the articles is discussed in Ch. 3, ***Articles of Incorporation*** .

b. Select date for reservation of corporate name within 60-day period prior to date selected for filing articles of incorporation.

NOTE:
The Secretary of State will not issue certificates reserving the same name for consecutive 60-day periods to the same applicant without a lapse of 24 hours over the course of a business day between periods [*Corp. Code § 201(c)*]. For detailed coverage of choosing and reserving a corporate name, see *§ 2.132*.

5. Select date for first meeting of board of directors.

NOTE:
This meeting may be held as soon as is convenient after the date the articles of incorporation are filed by the Secretary of State.

6. Select date for filing application for permit to issue securities, if financing through issuance of securities after incorporation is planned and permit is required.

NOTE:
The application can be filed immediately after the first meeting of the board of directors, at which the filing is authorized and the officers who will sign the application are appointed.

[2] Corporate Formation Process

NOTE:
This subsection lists the steps involved in actually forming the corporation, whose existence technically begins on the execution and filing of articles of incorporation [***see*** *Corp. Code § 200(c)*]. For further discussion, see Ch. 3, ***Articles of Incorporation*** .

For the steps in planning the formation of a close corporation, see *§ 2.131*. For additional coverage, see

CALIFORNIA SMALL BUSINESS GUIDE (Matthew Bender).

1. Advise persons who will act as directors (either those to be named as directors in articles of incorporation or the incorporators if directors are not named in articles) [*see Corp. Code §§ 210, 212(a)*] that they may:

a. Do whatever is necessary and proper to perfect organization of corporation.

b. Adopt and amend bylaws.

c. Elect directors and appoint officers.

2. Follow schedule for process of incorporation [*see* [1], *above*].

3. Choose and reserve corporate name [*see § 2.132*].

4. Choose initial agent for service of process [*see § 2.17*].

5. Prepare articles of incorporation [*see* Ch. 3, *Articles of Incorporation* (coverage of mandatory and optional provisions included in articles)] for execution by incorporators.

6. Have articles executed and acknowledged by incorporators [*Corp. Code § 200*; *see* Ch. 3, *Articles of Incorporation*].

[3] Post-Incorporation Process

1. Prepare bylaws or advise incorporators to do so [*see* Ch. 4, *Bylaws*].

2. Have incorporators pass resolutions adopting bylaws and electing directors [*see § 2.202* for form].

3. Obtain stock certificates, minute book, corporate seal, and other books, records, and accounts and provide them to person who will act as corporate secretary or secretary-treasurer.

NOTE:

A corporation may adopt, use, and, at will, alter a corporate seal, but failure to affix a seal does not affect the validity of an instrument [*Corp. Code § 207(a)*]. Although the General Corporation Law does not require that a corporation have a seal, corporations ordinarily obtain one. Its use may be required by banks, government agencies, or others.

The form in *§ 2.250* is an attorney letter that may be used as a cover letter to accompany the documents referred to above, and to advise the incorporators with respect to many of the matters noted in the remainder of this section.

4. Advise incorporators about importance of observing corporate formalities connection with operation of corporation [*see § 2.250[2]* (form)].

5. Advise directors to hold first board meeting as soon after formation of corporation as practicable [*see*

Ch. 5, *Directors' Meetings, Actions, and Resolutions*].

NOTE:

In planning for the first meeting of the board, counsel may wish to prepare resolutions and minutes in advance. Resolutions for adoption at, and minutes of, the first meeting are illustrated in Ch. 5, ***Directors' Meetings, Actions, and Resolutions***. For certain specific actions that must be taken with respect to preincorporation agreements, see *§§ 2.140* and *2.141*.

6. If corporation is to conduct business in other states, determine whether corporation needs to qualify to conduct business and, if so, what steps need to be taken.

7. Advise directors that immediately after formation, following steps must be taken to issue securities, if securities are to be issued:

a. Comply with Corporate Securities Law, federal securities laws, or other state or foreign country securities laws as necessary [*see* Ch. 6, *Securities Regulation Issues*].

b. Issue shares and securities in exchange for cash, assets or services promptly after formation of corporation and approval of permit and/or registration of securities [*see* Ch. 6I, *Issuance of Equity Securities*].

c. If articles authorize board to determine rights, preferences, privileges, or restrictions for any class or series of unissued shares, to designate any series of unissued shares, or to fix number of shares in a series, instruct board of directors to do following before issuing any shares in affected class or series as follows [*Corp. Code § 401(a)*]:

(1) Adopt resolution that fixes matters to be determined.

(2) Prepare certificate of determination that includes:

(a) Copy of resolution;

(b) Number of shares of affected class or series; and

(c) Statement that none of shares of affected class or series has been issued and executed officer's certificate.

(3) Execute and file as officer's Certificate of Determination with Secretary of State.

NOTE:

For a resolution and a certificate of determination, see Ch. 3, ***Articles of Incorporation*** .

8. Advise directors of their duty to establish books and records for corporation and make reports required by law [*see* Ch. 7, *Corporate Records and Reports*].

NOTE:

Within 90 days after filing the articles of incorporation (and annually thereafter) the corporation must file, on a form prescribed by the California Secretary of State, a statement of domestic stock corporation, containing such information as the names and addresses of the corporation's directors and officers, the address of the corporation's principal executive office, and the general type of business that constitutes its principal business activity [*Corp. Code § 1502(a)*]. A publicly traded corporation [***see*** *Corp. Code §*

1502.1(b)(1)] must file an additional disclosure statement within 150 days after the close of the corporation's fiscal year [*Corp. Code § 1502.1(a)*; ***see*** Ch. 3, ***Articles of Incorporation*** ; ***see also*** Ch. 7, ***Corporate Records and Reports*** (form)].

9. Advise directors to obtain any necessary business permits and licenses.

10. Advise future officers to comply with following tax requirements:

a. Determine and elect accounting period and accounting method [*see* I.R.C. §§ 441-448].

b. Pay estimated California franchise tax [*see Rev. & Tax. Code §§ 23151, 23153*].

NOTE:

For the first taxable year beginning on or after January 1, 2000, the tax imposed is the sum of (1) a tax according to or measured by net income, to be computed at the rate of 8.84 percent on the basis of net income for the next preceding income year, but not less than the minimum annual tax and (2) a tax according to or measured by net income, to be computed at the rate of 8.84 percent on the basis of net income for the first taxable year beginning on or after January 1, 2000, but not less than the minimum annual tax [*Rev. & Tax. Code § 23151(f)(1)*; ***see*** *Rev. & Tax. Code § 23153* (minimum tax)]. For other taxable years beginning on or after January 1, 2000, the tax imposed is a tax according to or measured by net income, to be computed at the rate of 8.84 percent on the basis of the net income for that taxable year, but not less than the minimum annual tax [*Rev. & Tax. Code § 23151(f)(2)*].

c. Pay estimated federal income tax in installments [*see I.R.C. § 6655*].

d. If corporation owns personal property with aggregate cost of $100,000 or more:

(1) File property statement with county assessor [*see Rev. & Tax. Code § 441*].

(2) Pay taxes when due [*see Rev. & Tax. Code § 2922*].

11. Apply for Tax I.D. number.

12. If corporation is to do business under name other than corporate name as stated in articles of incorporation [*see Bus. & Prof. Code § 17900(b)(3)*], advise future officers to file fictitious business name statement [*see Bus. & Prof. Code § 17900 et seq.*; *see also § 2.14*].

NOTE:

Counsel should also caution the officers filing the fictitious business name statement that it will expire five years from the date it is filed [*Bus. & Prof. Code § 17920(a)*; ***see*** *Bus. & Prof. Code § 17913*].

13. If corporation will qualify as "small business corporation" [*see I.R.C. § 1361(b)*] and principals desire federal income tax treatment as partners with minimal federal income tax imposed on corporation pursuant to Internal Revenue Code Subchapter S [*see I.R.C. § 1361* et seq.], advise them that after issuance of shares to not more than 100 shareholders [*I.R.C. § 1361(b)(1)(A)*], those shareholders may elect Subchapter S status for the corporation.

NOTE:

For the procedures involved in electing Subchapter S status, see Ch. 2B, ***Electing Subchapter S Status*** .

14. If corporation will have employees, officers must:

NOTE:
For detailed discussion of employers' responsibilities, see California Employment Law (Matthew Bender).

a. Obtain either [*see Lab. Code § 3700*]:

(1) Workers' compensation insurance from approved insurer; or

(2) Certificate of consent to self-insure from Department of Industrial Relations.

b. Obtain employer identification number on Internal Revenue Service Form SS-4 before commencing business [*see Treas. Reg. § 31.6011(b)-1*].

c. Have employee complete "Employee's Withholding Allowance Certificate" (IRS Form W-4).

d. Withhold state and federal income and employment taxes.

e. Comply with applicable state and federal labor laws.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationGeneral OverviewBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeGeneral OverviewTax LawState & Local TaxesFranchise TaxImposition of Tax



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

2-2 California Legal Forms--Transaction Guide § 2.131

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.131 Forming a Close Corporation

NOTE:
A "close corporation" is a corporation whose articles of incorporation, in addition to other required provisions [***see*** *Corp. Code § 202*], contain the following: (1) a provision that all of the corporation's issued shares of all classes must be held of record by not more than a specified number of persons, not exceeding 35, and (2) the statement "This corporation is a close corporation" [*Corp. Code § 158(a)*]. For other discussion relating to close corporations, see Ch. 3, ***Articles of Incorporation*** .

1. Determine current status of business.

NOTE:
A close corporation must be a corporation subject to the General Corporation Law [***see*** *Corp. Code § 158(a)*; ***see also*** *Corp. Code §§ 102, 162* (corporation defined)].

a. If dealing with preexisting corporation, amend corporate documents and alter corporate procedures to reflect special close corporation requirements [*see* PP 2-5, *below*].

b. If dealing with noncorporate going business, supplement normal procedure for incorporating going business [*see* Ch. 2A, *Incorporating a Going Business*] with special close corporation requirements [*see* PP 2-5, *below*].

NOTE:
The procedures for incorporating a going business and the consequences of such an action are also discussed in Ballantine & Sterling, California Corporation Laws, Ch. 3,

Formation of Corporations , § 54.08 (Matthew Bender).

c. If starting new business, supplement normal incorporation procedures [*see § 2.130*] with special close corporation requirements [*see* PP 2-5, *below*].

2. Confirm that corporation's name, as set forth in its articles, contains word "corporation," "incorporated," "limited," or abbreviation of one of those words [*Corp. Code § 202(a)*].

3. Include following in articles of incorporation:

NOTE:
When close corporation status is sought after shares have been issued, the following provisions must be included in the existing articles of incorporation by amendment, but only after the amendments have been adopted by the affirmative vote of all of the issued and outstanding shares of all classes [*Corp. Code § 158(b)*].

For articles of incorporation to be used by a close corporation, see Ch. 3, ***Articles of Incorporation*** [***see*** *Corp. Code §§ 158(a), 200-207, 212(a)*].

a. Provision that all issued shares of all classes must be held of record by not more than specified number of persons, not exceeding 35 [*Corp. Code § 158(a)*]; and

NOTE:
Special requirements relating to the manner in which shareholders must be counted are contained in *Corp. Code § 158(d)* [***see*** Ch. 3, ***Articles of Incorporation***].

A corporation ceases to be a close corporation if it acquires more than the maximum number of shareholders of record specified in its articles of incorporation as a result of the transfer of its shares [*Corp. Code § 158(e)*].

b. Legend stating: "This corporation is a close corporation" [*Corp. Code § 158(a)*].

NOTE:
Compliance with this statutory requirement assists the California Secretary of State in dealing with amendments of articles and mergers involving close corporations by making them readily identifiable.

4. Advise principals of proposed close corporation to consider issuance of "Section 1244 stock."

NOTE:
If the corporation is a "small business corporation" at the time the stock is issued [*I.R.C. § 1244(c)(1)(A)*], any loss on the disposition of its Section 1244 stock is deductible for income tax purposes as an ordinary loss and not as a capital loss [*I.R.C. § 1244(a)*]. For discussion, see *Ch. 6I,* ***Issuance of Equity Securities****, § 6I.21*.

5. If possible, structure issuance of proposed close corporation's stock to qualify for one of following exemptions from qualification requirements pursuant to *Corp. Code § 25110*:

a. Limited offering exemption; available if [*Corp. Code § 25102(f)*; *see* Ch. 6B, *California Limited Offering Exemptions*]:

(1) Sales are made to not more than 35 persons, excluding qualified persons as defined in *10 Cal. Code Regs. §§ 260.102.12, 260.102.13*; and

(2) Each purchaser either:

NOTE:
To be assured that these criteria are met, subscription agreements in which the purchaser warrants as to the purchaser's financial status and investor questionnaires should be used [***see*** *§ 2.213*].

(a) Has preexisting personal or business relationship with offeror or any of its partners, officers, directors, or controlling persons; or

(b) Can be reasonably assumed to have capacity to protect his, her or its interests.

b. Small offering exemption; available if [*Corp. Code § 25102(h)*; *see* Ch. 6C, *California Small Offering Exemption*]:

(1) Immediately after the transaction, there is only one class of stock beneficially owned by not more than 35 persons;

(2) Offer and sale was not advertised;

(3) Consideration received for stock consists of only the following:

(a) Cash or cancellation of debt upon initial organization of issuer;

(b) Cash, provided there is written approval of all existing shareholders and purchasers are existing shareholders; or

(c) If there is only one shareholder after the sale, any legal consideration;

(d) Assets, including cash, of an existing business transferred to issuer upon its initial organization, provided that persons receiving stock:
(i) Were owners of the existing business for not less than a year prior to transfer; and

(ii) Owned the existing business in same proportion as stock they will receive.

(4) No promotional consideration is paid; and

(5) Each purchaser represents that purchase is for purchaser's own account.

NOTE:
Shareholder limitation for purposes of the small offering exemption refers to beneficial owners, contrasted with record ownership test for close corporation [***see*** *Corp. Code §§ 158, 25102(h)*].

Because the small offering exemption is available only if the corporation has a single class of stock, a shareholders' agreement that effectively creates more than one class of shares by, for example, providing for differing dividend preferences, voting rights, or redemption privileges for different shareholders,

renders the small offering exemption unavailable [***see*** *Corp. Code § 25102(h)*].

PRACTICE TIP:

If a shareholders' agreement is contemplated for a close corporation, the corporation should try to qualify for the limited offering exemption because that exemption does not limit the corporation to a single class of stock. *Commentary by Marilyn E. Minger*.

c. Qualified purchaser offering exemption; available to California corporations and foreign corporations subject to *Corp. Code § 2115* if [*Corp. Code § 25102(n)*]:

(1) Offers and sales are made only to qualified purchaser or purchaser that issuer reasonably believes, after inquiry, are qualified purchasers;

NOTE:

Qualified purchasers generally are those who are sophisticated enough in business and investing to reasonably be assumed to be able to protect their interests; specific qualifications are set forth in *Corp. Code § 25102(n)(2)*.

(2) Each purchaser represents that purchase is for purchaser's own account;

(3) Each natural person purchaser, including corporations, partnerships, and other organizations, receives written disclosure statement complying with federal Regulation D [*see 17 C.F.R. § 230.501 et seq.*] at least five business days before securities are sold;

(4) General announcement of proposed offering is published by written document only and contains prescribed information;

(5) No telephone solicitation is made until issuer determines that prospective purchaser is qualified purchaser;

(6) Issuer files notice of transaction:

(a) At time of publication of general announcement of proposed offering or at time of initial offer, whichever is first; and

(b) Within 10 business days after close or abandonment of offering.

6. Make certain that appropriate legend is placed on face of all share certificates [*see Corp. Code § 174*] issued by corporation:

NOTE:

If the corporation issues uncertificated securities [***see*** *Corp. Code § 191.1*; *Com. Code § 8102(a)(18)*] instead of share certificates, the legend requirement will be satisfied if it appears on any instrument, indenture, or document (or in any constitution, statute, ordinance, rule, regulation, order, or the like) pursuant to which the security is issued [*Corp. Code § 174* ("on the certificate" defined); ***see*** *Com. Code § 8202(a)*; ***but see*** *Corp. Code § 418(a)* (transfer restrictions must appear on certificate, initial transaction statement, and written statements)]. Nevertheless, a transfer restriction on a security imposed by the issuer, even if otherwise valid, is ineffective against a person without knowledge of the restriction, unless the registered owner has been notified of the restriction [*Corp. Code § 174*; ***see*** *Com. Code § 8204*

].

For a discussion of initial transaction statements, and uncertificated securities generally, see Ch. 6I, ***Issuance of Equity Securities*** .

a. Conspicuous [*see Com. Code § 1201(10)*] legend stating:
"This corporation is a close corporation. The number of holders of record of its shares of all classes cannot exceed _____ [*number not in excess of 35*]. Any attempted voluntary inter vivos transfer which would violate this requirement is void. Refer to the articles, bylaws and any agreements on file with the secretary of the corporation for further restrictions" [*Corp. Code § 418(c)*].

b. Any other transfer restriction, conspicuously placed on face of share certificate.

7. Consider having close corporation elect Subchapter S status, since S corporations may have as many as 100 shareholders [*see I.R.C. § 1361(b)(1)(A)*; *see also* Ch. 2B, *Electing Subchapter S Status*].

NOTE:
Federal law permits S corporations to have as many as 100 shareholders [*I.R.C. § 1361(b)(1)*]. California Subchapter S law substantially conforms to federal law [***see, e.g.,*** *Rev. & Tax. Code § 23800 et seq.*; ***see also*** *Ch. 2B,* ***Electing Subchapter S Status****, § 2B.31* et seq.].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of Stock



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

2-2 California Legal Forms--Transaction Guide § 2.132

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§ 2.132 Selecting and Reserving Corporate Name

[1] Selecting Proposed and Alternative Names

NOTE:

In general, the incorporators will have selected the name they desire for the corporation on the basis of business and personal factors before consulting counsel. Counsel should suggest the selection of two or three alternative names, and should be prepared to check the choices made against the statutory restrictions on corporate names. The Secretary of State will not file articles of incorporation bearing a name that is prohibited by statute, or that would tend to mislead the public, or that deceptively resembles the name of another corporation either doing business within the state or otherwise coming within the provisions of *Corp. Code § 201(b)*. The following list indicates the types of names and specific words that should be avoided.

1. Do not use names likely to mislead public, such as [*Corp. Code § 201(b)*]:

a. Name indicating business of insurer when business is actually that of insurance agency.

b. Name likely to mislead public as to nature of entity, such as personal name without indication of corporate status.

c. Name of professional corporation without use of words denoting corporate existence [*see Corp. Code § 13409*; *see also* Ch. 12A, *Professional Corporations*].

NOTE:

Although a corporate name ordinarily is not required to include such words as

"company," "corporation," "incorporated," or "limited," the name of a close corporation must contain one of these last three words or an abbreviation of one of them [*Corp. Code § 202(a)*].

d. Name falsely implying a governmental affiliation.

2. Do not use names closely and deceptively resembling names of other corporations doing business in California [*Corp. Code § 201(b)*], whether:

NOTE:

A corporation may adopt a name that is similar but not identical to the name of an existing domestic or foreign corporation if the other corporation consents in writing to the use of the name and the Secretary of State's office finds that under the circumstances the public is not likely to be misled. The consent letter should be submitted on the letterhead of the consenting corporation and signed by an authorized officer of that corporation [*see* http://www.sos.ca.gov/business/corp/corp_naav2.htm#geninfo].

a. Domestic corporation; or

b. Foreign corporation authorized to transact business in California.

NOTE:

The prohibition against deceptively similar names does not apply to the names of professional corporations, provided that they conform to statutory limitations [***see*** *Corp. Code § 13409*; ***see also*** Ch. 12A, ***Professional Corporations***]. The test for determining the similarity of names is whether the two names so closely resemble each other that a person using normal care, caution, and observation that the public uses and may be expected to use would mistake one for the other [*Rixford v. Jordan (1931) 214 Cal. 547, 555, 6 P.2d 959]* . The Secretary of State will consider names deceptive if the only difference is a corporate ending [*see* http://www.sos.ca.gov/business/corp/corp_naav2.htm#geninfo].

Lists of names and addresses of various types of California businesses are available from several sources. Many state licensing agencies publish lists of their licensees. All California manufacturers are listed alphabetically by name and by product manufactured in the California Manufacturers Register, published annually by Times Mirror Press.

3. Do not use the following words indicating lending or trust activity without approval:

a. Words "bank," "trust," "trustee," or any related word, unless certificate of approval is obtained from Commissioner of Financial Institutions [*Corp. Code § 201(a)*; *see Fin. Code § 3392*].

NOTE:

The requirement for a certificate from the Commissioner does not apply if the corporation is subject to the Banking Law, for example, a bank or trust company [***see*** *Corp. Code § 163*]. In that case, the articles of incorporation must be endorsed with the approval of the Commissioner before submission to the Secretary of State [***see*** *Corp. Code § 201(a)*].

b. Words that indicate that business is involved in business of savings association unless authorized

under the Savings Association Law [*see Fin. Code § 5000 et seq.*], such as following [*Fin. Code § 5652*; *see Fin. Code § 5652(a)*]:

NOTE:
The corporate name of every savings and loan association must include words similar to those listed in (1), below [*Fin. Code § 5650*].

(1) "Savings association," "savings bank," "savings and loan association," "building and loan association," "building association"; or

(2) Any combination of "building," "loan," "bank," "institution," "society," "company," "fund," or "corporation" with one or more of "saving," "savings," or similar words.

c. Words that indicate that business is involved in industrial loan business unless authorized under Industrial Loan Law (also known as the Thrift and Loan Law) [*see Fin. Code § 18100 et seq.*], such as following [*see Fin. Code § 18104*]:

NOTE:
Companies authorized to engage in the industrial loan business must have words similar to those listed below [*Fin. Code § 18101.6*].

(1) "Industrial loan company" or "Investment and loan company"; or

(2) "Thrift company" or "thrift and loan company."

4. Do not use words indicating that proposed corporation is insurer without certificate of Insurance Commissioner approving corporate name [*see Corp. Code §§ 201.5, 202(b)(3), 2105(a)(6)*; *see also Ins. Code §§ 881, 881.5*].

NOTE:
If the proposed corporation is to engage in business as an insurer, it must attach a certificate obtained from the Insurance Commissioner approving the name to the articles of incorporation when filed with the Secretary of State [***see*** *Corp. Code §§ 201.5, 202(b)(3), 2105(a)(6)*; ***see also*** *Ins. Code §§ 881, 881.5*].

5. Do not use word "cooperative" or any abbreviation or derivation of that word or any similar word, unless proposed corporation will be incorporated as authorized cooperative as provided in *Corp. Code § 12311* or other applicable California statute as one of following [*Corp. Code § 12311(b)*]:

NOTE:
This prohibition does not apply to any credit union or organization owned for the mutual benefit of credit unions, any housing cooperative (if the financing is insured, guaranteed, or provided, in whole or in part, by a public or statutorily chartered entity pursuant to a program created for housing cooperatives), a nonprofit corporation (if a majority of the corporate membership is composed of cooperative corporations [***see*** Ch. 13, ***Nonprofit Corporations***]) or an academic institution that serves cooperative corporations [*Corp. Code § 12311(b)*].

a. Consumer cooperative corporation under *Corp. Code § 12200 et seq.* [*see* Ch. 14, *Consumer Cooperative Corporations*].

b. Nonprofit cooperative association under *Food & Agric. Code § 54001 et seq.* [*see* Ch. 14A, *Agricultural Nonprofit Cooperative Associations*].

c. Stock cooperative [*see Bus. & Prof. Code § 11003.2* (definition); *see also* Ch. 33C, *Stock Cooperatives*].

d. Limited equity housing cooperative [*see Bus. & Prof. Code § 11003.4*; *Civ. Code §§ 817, 817.1*; *see also* CALIFORNIA REAL ESTATE LAW & PRACTICE, Ch. 424, *Regulation of Subdivided Land Sales* (Matthew Bender)].

e. Credit union or organization owned for mutual benefit of credit unions.

6. Do not use words "Olympic," "Olympiad," "Citius Altius Fortius," or any combination or simulation tending to suggest connection with United States Olympic Committee or any Olympic activity, without consent of Committee [*36 U.S.C. § 380(a)(4)*].

7. Except as permitted by federal law, do not use names similar to those used by federal government or certain federal agencies, including [*18 U.S.C. § 709*]:

a. "National," "Federal," "United States," "reserve," or "Deposit Insurance."

b. "Federal Deposit," "Federal Deposit Insurance," "Federal Deposit Insurance Corporation," or any combination of three or more of these words.

c. "National Credit Union," "National Credit Union Administration," "National Credit Union Board," "National Credit Union Share Insurance Fund," "Share Insurance," "Central Liquidity Facility," "NCUA," "NCUSIF," "CLF," or any combination or variation of these.

d. "Federal Home Loan Bank" or any combination or variation of these words.

e. "Federal intermediate credit bank."

f. "Department of Housing and Urban Development," "Housing and Home Finance Agency," "Federal Housing Administra tion," "Government National Mortgage Association," "United States Housing Authority," "Public Housing Administration," "HUD," "FHA," "PHA," "USHA," or any combination or variation of these words.

g. "Federal Bureau of Investigation" or "F.B.I."

h. "Secret Service," "Secret Service Uniformed Division," "U.S.S.S.," or "U.D."

i. "United States Mint," "U.S. Mint," or colorable imitation of those terms.

j. "Overseas Private Investment Corporation," "Overseas Private Investment Corp." or "O.P.I.C."

k. "Drug Enforcement Agency" or "DEA."

l. "United States Marshals Service," "U. S. Marshals Service," "United States Marshal," "U. S. Marshal," "U.S.M.S.," or colorable imitation of those terms.

8. Do not use any of following phrases, except as authorized by federal law:

a. "Smokey Bear" [*18 U.S.C. § 711*].

b. "Woodsy Owl" [*18 U.S.C. § 711a*].

[2] Reserving Proposed Corporate Name

1. Check name availability with Secretary of State's Corporate Name Availability Unit by either:

a. Written request.

NOTE:
For information on obtaining, completing, and submitting the Secretary of State's Name Availability Inquiry Letter, which should be used when making a written request, see *§ 2.200A*.

b. Telephone.

NOTE:
Checking of name availability by telephone is only available to a party who has established a prepaid priority account. There is a $4 fee to check each name by telephone. [*see* http://www.sos.ca.gov/business/corp/corp_naav2.htm#avail].

(1) Establish prepaid account.

(2) Call special number, provide identification number and inquire about a name.

c. Direct Access.

(1) Establish Direct Access Account with office of Secretary of State.

(2) Access corporate records via personal computer.

2. Request reservation of proposed corporate name by [*see Corp. Code § 201(c)*]:

a. Written request as follows:

(1) List up to three names (in order of preference if only one name is to be reserved).

NOTE:
A written request for reservation of a corporate name may include up to three names, listed in preferred order, with the request that the first available name, or any number of the listed names, be reserved. A $10 fee must be included for each name to be reserved. For a written request for name reservation, see *§ 2.201*.

(2) State whether or not Corporate Name Availability Unit has previously checked and cleared name or names for which reservation is sought.

(3) State client's name and address and specify contact person.

(4) State principal business in which client will engage.

(5) State county in which proposed corporation's principal office will be located.

(6) Mail request to Secretary of State at Secretary of State, 1150 11th Street, Sacramento, CA 95814 Attention: Corporate Name Availability Unit.

(7) Written response in form of denial or Certificate of Name Reservation should be received in one to two weeks.

b. Telephone request as follows:

NOTE:
Reservation of a corporate name by telephone is only available to a party who has established a prepaid account. There is a $10 fee for each name reserved.

(1) Establish Prepaid Priority Account with office of Secretary of State.

(2) Call priority telephone number, provide account I.D. number, and reserve name.

(3) Account will be debited $14 if name is checked and reserved.

c. Over the counter as follows:

(1) Visit either main office of Secretary of State in Sacramento, or one of the regional offices in Fresno, Los Angeles, San Diego, or San Francisco.

NOTE:
For the office hours and addresses of the regional offices, visit the Secretary of State's website at http://www.sos.ca.gov/business/regional.htm#add.

(2) Present completed Name Reservation Request form for each name reservation requested [*see § 2.201* (form)].

(3) Pay $10 special handling fee for each name for which reservation is requested [*see 2 Cal. Code Reg. § 21903(b)(3), (c)(3)*].

NOTE:
The special handling must be remitted separately and will be retained whether the proposed name is accepted or denied for reservation.

3. Time request for name reservation so that articles will be filed within 60 days after name is reserved.

NOTE:
Reservation of a corporate name is effective for 60 days. The Secretary of State may not issue certificates reserving the same name for consecutive 60-day periods without a lapse of 24 hours over the

course of a business day between periods [*Corp. Code § 201(c)*]. For current processing times, refer to the Secretary of State's website at http://www.sos.ca.gov/business/bpd_processing_times.htm.

4. Reserve name in any other state in which corporation will conduct business.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawCorporate NamesFictitious NamesRegistration RequirementsBusiness & Corporate LawCorporate NamesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

2-2 California Legal Forms--Transaction Guide § 2.133

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.133 Procedures Relating to Preincorporation Agreements

[1] Using Preincorporation Subscriptions (Offers But Not Sales of Securities)

NOTE:

Although the Commissioner of Corporations recognizes that preincorporation subscription agreements may be used in California [***see*** *10 Cal. Code Reg. §§ 260.102.1, 260.102.2*; ***see also*** *§ 2.210[1]*], the more common practice is to incorporate first and then offer the corporation's shares to prospective purchasers. This enables the corporation to accept the subscriptions immediately [***see*** *§ 2.32[3]*] and to receive consideration for the shares when the agreement is executed (subject to any impound requirements imposed by the Commissioner or voluntarily agreed to by the promoter). This procedure is outlined in [2], ***below***, and is generally preferable to that described here.

1. Have principals designate party to act as officer or agent to receive subscriptions.

2. Obtain subscriptions from principals (and others if principals have decided to seek outside shareholders).

3. If subscription agent is to be used in obtaining subscriptions:

a. Instruct agent to make certain that representations relating to consideration to be received [*see § 2.116*, P 5] are consonant with preincorporation agreement provisions.

b. Have all incorporators execute agreement with agent to solicit preincorporation subscription agreements [*see § 2.212*].

4. Establish promoter accountability procedures:

a. Open escrow account for money received.

b. Set up records to account for property received.

c. Document receipt of labor or services performed on behalf of corporation.

5. Draft subscription agreement [*see § 2.210*].

6. Comply with federal and state securities laws.

NOTE:

The small offering exemption [***see*** *Corp. Code § 25102(h)*] and the limited offering exemption [***see*** *Corp. Code § 25102(f)*] from qualification under the Corporate Securities Law of 1968 are discussed in Ch. 6B, ***California Limited Offering Exemptions*** , and Ch. 6C, ***California Small Offering Exemption*** , respectively. Qualification of securities is discussed in Ch. 6H, ***Qualification of Securities*** .

7. Have all subscribers execute investor questionnaires.

8. Have all subscribers execute subscription agreements.

9. Give each subscriber one copy of the subscription agreement.

10. Retain at least two copies of agreement and deliver them to board of directors after incorporation.

11. Have board ratify or accept agreements as soon after incorporation as possible [*see* Ch. 5, *Directors' Meetings, Actions, and Resolutions*]:

a. Draft resolution stating:
(1) Time and place for receipt and acceptance of subscriptions.

(2) Consideration for shares.

(3) Payment terms:
(a) Lump sum.

(b) Installment.

(c) Other.

b. Have board determine fair value to corporation of any property to be transferred to corporation in return for shares [*see Corp. Code § 409(e)*].

c. Instruct board to adopt resolution at first meeting.

d. Mark copies of ratified agreements to indicate ratification or acceptance.

(1) Send one copy to subscriber

(2) Retain other copy with corporate records.

12. Advise board to issue call for payment and transmit it to subscribers.

NOTE:
It may be desirable to annotate a copy of the subscription agreement with an indication of acceptance and include it with the call.

13. Advise board to issue shares either:

a. Only after receipt of payment [*see Corp. Code § 410(b)*]; or

b. As partly paid shares on receipt of partial payment, subject to call for remainder of consideration due [*Corp. Code §§ 409(d), 410(b)*].

[2] Using Subscription Agreement After Incorporation

NOTE:
Although technically this is not a preincorporation procedure, it is included here because it is an alternative approach to that discussed in [1], above, and will be preferable in most instances [***see § 2.32[3]***].

1. Prepare and file articles of incorporation [*see* Ch. 3, *Articles of Incorporation*].

2. If corporation's shares must be qualified for sale or registered under Corporate Securities Law of 1968, federal securities laws, or securities laws of any other state or country, perform necessary qualification or registration procedures or insure compliance with applicable exemptions [*see* Ch. 6, *Securities Regulation Issues*].

3. If Commissioner has imposed impound condition, establish impound mechanism [*10 Cal. Code Reg. § 260.141.23*]:

a. Enter into agreement with escrow depositary.

NOTE:
The escrow depositary ordinarily will be a national bank located in California or a California bank [*10 Cal. Code Reg. § 260.141.23(a)*]. The minimum contents of this agreement are specified by regulation [***see*** 10 Cal. Code Reg. § 260.140.23(b)(3)].

b. Apply to Commissioner for approval of depositary, including:

(1) Name, branch office, and address of depositary.

(2) Written consent of depositary to act in that capacity.

(3) Copy of agreement with depositary.

4. Draft subscription agreement [*see § 2.210*].

5. Have board of directors pass resolution approving form for subscription agreement [*see* Ch. 6I, *Issuance of Equity Securities* , 6I.260[2]].

6. Have corporation designate party to act as officer or agent to accept subscriptions.

7. Distribute subscription agreement to prospective purchasers along with investor questionnaire and prospectus or offering circular.

NOTE:
All offers and sales must be conducted in accordance with the applicable qualification, registration or exemption requirements. For discussion, see Ch. 6, ***Securities Regulation Issues*** .

8. Have subscribers return:

a. Completed questionnaire.

b. Completed subscription agreement.

c. Payment for subscription (payable to escrow depositary if impound condition has been imposed).

9. Have corporation accept subscriptions as soon as possible after receipt.

10. If impound is involved, deposit all funds with escrow depositary within 48 hours of receipt [*10 Cal. Code Reg. § 260.141.21*].

11. If impound is involved, apply to Commissioner for order authorizing escrow depositary to release funds to corporation when conditions of impound have been satisfied [*see 10 Cal. Code Reg. § 260.141.24*]:

NOTE:
The Commissioner will authorize the depositary to release the funds when the full amount of funds specified in the impound condition has been deposited with the escrow depositary and any other conditions for the release of the funds have been satisfied, unless changed circumstances render the impounded funds inadequate or the Commissioner finds that sale of the securities would no longer be fair, just, and equitable [*10 Cal. Code Reg. § 260.141.24(a)*]. A partial release or modification may be allowed in unusual cases [*10 Cal. Code Reg. § 260.141.24(d)*].

a. Include statement by issuer that all required proceeds from sale have been placed with depositary in accordance with impound condition and that there have been no changes or other circumstances that would render amount of impounded funds inadequate to finance proposed plan of operation.

b. Include statement of depositary signed by appropriate officer and setting forth amount of impounds placed with depositary.

c. Include statement that required proceeds are represented by unconditional subscription agreements that are not loans and are not subject to rescission or rejection by the issuer or subscriber.

d. Any other information that Commissioner requires.

NOTE:

For example, the Commissioner may require a statement that the issuer has or has not engaged in business, and a statement setting forth all the issuer's liabilities, including contingent liabilities [***see*** *10 Cal. Code Reg. § 260.141.24(b)(4)*].

12. Issue share certificates to subscribers.

[3] Using Preincorporation Contracts With Third Parties

NOTE:

For discussion of the use of preincorporation agreements with third parties, see *§ 2.33*.

1. Advise principals to disclose nature of intended corporate format to present or potential key suppliers or customers of business or proposed corporation.

2. Advise principals to ascertain in advance whether and on what general terms those parties would be willing to conduct business with new corporation.

3. Draft commercial agreements with third parties for future dealings with proposed corporation that expressly:

a. Show other party's reliance on credit or services of corporation, and not on principals personally.

b. Depend on formal acceptance by directors of new corporation after formation.

4. At first meeting of the corporation's board of directors, have directors adopt resolutions [*see* Ch. 5, *Directors' Meetings, Actions, and Resolutions*]:

a. Expressly ratifying and adopting all preincorporation contracts entered into on behalf of corporation.

b. Expressly disaffirming all such contracts other than those specifically described as ratified and adopted.

5. Advise that incorporators or promoters should be expressly relieved from further liability under contracts adopted by board:

a. By resolution adopting contract.

b. Through agreement to indemnify incorporators or promoters and hold them harmless against any liability incurred in any preincorporation transaction [*see § 2.240* (form for indemnity agreement)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscriber RightsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscription AgreementsBusiness &

Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



172 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

2-2 California Legal Forms--Transaction Guide §§ 2.134-2.139

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 2.134[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
D. Drafting Guide

2-2 California Legal Forms--Transaction Guide § 2.140

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.140 Preincorporation Agreement Among Principals

NOTE:

While it may be argued that there is little need for a preincorporation agreement to incorporate, a preincorporation agreement is a prudent method of providing for and protecting the parties' investment of time, money, or materials, or for the contribution of a trade secret or process. In addition, a preincorporation agreement among principals may be the only document available to present to subscribers showing the type of corporation or investment intended.

The provisions outlined in this section include some that may be expected to be found in the articles of incorporation or bylaws. While copies of the proposed articles or bylaws may be attached to the preincorporation agreement and incorporated by reference, it may be desirable to include them in the body of the agreement.

A preincorporation agreement to incorporate is illustrated in *§ 2.230*.

1. Set forth names of all parties or principals.

2. Describe proposed corporation:

a. State name of proposed corporation.

b. Give address of its principal place of business.

c. Set forth addresses of other places in which it will do business.

d. Describe corporate purpose or business to be engaged in.

e. Specify that corporation is to be formed under California law.

f. State number of directors corporation will have and names of initial directors.

g. Specify titles for officers and names of initial officers.

3. Describe capitalization of proposed corporation:

a. Set forth initial capital contributions of principals in cash, property, or services.

b. Specify amount of capital to be borrowed and, generally, from whom.

c. Specify whether additional capital is to be raised by sale of subscriptions prior to incorporation or subscriptions and shares after incorporation.

d. Describe share structure, detailing number of shares authorized in each class or series, number to be issued initially, and consideration to be received for shares.

4. Set forth restrictions on shares, if any:

a. Powers, privileges, or limits on each class of shares to be issued.

b. Shareholders' rights to vote.

c. Shareholders' rights to transfer shares.

d. Vote needed to adopt bylaws.

e. Vote needed to elect or replace directors.

f. Terms protecting minority shareholders.

5. Specify terms of payment and nature of consideration for stock to be issued to each principal.

6. Describe post-incorporation position of each principal:

a. Specify employment or title.

b. Specify duties.

c. Set forth authority of each.

7. Set forth terms relating to officers of proposed corporation:

a. Detail salaries and fringe benefits to be paid.

b. State period of employment of each.

c. Specify duties, powers, and limitations.

8. Include terms governing following:

a. Deadlock.

b. Dissent.

c. Dissolution.

d. Buy-sell agreement, including basis for valuation of shares.

9. Specify whether cause of action for breach of agreement to incorporate is vested in either:

a. Other parties to agreement;

b. Corporation, when formed by remaining principals; or

c. Both.

10. Include special agreements to protect or provide for contributions by principals of following:

a. Trade secrets.

b. Secret processes.

c. Goodwill.

d. Going business.

11. Choose provisions designed to compensate promoters for preincorporation services:

a. Acquisition by promoters from corporation of voting shares, either for value, generally nominal (bonus or discount shares), or in sufficient amount to permit retention of control, and prior to public sale.

b. Issuance to promoters of stock options or warrants for nominal cash consideration.

c. Sale of property by promoter to corporation, avoiding secret profit problems through full disclosure, for cash or shares.

d. Employment of promoter by corporation as salaried employee pursuant to contract.

e. Commissions on sale of subscriptions to be paid on issuance of shares.

12. Consider drafting shareholders' agreement separate from preincorporation agreement.

NOTE:

A separate shareholders' agreement may be useful because it contains terms designed to survive the incorporation process.

13. Include provision under which principals who will be shareholders agree, if corporation is intended to qualify as small business, to consent to election of Subchapter S election after corporation is formed.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
D. Drafting Guide

2-2 California Legal Forms--Transaction Guide § 2.141

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.141 Preincorporation Contracts With Third Parties

1. Specify liability of parties under following circumstances:

a. Corporation is not organized.

b. Corporation is organized but does not adopt contract.

c. Corporation is organized, adopts contract, but later defaults either willfully, because of inability to perform, or because of insolvency.

2. Use devices designed to protect incorporator or promoter:

NOTE:
For further protection, the incorporators or promoters would be well advised to enter into an agreement with the corporation after its formation under which it agrees to indemnify them for, and hold them harmless against, any liability incurred as a result of any preincorporation transaction on its behalf [***see § 2.240*** (form for indemnity agreement)].

a. Disclose fact that contract is made by promoter for and on behalf of proposed corporation.

b. Specify that parties intend proposed corporation to be real party in interest.

c. Describe status of corporation at time contract is entered.

d. Draft "contract" or "proposal" as continuing irrevocable offer by third party to proposed corporation to become binding on acceptance by corporation when formed.

e. Have incorporator or promoter secure binding option from third party for stated consideration with provision permitting assignment to corporation when formed.

f. Limit obligation of incorporator or promoter under contract by providing that incorporator (and others) will form corporation, that they will cause it to accept contract, and that their liability will be discharged on performance of these obligations.

3. Set forth provisions designed to protect third party, such as:

a. Expressly provide that liability of other party (promoter or incorporator) will be discharged only by complete performance by corporation.

b. Provide that other party will not be discharged from personal liability when corporation accepts contract.

c. Provide that other party will be secondarily liable as guarantor when corporation accepts contract.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART III. TRANSACTION GUIDE
D. Drafting Guide

2-2 California Legal Forms--Transaction Guide §§ 2.142-2.199

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 2.142[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
A. Preincorporation Formation Forms

2-2 California Legal Forms--Transaction Guide § 2.200

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.200 Preincorporation Checklist

[1] Comment--Use of Form

This form is a checklist of information to be gathered for use in the incorporation process. The information gathered by using this form can be used to prepare preincorporation agreements, reserve the corporate name, draft the articles of incorporation, draft the bylaws, prepare minutes of the first board meeting, and issue stock. Use of a checklist is a handy method to ensure that no important information or procedure is overlooked. In addition to the information elicited by this form, the attorney may wish to use the lists presented in *§ 2.100* as an additional source of useful information.

The attorney may also use this form to confirm that the information relating to incorporation contained in the form is correct. This can be done by converting the checklist into letter format, and mailing it to the client for his or her approval before the attorney uses the information in the corporate formation process.

[2] Form

Preincorporation Checklist

PREINCORPORATION CHECKLIST

1. Type of corporation:

_____ [General *or* Bank *or* Trust Co. *or* Professional *or specify other*]

2. Is this a close corporation?

_____ Has a shareholder agreement been drafted?

_____ Specify terms of shareholder agreement:

_____

3. Name of corporation (list in order of preference):
(1)

_____
(2)

_____
(3)

_____
(4)

_____

_____ Has name search been performed?

_____ Have trademark conflicts been researched?

_____ Has name been reserved in California?

_____ Has name been reserved in

_____ [*specify other states*]?

_____ Will fictitious name be used?

_____ Has fictitious name statement been filed?

4. Corporate purpose:

_____ Specify any restrictions on corporate powers:

_____

5. Type of business to be conducted:

_____

6. Will preincorporation agreements be used?

_____ Specify terms of any preincorporation agreements:

_____

7. Address of principal executive office:

_____

8. Address of principal place of business:

_____

9. Name and address of initial agent for service of process:

_____

10. Initial directors (if different from incorporators):

Name	Address	Telephone
_____	_____	_____
_____	_____	_____
_____	_____	_____

Will the directors be named in the articles?

_____

11. Name and address of incorporators other than directors:

_____

12. Authorized capital stock (number of shares): Common shares:

_____

Preferred shares:

_____

Rights, preferences, privileges and restrictions attached to preferred shares:

_____

Persons to whom shares are to be issued:

Name	Address	Class, Amount	Consideration

_____	_____	_____	_____
___	_	_	_
_____	_____	_____	_____
___	_	_	_
_____	_____	_____	_____
___	_	_	_

13. Issuees of debt:

Name	Address	Principal Amount	Interest Rate & Maturity
_____	_____	_____	_____
___	_	_	_
_____	_____	_____	_____
___	_	_	_
_____	_____	_____	_____
___	_	_	_

14. Additional provisions for articles of incorporation:

Designation of different classes of shares:

_____

Rights, preferences, privileges, and restrictions of preferred shares:

_____

Shareholders' right to determine consideration for shares:

_____

Restriction on transfer of securities:

_____

Authorized number (or minimum and maximum) of directors:

_____

Percentage of supermajority vote required to change number of directors or other special matters:

_____

Preemptive rights:

_____

Provision limiting liability and allowing indemnification of directors to full extent permitted by California law:

_____

Duration of corporation (if other than perpetual):

_____

Merger approval provision:

_____

Limitation on amendment of articles:

_____

Limitation on amendment of bylaws:

_____

15. Provisions for bylaws:

Number of directors (fixed or variable):

_____

Qualifications of directors:

_____

Date of regular directors' meeting:

_____

Quorum required for directors' meeting:

_____

Provision for board committees:

_____

Call and notice for special directors' meetings:

_____

Qualifications for shareholders:

_____

Date of annual shareholders' meeting:

_____

Call and notice for shareholders' meeting:

_____

16. Officers

Title	Name
Board Chairperson	
President	_____
Vice-President	_____
Secretary	_____
Chief Financial Officer	_____
	_____

17. Tax, accounting, and financial information:

Accounting period:

_____

Accounting method:

_____

Subchapter S election?

_____

Section 1244 election?

_____

Name and address of accountant: _____

Location and account numbers of bank accounts: _____

Persons authorized to use bank accounts: _____

18. Deadline for incorporation: _____

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation &

BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationGeneral OverviewBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsFormationPlace of IncorporationGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
A. Preincorporation Formation Forms

2-2 California Legal Forms--Transaction Guide § 2.200A

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.200A Name Availability Inquiry Letter-Official Form

[1] Comment--Use of Form

This form may be used when inquiring about the availability of a proposed corporate name.

> ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State at http://www.sos.ca.gov/business/corp/pdf/naavinquiryform.pdf. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 2.200A Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

The completed form should be submitted by mail, along with a self-addressed stamped envelope to:

Secretary of State
Name Availability Unit
1500 11th Street, 3rd Floor Sacramento, CA 95814

There is no fee for submitting a written request. For further coverage, see *§ 2.13[2][b]*. Once availability of a name has been confirmed, the name may be reserved as discussed in *§§ 2.13[2][c]* and *2.132[2]*.

[2] FORM

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
A. Preincorporation Formation Forms

2-2 California Legal Forms--Transaction Guide § 2.201

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.201 Request for Reservation of Corporate Name--Official Form

[1] Comment--Use of Form

This form is the official name reservation form used by the California Secretary of State's office. The form may be used to request the reservation of a corporate, limited partnership, or limited liability company name.

PRACTICE TIP:

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State at http://www.sos.ca.gov/business/corp/pdf/naavreservform.pdf. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 2.201. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Up to three names may be listed, in order of preference, and the first available name will be reserved for a period of 60 days [*see Corp. Code § 201(c)*]. Only one reservation will be made per request form.

The request may be submitted by mail, along with a self-addressed envelope, to the Sacramento office at:

Secretary of State
Name Availability Unit
1500 11th Street, 3rd Floor Sacramento, CA 95814

Alternatively, the request may be submitted in person at the Secretary of State's Sacramento office, or at any of the

Secretary's regional offices located in Fresno, Los Angeles, San Diego, and San Francisco. For addresses of these offices, visit the Secretary of State's website at http://www.sos.ca.gov/business/regional.htm#add. A special handling fee of $10 applies to each name reserved in person. This fee must be remitted by separate check, payable to the Secretary of State. The fee will be retained regardless of whether the reservation of the proposed name is accepted or denied. Currently, email and online requests for name reservations are not accepted.

For discussion of name reservation for corporations, see *§ 2.13[2][c]*. For a procedural guide to assist in choosing a corporate name, see *§ 2.132*.

[2] Form

Request for Reservation of Corporate Name--Official Form

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName Reservations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
A. Preincorporation Formation Forms

2-2 California Legal Forms--Transaction Guide § 2.202

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.202 Incorporators' Action Perfecting Corporation

[1] Comment

[a] Use of Form

This form action is used by the incorporators of a corporation to adopt bylaws and elect directors [*see* [b], *below*]. It is intended to be used when directors were not named in the articles of incorporation. The action must be filed in the corporation's minute book. The board of directors should ratify the action taken by the incorporator.

[b] Authority for Action by Incorporators

If initial directors were not named in the articles of incorporation, until directors are elected, the incorporators may do whatever is necessary and proper to perfect the organization of the corporation, including adopting and amending the corporation's bylaws and electing directors and officers [*Corp. Code § 210*].

[2] Form

Incorporators' Action Perfecting Corporation

RESOLUTIONS OF INCORPORATOR OF
_____ [*name of corporation*]

The following resolutions are adopted by the Incorporator of_____[*name of corporation*], a California corporation, by written consent pursuant to *California Corporations Code Sections 210* and *307(c)*:

Bylaws

1. The following resolution approving the bylaws for the governance of this corporation is adopted:

RESOLVED, that the Bylaws presented to this Incorporator, and attached as Exhibit A hereto, are hereby adopted as the bylaws of this corporation.

Directors

2. The following resolution electing the directors of the corporation is adopted:

RESOLVED, that the following persons are elected as directors of this corporation for the ensuing year and until their successors have been elected and qualified:

[*list names of directors*].
_____
_____
_____

The undersigned, the Incorporator of this corporation, does hereby consent to the foregoing action this_____ day of_____.

_____ [*name*],
Incorporator

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



180 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
A. Preincorporation Formation Forms

2-2 California Legal Forms--Transaction Guide §§ 2.203-2.209

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 2.203[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
B. Subscription Agreements

2-2 California Legal Forms--Transaction Guide § 2.210

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.210 Preincorporation Subscription Agreement With No Public Offering

[1] Comment

[a] Use of Form

This form is a preincorporation subscription agreement for use among founders of a corporation and other investors when the offering is exempt from qualification and registration and that all offerees and purchasers are residents of California. It can be adapted (1) for use after the corporation has been formed to be an agreement between the corporation and a single subscriber, (2) for use by founders or purchasers alone or (3) for use in a public offering. Checklists of procedures relevant to preincorporation subscription agreements are set forth in *§ 2.133[1], [2]*.

PRACTICE TIP:

While the uninitiated may be able to wend their way through the thicket of rules, regulations, advisories and case law governing a public offering, they should be aware that it is a very complex area with potential serious civil and criminal penalties awaiting their stumbles. Before attempting to advise a client in undertaking a public offering, the attorney should either become something of an expert in the field or consult one. *Commentary by Marilyn E. Minger*.

[b] Contents of Subscription Agreements

Subscription agreements should contain express promises to buy a stated amount of shares at a stated price per share and to pay that price on stated terms. When it is intended that the offering will be exempt from qualification and registration, the agreement should also contain representations of the purchasers as to their financial status.

PRACTICE TIP:

Subscription agreements should be obtained even if there is a small number of shareholders and they are all well acquainted with each other, and may not think a formal agreement is necessary. It is also good

practice to include, as exhibits, all the proposed incorporation documents with a binding reference to these noted in the agreement. *Commentary by Marilyn E. Minger*.

[c] Nature of Subscription Agreements and Obligations of Subscribers

A stock subscription is an offer by the purchaser to take unissued shares of stock of a corporation. The agreement may be made either before or after incorporation. A preincorporation subscription agreement becomes binding when the corporation accepts it [*see § 2.32[3]*]. Thus, immediately after formation, the board of directors of the new corporation should specifically accept the agreements.

PRACTICE TIP:

An existing corporation may accept subscription agreements immediately upon receipt so the purchaser does not have an extended period of time to reconsider the offer. Consequently, an alternate to preincorporation subscription agreements is to form the corporation (by filing its articles of incorporation and paying the required franchise tax) before soliciting any subscriptions. *Commentary by Marilyn E. Minger*.

Execution of a subscription agreement with the name of a fictitious person or with the name of any person who does not intend in good faith to comply with it is a crime [*see Corp. Code § 2252*].

[d] Compliance With California Nonpublic Offering Requirements

When a small number of owners is forming a corporation, a securities exemption is usually available for a nonpublic transaction involving both offer and sale of the corporation's shares [*see* [e]-[h], *below*]. There is also an exemption for a small offering only. Sections 9 and 10 of this form require the purchasers to warrant that they comply with the requirements that permit the offering and sale to be exempt. See *section 6.200* of the Transaction Guide in Ch. 6, *Securities Regulation Issues*, for a checklist of exemptions. For further discussion, see Ch. 6, *Securities Regulation Issues* , pts. C, E.

[e] Limited Offering Exemption

Under the limited offering exemption [*see Corp. Code § 25102(f)*], the transaction can involve the sale of shares to no more than 35 persons [*Corp. Code § 25102(f)(1)*]. In computing the number of purchasers, "qualified purchasers" as defined in *10 Cal. Code Reg. § 260.102.13* are not counted as purchasers [*see Corp. Code § 25102(f)(4)*]. All purchasers [*Corp. Code § 25102(f)(2), (3)*]:

- Must either:
  - Have a preexisting personal or business relationship with the offeror or any of its partners, officers, directors or controlling persons; or
  - Be reasonably assumed to have the capacity to protect his, her or its own interests; and
- Must represent that he, she or it is purchasing the shares for his, her or its own account.

Although offers can be made to as many persons as would be consistent with the nonpublic nature of the exemption, all who subscribe to and ultimately purchase the shares must meet the investor qualifications.

[f] Small Offering Exemption

Under the small offering exemption, a sale of shares is exempt from qualification if [*Corp. Code § 25102(h)*]:

- Immediately after the transaction, there is only one class of stock beneficially owned by not more than 35 persons;
- The offer and sale was not advertised;
- The consideration received for the stock consists of only the following:
  - Cash or cancellation of debt upon the initial organization of the issuer;
  - Cash provided there is written approval of al the existing shareholders and the purchasers are existing shareholders; or
  - If there is only one shareholder after the sale, any legal consideration;
  - Assets, including cash, of an existing business transferred to the issuer upon its initial organization, and the persons receiving the stock (i) were owners of the existing business for not less than a year prior to transfer; and (ii) owned the existing business in the same proportion as the stock they will receive.
- No promotional consideration is paid; and
- Each purchaser represents that the purchaser is purchasing the shares for the purchaser's own account.

[g] Qualified Purchaser Offering Exemption

Under the qualified purchaser offering exemption, available to California corporations and foreign corporations subject to *Corp. Code § 2115*, offers and sales may be made to any number of "qualified persons" [*see below*] if [*Corp. Code § 25102(n)*]:

- Offers and sales are made only to qualified purchasers or purchasers that the issuer reasonably believes, after inquiry, are qualified purchasers;
- Each purchaser represents that the purchase is for the purchaser's own account;
- Each purchaser receives a written disclosure statement complying with federal Regulation D [*see 17 C.F.R. § 230.501 et seq.*] at least five business days before the securities are sold;
- A general announcement of the proposed offering is published by written document only and contains prescribed information;
- No telephone solicitation is made to any prospective purchaser until the corporation determines that the prospective purchaser is qualified; and
- The corporation files a notice of transaction:
  - At the time of publication of the general announcement of proposed offering or at the time of the initial offer, whichever is first; and

- Within 10 business days after the close or abandonment of the offering.

Generally, "qualified purchasers" are those who are sophisticated enough in business and investing to reasonably be assumed to be able to protect their interests, though specific qualifications are set forth in *Corp. Code § 25102(n)(2)*. Purchasers may be natural persons, corporations, partnerships, or any other type of organization formed to purchase interests in the corporation [*Corp. Code § 25102(n)(4)*].

[h] Nonpublic Offers

This exemption permits nonpublic offers (but not sales) in the form of wholly executory contracts of sale as long as [*Corp. Code § 25102(a)*]:

- No part of the purchase price is paid or received and the securities are not issued until the sale is qualified unless the sale is otherwise exempt; and

- The contract contains an appropriate warning concerning the need to qualify the securities before they are delivered or any consideration is received.

There is no limit on the number of offerees, as long as the offer is nonpublic.

The stipulations required by *Corp. Code § 25102(a)* regarding ultimate qualification of the securities before sale are included as optional provisions in this form. They need be used only if there is no other securities exemption available.

[i] Exemption From Federal Securities Regulation

In addition to complying with California securities requirements, a corporation offering securities has to either register the offering under the federal Securities Act of 1933 [*see 15 U.S.C. § 77a et seq.*] or qualify for an exemption from registration. The most commonly used federal exemptions are the "intrastate exemption" [*see 17 C.F.R. § 230.147* (SEC Rule 147)] and the three limited offering exemptions (SEC Rules 504, 505, and 506) set forth in SEC Regulation D [*17 C.F.R. §§ 230.501-230.508*]. These exemptions are discussed in Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* .

[j] Rule 144

Resale of securities obtained in a nonpublic offering may be restricted by the Securities Act of 1933. Rule 144 provides safe-harbor provisions concerning the resale of restricted securities [*see 17 C.F.R. § 230.144*].

[2] Form

Preincorporation Subscription Agreement With No Public Offering

SUBSCRIPTION AGREEMENT

THIS SUBSCRIPTION AGREEMENT ("Agreement") is made by and among_____,_____,[*names of the founders of proposed corporation*] (collectively the "Founders" and individually a "Founder") and the undersigned purchasers (collectively the "Purchasers" and individually a "Purchaser").

BACKGROUND

A. The Founders intend to form a corporation under the General Corporation Law of the State of California, to be known as_____[*proposed name of corporation*], or by any other name that may be mutually agreed to by the Founders (after its incorporation, the "Company"), for the purposes of engaging in the business of_____[*primary purpose of corporation*].

B. The Founders intend that the Company will be authorized to issue one class of shares of its capital stock consisting of_____[*number*] shares.

AGREEMENT

THEREFORE, in consideration of their mutual promises, the Founders and Purchasers hereby agree as follows:

1. **Founder Agreement to Subscribe.** Each Founder agrees to purchase, and each of them subscribes for, the number of shares of the Common Stock of the Company (the "Stock") set forth in this Agreement opposite his or her name for a purchase price of $_____ per share or an aggregate purchase price as set forth in this Agreement opposite his or her name (the "Purchase Price") within_____ days after the formation of the Company.

[*or*]

1. **Founder Agreement to Subscribe.** Each Founder agrees to purchase, and each of them subscribes for, the number of shares of the Common Stock of the Company (the "Stock") set forth in this Agreement opposite his or her name in exchange for the transfer by that Founder to the Company of all that Founder's right, title and interest in and to that certain_____[*describe property*] (the "Property") as more fully described in the exhibit noted opposite Founder name below.

[*Continue with the following:*]

2. **Purchaser Agreement to Subscribe.** Each Purchaser agrees to purchase, and each of them subscribes for, the number of shares of the Common Stock of the Company (the "Stock") set forth in this Agreement opposite his or her name for a purchase price of $_____ per share or an aggregate purchase price as set forth in this Agreement opposite his or her name (the "Purchase Price") within_____ days after the formation of the Company.

3. **Company Incorporation.** The Founders will use their best efforts to effect the incorporation of the Company in a timely manner.

4. **Time Condition.** This Agreement is expressly made subject to the following condition: the Company will be incorporated within_____[*number*] days from the_____[earliest *or* latest] date this agreement is executed by any party.

5. **Payment.** Each Founder and Purchaser must deliver to the Company the Purchase Price [*or* the Property] within_____ days after notice is given by the Company pursuant to Section 11 of this Agreement that the Company has been incorporated.

6. **Stock Certificate.** The Company will deliver a certificate representing the Stock to each Purchaser and Founder as soon as is practicable after the Company is incorporated.

7. **Independent Obligations of Purchasers.** The obligations of each Purchaser are independent obligations, and the failure of any Purchaser to perform that Purchaser's obligations under this Agreement will not excuse any other Purchaser or Founder from performing his or her obligations under this Agreement.

8. **Obligations of Founders.** The obligations of each Founder are independent obligations, except with respect to the obligations of Founders set forth in Section 3, and the failure of any Founder to perform that Founder's obligations under this Agreement will not excuse any other Founder or Purchaser from performing his or her obligations under this Agreement. The obligations of Founders set forth in Section 3 of this Agreement are joint and several obligations of Founders.

9. **Representations of Founders and Purchasers.** Because of the exemptions from the registration requirements of the federal Securities Act of 1933 (the "Act") and from the qualification requirements of the California Corporate Securities Law of 1968 (the "Law") relied upon by the Company in making the sale of the Stock to Founders and Purchasers, each Founder and Purchaser hereby warrants on his or her behalf that he or she:

(a) Is purchasing the Stock for investment for the Founder's or Purchaser's own account only and not with a view to, or for resale in connection with, any "distribution" thereof within the meaning of the Act or the Law.

(b) Does not have any contract, undertaking, agreement or arrangement with any person to sell, transfer or grant a participation in the Stock to that person or to any third person.

(c) Understands that the Stock has not been registered under the Act or qualified under the Law by reason of specific exemptions therefrom, which exemptions may depend upon, among other things, the bona fide nature of the Founder's investment intent as expressed herein.

(d) Further understands that the Stock must be held indefinitely unless it is subsequently registered under the Act and qualified under the Law or an exemption from registration and qualification is available.

(e) Is aware of Rule 144 promulgated under the Act which permits limited public resale of stock acquired in a non-public offering, subject to the satisfaction of certain conditions, including, among other things, the passage of not less than two years after the holder has purchased and completed payment for the stock to be sold.

(f) Further understands that in the event the requirements of Rule 144 are not met, registration under the Act, compliance with Regulation A or some other registration exemption will be required for any disposition of the Stock.

(g) Has his or her principal residence in the State of California; has owned or leased, and occupied, a residence in the State of California for at least the past six months; and does not currently intend to move to another state or otherwise shift domicile and residence from the State of California.

(h) Is not buying the Stock with the intent to sell or distribute the same to any person who is not a resident of the State of California.

(i) Agrees that the Company may refuse to effectuate any purported transfer of the Stock to a nonresident of the State of California if counsel for the Company should deem such a refusal necessary in order to maintain an exemption from the registration requirements of the Act.

(j) Acknowledges (i) that this Agreement was prepared with his or her knowledge and consent by counsel for the Company; (ii) that he or she was advised by the Company to consider seeking independent counsel to review this Agreement on his or her behalf; (iii) that he or she had adequate time to seek the advice of independent counsel and to review this Agreement; (iv) that he or she either obtained the advice of independent counsel or knowingly and intentionally chose not to seek such

advice; (v) that he or she fully understands this Agreement and all of its terms and provisions, including, but not limited to, those provisions which significantly restrict his or her ability to sell, transfer or otherwise dispose of the Stock; and (vi) the restrictions imposed upon his or her stock pursuant to this Agreement are reasonable.

10. **Additional Representations of Purchasers.** Because of the exemptions from the registration requirements of the Act and from the qualification requirements of the Law relied upon by the Company in making the sale of the Stock to Purchasers, each Purchaser hereby additionally warrants on his or her behalf that said Purchaser:

(a) Is aware that the Stock is highly speculative and that there can be no assurance as to what return, if any, there may be.

(b) Is aware of the Company's business affairs and financial condition; has acquired sufficient information about the Company to reach an informed and knowledgeable decision to acquire the Stock; and has received an opportunity to ask questions relating to the Company's business, legal and financial affairs and to obtain all additional information which Purchaser or his or her Purchaser representative or professional adviser requested.

(c) Has either (i) a preexisting business or personal relationship with the Company or its directors or officers, or (ii) by reason of Purchaser's business or financial experience or the business and financial experience of Purchaser's professional advisor, the capacity to protect Purchaser's own interest in connection with the transaction contemplated by this Agreement.

(d) Is (i) experienced in investing in companies recently organized and in the development stage, (ii) able to fend for itself, himself or herself in connection with this investment, and (iii) able to bear the economic risk of this investment.

(e) Has completely and truthfully completed the Investor Questionnaire submitted by the Purchaser to the Company and that all information provided by the Purchaser to the Company on that Questionnaire is true and correct.

11. **Acceptance By the Company.** This Agreement shall not become effective until the Company's acceptance, which shall only be given after the Company is incorporated and has reviewed the Investor Questionnaire completed and submitted by each Purchaser in accordance with the provisions of Section 10(e) of this Agreement and the Company's determination that the sale of the Stock is exempt from the registration provisions of the Act and qualified or registered under, or exempt from qualification or registration provisions of, the Law.

12. **Securities Legends.** The certificate evidencing the Stock will be imprinted with legends as follows:

"THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE BEEN ACQUIRED FOR THE PURCHASER'S OWN ACCOUNT AND NOT WITH A VIEW TO, OR FOR RESALE IN CONNECTION WITH, ANY DISTRIBUTION THEREOF. NO SALE OR OTHER DISPOSITION OF SUCH SECURITIES MAY BE EFFECTED WITHOUT THE (1) REGISTRATION OF SUCH SALE OR DISPOSITION UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND (2) QUALIFICATION OF SUCH SALE OR DISPOSITION UNDER THE CALIFORNIA CORPORATE SECURITIES LAW OF 1968, AS AMENDED, OR AN OPINION OF COUNSEL IN FORM AND SUBSTANCE SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION AND QUALIFICATION ARE NOT REQUIRED."

"THE SALE OF THE SECURITIES REPRESENTED BY THIS CERTIFICATE WAS NOT REGISTERED UNDER THE SECURITIES ACT OF 1933 IN RELIANCE, IN PART, UPON AN EXEMPTION PROVIDED BY SECTION

3(a)(11) THEREOF. RESALES OF THESE SECURITIES MAY BE MADE ONLY TO CALIFORNIA RESIDENTS FOR AN INDEFINITE LENGTH OF TIME."

THE TRANSFER OF THESE SECURITIES, OR ANY PORTION THEREOF OR INTEREST THEREIN, IS RESTRICTED BY AN AGREEMENT BETWEEN THE PURCHASER AND THE COMPANY. A COPY OF SUCH AGREEMENT MAY BE INSPECTED AT THE PRINCIPAL OFFICE OF THE CORPORATION AND ALL PROVISIONS OF SUCH AGREEMENT ARE INCORPORATED BY REFERENCE IN THIS CERTIFICATE.

13. **Notice.** All notices, requests, demands and other communications relating to this Agreement shall be in writing and shall be deemed to have been duly given on the date of service if served personally or by facsimile on the party to whom notice is to be given, or five days after mailing if mailed to a party to whom notice is to be given, by first class mail, postage prepaid, and addressed as set forth below.

14. **Entire Agreement.** This instrument contains the entire agreement of the Purchasers and Founders concerning the Stock and any promises, representations, inducements, or conditions not expressly set forth in this agreement are of no force or effect.

15. **Counterparts.** This agreement may be executed in one or more counterparts, which will be construed together as forming one agreement.

IN WITNESS WHEREOF, the undersigned have executed this Agreement as of the day and year of signing.

PURCHASERS:

[*repeated as needed*]

Number of shares:_____

Total purchase price:_____

Name, address, and telephone and facsimile numbers of Purchaser:_____

_____
_____
_____

FOUNDERS:

[*repeat as needed*]

Number of shares:_____

Total purchase price:_____

Name, address, and telephone and facsimile numbers of Founder:_____

_____

_____
_____

Date:_____ _____ [*signature*]
[*print name*]

[*or*]

[*repeat as needed*]

Number of shares:_____

Property to be exchange for shares described in Exhibit_____ attached hereto.

Name, address, and telephone and facsimile numbers of Founder:_____

_____
_____
_____

Date:_____ _____ [*signature*]
[*print name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscriber RightsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscription AgreementsBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersSecurities LawExemptions From RegistrationExempt Classes of SecuritiesSecurities LawBlue Sky LawsSecurities Exempt From RegistrationSecurities LawBlue Sky LawsExempted IssuersSecurities LawBlue Sky LawsSecurities RegistrationSecurities LawExemptions From RegistrationExempt TransactionsRegulation D Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
B. Subscription Agreements

2-2 California Legal Forms--Transaction Guide § 2.211

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.211 Subscription Agreement Provisions for Impound Condition

[1] Comment

[a] Use of Form

This form consists of provisions that should be used in a subscription agreement in an offering that is subject to an impound condition. An impound condition normally will be imposed if the securities are not firmly underwritten and if the Commissioner determines that a specific minimum amount of funds is necessary to finance the proposed undertaking as described in the application and that it is inadvisable for the issuer to expend any of the proceeds from the sale of the securities before receiving that minimum amount [*10 Cal. Code Reg. § 260.141.20*].

[b] Subscription Agreement Required

The Commissioner of Corporations will require that a subscription agreement be delivered to each subscriber whenever the Commissioner imposes an impound requirement in connection with the sale of securities [*10 Cal. Code Reg. § 260.141.22(a)*].

[c] Contents of Agreement

When an impound condition is imposed the form of the subscription agreement must be approved by the Commissioner, and must contain certain specified information, including [*10 Cal. Code Reg. § 260.141.22*]:

- The complete names and addresses of the issuer and the subscriber;
- The complete name of the agent of the issuer or broker receiving the payments;
- The number of securities purchased and the total purchase price;

- The amount of the payment received;
- The complete name and address of the depositary with whom the payment will be placed; and
- The date of the payment.

[d] Delivery of Copies

Subscription agreements must be consecutively numbered and prepared in quadruplicate. The original must be given to the subscriber, the first copy to the depositary together with the payment received, the second copy to the issuer, and the third to the broker, if any. The Commissioner may approve other modifications to the form, such as requiring the subscription agreements to be press-numbered [*10 Cal. Code Reg. § 260.141.22(a)*].

[2] Form

Subscription Agreement Provisions for Impound Condition

IMPOUND PROVISIONS

_____. **Agreement Subject to Terms of Qualification.** This subscription is made pursuant to, and is subject to, the terms and conditions of the qualification approved by the Commissioner of Corporations of the State of California for_____[*name of issuer*] under date of_____[*date of qualification*].

_____. **Delivery of Funds.** MAKE ALL CHECKS, DRAFTS, AND MONEY ORDERS ISSUED IN PAYMENT FOR SUBSCRIPTION PAYABLE TO_____[*name and address of escrow depositary*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscriber RightsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscription Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
B. Subscription Agreements

2-2 California Legal Forms--Transaction Guide § 2.212

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.212 Agreement Between Incorporators and Promoter for Solicitation of Subscriptions

[1] Comment

[a] Use of Form

This form is an agreement between incorporators and a promoter who will be soliciting subscription agreements on behalf of the corporation to be formed. If the corporation has been formed, this agreement may be modified to reflect the fact that it, and not the incorporators, is the party promising to issue shares or pay money on the successful completion of the solicitation. If the subscriptions will not be offered pursuant to the nonpublic offering exemption [*see Corp. Code § 25102(a)*; *see also § 2.210[1]*], and are not otherwise exempt, this form contains an optional provision (see Paragraph 4) requiring the incorporators to apply for a permit from the Corporations Commissioner that will qualify the subscriptions for sale in California.

This form contemplates the use of a person compensated for his or her solicitation of subscriptions on behalf of the issuer [*see Corp. Code § 25003*]. If the incorporators, in their capacity as directors or officers, will seek to obtain subscriptions to the corporation's shares without compensation, this agreement will be unnecessary.

[b] Characterization of Promoter as "Agent"

Paid promoters may be used to solicit subscriptions to shares of a corporation regardless of the size of the corporation or its ultimate number of shareholders. While it is true that the small offering exemption for 35 or fewer shareholders is not available if selling expenses are incurred in the sale of shares [*see Corp. Code § 25102(h)*], the limited offering exemption for corporations having 35 or fewer shareholders requires only that no advertisements be published and does not prohibit the use of a promoter [*see Corp. Code § 25102(f)*]. In addition, the qualified purchaser offering exemption [*see Corp. Code § 25102(n)*] does not prohibit the use of promoters as long as the mandatory disclosure requirements are fulfilled [*see Corp. Code § 25102(n)(5)-(7)*]. Promoters can also be used to solicit subscriptions under the exemption for nonpublic offers (but not sales) of securities [*see Corp. Code § 25102(a)*; *see also § 2.210[1]*].

It is important to know just how to characterize the person who will be soliciting subscriptions for the corporation's shares because, under certain circumstances, the corporation will be responsible for bonding that person and supervising his or her activities. An "agent" is defined in the Corporate Securities Law as any individual, other than a broker-dealer, who represents a broker-dealer, or who for compensation represents an issuer, in effecting or attempting to effect purchases or sales of securities in California. The definition excludes individuals who only represent an issuer in transactions exempted by *Corp. Code § 25102* (which includes, among other issuer exemptions, those for nonpublic offerings that are discussed above). Furthermore, an officer or director of the issuer, and any person occupying a similar status or performing similar functions, is an agent only if he or she receives compensation specifically related to purchases and sales of securities [*Corp. Code § 25003*]. It follows that a person who is uncompensated cannot be a statutory agent. Likewise, a person offering or selling securities pursuant to an issuer exemption (for example, the limited offering exemption) cannot be an agent even if he or she is compensated. Thus, only persons who, for compensation, will be soliciting agreements to purchase shares that must be qualified by the Commissioner of Corporations will be "agents." The decision to utilize an agent may be affected by the fact that the issuer is responsible for furnishing complete information concerning that person and furnishing a bond or undertaking. This information and this bond or undertaking must accompany the issuer's application to qualify its securities [*see 10 Cal. Code Reg. §§ 260.112, 260.113*].

[c] Nature of Compensation

Because the binding effect on the corporation of an agreement between the incorporators and a promoter may be open to question [*see § 2.32[3]*], it is in the promoter's interest that the incorporators can be required to pay cash in lieu of shares. This agreement gives both parties the option of payment in cash in lieu of shares.

The incorporators may have good reason to choose to compensate the promoter solely in cash and enter a separate agreement giving him or her the option of purchasing shares for the same price all other subscribers will pay. If the corporation does ratify the agreement and issue shares to the agent in compensation for his or her services, these shares will be "promotional shares," which, under the Commissioner of Corporation's rules, will likely be subject to waivers of assets and dividends [*see 10 Cal. Code Reg. §§ 260.140.30* (defining promotion shares), 260.140.32 (rights of promotional shares)]. The effect of these waivers may be to create, for Subchapter S election purposes, a separate class of stock, rendering the corporation ineligible for the election [*see Paige v. United States (9th Cir. 1978) 580 F.2d 960, 963]* .

[d] Status of Agreement Under Securities Law

An agreement between an issuer and a promoter who will solicit sales of the issuer's securities comes under the statutory exemption for transactions with "underwriters" [*see Corp. Code § 25022* (definition)] and is therefore exempt from qualification under the Corporate Securities Law [*Corp. Code § 25102(d)*]. The exemption refers only to "issuers" and does not mention incorporators or preincorporation agreements. However, once the corporation comes into existence and adopts the agreement, the exemption will apply. Before incorporation, the status of this agreement is not certain with respect to the Corporate Securities Law. It is unlikely, however, that the agreement involves the offer or sale of a "security," the only security in existence at the time being a preincorporation subscription.

[e] Time for Performance

This form contains two provisions that will have a direct bearing on the ability of the promoter to perform the contract. Paragraph 1 specifies the length of time that the promoter has to secure the requisite number of subscriptions. Paragraph 4, the optional provision requiring the incorporators to qualify the subscription agreements under the Corporate Securities Law, requires the incorporators to secure a permit within a definite time. Consequently, the time allowed for the promoter to perform should be added on to the number of days it is anticipated that it will take to obtain a permit

from the Department of Corporations.

[2] Form

Agreement Between Incorporators and Promoter for Solicitation of Subscriptions

AGREEMENT TO SOLICIT SUBSCRIPTIONS

This Agreement is made on_____[*date*], between_____[*name*] and_____[*name*] ("Incorporators"), and_____[*name*] ("Promoter").

BACKGROUND

A. Incorporators propose to form a corporation under the General Corporation Law of the State of California to be known as_____[*proposed name of corporation*], or by any other name that may be selected by them, for the purpose of engaging in the business of_____[*set forth specific business in which corporation is primarily to engage*], and;

B. It is proposed that the proposed corporation will secure a permit from the Commissioner of Corporations for the initial issuance by it of $_____ worth of its capital stock divided into_____[*number*] shares of the same class,

AGREEMENT

THEREFORE, the undersigned hereby agree as follows:

1. **Agreement to Solicit.** Promoter will secure and deliver to Incorporators within_____[*number*] days from the date of this agreement, bona fide written subscriptions from solvent persons for not less than_____[*number*] shares of the stock described in this agreement at a price of not less than $_____ per share, payable at the direction of the board of directors of the proposed corporation after its formation.

2. **Compensation.** As consideration for the services of Promoter in securing the subscriptions described in Paragraph 1 of this agreement, Incorporators will cause the corporation to issue to Promoter as fully paid, but subject to any conditions imposed by the Commissioner of Corporations,_____[*number*] of common shares at a price per share of $_____; or in lieu of the offer of shares, at the option of either party, Incorporators will pay Promoter the sum of $_____.

3. **Default Clause.** If Promoter fails to obtain the subscriptions within the time prescribed in Paragraph 1 of this agreement, this agreement will be null and void and no consideration of any kind will be due from Incorporators to Promoter.

[*When subscriptions must be qualified by Department of Corporations, add:*]

4. **Necessary Permits.** The Incorporators agree to apply for and to obtain a permit qualifying the offer and sale of the subscription agreements and the issuance of the underlying shares pursuant to the provisions of the California Corporate Securities Law. The permit must be obtained on or before_____[*date*], and if not obtained on or before that date, this agreement is null and void.

[*Continue with the following:*]

5. **Entire Agreement.** This instrument contains the entire agreement of the parties concerning the subscriptions and stock described in the agreement, and any promises, representations, inducements, or conditions not expressly set forth in this agreement are of no force or effect.

6. **Attorneys' Fees.** If any_____[legal action *or specify more limited provision, e.g.*, legal action based in contract law] is commenced between the parties concerning this agreement, or the rights and duties of either in connection with the agreement, the party prevailing in that action will be entitled to a reasonable sum for attorneys' fees in addition to any other relief that may be granted. The amount of this sum will be fixed by the court either as part of the costs of litigation or in a separate action brought for that purpose.

IN WITNESS WHEREOF, the undersigned have executed this Agreement as of the day and year first above written.

INCORPORATORS

_____[*signature*]
[*typed name*]

_____[*signature*]
[*typed name*]

PROMOTER

_____[*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawBlue Sky LawsOffer & SaleSecurities LawBlue Sky LawsOptions, Subscription Rights & WarrantsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscription AgreementsBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersSecurities LawBlue Sky LawsExcluded Transactions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
B. Subscription Agreements

2-2 California Legal Forms--Transaction Guide § 2.213

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.213 Purchaser Questionnaire

[1] Comment--Use of Form

This form should be used when it is intended that the proposed corporation will issue shares pursuant to exemption from qualification of the California securities laws and registration of the federal securities laws.

Often the linchpin of exemptions is the financial qualifications of the purchasers and the relationship of the purchasers to the principals of the corporation. This form provides a basis, in addition to the representations purchasers must make in subscription agreements, for the corporation to ascertain the qualifications of the investor.

The form provided here is designed for an individual purchaser. The form can be adapted to obtain additional information about trusts, partnerships or other corporations that might purchase the proposed corporation's shares. In adapting the form for those uses, detailed information should be obtained about the entity, its principals, its financial status, and its investment history.

[2] Form

Purchaser Questionnaire

INDIVIDUAL PURCHASER QUESTIONNAIRE

I,_____[*name of proposed investor*], may be interested in purchasing securities of_____[*proposed name of corporation*], a proposed corporation (the "Company"), as an investment. I understand that the Company will determine whether the sale of those securities to me must be qualified under the California Corporate Securities Law of 1968, as amended (the "Law"), or registered under the federal Securities Act of 1933, as amended (the "Act"), based on my representations set forth in this Questionnaire. Prior to answering this questionnaire, I have consulted with my personal advisors as I have deemed necessary.

I understand that all information I provide in this Questionnaire will be kept confidential; however, by signing this Questionnaire, I agree that the Company or any of its incorporators, directors, officers or attorneys may present this Questionnaire to such parties as any of them deem appropriate if called upon to establish the availability of an exemption from the qualification or registration provisions of the Law and the Act.

Questions or inquiries relating to income or financial status are designed to assist the Company in determining whether an investor meets certain suitability standards prescribed by the Law and the Act and regulations promulgated thereunder. These questions and inquiries are *not* an attempt by the Company to solicit unnecessary personal information. Questions relating to personal income or net worth are taken from guidelines promulgated by the Securities and Exchange Commission. Please answer the questions truthfully; a "no" answer does not necessarily disqualify you as an investor.

In reference to the foregoing, I represent and warrant to the Company that the following information concerning me is correct:

1. Name:

_____

Social Security or Taxpayer I.D. No.:

_____

2. Residence Address:

_____

_____

_____

Telephone Number:

_____

3. Business Address:

_____

_____

_____

Telephone Number:

_____

4. Principal Occupation:

_____

5. Amount I am considering investing: $

_____

6. (a) My net worth or joint net worth with my spouse is in excess of $1,000,000:
Yes [ ] No [ ]

(b) (i) My personal income, *not* including my spouse, exceeded $200,000 in the last two years *and* I expect personal income of $200,000 in the current year *or* (ii) my joint income, including my spouse, exceeded $300,000 in the last two years *and* I expect joint income of $300,000 in the current year. Income is defined as individual adjusted gross income increased by (a) any deduction for long term capital gains under *Internal Revenue Code Section 1202*; *(b)* any deduction for depletion under *Internal Revenue Code Section 611 et seq.* (c) any exclusion for interest under *Internal Revenue Code Section 103*; and *(d)* any losses of a partnership allocated to the individual limited partners as reported on Schedule E of Form 1040.
Yes [ ] No [ ]

(c) My cash flow from all sources is sufficient to satisfy my current needs, including possible contingencies, such that I have no need for liquidity in this proposed investment:
Yes [ ] No [ ]

(d) I can afford to lose my entire investment:
Yes [ ] No [ ]

(e) The investment does not exceed ten percent of my individual net worth or my joint net worth, including my spouse.
Yes [ ] No [ ]

7. I graduated from college: Yes [ ] No [ ]
I attended graduate school: Yes [ ] No [ ]
Degree received:

_____
Major fields of study:

_____

8. I have such knowledge and experience in financial and business matters that I am capable of evaluating the merits and risks of my prospective investment in the Company:
Yes [ ] No [ ]

9. Described briefly below are the principal positions I have held during the last five years or since graduation from college (whichever is less). (Specific employers need not be identified; what is sought is a sufficient description to enable the Company to determine the extent of vocationally related experience in financial and business matters):

_____

_____

_____

10. Described briefly below are any pre-existing personal or business relationships I have with the Company or any of its officers or directors:

_____

_____

_____

11. By reason of my business or financial experience, I have the capacity to protect my own interests in connection with my prospective investment in the Company:
Yes [ ] No [ ]

12. I have previously invested in:

(a) "Start-up" corporations:
Never [ ] Rarely [ ] Occasionally [ ] Frequently [ ]

(b) Marketable securities:
Never [ ] Rarely [ ] Occasionally [ ] Frequently [ ]

(c) Securities with limited marketability:
Never [ ] Rarely [ ] Occasionally [ ] Frequently [ ]

13. In previous investments in securities with limited marketability, if any, I utilized the services of the following to assist me in my evaluation of the transaction:
No previous investments [ ]
Accountant: Yes [ ] No [ ]
Lawyer: Yes [ ] No [ ]
Other:

_____
(If other, state the nature of his or her expertise)

14. In evaluating *this* prospective investment, I will use the services of the following person(s):
Accountant: Yes [ ] No [ ]
If yes, name:

_____
Lawyer: Yes [ ] No [ ] If yes, name:

_____
Other:

_____
(If other, state the nature of his or her expertise) The above person(s) will [ ] will not [ ] be my "Professional Advisor and Purchaser Representative" in connection with evaluating the merit and risks of this investment. If the above person(s) will be your "Professional Advisor and Purchaser Representative", please provide his or her name, address and telephone number below, and ask him or her to complete and forward to the Company Schedule 1 attached to this questionnaire).

_____

_____

_____

15. I have indicated below any additional information which I think may be helpful in enabling the Company to determine that my knowledge and experience in financial and business matters are sufficient to enable me to evaluate the merits and risks of this investment.

_____

_____

_____

16. My principal residence is in the State of California, and I do not currently intend to move from the State of California.
Yes [ ] No [ ]

To the best of my information and belief, the above information supplied by me is true and correct in all respects.

Date:_____ _____ _____
[NAME OF PROPOSED PURCHASER]

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawBlue Sky LawsSecurities Exempt From RegistrationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscriber RightsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsSubscription AgreementsBusiness & Corporate LawCorporationsFormationPreincorporationTransactions



185 of 192 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
B. Subscription Agreements

2-2 California Legal Forms--Transaction Guide §§ 2.214-2.219

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 2.214[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
C. Promotion Agreements

2-2 California Legal Forms--Transaction Guide § 2.220

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.220 Agreement Between Incorporators and Organizer-Manager

[1] Comment

[a] Use of Form

This form is an agreement between the persons who will act as the incorporators of a corporation and an "organizer-manager," that is, the person who will prepare plans for the operation of the business and, after incorporation, manage the business. It is for use when there are persons who desire to invest in (and incorporate) a new business in which they have little or no experience with a person who is experienced in the management of such a business. The agreement requires the organizer-manager not only to discover and assemble the facts necessary to determine whether a corporation should be formed, but to guide the new corporation during its initial period of development. The organizer-manager, whether he or she is the originator of the idea for the corporation or truly an outsider hired to perform these functions, generally will not be interested in associating with the venture unless he or she is given some incentive, usually stock in the proposed corporation, that will allow participation in the growth of the corporation. The organizer-manager also may want assurance that he or she will be retained by the corporation once incorporation and organization of the business have been accomplished.

[b] Enforceability of Preincorporation Agreement

The corporation contemplated by this agreement will not have been formed at the time the organizer-manager's services must begin, and it is not an absolute certainty at the time the agreement is executed that the corporation will ever be formed. Thus, the corporation itself will be unable to enter into a contract with the organizer-manager to compensate him or her for the contemplated services or to engage him or her as its manager after it is formed. At the time the services are to begin, the only existing legal entities with which that person may contract for compensation are the incorporators. When, as in this form, the persons who sign the agreement are to become, and do become, the only stockholders in the proposed corporation (that is, when it can be shown that there is a unity of interest and ownership between the shareholders and the corporation), the contract may be enforced against the corporation [*Chater v. San*

Francisco Sugar Refining Co. (1861) 19 Cal. 219, 245-247 ; *Judelson v. American Metal Bearing Co. (1948) 89 Cal. App. 2d 256, 262, 200 P.2d 836]* . In this situation, the interests of third parties are not affected and the corporation is treated as the mere agency of the incorporators created for the sake of convenience in carrying out the agreement made before the corporation was formed [*Hillman v. Hillman Land Co. (1947) 81 Cal. App. 2d 174, 184, 183 P.2d 730]* . This form provides that the incorporators are jointly and severally liable to pay the organizer-manager a stipulated amount for the services performed in case the corporation is not formed [*see* [2], P 6, *below*].

[c] Issuance of Promotional Securities

Almost invariably, the type of corporation contemplated by the agreement in this form will be eligible to use the limited offering exemption from qualification under the Corporate Securities Law [*see Corp. Code § 25102(f)*; *see also* Ch. 6B, *California Limited Offering Exemptions*]. Therefore, the Corporations Commissioner's restrictions and conditions on the issuance of promotional shares will not apply to the issuance of shares to the organizer-manager. If, for some reason, the exemption is not available and the shares of the corporation can only be issued pursuant to a permit granted by the Commissioner, the following discussion of the Commissioner's rules regarding promotional shares will apply.

When shares issued for preincorporation services must be qualified by the Commissioner of Corporations, they come within the Commissioner's definition of "promotional securities" [*10 Cal. Code Reg. § 260.140.30*]. The rules of the Commissioner contain comprehensive provisions governing the amount and manner in which promotional securities may be issued under the Commissioner's fair, just, and equitable standard [*see, e.g., 10 Cal. Code Reg. §§ 260.140.30, 260.140.33, 260.141, 260.141.3*].

Normally, only "unseasoned corporations" are permitted to issue promotional shares [*10 Cal. Code Reg. § 260.140.31*]. A "seasoned corporation" ordinarily is an issuer that has been conducting bona fide business operations, either directly or through a predecessor, for more than two years and has operated at a profit during at least one of the last three fiscal years [*10 Cal. Code Reg. § 260.001(g)*].

An unseasoned corporation may not issue an unreasonable number of promotional shares. A number that does not exceed 25 percent of all of the common shares issued and proposed to be issued is presumptively reasonable. However, additional promotional shares may be approved, depending on the nature of the services rendered, the nature and circumstances of the business enterprise being promoted, and the identity of the investors [*10 Cal. Code Reg. § 260.140.31*]. Promotional shares must be equity shares without preference to dividends, assets, or voting rights, and can have no greater rights than nonpromotional shares [*10 Cal. Code Reg. § 260.140.32*].

Promotional shares must be issued subject to a condition that the holders waive all rights to receive cash or property dividends and to participate in any distribution of assets on dissolution [*10 Cal. Code Reg. §§ 260.140.32, 260.141*]. They must bear a promotional legend condition set forth on the certificate [*10 Cal. Code Reg. §§ 260.140.32, 260.141.1*]. When the Commissioner determines that the legend condition will not provide sufficient protection from a possible transfer of the promotional shares to the public, the Commissioner is authorized to require an escrow condition on those shares [*10 Cal. Code Reg. § 260.141.3*]. For a discussion of the issuance of promotional securities and its effect on eligibility for Subchapter S status, see *§ 2.212[1][c]*.

[2] Form

Agreement Between Incorporators and Organizer-Manager

ORGANIZATION AND MANAGEMENT CONTRACT

This agreement is made on_____[*date*], between_____[*name*] and_____[*name*] ("Incorporators"), and_____[*name*] ("Manager").

BACKGROUND

A. Incorporators desire to form a corporation ("the corporation") under the General Corporation Law of the State of California for the purpose of engaging in the general business of_____[*set forth specific type of business in which corporation is primarily to engage, e.g.*, furniture manufacturing] and;

B. WHEREAS, Manager has engaged in the operation, management, and supervision of_____[*specify, e.g.*, furniture manufacturing] businesses in California for many years and represents that_____[he *or* she] is capable of establishing and operating the business proposed to be conducted by the corporation.

AGREEMENT

NOW, THEREFORE, it is agreed as follows:

1. **Duties of Manager.** Manager will prepare and submit to Incorporators on or before_____[*date*], complete plans for the establishment of a_____[*e.g.*, furniture manufacturing] business in the City of_____, California, including:

(a) A proposed lease of a building or other facilities suitable for occupancy of the business;

(b) A detailed statement of the items of furniture and equipment necessary for the establishment of the business and the required costs;

(c) A detailed estimate of the employees necessary for the successful establishment and conduct of the business and the required costs;

(d) A detailed statement of the plans for marketing products of the business, the required costs, and the anticipated revenue of the business;

(e) A proposed budget for the operation of the business for a period of one year following its establishment; and

(f) A detailed statement of all other matters necessary or desirable in the opinion of Manager for the establishment and operation of the business.

2. **Formation of Corporation.** If that plan, substantially as submitted to the Incorporators by Manager, is acceptable to the Incorporators, the Incorporators will forthwith, at their own cost and expense, cause to be formed under the General Corporation Law of the State of California, a corporation having the following attributes:

(a) The name of the corporation will be

_____ [*name*], or, if that name is unavailable, any other name that may be selected by the Incorporators.

(b) The specific business in which the corporation is primarily to engage will be stated in its articles of incorporation as

_____ [*e.g.*, the manufacture of furniture].

(c) The corporation will be authorized by its articles of incorporation to issue

_____ [*e.g.*, one class of shares of stock consisting of 10,000 shares].

(d) The number of directors of the corporation, as stated in its articles of incorporation, will be

_____ [*e.g.*, three].

(e) The bylaws of the corporation will provide for the appointment of a general manager who, under the direction of the board of directors, will have general supervision of the business operations of the corporation.

3. **Issuance of Shares.** The Incorporators, after formation of the corporation, will cause the corporation to issue [*add if shares must be issued under a permit from the Commissioner of Corporations:*, pursuant to any conditions imposed by the Commissioner of Corporations of the State of California,]_____[*number*] shares of its capital stock to the following persons for the following consideration:

(a)

_____ [*Number*] shares [of its common stock] to

_____ [

_____ (*name of unmarried incorporator*) *or*

_____ and

_____ (*names of incorporator and incorporator's spouse*), as

_____ (joint tenants *or* tenants in common),] for $

_____ cash, in lawful money of the United States.

(b)

_____ [*Number*] shares [of its common stock] to

_____ [

_____ (*name of unmarried incorporator*) *or*

_____ (*names of incorporator and incorporator's spouse*), as

_____ (joint tenants *or* tenants in common),] for $

_____ cash, in lawful money of the United States.

(c)

_____ [*Number*] shares [of its common stock] to the

_____ [Manager *or* Manager and

_____ (his *or* her) spouse, as

_____ (joint tenants *or* tenants in common),] as full compensation for the services of the Manager in preparing the plans and promoting the formation of the corporation.

4. **Contract of Employment.** After formation of the corporation, the Incorporators will cause the corporation to enter a contract of employment with the Manager employing Manager as general manager of the corporation for a period of five years from and after the date of the corporation's incorporation at a salary of $_____ per year. That contract of employment_____[will be in the form and contain the provisions set forth in the instrument attached to this agreement and marked as Exhibit A *or* will contain the following provisions:_____ (*list provisions*)].

5. **Reimbursement of Promotional Expenses.** After formation of the corporation, the Incorporators will cause the corporation to reimburse Manager for all expenditures made by Manager in preparing the plans described in this agreement, not exceeding $_____.

6. **Failure to Accept Plan.** If the plans described in this agreement, substantially as submitted to the Incorporators by the Manager, are not acceptable to the Incorporators, or if the Incorporators, for any reason, are unable to perform the acts required of them by this agreement, the Incorporators will reimburse the Manager for all expenditures made by Manager not exceeding $_____ in preparing the plans described in this agreement, and the Incorporators will pay to the Manager, and the Manager agrees to accept, the sum of $_____ as full compensation for all services rendered in preparing those plans and organizing the corporation. The obligations of the Incorporators to make the payments provided for in this Paragraph 6 are joint and several.

7. **Entire Agreement.** This instrument contains the entire agreement between the parties to this agreement concerning the services to be rendered by the Manager to the Incorporators. Any agreement or representation not expressly set forth in this instrument is null and void.

8. **Modifications.** This agreement may be modified only by an agreement in writing signed by the party against whom the modification is sought to be enforced.

9. **Attorneys' Fees.** If any_____[legal action *or specify more limited provision, e.g.,* legal action based in contract law] is commenced between the parties concerning the provisions of this agreement or the performance of this agreement, the party prevailing in that action will be entitled to a reasonable sum for attorneys' fees in addition to any other relief that may be granted. The amount of that sum will be determined by the court in that litigation or in a separate action brought for that purpose.

10. **Notices.** Any notices or other communications permitted under this agreement or by law will be deemed properly served when deposited in the United States mail, first class postage prepaid, addressed to the Incorporators at_____[*address*], or to the Manager at_____[*address*].

11. **Incurring Expenses.** The Manager will have no authority in performing this agreement to incur any debts or obligations in the name of or on the credit of the Incorporators.

12. **Assignment.** This agreement is for the personal services of the Manager and may not be assigned by_____[him *or* her], nor may the duties to be performed by Manager under this agreement be delegated by Manager to any other person or entity.

INCORPORATORS

_____[*signature*]
[*typed name*]

_____[*signature*]
[*typed name*]

MANAGER

_____[*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawBlue Sky LawsExempted IssuersBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockSecurities LawBlue Sky LawsExcluded Transactions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
C. Promotion Agreements

2-2 California Legal Forms--Transaction Guide §§ 2.221-2.229

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 2.221[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
D. Preincorporation Agreements to Incorporate

2-2 California Legal Forms--Transaction Guide § 2.230

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.230 Preincorporation Agreement to Incorporate

[1] Comment

[a] Use of Form

This form is an agreement among the principals or incorporators to form a corporation. When the future shareholders of a proposed corporation wish to establish a corporation, the use of this type of an agreement is appropriate to ensure that the proposed corporation will have the desired organizational features. By reducing the agreement to writing, the organizers of the corporation can effectively reduce or prevent disputes about the creation of the corporation. The preincorporation agreement can also be used to memorialize the agreement of the parties to protect or provide for investments of time, money, or materials, or to protect or provide for the contribution of trade secrets or processes by one or more of the principals.

[b] Contents of Agreement

At a minimum, a preincorporation agreement to incorporate should include all of the following:

- The purpose for which the corporation is to be formed, and any limitations on its purpose or powers.
- The proposed name of the corporation.
- The location of the principal executive office.
- The management structure and corporate organization.
- The financing and stock structure, including limitations on who made hold shares and protection of minority interests.

- Any commitments of arrangements to be made before incorporation.

Additional considerations and provisions are suggested in *§ 2.140*. For other additional provisions, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 3, *Formation of Corporations* (Matthew Bender).

Other types of agreements for the organization of a corporation are discussed and illustrated in Rabkin & Johnson, CURRENT LEGAL FORMS, Ch. 15, *Shareholders' Agreements* (Matthew Bender). These include an agreement for the conversion of a sole proprietorship to corporate form, agreements to form a corporation with varying kinds of contributions by the principals, agreements among partners for incorporation, and an agreement to form an S corporation.

[2] Form

Preincorporation Agreement to Incorporate

PREINCORPORATION AGREEMENT

This agreement is made on_____[*date*], by and between the undersigned parties.

1. **Agreement to Incorporate.** In consideration of the mutual promises contained in this agreement, the undersigned parties agree to organize a corporation to be known as_____[*proposed name of corporation*] under the laws of the State of California within_____[*number*] days after this agreement, for the purpose of engaging in the business of_____[*primary purpose of corporation*].

2. **Duration.** The period of the corporation's duration will be perpetual.

3. **Corporate Offices.** The principal executive office of the corporation will be at_____[*address*]. The corporation will also do business at_____[*address*].

4. **Directors of Corporation.** The first directors of the corporation will be:

Name	Address
_____	_____
_____	_____
_____	_____

5. **Officers of Corporation.** The first officers of the corporation will be:

President:_____ [*name*]
Vice-President:_____ [*name*]
Secretary:_____ [*name*]
Treasurer:_____ [*name*]

6. **Authorized Capital of Corporation.** The authorized capital of the corporation as stated in its articles of incorporation will be $_____ divided into_____[*number*] shares of the same class [*add if applicable:* having a par value of $_____ each].

7. **Paid-In Capital.** The corporation will not commence business until it has received [*add if applicable:* for the issuance of its shares] consideration in the total amount of at least $_____.

8. **Incorporation and Issuance of Securities.** The parties to this agreement agree to cause the corporation to issue

the shares of the corporation's stock to the parties as follows:

Name	Number of Shares	Description of Consideration
_____	_____	_____
_____	_____	_____
_____	_____	_____

9. **Costs of Incorporating.** All costs and expenses, including attorneys' fees, required for the formation and organization of the corporation, will be advanced by the parties to this agreement, share and share alike, and will be refunded to them by the corporation.

10. **Salaries for Services.** For services to be rendered to the corporation,_____[*name of first party*] will be paid the sum of $_____, and_____[*name of second party*] will be paid the sum of $_____, as annual salary. Each of these two named parties will work full time for the corporation._____[*Name of third party*] will not be required to work full time for the corporation and_____[will not be entitled to a salary from the corporation *or* will be entitled to receive_____ (*describe consideration*)]; in addition, the consent of_____[*name of third party*] must be obtained before the salaries specified in this Paragraph 10 may be modified.

IN WITNESS WHEREOF, the undersigned have executed this Agreement as of_____.

_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurposeBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



189 of 192 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
D. Preincorporation Agreements to Incorporate

2-2 California Legal Forms--Transaction Guide §§ 2.231-2.239

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 2.231[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
E. Indemnification Agreements

2-2 California Legal Forms--Transaction Guide § 2.240

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.240 Agreement Indemnifying Director, Officer, or Agent

[1] Comment

[a] Use of Form

This form is an indemnity agreement between a corporation and a director, officer, or agent of the corporation. It is used when the corporation wishes to eliminate or partially limit the personal liability of a director, officer, or agent. This agreement provides that personal liability will be eliminated to the full extent allowed by California law. An indemnity agreement gives greater protection to the indemnified party than a provision in the corporation's articles or incorporation or bylaws, because it cannot be unilaterally changed.

For this agreement to be effective concerning a director or agent, the corporation must first provide for elimination or limitation of liability in the articles of incorporation [*see Corp. Code § 204(a)(10), (11)*; *see also* [b], [c], *below*]. For a provision to include in the articles of incorporation eliminating a director's liability to the fullest extent possible, see *Ch. 3, Articles of Incorporation, § 3.280[2]*.

This form can be easily revised to provide similar limitation of personal liability for an incorporator or promoter [*see* [c], *below*].

[b] Limitation or Elimination of Director's Liability

The personal liability of a corporate director for monetary damages in an action brought by or in right of the corporation for breach of the director's obligations to the corporation or the shareholders may be eliminated or limited in the corporation's articles of incorporation [*Corp. Code § 309(c)*; *see Corp. Code § 204(a)(10)*]. However, this type of provision may not eliminate or limit the liability of a director for any of the following [*Corp. Code § 204(a)(10)*]:

- Acts or omissions that involve intentional misconduct or a knowing and culpable violation of law.

- Acts or omissions that a director believes to be contrary to the best interests of the corporation or its shareholders, or that involve the absence of good faith on the director's part.

- Any transaction from which a director derived an improper personal benefit.

- Acts or omissions that show a reckless disregard for the director's duty to the corporation or its shareholders in circumstances in which the director was aware, or should have been aware, in the ordinary course of performing a director's duties, of a risk of serious injury to the corporation or its shareholders.

- Acts or omissions that constitute an unexcused pattern of inattention that amounts to abdication of the director's duty to the corporation or its shareholders.

- Prohibited transactions between the corporation and the director [*see Corp. Code § 310*].

- Distributions, loans, and guarantees [*see Corp. Code § 316*].

In addition, no provision will eliminate or limit the liability of a director for any act or omission occurring before the effective date of the provision. Finally, no provision may eliminate or limit the liability of an officer for any act or omission as an officer, notwithstanding that the officer is also a director or that his or her actions, if negligent or improper, have been ratified by the directors [*Corp. Code § 204(a)(10)*].

[c] Limitation or Elimination of Agent's Liability

The articles of incorporation may contain a provision authorizing the indemnification of an agent in excess of that expressly permitted by *Corp. Code § 317* for breach of duty to the corporation or its stockholders [*Corp. Code § 204(a)(11)*]. The term "agent" includes any person who is or was a director, officer, employee, or other agent of the corporation [*Corp. Code § 317(a)*]. However, this type of provision may not provide for indemnification of an agent for acts or omissions from which a director may not be relieved of liability pursuant to *Corp. Code § 204(a)(10)* [*see* [b], *above*] or in circumstances in which *Corp. Code § 317* expressly prohibits indemnity [*Corp. Code § 204(a)(11)*; *see, e.g., Corp. Code § 317(c)* (indemnification prohibited for amounts paid by agent resolving pending action without court approval)].

In addition, an agent may not be indemnified if it would be inconsistent with the articles of incorporation, the bylaws, a resolution of the shareholders, other agreements, or a condition imposed by a court in approving a settlement [*see Corp. Code § 317(h)*].

For a provision to include in the articles of incorporation providing for the indemnification of agents, see *Ch. 3, Articles of Incorporation, § 3.280[2]*.

[d] Attorneys' Fees to Prevailing Party in Enforcement Proceeding

This form contains a provision for recovery of attorneys' fees (including fees on appeal) by the prevailing party in any suit or arbitration proceeding for enforcement or interpretation of the agreement. The provision includes this definition: "The prevailing party shall be the party entitled to recover its costs of suit or arbitration, regardless of whether such suit or arbitration proceeds to final judgment." A court of appeal holds that, in the context of a lawsuit, the word "suit" in such a definition would refer to the entire action, not to a single proceeding within the lawsuit; therefore, the prevailing party would be determined by looking at the action as a whole, not by viewing the trial proceedings and any appellate proceedings in isolation [*Butler-Rupp v. Lourdeaux (2007) 154 Cal. App. 4th 918, 929, 65 Cal. Rptr. 3d 242]* .

[2] Form

Agreement Indemnifying Director, Officer, or Agent

INDEMNIFICATION AGREEMENT

[NAME OF CORPORATION]

INDEMNITY AGREEMENT

THIS INDEMNITY AGREEMENT ("Agreement") is made and effective as of_____[*date*], by and between_____, a California corporation (the "Corporation"), and_____ (the "Agent").

BACKGROUND

A. Agent performs valuable service to the Corporation in Agent's capacity as a director, officer, employee or other agent of the Corporation or by serving at the Corporation's request as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise. The Agent's past, present and future services in all of the relevant capacities just described are sometimes hereinafter collectively referred to as Agent's service to the Corporation in the capacity of "Statutory Agent."

B. The Corporation's Articles of Incorporation ("Articles") authorize the indemnification of directors, officers, employees and other agents of the Corporation, including persons serving at the request of the Corporation in those capacities with another corporation, partnership, joint venture, trust or other enterprise, to the maximum extent permissible by the California General Corporation Law (the "Code").

C. The Articles, the Corporation's Bylaws ("Bylaws") and the Code permit contracts between the Corporation and its agents with respect to the indemnification of those persons.

D. In order to induce Agent to continue to serve the Corporation as a Statutory Agent of the Corporation, the Corporation has agreed to enter this Agreement with Agent.

AGREEMENT

NOW, THEREFORE, in consideration of Agent's continued service to the Corporation after the date hereof, the parties to this Agreement agree as follows:

1. **Definitions.** The following definitions shall apply when used in this Agreement:

(a) "Expenses" means expenses (including attorneys' fees and any expenses incurred to establish a right to indemnification from the Corporation), judgments, fines, penalties, settlements and other amounts actually and reasonably incurred by Agent in connection with the investigation, defense, settlement and appeal of a Proceeding.

(b) "Proceeding" means a threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative.

(c) "Service Termination Date" refers to the date Agent ceases to be (whether by voluntary resignation, death,

involuntary removal or otherwise) a Statutory Agent of the Corporation.

2. **Basic General Indemnity for All Actions other than those By or in Right of Corporation (*Corporations Code Section 317(b)* Indemnity).** Subject to the requirements and restrictions of the applicable provisions of this Agreement and to the fullest extent legally permissible under *Corporations Code Section 317*, the Corporation shall indemnify Agent against Expenses if Agent is made a party or is being threatened to be made a party to any Proceeding (other than in a Proceeding by or in the right of the Corporation to procure a judgment in its favor):

(a) By reason of Agent's service prior to the Service Termination Date as a Statutory Agent of the Corporation against Expenses;

(b) Whether or not Agent continues to hold any such position as Statutory Agent at the time the Expense is incurred and whether or not such a Proceeding is brought before or after the Service Termination Date;

(c) Provided, however, that no indemnification under this Section 2 shall be provided with respect to any Proceeding to the extent that:

(i) Agent did not act in good faith and in a manner Agent reasonably believed to be in the best interests of the Corporation; or

(ii) With respect to any criminal action or proceeding Agent had reasonable cause to believe that Agent's conduct was unlawful.

3. **Basic Indemnity for Actions By or in Right of Corporation (*Corporations Code Section 317(c)* Indemnity).** Subject to the requirements and restrictions of the applicable provisions of this Agreement and to the fullest extent legally permissible under *Corporations Code Section 317*, the Corporation shall indemnify Agent against Expenses if Agent is made a party or is being threatened to be made a party to any Proceeding brought by or in right of the Corporation to procure a judgment in its favor:

(a) By reason of Agent's service as Statutory Agent of the Corporation prior to the Service Termination Date;

(b) Whether or not Agent continues to hold any such position as Statutory Agent at the time the Expense is incurred and whether or not such a Proceeding is brought before or after the Service Termination Date);

(c) Provided, however, that no indemnification shall be provided under this Section 3 with respect to:

(i) Any claim, issue or matter as to which Agent did not act in good faith and in a manner Agent reasonably believed to be in the best interests of the Corporation and its shareholders;

(ii) Any claim, issue or matter as to which Agent is adjudged to be liable to the Corporation in the performance of Agent's duty to the Corporation and its shareholders, unless and only to the extent that the court in which such Proceeding is pending shall determine upon application that, in view of all the circumstances of the case, Agent is fairly and reasonably entitled to indemnity for such expenses and then only to the extent that the court shall so determine;

(iii) Any amounts paid in settling or otherwise disposing of a pending action without court approval (provided, however, that indemnification of Agent under this Agreement shall be available, assuming the other requirements of this Agreement and those imposed by applicable law are met, with respect to settlement costs and expenses of defense of any threatened action by or in the right of the Corporation if settlement is effected without court approval); or

(iv) Any expenses incurred in defending a pending action which is settled or otherwise disposed of without court

approval.

4. **Extended Indemnity Applicable to All Actions (*Corporations Code Section 204(a)(11)* Indemnity).**

(a) **Scope.** Subject to the requirements and restrictions of the applicable provisions of this Agreement and to the fullest extent legally permissible under *Corporations Code Section 204(a)(11)*, the Corporation shall indemnify Agent against Expenses by reason of Agent being made a party or being threatened to be made a party to any Proceeding by reason of a claim of breach of duty to the Corporation or its shareholders based upon Agent's service, prior to the Service Termination Date, as a Statutory Agent of the Corporation.

(b) **Limitations on Extended Indemnity.** The indemnities provided in this Section 4 shall not apply with respect to expenses or liabilities incurred as a result of any of the following:

(i) Acts or omissions by Agent that involve intentional misconduct or a knowing and culpable violation of law,

(ii) Acts or omissions that Agent believes to be contrary to the best interests of the Corporation or its shareholders or that involve the absence of good faith on the part of the Agent,

(iii) Any transaction from which Agent derived an improper personal benefit,

(iv) Acts or omissions that show a reckless disregard for the Agent's duty to the Corporation or its shareholders in circumstances in which the Agent was aware, or should have been aware, in the ordinary course of performing Agent's duties, of a risk of serious injury to the Corporation or its shareholders,

(v) Acts or omissions that constitute an unexcused pattern of inattention that amounts to an abdication of the Agent's duty to the Corporation or its shareholders,

(vi) A violation of *Corporations Code Section 310*,

(vii) A violation of *Corporations Code Section 316*, or

(viii) As to circumstances where indemnity of the Agent is expressly prohibited by *Corporations Code Section 317*.

5. **Advances to Cover Agent's Expenses.** All reasonable Expenses incurred by Agent in defending any Proceeding for which Agent may be or is entitled to be indemnified under this Agreement may be paid by the Corporation in advance of the final disposition of that Proceeding at the request of Agent after receipt by the Corporation of each statement or statements (in reasonable detail) from Agent requesting such advance or advances, conditioned in each case upon receipt of an undertaking by or on behalf of Agent to repay all such amounts if it is ultimately determined that Agent is not entitled to indemnification by the Corporation. Such an undertaking may be accepted by the Corporation without reference to the financial ability of Agent to make repayment.

6. **General Exclusions from Scope of Protection.** The indemnities provided in this Agreement and the provision for advances of Expenses under Section 5 shall not be available (unless Agent has been successful on the merits as provided in Section 9 of this Agreement or where that indemnification or advance is approved by the shareholders in the manner provided in clause (c) of Section 8 of this Agreement) in any circumstance in which it is found:

(a) That it would be inconsistent with any provision of the Articles or Bylaws or of any resolution of the Corporation's shareholders or under any agreement in effect at the time of the accrual of the alleged cause of action asserted against Agent in the proceeding in which the expenses were incurred or other amounts were paid, which prohibits or otherwise limits indemnification; or

(b) That it would be inconsistent with any condition expressly imposed by a court in approving a settlement.

7. **No Automatic Adverse Presumption.** The termination of any Proceeding by judgment, order, settlement, conviction, consent, decree or upon a plea of *nolo contendere* or its equivalent shall not, of itself:

(a) Create a presumption that the Agent did not act in good faith and in a manner which Agent reasonably believed to be in the best interests of the Corporation and its shareholders or, with respect to any criminal action or proceeding, that Agent had reasonable cause to believe that Agent's conduct was unlawful; or

(b) Otherwise adversely affect the rights of Agent to indemnification except as may be provided herein.

8. **Determination of Right to Indemnification Necessary when Agent Not Successful on Merits.** In all cases other than those in which Agent is successful on the merits and is therefore entitled to indemnification as a matter of right under Section 9 of this Agreement, the Corporation shall, as soon as reasonably practicable (after receipt of a notice of a claim of indemnification from Agent under Section 12 of this Agreement), take action to make a determination as to whether indemnification of the Agent is proper in the circumstances (based upon whether the Agent has met the applicable standard of conduct set forth herein) by any of the following:

(a) A majority vote of a quorum of the Board of Directors consisting of directors who are not parties to those Proceedings.

(b) If such a quorum of directors is not obtainable or, even if obtainable, if the Board of Directors by the majority vote of the directors (as provided in clause (a), *above*) so directs, by independent legal counsel in a written opinion to the Board of Directors, a copy of which shall be delivered to Agent. Independent legal counsel shall be selected by the Board of Directors. Upon any failure of the Board to so select independent legal counsel, independent legal counsel shall be selected by or upon the direction of an appropriate California court having jurisdiction.

(c) Approval of the shareholders (in the manner provided in *Corporations Code Section 153*), with the shares owned by the Agent not being entitled to vote thereon.

(d) The court in which the proceeding is or was pending, upon application made by the Corporation or the Agent or the attorney or other person rendering services in connection with the defense, whether or not that application by the Agent, attorney, or other person is opposed by the Corporation.

Under clauses (a) and (b), above, the Agent shall be presumed to have met the applicable standard of conduct required under this Agreement unless, after investigation, it shall be determined by the Board of Directors by a majority vote of a quorum consisting of directors who are not parties to the action, suit, or proceeding or, if such a quorum is not obtainable or, even if obtainable, if a quorum of disinterested directors so directs, by written opinion of independent legal counsel, that the Agent did not meet the required standard of conduct. If a determination is made or deemed to have been made pursuant to the terms of this Section 8 that Agent is entitled to indemnification, the Corporation shall be bound (to the maximum legal extent) by that determination and shall be precluded (to the maximum legal extent) from asserting that the determination has not been made or that the procedure by which that determination was made is not valid, binding, and enforceable.

9. **Automatic Indemnification When Agent is Successful on Merits.**

(a) If Agent has been successful on the merits in defense of any Proceeding described Sections 2 or 3 of this Agreement, or in the defense of any claim, issue, or matter therein, Agent shall be entitled to indemnification under this Agreement as a matter of right, without any necessity to obtain approval under Section 8. If any claim, action, suit, or proceeding in

which Agent becomes involved is disposed of, on the merits or otherwise, without: (i) the disposition being adverse to Agent, (ii) an adjudication that Agent is liable to the Corporation, (iii) a plea of guilty or of *nolo contendere* by Agent, or (iv) any adjudication that Agent failed to act in good faith and in a manner Agent reasonably believed to be in the best interests of the Corporation and its shareholders (and, with respect to any criminal action or proceeding, without an adjudication that Agent had reasonable cause to believe that his or her conduct was unlawful), then Agent shall be considered for the purposes of this section to have been wholly successful on the merits (except as set forth below) with respect thereto and shall be entitled to indemnification under this Agreement as a matter of right (without obtaining approval under Section 8).

(b) With respect to indemnification of an action by or in the right of the Corporation, Agent shall not be deemed to have been successful on the merits in defense with respect to amounts paid in settling or otherwise disposing of a pending action which is settled or otherwise disposed of without court approval or expenses incurred in defending a pending action which is settled or otherwise disposed of without court approval (provided, however, that indemnification of Agent shall not be precluded, assuming other requirements of this Agreement and those imposed by applicable law are met, with respect to settlement costs and expenses of defense of any threatened action by or in the right of the Corporation where settlement is effected without court approval). If Agent is only partially successful on the merits in the defense of any Proceeding of the types described in either Sections 2 or 3 of this Agreement, and as a result is not absolutely entitled under this Section 9 to indemnification by the Corporation for the total amount of the Expenses paid in settlement actually and reasonably incurred by Agent, the Corporation shall nevertheless indemnify Agent as a matter of right (without the need to comply with Section 8) and to the maximum extent legally permissible under this Section 9 to the extent Agent has been partially successful on the merits.

10. **Effect of Insurance Coverage.** The rights to indemnification provided in this Agreement shall be in addition to and shall not be affected by the existence of any directors' and officers' liability insurance policy maintained by the Corporation and which exists as of the date of this Agreement or as of the date a claim is made under this Agreement; provided, however, that to the extent any claim made under this Agreement is covered and timely paid by any directors' and officers' liability insurance policy maintained by the Corporation, the Corporation will only be obligated to provide coverage for any claim under this Agreement after the full coverage under any applicable directors' and officers' insurance policy is exhausted or coverage thereunder otherwise becomes unavailable.

11. **Required Notification By Agent and Manner of Defense of Claim.** Not later than 30 days after receipt by Agent of notice of the commencement of any Proceeding, if a claim in respect to that Proceeding is to be made against the Corporation under this Agreement, Agent will notify the Corporation of the commencement of that Proceeding; however, the omission to notify the Corporation will not relieve the Corporation from any liability it may have to Agent other than under this Agreement. With respect to any action, suit, or proceeding as to which Agent notifies the Corporation of the commencement thereof:

(a) **Corporation's Right to Participate.** The Corporation will be entitled to participate therein at its own expense.

(b) **Corporation's Assumption of Agent's Defense.** Except as otherwise provided below, the Corporation, at its option and jointly with any other indemnifying party similarly notified and electing to assume the defense, may assume the defense of the Proceeding with counsel reasonably satisfactory to Agent. After notice from the Corporation to Agent of its election to assume the defense, the Corporation will not be liable to Agent under this Agreement for any legal or other expenses subsequently incurred by Agent in connection with the defense, except for reasonable costs of investigation or otherwise as provided below.

(c) **Agent's Right to Employ Separate Counsel.** Agent shall have the right to employ separate counsel in any Proceeding; however, the fees and expenses of separate counsel incurred after notice from the Corporation of its assumption of the defense of the Proceeding shall be at the expense of Agent unless:

(i) The employment of counsel by Agent at the Corporation's expense has been authorized by the Corporation;

(ii) The proceeding in question is brought in the name of or on behalf of the Corporation; or

(iii) The Corporation shall not in fact have employed counsel to assume the defense of that action.

In each of the above-referenced circumstances the fees and expenses of Agent's separate counsel shall be borne by the Corporation if Agent is entitled to indemnification under this Agreement. The Corporation shall not be entitled to assume the defense of any Proceeding brought by or on behalf of the Corporation.

(d) **Approval of Settlements.** The Corporation shall not be liable to indemnify Agent under this Agreement for any amounts paid in settlement of any action or claim effected without its written consent, which consent shall not be unreasonably withheld. The Corporation shall be permitted to settle any action, except that it shall not settle any action or claim in any manner which would impose any penalty or limitation on Agent without Agent's written consent, which may be given or withheld in Agent's sole discretion.

12. **Enforcement Actions By Agent.** Any right of Agent to indemnification under this Agreement shall be enforceable by or on behalf of Agent in any court of competent jurisdiction, if:

(a) The claim for indemnification is denied by the Corporation, in whole or in part; or

(b) No disposition of the claim is made by the Corporation within 90 days of a request for such a disposition.

If Agent is successful in such an enforcement action, in whole or in part, Agent shall be entitled to be reimbursed for the expenses of prosecuting Agent's claim for indemnification under this Agreement. It shall be a defense to any action for which a claim for indemnification is made under this Agreement that Agent is not entitled to indemnification because of the express limitations set forth herein, with the burden of proving that defense to be borne by the Corporation. Neither the failure of the Corporation (including its Board of Directors and its shareholders) to have made a determination prior to the commencement of such an enforcement action that indemnification of Agent is proper in the circumstances nor an actual determination by the Corporation (including its Board of Directors and its shareholders) that indemnification is improper shall be a defense to any such an enforcement action.

13. **Term.** This Agreement will expire six years after the Service Termination Date, except that it will continue in effect with respect to any Proceeding pending on the expiration date until the final resolution or disposition of that Proceeding and the fulfillment of all obligations of the Corporation to the Agent under this Agreement with respect to that Proceeding.

14. **Rights Cumulative; Intended Scope of Indemnification.** The rights to indemnification and advancement of expenses provided in this Agreement shall be in addition to any rights to which Agent may otherwise be entitled under other agreements or as a matter of law, including, without limitation, rights under the Articles or Bylaws, and shall inure to the benefit of the heirs, executors and administrators of Agent. It is the intent of the Corporation that the indemnity provided to Agent under this Agreement shall be of the broadest scope legally permissible (subject to the express requirements and restrictions of this Agreement) and that all provisions of this Agreement shall be interpreted to give the Agent maximum benefit; provided, however, that all provisions of this Agreement shall be construed in such a manner as to comply with legal requirements.

Additionally, the Corporation hereby advises Agent that it is not presently aware of any agreement, provision of its Articles or Bylaws, court order or other obligation or requirement imposed on the Corporation (other than the precise requirements of applicable law) which would restrict or prevent in any material way the performance in full by the Corporation of its obligations to Agent under this Agreement. The Corporation agrees to utilize its best efforts not to

permit the imposition of any such requirement (through amendment of its Articles, Bylaws, agreement or otherwise) which would restrict the Corporation's ability to perform its full obligations under this Agreement with respect to any actions or inactions of Agent taken or failed to be taken prior to the date of the effectiveness of any such new requirement, restriction or obligation.

16. **Miscellaneous.**

(a) **Governing Law.** It is the intention of the parties to this Agreement that the internal laws of the State of California (irrespective of its choice of law principles) shall govern the validity of this Agreement, the construction of its terms and the interpretation and enforcement of the rights and duties of the parties under this Agreement.

(b) **Binding upon Successors and Assigns.** Subject to and unless otherwise provided in this Agreement, each and all of the covenants, terms, provisions and agreements contained herein shall be binding upon and shall inure to the benefit of the permitted successors, executors, heirs, representatives, administrators and assigns of the parties to this Agreement.

(c) **Severability.** If any provision of this Agreement or the application thereof shall for any reason and to any extent be invalid or unenforceable, the remainder of this Agreement and the application of such provision to other persons or circumstances shall be interpreted so as best to reasonably effect the intent of the parties to this Agreement. The parties further agree to replace any such void or unenforceable provision of this Agreement with a valid and enforceable provision which will achieve, to the fullest extent possible, the economic, business and other purposes of the void or unenforceable provision.

(d) **Entire Agreement.** This Agreement, together with any agreements and documents referenced herein, constitutes the entire understanding and agreement of the parties to this Agreement with respect to the subject matter hereof and supersedes all prior and contemporaneous agreements or understandings, inducements or conditions, express or implied, written or oral, between the parties with respect to this Agreement. The express terms hereof control and supersede any course of performance or usage of the trade inconsistent with any of the terms hereof.

(e) **Counterparts.** This Agreement may be executed in any number of counterparts, each of which shall be an original as against any party whose signature appears thereon and all of which together shall constitute one and the same instrument. This Agreement shall become binding when one or more counterparts hereof, individually or taken together, shall bear the signatures of all of the parties reflected hereon as signatories.

(f) **Amendments and Waivers.** Any term or provision of this Agreement may be amended and the observance of any term of this Agreement may be waived (either generally or in a particular instance and either retroactively or prospectively) only by a writing signed by the party to be bound thereby. The waiver by a party of any breach hereof for default in payment of any amount due under this Agreement or default in the performance hereof shall not be deemed to constitute a waiver of any other default or succeeding breach or default.

(g) **Attorneys' Fees.** Should suit or arbitration be brought to enforce or interpret any part of this Agreement, the prevailing party shall be entitled to recover, as an element of the costs of suit or arbitration and not as damages, reasonable attorneys' fees to be fixed by the court (including, without limitation, costs, expenses and fees on any appeal). The prevailing party shall be the party entitled to recover its costs of suit or arbitration, regardless of whether such suit or arbitration proceeds to final judgment. A party not entitled to recover its costs shall not be entitled to recover attorneys' fees. No sum for attorneys' fees shall be counted in calculating the amount of a judgment for purposes of determining if a party is entitled to recover costs or attorneys' fees.

(h) **Notices.** Whenever any party to this Agreement desires or is required to give any notice, demand or request with respect to this Agreement, each such communication shall be in writing and shall be effective only if it is delivered by personal service or mailed, United States certified mail, return receipt requested, postage prepaid, addressed as follows:

Agent:	To the address set forth on the signature page of this Agreement
Corporation:	_____ _____ _____ Attn:_____
If to Corporation, with a copy to	

_____

[*attorney*]

Communications shall be effective when they are received by the addressee; but if sent by certified mail in the manner set forth above, they shall be effective three business days after being deposited in the United States mail. Any party may change its address for communications by giving notice to the other party in conformity with this section.

(i) **Absence of Third Party Beneficiary Rights.** No provision of this Agreement is intended nor shall be interpreted to provide or create any third party beneficiary rights or any other rights of any kind in any client, customer, affiliate, shareholder or partner of any party to this Agreement or any other person; unless specifically provided otherwise herein, and except as so provided, all provisions hereof shall be personal solely between the parties to this Agreement.

(j) **Subrogation.** In the event of payment under this Agreement, the Corporation shall be subrogated to the extent of such payment to all of the rights of recovery of Agent, who shall execute all documents required and shall do all acts that may be necessary to secure those rights and to enable the Corporation effectively to bring suit to enforce those rights.

(k) **Survival of Rights.** The rights conferred on Agent by this Agreement shall continue after Agent has ceased to be a Statutory Agent of the Corporation and shall inure to the benefit of Agent's heirs, executors and administrators. The Corporation shall require any successor (whether direct or indirect and whether by purchase, merger, consolidation or otherwise) to all or substantially all of the business or assets of the Corporation to expressly assume and agree to perform this Agreement in the same manner and to the same extent that the Corporation would be required to perform if no such succession had taken place.

IN WITNESS WHEREOF, the parties to this Agreement have executed this Agreement as of the date first above written.

COMPANY: _____ [*name of corporation*]
By: _____ [*signature*]
[*typed name and title*]

AGENT:
_____ [*signature*]
[*typed name*]
Address of Agent:
_____
_____
_____

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawBusiness InsuranceDirectors & Officers Liability InsuranceObligationsIndemnificationBusiness & Corporate LawAgency RelationshipsDuties & LiabilitiesIndemnityBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesIndemnification



191 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
E. Indemnification Agreements

2-2 California Legal Forms--Transaction Guide §§ 2.241-2.249

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 2.241[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2 FORMATION OF CORPORATIONS
PART IV. FORMS
F. Miscellaneous Documents

2-2 California Legal Forms--Transaction Guide § 2.250

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 2.250 Attorney Letter Advising Client Regarding Post-Incorporation Matters

[1] Comment--Use of Form

This form is a letter from an attorney to a client regarding matters that the client needs to be aware of following an incorporation. It is assumed that the attorney has finished forming a corporation for the client and is transmitting the key corporate documents to the client. The form also contains basic advice to the client on corporate operations and the importance of preserving corporate formalities in order to preserve the character of the corporation as an independent entity, as well as advice with respect to license, taxation, and related issues that the corporation will have to address within a short time after formation. For more detailed discussion of the various topics discussed in this letter, see the following chapters:

- Ch. 1C, *Regulation of Employers*.
- Ch. 1D, *Overview of Employee Benefits*.
- Ch. 1E, *Taxation of Businesses*.
- Ch. 3, *Articles of Incorporation*.
- Ch. 4, *Bylaws*.
- Ch. 5, *Directors Meetings, Actions, and Resolutions*.
- Ch. 7, *Corporate Records and Reports*.
- Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*.

The statutory citations in the text are for the convenience of the attorney to provide references for the requirements mentioned in the form. When this form is sent to clients, these references may be eliminated if desired.

[2] Form

Attorney Letter Advising Client Regarding Post-Incorporation Matters

[*Attorney or law firm letterhead*]

_____[*date*]

_____[*Name of client*]
_____[*address*]

Re: _____[*Name of corporation*]; Observance of Corporate Formalities and Other Post-Incorporation Matters

Dear_____[*Name of corporate officer or client*]:

[*If corporation's minute book is enclosed:*]

Enclosed are the Minute Book of_____[*name of corporation*] (the "Corporation"), which contains a certified copy of the Articles of Incorporation, the original of the Bylaws, and_____[*specify other incorporation documents, e.g.,* the Incorporators' Action Perfecting the Corporation, (and) Minutes of the First Meeting of the Board of Directors]. Also enclosed are the Corporation's_____[*specify other items not included in the Minute Book, e.g.,* Corporate Seal and Share Book]. These items should all be retained in a safe place by the Corporation's secretary.

[*Or, if corporation's minute book is not enclosed:*]

Enclosed are copies of the following documents of_____[*name of corporation*] (the "Corporation"): the Articles of Incorporation, the Bylaws and_____[*specify other incorporation documents, e.g.,* the Incorporators' Action Perfecting the Corporation, (and) Minutes of the First Meeting of the Board of Directors]._____[I *or* We] have retained the Corporation's Minute Book which contains the originals of those documents._____[I *or* We] have also retained the Corporation's_____[*specify other items, e.g.,* Seal and Share Book]. Retention of the original documents and other items will enable_____[me *or* our law firm] to provide you with prompt service on any matters concerning the Corporation.

[*Add, if the Statement by Domestic Stock Corporation has not been previously filed and is included in materials being transmitted by this letter:*]

Also enclosed is a Statement by Domestic Stock Corporation which has been furnished by the Secretary of State. The completed form should be returned to_____[me *or* us] as soon as practicable for filing with the

Secretary of State. An updated version of this statement must be filed annually thereafter [*Corp. Code § 1502(a)*].

[*Add, if written consent has not previously been filed and is included in materials being transmitted by this letter:*]

Finally,_____[I *or* we] have enclosed a form for Written Consent by Shareholders which must be executed by the shareholders indicated on the execution page and promptly_____[returned to_____ (me *or* us) for filing *or* filed] in the Corporation's Minute Book. The Written Consent by Shareholder is necessary in order to validate Section_____[*e.g.*, 4.12] of the Bylaws which requires shareholder approval before the section is effective.

[*Continue with the following:*]

Now that the Corporation has been formed, it will be faced with numerous legal requirements that will require your attention. For convenience,_____[I am *or* we are] including a description of some of these basic legal requirements below._____[I *or* We] urge you to contact me if you have any questions about these formalities or any other aspect of the formation or operation of the Corporation

A. Observance of Corporate Formalities

1. **Importance.** The regular observance of the corporate formalities of shareholders' and directors' meetings is an important aspect of maintaining the many protections and advantages that the corporate form offers, one of the most important of which is the protection of shareholders against imposition of personal liability for obligations incurred by the Corporation. The failure to observe appropriate formalities in the conduct of corporate affairs may destroy that protection and cause the shareholders to be personally liable for corporate obligations. In that regard, it would be appropriate for you to observe the following formalities in connection with the ongoing operations of the Corporation:

2. **Shareholder Action.** The shareholders should take action to elect the Board of Directors of the Corporation annually [*Corp. Code § 600(b)*]. That action may be taken by written consent of the shareholders without a meeting, Directors may not be elected by written consent except by unanimous written consent of all shares entitled to vote for the election of directors, except that the shareholders may elect a director to fill a vacancy, other than a vacancy created by removal, by the written consent of a majority of the outstanding shares entitled to vote. [*Corp. Code § 603*]. In addition, certain specified fundamental changes in the form of operations of the Corporation require the consent or approval of the shareholders under California law, including the following:

(a) **Amendment of the Articles of Incorporation** (requires approval by vote or written consent of shareholders holding a majority of the outstanding shares [of each class or series entitled to vote on that matter as a class]) [*Corp. Code § 903*].

(b) **Sale of all or substantially all of the assets of the Corporation** (requires approval by vote or written consent of the shareholders holding a majority of the outstanding shares [of each class or series entitled to vote on that matter as a class]) [*Corp. Code § 1001*].

(c) **Merger or consolidation of the Corporation** with or into any other corporation (requires the vote or written consent of shareholders holding a majority of the outstanding shares [of each class or series entitled to vote on that matter as a class]) [*Corp. Code § 1101*].

(d) **Winding up and dissolution of the Corporation** (requires approval by vote or by written consent of shareholders holding a majority of the voting power) [*Corp. Code § 1900(a)*].

(e) **Any loan of money or property to, or any guaranty of an obligation of, any director or officer of the Corporation**, except under limited circumstances [*see Corp. Code § 315*].

3. **Director Action.** Matters of general operating policy should be considered and authorized by the Board of Directors of the Corporation [*see Corp. Code § 300*]. Although the laws governing corporations do not state how frequently the Board of Directors should act, it is typical, at least in the case of public corporations, that the Board of Directors meets quarterly, and in some cases even monthly, on a regular basis. In addition, a specially convened meeting of the Board, as authorized by the Bylaws, may be called if action is required before the next regular meeting of the Board. Action by the Board may also be taken by the unanimous written consent of the directors._____[I *or* We] recommend that the directors of the Corporation schedule a regular meeting at least quarterly to deal with significant matters that have arisen during the quarter. Matters appropriate for director action, which might arise during the quarter and be accumulated pending approval by the directors, include the following:

(a) **Election of officers, setting of salaries, and declaration of bonuses** (at least annually, typically at a meeting of the Board of Directors immediately following the annual meeting of shareholders) [*Corp. Code § 312*].

(b) **Appointment of Board committees** [*Corp. Code § 311*].

(c) **Opening of corporate bank accounts and the designation and change of corporate officers authorized as signatories** (any bank's corporate account form invariably includes a corporate resolution that the party executing the form represents to have been adopted by the Board).

(d) **Corporate borrowing** and the giving of security in connection with any loans or similar obligations entered into by the Corporation [*Corp. Code § 207(g)*].

(e) **Consummation of major contracts** for the acquisition or lease of significant assets or services or the disposition of assets, or for the rendition of services, outside of the ordinary course of the business of the Corporation [*Corp. Code § 207(g)*].

(f) **Policy decisions with respect to the construction of material assets or the investment of material amounts in research and development projects** (this area is particularly important to document, because of its relevance to the necessity for accumulation of surplus and the use of available cash).

(g) **Adoption of pension, profit sharing, bonus and other employee benefit plans** [*Corp. Code § 207(f)*].

(h) **Declaration of dividends or the redemption of shares** [*see Corp. Code § 501 et seq.*].

(i) **Amendment of the Bylaws** [*Corp. Code § 211*].

(j) **Review of financial statements** and, if the Corporation is a public corporation, approval of filings with the Securities and Exchange Commission.

(k) **Appointment of auditors.**

(l) **Any action that requires a shareholder vote** described in items 2(a) through (e), above.

(m) **Issuance and sale of shares by the Corporation** [*Corp. Code §§ 207(d), 400, 401*], or the grant of

options to purchase additional shares [*Corp. Code § 404*].

If the secretary of the Corporation will prepare a draft of the minutes or written consent evidencing any such director or shareholder actions,_____[I *or* we] will be happy to assist in finalizing the documentation. The form of minutes of the first meeting of the directors might be used as a format.

B. Other Post-Incorporation Matters

Although it is not intended to be exhaustive, the following checklist summarizes the legal requirements that a new corporation is most likely to encounter. Some of the requirements arise as a consequence of incorporation; others apply to any new business regardless of the form of organization. Certain requirements are highly formal and technical; many must be satisfied within a specified time period.

1. **Business Licenses and Permits.** The Corporation will probably be required to obtain a business license from the city in which it intends to operate. In addition, state licenses and permits may be required. Many of the required state licenses and permits are described in the "California License Handbook" which may be obtained from the Office of Small Business Development in Sacramento, and the "California Permit Handbook," which may be obtained from the Department of General Services, Documents Publications Section, in North Highlands, California.

[*Include if corporation has not yet obtained employer ID number:*]

2. **Employer Identification Number.** Every employer must obtain an employer identification number which will be used on federal tax returns and certain other documents [*see I.R.C. § 6109*]. The application form (Form SS-4) may be obtained from the Internal Revenue Service or the Social Security Administration.

[*Continue with the following:*]

3. **Estimated Federal Income Tax.** The Corporation will be required to pay estimated federal income tax in installments [*see I.R.C. § 6655*]. You should discuss this requirement with your accountant in the very near future.

4. **Estimated California Franchise Tax.** California franchise tax is imposed in advance for the privilege of exercising the corporate franchise in California for the taxable year. The minimum franchise tax of $_____ was paid when the Articles of Incorporation were filed. Estimated tax for subsequent years is payable in installments, and the first installment of the estimated tax is due by the 15th day of the fourth month after the corporation was incorporated [*see Rev. & Tax. Code §§ 19025, 23153*]. Note that the $_____ prepayment made at the time of incorporation, which was the first taxable year's minimum tax does *not* satisfy this requirement. Installments of estimated tax for the second taxable year's tax are paid during the first year. Filing requirements are described in the "Guide for Filing Franchise Tax Returns by Commencing Corporations" which should be mailed to the Corporation by the Franchise Tax Board.

5. **Income and Franchise Tax Returns.** Both federal and California income tax returns must be filed on or before the 15th day of the third month following the close of the taxable year [*I.R.C. § 6072(b)*; *Rev. & Tax. Code § 18601*]. Forms may be obtained from the Internal Revenue Service and from the Franchise Tax Board.

6. **Personal Property Taxes.** If the Corporation owns personal property having an aggregate cost of $100,000 or more for any assessment year, it must file a property statement with the County Assessor between April 1 and the last Friday in May in the county where the property is located [*see Rev. & Tax. Code § 441*]. Forms may be obtained from the County Assessor.

7. **Sales and Use Taxes.** If the Corporation expects to sell tangible personal property that would be subject to the

California Sales and Use Tax when sold at retail, it must obtain a seller's permit from the State Board of Equalization [*Rev. & Tax. Code §§ 6066(a), 6071*]. This permit may also be required even if the Corporation intends to conduct only a wholesale business. An officer of the Corporation or other person specifically authorized to sign the application must personally appear at the nearest office of the State Board of Equalization to apply for the permit. Registration as an employer for purposes of state income tax withholding and unemployment insurance may be accomplished at the same time on the same application form.

8. **Payroll Withholding.**

(a) **Federal.** The Corporation will be required to withhold income tax and social security tax from taxable wages paid to its employees [*see* I.R.C. §§ 3401-3403]. Funds withheld must be deposited in certain depositories accompanied by a Federal Tax Deposit Form 8109 deposit coupon [*see I.R.C. §§ 3402(a), 6302(c)*; *Treas. Reg. § 31.6302-1(i)(3)*]. An "Employer's Quarterly Federal Tax Return" (IRS Form 941) must then be filed before the end of the month following each calendar quarter [*see Treas. Reg. § 31.6011(a)-4*]. Any officer or other person charged with the withholding of taxes may become personally liable for 100 percent penalty if he or she fails to file the appropriate forms [*see I.R.C. § 6672*].

(b) **California.** The Corporation will also be required to withhold California income tax from its employees' taxable wages [*Unemp. Ins. Code §§ 13020, 13021*]. Within 15 days after becoming subject to the personal income tax withholding requirements, the employer must register with the Department of Employment Development [*Unemp. Ins. Code § 1086*]. A booklet entitled "Employer's Tax Guide for the Withholding, Payment and Reporting of California Income Tax" may be obtained from the Department.

9. **Federal Unemployment Tax.** The "Employer's Annual Federal Unemployment Tax Return" (IRS Form 940) must be filed and any balance due paid on or before January 31. Details may be found in IRS Circular E, the"Employer's Tax Guide."

10. **California Unemployment Compensation Insurance.** Registration with the California Department of Employment Development can be accomplished at the same time that the Corporation applies for a seller's permit from the Board of Equalization. Forms for returns are mailed automatically to all registered employers. A booklet entitled "Employer's Tax Guide: Unemployment Insurance Code of California" may be obtained from the Department of Employment Development.

11. **Workers' Compensation.** All employers must either be insured against workers' compensation liability by an authorized insurer or obtain from the Director of Industrial Relations a Certificate of Consent to Self-Insure. The required insurance may be obtained through the nearest local office of the State Compensation Insurance Fund, or it may be placed with a licensed workers' compensation private carrier.

We appreciate the opportunity to assist you and the Corporation in these matters. If you have any questions, please feel free to call us at any time.

Sincerely, _____ [*signature of attorney*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesGeneral OverviewLegal EthicsClient RelationsEffective RepresentationBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersManagement

Duties & LiabilitiesFiduciary ResponsibilitiesGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersGeneral OverviewGovernmentsState & Territorial GovernmentsLicenses



1 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS

2-2A California Legal Forms--Transaction Guide 2A.syn

§ 2A.syn Synopsis to Chapter 2A: INCORPORATING A GOING BUSINESS

§ 2A.01 California Sources

[1] Statutes

[2] Regulations

§ 2A.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 2A.03-2A.04 [Reserved]

§ 2A.05 Law Reviews and Periodicals

§ 2A.06 Annotations

§ 2A.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 2A.08-2A.09 [Reserved]

§ 2A.10 Transfer of Business Property to Corporation

[1] Formal Transfer of Assets

[2] Issuance of Shares

[3] Consideration for Shares

§ 2A.11 Requirements Regarding Bulk Sales

§ 2A.12 Liability Considerations

[1] Corporation's Liability for Debts of Preexisting Business

[2] Liability of Owners of Preexisting Business

[3] Other Liability Considerations

§ 2A.13 Incorporating Business Trusts

§§ 2A.14-2A.19 [Reserved]

§ 2A.20 Tax-Free Incorporation of a Going Business

[1] Advantages of Tax-Free Incorporation

[2] Disadvantages of Tax-Free Incorporation

[3] Treatment of Accounts Receivable and Accounts Payable

[4] Recognition of Gain in Otherwise Tax-Free Incorporation

[5] Tax-Free and Taxable Incorporation of Partnerships

§ 2A.21 Taxable Incorporation

[1] Consequences

[2] Procedures

§ 2A.22 Timing Date of Incorporation for Tax Purposes

[1] Deducting Net Operating Loss

[2] Avoiding Income Bunching

§ 2A.23 Depreciation and Investment Tax Credit

§ 2A.24 State Tax Considerations

[1] Sales and Use Tax

[2] Real Property Tax

§§ 2A.25-2A.99 [Reserved]

Scope

§ 2A.100 Facts

Scope

§ 2A.101 Documents

Scope

§§ 2A.102-2A.109 [Reserved]

§ 2A.110 Formation of Corporation

Scope

§ 2A.111 Transfers to Corporation From Going Business

Scope

§ 2A.112 Shareholders and Share Transactions

Scope

§ 2A.113 Notice Requirements

Scope

§§ 2A.114-2A.119 [Reserved]

§ 2A.120 Preincorporation Procedures

Scope

§ 2A.121 Incorporation Procedures

Scope

§§ 2A.122-2A.129 [Reserved]

§ 2A.130 Post-Incorporation Organization and Property Transfers

Scope

§ 2A.131 Tax and Business Procedures Following Incorporation

Scope

§§ 2A.132-2A.199 [Reserved]

§ 2A.200 Preincorporation Agreement Between Partners to Incorporate Partnership Business

[1] Comment

[a] Use of Form

[b] Exemptions From Qualification for Issuance of Shares on Formation of Corporation

[2] Form

Preincorporation Agreement Between Partners to Incorporate Partnership Business

§ 2A.201 Offer to Transfer Partnership for Shares of Successor Corporation

[1] Comment

[a] Use of Form

[b] Purpose of Offer

[c] Considerations in Transfer of Partnership

[d] Bulk Sale Requirements

[e] Exemption From Qualification of Shares

[2] Form

Offer to Transfer Partnership for Shares of Successor Corporation

§ 2A.202 Offer to Transfer Sole Proprietorship for Shares of Successor Corporation

[1] Comment

[a] Use of Form

[b] Purpose of Offer

[c] Bulk Sale Requirements

[d] Exemption From Qualification of Shares

[2] Form

Offer to Transfer Sole Proprietorship for Shares of Successor Corporation

§ 2A.203 Notice of Intended Transfer to a Corporation of the Assets of a Going Business [Com. Code §§ 6101-6111]

[1] Comment

[a] Use of Form

[b] Bulk Sale Notice Requirements

[c] Publication, Recordation, and Delivery of Notice

[d] Small Cash Sales

[e] Exemption for Sales to New Organizations

[2] Form

Notice of Intended Transfer to a Corporation of the Assets of a Going Business [Com. Code §§ 6101-6111]

§ 2A.204 Bill of Sale Transferring Going Business to Corporation

[1] Comment--Use of Form

[2] Form

Bill of Sale Transferring Going Business to Corporation



2 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS

2-2A California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter covers the incorporation of a going business, including problems relating to liability for the debts of the predecessor business, arrangements for the transfer of assets of the business to the corporation, bulk sale notice requirements, and federal and state tax aspects of the transfer. It also includes coverage of the various notices required in connection with the incorporation of a going business. The procedural steps to consider in incorporating a going business are outlined in the Transaction Guide, including forming the corporation, transferring assets to the corporation, and post-incorporation organizational and tax procedures. The Forms section includes various forms used to implement the incorporation process, including a preincorporation agreement among partners to incorporate, offers to sell a sole proprietorship and a partnership to a corporation, a bill of sale for the business assets, and a notice of bulk sale.

The preincorporation, incorporation, and post-incorporation matters covered in this chapter are those that are specific to the incorporation of a going business and should be used in conjunction with the substantive coverage in Ch. 2, *Formation of Corporations*, Ch. 3, *Articles of Incorporation*, Ch. 4, *Bylaws*, Ch. 5, *Directors' Meetings, Actions, and Resolutions*, Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*.

If the principals of the business wish to be treated for tax purposes as if they were partners in a partnership, with minimal taxation at the corporate level, and also wish to have the limited liability of corporate shareholders, they should consider electing Subchapter S status; for coverage of the law and procedures involved, see Ch. 2B, *Electing Subchapter S Status* . If the principals are professionals, see Ch. 12A, *Professional Corporations* , for relevant special considerations.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART I. RESEARCH GUIDE
A. Primary Sources

2-2A California Legal Forms--Transaction Guide § 2A.01

§ 2A.01 California Sources

[1] Statutes

Goodwill of business as transferable property interest. *Bus. & Prof. Code §§ 14100, 14102*.

Transfer of alcoholic beverage license. *Bus. & Prof. Code §§ 24071, 24073*.

Bulk sale provisions. *Com. Code §§ 6101-6111*.

Notice required for bulk sale of assets of going business. *Com. Code §§ 6104, 6105*.

General Corporation Law. *Corp. Code § 100 et seq.*

Formation of corporation. *Corp. Code § 200*.

Incorporating of existing unincorporated association. *Corp. Code § 200.5(a)*.

Consideration for issuance of shares. *Corp. Code § 409*.

Partnership liability provisions.

Uniform Partnership Act of 1994 (UPA '94), applicable to all partnerships after January 1, 1999. *Corp. Code §§ 16804, 16805*.

Corporate Securities Law of 1968. *Corp. Code § 25000 et seq.*

Nonpublic offering exemption. *Corp. Code § 25102(a)*.

Limited offering exemption from qualification for shares issued to 35 or fewer qualified persons. *Corp. Code § 25102(f).*

Small offering exemption from qualification requirement for shares issued in exchange for assets of existing business. *Corp. Code § 25102(h).*

Qualification of shares required before issue or sale. *Corp. Code §§ 25110-25117.*

Transfer of interest in real property as change in ownership causing reassessment of property. *Rev. & Tax. Code § 60.*

Transfer between individual and corporation that results solely in change in method of holding title, with no change in proportional ownership interest, is not "change in ownership." *Rev. & Tax. Code § 62(a)(2).*

Sales and Use Tax Law. *Rev. & Tax. Code §§ 6001-7176.*

"Occasional sale" defined. *Rev. & Tax. Code § 6006.5.*

Gross receipts from occasional sale of tangible personal property exempt from sales and use tax. *Rev. & Tax. Code § 6367.*

Successor liability for sales and use taxes of preexisting business. *Rev. & Tax. Code §§ 6811-6815.*

Successor liability for unemployment insurance obligations of the preexisting business. *Unemp. Ins. Code §§ 1731-1736.*

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"Nonpublic offering" defined. *10 Cal. Code Reg. § 260.102.1.*

"Nonpublic offering and sale" defined. *10 Cal. Code Reg. § 260.102.2.*

Small offering exemption.

"One class of stock" defined. *10 Cal. Code Reg. § 260.102.4.*

"Beneficial ownership" defined. *10 Cal. Code Reg. § 260.102.5.*

Use of transfer restriction legend on shares. *10 Cal. Code Reg. §§ 260.102.6, 260.141.11, 260.141.12.*

"Selling expenses" defined. *10 Cal. Code Reg. § 260.102.7.*

Notice of issuance. *10 Cal. Code Reg. §§ 260.102.8, 260.102.9.*

Advances and loans as consideration. *10 Cal. Code Reg. § 260.102.11.*

Limited offering exemption.

Interpretation of terms used in connection with limited offering exemption. *10 Cal. Code Reg. § 260.102.12.*

Purchasers excluded from count of purchasers for purposes of exemption. *10 Cal. Code Reg. § 260.102.13*.

Notice of transaction. *10 Cal. Code Reg. § 260.102.14*.

Exemption for issuance of shares in return for advances to corporation. *10 Cal. Code Reg. §§ 260.102.11, 260.105.23*.

Exemption for issuance of shares of professional corporations. *10 Cal. Code Reg. § 260.105.6*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART I. RESEARCH GUIDE
A. Primary Sources

2-2A California Legal Forms--Transaction Guide § 2A.02

§ 2A.02 Federal Sources

[1] Statutes

Recapture of investment tax credit. *I.R.C. § 50*.

Tax-free transfer of property of going business to controlled corporation. *I.R.C. § 351*.

Liability in excess of basis. *I.R.C. § 357(c)*.

Basis to distributees. *I.R.C. § 358*.

Basis to corporation. *I.R.C. § 362*.

"Controlled corporation" defined as 80 percent stock ownership by transferor. *I.R.C. § 368(c)*.

Basis of partnership interests. *I.R.C. § 705*.

Treatment of partnership assets transferred to corporation. *I.R.C. §§ 731, 732*.

Treatment of gains and losses on taxable incorporation. *I.R.C. §§ 1001(c), 1012*.

Treatment of gain from transfer of depreciable asset to corporation controlled by transferor. *I.R.C. § 1239*.

Recapture of depreciation. *I.R.C. §§ 1245(b)(3), 1250(d)(3)*.

Subchapter S corporation. I.R.C. §§ 1361-1379.

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Amortization of organizational expenses. *Treas. Reg. § 1.248-1(b)(2), (3)*.

Taxation of assets transferred to corporation. *Treas. Reg. § 1.357-2(a)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART I. RESEARCH GUIDE
A. Primary Sources

2-2A California Legal Forms--Transaction Guide §§ 2A.03-2A.04

[Reserved]

§§ 2A.03[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART I. RESEARCH GUIDE
B. Secondary Sources

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-2A California Legal Forms--Transaction Guide § 2A.06

§ 2A.06 Annotations

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-2A California Legal Forms--Transaction Guide § 2A.07

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Ch. 6, *Securities Regulation Issues*.

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-2A California Legal Forms--Transaction Guide §§ 2A.08-2A.09

[Reserved]

§§ 2A.08[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART II. LEGAL BACKGROUND
A. Procedures to Transfer Going Business to Corporation

2-2A California Legal Forms--Transaction Guide § 2A.10

§ 2A.10 Transfer of Business Property to Corporation

[1] Formal Transfer of Assets

The mere incorporation of an existing partnership or other unincorporated business does not, of itself, operate to transfer to the corporation the title to any real or personal property of the business. For title to be transferred to the corporation, there must be a conveyance, contract of sale, or assignment as in other types of property transfers [*see Maron v. Howard (1968) 258 Cal. App. 2d 473, 485, 66 Cal. Rptr. 70]* . Absent a transfer of property from the preexisting business to a corporation formed to succeed it, the preexisting business remains the owner of the property in question [*see Whitley v. Bradley (1910) 13 Cal. App. 720, 729, 110 P. 596]* . It has been stated that a corporation may acquire an equitable title to the property of a preexisting firm without a conveyance [*Maron v. Howard (1968) 258 Cal. App. 2d 473, 485, 66 Cal. Rptr. 70* ; *see Lance v. Forsberg (1951) 106 Cal. App. 2d 226, 230, 234 P.2d 662]* . However, there do not appear to be any direct holdings to that effect. The most prudent practice would be for the partners or the proprietor of the preexisting business to execute a formal conveyance of the business's property to the new corporation on its formation. For a bill of sale issued on the transfer of the property of a going business to the successor corporation, see *§ 2A.204*.

When an existing business association organized as a trust incorporates, the corporation succeeds automatically to the rights and property of the former association, without the requirement for formal transfer [*see Corp. Code § 200.5(d)*; *see also § 2A.13*].

[2] Issuance of Shares

If the transfer of the business property is to be in exchange for shares of the corporation, as is usually the case, the transfer should be timed to occur when the shares are issued. In general, offers or sales of securities in California must be qualified, exempted, or not subject to qualification [*see Corp. Code § 25110*]. However, if the issuance meets the requirements of one of the two following exemptions, the newly formed corporation may issue its shares in exchange for assets of a going business without having to qualify the issuance under the Corporate Securities Law of 1968 [*see Corp. Code §§ 25000-25706*]. Under the "small offering" exemption [*see Corp. Code § 25102(h)*], qualification is not required if there will be only one class of stock, which will be owned beneficially by no more than 35 persons [*Corp.*

Code § 25102(h)]. Alternatively, under the "limited offering" exemption [*see Corp. Code § 25102(f)*], the issuance is exempt from qualification if sales are made to no more than 35 persons who either have a preexisting personal or business relationship with the offeror or its partners, or, because of their business sophistication, can be expected to protect their own business interests [*Corp. Code § 25102(f)(1), (2)*]. For coverage of the issuance of equity securities and the procedures for qualification or exemption from qualification, see Ch. 6, *Securities Regulation Issues* .

Although it is seldom the case when a going business is being incorporated, if the newly formed corporation will issue shares to more than 35 persons and therefore have to qualify the issuance with the Commissioner of Corporations [*see Corp. Code § 25110*], some delay may occur between the time the articles of incorporation are filed and the date the business can be transferred to the corporation. Whether there is a delay will depend, in most cases, on how diligent counsel is in applying for the permit sufficiently in advance of the anticipated transfer.

[3] Consideration for Shares

Shares may be issued for tangible or intangible property actually received, as well as money paid, labor done, services actually rendered to the corporation, or debts or securities canceled [*Corp. Code § 409(a)(1)*]. Thus, a straight exchange of the assets of the going business for shares in the new corporation is valid. The owners of the business should be cautioned, however, that unsecured promissory notes or promises to render future services to the corporation in return for the issuance of shares are not permitted. Specifically, promissory notes are not permissible consideration for the issuance of shares unless they are adequately secured by collateral other than the shares themselves or are permitted under an employee stock purchase plan [*Corp. Code § 409(a)(1)*; *see Corp. Code § 408*].

Another factor to consider in issuing shares for assets is the position of future outside investors in the corporation. That is, the recited consideration for the transfer should not be inflated, and shares should not be issued for the transfer of intangibles not within the statutory definition of consideration, such as contracts for services to be performed in the future [*see Corp. Code § 409(a)(1)*]. The issuance of shares for overvalued property can give rise to a cause of action for fraud against persons who have, in effect, cheated the corporation by receiving a disproportionate number of shares for property contributed to the corporation. Such a cause of action is likely to be derivative in nature and could also be brought against directors who have participated in a fraudulent evaluation of property that the corporation has purchased with its shares [*see Corp. Code §§ 409(b), 415*; *see also* CALIFORNIA FORMS OF PLEADING AND PRACTICE, Ch. 162, *Corporations: Issuance of Shares* , (Matthew Bender)]. For additional coverage, see Ballantine and Sterling, CALIFORNIA CORPORATION LAWS, Ch. 7, *Issuance of Shares and Indebtedness* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesSecurities LawBlue Sky LawsExcluded Transactions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART II. LEGAL BACKGROUND
A. Procedures to Transfer Going Business to Corporation

2-2A California Legal Forms--Transaction Guide § 2A.11

§ 2A.11 Requirements Regarding Bulk Sales

Under the Uniform Commercial Code--Bulk Sales (Division 6 of the UCC) [*see Com. Code §§ 6101-6111*], certain actions must be taken before a bulk sale can be made. In the context of incorporating a going business, a "bulk sale" is a sale not in the ordinary course of the seller's business of more than half the seller's inventory and equipment, as measured by value on the date of the bulk-sale agreement [*Com. Code § 6102(a)(3)(ii)*]. Numerous types of transfers are exempted from the definition of "bulk sale" [*see Com. Code § 6103(c)*], including the sale of assets to a new organization that is organized to take over and continue the business of the seller, if certain requirements are met [*see Com. Code § 6103(c)(11)*; *see also § 2A.111*, PP 9, 10; *§ 2A.203[1]*].

In a bulk sale, the buyer must do all of the following [*Com. Code § 6104*]:

- Obtain from the seller a list of all business names and addresses used by the seller within the preceding three years.

- Give notice of the bulk sale by publication, recordation, and delivery to the tax collector in the county in which the assets are located [*see Com. Code § 6105*; *see Gifford v. J&A Holdings (1997) 54 Cal. App. 4th 996, 1003-1004, 63 Cal. Rptr. 2d 253* (interpreting *Com. Code § 6105* in light of legislative intent); *see also § 2A.203[1]*].

- For sales of $2 million or less, pay consideration to satisfy claims of the seller's creditors [*see Com. Code § 6106.2*].

If the buyer fails to comply with the statutory notice requirements, the buyer is liable for damages in the amount of any claims against the seller, less any amount that the claimant would not have realized if the buyer had complied with the notice requirement [*Com. Code § 6107(a)*; *see Com. Code § 6107(c)* (good faith effort at compliance), (d) (limitation of liability)].

For a notice of intended bulk sale to a corporation of the assets of a going business, see *§ 2A.203*. For detailed

discussion of bulk sales, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewCommercial Law (UCC)Bulk Sales (Article 6)Property Schedules & Creditor ListsCommercial Law (UCC)Bulk Sales (Article 6)General OverviewCommercial Law (UCC)Bulk Sales (Article 6)Notice to ClaimantsCommercial Law (UCC)Bulk Sales (Article 6)Noncompliance



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART II. LEGAL BACKGROUND
A. Procedures to Transfer Going Business to Corporation

2-2A California Legal Forms--Transaction Guide § 2A.12

§ 2A.12 Liability Considerations

[1] Corporation's Liability for Debts of Preexisting Business

Because it is a new and distinct entity [*see Merco Constr. Engineers, Inc. v. Municipal Court (1978) 21 Cal. 3d 724, 729, 147 Cal. Rptr. 631, 581 P.2d 636]* , a corporation is not automatically liable for the debts of its predecessors [*Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 28, 136 Cal. Rptr. 574, 560 P.2d 3]* . However, a new corporation will be liable for the debts of its predecessor business, or liable on the predecessor's contracts, if it expressly assumes that liability [*see Fisher v. Allis-Chalmers Corp. (2002) 95 Cal. App. 4th 1182, 1188-1190, 116 Cal. Rptr. 2d 310* (manufacturer's successor in interest was not entitled to summary judgment because it failed to establish that its agreement to assume liabilities excluded plaintiff's product liability claim); *Bryan v. Banks (1929) 98 Cal. App. 748, 754, 277 P. 1075]* . A corporation that succeeds to the business of its predecessor and voluntarily accepts the benefits of a transaction entered into by a predecessor business consents to all of the obligations arising from that transaction [*see Civ. Code § 1589*; *see also Citizens Suburban Co. v. Rosemont Dev. Co. (1966) 244 Cal. App. 2d 666, 676, 53 Cal. Rptr. 551]* . In addition to an express agreement regarding assumption of liability, a corporation may also be liable for its predecessor's debts under any of the following circumstances [*Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 28, 136 Cal. Rptr. 574, 560 P.2d 3* ; *see Franklin v. USX Corporation (2001) 87 Cal. App. 4th 615, 629-630, 105 Cal. Rptr. 2d 11* (successor corporation not liable for asbestos-related injuries under theories of express or implied assumption of tort liabilities of predecessor, de facto merger or mere continuation, or product line successor); *Chaknova v. Wilbur-Ellis Co. (1999) 69 Cal. App. 4th 962, 967-969, 969-970, 81 Cal. Rptr. 2d 871* (for purposes of successor liability in tort for asbestos-related injuries, successor did not expressly or impliedly assume other than specifically identified obligations of predecessor from whom successor purchased line of business; corporate merger did not effectuate adoption of that liability; and corporation was not product line successor under principles set forth in *Ray v. Alad Corp; see also* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 51, *Incorporating the Going Business* (Matthew Bender)]:

- An agreement to assume debts is implied by a court.
- The corporation is presumed to have assumed a predecessor's debts (usually when the predecessor

was a partnership).

- The transaction amounts to a consolidation or merger of two corporations.

- The purchasing corporation is a mere continuation of the seller [*see Katzir's Floor and Home Design, Inc. v. M-MLS.com (9th Cir. 2004) 394 F.3d 1143, 1149-1151* (inadequate consideration is essential ingredient to "mere continuation" finding; amended judgment adding new corporation as additional judgment debtor on successor liability grounds reversed)].

- The corporation participates in a fraudulent transfer to escape liability for the seller's debts.

Although a corporate successor that is liable for the torts of its predecessor by operation of law may seek coverage for that liability under its predecessor's insurance policies, when a corporation assumes liability by contract its rights are defined and limited by that contract [*Henkel Corp. v. Hartford (2003) 29 Cal. 4th 934, 941-943, 945, 129 Cal. Rptr. 2d 828, 62 P.3d 69* (in case in which successor was sued for injuries arising from predecessor's chemical products, any assignment of predecessor's insurance benefits required consent of insurers; no coverage existed when policy had no-assignment clause and insurers did not consent to assignment)].

The new corporation will be liable for sales and use taxes and unemployment insurance obligations of the preexisting business under the successor liability statutes [*see Rev. & Tax. Code §§ 6811-6814*; *Unemp. Ins. Code §§ 1731-1736*; *see also* Ch. 17, *Buying and Selling a Business or Professional Practice*].

When an existing business association organized as a trust incorporates, it becomes automatically subject to the debts and liabilities of the preexisting organization as if it had incurred them [*Corp. Code § 200.5(d)*; *see § 2A.13*].

In the case of a merger, the succeeding corporation is subject to all the debts and liabilities of the disappearing corporation [*see Corp. Code § 1107*]. For a detailed discussion of mergers, see Ch. 11C, *Mergers* .

[2] Liability of Owners of Preexisting Business

The former owners will remain personally liable to creditors of the predecessor business for debts incurred before incorporation, and may also be personally liable for debts incurred after incorporation if it is found that the creditor was not notified of the change to corporate form and that the credit was advanced on account of the preexisting business [*see Oregon Cedar Etc. Co. v. Ramos & Kohler (1957) 148 Cal. App. 2d 679, 681-683, 307 P.2d 447]* , or if the alter ego doctrine is applicable [*see Minton v. Cavaney (1961) 56 Cal. 2d 576, 579, 15 Cal. Rptr. 641, 364 P.2d 473* ; *see also Robbins v. Blecher (1997) 52 Cal. App. 4th 886, 892, 60 Cal. Rptr. 2d 815* ; *Associated Vendors, Inc. v. Oakland Meat Co. (1962) 210 Cal. App. 2d 825, 838-840, 26 Cal. Rptr. 806* (factors in deciding whether to disregard corporate entity)].

If the predecessor business was a partnership, in the absence of an express or implied agreement with the creditors to the contrary, the former partners remain personally liable to the partnership's creditors for debts incurred before its dissolution. Moreover, the former partners may be personally liable for debts incurred after incorporation if it is found that the creditor was not notified of the partnership's dissolution [*see Corp. Code §§ 16804, 16805*]. For further coverage of the dissolution of general partnerships, see Ch. 15, Part B, *Dissolution of General Partnerships* .

When a partnership is incorporated, the partnership ceases to exist after formation of the corporation, even if the entity is operated in a manner similar to that which it was operated as a partnership [*Persson v. Smart Inventions, Inc. (2005) 125 Cal. App. 4th 1141, 1157, 23 Cal. Rptr. 3d 335* (rejecting trial court conclusion that a "de facto" partnership continued to exist concurrently with corporate enterprise); *Cavasso v. Downey (1920) 45 Cal.App. 780, 785, 188 P. 594]* . Thus, the obligations among partners that flow from a partnership, including fiduciary duties among partners,

ordinarily no longer exist and therefore cannot be enforced against one another by the former partners turned shareholders, with the limited exception that courts will enforce pre-incorporation agreements among partners or joint venturers who have incorporated in order to carry out the agreement between or among the partners or joint venturers [*Persson v. Smart Inventions, Inc. (2005) 125 Cal. App. 4th 1141, 1157-1159, 23 Cal. Rptr. 3d 335* ; *see also Corp. Code § 16603* (effect of dissociation on fiduciary obligations of partner)].

[3] Other Liability Considerations

In addition to any known obligations that a corporation formed to operate an existing business would normally assume, there may be unknown or contingent claims that could be enforced against the corporation. Among these, and potentially the most devastating from the point of view of business planning, are products liability claims. Although a proprietor or partnership will remain liable after the transfer of the business for damages resulting from pre-transfer product sales [*see Rawlings v. D.M. Oliver, Inc. (1979) 97 Cal. App. 3d 890, 901, 159 Cal. Rptr. 119]* , a successor corporation is also likely to be liable if the corporation is subject to the rule imposing liability on a successor corporation when it is merely a continuation of the predecessor corporation [*see Pierce v. Riverside Mtg. Securities Co. (1938) 25 Cal. App. 2d 248, 254, 255, 77 P.2d 226* ; *see also Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 29, 136 Cal. Rptr. 574, 560 P.2d 3* (continuity of management as basis for imposition of liability on successor corporation); *Franklin v. USX Corporation (2001) 87 Cal. App. 4th 615, 629-630, 105 Cal. Rptr. 2d 11* (successor corporation not liable for asbestos-related injuries under theories of express or implied assumption of tort liabilities of predecessor, de facto merger or mere continuation, or product line successor); *Chaknova v. Wilbur-Ellis Co. (1999) 69 Cal. App. 4th 962, 967-969, 969-970, 81 Cal. Rptr. 2d 871* (no successor liability for asbestos-related injuries under *Ray v. Alad* principles)]. However, the persons most vulnerable in this situation will be the corporation's owners who, by incorporating, had thought to confer on themselves the benefit of limited liability. It is therefore prudent when transferring any business with possible products liability exposure to a corporation to provide in the sale document that the corporation will indemnify the former proprietor or partners against that type of claim and, when feasible, insure against that type of liability [*see § 2A.202[1][a]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewTortsVicarious LiabilityCorporationsPredecessor & Successor CorporationsMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawLiabilities & Rights of SuccessorsDe Facto MergersBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewMergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewMergers & Acquisitions LawLiabilities & Rights of SuccessorsMere ContinuationBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionPartnership LiabilitiesMergers & Acquisitions LawLiabilities & Rights of SuccessorsSuccessor Liability Doctrine



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART II. LEGAL BACKGROUND
A. Procedures to Transfer Going Business to Corporation

2-2A California Legal Forms--Transaction Guide § 2A.13

§ 2A.13 Incorporating Business Trusts

Existing unincorporated business associations organized as trusts under the laws of California or another state may incorporate [*see Corp. Code § 200.5*]. This legislation was intended almost exclusively for the benefit of real estate investment trusts (REITs), which may operate in corporate form. To convert to corporate status the approval of the board of trustees and the approval of a majority of the outstanding voting shares of beneficial interest must be obtained, and articles of incorporation that differ only slightly from those filed by corporations generally must be filed [*see Corp. Code § 200.5(a)*]. The contents, execution, and filing of articles incorporating a business trust are covered in Ch. 3, *Articles of Incorporation* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewReal Property LawTrustsReal Estate Investment Trusts (REITs)Business & Corporate LawUnincorporated AssociationsReal Property LawTrustsHolding Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART II. LEGAL BACKGROUND
A. Procedures to Transfer Going Business to Corporation

2-2A California Legal Forms--Transaction Guide §§ 2A.14-2A.19

[Reserved]

§§ 2A.14[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART II. LEGAL BACKGROUND
B. Tax Considerations

2-2A California Legal Forms--Transaction Guide § 2A.20

§ 2A.20 Tax-Free Incorporation of a Going Business

[1] Advantages of Tax-Free Incorporation

In general, it is desirable and possible to incorporate a going business without incurring significant tax liability from the incorporation process. A significant factor in tax-free incorporation is that no gain or loss is recognized for income tax purposes if property is transferred to a corporation solely in exchange for stock in that corporation and immediately after the exchange the persons who made the transfer are in control of the corporation [*I.R.C. § 351(a)*]. For the purposes of *I.R.C. § 351(a)*, "control" means ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of the corporation [*I.R.C. § 368(c)*]. Even though the transfer is not solely in exchange for stock, the transaction may still qualify under *I.R.C. § 351*, but the other assets received will be deemed taxable "boot" to the transferee and no loss to the recipient will be recognized [*see I.R.C. § 351(b)*]. For further discussion, see CALIFORNIA SMALL BUSINESS GUIDE, Ch. 5, *Obtaining Nonrecognition Treatment on Incorporation* , Part B (Matthew Bender).

The fact that a simple exchange of the assets of the going business for shares in the new corporation is tax-free under *I.R.C. § 351* could prove to be a problem when taxable gain to the business owners, and therefore a higher basis to the corporation for the business assets, is desired. In that case, the incorporators may have a difficult time avoiding *I.R.C. § 351* and making the transfer to the corporation taxable [*see § 2A.21*].

Tax-free incorporation has many advantages. In addition to the potential gain from the transaction not being taxed [*I.R.C. § 351(a)*], other benefits include the fact that the basis of the stock received by the transferor of the business will not be reduced by the amount of any potential loss on the transfer as long as the exchange is a simple exchange of business assets for stock [*I.R.C. § 358(a)(1)*], and the basis of the transferred assets will not be reduced by any potential loss [*I.R.C. § 362*]. In addition, it is possible that the holding period for long-term capital gain purposes of the stock received in the transfer can include the holding period of the assets before the transfer, and the holding period of the assets by the corporation will include the holding period of the transferor [*I.R.C. § 1223*].

Moreover, installment sales balances will not be taxed at the time of transfer, nor will the fact that the corporation

assumes the accounts payable of the going business cause the assumption to be treated as money or property received by the taxpayer or prevent the exchange from being treated as tax-free [*see I.R.C. §§ 351(a), 357(a)*; *see also* [3], *below*].

Ordinarily, there will be no recapture of depreciation [*I.R.C. §§ 1245(b)(3), 1250(d)(3)*] or investment tax credit [*I.R.C. § 50(a)*; *see I.R.C. §§ 46*-50] from the transferor on a tax-free incorporation. Instead, recapture of depreciation will be attributed to the corporation [*see Treas. Reg. § 1.1245-2(a)(4)*; *see also Rev. Rul. 71-569, 1971-2 C.B. 314*]. However, gain is recognized by the transferor to the extent that the transferor receives any assets (that is, "boot") in addition to stock in the Section 351 incorporation [*see I.R.C. § 351(b)*]. The characterization of the recognized gain, whether ordinary income or capital gain, will be determined with respect to the nature of each asset on which gain is recognized. To the extent that recognized gain is attributable to depreciable property, that gain will be taxed as ordinary income to the transferor [*see I.R.C. §§ 1245, 1250(a)(1)*].

There will usually be no recapture of investment tax credits even if all of the business assets are not transferred to the newly-formed corporation, such as when the business real property is retained by the original owner and leased to the corporation [*Rev. Rul. 83-65, 1983-1 C.B. 10*].

Entirely apart from the depreciation recapture rules, the Internal Revenue Code characterizes the entire amount of recognized gain as ordinary income if the gain is attributable to a depreciable asset and the particular transferor and certain members of the transferor's family own more than 50 percent in value of the outstanding stock of the transferee corporation [*see I.R.C. § 1239*].

[2] Disadvantages of Tax-Free Incorporation

A major disadvantage of tax-free incorporation is that a potential loss from the transaction is not deductible [*see I.R.C. § 351*]. In addition, the basis of the transferred assets will be the same to the corporation as it was to the transferor and cannot be increased to fair market value [*I.R.C. § 362*]. Similarly, the basis of the stock received will be the same as the basis of the assets transferred and cannot be increased to the fair market value of the assets at the time of the transfer [*see I.R.C. § 358*].

The basis of shares received by the transferor in an exchange to which *I.R.C. § 351* applies is the same as that of the property exchanged as long as the exchange is simply business assets for shares [*see I.R.C. § 358(a)(1)*]. However, if there is more than a simple exchange, the basis of those shares will be decreased by the amount of money and the fair market value of property received and the amount of loss recognized by the taxpayer on the exchange [*see I.R.C. § 358(a)(1)(A)*], and increased by the amount treated as a dividend and the amount of gain recognized to the taxpayer on the exchange [*see I.R.C. § 358(a)(1)(B)*].

[3] Treatment of Accounts Receivable and Accounts Payable

The transfer of the operating assets of a going business, including unrealized accounts receivable, to the corporation in exchange solely for the corporation's stock and the assumption by the corporation of the going business' liabilities, including accounts payable, is a tax-free exchange under *I.R.C. § 351(a)*. Therefore, no gain or loss is recognized to the transferor in the absence of any evidence that the transaction was designed for tax avoidance [*see I.R.C. §§ 351(a), 357*; *see also Hempt Bros., Inc. v. United States (3d Cir. 1974) 490 F.2d 1172, 1176-1178 , cert. denied, 419 U.S. 826 (1974)* ; *Rev. Rul. 80-198, 1980-2 C.B. 113*]. Tax avoidance would be evidenced by the accumulation of accounts receivable or the prepayment of accounts payable in anticipation of incorporation [*see Rev. Rul. 80-198, 1980-2 C.B. 113*].

[4] Recognition of Gain in Otherwise Tax-Free Incorporation

If the sum of the liabilities assumed by the exceeds the adjusted basis of that property, the excess will be considered as a gain on the exchange [*see I.R.C. § 357(c)(1)*; *see also Peracchi v. C.I.R. (9th Cir. 1998) 143 F.3d 487, 494-495* (because taxpayer transferred real property with encumbrances exceeding basis to corporation, along with promissory note for amount exceeding liabilities, no *I.R.C. § 357(c)* gain was recognized)]. However, certain liabilities transferred to the corporation are not included in determining the liabilities assumed by the corporation and will not give rise to taxable gain to the transferors. These liabilities include those, such as accounts payable, that would give rise to a deduction when paid, and amounts payable as guaranteed payments to a retiring or successor partner pursuant to *I.R.C. § 736(a)* [*see I.R.C. § 357(c)(3)(A)*]. These liabilities will not be considered in determining whether liabilities assumed by the corporation exceed the basis of assets transferred. However, if the incurrence of the liability resulted in the creation of, or any increase in, the basis of any property, the assumption of the liability by the corporation is included in determining whether there will be taxable gain to the transferor on the incorporation [*I.R.C. § 357(c)(3)(B)*]. In calculating the amount of liability assumed, any portion of a recourse liability is treated as having been assumed if, determined on the basis of all facts and circumstances, the transferee has agreed to (and is expected to) satisfy that liability regardless of whether the transferor has been relieved of the liability [*I.R.C. § 357(d)(1)(A)*]. Nonrecourse liabilities are treated as assumed, except that the amount is reduced by the lesser of (1) the amount of the liability that an owner of other assets not transferred to the transferee and also subject to the liability has agreed with the transferee, and is expected, to satisfy or (2) the fair market value of those other assets (determined without regard to *I.R.C. § 7701(g)*) [*I.R.C. § 357(d)(1)(B), (2)*].

If the person transferring property to a corporation receives nonqualified preferred stock, the transfer is not tax free and the stock is treated as boot [*I.R.C. § 351(g)(1)*; *see I.R.C. § 351(g)(2)* ("nonqualified preferred stock" defined)].

The tax basis of assets transferred to the corporation will be increased to the extent that gain is recognized on the transfer by reason of the fact that the corporation's assumption of liabilities included in the computation exceeds the original basis of those assets [*I.R.C. § 362(a)*]. However, to the extent that gain is not recognized on the transfer of the accounts receivable to the corporation, the tax basis of the accounts receivable and other assets to the corporation will be the tax basis of the accounts receivable and other assets to the business immediately before the transfer to the corporation [*see I.R.C. § 362(a)*; *see also P.A. Birren & Son v. Commissioner of Internal Revenue (7th Cir. 1940) 116 F.2d 718]* .

[5] Tax-Free and Taxable Incorporation of Partnerships

In the incorporation of a partnership, the fact that the basis of the partnership interests to the partners is greater than the basis of the assets to the partnership does not signal an advantageous step-up in the basis of those assets to the corporation under *I.R.C. § 351*. The partnership will be deemed the transferor of the assets to the corporation for the purpose of determining basis under *I.R.C. § 351*, regardless of whether it is the actual transferor or whether it terminates and either the partners transfer distributed assets or the partners transfer their interests to the corporation [*see I.R.C. §§ 351, 368(c)*; *Treas. Reg. § 1.351-1(a)(1)*]. The basis of the stock received by a partner will be an amount equal to the adjusted basis of his or her partnership interest [*I.R.C. § 732(b)*].

Three factual situations illustrate the different basis in stock and assets that may result from a tax-free incorporation of a partnership pursuant to *I.R.C. § 351(a)* [*see Rev. Rul. 84-111, 1984-2 C.B. 88*]:

- X partnership transfers all of its assets to new corporation R in exchange for all of R's outstanding stock and R's assumption of X's liabilities. X terminates by distributing all of R's stock to X's partners in proportion to their partnership interests [*see I.R.C. § 708(b)(1)(A)*]. R's basis in the X assets equals their basis to X immediately before the transfer [*I.R.C. § 362(a)*]. X's basis in the R stock equals its basis in the assets transferred to R, reduced by the liabilities assumed by R [*I.R.C. § 358(a)*]. Each partner's basis in the R stock is equal to the adjusted basis of his or her partnership interest [*I.R.C. § 732(b)*].

- Y partnership terminates by distributing all of its assets and liabilities to its partners in proportion to their partnership interests [*see I.R.C. § 708(b)(1)(A)*]. The partners transfer all of the Y assets to new corporation S in exchange for S's outstanding stock and S's assumption of Y's liabilities. The partners' basis in the S stock is equal to their basis in the Y assets received in liquidation [*see I.R.C. § 732(b)*], reduced by the liabilities assumed by S [*I.R.C. § 358(a)*]. S's basis in the Y assets equals the partners' basis in those assets immediately before transfer to S [*I.R.C. § 362(a)*].

- The partners of Z transfer their partnership interest to new corporation T in exchange for all of T's outstanding stock. The exchange terminates Z and its assets and liabilities become those of T. The partners' basis in the T stock equals the basis of their partnership interests transferred to T, reduced by Z's liabilities assumed by T [*I.R.C. § 358(a)*]. T's basis in the Z assets equals the partners' basis in their partnership interests [*see I.R.C. § 732(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesTax LawFederal Income Tax ComputationSales & ExchangesInstallment Sales (IRC secs. 1001, 1031, 1231)Recognition of Gains & LossesBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Tax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsTransfers of Interest (IRC secs. 741-743)BasisTax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)Stock & Other SecuritiesTax LawFederal Income Tax ComputationDeductions for Amortization, Depletion & DepreciationGeneral OverviewTax LawFederal Income Tax ComputationSales & ExchangesRecapture of Depreciation (IRC secs. 1245, 1250)Tax LawFederal Taxpayer GroupsS CorporationsBasis (IRC secs. 1361, 1367)



16 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART II. LEGAL BACKGROUND
B. Tax Considerations

2-2A California Legal Forms--Transaction Guide § 2A.21

§ 2A.21 Taxable Incorporation

[1] Consequences

In the usual incorporation of a going business, *I.R.C. § 351* will operate to make tax exemption of the incorporation the rule and taxability the exception. However, taxable incorporation can be advantageous. The primary benefit to be derived from a taxable incorporation is that it will enable the transferor to deduct any loss resulting from the transfer [*see I.R.C. § 1001(c)*], except when the transferor and his or her family own more than 50 percent of the stock of the transferee corporation [*see I.R.C. § 267*]. In addition, the basis of both the assets transferred to the corporation and the stock issued will be their fair market value at the time of transfer [*I.R.C. § 1012*]. This basis will allow an increased depreciation deduction on the assets.

The possibly disadvantageous consequences of taxable incorporation are that any gain to the transferor will be taxed [*I.R.C. § 1001*; *see* I.R.C. §§ 55-59, *1245*, *1250*], the corporation's holding period for long-term capital gain purposes will begin at the time of the transfer [*I.R.C. § 1222*], and the value of accounts receivable and installment sales balances will be taxed to the transferor at the time of transfer [*I.R.C. § 1001*]. Moreover, if the transfer results in a loss (that is, the former basis of the assets is higher than their fair market value), the basis of the stocks and securities transferred will be decreased accordingly [*I.R.C. § 1012*].

[2] Procedures

When the advantages of taxable incorporation are desired, careful attention must be paid to the particular facts of the incorporation to avoid tax-free status under *I.R.C. § 351*. The most commonly used methods are the issuance of more than 20 percent of at least one class of stock to outsiders (nontransferors and probably nonfamily) [*see I.R.C. §§ 351(a), 368(c)*], and the postponement of the transfer of certain assets until after the incorporation, with the subsequent sale of those assets to the corporation. In the case of a sale of assets, gain will be recognized to the transferor on the sale, and the assets will take a stepped-up basis, provided that the sale is not a part of the overall plan of incorporation [*see Tuller v. United States (Ct. Cl. 1936) 14 F. Supp. 188, 191]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesMergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsTax LawFederal Income Tax ComputationDeductions for Amortization, Depletion & DepreciationAmortization, Cost Recovery & Depreciation (IRC secs. 167-169, 171, 178, 194-195, 197, 216, 248, 280F)General OverviewTax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)Stock & Other SecuritiesTax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)General OverviewTax LawFederal Income Tax ComputationValuationCorporate SecuritiesBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsRecapitalizations (IRC sec. 368)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART II. LEGAL BACKGROUND
B. Tax Considerations

2-2A California Legal Forms--Transaction Guide § 2A.22

§ 2A.22 Timing Date of Incorporation for Tax Purposes

[1] Deducting Net Operating Loss

In most cases, the net operating loss of a business may be deducted from income of the two years preceding the year of the loss [*I.R.C. § 172(b)(1)(A)(i)*]. Net operating losses occurring in 2001 or 2002 may be deducted from income of the five taxable years preceding the year of the loss [*I.R.C. § 172(b)(1)(A)(i), (H)*; *see I.R.C. § 172(j)* (election to disregard 5-year carryback)]. Then, with certain exceptions, any excess net operating loss may be applied against income for the next 20 years [*see I.R.C. § 172(b)(1)(A)(ii)*], but, the excess loss of the unincorporated business may not be applied against the income of the corporate successor [New *Colonial Ice Co. v. Helvering (1934) 292 U.S. 435, 441, 54 S. Ct. 788, 78 L. Ed. 1348*]. Accordingly, it is often advisable to postpone the date of incorporation until at least some of the loss has been deducted.

[2] Avoiding Income Bunching

In the event of a transfer of partnership assets and interests to a corporation formed to carry on the business of the partnership, improper timing could result in the bunching of more than 12 months of partnership income into one tax year of the partners. This is because partners must compute their income on the basis of partnership income for any taxable year of the partnership ending within or with their taxable years [*I.R.C. § 706(a)*], and because in the event of the termination of the partnership, its taxable year will close [*I.R.C. § 706(c)*].

A partnership terminates if it discontinues its operation, or sells or exchanges more than half of the total interest in partnership capital and profits [*see I.R.C. § 708(b)*]. Thus, for example, assume that a partnership has a fiscal year ending on January 31 and that its two partners are calendar-year taxpayers. If the partnership were to terminate and incorporate on December 31, 1993, the partners would have to report their respective shares of partnership income not only for the 12 months ending January 31, 1993, but also for the 11 months ending December 31, 1993, or for a total of 23 months, on their individual income tax returns for the year 1993 [*see Guaranty Trust Co. v. Commissioner of Int. Rev. (1938) 303 U.S. 493, 500, 58 S. Ct. 673, 82 L. Ed. 975*]. Accordingly, an incorporating partnership may wish to schedule the date of incorporation to avoid this situation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewTax LawFederal Income Tax ComputationDeductions for LossesGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART II. LEGAL BACKGROUND
B. Tax Considerations

2-2A California Legal Forms--Transaction Guide § 2A.23

§ 2A.23 Depreciation and Investment Tax Credit

In general, the transferee corporation will be entitled to a deduction for depreciation in the value of the transferred assets from the exhaustion, wear, and tear (including a reasonable allowance for obsolescence) of property used in a trade or business or held for the production of income [*I.R.C. §§ 167(a), 168*]. Both the applicable method of depreciation [*see I.R.C. § 168(b)*] and the predetermined recovery period [*see I.R.C. § 168(c)*] applicable to various classes of property [*see I.R.C. § 168(e)*] are specified by statute [*see I.R.C. § 168(a)*], depending on when the property is placed in service [*see I.R.C. § 168(d)*; *see also I.R.C. § 168(f), (g)* (alternative depreciation system), (h) (exceptions), (k) (additional 50-percent first-year depreciation deduction)]. For further discussion of depreciation, see Ch. 53, *Personal Property Leasing* .

Ordinarily, an investment tax credit previously taken will be subject to recapture on early disposition [*I.R.C. § 50(a)(1)-(3)*]. However, this rule does not apply when there is a mere change in the form in which the trade or business involved is conducted, so long as the property is retained in the trade or business and the taxpayer retains a substantial interest in that business [*I.R.C. § 50(a)(4)*]. If the transferred assets are later sold by the corporation at a gain, the corporation will be subject to tax on the gain [*see I.R.C. §§ 1001, 1245, 1250*] and the shareholders will be subject to another tax on any distribution of the proceeds [*I.R.C. § 301*]. These adverse consequences can be avoided by leasing the property to the corporation rather than transferring it in exchange for shares.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewTax LawFederal Income Tax ComputationDeductions for Amortization, Depletion & DepreciationInvestment Tax Credit (IRC secs. 38, 39, 46-50)Tax LawFederal Income Tax ComputationSales & ExchangesRecapture of Depreciation (IRC secs. 1245, 1250)Mergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsTax LawFederal Income Tax ComputationDeductions for Amortization, Depletion & DepreciationAmortization, Cost Recovery & Depreciation (IRC secs. 167-169, 171, 178, 194-195, 197, 216, 248, 280F)Property Used in Business & TradeTax LawFederal Income Tax ComputationDeductions for Amortization, Depletion & DepreciationAmortization, Cost Recovery & Depreciation (IRC

secs. 167-169, 171, 178, 194-195, 197, 216, 248, 280F)General Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART II. LEGAL BACKGROUND
B. Tax Considerations

2-2A California Legal Forms--Transaction Guide § 2A.24

§ 2A.24 State Tax Considerations

[1] Sales and Use Tax

Various state taxation issues may arise in the incorporation of a going business. The Sales and Use Tax Law [*see Rev. & Tax. Code §§ 6001-7176*] imposes a tax on the gross receipts of a retailer from the sale of tangible personal property sold at retail in California [*Rev. & Tax. Code §§ 6051-6051.5*]. A sale "at retail" includes a sale for any purpose other than resale in the regular course of business [*Rev. & Tax. Code § 6007*]. A one-time sale of assets may qualify as a retail sale subject to the imposition of sales tax, even if the seller has never sold personal property at retail before [*see Santa Fe Energy Co. v. California State Bd. of Equalization (1984) 160 Cal. App. 3d 176, 182, 206 Cal. Rptr. 499]* . Accordingly, the transfer of personal property to the new corporation for consideration other than stock may be considered a taxable sale, subjecting the corporation to payment of state sales tax [*see 18 Cal. Code Reg. § 1595(b)(4)*].

However, various exemptions apply to prevent application of sales tax, such as the transfer of 80 percent of more of all tangible personal property used in a business when 80 percent or more of the real or ultimate ownership of the property is substantially the same after the transfer [*see 18 Cal. Code Reg. § 1595(b)(2)*]. In addition, the gross receipts from an "occasional sale" [*see Rev. & Tax. Code § 6006.5* (definition)] of tangible personal property are exempt from sales and use tax [*Rev. & Tax. Code § 6367*]. One of these exemptions is likely to be applicable to most incorporations of going businesses. For further discussion of the applicability of the Sales and Use Tax Law and other state and local taxes, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

[2] Real Property Tax

Real property in California is subject to property taxation at its full value unless exempt under California or federal law [*Cal. Const. art. XIII, § 1*; *Rev. & Tax. Code §§ 201, 401*]. When real property is subject to a change in ownership, its value is reassessed for property tax purposes [*Rev. & Tax. Code § 75.10(a)*; *see Rev. & Tax. Code § 110.1(a)(2)*]. Transfer of an interest in real property is a "change in ownership" that causes a reassessment of the property [*Rev. & Tax. Code § 60*]. However, a transfer between an individual and a corporation that results solely in a change in the method of holding title, with no change in proportional ownership interests, is not a "change in ownership" [*Rev. & Tax. Code § 62(a)(2)*]. For further discussion of real property taxes, see Ch. 23, *Real Property Sales Agreements* .

For further discussion of state taxation issues incident to the transfer of a business, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewTax LawState & Local TaxesSales TaxImposition of TaxTax LawState & Local TaxesSales TaxExemptionsTax LawState & Local TaxesReal Property TaxAssessment & ValuationValuationTax LawState & Local TaxesReal Property TaxAssessment & ValuationAssessment Methods & Timing



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART II. LEGAL BACKGROUND
B. Tax Considerations

2-2A California Legal Forms--Transaction Guide §§ 2A.25-2A.99

[Reserved]

§§ 2A.25[Reserved]



21 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-2A California Legal Forms--Transaction Guide

NOTE:

The following guide is limited to those items specifically applicable to incorporating a going business. Procedures generally applicable to the formation of any corporation are covered in detail in Ch. 2, ***Formation of Corporations*** **,** Ch. 3, ***Articles of Incorporation*** **,** Ch. 4, ***Bylaws*** , in Ch. 5, ***Directors' Meetings, Actions, and Resolutions,*** and Ch. 6, ***Securities Regulation Issues.***



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-2A California Legal Forms--Transaction Guide § 2A.100

§ 2A.100 Facts

1. Type or nature of business being incorporated.

NOTE:
This information will be useful in drafting the corporation's articles and determining whether a bulk transfer notice must be given to creditors [***see*** *§ 2A.111*, P 9].

2. Location of business, including county and judicial district in which it is located.

NOTE:
The fictitious business name certificate is filed in the county in which the place of business is located [***see*** *Bus. & Prof. Code §§ 17915, 17916*; ***see also*** Ch. 1A, ***Role of Counsel in Starting a New Business***]. Any required bulk sale notice must be (1) recorded in the office of the county recorder in the county or counties in which the tangible assets are located; (2) published in the judicial district in which the tangible assets are located, and, if different, the judicial district in which the seller is located [***see*** *Com. Code § 6103(a)(2)*]; and (3) delivered or sent to the county tax collector in the counties or counties in which the tangible assets are located [*Com. Code § 6105(b)*; ***see*** *Com. Code § 6105(b)(3)*; *Rev. & Tax. Code § 441*]. For further discussion, see *§ 2A.113*, Paragraph 2.

3. For all owners of going business:

a. Names and addresses.

b. Relationships to each other, whether family, partnership, or other.

c. Social Security or taxpayer identification numbers.

4. Net worth of business to determine amount of stock corporation may issue.

5. Each owner's interest in going business.

NOTE:
Shares to be issued by the corporation without a permit from the Commissioner of Corporations under the small offering exemption (no more than 35 persons) must be issued to the business owners in the same proportions as the business was owned by them immediately before the issuance of the shares [***see*** *Corp. Code § 25102(h)(2)(A)*]. No such restriction applies to shares issued under the limited offering exemption [***see*** *Corp. Code § 25102(f)*].

a. Net worth in dollar amounts.

b. Net worth as percentage of total net worth of business.

6. List of business assets, including inventory and accounts receivable, listing:

a. Adjusted basis of each owner of unincorporated business in each asset.

b. Value of each asset and manner in which value was determined:
(1) Appraised value.

(2) Depreciated "book" value.

(3) Fair market or other value.

(4) If construction or service business is being incorporated, manner of determining value of work in progress.

7. List of business liabilities, including accounts payable, and:

a. Names of creditors.

b. Purposes of obligations.

c. Terms of obligations.

8. Accounting method (cash or accrual) used by business for tax purposes.

9. Accounting and tax periods for:

NOTE:
This information will be useful in determining the date on which the business may most advantageously be transferred to the corporation [***see*** *§ 2A.22*].

a. Business to be incorporated.

b. Each of business owners.

10. Name, address, and telephone number of accountant, if any, employed by business.

NOTE:
It is desirable to obtain the comments and suggestions of the accountant with respect to the proposed capital structure of the new corporation and all tax and accounting aspects prior to incorporation.

11. Facts needed for exemption from qualification or qualification of offer and sale of shares:

a. Limited offering exemption [*see Corp. Code § 25102(f)*; *see also* Ch. 6B, *California Limited Offering Exemptions*].

b. Small offering exemption [*see Corp. Code § 25102(h)*; *see also* Ch. 6C, *California Small Offering Exemption*].

c. California "qualified purchaser" exemptions [*see Corp. Code § 25102(i), (n)*; *see also* Ch. 6C, *California Qualified Purchaser Exemption*].

d. Qualification if exemption does not apply [*see* Ch. 6H, *Qualification of Securities*].

12. Whether going business will continue to operate separately after formation of new corporation.

13. Names and addresses of any insurance agents or brokers servicing business.

14. Account numbers for:

a. State unemployment compensation.

b. Workers' compensation.

c. Sales and use tax.

15. Federal employer identification number used by business.

16. Details of any pending litigation.

17. Location and account numbers of all existing business bank or investment accounts.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationPreincorporationGeneral OverviewBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsFormationPlace of IncorporationGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsCommercial Law (UCC)Bulk Sales (Article 6)Notice to ClaimantsBusiness & Corporate LawCorporate NamesGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-2A California Legal Forms--Transaction Guide § 2A.101

§ 2A.101 Documents

1. Any leases that are to be assigned to corporation.

2. Instruments, such as deeds or title policies, that show legal description of any real property that is to be transferred to corporation and names in which title to property stands.

3. Financial statements:

a. Last available balance sheet.

b. Profit and loss statements for each of past three years, or, if business has been operated for less than three years, for period business has been operated.

NOTE:
This will be particularly necessary if the corporation will require a permit from the Commissioner of Corporations to issue its shares in exchange for the business.

4. Any instruments that are to be assigned to new corporation:

a. Contracts.

b. Franchise agreements.

c. Notes.

d. Other instruments.

5. Partnership agreement, if any.

6. Preincorporation agreement between owners of business to be incorporated, if any [*see § 2A.200*].

7. Copies of all insurance policies held by business or its owners for business purposes.

8. Copies of all licenses or permits issued to:

a. Owners.

b. Business.

c. Employees.

9. Any buy-sell agreements currently in force between owners of business.

10. Tax returns of going business showing, with respect to currently owned property:

a. Depreciation allowances allowed or allowable.

b. Investment tax credits taken.

11. Fictitious business name statement filed by going business.

NOTE:
The corporation, once formed, may have to file a new fictitious business name statement and the going business may have to file a statement of abandonment of its fictitious business name [***see § 2A.113***, P 3].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationPreincorporationGeneral OverviewBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawCorporate NamesFictitious NamesRegistration Requirements



24 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-2A California Legal Forms--Transaction Guide §§ 2A.102-2A.109

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§§ 2A.102[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2A California Legal Forms--Transaction Guide § 2A.110

§ 2A.110 Formation of Corporation

NOTE:
For the purposes of this section, it is assumed that a decision has already been made to incorporate the going business following due consideration of the advantages and disadvantages of doing business either as a sole proprietorship, a partnership, or a corporation.

1. Select name for corporation.

NOTE:
For the general considerations relating to the selection of a corporate name, see Ch. 2, ***Formation of Corporations*** **.**

a. Is use of existing firm's name as part of corporation's name advisable or desirable based on:
(1) Whether there is substantial goodwill or name identification associated with firm's name.

NOTE:
The "goodwill" of a business is the expectation of continued public patronage [*Bus. & Prof. Code § 14100*]. Goodwill is a transferable property interest [*Bus. & Prof. Code § 14102*]. For discussion of the issues involved in transferring the goodwill of a business, see Ch. 17, ***Buying and Selling a Business or Professional Practice*** .

(2) Whether change of name will be likely to have adverse effect on sales or income of firm.

(3) If firm's name includes name of owner, whether that name should continue as part of corporation's

name after owner's death.

b. Is name tentatively selected available for use as corporate name?

NOTE:

For coverage of checking the availability of and reserving a corporate name, see Ch. 2, ***Formation of Corporations*** .

2. Determine nature of new corporation's business.

NOTE:

The articles of incorporation must include a statement of the corporation's purpose [*Corp. Code § 202(b)*]. For coverage of the corporate purpose, see Ch. 3, ***Articles of Incorporation*** .

3. Set up schedule for process of incorporating going business [*see* Ch. 2, *Formation of Corporations*].

4. Should corporation, if eligible, elect Subchapter S status and, thus, be subject to minimal federal income tax but subject its shareholders to tax on corporate income [*see* Ch. 2B, *Electing Subchapter S Status*]?

5. Is it possible to protect shareholders of corporation, if it should become unprofitable, by having corporation issue "Section 1244 stock," that is, stock which, when sold at loss, would result in limited amount of loss being treated as ordinary rather than capital loss [*I.R.C. § 1244(a), (b)*]?

NOTE:

Section 1244 stock is preferred or common stock in a domestic corporation if, at the time of issue, the corporation is a small business corporation, the stock is issued for money or other property (but not for stock or securities), and the corporation derives more than half of its gross receipts from sources other than rents, royalties, dividends, interest, annuities, and sales or exchanges of stocks or securities during the five years preceding the loss [***see*** *I.R.C. § 1244(c)(1)*]. A corporation is treated as a "small business corporation" if the aggregate amount of money and other property received by it for stock, as a contribution to capital, and as paid-in surplus, does not exceed $1,000,000 [*I.R.C. § 1244(c)(3)*]. For further discussion of Section 1244 stock, see Ch. 6A, ***Federal Securities Exemptions for California Nonpublic Corporations*** .

6. Will corporation be formed as close corporation [*see* Ch. 2, *Formation of Corporations* ; *see also* CALIFORNIA SMALL BUSINESS GUIDE (Matthew Bender)]?

7. What accounting period is to be used by corporation?

a. Calendar year.

b. Fiscal year.

8. What method of accounting will be used by corporation?

a. Cash.

b. Accrual.

9. What effect will incorporation have on existing contracts, liabilities, and suppliers of business [*see* Ch. 2, *Formation*

of Corporations ; *see also § 2A.113*]?

10. What organizational expenses will be incurred in incorporating going business?

a. What costs can be expected [*see* Ch. 2, *Formation of Corporations*]?

b. Who will pay those costs?

c. If owners of business will advance these costs, will those advances be canceled by issuance of shares to those owners [*see 10 Cal. Code Reg. §§ 260.102.11, 260.105.23*; *see also* Ch. 2, *Formation of Corporations*]?

11. If going business will continue to operate separately after incorporation of new business, consider:

a. Desirability of noncompetition agreement between businesses [*see* Ch. 17, *Buying and Selling a Business or Professional Practice*].

b. Division of assets and liabilities between businesses [*see* Ch. 17, *Buying and Selling a Business or Professional Practice*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawCorporate NamesGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2A California Legal Forms--Transaction Guide § 2A.111

§ 2A.111 Transfers to Corporation From Going Business

1. On what date should business be transferred to corporation, depending largely on:

a. When income from business can best or most advantageously be shifted for income tax purposes from individual business owners to corporation; and

NOTE:
This factor involves consideration of whether lower income taxes will result when the corporation's first taxable year will be less than 12 months and its income for that year will be relatively small, or when its taxable income for its first taxable year will be relatively small. It also involves the general considerations set forth in Ch. 2, ***Formation of Corporations*** **.**

b. Date on which shares are to be issued, whether in exchange for business assets or for those assets and additional cash, property, or services?

NOTE:
Because the offer and sale of the corporation's shares will almost invariably be exempt from the qualification requirements of the Corporate Securities Law under either the limited offering exemption or the small offering exemption [***see*** *Corp. Code § 25102(f), (h)*], the date on which the business is to be transferred to the corporation may be set as the shareholders think desirable. However, timely filing of notices is required under both exemptions [***see*** *Corp. Code § 25102(f)(4), 25102(h)(4)*; ***see also*** Ch. 6B, ***California Limited Offering Exemptions*** , Ch. 6C, ***California Small Offering Exemption***].

2. Should transfer of business to corporation in exchange for its shares be tax-free [*see I.R.C. § 351*] or taxable?

NOTE:

For discussion of the advantages and disadvantages of choosing tax-free or taxable incorporation, see *§§ 2A.20* and *2A.21*. In general, the corporation's basis for federal income tax purposes of property transferred to it in a tax-free exchange is the same as the transferor's basis for that property before the exchange [***see*** *I.R.C. § 362*]. When appreciated property is being transferred to the corporation, it may be advisable to attempt to make the transfer taxable so that the corporation will get a new, higher basis for the property. Note, however, that a taxable transfer of depreciable property to a closely held corporation will be taxable as ordinary income rather than as capital gain [*I.R.C. § 1239*].

3. What cash assets of business should be transferred to corporation?

a. Should only minimal amount of cash be transferred to corporation to avoid possibility that subsequent withdrawal of cash from corporation will be treated as dividend if corporation has accumulated earnings and profits at that time?

NOTE:

In some cases it may be advisable to avoid transferring any cash to the corporation and having the corporation borrow cash from the shareholders or a lender, in which case the interest cost would be a deductible expense. However, when the owner of a going business loans money to the corporation, the IRS will scrutinize the transaction to determine whether the "loan" is debt or equity [***see*** *I.R.C. § 385*]. If equity, the "interest" payments would not be allowed as deductions and would be viewed instead, along with the payments of "principal," as disguised dividends to the shareholder. A high ratio of debt to equity is known as "thin incorporation." For a discussion of thin incorporation and the criteria employed by the IRS in determining whether a loan is debt or equity, see Ch. 2, ***Formation of Corporations*** . For further discussion, see Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 71, ***How to Obtain Significant Advantages Through Mixed Debt and Equity Shareholder Financing; Thin Corporations*** (Matthew Bender).

b. Consider retaining sufficient amount of cash to pay liabilities of business not being assumed by corporation.

4. Determine what liabilities and accounts receivable of going business should be assumed by or transferred to corporation:

a. Determine tax basis of assets other than accounts receivable to be transferred to corporation.

b. Determine tax basis of accounts receivable to be transferred to corporation.

NOTE:

For a discussion of the treatment of accounts receivable in a tax-free exchange, see *§ 2A.20[3]*. For the extent to which gain will be recognized to the transferors in an otherwise tax-free exchange, see *§ 2A.20[4]*.

c. Determine whether liabilities assumed will exceed tax basis of assets being transferred (assigning zero basis to accounts receivable transferred by cash basis owners of going business) [*see* P 4b, *above*; *see also Peracchi v. C.I.R. (9th Cir. 1998) 143 F.3d 487, 494-496* (taxpayer who transferred real property with encumbrances exceeding basis to corporation also gave promissory note for amount exceeding liabilities to avoid *I.R.C. § 357(c)* recognition of gain; basis of note held to be face value, and note held not to be "sham" or gift)].

NOTE:

In determining the net excess liabilities for the purpose of computing a transferor's net gain [***see*** *I.R.C. § 357(c)(1)*], liabilities for accounts payable that would give rise to a deduction by the transferor and for any obligations of the transferor for payments to a retiring partner or a deceased partner's successor are excluded [*I.R.C. § 357(c)(3)(A)*; ***see*** *I.R.C. § 736(a)*] unless incurrence of the liability resulted in creation of, or an increase in, the basis of any property [*I.R.C. § 357(c)(3)(B)*].

In calculating the amount of liability assumed, any portion of a recourse liability is treated as having been assumed if, determined on the basis of all facts and circumstances, the transferee has agreed to (and is expected to) satisfy that liability regardless of whether the transferor has been relieved of the liability [*I.R.C. § 357(d)(1)(A)*]. Nonrecourse liabilities are treated as assumed, except that the amount is reduced by the lesser of (1) the amount of the liability that an owner of other assets not transferred to the transferee and also subject to the liability has agreed with the transferee, and is expected, to satisfy or (2) the fair market value of those other assets (determined without regard to *I.R.C. § 7701(g)*) [*I.R.C. § 357(d)(1)(B), (2)*].

5. Should going business retain title to business real property and lease it to corporation or transfer it to corporation?

NOTE:

If the incorporation of a going business is structured as a taxable transaction, the gain recognized on the sale to the corporation of depreciable real property by any owner of the business who will own 50 percent or more of the corporation's stock is taxable as ordinary income [***see*** *I.R.C. § 1239*; ***see also*** *I.R.C. § 267(c)* (constructive ownership of stock)]. Such a shareholder should not plan to sell that type of property to the corporation, even at a subsequent date, unless it will be sold at its tax basis to eliminate taxable gain on the sale [***see*** *I.R.C. § 1239*]. In a tax-free exchange, for property placed in service before 1981 and acquired by the corporation in a tax-free exchange after 1980, or for property placed in service after 1986 without the corporation's electing to use straight-line depreciation [***see*** *I.R.C. § 168(b)(5)*], the corporation normally will use the accelerated cost recovery system (ACRS) of depreciation [***see*** former *I.R.C. § 168(e)(4)(C)* (as enacted by Pub. L. No. 97-248); *I.R.C. §§ 168, 381(c)(6)*], but for any other type of property only the straight-line method of depreciation may be used [***see*** *I.R.C. § 167(a), (c)*].

Retaining title to the business real property will not constitute a change in substance rather than form of the business that triggers application of the rules governing the recapture of investment tax credit [***see*** *I.R.C. § 50(a)*; ***see also*** *I.R.C. § 38*], as long as the business real property continues to be used in the trade or business and the taxpayer retains a substantial interest in that trade or business [*Rev. Rul. 83-65, 1983-1 C.B. 10* ; ***see*** *Treas. Reg. § 1.47-3(f)(1)(ii)*].

For a discussion of the ramifications of change of ownership of real property for California tax purposes, see *§ 2A.131*.

6. Should any patents or copyrights held by going business be retained by it and licensed to corporation with provisions for payment of royalties by corporation?

NOTE:

For discussion of licensing copyrights, see Ch. 103A, ***Copyrights*** , Part A.

7. Consider transfer of all other assets of going business to corporation.

NOTE:

The assets consisting of the self-employment retirement plan of the existing firm should not be transferred to the corporation since the proprietor or proprietors will no longer be self-employed but, instead, will be employed by the corporation, and contributions for retirement will be to different types of plans.

8. Consider effect of transfer of property by owner of going business to corporation when that person will own (directly or indirectly) more than 50 percent in value of corporation's outstanding shares.

NOTE:

No income tax deduction will be allowed to a more- than-50-percent shareholder for losses on the sale or exchange of the property [*I.R.C. § 267(a)(1), (b)(2)*] or for otherwise deductible expenses, under certain circumstances [***see** I.R.C. § 267(a)(2), (b)(2)*].

9. Determine whether transfer of firm's assets to corporation will be subject to bulk sale provisions of Commercial Code because:

NOTE:

If the Uniform Commercial Code--Bulk Sales Division applies, the buyer must give public notice of the bulk sale, essentially to provide notice to the seller's creditors [***see** Com. Code §§ 6101-6111*; ***see also** § 2A.113*, P 2]. For a form of notice of bulk sale, see *§ 2A.203*.

a. Seller's principal business is sale of inventory from stock, including business that manufactures what it sells, or principal business is that of restaurant owner [*Com. Code § 6103(a)(1)*; *see Com. Code § 6103(c)* (exceptions)];

b. On date of bulk sale agreement, seller is located in California or is located in jurisdiction outside United States but has its major American executive office in California [*Com. Code § 6103(a)(2)*; *see Com. Code § 6103(b)*]; and

c. Sale of assets is not in ordinary course of seller's business and constitutes more than half of seller's inventory and equipment [*Com. Code § 6102(a)(3)*].

NOTE:

In determining the percentage of the seller's inventory and equipment being transferred, the assets are valued at their fair market value as of the date of the bulk sale agreement [*Com. Code § 6102(a)(3), (8), (15)*]. If the consideration for the sale of assets is $2,000,000 or less and is substantially all in cash or an obligation of the buyer to pay cash in the future, the buyer or escrow agent is subject to additional requirements regarding payment of creditor claims [***see** Com. Code §§ 6106.2, 6106.4*].

10. If transfer would otherwise be subject to bulk sale provisions of Commercial Code [*see* P 9, *above*], does transfer qualify for exemption covering sales to new organizations because [*Com. Code § 6103(c)(11)*]:

NOTE:

Many transactions are specifically exempted from the bulk sales law [***see** Com. Code § 6103(c)*], including a sale of assets with a value of less than $10,000 or a value of more than $5,000,000 [*Com. Code § 6103(c)(12)*]. For further discussion of exemptions, see Ch. 17, ***Buying and Selling a Business or Professional Practice*** .

a. Sale of assets is to new organization that is organized to take over and continue business of seller;

b. Buyer has its principal place of business in United States [*see Com. Code §§ 6102(a)(14), 6103(b)*];

c. Buyer assumes in full all debts that were incurred in seller's business before date of bulk sale [*see Com. Code § 6102(a)(7)*];

d. Seller receives nothing from sale except interest in new organization that is subordinate to claims against new organization arising from assumption of debts; and

e. Buyer records and publishes notice of assumption of debts not later than 30 days after date of bulk sale [*see Com. Code §§ 6103(e), 6105*]?

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewTax LawFederal Income Tax ComputationDeductions for Amortization, Depletion & DepreciationInvestment Tax Credit (IRC secs. 38, 39, 46-50)Tax LawFederal Income Tax ComputationDeductions for Amortization, Depletion & DepreciationAmortization, Cost Recovery & Depreciation (IRC secs. 167-169, 171, 178, 194-195, 197, 216, 248, 280F)General OverviewTax LawFederal Income Tax ComputationDeductions for Amortization, Depletion & DepreciationGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsTax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)General OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewCommercial Law (UCC)Bulk Sales (Article 6)General OverviewTax LawFederal Income Tax ComputationTax AccountingGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2A California Legal Forms--Transaction Guide § 2A.112

§ 2A.112 Shareholders and Share Transactions

1. Should going business be transferred to corporation solely in exchange for shares of corporation, or for shares plus cash, notes, or other property?

NOTE:

Determination of this question will, in large part, depend on whether a tax-free or taxable transfer to the corporation is desirable [***see*** *§§ 2A.20, 2A.21*; ***see also*** Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 85, ***Transfers of Property to a Controlled Corporation***]. The California Board of Equalization indicates that a sales tax may be due on the transfer of fixtures and equipment to the corporation to the extent that anything other than securities of the corporation is received by the transferors [***see*** Gobar, ***California Sales Tax Problems in Disposing of a Close Corporation***, 19 S. Cal. Tax. Inst. 91, 102-104 (1967)].

The small offering exemption [*Corp. Code § 25102(h)*] from qualification for the issuance of the stock may be used even though notes as well as shares are issued by the corporation in consideration for the transfer of assets to it, since notes are not deemed a second class of securities for this purpose [*10 Cal. Code Reg. § 260.102.4*]. The limited offering exemption has no limitation on the type of consideration that can be received by shareholders [***see*** *Corp. Code § 25102(f)*]. However, when notes are issued by the corporation, there is a risk that the IRS will reclassify them as securities [***see*** *I.R.C. § 385*; ***see also*** *§ 2A.111*, P 3].

2. How much will each share issued by corporation in exchange for business be worth (that is, how much stock should be issued)?

NOTE:

For detailed coverage of initial financing and issuance of securities, see Ch. 6I, ***Issuance of Equity Securities*** .

3. Will issue of shares be exempt from qualification under one of following exemptions:

a. Limited offering exemption [*Corp. Code § 25102(f)*; *see* Ch. 6B, *California Limited Offering Exemptions* , Part E]?

b. Small offering exemption [*Corp. Code § 25102(h)*; *see* Ch. 6C, *California Small Offering Exemption*]?

4. What stock transfer restrictions should be included in:

a. Bylaws [*see* Ch. 4, *Bylaws*]?

b. Articles of incorporation [*see* Ch. 3, *Articles of Incorporation*]?

c. Shareholders' agreement if corporation is close corporation (that is, if corporation will have 35 or fewer shareholders) [*see Corp. Code § 158*]?

NOTE:
The shareholders of a close corporation, or the sole shareholder of a close corporation, and the corporation may enter into a shareholders' agreement [***see*** *Corp. Code §§ 186, 300(b)*]. A close corporation's articles and share certificates must state limitations on the number of shareholders the corporation may have [***see*** *Corp. Code §§ 158, 418*]. In contrast, a shareholders' agreement generally contains restrictions regarding share transfers and shareholders' rights of first refusal. If the corporation issues uncertificated securities [***see*** *Corp. Code § 191.1*; *Com. Code § 8102(a)(18)*], the statements required by *Corp. Code § 418* must appear on the initial transaction statement and written statements for those securities [*Corp. Code § 418*].

5. What fringe benefits will be available to corporation employees?

a. Qualified profit-sharing plan [*I.R.C. § 401*].

b. Qualified pension plan [*see I.R.C. § 401*].

c. Group life insurance [*see I.R.C. § 79*].

NOTE:
The corporation can deduct premiums and the employees will not have to include as income the amount of premiums on group term insurance not exceeding a coverage of $50,000 per employee [*I.R.C. §§ 79, 162(a)*]. Further, the cost of the excess coverage, while includable, is taxed at the rates provided in the regulations rather than at actual cost of the excess coverage [*Treas. Reg. § 1.79-3(d)(2)*]. However, if the corporation's group term life insurance plan discriminates in favor of key employees, either with respect to eligibility to participate or the type and amounts of available benefits, those key employees will not receive favorable tax treatment in terms of the exclusion or the uniform rates [***see*** *I.R.C. § 79(d)*]. For further discussion, see Ch. 12A, ***Professional Corporations*** .

d. Wage continuation plans [*I.R.C. § 105*].

NOTE:

Premium payments for disability insurance are deductible by the corporation [*Treas. Reg. § 1.162-10(a)*], and are not includable in the employee's gross income [*I.R.C. § 106*]. For further discussion, see Ch. 12A, ***Professional Corporations*** .

e. Accident and health plan [*I.R.C. § 106*].

f. Deferred compensation.

g. Death benefits.

NOTE:

In general, gross income does not include amounts received under a life insurance contract by reason of the death of the insured [*I.R.C. § 101(a)*]. Amounts paid for life insurance are deductible by the corporation [***see*** *I.R.C. § 162(a)*].

h. Employee stock ownership plan [*see I.R.C. § 422*].

NOTE:

For discussion of employee stock ownership plans, and forms to implement such plans, see Chapter 85, ***Employment Agreements*** . For complete discussion of employer stock ownership plans, see Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 13, ***Pension Plans and Other Exempt Employees' Plans*** (Matthew Bender).

i. Additional fringe benefits such as no-additional cost services, qualified employee discounts, working condition fringe benefits, de minimis fringe benefits, qualified transportation fringe benefits, and qualified moving expense reimbursements [*see I.R.C. § 132*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawBlue Sky LawsSecurities Exempt From RegistrationBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for Shares



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2A California Legal Forms--Transaction Guide § 2A.113

§ 2A.113 Notice Requirements

1. If incorporation will affect existing contract obligations, consider whether corporation should:

a. Merely notify other contracting parties of assignment of contract to corporation; or

b. Notify other party of assignment, and:
(1) Expressly assume liability; or

(2) Obtain agreement to novation.

NOTE:
For forms of novation agreements and discussion of applicable law, see Ch. 77, ***Discharge of Obligations*** .

2. What form of notice must be given to public or going business's creditors?

a. Public notice if business makes bulk sale and is required by Commercial Code to give notice.

NOTE:
The bulk sale provisions of the Commercial Code [***see*** *Com. Code §§ 6101-6111*] apply to sellers whose principal business is the sale of inventory from stock, whose principal business is to manufacture what they sell, and whose principal business is that of a restaurant owner [*Com. Code § 6103(a)*; ***see*** *Com. Code § 6103(c)* (exceptions)]. Unless specifically exempted, a bulk sale is subject to the public notice requirement [***see*** *Com. Code §§ 6104(b), 6105*] if the sale is not in the ordinary course of the seller's business and constitutes more than half of the seller's inventory and equipment [*Com. Code §*

6102(a)(3)]. For a notice of bulk sale, see *§ 2A.203*. For detailed discussion of bulk sale requirements, see Ch. 17, ***Buying and Selling a Business or Professional Practice*** .

b. Notice of intended transfer if retail alcoholic beverage license is involved [*see Bus. & Prof. Code § 24073*; *see also* Ch. 18, *Buying and Selling a Retail Alcoholic Beverage License and Business*].

c. If business is a partnership, file statement of dissolution of partnership [*see Corp. Code § 16805* (nonpartners have notice of dissolution 90 days after statement is filed)].

NOTE:
For detailed discussion of the dissolution of general partnerships, see Ch. 15, Part B, ***Dissolution of General Partnerships*** .

3. Is fictitious business name statement [*see Bus. & Prof. Code § 17900*] or statement of abandonment of fictitious business name [*see Bus. & Prof. Code § 17922*] required [*see* Ch. 1A, *Role of Counsel in Starting a New Business*]?

4. Do other organizations and persons need to be notified of change of business form?

a. Government entities, such as:

(1) Franchise Tax Board.

(2) State Board of Equalization.

(3) Employment Development Department.

(4) Workers' Compensation Appeals Board.

(5) Internal Revenue Service.

(6) Social Security Administration.

b. Business and private entities, such as:

(1) Insurance providers.

(2) Professional journals and publications.

(3) Business associates.

(4) Customers.

(5) Outside contractors.

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawPerformanceAssignmentGeneral OverviewBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporate NamesFictitious NamesRegistration RequirementsCommercial Law (UCC)Bulk Sales (Article 6)Notice to Claimants



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-2A California Legal Forms--Transaction Guide §§ 2A.114-2A.119

[Reserved]

§§ 2A.114[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

2-2A California Legal Forms--Transaction Guide § 2A.120

§ 2A.120 Preincorporation Procedures

NOTE:
Before any work is undertaken to form a corporation, the attorney should have an agreement with the client regarding the scope of incorporation work to be performed by the attorney on the client's behalf. For agreements between attorneys and clients to provide legal services, see Ch. 86A, ***Agreements for Legal Services*** .

1. Draft and have business owners execute agreement to incorporate [*see § 2A.200*] in order to:

a. Specify all pertinent terms and minimize misunderstandings.

b. Preclude claim by any owner that he or she did not consent to incorporation.

NOTE:
The agreement should be in exact accordance with the terms of any agreement under which the going business was organized with respect to any future incorporation.

c. Specify whether owners intend to dissolve going business entity or continue it as separate ongoing entity.

NOTE:
If there are any dissenting owners, the incorporation agreement should specify the dissolution of the existing entity and the terms under which dissenters' shares will be purchased. If the existing business is a partnership, the partnership agreement may govern and, accordingly, should be examined.

d. Provide for share transfer restrictions if corporation is to be close corporation (that is, have 35 or fewer shareholders) [*see Corp. Code § 158*].

2. Protect name selected by owners for new corporation:

a. If going business name is to be used as part of corporate name, have owners of going business execute agreement to transfer right to use that name to corporation.

b. If new name will be used, select name that complies with statutory requirements [*see Corp. Code § 201*; *see also* Ch. 2, *Formation of Corporations*].

c. File formal reservation with Secretary of State [*see* Ch. 2, *Formation of Corporations*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsEffective RepresentationBusiness & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawCorporationsFormationPreincorporationTransactions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

2-2A California Legal Forms--Transaction Guide § 2A.121

§ 2A.121 Incorporation Procedures

1. Draft articles of incorporation [*see* Ch. 3, *Articles of Incorporation*], which must include [*see Corp. Code § 202*]:

a. Name of corporation.

b. Purpose of corporation.

c. Name and address of initial agent for service of process.

d. If corporation is authorized to issue one class of shares, total number of shares authorized to be issued.

e. If corporation is authorized to issue more than one class of shares, number, designation, and rights, preferences, privileges, and restrictions of each class.

2. Have directors or incorporators execute articles of incorporation [*Corp. Code § 200*; *see* Ch. 3, *Articles of Incorporation*].

3. File articles of incorporation with Secretary of State [*Corp. Code § 200*; *see* Ch. 3, *Articles of Incorporation*].

4. Advise directors of new corporation to call, give proper notice of, and hold organizational meeting of corporation's board of directors, and to:

a. Approve organizational resolutions [*see* P 5, *below*].

b. Adopt bylaws for governance of corporation [*see* Ch. 4, *Bylaws*].

5. Draft organizational resolutions and have them adopted by organizational meeting of board:

a. Accepting business owners' offer to transfer business to corporation in exchange for its shares.

b. Determining fair value, in monetary terms, of business for which corporation's shares are to be exchanged [*Corp. Code § 409(e)*].

c. If corporation will require permit from Commissioner of Corporations to issue shares in exchange for business [*see Corp. Code §§ 25110, 25113*], draft and have adopted resolution authorizing officers of corporation to:
(1) Apply for permit.

(2) On receipt of permit, issue shares in strict compliance with provisions of permit [*see* Ch. 6I, *Issuance of Equity Securities*].

d. When issuance of shares by corporation in exchange for business qualifies for limited offering exemption or small offering exemption [*see* Ch. 6B, *California Limited Offering Exemptions* , and Ch. 6C, *California Small Offering Exemption*].

e. If transfer of business to corporation is subject to Uniform Commercial Code--Bulk Sales Division [*see § 2A.113*, P 2a], draft and have adopted resolution authorizing and instructing officers of corporation to do all things in connection with transfer of business to corporation that may be required by provisions of Uniform Commercial Code--Bulk Sales Division [*see Com. Code §§ 6101-6111*].

NOTE:
This resolution may be prepared using the format illustrated in the general form for corporate resolutions [***see*** Ch. 5, ***Directors' Meetings, Actions, and Resolutions*** , Form 5.50]. For discussion of the bulk sale notice requirements, see *§ 2A.203[1]*. The application of the bulk sale provisions are discussed in detail in Ch. 17, ***Buying and Selling a Business or Professional Practice*** .

f. Draft resolutions assuming liabilities under existing contracts of transferor business.

NOTE:
The general form for a corporate resolution [***see*** Ch. 5, ***Directors' Meetings, Actions, and Resolutions*** , Form 5.50] may be adapted for this purpose.

g. Draft and have adopted other resolutions that may be required or that are normally adopted at the first meeting of board of directors of corporation [*see* Ch. 5, *Directors' Meetings, Actions, and Resolutions*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum

Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFormationGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

2-2A California Legal Forms--Transaction Guide §§ 2A.122-2A.129

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§§ 2A.122[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

2-2A California Legal Forms--Transaction Guide § 2A.130

§ 2A.130 Post-Incorporation Organization and Property Transfers

1. Draft and have business owners execute offer to transfer business to corporation in exchange for its shares [*see §§ 2A.201* (partnership), *2A.202* (sole proprietorship)].

NOTE:
The offer should clearly indicate an intent to pass title or assign contractual rights to the transferee corporation. Although this type of offer is not required by statute, it serves as a useful tool in specifying the terms of the proposed transfer and in drafting the directors' resolutions accepting the offer.

2. Before date on which business is to be transferred to corporation (and after business owners' offer to transfer business in exchange for shares has been accepted by corporation's directors) [*see § 2A.131*]:

a. Prepare assignments of any leases or contracts that are to be transferred to corporation.

b. If lease is to be transferred to corporation, secure lessor's consent to that transfer.

NOTE:
If the lease is for a term in excess of 35 years, a change of ownership must be filed [***see*** *Rev. & Tax. Code §§ 62(c)(1), (g), 480*; ***see also*** *§ 2A.131*, P 22].

c. Prepare any deeds or other instruments required to transfer real property of business to corporation.

NOTE:
It may be desirable to obtain a title search and title insurance on any real property transferred to the corporation. For complete discussion, see Ch. 26A, ***Title Insurance*** .

d. Prepare bill of sale to be executed by business owners conveying to corporation all assets of business, both tangible and intangible, that they have agreed to transfer to corporation [*see § 2A.204*].

e. Include in any document of transfer such provisions as:

(1) Statement of consideration given.

(2) Description of property transferred.

(3) Date on which title held by transferee is to pass to corporation.

(4) Other terms in exact accordance with any relevant provisions in preincorporation agreement, articles, or bylaws.

3. On date that business is to be transferred to corporation:

a. Have all instruments of transfer, including bill of sale for business and its assets, any assignments of leases, assignments of contracts, deeds, or other instruments required to transfer any assets of business to corporation, signed by business owners and delivered to corporation's officers.

b. Have board of directors approve resolution formally accepting transferred property and authorizing issuance of stock in payment.

c. Prepare certificates of stock to be issued by corporation to business owners in exchange for business and have appropriate officers of corporation:

(1) Execute and deliver share certificates.

(2) File necessary securities exemption notices, such as:
(a) Notice of issuance of securities under small offering exemption [*see Corp. Code § 25102(h)(4)*; *10 Cal. Code Reg. § 260.102.8*; *see also* Ch. 6C, *California Small Offering Exemption*]; or

(b) Notice of issuance of securities under limited offering exemption [*see Corp. Code § 25102(f)(4)*; *see also* Ch. 6B, *California Limited Offering Exemptions*].

4. Ensure that creditors of incorporating business are protected in transfer of property to corporation by ensuring that preincorporation agreement and documents of transfer make specific provision for orderly payment of preexisting obligations, either by owners of preexisting firm, the business itself, or corporation.

NOTE:
For a discussion of transfers of property on incorporation of a going business and methods of avoiding transfers in fraud of the going business' creditors, see Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 51, ***Incorporating the Going Business*** (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate

LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock Certificates



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

2-2A California Legal Forms--Transaction Guide § 2A.131

§ 2A.131 Tax and Business Procedures Following Incorporation

1. Advise business owners to file final sales tax return for preexisting going business.

NOTE:

When shares of the corporation have been exchanged as the only consideration for the business, no sales tax will be due on the final sales tax return because of the transfer of the fixtures and equipment of the business to the corporation. However, a one-time sale of assets may qualify as a retail sale subject to the imposition of sales tax, even if the seller has never sold personal property at retail before [***see*** *Santa Fe Energy Co. v. California State Bd. of Equalization (1984) 160 Cal. App. 3d 176, 182, 206 Cal. Rptr. 499]* . Accordingly, the new corporation may have to pay sales tax on the transaction [***see*** *18 Cal. Code Reg. § 1595(b)(4)*], and the old business may have to file a sales tax return for the sale. If the transaction is deemed an "occasional sale" [***see*** *Rev. & Tax. Code § 6006.5* (definition)] of tangible personal property, it will be exempt from sales and use tax [*Rev. & Tax. Code § 6367*]. For further discussion of the imposition of sales tax and exemptions from the tax, see *§ 2A.24*.

2. If corporation will engage in retail sale of personal property subject to California sales tax, have corporation's officers obtain sales tax permit in name of corporation from State Board of Equalization (SBE).

NOTE:

The corporation should apply for a sales tax permit before it begins operating the business, and the application must be authenticated in a form or pursuant to methods prescribed by the SBE [*Rev. & Tax. Code § 6066(a)*]. The application may be filed using electronic media, as prescribed; electronic media includes but is not limited to computer modem, magnetic media, optical disk, facsimile machine, or telephone [*Rev. & Tax. Code*

§ 6066(b), (c)]. Whenever deemed necessary to ensure statutory compliance, the SBE may require a person charged with collecting sales tax to deposit security with the SBE before issuing the permit. In general, the SBE will fix the amount of the security as the lesser of (1) twice the estimated average liability of persons filing quarterly returns, (2) three times the estimated average liability of persons required to file monthly returns, or (3) $50,000 [*Rev. & Tax. Code § 6701*]. However, if the person has been given notice of a hearing to revoke his or her sales tax permit [***see*** *Rev. & Tax. Code § 6070*], the security will be the lesser of (1) three times the average liability of persons filing quarterly returns, (2) five times the average liability of persons filing monthly returns, or (3) $50,000 [*Rev. & Tax. Code § 6701*].

3. Have unemployment compensation account of former business shifted to corporation.

NOTE:
For discussion of unemployment compensation, see Ch. 1C, ***Regulation of Employers*** .

4. Advise corporation to inform workers' compensation insurance carrier of change of form of doing business.

NOTE:
For discussion of workers' compensation, see Ch. 1C, ***Regulation of Employers*** .

5. Advise corporation to contact insurance agent or broker to make necessary changes in all other insurance policies to cover corporation instead of former business firm.

NOTE:
For discussion of insurance issues, see Ch. 1F, ***Insurance Considerations in Business Formation*** .

6. Advise corporation to file application for new federal employer identification number in name of corporation.

NOTE:
For coverage of the procedures involved in filing for a federal employer identification number, see Ch. 1C, ***Regulation of Employers*** .

7. Advise former business to file final federal and California quarterly withholding returns.

NOTE:
For coverage of state and federal withholding tax procedures, see Ch. 1E, ***Taxation of Businesses*** .

8. Advise business owners to cancel or abandon any other permits and licenses issued to them as individuals for business and have corporation apply for necessary permits or transfer of permits to its name.

9. Notify creditors and other interested parties of dissolution or termination of business in its original form and that it is now corporation, by:

a. Public notice if business makes bulk sale and is required by Commercial Code to give notice [*see Com. Code §§ 6102(a)(3), 6103(a); see also § 2A.113*].

NOTE:
For a bulk sale notice, see *§ 2A.203*. For detailed coverage of bulk sale notices and procedures, see Ch. 17, ***Buying and Selling a Business or Professional Practice*** **.**

b. Notice of intended transfer if retail alcoholic beverage license is involved [*see Bus. & Prof. Code § 24073*; *see also* Ch. 18, *Buying and Selling a Retail Alcoholic Beverage License and Business*].

c. For general partnerships, statement of dissolution of partnership [*see Corp. Code § 16805* (nonpartners have notice of dissolution 90 days after statement is filed)].

10. If fictitious business name statement was ever filed by going business [*see Bus. & Prof. Code § 17900*], file and publish statement of abandonment of fictitious business name [*see Bus. & Prof. Code § 17922*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*].

11. If corporation will do business under name differing from corporate name, have it file statement of fictitious business name [*see Bus. & Prof. Code § 17900*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*].

12. Advise former business owners to minimize their personal liability for business debts:

a. As to obligations in existence before incorporation:

(1) Advise owners to confer with creditors and obtain written consent to assumption of obligations by corporation, thereby creating novation.

NOTE:
For novation agreements, see Ch. 77, ***Discharge of Obligations*** .

(2) Have corporation agree with owners to assume all debts of former business and indemnify them against any claim asserted against them on those obligations.

b. As to post-incorporation obligations, have former owners send notice on date of incorporation to creditors of former business that it has been incorporated and that they are no longer personally responsible for credit extended to corporation.

13. Advise corporation that it may either:

NOTE:
For discussion of liability issues incident to incorporation, see *§ 2A.12*.

a. Expressly assume all debts and obligations of going business in existence as of date of incorporation, by means of resolution authorizing both assumption and payment of those obligations, followed by letter stating express assumption and promise to pay; or

b. Attempt to avoid liability for debts of business by:

(1) Expressly disclaiming liability for preincorporation debts of former business.

(2) Obtaining written indemnification agreements from owners of former business as to any obligations that might render corporation liable or affect assets transferred to

corporation.

(3) Accepting from going business only portion of its assets, leaving in that business sufficient assets to pay all existing obligations.

14. If former business had out-of-state operations that corporation will continue, determine whether those operations are sufficiently substantial and continuous in each jurisdiction to require corporation to qualify as foreign corporation under local law and, if so, advise corporation to do so.

NOTE:
For discussion of the qualification of foreign corporations in California and issues to consider in deciding whether to incorporate in other states, see Ch. 12B, ***Foreign Corporations and Associations*** **.**

15. If corporation has 100 or fewer shareholders and they desire federal tax treatment as if they were partners in partnership, advise corporation to elect Subchapter S status [*see I.R.C. § 1361(b)(1)(A)*; *Rev. & Tax. Code § 23801*; *see also* Ch. 2B, *Electing Subchapter S Status*].

16. If former owners of business had previously made wills disposing of their interests in business, review and make appropriate revisions to their wills.

17. If desired, have any trade or service mark held by former business assigned to, and registered in, name of corporation.

NOTE:
For applicable procedures, see Ch. 103B, ***Trademarks*** .

18. Have business assign its copyrights and patents to corporation.

NOTE:
For discussion of copyrights, see Ch. 103A, ***Copyrights*** .

19. Change registration of any motor vehicles transferred to corporation.

NOTE:
For discussion of vehicle registration and transfer, see Ch. 102D, ***Registration and Transfer of Vehicles, Vessels, and Aircraft*** .

20. Change name of business on all:

a. Bank accounts.

b. Public utilities accounts.

c. Credit accounts transferred to corporation.

21. If no gain or loss is recognized on transfer of business property in exchange for shares of corporation [*see I.R.C. § 351*]:

a. Include detailed information on exchange in transferor's tax return for year of exchange.

b. Advise owners of former business to retain permanent records to permit determination of gain or loss

on ultimate disposition of stock [*see Treas. Reg. § 1.351-3*]

22. If real property is transferred to corporation, advise business owners that:

a. No "change of ownership" occurs if there is no change in their proportional interests [*see Rev. & Tax. Code § 62(a)(1)*].

b. Change of ownership does occur:

(1) On transfer of any leasehold interest with remaining term of 35 years or more, including renewal options [*see Rev. & Tax. Code § 61(c)(1)*], and that change of ownership statement must be filed in county where real property is located [*see Rev. & Tax. Code § 480*].

NOTE:
For an example of a preliminary change of ownership statement [*Rev. & Tax. Code §§ 480.3*, *480.4*], which is available free of charge on request from any county assessor or recorder, see Ch. 23, ***Real Property Sales Agreements*** , § 23.306.

(2) If, after incorporation, more than half of total interests in corporation are transferred [*see Rev. & Tax. Code § 64(d)*] and change in ownership statement must be filed in office of Franchise Tax Board in Sacramento [*see Rev. & Tax. Code §§ 480.1*, *480.2*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Labor & Employment LawDisability & Unemployment InsuranceUnemployment CompensationCoverage & DefinitionsBusiness & Corporate LawCorporationsFormationGeneral OverviewWorkers' Compensation & SSDICoverageGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsTax LawFederal Tax Administration & ProcedureAdministrationIdentification Numbers & Information Returns (IRC secs. 6031-6065)General OverviewTax LawState & Local TaxesSales TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

2-2A California Legal Forms--Transaction Guide §§ 2A.132-2A.199

[Reserved]

§§ 2A.132[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART IV. FORMS

2-2A California Legal Forms--Transaction Guide § 2A.200

§ 2A.200 Preincorporation Agreement Between Partners to Incorporate Partnership Business

[1] Comment

[a] Use of Form

This form is a simple agreement between partners to form a California corporation and to transfer all assets of their partnership business to a corporation that will be formed after the execution of the agreement. It states that the partners agree that the corporation (once it is formed) will issue shares of its stock to each of them in amounts equal to their proportionate equity interest in the partnership. However, it is not a subscription agreement. The agreement presumes that the currently existing partnership between the parties will be dissolved when the corporation is formed and the partnership business has been transferred to the corporation.

For another form of preincorporation agreement to incorporate, and a form of preincorporation subscription agreement with respect to a nonpublic offer of securities, see Ch. 2, *Formation of Corporations* . For an offer to transfer the partnership assets to a successor corporation, see *§ 2A.201*.

[b] Exemptions From Qualification for Issuance of Shares on Formation of Corporation

This form is not a subscription agreement and therefore is not a "security" within the meaning of *Corp. Code § 25019*. Because the agreement is not a security, no securities law issues arise from its execution. However, once a corporation is formed pursuant to this type of agreement, the corporation will issue securities and at that time it will have to comply with the Corporate Securities Law [*see Corp. Code § 25000 et seq.*] Although it is seldom the case when a going business is incorporated, if the newly formed corporation will issue shares to more than 35 shareholders, a permit will be required from the Commissioner of Corporations [*see Corp. Code § 25110*; *see also* Ch. 6I, *Issuance of Equity Securities*]. Instead, the corporation may choose to issue all its shares to not more than 35 persons in exchange for the assets of a going business owned by those persons under the small offering exemption from qualification under the Corporate Securities Law [*see Corp. Code § 25102(h)*; *see also* Ch. 6C, *California Small Offering Exemption*], or to not more than 35 qualified persons under the limited offering exemption [*see Corp. Code § 25102(f)*; *see also* Ch. 6B, *California Limited Offering Exemptions*] without a permit from the Commissioner of Corporations.

[2] Form

Preincorporation Agreement Between Partners to Incorporate Partnership Business

AGREEMENT TO INCORPORATE PARTNERSHIP

Preamble

This agreement is made on _____[*date*], between _____[*name of partner*], _____[*name of partner*], and _____[*name of partner*], referred to in this agreement as the "Partners" or the "Parties."

Recitals

The Parties to this agreement are engaged as Partners in the operation of a _____[*type*] business known as _____[*name of business*], referred to in this agreement as the "Partnership," located at _____[*address*], _____[*city*], California.

The Parties to this agreement desire to form a corporation under the General Corporation Law of the State of California for the purpose of carrying on the business.

THEREFORE, it is agreed as follows:

Agreement to Incorporate

1. _____[Within _____ (*number*) days after the date of this agreement *or* On or before _____ (*date*)], the Parties will form a corporation under the General Corporation Law of the State of California to be known as _____[*proposed name of corporation*], or by another name that may be selected by them, for the purpose of engaging in the business of _____[*primary purpose of corporation, which should be the same as that of the partnership business*].

Directors of Corporation

2. The articles of incorporation of the corporation will name the Parties as the initial directors of the corporation.

Authorized Capital of Corporation

3. The authorized capital of the corporation, as stated in its articles of incorporation, will be $ _____, divided into _____[*number*] shares of the same class.

Officers of Corporation

4. The initial officers of the corporation will be: _____[*name of partner*], President; _____[*name of partner*], Vice President; and _____[*name*], Secretary-Treasurer.

Transfer of Partnership Business

5. _____[Within _____ (*number*) days after the corporation is incorporated *or* On or before _____(*date*)], the Parties will transfer and assign _____[all assets of the

Partnership shown on an inventory attached to this agreement and marked Exhibit A *or* their respective interests in the Partnership] to the corporation. In addition, the Parties will cause the corporation to assume all liabilities of the Partnership existing as of _____[*date of last available financial report for the business before the date of transfer*], together with any additional liabilities that may have been incurred in the ordinary course of Partnership business between that date and the date of transfer of the business to the corporation [*add if corporation will assume products liability of partnership:* and any liabilities that may arise after the transfer of the business because of injury or damage caused by a defective product sold by the Partnership before the transfer]. The Parties will also cause the corporation to issue to each Party shares of the corporation's capital stock in an amount representing that Party's proportionate equity interest in the Partnership.

Preparation of Necessary Financial Statements

6. The Parties will authorize and instruct _____[*name*], the accountant for the Partnership, to prepare all financial statements pertaining to the Partnership business that _____[*name*], attorney for the Parties, deems necessary or proper for use in forming the corporation and qualifying the issuance and sale of the securities.

Costs of Incorporating

7. All costs and expenses, including attorneys' fees, required for the formation and organization of the corporation, will be advanced by the Parties in equal proportion from their Partnership business and will be refunded to them by the corporation on demand.

Signatures

Executed at _____[*city*], California on _____[*date*].

PARTNERS
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersTransfers of InterestsSecurities LawBlue Sky LawsExcluded Transactions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART IV. FORMS

2-2A California Legal Forms--Transaction Guide § 2A.201

§ 2A.201 Offer to Transfer Partnership for Shares of Successor Corporation

[1] Comment

[a] Use of Form

This form is an offer by a partnership to transfer all the assets of the partnership to a successor corporation in exchange for shares in the corporation. The form is drafted with the assumption that the securities will be exempted from qualification. However, alternative provisions are included if registration or qualification is required [*see* [e], *below*]. The form includes provisions for acceptance of the offer by the corporation, making the offer a binding agreement between the partnership and the corporation. This form is intended to be used when the transfer is subject to the bulk sale requirements of the Commercial Code, and provides that the actual transfer will not take place until the required bulk sale notice has been given [*see* [d], *below*].

For a bill of sale and agreement to transfer a business to a corporation, see *§ 2A.204*. For an offer to transfer a sole proprietorship to a corporation, see *§ 2A.202*. For other agreements to transfer business assets to a corporation, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Appendix A, *Corporate Forms* (Matthew Bender).

[b] Purpose of Offer

When the transfer to a corporation of a partnership in exchange for shares of the corporation is proposed, some attorneys prefer to memorialize the transaction by having the partnership make a formal written offer, such as this form, to transfer the partnership assets to the corporation. On receipt of this type of offer, the corporation's board of directors adopts a resolution accepting the offer and determining the fair value to the corporation, in monetary terms, of the property described in the offer [*see Corp. Code § 409(e)*], and authorizes the issuance of shares in exchange for the business. For a directors' resolution, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

[c] Considerations in Transfer of Partnership

Important considerations arise on the transfer of partnership assets to a successor corporation. First, the parties must consider liability issues. In the absence of an express or implied agreement with the partnership's creditors to the

contrary, the former partners remain personally liable to the creditors for debts incurred before its dissolution. Moreover, the former partners may be personally liable for debts incurred after incorporation if it is found that the creditor was not notified of the partnership's dissolution [*see Corp. Code §§ 16804, 16805*; *see also § 2A.12*]. This form provides that the successor corporation will expressly assume all existing liabilities of the partnership [*see* [2], P 4, *below*]. For detailed coverage of partners' liabilities on dissolution of a partnership, see Ch. 15, Part B, *Dissolution of General Partnerships* .

In addition, the parties should consider the income tax implications of the transfer. In general, no gain or loss is recognized if property is transferred to a corporation solely in exchange for stock in the corporation, and immediately after the exchange the transferors are in control of the corporation [*I.R.C. § 351(a)*; *see I.R.C. § 368(c)* ("control" defined)]. However, the partnership, not the partners, is deemed the transferor of the assets to a corporation for the purpose of determining basis under *I.R.C. § 351*, regardless of whether the partnership is the actual transferor or whether it terminates and the partners transfer either the distributed assets or their partnership interests to the corporation [*I.R.C. §§ 351, 368(c)*; *Treas. Reg. § 1.351-1(a)(1)*].

For further discussion of tax considerations incident to the transfer of partnership assets to a corporation, see *§ 2A.20[5]*. For further coverage of the dissolution of general partnerships, see Ch. 15, *General Partnerships* , Part B.

[d] Bulk Sale Requirements

This form is designed for use when the transfer of assets is subject to the bulk sale requirements of the Commercial Code [*see Com. Code §§ 6101-6111*]. In general, the bulk sale provisions apply to a bulk sale if (1) the seller's principal business is the sale of inventory from stock, including sellers who manufacture what they sell, or is that of a restaurant owner, and (2) the seller (or its major executive office) is located in California [*Com. Code § 6103(a)*; *see Com. Code § 6103(c)* (exceptions)]. In the context of the sale of a business, a "bulk sale" is a sale not in the ordinary course of the seller's business of more than half of the seller's inventory and equipment [*Com. Code § 6102(a)(3)*].

The key requirement imposed by the bulk sale provisions is that the buyer must give notice of the bulk sale [*Com. Code § 6104*; *see Com. Code § 6105*]. Because the required notice must be recorded with the county recorder, published in at least one newspaper, and delivered to the county tax collector at least 12 business days before the date of the bulk sale [*see Com. Code § 6105(b)*; *see Gifford v. J&A Holdings (1997) 54 Cal. App. 4th 996, 1003-1004, 63 Cal. Rptr. 2d 253* (interpreting Section 6105 in light of legislative intent); *see also § 2A.203[1]*], this form provides that the date of transfer will be 13 business days after the bulk sale notice has been recorded [*see* [2], P 2, *below*].

For a notice of bulk sale, see *§ 2A.203*. For detailed coverage of the bulk sale requirements, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

[e] Exemption From Qualification of Shares

This form is designed for use when the limited offering exemption will apply [*see Corp. Code § 25102(h)*]. Because shares will ultimately be issued to the former partners, the corporation will have to notify the Commissioner of Corporations that it has issued them pursuant to the small offering exemption [*see Corp. Code § 25102(h)(4)*]. For a discussion and the notice form, see Ch. 6C, *California Small Offering Exemption* .

This form contains optional text that complies with the statutory language provided by the nonpublic offering exemption [*see Corp. Code § 25102(a)*] for use if the offer is deemed to be a nonpublic offering, and optional text to include in the event that registration or qualification is required [*see* [2], P 5, *below*].

[2] Form

Offer to Transfer Partnership for Shares of Successor Corporation

OFFER TO TRANSFER PARTNERSHIP ASSETS TO CORPORATION

To: _____[*name of corporation*], a California Corporation:

Representations

1. We, _____[*name of partner*], _____[*name of partner*], and _____[*name of partner*], are partners of a partnership doing business under the name of _____[*name of partnership*] (the "Partnership"), located at _____[*address*], _____[*city*], California. A balance sheet of the partnership as of _____[*date*] (the "balance sheet") is attached to this offer, which fairly represents the financial position of the Partnership on that date in accordance with _____[generally accepted accounting principles *or specify other method of preparation*].

[*Choose one of the following paragraphs:*]

[*Use if bulk sale notice is required:*]

Offer

2. For the consideration and on the terms and conditions set forth in this offer, we offer to transfer the Partnership assets, as defined in Paragraph 3 of this offer, to you at the close of business on _____[*date thirteen business days after date of recording bulk sale notice*].

[*OR*]

[*Use if bulk sale notice and securities qualification are required:*]

Offer

2. For the consideration and on the terms and conditions set forth in this offer, we offer to transfer the Partnership assets, as defined in Paragraph 3 of this offer, to you on the date of transfer. "Date of transfer" means the later of the close of business on the last day of the calendar month in which the issuance of the shares described in Paragraph 4 of this offer is qualified by the Commissioner of Corporations of the State of California or the close of business on the thirteenth business day after the recording of a bulk sale notice of the intended transfer of the assets of the business to the corporation.

[*Continue with the following:*]

Partnership Assets

3. "Partnership assets" means all of the business assets of the Partnership, including those reflected by the balance sheet, and its name and goodwill, subject to all liens, claims, and encumbrances and to changes occurring in the ordinary course of business between the date of the balance sheet and the close of business on the date of transfer.

Consideration for Transfer

4. As consideration for the transfer, you agree:

(a) To assume and pay all of the debts and liabilities of the Partnership referred to on the balance sheet, together with those debts and liabilities resulting from changes occurring in the ordinary course of business between the date of the balance sheet and the date of transfer; and

(b) To issue and deliver on the date of transfer fully paid and nonassessable shares of your

_____ [*specify class, e.g.*, common] stock to the following persons in the following amounts:

Transferee	Number of Shares
_____	_____
_____	_____
_____	_____

[*Choose one of the following paragraphs:*]

[*Use if registration or qualification is required:*]

Registration of Securities

5. We acknowledge that the sale of shares of common stock referred to in this offer and any rights of the undersigned arising under this offer are expressly conditioned on registration of the stock under the Securities Act of 1933, and qualification of the sale under all applicable state securities and blue sky laws, to the extent that registration or qualification is required.

[*OR*]

[*Use if registration and qualification are not required:*]

Registration of Securities

5. We acknowledge that the sale of shares of common stock referred to in this offer has not been registered under the Securities Act of 1933, or qualified under securities or blue sky laws of any state. We also acknowledge that these shares of common stock may not be resold unless the sale is registered under the Securities Act of 1933 and qualified under all applicable securities or blue sky laws (or is exempt from registration and qualification). Each of the undersigned represents that this purchase of shares of common stock is for that person's account and not for sale in connection with any distribution of the security.

[*Add if offer constitutes a nonpublic offering:*]

The sale of the securities that are the subject of this offer has not been qualified with the Commissioner of Corporations of the State of California and the issuance of such securities or the payment or receipt of any part of the consideration for those shares before such qualification is unlawful, unless the sale of securities is exempt from qualification by Section 25100, 25102, or *25105 of the California Corporations Code*. The rights of all parties to this offer are expressly conditioned on such qualification being obtained, unless the sale is so exempt.

[*Continue with the following:*]

Transfer of Business and Execution of Documents

6. If this offer is accepted by you, we will, on the date of transfer, on delivery of the share certificates described in Paragraph 4 of this offer:

(a) Deliver possession of the Partnership assets described in Paragraph 3 of this offer to you; and

(b) Execute and deliver to you any instruments of transfer and other documents that may be required to transfer title to you and to fully perform your obligations under this offer.

Each partner will severally indemnify you against liability for personal taxes of the undersigned based on or measured by that partner's participation in profits of the Partnership, and, in the proportion that the number of shares of common stock issued to that partner bears to all shares issued, in each case under this offer, from loss sustained by liens, claims, and encumbrances, fixed or contingent, not reflected on the balance sheet.

If this offer is acceptable to you, please execute the acceptance below, at which time the offer will constitute a binding agreement between us.

Dated: _____.

_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]

Notation of Acceptance by Corporation

This offer was accepted by a resolution of the Board of Directors of _____[*name of corporation*] duly adopted on _____[*date*].

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawExemptions From RegistrationExempt Classes of Securities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART IV. FORMS

2-2A California Legal Forms--Transaction Guide § 2A.202

§ 2A.202 Offer to Transfer Sole Proprietorship for Shares of Successor Corporation

[1] Comment

[a] Use of Form

This form is an offer by a sole proprietor to transfer the assets, goodwill, and other components of his or her business to a corporation formed to carry on that business in return for all of the shares issued by the corporation. The form is drafted with the assumption that the securities will be exempted from qualification [*see* [d], *below*]. It includes provisions for acceptance of the offer by the corporation, making the offer a binding agreement between the sole proprietor and the corporation. The form is intended to be used when the transfer is subject to the bulk sale requirements of the Commercial Code, and provides that the actual transfer will not take place until the required bulk sale notice has been given [*see* [c], *below*].

This form contains an optional provision making the transferee corporation responsible for products liability claims brought after the transfer, even when they are based on sales made by the transferor before the transfer. For a discussion of the need for, and effect of, such a provision, see *§ 2A.12[1]*.

For a bill of sale and agreement to transfer a business to a corporation, see *§ 2A.204*. For an offer to transfer a partnership to a corporation, see *§ 2A.201*. For other agreements to transfer business assets to a corporation, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Appendix A, *Corporate Forms* (Matthew Bender).

[b] Purpose of Offer

When the transfer to a corporation of a going business in exchange for shares of the corporation is proposed, some attorneys prefer to memorialize the transaction by having a business owner make a formal written offer, such as this form, to transfer the business to the corporation. On receipt of this type of offer, the corporation's board of directors adopts a resolution accepting the offer and determining the fair value to the corporation, in monetary terms, of the property described in the offer [*see Corp. Code § 409(e)*], and authorizes the issuance of shares in exchange for the business. For a directors' resolution, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

[c] Bulk Sale Requirements

This form is designed for use when the transfer of assets is subject to the bulk sale requirements of the Commercial Code [*see Com. Code §§ 6101-6111*]. In general, the bulk sale provisions apply to a bulk sale if (1) the seller's principal business is the sale of inventory from stock, including sellers who manufacture what they sell, or is that of restaurant owner, and (2) the seller (or its major executive office) is located in California [*Com. Code § 6103(a)*; *see Com. Code § 6103(c)* (exceptions)]. In the context of the sale of a business, a "bulk sale" is a sale, not in the ordinary course of the seller's business, of more than half of the seller's inventory and equipment [*Com. Code § 6102(a)(3)*].

The key requirement imposed by the bulk sale provisions is that the buyer must give notice of the bulk sale [*Com. Code § 6104*; *see Com. Code § 6105*]. Because the required notice must be recorded with the county recorder, published in at least one newspaper, and delivered to the county tax collector at least 12 business days before the date of the bulk sale [*see Com. Code § 6105(b)*; *see Gifford v. J&A Holdings (1997) 54 Cal. App. 4th 996, 1003-1004, 63 Cal. Rptr. 2d 253* (interpreting § 6105 in light of legislative intent); *see also § 2A.203*], this form provides that the date of transfer will be 13 business days after the bulk sale notice has been recorded [*see* [2], P 5, *below*].

For a notice of bulk sale, see *§ 2A.203*. For detailed coverage of the bulk sale requirements, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

[d] Exemption From Qualification of Shares

This form is designed for use when the limited offering exemption will apply [*see Corp. Code § 25102(h)*]. Because shares will ultimately be issued to the sole proprietor, the corporation will have to notify the Commissioner of Corporations that it has issued them pursuant to the small offering exemption [*see Corp. Code § 25102(h)(4)*]. For a discussion and the notice form, see Ch. 6C, *California Small Offering Exemption* .

The form also contains optional text that complies with the statutory language provided by the nonpublic offering exemption [*see Corp. Code § 25102(a)*], if the offer is deemed to be a nonpublic offering.

[2] Form

Offer to Transfer Sole Proprietorship for Shares of Successor Corporation

OFFER TO TRANSFER BUSINESS TO CORPORATION

To: _____[*name of corporation*], a California Corporation:

Representations

1. I represent that:

(a) I am doing business as a sole proprietor of a

_____ [*type of business*], known as

_____ [*name of business*] (the "Business"), located at

_____ [*address*],

_____ [*city*], California.

(b) I have not conducted business under any other name or had any other business address within the three years preceding the date of this offer.

(c) A true and correct statement of the assets and liabilities of the Business as of the close of business on

_____ [*date*] is attached to this offer and marked Exhibit A, which fairly represents its financial position at that date in accordance with

_____ [generally accepted accounting principles *or specify other method of preparation*].

Offer

2. For the consideration and on the terms and conditions contained in this offer, I offer to transfer the Business assets listed in Paragraph 3 of this offer to you at the close of business on the date of transfer as defined in Paragraph 5 of this offer, subject to any changes that may occur in the ordinary course of business between the date of this offer and the date of transfer.

[*Add if offer constitutes a nonpublic offering:*]

The sale of the securities that are the subject of this offer has not been qualified with the Commissioner of Corporations of the State of California and the issuance of such securities or the payment or receipt of any part of the consideration for those shares before such qualification is unlawful, unless the sale of securities is exempt from qualification by *Section 25100*, *25102*, or *25105 of the California Corporations Code*. The rights of all parties to this offer are expressly conditioned on the qualification being obtained, unless the sale is so exempt.

[*Continue with the following:*]

Business Assets

3. The assets of the Business include all of the following:

(a) All stock in trade, merchandise, fixtures, equipment, and other tangible assets of the Business as shown on the financial statement attached to this offer and marked Exhibit A [*add if applicable:* except

_____ (*set forth any exceptions, e.g.:*

(1) The real property located at

_____ [*address*].

(2) The accounts receivable shown in the financial statement to be due and owing to the Business in the amount of $

_____)].

(b) The trade, business, name, goodwill, and other intangible assets of the Business.

Consideration for Transfer

4. As consideration for the sale and transfer, you agree:

(a) To assume and pay all debts and liabilities of the Business as shown on the financial statement attached to this offer marked Exhibit A, and all additional liabilities that may be reasonably incurred by me in the ordinary course of the Business between the date of the financial statement and the date of transfer as defined in Paragraph 5 of this offer. I will indemnify you against liability for personal taxes based on or measured by my income from the business, and from any loss sustained by reason of liens, claims, and encumbrances, not reflected in the financial statement.

[*Add if corporation will assume responsibility for products liability claims arising from sales made by proprietorship:*]

(b) To assume all liabilities or claims that do not arise, or that I receive no actual knowledge of, until after the transfer of the Business, if those liabilities or claims are for injury or damage caused by a defect in the design or manufacture of a product sold by me in the course of my operation of the Business.

[*Continue with the following:*]

(c) To issue and deliver on the date of transfer

_____ [*number*] shares of your fully paid and nonassessable capital [*or* common] stock to

_____ [*name of transferee or nominees*].

[*Choose one of the following paragraphs:*]

[*Use if bulk sale notice is required:*]

Date of Transfer Defined

5. As used in this offer, the term "date of transfer" means the close of business on the thirteenth business day after the recording of a bulk sale notice of the intended transfer of the assets of the Business to the corporation.

[*OR*]

[*Use if bulk sale notice and securities qualification are required:*]

Date of Transfer Defined

5. As used in this offer, the term "date of transfer" means the later of the close of business on the last day of the calendar month in which issuance of the shares described in Paragraph 2 of this offer is qualified by the Commissioner of Corporations of the State of California or the close of business on the thirteenth business day after the recording of a bulk sale notice of the intended transfer of the assets of the Business to the corporation.

[*Continue with the following:*]

Costs of Transfer

6. Except for the costs of preparing this offer and the financial statement attached to this offer marked Exhibit A, you agree to pay all costs, expenses, and attorneys' fees incurred in perfecting the transfer of the Business to you, including the costs of filing the notice of the issuance of the corporation's shares pursuant to *California Corporations Code Section 25102(h)* and any acts, notices, or publications required by the California Commercial Code--Bulk Sales Division, and not waived by you. I agree to pay any sales tax due the State of California on the transfer of the fixtures and equipment of the Business to you.

Transfer of Business and Execution of Documents

7. If this offer is accepted by you, I will, on delivery of the share certificates described in Paragraph 4 of this offer, and on the date of transfer as defined in Paragraph 5 of this offer:

(a) Deliver possession of the Business and assets described in Paragraph 3 of this offer to you; and

(b) Execute and deliver to you any instruments of transfer and other documents that may be required to fully perform my obligations under this offer or that may be required for the convenient operation of the Business after transfer by you.

If this offer is acceptable to you, please execute the acceptance below, at which time the offer will constitute a binding agreement between us.

Dated: _____.

_____ [*signature of offeror*]
[*typed name*]

Notation of Acceptance by Corporation

This offer was accepted by a resolution of the Board of Directors of _____[*name of corporation*] duly adopted on _____[*date*].

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Bulk Sales (Article 6)Notice to ClaimantsSecurities LawBlue Sky LawsExcluded TransactionsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesBusiness & Corporate LawCorporationsFormationPreincorporationTransactions



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART IV. FORMS

2-2A California Legal Forms--Transaction Guide § 2A.203

§ 2A.203 Notice of Intended Transfer to a Corporation of the Assets of a Going Business [Com. Code §§ 6101-6111]

[1] Comment

[a] Use of Form

This form is the statutory form for notice of the intended transfer of the assets of a going business to a corporation purchasing the going business [*see Com. Code § 6105*]. The notice must be given by the buyer when the selling business makes a bulk sale of its assets [*see Com. Code §§ 6102(a)(3)(ii), 6104(b)*]. If the buyer fails to comply with the notice requirements with respect to one or more claimants, the buyer is liable for damages in the amount of any claims against the seller, less any amount that the claimant would not have realized if the buyer had complied with the notice requirements [*see Com. Code § 6107(a)*; *see also Com. Code § 6107(c)* (good faith effort at compliance), (d) (limitation of liability)]. Because a corporation ordinarily agrees to assume only the business liabilities of the seller as listed on the books of the business, a notice of intended transfer is usually necessary to protect the corporation from the personal debts of the seller, and from contingent or other liabilities inadvertently omitted from the business books.

The notice is given by publication and recordation [*see Com. Code § 6105(b)*; *see also* [c], *below*]. The requirements of the Uniform Commercial Code--Bulk Sales Division are discussed in further detail in Ch. 17, *Buying and Selling a Business or Professional Practice* .

[b] Bulk Sale Notice Requirements

Unless specifically excepted by statute [*see Com. Code § 6103(c)*; *see also* [e], *below*], the Uniform Commercial Code--Bulk Sales Division applies to a bulk sale if (1) the seller's principal business is the sale of inventory from stock, including those who manufacture what they sell, or is that of restaurant owner [*Com. Code § 6103(a)(1)*]; and (2) the seller is located in California, or is located in a jurisdiction outside the United States but has its major American executive office in California, on the date of the bulk sale agreement [*Com. Code § 6103(a)(2)*; *see Com. Code § 6103(b)*]. A "bulk sale" is a sale outside the ordinary course of the seller's business of more than one half of the seller's inventory and equipment, as measured by the fair market value on the date of the bulk sale agreement [*Com. Code § 6102(a)(3), (8), (15)*]. The term "bulk sale" also encompasses such a sale when conducted by auction, and a sale or

series of sales conducted by a liquidator on the seller's behalf [*Com. Code § 6102(a)(3)(i)*].

[c] Publication, Recordation, and Delivery of Notice

The bulk sale notice must be published at least 12 business days before the date of the bulk sale [*Com. Code § 6105(b)(2)*; *see Com. Code § 6102(a)(7)* ("date of bulk sale" defined)].

One court, reading *Com. Code § 6105* in light of the legislative intent, has held that the notice must be published and recorded at least 12 business days before the anticipated sale date as specified in the notice. Otherwise, creditors do not have sufficient time to file a timely claim [*Gifford v. J&A Holdings (1997) 54 Cal. App. 4th 996, 999, 63 Cal. Rptr. 2d 253* (postponing actual date of sale until 12 business days after recordation did not comply with literal terms of statute; postponement without notice did not constitute good faith effort at compliance under *Com. Code § 6107(c)*)]. The notice must be published at least once in a newspaper of general circulation published in the judicial district in which the tangible assets are located and, if different, in the judicial district in which the seller is located [*Com. Code § 6105(b)(2)*; *see Com. Code § 6103(a)(2)*]. If no such newspaper exists, notice must be published in a newspaper of general circulation in the county in which the judicial district is located [*Com. Code § 6105(b)(2)*]. If the tangible assets are located in more than one judicial district, the notice must be published in the judicial district in which a greater portion of the assets are located and, if different, the judicial district in which the seller is located [*Com. Code § 6105(b)*; *see Com. Code § 6103(a)(3)*].

The notice must be recorded in the office of the county recorder of the county or counties in California in which the tangible assets are located and, if different, in the county in which the seller is located, at least 12 business days before the date of the bulk sale [*Com. Code § 6105(b)(1)*; *see Com. Code § 6103(a)(2)*; *see also Com. Code § 6102(a)(7)* ("date of bulk sale" defined)]. Further, the notice must be delivered, or sent by registered or certified mail, to the county tax collector in the California county or counties in which the tangible assets are located at least 12 business days before the date of the bulk sale [*Com. Code § 6105(b)(3)*]. In addition, if the notice is delivered or sent during the period from January 1 to May 7, inclusive, the notice must be accompanied by a completed business property statement with respect to the property involved in the bulk sale [*Com. Code § 6105(b)(3)*; *see Rev. & Tax. Code § 441* (procedure for filing property statements)].

Careful attorneys usually record the notice at least 13 or 14 business days before the date of the bulk sale, and determine, before setting the date of sale, the name, address, publication dates, and deadline dates of any newspapers of general circulation published in judicial districts (or counties) in which the notice will need to be published. A "business day" is any day other than a Saturday, Sunday, or day observed as a holiday by the California state government [*Com. Code § 6105(b)*].

[d] Small Cash Sales

If the consideration for a bulk sale is $2,000,000 or less and is substantially all cash, an obligation of the buyer to pay cash in the future to the seller, or a combination of the two, the buyer (or an escrow agent if the transaction is handled through an escrow) must apply the consideration in accordance with statutory distribution requirements [*see Com. Code § 6106.2(a), (b)*; *see also Com. Code § 6106.4* (escrow duties and distribution)]. This duty extends so far as is necessary to pay those debts of the seller for which claims are due and payable on or before the date of the bulk sale and are received in writing on or before the date specified as the last date to file claims with the person designated in the notice to receive claims [*Com. Code § 6106.2(b)*; *see Com. Code §§ 6105(b), 6106.2(f)*]. However, this duty does not apply to sales made at auction, or sales conducted by a liquidator on the seller's behalf [*Com. Code § 6106.2(b)*]. For further discussion, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

[e] Exemption for Sales to New Organizations

The application of the bulk sales requirements are subject to numerous exceptions [*see Com. Code § 6103(c)*]. For example, a sale of assets with a value of less than $10,000, or a value of more than $5,000,000, is exempted from the bulk sales law [*see Com. Code § 6103(c)(12)*]. A sale of assets, otherwise subject to the bulk sale provisions of Commercial Code [*see* [b] *above*], to a new organization that is organized to take over and continue the business of the seller and that has its principal place of business in the United States [*see Com. Code §§ 6102(a)(14), 6103(b)*] is exempt under the following circumstances [*Com. Code § 6103(c)(11)*]:

- The buyer assumes in full all debts that were incurred in the seller's business before the date of the bulk sale [*see Com. Code § 6102(a)(7)*];

- The seller receives nothing from the sale except an interest in the new organization that is subordinate to claims against the new organization arising from the assumption of debts; and

- The buyer records and publishes notice of assumption of debts not later than 30 days after the date of the bulk sale [*see Com. Code §§ 6103(e)* (contents of notice), 6105 (manner of recordation and publication)].

[2] Form

Notice of Intended Transfer to a Corporation of the Assets of a Going Business [Com. Code §§ 6101-6111]

NOTICE OF INTENDED TRANSFER

NOTICE IS HEREBY GIVEN that _____[*name of seller*], whose business address is _____[*street address*], _____[*city*], California, intends to transfer to _____[*name of corporation*], a California corporation, whose business address is _____[*address*], _____[*city*], California, the following property now located at _____[*street address*], _____[*city*], California: _____[*describe property, e.g.:* All the trade, fixtures, equipment, inventory, and supplies of that certain business known as _____ (*name of business*)], located at _____[*address*], _____[*city*], California.

During the last three years, _____[*name of seller*] has conducted business under the following names at the following addresses:

Dates	Business Names	Business Addresses
_____	_____	_____
_____	_____	_____
_____	_____	_____

The intended sale will be consummated on or after _____[*date*], at the office of _____[*name*], Attorney at Law, _____[*street address*], _____[*city*], California.

This transfer _____[is *or* is not] subject to *Section 6106.2 of the California Commercial Code*. [*If transfer is subject to Com. Code § 6106.2, add the following:* Claims for debts of the seller may be filed with

_____ (*name*), Attorney at Law, _____ (*street address*), _____ (*city*), California. The last date for filing claims for debts of the seller is _____ (*specify business day before the noticed sale date*)].
Dated: _____.

_____ [*signature of buyer*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Bulk Sales (Article 6)General OverviewBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsCommercial Law (UCC)Bulk Sales (Article 6)Notice to Claimants



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2A INCORPORATING A GOING BUSINESS
PART IV. FORMS

2-2A California Legal Forms--Transaction Guide § 2A.204

§ 2A.204 Bill of Sale Transferring Going Business to Corporation

[1] Comment--Use of Form

This form is designed to serve as both a bill of sale and an agreement transferring the business to the corporation. The final step usually performed by the attorney in incorporating a going business is to preside over the consummation of the entire transaction: the issuance and delivery of shares by the corporation to the former business owners, and the execution and delivery by the business owners to the corporation of a bill of sale for the assets of the going business.

This form is divided into three parts: the instrument of transfer (Paragraph 1), an agreement by the corporation to assume the obligations of the business (Paragraph 2), and, when the business's accounts receivable are being transferred to the corporation, the customary power of attorney given by the transferor to the transferee to collect those accounts receivable (Paragraph 3). For a discussion of the need for and effect of the optional sentence in Paragraph 2 regarding assumption of responsibility for products liability claims, see *§ 2A.12[1]*. If accounts receivable are not being transferred to the corporation, Paragraph 3 of this form may be adapted to make the corporation a collection agent for the transferor by deleting the words "for its own use and benefit" and "but without cost, expense, or damages to the transferor."

For an offer to transfer a partnership to a corporation, see *§ 2A.201*. For an offer to transfer a sole proprietorship to a corporation, see *§ 2A.202*.

[2] Form

Bill of Sale Transferring Going Business to Corporation

BILL OF SALE AND AGREEMENT

By this instrument, executed on _____[*date*] by _____[*name of transferor*] ("Transferor"), and _____[*name of corporation*] (the "Corporation"):

1. In consideration of the issuance to _____[Transferor *or* Transferor's order] of

_____[*number*] shares of the Corporation, Transferor sells, assigns, and transfers to the Corporation all _____[his *or* her] right, title, and interest in and to the following property: All the tangible assets listed on an inventory attached to this instrument marked Exhibit A, and all the stock in trade, goodwill, leasehold interests, trade names, and other intangible assets [*add if applicable:* except accounts receivable] of that certain business known as "_____[*name of business*]," located at _____[*street address*], _____[*city*], California.

2. In consideration of the transfer of that property to it, the Corporation agrees to assume, pay, and discharge all debts, duties, and obligations that appear, on the date of this instrument, on the books of the business as owed by Transferor on account of that business to any person or persons whatsoever. The Corporation further agrees to indemnify and hold Transferor and the property of Transferor free and harmless from any such debt, duty, or obligation, and from any suits, actions, or legal proceedings brought to enforce or collect any such debt, duty, or obligation. [*If the corporation will assume liability for products liability claims brought in the future, add:* The Corporation further agrees to so indemnify Transferor from liability or expense due to claims for injury or damage caused by a defect in the design or manufacture of a product sold by Transferor, in the course of Transferor's operation of the business, when Transferor had no actual knowledge of the liability or claim before the execution of this instrument.]

[*If accounts receivable of the business are being transferred to the corporation, add:*]

3. Transferor hereby appoints the Corporation as Transferor's attorney-in-fact to demand, receive, and collect for its own use and benefit all debts and obligations now owing to _____[*name*] business. Transferor further authorizes the Corporation to do all things legally permissible that may be required to recover and collect those debts and obligations and to use Transferor's name in any manner it may deem necessary for the collection and recovery of those debts and obligations but without cost, expense, or damages to Transferor.

[*Continue with the following:*]

Dated: _____.

TRANSFEROR
_____ [*signature of transferor*]
[*typed name*]

THE CORPORATION
_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationTransactions



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS

2-2B California Legal Forms--Transaction Guide 2B.syn

§ 2B.syn Synopsis to Chapter 2B: ELECTING SUBCHAPTER S STATUS

§ 2B.01 California Sources

[1] Statutes

[2] Regulations

§ 2B.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 2B.03-2B.04 [Reserved]

§ 2B.05 Law Reviews and Periodicals

§ 2B.06 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 2B.07-2B.09 [Reserved]

§ 2B.10 Qualification as S Corporation

[1] In General

[2] Number of Shareholders

[3] Types of Permitted Shareholders

[a] Individuals

[b] Estates

[c] Grantor Trusts

[d] Testamentary Trusts

[e] Voting Trusts

[f] Electing Small Business Trusts

[g] Qualified Subchapter S Trusts

[h] Specified Exempt Organizations

[4] One Class of Stock

[5] Corporations Ineligible for Subchapter S Status

[6] Trusts Ineligible for ESBT Status

[7] Qualified Subchapter S Subsidiaries

§ 2B.11 Election of Subchapter S Status

[1] Initial Election

[2] Election by Previously Terminated S Corporation

[3] Invalid Elections

[a] Untimely Elections

[b] Inadvertent Invalid Elections

§ 2B.12 Tax Year of S Corporation

[1] In General

[2] Election of Permitted Year

[3] Election of Alternative Year

§ 2B.13 Termination of Subchapter S Status

[1] Manner of Termination

[a] Revocation by Shareholders

[b] Loss of Small Business Corporation Status

[c] Receipt of Excess Passive Investment Income

[2] Waiver of Inadvertent Terminations

§ 2B.14 Taxation of S Corporations

[1] Overview

[2] General Computation of S Corporation's Taxable Income

[3] LIFO Benefits Recapture

[4] Investment Credit Recapture

[5] Tax on Passive Investment Income

[6] Built-In Gains Tax

§ 2B.15 Passthrough of Tax Items to S Corporation Shareholders

[1] Overview

[2] Character of Tax on Built-In Gains and Passive Investment Income

[3] Adjustments to Basis of Stock

§ 2B.16 Treatment of Corporate Distributions to S Corporation Shareholders

[1] In General

[2] S Corporation Without Accumulated Earnings and Profits

[3] S Corporation With Accumulated Earnings and Profits

[a] Treatment of Amount That Does Not Exceed Accumulated Adjustment Account

[b] Treatment of Amount Exceeding Accumulated Adjustment Account

§ 2B.17 Treatment of S Corporation as Partnership

[1] Taxation of Employee Fringe Benefits

[2] Taxation of Foreign Income

[3] Oil and Gas Depletion Allowance

§ 2B.18 Tax Treatment of Subchapter S Items

§ 2B.19 Coordination With Subchapter C

§§ 2B.20-2B.29 [Reserved]

§ 2B.30 California Generally Follows Federal Law

§ 2B.31 California Election of Subchapter S Status

[1] Initial Election

[a] Federal Election Required

[b] Special Rules for Tax Years on or After January 1, 1997

[c] Ineligible Corporations

[2] Foreign S Corporations Qualifying to Do Business in California

[3] Effect of Inadvertent Invalid or Untimely Elections

§ 2B.32 [Reserved]

§ 2B.33 Terminating California S Election

[1] In General

[2] Effect of Inadvertent Termination

§ 2B.34 Tax Year for California Purposes

§ 2B.35 California Tax Treatment of S Corporations

[1] Corporate and Franchise Tax

[2] California Modifications to Tax on Built-In Gains and Passive Investment Income

[a] In General

[b] Built-In Gains

[c] Passive Investment Income

[3] Miscellaneous Consequences of S Corporation Election

§§ 2B.36-2B.99 [Reserved]

Scope

§ 2B.100 Facts

[1] Relating to Corporation

Scope

[2] Relating to Each Shareholder

Scope

§ 2B.101 Documents

Scope

§ 2B.110 Qualification of Corporation to Elect Subchapter S Status

Scope

§ 2B.111 Advisability of Electing Subchapter S Status

Scope

Scope

§ 2B.120 Election of Subchapter S Status

[1] Initial Election by Small Business Corporation

Scope

[2] Election After Termination or Revocation of Prior Subchapter S Status

Scope

§ 2B.121 Termination of Subchapter S Status

[1] Revocation With Consent of Shareholders

Scope

[2] Termination on Cessation of Small Business Corporation Status

Scope

[3] Termination on Receipt of Excess Passive Investment Income

Scope

[4] Tax and Accounting Treatment of Termination Year

Scope

§§ 2B.122-2B.129 [Reserved]

§ 2B.130 Shareholders' Estate Plans and Agreements

Scope

§ 2B.131 Income Tax Returns

Scope

§§ 2B.132-2B.199 [Reserved]

§ 2B.200 Election by Small Business Corporation to Be Treated as S Corporation [I.R.C. § 1362]--Internal Revenue Service Form 2553

[1] Comment

[a] Use of Form

[b] Effect of Election

[c] Tax Year

[i] Overview

[ii] Permitted Year

[iii] Approval of Business Purpose Year

[iv] Alternative Year

[d] Shareholder Consents

[e] Execution of Election

[f] Time for Filing Election

[g] Manner of Filing Election

[h] Acceptance of Election

[i] QSST Election

[2] Form

Internal Revenue Service Form 2553

§ 2B.201 Shareholder's Consent to Corporation's Election to Be Treated as S Corporation [I.R.C. § 1362(a)]

[1] Comment

[a] Use of Form

[b] Contents of Consent

[2] Form

Shareholder's Consent to Corporation's Election to Be Treated as S Corporation

§ 2B.202 Application by Corporation for Extension of Time Within Which to File Shareholders' Consents to Subchapter S Election [Treas. Reg. § 1.1362-6(b)(3)(iii)]

[1] Comment

[a] Use of Form

[b] Requirements for Time Extension

[c] Untimely Election

[2] Form

Application by Corporation for Extension of Time Within Which to File Shareholders' Consents to Subchapter S Election

§ 2B.203 Statement of Business Purpose

[1] Comment

[a] Use of Form

[b] Statement Requirements

[c] Signature Requirements

[d] Penalty of Perjury Declaration

[e] Effect of Denial

[2] Form

Statement of Business Purpose

§ 2B.204 Request for Consent of IRS to Election Within Five Years After Termination or Revocation of Prior S Corporation Election [I.R.C. § 1362(g)]

[1] Comment

[a] Use of Form

[b] Obtaining Consent to Election

[2] Form

Request for Consent of IRS to Election Within Five Years After Termination or Revocation of Prior S Corporation Election

§ 2B.205 Election to Have a Tax Year Other Than a Required Tax Year [I.R.C. § 444]--IRS Form 8716

[1] Comment

[a] Use of Form

[b] Election Requirements

[c] Filing Requirements

[d] Tax Consequences of Election

[e] Duration of Election

[f] Use of Election as "Back-Up"

[2] Form

Election to Have a Tax Year Other Than a Required Tax Year

§§ 2B.206-2B.219 [Reserved]

§ 2B.220 Corporation's Statement Revoking Subchapter S Election--With Consent of Shareholders Attached [I.R.C. § 1362(d)(1)]

[1] Comment

[a] Use of Form

[b] Effective Date of Revocation

[c] Contents of Form

[d] Execution of Form

[2] Form

Corporation's Statement Revoking Subchapter S Election--With Consent of Shareholders Attached

§ 2B.221 Notice of Termination of Subchapter S Status by Corporation No Longer Qualified as Small Business Corporation [I.R.C. § 1362(d)(2)]

[1] Comment

[a] Use of Form

[b] Loss of Small Business Corporation Status

[c] Effective Date of Termination

[2] Form

Notice of Termination of Subchapter S Status by Corporation No Longer Qualified as Small Business Corporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS

2-2B California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter discusses the procedures to be used by a small business corporation to elect or terminate Subchapter S status. A corporation elects Subchapter S status so that it may be treated for income tax purposes as if it were a partnership, while retaining the advantages of incorporation [*see § 2B.111*].

The Legal Background discusses the criteria a corporation must meet to be eligible for Subchapter S status and the tax effect of an election on both the corporation and its shareholders. Termination and revocation of Subchapter S status are also described. The Transaction Guide is designed to aid the attorney in determining whether a corporation qualifies to elect Subchapter S status, and whether that election would be advisable. The Transaction Guide also includes procedural guides to the election and termination of Subchapter S status. Forms for use in electing or terminating Subchapter S status are also included.

This chapter refers to small business corporations that have elected Subchapter S status as "S corporations." Corporations that have not elected to be S corporations are referred to as "C corporations" [*see I.R.C. § 1361(a)*].

For discussion of the attorney's role regarding new businesses, see Ch. 1A, *Role of Counsel in Starting a New Business* . For further discussion of selecting the most appropriate form of business, see Ch. 1B, *Selecting Form of Business Entity* . For coverage of the incorporation process in general, see Ch. 2, *Formation of Corporations* . Related incorporation procedures are outlined in Ch. 3, *Articles of Incorporation* , and Ch. 4, *Bylaws* . Incorporation of a going business is covered in Ch. 2A. The taxation of businesses is discussed in Ch. 1E.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART I. RESEARCH GUIDE
A. Primary Sources

2-2B California Legal Forms--Transaction Guide § 2B.01

§ 2B.01 California Sources

[1] Statutes

Determination of gross income by S corporation shareholders. *Rev. & Tax. Code § 17087.5*.

Credit against California taxes allowed for taxes paid to another state by resident shareholder of corporation electing S status in both states. *Rev. & Tax. Code § 18006(b)*.

Taxation of S corporations and shareholders. *Rev. & Tax. Code §§ 23800-23811*.

General application of federal tax provisions. *Rev. & Tax. Code § 23800*.

Election of "S" status. *Rev. & Tax. Code § 23801*.

Taxation of S corporations. *Rev. & Tax. Code § 23802*.

Modification of federal provisions for California tax purposes. *Rev. & Tax. Code §§ 23800.5, 23802.5-23809*.

Tax on passive investment income. *Rev. & Tax. Code § 23811*.

[2] Regulations

Conditions on promotional shares. *10 Cal. Code Reg. §§ 260.141-260.141.3*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART I. RESEARCH GUIDE
A. Primary Sources

2-2B California Legal Forms--Transaction Guide § 2B.02

§ 2B.02 Federal Sources

[1] Statutes

"S corporation" defined. *I.R.C. § 1361(a)(1)*.

"C corporation" defined. *I.R.C. § 1361(a)(2)*.

"Small business corporation" defined. *I.R.C. § 1361(b)(1)*.

"Ineligible corporation" defined. *I.R.C. § 1361(b)(2)*.

Treatment of wholly owned subsidiaries. *I.R.C. § 1361(b)(3)*.

Treatment of qualified Subchapter S trust. *I.R.C. § 1361(d)*.

"Electing small business trust" defined. *I.R.C. § 1361(e)*.

Election of S corporation status. *I.R.C. § 1362(a), (b)*.

Termination by revocation. *I.R.C. § 1362(d)(1)*.

Termination when S corporation ceases to be small business corporation. *I.R.C. § 1362(d)(2)*.

Termination when S corporation's passive investment income exceeds 25 percent maximum. *I.R.C. § 1362(d)(3)*.

"Passive investment income" defined. *I.R.C. § 1362(d)(3)(C)*.

Inadvertent termination. *I.R.C. § 1362(f)*.

Treatment of S corporation's termination year. *I.R.C. § 1362(e)*.

"S termination year" defined. *I.R.C. § 1362(e)(4)*.

Effect of electing Subchapter S status. *I.R.C. § 1363*.

Tax treatment of S corporation shareholders.
Passthrough of "Subchapter S items" (income, loss, deductions, or credits). *I.R.C. § 1366(a)-(c)*.
Rules for losses and deductions. *I.R.C. § 1366(d)*.
Adjustments to basis of S corporation stock. *I.R.C. § 1367*.
Distributions by S corporation. *I.R.C. § 1368*.
"Accumulated adjustments account" defined. *I.R.C. § 1368(e)(1)*.
"S period" defined. *I.R.C. § 1368(e)(2)*.
Application of Subchapter C to S corporation. *I.R.C. § 1371*.
Application of partnership rules to fringe benefits. *I.R.C. § 1372*.
"Two-percent shareholder" defined. *I.R.C. § 1372(b)*.
Treatment of S corporation's foreign income. *I.R.C. § 1373*.
Tax on S corporation's built-in gains. *I.R.C. § 1374*.
Tax on S corporation's passive investment income. *I.R.C. § 1375*.
"Excess net passive income" defined. *I.R.C. § 1375(b)(1)*.
"Net passive income" defined. *I.R.C. § 1375(b)(2)*.
"Pro rata share" defined. *I.R.C. § 1377(a)*.
Taxable year of S corporation. *I.R.C. §§ 1378, 444*.
"Permitted year" defined. *I.R.C. § 1378(b)*.
Treatment of S corporations existing under prior law. *I.R.C. § 1379*.

Tax treatment of Subchapter S items.
Tax treatment determined at corporate level. *I.R.C. § 6241*.
Consistency of shareholders' returns with corporation's returns. *I.R.C. § 6242*.
Participation of shareholders in proceedings for determination of Subchapter S items. *I.R.C. § 6243*.
Application of partnership rules. *I.R.C. § 6244*.

[2] Regulations

Election to be an S corporation. *Treas. Reg. § 1.1362-1*.

Termination of S corporation election. *Treas. Reg. § 1.1362-2*.

Treatment of S termination year. *Treas. Reg. § 1.1362-3*.

Inadvertent terminations. *Treas. Reg. § 1.1362-4*.

Election after termination. *Treas. Reg. § 1.1362-5*.

Elections and consents. *Treas. Reg. § 1.1362-6*.

Effective date. *Treas. Reg. § 1.1362-7*.

Tax imposed on capital gains. *Treas. Reg. § 1.1374-1A.*

Tax imposed on passive investment income. Treas. Reg. § 1.1375-1A.

Election of alternative tax year. Temp. Treas. Reg. §§ 1.444-2T, 1.444-3T.

Tax treatment determined at corporate level. Temp. Treas. Reg. § 301.6241-1T.

Subchapter S items. Temp. Treas. Reg. § 301.6245-1T.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART I. RESEARCH GUIDE
A. Primary Sources

2-2B California Legal Forms--Transaction Guide §§ 2B.03-2B.04

[Reserved]

§§ 2B.03[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-2B California Legal Forms--Transaction Guide § 2B.05

§ 2B.05 Law Reviews and Periodicals

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-2B California Legal Forms--Transaction Guide § 2B.06

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-2B California Legal Forms--Transaction Guide §§ 2B.07-2B.09

[Reserved]

§§ 2B.07[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
A. Federal Law

2-2B California Legal Forms--Transaction Guide § 2B.10

§ 2B.10 Qualification as S Corporation

[1] In General

An "S corporation" is a small business corporation for which an S corporation election under *I.R.C. § 1362(a)* is in effect for that tax year [*I.R.C. § 1361(a)(1)*]. With limited exceptions, a small business corporation may elect to be an S corporation [*I.R.C. § 1362(a)*]. Unlike an ordinary corporation, known as a "C corporation," which is a separate tax-paying entity from its shareholders [*see I.R.C. § 11*], an S corporation is generally treated as a conduit of income, loss, deductions, and credits to the shareholders [*see I.R.C. §§ 1363, 1366*]. For a discussion of the advisability of electing to be an S corporation, see *§ 2B.111*.

A "small business corporation" is eligible to make the S election if it is a domestic corporation that has no more than 100 shareholders and no more than one class of stock [*I.R.C. § 1361(b)(1)(A), (D)*]. In addition, the shareholders of an S corporation must meet certain eligibility requirements [*see* [2], [3], *below*; *see also Cabintaxi Corp. v. Commissioner (7th Cir. 1995) 63 F.3d 614* (federal law determines whether beneficial of record shareholder makes election; state law determines whether particular investor was beneficial shareholder on date of election); *Pahl v. Commissioner (9th Cir. 1998) 150 F.3d 1124, 1127-1128* (court looks to federal law to determine what interest creates tax liability, and to state law to determine whether taxpayer has requisite interest)]. Certain types of corporations are ineligible to elect Subchapter S status [*see* [5], *below*], and certain types of trusts are ineligible [*see* [6], *below*].

[2] Number of Shareholders

An S corporation may have no more than 100 shareholders [*I.R.C. § 1361(b)(1)(A)*]. For S corporation purposes, a husband and wife (and their estates) are treated as one shareholder, and family members may elect to be treated as a single shareholder [*I.R.C. § 1361(c)(1)*]. Increasing the number of permitted shareholders expands the usefulness of S corporations in several ways:

- It facilitates the attraction of capital by permitting more investors.
- It enhances the S corporation's ability to acquire stock of other businesses.

- It enhances the S corporation's ability to use stock for employee compensation, such as options and restricted stock.

- It facilitates the reduction of estate taxes and the preservation of family businesses by allowing more gifts of S stock to a greater number of family members.

However, the expanded 100-shareholder limitation exceeds two important limited offering exemptions from registration under federal securities law [*see 17 C.F.R. §§ 230.505, 230.506* (Rule 505, 506 exemptions)], as well as the number of shareholders permitted for California close corporations [*see Corp. Code § 158*] and for the California small offering exemption [*see Corp. Code § 25102(h)*] and limited offering exemption [*see Corp. Code § 25102(f)*] under the California Corporate Securities Law of 1968 [*see Corp. Code §§ 25000-25706*]. For discussion of the California limited offering exemption, see Ch. 6B, *California Limited Offering Exemptions* . For discussion of the California small offering exemption, see Ch. 6C, *California Small Offering Exemption* . For discussion of the federal Rule 505 and 506 securities exemptions, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* . For more detailed discussion of close corporations, see California Small Business Guide (Matthew Bender).

[3] Types of Permitted Shareholders

[a] Individuals

An S corporation may have individuals as shareholders [*I.R.C. § 1361(b)(1)(B)*]. For purposes of determining the number of shareholders, husbands and wives (and their estates) are treated as one shareholder, and family members may elect to be treated as a single shareholder [*I.R.C. § 1361(c)(1)*]. However, an S corporation shareholder cannot be a nonresident alien [*I.R.C. § 1361(b)(1)(C)*].

[b] Estates

An S corporation may have estates as shareholders [*I.R.C. § 1361(b)(1)(B)*], including the estate of an individual in bankruptcy under Title 11 [*I.R.C. § 1361(c)(3)*; *see In re Stadler Assoc's, Inc. (S.D. Fla. 1995) 186 B.R. 762* (filing of Chapter 7 bankruptcy does not terminate S corporation status)].

[c] Grantor Trusts

A grantor trust--that is, a trust that is treated as owned by an individual who is a citizen or resident of the United States--is permitted to hold S corporation stock [*I.R.C. § 1361(b)(1)(B), (c)(2)(A)(i)*; *see also I.R.C. § 671* et seq. (grantors and others treated as substantial owners)]. The deemed owner is treated as the shareholder [*I.R.C. § 1361(c)(2)(B)(i)*].

A trust that was treated as a grantor trust immediately before the death of the deemed owner and continues as a trust may continue as an eligible shareholder for a two-year period beginning on the day of the deemed owner's death [*I.R.C. § 1361(b)(1)(B), (c)(2)(A)(ii)*]. The deemed owner's estate is treated as the shareholder [*I.R.C. § 1361(c)(2)(B)(ii)*].

[d] Testamentary Trusts

A testamentary trust is an eligible S corporation shareholder. The trust may hold S corporation stock for a two-year period beginning on the day that the stock is transferred to the trust [*I.R.C. § 1361(b)(1)(B), (c)(2)(A)(iii)*]. The estate of the testator is treated as the shareholder [*I.R.C. § 1361(c)(2)(B)(iii)*].

[e] Voting Trusts

A voting trust is an eligible S corporation shareholder [*I.R.C. § 1361(b)(1)(B), (c)(2)(A)(iv)*]. However, each beneficiary of the trust is treated as a shareholder for the purpose of the 100-shareholder limitation [*I.R.C. § 1362(c)(2)(B)(iv)*].

[f] Electing Small Business Trusts

An electing small business trust is an eligible S corporation shareholder [*I.R.C. § 1361(b)(1)(B), (c)(2)(A)(v)*]. An "electing small business trust" ("ESBT") is any trust if that trust does not have as a beneficiary any person other than an individual, an estate, or a specified charitable organization [*I.R.C. § 1361(e)(1)(A)(i)*]. These charitable organizations include corporations, trusts, community chests, funds, or foundations; posts or organizations of war veterans; domestic fraternal societies, orders, or associations; and cemetery companies operated exclusively for the benefit of its members [*I.R.C. § 170(c)(2), (3), (4), (5)*] and *I.R.C. § 170(c)(1)* organizations that hold a contingent interest in the ESBT and are not potential income beneficiaries [*see I.R.C. § 1361(e)(2), (3)*].

No interest in an ESBT may be acquired by purchase [*I.R.C. § 1361(e)(1)(A)(ii)*; *see I.R.C. § 1361(e)(1)(C)* ("purchase" means any acquisition of property with a cost basis)]. Therefore, an interest in an ESBT may be acquired by gift, bequest, or inheritance. Further, a trust must affirmatively elect to be treated as an electing small business trust [*I.R.C. § 1361(e)(1)(A)(iii)*]. The election must be made by the trustee of the trust. The election applies to the taxable year for which it is made, and may only be revoked with the consent of the Secretary [*I.R.C. § 1361(e)(3)*].

Each potential current beneficiary of the trust is treated as a shareholder, or, if there are no potential current beneficiaries, the trust is treated as the shareholder [*I.R.C. § 1361(c)(2)(B)(v)*]. A "potential current beneficiary" means any person, with respect to any period, who is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust determined without regard to any power of appointment to the extent it remains unexercised at the end of the period. If the trust disposes of all the stock that it holds in an S corporation, the term "potential current beneficiary" does not include any person who first became eligible to receive a distribution of income or principal during the one-year period before the disposition [*I.R.C. § 1361(e)(2)*]. All potential current beneficiaries are counted for purposes of the 100-shareholder limit and other shareholder eligibility rules [see *I.R.C. § 1361(c)(2)(B)(v), (e)(2)*]. Thus, for example, a nonresident alien who is a potential current beneficiary of an ESBT causes the loss of the S election; however, a nonresident alien who is only a contingent beneficiary does not affect the S corporation election.

Trusts that are ineligible to become an ESBT are discussed in [6], *below*.

[g] Qualified Subchapter S Trusts

A qualified Subchapter S trust (QSST) may hold S corporation stock if the beneficiary (or legal representative) so elects [*see I.R.C. § 1361(d)(1), (2)*]. A "qualified Subchapter S trust" is a trust that distributes (or is required to distribute) all of its income to one individual who is a citizen or resident of the United States [*I.R.C. § 1361(d)(3)(B)*; *see I.R.C. § 643(b)* ("income" defined)] and the terms of the trust satisfy all of the following requirements [*see I.R.C. § 1361(d)(3)(A)*]:

- During the life of the current income beneficiary, the trust has only one income beneficiary.
- Any corpus distributed during the life of the current income beneficiary may only be distributed to that beneficiary.
- The income interest of the current income beneficiary in the trust terminates on the earlier of that beneficiary's death or the termination of the trust.
- On termination of the trust during the life of the current income beneficiary, the trust distributes all

its assets to that beneficiary; the possibility of multiple beneficiaries after the death of the current income beneficiary does not disqualify the trust during the current single income beneficiary's lifetime.

A substantially separate and independent share of a trust is treated as a separate trust for determining eligibility as a qualified Subchapter S trust [*I.R.C. § 1361(d)(3)*; *see I.R.C. § 663(c)* (separate shares treated as separate trusts)].

If a qualified Subchapter S trust ceases to meet any of these requirements, the trust is no longer eligible as an S corporation shareholder [*I.R.C. § 1361(d)(4)*].

[h] Specified Exempt Organizations

Qualified retirement plans, such as qualified pensions, profit-sharing, and stock bonus plans [*see I.R.C. § 401(a)*], and charitable organizations [*see I.R.C. § 501(c)(3)*] that are exempt from tax under *I.R.C. § 501(a)* may be shareholders in S corporations [*I.R.C. § 1361(b)(1)(B), (c)(6)*]. For purposes of determining the number of shareholders of an S corporation, a qualified tax-exempt shareholder counts as one shareholder [*see* Senate Finance Com. Rpt., H.R. 3448, p. 63].

[4] One Class of Stock

An S corporation may have no more than one class of stock [*I.R.C. § 1361(b)(1)(D)*]. However, differences in common stock voting rights do not violate this one-class requirement [*I.R.C. § 1361(c)(4)*] and "straight debt" is not treated as a second class of stock [*I.R.C. § 1361(c)(5)(A)*]. A "straight debt" is a written unconditional promise to pay a specified sum on demand or on a specified date if (1) the interest rate and interest payment dates are fixed and not contingent on profits, the borrower's discretion, or similar factors; (2) the debt cannot be converted directly or indirectly into stock; and (3) the creditor is an individual, estate, or a trust permitted as an S corporation shareholder, or a person actively and regularly engaged in the business of lending money [*I.R.C. § 1361(c)(5)(B)*; *see* [3], *above*].

[5] Corporations Ineligible for Subchapter S Status

Certain corporations are ineligible to elect Subchapter S status. These "ineligible corporations" include [*I.R.C. § 1361(b)(2)*]:

- Financial institutions that uses the reserve method of accounting for bad debts [*see I.R.C. § 585* (reserves for losses on loans)].

- Insurance companies taxed under Subchapter L [*see I.R.C. § 800* et seq.].

- Corporations that operate in Puerto Rico or other territorial possessions of the United States and elect special tax treatment [*see I.R.C. § 936* (Puerto Rico and possession tax credit)].

- A domestic international sales corporation (DISC) or former DISC [*see I.R.C. § 991* et seq.].

[6] Trusts Ineligible for ESBT Status

A qualified subchapter S trust [*see* [4][v], *above*] may not elect to become an ESBT if an election [*see I.R.C. § 1362(d)(2)*] applies to any corporate stock held by the trust [*I.R.C. § 1362(e)(1)(B)(i)*]. Tax-exempt trusts are precluded from electing to become an ESBT [*I.R.C. § 1362(e)(1)(B)(ii)*]. Further, charitable remainder annuity trusts and charitable remainder unitrusts may not elect ESBT status [*I.R.C. § 1362(e)(1)(B)(iii)*; *see I.R.C. § 664(d)*].

[7] Qualified Subchapter S Subsidiaries

S corporation may own a qualified subchapter S subsidiary (QSSS) [*see I.R.C. § 1362(b)(3)(A)*]. Thus, both the parent and the subsidiary can be S corporations, as long as the subsidiary is a qualified subchapter S subsidiary. A QSSS is a domestic corporation that satisfies the following requirements [*see I.R.C. § 1362(b)(3)(B)*]:

- The QSSS is not an ineligible corporation [*see* [5], *above*].
- One hundred percent of the stock of the subsidiary is owned by an S corporation parent.
- The parent elects to treat the subsidiary as a QSSS.

If a subsidiary is a QSSS, it is not treated as a separate corporation [*I.R.C. § 1362(b)(3)(A)(i)*]. All the assets, liabilities, and items of income, deduction, loss, and credit of the subsidiary are treated as the assets, liabilities, and items of income, deduction, loss, and credit of the parent S corporation [*I.R.C. § 1362(b)(3)(A)(ii)*].

If a corporation ceases to be a QSSS, the corporation and any successor corporation are not eligible treatment as a qualified subchapter S subsidiary, or to make an S election before its fifth taxable year which begins after the first taxable year for which the termination was effective, unless the IRS consents to an earlier re-election [*I.R.C. § 1362(b)(3)(D)*]. The Internal Revenue Code does not appear to authorize the revocation of the QSSS election, so the only way to terminate S status is failure to own 100 percent of the stock. After cessation, the subsidiary will be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before that cessation from the parent S corporation in exchange for its stock [*I.R.C. § 1362(b)(3)(D)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Requirements



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
A. Federal Law

2-2B California Legal Forms--Transaction Guide § 2B.11

§ 2B.11 Election of Subchapter S Status

[1] Initial Election

In general, a qualifying small business corporation [*see I.R.C. § 1361(a)(1)*] that has never been an S corporation is free to elect that status [*I.R.C. § 1362(a)(1)*; *see I.R.C. § 1362(g)*; *see also* [2], *below*]. For a valid Subchapter S election, all of the shareholders in the corporation (as of the day of the election) must consent to the election [*I.R.C. § 1362(a)(2)*].

Ordinarily, the election for any tax year may be made at any time during the preceding tax year, or at any time on or before the 15th day of the third month of the tax year for which the election is to become effective [*I.R.C. § 1362(b)(1)*]. However, an election is treated as made for the following tax year, even though made in the first two and a half months of a tax year, if either the corporation was ineligible for one or more days or a shareholder failed to consent to the election [*I.R.C. § 1362(b)(2)*]. Any election made after the end of the first two and a half months of a tax year is treated as made for the following tax year [*I.R.C. § 1362(b)(3)*]; however, the Secretary is authorized to treat late elections as timely for the taxable year [*I.R.C. § 1362(b)(5)*; *see* [3][a], *below*].

An election, once made, is effective for the tax year for which it is made and all succeeding tax years until terminated [*I.R.C. § 1362(c)*; *see I.R.C. § 1362(d)* (termination); *see also § 2B.13*].

For a procedural guide to electing Subchapter S status, see *§ 2B.120*.

[2] Election by Previously Terminated S Corporation

A small business corporation whose previous Subchapter S election was terminated [*see I.R.C. § 1362(d)*; *see also § 2B.13*] is ineligible to make a new election for five tax years unless the consent of the IRS is obtained [*see I.R.C. § 1362(g)*]. For detailed coverage of the procedures involved in reelecting after termination, see *§ 2B.120[2]*.

[3] Invalid Elections

[a] Untimely Elections

The Secretary is authorized to treat late elections made after the prescribed first two and a half months of a tax year as timely made for that taxable year [*see I.R.C. § 1362(b)(5)*]. However, the Secretary must determine that reasonable cause existed for the failure to make the election in a timely manner [*I.R.C. § 1362(b)(5)(B)*]. This authority applies even when no S election was ever filed for the taxable year [*I.R.C. § 1362(b)(5)(A)*].

[b] Inadvertent Invalid Elections

The Secretary may waive the effect of an otherwise invalid S election caused by the failure to qualify as a small business corporation or the failure to obtain the required shareholder consents [*I.R.C. § 1362(f)(1)(A)*]. The validation of an ineffective S election must be based on a determination that the circumstances resulting in the ineffectiveness were inadvertent, and that steps were taken to qualify the corporation as a small business corporation, or acquire the requisite shareholder consents, within a reasonable time after discovery of the circumstances causing the ineffectiveness [*I.R.C. § 1362(f)(2), (3)*]. Further, the corporation and each shareholder must agree to make such adjustments to their income (consistent with the corporation's status as an S corporation) as are required by the IRS [*I.R.C. § 1362(f)(4)*]. The Committee Reports indicate that it is intended that the IRS be reasonable in exercising this authority and apply standards that are similar to those applied under former law to inadvertent subchapter S terminations and other late or invalid elections [Conf. Rept. H.R. 3448, Act § 1305].

The Secretary also may waive the effect of an inadvertent invalid election or termination of election to treat a subsidiary as a qualified Subchapter S subsidiary [*I.R.C. § 1362(f)*; *see § 2B.10[7]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Termination (IRC sec. 1362)Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)RequirementsTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Effects



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
A. Federal Law

2-2B California Legal Forms--Transaction Guide § 2B.12

§ 2B.12 Tax Year of S Corporation

[1] In General

The tax year of an S corporation must be a "permitted year" [*see I.R.C. § 1378(a), (b)*; *see* [2], *below*] or an "alternative year" [*see I.R.C. § 444*; *see* [3], *below*].

[2] Election of Permitted Year

A "permitted year" is a tax year that is either a calendar year or any other accounting period for which the corporation establishes a business purpose satisfactory to the IRS [*I.R.C. § 1378(b)*]. For this purpose, deferral of income to shareholders is not treated as a business purpose that justifies an accounting period different from the calendar year [*I.R.C. § 1378(b)*].

For a discussion of the requirements for obtaining automatic approval of a fiscal year, see *§ 2B.200[1][c][iv]*. For a discussion of the requirements for obtaining approval of a fiscal year by filing a separate statement of business purposes, see *§ 2B.203[1][b]*.

[3] Election of Alternative Year

An S corporation may elect an "alternative year"; that is, a year (other than a permitted year [*see* [2], *above*]) that is elected under *I.R.C. § 444* [*see § 2B.205*]. In general, the corporation may only elect an alternative year if the "deferral period," that is, the period of time between the beginning of the tax year elected and the close of the calendar year, does not exceed three months [*I.R.C. § 444(b)(1), (4), (e)*; *see I.R.C. § 444(b)(2), (3)* (exceptions for changing taxable year and 1986 entities)].

A corporation that is part of a "tiered structure," other than a tiered structure that consists of partnerships or S corporations (or both) that all have the same tax year, may not elect an alternative year [*I.R.C. § 444(d)(3)*]. Ordinarily, an S corporation is a member of a tiered structure if it owns any portion of, or is owned by, a partnership, S corporation, personal service corporation, or trust [*see* Temp. Treas. Reg. § 1.444-2T(b)(1)(ii)].

An S corporation that elects an alternative year must make certain advance tax payments [*I.R.C. § 444(c)(1)*; *see I.R.C. § 7519* (required payments)]. These payments are equal to the amount by which the corporation's required payment exceeds $500 [*I.R.C. § 7519(a)(2)*]; the "required payment" is determined by adding 1 percent to the highest rate of tax under *I.R.C. § 1*, multiplying the net base year income of the entity by the resulting percentage, and then deducting the amount of the required payment for the preceding applicable election year [*see I.R.C. § 7519(b)*].

An alternative-year election remains in effect until the corporation changes its tax year or otherwise terminates the election [*I.R.C. § 444(d)(2)(A)*]. A change from an alternative year to a permitted year may be made without IRS consent [*I.R.C. § 444(d)(2)(A)*; *see I.R.C. § 1378(b)* (permitted year); *see also* [2], *above*]. However, once a corporation changes to a permitted year it cannot elect another alternative year [*I.R.C. § 444(d)(2)(B)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsTaxable Year (IRC secs. 1361, 1378)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
A. Federal Law

2-2B California Legal Forms--Transaction Guide § 2B.13

§ 2B.13 Termination of Subchapter S Status

[1] Manner of Termination

[a] Revocation by Shareholders

Subchapter S status may be terminated by a revocation consented to by shareholders holding more than one half of the corporation's shares [*I.R.C. § 1362(d)(1)(A), (B)*]. A revocation may specify an effective date that is on or after the day the revocation is made [*see I.R.C. § 1362(d)(1)(D)*]. However, if an effective date is not specified, a revocation made on or before the 15th day of the third month of any tax year is effective for that tax year, and a revocation made after the 15th day of the third month is effective for the following tax year [*I.R.C. § 1362(d)(1)(C)*].

For a procedural guide to termination of S corporation status, see *§ 2B.130*.

[b] Loss of Small Business Corporation Status

A Subchapter S election terminates at any time after the first day of the first tax year for which the corporation is an S corporation if it ceases to be a small business corporation [*see I.R.C. § 1362(d)(2)*]. An S corporation ceases to be a small business corporation when it becomes an ineligible corporation, when it has more than 100 shareholders, has ineligible shareholders, or issues more than one class of shares [*see I.R.C. § 1361(b); see also § 2B.10*]. Termination is effective as of the date of cessation as a small business corporation [*see I.R.C. § 1362(d)(2)(B)*].

[c] Receipt of Excess Passive Investment Income

The Subchapter S status of a corporation is terminated if the corporation has accumulated earnings and profits at the close of each of three consecutive taxable years, and has gross receipts for each of those three taxable years more that 25 percent of which are passive investment income [*see I.R.C. § 1362(d)(3)(A)(i)*]. With certain exceptions, "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities [*I.R.C. § 1362(d)(3)(C)(i)*]. When capital assets other than stock and securities are disposed of, gross receipts are only included in this calculation to the extent of any net capital gain income [*I.R.C. §*

1362(d)(3)(B)].

"Passive investment income" does not include interest on any obligation acquired in the ordinary course of the corporation's trade or business from its sale of capital assets [*see I.R.C. § 1221*], the income of certain lending or finance companies [*see I.R.C. § 542*], receipts derived from certain types of corporate liquidations [*see I.R.C. § 1362(d)(3)(C)(ii)-(iv)*; *see also I.R.C. § 331*], or dividends from a C corporation to the extent that the dividends are attributable to earnings and profits from derived from the active conduct of a trade or business [*I.R.C. § 1362(d)(3)(E)*]. Special rules are used to determine the passive investment income of options dealers and commodities dealers [*see I.R.C. § 1362(d)(3)(D)*]. For a depository institution holding company, "passive investment income" does not include interest income or dividends on assets required to be held by the company [I.R.C. § 1362(d)(3)(F); *see* 12 U.S.C. § 1813(w)(1)].

Termination is effective on and after the first day of the first taxable year beginning after the third consecutive tax year in which S corporation status is terminated [*I.R.C. § 1362(d)(3)(A)(ii)*].

[2] Waiver of Inadvertent Terminations

Under certain circumstances, an inadvertent termination of Subchapter S status (or of qualified Subchapter S subsidiary status) may be excused [*see I.R.C. § 1362(f)*]. A corporation or qualified Subchapter S subsidiary that terminates its election is treated as continuing to be an S corporation during a period specified by the Secretary under the following circumstances [*see I.R.C. § 1362(f)(1)-(4)*]:

- The election was ineffective or was terminated because the S corporation ceased to be a small business corporation or violated the accumulated earnings and profits and accumulated earnings restrictions [*see I.R.C. § 1362(d)(2), (3)*; *see also* [1][b], [c], *above*].

- The Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent.

- Within a reasonable time after discovering the circumstances resulting in the ineffectiveness or termination, the corporation took steps so that the corporation for which the election was made or the termination occurred is again a small business corporation or a qualified Subchapter S subsidiary, as the case may be, or to acquire the requisite shareholder consents.

- The corporation for which the election was made or the termination occurred and each shareholder during the relevant period agree to make any adjustments required by the Secretary for that period.

Congress intends that the IRS be reasonable in granting waivers and that the government and taxpayers work out agreements that protect the revenues without undue hardship to taxpayers [*see* S. Rep. No. 97-640, p. 12 (1982)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Termination (IRC sec. 1362)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
A. Federal Law

2-2B California Legal Forms--Transaction Guide § 2B.14

§ 2B.14 Taxation of S Corporations

[1] Overview

With a few exceptions, S corporations are conduits of income, losses, deductions, or credits to their shareholders for federal income tax purposes [*see I.R.C. §§ 1363, 1366*]. Items passed through to shareholders must be separately stated [*I.R.C. § 1363(b)(1)*; *see I.R.C. § 1366(a)(1)(A)* (shareholders taxation); *see also Gitlitz v. Comm'r (2001) 531 U.S. 206, 121 S. Ct. 701, 706, 709, 148 L. Ed. 2d 613* (determining that under *I.R.C. § 1366(a)(1)(A)*, excluded discharged debt is item of income which passes through to shareholders and increases their bases in stock, and pass-through is performed before reduction of S corporation's tax attributes)].

An S corporation remains liable for any tax increase resulting from recapture of investment tax credits allowed for years when it was a C corporation [*see I.R.C. § 1371(d)(2)*; *see also* [4], *below*]. In addition, an S corporation with accumulated earnings and profits and passive investment income totaling more than 25 percent of gross receipts may be subject to a tax on that income [*see I.R.C. § 1375*; *see also* [5], *below*]. In certain circumstances, S corporations may be subject to income tax on built-in gains [*see I.R.C. § 1374*; *see also* [6], *below*].

[2] General Computation of S Corporation's Taxable Income

As with a partnership, the taxable income of an S corporation is computed in the same manner as in the case of an individual, with certain exceptions described below [*I.R.C. § 1363(b)*]. The corporation is not allowed the following deductions [*I.R.C. § 1363(b)(2)*; *see I.R.C. § 703(a)(2)* (partnership computation)]:

- Itemized deductions allowed to individuals.
- Deductions for personal exemptions.
- Deductions for foreign taxes, charitable contributions, net operating losses, or oil and gas depletion allowances.

An S corporation may amortize organizational expenses [*I.R.C. § 1363(b)(3)*; *see I.R.C. § 248* (organizational expenditures)].

If the S corporation (or any predecessor) was a C corporation for any of the three immediately preceding tax years, it must pay a minimum tax on any tax preference items, such as excess depreciation on real property, amortization of pollution control facilities, deductions related to percentage depletion of coal and iron ore, deductions related to mineral exploration and intangible drilling costs [*I.R.C. § 1363(b)(4)*; *see I.R.C. § 291*].

In general, any elections affecting the computing of items derived from the corporation must be made by the corporation [*I.R.C. § 1363(c)(1)*]. However, each shareholder must make any election regarding the deduction and recapture of certain mining expenses [*I.R.C. § 1363(c)(2)(A)*; *see I.R.C. § 617*] and the foreign tax credit [*I.R.C. § 1363(c)(2)(B)*; *see I.R.C. § 901*].

Items passed through to shareholders must be separately stated [*I.R.C. § 1363(b)(1)*; *see I.R.C. § 1366(a)(1)(A)* (shareholders taxation); *see also Gitlitz v. Comm'r (2001) 531 U.S. 206, 121 S. Ct. 701, 706, 709, 148 L. Ed. 2d 613* (determining that under *I.R.C. § 1366(a)(1)(A)*, excluded discharged debt is item of income subject to pass-through to shareholders, and pass-through is performed before reduction of S corporation's tax attributes)].

[3] LIFO Benefits Recapture

If a C corporation inventoried goods under the LIFO (last in, first out) method during the last tax year before its S election became effective, it must include the "LIFO recapture amount" in its gross income for that last tax year as a C corporation [*I.R.C. § 1363(d)(1), (3)*; *see I.R.C. § 472* ("LIFO" defined)]. The "LIFO recapture amount" is the amount by which the inventory amount of the inventory assets under the FIFO (first in, first out) method exceeds the inventory amount of those assets under the LIFO method [*I.R.C. § 1363(d)(3)*; *but see* I.R.C. § 1363(d)(5) (increase in tax due to LIFO recapture does not apply to specified decreases in basis pursuant to I.R.C. § 1367(a)(2)(D), or to adjustments made to corporation's earnings and profits pursuant to I.R.C. § 1371(c)(1))]. Any tax increase due to LIFO recapture is payable in four equal installments [*I.R.C. § 1363(d)(2)(A)*]. The first installment must be paid by the due date for the tax return for the last year in which the corporation was a C corporation [*I.R.C. § 1363(d)(2)(B)*].

[4] Investment Credit Recapture

The fact that an existing corporation elects Subchapter S status does not affect the applicability of the investment tax credit [*see I.R.C. § 1371(d)(1)*]. However, the corporation remains liable, regardless of the Subchapter S election, for recapture of any previously allowed investment credit if the corporation makes an early disposition of the property involved [*see I.R.C. §§ 49(b), 50(a), 1371(d)(2)*]. The investment credit recapture provisions do not apply for purposes of California taxation of S corporations [*Rev. & Tax. Code § 23806(c)*].

[5] Tax on Passive Investment Income

A tax is imposed on the "excess" net passive investment income of a corporation that existed as a C corporation before electing Subchapter S status if for any tax year it has accumulated earnings and profits at the close of the year and more than 25 percent of its gross receipts derived from passive investments [*I.R.C. § 1375(a), (b)(3)*; *see I.R.C. § 1362(d)(3)(D)*]. The highest corporate income tax rate is imposed on the excess net passive income [*see I.R.C. § 1375(a)*; *see also I.R.C. § 1375(b)* ("excess net passive income" and "net passive income" defined)]. Passive investment income is determined without taking into account any recognized built-in gain or loss for any tax year in the recognition period applicable to the determination of built-in gain or loss [*I.R.C. § 1375(b)(4)*; *see I.R.C. § 1374*].

The IRS may waive this tax if the S corporation establishes that it determined in good faith that it had no accumulated earnings and profits at the close of a tax year, and that it distributed any accumulated earnings and profits within a

reasonable time after it determined the existence of those earnings and profits [*I.R.C. § 1375(d)*].

[6] Built-In Gains Tax

An S corporation that previously was a C corporation may be subject to tax on its income if, during the recognition period, it has a "net recognized built-in gain" [*see I.R.C. § 1374(a), (c)(1), (d)(7)*]. The "recognition period" is the 10-year period beginning on the first day of the first tax year of the S corporation; for any amount includible in income based on *I.R.C. 593(e)*, this rule is applied without regard to the phrase "10-year period" [*I.R.C. § 1374(d)(7)*; *see I.R.C. § 593(e)* (distributions of property out of excess reserves to shareholders)]. For any tax year in the recognition period, "net recognized built-in gain" is the lesser of the corporation's taxable income for that year determined in a specified manner [*see I.R.C. § 1375(b)(1)(B)*] or the amount that would be the corporation's taxable income for that year if only recognized built-in gains and losses were taken into account [*I.R.C. § 1374(d)(2)(A)*; *see I.R.C. § 1374(c)(2)* (limitation on amount of net recognized built-in gain)]. "Recognized built-in gain or loss" is any gain or loss recognized during the recognition period on the disposition of any asset transferred by the C corporation to the S corporation [*I.R.C. § 1374(d)(3), (4)*]. However, any gain that exceeds the excess of the asset's fair market value at the beginning of the first tax year of the S corporation over the adjusted basis of the asset at that time, or any loss that exceeds the excess of the adjusted basis of the asset at the beginning of the first tax year over the asset's fair market value at that time, is not included in the determination of built-in gain or loss [*I.R.C. § 1374(d)(3)(B), (4)(B)*].

If the S corporation acquires an asset and determines its basis (in whole or in part) in that asset by reference to the basis of that asset or any other property in the hands of its predecessor C corporation, then a tax is imposed on any net recognized built-in gain attributable to the asset for any tax year beginning in the recognition period [*I.R.C. § 1374(d)(8)(A)*]. For purposes of determining the tax, the day on which the assets were acquired, rather than the beginning of the first tax year for which the corporation was an S corporation, applies [*I.R.C. § 1374(d)(8)(B)*].

The tax is computed at the highest corporate rate to the net recognized built-in gain of the S corporation for the tax year [*I.R.C. § 1374(b)(1)*; *see I.R.C. § 11(b)* (corporate tax rate)], or, if applicable, the alternative rate on capital gain income [*I.R.C. § 1374(b)(4)*; *see I.R.C. § 1201(a)*]. Any net operating loss carryforward arising in a tax year for which the corporation was a C corporation is allowed as a deduction [*I.R.C. § 1374(b)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsComputation of Income & Loss (IRC secs. 1366, 1371-1375)Tax LawFederal Taxpayer GroupsS CorporationsPassive Activities (IRC secs. 469, 1375)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
A. Federal Law

2-2B California Legal Forms--Transaction Guide § 2B.15

§ 2B.15 Passthrough of Tax Items to S Corporation Shareholders

[1] Overview

The general rule, analogous to partnership taxation rules, is that S corporation shareholders must account for their pro rata share of an S corporation's items of income, loss, deduction, or credit [*see I.R.C. § 1366(a)*; *see also I.R.C. § 702* (income and credits of partner); *Pahl v. Commissioner (9th Cir. 1998) 150 F.3d 1124, 1129-1131* (taxpayer was shareholder in S corporation and therefore should have reported pro rata share of law firm's income on his tax returns)]. The character of any item "passes through" from the corporation to the shareholders; the character of an item included in a shareholder's pro rata share is determined as if the item were realized directly from the source from which it was realized by the corporation, or incurred in the same manner as incurred by the corporation [*see I.R.C. § 1366(b)*; *see also Valentino v. Franchise Tax Board (2001) 87 Cal. App. 4th 1284, 1290, 1296, 105 Cal. Rptr. 2d 304* (this federal "conduit" rule has essentially been adopted in California in *Rev. & Tax. Code § 23800*; thus California source income of S corporation, passed through to nonresident, is subject to California tax)].

[2] Character of Tax on Built-In Gains and Passive Investment Income

If the corporation is subjected to a tax on excess net passive income, each item of passive investment income passed through to the shareholders may be reduced to take that tax into account [*see I.R.C. § 1366(f)(3)*; *see also I.R.C. § 1374*]. If any tax is imposed on the corporation for a built-in gain, the amount of the tax must be treated as a loss sustained by the corporation during that tax year and the character of the loss is determined by allocating the loss proportionately among the recognized built-in gains giving rise to the tax [*I.R.C. § 1366(f)(2)*; *see I.R.C. § 1374*; *see also § 2B.14[6]*].

A shareholder may account for losses, but only to the extent that the amount of losses and deductions passed through the corporation for the tax year does not exceed the sum of the adjusted basis of the shareholder's stock in the corporation and the shareholder's adjusted basis in any loans to the corporation [*I.R.C. § 1366(d)(1)*; *see I.R.C. § 1367(a)(1), (2)(A)*]. A loss or deduction that is disallowed because it exceeds basis is treated as incurred by the corporation in the succeeding tax year with respect to that shareholder [*I.R.C. § 1366(d)(2)(A)*; *see I.R.C. § 1366(d)(2)(B)* (spousal transfers and transfers incident to divorce)].

[3] Adjustments to Basis of Stock

Subchapter S provides for the adjustment of the basis of S corporation stock in much the same manner as is provided for partnerships [*see I.R.C. § 1367*; *see also I.R.C. § 705* (determination of basis of partner's interest)]. In general, both taxable and nontaxable income and deductible and nondeductible expenses serve either to increase or decrease the shareholders' bases in their stock [*see* S. Rep. No. 97-640, p. 18 (1982)]. Basis is adjusted before application of the rules relating to distributions for any particular tax year [*see I.R.C. §§ 1366(d), 1367(a)*]. Unlike the partnership rules, however, to the extent that property distributions are treated as a return of basis, basis is reduced by the fair market value of these properties [*see* S. Rep. No. 97-640, p. 18 (1982)]. Income passed through to a shareholder first increases the shareholder's basis in loans to the corporation to the extent that basis was previously reduced by the passthrough of losses [*see I.R.C. § 1367(b)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsComputation of Income & Loss (IRC secs. 1366, 1371-1375)Tax LawFederal Taxpayer GroupsS CorporationsPassive Activities (IRC secs. 469, 1375)Tax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Determination of Tax LiabilityTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)General OverviewTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Pro Rata Taxation of IncomeTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Adjustments to Basis of Shareholder Stock



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
A. Federal Law

2-2B California Legal Forms--Transaction Guide § 2B.16

§ 2B.16 Treatment of Corporate Distributions to S Corporation Shareholders

[1] In General

The treatment of corporate distributions that would otherwise be taxable to the shareholder [*see I.R.C. § 301(c)*] depends on whether or not the corporation has accumulated earnings and profits [*see I.R.C. § 1368(a)*; *see also* [2], [3], *below*]. A small business corporation is not deemed to have "earnings and profits" attributable to any tax year beginning after 1982 if a Subchapter S election was in effect for that year, since all items of income, loss, deduction, or credit pass through to the shareholders [*see I.R.C. § 1366(b)*]. A corporation can have earnings and profits attributable to tax years for which an election was not in effect, tax years beginning before 1983 for which an election was in effect, and any corporate acquisition that results in a carryover of earnings and profits [*see* S. Rep. No. 97-640, p. 20 (1982); *see also I.R.C. § 381* (carryovers in certain corporate acquisitions)]. Whether or not the S corporation has accumulated earnings and profits, the treatment of the distribution is determined after adjustments are made to the distributee-shareholder's stock [*see I.R.C. §§ 1367, 1368(d)(1)*; *see also § 2B.15[2]*] and to the corporation's "accumulated adjustments account" [*see I.R.C. § 1368(d)(2), (e)(1)*]. In the case of any distribution made during any taxable year, the adjusted basis of the stock is determined with regard to the adjustment increase provisions for the taxable year [*I.R.C. § 1368(d)*; *see I.R.C. § 1367(a)(1)*].

[2] S Corporation Without Accumulated Earnings and Profits

If the corporation does not have accumulated earnings and profits, the tax treatment of a distribution depends on the shareholder's basis in the stock [*see I.R.C. § 1368(b)*]. A distribution is not included in the shareholder's gross income to the extent it does not exceed the adjusted basis of the stock [*I.R.C. § 1368(b)(1)*]; the shareholder's basis in the stock is decreased by the amount of the distribution [*I.R.C. § 1367(a)(2)(A)*]. The amount of a distribution that exceeds the adjusted basis of the stock is treated as capital gain [*I.R.C. § 1368(b)(2)*].

[3] S Corporation With Accumulated Earnings and Profits

[a] Treatment of Amount That Does Not Exceed Accumulated Adjustment Account

If a corporation has accumulated earnings and profits, the portion of the distribution that does not exceed the corporation's accumulated adjustment account is treated in the same manner as distributions from S corporations without accumulated earnings and profits [*I.R.C. § 1368(c)(1)*; *see* [2], *above*]. Except in the case of certain redemptions, the "accumulated adjustment account" generally is the S corporation's post-1982 undistributed accumulated gross income less deductible expenses, but without an adjustment for federal taxes attributable to any tax year in which the corporation was a C corporation [*I.R.C. § 1368(e)(1)*; *see I.R.C. § 1367*; *see also I.R.C. § 1368(e)(1)(C)* (accumulated adjustments account determined without regard to net losses)]. To the extent that a distribution does not exceed the accumulated adjustment account, a corporation, with the consent of all affected shareholders, may elect to treat the distribution as a dividend for any particular tax year [*see I.R.C. § 1368(c)(1), (2), (e)(3)*].

[b] Treatment of Amount Exceeding Accumulated Adjustment Account

The amount of a distribution in excess of the accumulated adjustment account is treated as a dividend to the extent that it does not exceed accumulated earnings and profits [*I.R.C. § 1368(c)(2)*]. To the extent that the distribution does exceed accumulated earnings and profits, a distribution is treated in the same manner as a distribution from an S corporation without accumulated earnings and profits [*I.R.C. § 1368(c)(3)*; *see* [2], *above*]. If the distributions during the tax year exceed the amount in the accumulated adjustments account at the close of the tax year, the balance of that account must be allocated among the distributions in proportion to their respective sizes [*I.R.C. § 1368(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsDistributions (IRC secs. 1361, 1368)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
A. Federal Law

2-2B California Legal Forms--Transaction Guide § 2B.17

§ 2B.17 Treatment of S Corporation as Partnership

[1] Taxation of Employee Fringe Benefits

For the purpose of fringe benefit taxation for all tax years beginning after January 1, 1988, an S corporation is treated as a partnership [*I.R.C. § 1372*; *see* Pub. L. No. 97-354, § 6(d)]. The tax treatment of employee fringe benefits of a shareholder-employee of an S corporation depends on the amount of the corporation's stock owned by the shareholder. If the shareholder is a 2-percent shareholder [*see I.R.C. § 1372(b)* (definition)], he or she will be treated as a partner [*I.R.C. § 1372(a)(2)*], and amounts paid for fringe benefits are not deductible by the corporation [*see I.R.C. §§ 703(a)(2), 1363(b)(2)*]. The 2-percent shareholder must include the receipt of fringes, such as medical reimbursement payments, in gross income and may deduct medical expenses only to the same extent that a partner could. For tax years beginning between 1982 and 1988, the S corporation may be treated as a partnership for purposes of fringe benefit taxation under certain circumstances [*see* Pub. L. No. 97-354, § 6(d); *I.R.C. § 1372*].

[2] Taxation of Foreign Income

For the purpose of taxation of foreign income, an S corporation is treated as a partnership and the shareholders are treated as partners [*I.R.C. § 1373*]. This rule does not apply for purposes of California taxation [*Rev. & Tax. Code § 23808*].

[3] Oil and Gas Depletion Allowance

In general, the oil and gas depletion allowance will be treated in much the same way as it is by partnerships: the allowance is computed separately by each shareholder [*see I.R.C. § 613A(c)(11)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)General OverviewTax LawFederal

Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Pro Rata Taxation of IncomeTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Effects



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
A. Federal Law

2-2B California Legal Forms--Transaction Guide § 2B.18

§ 2B.18 Tax Treatment of Subchapter S Items

The tax treatment of Subchapter S items (that is, income, losses, deductions, and credits) and the applicability of any penalty, addition to tax, or additional amount relating to an adjustment to a partnership item are determined at the corporate level, except as otherwise provided in regulations issued by the IRS [*see I.R.C. § 6221*]. A shareholder's treatment of Subchapter S items must be consistent with the corporation's treatment of those items on its tax return unless the shareholder notifies the IRS of the inconsistency [*I.R.C. § 6222*]. The audit provisions relating to partnerships are applicable to S corporations [*see I.R.C. § 6224*]. Shareholders are entitled to participate in any administrative proceeding relating to the determination of partnership items at the partnership level, but may waive that right by filing a written notice of waiver with the [*I.R.C. § 6224(a), (b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Determination of Tax LiabilityTax LawFederal Tax Administration & ProcedureAudits & InvestigationsGeneral OverviewTax LawFederal Tax Administration & ProcedureAdministrationPartnership Proceedings (IRC secs. 6221-6234)Tax LawFederal Taxpayer GroupsS CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsDistributions (IRC secs. 1361, 1368)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
A. Federal Law

2-2B California Legal Forms--Transaction Guide § 2B.19

§ 2B.19 Coordination With Subchapter C

An S corporation cannot ignore the federal tax provisions governing C corporations. Subchapter C applies to S corporations and their shareholders except to the extent that it is inconsistent with Subchapter S [*I.R.C. § 1371(a)*]. No carryover or carryback may be made from a tax year in which a corporation is a C corporation to one in which it is an S corporation, nor may any carryforward or carryback arise at the corporate level in an S corporation tax year [*see I.R.C. § 1371(b)*].

Because an S corporation's earnings and profits are passed through to its shareholders, generally Subchapter C adjustments to S corporation earnings and profits are not applicable [*see I.R.C. § 1371(c)(1)*]. However, Subchapter C adjustments are made to accumulated earnings and profits in the case of redemptions, liquidations, and reorganizations [*see I.R.C. § 1371(c)(2)*] and in the case of certain distributions treated as dividends [*I.R.C. § 1371(c)(3)*; *see I.R.C. § 1368(c)(2)*]. In addition, an S corporation's earnings and profits are reduced by the amount of investment credit recapture tax imposed on the corporation with regard to any investment credits [*I.R.C. § 1371(d)*; *see I.R.C. §§ 49(b), 50(a)*]. A distribution of money to shareholders after termination of Subchapter S status reduces the adjusted basis of the stock to the extent that the distribution does not exceed the accumulated adjustments account [*I.R.C. § 1371(e)(1)*; *see also I.R.C. § 1368(e)(1)* ("accumulated adjustments account" defined)]. An S corporation may elect not to reduce the adjusted basis of its stock with regard to all distributions made during its post-termination transition period; however, this election requires the consent of all shareholders of the S corporation to whom distributions are made during the transition period [*I.R.C. § 1371(e)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Adjustments to Basis of Shareholder StockTax LawFederal Taxpayer GroupsS CorporationsBasis (IRC secs. 1361, 1367)Tax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Determination of Tax LiabilityTax LawFederal Taxpayer GroupsS CorporationsComputation of Income & Loss (IRC secs. 1366, 1371-1375)Tax LawFederal Taxpayer GroupsS CorporationsDistributions (IRC secs. 1361, 1368)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
A. Federal Law

2-2B California Legal Forms--Transaction Guide §§ 2B.20-2B.29

[Reserved]

§§ 2B.20[Reserved]



60 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
B. California Law

2-2B California Legal Forms--Transaction Guide § 2B.30

§ 2B.30 California Generally Follows Federal Law

California Subchapter S law substantially conforms to federal law, including the 1996 federal legislation that liberalized the S corporation rules [*see, e.g., Rev. & Tax. Code § 23800 et seq.*; *see also § 2B.31* et seq.]. Two primary exceptions to this rule exist: (1) qualified Subchapter S corporations are subject to the minimum franchise tax [*Rev. & Tax. Code § 23802(c)*; *see § 2B.34[1]*]; and (2) inadvertent invalid elections and terminations are permitted prospectively but not retroactively [*Rev. & Tax. Code § 23801(i)*; *see § 2B.33*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of TaxTax LawState & Local TaxesFranchise TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
B. California Law

2-2B California Legal Forms--Transaction Guide § 2B.31

§ 2B.31 California Election of Subchapter S Status

[1] Initial Election

[a] Federal Election Required

Qualifying California corporations may elect to be treated as S corporations for state tax purposes [*Rev. & Tax. Code § 23800*; *see Valentino v. Franchise Tax Board (2001) 87 Cal. App. 4th 1284, 1290* (§ 23800 essentially adopts federal "conduit" rule; thus California source income of S corporation, passed through to nonresident, is subject to California tax)]. A corporation that has a valid election under *I.R.C. § 1362(a)* in effect for federal purposes will be an S corporation under California tax law [*Rev. & Tax. Code § 23801(a), (b)*], and its shareholders will be shareholders of an S corporation without regard to whether the corporation is qualified to do business or is incorporated in California [*Rev. & Tax. Code § 23801(b)*; *see § 2B.11*].

PRACTICE TIP:

The former authority permitting an S corporation to elect to be taxed as a C corporation for California tax purposes has been repealed [*see* former Rev. & Tax. Code § 23801(a)(4)(A)(ii)]. If a corporation that had in effect a valid federal S corporation election for federal purposes and a valid state election to be taxed as a C corporation for state purposes for taxable years beginning before January 1, 2002, is an S corporation pursuant to *Rev. & Tax. Code § 23801*, as amended in 2002, the effective date of the election to be treated as an S corporation for state purposes will be the first day of the taxable year beginning on or after January 1, 2002 [2002 Cal. Stats. Ch. 807, § 20, amending 2002 Cal. Stats. Ch. 35, § 76].

[b] Special Rules for Tax Years on or After January 1, 1997

The provisions of *I.R.C. § 1362(b)(5)*, relating to authority to treat late elections, as timely, applies only for taxable years beginning on or after January 1, 1997, with respect to federal S corporation elections for taxable years beginning on or after January 1, 1997 [*Rev. & Tax. Code § 23801(h)(1)*]. However, if for any taxable year beginning on or after January 1, 2003, a corporation fails to qualify as an S corporation for federal income tax purposes solely because the federal Form 2553 (Election by a Small Business Corporation) was not filed in a timely manner, the corporation will be

treated for tax purposes as an S corporation for the taxable year that the election should have been made, and for each subsequent year until terminated, if both of the following conditions are met [*Rev. & Tax. Code § 23801(h)(2)*]:

- The corporation and all of its shareholders reported their income for California tax purposes on original returns consistent with S corporation status for the year that the election should have been made, and for each subsequent taxable year (if any) until terminated; and

- The corporation and its shareholders have filed federal Form 2553 with the IRS requesting automatic relief with respect to the late S corporation election, in full compliance with the federal *Rev. Proc. 97-48, 1997-2 C.B. 521* , and have received notification of the acceptance of the untimely filed election from the IRS. A copy of the notification must be provided to the FTB on request.

The provisions of *I.R.C. § 1362(f)*, relating to inadvertent invalid elections or terminations, applies only for taxable years beginning on or after January 1, 1997, with respect to federal elections for taxable years beginning on or after January 1, 1997 [*Rev. & Tax. Code § 23801(i)*].

[c] Ineligible Corporations

California law shares the federal prohibition against insurance companies taxed under Subchapter L, corporations that operate in Puerto Rico or other territorial possessions of the United States and elect special tax treatment, and DISCs and former DISCs [*I.R.C. § 1361(b)(2)(B)-(D)*; *see Rev. & Tax. Code § 23800*; *see also § 2B.10[5]*].

[2] Foreign S Corporations Qualifying to Do Business in California

A corporation that has a valid election under *I.R.C. § 1362(a)* in effect for federal purposes will be an S corporation under California tax law [*Rev. & Tax. Code § 23801(a)*], and its shareholders will be shareholders of an S corporation, without regard to whether the corporation is qualified to do business or is incorporated in California [*Rev. & Tax. Code § 23801(b)*; *see § 2B.11*].

[3] Effect of Inadvertent Invalid or Untimely Elections

For federal purposes, the Secretary may waive the effect of an otherwise invalid S election caused by the failure to qualify as a small business corporation or the failure to obtain the required shareholder consents, or waive the effect of an invalid election or termination of election to treat a subsidiary as a qualified Subchapter S subsidiary [*see § 2B.10[7]*], if the circumstances resulting in the ineffectiveness were inadvertent [*I.R.C. § 1362(f)*; *see § 2B.11[3][b]*]. For California purposes, inadvertent invalid elections are permitted prospectively after January 1, 1997, but not retroactively [*Rev. & Tax. Code § 23801(i)*].

For federal purposes, the Secretary is authorized to treat late elections made after the prescribed first two and a half months of a tax year as timely made for that taxable year based on a finding of reasonable cause [*I.R.C. § 1362(b)(5)(B)*; *see § 2B.11[3][a]*]. For California purposes, untimely elections are permitted prospectively after January 1, 1997, but not retroactively [*Rev. & Tax. Code § 23801(h)(1)*]. A special rule applies for taxable years beginning on or after January 1, 2003, if the corporation fails to qualify as an "S corporation" for federal income tax purposes solely because the corporation failed to timely file federal Form 2553 (Election by a Small Business Corporation) [*see Rev. & Tax. Code § 23801(h)(2)*; *see also § 2B.31[1][b]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of TaxTax LawFederal Taxpayer GroupsS

CorporationsElections (IRC secs. 1362-1363)RequirementsTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Pro Rata Taxation of IncomeTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Termination (IRC sec. 1362)Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
B. California Law

2-2B California Legal Forms--Transaction Guide § 2B.32

[Reserved]

§ 2B.32[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
B. California Law

2-2B California Legal Forms--Transaction Guide § 2B.33

§ 2B.33 Terminating California S Election

[1] In General

Termination of a federal S election (other than an inadvertent termination) simultaneously terminates the S corporation election for purposes of California taxation [*Rev. & Tax. Code § 23801(e)(1)*; *see I.R.C. § 1362(d), (f)* (termination; inadvertent termination); *see also § 2B.13*]. A federal termination by revocation is an effective California termination; it must be reported to the FTB in the prescribed form and manner no later than the last date allowed for filing a federal termination for that year [*Rev. & Tax. Code § 23801(e)(2)*; *see* FTB Form 3560; *I.R.C. § 1362(d)*].

[2] Effect of Inadvertent Termination

For federal purposes, the IRS may waive the effect of an inadvertent termination caused by the failure to qualify as a small business corporation or the failure to obtain the required shareholder consents [*I.R.C. § 1362(f)*; *see § 2B.13[2]*]. For California purposes, inadvertent terminations are permitted prospectively for taxable years on or after January 1, 1997, but not retroactively [*Rev. & Tax. Code § 23801(i)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of TaxTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Termination (IRC sec. 1362)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
B. California Law

2-2B California Legal Forms--Transaction Guide § 2B.34

§ 2B.34 Tax Year for California Purposes

For purposes of California taxation, the taxable year of a taxpayer may not be different from the taxpayer's federal tax year unless initiated or approved by the FTB [*Rev. & Tax. Code § 24632*]. If a taxpayer is required to make a federal return for a period of less than 12 months, that period is deemed to be a tax year and a California return for the short period must be filed [*see Rev. & Tax. Code § 24634* (short-period return requirement)]. The due date of that return is the same date that the short-period federal return must be filed. In addition, a short-period return must be filed when the taxpayer, with FTB approval, changes its annual accounting period; when the taxpayer is in existence during only part of what would otherwise be its income year; or when the FTB terminates the taxpayer's income year [*Rev. & Tax. Code § 24634*; *see Rev. & Tax. Code § 25761* (jeopardy assessments)]. For taxable years beginning on or after January 1, 1987, the federal provisions regarding selection of an alternative tax year apply in California, other than the provision governing the effect of the election [*Rev. & Tax. Code § 24637*; *see I.R.C. § 444* (alternative tax year)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsTaxable Year (IRC secs. 1361, 1378)Tax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of TaxTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Effects



65 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
B. California Law

2-2B California Legal Forms--Transaction Guide § 2B.35

§ 2B.35 California Tax Treatment of S Corporations

[1] Corporate and Franchise Tax

California tax treatment of S corporations is determined in accordance with the applicable federal provisions except as otherwise provided [*Rev. & Tax. Code § 23800*]. S corporations continue to be subject to California's corporate income tax [*see Rev. & Tax. Code § 23501 et seq.*] and corporate franchise tax [*see Rev. & Tax. Code § 23151 et seq.*], but at lower rates than other corporations [*Rev. & Tax. Code § 23802(b)*]. The rate of income tax and franchise tax for S corporations is 1.5 percent [*Rev. & Tax. Code § 23802(b)(1)*; *see Rev. & Tax. Code §§ 23151* (franchise tax), 23501 (income tax)]. The corporate income or franchise tax rate for an S corporation that is also a financial corporation is increased by the excess of the rate imposed for financial corporations over the rate imposed on general corporations [*Rev. & Tax. Code § 23802(b)(2)*; *see Rev. & Tax. Code §§ 23151*, *23183* (rate for general corporations; rate for financial corporations)]. S corporations can claim the credits allowed to other corporations, but only one third of the amount [*Rev. & Tax. Code § 23803(a)(1)*; *see Rev. & Tax. Code § 23803(a)(2)(A)-(C)* (carry-forward rules)].

S corporations are subject to the minimum franchise tax to the same extent as other corporations [*Rev. & Tax. Code § 23802(c)*; *see Rev. & Tax. Code §§ 23151*, *23153*, *23221*]. Thus, S corporations that incorporate or qualify to do business in California on or after January 1, 2000, are not subject to the minimum franchise tax for the first taxable year of corporate existence [*Rev. & Tax. Code § 23153(f)(1)*], unless the corporation reorganized solely for the purpose of avoiding payment of the minimum franchise tax [*Rev. & Tax. Code § 23153(f)(3)*]. However, this exemption from tax does not apply to qualified Subchapter S subsidiaries [*Rev. & Tax. Code § 23151(f)(2)*; *see I.R.C. § 1363(b)(3)*].

[2] California Modifications to Tax on Built-In Gains and Passive Investment Income

[a] In General

Although the amount of tax imposed on certain built-in gains and passive investment income is generally determined in accordance with federal provisions, there are California modifications [*see Rev. & Tax. Code §§ 23809*, *23811* (built-in gains; passive investment income)]. An S corporation is allowed a deduction, in accordance with the federal allowance, from net income for the amount of built-in gains and passive investment income subject to tax [*Rev. & Tax. Code §*

23802(e); *see I.R.C. §§ 1374, 1375* (built-in gains; passive investment income)].

[b] Built-In Gains

California law also imposes a tax on built-in gains, to be computed according to federal law, with certain modifications [*Rev. & Tax. Code § 23809*; *see I.R.C. § 1374*]. The California tax is on built-in gains attributable to built-in gains from California sources [*Rev. & Tax. Code § 23809*] and is computed at the applicable state rate rather than the federal rate [*Rev. & Tax. Code § 23809(a)(1)*; *see Rev. & Tax. Code § 23151* (California rate); *I.R.C. § 11(b)* (federal rate)]. For S corporations that are also financial corporations, the rate of tax is increased by the excess of the rate imposed for financial corporations over the rate imposed on general corporations [*Rev. & Tax. Code § 23809(a)(2)*; *see Rev. & Tax. Code §§ 23151, 23183* (general corporation rate; financial corporation rate); *see also Marble Mortgage Co. v. Franchise Tax Bd. (1966) 241 Cal. App. 2d 26, 34, 50 Cal. Rptr. 345* ("financial corporation" is corporation in substantial competition with national banks)].

The tax on built-in gains may not be reduced by any credits [*see Rev. & Tax. Code § 23809(b)*; *see also I.R.C. § 1374(b)(3)*]. Further the *I.R.C. § 1201(a)* coordination provisions do not apply [*Rev. & Tax. Code § 23809(c)*; *see I.R.C. §§ 1201(a), 1374(b)(4)*].

[c] Passive Investment Income

California law also imposes a tax on passive investment income to be computed according to federal law, with certain modifications [*Rev. & Tax. Code § 23811*; *see I.R.C. § 1375*]. For California tax purposes, the term "Subchapter C earnings and profits" or "accumulated earnings and profits" includes only the Subchapter C earnings and profits from California sources [*Rev. & Tax. Code § 23811(d)*; *see Rev. & Tax. Code § 23811(e)* (modifications)] and the rate of tax is computed at the applicable state rate rather than the federal rate [*Rev. & Tax. Code § 23811(b)(1)*; *see Rev. & Tax. Code § 23151* (state rate); *I.R.C. § 11(b)* (federal rate)]. For an S corporation that is also a financial corporation, the rate of tax is increased by the excess of the rate imposed for financial corporations over the rate imposed on general corporations [*Rev. & Tax. Code § 23811(b)(2)*; *see Rev. & Tax. Code §§ 23151, 23183* (general corporation rate; financial corporation rate); *see also Marble Mortgage Co. v. Franchise Tax Bd. (1966) 241 Cal. App. 2d 26, 34, 50 Cal. Rptr. 345* ("financial corporation" is corporation in substantial competition with national banks)].

The federal rules relating to circumstances when passive investment income exceeds 25 percent of gross receipts for three consecutive taxable years and the corporation has accumulated earnings and profits [*see I.R.C. § 1362(d)(3)*; *see also § 2B.13[1][c]*] do not apply for California purposes unless the S corporation election is terminated for federal income tax purposes [*Rev. & Tax. Code § 23801(g)*].

[3] Miscellaneous Consequences of S Corporation Election

An S corporation is allowed a net operating loss (NOL) deduction only for losses incurred while the corporation is an S corporation [*Rev. & Tax. Code § 23802(d)*; *see Rev. & Tax. Code §§ 24416, 24416.1-24416.7* (NOL deductions)]. Although the S corporation itself can carry forward only a specified percentage (ranging from 55 to 65 percent depending on year) of its NOL for any tax year, all of the NOL is passed through to the shareholders [*see Rev. & Tax. Code §§ 17276, 23802(b), (d)*; *see also Rev. & Tax. Code §§ 17276.1-17276.10* (additional modifications to *I.R.C. § 172*)]. For further discussion of the NOL, see California Small Business Guide, Ch. 6, *Using the S Corporation Election* (Matthew Bender).

An S corporation is not subject to the alternative minimum tax [*Rev. & Tax. Code § 23400(b)*].

An S corporation must compute its deductions for amortization and depreciation under the provisions applicable to personal income tax [*Rev. & Tax. Code § 23802(f)(1)*]. The limitations of deductions to the amount at risk [*see I.R.C. §*

465] and the limitations on passive activity losses and credits [*see I.R.C. § 469*] are applied in the same manner as in the case of an individual [*Rev. & Tax. Code § 23802(f)(2), (3)(A)*]. An S corporation may not exclude any gain from the sale or exchange of qualified small business stock held for more than five years [*Rev. & Tax. Code § 23802(f)(4)*; *see Rev. & Tax. Code § 18152.5*]. Further, an S corporation is not allowed a deduction for bad debts [*Rev. & Tax. Code § 23802(f)(5)*; *see Rev. & Tax. Code § 24348(a)(2)*].

The federal provision relating to recapture of LIFO benefits applies for California purposes [*Rev. & Tax. Code § 23802(g)(1)*; *see I.R.C. § 1363(d)*]. An S corporation cannot be included in a combined tax report [*Rev. & Tax. Code § 23801(c)*; *see Rev. & Tax. Code § 25102*; *see also Rev. & Tax. Code § 23801(d)* (use of unitary combination to reflect income or loss of members of group of commonly controlled or owned corporations)].

For purposes of the taxation of employee fringe benefits, under federal law an S corporation is treated as a partnership [*I.R.C. § 1372*; *see § 2B.17[1]*]. For California taxation, Internal Revenue Code partnership tax provisions apply, as modified by California law [*Rev. & Tax. Code § 23807*].

For purposes of the definition of estimated tax under *Rev. & Tax. Code § 19023* and the addition to tax for underpayment of estimated tax under *Rev. & Tax. Code § 19142*, the tax imposed on S corporation income at the entity level does not constitute a "tax imposed by this part" referenced in those code sections [*Rev. & Tax. Code § 23802(g)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)General OverviewTax LawState & Local TaxesIncome TaxPartnershipsTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of TaxTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)EffectsTax LawState & Local TaxesFranchise TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART II. LEGAL BACKGROUND
B. California Law

2-2B California Legal Forms--Transaction Guide §§ 2B.36-2B.99

[Reserved]

§§ 2B.36[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-2B California Legal Forms--Transaction Guide

NOTE:

Facts and documents obtained from the client aid the attorney in determining whether the corporation qualifies to elect Subchapter S status [***see** § 2B.110*] and whether the election is advisable [***see** § 2B.111*].



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-2B California Legal Forms--Transaction Guide § 2B.100

§ 2B.100 Facts

[1] Relating to Corporation

1. Name and address of corporation.

2. Date of incorporation.

3. Tax year of corporation.

NOTE:

A corporation may not elect Subchapter S status unless its tax year is either "permitted" or an approved "alternative" year [***see*** *§ 2B.12*]. A permitted year is either a calendar year or an accounting period for which the corporation can establish a business purpose satisfactory to the IRS [***see*** *I.R.C. § 1378* ("permitted year")]. Deferral of income to shareholders is not a business purpose that justifies an accounting period different from the calendar year [*I.R.C. § 1378(b)*]. In general, an S corporation may elect a tax year other than a permitted year if the "deferral period," that is, the period of time between the beginning of the tax year elected and the close of the first tax year otherwise required ending within that year, is no longer than three months [*I.R.C. § 444(b)*]. The use of an alternative year subjects the S corporation to advance tax payment requirements [*I.R.C. § 444(c)(1)*; ***see*** *I.R.C. § 7519*]. For further discussion of the tax year, see *§ 2B.12*.

The taxpayer's California taxable year may not differ from its federal tax year, unless initiated or approved by the Franchise Tax Board [*Rev. & Tax. Code § 24632*]. For taxable years beginning on or after January 1, 1987, an alternative year may be elected for California taxation purposes [*Rev. & Tax. Code § 24637*].

4. Employer identification number.

5. Classes of shares authorized and outstanding.

6. Number of each of following shareholders:

a. Unmarried individuals.

b. Married individuals.

c. Grantor trusts.

d. Trusts of deceased grantors.

e. Beneficiaries of voting trusts.

f. Testamentary trusts.

g. Qualified Subchapter S trusts.

h. Estates, including estates of individuals in Chapter 11 bankruptcy.

i. Electing small business trusts.

j. Exempt organizations.

7. Whether corporation is or has ever operated as domestic international sales corporation (DISC).

8. Percentage of other corporation's shares owned by corporation and name of other corporation.

9. Type of business corporation is involved in, such as:

a. Lending.

b. Insurance.

c. Trade or business intended to make profit.

10. If going business is being incorporated as S corporation:

a. Name of predecessor business.

b. Type of organization.

c. Period of its existence.

d. Its tax year.

11. If C corporation is making Subchapter S election, amount of accumulated earnings and profits retained by corporation from previous C corporation tax years.

12. Source of corporation's projected income:

a. Ordinary income.

b. Capital gains.

c. Passive investment income (that is, income derived from rents, royalties, dividends, interest, annuities, or gains from sales or exchanges of securities).

13. Whether corporation or its predecessor ever had S corporation status and, if so, date status was terminated.

[2] Relating to Each Shareholder

1. Names and addresses of shareholders:

a. Individual shareholders and spouses.

b. Deemed owners of grantor trusts.

c. Estates of:
(1) Deceased grantor of grantor trust.

(2) Testator of testamentary trust.

(3) Deceased individual shareholders.

(4) Individual in Chapter 11 bankruptcy.

d. Beneficiaries of voting trusts.

e. Beneficiaries of qualified Subchapter S trusts.

f. Potential current beneficiaries of small business trusts.

g. Qualified tax-exempt shareholder of exempt organization.

2. Capacity in which individual holds shares:

a. Owner.

b. Trustee.

c. Executor or administrator.

d. Guardian.

e. Custodian under Uniform Gift to Minors Act.

3. Basis of shareholder's stock.

4. Amount and character of loans made by shareholder to corporation.

5. Citizenship and, if alien, United States residency status.

6. Social Security number.

7. Tax year.

8. IRS office in which shareholder's income tax returns are filed.

9. If shareholder is employee of corporation:

a. Position or title.

b. Fringe benefits, including:

(1) Pensions.

(2) Stock options.

(3) Profit sharing.

(4) Insurance coverage.

10. Estate plans for shares:

a. Number of transferees contemplated.

NOTE:
While an estate may hold S corporation shares [*I.R.C. § 1361(b)(1)(B)*], S corporation status will terminate if the total number of shareholders exceeds 100 after distribution of shares from a deceased shareholder's estate [***see*** *I.R.C. §§ 1361(b)(1)(A), 1362(d)(2)(A)*; ***see also*** *§ 2B.13*].

b. Trusts [*see I.R.C. § 1361(b)(1)(B)*].

NOTE:
Subchapter S stock may be held by grantor trusts [*I.R.C. § 1361(c)(2)(A)(i)*; ***see*** *I.R.C. § 671* et seq.]. If shares are held in a grantor trust, the trust may hold the shares after the grantor's death for up to two years if the entire corpus of the trust is includable in the deemed owner's gross estate [*I.R.C. § 1361(c)(2)(A)(ii)* (two-year period begins on day of deemed owner's death)]. If shares are transferred to a testamentary trust under the owner's will, the trust may hold the shares for up to two years [*I.R.C. § 1361(c)(2)(A)(iii)*]. Shares may be held by voting trusts [*I.R.C. § 1361(c)(2)(A)(iv)*], by electing small business trusts [*I.R.C. § 1361(c)(2)(A)(v)*], and qualified Subchapter S trusts [*I.R.C. § 1361(c)(2)(A)(i), (d)*]. Shares of a bank [*see* I.R.C. § 581 (definition)] or a depository institution holding

> company [*see* 12 U.S.C. § 1813(w)(1) (definition)] may be held by a trust that constitutes and individual retirement account, including a Roth IRA [*see* I.R.C. §§ 408(a), 408A], but only to the extent of shares held by the trust in that bank or company as of October 22, 2004 [I.R.C. § 1361(c)(2)(A)(vi)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)RequirementsTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Effects



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-2B California Legal Forms--Transaction Guide § 2B.101

§ 2B.101 Documents

1. Articles of incorporation.

2. Bylaws.

3. Most recent income tax return.

4. Shareholder list.

5. Most recent financial statement.

6. Annual report.

7. Fringe benefit plans and agreements.

8. All agreements, notes, and allied documents relating to loans by shareholders to corporation.

9. Any instrument under which corporation's stock is held, including:

a. Trust instruments for trusts holding corporation's shares.

b. Will under which any deceased shareholder's S corporation stock is held by estate.

c. Bankruptcy court order under which bankrupt shareholder's stock is held by bankrupt's estate.

d. Court order for guardianship.

10. Any buy-sell agreement between any shareholder and any member of shareholder's family, if that agreement was and has continued in existence since September 28, 1982.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Requirements



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
. TRANSACTION GUIDE
B. Preliminary Determinations

2-2B California Legal Forms--Transaction Guide § 2B.110

§ 2B.110 Qualification of Corporation to Elect Subchapter S Status

1. Will corporation engage in trade or business for profit rather than operate as mere hobby or recreational activity for its shareholders?

NOTE:

A Subchapter S election is available only to a corporation that carries on a trade or business [*DuPont, Jr. v. United States (D. Del. 1964) 234 F. Supp. 681, 684]* . However, an activity as small as the ownership of only one parcel of real estate is sufficient to qualify a corporation for S corporation status [***see*** *Rev. Rul. 75-188, 1975-1 C.B. 276*].

2. Where is corporation incorporated?

NOTE:

Only a domestic corporation qualifies as a small business corporation that may elect Subchapter S status [***see*** *I.R.C. § 1361(a)(1), (b)(1)*].

3. How many shareholders are there in each of following categories:

NOTE:

An S corporation may have no more than 100 shareholders [*I.R.C. § 1361(b)(1)(A)*]. The IRS will examine the substance of a transaction to determine whether the shareholder limitation is satisfied for Subchapter S purposes. Although an S corporation may join a partnership with other persons, it cannot do so merely to avoid the limitation on the number of shareholders it may have [***see*** *Rev. Rul. 77-220, 1977-1 C.B. 263*]. In this situation, the IRS will consider the partnership a sham and count each of the individual partners or all of the shareholders of each partner as shareholders in the S corporation whose qualification is in question [*Rev. Rul. 77-220, 1977-1 C.B. 263*].

a. Individuals [*I.R.C. § 1361(b)(1)(B)*].

NOTE:
Spouses and their estates are treated in the aggregate as one shareholder of the S corporation, and family members may elect to be treated as a single shareholder [*I.R.C. § 1361(c)(1)*].

b. Estates of individual shareholders [*I.R.C. § 1361(b)(1)(B)*].

c. Estates of individuals in Chapter 11 bankruptcy [*see I.R.C. § 1361(b)(1)(B), (c)(3)*].

d. Grantor trusts during life of grantor [*I.R.C. § 1361(b)(1)(B), (c)(2)(A)(i)*].

NOTE:
The grantors are treated as the shareholders [***see** I.R.C. § 1361(c)(2)(B)(i)*; ***but see** I.R.C. § 678* (when person other than grantor will be treated as substantial owner)].

e. Grantor trusts existing after death of grantor [*I.R.C. § 1361(b)(1)(B), (c)(2)(A)(ii)*].

NOTE:
A grantor trust that exists after the death of the deemed owner may continue as a shareholder for up to two years if the entire corpus of the trust is includable in the deemed owner's gross estate) [*I.R.C. § 1361(c)(2)(A)(ii)*]; the grantor's estate is treated as the shareholder [*I.R.C. § 1361(c)(2)(B)(ii)*].

f. Testamentary trust to which S corporation stock was transferred under shareholder's will, during two-year period after transfer [*I.R.C. § 1361(b)(1)(B), (c)(2)(A)(iii)*].

NOTE:
The testator's estate is treated as the shareholder [*I.R.C. § 1361(c)(2)(B)(iii)*].

g. Voting trust holding S corporation stock [*I.R.C. § 1361(b)(1)(B), (c)(2)(A)(iv)*].

NOTE:
Each beneficiary of a voting trust is treated as a shareholder [*I.R.C. § 1361(c)(2)(B)(iv)*].

h. Electing small business trusts [*see I.R.C. § 1361(b)(1)(B), (c)(2)(A)(v)*; *see also I.R.C. § 1361(e)* (defined); *§ 2B.10[3][f]*].

NOTE:
Each potential current beneficiary is treated as a shareholder; if the trust lacks a potential current income beneficiary for any period, the trust is treated as the shareholder during that period [*I.R.C. § 1361(c)(2)(B)(v)*].

i. Electing qualified Subchapter S trusts [*see I.R.C. § 1361(b)(1)(B), (c)(2)(A)(i), (d)(1)(A)*; *see also I.R.C. § 1361(d)(3)* (defined)].

NOTE:
An electing qualified Subchapter S trust is treated as a grantor trust for these purposes [

I.R.C. § 1361(d)(1)(A)]. The beneficiary of the trust is treated as the owner of that portion of the trust consisting of S corporation stock with respect to which an elections is made [*I.R.C. § 1361(d)(1)(B)*].

j. Certain exempt organizations [*see I.R.C. § 1361(b)(1)(B), (c)(6)*].

NOTE:

Qualified retirement plans [***see** I.R.C. § 401(a)*] and 501(c)(3) charitable organizations [***see** I.R.C. § 501(c)(3)*] that are exempt from taxation may be S corporation shareholders [*I.R.C. § 1361(b)(1)(B), (c)(6)*]. A qualified tax-exempt shareholder counts as one shareholder [***see*** Senate Finance Committee Rept., H.R. 3448, p. 3].

4. What is citizenship and United States residency status of shareholders?

NOTE:

An S corporation may not have a nonresident alien as a shareholder [*I.R.C. § 1361(b)(1)(C)*].

5. Does corporation have more than one class of following shares:

NOTE:

An S corporation may have only one class of shares [*I.R.C. § 1361(b)(1)(D)*]. However, differences in voting rights among shares of common stock does not cause the corporation to be treated as having more than one class of stock [*I.R.C. § 1361(c)(4)*]. Further, straight debt instruments is not treated as a second class of stock [*I.R.C. § 1361(c)(5)*]. For discussion, see *§ 2B.10[4]*.

a. Issued and outstanding shares.

b. Shares subject to conditions or restrictions imposed by Corporations Commissioner.

NOTE:

Promotional shares normally are subject to the conditions that the holders waive rights to receive cash or property dividends and to participate in distribution of assets in the event of liquidation [***see** 10 Cal. Code Reg. § 260.141*]. Almost invariably, these conditions will be implemented by the imposition of a requirement that promotional share certificates bear a legend setting forth the conditions [***see** 10 Cal. Code Reg. § 260.141.1*]. However, in unusual circumstances in which there is danger that the shares could be distributed to the public, the Commissioner may require them to be deposited in escrow [*10 Cal. Code Reg. § 260.141.3*].

The effect of imposing dividend and asset waivers by legend condition or escrow of shares may be to create a second class of stock. Even though a corporation's articles of incorporation authorized the issuance of only one class of stock, the imposition by the Corporations Commissioner of waiver of rights to distributions and dividends by shareholders who paid with property and an escrow condition on those shares until specified dividends had been paid on shares issued for cash was held to result, in effect, in the issuance of two classes of shares [*Paige v. United States (9th Cir. [Cal.] 1978) 580 F.2d 960, 963-964]* . The fact that under California law the corporation could only issue one class of shares was immaterial; whether a corporation has issued more than one class of shares for Subchapter S purposes is a matter for determination under federal law [*Paige v. United States (9th Cir. [Cal.] 1978) 580 F.2d 960, 963* ; ***see*** *Rev. Rul. 71-522,*

1971-2 C.B. 316].

6. Is corporation ineligible financial institution [*see I.R.C. § 1361(b)(2)(A)*; *see also I.R.C. § 585*]?

NOTE:

A financial corporation that uses the reserve method of accounting for bad debts is ineligible for federal Subchapter S status [*I.R.C. § 1361(b)(2)(A)*; *Rev. & Tax. Code § 23800*].

7. Is corporation ineligible insurance company [*see I.R.C. § 1361(b)(2)(B)*; *Rev. & Tax. Code § 23800*; *see also I.R.C. § 801* et seq.]?

8. Does corporation operate within Puerto Rico or other territorial possession of United States and, if so, has it elected to take special tax credit?

NOTE:

Corporations that operate in Puerto Rico or other territorial possessions of the United States and elect special tax treatment are ineligible for Subchapter S status [***see*** *I.R.C. § 1361(b)(2)(C)*; *Rev. & Tax. Code § 23800*; ***see*** also *I.R.C. § 936* (tax credit)].

9. Has corporation ever elected treatment as domestic international sales corporation (DISC)?

NOTE:

A DISC or former DISC is ineligible for Subchapter S status [***see*** *I.R.C. § 1361(b)(2)(D)*; *Rev. & Tax. Code § 23800*].

10. If corporation has retained accumulated earnings and profits from its C corporation years, what percentage of its income derives from passive investments?

NOTE:

A tax applies to the "excess" passive investment income of a corporation that existed as a C corporation before electing Subchapter S status and that has retained accumulated earnings and profits from its C corporation years [***see*** *I.R.C. § 1375(a)*; ***see also*** *§ 2B.14[5]*].

If an S corporation has Subchapter C accumulated earnings and profits at the close of each of three consecutive taxable years, and has gross receipts for each of those three taxable years more that 25 percent of which are passive investment income, its Subchapter S status will be terminated [***see*** *I.R.C. § 1362(d)(3)(A)(i)*]. "Passive investment income" does not include gross receipts from the sale of capital assets other than stock and securities other than the net capital gain from the sale [*I.R.C. § 1362(d)(3)(B)*; ***see*** *I.R.C. § 1362(d)(3)(C)* ("passive investment" defined); ***see also*** *§§ 2B.13[1][c], 2B.35[2][c]*].

11. If corporation terminated previous Subchapter S status within past five years, what valid business reasons exist for reelecting that status before end of five-year period?

NOTE:

IRS consent is required for any new election made within five years from the termination of S corporation status [***see*** *I.R.C. § 1362(g)*; *Treas. Reg. § 1.1362-5*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal

Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
. TRANSACTION GUIDE
B. Preliminary Determinations

2-2B California Legal Forms--Transaction Guide § 2B.111

§ 2B.111 Advisability of Electing Subchapter S Status

NOTE:

For a detailed discussion of the advantages and possible pitfalls of a Subchapter S election, see Cavitch, Tax Planning for Corporations and Shareholders, Ch. 3, ***Making the Most of Subchapter S*** (Matthew Bender). For a discussion of the advantages and disadvantages of electing S corporation status for California purposes, see California Small Business Guide, Ch. 6, ***Using the S Corporation Election*** (Matthew Bender).

1. Is corporation likely to operate at loss for period of time and, if so, do shareholders desire to deduct losses from personal income?

NOTE:

If losses are contemplated and shareholders wish to deduct those losses from their personal income, it could be beneficial to the shareholders to have the corporation elect Subchapter S status. However, losses will be applied first to reduce a shareholder's basis in the S corporation stock [***see*** *I.R.C. § 1367(a)(2)*; ***see also*** *§ 2B.15[3]*].

2. Is sum of income tax levied against C corporation and shareholders likely to exceed amount of income tax likely to be levied against shareholders after election of Subchapter S status?

NOTE:

If less income is lost to federal income taxation after an election of Subchapter S status, the election would be beneficial to the shareholders, all other things being equal.

a. Can income tax savings be realized on specific income, loss, deduction, or credit items only if attributable to shareholders for tax purposes?

NOTE:

Fringe benefit costs pass through to the shareholders of a new S corporation in most cases, and shareholders can take deductions for those costs only if they would otherwise be entitled to take them as personal deductions [***see*** *I.R.C. § 1372*; ***see also*** *§ 2B.17[1]*].

b. Whether and to what extent would corporate distributions be tax-free to shareholders of S corporation?

3. Will period of time during which Subchapter S status is intended to be effective make it feasible to schedule anticipated profits, losses, credits, or deductions within that period?

a. From date election becomes effective.

NOTE:

A Subchapter S election is effective either for the current tax year or the next tax year [***see*** *I.R.C. § 1362(b)*; *Treas. Reg. § 1.1362-6(a)(2)(ii)*; ***see also*** *§§ 2B.12, 2B.120[1]*, P 3].

b. To date termination takes effect, either:

NOTE:

Termination of Subchapter S status does not take effect retroactively. Possible tax advantages of converting to C corporation status cannot be manipulated after the taxable event that gives rise to the advantage. The termination of an S corporation must be planned carefully, on the basis of the fullest possible information from the principals of the proposed S corporation with regard to any expected profits or losses, taking into consideration that once Subchapter S status has been terminated or revoked, a new election cannot be made for five years without the consent of the IRS [***see*** *I.R.C. § 1362(g)*; *Treas. Reg. § 1.1362-5*; ***see also*** *§ 2B.120[2]*].

Shareholders can plan ahead for and manipulate the "placement" of taxable events either in an S corporation tax year or a C corporation tax year. For the procedures involved in the tax treatment of a termination year, see *§ 2B.121[4]*.

(1) If shareholder revocation, current or next tax year or date set for termination by agreement of shareholders [*see I.R.C. § 1362(d)(1)(C), (D)*; *Treas. Reg. § 1.1362-2(a)*; *see also § 2B.121[1]*];

(2) Date on which corporation ceases to be qualified small business corporation [*see I.R.C. § 1362(d)(2)*; *Treas. Reg. § 1.1362-2(b)*; *see also § 2B.121[2]*]; or

(3) If corporation elects Subchapter S status and has accumulated earnings and profits for three consecutive years, first day of taxable year that begins after third consecutive tax year in which it has excess passive investment income [*see I.R.C. § 1362(d)(3)(A)(ii)*; *see also Treas. Reg. § 1.1362-2(c)(2)*; *see § 2B.121[3]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61,

132)General OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Determination of Tax LiabilityTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)EffectsTax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
. TRANSACTION GUIDE
C. Procedural Guide

2-2B California Legal Forms--Transaction Guide

NOTE:

This Procedural Guide applies to federal Subchapter S elections. For California taxation purposes, a corporation cannot elect S corporation status unless it has made a valid federal election for the same year [*Rev. & Tax. Code § 23801(a)(1)*]. In general, for income years beginning on or after January 1, 1990, a corporation's federal S election is treated as an S election for California purposes, unless the corporation specifically elects to be treated as a C corporation [***see** Rev. & Tax. Code § 23801(a)(4)*] or is not qualified to be an S corporation [***see** Rev. & Tax. Code § 23801(a)(5)*]. For further discussion, see *§ 2B.31*.

California tax treatment of S corporations and their shareholders is determined in accordance with applicable Internal Revenue Code provisions [***see*** I.R.C. §§ 1361-1379], except as otherwise provided [*Rev. & Tax. Code § 23800*]. References throughout this Procedural Guide are to federal provisions, unless a specific California modification applies.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
. TRANSACTION GUIDE
C. Procedural Guide

2-2B California Legal Forms--Transaction Guide § 2B.120

§ 2B.120 Election of Subchapter S Status

[1] Initial Election by Small Business Corporation

1. Ensure that corporation:

a. Is eligible to elect Subchapter S status.

NOTE:
For a checklist of eligibility criteria, see *§ 2B.110*; for a further discussion of eligibility, see *§ 2B.10*.

b. Has authorized its officers to take all actions necessary to apply for S corporation status.

2. Have corporation select one of following as its tax year:

a. Calendar year as "permitted year" [*see I.R.C. § 1378(b)(1)*];

b. Other accounting period for which corporation can establish business purpose satisfactory to IRS as "permitted year" [*see I.R.C. § 1378(b)(2)*]; or

NOTE:
A corporation may establish a satisfactory business purpose in either of two ways. It may request a permitted year and provide evidence of its business purpose or it may obtain expedited IRS approval of a tax year that is either a "natural business year" or an "ownership tax year" [*Rev. Proc. 87-32, 1987-2 C.B. 396, 398-399]* . A tax year is a natural business year if it meets certain financial tests [*Rev. Proc. 87-32, 1987-2 C.B. 396, 399* ; ***see*** *§ 2B.200[1][c]*]. A tax year is an ownership tax year if shareholders

holding more than one half of the corporation's issued and outstanding shares of stock (as of the first day of the tax year to which the request relates) have changed to or are currently changing to the same tax year [*Rev. Proc. 87-32, 1987-2 C.B. 396, 399]* .

(1) If corporation qualifies for expedited IRS approval of tax year, have corporation complete Part II(P) of IRS Form 2553 [*see § 2B.200[2]*].

(2) If corporation does not qualify for expedited IRS approval, have corporation request approval of tax year in following manner [*Rev. Proc. 87-32, 1987-2 C.B. 396, 401]* :

(a) Indicate in Part II(Q) of IRS Form 2553 [*see § 2B.200[2]*] that request for approval is being made; and

(b) Attach statement [*see § 2B.200[2]*] setting forth business purpose for desired fiscal year and other necessary information pursuant to general ruling request requirements.

NOTE:

The first revenue procedure of each year usually sets forth the general ruling request requirements [***see, e.g.,*** Rev. Proc. 2004-1, 2004-1 I.R.B. 1]. Any deferral of income to shareholders does not constitute a business purpose [*I.R.C. § 1378(b)*].

c. Any other tax year, pursuant to election under *I.R.C. § 444*.

(1) Have corporation indicate in Part II(Q) of IRS Form 2553 [*see § 2B.200[2]*] its intention to make election of alternative tax year [Temp. Treas. Reg. § 1.444-3T(b)(3)].

NOTE:

Rather than making an initial election under *I.R.C. § 444*, the corporation may instead request permission to use a particular tax year that is based on a business purpose and file a "back-up" Section 444 election. If the business purpose request is denied, the corporation will be able (if otherwise qualified) to use the Section 444 election for the alternative tax year. If the corporation chooses to use a Section 444 election as a back-up, this intention must be stated in Part II(Q) of IRS Form 2553 [***see*** *§ 2B.200*] and indicated on IRS Form 8716 [Temp. Treas. Reg. § 1.444-3T(b)(3), (4); ***see*** *§ 2B.205* (IRS Form 8716)].

(2) File IRS Form 8716 by earlier of [Temp. Treas. Reg. § 1.444-3T(b)(1); *see § 2B.205*]:

(a) Fifteenth day of fifth month following month that includes first day of tax year for which election will be effective; or

(b) Due date (without regard to extensions) of income tax return resulting from election.

3. Advise corporation when S corporation election may be made:

NOTE:

An election is effective for the tax year for which it is made and for all succeeding tax years of the corporation until the election is terminated [*I.R.C. § 1362(c)*]. The corporation's tax year must be established first and then the election and consent forms must be completed within the times indicated

below.

a. For current tax year, either:

(1) At any time during preceding tax year [*I.R.C. § 1362(b)(1)(A)*]; or

(2) On or before 15th day of third month of current tax year [*I.R.C. § 1362(b)(1)(B)*].

NOTE:
If the corporation is not a qualifying small business corporation on any day during this period, or if a shareholder did not consent, the election is treated as made for the following tax year [*I.R.C. § 1362(b)(2)*]. The IRS may extend the time for filing shareholder consents on a showing of reasonable cause for the failure to file; this would validate an application for Subchapter S status during the current tax year that would otherwise be invalid for the lack of shareholder consents [***see*** P 6, ***below***].

b. For following tax year, by making election after 15th day of third month of current tax year but on or before 15th day of third month of following tax year [*I.R.C. § 1362(b)(3)*].

c. For current tax year of two and one-half months or less, by making election not later than two months and 15 days after first day of tax year [*I.R.C. § 1362(b)(4)*].

4. Obtain IRS Form 2553, Election by a Small Business Corporation [*I.R.C. § 1362(a)(1)*; *Treas. Reg. § 1.1362-6(a)(2)*; *see § 2B.200[2]*] and have completed form signed by any person authorized to sign corporate income tax returns [*see I.R.C. § 6062*].

NOTE:
Part II of IRS Form 2553 must be completed if the corporation chooses a tax year other than a calendar year [***see*** *I.R.C. § 1378(b)*; *Rev. Proc. 87-32, 1987-2 C.B. 396*].

5. Have each shareholder of corporation as of date of election sign consent to election either [*I.R.C. § 1362(a)(2)*; *see Treas. Reg. § 1.1362-6(a)(2), (b)(3)(i)*]:

NOTE:
Persons who become shareholders after the day on which the election is made need not consent since an election is effective until terminated [***see*** *I.R.C. § 1362(c)*; ***see also*** *Treas. Reg. § 1.1362-6(a)(2)*].

a. On corporation's election form [*see § 2B.200[2]*]; or

b. By means of separate consents [*see § 2B.201[2]*].

6. Have shareholder consents executed by [*see Treas. Reg. § 1.1362-6(b)(2)*]:

a. Individual owners.

NOTE:
Because a husband and wife (and their estates) are treated as a single shareholder, each must consent [***see*** *I.R.C. § 1361(c)(1)*]. Moreover, when stock is owned by a husband and wife as community property or the income from the stock is community property, both

must consent [*Treas. Reg. § 1.1362-6(b)(2)(i)*]. When family members elect to be treated as a single shareholder [***see** I.R.C. § 1361(c)(1)*], all must consent.

If the election is made within the corporation's first tax year for which it is effective, each person who was a shareholder before the election but who is not a shareholder at the time of the election must also consent to the election [*Treas. Reg. § 1.1362-6(b)(3)(i)*].

b. Joint owners.

NOTE:
If stock is owner by tenants in common, joint tenants, or tenants by the entirety, each person having a community interest in the stock or an income interest, and each tenant in common, joint tenant, and tenant by the entirety must consent [*Treas. Reg. § 1.1362-6(b)(2)(i)*].

c. Minors, by minor or legal representative (or natural or adoptive parent if no legal representative has been appointed) [*Treas. Reg. § 1.1362-6(b)(2)(ii)*].

d. Estates, by executor, administrator, or other appointed fiduciary [*Treas. Reg. § 1.1362-6(b)(2)(iii)*].

e. Grantor trusts, by grantors.

f. Qualified Subchapter S trusts, by deemed owners.

g. Voting trust holding S corporation stock, by each beneficiary.

7. If consent of person who was shareholder on date of election cannot be filed with corporation's election, advise corporation to draft request for extension of time for filing consents [*see Treas. Reg. § 1.1362-6(b)(3)(iii)*; *see also § 2B.202*]:

NOTE:
An election that is timely for any tax year and that would be valid except for the failure of a shareholder to file a timely consent will not be invalid for that reason if the request for a time extension is approved [***see** Treas. Reg. § 1.1362-6(b)(3)(iii)*].

a. Advise corporation that it must show to satisfaction of IRS that:

(1) There was reasonable cause for failure to file consent.

(2) Request for extension of time to file consent is made within reasonable time under circumstances.

(3) Government's interests will not be jeopardized.

b. Advise corporation that if application is approved:

(1) Shareholders whose consents were subject of application must be filed within extension period granted by IRS.

(2) Consents will have to be filed for all shareholders who became shareholders subsequent to invalid election.

8. Advise corporation to file election and unanimous shareholder consents (or consents plus application for extension of time for filing consents):

a. In timely manner [*see* P 3, *above*].

NOTE:
Mail or deliver the election so that it actually arrives before any deadline; a letter deposited late on the deadline day may not be postmarked until the next day, in which case the election may not become effective for the intended tax year [***see*** *Joseph W. Feldman (1966) 47 T.C. 329, 334* ; *Simons v. United States (D. Conn. 1962) 208 F. Supp. 744]* .

b. With appropriate IRS Service Center [*see Treas. Reg. § 1.1362-6(a)(2)*].

NOTE:
If the corporation's principal business, office, or agency is located in the California counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, or Yuba, the IRS Service Center address is Ogden, UT 84201. For all other California counties, the IRS Service Center address is Fresno, CA 93888.

If the election is mailed, send it by certified or registered mail with a transmittal letter requesting that a copy of the letter, the election form, and any accompanying consents or other documents be stamped "received" and returned in an enclosed self-addressed stamped envelope.

[2] Election After Termination or Revocation of Prior Subchapter S Status

1. If small business corporation had made Subchapter S election and that election has been terminated or revoked, advise corporation (or any successor corporation) that [*I.R.C. § 1362(d), (g)*; *see Treas. Reg. § 1.1362-5(b)* ("successor corporation" defined)]:

a. Corporation is not eligible to make another election for any tax year before its fifth tax year following first tax year for which termination or revocation became effective, in most situations.

b. Corporation may make earlier reelection with IRS consent.

c. To obtain IRS consent, burden is on corporation to show that, under relevant facts and circumstances, IRS should consent to new election [*see Treas. Reg. § 1.1362-5(a)*].

NOTE:
The fact that more than half of the stock of the corporation is now owned by persons who did not own shares during the first tax year for which the termination was applicable tends

to establish that consent should be granted. The fact that the event that caused the original termination was not reasonably within the control of the corporation or shareholders having a substantial interest in the corporation, and was not part of a plan participated in by those shareholders to terminate the election, also tends to establish grounds for IRS consent [***see*** *Treas. Reg. § 1.1362-5(a)*].

2. If corporation's Subchapter S status was inadvertently terminated because it ceased to be qualifying small business corporation, or because passive investment income was excessive [*see I.R.C. § 1362(d)(2), (3)*], advise corporation that it may be treated as continuing to be an S corporation on [*see I.R.C. § 1362(f)*; *Treas. Reg. § 1.1362-4*]:

a. Showing that termination occurred inadvertently and determination to that effect is made by IRS.

NOTE:

Congress has indicated its intent that the IRS should be reasonable in granting waivers and that the government and taxpayers should work out agreements that protect the revenues without undue hardship to taxpayers [***see*** S. Rep. No. 97-640, p. 12 (1982)]. The corporation has the burden of showing that under relevant facts and circumstances IRS should find termination was inadvertent [*Treas. Reg. § 1.1362-4(b)*]. Inadvertent termination tends to be established by the fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate, or that the event took place without the knowledge of the corporation despite due diligence to safeguard itself against such an event [*Treas. Reg. § 1.1362-4(b)*].

b. Showing that, within reasonable period after discovery of terminating event, steps were taken (1) so that corporation qualifies as small business corporation or (2) to acquire requisite shareholder consents.

c. Having corporation and each shareholder agree to make adjustments consistent with S corporation status and required by IRS.

3. Have corporation complete request for consent of IRS to new election [*see Treas. Reg. § 1.1362-4(c)*; *see also § 2B.204*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Termination (IRC sec. 1362)Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
. TRANSACTION GUIDE
C. Procedural Guide

2-2B California Legal Forms--Transaction Guide § 2B.121

§ 2B.121 Termination of Subchapter S Status

[1] Revocation With Consent of Shareholders

1. Advise corporation that its Subchapter S election may be revoked with consent of shareholders who hold more than half of its shares on date of revocation [*I.R.C. § 1362(d)(1)(A), (B)*].

2. If revocation is desired, draft corporation's statement revoking election with shareholders' consent to revocation [*see Treas. Reg. §§ 1.1362-2(a)*, 1.1362-6(a)(3); *see also § 2B.220*].

3. Have shareholders holding more than half of corporation's shares sign consent to revocation of its Subchapter S status [*I.R.C. § 1362(d)(1)(B)*].

4. Have corporation send notice of revocation and all consents to appropriate IRS Service Center [*Treas. Reg. § 1.1362-6(a)(3)*].

NOTE:
For the locations of appropriate IRS Service Centers, see the Note to *§ 2B.120[1]*, P 8b.

5. Have corporation take any necessary accounting actions [*see* [4], *below*].

[2] Termination on Cessation of Small Business Corporation Status

1. Advise small business corporation that its Subchapter S election terminates when it ceases to be small business corporation because it [*I.R.C. § 1362(b)(1), (2)*; *see also § 2B.10*]:

a. Has more than 100 shareholders.

b. Has as shareholder person, other than estate, permitted trust, or eligible exempt organization who is not individual.

c. Has nonresident alien as shareholder.

d. Has more than one class of stock.

e. Becomes ineligible lending institution.

f. Becomes ineligible insurer.

g. Begins to operate in territorial possession of United States and elects special tax treatment.

h. Becomes domestic international sales corporation.

NOTE:
Termination is effective, at any time on or after first day of first tax year for which the corporation becomes an S corporation, whenever the corporation ceases to be a small business corporation [*I.R.C. § 1362(d)(2)(A)*].

2. Advise corporation that if termination is inadvertent it may seek waiver from IRS [*see § 2B.120[2]*].

3. If termination is intended to take effect, draft corporation's notification of termination stating that termination has occurred and date of termination [*see Treas. Reg. § 1.1362-2(b)(1)*; *see also § 2B.221*].

4. Have corporation attach notice of termination to tax return for tax year in which termination occurs.

5. Have corporation take necessary accounting actions [*see* [4], *below*].

[3] Termination on Receipt of Excess Passive Investment Income

1. If S corporation was C corporation and retained earnings and profits from its C corporation years, advise it that its Subchapter S status terminates whenever it has both [*I.R.C. § 1362(d)(3)(A)(i)*; *Treas. Reg. § 1.1362-2(c)(1)*]:

a. Accumulated earnings and profits at close of each of three consecutive tax years (after December 31, 1981, and during which it was S corporation [*see I.R.C. § 1362(d)(3)(A)(iii)*]); and

b. Gross receipts for each of those three consecutive tax years more than 25 percent of which are passive investment income [*see I.R.C. § 1362(d)(3)(C)(i)*; *Treas. Reg. § 1.1362-2(c)(4), (5)*; *see also § 2B.13[1]*].

2. Advise corporation that termination for this reason is effective on first day of first taxable year beginning after third consecutive year of excess passive investment income [*I.R.C. § 1362(d)(3)(A)(ii)*;

Treas. Reg. § 1.1362-2(c)(2)].

3. Advise corporation that if termination is inadvertent it may seek waiver from IRS [*see §§ 2B.13[2], 2B.120[2]*].

[4] Tax and Accounting Treatment of Termination Year

1. When S corporation status terminates on day other than first day of tax year, divide termination year into two parts:

NOTE:
The taxable year in which the Subchapter S status of a corporation terminates is referred to as an "S termination year" [***see*** *I.R.C. § 1362(e)(4)*; ***see also*** *Treas. Reg. § 1.1362-3*]. Subchapter S status terminates during a tax year only in the case of either the cessation of S corporation status or a revocation if the revocation instrument provides for it.

a. Treat portion of year ending before date on which termination is effective as "S short year," or short tax year for which corporation is S corporation [*I.R.C. § 1362(e)(1)(A)*].

b. Treat portion of year beginning on first day for which termination is effective as "C short year," or short tax year for which corporation is C corporation [*I.R.C. § 1362(e)(1)(B)*].

2. Account for or make allocation of income, loss, gains, and credits among S and C short years either:

NOTE:
Under this method of allocation between S and C short years during an S termination year, it is not necessary for the corporation to close its books at the end of the S short year.

a. By pro rata allocation [*see* P 3, *below*]; or

b. Under normal accounting rules [*see* P 4, *below*].

3. If desired, make pro rata allocation [*I.R.C. § 1362(e)(2)*]:

a. Determine for S termination year amount of each item of income, loss, deduction, or credit and amount of nonseparately computed income or loss [*I.R.C. § 1362(e)(2)(A)*].

b. Assign equal portion of each amount so determined to each day of S termination year [*I.R.C. § 1362(e)(2)(B)*].

4. If allocation among short years is desired on basis of normal tax accounting rules rather than pro rata allocation:

a. Have corporation affirmatively elect not to use pro rata allocation and have all shareholders consent to election [*I.R.C. § 1362(e)(3)*; *see Treas. Reg. § 1.1362-6* (time

and manner of election)].

b. Report taxable income or loss on each return (Subchapter S and Subchapter C) on basis of income or loss shown on corporation's permanent records, including work papers [*see* S. Rep. 97-640, p. 11 (1982)].

c. Attribute items to each short year according to time item was incurred or realized, as reflected in corporation's records [*see* S. Rep. 97-640, p. 11 (1982)].

5. Determine tax for C short year:

a. Annualize taxable income for C short year by [*I.R.C. § 1362(e)(5)(A)*]:
(1) Multiplying taxable income for C short year by number of days in S termination year.

(2) Dividing result by number of days in C short year.

(3) Calculating tax as same part of tax computed on annual basis as number of days in C short year is of number of days in S short year.

b. Make necessary adjustment in computing minimum tax for tax preferences [*see I.R.C. §§ 443(d), 1362(e)(5)(B)*].

c. Do not take S short year into account for purpose of determining number of tax years to which any item may be carried back or forward by corporation [*see I.R.C. § 1362(e)(6)(A)*].

6. Complete tax returns for both short years.

NOTE:
Both tax returns are due on the same day [***see*** *I.R.C. § 1362(e)(6)(B)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsTaxable Year (IRC secs. 1361, 1378)Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Termination (IRC sec. 1362)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
. TRANSACTION GUIDE
C. Procedural Guide

2-2B California Legal Forms--Transaction Guide §§ 2B.122-2B.129

[Reserved]

§§ 2B.122[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
. TRANSACTION GUIDE
D. Related and Subsequent Procedures

2-2B California Legal Forms--Transaction Guide § 2B.130

§ 2B.130 Shareholders' Estate Plans and Agreements

1. Review shareholders' estate plans to determine disposition of S corporation shares on death.

2. If estate plan contemplates transfer of S corporation shares to shareholder's estate, advise corporation and shareholder that corporation's Subchapter S status can continue [*see I.R.C. § 1361(b)(1)(B)*].

3. If estate plan contemplates transfer of S corporation shares to grantor or testamentary trust, advise corporation and shareholder that:

NOTE:
For a discussion of the types of trusts that are permitted to hold S corporation shares, and the requirements and limitations applicable to those trusts, see *§ 2B.10[3][e]-[g]*. Ordinarily, in order to hold S corporation shares for more than a limited period of time, a trust must be able to qualify as either an "electing small business trust" (ESBT) [*I.R.C. § 1361(b)(1)(B), (c)(2)(A)(v)*; ***see*** *§ 2B.10[3][f]* or a "qualified Subchapter S trust" (QSST) [*I.R.C. § 1361(d)(1), (2)*; ***see*** *§ 2B.10[3][g]*]. For additional discussion of estate planning issues relating to the disposition of S corporation shares in trust, see *California Wills & Trusts, Ch. 29,* ***Devises of Businesses and Business Interests,*** *§ 29.05[1][c]*; *Ch. 94,* ***Trust Property,*** *§ 94.06[3][b]* (Matthew Bender).

a. Corporation's Subchapter S status can continue for only limited period [*see I.R.C. §§ 1361(c)(2)(A)(ii), (iii), 1362(d)(2)*; *see also § 2B.10[3][c][i], [ii]*].

b. Another arrangement is required if continued Subchapter S status is contemplated.

4. If review of all shareholders' estate plans reveals that transfers could result in corporation having more

than 100 shareholders, advise corporation and shareholders that there is risk of loss of Subchapter S status if any transfer results in more than 100 shareholders [*see I.R.C. §§ 1361(b)(1)(A), 1362(d)(2)*].

5. Consider use of following to avoid loss of Subchapter S status:

a. Make sure that shareholders' wills do not provide for more than 100 beneficiary-recipients of S corporation stock.

b. Include share transfer restrictions in:
(1) Articles of incorporation or bylaws.

NOTE:
For share transfer provisions, see Ch. 3, ***Articles of Incorporation*** , and Ch. 4, ***Bylaws*** .

(2) Buy-sell agreements between shareholders.

NOTE:
For buy-sell agreements, see Ch. 8D, ***Buy-Sell Agreements*** .

6. If share transfer does inadvertently result in termination, seek waiver [*see I.R.C. § 1362(f)*; *Treas. Reg. § 1.1362-4*; *see also § 2B.120[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)General OverviewTax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)Business & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
. TRANSACTION GUIDE
D. Related and Subsequent Procedures

2-2B California Legal Forms--Transaction Guide § 2B.131

§ 2B.131 Income Tax Returns

1. Advise corporation that it must file annual return (IRS Form 1120-S) on or before 15th day of third month following close of its tax year, showing [*see I.R.C. § 6037*; *see also Treas. Reg. § 1.6037-1(a), (b)*]:

a. Items of gross income.

b. Allowable deductions.

c. Names and addresses of all shareholders during tax year.

d. Number of shares held by each shareholder during tax year.

e. Amount of money and other property distributed to each shareholder during tax year.

f. Date of each distribution.

g. Each shareholder's pro rata share of each item for tax year.

2. Have tax return signed by one of following [*see I.R.C. § 6062*]:

a. President;

b. Vice-president;

c. Treasurer or assistant treasurer;

d. Chief accounting officer; or

e. Any other officer duly authorized to sign.

3. Advise corporation to file IRS Forms 1096 and 1099 at end of each calendar year for payments of business expenses in course of trade or business of $600 or more [*I.R.C. § 6041*].

4. Advise corporation to furnish to each shareholder copy of information shown on return and advise shareholders to report income, deductions, credits, and losses passed through to them from S corporation on their individual income tax returns.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Tax Administration & ProcedureAdministrationIdentification Numbers & Information Returns (IRC secs. 6031-6065)S Corporation ReturnsTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Pro Rata Taxation of IncomeTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Determination of Tax Liability



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
. TRANSACTION GUIDE
D. Related and Subsequent Procedures

2-2B California Legal Forms--Transaction Guide §§ 2B.132-2B.199

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§§ 2B.132[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART IV. FORMS
A. Election of Subchapter S Status

2-2B California Legal Forms--Transaction Guide § 2B.200

§ 2B.200 Election by Small Business Corporation to Be Treated as S Corporation [I.R.C. § 1362]--Internal Revenue Service Form 2553

[1] Comment

[a] Use of Form

This form is the official form (IRS Form 2553) to be used by a corporation that qualifies as a small business corporation [*see I.R.C. § 1361(b)*] to elect treatment for federal income tax purposes as an S corporation [*see I.R.C. §§ 1361(b), 1362*; *Treas. Reg. § 1.1362-1(a)*]. The IRS instructions are reproduced here along with the text of the form. Form 2553 may be filled in online, downloaded, and printed out by going to the forms and publications page of the IRS website at http://www.irs.gov/formspubs/index.html?portlet=3.

For a guide to determining the eligibility of a corporation to elect Subchapter S status, see *§ 2B.110*. Factors relevant to the advisability of making this election are set forth in *§ 2B.111*. For a procedural guide to use in making an election, whether it is an initial election or one made by a former S corporation after its Subchapter S status has been terminated or revoked, see *§ 2B.120*.

[b] Effect of Election

A Subchapter S election permits the S corporation to retain the corporate advantage of limited liability for its shareholders while being treated for income tax purposes as if it were a partnership, passing through to its shareholders items of income, loss, deduction, or credit with minimal taxation at the corporate level [*see I.R.C. §§ 1363, 1366*; *see also Rev. & Tax. Code § 23802.5*]. For discussion of S corporation taxation, see *§§ 2B.14-2B.19*. Once a valid election is filed, it is effective until terminated or revoked; the election need not be renewed annually [*see I.R.C. § 1362(c)*].

A corporation that has a valid election under *I.R.C. § 1362(a)* in effect for federal purposes will be an S corporation under California tax law [*Rev. & Tax. Code § 23801(a), (b)*], and its shareholders will be shareholders of an S corporation, without regard to whether the corporation is qualified to do business or is incorporated in California [*Rev. & Tax. Code § 23801(b)*; *see § 2B.31*]. California tax treatment of S corporations and their shareholders is determined

in accordance with the applicable provisions of the Internal Revenue Code [*see* I.R.C. §§ 1361-1379], except as otherwise provided [*Rev. & Tax. Code § 23800*; *see Valentino v. Franchise Tax Board (2001) 87 Cal. App. 4th 1284, 1290* (*Rev. & Tax Code § 23800* essentially adopts federal "conduit" rule; thus California source income of S corporation, passed through to nonresident, is subject to California tax)]. For further discussion of the California election and taxation, see *§§ 2B.30-2B.34*.

[c] Tax Year

[i] Overview

Part I(I) of IRS Form 2553 requires the corporation to state its tax year. As discussed in [ii], *below*, an S corporation may use a "permitted year," which is either a calendar year or any other accounting period for which the corporation satisfactorily establishes a business purpose [*I.R.C. § 1378(b)(1), (2)*], or an "alternative year" [*I.R.C. § 444*; *see § 2B.12*].

[ii] Permitted Year

An S corporation may use a "permitted year" as its tax year. A "permitted year" is a calendar year or any other year for which the corporation has a business purpose [*I.R.C. § 1378(b)*; *see* [iii], *below*]. If a corporation's request to use a business purpose year is denied and it has not made a back-up election under *I.R.C. § 444*, the corporation must use a calendar year to continue its status as an S corporation [*see* Part II(Q) of IRS Form 2553]. Similarly, if the corporation is ultimately unqualified to make an election under *I.R.C. § 444*, the corporation must use a calendar year to continue to be an S corporation [*see* Part II(R) of IRS Form 2553]. An S corporation may adopt as a "permitted year" any accounting period for which it can establish a business purpose to the satisfaction of the IRS [*I.R.C. § 1378(b)(2)*]. For purposes of this determination, deferral of income to shareholders is not considered a business purpose [*I.R.C. § 1378(b)*].

[iii] Approval of Business Purpose Year

A corporation may obtain "expeditious approval" of its business purpose year when the desired fiscal year is either a "natural business year" or an "ownership tax year" [*Rev. Proc. 87-32, 1987-2 C.B. 396*]. A tax year is a natural business year if the results of both of the following tests equal or exceed 25 percent [*Rev. Proc. 87-32, 1987-2 C.B. 396*]:

- Gross receipts from sales and services for the most recent 12-month period that ends before the filing of the request and that ends with the last month of the requested year are computed, employing the accounting method used to prepare tax returns for that year. The amount is divided into the amount of gross receipts from sales and services for the last two months of the 12-month period.

- The same computation is made for the two 12-month periods immediately preceding the 12-month period described in (1), *above*.

A tax year is an ownership tax year if shareholders holding more than one half of the corporation's issued and outstanding shares of stock (as of the first day of the tax year to which the request relates) have changed to or are currently changing to the same tax year [*Rev. Proc. 87-32, 1987-2 C.B. 396*].

To obtain expedited approval of its tax year, a corporation must state in Part II(P) of IRS Form 2553 that it is selecting a tax year that is either a natural business year or an ownership tax year. If the corporation selects a natural business year, it must also attach a statement showing the amount of gross receipts for each of the most recent 47 months [*see Rev. Proc. 87-32, 1987-2 C.B. 396*]. If it is not using the expeditious approval provisions, a corporation must indicate in Part II(Q) of IRS Form 2553 that the corporation is requesting a business purpose year and must attach a statement of its

business purpose [*Rev. Proc. 87-32, 1987-2 C.B. 396* ; *see § 2B.203*].

Once the tax year is selected, a corporation must (1) file a timely federal income tax return for any short period (the time from the close of the old tax year to the day before the new tax year begins) required to adopt the tax year, (2) close its books on the last day of the short period if a new tax year is requested, and (3) keep its books and records on the basis of the requested tax year [*Rev. Proc. 87-32, 1987-2 C.B. 396*].

[iv] Alternative Year

An S corporation may have a tax year that is an "alternative year" [*I.R.C. § 444(a), (e)*; *see I.R.C. § 1378*] if the period of time between the beginning of the tax year elected and the close of the first calendar year ending within the elected year is no longer than three months [*I.R.C. § 444(b)(1)*]. This election requires that the corporation make certain advance tax payments [*I.R.C. § 444(c)(1)*; *see I.R.C. § 7519*].

The election is made by filing IRS Form 8716 [*see § 2B.205*]. The corporation must also state in Part II(R) of IRS Form 2553 its intent to elect an alternative tax year [Temp. Treas. Reg. § 1.444-3T(b)(3)]. If the Section 444 election is made as a back-up to a business purpose request, that intention must be stated in Part II(Q) of IRS Form 2553 and indicated on IRS Form 8716 [Temp. Treas. Reg. 1.444-3T(b)(3), (4); *see § 2B.205*].

[d] Shareholder Consents

Each person who is a shareholder on the date of the S corporation election must consent to the election [*I.R.C. § 1362(a)(2)*; *see* Part I(K) of IRS Form 2553]. If a husband and wife own stock as community property, or the income from the stock is community property, both must consent to the election, even though they (and their estates) are treated as one shareholder for purposes of determining the number of shareholders in the corporation [*Treas. Reg. § 1.1362-6(b)(2)(i)*; *see I.R.C. § 1361(c)(1)*]. Each tenant in common, joint tenant, and tenant by the entirety must also consent to the election [*Treas. Reg. § 1.1362-6(b)(2)(i)*; *see* IRS Form 2553, Instructions].

The consent of a minor must be made by the minor or by the minor's legal representative or by a natural or adoptive parent if no legal representative has been appointed [*Treas. Reg. § 1.1362-6(b)(2)(ii)*]. The consent of an estate must be made by the executor, administrator, or other appointed fiduciary of the estate [*Treas. Reg. § 1.1362-6(b)(2)(iii)*]. In the case of a trust, consent ordinarily must be obtained from the person treated as a shareholder for the purpose of determining the number of shareholders [*see Treas. Reg. § 1.1362-6(b)(2)(iv)*; *see § 2B.10[3]*].

The consents may be entered in Column K of IRS Form 2553, or may be submitted in a separate attachment. If a separate consent statement is used, it must include the name, address, and employer identification number of the corporation and all the information required in Columns J through N in Part I of IRS Form 2553 [*Treas. Reg. § 1.1362-6(b)(1), (3)*; *see § 2B.201[2]*]. All of the shareholders' consents may be combined into one statement [*see* IRS Form 2553, Instructions].

A shareholder's consent is binding and may not be withdrawn after the corporation has made a valid election [*Treas. Reg. § 1.1362-6(b)(3)*].

[e] Execution of Election

The election must be signed by a person who is authorized to sign corporate income tax returns [*Treas. Reg. § 1.1362-6(a)(1)*]. The corporation's president, vice president, treasurer, assistant treasurer, chief accounting officer, or another authorized officer, such as a tax officer, may sign returns [*see I.R.C. § 6062*].

[f] Time for Filing Election

A corporation's election to be treated as an S corporation for any tax year must be filed at any time during the preceding tax year or at any time during the first two and one-half months of the tax year for which the election is made [*I.R.C. § 1362(b)(1)*; *Treas. Reg. § 1.1362-6(a)(2)(ii)*]. If a corporation makes the election in the first two and one-half months of its tax year but during this period the corporation is not eligible for S corporation status or a shareholder fails to consent, or if the election is untimely for that year, the election will be treated as if made for the following tax year [*I.R.C. § 1362(b)(2)*]. However, if the election would be timely and valid except for the failure of a shareholder to file a timely consent [*see Treas. Reg. § 1.1362-6(b)(1)*], and the corporation can show that there was reasonable cause for the failure, the corporation may receive an extension of time to file consents [*see Treas. Reg. § 1.1362-6(b)(2)(iii)*; *see also § 2B.202*].

[g] Manner of Filing Election

The election form, any separate shareholder consents, and all accompanying documents must be filed with the appropriate Internal Revenue Service Center [*see Treas. Reg. § 1.1362-6(a)(2)*; *see also § 2B.120[1]*]. The election may be personally delivered to an office of the IRS and stamped as filed there or it may be mailed. If the election form is mailed, it is a good practice to include a cover letter and request that the letter be stamped "received" and returned in an enclosed, self-addressed envelope. The election form should be mailed so that it arrives at the IRS Service Center on or before the last date. If the letter is mailed late on the last day, it may not be postmarked until the next day under local post office practices, and the election will not be considered valid [*J.W. Feldman (1966) 47 T.C. 329* ; *see Simons v. United States (D. Conn. 1962) 208 F. Supp. 744]* .

[h] Acceptance of Election

The corporation will usually receive a determination regarding the election within 60 days after filing the election form. However, if a business purpose year that is not subject to expedited approval procedures is requested, the corporation will receive a ruling letter from the IRS and must generally wait an additional 90 days for the determination [*see* IRS Form 2553, Instructions].

[i] QSST Election

The beneficiary of a QSST (or his or her authorized legal representative) may elect to be treated in the same manner as a grantor trust [*I.R.C. § 1362(d)(1)(A), (2)*; *see I.R.C. § 1362(d)(2)(B)* (ownership rule); *see also § 2B.10[3][g]*]. Once made, this election is generally irrevocable; it may only be revoked with the consent of the Secretary [*I.R.C. § 1362(d)(2)(C)*]. The election may be made on IRS Form 2553, or on a separate statement; however, IRS Form 2553 may be used to make this election only if the corporate stock has been transferred to the trust on or before the date on which the corporation makes the election to be an S corporation [*see* IRS Form 2553, Instructions].

[2] Form

Internal Revenue Service Form 2553

Click here to view image.

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)Tax LawFederal Taxpayer GroupsS CorporationsTaxable Year (IRC secs. 1361, 1378)Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)RequirementsTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs.

1362-1363)Effects



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART IV. FORMS
A. Election of Subchapter S Status

2-2B California Legal Forms--Transaction Guide § 2B.201

§ 2B.201 Shareholder's Consent to Corporation's Election to Be Treated as S Corporation [I.R.C. § 1362(a)]

[1] Comment

[a] Use of Form

This form is a shareholder's consent to a corporation's election to be treated as an S corporation. It should be used when the consent is submitted as a separate attachment to IRS Form 2553. When a corporation elects to be taxed as a Subchapter S corporation, all of the shareholders must consent [*see I.R.C. § 1362(a)(2)*]. If the election is made within the corporation's first tax year for which it is effective, anyone who was a shareholder during that year and prior to the election, but who is not a shareholder at the time of the election, must also consent [*Treas. Reg. § 1.1362-6(b)(3)(i)*].

The consent of each shareholder is usually entered in Column K of IRS Form 2553 [*see § 2B.200*]. Alternatively, however, shareholder consents may be submitted in the form of a separate attachment or attachments [*see Treas. Reg. § 1.1362-6(b)(1)*]. Separate consent forms may be preferable when it is necessary to obtain the signatures by mail. The possibility of losing the election form and the consequent duplication of effort required to reacquire the signatures can thus be eliminated.

[b] Contents of Consent

In addition to an affirmative statement that the shareholder consents to the corporate election, the statement of consent must set forth the following [*Treas. Reg. § 1.1362-6(b)(1)*]:

- The names and addresses of the corporation and the shareholder.
- Taxpayer identification numbers of the corporation and the shareholder.
- The number of shares owned by the shareholder.
- The date or dates on which those shares were acquired by the shareholder.

- The date on which the shareholder's tax year ends.

The statement must be signed by the shareholder under penalty of perjury [*Treas. Reg. § 1.1362-6(b)(1)*]. No official IRS Form is provided for separate shareholder consents.

[2] Form

Shareholder's Consent to Corporation's Election to Be Treated as S Corporation

ELECTING SUBCHAPTER S STATUS
SHAREHOLDERS' CONSENT

The undersigned, being a shareholder of _____[*name of corporation*], a California corporation, hereby consents to the election of that corporation, made on Internal Revenue Service Form 2553 to which this statement is attached, to be subject to the provisions of Subchapter S of the Internal Revenue Code of 1986.

1. The name and address of the corporation are _____[*name of corporation*], _____[*street address*], _____, California. The corporation's taxpayer identification number is _____.

2. The undersigned shareholder's name, address, and taxpayer identification number are as follows:

Name and Address: _____ [*name*]
_____ [*address*]

Taxpayer Identification Number: _____

3. The undersigned shareholder's tax year ends on _____[*date*].

4. The number of shares owned by the undersigned shareholder, and the date or dates when the undersigned shareholder acquired those shares, are as follows:

Number of Shares _____.

Date(s) Acquired _____.

Under penalties of perjury, I declare that I have examined this statement and to the best of my knowledge and belief, it is true, correct, and complete.
_____ Dated:

_____ [*signature*]
[*typed name*]

[*OR, if minor owns shares:*]

_____ [*name*], a Minor
By _____ [*signature*], Guardian
[*typed name*]

[*OR, if shares are held in common ownership:*]

_____ [*signature*], Cotenant
[*typed name*]
_____ [*signature*], Cotenant
[*typed name*]

[*OR, if shares are held in trust:*]

_____ [*name of trust*],
A _____ [*type*] Trust
_____ [*signature of grantor, grantor's estate, testator's estate, or beneficiary of voting trust, electing small business trust, or qualified Subchapter S trust*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART IV. FORMS
A. Election of Subchapter S Status

2-2B California Legal Forms--Transaction Guide § 2B.202

§ 2B.202 Application by Corporation for Extension of Time Within Which to File Shareholders' Consents to Subchapter S Election [Treas. Reg. § 1.1362-6(b)(3)(iii)]

[1] Comment

[a] Use of Form

This form is an application by a corporation seeking Subchapter S corporation status for an extension of time to file shareholders' consents to Subchapter S election. Ordinarily, a Subchapter S election is effective for the current tax year if it is filed at any time during the preceding tax year [*I.R.C. § 1362(b)(1)(A)*], or on or before the 15th day of the third month of the current tax year [*I.R.C. § 1362(b)(1)(B)*]. However, if a shareholder has failed to consent, the election is treated as having been made for the following tax year [*I.R.C. § 1362(b)(2)*]. This form should be used to avoid having the election treated as made for the following tax year.

This form has been designed to be filed with IRS Form 2553 [*see § 2B.200[2]*] if the corporation is unable to file the consents of one or more of its shareholders within two and one-half months after the start of its first tax year.

[b] Requirements for Time Extension

An election that is timely for any tax year and that would be valid except for the failure of a shareholder to file a timely consent is not invalid for that reason if an application for an extension of the time to file shareholder consents is approved [*see Treas. Reg. § 1.1362-6(b)(3)(iii)*]. The corporation must show, to the satisfaction of the IRS, that reasonable cause existed for its failure to file the consent, that the request for the extension of time to file a consent is made within a reasonable time under the circumstances, and that the government's interests will not be jeopardized by treating the election as valid [*Treas. Reg. § 1.1362-6(b)(3)(iii)*]. If the application is approved, the shareholders whose consents were the subject of the application must be filed within the extension period granted by the IRS and consents must also be filed by all those who became shareholders after the election was filed [*see Treas. Reg. § 1.1362-6(b)(3)(iii)(B)*].

[c] Untimely Election

If the election (rather than the consents to it) is too late to be effective for the current tax year, there is no provision allowing an extension of time to make a Subchapter S election. Therefore, the election itself must be timely to be effective for a current tax year. However, an untimely election can still operate as an election for the following tax year. An election will be treated as made for the following tax year if made after the 15th day of the third month of the current tax year and on or before the 15th day of the third month of the following tax year [*I.R.C. § 1362(b)(3)*].

[2] Form

Application by Corporation for Extension of Time Within Which to File Shareholders' Consents to Subchapter S Election

APPLICATION FOR EXTENSION

Internal Revenue Service Center
_____[Fresno, CA 93888 *or* Ogden, UT 84201]

RE: _____[*name of corporation*] Application for Extension of Time to File Consents of Shareholders to Election Under *Internal Revenue Code Section 1362*

_____[*name of corporation*] hereby applies for an extension of time to file the consents of its shareholders to its election to be subject to the provisions of Subchapter S of the Internal Revenue Code of 1986 and states:

1. It is a corporation duly incorporated under the laws of the State of California on _____[*date articles of incorporation filed with Secretary of State*].

2. It _____[acquired assets *or* began doing business] on _____[*date less than two and one-half months before date election and application will be filed*].

3. It attaches its election on IRS Form 2553 to be subject to the provisions of Subchapter S of the Internal Revenue Code of 1986.

4. The consents of the following shareholders to the corporation's election to be subject to the provisions of Subchapter S of the Internal Revenue Code, cannot be filed with the corporation's election on IRS Form 2553 for the following reasons: _____[*detailed reasons consent of shareholder(s) not timely filed*]. The persons named below have agreed and are willing to execute consents to the corporation's election to be taxed as a Subchapter S corporation:

_____ [*name*]
_____ [*name*]
_____ [*name*]

5. This request for the extension of time to file a consent is made within a reasonable time under the circumstances in that _____[*facts showing reason application made within reasonable time*].

6. The interest of the government will not be jeopardized by treating its election, filed herewith on Form 2553, as valid, for the reason that _____[*set forth reason*].

Under penalties of perjury, I declare that I have examined this statement and to the best of my knowledge and belief, it

is true, correct, and complete.
_____ Dated:

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsTaxable Year (IRC secs. 1361, 1378)Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)RequirementsTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Effects



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART IV. FORMS
A. Election of Subchapter S Status

2-2B California Legal Forms--Transaction Guide § 2B.203

§ 2B.203 Statement of Business Purpose

[1] Comment

[a] Use of Form

This statement of business purpose must be attached to IRS Form 2553 [*see § 2B.200[2]*] when a corporation wishing to use a fiscal year is not eligible for expedited IRS approval of that fiscal year. A corporation that qualifies for expedited approval does not need to attach this statement to IRS Form 2553; expedited approval can be obtained for a "natural business year" or an "ownership year" [*see § 2B.200[1][c][iii]*]. The corporation must also attach a statement showing separately the amount of gross receipts from sales or services (and inventory costs, if applicable) for each of the most recent 47 months [*see Rev. Proc. 87-32, 1987-2 C.B. 396* ; IRS Form 2553, Instructions]. A corporation that lacks a 47-month period of gross receipts cannot establish a natural business year [*see Rev. Proc. 87-32* , § 4.01(1), *1987-2 C.B. 396* ; § 2B.200[2] (IRS Form 2553, Instructions)].

[b] Statement Requirements

The statement must set forth the corporation's business purpose for the desired tax year [*Rev. Proc. 87-32, 1987-2 C.B. 396*]. Deferral of income to shareholders is not a satisfactory business purpose [*I.R.C. § 1378(b)*; *see Rev. Rul. 87-57, 1987-2 C.B. 117* (examples of acceptable business purposes for fiscal tax year)].

The statement must comply with the requirements applicable to ruling requests generally [*Rev. Proc. 87-32, 1987-2 C.B. 396* ; *see* IRS Form 2553, Instructions], including attachment of a completed "Checklist" [*see, e.g., Rev. Proc. 96-1, 1996-1 C.B. 385* (updated annually)]. Although some statements mandated by these general requirements appear to have only marginal relevance to this particular type of request, they are included in this form to preclude any possibility that failure to do so would result in denial of the request [*see* [e], *below*]. The following information is mandated by the general ruling request requirements [*see, e.g., Rev. Proc. 96-1, 1996-1 C.B. 385* (updated annually)]:

- Name, address, telephone number, and taxpayer identification number of all interested parties.

- The location of the District Office that has jurisdiction over the return.

- A complete statement of the business reasons for the transaction.

- A detailed description of the transaction, including copies of applicable documents; all material facts from documents must be set forth in the statement, not merely incorporated by reference, and the facts must be accompanied by an analysis of their bearing on the issues.

- A statement of whether, to the best of the taxpayer's knowledge, the identical issue is in an earlier return of the taxpayer, and if so, whether it (1) is being examined by a District Director; (2) has been examined, but the statutory period of limitation for assessment or filing a claim for refund has not expired, or a closing agreement has not been entered into by a District Director; (3) is being considered by an Appeals Office; or (4) is pending in litigation.

- A statement of whether, to the best knowledge of the taxpayer and the taxpayer's representatives, an identical or similar issue has been either submitted to the IRS by the taxpayer or its predecessor but withdrawn before a ruling was issued or ruled on by the IRS with regard to the taxpayer or the taxpayer's predecessor, and, if so, when and with what results.

- A statement that no information other than names, addresses, and identifying documents need to be deleted from any ruling made public; if the taxpayer requests additional deletions, a separate deletions statement must be filed [*see I.R.C. § 6110(c)*].

- The taxpayer's views on the tax results of the proposed action and a statement of relevant authorities to support those views. The IRS encourages the taxpayer to identify, and discuss the implications of, any contrary authorities; if the taxpayer determines that no contrary authorities exist, a statement to that effect should be included.

- A statement identifying any pending legislation that may affect the transaction.

This form is drafted based on the assumption that there will be a negative response to the fifth, sixth, and seventh items above.

[c] Signature Requirements

The statement must be signed by the taxpayer or the taxpayer's authorized representative. If the request is signed by a representative, or if the representative will appear before the IRS in connection with the request, the representative must be one of the following [*see, e.g., Rev. Proc. 96-1, 1996-1 C.B. 385* (updated annually)]:

- An attorney who is a member in good standing of the bar of any state, possession, territory, commonwealth, or the District of Columbia, and who files a written declaration with the IRS showing current qualification as an attorney and current authorization to represent the taxpayer.

- A certified public accountant qualified to practice in any state, possession, territory, commonwealth, or the District of Columbia, and who files with the IRS a written declaration showing current qualification as a CPA and current authorization to represent the taxpayer.

- Any other person who is currently enrolled to practice before the IRS and who files a written declaration to that effect showing current enrollment and authorization to represent the taxpayer.

- A foreign representative who has received a letter of authorization from the IRS.

[d] Penalty of Perjury Declaration

The statement must contain a declaration, under penalty of perjury, that the declarant has examined the statement and believes the facts presented to be true, correct, and complete. The declaration must be signed by the taxpayer. For a corporate taxpayer, the person signing the declaration must be an officer of the corporate taxpayer who has personal knowledge of the facts and the officer must be one whose duties are not limited to obtaining a ruling or determination letter from the IRS [*see, e.g., Rev. Proc. 96-1, 1996-1 C.B. 385* (updated annually)].

[e] Effect of Denial

Denial of a corporation's tax year request renders its S corporation election ineffective unless the corporation files a back-up request [*Rev. Proc. 87-32, 1987-2 C.B. 396*]. Part II(Q) of IRS Form 2553 contains a box that may be checked if the corporation intends to make a back-up election under *I.R.C. § 444* in the event the IRS fails to approve the business purpose request. Part II(Q) of IRS Form 2553 also contains a box to be checked to show the corporation's agreement to adopt or change to a calendar year if the IRS either fails to approve both the business purpose request and the back-up Section 444 election, or fails to approve the business purpose request and the corporation did not make a back-up Section 444 election.

[2] Form

Statement of Business Purpose

STATEMENT OF BUSINESS PURPOSE

_____[*name of corporation*]
_____[*corporate address*]
_____[*telephone number*]
_____[*taxpayer identification number*]

Internal Revenue Service District Office with jurisdiction over corporation's tax returns:
_____[*location*]

1. This corporation proposes to adopt a tax year ending _____[*month and day*] of each year, effective _____[*date proposed tax year will take effect*].

2. The business purpose of this tax year will be as follows: _____[*full and precise statement of purpose*].

3. The following authorities support the use of the proposed tax year for business purposes: [*set forth authorities*].

[*Choose one of the following paragraphs:*]

4. Taxpayer knows of no contrary authorities.

[*OR*]

4. The following authorities are believed contrary to the taxpayer's position: _____[*discussion of contrary authorities and implications of those authorities*].

[*Continue with the following:*]

5. To the best of the knowledge of this taxpayer, and its representatives, the identical issue presented here is not presented in any return of this taxpayer.

6. To the best knowledge of this taxpayer, and its representatives, no identical or similar issue has been presented by this taxpayer or any predecessor of this taxpayer and withdrawn before a ruling was issued or ruled on by the Internal Revenue Service.

7. No information other than names, addresses, and identifying documents need to be deleted if a ruling on this matter is made public.

8. The tax results of the requested tax year will be as follows: _____[*taxpayer's views on tax results and supporting authorities*].

_____ [*name of corporation*]
By _____[*signature of officer or authorized representative*]
[*typed name and title*]

Declaration

Under penalty of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the requested ruling or determination letter are true, correct, and complete.

_____ [*signature of officer*]
_____ [*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)RequirementsTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Effects



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART IV. FORMS
A. Election of Subchapter S Status

2-2B California Legal Forms--Transaction Guide § 2B.204

§ 2B.204 Request for Consent of IRS to Election Within Five Years After Termination or Revocation of Prior S Corporation Election [I.R.C. § 1362(g)]

[1] Comment

[a] Use of Form

This form may be used to state the reasons why the Internal Revenue Service should consent to a new Subchapter S election within five years after the corporation's prior Subchapter S election was terminated or revoked. This form should be attached to and filed with a newly completed S corporation election form (IRS Form 2553) [*see § 2B.200*]. The fact that this form is attached should be noted on the face of Form 2553. This form will require modification to fit the particular circumstances of each case; all of the facts supporting the corporation's position should be explained in detail. The general requirements for a ruling request must be satisfied, including attachment of a completed Checklist [*see § 2B.203[1][b]*].

[b] Obtaining Consent to Election

A corporation may not make a new Subchapter S election within five years after its prior election was revoked or terminated unless the IRS consents to the new election [*I.R.C. § 1362(g)*]. The corporation has the burden of showing that, under the relevant facts and circumstances, consent should be given [*Treas. Reg. § 1.1362-5(a)*]. The fact that more than 50 percent of the corporation's stock is now owned by persons who did not own any stock in the corporation on the termination date tends to establish that consent should be granted [*Treas. Reg. § 1.1362-5(a)*]. In the absence of this fact, consent ordinarily will be denied unless the corporation shows that the terminating event was not reasonably within the control of the corporation or shareholders having a substantial interest in the corporation and was not part of a plan on the part of the corporation or of the shareholders to terminate the election [*Treas. Reg. § 1.1362-5(a)*].

[2] Form

Request for Consent of IRS to Election Within Five Years After Termination or Revocation of Prior S Corporation Election

REQUEST FOR CONSENT TO ELECTION BY SMALL BUSINESS CORPORATION WITHIN FIVE YEARS AFTER _____ [TERMINATION *OR* REVOCATION] OF ITS PRIOR ELECTION

_____[*name of corporation*]
_____[*corporate address*]
_____[*telephone number*]
_____[*taxpayer identification number*]

Internal Revenue Service District Office with jurisdiction over corporation's tax returns:
_____[*location*]

1. _____[*name of corporation*] (the "Corporation") made an election to be treated as an electing small business corporation under Subchapter S of the Internal Revenue Code of 1954 on _____[*date*]. That election was _____[terminated *or* revoked] on _____[*date*], effective for the tax year ending _____[*date*], and for all succeeding tax years, because _____[*state reason for termination or revocation in detail*].

[*Choose one of the following paragraphs:*]

[*If more than 50 percent of stock is owned by persons who did not own any stock during first tax year for which termination or revocation was applicable, use:*]

2. More than 50 percent of the outstanding stock of the Corporation is owned, directly or indirectly, by persons who did not own, directly or indirectly, any stock of the Corporation during the first year for which the _____[termination *or* revocation] was applicable. The following persons owned all of the outstanding stock of the Corporation during the first tax year for which the termination was applicable:

Name	Address	Number of Shares Owned	Dates Owned
_____	_____	_____	_____
_____	____	_	____
_____	_____	_____	_____
_____	____	_	____
_____	_____	_____	_____
_____	____	_	____
_____	_____	_____	_____
_____	____	_	____

The following persons now own all of the outstanding stock of the Corporation:

An error occurred in the processing of a table at this point in the document. Please refer to the table in the online document.

[*OR*]

[*If event causing termination was not reasonably within control of corporation or shareholders and was not part of plan to terminate election, use:*]

2. The event causing the termination of the election of the Corporation to be treated as an electing small business corporation was not part of a plan to terminate the election in which those shareholders having a substantial interest in the Corporation participated. The termination was caused by _____[*describe in detail event that caused termination and why event was not within the control of corporation or those shareholders with substantial interest*].

[*Continue with the following:*]

3. The following authorities support taxpayer's request for consent to its Subchapter S election within five years after the _____[termination *or* revocation] of its prior election: [*set forth authorities*].

[*Choose one of the following paragraphs:*]

4. Taxpayer knows of no contrary authorities.

[*OR*]

4. The following authorities are believed contrary to the taxpayer's position: _____[*discuss contrary authorities and implications of those authorities*].

[*Continue with the following:*]

5. To the best of the knowledge of this taxpayer, and its representatives, the identical issue presented here is not presented in any return of this taxpayer.

6. To the best knowledge of this taxpayer, and its representatives, no identical or similar issue has been presented by this taxpayer or any predecessor of this taxpayer and withdrawn before a ruling was issued or ruled on by the Internal Revenue Service.

7. No information other than names, addresses, and identifying documents need to be deleted if a ruling on this matter is made public.

8. The tax results of consent to taxpayer's election will be as follows: _____[*taxpayer's views on tax results and supporting authorities*].

_____ [*name of corporation*]
By _____[*signature of officer or authorized representative*]
[*typed name and title*]

Declaration

Under penalty of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the requested ruling or determination letter are true, correct, and complete.

_____ [*signature of officer*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Termination (IRC sec. 1362)Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART IV. FORMS
A. Election of Subchapter S Status

2-2B California Legal Forms--Transaction Guide § 2B.205

§ 2B.205 Election to Have a Tax Year Other Than a Required Tax Year [I.R.C. § 444]--IRS Form 8716

[1] Comment

[a] Use of Form

This form is IRS Form 8716, which must be used by an S corporation (as well as by a partnership or personal service corporation) to elect a tax year other than a "permitted year" [*I.R.C. § 444*; *see I.R.C. § 1378* ("permitted year")]. It will be used by a corporation that cannot obtain expedited IRS approval of a fiscal year [*see Rev. Proc. 87-32, 1987-2 C.B. 396* ; *see also § 2B.200[1][c][iii]*] or IRS approval of a satisfactory business purpose for a fiscal year [*see I.R.C. § 1378(b)(2)*]. The official instructions are reproduced here along with the text of the form.

[b] Election Requirements

An S corporation may elect an "alternative year" if its "deferral period," that is, the period of time between the beginning of the tax year elected and the close of the first tax year otherwise required ending within that year, is no longer than three months with certain exceptions [*I.R.C. § 444(b)*]. However, no election may be made by a corporation that is part of a tiered structure, unless that tiered structure is composed of one or more partnerships or S corporations (or both) that all have the same tax year [*I.R.C. § 444(d)(3)*]. An S corporation is a member of a tiered structure if it owns any portion of, or is owned by, a partnership, S corporation, personal service corporation, or trust [*see* Temp. Treas. Reg. § 1.444-2T(b)(1), (2)]. For a further discussion of the corporation's tax year, see *§ 2B.12*.

[c] Filing Requirements

This form must be signed and dated by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or any other corporate officer authorized to sign the corporation's tax return. If a receiver, trustee in bankruptcy, or assignee controls the corporation's property or business, that person must sign the election [*see* IRS Form 8716, Instructions].

The corporation must file this form at the Internal Revenue Service Center where it will file its tax return, generally by

the earlier of the following [Temp. Treas. Reg. § 1.444-3T(b)(1)]:

- The 15th day of the fifth month following the month that includes the first day of the tax year the election will first be effective; or

- The due date (not including extensions) of the income tax return resulting from the election.

[d] Tax Consequences of Election

If the IRS accepts the election, it will stamp the form "ACCEPTED" and return a copy of the form to the corporation [*see* IRS Form 8716, Instructions]. A corporation making a Section 444 election must also make certain advance tax payments [*I.R.C. §§ 444(c)(1), 7519*]. The S corporation must make an advance payment if its "required payment" exceeds $500 [*I.R.C. § 7519(a)*]; the "required payment" is determined by adding one percentage point to the highest individual income tax rate, multiplying the net base year income of the entity by the resulting percentage, and then deducting the amount of the required payment for the preceding applicable election year [*I.R.C. § 7519(b)*].

By May 15 following the calendar year in which each election year begins, the corporation must file IRS Form 8752 for each year that the election is in effect. IRS Form 8752 is used either to calculate and make the required payments, or to obtain a refund of net prior year payments. The required payments are made on the second quarter IRS Form 720 (quarterly federal excise tax return)].

[e] Duration of Election

The elected alternative tax year remains in effect until the corporation changes its accounting period to a calendar year or some other permitted year. A change to a "permitted year" may be made without the consent of the IRS [*I.R.C. § 444(d)(2)(A)*; *see I.R.C. § 1378(b)* ("permitted year"); *see also § 2B.12*]. However, if the corporation terminates its Section 444 election by changing to a "permitted year," it cannot make another election of an alternative tax year [*I.R.C. § 444(d)(2)(B)*].

The Section 444 election also terminates if the S corporation terminates its election (unless it immediately becomes a personal service corporation), or willfully fails to comply with *I.R.C. § 7519* [*see* IRS Form 1120S Instructions (S corporation income tax return); *I.R.C. § 7519(f)(4)(C)*; *see also* [d], *above*].

[f] Use of Election as "Back-Up"

The corporation may state on IRS Form 2553 [*see § 2B.200[2]*] its intention to use the Section 444 election as a "back-up" to a request for a tax year based on a business purpose [Temp. Treas. Reg. 1.444-3T(b)(3), (4); *see I.R.C. § 1378(b)(2)*; *see also § 2B.203*]. If the business purpose year request is denied, the corporation will (if otherwise qualified) be able to obtain its desired tax year pursuant to a Section 444 election [Temp. Treas. Reg. 1.444-3T(b)(4)]. If the corporation is making a back-up election, the words "BACKUP ELECTION" must be typed or printed at the top of IRS Form 8716 [*see* Temp. Treas. Reg. § 1.444-3T(b)(4)(ii)]. To activate a Section 444 election, the corporation must file IRS Form 720 (quarterly federal excise tax return) and the required payment by the later of the regular due date for filing that return or 60 days from the date the Commissioner denies the business purpose request [Temp. Treas. Reg. §§ 1.444-3T(b)(4), 1.7519-2T].

[2] Form

Election to Have a Tax Year Other Than a Required Tax Year

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsTaxable Year (IRC secs. 1361, 1378)Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)RequirementsTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Effects



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART IV. FORMS
A. Election of Subchapter S Status

2-2B California Legal Forms--Transaction Guide §§ 2B.206-2B.219

[Reserved]

§§ 2B.206[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART IV. FORMS
B. Termination of Subchapter S Status

2-2B California Legal Forms--Transaction Guide § 2B.220

§ 2B.220 Corporation's Statement Revoking Subchapter S Election--With Consent of Shareholders Attached [I.R.C. § 1362(d)(1)]

[1] Comment

[a] Use of Form

This form is to be used by an S corporation and its shareholders to revoke the corporation's Subchapter S election. A Subchapter S election may be terminated by revocation if and when shareholders holding more than half of the corporation's stock on the day of the revocation consent to the revocation [*I.R.C. § 1362(d)(1)(A), (B)*]. The revocation statement, including the shareholder consents, must be filed with the service center where the corporation's original Subchapter S election was filed [*see Treas. Reg. § 1.1362-6(a)(3)*]. See *§ 2B.13* for further discussion of revocation by shareholders, and *§ 2B.121* for the procedures involved.

[b] Effective Date of Revocation

If the statement of revocation specifies a revocation date, the revocation will be effective on and after that date [*I.R.C. § 1362(d)(1)(D)*]. In the absence of a specified date, however, a revocation made on or before the 15th day of the third month of the current tax year is effective from the first day of the taxable year [*I.R.C. § 1362(d)(1)(C)(i)*]; a revocation made during the current tax year but later than the 15th day of its third month will be effective from the first day of the next tax year [*I.R.C. § 1362(d)(1)(C)(ii)*]. If a revocation date other than the beginning of any tax year is specified, it will be necessary to divide the tax year in which the termination occurs into two separate parts for tax accounting purposes [*see I.R.C. § 1362(e)*]. For the procedures involved in tax accounting in the termination year, see *§ 2B.121[4]*.

[c] Contents of Form

The statement of revocation must state that the corporation revokes its prior Subchapter S election; it must also state the number of shares (including nonvoting stock) issued and outstanding at the time of the revocation [*Treas. Reg. § 1.1362-6(a)(3)*]. If intra-year tax accounting is to be avoided [*see* [b], *above*], the statement should specify a date that is the beginning of the current tax year if the statement and revocation are made within the first two and one-half months

of that tax year or the beginning of the next tax year if made after the first two and one-half months.

The statement of revocation must be accompanied by a signed statement of consent for each of the requisite number of shareholders [*see I.R.C. § 1362(d)(1)(A), (B); see also Treas. Reg. § 1.1362-6(a)(3), (b)*]. The statement of consent must indicate the number of issued and outstanding shares (including nonvoting stock) held by each shareholder at the time of the revocation, as well as each shareholder's consent to the revocation [*Treas. Reg. § 1.1362-6(a)(3), (b)*]. Each consent must also set forth the name, address, and taxpayer identification number of the consenting shareholder, the date or dates on which the stock was acquired by the shareholder, the date on which the shareholder's tax year ends, and the name and taxpayer identification number of the corporation [*Treas. Reg. § 1.1362-6(b)*].

[d] Execution of Form

The statement of revocation should be signed by a person authorized to sign the corporation's tax return [*see Treas. Reg. § 1.1362-6(a)*]. These persons include the corporation's president, vice president, treasurer or assistant treasurer, chief accounting officer, or other person duly authorized to sign the return [*see I.R.C. § 6062*]. The accompanying consents must be signed under penalty of perjury by the shareholders concerned [*Treas. Reg. § 1.1362-6(b)*].

[2] Form

Corporation's Statement Revoking Subchapter S Election--With Consent of Shareholders Attached

STATEMENT OF REVOCATION

District Director of Internal Revenue
_____[*address of office in which election was filed*]

RE: _____[*name of S corporation*]
Taxpayer Identification Number: _____
Revocation of Subchapter S Election

_____[*name of S corporation*], a California Corporation, whose address is _____[*street address*], _____, California, hereby revokes its election filed with you on IRS Form 2553 dated _____ to be subject to the provisions of Subchapter S of the Internal Revenue Code of 1954. There are _____[*number*] shares of the corporation's stock (including nonvoting stock) issued and outstanding at the time of this revocation. This revocation is intended to be effective _____[on and after _____ (*specify date*) or for the corporation's tax year beginning _____ (*specify date, either current tax year or next tax year*)].
_____Dated:

_____ [*name of corporation*]
By _____ [*signature of officer or authorized representative*]
[*typed name and title*]

SHAREHOLDER'S CONSENT TO REVOCATION OF SUBCHAPTER S ELECTION

The undersigned, being a shareholder of _____[*name of corporation*], a California corporation, hereby consents to the revocation by that corporation of its election to be subject to the provisions of Subchapter S of the Internal Revenue Code of 1986.

1. The name and address of the corporation are: _____[*name of corporation*], _____[*street address*], _____, California. The corporation's taxpayer identification number is: _____.

2. The undersigned shareholder's name and address and taxpayer identification number are as follows:

Name: _____
Address: _____
Taxpayer Identification Number: _____

3. The undersigned shareholder's tax year ends on _____[*date*].

4. The number of shares owned by the undersigned shareholder, and the date or dates when the undersigned shareholder acquired those shares, are as follows:

An error occurred in the processing of a table at this point in the document. Please refer to the table in the online document.

Under penalty of perjury, I declare that I have examined this statement and to the best of my knowledge and belief, it is true, correct, and complete.
_____ Dated:

_____ [*signature*]
[*typed name*]

[*OR, if minor owns shares:*]

_____ [*name*], a Minor
By _____ [*signature*], Guardian
[*typed name*]

[*OR, if shares are held in common ownership:*]

_____ [*signature*], Cotenant
[*typed name*]
_____ [*signature*], Cotenant
[*typed name*]

[*OR, if shares are held in trust:*]

_____ [*name of trust*],
A _____ [*type*] Trust
_____ [*signature of grantor, grantor's estate, testator's estate, or beneficiary of voting trust, electing small business trust, or qualified Subchapter S trust*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Termination (IRC sec. 1362)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 2B ELECTING SUBCHAPTER S STATUS
PART IV. FORMS
B. Termination of Subchapter S Status

2-2B California Legal Forms--Transaction Guide § 2B.221

§ 2B.221 Notice of Termination of Subchapter S Status by Corporation No Longer Qualified as Small Business Corporation [I.R.C. § 1362(d)(2)]

[1] Comment

[a] Use of Form

This form is for use by an S corporation to notify the IRS that its Subchapter S status has terminated because it has ceased to be a small business corporation. This notice should be attached to the return for the tax year in which termination occurs and must state that termination has occurred and specify the date of termination [*Treas. Reg. § 1.1362-2(b)(1)*].

[b] Loss of Small Business Corporation Status

An election of Subchapter S status terminates when an S corporation ceases to qualify as a small business corporation [*see I.R.C. § 1362(d)(2)*]. In general, an S corporation ceases to be a small business corporation when it becomes an ineligible corporation, when it has more than 100 shareholders, has impermissible shareholders, or issues more than one class of shares [*see I.R.C. § 1361(b)*]. See *§§ 2B.10* and *2B.110* for further discussion of qualification as a small business corporation eligible for S corporation treatment.

[c] Effective Date of Termination

If the election terminates because of a specific event that caused the corporation to no longer meet the definition of small business corporation, S corporation status terminates on the same day that the specific event occurs [*I.R.C. § 1362(d)(2)(B)*; *Treas. Reg. § 1.1362-2(b)(2)*]. If an election is filed to take effect beginning with the following taxable year and the corporation is not a small business corporation on the first day of that following taxable year, the election is treated as having terminated on that first day. If a corporation is a small business corporation on the first day of the taxable year for which the election is effective, the election does not terminate even if the corporation is not a small business corporation during all or part of the period beginning after the date that the election was made and ending before the first day of the taxable year for which the election is effective [*Treas. Reg. § 1.1362-2(b)(2)*].

Because the termination date is likely to be during a tax year, it will be necessary to divide the tax year in which the termination occurs into two separate parts for tax accounting purposes [*see I.R.C. § 1362(e)*]. See *§ 2B.121[4]* for the procedures involved in tax accounting in the termination year.

[2] Form

Notice of Termination of Subchapter S Status by Corporation No Longer Qualified as Small Business Corporation

NOTICE OF TERMINATION OF SUBCHAPTER S STATUS BY CORPORATION NO LONGER QUALIFIED AS SMALL BUSINESS CORPORATION

Internal Revenue Service Center
[Fresno, CA 93888 *OR* Ogden, UT 84201]

RE: _____[*name of S corporation*]
_____[*corporate address*]
_____[*telephone number*]
_____[*taxpayer identification number*]

Internal Revenue Service District Office with jurisdiction over corporation's tax returns:
_____[*location*]

Notice is hereby given, pursuant to *Treasury Regulation Section 1.1362-2(b)(1)*, that the election of _____[*name of S corporation*], a California Corporation, to be subject to the provisions of Subchapter S of the Internal Revenue Code of 1986, filed with you on _____[*date*], terminated on _____[*date*] when it ceased to qualify as a small business corporation.
_____ Dated:

_____ [*name of corporation*]
By _____ [*signature of officer or authorized representative*]
_____ [*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Termination (IRC sec. 1362)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION

2-3 California Legal Forms--Transaction Guide 3.syn

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.syn Synopsis to Chapter 3: ARTICLES OF INCORPORATION

§ 3.01 California Constitution

§ 3.02 California Statutes

§ 3.03 California Regulations

§ 3.04 [Reserved]

§ 3.05 Law Reviews and Periodicals

§ 3.06 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 3.07-3.09 [Reserved]

§ 3.10 Applicability of General Corporation Law to Specific Types of Corporations

§ 3.11 Corporate Business Activities Authorized Under General Corporation Law

§ 3.12 General Powers of Corporation Under General Corporation Law

§ 3.13 Commencement of Corporate Existence

§ 3.14 Proof of Corporate Existence

§ 3.15 Authorization Required for Certain Types of Corporations

§ 3.16 Definition of "Articles"

§ 3.17 Mandatory Provisions for Articles

[1] In General

[2] Name of Corporation

[3] Purpose of Corporation

[4] Agent for Service of Process

[5] Stock Structure

[6] Additional Statement Required for Incorporation of Existing Business Association Organized as Trust

[7] Additional Requirements for Statutory "Close Corporation"

§ 3.18 Optional or Permissive Provisions for Articles

§ 3.19 Filing Articles With Secretary of State

§§ 3.20-3.99 [Reserved]

§ 3.100 General Information for Articles

[1] Facts

Scope

[2] Documents

Scope

§§ 3.101-3.109 [Reserved]

§ 3.110 Stock Structure

Scope

§ 3.111 Corporate Actions and Business

Scope

§§ 3.112-3.119 [Reserved]

§ 3.120 Obtaining Name Clearances

Scope

§ 3.121 Executing and Filing Articles

Scope

§§ 3.122-3.129 [Reserved]

§ 3.130 Articles of Incorporation

Scope

§§ 3.131-3.139 [Reserved]

§ 3.140 Correction or Amendment of Articles

Scope

§ 3.141 Filing Mandatory Statement of Domestic Stock Corporation and Designating Agent for Service of Process

Scope

§ 3.142 Filing Certificate of Determination

Scope

§§ 3.143-3.199 [Reserved]

§ 3.200 Articles of Incorporation for Corporation With Simple Stock Structure (Long Form)

[1] Comment

[a] Use of Form

[b] Mandatory Provisions

[i] Overview

[ii] Name of Corporation

[iii] Purpose of Corporation

[iv] Agent for Service of Process

[v] Stock Structure

[c] Permissive Provisions

[d] Requirements for Provisions Made Dependent on Facts Ascertainable Outside Articles

[e] Format Specifications

[f] Execution Requirements

[g] Filing, Certified Copies, and Fees

[h] Effective Filing Date and Effect of Nonconforming Articles

[i] Cancellation of Filing for Nonpayment

[j] Special Requirements for Incorporation of Existing Business Association Organized as Trust

[i] Filing Requirements

[ii] Execution and Certification

[iii] Effect of Filing Articles

[k] Special Requirements for Articles of Corporation Formed Pursuant to Conversion of Other Business Entity or Foreign Corporation

[2] FORM

Articles of Incorporation for Corporation with Simple Stock Structure (Long Form)

§ 3.201 Short Form of Articles for General Business Corporation With Simple Stock Structure

[1] Comment--Use of Form

[2] FORM

Short Form of Articles for General Business Corporation With Simple Stock Structure

§ 3.202 Articles of Incorporation for Close Corporation

[1] Comment

[a] Use of Form

[b] Execution, Format, and Filing Requirements

[c] Definition of "Close Corporation" and Required Special Provisions for Articles

[d] Requirements for Name of Corporation

[e] Determination of Number of Shareholders

[f] Inclusion or Deletion of Required Special Provisions After Initial Incorporation

[g] Shareholders' Agreement

[i] Definition and General Provisions

[ii] Effect of Agreement on Shareholders and Transferees

[h] Termination of Status as Close Corporation

[2] FORM

Articles of Incorporation for Close Corporation

§ 3.203 Articles of Incorporation for Stock Corporation With Complex Stock Structure

[1] Comment

[a] Use of Form

[b] Execution and Filing

[c] Illustrative Stock Structure Used in Form

[d] Definition of "Class", "Series", and Other Terms

[e] Mandatory Provisions for Articles

[f] Overview of Drafting Considerations

[i] Distinction or Difference Required Between Classes or Series

[ii] Authority of Board to Fix Number, Rights, Preferences, and Restrictions for Unissued Series

[iii] Requirement That Shares of Same Class or Series Have Same Rights and Restrictions

[iv] Par Value

[2] FORM

Articles of Incorporation for Stock Corporation With Complex Stock Structure

§§ 3.204-3.209 [Reserved]

§ 3.210 Transmittal Letter for Filing Articles of Incorporation With Secretary of State

[1] Comment

[a] Use of Form

[b] Fees

[2] FORM

Transmittal Letter for Filing Articles of Incorporation With Secretary of State

§ 3.211 Certificate of Consent of Corporation to Act as Agent for Service of Process for Another Corporation [Corp. Code § 1505]--Secretary of State Form

[1] Comment

[a] Use of Form

[b] Filing Procedures

[c] Required Contents of Certificate

[d] Supplemental Filings

[e] Resignation of Agent

[f] Designation of New Agent

[2] FORM

Certificate of Consent of Corporation to Act as Agent for Service of Process for Another Corporation [Corp. Code § 1505]--Secretary of State Form

§§ 3.212-3.219 [Reserved]

§ 3.220 Business Purpose as Insurer [Corp. Code § 202(b)(1)(i), (3)]

[1] Comment

[a] Use of Form

[b] Special Filing Requirements

[2] FORM

Business Purpose as Insurer [Corp. Code § 202(b)(1)(i), (3)]

§ 3.221 Purpose Clause for Commercial Bank Not Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(a)]

[1] Comment

[a] Use of Form

[b] Applicability of Banking Law

[2] FORM

Purpose Clause for Commercial Bank Not Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(a)]

§ 3.222 Purpose Clause for Commercial Bank Also Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(b)]

[1] Comment--Use of Form

[2] FORM

Purpose Clause for Commercial Bank Also Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(b)]

§ 3.223 Purpose Clause for Trust Company (Not Also a Commercial Bank) [Corp. Code § 202(b)(2); Fin. Code § 600(e)]

[1] Comment--Use of Form

[2] FORM

Purpose Clause for Trust Company (Not Also a Commercial Bank) [Corp. Code § 202(b)(2); Fin. Code § 600(c)]

§ 3.224 Purpose Clause for Industrial Bank Not Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(c)]

[1] Comment--Use of Form

[2] FORM

Purpose Clause for Industrial Bank Not Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(c)]

§ 3.225 Purpose Clause for Industrial Bank Also Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(d)]

[1] Comment--Use of Form

[2] FORM

Purpose Clause for Industrial Bank Also Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(d)]

§§ 3.226-3.229 [Reserved]

§ 3.230 Restriction on Corporate Business Purpose or Activities

[1] Comment

[a] Use of Form

[b] Permitted Business Activities

[2] FORM

Restriction on Corporate Business Purpose or Activities

§ 3.231 Specific Restrictions on Corporate Powers

[1] Comment

[a] Use of Form

[b] Powers of Corporation

[2] FORM

Specific Restrictions on Corporate Powers

§§ 3.232-3.239 [Reserved]

§ 3.240 Rights, Preferences, Privileges, and Restrictions: Preferred Shares Issuable in Series--Certain Terms for All Series Fixed by Articles, Other Terms of Each Series to Be Fixed by Directors

[1] Comment

[a] Use of Form

[b] Mandatory Information Regarding Corporation's Stock Structure

[2] FORM

Rights, Preferences, Privileges, and Restrictions: Preferred Shares Issuable in Series--Certain Terms for All Series Fixed by Articles, Other Terms of Each Series to Be Fixed by Directors

§ 3.241 Rights, Preferences, Privileges, and Restrictions: Preferred Shares Issuable in Series--Directors Granted Broadest Authority to Fix Term of Any Series

[1] Comment

[a] Use of Form

[b] Authority of Board to Fix Terms Required to be Stated in Articles

[2] FORM

Rights, Preferences, Privileges, and Restrictions: Preferred Shares Issuable in Series--Directors Granted Broadest Authority to Fix Term of Any Series

§ 3.242 Rights, Preferences, Privileges, and Restrictions: All Terms of Preferred Class or Series Stated in Articles--Outline Form

[1] Comment

[a] Use of Form

[b] Terms Required to Be Stated in Articles

[2] FORM

Rights, Preferences, Privileges, and Restrictions: All Terms of Preferred Class or Series Stated in Articles--Outline Form

§ 3.243 Dividend Provision for Cumulative, Partially Participating Preferred Shares

[1] Comment

[a] Use of Form

[b] Authority of Corporation to Pay Dividends

[c] Dividend Cumulative Rights

[d] Dividend Rates and Date of Payment

[e] Dividend Participation Rights

[f] Requirements of Commissioner of Corporations

[2] FORM

Dividend Provision for Cumulative, Partially Participating Preferred Shares

§ 3.244 Dividend Provisions for Cumulative Nonparticipating Preferred Shares

[1] Comment--Use of Form

[2] FORM

Dividend Provisions for Cumulative Nonparticipating Preferred Shares

§ 3.245 Dividend Provision for Noncumulative, Nonparticipating Preferred Shares

[1] Comment--Use of Form

[2] FORM

Dividend Provision for Noncumulative, Nonparticipating Preferred Shares

§ 3.246 Liquidation Preferences of Preferred Shares--Cumulative and Participating

[1] Comment

[a] Use of Form

[b] Definition of "Liquidation Preference"

[c] Restrictions on Liquidation Distributions

[d] Distribution Plan Contrary to Liquidation Preferences

[e] Drafting Considerations

[2] FORM

Liquidation Preferences of Preferred Shares--Cumulative and Participating

§ 3.247 Liquidation Preferences--Noncumulative and Nonparticipating

[1] Comment--Use of Form

[2] FORM

Liquidation Preferences--Noncumulative and Nonparticipating

§ 3.248 Liquidation Preferences of Preferred Shares--Cumulative and Nonparticipating

[1] Comment--Use of Form

[2] FORM

Liquidation Preferences of Preferred Shares--Cumulative and Nonparticipating

§ 3.249 Redemption Provisions--Cumulative or Noncumulative Nonparticipating Preferred

[1] Comment

[a] Use of Form

[b] Authority for Redemption

[c] Limitations and Restrictions

[d] Redemption Price

[e] Procedure for Redemption of Shares

[i] General Requirements

[ii] Notice of Redemption

[iii] Trust Fund for Redemption of Shares

[f] Status of Redeemed Shares and Required Amendment of Articles

[g] Need for Redemption Provisions

[2] FORM

Redemption Provisions--Cumulative or Noncumulative Nonparticipating Preferred

§ 3.250 Creation of Sinking Fund for Redemption of Preferred Shares

[1] Comment

[a] Use of Form

[b] Distinction Between Ordinary Redemption and Sinking Fund Redemption

[c] Drafting Considerations

[2] FORM

Creation of Sinking Fund for Redemption of Preferred Shares

§ 3.251 Conversion Rights With Antidilution Provisions Based on Conversion Price Theory

[1] Comment

[a] Use of Form

[b] General Definition of "Conversion"

[c] Authority of Corporation to Issue Convertible Shares

[d] Regulations of Commissioner of Corporations

[e] Effect of Conversion

[f] Amendment of Articles to Increase Shares

[g] Fractional Shares

[h] Protection Against Dilution of Conversion Rights

[i] Drafting Considerations

[2] FORM

Conversion Rights With Antidilution Provisions Based on Conversion Price Theory

§ 3.252 Conversion Rights of Preferred Shares With Antidilution Provisions Based on Market Value Theory

[1] Comment

[a] Use of Form

[b] Antidilution Adjustment Based on Market Price Theory

[2] FORM

Conversion Rights of Preferred Shares With Antidilution Provisions Based on Market Value Theory

§ 3.253 Contingent Voting Rights for Cumulative Preferred Shares--To Elect Majority of Directors

[1] Comment

[a] Use of Form

[b] Contingent Voting Rights of Preferred Shares

[c] Voting Rights in General

[d] Call and Notice of Special Meeting of Shareholders

[2] FORM

Contingent Voting Rights for Cumulative Preferred Shares--To Elect Majority of Directors

§ 3.254 Contingent Voting Rights for Cumulative Preferred Shares--To Elect All of Directors

[1] Comment--Use of Form

[2] FORM

Contingent Voting Rights for Cumulative Preferred Shares--To Elect All of Directors

§ 3.255 Protective Provisions for Preferred Shares

[1] Comment

[a] Use of Form

[b] Protective Provisions Required by Commissioner of Corporations

[c] Statutory Protections for Certain Amendments to Articles

[2] FORM

Protective Provisions for Preferred Shares

§ 3.256 Rights of Common Shares

[1] Comment

[a] Use of Form

[b] Voting Rights In General

[2] FORM

Rights of Common Shares

§ 3.257 Prohibition Against Reissuance of Preferred Shares Acquired by Corporation

[1] Comment

[a] Use of Form

[b] Status of Acquired Shares and Required Amendment of Articles

[2] FORM

Prohibition Against Reissuance of Preferred Shares Acquired by Corporation

§§ 3.258-3.259 [Reserved]

§ 3.260 Grant of Authority to Levy Assessments on Shares

[1] Comment

[a] Use of Form

[b] Statutory Requirements for Assessment of Shares

[c] Exclusivity of Statutory Remedy

[d] Required Information for Levy of Assessment

[e] Notice Requirements

[f] Effect of Assessment as Lien and Waiver of Lien

[g] Postponement of Sale

[h] Penalty Imposed for Payment After Delinquency

[i] Sale and Transfer of Shares

[j] Secretary's Certificate of Sale

[k] Irregularities in Proceeding

[2] FORM

Grant of Authority to Levy Assessments on Shares

§ 3.261 Authorization for Shareholders to Determine Price or Consideration for Shares

[1] Comment--Use of Form

[2] FORM

Authorization for Shareholders to Determine Price or Consideration for Shares

§ 3.262 Preemptive Rights to Purchase Shares Granted to Shareholders

[1] Comment--Use of Form

[2] FORM

Preemptive Rights to Purchase Shares Granted to Shareholders

§ 3.263 Restricting Shareholders to Persons with Special Qualifications

[1] Comment--Use of Form

[2] FORM

Restricting Shareholders to Persons with Special Qualifications

§ 3.264 Restrictions on Transfer of Shares

[1] Comment

[a] Use of Form

[b] Funding the Purchase

[c] Purchase Price

[d] Required Notice of Restriction on Share Certificate

[e] Rules of Commissioner of Corporations

[2] FORM

Restrictions on Transfer of Shares

§§ 3.265-3.269 [Reserved]

§ 3.270 Requiring Vote of Larger Proportion of Shareholders Than Otherwise Required by Law

[1] Comment--Use of Form

[2] FORM

Requiring Vote of Larger Proportion of Shareholders Than Otherwise Required by Law

§ 3.271 Approval of Shareholders or Outstanding Shares Required to Hypothecate Corporate Property

[1] Comment

[a] Use of Form

[b] Power of Corporation to Hypothecate Its Property

[c] Inclusion of Provision in Articles

[2] FORM

Approval of Shareholders or Outstanding Shares Required to Hypothecate Corporate Property

§ 3.272 Provision That Alters Statutory Quorum Requirements for Shareholders' Meeting

[1] Comment--Use of Form

[2] FORM

Provision That Alters Statutory Quorum Requirements for Shareholders' Meeting

§ 3.273 Restrictions on, or Elimination of, Shareholder Action by Written Consent

[1] Comment--Use of Form

[2] FORM

Restrictions on, or Elimination of, Shareholder Action by Written Consent

§ 3.274 Election of One or More Directors by Holders of Class or Series of Shares

[1] Comment

[a] Use of Form

[b] Election of Directors

[2] FORM

Election of One or More Directors by Holders of Class or Series of Shares

§ 3.275 Grant of Voting Rights to Corporation's Debtholders

[1] Comment

[a] Use of Form

[b] General Power of Corporation to Incur Indebtedness

[c] Rules of Commissioner of Corporations

[2] FORM

Grant of Voting Rights to Corporation's Debtholders

§§ 3.276-3.279 [Reserved]

§ 3.280 Elimination of Directors' Liability for Monetary Damages (to Maximum Extent Permitted by Law)

[1] Comment

[a] Use of Form

[b] Limitation or Elimination of Liability

[c] Language of Provision

[2] FORM

Elimination of Directors' Liability for Monetary Damages (to Maximum Extent Permitted by Law)

§ 3.281 Authorization to Indemnify Directors and Officers to Maximum Extent Permitted by Law

[1] Comment

[a] Use of Form

[b] Definition of "Agent"

[c] Statutory Authorization for "Excess Indemnification"

[d] Advancement of Expenses

[e] Language of Provision Authorized by Statute

[2] FORM

Authorization to Indemnify Directors and Officers to Maximum Extent Permitted by Law

§ 3.282 Provision for Variable Number of Directors

[1] Comment

[a] Use of Form

[b] Designating Number of Directors in Articles or Bylaws

[c] Minimum Number of Directors

[d] Variable Board of Directors

[e] Different Classes of Directors for Listed Corporations

[2] FORM

Provision for Variable Number of Directors

§ 3.283 Provision for Fixed Number of Directors

[1] Comment--Use of Form

[2] FORM

Provision for Fixed Number of Directors

§ 3.284 Names and Addresses of Initial Directors

[1] Comment

[a] Use of Form

[b] Execution and Acknowledgment

[c] Special Restrictions on Amending Provision That Names Initial Directors

[2] Form

Names and Addresses of Initial Directors

§ 3.285 Requirement That Directors Possess Particular Qualifications

[1] Comment--Use of Form

[2] Form

Requirement That Directors Possess Particular Qualifications

§ 3.286 Designation of Persons Authorized to Call Board Meeting

[1] Comment

[a] Use of Form

[b] Notice of Meetings

[2] Form

Designation of Persons Authorized to Call Board Meeting

§ 3.287 Establishing Higher or Lower Quorum for Board of Directors

[1] Comment--Use of Form

[2] Form

Establishing Higher or Lower Quorum for Board of Directors

§ 3.288 Increasing Vote Required for Director Action

[1] Comment--Use of Form

[2] Form

Increasing Vote Required for Director Action

§ 3.289 Restrictions on Board's Power to Adopt, Amend, or Repeal Bylaws

[1] Comment

[a] Use of Form

[b] Corporate Powers Regarding Bylaws

[2] FORM

Restrictions on Board's Power to Adopt, Amend, or Repeal Bylaws

§§ 3.290-3.299 [Reserved]

§ 3.300 Limiting Duration of Corporate Existence to Specified Date

[1] Comment--Use of Form

[2] FORM

Limiting Duration of Corporate Existence to Specified Date

§§ 3.301-3.309 [Reserved]

§ 3.310 Certificate of Determination That Designates Initial Series of Preferred Shares and Fixes Number of Shares, and Rights, Preferences, Privileges, and Restrictions for That Series

[1] Comment

[a] Use of Form

[b] Shareholder Approval Required for Supermajority Vote Provision

[c] Execution and Filing Requirements

[2] FORM

Certificate of Determination That Designates Initial Series of Preferred Shares and Fixes Number of Shares, and Rights, Preferences, Privileges, and Restrictions for That Series

§ 3.311 Amendatory Certificate of Determination to Alter or Revoke Certain Rights, Preferences, Privileges, or Restrictions Fixed in Previously Filed Certificate of Determination

[1] Comment

[a] Use of Form

[b] Formal Requirements for Certificate

[c] Shareholder Approval Requirement

[2] FORM

Amendatory Certificate of Determination to Alter or Revoke Certain Rights, Preferences, Privileges, or Restrictions Fixed in Previously Filed Certificate of Determination

§ 3.312 Amendatory Certificate of Determination to Increase or Decrease Number of Shares in Series Fixed in Previously Filed Certificate of Determination

[1] Comment

[a] Use of Form

[b] Authority of Board to Change Number of Shares in Series

[c] Procedure to Increase or Decrease Number of Shares

[2] FORM

Amendatory Certificate of Determination to Increase or Decrease Number of Shares in Series Fixed in Previously Filed Certificate of Determination

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FOOTNOTES:

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION

2-3 California Legal Forms--Transaction Guide Scope

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

Scope

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Practice Consultants Scope

This chapter covers the requirements for drafting and filing articles of incorporation for a general business corporation that will be incorporated under the General Corporation Law. The Legal Background summarizes the general requirements for articles. The Transaction Guide includes a drafting guide and procedural guide for filing articles with the Secretary of State. The bulk of this chapter consists of illustrative forms, including complete sets of articles and separate, alternative, and optional provisions that may be included in the articles. Related forms are also included; for example, certificates of determination that must be filed with the Secretary of State under certain circumstances [*see § 3.310*] and a consent form that must be filed by a corporation that will be designated as another corporation's agent for service of process [*see § 3.211*].

Coverage in this chapter is limited to the formal requirements for drafting and filing articles of incorporation under the General Corporation Law and does not discuss other matters related to the initial incorporation process that are covered elsewhere in this set. For example, general preincorporation considerations (including subscription and promotion agreements and preincorporation agreements to incorporate) are covered in Ch. 2, *Formation of Corporations* . Incorporating a going business and electing Subchapter S status are covered in Ch. 2A, *Incorporating a Going Business* , and Ch. 2B, *Electing Subchapter S Status* , respectively. Corporate financing, including the issuance of equity and debt securities, is discussed in Ch. 6I, *Issuance of Equity Securities* , and Ch. 6J, *Issuance of Debt Securities* [*see also* Ballantine & Sterling, California Corporation Laws, Ch. 3, *Formation of Corporations* (Matthew Bender)]. Requirements for the qualification of securities and exemptions from qualification are also covered in Ch. 6, *Securities Regulation Issues* , and in Chs. 6A-6D. For coverage of state and federal licensing, permit, and registration requirements that may apply to a particular type of business, see Chs. 1A- 1F.

The incorporation of professional corporations and nonprofit corporations, including the requirements for articles of incorporation, are covered separately in Ch. 12A, *Professional Corporations* , and in Ch. 13, *Nonprofit Corporations* . Foreign corporations are covered in Ch. 12B, *Foreign Corporations and Associations* . The conversion of foreign and domestic other business entities or foreign corporations into California corporations, including the statutory

requirements for articles of incorporation, are covered separately in Ch. 11F, *Corporate Conversions* .

FOOTNOTES:

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART I. RESEARCH GUIDE
A. Primary Sources

2-3 California Legal Forms--Transaction Guide § 3.01

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§ 3.01 California Constitution

Reservation of power to Legislature to amend or repeal laws concerning corporations. *Cal. Const., art. XX, § 5*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART I. RESEARCH GUIDE
A. Primary Sources

2-3 California Legal Forms--Transaction Guide § 3.02

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§ 3.02 California Statutes

Fictitious business name statement. *Bus. & Prof. Code §§ 17900-17930*.

Filing fees for instruments filed with Secretary of State.

Fee determined by reference to Government Code. *Corp. Code § 108*.

Certification by Secretary of State of filed instrument. Code §§ 12182, 12183, 12185.

Articles of incorporation. Code § 12186.

Statement of corporate officers and designation of agent for service of process. Code 12186(g).

Certificates of consent of corporation to act as agent for service of process. Code § 12186(p).

Provisions of articles made dependent on facts ascertainable outside articles. *Corp. Code § 109.5*.

Filing and effective date for articles; nonconformity to law as grounds for nonfiling. *Corp. Code § 110*.

Cancellation of filing of articles for nonpayment of filing fee or franchise tax. *Corp. Code § 110.5*.

Definition of "articles." *Corp. Code § 154*.

Definition of "close corporation" and special requirements for articles. *Corp. Code § 158*.

Corporations subject to Banking Law. *Corp. Code § 163*.

Persons authorized to form corporation by filing articles. *Corp. Code § 200(a)*.

Execution requirements for articles. *Corp. Code § 200(b)*.

Acknowledgment of articles by named directors. *Corp. Code § 200(b)*.

Commencement of corporate existence on filing of articles. *Corp. Code § 200(c)*.

Supplemental information required in articles for incorporation of existing business association organized as trust. Civ. Code § 200.5.

Restrictions on corporate names containing "bank," "trust," "trustee," or related words. *Corp. Code § 201(a)*.

Restrictions on misleading or similar corporate names. *Corp. Code § 201(b)*.

Reservation of corporate name. *Corp. Code § 201(c)*.

Approval required for corporation doing business as insurer. *Corp. Code § 201.5*.

Mandatory provisions for articles of incorporation. *Corp. Code § 202*.

Designation of agent for service of process required in articles. *Corp. Code § 202(c)*.

Requirement that distinctions between classes or series of shares appear in articles. *Corp. Code § 203*.

Special requirements for articles of corporation with more than one class or series of shares. *Corp. Code § 203.5*.

Optional provisions for articles of incorporation. *Corp. Code § 204*.

Article provision that limits director liability for monetary damages. *Corp. Code § 204.5*.

Authorized business activities of corporation absent restriction in articles. *Corp. Code § 206*.

Powers of corporation absent limitation in articles. *Corp. Code § 207*.

Certified copy of articles as prima facie evidence of corporate existence. *Corp. Code § 209*.

Power of incorporators until directors are elected. *Corp. Code § 210*.

Restriction of board to adopt, amend, or repeal bylaws imposed by provision of articles or bylaws. *Corp. Code § 211*.

Requirement that number of directors appear in bylaws or articles. *Corp. Code § 212*.

Certificate of determination, filing required prior to issuance of shares. *Corp. Code §§ 401, 710*.

Amendment of articles of incorporation. *Corp. Code §§ 900-911*.

Required contents of statement of conversion in articles of corporation formed pursuant to conversion from domestic or

foreign other business entity or foreign corporation. *Corp. Code § 1157(d), (e)*.

Statement of directors and officers required after incorporation. *Corp. Code § 1502*.

Statement to be filed by corporation before it may be designated as agent for service of process of another corporation. *Corp. Code § 1505*.

Corporate Securities Law of 1968. *Corp. Code § 25000 et seq.*

Articles for financial institutions.

Banks. *Fin. Code §§ 350, 600-602*.

International or foreign banking corporations. *Fin. Code § 3502*.

Savings and loan associations. *Fin. Code § 5501.5*.

Credit unions. *Fin. Code § 14101*.

Industrial loan companies. *Fin. Code § 18102*.

Taxes on corporations.

Sales and use taxes. *Rev. & Tax. Code §§ 6001, 7176*.

Annual tax. *Rev. & Tax. Code §§ 23153, 23221*.

Alternative minimum tax. *Rev. & Tax. Code §§ 23400, 23453-23459*.

Corporations exempt from tax. *Rev. & Tax. Code §§ 23701, 23702*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART I. RESEARCH GUIDE
A. Primary Sources

2-3 California Legal Forms--Transaction Guide § 3.03

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§ 3.03 California Regulations

Definition of "charter documents" includes articles of incorporation. *10 Cal. Code Reg. § 260.001(a)*.

Rights of security holders. *10 Cal. Code Reg. §§ 260.140.1-260.140.10*.

Rights of promotional shares and conditions of qualification. *10 Cal. Code Reg. §§ 260.140.33, 260.141-260.141.3*.

Rights, warrants, and options. *10 Cal. Code Reg. §§ 260.140.40-260.140.46*.

Restrictions on transfer of securities as condition of qualification. *10 Cal. Code Reg. §§ 260.141.10-260.141.15*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART I. RESEARCH GUIDE
A. Primary Sources

2-3 California Legal Forms--Transaction Guide § 3.04

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§ 3.04[Reserved]



94 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART I. RESEARCH GUIDE
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2-3 California Legal Forms--Transaction Guide § 3.05

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§ 3.05 Law Reviews and Periodicals

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART I. RESEARCH GUIDE
B. Secondary Sources

2-3 California Legal Forms--Transaction Guide § 3.06

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§ 3.06 Text References

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Ch. 3, *Formation of Corporations*.

Ch. 11, *Amendment of Articles and Bylaws*.

California Small Business Guide(Matthew Bender).

California Legal Forms (Matthew Bender).

Ch. 2, *Formation of Corporations*.

Ch. 2A, *Incorporating a Going Business*.

Ch. 2B, *Electing Subchapter S Status*.

Ch. 4, *Bylaws*.

Ch. 5, *Directors' Meetings, Actions and Resolutions*.

Ch. 6, *Securities Regulation Issues*.

Ch. 7, *Corporate Records and Reports*.

Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*.

Ch. 10, *Amendment of Articles*.

Ch. 11F, *Corporate Conversions*.

Ch. 12A, *Professional Corporations*.

Ch. 13, *Nonprofit Corporations*.

California Forms of Pleading and Practice, Ch. 160, *Corporations: Capacity* , through Ch. 170, *Corporations: Dissolution and Winding Up* (Matthew Bender).

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96 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART I. RESEARCH GUIDE
B. Secondary Sources

2-3 California Legal Forms--Transaction Guide §§ 3.07-3.09

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART II. LEGAL BACKGROUND

2-3 California Legal Forms--Transaction Guide § 3.10

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§ 3.10 Applicability of General Corporation Law to Specific Types of Corporations

Most general business corporations are subject to and must be organized under the General Corporation Law [*see Corp. Code § 100 et seq.*] of the Corporations Code [*see Corp. Code § 102*]. Separate provisions of the Corporations Code govern the formation of and articles of incorporation for consumer cooperative corporations [*see Corp. Code §§ 12200-12704*], fish marketing associations [*see Corp. Code §§ 13200-13356*], and small business development corporations [*see Corp. Code § 14000 et seq.*]. For certain types of specialized corporations, other special statutory provisions apply [*see, e.g., Civ. Code §§ 330.24-330.26, 548-552* (water companies)].

Insurance companies may be incorporated and, except as otherwise provided in the Insurance Code, incorporated insurers are subject to the provisions of the General Corporation Law in the same way as are other corporations [*see Ins. Code § 1140*; *see also § 3.220*].

Professional corporations are subject to the General Corporation Law except when those provisions are in conflict with or inconsistent with the provisions of the Moscone-Knox Professional Corporation Act [*Corp. Code § 13403*; *see Corp. Code § 13400 et seq.*]. Professional corporations, including the special requirements for articles of incorporation, are covered in Ch. 12A, *Professional Corporations* .

The General Corporation Law applies to banks and trust companies except when inconsistent with applicable provisions of the Financial Code [*see Fin. Code § 101(b)*; *Corp. Code §§ 102(a), 163* (description of corporations subject to Banking Law)]. For example, banks and trust companies are required to include in their articles a "purpose" statement prescribed by the Banking Law, rather than the general business purpose clause otherwise required under the General Corporation Law [*Corp. Code § 202(b)(2)*; *see §§ 3.221-3.224* (illustrative purpose clauses for banks and trust companies)].

California savings associations (formerly, and still commonly referred to savings and loan associations) are incorporated under the Savings Association Law [*see Fin. Code § 5000 et seq.*], not the General Corporation Law. In addition to the rights, powers, and privileges granted in the Savings Association Law, savings associations have, all of

the powers and privileges granted under the General Corporation Law, except as otherwise provided in the Savings Association Law [*Fin. Code § 6500*].

Nonprofit corporations must be organized under and are governed by the Nonprofit Corporation Law [*Corp. Code § 5000 et seq.*; *see* Ch. 13, *Nonprofit Corporations*]. For general coverage of foreign corporations, see Ch. 12B, *Foreign Corporations and Associations* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawProfessional Associations & CorporationsBusiness & Corporate LawForeign BusinessesGeneral Overview



98 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART II. LEGAL BACKGROUND

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§ 3.11 Corporate Business Activities Authorized Under General Corporation Law

Subject to any limitation contained in the articles [*see § 3.230*] and any applicable laws, any corporation other than a corporation subject to the Banking Law [*see Corp. Code § 163* (definition)] or a professional corporation [*see Corp. Code § 13401(b)* (definition)] may engage in any business activity. A corporation subject to the Banking Law or a professional corporation may engage in any business activity not prohibited by the statutes and regulations to which it is subject [*Corp. Code § 206*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawBank ActivitiesGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurposeBusiness & Corporate LawProfessional Associations & CorporationsBusiness & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART II. LEGAL BACKGROUND

2-3 California Legal Forms--Transaction Guide § 3.12

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§ 3.12 General Powers of Corporation Under General Corporation Law

Subject to any limitations contained in the articles [*see § 3.231*] and the General Corporation Law, and any other applicable laws, a corporation has all of the powers of a natural person in carrying out its business activities [*Corp. Code § 207*]. Specific powers included in this general power are listed by statute by way of illustration and not limitation [*see Corp. Code § 207*]. If a corporation is to be denied any of these listed powers or any others of a natural person, that limitation must appear in the articles [*Corp. Code §§ 202(b), 207*; *see § 3.231*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePowersGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistence



100 of 187 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART II. LEGAL BACKGROUND

2-3 California Legal Forms--Transaction Guide § 3.13

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.13 Commencement of Corporate Existence

Corporate existence begins on the date articles of incorporation are filed with the Secretary of State and, unless otherwise provided by law or in the articles, continues perpetually [*Corp. Code § 200(c)*]. One or more natural persons, partnerships, associations, or corporations (domestic or foreign) may form a corporation by executing and filing the articles of incorporation [*Corp. Code § 200(a)*]. If initial directors are not named in the articles (and they are not required to be so named), the person or persons who execute and file the articles of incorporation are referred to as the incorporator or incorporators [*see Corp. Code §§ 200(b), 210*]. Under these circumstances, the incorporator or incorporators, until the time directors are elected, may do whatever is necessary and proper to perfect the organization of the corporation, including the adoption and amendment of bylaws of the corporation and the election of directors and officers [*Corp. Code § 210*]. If initial directors are named in the articles, each director must execute and acknowledge the articles prior to filing them with the Secretary of State [*Corp. Code § 200(b)*].

The conversion of an other business entity, foreign other business entity, or foreign corporation into a California corporation will be effective at the time articles of incorporation of the converted corporation containing a statement of conversion are filed with the Secretary of State [*Corp. Code § 1157(d)*]. Thus, the entity "becomes" a California corporation at that time. This filing has the effect of the filing of a certificate of cancellation by a converting foreign limited liability company or foreign limited partnership [*Corp. Code § 1157(f)*; *see Corp. Code §§ 15696*, 15909.06, *17455*]. If a converting entity is a foreign corporation qualified to transact business in California, the foreign corporation, by virtue of filing the articles of incorporation, automatically surrenders its right to transact intrastate business [*Corp. Code § 1157(f)*]. For further discussion, see *Ch. 11F, Corporate Conversions, § 11F.57*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawForeign BusinessesDomesticationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistence



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART II. LEGAL BACKGROUND

2-3 California Legal Forms--Transaction Guide § 3.14

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.14 Proof of Corporate Existence

For all purposes other than an action in the nature of quo warranto, a copy of the articles of incorporation duly certified by the Secretary of State is conclusive evidence of the formation of the corporation and prima facie evidence of its corporate existence [*Corp. Code § 209*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistence



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART II. LEGAL BACKGROUND

2-3 California Legal Forms--Transaction Guide § 3.15

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.15 Authorization Required for Certain Types of Corporations

The prior approval of the articles is required to form a commercial banking or trust corporation [*Fin. Code § 400*; *see Fin. Code § 350*] or an international or foreign banking or other financing corporation [*Fin. Code § 3503*; *see Fin. Code § 3535*]. The prior approval of the articles by the Savings and Loan Commissioner is required to form a savings association [*Fin. Code § 5505*]. In many other cases prior approval from a regulatory agency or a business license is required before a corporation may engage in a particular business [*see* Ch. 1A, *Role of Counsel in Starting a New Business*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawBank ActivitiesGeneral OverviewBanking LawBank ExpansionBank Creations & ReorganizationsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistenceBanking LawRegulatory AgenciesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART II. LEGAL BACKGROUND

2-3 California Legal Forms--Transaction Guide § 3.16

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§ 3.16 Definition of "Articles"

The term "articles" includes articles of incorporation, amendments to articles, amended articles, restated articles, certificates of incorporation, and certificates of determination [*see §§ 3.110*-3.112]. All references in the General Corporation Law to a vote required by the "articles" include, in the case of a statutory "close corporation" [*see Corp. Code § 158*], any vote required by shareholders' agreements [*Corp. Code § 154*]. "Close corporations" and shareholder agreements are briefly discussed in *§ 3.202[1]*. For additional coverage, see California Small Business Guide (Matthew Bender). The procedures for amending articles of incorporation are covered in this publication in Ch. 10, *Amendment of Articles*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART II. LEGAL BACKGROUND

2-3 California Legal Forms--Transaction Guide § 3.17

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.17 Mandatory Provisions for Articles

[1] In General

All corporations organized under the General Corporation Law must include certain mandatory provisions in their articles [*see Corp. Code § 202*]. These are briefly outlined below. Complete sets of articles of incorporation containing the mandatory requirements are set forth in *§§ 3.200* (corporation with simple stock structure--long form), *3.201* (general business corporation with simple stock structure--short form), *3.202* (statutory "close corporation"), and *3.203* (corporation with complex stock structure).

[2] Name of Corporation

The articles must set forth the name of the corporation [*Corp. Code § 202(a)*]. The Secretary of State will not file articles that set forth a name that is likely to mislead the public or that is the same as or too closely resembles the name of another corporation [*see Corp. Code § 201(b)*]. Corporations with a name that includes "bank," "trust," "trustee," or related words must be previously approved by the Commissioner of Financial Institutions [*see Corp. Code § 201(a)*]. The corporate name of an insurer must be approved by the Insurance Commissioner [*see Corp. Code § 201.5*]. Name restrictions also apply to a statutory "close corporation" [*Corp. Code § 202(a)*; *see § 3.202*]. California does not require that the corporate name of other corporations include "Corp.," "Inc.," or any other similar designation.

Other specific corporate name restrictions and the procedures for clearing and reserving a proposed corporate name are summarized in the Transaction Guide in Ch. 2, *Formation of Corporations*.

[3] Purpose of Corporation

The purpose of the corporation being incorporated must be stated in the articles. This requirement is satisfied by including the appropriate purpose statement required by statute, which varies depending on the type of corporation. Professional corporations and corporations subject to the Banking Law are each required to use a separate purpose statement [*see Corp. Code § 202(b)(1)(ii), (2), (4)*; *see also* Ch. 12A, *Professional Corporations* (articles of

incorporation for professional corporation); 3.221-3.224 (purpose clauses prescribed by Banking Law)]. All other corporations are required to use the general business purpose statement set forth by statute [*see Corp. Code § 202(b)(1)(i)*; *§ 3.201[2]*, Article II (general business purpose statement)]. If a corporation is an insurer, a statement to that effect must also be included in the articles [*Corp. Code § 202(b)(3)*; *see § 3.220*].

Except for the required purpose statement, the articles may not set forth any further or additional statement with respect to the purposes [*see § 3.11*] or powers [*see § 3.12*] of the corporation, except by way of limitation or except as expressly required by any law of California other than the General Corporation Law or any federal or other statute or regulation (including the Internal Revenue Code and regulations as a condition of acquiring or maintaining a particular status for tax purposes) [*Corp. Code § 202(b)*]. Any limitation or restriction on the corporation's purpose or powers must be set forth in the articles [*Corp. Code § 204(a)(6)*; *see §§ 3.230, 3.231*].

[4] Agent for Service of Process

The articles of incorporation must designate, by name and address in California, the corporation's initial agent for service of process [*Corp. Code § 202(c)*]. The initial agent must be either a natural person or a corporation that has previously filed with the Secretary of State its consent to be the designated agent for another corporation [*Corp. Code § 1502(b)*; *see § 3.211* (certificate of corporation consenting to act as agent)].

[5] Stock Structure

If a corporation is authorized to issue only one class of shares, only the total number of shares authorized is required to be specified in the articles [*Corp. Code § 202(d)*; *see § 3.201[2]* (illustrative provision)]. If the corporation is authorized to issue more than one class of shares, or if any class of shares is to have two or more series, the classes and series ordinarily must be designated, and the rights, preferences, privileges, and restrictions for each class or series must be described, in the articles [*see Corp. Code §§ 202(e), 203*]. Alternatively, the articles may authorize the corporation's board of directors to determine some of these matters for unissued shares. Under those circumstances, the board must subsequently determine the matters by resolution and file a certificate of determination with the Secretary of State prior to issuing any of the affected shares [*see Corp. Code § 401(a)*; *see also § 3.310* (certificate of determination)].

California law no longer includes the concept of "par value." Corporations can elect to have a par value for shares, but there is no legal significance to such an election. *Corp. Code § 205* provides that solely for the purpose of any statute or regulation imposing any tax or fee based on the capitalization of a corporation, all authorized shares of a corporation organized under the Code are deemed to have a par value of $1 per share. Further, if any federal or other statute or regulation applicable to a corporation (e.g., franchise taxes imposed by other states upon qualification to do business as a foreign corporation) requires that the shares have a par value, those shares will have the par value determined by the board in order to satisfy the requirements of that statute or regulation [*Corp. Code § 205*].

Detailed requirements for the stock structure of a corporation with more than one class of shares and an illustrative set of articles for a corporation with a complex stock structure are set forth in *§ 3.203*. Alternative stock provisions are included in §§ 3.240-3.257.

[6] Additional Statement Required for Incorporation of Existing Business Association Organized as Trust

An existing business association organized as a trust under the laws of California or of a foreign jurisdiction may incorporate by filing articles under the General Corporation Law if the incorporation is approved by its board of trustees (or similar governing body) and the holders of beneficial interests in the trust [*see Corp. Code § 200.5(a)*]. Under these circumstances, the articles of incorporation must contain the mandatory provisions discussed in [1] through [5], *above*, and a statement that an unincorporated association is being incorporated by the filing of the articles [*Corp. Code § 200.5(b)*]. A certificate attesting to the required approval of incorporation by the board and the holders of beneficial

interests must also be attached to the articles [*Corp. Code § 200.5(c)*]. These requirements are further discussed in *§ 3.200[1][j]*.

[7] Additional Requirements for Statutory "Close Corporation"

If a corporation is to be governed by the statutory provisions governing a "close corporation" [*see Corp. Code § 158*], its articles must include the mandatory provisions outlined in [1] through [5], *above*, and two additional provisions. First, the articles must state that all of the corporation's issued shares of all classes must be held of record by not more than a specified number of persons, which number may not exceed 35. Second, the articles must expressly state that the corporation is a "close corporation" [*Corp. Code § 158(a)*]. Special requirements also apply to the name of a close corporation [*see Corp. Code § 202(a)*]. For additional discussion of these requirements, and an illustrative set of articles for a close corporation, see *§ 3.202*. For more detailed coverage, see California Small Business Guide(Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurposeBusiness & Corporate LawCorporate NamesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART II. LEGAL BACKGROUND

2-3 California Legal Forms--Transaction Guide § 3.18

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.18 Optional or Permissive Provisions for Articles

Only the article provisions summarized in *§ 3.17* are mandatory under the General Corporation Law. As a general rule, any provision not in conflict with law (including the provisions of the General Corporation Law), relative to the management of the corporation's business or to the conduct of its affairs, may be included in the articles, including any provision that is required or permitted by the General Corporation Law to be stated in the bylaws [*Corp. Code § 204(d)*; *see Corp. Code § 212(b)* (permissive provisions for bylaws)]. Certain permissive provisions, for example, one that requires shareholders to possess special qualifications [*see § 3.263*], must be, in order to be effective, expressly included in the articles (or in the case of a close corporation, in a shareholders' agreement) [*Corp. Code § 204(a)*; *see § 3.200[1][c]* (discussion of other provisions subject to same requirement)].

Provisions may also be included in the articles that modify statutory provisions that would otherwise apply under the General Corporation Law [*see, e.g., § 3.272*], except in those cases in which modification or variation is prohibited. For example, statutory rights of shareholders to inspect certain corporate records may not be limited by the articles or bylaws [*see Corp. Code § 1600(d)*]. In addition, the articles or bylaws may not provide that a lesser vote than a majority of the directors present at a meeting is the act of the board [*see Corp. Code § 307(a)(8)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART II. LEGAL BACKGROUND

2-3 California Legal Forms--Transaction Guide § 3.19

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.19 Filing Articles With Secretary of State

On its receipt of articles that conform to law and required filing fees (including the minimum franchise tax), the Secretary of State will file the articles and endorse the date of filing on the articles [*see Corp. Code § 110(a)*]. Execution and filing requirements, and required fees, are fully discussed in *§ 3.200[1]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART II. LEGAL BACKGROUND

2-3 California Legal Forms--Transaction Guide §§ 3.20-3.99

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

[Reserved]

§§ 3.20[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-3 California Legal Forms--Transaction Guide § 3.100

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.100 General Information for Articles

[1] Facts

1. Client's name, address, and telephone number.

2. General business purpose of corporation.

3. Whether business to be incorporated is new or existing.

4. For existing business, type of present entity or organization (e.g., sole proprietorship, general partnership, or other).

5. Proposed name of corporation or corporate name reserved with Secretary of State, if any [*see* Ch. 2, *Formation of Corporations*].

6. Any fictitious names presently used or proposed to be used by business to be incorporated.

7. Address of principal executive office for corporation.

8. Locations (by county and state) where corporation intends to do business.

9. Proposed shareholders: limited group or public in general.

[2] Documents

1. Reservation of corporate name certificate from Secretary of State, if any [*see Corp. Code § 201(c)*; *see also* Ch. 2, *Formation of Corporations*].

2. Copy of any agreement between client and others regarding formation of corporation [*see* Ch. 2, *Formation of Corporations*].

3. Copy of any fictitious business name statements previously filed by client (if corporation will do business under any of those names).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationTransactionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersBusiness & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporate NamesGeneral OverviewBusiness & Corporate LawCorporate NamesFictitious NamesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-3 California Legal Forms--Transaction Guide §§ 3.101-3.109

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

[Reserved]

§§ 3.101[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-3 California Legal Forms--Transaction Guide § 3.110

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.110 Stock Structure

NOTE:

This part of the Transaction Guide outlines only specific matters that should be determined prior to drafting and filing articles of incorporation. For coverage of more general matters to be considered in forming and organizing a corporation, for example, whether to incorporate, where to incorporate, and the procedure for reserving a corporate name, see the Transaction Guide in Ch. 2, ***Formation of Corporations.*** Preliminary determinations necessary to incorporate a going business are summarized in Ch. 2A, ***Incorporating a Going Business.*** For preliminary determinations concerning the election of Subchapter S status, see Ch. 2B, ***Electing Subchapter S Status*** .

1. Are offering and sale of corporation's shares exempt from or subject to qualification with Commissioner of Corporations [*see* Ch. 6, *Securities Regulation Issues*]?

2. Are offering and sale of corporation's shares exempt from or subject to registration with Securities and Exchange Commission [*see* Ch. 6, *Securities Regulation Issues* ; Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*]?

3. Will corporation be authorized to issue only one class of shares or more than one class of shares [*see Corp. Code § 202(d), (e)*; *§§ 3.200[1][b][v], 3.203[1]*]?

4. Will any authorized class of shares be issuable in series [*Corp. Code § 202(e)*; *see § 3.203[1][d], [f][i]*]?

5. For multiple classes or series of shares, what will be general distinction (with respect to rights,

preferences, and restrictions) between shareholders of each class or series [*see Corp. Code §§ 203, 202(e)*; § 3.203[1][f]]?

6. Will corporation have power to levy assessments on shares or any class of shares [*Corp. Code § 204(a)(1)*; *see § 3.260*]?

7. Will shareholders be granted preemptive rights to subscribe to any or all issues of shares or securities [*Corp. Code § 204(a)(2)*; *see § 3.262*]?

8. Will shareholders be required to possess any special qualifications [*Corp. Code § 204(a)(3)*; *see § 3.263*]?

9. Will shareholders be given any right to determine consideration for which shares will be issued [*Corp. Code § 204(a)(8)*; *see § 3.261*]?

10. Will any restrictions be placed on right to transfer or hypothecate shares of any class or classes or series of shares [*Corp. Code § 204(b)*; *see § 3.264*]?

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawBlue Sky LawsExempted IssuersBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of Stock



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-3 California Legal Forms--Transaction Guide § 3.111

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.111 Corporate Actions and Business

1. Will corporation be statutory "close corporation" [*see Corp. Code § 158*]?

2. Will duration of corporation's existence be limited to specified date [*Corp. Code § 204(a)(4)*; *see § 3.300*]?

3. For any or all corporate actions, will higher shareholder vote be required than is ordinarily required under General Corporation Law [*Corp. Code § 204(a)(5)*; *see § 3.270*]?

4. For any or all corporate actions, will higher percentage vote or quorum of directors be required than is ordinarily required under General Corporation Law [*Corp. Code § 204(a)(5)*; *see §§ 3.287*, *3.288*]?

5. Will there be any restrictions on business in which corporation is permitted to engage [*Corp. Code § 204(a)(6)*; *see § 3.230*]?

6. Will any specific limitations or restrictions be placed on corporation's powers [*Corp. Code § 204(a)(6)*; *see § 3.231*]?

7. Will any holders of corporation's indebtedness be granted right to vote in election of directors or on any other matter [*Corp. Code § 204(a)(7)*; *see § 3.275*]?

8. Will shareholder approval be required for any corporation action that does not ordinarily require approval under General Corporation Law [*Corp. Code § 204(a)(9)*; *see, e.g., § 3.271*]?

9. Will personal liability of directors for monetary damages for breach of duty to corporation and shareholders be eliminated or limited to maximum extent permitted by law or otherwise [*Corp. Code § 204(a)(10)*; *see § 3.280*]?

10. Will indemnification in excess of that permitted by statute [*see Corp. Code § 317*] be authorized for corporate agents [*Corp. Code § 204(a)(11)*; *see § 3.281*]?

11. Considering all factors relevant to particular corporation, is it necessary to vary (by article provision or otherwise), to extent permitted, any provision of General Corporation Law that otherwise governs management of business or conduct of corporate affairs [*see Corp. Code § 204(d)*]?

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesIndemnificationBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePowersGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurpose



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-3 California Legal Forms--Transaction Guide §§ 3.112-3.119

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[Reserved]

§§ 3.112[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
C. Procedural Guide

2-3 California Legal Forms--Transaction Guide § 3.120

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.120 Obtaining Name Clearances

1. Have proposed corporate name cleared or reserved with Secretary of State [*Corp. Code § 201(b), (c)*; *see* Code § 12186(a); (fee) *see also* Ch. 2, *Formation of Corporations*].

2. If corporate name includes "bank," "trust," "trustee," or related words, obtain certificate approving corporate name [*see Corp. Code § 201(a)*].

NOTE:
If the corporation is subject to the Banking Law [***see*** *Corp. Code § 163*] this requirement does not apply. Rather, the articles themselves must be approved and endorsed by Commissioner of Financial Institutions [*Corp. Code § 201(a)*].

3. If corporate business is insurance, obtain certificate from Insurance Commissioner approving corporate name [*Corp. Code § 201.5*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawCorporate NamesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
C. Procedural Guide

2-3 California Legal Forms--Transaction Guide § 3.121

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.121 Executing and Filing Articles

NOTE:
The procedures for drafting articles are outlined in *§ 3.130*.

1. If articles do not name initial directors, have incorporator or incorporators sign articles [*Corp. Code § 200(b)*].

2. If articles name initial directors, have each director execute and acknowledge articles [*see Corp. Code § 200(b)*; *see § 3.284*].

3. For articles of corporation subject to Banking Law, have articles endorsed and approved by Commissioner of Financial Institutions [*Corp. Code § 201(a)*].

4. Determine and have made number of copies required to be certified by Secretary of State [*see § 3.200[1][g]*].

5. If articles will be filed by mail, draft transmittal letter requesting that articles be filed and that designated number of copies be certified by Secretary of State [*see § 3.210*].

6. Have checks prepared for all required fees payable to Secretary of State:

NOTE:
Corporations are subject to the minimum franchise tax [***see*** *Rev. & Tax. Code §§ 23151, 23153(d)*]. For the first taxable year beginning on or after January 1, 2000, the tax

imposed is the sum of (1) a tax according to or measured by net income, to be computed at the rate of 8.84 percent on the basis of net income for the next preceding income year, but not less than the minimum annual tax and (2) a tax according to or measured by net income, to be computed at the rate of 8.84 percent on the basis of net income for the first taxable year beginning on or after January 1, 2000, but not less than the minimum annual tax [*Rev. & Tax. Code § 23151(f)(1)*; ***see*** *Rev. & Tax. Code § 23153* (minimum tax)]. For other taxable years beginning on or after January 1, 2000, the tax imposed is a tax according to or measured by net income, to be computed at the rate of 8.84 percent on the basis of the net income for that taxable year, but not less than the minimum annual tax [*Rev. & Tax. Code § 23151(f)(2)*]. However, the requirement that the annual minimum franchise tax must be prepaid now applies only to credit unions [***see*** *Rev. & Tax. Code § 23221*].

a. Filing fee of $100 [Code § 12186(c); *see Corp. Code § 108*].

b. Separate charge for each certified copy in excess of two copies submitted with original articles.

NOTE:
The Secretary of State will compare and certify up to two copies of the articles without charge, provided the copies are submitted with the original to be filed [Code § 12185]. Additional fees may be charged for copying, certifying, and preclearance of documents [***see*** Code § 12182].

c. Special handling fee if articles will be filed over the counter at branch location [*see* Code § 12182].

7. Assemble package for filing:

a. Original signed articles, with appropriate number of copies to be certified.

b. Checks for required fees.

c. If articles will be filed by mail, transmittal letter and self-addressed, postage prepaid envelope to be used by Secretary of State to return certified copies of filed articles.

d. For corporation in business of insurance, certificate of Insurance Commissioner approving corporate name [*see Corp. Code § 201.5*].

e. For incorporation of existing business organized as trust, officers' certificate stating that incorporation of association has been approved by trustees and by required vote of holders of shares of beneficial interest [*Corp. Code § 200.5(b)*; *see § 3.200[1][j]* (discussion of additional requirements and illustrative certificate)].

8. To file articles, either:

a. Send by mail to Secretary of State, 1500 Eleventh Street, Sacramento, CA 95814; or

b. File (or have filed) over the counter at any branch office of Secretary of State.

9. Confirm filing.

NOTE:

Certified copies of articles filed by mail are returned by mail with the filing date stamped on the copies, together with the receipt for fees, and the corporate number assigned to the new corporation. For over the counter filings, the same items are returned at the time of filing.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersBusiness & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFinanceFranchise TaxComputation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
C. Procedural Guide

2-3 California Legal Forms--Transaction Guide §§ 3.122-3.129

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[Reserved]

§§ 3.122[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
D. Drafting Guide

2-3 California Legal Forms--Transaction Guide § 3.130

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.130 Articles of Incorporation

1. Set forth complete name of corporation [*Corp. Code § 202(a)*].

a. Do not use any name that is likely to mislead public or is too similar to another corporation's [*Corp. Code § 201(b)*].

NOTE:
Corporate name clearances are covered in Ch. 2, ***Formation of Corporations*** .

b. For corporation that is to be subject to statutory provisions for "close corporation" [*see Corp. Code § 158*], include word "corporation," "incorporated," or "limited," or abbreviation of one of those words in corporate name [*Corp. Code § 202(a)*; *see § 3.202[1][d]*].

c. For corporation that will engage in insurance business, use only name that has been approved by Insurance Commissioner [*Corp. Code § 201.5*].

NOTE:
Articles will not be filed by the Secretary of State unless a certificate of the Insurance Commissioner approving the corporate name is attached to the articles [*Corp. Code § 201.5*].

d. Do not use name in which word, "bank," "trust," "trustee," or related word appears unless [*Corp. Code § 201(a)*]:

(1) Certificate of approval of Commissioner of Financial Institutions is attached to articles; or

(2) For articles of any corporation subject to Banking Law [*see Corp. Code § 163* (definition)],

approval of Commissioner of Financial Institutions is endorsed on articles.

2. Describe purpose of corporation.

a. Use appropriate "purpose" provision required by statute:

(1) For any corporation except one engaged in banking business, trust company business, or practice of profession permitted to be incorporated, use general business purpose statement required by statute [*Corp. Code § 202(b)(1)(i)*; *see § 3.201[2]*, art. II].

(2) For corporation engaged in insurance business, use general business purpose statement described in P (1), *above*, but also state that business of corporation is to be insurer [*Corp. Code § 202(b)(3)*; *see § 3.220*].

(3) For corporation engaged in profession permitted to be incorporated, use professional corporation purpose provision required by statute [*Corp. Code § 202(b)(1)(ii), (4)*; *see Ch. 12A, Professional Corporations, § 12A.200*].

(4) For corporation subject to Banking Law [*see Corp. Code § 163*], use statement of purpose required by appropriate provision of Banking Law [*Corp. Code § 202(b)(2)*; *see §§ 3.221-3.224* (illustrative provisions)].

b. Do not set forth any further or additional statement with respect to purposes or power of corporation except [*Corp. Code § 202(b)*]:

(1) To describe any specific limitation on corporate purpose [*see Corp. Code §§ 202(b), 206*; *see also § 3.230* (illustrative limitation provision)];

(2) To describe any specific limitation on corporate powers [*see Corp. Code § 207*; *see also § 3.231* (illustrative limitation provision)]; or

(3) If expressly required by any law of California other than General Corporation Law or any federal or other statute or regulation (including Internal Revenue Code and its regulations as condition of acquiring or maintaining particular status for tax purposes).

3. Designate corporation's initial agent for service of process [*Corp. Code §§ 202(c), 1502(b)*]:

a. Name either [*Corp. Code § 1502(b)*]:

(1) Natural person who resides in California; or

(2) Corporation that has previously filed with Secretary of State its consent to act as agent for service of process [*see Corp. Code § 1505* (requirements for certificate of consent); *see also § 3.211* (illustrative certificate of consent)].

b. If natural person is named, include agent's complete business or residence street address [*Corp. Code § 1502(b)*].

NOTE:

An address is not required for an authorized corporate agent [*Corp. Code § 1502(b)*] since that

information is listed on the designated corporation's certificate of consent required to be on file with the Secretary of State [***see*** *Corp. Code § 1505(a)(1)*].

4. For incorporation of existing business association organized as trust, include statement that existing unincorporated association (by name) is being incorporated by filing of articles [*see Corp. Code § 200.5*; *see also § 3.200[1][j]* (illustrative provision and discussion of additional requirements)].

5. For corporation that is to be subject to statutory provisions governing "close corporation" [*see Corp. Code § 158*; *see also § 3.202* (illustrative article provisions)], include:

a. Provision stating that all of corporation's issued shares of all classes will be held of record by not more than specified number of persons, not exceeding 35; and

b. Statement: "This corporation is a close corporation."

6. If corporation is authorized to issue only one class of shares, specify total number of shares authorized [*Corp. Code § 202(d)*; *see, e.g., § 3.201[2]*].

7. If corporation is authorized to issue more than one class of shares, or if any class of shares is to have two or more series [*Corp. Code § 202(e)*]:

NOTE:
The following is merely a summary of mandatory provisions for articles of a corporation with more than one class of shares. Detailed requirements are further discussed in *§ 3.203[1]*.

a. Designate each class (e.g., common and preferred) and specify total number of shares in each class corporation is authorized to issue [*Corp. Code § 202(e)(1), (2)*; *see, e.g., § 3.203[2]*, art. IV].

b. For any class, for example, preferred stock, to be issuable in series, include in articles either [*Corp. Code § 202(e)(1), (2)*]:

(1) Designation or number of shares in each series; or

(2) Authorization that permits board of directors to designate or fix number of shares in any series.

c. For rights, preferences, privileges and restrictions granted to or imposed on respective classes or series of shares (or shareholders), either [*Corp. Code § 202(e)(3)*]:

(1) Describe these in articles [*see §§ 3.242-3.257*]; or

(2) State that board of directors may determine or alter rights, preferences, privileges, and restrictions granted to or imposed on any wholly unissued class or series of shares, and describe any limitations or restrictions on this power [*see § 3.203[2]*, art. V; *see also §§ 3.240, 3.241*].

d. If articles fix, or authorize board to fix, number of shares in any series [*see* P b, *above*], consider including provision that authorizes board to increase or decrease number originally fixed after shares in that series have been issued [*see Corp. Code §§ 202(e)(3), 203.5(b)* (restrictions on this type of

provision)].

8. If desired by corporation, draft appropriate article provision to accomplish any of following [*Corp. Code § 204(a)*]:

NOTE:
To be effective, any of these provisions must be expressly included in the articles, or in the case of "close corporation" [***see** Corp. Code § 158*], in a shareholder's agreement. However, this rule does not affect the enforceability between the parties to any lawful agreement not otherwise contrary to public policy [*Corp. Code § 204(a)*].

a. Grant corporation power, with or without limitations, to levy assessments on shares or any class of shares [*see § 3.260*].

b. Grant shareholders preemptive rights to subscribe to any or all issues of shares or securities [*see § 3.262*].

c. Require special qualifications for shareholders [*see § 3.263*].

d. Limit duration of corporation's existence to specified date [*see § 3.300*].

e. Require for any or all corporate actions greater percentage of shareholder vote for any class or series of shares than is otherwise required under General Corporation Law [*see § 3.270*].

f. Require for any or all corporate actions greater percentage of director vote or higher quorum of directors than is otherwise required under General Corporation Law [*see §§ 3.287, 3.288*].

g. Limit or restrict business in which corporation may engage [*see § 3.230*].

h. Limit or restrict powers that corporation may exercise [*see § 3.231*].

i. Give holders of any evidences of indebtedness, issued or to be issued by corporation, right to vote in election of directors or on any other matter on which shareholders are entitled to vote [*see § 3.275*].

j. Give shareholders right to determine consideration for which shares will be issued [*see § 3.261*].

k. Require shareholder approval for any corporate action not otherwise required to be approved by them under General Corporation Law [*see, e.g., § 3.271*].

l. Eliminate or limit personal liability or director for monetary damages for breach of director's duties to corporation and shareholder to extend permitted by law [*see § 3.280*].

m. Authorize indemnification of corporate agents in excess of that otherwise permitted by statute [*see § 3.281*].

9. If reasonable restrictions will be imposed on right to transfer or hypothecate shares of any class or classes or series, consider including provision in articles that describes those restrictions [*see Corp. Code § 204(b)*].

NOTE:
This type of provision may but is not required to be included in the articles [***see** Corp. Code § 204(b)*]. It

may instead be included in the bylaws [***see*** *Corp. Code § 212(b)(1)*] or, for a close corporation [***see*** *Corp. Code § 158*], in a shareholder's agreement [***see*** *Corp. Code §§ 300, 418(c), (d), 421*]. For a discussion of the circumstances under which transfer restrictions on shares are not permitted, see *§ 3.264[1]*.

10. If desired, set forth names and addresses of persons appointed to act as initial directors [*see Corp. Code § 204(c)*].

NOTE:

Initial directors are not required to be named in the articles and are usually not named for several reasons. First, if directors are named, each must sign and acknowledge the articles. If they are not named, only the incorporator needs to sign the articles and no acknowledgment is necessary [***see*** *Corp. Code § 200(b)*]. Second, if initial directors are named in the articles, a correction or deletion of this information may not be made until after the corporation files its first "Statement by Domestic Stock Corporation" (referred to in the Code as an annual statement) with the Secretary of State [*Corp. Code § 900(b)*] That statement must be filed within 90 days of incorporation and annually thereafter [***see*** *Corp. Code § 1502(a)*; ***see also*** *§ 3.141* (requirements for filing)]. Third, directors need not be named until the corporation files its first "Statement by Domestic Stock Corporation" within 90 days after incorporation, which permits the corporation more time to elect the directors. If articles do not establish the number of directors, the number must be stated (as a fixed or variable number) in the bylaws [***see*** *Corp. Code § 212*; ***see also*** *§§ 3.282-3.284*].

11. If intent of corporation is to vary any requirements of General Corporation Law that otherwise govern management of business and conduct of corporate affairs:

a. Confirm that specific statutory provision to be altered does not prohibit variation from or exceptions to its requirements.

b. If specific statutory provision expressly requires that any exception to or variation from its provisions be included in articles, draft appropriate article provision.

c. If specific statutory provision does not expressly require that any exception to or variation from its provisions be included in articles, draft appropriate provision for inclusion either in articles or bylaws (or, in case of "close corporation", shareholder's agreement) [*see Corp. Code §§ 204(d), 212(b)*; *see also Corp. Code §§ 186, 300(b)* (shareholders' agreement)].

12. If corporation is being converted from domestic or foreign other business entity or foreign corporation, include required statement of conversion [*see Corp. Code § 1157(d), (e)*].

NOTE:

For a drafting guide and form containing the contents required by statute, see Ch. 11F, ***Corporate Conversions***, §§ 11F.160 (drafting guide), 11F.250 (form for articles provision).

13. In final version of articles, confirm that all format and technical requirements of Secretary of State for legibility and otherwise are satisfied [*see § 3.200[1][e]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of

Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurposeBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersBusiness & Corporate LawCorporate NamesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
D. Drafting Guide

2-3 California Legal Forms--Transaction Guide §§ 3.131-3.139

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§§ 3.131[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

2-3 California Legal Forms--Transaction Guide § 3.140

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.140 Correction or Amendment of Articles

NOTE:

Many procedures related to a corporation's organization and its commencement of business are covered elsewhere in this publication. Requirements for a corporation's bylaws are covered in Ch. 4, ***Bylaws*** . Requirements for the corporation's organizational and subsequent meetings and actions are covered in Ch. 5, ***Directors' Meetings, Actions, and Resolutions*** . Required corporate records and reports are covered in Ch. 7, ***Corporate Records and Reports*** . Securities qualification (or obtaining exemptions from qualification) is covered in Chs. 6-6H. For coverage of general business matters, such as filing fictituous business name statements and complying with licensing requirements, see Chs. 1A- 1F [***see also*** Ch. 2A, ***Incorporating a Going Business***].

1. If mistake of fact or error in execution of articles is discovered in articles after they have been filed in Secretary of State's office, correct mistake or error by filing certificate of correction [*Corp. Code § 109*; *see* Ch. 10, *Amendment of Articles*].

2. To change any other provision of filed articles, file certificate of amendment or restated articles [*see Corp. Code §§ 900-911*; *see also* Ch. 10, *Amendment of Articles*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

2-3 California Legal Forms--Transaction Guide § 3.141

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.141 Filing Mandatory Statement of Domestic Stock Corporation and Designating Agent for Service of Process

1. Within 90 days after articles are filed, submit to office of Secretary of State required filing fee [*see* Code § 12186(g); *see also Corp. Code § 1502(i)* (additional fee)] and completed "Statement by Domestic Stock Corporation" (form prescribed by Secretary of State) that contains following information [*see Corp. Code § 1502(a), (b)*; *see also* Ch. 7, *Corporate Records and Reports* (form)]:

NOTE:

After the articles are filed, the Secretary of State's office routinely sends a blank copy of the form to the new corporation. If for any reason the blank form is not received, one should be requested from the Secretary of State. A penalty may be assessed for failure to file after receiving a notice of delinquency from the Secretary of State's office [***see*** *Corp. Code § 2204*].

This statement will be held available and open to the public for inspection. The Secretary of State is required by statute to provide access to all information contained in this statement by means of an online database [*Corp. Code § 1502(h)*].

a. Names and complete business or residence addresses of all incumbent directors.

b. Number of vacancies on board of directors, if any.

c. Names and complete business or residence addresses of corporation's:
(1) Chief executive officer.

(2) Secretary.

(3) Chief financial officer.

d. Street address of principal executive office.

e. Mailing address of corporation, if different from street address of its principal executive office.

f. If address of principal executive office is not in California, street address of principal business office in California, if any.

g. Statement of general type of business that constitutes principal business activity of corporation.

h. Designation of agent for service of process, which must name either [*Corp. Code § 1502(b)*]:

(1) Natural person residing in California (including that person's complete business or residence street address); or

(2) Corporation that has agreed to serve as agent and that previously has filed required certificate with Secretary of State [*see Corp. Code § 1505*; *see also § 3.211* (form for certificate and discussion of specific requirements)].

g. Have corporation certify that information in statement is true and correct [*Corp. Code §§ 1502(j), 1502.1(d)*].

NOTE:
No claim may be made against the state for inaccurate information contained in the statement [*Corp. Code § 1502(j)*].

2. Annually thereafter, by end of calendar month of anniversary date of initial incorporation, file renewal "Statement by Domestic Stock Corporation", together with required filing fee [*see* Code § 12186(g), (j); *see also Corp. Code § 1502(i)*], and "Statement for Publicly Traded Corporations," in office of Secretary of State [*Corp. Code § 1502(a)*; *see* Ch. 7, *Corporate Records and Reports* (form)]:

NOTE:
The Secretary of State will mail a reminder notice of compliance with the annual filing requirement to each corporation approximately three months prior to the filing deadline. The notice will state the due date and will be mailed to the corporation's address of record with the Secretary of State. The failure of the corporation to receive the notice is not an excuse for failing to file [*Corp. Code § 1502(d)*; ***see*** *Corp. Code § 2204* (assessment of penalties after delinquency notice)]. If there has been no change in information set forth in the last filed statement of the corporation on file in the Secretary of State's office, the corporation, in lieu of completing the entire form, may complete only the portion declaring that no changes have occurred since the last filing [***see*** *Corp. Code § 1502(c)*; ***see also*** official instructions to form].

3. If any information listed in P 1, *above*, is changed, except designation of agent for service of process, consider filing new statement prior to next annual filing date [*Corp. Code § 1502(e)*].

NOTE:

Filing a new statement prior to the next required annual filing is not mandatory under these circumstances [***see*** *Corp. Code § 1502(e)*]. There is no fee for filing an amended statement that is not an annual filing [***see*** Form instructions; ***see also*** Ch. 7, ***Corporate Records and Reports*** .

4. In order to change designation of agent for service of process, immediately file new statement containing all information noted in P 1, *above* [*Corp. Code § 1502(e)*].

NOTE:

For this purpose, filing a new statement before the next required annual filing is mandatory [***see*** *Corp. Code § 1504*]. When a new statement is filed, it supersedes any previously filed statement and the statement in the articles as to the agent for service of process and the address of the agent [*Corp. Code § 1502(e)*].

5. If corporation is publicly traded, complete "Corporate Disclosure Statement" as prescribed by Secretary of State, with following information [*Corp. Code § 1502.1(a)*]:

NOTE:

A "publicly traded corporation" is a corporation [*see Corp. § 162*] that (1) is an issuer as defined in Section 3 of the Securities Exchange Act [*see 15 U.S.C. § 78c*] and (2) has at least one class of securities listed or admitted for trading on a national securities exchange, on the OTC Bulletin Board, or the electronic service operated by Pink OTC Markets Inc. [*Corp. Code § 1502.1(b)(1)*].

a. Name of independent auditor that prepared most recent auditor's report on corporation's annual financial statements.

b. Description of other services, if any, performed for corporation during its two most recent fiscal years and period between end of its most recent fiscal year and date of statement by foregoing independent auditor, by its parent corporation, or by subsidiary or corporate affiliate of that independent auditor or its parent corporation.

c. Name of independent auditor employed by corporation on date of statement, if different from independent auditor listed above.

d. Compensation paid, including number of any shares issued, options for shares granted, and similar equity-based compensation granted, for corporation's most-recent fiscal year, to:

(1) Each member of board of directors; and

(2) Each of five most highly compensated executive officers who are not members of board.

NOTE:

For this purpose, "executive officer" is defined as the chief executive officer, the president, any vice president in charge of a principal business unit, division, or function, any other officer of the corporation who performs a policy-making function, or any other person who performs similar policy-making functions for the corporation [*Corp. Code § 1502.1(b)(2)*]. "Compensation" includes all plan and nonplan compensation awarded to, earned by, or paid to the person for all services rendered in all capacities to the corporation and to its subsidiaries, as the compensation is specified by Item 402 of SEC

Regulation S-K [*Corp. Code § 1502.1(b)(3)*; ***see*** *17 C.F.R. § 229.402*]. If the chief executive officer is not among the five most highly compensated executive officers of the corporation, the compensation paid to the chief executive officer must be included anyway [*Corp. Code § 1502.1(a)(4)*].

e. Description of any loan, including amount and terms, made to any member of board of directors by corporation during corporation's two most-recent fiscal years at interest rate lower than interest rate available from unaffiliated commercial lenders generally to similarly situated borrower.

NOTE:

The term "loan" does not include advances for reimbursable expenses [***see*** *Corp. Code § 315(d)*], certain premium payments for life insurance [***see*** *Corp. Code § 315(e)*], and advances for litigation expenses [*Corp. Code § 1502.1(b)(4)*; ***see*** *Corp. Code § 317*].

f. Statement indicating whether order for relief has been entered in bankruptcy case with respect to corporation, its executive officers, or board members during 10 years preceding date of statement.

g. Statement indicating whether any board member or executive officer of corporation was convicted of fraud during 10 years preceding date of statement.

NOTE:

This disclosure is not required if the conviction has been overturned or expunged [*Corp. Code § 1502.1(a)(7)*].

h. Description of any material pending legal proceedings, other than ordinary routine litigation incidental to business, to which corporation or any of its subsidiaries is party or of which any of their property is subject [*see* 12 C.F.R. § 229.103 (Item 103 of Regulation S-K)].

i. Description of any material legal proceeding during which corporation was found legally liable by entry of final judgment or final order that was not overturned on appeal during five years preceding date of statement.

6. File "Corporate Disclosure Statement" within 150 days after end of corporation's fiscal year and annually thereafter [*Corp. Code § 1502.1(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

2-3 California Legal Forms--Transaction Guide § 3.142

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.142 Filing Certificate of Determination

1. If articles authorize board to determine rights, preferences, privileges, and restrictions (or any of them) for any class or series of shares, to designate any series of shares, or to fix number of shares in series [*see, e.g., § 3.203[2]*, art. V], instruct board of directors to do following *prior* to issuing any shares in affected class or series [*Corp. Code § 401(a)*]:

a. Adopt resolution that fixes matters to be determined.

b. Prepare certificate of determination that includes copy of resolution and executed officer's certificate [*see § 3.310*].

c. File certificate of determination with Secretary of State.

2. If board desires to alter or revoke any right, preference, privilege, or restriction fixed or determined by previously filed certificate of determination, and no shares in affected class or series have yet been issued [*Corp. Code § 401(b)*]:

a. Adopt new resolution that reflects alteration or revocation.

b. Prepare amendatory certificate of determination that includes copy of new resolution and executed officer's certificate [*see § 3.311*].

c. File amendatory certificate of determination with Secretary of State.

3. If board desires (and is so authorized by articles) to increase or decrease number of shares in any series specified in any previously filed certificate of determination (whether or not affected shares have been issued) [*Corp. Code § 401(c)*]:

a. Adopt new resolution stating increase or decrease.

b. Prepare amendatory certificate of determination that includes copy of new resolution and executed officer's certificate [*see § 3.312*].

c. File amendatory certificate of determination with Secretary of State.

NOTE:
If a previously filed certificate of determination has been incorporated in restated articles filed with the Secretary of State [***see*** *Corp. Code § 910*], the board may, alternatively, increase or decrease the number of shares by amending the articles [***see*** *Corp. Code § 401(c)*].

4. If board desires to alter or revoke any right, preference, privilege, or restriction fixed or determined by previously filed certificate of determination, and shares in affected class or series have been issued, adopt, approve, and file amendment to articles [*Corp. Code § 401(d)*; *see* Ch. 10, *Amendment of Articles*].

NOTE:
If the alteration or revocation relates only to an increase or decrease in the number of shares for a series described in P 3, ***above***, the alteration or revocation may instead be accomplished by filing a certificate of determination described in P 3, ***above*** [***see*** *Corp. Code § 401(d)*].

The alteration of the rights, preferences, privileges, or restrictions on outstanding securities constitutes a sale of the securities under the California Corporate Securities Law [***see*** *Corp. Code § 25017(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of Stock



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

2-3 California Legal Forms--Transaction Guide §§ 3.143-3.199

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[Reserved]

§§ 3.143[Reserved]



122 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
A. Complete Sets of Articles and Related Forms
1. Complete Articles

2-3 California Legal Forms--Transaction Guide § 3.200

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.200 Articles of Incorporation for Corporation With Simple Stock Structure (Long Form)

[1] Comment

[a] Use of Form

This is a set of articles of incorporation for a stock corporation with one class of stock that will be incorporated by a single incorporator. These articles contain only the mandatory provisions required by statute and do not include any of the optional or alternative clauses that may be included in articles of incorporation [*see* [c], *below*].

For other complete sets of articles, see *§§ 3.201* (corporation with simple stock structure--short form), 3.202 (close corporation), and 3.203 (corporation with complex stock structure). If an existing business association, presently organized as a trust, is to be incorporated under the General Corporation Law, special requirements apply to drafting and executing its articles of incorporation [*see* [j], *below*].

If an other business entity, foreign other business entity, or foreign corporation is converting into a California corporation pursuant to Chapter 11.5 of the General Corporation Law [*see Corp. Code § 1150 et seq.*], special content requirements apply to the articles of incorporation [*see Corp. Code § 1157(d), (e)*; *see also* [k], *below*].

[b] Mandatory Provisions

[i] Overview

The articles of incorporation must set forth the following [*Corp. Code § 202*]:

- The name of the corporation [*see* [b][ii], *below*].

- The purpose of the corporation [*see* [b][iii], *below*].

- The name and address in California of the corporation's initial agent for service of process [*see* [b][iv], *below*].

- If the corporation is authorized to issue only one class of shares, the total number of shares that it is authorized to issue [*see* [b][v], *below*].

- If the corporation is authorized to issue more than one class of shares, or if any class of shares is to have two or more series, the specific information required by statute [*Corp. Code § 202(e)*] and summarized in *§ 3.203[1]*.

[ii] Name of Corporation

The name of the corporation must be set forth in the articles of incorporation [*Corp. Code § 202(a)*; *see* [2], art. I, *below*]. Statutory restrictions on corporate names and the procedure for reserving a corporate name [*see Corp. Code § 201*] are discussed in Ch. 2, *Formation of Corporations* . Special requirements that apply to the name of a statutory "close corporation" [*see Corp. Code § 202(a)*] are discussed in *§ 3.202[1][d]*.

[iii] Purpose of Corporation

The business purpose provision set forth in this form [*see* [2], art. II, *below*] must be included in the articles of incorporation for any corporation formed under the General Corporation Law, except a professional corporation or a corporation engaged in the banking or trust company business. The language of this single-statement provision is mandated by statute [*see Corp. Code § 202(b)(1)(i)*]. If the corporation is subject to the Insurance Code as an insurer, the articles must also state that the business of the corporation is to be an insurer [*Corp. Code § 202(b)(3)*; *see § 3.220*]. Otherwise, no additional statement with respect to the purpose or powers of the corporation may be included in the articles except by way of limitation [*see, e.g., §§ 3.230, 3.231*] or except as expressly required by any law of California other than the General Corporation Law or any federal or other statute or regulation (including the Internal Revenue Code and its regulations as a condition of acquiring or maintaining a particular status for tax purposes) [*Corp. Code § 202(b)*; *see Corp. Code § 207* (enumeration of general corporate powers)]. To be effective, any provision that limits or restricts the business in which the corporation may engage or the power that it may exercise must be included in the articles, or in the case of a close corporation [*see Corp. Code § 158*], in a shareholders' agreement [*Corp. Code § 204(a)(6)*; *but see Corp. Code § 208(a)* (limitations on enforcement in third party actions); *see also § 3.202[1][g]* (shareholders' agreements)].

For illustrative purpose provisions for a corporation subject to the banking law, see *§§ 3.221-3.224*. For an example of a purpose clause for a profession permitted to be incorporated under the General Corporation Law [*see Corp. Code § 202(b)(1)(ii)*], see *Ch. 12A, Professional Corporations, § 12A.200[2]*, art. II.

Subject to any limitation contained in the articles and to compliance with any other applicable laws, any corporation other than a corporation subject to the Banking Law [*see Corp. Code § 163* (definition); *see also §§ 3.221-3.224*], or a professional corporation [*see* Ch. 12A, *Professional Corporations*] may engage in any business activity. A professional corporation or a corporation subject to the Banking Law may engage in any business activity not prohibited by the respective statutes and regulations to which it is subject [*Corp. Code § 206*].

[iv] Agent for Service of Process

The name and address in California of the corporation's initial agent for service of process must be included in the articles of incorporation [*Corp. Code § 202(c)*; *see* [2], art. III, *below*]. A natural person who resides in California

ordinarily must be designated. A corporation may be designated as agent, but only if that corporation previously has filed with the Secretary of State a certificate consenting to act as the agent for service of process and that consent has not been terminated [*Corp. Code § 1502(b)*; *see Corp. Code § 1505*; *see also § 3.211* (requirements for and form of certificate)].

If a natural person is designated, that person's complete business or residence street address must be included in the articles [*Corp. Code §§ 202(c), 1502(b)*]. If a corporation is named as agent, an address need not be included in the articles since that information is contained in the designated corporation's certificate consenting to act as agent [*see Corp. Code § 1505*; *see also § 3.211*], which must have been filed previously with the Secretary of State [*see Corp. Code § 1502(b)*].

The provision in the articles of incorporation that appoints the corporation's "initial" agent for service of process cannot be amended (or deleted) until after the corporation files with the Secretary of State a "Statement by Domestic Stock Corporation" [*Corp. Code § 900(b)*]. The contents of the statement are outlined by statute and the form is prescribed by the Secretary of State [*see Corp. Code § 1502*]. The statement must be filed within 90 days after filing its original articles and then annually thereafter [*see Corp. Code § 1502(a)*]. Requirements for filing the statement are further discussed in *§ 3.141*. Requirements for changing the corporation's agent for service of process also are summarized in § 3.141. For a discussion of the requirements for amending articles, before or after shares are issued, see Ch. 10, *Amendment of Articles* .

[v] Stock Structure

The articles set forth below are appropriate for use by a corporation that is authorized to issue only one class of shares [*see* [2], art. IV, *below*]. Under these circumstances, only the authorized number of shares must be stated in the articles [*see Corp. Code § 202(d)*]. There is no statutory minimum or maximum for the number of authorized shares stated in the articles. Often this figure is an arbitrary one, for example 10,000 or 100,000 shares. It is important to bear in mind, however, that the corporation cannot issue more shares than are specified in the articles without amending the articles to increase the number of authorized shares [*see Corp. Code §§ 202(d), (e), 400, 401(c)* (board may increase or decrease number of shares in any series if authorized in the articles pursuant to *Corp. Code § 202(e)*)].

The Secretary of State's office advises that the authorized number of shares must be at least one share; articles specifying zero shares will not be accepted.

If a corporation will have more than one class of shares, or if any class of shares is to have two or more series, additional information must be included in the articles [*see Corp. Code § 202(e)*]. That required information, as well as a discussion of the distinctions between and definitions of "class," "series," and other relevant terms, is presented in *§ 3.203[1]*.

[c] Permissive Provisions

Under the General Corporation Law, provisions that do the following may be included in the articles of incorporation [*see Corp. Code § 204*; *see also* [2], art. V, *below*]:

(1) Granting, with or without limitations, the power to levy assessments on the shares or any class of shares [*Corp. Code § 204(a)(1)*; *see Corp. Code § 423*; *see also § 3.260*];

(2) Granting to shareholders preemptive rights to subscribe to any or all issues of shares or securities [*Corp. Code § 204(a)(2)*; *see § 3.262*];

(3) Setting forth special qualifications of persons who may be shareholders [*Corp. Code § 204(a)(3)*; *see*

Corp. Code § 403(a)(2); *see also § 3.263*];

(4) Limiting the duration of the corporation's existence to a specified date [*Corp. Code § 204(a)(4)*; *see § 3.300*];

(5) Requiring, for any or all corporate actions [except as provided in *Corp. Code §§ 303* (relating to removal of directors), *402.5(b)* (relating to vote required for dissolution), *708(c)* (relating to election of directors), and *1900* (relating to voluntary dissolution of corporation)], the vote of a larger proportion or of all of the shares of any class or series, or the vote or quorum for taking action of a larger proportion or of all of the directors than is otherwise required by the General Corporation Law [*Corp. Code § 204(a)(5)*; *see § 3.270*];

(6) Limiting or restricting the business in which the corporation may engage or the powers that the corporation may exercise, or both [*Corp. Code § 204(a)(6)*; *see Corp. Code §§ 202(b), 207*; *see also §§ 3.230, 3.231*];

(7) Conferring on the holders of any evidences of indebtedness, issued or to be issued by the corporation, the right to vote in the election of directors and on any other matters on which shareholders may vote [*Corp. Code § 204(a)(7)*; *see Corp. Code § 111*; *see also § 3.275*];

(8) Conferring on shareholders the right to determine the consideration for which shares shall be issued [*Corp. Code § 204(a)(8)*; *see Corp. Code § 409*; *see also § 3.261*].

(9) Requiring the "approval of the shareholders" [*see Corp. Code § 153*], or the "approval of the outstanding shares" [*see Corp. Code § 152*] for any corporate action, even though not otherwise required by the General Corporation Law [*see Corp. Code § 204(a)(9)*; *see also § 3.271*];

(10) Eliminating or limiting the personal liability of a director for monetary damages in an action brought by or in the right of the corporation for breach of a director's duties to the corporation and its shareholders, provided the provision complies with all applicable statutory requirements and restrictions [*Corp. Code § 204(a)(10)*; *see Corp. Code § 309*; *see also § 3.280* (discussion of specific requirements and restrictions)].

(11) Authorizing, whether by bylaw, agreement, or otherwise, the indemnification of agents [*see Corp. Code § 317* (definition)], in excess of that expressly permitted by statute for those agents of the corporation for breach of duty to the corporation and its stockholders, provided the provision complies with relevant statutory restrictions [*Corp. Code §§ 204(a)(11), 317*; *see also § 3.281* (discussion of specific restrictions)].

(12) Reasonably restricting the right to transfer or hypothecate shares of any class or classes (but no such restriction is binding with respect to shares issued prior to its adoption unless the holders of those shares voted in favor of it) [*Corp. Code § 204(b)*; *see § 3.264*].

(13) Setting forth the names and addresses of the persons appointed to act as initial directors [*Corp. Code § 204(c)*; *see* [f], *below*; *see also § 3.284*].

(14) Any other provision, not in conflict with law, for the management of the business and for the conduct of the affairs of the corporation, including any provision required or permitted by the General Corporation Law to be stated in the bylaws [*Corp. Code § 204(d)*; *see Corp. Code § 212(b)* (content of bylaws generally); *see also §§ 3.272-3.274, 3.282-3.289*].

The first 11 categories of provisions listed above *must* be included in the articles (or in the case of close corporation, in a shareholders' agreement [*see § 3.202[1][g]*]), in order to be effective [*see Corp. Code § 204(a)*]. However, notwithstanding this general rule, the bylaws may require the affirmative vote of a majority of the authorized number of directors for all or any actions by the board of directors. In addition, the general rule does not affect the enforceability, as between the parties, of any lawful agreement not otherwise contrary to public policy [*Corp. Code § 204(a)*].

Corp. Code § 301.5 also allows a corporation, by amendment of its articles or bylaws, to adopt provisions to divide the board of directors into two or three classes to serve for two or three years, respectively, or to eliminate cumulative voting, or both. These provisions are only effective if the corporation is a "listed corporation" as defined in *Corp. Code § 301.5(d)*. However, a corporation that is not a listed corporation can adopt such amendment provisions after the issuance of shares to become effective when the corporation becomes a listed corporation. Such an amendment to the articles may only be adopted by the approval of the board and the outstanding shares voting as a single class, notwithstanding *Corp. Code § 903* [*Corp. Code § 301.5(a)*.]

[d] Requirements for Provisions Made Dependent on Facts Ascertainable Outside Articles

Article provisions that cover matters described in [c], Paragraphs (1)-(12), *above* [*Corp. Code § 204(a), (b)*], and those that concern the rights, preferences, privileges, and restrictions imposed on shares [*Corp. Code § 202(e)(3)*; *see, e.g., § 3.203[2]*, art. V], may be made dependent on facts ascertainable outside the articles, if the manner in which those facts will operate on those provisions is clearly and expressly set forth in the articles [*Corp. Code § 109.5(a)*]. If any article provision is dependent on facts ascertainable through a reference to an agreement or similar document, the corporation must (1) maintain a copy of the agreement and all amendments at its principal executive office, and (2) provide to its shareholders a copy of the agreement and any amendments without charge, on written request [*Corp. Code § 109.5(b)*].

If the reference is to an agreement to which the corporation is a party, the outstanding shares [*see Corp. Code § 152*] of the affected class or series must approve an amendment or revision of the referenced agreement in the following situations [*Corp. Code § 109.5(c)*]:

- The amendment or revision of the agreement would result in a material change in the rights, preferences, privileges, or restrictions of a class or series of shares.

- The amendment or revision of the agreement would result in a material change in the rights or liabilities of any class or series of shares with respect to information described in *Corp. Code § 204(a)(1)-(3), (5), (9)* [*see* [c], Paragraphs (1)-(3), (5), (9), *above*].

- The amendment or revision of the agreement would result in a material change in the restrictions on transfer or hypothecation of any class or series of shares.

If the amendment or revision of the referenced agreement would result in a change of any of the principal terms of an agreement of merger, the amendment or revision must be approved in the same manner as is required for a change in the principal terms of a merger agreement [*Corp. Code § 109.5(c)(4)*; *see Corp. Code § 1104*].

[e] Format Specifications

Documents submitted for filing with the Secretary of State must be original documents, bearing the actual, manual signature or signatures of one or more incorporators. However, if the directors are named in the articles, each named person must sign and acknowledge the document. The names of signatories must be typed directly below the signatures.

Because filed documents are microfilmed, they must be typed with letters in dark contrast to the paper; documents

submitted for filing that would produce poor microfilm will be returned unfiled.

[f] Execution Requirements

One or more natural persons, partnerships, associations, or corporations, domestic or foreign, may form a corporation by executing and filing articles of incorporation [*Corp. Code § 200(a)*]. If initial directors are named in the articles, each director named must sign and acknowledge the articles. If initial directors are not named, the "incorporator" must sign the articles but need not acknowledge them [*see Corp. Code § 200(b)*]. The articles below provide for incorporation by an incorporator and do not name the initial directors. For a provision that may be added to these articles to name directors (with appropriate signature lines and acknowledgment provisions), see *§ 3.284*. If initial directors are not named in the articles, the incorporators, until the time directors are elected, may do whatever is necessary and proper to perfect the organization of the corporation, including the adoption and amendment of bylaws and the election of directors and officers [*Corp. Code § 210*].

[g] Filing, Certified Copies, and Fees

The articles of incorporation may be filed by mail or hand delivered for over the counter processing to the Secretary of State's Sacramento headquarters at the following address:

Business Filings
1500 11th Street
Sacramento, CA 95814
Attention: Document Filing Support Unit

The Secretary of State offers preclearance and expedited filing services for documents filed with the Secretary pursuant to the Corporations Code, including articles of incorporation. Preclearance service provides a customer with the opportunity to submit a business entity document in person to the Secretary's Sacramento office prior to filing to determine if the articles conform to law and to receive a preclearance response within a guaranteed time frame. Expedited filing service provides the opportunity to submit articles for filing in person to the Secretary of State's Sacramento office and to receive a filing response within a guaranteed time frame. For an additional fee, expedited filing services for a guaranteed same-day response are also available [*see* http://www.sos.ca.gov/business/precexp.htm].

The articles also may be hand delivered for over the counter processing to any of the corporate branch offices located in Fresno, Los Angeles, San Diego, and San Francisco. When filing in a branch office, duplicate originals must be submitted for filing, plus any copies to be certified and returned. The original and at least two copies must be submitted for filing, together with the applicable fees.

The original articles should be submitted for filing with the appropriate conformed copies to be certified at the time of filing. The Secretary of State will compare and certify two copies without charge if the copies are submitted with the original to be filed [Code § 12185]. If additional certified copies are required, an additional fee must be paid [*see* Code §§ 12182, 12183; *see also* Secretary of State's information packet]. The number of certified copies a corporation needs depends on the particular corporation. For example certified copies may be needed for inclusion in the corporation's minute book as prima facie evidence of the corporate existence [*Corp. Code § 209*], for the registration of securities with the Securities and Exchange Commission or on a national security exchange, for qualifying to do business in other states, for filing in connection with applications for business licenses and permits, when required; and for filing any application for a franchise tax exemption [*Rev. & Tax. Code §§ 23701, 23702*].

The appropriate filing fee for filing articles of incorporation must be submitted at the time of filing [*see* Code § 12186; *see also Corp. Code § 108*]. If more than two certified copies are requested, additional copies submitted with the

original will be certified on prepayment of a fee. For expedited processing of articles delivered in person, over the counter, a special handling fee must be remitted by separate check; the special handling fee will be retained regardless of whether or not the articles are accepted for filing.

Although corporations are subject to the minimum franchise tax [*see Rev. & Tax. Code §§ 23151, 23153(d)*], the requirement that the annual minimum franchise tax must be prepaid now applies only to credit unions [*see Rev. & Tax. Code § 23221*]. For further discussion of the calculation of the tax, see the note to *§ 3.121*, P 6.

The Secretary of State's office advises that to expedite processing, articles of incorporation submitted for filing by mail should be accompanied by a self-addressed envelope and a cover letter. For an illustrative cover letter that may be used to request the filing of articles of incorporation, see *§ 3.210*.

[h] Effective Filing Date and Effect of Nonconforming Articles

If the articles conform to law, the Secretary of State will file, and endorse the date of filing, on them [*Corp. Code § 110(a)*]. Corporate existence begins on the filing of the articles and continues perpetually, unless otherwise expressly provided by law or in the articles [*Corp. Code § 200(c)*].

The date of filing is the date the articles are received by the Secretary of State unless the articles are withheld from filing for a period of time pursuant to a request by the party submitting them for filing, or unless in the judgment of the Secretary of State the filing is intended to be coordinated with the filing of some other corporate document that cannot be filed. The Secretary of State will file the articles as of any requested future date, not more than 90 days after their receipt, including a Saturday, Sunday, or legal holiday, if they are received in that office at least one business day prior to the requested date of filing. An instrument does not fail to conform to law because it is not accompanied by the full filing fee if the unpaid portion of the fee does not exceed the limits established by the policy of the Secretary of State for extending credit in such cases [*Corp. Code § 110(a)*; *but see* [i], *below*].

If the articles do not conform to law, that is, they are defective in some particular, they will be returned unfiled. In that case, they may be resubmitted to the Secretary of State accompanied by the written opinion of the member of the State Bar of California submitting them, or representing the person submitting them, to the effect that the specific provision objected to by the Secretary of State does conform to law and stating the points and authorities on which the opinion is based. Subject to a few exceptions [*see Corp. Code §§ 201* (corporate names), *2101*, *2106* (registration and qualification of foreign corporations)], the Secretary of State is required to rely, with respect to any disputed point of law, on the written opinion in determining whether the articles conform to law. The date of filing in under these circumstances is the date the articles are received on resubmission [*Corp. Code § 110(b)*].

[i] Cancellation of Filing for Nonpayment

The Secretary of State may cancel the filing of articles if a check or other remittance accepted in payment of the filing fee or franchise tax is not paid on presentation. If it receives written notification that the item presented for payment has not been honored for payment, the Secretary of State must give written notice that the filing is subject to cancellation and specify a cancellation date. The notice must be given 70 days or less after the original filing of the articles. The cancellation date specified in the notice must be not less than 20 days from the date the Secretary of State mails its certified notice to the agent for service of process or to the person submitting the articles. Cancellation becomes effective if the amount has not been paid by cashier's check or equivalent before the date of cancellation date specified in the notice [*Corp. Code § 110.5*].

[j] Special Requirements for Incorporation of Existing Business Association Organized as Trust

[i] Filing Requirements

An existing business association organized as a trust may be incorporated under the General Corporation Law. The incorporation must be approved by the trust's board of trustees or similar governing body and by a majority of the outstanding voting shares of beneficial interest (or any greater proportion required by its declaration of trust or bylaws), and articles of incorporation must be filed in the office of the Secretary of State [*see Corp. Code § 200.5(a)*]. In addition to the mandatory article provisions required for any corporation [*see Corp. Code § 202*; [b], *above*], the articles must state that an existing unincorporated association (specified by name) is being incorporated by the filing of the articles [*Corp. Code § 200.5(b)*; *see* [2], optional art. VII, *below*].

A copy of the articles of incorporation certified by the Secretary of State may be filed for record in the office of the county recorder of any county in which any real property of the former association is located. This filing is evidence that the corporation is the record owner of all interests of the former association in and to the real property located in that county [*Corp. Code § 200.5(e)*].

[ii] Execution and Certification

The articles must be signed by the president or any vice-president, and by the secretary or any assistant secretary of the existing association. They must be accompanied by a certificate signed and verified by the persons signing the articles stating that the incorporation has been approved by the trustees and by a vote of the required number of shares of beneficial interest [*Corp. Code § 200.5(c)*; *see* [j][i], *above*]. This form includes the required certificate immediately following the verification.

[iii] Effect of Filing Articles

When it files its articles of incorporation, the unincorporated association becomes a corporation [*see Corp. Code § 200(c)*] and automatically succeeds to all of the rights and property of the former association and is subject to all of its debts and liabilities. The trustees of the former association are the initial directors of the corporation and serve until the next annual meeting of the shareholders unless they die, resign, or are removed prior to that time. All creditors' rights and liens on association property are preserved. Any action pending by or against the association may be prosecuted to judgment and the judgment will bind the corporation; or, in the alternative, the corporation may be substituted in the action [*see Corp. Code § 200.5(d)*].

[k] Special Requirements for Articles of Corporation Formed Pursuant to Conversion of Other Business Entity or Foreign Corporation

An other business entity, foreign other business entity, or foreign corporation may be converted into a corporation pursuant to Chapter 11.5 of the General Corporation Law [*see Corp. Code § 1150 et seq.*] if the converting entity is authorized by the laws under which it is organized to effect the conversion. The conversion by an other business entity, foreign other business entity, or foreign corporation into a California corporation will be effective at the time articles of incorporation of the converted corporation containing a statement of conversion are filed with the Secretary of State [*Corp. Code § 1157(d)*]. The contents of this statement are specified by statute [*see Corp. Code § 1157(e)*]. The filing of the articles has the effect of the filing of a certificate of cancellation by a converting foreign limited liability company or foreign limited partnership [*Corp. Code § 1157(f)*; *see Corp. Code §§ 15696*, 15909.06, *17455*]. If a converting entity is a foreign corporation qualified to transact business in California, the foreign corporation, by virtue of filing the articles of incorporation, automatically surrenders its right to transact intrastate business [*Corp. Code § 1157(f)*]. For a drafting guide and form containing the contents required by statute, see Ch. 11F, *Corporate Conversions*, §§ 11F.160 (drafting guide), 11F.250 (form for articles provision).

[2] FORM

Articles of Incorporation for Corporation with Simple Stock Structure (Long Form)

ARTICLES OF INCORPORATION OF _____ [*name of corporation*]

I. Name

The name of this corporation is _____ [*name of corporation*].

[This Article II must not be used for any corporation subject to the Banking Law (see *§§ 3.221-3.224*) or for any professional corporation (see *Ch. 12A, Professional Corporations, § 12A.200*).]

II. Purpose

The purpose of the corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business, or the practice of a profession permitted to be incorporated by the California Corporations Code. [*If corporation is subject to Insurance Code as an insurer, add:* The business of this corporation is to be an insurer.]

[*If the corporation's purposes or powers are to be restricted, insert appropriate provisions here (see, e.g., §§ 3.230, 3.231).*]

[*For Article III, use either Alternative 1 or Alternative 2.*]

[*Alternative 1: For use if agent is natural person.*]

III. Initial Agent for Service of Process

The name and address in the State of California of this corporation's initial agent for service of process is: _____ [*name of agent and complete business or residence address*], California _____, [*zip code*].

[*Alternative 2: For use if agent is corporation that has previously filed consent to act as agent (see § 3.211).*]

III. Initial Agent for Service of Process

The name of the corporation's initial agent for service of process is _____[*name*].

[*CONTINUE*]

IV. Shares

The corporation is authorized to issue only one class of shares of stock [*add, if appropriate:* designated Common stock]; and the total number of shares that this corporation is authorized to issue is _____[*number*].

V. Additional Provisions

[*Optional Provisions:*]

[*The following provisions may be included in the articles. Provisions described in paragraphs (a)-(j), below, must be expressly provided in the articles to be effective, except that for a "close corporation," the provisions may instead be included in a shareholders' agreement (see Corp. Code § 204(a); see also § 3.202 [1][g]). This same requirement applies to any provision that limits or restricts the business in which the corporation may engage or the powers that the corporation may exercise, or both (see instructions at bottom of Article II, above).*]

(a) _____ [*If shares are to be assessable, include provision that describes terms and conditions of assessments (see, e.g., § 3.260)*].

(b) _____ [*If shareholders are to be granted preemptive rights to subscribe to any or all issues of shares or securities, describe preemptive rights (see, e.g., § 3.262)*].

(c) _____ [*If shareholders will be required to possess special qualifications, describe specific qualifications (see, e.g., § 3.263)*].

(d) _____ [*If corporation's existence is to be limited to a specified date, insert appropriate provision to that effect (see, e.g., § 3.300)*].

(e) _____ [*For any or all corporate actions, if the vote must consist of a larger proportion or of all the shares of any class or series, or the vote or quorum for taking action must consist of a larger proportion all of the directors, than is otherwise required by the General Corporation Law (e.g., a requirement that certain matters be approved by more than a majority of the authorized number of directors or that a quorum be larger than a majority), describe specific requirements (see, e.g., §§ 3.270, 3.287, and 3.288)*].

(f) _____ [*If the holders of any evidences of indebtedness, issued or to be issued by the corporation, are to have the right to vote in the election of directors or on any other matters on which shareholders may vote, describe those rights (see, e.g., § 3.275)*].

(g) _____ [*If shareholders are to have right to determine consideration for which shares are to be issued, describe those specific rights (see, e.g., § 3.261)*].

(h) _____ [*If shareholder approval will be required for any corporate action that is not otherwise required under the General Corporation Law, specify specific requirements (see, e.g., § 3.271)*].

(i) _____ [*If personal liability of directors for monetary damages is to be limited, insert appropriate provision to that effect (see, e.g., § 3.280)*].

(j) _____ [*If corporation will be authorized to indemnify its agents to fullest extent permitted under state law, insert provision to that effect (see, e.g., § 3.281)*]. (k) _____ [*If there are to be any restrictions on the right to transfer or hypothecate shares of any class or classes, describe specific restrictions (see, e.g., § 3.264)*].

(l) _____ [*Include any other desired provisions, not in conflict with law, for the management of the business and for the conduct of corporate affairs, including any desired provision that is required or permitted by the General Corporation Law to be stated in the corporation's bylaws (see, e.g., §§ 3.272-3.274, 3.282-3.289)*].

[*Optional:*]

VI. Initial Directors

[*If desired, name initial directors and set forth their addresses in this separately numbered article (see § 3.284 for illustrative provision). If directors are so named, each named person must execute and acknowledge articles (see § 3.284 for signature lines and form of acknowledgment)*].

[*CONTINUE to end with either Alternative 1 or 2:*]

[*Alternative 1: For incorporation of any general business corporation except one by existing business association organized as trust.*]

_____ [*signature*]
[*typed name*], Incorporator

[*If more than one incorporator, add additional signature lines.*]

[*Alternative 2: For incorporation of existing business association organized as trust.*]

VII. Execution

The name of the existing unincorporated association now being incorporated by the filing of these articles is _____ [*name of association*].

_____ [*signature of president or vice- president of existing association*]

[*typed name and title*]

_____ [*signature of secretary or assistant secretary of existing association*]

[*typed name and title*]

Declaration/Certificate

_____ [*name of president or vice-president executing articles*] and _____ [*name of secretary or assistant secretary executing articles*] certify that:

1. They are the _____ [president *or* vice-president] and _____ [secretary *or* assistant secretary], respectively, of _____ [*name of association*], the unincorporated association referred to in the Articles of Incorporation to which this Certificate is attached.

2. The association has duly authorized its incorporation by means of Articles of Incorporation to which this certificate is attached.

3. Incorporation has been duly approved by the association's board of trustees [*or specify other governing body*].

4. Incorporation has been duly approved by the required vote of the outstanding voting shares of beneficial interest in accordance with the association declaration of trust [*or* bylaws *or other*]. The declaration of trust [*or* bylaws *or other*] require the affirmative vote of a majority [*or specify other required percentage*] of the outstanding voting shares of beneficial interest. The total number of outstanding voting shares of the association is _____[*number*]. The number of voting shares voting in favor of incorporation equaled or exceeded the vote required. We declare under penalty of perjury under the laws of the State of California that the matters set forth in this certificate are true and correct of our own knowledge.

Executed at_____[*city*], California, on _____[*date*].

_____ [*signature of president or vice- president executing articles*]
[*typed name and title*]

_____ [*signature of secretary or assistant secretary executing articles*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurposeBusiness & Corporate LawCorporate NamesGeneral OverviewCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



123 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
A. Complete Sets of Articles and Related Forms
1. Complete Articles

2-3 California Legal Forms--Transaction Guide § 3.201

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§ 3.201 Short Form of Articles for General Business Corporation With Simple Stock Structure

[1] Comment--Use of Form

This is a short form of articles of incorporation for a general business corporation with one class of stock. It contains only the minimum mandatory provisions for articles required under the General Corporation Law [*see Corp. Code § 202*] and is typical of the simplest form of articles of incorporation often filed by a general business corporation. The mandatory article provisions are discussed in *§ 3.200[1][b]*.

These articles use a single incorporator to effect the incorporation [*see Corp. Code § 200(a), (b)*; *see also § 3.200[1][f]*] and do not name initial directors of the corporation [*see § 3.284* (provision for naming directors and required signature lines and form of acknowledgment)]. Article III of the form assumes that a natural person, rather than a corporation, will be designated as the corporation's initial agent for service of process [*see § 3.200[1][b][iii]*].

Article II of this form sets forth the purpose statement required by statute for a general business corporation. Other purpose statements are required and these articles should not be used (without modification) for a corporation in the insurance business [*see Corp. Code § 202(b)(3)*; *see § 3.220* (illustrative purpose provision)], a corporation subject to the Banking Law [*see Corp. Code § 163*; *see §§ 3.221-3.224* (purpose provisions)], or the incorporation of a professional practice [*see Corp. Code § 202(b)*; *see also Ch.12A, Professional Corporations, § 12A.200*]. These articles also should not be used without modification for any corporation that desires to limit or restrict the purpose or powers of the corporation, since any restrictions or limitations of that type must be expressly included in the articles [*see Corp. Code §§ 202(b), 204(a)(6)*; *see also §§ 3.230, 3.231*].

These articles do not contain any of the "permissive" provisions that may (and must be, to be effective) included in the articles [*see Corp. Code § 204(a)*; *see § 3.200[1][c]* (listing of these provisions)]. They also do not contain the special mandatory article provisions required for a statutory "close corporation" [*see Corp. Code § 158*]. Those requirements

and an illustrative set of articles for a close corporation are set forth in *§ 3.202*. More detailed coverage is presented in California Small Business Guide(Matthew Bender).

For a longer set of articles that outlines alternative and optional provisions for a general business corporation with a simple stock structure, see *§ 3.200*. Complete articles for a corporation with a complex stock structure (that is, more than one class of stock) are set forth in *§ 3.203*.

Execution and filing requirements for articles of incorporation are covered in *3.200[1][e]-[i]*.

[2] FORM

Short Form of Articles for General Business Corporation With Simple Stock Structure

ARTICLES OF INCORPORATION OF _____ [*name of corporation*]

I. Name

The name of this corporation is _____ [*name of corporation*].

II. Purpose

The purpose of the corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business, or the practice of a profession permitted to be incorporated by the California Corporations Code.

III. Initial Agent for Service of Process

The name and address in the State of California of this corporation's initial agent for service of process is: _____ [*name of natural person and complete business or residence address*], California _____ [*zip code*].

IV. Shares

The corporation is authorized to issue only one class of shares of stock [designated Common stock]; and the total number of shares that this corporation is authorized to issue is _____[*number*].

_____ [*signature*]

[*typed name*], Incorporator

[*If more than one incorporator, add additional signature lines.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation &

BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of Stock



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
A. Complete Sets of Articles and Related Forms
1. Complete Articles

2-3 California Legal Forms--Transaction Guide § 3.202

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§ 3.202 Articles of Incorporation for Close Corporation

[1] Comment

[a] Use of Form

This form is a set of articles of incorporation for a statutory "close corporation" [*see Corp. Code § 158(a)*; *see also* [c], *below* (definition)] with a simple stock structure (that is, only one class of shares). These articles contain only the mandatory provisions required for any stock corporation [*see Corp. Code § 202*; *see also § 3.200[1][b]*], plus the additional, special provisions required for a corporation that elects to be subject to the special statutory provisions of the General Corporation Law applicable to a close corporation [*see Corp. Code §§ 158(a), 202(a)*; *see also* [c], *below*]. The mandatory provisions appear in Articles I, III, IV, and V of this form and are discussed in *§ 3.200[1][b]*. The special provisions required for a close corporation are included in Article II of this form and are discussed in [c], *below*. "Permissive" provisions that may be included in articles of incorporation are listed in Article VI of this form [*see Corp. Code § 204*; *see also § 3.200[1][c]*].

For a set of articles for a corporation with a complex stock structure, see *§ 3.203*. Articles for a general business corporation with a simple stock structure are set forth in *§ 3.200* (long form) and *§ 3.201* (short form). For more detailed coverage, see California Small Business Guide(Matthew Bender).

[b] Execution, Format, and Filing Requirements

Because these articles do not name initial directors, the articles must only be signed by the incorporator or incorporators [*see Corp. Code § 200(b)*]. If initial directors are named [*see § 3.284*], the articles must be signed and acknowledged by each of the named directors [*Corp. Code § 200(b)*]. For an article provision that names initial directors, with appropriate signature lines and an acknowledgment form, see *§ 3.284*. Execution, format, and filing requirements for a statutory close corporation are the same as for any corporation, and those requirements are discussed in detail in *§ 3.200[1][e]-[i]*

.

[c] Definition of "Close Corporation" and Required Special Provisions for Articles

The statutory definition of a "close corporation" refers to the special provisions that must be included in the articles of incorporation for a close corporation. Under this definition, a "close corporation" means a corporation whose articles contain, in addition to the mandatory provisions required for any corporation [*see Corp. Code § 202*; *see also § 3.200[1][b]*], a provision that all of the corporation's issued shares of all classes must be held of record by not more than a specified number of persons, not exceeding 35, and the statement "This corporation is a close corporation" [*Corp. Code § 158(a)*]. These special provisions are set forth in Article II of this form.

The precise elements of a statutory close corporation are distinct from "S corporations" [*see I.R.C. § 1372*] and from corporations that are eligible for the "notice" filing procedures with the Commissioner of Corporations under the limited offering exemption, small offering exemption, or qualified purchaser offering exemption from qualification [*see Corp. Code § 25102(f), (h), (n)*]. While the three types of corporations may have some elements in common, they are in fact separate and independent concepts. For example, for a corporation to qualify for the notice filing procedure under the limited offering or small offering exemption or to make an "S corporation" election, it is not necessary that the corporation's articles conform to the requirements for a statutory close corporation discussed here.

Requirements for exemption from qualification under the small and limited offering exemptions are covered in Ch. 6B, *California Limited Offering Exemptions* and Ch. 6C, *California Small Offering Exemption* . Electing Subchapter S status is covered in Ch. 2B, *Electing Subchapter S Status* .

[d] Requirements for Name of Corporation

The articles of incorporation for any corporation must state the name of the corporation [*Corp. Code § 202(a)*; *see Corp. Code § 201* (prohibited names); *see also* Ch. 2, *Formation of Corporations*]. For the corporation to be subject to the provisions of the General Corporation Law applicable to a close corporation [*see Corp. Code § 158*], the name of the corporation must contain the word "corporation," "incorporated," "limited," or an abbreviation of one of these words [*Corp. Code § 202(a)*].

[e] Determination of Number of Shareholders

As discussed in [c], *above*, the articles for a close corporation must contain a provision that states that all of the corporation's issued shares of all classes shall be held of record by not more than a specified number of persons, and this number may not exceed 35 [*Corp. Code § 158(a)*]. For purposes of determining the number of shareholders, the following rules apply [*Corp. Code § 158(d)*]:

- A husband and wife and the personal representative of either are counted as one, regardless of how shares may be held by either or both of them;

- A trust or personal representative of a decedent holding shares is counted as one regardless of the number of trustees or beneficiaries, unless the primary purpose of the trust was the acquisition or voting of the shares, in which case it is counted according to the number of beneficial interests;

- A partnership, corporation, or business association holding shares is counted as one, unless the primary purpose of the entity was the acquisition or voting of the shares, in which case it is counted according to the number of beneficial interests in it.

[f] Inclusion or Deletion of Required Special Provisions After Initial Incorporation

The special provisions that must be included in the articles of incorporation for a close corporation [*see Corp. Code § 158(a)*; *see also* [c], *above*] may be included in the articles by amendment. However, if shares have been issued, the amendment may be adopted only by the affirmative vote of all of the issued and outstanding shares of all classes [*Corp. Code § 158(b)*], regardless of limitations or restrictions on voting rights [*Corp. Code § 117*].

Also by amendment, the special article provisions may be deleted from the articles or the number of shareholders specified in the articles may be changed. However, if shares have been issued, the amendment may be adopted only by the affirmative vote of at least two-thirds of each class of the outstanding shares, unless otherwise provided in the articles. The articles may provide for a lesser vote, but not less than a majority of the outstanding shares, or may deny a vote to any class, or both [*Corp. Code § 158(c)*; *see also Corp. Code §§ 117*, *902(f)*]. These restrictions on amendments do not invalidate any agreement among the shareholders to vote for the deletion from the articles of the special provisions on the lapse of a specified period of time or on the occurrence of a certain event or condition or otherwise [*Corp. Code § 158(f)*].

If a close corporation acquires more shareholders of record than is permitted by its articles, the special provisions in the articles required for a close corporation must be promptly deleted by the corporation's board of directors [*Corp. Code § 158(e)*; *see* [h], *below*].

[g] Shareholders' Agreement

[i] Definition and General Provisions

By statutory definition, a "shareholders' agreement"is a written agreement among all of the shareholders of a close corporation (or if a close corporation has only one shareholder, between that shareholder and the corporation) as authorized by *Corp. Code § 300(b)* [*Corp. Code § 186*].

Among other things, *Corp. Code § 300(b)* provides that, except as noted below, a shareholders' agreement that relates to any phase of the affairs of a close corporation, including but not limited to management of its business, division of its profits, or distribution of its assets on liquidation, will not be invalid as between the parties to it on the ground that (1) it so relates to the conduct of the affairs of the corporation as to interfere with the discretion of the board or (2) it is an attempt to treat the corporation as if it were a partnership or to arrange their relationships in a manner that would be appropriate only between partners [*Corp. Code § 300(b)*].

Although this statutory authorization grants a close corporation greater flexibility in its structure and management than is generally permitted for corporations under the General Corporation Law, the flexibility is not unrestricted. For example, several provisions of the General Corporation Law may not be altered or waived by the terms of a shareholders' agreement. Specifically, these provisions are *Corp. Code §§ 158*, *500*, *501* (distributions to shareholders), *417*, *418* (required statements on share certificates), *1111* (mergers), *1201(e)* (reorganization), *1500-1512* (records and reports), *1600-1605* (rights of inspection), *1800-1809* (involuntary dissolution), *2009*, *2010*, *2011* (distribution on dissolution and powers of dissolved corporations), and *2200-2260* (crimes and penalties). All other provisions of the General Corporation Law may be altered or waived as between the parties to a shareholders' agreement, except the required filing of any document with the Secretary of State [*Corp. Code § 300(c)*].

To be effective, certain types of provisions must be included in the articles, or in the case of a close corporation, in a shareholders' agreement [*see Corp. Code § 204(a)*]. These provisions are discussed in *§ 3.200[1][c]* and are listed in Article VI of this form.

[ii] Effect of Agreement on Shareholders and Transferees

The failure of a close corporation to observe corporate formalities relating to meetings of directors or shareholders in

connection with the management of its affairs, pursuant to a shareholders' agreement [*see Corp. Code §§ 186, 300(b)*], will not be considered a factor tending to establish that the shareholders have personal liability for corporate obligations [*Corp. Code § 300(e)*]. However, to the extent that the agreement controls the discretion or powers of the board in its management of corporate affairs, it does impose on each shareholder liability for managerial acts or omissions performed by that shareholder to the extent that the liability would otherwise be imposed on directors (and, conversely, the directors are relieved of that liability) [*Corp. Code § 300(d)*].

A transferee of shares covered by a shareholders' agreement that is filed with the secretary of the corporation for inspection by any prospective purchaser of shares, who has actual knowledge of the agreement or notice of the agreement by a notation on the share certificate [*see Corp. Code §§ 418*], is bound by the provisions of the agreement and is a party to it for the purposes of shareholder liability for managerial acts or omissions discussed in the preceding paragraph [*Corp. Code § 300(b)*; *see Corp. Code § 300(d)*]. Original issuance of shares by the corporation to a new shareholder who does not become a party to the agreement terminates the agreement, except that if the agreement so provides, it will continue to the extent it is enforceable apart from applicable statutory provisions [*see Corp. Code § 300(b)*]. The agreement may not be modified, extended, or revoked without the consent of the transferee, subject to any provision of the agreement permitting modification, extension, or revocation by less than unanimous agreement of the parties. A transferor of shares covered by a shareholders' agreement ceases to be a party to it on ceasing to be a shareholder of the corporation unless the transferor is a party to the agreement other than as shareholder [*Corp. Code § 300(b)*]. A shareholders' agreement terminates when the corporation ceases to be a close corporation [*see* [h], *below*], except that if the agreement so provides, it will continue to the extent it is enforceable apart from applicable statutory provisions [*see Corp. Code § 300(b)*]. The rules discussed in this paragraph do not apply to voting trust agreements authorized for close corporations [*Corp. Code § 300(b)*; *see Corp. Code § 706(a)* (voting trust agreements)].

[h] Termination of Status as Close Corporation

A corporation ceases to be a close corporation [*Corp. Code § 158(e)*]:

- On the filing of an amendment to its articles of incorporation that deletes the provisions required for a close corporation [*see Corp. Code § 158(c)*; [c], *above*];

- If it has more than the maximum number of holders of record of its shares specified in its articles as a result of:

  - An inter vivos transfer of shares that is not void under applicable statute [*see Corp. Code § 418(d)*];

  - The transfer of shares on distribution by will pursuant to the laws of descent and distribution;

  - The dissolution of a partnership, corporation, or business association, or the termination of a trust that holds shares;

  - By court decree on dissolution of marriage; or

  - Otherwise by operation of law.

Promptly on acquiring more than the specified number of shareholders of record, a close corporation must execute and file in the Secretary of State's office [*see Corp. Code § 169* (definition of "filed")] an amendment to its articles deleting the special article provisions required for a close corporation [*see Corp. Code § 158(a)*; *see also* [c], *above*], and deleting any other provisions not permissible for a corporation that is not a close corporation. The amendment must be

promptly approved and filed by the board of directors, and need not be approved by the outstanding shares [*Corp. Code § 158(e)*].

[2] FORM

Articles of Incorporation for Close Corporation

ARTICLES OF INCORPORATION OF _____ [*name as it appears in Article I*]

I. Name

The name of the corporation is _____ [*specify name that contains the word "corporation," "incorporated," or "limited," or abbreviation of one of these words*].

II. Close Corporation

This corporation is a close corporation. All of this corporation's issued shares [*if corporation will have more than one class of shares, add:* of all classes] shall be held of record by not more than _____ [*number not exceeding 35*] persons.

III. Purpose

The purpose of the corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business, or the practice of a profession permitted to be incorporated by the California Corporations Code.

[*If corporate purpose or powers are to be limited or restricted, add appropriate provisions (see, e.g., §§ 3.230, 3.231).*]

IV. Initial Agent for Service of Process

[*Select from one of the following alternatives:*]

[*For individual agents, use:*]

The name and address in the State of California of this corporation's initial agent for service of process is: _____ [*name, complete street address, city*], California _____ [*zip code*].

[*Or, for corporate agents, use:*]

The name of the corporation's initial agent for service of process is _____ [*name of corporation serving as agent*].

[*Continue with the following:*]

V. Shares

The corporation is authorized to issue only one class of shares of stock [*add if appropriate:*, designated Common stock]; and the total number of shares that this corporation is authorized to issue is _____[*number*].

[*Optional Provisions:*]

VI. Additional Provisions

[*The following provisions may be included in the articles. Provisions described in paragraphs (a) through (j), below, must be expressly provided in the articles to be effective, except that for a "close corporation" the provisions may instead by included in a shareholders' agreement (see Corp. Code § 204(a); § 3.202 [1][g]). This same requirement applies to any provision that limits or restricts the business in which the corporation may engage or the powers that the corporation may exercise, or both (see instructions at bottom of Article III, above).*]

(a) _____ [*If shares are to be assessable, include provision that describes terms and conditions of assessments (see, e.g., § 3.260)*].

(b) _____ [*If shareholders are to be granted preemptive rights to subscribe to any or all issues of shares or securities, describe preemptive rights (see, e.g., § 3.262)*].

(c) _____ [*If shareholders will be required to possess special qualifications, describe specific qualifications (see, e.g., § 3.263)*]. (d) _____ [*If the corporation's existence is to be limited to a specified date, insert appropriate provision to that effect (see, e.g., § 3.300)*].

(e) _____ [*For any or all corporate actions, if the vote must consist of a larger proportion or of all the shares of any class or series, or the vote or quorum for taking action must consist of a larger proportion all of the directors, than is otherwise required by the General Corporation Law (e.g., a requirement that certain matters be approved by more than a majority of the authorized number of directors or that a quorum be larger than a majority), describe specific requirements (see, e.g., §§ 3.270, 3.287, and 3.288)*].

(f) _____ [*If the holders of any evidences of indebtedness, issued or to be issued by the corporation, are to have the right to vote in the election of directors or on any other matters on which shareholders may vote, describe those rights (see, e.g., § 3.275)*].

(g) _____ [*If shareholders are to have right to determine consideration for which shares are to be issued, describe those specific rights (see, e.g., § 3.261)*].

(h) _____ [*If shareholder approval will be required for any corporate action that is not otherwise required under the General Corporation Law, specify specific requirements (see, e.g., § 3.271)*].

(i) _____ [*If personal liability of directors for monetary damages is to be limited, insert appropriate provision to that effect (see, e.g., § 3.280)*].

(j) _____ [*If corporation will be authorized to indemnify its agents to fullest extent permitted under state law, insert provision to that effect (see, e.g., § 3.281)*].

(k) _____ [*If there are to be any restrictions on the right to transfer or hypothecate shares of any*

class or classes, describe specific restrictions (see, e.g., § 3.264)].

(l) _____ [*Include any other desired provisions, not in conflict with law, for the management of the business and for the conduct of corporate affairs, including any desired provision that is required or permitted by the General Corporation Law to be stated in the corporation's bylaws (see, e.g., §§ 3.272-3.274, 3.282-3.289)*].

_____ [*signature of incorporator*]

[*typed name*], Incorporator

[*If more than one incorporator, add additional signature lines.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



125 of 187 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
A. Complete Sets of Articles and Related Forms
1. Complete Articles

2-3 California Legal Forms--Transaction Guide § 3.203

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§ 3.203 Articles of Incorporation for Stock Corporation With Complex Stock Structure

[1] Comment

[a] Use of Form

This form is a set of articles of incorporation for a corporation with a complex stock structure. For articles for a corporation with a simple stock structure (that is, only one class of shares), see *§§ 3.200* (long form) and *3.201* (short form). A complete set of articles of incorporation for a statutory close corporation [*see Corp. Code § 158*] is set forth in *§ 3.202*.

These articles contain the minimum mandatory article provisions regarding the corporate name, purpose, and agent for service of process [*see* [2], arts. I, II, and III, *below*]; requirements relative to those provisions are discussed in *§ 3.200[1][b]*. Articles IV and V of this form establish the corporation's stock structure and are discussed in the remainder of this Comment. Article VI lists optional provisions that may be included in articles; requirements relative to those provisions are discussed in *§ 3.200[1][c]*.

[b] Execution and Filing

These articles provide for incorporation by a single incorporator and do not name initial directors for the corporation. Under these circumstances, the articles must be executed by the incorporator, or if more than one, the incorporators. If initial directors are named, in the articles, each director must execute and acknowledge the articles [*Corp. Code § 200(b)*; *see § 3.284* (article provision that names initial directors and discussion of execution and acknowledgment requirements)]. Specific format and filing requirements for articles of incorporation are discussed in *§ 3.200[1][e]-[i]*.

[c] Illustrative Stock Structure Used in Form

This form provides for the following stock structure [*see* [2], arts. IV and V, *below*]: two classes of shares, common and preferred [*see* [2], art. IV, *below*; *see also Corp. Code §§ 159, 176* (definitions)]. Article V of the form provides that preferred shares are to be issued in series. The terms (rights, preferences, privileges, and restrictions) of the first series, and certain terms common to all series, are specified and outlined in these articles [*see* [2], art. V, *below*]. The articles authorize the board of directors to fix the terms for additional series. This form provides for a first series (designated below as "Series A"), which has cumulative, nonparticipating dividends [*see* [2], art. V, P (a), *below*], is redeemable at any time [*see* [2], art. V, P (c)], has a liquidation preference [*see* [2], art. V, P (b), *below*], and has contingent voting rights [*see* [2], art. V, P (f), *below*]. General requirements and drafting considerations for those provisions are discussed in *§§ 3.243* (dividend and participation rights), *3.249* (redemption provisions), *3.246* (liquidation preferences), and *3.253* (contingent voting rights).

Article V of this form does not contain provisions for a sinking fund, conversion rights, or protective provisions. Because those types of provisions are likely to vary with each series of shares, they are more often included in a certificate of determination rather than in the original articles [*see* [e], *below*]. However, illustrative provisions for those matters are included in this chapter that may be included either in the articles, or with slight modification, in a certificate of determination [*see § 3.250* (sinking fund); *see also §§ 3.251, 3.252* (conversion rights); and *§ 3.255* (protective provisions)].

The stock structure provisions used in this form are illustrative only and any specific provisions must be modified to fit the specific needs and requirements of a particular corporation. For alternative provisions that may be used in lieu of Article V of this form, see 3.240 through 3.242.

[d] Definition of "Class", "Series", and Other Terms

A "shareholder" is a holder of record of shares [*Corp. Code § 185*]. Shares are the units into which the proprietary interests in a corporation are divided in the articles of incorporation [*Corp. Code § 184*]. "Classes" of shares are either common or preferred. "Common shares" are those having no preference over any other shares with respect to distribution of assets on liquidation or with respect to payment of dividends [*Corp. Code § 159*]. "Preferred shares" are any shares other than common shares [*Corp. Code § 176*].

A "series" of shares means those shares within a class that have the same rights, preferences, privileges, and restrictions, but that differ in one or more rights, preferences, privileges, or restrictions from other shares within the same class [*Corp. Code § 183*; *see Corp. Code § 400(b)*]. Certificated securities [*Corp. Code § 156.1*; *see Com. Code § 8102(a)(4), (15)*] and uncertificated securities [*Corp. Code § 191.1*; *see Com. Code § 8102(a)(15), (18)*] do not constitute different series if the only difference between them is their certificated and uncertificated status [*Corp. Code § 183*]. For a discussion of the distinction between certificated and uncertificated securities, see the discussions under "Share Certificates--Issuance" and subsequent headings in the Legal Background to Ch. 6I, *Issuance of Equity Securities*.

[e] Mandatory Provisions for Articles

Articles I, II, and III of this form contain the mandatory provisions for articles of incorporation regarding the corporate name, corporate purpose, and initial agent for service of process [*see Corp. Code § 202(a)-(c)*]. Requirements for these provisions are discussed in *§ 3.200[1][b]*.

In addition to the above, the articles must contain certain information regarding the corporation's stock structure. If the corporation is authorized to issue only one class of shares, only the total number of shares must be specified in the articles [*Corp. Code § 202(d)*; *see § 3.201[2]*, art. IV, *below*]. If a corporation is authorized to issue more than one class of shares, or if any class of shares is to have two or more series, the articles must set forth the following [*Corp. Code § 202(e)*]:

- The total number of shares of each class the corporation is authorized to issue [*see* [2], art. IV, *below*], and the total number of shares of each series that the corporation is authorized to issue or a statement that the board of directors is authorized to fix the number of shares of any such series [*see* [2], art. V, *below*];

- The designation of each class [*see* [2], art. IV, *below*], and the designation of each series or a statement that the board of directors may determine the designation of any such series [*see* [2], art. V, *below*]; and

- The rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares or their holders, or a statement that the board of directors, within any limits and restrictions stated, may determine or alter the rights, preferences, privileges, and restrictions granted to or imposed on any wholly unissued class of shares or any wholly unissued series of any class of shares [*Corp. Code § 202(e)*; *see* [2], art. V, *below*].

If the articles set forth the designation and number of shares of one or more series within a class [*see* PP (1), (2), *above*], the stated number of shares for all series within that class may be less than, but must not exceed, the stated number of shares for the class [*Corp. Code § 203.5(a)*]. Under those same circumstances, the articles may authorize the board to amend the articles to increase or decrease (but not below the number of shares of the series then outstanding) the number of shares of a series [*Corp. Code § 203.5(b)*]. If the articles authorize the board to fix the number of shares for any series [*see* P (1), *above*], the articles may also authorize the board, within any limits and restrictions stated in the articles or in the board resolution originally fixing the number of shares constituting any series, to increase or decrease (but not below the number of shares of that series then outstanding) the number of shares of any such series subsequent to the issuance of shares of that series. If the number of shares of a series is so decreased, the shares constituting the decrease resume the status they had before the adoption of the resolution originally fixing the number of shares of that series [*Corp. Code § 202(e)(3)*].

If the articles authorize a class of shares that is stated to be issuable in series [*see* [2], art. V, *below*], the articles must include either the designation and number of shares for at least one series within that class or an authorization of common shares [*Corp. Code § 203.5(c)*].

[f] Overview of Drafting Considerations

[i] Distinction or Difference Required Between Classes or Series

Unless otherwise provided in the articles (or, in the case of a close corporation, in any shareholders' agreement [*see Corp. Code §§ 158, 186, 300*; *see also § 3.202[1][g]*), no distinction exists between classes or series of shares, or between shareholders [*Corp. Code § 203*].

When the articles provide for two or more classes of shares, or two or more series of a class of shares, the articles must set forth the distinctions that make the classes or series different from one another [*see Corp. Code § 202(e)(3)*].

A series of shares within a class must also differ in one or more rights, preferences, privileges, or restrictions from shares in another series in the class [*see Corp. Code § 183*]. Certificated securities [*Corp. Code § 156.1*; *see Com. Code § 8102(a)(4), (15)*] and uncertificated securities [*Corp. Code § 191.1*; *see Com. Code § 8102(a)(15), (18)*] do not constitute different series if the only difference between them is their certificated and uncertificated status [*Corp. Code § 183*].

Distinctions between separate classes or series, which is required, must be distinguished from distinctions within the same class or series, which is prohibited. Examples of provisions that violate the latter prohibition are discussed in [iii],

below.

[ii] Authority of Board to Fix Number, Rights, Preferences, and Restrictions for Unissued Series

Articles of incorporation may authorize the board of directors to fix the number or designation of an unissued series of a class of shares, or to fix the rights, preferences, privileges, and restrictions of a wholly unissued class of shares or a wholly unissued series of a class of shares [*Corp. Code § 202(e)*]. In other words, the articles may grant this authority to the board instead of setting forth the particular terms in the articles themselves. However, the board of directors may not be granted this authority for all of the authorized classes of shares. There must always be at least one class (or series) authorized in the articles as to which the board of directors is not given authority to determine the rights, preferences, privileges, or restrictions. When the authority is given, the authority must be limited to shares of a wholly unissued class or series and may not be extended to issued and outstanding shares (subject to one possible exception for changing the number of shares in a series discussed in [e], *above*) [*see Corp. Code § 202(e)*].

If the articles grant the board the authority described above, the board ultimately exercises the authority by adopting a resolution [*see Corp. Code § 401*]. Then, before the corporation issues shares affected by the resolution, the corporation must file a certificate of determination with the Secretary of State [*Corp. Code § 401(a), (b)*; *see §§ 3.310-3.312* (forms of certificate)]. This certificate of determination is then considered to be a part of the corporation's article of incorporations [*see Corp. Code § 154*].

[iii] Requirement That Shares of Same Class or Series Have Same Rights and Restrictions

All shares of any one class must have the same voting, conversion and redemption rights and other rights, preferences, privileges and restrictions, unless the class is divided into series. In that case, all the shares of any one series must have the same voting, conversion and redemption rights and other rights, preferences, privileges and restrictions [*Corp. Code § 400(b)*]. This rule is violated, for example, by an article provision specifying that the shares of a single class held by a shareholder who is not, or ceases to be, an officer, director, or full time employee of the corporation, does not have any voting rights. A provision providing that shares of a particular class, held by shareholders whose whereabouts are unknown to the corporation, is not entitled to receive dividends, also violates the rule.

[iv] Par Value

Under the General Corporation Law, shares do not have any par value and no statement about par value is required to be included in the articles of incorporation. Solely for the purpose of any statute or regulation imposing any tax or fee based on the capitalization of a corporation, all authorized shares of a corporation organized under the General Corporation Law are deemed to have a nominal or par value of $1 per share. If any federal or other statute or regulation applicable to a particular corporation requires that shares have a par value, those shares will have the par value determined by the board of directors in order to satisfy the requirements of that statute or regulation [*Corp. Code § 205*; *see* Ballantine & Sterling, California Corporation Laws, Ch. 3, *Formation of Corporations*, § 51.02(b)].

PRACTICE TIP:

It is easier to designate par value. *Commentary by August J. Moretti.*

[2] FORM

Articles of Incorporation for Stock Corporation With Complex Stock Structure

ARTICLES OF INCORPORATION OF _____ [*name of corporation*]

I. Name

The name of the corporation is _____[*name*].

[This Article II must not be used for any corporation subject to the Banking Law (see *§§ 3.221-3.224* for alternative provisions) or for a professional corporation (see *Ch. 12A, Professional Corporations, § 12A.200*).]

II. Purpose

The purpose of the corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business, or the practice of a profession permitted to be incorporated by the California Corporations Code. [*If corporation is subject to Insurance Code as an insurer, add:* The business of this corporation is to be an insurer.]

[*If the corporation's purposes or powers are to be restricted, insert appropriate provisions here (see, e.g., §§ 3.230, 3.231).*]

[*For Article III, use either Alternative 1 or Alternative 2.*]

[*Alternative 1: For use if agent is natural person.*]

III. Initial Agent for Service of Process

The name and address in the State of California of this corporation's initial agent for service of process is: _____ [*name of agent and complete business or residence address*], California _____, [*zip code*].

[*Alternative 2: For use if agent is corporation that has previously filed consent to act as agent (see § 3.211).*]

III. Initial Agent for Service of Process

The name of the corporation's initial agent for service of process is _____[*name*].

[*CONTINUE*]

IV. Share Structure

This corporation is authorized to issue two classes of shares designated respectively "Common Stock" and "Preferred Stock." These classes are referred to in these Articles as Common Stock or Common shares, or as Preferred Stock or Preferred shares, respectively. The total number of shares of Common Stock is _____[*number*] and the total number of shares of Preferred Stock is _____[*number*].

V. Preferred Shares

The Preferred shares of this Corporation may be issued from time to time in one or more series. The first series of Preferred shares shall (i) be and is hereby designated as _____ [*name of series, e.g.,* Series "A"]; (ii) consist of _____ [*number, e.g.,* 1,000] shares; (iii) be entitled to dividends at the annual rate of $ _____ [*dollar amount e.g.,* $4] per share per annum as provided in paragraph (a) of this Article V; (iv) be entitled to receive, on liquidation, dissolution, or winding up of the corporation, $ _____ per share on and subject to the conditions provided in paragraph (b) of this Article V plus, if liquidation, dissolution or winding up is voluntary, a preferential amount of $ _____ per share and a further preferential amount equal to all accrued and unpaid dividends on those shares to and including the date that payment is made available to the holders of the Series _____ [*name of first series designated above, e.g.,* "A"] shares; (v) be redeemable in the manner and otherwise on the conditions provided in subparagraph (1) of paragraph (c) of this Article V by payment of a redemption price equal to $ _____ [*dollar amount e.g.,* $40] per share and unpaid dividends accrued on those shares to and including the date fixed for redemption and a premium of $ _____ [*dollar amount, e.g.,* $4] per share if redeemed on or before _____[*date*], or a premium of $ _____ [*dollar amount, e.g.,* $3] per share if redeemed after _____ [*same date*]; (vi) be entitled to voting rights under the circumstances and to the extent provided in paragraph (f); and (vii) be entitled to all other rights, preferences, and privileges and be subject to all such restictions as are in this Article V granted to or imposed on the shares of Series _____ [*name of first series designated above, e.g.,* "A"].

Except as to Series _____ [*name of same initial series, e.g.,* "A"], the Board of Directors is authorized, except as to matters fixed as to Preferred shares in this Article V, (i) to determine the designation of any series and to fix the number of shares of any series; (ii) to increase or decrease (but not below the number of shares of any such series then outstanding), the number of shares of any such series after the issue of shares of that series; and (iii) to determine or alter the rights, preferences, privileges, and restrictions granted to or imposed on any wholly unissued series and, within the limitations or restrictions stated in any resolution of the Board of Directors originally fixing the number of shares constituting any series. All Preferred shares shall have the following rights, preferences, privileges, and restrictions:

(a) *Dividend Rights.* The holders of the Preferred shares of each series shall be entitled to receive, when and as declared by the Board of Directors, out of any assets at the time legally available, dividends in cash at the respective rates fixed for that series, and no more. Those dividends shall be payable quarterly on the _____ day of March, June, September, and December in each year to holders of Preferred shares of record on a date not more than 60 nor fewer than 10 days preceding each respective payment date as specified by the Board of Directors or, if not so specified, as provided by law, except that, preceding any of those dates, the initial dividend on the Preferred shares may be paid on the next succeeding quarterly dividend payment date. Those dividends shall accrue and be cumulative as follows: As to shares issued when no other shares of the same series are outstanding, from the date of issuance; as to shares issued when other shares of the same series are outstanding, from that date as shall make the dividend rights per share of the shares being issued uniform with the dividend rights per share of the shares then outstanding of that series, excluding rights to dividends declared and directed to be paid to shareholders of record as of a date preceding the date of issuance of the shares being issued. Dividends on Preferred shares shall accrue at the respective rates fixed for those shares whether or not those dividends are earned. Each Preferred share shall rank with each other Preferred share, irrespective of series, on a parity, proportionately, with respect to dividends at the respective rates fixed for that series, and no dividends shall be declared or paid or set apart for payment on the Preferred shares of any series unless at the same time a dividend, bearing the same proportion to the applicable dividend accrual, shall also be declared or paid or set apart for payment, as the case may be, on the Preferred shares of each other series then outstanding. An accumulation of dividends on Preferred shares shall not bear interest.

Dividends shall be declared and paid in full for all previous quarterly dividend periods, and declared and paid or set

apart for payment in full for the current quarterly dividend period, before the corporation makes any distribution (as defined below) to the holders of common shares. "Distribution" in this paragraph (a) means the transfer of cash or property without consideration, whether by way of dividend or otherwise (except a dividend in shares of the corporation that are junior to the Preferred shares as to dividends or assets) or the purchase or redemption of shares of the corporation for cash or property (except junior shares), including any transfer, purchase, or redemption by a subsidiary of the corporation. The time of any distribution by way of dividend shall be the date the dividend is declared, and the time of any distribution by purchase or redemption of shares or otherwise than by dividend shall be the day cash or property is transferred by the corporation, whether or not pursuant to a contract of an earlier date; provided that, when a debt obligation that is a security is issued in exchange for shares, the time of the distribution is the date when the corporation acquires the shares in that exchange [*or omit this sentence and leave this matter to operation of law (see Corp. Code § 166)*]. At any time after all dividends on the Preferred shares of all series for all previous quarterly dividend periods shall have been declared and paid in full and dividends on the outstanding Preferred shares of all series for the current quarterly dividend period have been declared and paid or set apart for payment in full, distributions (as defined above) may be made to the holders of Common shares out of any assets at the time legally available for that purpose, subject, however, to the observance of any limitations then existing by reason of paragraphs (d) or (e) of this Article V.

(b) *Liquidation Rights.* In the event of any voluntary or involuntary liquidation, dissolution, or winding up of the corporation, the holders of the Preferred shares of each series shall be entitled to receive from the assets of the corporation such preferential amount in cash as may be fixed for the series in redemption of those shares [*or specify other amount*] and, a further preferential amount in cash equal to all accrued and unpaid dividends on those shares to and including the date that payment is made available to the holders of Preferred shares. Those preferential amounts shall be paid or set apart for payment before the payment or setting apart for payment of any amount for, or the distribution of any assets of the corporation to, the holders of Common shares in connection with the liquidation, dissolution, or winding up. If the resolution or resolutions fixing the terms of the Preferred shares of any series shall so provide, the preferential amount payable to the holders of Preferred shares of the series in the event of any liquidation, dissolution, or winding up of the corporation may vary depending on the time of liquidation, dissolution, or winding up. With respect to the respective preferential amounts fixed for the series payable on any distribution of assets by way of liquidation, dissolution, or winding up of the corporation, each Preferred share shall rank with each other Preferred share, irrespective of series, in parity proportionate to those respective preferential amounts. No such amounts shall be paid or set apart for payment on the Preferred shares of any series unless at the same time amounts in like proportion to the respective preferential amounts to which the Preferred shares of each other series are entitled shall be paid or set apart for payment on each other series then outstanding. After the payment or the setting apart for payment to the holders of Preferred shares of the preferential amounts so payable to them, the holders of Common shares shall be entitled to receive, ratably, all remaining assets of the corporation. A consolidation or merger of this corporation with or into any other corporation or corporations, or a sale of all or substantially all of the assets of this corporation, shall not be deemed to be a liquidation, dissolution, or winding up within the meaning of this paragraph.

(c) *Redemption.* Any or all of the Preferred shares of any series may be redeemed at the option of the corporation, by resolution of the Board of Directors adopted at any time, at a price or prices per share fixed for that series, plus an amount equal to all accrued and unpaid dividends on those shares to and including the date fixed for redemption, that sum referred to in this Article V as the "redemption price." If the resolution or resolutions fixing the terms of the Preferred shares of any series shall so provide, the redemption price or prices at which the Preferred shares of that series may be redeemed may vary depending on the time or circumstances of redemption. The resolution fixing the terms of any series may also fix the price or prices at which the shares of that series may be redeemed for the purpose of any sinking fund provided for that series by that resolution. In case of the redemption of fewer than all Preferred shares of a particular series at the time outstanding, the shares of the series to be redeemed shall be selected by the corporation pro rata or by lot [*or specify other method or state that manner or method of selecting shares to be redeemed shall be determined by approval of or in discretion of Board of Directors (see Corp. Code § 402(b))*]. Fewer than all of the Preferred shares at any time outstanding may not be redeemed until all dividends accrued and in arrears on all Preferred

shares outstanding shall have been paid for all past dividend periods.

The corporation shall give notice of any redemption as provided in this subparagraph (c). The notice of redemption shall set forth the series of Preferred shares or the part of any series of Preferred shares to be redeemed, the date fixed for redemption, the redemption price, if the shares are convertible, the then-current conversion price (as defined with respect to the convertible shares) and the date of termination of the right to convert, and, if the shares are certificated securities, the place or places at which the shareholders may obtain payment of the redemption price on surrender of their share certificates [*or, if shares are uncertificated, describe different procedure for payment of redemption price*].

[*Add following sentence if notice will be published. Publication is not required, but notice by publication, as described in the following sentence, is expressly authorized by statute (see Corp. Code § 509(b)):*]

Notice of redemption shall be given by the corporation by causing a notice of redemption to be published in a newspaper of general circulation in the county in which the principal executive office of the corporation is located at least once a week for two successive weeks, in each instance on any day of the week, commencing not earlier than 60 nor later than 20 days before the date fixed for redemption.

[*CONTINUE*]

The corporation shall [also] mail a copy of the notice, postage prepaid, to each holder of record of shares to be redeemed as of the date of mailing or as of a record date lawfully fixed, addressed to the holder at the holder's address appearing on the books of the corporation or given to the corporation for the purpose of notice, of if no such address appears or is given, at the place where the principal executive office of the corporation is located, not earlier than 60 nor later than 20 days before the date fixed for redemption. Failure to comply with this paragraph shall not invalidate the redemption of shares.

On or after the date fixed for redemption and stated in the notice, each holder of Preferred shares called for redemption shall, if the shares are certificated, surrender the certificate evidencing those shares to the corporation at the place designated in the notice and shall then be entitled to receive payment of the redemption price. If less than all shares represented by any surrendered certificate are redeemed, a new certificate shall be issued representing the unredeemed shares. If the notice of redemption shall have been duly given, and if on the date fixed for redemption funds necessary for the redemption shall be available, then, notwithstanding that the certificates evidencing any Preferred shares so called for redemption shall not have been surrendered, the dividends with respect to the shares so called for redemption shall cease to accrue after the date fixed for redemption and all rights with respect to the shares so called for redemption shall after that date cease and terminate, excepting only the right of the holders to receive the redemption price without interest on surrender of their certificates, if the Preferred shares are certificated.

If, on or prior to the date fixed for redemption of Preferred shares, the corporation deposits with any bank or trust company in California, as a trust fund, (i) a sum sufficient to redeem, on the date fixed for redemption, (ii) in the case of the redemption of uncertificated securities, an officer's certificate (as defined below) setting forth the holders of Preferred shares registered on the books of the corporation and the number of shares held by each, and (iii) irrevocable instructions and authority to the bank or trust company to publish the notice of redemption of Preferred shares (or to complete publication if it has previously been commenced) and to pay, on or after the date fixed for redemption or prior to redemption, the redemption price of the shares to their respective holders on the surrender of their share certificates in the case of certificated securities, then from and after the date of the deposit (although prior to the date fixed for redemption) the shares so called shall be redeemed and dividends on those shares shall cease to accrue after the date fixed for redemption. "Officer's Certificate", as used in this paragraph (c), means a certificate signed and verified by the Board Chairperson or the President or any Vice-President and by the Secretary, the Chief Financial Officer, the

Treasurer, or any Assistant Secretary or Assistant Treasurer of the corporation. The deposit shall constitute full payment of the shares to their holders, and from and after the date of the deposit, the shares shall no longer be outstanding, and the holders of those shares shall cease to be shareholders with respect to those shares and shall have no rights with respect to those shares, except the right to receive from the bank or trust company payment of the redemption price of the shares without interest, on surrender of their certificates if the shares redeemed are certificated and without such surrender if the shares redeemed are uncertificated, and any rights of conversion that may beprovided for those shares in the resolution fixing their terms. Any funds so deposited on account of the redemption price of Preferred shares that are convertible and are converted after the making of that deposit shall be repaid to the corporation promptly on the conversion of those Preferred shares. Any interest accrued on any funds so deposited shall be the property of, and paid to, the corporation. If the holders of Preferred shares so called for redemption shall not, at the end of six years from the date fixed for redemption, have claimed any funds deposited, the bank or trust company shall pay over to the corporation the unclaimed funds, and the bank or trust company shall from that time be relieved of all responsibility to those holders, and those holders shall look only to the corporation for payment of the redemption price.

(d) *Application to Other Junior Shares.* Preferences of Preferred shares over Common shares shall also apply to any shares ("other junior shares") that may be subsequently authorized and that are junior to the Preferred shares as to dividends or assets, and all prohibitions, limitations, or restrictions on the declaration or payment of any dividends on, the making of any distribution of assets on, or the application of any assets to the purchase, redemption, or other acquisition of, Common shares shall correspondingly apply to similar action in respect of other junior shares.

(e) *Excepted Transactions.* The provisions of this Article V shall not be deemed to restrict or prohibit (i) the declaration or payment of dividends consisting solely of Common shares or other junior shares, (ii) subject to any contrary provisions established by the Board of Directors in fixing the rights and preferences of any series of Preferred shares, the purchase, redemption or other acquisition of Common shares or other junior shares that is made by the application of a sum not greater than the net proceeds received from the issuance of Common shares or other junior shares, or (iii) an acquisition of Common shares or other junior shares through the issuance of Common shares or other junior shares in exchange for those shares.

(f) *Voting Rights.* Except as in this Article V otherwise expressly provided or as otherwise provided by law, the holders of Common shares shall have and possess the exclusive right to notice of shareholders' meetings and the exclusive voting rights and powers and the holders of Preferred shares shall not be entitled to notice of any shareholders' meetings or to vote on the election of directors or on any other matter. If at any time dividends on any series of Preferred shares shall _____ [be in arrears in an amount at least equal to eight quarterly dividends (whether consecutive or not), then, until all arrears in dividends on the Preferred shares shall have been paid and the full dividend on the Preferred shares for the then current quarterly dividend period shall have been declared and paid or set apart for payment *or* fail to be paid in a timely manner as required by these articles eight times, whether or not subsequently paid], the holders of _____[Preferred shares then outstanding *or specify minimum number of preferred shares outstanding in order for preferred shares to have this right*] shall be entitled, voting as a class, to elect the smallest number of directors that will constitute a majority of the authorized number of directors and the holders of Common shares then outstanding shall be entitled, voting as a class, to elect the remaining directors. The directors elected by the holders of Preferred shares voting as a class pursuant to this paragraph (f) shall be subject to removal only by the vote of the holders of Preferred shares so long as the right of the holders of Preferred shares voting as a class to elect directors shall continue.

(g) *Application to Subsidiaries.* The corporation shall not suffer or permit a subsidiary to purchase, redeem, or otherwise acquire for value Common shares or other junior shares of the corporation unless those shares could be acquired by the corporation itself in compliance with this Article V.

[*Optional Provisions:*]

VI. Additional Provisions

[*The following provisions may be included in the articles. Provisions described in paragraphs (a)-(j) below must be expressly provided in the articles to be effective, except that for a "close corporation", the provisions may instead be included in a shareholders' agreement (see Corp. Code § 204(a); see also § 3.202 [1][g]). This same requirement applies to any provision that limits or restricts the business in which the corporation may engage or the powers that the corporation may exercise or both (see instructions at bottom of Article II, above).*]

(a) _____ [*If shares are to be assessable, include provision that descrives terms and conditions of assessments (see, e.g., § 3.260)*].

(b) _____ [*If shareholders are to be granted preemptive rights to subscribe to any or all issues of shares or securities, describe preemptive rights (see, e.g., § 3.262)*].

(c) _____ [*If shareholders will be required to possess special qualifications, describe specifie qualifications (see, e.g., § 3.263)*].

(d) _____ [*If corporation's existence is to be limited to a specified date, insert appropriate provision to that effect (see, e.g., § 3.300)*].

(e) _____ [*If the vote of a larger proportion or of all the shares of any class or series, or the vote or quorum for taking action of a larger proportion all of the directors, than is otherwise required by the General Corporation Law (e.g., a requirement that certain matters be approved by more than a majority of the authorized number of directors or that a quorum be larger than a majority) is to be required for any or all corporate actions, describe specific requirements (see, e.g., §§ 3.270, 3.287, and 3.288)*].

(f) _____ [*If the holders of any evidences of indebtedness, issued or to be issued by the corporation, are to have the right to vote in the election of directors or on any other matters on which shareholders may vote, describe those rights (see, e.g., § 3.275)*].

(g) _____ [*If shareholders are to have right to determine consideration for which shares are to be issued, describe those specific rights (see, e.g., § 3.261)*].

(h) _____ [*If shareholder approval will be required for any corporate action that is not otherwise required under the General Corporation Law, specify specific requirements (see, e.g., § 3.271)*].

(i) _____ [*If personal liability of directors for monetary damages is to be limited, insert appropriate provision to that effect (see, e.g., § 3.280)*].

(j) _____ [*If corporation will be authorized to indemnify its agents to fullest extent permitted under state law, insert provision to that effect (see, e.g., § 3.281)*].

(k) _____ [*If there are to be any restrictions on the right to transfer or hypothecate shares of any class or classes, describe specific restrictions (see, e.g., § 3.264)*].

(l) _____ [*Include any other desired provisions, not in conflict with law, for the management of the business and for the conduct of corporate affairs, including any desired provision that is required or permitted by the General Corporation Law to be stated in the corporation's bylaws (see, e.g., §§ 3.272-3.274, 3.282-3.289)*].

[*Optional:*]

VII. Initial Directors

[*If desired, name initial directors and set forth their addresses in this separately numbered article (see § 3.284 for illustrative provision). If directors are so named, each named person must execute and acknowledge articles (see § 3.284 for signature lines and form of acknowledgment)*].

_____ [*signature*]

[*typed name*], Incorporator

[*If more than one incorporator, add additional signature lines.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurposeBusiness & Corporate LawCorporate NamesRequirements



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
A. Complete Sets of Articles and Related Forms
1. Complete Articles

2-3 California Legal Forms--Transaction Guide §§ 3.204-3.209

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

[Reserved]

§§ 3.204[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
A. Complete Sets of Articles and Related Forms
2. Related Forms

2-3 California Legal Forms--Transaction Guide § 3.210

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.210 Transmittal Letter for Filing Articles of Incorporation With Secretary of State

[1] Comment

[a] Use of Form

This form is a transmittal letter that may be submitted with articles of incorporation sent by mail for filing with the Secretary of State. It requests the Secretary of State's office to file the original articles, and certify and return the enclosed copies. Format, execution, and filing requirements for the articles are more fully discussed in *§ 3.200[1][e]-[g]*.

[b] Fees

The filing fee for articles of incorporation is $100 [*see* Code § 12186(c), (d)]. Two copies of the articles will be certified without charge; additional copies may be certified on prepayment of a nominal charge when submitted with the original. For expedited processing of articles delivered in person, over the counter, a special handling fee must be remitted by separate check; the special handling fee will be retained regardless of whether or not the articles are accepted for filing [Secretary of State's information packet; *see § 3.121*].

Although corporations are subject to the minimum franchise tax [*see Rev. & Tax. Code §§ 23151, 23153(d)*], the requirement that the annual minimum franchise tax must be prepaid now applies only to credit unions [*see Rev. & Tax. Code § 23221*]. For further discussion of the calculation of the tax, see the note to § 3.121, P 6.

[2] FORM

Transmittal Letter for Filing Articles of Incorporation With Secretary of State

_____[*date*]

Business Filings
1500 11th Street
Sacramento, CA 95814
Attention: Document Filing Support Unit

Re: Articles of Incorporation
Dear Sir or Madam:

Enclosed for filing are the original and _____ [*specify at least two*] conformed copies of the Articles of Incorporation of _____ [*name of proposed corporation*]. Please file these articles, certify and endorse the file date on the enclosed copies, and return the copies to the undersigned.

A self-addressed[, postage prepaid] envelope is included for your convenience.

A check in the amount of $ _____ is enclosed to cover the filing fee for the articles and the applicable minimum franchise tax. [*Optional:* This check also covers the fee for certifying _____ additional copies.]

Thank you for your attention to this matter.

Sincerely,

_____ [*signature*]

[*typed name*]

_____ [*name of person submitting articles*]
_____[*address*]
_____ [*telephone number*]

Encls.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsFinanceFranchise TaxComputationTax LawState & Local TaxesFranchise TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
A. Complete Sets of Articles and Related Forms
2. Related Forms

2-3 California Legal Forms--Transaction Guide § 3.211

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.211 Certificate of Consent of Corporation to Act as Agent for Service of Process for Another Corporation [Corp. Code § 1505]--Secretary of State Form

[1] Comment

[a] Use of Form

This form is the Secretary of State's official form for a certificate of consent by a corporation to act as the agent for service of process for another corporation or entity. The agent corporation must file this certificate with the Secretary of State, together with the required filing fee [*see Corp. Code § 108*; *see* Code § 12186(p)], before any other corporation or other entity may designate it as agent [*Corp. Code § 1505(a)*]. A corporation (domestic or foreign) may not file this certificate unless it is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State [*Corp. Code § 1505(c)*]. When a corporation files the required "Statement by Domestic Stock Corporation" [*see Corp. Code § 1502*; *see also § 3.141*] subsequent to its incorporation, it may not designate a corporation as its agent for service of process unless the certificate set forth below has been previously filed by the agent corporation and is still in effect [*see Corp. Code §§ 1502(b), 1505(a)*].

ELECTRONIC FORMS NOTE

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.sos.ca.gov/business/bpd_forms.htm#corp. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 3405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 3.211. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Filing Procedures

The original and at least two copies of the certificate should be included with the submittal for filing. The Secretary of State will certify two copies of the filed certificate without charge, provided that the copies are submitted to the Secretary of State with the original to be filed. Any additional copies submitted with the original will be certified upon request and payment of the applicable certification fee.

Certificates pursuant to *Corp. Code § 1505* are not filed in the branch offices of the Secretary of State, but rather must be mailed or hand delivered to the Sacramento office. A $15.00 special handling fee is applicable for processing documents delivered in person at the public counter in the Sacramento Office. The special handling fee must be remitted by separate check and will be retained whether the documents are filed or rejected. The special handling fee does not apply to documents submitted by mail. Preclearance or expedited filing of eligible corporate documents can be requested in a specified time frame, for an additional fee (in lieu of the special handling fee).

The Secretary of State's office requests that reference to the corporation's number be made when submitting documents for filing.

[c] Required Contents of Certificate

The certificate must contain all of the following information [*Corp. Code § 1505(a)*]:

- The complete address of the corporate agent's office or offices in California at which the entity designating it as agent may be served with process.

- The name of each person employed by the corporate agent at each designated office who is authorized to take delivery of a copy of process.

- The agent's consent that delivery to any designated employee at a designated office will constitute delivery of any such copy to it, as its agent.

The certificate must be executed in the name of the corporation by a corporate officer [*Corp. Code § 1505(a)*].

[d] Supplemental Filings

A corporation that has filed this certificate may subsequently file any number of supplemental certificates, provided the supplement certificates contain all the information required for the original certificate [*see* [b], *above*]. A filed supplemental certificate supersedes the original and all previous supplemental certificates [*Corp. Code § 1505(b)*].

[e] Resignation of Agent

An agent designated for service of process may file a signed and acknowledged statement of resignation as agent, which will terminate the agent's authority to act in that capacity. The Secretary of State will mail written notice of the resignation to the corporation at its principal executive office [*Corp. Code § 1503(a)*]. For an illustration of the Secretary of State's official form (form RA) for resignation of an agent for service of process, see *Ch. 7, Corporate Records and Reports, § 7.209*. Under regulations adopted by the Secretary of State, the resignation of an agent may also be effective if the agent disclaims having been properly appointed as the agent [*see Corp. Code § 1503(b)*; *2 Cal. Code Reg. § 21906*].

[f] Designation of New Agent

If the agent for service of process is a natural person who dies, resigns, or no longer resides in California, or if the agent

is a corporate agent that resigns, dissolves, withdraws from the state, forfeits its right to transact intrastate business, has its corporate rights, powers, and privileges suspended, or ceases to exist, the designating corporation must designate a new agent on the form prescribed by the Secretary of State [*Corp. Code § 1504*; *see Corp. Code § 1502*; *see also § 3.141* (contents of required form)]. For an illustration of Secretary of State Form SO-200C, which is used to designate a new agent, see *Ch. 7, Corporate Records and Reports, § 7.207*.

[2] FORM

Certificate of Consent of Corporation to Act as Agent for Service of Process for Another Corporation [Corp. Code § 1505]--Secretary of State Form

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Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
A. Complete Sets of Articles and Related Forms
2. Related Forms

2-3 California Legal Forms--Transaction Guide §§ 3.212-3.219

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

[Reserved]

§§ 3.212[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
1. Corporation's Business Purpose

2-3 California Legal Forms--Transaction Guide § 3.220

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.220 Business Purpose as Insurer [Corp. Code § 202(b)(1)(i), (3)]

[1] Comment

[a] Use of Form

This provision must be included as a separate article in the articles of incorporation for a corporation that is subject to the Insurance Code as an insurer [*see Corp. Code § 202(b)(3)*]. The first sentence of the provision is the general business purpose statement required to be included in the articles of incorporation for any corporation formed under the General Corporation Law, except a professional corporation or a corporation engaged in the banking or trust company business [*see Corp. Code § 202(b)(1)(i)*]. The second sentence of the provision is the additional statement required for a corporation subject to the Insurance Code as an insurer; it merely states that the business of the corporation is to be an insurer [*Corp. Code § 202(b)(3)*]. Other than these two required sentences, no additional statement with respect to the purpose or powers of the corporation may be included in the articles except by way of limitation, or except as expressly required by any law of California other than the General Corporation Law or any federal or other statute or regulation (including the Internal Revenue Code and its regulations as a condition of acquiring or maintaining a particular status for tax purposes) [*Corp. Code § 202(b)*; *see Corp. Code § 207* (enumeration of general corporate powers)]. Any provision that limits or restricts the business in which the corporation may engage or the power that it may exercise, or both, in order to be effective, must be included in the articles, or in the case of a close corporation [*see Corp. Code § 158*], a shareholders' agreement [*Corp. Code § 204(a)(6)*; *but see Corp. Code § 208(a)* (limitations on enforcement in third party actions)]. For provisions that may be added to this form to restrict the corporation's business activities or its powers, see *§§ 3.230* and *3.231*.

For an article provision to be used by most corporations to state a general business purpose, see Article II in *§ 3.201[2]* [*see also § 3.200[1][b][ii]* (discussion of requirements)]. For illustrative purpose provisions for a corporation subject to the banking law, see *§§ 3.221* through 3.224. For an example of a purpose clause for a professional corporation [*see Corp. Code § 202(b)(1)(ii)*], see Ch. 12A, *Professional Corporations* .

[b] Special Filing Requirements

The Secretary of State will not file articles in which the business is to be an insurer unless the certificate of the Insurance Commissioner approving the corporate name is attached to the articles [*Corp. Code § 201.5*]. Otherwise, the usual filing requirements for articles of incorporation apply [*see § 3.200[1][e]-[g]*].

[2] FORM

Business Purpose as Insurer [Corp. Code § 202(b)(1)(i), (3)]
_____ [*Article number*]

The purpose of the corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business, or the practice of a profession permitted to be incorporated by the California Corporations Code. This corporation will engage in the insurance business and is subject to the Insurance Code of the State of California as an insurer.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurposeInsurance LawIndustry RegulationInsurance Company OperationsOwnershipGeneral Overview



131 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
1. Corporation's Business Purpose

2-3 California Legal Forms--Transaction Guide § 3.221

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.221 Purpose Clause for Commercial Bank Not Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(a)]

[1] Comment

[a] Use of Form

This form is a "purpose" clause that must be included in the articles of incorporation for a commercial bank that is not authorized to engage in the trust business [*see Fin. Code § 600(a)*]. Any corporation that is subject to the Banking Law [*see Corp. Code § 163* (description of corporations subject to Banking Law)] must include in its articles a statement of purpose prescribed by the Banking Law, rather than the purpose clause mandated for general business corporations under the General Corporation Law [*Corp. Code § 202(b)(2)*; *see, e.g., § 3.201[2]*, art. II]. Articles must also conform to specific requirements of the Banking Law [*see* [b], *below*].

The clause below is mandated by the Banking Law for commercial banks that will not engage in the trust business. If the commercial bank being incorporated will engage in the trust business, a different clause is required [*see § 3.222*]. A different clause also is required for a corporation engaged in the business of international and foreign banking and other international and foreign financial operations [*see Fin. Code § 3502*].

[b] Applicability of Banking Law

The General Corporation Law is applicable to banks and trust companies [*see Fin. Code § 101(b)*] except when inconsistent with applicable provisions of the Financial Code [*see Fin. Code § 101*; *see also Corp. Code §§ 102, 163, 206*]. Some of these provisions, which are not covered in this chapter, extend to the articles of incorporation and structure of the corporation. Other important areas in which the Banking Law supersedes the provisions of the General Corporation Law include distributions to shareholders [*see Fin. Code §§ 640-646*], denial of close corporation status [*see Fin. Code § 351*], and loans to insiders [*see Fin. Code §§ 780-787*].

Prior approval of the articles is required to form a commercial banking or trust corporation [*Fin. Code § 400*; *see Fin. Code § 350*] or an international or foreign banking or other financing corporation [*Fin. Code § 3503*; *see Fin. Code § 3535*]. The Secretary of State will not file articles setting forth a name in which "bank," "trust," "trustee," or related words appear, unless a certificate of approval is attached to the articles. This prohibition does not apply to the articles of any corporation subject to the Banking Law on which is endorsed the approval of the Commissioner of Financial Institutions [*Corp. Code § 201(a)*]. Requirements for filing articles with the Secretary of State are covered in *§ 3.200[1][e] through [i]*.

[2] FORM

Purpose Clause for Commercial Bank Not Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(a)]

_____ [*Article number*]

The purpose of the corporation is to engage in commercial banking business and any other lawful activities that are not, by applicable laws or regulations, prohibited to a commercial bank.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawBank ActivitiesGeneral OverviewBanking LawBank ExpansionBank Creations & ReorganizationsBanking LawDepository InstitutionsCommercial BanksBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurposeBusiness & Corporate LawCorporate NamesRequirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
1. Corporation's Business Purpose

2-3 California Legal Forms--Transaction Guide § 3.222

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.222 Purpose Clause for Commercial Bank Also Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(b)]

[1] Comment--Use of Form

This form is a "purpose" clause that must be included in the articles of incorporation for a commercial bank authorized to engage in the trust business [*see Fin. Code § 600(b)*]. Any corporation that is subject to the Banking Law [*see Corp. Code § 163* (description of corporations subject to Banking Law)] must include in its articles a statement of purpose prescribed by the Banking Law, rather than the business purpose clause mandated for general business corporations under the General Corporation Law [*Corp. Code § 202(b)(2)*; *see, e.g., § 3.201[2]*, art. II]. Articles for banks must also conform to specific requirements of the Banking Law [*see § 3.221[1][b]*].

The clause below is mandated by the Banking Law for commercial banks that will engage in the trust business [*see Fin. Code § 600(b)*]. If the commercial bank being incorporated will not engage in the trust business, a different clause is required [*see § 3.221*]. A different purpose statement also is required for the incorporation of a business engaged in international and foreign banking and other international and foreign financial operations [*see Fin. Code § 3502*].

[2] FORM

Purpose Clause for Commercial Bank Also Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(b)]

_____ [*Article number*]

The purpose of the corporation is to engage in commercial banking business and trust business and any other lawful activities that are not, by applicable laws or regulations, prohibited to a commercial bank authorized to engage in trust business.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawBank ActivitiesSecuritiesTrust Investment ServicesBanking LawBank ActivitiesCommon Trust FundsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurposeBanking LawBank ActivitiesGeneral OverviewBanking LawDepository InstitutionsCommercial Banks



133 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
1. Corporation's Business Purpose

2-3 California Legal Forms--Transaction Guide § 3.223

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.223 Purpose Clause for Trust Company (Not Also a Commercial Bank) [Corp. Code § 202(b)(2); Fin. Code § 600(e)]

[1] Comment--Use of Form

This form is a "purpose" clause that must be included in the articles of incorporation for a corporation that is solely a trust company [*see Fin. Code § 600(e)*]. Any corporation that is subject to the Banking Law [*see Corp. Code § 163* (description of corporations subject to Banking Law that includes a trust company)] must include in its articles a statement of purpose prescribed by the Banking Law, rather than the business purpose clause mandated for general business corporations under the General Corporation Law [*Corp. Code § 202(b)(2)*; *see, e.g., § 3.201[2]*, art. II]. Articles for a trust company are also subject to additional requirements of the Banking Law [*see § 3.221[1][b]*].

The clause below is mandated by the Banking Law for a corporation that is solely a trust company [*see Fin. Code § 600(e)*]. Different purpose clauses are required for a commercial bank that is not authorized to engage in trust business [*see § 3.221*], a commercial bank that is not authorized to engage in trust business [*see § 3.221*], a commercial bank that will engage in trust business [*see § 3.222*], and for industrial banks that are or are not authorized to engage in trust business [*see §§ 3.224, 3.225*].

[2] FORM

Purpose Clause for Trust Company (Not Also a Commercial Bank) [Corp. Code § 202(b)(2); Fin. Code § 600(c)]

_____ [*Article number*]

The purpose of the corporation is to engage in trust business and any other lawful activities that are not, by applicable laws or regulations, prohibited to a trust company.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawBank ActivitiesSecuritiesTrust Investment ServicesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurpose



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
1. Corporation's Business Purpose

2-3 California Legal Forms--Transaction Guide § 3.224

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.224 Purpose Clause for Industrial Bank Not Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(c)]

[1] Comment--Use of Form

This form is a "purpose" clause that must be included in the articles of incorporation for a corporation that is solely an industrial bank [*see Fin. Code § 600(c)*]. Any corporation that is subject to the Banking Law [*see Corp. Code § 163* (description of corporations subject to Banking Law); *see also § 3.221[1][b]*] must include in its articles a statement of purpose prescribed by the Banking Law, rather than the business purpose clause mandated for general business corporations under the General Corporation Law [*Corp. Code § 202(b)(2)*; *see, e.g., § 3.201[2]*, art. II].

The clause below is mandated by the Banking Law for a corporation that is an industrial bank not authorized to engage in trust business [*Fin. Code § 600(c)*]. Different purpose clauses are required for a commercial bank that will not engage in the trust business [*see § 3.221*], a commercial bank that will engage in the trust business [*see § 3.222*], a trust company that is not a commercial bank [*see § 3.223*], and an industrial bank that is authorized to engage in trust business [*see § 3.225*].

[2] FORM

Purpose Clause for Industrial Bank Not Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(c)]

_____ [*Article number*]

The purpose of the corporation is to engage in industrial banking business and any other lawful activities that are not, by applicable laws or regulations, prohibited to an industrial bank.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurposeBanking LawBank ActivitiesGeneral OverviewBanking LawDepository InstitutionsCommercial Banks



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
1. Corporation's Business Purpose

2-3 California Legal Forms--Transaction Guide § 3.225

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.225 Purpose Clause for Industrial Bank Also Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(d)]

[1] Comment--Use of Form

This form is a "purpose" clause that must be included in the articles of incorporation for a corporation that is an industrial bank authorized to engage in trust business [*see Fin. Code § 600(d)*]. Any corporation that is subject to the Banking Law [*see Corp. Code § 163* (description of corporations subject to Banking Law); *see also § 3.221[1][b]*] must include in its articles a statement of purpose prescribed by the Banking Law, rather than the business purpose clause mandated for general business corporations under the General Corporation Law [*Corp. Code § 202(b)(2)*; *see, e.g., § 3.201[2]*, art. II].

The clause below is mandated by the Banking Law for a corporation that is an industrial bank that is authorized to engage in trust business [*Fin. Code § 600(d)*]. Different purpose clauses are required for a commercial bank that will not engage in the trust business [*see § 3.221*], a commercial bank that will engage in the trust business [*see § 3.222*], a trust company that is not a commercial bank [*see § 3.223*], and an industrial bank that is not authorized to engage in trust business [*see § 3.224*].

[2] FORM

Purpose Clause for Industrial Bank Also Authorized to Engage in Trust Business [Corp. Code § 202(b)(2); Fin. Code § 600(d)]

_____ [*Article number*]

The purpose of the corporation is to engage in industrial banking business and trust business and any other lawful activities that are not, by applicable laws or regulations, prohibited to an industrial bank authorized to engage in trust business.

Legal Topics:

For related research and practice materials, see the following legal topics:
Banking LawBank ActivitiesSecuritiesTrust Investment ServicesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurposeBanking LawBank ActivitiesGeneral OverviewBanking LawDepository InstitutionsCommercial Banks



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
1. Corporation's Business Purpose

2-3 California Legal Forms--Transaction Guide §§ 3.226-3.229

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

[Reserved]

§§ 3.226[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
2. Restrictions on Corporate Business Activities or Powers

2-3 California Legal Forms--Transaction Guide § 3.230

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.230 Restriction on Corporate Business Purpose or Activities

[1] Comment

[a] Use of Form

The provision in this form may be included in the articles of incorporation to restrict or limit the business in which a corporation is otherwise permitted by law to engage [*see Corp. Code §§ 202(b), 204(a)(6)*; *see also* [b], *below* (permitted business purposes and activities in absence of restriction or limitation)]. If used, the provision should be used in conjunction with the appropriate "business purpose" clause required by statute to be included in the articles of incorporation [*see Corp. Code § 202(b)*; *see, e.g., § 3.201[2]*, art. II (general business purpose clause)]. Other than the mandated business purpose clause, no additional statement with respect to the purpose or powers of the corporation may be included in the articles except by way of limitation (as illustrated by this form) or except as expressly required by any law of California other than the General Corporation Law or any federal or other statute or regulation (including the Internal Revenue Code and its regulations as a condition of acquiring or maintaining a particular status for tax purposes) [*Corp. Code § 202(b)*]. In order to be effective, a provision that limits or restricts the business in which the corporation may engage (this form) or the powers that the corporation may exercise [*see § 3.231*], or both, must be included in the articles, or in the case of a close corporation [*see Corp. Code § 158*], a shareholders' agreement [*Corp. Code § 204(a)(6)*; *but see Corp. Code §§ 204(a)* (enforceability as between parties to lawful agreement not affected), 208(a) (limitations applicable to third party actions)].

This provision may or may not be used in conjunction with a provision that limits the powers of a corporation [*see § 3.231*].

[b] Permitted Business Activities

Subject to any limitation contained in the articles (for example, this form) and to compliance with any other applicable

laws, any corporation other than a corporation subject to the Banking Law [*see Corp. Code § 163* (definition)], or a professional corporation [*see* Ch. 12A, *Professional Corporations*] may engage in any business activity. A professional corporation or a corporation subject to the Banking Law may engage in any business activity not prohibited by the respective statutes and regulations to which it is subject [*Corp. Code § 206*].

[2] FORM

Restriction on Corporate Business Purpose or Activities

[*Add following to end of Article that contains corporation's mandatory "purpose" clause (see, e.g., Article II in § 3.201[2]):*]

Notwithstanding the general business purpose of the corporation stated in these Articles of Incorporation, the corporation may not engage in the business of _____ [*describe specific restriction, including type of business, and if desired, time period to which restriction applies, e.g.,* manufacturing, wholesaling, or retailing baseball caps or other similar headgear in the City and County of San Francisco, California at any time before December 31, 2010].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePowersGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurpose



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
2. Restrictions on Corporate Business Activities or Powers

2-3 California Legal Forms--Transaction Guide § 3.231

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.231 Specific Restrictions on Corporate Powers

[1] Comment

[a] Use of Form

This provision may be included in the articles of incorporation to restrict or limit the powers that a corporation is otherwise entitled by law to exercise [*see Corp. Code §§ 202(b), 204(a)(6)*; *see also* [b], *below* (powers of corporation in absence of restriction or limitation)]. If used, this provision (or a similar one) should be used in conjunction with the appropriate "business purpose" clause required by statute to be included in the articles of incorporation [*see Corp. Code § 202(b)*; *see, e.g., § 3.201[2]*, art. II (general business purpose clause)]. Other than the mandated business purpose clause, no additional statement with respect to the purpose or powers of the corporation may be included in the articles except by way of limitation (as illustrated by this form) or except as expressly required by any law of California other than the General Corporation Law or any federal or other statute or regulation (including the Internal Revenue Code and its regulations as a condition of acquiring or maintaining a particular status for tax purposes) [*Corp. Code § 202(b)*]. In order to be effective, a provision that limits or restricts the powers that the corporation may exercise or the business in which the corporation may engage [*see § 3.230*], or both, must be included in the articles, or in the case of a close corporation [*see Corp. Code § 158*], a shareholders' agreement [*Corp. Code § 204(a)(6)*; *but see Corp. Code §§ 204(a)* (enforceability as between parties to lawful agreement not affected), 208(a) (limitations applicable to third party actions)].

This provision may or may not be used in conjunction with a provision that limits the purpose or business activities of the corporation [*see § 3.230*].

[b] Powers of Corporation

Subject to any limitations contained in the articles of incorporation and to compliance with other provisions of the

General Corporation Law and any other applicable laws, a corporation has all of the powers of a natural person in carrying out its business activities. These powers include, but are not limited to, the following powers [*Corp. Code § 207*]:

- Adopt, use, and, at will, alter a corporate seal, but failure to affix a seal does not affect the validity of any instrument;

- Adopt, amend, and repeal bylaws;

- Qualify to do business in any other state, territory, dependency, or foreign country;

- Subject to statutory restrictions [*see Corp. Code § 510*], issue, purchase, redeem, receive, take or otherwise acquire, own, hold, sell, lend, exchange, transfer or otherwise dispose of, pledge, use and otherwise deal in and with its own shares, bonds, debentures, and other securities;

- Make donations, regardless of specific corporate benefit, for the public welfare or for community fund, hospital, charitable, educational, scientific, civic, or similar purposes;

- Pay pensions, and establish and carry out pension, profit-sharing, share bonus, share purchase, share option, savings, thrift and other retirement, incentive and benefit plans, trusts and provisions for any or all of the directors, officers and employees of the corporation or any of its subsidiary or affiliated corporations, and indemnify and purchase and maintain insurance on behalf of any fiduciary of those plans, trusts, or provisions;

- Subject to specific statutory restrictions [*see Corp. Code § 315*], assume obligations, enter into contracts, including contracts of guaranty or suretyship, incur liabilities, borrow and lend money and otherwise use its credit, and secure any of its obligations, contracts or liabilities by mortgage, pledge or other encumbrance of all or any part of its property, franchises and income; and

- Participate with others in any partnership, joint venture or other association, transaction or arrangement of any kind, whether or not that participation involves sharing or delegation of control with or to others.

[2] FORM

Specific Restrictions on Corporate Powers

[*Add following to end of Article that contains corporation's mandatory "purpose" clause (see, e.g., Article II in § 3.201[2])*:]

Notwithstanding the general powers conferred on a corporation by the General Corporation Law or any other law, the corporation is not authorized to and shall not _____ [*describe specific restriction, e.g.,* conduct or engage in business or qualify to do business in any other state, territory, or dependency of the United States or foreign country].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers &

PurposePowersGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurpose



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
2. Restrictions on Corporate Business Activities or Powers

2-3 California Legal Forms--Transaction Guide §§ 3.232-3.239

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

[Reserved]

§§ 3.232[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.240

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.240 Rights, Preferences, Privileges, and Restrictions: Preferred Shares Issuable in Series--Certain Terms for All Series Fixed by Articles, Other Terms of Each Series to Be Fixed by Directors

[1] Comment

[a] Use of Form

This form may be included in articles of incorporation, as a separate article, to provide for the rights, preferences, privileges, and restrictions granted to or imposed on the corporation's respective classes or series of shares [*see Corp. Code § 202(e)(3)*; *see also* [b], *below*]. Use of this form assumes that two classes of shares are authorized, common and preferred, and this form must be used in conjunction with a provision to that effect that also states the number of shares authorized for each class [*see, e.g., § 3.203 [2]*, art. IV; *see also* [b], *below*].

This form provides that preferred shares are issuable in series. Certain terms for all series of shares are specified, but the board of directors is granted authority to fix other terms for each series [*see Corp. Code § 202(e)*; *see also* [b], *below*]. In this form, preferred shares have cumulative, nonparticipating dividends [*see* P (a), *below*; *see also § 3.243*], have a liquidation preference [*see* P (b), *below*; *see also § 3.246*], and are redeemable at any time [*see* P (c), *below*; *see also § 3.249*]. This form does not contain any reference to, or limitation on, voting rights. Under these circumstances, preferred shares and common shares would both have voting rights and the right to receive notice of meetings [*see Corp. Code § 700(a)*]. For a provision that may be used to eliminate or restrict these rights with respect to preferred shares, see *§ 3.203 [2]*, Article V, Paragraph (f).

This form also does not contain any provisions for a sinking fund, conversion rights, or protective provisions. Because these matters are likely to vary with each series, they are usually covered in a subsequent board resolution and certificate of determination [*see* [b], *below*; *see also § 3.310*]. However, illustrative provisions are included in this chapter that may be included in the articles, or with slight modification in a certificate of determination [*see § 3.250* (sinking fund); *see also §§ 3.251, 3.252* (conversion rights), *3.255* (protective provisions)].

The provisions in this form are designated Article V only to facilitate understanding that the Article contained in this form is an alternative to other illustrative provisions designated Article V in this chapter. For example, Article V in the complete set of articles set forth in *§ 3.203[2]* also authorizes shares issuable in series, but differs from this form in that its provisions fix terms of the first series (and certain provisions relating to all series) and authorizes the directors only to fix the terms of additional series. The provision in *§ 3.241[2]* (also designated Article V and that also authorizes two classes with preferred shares issuable in series) does not fix any terms for the series, but rather grants the broadest possible authority to the directors to fix the terms of each series. At the other end of the spectrum, the provision in § 3.242[2] (also designated Article V for purposes of reference) may be used if all terms of a class or series will be stated in the articles and no authority will be granted to directors to determine those matters.

[b] Mandatory Information Regarding Corporation's Stock Structure

Articles of incorporation must contain certain information regarding the corporation's stock structure. If the corporation is authorized to issue only one class of shares, only the total number of shares must be specified in the articles [*Corp. Code § 202(d)*; *see § 3.201[2]*, art. IV]. If a corporation is authorized to issue more than one class of shares, of if any class of shares is to have two or more series, the articles must set forth the following [*Corp. Code § 202(e)*]:

- The total number of shares of each class the corporation is authorized to issue, and the total number of shares of each series that the corporation is authorized to issue or a statement that the board of directors is authorized to fix the number of shares of any such series;

- The designation of each class, and the designation of each series or a statement that the board of directors may determine the designation of any such series; and

- The rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares or their holders, or a statement that the board of directors [*see Corp. Code § 155*], within any limits and restrictions stated, may determine or alter the rights, preferences, privileges, and restrictions granted to or imposed on any wholly unissued class of shares or any wholly unissued series of any class of shares [*Corp. Code § 202(e)*; *see § 3.203*].

If the articles set forth the designation and number of shares of one or more series within a class, the stated number of shares for all series within that class may be less than, but must not exceed, the stated number of shares for the class [*Corp. Code § 203.5(a)*]. Under those same circumstances, the articles may authorize the board to amend the articles to increase or decrease (but not below the number of shares of the series then outstanding) the number of shares of a series [*Corp. Code § 203.5(b)*]. If the articles authorize the board to fix the number of shares for any series, the articles may also authorize the board, within any limits and restrictions stated in the articles or in the board resolution originally fixing the number of shares constituting any series, to increase or decrease (but not below the number of shares of that series then outstanding) the number of shares of any such series subsequent to the issue of shares of that series. If the number of shares of a series is so decreased, the shares constituting the decrease resume the status they had prior to the adoption of the resolution originally fixing the number of shares of that series [*Corp. Code § 202(e)(3)*].

If the articles authorize a class of shares that is stated to be issuable in series [*see* [2], *below*], the articles must include either the designation and number of shares for at least one series within that class or an authorization of common shares [*Corp. Code § 203.5(c)*].

For a discussion of additional general considerations for drafting stock structure provisions for the articles, see *§ 3.203[1]*.

[2] FORM

Rights, Preferences, Privileges, and Restrictions: Preferred Shares Issuable in Series--Certain Terms for All Series Fixed by Articles, Other Terms of Each Series to Be Fixed by Directors
V. Preferred Shares

The Preferred shares may be issued from time to time in one or more series. The Board of Directors is authorized to fix the number of any series of Preferred shares and to determine the designation of any series. The Board of Directors is also authorized, except as to matters fixed as to Preferred shares in this Article V, to determine or alter the rights, preferences, privileges, and restrictions granted to or imposed on any wholly unissued series of Preferred shares and, to increase or decrease (but not below the number of shares of that series then outstanding) the number of shares of any series after the issue of shares of that series. All Preferred shares shall have the following rights, preferences, privileges, and restrictions:

(a) *Dividend Rights.* The holders of the Preferred shares of each series shall be entitled to receive, when and as declared by the Board of Directors, out of any assets at the time legally available, dividends in cash at the respective rates fixed for that series, and no more. Those dividends shall be payable quarterly on the _____ day of March, June, September, and December in each year to holders of Preferred shares of record on a date not more than 60 nor fewer than 10 days preceding each respective payment date as specified by the Board of Directors or, if not so specified, as provided by law, except that, preceding any of such dates, the initial dividend thereon may be paid on the next succeeding quarterly dividend payment date. Those dividends shall accrue and be cumulative as follows: As to shares issued when no other shares of the same series are outstanding, from the date of issuance; as to shares issued when other shares of the same series are outstanding, from such date as shall make the dividend rights per share of the shares being issued uniform with the dividend rights per share of the shares then outstanding of that series, excluding rights to dividends declared and directed to be paid to shareholders of record as of a date preceding the date of issuance of the shares being issued. Dividends on Preferred shares shall accrue at the respective rates fixed for those shares whether or not those dividends are earned. Each Preferred share shall rank with each other Preferred share, irrespective of series, on a parity, proportionately, with respect to dividends at the respective rates fixed for that series, and no dividends shall be declared or paid or set apart for payment on the Preferred shares of any series unless at the same time a dividend, bearing the same proportion to the applicable dividend accrual, shall also be declared or paid or set apart for payment, as the case may be, on the Preferred shares of each other series then outstanding. An accumulation of dividends on Preferred shares shall not bear interest.

Dividends shall be declared and paid in full for all previous quarterly dividend periods, and declared and paid or set apart for payment in full for the current quarterly dividend period, before the corporation makes any distribution (as defined below) to the holders of common shares. "Distribution" in this paragraph (a) means the transfer of cash or property without consideration, whether by way of dividend or otherwise (except a dividend in shares of the corporation that are junior to the Preferred shares as to dividends or assets) or the purchase or redemption of shares of the corporation for cash or property (except such junior shares), including any such transfer, purchase, or redemption by a subsidiary of the corporation. The time of any distribution by way of dividend shall be the date the dividend is declared, and the time of any distribution by purchase or redemption of shares or otherwise than by dividend shall be the day cash or property is transferred by the corporation, whether or not pursuant to a contract of an earlier date; provided that when a debt obligation that is a security is issued in exchange for shares, the time of the distribution is the date when the corporation acquires the shares in that exchange [*or omit this sentence and leave this matter to operation of law (see Corp. Code § 166)*]. At any time after all dividends on the Preferred shares of all series for all previous quarterly dividend periods shall have been declared and paid in full and dividends on the outstanding Preferred shares of all series for the current quarterly dividend period have been declared and paid or set apart for payment in full, distributions (as defined above) may be made to the holders of Common shares out of any assets at the time legally available for that purpose, subject, however, to the observance of any limitations then existing by reason of paragraphs (d) or (e) of this Article V.

(b) *Liquidation Rights.* In the event of any voluntary or involuntary liquidation, dissolution, or winding up of the

corporation, the holders of the Preferred shares of each series shall be entitled to receive from the assets of the corporation such preferential amount in cash as may be fixed for the series in redemption of those shares [*or specify other amount*] and, a further preferential amount in cash equal to all accrued and unpaid dividends on those shares to and including the date that payment is made available to the holders of Preferred shares. Those preferential amounts shall be paid or set apart for payment before the payment or setting apart for payment of any amount for, or the distribution of any assets of the corporation to, the holders of Common shares in connection with the liquidation, dissolution, or winding up. If the resolution or resolutions fixing the terms of the Preferred shares of any series shall so provide, the preferential amount payable to the holders of Preferred shares of the series in the event of any liquidation, dissolution, or winding up of the corporation may vary depending on the time of liquidation, dissolution, or winding up. With respect to the respective preferential amounts fixed for the series payable on any distribution of assets by way of liquidation, dissolution, or winding up of the corporation, each Preferred share shall rank with each other Preferred share, irrespective of series, in parity proportionate to those respective preferential amounts. No such amounts shall be paid or set apart for payment on the Preferred shares of any series unless at the same time amounts in like proportion to the respective preferential amounts to which the Preferred shares of each other series are entitled shall be paid or set apart for payment on each other series then outstanding. _____ [After the payment or the setting apart for payment to the holders of Preferred shares of the preferential amounts so payable to them, the holders of Common shares shall be entitled to receive, ratably, all remaining assets of the corporation *or, for "participating" preferred shares:* The holders of Common and Preferred shares shall be entitled to receive, ratably on a share-by-share basis], all remaining assets of the corporation. A consolidation or merger of this corporation with or into any other corporation or corporations, or a sale of all or substantially all of the assets of this corporation, shall not be deemed to be a liquidation, dissolution, or winding up within the meaning of this paragraph.

(c) *Redemption.* Any or all of the Preferred shares of any series may be redeemed at the option of the corporation, by resolution of the Board of Directors adopted at any time or from time to time, at a price or prices per share fixed for that series, plus an amount equal to all accrued and unpaid dividends on those shares to and including the date fixed for redemption, that sum referred to in this Article V as the "redemption price." If the resolution or resolutions fixing the terms of the Preferred shares of any series shall so provide, the redemption price or prices at which the Preferred shares of that series may be redeemed may vary depending on the time or circumstances of redemption. The resolution fixing the terms of any series may also fix the price or prices at which the shares of that series may be redeemed for the purpose of any sinking fund provided for that series by that resolution. In case of the redemption of fewer than all Preferred shares of a particular series at the time outstanding, the shares of the series to be redeemed shall be selected by the corporation pro rata or by lot [*or specify other method or state that manner or method of selecting shares to be redeemed shall be determined by approval of or in discretion of Board of Directors (see Corp. Code § 402(b))*]. Fewer than all of the Preferred shares at any time outstanding may not be redeemed until all dividends accrued and in arrears on all Preferred shares outstanding shall have been paid for all past dividend periods.

The corporation shall give notice of any redemption as provided in this subparagraph (c). The notice of redemption shall set forth the series of Preferred shares or the part of any series of Preferred shares to be redeemed, the date fixed for redemption, the redemption price, if the shares are convertible, the then-current conversion price (as defined with respect to the convertible shares) and the date of termination of the right to convert, and, if the shares are certificated securities, the place or places at which the shareholders may obtain payment of the redemption price on surrender of their share certificates [*or, if shares are uncertificated, describe different procedure for payment of redemption price*].

[*Add following sentence if notice will be published. Publication is not required, but notice by publication, as described in the following sentence, is expressly authorized by statute (see Corp. Code § 509(b)):*]

Notice of redemption shall be given by the corporation by causing a notice of redemption to be published in a newspaper of general circulation in the county in which the principal executive office of the corporation is located at least once a week for two successive weeks, in each instance on any day of the week, commencing not earlier than 60

nor later than 20 days before the date fixed for redemption.

[*CONTINUE*]

The corporation shall [also] mail a copy of the notice, postage prepaid, to each holder of record of shares to be redeemed as of the date of mailing or as of a record date lawfully fixed, addressed to the holder at the holder's address appearing on the books of the corporation or given to the corporation for the purpose of notice, of if no such address appears or is given, at the place where the principal executive office of the corporation is located, not earlier than 60 nor later than 20 days before the date fixed for redemption. Failure to comply with this paragraph shall not invalidate the redemption of shares.

On or after the date fixed for redemption and stated in the notice, each holder of Preferred shares called for redemption shall, if the shares are certificated, surrender the certificate evidencing those shares to the corporation at the place designated in the notice and shall then be entitled to receive payment of the redemption price. If less than all shares represented by any surrendered certificate are redeemed, a new certificate shall be issued representing the unredeemed shares. If the notice of redemption shall have been duly given, and if on the date fixed for redemption funds necessary for the redemption shall be available, then, notwithstanding that the certificates evidencing any Preferred shares so called for redemption shall not have been surrendered, the dividends with respect to the shares so called for redemption shall cease to accrue after the date fixed for redemption and all rights with respect to the shares so called for redemption shall after that date cease and terminate, excepting only the right of the holders to receive the redemption price without interest on surrender of their certificates, if the Preferred shares are certificated.

If, on or prior to the date fixed for redemption of Preferred shares, the corporation deposits with any bank or trust company in California, as a trust fund, (i) a sum sufficient to redeem, on the date fixed for redemption, (ii) in the case of the redemption of uncertificated securities, an officer's certificate (as defined below) setting forth the holders of Preferred shares registered on the books of the corporation and the number of shares held by each, and (iii) irrevocable instructions and authority to the bank or trust company to publish the notice of redemption of Preferred shares (or to complete publication if it has previously been commenced) and to pay, on or after the date fixed for redemption or prior thereto, the redemption price of the shares to their respective holders on the surrender of their share certificates in the case of certificated securities, then from and after the date of the deposit (although prior to the date fixed for redemption) the shares so called shall be redeemed and dividends on those shares shall cease to accrue after the date fixed for redemption. "Officer's Certificate", as used in this Paragraph (c), means a certificate signed and verified by the Board Chairperson or the President or any Vice-President and by the Secretary, the Chief Financial Officer, the Treasurer, or any Assistant Secretary or Assistant Treasurer of the corporation. The deposit shall constitute full payment of the shares to their holders, and from and after the date of the deposit, the shares shall no longer be outstanding, and the holders of those shares shall cease to be shareholders with respect to those shares and shall have no rights with respect to those shares, except the right to receive from the bank or trust company payment of the redemption price of the shares without interest, on surrender of their certificates if the shares redeemed are certificated and without such surrender if the shares redeemed are uncertificated, and any rights of conversion that may be provided for thoe shares in the resolution fixing their terms. Any funds so deposited on account of the redemption price of Preferred shares that are convertible and are converted after the making of that deposit shall be repaid to the corporation promptly on the conversion of those Preferred shares. Any interest accrued on any funds so deposited shall be the property of, and paid to, the corporation. If the holders of Preferred shares so called for redemption shall not, at the end of six years from the date fixed for redemption, have claimed any funds to deposited, the bank or trust company shall pay over to the corporation the unclaimed funds, and the bank or trust company shall from that time be relieved of all responsibility to those holders, and those holders shall look only to the corporation for payment of the redemption price.

(d) *Application to Other Junior Shares.* Preferences of Preferred shares over Common shares shall also apply to any shares ("other junior shares") hereafter authorized that are junior to the Preferred shares as to dividends or assets, and all

prohibitions, limitations, or restrictions on the declaration or payment of any dividends on, the making of any distribution of assets on, or the application of any assets to the purchase, redemption, or other acquisition of, Common shares shall correspondingly apply to similar action in respect of other junior shares.

(e) *Excepted Transactions.* The provisions of this Article V shall not be deemed to restrict or prohibit (i) the declaration or payment of dividends consisting solely of Common shares or other junior shares, (ii) subject to any contrary provisions established by the Board of Directors in fixing the rights and preferences of any series of Preferred shares, the purchase, redemption or other acquisition of Common shares or other junior shares that is made by the application of a sum not greater than the net proceeds received from the issuance of Common shares or other junior shares, or (iii) an acquisition of Common shares or other junior shares through the issuance of Common shares or other junior shares in exchange for those shares.

(f) *Application to Subsidiaries.* The corporation shall not suffer or permit a subsidiary to purchase, redeem, or otherwise acquire for value Common shares or other junior shares of the corporation unless those shares could be acquired by the corporation itself in compliance with this Article V.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.241

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.241 Rights, Preferences, Privileges, and Restrictions: Preferred Shares Issuable in Series--Directors Granted Broadest Authority to Fix Term of Any Series

[1] Comment

[a] Use of Form

This form may be included, as a separate article, in articles of incorporation for a corporation with two classes of shares (common and preferred) to grant the board of directors authority to issue the preferred shares in series and to fix the rights, preferences, privileges, and restrictions granted to or imposed on each series of shares [*see Corp. Code § 202(e)(3)*; *see also* [b], *below*]. If used, this form must be used in conjunction with a provision that authorizes two classes of shares, common and preferred, and that also states the number of shares authorized for each class [*see, e.g., § 3.203 [2]*, art. IV; *see also* [b], *below*].

The form is designated Article V only for purposes of reference; it is an alternative to certain other illustrative provisions designated Article V in this chapter. For a description of and cross-references to those other illustrative provisions, see *§ 3.240[1][a]*.

[b] Authority of Board to Fix Terms Required to be Stated in Articles

If a corporation is authorized to issue more than one class of shares, or if any class of shares is to have two or more series, the designation of each class and the total number of shares authorized for each class must be stated in the articles of incorporation [*Corp. Code § 202(e)(1), (2)*; *see § 3.203 [2]*, art. IV (illustrative provision)]. In addition, the articles must either state the rights, preferences, privileges and restrictions granted to or imposed on the respective classes or series of shares or grant the authority to the board of directors to determine all or some of those matters [*see Corp. Code § 202(e)(3)*].

The provision below grants maximum authority to the board of directors to determine the rights, preferences, privileges, and restrictions granted to or imposed on each series of preferred shares. When these matters are fixed and determined by resolution of the board of directors for a series, a certificate of determination must be filed with the Secretary of State prior to the time shares are issued in that series [*Corp. Code § 401*]. That certificate, in effect, then becomes a part of the corporation's articles [*see Corp. Code § 154*]. Requirements for a certificate of determination are discussed in *§ 3.310*.

For further discussion of general considerations and requirements applicable to stock provisions for articles of incorporation, see *§ 3.203 [1]*.

[2] FORM

Rights, Preferences, Privileges, and Restrictions: Preferred Shares Issuable in Series--Directors Granted Broadest Authority to Fix Term of Any Series

V. Preferred Shares

The Preferred shares may be issued from time to time in one or more series. The Board of Directors is authorized to fix the number of shares of any series of Preferred shares and to determine the designation of any series. The Board of Directors is also authorized to determine or alter the rights, preferences, privileges, and restrictions granted to or imposed on any wholly unissued series of Preferred shares and, within the limits and restrictions stated in any resolution or resolutions of the Board of Directors originally fixing the number of shares constituting any series, to increase or decrease (but not below the number of shares of such series then outstanding) the number of shares of any such series subsequent to the issue of shares of that series.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.242

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.242 Rights, Preferences, Privileges, and Restrictions: All Terms of Preferred Class or Series Stated in Articles--Outline Form

[1] Comment

[a] Use of Form

This form may be included, as a separate article, in articles of incorporation for a corporation with two classes of shares (common and preferred) to set forth the rights, preferences, privileges, and restrictions granted to or imposed on a particular class or series of shares [*see Corp. Code § 202(e)(3)*; *see also* [b], *below*]. If used, this form must be used in conjunction with a provision that authorizes two classes of shares, common and preferred, and that also states the number of shares authorized for each class [*see, e.g., § 3.203[2]*, art. IV; *see also* [b], *below*].

The form is designated Article V only for purposes of reference; it is an alternative to certain other illustrative provisions designated Article V in this chapter. For a description of and cross-references to those other specific provisions, see *§ 3.240[1][a]*.

[b] Terms Required to Be Stated in Articles

If a corporation is authorized to issue more than one class of shares, or if any class of shares is to have two or more series, the designation of each class and the total number of shares authorized for each class must be stated in the articles of incorporation [*Corp. Code § 202(e)(1), (2)*; *see § 3.203[2]*, art. IV (illustrative provision)]. In addition, the articles must either state the rights, preferences, privileges and restrictions granted to or imposed on the respective classes or series of shares or grant the authority to the board of directors to determine all or some of those matters [*see Corp. Code § 202(e)(3)*].

In contrast to the form in *§ 3.241*, which grants maximum authority to the board of directors to determine these matters,

this form should be used if the rights, preferences, privileges and restrictions granted to or imposed on a particular class or series of shares are to be fully set forth in the articles. It lists, in skeleton form, the specific provisions that should be included or considered for inclusion, with a cross-reference to the location where those specific provisions are included in this chapter.

Alternative provisions are included in this chapter that set forth some of the rights, preferences, privileges, and restrictions for a class or series of shares but grant the board of directors authority to determine other matters [*see § 3.203[2]*, art. V; *see also §§ 3.240, 3.241*].

For further discussion of general considerations and requirements applicable to stock provisions for articles of incorporation, see *§ 3.203[1]*.

[2] FORM

Rights, Preferences, Privileges, and Restrictions: All Terms of Preferred Class or Series Stated in Articles--Outline Form

V.

The rights, preferences, privileges, and restrictions granted to or imposed on the respective classes [or series] of shares or the holders of those shares are as follows:

(a) [*Dividend provisions--see §§ 3.243-3.245.*]

(b) [*Liquidation preferences--see §§ 3.246-3.248.*]

(c) [*Redemption provisions--see § 3.249.*]

(d) [*Sinking fund provisions--see § 3.250.*]

(e) [*Conversion rights--see §§ 3.251, 3.252.*]

(f) [*Contingent voting rights--see §§ 3.253, 3.254.*]

(g) [*Protective provisions--see § 3.255.*]

(h) [*Provisions relating to common shares--see § 3.256.*]

(i) [*Prohibition against reissuance of shares--see § 3.257.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePowersGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.243

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.243 Dividend Provision for Cumulative, Partially Participating Preferred Shares

[1] Comment

[a] Use of Form

This form is a provision that may be included in a corporation's articles to specify the dividend rights for preferred shares; it provides for dividend rights that are cumulative and partially participating [*see* [c], [e], *below*]. If used, this provision should be included as a separately designated paragraph in the articles' "preference statement," that is, under the specific article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares. A preference statement (in skeleton form) that may be use under these circumstances is set forth in *§ 3.242[2]*. That form lists the other provisions that should also ordinarily be included in the preference statement, for example, provisions for liquidation preferences and redemption rights.

This form must also be used in conjunction with a provision that authorizes two classes of stock, common and preferred, and designates the number of shares in each class [*see, e.g., § 3.203[2]*, art. IV].

For alternative dividend provisions, see *§§ 3.244* (cumulative nonparticipating preferred) and 3.245 (noncumulative nonparticipating preferred). Mandatory stock structure provisions required in the articles of incorporation for a corporation with more than one class of shares are discussed in *§ 3.203[1]*.

Rather than specify the particular rights, preferences, privileges, and restrictions for a class or series of shares, the articles may instead authorize the board of directors to fix all or some of those terms for unissued shares of a class or series [*see Corp. Code § 202(e)*]. For illustrative article provisions that should be used under those circumstances, see *§ 3.203[2]*, Article V; and *§§ 3.240* and *3.241*.

[b] Authority of Corporation to Pay Dividends

Statutory provisions govern the circumstances under which a corporation or its subsidiaries may make a distribution to the corporation's shareholders [*see Corp. Code §§ 500-511*]. The term "distribution to its shareholders" includes dividends, other than dividends in shares of the corporation [*Corp. Code § 166*].

The authority of a corporation to pay dividends depends on its then current financial condition. Dividends may be paid out of retained earnings [*see Corp. Code §§ 114, 166, 500(a)*], although if sufficient retained earnings are not available, a distribution is still possible provided the corporation meets both a balance sheet and a liquidity test [*see Corp. Code § 500(b)*]. Any distribution, however, is subject to a solvency test [*see Corp. Code § 501*]. Other statutory restrictions protect the interests of preferred shareholders with respect to a corporation's distributions to common shareholders [*see, e.g., Corp. Code §§ 502, 503*; *see § 3.255*]. Additional restrictions regarding a corporations's declaration of dividends may be included in that corporation's articles or bylaws or in any indenture or other agreement entered into by the corporation [*see Corp. Code § 505*].

[c] Dividend Cumulative Rights

Preferred stock may have the right to cumulative dividends, that is, the right to receive all arrearages at a specified rate, whether or not earned or declared, before any dividends may be paid to the common shareholders. Cumulative dividend rights are normally required by the Commissioner of Corporations when preferred shares are nonparticipating [*see* [e], *below*] and nonconvertible [*10 Cal. Code Reg. § 260.140.3*; *see* [f], *below*]. For a provision that provides for noncumulative dividends, see *§ 3.245*.

[d] Dividend Rates and Date of Payment

As illustrated in the form below, the dividend rate for preferred shares may be expressed as a specific sum for a specific period, for example, $2.00 per share per annum. Alternatively, it may be expressed as a specific percentage of a specific sum for a specific period.

Although the dividend rate is annual, the dates for payment may be fixed on a quarterly basis [*see* [2], first sentence, *below*] or at other intervals or times determined by the board of directors. Cumulative dividends are generally cumulative from the date of issue, but if preferred shares of the same class or series will be issued over a period of time, the dividends should instead begin to accrue on a fixed date. If it is possible that some of the shares would be issued after a dividend payment date, the time at which dividends begin to accrue should be stated to be the later of either a fixed date or a date to which dividends have been paid on outstanding preferred shares. Optional language is included in the form below to cover these situations.

[e] Dividend Participation Rights

The articles of incorporation should specify: (1) whether or not the preferred shares are entitled to receive additional dividends after their fixed rate is paid, and, if so, (2) when this participation with the common shares begins, and (3) the extent of the participation. In the form below, the preferred shares are partially participating. For provisions in which preferred shares have no participation rights, see *§§ 3.244* and *3.245*.

If there is to be participation, it may commence immediately or be delayed until the common shares have received a certain amount or percent of dividends (often the same amount or percent granted to the preferred) [*see* [2], PP 1, 2, *below*]. The rate or limitations on participation, after participation has commenced, should be specified: (1) full participation equally with common on a share-for-share or dollar value basis; or (2) limited participation up to a specified dollar amount, or a percentage of the total amount to be distributed as dividends.

[f] Requirements of Commissioner of Corporations

For unseasoned corporations [*see 10 Cal. Code Reg. § 260.001(g)*] selling securities pursuant to an open qualification, the Commissioner of Corporations ordinarily requires that preferred shares be convertible into common stock on a fair and equitable basis [*see § 3.251*] or fully participating and nonredeemable [*see 10 Cal. Code Reg. § 260.140.9*]. A corporation that proposes to issue preferred shares that are not participating and are not convertible on a fair and equitable basis must ordinarily include in its articles reasonable protective provisions for the preferred shareholders, including when appropriate: (1) cumulative dividend rights; (2) withholding of dividends on common shares while dividends on preferred shares are in arrears; (3) a requirement for the approval by the vote or written consent of a specified percentage of the preferred shares of any adverse change in the rights of those shares and of the issuance of any shares having priority over those preferred shares; and (d) appropriate dividend restrictions on common shares [*see 10 Cal. Code Reg. § 260.140.3*]. A corporation that proposes to issue preferred stock without full voting rights (and that is also nonparticipating and not convertible) must ordinarily grant those preferred shareholders the right to reasonable representation on the board of directors on a cumulative default, whether consecutive or not, of eight quarterly dividends [*10 Cal. Code Reg. § 260.140.2*; *see § 3.253*]. The right to elect a majority of the board is presumptively reasonable [*10 Cal. Code Reg. § 260.140.2*].

[2] FORM

Dividend Provision for Cumulative, Partially Participating Preferred Shares

_____ [*Article number*]

(a) 1. The holders of outstanding Preferred shares [*or if this provision applies only to a particular series, identify that series here and in remainder of this provision*] shall be entitled to receive, when and as declared by the Board of Directors, out of any assets at the time legally available, dividends in cash at the annual rate of $ _____ [*dollar amount, e.g.,* $4] per Preferred share, payable quarterly on the _____ day of each _____, _____, _____, and _____ [*months*] in each year. Dividends shall accrue on each share from the date of its original issuance [*or, if it is desired that dividends commence to accrue from a fixed date, e.g., in the situation when preferred shares of the same class or series are issued over a period of time and sold for the purchase price plus accrued dividends:* from _____ (*insert specific date*); *or, if it is possible that some of the shares would be issued after a dividend payment date:* from _____ (*insert specific date*) or the date to which dividends have been paid on outstanding Preferred shares, whichever is later] and shall accrue from day to day, whether or not earned or declared. Dividends shall be cumulative so that if dividends in respect of any previous quarterly dividend period at the annual rate set forth above shall not have been paid or declared and set apart for all Preferred shares at the time outstanding, the deficiency shall be fully paid or declared and set apart for those shares before the corporation makes any distribution to holders of Common shares. "Distribution" in this subparagraph 1 means the transfer of cash or property without consideration, whether by way of dividend or otherwise (except a dividend in shares of the corporation that are junior tothe Preferred shares as to dividends or assets) or the purchase or redemption of shares of the corporation for cash or property (except such junior shares), including any such transfer, purchase, or redemption by a subsidiary of the corporation. The time of any distribution by way of dividend shall be the date on which the dividend is declared and the time of any distribution by purchase or redemption of shares or otherwise than by dividend shall be the day cash or property is transferred by the corporation, whether or not pursuant to a contract of an earlier date; provided that when a debt obligation that is a security is issued in exchange for shares, the time of the distribution is the date when the corporation acquires the shares in that exchange [*or omit this sentence and leave this matter to operation of law (see Corp. Code § 166)*].

2. After all cumulative dividends on the outstanding Preferred shares shall have been paid or declared and set apart for payment for all previous dividend periods, as provided in subparagraph 1 of this paragraph (a), holders of the Common shares shall be entitled to receive in any fiscal year out of any assets legally available, cash dividends at the annual rate of $ _____ [*specify dollar amount that is ordinarily same as dollar amount in subparagraph 1, above*] per share for that fiscal year, payable in cash quarterly or at any other intervals as the Board of Directors may from time to time determine before any further dividend shall be declared on the Preferred shares. The right of the holders of Common shares to receive those dividends shall not be cumulative, and no rights shall accrue to

those holders by reason of the fact that dividends on Common shares are not paid or declared or set apart for payment in or for any prior year or years, nor shall any such undeclared or unpaid dividend bear or accrue interest.

3. After all cumulative dividends on the Preferred shares, as provided in this subparagraph (a), have been paid or declared and set apart for payment, and noncumulative dividends on the Common shares at the annual rate set forth in subparagraph 2, have been paid or set apart for payment in any fiscal year, if the Board of Directors shall elect to make further distributions or dividends, those distributions or dividends shall be made to all shares, Preferred and Common, and the amount of any distributions or dividends on each Preferred share shall bear the same ratio to the amount of any dividend on each Common share as the annual cumulative dividend on one Preferred share as provided herein bears to the dividend at the rate set forth in Paragraph 2 on one Common share; provided, however, that the holders of Preferred shares shall not receive in any one fiscal year dividends under this subparagraph 3, in addition to cumulative dividends provided for in subparagraph 1, which in the aggregate are in excess of $ _____ per share. The dividends authorized by this subparagraph 3 shall not be cumulative and no rights shall accrue to the holders of either Preferred or Common shares by reason of the fact that dividends have not been paid or declared and set apart for payment in any year or years.

4. Subject to the rights of the holders of Preferred shares, as provided in subparagraphs 1 and 3, the holders of Common shares shall be entitled to receive dividends in excess of the sum of $ _____ per share for any fiscal year, out of any funds of the corporation legally available for the declaration of dividends, as and when declared by the Board of Directors.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesRight to DividendsBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & Distribution



144 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.244

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.244 Dividend Provisions for Cumulative Nonparticipating Preferred Shares

[1] Comment--Use of Form

This form is a provision that may be included in a corporation's articles to grant preferred shares cumulative, nonparticipating dividend rights. For alternative dividend provisions, see *§§ 3.243* (cumulative, partially participating preferred) and 3.245 (noncumulative, nonparticipating preferred). For article provisions that grant authority to the board of directors to determine some or all of the rights, preferences, privileges, and restrictions with respect to the corporation's stock, see *§ 3.203[2]*, Article V, *§ 3.240*, and *§ 3.241*.

If used, this provision should be included as a separately designated paragraph in the articles' "preference statement," that is, under the specific article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares. A preference statement (in skeleton form) that may be used under those circumstances is set forth in *§ 3.242[2]*. That form lists other provisions that should ordinarily also be included in the preference statement, for example, provisions for liquidation preferences and redemption rights.

This form must also be used in conjunction with a provision that authorizes two classes of stock, common and preferred, and designates the number of shares in each class [*see, e.g., § 3.203[2]*, Article IV].

Drafting considerations and certain requirements of the Commissioner of Corporations for dividend provisions are discussed in *§ 3.243[1]*. Mandatory stock structure provisions required in the articles of incorporation for a corporation with more than one class of shares are discussed in *§ 3.203[1]*.

[2] FORM

Dividend Provisions for Cumulative Nonparticipating Preferred Shares

_____ [*Article number*]

(a) The holders of outstanding Preferred shares [*or if this provision applies only to a particular series, identify that series here and in remainder of this provision*] shall be entitled to receive, when and as declared by the Board of Directors, out of any assets at the time legally available, dividends at the annual rate of $ _____ [*dollar amount, e.g.,* $4] per Preferred share, payable in cash quarterly on the _____ day of each _____, _____, _____, and _____ [*months*] to holders of Preferred shares of record on a date not more than _____ [*number that is no higher than 60 (see Corp. Code § 701)*] nor fewer than _____ [*number that is not less than 10 (see Corp. Code § 701)*] days preceding each respective payment date as specified by the Board of Directors or, if not so specified, as provided by law. Dividends shall accrue on each Preferred share from the date of its original issuance and shall accrue from day to day, whether or not earned or declared. Dividends shall be cumulative so that if dividends in respect of any previous quarterly dividend period [*if desired, add:* and for the current quarterly dividend period] at the annual rate per share shall not have been paid or declared and set apart for all Preferred shares at the time outstanding, the deficiency shall be fully paid or declared and set apart for those shares before the corporation makes any distribution to holders of Common shares. "Distribution" in this paragraph (a) means the transfer of cash or property without consideration, whether by way of dividend or otherwise (except a dividend in shares of the corporation that are junior to the Preferred shares as to dividends or assets) or the purchase or redemption of shares of the corporation for cash or property (except such junior shares), including any such transfer, purchase, or redemption by a subsidiary of the corporation. The time of any distribution by way of dividend shall be the date the dividend is declared and the time of any distribution by purchase or redemption of shares or otherwise than by dividend shall be the day cash or property is transferred by the corporation, whether or not pursuant to a contract of an earlier date; provided that when a debt obligation that is a security is issued in exchange for shares, the time of the distribution is the date when the corporation acquires the shares in that exchange [*or omit this sentence and leave this matter to operation of law (see Corp. Code § 166)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.245

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.245 Dividend Provision for Noncumulative, Nonparticipating Preferred Shares

[1] Comment--Use of Form

This form is a provision that may be included in the articles to provide that preferred shares have noncumulative, nonparticipating dividend rights. For alternative dividend provisions included in this chapter, see *§§ 3.243* (cumulative partially participating preferred) and *3.244* (cumulative nonparticipating preferred). For article provisions that grant authority to the board of directors to determine some or all of the rights, preferences, privileges and restrictions with respect to the corporation's stock, see *§ 3.203[2]*, Article V; and *§§ 3.240* and *3.241*.

If used, this provision should be included in the articles' "preference statement," that is, under the specific article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares. A preference statement (in skeleton form) that may be used under these circumstances is set forth in *§ 3.242[2]*. That form lists other provisions that should also be included in the preference statement, for example, provisions for liquidation preferences and redemption rights.

This form must also be used in conjunction with an article provision that authorizes two classes of shares, common and preferred, and designates the number of shares in each class [*see § 3.203[2]*, Article IV].

Dividend and participation rights, and certain requirements of the Commissioner of Corporations relating to those matters, are discussed in *§ 3.243[1]*.

[2] FORM

Dividend Provision for Noncumulative, Nonparticipating Preferred Shares

_____ [*Article number*]

(a) The holders of the Preferred shares [*or if this provision is to only apply to a particular series, specify that particular series here and in remainder of provision*] shall be entitled in any fiscal year to receive dividends, when and as declared by the Board of Directors, out of any funds legally available for the payment of dividends, paid in cash at the rate of $ _____ [*dollar amount, e.g.,* $4] per Preferred share, before any dividend is paid on Common shares. This dividend may be payable quarterly or otherwise as the Board of Directors may from time to time determine. Dividends may be declared and paid on Common shares in any fiscal year of the corporation only if dividends shall have been paid to or declared and set apart on all Preferred shares at that annual rate for each quarter of the fiscal year of the corporation, including the quarter in which dividends on Common shares are declared. The right to dividends on Preferred shares shall not be cumulative, and no right shall accrue to the holders of Preferred shares by reason of the fact that dividends on those shares are not declared in any prior year, nor shall any undeclared or unpaid dividend bear or accrue interest.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesRight to Dividends



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.246

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.246 Liquidation Preferences of Preferred Shares--Cumulative and Participating

[1] Comment

[a] Use of Form

This provision may be included in the articles to create cumulative and participating liquidation preferences for preferred shares [*see Corp. Code §§ 202(e)(3), 2004*]. Optional language is included for use if the preferences will be noncumulative. If used, this provision should be included as a separately designated paragraph in the article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares (commonly referred to as the "preference statement"). A skeleton form of preference statement is set forth in *§ 3.242[2]*. That form lists the other provisions that should ordinarily also be included in the preference statement, for example, provisions for dividends, redemption, and voting rights.

Rather than specify the particular rights, preferences, privileges, and restrictions for a class or series of shares (including, for example, liquidation preferences), the articles may instead authorize the board of directors to fix all or some of those terms for unissued shares of a class or series [*see Corp. Code § 202(e)*]. For illustrative article provisions that may be used under those circumstances, see *§ 3.203[2]*, Article V; and *§§ 3.240* and *3.241*.

This provision provides that holders of preferred and common shares share equally on a per share basis in any distribution in excess of the liquidation preference of the preferred shares and the amount stated with respect to the common shares. If the participating preference of the preferred is to be limited, or to be in some specified ratio to distributions on common shares, or if the common shares are to receive a stated amount *after* payout of the preferred liquidation preference and *before* participation by the preferred shareholders, this form should be modified to provide for that limitation or proportion.

This form provides for the same liquidation rate for either an involuntary or a voluntary liquidation. It must be modified

if a different rate is desired under those separate circumstances.

For alternative provisions for liquidation preferences that may be used in lieu of the one in this form, see *§§ 3.247* (nonparticipating noncumulative preferred) and *3.248* (cumulative and nonparticipating preferred).

[b] Definition of "Liquidation Preference"

"Liquidation preference" or "liquidation price" means amounts payable on shares of any class on voluntary or involuntary dissolution, winding up, or distribution of the entire assets of the corporation [*see Corp. Code §§ 1800-1809, 1900-1907, 2000-2011*], including any cumulative dividends [*see § 3.243*] accrued and unpaid, in priority to shares of another class or classes [*Corp. Code § 172*].

[c] Restrictions on Liquidation Distributions

A corporation may not make any distribution to its shareholders [*see Corp. Code § 166* (definition of "distribution to its shareholders")] on any class or series of its shares that are junior to the outstanding shares of any other class or series with respect to distribution of assets on liquidation if, after giving effect to the distribution, the excess of its assets (exclusive of goodwill, capitalized research and development expenses, and deferred charges) over its liabilities (not including deferred taxes, deferred income, and other deferred credits) would be less than the liquidation preference of all shares having a preference on liquidation over the class or series to which the distribution is made [*Corp. Code § 502*]. However, for the purpose of applying this rule to a distribution by a corporation of cash or property in payment by the corporation in connection with the purchase of its shares, there must be deducted from liabilities all amounts that had been previously added with respect to the obligations incurred in connection with the corporation's repurchase of its shares and reflected on the corporation's balance sheet, but not in excess of the principal of the obligations that will remain unpaid after the distribution. Further, no deduction from liabilities may occur on account of any obligation that is a distribution to the corporation's shareholders when the obligation is incurred [*Corp. Code § 502*].

[d] Distribution Plan Contrary to Liquidation Preferences

If a corporation in the process of winding up has both preferred and common shares outstanding, a plan of distribution of the shares, obligations, or securities of any other corporation, domestic or foreign, or assets other than money that is not in accordance with the liquidation rights of the preferred shares as specified in the articles may nevertheless be adopted if approved by the board of directors and by the outstanding shares [*see Corp. Code § 152*] of each class [*Corp. Code § 2007(a)*]. The plan may provide that the distribution is in complete or partial satisfaction of the rights of those shareholders on distribution and liquidation of the assets [*Corp. Code § 2007(a)*].

The board must cause notice of the adoption of the plan to be given by mail within 20 days after its adoption to all holders of shares having a liquidation preference [*Corp. Code § 2007(b)*].

The approved plan is binding on all shareholders [*Corp. Code § 2007(b)*], except that a dissenting shareholder with a liquidation preference who files a timely demand for payment is entitled to be paid the amount of his or her liquidation preference in cash unless the corporation subsequently determines to abandon the plan of distribution [*Corp. Code § 2007(c)*]. The board in its discretion may abandon the plan without further approval of the outstanding shares, and all shareholders will then be entitled to distribution according to their rights and liquidation preferences in the process of winding up [*Corp. Code § 2007(d)*].

The statutory provisions described above do not apply to any distribution made in accordance with a merger reorganization [*Corp. Code § 181(a)* (definition); *see* Ch. 11C, *Mergers*] or a sale-of-assets reorganization [*Corp. Code § 181(c)* (definition); *see* Ch. 11E, *Acquisition of Assets for Shares*] in which (1) the terms of the reorganization provide that a class or series of preferred shares will receive as a distribution a lesser amount than would be required by

applicable article provisions, and (2) the principal terms have been approved by the same percentage of outstanding shares of that class or series as would be required to approve an amendment of the article provisions to provide for the distribution of that lesser amount [*Corp. Code § 2007(e)*; *see Corp. Code § 1202(b)*].

[e] Drafting Considerations

Article provisions that create liquidation preferences should, at a minimum, cover the following matters:

- The circumstances under which the preference applies--usually "voluntary or involuntary liquidation, dissolution, or winding up of the corporation"--and the circumstances, if any, under which the preference does not apply, such as a consolidation or merger or a sale of all or substantially all of the corporation's assets [*see* [2], last sentence, *below*].

- Liquidation price per preferred share, and whether or not this amount varies depending on whether the liquidation is voluntary or involuntary [*see* [2], first paragraph, *below*].

- Whether or not preference payment on liquidation will include dividend arrearages [*see* [2], first paragraph, *below*; *see also § 3.247* (noncumulative)].

- The extent, if any, to which the preferred shares will participate with the common shareholders after payment of the liquidation preference, for example: (a) full and immediate participation on a share-for-share or dollar basis; (b) full participation after common has received a certain amount [*see* [2], first paragraph, *below*]; (c) limited participation up to a dollar amount, a percentage of stated value, or a percentage of the total remaining assets to be distributed; or (d) no participation [*see §§ 3.247, 3.248*].

- Procedure for paying preferred shares if assets are insufficient to pay full preference amount, for example, pro rata payment or all assets to preferred shares [*see* [2], second paragraph, *below*].

[2] FORM

Liquidation Preferences of Preferred Shares--Cumulative and Participating

V. Preferred Shares

(b) On any voluntary or involuntary liquidation, dissolution, or winding up of the corporation, the holders of the Preferred shares [*if provision is only to apply to specific series, designate that series here and in remainder of provision*] shall be entitled to receive, out of the assets of the corporation, whether those assets are capital or surplus of any nature, an amount equal to $ _____ [*dollar amount, e.g.*, $40] per Preferred share, plus an amount equal to [*for cumulative participating preferred shares:* any dividends accrued and unpaid on those shares *or for noncumulative participating preferred:* the dividends declared and unpaid on those shares], as provided in paragraph _____ [*designation of paragraph that describes dividend rights, e.g.*, (a)] of this Article V, to the date that payment is made available to holders of Preferred shares, and, after payment to the holders of Common shares of $ _____ [*specify dollar amount that is ordinarily same amount specified above for Preferred shares*] per share, the remaining assets of the corporation to be distributed shall be distributed in like amounts per share to the holders of the Preferred shares and the holders of the Common shares.

If, on liquidation, dissolution, or winding up, whether voluntary or involuntary, the assets distributed among the holders of the Preferred shares shall be insufficient to permit the payment of the full preferential amounts, then the entire assets of the corporation to be distributed shall be distributed ratably among the holders of Preferred shares. A consolidation or merger of the corporation with or into any other corporation or corporations, or a sale of all or substantially all of the assets of the corporation, shall [not] be deemed a liquidation, dissolution, or winding up of the corporation within the meaning of this paragraph.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of Stock



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.247

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.247 Liquidation Preferences--Noncumulative and Nonparticipating

[1] Comment--Use of Form

This provision may be included in the articles to create noncumulative and nonparticipating liquidation preferences for preferred shares. If used, this provision should be included as a separately designated paragraph in the article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares (commonly referred to as the "preference statement"). For a skeleton form of preference statement that may be used for this purpose, see *§ 3.242[2]*. That form also lists the other provisions that ordinarily should be included in the preference statement, for example, provisions for dividends, redemption, and voting rights.

This provision provides that holders of preferred shares receive a specified amount only (plus any declared but unpaid dividends) in the event of the corporation's voluntary or involuntary liquidation, dissolution, or winding up. After payment of this liquidation preference, the remaining assets of the corporation must be distributed, ratably, to the holders of Common shares.

For alternative provisions for liquidation preferences that may be used in lieu of the one in this form, see *§§ 3.246* (cumulative participating preferred) and 3.248 (cumulative and nonparticipating preferred). Statutory restrictions and requirements and drafting considerations for liquidation preferences are discussed in *§ 3.246*.

For article provisions that do not fix all of the particular rights, preferences, privileges, and restrictions for a class or series of shares (including, for example, liquidation preferences) but instead authorize the board of directors to fix all or some of those terms for unissued shares of a class or series [*see Corp. Code § 202(e)*], see *§ 3.203[2]*, Article V; and *§§ 3.240* and *3.241*.

[2] FORM

Liquidation Preferences--Noncumulative and Nonparticipating

V. Preferred Shares

(b) On any voluntary or involuntary liquidation, dissolution, or winding up of the corporation, the holders of the Preferred shares [*or if this provision is to apply only to a particular series, designate that series here and in remainder of this provision*] shall be entitled to receive, out of the assets of the corporation, whether those assets are capital or surplus of any nature, an amount equal to $ _____ per Preferred share, plus an amount equal to any dividends on those Preferred shares declared and unpaid on the date of that distribution, and no more, before any payment shall be made or any assets distributed to the holders of Common shares. If on liquidation, dissolution, or winding up of the corporation the assets so distributed among the holders of Preferred shares shall be insufficient to permit full payment to those shareholders of the full preferential amounts, then the entire assets of the corporation shall be distributed ratably among the holders of Preferred shares.

After payment or distribution to the holders of Preferred shares of the full preferential amounts, the holders of Common shares shall be entitled to receive, ratably, all remaining assets of the corporation.

A consolidation or merger of the corporation with or into any other corporation or corporations, or a sale of all or substantially all of the assets of the corporation, shall [not] be deemed to be a liquidation, dissolution, or winding up of the corporation within the meaning of this paragraph (b).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of Stock



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.248

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.248 Liquidation Preferences of Preferred Shares--Cumulative and Nonparticipating

[1] Comment--Use of Form

This provision may be included in the articles to create cumulative and nonparticipating liquidation preferences for preferred shares. If used, this provision should be included as a separately designated paragraph in the article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares (commonly referred to as the "preference statement"). A skeleton form of preference statement that may be used for this purpose is set forth in *§ 3.242[2]*. That form lists the other provisions that should ordinarily also be included in the preference statement, for example, provisions for dividends, redemption, and voting rights.

This provision provides for payment to the holders of preferred shares a specific dollar amount, plus the amount of any accrued but unpaid dividends on those shares, in the event of the corporation's voluntary or involuntary liquidation, dissolution, or winding up of the corporation. After this preferential payment, the holders of common shares are entitled to receive, ratably, any remaining assets of the corporation.

For alternative provisions for liquidation preferences that may be used in lieu of the one in this form, see *§§ 3.246* (cumulative participating preferred) and *3.247* (noncumulative nonparticipating preferred). Statutory restrictions on and other requirements for liquidation preferences are discussed in *§ 3.246[1]*.

For article provisions that do not fix all of the particular rights, preferences, privileges, and restrictions for a class or series of shares (including, for example, liquidation preferences) but instead authorize the board of directors to fix all or some of those terms for unissued shares of a class or series [*see Corp. Code § 202(e)*], see *§ 3.203[2]*, Article V; and *§§ 3.240* and *3.241*.

[2] FORM

Liquidation Preferences of Preferred Shares--Cumulative and Nonparticipating

V. Preferred Shares

(b) On any voluntary or involuntary liquidation, dissolution, or winding up of the corporation, the holders of the Preferred shares [*or if this provision will apply only to a specific series, designate that series here and in remainder of this provision*] shall receive out of assets of the corporation, whether those assets are capital or surplus of any nature, the sum of $ _____ [*dollar amount, e.g.,* $40] per Preferred share, plus an amount equal to any dividends accrued and unpaid on those Preferred shares, as provided in paragraph _____ [*designate paragraph that describes dividend rights*] of this Article V, to the date that payment is made available to the holders of Preferred shares, whether earned or declared or not, and no more, before any payment shall be made or any assets distributed to the holders of Common shares.

If on liquidation, dissolution, or winding up of the corporation, the assets so distributed among the holders of Preferred shares shall be insufficient to permit full payment to those shareholders of the full preferential amounts, then the entire assets of the corporation to be distributed shall be distributed ratably among the holders of Preferred shares.

In the event of any voluntary or involuntary liquidation, dissolution, or winding up of the corporation, subject to all of the preferential rights of the holders of Preferred shares on distribution or otherwise, the holders of Common shares shall be entitled to receive, ratably, all remaining assets of the corporation.

A consolidation or merger of the corporation with or into any other corporation or corporations, or a sale of all or substantially all of the assets of the corporation, shall [not] be deemed to be a liquidation, dissolution, or winding up of the corporation within the meaning of this paragraph (b).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of Stock



149 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.249

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§ 3.249 Redemption Provisions--Cumulative or Noncumulative Nonparticipating Preferred

[1] Comment

[a] Use of Form

This form contains illustrative redemption provisions that may be included in a corporation's articles of incorporation. It provides for the redemption of cumulative or noncumulative, nonparticipating preferred shares [*see Corp. Code §§ 202(e)(3), 402(a)*], at the option of the corporation, or on the occurrence of other events [*see* [b], *below*].

In determining whether or not to include redemption provisions in the articles, the effect of the specific contemplated provisions must be carefully considered. There is no statutory requirement that shares must be redeemable at the option of the issuer. If the shareholders are granted the right to demand redemption (or redemption is otherwise triggered by some event), the corporation is deprived, to the extent of the redemption, of its discretion with respect to retained earnings. Restrictions on redemption may be necessary, for example, to protect the right of one class or series of shares to participate as to dividends, redemption, or other matters with other classes or series or, in the case of convertible shares, to assure the holders that those shares will remain outstanding long enough for the conversion right to be meaningful.

If used, this provision should be included as a separately designated paragraph in the article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares (commonly referred to as the "preference statement"). For a skeleton form of preference statement that may be used for this purpose, see *§ 3.242[2]*. That form lists the other provisions that should ordinarily also be included in the preference statement, for example, provisions for dividends, liquidation preferences, and voting rights. Rather than specify all of the rights, preferences, privileges, and restrictions for a class or series of shares, the articles may instead authorize the board of directors to fix all or some of these terms for unissued shares of a class or series [*see Corp. Code § 202(e)*]. For illustrative article provisions that may be used under those circumstances, see *§ 3.203[2]*, Article V; and *§§ 3.240* and

3.241.

[b] Authority for Redemption

A corporation may provide in its articles for one or more classes or series of shares that are redeemable in whole or in part at the option of the corporation, or to the extent and on the happening of one or more specified events [*Corp. Code § 402(a)*]. Alternatively, the articles may provide for one or more classes or series of preferred shares that are redeemable, in whole or in part, (1) at the option of the corporation, or to the extent and on the happening of one or more specified events; (2) at the option of the holder, or (3) on the vote of at least a majority of the outstanding shares of the class or series to be redeemed [*Corp. Code § 402(a)*]. An open-end investment company registered under the United States Investment Company Act of 1940 may, if its articles so provide, issue shares that are redeemable at the option of the holder at a price approximately equal to the shares' proportionate interest in the net assets of the corporation, and a shareholder may compel redemption of those shares in accordance with their terms [*Corp. Code § 402(b)*].

This form provides two alternatives for describing the circumstances under which redemption may occur. The first alternative permits redemption of preferred shares only at the option of the corporation. The second alternative contains different clauses, which may be used as desired, to describe the other circumstances that will trigger the right to redemption, for example, at the option of the holder of the preferred shares.

[c] Limitations and Restrictions

The general rule is that a corporation may not issue or redeem redeemable common shares unless the corporation at that time has outstanding a class of common shares that is not subject to redemption. However, this general rule does not apply to three types of shares: (1) shares issued by an open end investment company registered under the United States Investment Company Act of 1940; (2) shares of a corporation that has a license or franchise from a government agency to conduct its business or is a member corporation of a national securities exchange registered under the Securities Exchange Act of 1934 and that license, franchise, or membership is conditioned on some or all of the shareholders possessing prescribed qualifications to the extent necessary to reinstate or prevent the loss of the license, franchise, or membership; (3) shares of a professional corporation [*Corp. Code § 402(c)*].

Any redemption by a corporation of its shares is subject to the provisions of the General Corporation Law governing, among other things, distributions to a corporations shareholders [*Corp. Code § 402(d)*; *see Corp. Code §§ 166, 500-511*]. A corporation's redemption of its own shares is considered to be a distribution to the corporation's shareholders [*see Corp. Code § 166*]. Accordingly, the corporation may redeem shares only it is able to satisfy the financial and other requirements for a distribution [*see Corp. Code §§ 500-504*; *see also § 3.243[1][b]*]. A corporation may to the extent permitted by statute create a sinking fund or similar provision for the redemption or purchase of its shares [*see Corp. Code § 402(d)*; *see § 3.250* (sinking fund provision)].

A corporation's articles or bylaws, or any indenture or other agreement entered into by the corporation, may impose restrictions on its redemption of shares that are more restrictive than and in addition to any statutory restrictions [*Corp. Code § 505*].

Under rules of the Commissioner of Corporations, preferred stock to be sold under an open qualification [*see 10 Cal. Code Reg. § 260.001(f)*] by an unseasoned corporation [*see 10 Cal. Code Reg. § 260.001(g)*] should normally be either fully participating and nonredeemable or convertible into common stock on an equitable basis [*see 10 Cal. Code Reg. § 260.140.9*; *see also § 3.251*].

[d] Redemption Price

The amount payable in cash, property, securities, or any combination of these on the redemption of shares is the "redemption price." Unless otherwise expressly provided, the redemption price is payable in cash [*Corp. Code § 180*].

This form fixes a specified dollar amount for the redemption price, plus an additional amount that depends on whether the preferred shares are cumulative or noncumulative [*see* [2], P 2, *below*]. If it is desired that the redemption price include a premium for early redemption, that modification should be made to this form. Also, it should modified if the redemption price will vary depending on the event causing the redemption, for example, option of the board, required vote of the shareholders, option of the shareholder, or another event.

[e] Procedure for Redemption of Shares

[i] General Requirements

Any redemption of shares must be effected at the price or prices, within the time and on the terms and conditions as are stated in the articles. When the articles permit partial redemption of a class or series of shares, the articles must prescribe the method selecting the shares to be redeemed, which may be pro rata, by lot, at the discretion of, or in a manner approved by the board, or on any other terms specified in the articles [*Corp. Code § 402(b)*; *see* [2], P 2, *below*].

The corporation may redeem any or all shares that are redeemable at its option by giving notice of redemption, and payment or deposit of the redemption price of the shares as provided in its articles, or deposit of the redemption price with a bank or trust company in California in accordance with statutory requirements [*Corp. Code § 509(a)*; *see Corp. Code § 509(d)* (requirements for deposit with bank or trust company)].

[ii] Notice of Redemption

Subject to any provisions in the articles with respect to the notice required for the redemption of shares, the corporation may satisfy the requirement for giving notice of the redemption [*see* [i], *above*] by causing a notice to be published in a newspaper of general circulation in the county in which the corporation has its principal executive office at least once a week for two successive weeks, commencing not earlier than 60, nor later than 20, days before the date fixed for redemption. The notice must set forth (1) the class or series of shares, or the part of that class or series, to be redeemed; (2) the date fixed for redemption; (3) the redemption price; and (4) if the shares are certificated securities, the place at which the shareholders may obtain payment of the redemption price on surrender of their share certificates [*Corp. Code § 509(b)*].

Notice by publication described above is not mandatory and is not provided for in this form [*but see § 3.240[2]*]. Even if the notice is given by publication, it must still be given directly to affected shareholders either in accordance with the procedure described below or with the procedure set forth in the corporation's articles [*see Corp. Code § 509(b), (c)*].

If the corporation gives notice by publication described above, it must also mail a copy of the notice by first-class mail, postage prepaid [*Corp. Code § 113*], to each holder of record of shares to be redeemed as of the date of mailing or a lawfully fixed date of record [*see Corp. Code § 701*]. The notice must be addressed to the holder at the holder's address appearing on the books of the corporation or given by the holder to the corporation for the purpose of notice, or, if no such address appears or is given, at the place where the principal executive office of the corporation is located. It must be mailed not earlier than 60 nor later than 20 days before the date fixed for redemption. Failure to comply with these requirements does not, however, invalidate the redemption [*Corp. Code § 509(c)*].

[iii] Trust Fund for Redemption of Shares

Statutory provisions outline a procedure by which a corporation may deposit with any bank or trust company in California as a trust fund, a sum sufficient to redeem the shares called for redemption, with irrevocable instructions and authority to give notice of the redemption and to pay the holders the redemption price for their shares. Under this

procedure, the deposit constitutes full payment for the shares that, from the date of the deposit, are no longer outstanding. From that same date, the holders also have no rights with respect to their shares except to receive the redemption price from the bank or trust company on surrender of their share certificates (for certificated securities [*see Corp. Code § 156.1*; *Com. Code § 8102(a)(4), (15)*]) or delivery of an appropriate officer's certificate (for uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(15), (18)* (definition)]) and except to convert their shares if so authorized by the articles [*Corp. Code § 509(d)*; *see § 3.251* (rights of conversion)].

The trust fund method of redeeming shares is authorized but not required by statute. The articles may instead provide some other method for the payment or deposit of the redemption price [*see Corp. Code § 509(a)*]. This form [*see* [2], P 4, *below*] does use the trust fund method and reflects the statutory requirements for that method [*see Corp. Code § 509(d)*].

[f] Status of Redeemed Shares and Required Amendment of Articles

When a corporation reacquires its own shares, those shares are restored to the status of authorized but unissued shares unless the articles prohibit the reissue of reacquired shares [*Corp. Code § 510(a)*]. The term "reacquires" means that a corporation purchases, redeems, acquires by way of conversion to another class or series, or otherwise acquires its own shares or that issued and outstanding shares cease to be outstanding [*Corp. Code § 510(d)*].

If a corporation reacquires authorized shares of a class or series and the articles prohibit the reissuance of those shares, the following rules apply [*Corp. Code § 510(b)*]:

- If all of the authorized shares of that class or series are reacquired then (1) that class or series is automatically eliminated; (2) in the case of reacquisition of all authorized shares of a series, the authorized number of shares of the class to which the shares belonged is reduced by the number of shares so acquired; and (3) the articles must be amended to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that class or series.

- If less than all of the authorized shares but all of the issued and outstanding shares of that class or series are reacquired, the authorized number of shares of the class or series is automatically reduced by the number of shares reacquired and the board must determine either (1) to eliminate that class or series, which requires amending the articles to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that class or series; or (2) not to eliminate that class or series, which requires amending the articles to reflect that reduction of the number of authorized shares of that class or series by the number of reacquired shares.

- If less than all of the authorized shares and less than all of the issued and outstanding shares of a class or series are reacquired, the authorized number of shares of that class or series is automatically reduced by the number of reacquired shares and the articles must be amended to reflect that reduction.

If a corporation reacquires authorized shares of a series of shares and the articles prohibit only the reissuance of those shares as shares of the same series, the following rules apply [*Corp. Code § 510(c)*]:

- If all of the authorized shares of that series are reacquired, then that series is automatically eliminated, the articles must be amended to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that series, and the board must determine either (1) to return those shares to the status of authorized but undesignated shares of the class to which they belong or (2) to eliminate those shares entirely. In either case, the articles must be amended to reflect the reduction in authorized shares of that series and any effect on the class to which that series belongs.

- If all of the issued and outstanding shares of that series, but less than all of the authorized shares of that series, are reacquired, the board must determine either (1) to eliminate that series, which requires amending the articles to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that series; or (2) not to eliminate that series, which requires amending the articles to reflect the return of the reacquired shares to the status of authorized but undesignated shares of the class to which they belong.

- If less than all of the issued and outstanding shares of that series are reacquired, the authorized number of shares of that series is automatically reduced by the number of reacquired shares and the board must determine either (1) to return those shares to the status of authorized but undesignated shares of the class to which they belong or (2) to eliminate those shares entirely. In either case, the articles must be amended to reflect the reduction in authorized shares of that series and any effect on the class to which that series belongs.

A certificate of amendment must be filed in accordance with statutory requirements, reflecting any elimination or reduction of authorized shares, and any related elimination from the articles of the designation and the rights, preferences, privileges, and restrictions of any series or class of stock that is eliminated [*Corp. Code § 510(f)*; *see Corp. Code §§ 900-911*], except that approval by the outstanding shares [*see Corp. Code § 152*] ordinarily required is not required to adopt this type of amendment [*Corp. Code § 510(f)*].

These corporate reacquisition rules may be varied in the articles [*Corp. Code § 510(e)*]. Further, nothing in these rules is intended to alter or otherwise affect the powers of the board to amend the articles [*Corp. Code § 510(f)*; *see Corp. Code §§ 202, 401*].

[g] Need for Redemption Provisions

Redemption provisions provide the corporation with needed flexibility in those cases in which the preferred shares have protective provisions or voting rights. They are particularly important if the protective provisions or voting rights run in favor of "any" preferred shares rather than requiring a minimum number of outstanding shares for the continuing effectiveness of the protective provisions or voting rights. The corporation retains the right to redeem the preferred shares to eliminate the protective provisions or voting rights.

[2] FORM

Redemption Provisions--Cumulative or Noncumulative Nonparticipating Preferred

[*Begin with either Alternative 1 or Alternative 2, and then continue with remainder of provision where indicated below.*]

[*Alternative 1: Use if board of directors has sole discretion as to whether and when to redeem.*]

V. Redemption of Preferred Shares

(c) 1. Subject to the provisions of the California General Corporation Law and to any other applicable restrictions on the right of a corporation to redeem its own shares, the corporation, at the option of the Board of Directors, may at any time or from time to time redeem the whole or any part of the outstanding Preferred shares [*or if this provision is to apply to a particular series, designate that series here and in remainder of this provision*].

[*Alternative 2: If shareholders will be given right to demand redemption or if specific event or set of circumstances will*

give rise to redemption, select applicable provisions from following.]

V. Redemption of Preferred Shares

(c) 1. Subject to the provisions of the California General Corporation Law and to any other applicable restrictions on the right of a corporation to redeem its own shares, Preferred shares [*or if this provision is to apply to a particular series, designate that series here and in remainder of this provision*] shall be redeemed by the Corporation in one or more of the following circumstances:

a. If called for redemption at the option of the Board of Directors, at any time or from time to time in whole or any part;

b. At the option of the holder, on not less than _____ days notice in writing to the corporation at _____[*address*], to the attention of _____ [*title of corporate officer*] or at any other address as the corporation shall have previously given the holder for notice;

c. On the vote of at least _____ [*specify required vote, which must be at least a majority of the outstanding preferred shares (see Corp. Code § 402(a))*] of the holders of the Preferred Shares, which vote shall specify a redemption date that shall be not less than _____[*number*] days after the vote and after written notice of that vote is provided to the corporation; or

d. On the happening of _____ [*describe event that will trigger redemption, and, if less than all of the preferred shares are to be redeemed on the happening of that event, specify which shares or what number of shares are to be redeemed and how they are to be selected*].

[*CONTINUE*]

2. On redemption, the corporation shall pay for each share redeemed, cash in the amount of $ _____ per share plus _____ [*for cumulative preferred, add:* an amount in cash equal to all dividends on Preferred Shares accrued and unpaid as provided in paragraph _____ (*designation of paragraph that describes dividend rights*) in this Article V, whether earned or declared or not, to and including the date for redemption *or, for noncumulative preferred, add:* an amount equal to all dividends on Preferred shares declared but unpaid on the date fixed for redemption] (referred to as the "redemption price") [*or describe other redemption price, for example one that sets a premium redemption price if redemption occurs on or before a specific date, or one that varies depending on the circumstances under which redemption occurs*]. In case of the redemption at the option of the corporation of a part only of the outstanding Preferred shares, the corporation may designate pro rata or by lot [*or other specify some other method (see Corp. Code § 402(b))*] the shares to be redeemed. Less than all of the Preferred shares at any time outstanding may not be redeemed [*if preferred shares are redeemable at option of or on vote of holders, add:* except at the option of a holder or holders] until all dividends accrued and unpaid on all Preferred shares outstanding shall have been paid for all past dividend periods, and until full dividends for the then current dividend period on all Preferred shares then outstanding, other than the shares to be redeemed, shall have been paid or declared and the full amount set apart for payment.

3. At least _____ [*number that is at least 30 but not more than 60*] days prior to the date fixed for redemption, the corporation shall mail notice of the redemption to the holders of record of the Preferred shares to be redeemed as of the date of mailing or as of a record date lawfully fixed by the corporation. The notice shall be mailed by first-class mail, postage prepaid to each of those shareholders at the address of that holder appearing on the books of the corporation or given by that holder to the corporation for the purpose of notice, of if no such address appears or is so given, at the place where the principal office of the corporation is located. The notice shall state the date fixed for redemption, the redemption price, [*if shares are convertible, add:* the then current conversion price (as defined with

respect to those convertible shares) and the date of termination of the right to convert] and shall require the holder to surrender to the corporation on the date fixed and at the place designated in the notice, the holder's certificate or certificates representing the shares to be redeemed if those shares are certificated. On or after the date fixed for redemption, each holder of Preferred shares called for redemption shall, if those shares are certificated [*if shares are convertible, add:*, (unless the holder has previously exercised its option to convert preferred shares as provided in paragraph _____ (*paragraph designation that describes conversion rights*) of this Article V], surrender the certificate evidencing the shares to the corporation at the place designated in the redemption notice and shall at that time be entitled to receive payment of the redemption price. If less than all the shares represented by any surrendered certificate are redeemed, a new certificae for the unredeemed shares shall be issued. If the redemption notice is duly given and if sufficient funds are available on the date fixed for redemption to pay the redemption price, then, whether or not the certificates evidencing the Preferred shares to be redeemed are surrendered, the dividends with respect to the shares so called for redemption shall cease to accrue after the date fixed for redemption and all rights with respect to those shares so called for redemption shall cease and terminate as of the date fixed for redemption, except the right of the holders to receive the redemption price, without interest, on surrender of their certificates, if those Preferred shares are certificated.

4. If, on or prior to any date fixed for redemption of Preferred shares, the corporation deposits with any bank or trust company in California, as a trust fund: (a) a sum sufficient to redeem, on the date fixed for redemption, the shares called for redemption; (b) in the case of the redemption of any uncertificated securities, an officer's certificate (defined below) setting forth the holders of the shares called for redemption, registered on the books of the corporation and the number of shares held by each; and (c) irrevocable instructions and authority to the bank or trust company to give the notice of redemption (or to complete the giving of notice if commenced) and to pay, on and after the date fixed for redemption or prior to that time, the redemption price of the shares to their respective holders on surrender of their share certificates (for certificated securities), then from and after the date of the deposit, even though that date may be prior to the date fixed for redemption, the shares so called shall be redeemed and dividends on those shares shall cease to accrue after the date fixed for redemption. "Officer's certificate," as used in the preceding sentence, means a certificate signed and verified by the Board Chairperson or the President or any Vice-President, and by the Secretary, the Chief Financial Officer, the Treasurer, or any assistant secretary or assistant treasurer of the corporation. The deposit shall constitute full payment of the shares to their holders, and from and after the date of the deposit, the shares shall no longer be outstanding, and the holders of those shares shall cease to be shareholders with respect to those shares and shall have no rights with respect to them, except the right to receive from the bank or trust company payment of the redemption price of the shares, without interest, on surrender of their certificates if the shares redeemed are certificated and without surrender if the shares redeemed are uncertificated [*if shares are convertible, add:*, and the right to convert those shares as provided in paragraph _____ (*designate paragraph that sets forth conversion rights*) of this Article V at any time up to but not after the close of business on the _____ day prior to the date fixed for redemption of those shares. Any moneys so deposited on account of the redemption price of Preferred shares converted after the making of the deposit shall be repaid to the corporation immediately on the conversion of the Preferred shares]. Any interest accrued on any funds so deposited shall be the property of, and paid to, the corporation. If the holders of Preferred shares so called for redemption shall not, at the end of six years from the date fixed for redemption, have claimed any funds to deposited, the bank or trust company shall pay over to the corporation the unclaimed funds, and the bank or trust company shall thereafter be relieved of all responsibility to those holders and those holders shall look only to the corporation for payment of the redemption price.

[*Optional:*]

5. Notwithstanding the foregoing provisions of this paragraph (_____) [*paragraph designation first set forth above, e.g.*, (c)] none of the Preferred shares may be redeemed prior to _____[*date*] if redemption is for the purpose or in anticipation of any refunding operation involving, directly or indirectly, the incurring of indebtedness or the issuance of Preferred Stock senior to or on a parity with the Preferred shares as to dividends or on liquidation, if the interest on that indebtedness or the dividends on that Preferred Stock would result in

an effective cost of money to the corporation (computed in accordance with generally accepted financial practice) of less than _____ percent per year.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.250

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§ 3.250 Creation of Sinking Fund for Redemption of Preferred Shares

[1] Comment

[a] Use of Form

This form contains provisions that may be included in the articles to establish a "sinking fund" for the purchase or redemption of preferred shares [*see Corp. Code § 402(d)*; *see also § 3.249* (provision that provides for redemption of preferred shares)]. A corporation is permitted to create a sinking fund or to make other provision for the redemption or purchase of its shares to the extent permitted by statutory provisions of the General Corporation Law governing corporate distributions [*Corp. Code § 402(d)*]. Those relevant provisions [*see Corp. Code §§ 500-511*] prohibit distributions to a corporation's shareholders unless certain tests are satisfied [*see, e.g., Corp. Code § 500*]. As defined by statute, a distribution to a corporation's shareholders would include a payment pursuant to a sinking fund [*see Corp. Code § 166*].

If used, this provision should be included as a separately designated paragraph in the article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares (commonly referred to as the "preference statement"). A skeleton form preference statement that may be used for this purpose is set forth in *§ 3.242[2]*. That form lists the other provisions that should ordinarily also be included in the preference statement, for example, provisions for dividends, redemption, and liquidation preferences.

Because sinking fund provisions may vary with each series of preferred shares, it may be preferable to include in the articles a provision that grants authority to the board of directors to determine the sinking fund provisions for all or some of the series rather than to specify those matters in the articles. For article provisions that grant the board authority to fix some or all of the rights, preferences, privileges and restrictions for preferred shares (including, for example, sinking fund provisions), see *§ 3.203[2]*, Article V; and *§§ 3.240* and *3.241*. If those provisions are used, the board, when it subsequently adopts sinking fund provisions for a particular class or series, must do so by adopting a resolution

and filing a certificate of determination with the Secretary of State [*see Corp. Code § 401*]. The provisions below, with some modification, could then be included in that certificate. Requirements for certificates of determination are discussed in *§ 3.310*.

[b] Distinction Between Ordinary Redemption and Sinking Fund Redemption

The statute governing redemptions in general [*see Corp. Code § 402*] would permit the creation of periodic mandatory redemptions of a specified number of shares without their being characterized as part of a "sinking fund." There is, however, a difference between an ordinary redemption and a sinking fund redemption. The statutory definition of "distribution [by a corporation] to its shareholders" [*Corp. Code § 166*] provides that a distribution (a repurchase of shares through their redemption is a distribution) is made when cash or property is transferred by the corporation. It further provides that, in the case of a sinking fund, cash or property is transferred within the meaning of the same statutory definition [*see Corp. Code § 166*] at the time it is delivered to a trustee for the holders of preferred shares to be used for the redemption of those shares or physically segregated by the corporation in trust for that purpose. Therefore, if the corporation holds funds for redemption of the shares but has physically segregated them in trust, the distribution would be deemed made at the time of segregation rather than at the later time when it is actually paid out. This difference might make use of the "sinking fund" terminology worthwhile in many cases [Ballantine & Sterling, California Corporation Laws, Appendix A, Form 4.18, note 24].

[c] Drafting Considerations

In drafting provisions for a sinking fund, the following matters should be determined and specified:

- The year in which payments to the sinking fund are to commence and the payment date for each payment, for example, at the beginning of each fiscal year [*see* [2], P 1, *below*];
- Amount to be contributed for each period [*see* [2], P 1, *below*];
- Source of funds for contribution, for example, any moneys legally available for this purpose or only net earnings of the corporation for the preceding fiscal year [*see* [2], P 1, *below*];
- Whether sinking fund requirements are cumulative or noncumulative [*see* [2], P 1, *below*];
- Mechanics of making a payment and earmarking the funds [*see* [2], PP 1, 2, *below*];
- Whether the corporation is entitled to take a credit against the fund for shares acquired other than through the fund [*see* [2], PP 1, 2, *below*];
- How amounts in the fund are to be applied, for example, for the purchase or redemption of shares, with prices for each type of acquisition specified and the minimum number or percentage of shares designated [*see* [2], P 3, *below*];
- Duration of fund's existence, for example, until the retirement of all preferred shares [*see* [2], P 3, *below*];
- Disposition of cash in fund after fund's purpose has been achieved [*see* [2], P 3, *below*]; and
- Whether the corporation will be authorized to make optional sinking funds payments and purchases [*see* [2], P 4, *below*].

[2] FORM

Creation of Sinking Fund for Redemption of Preferred Shares

V. Sinking Fund

(d) 1. So long as any of the Preferred shares [*or if this provision applies only to a specific series, designate that series here and in remainder of this provision*] shall be outstanding, the corporation, as a sinking fund for the purchase or redemption of those shares (the "Sinking Fund") shall set aside in cash out of any moneys legally available [*or* from the net earnings of the corporation for any preceding fiscal year or years] after full payment or provision for payment of dividends on the Preferred shares and all other shares of the corporation ranking prior to or on a parity with the Preferred shares for all prior periods through the end of the last preceding quarterly dividend period for those shares, on _____[*date*] of each year (the "Sinking Fund payment date") commencing with the year _____, a sum equal to $ _____ [*dollar amount that is usually equal to a percentage of the redemption price per year that would, over a desired number of years (e.g., 15 or 20 years), aggregate 100 percent of the redemption price per share (not including any premium)*] per share times the total number of Preferred shares previously issued.

[*EITHER*]

If, on any Sinking Fund payment date, the funds of the corporation legally available shall be insufficient to discharge the Sinking Fund requirements in full, funds to the extent legally available for that purpose shall be set aside for the Sinking Fund. These Sinking Fund requirements shall be cumulative, so that if for any year or years the requirements shall not be fully discharged as they accrue, funds legally available for that purpose, after such payment or provision for dividends, for each fiscal year thereafter shall be applied to the Sinking Fund until the requirements are fully discharged.

[*OR, if sinking fund obligations will not be cumulative:*]

If the funds legally available, on any Sinking Fund payment date, after payment or provision for dividends, are not sufficient fully to discharge the Sinking Fund requirements, the corporation shall not be required to set apart those sums in full but shall set apart for the Sinking Fund, funds to the extent legally available for that purpose, and to the extent that the expressed Sinking Fund obligation remains unsatisfied it shall not be cumulative.

[*CONTINUE*]

2. The corporation at its option shall be entitled to use as a credit against its Sinking Fund obligation for any year, in an amount equal to $ _____ per share, Preferred shares that the corporation has previously acquired by purchase or redemption, otherwise than through the operation of the Sinking Fund, and for which credit has not previously been taken against any Sinking Fund requirement.

3. On or before the _____ [*number, e.g.*, 90th] day next following each Sinking Fund payment date, the cash in the Sinking Fund shall be used to acquire _____ percent of the total number of Preferred shares previously issued, by purchase, at a price or prices not exceeding $ _____ per share, or by redemption, at $ _____ per share, in the manner provided in paragraph _____ [*designation of paragraph that describes redemption rights*] of this Article V, in each case plus accrued dividends on those shares to the date of purchase or redemption that shall be paid from the general funds of the corporation and not from the Sinking Fund, or by both purchase and redemption. On retirement of all Preferred shares, any cash remaining in the Sinking Fund in excess of that required to complete payment for any shares purchased or agreed to be purchased, or to redeem shares called for redemption through the operation of the Sinking Fund, shall

become a part of the general funds of the corporation.

[*Optional:*]

4. At its option, the corporation may, on the same terms and conditions as the Sinking Fund payments required by this paragraph (d) annually, make additional payments to, and make purchases or redemptions of Preferred shares pursuant to, the Sinking Fund, commencing on _____[*date*]. Any such optional Sinking Fund payments and purchases may not exceed in any 12-month period commencing _____[*date*], a sum equal to _____ percent of the aggregate liquidation value of the Preferred shares previously issued, shall not be cumulative, and shall not result in a credit against the Sinking Fund requirements of the corporation for any year.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.251

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§ 3.251 Conversion Rights With Antidilution Provisions Based on Conversion Price Theory

[1] Comment

[a] Use of Form

The provisions below may be included in the articles to grant the holders of redeemable preferred shares the right to convert their shares into common stock. Also included are protective provisions that protect against dilution of these holders' conversion rights and that are based on a conversion price theory [*see* [h], *below*]. For alternative conversion rights with antidilution provisions based on the "market price theory," see *§ 3.252*.

If preferred shareholders are to have the right to convert their shares into common shares, that right must be stated in the articles [*see Corp. Code §§ 202(e)(3), 403*]. The articles must either set forth the terms and conditions of conversion rights or grant the board of directors authority to determine the rights for a particular class or series [*see Corp. Code §§ 202(e)(3), 403*]. The provisions in this form may be used in the first situation, that is, when the articles will set forth the particular conversion rights. They should be included as a separately designated paragraph in the article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares (commonly referred to as the "preference statement"). A skeleton form preference statement that may be used for this purpose is set forth in *§ 3.242[2]*]. That form also lists the other provisions that ordinarily should be included in the preference statement, for example, provisions for dividends, redemption, and liquidation preferences.

Because conversion rights may vary with each series of preferred shares, it may be preferable to include in the articles a provision that grants authority to the board of directors to determine conversion rights for all or some of the series rather than to specify particular conversion rights in the articles. For article provisions that grant the board authority to fix some or all of the rights, preferences, privileges and restrictions for preferred shares (including, for example, conversion rights), see *§ 3.203[2]*, Article V; and *§§ 3.240* and *3.241*. If those provisions are used, the board, when it subsequently determines conversion rights, must do so by adopting a resolution and filing a certificate of determination with the

Secretary of State [*see Corp. Code § 401*]. The provisions below, with some modification, could then be included in that certificate. Requirements for certificates of determination are discussed in *§ 3.310*.

[b] General Definition of "Conversion"

The term "conversion"may be broadly defined as the act of exchanging securities of one class for securities of a different class, with the exchange being effected by a surrender of the original security and the issuance to the holder of a new security in its place. Convertible corporate securities may, pursuant to their terms, be changed or exchanged for other securities, such as bonds or notes exchangeable for preferred or common stock, or preferred stock exchangeable for common stock.

[c] Authority of Corporation to Issue Convertible Shares

When so provided in its articles, a corporation may issue shares convertible within the time or on the happening of one or more specified events and on the terms and conditions as are stated in its articles [*Corp. Code § 403(a)*]:

- At the option of the holder only or automatically on the happening of one or more specified events, into shares of any class or series; or

- If it is a corporation that has a license or franchise from a governmental agency to conduct its business or a member corporation of a national securities exchange registered under the Securities Exchange Act of 1934, the license, franchise, or membership of which is conditioned on some or all of the holders of its stock possessing prescribed qualifications, to the extent necessary to prevent the loss of that license, franchise, or membership, or to reinstate it, at the option of the corporation, into shares of any class or series or into any other security of the corporation.

- If the corporation is a "listed corporation" [*see Corp. Code § 301.5(d)* (definition)], both at the time of the original issuance of the convertible shares and at the time of the conversion, at the option of the corporation into shares of any class or series, or into any other security of the corporation, provided that any securities received on conversion are listed or qualified for trading on a stock exchange or market system.

Unless otherwise provided in the articles, a corporation may issue its debt securities convertible into other debt securities or into shares of the corporation within the time or on the happening of one or more specified events and on the terms and conditions as are fixed by the board of directors [*Corp. Code § 403(b)*].

Unless the articles provide otherwise, the board of directors may issue shares, options, or securities having conversion or option rights [*see Corp. Code § 404*] without first offering them to shareholders of any class [*Corp. Code § 406*]. For article provisions granting preemptive rights to preferred shareholders, see *§ 3.262*.

[d] Regulations of Commissioner of Corporations

Preferred stock to be sold under an open qualification [*see 10 Cal. Code Reg. § 260.001(f)* (definition)] by an unseasoned corporation [*see 10 Cal. Code Reg. § 260.001(g)* (definition of "seasoned corporation")] should normally be convertible into common stock on a fair and equitable basis or be fully participating and nonredeemable [*10 Cal. Code Reg. § 260.140.9*]. A limited offering qualification may, however, be approved by the Corporations Commissioner for an unseasoned corporation to sell nonconvertible and nonparticipating senior securities if they are to be issued to the holders of the residual equity securities on a pro rata basis or if the circumstances otherwise justify [*10 Cal. Code Reg. § 260.140.9*].

If the corporation proposes to issue convertible preferred shares, the corporate articles or other charter document [*see 10 Cal. Code Reg. § 260.001(a)*] should normally contain an appropriate antidilution provision providing for an adjustment of the number of shares into which such shares are convertible or the number of shares purchasable on any stock split or stock dividend or other recapitalization of the corporation [*10 Cal. Code Reg. § 260.140.6*; *see* [h], *below*]. The charter documents may also provide for a similar adjustment on the issuance of additional common stock by the corporation for a consideration less than the conversion price of the preferred shares or the then current market price for the common stock [*10 Cal. Code Reg. § 260.140.6*].

Preferred shares that are not convertible must ordinarily be granted certain voting or other protective rights [*see 10 Cal. Code Reg. §§ 260.140.2, 260.140.3*]. Illustrative protective provisions are included and discussed in *§ 3.255*.

[e] Effect of Conversion

When a corporation reacquires its own shares, those shares are restored to the status of authorized but unissued shares unless the articles prohibit the reissue of reacquired shares [*Corp. Code § 510(a)*]. The term "reacquires" means that a corporation purchases, redeems, acquires by way of conversion to another class or series, or otherwise acquires its own shares or that issued and outstanding shares cease to be outstanding [*Corp. Code § 510(d)*].

If a corporation reacquires authorized shares of a class or series and the articles prohibit the reissuance of those shares, the following rules apply [*Corp. Code § 510(b)*]:

- If all of the authorized shares of that class or series are reacquired then (1) that class or series is automatically eliminated; (2) in the case of reacquisition of all authorized shares of a series, the authorized number of shares of the class to which the shares belonged is reduced by the number of shares so acquired; and (3) the articles must be amended to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that class or series.

- If less than all of the authorized shares but all of the issued and outstanding shares of that class or series are reacquired, the authorized number of shares of the class or series is automatically reduced by the number of shares reacquired and the board must determine either (1) to eliminate that class or series, which requires amending the articles to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that class or series; or (2) not to eliminate that class or series, which requires amending the articles to reflect that reduction of the number of authorized shares of that class or series by the number of reacquired shares.

- If less than all of the authorized shares and less than all of the issued and outstanding shares of a class or series are reacquired, the authorized number of shares of that class or series is automatically reduced by the number of reacquired shares and the articles must be amended to reflect that reduction.

If a corporation reacquires authorized shares of a series of shares and the articles prohibit only the reissuance of those shares as shares of the same series, the following rules apply [*Corp. Code § 510(c)*]:

- If all of the authorized shares of that series are reacquired, then that series is automatically eliminated, the articles must be amended to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that series, and the board must determine either (1) to return those shares to the status of authorized but undesignated shares of the class to which they belong or (2) to eliminate those shares entirely. In either case, the articles must be amended to reflect the reduction in authorized shares of that series and any effect on the class to which that series belongs.

- If all of the issued and outstanding shares of that series, but less than all of the authorized shares of

that series, are reacquired, the board must determine either (1) to eliminate that series, which requires amending the articles to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that series; or (2) not to eliminate that series, which requires amending the articles to reflect the return of the reacquired shares to the status of authorized but undesignated shares of the class to which they belong.

- If less than all of the issued and outstanding shares of that series are reacquired, the authorized number of shares of that series is automatically reduced by the number of reacquired shares and the board must determine either (1) to return those shares to the status of authorized but undesignated shares of the class to which they belong or (2) to eliminate those shares entirely. In either case, the articles must be amended to reflect the reduction in authorized shares of that series and any effect on the class to which that series belongs.

A certificate of amendment must be filed in accordance with statutory requirements, reflecting any elimination or reduction of authorized shares, and any related elimination from the articles of the designation and the rights, preferences, privileges, and restrictions of any series or class of stock that is eliminated [*Corp. Code § 510(f)*; *see Corp. Code §§ 900-911*], except that approval by the outstanding shares [*see Corp. Code § 152*] ordinarily required is not required to adopt this type of amendment [*Corp. Code § 510(f)*].

These corporate reaquisition rules may be varied in the articles [*Corp. Code § 510(e)*]. Further, nothing in these rules is intended to alter or otherwise affect the powers of the board to amend the articles [*Corp. Code § 510(f)*; *see Corp. Code §§ 202, 401*].

[f] Amendment of Articles to Increase Shares

If at the time option or conversion rights are granted, or at any later time, the corporation is not authorized by its articles to issue all the shares required to satisfy those rights, if and when exercised, the additional number of shares required to be issued on the exercise of those rights must be authorized by an amendment to the articles [*Corp. Code § 405(a)*].

If approval of the outstanding shares [*see Corp. Code § 152* (definition)] to issue options or convertible securities has been obtained, the board may, without further approval of the outstanding shares, amend the articles to increase the authorized shares of any class or series to that number as will be sufficient from time to time, when added to the previously authorized but unissued shares of such class or series, to satisfy any option or conversion rights [*Corp. Code § 405(b)*].

[g] Fractional Shares

A corporation may, but is not required to, issue fractions of a share originally or on transfer, for example, in connection with a conversion. For an original issue, if the corporation does not issue fractional shares, it must comply with certain requirements for disposition of any fractional interests [*see Corp. Code § 407*]. If the fraction of a share that any person would otherwise be entitled to receive in a merger or reorganization is less than one-half of one percent of the total shares that person is entitled to receive, a merger or reorganization agreement may provide that fractions of a share will be disregarded or that shares issuable in the merger will be rounded off to the nearest whole share [*Corp. Code § 407*]. This form prohibits the issuance of fractional shares but provides for compensation for fractional interests by payment in cash or the issuance of nondividend bearing and nonvoting scrip certificates [*see* [2], P 3, *below*].

[h] Protection Against Dilution of Conversion Rights

Convertible preferred share provisions should normally provide for protection against dilution of the conversion right by adjusting the number of shares into which the preferred shares are convertible on any stock dividend, stock split, or

other recapitalization of the corporation. Many investors also seek antidilution protection in the event that the corporation later has a "down round" of financing and issues capital stock at a price per share lower than the current price. Antidilution provisions may adjust the conversion rights when additional common stock is issued for a consideration less than the conversion price of the preferred shares or less than the then current market price for the common shares [*see 10 Cal. Code Reg. § 260.140.6*].

Two general theories exist as to the extent of protection that should be provided in the case of an offering of additional common shares for cash or property. These are commonly referred to as the "conversion price theory" and the "market value theory". Discussion of either theory requires an understanding of how the conversion price of common shares into which preferred shares are convertible is determined. In effect, that price is generally the price per common share that the holder of the convertible preferred pays by exercising the conversion privilege. It is usually determined by dividing the original public offering price (or original issuance price) of a share of convertible preferred, by the number of common shares into which that preferred share is initially convertible. For example, if a preferred share originally issued by the corporation for $100 is convertible into four shares of common, the conversion price of the common is $25 per share.

The "conversion price theory" maintains that the conversion right is diluted if the corporation subsequently issues common shares at less than the conversion price (as in effect from time to time) or gives to common shareholders the right to subscribe to additional common shares at a price below that conversion price even though the later proposed issuance or subscription price is approximately the market value of the common at that time. This form contains provisions intended to compensate for that dilution by proportionately decreasing the "conversion price," that is, the price at which common shares shall be deliverable on conversion of the preferred, in case of an additional issue at less than the conversion price in effect at that time.

The "market value theory" is discussed in *§ 3.252*, which also contains antidilution clauses based on that theory. Market value dilution clauses should be used only by a corporation whose shares have a readily ascertainable market value, that is, one whose shares are regularly traded [Ballantine & Sterling, California Corporation Laws, Form 4.19, n. 26].

Antidilution protection, whether based on the "conversion price" or "market value" theory, has two broad variations: the "full ratchet" and "weighted average" methods. In turn, there are many variations on the formulae used to apply the "weighted average" method. In general, "full ratchet" antidilution protection provides that if the corporation issues additional equity securities at a price below the then-effective "conversion" price, the "conversion price" will be reduced to the price at which the new equity securities are issued, thus treating the holders of the preferred stock as if they had purchased their preferred stock at the lower price paid by purchasers of the new equity securities. In contrast, weighted average antidilution protection determines how many shares of stock the new purchasers could have purchased if they had paid the same price as the preferred, and adjusts the "conversion price" by a fraction based on a calculation of the number of "additional" shares issued as a result of the lower price paid by the purchasers of the new equity securities.

The harshest form of anti-dilution protection from the perspective of the corporation is "full-ratchet" anti-dilution, which adjusts the conversion price to the lower price paid in the "down round" of financing. An example of "full ratchet" antidilution is illustrated in the first alternative to § 4(d) of this form. Alternatively, investors and the corporation may agree to use "weighted average" antidilution protection in the event of a "down round" of financing. When this type of anti-dilution protection is triggered, the conversion price (or prices if there are multiple series of preferred shares with anti-dilution protection) is multiplied by a formula, the numerator of which is the number of shares which the aggregate consideration received by the corporation in the "down round" would purchase at the then-applicable conversion price plus some factor X, and the denominator of which is the number of shares purchased in the "down round" plus X. There are two general types of weighted average antidilution--"narrow-based" and "broad-based." The most restrictive narrow-based antidilution formula defines "X" as outstanding common shares only, while the most expansive broad-based anti-dilution formula defines X as outstanding common shares, common shares issuable upon conversion of the preferred shares, options issued or issuable under the current stock option plan, and any

other security issued or issuable by the corporation. As the numerator and denominator become larger, the adjustment to the conversion price becomes smaller. As the factor X becomes smaller, the adjustment to the conversion price moves closer to a full-ratchet adjustment. In most cases, the investors and the corporation agree on some form of weighted average anti-dilution in between the extremes discussed above. An example of a standard weigted average formula is illustrated in the second alternative to P 4(d) of this form.

[i] Drafting Considerations

At a minimum, provisions in the articles that cover conversion rights should specify the following:

- Circumstances under which the conversion rights may be exercised.
- Method required to exercise the election to convert, for example, by notice.
- Conversion price of common shares and the price of preferred shares for the purpose of conversion.
- Whether or not fractional shares will be issued on conversion, and if so, the procedure for issuing fractional shares.
- Antidilution provisions that adjust the conversion price when changes, such as stock splits or the exchanges of securities, are made in the capital structure of the corporation, and additional equity securities are issued at a lower price.
- Status of preferred shares after conversion, including any prohibition against their reissuance;
- Date when the converting shareholder becomes a common shareholder.
- Authorization for and reservation of common shares sufficient to cover the conversion.

[2] FORM

Conversion Rights With Antidilution Provisions Based on Conversion Price Theory

V. Conversion Rights

The holder of any Preferred shares shall have conversion rights as follows:

1. Right to Convert. The Preferred shares shall be convertible, at the option of the holders of the shares, at any time after the issuance of those shares, at the office of the Corporation or any transfer agent for those shares. The Preferred shares shall be converted into that number of fully-paid and non-assessable Common shares as is determined by dividing the original purchase prices for those Preferred shares by the conversion price for those preferred shares, determined as hereinafter provided, in effect at the time of conversion. The initial coversion price for [each series of] the Preferred Shares is _____ [*state initial per-share conversion of preferred shares or, if one more than one series of preferred shares will be issued:* as follows: _____ (*identify each series of shares and state initial per-share conversion price for each series*)]. _____ [This conversion price *or* Each of these conversion prices] shall be subject to adjustment as provided below.

2. Automatic Conversion. The Preferred shares shall automatically be converted into Common shares at the then effective Conversion Prices [for that series of Preferred shares] upon the earlier of _____ [*describe specific event or events, e.g.,* (a) the closing of a firm committment underwritten public offering pursuant to an effective registration statement under the Securities Act of 1933, as amended, covering the offer and sale of Common shares for the account of the Corporation to the public with aggregate proceeds to the Company in excess of $10,000,000 (before

deduction for underwriters' commissions and expenses) and a per-share price of not less than $ _____ per share (appropriately adjsuted for any stock combination, stock split, stock dividend, recapitalization, or other similar transaction, or (b) the date on which a total of 50 percent of the [shares of that series of] Preferred shares originally issued have been converted into Common shares (each such event is an "Automatic Conversion"). In the event of an Automatic Conversion of the Preferred shares upon a public offering as stated above, the person or persons entitled to receive the Common shares issuable on that conversion of Preferred shares shall not be deemed to have converted those Preferred shares until immediately prior to the closing of that sale of securities].

3. Mechanics of Conversion. No fractional Common shares shall be issued upon conversion of Preferred shares. All Common shares (including fractions thereof) issuable upon conversion of more than one share of Preferred shares by a holder of Preferred shares shall be aggregated for purposes of determining whether the conversion would result in the issuance of any fractional share. If, after the aforementioned aggregation, the conversion would result in the issuance of a fraction of a share of Common shares, the Corporation shall pay, in lieu of issuing any fractional shares to which the holder would otherwise be entitled, cash equal to that fraction multiplied by the then-effective conversion price for [that series of] Preferred shares. Before any holder of Preferred shares shall be entitled to convert those shares into full Common shares and to receive certificates for Common shares, the holder shall (a) give written notice to the Corporation, at the office of the Corporation or of any transfer agent for the Preferred shares, that he or she elects to convert the same, and (b) surrender the certificate or certificates for those Preferred shares, duly endorsed, at the office of the Corporation or of any transfer agent for the Preferred shares, or notify the Corporation or its transfer agent that the certificates have been lost stolen, or destroyed, and execute an agreement satisfactory to the Corporation to indemnify the Corporation from any loss incurred by it in connection with those certificates [*if preferred shares are convertible automatically, add:*; provided, however, that in the event of an Automatic Conversion, the outstanding Preferred shares shall be converted automatically without any further action by the holders of those shares and whether or not the certificates representing those shares are surrendered to the Corporation or its transfer agent, and provided further that the Corporation shall not be obligated to issue certificates evidencing the Common shares issuable upon such an Automatic Conversion unless the certificates evidencing those Preferred shares are either delivered to the Corporation or its transfer agent as provided above, or the holder notifies the Corporation or its transfer agent that the certificates have been lost stolen, or destroyed, and executes an agreement satisfactory to the Corporation to indemnify the Corporation from any loss incurred by it in connection with those certificates]. The Corporation shall, as soon as practicable after such a delivery, or the execution of such an agreement and indemnification in the case of a lost certificate, issue and deliver at that office to that holder of Preferred shares a certificate or certificates for the number of Common shares to which that holder is entitled, and a check payable to the holder in the amount of any cash amounts payable as the result of a conversion into fractional Common shares. The conversion shall be deemed to have been made immediately prior to the close of business on the date of surrender of the Preferred shares to be converted [, or in the case of Automatic Conversion, on the date of closing of the offering or the date on which a total of 50 percent of the shares of (that series of) Preferred shares originally issued have been converted into Common shares, as applicable,] and the person or persons entitled to receive the Common shares issuable upon conversion shall be treated for all purposes as the record holder or holders of those Common shares on that date.

4. Adjustments to Conversion Price.

(a) Adjustments for Dividends, Splits, Subdivisions, Combinations, or Consolidation of Common Shares. In the event the outstanding Common shares shall be increased by stock dividend payable in Common shares, stock split, subdivision, or other similar transaction occurring after the filing of these [Amended and Restated] Articles of Incorporation, into a greater number of Common shares, the Conversion Price then in effect for [each series of] Preferred shares shall, concurrently with the effectiveness of that event, be decreased in proportion to the percentage increase in the outstanding number of Common shares. In the event the outstanding Common shares shall be decreased by reverse stock split, combination, consolidation, or other similar transaction occurring after the filing of these [Amended and Restated] Articles of Incorporation, into a lesser number of Common Shares, the Conversion Price then in effect for [each series of] Preferred Shares shall, concurrently with the effectiveness of that event, be increased in

proportion to the percentage decrease in the outstanding number of Common shares.

(b) Adjustments for Other Distributions. In the event the Corporation at any time, or from time to time makes, or fixes a record date for the determination of holders of Common shares entitled to receive, any distribution payable in securities of the Corporation other than Common shares and other than as otherwise adjusted in this Article, then and in each such event provision shall be made so that the holders of Preferred shares shall receive upon conversion thereof, in addition to the number of Common shares receivable thereupon, the amount of securities of the Corporation that they would have received had their Preferred shares been converted into Common shares on the date of that event and had they thereafter, during the period from the date of that event to and including the date of conversion, retained those securities receivable by them during that period, subject to all other adjustments called for during that period under this Article with respect to the rights of the holders of the Preferred shares.

(c) Adjustments for Reclassification, Exchange and Substitution. If the Common shares issuable upon conversion of the Preferred shares shall be changed into the same or a different number of shares of any other class or classes of stock, whether by capital reorganization, reclassification, or otherwise (other than a subdivision or combination of shares provided for above), the Conversion Price then in effect for each series of Preferred shares shall, concurrently with the effectiveness of the reorganization or reclassification, be proportionately adjusted so that the Preferred shares shall be convertible into, in lieu of the number of Common shares that the holders would otherwise have been entitled to receive, a number of shares of that other class or classes of stock equivalent to the number of Common shares that would have been subject to receipt by the holders upon conversion of their Preferred shares immediately before that change.

[*EITHER, to provide "full-ratchet" anti-dilution, which is the harshest form of antidilution protection from the perspective of the corporation:*]

(d) Adjustments Upon Issuance of Additional Stock. If the Corporation shall issue "Additional Stock" (as defined below) for a consideration per share less than the Conversion Price for [any series of] Preferred shares then in effect on the date and immediately prior to that issue, then and in that event, the Conversion Price [or Conversion Prices, as applicable,] shall be reduced concurrently with that issue, to a price equal to the aggregate consideration paid per share in that issue.

[*OR, to provide a standard weighted average formula for antidilution protection (see discussion in comment to this form), include the following:*]

(d) Adjustments Upon Issuance of Additional Stock. If the Corporation shall issue "Additional Stock" (as defined below) for a consideration per share less than the Conversion Price for [any series of] Preferred shares then in effect on the date and immediately prior to that issue, then and in that event, the Conversion Price shall be reduced, concurrently with that issue, to a price (calculated to three decimal places) determined by multiplying that Conversion Price by a fraction (i) the numerator of which shall be the number of Common shares outstanding immediately prior to that issue (including all Common shares issuable upon conversion of the outstanding Preferred shares and all Common shares issuable upon exercise of all outstanding options) plus the number of Common shares that the aggregate consideration received by the Corporation for the total number of Additional Stock so issued (or deemed to be issued) would purchase at that Conversion Price; and (ii) the denominator of which shall be the number of Common shares outstanding immediately prior to that issue (including Common shares issuable upon conversion of the outstanding Preferred shares and all Common shares issuable upon exercise of all outstanding options) plus the number of shares of Additional Stock so issued.

[*CONTINUE*]

For purposes of this Paragraph 4, "Additional Stock" shall mean all Common shares issued by the Corporation after the date on which shares of the applicable Preferred shares were first issued other than Common shares issued or issuable at any time (i) upon conversion of the Preferred shares; (ii) to officers, directors, and employees of, and consultants to, the Corporation after the date on which shares of the applicable Preferred shares were first issued as designated and approved by the Board of Directors; (iii) in connection with equipment leasing or bank financing transactions approved by the Corporation's Board of Directors; (iv) as a dividend or distribution in Preferred shares; or (v) as described in subparagraphs (a), (b) and (c) of this Paragraph 4.

For the purpose of making any adjustment in the Conversion Price as provided above, the consideration received by the Corporation for any issue or sale of Common shares will be computed as follows:

(i) To the extent it consists of cash, as the amount of cash received by the Corporation before deduction of any offering expenses payable by the Corporation and any underwriting or similar commissions, compensation, or concessions paid or allowed by the Corporation in connection with the issue or sale;

(ii) To the extent it consists of property other than cash, at the fair market value of that property as determined in good faith by the Corporation's Board of Directors [in accordance with the provisions of the applicable provisions, if any, of _____ (Article *or* Section) _____ (*number of article or section, if any, governing liquidation preferences*)]; and

(iii) If Common shares are issued or sold together with other stock or securities or other assets of the Corporation for a consideration which covers both, as the portion of the consideration so received that may be reasonably determined in go faith by the Board of Directors to be allocable to those Common shares.

If the Corporation (i) grants any rights or options to subscribe for, purchase, or otherwise acquire Common shares, or (ii) issues or sells any security convertible into Common shares, then, in each case, the price per Common share issuable on the exercise of the rights or options or the conversion of the securities will be determined by dividing the total amount, if any, received or receivable by the Corporation as consideration for the granting of the rights or options or the issue or sale of the convertible securities, plus the minimum aggregate amount of additional consideration payable to the Corporation on exercise or conversion of the securities, by the maximum number of Common shares issuable on the exercise of conversion. Such a grant, issue, or sale will be considered to be an issue or sale for cash of the maximum number of Common shares issuable on exercise or conversion at the price per share determined under this subparagraph, and the Conversion Price will be adjusted as provided above to reflect (on the basis of that determination) the issue or sale. No further adjustment of the Conversion Price will be made as a result of the actual issuance of Common shares on the exercise of any such rights or options or the conversion of any such convertible securities.

On the redemption or repurchase of any such securities, or the expiration or termination of the right to convert into, exchange for, or exercise with respect to, Common shares, the Conversion Price will be readjusted to the price that would have been obtained had the adjustment made upon their issuance been made upon the basis of the issuance of only the number of those securities that were actually converted into, exchanged for, or exercised with respect to, Common shares. If the purchase price or conversion or exchange rate provided for in any such security changes at any time, then, at the time any such change becomes effective, the Conversion Price then in effect will be readjusted forthwith to the price that would have been obtained had the adjustment made upon the issuance of those securities been made upon the basis of (i) the issuance of only the number of Common shares theretofore actually delivered upon the conversion, exchange or exercise of those securities, and the total consideration received therefor, and (ii) the granting or issuance, at the time of the change, of any of those securities then still outstanding for the consideration, if any, received by the Company therefor and to be received on the basis of that changed price or rate.

5. No Impairment. [Except as provided in the protective covenants provisions, as applicable,] [T]he Corporation will not, by amendment of its Articles of Incorporation or through any reorganization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities, or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed under this Article by the Corporation, but will at all times in good faith assist in the carrying out of all the provisions of this Article and in the taking of all action that may be necessary or appropriate in order to protect the conversion rights of the holders of the Preferred shares against impairment.

6. Certificate as to Adjustments. On the occurrence of each adjustment or readjustment of the Conversion Price of each series of Preferred shares, the Corporation at its expense shall promptly compute that adjustment or readjustment in accordance with the terms of this Article, and furnish to each holder of Preferred shares a certificate setting forth that adjustment or readjustment and showing in detail the facts upon which that adjustment or readjustment is based. The Corporation shall, upon the written request of any holder of Preferred shares, furnish or cause to be furnished to that holder a like certificate setting forth (a) those adjustments and readjustments, (b) the Conversion Price at the time in effect, and (c) the number of Common shares and the amount, if any, of other property which at the time would be received upon the conversion of the Preferred shares.

7. Notices of Record Date. In the event that this Corporation shall propose at any time:

(a) To declare any dividend or distribution upon its Common shares, whether in cash, property, stock, or other securities, whether or not a regular cash dividend and whether or not out of earnings or earned surplus;

(b) To offer for subscription pro rata to the holders of any class or series of its stock any additional shares of stock of any class or series or other rights;

(c) To effect any reclassification or recapitalization of its Common shares outstanding involving a change in the Common shares; or

(d) To merge or consolidate with or into any other corporation, or sell, lease, or convey all or substantially all its property or business, or to liquidate, dissolve, or wind up;

Then, in connection with each such event, this Corporation shall send to the holders of the Preferred shares:

(a) At least 20 days' prior written notice of the date on which a record shall be taken for that dividend, distribution, or subscription rights (and specifying the date on which the holders of Common shares shall be entitled thereto) or for determining rights to vote in respect of the matters referred to in (c) and (d), above; and

(b) In the case of the matters referred to in (c) and (d), above, at least 20 days' prior written notice of the date when the events shall take place (and specifying the date on which the holders of Common shares shall be entitled to exchange their Common shares for securities or other property deliverable upon the occurrence of event or the record date for the determination of those holders if that record date is earlier).

Each such written notice shall be delivered personally or given by first class mail, postage prepaid, addressed to the holders of the Preferred shares at the address for each such holder as shown on the books of this Corporation.

8. Issue Taxes. The Corporation shall pay any and all issue and other taxes (other than income taxes) that may be payable in respect of any issue or delivery of Common shares on conversion of Preferred shares under this Article; provided, however, that the Corporation shall not be obligated to pay any transfer taxes resulting from any transfer requested by any holder in connection with any such conversion.

9. Reservation of Stock Issuable on Conversion. The Corporation shall at all times reserve and keep available out

of its authorized but unissued Common shares, solely for the purpose of effecting the conversion of the shares of the Preferred shares, such a number of its Common shares as shall from time to time be sufficient to effect the conversion of all outstanding Preferred shares; and if at any time the number of authorized but unissued Common shares shall not be sufficient to effect the conversion of all then outstanding Preferred shares, the Corporation will take such corporate action as may, in the opinion of its counsel, be necessary to increase its authorized but unissued Common shares to that number of shares which shall be sufficient for that purpose, including, without limitation, engaging in best efforts to obtain the requisite shareholder approval of any necessary amendment to its Articles of Incorporation.

10. Status of Converted Stock. In case any series of Preferred shares shall be converted pursuant to this Article, the shares so converted shall resume the status of authorized but unissued Preferred shares undesignated as to series.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.252

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.252 Conversion Rights of Preferred Shares With Antidilution Provisions Based on Market Value Theory

[1] Comment

[a] Use of Form

This form contains provisions that may be included in the articles to grant the holders of redeemable preferred shares the right to convert their shares into common stock. Also included are protective provisions that protect against dilution of these holders' conversion rights and that are based on a market value theory [*see* [b], *below*]. These antidilution provisions are not appropriate for use in the articles of a corporation whose common shares are not generally traded in and, therefore, do not have a readily ascertainable market value. For alternative conversion rights with antidilution provisions based on the "conversion price theory," see *§ 3.251*. Specific requirements and drafting considerations for conversion rights are discussed in *§ 3.251[1]*.

If preferred shareholders are to have the right to convert their shares into common shares, that right must be stated in the articles [*see Corp. Code §§ 202(e)(3), 403*]. The articles must either set forth the terms and conditions of conversion rights or grant the board of directors authority to determine the rights for a particular class or series [*see Corp. Code §§ 202(e)(3), 403*]. The provisions in this form are intended for use in the first situation, that is, when the articles will set forth the particular conversion rights. They should be included as a separately designated paragraph in the article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares (commonly referred to as the "preference statement"). A skeleton form preference statement for use under these circumstances is set forth in *§ 3.242[2]*. That form also lists the other provisions that should ordinarily be included in the preference statement, for example, provisions for dividends, redemption, and liquidation preferences.

Because conversion rights may vary with each series of preferred shares, it may be preferable to include in the articles a provision that grants authority to the board of directors to determine conversion rights for all or some of the series rather than to specify particular conversion rights in the articles. For article provisions that grant the board authority to fix

some or all of the rights, preferences, privileges and restrictions for preferred shares (including, for example, conversion rights), see *§ 3.203[2]*, Article V; and *§§ 3.240* and *3.241*. If those provisions are used, the board, when it subsequently determines conversion rights, must do so by adopting a resolution and filing a certificate of determination with the Secretary of State [*see Corp. Code § 401*]. The provisions below, with some modification, could then be included in that certificate. Requirements for certificates of determination are discussed in *§ 3.310*.

[b] Antidilution Adjustment Based on Market Price Theory

Convertible preferred share provisions should normally provide for protection against dilution of the conversion right by adjusting the number of shares into which the preferred shares are convertible on any stock dividend, stock split, or other recapitalization of the corporation. Antidilution provisions may also adjust the conversion rights when additional common stock is issued for a consideration less than the conversion price of the preferred shares or less than the then current market price for the common shares [*see 10 Cal. Code Reg. § 260.140.6*].

Two general theories exist as to the extent of protection that should be provided in the case of an offering of additional common shares for cash or property. These are commonly referred to as the "conversion price theory" and the "market value theory". Discussion of either theory requires an understanding of how the conversion price of common shares into which preferred shares are convertible is determined. In effect, that price is generally the price per common share that the holder of the convertible preferred pays by exercising the conversion privilege. It is usually determined by dividing the original public offering price (or original issuance price) of a share of convertible preferred, by the number of common shares into which that preferred share is initially convertible. For example, if a preferred share originally issued by the corporation for $100 is convertible into four shares of common, the conversion price of the common is $25 per share.

The "conversion price theory" is described in *§ 3.251[1][h]*. The "market value theory" holds that the conversion right is diluted whenever the corporation issues additional common shares (or rights to subscribe for those shares) for a consideration less than the then current market value of common shares of the corporation, whether or not the consideration is less than the conversion price then in effect. The antidilution provisions in this form [*see* [2], PP 2, 3, *below*] provide protection by proportionately increasing the number of common shares issuable on conversion, in the event of an additional issue of common stock at less than market value. They should be used only for a corporation whose shares are commonly traded in and have a readily ascertainable market value.

For discussion of the "full ratchet" and "weighted average" methods of calculating antidilution protection, see *§ 3.251[1][h]*.

[2] FORM

Conversion Rights of Preferred Shares With Antidilution Provisions Based on Market Value Theory

V. Conversion of Shares

(e) 1. The Preferred shares [*or if this provision applies only to a particular series, designate that series here and in remainder of provision*] shall be convertible at the option of the respective holders of the shares [*or* automatically converted on _____ (*either describe specific event or insert:* the vote of _____ (*specify percent not less than a majority*)) of the outstanding Preferred Shares] on or before the _____ day before the date, if any fixed for the redemption of those shares in any notice of redemption given as provided in paragraph _____ [*designation of paragraph that provides for redemption rights and procedure*]. Before any Preferred shares may be converted into Common shares at the option of the holder, the holder must surrender the certificate or certificates for those shares to be converted into fully paid and nonassessable Common shares of the corporation, at the rate of _____[*number*] Common shares for each Preferred share so surrendered for conversion; provided, however, that no adjustment shall be made with respect to dividends that may be accrued and unpaid at the date of surrender for conversion [*or if shares are uncertificated (see Corp. Code § 191.1), delete all*

references to share certificates and their surrender in this provision and instead describe required procedure for uncertificated securities (see, e.g., § 3.240[2])]. To exercise this option to convert, a holder of Preferred shares shall surrender for that purpose to the corporation, at any place where the corporation maintains a transfer agent for its Common shares or its Preferred shares, certificates representing the shares to be converted. The holder shall also give written notice to the corporation at that office that the holder elects to convert a specified number or all of the shares represented by the surrendered certificate(s). The notice shall also specify the name or names in which the holder wishes the certificate or certificates for the Common shares to be issued. If a name specified is not that of the holder, the notice shall also state the address of the new holder and any other information required by law. At the time of surrender, the person surrendering the shares to be converted shall be deemed to be the holder of record of the Common shares issuable on conversion, notwithstanding that the share register of the corporation shall then be closed or the certificates representing the Common shares shall not then be actually delivered to that person. The corporation shall, as soon as practicable thereafter, issue and deliver at such office to the holder of Preferred shares converted, or to that holder's nominee or nominees, certificates for the number of full Common shares to which the holder shall be entitled to receive, together with a scrip certificate or cash in lieu of any fraction of a share as provided below.

[*If preferred shares are convertible automatically or on a vote of holders, add:*]

Preferred shares that are converted on _____ [*describe event that causes automatic conversion or event that otherwise triggers conversion*] shall on that occurrence be converted into Common shares on the basis set forth above, and Common shares shall thereon be issued and outstanding. The board may order any holders of outstanding certificates for Preferred shares to surrender them for certificates evidencing Common shares. The order may provide that a holder of certificates to be so exchanged is not entitled to vote or to receive dividends or to exercise any other rights of a shareholder until the holder has complied with the order, but this order shall be operative only after notice and only until compliance.

[*CONTINUE*]

2. The number of Common shares into which Preferred shares may be converted shall be subject to adjustment from time to time in certain cases as follows:

(A) If the corporation subdivides or combines its outstanding Common shares into a greater or smaller number of shares, then in each case, the number of Common shares into which Preferred shares may be converted shall be increased or reduced in the same proportion.

(B) If the corporation sets a record date for the purpose of entitling the holders of its Common shares to receive a dividend or other distribution payable in Common shares or securities convertible into or exchangeable for Common shares, then in each case, the maximum number of Common shares issuable in payment of the dividend or distribution, or on conversion of or in exchange for the securities convertible into or exchangeable for Common shares, shall be deemed to have been issued and to be outstanding as of that record date, and in each case the number of Common shares into which Preferred shares may be converted, shall be increased in proportion to the increase, through the dividend or distribution, of the number of outstanding Common shares.

(C) If the corporation sets a record date for the purpose of entitling the holders of its Common shares to subscribe for additional Common shares on payment of an amount per common share less than the "market value" (as defined in (D), below) per Common share on that date, then in each case the number of Common shares deliverable on the conversion of each Preferred share shall be increased in the ratio that (i) the sum of the number of Common shares outstanding on that record date and the number of Common shares offered bears to (ii) the sum of the number of Common shares outstanding on that record date and the number of Common shares that the aggregate subscription price would purchase at the market value per share of the Common shares on that record date [*or provide for adjustment of conversion price based on number of shares actually sold, rather than shares offered, see, e.g., § 3.251[2]*]. On the

setting of a record date by the corporation for the purpose of entitling the holders of its Common shares to subscribe for shares or other securities convertible into, exchangeable for, or carrying rights of purchase of, Common shares, a record date shall be deemed to have been set for the purpose of entitling the holders of its Common shares to subscribe for the total number of Common shares deliverable on the exercise of those rights of conversion, exchange, or purchase, on payment of an aggregate price equal to the sum of (i) the total consideration payable to the corporation for the stock or other securities so convertible or exchangeable, and (ii) in the case of the stock or other securities carrying those rights but not so convertible or exchangeable, the amount (if any) by which the consideration payable to the corporation for that stock or other securities shall exceed the distributive amounts (excluding dividends) payable on voluntary liquidation of the corporation with respect to that stock or the principal amount of securities, as the case may be, or the redemption price thereof, whichever is higher, and (iii) any additional amount thereafter payable to the corporation on the exercise of the rights of conversion, exchange, or purchase.

(D) The "market value"per share of Common shares at the time as of which the then "market value" is determined shall be deemed to be the average of the daily closing prices for _____ [*e.g.,* 30] consecutive business days selected by the corporation out of the _____ [*number, e.g.,* 40] days immediately preceding the date as of which "market value" is determined. For purposes of the preceding sentence, a "business day" means a day on which the principal stock exchange or other market on which the Common shares are traded was open for at least one-half of its normal business day. The closing price on any day shall be the last sale price, regular way, as reported in a composite published report of transactions that includes transactions on the exchange or other principal markets in which the Common shares are traded or, if there is no such composite report as to any day, the last reported sales price, regular way (or if there is no such reported sale on that day, the average of the closing reported bid and asked prices) on the principal United States securities trading market (whether a stock exchange, NASDAQ, or otherwise) in which the Common shares are traded; provided, however, that if the Common shares are not publicly traded or listed during the time of any computation pursuant to this paragraph, their "market value" for the purposes of computation shall be the fair value as determined in good faith and certified to the corporation by any person agreed on by, and mutually satisfactory to, the President of the corporation and a member of the Board of Directors of the corporation elected by the holders of Preferred shares. However, if those persons are unable to agree on a mutually satisfactory person, or if at the time there is no director in office who was elected by holders of Preferred shares, then in each case the "market value" shall be the fair value as determined in good faith by the Board of Diectors of the corporation.

(E) If there occurs any capital reorganization or any reclassification of the capital stock of the corporation, the consolidation or merger of the corporation with or into another corporation, or the sale or conveyance of all or substantially all of the assets of the corporation to another corporation, each Preferred share shall thereafter be convertible into the same kind and amounts of securities (including shares of stock) or other assets, or both, issuable or distributable to the holders of outstanding Common shares of the corporation on reorganization, reclassification, consolidation, merger, sale, or conveyance, in respect of the number of Common shares into which that Preferred share might have been converted immediately prior to the reorganization, reclassification, consolidation, merger, sale, or conveyance. In any of those cases, appropriate adjustments, as determined by the Board of Directors of the corporation, shall be made by applying the provisions of this paragraph (e) with respect to the rights and interests thereafter of the holders of the Preferred shares, to the end that the provisions set forth (including provisions with respect to changes in, and other adjustments of, the conversion rate) shall thereafter be applicable, as nearly as reasonably may be, in relation to any securities or other assets deliverable on conversion of the Preferred shares.

3. Immediately on adjustment of the amount of Common shares or other securities deliverable on the conversion of Preferred shares, the corporation shall file, at its principal executive office and with any transfer agent or agents for Preferred shares and for Common shares, a statement signed by the Board Chairperson, President, or one of the Vice-Presidents of the corporation, and by its Chief Financial Officer or one of its Assistant Treasurers, stating the adjusted amount of its Common shares or other securities deliverable per Preferred share, calculated to the nearest _____ [*fraction, e.g.,* one one-hundredth (1/100)] of a share, and setting forth in reasonable detail the method of calculation and the facts requiring the adjustment and on which the calculation is based. Each adjustment

shall remain in effect until a subsequent adjustment is required.

4. The corporation shall at all times reserve and keep available out of its authorized but unissued Common shares solely the full number of Common shares deliverable on the conversion of all the then outstanding Preferred shares and shall take all action and obtain all permits or orders that may be necessary to enable the corporation lawfully to issue Common shares on the conversion of Preferred shares.

5. No fractions of Common shares shall be issued on conversion. If lieu of fractional shares, nondividend bearing, nonvoting scrip (exchangeable for full shares) shall be issued in form (bearer or registered), and denominations, expiring after a reasonable time and containing any other terms and provisions, as the Board of Directors of the corporation may from time to time determine prior to the issue of the scrip. The corporation may, however, at its option, in lieu of issuing scrip, make equitable provision for the stockholders otherwise entitled to receive scrip as the Board of Directors may determine, including payment of cash, or sale of stock to the extent of that scrip and distribution of the net proceeds or otherwise [*or provide other procedure for fractional interests; see, e.g., § 3.251[2] (Corp. Code § 407)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.253

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§ 3.253 Contingent Voting Rights for Cumulative Preferred Shares--To Elect Majority of Directors

[1] Comment

[a] Use of Form

This form contains provisions that may be included in the articles to grant the holders of common shares exclusive voting rights in the corporation, subject to the contingent right of holders of cumulative preferred shares to elect a majority of the corporation's board of directors in the event the corporation is in arrears on the payment of dividends to the preferred shareholders. For provisions that grant preferred shareholders the right to elect all directors on the board under those circumstances, see *§ 3.254*.

If used, the provisions in this form should be included as a separately designated paragraph in the article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares (commonly referred to as the "preference statement"). A skeleton form preference statement is set forth in *§ 3.242 [2]*. That form lists the other provisions that should ordinarily also be included in the preference statement, for example, provisions for dividends, redemption, and liquidation preferences. For alternative article provisions that grant the board authority to fix some or all of the rights, preferences, privileges and restrictions for preferred shares (including, for example, contingent voting rights), see *§ 3.203[2]*, Article V; and *§§ 3.240* and *3.241*.

[b] Contingent Voting Rights of Preferred Shares

If preferred shares are to be nonvoting, the articles must specifically so provide or the shares will have the same voting right as common shares [*see Corp. Code § 700(a)*]. Except for the cumulative voting of directors [*see Corp. Code § 708*] and except as may otherwise be provided in the articles of incorporation, each outstanding share, regardless of class, is entitled to one vote on each matter submitted to a vote of shareholders [*Corp. Code § 700(a)*].

Preferred shares are often nonvoting but are granted limited voting rights whenever (a) dividends have not been paid for a certain period [*see 10 Cal. Code Reg. § 260.140.2*], or (b) the preferred shares will be adversely affected by some proposed corporate action such as a change in the stock structure [*see, e.g., 10 Cal. Code Reg. § 260.140.3*; *Corp. Code §§ 903, 904*].

Under rules of the Commissioner of Corporations, a corporation proposing to issue preferred shares (which are not participating and not convertible on a fair and equitable basis) without full voting rights must provide in its articles or other charter document [*see 10 Cal. Code Reg. § 260.001(a)*] that the holders of the preferred shares have the right to reasonable representation on the board of directors on a cumulative default, whether consecutive or not, of eight quarterly dividends and that this right continues until all arrears in dividends on the preferred shares have been fully paid [*10 Cal. Code Reg. § 260.140.2*]. The right to elect a majority of the board is presumptively reasonable [*10 Cal. Code Reg. § 260.140.2*], and that right is granted in the form below.

Preferred shares may have certain voting rights by law, regardless of restrictions or limitations contained in the articles [*see* [2], first sentence, *below*]. For example, an amendment of the articles that would make shares assessable or would authorized remedy by action for the collection of an assessment on fully paid shares must be approved by all of the outstanding shares affected (including preferred to the extent affected) regardless of limitations or restrictions on the voting rights of any affected shares [*see Corp. Code § 904*]. Other actions that require the approval of the outstanding shares [*see Corp. Code § 152*] include the sale or other disposition of all or substantially all of the corporation's property [*Corp. Code § 1001*], certain amendments to the corporation's articles [*see Corp. Code § 903*], and in certain cases, a reorganization by the corporation [*Corp. Code § 1201*].

[c] Voting Rights in General

A corporation may issue one or more classes or series of shares or both with full, limited, or no voting rights, and with such other rights, preferences, privileges, and restrictions as are stated or authorized in its articles. Any denial or limitation of voting rights is not effective unless at the time one or more classes or series of outstanding shares or debt securities, singly or in the aggregate, are entitled to full voting rights (for example, the common shares) [*Corp. Code § 400(a)*]. All shares of the same class must have the same voting rights unless the class is divided into series. If it is divided into series, all shares of any one series must have the same voting rights [*Corp. Code § 400(b)*]. Promotional shares [*see Corp. Code § 409(a)(1)*; *10 Cal. Code Reg. § 260.140.30*] must not be preferred as to voting rights and must have no greater rights per share than securities issued for cash or its equivalent [*10 Cal. Code Reg. § 260.140.32*].

[d] Call and Notice of Special Meeting of Shareholders

The second paragraph of this form outlines the procedure for calling a special meeting of the shareholders to elect directors at any time after the power to elect directors becomes vested in the holders of the preferred shares. These provisions incorporate statutory provisions of the General Corporation Law that designate the persons entitled to call a special meeting [*see Corp. Code § 600(d)*], specify the notice requirements for a special meeting [*see Corp. Code § 601*], and establish quorum requirements for meetings [*see Corp. Code § 602*].

[2] FORM

Contingent Voting Rights for Cumulative Preferred Shares--To Elect Majority of Directors

V. Notice and Voting Rights

(f) Except as otherwise provided by law or by these Articles of Incorporation, the holders of the Common shares issued and outstanding shall have and possess the exclusive right to notice of shareholders' meetings, and the exclusive voting rights and powers, and the holders of Preferred shares shall not be entitled to notice of any shareholders' meeting, or to vote on the election of directors or on any other matter. If, however, at any time _____ [*number that is ordinarily eight (see 10 Cal. Code Reg. § 260.140.2)*] or more quarterly dividends, whether consecutive or not,

on the Preferred shares shall be in arrears, in whole or in part, the holders of the Preferred shares as a class shall be entitled to elect the smallest number of Directors constituting a majority of the authorized number of directors, and the holders of the Common shares as a class shall be entitled to elect the remaining Director[s]. When all dividends accrued on the outstanding Preferred shares shall have been paid or declared and set apart for payment, the rights of the holders of Preferred shares to vote as provided in this paragraph (f) shall cease, subject to renewal from time to time on the same terms and conditions.

At any time after the voting power to elect a majority of the Board of Directors shall have become vested in the holders of the Preferred shares as provided in this paragraph (f), the Secretary of the corporation may, and on the request of the record holders of at least 10 percent of the Preferred shares then outstanding addressed to the Secretary at the principal executive office of the corporation shall, call a special meeting of the shareholders for the election of directors, to be held at the place and on the notice provided in the Bylaws of the corporation for the holding of annual meetings. If notice of the requested meeting is not given within 20 days after receipt of the request for the meeting, then a person designated by the record holders of at least 10 percent of the Preferred shares then outstanding may call such a special meeting at the place and on the notice above provided, and for that purpose shall have access to the stock books of the corporation. At any meeting so called or at any annual meeting held while the holders of the Preferred shares have the voting power to elect a majority of the Board of Directors, the holders of a majority of the then outstanding Preferred shares, present in person or by proxy, shall constitute a quorum for the election of Directors as provided in this paragraph (f). The terms of office of all persons who are directors of the corporation at the time of the meeting shall terminate on the election at the meeting by the holders of the Preferred shares of the number of directors they are entitled to elect, and the persons so elected as directors by the holders of the Preferred shares, together with the persons, if any, elected as directors by the holders of the Common shares, shall constitute the duly elected directors of the corporation. In the event the holders of the Common shares fail to elect the number of Directors that they are entitled to elect at the meeting, the resulting vacancies may be filled by the directors who are elected.

Whenever the voting rights of holders of the Preferred shares shall cease as provided in this Paragraph (f), the term of office of all persons who are at the time directors of the corporation shall terminate on election of their successors by the holders of the Common shares [*or provide for optional special meeting for election of directors by holders of common shares (see, e.g., § 3.254[2], last paragraph of form)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



154 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.254

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§ 3.254 Contingent Voting Rights for Cumulative Preferred Shares--To Elect All of Directors

[1] Comment--Use of Form

This form contains provisions that may be included in the articles to grant the holders of common shares exclusive voting rights in the corporation, subject to the contingent right of holders of cumulative preferred shares to elect all of the corporation's board of directors in the event the corporation is in arrears on the payment of dividends to the preferred shareholders [*see 10 Cal. Code Reg. § 260.140.2*]. For provisions that grant preferred shareholders the right to elect only a majority of directors on the board under those circumstances, see *§ 3.253*.

If preferred shares are to be nonvoting, the articles must specifically so provide or the shares will have the same voting right as common shares [*see Corp. Code § 700(a)*]. Contingent voting rights of preferred shares and voting rights in general are discussed in *§ 3.253[1]*.

If used, the provisions in this form should be included as a separately designated paragraph in the article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares (commonly referred to as the "preference statement"). For a skeleton form of preference statement, see *§ 3.242[2]*. That form also lists the other provisions that should ordinarily be included in the preference statement, for example, provisions for dividends, redemption, and liquidation preferences. For alternative article provisions that grant the board authority to fix some or all of the rights, preferences, privileges and restrictions for preferred shares (including, for example, contingent voting rights), see *§ 3.203[2]*, Article V; and *§§ 3.240* and *3.241*.

[2] FORM

Contingent Voting Rights for Cumulative Preferred Shares--To Elect All of Directors
V. Notice and Voting Rights

(f) Except as otherwise provided by law or by these Articles of Incorporation, the holders of the Common shares issued and outstanding shall have and possess the exclusive right to notice of shareholders' meetings, and the exclusive voting rights and powers, and the holders of Preferred shares shall not be entitled to notice of any shareholders' meeting, or to vote on the election of directors or on any other matter. If, however, at any time _____ [*number that is ordinarily eight (see 10 Cal. Code Reg. § 260.140.2)*] or more quarterly dividends, whether consecutive or not, on the Preferred shares shall be in arrears, in whole or in part, then, at the next meeting of shareholders for the election of directors (unless at the time of the meeting all arrears in dividends shall have been paid and the dividend for the current quarterly dividend period shall have been set aside or paid) and at each such meeting thereafter, until all arrears in dividends on the Preferred shares shall have been paid and the dividend for the current quarterly dividend period shall have been set aside or paid, the voting rights of the holders of the Common shares shall cease and the voting power shall be vested exclusively in the holders of the Preferred shares.

Immediately after the voting rights of the holders of the Common shares shall cease and the voting power shall be vested exclusively in the holders of the Preferred shares, a special meeting of the shareholders of the corporation entitled to vote shall be called by the President or Secretary of the corporation, if requested in writing by the holders of not less than 10 percent of the total number of Preferred shares then outstanding. If the President and Secretary shall, for a period of 20 days after receipt of that request, fail to call the requested meeting, then such a meeting may be called and noticed in the manner provided for annual meetings by the holders of not less than 10 percent of the total number of Preferred shares then outstanding who for that purpose shall have access to the stock books of the corporation. At that special meeting, or, if no special meeting shall have been called, then at the next annual meeting of the shareholders, the shareholders of the corporation then entitled to vote pursuant to this paragraph (f) shall elect a Board of Directors and the term of office of the directors in office at the time of the election shall expire on the election of their successors at the meeting. Nothing contained in this paragraph (f) shall be construed to be a bar to the reelection of any director at such a meeting. At any meeting so called or at any annual meeting held while the holders of Preferred shares have the voting power to elect the Board of Directors, the holders of a majority of the then outstanding Preferred shares, present in person or by proxy, shall be sufficient to constitute a quorum for the election of directors.

When all arrears in dividends on the Preferred shares shall have been paid and the full dividend on those shares for the then current quarterly dividend period shall have been declared and paid or set aside for payment, the voting rights of the Preferred shares shall cease and the exclusive voting power shall again be vested in the holders of the Common shares, each holder of Common shares to have one vote for each Common share held [*or if common shares have more or less than one vote per share, modify this provision to correspond to actual voting power of common shares*]. Immediately thereafter a special meeting of the shareholders entitled to vote shall be called by the President or Secretary of the corporation if requested in writing by the holders of not less than 10 percent of the number of Common shares then outstanding. If the President and Secretary shall, for a period of 20 days after receipt of that request, fail to call the requested meeting, then the meeting may be called and noticed in the manner provided for annual meetings by the holders of not less than 10 percent of the total number of Common shares then outstanding. At that special meeting, or, if no special meeting shall have been called, then at the next annual meeting of the shareholders, a Board of Directors shall be elected and the term of office of the directors in office at the time of that meeting shall expire on the election of their successors at that meeting. Nothing contained in this paragraph (f) shall be construed to be a bar to the reelection of any director at that meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.255

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§ 3.255 Protective Provisions for Preferred Shares

[1] Comment

[a] Use of Form

The provisions in this form may be included in the articles to create certain protections for the holders of preferred shares. These provisions are illustrative only, and additional or alternative provisions should be included depending on the particular type of protection desired and the nature of the corporation's business. Care must be taken to ensure that any protective provisions do not conflict with other provisions in the articles respecting the preferred shares or with the purposes of the corporation. For a more complex and detailed form for protective provisions, see Ballantine & Sterling, California Corporation Laws, Appendix A, Form 4.23 (Matthew Bender).

The articles must either set forth any protective provisions for the preferred shareholders or grant the board of directors authority to determine those provisions for a particular class or series [*see Corp. Code § 202(e)(3)*; *10 Cal. Code Reg. § 260.140.3*; *see also* [b], *below*]. The provisions in this form are intended for use in the first situation, that is, when the articles will set forth the particular conversion rights. They should be included as a separately designated paragraph in the article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares (commonly referred to as the "preference statement"). A skeleton form preference statement is set forth in *§ 3.242 [2]*]. That form lists the other provisions that should also be included in the preference statement, for example, provisions for dividends, redemption, and liquidation preferences.

Because protective provisions may vary with each series of preferred shares, it may be preferable to include in the articles a provision that grants authority to the board of directors to determine those matters for all or some of the series rather than to specify particular protections in the articles. For article provisions that grant the board authority to fix some or all of the rights, preferences, privileges and restrictions for preferred shares (including, for example, protections for preferred shares), see *§ 3.203[2]*, Article V, and *§§ 3.240* and *3.241*. If those provisions are used, the board, when it

subsequently determines specific protections, must do so by adopting a resolution and filing a certificate of determination with the Secretary of State [*see Corp. Code § 401*]. The provisions below, with some modification, could then be included in that certificate. Requirements for certificates of determination are discussed in *§ 3.310*.

[b] Protective Provisions Required by Commissioner of Corporations

Under rules of the Commissioner of Corporations, the articles (or other charter document [*see 10 Cal. Code Reg. § 260.001(a)*]) of a corporation proposing to issue preferred shares that are nonparticipating and nonconvertible must ordinarily provide reasonable protective provisions for the preferred shareholders, including the following, if appropriate [*10 Cal. Code Reg. § 260.140.3*]:

- A provision that the dividends on those shares are cumulative [*see § 3.243*];

- A provision prohibiting any dividends on common stock during the existence of any arrears on the preferred shares;

- A appropriate requirement for the approval by the vote or written consent of a specified percentage of the preferred shares of any adverse changes in the rights of such shares and of the issuance of any shares having priority over those preferred shares (this form); and

- IAppropriate dividend restrictions on the common stock.

[c] Statutory Protections for Certain Amendments to Articles

A proposed amendment of the articles must be approved by the outstanding shares [*see Corp. Code § 152*] of a class, whether or not that class is entitled to vote on that matter by the provisions of the articles, and by the outstanding voting shares [*see Corp. Code § 152*] if the amendment would do the following [*Corp. Code § 903(a), (c)*]:

- Increase or decrease the aggregate number of authorized shares of the affected class, other than an increase incident to certain article amendments resulting from the approved issue of options to purchase shares or of securities convertible into shares of the corporation [*see Corp. Code § 405(b)*] or a stock split [*see Corp. Code § 902(c)*].

- Effect an exchange, reclassification or cancellation of all or part of the shares of the affected class, including a reverse stock split but excluding a stock split.

- Effect an exchange, or create a right of exchange, of all or part of the shares of another class into the shares of the affected class.

- Change the rights, preferences, privileges or restrictions of the shares of the affected class.

- Create a new class of shares having rights, preferences or privileges prior to the shares of the affected class, or increase the rights, preferences or privileges or the number of authorized shares of any class having rights, preferences or privileges prior to the shares of that affected class.

- In the case of preferred shares, divide the shares of any class into series having different rights, preferences, privileges or restrictions or authorize the board to do so.

- Cancel or otherwise affect dividends on the shares of the affected class that have accrued but have not been paid.

For purposes of the above requirements, different series of the same class do not constitute different classes for the purpose of voting by classes except when a series is adversely affected by an amendment in a different manner than other shares of the same class [*Corp. Code § 903(b)*].

A greater vote than is otherwise required under the General Corporation Law for the amendment of articles is required to amend articles in certain ways that would adversely affect shares [*see, e.g., Corp. Code § 904* (assessment of shares)], and the articles themselves may require an even greater vote of any class or series for certain corporation actions [*Corp. Code § 204(a)(5)*; *see § 3.270* (illustrative provision)]. A provision in the articles requiring the vote of a larger proportion or of all of the shares of any class or series, or the vote or quorum for taking action of a larger proportion or of all of the directors, than is otherwise required by the General Corporation Law cannot be altered, amended, or repealed except by that greater vote unless the articles otherwise provide [*Corp. Code § 902(e)*].

[2] FORM

Protective Provisions for Preferred Shares

V. Preferred Shares

(g) So long as _____ [any *or, with respect to those protective provisions that are not provided by statute, consider specifying a minimum amount of outstanding shares as a condition of continuing effectiveness*] of the Preferred shares [*or if this provision only applies to a particular series of preferred shares, designate that series here and in remainder of this provision*] are issued and outstanding, the corporation shall not, without first obtaining the approval (by vote or written consent, as provided by law) of the holders of at least _____ [*specify required proportion (see Corp. Code § 710), e.g.,* two-thirds] of the total number of Preferred shares outstanding:

1. Alter or change any of the rights, preferences, or privileges of the Preferred shares so as to materially adversely affect the Preferred shares; or

2. Increase the authorized number of Preferred shares; or

3. Create any new class of shares having preferences over or being on a parity with the Preferred shares as to dividends or assets, unless the purpose of creation of the new class is, and the proceeds to be derived from its sale and issuance are to be used for, the retirement of all Preferred shares then outstanding; or

4. Purchase any Common shares; or

5. Merge or consolidate with any other corporation, except into or with a wholly owned subsidiary corporation with the requisite shareholder approval; or

6. Sell, convey, or otherwise dispose of, or create or incur any mortgage, lien, charge, or encumbrance on or security interest in or pledge of, or sell and leaseback, all or substantially all of the property or business of the corporation; or

7. Incur, assume, or guarantee any indebtedness (other than that represented by the obligation to pay rent under leases) maturing more than _____ [*number, e.g.,* 18] months after the date on which it is incurred, assumed, or guaranteed by the corporation, except purchase money obligations, obligations assumed as part of the price of property purchased, or the extension, renewal, or refunding of any of those obligations.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation &

BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of Stock



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.256

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§ 3.256 Rights of Common Shares

[1] Comment

[a] Use of Form

This is a provision for articles of a corporation with two classes of shares (common and preferred) [*see, e.g., § 3.203[2],* art. IV] that sets forth the rights of the holders of the common shares. It states that except as otherwise provided by law or in the articles, the holders of common shares have exclusive voting rights and the exclusive right to receive notice of shareholders' meetings. The reference "except as otherwise provided by law or in the articles" refers to those limited voting rights conferred on preferred shareholders by law [*see § 3.253[1][b]*] and to any contingent voting rights that may be granted to preferred shareholders for dividend arrearages [*see §§ 3.253, 3.254*].

These provisions may be included in articles of incorporation (as a separately designated paragraph) in the article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares (commonly referred to as the "preference statement"). A skeleton form of preference statement is set forth in *§ 3.242[2]*. That form also lists the other provisions that should ordinarily be included in the preference statement, for example, provisions for dividends, redemption, and liquidation preferences. For alternative forms of preference statements that grant authority to the board of directors to determine some or all of the terms of shares in the preferred class, see *§ 3.203[2]*, Article V; and *§§ 3.240* and *3.241*.

[b] Voting Rights In General

A corporation may issue one or more classes or series of shares or both with full, limited, or no voting rights, and with such other rights, preferences, privileges, and restrictions as are stated or authorized in its articles. Any denial or limitation of voting rights is not effective unless at the time one or more classes or series of outstanding shares or debt securities, singly or in the aggregate, are entitled to full voting rights (for example, the common shares) [*Corp. Code §*

400(a)]. All shares of the same class must have the same voting rights unless the class is divided into series. If it is divided into series, all shares of any one series must have the same voting rights [*Corp. Code § 400(b)*]. Promotional shares [*see Corp. Code § 409(a)(1)*; *10 Cal. Code Reg. § 260.140.30*] must not be preferred as to voting rights and must have no greater rights per share than securities issued for cash or its equivalent [*10 Cal. Code Reg. § 260.140.32*].

If preferred shares are to be nonvoting, the articles must specifically so provide or the shares will have the same voting right as common shares [*see Corp. Code § 700(a)*]. Except for the cumulative voting of directors [*see Corp. Code § 708*] and except as may otherwise be provided in the articles of incorporation, each outstanding share, regardless of class, is entitled to one vote on each matter submitted to a vote of shareholders [*Corp. Code § 700(a)*]. Preferred shares are ordinarily nonvoting but are granted limited voting rights whenever (a) dividends have not been paid for a certain period [*see 10 Cal. Code Reg. § 260.140.2*], or (b) the preferred shares will be adversely affected by some proposed corporate action such as a change in the stock structure [*see, e.g., 10 Cal. Code Reg. § 260.140.3*; *Corp. Code §§ 903, 904*]. These limited voting rights are further discussed in *§ 3.253[1][b]*.

[2] FORM

Rights of Common Shares

V. Notice and Voting Rights

(h) Except when otherwise provided by law or by these Articles of Incorporation, the holders of Common shares issued and outstanding shall have and possess the exclusive right to notice of shareholders' meetings and the exclusive voting rights and powers, and the holders of the Preferred shares shall not be entitled to any notice of shareholders' meetings or to vote on the election of directors or on any other matter, except if the notice or vote is required by law or by these Articles of Incorporation.

Subject to all of the rights of the Preferred shares, dividends may be paid on the Common shares, as and when declared by the Board of Directors, out of any funds of the corporation legally available for the payment of dividends.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide § 3.257

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§ 3.257 Prohibition Against Reissuance of Preferred Shares Acquired by Corporation

[1] Comment

[a] Use of Form

This provision may be included in the articles of a corporation that is to be prohibited from reissuing any of its own shares that it has purchased, redeemed, acquired by way of conversion to another class or series, or otherwise acquired. Without this prohibition in its articles, the shares of the corporation reacquired under those circumstances are restored to the status of authorized but unissued shares [*Corp. Code § 510(a)*; *see* [b], *below*].

These provisions may be included in articles of incorporation (as a separately designated paragraph) in the article that describes the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes or series of shares (commonly referred to as the "preference statement"). For a skeleton form of preference statement, see *§ 3.242[2]*. That form also lists the other provisions that are commonly included in the preference statement, for example, provisions for dividends, redemption, and liquidation preferences. For alternative preference statements that grant authority to the board of directors to determine some or all of the terms of shares in the preferred class, see *§ 3.203[2]*, Article V, and *§§ 3.240* and *3.241*.

[b] Status of Acquired Shares and Required Amendment of Articles

When a corporation reacquires its own shares, those shares are restored to the status of authorized but unissued shares unless the articles prohibit the reissue of reacquired shares [*Corp. Code § 510(a)*]. The term "reacquires" means that a corporation purchases, redeems, acquires by way of conversion to another class or series, or otherwise acquires its own shares or that issued and outstanding shares cease to be outstanding [*Corp. Code § 510(d)*].

If a corporation reacquires authorized shares of a class or series and the articles prohibit the reissuance of those shares,

the following rules apply [*Corp. Code § 510(b)*]:

- If all of the authorized shares of that class or series are reacquired then (1) that class or series is automatically eliminated; (2) in the case of reacquisition of all authorized shares of a series, the authorized number of shares of the class to which the shares belonged is reduced by the number of shares so acquired; and (3) the articles must be amended to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that class or series.

- If less than all of the authorized shares but all of the issued and outstanding shares of that class or series are reacquired, the authorized number of shares of the class or series is automatically reduced by the number of shares reacquired and the board must determine either (1) to eliminate that class or series, which requires amending the articles to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that class or series; or (2) not to eliminate that class or series, which requires amending the articles to reflect that reduction of the number of authorized shares of that class or series by the number of reacquired shares.

- If less than all of the authorized shares and less than all of the issued and outstanding shares of a class or series are reacquired, the authorized number of shares of that class or series is automatically reduced by the number of reacquired shares and the articles must be amended to reflect that reduction.

If a corporation reacquires authorized shares of a series of shares and the articles prohibit only the reissuance of those shares as shares of the same series, the following rules apply [*Corp. Code § 510(c)*]:

- If all of the authorized shares of that series are reacquired, then that series is automatically eliminated, the articles must be amended to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that series, and the board must determine either (1) to return those shares to the status of authorized but undesignated shares of the class to which they belong or (2) to eliminate those shares entirely. In either case, the articles must be amended to reflect the reduction in authorized shares of that series and any effect on the class to which that series belongs.

- If all of the issued and outstanding shares of that series, but less than all of the authorized shares of that series, are reacquired, the board must determine either (1) to eliminate that series, which requires amending the articles to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that series; or (2) not to eliminate that series, which requires amending the articles to reflect the return of the reacquired shares to the status of authorized but undesignated shares of the class to which they belong.

- If less than all of the issued and outstanding shares of that series are reacquired, the authorized number of shares of that series is automatically reduced by the number of reacquired shares and the board must determine either (1) to return those shares to the status of authorized but undesignated shares of the class to which they belong or (2) to eliminate those shares entirely. In either case, the articles must be amended to reflect the reduction in authorized shares of that series and any effect on the class to which that series belongs.

A certificate of amendment must be filed in accordance with statutory requirements, reflecting any elimination or reduction of authorized shares, and any related elimination from the articles of the designation and the rights, preferences, privileges, and restrictions of any series or class of stock that is eliminated [*Corp. Code § 510(f)*; *see Corp. Code §§ 900-911*], except that approval by the outstanding shares [*see Corp. Code § 152*] ordinarily required is not required to adopt this type of amendment [*Corp. Code § 510(f)*].

These corporate reaquisition rules may be varied in the articles [*Corp. Code § 510(e)*]. Further, nothing in these rules is intended to alter or otherwise affect the powers of the board to amend the articles [*Corp. Code § 510(f)*; *see Corp. Code §§ 202, 401*].

[2] FORM

Prohibition Against Reissuance of Preferred Shares Acquired by Corporation

V. Redeemed and Reacquired Shares

(i) No Preferred shares [*or if prohibition against reissuance will only apply to particular series, designate that series*] of the corporation that have been redeemed or reacquired in any manner by the corporation after their original issuance shall ever again be reissued [*if prohibition against reissuance will extend only to particular series designated, add:* as part of that series] and all those shares so redeemed or reacquired shall on that redemption or reacquisition cease to be a part of the authorized shares of the corporation [*or if prohibition against reissuance will extend only to particular designated series:* shall on that redemption or reacquisition be restored to the status of authorized but unissued shares of _____ (*designate class of which series is a part, e.g.,* Preferred Stock)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceCorporate Ownership of StockBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDisposition of Reacquired Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
B. Alternatives for Mandatory Article Provisions
3. Stock Rights, Preferences, Privileges, and Restrictions (for Corporations With Two Classes of Shares)

2-3 California Legal Forms--Transaction Guide §§ 3.258-3.259

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[Reserved]

§§ 3.258[Reserved]



159 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
1. Stock and Stock Ownership

2-3 California Legal Forms--Transaction Guide § 3.260

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.260 Grant of Authority to Levy Assessments on Shares

[1] Comment

[a] Use of Form

This is an optional provision that may be included in the articles of incorporation to authorize the corporation or its board of directors to levy and collect assessments on shares of any or all classes of shares. If a corporation is to have this power, the authority (and any limitations) must be expressly stated in the articles [*see Corp. Code §§ 204(a)(1), 423(a)*]. For a statutory "close corporation" [*see Corp. Code § 158*; *see also § 3.202*], the authority may instead be granted in a shareholder's agreement [*see Corp. Code § 204(a)*]. This provision may included in any of the complete sets of articles in this chapter, for example, under the article that contains "optional provisions"[*see, e.g., § 3.203[2],* art. VI].

Under the Commissioner of Corporation's regulations, securities must ordinarily be nonassessable, except that issuers organized solely to supply services or property to their members on a continuing basis may provide for an equitable assessment corresponding to the services or property supplied [*10 Cal. Code Reg. § 260.140.7*; *see 10 Cal. Code Reg. § 260.140* (application and variations of Commissioner's standards)].

[b] Statutory Requirements for Assessment of Shares

If the assessment of shares is authorized in a corporation's articles, the board's levy and collection of assessments is subject to any specific limitations stated in the articles and to compliance with the applicable statutory requirements of the General Corporation Law [*see Corp. Code § 423*]. Shares are not assessable except as provided by those statutory requirements (which are discussed in [b]-[k], *below*) or as otherwise provided by a statute other than the General Corporation Law [*Corp. Code § 423(a)*]. The authority of a corporation, if any, granted by its articles to levy and collect assessments on shares is in addition to the right of the corporation to recover the unpaid subscription price of shares or

the remainder of the consideration to be paid for those shares [*Corp. Code § 423(a)*].

If the authority to assess shares is not granted in the original articles but is proposed to be added by amendment to the articles, the amendment must be approved by all of the outstanding shares affected regardless of limitations or restrictions on the voting rights of those shares. The same approval requirement applies to any amendment to authorize remedy by judicial action for the collection of an assessment on fully paid shares [*Corp. Code § 904(a)*; *see* [c], *below* (requirement for authorizing remedy of judicial action)]. Similar, but slightly different, provisions apply to amendments to the articles of a mutual water company [*see Corp. Code § 904(b)*].

[c] Exclusivity of Statutory Remedy

The exclusive remedy for the collection of an assessment on fully paid shares is ordinarily the sale or forfeiture of the shares pursuant to the statutory requirements [*see Corp. Code § 423(n)*] discussed in [d]-[k], *below*]. However, remedy by judicial action is permitted if (1) that remedy is authorized either in the original articles or by amendment to the articles adopted by the unanimous consent of the shareholders; and (2) a statement of that remedy appears on the face of the share certificate [*Corp. Code § 423(n)*]. The provision below does not authorize the judicial remedy and instead requires the board to comply with the statutory requirements for levy and collection discussed in this Comment.

[d] Required Information for Levy of Assessment

Every levy of an assessment must specify the following [*Corp. Code § 423(b)*]:

- Specify the amount of the levy and to whom and where it is payable;

- Fix, or if proceedings or filings with any governmental or other agency for any qualification, registration, or exemption from either are required as a condition precedent to the levy or payment of an assessment, provide for the establishment of a date on which the assessment is payable;

- Fix a date, not less than 30 or more than 60 days from the date on which the assessment is payable, on which the assessment becomes delinquent if not paid;

- Fix a date, not less than 15 or more than 60 days from the date on which the unpaid assessment becomes delinquent, for the sale of delinquent shares; and

- Fix the hour and place of sale, which place must be in the county in California in which the corporation's principal executive office or principal business office is located [*see Corp. Code § 213*], or if neither is located in California, in Sacramento.

[e] Notice Requirements

On or before the date an assessment is payable, the secretary of the corporation must give notice of the assessment that is substantially in the form required by statute [*see Corp. Code § 423(c)*]. The notice must be served personally on each holder of record of shares assessed; provided, however, that in lieu of personal service the notice may be mailed to each shareholder addressed to the last address of the shareholder appearing on the books of the corporation or given by the shareholder to the corporation for the purpose of notice, or if no such address appears or is given, at the place where the principal executive office of the corporation is located. The notice must also be published once in a newspaper of general circulation in the county in which the principal executive office of the corporation is located. If there is no such newspaper in that county, the publication must be made in a newspaper of general circulation in an adjoining county [*Corp. Code § 423(d)*].

[f] Effect of Assessment as Lien and Waiver of Lien

The assessment is a lien on the shares assessed from the time of personal service or the publication of the notice of assessment, unless the articles provide that an assessment is a lien from the time of the levy [*see* optional language in form]. Unless otherwise provided by law, a transfer of the shares on the books of the corporation after the lien of an assessment has attached is a waiver of the lien unless a conspicuous legend is placed on the face of any certificate issued on that transfer (or, in the case of uncertificated securities, on the initial transaction statement) setting forth the information that must be included in the required notice of the assessment [*see Corp. Code § 423(c)* (required contents of notice); *see also Ch. 6I, Issuance of Equity Securities, § 6I.200,* (required legend) and discussion in *§ 6I.20* (distinction between certificated and uncertificated shares)]. The legend must be removed if the assessment on the shares evidenced by the certificate is paid or if the shares are sold to pay the assessment or forfeited for nonpayment [*Corp. Code § 423(e)*].

[g] Postponement of Sale

The date of sale of delinquent shares fixed in any levy of an assessment may be extended from time to time for not more than 30 days at a time by order of the Board of Directors entered on the records of the corporation, or when the sale is restrained by order of a court. Notice of any extension must be given by announcement by the Secretary, or other person authorized to conduct the sale, made at the time and place of sale last previously fixed. If a date of sale of delinquent shares is extended for more than five days, the corporation must mail a notice to the affected shareholder or shareholders that sets forth the new date and time for the sale [*Corp. Code § 423(f)*].

[h] Penalty Imposed for Payment After Delinquency

If payment is made after delinquency and before the sale, the shareholder must pay a penalty of 5 percent of the amount of the assessment on the shares, in addition to the assessment [*Corp. Code § 423(g)*].

[i] Sale and Transfer of Shares

At the place and time appointed in the notice of levy any officer or an agent of the corporation must, unless otherwise ordered by the Board of Directors, sell or cause to be sold to the highest bidder for cash as many shares of each delinquent holder of the assessed shares as may be necessary to pay the assessment and charges specified in the notice. The highest bidder is the person offering at the sale to pay the assessment and penalty for the smallest number of shares. The shares purchased must be transferred to the highest bidder on the share register of the corporation and a new certificate for them issued to that bidder. The corporation is not required to accept an offer for a fraction of a share [*Corp. Code § 423(h)*]. If no bidder offers to pay the amount due on the shares, together with the 5 percent penalty provided in the notice of the levy of the assessment, the shares must be forfeited to the corporation in satisfaction of the assessment and penalty [*Corp. Code § 423(i)*].

After the sale or forfeiture of shares for nonpayment of an assessment, the holder or owner of the delinquent shares must, if they are certificated securities, surrender the certificate for the shares to the corporation for cancellation or, if they are uncertificated securities, have no further rights with respect to the shares. This duty may be enforced by court order or decree, and the holder or owner is liable to the corporation for damages for failure to surrender the certificate for cancellation on demand without good cause or excuse. Any certificate not so surrendered becomes null and void and ceases to be evidence of the right or title of the holder or any purported transferee. Neither the corporation nor the purchaser of the shares incurs any liability to a purported transferee. The purchaser of shares at a delinquency sale, whenever made, is entitled to the issue of a new certificate representing the shares so purchased [*Corp. Code § 423(j)*].

[j] Secretary's Certificate of Sale

The certificate of the secretary or of an assistant secretary of the corporation is prima facie evidence of the time and place of sale and any postponement of it, of the quantity and particular description of the shares sold, to whom, for what

price, and of the fact of payment of the purchase money. The certificate must be filed in the office of the corporation. Copies of the certificate, certified by the secretary or an assistant secretary of the corporation, are prima facie evidence of the facts stated in the certificate [*Corp. Code § 423(k)*].

[k] Irregularities in Proceeding

An assessment is not invalidated by the failure of the corporation to publish the notice of assessment or by the nonperformance of any act required by statute in order to enforce payment of the assessment. However, in the case of any substantial error or omission in the course of proceedings for collection of the assessment on any shares, all previous proceedings, except the levy of the assessment, are void as to those shares and must be taken anew [*Corp. Code § 423(l)*].

No action may be maintained to recover shares sold for delinquent assessments on the ground of irregularity in the assessment, irregularity or defect of the notice of sale, or defect or irregularity in the sale, unless the party seeking to maintain the action first pays or tenders to the corporation, or to the party holding the shares sold, the sum for which the shares were sold, together with all subsequent assessments that may have been paid on the shares, plus interest on those sums from the time they were paid. No action may be maintained unless it is commenced by the filing of a complaint and the issuance of a summons within 6 months after the sale was made [*Corp. Code § 423(m)*].

[2] FORM

Grant of Authority to Levy Assessments on Shares

_____ [*Article number*]

(_____) The directors of the corporation are hereby granted power and authority to levy and collect from time to time, as in their discretion they may deem advisable, assessments on all of the shares of stock of the corporation at any time issued and outstanding, and shall have all of the authority, rights, and privileges with reference to assessments as are provided by law in respect to corporations the directors of which have the power of assessment; provided, however, that neither any assessment nor the levy of any assessment shall create any personal liability whatsoever of any shareholder of the corporation.

Any assessment on shares authorized by this paragraph constitutes a lien on the shares assessed from the time of the Board's levy of the assessment.

[*Optional: Use only if intent is to have lien arise on date of levy rather than on date that otherwise applies, i.e., date notice of assessment is personally served or published in newspaper (see Corp. Code § 423(e)).*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePowersGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of Stock



160 of 187 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
1. Stock and Stock Ownership

2-3 California Legal Forms--Transaction Guide § 3.261

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.261 Authorization for Shareholders to Determine Price or Consideration for Shares

[1] Comment--Use of Form

This optional provision may be included in the articles to give shareholders the right to determine the consideration for which shares shall be issued. To be effective, a provision that grants this right must be included in the articles, or in the case of a close corporation [*see Corp. Code § 158*; *see also § 3.202*], in a shareholders' agreement [*Corp. Code § 204(a)(8)*]. The provision can be made dependent on facts ascertainable outside the articles if certain conditions are met [*see Corp. Code § 109.5*; *see also § 3.200[1][d]*]. This form may be included in any of the complete sets of articles in this chapter, for example, as a separately numbered paragraph under the article containing "optional provisions" [*see § 3.203[2]*, art. VI].

If the articles grant the shareholders the right to determine the consideration for shares, that determination must be made by approval of the outstanding shares [*Corp. Code § 409(c)*; *see Corp. Code § 152* (definition of "approval of the outstanding shares")]. Those approval requirements are incorporated into the form below.

In the absence of an article provision giving shareholders the right to determine consideration for which shares shall be issued, the board of directors may issue shares for such consideration as is determined from time to time (subject to specific restrictions) [*see Corp. Code § 409(a)(1)*]. Also, unless the articles provide otherwise, the board may issue shares without shareholder approval and without first offering them to shareholders [*see Corp. Code § 406*].

If the shareholder right to determine consideration for shares is to apply only under certain circumstances, or to a certain class or series of shares, this form should be modified to precisely describe those circumstances.

[2] FORM

Authorization for Shareholders to Determine Price or Consideration for Shares

_____ [*Article number*]

(_____) Shares of the corporation may be issued only for consideration determined from time to time by the affirmative vote at a meeting or by written consent without a meeting of a majority of the outstanding shares of the corporation entitled to vote, including the affirmative vote of a majority of the outstanding shares of each class or series of any class at the time outstanding and entitled to vote as a class or series in the election of directors.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for Shares



161 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
1. Stock and Stock Ownership

2-3 California Legal Forms--Transaction Guide § 3.262

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§ 3.262 Preemptive Rights to Purchase Shares Granted to Shareholders

[1] Comment--Use of Form

This optional provision may be included in the articles to grant the holders of common shares of the corporation preemptive rights to purchase common shares that may be issued from time to time by the corporation. If shareholders are to have these rights, an express provision to that effect must be included in the articles, or in the case of a close corporation, in a shareholders' agreement [*see Corp. Code § 204(a)(2)*]. Unless the articles provide otherwise (this form), the board of directors may issue shares, options, or securities having conversion or option rights without first offering them to the shareholders of any class [*Corp. Code § 406*].

The preemptive rights granted in this form extend only to issuances for cash or certain evidences of indebtedness; if rights will be granted to issuances for other types of consideration, the form should be so modified. Except for certain employee stock purchase or stock option plans [*see Corp. Code § 408*], unsecured evidences of indebtedness of the purchaser of shares are not lawful consideration for the issuance of shares [*Corp. Code § 409(a)(1)*].

[2] FORM

Preemptive Rights to Purchase Shares Granted to Shareholders
_____ [*Article number*]

(_____) Subject to the provisions of this paragraph (_____), the holders of Common shares of the corporation shall have the right to purchase, during the period or periods, at the prices and on the other terms and conditions fixed by the Board of Directors of the corporation, any Common shares of the corporation, and any rights, options, warrants, or other instruments or securities exchangeable for or convertible into Common shares or evidencing any right to subscribe for, purchase, or otherwise acquire Common shares, which may be issued from time to time for cash or evidences of indebtedness payable at sight, on presentation, or on demand, or having a due date

of less than _____[*number*] days at the time of receipt by the corporation.

Notwithstanding the above provisions, and without first offering the same to the shareholders of the corporation, any share or shares of Common stock now or hereafter authorized may be issued as follows:

(1) In exchange for capital stock or indebtedness of the corporation;

(2) To fulfill or comply with any obligation of the corporation to issue Common shares pursuant to any present or future stock option plan, stock purchase, bonus, savings investment, or other stock incentive programs for the benefit of the employees of the corporation or any subsidiary corporation of the corporation; or

(3) On conversion of convertible securities the issuance of which was approved by the holders of the majority of the outstanding Common shares on or prior to that issuance.

The portion of the securities each holder of Common shares shall have the initial right to purchase in any issuance subject to this paragraph (_____) shall be in the same ratio to the total number of securities to be issued as the number of Common shares held of record by that shareholder on the date set for the determination of shares entitled to that right bears to the total number of Common shares at the time outstanding.

[*EITHER*]

After giving notice of any proposed issuance of Common shares and affording the holders of outstanding Common shares the opportunity to purchase those shares during a period of not less than _____[*number*] days after the date of giving the notice, the corporation may thereafter sell any of those Common shares that are not purchased by holders of Common shares without further offering them to holders of Common shares.

[*OR*]

Any offering of Common shares pursuant to the right set forth in this paragraph (_____) shall provide that shareholders who have purchased securities in any such offering shall have the additional right also to purchase any securities not purchased by other shareholders. The portion of the unsold securities each purchasing shareholder shall have the right to purchase pursuant to the additional right shall be in the same ratio to the total number of unsold securities as the number of Common shares purchased by that shareholder pursuant to the initial right bears to the total number of Common shares initially purchased by all shareholders. Unpurchased securities shall be reoffered to purchasing shareholders so that holders of Common shares have a reasonable opportunity to purchase all securities subject to those holders' purchase rights. Any shares then remaining unsold may be sold by the corporation on the terms and conditions set forth in the notice without further offering them to holders of Common shares.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
1. Stock and Stock Ownership

2-3 California Legal Forms--Transaction Guide § 3.263

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§ 3.263 Restricting Shareholders to Persons with Special Qualifications

[1] Comment--Use of Form

This optional provision may be included in the articles of a corporation that desires to restrict the persons entitled to be shareholders to persons who possess special qualifications. To be effective, a provision of this type must be expressly included in the articles of incorporation or, in the case of a close corporation, in a shareholders' agreement [*see Corp. Code § 204(a)(3)*]. The provision in the articles can be made dependent on facts ascertainable outside the articles if the manner in which the facts affect the provision is clearly and expressly set forth in the articles, and if certain conditions are met [*see Corp. Code § 109.5*].

[2] FORM

Restricting Shareholders to Persons with Special Qualifications
_____ [*Article number*]

(_____) 1. No person may be a shareholder of this corporation unless and until that person meets the following qualifications: _____ [*describe specific qualifications*].

2. If any shareholder no longer meets those qualifications (a "disqualified shareholder"), the value of the disqualified shareholder's shares shall be determined as set forth below. The corporation (or, if the corporation may not lawfully do so, the other holders of shares of the same class, pro rata) shall have the option to purchase, and the disqualified shareholder shall have the obligation to sell, at the price and on the terms set forth below, all of the shares of the corporation owned beneficially or of record by the disqualified shareholder. On purchase or tender of the purchase price, the disqualified shareholder shall no longer be entitled to any right, privilege, or benefit as a shareholder of this corporation.

3. _____ [*Describe formula or method for determining value of shares and method of payment, e.g., book value, appraised value, capitalized earnings, or negotiation and agreement of the parties and arbitration if agreement is not reached. For examples of provisions in buy/sell agreements that may be adapted for this purpose, see Ch. 8D, Buy-Sell Agreements*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
1. Stock and Stock Ownership

2-3 California Legal Forms--Transaction Guide § 3.264

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§ 3.264 Restrictions on Transfer of Shares

[1] Comment

[a] Use of Form

This form contains optional provisions that may be included in a corporation's articles of incorporation to impose restrictions on the transfer of the corporation's shares. Specifically, it grants the corporation an option to purchase shares of a selling shareholder, and if the option is not exercised by the corporation, the other shareholders have the same option to purchase the shares. These provisions are illustrative only of one specific type of transfer restriction that may or may not be desired by a particular corporation.

Reasonable restrictions on the right to transfer or hypothecate shares of any class or classes or series may be set forth in the articles. However, no restriction of this type is binding with respect to shares issued prior to the adoption of the restriction unless the holders of the affected shares voted in favor of the restriction [*Corp. Code § 204(b)*]. Any restrictions on transfer are not required to be included in the articles of incorporation, but may instead be included in the corporation's bylaws [*see Corp. Code § 212(b)(1)*; *see also* Ch. 4, *Bylaws* (discussion of restrictions)]. This form exempts transfers resulting from the shareholder's death [*see* [2], P 4, *below*]. If that contingency will also give rise to the corporation's purchase option rights, a provision to that effect must be added that also contains the method of valuing the shares under those circumstances.

[b] Funding the Purchase

When a corporation acquires its own shares (as contemplated in the form below), it may do so only if it meets the requirements for a "distribution" [*see Corp. Code §§ 166, 500-511*; *see also § 3.249*]. If the corporation is unable to purchase the shares, the remaining shareholders may or may not be able to procure sufficient cash to purchased the offered shares. Life insurance provisions or installment provisions are often used in these situations to ensure that either

or both the corporation and the remaining shareholders will have sufficient funds to purchase shares offered by a selling shareholders. For examples of these provisions in the context of buy/sell agreements, see Ch. 8D, *Buy-Sell Agreements* .

[c] Purchase Price

This form provides that the option price of the offered shares will be jointly determined by the corporation and the selling shareholder by use of a specified formula based on the fair market value of the shares. It provides for arbitration in the event the parties are unable to agree on a price. Other methods for valuation may be used, for example those based on book value or appraisal. For methods of determining price deemed presumptively reasonable by the Commissioner of Corporations, see [e], *below*.

[d] Required Notice of Restriction on Share Certificate

Reference to a restriction on the transferability of shares must be made conspicuously on the share certificate for certificated securities [*see Corp. Code § 156.1*; *see also Com. Code § 8102(a)(4), (15)* (definition)] and on the initial transaction statement and written statements in the case of uncertificated securities [*Corp. Code § 418(a)(1)*; *see Corp. Code § 191.1*; *Com. Code § 8102(a)(15), (18)* (definition)]. That requirement is referenced in the last paragraph of this form. A separate legend must appear on the share certificate representing shares of a close corporation [*see Corp. Code § 418(c), (d)*].

[e] Rules of Commissioner of Corporations

Limited, but not open qualification, will be approved for securities to be issued subject to transfer restrictions [*10 Cal. Code Reg. § 260.140.8*]. An "open qualification" is a qualification that authorizes the offer and sale of securities to the public generally, without restriction as to persons or class of persons [*10 Cal. Code Reg. § 260.001(f)*].

Limited offering qualifications may be approved for the issuance of securities subject to transfer restrictions, provided the restrictions do not unfairly prejudice the opportunity of the holder to realize a reasonable price for the securities [*10 Cal. Code Reg. § 260.140.8*]. A "limited offering qualification" is a qualification that authorizes the offer and sale of securities only to persons designated by name or class [*10 Cal. Code Reg. § 260.001(e)*].

Provisions that base the price at which the corporation or the other shareholders may purchase the securities, in the event of a desire to sell by the holder, on the offer received from a third party, on the appraised value of the securities, or on the book value (except in the case of a type of business where book value is not a significant indication of the value of the securities) are presumptively reasonable. Provisions that absolutely prohibit the transfer of securities or permit a transfer only on the consent of the corporation or the other shareholders or give a purchase option to the corporation or other shareholders regardless of the desire of the shareholder to sell are ordinarily prohibited [*see 10 Cal. Code Reg. § 260.140.8(b)(3)*].

Since restrictions on a transfer of shares are not favored by the Commissioner [*see 10 Cal. Code Reg. § 260.140.8*], it is probable that escrow or legend conditions may be imposed [*see 10 Cal. Code Reg. § 260.141.10*] on shares subject to those restrictions unless the original sale of shares is exempt from qualification [*see Corp. Code §§ 25100-25105*]. Restrictions placed on shares subsequent to their issuance, whether contained in an amendment to the articles or a bylaw, will require qualification even though the original issue was exempt [*Corp. Code § 25103(e)(11)*]. However, transfer restrictions imposed by an agreement among shareholders do not come under the Commissioner's scrutiny and is frequently the method relied on in lieu of an amendment to the articles or a bylaw [*see* Ballantine & Sterling, California Corporation Laws, Appendix A, Form 4.41, n. 16].

[2] FORM

Restrictions on Transfer of Shares

_____ [*Article number*]

(_____) Except as otherwise provided in this paragraph (_____), no shares of the corporation shall be sold or otherwise disposed of by any shareholder until after written notice of the intended sale or disposition has been delivered to the corporation, and until _____ [*number, e.g.,* 30] days have expired subsequent to a final determination of a price per share for those shares, all as provided below.

1. If any shareholder proposes to sell or otherwise dispose of all or any part of that shareholder's shares, the shareholder shall sign and deliver to the corporation a written notice stating the shareholder's desire to sell or dispose of the designated number of shares. The shareholder and the corporation shall then fix a price per share computed by _____ [*describe computation method, e.g., for a corporation with only one class of stock*: determining the fair market value of the net assets of the corporation (excluding "goodwill") on the date of the notice, and multiplying the resulting figure by a fraction, the numerator of which shall be one and denominator of which shall be the number of shares of the capital stock of the corporation issued and outstanding, as of the date of the notice]. In the event that the shareholder and corporation cannot agree on the price per share so computed, the shareholder and the corporation shall each appoint an independent arbitrator. If either the shareholder or the corporation fails to appoint an arbitrator, the arbitrator appointed by the other shall have the power to act alone. The arbitrator(s) selected shall determine the price per share computed as above, and their decision shall be final and conclusive on the parties; in the event the two arbitrators cannot agree on the price per share, the two arbitrators shall appoint a third arbitrator. The third arbitrator shall receive the advice and counsel of the two previously appointed arbitrators, but the decision of the third arbitrator acting alone, as to the price per share computed as stated above, shall be final, binding, and conclusive on the parties.

2. For a period of _____ [*number, e.g.,* 30] days following the final determination of the price per share, the corporation shall have the prior option and right to purchase all or any part of those shares at the price so determined. In the event the corporation does not exercise its option within the required time period with respect to all of the shares, each remaining shareholder of the corporation shall have an option for a period of _____ [*number, e.g.,* 10] days next succeeding the expiration of that _____ [*same time period first above mentioned for corporation's option, e.g.,* 30-day] period to purchase pro rata to the number of shares owned by that shareholder the shares remaining for sale at the price per share determined as stated above in subparagraph 1. In the event options have not been exercised with respect to all of the shares specified in the written notice pursuant to the options granted to the corporation and to the shareholders as above set forth, shareholders who exercise their option within the _____ [*same time period first above mentioned for shareholders' option, e.g.,* 10-day] period shall have an additional option for a period of five days next succeeding the expiration of the _____ [*same time period first above mentioned for shareholders' option, e.g.,* 10-day] period to purchase all or any part of the balance of those shares at the price per share determined as stated above in subparagraph 1. In the event there are two or more shareholders who exercise the last mentioned option for a total number of shares in excess of the number available, the shares available for that option shall be allocated to those shareholders pro rata to the number of shares owned by each shareholder.

3. If the corporation and the remaining shareholders do not exercise their options to purchase all the shares set forth in the written notice delivered to the corporation within _____ [*same number first used in subparagraph 2 above for corporation's option, e.g.,* 30] days after the date of final determination of the price per share as stated above, the shareholder giving the written notice may sell all remaining shares that were the subject of the notice to third parties at the price per share determined as stated above, not later than _____ [*number, e.g.,* 30] days after the expiration of the _____ [*same time period first used in subparagraph 2 above for corporation's option, e.g.,* 30- day] period. If the shareholder wishes to sell or otherwise dispose of any such shares at a price per share less than determined as stated above, or on terms more favorable than previously offered to the corporation and the remaining shareholders, as a condition precedent those shares must first have been offered to the corporation and the remaining shareholders on the same terms and conditions in accordance with the procedures and

time periods set forth above.

4. The provisions of this paragraph (_____) shall be applicable to all sales or other dispositions of shares of the corporation except (a) any transfer of shares to the spouse, issue, or other heirs of a shareholder on the death of that shareholder, and (b) any change in the respective interests in shares solely between or among persons who beneficially hold shares as community property, joint tenants, or tenants in common [*or specify other exceptions or delete this paragraph if there are to be no exceptions*].

5. The Secretary or Assistant Secretary of the corporation shall endorse conspicuously on each stock certificate issued by this corporation, the following: "This stock certificate and the shares represented by it are issued and shall be held subject to qualifications, limitations, and restrictions governing the sale or transfer of stock as set forth in _____ [*designate location of relevant provision in articles, by Article and paragraph*] of the Articles of Incorporation of the corporation. These matters are referred to and made part of this certificate. The holder of this certificate agrees to all of them. Subsequent purchasers of the shares represented by this certificate take subject to all these qualifications, limitations, and restrictions."

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
1. Stock and Stock Ownership

2-3 California Legal Forms--Transaction Guide §§ 3.265-3.269

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

[Reserved]

§§ 3.265[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
2. Voting Rights of Shareholders and Others

2-3 California Legal Forms--Transaction Guide § 3.270

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.270 Requiring Vote of Larger Proportion of Shareholders Than Otherwise Required by Law

[1] Comment--Use of Form

This form is a provision that must be included in the articles for any corporation that will require a larger proportion of shareholder vote to approve certain corporate actions than would otherwise be required by the General Corporation Law [*see Corp. Code § 204(a)(5)*]. Provisions of this type are commonly referred to as a "supermajority" provision. Subject to limited exceptions discussed below [*see Corp. Code §§ 303* (vote required for removal of directors), *402.5* (vote by preferred shareholders for voluntary dissolution), *708(c)* (number of votes needed to elect directors), *1900* (vote required to elect voluntary dissolution)], the articles (or in the case of a close corporation, a shareholders' agreement) may require the vote of a larger proportion or of all of the shares of any class or series for taking any or all corporate actions than is otherwise required by the General Corporation Law [*Corp. Code § 204(a)(5)*]. To be effective, the provision must be included in the articles, or in the case of a close corporation, a shareholders' agreement [*Corp. Code § 204(a)*].

Unless a corporation's articles contain a supermajority provision, most corporate actions that require shareholder approval need only approval by a majority of the outstanding shares, approval by a majority of the outstanding shares entitled to vote, or approval by a majority of the shares represented and voting at a meeting duly held at which a quorum is present (which shares voting affirmatively must constitute a majority of the required quorum) [*see Corp. Code §§ 152, 153*]. If the articles do contain a provision that requires a larger portion of all of the shares of any class or series for taking a particular corporation action, that provision may not be altered, amended, or repealed except by the same greater vote, unless otherwise provided in the articles [*Corp. Code § 902(e)*].

Special requirements apply to a corporation with 100 or more shareholders of record that files an amendment of articles or a certificate of determination containing a supermajority provision [*see Corp. Code § 710*; *see also § 3.310[1][b]*].

[2] FORM

Requiring Vote of Larger Proportion of Shareholders Than Otherwise Required by Law

_____ [*Article number*]

(_____) Any of the following actions shall require the prior approval (by vote or written consent) of the shareholders entitled to exercise not less than _____ percent of the voting power of this corporation, notwithstanding that applicable law would otherwise permit those actions with the approval of a lesser percentage: _____ [*describe particular corporate actions*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePowersGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



166 of 187 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
2. Voting Rights of Shareholders and Others

2-3 California Legal Forms--Transaction Guide § 3.271

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.271 Approval of Shareholders or Outstanding Shares Required to Hypothecate Corporate Property

[1] Comment

[a] Use of Form

This provision may be included in the articles to require that a corporation obtain the consent of its shareholders prior to mortgaging or otherwise hypothecating any corporate property. Because shareholder approval is not otherwise required under the General Corporation Law in this situation, [*see Corp. Code §§ 207(g), 1000*; *see also* [b], *below*], a provision such as this one must be included in the articles (or for a close corporation, in a shareholders' agreement) in order to be effective [*see Corp. Code § 204(a)(5), (9)*; *see also* [c], *below*].

[b] Power of Corporation to Hypothecate Its Property

Subject to any limitations contained in its articles of incorporation and to compliance with other provisions of the General Corporation Law and any other applicable laws, a corporation has the power to assume obligations, enter into contracts, including contracts of guaranty or suretyship, incur liabilities, borrow and lend money, and otherwise use its credit, and secure any of its obligations, contracts, or liabilities by mortgage, pledge, or other encumbrance of all or any part of its property, franchises, and income [*Corp. Code § 207(g)*]. Specific restrictions on this general power apply in the case of corporate loans to or a corporate guarantee of loans to directors and officers of the corporation [*see Corp. Code § 315*].

The board of directors may approve any mortgage, deed of trust, pledge, or other hypothecation of all or any part of the corporation's property, real or personal, for the purpose of securing the payment or performance of any contract or obligation. Unless the articles otherwise provide, no approval of the shareholders [*see Corp. Code § 153*] or of the outstanding shares [*see Corp. Code § 152*] is necessary for those actions [*Corp. Code § 1000*].

[c] Inclusion of Provision in Articles

The articles of incorporation may set forth a provision requiring the approval of the shareholders [*see Corp. Code § 153* (definition); *see also* [2], Alternative 1, *below*] or the approval of the outstanding shares [*see Corp. Code § 152* (definition); *see also* [2], Alternative 2, *below*] for any corporate action, even though that approval is not otherwise required by the General Corporation Law [*Corp. Code § 204(a)(9)*]. They may also set forth, with exceptions not here applicable, a provision that requires for any or all corporate actions, the vote of a larger proportion or of all of the shares of any class or series, or of a larger proportion or of all of the directors, than is otherwise required by the General Corporation Law [*Corp. Code § 204(a)(5)*]. Either type of provision must be included in the articles (or for a close corporation, in a shareholders' agreement) in order to be effective [*Corp. Code § 204(a)*]. Unless otherwise provided in the articles, an article provision that requires the vote of a larger proportion or of all of the shares of any class or series, or of a larger proportion or of all of the directors for any corporation action than is otherwise required under the General Corporation law, cannot be altered, amended, or repealed except by the same percentage vote required for the corporate action [*see Corp. Code § 902(e)*].

[2] FORM

Approval of Shareholders or Outstanding Shares Required to Hypothecate Corporate Property

_____ [*Article number*]

(_____) The Board of Directors shall not make or authorize any mortgage, deed of trust, pledge, or other hypothecation of all or any part of the corporation's property, real or personal, without first obtaining

[*Alternative 1: For approval by shareholders.*]

the prior approval of a majority [*or other percentage*] of the shareholders represented and voting at a duly held meeting at which a quorum is present (which shares voting affirmatively also constitute at least a majority of the required quorum) or who have given their approval by written consent.

[*Alternative 2: For approval by outstanding shares.*]

the prior approval of a majority [*or other percentage*] of the outstanding shares entitled to vote.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePowersGeneral OverviewReal Property LawFinancingMortgages & Other Security InstrumentsFormalities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
2. Voting Rights of Shareholders and Others

2-3 California Legal Forms--Transaction Guide § 3.272

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.272 Provision That Alters Statutory Quorum Requirements for Shareholders' Meeting

[1] Comment--Use of Form

This optional provision may be included in the articles of a corporation that desires to alter the quorum requirements for shareholders' meetings that would otherwise apply under the General Corporation Law [*see Corp. Code § 602(a)*]. Unless otherwise provided in the articles of incorporation, a majority of the shares entitled to vote, represented in person or by proxy, constitutes a quorum at a meeting of shareholders [*Corp. Code § 602(a)*; *see Corp. Code §§ 178, 179, 604, 705* (proxies)]. In any event, a quorum may not consist of less than one-third (or, in the case of a mutual water company, 20 percent) of the shares entitled to vote at a meeting. For a close corporation [*see Corp. Code § 158*; *see also § 3.202*], a quorum may not be more than a majority of the shares entitled to vote at the meeting [*Corp. Code § 602(a)*]. The provision below may be used to either raise or lower the ordinary quorum requirements, within the permitted parameters discussed above.

As a general rule, the affirmative vote of a majority of the shares represented and voting at a duly held meeting at which a quorum is present (which shares voting affirmatively also constitute at least a majority of the required quorum) is the act of the shareholders, unless the vote of a greater number or voting by classes is required by the General Corporation Law or the articles [*Corp. Code § 602(a)*]. A lesser voting margin applies to business conducted at a meeting that has a quorum of shareholders but that subsequently has less than a quorum because shareholders leave or withdraw from the meeting [*see Corp. Code § 602(b)*].

[2] FORM

Provision That Alters Statutory Quorum Requirements for Shareholders' Meeting

_____ [*Article number*]

(_____) _____ [*fractional amount or percentage that is not less than one-third, or*

for mutual water company, not less than twenty percent, and for close corporation, not more than a majority, e.g., One-third] of the shares entitled to vote, represented in person or by proxy at any shareholders' meeting, constitutes a quorum for any shareholder's meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
2. Voting Rights of Shareholders and Others

2-3 California Legal Forms--Transaction Guide § 3.273

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.273 Restrictions on, or Elimination of, Shareholder Action by Written Consent

[1] Comment--Use of Form

This form is an optional provision that may be included in articles of incorporation to prohibit entirely or to restrict, shareholder action taken by written consent that is otherwise permitted under the General Corporation Law [*see Corp. Code § 603*]. Unless otherwise provided in the articles of incorporation (this form), any action that may be taken at any annual or special meeting of shareholders may be taken without a meeting and without prior notice, if a written consent, setting forth the action so taken is signed by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote on the action were present and voted [*Corp. Code § 603(a)*].

The election of directors by written consent of the shareholders ordinarily requires the unanimous written consent of all shares entitled to vote for the election of directors [*Corp. Code § 603(d)*; *see Corp. Code § 305(b)*]. However, unless otherwise provided in the articles, shareholders may elect a director to fill a vacancy, other than a vacancy created by removal, by the written consent of a majority of the outstanding shares entitled to vote [*Corp. Code § 603(d)*].

[2] FORM

Restrictions on, or Elimination of, Shareholder Action by Written Consent

_____ [*Article number*]

(_____) Any action required or permitted to be taken by shareholders of this corporation must be taken at a duly called annual meeting or a special meeting of shareholders of the corporation and no action may be taken by the written consent of the shareholders [*if there are any exceptions to this requirement, add:*, except _____ (*describe*

exception)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
2. Voting Rights of Shareholders and Others

2-3 California Legal Forms--Transaction Guide § 3.274

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.274 Election of One or More Directors by Holders of Class or Series of Shares

[1] Comment

[a] Use of Form

This form is a provision for articles of incorporation that gives the shareholders of a specific class or series of shares, voting as a class or series, the right to elect one or more directors [*see Corp. Code § 301(a)*]. Except as may be otherwise provided for "listed corporations" [*see Corp. Code § 301.5(d)* (definition); *see also § 3.282[1][e]*], directors are elected at each annual meeting of the shareholders to hold office until the next annual meeting. However, shorter terms for directors may be authorized by the articles in order to effectuate a "voting shift" [*Corp. Code § 301(a)*]. A "voting shift" is a change, pursuant to or by operation of an article provision, in the relative rights of the holders of one or more classes or series of shates, voting as one or more separate classes or series, to elect one or more directors [*Corp. Code § 194.7*]. Unless otherwise provided in the articles, and except for cumulative voting for directors [*see Corp. Code § 708*], each outstanding share, regardless of class, is entitled to one vote on each matter submitted to a vote of shareholders [*Corp. Code § 700(a)*]. A director elected by the holders of the shares of any class or series of shares, voting as a class or series, may be removed only by the applicable vote of the holders of the shares of that class or series [*Corp. Code § 303(a)(2)*].

[b] Election of Directors

Each director, including a director elected to fill a vacancy, holds office until expiration of the term for which he or she was elected and until a successor has been elected and qualified [*Corp. Code § 301(b)*]. Unless otherwise required by the bylaws or the articles [*Corp. Code § 204(d)*], elections for directors need not be by ballot unless a shareholder demands election by ballot at the meeting and before the voting begins [*Corp. Code § 708(e)*].

Unless an election is uncontested [*see* Corp. Code § 708.5; *see also § 8A.41*], in any election of directors, the candidates

receiving the highest number of votes of the shares entitled to be voted for them, up to the number of directors to be elected by these shares, are elected [*Corp. Code § 708(c)*], and the articles may not require a higher number of votes [*Corp. Code § 204(a)(5)*].

[2] FORM

Election of One or More Directors by Holders of Class or Series of Shares
_____ [*Article number*]

(_____) Commencing at the first meeting of the shareholder and continuing at each annual meeting thereafter, the holders of the _____ [*specify class or series*] shares, voting as a _____ [class *or* series], shall be entitiled to elect _____ [*specify number that is one or more*] of the _____[*number*] total Directors authorized for the coporations board of directors. Any Director so elected shall hold office until the next annual meeting and may not be removed from the board except by the vote of a majority [*or if percentage other than majority is required to elect directors, specify that same other percentage*] of the holders of the [*specify same series or class as above*] of shares, voting as a _____ [class *or* series]. In the event any Director [*or* Directors] elected under the provisions of this paragraph is removed or resigns from the Board, a new Director shall be elected by the holders of the _____ [*specify same class or series as above*] of shares, voting as a _____ [class *or* series] to serve on the Board until the next annual meeting of the shareholders.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & Removals



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
2. Voting Rights of Shareholders and Others

2-3 California Legal Forms--Transaction Guide § 3.275

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.275 Grant of Voting Rights to Corporation's Debtholders

[1] Comment

[a] Use of Form

The optional provisions in this form may be used to grant certain voting rights in the corporation to the corporation's debtholders. If the holders of any evidences of indebtedness, issued or to be issued by the corporation, are to be granted the right to vote in the election of directors or on any other matter on which shareholders may vote, an express provision to that effect must be included in the articles (or in the case of close corporation, in a shareholders' agreement) [*Corp. Code § 204(a)(7)*]. The provision in the articles can be made dependent on facts ascertainable outside the articles if the manner in which the facts affect the provision is clearly and expressly set forth in the articles, and if certain conditions are met [*see Corp. Code § 109.5*; *see also § 3.200[1][d]*].

Two alternative provisions are set forth below. In the first, debtholders are granted general voting rights identical to the holders of common shares and must vote as a class with the common shares. In the second alternative, debtholders are granted the right to elect a majority of the corporation's directors only if, and for so long as, the corporation is in arrears in its payments to the debtholder. Also under this alternative, the holders of indebtedness are given the right to vote separately as a class. These provisions are illustrative only and must be modified to fit the specific requirements of a particular debtholder.

Provisions for the voting rights of debtholders are ordinarily added to the articles by amendment when a proposed issuance of debt securities so necessitates, rather than included in the original articles. When these provisions are included in the articles, other provisions of the articles must be carefully reviewed to determine whether the rights proposed to be granted to the debtholders conflict with any voting or other rights in any class of shares. For example, if the articles vest exclusive voting power in the holders of common shares, that provision would require modification to accommodate the rights granted to debtholders.

The provisions below are intended to cover only holders of registered debt securities, and not holders of bearer securities. Voting rights and procedure for holders of bearer securities are ordinarily covered in an indenture executed by the corporation and a trustee. In that case, an article provision dealing with the rights of debtholders would typically refer to that indenture for the manner in which voting rights must be exercised.

[b] General Power of Corporation to Incur Indebtedness

Subject to any limitations contained in the articles of incorporation and to compliance with the provisions of the General Corporation Law and any other applicable laws, a corporation has all the powers of a natural person in carrying out its business activities [*Corp. Code § 207*]. These powers include the power to issue, purchase, redeem, receive, take or otherwise acquire, own, hold, sell, lend, exchange, transfer or otherwise dispose of, pledge, use and otherwise deal in and with its own shares, bonds, debentures and other securities [*Corp. Code § 207(d)*; *but see Corp. Code § 510* (status of shares reacquired by corporation)]. A corporation also has the power to incur liabilities, borrow and lend money and otherwise use its credit, and to secure any of its obligations, contracts or liabilities by mortgage, pledge or other encumbrance of all or any part of its property, franchises and income [*Corp. Code § 207(g)*; *but see Corp. Code § 315* (restrictions on loans or guarantees to directors or officers)]. All references in the General Corporation Law to "the voting of shares" include the voting of any holders of indebtedness granted voting rights in the articles [*Corp. Code § 111*].

[c] Rules of Commissioner of Corporations

An "open qualification" will not normally be approved by the Commissioner of Corporations for the issuance of debt securities unless they are issued under a trust indenture complying with the provisions of the Trust Indenture Act of 1939 [*15 U.S.C. §§ 77aaa-77bbbb*], whether or not the indenture is required to be qualified under that Act [*10 Cal. Code Reg. § 260.140.5*]. An "open qualification" is a qualification that authorizes the offer and sale of securities to the public generally, without restriction as to persons or class of persons [*10 Cal. Code Reg. § 260.001(f)*].

A "limited offering" qualification may be approved for the issuance of debt securities that are not accompanied by a trust indenture or that are issued under a trust indenture not complying with all of the provisions of the Trust Indenture Act of 1939, if the trust indenture or other instruments provide adequate protection to the holders of the debt securities under the circumstances of the particular case. The indenture should provide that the trustee or a cotrustee must be a bank or trust company or, if a bank or trust company is not a trustee or cotrustee, that any person who is to act in that capacity must have the written approval of the Commissioner [*10 Cal. Code Reg. § 260.140.5*]. A "limited offering qualification" is a qualification that authorizes the offer and sale of securities only to persons designated by name or class [*10 Cal. Code Reg. § 260.001(e)*].

Nonconvertible debt securities, and the indenture or other instrument under which the securities are issued, may be required to satisfy additional requirements of the Commissioner [*see 10 Cal. Code Reg. § 260.140.4*].

[2] FORM

Grant of Voting Rights to Corporation's Debtholders

_____ [*Article number*]

[*Alternative 1: Use to grant debtholders general voting rights.*]

(_____) Each holder of _____ [*describe and define specific type(s) of indebtedness to have voting rights*] from time to time outstanding (the "Debtholders") in whose name that indebtedness is registered on the books of the corporation (including books of any indenture trustee or agent of the corporation) on the record date

for any action of shareholders established pursuant to applicable law shall have voting rights identical to those held by the holders of Common shares of the corporation, and shall vote as a class with the common shares. Each Debtholder shall have one vote for each $ _____ principal amount of indebtedness held by that Debtholder on that date on any matter on which shareholders are entitled to vote. Each Debtholder shall be entitled to receive all notices from the corporation as fully as though a shareholder of the corporation. There shall be no fraction of a vote for less than $ _____ of indebtedness. At any meeting so called or at any annual meeting held while the Debtholders have voting power, the holders of a majority of the then outstanding indebtedness entitled to vote, present in person or by proxy, shall be sufficient to constitute a quorum for the election of directors.

[*Alternative 2: Use to grant voting rights only on occurrence of specified default.*]

(_____) The holders of _____ [*describe and define the indebtedness*] from time to time outstanding ("the Debtholders") shall have the following voting rights and powers:

1. If at any time _____[*number*] payments of principal or interest on the indebtedness, whether consecutive or not, shall be in arrears, then, at the next meeting of shareholders for the election of directors (unless at the time of that meeting all arrears shall have been paid and the principal or interest payment next due shall have been set aside or paid) and at each meeting thereafter, until all arrears on the indebtedness shall have been paid, the Debtholders shall be entitled, voting as a class and in the same manner as holders of Common Stock, to elect the smallest number of directors that will constitute a majority of the authorized number of directors and the holders of the remaining voting rights of the corporation shall be entitled, voting as a class, to elect the remaining directors. The directors elected by the Debtholders pursuant to this subparagraph shall be subject to removal only by the vote of the Debtholders so long as the right of the Debtholders to elect directors shall continue. When all principal or interest payments in arrears have been paid or set apart for payment, the rights of the Debtholders to vote as provided in this paragraph shall cease, subject to renewal from time to time on the same terms and conditions. Rights to vote pursuant to this paragraph shall be exercisable only by Debtholders in whose name the indebtedness is registered on the books of the corporation (including books of any indenture trustee or agent of the corporation) on the record date for any such meeting established pursuant to applicable law. If the Debtholders are entitled to exercise voting rights pursuant to this paragraph, each Debtholder shall have, for the purposes of the class vote, one vote for each $_____ principal amount of indebtedness held by that Debtholder. Each such Debtholder shall be entitled to receve all notices from the corporation as fully as though a shareholder of the corporation. There shall be no fraction of a vote for less than $_____ of indebtedness. At any meeting so called or at any annual meeting held while the Debtholders have voting power, the holders of a majority of the then outstanding indebtedness entitled to vote, present in person or by proxy, shall be sufficient to constitute a quorum for the election of directors.

2. _____ [*describe voting procedures, e.g., use second and third paragraphs of form in § 3.253[2] or § 3.254[2], with appropriate modifications*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePowersGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
2. Voting Rights of Shareholders and Others

2-3 California Legal Forms--Transaction Guide §§ 3.276-3.279

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

[Reserved]

§§ 3.276[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
3. Board of Directors

2-3 California Legal Forms--Transaction Guide § 3.280

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.280 Elimination of Directors' Liability for Monetary Damages (to Maximum Extent Permitted by Law)

[1] Comment

[a] Use of Form

This provision may be included in articles of incorporation to eliminate the liability of directors of a corporation for monetary damages, to the maximum extent permitted by California law [*see Corp. Code §§ 204(a)(10), 204.5(a)*]. This provision is not one of the mandatory provisions required to be included in a corporation's articles [*see Corp. Code § 202*]. It is however, one of the "optional" provisions designated by statute that must be expressly included in the articles (rather than in some other governing instrument for the corporation, such as the bylaws) in order to be effective [*see Corp. Code § 204(a)(10)*; *see also § 3.200[1][c]*]. For a statutory close corporation [*see Corp. Code § 158*], it may instead be included in a shareholders' agreement [*Corp. Code § 204(a)*].

The elimination of liability under this provision extends to directors only (not officers) and applies only in cases of liability to the corporation or to the shareholders. For these reasons, it may have no or little effect on the many corporations with only one or only a few shareholders. On the other hand, its potential application is much greater for large, publicly held corporations.

For a discussion of directors' duties imposed by statute [*see Corp. Code § 309*], see "Duties of Directors" in the Legal Background to Ch. 5, *Directors' Meetings, Actions, and Resolutions*.

[b] Limitation or Elimination of Liability

The articles may contain a provision eliminating or limiting the personal liability of a director for monetary damages in an action brought by or in the right of the corporation for breach of a director's duties to the corporation and its shareholders [*Corp. Code § 204(a)(10)*; *see Corp. Code § 309* (scope of duty)]. However, this authorization is subject to

several restrictions set by statute. Specifically, a provision of this type may not eliminate or limit the liability of directors for any of the following [*Corp. Code § 204(a)(10)*]:

- Acts or omissions that involve intentional misconduct or a knowing and culpable violation of law;
- Acts or omissions that a director believes to be contrary to the best interests of the corporation or its shareholders or that involve the absence of good faith on the part of the director;
- Any transaction from which a director derived an improper personal benefit;
- Acts or omissions that show a reckless disregard for the director's duty to the corporation or the shareholders in circumstances in which the director was aware or should have been aware, in the ordinary course of performing a director's duties, of a risk of serious injury to the corporation or its shareholders;
- Acts or omissions that constitute an unexcused pattern of inattention that amounts to an abdication of the director's duty to the corporation or its shareholders;
- Statutory provisions that govern contracts in which a director has a material financial interest [*see Corp. Code § 310*]; or
- Statutory provisions that prohibit illegal distributions, loans, and guarantees [*see Corp. Code § 316*].

In addition to the above-listed restrictions, the provision may not eliminate or limit the liability of a director for any act or omission occurring before the effective date of the provision. Finally, a provision may not eliminate or limit the liability of an officer for any act or omission as an officer, notwithstanding that the officer is also a director or that his or her actions, if negligent or improper, have been ratified by the directors [*Corp. Code § 204(a)(10)*].

[c] Language of Provision

The corporation will be considered to have adopted a provision authorized by *Corp. Code § 204(a)(10)* and described in [b], *above*, and will not be required to use more specific language, if a provision of its articles reads substantially as follows: "The liability of the directors of the corporation for monetary damages shall be eliminated to the fullest extent permissible under California law" [*Corp. Code § 204.5(a)*]. This language is used in the form below, but it is not the exclusive method by which the applicable statutory provisions for eliminating director liability may be included in the articles [*Corp. Code § 204.5(b)*]. The statutory authorization to eliminate director liability for monetary damages (to the extent permitted by law) also does not change the otherwise applicable standards or duties to make full and fair disclosure to shareholders when shareholder approval of that provision is sought [*Corp. Code § 204.5(c)*].

[2] FORM

Elimination of Directors' Liability for Monetary Damages (to Maximum Extent Permitted by Law)

_____ [*Article number*]

(_____) The liability of the directors of the corporation for monetary damages shall be eliminated to the fullest extent permissible under California law.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation &

BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesCauses of ActionGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesFiduciary ResponsibilitiesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
3. Board of Directors

2-3 California Legal Forms--Transaction Guide § 3.281

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.281 Authorization to Indemnify Directors and Officers to Maximum Extent Permitted by Law

[1] Comment

[a] Use of Form

This form illustrates provisions that may be included in the articles of incorporation to give a corporation the authority to indemnify its directors and officers [*see* [b], *below*] in excess of that ordinarily permitted by statute [*see Corp. Code § 317*]. In order to be effective, this type of provision must be included in the articles (or in the case of a close corporation, in a shareholders' agreement) [*see Corp. Code §§ 204(a)(11), 317(g)*].

Corporations seeking to give maximum indemnification protection to officers and directors may rely on the "short form" alternative illustrated in this form and enter into separate indemnification agreements with each officer or director, or alternatively may use the "long form" alternative illustrated in the form.

For further discussion of indemnification of corporate agents, see Ballantine & Sterling, California Corporation Laws, Ch. 6, *Management: Duties and Liability of Directors and Controlling Shareholders* (Matthew Bender).

[b] Definition of "Agent"

For purposes of the provisions of the General Corporation Law that govern the indemnification of agents [*see Corp. Code §§ 317, 204(a)(11)*], "agent" means any person who is or was a director, officer, employee, or other agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, or other enterprise, or was a director, officer, employee, or agent of a foreign or domestic corporation that was a predecessor corporation of the corporation or of another enterprise at the request of the predecessor corporation [*Corp. Code § 317(a)*].

[c] Statutory Authorization for "Excess Indemnification"

Subject to specific limitations outlined below, the articles of incorporation may contain a provision authorizing, whether by bylaw, agreement, or otherwise, the indemnification of agents [*see* [b], *above* (definition)] in excess of that expressly permitted by statute [*see Corp. Code § 317*; *see also* [e], *below*] for breach of duty to the corporation and its stockholders. If this authorization is to be given, it must be expressly provided for in the articles [*see Corp. Code §§ 204(a)(11), 317(g)*].

Two specific restrictions apply to a provision that authorizes indemnification in excess of that permitted by statute for a breach of duty to the corporation and its shareholders. First, the provision may not provide for indemnification of any agent for any acts or omissions or transactions from which a director may not be relieved of liability [*Corp. Code § 204(a)(11)*]. These acts, omissions, and transactions are described in *§ 3.280[1][b]* [*see Corp. Code § 204(a)(10)*]. Second, the provisions may not provide for indemnification under circumstances in which indemnity is expressly prohibited by the statute covering the indemnification of agents [*Corp. Code § 204(a)(11)*; *see Corp. Code § 317* (statute covering indemnification of agents)].

The statute covering indemnification of agents also provides for indemnification for certain acts, omissions, or transactions of directors and officers that do not involve a breach of duty to the corporation and its shareholders [*see Corp. Code § 317*]. If additional rights of indemnification under these circumstances are to exist, they must be authorized in the articles of incorporation [*Corp. Code § 317(g)*]. Use of the provision below creates "excess" indemnification rights for officers and directors under these circumstances (that is, acts, omissions, or transactions not involving a breach of duty to the corporation and its shareholders) and under circumstances in which a breach of duty to the corporation and its shareholders is involved [*see* [e], *below*].

[d] Advancement of Expenses

A corporation may advance expenses incurred in defending any proceeding before the final disposition of the proceeding on receipt of an undertaking by or on behalf of the agent to repay that amount if it is ultimately determined that the agent is not entitled to indemnification [*Corp. Code § 317(f)*]. This type of advancement is not prohibited by the ban on loans to directors and officers [*Corp. Code § 317(b)*; *see Corp. Code § 315(a)*].

[e] Language of Provision Authorized by Statute

An article provision that authorizes indemnification "in excess of that otherwise permitted by § 317" or "to the fullest extent permissible under California law" (or the substantial equivalent of either) will be construed to be both (1) a provision for additional indemnification for breach of duty to the corporation and its shareholders as referred to and within the limitations by relevant statute [*Corp. Code § 204(a)(11)*; *see* [c], *above*]; and (2) a provision for additional indemnification for directors' and officers' acts, omissions, or transactions not involving a breach of duty to the corporation and its shareholders [*Corp. Code § 317(g)*; *see* [c], *above*].

The language suggested by this statute is used in the provisions below to authorize the maximum indemnification of officers and directors permitted by law. If a lesser degree of indemnification is desired, the provisions must be modified to describe any desired restrictions.

[2] FORM

Authorization to Indemnify Directors and Officers to Maximum Extent Permitted by Law

_____ [*Article number*]

[*Short form:*]

This Corporation is authorized, to the fullest extent permissible under California law, to indemnify its agents (as defined in *Corp. Code § 317*), whether by bylaw, agreement, or otherwise, for breach of duty to this Corporation and its shareholders in excess of that expressly permitted by *Corp. Code § 317*, and to advance defense expenses to its agents in connection with such matters as those expenses are incurred. If, after the effective date of this Article, California law is amended in a manner that permits a corporation to limit the monetary or other liability of its directors or to authorize indemnification of, or advancement of those defense expenses to, its directors or other persons, in any such case to a greater extent than is permitted on the effective date of this Article, the references in this Article to "California law" shall to that extent be deemed to refer to California law as so amended. Any repeal or modification of this Article shall not adversely affect any right of indemnification or limitation of liability of an agent of this corporation relating to actions or omissions prior to that repeal or modification.

[*OR*]

[*Long form:*]

1. Indemnification of Directors. The Corporation shall, to the maximum extent and in a manner permitted by the California Corporations Code, indemnify each of its Directors against expenses (as defined in *Corp. Code § 317(a)*), judgments, fines, settlements and other amounts actually and reasonably incurred in connection with any proceeding (as defmed in *Corp. Code § 317(a)*), arising by reason of the fact that the person is or was a Director of the Corporation. For purposes of this Article, a "Director" of the Corporation includes any person (i) who is or was a Director of the Corporation, (ii) who is or was serving at the request of the Corporation as a director of another foreign or domestic corporation, partnership, joint venture, trust, or other enterprise, or (iii) who was a director of a corporation which was a predecessor corporation of the Corporation or of another enterprise at the request of such a predecessor corporation.

2. Indemnification of Others. The Corporation shall have the power, to the extent and in the manner permitted by the California Corporations Code, to indemnify each of its employees, officers, and agents (other than Directors) against expenses (as defined in *Corp. Code § 317(a)*), judgments, fines, settlements, and other amounts actually and reasonably incurred in connection with any proceeding (as defined in *Corp. Code § 317(a)*), arising by reason of the fact that the person is or was an employee, officer, or agent of the Corporation. For purposes of this Article, an "employee" or "officer" or "agent" of the Corporation (other than a Director) includes any person (i) who is or was an employee, officer, or agent of the Corporation, (ii) who is or was serving at the request of the Corporation as an employee, officer, or agent of another foreign or domestic the corporation, partnership, joint venture, trust, or other enterprise, or (iii) who was an employee, officer, or agent of a corporation which was a predecessor corporation of the Corporation or of another enterprise at the request of such a predecessor corporation.

3. Payment of Expenses in Advance. Expenses and attorneys' fees incurred in defending any civil or criminal action or proceeding for which indemnification is required pursuant to this Article, or if otherwise authorized by the Board of Directors, shall be paid by the Corporation in advance of the final disposition of that action or proceeding upon receipt of an undertaking by or on behalf of the indemnified party to repay that amount if it shall ultimately be determined that the indemnified party is not entitled to be indemnified as authorized in this Article.

4. Indemnity Not Exclusive. The indemnification provided by this Article shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled under any Bylaw, agreement, vote of shareholders or Directors, or otherwise, both as to action in an official capacity and as to action in another capacity while holding such an office. The rights to indemnity hereunder shall continue as to a person who has ceased to be a Director, officer, employee, or agent and shall inure to the benefit of the heirs, executors, and administrators of the person.

5. Insurance Indemnification. The Corporation shall have the power to purchase and maintain insurance on behalf of any person who is or was a Director, officer, employee, or agent of the Corporation against any liability asserted

against or incurred by that person in that capacity, or arising out of that person's status as a Director, officer, employee, or agent of the Corporation, whether or not the Corporation would have the power to indemnify that person against that liability under the provisions of this Article.

6. Conflicts. No indemnification or advance shall be made under this Article, except when such an indemnification or advance is mandated by law or the order, judgment, or decree of any court of competent jurisdiction, in any circumstance when it appears:

(a) That it would be inconsistent with a provision of these Articles, a resolution of the shareholders, or an agreement in effect at the time of the accrual of the alleged cause of the action asserted in the proceeding in which the expenses were incurred or other amounts were paid, which prohibits or otherwise limits indemnification; or

(b) That it would be inconsistent with any condition expressly imposed by a court in approving a settlement.

7. Right to Bring Suit. If a claim under this Article is not paid in full by the Corporation within 90 days after a written claim has been received by the Corporation (either because the claim is denied or because no determination is made), the claimant may at any time thereafter bring suit against the Corporation to recover the unpaid amount of the claim and, if successful in whole or in part, the claimant shall also be entitled to be paid the expenses of prosecuting that claim. The Corporation shall be entitled to raise as a defense to any such action that the claimant has not met the standards of conduct that make it permissible under the California Corporations Code for the Corporation to indemnify the claimant for the claim. Neither the failure of the Corporation (including its Board of Directors, independant legal counsel, or its shareholders) to have a determination prior to the commencement of such an action that indemnification of the claimant is permissible in the circumstances described because he or she has met the applicable standard of conduct, if any, nor an actual determination by the Corporation (including its Board of Directors, independent legal counsel, or its shareholders) that the claimiant has not met the applicable standard of conduct, shall be a defense to such an action or create a presumption for the purpose of such an action that the claimant has not met the applicable standard of conduct.

8. Indemnity Agreements. The Board of Directors is authorized to enter into a contract with any Director, officer, employee, or agent of the Corporation, or any person who is or was serving the request of the Corporation as a Director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise, including employee benefit plans, or any person who was a Director, officer, employee, or agent of a corporation that was a predecessor corporation of the Corporation or of another enterprise at the request of such a predecessor corporation, providing for indemnification rights equivalent to or, if the Board of Directors so determines and to the extent permitted by applicable law, greater than, those provided for in this Article.

9. Amendment, Repeal, or Modification. Any amendment, repeal, or modification of this Article shall not adversely affect any right or protection of a Director or agent of the Corporation existing at the time of the amendment, repeal or modification.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesIndemnification



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
3. Board of Directors

2-3 California Legal Forms--Transaction Guide § 3.282

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.282 Provision for Variable Number of Directors

[1] Comment

[a] Use of Form

This provision may be included in the articles of incorporation to provide for a variable number of directors [*see Corp. Code § 164* ("directors" defined)]. For a provision that establishes a fixed number of directors, see *§ 3.283*. The number of directors (expressed either as a variable or fixed number) is not required to be stated in the articles. Instead, this information may be, and probably most often is, included in the bylaws for the corporation [*see Corp. Code § 212(a)*; [b], *below*]. Directors may be, but are not required to be named in the articles of incorporation [*see Corp. Code § 204(c)*]. If directors are named, each director must execute and acknowledge the articles of incorporation [*Corp. Code § 200(b)*; *see § 3.284* (provision and required acknowledgment certificate].

[b] Designating Number of Directors in Articles or Bylaws

Either the bylaws or the articles of incorporation must contain a provision that fixes the number of directors of the corporation or a provision that establishes a variable board of directors [*see* [d], *below*]. If included in the articles, either type of provision may be changed only by amending the articles. Since bylaws are generally easier to amend than articles (absent a contrary provision in the articles or bylaws [*see Corp. Code § 211*]), provisions that provide for the number of directors are often included in the bylaws rather than the articles.

Once shares are issued, a bylaw (or article provision) specifying or changing a fixed number of directors or the minimum and maximum numbers or changing from a fixed to a variable board or vice versa may be adopted only by approval of the outstanding shares. However, a bylaw or amendment of the articles that reduces the number or the minimum number of directors to a number less than five cannot be adopted if the votes cast against its adoption at a meeting or the shares not consenting in the case of action by written consent [*see Corp. Code §§ 194*, *603*] are equal to

more than 16 2/3 percent of the outstanding shares entitled to vote [*Corp. Code § 212(a)*]. Subject to these restrictions and some others [*see Corp. Code § 212*], the power of the board to adopt, amend, or repeal bylaws may be restricted or eliminated by the articles or by the bylaws themselves [*Corp. Code § 211*; *see § 3.289* (provision for imposing this restriction)]. Any reduction of the authorized number of directors or amendment reducing the number of classes of directors [*see Corp. Code § 301.5*] does not remove any director before the expiration of his or her term of office [*Corp. Code § 303(b)*].

[c] Minimum Number of Directors

As a general rule, the number of directors that a corporation must have, or the minimum number if the number is variable, cannot be less than three. However, there are several exceptions to this general rule. For example, the corporation is permitted to have only one director before the time it issues its shares, or for so long as the corporation has only one shareholder. Two directors are permitted before the time the corporation issues its shares, or for so long as the corporation has only one or only two shareholders [*Corp. Code § 212(a)*]. For a discussion of the number of directors required for a "listed corporation" with multiple classes of directors, see [e], *below*.

[d] Variable Board of Directors

To provide for a variable number of directors, the articles (or bylaws) [*see* [b], *above*] must first define the permitted range of directors by stating that the number of directors may not be less than a stated minimum or more than a stated maximum (which in no case can be greater than two times the stated minimum minus one). Second, the articles (or bylaws) must state that the exact number of directors will be fixed, within the limits of the defined range, by approval of either the board of directors [*see Corp. Code § 307(a)(7), (8), (b)*] or the shareholders [*see Corp. Code § 153* ("approval of the shareholders" defined)] in the manner provided in the bylaws (or articles) [*Corp. Code § 212(a)*].

If approval of the board or the shareholders requires the vote of a larger proportion or of all of the shares of any class or series of shares, or the vote or quorum for taking action of a larger proportion or of all of the directors, than is otherwise required under the General Corporation Law, that fact must be stated (and the precise voting requirements outlined) in the articles of incorporation in order for the voting provision to be effective [*Corp. Code § 204(a)(5)*; *see Corp. Code § 212(a)*]. This form does *not* require a larger proportion of shareholder or board approval than otherwise is required under the General Corporation Law [*see Corp. Code §§ 153* (approval of shareholders), *307(a)(7), (8), (b)* (approval by board of directors)].

[e] Different Classes of Directors for Listed Corporations

A "listed corporation" (defined below) may, by amendment of its articles or bylaws (but not in its original articles) adopt provisions to divide the board of directors into two or three classes to serve for terms of two or three years respectively, or to eliminate cumulative voting, or both [*Corp. Code § 301.5(a), (e)*; *see Corp. Code § 301(a)*]. A corporation that is not a listed corporation, after it issues shares, may adopt these same provisions, to take effect when it does become a listed corporation [*Corp. Code § 301.5(a)*]. An article or bylaw amendment providing for division of the board of directors into classes, or a change in the number of classes, or the elimination of cumulative voting may be adopted only by the approval of the board [*see Corp. Code § 151*] and the outstanding shares [*see Corp. Code § 152*] voting as a single class, notwithstanding the ordinary requirements for shareholder approval of article amendments [*Corp. Code § 301.5(a)*; *see Corp. Code § 903* (ordinary shareholder approval requirements for article amendments)].

A "listed corporation" is a corporation with outstanding shares listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market [*Corp. Code § 301.5(d)*].

If the board of directors is divided into two classes to serve for terms of two years, the authorized number of directors must be no fewer than six, and one half of the directors (or as close an approximation as possible) must be elected at

each annual meeting of shareholders. If the board is divided into three classes to serve for three years each, the authorized number of directors must be no fewer than nine, and one third (or as close an approximation as possible) must be elected at each annual meeting. Directors of a listed corporation may be elected by classes at a shareholder meeting at which an amendment adopting provisions for dividing the board into classes is approved. However, the extended terms for directors are contingent on approval of that amendment, and if that amendment is to the articles, the filing of any necessary amendment to the articles [*Corp. Code § 301.5(b)*; *see Corp. Code §§ 905, 910* (required filing of article amendments)]. If directors for more than one class will be elected by the shareholders at any one meeting and the election is by cumulative voting [*see Corp. Code § 708*], votes may be cumulated only for directors to be elected within each class [*Corp. Code § 301.5(c)*].

For further discussion of the procedure for amending articles for a listed corporation, see Ch. 10, *Amendment of Articles* .

[2] FORM

Provision for Variable Number of Directors
_____ [*Article number*]

(_____) The corporation's board of directors shall have not fewer than _____ [*specify number, that is at least three; except that if shares have not yet been issued or if corporation has only one shareholder, number may be one or two, or if corporation has only two shareholders, number may be two*] nor more than _____ [*a stated maximum not exceeding two times the stated minimum minus one*] Directors, the exact number of which shall be fixed by approval of the Board of Directors [*or* by approval of the shareholders].

[*EITHER*]

"Approval of the Board of Directors" means the vote of a majority of the directors present at a meeting duly held at which a quorum is present or the unanimous written consent of the Board of Directors.

[*OR*]

"Approval of the shareholders" means the affirmative vote of a majority of the shares represented and voting at a duly held meeting at which a quorum is present (which shares voting affirmatively also constitute at least a majority of the required quorum) or by the written consent of holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take the same action at a meeting at which all shares entitled to vote on the matter were present and voted [*or specify greater proportion of shareholder vote (see Corp. Code §§ 153, 204(a)(5))*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & Removals



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
3. Board of Directors

2-3 California Legal Forms--Transaction Guide § 3.283

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.283 Provision for Fixed Number of Directors

[1] Comment--Use of Form

This provision may be included in the articles of incorporation to provide for a fixed number of directors for the corporation. For a provision that establishes a variable number of directors, see *§ 3.282*. The number of directors (expressed either as a variable or fixed number) is not required to be stated in the articles. Instead, this information may be, and probably most often is, included in the bylaws for the corporation [*see Corp. Code § 212(a)*; *see also § 3.282[1][b]*]. Specifying the number of directors in the articles is not usually recommended, particularly where the ultimate number of shareholders is unknown or the possibility of increasing the size of the board otherwise exists. Regardless of whether a provision for the number of directors (fixed or variable) is included in the bylaws or articles, restrictions apply in the event the provision is subsequently amended [*see Corp. Code § 212(a)*; *see § 3.282[1][b]* (discussion of restrictions)].

Directors may be, but are not required to be named in the articles of incorporation [*see Corp. Code § 204(c)*]. If directors are named, each director must execute and acknowledge the articles of incorporation [*Corp. Code § 200(b)*; *see § 3.284* (provision and required acknowledgment certificate].

Ordinarily, a corporation with a fixed number of directors must have at least three directors. However, before shares are issued, the number may be one or two. In addition, for so long as the corporation has only one shareholder, the corporation may have one or two directors. Finally, for so long as the corporation has only two shareholders, there may be two directors [*Corp. Code § 212(a)*].

For an article provision that names the initial directors for corporation, which may or may not be used in conjunction with this provision, see *§ 3.284*.

[2] FORM

Provision for Fixed Number of Directors

_____ [*Article number*]

(_____) The corporation's Board of Directors shall have _____ [*specify number that is at least three; except that if shares have not yet been issued or if corporation has only one shareholder, number may be one or two, or if corporation has only two shareholders, number may be two*] Directors.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
3. Board of Directors

2-3 California Legal Forms--Transaction Guide § 3.284

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.284 Names and Addresses of Initial Directors

[1] Comment

[a] Use of Form

This provision may be included in the articles of incorporation to designate the initial directors for the corporation and to set forth their respective addresses [*see Corp. Code § 204(c)*]. If the names and addresses of the initial directors are specified in the articles, this information must be set forth in a separately numbered article, and each designated director must sign and acknowledge the articles [*see Corp. Code § 200(b)*]. Directors are not required to be named in the articles [*see Corp. Code §§ 202, 204(c)*], and if they are not, the articles of incorporation must be signed (but they need not be acknowledged) by the incorporators [*Corp. Code § 200(b)*; *see, e.g., § 3.200[2]*].

This form, for illustrative purposes only, uses three directors. For requirements regarding the minimum number of directors, see *§ 3.282[1][c]*.

The provision in this form may be added, as a separate article, to any of the complete sets of articles set forth in this chapter [*see §§ 3.200-3.203*]. Since all of the complete sets of articles do not name initial directors but rather use a single incorporator, signature lines for directors are included in this form that must be substituted for the incorporator signature lines contained in those complete sets of articles. This form also contains an acknowledgment or declaration that must be used if directors sign the articles [*see* [b], *below*].

[b] Execution and Acknowledgment

If initial directors are named in the articles of incorporation, those directors must sign and acknowledge the articles [*Corp. Code § 200(b)*]. As used in the General Corporation Law, the word "acknowledged" means that the instrument is either of the following [*Corp. Code § 149*]:

- Formally acknowledged as provided in the Civil Code [*see Civ. Code §§ 1180-1207*]; or

- Accompanied by a declaration in writing signed by the persons executing it that they are those persons and that the instrument is their act and deed [*see Corp. Code § 193* (definition of "verified"); *Code Civ. Proc. § 2015.5* (declarations under penalty of perjury)].

A declaration and a certificate of acknowledgment are included in this form following the signature lines for directors; only one or the other should be used. The certificate of acknowledgment is in the form prescribed by statute for when the officer taking the acknowledgment is a notary [*Civ. Code § 1188*; *see Civ. Code § 1189* (required form)].

Any certificate of acknowledgment taken outside California before a notary public or a judge or clerk of a court of record having an official seal is sufficient in California and need not be further authenticated [*Corp. Code § 149*; *see Civ. Code § 1189(b)*].

[c] Special Restrictions on Amending Provision That Names Initial Directors

If a corporation names its initial directors in its original articles of incorporation, that provision cannot be amended (or deleted) until after the corporation files with the Secretary of State a "Statement by Domestic Stock Corporation" [*Corp. Code § 900(b)*]. The contents of the statement are outlined by statute and the form is prescribed by the Secretary of State [*see Corp. Code § 1502*]. The statement must be filed within 90 days after filing its original articles and then annually thereafter [*see Corp. Code § 1502*]. Requirements for filing the statement are further discussed in *§ 3.141*. For discussion of the requirements for amending articles of incorporation, see Ch. 10, *Amendment of Articles* .

[2] Form

Names and Addresses of Initial Directors

_____ [*Article number*]

The names and addresses of the persons appointed to act as the first Directors of this corporation are:

_____ [*name*], whose address is _____ [*street, city, and state*].

_____ [*name*], whose address is _____ [*street, city, and state*].

_____ [*name*], whose address is _____ [*street, city, and state*].

[*Use following signature lines in articles that name initial directors:*]

_____ [*signature of director*]
[*typed name*]

_____ [*signature of director*]
[*typed name*]

_____ [*signature of director*]

[*typed name*]

[*EITHER*]

DECLARATION

We declare that we are the persons who executed the foregoing articles of incorporation and that the execution is our act and deed.

_____ [*signature of director*]

_____ [*signature of director*]

_____ [*signature of director*]

[*OR*]

ACKNOWLEDGMENT

[*Acknowledgments taken in California must be in the following form (Civ. Code § 1189(a)):*]

State of California)
County of _____)

On _____[*date*], before me, _____[*name and title of officer taking acknowledgment*], personally appeared _____[*names of persons signing instrument*], _____[personally known to me *or* proved to me on the basis of satisfactory evidence] to be the person[s] whose name[s] _____[is *or* are] subscribed to the within instrument and acknowledged to me that _____[he *or* she *or* they] executed the same in _____[his *or* her *or* their] authorized _____[capacity *or* capacities], and that by _____[his *or* her *or* their]signature[s] on the instrument the person[s], or the entity on behalf of which the person[s] acted, executed the instrument.

WITNESS my hand and official seal

Signature _____ [*Seal*]

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeRemoval & ResignationBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeGeneral Overview



177 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
3. Board of Directors

2-3 California Legal Forms--Transaction Guide § 3.285

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.285 Requirement That Directors Possess Particular Qualifications

[1] Comment--Use of Form

The is an optional provision that may be included in the articles of incorporation for a corporation that will require its directors to possess particular qualifications. Under the General Corporation Law, the bylaws may (but are not required to) prescribe qualifications for directors [*see Corp. Code § 212(b)(4)*], and any provision that is required or permitted to be stated in the bylaws may be included in a corporation's articles of incorporation [*Corp. Code § 204(d)*].

If this provision is included in the articles, the particular qualifications required should be clearly stated. For example, a corporation may require that its directors also be shareholders of the corporation. There is no requirement under the General Corporation Law that directors be shareholders of the corporation. However, other statutory provisions that govern special types of corporations may impose this requirement.

[2] Form

Requirement That Directors Possess Particular Qualifications
_____ [*Article number*]

(_____) [Other than the initial Directors,] no person shall be a Director of the corporation unless that person _____ [*describe specific qualifications*] at all times during that person's term of office.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
3. Board of Directors

2-3 California Legal Forms--Transaction Guide § 3.286

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.286 Designation of Persons Authorized to Call Board Meeting

[1] Comment

[a] Use of Form

This form is an optional provision that may be included in the articles of a corporation that desires to vary the statutory provisions that otherwise apply as to which persons are authorized to call a meeting of the board of directors. Unless otherwise provided in the articles or in the bylaws [*see Corp. Code §§ 204(d), 212(b)(2)*], meetings of the board may be called by the board chairperson or the president or any vice president or the secretary or any two directors [*Corp. Code § 307(a)*]. If a corporation desires in any way to vary this statutory norm, the appropriate provision must be included in either the articles or the bylaws. For example, a corporation may determine to authorize a single director, instead of the two ordinarily required, to call a meeting of the board.

[b] Notice of Meetings

Unless otherwise provided in the articles or bylaws, regular meetings of the board may be held without notice if the time and place of the meetings are fixed by the bylaws or the board. Special meetings of the board must be held on four days notice by mail or 48 hours notice delivered personally or by telephone, including a voice messaging system or by electronic transmission by the corporation [*Corp. Code § 307(a)(2)*; *see Corp. Code § 20* (definition)]. The articles or bylaws may not dispense with notice of a special meeting. A notice, or waiver of notice, need not specify the purpose of any regular or special meeting of the board [*Corp. Code § 307(a)(2)*].

Notice of a meeting need not be given to any director who provides a waiver of notice, or a consent to holding the meeting or an approval of the minutes of the meeting in writing, whether before or after the meeting, or who attends the meeting without protesting, prior to the meeting or at its commencement, the lack of notice to that director. All waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meeting [*Corp.*

Code § 307(a)(3)].

[2] Form

Designation of Persons Authorized to Call Board Meeting
_____ [*Article number*]

(_____) Meetings of the Board of Directors may be called by _____ [*insert titles of authorized persons, e.g.,* any Director or officer of the corporation].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
3. Board of Directors

2-3 California Legal Forms--Transaction Guide § 3.287

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.287 Establishing Higher or Lower Quorum for Board of Directors

[1] Comment--Use of Form

This provision may be included in the articles of incorporation to vary the statutory rule that otherwise applies to the determination of a quorum for the board of directors. Its effect may be extended to all corporate actions or limited to only specified types of actions.

Unless otherwise provided in the articles of incorporation (or bylaws), a majority of the authorized number of directors constitutes a quorum of the board for the transaction of business [*Corp. Code § 307(a)(7)*]. While the articles may provide for a different quorum, they may not provide for one that is less than one-third of the authorized number of directors or less than two, whichever is larger, unless the authorized number of directors is one, in which case one director constitutes a quorum [*Corp. Code § 307(a)(7)*]. Any provision that requires, for any or all corporate actions, the vote or quorum for taking action of a larger proportion or of all of the directors than is otherwise required under the General Corporation Law, must be expressly provided in the articles (or in the case of close corporation, the shareholders' agreement) in order to be effective [*see Corp. Code § 204(a)(5)*].

[2] Form

Establishing Higher or Lower Quorum for Board of Directors

_____ [*Article number*]

(_____) A quorum of the Board of Directors for the transaction of all corporate business [*or describe specific matters to which this provision applies*] shall be _____ [*specify number, fraction, or percentage that is not less than one-third of authorized number of directors or less than two, whichever is larger*] [of the number of] Directors [authorized].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
3. Board of Directors

2-3 California Legal Forms--Transaction Guide § 3.288

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.288 Increasing Vote Required for Director Action

[1] Comment--Use of Form

This form contains provisions that may be included in the articles to increase the percentage vote otherwise required by statute for director action. From a practical standpoint, corporations that elect to use this type of provision will probably extend its effect only to specific corporate matters [*see* [2], Alternative 1, *below*] rather than to all corporate business [*see* [2], Alternative 2, *below*]. However, there is no statutory prohibition against using this type of provision for all corporate business [*see Corp. Code § 204(a)(5)*].

A provision that requires, for any or all corporate actions, the vote or quorum for taking action of a larger proportion or of all of the directors, that is otherwise required under the General Corporation Law, must be expressly set forth in the corporation's articles (or in the case of a close corporation, in a shareholders' agreement) in order to be effective [*see Corp. Code § 204(a)(5)*]. Unless otherwise provided in the articles of incorporation or in the bylaws, every act or decision done or made by a majority of the directors present at a meeting duly held at which a quorum is present is, subject to statutory provisions relating to directors' contracts and indemnification of directors and other agents [*see Corp. Code §§ 310, 317(e)*], the act of the board of directors. Although the articles or bylaws may vary this requirement, they may not provide that a lesser vote than a majority of the directors present at a meeting is the act of the board [*Corp. Code § 307(a)(8)*].

Under the General Corporation Law, any action required or permitted to be taken by the board may be taken without a meeting, if all members of the board individually or collectively consent in writing to the action and the number of board members serving at the time of the action constitutes a quorum [*Corp. Code § 307(b)*]. Neither of the alternative provisions below varies this statutory provision. For further discussion of board action by unanimous written consent, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

[2] Form

Increasing Vote Required for Director Action

_____ [*Article number*]

[*Alternative 1: Use to require higher percentage vote only on specific matters.*]

(_____) Except as otherwise provided by law or in this paragraph [*or* subparagraph], any act done or decision made on behalf of the Corporation shall require the affirmative vote of a majority of the Directors of the corporation present at a meeting duly held at which a quorum is present, or in the absence of a meeting, the written consent (individually or collectively) of all Directors who constitute a quorum at the time of consent. For any act or decision relating to _____ [*describe specific matter to which higher percentage vote will apply*], the affirmative vote of _____ [*specify percentage higher than majority*] percent of the Directors of the corporation present at a meeting duly held at which a quorum is present shall be required, or in the absence of a meeting, the written consent (individually or collectively) of all Directors.

[*Alternative 2: Use to require higher percentage vote on all matters.*]

(_____) Except as otherwise provided by law, any act done or decision made on behalf of the Corporation shall require the affirmative vote of [*specify number or percentage that is greater than majority*] of the Directors of the corporation present at a meeting duly held at which a quorum is present, or in the absence of a meeting, the written consent (individually or collectively) of all Directors who constitute a quorum at the time of consent.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
3. Board of Directors

2-3 California Legal Forms--Transaction Guide § 3.289

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.289 Restrictions on Board's Power to Adopt, Amend, or Repeal Bylaws

[1] Comment

[a] Use of Form

This form may be included in the articles to restrict the power of the board of directors to adopt, amend, or repeal bylaws that otherwise exists by law [*see Corp. Code § 211*; *see also* [b], *below*]. The restriction may be extended to the adoption, amendment, or repeal of any bylaw, or may be instead limited to bylaws covering specified matters. The provision also may be modified to limit the power of the board only with respect to adoption, or to amendment, or to repeal, of the bylaws, or any combination of these.

[b] Corporate Powers Regarding Bylaws

Subject to any limitations contained in the articles of incorporation and to compliance with other provisions of the General Corporation Law and any other applicable laws, a corporation has the power to adopt, amend, and repeal bylaws [*Corp. Code § 207(b)*]. If initial directors are not named in the articles, the incorporators may adopt and amend bylaws but only until the directors are elected [*Corp. Code § 210*].

Except for provisions that specify or change the number of directors or that change the board of directors from a fixed to a variable board, or vice versa [*see Corp. Code § 212*; *see also § 3.282[1][b]*], bylaws may be adopted, amended, or repealed either by approval of the outstanding shares [*see Corp. Code § 152* (definition)] or by approval of the board of directors [*Corp. Code § 211*]. However, subject to any article provision that requires a larger proportion of shareholder or director vote than otherwise required under the General Corporation Law [*see Corp. Code § 204(a)(5)*; *see also §§ 3.270*, *3.287*, and *3.288*], the articles or bylaws may restrict or eliminate the power of the board to adopt, amend, or repeal any or all bylaws [*Corp. Code § 211*].

[2] FORM

Restrictions on Board's Power to Adopt, Amend, or Repeal Bylaws

_____ [*Article number*]

(_____) Except as may otherwise be provided by law or by these Articles of Incorporation, the Board of Directors may not, and shall have no authority or power to adopt, amend, or repeal any of this corporation's Bylaws [*if restriction is limited to specific Bylaws, add:* respecting _____ (*describe specific provisions to which restriction applies*)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityLimitationsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Bylaws



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
3. Board of Directors

2-3 California Legal Forms--Transaction Guide §§ 3.290-3.299

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[Reserved]

§§ 3.290[Reserved]



183 of 187 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
4. Miscellaneous

2-3 California Legal Forms--Transaction Guide § 3.300

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.300 Limiting Duration of Corporate Existence to Specified Date

[1] Comment--Use of Form

This provision may be included in the articles to limit the duration of the corporation's existence to a specified date. If the corporation's duration is to be so limited, an express provision to that effect must be included in the articles (or, in the case of a close corporation, a shareholders' agreement) [*Corp. Code § 204(a)(4)*]. Unless otherwise provided by law or in the articles, corporate existence begins when the articles of incorporation are filed and continues perpetually [*Corp. Code § 200(c)*].

[2] FORM

Limiting Duration of Corporate Existence to Specified Date
_____ [*Article number*]

(_____) The existence of this corporation shall terminate on _____[*specify date*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistenceBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
C. Optional Article Provisions
4. Miscellaneous

2-3 California Legal Forms--Transaction Guide §§ 3.301-3.309

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

[Reserved]

§§ 3.301[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
D. Certificates of Determination

2-3 California Legal Forms--Transaction Guide § 3.310

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.310 Certificate of Determination That Designates Initial Series of Preferred Shares and Fixes Number of Shares, and Rights, Preferences, Privileges, and Restrictions for That Series

[1] Comment

[a] Use of Form

This form is an illustrative certificate of determination that may be used to designate the first series of preferred shares, to fix the number of shares in that series, and to fix the rights, preferences, privileges and restrictions for that series. If the articles of incorporation for a corporation with two or more classes of shares (or a corporation with a single class but two or more series) do not set forth rights, preferences, privileges, and restrictions for an unissued class or series or do not fix the number or designation of a series within a class but instead authorize the board to determine these matters [*see, e.g., § 3.241*], a certificate of determination must be filed with the Secretary of State before the shares in that class or series are issued [*Corp. Code §§ 401(a), 202(e)*].

In general terms, a certificate of determination must be filed in order to provide a preference statement and other information that is otherwise required to be included in the articles of incorporation [*see Corp. Code § 202(e)*]. The statutory definition of "articles" includes certificates of determination [*Corp. Code § 154*].

If the articles of incorporation authorize the board of directors to fix the number of shares or to determine the designation of any series of a class of shares or to determine or alter the rights, preferences, privileges and restrictions granted to or imposed on any wholly unissued class or series of shares, the board, within the bounds of authority granted to it in the articles, must fix these matters by resolution [*see Corp. Code §§ 202(e)*; *401(a)*]. Then, before the corporations issues any shares of any class or series that are affected by the board's action and resolution, it must file an officer's certificate that sets forth a copy of the resolution, the number of shares of the class or series, and a statement that none of the shares of the class or series has been issued [*Corp. Code § 401(a)*; *see* [c], *below* (execution and filing requirements)]. An officers' certificate containing this required information is referred to as a certificate of determination [*see Corp. Code §§ 156, 401(b)*; *see also Corp. Code § 154* (definition of articles of incorporation

includes certificates of determination). If the rights, preferences, privileges, and restrictions of the class or series contain a supermajority vote provision [*see Corp. Code § 710(b)*] subject to *Corp. Code § 710* [*see* [b], *below*], the certificate must state that the provision has been approved by the shareholders in accordance with *Corp. Code § 710(c)* [*Corp. Code § 401(g)*; *see* [b], *below*].

For an amendatory certificate of determination that may be used (prior to the time affected shares are issued) to alter or revoke one or more rights, preferences, privileges, or restrictions fixed by the board in a previously filed certificate of determination, see *§ 3.211*. An amendatory certificate for increasing or decreasing the number of shares of a series fixed in a previously filed certificate of determination is set forth in § 3.212.

[b] Shareholder Approval Required for Supermajority Vote Provision

In general, if a corporation with outstanding shares held of record by 100 or more persons [*see Corp. Code § 605*] files a certificate of determination that includes a "supermajority vote" requirement, the certificate must be approved by at least as large a proportion of the outstanding shares [*see Corp. Code § 152*] as is required pursuant to that certificate of determination for the approval of the specified corporate action or actions [*Corp. Code § 710(a), (c)*].

This requirement does not apply to a corporation that files an amendment of articles or certificate of determination after 1993 if, at the time of filing, the corporation has never had a supermajority vote provision subject to the requirement of periodic readoption described below [*see Corp. Code § 710(c)*] and has (1) oustanding shares of more than one class or series, (2) no class of equity securities registered under § 12(b) or (g) of the Securities Exchange Act of 1934 [*see 15 U.S.C. § 78l(b), (g)*], and (3) outstanding securities held of record by fewer than 300 persons [*Corp. Code § 710(a)*; *see Corp. Code § 605*; *see also Corp. Code § 710(d)*].

A "supermajority vote" is a requirement that specified corporate action or actions be approved by a larger proportion of the outstanding shares than a majority, or by a larger proportion of the outstanding shares of a class or series than a majority [*Corp. Code § 710(b)*]. For corporations with outstanding shares held of record by 100 or more persons, the supermajority vote provision may not require a vote in excess of 662/3 percent of the outstanding shares or 662/3 percent of the outstanding shares of any class or series of those shares [*Corp. Code § 710(b)*]. This form does not include a supermajority vote provision; if one is to be included, the form must be modified accordingly with a description of the provision and a recitation that the requisite shareholder approval for the provision has been obtained.

[c] Execution and Filing Requirements

As discussed in [a], *above*, a certificate of determination must include an "officers' certificate" [*see Corp. Code § 401(a)*]. This means a certificate that is signed and verified by the board chairprson, the president, or any vice-president, and by the secretary, the chief financial officer, the treasurer, or any assistant secretary or assistant treasurer of the corporation [*Corp. Code § 173*]. "Verified" means that the statements contained in the certificate are declared to be true of the own knowledge of the persons executing the certificate in either of the following [*Corp. Code § 193*]:

- An affidavit signed by them under oath before an officer authorized by the laws of this state or of the place where it is executed to administer oaths; or

- A declaration in writing executed by them "under penalty of perjury" [*see Code Civ. Proc. § 2015.5*] and stating the date and place (within or without this state) of execution [*Corp. Code § 193*].

Any affidavit sworn to outside California before a notary public or a judge or clerk of a court of record having an official seal satisfies the statutory requirements for verification and need not be further authenticated [*Corp. Code § 193*]. The form below meets the statutory requirements for a declaration under penalty of perjury referred above.

The duly executed and verified certificate of determination must be filed in the office of the Secretary of State [*Corp. Code §§ 401(a), 169*], together with the appropriate filing fee [*see Gov. Code § 12186(p)*; *Corp. Code § 108*]. The Secretary of State will compare and certify two copies without charge, provided the copies are submitted with the original to be filed [*Gov. Code § 12185*]. Otherwise, separate fees for certification [*Gov. Code § 12183*], copying, preclearance of documents, and special handling must be submitted [*see Gov. Code § 12182*].

[2] FORM

Certificate of Determination That Designates Initial Series of Preferred Shares and Fixes Number of Shares, and Rights, Preferences, Privileges, and Restrictions for That Series

CERTIFICATE OF DETERMINATION for _____ [*name of corporation*], a California corporation

_____ [*Name of board chairperson, president, or vice-president executing this certificate*] and _____ [*name of secretary, chief financial officer, treasurer, assistant secretary, or assistant treasurer executing this certificate*] certify:

1. They are the _____ [*board chairperson, president, or vice-president*] and the _____ [*secretary, chief financial officer, treasurer, assistant secretary, or assistant treasurer*], respectively, of _____ [*name of corporation, exactly as of record in office of Secretary of State*], a California corporation.

2. The authorized number of shares of the corporation's Preferred stock is _____[*number*], and the number of shares constituting _____ [*name of series subject to this Certificate, e.g.*, Preferred Series A] (that is the series affected by this Certificate of Determination and the resolution set forth below) is _____[*number*]. None of the shares of that series has been issued.

3. Pursuant to authority granted by the corporation's Articles of Incorporation, the following resolution has been duly adopted and approved by the Board of Directors.

[4. *If appropriate, add:* The rights, preferences, privileges, and restrictions of the _____ (class *or* series) affected by this Certificate of Determination and the resolution set forth below contain a supermajority vote provision subject to *Section 710 of the Corporations Code*. The provision has been approved by the shareholders in accordance with subdivision (c) of Section 710.]

RESOLUTION OF BOARD OF DIRECTORS

WHEREAS, the Articles of Incorporation of this corporation provide for a class of shares known as Preferred Stock, issuable from time to time in one or more series; and

WHEREAS, the Board of Directors of this corporation is authorized to determine or alter the rights, preferences, privileges, and restrictions granted to or imposed on any wholly unissued series of Preferred Stock, to fix the number of shares constituting any such series, and to determine the designation of that series, or any of them; and

WHEREAS, this corporation has not issued any shares of Preferred Stock and the Board of Directors of this corporation desires, pursuant to its authority, to determine and fix the rights, preferences, privileges, and restrictions relating to the initial series of Preferred Stock and the number of shares constituting and the designation of the series;

IT IS THEREFORE RESOLVED, that the Board of Directors authorizes the original issue of a series of Preferred shares that shall be designated and known as _____ [*name of series, e.g.*, "Preferred Series A"]. The number of shares of this series shall be _____[*number*]. All shares in this series are subject to the following rights, preferences, privileges, and restrictions:

(a) _____ [*Describe dividend rights and rate; see §§ 3.243-3.245*];

(b) _____ [*Describe liquidation preferences; see §§ 3.246-3.248*];

(c) _____ [*Set forth redemption provisions; see § 3.249*];

(d) _____ [*Include sinking fund provisions if desired; see § 3.250*];

(e) _____ [*Specify conversion rights, if any; see §§ 3.251, 3.252*];

(f) _____ [*Describe voting rights; see §§ 3.253, 3.254*];

(g) _____ [*Insert any other desired provisions, e.g., see §§ 3.255-3.257*].

RESOLVED FURTHER, that the Board Chairperson, the President or any Vice-President, and the Secretary, the Chief Financial Officer, the Treasurer, or any Assistant Secretary or Assistant Treasurer of this corporation are each authorized to execute, verify, and file in the office of the California Secretary of State a Certificate of Determination in accordance with this resolution and California law.

5. We further declare under penalty of perjury under the laws of the State of California that the matters set forth in this Certificate are true and correct of our own knowledge.

Executed on _____[*date*] at _____ [*city and state*].

_____ [*signature of board chairperson, president, or vice-president*]
[*typed name*]

_____ [*signature of secretary, chief financial officer, treasurer, assistant treasurer, or assistant secretary*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock CertificatesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
D. Certificates of Determination

2-3 California Legal Forms--Transaction Guide § 3.311

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.311 Amendatory Certificate of Determination to Alter or Revoke Certain Rights, Preferences, Privileges, or Restrictions Fixed in Previously Filed Certificate of Determination

[1] Comment

[a] Use of Form

This form is a certificate of determination that may be used to alter or revoke any right, preference, privilege, or restriction fixed by the board of directors for a series of shares in a certificate of determination previously filed with the Secretary of State [*Corp. Code § 401(b)*; *see § 3.310*]. It should be filed with the Secretary of State only if the corporation has *not* issued any shares of the series affected by the board resolution contained in the previously filed certificate of determination [*Corp. Code § 401(b)*]. If shares of an affected series have been issued, the provisions of a resolution set forth in a previously filed certificate of determination may be amended only by following the statutory procedures required for an amendment of the articles [*Corp. Code § 401(d), (e)*; *see Corp. Code §§ 902-905, 908* (approval and filing requirements for amendment of articles); *see also* Ch. 10, *Amendment of Articles*]. An increase or decrease by the board of directors in the number of shares of a series designated in a previously filed certificate of determination is not subject to this rule [*see Corp. Code § 401(d)*; *see also § 3.312* (amendatory certificate for increasing or decreasing number of shares)].

[b] Formal Requirements for Certificate

The board of directors may alter or revoke any right, preference, privilege, or restriction fixed by resolution in a previously filed certificate of determination by adopting an appropriate resolution and filing a certificate of determination in the office of the Secretary of State. The certificate of determination must set forth an officers' certificate with the resolution adopted by the board and a statement that none of the shares of the series affected by the resolution has been issued [*Corp. Code § 401(b)*]. An officers' certificate must be signed and verified by specific officers of the corporation [*see Corp. Code §§ 173, 193*]; those requirements are discussed in *§ 3.310[1][c]* and incorporated into the form below.

A certificate of determination that amends a previously filed certificate of determination must identify the specific provision or provisions of the original certificate being amended [*Corp. Code § 401(e)*]. It must do so (in compliance with the requirements for amending articles of incorporation) by establishing the wording of the amendment by one or more of the following means [*Corp. Code § 401(e)*; *see Corp. Code § 907(a)* (requirements for certificate of amendment for articles of incorporation)]:

- By stating that the original certificate will be amended to read as set forth in full in the amended certificate;

- By stating that any provision of the original certificate (which must be identified by the numerical or other designation given it in the original certificate, or by stating its exact wording) will be stricken from the certificate, or will be amended to read as set forth in the amended certificate;

- By stating that the provisions set forth in the amended certificate of determination will be added to the provisions of the original certificate.

[c] Shareholder Approval Requirement

If a corporation with outstanding shares held of record by 100 or more persons [*see Corp. Code § 605*] files a certificate of determination [*see Corp. Code §§ 156, 401*] containing a "supermajority vote" provision [*see Corp. Code § 710(b)*], the certificate must be approved by at least as large a proportion of the outstanding shares [*see Corp. Code § 152*] as is required pursuant to that certificate of determination for the approval of the specified corporate action or actions [*Corp. Code § 710(a), (c)*]. This requirement does not apply to a corporation that files an amendment of articles or certificate of determination after 1993 if, at the time of filing, the corporation has never had a supermajority vote provision subject to the requirement of periodic readoption [*see Corp. Code § 710(c)*] and has (1) outstanding shares of more than one class or series, (2) no class of equity securities registered under § 12(b) or (g) of the Securities Exchange Act of 1934 [*15 U.S.C. § 78l(b), (g)*], and (3) outstanding securities held of record by fewer than 300 persons [*Corp. Code § 710(a)*; *see Corp. Code § 605*].

[2] FORM

Amendatory Certificate of Determination to Alter or Revoke Certain Rights, Preferences, Privileges, or Restrictions Fixed in Previously Filed Certificate of Determination

AMENDATORY CERTIFICATE OF DETERMINATION for _____ [*name of corporation*], a California corporation

_____ [*name of board chairperson, president, or vice-president executing this certificate*] and _____ [*name of secretary, chief financial officer, treasurer, assistant secretary, or assistant treasurer executing this certificate*] certify that:

1. They are the _____ [*board chairperson, president, or vice-president*] and the _____ [*secretary, chief financial officer, treasurer, assistant secretary, or assistant treasurer*], respectively, of _____ [*name of corporation, exactly as of record in office of Secretary of State*], a California corporation.

2. None of the shares of the series designated _____ [*name of affected series, e.g.,* Preferred Series A], which is the series of shares affected by this Amendatory Certificate of Determination, has been issued.

3. Paragraph [*or subparagraph or other designation*] _____ [*insert same number, letter, or other designation used in previously filed certificate*] of the corporation's Certificate of Determination filed on _____[*date*], is amended to read as follows: _____ [*set forth amended provision*) *or* is revoked].

4. The foregoing amendment has been duly approved by the Board of Directors in a resolution adopted by it and which is set forth below.

[5. *If appropriate (see § 3.310[1][b]), add:* The rights, preferences, privileges, and restrictions of the _____ (class *or* series) affected by this Amendatory Certificate of Determination and the resolution set forth below contain a supermajority vote provision subject to *Section 710 of the Corporations Code*. The provision has been approved by the shareholders in accordance with subdivision (c) of Section 710.]

RESOLUTION OF BOARD OF DIRECTORS

WHEREAS, the Articles of Incorporation of this corporation provide for a class of shares known as Preferred Stock, issuable from time to time in one or more series; and

WHEREAS, the Board of Directors of this corporation is authorized to determine or alter the rights, preferences, privileges, and restrictions granted to or imposed on any wholly unissued series of Preferred Stock, to fix the number of shares constituting any such series, and to determine the designation of that series, or any of them, and to increase or decrease (but not below the number of shares of such series then outstanding) the number of shares of any series after the issue of shares of that series [*or reword with language that matches authorization contained in corporation's articles*]; and

WHEREAS, the rights, preferences, privileges, and restrictions relating to a series of Preferred shares, designated _____ [*name of series, e.g.,* Preferred Series A] were fixed by a resolution adopted on _____[*date*] and set forth in a Certificate of Determination filed in the office of the California Secretary of State on _____[*date*]; and

WHEREAS, no Preferred shares of that series have been issued; and

WHEREAS, the Board of Directors now desires to alter or revoke certain of the rights, preferences, privileges, or restrictions for Preferred shares of that series as set forth in that Certificate of Determination;

IT IS THEREFORE RESOLVED, that the Board hereby amends [or revokes] _____ [*identify specific provision being amended, by letter, number or other descriptive designation, e.g.,* subparagraph (a) of the RESOLUTION OF BOARD OF DIRECTORS set forth in Paragraph 3] of the Certificate of Determination filed on _____[*date*] [*for amendment, continue:* to read as follows: _____ (*set forth amended provision*)]. RESOLVED, FURTHER, that the rights, preferences, privileges, and restrictions fixed for Preferred shares of that series by that resolution of the Board of Directors and set forth in the Certificate of Determination of Preferences referred to above, shall be and remain unchanged except as altered or revoked by the foregoing resolution; and

RESOLVED FURTHER, that the Board Chairperson, the President or any Vice-President, and the Secretary, the chief financial officer, the Treasurer, or any Assistant Secretary or Assistant Treasurer of this corporation are each authorized to execute, verify, and file in the office of the California Secretary of State an Amendatory Certificate of Determination in accordance with this resolution and California law.

5. We further declare under penalty of perjury under the laws of the State of California that the matters set forth in this certificate are true and correct of our own knowledge.

Executed on _____[*date*] at _____ [*city and state*].

[*signature of board chairperson, president, or vice-president*]
[*typed name and title*]

_____[*signature of secretary, chief financial officer, treasurer, assistant secretary, or assistant treasurer*]

[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock Certificates



187 of 187 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 3 ARTICLES OF INCORPORATION
PART IV. FORMS
D. Certificates of Determination

2-3 California Legal Forms--Transaction Guide § 3.312

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Practice Consultants

§ 3.312 Amendatory Certificate of Determination to Increase or Decrease Number of Shares in Series Fixed in Previously Filed Certificate of Determination

[1] Comment

[a] Use of Form

This form is an amendatory certificate of determination that may be filed with the office of the Secretary of State to increase or decrease the number of shares of a series fixed in a previously filed certificate of determination [*see Corp. Code § 401(c)*]. For a discussion of execution, verification, and filing requirements for any certificate of determination, see *§ 3.310[1][c]*. Because this is an amendatory certificate, the provision in the previously filed certificate of determination that is being amended must be identified, and the wording of the amendment in the amendatory certificate must be established by one of the methods required by statute for the amendment of articles of incorporation [*Corp. Code § 401(e)*; *see Corp. Code § 907(a)*; *see also* [2], *below*, Paragraphs 3, 4]. For a discussion of circumstances under which shareholder approval is required for a certificate of determination, see *§ 3.310[1][b]*.

[b] Authority of Board to Change Number of Shares in Series

If the articles of incorporation authorize the board of directors to fix the number of shares in a series [*Corp. Code § 202(e)(1)*; *see, e.g., § 3.241*], the articles may also authorize the board (within the limits and restrictions stated in the articles or the resolution fixing the number of shares constituting any series) to increase or decrease the number of shares of that series after they have been issued. However, the number of shares may not be decreased to a number below the number of shares in that series then outstanding. If the number is decreased, the shares constituting the decrease resume the status they had before the adoption of the resolution originally fixing the number of shares of that series [*Corp. Code § 202(e)(3)*].

[c] Procedure to Increase or Decrease Number of Shares

After a certificate of determination has been filed that fixes the number of shares of a series [*see § 3.310*], the board, if so authorized by the articles [*see Corp. Code § 202(e)*; *see also* [b], *above*], may increase or decrease the number of shares constituting that series by adopting a resolution for that purpose and executing and filing an amendatory certificate of determination with the Secretary of State. The amendatory certificate (this form) must include an officers' certificate [*see Corp. Code § 173*; *see also § 3.310[1][c]* (discussion of requirements)] that sets forth a copy of the resolution, the number of shares of the series then outstanding, and the increase or decrease in the number of shares constituting the series [*Corp. Code § 401(c)*].

The amendatory certificate may be filed either before or after shares in the affected series have been issued [*see Corp. Code § 401(d)*]. However, if the certificate is filed after shares of the series have been issued, the number of shares may not be decreased below the number of shares of that series then outstanding [*see Corp. Code § 202(e)(3)*; *see also* [b], *above*]. If a certificate of determination is filed to decrease the number of shares of a series to zero, the previously filed certificate of determination that established the series is no longer in force and the series is no longer an authorized series of the corporation [*Corp. Code § 401(f)*].

If a previously filed certificate of determination has been incorporated in restated articles of incorporation that have been filed [*see Corp. Code § 910*], the board (without obtaining shareholder approval that is ordinarily required) [*see Corp. Code § 902*] may increase or decrease the number of shares of a series designated in a previously filed certificate of determination by amending the articles [*Corp. Code § 401(c)*]. Requirements for amending articles of incorporation are covered in Ch. 10, *Amendment of Articles* .

[2] FORM

Amendatory Certificate of Determination to Increase or Decrease Number of Shares in Series Fixed in Previously Filed Certificate of Determination

AMENDATORY CERTIFICATE OF DETERMINATION for _____ [*name of corporation*], a California corporation

_____ [*name of board chairperson, president, or vice-president executing this certificate*] and _____ [*name of secretary, chief financial officer, treasurer, assistant secretary, or assistant treasurer executing this certificate*] certify that:

1. They are the _____ [Board Chairperson *or* President *or* Vice-President] and the _____ [Secretary *or* Assistant Secretary *or* Chief Financial Officer *or* Treasurer *or* Assistant Treasurer], respectively, of _____ [*name of corporation, exactly as of record with office of Secretary of State*], a California corporation.

[*Alternative 1: Use if no shares in affected series have been issued:*]

2. None of the shares of the series designated _____ [*name of affected series*], which is the series of shares affected by this Amendatory Certificate of Determination, has been issued. The effect of this amendatory Certificate of Determination is to increase [*or* decrease] the number of shares in the series designated _____ [*name of affected series, same as above*] from _____[*number*] to _____[*number*].

[*Alternative 2: Use if there are any shares outstanding in affected series.*]

2. There are _____[*number*] shares outstanding in the series designated _____ [*name of affected series*], which is the series of shares affected by this Amendatory Certificate of Determination. The effect of this amendatory Certificate of Determination is to increase [*or* decrease] the number of shares in the series designated

_____ [*name of affected series*] from _____[*number*] to _____ [*number, which if for decrease, is not less than number of shares outstanding*].

[*CONTINUE*]

3. The provision in _____ [*describe location of provision contained in previously filed Certificate of Determination, e.g.,* the RESOLUTION OF THE BOARD OF DIRECTORS set forth in Paragraph 3] of the corporation's Certificate of Determination filed on _____[*date*] which now reads _____ [*set forth exact wording of provision in quotation marks, e.g.,* "The number of shares of this series shall be 1000."] is amended to read _____ [*set forth exact wording for new provision in quotation marks, e.,g.,* "The number of shares of this series shall be 2000."].

4. The foregoing amendment has been duly approved by the Board of Directors in a resolution adopted by it and that is set forth below.

[5. *If appropriate (see § 3.310[1][b]), add:* The rights, preferences, privileges, and restrictions of the _____ (class *or* series) affected by this Amendatory Certificate of Determination and the resolution set forth below contain a supermajority vote provision subject to *Section 710 of the Corporations Code*. The provision has been approved by the shareholders in accordance with subdivision (c) of § 710.]

RESOLUTION OF BOARD OF DIRECTORS

WHEREAS, the Articles of Incorporation of this corporation provide for a class of shares known as Preferred Stock, issuable from time to time in one or more series; and

WHEREAS, the Board of Directors of this corporation is authorized to determine or alter the rights, preferences, privileges, and restrictions granted to or imposed on any wholly unissued series of Preferred Stock and to increase or decrease (but not below the number of shares of such series then outstanding) the number of shares of any series after the issue shares of that series [*or reword to match authorization contained in articles of incorporation*]; and

WHEREAS, the rights, preferences, privileges, and restrictions relating to a series of Preferred shares, designated _____ [*name of affected series, e.g.,* Preferred Series A], were fixed by a resolution by the Board of Directors adopted on _____[*date*] and set forth in a Certificate of Determination filed in the office of the California Secretary of State on _____[*date*]; and

WHEREAS, the number of Preferred shares of that series is _____ [*number, e.g.,* 1000] and this Board of Directors now desires to [increase *or* decrease] that number to _____ [*number, e.g.,* 2000], and there are no limits or restrictions [or if articles do contain limits or restrictions, recite compliance with those] stated in the resolution of the Board of Directors originally fixing the number of shares constituting Preferred shares of that series; and

WHEREAS, none of the shares of this series have been issued by the corporation [*or* there are _____ (*number*) shares outstanding in this series].

IT IS THEREFORE RESOLVED, that the Board hereby amends the provision in _____ [*describe location of provision contained in previously filed Certificate of Determination, e.g.,* the RESOLUTION OF THE BOARD OF DIRECTORS set forth in Paragraph 3] of the corporation's Certificate of Determination filed on _____[*date*], which now reads _____ [*set forth exact wording of provision in quotation marks, e.g.,* "The number of shares of this series shall be 1000."] to read _____ [*set forth*

exact wording for new provision in quotation marks, e.,g., "The number of shares of this series shall be 2000."].

RESOLVED FURTHER, that the Board Chairperson, the President or any Vice-President, and the Secretary, the chief financial officer, the Treasurer, or any Assistant Secretary or Assistant Treasurer of this corporation are each authorized to execute, verify, and file in the office of the California Secretary of State an Amendatory Certificate of Determination in accordance with this resolution and California law.

5. We further declare under penalty of perjury under the laws of the State of California that the matters set forth in this certificate are true and correct of our own knowledge.

Executed on _____[*date*] at _____ [*city and state*].

_____ [*signature*]

[*typed name and title*]

_____ [*signature*]

[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock Certificates



1 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS

2-4 California Legal Forms--Transaction Guide 4.syn

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§ 4.syn Synopsis to Chapter 4: BYLAWS

§ 4.01 California Statutes

§ 4.02 Federal Statutes

§ 4.03 Regulations

§ 4.04 [Reserved]

§ 4.05 Law Reviews

§ 4.06 Annotations

§ 4.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 4.08-4.09 [Reserved]

§ 4.10 Definition and Nature of Bylaws

§ 4.11 Right of Corporation to Adopt Bylaws

§ 4.12 Restrictions on Bylaws

§ 4.13 Who May Adopt, Amend, Repeal Bylaws

§ 4.14 Amending Bylaws of Listed Corporations

§ 4.15 Construction of Bylaws

§ 4.16 Waiver of Bylaws

§ 4.17 Proof of Execution

§ 4.18 Keeping of Bylaws

§§ 4.19-4.99 [Reserved]

§ 4.100 Facts

Scope

§ 4.101 Documents

Scope

§§ 4.102-4.119 [Reserved]

§ 4.120 Preliminary Determinations

Scope

§ 4.121 Drafting Bylaws

Scope

§ 4.122 Preparation of Resolution or Written Consent for Adoption of Bylaws

Scope

§ 4.123 Adoption of Resolution or Execution of Consent

Scope

§ 4.124 Execution of Certificate Authenticating Bylaws

Scope

§§ 4.125-4.129 [Reserved]

§ 4.130 Preliminary Determinations

Scope

§ 4.131 Procedure for Amendment or Repeal of Bylaws

Scope

§§ 4.132-4.199 [Reserved]

§ 4.200 Complete Bylaws--Long Form

[1] Comment

[a] Use of Form

[b] General Drafting Considerations

[c] Use of Statutory Provisions

[d] Variations in Statutory Provisions

[e] Problem in Using Statutory Provisions

[f] Inclusion of Matters Not Regulated by Statute

[g] Amending Bylaws--In General

[h] Listed Corporations

[i] Special Considerations for Close Corporations

[i] Shareholders' Agreement

[ii] Failure to Observe Corporate Formalities

[iii] Transfer of Shares

[iv] Termination of Agreement

[2] Form

Complete Bylaws--Long Form

§ 4.201 Complete Bylaws--Short Form

[1] Comment--Use of Form

[2] Form

Complete Bylaws--Short Form

§§ 4.202-4.209 [Reserved]

§ 4.210 Principal Executive Office [Corp. Code § 1502(a)]

[1] Comment

[a] Use of Form

[b] Designation of Office in Bylaws

[2] Form

Principal Executive Office [Corp. Code § 1502(a)]

§ 4.211 Number of Directors [Corp. Code § 212(a)]

[1] Comment

[a] Use of Form

[b] Number of Directors

[c] Classes of Directors

[2] Form

Number of Directors [Corp. Code § 212(a)]

§ 4.212 Qualifications of Directors [Corp. Code § 212(b)(4)]

[1] Comment

[a] Use of Form

[b] Statutory Authorization

[2] Form

Qualifications of Directors [Corp. Code § 212(b)(4)]

§ 4.213 Filling Vacancies Caused by Other Than Removal of Director [Corp. Code § 305(a)]

[1] Comment

[a] Use of Form

[b] Statutory Authorization

[2] Form

Filling Vacancies Caused by Other Than Removal of Director [Corp. Code § 305(a)]

§ 4.214 Shareholders' Authorization to Board to Fill Board Vacancies Caused by Removal [Corp. Code § 305(a)]

[1] Comment

[a] Use of Form

[b] Statutory Authorization

[2] Form

Shareholders' Authorization to Board to Fill Board Vacancies Caused by Removal [Corp. Code § 305(a)]

§ 4.215 Compensation of Directors [Corp. Code § 212(b)(4)]

[1] Comment--Use of Form

[2] Form

Compensation of Directors [Corp. Code § 212(b)(4)]

§ 4.216 Purposes and Powers [Corp. Code §§ 206, 207, 300, 317]

[1] Comment

[a] Use of Form

[b] Purposes of Corporation

[c] Powers of Corporation

[d] Management of Business and Exercise of Powers

[2] Form

Purposes and Powers [Corp. Code §§ 206, 207, 300, 317]

§ 4.217 Place of Meetings of Directors and Board Committees [Corp. Code §§ 212(b)(2), 307(a)(2), (5), (6), (c)]

[1] Comment

[a] Use of Form

[b] Statutory Authorization

[c] Place of Meetings

[2] Form

Place of Meetings of Directors and Board Committees [Corp. Code §§ 212(b)(2), 307(a)(2), (5), (6), (c)]

§ 4.218 Time and Notice of Meetings of Directors and Board Committees [Corp. Code §§ 113, 212(b)(2), 307(a)(2), (3), (c)]

[1] Comment

[a] Use of Form

[b] Statutory Authorization

[c] Notice and Waiver of Notice

[2] Form

Time and Notice of Meetings of Directors and Board Committees [Corp. Code §§ 113, 212(b)(2), 307(a)(2), (3), (c)]

§ 4.219 Notice of Special Meetings of Directors or Board Committees [Corp. Code §§ 113, 212(b)(2), 307(a)(2), (3), (c)]

[1] Comment--Use of Form

[2] Form

Notice of Special Meetings of Directors or Board Committees [Corp. Code §§ 113, 212(b)(2), 307(a)(2), (3), (c)]

§ 4.220 Calling Special Meetings of Directors or Board Committees [Corp. Code §§ 212(b)(2), 307(a)(1), (c)]

[1] Comment--Use of Form

[2] Form

Calling Special Meetings of Directors or Board Committees [Corp. Code §§ 212(b)(2), 307(a)(1), (c)]

§ 4.221 Quorum for Meetings of Directors [Corp. Code §§ 212(b)(4), 307(a)(7)]

[1] Comment

[a] Use of Form

[b] Statutory Authority

[2] Form

Quorum for Meetings of Directors [Corp. Code §§ 212(b)(4), 307(a)(7)]

§ 4.222 Number of Directors or Committee Members Required for Board or Committee Action [Corp. Code §§ 204(a)(5), 307(a)(8)]

[1] Comment

[a] Use of Form

[b] Transaction of Business

[2] Form

Number of Directors or Committee Members Required for Board or Committee Action [Corp. Code §§ 204(a)(5), 307(a)(8)]

§ 4.223 Conduct of Meetings of Directors and Board Committees [Corp. Code §§ 212(b)(2), 307(a)(6), (c)]--Presiding Officer, Secretary, Procedure

[1] Comment

[a] Use of Form

[b] Statutory Authority

[c] Adjournment for Failure of Quorum

[2] Form

Conduct of Meetings of Directors and Board Committees [Corp. Code §§ 212(b)(2), 307(a)(6), (c)]--Presiding Officer, Secretary, Procedure

§ 4.224 Conduct of Meetings of Directors and Board Committees [Corp. Code § 212(b)(2)]--Order of Business

[1] Comment--Use of Form

[2] Form

Conduct of Meetings of Directors and Board Committees [Corp. Code § 212(b)(2)]--Order of Business

§ 4.225 Action by Directors or Board Committee Members Without Meeting [Corp. Code § 307(b), (c)]

[1] Comment

[a] Use of Form

[b] Action Without Meeting

[2] Form

Action by Directors or Board Committee Members Without Meeting [Corp. Code § 307(b), (c)]

§ 4.226 Board Committees [Corp. Code §§ 307, 311, 1500]

[1] Comment

[a] Use of Form

[b] Appointment of Board Committees

[c] Powers and Limitations

[d] Meetings

[e] Minutes

[2] Form

Board Committees [Corp. Code §§ 307, 311, 1500]

§ 4.227 Qualifications of Shareholders

[1] Comment

[a] Use of Form

[b] Qualifications of Shareholders

[2] FORM

Qualifications of Shareholders

§ 4.228 Place of Shareholders' Meetings [Corp. Code §§ 212(b)(2), 600(a)]

[1] Comment

[a] Use of Form

[b] Statutory Authority

[c] Place of Meetings

[d] Validity of Transactions; Waivers, Consents, and Approvals

[2] FORM

Place of Shareholders' Meetings [Corp. Code §§ 212(b)(2), 600(a)]

§ 4.229 Time of Annual Shareholders' Meeting [Corp. Code §§ 212(b)(2), 600(b)]

[1] Comment

[a] Use of Form

[b] Statutory Authority

[c] Annual Meeting

[d] Selecting Time of Annual Meeting

[e] Failure to Hold Annual Meeting

[2] FORM

Time of Annual Shareholders' Meeting [Corp. Code §§ 212(b)(2), 600(b)]

§ 4.230 Time, Manner of Giving, and Contents of Notice of Shareholders' Meeting [Corp. Code §§ 212(b)(2), 601(a)-(c), (e), (f)]

[1] Comment

[a] Use of Form

[b] Statutory Authority

[c] Time of Notice

[d] Contents of Notice

[e] Manner of Giving Notice

[f] Waiver of Notice by Attendance at Meeting

[g] Validity of Transactions: Waivers, Consents, and Approvals

[2] Form

Time, Manner of Giving, and Contents of Notice of Shareholders' Meeting [Corp. Code §§ 212(b)(2), 601(a)-(c), (e), (f)]

§ 4.231 Adjournment of Shareholders' Meeting [Corp. Code §§ 601(d), 602(c)]

[1] Comment

[a] Use of Form

[b] Adjournment Provisions

[c] Transaction of Business at Adjourned Meeting

[2] Form

Adjournment of Shareholders' Meeting [Corp. Code §§ 601(d), 602(c)]

§ 4.232 Persons Entitled to Call Special Meetings of Shareholders [Corp. Code § 600(d)]

[1] Comment--Use of Form

[2] Form

Persons Entitled to Call Special Meetings of Shareholders [Corp. Code § 600(d)]

§ 4.233 Quorum of Shareholders [Corp. Code §§ 112, 602(a)]

[1] Comment

[a] Use of Form

[b] What Constitutes a Quorum

[c] Effect of Vote if Quorum Present

[2] Form

Quorum of Shareholders [Corp. Code §§ 112, 602(a)]

§ 4.234 Voting for Directors by Ballot [Corp. Code § 708(e)]

[1] Comment--Use of Form

[2] Form

Voting for Directors by Ballot [Corp. Code § 708(e)]

§ 4.235 Shareholders' Meetings--Proxies [Corp. Code §§ 178, 179, 604, 702(a), (d), 704, 705]

[1] Comment

[a] Use of Form

[b] Statutory Authority

[2] Form

Shareholders' Meetings--Proxies [Corp. Code §§ 178, 179, 604, 702(a), (d), 704, 705]

§ 4.236 Conduct of Shareholders' Meetings [Corp. Code § 212(b)(2)]--Presiding Officer, Secretary, and General Rules

[1] Comment

[a] Use of Form

[b] Statutory Authority

[c] Failure to Obtain Quorum

[2] Form

Conduct of Shareholders' Meetings [Corp. Code § 212(b)(2)]--Presiding Officer, Secretary, and General Rules

§ 4.237 Conduct of Shareholders' Meetings [Corp. Code § 212(b)(2)]--Order of Business

[1] Comment--Use of Form

[2] Form

Conduct of Shareholders' Meetings [Corp. Code § 212(b)(2)]--Order of Business

§ 4.238 Appointment, Compensation, and Tenure of Officers [Corp. Code §§ 212(b)(6), 312(a)]

[1] Comment

[a] Use of Form

[b] Statutory Authority

[c] Officers Required

[d] Selection and Tenure of Officers

[e] Resignation

[2] Form

Appointment, Compensation, and Tenure of Officers [Corp. Code §§ 212(b)(6), 312(a)]

§ 4.239 Executive Vice-President [Corp. Code §§ 212(b)(6), 312(a)]

[1] Comment--Use of Form

[2] Form

Executive Vice-President [Corp. Code §§ 212(b)(6), 312(a)]

§ 4.240 Controller [Corp. Code §§ 212(b)(6), 312(a)]

[1] Comment--Use of Form

[2] Form

Controller [Corp. Code §§ 212(b)(6), 312(a)]

§ 4.241 Prohibition Against Issuance of Fractional Shares [Corp. Code § 407]

[1] Comment

[a] Use of Form

[b] Issuance of Fractional Shares

[2] Form

Prohibition Against Issuance of Fractional Shares [Corp. Code § 407]

§ 4.242 Issuance of Partly Paid Shares [Corp. Code §§ 409(d), 410(b), 411-413, 418]

[1] Comment

[a] Use of Form

[b] Issuance of Partly Paid Shares

[c] Share Certificates and Uncertificated Shares

[d] Liability of Transferor and Transferee of Partly Paid Shares

[e] Liability of Holder of Shares

[f] Dividends

[2] Form

Issuance of Partly Paid Shares [Corp. Code §§ 409(d), 410(b), 411-413, 418]

§ 4.243 Employees' Stock Purchase Plan [Corp. Code §§ 207(f), 408]

[1] Comment

[a] Use of Form

[b] Power of Corporation to Provide Plan

[c] Corporations Commissioner's Regulations

[d] Tax Treatment

[2] Form

Employees' Stock Purchase Plan [Corp. Code §§ 207(f), 408]

§ 4.244 Stock Transfer Restrictions [Corp. Code §§ 204(b), 212(b)(1)]

[1] Comment

[a] Use of Form

[b] Statutory Authority

[c] Kinds of Restrictions

[d] Enforceability of Restrictions

[e] Restrictions of Corporations Commissioner

[f] Share Certificates

[2] Form

Stock Transfer Restrictions [Corp. Code §§ 204(b), 212(b)(1)]

§ 4.245 Restriction on Transfer of Shares [Corp. Code §§ 204(b), 212(b)(1)]--Price of Shares Determined by Formula or Arbitration

[1] Comment--Use of Form

[2] FORM

Restriction on Transfer of Shares [Corp. Code §§ 204(b), 212(b)(1)]--Price of Shares Determined by Formula or Arbitration

§ 4.246 Waiver of Annual Report to Shareholders [Corp. Code § 1501]

[1] Comment

[a] Use of Form

[b] When Annual Report Is to Be Sent

[c] Contents of Report

[d] Waiver of Report

[2] Form

Waiver of Annual Report to Shareholders [Corp. Code § 1501]

§ 4.247 Corporate Seal [Corp. Code § 207(a)]

[1] Comment

[a] Use of Form

[b] Definition and Use of "Seal"

[c] Power of Corporation to Adopt Seal

[2] Form

Corporate Seal [Corp. Code § 207(a)]

§ 4.248 Limitations on Amendment of Bylaws [Corp. Code §§ 204(a), 211]

[1] Comment

[a] Use of Form

[b] Limitations on Amendment

[2] Form

Limitations on Amendment of Bylaws [Corp. Code §§ 204(a), 211]

§ 4.249 Loans to or Guarantees of Obligations of Officers or Directors [Corp. Code § 315(b)]

[1] Comment

[a] Use of Form

[b] Authority for Loans and Guarantees

[c] Transactions Secured by Corporate Shares

[d] Excepted Transactions

[2] Form

Loans to or Guarantees of Obligations of Officers or Directors [Corp. Code § 315(b)]

§§ 4.250-4.257 [Reserved]

§ 4.258 Resolution of Incorporator(s) Adopting Bylaws [Corp. Code § 210]

[1] Comment--Use of Form

[2] Form

Resolution of Incorporator(s) Adopting Bylaws [Corp. Code § 210]

§ 4.259 Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Incorporator(s)

[1] Comment--Use of Form

[2] Form

Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Incorporator(s)

§ 4.260 Resolution of Board of Directors Adopting Bylaws [Corp. Code § 211]--Long Form

[1] Comment

[a] Use of Form

[b] Adoption by Directors

[c] Record of Adoption

[2] Form

Resolution of Board of Directors Adopting Bylaws [Corp. Code § 211]--Long Form

§ 4.261 Resolution of Board of Directors Adopting Bylaws--Short Form

[1] Comment--Use of Form

[2] Form

Resolution of Board of Directors Adopting Bylaws--Short Form

§ 4.262 Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Approval of Board of Directors [Corp. Code § 211] at Meeting--Long Form

[1] Comment

[a] Use of Form

[b] Keeping Copy Available to Shareholders

[c] Certification

[2] Form

Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Approval of Board of Directors [Corp. Code § 211] at Meeting--Long Form

§ 4.263 Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314]--Short Form

[1] Comment--Use of Form

[2] Form

Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314]--Short Form

§ 4.264 Written Consent of Directors Adopting Bylaws [Corp. Code §§ 211, 307(b)]--Collective Form

[1] Comment

[a] Use of Form

[b] Adoption by Written Consent

[2] Form

Written Consent of Directors Adopting Bylaws [Corp. Code §§ 211, 307(b)]--Collective Form

§ 4.265 [Reserved]

§ 4.266 Certificate of Secretary of Corporation Authenticating Adoption of Bylaws [Corp. Code § 314] by Unanimous Written Consent of Directors [Corp. Code §§ 211, 307(b)]

[1] Comment--Use of Form

[2] Form

Certificate of Secretary of Corporation Authenticating Adoption of Bylaws [Corp. Code § 314] by Unanimous Written Consent of Directors [Corp. Code §§ 211, 307(b)]

§ 4.267 Written Consent of Outstanding Shares Approving Adoption of Bylaws [Corp. Code §§ 152, 211, 603]--Collective Form

[1] Comment

[a] Use of Form

[b] Adoption by Outstanding Shares

[c] Revocation of Consent

[2] Form

Written Consent of Outstanding Shares Approving Adoption of Bylaws [Corp. Code §§ 152, 211, 603]--Collective Form

§ 4.268 Written Consent of Outstanding Shares Approving Adoption of Bylaws--Individual Form

[1] Comment--Use of Form

[2] Form

Written Consent of Outstanding Shares Approving Adoption of Bylaws--Individual Form

§ 4.269 Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Written Consent of Shareholders [Corp. Code §§ 211, 603]

[1] Comment--Use of Form

[2] Form

Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Written Consent of Shareholders [Corp. Code §§ 211, 603]

§ 4.270 Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Approval of Outstanding Shares at Shareholders' Meeting [Corp. Code §§ 211, 601]

[1] Comment--Use of Form

[2] Form

Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Approval of Outstanding Shares at Shareholders' Meeting [Corp. Code §§ 211, 601]

§ 4.271 Resolution of Board of Directors Repealing Existing Bylaws and Adopting New Bylaws

[1] Comment

[a] Use of Form

[b] Amending and Repealing Bylaws

[c] Nature of Bylaw Being Amended or Repealed

[d] Amending Bylaws of Listed Corporations

[2] Form

Resolution of Board of Directors Repealing Existing Bylaws and Adopting New Bylaws

§ 4.272 Resolution of Board of Directors Repealing Certain Bylaws and Amending Others [Corp. Code § 211]--Long Form

[1] Comment--Use of Form

[2] Form

Resolution of Board of Directors Repealing Certain Bylaws and Amending Others [Corp. Code § 211]--Long Form

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financings.



2 of 166 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS

2-4 California Legal Forms--Transaction Guide Scope

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Scope

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This chapter covers procedure and forms for drafting, adopting, amending, and repealing bylaws of corporations formed under the General Corporation Law [*Corp. Code §§ 1-2319*], that is, stock and profit corporations. Bylaws for professional corporations and for nonprofit corporations and other types of entities, such as agricultural cooperatives and real estate investment trusts, are covered in the chapters dealing with the particular entity.

Particular classes of corporations may be governed by statutes in other codes that may impose, with regard to those corporations, requirements in addition to, or in lieu of, those imposed by the General Corporation Law. For example, banks, trust companies, savings and loan associations, credit unions, escrow agents, indust rial loan companies, pawnbrokers, and personal property brokers are governed by the Financial Code; limited dividend housing c orporations are governed by *Health and Safety Code §§ 34800-34948* and land chest corporations by *Health and Safety Code §§ 35100-35237*; public utilities are governed by the Public Utilities Code. When forming one of these corporations, counsel should check the applicable code to determine what, if any, limitations are imposed on the purposes and powers of the corporation or the content of its bylaws.

The process of drafting bylaws may be as complex and thorough as enumerating all possible provisions, reviewing the law applicable to each and determining the desires of the incorporators concerning the provision, considering alternative phrasing, and, finally, drafting the provision. More commonly, bylaws are prepared by copying a set of bylaws used previously or published in a form book. The minimum requirements for this practice are a careful reading of each provision to be copied and a quick check of the provision against the applicable code section, if any. Whichever method is used, this chapter has been designed to facilitate the proper drafting of bylaws by including the following features:

- Two complete sets of bylaws--a long form and a short form--each with a comment indicating the factors that were considered in drafting the set and the types of provisions that were included or excluded. Within these complete sets of bylaws, applicable code sections are included in the heading of

each provision for quick reference, and following each provision is a reference to other forms containing variations of the same provision and discussion concerning use of the provision.

- Individual forms for particular provisions, usually those in which a variation from the statutory requirement is permitted or those not specifically authorized by statute, with detailed discussion of the use of the provision.

- A transaction guide and forms for resolutions and consents for the adoption, amendment, or repeal of bylaws.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
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2-4 California Legal Forms--Transaction Guide § 4.01

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§ 4.01 California Statutes

Definitions of terms. *Corp. Code §§ 112-195*.

Meaning of terms "majority" or other proportion when articles provide more or less than one vote per share. *Corp. Code § 112*.

Approved by (or approval of) board. *Corp. Code § 151*.

Approved by (or approval of) outstanding shares. *Corp. Code § 152*; *Corp. Code § 700(a)*.

Approved by (or approval of) shareholders. *Corp. Code § 153*.

Articles. *Corp. Code § 154*.

Board as meaning board of directors. *Corp. Code § 155*.

Close corporation. *Corp. Code § 158*.

Directors. *Corp. Code § 164*.

Proxy. *Corp. Code § 178*.

Proxyholder. *Corp. Code § 179*.

Shareholder. *Corp. Code § 185*.

Vacancy when used with respect to board. *Corp. Code § 192*.

Vote. *Corp. Code § 194*.

Voting Power. *Corp. Code § 194.5*.

Written or in writing. *Corp. Code § 195*.

Power of corporation to adopt, amend, and repeal bylaws. *Corp. Code § 207(b)*.

Adoption and amendment of bylaws by incorporators when initial directors were not named in articles and have not yet been elected. *Corp. Code § 210*.

Adoption, amendment, or repeal of bylaws by approval of outstanding shares or by approval of board of directors. *Corp. Code § 211*.

Adoption of bylaw reducing number or minimum number of directors to number less than five, or specifying or changing fixed number of directors or maximum or minimum number or changing from fixed to a variable board or vice versa. *Corp. Code § 212(a)*.

Provision not in conflict with law or articles for management of business and conduct of affairs of corporation. *Corp. Code §§ 212(b)(1), 204(d)*.

Names and addresses of persons appointed to act as initial directors. *Corp. Code §§ 212(b)(1), 204(c)*.

Reasonable restrictions on right to transfer or hypothecate shares. *Corp. Code §§ 212(b)(1), 204(b)*.

Time, place, and manner of calling, conducting, and giving notice of board committee meetings. *Corp. Code §§ 212(b)(2), 307(c)*.

Manner of execution, revocation, and use of proxies. *Corp. Code § 212(b)(3)*.

Qualifications, duties, and compensation of directors. *Corp. Code § 212(b)(4)*.

Requirements of a quorum for directors' meetings and board committee meetings. *Corp. Code §§ 212(b)(4), 307(a)(7)*.

Time of election of directors. *Corp. Code § 212(b)(4)*.

Appointment and authority of board committees. *Corp. Code § 212(b)(5)*.

Appointment, duties, compensation, and tenure of officers. *Corp. Code § 212(b)(6)*.

Mode of determination of holders of record of shares. *Corp. Code § 212(b)(7)*.

Making of annual reports and financial statements to shareholders. *Corp. Code § 212(b)(8)*.

Duty to provide shareholder with copy of bylaws as amended to date, inspection of bylaws by shareholders at reasonable times during office hours. *Corp. Code § 213*.

Limitation on power of board to manage corporation and exercise its corporate powers. *Corp. Code § 300(a)*.

Adoption of amendment by listed corporation to divide board into classes or eliminate cumulative voting. *Corp. Code § 301.5*.

Adoption of bylaw authorizing board of directors to fill vacancies on board occurring by reason of removal of directors. *Corp. Code § 305(a)*.

Appointment of provisional director by superior court when directors are deadlocked. *Corp. Code § 308*.

Specifying authority of board committees; exceptions. *Corp. Code § 311*.

Specification of officers, in addition to chair of board or president or both, secretary, and chief financial officer, with their titles and duties stated; limitation on number of offices that same person may hold. *Corp. Code § 312(a)*.

Manner in which officers will be chosen and serve. *Corp. Code § 312(b)*.

Effect of certification of bylaws by person purporting to be secretary or assistant secretary of corporation. *Corp. Code § 314*.

Statutory provisions governing indemnification not exclusive of other rights granted by article provision, bylaw, agreement, or vote of shareholders or directors. *Corp. Code § 317(g)*.

Indemnification or advance not permitted when inconsistent with provisions of articles, bylaws, resolution of shareholders, agreement, or any condition imposed by court when approving a settlement. *Corp. Code § 317(h)*.

Restrictions in addition to those imposed by statute on declaration of dividends or purchase or redemption of corporation's own shares. *Corp. Code § 505*.

Place and time of annual and special meetings. *Corp. Code § 600*.

Where shareholders' meetings may be held. *Corp. Code § 600(a)*.

Date and time of annual shareholders' meeting. *Corp. Code § 600(b)*.

Who may call special meetings of shareholders. *Corp. Code § 600(d)*.

Notice of adjourned shareholders' meeting. *Corp. Code § 601(d)*.

Specification of business to be transacted at or purpose of any regular or special meeting of shareholders in written waiver of notice. *Corp. Code § 601(e)*.

Vote per share. *Corp. Code § 700(a)*.

Voting of shares by personal representatives or other fiduciaries, minors, entities, or proxies, or shares held of record by two or more persons. *Corp. Code §§ 702-705*.

Voting agreements. *Corp. Code § 706*.

Cumulative voting rights for directors of mutual water companies. *Corp. Code § 708(d)*.

Election of directors by ballot or without ballot. *Corp. Code § 708(e)*.

Amendment or repeal of bylaws by domestic corporation in reorganizations under federal law. *Corp. Code § 1400(b)*.

Waiver of requirement that annual report be sent to shareholders not later than 120 days after close of fiscal year if corporation has less than 100 holders of record of its shares. *Corp. Code § 1501(a)(1)*.

Limiting rights of shareholders or holders of voting trust certificates to inspect and copy record of shareholders' names, addresses, and shareholdings as provided in *Corp. Code § 1600*. *Corp. Code § 1600(d)*.

Limiting rights of shareholders or holders of voting trust certificates to inspect, copy, and make extracts of accounting books and records and minutes as provided in *Corp. Code § 1601*. *Corp. Code § 1601(b)*.



4 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART I. RESEARCH GUIDE
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§ 4.02 Federal Statutes

Submission of bylaws with registration statement where securities are to be registered with Securities and Exchange Commission under Securities Act of 1933 (*15 U.S.C. §§ 77a-77aa*). *15 U.S.C. § 77aa*, Schedule A, P 31(a).

Submission of bylaws with application to register security on national securities exchange. *15 U.S.C. § 78l(b)(2)*.



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CHAPTER 4 BYLAWS
PART I. RESEARCH GUIDE
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2-4 California Legal Forms--Transaction Guide § 4.03

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§ 4.03 Regulations

Filing bylaws with application for permit. *10 Cal. Code Reg. § 260.113.*



6 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART I. RESEARCH GUIDE
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2-4 California Legal Forms--Transaction Guide § 4.04

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§ 4.04[Reserved]



7 of 166 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART I. RESEARCH GUIDE
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2-4 California Legal Forms--Transaction Guide § 4.05

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§ 4.05 Law Reviews

Stein, *How to Use Defined Terms to Make Transactional Documents Work Better*, 43(7) Prac. Law. 15 (1997).

Harris & Bullock, *Reviewing Agreements for Corporate Fiduciaries: A Primer*, 41(4) Prac. Law. 43 (1995).

Freeman, *Shark Repellant Charter and Bylaw Provision, 16 J. Corp. L. 491 (1991).*



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CHAPTER 4 BYLAWS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-4 California Legal Forms--Transaction Guide § 4.06

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§ 4.06 Annotations

Annot., Validity, Construction, and Effect of Provision in Charter or Bylaw Requiring Supermajority Vote, 80 A.L.R.4th 667 (1990) .

Annot., Validity of Stockholders' Agreement Allegedly Infringing on Directors' Management Powers-- Modern Cases, 15 A.L.R.4th 1078 (1982) .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-4 California Legal Forms--Transaction Guide § 4.07

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§ 4.07 Text References

[1] Matthew Bender Sources

Ballantine & Sterling, California Corporation Laws (Matthew Bender).

California Forms of Pleading and Practice, Ch. 165, *Corporations: Corporate Records and Reports* (Matthew Bender).

California Legal Forms (Matthew Bender).
Ch. 3, *Articles of Incorporation.*
Ch. 5, *Directors' Meetings, Actions, and Resolutions.*
Ch. 7, *Corporate Records and Reports*.
Ch. 8A, *Shareholders' Meetings, Voting, and Agreements.*

Cavitch, Business Organizations with Tax Planning (Matthew Bender).

[2] Additional Text References

Witkin, Summary of California Law, vol. 9, *Corporations,* §§ 84-87 (10th ed. 2005).



10 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-4 California Legal Forms--Transaction Guide §§ 4.08-4.09

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§§ 4.08[Reserved]



11 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART II. LEGAL BACKGROUND

2-4 California Legal Forms--Transaction Guide § 4.10

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§ 4.10 Definition and Nature of Bylaws

The term "bylaws" is not defined by statute, but is understood to mean the rules adopted by a corporation for its internal government [*see Corp. Code § 212(b)* (bylaws may be adopted by a corporation for the management of its business and conduct of its affairs)].

Articles of incorporation and bylaws are similar to constitutions and statutes, respectively. Constitutions establish the governmental structure, define and restrict the powers of government, and spell out mandatory duties. Statutes, on the other hand, generally regulate the conduct of citizens in relation to each other and to the government. Articles of incorporation, like constitutions, establish the governing structure of the corporation, limit or restrict its powers if that is desired, and set forth mandatory duties, if any, for the management of the business and conduct of the affairs of the corporation [*see, e.g., Corp. Code §§ 202, 204, 206*]. Bylaws, on the other hand, regulate the management of the business and conduct of the affairs of the corporation generally and prescribe the rights and duties of the members of the corporation towards the corporation and among themselves in reference to the management of its affairs [*see, e.g., Corp. Code § 212(b)*; *see also Olincy v. Merle Norman Cosmetics, Inc. (1962) 200 Cal. App. 2d 260, 267, 19 Cal. Rptr. 387* ; *Casady v. Modern Metal Etc. Mfg. Co. (1961) 188 Cal. App. 2d 728, 733-734, 10 Cal. Rptr. 790* ; *Bornstein v. District Grand Lodge No. 4 (1906) 2 Cal. App. 624, 628* (comparing construction of bylaws with construction of statutes)].

Bylaws have been said to constitute a contract between the shareholders and the corporation, and also a contract among the shareholders [*Casady v. Modern Metal Etc. Mfg. Co. (1961) 188 Cal. App. 2d 728, 732-733, 10 Cal. Rptr. 790]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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CHAPTER 4 BYLAWS
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2-4 California Legal Forms--Transaction Guide § 4.11

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§ 4.11 Right of Corporation to Adopt Bylaws

Corp. Code § 207(b) provides that a corporation may adopt, amend, and repeal bylaws, and *Corp. Code § 211* provides that bylaws may be adopted, amended, or repealed by the shareholders or the board. These sections do not require that a corporation adopt bylaws. Nor can it be said that they authorize a corporation to do so, since it is fundamental in corporation law throughout the United States that the right to be a corporation implies an inherent right to make bylaws so far as they are not inconsistent with the federal or state constitutions, statutory restrictions, provisions in their articles, or essential reasonableness, and that was the rule at common law [*Olincy v. Merle Norman Cosmetics, Inc. (1962) 200 Cal. App. 2d 260, 266-267, 19 Cal. Rptr. 387]* . At most, the statutes merely recognize and confirm the inherent power of a corporation to adopt bylaws.

Although it has the power to adopt bylaws, a corporation is not required to do so [*Canal Oil Co. v. National Oil Co. (1937) 19 Cal. App. 2d 524, 537, 66 P.2d 197]* , and, if the corporation fails to do so, the authority to perform acts that may be controlled by bylaws is vested in the board of directors [*Canal Oil Co. v. National Oil Co. (1937) 19 Cal. App. 2d 524, 537, 66 P.2d 197]* and board committees [*Corp. Code § 300(a)*]. Nevertheless, most corporations adopt bylaws as a part of formation procedure. Failure to adopt bylaws could cause certain difficulties when a state or federal agency regulating the activities of the corporation requires that copies of the charter documents be filed as exhibits to applications. For example, the California Corporations Commissioner requires that a copy of the bylaws be attached to an application for a permit to issue securities [*see 10 Cal. Code Reg. §§ 260.001(a), 260.112, 260.113*]. A copy of the bylaws must be included in the registration statement if securities are to be registered with the Securities and Exchange Commission under the Securities Act of 1933 (*15 U.S.C. §§ 77a-77aa*) [*15 U.S.C. § 77aa*, Schedule A, P 31(a)], in the application if securities are to be registered on a national securities exchange, or in the registration statement filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (*15 U.S.C. §§ 78a-78jj*) [*15 U.S.C. § 78l(b)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewBusiness & Corporate LawCorporationsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



13 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART II. LEGAL BACKGROUND

2-4 California Legal Forms--Transaction Guide § 4.12

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§ 4.12 Restrictions on Bylaws

While a corporation has inherent power to adopt bylaws, the legislature may prescribe the formalities to be observed in their adoption and may limit the scope and subjects for which bylaws may be adopted [*Olincy v. Merle Norman Cosmetics, Inc. (1962) 200 Cal. App. 2d 260, 267, 19 Cal. Rptr. 387]* . The bylaws thus may not be in conflict with law, or with the corporation's articles of incorporation [*Corp. Code § 212(b)*]. Bylaws are subject to the further general requirement that they be reasonable [*see Olincy v. Merle Norman Cosmetics, Inc. (1962) 200 Cal. App. 2d 260, 266-267, 19 Cal. Rptr. 387* (not inconsistent with essential reasonableness); *Mancini v. Patrizi (1927) 87 Cal. App. 435, 439-440, 262 P. 375* (must not be unreasonable in their practical application); *Bornstein v. District Grand Lodge No. 4 (1906) 2 Cal. App. 624* (bylaw must be reasonable); *see also* Ballantine & Sterling, California Corporation Laws, § 54.03[1] (Matthew Bender)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART II. LEGAL BACKGROUND

2-4 California Legal Forms--Transaction Guide § 4.13

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§ 4.13 Who May Adopt, Amend, Repeal Bylaws

Bylaws may be adopted, amended, or repealed by the approval of the outstanding shares, as that term is defined in *Corp. Code § 152*, or by approval of the board of directors [*Corp. Code § 211*], or by the incorporator(s) if initial directors were not named in the articles and have not yet been elected [*Corp. Code 210*]. However, after shares have been issued, a bylaw specifying or changing a fixed number of directors or the maximum or minimum number in the case of a variable board, or changing from a fixed to a variable board or vice versa, may be adopted only by approval of the outstanding shares [*Corp. Code §§ 211, 212(a)*]. The articles of incorporation (or, in the case of a close corporation, a shareholders' agreement [*see Corp. Code §§ 154, 158, 186*]) may, however, require the vote of a larger proportion or all of the shares of any class or series, or the vote or quorum for taking action of a larger proportion or all of the directors than is otherwise required by the General Corporation Law [*Corp. Code § 204(a)(5)*], to adopt, amend, or repeal bylaws [*see Corp. Code § 204(a)(9)*]. In addition, the bylaws themselves may require the vote of a majority of the authorized number of directors [*see Corp. Code § 204(a)*], rather than a majority of the directors present at a meeting at which a quorum is present [*see Corp. Code §§ 151, 211, 307(a)(8)*], to amend or repeal the bylaws. On the other hand, subject to *Corp. Code § 204(a)(5)*, either the articles or the bylaws may restrict or eliminate the power of the board to adopt, amend, or repeal any or all bylaws [*Corp. Code § 211*]. Board committees have no power to adopt, amend, or repeal bylaws [*Corp. Code § 311(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Bylaws



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART II. LEGAL BACKGROUND

2-4 California Legal Forms--Transaction Guide § 4.14

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§ 4.14 Amending Bylaws of Listed Corporations

A listed corporation, by amendment of its bylaws (or articles), may adopt provisions to divide the board of directors into two or three classes to serve for terms of two or three years respectively, or to eliminate cumulative voting [*Corp. Code § 301.5(a)*; *see Corp. Code § 301(a)*]. A "listed corporation" is a corporation with outstanding shares listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market [*Corp. Code § 301.5(d)*]. After issuance of shares, a corporation that is not a listed corporation may adopt those provisions pursuant to amendment of its bylaws (or articles), to take effect when it becomes a listed corporation [*Corp. Code § 301.5(a)*; *see Corp. Code § 301.5(g), (i)* (effective date of amendment); *see also Corp. Code § 301.5(e), (f), (h)* (effect of loss of listed corporation status)].

A bylaw (or article) amendment providing for division of the board of directors into classes, a change in the number of classes, or the elimination of cumulative voting, may be adopted only by the approval of the board [*see Corp. Code § 151*] and the outstanding shares [*see Corp. Code § 152*] voting as a single class, notwithstanding the requirements of *Corp. Code § 903* (shareholder approval of amendments) [*Corp. Code § 301.5(a)*]. If the board of directors is divided into two classes pursuant to the amendment, the authorized number of directors must be no fewer than six, and one half of the directors (or as close an approximation as possible) must be elected at each annual meeting. If the board is divided into three classes, the authorized number must be no fewer than nine, and one third (or as close an approximation as possible) must be elected at each annual meeting. Directors of a listed corporation may be elected by classes at a shareholder meeting at which an amendment adopting provisions for dividing the board into classes is approved. However, the extended terms for directors are contingent on approval of the amendment [*Corp. Code § 301.5(b)*]. If directors for more than one class will be elected by the shareholders at any one meeting and the election is by cumulative voting [*see Corp. Code § 708*], votes may be cumulated only for directors to be elected within each class [*Corp. Code § 301.5(c)*].

If a listed corporation adopts this amendment to the bylaws, the amendment must include a statement of the facts showing that the corporation is a listed corporation [*Corp. Code § 301.5(j)*; *see Corp. Code § 301.5(d)* (definition of "listed corporation")]. If a corporation that is not yet listed adopts this type of bylaw amendment, the provision as

adopted must include the following statement or its substantial equivalent [*Corp. Code § 301.5(j)*]: "This provision shall become effective only when the corporation becomes a listed corporation within the meaning of *§ 301.5 of the Corporations Code*."

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Bylaws



16 of 166 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART II. LEGAL BACKGROUND

2-4 California Legal Forms--Transaction Guide § 4.15

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§ 4.15 Construction of Bylaws

Bylaws are to be reasonably construed and should be given a construction that will sustain their validity. Thus, if a bylaw is reasonably susceptible to different constructions, one in harmony and the other in conflict with a statute, the former construction will be adopted. Likewise, a bylaw will be construed in harmony with the articles of incorporation if it is reasonably susceptible to that construction [*Olincy v. Merle Norman Cosmetics, Inc. (1962) 200 Cal. App. 2d 260, 272, 19 Cal. Rptr. 387]* . Moreover, a bylaw, like a statute, will not be construed to operate retrospectively unless its terms expressly so provide [*Casady v. Modern Metal etc. Mfg. Co. (1961) 188 Cal. App. 2d 728, 733, 10 Cal. Rptr. 790]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsInterpretation of Bylaws



17 of 166 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART II. LEGAL BACKGROUND

2-4 California Legal Forms--Transaction Guide § 4.16

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.16 Waiver of Bylaws

The shareholders or members of a corporation may waive the protection of bylaws that operate in their favor by express ratification of action in conflict with the bylaws. Ratification may be made by the vote of the same pcentage of shares necessary to enact the bylaw [*Horner v. Marine Engineers' Etc. Ass'n. (1959) 175 Cal. App. 2d 837, 842, 1 Cal. Rptr. 113* ; *see People's Home Sav. Bank v. Rickard (1903) 139 Cal. 285, 292, 73 P. 858* (holding that a bylaw relating to the transfer of stock was waived by the corporation for whose protection it was made, and that the corporation, having once waived the requirements of its bylaws by accepting defendant as a stockholder, entering the transfer in its books, and issuing her a certificate, which she accepted, could not subsequently obviate the effect of the waiver); *see also §§ 4.11, 4.13*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsInterpretation of Bylaws



18 of 166 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART II. LEGAL BACKGROUND

2-4 California Legal Forms--Transaction Guide § 4.17

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.17 Proof of Execution

The original or a copy (in writing or in any other form capable of being converted into clearly legible tangible form) of the bylaws certified to be a true copy by a person purporting to be the secretary or an assistant secretary of the corporation is prima facie evidence of the adoption of those bylaws and the matters stated in them [*Corp. Code § 314*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART II. LEGAL BACKGROUND

2-4 California Legal Forms--Transaction Guide § 4.18

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§ 4.18 Keeping of Bylaws

The corporation is required to keep the original or a copy of its bylaws, as amended to date, at its principal executive office in California or, if its principal executive office is not in this state, at its principal business office in this state. In addition, the bylaws must be open to inspection by the shareholders at all reasonable times during office hours [*Corp. Code § 213*].

If the principal executive office of the corporation is outside the state of California, and the corporation has no principal business office in this state, it must furnish to the shareholder, on written request, a copy of the bylaws as amended to date [*Corp. Code § 213*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholders



20 of 166 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART II. LEGAL BACKGROUND

2-4 California Legal Forms--Transaction Guide §§ 4.19-4.99

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§§ 4.19[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-4 California Legal Forms--Transaction Guide § 4.100

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§ 4.100 Facts

NOTE:

The following section contains lists of bylaws provisions contained in the forms in this chapter. This section may be used as a quick checklist of facts to be obtained from the client. Cross references to forms and paragraph numbers where the provisions appear are included for each provision. Some of the statutory provisions are mandatory and may not be changed by the bylaws; others may be changed by the articles but not by the bylaws; still others may be changed or varied by the bylaws in whole or in part [see *§ 4.271[1]*]. Mandatory statutory provisions apply whether or not set forth in the bylaws. They are included in the bylaws merely for the information of management and the shareholders. Two statutes in the General Corporation Law require that certain matters be set forth in the bylaws. *Corp. Code § 212(a)* requires that the number of directors, or the minimum and maximum number in the case of a variable board, be stated in the bylaws, and *Corp. Code § 600(b)* requires that the date and time of the shareholders' annual meeting, or the manner of fixing the date and time, be stated in the bylaws. However, these provisions may be included in the articles in addition to, or in lieu of, being set forth in the bylaws [*see Corp. Code §§ 204(d), 212(a)*]. If the provisions are set forth in the articles, however, they cannot be changed by an amendment to the bylaws; rather, the articles themselves will have to be amended. The cost to the client of preparation and filing of an amendment to the articles of incorporation should be considered when deciding whether the provision should appear in the bylaws or the articles.

1. Provisions governing location of corporate office:

a. Street address of corporation's principal executive office [*Corp. Code § 1502(a)(4)*; *see §§ 4.200[2]*, P 1.01; *4.201*, P 1.01; *4.210*].

b. If address of corporation's principal executive office is not in California, street address of its principal business office in this state, if any [*Corp. Code § 1502(6)*].

2. Provisions governing directors and board committees:

a. Number of directors, or minimum and maximum number in case of variable board [*Corp. Code § 212(a)*; *see §§ 4.200[2],* P 2.03; *4.201[2],* P 2.02; *4.211*].

b. Qualifications of directors [*Corp. Code § 212(b)(4)*; *see § 4.212*].

c. Election of directors and terms of office [*Corp. Code § 301*; *see §§ 4.200[2],* P 2.04; *4.201[2],* P 2.03].

d. Election of directors by ballot or voice vote [*Corp. Code § 708(e)*; *see §§ 4.200[2],* P 4.07; *4.201[2],* P 3.07; *4.234*].

e. Duties and compensation of directors [*Corp. Code § 212(b)(4)*; *see §§ 4.200[2],* PP 2.02, 2.21, 2.22; *4.201[2],* P 2.14; *4.215*].

f. Resignation of directors [*Corp. Code § 305(d)*; *see § 4.200[2],* P 2.05].

g. Place of board and board committee meetings [*Corp. Code §§ 212(b)(2), 307(a)(2), (5), (6), (c)*; *see §§ 4.200[2],* P 2.09; *4.201[2],* P 2.07; *4.217*].

h. Time and notice of board and board committee meetings [*Corp. Code §§ 113, 212(b)(2), 307(a)(2), (3), (c)*].

i. Calling special meetings of board or board committee [*Corp. Code §§ 212(b)(2), 307(a)(1), (c)*; *see §§ 4.200[2],* P 2.08; *4.201[2],* P 2.06; *4.220*].

j. Number of directors or committee members constituting quorum [*Corp. Code §§ 212(b)(4), 307(a)(7), (c)*; *see §§ 4.200[2],* P 2.13; *4.201[2],* P 2.10; *4.221*].

k. Number of directors or committee members required for board or committee action [*Corp. Code §§ 307(a)(8), (c)*; *see §§ 4.200[2],* PP 2.14, 2.15; *4.201[2],* P 2.11; *4.222*].

l. Conduct of board and board committee meetings [*Corp. Code §§ 212(b)(2), 307(a)(6), (c)*; *see §§ 4.200[2],* PP 2.18, 2.19; *4.201[2],* P 2.13; *4.223*; *4.224*].

m. Adjournment of board meetings [*Corp. Code § 307(a)(4)*; *see § 4.200[2],* P 2.16].

n. Action by directors or board committee members without meeting [*Corp. Code § 307(b), (c)*; *see §§ 4.200[2],* P 2.20; *4.225*].

o. Transactions of directors with corporation [*Corp. Code § 310*; *see § 4.200[2],* P 2.23].

p. Liability of directors to corporation [*Corp. Code § 316*; *see § 4.200[2],* P 2.24].

q. Indemnification of directors and employees [*Corp. Code § 317*; *see §§ 4.200[2],* PP

2.25-2.32; *4.201[2]*, P 2.15].

r. When vacancy on board occurs [*Corp. Code §§ 192, 302-304*; *see §§ 4.200[2]*, P 2.06; *4.201[2]*, P 2.04].

s. Filling vacancies on board [*Corp. Code § 305(a)*; *see §§ 4.200[2]*, PP 2.06, 2.07; *4.213*; *4.214*].

t. Board committees [*Corp. Code § 311*; *see §§ 4.200[2]*, P 2.33; *4.226*].

3. Provisions governing shareholders and shareholders' meetings:

a. Special qualifications of shareholders [*see § 4.227*].

b. Determining shareholders of record [*Corp. Code § 701*; *see § 4.200[2]*, P 3.01].

c. Place of shareholders' meetings [*Corp. Code §§ 212(b)(2), 600(a)*; *see §§ 4.200[2]*, P 4.01; *4.201[2]*, P 3.01; *4.228*].

d. Time of annual shareholders' meetings [*Corp. Code § 212(b)(2), 600(b)*; *see §§ 4.200[2]*, P 4.02; *4.201[2]*, P 3.02; *4.229*].

e. Notice of meetings [*Corp. Code §§ 212(b)(2), 601(a)-(c), (e), (f)*; *see 4.200[2]*, PP 4.03(a)-(d), (f), 4.04(a); *4.201[2]*, P 3.04; *4.230*].

f. Adjournment of shareholders' meetings [*Corp. Code §§ 601(d), 602(c)*; *see §§ 4.200[2]*, PP 4.03(e), 4.05(c); *4.201[2]*, P 3.06; *4.231*].

g. Calling of, and persons entitled to call, special meetings [*Corp. Code §§ 177, 212(b)(2), 600(d), 601(c)*; *see §§ 4.200[2]*, P 4.04; *4.201[2]*, P 3.03; *4.232*].

h. Quorum of shareholders [*Corp. Code §§ 112, 602(a)*; *see §§ 4.200[2]*, P 4.05; *4.201[2]*, P 3.06; *4.233*].

i. Effect of vote at meeting [*Corp. Code §§ 112, 602(a)*; *see § 4.200[2]*, P 4.06].

j. Voting of shares [*Corp. Code §§ 112, 407, 700*; *see § 4.200[2]*, PP 4.07-4.11].

k. Proxies [*Corp. Code §§ 178, 179, 604, 702(a), (d), 704, 705*; *see §§ 4.200[2]*, P 4.12; *4.235*].

l. Voting agreement and trust [*Corp. Code § 706*; *see § 4.200[2]*, P 4.13].

m. Inspectors of election [*Corp. Code § 707*; *see § 4.200[2]*, P 4.14].

n. Conduct of meetings [*Corp. Code § 212(b)(2)*; *see §§ 4.200[2]*, P 4.15; *4.236*; *4.237*].

o. Action without meeting [*Corp. Code § 603*; *see § 4.200[2]*, P 4.16].

4. Provisions governing officers:

a. Enumerated [*Corp. Code §§ 212(b)(6), 312(a)*; *see §§ 4.200[2],* PP 5.01, 5.03; *4.238*].

b. Appointment [*Corp. Code §§ 212(b)(6), 312(b)*; *see §§ 4.200[2],* P 5.02; *4.238*].

c. Compensation [*Corp. Code § 212(b)(6)*; *see §§ 4.200[2],* P 5.13; *4.238*].

d. Tenure [*Corp. Code § 212(b)(6)*; *see § 4.238*].

e. Removal and resignation [*Corp. Code §§ 212(b)(6), 312(b)*; *see §§ 4.200[2],* P 5.04; *4.238*].

f. Vacancies [*Corp. Code §§ 212(b)(6), 312(a)*; *see § 4.200[2],* P 5.05].

g. Duties:
(1) Board chairperson [*Corp. Code §§ 212(b)(6), 312(a), 416(a)*; *see §§ 4.200[2],* P 5.06; *4.201[2],* P 4.02].

(2) President [*Corp. Code §§ 212(b)(6), 312(a), 416(a), 703(a)*; *see §§ 4.200[2],* P 5.07; *4.201[2],* P 4.03].

(3) Vice-President [*Corp. Code §§ 212(b)(6), 312(a)*; *see §§ 4.200[2],* P 5.08; *4.201[2],* P 4.04].

(4) Executive Vice-President [*Corp. Code §§ 212(b)(6), 312(a)*; *see § 4.239*].

(5) Secretary [*Corp. Code §§ 212(b)(6), 312(a), (c), 314, 416(a), 1500, 1600(a), (d), 1601, 1602*; *see §§ 4.200[2],* P 5.09; *4.201[2],* P 4.05].

(6) Assistant Secretary [*Corp. Code §§ 212(b)(6), 312(a)*; *see § 4.200[2],* P 5.10].

(7) Treasurer or Chief Financial Officer [*Corp. Code §§ 114, 212(b)(6), 312(a), 416(a), 1500, 1501, 1601, 1602*; *see §§ 4.200[2],* P 5.11; *4.201[2],* P4.06].

(8) Assistant Treasurer [*Corp. Code §§ 212(b)(6), 312(a)*; *see § 4.200[2],* P 5.12].

(9) Controller [*Corp. Code §§ 212(b)(6), 312(a)*; *see § 4.240*].

5. Provisions governing issuance of shares and share certificates:

a. Authority to issue [*Corp. Code §§ 207(d), 400(a)*; *see § 4.200[2],* P 7.01(a)].

b. Fractional shares [*Corp. Code § 407*; *see §§ 4.200[2],* P 7.02; *4.241*].

c. Partly paid shares [*Corp. Code §§ 409(d), 410(b), 411-413, 418*; *see §§ 4.200[2],* P 7.03; *4.242*].

d. Consideration for shares [*Corp. Code § 409*; *see § 4.200[2],* P 7.01(c)].

e. Options [*Corp. Code § 404*; *see § 4.200[2],* P 7.04].

f. Preemptive rights [*Corp. Code § 406*; *see § 4.200[2]*, P 7.05].

g. Employee plans [*Corp. Code §§ 207(f), 408*; *see §§ 4.200[2]*, P 7.06; *4.243*].

h. Certificates of determination [*Corp. Code §§ 173*, *401*; *see § 4.200[2]*, P 7.07].

i. Share certificates [*Corp. Code §§ 407, 409(d), 416(a)*; *see §§ 4.200[2]*, PP 7.08, 7.09; *4.201[2]*, PP 6.01, 6.02; *4.242[2]*].

j. Exchange of certificates [*Corp. Code § 422*; *see §§ 4.200[2]*, P 7.10; *4.201[2]*, P 6.03].

k. Issuance of new certificate for one lost, stolen, or destroyed [*Corp. Code § 419(a)*; *Com. Code § 8405(b)*; *see §§ 4.200[2]*, P 7.11; *4.201[2]*, P 6.04].

NOTE:
A bond or other security is a prerequisite to the replacement of a lost, stolen, or destroyed certificate [***see*** *Corp. Code § 419(a)*; ***see also*** *Com. Code § 8405(a)*]. The Bond and Undertaking Law [*Code Civ. Proc. §§ 995.010-996.560*] provides that an undertaking may be substituted for any bond required by statute [***see*** *Code Civ. Proc. § 995.210(a)*].

l. Alternative system in lieu of certificates [*Corp. Code § 416(b)*; *see § 4.200[2]*, P 7.12].

NOTE:
For a general discussion of certificated and uncertificated securities, see "Share Certificates--Issuance" and subsequent headings in the Legal Background to Ch. 6I, *Issuance of Equity Securities*.

6. Provisions governing transfer of shares:

a. Duty of corporation [*Com. Code § 8401*; *see § 4.200[2]*, P 8.01].

b. Nonliability of corporation [*Com. Code § 8404*; *see § 4.200[2]*, P 8.02].

c. Liability of corporation [*Com. Code §§ 8104, 8210, 8405*; *see § 4.200[2]*, P 8.03].

d. Liability of transferor and transferee of partly paid shares [*Corp. Code §§ 411, 412*; *see § 4.200[2]*, P 8.04].

e. Restrictions on transfer [*Corp. Code §§ 204(b), 212(b)(1)*; *see §§ 4.244[2], 4.245[2]*].

7. Provisions governing corporate records, reports, and seal:

a. Duty to keep minutes, books and records of account, and record of shareholders [*Corp. Code § 1500*; *see § 4.200[2]*, PP 9.01-9.03].

b. Shareholders' right to inspect corporate records [*Corp. Code §§ 1600(a), (d), 1601*; *see §§ 4.200[2]*, PP 9.04, 9.05; *4.201[2]*, P 7.02].

c. Directors' right to inspect corporate records and properties [*Corp. Code § 1602*; *see §§ 4.200[2]*, P 9.06; *4.201[2]*, P 7.02].

d. Annual report [*Corp. Code § 1501*; *see §§ 4.200[2]*, P 9.07; *4.201[2]*, P 7.03; *4.246[2]*].

e. Special financial statements to shareholders [*Corp. Code § 1501(c), (d)*; *see § 4.200[2]*, P 9.08].

f. Fiscal year [*see § 4.200[2]*, P 9.09].

g. Seal [*Corp. Code § 207(a)*; *see §§ 4.200[2]*, P 9.10; *4.216[2]*, P (b)(1); *4.247[2]*].

8. Provisions governing certification, inspection, amendment, and construction of bylaws:

a. Inspection and certification [*Corp. Code §§ 213, 314*; *see § 4.200[2]*, P 10.01].

b. Adoption, amendment, and repeal of bylaws [*Corp. Code §§ 207(b), 211, 212*; *see §§ 4.200[2]*, PP 10.02, 10.03; *4.216[2]*, P (b)(2); *4.248[2]*].

c. Construction of bylaws [*see § 4.200[2]*, P 11.01].

9. Miscellaneous provisions:

a. Execution of instruments [*see §§ 4.200[2]*, PP 6.01-6.03; *4.201[2]*, P 5.01].

b. Deposit and withdrawal of funds [*see § 4.200[2]*, P 6.04].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Bylaws



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-4 California Legal Forms--Transaction Guide § 4.101

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§ 4.101 Documents

1. Any proposed drafts of bylaws.

2. Any bylaws of former corporation or related corporation.

3. Any other documents concerning required or useful bylaws for management of corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to BylawsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



23 of 166 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-4 California Legal Forms--Transaction Guide §§ 4.102-4.119

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Adoption of Initial Bylaws

2-4 California Legal Forms--Transaction Guide § 4.120

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.120 Preliminary Determinations

NOTE:

Bylaws may be adopted by either (1) the approval of the outstanding shares, that is, by the affirmative vote of a majority of the outstanding voting shares [*Corp. Code § 152*], at a shareholders' meeting [***see*** *Corp. Code § 601(a)*] or, unless otherwise provided in the articles of incorporation, by the written consent of a majority of the outstanding shares without a meeting [*Corp. Code §§ 194, 603(a)*]; or (2) by the approval of the board of directors [*Corp. Code § 211*], that is, by the affirmative vote of a majority of the directors present at a meeting duly held at which a quorum is present [***see*** *Corp. Code §§ 151, 307(a)(8)*] or by the unanimous written consent of the directors without a meeting [*Corp. Code §§ 194, 307(b)*].

The articles, however, may prohibit shareholder action by written consent [*Corp. Code § 603(a)*], may require the vote of a larger proportion or of all of the shares of any class or series, or the vote or quorum for taking action of a larger proportion or of all of the directors [*Corp. Code § 204(a)(5)*] for the adoption of bylaws, or may restrict or eliminate the power of the board to adopt any or all bylaws [*Corp. Code § 211*].

If initial directors were not named in the articles and have not yet been elected, bylaws may be adopted by the incorporators [*Corp. Code § 210*].

1. Determine if there are any requirements, limitations, or restrictions on adoption of bylaws set forth in articles of incorporation.

NOTE:

If there are limitations or restrictions, they must be complied with [***see*** NOTE, ***above***].

2. Determine manner in which bylaws are to be adopted:

a. By resolution adopted by the incorporator(s).

b. By resolution at first meeting of board of directors (most common manner of adopting initial bylaws).

c. By unanimous written consent of directors without meeting.

d. By affirmative vote of outstanding voting shares at shareholders' meeting.

e. By written consent of outstanding voting shares without meeting, if not prohibited by articles.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Adoption of Initial Bylaws

2-4 California Legal Forms--Transaction Guide § 4.121

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.121 Drafting Bylaws

1. Determine purpose and importance of bylaws for particular corporation, and desires of incorporators for including statutory provisions governing their activities, varying these statutory provisions when allowed, and adding other regulations not prohibited by statute [*see § 4.200[1]*].

NOTE:
These determinations will govern the content and length of the bylaws, and will indicate to counsel the amount of time that should be spent in analysis and phrasing of the various possible provisions. At the time bylaws are prepared, the incorporators generally have little concern over what they should provide. Therefore, it is up to counsel to anticipate their needs, and to suggest what the bylaws should include and how they should be used.

2. Select best method for preparing bylaws under the circumstances, either:

a. For each possible provision:
(1) Consider governing law.

(2) Determine whether provision should be included.

(3) Determine whether there are any alternative provisions that would be better under the circuumstances.

(4) If provision is to be included, draft it accordingly.

b. Select one of complete sets of bylaws provided in this chapter [*see §§ 4.200* (long form), *4.201* (short

form)] after reading provisions and checking code section or sections governing provision as indicated in heading of provision.

c. Purchase and fill in blanks of pretyped bylaws prepared and sold by printing or attorneys' supply companies.

NOTE:

Certain printing companies in California sell prepared bylaws. These companies also include two copies of bylaws in a kit containing the minute book, first minutes, stock certificates, and corporate seal. Although these prepared forms are commonly used for small corporations, these forms have significant drawbacks. First and foremost, they do not permit modification or customization to fit a particular corporation. Moreover, they can become outdated due to changes in the law or the corporation and require amendment. The need for amendment may be difficult to detect because they do not include citations to the relevant statutory provisions to facilitate review. In contrast, the forms in this chapter do contain such provisions.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Adoption of Initial Bylaws

2-4 California Legal Forms--Transaction Guide § 4.122

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.122 Preparation of Resolution or Written Consent for Adoption of Bylaws

1. If adoption is to be by resolution of the incorporator(s) (if initial directors were not named in the articles and have not yet been elected), draft resolution. [*see* § 4.257].

2. If adoption is to be by resolution of board of directors adopted at first directors' meeting, draft resolution [*see §§ 4.260, 4.261*].

3. If adoption is to be by written consent of directors without meeting, prepare written consent for execution by directors [*see §§ 4.264, 4.265*].

4. If adoption is to be by resolution adopted by holders of outstanding voting shares at shareholders' meeting, draft resolution [*see § 4.267*].

5. If adoption is to be written consent of holders of outstanding voting shares, prepare written consent to be submitted to shareholders for their signatures [*see §§ 4.267, 4.268*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Adoption of Initial Bylaws

2-4 California Legal Forms--Transaction Guide § 4.123

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.123 Adoption of Resolution or Execution of Consent

1. Adopt bylaws by one of following methods:

a. By incorporator(s) immediately after articles of incorporation are filed, if initial directors were not named in articles and directors have not yet been elected;

b. At first meeting of board of directors; or

NOTE:
A resolution adopting the bylaws is customarily adopted at the first meeting of the board of directors [***see*** Ch. 5, ***Directors' Meetings, Actions, and Resolutions***].

c. By written consent of directors without meeting immediately after articles of incorporation are filed.

2. If bylaws are to be adopted by holders of outstanding voting shares, wait until after shares have been issued.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



28 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Adoption of Initial Bylaws

2-4 California Legal Forms--Transaction Guide § 4.124

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.124 Execution of Certificate Authenticating Bylaws

1. Place certificate on last page of bylaws [*see §§ 4.200, 4.201*].

2. State manner in which bylaws were adopted:

   a. Adopted by resolution of the incorporator(s) [*see § 4.258*].

   b. Adopted by board resolution at meeting [*see § 4.262*].

   c. Adopted by written consent of directors without meeting [*see § 4.266*].

   d. Adopted by vote of holders of outstanding voting shares at meeting [*see § 4.270*].

   e. Adopted by written consent of holders of outstanding voting shares without meeting [*see § 4.269*].

3. Direct secretary or assistant secretary of corporation to sign certificate [*Corp. Code § 314*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



29 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Adoption of Initial Bylaws

2-4 California Legal Forms--Transaction Guide §§ 4.125-4.129

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

[Reserved]

§§ 4.125[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures--Amendment or Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.130

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.130 Preliminary Determinations

1. Determine whether specific bylaws sought to be amended or repealed merely duplicate provisions set forth in articles of incorporation.

NOTE:
If they do, the amendment or repeal of the bylaws cannot be effective until articles themselves are amended [***see*** *Corp. Code § 212(b)*].

2. Determine if there are any limitations or restrictions on amendment or repeal of bylaws in articles of incorporation or in bylaws; such as:

NOTE:
These limitations may be imposed on who may amend or repeal bylaws generally [***see*** *Corp. Code § 211*], or the vote required to amend or repeal bylaws generally, or on the amendment or repeal of specific bylaws [***see*** *Corp. Code §§ 204(a)(5), 204(a),* last paragraph].

a. Articles of incorporation or bylaws may restrict or eliminate power of board of directors to amend or repeal any or all bylaws [*Corp. Code § 211*].

b. Articles may require larger vote for amendment or repeal of bylaws than would otherwise be required [*Corp. Code § 204(a)(5)*].

c. Articles may prohibit action by shareholders by written consent [*Corp. Code § 603(a)*].

d. Bylaws may require approval by majority of authorized directors for amendment or repeal of bylaws [*see Corp. Code § 204(a)*, last paragraph].

3. Determine if there are any statutory restrictions on amendment or repeal of specific bylaws in question.

NOTE:

For example, after shares have been issued, a bylaw specifying or changing the fixed number of directors or the maximum or minimum number or changing from a fixed to a variable board or vice versa may be adopted only by approval of the outstanding shares; that is, by the affirmative vote of a majority of the outstanding shares entitled to vote [*Corp. Code § 212(a)*; ***see*** *Corp. Code § 152* ("approved by the outstanding shares" defined)]. A bylaw or amendment of the articles reducing the fixed number or minimum number of directors to a number of directors less than five cannot be adopted if the votes cast against its adoption at the meeting, or the shares not consenting in the case of action by written consent, are equal to more than 16 2/3 percent of the outstanding shares entitled to vote [*Corp. Code § 212(a)*].

4. Subject to any applicable limitations and restrictions [*see* Paragraphs 2, 3, *above*], determine whether amendment or repeal is to be by:

a. Resolution of board of directors approved at meeting.

b. Unanimous written consent of directors without meeting.

c. Vote of holders of outstanding voting shares at shareholders' meeting.

d. Written consent of holders of outstanding voting shares without meeting.

5. Determine whether corporation is "listed corporation" [*see Corp. Code § 301.5*].

NOTE:

A listed corporation may amend its bylaws to divide the board of directors into classes or eliminate cumulative voting [Civ. Code § 301.5(a)]. A corporation is "listed" if it has outstanding securities listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market [*Corp. Code § 301.5(d)*; *see § 4.14*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to BylawsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



31 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures--Amendment or Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.131

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.131 Procedure for Amendment or Repeal of Bylaws

1. Prepare directors' resolution [*see §§ 4.271*, *4.272*], unanimous written consent of directors [*see §§ 4.264*, *4.265*], written sonsent of incorporators if no directors have been elected [*see § 4.258*], or written consent of holders of outstanding voting shares [*see §§ 4.267*, *4.268*] and have it adopted or executed.

2. Prepare certificate of amendment or repeal and have it signed by secretary or assistant secretary of corporation [*Corp. Code § 314*].

3. Make changes in original bylaws or redraft bylaws to incorporate changes and have them certified as true and correct by secretary or assistant secretary of corporation [*Corp. Code § 314*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Bylaws



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures--Amendment or Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide §§ 4.132-4.199

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

[Reserved]

§§ 4.132[Reserved]



33 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
A. Sets of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.200

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.200 Complete Bylaws--Long Form

[1] Comment

[a] Use of Form

This form is a comprehensive set of bylaws detailing the duties, liabilities, and limitations imposed by the General Corporation Law [*Corp. Code §§ 1-2319*]. Because it provides a detailed list of the requirements that will determine the corporation's operating framework, this form may be particularly appropriate for corporations that will not have a regularly employed or retained legal counsel to advise them in matters relating to their corporate operations. In that situation, however, care should be taken to explain to the officers and directors the need to comply with the bylaws and the limitations on their ability to amend provisions that reflect statutory requirements [*see* [e], [g], *below*].

The secretary's certificate at the end of the bylaws is for use if the bylaws are adopted at the first meeting of directors, as is usually the case. For other methods of adoption, and appropriate certificates, see Part C.

This form assumes that the corporation has elected to issue stock certificates rather than utilize an electronic system of issuance, recordation, and transfer [*see Corp. Code § 416(b)*]. Paragraph 7.12 of the form allows the corporation to adopt this alternative system of uncertificated securities. For a general discussion of certificated and noncertificated securities, see Ch. 6K, *Nonissuer Transactions in Investment Securities* , and Ch. 6I, *Issuance of Equity Securities* .

[b] General Drafting Considerations

The general issues to be determined in preparing bylaws are the following:

- Whether to restate or paraphrase statutory regulations of the corporation's affairs for the information of the directors, officers, and shareholders.

- Whether to vary the statutory requirements by a specific bylaw when permitted by statute.

- Whether to add additional regulations not specifically governed by statute but authorized to be included in the bylaws, either by a specific code section [*see, e.g., Corp. Code § 212(b)*] or by the inherent power of the corporation to adopt bylaws not in conflict with law or with its articles of incorporation.

The answers to all of these questions require a general familiarity with the provisions of the Corporations Code governing directors, officers, and shareholders, and a thorough understanding of all those code sections specifically mentioning bylaws.

[c] Use of Statutory Provisions

Many aspects of the internal affairs of a corporation are dictated by statute, but significant statutory requirements customarily are restated in the bylaws for the information and guidance of the directors, officers, and shareholders, who do not usually have the statutes available for reference. In restating statutory provisions, the basic issues are the following:

- Which provisions to include; and

- Whether to set the provisions out in full or to paraphrase or condense them.

The statutory provisions that should considered for inclusion in the bylaws are those governing the following issues:

- Directors and management [*Corp. Code §§ 300-317*].

- Issuance of shares [*Corp. Code §§ 400-415, 423*].

- Certificates and transfer of shares [*Corp. Code §§ 416-422*].

- Shareholders' meetings [*Corp. Code §§ 600-605*].

- Voting rights [*Corp. Code §§ 700-709*].

- Corporate records and reports [*Corp. Code §§ 1500-1508*].

The blocks of sections noted above contain some reference to bylaws and cover subjects referred to by *Corp. Code § 212(b)*, which lists some of the permissible bylaws. The provisions concerning dividends and purchase and redemption of shares are a notable exception [*Corp. Code §§ 500-511*]. These sections could be restated in bylaws, but they are lengthy and usually are not included. This form includes all the appropriate statutory regulations that would customarily be found in bylaws of a California corporation. Only those code sections within the series stated above that do not concern internal corporate relationships have been excluded.

Once the pertinent statutory provisions have been selected, the next question is whether to use the statutory language or to paraphrase or summarize that language. If the statutory regulation is worth including in the bylaws, it is worth including accurately and fully. The danger in rewording a statement of law is obvious. In the bylaws below, all pertinent statutory regulations that commonly appear in bylaws have been included in the language of the statute, except for minor changes necessary to make the provision applicable to a specific corporation rather than every corporation. In the heading of each provision the code section from which the provision was taken is indicated, so that counsel may quickly make a comparison if necessary. Since brevity may be desirable in some situations, a set of bylaws that covers many of

the same regulations, in condensed form, is furnished in § 4.201.

[d] Variations in Statutory Provisions

Some statutory rules do not apply if the bylaws provide otherwise. In including these statutory rules, it must be determined whether it is advisable to alter them. In general, the statutory provisions are reasonable and should not be varied unless there is special justification.

[e] Problem in Using Statutory Provisions

One of the problems that may occur if statutory requirements are set forth in the bylaws is that if the statute is amended or repealed, the bylaw must also be amended or removed to comply with the statutory change. Otherwise, the bylaw might be cease to reflect the applicable law and therefore be invalid [*see Corp. Code § 212(b)*]. This problem can be reduced by either noting in the bylaws themselves the statute on which the provision is based, or keeping a separate record of it, checking new legislation annually to see whether any of these statutes have been amended or repealed and, if they have, amending the bylaws accordingly. Normally, new legislation (other than urgency legislation and legislation with a delayed operative date) takes effect on January 1 of the year following its enactment.

[f] Inclusion of Matters Not Regulated by Statute

Bylaws may include any provision for the management of the business and the conduct of corporate affairs that is not in conflict with the law or with the corporation's articles of incorporation [*Corp. Code § 212(b)*]. Thus, in addition to matters regulated by statute, other matters that the corporation wishes to formally regulate should be considered. Examples of regulations that frequently appear in bylaws, in addition to those matters specified in *Corp. Code § 212(b)*, are the following:

- Authorization for execution of instruments and making deposits of funds [*see* [2], PP 6.01-6.04, *below*].
- The establishment of a fiscal year [*see* [2], P 9.09, *below*].
- Adoption and design of a corporate seal [*see* [2], P *9.10, below*].

[g] Amending Bylaws--In General

When amending bylaws, the attorney should first check the statute governing the particular provision sought to be amended, to ensure that the amendment is permissible. If it is, the attorney should then check the articles of incorporation to ensure that the proposed amendment is not contrary to any article provision [*see Corp. Code § 212(b)*]. Finally, the drafting attorney should check the bylaws themselves to verify that the proposed amendment does not conflict with some other provision in the bylaws, and that any requirements set forth regarding the manner of amendment are complied with.

[h] Listed Corporations

A listed corporation, by amendment of its bylaws, may adopt provisions to divide the board of directors into two or three classes to serve for terms of two or three years respectively, or to eliminate cumulative voting [*Corp. Code § 301.5(a)*; *see Corp. Code § 301(a)*]. If cumulative voting is eliminated, a listed corporation may amend its bylaws to provide that, in an uncontested election, approval of a majority, rather than a plurality, of the shareholders is required to elect a director [*Corp. Code § 708.5(b)*; *see Corp. Code § 708.5(a)(1)* ("uncontested election" defined)]. A "listed corporation" is a corporation with outstanding shares listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market [*Corp. Code § 301.5(d)*].

A corporation that is not a listed corporation, after issuance of shares, may adopt the above provisions pursuant to amendment of its bylaws (or articles), to take effect when it becomes a listed corporation [*Corp. Code § 301.5(a)*].

The bylaw amendment is required to contain particular language when the corporation adopts the amendment before becoming a listed corporation [*see Corp. Code § 301.5(j)*]. For further discussion, see *§ 4.14*.

[i] Special Considerations for Close Corporations

[i] Shareholders' Agreement

To the extent and so long as a shareholders' agreement controls the discretion or powers of the board in its management of corporate affairs, each shareholder who is a party to the agreement is liable for managerial acts performed or omitted by that shareholder pursuant to the agreement, to the extent that the General Corporation Law ordinarily would impose liability on the directors. When liabilitry attaches to the shareholders in this manner, the directors are relieved of liability to that extent [*Corp. Code § 300(d)*].

Notwithstanding *Corp. Code § 300(a)* specifying the corporate powers to be exercised by the board, or any other provision of the General Corporation Law (but subject to *Corp. Code § 300(c)*, discussed *below*), no shareholders' agreement [*see Corp. Code §§ 154, 186*] that relates to any phase of the affairs of a close corporation, including but not limited to management of its business, division of its profits, or distribution of its assets on liquidation, is invalid as between the parties to it on the ground that it so relates to the conduct of the affairs of the corporation as to interfere with the board's discretion, or that it is an attempt to treat the corporation as if it were a partnership or to arrange their relationships in a manner that would be appropriate only between partners [*Corp. Code § 300(b)*]. However, this rule does not apply to an agreement authorized by *Corp. Code § 706(a)*, relating to voting agreements [*Corp. Code § 300(b)*].

A shareholders' agreement may not alter or waive the provisions of *Corp. Code §§ 158* (defining and setting forth the requirements of a close corporation), *417*, *418* (share certificates), and *500*, *501* (distributions to a corporation's shareholders [*see Corp. Code § 166*]), or of *Corp. Code §§ 1111* (mergers), *1201(e)* (reorganizations), and *§§ 2009-2011* (dissolution of corporation), or of Chapters 15 [*Corp. Code §§ 1500-1508* (records and reports)], 16 [*Corp. Code §§ 1600-1605* (rights of inspection of corporate books, records, and shareholders' record)], 18 [*Corp. Code §§ 1800-1809* (involuntary dissolution)], and 22 [*Corp. Code §§ 2200-2260* (crimes and penalties)]. All other provisions of the General Corporation Law may be altered or waived as between the parties to a shareholders' agreement, except the required filing of any document with the Secretary of State [*Corp. Code § 300(c)*].

For detailed coverage of shareholders' agreements, see Ch. 8C, *Close Corporation Shareholder Agreements* . For coverage of voting agreements, see Ch. 8B, *Voting Agreements and Voting Trusts* .

[ii] Failure to Observe Corporate Formalities

The failure of a close corporation to observe corporate formalities relating to meetings of directors or shareholders in connection with the management of its affairs pursuant to a shareholders' agreement is not a factor tending to establish that the shareholders have personal liability for corporate obligations [*Corp. Code § 300(e)*]. That is, it is not a factor in determining the applicability of the alter ego doctrine.

[iii] Transfer of Shares

When shares are covered by a shareholders' agreement and that agreement has been filed with the secretary of the corporation for inspection by any prospective purchaser of shares, a transferee of the shares who has actual knowledge of the agreement, or notice of it by a notation on the certificate pursuant to *Corp. Code § 418*, is bound by its provisions

and is a party to the agreement for the purposes of *Corp. Code § 300(d)*. The agreement may not be modified, extended, or revoked without the transferee's consent, subject to any provision of the agreement permitting modification, extension, or revocation by less than unanimous agreement of the parties. A transferor of shares covered by the agreement ceases to be a party to it on ceasing to be a shareholder of the corporation [*Corp. Code § 300(b)*].

[iv] Termination of Agreement

Original issuance of shares by the corporation to a new shareholder who does not become a party to a shareholders' agreement terminates the agreement, except that if the agreement so provides, it will continue to the extent it is enforceable apart from the General Corporation Law. The agreement also terminates when the corporation ceases to be a close corporation [*Corp. Code § 300(b)*].

[2] Form

Complete Bylaws--Long Form

BYLAWS OF _____ [*name of corporation*]

ARTICLE I
OFFICES

Principal Executive Office [*Corp. Code § 1502(a)*]

1.01. The principal executive office of the corporation shall be located at _____[*complete address*].

[*See § 4.210 for alternative provisions.*]

Other Offices

1.02. The corporation may also have offices at any other places, within or without the State of California, where the corporation is qualified to do business, as the Board of Directors may from time to time designate or the business of the corporation may require.

ARTICLE II
DIRECTORS

Definitions

"Board"

2. 01 (a) As used in these Bylaws, the word "Board" means the Board of Directors of the corporation.

"Directors"

(b) "Directors," as used in these bylaws in relation to any power or duty requiring collective action, means the Board of Directors of the corporation.

Responsibility of Board [*Corp. Code § 300(a)*]

2.02. Subject to the provisions of the General Corporation Law and to any limitations in the Articles of Incorporation relating to action required to be approved by the shareholders, as that term is defined in *California Corporations Code § 153*, or by the outstanding shares, as that term is defined in *California Corporations Code § 152*, the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the Board of Directors. The Board may delegate the management of the day-to-day operation of the business of the corporation to a management company or other person provided that the business and affairs of the corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the Board.

[*See § 4.216 for comment and consolidation of this provision with provisions setting forth purposes and powers of corporation. See § 4.200[1][i], above, for discussion of the applicability of this provision to close corporations.*]

Number of Directors [*Corp. Code § 212(a)*]

2.03. The number of directors of the corporation shall be _____ [*number not less than three, provided, however, that (1) before shares are issued, the number may be one; (2) before shares are issued, the number may be two; (3) as long as the corporation has one shareholder, the number may be one or two, and (4) as long as the corporation has only two shareholders, the number may be two*].

[*For limitation on amendment of this provision, see PP 10.02 and 10.03 of this form. See § 4.211 for comment and alternative provisions. For provisions setting forth qualifications of directors, see § 4.212.*]

Election and Term of Office [*Corp. Code § 301*]

2.04. Directors shall be elected at each annual meeting of shareholders to hold office until the next annual meeting. Each director, including a director elected to fill a vacancy (see Paragraph 2.07 of these Bylaws), shall hold office until the expiration of the term for which he or she was elected and until a successor has been elected and qualified.

[*See § 4.201, P 2.03, for alternative provision.*]

Resignation [*Corp. Code § 305(d)*]

2.05. Any director may resign effective on giving written notice to the Board Chairperson, the President, the Secretary, or the Board of Directors of the corporation, unless the notice specifies a later time for the effectiveness of the resignation. If the resignation is effective at a future time, a successor may be elected to take office when the resignation becomes effective.

Vacancies [*Corp. Code §§ 192, 302-304*]

When Vacancy Occurs [*Corp. Code § 192*]

2.06. (a) A vacancy on the Board occurs when any authorized position of director is not filled by a duly elected director, whether caused by death, resignation, removal, change in the authorized number of directors (by the Board or the shareholders), or otherwise.

[*If a corporation has not issued shares and all the directors resign, die, or become incompetent, or the corporation's*

initial directors have not been named in the articles and all the incorporators resign, die, or become incompetent before the election of the initial directors, the superior court of any county may appoint directors of the corporation on application by any party in interest (Corp. Code § 306).]

Declaration of Vacancy [*Corp. Code § 302*]

(b) The Board may declare vacant the office of a director who has been declared of unsound mind by an order of court or convicted of a felony.

Removal of Director by Shareholders
[*Corp. Code § 303(a)*]

(c) Any or all of the directors may be removed without cause if removal is approved by the outstanding shares, as that term is defined in *California Corporations Code Section 152*, subject to the following:

(1) No director may be removed (unless the entire Board is removed) when the votes cast against removal, or not consenting in writing to that removal, would be sufficient to elect that director if voted cumulatively at an election at which the same total number of votes were cast (or, if action is taken by written consent, all shares entitled to vote were voted) and the entire number of directors authorized at the time of the director's most recent election were then being elected; and

(2) When by the provisions of the Articles the holders of the shares of any class or series, voting as a class or series, are entitled to elect one or more directors, any director so selected may be removed only by the applicable vote of the holders of the shares of that class or series.

[*See § 4.201, P 2.04, for alternative provision.*]

Removal by Court [*Corp. Code § 304*]

(d) Shareholders holding at least 10 percent of the number of outstanding shares of any class of the corporation may sue in the superior court of the county in which the principal executive office of the corporation is located to remove from office any director in case of fraudulent or dishonest acts or gross abuse of authority or discretion with reference to the corporation. In that case, the corporation shall be made a party to the action.

Reduction of Authorized Number of Directors
[*Corp. Code § 303(b)*]

(e) Any reduction of the authorized number of directors sallnot remove any director prior to the expiration of the director's term of office.

Provisions Exclusive [*Corp. Code § 303(c)*]

(f) Except as provided in subparagraphs (a) through (d) of this Paragraph 2.06, no director may be removed from office prior to the expiration of the director's term of office.

Filling Vacancies

By Board [*Corp. Code § 305(a)*]

2.07. (a) Except as otherwise provided in the Articles or in these Bylaws, and except for a vacancy created by the removal of a director as provided in Paragraph 2.06, vacancies on the Board may be filled by approval of the Board pursuant to *Corporations Code Section 151*, or, if the number of directors then in office is less than a quorum, by (1) the unanimous written consent of the directors then in office; (2) the affirmative vote of a majority of the directors then in office at a meeting held pursuant to notice or waivers of notice complying with *Corporations Code Section 307*; or *(3)* a sole remaining director.

[*See § 4.213 for alternative provisions.*]

By Shareholders [*Corp. Code §§ 305(a), (b), 603(d)*]

(b) Unless the Articles or a bylaw adopted by the shareholders provide that vacancies occurring in the Board by reason of the removal of directors may be filled by the Board, those vacancies may be filled only by approval of the shareholders, as that term is defined in *Corporations Code Section 153*. Moreover, the shareholders may elect a director at any time to fill any vacancy not filled by the directors. Directors may be elected by written consent only upon the unanimous written consent of all shares entitled to vote for the election of directors, except that the shareholders may elect a director to fill a vacancy, other than a vacancy created by removal, by the written consent of a majority of the outstanding shares entitled to vote.

PRACTICE TIP:

The requirement that written consent of the shareholders in the election of directors (other than filling vacancies not created by removal) be *unanimous* is one of the most frequently overlooked provisions of the California Corporations Code. *Commentary by Mary E. Ahern.*

[*See § 4.214 for comment and alternative provision.*]

By Special Meeting [*Corp. Code § 305(c)*]

(c) If, after the filling of any vacancy by the directors, the directors then in office who have been elected by the shareholders shall constitute less than a majority of the directors then in office, any holder or holders of an aggregate of 5 percent or more of the total number of shares at the time outstanding having the right to vote for the directors may call a special meeting of the shareholders, or apply to the superior court of the county in which the principal executive office of the corporation is located for an order that a special meeting be held to elect the entire Board. The term of office of any director not elected by the shareholders shall terminate on the election of a successor.

[*The procedure for applying to the court for this type of order and the hearing on the application is set forth in Corp. Code § 305(c).*]

Call of Meetings [*Corp. Code §§ 212(b)(2), 307(a)(1)*]

2.08. Meetings of the Board may be called by the Board Chairperson, or the President, or any Vice-President, or the Secretary, or any two directors of the corporation.

[*See § 4.220 for comment and alternative provisions.*]

Place of Meetings [*Corp. Code §§ 212(b)(2), 307(a)(5)*]

2.09. Meetings of the Board may be held at any place within or without California that has been designated in the notice of the meeting or, if not stated in the notice or if there is no notice, designated by resolution of the Board, and if not so designated, then at the principal executive office of the corporation.

[*See § 4.201, P 2.07, and § 4.217 for alternative provisions.*]

Time of Regular Meetings
[*Corp. Code §§ 212(b)(2), 307(a)(2)*]

2.10. Regular meetings of the Board of Directors shall be held on _____ [*date or day, e.g.*, the 15th day of each calendar month *or* the first and 15th days of each calendar month *or* the first Tuesday of each calendar month *or* Wednesday of each week] commencing at the hour of _____ M.

[*See § 4.201[2], P 2.08, and § 4.218 for alternative provisions.*]

Notice of Meetings [*Corp. Code §§ 20, 113, 118, 212(b)(2), 307(a)(2)*]

2.11. Regular meetings of the Board may be held without notice. Special meetings shall be held on four days notice by first-class mail, postage prepaid, or 48 hours notice delivered personally or by telephone, including a voice messaging system or by electronic transmission by the corporation. The notice need not specify the purpose of the meeting.

[*See § 4.201[2], P 2.09, and §§ 4.218, 4.219 for alternative provisions.*]

Waiver of Notice [*Corp. Code §§ 212(b)(2), 307(a)(2), (3)*]

2.12. Notice of any meeting need not be given to any director who signs a waiver of notice, or a consent to holding the meeting or an approval of the minutes of the meeting, whether before or after the meeting, or who attends the meeting without protesting, prior to the meeting or at its commencement, the lack of notice to the director. Any waiver of notice need not specify the purpose of the meeting. All waivers, consents, and approvals of minutes shall be filed with the corporate records or made a part of the minutes of the meeting to which they pertain.

[*See § 4.201[2], P 2.09, and § 4.218 for alternative provisions.*]

Quorum [*Corp. Code §§ 212(b)(4), 307(a)(7)*]

2.13. A majority of the authorized number of directors constitutes a quorum of the Board for the transaction of business.

[*See § 4.221 for comment and alternative provisions.*]

Transactions of Board [*Corp. Code § 307(a)(8)*]

2.14. Except as otherwise provided in the Articles of Incorporation or in these Bylaws, every act or decision done or made by a majority of the directors present at a meeting duly held at which a quorum is present is the act of the Board, subject to the provisions of Paragraphs 2.23 and 2.28 of these Bylaws.

[*See § 4.222 for Comment and alternative provisions.*]

Withdrawal of Quorum [*Corp. Code § 307(a)(8)*]

2.15. Any meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for the meeting.

[*See § 4.222 for Comment and alternative provisions.*]

Adjournment [*Corp. Code § 307(a)(4)*]

2.16. A majority of the directors present, whether or not a quorum is present, may adjourn any meeting to another time and place.

Notice of Adjournment [*Corp. Code § 307(a)(4)*]

2.17. If the meeting is adjourned for more than 24 hours, however, notice of the adjournment to another time or place must be given prior to the time of the adjourned meeting to the directors who were not present at the time of the adjournment.

Conduct of Meetings [*Corp. Code § 212(b)(2)*]

2.18. At every meeting of the Board, the Board Chairperson or, in the Chairperson's absence, the President of the corporation or, in the President's absence, the Vice-President designated by the President, or, in the absence of a designation, a chairperson chosen by a majority of the directors present shall preside. The Secretary of the corporation shall act as Secretary of the Board. In the event the Secretary is absent from any meeting, the Chairperson may appoint any person to act as secretary of the meeting.

Telephone and Electronic Participation
[*Corp. Code §§ 212(b)(2), 307(a)(6)*]

2.19. Members of the Board may participate in any meeting through use of conference telephone, electronic video screen communication, or electronic transmission by and to the corporation.

Participation in a meeting through use of conference telephone or electronic video screen communication pursuant to this Paragraph constitutes presence in person at that meeting as long as all members participating in the meeting are able to hear one another.

Participation in a meeting through electronic transmission by and to the corporation (other than conference telephone and electronic video screen communication) constitutes presence in person at that meeting if both of the following are true:

(1) Each board member participating in the meeting can communicate with all of the other members concurrently.

(2) Each member is provided the means of participating in all matters before the board, including the capacity to propose, or interpose an objection, to a specific action to be taken by the corporation.

[*See § 4.223 for comment and alternative provisions.*]

Action Without Meeting [*Corp. Code § 307(b)*]

2.20. Any action required or permitted to be taken by the Board may be taken without a meeting if all members of the Board individually or collectively consent in writing to the action, provided that the number of Board members serving at the time the action is taken constitutes a quorum. The written consent or consents must be filed with the minutes of the proceedings of the Board.

[*See § 4.225 for comment and alternative provisions.*]

Duties of Directors [*Corp. Code § 309*]

2.21. (a) Each director shall perform the duties of a director, including duties as a member of any committee of the Board on which the director may serve, in good faith, in a manner the director believes to be in the best interests of the corporation and its shareholders and with the care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.

(b) In performing his or her duties each director shall be entitled, so long as he or she acts in good faith after reasonable inquiry when the need for it is indicated by the circumstances and without knowledge that would cause the reliance to be unwarranted, to rely on information, opinions, reports, or statements, including financial statements and other financial data, in each case prepared or presented by:

(1) One or more officers or employees of the corporation whom the director believes to be reliable and competent in the matters presented.

(2) Counsel, independent accountants, or other persons as to matters that the director believes to be within the person's professional or expert competence.

(3) A committee of the Board on which the director does not serve, as to matters within its designated authority, which committee the director believes to merit confidence.

(c) A person who performs the duties of director in accordance with subparagraphs (a) and (b) of this Paragraph 2.21 shall have no liability based on any alleged failure to discharge the person's obligation as a director.

Compensation [*Corp. Code § 212(b)(4)*]

2.22. Directors shall receive the compensation for their services and reimbursement for their expenses as shall be determined from time to time by resolution of the Board. Any director may serve the corporation in any other capacity as an officer, agent, employee, or otherwise and receive compensation for that service.

[*See § 4.215 for comment and alternative provision.*]

Transactions With Corporation [*Corp. Code § 310*]

2.23. (a) No contract or other transaction between the corporation and one or more of its directors, or between the corporation and any corporation, firm, or association in which one or more of the directors of this corporation has a material financial interest, is either void or voidable because the director or directors or the other corporation, firm, or association are parties or because the director or directors are present at the meeting of the Board or Board committee that authorizes, approves, or ratifies the contract or transaction, if:

(1) The material facts regarding the transaction and regarding the director's interest are fully disclosed or known to the shareholders and the contract or transaction is approved by the shareholders, as that term is defined in *Section 153 of the California Corporations Code*, in good faith, and the shares owned by the interested director or directors are prohibited from voting on the contract or transaction, or

(2) The material facts regarding the transaction and regarding the director's interest are fully disclosed or known to the Board or Board committee, and the Board or Board committee authorizes, approves, or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the interested director or directors and the contract or transaction is just and reasonable as to the corporation at the time it is authorized, approved, or ratified, or

(3) Regarding contracts or transactions not approved as provided in clauses (1) and (2), above, of this subparagraph (a), the person asserting the validity of the contract or transaction sustains the burden of proving that the contract or transaction was just and reasonable with regard to the corporation at the time it was authorized, approved, or ratified.

A mere common directorship does not constitute a material financial interest within the meaning of the above provisions. A director is not interested within the meaning of the above provisions in a resolution fixing the compensation of another director as a director, officer, or employee of the corporation, notwithstanding the fact that the first director is also receiving compensation from the corporation.

(b) No contract or other transaction between the corporation and any corporation or association of which one or more of the directors of this corporation are directors is either void or voidable because the director or directors are present at the Board or Board committee meeting that authorizes, approves, or ratifies the contract or transaction, if:

(1) The material facts regarding the transaction and regarding the director's other directorship are fully disclosed or known to the Board or Board committee, and the Board or Board committee authorizes, approves, or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the common director or directors, or

(2) As to contracts or transactions not approved as provided in clause (1) of this subparagraph (b), the contract or transaction is just and reasonable as to the corporation at the time it is authorized, approved, or ratified.

This provision does not apply to contracts or transactions covered by subparagraph (a) of this Paragraph 2.23.

(c) Interested or common directors may be counted in determining the presence of a quorum at a meeting of the Board or Board committee that authorizes, approves, or ratifies a contract or transaction.

Liability of Directors [*Corp. Code § 316(a), (b), (e)*]

2.24. (a) Subject to the provisions of Paragraph 2.21 of these Bylaws, directors who approve any of the following

corporate actions will be jointly and severally liable to the corporation for the benefit of all of the creditors or shareholders entitled to institute an action under *Section 316(c) of the California Corporations Code*:

(1) The making of any distribution to its shareholders, as that term is defined in *Section 166 of the California Corporations Code*, to the extent that it is contrary to the provisions of *California Corporations Code Sections 500 to 503*, inclusive.

(2) The distribution of assets to shareholders after institution of dissolution proceedings of the corporation, if any, without paying or adequately providing for all known liabilities of the corporation, excluding any claims not filed by creditors within the time limit set in the notice given to creditors under the provisions of *California Corporations Code Sections 1800 to 2011*, inclusive.

(3) The making of any loan or guaranty contrary to *Section 315 of the California Corporations Code*.

(b) A director who is present at a meeting of the Board, or any Board committee, at which action specified in subparagraph (a) of this Paragraph 2.24 is taken and who abstains from voting will be considered to have approved the action.

(c) Directors liable under this Paragraph of these Bylaws shall be entitled to be subrogated to the rights of the corporation:

(1) With regard to clause (1) of subparagraph (a) of this Paragraph 2.24, against shareholders who received the distribution.

(2) With regard to clause (2) of subparagraph (a) of this Paragraph 2.24, against shareholders who received the distribution of assets.

(3) With regard to clause (3) of subparagraph (a) of this Paragraph 2.24, against the person who received the loan or guaranty.

[*Who may bring the action against the directors, the amount of damages recoverable, and procedure for subrogation are set forth in Corp. Code § 316(c)-(f).*]

Indemnification [*Corp. Code § 317*]

Definitions [*Corp. Code § 317(a)*]

2.25. (a) For the purposes of Paragraphs 2.26-2.32 of these Bylaws, "agent" means any person who is or was a director, officer, employee, or other agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, or other enterprise [, or was a director, officer, employee, or agent of a foreign or domestic corporation that was a predecessor corporation of the corporation or of another enterprise at the request of the predecessor corporation].

(b) For the purposes of Paragraphs 2.26-2.32 of these Bylaws, "proceeding" means any threatened, pending, or completed action or proceeding, whether civil, criminal, administrative, or investigative; and "expenses" include without limitation attorneys' fees and any expenses of establishing a right to indemnification under Paragraph 2.27 or subparagraph (d) of Paragraph 2.28.

[*See § 4.201[2], P 2.15, and § 4.216 [2], P (b)(9), for alternative provisions for use in lieu of PP 2.25-2.32 of this form.*]

Power to Indemnify [*Corp. Code § 317(b), (c)*]

2.26. (a) The corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any proceeding (other than an action by or in the right of the corporation to procure a judgment in its favor) by reason of the fact that that person is or was an agent of the corporation, against expenses, judgments, fines, settlements, and other amounts actually and reasonably incurred in connection with that proceeding if the person acted in good faith and in a manner the person reasonably believed to be in the best interests of the corporation and, in the case of a criminal proceeding, had no reasonable cause to believe the conduct of that person was unlawful. The termination of any proceeding by judgment, order, settlement, conviction, or on a plea of nolo contendere or its equivalent shall not, of itself, create a presumption that the person did not act in good faith and in a manner that the person reasonably believed to be in the best interests of the corporation or that the person had reasonable cause to believe was unlawful.

(b) The corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending, or completed action by or in the right of the corporation to procure a judgment in its favor by reason of the fact that the person is or was an agent of the corporation, against expenses actually and reasonably incurred by the person in connection with the defense or settlement of that action if that person acted in good faith, in a manner the person believed to be in the best interests of the corporation and its shareholders. No indemnification shall be made for any of the following:

(1) Any claim, issue, or matter for which any person has been adjudged liable to the corporation in the performance of that person's duty to the corporation and its shareholders, unless and only to the extent that the court where the proceeding was or is pending determines on application that, in view of all the circumstances of the case, the person is fairly and reasonably entitled to indemnity for expenses, and then only to the extent that the court determines;

(2) Amounts paid in settling or otherwise disposing of a threatened or pending action without court approval; or

(3) Expenses incurred in defending a threatened or pending action that is settled or otherwise disposed of without court approval.

Expenses of Successful Agent [*Corp. Code § 317(d)*]

2.27. To the extent that an agent of this corporation has been successful on the merits in the defense of any proceeding referred to in Paragraph 2.26 or in defense of any claim, issue, or matter specified in that paragraph, the agent shall be indemnified against expenses actually and reasonably incurred by the agent in connection with the matter.

Determination That Indemnification Is Proper [*Corp. Code § 317(e)*]

2.28. Except as provided in Paragraph 2.27, any indemnification under Paragraphs 2.26-2.31 of these Bylaws will be made by the corporation only if authorized in the specific case, on a determination that indemnification of the agent is proper in the circumstances because the agent has met the applicable standard of conduct set forth in Paragraph 2.26 by any of the following:

(a) A majority vote of a quorum consisting of directors who are not parties to that proceeding;

(b) If a quorum of directors is not obtainable, by independent legal counsel in a written opinion;

(c) Approval of the shareholders, as that term is defined in *Section 153 of the California Corporations Code*, and the shares owned by the person to be indemnified are not entitled to vote on the matter; or

(d) The court where that proceeding is or was pending on application made by the corporation or the agent or the attorney or other person rendering services in connection with the defense, whether or not the application by the agent, attorney, or other person is opposed by the corporation.

Advance of Expenses [*Corp. Code § 317(f)*]

2.29. Expenses incurred in defending any proceeding may be advanced by the corporation before the final disposition of that proceeding on receipt of an undertaking by or on behalf of the agent to repay that amount if it is determined ultimately that the agent is not entitled to be indemnified as authorized in Paragraphs 2.26-2.31 of these Bylaws. An advancement of expenses under this Paragraph does not violate the prohibition against corporate loans to officers of *Corporations Code Section 315(a)* or result in any liability to any director approving the advancement under Paragraph 2.24.

Nonexclusive Provisions [*Corp. Code § 317(g)*]

2.30. The indemnification authorized by Paragraphs 2.26-2.31 of these Bylaws shall not be deemed exclusive of any additional rights to indemnification for breach of duty to the corporation and its shareholders while acting in the capacity of a director or officer of the corporation to the extent the additional rights to indemnification are authorized in an article provision adopted pursuant to *California Corporations Code Section 204(a)(11)*. The indemnification provided by Paragraphs 2.26-2.31 of these Bylaws for acts, omissions, or transactions while acting in the capacity of, or while serving as, a director or officer of the corporation but not involving breach of duty to the corporation and its shareholders shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled under any bylaw, agreement, vote of shareholders or disinterested directors, or otherwise, to the extent the additional rights to indemnification are authorized in the Articles.

An Article provision authorizing indemnification "in excess of that otherwise permitted by *Corporations Code Section 317*" or "to the fullest extent permissible under California law" or the substantial equivalent of this provision shall be construed to be both a provision for additional indemnification for breach of duty to the corporation and its shareholders as referred to in, and with the limitations required by, *California Corporations Code Section 204(a)(11)*, and a provision for additional indemnification.

The rights to indemnity shall continue for a person who has ceased to be a director, officer, employee, or agent and shall inure to the benefit of the heirs, executors, and administrators of the person. Nothing contained in this Paragraph shall affect any right to indemnification to which persons other than the directors and officers may be entitled by contract or otherwise.

Limitation on Indemnification [*Corp. Code § 317(h)*]

2.31. No indemnification or advance shall be made under Paragraphs 2.26-2.29 of these Bylaws, except as provided in Paragraph 2.27 or subparagraph (d) of Paragraph 2.28, in any circumstance in which it appears:

(a) That it would be inconsistent with a provision of the Articles, these Bylaws, a resolution of the shareholders, or an agreement in effect at the time of the accrual of the alleged cause of action asserted in the proceeding in which the expenses were incurred or other amounts were paid, that prohibits or otherwise limits indemnification; or

(b) That it would be inconsistent with any condition expressly imposed by a court in approving a settlement.

Insurance [*Corp. Code § 317(i)*]

2.32. The corporation shall have power to purchase and maintain insurance on behalf of any agent against any liability asserted against or incurred by the agent in that capacity or arising out of the agent's status as an agent, whether or not the corporation would have power to indemnify the agent against that liability under the provisions of Paragraphs 2.25-2.31 of these Bylaws.

The fact that the corporation owns all or a portion of the shares of the company issuing a policy of insurance shall not affect the corporation's power to purchase and maintain that insurance in the following circumstances: (1) if authorized in the corporation's articles, any policy issued is limited to the extent provided in *Corporations Code Section 204(d)*; or *(2)* the company issuing the policy is organized, licensed, and operated in a manner that complies with the insurance laws and regulations applicable to its jurisdiction of organization; that company provides procedures for processing claims that do not permit it to be subject to the direct control of the corporation that purchased the policy; and the policy provides for some manner of risk sharing between the issuer and purchaser of the policy, and some unaffiliated person or persons. Risk sharing may be undertaken by providing for more than one unaffiliated owner of the company issuing the policy, or by providing that a portion of the coverage furnished will be obtained from some unaffiliated insurer or reinsurer.

Board Committees

Authority to Appoint [*Corp. Code § 311*]

2.33. (a) The Board, by resolution adopted by a majority of the authorized number of directors, may designate one or more committees, each consisting of two or more directors, to serve at the pleasure of the Board. The Board may designate one or more directors as alternate members of any committee, who may replace any absent member at any meeting of the committee. The appointment of members or alternate members of a committee shall require the vote of a majority of the authorized number of directors.

Authority of Committee [*Corp. Code § 311*]

(b) Any committee referred to in subparagraph (a) of this Paragraph 2.33, to the extent provided in the Board resolution or in these Bylaws, shall have all the authority of the Board, except with regard to the following:

(1) The approval of any action for which the General Corporation Law also requires shareholders' approval, as that term is defined in *Section 153 of the California Corporations Code*, or approval of the outstanding shares, as that term is defined in *Section 152 of the California Corporations Code*.

(2) The filling of vacancies on the Board or in any committee.

(3) The fixing of compensation of the Directors for serving on the Board or on any committee.

(4) The amendment or repeal of these Bylaws or the adoption of new bylaws.

(5) The amendment or repeal of any resolution of the Board that, by its express terms, is not so amendable or repealable.

(6) A distribution to the shareholders of the corporation, as defined in *Section 166 of the California Corporations Code*, except at a rate or in a periodic amount or within a price range determined by the

Board.

(7) The appointment of other committees of the Board or the members of the Board.

Applicability of Other Paragraphs
[*Corp. Code § 307(c)*]

(c) The provisions of Paragraphs 2.08-2.17, inclusive, and of Paragraphs 2.19 and 2.20 of this Article II apply to the committees.

[*See § 4.226 for comment and alternative provisions.*]

ARTICLE III
DETERMINING SHAREHOLDERS OF RECORD

Record Date Fixed by Board
[*Corp. Code §§ 212(b)(7), 701(a)*]

3.01. (a) In order that the corporation may determine the shareholders entitled to notice of any meeting or to vote, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights regarding any other lawful action, the Board may fix, in advance, a record date, which shall not be more than 60 nor less than 10 days before the date of the meeting nor more than 60 days before any of the other aforementioned actions.

Record Date Not Fixed [*Corp. Code § 701(b)*]

(b) If no record date is fixed,

(1) The record date for determining shareholders entitled to notice of or to vote at a meeting of shareholders shall be the close of business on the business day next preceding the day on which notice is given or, if notice is waived, at the close of business on the business day next preceding the day on which the meeting is held.

(2) The record date for determining shareholders entitled to give consent to corporate action in writing without a meeting (see Paragraph 4.16), when no prior action by the Board has been taken, shall be the day on which the first written consent is given.

(3) The record date for determining shareholders for any other purpose shall be the close of business on the day on which the Board adopts the resolution relating to the record date, or the 60th day before the date of the other action, whichever is later.

Record Date for Adjourned Meeting
[*Corp. Code § 701(c)*]

(c) A determination of shareholders of record entitled to notice of or to vote at a meeting of shareholders shall apply to any adjournment of the meeting unless the Board fixes a new record date for the adjourned meeting. The Board must fix a new record date, however, if the meeting is adjourned for more than 45 days from the date set for the original meeting.

Rights of Shareholders of Record
[*Corp. Code § 701(d)*]

(d) Shareholders at the close of business on the record date are entitled to notice and to vote or to receive the dividend, distribution, or allotment of rights, or to exercise the rights, as the case may be, notwithstanding any transfer of any shares on the books of the corporation after the record date, except as otherwise provided in the Articles or by agreement or in the General Corporation Law.

ARTICLE IV
SHAREHOLDERS' MEETINGS

Place of Meetings [*Corp. Code §§ 212(b)(2), 600(a)*]

4.01. Meetings of shareholders shall be held at any place within or without the State of California designated in the notice of the meeting or by resolution of the Board of Directors. In the absence of any designation or resolution, shareholders' meetings shall be held at the principal executive office of the corporation.

[*See § 4.201[2], P 3.01, and § 4.228, for alternative provisions.*]

Annual Meeting

Time of Meeting; Business Transacted
[*Corp. Code §§ 212(b)(2), (4), 600(b), 601(a)*]

4.02. (a) The annual meeting of shareholders shall be held on the _____ [*number, e.g.*, first] _____ [*day of week, e.g.*, Tuesday] of _____ [*month*] of each year, at the hour of _____ M., provided, however, that if the day falls on a legal holiday, the meeting shall be held at the same time on the next day that is not a legal holiday. At the meetings directors shall be elected, reports on the affairs of the corporation shall be considered, and any other proper matter may be presented and business transacted that is within the power of the shareholders.

[*See § 4.229 for comment and alternative provisions.*]

Failure to Hold [*Corp. Code §§ 177, 600(c)*]

(b) If there is a failure to hold the annual meeting for a period of 60 days after the date designated for the meeting as provided in subparagraph (a) of this Paragraph 4.02, any shareholder may apply to the superior court of the county in which the corporation's principal executive office is located for an order compelling the corporation to hold the meeting. The shares represented at the meeting so held, either in person or by proxy, and entitled to vote at the meeting shall constitute a quorum for the purpose of the meeting, despite any provision of the Articles, these Bylaws, or the General Corporation Law to the contrary.

[*Corp. Code § 600(c) in part provides that the superior court of the proper county (see Corp. Code § 177) may summarily order a meeting to be held on the application of any shareholder after notice to the corporation giving it an opportunity to be heard, and that the court in the proceeding may issue orders as may be appropriate, including, without limitation, orders designating the time and place of the meeting, the record date for determination of shareholders entitled to vote, and the form of notice of the meeting.*]

Notice of Meetings [*Corp. Code §§ 212(b)(2), 601(a)*]

4.03. (a) Whenever shareholders are required or permitted to take any action at a meeting, a written notice of the meeting shall be given to each shareholder entitled to vote at the meeting, subject to the provisions of subparagraph (f) of this Paragraph 4.03.

Method of Giving Notice of Meeting
[*Corp. Code §§ 212(b)(2), 601(b)*]

(b) Notice of a shareholders' meeting shall be given personally, or by electronic transmission by the corporation, or by first-class mail, postage prepaid, or other means of written communication, addressed to the shareholder at the address of the shareholder appearing on the books of the corporation or given by the shareholder to the corporation for the purpose of notice; or if no address appears or is given, at the place where the principal executive office of the corporation is located or by publication at least once in a newspaper of general circulation in the county in which the principal executive office is located. The notice shall be deemed to have been given at the time when delivered personally or deposited in the mail or sent by other means of written communication.

If any notice addressed to the shareholder at the address of the shareholder appearing on the books of the corporation is returned to the corporation by the United States Postal Service marked to indicate that the United States Postal Service is unable to deliver it to the shareholder at the address, all future notices shall be deemed to have been duly given without further mailing if the notices are available to the shareholder on written demand of the shareholder at the principal executive office of the corporation for a period of one year from the date of the giving of the notice to all other shareholders.

Time of Notice [*Corp. Code §§ 212(b)(2), 601(a)*]

(c) Notice of any meeting of the shareholders will be sent by first class mail to each shareholder entitled to the notice not less than 10 nor more than 60 days before the date of the meeting; provided, however, that at any time that this corporation has outstanding shares held of record by 500 or more persons (determined as provided in *California Corporations Code Section 605*) on the record date for the shareholders' meeting, notice may be sent by third class mail if sent not less than 30 days before the date of the meeting.

Contents of Notice [*Corp. Code § 601(a), (f)*]

(d) The notice of any meeting of the shareholders shall state the place, date, and hour of the meeting, any means of electronic transmission by and to the corporation or electronic video screen communication by which shareholders may participate at the meeting, and: (1) in the case of a special meeting, the general nature of the business to be transacted, and that no other business may be transacted; or (2) in the case of the annual meeting, those matters that the Board, at the time of the mailing of the notice, intends to present for action by the shareholders, but any proper matter may be presented at the meeting for the action, provided, however, that any shareholder approval at a meeting, other than unanimous approval by those entitled to vote, pursuant to *Corporations Code Section 310* (relating to contracts and transactions between the corporation and any director or legal entity in which a director has a material financial interest (see Paragraph 2.23 of these Bylaws)), Section 902 (relating to amendment of the articles), Section 1152 (relating to corporate conversions), Section 1201 (relating to reorganizations), Section 1900 (relating to voluntary dissolution), or Section 2007 (relating to distribution plans on dissolution), shall be valid only if the general nature of the proposal so approved was stated in the notice of meeting or in any written waiver of notice. The notice of any meeting at which directors are to be elected must include the names of nominees intended at the time of the notice to be presented by management for election.

[*See § 4.230[1], § 4.201[2], P 3.04, and § 4.230 [2], for alternative provisions to those set forth in subparagraphs (a)*

through (d), above.]

Notice of Adjourned Meeting [*Corp. Code § 601(d)*]

(e) When a shareholders' meeting is adjourned to another time or place, notice need not be given of the adjourned meeting if the time and place of the adjourned meeting (or any means of electronic transmission by and to the corporation or electronic video screen communication by which shareholders may participate at the meeting) are announced at the meeting at which the adjournment is taken, provided, however, that if the adjournment is for more than 45 days or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting must be given to each shareholder of record entitled to vote at the meeting. At the adjourned meeting the corporation may transact any business that might have been transacted at the original meeting.

[*See § 4.231 for comment and alternative provisions.*]

Waiver of Notice and Other Defects
[*Corp. Code § 601(e), (f)*]

(f) The transactions of any meeting of shareholders, however called and noticed and wherever held, are as valid as though made at a meeting duly held after regular call and notice, if a quorum (see Paragraph 4.05 of these Bylaws) is present either in person or by proxy and if, either before or after the meeting, each of the persons entitled to vote, not present in person or by proxy, signs a written waiver of notice, or a consent to the holding of the meeting, or an approval of the minutes of the meeting. All waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meeting. Except as provided in subparagraph (d) of this Paragraph 4.03 and unless otherwise provided in the Articles, neither the business to be transacted nor the purpose of any regular or special meeting of shareholders need be specified in any written waiver of notice, consent to the holding of the meeting, or approval of the minutes of the meeting.

Attendance by a person at any meeting also constitutes a waiver of notice to that person if he or she fails to object at the beginning of the meeting to the transaction of business because the meeting was not lawfully called or convened, but attendance does not constitute a waiver of the right to object to the consideration of matters required to be included in the notice but not so included if the objection is expressly made at the meeting.

[*See § 4.229[1], § 4.201[2], P 3.04, and § 4.229 [2], for alternative provisions.*]

Calling of Special Meetings
[*Corp. Code §§ 177, 212(b)(2), 601(c)*]

4.04. (a) On request in writing to the corporation addressed to the attention of the Board Chairperson, or the President, or a Vice-President, or the Secretary of the corporation by any person (other than the Board) entitled to call a special meeting of shareholders (see subparagraph (b) of this Paragraph 4.04), the officer immediately shall cause notice to be given to the shareholders entitled to vote that a meeting will be held at a time requested by the person or persons calling the meeting, not less than 35 nor more than 60 days after receipt of the request. If the notice is not given within 20 days after receipt of the request, the persons entitled to call the meeting may give the notice or they may apply to the superior court of the county in which the principal executive office of the corporation is located or an order, after notice to the corporation giving it an opportunity to be heard, summarily ordering the giving of the notice.

[*The procedure set forth in Corp. Code § 305(c) applies to the application, and the orders that the court may make are*

specified in Corp. Code § 601(c).]

[*See § 4.230 for comment and alternative provisions.*]

Persons Entitled to Call Special Meetings
[*Corp. Code §§ 212(b)(2), 600(d)*]

(b) Special meetings of the shareholders may be called by the Board of Directors, the Board Chairperson, the President, or the holders of shares entitled to cast not less than 10 percent of the votes at the meeting.

[*See § 4.232 for comment and alternative provisions.*]

Quorum of Shareholders [*Corp. Code §§ 112, 602(a)*]

4.05. (a) A majority of the shares entitled to vote, represented in person or by proxy, shall constitute a quorum at a meeting of shareholders, provided, however, that whenever shares are disqualified by the General Corporation Law from voting on any matter, they shall not be considered outstanding for the determination of a quorum at any meeting to act on that matter under any other provision of the General Corporation Law or the Articles or these Bylaws.

[*See § 4.233 for comment and alternative provisions.*]

Loss of Quorum [*Corp. Code § 602(b)*]

(b) The shareholders present at a duly called or held meeting at which a quorum is present may continue to transact business until adjournment despite the withdrawal of enough shareholders to leave less than a quorum, if any action taken (other than adjournment) is approved by at least a majority of the shares required to constitute a quorum, or the vote of any greater number or voting by classes as required by law or the articles of incorporation.

Adjournment for Lack of Quorum [*Corp. Code § 602(c)*]

(c) In the absence of a quorum, any meeting of shareholders may be adjourned from time to time by the vote of a majority of the shares represented either in person or by proxy, but no other business may be transacted, except as provided in subparagraph (b) of this Paragraph 4.05.

[*See § 4.231 for comment and alternative provisions.*]

Effect of Vote [*Corp. Code §§ 112, 602(a)*]

4.06. If a quorum is present, the affirmative vote of the majority of the shares represented at the meeting and entitled to vote on any matter shall be the act of the shareholders, unless the vote of a greater number or voting by classes is required by the General Corporation Law or the Articles, and except as provided in subparagraph (a) of Paragraph 4.05 of these Bylaws, provided, however, that whenever shares are disqualified by the General Corporation Law from voting on any matter, they shall not be considered outstanding for the determination of the required vote to approve action on that matter under any other provision of the General Corporation Law or the Articles or these Bylaws.

Election of Directors [*Corp. Code § 708(c), (e)*]

4.07. Elections for directors need not be by ballot unless a shareholder demands election by ballot at the meeting and before the voting begins. In any election of directors, the candidates receiving the highest number of affirmative votes of the shares entitled to be voted for them up to the number of directors to be elected by the shares are elected. Votes against the director and votes withheld shall have no legal effect.

[*See § 4.234 for comment and alternative provisions.*]

[*A shareholder or person who claims to have been denied the right to vote may file an action in the superior court of the proper county (see Corp. Code § 177 defining "proper county") to contest the election or appointment of a director (Corp. Code § 709(a)). The procedure is set forth in Corporations Code Section 709(b), (c).*]

Votes Per Share--Voting of Fractional Shares
[*Corp. Code §§ 112, 407, 700(a)*]

4.08. Except as provided in Paragraph 4.09 and except as may otherwise be provided in the Articles, each outstanding share, regardless of class, shall be entitled to one vote on each matter submitted to a vote of shareholders. A certificate for a fractional share shall, but scrip or warrants shall not unless otherwise provided in the scrip or warrant, entitle the holder to exercise voting rights.

[*See § 4.241 for a provision prohibiting issuance of fractional shares.*]

Voting Multiple Shares [*Corp. Code § 700(b)*]

4.09. Any holder of shares entitled to vote on any matter may vote part of the shares in favor of the proposal and refrain from voting the remaining shares or vote them against the proposal, other than elections to office, but, if the shareholder fails to specify the number of shares being voted affirmatively, it will be conclusively presumed that the shareholder's approving vote is with respect to all shares the shareholder is entitled to vote.

Cumulative Voting [*Corp. Code § 708(a)-(c)*]

4.10. Every shareholder entitled to vote at any election of directors may cumulate votes and give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which the shareholder's shares are entitled, or distribute them on the same principle among as many candidates as the shareholder thinks fit. No shareholder shall be entitled to cumulate votes (i.e., cast for any one or more candidates a number of votes greater than the number of the shareholder's shares) unless the candidate's or candidates' names have been placed in nomination before the voting and the shareholder has given notice at the meeting before the voting of the shareholder's intention to cumulate votes. If any one shareholder has given the notice, all shareholders may cumulate their votes for candidates in nomination.

Voting of Shares by Fiduciaries, Minors, or Entities
[*Corp. Code §§ 702-704*]

4.11. (a) The rights of the persons and entities specified in this section to vote shares are governed by the provisions of this Paragraph of the Bylaws.

Personal Representative [*Corp. Code § 702(a)*]

(b) Except as provided in subparagraph (i) of this Paragraph 4.11, shares held by an administrator, executor, guardian, conservator, or custodian may be voted by the holder either in person or by proxy, without a transfer of the

shares into the holder's name.

Trustee [*Corp. Code § 702(a)*]

(c) Shares standing in the name of a trustee may be voted by the trustee, either in person or by proxy, but no trustee shall be entitled to vote shares so held without a transfer of them into the trustee's name.

Receiver [*Corp. Code § 702(b)*]

(d) Shares standing in the name of a receiver may be voted by the receiver. Shares held by or under the control of a receiver may be voted by the receiver without the shares being transferred into the receiver's name if authority to vote them is contained in the court order appointing the receiver.

Pledgee [*Corp. Code § 702(c)*]

(e) Subject to the provisions of Paragraph 4.12 of these Bylaws and except when otherwise agreed in writing between the parties, a shareholder whose shares are pledged shall be entitled to vote the shares until they have been transferred into the name of the pledgee, thereafter the pledgee shall be entitled to vote the shares so transferred.

Minor [*Corp. Code § 702(d)*]

(f) Shares standing in the name of a minor may be voted and the corporation may treat all rights incident to the shares as exercisable by the minor, in person or by proxy, whether or not the corporation has notice, actual or constructive, of the minority, unless a guardian of the minor's property has been appointed and written notice of the appointment given to the corporation.

Corporation [*Corp. Code § 703(a)*]

(g) Shares standing in the name of another corporation, domestic or foreign, may be voted by the officer, agent, or proxyholder as the bylaws of the other corporation may prescribe or, in the absence of a provision, as the board of directors of the other corporation may determine or, in the absence of a determination, by the board chairperson, president, or any vice-president of the other corporation, or by any other person authorized to do so by the board chairperson, president, or any vice-president of the other corporation. Shares that are purported to be voted or any proxy purported to be executed in the name of a corporation (whether or not any title of the person signing is indicated) shall be presumed to be voted or the proxy executed in accordance with the foregoing provisions, unless the contrary is shown.

Subsidiary [*Corp. Code § 703(b)*]

(h) Shares of the corporation owned by any subsidiary of the corporation shall not be entitled to vote on any matter.

Corporate Fiduciary [*Corp. Code § 703(c)*]

(i) Shares held by the corporation in a fiduciary capacity, and shares of the corporation held in a fiduciary capacity by its subsidiary, if any, shall not be entitled to vote on any matter, except to the extent that the settlor or beneficial owner possesses and exercises a right to vote or to give the corporation binding instructions as to how to vote the shares.

Shares in Names of Two or More Persons
[*Corp. Code § 704*]

(j) If shares stand of record in the names of two or more persons, whether fiduciaries, members of a partnership,

joint tenants, tenants in common, husband and wife as community property, tenants by the entirety, voting trustees, [persons entitled to vote under a shareholder voting agreement,] or otherwise, or if two or more persons (including proxyholders) have the same fiduciary relationship respecting the same shares, unless the Secretary of the corporation is given written notice to the contrary and is furnished with a copy of the instrument or order appointing them or creating the relationship where it is so provided, their acts with respect to voting shall have the following effect:

(1) If only one votes, the act binds all.

(2) If more than one vote, the act of the majority so voting binds all.

(3) If more than one vote, but the vote is evenly split on any particular matter, each faction may vote the securities in question proportionately.

If the instrument so filed or the registration of the shares shows that any tenancy is held in unequal interests, a majority or even split for the purpose of the above shall be a majority or even split in interest.

Proxies [*Corp. Code § 705*]

4.12. (a) Every person entitled to vote shares may authorize another person or persons to act by proxy with respect to the shares. Except as otherwise provided by written agreement between the parties, the recordholder of shares that a person holds as pledgee or otherwise as security or that belong to another must issue to the pledgor or to the owner of the shares, on demand and payment of necessary expenses, a proxy to vote or take other action on the shares.

Presumptive Validity [*Corp. Code § 705(a)*]

(b) Any proxy purporting to be executed in accordance with this Paragraph 4.12 shall be presumptively valid.

Duration of Proxy [*Corp. Code § 705(b)*]

(c) No proxy shall be valid after the expiration of 11 months from the date of the proxy unless otherwise provided in the proxy. Every proxy continues in full force and effect until revoked by the person executing it before the vote for which the proxy was issued, except as provided in subparagraphs (f) and (g) of this Paragraph 4.12. The dates contained on the forms of proxy presumptively determine the order of execution, regardless of the postmark dates on the envelopes in which they are mailed.

Death or Incapacity of Maker [*Corp. Code § 705(c)*]

(d) A proxy is not revoked by the death or incapacity of the maker, unless (except as provided in subparagraph (f) of this Paragraph 4.12), before the vote is counted, written notice of the death or incapacity is received by the corporation.

Revocation of Proxy [*Corp. Code §§ 212(b)(3), 705(b)*]

(e) Revocation of a proxy is effected by a writing delivered to the corporation stating that the proxy is revoked or by a subsequent proxy executed by, or as to any meeting by attendance at the meeting and voting in person by, the person executing the proxy.

Proxy Providing for Irrevocability [*Corp. Code § 705(e)*]

(f) A proxy that states that it is irrevocable is irrevocable for the period specified in the proxy (notwithstanding subparagraph (d) of this Paragraph 4.12) when it is held by any of the following or a nominee of any of the following:

(1) A pledgee.

(2) A person who has purchased or agreed to purchase or holds an option to purchase the shares or a person who has sold a portion of the person's shares in the corporation to the maker of the proxy.

(3) A creditor or creditors of the corporation or the shareholder who extended or continued credit to the corporation or the shareholder in consideration of the proxy if the proxy states that it was given in consideration of the extension or continuation of credit and the name of the person extending or continuing credit.

(4) A person who has contracted to perform services as an employee of the corporation, if a proxy is required by the contract of employment and if the proxy states that it was given in consideration of the contract of employment, the name of the employee, and the period of employment contracted for.

(5) A beneficiary of a trust with regard to shares held by the trust.

[*If corporation is a close corporation, add:*]

(6) A person designated by or under an agreement under *Section 706 of the Corporations Code*, relating to voting agreement between shareholders (see subparagraph (a) of Paragraph 4.13 of these Bylaws).

[*For all corporations, CONTINUE:*]

In addition, a proxy may be made irrevocable (notwithstanding subparagraph (d) of this Paragraph 4.12) if it is given to secure the performance of a duty or to protect a title, either legal or equitable, until the happening of events that, by its terms, discharge the obligations secured by it.

When Irrevocable Proxy Is Revocable
[*Corp. Code § 705(e), (f)*]

(g) Notwithstanding the period of irrevocability specified in the proxy as provided in subparagraph (f) of this Paragraph 4.12, the proxy becomes revocable when _____ [the pledge is redeemed, the option or agreement to purchase is terminated, or the seller no longer owns any shares of the corporation or dies, the debt of the corporation or the shareholder is paid, the period of employment provided for in the contract of employment has terminated *or* the person ceases to be a beneficiary of the trust *or* the agreement under *Section 706 of the Corporation Code* has terminated].

A proxy may be revoked, notwithstanding a provision making it irrevocable, by a transferee of shares without knowledge of the existence of the provision unless the existence of the proxy and its irrevocability appears on the certificate representing the shares.

[*Add if corporation does not or will not have an outstanding class of securities registered under Section 12 (15 U.S.C. § 78l) of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78a-78jj) or securities exempted from registration by Section 12(g)(2) of that Act:*]

Form of Proxy or Written Consent [*Corp. Code § 604*]

(h) Any form of proxy or written consent (see Paragraph 4.16 of these Bylaws) distributed to 10 or more shareholders must, if the outstanding shares are held of record by 100 or more persons as determined under *Section 605 of the California Corporations Code*, afford an opportunity on the proxy or form of written consent to specify a choice between approval and disapproval of each matter or group of related matters intended to be acted on at the meeting for which the proxy is solicited or by the written consent, other than elections to office, and must provide, subject to reasonable specified conditions, that where the person solicited specifies a choice with regard to any matter the shares will be voted in accordance with the specification.

In any election of directors, any form of proxy in which the directors to be voted on are named in the proxy as candidates and that is marked by a shareholder "withhold" or otherwise marked in a manner indicating that the authority to vote for the election of directors is withheld shall not be voted either for or against the election of a director.

Failure to comply with this subparagraph (h) does not invalidate any corporate action taken, but may be the basis for challenging any proxy at a meeting and any shareholder may sue in the superior court to compel compliance with the proxy instructions.

Directors' Determination of Execution and Use of Proxies
[*Corp. Code § 212(b)(3)*]

(i) The Board of Directors may, in advance of any annual or special meeting of the shareholders, prescribe additional regulations concerning the manner of execution and filing of proxies and the validation of the same, which are intended to be voted at any meeting.

[*See § 4.235 for comment and additional provisions.*]

Voting Agreement and Trust [*Corp. Code § 706*]

Voting Agreement [*Corp. Code § 706(a)*]

4. 13 (a) [*Use this paragraph only if corporation is a close corporation; otherwise omit and reletter subsequent paragraphs of this section accordingly.*] Any two or more shareholders of this corporation may, in a written agreement signed by them, provide that in exercising any voting rights the shares held by them shall be voted as provided in the agreement, or as the parties may agree, or as determined in accordance with a procedure agreed on by them, and the parties may transfer the shares covered by an agreement to a third party or parties with authority to vote them in accordance with the terms of the agreement.

[*The agreement may not be denied specific performance by a court on the ground that the remedy at law is adequate or on other grounds relating to the jurisdiction of a court of equity (Corp. Code § 706(a)). Nor will it to be held invalid or unenforceable on the ground that it is a voting trust that does not comply with the provisions of Corp. Code § 706(b), or on the ground that it is a proxy that does not comply with Corp. Code § 705 (Corp. Code § 706(c)).*]

Voting Trust [*Corp. Code § 706(b)*]

(b) Shares may be transferred by written agreement to trustees in order to confer on them the right to vote and otherwise represent the shares for the period of time, not exceeding 10 years, as may be specified in the agreement. At any time within two years before the time of expiration of any voting trust agreement as originally fixed or as last extended as provided in this paragraph, one or more beneficiaries under the voting trust agreement may, by written agreement and with the written consent of the voting trustee or trustees, extend the duration of the voting trust

agreement with regard to their shares for an additional period not exceeding 10 years from the expiration date of the trust as originally fixed or as last extended as provided in this paragraph. A duplicate of the voting trust agreement and any extension of the agreement must be filed with the Secretary of the corporation and must be open to inspection by a shareholder, a holder of a voting trust certificate, or the agent of either, on the same terms as the record of shareholders of the corporation is open to inspection.

[*The validity of a voting trust agreement, otherwise lawful, is not affected during a period of 10 years from the date when it was created or last extended by the fact that under its terms it will or may last beyond the 10-year period (Corp. Code § 706(b)).*]

Effect of Paragraph [*Corp. Code § 706(d)*]

(c) This section of the Bylaws is not intended to invalidate any voting or other agreement among shareholders or any irrevocable proxy meeting the requirements of subparagraph (f) of Paragraph 4.12 of these Bylaws.

Inspectors of Election [*Corp. Code § 707*]

Appointment [*Corp. Code § 707(a)*]

4. 14 (a) In advance of any meeting of shareholders the Board may appoint inspectors of election to act at the meeting and any adjournment of the meeting. If inspectors of election are not so appointed, or if any persons so appointed fail to appear or refuse to act, the chairperson of any meeting of shareholders may, and on the request of any shareholder or a shareholder's proxy must, appoint inspectors of election (or persons to replace those who so fail or refuse) at the meeting.

Number [*Corp. Code § 707(a)*]

(b) The number of inspectors shall be either one or three. If the inspector or inspectors are appointed at a meeting on the request of one or more shareholders' or proxies, the majority of shares represented in person or by proxy will determine whether one or three inspectors are to be appointed.

Duties [*Corp. Code § 707(b), (c)*]

(c) The inspector or inspectors of election shall

(1) Determine the number of shares outstanding and the voting power of each, the shares represented at the meeting, the existence of a quorum, and the authenticity, validity, and effect of proxies.

(2) Receive votes, ballots, or consents.

(3) Hear and determine all challenges and questions in any way arising in connection with the right to vote.

(4) Count and tabulate all votes or consents.

(5) Determine when the polls shall close.

(6) Determine the result of the election.

(7) Do such acts as may be proper to conduct the election or vote with fairness to all shareholders.

(8) Perform his, her, or their duties impartially, in good faith, to the best of his, her, or their ability and as expeditiously as is practical.

Decision, Act, or Certificate [*Corp. Code § 707(c)*]

(d) If there are three inspectors of election, the decision, act, or certificate of a majority is effective in all respects as the decision, act, or certificate of all. Any report or certificate made by the inspectors of election is prima facie evidence of the facts stated therein.

Conduct of Meetings [*Corp. Code § 212(b)(2)*]

4.15. At every meeting of the shareholders, the President of the corporation, or in the President's absence the Vice-President designated by the President, or in the absence of a designation a chairperson (who shall be one of the Vice-Presidents, if any is present) chosen by a majority in interest of the shareholders of the corporation present in person or by proxy and entitled to vote, shall act as chairperson. The Secretary of the corporation, or in the Secretary's absence an Assistant Secretary, if any, shall act as Secretary of all meetings of the shareholders. The chairperson may appoint another person to act as secretary for any shareholders' meeting only in the absence of the Secretary and all Assistant Secretaries.

[*See § 4.236 for comment and alternative provisions.*]

Action Without a Meeting [*Corp. Code § 603*]

When Authorized [*Corp. Code § 603(a), (d)*]

4.16. (a) Unless otherwise provided in the Articles, any action that may be taken at any annual or special meeting of shareholders may be taken without a meeting and without prior notice, if a consent in writing, setting forth the action taken, is signed by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take the action at a meeting where all shares entitled to vote on the matter were present and voted, provided, however, that directors may not be elected by written consent except by the unanimous written consent of all shares entitled to vote for the election of directors.

[*The form of the consent is subject to the provisions of subparagraph (h) of P 4.12 of these Bylaws.*]

Notice of Shareholder Approval [*Corp. Code § 603(b)*]

(b) Unless the consents of all shareholders entitled to vote have been solicited in writing, notice to those shareholders entitled to vote who have not consented in writing must be given as follows:

(1) Notice of any shareholder approval pursuant to *California Corporations Code Section 310* (relating to contract or transaction between corporation and its director or legal entity in which one or more of its directors has a material financial interest (see Paragraph 2.23 of these Bylaws)), Section *317* (relating to indemnification by corporation of its director, officer, employee, or agent arising out of court, administrative, or investigative proceeding (see Paragraphs 2.25-2.32 of these Bylaws)), Section *1152* (relating to corporate conversions), Section *1201* (relating to reorganizations), or Section 2007 (relating to plan of distribution on dissolution), without a meeting by less than unanimous written consent must be given at least 10 days before the consummation of the action authorized by the approval; and

(2) Prompt notice must be given of the taking of any other corporate action approved by shareholders without a meeting by less than unanimous written consent.

Subparagraph (b) of Paragraph 4.03 of these Bylaws, relating to the method of giving notice, applies to the notice provided by this section.

Revocation of Consent [*Corp. Code § 603(c)*]

(c) Any shareholder giving a written consent, or the shareholder's proxyholders, or a transferee of the shares, or a personal representative of the shareholder, or their respective proxyholders, may revoke the consent by a writing received by the corporation before the time that written consents of the number of shares required to authorize the proposed action have been filed with the Secretary of the corporation, but may not do so after the consents have been filed. The revocation is effective on its receipt by the Secretary of the corporation.

ARTICLE V
OFFICERS

Number and Titles [*Corp. Code §§ 212(b)(6), 312(a)*]

5.01. The officers of the corporation shall be _____ [a Board Chairperson *or* a President *or* both a Board Chairperson and a President], a Secretary, and a Chief Financial Officer who may also be called Treasurer. The corporation may also have, at the discretion of the Board, any other officers that may be appointed in accordance with the provisions of Paragraph 5.03 of this Article. One person may hold two or more offices [*specify any restrictions, e.g.,*, except that one person may not be both President and Secretary]. In its discretion, the Board of Directors may leave unfilled, for any period it may fix, any office except the offices of _____ [Board Chairperson *or* President], Secretary, and Chief Financial Officer.

[*See § 4.238 for comment and alternative provisions.*]

Appointment [*Corp. Code §§ 212(b)(6), 312(b)*]

5.02. The officers of the corporation, except those officers appointed in accordance with the provisions of Paragraphs 5.03 or 5.05 of this Article, shall be chosen _____ [*specify time of appointment, e.g.,* annually] by the Board. Each officer shall serve at the pleasure of the Board, subject to any rights that he or she has under any employment contract with the corporation, and shall hold office until the appointment of his or her successor, or until his or her resignation, removal from office pursuant to Paragraph 5.04, or other disqualification.

[*See § 4.238 for alternative provisions.*]

Other Officers [*Corp. Code §§ 212(b)(6), 312(a)*]

5.03. The Board may appoint any officers necessary to enable the corporation to sign instruments and share certificates [, including (*specify additional officers, e.g.,* one or more Vice-Presidents, one or more Assistant Secretaries, and one or more Assistant Treasurers)]. Each officer shall hold office for the period, have the authority, and perform duties that the Board may, by resolution, from time to time determine.

[*See § 4.238 for alternative provisions.*]

Removal and Resignation
[*Corp. Code §§ 212(b)(6), 312(b)*]

5.04. Any officer may be removed, either with or without cause, subject to any rights of the officer under any employment contract with the corporation, by the vote of the Board at any regular or special meeting of the Board, or by the unanimous written consent of the directors then in office without a meeting. Any officer may resign at any time without prejudice to any rights of the corporation under any contract to which the officer is a party by giving written notice to the Board Chairperson, if there is an officer, or to the President, or to the Secretary of the corporation. Any resignation shall take effect on the date the notice is received unless a later effective date is specified, in which case the resignation is effective on the specified date. Unless otherwise specified in the notice, acceptance of the resignation by the Board shall not be necessary to make it effective.

Vacancies [*Corp. Code §§ 212(b)(6), 312(a)*]

5.05. If the office of Board Chairperson, President, Secretary, or Chief Financial Officer becomes vacant by reason of death, resignation, removal, or otherwise, the Board shall fill it by appointing a successor officer [who shall hold the office for the unexpired term]. If any other office becomes vacant, the Board may, in its discretion, leave it unfilled for any period that it may fix or it may appoint a successor officer to fill the vacancy.

Board Chairperson
[*Corp. Code §§ 212(b)(6), 312(a), 416(a)*]

5.06. The Board Chairperson, if there is an officer, shall, if present, preside at all meetings of the Board and exercise and perform any other powers and duties that are assigned to him or her by the Board or prescribed by law or by these Bylaws. When so directed by the Board, the Chairperson shall, with the Secretary or an Assistant Secretary, if any, or the Chief Financial Officer or Assistant Treasurer, if any, sign share certificates. Signatures on the certificates may be facsimile.

[*See § 4.201[2], P 4.02, for alternative provisions.*]

President [*Corp. Code §§ 212(b)(6), 312(a)*]

5.07. Subject to the supervisory powers, if any, that may be given by the Board to the Board Chairperson, if there is an officer, the President shall be the chief executive officer of the corporation and, except as otherwise provided in these Bylaws, shall have: (1) general supervision, direction, and control of the business and officers of the corporation; (2) the general powers and duties of management usually vested in the office of President of a corporation; and (3) any other powers and duties prescribed by the Board or by these Bylaws. Within this authority and in the course of his or her duties, the President shall:

Meetings

(a) Preside at all meetings of the shareholders, preside at Board Meetings in the absence of the Board Chairperson, or if there is none, at all meetings of the Board, and be ex officio a member of all Board committees.

Share Certificates [*Corp. Code § 416(a)*]

(b) Except when otherwise directed by the Board, sign, with the Secretary or an Assistant Secretary, if any, or the Chief Financial Officer or Assistant Treasurer, if any, all share certificates of the corporation. Signatures on the certificates may be facsimile.

Instruments

(c) Sign corporate instruments on behalf of the corporation as provided in Paragraph 6.02 of Article VI of these Bylaws.

Hire and Fire Employees

(d) Subject to direction from the Board, appoint and remove, employ and discharge, and prescribe the duties and fix the compensation of all agents and employees of the corporation other than the officers. These functions may, however, be delegated by the President, or the Board, to specified persons in the various levels of management.

Voting Shares of Other Corporations
[*Corp. Code § 703(a)*]

(e) Unless otherwise directed by the Board and subject to its control, attend in person and, unless prohibited by law, act and vote, on behalf of this corporation, at all meetings of the shareholders of any corporation in which this corporation holds shares.

[*See § 4.201[2], P 4.03 for alternative provisions.*]

Vice-President [*Corp. Code §§ 212(b)(6), 312(a)*]

5.08. In the absence or disability of the President, the Vice-President, or the Vice-Presidents if there are more than one in order of their rank as fixed by the Board, or if not ranked the Vice-President designated by the Board, shall perform all the duties of the President and shall for this purpose act within the President's scope of authority. The Vice-President or the Vice-Presidents shall have any other powers and perform any other duties prescribed for them respectively by the Board or by these Bylaws.

[*See § 4.201[2], P 4.04, for alternative provisions.*]

Secretary [*Corp. Code §§ 212(b)(6), 312(a)*]

5.09. The Secretary shall

Seal [*Corp. Code § 207(a)*]

(a) Have custody of the corporate seal and shall affix it in appropriate cases to all corporate instruments.

Records, Reports, and Statements

(b) Have custody of the records of the corporation and ensure that the books, reports, statements, certificates, and all other documents and records required by law are properly kept and filed.

Notices

(c) Ensure that all notices are given in accordance with the provisions of these Bylaws or as required by law. In case of the Secretary's absence, disability, or neglect or refusal to act, notice may be given and served or caused to be served by an Assistant Secretary, if any, by the President or a Vice-President of the corporation, or by the Board of

Directors.

Minutes

(d) Act as Secretary at all meetings of shareholders and of the Board and record, or cause to be recorded, in the minute book all actions taken at those meetings. In case of the Secretary's absence, disability, neglect of duties, or refusal to act, this duty may be performed by an Assistant Secretary, if any, or any other person appointed by the person presiding at the meeting.

Minute Book [*Corp. Code § 1500*]

(e) Keep a written book of minutes, at the corporation's principal executive office or other place designated by the Board, of all proceedings of the corporation's shareholders, Board, and Board committees, including: the time and place of meeting; whether the meeting was regular or special; the authorization for any special meeting; the type of notice given, the names of the persons attending Board and committee meetings; the number of shares present or represented at shareholder meetings; and the proceedings of the meeting.

Articles of Incorporation
[*see* *Corp. Code § 209*]

(f) Keep the original or a copy of the Articles of Incorporation, certified by the Secretary of State, with all amendments in the minute book.

Bylaws [*Corp. Code § 213*]

(g) Keep at the corporation's principal executive office [*or, if its principal executive office is not in California:* its principal business office in California] the original or a copy of these Bylaws to date, that shall be open to inspection by the shareholders at all reasonable times during office hours.

Record of Shareholders [*Corp. Code § 1500*]

(h) Keep at the corporation's principal executive office or at the office of its transfer agent or registrar in California a record of the corporation's shareholders, showing the names and addresses of all shareholders and the number and class of shares held by each.

Certify Records [*Corp. Code § 314*]

(i) When requested to do so by the Board, any director individually, a Board Committee, or the President or other officer of this corporation, or when so required by law, certify as a true copy a copy of the Bylaws of the corporation, or of the minutes of any meeting of the incorporators, shareholders, directors, Board committee, or other, or of any resolution adopted by the Board, a Board committee, or the shareholders. This duty may be performed by any Assistant Secretary of the corporation.

Share Certificates [*Corp. Code § 416(a)*]

(j) Sign, with the Board Chairperson or the Vice Chairperson, if any, or the President or a Vice-President, all share certificates of the corporation. In lieu of signing by the Secretary, the certificates may be signed by an Assistant Secretary, if any, or by the Chief Financial Officer or Assistant Treasurer, if any, of the corporation. Signatures on the certificates may be facsimile.

Exhibit Record of Shareholders

[*Corp. Code § 1600(a), (c), (d)*]

(k) Make the record of shareholders available during usual business hours for inspection and copying

(1) To any shareholder or shareholders who hold at least 5 percent in the aggregate of the outstanding voting shares of a corporation, or who hold at least 1 percent of those voting shares and who have filed a Schedule 14A with the United States Securities and Exchange Commission [*or, if the corporation is a bank whose deposits are insured under the Federal Deposit Insurance Act:* a Form F-6 with the appropriate federal bank regulatory agency] relating to the election of directors of the corporation, on five business days' prior written demand on the corporation; and

(2) To any shareholder or holder of a voting trust certificate on written demand on the corporation for a purpose reasonably related to that holder's interests as a shareholder or holder of a voting trust certificate.

Any inspection and copying under this paragraph may be made in person or by agent or attorney.

Exhibit Minutes to Shareholder [*Corp. Code § 1601*]

(l) On the written demand on the corporation of any shareholder or holder of a voting trust certificate, make available for inspection at any reasonable time during usual business hours to that shareholder or holder of the voting trust certificate for a purpose reasonably related to that holder's interests as a shareholder or as the holder of that voting trust certificate, or to his or her agent or attorney, the minutes of any proceedings of the shareholders, the Board, or Board committee, or any accounting books and records in the Secretary's custody. This right of inspection includes the right to copy and make extracts.

Exhibit Records to Director [*Corp. Code § 1602*]

(m) Make available at any reasonable time to any director who requests, or to his or her agent or attorney, for inspection all books, records, and documents of every kind of the corporation that the Secretary is charged by these Bylaws with maintaining or keeping or that are in the Secretary's custody. This right of inspection includes the right to copy and make extracts.

Other Duties

(n) Perform any and all other functions and duties that may be specified in other sections of these Bylaws and any other duties that may from time to time be assigned by the Board.

Absence of Secretary

(o) In case of the Secretary's absence, disability, neglect of duties, or refusal to act, the Assistant Secretary, or if there is none, the Chief Financial Officer acting as Assistant Secretary may perform all of the functions and duties of the Secretary. In case of the absence, disability, neglect of duties, or refusal to act, of the Assistant Secretary or Chief Financial Officer, as the case may be, as well as of the Secretary, then any person authorized by the President, Vice-President, or Board of Directors shall perform the functions and duties of the Secretary.

[*See § 4.201[2], P 4.05, for alternative provisions.*]

Assistant Secretary
[*Corp. Code §§ 212(b)(6), 312(a)*]

5.10. If the Board appoints one or more Assistant Secretaries, then, at the request of the Secretary or in case of the Secretary's absence or disability, the Assistant Secretary, or, if there is more than one, the Assistant Secretary designated by the Secretary, shall perform all the duties of the Secretary, and shall for this purpose act within the Secretary's scope of authority. The Assistant Secretary or Assistant Secretaries shall also perform any other duties that from time to time may be assigned to them by the Board or by the Secretary.

Chief Financial Officer
[*Corp. Code §§ 212(b)(6), 312(a)*]

5.11. The Chief Financial Officer shall:

Funds--Custody and Deposit

(a) Have charge and custody of, and be responsible for, all funds and securities of the corporation, and deposit all funds in the name of the corporation in the banks, trust companies, or other depositaries selected by the Board.

Funds--Receipt

(b) Receive, and give receipt for, moneys due and payable to the corporation from any source whatever.

Funds--Disbursement

(c) Disburse or cause to be disbursed, the funds of the corporation as may be directed by the Board, taking proper vouchers for those disbursements.

Maintain Accounts [*Corp. Code § 1500*]

(d) Keep and maintain adequate and correct books and records of account either in written form or in any other form capable of being converted into written form.

Reports to President and Directors

(e) Render to the President and directors, whenever they request it, an account of all transactions as Chief Financial Officer and of the financial condition of the corporation.

Financial Reports to Shareholders
[*Corp. Code §§ 114, 1501(a), (c), (d)*]

(f) Take the following actions with respect to financial reports:

(1) Prepare, or cause to be prepared, the balance sheet, income statement, and statement of cashflows for the fiscal year to be included in the annual report to shareholders, and either ensure that the statements are accompanied by a report on them of independent accountants or, if there is no accountant's report, certify that the statements were prepared without audit from the books and records of the corporation.

(2) On the written request of any shareholder or shareholders holding at least 5 percent of the outstanding shares of any class, prepare, or cause to be prepared, and deliver or mail to the person making the request within 30 days after the request an income statement of the corporation for the three-month, six-month, or nine-month period of the current fiscal year ended more than 30 days before the date of the request and a balance sheet of the corporation as of the end of that period and, if no annual report for the last fiscal year was sent to shareholders, the statements required by clause (1) of this paragraph.

(3) Keep on file in the corporation's principal office for a period of 12 months a copy of the statements referred to in clause (2) of this paragraph and exhibit them at all reasonable times to any shareholder demanding an examination of them or mail a copy of them to that shareholder.

(4) Either cause the quarterly income statements and balance sheets referred to in clause (2) of this paragraph to be accompanied by the report on the statements prepared by independent accountants engaged by the corporation or, if there is no report, certify that the statements were prepared without audit from the books and records of the corporation.

[*EITHER*]

(5) Prepare the financial statements, balance sheets, income statements, and statements of cashflows referred to in this paragraph, or have them prepared, in accordance with generally accepted accounting principles.

[*OR, if there are less than 100 shareholders of record, and the bylaws expressly waive the requirement for financial statements (Corp. Code §§ 605, 1501(a)(1)):*]

(5) Prepare the financial statements, balance sheets, income statements, and statements of cashflows referred to in this paragraph (or have them prepared) by reasonably setting forth the assets and liabilities and the income and expense of the corporation, and disclosing the accounting basis used in their preparation.

[*CONTINUE:*]

Exhibit Accounts to Shareholders [*Corp. Code § 1601*]

(g) On the written demand on the corporation of any shareholder or holder of a voting trust certificate, exhibit for inspection at any reasonable time during usual business hours to that shareholder or holder of the voting trust certificate for a purpose reasonably related to that holder's interests as a shareholder or as the holder of the voting trust certificate, or to his or her agent or attorney any or all of the accounting books and records of the corporation. This right of inspection includes the right to copy and make extracts.

Exhibit Accounts to Directors [*Corp. Code § 1602*]

(h) Exhibit at any reasonable time to any director of the corporation who so requests, or to his or her agent or attorney, for inspection any and all books, records, and documents of every kind that the Chief Financial Officer is charged by these Bylaws with maintaining and/or keeping or that are in the Chief Financial Officer's custody. This right of inspection includes the right to copy and make extracts.

Share Certificates [*Corp. Code § 416(a)*]

(i) Sign, with the Board Chairperson or Vice Chairperson, if any, or the President or a Vice-President, all share certificates of the corporation. In lieu of signing by the Chief Financial Officer, those certificates may be signed by an

Assistant Treasurer, if any, or by the Secretary or by an Assistant Secretary, if any, of the corporation. Signatures on the certificates may be facsimile.

Bond

(j) If required by the Board or the President, give to the corporation a bond, with one or more sureties or a surety company, in a sum satisfactory to the Board, for the faithful performance of the duties as Chief Financial Officer and for the restoration to the corporation, in the event of the Chief Financial Officer's death, resignation, retirement, or removal from office, of all books, papers, vouchers, money, and other property of whatever kind in his or her possession or under his or her control belonging to the corporation.

Other Duties

(k) Perform any and all other functions and duties required of the Chief Financial Officer that may be specified in other sections of these Bylaws and, in general, perform all the duties incident to the office of Chief Financial Officer and the other duties as from time to time may be assigned by the Board.

Absence of Chief Financial Officer

(l) In case of the Chief Financial Officer's absence, disability, refusal to act, or neglect of duties, the Assistant Treasurer, or if there is none, the Secretary acting as Assistant Treasurer may perform all of the functions and duties of the Chief Financial Officer. In case of the absence, disability, refusal to act, or neglect of duties, of the Assistant Treasurer or Secretary, as the case may be, as well as of the Chief Financial Officer, then any person authorized by the President or Vice-President or by the Board shall perform the functions and duties of the Chief Financial Officer.

[*See § 4.201[2], P 4.06, for alternative provisions.*]

Assistant Treasurer [*Corp. Code §§ 212(b)(6), 312(a)*]

5.12. If the Board appoints one or more Assistant Treasurers they shall, if so required by the Board, each give a bond for the faithful discharge of his or her respective duties in the sum, and with the sureties, as the Board shall require. At the request of the Chief Financial Officer or in the case of the Chief Financial Officer's absence or disability, the Assistant Treasurer shall perform all the duties of the Chief Financial Officer and for these purposes shall act within the Chief Financial Officer's scope of authority. If there is more than one Assistant Treasurer, the Assistant Treasurer designated by the Chief Financial Officer, or, if there has been no designation, the Assistant Treasurer designated by the Board, shall perform these duties. The Assistant Treasurer or Assistant Treasurers shall also perform any other duties that may from time to time be assigned to them by the Board of Directors or by the Chief Financial Officer.

Compensation [*Corp. Code § 212(b)(6)*]

5.13. The officers of the corporation shall receive the salaries and other compensation that are fixed from time to time by the Board, and no officer shall be prevented from receiving that salary and compensation by reason of the fact that he or she is also a director of the corporation.

[*See § 4.238[2] for alternative provisions.*]

ARTICLE VI
EXECUTION OF INSTRUMENTS AND DEPOSIT OF FUNDS

Limitations [*see* *Corp. Code § 313*; *Snukal v. Flightways Manufacturing, Inc. (2000) 23 Cal. 4th 754, 786-787, 98 Cal. Rptr. 2d 1, 3 P.3d 286]*

6.01. Except as otherwise provided in these Bylaws, the Board may, by duly adopted resolution, authorize any officer or agent of the corporation to enter into any contract, or to execute and deliver any instrument, in the name of and on behalf of this corporation. Authorization may be general or may be confined to specified instances. Unless expressly authorized, no officer, agent, or employee shall have any power or authority to bind the corporation by any contract or engagement, or to pledge its credit, or to render it liable pecuniarily for any purpose or in any amount.

[*See § 4.201[2], P 5.01, for an alternative provision.*]

Execution of Instruments and Papers [*see* *Corp. Code §§ 313, 416(a)*; *Snukal v. Flightways Manufacturing, Inc. (2000) 23 Cal. 4th 754, 786-787, 98 Cal. Rptr. 2d 1, 3 P.3d 286]*

6.02. Unless otherwise expressly required by the Board or by law, deeds and other conveyances, promissory notes, deeds of trust, mortgages, and other evidences of indebtedness of the corporation, and share certificates shall be executed, signed, or endorsed by the Board Chairperson, if any, or by the President or a Vice-President of the corporation, and by the Chief Financial Officer or any Assistant Treasurer or the Secretary or any Assistant Secretary of the corporation. Signatures on share certificates only may be facsimile.

Signing of Checks

6.03. All checks, drafts, or other orders for the payment of money issued in the name of the corporation shall be signed by the person or persons and in the manner determined from time to time by resolution of the Board.

Deposit and Withdrawal of Funds

6.04. (a) All funds of the corporation, including all checks, drafts, or other orders for the payment of money payable to the corporation, shall be deposited by the Chief Financial Officer from time to time to the credit of the corporation with any banks, trust companies, or other depositaries that the Board may select or that may be selected by any Board committee, officer, or agent of the corporation to whom that power may be delegated from time to time by the Board. All checks, drafts, or other orders for the payment of money requiring endorsement by the corporation before deposit shall be endorsed "for deposit only" by hand-stamped impression in the name of the corporation.

(b) The withdrawal of funds from any accounts may be made only by check signed as provided in Paragraph 6.03 of this Article.

ARTICLE VII
ISSUANCE OF SHARES AND SHARE CERTIFICATES

Authority to Issue [*Corp. Code §§ 207(d), 400(a)*]

7.01. (a) The corporation may issue one or more classes or series of shares or both, with full, limited, or no voting rights and with any other rights, preferences, privileges, and restrictions that are stated or authorized in its Articles of Incorporation. No denial of limitation of voting rights shall, however, be effective unless at the time one or more classes or series of outstanding shares or debt securities, singly or in the aggregate, are entitled to full voting rights. No denial or limitation of dividend or liquidation rights shall be effective unless at the time one or more classes or series of outstanding shares, singly or in the aggregate, are entitled to unlimited dividend and liquidation rights.

Equality of Rights [*Corp. Code § 400(b)*]

(b) All shares of any one class shall have the same voting, conversion, and redemption rights and other rights, preferences, privileges, and restrictions, unless the class is divided into series. If a class is divided into series, all the shares of any one series shall have the same voting, conversion, and redemption rights and other rights, preferences, privileges, and restrictions.

Consideration [*Corp. Code § 409(a)(1), (b), (c)*]

(c) Shares may be issued for any consideration that is determined from time to time by the Board [*if the articles authorize the shareholders to determine the consideration add,* or by approval of the outstanding shares as that term is defined in *California Corporations Code Section 152*], consisting of any or all of the following:

(1) Money paid;

(2) Labor done;

(3) Services actually rendered to the corporation or for its benefit or in its formation or reorganization;

(4) Debts or securities canceled;

(5) Tangible or intangible property actually received either by this corporation or by any wholly owned subsidiary of this corporation.

(6) Any other consideration allowed by law.

Neither promissory notes of the purchaser (unless adequately secured by collateral other than the shares acquired or unless permitted by Paragraph 7.06 of this Article) nor future services shall constitute payment or part payment of shares of the corporation.

When shares are issued for any consideration other than money, the Board must state by resolution its determination of the fair value of the consideration to the corporation in monetary terms.

In the absence of fraud in the transaction, the judgment of the directors as to the value of the consideration for shares shall be conclusive.

Share Dividend; Reclassification of Shares
[*Corp. Code § 409(a)(2)*]

(d) Shares may also be issued as a share dividend or on a stock split, reverse stock split, reclassification of outstanding shares into shares of another class, conversion of outstanding shares into shares of another class, exchange of outstanding shares for shares of another class, or other change affecting outstanding shares.

Compliance With Corporate Securities Law

(e) The corporation shall not offer to sell or sell any security issued by it, whether or not through underwriters, until the offer or sale has been qualified by the California Commissioner of Corporations as required by the Corporate Securities Law and the rules and regulations of the Commissioner, unless the security or transaction is exempted from the qualification and the applicable statutes and rules and regulations have been complied with.

Payment for Shares [*Corp. Code § 410*]

(f) Every subscriber to shares and every person to whom shares are originally issued is liable to the corporation for the full consideration agreed to be paid for the shares. The full agreed consideration shall be paid prior to or concurrently with the issuance of the shares, unless the shares are issued as partly paid pursuant to Paragraph 7.03 of this Article, in which case the consideration shall be paid in accordance with the agreement of subscription or purchase.

Shares as Deemed Fully Paid [*Corp. Code § 409(b)*]

(g) Except as provided in Paragraph 7.03 of this Article, shares issued as provided in subparagraphs (c) and (d) of this Paragraph or Paragraph 7.06 of this Article shall be declared and taken to be fully paid stock and not liable to any further call, nor shall the holder of the shares be liable for any further payments under the provisions of the General Corporation Law.

Fractional Shares [*Corp. Code § 407*]

Authority to Issue

7.02. (a) The corporation may, if the Board so determines, issue fractions of a share originally or on transfer.

Failure to Issue

(b) If the corporation does not issue fractions of a share, it shall, in connection with any original issuance of shares,

(1) Arrange for the disposition of fractional interests by those entitled to them;

(2) Pay in cash the fair value of fractions of a share as of the time when those entitled to receive the fractions are determined (provided, however, that the corporation may not pay cash for fractional shares if that action would result in the cancellation of more than 10 percent of the outstanding shares of any class); or

(3) Issue scrip or warrants in registered form, as certificated or uncertificated securities, or in bearer form as certificated securities, that shall entitle the holder to receive a certificate for a full share on the surrender of the scrip or warrants aggregating a full share. Scrip or warrants shall not, however, unless they provide otherwise, entitle the holder to exercise voting rights, to receive dividends on them, or to participate in any of the assets of the corporation in the event of liquidation.

[*See § 4.241[2] for a provision prohibiting issuance of fractional shares.*]

Partly Paid Shares [*Corp. Code §§ 409(d), 410, 413*]

7.03. The corporation may, if the Board so determines, issue the whole or any part of its shares as partly paid and subject to call for the remainder of the consideration to be paid for them. If shares are so issued, the corporation shall, on the declaration of any dividend on fully paid shares, declare a dividend on partly paid shares of the same class, but only on the basis of the percentage of the consideration actually paid on them.

A subscriber to partly paid shares is liable to the corporation as provided in Paragraph 7.01(f) of this Article, but a person holding shares as a pledgee, executor, administrator, guardian, conservator, trustee, receiver, or in any representative or fiduciary capacity is not personally liable for any unpaid balance, although the estate and funds in the hands of the fiduciary or representative are liable for any unpaid balance of the subscription price and the shares are

subject to sale for the unpaid balance.

[*See § 4.242[2] for additional provisions relating to partly paid shares.*]

Options [*Corp. Code § 404*]

7.04. Either in connection with the issue, subscription, or sale of any of its shares, bonds, debentures, notes, or other securities, or independently of the foregoing, the corporation may, if so determined by the Board, grant options to purchase or subscribe for shares of any class or series on any terms and conditions that the Board may deem expedient. Option rights may be transferable or nontransferable and separable or inseparable from other securities of the corporation, as determined by the Board.

No Preemptive Rights [*Corp. Code § 406*]

7.05. Unless the Articles provide otherwise, the Board may issue shares, options, or securities having conversion or option rights without first offering them to shareholders of any class.

Employee Plans

Authority to Adopt [*Corp. Code §§ 207(f), 408(a)*]

7.06. (a) The corporation may, as determined by the Board, and subject to the approval of the shareholders, as that term is defined in *California Corporations Code Section 153*, adopt and carry out a stock purchase plan or agreement, or stock option plan or agreement providing for the issue and sale for any consideration that may be fixed of its unissued shares or of issued shares acquired or to be acquired, to one or more of the employees or directors of the corporation or of any subsidiary or parent of the corporation or to a trustee on their behalf and for the payment of those shares in installments or at one time, and may provide for aiding those persons in paying for those shares by compensation for services rendered, promissory notes, or otherwise.

Includable Features [*Corp. Code § 408(b)*]

(b) The plan or agreement may include, among other features, as determined by the Board, the fixing of eligibility for participating in it; the class and price of shares to be issued or sold under the plan or agreement; the number of shares that may be subscribed for; the method of payment for the shares; the reservation of title until full payment has been made; the effect of the termination of employment; an option or obligation on the part of the corporation to repurchase the shares on termination of employment, subject to *California Corporations Code Sections 500-511*; restrictions on transfer of the shares; and the time limits of and termination of the plan.

[*See § 4.243[2] for alternative provisions.*]

Certificates of Determination

Execution of Officers' Certificate
[*Corp. Code §§ 173, 401(a)*]

7.07. (a) Before the corporation issues any share of any class or series of which the rights, preferences, privileges, and restrictions, or any of them, or the number of shares constituting any series or the designation of the series, are not set forth in the Articles but are fixed in a resolution adopted by the Board pursuant to authority given in its articles, an

officers' certificate, as that term is defined in *California Corporations Code Section 173*, setting forth a copy of the resolution and the number of shares of the class or series, and stating that none of the shares of the class or series has been issued, shall be executed and filed in the office of the California Secretary of State.

Change in Rights [*Corp. Code § 401(b), (d), (e)*]

(b) After any certificate of determination as provided in Subparagraph (a) of this section has been filed in the office of the California Secretary of State, but before the corporation has issued any shares of the class or series covered by it, the Board may alter or revoke any right, preference, privilege, or restriction fixed or determined by the resolution set forth in the certificate by the adoption of another resolution appropriate for that purpose and the execution and filing of an officers' certificate setting forth a copy of the resolution and stating that none of the shares of the class or the series affected has been issued.

After shares of a class or series have been issued, the provisions of the resolution set forth in a certificate of determination may be amended only by the adoption and approval of an amendment in accordance with *California Corporations Code Sections 902*, *903*, or *904*, and the filing of a certificate of amendment in accordance with *California Corporations Code Sections 905* and *908*. However, a certificate to increase or decrease the number of shares of a series also may be filed as permitted by *California Corporations Code Section 401(c)*, as set forth in subparagraph (c) of this section.

When the Board effects a change in rights, the provision of the original certificate of determination being amended must be identified in the amendment in accordance with *California Corporations Code Section 907(a)*.

[*If the articles pursuant to Corp. Code § 202(e) authorize the board to increase or decrease the number of shares of a series subsequent to the issue of shares of that series, add:*]

Changing Number of Shares of Series
[*Corp. Code § 401(c), (e), (f)*]

(c) After any certificate of determination has been filed in the office of the California Secretary of State, the Board may increase or decrease the number of shares constituting any series by the adoption of another resolution appropriate for that purpose and the execution and filing in the office of the California Secretary of State of an officers' certificate, as that term is defined in *California Corporations Code Section 173*, setting forth a copy of the resolution, the number of shares of the series then outstanding, and the increase or decrease in the number of shares constituting that series.

If the Board increases or decreases the number of shares constituting any series in this manner, the provision of the original certificate of determination being amended must be identified in the amendment in accordance with *California Corporations Code Sectrion 907(a)*. If the number of shares in a series is decreased to zero, the certificate of determination that established the series is no longer an authorized series of the corporation.

Shareholder's Right to Share Certificate
[*Corp. Code § 416(a)*]

7.08. (a) Every holder of shares in the corporation shall be entitled to have a certificate signed in the name of the corporation by the Board Chairperson [or Vice Chairperson], if any, or the President or a Vice-President and by the Chief Financial Officer or an Assistant Treasurer, or the Secretary or any Assistant Secretary of the corporation, certifying the number of shares and the class or series of shares owned by the shareholder. Any or all of the signatures on the certificate may be facsimile. In case any officer, transfer agent, or registrar who has signed or whose facsimile signature has been placed on a certificate shall have ceased to be an officer, transfer agent, or registrar before that certificate is issued, the certificate may be issued by the corporation with the same effect as if that person were an

officer, transfer agent, or registrar at the date of issue.

[*For the civil liability imposed on the unreasonable neglect, failure, or refusal to issue share certificates, see Corp. Code § 2201.*]

Fractional Shares [*Corp. Code § 407*]

(b) If the corporation issues fractions of a share originally or on transfer, it shall issue certificates for those shares as provided in subparagraph (a) of this section. A certificate for a fractional share shall entitle the holder to exercise voting rights, to receive dividends on the shares, and to participate in any of the assets of the corporation in the event of liquidation.

Partly Paid Shares [*Corp. Code § 409(d)*]

(c) If the corporation issues partly paid shares, it shall issue certificates for those shares as provided in subparagraph (a) of this section.

[*See § 4.201[2], P 6.01, for an alternative provision; see also § 4.242 [2] for additional provisions relating to partly paid shares.*]

Contents of Certificate
[*Corp. Code §§ 409(d), 417, 418(a), (c), (d)*]

7. 09 (a) The certificates shall contain the matter specified in Paragraph 7.08(a) of this Article. In addition, if the shares of the corporation are classified or if any class of shares has two or more series, there shall appear on the certificate one of the following:

(1) A statement of the rights, preferences, privileges, and restrictions granted to or imposed on each class or series of shares authorized to be issued and on the holders of the shares.

(2) A summary of the rights, preferences, privileges, and restrictions with reference to the provisions of the Articles of Incorporation and any certificates of determination establishing those rights and restrictions.

(3) A statement setting forth the office or agency of the corporation from which shareholders may obtain, on request and without charge, a copy of the statement referred to in clause (1) of this paragraph.

(b) There shall also appear on the certificate (unless stated or summarized under clause (1) or clause (2) of subparagraph (a) of this section the statements required by all of the following clauses to the extent applicable:

(1) The fact that the shares are subject to restrictions on transfer.

(2) If the shares are assessable or are not fully paid, a statement that they are assessable or a statement of the total amount of consideration to be paid and the amount paid, as required by *Corporations Code Section 409(d)*.

(3) The fact that the shares are subject to a voting agreement under *California Corporations Code Section 706(a)* or an irrevocable proxy under *California Corporations Code Section 705(e)* or restrictions on voting rights contractually imposed by the corporation.

(4) The fact that the shares are redeemable.

(5) The fact that the shares are convertible and the period for conversion.

[*Unless stated on the certificate as set forth above, no restrictions on transfer, no right of redemption and no voting agreement under Corp. Code § 706(a), no irrevocable proxy under Corp. Code § 705(e) or voting restriction imposed by the corporation will be enforceable against a transferee (including a purchaser from the corporation) of the shares without actual knowledge of the restriction, liability, right, agreement, or proxy. No liability to assessment or for the unpaid portion of the subscription price will be enforceable against a transferee of the shares (including a purchaser from the corporation) unless stated on the certificate as set forth above (Corp. Code § 418(b)).*]

[*If corporation is a close corporation add:*]

(c) The following conspicuous legend must also appear on the face of the certificate: "This corporation is a close corporation. The number of holders of record of its shares of all classes cannot exceed _____ [*a number not in excess of 35*]. Any attempted voluntary inter vivos transfer that would violate this requirement is void. Refer to the Articles, Bylaws and any agreements on file with the secretary of the corporation for further restrictions." Any attempted voluntary inter vivos transfer of the shares of this corporation that would result in the number of holders of record of its shares exceeding the maximum number specified in its Articles is void if the certificate contains the foregoing legend.

[*By accepting share certificates containing the above legend, the original or subsequent holder of shares of a close corporation agrees and consents that he or she cannot make any transfer of shares that would violate the last sentence of subparagraph (c), above, and waives any right that he or she might otherwise have under any other law to sell those shares to a greater number of purchasers or to demand their registration under the Securities Act of 1933, or otherwise, as long as the corporation is a close corporation (Corp. Code § 421).*]

[*See § 4.201[2], P 6.02, for alternative provisions.*]

Exchange of Certificates

On Amendment of Articles or Otherwise
[*Corp. Code § 422(a)*]

7.10. (a) If the Articles are amended in any way affecting the statements contained in the certificates for outstanding shares, or it becomes desirable for any reason, in the discretion of the Board of Directors, to cancel any outstanding certificate for shares and issue a new certificate for the shares conforming to the rights of the holder, the Board may order any holders of outstanding certificates for shares to surrender and exchange them for new certificates within a reasonable time to be fixed by the Board.

Contents of Order [*Corp. Code § 422(b)*]

(b) The order may provide that a holder of any certificates so ordered to be surrendered is not entitled to vote or to receive dividends or exercise any of the other rights of shareholders until the holder has complied with the order, but the order operates to suspend those rights only after notice and until compliance. The duty of surrender of any outstanding certificates may also be enforced by the corporation by civil action.

[*See § 4.201[2], P 6.03, for alternative provisions.*]

**Lost, Stolen, or Destroyed Certificate;
Issuance of New Certificate [*Corp. Code § 419(a)*]**

7.11. (a) The corporation may issue a new share certificate or a new certificate for any other security in the place of any certificate previously issued by it, that is alleged to have been lost, stolen, or destroyed. The corporation may require the owner of the lost, stolen, or destroyed certificate, or the owner's legal representative, to give the corporation a bond (or other adequate security) sufficient to indemnify it against any claim that may be made against it (including any expense or liability) on account of the alleged loss, theft, or destruction of any certificate or the issuance of a new certificate.

[*The provision set out above reflects the provisions of Corp. Code § 419(a). In addition, Com. Code § 8405(a) provides for replacement of a lost, stolen, or destroyed share certificate if the owner requests replacement before the issuer receives notice that a protected purchaser has acquired the original, satisfies any reasonable requirements established by the issuer, and files an indemnity bond with the issuer. An undertaking that satisfies the requirements for the bond may be substituted for the bond required by statute (see Code Civ. Proc. § 995.210(a)). If the corporation refuses to issue a new share certificate, the owner of the lost, stolen, or destroyed certificate or the owner's legal representative may sue in the superior court to compel it to do so (Corp. Code § 419(b), (c)).*]

Purchase by Protected Purchaser [*Com. Code 8405(b)*]

(b) If after a new security has been issued for a lost, destroyed, or stolen security, a protected purchaser of the original security presents it for registration or transfer, the corporation must register the transfer unless registration would result in overissue, in which event the corporation's liability is that set forth in the last paragraph of Paragraph 8.03 of Article VIII of these Bylaws. In addition to any rights on the indemnity bond, the corporation may recover the new security from the person to whom it was issued or any person taking under him or her except a protected purchaser.

[*See § 4.201[2], P 6.04, for alternative provisions.*]

**Alternative System in Lieu of Certificates
[*Corp. Code § 416(b)*]**

7.12. Notwithstanding the provisions of subparagraph (a), Paragraph 7.08, of this Article VII, the corporation may adopt a system of issuance, recordation, and transfer of its shares by electronic or other means not involving any issuance of certificates, including provisions for notice to purchasers in substitution for the required statements on the certificates under subparagraphs (a) and (b) of Paragraph 7.09 of this Article VII, which system has been approved by the United States Securities and Exchange Commission, or that is authorized in any statute of the United States, or is in accordance with Division 8 of the California Commercial Code.

ARTICLE VIII
TRANSFER OF SHARES

Duty of Corporation [*Com. Code § 8401*]

8.01. When a security in registered form is presented to the corporation with a request to register transfer, the corporation is under a duty to register the transfer as required if

(a) Under the terms of the security, the person seeking registration of transfer is eligible to have the security registered in its name;

(b) The security is endorsed by the appropriate person, or by an agent who has actual authority to act for the appropriate person;

(c) Reasonable assurance is given that those endorsements are genuine and effective;

(d) Any applicable law relating to the collection of taxes has been complied with;

(e) The transfer does not violate any restriction on transfer imposed by the corporation;

(f) A demand that the corporation not register the transfer is not in effect, or the corporation has discharged its notification obligations under *Commercial Code Section 8403(b)* and no legal process or indemnity bond is obtained by the person demanding that the transfer not be registered; and

(g) The transfer is in fact rightful, or is to a protected purchaser.

[*For the authority of the corporation to require assurance that each necessary endorsement (see Com. Code § 8308) is genuine and effective, see Com. Code § 8402. For circumstances under which the corporation has a duty to notify, see Com. Code § 8403. A corporation under a duty to register a transfer of a security is liable to the person presenting it for registration or that person's principal for loss resulting from any unreasonable delay in registration or from failure or refusal to register the transfer (Com. Code § 8401(b)).*]

Nonliability of Corporation

Registration of Transfer [*Com. Code § 8404(a)*]

8.02. (a) Except as otherwise provided in any law relating to the collection of taxes, the corporation is not liable to the owner or any other person suffering loss as a result of the registration of a transfer of a security if

(1) Registration was made pursuant to an effective endorsement;

(2) The corporation received no demand that the corporation not register the transfer, such a demand was received but did not take effect, or the corporation complied with its notification obligations under *Commercial Code Section 8403(b)*;

(3) The corporation registered the transfer before receipt of, and reasonable opportunity to act on, legal process enjoining the corporation from registering the transfer; and

(4) The corporation was not acting in collusion with the wrongdoer.

[*For information on endorsements, see Com. Code § 8308; for the duty to notify, see Com. Code § 8403*].

Failure to Notify Corporation of Lost, Destroyed, or Stolen Security [*Com. Code § 8406*]

(b) If a security has been lost, apparently destroyed, or wrongfully taken and the owner fails to notify the corporation of that fact within a reasonable time after he or she has notice of it and the corporation registers a transfer of the security before receiving the notification, the owner is precluded from asserting against the corporation any claim

for registering the transfer or any claim to a new security.

Liability of Corporation
[*Com. Code §§ 8104, 8210, 8405*]

8.03. If the corporation has registered a transfer of a security to a person not entitled to it, the corporation on demand must deliver a like security to the true owner unless

(a) The registration was pursuant to subparagraph (a) of Paragraph 8.02 of this Article VIII;

(b) The owner is precluded from asserting any claim for registering the transfer as provided in subparagraph (c) of Paragraph 8.02 of this Article VIII; or

(c) The delivery would result in overissue.

In this last case, if an identical security that does not constitute an overissue is reasonably available for purchase, the person entitled to the issue may compel the corporation to purchase and deliver it to him or her against surrender of the security, if any, that he or she holds; or if the security is not reasonably available for purchase, the person entitled to the issue may recover from the corporation the purchase price the person or the last purchaser for value paid for it with interest from the date of demand.

Liability on Transfer of Partly Paid Shares

Good Faith Purchaser [*Corp. Code § 411*]

8.04. (a) A transferee of shares for which the full agreed consideration has not been paid to the corporation, who acquired them in good faith, without knowledge that they were not paid in full or to the extent stated on the certificate representing them, is liable only for the amount shown by the certificate to be unpaid on the shares represented by the certificate, until the transferee transfers the shares to one who becomes liable for the amount. The liability of any holder of the shares who derives title through a transferee and who is not a party to any fraud affecting the issue of the shares is the same as that of the transferee through whom title was derived.

Purchase With Knowledge [*Corp. Code § 412*]

(b) Every transferee of partly paid shares who acquired them under a certificate showing the fact of part payment, and every transferee of the shares (other than a transferee who derives title through a holder in good faith without knowledge and who is not a party to any fraud affecting the issue of the shares) who acquired them with actual knowledge that the full agreed consideration had not been paid to the extent stated on the certificate for the shares, is personally liable to the corporation for installments of the amount unpaid becoming due until the shares are transferred to one who becomes liable for the unpaid amount.

Transferor [*Corp. Code §§ 411, 412*]

(c) In either case mentioned in subparagraph (a) or (b) of this Paragraph 8.04, the transferor shall remain personally liable for the unpaid consideration if so provided in the certificate or agreed on in writing.

[*See §§ 4.244 and 4.245, for stock transfer restrictions.*]

ARTICLE IX. CORPORATE RECORDS, REPORTS, AND SEAL

Minutes of Meetings [*Corp. Code § 1500*]

9.01. The corporation shall keep minutes in written form of the proceedings of its shareholders, Board, and Board committees.

Books and Records of Account [*Corp. Code § 1500*]

9.02. The corporation shall keep adequate and correct books and records of account either in written form or in any other form capable of being converted into written form.

[*For the civil penalty imposed if a corporation neglects, fails, or refuses to keep or cause to be kept or maintained books of account, see Corp. Code § 2200.*]

Record of Shareholders [*Corp. Code § 1500*]

9.03. The corporation shall keep at its principal executive office, or at the office of its transfer agent or registrar, a record of its shareholders, giving the names and addresses of all shareholders and the number and class of shares held by each. The record must be kept either in written form or in any other form capable of being converted into written form.

[*For the civil penalty imposed if a corporation neglects, fails, or refuses to keep or cause to be kept or maintained the record of shareholders, see Corp. Code § 2200.*]

Shareholders' Right to Inspect Record of Shareholders by Written Demand of Holders of Specified Percentage of Shares [*Corp. Code § 1600(a)*]

9.04. (a) A shareholder or shareholders holding at least 5 percent in the aggregate of the outstanding voting shares of the corporation [*if applicable, add:* or who hold at least 1 percent of the voting shares and have filed _____ (a Schedule 14A with the United States Securities and Exchange Commission *or, if a bank with federally insured deposits,* a Form F-6 with the appropriate federal bank agency) relating to the election of directors of the corporation] shall have an absolute right to:

(1) Inspect and copy the record of shareholders' names and addresses and shareholdings during usual business hours on 5 business days' prior written demand on the corporation; and

(2) Obtain from the corporation's transfer agent, on written demand and on the tender of its usual charges for a list (the amount of which charges must be stated to the shareholder by the transfer agent on request), a list of shareholders' names and addresses, who are entitled to vote for the election of directors, and their shareholdings, as of the most recent record date for which it has been compiled or as of a date specified by the shareholder after the date of the demand. The list must be made available on or before the later of 5 business days after the demand is received or the date specified in the demand as the date when the list is to be compiled. The corporation shall have the responsibility to cause its transfer agent to comply with this requirement.

By Written Demand of Any Shareholder
[*Corp. Code § 1600(c)*]

(b) The record of shareholders shall also be open to inspection and copying by any shareholder [or holder of a

voting trust certificate] at any time during usual business hours on written demand on the corporation, for a purpose reasonably related to the holder's interests as a shareholder [or holder of a voting trust certificate].

Inspection by Agent or Attorney [*Corp. Code § 1600(d)*]

(c) Any inspection and copying under this Paragraph 9.04 may be made in person or by agent or attorney.

[*See § 4.201[2], P 7.02, for alternative provisions.*]

Shareholders' Right to Inspect Books of Account and Minutes [*Corp. Code § 1601*]

9.05. The accounting books and records and minutes of proceedings of the shareholders, Board, and Board committees of this corporation shall be open to inspection on the written demand on the corporation of any shareholder [or holder of a voting trust certificate] at any reasonable time during usual business hours, for a purpose reasonably related to the holder's interests as a shareholder [or as the holder of the voting trust certificate]. The inspection may be made in person or by agent or attorney, and the right of inspection includes the right to copy and make extracts.

[*See § 4.201[2], P 7.02, for alternative provisions.*]

Inspection by Directors [*Corp. Code § 1602*]

9.06. Every director of this corporation shall have the absolute right at any reasonable time to inspect and copy all books, records, and documents of every kind and to inspect the physical properties of this corporation. The inspection may be made in person or by agent or attorney and the right of inspection includes the right to copy and make extracts.

[*See § 4.201[2], P 7.02, for alternative provisions.*]

Annual Report

When Waived [*Corp. Code § 1501(a)(1)*]

9.07. (a) No annual report shall be prepared or sent to shareholders as long as this corporation has less than 100 holders of record of its shares determined as provided in *California Corporations Code Section 605*.

When Required [*Corp. Code §§ 113, 601(a), 1501(a)(1)*]

(b) If the corporation has 100 or more holders of record of its shares determined as provided in *California Corporations Code Section 605*, the Board of Directors shall cause an annual report to be sent by first-class mail, postage prepaid, to the shareholders not later than 120 days after the close of the fiscal year and at least 15 days before the annual meeting of shareholders to be held during the next fiscal year; provided, however, that the annual report may be sent by third-class mail if it is sent to shareholders at least 35 days before the annual meeting. The report and any accompanying material may also be sent by electronic transmission in accordance with *California Corporations Code Section 20*.

[This provision may be modified to permit a corporation that is registered under Section 12 of the Securities Exchange Act of 1934 (see 15 U.S.C. § 78l) to satisfy the delivery requirement by posting its annual report on an Internet website and providing its shareholders with written notice of the availability of the report (see Corp. Code § 1501(a)(4); see also 17 C.F.R. § 240.14a-16).]

Contents [*Corp. Code § 1501(a)(1), (b)*]

(c) (1) The annual report shall contain a balance sheet as of the end of the fiscal year and an income statement and statement of cashflows for the fiscal year, accompanied by any report of independent accountants or, if there is no report, the certificate of an authorized officer of the corporation that the statements were prepared without audit from the books and records of the corporation.

(2) In addition, if the corporation is either not subject to the reporting requirements of Section 13 of the Securities Exchange Act of 1934, or is exempted from the reporting requirements by Section 12(g)(2) of that Act, the annual report shall also describe briefly both of the following:

(i) Any transaction (excluding compensation of officers and directors) during the previous fiscal year involving an amount in excess of $40,000 (other than contracts let at competitive bid or services rendered at prices regulated by law) to which the corporation [or its parent or subsidiary] was a party and in which any director or officer of the corporation [or of a subsidiary] or [(if known to the corporation or its parent or subsidiary)] any holder of more than 10 percent of the outstanding voting shares of the corporation had a direct or indirect material interest, naming the person and stating the person's relationship to the corporation, the nature of the person's interest in the transaction and, if practicable, the amount of the interest; provided, that in the case of a transaction with a partnership of which the person is a partner, only the interest of the partnership need be stated; and provided further that no report need be made in the case of transactions approved by the shareholders, as that term is defined in *California Corporations Code Section 153* (see Paragraph 2.23 of these Bylaws).

(ii) The amount and circumstances of any indemnification or advances aggregating more than ten thousand dollars paid during the fiscal year to any officer or director of the corporation pursuant to *California Corporations Code Section 317* (see Paragraphs 2.25-2.31 of these Bylaws); provided, that no report need be made in the case of indemnification approved by the shareholders, as that term is defined in *California Corporations Code Section 153*, under *California Corporations Code Section 317(e)(3)* (see Paragraph 2.28 of these Bylaws).

[*See § 4.246[1], § 4.201[2], P 7.03, and § 4.246 [2], for alternative provisions. For the penalty imposed when a corporation neglects, fails, or refuses to prepare or cause to be prepared or submitted the financial statements required by the General Corporation Law to be prepared or submitted, see Corp. Code § 2200. For the criminal penalties imposed for false or fraudulent accounts, statements of operation, values, etc., see Corp. Code §§ 2254-2256.*]

Special Financial Statements to Shareholders
[*Corp. Code § 1501(c), (d)*]

9.08. (a) Any shareholder or shareholders holding at least 5 percent of the outstanding shares of any class of this corporation may make a written request to the corporation for an income statement of the corporation for the 3-month, 6-month, or 9-month period of the current fiscal year ended more than 30 days before the date of the request and a balance sheet of the corporation as of the end of that period and, in addition, if no annual report for the last fiscal year has been sent to shareholders, the statements referred to in clause (1) of subparagraph (c) of Paragraph 9.07 of this Article IX for the last fiscal year. The statement must be delivered or mailed to the person making the request within 30 days after the request. A copy of the statements must be kept on file in the principal office of the corporation for 12 months and they must be exhibited at all reasonable times to any shareholder demanding an examination of them or a copy must be mailed to that shareholder.

(b) The quarterly income statements and balance sheets referred to in this Paragraph 9.08 must be accompanied by

the report, if any, of any independent accountants engaged by the corporation or the certificate of an authorized officer of the corporation that those financial statements were prepared without audit from the books and records of the corporation.

[*For the civil penalty imposed when a corporation neglects, fails, or refuses to prepare or cause to be prepared or submitted the financial statements required by the General Corporation Law to be prepared or submitted, see Corp. Code § 2200. For the criminal penalties imposed for false or fraudulent accounts, statements of operations, and values, see Corp. Code §§ 2254-2256.*]

Fiscal Year

9.09. The fiscal year of the corporation shall begin on the first day of _____ [*month*] and end on the last day of _____ [*month*] in each year.

Corporate Seal [*Corp. Code § 207(a)*]

9.10. The Board shall adopt a corporate seal that shall be in the following form and design: _____ [*specify*]. The Secretary of the corporation shall have custody of the seal and affix it in appropriate cases to all corporate documents. Failure to affix the seal does not, however, affect the validity of any instrument.

[*See § 4.247[2] for alternative provisions. See also § 4.216[2], P (b)(1), for provision merely confirming power of corporation to adopt seal.*]

ARTICLE X
CERTIFICATION, INSPECTION, AND AMENDMENT OF BYLAWS

Inspection and Certification of Bylaws
[*Corp. Code §§ 213, 314*]

10. 01. The corporation shall keep at its principal executive office in California the original or a copy of its Bylaws as amended to date, which shall be open to inspection by the shareholders at all reasonable times during office hours. The original or a copy of the Bylaws certified to be a true copy by a person purporting to be the Secretary or an Assistant Secretary of the corporation is prima facie evidence of the adoption of the bylaws and of the matters stated in them.

Adoption, Amendment, Repeal of Bylaws
by Shareholders [*Corp. Code §§ 207(b), 211, 212*]

10. 02. These Bylaws may, from time to time and at any time, be amended or repealed, and new or additional bylaws adopted, by approval of the outstanding shares of the corporation, as that term is defined in *Section 152 of the California Corporations Code*, provided, however, that the bylaws may not contain any provision in conflict with law or with the Articles of Incorporation of the corporation and, provided further, that a bylaw reducing the number of directors to a number less than 5 (see Paragraph 2.03 of Article II of these Bylaws) cannot be adopted if the votes cast against its adoption at a meeting of shareholders or the shares not consenting in the case of action by written consent are equal to more than 16 2/3 percent of the outstanding shares entitled to vote.

[*See § 4.216 [2], P (b)(2), for alternative provisions.*]

Adoption, Amendment, Repeal of Bylaws by Directors [*Corp. Code §§ 211, 212*]

10. 03. Subject to the right of the outstanding shares to adopt, amend, or repeal bylaws (see Paragraph 10.02 of these Bylaws) and to any restrictions imposed by the Articles on the power of the Board to adopt, amend, or repeal bylaws, these Bylaws may, from time to time and at any time, be amended or repealed, and new or additional bylaws adopted, by approval of the Board of Directors, provided, however, that the bylaws may not contain any provision in conflict with law or with the Articles and, provided further, that after shares are issued any bylaw changing the number of directors or changing from a fixed to a variable Board may be adopted only by approval of the outstanding shares.

[*See § 4.216 [2], P (b)(2), for alternative provision. See § 4.248 [2] for provisions limiting power of board to adopt, amend, or repeal bylaws.*]

ARTICLE XI
CONSTRUCTION OF BYLAWS

11. 01. Unless otherwise stated in these Bylaws or unless the context otherwise requires, the definitions contained in the General Corporation Law shall govern the construction of these Bylaws. Without limiting the generality of the foregoing, the masculine gender includes the feminine and neuter, the singular number includes the plural and the plural number includes the singular, and the word "person" includes a corporation or other entity as well as a natural person.

CERTIFICATE OF SECRETARY [*Corp. Code § 314*]

I, the undersigned, do hereby certify:

1. That I am the Secretary of _____ [*name of corporation*], a California corporation; and

2. That the foregoing Bylaws, consisting of _____ pages, constitute the Bylaws of said corporation as duly approved by unanimous vote of the persons named in the Articles of Incorporation to act as the first directors of this corporation, at a meeting of the Board of Directors duly held on _____[*date*], at _____ [*location of meeting, e.g.*, the principal executive office of the corporation located at _____ (*address*), California].

IN WITNESS WHEREOF, I have signed my name and affixed the seal of the corporation on _____[*date*].

_____ [*signature*]

[*typed name*]

Secretary

[*For other forms for certificates, see §§ 4.201[2], 4.261[2], 4.262[2].*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness

& Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock CertificatesBusiness & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
A. Sets of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.201

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.201 Complete Bylaws--Short Form

[1] Comment--Use of Form

This form is a shorter set of bylaws than the one illustrated in *§ 4.200[2]*. It omits many of the statutory provisions contained in § 4.200[2] that cannot be varied by the bylaws, as well as some of the permissive provisions. These bylaws are for use by a corporation whose directors and officers have access to legal counsel or who are generally familiar with the General Corporation Law, the Corporate Securities Act, the rules and regulations of the Commissioner of Corporations, and applicable federal statutes and regulations.

Some of the mandatory statutory provisions of particular interest to directors, officers, and shareholders are included [*see* [2], PP 2.03- *2.05*, *3.04*, *3.05*, 3.08, *6.01*, 6.03, *6.06*, 6.08, *7.01*, *7.02*, 8.01, *below*]. Provisions based on statutes setting forth mandatory requirements, unless the bylaws otherwise provide, or subject to additional requirements included in the bylaws, are also set forth [*see* [2], PP *2.06*, *2.07*, 2.09, *2.10*, *3.01*, *3.03*, *3.06*, 3.07, *4.01*, 7.03, *below*], as are provisions covering matters expressly authorized or required by statute to be included in the bylaws [*see* [2], PP 2.08, *2.13*, *2.14*, *3.02*, *4.02- 4.06*, *below*] and provisions based only in part on mandatory statutory provisions [*see* [2], PP *6.02*, 6.04, *below*].

The governing or applicable statutes, if any, are cited in the heading immediately above the section or paragraph to which they apply. If any of the bylaws set forth are to be varied, the statutes cited should be checked to ascertain whether the change is permissible and, if it is, to note any restrictions or limitations imposed by the statutes.

This form assumes that the corporation has elected to issue stock certificates rather than use an electronic system of issuance, recordation and transfer [*see Corp. Code § 416(b)*]. Paragraph 6.08 of the form allows the corporation to adopt this alternative system of uncertificated securities. For a general discussion of certificated and uncertificated securities, see "Share Certificates--Issuance" and subsequent headings in the Legal Background to Ch. 6I, *Issuance of Equity Securities*.

[2] Form

Complete Bylaws--Short Form

BYLAWS OF _____ [*name of corporation*]

ARTICLE I
OFFICES
[*Corp. Code § 1502(a)*]

1.01. The corporation shall have its principal executive office in _____ [*city and county*], California, and may have offices at other places within or outside California as the Board of Directors may from time to time designate.

[*See § 4.210 for comment and alternative provisions.*]

ARTICLE II
DIRECTORS

Responsibility of Board [*Corp. Code § 300(a)*]

2.01. Subject to the provisions of the General Corporation Law and to any limitations in the Articles of Incorporation of the corporation relating to action required to be approved by the shareholders, as that term is defined in *California Corporations Code Section 153*, or by the outstanding shares, as that term is defined in *California Corporations Code Section 152* or by less than a majority vote of a class or series of preferred shares, as that term is defined in *California Corporations Code Section 402.5*, the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the Board of Directors. The Board may delegate the management of the day-to-day operation of the business of the corporation to a management company or other person, provided that the business and affairs of the corporation are managed and all corporate powers are exercised under the ultimate direction of the Board.

[*See § 4.216[2] for consolidation of this provision with provisions setting forth purposes and powers of corporation.*]

Number of Directors [*Corp. Code § 212(a)*]

2.02. The number of directors of this corporation shall be _____ [*a number not less than three*].

[*See § 4.211[2] for alternative provisions. For clauses setting forth qualifications of directors, see § 4.212[2].*]

Election and Term of Office [*Corp. Code § 301*]

2.03. Directors shall be elected at each annual meeting of shareholders to hold office until the next annual meeting of shareholders and until a successor has been elected and qualified.

[*See § 4.200[2], P 2.04, for alternative provision.*]

Removal of Directors [*Corp. Code §§ 302-304*]

2.04. Any individual director or the entire Board of Directors may be removed from office in the manner provided by law.

[*See § 4.200[2], P 2.06(c), (d), for alternative provisions.*]

Filling Vacancies

By Board [*Corp. Code § 305(a)*]

2.05. (a) Except as otherwise provided in the Articles of Incorporation of the corporation or in these Bylaws, and except for a vacancy created by the removal of a director, vacancies on the Board may be filled by approval of the Board of Directors pursuant to *Corporations Code Section 151*, or, if the number of directors then in office is less than a quorum, by (1) the unanimous written consent of the directors then in office; (2) the affirmative vote of a majority of the directors then in office at a meeting held pursuant to notice or waivers of notice complying with *Corporations Code Section 307*; or *(3)* a sole remaining director.

[*See § 4.213[2] for alternative provisions.*]

By Shareholders [*Corp. Code §§ 305(a)-(c), 603(d)*]

(b) Unless the Articles of Incorporation of the corporation are amended, or a Bylaw is adopted by the shareholders to provide that vacancies occurring in the Board by reason of the removal of directors may be filled by the Board, any vacancies may be filled only by approval of the shareholders as that term is defined in *California Corporations Code Section 153*. Any vacancy authorized to be filled but not filled by the directors may be filled by the shareholders and any election by written consent requires the consent of a majority of the outstanding shares entitled to vote; provided, however, that no director shall be elected by written consent to fill a vacancy created by removal of any director except by the unanimous written consent of all shares entitled to vote for the election of directors.

[*See § 4.214[2] for alternative provisions.*]

Call of Meetings [*Corp. Code §§ 212(b)(2), 307(a)(1)*]

2.06. Meetings of the Board may be called by the Board Chairperson, if any, or the President, or any Vice-President, or the Secretary, or any two directors of the corporation.

[*See § 4.220[2] for alternative provisions.*]

Place of Meetings [*Corp. Code §§ 212(b)(2), 307(a)(5)*]

2.07. All meetings of the Board shall be held at the corporation's principal executive office.

[*See § 4.200[2], P 2.09, and § 4.217[2], for alternative provisions.*]

PRACTICE TIP:

The above provision gives the Board less flexibility than the alternate provision which allows the Board to designate the place of the meeting [*see § 4.217[2]*]. *Commentary by Mary E. Ahern.*

Time of Regular Meetings
[*Corp. Code §§ 212(b)(2), 307(a)(2)*]

2.08. Regular meetings of the Board shall be held, without call or notice, immediately following each annual meeting of the shareholders of this corporation.

[*See § 4.200[2], PP 2.10, 2.11, and § 4.218[2], for alternative provisions.*]

Notice of Waiver

Notice of Special Meetings
[*Corp. Code §§ 20, 113, 212(b)(2), 307(a)(2)*]

2.09. Notice of any special meeting of the Board shall be given to each director by first-class mail, postage prepaid, at least four days in advance of the meeting, or delivered in person or by telephone, including a voice messaging system, or by electronic transmission at least 48 hours in advance of the meeting.

Waiver of Notice [*Corp. Code §§ 212(b)(2), 307(a)(3)*]

Notice need not be given to any director who signs, before or after the meeting, either a waiver of notice, a consent to the holding of the meeting, or an approval of the minutes of the meeting, or who attends the meeting without protesting the lack of notice before or at the commencement of the meeting. All waivers, consents, and approvals shall be filed with the corporate records or made a part of the minutes of the meeting to which they pertain.

[*See § 4.200[2], PP 2.11, 2.12, and §§ 4.218[2] and 4.219[2], for alternative provisions.*]

Quorum [*Corp. Code § 307(a)(7)*]

2.10. A majority of the authorized number of directors constitutes a quorum of the Board for the transaction of business except as provided below.

[*See § 4.221 for comment and alternative provisions.*]

Transactions of Board [*Corp. Code § 307(a)(8)*]

2.11. Except as otherwise provided in the Articles, in these Bylaws, or by law, every act or decision done or made by a majority of the directors present at a duly held meeting at which a quorum is present is the act of the Board, provided, however, that any meeting at which a quorum was initially present may continue to transact business notwithstanding the withdrawal of directors if any action taken is approved by at least a majority of the required quorum for the meeting.

[*See § 4.222 for comment and alternative provisions.*]

Adjournment [*Corp. Code § 307(a)(4)*]

2.12. A majority of the directors present at any meeting, whether or not a quorum is present, may adjourn the meeting to another time and place. If the meeting is adjourned for more than 24 hours, notice of the adjournment to another time or place must be given before the time of the adjourned meeting to the directors who were not present at the time of the adjournment.

Conduct of Meetings
[*Corp. Code §§ 212(b)(2), 307(a)(6)*]

2.13. The Board Chairperson, or if there is no such person, the President, or, in the Chairperson's absence, any director selected by the directors present, shall preside at meetings of the Board of Directors. The Secretary of the corporation or, in the Secretary's absence, any person appointed by the presiding officer shall act as Secretary of the Board. Board members may participate at board meetings through use of a conference telephone call, electronic video screen communication, or electronic transmission by and to the corporation.

Participation in a meeting through use of a conference telephone call or electronic video screen communication pursuant to this Paragraph constitutes presence in person at that meeting as long as all members participating in the meeting are able to hear one another.

Participation in a meeting through electronic transmission by and to the corporation (other than a conference telephone call and electronic video screen communication) constitutes presence in person at that meeting if both of the following are true:

(1) Each board member participating in the meeting can communicate with all of the other members concurrently.

(2) Each member is provided the means of participating in all matters before the board, including the capacity to propose, or interpose an objection, to a specific action to be taken by the corporation.

Compensation [*Corp. Code § 212(b)(4)*]

2.14. Directors shall receive such compensation for their services and reimbursement for their expenses as shall be determined from time to time by resolution of the Board.

[*See § 4.215 for comment and alternative provision.*]

Indemnification [*Corp. Code § 317*]

2.15. The corporation has power to indemnify any person who is or was a director, officer, employee, or other agent of this corporation or of its predecessor, or is or was serving as such of another corporation, partnership, joint venture, trust, or other enterprise, at the request of this corporation against expenses, judgments, fines, settlements, and other amounts actually and reasonably incurred in connection with any threatened, pending, or completed action or proceeding, whether civil, criminal, administrative, or investigative, as provided in *Section 317 of the California Corporations Code*, as that section now exists or may from time to time be amended to provide.

[*See § 4.200[2], PP 2.25-2.32, and § 4.216 [2], P (b)(9), for alternative provisions.*]

ARTICLE III
SHAREHOLDERS' MEETINGS

Place of Meetings
[*Corp. Code §§ 212(b)(2), 600(a)*]

3.01. Meetings of the shareholders shall be held at the corporation's principal executive office.

[*See § 4.200[2], P 4.01, and § 4.228[2] for alternative provisions.*]

PRACTICE TIP:
The foregoing provision gives the Board less flexibility than the alternate provision which allows the Board to designate the place of the meeting [*see § 4.228[2]*]. *Commentary by Mary E. Ahern.*

Time of Meeting
[*Corp. Code §§ 212(b)(2), (4), 600(b)*]

3.02. The annual meeting of shareholders shall be held on the _____ [*number, e.g.,* first] _____ [*day of week, e.g.,* Tuesday] of _____ [*month*] of each year at _____ [*hour*] _____.M. If this day falls on a legal holiday, the annual meeting shall be held at the same time on the next business day following the holiday.

[*See § 4.229 for comment and alternative provisions.*]

Persons Entitled to Call Special Meetings
[*Corp. Code §§ 212(b)(2), 600(d)*]

3.03. Special meetings of the shareholders may be called at any time by the Board of Directors, the Board Chairperson, if any, the President of the corporation, or the holders of shares entitled to cast not less than 10 percent of the votes of the meeting.

[*See § 4.232 for comment and alternative provisions.*]

Notice of Meeting [*Corp. Code §§ 212(b)(2), 601*]

3.04. Notice of annual and special meetings of the shareholders shall be given as provided in *Section 601 of the Corporations Code* as that section now exists or may from time to time be amended to provide.

[*See § 4.200[2], P 4.03, § 4.230[2], and § 4.231[2], for alternative provisions.*]

Waiver of Notice and Other Defects
[*Corp. Code § 601(e)*]

3.05. The transactions of any meeting of shareholders, however called and noticed and wherever held, shall be as valid as though had at a meeting duly held after regular call and notice, if a quorum is present either in person or by proxy and if, either before or after the meeting, each of the persons entitled to vote not present in person or by proxy signs a written waiver of notice or a consent to the holding of the meeting or an approval of the minutes of the meeting. All such waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meeting. Attendance by a person at the meeting also constitutes a waiver of notice to that person if he or she fails to

object at the beginning of the meeting to the transaction of business because the meeting was not lawfully called or convened, but such attendance does not constitute a waiver of the right to object to the consideration of matters required by law or these Bylaws to be included in the notice but not so included if the objection is expressly made at the meeting.

[*See § 4.200[2], P 4.03, for alternative provisions and § 4.229[1].*]

Quorum [*Corp. Code §§ 112, 602*]

3.06. A majority of the shares entitled to vote, represented in person or by proxy, constitutes a quorum for the transaction of business. Business may be continued after withdrawal of enough shareholders to leave less than a quorum, provided any action taken (other than adjournment) is approved by at least a majority of the shares required to constitute a quorum. In the absence of a quorum, any meeting may be adjourned by a majority vote of the shares represented in person or by proxy.

[*See § 4.233 for comment and alternative provisions. See also § 4.231[2] for alternative provisions regarding adjourned meetings.*]

Election by Ballot [*Corp. Code § 708(e)*]

3.07. Elections for directors need not be by written ballot unless a shareholder demands election by ballot at the meeting and before the voting begins.

[*See § 4.234 for comment and alternative provision.*]

Voting [*Corp. Code § 701(d)*]

3.08. Except as otherwise provided in the Articles of Incorporation or by agreement or by the General Corporation Law, shareholders at the close of business on the record date are entitled to notice and to vote, notwithstanding the transfer of any shares on the books of the corporation after the record date.

ARTICLE IV
OFFICERS

Titles, Appointment, Terms, and Compensation
[*Corp. Code §§ 212(b)(6), 312(a)*]

4.01. This corporation shall have _____ [a Board Chairperson *or* a President *or* both a Board Chairperson and a President], a Secretary, and a Chief Financial Officer who may also be called Treasurer. The Board of Directors may designate and appoint any other officers that may be necessary to enable the corporation to sign instruments and share certificates [*specify additional officers if desired, e.g.*,, including one or more Vice-Presidents, one or more Assistant Secretaries, and one or more Assistant Treasurers]. These other officers shall hold office for the period, have the authority, and perform the duties that the Board may, by resolution, determine. One person may hold any two or more offices [*specify any restrictions, e.g.*,, except that one person may not hold the offices of both President and Secretary or President and Vice-President]. In its discretion, the Board of Directors may leave unfilled, for any period it may fix, any offices except those of _____ [Board Chairperson *or* President], Secretary, and Chief Financial Officer. All officers shall be chosen by, and, subject to any rights an officer may have under an employment contract with the corporation, hold office at the pleasure of, the Board. The Board shall fix each officer's

compensation.

[*See § 4.238[2] for alternative provisions.*]

Board Chairperson
[*Corp. Code §§ 212(b)(6), 312(a)*]

4.02. The Board Chairperson, if there is such an officer, shall, if present, preside at all meetings of the Board and perform any other powers and duties that may from time to time be assigned by the Board or prescribed by law or by these Bylaws.

[*See § 4.200[2], P 5.06, for alternative provisions.*]

President [*Corp. Code §§ 212(b)(6), 312(a)*]

4.03. Subject to any supervisory powers that may be given by the Board of Directors to the Board Chairperson, if there is such an officer, the President shall be the chief executive officer of the corporation and shall perform all the duties commonly incident to that office. The President shall preside at all meetings of the shareholders and, if there is no Board Chairperson, at all meetings of the Board.

[*See § 4.200[2], P 5.07, for alternative provisions.*]

Vice-President [*Corp. Code §§ 212(b)(6), 312(a)*]

4.04. The Vice-President, or the Vice-Presidents in the order of their seniority, may assume and perform the duties of the President in the absence or disability of the President or whenever the office of President is vacant, and shall perform any other duties and have any other powers that the Board or the President shall from time to time designate.

[*See § 4.200[2], P 5.08, for alternative provisions.*]

Secretary [*Corp. Code §§ 212(b)(6), 312(a)*]

4.05. The Secretary shall ensure that all notices are duly given in accordance with the provisions of these Bylaws or as required by law; shall keep the minutes of all proceedings of shareholders and of the Board; and shall perform any other duties that are incident to the office of Secretary or that are assigned from time to time by the Board or by the President.

[*See § 4.200[2], P 5.09, for alternative provisions.*]

Chief Financial Officer
[*Corp. Code §§ 212(b)(6), 312(a), 1500*]

4.06. The Chief Financial Officer shall receive and have custody of all funds and securities of the corporation; keep and maintain adequate and correct books and records of account and of the corporation's assets and liabilities; and shall perform any other duties that may be assigned from time to time by the Board or by the President.

[*See § 4.200[2], P 5.11, for alternative provisions.*]

ARTICLE V
EXECUTION OF INSTRUMENTS

Execution [*Corp. Code § 313*; *see Snukal v. Flightways Manufacturing, Inc. (2000) 23 Cal. 4th 754, 786-787, 98 Cal. Rptr. 2d 1, 3 P.3d 286]*

5.01. The Board of Directors may, in its discretion, determine the method and by resolution designate the signatory officer or officers, or other person or persons, to execute any corporate instrument or document, or to sign the corporate name without limitation, except as otherwise provided by law, and that execution or signature shall be binding on the corporation.

[*See § 4.200[2], PP 6.01-6.04, for alternative provisions.*]

ARTICLE VI
ISSUANCE AND TRANSFER OF SHARES

Shareholder's Right to Certificate
[*Corp. Code §§ 407, 409(d), 416(a)*]

6.01. Every holder of shares in the corporation shall be entitled to a certificate certifying the number of shares and the class or series of shares owned by him or her. This right extends to fractional shares and partly paid shares if those shares are issued by the corporation.

[*See § 4.200[2], P 7.08, for alternative provisions; see § 4.241[2], for provision prohibiting issuance of fractional shares, and § 4.242[2], for additional provisions relating to partly paid shares.*]

Share Certificates
[*Corp. Code §§ 409(d), 416(a), 417, 418(a), (c), (d)*]

6.02. The certificates shall be in the form provided by the Board of Directors and shall fully comply with the provisions of the California Corporations Code. The certificates shall be signed by the Board Chairperson or Vice Board Chairperson, if any, or the President or a Vice-President, and by the Chief Financial Officer or an Assistant Treasurer or the Secretary or any Assistant Secretary of the corporation, and the seal of the corporation shall be affixed to the certificates.

[*See § 4.200[2], P 7.09, for alternative provisions.*]

Exchange of Certificates [*Corp. Code § 422(a)*]

6.03. If the Articles of Incorporation are amended in any way affecting the statements contained in the certificates for outstanding shares, or it becomes desirable for any reason, in the discretion of the Board of Directors, to cancel any outstanding certificate for shares and issue a new certificate conforming to the rights of the holder, the Board may order any holders of outstanding certificates to surrender and exchange them for new certificates within a reasonable time to

be fixed by the Board.

[*See § 4.200[2], P 7.10, for alternative provisions.*]

Replacement of Certificates
[*Corp. Code §§ 419(a), 422(b); Com. Code § 8405*]

6.04. No new certificate shall be issued until the former certificate for the shares represented has been surrendered and canceled. However, if the certificate is lost, stolen, or destroyed, the corporation shall, if so requested by the shareholder, issue a new certificate, provided it has received no notice that the certificate has been acquired by a bona fide purchaser, but it may require the giving of a bond, undertaking, or other adequate security sufficient to indemnify it against any claim that may be made against it on account of the alleged loss, theft, or destruction of the certificate or the issuance of the new certificate.

[*See § 4.200[2], P 7.11, for alternative provisions.*]

Transfer of Shares

6.05. Shares of the corporation may be transferred by endorsement by the signature of the owner, the owner's authorized agent, attorney, or legal representative, and the delivery of the certificate; but a transfer is not valid, except as to the parties to the transfer, until it is entered on the books of the corporation so as to show the names of the parties by whom and to whom transferred, the number of the certificate, and the number or designation of the shares and the date of the transfer, and until the old certificate is surrendered to the corporation and canceled.

[*See §§ 4.244[2] and 4.245[2] for stock transfer restrictions.*]

Duty of Corporation to Register Transfer
[*Com. Code § 8401(a)*]

6.06. The corporation is under a duty to register the transfer when the certificate, properly endorsed, is presented to it with a request to register transfer; the person seeking registration of transfer is eligible to have the security registered in its name; reasonable assurance is given that the endorsements are genuine and effective; the transfer does not violate any restriction on transfer imposed by the corporation; a demand that the corporation not register the transfer is not in effect, or the corporation has discharged its notification obligations under *Commercial Code Section 8403(b)* and no legal process or indemnity bond is obtained by the person demanding that the transfer not be registered; the transfer is in fact rightful, or is to a protected purchaser; and any applicable law relating to the collection of taxes has been compiled with.

[*For the civil penalty imposed if the corporation unreasonably neglects, fails, or refuses to enter a transfer of shares on the corporate books, see Corp. Code § 2201.*]

Liability for Partly Paid Shares
[*Corp. Code §§ 411, 412*]

6.07. The transferor and transferee of partly paid shares, if any are issued, shall be liable to the corporation for the unpaid balance of those shares as provided by law.

[*See § 4.242 for comment and additional provisions relating to partly paid shares.*]

Alternative System in Lieu of Certificates
[*Corp. Code § 416(b)*]

6.08. Notwithstanding the foregoing provisions of this Article VI, the corporation may adopt a system of issuance, recordation, and transfer of its shares by electronic or other means not involving any issuance of certificates, if the system has been approved by the United States Securities and Exchange Commission, if it is authorized in any statute of the United States, or if it is in accordance with Division 8 of the California Commercial Code.

ARTICLE VII
CORPORATE RECORDS AND REPORTS

Keeping Records [*Corp. Code § 1500*]

7.01. The corporation shall keep adequate and correct books and records of account and shall keep minutes of the proceedings of its shareholders, Board of Directors, and Board committees, and shall keep at its principal executive office, or at the office of its transfer agent or registrar, a record of its shareholders, giving the names and addresses of all shareholders and the number and class of shares held by each. The minutes must be kept in written form. The other books and records shall be kept either in written form or in any other form capable of being converted into written form.

[*For the civil penalty imposed if a corporation neglects, fails, or refuses to keep or cause to be kept or maintained the record of shareholders or book of account, see Corp. Code § 2200; for criminal penalties imposed for false statements in reports, accounts, etc., see Corp. Code §§ 2254-2256.*]

Inspection by Shareholders and Directors
[*Corp. Code §§ 1600(a), (d), 1601, 1602*]

7.02. Any shareholder [or holder of a voting trust certificate] shall have the right on written demand to inspect and copy the record of shareholders, the accounting books and records, and the minutes as provided by law. Each director shall have the absolute right at any reasonable time to inspect and copy all books, records, and documents of every kind and to inspect the physical properties of the corporation.

[*See § 4.200[2], PP 9.04-9.06, for alternative provisions.*]

Waiver of Annual Report [*Corp. Code § 1501(a)(1)*]

7.03. So long as this corporation has less than 100 holders of record of its shares, determined as provided in *Corporations Code Section 605*, no annual report shall be required to be sent to shareholders.

[*See § 4.246[2], § 4.200[2], P 9.07, and § 4.246 [2] for alternative provisions.*]

ARTICLE *VIII*
AMENDMENT OF BYLAWS

By Shareholders and Directors

[*Corp. Code §§ 207(b), 211, 212*]

8.01. These Bylaws may, from time to time and at any time, be amended or repealed, and new or additional bylaws adopted, by approval of the outstanding shares, as that term is defined in *California Corporations Code Section 152*, or, subject to any restrictions imposed by the Articles of Incorporation on the power of the Board of Directors to adopt, amend, or repeal Bylaws, by approval of the Board; provided, however, that such Bylaws may not contain any provision in conflict with law or with the Articles of this corporation, and, provided further, that: (1) after shares are issued a Bylaw changing the number of directors or from a fixed to a variable Board can be adopted only by approval of the outstanding shares; and (2) any such Bylaw reducing the number of directors below five cannot be adopted if the votes cast against its adoption at a shareholders' meeting, or the shares not consenting in the case of action by written consent, are equal to more than 16 2/3 percent of the outstanding shares entitled to vote.

[*See § 4.200[2], PP 10.02 and 10.03 for alternative provisions.*]

CERTIFICATE OF SECRETARY [*Corp. Code § 314*]

I certify that:

1. I am the Secretary of _____ [*name of corporation*].

2. The attached Bylaws are the Bylaws of the corporation approved by the Board of Directors on _____[*date*], _____ [*either* at a meeting duly held *or* by their unanimous written consent].

_____Dated:

_____ [*signature*]

[*typed name*]

Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock CertificatesBusiness & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of Stock



35 of 166 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
A. Sets of Bylaws

2-4 California Legal Forms--Transaction Guide §§ 4.202-4.209

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

[Reserved]

§§ 4.202[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.210

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.210 Principal Executive Office [Corp. Code § 1502(a)]

[1] Comment

[a] Use of Form

This provision may be used if the bylaws are to specify the complete address of the corporation's principal executive office in California and to authorize the board of directors to change that address and to establish additional offices. Paragraph 1.01 of the form in *§ 4.200[2]* sets forth the complete address (street, city, and state) of the corporation's principal executive office. Paragraph 1.01 of the form in *§ 4.201[2]* sets forth only the city and county in California in which the corporation's principal executive office is located.

[b] Designation of Office in Bylaws

Corp. Code § 1502(a) requires that the street address of the corporation's principal executive office or, if that office is not in California, the street address of its principal business office in this state be set forth in the statement filed in the office of the Secretary of State. However, there is no requirement that the location of the corporation's principal executive office be set forth in the articles of incorporation or in the bylaws.

[2] Form

Principal Executive Office [Corp. Code § 1502(a)]
Principal Executive Office

The principal executive office of the corporation shall be located at _____ [*street address, city, and county*], California. The location may be changed by approval of a majority of the authorized directors, and additional offices may be established and maintained at such other place o r places, either within or without California, as the Board of Directors may from time to time designate.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationPlace of IncorporationPrincipal Office



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.211

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.211 Number of Directors [Corp. Code § 212(a)]

[1] Comment

[a] Use of Form

This form contains alternative bylaw provisions for a fixed number of directors [*see § 4.200[2]*, P 2.03, *§ 4.201[2]*, P 2.02]. It also contains a provision for a variable board that may be used in lieu of the provisions set forth in *§§ 4.200* and *4.201*.

[b] Number of Directors

Unless set forth in the articles of incorporation, the bylaws musteither set forth the exact number of directors of the corporation or that the number will not be less than a stated minimum or more than a stated maximum (which in no case can be greater than two times the stated minimum minus one). The exact number of directors then is to be fixed, within the limits specified, by approval of the board of directors or by the shareholders [*see Corp. Code §§ 151, 153*], in the manner provided in the bylaws, subject to *Corp. Code § 204(a)(5)* (authorizing the articles to require for corporate action the vote of a larger proportion or of all the shares of any class or series or the vote or quorum for taking action of a larger proportion or of all the directors than is otherwise required by the General Corporation Law) [*Corp. Code § 212(a)*].

The number, or minimum number, of directors cannot be less than three, except as follows [*Corp. Code § 212(a)*]:

- Before shares are issued, the number may be one.
- Before shares are issued, the number may be two.
- So long as the corporation has only one shareholder, the number may be one.

- So long as the corporation has only one shareholder, the number may be two.
- So long as the corporation has only two shareholders, the number may be two.

After shares have been issued, a bylaw specifying or changing a fixed number of directors or the maximum or minimum number or changing from a fixed to a variable board or vice versa may be adopted only by approval of the outstanding shares [*see Corp. Code § 152*] provided, however, that a bylaw (or amendment of the articles if the number is specified in the articles) reducing the fixed number or the minimum number of directors to a number less than five cannot be adopted if the votes cast against its adoption at a meeting of the shareholders or the shares not consenting in the case of action by written consent are equal to more than 16 2/3 percent of the outstanding shares entitled to vote [*Corp. Code § 212(a)*].

[c] Classes of Directors

A listed corporation, by amendment of its bylaws, may adopt provisions to divide the board of directors into two or three classes to serve for terms of two or three years respectively [*Corp. Code § 301.5(a)*; *see Corp. Code § 301(a)*]. A "listed corporation" is a corporation with outstanding shares listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market [*Corp. Code § 301.5(d)*]. A corporation that is not listed, after issuance of shares, may adopt those provisions pursuant to amendment of its bylaws, to take effect when it becomes a listed corporation [*Corp. Code § 301.5(a)*].

A bylaw amendment providing for division of the board of directors into classes or a change in the number of classes may be adopted only by the approval of the board [*see Corp. Code § 151*] and the outstanding shares [*see Corp. Code § 152*] voting as a single class, notwithstanding the requirements of *Corp. Code § 903* (shareholder approval of amendments) [*Corp. Code § 301.5(a)*]. If the board of directors is divided into two classes pursuant to such an amendment, the authorized number of directors must be no fewer than six, and one half of the directors (or as close an approximation as possible) must be elected at each annual meeting. If the board is divided into three classes, the authorized number must be no fewer than nine, and one third (or as close an approximation as possible) must be elected at each annual meeting. Directors of a listed corporation may be elected by classes at a shareholder meeting at which an amendment adopting provisions for dividing the board into classes is approved. However, the extended terms for directors are contingent on approval of the amendment [*Corp. Code § 301.5(b)*]. If directors for more than one class will be elected by the shareholders at any one meeting and the election is by cumulative voting [*see* Corp. Code § 708], votes may be cumulated only for directors to be elected within each class [*Corp. Code § 301.5(c)*].

For further discussion, see *§ 4.14*.

[2] Form

Number of Directors [Corp. Code § 212(a)]
Fixed Number

[*EITHER*]

(a) The number of directors of this corporation shall be _____ [*if there is one shareholder:* one *or, if there are two shareholders:* two *or, if there are three or more shareholders, specify number (must be at least three)*]. t

[*OR, for variable board:*]

Variable Board

(a) The number of directors of the corporation shall be not less than _____ [*a stated minimum not less than three*] or more than _____ [*a stated maximum not exceeding two times the stated minimum minus one*]. The exact number of directors within these limits shall be fixed by approval of the _____ [Board of Directors *or* shareholders, as that term is defined in *Section 153 of the Corporations Code*] as follows: _____ [*specify*].

Change in Board

PRACTICE TIP:

The Board is afforded more flexibility if the exact number is set by resolution of the Board.
Commentary by Mary E. Ahern.

(b) After shares have been issued, a bylaw [specifying or] changing _____ [*either* the fixed number *or* the maximum or minimum number] of directors may be adopted only by approval of the outstanding shares, as that term is defined in *Section 152 of the California Corporations Code*, provided, however, that a bylaw reducing the _____ [fixed *or* minimum] number to a number less than five cannot be adopted if the votes cast against its adoption at a meeting of shareholders or the shares not consenting in the case of action by written consent are equal to more than 16 2/3 percent of the outstanding shares entitled to vote.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsSecurities LawSelf-Regulating EntitiesNational Securities ExchangesAmerican Stock ExchangeBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.212

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.212 Qualifications of Directors [Corp. Code § 212(b)(4)]

[1] Comment

[a] Use of Form

This form illustrates clauses that may be included in bylaws when qualifications on who may be a director are to be imposed.

[b] Statutory Authorization

The bylaws may set forth the qualifications of directors, provided that any such provisions do not conflict with law or with the articles of incorporation [*Corp. Code § 212(b)(4)*]. Other than the foregoing authorization, the General Corporation Law imposes no qualifications on the directors and, frequently, none will be imposed by the articles or by the bylaws. Other statutes, such as those governing various licenses and permits may, however, impose qualifying requirements (and if a given corporation is subject to such other statutes, those other statutes must be complied with). But even apart from statutory requirements, the corporation may wish to impose qualifications. For example, a close or small corporation may wish to require that its directors be shareholders or residents of the state. A corporation may also wish to require that its directors have a background or reputation compatible with the purposes of the corporation.

The two clauses in this form are merely illustrative. The qualifications that may be imposed are almost as varied as the kinds of businesses that may be incorporated.

[2] Form

Qualifications of Directors [Corp. Code § 212(b)(4)]
Directors as Shareholders

The first directors need not be shareholders. Succeeding directors must be shareholders of the corporation [holding at least _____ (*number*) of shares].

Directors as Residents

The directors of the corporation must be residents of the State of California.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.213

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.213 Filling Vacancies Caused by Other Than Removal of Director [Corp. Code § 305(a)]

[1] Comment

[a] Use of Form

This form may be used as an alternative to Paragraph 2.07 of the form in *§ 4.200[2]* if it is desirable to change the manner in which vacancies can be filled as specified in *Corp. Code § 305(a)*. The provisions set forth in the form are illustrative only.

[b] Statutory Authorization

Unless otherwise provided in the articles or bylaws, and except for a vacancy created by the removal of a director, vacancies on the board may be filled by approval of the board [*see Corp. Code § 151*], or, if the number of directors then in office is less than a quorum, by either (1) the unanimous written consent of the directors then in office; (2) the affirmative vote of a majority of the directors then in office at a meeting held pursuant to notice or waiver of notice complying with *Corp. Code § 307*; or *(3)* a sole remaining director [*Corp. Code § 305(a)*].

[2] Form

Filling Vacancies Caused by Other Than Removal of Director [Corp. Code § 305(a)]
Minimum Vote of Directors

Vacancies on the Board of Directors caused other than by the removal of a director may not be filled by the remaining directors without the vote or consent of _____[*number*] directors.

[*OR*]

Vote of Shareholders

Vacancies on the Board of Directors may be filled only by approval of the shareholders, as that term is defined in *Section 153 of the Corporations Code*, and not otherwise.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeVacancies



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.214

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.214 Shareholders' Authorization to Board to Fill Board Vacancies Caused by Removal [Corp. Code § 305(a)]

[1] Comment

[a] Use of Form

This form is an alternative to Paragraph 2.07 of the form in *§ 4.200[2]* to delegate authority to the directors to fill vacancies on the board caused by the removal of a director.

[b] Statutory Authorization

Unless the articles of incorporation or a bylaw adopted by the shareholders provide that the board of directors may fill vacancies occurring in the board by reason of the removal of directors, such vacancies may be filled only by approval of the shareholders, as that term is defined in *Corp. Code § 153* [*Corp. Code § 305(a)*].

[2] Form

Shareholders' Authorization to Board to Fill Board Vacancies Caused by Removal [Corp. Code § 305(a)]

Any vacancy on the Board of Directors created by the removal of a director may be filled by a majority of the directors then in office, whether or not less than a quorum, or by the sole remaining director.

[*Note: The number of directors required to fill the vacancy may be varied.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersTerms in OfficeVacanciesBusiness & Corporate

LawCorporationsDirectors & OfficersTerms in OfficeRemoval & ResignationBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElections



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.215

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.215 Compensation of Directors [Corp. Code § 212(b)(4)]

[1] Comment--Use of Form

Compensation of directors may be fixed in the bylaws [*Corp. Code § 212(b)(4)*], but the bylaws customarily leave the determination to the board of directors [*see § 4.200[2]*, P 2.22, *§ 4.201[2]*, P 2.14]. The provisions in this form may be used if the directors are to serve without compensation.

[2] Form

Compensation of Directors [Corp. Code § 212(b)(4)]
Directors' Compensation

Directors shall not receive any stated salary for their services as directors but, by resolution of the Board, a fixed fee, with or without expenses of attendance, may be allowed for attendance at each meeting. Nothing contained in these bylaws shall be construed to preclude any director from serving the corporation in any othe r capacity as an officer, agent, employee, or otherwise, and receiving compensa tion for that service.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersCompensationSalaries



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.216

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.216 Purposes and Powers [Corp. Code §§ 206, 207, 300, 317]

[1] Comment

[a] Use of Form

This form essentially restates the Corporations Code provisions that specify the business purposes for which a corporation may be formed [*see Corp. Code § 206*] and the powers that it may exercise [*see Corp. Code § 207*]. These matters are fixed by statute, subject to any limitations contained in the articles of incorporation [*see Corp. Code §§ 206, 207*]. Thus, any bylaw provisions governing these matters must simply reflect the governing statutes and any limitations imposed by the articles of incorporation. Although bylaw provisions dealing with these topics therefore are somewhat redundant, it nevertheless may be desirable to set forth these statutory purposes and powers in the bylaws for the benefit of the officers, directors, and shareholders.

If the statutory purposes and powers have been limited or restricted by the articles, the statutory provisions restated in this form should be modified appropriately to conform with those set forth in the articles. Any additional statutory powers, or nonstatutory powers not in conflict with the governing statutes or with the articles of incorporation, may be included.

[b] Purposes of Corporation

Corp. Code § 206 provides that subject to any limitation contained in the articles of incorporation and to compliance with any other applicable laws, any corporation other than a corporation subject to the Banking Law [*see Corp. Code § 163*] or professional corporation may engage in any business activity, and that a corporation subject to the Banking Law [*see Corp. Code § 163*] or professional corporation may engage in any business activity not prohibited by the respective statutes and regulations to which it is subject [*see Corp. Code § 202(b)*].

The articles may set forth a provision limiting or restricting the business in which the corporation may engage, but if

they do not do so, no such limitation is effective [*Corp. Code § 204(a)(6)*] unless the corporation is a close corporation and the limitations are set forth in a shareholders' agreement [*see Corp. Code § 204(a)*, last paragraph].

[c] Powers of Corporation

Subject to any limitations contained in the articles and to compliance with other provisions of the General Corporation Law and with any other applicable laws, a corporation has all the powers of a natural person in carrying out its business activities [*Corp. Code § 207*]. A number of these powers are expressly enumerated in *Corp. Code § 207*, as well as in other sections throughout the General Corporation Law [*see, e.g., Corp. Code §§ 317* (power to indemnify corporate agents), *400* (power to issue shares), *407* (power to issue fractional shares), *408* (power to adopt and carry out stock purchase or option plan or agreement for employees), *409(d)* (power to issue partly paid shares)].

The *articles* may set forth a provision limiting or restricting the powers that the corporation may exercise, but if they do not do so, no such provision in the *bylaws* is effective [*Corp. Code § 204(a)(6)*] unless the corporation is a close corporation and the limitations are set forth in a shareholders' agreement [*see Corp. Code § 204(a)*, last paragraph].

[d] Management of Business and Exercise of Powers

Subject to the provisions of the General Corporation Law and to any limitations in the articles relating to action required to be approved by the shareholders, as that term is defined in *Corp. Code § 153*, or by the outstanding shares, as that term is defined in *Corp. Code § 152*, the business and affairs of the corporation must be managed and all corporate powers exercised by or under the direction of the board of directors. The board may delegate the management of the day-to-day operation of the business of the corporation to a management company or other person, provided that the business and affairs of the corporation are managed and all corporate powers are exercised under the ultimate direction of the board [*Corp. Code § 300(a)*].

For discussion of the effect of shareholders' agreements on the above provisions in the case of close corporations, see the note concerning close corporations, following Paragraph 2.02 of *§ 4.200[2]*. For the criminal penalties imposed on directors and other persons for violations of their various duties or fraudulent acts, see *Corp. Code §§ 2251-2257* and *2260*.

[2] Form

Purposes and Powers [Corp. Code §§ 206, 207, 300, 317]

Purposes [*Corp. Code § 206*]

(a) Subject to compliance with any applicable laws [and to any limitations contained in the Articles of Incorporation], this corporation may engage in any business activity.

Powers [*Corp. Code § 207*]

(b) Subject to compliance with the provisions of the General Corporation Law and any other applicable laws [and to any limitations contained in the Articles of Incorporation], this corporation shall have all the powers of a natural person in carrying out its business activities, including, without limitation, the power to:

Seal [*Corp. Code § 207(a)*]

(1) Adopt, use, and at will alter a corporate seal (but failure to affix a seal does not affect the validity of any instrument).

[*See § 4.247 for comment and alternative provisions. See also § 4.200[2], P 9.10, for an alternative provision requiring the corporation to adopt a seal.*]

Bylaws [*Corp. Code § 207(b)*]

(2) Adopt, amend, and repeal bylaws.

[*See § 4.200[2], PP 10.02, 10.03, and § 4.201[2], P 8.01, for provisions setting forth manner of amendment.*]

Out-of-State Business [*Corp. Code § 207(c)*]

(3) Qualify to do business in any other state, territory, dependency, or foreign country.

Deal With Own Securities [*Corp. Code § 207(d)*]

(4) Subject to the provisions of *Section 510 of the California Corporations Code* (relating to the reacquisition by a corporation of its own shares), issue, purchase, redeem, receive, take, or otherwise acquire, own, hold, sell, lend, exchange, transfer, or otherwise dispose of, pledge, use, and otherwise deal in and with its own shares, bonds, debentures, and other securities.

Charitable Donations [*Corp. Code § 207(e)*]

(5) Make donations, regardless of specific corporate benefit, for the public welfare or for community fund, hospital, charitable, educational, scientific, civic, or similar purposes.

Employee Plans [*Corp. Code § 207(f)*]

(6) Pay pensions, and establish and carry out pension, profit-sharing, share bonus, share purchase, share option, savings, thrift, and other retirement, incentive, and benefit plans, trusts, and provisions for any or all of the directors, officers, and employees of this corporation or of its subsidiary or affiliated corporations, if any, and indemnify and purchase and maintain insurance on behalf of any fiduciary of such plans, trusts, or provisions.

Obligations [*Corp. Code § 207(g)*]

(7) Subject to the provisions of *Section 315 of the California Corporations Code* (relating to certain loans and guaranties), assume obligations, enter into contracts, including contracts of guaranty or suretyship, incur liabilities, borrow and lend money, and otherwise use its credit and secure any of its obligations, contracts, or liabilities by mortgage, pledge, or other encumbrance of all or any part of its property, franchises, and income.

Joint Ventures [*Corp. Code § 207(h)*]

(8) Participate with others in any partnership, joint venture, or other association, transaction, or arrangement of any kind, whether or not such participation involves sharing or delegation of control with or to others.

Indemnification of Agents [*Corp. Code § 317*]

(9) Indemnify its agents, as that term is defined in *Section 317(a) of the California Corporations Code*, against expenses, judgments, fines, settlements, and other amounts actually and reasonably incurred in connection with any threatened, pending, or completed civil, criminal, administrative, or investigative action or proceeding, as provided in *Section 317 of the California Corporations Code*, and to maintain insurance on behalf of any of its agents against any liability asserted against or incurred by the agent in such capacity or arising out of the agent's status as such, whether or not the corporation would have the power under the the provisions of *Section 317 of the California Corporations Code* to indemnify the agent against such liability.

[*See § 4.200[2], PP 2.25-2.32, and § 4.201[2], P 2.15, for alternative provisions.*]

Conduct of Business [*Corp. Code § 300(a)*]

(c) Subject to the provisions of the General Corporation Law [and to any limitation in the articles relating to action required to be approved by the shareholders, as that term is defined in *Section 153 of the California Corporations Code*, or by the outstanding shares, as that term is defined in *Section 152 of the California Corporations Code*], the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the Board of Directors. The Board may delegate the management of the day-to-day operation of the business of the corporation to a management company or other person, provided that the business and affairs of the corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the Board.

[*See § 4.200[2], P 2.02, and § 4.201[2], P 2.01, fo r alternative provisions.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePowersGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePurpose



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.217

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.217 Place of Meetings of Directors and Board Committees [Corp. Code §§ 212(b)(2), 307(a)(2), (5), (6), (c)]

[1] Comment

[a] Use of Form

This form is an alternative to Paragraph 2.09 of the form in *§ 4.200[2]* and Paragraph 2.07 of the form in *§ 4.201[2]* when it is desired that the bylaws specify the place of meetings of the board of directors or board committees.

[b] Statutory Authorization

The bylaws of a corporation may make provisions not in conflict with law or with the articles of incorporation for the place and manner of conducting meetings of the board of directors and board committees [*Corp. Code § 212(b)(2)*].

[c] Place of Meetings

Unless otherwise provided in the articles or bylaws, meetings of the board (and board committees [*Corp. Code § 307(c)*]) may be held at any place within or outside California that is designated in the notice of the meeting or, if not so stated or there is no notice, designated in the bylaws or by board resolution [*Corp. Code § 307(a)(5)*]. Regular meetings of the board (or board committees) may be held without notice if the time and place of such meetings are fixed by the bylaws or by resolution of the board or board committee [*Corp. Code § 307(a)(2), (c)*].

[2] Form

Place of Meetings of Directors and Board Committees [Corp. Code §§ 212(b)(2), 307(a)(2), (5), (6), (c)]
Place of Meetings

Regular meetings of the Board of Directors [and of all Board committ ees] shall be held at _____ [

location, e.g., the principal executive office of the corporation located at _____ (*address*)]. Special meetings of the Board [and of all Board committees] shall be held at the location specified in the notice of the meeting or, in the absence of such specification, at _____ [*location, e.g.,* the principal executive office of the corporation]. The Board is authorized to designate, from time to time and by duly adopted resolution, a place or places other than those specified above as the place for regular or special meetings of the Board [and of all Board committees].

[*See § 4.226[2] for integrated provisions regarding board committees set forth in a separate bylaw.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.218

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.218 Time and Notice of Meetings of Directors and Board Committees [Corp. Code §§ 113, 212(b)(2), 307(a)(2), (3), (c)]

[1] Comment

[a] Use of Form

This form is an alternative to Paragraphs 2.10 through 2.12 of the form in *§ 4.200[2]* and Paragraphs 2.08 and 2.09 of the form in *§ 4.201[2]* when it is desired that the bylaws specify the time of regular meetings of the board of directors and board committees, the manner of giving notice, and waiver of notice. For additional discussion, see *§ 4.219*.

[b] Statutory Authorization

The bylaws of a corporation may make provisions not in conflict with law or with the articles of incorporation for the time and manner of calling and giving notice of meetings of the board of directors and board committees [*Corp. Code § 212(b)(2)*].

[c] Notice and Waiver of Notice

Unless otherwise provided in the articles of incorporation or in the bylaws, regular meetings of the board (or of a board committee [*Corp. Code § 307(c)*]) may be held without notice if the time and place of those meetings are fixed by the bylaws or the board. Special meetings of the board (or of a board committee) require four days' notice by mail or 48 hours' notice delivered personally or by telephone, including a voice messaging system, or by electronic transmission by the corporation [*Corp. Code § 307(a)(2)*; *see Corp. Code § 20* (definition)]. However, no notice need be given to any director or committee member who provides a waiver of notice, or a consent to holding the meeting or an approval of the minutes of the meeting in writing, whether before or after the meeting, or who attends the meeting without protesting, before the meeting or at its commencement, the lack of notice to him or her [*Corp. Code § 307(a)(3)*]. Neither a notice nor a waiver of notice need specify the purpose of any regular or special meeting of the board (or board

committee) [*Corp. Code § 307(a)(2)*]. All waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meeting [*Corp. Code § 307(a)(3)*].

[2] Form

Time and Notice of Meetings of Directors and Board Committees [Corp. Code §§ 113, 212(b)(2), 307(a)(2), (3), (c)]

Regular Meetings

(a) Regular meetings of the Board of Directors shall be held, without call, _____ [*specify e.g.,* on the first Tuesday in the months of March, June, September, and December at 2:30 P.M.]. [*Add any provisions desired specifying the times of meetings of board committees.*] Should any specified day fall on a legal holiday, the meeting scheduled for that day shall be held at the same hour on the next succeeding day that is not a legal holiday.

Special Meetings

(b) Special meetings of the Board of Directors [and Board committees] shall be held on four days' notice by first-class mail, postage prepaid, or 48 hours' notice delivered personally or by telephone, including a voice messaging system, or by electronic transmission by the corporation. The notice need not specify the purpose of the meeting.

[*See § 4.219[2] for alternative provisions.*]

PRACTICE TIP:

The corporation may wish to limit the means by which notice of special meetings may be given. The preceding provision may be altered accordingly. *Commentary by Mary E. Ahern.*

Waiver of Notice

(c) No notice of a meeting need be given to any director [or Board committee member] who signs a waiver of notice, or a consent to holding the meeting or an approval of the minutes of the meeting, whether before or after the meeting, or who attends the meeting without protesting, before the meeting or at its commencement, the lack of notice to him or her.

[*See § 4.226[2] for integrated provisions regarding board committees set forth in a separate bylaw.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.219

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.219 Notice of Special Meetings of Directors or Board Committees [Corp. Code §§ 113, 212(b)(2), 307(a)(2), (3), (c)]

[1] Comment--Use of Form

This form contains provisions incorporating the statutory requirements for notice of special meetings [*see Corp. Code § 307(a)(2)*]. For an alternative provision, see *§ 4.218*.

[2] Form

Notice of Special Meetings of Directors or Board Committees [Corp. Code §§ 113, 212(b)(2), 307(a)(2), (3), (c)]
Method and Time of Notice

(a) Notice of the time and place of any special meeting of the Board of Directors or any Board committee must be in writing and delivered on four days' notice if delivered by mail or on 48 hours' notice if delivered personally or by telephone, including a voice messaging system, or by electronic transmission by the corporation. Notice by mail must be by first-class mail, postage prepaid, addressed to him or her at his or her address as stated in the corporation's records or, if not so stated, at the place where the meetings of the Board or the Board committee are regularly held. Notice given as provided in this paragraph shall constitute due and legal notice to the director or Board committee member.

[*See § 4.226[2] for integrated provisions regarding board committees set forth in a separate bylaw*.]

Entry of Service of Notice

(b) The fact of service of notice, showing that it was given in the manner provided above, shall be entered in the minutes of the proceedings of the Board of Directors or Board committee, and the entry, if the minutes are approved at a

subsequent meeting of the Board of Directors or Board committee, shall be conclusive on the question of service.

Registration of Address for Notice

(c) Each director shall register his or her address with the Secretary, and notices of meetings mailed or telegraphed to that address shall be valid notices of the meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial Meetings



46 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.220

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.220 Calling Special Meetings of Directors or Board Committees [Corp. Code §§ 212(b)(2), 307(a)(1), (c)]

[1] Comment--Use of Form

This form is a set of bylaw provisions that may be used to expand or limit the statutory list of persons that are authorized to call a special meeting of the board or board committees. Unless otherwise provided in the articles or bylaws, meetings of the board of directors may be called only by the board chairperson, the president, any vice-president, the secretary, or any two directors [*Corp. Code § 307(a)(1)*; *see § 4.200[2]*, P 2.08, *§ 4.201[2]*, P 2.06]. Committee meetings are subject to the same restriction [*Corp. Code § 307(c)*]. The bylaws may make provisions not in conflict with law or with the articles for the manner of calling meetings of the board of directors and of board committees [*Corp. Code § 212(b)(2)*].

[2] Form

Calling Special Meetings of Directors or Board Committees [Corp. Code §§ 212(b)(2), 307(a)(1), (c)]
Special Meetings of Board of Directors

[*For a provision restricting statutory list:*]

Special meetings of the Board of Directors may be called by the President of the corporation, any Vice-President, or a majority of the authorized directors.

[*OR, for a provision expanding statutory list:*]

Special meetings of the Board of Directors may be called by the Board Chairperson or the Vice Board Chairperson, if there are any such officers, or by the President, any Vice-President, the Secretary, the Treasurer, or any director of the

corporation.

Special Meetings of Board Committees

Special meetings of any Board committee may be called by _____ [*specify, e.g.,* its Chairperson or any two members of the committee].

[*See § 4.226 for integrated provisions of the committee regarding board committees set forth in a separate bylaw.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.221

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.221 Quorum for Meetings of Directors [Corp. Code §§ 212(b)(4), 307(a)(7)]

[1] Comment

[a] Use of Form

This form is an alternative to Paragraph 2.13 of the form in *§ 4.200[2]*, and Paragraph 2.10 of the form in *§ 4.201[2]*, if it is desired that a quorum for board meetings be reduced from the proportion specified by statute.

[b] Statutory Authority

The bylaws of a corporation may make provisions, not in conflict with law or with the articles of incorporation, for the requirements of a quorum for meetings of the directors and of board committees [*Corp. Code § 212(b)(4)*]. Since a bylaw setting quorum requirements for directors' meetings may not conflict with the law, a bylaw provision may only reduce, but not increase, the required quorum for taking action. This result follows from the introductory paragraph of *Corp. Code § 307(a)*, which provides that unless provided in the articles or "(subject to paragraph (5) of subdivision (a) of [*Corp. Code] Section 204*) in the bylaws" the provisions of *Corp. Code § 307* regarding board meetings will apply. *Corp. Code § 204(a)(5)* provides that a provision requiring the vote or quorum for taking action of a larger proportion or of all the directors than is otherwise required may appear in the articles. Thus, unless a provision in the articles so increases the quorum, or a bylaw or article provision reduces it, a majority of the authorized number of directors constitutes a quorum of the board of directors for the transaction of business. However, neither the articles nor the bylaws may provide that a quorum will be less than one-third the authorized number of directors or less than two, whichever is larger, unless the authorized number of directors is one, in which case one director constitutes a quorum [*Corp. Code § 307(a)(7)*]. The provisions of *Corp. Code § 307* also apply to board committees [*Corp. Code § 307(c)*].

[2] Form

Quorum for Meetings of Directors [Corp. Code §§ 212(b)(4), 307(a)(7)]

Quorum if Corporation Has Two or More Directors

At all meetings of the Board of Directors, _____ [*number not less than one third of authorized number of directors or not less than two, whichever is larger*] directors shall constitute a quorum for the transaction of business.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.222

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.222 Number of Directors or Committee Members Required for Board or Committee Action [Corp. Code §§ 204(a)(5), 307(a)(8)]

[1] Comment

[a] Use of Form

This form is an alternative to the provisions set forth in Paragraph 2.14 of the form in *§ 4.200[2]*, and in Paragraph 2.11 of the form in *§ 4.201[2]*. This form should be used if it is desired that the affirmative vote of a majority of the authorized number of directors, rather than the vote of a majority of directors present at a meeting at which a quorum is present, be required before their acts or decisions are to be the acts or decisions of the board or board committee.

[b] Transaction of Business

Unless otherwise provided in the articles of incorporation or in the bylaws, every act or decision done or made by a majority of the directors present at a meeting duly held at which a quorum is present is the act of the board, subject to the provisions of *Corp. Code § 310* (relating to contracts and transactions between the corporation and its directors or a legal entity in which one or more of its directors has a material financial interest) and *Corp. Code § 317(e)* (relating to indemnification by a corporation of its agents). Neither the articles nor the bylaws may provide, however, that a lesser vote than a majority of the directors present at a meeting is the act of the board [*Corp. Code § 307(a)(8)*]. As stated in *§ 4.221[1]*, if a supermajority vote of directors is to be required for the approval of any or all business transacted by the board, the provision setting forth the requirements must appear in the articles [*see Corp. Code §§ 204(a)(5), 307(a)*, first paragraph]. The bylaws, however, may contain a provision, as set forth in this form, requiring the affirmative vote of a majority of the authorized number of directors for any or all actions by the board [*Corp. Code § 204(a)*, last paragraph].

The provisions of *Corp. Code § 307* discussed above also apply to board committees [*Corp. Code § 307(c)*].

[2] Form

Number of Directors or Committee Members Required for Board or Committee Action [Corp. Code §§ 204(a)(5), 307(a)(8)]

Except as otherwise required by law, or in the Articles of Incorporation of this corporation, or in these Bylaws, every act or decision of the board of directors shall be approved by the affirmative vote of not less than a majority of the authorized number of directors of this corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.223

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.223 Conduct of Meetings of Directors and Board Committees [Corp. Code §§ 212(b)(2), 307(a)(6), (c)]--Presiding Officer, Secretary, Procedure

[1] Comment

[a] Use of Form

This form is an alternative to Paragraphs 2.18 and 2.19 of the form in *§ 4.200[2]*, and Paragraph 2.13 of the form in *§ 4.201[2]*, governing the conduct of board meetings and meetings of board committees. Even if the number of directors or board committee members is few, meetings can be expedited and the minutes more accurately recorded if basic rules of procedure are provided for and followed. Thus, bylaws may set forth at least the order of business for such meetings [*see § 4.224*] and provide that procedure on motions and other matters is, to the extent that no other provision is made for the procedure, to be governed by Robert's Rules of Order.

[b] Statutory Authority

The bylaws of a corporation may make provisions not in conflict with law or with the articles of incorporation for the manner of conducting meetings of the directors and board committees [*Corp. Code § 212(b)(2)*].

[c] Adjournment for Failure of Quorum

A meeting that fails to obtain a quorum, as defined either in the articles [*see Corp. Code § 204(a)(5)* (permitting articles to specify increased quorum requirements)] or in the bylaws (which may only provide for lower quorums than specified by statute) or, in the absence of a definition in the articles or bylaws, by statute [*see Corp. Code § 307(a)(7)*] may transact no business [*see Corp. Code § 307(a)(8)*], but must adjourn. The adjournment may be to another time and place by the vote of a majority of the directors present [*Corp. Code § 307(a)(4)*]. These rules also apply to meetings of incorporators and to board committee meetings [*Corp. Code § 307(c)*].

[2] Form

Conduct of Meetings of Directors and Board Committees [Corp. Code §§ 212(b)(2), 307(a)(6), (c)]--Presiding Officer, Secretary, Procedure
Board of Directors

(a) Meetings of the Board of Directors shall be presided over by the Board Chairperson or in the Chairperson's absence by the Vice Board Chairperson, if there are these officers, or, if there are not, by the President of the corporation or, if _____ [he *or* she] is not present, by any Vice-President of the corporation, and, if no such officer is present, by any director chosen by a majority of the directors present. The Secretary, or an Assistant Secretary, of the corporation shall attend and take minutes of the meetings. In the absence of the Secretary or an Assistant Secretary, the presiding officer shall designate some person present to take minutes of the meeting.

Board Committee Meetings

(b) Meetings of Board committees, if any, shall be presided over by their respective chairpersons or, in the absence of the chairpersons, by any member chosen by a majority of the members present. Minutes of the meetings shall be taken by the secretary of the committee if there is such an officer or, if there is not or in the officer's absence, by the person designated by the chairperson or acting chairperson of the committee.

[*See § 4.226[2] for integrated provisions regarding board committees set forth in a separate bylaw*.]

Use of Conference Telephone

(c) Directors and Board committee members may participate in their respective meetings by conference telephone, electronic video screen communication, or other communications equipment, whenever the board authorizes this type of participation by adopting a resolution. The resolution must require that the corporation (1) verify the identity of any director communicating by telephone, electronic video screen, or other communication equipment and that director's right to participate in the board meeting and (2) verify that all statements, questions, actions, and votes made by telephone, electronic video screen, or other communications equipment were made by that director and not by someone not permitted to participate as a director.

Participation in a meeting pursuant to this Paragraph constitutes presence in person at the meeting if all the following are true:

(1) Each board member participating in the meeting can communicate with all of the other members concurrently.

(2) Each member is provided the means of participating in all matters before the board, including the capacity to propose, or interpose an objection, to a specific action to be taken by the corporation.

(3) The board adopts a resolution pursuant to this Paragraph.

Procedure

(d) The precedence of, and procedure on, motions and other procedural matters at Board committee meetings shall be governed so far as practicable by Robert's Rules of Order when those rules are not inconsistent with law, with the corporation's Articles of Incorporation, with these Bylaws, or with Board resolutions.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.224

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.224 Conduct of Meetings of Directors and Board Committees [Corp. Code § 212(b)(2)]--Order of Business

[1] Comment--Use of Form

This form is a bylaw provision that sets forth the order of business for meetings of directors and board committees. For a discussion of the use of this form, see *§ 4.223*.

[2] Form

Conduct of Meetings of Directors and Board Committees [Corp. Code § 212(b)(2)]--Order of Business

The order of business at the meetings shall be as follows, unless the notice of the meeting provides otherwise:

(1) Call to order.

(2) Announcement of a quorum.

(3) Reading, or waiver of reading, and approval of minutes of previous meeting.

(4) Announcements.

(5) Reports of officers.

(6) Reports of committees.

(7) Old, or unfinished, business.

(8) New business.

(9) Adjournment.

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.225

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.225 Action by Directors or Board Committee Members Without Meeting [Corp. Code § 307(b), (c)]

[1] Comment

[a] Use of Form

This form restates the statutory provisions governing actions by directors or board committee members without a meeting. These provisions would be included in the bylaws for informational purposes only. They are fixed by statute and are not subject to limitation by the articles or the bylaws [*see Corp. Code § 307(b)*].

[b] Action Without Meeting

Any action required or permitted to be taken by the board of directors may be taken without a meeting if all members of the board individually or collectively consent in writing to the action and if the number of Board members serving at the time the action is taken constitutes a quorum. The written consent or consents must be filed with the minutes of the proceedings of the board [*Corp. Code § 307(b)*].

For purposes of unanimous board action without a meeting, the term "all members of the board" includes an "interested director" [*see Corp. Code § 310(a)*] or a "common director" [*see Corp. Code § 310(b)*] who abstains in writing from providing consent, when [*Corp. Code § 307(b)*]:

- The disclosures required by *Corp. Code § 310* (generally requiring full disclosure of the material facts regarding the transaction and the director's interest) [*see § 4.200[2],* Section 2.23] have been made to the noninterested or noncommon directors, as applicable, before their execution of the written consent or consents;

- The specified disclosures are conspicuously included in the written consent or consents executed by the noninterested or noncommon directors; and

- The noninterested or noncommon directors, as applicable, approve the action by a vote that is sufficient without counting the votes of the interested or common directors.

If the directors give written consent in accordance with this rule, but the disclosures made regarding the action that is the subject of the consent do not satisfy statutory requirements [*see Corp. Code § 310*], the action that is the subject of the consent will be deemed approved. However, in any suit brought to challenge the action, the party asserting the validity of the action has the burden of proof in establishing that the action was just and reasonable to the corporation at the time it was approved [*Corp. Code § 307(b)*].

This provision is not subject to modification by the articles or the bylaws and, under *Corp. Code § 307(c)*, is made applicable to board committee action.

[2] Form

Action by Directors or Board Committee Members Without Meeting [Corp. Code § 307(b), (c)]

Any action required or permitted to be taken by the Board of Directors or by any Board committee may be taken without a meeting if all members of the Board or Board committee shall individually or collectively consent in writing to the action, provided that the number of board members serving at the time the action is taken constitutes a quorum.

[*Optional* (*Corp. Code § 307(b)*):]

For purposes of unanimous board action without a meeting, the term "all members of the board" includes an "interested director" (as described in *Corporations Code Section 310(a)*) or a "common director" (as described in *Corporations Code Section 310(b)*) who abstains in writing from providing consent, providing (1) the disclosures required by *Corporations Code Section 310* have been made to the noninterested or noncommon directors before their execution of the written consent or consents; (2) these disclosures are conspicuously included in the written consent or consents executed by the noninterested or noncommon directors; and (3) the noninterested or noncommon directors approve the action by a vote that is sufficient without counting the votes of the interested or common directors; provided, however, that when written consent is provided by the directors under the rule stated in this sentence, the action that is the subject of the consent will be deemed approved even if the disclosures made with respect to common or interested directors do not satisfy the applicable statutory requirements.

[*Continue with the following:*]

The written consent or consents shall be filed with the minutes of the proceedings of the Board or Board committee and the action by written consent shall have the same force and effect as a unanimous vote of the directors or Board committee members.

[*See § 4.226[2] for integrated provisions regarding board committees set forth in a separate bylaw*.]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.226

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.226 Board Committees [Corp. Code §§ 307, 311, 1500]

[1] Comment

[a] Use of Form

This form is a bylaw provision specifying the authority of board committees. It may be used in lieu of Paragraph 2.33 of the form in *§ 4.200[2],* or the separate provisions relating to board committees set forth in §§ 4.217 through 4.225.

[b] Appointment of Board Committees

The board of directors, by resolution adopted by a majority of the authorized number of directors, may designate one or more committees, each consisting of two or more directors, to serve at the pleasure of the board. The board may designate one or more directors as alternate members of any committee, who may replace any absent member at any meeting of the committee. The appointment of members or alternate members of a committee requires the vote of a majority of the authorized number of directors [*Corp. Code § 311*].

[c] Powers and Limitations

A board committee, to the extent provided in the board resolution or in the bylaws, has all the authority of the board of directors, except with regard to the following issues [*Corp. Code § 311*]:

- The approval of any action for which the General Corporation Law also requires shareholders' approval, as that term is defined in *Corp. Code § 153,* or approval of the outstanding shares, as that term is defined in *Corp. Code § 152*;

- The filling of vacancies on the board or in any committee;

- The fixing of compensation of the directors for serving on the board or on any committee;

- The amendment or repeal of bylaws or the adoption of new bylaws;

- The amendment or repeal of any resolution of the board that, by its express terms, is not so amendable or repealable;

- A "distribution to the shareholders" of the corporation, as that term is defined in *Corp. Code § 166,* except at a rate or in a periodic amount or within a price range determined by the board; and

- The appointment of other committees of the board or the members of the board.

[d] Meetings

Corp. Code § 307(a), (b) sets forth the manner of calling, giving and waiving notice of, the quorum for, and the effect of actions taken at board of directors' meetings and action by the directors without a meeting. These provisions are also applicable to board committees and their actions [*Corp. Code § 307(c)*].

[e] Minutes

A corporation must keep minutes of all board committee proceedings [*Corp. Code § 1500*]. The minutes must be kept in written form or in another form capable of being converted into clearly legible tangible form [*Corp. Code § 1500*] and open to inspection and copying on the written demand of any shareholder or holder of a voting trust certificate at any reasonable time during usual business hours for a purpose reasonably related to the holder's interests as a shareholder or holder of a voting trust certificate [*Corp. Code § 1601(a)*; *see Jara v. Suprema Meats, Inc. (2004) 121 Cal. App. 4th 1238, 1263-1265, 18 Cal. Rptr. 3d 187* (corporation required only to allow inspection at corporate offices, not to provide copies or even to respond to demands for disclosure falling outside scope of *Corp. Code § 1601*)]. Directors have an absolute right at any reasonable time to inspect and copy all books, records, and documents of the corporation [*Corp. Code § 1602*]. The provision is broad enough to include the right to inspect and copy the minute book.

[2] Form

Board Committees [Corp. Code §§ 307, 311, 1500]

The Board of Directors, by resolution duly adopted by a majority of the authorized number of directors, may designate one or more committees, each consisting of two or more directors and with the powers as it may designate, consistent with the Articles of Incorporation, these Bylaws, and the General Corporation Law. The appointment of members or alternate members of a committee requires the vote of a majority of the authorized number of the Board. The committees shall hold office at the pleasure of the Board.

[*OR*]

(a) The Board of Directors may appoint one or more committees, each consisting of two or more directors, to serve at the pleasure of the Board. The appointment of members or alternate members of a committee requires the vote of a majority of the authorized number of the Board. The Board may delegate to any committee any of the Board's powers and authority in the management of the business and affairs of the corporation except the authority:

(1) To approve any action also required by the General Corporation Law to be approved by the shareholders or by the outstanding shares, as those terms are defined, respectively, in *Sections 153* and *152 of the California Corporations Code.*

(2) To fill vacancies on the Board or in any committee.

(3) To fix the compensation of directors for serving on the Board or on any committee.

(4) To amend or repeal bylaws or adopt new ones.

(5) To amend or repeal any Board resolution that, by its terms, is not amendable or repealable.

(6) To make any distribution to the shareholders except at a rate or in a periodic amount or within a price range determined by the Board.

(7) To appoint other Board committees or their members.

[*Add, if desired:*]

The Board Chairperson if there is such an officer and, if none, the President of the corporation, shall be an ex officio member of each Board committee so appointed.

(b) The Board of Directors may prescribe the manner in which committee proceedings are conducted or authorize the committee to do so. Regular meetings of any committee shall be held at the time and place specified in any resolution duly adopted by the Board, or, in the absence of a resolution, by the committee. On failure to designate the place, the meetings shall be held at the principal executive office of the corporation. Special meetings of any committee may be called by the chairperson or any two members of the committee, or by the Board Chairperson if there is such an officer or, if none, by the President of the corporation, by written notice to the members and shall be held at the time and place specified in the notice or, on failure to specify the place, at the principal executive office of the corporation. Notice of the meetings shall be given in the same manner as is required by these Bylaws for the giving of notice of Board meetings. A majority of the authorized number of members of any committee shall constitute a quorum of that committee for the transaction of business. Minutes of each committee meeting shall be kept. The original or a copy of the minutes, certified by the committee chairperson or another person as he or she designates, shall be delivered to the Secretary of the corporation for placement in the corporation's minute book and a copy shall be retained by the committee. The transactions of any meeting of any committee, however called and noticed or wherever held, shall be as valid as though had at a meeting duly held after regular call and notice if a quorum is present and if, either before or after the meeting, each of the members not present signs a written waiver of notice or a consent to the holding of the meeting, or an approval of the minutes of the meeting. All waivers, consents, or approvals shall be made a part of the minutes of the meeting. Any action required or permitted to be taken by any Board committee may be taken without a meeting, if all members of the committee shall individually or collectively consent in writing to the action and the written consent or consents are filed with the minutes of the proceedings of the Board committee.

(c) Vacancies in any committee may be filled only by the Board.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityLimitationsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.227

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.227 Qualifications of Shareholders

[1] Comment

[a] Use of Form

This form may be used if the articles of incorporation have imposed qualifications on persons who may be shareholders and it is desired to have this information repeated in the bylaws.

[b] Qualifications of Shareholders

The articles of incorporation are authorized to include provisions setting forth special qualifications of persons who may be shareholders [*Corp. Code § 204(a)(3)*], but unless expressly provided in the articles, or, in the case of a close corporation, in a shareholder's agreement, the provision is not effective [*Corp. Code § 204(a)*]. There is no authority for such qualifications to be imposed by the bylaws [*see Corp. Code § 212(b)*].

Such provisions are seldom required, however. While they might be useful for a close corporation that wishes to keep its membership controlled, stock transfer restrictions [*see §§ 4.244, 4.245*], set forth in the articles [*Corp. Code § 204(b)*] or in the bylaws [*Corp. Code § 212(b)(1)*], are normally sufficient for this purpose.

[2] FORM

Qualifications of Shareholders

No person may be a shareholder in this corporation unless the person is _____ [*state qualifications*], or is approved by unanimous vote of the Board of Directors.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.228

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.228 Place of Shareholders' Meetings [Corp. Code §§ 212(b)(2), 600(a)]

[1] Comment

[a] Use of Form

This form is an alternative to Paragraph 4.01 of the form in *§ 4.200[2]*, and Paragraph 3.01 of the form in *§ 4.201[2]*. This form should be included if it is desired that the bylaws specify the place of shareholders' meetings.

Bylaws customarily specify the principal executive office of the corporation as the place of meeting and grant the directors authority to designate other places.

[b] Statutory Authority

The bylaws of a corporation may make provision not in conflict with law or with the articles of incorporation for the place of shareholders' meetings [*Corp. Code § 212(b)(2)*].

[c] Place of Meetings

Meetings of shareholders may be held at any place inside or outside California stated in or fixed in accordance with the bylaws. If no other place is stated or fixed, shareholders' meetings must be held at the principal executive office of the corporation [*Corp. Code § 600(a)*].

[d] Validity of Transactions; Waivers, Consents, and Approvals

The transactions of any meeting of shareholders, however called and noticed and wherever held, are as valid as though had at a meeting duly held after regular call and notice if a quorum is present either in person or by proxy and if, either before or after the meeting, each of the persons entitled to vote and not present in person or by proxy signs a written

waiver of notice or a consent to the holding of the meeting or an approval of the minutes of the meeting. All waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meeting [*Corp. Code § 601(e)*]. These provisions are not subject to qualification by the articles or the bylaws. For further discussion of the validity of transactions and waiver, see *§ 4.230[1]*.

[2] FORM

Place of Shareholders' Meetings [Corp. Code §§ 212(b)(2), 600(a)]

All annual meetings of shareholders shall be held at _____ [*location, e.g.,* the principal executive office of the corporation located at _____ (*address*)]. All other meetings of shareholders shall be held either at _____ [*location, e.g.,* the principal executive office of the corporation] or at another place inside or outside the State of California designated by the Board of Directors and specified in the notice of the meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.229

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§ 4.229 Time of Annual Shareholders' Meeting [Corp. Code §§ 212(b)(2), 600(b)]

[1] Comment

[a] Use of Form

This form is an alternative to Paragraph 4.02 of the form in *§ 4.200[2]*, and Paragraph 3.02 of the form in *§ 4.201[2]*.

Four items can be covered in the annual meeting provision:

- The date and time of the meeting.
- A provision for holidays.
- A provision for calling another meeting if the annual meeting is not held.
- A description of the business to be covered by the meetings.

The only necessary provisions are the first two listed above, but the others are frequently included. This form, in addition to the four provisions mentioned above, specifies the year after which the annual meetings will begin to be held, specifies the place of the meeting, provides for adjournment, and requires the directors to call a new meeting if the annual meeting is not held.

[b] Statutory Authority

The bylaws of a corporation may make provision not in conflict with law or with the articles of incorporation specifying the time for the holding of shareholders' meetings [*Corp. Code § 212(b)(2)*].

[c] Annual Meeting

An annual meeting of shareholders must be held for the election of directors on a date and at a time stated in or fixed in accordance with the bylaws [*Corp. Code § 600(b)*]. The date and time of the annual shareholders' meeting for a regulated management, company must be held in accordance with the Federal Investment Company Act of 1949 [*15 U.S.C. §§ 80a-1-80a-64*; *see 15 U.S.C. § 80a-16* (election of directors)], rather than in accordance with the corporation's bylaws [*Corp. Code § 600(b)*; *see* I.R.C. § 851 ("regulated management company" defined for these purposes)].

[d] Selecting Time of Annual Meeting

In selecting the time of the annual meeting, it should be kept in mind that, unless in the case of a corporation with less than 100 holders of record of its shares the requirement is expressly waived in the bylaws, the board of directors must cause an annual report to be sent to the shareholders not later than 120 days after the close of the fiscal year and at least 15 days prior to the annual meeting of shareholders to be held during the next fiscal year [*Corp. Code § 1501(a)(1)*]. If the annual meeting is held less than 120 days after the close of the fiscal year, it will reduce the number of days allowed by statute to prepare and mail the annual report.

[e] Failure to Hold Annual Meeting

If there is a failure to hold the annual meeting for a period of 60 days after the date designated for it or, if no date has been designated, for a period of 15 months after the corporation was organized or after its last annual meeting, the superior court of the proper county (as defined in *Corp. Code § 177*) may, on the application of any shareholder after notice to the corporation giving it an opportunity to be heard, summarily order a meeting to be held. The court may issue such orders as may be appropriate, including, without limitation, orders designating the time and place of the meeting, the record date for determination of shareholders entitled to vote and the form of notice of the meeting [*Corp. Code § 600(c)*].

The shares represented at the meeting, either in person or by proxy, and entitled to vote constitute a quorum for the purpose of that meeting, despite any provision of the articles of incorporation or bylaws or of the General Corporation Law to the contrary [*Corp. Code § 600(c)*].

[2] FORM

Time of Annual Shareholders' Meeting [Corp. Code §§ 212(b)(2), 600(b)]

The annual meeting of the shareholders, after the year _____, shall be held at the principal executive office of the corporation at _____M., on the _____ [*number, e.g.,* first] _____ [*day of week*] in _____ [*month*] in each year, if not a legal holiday, and if a legal holiday, on the next business day following; provided, however, that any annual meeting may be adjourned as provided by these Bylaws. If the annual meeting of shareholders shall not be held on the date specified above, the Board of Directors shall cause a meeting in lieu of that meeting to be held as soon after as convenient, and, in any case, not later than 60 days after the date designated above, and any business transacted or election held at the meeting shall be as valid as if transacted or held at the annual meeting. At the annual meeting directors shall be elected, reports of the affairs of the corporation shall be considered, and any other business may be transacted that is within the powers of the shareholders.

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.230

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.230 Time, Manner of Giving, and Contents of Notice of Shareholders' Meeting [Corp. Code §§ 212(b)(2), 601(a)-(c), (e), (f)]

[1] Comment

[a] Use of Form

This form is an alternative to Paragraphs 4.03(a)-(d) and 4.04(a) of the form in *§ 4.200[2]*, and Paragraph 3.04 of the form in *§ 4.201[2]*. This form reduces the notice requirements to essentials and is consequently less detailed than the parallel provisions of the long form bylaws [*see § 4.200[2]*] while providing the secretary of the corporation with more than a reference to the Corporations Code, as in the form in *§ 4.201[2]*.

[b] Statutory Authority

The bylaws of a corporation may make provision not in conflict with law or with the articles of incorporation on the manner of giving notice of shareholders' meetings [*Corp. Code § 212(b)(2)*].

[c] Time of Notice

Whenever shareholders are required or permitted to take any action at a meeting, a written notice of the meeting must be given not less than 10 nor more than 60 days before the date of the meeting to each shareholder entitled to vote at the meeting [*Corp. Code § 601(a)*]. However, since a corporation having 500 or more record shareholders (as determined by *Corp. Code § 605*) on the record date for a meeting may use third-class mail for giving notice, a correspondingly longer lead time of at least 30 days prior to the meeting is required where third-class mail is used [*Corp. Code § 601(a), (b)*].

In the case of special meetings called by persons other than the board of directors [*see § 4.232*], the officer to whom the request is delivered must give notice of the meeting "forthwith," but if the notice is not given within 20 days after

receipt of the request, the persons entitled to call the meeting may give the notice, or the superior court of the proper county (as defined in *Corp. Code § 177*) will summarily order the giving of the notice, after notice to the corporation giving it an opportunity to be heard. The procedure provided in *Corp. Code § 305(c)* applies to such an application, and the court may issue such orders as may be appropriate, including, without limitation, orders designating the time and place of the meeting, the record date for determination of shareholders entitled to vote, and the form of notice [*Corp. Code § 601(c)*].

[d] Contents of Notice

The notice must state the place, date, and hour of the meeting, any means of electronic transmission by and to the corporation or electronic video screen communication by which shareholders may participate in the meeting, and (1) in the case of a special meeting, the general nature of the business to be transacted, and no other business may be transacted; or (2) in the case of the annual meeting, those matters that the board of directors, at the time of the mailing of the notice, intends to present for action by the shareholders, but subject to the provisions of *Corp. Code § 601(f)* [*see* [g], *below*], any proper matter may be presented at the meeting for action. If directors are to be elected, the notice must include the names of nominees intended at the time of the notice to be presented by management for election [*Corp. Code § 601(a)*].

[e] Manner of Giving Notice

Notice of a shareholders' meeting must be given personally or by electronic transmission by the corporation, or first-class mail, postage prepaid [*Corp. Code § 113*], or other means of written communication, addressed to the shareholder at the address appearing on the corporate books or given by the shareholder to the corporation for the purpose of notice, or, if no such address appears or was given, at the place where the corporation's principal executive office is located or by publication at least once in a newspaper of general circulation in the county of the corporation's principal executive office [*Corp. Code § 601(b)*].

The notice is deemed given when delivered personally, sent by electronic transmission by the corporation deposited in the mail, or sent by other means of written communication, as the case may be. An affidavit (or declaration under penalty of perjury [*Code Civ. Proc. § 2015.5*]) of mailing or electronic transmission of a notice in accordance with the General Corporation Law, executed by the secretary, assistant secretary, or transfer agent of the corporation, is prima facie evidence that the notice was given [*Corp. Code § 601(b)*].

If a properly addressed notice is returned to the corporation by the United States Postal Service marked to indicate that delivery at that address was not possible, future notices are deemed to have been duly given without further mailing if they are available to the shareholder on written demand at the corporation's principal executive office for a period of one year from the date the notice was given to the other shareholders [*Corp. Code § 601(b)*].

[f] Waiver of Notice by Attendance at Meeting

Attendance of a person at a meeting constitutes a waiver of notice of that meeting, except when the person objects, at the beginning of the meeting, to the transaction of any business because the meeting was not lawfully called or convened, but such attendance is not a waiver of any right to object to the consideration of matters required by the General Corporation Law to be included in the notice of the meeting but not so included, if the objection is expressly made at the meeting [*Corp. Code § 601(e)*].

[g] Validity of Transactions: Waivers, Consents, and Approvals

The transactions of any meeting of shareholders, however called and noticed and wherever held, are as valid as if made at a meeting duly held after regular call and notice if a quorum is present either in person or by proxy and if, either before or after the meeting, each of the persons entitled to vote, not present in person or by proxy, signs a written waiver

of notice or a consent to the holding of the meeting or an approval of the minutes of the meeting. All such waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meeting [*Corp. Code § 601(e)*]. These provisions are not subject to qualification by the articles or the bylaws.

Neither the business to be transacted nor the purpose of any regular or special meeting of shareholders need be specified in any written waiver of notice, consent to the holding of the meeting, or approval of the minutes of the meeting, unless otherwise provided in the articles of incorporation or bylaws, except as provided by *Corp. Code § 601(f)* [*Corp. Code § 601(e)*].

Corp. Code § 601(f) provides that any shareholder approval at a meeting, other than unanimous approval by those entitled to vote, pursuant to *Corp. Code § 310* (contracts and transactions between a corporation and a director or legal entity in which one or more of its directors has a material financial interest), *902* (amendment of articles), *1152* (corporate conversions), *1201* (reorganizations), *1900* (voluntary dissolution), or *2007* (distribution plans on winding up), will be valid only if the general nature of the proposal so approved was stated in the notice of the meeting or in any written waiver of notice.

[2] Form

Time, Manner of Giving, and Contents of Notice of Shareholders' Meeting [Corp. Code §§ 212(b)(2), 601(a)-(c), (e), (f)]

Time and Manner of Giving Notice

(a) Written notice of any meeting at which shareholders are required or permitted to take any action shall be sent by mail, postage prepaid, to each shareholder entitled to vote at the meeting. That notice shall be sent not less than 10 (or, if third-class mail is permitted to be used, not less than 30) nor more than 60 days before the date of the meeting; provided, however, that in the case of a special meeting called by a person other than the board of directors, notice of the meeting shall be sent forthwith but in any event within 20 days after the request for the meeting is received by the Board Chairperson (if there is one), or the President, a Vice-President, or the Secretary of the corporation.

Contents of Notice

(b) The notice shall state the place, date, and hour of the meeting, and (1) in the case of a special meeting, the general nature of the business to be transacted, and that no other business may be transacted; or (2) in the case of the annual meeting, those matters that the Board of Directors at the time of the mailing of the notice intends to present for action by the shareholders. If directors are to be elected, the notice must include the names of nominees intended at the time of the notice to be presented by management for election.

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.231

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.231 Adjournment of Shareholders' Meeting [Corp. Code §§ 601(d), 602(c)]

[1] Comment

[a] Use of Form

This form is a provision governing the adjournment of shareholders' meeting. It is an alternative to the provisions set forth in Paragraphs 4.03(e) and 4.05(c) of the form in *§ 4.200[2]* and, in part, to those set forth in Paragraph 3.06 of the form in *§ 4.201[2]*.

[b] Adjournment Provisions

Adjournment of meetings may be necessitated in two situations:

- When the shareholders are unable to complete the business of the meeting or wish to defer action until later.

- When there is less than a quorum present.

When there is less than a quorum present, the meeting may be adjourned from time to time by the vote of a majority of the shares represented either in person or by proxy, but no other business may be transacted [*Corp. Code § 602(c)*]. However, if a quorum initially was present, the shareholders present at a duly called or held meeting may continue to transact business until adjournment notwithstanding the withdrawal of enough shareholders to leave less than a quorum provided any action taken (other than adjournment) is approved by at least a majority of the shares required to constitute a quorum, or by any greater voting requirement imposed by law or the articles of incorporation [*Corp. Code § 602(b)*].

If a shareholders' meeting is adjourned for more than 45 days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting must be given to each shareholder of record entitled to vote at

the meeting. Otherwise, notice of the adjourned meeting need not be given if the time and place of the meeting, or any means of electronic transmission by and to the corporation or electronic video screen communication by which shareholders may participate in the adjourned meeting, were announced at the meeting at which the adjournment was taken, unless the bylaws require notice [*Corp. Code § 601(d)*]. Hence, the bylaws may require that notice of a meeting adjourned for 45 days or less be given even if the time and place of the adjourned meeting are announced at the meeting at which the adjournment is taken.

[c] Transaction of Business at Adjourned Meeting

At the adjourned meeting the corporation may transact any business that might have been transacted at the original meeting [*Corp. Code § 601(d)*].

[2] Form

Adjournment of Shareholders' Meeting [Corp. Code §§ 601(d), 602(c)]

Any meeting of the shareholders may adjourn by the vote of a majority of the shares represented either in person or by proxy to another time or place, or from day to day or time to time, until its business is completed, or, if a quorum is not and was not present in person or by proxy, until a quorum is present. Any adjournment and the reason for it shall be recorded in the minutes of the meeting. If the adjournment is for more than 45 days, or if the time and place of the adjourned meeting are not announced at the meeting at which the adjournment is taken, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each shareholder of record entitled to vote at the meeting. Otherwise, no notice of the adjourned meeting need be given [*or set forth notice requirements*]. At the adjourned meeting, the corporation may transact any business that might have been transacted at the original meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.232

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.232 Persons Entitled to Call Special Meetings of Shareholders [Corp. Code § 600(d)]

[1] Comment--Use of Form

This form is a bylaw provision that may be used to expand the list of persons who may call a special meeting of shareholders. Except as otherwise provided in the articles or bylaws, special shareholder meetings may be called only by the board of directors, the board chairperson, the president, or the holders of shares entitled to cast not less than 10 percent of the votes at the meeting [*Corp. Code § 600(d)*; *see § 4.200[2]*, P 4.04(b), *§ 4.201[2]*, P 3.03]. The bylaws of a corporation may contain any provision, not in conflict with law or the articles, for the manner of calling shareholders' meetings [*Corp. Code § 212(b)(2)*].

[2] Form

Persons Entitled to Call Special Meetings of Shareholders [Corp. Code § 600(d)]

Special meetings of the shareholders may be called at any time by the Board of Directors, the Board Chairperson if there is such an officer, the President of the corporation, the holders of shares entitled to cast not less than 10 percent of the votes at the meeting, or _____ [*specify, e.g.*, any three directors, *or* the Secretary and Chief Financial Officer of the corporation, acting jointly].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.233

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.233 Quorum of Shareholders [Corp. Code §§ 112, 602(a)]

[1] Comment

[a] Use of Form

This form may be used when the articles of incorporation have modified the statutory provisions governing a quorum [*Corp. Code § 602(a)*; *see § 4.200[2]*, P 4.05, *§ 4.201[2]*, P 2.06] and it is desired that the provision be repeated in the bylaws.

[b] What Constitutes a Quorum

Unless otherwise provided in the articles of incorporation, a majority of the shares entitled to vote, represented in person or by proxy, constitutes a quorum at a shareholders' meeting, but in no event can a quorum consist of less than one third (or, in the case of a mutual water company, 20 percent) of the shares entitled to vote at the meeting or, except in the case of a close corporation [*see Corp. Code § 158* (defining "close corporation")], of more than a majority of the shares entitled to vote at the meeting [*Corp. Code § 602(a)*]. The bylaws may not vary these provisions.

If the articles provide for more or less than one vote for any share on any matter, the above references to "a majority" and to "one third" and "20 percent" of the shares entitled to vote means, as to such matter, a majority or other proportion of the votes entitled to be cast. Whenever shares are disqualified by the General Corporation Law from voting on any matter, they are not to be considered outstanding for the determination of a quorum at any meeting to act on, or the required vote to approve action on, that matter under any other provision of the General Corporation Law, or the articles or bylaws [*Corp. Code § 112*].

References to the voting of shares include the voting of other securities given voting rights in the articles pursuant to *Corp. Code § 204(a)(7)* [*Corp. Code § 111*].

[c] Effect of Vote if Quorum Present

The affirmative vote of a majority of the shares represented and voting at a duly held meeting at which a quorum is present (which shares voting affirmatively also constitute at least a majority of the required quorum) is the act of the shareholders [*Corp. Code § 602(a)*]. However, if a quorum was initially present the shareholders present at a duly called or held meeting may continue to transact business until adjournment notwithstanding the withdrawal of enough shareholders to leave less than a quorum, if any action taken (other than adjournment) is approved by at least a majority of the shares required to constitute a quorum, or by any greater voting requirement imposed by law or the articles of incorporation [*Corp. Code § 602(b)*].

[2] Form

Quorum of Shareholders [Corp. Code §§ 112, 602(a)]

_____ [*Specify proportion as set forth in articles of incorporation*] of the shares entitled to vote shall constitute a quorum at any meeting of the shareholders.

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.234

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.234 Voting for Directors by Ballot [Corp. Code § 708(e)]

[1] Comment--Use of Form

This form requires that voting to be by ballot. Unless the bylaws so require, elections for directors need not be by ballot unless a shareholder demands election by ballot at the meeting and before the voting begins [*Corp. Code § 708(e)*]. Paragraph 4.07 of the form in *§ 4.200[2],* and Paragraph 3.07 of the form in *§ 4.201[2]* restate the statutory provision.

[2] Form

Voting for Directors by Ballot [Corp. Code § 708(e)]

Voting for the election of directors must be by ballot unless a majority of the shares represented either in person or by proxy at the meeting vote to dispense with a ballot vote.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & Removals



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.235

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.235 Shareholders' Meetings--Proxies [Corp. Code §§ 178, 179, 604, 702(a), (d), 704, 705]

[1] Comment

[a] Use of Form

This form sets out in detail the rules to follow in determining the validity of proxies when there is a proxy contest. The statutory provisions governing proxies [*see* [b], *below*] are usually incorporated in the bylaws without additional requirements [*see § 4.200[2]*, P 4.12].

[b] Statutory Authority

The bylaws of a corporation may make provision, not in conflict with law or with the articles of incorporation, for the manner of execution, revocation, and use of proxies [*Corp. Code § 212(b)(3)*]. The statutory provisions governing use of proxies cover authorization of use of proxies [*Corp. Code § 705(a)*]; duration of a proxy [*Corp. Code § 705(b)*]; effect of the death or incapacity of the maker of a proxy [*Corp. Code § 705(c)*]; revocation of a proxy [*Corp. Code § 705(e), (f)*]; voting by proxy of shares held by an administrator, executor, guardian, conservator, or custodian [*Corp. Code § 702(a)*]; voting by proxy of shares standing in the name of a minor [*Corp. Code § 702(d)*]; voting by proxy of shares standing of record in the names of two or more persons [*Corp. Code § 704*]; and the form of proxy [*Corp. Code § 604*]. The terms "proxy" and "proxyholder" are defined in *Corp. Code §§ 178* and *179*, respectively.

[2] Form

Shareholders' Meetings--Proxies [Corp. Code §§ 178, 179, 604, 702(a), (d), 704, 705]
Validity of Proxies

(a) Subject to the provisions of the Articles of Incorporation or any law, statute, or regulation to the contrary, in the event of a proxy contest involving the solicitation of proxies for any annual or special meeting of the shareholders of the

corporation for rival slates of candidates or opposing or proposing action proposed or opposed, as the case may be, by another group of shareholders soliciting proxies, the following presumptions shall be followed in determining the authenticity or validity of proxies filed with the corporation:

(1) Proxies bearing no handwritten or handprinted signature are presumptively invalid except that facsimile signatures may be accepted from securities brokers or dealers and by banks and trust companies and such facsimile signatures are presumptively valid in the absence of evidence of lack of authenticity or authorization.

(2) Proxies are presumptively valid whether or not dated and whether signed in either pencil or ink, and whether or not there are slight changes or variations in spelling as between the registered name of the shareholder and his or her written signature provided that the name as signed is phonetically similar to the name as registered.

(3) The addition of an address different from that appearing on the record of shareholders or the addition or omission of titles such as "Mr.," "Mrs.," "Miss," "Ms.," or "Dr." shall not invalidate a proxy.

(4) A proxy shall be presumed valid in the event that the initials are substituted for the first or middle names of the registered holders or where the names are used in the signature and only initials appear in the record of shareholders, and names or initials may be added or omitted or substituted for the first or middle initial of a name.

(5) The addition or omission of "Jr." or "Sr." or roman or arabic numerals after the signature shall not render a proxy presumptively invalid. However the substitution after the signature of "Jr." for "Sr." or roman or arabic numerals that are different from those appearing in the record of shareholders shall render the proxy presumptively invalid.

(6) A proxy signed in the shareholder's name by someone other than the shareholder is presumptively invalid in the absence of evidence that the signer was authorized to act for the shareholder. Proxies executed by trustees, pledgees, fiduciaries, guardians, administrators, or executors, signed in their own name and indicating the capacity in which they make the proxy are presumptively valid notwithstanding that the shares do not stand in their names in the record of shareholders. If the vote offered by the proxy of any such person is challenged it shall be the duty of the proxy holder to establish the authority of the maker.

(7) If the shares stand in the name of a trustee, pledgee, fiduciary, guardian, executor, or administrator, in the record of shareholders the proxy of such a person shall be presumptively valid regardless of the addition or omission of wording in the proxy designating such capacity.

(8) Proxies for shares standing in the name of a partnership are presumptively valid if signed in the partnership name only, or by one of the partners whose name appears in the partnership name, or by a general partner or other person indicating in the proxy that he has authority to execute the same.

(9) Proxies representing shares registered in the name of a corporation, unincorporated association, or other organization or entity are presumptively valid if signed in the registered name or by a person purporting to act with authority.

(10) If more than one proxy is executed by a stockbroker, dealer, or other custodian, all such proxies are presumptively valid and shall be considered applicable to different shares registered in the name of the proxy maker, provided, however, that the total number of proxies does not exceed the total number of

shares standing in the maker's name, and if such is the case the first proxy filed after proxies have been issued for all of the shares registered in the maker's name shall revoke the first proxy filed by the maker and subsequent proxies shall be treated accordingly, and provided that no proxy executed by such a maker specifically revokes the prior proxies by specific language in addition to that appearing on the proxy forms.

(11) If a proxy bears a legible date it will be presumed to have been executed on that date. If the proxy bears no legible date it will be presumed to have been executed on the date of the postmark of the envelope in which it was transmitted, and in the absence of evidence of such a postmark will be presumed to have been executed on the date it was received by the corporation.

(b) Insofar as they are not clearly inconsistent with any law, regulation, article, bylaw, resolution, or other pertinent matter, votes representing all of the shares of the corporation are presumptively valid. If evidence to the contrary is presented, the burden of proving the invalidity shall be on the person offering the evidence.

(c) Notwithstanding the presumptions of validity or invalidity of a proxy or its execution contained in these Bylaws, evidence of the actual validity or invalidity may be accepted or rejected in determining the question of validity in the discretion of the Chairperson, Secretary, or Inspectors of Election. The amount of evidence for or against validity shall also be in the discretion of the Chairperson, Secretary, or Inspectors of Election. However, nothing contained in these Bylaws shall be construed to require investigation or a request for further information or evidence before or after the determination to accept or reject the vote.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.236

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.236 Conduct of Shareholders' Meetings [Corp. Code § 212(b)(2)]--Presiding Officer, Secretary, and General Rules

[1] Comment

[a] Use of Form

This form is an alternative to Paragraph 4.15 of the form in *§ 4.200[2]*, to specify who shall preside over and act as secretary at shareholders' meetings and to provide rules of procedure. Even if the number of shareholders is few, meetings can be expedited and the minutes of the meetings more accurately recorded if basic rules of procedure are provided for and followed. Thus, bylaws may set forth at least the order of business for such meetings [*see § 4.237*], and often provide that procedure on motions and other matters is to be governed by Robert's Rules of Order.

[b] Statutory Authority

The bylaws may make provision not in conflict with law or with the corporation's articles of incorporation for the manner of conducting shareholders' meetings [*Corp. Code § 212(b)(2)*].

[c] Failure to Obtain Quorum

A meeting that fails to obtain a quorum [*see § 4.233*] may transact no business but must adjourn. The adjournment may be from time to time by the vote of a majority of the shares represented in person or by proxy [*Corp. Code § 602(c)*; *see § 4.231*].

[2] Form

Conduct of Shareholders' Meetings [Corp. Code § 212(b)(2)]--Presiding Officer, Secretary, and General Rules

Shareholders' meetings shall be presided over by the President of the corporation or, in the President's absence, by any Vice-President of the corporation, or, if no such officer is present, by a chairperson chosen at the meeting by a majority of the voting shares represented in person or by proxy. The Secretary of the corporation or, in the Secretary's absence, an Assistant Secretary, or, if no such officer is present, a person designated by the presiding officer, shall act as Secretary of the meeting. The precedence of, and procedure on, motions and other procedural matters at such meetings shall be governed by Robert's Rules of Order insofar as those rules are not inconsistent with law, the corporation's Articles of Incorporation, or with these Bylaws.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.237

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.237 Conduct of Shareholders' Meetings [Corp. Code § 212(b)(2)]--Order of Business

[1] Comment--Use of Form

This form may be used if it is desired that the bylaws specify the order of business at shareholders' meetings. When the order of business is so specified, any business considered out of order without approval of a majority of the shares present will be subject to a "point of order" objection. For discussion of the authority for the bylaws to contain provisions governing the conduct of shareholders' meetings, see *Corp. Code § 212(b)(2)* and *§ 4.236[1]*.

[2] Form

Conduct of Shareholders' Meetings [Corp. Code § 212(b)(2)]--Order of Business

The order of business at all annual meetings, and so far as practicable at special meetings, of the shareholders shall be as follows:

(1) Call to order.

(2) Proof of due notice of the meeting by the Secretary.

(3) Roll call.

(4) Presentation and examination of proxies.

(5) Announcement of a quorum.

(6) Reading, or waiver of reading, and approval of the minutes of the previous meeting.

(7) Announcements.

(8) Reports of officers.

(9) Reports of committees.

(10) Election of directors.

(11) Old, or unfinished, business.

(12) New business.

(13) Adjournment.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.238

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.238 Appointment, Compensation, and Tenure of Officers [Corp. Code §§ 212(b)(6), 312(a)]

[1] Comment

[a] Use of Form

This form is an alternative to Paragraphs 5.01 through 5.03 and 5.13 of the form in *§ 4.200[2]*, and in Paragraph 4.01 of the form in *§ 4.201[2]* to designate the corporate officers, their qualifications, selection, tenure, and compensation.

[b] Statutory Authority

The bylaws of a corporation may make provision not in conflict with law or with the articles of incorporation for the appointment, compensation, and tenure of officers [*Corp. Code § 212(b)(6)*].

[c] Officers Required

A corporation must have a board chairperson or a president or both, a secretary, a chief financial officer and other officers with titles and duties as are stated in the bylaws or determined by the board of directors as necessary to enable it to sign instruments and share certificates [*Corp. Code § 312(a)*; *see § 4.200[2]*, P 5.01, *§ 4.201[2]*, P 4.01; *see also Corp. Code § 416(a)* (officers required to sign share certificates)].

Any number of offices may be held by the same person unless the articles or bylaws provide otherwise [*Corp. Code § 312(a)*].

[d] Selection and Tenure of Officers

Except as otherwise provided by the articles or bylaws, officers are chosen by and serve at the pleasure of the board, subject to any rights an officer may have under an employment contract with the corporation [*Corp. Code § 312(b)*].

[e] Resignation

Any officer may resign at any time on written notice to the corporation without prejudice to any rights the corporation may have under any contract to which the officer is a party [*Corp. Code § 312(b)*].

[2] Form

Appointment, Compensation, and Tenure of Officers [Corp. Code §§ 212(b)(6), 312(a)]

Designation of Officers

The corporation shall have _____ [*designate, e.g.*, a President, a Vice-President, a Secretary, and a Chief Financial Officer].

Membership on Board

No officer shall be a member of the Board of Directors.

[*OR*]

Only duly elected directors may serve as officers of the corporation.

[*OR*]

Only duly elected directors may serve as _____ [*specify titles of officers*]; other officers need not be directors.

[*OR*]

No one shall be eligible for the office of _____ [*specify office, e.g.*, President or Vice-President] who is not a director of the corporation, and any such officer who ceases to be a director shall cease to hold office as _____ [*specify office, e.g.*, President or Vice-President], as well.

Selection and Tenure of Officers

Officers shall be chosen by and serve at the pleasure of the Board of Directors, subject to any rights an officer may have under an employment contract with the corporation. Any person may hold two or more offices, other than the offices of _____ [*specify offices, e.g.*, President and Vice-President].

Compensation

Officers shall receive the salaries and other compensation that is determined from time to time by the Board of Directors.

Resignation

Any officer may resign at any time on written notice to the corporation without prejudice to any rights the corporation may have under any contract to which the officer is a party. [*Add, if desired:* Resignation from office does not, however, by itself constitute resignation from the Board of Directors.]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.239

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.239 Executive Vice-President [Corp. Code §§ 212(b)(6), 312(a)]

[1] Comment--Use of Form

This form is for use to require that the corporation have an executive vice-president and to specify the duties of that officer. For a discussion of the appointment, compensation, and tenure of officers, see *§ 4.238[2]*.

[2] Form

Executive Vice-President [Corp. Code §§ 212(b)(6), 312(a)]

The corporation shall have an Executive Vice-President. The Executive Vice-President shall direct the day-to-day activities of the corporation in accordance with policies and objectives established by the President and the Board of Directors to achieve maximum profitability of operations. The Executive Vice-President shall assist the President in developing policies of the corporation and an organization that will insure that full advantage is taken of the long-range potentialities of the business. In the absence of the President, the Executive Vice-President shall direct and coordinate the activities of the corporation's staffs and operations.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



66 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.240

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.240 Controller [Corp. Code §§ 212(b)(6), 312(a)]

[1] Comment--Use of Form

This form is a bylaw provision that requires the corporation to have a controller. For a discussion of the officers that a corporation must or may have, see *§ 4.238[1][c]*.

[2] Form

Controller [Corp. Code §§ 212(b)(6), 312(a)]
Controller

The corporation shall have a Controller. The Controller shall be responsible for developing and maintaining the necessary procedures for the financial control of the business and for safeguarding assets; for directing internal audits; for seeing that all necessary accounting activities are developed and maintained; for directing the preparation and interpretation of consolidated financial statements and profit plans; for directing studies of administrative and office systems and procedures; for developing data processing; and for recommending changes in accounting, auditing, and profit-planning policies.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesFiduciary ResponsibilitiesGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.241

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.241 Prohibition Against Issuance of Fractional Shares [Corp. Code § 407]

[1] Comment

[a] Use of Form

This form is a bylaw provision prohibiting the issuance of fractional shares. For alternative provisions authorizing the issuance of fractional shares, see Paragraphs 4.08 and 7.02 of the form in *§ 4.200[2]*.

[b] Issuance of Fractional Shares

A corporation may, but is not required to, issue fractions of a share originally or on transfer. If it does not issue fractional shares, the corporation must, in connection with any original issuance of shares do the following:

- Arrange for the disposition of fractional interests by those entitled to them;

- Pay in cash the fair value of fractions of a share (the board's determination of fair value is conclusive, in the absence of fraud) as of the time when those entitled to receive fractions are determined; provided, however, that a corporation may not pay cash for fractional shares if the action would result in the cancellation of more than 10 percent of the outstanding shares of any class; or

- Issue scrip or warrants in registered or bearer form that entitle the holder to receive a certificate for a full share on the surrender of the scrip or warrants aggregating a full share [*Corp. Code § 407* (setting forth a separate provision applicable to merger or reorganization agreements)]. The corporation may issue scrip or warrants in registered form as certificated securities or uncertificated securities [*Corp. Code § 191.1*; *see Com. Code § 8102(a)(18)* ("uncertificated securities" defined)], or in bearer form as certificated securities [*Corp. Code § 407*].

A certificate for a fractional share does, but scrip or warrants do not, unless otherwise provided in the scrip or warrants, entitle the holder to exercise voting rights, to receive dividends on them, and to participate in any of the assets of the corporation in the event of liquidation. The board of directors may cause scrip or warrants to be issued subject to the condition that they will become void if not exchanged for certificates representing full shares before a specified date or that the shares for which scrip or warrants are exchangeable may be sold by the corporation and the proceeds distributed to the holder of the scrip or warrants or any other condition that the board may impose [*Corp. Code § 407*].

The board may cause scrip or warrants to be issued subject to the condition that they will become void if not exchanged for full shares, whether certificated or uncertificated, before the time discussed in the text [*Corp. Code § 407*].

This form assumes that only certificated securities will be issued by the corporation [*see* [2], *below*]. For further discussion of certificated and uncertificated securities, see "Share Certificates--Issuance" and subsequent headings in Ch. 6I, *Issuance of Equity Securities*.

[2] Form

Prohibition Against Issuance of Fractional Shares [Corp. Code § 407]

The corporation shall not issue fractions of a share either originally or on transfer, but, in connection with any original issuance of shares, shall pay in cash the fair value, as determined by the Board of Directors, of fractions of a share as of the time when those entitled to receive the fractions are determined, provided, however, that the corporation shall not pay cash for fractional shares if that action would result in the cancellation of more than 10 percent of the outstanding shares of any class [*or* issue scrip or warrants in registered or bearer form that shall entitle the holder to receive a certificate for a full share on the surrender of scrip or warrants aggregating a full share. Scrip or warrants, unless otherwise provided in the srip or warrants, shall not entitle the holder to exercise voting rights, to receive dividends on them, or to participate in any of the assets of the corporation in the event of liquidation. The board may cause scrip or warrants to be issued subject to the condition that they shall become void if not exchanged for certificates representing full shares before a specified date or that the shares for which scrip or warrants are exchangeable may be sold by the corporation and the proceeds distributed to the holder of the scrip or warrants or any other condition that the Board may impose].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock CertificatesBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.242

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.242 Issuance of Partly Paid Shares [Corp. Code §§ 409(d), 410(b), 411-413, 418]

[1] Comment

[a] Use of Form

This form sets forth the terms of the deferred payment for partly paid shares. Alternatively, the the bylaws could prohibit issuance of such shares if issuance is not authorized by the articles of incorporation [*see Corp. Code §§ 212(b), 212(b)(1), 204(d)*].

Paragraph 7.03 of the form in *§ 4.200[2]* briefly provides that the corporation may issue partly paid shares if the board of directors so determines. Paragraph 7.01(e) of that section sets forth the liability of the subscriber for partly paid shares and Paragraph 7.08(c) provides for the issuance of certificates for such shares. The form in *§ 4.201[2]* contains no express provision authorizing issuance of partly paid shares, but instead simply relies on the authorization contained in *Corp. Code § 409(d)*. Paragraph 6.01 of the form in *§ 4.201[2]*, however, does provide for the issuance of certificates for partly paid shares and Paragraph 6.07 provides for the liability of the transferee of partly paid shares "as provided by law."

[b] Issuance of Partly Paid Shares

A corporation may issue the whole or any part of its shares partly paid and subject to call for the remainder of the consideration to be paid for them [*Corp. Code § 409(d)*]. The consideration must be paid in accordance with the subscription or purchase agreement [*Corp. Code § 410(b)*].

[c] Share Certificates and Uncertificated Shares

The total amount of the consideration to be paid and that paid for the shares must be stated on the certificate issued to represent them [*Corp. Code §§ 409(d), 418(a)(2)*]. If it is not, no liability for the unpaid portion of the subscription price

is enforceable against a transferee of the shares without actual knowledge of that liability [*Corp. Code § 418(b)*].

If the corporation issues uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)* (definition)] instead of share certificates, the total amount of consideration to be paid and the amount actually paid should be set forth in the initial transaction statement and subsequent written statements for those securities [*Corp. Code §§ 409(d), 418*]. For a general explanation of the law governing initial transaction statements and uncertificated securities, see the discussion under "Share Certificates--Issuance" and subsequent headings in the Legal Background to Ch. 6I, *Issuance of Equity Securities*.

[d] Liability of Transferor and Transferee of Partly Paid Shares

A transferee of shares for which the full agreed consideration has not been paid to the issuing corporation, who acquired them in good faith and without knowledge that they were not paid in full or to the extent stated on the certificate representing them, is liable only for the amount shown by the certificate to be unpaid on the shares represented by it until the transferee transfers the shares to one who becomes liable, but the transferor remains personally liable if so provided on the certificate or agreed on in writing. The liability of any holder of the shares who derives title through such a transferee and who is not a party to any fraud affecting the issue of the shares is the same as that of the transferee through whom title is derived [*Corp. Code § 411*].

Every transferee of partly paid shares who acquired them under a certificate showing the fact of part payment, and every transferee of such shares (other than a transferee who derives title through a holder in good faith without knowledge and who is not a party to any fraud affecting the issue of the shares) who acquired them with actual knowledge that the full agreed consideration had not been paid to the extent stated on the certificate for them, is personally liable to the corporation for installments of the amount unpaid becoming due until the shares are transferred to one who becomes personally liable for them. The transferor, however, remains personally liable if so provided on the certificate or agreed on in writing [*Corp. Code § 412*]. This is equally applicable to information on initial transaction statements or subsequent written statements when the shares are uncertificated securities [*Corp. Code § 412*]. For a discussion of uncertificated securities, see "Share Certificates--Issuance" and subsequent headings in the Legal Background to Ch. 6I, *Issuance of Equity Securities*.

A transferee who acquires shares without knowledge that they are not paid in full or to the extent stated on the certificate representing them (or in the case of uncertificated securities, on the applicable initial transaction statement) is liable only for the amount shown by the certificate or statement to be unpaid on the shares, until the transferee transfers the shares to one who becomes liable [*Corp. Code § 411*; *see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)* ("uncertificated security" defined)].

[e] Liability of Holder of Shares

A person holding shares as pledgee, executor, administrator, guardian, trustee, receiver, or in any representative or fiduciary capacity is not personally liable for any unpaid balance of the subscription price of the shares because the shares are so held, but the estate and funds in the hands of that fiduciary or representative are liable and the shares are subject to sale for the unpaid balance [*Corp. Code § 413*].

[f] Dividends

On the declaration of any dividend on fully paid shares, the corporation must also declare a dividend on partly paid shares of the same class, but only on the basis of the percentage of the consideration actually paid [*Corp. Code § 409(d)*].

[2] Form

Issuance of Partly Paid Shares [Corp. Code §§ 409(d), 410(b), 411-413, 418]

The corporation may issue its shares prior to full payment and permit deferred payment arrangements under the following conditions:

(a) Not less than 25 percent of the aggregate price shall be payable immediately in cash;

(b) The balance of the aggregate price shall be payable within one year from the date of sale and, if the portion of the aggregate price that is payable immediately in cash is less than 40 percent of the aggregate price, then that balance shall be payable in equal monthly installments over a period not to exceed one year from date of sale;

(c) The sale shall be pursuant to a subscription agreement setting forth the terms of payment, or the balance of the aggregate price shall be represented by one or more promissory notes;

(d) The securities sold shall be issued in the name of the purchaser, or the purchaser's designee, but shall be retained by the issuer as collateral for the unpaid balance of the aggregate price;

(e) The corporation may not discount or assign the promissory note or notes, or its rights pursuant to the subscription agreement, unless the net cash proceeds to the corporation from the action is equal to not less than the offering price of the securities, after deducting the authorized selling expenses;

(f) The certificates shall state the total amount of the consideration to be paid for the shares, the amount paid, and the terms of payment; and

(g) As a condition of the transfer on the books of the corporation of those shares, all installments of the purchase or subscription price shall be paid before the transfer.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.243

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.243 Employees' Stock Purchase Plan [Corp. Code §§ 207(f), 408]

[1] Comment

[a] Use of Form

This form is a bylaw provision authorizing an employee stock purchase plan. It is an alternative to Paragraph 7.06 of the form in *§ 4.200[2]*. The articles of incorporation [*see Corp. Code § 204(d)*] or the bylaws [*see Corp. Code § 212(b)(1)*] may provide for stock purchase or option plans. In addition, since corporations have the statutory power to adopt such plans subject to any limitations in their articles [*Corp. Code §§ 207(f), 408*], plans may be established even if they are not mentioned in either the articles or the bylaws.

For a statutory incentive stock option plan [*see I.R.C. § 422*], and more detailed discussion of that type of plan, see *Ch. 6I, Issuance of Equity Securities, § 6I.240* et seq.

[b] Power of Corporation to Provide Plan

A corporation, subject to any limitations contained in its articles of incorporation and to compliance with other provisions of the General Corporation Law and any other applicable laws, has power to establish and carry out share purchase and share option plans for any or all of its directors, officers, and employees, or the directors, officers, and employees of its parent corporation or any of its subsidiary [*see Corp. Code § 189* (defining "subsidiary")] or affiliated [*see Corp. Code § 150* (defining "affiliated")] corporations [*Corp. Code § 207(f)*].

A stock purchase or option plan may provide for the issue of unissued stock and the sale of that stock or of previously issued stock to the employees or directors of the corporation, its parent, or its subsidiaries. The plan may provide for the consideration to be paid and for the payment of that consideration in installments. It may also permit the corporation to aid the buyers in making payment by compensation for services rendered, promissory notes, or otherwise [*Corp. Code § 408(a)*].

The plan or agreement may include the fixing of eligibility for participation; the class and price of shares to be issued or sold under the plan or agreement; the number of shares that may be subscribed for; the method of payment; the reservation of title until full payment; the effect of the termination of employment; an option or obligation on the part of the corporation to repurchase the shares on termination of employment, subject to *Corp. Code §§ 500-511* (governing reacquisition of shares); restrictions on transfer of the shares; and the time limits of and termination of the plan [*Corp. Code § 408(b)*; *see, e.g., Barton v. Elexsys International Inc. (1998) 62 Cal. App. 4th 1182, 1188, 1189, 73 Cal. Rptr. 2d 212* (terminated executive sued for breach of contract and fraud after former employer refused to allow exercise of stock options one year after termination; court held that stock option agreements provided that options would not vest after termination, had to be exercised within 30 days of termination or ceased to be exercisable, and were not altered by severance agreement)].

The provisions of the Labor Code requiring that any property put up by an employee as part of an employment contract be deemed a bond, and under which it is illegal to make investments in a business and to sell stock in a business in connection with obtaining employment in that business [*see Lab. Code §§ 406, 407*], are inapplicable to shares issued by any foreign or domestic corporation to participants in a stock purchase or option plan or, in any transaction in connection with securing employment, to a person who is or is about to become an officer of the corporation or of its parent or subsidiary [*Corp. Code § 408(c)*].

[c] Corporations Commissioner's Regulations

If an issuer attempts to qualify the offer or sale of stock options by permit [*see Corp. Code § 25113*; *see* Ch. 6H, *Qualification of Securities*], the Corporations Commissioner may refuse to issue a permit unless he or she finds the proposed issuance of the securities to be fair, just, and equitable [*Corp. Code § 25140(b)*]. A permit may not be required if the proposed issuance of securities under a plan or agreement is exempt under *Corp. Code 25102(o)* and the required notice is filed with the Commissioner of Corporations within the statutory time limit or within 15 days after the Commissioner's demand, together with the applicable fee [*see Corp. Code 25102(o)*]. The standards relating to a presumption of fairness require a stock option plan to meet criteria regarding number of shares; persons eligible; exercise price, period, and rights; nontransferability; adjustment on stock split, stock dividend, recapitalization, combination, or reclassification; termination; shareholder approval; disclosure to employees; repurchase rights and voting rights [*see 10 Cal. Code Reg. § 260.140.41*; *see also 10 Cal. Code Reg. § 260.140.1* (voting rights requirements)]. Similar requirements apply to employee stock purchase plans [*see 10 Cal. Code Reg. § 260.140.42*].

A stock option plan must also provide for annual financial statements regarding the issuer to be given to option holders. However, these financial statements need not comply with the requirements of *10 Cal. Code Reg. § 260.613*. Further, the annual financial statement requirement does not apply when the issuance of stock is limited to key employees whose duties in connection with the issuer ensure them access to equivalent information [*10 Cal. Code Reg. § 260.140.46*].

The total number of shares called for by employee stock purchase, stock option, and stock bonus plans must not exceed 30 percent of the then-outstanding shares of the issuer, excluding shares subject to promotional waivers, unless a percentage higher than 30 percent is approved by at least two-thirds of the outstanding shares entitled to vote [*see 10 Cal. Code Reg. § 260.140.45*]. This limitation is determined without regard to shares represented by pro rata rights issued to shareholders [*see 10 Cal. Code Reg. § 260.140.40*], shares called for by warrants issued to debt or equity purchasers [*see 10 Cal. Code Reg. §§ 260.140.43, 260.140.44*], or to shares sold to employees, directors, or consultants [*see 10 Cal. Code Reg. § 260.140.42*], provided the stock purchase plan provides that all shares will have a purchase price of 100 percent of the stock's fair value, either at the time the person is granted the right to purchase shares or at the time the purchase is consummated [*10 Cal. Code Reg. § 260.140.45*]. This limitation is deemed satisfied when the plan or agreement provides that at no time may the total number of securities issuable on the exercise of all outstanding options and the total number of shares provided for under the stock bonus or similar arrangement exceed the applicable percentage limitation based on the issuer's securities that are outstanding at the time the calculation is made [*Cal. Code*

Reg. § 260.140.45]. For further discussion, see *Ch. 6I, Issuance of Equity Securities, § 6I.240*.

[d] Tax Treatment

Statutory "incentive stock options" receive special tax treatment [*see I.R.C. § 422(a)*]. For an example and discussion of an incentive stock option, see *§ 85.383* in Ch. 85, *Employment Agreements.* Nonstatutory stock options, however, are subject to the general tax rules for property transferred in connection with employment [*see I.R.C. § 83*; *see also §§ 85.384, 85.385* in Ch. 85, *Employment Agreements*].

[2] Form

Employees' Stock Purchase Plan [Corp. Code §§ 207(f), 408]

The corporation, on terms and conditions authorized in these Bylaws, may establish and operate a stock purchase plan, or plans, providing for the issue and sale, or for the granting of options for the purchase, of its unissued shares, or of issued shares purchased or to be purchased or acquired, to employees or directors of the corporation or of any subsidiary or parent of the corporation or to a trustee on their behalf. The plan may specify the consideration for the payment of those shares in installments, or at one time, and for aiding any eligible persons in paying for those shares by compensation or services rendered, promissory notes, or otherwise. Any plan, before becoming effective, must be approved or authorized by the Board of Directors of the corporation and at least 12 months thereafter by vote of the shareholders.

A plan may include, among other things, provisions determining or providing for the determination by the Board of Directors, or any committee designated by the Board of Directors, of:

- Eligibility of directors and employees to participate.
- The number and class of shares that may be subscribed for or for which options may be granted under the plan.
- The time and method of payment for those shares.
- The price or prices at which the shares shall be issued or sold.
- Whether or not title to the shares shall be reserved to the corporation until fully paid for.
- The effect of the death of a director or employee participating in the plan, or the termination of a participating person's employment, including whether there shall be any option or obligation on the part of the corporation to repurchase the shares.
- Restrictions, if any, upon the transfer of the shares, and the time limits and termination of the plan.
- Termination, continuation, or adjustments of the rights of participating directors and employees on the happening of specified contingencies, including increase or decrease in the number of issued shares of the class covered by the plan without receipt of consideration by the corporation or any exchange of shares of that class for stock or securities of another corporation pursuant to a reorganization or merger, consolidation or dissolution of the corporation.
- Amendment, termination, interpretation, and administration of the plan by the Board of Directors or any committee designated by the Board of Directors.

- Any other matters, not in conflict with the law or the Articles of Incorporation, that may be included in the plan.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewSecurities LawExemptions From RegistrationExempt Classes of SecuritiesBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewPensions & Benefits LawEmployee Benefit PlansEmployee Stock Ownership PlansTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsStock Options (IRC secs. 421-424)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.244

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§ 4.244 Stock Transfer Restrictions [Corp. Code §§ 204(b), 212(b)(1)]

[1] Comment

[a] Use of Form

This form is for use if the corporation and other shareholders are to have the right of first refusal before a shareholder may sell or otherwise dispose of his or her shares to a third person. For an alternative provision, see *§ 4.245*.

A restriction on the transfer of shares may be limited to sales only and not to other kinds of voluntary transfers, such as transfer by gift, will, or division of property on dissolution of marriage, or to transfers by operation of law. Careful consideration should be given before limiting the restriction, since any kind of transfer may result in unwanted persons becoming shareholders. This is also true of hypothecation; a foreclosure of the security interest would result in the transfer of the shares.

In the form the price to be paid for the shares is that which the shareholder and the proposed purchaser have in good faith agreed on or, if there is no proposed purchase, the price fixed by the shareholder. In the form in *§ 4.245[2]*, the price to be paid by the corporation and shareholders is to be fixed by a formula or by arbitration.

[b] Statutory Authority

The bylaws of a corporation may impose reasonable restrictions on the right to transfer or hypothecate shares of any class or classes, although no restriction on shares issued prior to the adoption of the restriction is binding unless the holders of those shares voted in favor of it [*Corp. Code §§ 204(b), 212(b)(1)*].

[c] Kinds of Restrictions

The following are the common types of restrictions imposed on transferability of shares:

- A right of the corporation to purchase the shares in preference to others and, because of the statutory restrictions on purchases by a corporation of its own shares [*see Corp. Code §§ 166, 500-510*], a secondary right to purchase the shares in the other shareholders if the corporation fails to exercise its right in whole or in part.

- A right of the other shareholders to purchase the shares in preference to others.

- Various combinations of rights in favor of both the corporation and the other shareholders.

- Making the transfer subject to the approval or consent of the directors or other shareholders.

- A limitation on the classes of persons to whom a transfer can be made.

- Reserving a lien on shares to secure payment of debts due to the corporation.

A stock transfer restriction giving the corporation or other shareholders the right to purchase the shares may provide for purchase at a fixed price, such as book value. "Book value" is the value of the net assets of the corporation as shown by the corporate books divided by the number of shares outstanding [*see Brown v. Halbert (1969) 271 Cal. App. 2d 252, 259, 76 Cal. Rptr. 781]* . If that term is used in the bylaws, it should be defined [*see Piedmont Publishing Co. v. Rogers (1961) 193 Cal. App. 2d 171, 175, 183-188, 14 Cal. Rptr. 133* (discussing various meanings of the term "book value")]. Alternatively, the restriction may provide for a purchase price to be determined by a formula or appraisal [*see Piedmont Publishing Co. v. Rogers (1961) 193 Cal. App. 2d 171, 175-176, 14 Cal. Rptr. 133* ; *see also* [d], *below*; *§ 4.245*]. Or, the restriction may merely tprovide, as in this form, that the corporation or other shareholders are to have a right of first refusal to purchase the shares at the price reached in good faith between the shareholder and the prospective purchaser or, if there is no prospective purchaser, at the price fixed by the shareholder. The restriction could also require either the corporation, subject to the provisions of *Corp. Code §§ 166* and *500-510*, relating to distributions to shareholders, or the other shareholders to purchase the shares at the price fixed, determined, or reached in good faith between the shareholder and the prospective purchaser, or at a fixed price, or at a price determined by formula.

The provisions usually contained in the stock transfer restriction if the corporation or the other shareholders are to be given the right of first refusal are the following:

- Notice to the corporation of the shareholder's intent to sell.

- Determination of the price to be paid for the shares.

- Right of the corporation or other shareholders to offer to purchase their pro rata portion of the shares.

- Right of the other shareholders, if the corporation offers to purchase only a portion of the shares, to offer to purchase the remaining shares.

- Limitation on the amount of shares to be purchased by each shareholder.

- Release of the restriction on sale or transfer if less than all the shares to be sold are offered to be purchased by the corporation and the other shareholders.

[d] Enforceability of Restrictions

Restrictions on the right to transfer or hypothecate shares are recognized as essential to the successful operation of close

or closely held corporations in California and are enforceable as long as they do not constitute an unreasonably restrictive curtailment of the right of alienation, or otherwise unreasonably deprive shareholders of substantial rights [*Tu-Vu Drive-In Corp. v. Ashkins (1964) 61 Cal. 2d 283, 287*]. Restrictions reserving the right of first refusal in other shareholders or the corporation are regarded as reasonable, since they merely limit the choice of transferees while insuring to the selling shareholder the price and terms equal to those offered by outsiders [*Sanchez v. Centro Mexicano of Sacramento (1969) 1 Cal. App. 3d 756, 759, 81 Cal. Rptr. 875]* .

In determining whether a right of first refusal has been triggered, a court must first carefully consider the contract terms to determine the conditions necessary to invoke the right. If the right of first refusal is conditioned on receipt of a bona fide third-party offer to buy the property, then the right will not be triggered by the mere conveyance of that property to a third party. Only when the conveyance is marked by arms-length dealing and a change in control of the property may such a right be exercised. Generally speaking, it is the concurrence of both an arms-length transaction and a change in control of the property that characterizes a bona fide sale. The absence of the first factor, as in the case of a gift, or of the second factor, as in the case of a transfer between entities owned and controlled by the same individuals, usually indicates that there was no sale, or no bona fide offer for sale, within the meaning of the typical right of first refusal [*Hartzheim v. Valley Land & Cattle Co. (2007) 153 Cal. App. 4th 383, 393, 62 Cal. Rptr. 3d 815]* .

In addition, the court must look through the formalities of the transaction and determine its true nature. Courts will not tolerate schemes designed to avoid a contractual right; for example, a landlord cannot avoid a right of first refusal to purchase the demised property by accepting an offer to purchase a larger parcel that includes the portion subject to the right. On the other hand, legitimate business or personal reasons, untainted by an intent to avoid a contractual preemptive right, will weigh in favor of finding that the right was not triggered by the transaction [*Hartzheim v. Valley Land & Cattle Co. (2007) 153 Cal. App. 4th 383, 393, 62 Cal. Rptr. 3d 815]* .

[e] Restrictions of Corporations Commissioner

An open qualification [*see 10 Cal. Code Reg. § 260.001(f)* (definition)] will not be approved if the securities are subject to a restriction on transfer that is imposed by the issuer's charter documents, indenture agreements, or other instruments or agreements under which the securities are to be issued [*10 Cal. Code Reg. § 260.140.8(a)*].

However, a limited offering [*see 10 Cal. Code Reg. § 260.001(e)* (definition)] may be approved even though the securities are subject to transfer restrictions if the restrictions do not unfairly prejudice the opportunity of the shareholders to receive the fair value of the securities [*10 Cal. Code Reg. § 260.140.8(b)*; *see 10 Cal. Code Reg. § 260.140.50*]. Provisions are presumptively reasonable when there is no third-party offeror and the holder wishes to sell, if the provisions base the price at which the issuer or other holder may purchase the securities on either (1) an independent appraised value or (2) the book value (unless the business is one for which book value is not a significant indication of value) [*10 Cal. Code Reg. § 260.140.8(b)(1)*].

Rights of first refusal in favor of the issuer or other holder are presumptively reasonable in the following situations [*10 Cal. Code Reg. § 260.140.8(b)(2)*]:

- They apply only if there is a bona fide third-party offeror and the selling holder wishes to sell the securities;

- The right of first refusal requires the issuer or other holder to make its election to purchase the securities subject to the right of refusal, if at all, by giving notice of election no more than 30 days after receipt of notice of the right of first refusal; and

- On exercise of the right, the issuer or other holder exercising the right of first refusal must purchase all (but not less than all, unless the selling holder consents) of the offered securities on the same terms

offered by the bona fide third-party offeror within 60 days after receipt of the notice of election, unless a longer period is offered by the bona fide third-party offeror.

Provisions are *not* presumptively reasonable in the following situations [*10 Cal. Code Reg. § 260.140.8(b)(3)*; *see 10 Cal. Code Reg. §§ 260.140.41, 260.140.42*]:

- They absolutely prohibit the transfer of securities,
- They permit transfer only on the consent of the issuer or other holder, or
- They give an option to the issuer or the other holder to purchase, regardless of the desire of the selling holder to sell, and will be permitted only when justified by the issuer, except as otherwise permitted.

Provisions giving an issuer the right to repurchase securities upon termination of employment are presumptively reasonable if the repurchase price [*10 Cal. Code Reg. § 260.140.8(b)(4)*]:

- Is not less than the fair value of the securities to be repurchased on the date of termination of employment, and the right to repurchase will be exercised for cash or cancellation of purchase money indebtedness for the securities within six months of termination of employment (or in the case of securities issued upon exercise of options after the date of termination, within six months after the date of exercise), and the right terminates when the issuer's securities become publicly traded; or
- Is at the original purchase price, provided that (1) the right to repurchase at the original price lapses at the rate of at least 20 percent of the securities per year over five years from the date the option is granted (without respect to the date the option was exercised or became exercisable), and (2) the right to repurchase must be exercised for cash or cancellation of purchase money indebtedness for the securities within six months of termination of employment (or in the case of securities issued upon exercise of options after the date of termination, within six months after the date of the exercise).

In addition, the securities held by an officer, director, general partner, trustee (when the issuer is a business trust), manager, advisor, or consultant of the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer's parents, or an affiliate of the issuer, may be subject to additional or greater restrictions [*10 Cal. Code Reg. § 260.140.8*].

If the issuance of shares is subject to qualifications by permit from the Commissioner, the application for qualification must include, as exhibits, any "shareholders' agreement" between members of a "close corporation" [*see Corp. Code §§ 158, 186*], and any agreements by or among shareholders that materially affect, among other things, transfer restrictions [*see 10 Cal. Code Reg. § 260.113*]. Therefore, the Commissioner's standards of fairness will have to be met with regard to transfer restrictions appearing in the articles, bylaws, or a shareholders' agreement, all of which are "charter documents" [*see 10 Cal. Code Reg. § 260.001(a)*], at least when shares must be qualified. It is questionable whether the standards would apply to restrictions appearing in other forms of private agreements, because *10 Cal. Code Reg. § 260.140.8* only reaches restrictions imposed by the issuer's charter documents, indenture agreements or other instruments or agreements under which the securities are to be issued. Only a strained interpretation of the latter phrase would include private agreements restricting transfer, that is, those to which the corporation is not a party. Thus, although an applicant for a permit to issue securities might have no objection to the Commissioner's granting only a limited qualification, there could be well-founded objection to any attempt by the Commissioner to regulate the terms of a private agreement pursuant to the standards set forth in *10 Cal. Code Reg. § 260.140.8*.

[f] Share Certificates

This form assumes that the corporation has elected to issue stock certificates rather than utilize an electronic system of issuance, recordation and transfer [*see Corp. Code § 416(b)*]. When a transfer restriction is imposed on certificated securities, the restriction must be noted conspicuously on the security certificate [*Com. Code 8204(1)*]. For a general discussion of certificated and uncertificated securities, see "Share Certificates--Issuance" and subsequent headings in the Legal Background to Ch. 6I, *Issuance of Equity Securities*.

If the shares are classified or if any class of shares has two or more series, the share certificate must contain either a statement of the rights, preferences, privileges, and restrictions granted or imposed [*Corp. Code § 417(a)*]; a summary of those provisions with a reference to the articles establishing them [*Corp. Code § 417(b)*]; or a statement setting forth the office or agency of the corporation from which shareholders can obtain a complete statement of any rights and restrictions [*Corp. Code § 417(c)*]. In all cases in which restrictions on transfer are imposed, a conspicuous statement of the fact that the shares are subject to restriction on transfer must appear on the certificate [*Corp. Code § 418(a)(1)*]. Unless so stated, no restriction on transfer is enforceable against a transferee (including a purchaser from the corporation) of the shares without actual knowledge of the restriction [*Corp. Code § 418(b)*; *Com. Code § 8204(1)*].

If the corporation issues uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)* (definition)], the information normally required to appear on share certificates must appear on the initial transaction statement and written statements instead [*Corp. Code §§ 417, 418*].

In the case of a close corporation [*see Corp. Code § 158*], all certificates representing shares of the corporation must contain, in addition to any other statements required by *Corp. Code § 418*, this conspicuous legend on their face: "This corporation is a close corporation. The number of holders of record of its shares of all classes cannot exceed _____ [*a number not in excess of 35*]. Any attempted voluntary inter vivos transfer that would violate this requirement is void. Refer to the articles, bylaws and any agreements on file with the secretary of the corporation for further restrictions" [*Corp. Code § 418(c)*]. If the certificate contains this legend, any attempted voluntary inter vivos transfer of the shares that would result in the number of holders of record of shares exceeding the maximum number specified in the articles is void [*Corp. Code § 418(d)*].

[2] Form

Stock Transfer Restrictions [Corp. Code §§ 204(b), 212(b)(1)]

Void Transfers

(a) No holder of shares of the corporation shall sell or otherwise dispose of his or her shares or any right or interest in them without first offering to sell them to the corporation and the other shareholders in the manner set forth in this article _____[*number*]. Any sale or other disposition of the shares in violation of the provisions of this Section _____ shall be null and void.

Notice of Intent to Sell

(b) Any shareholder desiring to sell or otherwise dispose of all or any part of his or her shares in the corporation or of an interest in them shall give written notice of that fact to the corporation. The notice must be given by registered or certified mail, return receipt requested, addressed to the Secretary of the corporation at the corporation's principal executive office or delivered in person to the Secretary of the corporation. The notice must designate the number of shares to be sold, the name of the proposed purchaser, if any, the price per share agreed on in good faith between the shareholder and the proposed purchaser, if any, and the total amount of the sales price, or if there is no proposed purchaser the price per share at which the shareholder offers to sell and the total amount of the sales price, and the terms on which the shareholder intends to make the sale.

Offer by Corporation

(c) Within _____ [*e.g.*, 30 days] after receipt by the corporation of the notice to the Secretary, if the corporation desires to purchase all of the shares, it must mail or deliver to the offering shareholder a written offer to purchase the shares at the price and on the terms stated in the notice to the Secretary.

Notification to Shareholders

(d) In the event that the corporation elects within the _____ [*e.g.*, 30-day] period mentioned above to purchase none or less than all of the shares so offered, the Secretary shall, at the termination of that _____-day period, mail or deliver to each of the other shareholders of record a notification specifying the number of shares remaining to be sold, the price per share, the terms on which the offering shareholder intends to make the sale, and the name of the proposed purchaser, if any, or, if none, a statement of that fact. This notification may be delivered to the shareholders personally or may be mailed to the last known addresses of the shareholders, as the same may appear on the books of the corporation.

Offer by Shareholders

(e) Within _____ [*e.g.*, 20 days] after the mailing or delivering of the notification to the other shareholders, any such shareholder or shareholders desiring to purchase any part or all of the shares referred to in the notification shall deliver by mail or otherwise to the Secretary of the corporation a written offer or offers to purchase a specified number of the shares at the price and on the terms stated in the notification.

Pro Rata Allocation of Shares

(f) If the total number of shares specified in the offers from the shareholders exceeds the number of shares referred to in the notification, the shares to be sold shall be allocated among the offering shareholders pro rata to the number of shares owned by each shareholder.

Purchase in Excess of Pro Rata Amount

(g) If all the shares referred to in the notification are not disposed of under apportionment provided in paragraph (f) of this Section _____, each shareholder desiring to purchase shares in a number in excess of his or her pro rata share, as provided above, shall be entitled to purchase the proportion of the shares that remain undisposed of as the total number of shares that he or she holds bears to the total number of shares held by all the shareholders desiring to purchase shares in excess of those to which they are entitled under the apportionment, or all of the shares if there is no other shareholder desiring to purchase shares in excess of those to which he or she is entitled under the apportionment provided for above.

Release of Restriction

(h) Unless all of the offered shares have been purchased by the corporation or by the shareholders or by both within a period of _____ [*e.g.*, 60 days] after the mailing or delivery of the notice to the Secretary required by paragraph (b) of this Section _____, all the offered shares shall be released from the restrictions on sale or other disposition, provided, however, that the shares shall be released solely for the purpose of the proposed sale or other disposition in the total amount specified and at the price specified in the notice to the Secretary, or at a greater price than that specified, and provided further that the sale or other disposition be completed within _____ [*e.g.*, 30 days] after the _____ [*e.g.*, 60-day] period referred to above. After completion of the sale or other disposition, or after the expiration of the _____ [*e.g.*, 30 days] within which the sale or disposition must be completed, whichever first occurs, the shares shall again be and remain subject to the restrictions on sale or other disposition imposed by this Section.

Transfer Restrictions Endorsed on Share Certificates

(i) There shall appear on all share certificates a statement of the fact that the shares are subject to restrictions on transfer [*if shares are classified or issued in series add:* and a statement of the restrictions imposed on each class or series of shares authorized to be issued and the holders of those shares].

Restrictions Binding on Heirs, Successors, and Permitted Assigns

(j) All the terms, conditions, and provisions of this Section _____ restricting the sale or other disposition of shares of the corporation or of an interest in them shall apply to and bind the heirs, successors, or assigns of each of the owners or holders of any of the shares.

Sale or Transfer of Shares With Shareholders' Written Assent

(k) Notwithstanding anything in these Bylaws to the contrary, any or all of the shares of the corporation may be sold, transferred, or otherwise disposed of, or hypothecated without restriction, provided written assent or approval to the proposed sale, transfer, other disposition, or hypothecation is obtained and signed by the holders of not less than all of the shares of this corporation entitled to vote. All consents or approvals shall be filed with the Secretary of the corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.245

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.245 Restriction on Transfer of Shares [Corp. Code §§ 204(b), 212(b)(1)]--Price of Shares Determined by Formula or Arbitration

[1] Comment--Use of Form

This provision may be inserted in a bylaw restricting transfer of shares when it is desirable to fix the price of the shares at the fair market value of the net assets of the corporation [*see Piedmont Publishing Co. v. Rogers (1961) 193 Cal. App. 2d 171, 183-188, 14 Cal. Rptr. 133]* .

[2] FORM

Restriction on Transfer of Shares [Corp. Code §§ 204(b), 212(b)(1)]--Price of Shares Determined by Formula or Arbitration

In the event any shareholder proposes to sell or otherwise dispose of all or any part of his or her shares, he or she shall sign and deliver to the corporation a written notice stating his or her desire to sell and dispose of the designated number of shares. The shareholder and the corporation shall then fix a price per share computed by determining the fair market value of the net assets of the corporation (excluding "goodwill") on the date of the notice, and multiplying the resulting figure by a fraction, the numerator of which shall be one and the denominator of which shall be the number of common shares of the corporation issued and outstanding as of the date of the notice. In the event that the shareholder and the corporation cannot agree on the price per share, computed in this manner, the shareholder and the corporation shall each appoint an independent arbitrator. If either the shareholder or the corporation fails to appoint an arbitrator, the arbitrator appointed by the other shall have power to act alone. The arbitrators or arbitrator thus selected shall determine the price per share computed, and their or his or her decision shall, in the absence of fraud or mistake, be final and conclusive on the parties; in the event the two arbitrators cannot agree on the price per share, the two arbitrators shall appoint a third arbitrator. The third arbitrator shall receive the advice and counsel of the two previously appointed arbitrators, but the decision of the third arbitrator acting alone, as to the price per share computed as described above, shall, in the absence of fraud or mistake, be final, binding, and conclusive on the parties.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.246

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.246 Waiver of Annual Report to Shareholders [Corp. Code § 1501]

[1] Comment

[a] Use of Form

This form is a bylaw provision waiving the requirement of an annual report. It is an alternative to Paragraph 9.07 of the form in *§ 4.200[2]*, and Paragraph 7.03 of the form in *§ 4.201[2]*. *Corp. Code § 2200* imposes a civil penalty when a corporation neglects, fails, or refuses to prepare the financial statements required by the General Corporation Law. In addition, *Corp. Code § 2254-2256* impose criminal penalties for false or fraudulent reports or accounts.

[b] When Annual Report Is to Be Sent

Except in certain cases when the requirements may be waived [*see* [d], *below*], the board of directors must cause an annual report to be sent to the shareholders not later than 120 days after the close of the fiscal year and at least 15 days before the annual meeting of shareholders to be held during the next fiscal year [*Corp. Code § 1501(a)(1), (2)*]. If third-class rather than first-class mail is used to send the annual report, it must be sent 35 days before the annual meeting. The report and any accompanying material may also be sent by electronic transmission. [*Corp. Code § 1501(a)(2)*; *see Corp. Code § 20* (electronic transmission)].

A corporation that is registered under Section 12 of the Securities Exchange Act of 1934 [*see 15 U.S.C. § 78l*] may satisfy the delivery requirement by posting its annual report on an Internet website and providing its shareholders with written notice of the availability of the report [*see Corp. Code § 1501(a)(4)*; see also *17 C.F.R. § 240.14a-16*].

[c] Contents of Report

The annual report must contain a balance sheet as of the end of the fiscal year and an income statement and statement of cashflows for the fiscal year, accompanied by any report on those statements of independent accountants [*see Corp.*

Code § 115 (defining "independent accountant")] or, if there is no such report, the certificate of an authorized officer of the corporation that those statements were prepared without audit from the books and records of the corporation [*Corp. Code § 1501(a)(1)*].

In addition to the above, the annual report of any corporation having 100 or more holders of record of its shares (determined as provided in *Corp. Code § 605*) and having no class of securities registered under Section 13 of the Securities Exchange Act of 1934, or exempted from the registration by Section 12(g)(2) of that Act, must also briefly describe the following:

- Any transaction (excluding compensation of officers and directors) during the previous fiscal year involving an amount in excess of $40,000 (other than contracts let at competitive bid or services rendered at prices regulated by law) to which the corporation or its parent [*see Corp. Code § 175* (defining "parent")] or subsidiary [*see Corp. Code § 189* (defining "subsidiary")] was a party and in which any director or officer of the corporation or of a subsidiary or (if known to the corporation or its parent or subsidiary) any holder of more than 10 percent of the outstanding voting shares of the corporation had a direct or indirect material interest, naming the person and stating the person's relationship to the corporation, the nature of the person's interest in the transaction, and, where practicable, the amount of the interest; provided that in the case of a transaction with a partnership of which the person is a partner, only the interest of the partnership need be stated; and provided, further, that no report need be made in the case of transactions approved by the shareholders [*see Corp. Code § 153* (defining "approved by the shareholders")] under *Corp. Code § 310(a)* [*Corp. Code § 1501(b)(1)*]. This applies to transactions approved by the shareholders, rather than only to transactions approved by the shareholders under *Corp. Code § 310(a)* as stated in the text [*see Corp. Code § 1501(b)(1)*].

- The amount and circumstances of any indemnification or advances aggregating more than $10,000 paid during the fiscal year to any officer or director of the corporation pursuant to *Corp. Code § 317*; provided that no report need be made in the case of indemnification approved by the shareholders under *Corp. Code § 317(e)(3)* [*Corp. Code § 1501(b)(2)*].

[d] Waiver of Report

A corporation with less than 100 holders of record of its shares (determined as provided in *Corp. Code § 605*) may in its bylaws expressly waive the requirement of an annual report [*Corp. Code § 1501(a)(1)*].

[2] Form

Waiver of Annual Report to Shareholders [Corp. Code § 1501]

The requirement for an annual report to shareholders as set forth in *Section 1501 of the California Corporations Code* is expressly waived, but nothing in these bylaws shall be construed as prohibiting the Board of Directors from issuing reports, or construed as affecting the rights of shareholders to obtain special financial statements as provided in *Section 1501(c), (d)* of the California Corporations Code.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.247

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§ 4.247 Corporate Seal [Corp. Code § 207(a)]

[1] Comment

[a] Use of Form

This form is an alternative to Paragraph 9.10 of the form in *§ 4.200[2]*, and paragraph (b)(1) of the form in *§ 4.216*. A provision authorizing or requiring the board of directors to adopt a corporate seal or requiring the board to adopt a seal in a specified form and design may be included in the articles of incorporation [*see Corp. Code § 204(d)*] or in the bylaws [*see Corp. Code § 212(b)(1)*]. Since a corporation has statutory power to adopt a seal [*see* [2], *below*], however, it may do so although neither the articles nor the bylaws authorize it.

[b] Definition and Use of "Seal"

A seal is a particular sign, made to attest, in the most formal manner, to the execution of an instrument [*Code Civ. Proc. § 1930*]. Private writings are either sealed or unsealed [*Code Civ. Proc. § 1929*]. In California, however, there is no difference in legal effect between sealed and unsealed writings. Hence, a writing under seal may be subsequently changed or altogether discharged by another writing not under seal [*Code Civ. Proc. § 1932*]. If a corporate seal is used, it may be affixed to an instrument by a mere impression on the paper or other material on which the instrument is written [*Civ. Code § 1628*].

[c] Power of Corporation to Adopt Seal

A corporation, subject to any limitations contained in its articles of incorporation and to compliance with other provisions of the General Corporation Law and any other applicable laws, is expressly authorized to adopt, use, and alter at will a corporate seal, although failure to affix a seal does not affect the validity of any instrument [*Corp. Code § 207(a)*; *see also Code Civ. Proc. § 1932*].

[2] Form

Corporate Seal [Corp. Code § 207(a)]

The Board of Directors may provide a suitable seal for the corporation, which shall be in circular form and shall contain the following inscription _____ [*state inscription*]. When authorized by the Board of Directors, a duplicate of the corporate seal may be kept and used by any officer or person whom the Board of Directors may designate.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityCorporate Seals



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.248

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.248 Limitations on Amendment of Bylaws [Corp. Code §§ 204(a), 211]

[1] Comment

[a] Use of Form

This form is for use in addition to Paragraph 10.03 of the form in *§ 4.200[2]*, and Paragraph 8.01 of the form in *§ 4.201[2]*, if it is desired to limit the board's power to adopt, amend, or repeal bylaws.

[b] Limitations on Amendment

Subject to *Corp. Code § 204(a)(5)* (authorizing the articles of incorporation to set forth a provision requiring, with specified exceptions, the vote of a larger proportion of all of the shares of any class or series or of a larger proportion or of all of the directors for corporate action than is otherwise required by the General Corporation Law) either the articles or the bylaws may restrict or eliminate the power of the board of directors to adopt, amend, or repeal any or all bylaws [*Corp. Code § 211*]. Moreover, bylaws themselves may require for all or any actions by the board the affirmative vote of a majority of the authorized number of directors [*Corp. Code § 204(a)*]. This latter provision would appear to apply to the adoption, amendment, or repeal of bylaws, as well as to other board actions.

[2] Form

Limitations on Amendment of Bylaws [Corp. Code §§ 204(a), 211]

The Board of Directors shall have no power to amend or repeal the bylaws of the corporation.

[*OR*]

The Board of Directors shall have no power to amend or repeal any bylaw adopted by the shareholders.

[*OR*]

Any amendment or repeal of these bylaws by the Board of Directors shall be effected only by the affirmative vote of a majority of the authorized number of directors.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityLimitationsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Bylaws



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide § 4.249

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.249 Loans to or Guarantees of Obligations of Officers or Directors [Corp. Code § 315(b)]

[1] Comment

[a] Use of Form

This form is a bylaw provision authorizing the board of directors to approve a loan to or guarantee the obligation of an officer of the corporation. This provision becomes operative only when the corporation has outstanding shares held of record by 100 or more persons on the date on which the directors approve the loan or guarantee [*see Corp. Code § 315(b)*]. It does not apply to employee stock purchase or stock option plans [*Corp. Code § 315(f)(1)*; *see Corp. Code § 408*], depository institutions [*Corp. Code § 315(f)(2)*; *see 12 U.S.C. § 3201(1)*], or to loans made pursuant to any statute regulating special classes of corporations [*Corp. Code § 315(f)(3)*].

[b] Authority for Loans and Guarantees

In general, a corporation may not loan money or property to, or guarantee the obligation of, any director or officer of the corporation or its parent unless the transaction (or an employee benefit plan authorizing the transaction) is approved by a majority of shareholders entitled to act on the matter [*see Corp. Code § 315(a)*]. "Approval by a majority entitled to act" means either (1) written consent of a majority of the outstanding shares, without counting any shares owned by interested officers or directors, (2) the affirmative vote of a majority of the shares present and voting at a meeting at which a quorum is present, without counting any shares owned by interested officers or directors, or (3) the unanimous vote or written consent of the shareholders. If the corporation has more than one class or series of shares outstanding, only those shareholders entitled under the articles to vote on all matters or on loans to directors and officers are considered entitled to act [*Corp. Code § 315(g)*].

However, the board of directors alone may approve the loan or guarantee if the corporation has the requisite number of shareholders on the day the transaction is approved by the board and has a bylaw such as the one set forth in this form (or an employee benefit plan authorizing loans or guarantees to officers). If the bylaws include this provision, and the

board determines that the loan, guarantee, or employee benefit plan may reasonably be expected to benefit the corporation, it may approve the transaction by a vote sufficient to do so, without counting the vote of any interested directors. Before the bylaw can become effective, it must be approved by a majority of the outstanding shares entitled to vote [*Corp. Code § 315(b)*; *see Corp. Code § 152*].

[c] Transactions Secured by Corporate Shares

A corporation may not make a loan or guarantee on the security of its shares or those of its parent if the corporation's recourse in the event of default is limited to the security for the loan or guaranty. The loan must either be otherwise adequately secured or approved by a majority of the shareholders entitled to act on the matter [*Corp. Code § 315(c)*]. For the definition of "approval by the majority," see [b], *above*.

[d] Excepted Transactions

Advances and life insurance premiums are excepted from the general rule discussed in [b], above. A corporation may advance money to a director or officer of the corporation or of its parent for expenses it reasonably anticipates will be incurred in the performance of that person's duties, provided that in the absence of the advance the person would be entitled to reimbursement [*see Corp. Code § 315(d)*]. Similarly, the restrictions stated in the general rule do not apply to the payment of premiums on life insurance covering a director or officer if repayment to the corporation of the amount paid is secured by the proceeds of the policy and its cash surrender value [*see Corp. Code § 315(e)*].

[2] Form

Loans to or Guarantees of Obligations of Officers or Directors [Corp. Code § 315(b)]
Loans or Guarantees

The Board of Directors alone may approve loans to or guarantees of the obligations of an officer of the Corporation, whether or not that officer is a Director of the Corporation, without counting the vote of any interested Director or Directors, if the Board of Directors determines that the loan or guarantee may reasonably be expected to benefit the Corporation and if, on the date of approval, the Corporation has outstanding shares held of record by 100 or more persons.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePowersContractual AgreementsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
B. Individual Bylaw Provisions

2-4 California Legal Forms--Transaction Guide §§ 4.250-4.257

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

[Reserved]

§§ 4.250[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.258

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.258 Resolution of Incorporator(s) Adopting Bylaws [Corp. Code § 210]

[1] Comment--Use of Form

This form is for use by the incorporator(s) to adopt the initial bylaws of the corporation if initial directors were not named in the articles of incorporation and directors have not yet been elected [*see Corp. Code § 210*].

PRACTICE TIP:
The board may wish to ratify adoption of the bylaws at its first meeting or in its unanimous written consent in lieu of first meeting [*see Corp. Code 307*]. *Commentary by Mary E. Ahern.*

[2] Form

Resolution of Incorporator(s) Adopting Bylaws [Corp. Code § 210]
_____ [Incorporator's ***or*** Incorporators'] Resolution Adopting Bylaws

RESOLVED, that the Bylaws attached to these resolutions as Exhibit _____ are hereby approved and adopted as, and for, the Bylaws of the corporation, and that the Secretary of the corporation when elected is authorized and directed to execute a certificate of adoption of the Bylaws, to insert the Bylaws as so certified in the book of minutes of the corporation, and to see that a copy of the Bylaws, similarly certified, is kept at the principal executive office of the corporation in accordance with *California Corporations Code § 213*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



78 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.259

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.259 Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Incorporator(s)

[1] Comment--Use of Form

This form is for use by the secretary or an assistant secretary of the corporation to certify the original or a copy of the bylaws as duly adopted by approval of the incorporator(s). For a certificate that may be used if the bylaws were adopted by approval of the board of directors at a meeting, see *§ 4.262[2]*. For a certificate that may be used if the bylaws were adopted by unanimous written consent of the board of directors in lieu of a meeting, see *§ 4.266*. For a short form certificate that may be used regardless of the manner of adoption and whether adoption is by approval of the board of directors, the outstanding shares, or the incorporator(s), see *§ 4.263*. See *§ 4.262[1][b]* and *[c]* for a discussion of additional requirements in connection with certificate of bylaws by the secretary or assistant secretary.

[2] Form

Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Incorporator(s)
CERTIFICATE

I, _____, hereby certify:

That I am _____ [the Secretary *or* an Assistant Secretary] of _____[*name*], a California corporation; and

That the _____ [foregoing *or* attached] Bylaws, consisting of _____[*number*] pages, are a true and correct copy of the Bylaws of the corporation as duly adopted by the incorporator[s] of the corporation by resolution dated _____.

IN WITNESS WHEREOF, I have signed [*add, if appropriate:* and affixed the seal of the corporation] this _____ day of _____ [*month, year*].

[*Seal*]

_____ [*signature*]

[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.260

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.260 Resolution of Board of Directors Adopting Bylaws [Corp. Code § 211]--Long Form

[1] Comment

[a] Use of Form

This form is for use by the board of directors to adopt the initial bylaws of the corporation. For written consents to the adoption of the bylaws by board approval without a meeting, see *§§ 4.264* and *4.265*. For additional forms, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* . For a certificate of adoption, see *§ 4.262*. While there is no requirement that the copy of the bylaws maintained by the corporation in its minute book be certified [*see Corp. Code § 213*], the better practice is to have the secretary execute and attach a certificate to them. The certificate ordinarily will indicate the manner and date of adoption.

[b] Adoption by Directors

Bylaws may be adopted either by approval of the outstanding shares, as that term is defined in *Corp. Code § 152*, or, unless otherwise provided in the articles or bylaws, by approval of the board of directors, except as provided in *Corp. Code § 212*, relating to the number of directors. The power of the board to adopt bylaws may be restricted or eliminated by the articles of incorporation or by the bylaws [*Corp. Code § 211*; *see Boericke v. Weise (1945) 68 Cal. App. 2d 407, 415, 156 P.2d 781* (construing a predecessor statute)]. Seldom, if ever, however, are directors absolutely prohibited by the articles or by a bylaw adopted by the outstanding shares from adopting bylaws. In the usual situation, bylaws are adopted by the directors at their first meeting by resolution such as that set forth in this form or in *§ 4.261*.

[c] Record of Adoption

The minutes of the corporation must record the proceedings of all directors' meetings [*Corp. Code § 1500*] and, therefore, the minutes of the first meeting must contain the resolution adopting the bylaws and a copy of the bylaws themselves. The original or a copy (in writing or in any other form capable of being converted into clearly legible

tangible form) of the minutes, certified by the secretary or an assistant secretary of the corporation, is prima facie evidence of the adoption of the bylaws, of the due holding of the meeting, and of the other matters stated in the minutes [*Corp. Code § 314*].

[2] Form

Resolution of Board of Directors Adopting Bylaws [Corp. Code § 211]--Long Form

RESOLUTION OF BOARD OF DIRECTORS
ADOPTING BYLAWS

WHEREAS, *California Corporations Code Section 211* authorizes the Board of Directors, as well as the outstanding voting shares of the corporation, to adopt Bylaws unless prohibited from so doing by the corporation's Articles of Incorporation or by the Bylaws; and

WHEREAS, the Articles of Incorporation of this corporation do not prohibit the Board of Directors from adopting Bylaws; and

WHEREAS, no shares of this corporation have been issued and the Board of Directors has not yet adopted any Bylaws for the management of the business and for the conduct of the affairs of this corporation; and

WHEREAS, Bylaws have been presented to the Directors at this meeting and it is deemed to be in the best interests of the corporation that the Bylaws be adopted;

NOW, THEREFORE, BE IT RESOLVED that the Bylaws so presented be, and they hereby are, approved and adopted as and for the Bylaws of this corporation.

BE IT FURTHER RESOLVED that the Secretary of this corporation be, and hereby is, authorized and directed to certify copies of the Bylaws and to insert one certified copy in the minute book of this corporation and to keep another certified copy at the corporation's principal executive office where it shall be open to inspection by the shareholders at all reasonable times during office hours, as provided in *California Corporations Code Section 213*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.261

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.261 Resolution of Board of Directors Adopting Bylaws--Short Form

[1] Comment--Use of Form

This form is for use by the directors at a board meeting to adopt bylaws. See *§ 4.260[2]* for an alternative form. For a discussion of the adoption of the bylaws, see *§ 4.260[1]*.

[2] Form

Resolution of Board of Directors Adopting Bylaws--Short Form
DIRECTORS' RESOLUTION ADOPTING BYLAWS

RESOLVED, that the Bylaws presented to and read at the meeting are hereby approved and adopted as, and for, the Bylaws of the corporation, and that the Secretary of the corporation is authorized and directed to execute a certificate of the adoption of the Bylaws, to insert the Bylaws as so certified in the book of minutes of the corporation, and to see that a copy of the Bylaws, similarly certified, is kept at the principal executive office of the corporation in accordance with *California Corporations Code Section 213*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.262

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.262 Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Approval of Board of Directors [Corp. Code § 211] at Meeting--Long Form

[1] Comment

[a] Use of Form

This form is for use by the secretary or an assistant secretary of the corporation to certify the original or a copy of the bylaws as duly adopted by approval of the board of directors at a meeting. For a certificate for use if the bylaws were adopted by the unanimous written consent of the directors, see *§ 4.266*. For a short form certificate that may be used regardless of the manner of adoption and whether by the approval of the directors or the outstanding shares, see *§ 4.263*.

[b] Keeping Copy Available to Shareholders

Every corporation must keep at its principal executive office in California, or if its principal executive office is not in California, at its principal business office in California, the original or a copy of its bylaws as amended to date. This original or copy must be open to inspection by the shareholders at all reasonable times during office hours [*Corp. Code § 213*].

If the principal executive office of the corporation is outside California and the corporation has no principal business office in California, it must, on the written request of any shareholder, furnish to the shareholder a copy of the bylaws as amended to date [*Corp. Code § 213*].

[c] Certification

The original or a copy (in writing or in any other form capable of being converted into clearly legible tangible form) of the bylaws certified to be a true copy by a person purporting to be the secretary or an assistant secretary of the corporation is prima facie evidence of the adoption of those bylaws [*Corp. Code § 314*]. For the purpose of evidence,

when a copy of a writing is certified, the certificate must state in substance that the copy is a correct copy of the original, or of a specified part of it, as the case may be [*Evid. Code § 1531*].

[2] Form

Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Approval of Board of Directors [Corp. Code § 211] at Meeting--Long Form

CERTIFICATE

I, _____[*name*], hereby certify:

That I am the Secretary [*or* an Assistant Secretary] of _____[*name*], a California corporation; and

That the foregoing [*or* attached] Bylaws, consisting of _____ pages, are a true and correct copy of the Bylaws of the corporation as duly adopted by approval of the Board of Directors of the corporation at a regular [*or* special] meeting duly held on _____[*date*] at the corporation's principal executive office, located at _____ [*street address and city*], _____ County, California.

IN WITNESS WHEREOF, I have signed [*add, if appropriate:* and affixed the seal of the corporation] this _____ day of _____ [*month, year*].

[*Seal*]

_____ [*signature*]

[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.263

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.263 Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314]--Short Form

[1] Comment--Use of Form

This form may be used by the secretary or an assistant secretary of the corporation to certify the original or a copy of the bylaws as the bylaws of the corporation regardless of their manner of adoption and whether adopted by the approval of the directors or of the outstanding shares or by the incorporators.

For a discussion of the certification, see *§ 4.262[2]*.

[2] Form

Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314]--Short Form

CERTIFICATE

I, _____[*name*], certify that I am the Secretary [*or* an Assistant Secretary] of _____[*name*], a California Corporation, and that the foregoing [*or* attached] Bylaws are a true and correct copy of the Bylaws of the corporation [as amended to date].

Dated: _____.

[*Seal*]

_____ [*signature*]

[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.264

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.264 Written Consent of Directors Adopting Bylaws [Corp. Code §§ 211, 307(b)]--Collective Form

[1] Comment

[a] Use of Form

This form is for use if bylaws are to be adopted by the unanimous written consent of the directors without a meeting. With appropriate modifications, this form may be adapted for use to effect subsequent adoptions, amendments, or repeal of bylaws by unanimous written consent without a meeting. For a certificate authenticating bylaws adopted in this manner, see *§ 4.266*.

[b] Adoption by Written Consent

Bylaws usually are adopted by the board of directors at its first meeting [*see § 4.260[1]*], but they may be adopted by the board without a meeting by the unanimous written consent of the directors, provided that the number of board members serving at that time constitutes a quorum [*Corp. Code § 307(b)*]. In such a case, the written consent, if collectively executed, or consents, if individually executed, must be filed with the minutes of the proceedings of the board [*Corp. Code § 307(b)*]. If this method is used, the directors usually execute a single collective consent form.

[2] Form

Written Consent of Directors Adopting Bylaws [Corp. Code §§ 211, 307(b)]--Collective Form
WRITTEN CONSENT OF DIRECTORS ADOPTING BYLAWS

We, the undersigned, are all of the persons named as the initial directors in the Articles of Incorporation of _____[*name*], a California corporation, and, pursuant to the authority granted to the directors in *Section 307(b) of the California Corporations Code* to take action by unanimous written consent without a meeting, we consent to and hereby do approve and adopt the foregoing [*or* attached] Bylaws, consisting of _____

pages, as the Bylaws of the corporation.
Dated: _____

_____ [*signature*]

[*typed name*], Director

_____ [*signature*]

[*typed name*], Director

_____ [*signature*]

[*typed name*], Director

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



84 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.265

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

[Reserved]

§ 4.265[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.266

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.266 Certificate of Secretary of Corporation Authenticating Adoption of Bylaws [Corp. Code § 314] by Unanimous Written Consent of Directors [Corp. Code §§ 211, 307(b)]

[1] Comment--Use of Form

This form is for use by the secretary or an assistant secretary of the corporation to certify the original or a copy of the bylaws as duly adopted by the unanimous written consent of the directors without a meeting. For a short form certificate that may be used regardless of the manner of adoption and whether adopted by the approval of the directors or of the outstanding shares, see *§ 4.263*.

For a discussion of the certification, see *§ 4.262[1]*.

[2] Form

Certificate of Secretary of Corporation Authenticating Adoption of Bylaws [Corp. Code § 314] by Unanimous Written Consent of Directors [Corp. Code §§ 211, 307(b)]
CERTIFICATE

I, _____[*name*], hereby certify:

That I am the Secretary [*or* an Assistant Secretary] of _____[*name*], a California corporation; and

That the foregoing [*or* attached] Bylaws, consisting of _____ pages, are a true and correct copy of the Bylaws of the corporation as duly adopted [on _____ (*date*)] by the unanimous written consent of the directors of the corporation.

IN WITNESS WHEREOF, I have signed this document [and affixed the seal of the corporation] on _____[*date*].

[*Seal*]

_____ [*signature*]

[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.267

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.267 Written Consent of Outstanding Shares Approving Adoption of Bylaws [Corp. Code §§ 152, 211, 603]--Collective Form

[1] Comment

[a] Use of Form

This form, and the form in *§ 4.268[2]*, are designed for use if one or more bylaws are to be adopted by the written consent of the outstanding shares, rather than by the directors. With appropriate modifications, these forms may also be used for the adoption of future bylaws, or to amend or repeal bylaws, subject to *Corp. Code § 212(a)* (relating to number of directors). A collective form such as this might be used where the shareholders are centrally located and few in number, as in the case of a close corporation. Of course, if the shareholders are numerous or widely distributed, individual consents would more appropriately be utilized [*see § 4.268*].

For a certificate authenticating adoption of the bylaws by the written consent of the outstanding shares, see *§ 4.269*.

[b] Adoption by Outstanding Shares

Bylaws may be adopted by approval of the outstanding shares, as that term is defined in *Corp. Code § 152*, or, except as provided in *Corp. Code § 212(a)*, approval of the board of directors [*Corp. Code § 211*; *see § 4.260 [1]*].

Corp. Code § 152 defines "approval of the outstanding shares" as meaning approved by the affirmative vote of a majority of the outstanding shares entitled to vote. That section adds that such approval includes the affirmative vote of a majority of the outstanding shares of each class or series entitled, by any provision of the articles of incorporation or the General Corporation Law, to vote as a class or series on the subject matter being voted on and also includes the affirmative vote of the greater proportion (including all) of the outstanding shares of any class or series if a greater proportion is required by the articles (or, in the case of a close corporation, a shareholders' agreement [*see Corp. Code § 154*]) or the General Corporation Law.

All references in the General Corporation Law to the voting of shares include the voting of other securities given voting rights in the article pursuant to *Corp. Code § 204(a)(7)* [*Corp. Code § 111*; *see Corp. Code § 112*].

The bylaws may be voted on at any meeting of the shareholders [*see Corp. Code § 601(a)*] or, unless otherwise provided in the articles of incorporation, they may be adopted without a meeting and without prior notice, if a consent in writing setting forth the action so taken is signed by the holders of outstanding shares having not less than the minimum of votes that would be necessary to authorize or take that action at a meeting at which all shares entitled to vote on the matters were present and voted [*Corp. Code § 603(a)*]. Unless the consents of all shareholders entitled to vote were solicited in writing, and the approval of the shareholders without a meeting by written consent was less than unanimous, prompt notice must be given to those shareholders entitled to vote who did not consent in writing [*Corp. Code § 603(b)*].

[c] Revocation of Consent

Any shareholder giving a written consent, or the shareholder's proxyholders, or a transferee of the shares or a personal representative of the shareholder [*see Corp. Code §§ 702-705*], may revoke the consent by a writing received by the corporation before the time that written consents of the number of shares required to authorize the proposed action have been filed with the secretary of the corporation, but may not do so after that time. The revocation is effective on its receipt by the secretary of the corporation [*Corp. Code § 603(c)*].

[2] Form

Written Consent of Outstanding Shares Approving Adoption of Bylaws [Corp. Code §§ 152, 211, 603]--Collective Form

WRITTEN CONSENT OF OUTSTANDING SHARES APPROVING ADOPTION OF BYLAW(S)

We, the undersigned, are the holders of a majority [*or where articles require more than simple majority* (more than) _____ percent] of the outstanding voting shares of _____[*name*], a California corporation and each of us holds the number of those shares set opposite our signatures below. We hereby consent to, and do, adopt the foregoing [*or* attached] Bylaw[s], consisting of _____ pages as _____ [a *or* the] Bylaw[s] of the corporation.

Dated: _____.

Name	Number of Shares
_____[*signature*] [*typed name*]	_____
_____[*signature*] [*typed name*]	_____
_____[*signature*] [*typed name*]	_____

[*OR, if signatures obtained on different days:*]

Name	Date	Number of Shares
_____[*signature*] _____ [*typed name*]	_____	_____
_____[*signature*] _____ [*typed name*]	_____	_____
_____[*signature*] _____ [*typed name*]	_____	_____

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to BylawsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.268

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.268 Written Consent of Outstanding Shares Approving Adoption of Bylaws--Individual Form

[1] Comment--Use of Form

The form is for use if the first bylaws are to be adopted by approval of the outstanding shares by written consent rather than at a meeting and individual consents are to be executed rather than a single collective consent.

For a discussion of shareholder approval by written consent, see *§ 4.267[1]*.

[2] Form

Written Consent of Outstanding Shares Approving Adoption of Bylaws--Individual Form

WRITTEN CONSENT OF SHAREHOLDER
APPROVING ADOPTION OF BYLAWS

I, the undersigned, am the holder of record [or other capacity entitling person to vote shares] of _____[*number*] of the outstanding voting shares of _____[*name*], a California corporation, and hereby consent to, and approve, the adoption of the foregoing [*or* attached] Bylaw[s], consisting of _____ pages, as _____ [a *or* the] Bylaw[s] of the corporation.
_____Dated:

_____ [*signature*]

[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
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2-4 California Legal Forms--Transaction Guide § 4.269

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.269 Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Written Consent of Shareholders [Corp. Code §§ 211, 603]

[1] Comment--Use of Form

This form is for use by the corporate secretary, or an assistant secretary, to certify the adoption of the bylaws by written consent of the shareholders without a meeting. For a discussion of certification and of shareholder approval by written consent, see *§§ 4.262* and *4.267*, respectively.

[2] Form

Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Written Consent of Shareholders [Corp. Code §§ 211, 603]
CERTIFICATE

I, _____[*name*], hereby certify:

That I am the Secretary [*or* an Assistant Secretary] of _____[*name*], a California corporation; and

That the foregoing [*or* attached] Bylaw[s], consisting of _____ pages, is [are] a true and correct copy of the bylaw[s] of the corporation as duly adopted [on _____ (*date*)] by the written consent of a majority [*or, if the articles require more than a simple majority:* (more than) _____ percent] of the outstanding voting shares of the corporation.

IN WITNESS WHEREOF, I have signed this certificate [and affixed the seal of the corportion] on _____[*date*].

[*Seal*]

_____ [*signature*]

[*typed named and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.270

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.270 Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Approval of Outstanding Shares at Shareholders' Meeting [Corp. Code §§ 211, 601]

[1] Comment--Use of Form

This form is for use if the bylaws are adopted by approval of the outstanding shares at a meeting rather than by written consent.

For a discussion of certification and of adoption of bylaws by shareholder approval, see *§§ 4.262[1]* and *4.267[1]*, respectively.

[2] Form

Certificate of Secretary of Corporation Authenticating Bylaws [Corp. Code § 314] Adopted by Approval of Outstanding Shares at Shareholders' Meeting [Corp. Code §§ 211, 601]

CERTIFICATE

I, _____[*name*], hereby certify:

That I am the Secretary [*or* an Assistant Secretary] of _____[*name*], a California corporation; and

That the foregoing [*or* attached] Bylaws, consisting of _____ pages, are a true and correct copy of the Bylaw[s] of the corporation as duly adopted by the approval of a majority [*or, if the articles require more than a simple majority:* (more than) _____ percent] of the outstanding voting shares of the corporation at a meeting of the shareholders duly held on _____[*date*] at the corporation's principal executive office, located at _____ [*street address and city*], _____ County, California.

IN WITNESS WHEREOF, I have signed [*add, if appropriate:* and affixed the seal of the corporation] on

_____[*date*].

[*Seal*]

_____ [*signature*]

[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.271

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.271 Resolution of Board of Directors Repealing Existing Bylaws and Adopting New Bylaws

[1] Comment

[a] Use of Form

This resolution is for use by the board of directors to repeal the existing bylaws and adopt new bylaws. For a short form resolution that may be adapted for use where bylaws are repealed and new bylaws adopted, see *§ 4.261*. For a resolution repealing certain bylaws and amending others, see *§ 4.272*.

[b] Amending and Repealing Bylaws

Generally, bylaws may be amended or repealed by approval of the board of directors in the same manner in which they were adopted [*see Corp. Code §§ 207(b), 211*]. However, if the articles of incorporation or a bylaw limits or restricts the power of the board to amend or repeal bylaws or deprives them of the power to do so [*see Corp. Code § 211*], the limitation, restriction, or prohibition is binding on the directors.

[c] Nature of Bylaw Being Amended or Repealed

In determining whether to amend one or more specific bylaws, the directors will want to consider the nature of the bylaw in question. This consideration is necessary because the bylaws as adopted may contain any of the following different kinds of provisions:

- Mandatory statutory provisions that cannot be varied by the articles, the bylaws, amendment of the bylaws, or repeal of the bylaws. An illustration of such a provision is one relating to the shareholders' rights to inspect the corporation's record of shareholders, the corporate books and records of account, and minutes of meetings. These rights are granted by statute and cannot be limited in the articles or bylaws [*Corp. Code §§ 1600(d), 1601(b)*]. An attempted amendment would be void.

- Mandatory statutory provisions that authorize some variance and can be varied only as authorized in the pertinent statute. For example, *Corp. Code § 601(d)* provides that notice of an adjourned shareholders' meeting need not be given if the time and place are announced at the meeting at which the adjournment is taken, unless the bylaws otherwise require. Pursuant to this provision, the bylaws could initially require or be amended to require that notice of the adjourned meeting be given. If the adjournment is for more than 45 days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting must be given to each shareholder of record entitled to vote at the meeting [*Corp. Code § 601(d)*]. This provision is not subject to variation by the bylaws and the bylaws may, therefore, not provide that this notice be dispensed with, either initially or by amendment.

- Permissive provisions, which are of four kinds:

    - Those derived from a statute authorizing the bylaws to so provide and not making any alternative provision [*see, e.g., Corp. Code § 204(d)*, providing that the bylaws may contain any provision not in conflict with law or with the articles of incorporation for the management of the business and for the conduct of the affairs of the corporation].

    - Those derived from a statute authorizing the bylaws to so provide, but providing alternatives in the absence of such provision [*see, e.g. Corp. Code § 600(a)*, providing that meetings of shareholders may be held at any place within or without California that may be stated in or fixed in accordance with the bylaws, but that if no other place is stated or so fixed, the meetings must be held at the corporation's principal executive office].

    - Those derived from a statute authorizing either the articles or the bylaws to so provide and not making any alternative provision [*see, e.g., Corp. Code § 204(b)*, authorizing the articles to impose reasonable restrictions on the right to transfer or hypothecate shares, and *Corp. Code § 212(b)(1)*, authorizing the bylaws to include any provision referred to in *Corp. Code § 204(b)* not in conflict with the articles or with law].

    - Those derived from a statute authorizing either the articles or bylaws to so provide and providing alternatives in the absence of such provision [*see, e.g., Corp. Code § 307(a)(5)*, providing that unless otherwise provided in the articles or the bylaws, meetings of the board of directors may be held at any place within or outside California]. These provisions in the bylaws can be effectively amended or repealed provided they do not also appear in the articles. If they also appear in the articles, then the articles themselves will have to be amended.

- Provisions also contained in the articles of incorporation, which cannot be effectively amended or repealed until the articles themselves are amended. Since bylaws may not contain provisions in conflict with the articles [*see Corp. Code § 212(b)*], they may not be amended to do so.

- Provisions that can be amended or repealed only by the outstanding shares (for example, a provision changing the number of directors or from a fixed to a variable board or vice versa). *Corp. Code § 212(a)* provides that after the issuance of shares, a bylaw specifying or changing a fixed number of directors or the maximum or minimum number or changing from a fixed to a variable board or vice versa may only be adopted by approval of the outstanding shares; provided, however, that a bylaw or amendment of the articles reducing the fixed number or the minimum number of directors to a number less than five cannot be adopted if the votes cast against its adoption at a meeting or the shares not consenting in the case of

action by written consent are equal to more than 16 2/3 percent of the outstanding shares entitled to vote. Any provision in the new bylaws referred to in the form below that would change a fixed number of directors or from a fixed to a variable board or vice versa could not be adopted by the board of directors but would require approval of the outstanding shares. For the purposes of the form, it is therefore assumed that shares have not been issued or that the provision in the bylaws being adopted governing directors is identical to or does not change in a prohibited manner the provision in the bylaws being repealed.

- Other provisions, which can be amended or repealed provided the amended provision does not conflict with law or with the articles. Such a limitation, of course, applies to all amendments [*see Corp. Code § 212(b)*].

[d] Amending Bylaws of Listed Corporations

A listed corporation may, by amendment of its bylaws, adopt provisions to divide the board of directors into two or three classes to serve for terms of two or three years respectively, or to eliminate cumulative voting [*Corp. Code § 301.5(a)*; *see Corp. Code § 301(a)*]. A "listed corporation" is a corporation with outstanding shares listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market [*Corp. Code § 301.5(d)*]. A corporation that is not listed may, after issuance of shares, adopt those provisions pursuant to amendment of its bylaws (or articles), to take effect when it becomes a listed corporation [*Corp. Code § 301.5(a)*; *see Corp. Code § 301.5(g), (i)* (effective date of amendment); *see also Corp. Code § 301.5(e), (f), (h)* (effect of loss of listed corporation status)].

A bylaw amendment providing for division of the board of directors into classes, a change in the number of classes, or the elimination of cumulative voting, may be adopted only by the approval of the board [*see Corp. Code § 151*] and the outstanding shares [*see Corp. Code § 152*] voting as a single class, notwithstanding the requirements of *Corp. Code § 903* (shareholder approval of amendments) [*Corp. Code § 301.5(a)*]. If the board of directors is divided into two classes pursuant to such an amendment, the authorized number of directors must be no fewer than six, and one half of the directors (or as close an approximation as possible) must be elected at each annual meeting. If the board is divided into three classes, the authorized number must be no fewer than nine, and one third (or as close an approximation as possible) must be elected at each annual meeting. Directors of a listed corporation may be elected by classes at a shareholder meeting at which an amendment adopting provisions for dividing the board into classes is approved. However, the extended terms for directors are contingent on approval of the amendment [*Corp. Code § 301.5(b)*]. If directors for more than one class will be elected by the shareholders at any one meeting and the election is by cumulative voting [*see Corp. Code § 708*], votes may be cumulated only for directors to be elected within each class [*Corp. Code § 301.5(c)*].

If a corporation that is not yet listed adopts such a bylaw amendment, the provision as adopted must include the following statement or its substantial equivalent [*Corp. Code § 301.5(j)*]: "This provision shall become effective only when the corporation becomes a listed corporation within the meaning of *Section 301.5 of the Corporations Code*."

[2] Form

Resolution of Board of Directors Repealing Existing Bylaws and Adopting New Bylaws

RESOLUTION OF BOARD OF DIRECTORS REPEALING BYLAWS AND ADOPTING NEW BYLAWS

WHEREAS, except as otherwise provided in *Section 212 of the California Corporations Code*, the Board of Directors of this corporation is authorized by the provisions of *Section 211 of the California Corporations Code* to repeal and adopt Bylaws, unless prohibited from so doing by the corporation's Articles of Incorporation or by the Bylaws; and

WHEREAS, neither the Articles of Incorporation of this corporation nor the Bylaws prohibit the Board from adopting, amending, or repealing Bylaws, or limit or restrict their power to do so; and

WHEREAS, the Board of Directors deems it to be in the best interests of the corporation to repeal the Bylaws; and

WHEREAS, new Bylaws have been presented to the Board of Directors at this meeting and it is deemed to be in the best interests of the corporation and of its shareholders that such Bylaws be adopted;

NOW, THEREFORE, IT IS RESOLVED that the existing Bylaws of this corporation are hereby repealed;

IT IS FURTHER RESOLVED that the Bylaws presented to this meeting are hereby adopted as and for the Bylaws of this corporation;

RESOLVED FURTHER that the Secretary of this corporation is hereby authorized and directed to certify copies of the new Bylaws, to insert one certified copy in the corporation's minute book, and to keep one certified copy at the corporation's principal executive office where it shall be open to inspection by the shareholders at all reasonable times during office hours, as provided in *Section 213 of the California Corporations Code*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to BylawsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityLimitationsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 4 BYLAWS
PART IV. FORMS
C. Adoption, Amendment, and Repeal of Bylaws

2-4 California Legal Forms--Transaction Guide § 4.272

AUTHOR: August J. Moretti, J.D., Peter N. Townshend, M.B.A., J.D. Mary E. Ahern, B.A., J.D. Practice Consultants

§ 4.272 Resolution of Board of Directors Repealing Certain Bylaws and Amending Others [Corp. Code § 211]--Long Form

[1] Comment--Use of Form

This form is a resolution repealing and amending bylaws. It may be modified for use if specific bylaws are being amended, or if specific bylaws are being repealed, as well as in the situation in which some bylaws are being repealed and others amended. For a short form resolution that may be adapted for use when bylaws are amended or otherwise altered, see *§ 4.261*. For a resolution repealing existing bylaws and adopting new bylaws, see *§ 4.271*.

For a discussion of the factors to be considered in amending or repealing bylaws, see *§ 4.271[1]*.

[2] Form

Resolution of Board of Directors Repealing Certain Bylaws and Amending Others [Corp. Code § 211]--Long Form

RESOLUTION OF BOARD OF DIRECTORS REPEALING CERTAIN BYLAWS AND AMENDING OTHER BYLAWS

WHEREAS, except as otherwise provided in *Section 212 of the Corporations Code*, the Board of Directors of this corporation is authorized by the provisions of *Section 211 of the California Corporations Code* to repeal and amend Bylaws, unless prohibited from so doing by the corporation's Articles of Incorporation or by the Bylaws; and

WHEREAS, neither the Articles of Incorporation of this corporation nor the Bylaws prohibit the Board of Directors from amending or repealing bylaws, or limit or restrict their power to do so; and

WHEREAS, the Board of Directors deems it to be in the best interests of the corporation to repeal certain Bylaws and amend other Bylaws;

NOW, THEREFORE, IT IS RESOLVED that _____ [*identify bylaws being repealed*] of the Bylaws of this corporation hereby are repealed.

IT IS FURTHER RESOLVED that the following Bylaws hereby are amended to read as follows:

Section _____ [*set forth exact wording of section as amended*].

[*Identify amendments of subsequent provisions in the same manner*.]

RESOLVED FURTHER that the Secretary of the corporation hereby is aut horized and directed to compile and certify copies of the Bylaws as amended and to place one copy in the corporation's minute book and keep another copy at the corporation's principal executive office where it shall be open to inspection by the shareholders at a ll reasonable times during office hours, as provided in *Section 213 of the Corporations Code*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Bylaws



92 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS

2-5 California Legal Forms--Transaction Guide 5.syn

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.syn Synopsis to Chapter 5: DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS

§ 5.01 California Statutes

§ 5.02 Federal Statutes

§§ 5.03-5.04 [Reserved]

§ 5.05 Law Reviews and Periodicals

§ 5.06 Annotations

§ 5.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 5.08-5.09 [Reserved]

§ 5.10 Directors' Powers

[1] Managerial Responsibilities and Corporate Powers Exercisable by Board of Directors

[2] Requirement that Directors Act Jointly

[3] Delegation of Board Authority

[a] To Board Committees

[b] To Management Company or Manager

§ 5.11 Directors' Duties of Good Faith and Prudence

§ 5.12 Directors' Liability for Breach of Duty and Exceeding Authority

[1] In General

[a] Limiting Provision in Articles of Incorporation

[b] Director Acts and Omissions Not Subject to Elimination or Limitation of Liability

[c] Indemnification of Corporate Agents

[2] Directors' Liability for Tortious Action

[3] Director's Liability for Distributions, Loans, and Guarantees

[a] Prohibited Actions

[b] Persons Entitled to Bring Suit

[c] Damages

[d] Subrogation

[4] Directors' Liability Related to Issue and Transfer of Shares

[5] Shareholders' Liability under Close Corporation Shareholders Agreement

[6] Criminal Penalties

§ 5.13 Naming Initial Directors

§ 5.14 Election and Term of Subsequent Directors

[1] In General

[2] Voting Shifts

[3] Listed Corporations

§ 5.15 Vacancies on Board of Directors

[1] Vacancy Defined

[2] Removal of Directors

[a] For Cause

[b] Without Cause

[c] Reduction in Authorized Number of Directors

[3] Resignation of Directors

§ 5.16 Filling Vacancies

[1] Vacancies Created by Removal

[2] Vacancies Not Created by Removal

[3] Court Appointment of Directors

§ 5.17 Court Appointment of Provisional Directors

[1] Deadlocked Board

[2] Deadlocked Shareholders

[3] Qualifications and Powers of Provisional Director

§§ 5.18-5.29 [Reserved]

§ 5.30 Procedures for Action by Board of Directors

§ 5.31 Types of Meetings

§ 5.32 Meeting Procedures

[1] Applicability to Close Corporations

[2] Applicability to Board Committees and Incorporators

[3] Persons Authorized to Call Meeting

[4] Place of Meeting

[5] Notice

[6] Quorum Requirements

[a] Definition and Effect

[b] Computing Quorum--In General

[c] Participation Through Communications Equipment

[d] Counting Interested Directors in Computing Quorum

[e] Actions Permitted Absent a Quorum

[7] Adjournment

[8] Voting Requirements

[9] Minutes of Board Meeting

§ 5.33 Action by Unanimous Written Consent Without Meeting

§ 5.34 Ratification of Board Action Despite Irregularity of Meeting

§§ 5.35-5.99 [Reserved]

§ 5.100 Client Interview

[1] Facts

[a] The Corporation

Scope

[b] Directors Meetings

Scope

[2] Documents

Scope

§§ 5.101-5.109 [Reserved]

§ 5.110 First Meeting

Scope

§ 5.111 Regular or Special Meetings

Scope

§ 5.112 Adjourned Meetings

Scope

§ 5.113 Written Consents without Meeting

Scope

§§ 5.114-5.119 [Reserved]

Scope

§ 5.120 Pre-Meeting Procedure

Scope

§ 5.121 Procedure at First Meeting

Scope

§ 5.122 Post-First Meeting Procedure

Scope

§§ 5.123-5.129 [Reserved]

§ 5.130 Call and Notice

Scope

§ 5.131 Waivers of Notice; Consents to Holding Meeting; Approval of Minutes; Minutes

Scope

§§ 5.132-5.139 [Reserved]

§ 5.140 Holding Regular or Special Meetings

Scope

§ 5.141 Holding Adjourned Meetings

Scope

§§ 5.142-5.149 [Reserved]

§ 5.150 Preparing Required Documents

Scope

§ 5.151 Checklist for Minutes

Scope

§§ 5.152-5.159 [Reserved]

§ 5.160 Action by Written Consent Without Meeting

Scope

§§ 5.161-5.199 [Reserved]

§ 5.200 Call of Directors Meeting

[1] Comment

[a] Use of Form

[b] Written Call Not Required

[c] Call and Notice Distinguished

[d] Persons Authorized to Call Meeting

[2] Form

Call of Directors Meeting

§ 5.201 Notice of Directors Meeting

[1] Comment

[a] Use of Form

[b] When Notice is Required

[c] Waiver of Notice

[d] Contents of Notice

[e] Place of Meeting

[f] Proof of Notice

[g] Rules Applicable to Committee Meetings

[2] Form

Notice of Directors Meeting

§ 5.202 Notice of Adjourned Directors Meeting

[1] Comment

[a] Use of Form

[b] When Notice is Required

[2] Form

Notice of Adjourned Directors Meeting

§ 5.203 Declaration of Giving Notice of Directors Meeting

[1] Comment--Use of Form

[2] FORM

Declaration of Giving Notice of Directors Meeting

§§ 5.204-5.209 [Reserved]

§ 5.210 Waiver of Notice, Consent to Holding of Directors Meeting, and Approval of Minutes

[1] Comment

[a] Use of Form

[b] Effect of Waiver, Consent, and Approval; Statutory Requirements

[2] FORM

Waiver of Notice, Consent to Holding of Directors Meeting, and Approval of Minutes

§§ 5.211-5.219 [Reserved]

§ 5.220 Letter to Director Regarding Directors' Written Consent to Action without Meeting

[1] Comment--Use of Form

[2] Form

Letter to Director Regarding Directors' Written Consent to Action without Meeting

§ 5.221 Action by Unanimous Written Consent of Directors

[1] Comment

[a] Use of Form

[b] Effect; Statutory Requirements

[2] Form

Action by Unanimous Written Consent of Directors

§ 5.222 First Actions of Directors by Unanimous Written Consent

[1] Comment

[a] Use of Form

[b] When First Actions of Directors Should Be Taken

[c] Offer and Sale of Corporate Shares

[d] Use of Share Certificates

[e] Qualification as Small Business (I.R.C. § 1244) Stock

[f] Qualification and Taxation as S Corporation

[g] Indemnity Agreement

[h] Confidentiality Agreement

[i] Qualification to do Business in Other States or Countries

[2] FORM

First Actions of Directors by Unanimous Written Consent

§ 5.223 Annual Organization Action by Unanimous Written Consent of Directors

[1] Comment--Use of Form

[2] FORM

Annual Organization Action by Unanimous Written Consent of Directors

§ 5.224 Action of Incorporator to Elect Directors and Adopt Bylaws

[1] Comment--Use of Form

[2] FORM

Action of Incorporator to Elect Directors and Adopt Bylaws

§§ 5.225-5.229 [Reserved]

§ 5.230 Minutes of Directors' Regular or Special Meeting--Formal Format

[1] Comment

[a] Use of Form

[b] Directors' Participation in Meeting

[c] Duty to Keep Minutes

[d] Certification of Minutes; Use of Parol Evidence

[e] Contents of Minutes

[f] Right to Inspect Minutes

[2] FORM

Minutes of Directors' Regular or Special Meeting--Formal Format

§ 5.231 Minutes of Directors' Regular or Special Meeting--Outline Format

[1] Comment--Use of Form

[2] FORM

Minutes of Directors' Regular or Special Meeting--Outline Format

§ 5.232 Agenda for Directors Meeting

[1] Comment--Use of Form

[2] FORM

Agenda for Directors Meeting

§§ 5.233-5.239 [Reserved]

§ 5.240 Formats of Resolutions

[1] Comment

[a] Use of Form

[b] Resolution Formats

[c] Preambles Used to Provide Reasons for Adopting Resolutions

[2] FORM

Formats of Resolutions

§ 5.241 Certificate of Adoption of Resolution by Board of Directors

[1] Comment

[a] Use of Form

[b] Certification as Evidence of Adoption of Resolution

[2] FORM

Certificate of Adoption of Resolution by Board of Directors

§ 5.242 Resolution Authorizing Execution of Employment Agreement

[1] Comment--Use of Form

[2] FORM

Resolution Authorizing Execution of Employment Agreement

§ 5.243 Resignation of Director

[1] Comment

[a] Use of Form

[b] Resignation of Directors

[2] FORM

Resignation of Director

§ 5.244 Resolution Accepting Resignation and Filling Vacancy on Board of Directors

[1] Comment

[a] Use of Form

[b] Filling Vacancies Created by Removal

[c] Filling Vacancies Not Created by Removal

[d] New Directors' Term of Office

[2] FORM

Resolution Accepting Resignation and Filling Vacancy on Board of Directors

§ 5.245 Resolution Establishing Board Committee

[1] Comment

[a] Use of Form

[b] Authority to Establish Board Committee

[c] Limitations on Authority of Board Committees

[d] Meeting Procedures Applicable to Board Committees

[e] Common Committees

[2] FORM

Resolution Establishing Board Committee

§ 5.246 Resolution Authorizing Corporation to Borrow Money

[1] Comment

[a] Use of Form

[b] Liability of Corporation on Note

[2] FORM

Resolution Authorizing Corporation to Borrow Money

§ 5.247 Resolution Authorizing Repurchase of Corporate Shares

[1] Comment

[a] Use of Form

[b] Restrictions on Corporate Purchases; Statutory Tests

[c] Exception for Agreements Funded with Insurance

[d] Directors' Reliance on Advice of Others

[2] FORM

Resolution Authorizing Repurchase of Corporate Shares

§ 5.248 Resolution Fixing Value of Nonmonetary Consideration for Shares to Be Issued

[1] Comment

[a] Use of Form

[b] Consideration for Shares

[2] FORM

Resolution Fixing Value of Nonmonetary Consideration for Shares to Be Issued

§ 5.249 Resolution Authorizing Execution of Transactional Agreement

[1] Comment--Use of Form

[2] FORM

Resolution Authorizing Execution of Transactional Agreement

§ 5.250 Board Resolution Approving Conversion

[1] Comment--Use of Form

[2] FORM

Board Resolution Approving Conversion

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FOOTNOTES:

(n23)Footnote *. Marilyn E. Minger is a sole practitioner in Oakland, California specializing in business law, personal injury, bankruptcy, and probate. Ms. Minger formerly worked for Heller, Ehrman, White & McAuliffe and Pettit & Martin in San Francisco, where she practiced corporate law.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS

2-5 California Legal Forms--Transaction Guide Scope

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Scope

Marilyn E. Minger, Practice Consultantn* Scope

This chapter discusses the statutory requirements and procedures for holding directors meetings, including place, date, and time requirements, notice, waivers of notice, quorum, and voting requirements. It also discusses actions by written consent without a meeting. This chapter covers the functioning of directors, including their election and term, removal and resignation, and filling vacancies. It discusses the corporate powers exercisable by directors, their managerial responsibilities, their duties, and liability for breach of those duties and powers. The Transaction Guide includes procedural guides for the first meeting of directors, and for subsequent directors meetings, as well as a checklist for minutes of meetings. Forms include notices of annual, special, and adjourned meetings, the call of special meetings, written waivers of notice, consents to hold, and approvals of minutes of meetings, agendas and minutes, actions by written consent without a meeting, and specific resolutions for various purposes.

Corporate records and reports are further discussed in Ch. 7, *Corporate Records and Reports* . Corporate securities issues are covered in detail in Ch. 6, *Securities Regulation Issues* . Preincorporation planning is covered in Ch. 2, *Formation of Corporations* . Shareholders' meetings, voting, and agreements are discussed in Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* . Voting Agreements and voting trusts are discussed in Ch. 8B, *Voting Agreements and Voting Trusts* . Close corporation shareholder agreements are covered in Ch. 8C, *Close Corporation Shareholder Agreements* . The conversion of a California corporation into an other business entity is covered separately in Ch. 11F, *Corporate Conversions* .

FOOTNOTES:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART I. RESEARCH GUIDE
A. Primary Sources

2-5 California Legal Forms--Transaction Guide § 5.01

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.01 California Statutes

Voting of shares defined. *Corp. Code § 111*.

Majority of shares defined. *Corp. Code § 112*.

Effect of disqualified shares on quorum. *Corp. Code § 112*.

Independent accountant defined. *Corp. Code § 115*.

Requirement for vote of each class of outstanding shares. *Corp. Code § 117*.

Approval of outstanding shares defined. *Corp. Code § 152*.

Approval of shareholders defined. *Corp. Code § 153*.

Board defined. *Corp. Code § 155*.

Close corporation defined. *Corp. Code § 158*.

Directors defined. *Corp. Code § 164*.

Distribution to shareholders defined. *Corp. Code § 166*.

Proxy defined. *Corp. Code § 178*.

Proxyholder defined. *Corp. Code § 179*.

Vacancy, used with respect to board of directors, defined. *Corp. Code § 192*.

Vote includes authorization by written consent. *Corp. Code § 194*.

Voting shift defined. *Corp. Code § 194.7*.

Written and in writing defined. *Corp. Code § 195*.

Creation of additional voting rights or imposition of additional voting requirements are optional provisions in articles of incorporation. *Corp. Code § 204(a)(5), (9)*.

Naming initial directors in articles or bylaws. *Corp. Code §§ 204(c), 212(b)(1)*.

Corporate powers generally. *Corp. Code § 207*.

Actions by incorporators in lieu of directors. *Corp. Code § 210*.

Required number of directors. *Corp. Code § 212(a)*.

Optional bylaw provisions related to time, place, manner of calling, conducting, and giving notice of directors' and committees' meetings. *Corp. Code § 212(b)(2)*.

Management of corporate affairs and exercise of corporate powers. *Corp. Code § 300(a)*.

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Election of directors at annual meeting of shareholders; term of office. *Corp. Code § 301*.

Provisions dividing directors into classes for specified terms, or eliminating cumulative voting. *Corp. Code § 301.5*.

Removal of director for cause. *Corp. Code § 302*.

Removal of director without cause. *Corp. Code § 303*.

Removal of director by shareholder suit. *Corp. Code § 304*.

Election of director by shareholders to fill vacancy. *Corp. Code § 305*.

Appointment of director by superior court. *Corp. Code § 306*.

Persons authorized to call board meetings. *Corp. Code § 307(a)(1)*.

Written notice of special board meetings. *Corp. Code § 307(a)(2)*.

Waiver of notice and consent to holding of board meeting. *Corp. Code § 307(a)(3)*.

Adjourned board meeting. *Corp. Code § 307(a)(4)*.

Place of board meetings. *Corp. Code § 307(a)(5)*.

Presence at meeting of board members defined. *Corp. Code § 307(a)(6)*.

Quorum at board meeting. *Corp. Code § 307(a)(7), (8)*.

Written consent to action taken without board meeting. *Corp. Code § 307(b)*.

Meetings and actions of board committees. *Corp. Code § 307(c)*.

Provisional directors. *Corp. Code § 308*.

Duties and liabilities of directors. *Corp. Code § 309*.

Transactions in which directors have financial interest. *Corp. Code § 310*.

Designation, membership, and powers of board committees. *Corp. Code § 311*.

Corporate loans and guarantees to directors, officers, and others. *Corp. Code § 315*.

Director liability for illegal distributions, loans, or guarantees. *Corp. Code § 316*.

Indemnification of corporate agent. *Corp. Code § 317*.

Board issuance of shares and determination of consideration for those shares. *Corp. Code § 409*.

Required legend on share certificates regarding transfer restrictions. *Corp. Code § 418(a)(1), (c)*.

Financial tests required for corporate distributions. *Corp. Code § 500-503*.

Exception from distribution financial tests for redemption of deceased shareholder's shares. *Corp. Code § 503.1*.

Exception from distribution financial tests for redemption of disabled shareholder's shares. *Corp. Code § 503.2*.

Board call of special shareholders' meetings [*Corp. Code § 600*].

Filling a vacancy on board created by removal by unanimous written consent of all shares entitled to vote for election of directors. *Corp. Code § 603(d)*.

Amendments to articles of incorporation after issuance of shares. *Corp. Code § 902*.

Required shareholder approval of amendments to articles. *Corp. Code § 903*.

Required shareholder approval of amendments to articles of incorporation permitting assessments. *Corp. Code § 904*.

Sale or transfer of all corporate assets. *Corp. Code § 1001*.

Board approval of merger agreement. *Corp. Code § 1101*.

Conversion of corporation into domestic other business entity. *Corp. Code § 1151*.

Board approval of reorganization. *Corp. Code § 1200*.

Required minutes of proceedings of board and board committees. *Corp. Code § 1500*.

Liability for false information in corporate minutes. *Corp. Code § 1507*.

Directors' right to inspect corporate records and properties. *Corp. Code § 1602*.

Board's powers make contracts and otherwise act in name of corporation during corporate dissolution. *Corp. Code § 2001*.

Criminal acts and penalties. *Corp. Code § 2200 et seq.*

Limited offering exemption. *Corp. Code § 25102(f)*.

Small offering exemption. *Corp. Code § 25102(h)*.

Issuer transaction securities qualification requirements. *Corp. Code § 25110*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART I. RESEARCH GUIDE
A. Primary Sources

2-5 California Legal Forms--Transaction Guide § 5.02

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§ 5.02 Federal Statutes

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96 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART I. RESEARCH GUIDE
A. Primary Sources

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-5 California Legal Forms--Transaction Guide § 5.05

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98 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-5 California Legal Forms--Transaction Guide § 5.06

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

2-5 California Legal Forms--Transaction Guide § 5.07

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.07 Text References

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Ch. 4, *Close Corporations*.

Ch. 5, *Management: Functions of Directors, Officers, and Committees*.

Ch. 6, *Management: Duties and Liabilities of Controlling Shareholders*.

Ch. 8, *Dividends and Reacquisition of Shares*.

Ch. 9, *Shareholders' Meetings and Voting*.

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Ch. 1B, *Selecting Form of Business Entity*.

Ch. 2, *Formation of Corporations*.

Ch. 2B, *Electing Subchapter S Status*.

Ch. 3, *Articles of Incorporation*.

Ch. 4, *Bylaws*.

Ch. 6I, *Issuance of Equity Securities*.

Ch. 6J, *Issuance of Debt Securities*.

Ch. 7, *Corporate Records and Reports*.

Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*.

Ch. 8B, *Voting Agreements and Voting Trusts*.

Ch. 8C, *Close Corporation Shareholder Agreements*.

Ch. 9 *Dividends, Reacquisitions of Shares, and Assessments*.

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100 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

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AUTHOR: Marilyn E. Minger, Practice Consultant

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
A. Purpose and Functioning of Board of Directors

2-5 California Legal Forms--Transaction Guide § 5.10

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§ 5.10 Directors' Powers

[1] Managerial Responsibilities and Corporate Powers Exercisable by Board of Directors

A corporation's business, affairs, and powers are managed and exercised, in general, by or under the direction of the board of directors [*Corp. Code § 300(a)*]. A statutory close corporation, however, may modify this traditional pattern of corporate control and allocate the management of corporate affairs ordinarily exercised by the board to shareholders or other corporate officials through use of a shareholders' agreement [*see Corp. Code § 300(d)*; *see also* Ch. 8C, *Close Corporation Shareholder Agreements*].

The following actions may be taken by, or require the approval of, the board of directors, although some of these actions may also require shareholder consent [*see* Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*]. Although not an exhaustive list, it enumerates significant board activity:

- Adopt, use, and alter a corporate seal [*Corp. Code § 207(a)*].

- Adopt, amend, and repeal bylaws [*Corp. Code § 207(b)*; *see Corp. Code § 211* (limitations on board's power)].

- Qualify to do business in any other state, territory, or country [*Corp. Code § 207(c)*].

- Issue, purchase, redeem, hold, lend, exchange, transfer, or otherwise deal in or with the corporation's shares or other securities [*Corp. Code § 207(d)*; *see Corp. Code § 510* (limitations on reissuance of redeemed shares)].

- Make donations (regardless of specific corporate benefit) for public welfare, hospital, charitable, educational, scientific, civic, or similar purposes [*Corp. Code § 207(e)*].

- Establish pension, profit-sharing, and other retirement, incentive, and benefit plans; and pay pensions [*Corp. Code § 207(f)*; *see Corp. Code §§ 315(b), 408*].

- Approve corporate borrowing and loans, including encumbering the corporation's property, franchises, and income [*Corp. Code § 207(g)*; *see Corp. Code §§ 310, 315, 316* (restrictions on loans to and guarantees of directors' or officers' obligations)].

- Enter into contracts on behalf of the corporation [*Corp. Code § 207(g)*].

- Enter a partnership or other business association [*Corp. Code § 207(h)*].

- Amend the corporation's articles in specified cases [*see Corp. Code §§ 212(a)* (fixing number of directors), *901, 902* (limitations before and after share issuance), *2303, 2304* (effect of transitional provisions)].

- Manage the business and affairs of the corporation [*Corp. Code § 300(a)*].

- Divide and distribute corporate profits, including declaring a dividend or other shareholder distribution [*see Corp. Code §§ 300(a), (b), 311(f)*; *see also Corp. Code § 166* (distribution to shareholders defined)].

- Approve the sale, lease, conveyance, exchange, transfer, or other disposition of corporate assets [*see Corp. Code §§ 300(b)* (distribution of assets on liquidation), *1001* (sale or transfer of all corporate assets)].

- Remove a director who has been declared of unsound mind, or who has been convicted of a felony [*Corp. Code § 302*].

- Elect directors to fill vacancies on the board created by a director's resignation [*Corp. Code § 305(a)*].

- Designate committees made up of board members and delegate to these committees authority to act on behalf of the board [*Corp. Code § 311(a)*].

- Elect corporate officers [*Corp. Code § 312*].

- Authorize indemnification of directors, officers, employees, or other agents of the corporation [*Corp. Code § 317*].

- Approve issuance of shares, and determine the consideration for those shares [*Corp. Code § 409*].

- Call annual and special shareholders' meetings [*Corp. Code § 600*].

- Approve a merger agreement [*Corp. Code § 1101*] or reorganization [*Corp. Code § 1200*].

- Make contracts and otherwise act in the name of the corporation during corporate dissolution [*see Corp. Code § 2001*].

The exercise of directors' voting rights is discussed in *§ 5.32[8]*.

[2] Requirement that Directors Act Jointly

The power and authority to manage the business and affairs of the corporation are vested in the directors collectively, as a board, and not as individuals [*see e.g., Anmaco, Inc. v. Bohlken (1993) 13 Cal. App. 4th 891, 898-900, 16 Cal. Rptr. 2d 675* (holding that individual who was 50 percent shareholder, director, and president had no presumptive or implied authority to institute litigation in the corporate name against co-director and equal shareholder, because latter could claim equal authority to bring suit in corporate name)].

This means that the directors of a corporation must generally act in concert, either in a formal meeting or by unanimous written consent [*see Corp. Code § 307(a), (b)*; *see also Corp. Code § 300(d)* (exception for close corporations)]. Action by the entire board, however, is not required when the board delegates certain of its powers to board committees [*see* [3], *below*]. However, committee decisions, like board decisions, must be reached collectively. For this reason, the same procedures that govern board meetings generally govern committee meetings. Meeting procedures are discussed in *§§ 5.30-5.32*. For discussion of board action without a meeting, see *§ 5.33*. For detailed discussion of board committees, see Cavitch, Business Organizations, Ch. 126 *Board Committees* (Matthew Bender).

[3] Delegation of Board Authority

[a] To Board Committees

The board of directors may establish committees consisting of two or more directors, to serve at the pleasure of the board, and may delegate to these committees the authority to act on behalf of the entire board [*Corp. Code § 311*]. The board, however, may *not* delegate to board committees the authority to take the following actions:

- Actions that also require approval of the shareholders or of the outstanding shares [*Corp. Code § 311(a)*].
- Filling vacancies on the board or committees [*Corp. Code § 311(b)*].
- Fixing the compensation of directors [*Corp. Code § 311(c)*].
- Adopting, amending, or repealing bylaws [*Corp. Code § 311(d)*].
- Amending or repealing any board resolution that expressly provides that it may not be amended or repealed by committee [*Corp. Code § 311(e)*].
- Authorizing a distribution to shareholders, except according to guidelines set forth in the articles or established by the directors [*Corp. Code § 311(f)*].
- Establishing other board committees or appointing committee members [*Corp. Code § 311(g)*].

Committees of the board are established by the bylaws [*see Corp. Code § 212(b)(5)*], or by a resolution adopted by a majority of the board of directors [*Corp. Code § 311*; *see § 5.245*]. The board may also designate directors as alternate committee members to replace any absent committee members at committee meetings [*Corp. Code § 311*]. A vote of the majority of the authorized number of directors is required to appoint members or alternate members of a committee [*Corp. Code § 311*].

[b] To Management Company or Manager

In addition to delegating authority to board committees, the board may delegate the management of the day-to-day

operation of the corporation to a management company or to an individual manager, provided that the business and affairs of the corporation are managed and all powers are exercised under the ultimate direction of the board [*Corp. Code § 300(a)*]. Unless the corporation is a close corporation, the board typically will formulate major corporate policies, rather than directly participate in day-to-day operations [*see* Report of Assembly Select Committee on the Revision of the Corporate Code (12/01/75), p. 41].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityLimitationsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityCorporate SealsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
A. Purpose and Functioning of Board of Directors

2-5 California Legal Forms--Transaction Guide § 5.11

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.11 Directors' Duties of Good Faith and Prudence

A director must perform the duties of a director, including duties as a member of any committee of the board, in good faith, in a manner that the director believes to be in the best interests of the corporation and its shareholders, and with the care, including reasonable inquiry, that an ordinarily prudent person would use under similar circumstances [*Corp. Code § 309(a)*].

Provided a director acts in good faith, after reasonable inquiry when inquiry is warranted, he or she is entitled to rely on the information, opinions, reports, or statements, including financial statements and other financial data, presented by [*Corp. Code § 309(b)*]:

- Corporate officers or employees whom the director believes to be reliable and competent in the matters presented.

- Counsel, independent accountants [*see Corp. Code § 115* (independent accountant defined)], or other persons on matters which the director believes to be within the person's professional or expert competence.

- Board committees (on which the director does not serve) on matters within the committee's designated and apparently competent authority.

A director who performs his or her duties in accordance with these statutory requirements of good faith and reasonable inquiry [*see Corp. Code § 309(a), (b)*] has no liability based on any alleged failure to discharge his or her obligation as a director [*Corp. Code § 309(c)*].

This business judgment rule has been held to immunize the directors of a federally insured national bank from liability for purely negligent acts [*see FDIC v. Castetter (9th Cir. 1999) 184 F.3d 1040, 1044-1046* (nonofficer directors

entitled to rely on company employees and advisors without duty of further inquiry, absent special circumstances)]. When a director/officer has acted in good faith, that officer's failure to obtain prior board approval for his or her action does not by itself make the business judgment rule inapplicable [*see Biren v. Equality Emergency Medical Group, Inc. (2002) 102 Cal. App. 4th 125, 136-138, 125 Cal. Rptr. 2d 325* (dismissal of billing contractor by director/officer of closely held corporation without obtaining required board approval was protected by business judgment rule; dismissal without board approval was honest mistake and officer/director reasonably believed she had authority to act)].

PRACTICE TIP:

The board may choose to utilize indemnification agreements with directors, officers and other agents to commit to advancing expenses to the fullest extent of the law if the agent is sued for reasons related to his or her actions as an agent. *Commentary by Marilyn E. Minger*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
A. Purpose and Functioning of Board of Directors

2-5 California Legal Forms--Transaction Guide § 5.12

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.12 Directors' Liability for Breach of Duty and Exceeding Authority

[1] In General

[a] Limiting Provision in Articles of Incorporation

The articles of incorporation may contain a provision eliminating or limiting a director's personal liability for monetary damages in an action brought by, or on behalf of, the corporation for breach of the director's duties to the corporation and its shareholders imposed by *Corp. Code § 309* [*Corp. Code § 204(a)(10)*; *see § 5.11* (for discussion of *Corp. Code § 204(a)(10)*]. The provision will not eliminate or limit a director's liability for any act or omission occurring before the effective date of the provision, or for any act or omission as an officer.

A provision in the articles provides the protection authorized by *Corp. Code § 204(a)(10)* if it reads substantially as follows: "The liability of the directors of the corporation for monetary damages shall be eliminated to the fullest extent permissible under California law" [*Corp. Code § 204.5(a)*]. More specific (or different) language, although not required, is permitted [*Corp. Code § 204.5(a), (b)*]. Such a provision, however, will not change the otherwise applicable standards or duties to make full and fair disclosure to shareholders when approval of the provision is sought [*Corp. Code § 204.5(c)*].

For further discussion and an example of this type of provision limiting or eliminating directors' liability, see Ch. 3, *Articles of Incorporation* .

[b] Director Acts and Omissions Not Subject to Elimination or Limitation of Liability

The liability of a director will not be limited by the limiting provision discussed in [a], above, for any of the following [*Corp. Code § 204(a)(10)*]:

- Acts or omissions that involve intentional misconduct or a knowing and culpable violation of law.

- Acts or omissions that a director believes are contrary to the best interests of the corporation or its shareholders, or that involve the absence of good faith on the part of the director.

- Transactions from which a director derived an improper personal benefit.

- Acts or omissions that show a reckless disregard for the director's duty to the corporation or its shareholders when the director was (or should have been) aware, in the ordinary course of performing a director's duties, of a risk of serious injury to the corporation or its shareholders.

- Acts or omissions that constitute an unexcused pattern of inattention, amounting to an abdication of the director's duty to the corporation or its shareholders.

- Prohibited transactions between corporations and directors [*see Corp. Code § 310*].

- Prohibited distributions, loans, and guarantees [*see Corp. Code § 316*].

Ratification by the directors of any negligent or improper action by an officer who is also a director will not eliminate or limit the officer's liability [*Corp. Code § 204(a)(10)*].

[c] Indemnification of Corporate Agents

The articles of incorporation may also contain a provision authorizing by bylaw, agreement, or otherwise, the indemnification of corporate agents [*see Corp. Code § 317* ("agent" defined)] in excess of that expressly permitted by *Corp. Code § 317* for breach of duty to the corporation and its stockholders [*Corp. Code § 204(a)(11)*]. However, such a provision in the articles of incorporation may not provide for indemnification for any acts or omissions from which a director may not be relieved of liability pursuant to *Corp. Code § 204(a)(10)* [*see* [b], *above*], or in any circumstances expressly prohibited by *Corp. Code § 317* [*Corp. Code § 204(a)(11)*; *see Corp. Code § 317(c)* (indemnification prohibited for amounts paid by agent to dispose of, settle, or defend pending action without court approval), *§ 317(h)* (indemnification prohibited when inconsistent with provision of articles, bylaws, shareholder resolution or agreement, or court-imposed condition)].

For further discussion and an example of an article provision authorizing indemnification, see Ch. 3, *Articles of Incorporation* . For further discussion of indemnification of agents, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 6, *Management: Duties and Liabilities of Controlling Shareholders* , § 109 (Matthew Bender).

[2] Directors' Liability for Tortious Action

Directors may be personally liable to third parties for tortious actions performed in their role as directors, whether or not they acted on behalf of the corporation, and whether or not the corporation is also liable. Liability results when a director specifically authorizes, directs, or participates in tortious conduct toward a third party and that conduct is clearly unreasonable under the circumstances known to the director at the time. Liability is based on common-law tort principles [*see Frances T. v. Village Green Owners Ass'n (1986) 42 Cal. 3d 490, 508-509, 229 Cal. Rptr. 456, 723 P.2d 573* (directors of condominium owners association ordered woman owner to disconnect protective exterior lighting, resulting in burglary of her home, and rape)].

In an action for misappropriation of trade secrets, unfair competition, and interference with prospective economic action, the court of appeal held that a corporate director or officer may be liable for an intentional tort if all of the following exist [*PMC, Inc. v. Kadisha (2000) 78 Cal. App. 4th 1368, 1372, 93 Cal. Rptr. 2d 663* (reversing summary

judgment, finding that plaintiffs raised a triable issue of material fact as to individual defendants' active meaningful participation in, consent to, or approval of, the tortious conduct)]:

- The officer or director purchased or invested in the corporation, the principal assets of which were the result of unlawful conduct.

- The officer or director took control of the corporation and appointed personnel to run the corporation which was engaging in unlawful conduct.

- The officer or director did so with knowledge or, with respect to trade secret misappropriation, when he or she had reason to know, of the unlawful conduct.

[3] Director's Liability for Distributions, Loans, and Guarantees

[a] Prohibited Actions

Subject to their statutory duties of good faith and prudence [*see Corp. Code § 309*; 5.11], the directors will be jointly and severally liable to the corporation for the benefit of all the creditors or shareholders entitled to bring suit [*see* [b], *below*] if they approve any of the following corporate actions [*Corp. Code § 316(a)*]:

- Making any prohibited distribution to the shareholders [*see Corp. Code §§ 500-503*; *see also* Ch. 9, *Dividends, Reacquisitions of Shares, and Assessments*].

- Distributing assets to the shareholders after dissolution proceedings have been instituted [*see* ch. 12, *Winding Up and Dissolution*], without paying or adequately providing for all known liabilities (excluding claims not filed by creditors within the time limit set by the court) [*see Corp. Code §§ 1800 et seq.* (involuntary dissolution), *1900 et seq.* (voluntary dissolution), *2000 et seq.* (dissolution procedures)].

- Making any prohibited loan or guarantee to a director or officer [*see Corp. Code § 315*; *see also* Ch. 4, *Bylaws*].

A director who is present at a meeting of the board (or any board committee) at which any of the above actions are taken, and who abstains from voting, will be considered to have approved the action [*Corp. Code § 316(b)*].

[b] Persons Entitled to Bring Suit

Any person entitled to bring suit to enforce the shareholders' liability for receiving prohibited distributions [*see Corp. Code § 506(b)*; *see also* Ch. 9, *Dividends, Reacquisitions of Shares, and Assessments*] may bring suit in the name of the corporation against any director liable for approving an unlawful distribution [*Corp. Code § 316(c)(1)*; *see Corp. Code § 316(a)(1)*]. Any creditor of the corporation, whose debts or claims arose before the corporation made a prohibited distribution of assets [*see Corp. Code § 316(a)(2)*], or prohibited loan or guarantee [*see Corp. Code § 316(a)(3)*], may also bring suit against any director liable for approving the prohibited distribution, loan, or guarantee [*Corp. Code § 316(c)(2)*]. In addition, any shareholder whose shares were outstanding at the time any prohibited loan or guarantee [*see Corp. Code § 316(a)(3)*] was made, who has not consented to the corporate action [*see Corp. Code § 316(c)(3)*; *see also Corp. Code § 800* (inapplicable shareholder derivative actions)], may bring suit against any director liable for approving the prohibited loan or guarantee [*Corp. Code § 316(c)(3)*].

[c] Damages

The damages recoverable from a director are the amount of the illegal distribution or loss suffered by the corporation as

a result of the illegal loan or guarantee. If the illegal distribution consists of property, the recoverable damages are the fair market value of the property at the time of the illegal distribution. In either case, damages include interest from the date of the distribution, computed at the legal rate on judgments until paid, together with all reasonably incurred costs of appraisal or other valuation, if any, of the property or loss. The amount of damages recoverable, however, may not exceed the liabilities of the corporation owed to nonconsenting creditors at the time of the violation and the injury suffered by nonconsenting shareholders [*Corp. Code § 316(d)*].

[d] Subrogation

Any director who has been sued may implead all other directors who are liable, and may compel contribution either in that action or in an independent action against those directors not joined in the first action [*Corp. Code § 316(e)*]. Directors held liable are also entitled to be subrogated to the rights of the corporation [*Corp. Code § 316(f)*]. A director who is liable with respect to the making of prohibited distributions [*see Corp. Code § 316(a)(1)*] is entitled to subrogation against shareholders who received the distribution [*Corp. Code § 316(f)(1)*]. A director who is liable with respect to the prohibited distribution of assets during dissolution [*see Corp. Code § 316(a)(2)*] is entitled to subrogation against shareholders who received the distribution [*Corp. Code § 316(f)(2)*]. A director who is liable with respect to the making of prohibited loans or guaranties [*see Corp. Code § 316(a)(3)*; *Corp. Code § 315*] is entitled to subrogation against the person who received the loan or guarantee [*Corp. Code § 316(f)(3)*].

Any director who is sued may file a cross-complaint against the person or persons who are liable to the director as a result of the subrogation, or may proceed against them in an independent action [*Corp. Code § 316(f)(3)*].

[4] Directors' Liability Related to Issue and Transfer of Shares

A director who unreasonably causes a corporate officer whose duty it is to enter a transfer of shares on the corporate books and issue a share certificate (or an initial transaction statement or written statement [*see Corp. Code § 171.1*] for uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)*; *see also* Ch. 6I, *Issuance of Equity Securities* ; Ch. 6K, *Nonissuer Transactions in Investment Securities*]) to unreasonably neglect, fail, or refuse to do so after written request is subject to penalty [*Corp. Code § 2201*]. A monetary penalty of $100, and an additional penalty of $10 for each day that default continues (up to a maximum of $500) must be paid to each person aggrieved [*Corp. Code § 2201*]. The penalties may be enforced by judicial action [*Corp. Code § 2201*; *see Corp. Code § 2202* (additional remedies; reduced penalties)].

[5] Shareholders' Liability under Close Corporation Shareholders Agreement

Every shareholder in a close corporation in which the discretion and powers of the board are controlled by a shareholders' agreement is subject to personal liability for managerial acts performed or omitted by that shareholder [*Corp. Code § 300(d)*]. In this case, any directors of the corporation are relieved of liability for those actions [*Corp. Code § 300(d)*].

This does not mean, however, that a shareholder in a close corporation operated under a shareholders' agreement is personally liable for the debts of the corporation. A corporation exists as a separate legal entity, independent of its directors, officers, and shareholders [*Corp. Code § 200(c)*]. As a separate legal entity, a corporation is liable for its own obligations [*see Corp. Code § 204(a)*], and its directors, officers, and shareholders ordinarily are not liable for corporate debts and other obligations [*see Corp. Code § 309(c)*]. In fact, the failure of a close corporation to observe corporate formalities relating to directors' and shareholders' meetings in connection with the management of its affairs, as provided in a shareholders' agreement, will not be considered a factor tending to establish that the shareholders have personal liability for corporate actions [*Corp. Code § 300(e)*].

Shareholders who undertake to exercise the power and duties of the directors, however, also assume the directors'

responsibility for the faithful exercise of those powers and duties [*Corp. Code § 300(d)*]. Directors may be personally liable for breach of duty to corporate creditors, the corporation itself, or its shareholders [*see Corp. Code §§ 309, 316(a)-(d), 506(b)*; *see also Jones v. H.F. Ahmanson & Co. (1969) 1 Cal. 3d 93, 81 Cal. Rptr. 592, 460 P. 2d 464]* . Thus, shareholders of a close corporation who exercise the powers of a board of directors under a shareholders' agreement may be personally liable to the same extent that the directors would have been [*Corp. Code §§ 300(d), 316(c), (d), 506(b)*].

[6] Criminal Penalties

Any director who knowingly and willfully issues or consents to the issuance of certificates for certificated securities, initial transaction statements, or written statements [*see Corp. Code § 171.1*] for uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(4), (18)*; *see* Ch. 6I, *Issuance of Equity Securities* ; Ch. 6K, *Nonissuer Transactions in Investment Securities*], in violation of the General Corporation Law with intent to defraud present or future shareholders, subscribers, purchasers of shares, or creditors, is guilty of a misdemeanor punishable by a fine of not more than $1,000 or imprisonment for not more than one year, or both [*Corp. Code § 2251*].

Any person (including a director) who does either of the following acts is guilty of a misdemeanor [*Corp. Code § 2252*]:

- Signs the name of a fictitious person to any subscription for or agreement to take stock in a corporation, or

- Signs the name of any person to any subscription or agreement, knowing that the person has no means or does not intend in good faith to comply with all the terms of the instrument, or that there is any understanding or agreement that the terms of the subscription or agreement are not to be complied with or enforced.

Any director who does any of the following is also guilty of a crime:

- Concurs in any vote or act of any director, knowingly and with dishonest or fraudulent purpose, to make any dividend or distribution of assets (except as allowed by law), either with the design of defrauding creditors or shareholders, or of giving a false appearance to the value of the stock, and as a result, defrauding subscribers or purchasers [*Corp. Code § 2253* (a misdemeanor punishable by up to $1,000 fine or up to one year imprisonment or both)].

- Knowingly concurs in making, publishing, or posting, either generally or privately, to the shareholders or other persons [*Corp. Code § 2254* (a felony)]:

    - Any written report, exhibit, statement of the corporation's affairs or pecuniary condition, or notice containing any material statement that is false,

    - Any untrue or willfully or fraudulently exaggerated report, prospectus, account, statement of operations, values, business, profits, expenditures, or prospects, or

    - Any other paper or document intended (or having the tendency) to produce or give the shares of stock in that corporation a greater value or a less apparent market value than they really possess.

- Refuses to make any book entry or post any notice required by law, in the manner required by law [*Corp. Code § 2254* (a felony)].

- Knowingly receives or acquires possession of any property of the corporation other than in payment of a just demand, and with intent to defraud, omits to make (or have made) a full and true entry of it in the corporate books of account [*Corp. Code § 2255(a), (c)* (a public offense punishable by imprisonment in a state prison, or imprisonment in a county jail for up to one year, or by a fine up to $1,000, or by both fine and imprisonment)].

- With intent to defraud, destroys, alters, mutilates, or falsifies any of the books, papers, writings, or securities belonging to the corporation, or makes or concurs in omitting to make any material entry in any book of accounts or other record or document kept by the corporation [*Corp. Code § 2255(b), (c)* (a public offense punishable by imprisonment in a state prison, or imprisonment in a county jail for up to one year, or by a fine up to $1,000, or by both fine and imprisonment)].

Every corporate agent who, proposing to increase the capital stock of the corporation, knowingly exhibits any false, forged, or altered book, paper, voucher, security, or other instrument of evidence to any public officer or board authorized by law to examine the organization of the corporation or to investigate its affairs, or to allow an increase of its capital, with intent to deceive that officer or board, is punishable by imprisonment in a state prison for not more than 10 years, or in a county jail for not more than one year [*Corp. Code § 2256*].

Any person who, without being authorized to do so, subscribes the name of another to, or inserts the name of another in, any prospectus, circular, or other advertisement or announcement of the corporation, with intent to permit the document to be published and to lead others to believe that the person whose name is so subscribed is an officer, agent, shareholder, or promoter of the corporation, when in fact no such relationship exists to the knowledge of that person, is guilty of a misdemeanor [*Corp. Code § 2257*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersActions Against CorporationsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesCauses of ActionGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesCauses of ActionNegligent Acts of Directors & OfficersBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesIndemnificationBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
A. Purpose and Functioning of Board of Directors

2-5 California Legal Forms--Transaction Guide § 5.13

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.13 Naming Initial Directors

The names and addresses of the initial directors may be set forth in the articles of incorporation [*Corp. Code § 204(c)*] or in the bylaws [*Corp. Code § 212(b)(1)*], or in both, or may be elected by the incorporator or incorporators.

PRACTICE TIP:
Initial directors usually are not named in the articles of incorporation or the bylaws, but rather are named in a written action by the incorporator that is filed in the corporation's minute book [*see § 5.224*].
Commentary by Marilyn E. Minger

If initial directors are not named in the bylaws, the incorporators, until the directors are elected [*see § 5.14*], may do whatever is necessary to perfect the organization of the corporation, including adopting and amending the bylaws, and electing directors and officers [*Corp. Code § 210*; *see Corp. Code § 312* (required corporate officers)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeGeneral Overview



105 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
A. Purpose and Functioning of Board of Directors

2-5 California Legal Forms--Transaction Guide § 5.14

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.14 Election and Term of Subsequent Directors

[1] In General

With two exceptions [*see* [2] (voting shifts), [3] (listed corporations), *below*], directors are elected at the annual shareholders' meeting, to hold office until the next annual meeting and until a successor has been elected and qualified [*Corp. Code § 301(a)*]. Unless removed [*see Corp. Code § 302-304*; *see also § 5.15[2]*], each director (including one elected to fill a vacancy) holds office until the expiration of the term for which elected and until a successor has been elected and qualified [*Corp. Code § 301(b)*; *see Corp. Code § 305(c)* (exception when election causes number of directors elected by shareholders to constitute less than majority of directors in office); *see also § 5.16[2]*]. A director whose resignation is to take effect on the election and qualification of a successor may vote as a director on the choice of a successor [*Mayo v. Interment Properties, Inc. (1942) 53 Cal. App. 2d 654, 659, 128 P.2d 417]* . A director's tenure is subject to resignation, removal, death, or other vacation of office before the expiration of the director's term [*see § 5.15[2], [3]*].

[2] Voting Shifts

A director's term of office may be shortened to less than one year, through the effect of a voting shift, if the articles so provide [*Corp. Code § 301(b)*]. A voting shift occurs when there is change in the relative rights of the holders of one or more classes or series of shares, voting as separate classes or shares, to elect directors [*Corp. Code § 194.7*]. Voting shifts commonly occur in relation to preferred shares. Holders of preferred shares often are not be entitled to vote in elections for directors if preferred dividends are current. However, if the articles of incorporation provide for a voting shift, then when the payment of preferred dividends is in arrears, the holders of preferred shares will become entitled, voting as a class or series, to elect a specified number or proportion (often a majority) of the directors, as long as the dividends remain unpaid (after which the voting rights switch back). For further discussion and a provision to include in the articles of incorporation to effect a voting shift, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS (Matthew Bender), Ch. 5, *Directors, Officer, and Committees* , § 81.03 and Appendix, Form 4.09.

[3] Listed Corporations

By amending its articles or bylaws, a listed corporation may adopt provisions to divide the board of directors into two or three classes to serve for terms of two or three years, respectively [*Corp. Code § 301.5(a)*; *see Corp. Code § 301(a)*; *see also Corp. Code § 301.5(b)-(j)* (procedures and requirements)]. A "listed corporation" is a corporation with outstanding shares listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market [*Corp. Code § 301.5(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual Meetings



106 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
A. Purpose and Functioning of Board of Directors

2-5 California Legal Forms--Transaction Guide § 5.15

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.15 Vacancies on Board of Directors

[1] Vacancy Defined

When used with respect to the board of directors, vacancy means any authorized position of director that is not currently filled with a properly elected director [*Corp. Code § 192*]. A vacancy may be caused, for example, by death, resignation, removal, or a change in the number of authorized directors [*see Corp. Code § 192*].

[2] Removal of Directors

[a] For Cause

The board of directors may remove a director before the expiration of that director's term [*Corp. Code § 303(c)*] by declaring his or her office vacant when the director is either declared of unsound mind by the court or convicted of a felony [*Corp. Code § 302*]. The superior court may also remove a director before the expiration of that director's term [*Corp. Code § 303(c)*] at the suit of shareholders holding at least 10 percent of the outstanding shares of any class, for fraudulent or dishonest acts, or gross abuse of authority related to the corporation, and may bar the director from reelection for a period prescribed by the court [*Corp. Code § 304*].

[b] Without Cause

The outstanding shares [*see Corp. Code § 152* (outstanding shares defined)] may remove any or all of the directors without cause, by a majority vote, before the expiration of the director's term, subject to certain limitations discussed below [*see Corp. Code § 303(a)*]. The articles of incorporation may not require a vote greater than a majority to accomplish removal [*Corp. Code § 204(a)(5)*; *see Corp. Code § 300(b), (c)* (waiver of this requirement in close corporation shareholders' agreement)]. This limitation is designed to protect the rights of shareholders.

A director of a corporation whose directors do not have staggered terms of office [*see Corp. Code § 301.5*] may not be

removed without cause (unless the entire board is removed) when the votes cast (or the consents in writing) against removal would be sufficient to elect the director if voted cumulatively at an election at which the same total number of votes were cast (or, if the action is taken by written consent, in which all shares entitled to vote were voted), and the entire number of directors authorized at the time of the directors' most recent election were being elected [*Corp. Code § 303(a)(1)*]. If the removal action is by written consent, all shares entitled to vote are assumed to have been voted, and abstentions are counted as negative votes [*Corp. Code § 303(a)(1)*; *see* Report of Assembly Select Committee on the Revision of the Corporate Code (12/01/75), pp. 43-44]. This limitation is designed to protect the cumulative voting rights of minority shareholders. For an explanation of cumulative voting, see Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

When the articles of incorporation give the shareholders of any class or series, voting as a class or series, the right to elect directors, any director so elected may be removed without cause only by the applicable vote of the shareholders of that class or series [*Corp. Code § 303(a)(2)*].

In addition, special limitations apply to the removal without cause of a director of a corporation with a staggered board [*see Corp. Code § 303(a)(3)*].

[c] Reduction in Authorized Number of Directors

A reduction of the authorized number of directors (or, for listed corporations, an amendment reducing the number of classes of directors) does not remove any director before the expiration of that director's term of office [*Corp. Code § 303(b)*; *see Corp. Code § 301.5* (listed corporations)]. Further, except as provided in *Corp. Code §§ 302-304* [*see* [a], [b], *above*], no director may be removed from office before the expiration of his or her term [*Corp. Code § 303(c)*].

[3] Resignation of Directors

Any director may resign by giving written notice to the chair of the board, the president, the secretary, or the board of directors [*Corp. Code § 305(d)*]. A director's resignation creates a vacancy on the board [*Corp. Code § 192*]. For a resignation form, see *§ 5.243*.

Resignation takes effect on the giving of written notice of resignation, unless the notice specifies a later time [*Corp. Code § 305(d)*]. Unless the resignation is made contingent on acceptance [*Clark v. Oceano Beach Resort Co. (1930) 106 Cal. App. 574, 576, 289 P. 946]* , it takes effect even if the board neither accepts nor acts on it [*Security Inv. Realty Co. v. Superior Court (1929) 101 Cal. App. 450, 452, 281 P. 709]* . For a form for accepting a resignation and appointing a successor, see *§ 5.244*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersTerms in OfficeVacanciesBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeRemoval & Resignation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
A. Purpose and Functioning of Board of Directors

2-5 California Legal Forms--Transaction Guide § 5.16

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.16 Filling Vacancies

[1] Vacancies Created by Removal

Unless the articles of incorporation or bylaws adopted by the shareholders provide that the board may fill vacancies occurring on the board by reason of the removal of directors, those vacancies may be filled only by approval of the shareholders [*Corp. Code § 305(a)*; *see Corp. Code § 153* (approval of shareholders defined)]. Filling a removal-created vacancy by written consent requires the unanimous written consent of all shares entitled to vote for the election of directors [*Corp. Code §§ 305(b), 603(d)*].

[2] Vacancies Not Created by Removal

Unless otherwise provided in the articles or bylaws, and except for a vacancy created by the removal of a director [*see* [1], *above*], vacancies on the board may be filled by approval of the board [*see Corp. Code § 151* (approval of board defined)], or if the number of directors in office is less than a quorum, by one of the following [*Corp. Code § 305(a)*]:

- The unanimous written consent of the directors in office.
- The affirmative vote of a majority of the directors in office at a meeting held pursuant to statutory notice or waivers of notice [*see Corp. Code § 307*].
- The sole remaining director.

If, after the directors fill any vacancy, the directors in office who have been elected by the shareholders constitute less than a majority of the directors in office, any shareholder or shareholders representing at least five percent of the outstanding shares with the right to vote for those directors may call a special shareholders' meeting to elect the entire board [*Corp. Code § 305(c)(1)*]. Alternatively, such a shareholder or shareholders may petition the superior court to order a special shareholders' meeting to elect the entire board [*Corp. Code § 305(c)(2)*].

The shareholders may also elect a director at any time to fill a vacancy not filled by the directors [*Corp. Code § 305(b)*]. Any such election by written consent (other than one to fill a vacancy created by the removal of a director [*see* [1], *above*]) requires the consent of a majority of the outstanding shares entitled to vote [*Corp. Code §§ 305(b), 603(d)*].

[3] Court Appointment of Directors

If a corporation has not issued shares (so that no shareholders exist to elect directors [*see Corp. Code § 305(b)*]) and all the directors resign, die, or become incompetent, the superior court may appoint directors of the corporation on the application of any party in interest. Similarly, if a corporation's initial directors have not been named in the articles and all the incorporators resign, die, or become incompetent before the election of the initial directors, the superior court may appoint directors [*Corp. Code § 306*; *see Corp. Code § 210*; *see also § 5.13*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersTerms in OfficeRemoval & ResignationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeVacancies



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
A. Purpose and Functioning of Board of Directors

2-5 California Legal Forms--Transaction Guide § 5.17

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.17 Court Appointment of Provisional Directors

[1] Deadlocked Board

If a corporation has an even number of directors who are equally divided and cannot agree on the management of its affairs, to the detriment of the corporation's business or its property, any director or any shareholder or shareholders representing at least 33 1/3 percent of the corporation's voting power may bring suit, in superior court, for the appointment of a provisional director to break the deadlock [*Corp. Code § 308(a)*; *see Corp. Code § 308(d)* (exempted corporations)]. Such an appointment may be made regardless of provisions in the articles or bylaws to the contrary, or whether an action is pending for the involuntary dissolution or winding up of the corporation [*Corp. Code § 308(a)*]. The appointment may also be made when a shareholders' agreement has shifted some of the board's powers to the shareholders [*see Corp. Code § 300(b)*; Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*], if the issues subject to the deadlock are matters on which a provisional board may vote in accordance with the board's retained ability to exercise corporate powers [*In re Annrhon, Inc. (1993) 17 Cal. App. 4th 742, 754-756, 21 Cal. Rptr. 2d 599]* . The order appointing a provisional director is appealable [*In re Annrhon, Inc. (1993) 17 Cal. App. 4th 742, 751, 21 Cal. Rptr. 2d 599]* .

If the corporation's business is profitable, the appointment of a provisional director may be a desirable alternative to the drastic remedy of an involuntary winding up or dissolution [*see, e.g., In re Jamison Steel Corp. (1958) 158 Cal. App. 2d 27, 322 P.2d 246]* , or the appointment of a receiver [*see In re Annrhon (1993) 17 Cal. App. 4th 742, 752, 21 Cal. Rptr. 2d 599* , quoting *In re Jamison Steel Corp. (1958) 158 Cal. App. 2d 27, 35-37, 322 P.2d 246]* .

[2] Deadlocked Shareholders

If a corporation has an uneven number of directors, and the shareholders are deadlocked so that they cannot elect a successor board at an annual shareholders' meeting, any shareholder or shareholders representing at least 50 percent of the corporation's voting power may petition the superior court to appoint a provisional director (or directors), or to order other equitable relief as appropriate [*Corp. Code § 308(b)*; *see Corp. Code § 308(d)* (exempted corporations)]. Any

appointment of one or more provisional directors may be made regardless of provisions in the articles or bylaws to the contrary [*Corp. Code § 308(b)*]. The court's ability to appoint more than one provisional director [*see Corp. Code § 308(b)*] eliminates the possibility of a potential deadlock caused by the appointment of a single provisional director to an uneven-numbered board, and ends control of the board by an incumbent majority elected or perpetuated by only 50 percent of the corporation's voting power. For further discussion of this issue, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 5, *Directors, Officers, and Committees* , § 82.03 (Matthew Bender).

[3] Qualifications and Powers of Provisional Director

A provisional director must be an impartial person who is neither a shareholder nor creditor of the corporation, nor related by consanguinity (blood relationships) or affinity (relationship by marriage between one spouse and the blood relations of the other spouse) within the third degree, according to common law, to any other directors of the corporation or to any judge of the court appointing the provisional director [*Corp. Code § 308(c)*].

A provisional director has all the rights and powers of a director [*see §§ 5.10[1]*] until the deadlock in the board or among shareholders is broken, or until the director is removed by court order or by approval of the outstanding shares [*Marik v. Superior Court (1987) 191 Cal. App. 3d 1136, 1140, 236 Cal. Rptr. 751]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersActions Against CorporationsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersActions Against CorporationsStandingGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeGeneral OverviewBusiness & Corporate LawCorporationsShareholdersActions Against CorporationsInternal Corporate Affairs



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
A. Purpose and Functioning of Board of Directors

2-5 California Legal Forms--Transaction Guide §§ 5.18-5.29

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 5.18[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
B. Board of Directors Meetings and Actions by Written Consent without Meeting

2-5 California Legal Forms--Transaction Guide § 5.30

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.30 Procedures for Action by Board of Directors

Action by the directors may be taken at annual, regular, or special meetings of directors or of committees of the board [*Corp. Code §§ 307, 311*; *see § 5.31*], or by the unanimous written consent of the directors without a meeting [*Corp. Code § 307(b)*; *see § 5.33*]. The significant matters on which a director's vote is required or permitted are enumerated in § 5.10[1]. The exact nature of the vote required depends on statutory requirements and any special voting provisions in the articles or the bylaws [*see § 5.32[8]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



111 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
B. Board of Directors Meetings and Actions by Written Consent without Meeting

2-5 California Legal Forms--Transaction Guide § 5.31

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.31 Types of Meetings

Immediately after each annual shareholders' meeting, the board of directors normally holds its own annual meeting. This meeting is sometimes referred to as an organizational meeting because it is the first meeting following the annual election of directors. Although not required by statute, this meeting ordinarily is held to elect the officers of the corporation who will serve during the coming year. Other regular meetings are customarily held periodically as fixed in the bylaws or as determined by the board of directors [*see Corp. Code § 307(a)(2)*]. Special meetings of the board may be called for any purpose at any time by the chair of the board, the president, any vice president, the secretary, or any two directors [*see Corp. Code § 307(a)(2)*].

The number and frequency of the meetings of a corporation's board of directors depends on a number of factors, including the type and extent of the corporation's business, whether the corporation is closely held, and whether it has outside directors.

Call and notice requirements for these meetings are discussed in *§ 5.32[3], [5]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
B. Board of Directors Meetings and Actions by Written Consent without Meeting

2-5 California Legal Forms--Transaction Guide § 5.32

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.32 Meeting Procedures

[1] Applicability to Close Corporations

The General Corporation Law provides that for a statutory close corporation, all of its provisions may be waived or altered in a shareholders' agreement between the parties to that agreement, except for the required filing of any document with the Secretary of State and for certain enumerated chapters and sections of the law [*see Corp. Code § 300(c)*]. The enumerated chapters and sections do not include those that generally govern directors meetings [*see Corp. Code § 307*]. As a result, the provisions governing directors meetings may be waived by close corporations. For further discussion of the waiver of these provisions in close corporation shareholder agreements, see Ch. 8C, *Close Corporation Shareholder Agreements* .

[2] Applicability to Board Committees and Incorporators

The provisions of the General Corporation Law, which govern directors meetings [*see Corp. Code § 307*] apply also to board committees and incorporators [*see Corp. Code § 311*] and their actions [*Corp. Code § 307(c)*].

[3] Persons Authorized to Call Meeting

Unless otherwise provided in the articles of incorporation or the bylaws, board meetings may be called by the chair of the board, the president, any vice president, the corporate secretary, or any two directors [*Corp. Code § 307(a)(1)*]. For a form to be used for a call, *see § 5.200*.

[4] Place of Meeting

Meetings may be held at any place in California or elsewhere that has been designated in the meeting's notice [*Corp. Code § 307(a)(5)*]. If the meeting place is not stated in the notice, or if there is no notice, the meeting may be held at any place designated in the bylaws or by resolution of the board [*Corp. Code § 307(a)(5)*; *see Corp. Code § 212(b)(2)*].

[5] Notice

Regular board meetings may be held without notice, if the time and place are fixed by the bylaws or the board [*Corp. Code § 307(a)(2)*]. Notice of special board meetings, however, may not be dispensed with by the articles or bylaws [*Corp. Code § 307(a)(2)*]. Special meetings may be held on four days notice by mail, or 48 hours notice delivered personally, by telephone, including a voice messaging system, or by electronic transmission by the corporation [*Corp. Code § 307(a)(2)*]. The notice does not need to specify the purpose of either regular or special meetings of the board [*Corp. Code § 307(a)(2)*].

Notice does not need to be given to any director who before or after the meeting provides a waiver of notice, a consent to hold the meeting, or an approval of the minutes of the meeting in writing, or who attends the meeting without protesting the lack of notice before or at the beginning of the meeting [*Corp. Code § 307(a)(3)*]. Waivers, consent, and approvals of the minutes must be filed with the corporate records, or made a part of the minutes of the meeting [*Corp. Code § 307(a)(3)*]. The waiver does not need to specify the purpose of the meeting for which notice is waived [*Corp. Code § 307(a)(2)*].

A board meeting held without the required notice to one director is void unless the notice is properly waived. The directors present at such a meeting cannot validly take any action on behalf of the corporation [*In re Mathews Constr. Co. (1954) 120 F. Supp. 818, 821* (construing former Corp. Code § 813); *see* [6], *below*].

PRACTICE TIP:

Small or medium-sized corporations often dispense with formal written notice to the directors, and instead call meetings by informal notice, using a waiver of notice or consent to holding the meeting, or a written approval of the minutes of the meeting signed by any director not present and filed with the corporate records. If there is any question that a board member may not sign a waiver or consent proper notice should be given. *Commentary by Marilyn E. Minger*

[6] Quorum Requirements

[a] Definition and Effect

A quorum is the number of directors at a meeting whose presence is required to validly transact corporate business [*see Corp. Code § 307(a)(8)*]. Participation in a meeting through use of a conference telephone call or electronic video screen communication or through electronic transmission by and to the corporation constitutes presence in person at the meeting, provided that specified requirements are met [*see Corp. Code § 307(a)(6)*; *see also* [c], *below*].

Any act or decision by a majority of directors at a meeting at which a quorum is present is a valid action of the board, subject to special rules applicable to transactions involving an interested director [*Corp. Code § 307(a)(8)*; *see Corp. Code §§ 310, 317(e)*; *see also* [d], *below*]. If a quorum is not present, any acts taken at the meeting are voidable by the corporation or its shareholders [*see Olincy v. Merle Norman Cosmetics, Inc. (1962) 200 Cal. App. 2d 260, 273, 19 Cal. Rptr. 387]* , although a majority of the directors present may adjourn the meeting to another time and place [*Corp. Code § 307(a)(4)*; *see* [8], *below*].

A meeting at which a quorum initially is present may continue to transact business even if enough directors leave the meeting to reduce the number in attendance to less than a quorum, if the action taken is approved by at least a majority of the required quorum for the meeting [*Corp. Code § 307(a)(8)*].

[b] Computing Quorum--In General

Unless otherwise provided in the articles of incorporation [*see Corp. Code § 204(a)(5)*], a quorum is a majority of the authorized number of directors [*Corp. Code § 307(a)(7)*]. The articles or bylaws may provide that less than a majority

of directors constitutes a quorum. However, a quorum may not be less than one-third the authorized number of directors or two directors, whichever is larger (except for corporations with one director, in which case one director constitutes a quorum) [*Corp. Code § 307(a)(7)*; *see Corp. Code § 212(b)(4)* (bylaw provisions)]. Neither the articles nor the bylaws may provide that a vote of less than a majority of the directors present at a meeting is a valid action of the board [*Corp. Code § 307(a)(8)*].

The articles (or a statutory close corporation shareholders' agreement) may require a quorum greater than a majority of the authorized number of directors [*Corp. Code §§ 204(a)(5), 300(b), (c)*].

[c] Participation Through Communications Equipment

Directors, unlike shareholders, may not vote or attend a meeting by proxy [*see Corp. Code § 307* (requiring physical or audio presence); *see also* Cavitch, *Business Organizations, Ch. 125, Board Meetings, § 125.02[3]* (Matthew Bender)]. Because board meetings are viewed as an opportunity to exchange views leading to action by consensus, proxy voting is not considered a viable alternative to a director's presence [*see* Cavitch, *Business Organizations, Ch. 125, Board Meetings, § 125.02[4]* (Matthew Bender)]. Nonetheless, directors may participate in a meeting through the use of a conference telephone call or electronic video screen communication or through electronic transmission by and to the corporation [*see Corp. Code § 307(a)(6)*].

Participation through use of a conference telephone call or electronic video screen communication constitutes presence in person at the meeting provided that all directors participating in the meeting can hear one another [*Corp. Code § 307(a)(6)*].

Participation through electronic transmission by and to the corporation (other than a conference telephone call and electronic video screen communication) constitutes presence in person at the meeting if *both* the following apply [*Corp. Code § 307(a)(6)*]:

- Each participating director can communicate with all other directors concurrently.

- Each director has the means to participate in all matters before the board, including the ability to propose or object to a specific corporate action.

[d] Counting Interested Directors in Computing Quorum

Although their votes on the matter may not be counted [*Corp. Code § 310(a)(2), (b)(1)*], interested or common directors may be counted in determining the presence of a quorum at a meeting of the board (or board committee) which authorizes or approves a transaction between the corporation and the interested director, or between the corporation and the entity in which the director has a material interest [*Corp. Code § 310(c)*].

[e] Actions Permitted Absent a Quorum

Absent a quorum at the beginning of the meeting, it appears that the directors may take only two valid actions:

- Except for a vacancy created by the removal of a director [*see § 5.16[1]*] (and unless otherwise provided in the articles or bylaws), vacancies on the board may be filled by a director or directors, as prescribed by statute, if the number of directors in office is less than a quorum [*Corp. Code § 305(a)*; *see § 5.16[2]*].

- A majority of the directors present (even without a quorum) may adjourn a meeting [*Corp. Code § 307(a)(4)*; *see* [8], *below*].

Business may continue to be transacted at a meeting, however, at which a quorum was initially present after some directors leave, provided that any action taken is approved by a majority of the quorum required for the meeting [*Corp. Code § 307(a)(8)*].

[7] Adjournment

A majority of directors present at a meeting may adjourn the meeting to another time and place, whether or not there is a quorum [*Corp. Code § 307(a)(4)*]. If the meeting is adjourned for more than 24 hours, notice of adjournment to another time and place must be given before the time of the adjourned meeting to the directors who were not present when the original meeting was adjourned [*Corp. Code § 307(a)(4)*]. For a notice of adjourned meeting, see *§ 5.202*.

[8] Voting Requirements

Ordinarily, the vote of a majority of directors present at a meeting at which a there is a quorum is required for a valid board action, subject to special rules applicable to transactions involving an interested director [*Corp. Code § 307(a)(8)*; *see Corp. Code §§ 310, 317(e)*; *see also Corp. Code § 307(a)(6)* (presence at meeting defined); [7][a], *above*]. The articles or bylaws may not provide for a lesser vote for board action [*Corp. Code § 307(a)(8)*], although they may require a greater than majority vote for a specific type of action [*see Corp. Code §§ 204(a)(6), 212(b)*]. However, the vote of a majority of the *quorum* required for a meeting may continue to transact business at a meeting at which a quorum was initially present but later lost as a result of directors leaving the meeting [*Corp. Code § 307(a)(8)*]. Further, the vote of only a majority of the directors present, whether or not there is a quorum, is required to adjourn the meeting to another time and place [*Corp. Code § 307(a)(4)*].

[9] Minutes of Board Meeting

Each corporation must keep a record (minutes) of the proceedings of its board of directors and of committees of the board [*Corp. Code § 1500*; *see Corp. Code §§ 300(e)* (relaxation of rules related to directors meetings for close corporations), 1507 (liability for false information)]. Minutes of each directors meeting, or the unanimous written consents of directors to action, are ordinarily kept in a minute book. Copies of notices, waivers of notice, consents to holding the meeting, and approvals of the minutes should also be filed in the minute book. The original or a copy of the minutes of a meeting, certified by the corporate secretary or assistant corporate secretary, is prima facie evidence that the meeting was held and the matters stated in the minutes are true and correct [*Corp. Code § 314*].

The corporation may keep the minutes in written form or in another form capable of being converted into clearly legible tangible form. When minutes and other books and records are kept in a form capable of being converted into clearly legible paper form, the clearly legible paper form into which those minutes and other books and records are converted is admissible in evidence, and acceptable for all other purposes, to the same extent as an original paper record of the same information would be, provided the paper form accurately portrays the record [*Corp. Code § 1500*].

For a discussion of what minutes should contain and a checklist for their preparation, see *§§ 5.230* and *5.151*, respectively.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
B. Board of Directors Meetings and Actions by Written Consent without Meeting

2-5 California Legal Forms--Transaction Guide § 5.33

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.33 Action by Unanimous Written Consent Without Meeting

The directors may act by written consent without a meeting [*see, e.g., §§ 5.221-5.223*]. However, an action by written consent requires the consent of all the members of the board, and the number of board members serving at that time must constitute a quorum [*Corp. Code § 307(b)*].

For purposes of unanimous board action without a meeting, the term "all members of the board" includes an "interested director" [*see Corp. Code § 310(a)*] or a "common director" [*see Corp. Code § 310(b)*] who abstains in writing from providing consent, when [*Corp. Code § 307(b)*]:

- The disclosures required by *Corp. Code § 310* (generally requiring full disclosure of the material facts regarding the transaction and the director's interest) [*see Ch. 4, Bylaws, § 4.200[2]*, Section 2.23] have been made to the noninterested or noncommon directors, as applicable, before their execution of the written consent or consents;

- The specified disclosures are conspicuously included in the written consent or consents executed by the noninterested or noncommon directors; and

- The noninterested or noncommon directors, as applicable, approve the action by a vote that is sufficient without counting the votes of the interested or common directors.

If the directors give written consent in accordance with the preceding rule, but the disclosures made regarding the action that is the subject of the consent do not satisfy statutory requirements [*see Corp. Code § 310*], the action that is the subject of the consent will be deemed approved. However, in any suit brought to challenge the action, the party asserting the validity of the action has the burden of proof in establishing that the action was just and reasonable to the corporation at the time it was approved [*Corp. Code § 307(b)*].

The consent may be in the form of individual consents or one collective consent, or a facsimile of either type of consent, or by telegraphic or other electronic communication authorized by the Corporations Code [*see Corp. Code §§ 195, 307(b)*].

PRACTICE TIP:

When preparing written consents, include a provision that the consent "may be executed in counterparts, each of which shall be deemed an original and all of which, taken together, shall constitute one and the same instrument." This permits use of a collective consent but does not require that all directors sign the same piece of paper. *Commentary by Marilyn E. Minger*

The consents must be filed with the minutes of the board's proceedings [*Corp. Code § 307(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
B. Board of Directors Meetings and Actions by Written Consent without Meeting

2-5 California Legal Forms--Transaction Guide § 5.34

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.34 Ratification of Board Action Despite Irregularity of Meeting

The actions of the board may be ratified by actions of the individual directors, and the ratification will have retroactive effect to the time when the action by the board was originally taken [*Meyers v. El Tejon Oil & Refining Co. (1946) 29 Cal. 2d 184, 186-187, 174 P.2d 1]* . For example, in *Meyers v. El Tejon Oil & Refining Co.* [*Meyers v. El Tejon Oil & Refining Co. (1946) 29 Cal. 2d 184, 174 P.2d 1]* , a board of directors meeting was attended by four of seven directors. No notice of the meeting was given, nor did the absent directors sign a waiver of notice, a consent to the meeting, or an approval of its minutes. The board declared a cash dividend, and the dividend was paid to the shareholders, including the three absent directors who then returned the cash dividend and received promissory notes in exchange. The court held that this action on the part of the three absent directors ratified the action taken by the board of directors, in spite of the irregularity of the meeting [*Meyers v. El Tejon Oil & Refining Co. (1946) 29 Cal. 2d 184, 187, 174 P.2d 1]* .

Further, in a contract action in which a corporation raised the defense that the meeting at which the directors agreed to the contract was not properly held, the court held that if all of the directors of the corporation are present when the terms of a transaction are agreed to, the corporation cannot deny the contract on the ground that it was not made at a legal meeting [*Thompson v. M. K. & T. Oil Co. (1935) 5 Cal. App. 2d 117, 123, 42 P.2d 374]* . The court further held that if the contract was made by the board of directors of the corporation, it was immaterial whether or not the minutes of the meeting showed the transaction [*see* Thompson v. M.K. & T. Oil Co. (1935) 5 Cal. App. 2d 117, 124].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



115 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART II. LEGAL BACKGROUND
B. Board of Directors Meetings and Actions by Written Consent without Meeting

2-5 California Legal Forms--Transaction Guide §§ 5.35-5.99

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 5.35[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-5 California Legal Forms--Transaction Guide § 5.100

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.100 Client Interview

NOTE:
If the client interview is in connection with the formation of a corporation, more information than listed below is needed. For a preincorporation planning checklist, see Ch. 2, ***Formation of Corporations*** .

[1] Facts

[a] The Corporation

1. Exact name of corporation.

2. Name and address of principal executive office of corporation.

3. Date of incorporation.

4. State of incorporation.

5. Tax year of corporation.

6. Employer identification number.

7. Principal business.

8. Authorized number of directors.

9. Names, addresses, and telephone and facsimile numbers of directors.

10. Name of chair of board of directors.

11. Names, addresses, telephone and facsimile numbers, and titles of officers likely to be involved in directors meetings, call, or notice.

12. Name, address, and telephone and facsimile number of any other person likely to attend directors meetings.

13. Name, address, and telephone number of accountant.

14. Name and address of corporation's transfer agent, if any.

15. Date and time of annual meeting.

16. Number of shareholders.

17. Total number of shares issued.

18. Authorized number, class, and series of shares.

19. Voting rights of each class or series of shares.

20. Approximate fair market value of shares, if known.

21. Whether corporation is a professional corporation.

22. Whether corporation has elected Subchapter S status [*see § 5.222[1][f]*].

[b] Directors Meetings

1. Place of directors meetings, if stated in bylaws or fixed by board resolution [*see Corp. Code § 307(a)(5)*], and frequency or minimum number of meetings per year.

NOTE:

Meetings may be held at any place in California or elsewhere that has been designated in the meeting's notice [*Corp. Code § 307(a)(5)*]. If the meeting place is not stated in the notice, or there is no notice, the meeting may be held at any place designated in the bylaws or by resolution of the board [*Corp. Code § 307(a)(5)*; ***see*** *Corp. Code § 212(b)(2)*].

2. For any proposed directors meeting:

a. Type of meeting (annual, regular, or special).

b. Date and time.

c. Place.

d. Action proposed to be taken by director vote or written consent.

3. If original meeting has been adjourned:

a. Date and time of original meeting.

b. Time and place of adjourned meeting.

c. Number of hours or days between original and adjourned meetings.

NOTE:
If the meeting is adjourned for more than 24 hours, notice of adjournment to another time and place must be given before the time of the adjourned meeting to the directors who were not present at the time the original meeting was adjourned [*Corp. Code § 307(a)(4)*; ***see*** *§ 5.202*].

[2] Documents

1. Articles of incorporation.

2. Bylaws.

3. Minute book.

4. Any preincorporation subscription or other agreements.

5. Any documents regarding qualification or exemption of issuance or transference of corporate shares under state and federal securities laws.

6. Share certificates.

7. Shareholder list.

8. Any instrument under which corporation's stock is held, including:

a. Trust instruments for trusts holding corporation's shares.

b. Will under which any deceased shareholder's corporate stock is held by estate.

c. Bankruptcy court order under which bankrupt shareholder's stock is held by bankrupt's estate.

d. Court order for guardianship.

e. Voting trust or other voting or shareholder agreement [*see* Ch. 8B, *Voting Agreements and Voting Trusts*].

9. Copy of resignation of any director who has not yet been replaced.

10. Copies of any documents to be presented at any scheduled meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

2-5 California Legal Forms--Transaction Guide §§ 5.101-5.109

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 5.101[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-5 California Legal Forms--Transaction Guide § 5.110

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.110 First Meeting

1. Determine whether board needs to ratify actions of incorporator or incorporators.

2. Determine matters to be covered in bylaws [*see* Ch. 4, *Bylaws*] if bylaws were not already adopted by incorporator.

3. Ascertain names and titles of officers to be elected.

4. Determine officer's compensation.

5. Determine directors' compensation, if any.

6. Determine form of share certificate to be adopted.

7. Determine whether directors will fix, by resolution, the number or designation (or both) of any series of shares to be issued, or rights, preferences, privileges, and restrictions to be granted to or imposed on any class or series of shares or on their holders [*see Corp. Code § 202(e)*].

8. Determine consideration to be received for shares.

9. If nonmonetary consideration was or will be received for shares, determine its fair value in monetary terms to corporation.

10. Determine whether transfers of stock to directors are just and reasonable to corporation [*see Corp.*

Code § 310].

11. Determine whether issuance of shares will require permit from California Commissioner of Corporations or whether issuance will be exempt from qualification) [*see Corp. Code § 25100 et seq.*; Ch. 6, *Securities Regulation Issues* ; Ch. 6I, *Issuance of Equity Securities* .

12. Determine whether issuance of shares will require registration with Securities and Exchange Commission [*see* Ch. 6, *Securities Regulation Issues* ; Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* ; Ch. 6I, *Issuance of Equity Securities*].

13. Determine whether issuance of shares will require compliance with securities laws of other states.

14. Determine whether to execute indemnity agreements with directors [*see §§ 5.11, 5.221[1][g]*].

15. Determine whether to execute confidentiality agreements with directors and officers as a condition of employment.

16. Determine whether to elect Subchapter S status [*see* I.R.C. §§ 1361-1379].

NOTE:
Election of S corporation status must be made on or before the fifteenth day of the third month of the first taxable year to which the election applies [*I.R.C. § 1362(b)*].

17. Determine whether shares will be qualified as *I.R.C. § 1244* (small business) stock [*see § 5.222[1][e]*; Ch. 6I, *Issuance of Equity Securities*].

18. Determine which bank will house corporate checking and savings accounts and serve as depository for employment trust fund taxes.

19. Determine corporation's fiscal year.

20. Determine professional advisors of corporation (*i.e.*, attorneys, accountants).

21. Determine whether corporation will do business under fictitious name [*see* Ch. 1B, *Selecting Form of Business Entity*].

22. Determine whether corporation must secure any business or professional licenses or local permits.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-5 California Legal Forms--Transaction Guide § 5.111

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.111 Regular or Special Meetings

1. If meeting is annual organizational meeting, ascertain names of officer nominees for election.

NOTE:
Immediately after each annual shareholders' meeting, the board of directors normally holds its own annual meeting. This meeting is sometimes referred to as an organizational meeting, because it is the first meeting following the annual election of directors. Although not required by statute, this meeting ordinarily is held to elect the officers of the corporation who will serve during the coming year.

2. If meeting is a special meeting, determine whether party requesting meeting is authorized to call it [*see Corp. Code § 307(a)(2)* (parties authorized to call special directors meetings); *§ 5.32[3]*].

3. Determine date of meeting.

4. Determine place of meeting.

NOTE:
Meetings may be held at any place (within California or elsewhere) designated in the meeting's notice, or if not stated in the notice or there is no notice, designated in the bylaws or by board resolution [*Corp. Code § 307(a)(5)*].

5. Determine whether notice of meeting is required [*see Corp. Code § 307(a)(2)*].

6. If notice is required, determine date by which corporate secretary or other officer must send notice.

NOTE:

Special meetings may be held on four days notice by mail, or 48 hours notice delivered personally or by telephone, including a voice messaging system, or by electronic transmission by the corporation [*Corp. Code § 307(a)(2)*].

7. Determine number of directors required for quorum at meeting [*see Corp. Code § 307(a)(8); § 5.32[6]*].

8. Determine business to be conducted at meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-5 California Legal Forms--Transaction Guide § 5.112

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.112 Adjourned Meetings

1. Determine whether notice of meeting is required.

   NOTE:
   If the meeting is adjourned for more than 24 hours, notice of adjournment to another time and place must be given before the time of the adjourned meeting to the directors who were not present when the original meeting was adjourned [*Corp. Code § 307(a)(4)*; ***see*** *§ 5.32[7]*].

2. Determine business to be considered at adjourned meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-5 California Legal Forms--Transaction Guide § 5.113

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.113 Written Consents without Meeting

1. Determine whether all directors will consent to specified action.

NOTE:
An action by written consent without a meeting requires the consent of ***all*** the members of the board, and the number of board members serving at that time must constitute a quorum [*Corp. Code § 307(b)*; ***see*** *§ 5.33*].

2. Determine whether action by written consent is preferable to vote at directors meeting.

PRACTICE TIP:
Corporate actions can be taken more quickly using written consents than at meetings because action taken at a directors meeting requires the presence of at least a quorum. Taking action by written consent can be accomplished quickly because facsimile signatures can be used. If obtaining signatures by facsimile, also request an original copy by mail. *Commentary by Marilyn E. Minger*

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

2-5 California Legal Forms--Transaction Guide §§ 5.114-5.119

AUTHOR: Marilyn E. Minger, Practice Consultant

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§§ 5.114[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Directors' First Meeting

2-5 California Legal Forms--Transaction Guide

AUTHOR: Marilyn E. Minger, Practice Consultant

NOTE:

There is no statutory distinction between a first meeting of directors and any other directors meeting, whether the actions are taken by written consent without a meeting or at a meeting. The first meeting is distinguished in practice, however, by the type of actions taken and resolutions passed. The first meeting is generally an organizational meeting during which formal organizational actions are taken. Those actions include adopting the bylaws (if not already done so by the incorporators), adopting a form of share certificate, authorizing issuance of shares. For a list of actions often taken at the first directors meeting see *§ 5.121*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Directors' First Meeting

2-5 California Legal Forms--Transaction Guide § 5.120

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.120 Pre-Meeting Procedure

NOTE:

The directors may act by written consent without a meeting. However, an action by written consent requires the consent of the members of the board, and the number of board members serving at that time must constitute a quorum [*Corp. Code § 307(b)*]. For further discussion of written consents, see *§ 5.33*. For a form for first actions by written consent, see *§ 5.222*. With minor modifications, this form may be used when the actions are taken at a meeting rather than by written consent. For a form for minutes of a regular directors meeting, see *§ 5.230*.

If any of the actions to be taken require discussion, or have not been fully, although informally, agreed on by the directors, the better practice may be to hold a meeting where the matters can be discussed and any differences resolved.

1. Fix time and place of meeting (or arrange to have written consents signed).

2. If meeting is to be held, have directors call it [*see § 5.200*].

NOTE:

A meeting of the board of directors may be called by any two directors and, if officers have been elected or appointed by the incorporators [***see*** *Corp. Code § 210*], by the chair of the board, the president, any vice president, or the secretary of the corporation [*Corp. Code § 307(a)(1)*].

3. Prepare notice of meeting [*see Corp. Code § 307(a)(2)*; *§§ 5.111(6), 5.201*], or the waiver of notice to

be signed by each director [*see Corp. Code § 307(a)(3)*; *§ 5.210*].

4. Draft documents that need approval at meeting, such as bylaws, indemnity agreements, confidentiality agreements, subscription agreements.

5. Draft resolutions to be adopted at first meeting or by unanimous written consent [*see § 5.222[2]*; *see also §§ 5.240 et seq.*], including, as appropriate, resolutions that:

NOTE:
The only resolutions ordinarily adopted at the first meeting of the directors are formal organizational resolutions, as to which there are generally no disputes, and the gist of which have already been decided by the incorporators.

a. Ratify actions taken by incorporator or incorporators.

b. Ratify articles of incorporation.

c. Approve any preincorporation contracts entered into on behalf of corporation.

d. Direct corporation to maintain minute book.

e. Adopt corporate seal.

f. Adopt bylaws of corporation [*see* Ch. 4, *Bylaws*].

g. Name corporation's agent for service of process.

h. Designate location of corporation's principal executive office [*see Corp. Code § 1502(a)*].

i. Adopt form of corporation's share certificate.

j. Adopt corporation's fiscal year.

k. Select officers of corporation, and fix their compensation.

l. Fix directors' compensation.

m. Fix number of shares, price per share, and (if known) persons or entities to whom shares will be sold.

n. Authorize all actions necessary for corporation to issue and sell shares, in accordance with applicable laws, including (if applicable):

NOTE:
The actions required to comply with the California securities laws will depend on whether or not the securities will have to be qualified for sale in California or, if not, on the specific exemption from qualification that the corporation will rely on in issuing the securities. Similar issues frequently exist under federal laws and, if an offering will be

made in more than one state, compliance with the blue sky laws of the other states involved will also be required. For an overview of the regulatory issues relating to offerings of securities, see Ch. 6, ***Securities Regulation Issues*** . For detailed coverage of the requirements under some of the more commonly used exemptions from California qualification, see Ch. 6B, ***California Limited Offering Exemption*** , Ch. 6C, ***California Small Offering Exemption*** , and Ch. 6C, ***California Qualified Purchaser Exemptions*** . For coverage of the California qualification process, see Ch. 6H, ***Qualification of Securities*** . Federal securities exemptions are covered in Ch. 6A, ***Federal Securities Exemptions for California Nonpublic Corporations*** .

(1) Filing appropriate notice under *Corp. Code § 25102(f)* or *25102(h)* with Commissioner of Corporations, or obtaining qualification of offer and sale of shares from California Commissioner of Corporations; and

(2) Completing all acts necessary under federal securities laws and applicable securities laws of any other state.

o. Approve form and authorize execution of indemnity agreements.

p. Approve form and authorize execution of confidentiality agreements.

q. Authorize sale of shares in accordance with *I.R.C. § 1244*.

r. Elect Subchapter S status, if appropriate.

s. Authorize and direct officers to qualify corporation to do business in other states.

t. Authorize and direct officers to obtain federal and state employee identification numbers.

u. Authorize and direct corporate secretary to file Statement by Domestic Stock Corporation (annual informational statement) with the California Secretary of State [*see Corp. Code § 1502(a)*].

v. Authorize and direct corporate secretary (or appropriate officer) to obtain licenses, authorizations, and permits for the corporation's business.

w. Select bank for corporation's checking and savings accounts and depositary for corporation's employment taxes trust funds.

x. Designate corporate officers authorized to endorse checks, drafts, or other evidences of indebtedness made payable to corporation.

y. Designate required signatories for checks, drafts, and other instruments obligating corporation to pay money.

z. Adopt standard form of corporate resolution required by bank for opening corporate accounts.

aa. Designate required signatories for contracts, agreement, and documents other than check, drafts, and other evidences of indebtedness [*see* P z, *above*].

bb. Direct chief financial officer to pay corporation's expenses of incorporation and organization.

cc. Appoint corporation's legal counsel.

dd. Appoint corporation's accountant.

ee. Grant general authority to officers to undertake acts to carry out the resolutions adopted.

6. Determine any other matters that should be dealt with at first directors meeting.

7. Obtain from legal stationer:

a. Minute book.

NOTE:
The minute book is essentially a binder into which the minutes, calls, notices, and waivers of notice of directors', shareholders', and board committee meetings are put [***see*** *Corp. Code §§ 307(a)(3), 601(e), 1500*].

b. Share certificates to be adopted by directors at first meeting.

8. Obtain from bank where corporation will maintain its account:

a. Copies of form resolution, which bank requires directors to adopt, authorizing corporation to maintain its account at that bank.

b. Appropriate signature cards for corporate secretary to certify.

9. If actions required to be taken at first meeting will be taken by unanimous written consent:

a. Prepare written consent or consents [*see § 5.222*].

b. Have each director sign either collective form or individual form of consent.

c. Deliver signed consent or consents to corporate secretary to file with minutes of board proceedings [*see Corp. Code § 307(b)*].

10. If directors will participate through use of electronic video screen communication or electronic transmission by and to corporation, advise corporation to adopt and implement procedures to [*Corp. Code § 307(a)(6)*; *see § 5.32*]:

NOTE:
At the meeting, each director participating through use of communications equipment other than a conference telephone must be able to communicate with all other directors concurrently. Further, each director must be able to participate in all matters before the board, including the ability to propose or object to a specific corporate action [*Corp. Code § 307(a)(6)*].

a. Verify identity of director or other person entitled to participate in meeting.

b. Ensure that all board actions or votes are taken or cast *only* by directors.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Directors' First Meeting

2-5 California Legal Forms--Transaction Guide § 5.121

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.121 Procedure at First Meeting

1. Distribute meeting's agenda to each director [*see § 5.232*].

2. Confirm that quorum is present.

NOTE:

Unless otherwise provided in the articles of incorporation [***see*** *Corp. Code § 204(a)(5)*], a quorum is a majority of the authorized number of directors [*Corp. Code § 307(a)(7)*]. The articles or bylaws may provide that less than a majority of directors constitutes a quorum. However, a quorum may not be less than one third of the authorized number of directors or two directors, whichever is larger (except for corporations with one director, in which case one director constitutes a quorum) [*Corp. Code § 307(a)(7)*; ***see*** *Corp. Code § 212(b)(4)* (bylaw provisions)]. Furthermore, neither the articles nor the bylaws may provide that a vote of less than a majority of the directors present at a meeting is a valid action of the board [*Corp. Code § 307(a)(8)*]. The articles, or a statutory close corporation shareholders' agreement, may require a quorum greater than a majority of the authorized number of directors [*Corp. Code §§ 204(a)(5), 300(b), (c)*]. For further discussion of computing a quorum, see *§ 5.32[6][c]*.

3. Call meeting to order.

4. Select director to act as temporary chair and another to act as temporary secretary.

5. Deliver minute book to temporary secretary and have secretary take minutes of meeting [*see Corp. Code § 1500*; *see also §§ 5.222[2], 5.230*].

6. Confirm that meeting is being held pursuant to:

a. Notice [*see Corp. Code § 307(a)(2)*];

b. Waiver of notice [*see Corp. Code § 307(a)(3)*]; or

c. Presence at meeting without protesting lack of notice [*see Corp. Code § 307(a)(3)*].

7. Confirm that articles of incorporation have been filed with Secretary of State.

NOTE:
Corporate existence begins with the filing of the articles of incorporation [***see*** *Corp. Code § 200(c)*; ***see also*** *Corp. Code § 169* ("filed" defined)].

8. Direct that copy of articles, certified by Secretary of State, be filed in minute book or corporate records.

NOTE:
Although there is no statutory requirement that the articles be filed in the minute book, it is customary to do so.

9. Confirm that agent for service of process designated in articles [*see Corp. Code § 202(c)*] has consented to serve.

10. If agent is corporation, confirm that it has filed required certificate with Secretary of State [*see Corp. Code § 1505*].

11. Ratify actions of incorporator or incorporators.

12. Adopt proposed bylaws [*see Corp. Code §§ 207(b), 211*] as presented or amended at meeting [*see § 5.120*, P 5f].

13. Direct that copy of bylaws, certified by corporate secretary, be kept at corporation's principal executive office in California, and another copy, similarly certified, be filed in minute book.

NOTE:
Although a copy of the bylaws as amended to date must be kept at the corporation's principal executive office in California [***see*** *Corp. Code § 213*], there is no statutory requirement that the copy be certified by the secretary or that a copy be filed in the minute book. It is customary, however, to do so. A copy of the bylaws certified by the corporate secretary or an assistant secretary is prima facie evidence of the adoption of the bylaws and of the matters stated in them [*Corp. Code § 314*].

14. Elect additional directors if number of initial directors is less than number fixed in the bylaws [*see Corp. Code § 305*].

NOTE:
The adoption of bylaws fixing a greater number of directors than the number initially named may destroy a quorum at the first meeting. In that case, the additional directors to be elected should be present at the meeting in order to assume office immediately on their

election to assure the continuation of a quorum [***see*** *Corp. Code § 307(a)(7), (8)*]. Alternatively, the adoption of the bylaws may be moved to the end of the agenda.

15. Fix directors' compensation.

16. Elect officers and fix officer compensation [*see Corp. Code § 312(a)*].

17. Turn meeting over to newly elected officers, if present.

18. Adopt resolution directing secretary or other officer to keep minute book.

19. Adopt resolution establishing street address of corporation's principal executive office, if not done in bylaws [*see Corp. Code § 1502(a)(4)*; *see also § 5.120*, P 5h].

20. Adopt seal [*see Corp. Code § 207(a)*], if not done in bylaws.

21. Adopt form of share certificate [*see § 5.120*, P 5i].

NOTE:

For a general discussion of the use of an electronic system of share issuance, recordation, and transfer in lieu of stock certificates, see Ch. 6I, ***Issuance of Equity Securities*** .

22. Ratify and adopt any preincorporation contracts [*see 5.120*, P 5c].

NOTE:

If an ongoing business is to be transferred to the corporation, a conveyance, contract of sale, or assignment is required [***see*** *Maron v. Howard (1968) 258 Cal. App. 2d 473, 485, 66 Cal. Rptr. 70* (incorporation of sole proprietorship); *Lance v. Forsberg (1951) 106 Cal. App. 2d 226, 230, 234 P.2d 662* (incorporation of partnership)]. Frequently, a formal written offer to transfer the business to the corporation for the consideration specified will be delivered to the board of directors which will adopt a resolution accepting the offer. If shares will be issued in exchange for the business, the resolution should state in monetary terms the value of the business to the corporation [***see*** *Corp. Code § 409(e)*] and authorize issuance of shares in exchange for the business [***see also*** *Com. Code § 6101 et seq.* (application of bulk transfer provisions)]. If liabilities will be assumed, appropriate resolutions should be adopted and notices given to creditors. The transfer of property in exchange for shares should be timed to occur when the shares are issued.

The tax consequences of the transfer of property to a corporation in exchange wholly or in part for shares are discussed in Rabkin & Johnson, *Federal Income, Gift, and Estate Taxation, Ch. 31,* ***Exchange for Securities****, § 31.03 et seq.* (Matthew Bender).

For discussion of the sale of an ongoing business, including discussion of the Bulk Sales Division of the Commercial Code [***see*** *Com. Code § 6101 et seq.*], see Ch. 17, ***Buying and Selling a Business or Professional Practice*** . For discussion of the sale of a business and liquor license, see Ch. 18 ***Buying and Selling a Retail Alcoholic Beverage License and Business*** . For discussion of the acquisition of assets for corporate shares, see Ch. 11E, ***Acquisition of Assets for Shares*** .

23. Fix consideration to be received for shares or other securities [*see Corp. Code § 409(a)(1)*; *see also*

§§ 5.120, P 5m, *5.248*].

24. Authorize issuance of shares or other securities and necessary proceedings before, or filings with, California Corporations Commissioner related to qualification or exemption from qualification [*see Corp. Code § 25100 et seq.*; *see also § 5.120*, P 5n; Ch. 6, *Securities Regulation Issues*].

25. Subject to compliance with the Corporate Securities Law, accept any preincorporation subscription agreements [*see § 5.120*, P 5m].

26. Authorize filings with Securities and Exchange Commission [*see* 17 C.F.R. §§ 230, *231*; *see also § 5.120*, P 5n].

27. Authorize compliance with securities laws of other states.

28. Approve form and authorize execution of indemnity agreements.

29. Approve form and authorize execution of confidentiality agreements.

30. Authorize sale of shares in accordance with *Internal Revenue Code § 1244*.

31. Elect Subchapter S status, if applicable.

32. Authorize and direct officers to qualify corporation to do business in other states.

NOTE:

Shares are not required under the General Corporation Law to have a par value. However, solely for the purpose of any statute or regulation imposing a tax or fee based on the capitalization of a corporation, all authorized shares of a corporation organized under the General Corporation Law are deemed to have a nominal or par value of $1 [*Corp. Code § 205*]. This provision was designed to apply when a California corporation seeks to qualify to do business in other jurisdictions imposing taxes or fees based on the capitalization of qualified foreign corporations [***see*** Report of Assembly Select Committee on the Revision of the Corporate Code, pp. 35, 36 (Dec. 1, 1975)]. For corporations subject to the "prior" corporations law in effect before 1977 [***see*** *Corp. Code § 2300*], the absence of any reference to par value in the articles is equivalent to a statement that the shares of stock have no par value [*Corp. Code § 2302.5*].

33. Authorize and direct officers to obtain federal and state employee identification numbers.

34. Authorize and direct corporate secretary to file Statement by Domestic Stock Corporation (annual informational statement) with the California Secretary of State [*see Corp. Code § 1502(a)*; *see also* Ch. 7 *Corporate Records and Reports* (form)].

NOTE:

Publicly traded corporations must file an additional disclosure statement [***see*** *Corp. Code § 1502.1*; ***see also*** Ch. 7, ***Corporate Records and Reports*** (form)].

35. Authorize preparation and filing of applications for any required business, professional licenses or registrations, or any local permits or licenses [*see § 5.120*, P 5w].

NOTE:

Many businesses must first obtain a license or permit from, or register with, one or more public entities, including state and local municipalities, in order to engage in business.

36. Approve payment of organizational and incorporation expenses [*see § 5.120*, P 5cc].

NOTE:

For rules governing reimbursement of actual and necessary expenses paid by a promoter in connection with the organization, see *10 Cal. Code Reg. § 260.140.33*. Promotional shares are covered in *10 Cal. Code Reg. § 260.140.30 et seq.* If any director has a material financial interest in the arrangements between the corporation and its promoters, the transaction must meet the disclosure and approval requirements specified in *Corp. Code § 310*.

For the rules governing treatment of organizational expenses for tax purposes, see *I.R.C. § 248(a)*; *Treasury Regulations § 1.248-1(a)* (expenses paid or incurred before Sept. 8, 2008); Treasury Regulations § 1.248-1T(a) (expenses paid or incurred on or after Sept. 8, 2008, and before July 7, 2011, when section is due to expire); *Rev. & Tax. Code § 24407*; and *18 Cal. Code Reg. §§ 24407-24409*. An "organizational expenditure" is defined (for tax purposes) as any expenditure that is (1) incident to the creation of the corporation; (2) chargeable to a capital account; and (3) of a character which, if expended incident to the creation of a corporation having a limited life, would be amortizable over that life [*I.R.C. § 248(b)*; *Treas. Reg. § 1.248-1(b)*; *Rev. & Tax. Code § 24408*]. An expenditure that does not meet each of these three tests may not be considered an organizational expenditure for purposes of *I.R.C. § 248* or *Rev. & Tax. Code § 24407*, and the regulations under these codes [*Treas. Reg. § 1.248-1(b)(1)*; 18 Cal. Code Reg. §§ 24407-24409].

37. Adopt corporation's fiscal year [*see § 5.120*, P 5j].

NOTE:

For factors to consider in selecting the fiscal year, see Ballantine & Sterling, California Corporation Laws, Ch. 3, ***Formation of Corporations*** (Matthew Bender).

38. Select bank for corporation's checking and savings accounts and depositary for corporation's employment taxes trust funds.

39. Designate corporate officers authorized to endorse checks, drafts, or other evidences of indebtedness made payable to corporation.

40. Designate required signatories for checks, drafts, and other instruments obligating corporation to pay money.

41. Adopt standard form of corporate resolution required by bank for opening corporate accounts.

42. Designate required signatories for contracts, agreement, and documents other than check, drafts, and other evidences of indebtedness.

43. Appoint corporation's legal counsel.

44. Appoint corporation's accountant.

45. Approve or consider other matters, if any, on agenda [*see, e.g., §§ 5.222[1][e]-[i]*, 5.242 et seq.].

46. Adjourn meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Directors' First Meeting

2-5 California Legal Forms--Transaction Guide § 5.122

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.122 Post-First Meeting Procedure

1. Ensure that copy of bylaws certified by corporate secretary is kept at corporation's principal executive office in California, and another copy, similarly certified, is filed in minute book [*see § 5.121*, P 12].

NOTE:
Additional copies may be required to be certified for filing with the Commissioner of Corporations, the Securities and Exchange Commission, or other parties with whom the corporation will transact business.

2. Have corporate secretary certify copies of resolutions adopted at the meeting relating to issuance of shares or other matters involving third parties, such as Commissioner of Corporations or banks.

3. Prepare (and file, as required) any documents or applications required to effectuate matters authorized in adopted resolutions.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Directors' First Meeting

2-5 California Legal Forms--Transaction Guide §§ 5.123-5.129

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 5.123[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Subsequent Directors Meetings
1. Pre-Meeting Procedure

2-5 California Legal Forms--Transaction Guide § 5.130

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.130 Call and Notice

1. If meeting is a special meeting, prepare call [*see § 5.200*].

NOTE:
Meetings of the board may be called by the chair of the board, the president, the corporate secretary, or any two directors [*Corp. Code § 307(a)(1)*].

2. If meeting is a regular meeting, prepare written notice of meeting, if time and place of meeting is not stated in bylaws or fixed by board, including [*see Corp. Code § 307(a)(2)*]:

a. Place of meeting [*see Corp. Code § 307(a)(5)*].

b. Date and time of meeting [*Corp. Code § 307(a)(2)*.

c. Matters that board, at time of mailing notice, intends to present for action by directors.

NOTE:
As a practical matter, although not required by statute [***see*** *Corp. Code § 307(a)(2)*], the meeting's agenda is often included in the meeting notice [***see, e.g.,*** *§ 5.232*].

3. If special meeting, prepare written notice of meeting, including [*see Corp. Code § 307(a)(2)*]:

a. Place of meeting [*see Corp. Code § 307(a)(5)*].

b. Date and time of meeting [*Corp. Code § 307(a)(2)*.

c. Matters that board, at time of mailing notice, intends to present for action by directors.

NOTE:

As a practical matter, although not required by statute [***see*** *Corp. Code § 307(a)(2)*], the meeting's agenda is often included in the meeting notice [***see, e.g.,*** *§ 5.232*].

Unlike regular meetings, which may be held without notice if the time and place are fixed by the bylaws or the board [*Corp. Code § 307(a)(2)*], notice of special board meetings may not be dispensed with by the articles or bylaws [*Corp. Code § 307(a)(2)*]. Special meetings may be held on four days notice by mail, or 48 hours notice delivered personally, by telephone, including a voice messaging system, or by electronic transmission by the corporation [*Corp. Code § 307(a)(2)*]. For further discussion, see *§ 5.32[5]*.

4. Ensure that written notice is given to each director [*see Code Civ. Proc. § 116.130* (mail defined); *Corp. Code § 118* (time notice is given)].

5. Prepare proof of giving notice [*see § 5.203*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Subsequent Directors Meetings
1. Pre-Meeting Procedure

2-5 California Legal Forms--Transaction Guide § 5.131

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.131 Waivers of Notice; Consents to Holding Meeting; Approval of Minutes; Minutes

1. If desired, prepare and send written waiver of notice, consent to holding of meeting, or approval of minutes to directors before meeting [*Corp. Code § 307(a)(3)*; *see § 5.210*].

2. Ensure that any waivers, consents, or approvals of the minutes are signed and filed with corporate records or minutes.

NOTE:

Notice of a meeting does not need to be given to any director who either before or after the meeting signs a waiver of notice or a consent to hold the meeting, an approval of the minutes of the meeting, or who attends the meeting without protesting the lack of notice before or at the commencement of the meeting [*Corp. Code § 307(a)(3)*]. Waivers, consent, and approvals of the minutes must be filed with the corporate records, or made a part of the minutes of the meeting [*Corp. Code § 307(a)(3)*]. The waiver does not need to specify the purpose of the meeting for which notice is waived [*Corp. Code § 307(a)(2)*].

Some practitioners recommend that small, closely held corporations make it a practice to have all the directors sign one of these forms even though call and notice of the meeting were regularly given, in the event of a possible irregularity.

3. If practical, prepare minutes of meeting in advance [*see* Ch. 7, *Corporate Records and Reports*].

NOTE:

In closely held corporations, minutes are frequently prepared in advance when unanimous

approval to proposed actions is anticipated.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawClosely Held CorporationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Subsequent Directors Meetings
1. Pre-Meeting Procedure

2-5 California Legal Forms--Transaction Guide §§ 5.132-5.139

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 5.132[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Subsequent Directors Meetings
2. Procedure at Meeting

2-5 California Legal Forms--Transaction Guide § 5.140

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.140 Holding Regular or Special Meetings

NOTE:
For a meeting agenda the presiding officer may use at the meeting see *§ 5.232*. The steps enumerated in the paragraphs below are those likely to be the responsibility of the corporation's attorney, who is not necessarily the presiding officer.

1. Determine whether a quorum is present [*see Corp. Code § 307(a)(7), (8)*].

NOTE:
For further discussion of the statutory requirements for a quorum, including how to compute a quorum and the actions permitted absent a quorum, see *§ 5.32[6]*.

2. If quorum is not present, have majority of directors present adjourn meeting [*Corp. Code § 307(a)(4)*; *see § 5.32[7]* for procedures applicable to adjourned meetings].

NOTE:
A majority of directors present at a meeting may adjourn the meeting to another time and place, whether or not there is a quorum [*Corp. Code § 307(a)(4)*]. However, unless the articles or bylaws require otherwise, business may continue to be transacted at a meeting at which a quorum was initially present even after enough directors leave to destroy the quorum, provided that any action taken is approved by a majority of the quorum required for the meeting [*Corp. Code § 307(a)(8)*].

3. Record and tabulate votes on specific proposals.

4. After business has been transacted, have presiding director adjourn meeting.

5. If meeting was irregularly called or noticed:

a. Send directors (if not done before meeting) written waiver of notice of meeting, consent to holding of meeting and approval of minutes of meeting [*Corp. Code § 307(a)(3)*; *see § 5.210*].

b. Ensure that any waivers, consents, or approvals are filed with corporate records, or made part of minutes of meeting [*Corp. Code § 307(a)(3)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Subsequent Directors Meetings
2. Procedure at Meeting

2-5 California Legal Forms--Transaction Guide § 5.141

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.141 Holding Adjourned Meetings

1. If notice of meeting is required [*Corp. Code § 307(a)(4)*; *see § 5.32[5]*], prepare and send notice of adjourned meeting [*see § 5.202*] to each director not present at time of adjournment.

2. Transact any appropriate business [*see § 5.10[1]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Subsequent Directors Meetings
2. Procedure at Meeting

2-5 California Legal Forms--Transaction Guide §§ 5.142-5.149

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 5.142[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Subsequent Directors Meetings
3. Post-Meeting Procedure

2-5 California Legal Forms--Transaction Guide § 5.150

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.150 Preparing Required Documents

1. Prepare (and file, as required) any documents or applications required to effectuate matters authorized in adopted resolutions.

2. Have corporate officer prepare, sign, and file minutes [*see* Ch. 7, *Corporate Records and Reports*].

NOTE:
A corporation is required to keep minutes of the proceeding of its board of directors and the committees of the board in written form or in another form capable of being converted into clearly legible tangible form [*Corp. Code § 1500*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Subsequent Directors Meetings
3. Post-Meeting Procedure

2-5 California Legal Forms--Transaction Guide § 5.151

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.151 Checklist for Minutes

NOTE:
This checklist may be used by the attorney or corporate official assigned to take the minutes as the basis for preparing the formal minutes of the meeting. For discussion of how much elaboration of the board's discussions is appropriate in recordings of board proceedings, see *§ 5.230[1][e]*.

1. Name of corporation.

2. Date and time of meeting.

3. Place of meeting.

4. Type of meeting (regular, special, or adjourned).

5. Whether notice was required, given, or waived [*see § 5.32[5]*].

6. Number of directors required for a quorum [*see 5.32[8]*].

7. Names of directors who are present.

8. Names of directors who are absent.

9. Names of other persons present.

10. Names of presiding director and person taking minutes.

11. Whether minutes of preceding meeting were approved.

12. Election of officers (after annual shareholders' meeting, or as required by resignation or removal).

NOTE:

A corporation must have a chair of the board or a president (or both), a corporate secretary, a chief financial officer, and other officers as necessary, to sign instruments and share certificates [*Corp. Code § 312(a)*].

Unless otherwise provided in the articles or bylaws, the president or the chair of the board (if there is no president) is the corporation's general manager and chief executive officer [*Corp. Code § 312(a)*].

Unless otherwise provided in the articles or bylaws, the same person may hold any number of offices [*Corp. Code § 312(a)*].

13. Other actions taken at meeting.

14. Other matters considered.

15. Time and place of next meeting, if customary or necessary.

16. Adjournment.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Subsequent Directors Meetings
3. Post-Meeting Procedure

2-5 California Legal Forms--Transaction Guide §§ 5.152-5.159

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 5.152[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
E. Procedural Guide to Action by Written Consent without Meeting

2-5 California Legal Forms--Transaction Guide § 5.160

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.160 Action by Written Consent Without Meeting

1. Prepare appropriate written consent form [*see, e.g., §§ 5.220-5.223*].

2. Send consent form to each director for signature.

3. Contact any director who fails to return consent form within specified time period.

4. Tabulate consents to determine whether [*see Corp. Code § 307(b)*; *see also § 5.33*]:

a. Proposed action received unanimous consent of all members of board; and

NOTE:
For purposes of unanimous board action without a meeting, the term "all members of the board" includes an "interested director" [*see* *Corp. Code § 310(a)*] or a "common director" [***see*** *Corp. Code § 310(b)*] who abstains in writing from providing consent, when (1) the disclosures required by *Corp. Code § 310* (generally requiring full disclosure of the material facts regarding the transaction and the director's interest) [***see*** *Ch. 4,* ***Bylaws****, § 4.200[2],* Section 2.23] have been made to the noninterested or noncommon directors, as applicable, before their execution of the written consent or consents; (2) the specified disclosures are conspicuously included in the written consent(s) executed by the noninterested or noncommon directors; and (3) the noninterested or noncommon directors, as applicable, approve the action by a vote that is sufficient without counting the votes of the interested or common directors [*Corp. Code § 307(b)*]. If the directors give written consent in accordance with this rule, but the disclosures made regarding the action that is the subject of the consent do not satisfy

statutory requirements [***see*** *Corp. Code § 310*], the action that is the subject of the consent nevertheless will be deemed approved. However, in any suit brought to challenge the action, the party asserting the validity of the action bears the burden of proof in establishing that the action was just and reasonable to the corporation at the time it was approved [*Corp. Code § 307(b)*].

b. Number of board members consenting to action constitutes a quorum.

5. Have corporate secretary file following as part of corporate records:

a. Written consents.

b. Copies of any notices sent to directors.

6. Furnish copies of consent to officers directed to take action.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART III. TRANSACTION GUIDE
E. Procedural Guide to Action by Written Consent without Meeting

2-5 California Legal Forms--Transaction Guide §§ 5.161-5.199

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 5.161[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
A. Calls and Notices

2-5 California Legal Forms--Transaction Guide § 5.200

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.200 Call of Directors Meeting

[1] Comment

[a] Use of Form

This form is to be used to call a regular or special meeting of the board of directors. For a notice of a regular or special meeting, see *§ 5.201*. If the call of meeting of a *committee* of the board of directors is desired, this form may be modified accordingly [*see Corp. Code § 307(c)*].

[b] Written Call Not Required

Although the statute does not require a written call of the meeting, it may be useful as a record that the meeting was properly called [*see* [d], *below*]. If a call is used, it should be filed with the notice of the minutes in the corporate minute book.

[c] Call and Notice Distinguished

A call orders a meeting held; a notice informs the directors of the meeting and the time and place it will be held [*see Bell v. Standard Quicksilver Co. (1905) 146 Cal. 699, 705, 81 P. 17]* . A call, therefore, should be signed and delivered [*see* [d], *below*] to the person, frequently the corporate secretary, who will give notice of the meeting.

[d] Persons Authorized to Call Meeting

Unless otherwise provided in the articles of incorporation or the bylaws, board meetings may be called by the chair of the board, the president, any vice president, the corporate secretary, or any two directors [*Corp. Code § 307(a)(1)*].

[2] Form

Call of Directors Meeting

_____ [*name of corporation*]
CALL OF [REGULAR *or* SPECIAL] MEETING OF
THE BOARD OF DIRECTORS

The undersigned, _____ [*name(s) of person(s) giving call*], as _____ [*capacity in which call is made, as provided by statute, or the articles or bylaws*] of _____ [*name of corporation*], hereby calls a _____ [regular *or* special] meeting of the board of directors of said corporation, to be held at _____[*address*], on _____[*date*], at _____[*time*].

[*Add, if desired:*]

The purpose of this meeting is to consider the following matters: _____ [*list topics*] and any other matters or business as may properly come before the board.

[*If notice is required, use:*]

The _____ [Corporate Secretary *or other officer whose responsibility it is to give notice*] is directed to give notice of this meeting as provided in _____ [the articles of incorporation *or* the bylaws *or* by statute].

[*Continue with the following:*]

Dated: _____

_____ [*signature*]

_____ [*printed name*]

_____ [*title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
A. Calls and Notices

2-5 California Legal Forms--Transaction Guide § 5.201

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.201 Notice of Directors Meeting

[1] Comment

[a] Use of Form

This form is to be used to give notice to the directors of a regular, special, or annual organizational meeting of the board. The original notice signed by the corporate secretary or other officer whose responsibility it is to give notice is ordinarily filed with the minutes of the meeting to which it relates.

PRACTICE TIP:
When sending notice of a meeting to the directors, include a copy of the minutes of the previous minutes so the directors may review them prior to the meeting at which they will need to be approved.
Commentary by Marilyn E. Minger

If a written call signed by an officer authorized to call a board meeting [*see Corp. Code § 307(a)(1)*; *§ 5.200[1][d]*] contains the information required in the notice [*see* [d], *below*], a copy of the call may be sent to each director instead of the notice [*see Bell v. Standard Quicksilver Co. (1905) 146 Cal. 699, 705, 81 P. 17]* . For a call form, see *§ 5.200*.

[b] When Notice is Required

Regular board meetings may be held without notice if the time and place are fixed by the bylaws or the board [*Corp. Code § 307(a)(2)*]. Notice of special board meetings, however, may not be dispensed with by the articles or bylaws [*Corp. Code § 307(a)(2)*]. Special meetings may be held on four days notice by mail, or 48 hours notice delivered personally, by telephone, including a voice messaging system, or by electronic transmission by the corporation [*Corp. Code § 307(a)(2)*]. For notice requirements applicable to adjourned meetings, see *§ 5.32[7]*.

[c] Waiver of Notice

Notice does not need to be given to any director who, before or after the meeting, signs a waiver of notice or a consent to hold the meeting, an approval of the minutes of the meeting, or who attends the meeting without protesting the lack of notice before or at the beginning of the meeting [*Corp. Code § 307(a)(3)*].

[d] Contents of Notice

The notice includes the date, time, and ordinarily, the place [*see* [e], *below*] of the meeting [*see Bell v. Standard Quicksilver Co. (1905) 146 Cal. 699, 705, 81 P. 17]* . Unless the articles or bylaws provide otherwise, however, the notice does not need to specify the purpose of either regular or special meetings of the board [*Corp. Code § 307(a)(2)*]. The optional provision in the form below, enumerating the matters to be brought before the board at the meeting, may be included if desired.

[e] Place of Meeting

Meetings may be held at any place in California or elsewhere that has been designated in the meeting's notice [*Corp. Code § 307(a)(5)*]. If the meeting place is not stated in the notice, or there is no notice, the meeting may be held at any place designated in the bylaws or by resolution of the board [*Corp. Code § 307(a)(5)*; *see Corp. Code § 212(b)(2)*].

[f] Proof of Notice

If notice is given, the minutes of the meeting usually recite that the meeting is being held pursuant to notice, given to each director in a correct and timely manner [*see, e.g., § 5.230[2]*]. Such a recital in the minutes is itself prima facie proof that the notice was properly given and may, on approval of the minutes at a subsequent meeting at which all the directors participated, become conclusive proof [*see Sferlazzo v. Oliphant (1914) 24 Cal. App. 81, 85, 140 P. 289]* . Other proof, however, may also be introduced to show that notice was properly given [*see Sferlazzo v. Oliphant (1914) 24 Cal. App. 81, 85, 140 P. 289]* .

[g] Rules Applicable to Committee Meetings

The notice requirements discussed in this section also apply to meetings of committees of the board and of incorporators [*Corp. Code § 307(c)*].

[2] Form

Notice of Directors Meeting
_____ [*name of corporation*]

NOTICE OF [REGULAR *or* SPECIAL *or*
ANNUAL ORGANIZATIONAL] MEETING OF
THE BOARD OF DIRECTORS

[*Choose one of the following paragraphs:*]

[*If the meeting is a regular or special meeting, use:*]

To the Directors of _____ [*name of corporation*], a California corporation:

Notice is hereby given that, a _____ [regular *or* special] meeting of the board of directors of _____ [*name of corporation*], will be held at _____[*address*], on _____[*date*], at _____[*time*].

[*OR*]

[*If the meeting is the annual organizational meeting, use:*]

To the Directors of _____ [*name of corporation*], a California corporation:

Notice is hereby given that, immediately following the annual shareholders' meeting, which will be held at _____[*address*], on _____[*date*], at _____[*time*], there will be a meeting of the board of directors at _____[*address*], [*add, if applicable:* as required by the bylaws of the corporation].

[*Continue with the following:*]

[*If the meeting is a special meeting, add:*]

This meeting has been called by _____ [*specify title of person authorized to call meeting*].

[*Add, if desired:*]

The purpose of this meeting is to consider the following matters: _____ [*list topics*] and any other matters or business as may properly come before the board.

[*Continue with the following:*]

Dated: _____

_____ [*signature*]

_____ [*printed name*]

_____ [*title, e.g.,* Corporate Secretary]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
A. Calls and Notices

2-5 California Legal Forms--Transaction Guide § 5.202

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.202 Notice of Adjourned Directors Meeting

[1] Comment

[a] Use of Form

This form is to be used to give notice to the directors of an adjourned meeting of the board. Alternate provisions are provided for use if the adjournment resulted from the lack of a quorum, or if the adjournment was for any other reason. For a notice of a regular or special meeting, see *§ 5.201*. For discussion of the contents of the notice, the place of meeting, waiver of notice, proof of notice, and applicability of these rules to meetings of committees of the board, see *§ 5.201[c]-[g]*. For discussion of the requirements and effect of a quorum, and how to compute a quorum, see *§ 5.32[6]*. For further discussion of adjournment, see *§ 5.32[7]*.

[b] When Notice is Required

If the meeting is adjourned for more than 24 hours, notice of adjournment to another time and place must be given before the time of the adjourned meeting to the directors who were not present when the original meeting was adjourned [*Corp. Code § 307(a)(4)*].

[2] Form

Notice of Adjourned Directors Meeting
_____ [*name of corporation*]
NOTICE OF ADJOURNED MEETING OF
THE BOARD OF DIRECTORS

[*Choose one of the following paragraphs:*]

[*If meeting is adjourned for lack of a quorum, use:*]

To the Directors of _____ [*name of corporation*], a California corporation:

Notice is hereby given that, the _____ [regular *or* special] meeting of the board of directors of _____ [*name of corporation*], which was to be held at _____[*address*], on _____[*date*], at _____[*time*], was adjourned for lack of a quorum. Another [regular *or* special] meeting of the board of directors will be held at _____[*address*], on _____[*date*], at _____[*time*]. _____ [*number of directors necessary for a quorum*] or more directors will constitute a quorum for the transaction of business at the meeting.

[*OR*]

[*If meeting is adjourned for any reason other than lack of a quorum, use:*]

To the Directors of _____ [*name of corporation*], a California corporation:

Notice is hereby given that, the _____ [regular *or* special] meeting of the board of directors of _____ [*name of corporation*], scheduled for _____[*date*], at _____[*time*], was adjourned and will be reconvened at _____[*address*], on _____[*date*], at _____[*time*].

[*Add, if desired:*]

The purpose of this meeting is to consider the following matters: _____ [*list topics*] and any other matters or business as may properly come before the board.

[*Continue with the following:*]

_____Dated:

_____ [*signature*]

_____ [*printed name*]

_____ [*title, e.g.,* Corporate Secretary]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



142 of 166 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
A. Calls and Notices

2-5 California Legal Forms--Transaction Guide § 5.203

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.203 Declaration of Giving Notice of Directors Meeting

[1] Comment--Use of Form

This form is to be used by the corporate officer (often the Corporate Secretary) whose responsibility it is to give notice of the meeting, to prove that notice of the meeting was given [*see Code Civ. Proc. § 2009* (affidavit may be used to prove notice); *Code Civ. Proc. § 2015.5* (declaration under penalty of perjury may be used in lieu of affidavit)]. Although the statute does not require a written declaration of giving notice, it is sometimes useful to provide a record. If used, this form should be filed with the notice and the minutes of the meeting.

For discussion and a form for notice, see *§§ 5.201, 5.202*.

[2] FORM

Declaration of Giving Notice of Directors Meeting

DECLARATION OF GIVING NOTICE OF
MEETING OF
THE BOARD OF DIRECTORS OF
_____ [*name of corporation*]

I, *name of undersigned*, declare as follows:

1. I am the duly elected and acting _____ [*title, e.g.,* Secretary] of _____ [*name of corporation*], a California corporation.

2. On _____[*date*], I gave notice by [*manner in which notice was given, e.g.,*, mail or facsimile or hand delivery] of a _____ [regular *or* special *or* adjourned] meeting of the board of directors, to be held at _____[*address*], on _____[*date*], at

_____[*time*].

3. [*Choose one of the following paragraphs and attach the appropriate list of directors to the declaration:*]

[*If notice of a regular or special meeting was given, use:*]

Notice was given to each of the directors of the corporation, as enumerated on the attached list.

[*OR*]

[*If notice of an adjourned meeting was given only to those directors who were not present when the original meeting was adjourned, use:*]

Notice was given to those directors who were not present when the original meeting was adjourned, as enumerated on the attached list.

[*Continue with the following:*]

4. I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed on _____[*date*], at _____ [*city, state*].

_____ [*signature*]

_____ [*printed name*]

_____ [*title, e.g.,* Corporate Secretary]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
A. Calls and Notices

2-5 California Legal Forms--Transaction Guide §§ 5.204-5.209

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 5.204[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
B. Waiver of Notice, Consent to Hold Meeting, Approval of Minutes

2-5 California Legal Forms--Transaction Guide § 5.210

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.210 Waiver of Notice, Consent to Holding of Directors Meeting, and Approval of Minutes

[1] Comment

[a] Use of Form

This form is for use by directors to waive notice and consent to the holding of a board meeting and to approve the minutes of that meeting. *Corp. Code § 307(a)(3)* provides that notice need not be given to a director who signs a waiver, a consent to holding the meeting, or an approval of the minutes of the meeting. The usual practice is to use a form in which the director or directors do all three things: waive, consent, and approve. If there is a reason for the director not to concurrently waive, consent and approve, the form may be modified accordingly.

Individual waivers may be signed, or a single waiver may be signed collectively or in counterparts. This form may be signed either before or after the meeting [*see* [b], *below*], and must be filed with the corporate records or made a part of the minutes of the meeting [*see* [b], *below*].

This form may be modified for similar use with respect to meetings of committees of the board.

The optional paragraph in this form must be included if the corporation's articles of incorporation or bylaws require that any waiver of notice or consent to the holding of a meeting specify the business to be transacted and/or the purpose of any regular or special meeting [*see Corp. Code § 307(a)*].

In practice, small or medium-sized corporations often dispense with formal written notice to the directors and call meetings by informal notice, using a waiver of notice and consent signed by any director not present and filed with the corporate records [*see Corp. Code § 307(a)(3)*; [b], *below*]. Some practitioners recommend that small, closely held corporations require their directors to sign this type of form even if call and notice of the meeting were regularly given, as a protection against any possible irregularity in the call or notice.

If any director refuses or is unable to sign a waiver of notice and consent, or attend a meeting, the meeting may be held after providing statutory call and notice. For discussion of and forms for call and notice, see *§§ 5.200* and *5.201-5.202*, respectively.

[b] Effect of Waiver, Consent, and Approval; Statutory Requirements

Notice of a meeting does not need to be given to any director who, either before or after the meeting, signs a waiver of notice, a consent to hold the meeting, an approval of the minutes of the meeting, or who attends the meeting without protesting the lack of notice before or at the beginning of the meeting [*Corp. Code § 307(a)(3)*]. Waivers, consents, and approvals of the minutes must be filed with the corporate records or made a part of the minutes of the meeting [*Corp. Code § 307(a)(3)*].

Unless the articles or bylaws provide otherwise, the waiver, consent and approval does not need to specify the purpose of the meeting for which notice is waived [*Corp. Code § 307(a)(2)*].

[2] FORM

Waiver of Notice, Consent to Holding of Directors Meeting, and Approval of Minutes

WAIVER OF NOTICE,
CONSENT TO THE HOLDING OF MEETING,
AND APPROVAL OF MINUTES OF MEETING OF
THE BOARD OF DIRECTORS OF
_____ [*name of corporation*]

The undersigned director[s] of _____ [*name of corporation*], a California corporation, hereby waive[s] notice and consent[s] to the holding of the _____ [regular *or* special] meeting of the Board of Directors at _____[*address*], on _____[*date*], at _____[*time*], and hereby acknowledge[s] receipt of a copy of the minutes of the meeting, a copy of which minutes are attached hereto, and approve[s] those minutes.

The undersigned director[s] agree[s] that any business transacted at this meeting _____ [will be *or* was] as valid as if transacted at a meeting regularly called and noticed.

[*If the articles or bylaws require that any consent to holding a directors meeting specify the business to be transacted and/or the purpose of any regular or special meeting, use:*]

The following proposal[s] will be considered [*or* _____ (was *or* were) approved] at this meeting:

[*Repeat, as required:*]

_____. _____ [*specify general nature/purpose of proposal*].

[*Continue with the following:*]

Dated: _____

[*Repeat, as required:*]

_____ [*signature*]

_____ [*printed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
B. Waiver of Notice, Consent to Hold Meeting, Approval of Minutes

2-5 California Legal Forms--Transaction Guide §§ 5.211-5.219

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 5.211[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
C. Directors' Action by Written Consent

2-5 California Legal Forms--Transaction Guide § 5.220

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.220 Letter to Director Regarding Directors' Written Consent to Action without Meeting

[1] Comment--Use of Form

This form is a letter to the directors to be used to explain the request for the directors' written consent to a proposed action that requires the consent of the directors [*see § 5.10[1]*]. For discussion of and a form for directors' action by written consent, see *§§ 5.33* and *5.221-5.223*.

[2] Form

Letter to Director Regarding Directors' Written Consent to Action without Meeting

LETTER SOLICITING DIRECTORS' WRITTEN CONSENT

_____[*date*]
_____[*director's name*]
_____[*address*]

Re: Unanimous Written Consent of Directors of _____ [*name of corporation*], a California corporation, to Action without Meeting

Dear Director:

I hope you will take the time to read the important information attached, which requests your written consent to _____ [*proposed action(s)*]. I believe that _____ [this action is *or* these actions are]

in the best interests of _____ [*name of corporation*] for the following reason[s]:
_____ [*specify reason(s)*].

The California Corporations Code requires that all members of the board of directors approve an action by written consent. If you consent, please sign and date the enclosed form and return it **BY** _____[*date*]. An addressed envelope, with postage pre-paid, is enclosed for your convenience.

Please call me if you have any questions about this matter. I look forward to receiving your consent.

Sincerely,
_____ [*signature*]
_____ [*printed name*]
_____ [*title, e.g.,* Chair of the Board]

encl.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
C. Directors' Action by Written Consent

2-5 California Legal Forms--Transaction Guide § 5.221

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.221 Action by Unanimous Written Consent of Directors

[1] Comment

[a] Use of Form

This form is a unanimous written consent to be used by the directors to approve a corporate action without a meeting. In practice, nonpublic corporations often act without a meeting, using a written consent. Individual consents may be signed, or a single consent may be signed collectively or in counterparts [*see* [2], *below*]. The wording of a resolution to be approved by the directors in an action by written consent is usually in the same form as it would appear in the minutes of a board meeting, had one been held. For discussion of the various formats for resolutions, see *§ 5.240*. This form and *§§ 5.222* and *5.223* illustrate different format options. For sample resolutions covering common corporate actions, see *§§ 5.222* and *5.242* et seq. For a letter soliciting the directors' consent in writing, see *§ 5.220*.

This form may be modified for use to approve actions of a board committee by written consent.

[b] Effect; Statutory Requirements

The directors may act by written consent without a meeting. However, an action by written consent without a meeting requires the consent of all of the members of board and, in addition, the number of board members consenting to action must be sufficient to constitute a quorum [*Corp. Code § 307(b)*; *see Corp. Code § 194* (vote includes authorization by written consent)].

For purposes of unanimous board action without a meeting, the term "all members of the board" includes an "interested director" [*see Corp. Code § 310(a)*] or a "common director" [*see Corp. Code § 310(b)*] who abstains in writing from providing consent, when [*Corp. Code § 307(b)*]:

- The disclosures required by *Corp. Code § 310* (generally requiring full disclosure of the material

facts regarding the transaction and the director's interest) [*see Ch. 4, Bylaws, § 4.200[2]*, Section 2.23] have been made to the noninterested or noncommon directors, as applicable, before their execution of the written consent or consents;

- The specified disclosures are conspicuously included in the written consent or consents executed by the noninterested or noncommon directors; and

- The noninterested or noncommon directors, as applicable, approve the action by a vote that is sufficient without counting the votes of the interested or common directors.

If the directors give written consent in accordance with the preceding rule, but the disclosures made regarding the action that is the subject of the consent do not satisfy statutory requirements [*see Corp. Code § 310*], the action that is the subject of the consent will be deemed approved. However, in any suit brought to challenge the action, the party asserting the validity of the action has the burden of proof in establishing that the action was just and reasonable to the corporation at the time it was approved [*Corp. Code § 307(b)*].

The consent may be in the form of individual consents or one collective consent, which collective consent may be executed in counterparts [*see Corp. Code § 307(b)*]. A "written" consent includes signatures collected by facsimile or by telegraphic communication [*see Corp. Code § 195*]. The consents must be filed with the minutes of the board's proceedings [*Corp. Code § 307(b)*].

[2] Form

Action by Unanimous Written Consent of Directors

ACTION BY UNANIMOUS WRITTEN CONSENT OF DIRECTORS OF
_____[*name of corporation*]

The undersigned, constituting all of the Directors of _____[*name of corporation*], a California corporation, acting under the authority of *California Corporations Code Section 307(b)* and the bylaws of this corporation, hereby consent to the following action[s] by the board of directors:

[*Repeat, as required:*]

_____. _____ [*descriptive title and text of resolution for corporate action, e.g.*, Declaration and Payment of Dividend. A dividend of $1.00 is declared on each common share of the corporation, to be paid on January 25, 1995, to shareholders of record on December 21, 1994; and the Chief Financial Officer is directed to arrange for the payment of this dividend and to charge the full amount to the corporation's earned surplus account].

[*Continue with the following:*]

[*Repeat, as required:*]

Dated: _____

_____ [*signature*]

[*printed name*],

Director

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
C. Directors' Action by Written Consent

2-5 California Legal Forms--Transaction Guide § 5.222

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.222 First Actions of Directors by Unanimous Written Consent

[1] Comment

[a] Use of Form

This form is for use when a directors' first meeting will be by unanimous written consent, signed collectively by each of the directors [*see Corp. Code § 307(b)*]. For discussion of the effect of, and statutory requirements for, an action by written consent without a meeting, see *§ 5.221*. For a letter explaining the chair of the board's request for the directors' written consent to a proposed action, see *§ 5.220*.

There is no statutory distinction between a first meeting of directors and any other directors meeting, whether the actions are taken by written consent without a meeting or at a meeting. The first meeting is distinguished in practice, however, by the type of actions taken and resolutions passed. Actions commonly taken include adopting the corporation's bylaws, electing corporate officers, and delegating particular duties such as the duty to apply to the California Commissioner of Corporations for a permit to issue stock, or for an exemption from qualification, and to issue the stock when the permit is obtained from or the notice filed with the Commissioner [*see* [c], *below*]. With minor modifications, this form may also be used when the actions taken by this written consent are taken instead at a first meeting of directors. For a form of minutes of a regular directors meeting, see *§§ 5.230-5.231*.

The wording of a resolution to be approved by the directors in an action by written consent is usually in the same form as it would appear in the minutes of a board meeting, had one been held. For discussion of the various formats for resolutions, see *§ 5.240*. This form and *§§ 5.221* and *5.223* illustrate different format options. For sample resolutions covering other common corporate actions, see *§ 5.242* et seq.

For a preincorporation planning checklist, see Ch. 2, *Formation of Corporations* . For a checklist of other matters to be considered for approval at the first meeting of the board of directors, see Ballantine & Sterling, California Corporation Laws, Ch. 3, *Formation of Corporations*, § 54.02 (Matthew Bender). Optional provisions in the form below include the

qualification of the corporation's common stock for treatment under *I.R.C. § 1244* [*see* [e], *below*], the election of subchapter S status [*see* [f], *below*], the adoption of an indemnity agreement [*see* [g], *below*], the adoption of a confidentiality agreement [*see* [h], *below*], and qualification to do business in another state or country [*see* [i], *below*]. Caution should be exercised to ensure that this form is modified as needed to reflect the specific facts and requirements of the corporation for which counsel is drafting the consent.

[b] When First Actions of Directors Should Be Taken

The actions at the first meeting of the board of directors, whether by written consent or at a meeting, should be taken immediately after the corporation's articles have been filed and a decision regarding the issuance of shares, including consideration for those shares, has been reached. Because the corporation may not have bylaws until they are adopted at the first meeting, the corporation has neither the power to file an application for a permit to issue shares, nor are the officers able to sign the application, until these actions are authorized by the directors at the first meeting.

[c] Offer and Sale of Corporate Shares

All corporations are prohibited from offering or selling securities in California unless the offer or sale has been qualified or the security or transaction is exempt from qualification [*see Corp. Code § 25110*; *see also 15 U.S.C. §§ 77c(a), 78c(a)(10)* (requiring registration of securities under federal law unless exemptions from registration exist)].

A corporation with 35 or fewer shareholders may be exempt from qualification based on the small offering exemption [*see Corp. Code § 25102(h)*; *see also* Ch. 6C, *California Small Offering Exemption*] or the limited offering exemption [*see Corp. Code § 25102(f)*; *see also* Ch. 6B, *California Limited Offering Exemptions*]. Special attention should be paid to the requirements of these exemption to ensure that the offering meets the specific requirements of the exemption selected. In most cases the criteria for the small offering exemption are stricter than their limited offering counterparts. For example, a corporation utilizing the small offering exemption must issue only one class of voting common stock [*Corp. Code § 25102(h)*; *see Ch. 6C, California Small Offering Exemption, § 6C.22*], while the limited offering exemption potentially applies to almost any offer or sale of any security [*Corp. Code § 25102(f)*]. Furthermore, the small offering exemption requires that after the proposed sale and issuance the corporation must have a total of no more than 35 shareholders [*Corp. Code § 25102(h)*; *see Ch. 6C, California Small Offering Exemption, § 6C.23*], whereas the limited offering exemption permits more than 35 shareholders of the corporation as a whole, provided that the transaction in question results in sales to no more than 35 persons, plus any purchasers that may be excluded from the 35 purchaser count [*Corp. Code § 25102(f)*]. For a more detailed comparison of the requirements of the small and limited offering exemptions, see *Ch. 6B, California Small Offering Exemption, § 6C.20[2]*.

The provisions in this form authorize actions to be taken either in the (unusual) event that a close or closely held corporation is ineligible for either the small offering or the limited offering exemption and must qualify its securities, or when an exemption from qualification applies. For other resolutions related to the issuance of securities, see Ch. 6I, *Issuance of Equity Securities* and Ballantine & Sterling, California Corporation Laws, *Appendix*, Forms 9.17 et seq. (Matthew Bender).

[d] Use of Share Certificates

This form assumes that the corporation has elected to issue stock certificates, rather than to use an electronic system to issue, record, and transfer shares. The corporation, however, may adopt any other system that has been approved by the Securities and Exchange Commission, is authorized in any United States statute, or is in accordance with Division 8 [Com. Code *§ 8101 et seq. of the California Commercial Code* [*see Corp. Code § 416(b)*]. If another system is adopted, this form should be modified accordingly. For discussion of uncertificated securities, see *Ch. 6I, Issuance of Equity Securities, § 6I.20[2]*.

If share certificates are issued, each shareholder is entitled to have a certificate signed in the name of the corporation by the chair, the vice chair of the board, the president, or any vice president and by the chief financial officer, assistant treasurer, secretary, or any assistant secretary, certifying the number of shares and the class or series of shares owned by the shareholder [*Corp. Code § 416(a)*]. Signatures may be facsimile [*Corp. Code § 416(a)*]. Additional statements are required on the certificates if the shares are classified or if any class of shares has more than one series [*see Corp. Code § 417*], or if the shares are subject to a voting agreement, irrevocable proxy, restriction on transfer, or are assessable, not fully paid, redeemable, or convertible [*Corp. Code § 418*; *see* Ch. 8B, *Voting Agreements and Voting Trusts*].

If the corporation issues uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)* (uncertificated security defined)], the statements normally required to appear on share certificates must appear on the initial transaction statement and written statements instead [*Corp. Code §§ 417, 418*].

[e] Qualification as Small Business (I.R.C. § 1244) Stock

Individual shareholders of qualifying "small business corporations" may claim, within limits, an ordinary loss, rather than a capital loss, on the sale or worthlessness of Section 1244 stock [*see I.R.C. § 1244*; *see also I.R.C. §§ 1244(c)(3)* (small business corporation defined), *(d)(4)* (individual defined)].

A domestic corporation and its stock must meet the following requirements to qualify as Section 1244 stock [*I.R.C. § 1244(c)*]:

- The corporation's equity may not exceed $1,000,000 at the time the stock is issued, including amounts received for the stock to be issued;

- The stock must be issued for money and property (other than stock and securities); and

- The corporation, for the five years preceding the shareholder's loss, must generally have derived more than half its gross receipts from business operations and not from passive income, such as rents, royalties, dividends, interest, annuities, or gains from the sales or exchanges of stock or securities. This five year requirement is waived if the corporation's deduction, other than for dividends received or net operating losses, exceed gross income. If the corporation has not been in existence for five years before the loss, then generally the period for which the corporation has been in existence is examined for the gross receipts requirement.

A sale or exchange of Section 1244 stock is not necessary to obtain an ordinary loss. If the stock becomes worthless, a loss is deemed to occur [*Treas. Reg. § 1.1244(a)-1(a)*]. An ordinary loss up to $50,000 (or $100,000 on a joint tax return) may be claimed in a single taxable year [*I.R.C. § 1244(b)*; *cf. I.R.C. § 1211(b)* (deductions limited to capital losses, which are deductible only against capital gains plus $3,000)]. Losses in excess of these limits are deductible as capital losses; gains on Section 1244 stock are reported as capital gains [*see I.R.C. §§ 1001, 1244(a)*]. An ordinary loss may be claimed only by the original owner of the stock [*see I.R.C. § 1244(a)*].

An ordinary loss deduction for Section 1244 stock may be denied if Internal Revenue Service reporting or recordkeeping requirements are not met [*see Treas. Reg. § 1.1244(e)-1*; *see also I.R.C. 6001*]. For example, in *Carroll Cutler* [Carroll Cutler, (1994) R.I.A. T.C. Memo. P 94090], the Tax Court barred a shareholder from claiming a Section 1244 loss on shares he held in a bankrupt company because the shareholder failed to attach to his income tax return a statement that showed the company's address, the way the stock was acquired, and the amount paid for the stock [Carroll Cutler, (1994) R.I.A. T. C. Memo. P 94090, 94-411; *see also Martin J. Cournan (1989) T.C. Memo. 1989-520, P.H. TCM P 89520* (section 1244 loss denied for failure to file statement required by regulation)].

[f] Qualification and Taxation as S Corporation

A small business corporation may elect to be an S corporation [*I.R.C. § 1362(a)*] if it meets the applicable requirements. Unlike a C corporation, which is a separate tax-paying entity [*see I.R.C. § 11*], an S corporation generally is treated as a conduit of income, loss, deductions, and credits to the shareholders [*see I.R.C. §§ 1363, 1366*]. For a detailed discussion of the Subchapter S eligibility requirements, the taxation of S corporations, and the advisability of electing to be an S corporation, see Chs. 2B, *Electing Subchapter S Status* and 1B, *Selecting Form of Business Entity* .

[g] Indemnity Agreement

In addition to inserting a provision in the articles of incorporation eliminating or limiting a director's liability for acts or omissions taken in his or her capacity as a director [*see § 5.12*], a corporation may enter into an indemnity agreement with its directors that spells out the parameters of the director's personal liability.

PRACTICE TIP:

Indemnity agreements may be used to encourage reluctant individuals to take on the responsibilities of being a corporate director. Provisions providing that the corporation will advance costs to the director to defend a suit if the director is sued in his or her capacity as a director should be included. *Commentary by Marilyn E. Minger*

[h] Confidentiality Agreement

Depending on the nature of the business of the corporation, the directors my determine that the directors and the officers, as a condition of employment, should enter into confidentiality agreements with the corporation.

[i] Qualification to do Business in Other States or Countries

If the corporation intends to conduct business in other states or countries, the directors should authorize the officers to undertake the actions that those other jurisdictions may require for a foreign corporation to conduct business [*see § 5.121(32)*].

[2] FORM

First Actions of Directors by Unanimous Written Consent

ACTION BY UNANIMOUS WRITTEN CONSENT
OF
_____ [*name of corporation*]
A California Corporation

Introduction

The undersigned, constituting all of the directors of _____ [*name of corporation*], a California corporation, acting by unanimous written consent without a meeting, in accordance with *California Corporations Code Section 307(b)* [*add, if desired:* and Article _____, Section _____ of the bylaws of the corporation], consent to their election as directors, accept the resignation of the incorporator, and adopt the following resolutions:

1 . Ratification of Action of Incorporator

RESOLVED, that the actions of _____ [*name of incorporator*], Incorporator, pursuant to *California Corporations Code Sections 210* and *307(c)* be, and hereby are, ratified and approved.

2 . Minute Book

RESOLVED, that this corporation shall maintain as part of its corporate records a minute book, which shall include, but not be limited to, a record of its articles of incorporation and amendments thereto, its bylaws and amendments thereto, minutes of all meetings of its directors and shareholders, with the time and place of holding, whether regular or special, and, if special, how authorized, the notice thereof given, the names of the directors or shareholders present or represented at directors' or shareholders' meetings and the proceedings thereof, minutes of all meetings of board committees, with the time and place of holding, the notice thereof given, the names of the directors present, and the proceedings thereof, and all written consents of board of directors' meetings and board committees.

3 . Articles of Incorporation

RESOLVED, that a copy of the Articles of Incorporation of this corporation as filed with the Secretary of State of the State of California and bearing the file stamp and certification of the Secretary of State of the State of California be inserted in the Minute Book of this corporation and that the contents of those Articles be, and hereby are, ratified and approved.

4 . Agent for Service of Process

[*Select one of the following alternatives:*]

RESOLVED, that _____[*name*], a resident of California, whose business address is _____[*address*], is approved as this corporation's agent for service of process in California, as required by *California Corporations Code Section 1502*.

[*or*]

RESOLVED, that the agent named as the initial agent for service of process in the Articles of Incorporation of this corporation is hereby confirmed as this corporation's agent for the purpose of service of process.

[*Continue with the following:*]

5 . Bylaws

RESOLVED, that the bylaws adopted by the incorporator[s] of this corporation are approved; and

RESOLVED FURTHER, that the secretary of this corporation is authorized and directed to execute a certificate of the adoption of those bylaws, to insert those bylaws as so certified in the minute book of this corporation, and to cause a copy of those bylaws, as they may be amended from time to time, to be kept and maintained at the principal executive office of this corporation, in accordance *California Corporations Code Section 213*.

6 . Corporate Seal

RESOLVED, that the corporate seal presented to this board of directors is adopted as the seal of this corporation; and

RESOLVED FURTHER, that the secretary is directed to affix an impression of the corporate seal of this corporation to the minutes of this meeting in the margin opposite this resolution.

7 . Share Certificate

RESOLVED, that the form of share certificate presented to this board of directors to represent the Common Stock of this corporation is adopted for use by this corporation, and the secretary is directed to insert a copy of that form of share certificate in the corporation's minute book immediately following the minutes of the meeting.

8 . Fiscal Year

RESOLVED, that the first fiscal year of this corporation will begin on the date that the Articles of Incorporation of the corporation were filed and shall end on _____ [*date, including year, e.g.*, December 31, 1998] and thereafter the corporation's fiscal year will end on _____ [*date, e.g.*, December 31] of each year.

9 . Principal Executive Office

RESOLVED, that _____[*address*] is designated as the principal executive office of this corporation.

10 . Election of Officers and Officer Compensation

RESOLVED, that the following persons are elected to the offices set forth opposite their names:

Name	Office
_____ [*name*]	[*e.g.*, President]
_____ [*name*]	[*e.g.*, Vice-President]
_____ [*name*]	[*e.g.*, Secretary]
_____ [*name*]	[*e.g.*, Chief Financial Officer]

to serve at the pleasure of the board; and

RESOLVED FURTHER, that for purposes of giving any reports or executing any documents requiring the signature of the "treasurer," the chief financial officer is also deemed to be the treasurer of this corporation.

[*Use the following if corporate officers will be salaried:*]

RESOLVED FURTHER, that, until further action by this Board of Directors, the annual salaries of the officers are fixed in the following amounts, effective _____[*date*], and payable in installments and at times prescribed by the Board.

Office	Salary
[*e.g.*, President]	$ _____ [*dollar amount*]
[*e.g.*, Vice President]	$ _____ [*dollar amount*]
[*e.g.*, Secretary]	$ _____ [*dollar amount*]
[*e.g.*, Chief Financial Officer]	$ _____ [*dollar amount*]

RESOLVED FURTHER, that the above-stated salaries shall be payable on a _____ [*e.g.*, monthly *or* bi-monthly *or specify other arrangement*] basis on _____ [*e.g.*, the first day *or* Thursday] of _____ [*e.g.*, each month *or* every other week].

[*Or, if officers will not be compensated, use the following:*]

RESOLVED FURTHER, that the officers of this corporation shall not be compensated for the performance of their duties as officers.

[*Continue with the following:*]

11 . Directors' Compensation

[*If directors will not be compensated:*]

RESOLVED, that the Directors of this corporation shall not be compensated for the performance of their duties as Directors.

[*Or, if directors will be compensated:*]

RESOLVED, that the Directors shall be compensated as follows: *set forth directors' compensation, e.g.,* A Director shall be paid One Thousand Dollars per meeting for each board meeting or committee meeting he or she attends].

[*Continue with the following:*]

12 . Issuance of Shares

RESOLVED, that this corporation be authorized to sell and issue _____ [*number of authorized shares*] shares of common stock, and that each of the officers is hereby authorized to issue and sell an aggregate of _____ [*number of shares, e.g.,* 10,000] shares of its common stock to the following persons, at a purchase price per share of _____ [*dollar amount, e.g.,* $0.10], payable in cash or by certified or other check acceptable to the officer receiving the same, in the number set forth opposite their names, respectively:

Name	Number of Shares	Price
_____ [*name*]	_____ [*number*]	$ _____ [*price*]
_____ [*name*]	_____ [*number*]	$ _____ [*price*]
_____ [*name*]	_____ [*number*]	$ _____ [*price*]
_____ [*name*]	_____ [*number*]	$ _____ [*price*]

[*Use the following if consideration for shares is property:*]

RESOLVED FURTHER, that each of the officers is hereby authorized to sell and issue _____ [*number of shares*] shares of the common stock of this corporation to _____ [*name of purchaser*] in exchange for the transfer by _____ [*name of purchaser*] to this corporation of all of _____[*name of purchaser*]'s right, title and interest in and to _____ [*describe the property to be exchanged for shares*] (the "Property").

RESOLVED FURTHER, that this board of directors does hereby adjudge and determine in accordance with *California Corporations Code Section 409(e)* that the fair value to this corporation in monetary terms of the Property is not less than $ _____ [*dollar amount*].

[*Use the following if corporation is selling shares to directors of the corporation:*]

RESOLVED FURTHER, that in accordance with *California Corporations Code Section 310*, the terms and provisions of the sale of common stock of this corporation to those directors are just and reasonable to this corporation, and the same are hereby ratified, confirmed, adopted and approved.

[*Use the following if corporation is selling shares pursuant to a subscription agreement:*]

RESOLVED FURTHER, that shares of common stock of this corporation shall be sold pursuant to and in accordance with the subscription agreement presented to this meeting and the form, terms and provisions of the subscription agreement be, and hereby are, ratified and approved and each of the officers of this corporation is hereby authorized to execute, deliver and perform that subscription agreement on behalf of the corporation in substantially the same form as presented to this meeting.

[*Use the following if intending to qualify as a nontaxable transaction under I.R.C. § 351:*]

RESOLVED FURTHER, that this corporation and the proposed shareholders referenced above intend that the transactions contemplated hereby qualify as a nontaxable transaction pursuant to *Internal Revenue Code Section 351*, as amended, and that each of the officers is hereby authorized and directed to take such action as such officer deems necessary or appropriate to satisfy the requirements of *Internal Revenue Code Section 351*.

[*Continue with the following:*]

RESOLVED FURTHER, that when any shares of the common stock of this corporation are issued pursuant to these resolutions and the consideration specified above has been duly received by this corporation, the shares so issued shall be duly and validly issued, fully paid and nonassessable, and free to the holder thereof from all taxes, liens and charges with respect to the issuance thereof.

RESOLVED FURTHER, that upon receipt of the consideration therefor, the officers are authorized and directed to issue certificates representing the shares of the common stock of the corporation.

RESOLVED FURTHER, that each of the officers of the corporation are hereby authorized and directed to execute any and all documents, agreements and other papers and to take such other actions as that officer deems necessary or advisable for this corporation to issue and sell the above-listed shares to the persons named, in accordance with applicable laws, and that those actions will include, when necessary: (1) filing with the Commissioner of Corporations an appropriate notice under *California Corporations Code Section 25102(f)* or *25102(h)* or obtaining qualification of the offer and sale of the shares from the California Commissioner of Corporations; (2) doing all acts that may be necessary under the federal securities laws and the applicable securities laws of any other state; and (3) doing all acts necessary to expedite these transactions or conform them, or any of them, to the requirements of any applicable law.

13 . Tax I.D. Numbers

RESOLVED, that the officers are directed to apply to the IRS District Director for an employer's identification number on Form SS-4 and to the Employment Development Department of the State of California for an account number on Form DE-1 or other applicable forms.

14 . Corporate and Other Filings

The following resolutions are adopted with respect to the corporation's filing of a Statement by Domestic Stock Corporation (annual informational statement) with the California Secretary of State, in accordance with *California Corporations Code Section 1502* and other filings as necessary:

RESOLVED, that the secretary of this corporation is authorized and directed to prepare and to file or cause to be filed with the Secretary of State the necessary statement in compliance with *California Corporations Code Section 1502*, and to take whatever action is necessary to obtain licenses, authorizations, and permits that are necessary or desirable for the corporation's business.

RESOLVED FURTHER, that the secretary is directed to insert a copy of the Statement by Domestic Stock Corporation in the minute book following the minutes of this meeting.

15 . Bank Resolutions

The following resolutions are adopted with respect to the selection of one or more bank checking and savings accounts for the corporation and a depositary for the corporation's employment taxes trust funds:

RESOLVED, that this corporation establish in its name one or more deposit accounts with _____ [*name and address of bank*], or any other bank or depositary, as determined by the _____ [*title(s) of authorized officer(s), e.g.*, President] of this corporation, and that the _____ [*title(s) of authorized officer(s), e.g.*, president and the secretary] of this corporation are authorized to establish such an account or accounts, on terms and conditions as agreed on with the bank.

RESOLVED FURTHER, that the corporation's employment taxes trust funds shall be deposited with _____ [*name of bank*] or any other bank or depositary, as determined by the President of this corporation.

RESOLVED FURTHER, that the _____ [*title(s) of authorized officer(s), e.g.*, president] is authorized to designate as depositaries of this corporation's funds one or more other banks, trust companies, or other financial institutions, and to open, keep, and close general and special accounts in these depositaries.

RESOLVED FURTHER, that any officer of the corporation is authorized to endorse checks, drafts, or other evidences of indebtedness made payable to the corporation, but only for the purpose of deposit; and

RESOLVED FURTHER, that all checks, drafts, and other instruments obligating the corporation to pay money, including instruments payable to officers or other persons authorized to sign them, will be signed on the corporation's behalf by _____ [*required signatories, e.g.*, either the president or vice president; provided, however, that if the amount of the check is in excess of _____ (*dollar amount, e.g.*, $3,000), the signature of the president will be required].

RESOLVED FURTHER, that the standard form of corporate resolution required by _____ [*name of bank*] for opening a corporate account, a copy of which is attached to these minutes, is adopted as the resolution of the board of directors, and the secretary is directed to obtain the necessary signatures, execute the necessary certifications, and take such other steps as needed to open this account.

16 . Execution of Contracts and Other Documents

The following resolution is adopted with respect to contracts, agreement, and documents other than check, drafts, and other evidences of indebtedness as covered in Section 9.

RESOLVED, that all contracts and agreements of this Corporation, including but not limited to leases and mortgages, will be signed on the Corporation's behalf by _____ [*required signatories, e.g.,* its President or Chief Financial Officer jointly with its Vice President or Secretary].

17 . Payment of Expenses

The following resolution is adopted with respect to the payment of incorporation and organization expenses:

RESOLVED, that the Chief Financial Officer of the corporation is authorized and directed to pay the corporation's expenses of incorporation and organization.

18 . Appointment of Legal Counsel

The following resolution is adopted with respect to the corporation's legal counsel:

RESOLVED, that the law firm of _____[*name*] is appointed to serve as the corporation's legal counsel.

19 . Appointment of Accountant

The following resolution is adopted with respect to the corporation's accounting needs:

RESOLVED, that _____[*name*], will serve as the corporation's accountant.

20 . Consent Filed with Minutes

This Consent is executed in accordance with *Corporations Code Section 307(b)* and is to be filed with the minutes of the Board of Directors' proceedings.

21 . General Authority

RESOLVED, that each of the officers of the corporation is hereby authorized, directed and empowered to execute any and all documents, agreements and other papers and to take such other action as such officer deems necessary or advisable in order to carry out and perform the purposes and intent of these resolutions.

[*If the corporation intends to execute an indemnity agreement with the directors, use:*]

_____. Indemnity Agreement

RESOLVED, that the form, terms and provisions of the indemnity agreement presented to this meeting be, and hereby are, ratified and approved and each of the officers of this corporation is hereby authorized to enter into such an indemnity agreement on behalf of the corporation with each of the directors of the corporation in substantially the same form as presented to this meeting (with such changes therein as the officer or officers acting on behalf of this corporation shall approve; approval shall be conclusively evidenced by the execution of that document).

[*If the corporation intends to require a confidentiality agreement, use:*]

_____. Confidentiality Agreement

RESOLVED, that all officers and employees of this corporation, as a condition of the commencement and continuation of their employment, shall enter into a confidentiality agreement.

RESOLVED FURTHER, that the terms and provisions of the confidentiality agreement in the form presented to this meeting be, and hereby are, ratified and approved and each of the officers of this corporation is hereby authorized to enter into such a confidentiality agreement on behalf of this corporation in substantially the same form as presented to this meeting (with such changes therein as the officer or officers acting on behalf of this corporation shall approve; approval shall be conclusively evidenced by the execution of that document).

[*If the corporation intends to qualify its stock for treatment under I.R.C. § 1244, use:*]

_____. Section 1244 Stock

The following resolution is adopted with respect to the application of *Internal Revenue Code Section 1244* to the corporation's common stock:

RESOLVED, that this corporation intends to qualify its common stock for treatment under *Internal Revenue Code Section 1244*, pursuant to which the corporation plans that its total equity capital and paid-in surplus shall not in any event exceed $1,000,000, that it shall be largely an operating company, with less than 50 percent of its gross receipts coming from passive sources (royalties, rents, dividends, interest, annuities, and sales or exchanges of stocks or securities), and that it shall conform in all other respects to the requirements necessary to qualify its common stock for treatment under *Internal Revenue Code Section 1244*.

RESOLVED FURTHER, that the secretary of this corporation is authorized and directed to keep all records, prepare all reports and returns, and take all other steps as may be necessary to qualify this corporation's common stock for treatment under *Internal Revenue Code Section 1244*.

[*If the corporation intends to elect Subchapter S status, use:*]

_____. Subchapter S Election

The following resolution is adopted with respect to the election to be taxed, as an S corporation, in accordance with *Internal Revenue Code Section 1362(a)* and *California Revenue and Taxation Code Section 23801*:

RESOLVED, that the corporation elects to be taxed in accordance with *Internal Revenue Code Section 1362(a)* [*add, if a California election is also made:* and *California Revenue and Taxation Code Section 23801*].

RESOLVED FURTHER, that each of the officers of this corporation is authorized and directed to execute all documents and to take any other action necessary or advisable to carry out the purposes of this resolution.

[*If the corporation intends to conduct business in other states or countries, use:*]

_____. Qualification to do Business in Other States

RESOLVED that for the purpose of authorizing the corporation to do business in any state, territory or dependency of the United States or any foreign country in which it is necessary or expedient for this corporation to transact business, each of the officers of this corporation is hereby authorized to appoint and substitute all necessary agents or attorneys for service of process, to designate and change the location of all necessary statutory offices and, under the corporate seal, to make and file all necessary certificates, reports, powers of attorney and other instruments as may be required by the laws of such state, territory, dependency or country to authorize the corporation to transact business therein and whenever it is expedient for the corporation to cease doing business therein and withdraw therefrom, to revoke any appointment of agent or attorney for service of process, and to file such certificates, reports, revocation of appointment or surrender of authority as may be necessary to terminate the authority of the corporation to do business in any such state, territory, dependency or country.

[*Repeat, as required:*]

_____Dated:

_____ [*director's signature*]

_____ [*printed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)RequirementsSecurities LawBlue Sky LawsSecurities Exempt From RegistrationTax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
C. Directors' Action by Written Consent

2-5 California Legal Forms--Transaction Guide § 5.223

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.223 Annual Organization Action by Unanimous Written Consent of Directors

[1] Comment--Use of Form

This form is for use when the directors elect officers by unanimous written consent without a meeting. An optional provision is included, fixing the annual salaries of officers of the corporation. With minor modifications, this form may also be used when the actions taken by this written consent are taken instead at a meeting of directors. For minutes of a regular directors meeting, see *§§ 5.230-5.231*.

Immediately after each annual shareholders' meeting, the board of directors ordinarily holds its own annual meeting. This meeting is sometimes referred to as an organizational meeting because it is the first meeting following the annual election of directors. Although not required by statute, this meeting ordinarily is held to elect the officers of the corporation who will serve during the coming year. In practice, directors of small, closely held corporations often hold their annual meeting without a meeting, using a written consent.

For discussion of the effect of and statutory requirements for an action by written consent without a meeting, see *§ 5.221*. For a form for use when a directors' first meeting will be by unanimous written consent, see *§ 5.222*. For a letter soliciting the directors' consent in writing, see *§ 5.220*.

The wording of a resolution to be approved by the directors in an action by written consent is usually in the same form as it would appear in the minutes of a board meeting, had one been held. For discussion of the various forms of resolutions, see *§ 5.240*. Sections *5.221*, *5.222*, and this form illustrate different format options. For sample resolutions covering other common corporate actions, see *§§ 5.222* and *5.242* et seq.

[2] FORM

Annual Organization Action by Unanimous Written Consent of Directors
ANNUAL ORGANIZATION ACTION

BY UNANIMOUS WRITTEN CONSENT
OF
_____ [*name of corporation*]
A California Corporation

The undersigned, constituting all of the directors of _____ [*name of corporation*], a California corporation, acting by unanimous written consent without a meeting, in accordance with *California Corporations Code Section 307(b)* and [*add, if desired:* Article _____, Section _____ of the bylaws of the corporation], hereby adopt the following resolutions:

IT IS UNANIMOUSLY RESOLVED AS FOLLOWS:

1 . Election of Officers

The following persons are elected as officers of the corporation, to serve until their respective successors are properly designated or elected:

Name	Office
_____ [*name*]	[*e.g.*, President]
_____ [*name*]	[*e.g.*, Vice President]
_____ [*name*]	[*e.g.*, Secretary]
_____ [*name*]	[*e.g.*, Chief Financial Officer]

[*If annual salaries will be set, use:*]

2 . Annual Salaries of Officers

_____ [Until further action by this Board of Directors *or* For one year], the annual salaries of the officers of the corporation are fixed in the following amounts beginning _____[*date*], payable _____ [*specify how paid, e.g.*, in monthly installments on the first day of each month *or* in installments and at times prescribed by the Board].

Office	Salary
[*e.g.*, President]	$ _____ [*dollar amount*]
[*e.g.*, Vice President]	$ _____ [*dollar amount*]
[*e.g.*, Secretary]	$ _____ [*dollar amount*]
[*e.g.*, Chief Financial Officer]	$ _____ [*dollar amount*]

[*Continue with the following:*]

3 . Consent To Be Filed with Minutes

This Consent is executed in accordance with *Corporations Code Section 307(b)* and is to be filed with the minutes of the Board of Directors' proceedings.

[*Repeat, as required:*]

_____Dated:

_____[*director's signature*]

_____ [*printed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



150 of 166 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
C. Directors' Action by Written Consent

2-5 California Legal Forms--Transaction Guide § 5.224

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.224 Action of Incorporator to Elect Directors and Adopt Bylaws

[1] Comment--Use of Form

This form is used by the incorporator or incorporators of the corporation to elect the initial directors of the corporation and adopt bylaws.

[2] FORM

Action of Incorporator to Elect Directors and Adopt Bylaws

ACTION OF INCORPORATOR OF
_____ [*name of corporation*]
TAKEN WITHOUT A MEETING
BY WRITTEN CONSENT

The following action is taken by the Incorporator of _____ [*name of corporation*], a California corporation, by written consent, pursuant to *California Corporations Code Sections 210* and *307(c)*, that action to be effective on the date set forth below.

Adoption of Bylaws. The following resolution approving a form of bylaws for the government of this corporation is adopted:

RESOLVED, that the Bylaws presented to this Incorporator be, and the same hereby are, adopted as and for the Bylaws of this corporation.

Election of Directors. The following resolution electing the directors of the corporation is adopted:

RESOLVED, that _____ [*name of director*] and _____ [*name of director*] be, and they each hereby are, elected as directors of this corporation for the ensuing year and until their successors have been elected and qualified.

The undersigned, the Incorporator of this corporation, does hereby consent to the foregoing action.
_____Dated:

_____ [*incorporator's signature*]

[*incorporator's name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & Promoters



151 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
C. Directors' Action by Written Consent

2-5 California Legal Forms--Transaction Guide §§ 5.225-5.229

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 5.225[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
D. Agendas and Minutes of Directors Meetings

2-5 California Legal Forms--Transaction Guide § 5.230

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.230 Minutes of Directors' Regular or Special Meeting--Formal Format

[1] Comment

[a] Use of Form

This form is for use by the officer (frequently the corporate secretary) responsible for taking the minutes of a regular or special directors meeting. For discussion of types of meetings, see *§ 5.31*. For discussion of, and forms for, notice of directors meetings, see *§§ 5.201-5.202*. For discussion of meeting procedure, see *§ 5.32*. For discussion of the various formats for resolutions, see *§ 5.240*. This form and the forms in *§§ 5.221* and *5.223* illustrate different format options. For sample resolutions covering common corporate actions, see *§§ 5.222* and *5.242* et seq. For an alternative format for the minutes themselves, see *§ 5.231*.

PRACTICE TIP:

Always use subheadings in minutes, even if the agenda consists of a single item. Those headings are extremely useful when searching through filed minutes to determine whether certain actions have been taken or addressed. *Commentary by Marilyn E. Minger*

If actions will be taken by written consent rather than at a meeting, the forms in *§§ 5.221-5.223* should be used.

[b] Directors' Participation in Meeting

Unless the articles or bylaws provide otherwise, directors may participate in directors meetings in person or through use of a conference telephone call, electronic video screen communication, or electronic transmission by and to the corporation [*Corp. Code § 307(a)(6)*; *see Corp. Code §§ 20, 21* (definitions)]. [*Corp. Code § 307(a)(6)*]. Directors who participate by conference telephone call or electronic video screen communication are considered to be present at that meeting so long as all members participating can hear one another [*Corp. Code § 307(a)(6)*].

PRACTICE TIP:

When one or more directors participate in a meeting by telephone include a statement in the minutes to the effect that, "All participants could hear and be heard by each other." *Commentary by Marilyn E. Minger*

Directors who participate through electronic transmission by and to the corporation (other than a conference telephone call and electronic video screen communication) are considered to be present at the meeting if both the following apply [*Corp. Code § 307(a)(6)*]:

- Each participating director can communicate with all other directors concurrently.

- Each director has the means to participate in all matters before the board, including the ability to propose or object to a specific corporate action.

PRACTICE TIP:

When one or more directors will participate through use of electronic video screen communication or other communications equipment (other than a conference telephone), the corporation must first establish and implement a verification mechanism. A statement should be included in the minutes to the effect that, "The identities of all directors and other authorized participants were verified as true. During the meeting, each participating director could communicate with each other concurrently, and each director was able to participate in all matters before the board. All board actions or votes were taken or cast only by directors." *Commentary by Publisher's Editorial Staff*

A quorum (or requisite number of directors) is required to validly transact corporate business, subject to special rules applicable to transactions involving an interested director [*Corp. Code § 307(a)(8)*; *see Corp. Code §§ 310, 317(e)*]. If a quorum is not present, any acts taken at the meeting are voidable by the corporation or its shareholders [*see Olincy v. Merle Norman Cosmetics, Inc. (1962) 200 Cal. App. 2d 260, 273, 19 Cal. Rptr. 387]* , although a majority of the directors present may adjourn the meeting to another time and place [*Corp. Code § 307(a)(4)*]. For further discussion of quorum requirements, including how to compute a quorum and the actions permitted absent a quorum, see *§ 5.32[6]*.

[c] Duty to Keep Minutes

Each corporation must keep minutes of the proceedings of its board of directors and committees of the board in writing or in another form capable of being converted into clearly legible tangible form [*see Corp. Code § 1500*].

Minutes ordinarily are kept in a "minute book," a loose leaf binder or a special book available from legal stationers. The minutes of directors meetings are filed chronologically along with notices of meetings, actions taken by the directors or committees of the board by unanimous written consent without a meeting [*see Corp. Code § 307(b)*], waivers of notice, consents to the holding of directors meetings, and approvals of the minutes [*see Corp. Code § 307(a)(3)*]. Minute books also frequently contain the articles of incorporation, certificates of amendment, restated articles, certificates of determination, bylaws and amendments to the bylaws, and copies of the annual informational filing required by the California Secretary of State [*see Corp. Code § 1502(a)*].

[d] Certification of Minutes; Use of Parol Evidence

The original or a copy (in writing or in any other form capable of being converted into clearly legible tangible form) of the minutes of a meeting of the board of directors or of committees of the board (or any resolution adopted the board or board committee), certified to be a true copy by a person purporting to be the corporate secretary or assistant corporate secretary, is prima facie evidence of the adoption of the resolution or the due holding of the meeting and of the matters stated in the minutes [*Corp. Code § 314*; *see Evid. Code §§ 1520, 1521* (secondary evidence rule)].

Although the minutes of a directors meeting are often the best evidence of what took place at the meeting, parol evidence is admissible to supplement or contradict the events as reported in (or omitted from) the minutes [*see Code Civ. Proc. § 1856*; *Lawrence v. Premier Indem. Assur. Co. (1919) 180 Cal. 688, 697, 182 P. 431* ; *Fowler Gas Co. v. First Nat'l. Bank (1919) 180 Cal. 471, 477-478, 181 P. 663]* . However, oral testimony ordinarily is not admissible to prove the contents of the minutes [*Evid. Code § 1523(a)*]. Nevertheless, testimony as to the contents of the writing is not inadmissible when the proponent lacks possession or control of the original or a copy and (1) the original is lost or destroyed without fraudulent intent on the part of the proponent or (2) neither the original or a copy was reasonably procurable by the proponent or the writing is not closely related to the controlling issues and it would be inexpedient to require production [*Evid. Code § 1523(b), (c)*; *see Evid. Code § 1523(d)* (exception when writing consists of numerous accounts or writings that cannot be examined without great loss of time and evidence sought is only general result of whole)].

[e] Contents of Minutes

The statute is silent on the contents of the minutes; it requires only that they contain the "proceedings" of the meeting [*see Corp. Code § 1500*]. There is no consensus on what minutes should contain. However, there are certain items that corporate custom (and common sense) would require to be put into the minutes, including the following:

- The date, time, and place of the meeting. Recording the date and time ensures the accuracy of the meeting's notice. Improper notice can make the meeting irregular and actions taken at the meeting voidable [*In re Mathews Constr. Co. (1954) 120 F. Supp. 818, 821* (construing former Corp. Code § 813); *see § 5.32[5]*]. Recording the meeting's location may aid the officer whose responsibility it is to reimburse directors for their travel expenses.

- The type of meeting (regular, special, or adjourned), and whether notice was required, given, or waived. For discussion of types of meetings and notice requirements, see *§§ 5.31* and *5.32[5]*, respectively.

- The names of those present, including directors and individuals who are not directors, and the existence of a quorum of directors. A list of directors present provides a record of those counted in determining whether a quorum was present [*see § 5.32[6][b], [c]*]. Persons who are not directors who are likely to be invited to attend directors meetings include the corporation's attorney, accountant, financial advisor and consultants. Whether outsiders may attend a meeting of the board of directors or a board committee is within the discretion of the board or committee involved [*see, e.g., American Center for Education, Inc. v. Cavnar (1978) 80 Cal. App. 3d 476, 491, 145 Cal. Rptr. 736]* .

- The names of the presiding officer and the person taking the minutes.

- A statement whether the minutes of the last meeting were approved as distributed or as amended. Directors concerned about potential liability will want to ensure that the minutes accurately reflected their votes on certain actions [*see §§ 5.11-5.12*].

- The actions taken at the meeting, with or without the directors' rationale for each action.

- Adjournment, and if necessary, the date, time, and location of the next meeting. Notice of a regular directors meeting does not need to be given if the time and place of the meeting have been established either by the bylaws or by the board of directors [*Corp. Code § 307(a)(2)*].

As long as the basic information enumerated above is included, minutes may be detailed or summary [*see* Brewer &

Solberg, *Corporate Minutes: What Should They Include? 20 Bus. Law 745 (1965)*; *see also* Vagts, *Why Directors Need to Keep Records*, 11-12 Harv. Bus. Rev. 29, 30 (1978)].

PRACTICE TIP:

When extraordinary action is taken or an unexpected result is reached by the board, the minutes of the meeting should contain detail sufficient to explain or justify the action or result. When preparing minutes, always keep in mind that minutes are among the corporate records that may be inspected by shareholders [*see* [f], *below*] and are subject to subpoena in a lawsuit. *Commentary by Marilyn E. Minger*

[f] Right to Inspect Minutes

A shareholder or holder of a voting trust certificate (or that person's agent or attorney) has the right on written demand to inspect the minutes of the meetings of directors or of board committees [*Corp. Code § 1601*]. The minutes may be inspected at any reasonable time during usual business hours, if the purpose for inspection is reasonably related to the holder's interest in the corporation as a shareholder or voting trust certificate holder [*Corp. Code § 1601(a)*]. This right of inspection includes the right to copy and make extracts [*Corp. Code § 1601(b)*] and extends to the minutes of a subsidiary of the corporation [*Corp. Code § 1601(a)*]. Neither the articles nor the bylaws may limit this right of inspection [*Corp. Code § 1601(b)*]. The corporation may not thwart the exercise of these rights by failing to respond to proper requests, by sending communications that make further requests futile, or by actions impeding the inspection process [*Jara v. Suprema Meats, Inc. (2004) 121 Cal. App. 4th 1238, 1264, 18 Cal. Rptr. 3d 187]* . However, the corporation is required only to allow inspection at corporate offices, is not required to mail or otherwise provide copies, and is not required to respond to demands for disclosure falling outside scope of what is required by statute [*Jara v. Suprema Meats, Inc. (2004) 121 Cal. App. 4th 1238, 1263-1265, 18 Cal. Rptr. 3d 187]* .

A director (or the director's agent or attorney) has the absolute right at any reasonable time to inspect all books, records, and documents (including minutes) of the corporation of which he or she is a director, and of its subsidiary corporations [*Corp. Code § 1602*]. This right of inspection includes the right to copy and make extracts [*Corp. Code § 1602*].

[2] FORM

Minutes of Directors' Regular or Special Meeting--Formal Format

MINUTES OF _____ [REGULAR *or* SPECIAL] MEETING
OF
BOARD OF DIRECTORS OF
OF _____ [*name of corporation*]
A California Corporation

1 . Introduction

A _____ [regular *or* special] meeting of the Board of Directors of _____ [*name of corporation*], a California corporation, was held at _____[*address*], on _____[*date*], at _____[*time*].

2 . Chair and Secretary

_____ [*name and title*] acted as Chair; _____ [*name and title*] acted as Secretary of the meeting.

3 . Notice

[*If notice was duly given, use:*]

The meeting was held pursuant to written notice, given to all directors of the corporation. A copy of the notice was directed to be inserted in the minute book immediately preceding the minutes of this meeting.

[*Or, if no notice was given, choose one of the following:*]

[*EITHER*]

No notice was given _____ [in accordance with the bylaws *or* because the meeting was fixed by board resolution].

[*OR*]

The signed _____ [waiver(s) of notice *or* consent(s) to holding this meeting *or* approval(s) of the minutes of this meeting] are attached to these minutes and made a part of them by this reference.

[*Continue with the following:*]

4 . Persons Present; Quorum

The following directors were present:

_____ [*name*]
_____ [*name*]
_____ [*name*]
_____ [*name*]

Of these directors, the following attended by conference telephone:

_____ [*name*]
_____ [*name*]
_____ [*name*]
_____ [*name*]

During the meeting all directors attending could hear one another.

[*If any directors attended by communications equipment other than conference telephone, use:*]

Of these directors, the following attended by _____ [electronic video screen communication *or* communications equipment other than conference telephone]:

_____[*name*]
_____[*name*]

_____[*name*]
_____[*name*]

The identities of all directors and other authorized participants were verified as true. During the meeting, each participating director could communicate with each other concurrently, and each director was able to participate in all matters before the board. All board actions or votes were taken or cast only by directors.

[*If any directors were absent, use:*]

The following directors were absent:

_____ [*name*]
_____ [*name*]
_____ [*name*]
_____ [*name*]

[*If other persons were present, use:*]

The following [person *or* persons] were also present:

_____ [*name*]
_____ [*name*]
_____ [*name*]
_____ [*name*]

[*Continue with the following:*]

5 . Call to Order; Quorum

Since there was a quorum of directors present, the Chair called the meeting to order.

6 . Minutes of Previous Meeting

The minutes of the previous meeting of the Board of Directors were [*add, if desired:* read and] approved, _____ [as originally presented *or* as amended].

7 . Adoption of Resolution Related to: _____ [*subject of resolution, e.g.,* Declaration and Payment of Dividend]

The _____ [*name and title of officer*] suggested _____ [*summary of corporate action to be taken, e.g.,* that the financial affairs of the corporation were in good order and that there was no reason not to declare the regular quarterly dividend of $1.00 a share].

On motion duly made, seconded, and [unanimously] carried, the following resolution was adopted:

RESOLVED THAT _____ [*text of resolution for corporate action e.g.,* a dividend of $1.00 is declared on each common share of the corporation, to be paid on January 25, 1999, to shareholders of record on December 21,

1998; and the Chief Financial Officer is directed to arrange for the payment of this dividend and to charge the full amount to the corporation's earned surplus account].

[*If any directors voted against the resolution, add, if desired:*]

The following directors voted against the adoption of the resolution:

_____ [*name*]
_____ [*name*]
_____ [*name*]
_____ [*name*]

[*If the reasons for the negative vote(s) or abstention(s) will be included, use:*]

These directors voted against this resolution for the following [reason *or* reasons:] _____

[*If any directors abstained from voting, add, if desired:*]

The following directors abstained from voting.

_____ [*name*]
_____ [*name*]
_____ [*name*]
_____ [*name*]

[*Continue with the following, and repeat, as required:*]

_____. Adoption of Resolution Related to: _____ [*subject of resolution*]

The board then _____ [reviewed *or* discussed *or* considered, etc.] _____ [*summary of corporate action to be taken*].

On motion duly made, seconded, and [unanimously] carried, the following resolution was adopted:

RESOLVED THAT _____ [*text of resolution for corporate action*].

[*If the next meeting is a regular meeting, to be held without notice because the time and place are fixed by the board, add:*]

_____. Adoption of Resolution Related to Next Regular Meeting of the Board of Directors

The Chair then stated the time and place of the next regular meeting of the Board of Directors of _____ [*name of corporation*].

On motion duly made, seconded, and [unanimously] carried, the following resolution was adopted:

_____ RESOLVED THAT the next regular meeting of the Board of Directors of _____ [*name of corporation*] will be held at _____[*address*], on _____[*date*], at _____[*time*].

[*Continue with the following:*]

There being no further business, the meeting was duly adjourned.
_____Dated:

_____ [*signature*]

_____ [*printed name*]

_____ [*title, e.g.,* Corporate Secretary *or* Assistant Corporate Secretary]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsDirectorsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
D. Agendas and Minutes of Directors Meetings

2-5 California Legal Forms--Transaction Guide § 5.231

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.231 Minutes of Directors' Regular or Special Meeting--Outline Format

[1] Comment--Use of Form

This form is for use by the officer (frequently the corporate secretary) responsible for taking the minutes of a regular or special directors meeting. Its outline format provides an alternative to the more formal format used in *§ 5.230*. For discussion of the various formats for resolutions, see *§ 5.240*. For sample resolutions covering common corporate actions, see *§§ 5.222* and *5.242* et seq. For an agenda for a directors meeting, see *§ 5.232*. For discussion of types of meetings, see *§ 5.31*. For discussion of and forms for notice of directors meetings, see *§§ 5.201-5.202*. For discussion of meeting procedure, see *§ 5.32*.

If actions will be taken by written consent rather than at a meeting the forms in *§§ 5.221-5.223* should be used.

[2] FORM

Minutes of Directors' Regular or Special Meeting--Outline Format

MINUTES OF [REGULAR *or* SPECIAL] MEETING
OF
BOARD OF DIRECTORS OF
OF _____ [*name of corporation*]
A California Corporation

Date: _____
Place: _____[*address*]
Type of meeting: _____ [regular *or* special]

[*Add, if applicable:*]

Meeting called by: _____ [*name(s), e.g.,* President)].

[*Continue with the following:*]

Notice was: _____ [*e.g.*, not required and not given *or* given by mail to each director on _____ (*date at least four days before date of meeting*)].

Directors present:

_____ [*name*]
_____ [*name*]
_____ [*name*]
_____ [*name*]

(Directors attending by conference telephone are noted with an asterisk.)

[*Add, if applicable:*]

Directors absent:

_____ [*name*]
_____ [*name*]
_____ [*name*]
_____ [*name*]

[*Add, if applicable:*]

Others present:

[*Repeat, as required;*]

_____ [*name*]
_____ [*name*]
_____ [*name*]
_____ [*name*]

1 . Call to Order

The meeting was called to order at _____[*time*] by the _____ [*person presiding, e.g.,* Chair of the Board], who announced that a quorum was present.

2 . Approval of Minutes of Last Meeting

The minutes of the Board meeting held on _____[*date*] were _____ [*specify, e.g.,*: read and approved as read *or* approved *or* read and the statement that _____ (*specify matter as originally stated*) was corrected to read _____ (*specify correction*), and the minutes were then approved as corrected].

3 . Adoption of Resolution

[*Repeat, as required;*]

The following resolution was considered by the Board and adopted by _____ [majority *or* unanimous] vote of the directors present:

RESOLVED, _____ [*text of resolution*].

Voting for:

_____ [*name*]
_____ [*name*]
_____ [*name*]
_____ [*name*]

Voting against:

_____ [None *or* name(s)]

Abstaining:

_____ [None *or* name(s)]

[*Insert, if desired:*]

4 . Defeat of Resolution

[*Repeat, as required;*]

The following resolution was considered by the Board and was not approved:

RESOLVED, _____ [*text of resolution*].

Voting for:

_____ [*name*]
_____ [*name*]
_____ [*name*]
_____ [*name*]

Voting against:

_____ [*name*]
_____ [*name*]
_____ [*name*]
_____ [*name*]

Abstaining:

_____ [None *or* name(s)]

5 . Adjournment

Meeting adjourned at _____[*time*].
_____Dated:

_____ [*signature*]

_____ [*printed name*]

_____ [*title, e.g.,* Corporate Secretary *or* Assistant Corporate Secretary]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
D. Agendas and Minutes of Directors Meetings

2-5 California Legal Forms--Transaction Guide § 5.232

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.232 Agenda for Directors Meeting

[1] Comment--Use of Form

This form is for use by the presiding officer conducting the board meeting. Although notice of the meeting does not need to specify the business to be conducted, an agenda may also be included for convenience. Specific matters to be considered should be inserted as appropriate.

For discussion of and forms for notice of directors meetings, see *§§ 5.201-5.202*. For discussion of meeting procedure, see *§ 5.32*. For discussion of types of meetings, see *§ 5.31*. For forms of meeting minutes, see *§ 5.230* and *5.231*.

[2] FORM

Agenda for Directors Meeting

AGENDA FOR [REGULAR *or* SPECIAL] MEETING
OF
BOARD OF DIRECTORS OF
OF _____ [*name of corporation*]
A California Corporation

1. Call meeting to order.

2. Take attendance; determine if quorum is present.

3. Consider minutes of last meeting.

4. Make announcements.

5. Receive reports.

6. Discuss old business, if any.

7. Discuss new business.

8. Discuss any other business.

9. Adjourn meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



155 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
D. Agendas and Minutes of Directors Meetings

2-5 California Legal Forms--Transaction Guide §§ 5.233-5.239

AUTHOR: Marilyn E. Minger, Practice Consultant

[Reserved]

§§ 5.233[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
E. Specific Resolutions

2-5 California Legal Forms--Transaction Guide § 5.240

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.240 Formats of Resolutions

[1] Comment

[a] Use of Form

This form illustrates the formats commonly used for resolutions adopted by the board of directors. Sections *5.221[2]*, *5.222[2]*, and *5.223[2]* also illustrate these alternative formats.

For a certificate of adoption of a resolution by the board of directors, see *§ 5.241*. Minutes of the proceedings of the board are discussed in *§ 5.230*. Actions by written consent are discussed in *§§ 5.33* and *5.220-5.223*.

Refer to *§ 5.222* for resolutions authorizing actions commonly taken at the *first* meeting of directors, including adopting the corporation's bylaws, electing corporate officers and fixing their salaries, approving the corporation's agent for service of process, designating the corporation's principal executive office, adopting the corporate seal and share certificate, selecting the corporation's fiscal year, authorizing required corporate filings with the Secretary of State, selecting bank checking and saving accounts and choosing a depository for the corporation's employment tax trust funds, delegating particular duties (such as the duties related to the offer and sale of corporate shares) and the authority to execute contracts and other documents, electing subchapter S status, qualifying the corporation's common stock for treatment under *I.R.C. § 1244*, paying incorporation and organization expenses, and appointing the corporation's legal counsel and accountants. For discussion of and a resolution fixing the time and place of the next meeting of the board of directors, see *§ 5.230*.

[b] Resolution Formats

California law neither defines resolutions nor prescribes a form for them. However, certain standard formats are commonly used.

The most traditional format is discussed in Robert's Rules of Order, Revised (the Seventy-Fifth Anniversary Edition), and is illustrated in the first alternative of the form below and in *§ 5.222[2]*. This edition provides that a resolution should begin with the words "Resolved, that" [Robert's Rules of Order Revised, § 4]. It also provides that the resolution may be divided into a series of resolutions which may be numbered with arabic numerals, or may be stated as a single resolution with separate paragraphs, each beginning with the word "That" and numbered "First," "Second," and "Third" [Robert's Rules of Order Revised, § 4]. When the resolution is divided into a series of resolutions, it is common to begin the second and subsequent resolutions with the words "Resolved Further" to show they are part of the same series.

More modern, simplified formats include simple numbered paragraphs, each followed by a descriptive title and the text of the resolution (illustrated in the second alternative in the form below and in *§ 5.221[2]*), or that same format, preceded by the words "IT IS [UNANIMOUSLY] RESOLVED AS FOLLOWS:" (illustrated in the third alternative in the form below and in *§ 5.223[2]*).

[c] Preambles Used to Provide Reasons for Adopting Resolutions

The statute is silent on the content of resolutions, as it is on the content of minutes of the meetings of directors. There is no consensus on what resolutions (or minutes) should contain. Whether or not an explanation of the background of the resolution or the reasons for its adoption is appropriate depends on the circumstances of the particular case. This issue is further discussed in *§ 5.230[1][e]*.

According to Robert's Rules of Order, Revised, when reasons for adopting a resolution are given, they are usually stated in the "preamble" to the resolution. Each clause of the preamble is a separate paragraph beginning with the word "Whereas" [Robert's Rules of Order Revised, § 4]. According to Robert's Rules of Order Revised, periods should never be used in the preamble; each paragraph (except the last) should end with a comma or semicolon followed by the word "and." The last paragraph of the preamble should end with the word "therefore" or the words "therefore, be it" [Robert's Rules of Order Revised, § 4]. In practice, however, most attorneys who still use this general format use less archaic language than set forth in Robert's Rules of Order, Revised [*see, e.g., § 5.242[2]*].

Copies of legal opinions, contracts, letters, or other documents that come before the directors at a meeting, or that relate to matters on which resolutions are adopted, may also be included in the minutes or attached to them and maintained in the minute book [Robert's Rules of Order Revised, § 60; [*see, e.g., § 5.242[2]*].

A more modern format, illustrated in *§ 5.230[2]*, inserts a simple explanation for the resolution in a paragraph after the resolution's title, before the text of resolution.

[2] FORM

Formats of Resolutions

RESOLUTION FORMATS

[*If format from Robert's Rules of Order will be followed, use:*]

[*Add, if preamble is desired:*]

WHEREAS, _____ [*specify background or reasons for resolution, e.g.,* this corporation reimburses its sales representatives for automobile expenses at the rate of twenty-nine cents per mile for each mile traveled by them]; and

WHEREAS, _____ [*specify further background or reasons for resolutions, e.g.,* the annual cost of making these mileage payments exceeds the anticipated annual cost of providing sales representatives with corporation-owned automobiles]; therefore [*or* now, therefore be it]:

[*Continue with the following:*]

RESOLVED, that _____ [*text of resolution, e.g.,* the corporation purchase, at a price not exceeding $22,000 each, ten automobiles for the use of its sales representatives].

RESOLVED FURTHER, that _____ [*continuing text of resolution, e.g.,* the President and Secretary of the corporation are authorized and instructed to purchase these automobiles for the corporation].

[*OR*]

1. RESOLVED, that _____ [*text of resolution, e.g.,* the corporation purchase at a price not exceeding $22,000 each, ten automobiles for the use of its sales representatives].

2. RESOLVED, that _____ [*continuing text of resolution, e.g.,* the President and Secretary of the corporation are authorized and instructed to purchase these automobiles for the corporation].

[*OR*]

RESOLVED,

FIRST, that _____ [*text of resolution, e.g.,* the corporation purchase at a price not exceeding $22,000 each, ten automobiles for the use of its sales representatives].

SECOND, that _____ [*continuing text of resolution, e.g.,* the President and Secretary of the corporation are authorized and instructed to purchase these automobiles for the corporation].

[*OR*]

RESOLVED, that:

1. _____ [*text of resolution, e.g.,* the corporation purchase at a price not exceeding $22,000 each, ten automobiles for the use of its sales representatives].

2. _____ [*continuing text of resolution, e.g.,* the President and Secretary of the corporation are authorized and instructed to purchase these automobiles for the corporation].

[*If one of the more modern formats is used, choose one of the following paragraphs:*]

[*EITHER*]

_____. _____ [*descriptive title and text of resolution for corporate action, e.g.,* **Purchase of**

Company Cars for Use by Sales Representatives. The corporation will purchase, at a price not exceeding $22,000 each, ten automobiles for the use of its sales representatives; and the President and Secretary of the corporation are authorized and instructed to purchase these automobiles for the corporation].

[*OR*]

IT IS [UNANIMOUSLY] RESOLVED AS FOLLOWS:

1. _____ [*title of resolution for corporate action, e.g.*, **Purchase of Company Cars for Use by Sales Representatives**]

_____ [*text of resolution for corporate action, e.g.*, The corporation will purchase, at a price not exceeding $22,000 each, ten automobiles for the use of its sales representatives; and the President and Secretary of the corporation are authorized and instructed to purchase these automobiles for the corporation].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
E. Specific Resolutions

2-5 California Legal Forms--Transaction Guide § 5.241

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.241 Certificate of Adoption of Resolution by Board of Directors

[1] Comment

[a] Use of Form

This form is for use by the corporate secretary or an assistant secretary to certify the original or a copy of a resolution adopted by the board of directors. It will be used frequently as evidence of the board's authorization to enter into contracts or to transact business. Therefore, it is important that counsel either prepare or instruct the corporate secretary on the form of certificate.

For discussion and examples of various formats for resolutions, see *§ 5.240*. Minutes of the proceedings of the board are discussed in *§ 5.230*. Actions by written consent are discussed in *§§ 5.33* and *5.220-5.223*.

[b] Certification as Evidence of Adoption of Resolution

The original or a copy of any resolution adopted by the board or by a committee of the board, certified to be a true copy by a person purporting to be the secretary or an assistant secretary of the corporation, is prima facie evidence of the adoption of that resolution and of the matters stated in it [*Corp. Code § 314*].

Thus, a board resolution certified by the appropriate officer and authenticated by the corporate seal is presumptively the act of the corporation, and is admissible in evidence in a court proceeding [*Purser v. Eagle Lake L. & I. Co. (1896) 111 Cal. 139, 141-142, 43 P. 523 but see Corp. Code § 207(a)* (failure to affix seal does not affect instrument's validity)]. In the absence of any countervailing proof, the recitals of the resolution are binding on the corporation [*Purser v. Eagle Lake L. & I. Co. (1896) 111 Cal. 139, 142, 43 P. 523* (action to foreclose mortgage given by corporation to secure promissory note; execution of note and mortgage by corporate president and secretary ratified by board resolution, a certified and authenticated copy of which was delivered to the mortgagee)]. The act of a corporate secretary in certifying the adoption of the resolution by the corporation is within the secretary's authority and binding on

the corporation even if the resolution is spurious [*Associates Discount Corp. v. Tobb Co. (1966) 241 Cal. App. 2d 541, 547, 50 Cal. Rptr. 738]* .

[2] FORM

Certificate of Adoption of Resolution by Board of Directors

CERTIFICATION OF RESOLUTION OF
BOARD OF DIRECTORS OF
OF _____ [*name of corporation*]
A California Corporation

I certify that:

I am the duly qualified and acting [Assistant] Secretary of _____ [*name of corporation*], a California corporation.

[*Choose of the following paragraphs:*]

[*If resolution was adopted at directors meeting, use:*]

_____ [Attached to this certification and marked Exhibit A *or* Set forth below] is a true and correct copy of a resolution duly adopted by the Board of Directors of the corporation at a regular [*or* special] meeting held on _____[*date*].

[*If resolution was adopted by written consent without meeting, use:*]

_____ [Attached to this certification and marked Exhibit A *or* Set forth below] is a true and correct copy of a resolution duly adopted by the Board of Directors of the corporation by unanimous written consent without a meeting, as authorized by *California Corporations Code Section 307(b).*

[*Continue with the following:*]

This resolution has not been modified or rescinded and is in full force and effect at the date of this certificate.
_____Dated:

_____ [*signature*]

_____ [*printed name*]

_____ [*title, e.g.,* Corporate Secretary *or* Assistant Corporate Secretary]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate

LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral Overview



158 of 166 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
E. Specific Resolutions

2-5 California Legal Forms--Transaction Guide § 5.242

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.242 Resolution Authorizing Execution of Employment Agreement

[1] Comment--Use of Form

This form is for use by the board of directors to authorize the execution of an employment contract with an employee. For discussion and examples of various formats for resolutions, see *§ 5.240*. For a certificate of adoption of a resolution by the board of directors, see *§ 5.241*. Minutes of the proceedings of the board are discussed in *§ 5.230*. Actions by written consent are discussed in *§§ 5.33* and *5.220-5.223*.

[2] FORM

Resolution Authorizing Execution of Employment Agreement
RESOLUTION AUTHORIZING EXECUTION OF EMPLOYMENT AGREEMENT

WHEREAS the Board of Directors has considered the terms and conditions of the proposed employment of _____[*name*], as _____ [*title*], by the Corporation, as set forth in the form of an employment agreement; and

WHEREAS the Board of Directors believes that the salary and other benefits provided constitute reasonable compensation in view of the anticipated services of _____[*name*], as _____ [*title*], to the Corporation, and in relation to the compensation received by others in similar positions in the industry;

Therefore, it is

RESOLVED, that the terms and conditions of the employment by the Corporation of _____[*name*], as _____ [*title*], as set forth in the employment agreement, are approved.

RESOLVED FURTHER, that the officers of the Corporation are authorized to execute the agreement on behalf of the

Corporation and are directed to file a copy of the executed employment agreement in the Corporation's minute book, immediately following the [minutes of this meeting *or* unanimous written consent approving the agreement].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewLabor & Employment LawEmployment RelationshipsEmployment ContractsFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
E. Specific Resolutions

2-5 California Legal Forms--Transaction Guide § 5.243

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.243 Resignation of Director

[1] Comment

[a] Use of Form

This form is for use by a director to submit his or her resignation to the corporation. Although a resignation must be in writing [*see Corp. Code § 305(d)*], there is no prescribed form for the resignation. This form is a simple memorandum. However, other forms, such as letters or notices would be equally effective. If the director is also a corporate officer and wants to resign that office as well, this form may be modified accordingly.

For discussion and examples of various formats for resolutions, see *§ 5.240*. For a certificate of adoption of a resolution by the board of directors, see *§ 5.241*. Minutes of the proceedings of the board are discussed in *§ 5.230*. Actions by written consent are discussed in *§ 5.33* and *§§ 5.220-5.223*.

[b] Resignation of Directors

Any director may resign by giving written notice to the chair of the board, the president, the secretary, or the board of directors [*Corp. Code § 305(d)*]. A director's resignation creates a vacancy on the board [*Corp. Code § 192*].

Resignation takes effect on the giving of written notice of resignation, unless the notice specifies a later time [*Corp. Code § 305(d)*]. Unless the resignation is made contingent on its acceptance [*Clark v. Oceano Beach Resort Co. (1930) 106 Cal. App. 574, 576, 289 P. 946]* , it takes effect even if the board neither accepts nor acts on it [*Security Inv. Realty Co. v. Superior Court (1929) 101 Cal. App. 450, 452, 281 P. 709]* . For a form for accepting a resignation and appointing a successor, see *§ 5.244*.

[2] FORM

Resignation of Director

RESIGNATION OF DIRECTOR

TO: _____[*name*]
_____ [*title*]
_____ [*name of corporation*]

I hereby resign as director of _____ [*name of corporation*] effective on [your receipt of this notice *or* _____ (*date*) *or* its acceptance by the Board of Directors].

[*Add, if desired:*]

You are requested to acknowledge receipt of this resignation at your earliest convenience.
_____Dated:

_____ [*signature*]

[*printed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersTerms in OfficeRemoval & Resignation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
E. Specific Resolutions

2-5 California Legal Forms--Transaction Guide § 5.244

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.244 Resolution Accepting Resignation and Filling Vacancy on Board of Directors

[1] Comment

[a] Use of Form

This form is a resolution by the board of directors accepting the resignation of a director and appointing a director to fill a vacancy on the board. When used with respect to the board of directors, vacancy means any authorized position of director that is not currently filled with a properly elected director [*Corp. Code § 192*]. A vacancy may be caused, for example, by death, resignation, removal, or a change in the number of authorized directors (by the board of directors or the shareholders) [*see Corp. Code § 192*]. This form is designed for use when a vacancy is created by resignation. If the vacancy occurs for any reason other than the resignation (or removal [*see* [b], *below*]) of a director, this form should be modified accordingly.

For discussion and examples of various formats for resolutions, see *§ 5.240*. For a certificate of adoption of a resolution by the board of directors, see *§ 5.241*. Minutes of the proceedings of the board are discussed in *§ 5.230*. Actions by written consent are discussed in *§§ 5.33* and *5.220-5.223*.

[b] Filling Vacancies Created by Removal

Unless the articles or a bylaw adopted by the shareholders provide that the board may fill vacancies occurring on the board by reason of the removal of directors, those vacancies may be filled only by approval of the shareholders [*Corp. Code § 305(a)*; *see Corp. Code § 153* (approval of shareholders defined)]. Filling a removal-created vacancy by written consent requires the unanimous written consent of all shares entitled to vote for the election of directors [*Corp. Code §§ 305(b), 603(d)*].

[c] Filling Vacancies Not Created by Removal

Unless otherwise provided in the articles or bylaws, and except for a vacancy created by the removal of a director [*see* [b], *above*], vacancies on the board may be filled by approval of the board [*see Corp. Code § 151* (approval of board defined)], or if the number of directors in office is less than a quorum, by one of the following [*Corp. Code § 305(a)*]:

- The unanimous written consent of the directors in office.

- The affirmative vote of a majority of the directors in office at a meeting held pursuant to statutory notice or waivers of notice [*see Corp. Code § 307*].

- The sole remaining director.

If, after the directors fill any vacancy, the directors in office who have been elected by the shareholders constitute less than a majority of the directors in office, any shareholder or shareholders representing at least five percent of the outstanding shares with the right to vote for those directors may call a special shareholders' meeting to elect the entire board [*Corp. Code § 305(c)(1)*]. Alternatively, the shareholders may petition the superior court to order a special shareholders' meeting to elect the entire board [*Corp. Code § 305(c)(2)*].

The shareholders may also elect a director at any time to fill a vacancy not filled by the directors [*Corp. Code § 305(b)*]. Any such election by written consent (other than one to fill a vacancy created by the removal of a director [*see* [1], *above*]) requires the consent of a majority of the outstanding shares entitled to vote [*Corp. Code §§ 305(b), 603(d)*].

For discussion of court appointment of directors, see *§ 5.16[3]*. For discussion of the removal of directors with and without cause, and a change in the number of authorized directors, see *§ 5.15*.

[d] New Directors' Term of Office

Directors elected to fill vacancies hold office until the expiration of the term for which they have been elected, and until a successor has been elected and qualified [*Corp. Code § 301(b)*; *but see Corp. Code § 305(c)*; [c], *above*]. The phrase "and until a successor has been elected and qualified" covers the situation in which the corporation has not held annual shareholders meetings and yet someone needs to have the authority to run the corporation.

[2] FORM

Resolution Accepting Resignation and Filling Vacancy on Board of Directors

RESOLUTION ACCEPTING DIRECTOR'S RESIGNATION AND APPOINTING DIRECTOR TO FILL VACANCY

RESOLVED, that the resignation of _____[*name*] as Director [and also as _____ (*officer title*)] of this corporation, effective _____[*date*], is accepted.

RESOLVED FURTHER, that _____ [*name of appointee*] is elected

[*EITHER, if the number of directors in office constitutes a quorum:*]

by approval of the Board of Directors, in accordance with *Corporations Code Section 151*,

[*OR, if the number of directors in office is less than a quorum, choose one of the following:*]

by the unanimous written consent of the directors in office,

[*OR*]

by the affirmative vote of a majority of the directors in office at a meeting held pursuant to notice or waivers of notice complying with *Corporations Code Section 307*,

[*OR*]

by _____[*name*], the sole remaining director,

[*Continue with the following:*]

to fill that vacancy and to hold office as a director of this corporation in accordance with the bylaws of this Corporation. This election is effective when the resignation is effective.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersTerms in OfficeVacanciesBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeRemoval & ResignationBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
E. Specific Resolutions

2-5 California Legal Forms--Transaction Guide § 5.245

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.245 Resolution Establishing Board Committee

[1] Comment

[a] Use of Form

This form is a resolution for use by the board of directors creating special committees. It designates a committee to be composed of two or more members of the board of directors.

For discussion and examples of various formats for resolutions, see *§ 5.240*. For a certificate of adoption of a resolution by the board of directors, see *§ 5.241*. Minutes of the proceedings of the board are discussed in *§ 5.230*. Actions by written consent are discussed in *§§ 5.33* and *5.220-5.223*.

[b] Authority to Establish Board Committee

The board of directors may by resolution adopted by a majority of the authorized number of directors establish committees consisting of two or more directors to serve at the pleasure of the board [*Corp. Code § 311*]. One or more directors may by a vote of the majority of the authorized number of directors be designated as alternate members of these board committees [*Corp. Code § 311*]. Alternate members may replace any absent member at any committee meeting [*Corp. Code § 311*].

[c] Limitations on Authority of Board Committees

To the extent provided in the resolution creating a board committee or in the bylaws of the corporation, a board committee has all the authority of the board except with respect to the following matters [*Corp. Code § 311*]:

- Actions that also require approval of the shareholders or of the outstanding shares [*Corp. Code § 311(a)*].

- Filling vacancies on the board or committees [*Corp. Code § 311(b)*].

- Fixing the compensation of directors [*Corp. Code § 311(c)*].

- Adopting, amending, or repealing bylaws [*Corp. Code § 311(d)*].

- Amending or repealing any board resolution that expressly provides that it may not be amended or repealed by committee [*Corp. Code § 311(e)*].

- Authorizing a distribution to shareholders, except according to guidelines set forth in the articles or established by the directors [*Corp. Code § 311(f)*].

- Establishing other board committees or appointing committee members [*Corp. Code § 311(g)*].

[d] Meeting Procedures Applicable to Board Committees

The provisions of the General Corporation Law [*Corp. Code § 1 et seq.*] that govern directors meetings [*see Corp. Code § 307*] apply to board committees and incorporators [*see Corp. Code § 311*] and their actions [*Corp. Code § 307(c)*]. Thus, for example, a committee may act by unanimous written consent and its members may participate in meetings by conference telephone call, electronic video screen communication, or electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*], in the same manner as directors [*see Corp. Code § 307(a)(6), (b)*]. For further discussion of meeting procedure, see *§ 5.32*.

[e] Common Committees

The following are committees that boards of directors often establish:

- Compensation Committee: staffed by outside directors to set compensation of officers who are also directors.

- Audit Committee: oversees audit and financial risk management.

- Nominating Committee: develops lists of potential directors.

[2] FORM

Resolution Establishing Board Committee

RESOLUTION ESTABLISHING _____ [*name*] COMMITTEE OF THE BOARD

WHEREAS, *Corporations Code Section 311* authorizes the Board of Directors to establish one or more committees consisting of directors of this Corporation to which may be delegated, with certain exceptions, all authority of this Board of Directors, and the bylaws of the Corporation do not limit that authority; and,

WHEREAS, this Board has determined that it is in the best interests of this Corporation and its shareholders that such a committee be established;

Therefore, it is

RESOLVED, that a committee, known as the _____ [*name, e.g.*, Executive *or* Building] Committee, and consisting of _____ [*number not less than two*] directors is established, and that the following

directors are appointed as its members _____ [*names of directors*];

RESOLVED FURTHER, that _____ [*names of directors*] are appointed as alternate members of the committee (each of whom will receive notices of all the proceedings of the committee as though they were regular members) to serve on the committee, as a regular member, in the order in which listed in this resolution, in the absence of any regular member or members of the committee.

RESOLVED FURTHER, that each member (and alternate member) will serve until that member's (or alternate member's) successor is appointed by the Board of Directors or until the existence of this committee is terminated by the Board of Directors.

RESOLVED FURTHER, that the committee meetings may be held at any place, and in any manner, as permitted by applicable law and the bylaws of this Corporation. The Committee will adopt rules of procedure and will meet as provided by those rules, or as provided by this resolution or the corporation's bylaws. Meetings of the committee will be held when called by any member of the committee [*add if appropriate:* or otherwise as provided in the bylaws]. Written notice to the members of the committee of the time and place of any special meeting will be given in the manner provided for the giving of written notice to members of the Board of Directors of the time and place of special meetings of the Board of Directors. All calls, notices, and any waivers, consents, or approvals related to a meeting will be made a part of the minutes.

RESOLVED FURTHER, that minutes will be kept of each meeting of the committee.

RESOLVED FURTHER, that _____[*number*] members of the committee will constitute a quorum for the transaction of business.

RESOLVED FURTHER, that the committee shall have all the authority of the Board of Directors with respect to _____ [*specify authority, e.g.*, the management of the business and affairs of the Corporation, including the authority to issue stock], except that it will have no authority to:

(1) Approve any actions that also require approval of the shareholders or of the outstanding shares.

(2) Fill vacancies on the board or committees.

(3) Fix the compensation of directors.

(4) Adopt, amend, or repeal bylaws.

(5) Amend or repeal any board resolution that expressly provides that it may not be amended or repealed by committee.

(6) Authorize a distribution to shareholders, except according to guidelines set forth in the articles or established by the directors.

(7) Establish other board committees or appoint committee members.

[*Add any additional limitations, if desired.*]

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityLimitationsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
E. Specific Resolutions

2-5 California Legal Forms--Transaction Guide § 5.246

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.246 Resolution Authorizing Corporation to Borrow Money

[1] Comment

[a] Use of Form

This form is a resolution for use by the board of directors authorizing directors or officers to borrow money on behalf of the corporation [*see Corp. Code § 207(g)*] from a bank or other financial institution. For a discussion of the issuance of debt securities, see Ch. 6J, *Issuance of Debt Securities* . This type of resolution is commonly required by the financial institution making the loan. In some cases, financial institutions require their own form of corporate resolution. In these circumstances, that resolution should be adopted as the resolution of the board of directors.

For discussion and examples of various formats for resolutions, see *§ 5.240*. For a certificate of adoption of a resolution by the board of directors, see *§ 5.241*. Minutes of the proceedings of the board are discussed in *§ 5.230*. Actions by written consent are discussed in *§§ 5.33* and *5.220-5.223*.

[b] Liability of Corporation on Note

Subject to *Corp. Code § 208(a)*, any note, mortgage, evidence of indebtedness, contract, share certificate, conveyance, or other instrument in writing, and any assignment or endorsement of that instrument, executed or entered into between any corporation and any other person, when signed by both the chair of the board, the president, or any vice president, as well as by the secretary, any assistant secretary, the chief financial officer, or any assistant treasurer of the corporation, is not invalidated as to the corporation by any lack of authority of the signing officers, in the absence of actual knowledge on the part of the other person that the signing officers had no authority to execute the instrument [*Corp. Code § 313*]. In interpreting *Corp. Code § 313*, the California Supreme Court held that the signature of one person alone is sufficient to bind a corporation, as long as he or she holds corporate offices in each of the two series or categories ("operational group" and "financial group") described in that statute [*Snukal v. Flightways Manufacturing, Inc. (2000) 23 Cal. 4th 754, 785-787, 98 Cal. Rptr. 2d 1, 3 P.3d 286* (instrument not invalidated by lack of authority,

even though individual signing listed only one of offices held when executing instrument)].

[2] FORM

Resolution Authorizing Corporation to Borrow Money

RESOLUTION AUTHORIZING CORPORATION TO BORROW MONEY

RESOLVED, that _____ [*name(s) and title(s)*] _____ [is *or* are] authorized to borrow on behalf of this corporation the sum of $ _____ from _____ [*name of financial institution*] and to execute and deliver on behalf of this corporation to _____ [*name of financial institution*] the promissory note of this corporation in a form substantially the same as that submitted to this Board, providing for repayment of the principal and interest at the rate of _____ percent per year;

RESOLVED FURTHER, that the Corporate Secretary is directed to attach a copy of the promissory note to the minutes of this meeting;

RESOLVED FURTHER, that the Corporate Secretary is directed to certify this resolution and to deliver the certification in support of the authority of the officers named above to act on behalf of this corporation.

[*Add, if desired:*]

RESOLVED FURTHER, that as security for this loan, the officer[s] named above _____ [is *or* are] authorized and directed to execute and deliver to _____ [*name of financial institution*] documents evidencing the mortgage or pledge of any of the property of the corporation in a form to be agreed on by the officers named above and _____ [*name of financial institution*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
E. Specific Resolutions

2-5 California Legal Forms--Transaction Guide § 5.247

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.247 Resolution Authorizing Repurchase of Corporate Shares

[1] Comment

[a] Use of Form

This form is a resolution authorizing the corporation to repurchase corporate shares. This type of resolution is for use by a corporation with an entity purchase buy-sell agreement, or a hybrid (entity purchase/cross purchase) agreement.

Except for entity purchase agreements adequately funded by life or disability insurance (which cover only the death or disability of the shareholder and not other events that may trigger the sale of shares) [*see Corp. Code §§ 503.1*, *503.2*], an entity purchase agreement may be unenforceable at the time the shareholder withdraws from the corporation. A corporation is prohibited from repurchasing its shares unless at the time of the shareholder's death or withdrawal it can meet certain statutory financial tests that do not apply to a cross-purchase agreement [*see Corp. Code §§ 166*, *500-503*; *see* [b], *below*; *see also* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 8, *Dividends and Reacquisition of Shares* (Matthew Bender) (enforcement and validity of contracts by corporations to repurchase their shares)]. For further discussion of buy-sell agreements, see Ch. 8D, *Buy-Sell Agreements* .

Further, if the corporation's securities are publicly traded, careful attention should also be paid to applicable rules and regulations of the Securities and Exchange Commission under the Securities and Exchange Act of 1934, and any stock exchange rules. For further discussion of federal securities issues, see Gadsky, Business Organizations--Federal Securities Exchange Act of 1934, Ch. 4, *Exchange Act Registration and Reporting Requirements* (Matthew Bender). For discussion of California securities requirements, see Ch. 6, *Securities Regulation Issues* .

For discussion and examples of various formats for resolutions, see *§ 5.240*. For a certificate of adoption of a resolution by the board of directors, see *§ 5.241*. Minutes of the proceedings of the board are discussed in *§ 5.230*. Actions by written consent are discussed in *§ 5.33* and *§§ 5.220-5.223*. The statutory test for corporate distributions discussed below, in relation to stock redemptions, also apply to dividends [*see Corp. Code § 166* (distribution to shareholders

defined)]. Thus, if the board of directors will authorize a dividend, this form may be modified accordingly. The text of a resolution for the declaration and payment of a dividend is contained in *§ 5.221[2]*.

[b] Restrictions on Corporate Purchases; Statutory Tests

A corporation must satisfy certain statutory financial tests to purchase or redeem its shareholders' shares under an entity purchase agreement not funded by insurance. Under the General Corporation Law, the purchase or redemption by a corporation of its shares for cash or property is a "distribution to its shareholders" [*Corp. Code § 166*]. To make any valid distribution to its shareholders, a corporation must be able to pass either the retained earnings or remaining assets test [*Corp. Code § 500*], the general solvency test [*Corp. Code § 501*], and when applicable, the liquidation preference and dividend preference tests [*Corp. Code §§ 502, 503*]. However, a corporation licensed as a broker-dealer under *Corp. Code § 25210 et seq.* to effect transactions in securities for the account of others is not required to pass either the retained earnings or remaining assets test [*see Corp. Code § 500(a), (b)*] if immediately after any distribution it is in compliance with the net capital rules of the Commissioner of Corporations [*see 10 Cal. Code Reg. § 260.216.12*] and the Securities and Exchange Commission [*Corp. Code § 500(e)*; *see 17 C.F.R. § 240.15c3-1*].

The retained earnings requirement provides that a corporation may purchase its own shares if its retained earnings immediately prior to the distribution equal or exceed the amount of the proposed distribution [*Corp. Code § 500(a)*]. "Retained earnings" means the balance of net profits after the deduction of distributions to shareholders, and transfer to capital accounts under generally accepted accounting principles [*see Corp. Code § 114*; Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 8. *Dividends and Reacquisition of Shares* , § 141.06[3] (Matthew Bender)].

A corporation with insufficient retained earnings may still purchase its own shares if its meets the remaining assets test. This test provides for purchase of shares if, immediately after the distribution:

- Corporate assets (excluding goodwill, capitalized research and development expenses and deferred charges) equal at least 125 percent of corporate liabilities (excluding deferred taxes, deferred income and other deferred credits), and

- Current assets equal current liabilities. However, current assets must equal 125 percent of current liabilities if the average earnings of the corporation before income taxes and interest expenses were less than the average interest expenses for the two preceding fiscal years [*Corp. Code § 500(b)(2)*]. The second part of this test [*Corp. Code § 500(b)(2)*] does not apply to a corporation that is not required to classify its assets into current and fixed under generally accepted accounting principles [*Corp. Code § 500(b)(2)*].

For the purpose of applying *Corp. Code § 500* to a distribution by a corporation of cash or property in payment by the corporation in connection with the purchase of its shares, there must be added to retained earnings all amounts that had been previously deducted from retained earnings with respect to obligations incurred in connection with the corporation's repurchase of its shares and reflected on the corporation's balance sheet, but not in excess of the principal of the obligations that remain unpaid immediately prior to the distribution. In addition, there must be deducted from liabilities all amounts that had been previously added to liabilities with respect to the obligations incurred in connection with the corporation's repurchase of its shares and reflected on the corporation's balance sheet, but not in excess of the principal of the obligations that will remain unpaid after the distribution, provided that no addition to retained earnings or deduction from liabilities under *Corp. Code § 500(b)(2)* may occur on account of any obligation that is a distribution to the corporation's shareholders [*see Corp. Code § 166* (when distribution is made)] at the time the obligation is incurred [*Corp. Code § 500(d)*].

The solvency test requires that a corporation not make any distribution to the corporation's shareholders if as a result the

corporation is or would be likely to be unable to meet its liabilities as they mature [*Corp. Code § 501*]. This test must be met even if the corporation satisfies the retained earnings or remaining assets test [*Flynn v. California Casket Co. (1951) 105 Cal. App. 2d 196, 205-206, 233 P.2d 131]* .

Finally, a corporation may not make distributions to junior shares that affect the liquidation or dividend preferences of senior shares [*see Corp. Code §§ 502, 503*].

For an further discussion of these tests, see Ch. 9, *Dividends, Reacquisitions of Shares, and Assessments* , and Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 8, *Dividends and Reacquisition of Shares* , § 141 (Matthew Bender).

[c] Exception for Agreements Funded with Insurance

When the entity purchase agreement is funded with insurance, the statutory tests discussed in [b], above, are partially inapplicable. They do not apply to a purchase or redemption of shares of a deceased shareholder from the proceeds of life insurance on that shareholder in excess of the total amount of all premiums paid by the corporation for the insurance, if the shares are purchased to carry out the provisions of an agreement between the corporation and the shareholder to purchase or redeem the shares upon the death of the shareholder [*Corp. Code § 503.1*]. A similar rule applies to the proceeds of disability insurance used to purchase a disabled shareholder's shares [*see Corp. Code § 503.2*]. Even if the proceeds exceeding the premiums paid by the corporation are inadequate for the redemption, those proceeds received by the corporation should increase its retained earnings and enable it to pass the statutory balance sheet tests [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations*, § 63.03[b][i]] (Matthew Bender).

[d] Directors' Reliance on Advice of Others

A director is entitled to rely on information from corporate officers and employees, counsel, independent accountants, and board committees, if the director believes the source is reliable and competent [*see Corp. Code § 309(b)*; 5.11].

[2] FORM

Resolution Authorizing Repurchase of Corporate Shares

RESOLUTION AUTHORIZING REPURCHASE OF SHARES

WHEREAS the directors have received and carefully reviewed a report prepared by _____ [*name(s) and title(s) of officers*], including financial statements and other financial data as of _____[*date*] with respect to the retained earnings, assets, and liabilities of the corporation; and

WHEREAS the directors believe that _____ [*name(s) and title(s) of officers*] _____ [is *or* are] reliable and competent with respect to those matters; and

WHEREAS the report indicates that the corporation may spend at least $ _____ [*dollar amount*] to repurchase its stock without violating any provisions of the California Corporation Code or any provisions in the Articles of Incorporation or Bylaws of, or any agreement entered into by, the corporation; and

WHEREAS the directors consider it to be in the best interests of the corporation and its shareholders to repurchase, in the aggregate, up to _____ [*number of shares*] of its stock;

Therefore, it is

RESOLVED, that the directors authorize the repurchase of up to _____ [*number of shares*] of the

corporation's stock, for a price not to exceed $ _____ [*dollar amount*] per share, on the terms and conditions as the officers of the corporation consider to be appropriate, and as required by applicable law or agreement, provided that, at the time of the repurchase, all applicable statutory requirements and any agreements to which this corporation is a party, are satisfied with respect to the repurchase.

RESOLVED FURTHER, that each of the officers of this corporation is authorized and directed to execute all documents and to take any other action necessary or advisable to carry out the purposes of this resolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsSecurities LawAdditional Offerings & the Securities Exchange Act of 1934Issuer Recordkeeping & ReportingGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceCorporate Ownership of StockBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
E. Specific Resolutions

2-5 California Legal Forms--Transaction Guide § 5.248

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.248 Resolution Fixing Value of Nonmonetary Consideration for Shares to Be Issued

[1] Comment

[a] Use of Form

This form is for use where shares are to be issued for consideration other than money.

For further discussion of federal securities issues, see Gadsky, Business Organizations--Federal Securities Exchange Act of 1934, Ch. 4, *Exchange Act Registration and Reporting Requirements* (Matthew Bender). For discussion of California securities requirements, see Ch. 6, *Securities Regulation Issues* .

For discussion and examples of various formats for resolutions, see *§ 5.240*. For a certificate of adoption of a resolution by the board of directors, see *§ 5.241*. Minutes of the proceedings of the board are discussed in *§ 5.230*. Actions by written consent are discussed in *§§ 5.33* and *5.220-5.223*.

[b] Consideration for Shares

Shares may be issued for such consideration as is determined by the board of directors (or by the shareholders, if the articles so provide), consisting of any (or all) of the following: money paid, labor done, services actually rendered to the corporation or for its benefit or in its formation or reorganization, debts or securities canceled, and tangible or intangible property actually received either by the issuing corporation or by a wholly owned subsidiary [*Corp. Code § 409(a)(1)*]. However, neither promissory notes of the buyer (unless adequately secured by collateral other than the shares acquired or unless permitted by an employee stock purchase plan, or option plan or agreement [*see Corp. Code § 408*], nor future services constitute payment or part payment for shares of the corporation [*Corp. Code § 409(a)(1)*].

When the consideration is other than money, the board of directors must state by resolution its determination of the fair value to the corporation in monetary terms of the consideration for which shares are issued [*Corp. Code 409(e)*]. This

requirement does not affect the proper accounting treatment to be accorded a given transaction, which must conform to generally accepted accounting principles [*Corp. Code 409(e)*]. Thus, in a merger, use of "pooling of interests" accounting may be required, in which case the value of noncash consideration as determined by the board might be significantly different from that recorded in the surviving corporation's books.

[2] FORM

Resolution Fixing Value of Nonmonetary Consideration for Shares to Be Issued

RESOLUTION FIXING VALUE OF NONMONETARY CONSIDERATION FOR SHARES

RESOLVED, that this Board of Directors does hereby adjudge and determine in accordance with *California Corporations Code Section 409(e)* that the fair market value in monetary terms of the _____ [*describe consideration, e.g.,* legal services rendered by _____ (*name*) in the formation of this corporation *or* real property described above which is to be conveyed to this corporation in exchange for its shares] is not less than $ _____ [*dollar amount*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
E. Specific Resolutions

2-5 California Legal Forms--Transaction Guide § 5.249

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.249 Resolution Authorizing Execution of Transactional Agreement

[1] Comment--Use of Form

This form is for use by the directors to authorize the execution of various types of agreements by the corporation. For discussion and examples of various formats for resolutions, see *§ 5.240*. For a certificate of adoption of a resolution by the board of directors, see *§ 5.241*. Minutes of the proceedings of the board are discussed in *§ 5.230*. Actions by written consent are discussed in *§§ 5.33* and *5.220-5.223*.

[2] FORM

Resolution Authorizing Execution of Transactional Agreement

RESOLUTION AUTHORIZING EXECUTION OF TRANSACTIONAL AGREEMENT

WHEREAS the Board of Directors of the corporation finds that the _____ [*name of agreement*] Agreement (the "Agreement") and the transactions contemplated thereby are in the best interests of the corporation;

NOW, THEREFORE, BE IT RESOLVED, that the Board of Directors of the corporation hereby approves the corporation's entering into the transaction contemplated by the Agreement.

RESOLVED FURTHER, that the Agreement, and the execution, delivery and performance thereof, are hereby ratified, confirmed and approved in all respects.

RESOLVED FURTHER, that the officers of the corporation are, and each individually is, authorized on behalf of the corporation to consummate the transactions contemplated by the Agreement and to cause the corporation to perform all of its duties and obligations thereunder.

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawRemediesRatificationBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 5 DIRECTORS MEETINGS, ACTIONS, AND RESOLUTIONS
PART IV. FORMS
E. Specific Resolutions

2-5 California Legal Forms--Transaction Guide § 5.250

AUTHOR: Marilyn E. Minger, Practice Consultant

§ 5.250 Board Resolution Approving Conversion

[1] Comment--Use of Form

This form is a resolution by the board of directors of a California corporation authorizing the conversion of the corporation into another business entity pursuant to Chapter 11.5 of the General Corporation Law [*Corp. Code § 1150 et seq.*]. For extensive discussion of the law authorizing corporate conversions, as well as procedural guides and forms for effectuating such a conversion, see Ch. 11F, *Corporate Conversions* .

[2] FORM

Board Resolution Approving Conversion
BOARD RESOLUTION APPROVING CONVERSION INTO OTHER BUSINESS ENTITY

WHEREAS, it is deemed to be in the best interests of this corporation and its shareholders that the corporation convert into a California _____ [*specify type of other business entity, e.g.,* limited partnership] (the "Converted Entity") pursuant to Chapter 11.5 of the General Corporation Law of California; and

WHEREAS, to do so this corporation must adopt a Plan of Conversion (the "Plan") and a proposed Plan has been presented to this meeting; and

WHEREAS, the Board of Directors has considered and hereby approves the Plan in accordance with *Corporations Code Section 1152*; and

WHEREAS, the Plan meets the requirements regarding conversion of shares of this corporation into interests in the Converted Entity and applicable governing law set forth in *Corporations Code Section 1151*;

Therefore, it is

RESOLVED, that the form, terms, and provisions of the Plan of Conversion ("Plan") presented to and considered at this meeting be and each of them is hereby approved but with such changes therein (other than as to the type of entity into which this corporation is to be converted and the manner of conversion of the shares of this corporation into interests of the Converted Entity), if any, as the officer or officers acting in the premises shall approve, such approval to be conclusively evidenced by his, her, or their action in the premises.

RESOLVED FURTHER, that this corporation shall convert into the Converted Entity pursuant to the Plan.

RESOLVED FURTHER, that the officers of this corporation are each authorized and directed to seek approval by the shareholders of the principal terms of the Plan as required by *Corporations Code Section 1152(b)* [*if the converting corporation is a close corporation, add:* and the consent required by the last sentence of *Corporations Code Section 1152(b) and/or if some shares of the converting corporation are not to be treated equally with other shares of the same class or series, add:* and the consent required by *Corporations Code Section 1151(a).*]

RESOLVED FURTHER, that each of the officers of this corporation is authorized and directed to execute all documents and to take any other action necessary or advisable to carry out the purpose of this resolution.

RESOLVED FURTHER, that the Corporate Secretary is directed to attach a copy of the Plan to the minutes of this meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



1 of 193 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES

3-6 California Legal Forms--Transaction Guide 6.syn

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.syn Synopsis to Chapter 6: SECURITIES REGULATION ISSUES

§ 6.01 California Sources

[1] Statutes

[2] Regulations

[3] Releases of the Corporations Commissioner

§ 6.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 6.03-6.04 [Reserved]

§ 6.05 Law Reviews and Periodicals

§ 6.06 Annotations

§ 6.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 6.08-6.09 [Reserved]

§ 6.10 Nature and Effect of Securities Laws

[1] Basic Issues in Securities Transactions

[2] Securities Regulation in the United States

[3] California Securities Laws

[4] Federal Securities Laws

[5] Evaluating Application of Securities Laws

§ 6.11 What Constitutes a "Security"

[1] Statutory Definition

[2] Judicial Rules Applicable to Transactions Not Specifically Listed in Statute

[3] Specific Transactions

[a] Promissory Notes and Evidences of Indebtedness

[b] General Partnership and Joint Venture Interests

[c] Limited Partnership Interests

[4] Statutory Exclusions to Definition of "Security"

§ 6.12 What Constitutes "Offers" and "Sales"

[1] Offers

[2] Sales

[3] Specific Transactions

[4] Exclusions

§ 6.13 What Constitutes Offer or Sale "In This State"

[1] Offers and Sales in California

[2] Offers to Buy in California

[3] Accepted Offers

[4] Delivery of Securities

[5] Offers Deemed Not Made in California

[6] Offers Made on the Internet

§ 6.14 Types of Regulated Transactions

[1] Importance of Distinctions

[2] Issuers and Issuer Transactions

[3] Nonissuer Transactions

[4] Recapitalizations and Reorganizations

§ 6.15 Federal Preemption of State Securities Regulation

[1] National Securities Markets Improvement Act of 1996

[2] Extent of Federal Preemption

[3] California Response and Implementation

[4] Continued State Authority

[a] Fraud Enforcement Actions

[b] Notice Filing Requirements

[5] Definition of "Covered Security"

[a] Nationally Traded Securities

[b] Registered Investment Companies

[c] Sales to Qualified Purchasers

[d] Exempt Offerings

[6] Practical Effect of Preemption Provisions on Nonpublic Offerings

§§ 6.16-6.29 [Reserved]

§ 6.30 Nature, Classes, and Importance of Exemptions

[1] Compared With Qualification

[2] Basic Classes of California Securities Exemptions

[3] Number and Significance

[4] Exemptions Most Frequently Used by California Nonpublic Corporations and Other Similar Business Entities

§ 6.31 Limited Offering Exemptions

[1] Requirements

[2] Integration

[3] Number of Purchasers

[4] Exclusions From Purchaser Count

[5] Investor Suitability Requirements

[6] Investment Intent

[7] Prohibition on Advertising

[8] Disclosure of Material Facts

[9] Notice of Transaction

[a] Copy of SEC Form

[b] Electronic Filing; Hardship Exception

[c] Time for Filing

[d] Failure to File

[10] Impact of National Securities Markets Improvement Act

§ 6.32 Small Offering Exemption

[1] Requirements

[2] Type of Stock

[3] Number of Owners

[4] Prohibition on Advertising

[5] Prohibition on Selling Expenses

[6] Consideration for Securities

[7] Promotional Activities

[8] Notice and Opinion of Counsel

[9] Investment Intent

§ 6.33 California Qualified Purchaser Exemptions

[1] In General

[2] Institutional Investor Exemption

[3] Limited Offering Qualified Purchaser Exemption

[4] Comparison of Exemptions

§ 6.34 Selecting the Most Appropriate California Exemption

[1] Comparison of Commonly Used Exemptions

[2] Analysis of Differences

§§ 6.35-6.39 [Reserved]

§ 6.40 When Qualification Is Necessary

§ 6.41 Nature of Qualification Process

[1] Application and Review by Commissioner

[2] Merit Standards

§ 6.42 Methods of Qualification

[1] Methods

[2] Issuer Transactions

[3] Nonissuer Transactions

[4] Reorganizations and Recapitalizations

[5] Qualification by Coordination

[a] Procedure

[b] Effective Date

[6] Qualification by Notification

[a] Availability

[b] Procedure

[c] Effective Date

[7] Qualification by Permit

[a] Availability

[b] Application

§§ 6.43-6.49 [Reserved]

§ 6.50 Relevance to Securities Sold in California

§ 6.51 Governing Law

[1] Statutes

[2] Administrative Authorities

§ 6.52 The Securities Act of 1933

[1] Purpose

[2] Registration Requirement

[3] Exemptions From Registration Requirement

[4] Exempt Categories of Securities

[5] Exempt Types of Transactions

[6] Small Offering Exemption

§ 6.53 Regulation D

[1] In General

[2] Accredited Investors Under Regulation D

[a] Definition and Classification

[b] Comparison With California Law

[3] Calculation of Number of Purchasers

[a] Federal Law

[b] Comparison With California Law

§ 6.54 Rule 504

[1] Eligible Issuers

[2] Eligible Offerings

[3] Comparison to California Limited Offering Exemption and Qualified Purchaser Exemption

§ 6.55 Rule 505

[1] Eligible Issuers

[2] Eligible Offerings

[3] Comparison to California Limited Offering Exemption

§ 6.56 Rule 506

[1] Eligible Issuers

[2] Eligible Offerings

[3] Purchaser Representative

[4] Comparison to California Limited Offering Exemption

§ 6.57 Regulation A

§ 6.58 Intrastate Offerings

[1] Rule 147

[2] Residence/Doing Business Requirement--Issuer

[3] Residence/Doing Business Requirement--Offerees and Purchasers

[4] Other Issuer Requirements for Rule 147

§ 6.59 Other Exemptions

§§ 6.60-6.69 [Reserved]

§ 6.70 Interstate Offerings

§ 6.71 Coordinated Equity Review Program

[1] California Participation

[2] Coordinated Review

[3] Guidelines

§§ 6.72-6.99 [Reserved]

§ 6.100 Facts--Issuer

Scope

§ 6.101 Facts--Management and Shareholders

Scope

§ 6.102 Facts--Outstanding Securities

Scope

§ 6.103 Facts--Securities Involved in Transaction

Scope

§ 6.104 Facts--Potential Purchasers

Scope

§ 6.105 Facts--Method of Publicizing Offering and Sale

Scope

§ 6.106 Documents

Scope

§§ 6.107-6.109 [Reserved]

Scope

§ 6.110 Existence of Security

Scope

§ 6.111 Existence of Offer or Sale

Scope

§ 6.112 Whether Offer to Buy or Sell Is Made in California

Scope

§ 6.113 Type of Transaction

Scope

§ 6.114 Single or Multiple Transactions

Scope

§ 6.115 Securities Exempt From Qualification

Scope

§ 6.116 Securities Transactions Exempt From Qualification

Scope

§ 6.117 Federal Preemption

Scope

§ 6.118 California Qualification

Scope

§ 6.119 Intrastate or Interstate Offering

Scope

§ 6.120 Applicable Federal Requirements

Scope

§§ 6.121-6.139 [Reserved]

§ 6.140 Compliance With Applicable Securities Laws

Scope

§ 6.141 Compliance With California Requirements Relating to Federally Preempted Securities and Transactions

Scope

§§ 6.142-6.199 [Reserved]

§ 6.200 Table of All California Securities Exemptions

[1] Comment--Use of Table

[2] Table

§ 6.201 Chart Comparing Commonly Used California and Federal Exemptions

[1] Comment

[a] Use of Chart

[b] Exemptions Included in Table

[2] Chart

§§ 6.202-6.209 [Reserved]

§ 6.210 Worksheet for Determining Available Exemptions

[1] Comment--Use of Form

[2] FORM

Worksheet for Determining Available Exemptions

§§ 6.211-6.229 [Reserved]

§ 6.230 Request for Interpretive Opinion [Corp. Code § 25618; 10 Cal. Code Reg. § 250.12]

[1] Comment

[a] Use of Form

[b] Contents of Request

[c] Discretion to Render Opinion

[d] Public Access to Requests and Replies

[2] FORM

Request for Interpretive Opinion [Corp. Code § 25618; 10 Cal. Code Reg. § 250.12]

§ 6.231 Request for Designation as Exempt Life Income Contract Issuer [Corp. Code § 25100(k); 10 Cal. Code Reg. § 260.100.1]

[1] Comment--Use of Form

[2] FORM

Request for Designation as Exempt Life Income Contract Issuer [Corp. Code § 25100(k); 10 Cal. Code Reg. § 260.100.1]

§ 6.232 Request for Order of Exemption for Short-Term Commercial Paper [Corp. Code § 25100(l); 10 Cal. Code Reg. § 260.100.3]

[1] Comment--Use of Form

[2] FORM

Request for Order of Exemption for Short-Term Commercial Paper [Corp. Code § 25100(l); 10 Cal. Code Reg. § 260.100.3]

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FOOTNOTES:

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES

3-6 California Legal Forms--Transaction Guide Scope

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

Scope

Marilyn Mingern* Frances E. Lossingn**
Practice Consultant Scope

This chapter discusses the issues that must be considered and resolved in connection with the issuance, offer, or sale of securities, with specific emphasis on nonpublic or closely held corporations. It focuses on the California and federal securities laws and the ways in which these laws can impact on the issuance and sale of corporate stock and other securities. It is intended to guide attorneys in structuring securities transactions in a manner that will be most appropriate to the goals of the client, by helping the attorney to balance the often-competing considerations of minimum regulatory involvement and maximum flexibility in offering and selling the securities.

The chapter is designed to assist practitioners in determining whether or not the California securities laws are applicable to a planned transaction. It addresses the issues of whether an instrument is classified as a "security" for purposes of the California securities laws [*see § 6.11*], whether or not a particular transaction involves an "offer" and/or "sale" [*see § 6.12*], and whether that transaction occurs "in California" [*see § 6.13*] for purposes of the securities laws.

The chapter contains a discussion of the National Securities Markets Improvement Act of 1996 [*see § 6.15*] and the effect of its preemption provisions on California regulation of securities transactions. It discusses the various exemptions from qualification that exist under the California securities laws [*see § 6.30*], and focuses on some of the more commonly used exemptions in connection with nonpublic offerings by California corporations, and the considerations involved in selecting the exemption best suited to a particular transaction [*see §§ 6.31-6.34*]. Finally, it discusses the basic nature of the qualification process, the several methods of qualification available, and the distinguishing features of each [*see §§ 6.40-6.42*].

The Legal Background includes a basic discussion of the federal laws governing securities transactions [*see § 6.50*], explains how these laws operate, and compares them to analogous provisions of California law. The federal exemptions under Regulation D, Regulation A, and SEC Rule 147 are explained [*see §§ 6.51-6.58*].

The forms include a table containing a complete list of all the California statutory exemptions from qualification [*see § 6.200*], and a chart comparing the requirements of the most commonly used California and federal exemptions [*see §*

6.201]. A worksheet is also included [*see § 6.210*], along with a form requesting an interpretive opinion from the Commissioner of Corporations [*see § 6.230*] and forms relating to some exemptions not discussed elsewhere in this publication [*see §§ 6.231, 6.232*].

Other chapters in this publication contain in-depth coverage of some of the exemptions and qualification requirements introduced in this chapter:

- For detailed discussion of the federal securities exemptions, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* .

- For detailed discussion of the California limited offering exemptions, see Ch. 6B, *California Limited Offering Exemptions* .

- For detailed discussion of the California small offering exemption, see Ch. 6C, *California Small Offering Exemption* .

- For detailed coverage of the California institutional investor and qualified purchaser exemptions, see Ch. 6D, *California Qualified Purchaser Exemptions* .

The issuance of securities is discussed in Ch. 6I, *Issuance of Equity Securities* , and Ch. 6J, *Issuance of Debt Securities* , respectively.

FOOTNOTES:

(n29)Footnote *. Marilyn E. Minger is a sole practitioner in Oakland, California, specializing in business, personal injury, bankruptcy, and probate. Ms. Minger formerly worked for Heller, Ehrman, White & McAuliffe and Pettit & Martin in San Francisco, where she practiced corporate law.

(n30)Footnote **. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6 California Legal Forms--Transaction Guide § 6.01

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.01 California Sources

[1] Statutes

Bond and Undertaking Law. *Code Civ. Proc. §§ 995.010-996.560.*

Definition of "close corporation." *Corp. Code § 158.*

Pseudo-California corporation requirements. *Corp. Code § 2115*.

Corporate Securities Law of 1968. *Corp. Code § 25000 et seq.*

Definitions. *Corp. Code §§ 25000-25022*.

"Advertisement" defined. *Corp. Code § 25002.*

"Agent" defined. *Corp. Code § 25003*.

"Broker Dealer" defined. *Corp. Code § 25004.*

Offer or sale of securities in this state; offer to buy or purchase in *California. Corp. Code § 25008.*

"Investment adviser"--Commissioner's authority over persons excepted from definition of "investment adviser by federal law. *Corp. Code § 25009.1*.

"Investment adviser representative" or "associated person of an "Investment adviser" defined. *Corp. Code § 25009.5*.

"Issuer" defined. *Corp. Code § 25010*.

"Person" defined. *Corp. Code § 25013*.

"Publish" defined. *Corp. Code § 25014*.

"Roll-up participants" defined. *Corp. Code § 25014.5*.

"Rollup transaction" defined. *Corp. Code § 25014.6*.

"Rule" defined. *Corp. Code § 25016*.

"Offer," "offer to sell," "sale," and "sell" defined. *Corp. Code § 25017*.

"Securities" defined. *Corp. Code § 25019*.

Exemptions. *Corp. Code §§ 25100-25105*.

Limited offering exemption. *Corp. Code § 25102(f)*.

Small offering exemption from issuer transactions. *Corp. Code § 25102(h)*.

Institutional Investor Exemption. *Corp. Code § 25102(i)*.

Qualified Purchaser Limited Public Offering Exemption. *Corp. Code § 25102(n)*.

Private placement exemption for evidences of indebtedness. *Corp. Code § 25102(e)*.

Rule 701 exemption. *Corp. Code § 25102(o)*.

Qualification Requirements. *Corp. Code § 25110 et seq.*

Issuer Transactions. *Corp. Code §§ 25110-25117*.

Recapitalizations and reorganizations. *Corp. Code §§ 25120-25122*.

Nonissuer transactions. *Corp. Code §§ 25130-25134*.

Authority of Commissioner. *Corp. Code §§ 25140-25151*.

General provisions pertaining to applications for qualification of securities. *Corp. Code §§ 25160-25166*.

Regulation of agents, broker-dealers, investment adviser representatives, and investment advisers. *Corp. Code § 25200 et seq.*

Advertising securities. *Corp. Code §§ 25300-25302*.

Fraudulent and prohibited practices. *Corp. Code §§ 25400-25404*.

Burden of proving exemption is on issuer. *Corp. Code § 25401*.

Enforcement. *Corp. Code §§ 25500-25550*.

Administration. *Corp. Code §§ 25600-25619*.

Authority of Commissioner to cooperate with other securities agencies. *Corp. Code § 25612.5(a)*.

General provisions. *Corp. Code §§ 25700-25707*.

[2] Regulations

No implied requirement of written findings. *10 Cal. Code Reg. § 1.8*.

Time. *10 Cal. Code Reg. § 1.9*.

Service. *10 Cal. Code Reg. § 1.10*.

Rules of the Corporations Commissioner. *10 Cal. Code Reg. § 250.9 et seq.*

Administration. *10 Cal. Code Reg. §§ 250.9-250.16*.

Hearings. *10 Cal. Code Reg. §§ 250.17-250.25*.

Conflict of interest. *10 Cal. Code Reg. § 250.30*.

Limitation on licenses and certificates to aliens. *10 Cal. Code Reg. §§ 250.60, 250.61*.

Administrative penalties. *10 Cal. Code Reg. § 250.70*.

Definitions. *10 Cal. Code Reg. §§ 260.000-260.019.2*.

Exemptions from qualification. *10 Cal. Code Reg. §§ 260.100-260.105.39*.

Non-public offering and sale. *10 Cal. Code Reg. § 260.102.2*.

Small offering exemption. *10 Cal. Code Reg. §§ 260.102.4-260.102.9, 260.102.11*.

Designation of institutional investors and governmental agencies and instrumentalities by class. *10 Cal. Code Reg. § 260.102.10*.

Distribution under Securities and Exchange Commission Rule 144A. *10 Cal. Code Reg. § 260.102.10.1*.

Advances and loans in connection with small offering exemption. *10 Cal. Code Reg. § 260.102.11*.

Limited offering exemption interpretations. *10 Cal. Code Reg. § 260.102.12*.

Limited offering exemption excluded purchasers. *10 Cal. Code Reg. § 260.102.13*.

Notice of transaction for purchase or option plans or agreements. *10 Cal. Code Reg. § 260.102.19*.

Limited public offering exemption notice of transaction. *10 Cal. Code Reg. § 260.102.16*.

Disclosure statement requirement for Section 25102(n)/Rule 504 Offerings. *10 Cal. Code Reg. § 260.102.17*.

Distribution under Securities and Exchange Commission Rule 144A. *10 Cal. Code Reg. § 260.102.18*.

Contribution of Securities by Issuer to pension or profit sharing plans, to which offers or sales may not be made under *Corp. Code § 25102(i)*. *10 Cal. Code Reg. § 260.105.5*.

Incentive stock option plans. *10 Cal. Code Reg. § 260.105.8*.

Sales to public agencies. *10 Cal. Code Reg. § 260.105.14*.

Procedure for qualification. *10 Cal. Code Reg. §§ 260.110-260.131*.

Standards for the exercise of the Commissioner's authority. *10 Cal. Code Reg. §§ 260.140-260.140.05*.

Conditions of qualification. *10 Cal. Code Reg. §§ 260.141-260.141.50*.

Other provisions concerning exercise of the Commissioner's authority. *10 Cal. Code Reg. §§ 260.142-260.151*.

General provisions relating to qualification. *10 Cal. Code Reg. §§ 260.162-260.165*.

Licensing of broker-dealers and agents. *10 Cal. Code Reg. §§ 260.200-260.211.3*.

Regulation of broker-dealers and agents. *10 Cal. Code Reg. §§ 260.216-260.218.6*.

Licensing and regulation of investment advisers. *10 Cal. Code Reg. §§ 260.230-260.238*.

General provisions relating to agents, broker-dealers, and investment advisers. *10 Cal. Code Reg. §§ 260.240-260.242*.

Advertising securities. *10 Cal. Code Reg. §§ 260.300-260.302*.

General provisions. *10 Cal. Code Reg. §§ 260.504.2-260.617*.

[3] Releases of the Corporations Commissioner

NOTE:

The Commissioner periodically publishes releases that set forth information concerning the regulatory activities of the Commissioner, inform practitioners as to policies, or disclose interpretive opinions. Attorneys may obtain individual copies of releases from any office of the Department of Corporations at no charge [***see*** *10 Cal. Code Reg. § 260.608(b)*], or may be placed on a mailing list for distribution of Corporate Securities Law material at a cost of $10 per year [*10 Cal. Code Reg. § 260.608(c)(5)*]. Releases are also reproduced in Ballantine & Sterling, California Corporation Laws, vol. 7 (Matthew Bender), Marsh & Volk, Practice Under the California Securities Laws, Appendix A-4 (Matthew Bender), and the California Corporations Code (Matthew Bender.).

Offices for filing with the Department of Corporations. Dept. of Corps. Release No. 13-G (Revised; June 10, 2004).

Notification to Department of Corporations of pending class action settlements involving matters within Department's authority, under Class Action Fairness Act of 2005 [*28 U.S.C. § 1332(d), 1453,* 1711-1715]. Dept. of Corps. Release No. 18-G (Nov. 6, 2007). Temporary suspension of selected fees under the Corporate Securities Law of 1968. Dept. of Corps. Release No. 112-C (Sept. 4, 1998).

Participation in NASAA's Coordinated Equity Review Program. Dept. of Corps. Release No. 111-C (Apr. 16, 1998).

Offers of securities made on the Internet. Dept. of Corps. Release No. 100-C (Oct. 5, 1996).

Acceptance of Form NF to satisfy California's notice filing requirement for offerings of investment company securities. Dept. of Corps. Release No. 106-C (July 11, 1997).

Notice filing and fee payment requirements for securities offerings under SEC Rule 506. Dept. of Corps. Release No. 103-C (Dec. 12, 1996).

Small corporate offering registration (SCOR) application process and offerings of securities under SEC Regulation A.Dept. of Corps. Release No. 93-C (Oct. 13, 1993).

Procedures and requirements for qualification of the sale of securities by SEC Form S-3 or Form F-3 registrants utilizing Rule 415 for delayed or continuous offerings of securities. Dept. of Corps. Release No. 70-C (June 24, 1982, as revised Nov. 5, 1982 and Dec. 31, 1983).

Use of escrow in nonissuer transactions involving legended securities may not require Commissioner's prior written consent. Dept. of Corps. Release No. 60-C (Oct. 19, 1979).

Use of "due diligence" material as advertising. Dept. of Corps. Release No. 40-C (Jan. 3, 1975).

Repurchase offers. Dept. of Corps. Release No. 36-C (Feb. 25, 1974, as revised Feb. 14, 1975).

Reference to tax counsel's opinion in advertisement of securities. Dept. of Corps. Release No. 23-C (Nov. 12, 1971).

Suitability of securities. Dept. of Corps. Release No. 8-C (Feb. 27, 1969).

Guidelines for determining when securities are being issued to the public. Dept. of Corps. Release No. 5-C (Jan. 31, 1969).

Use of Internet in *Corp. Code § 25102(n)* offering. Commissioner's Opinion No. 96/2.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6 California Legal Forms--Transaction Guide § 6.02

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.02 Federal Sources

[1] Statutes

Securities Act of 1933. *15 U.S.C. § 77a et seq.*

[Section 2] Definitions. *15 U.S.C. § 77b(a)*.

[Section 3] Exempt securities. *15 U.S.C. § 77c*.

Interstate exemption. *15 U.S.C. § 77c(a)(11)*.

Small offering exemption. *15 U.S.C. § 77c(b)*.

[Section 4] Exempt transactions. *15 U.S.C. § 77d*.

Private transaction exemption. *15 U.S.C. § 77d(2)*.

[Sections 5 and 6] Registration requirement. *15 U.S.C. §§ 77e, 77f*.

[Section 18] Federal preemption of state securities regulation. *15 U.S.C. § 77r*.

[Section 20] Injunctions and prosecution of offenses. *15 U.S.C. § 77t*.

Trust Indenture Act of 1939. *15 U.S.C. §§ 77aaa-77bbbb*.

Securities Exchange Act of 1934. *15 U.S.C. §§ 78a-78mm*.

Collapsible corporations. *I.R.C. § 341*.

Personal holding companies. *I.R.C. §§ 541*-547.

Limitations on capital losses. *I.R.C. § 1211*.

Stock loss as ordinary income deduction. *I.R.C. § 1244*.

Corporation taxed as partnership (Subchapter S corporation). *I.R.C. §§ 1361*-1379.

[2] Regulations

Regulation S-K. *17 C.F.R. § 229.10 et seq.*

General rules and regulations, Securities Act of 1933. *17 C.F.R. § 230.100 et seq.*

[Rule 147] Intrastate offering "safe harbor" exemption. *17 C.F.R. § 230.147*.

Conditional small offering exemption under Securities Act of 1933 (Regulation A). *17 C.F.R. § 230.251 et seq.*

[Rule 251] Scope of exemption. *17 C.F.R. § 230.251*.

[Rule 252] Offering statement. *17 C.F.R. § 230.252*.

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[Rule 255] Preliminary offering circulars. *17 C.F.R. § 230.255*.

[Rule 256] Filing of sales material. *17 C.F.R. § 230.256*.

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[Rule 258] Suspension of exemption. *17 C.F.R. § 230.258*.

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[Rule 502] General conditions to be met. *17 C.F.R. § 230.502*.

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Exemption for offers and sales of securities pursuant to certain compensatory benefit plans and contracts relating to compensation. *17 C.F.R. § 230.701*.

Exemption for transactions exempt from qualification under *Corp. Code § 25102(n)*. *17 C.F.R. § 230.1001*.

Documents filed under Regulation A or Regulation D must be submitted in paper form only (not eligible for electronic filing). *17 C.F.R. § 232.101(c)(6)*.

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5 of 193 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6 California Legal Forms--Transaction Guide §§ 6.03-6.04

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6 California Legal Forms--Transaction Guide § 6.05

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6 California Legal Forms--Transaction Guide § 6.06

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6 California Legal Forms--Transaction Guide § 6.07

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6 California Legal Forms--Transaction Guide §§ 6.08-6.09

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§§ 6.08[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
A. Scope of California Regulation

3-6 California Legal Forms--Transaction Guide § 6.10

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.10 Nature and Effect of Securities Laws

[1] Basic Issues in Securities Transactions

Two basic types of issues arise in connection with the issuance, offer, and sale of interests in corporations and other business entities:

- First, issues related to the mechanics of issuance and the rights, privileges, and obligations of the holder of the interest in relation to the entity and the holders of other interests in the entity. These issues are discussed in Ch. 6I, *Issuance of Equity Securities* , and Ch. 6J, *Issuance of Debt Securities* .

- Second, issues relating to government regulation of the interests. These issues are discussed in this chapter and in Chapters 6A through 6H of this publication.

[2] Securities Regulation in the United States

Laws regulating the offer and sale of interests in corporations and other business entities have been enacted by the federal government as well as all states, the District of Columbia, Guam, and Puerto Rico. These laws are known generically as the "securities laws," and they are applicable not merely to corporate shares and similar interests, but to any interest falling within the definition of a "security," as discussed in *§ 6.11*. The definition of a "security," which may vary slightly from one statute to the next, generally is broad enough to encompass a wide variety of interests. Securities laws regulate the offer, subscription, sale, transfer and issuance of shares of stock and other securities by corporations, associations, business trusts, public partnerships, and joint stock companies, and even by individuals in some cases.

Securities laws other than those enacted by the federal government are commonly known as "blue sky laws." The term "blue sky laws" comes from an early judicial opinion, rendered prior to the enactment of the federal securities laws, that described the purpose of state regulations as the prevention of "speculative schemes which have no more basis than so many feet of blue sky" [*Hall v. Geiger-Jones Co. (1917) 242 U.S. 539, 550, 37 S. Ct. 217, 61 L. Ed. 480]* .

Securities laws have been enacted to protect the public against the imposition of insubstantial, unlawful, and fraudulent stock and investment schemes, and to promote full disclosure of all information necessary to enable investors to make informed and intelligent investment decisions [*see People v. Figueroa (1986) 41 Cal. 3d 714, 736, 224 Cal. Rptr. 719, 715 P.2d 680* ; *see also Diamond Multimedia Systems, Inc. v. Superior Court (1999) 19 Cal. 4th 1036, 1064, 80 Cal. Rptr. 2d 828, 968 P.2d 539 , cert. denied, 119 S. Ct. 2338* (out-of-state purchasers/sellers of securities whose price has been affected by unlawful market manipulation under *Corp. Code § 25400* may avail themselves of *Corp. Code § 25500* remedy, which is not limited to transactions made in *California); Moreland v. Department of Corporations (1987) 194 Cal. App. 3d 506, 512, 239 Cal. Rptr. 558]* .

[3] California Securities Laws

In California, offers and sales of securities are governed by the Corporate Securities Law of 1968 [*Corp. Code § 25000 et seq.*], supplemented by the rules of the Commissioner of Corporations [*10 Cal. Code Reg. § 260.000 et seq.*]. Additional guidance is periodically provided by the Commissioner in releases and in interpretive opinions. The Corporate Securities Law governs issuer transactions, nonissuer transactions, recapitalizations and reorganizations, and exchanges of securities (including changes in the terms of outstanding securities that may be treated as a securities exchange).

The Corporate Securities Law requires that securities must be "qualified" with the Commissioner of Corporations prior to being offered or sold in California, unless they are exempt from the statutory qualification requirements [*Corp. Code § 25110*]. "Qualification" is essentially a process by which the security in question is reviewed by the Commissioner and approved for offer and sale in California. The California Corporate Securities Law of 1968 is a "merit statute" that regulates the offer and sale of securities by applying a "fair, just and equitable" standard [*see Corp. Code § 25140* (authority of Commissioner)].

It is unlawful to offer or sell securities that have not been qualified or exempted from qualification, or that are offered or sold in a manner that varies or differs from a material condition of the qualification [*Corp. Code § 25110*]. It is unlawful willfully to make any untrue statement of a material fact in any application, notice, or report filed with the Commissioner, or in any offering document, or willfully to omit to state any material fact that is required to be stated in any application, notice, report, or offering document [*Corp. Code §§ 25166, 25401*; *see also Small v. Fritz Companies, Inc. (2003) 30 Cal. 4th 167, 171, 132 Cal. Rptr. 2d 490* (plaintiff may bring "holder's action"--cause of action by persons wrongfully induced to hold stock--for fraud or negligent misrepresentation; cause of action limited to stockholders who can make bona fide showing of actual reliance on misrepresentation); *Murphy v. BDO Seidman, LLP (2003) 113 Cal. App. 4th 687* (citing *Small* and following its new pleading rule for plaintiffs relying on forbearance theory)].

The regulation of certain types of securities and securities transactions have been preempted by federal law, and the California securities laws have only limited application to those transactions. Federal preemption is discussed in greater detail in § 6.15.

[4] Federal Securities Laws

The two principal federal securities laws are the Securities Act of 1933 [*see 15 U.S.C. § 77a et seq.*] ("Securities Act") and the Securities Exchange Act of 1934 [*see 15 U.S.C. § 78a et seq.*] ("Securities Exchange Act"). The federal Securities and Exchange Commission (SEC) enforces and interprets these laws.

The Securities Act is a "disclosure law" rather than a "merit law." It generally requires a corporation, when undertaking to sell its securities, to give potential investors full disclosure of all material facts--facts that investors would find important in making an investment decision [*see 15 U.S.C. § 77j* (information required in prospectus)]. The Act also

requires the corporation to file a registration statement with the SEC that includes information for investors [*see 15 U.S.C. §§ 77e, 77f*]. The SEC does not evaluate the merits of offerings or determine whether the securities offered are good investments. The SEC's staff only reviews a registration statement and declares it "effective" if it satisfies the Act's disclosure requirements. The Securities Act contains numerous exemptions from the registration requirement.

PRACTICE TIP:

SEC disclosure requirements may, however, impact the business of the issuer. For instance, financial statements must be prepared in accordance with generally accepted accounting principles and Regulation S-X [*17 C.F.R. § 210.1-01 et seq.*] and must be audited. These requirements may alter the manner in which the company has previously prepared its financial statements. As a result, the company may find that its revenues, earnings and assets are reduced or its liabilities increased. A company may also prefer to alter certain of its business practices regarding compensation of officers and directors, affiliate transactions or other matters rather than disclose these practices. A company may also be concerned about disclosure of sensitive business information which it believes may be of value to its competitors. *Commentary by Frances E. Lossing.*

Under the Exchange Act, a corporation that has not filed a registration statement under the Securities Act must file an Exchange Act registration statement if and when one of these conditions is satisfied:

- The corporation's securities become exchange-listed [*see 15 U.S.C. § 78l(b)*].

- The corporation has a class of equity securities with 500 or more shareholders and has total assets exceeding $1 million at the end of its last two fiscal years, or a class of equity securities with 750 or more shareholders and has total assets exceeding $1 million at the end of its last fiscal year [*see 15 U.S.C. § 78l(g)*; *17 C.F.R. § 240.12g-1*].

A corporation that has filed an Exchange Act registration statement is subject to reporting requirements [*see 15 U.S.C. § 78m*] and is commonly known as a reporting company. Major shareholders, officers, and directors of the corporation also may be subject to reporting requirements [*see 15 U.S.C. § 78m(d)*]. In addition, the corporation will be subject to regulatory oversight of proxies and tender offers. Because the Exchange Act registration provisions are applicable only to large, publicly held corporations, ordinarily they do not figure into the planning for close or closely held corporations in California.

All securities transactions, even exempt transactions, are subject to the antifraud provisions of the federal securities laws, such as Section 17(a) of the Securities Act [*15 U.S.C. § 77q(a)*], Section 10(b) of the Exchange Act [*15 U.S.C. § 78j(b)*], and *Rule 10b-5* [*17 C.F.R. § 240.10b-5*]. The corporation and responsible individuals will be liable for false or misleading statements, whether oral or written. The SEC and other agencies can enforce the antifraud provisions through criminal, civil, and administrative proceedings. Enforcement also may be pursued through private lawsuits. Unless all conditions of an exemption are met, the buyers of the securities may be able to obtain rescission and restitution.

The Securities Act is discussed in greater detail in §§ 6.50-6.58. For more detailed discussion of the federal securities laws, federal exemptions from registration that are typically used by nonpublic corporations in California and elsewhere, and coordination of California and federal exemption requirements, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* .

[5] Evaluating Application of Securities Laws

A party that is planning to offer or sell business or investment interests in California must determine whether, and the extent to which, the California and federal securities laws apply to the transaction. Basically, the process of

determination involves the following issues, which are discussed in greater detail throughout this chapter:

- Is the interest in question a "security" [*see §§ 6.11, 6.110*]?
- Will there be an "offer" or "sale" for value [*see §§ 6.12, 6.111*]?
- Will the offer and sale be made in California [*see §§ 6.13, 6.112*]?
- Are any exemptions from qualification available [*see §§ 6.30, 6.115, 6.116*]?
- If qualification is required, what must be done to qualify the offering [*see §§ 6.40-6.42, 6.118*; *see also* Ch. 6H, *Qualification of Securities*]?
- How will this transaction be treated under the federal securities laws [*see §§ 6.50-6.58*]?

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawBlue Sky LawsSecurities Exempt From RegistrationSecurities LawInitial Public Offerings & the Securities Act of 1933Registration of SecuritiesDisclosures & SchedulesSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
A. Scope of California Regulation

3-6 California Legal Forms--Transaction Guide § 6.11

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§ 6.11 What Constitutes a "Security"

[1] Statutory Definition

The definition of "security" under California law is fairly broad. *Corp. Code § 25019* lists numerous instruments, financial arrangements, and transactions that constitute securities. *Corp. Code § 25019* defines "security" to mean any of the following, whether or not evidenced by a written instrument [*Corp. Code § 25019*]:

- Any note.
- Stock, including treasury stock.
- Membership in an incorporated or unincorporated association.
- Bond, debenture, or evidence of indebtedness.
- Certificate of interest or participation in any profit-sharing agreement.
- Collateral trust certificate.
- Preorganization certificate or subscription.
- Transferable share.
- Investment contract.
- Viatical settlement contract [*see Corp. Code § 25023* (definition); *see also § 6.110[1][m]*] or

fractionalized or pooled interest therein.

- Life settlement contract or fractionalized or pooled interest therein [*see Corp. Code § 25023* (definition); *see also § 6.110[1][n]*].

- Voting trust certificate.

- Certificate of deposit for a security.

- Interest in a limited liability company and any class or series of such an interest, including any fractional or other interest, except a membership interest in a limited liability company in which all of the members are actively engaged in the management of the limited liability company (evidence of the right to vote without more does not establish that all members are actively engaged in the management of the company) [*see* Ch. 12C, *Limited Liability Companies*].

PRACTICE TIP:
The determination of whether a limited liability company interest is a security is similar to the determination of whether a general partnership or joint venture interest is a security. Interpretive opinions in the joint venture or general partnership area may therefore be useful in helping counsel making this determination. *Commentary by Frances E. Lossing.*

- Certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease.

- Any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities, including any interest in any of these or any interest based on their value.

- Any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency.

- Any beneficial interest or other security issued in connection with a funded employee's pension, profit-sharing, stock bonus, or similar benefit plan.

- In general, any interest or instrument commonly known as a security.

- Any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase any of the foregoing.

The statutory list is illustrative rather than all-inclusive [*see People v. Syde (1951) 37 Cal. 2d 765, 768, 235 P.2d 601]* .

[2] Judicial Rules Applicable to Transactions Not Specifically Listed in Statute

Whether or not a financial arrangement or transaction not listed in *Corp. Code § 25019* involves securities is a question of fact that must be determined on a case-by-case basis [*People v. Figueroa (1986) 41 Cal. 3d 714, 736, 224 Cal. Rptr. 719, 715 P.2d 680* ; *Moreland v. Department of Corporations (1987) 194 Cal. App. 3d 506, 512, 239 Cal. Rptr. 558]* . To determine whether or not securities are involved, courts ask whether the arrangement in question comes within the regulatory purpose of the Corporate Securities Act: to protect the public against "spurious schemes" to attract capital [*Silver Hills Country Club v. Sobieski (1961) 55 Cal. 2d 811, 814, 13 Cal. Rptr. 186, 361 P.2d 906]* . Courts use two tests to answer this question: the "risked capital" test and the "common enterprise" test:

- Under the "risked capital" test, a security is found whenever capital is sought from third parties to be risked in the start-up of a business venture for profit [*see Silver Hills Country Club v. Sobieski (1961) 55 Cal. 2d 811, 815, 13 Cal. Rptr. 186, 361 P.2d 906* ; *People v. Wind River Mining Project (1990) 219 Cal. App. 3d 1390, 1399-1400, 269 Cal. Rptr. 106]* .

- Under the "common enterprise" test, adopted from the test used under federal law to determine whether a transaction constitutes an investment contract, a security will be found when a person has invested value in a "common enterprise" with an expectation of profit to be derived from the substantial efforts of others [*see Moreland v. Department of Corporations (1987) 194 Cal. App. 3d 506, 513-519, 239 Cal. Rptr. 558* (applying *Securities & Exch. Com. v. Howey Co. (1946) 328 U.S. 293, 301, 66 S. Ct. 1100, 90 L. Ed. 1244*)].

Both tests have been applied, either separately or together, by California courts in making the factual determination of whether a particular transaction is a security under *Corp. Code § 25019* [*Reiswig v. Department of Corps. (2006) 144 Cal. App. 4th 327, 333-342, 50 Cal. Rptr. 3d 386* (bait-and-switch scheme offering above-market interest on bank-issued CDs, which was used by life insurance seller to lure potential buyers of annuities, was not a security and scheme was not subject to regulatory power of Department of Corporations, although Department of Insurance might have regulatory oversight); *Moreland v. Department of Corporations (1987) 194 Cal. App. 3d 506, 513, 239 Cal. Rptr. 558]* .

[3] Specific Transactions

[a] Promissory Notes and Evidences of Indebtedness

Although *Corp. Code § 25019* provides that a security includes "any note," courts have held that not all notes or evidences of indebtedness are securities. If a note is one for which the purchaser has only the right to expect payment of principal and interest according to the terms of the note, and has no expectation of profit otherwise, the note is not a security [*People v. Davenport (1939) 13 Cal. 2d 681, 685, 690, 91 P.2d 892]* . On the other hand, if the note is given in consideration of risk capital, is inadequately secured, and repayment of the debt is dependent on the success of the enterprise, the debt is a security [*People v. Figueroa (1986) 41 Cal. 3d 714, 735-738, 224 Cal. Rptr. 719, 715 P.2d 680]* .

PRACTICE TIP:

The term "evidence of indebtedness" is quite expansive and may encompass arrangements that may not be easily recognized by laymen as involving the issuance of securities. A common problem area involves employee compensation arrangements, such as deferred compensation plans and employee bonus arrangements based on the earnings of a corporation or unit for periods longer than a year. The Commissioner has issued numerous interpretive opinions in this area that should be reviewed by counsel preparing these types of plans. Compensation plans that do not involve the issuance of a security under federal law may nevertheless involve the issuance of a security under California law since the Commissioner interprets the term "security" and offer or sale "for value" much more broadly than the SEC. *Commentary by Frances E. Lossing.*

[b] General Partnership and Joint Venture Interests

The definition of a "security" in *Corp. Code § 25019* does not specifically include a partnership interest. Courts have held that a bona fide general partnership or joint venture interest is not a "security" within the regulatory purpose of the statute [*see People v. Feno (1984) 154 Cal. App. 3d 719, 725-726, 201 Cal. Rptr. 513]* . The legal right of the general partner directly to exercise control over the operations of the business has been considered to negate the existence of any security within the regulatory purposes of the Corporate Securities Law. A general partnership interest, however,

may constitute a security if the actual arrangement is such that the general partners are merely passive investors and the direction and control of the enterprise is concentrated in the hands of only one or a few of the ostensible general partners, the interest of the other partners may be a "security" within the regulatory purpose of the statute [*see Goldberg v. Paramount Oil Co. (1956) 143 Cal. App. 2d 215, 222, 300 P.2d 329]* .

One of the tests for determining whether a partnership interest or joint venture interest is actually a security is to inquire whether the purported partner or venturer is so inexperienced and unknowledgeable in business affairs as to be incapable of intelligently exercising real partnership or venture powers, that is, incapable of participating in any meaningful way except as a passive investor. The leading case on when a general partnership interest or joint venture interest constitutes a security is a Fifth Circuit case [*Williamson v. Tucker (5th Cir. 1981) 645 F.2d 404]* , under which the scope of that inquiry relates specifically to the nature of the partnership or joint venture. The question would be whether the purported partners or venturers have experience in the particular kinds of business affairs in which the partnership or joint venture is to be engaged. If so, the partnership interests or joint venture interests probably are genuine; if not, they probably are securities. This approach has been used by a court of appeal in California [*Consolidated Management Group, LLC v. Department of Corps. (2008) 162 Cal. App. 4th 598, 610-612, 75 Cal. Rptr. 3d 795]* . The court acknowledged but rejected the Ninth Circuit's preference for finding a genuine partnership or joint venture when the purported partners or venturers merely have experience in business affairs generally. The Ninth Circuit holds that it is not proper to inquire whether the purported partners or joint venturers are "experienced and sophisticated in the particular industry or area" in which the partnership or joint venture is to be engaged [*Holden v. Hagopian (9th Cir. 1992) 978 F.2d 1115, 1121]* . In the California court's view, however, the Fifth Circuit standard is consonant with the remedial purpose of the securities laws and takes into account the reality that general business sophistication does not necessarily equip an investor to manage a specialized enterprise [*Consolidated Management Group, LLC v. Department of Corps. (2008) 162 Cal. App. 4th 598, 612, 75 Cal. Rptr. 3d 795]* .

[c] Limited Partnership Interests

Limited partnership agreements ordinarily will be securities, despite the fact that they are not specifically mentioned in *Corp. Code § 25019*. Under California law, an investment may constitute a security notwithstanding that investor participation is contemplated or required, as long as the investor is not involvedin "those essential managerial efforts which affect the failure or success of the enterprise." Under *Corp. Code §§ 15632* (CRLPA), 15903.03 (ULPA '08), a limited partner *cannot* maintain limited partner status and at the same time exercise managerial control over the partnership; thus a true limited partnership interest, by definition, satisfies this "nocontrol" requirement [*People v. Graham (1985) 163 Cal. App. 3d 1159, 1168-1169, 210 Cal. Rptr. 318* (decided under *Corp. Code § 15507* (ULPA); *see now Corp. Code § 15903.03* (ULPA '08)); *accord, SEC v. Glenn W. Turner Enters., Inc. (9th Cir. 1973) 474 F.2d 476, 482]* . For additional discussion of limited partnership interests as securities, see Ch. 16, *Formation of Limited Partnerships* .

[4] Statutory Exclusions to Definition of "Security"

By statute, the term "security" specifically excludes the following [*Corp. Code § 25019*]:

- Any beneficial interest in any voluntary inter vivos trust that is not created for the purpose of carrying on any business or solely for the purpose of voting [*see also 10 Cal. Code Reg. §§ 260.019.1, 260.019.2*; Commissioner's Opinion No. 06/1C (June 2, 2006)(concluding that certain beneficial interests in trusts were not securities under this exclusion)].

- Any beneficial interest in any testamentary trust.

- Any insurance or endowment policy or annuity contract under which an insurance company admitted in California promises to pay a sum of money (whether or not based on the investment performance of a

segregated fund) either in a lump sum or periodically for life or some other specified period.

- Any franchise subject to registration under the Franchise Investment Law [*Corp. Code § 31000 et seq.*], or exempted from registration under that law by *Corp. Code § 31100* or *31101*.

- Discretionary accounts maintained with a commodity broker for trading in commodities or commodities' futures [*10 Cal. Code Reg. § 260.019*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
A. Scope of California Regulation

3-6 California Legal Forms--Transaction Guide § 6.12

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.12 What Constitutes "Offers" and "Sales"

[1] Offers

Offers to sell and sales of securities in California must be qualified unless the security or the transaction is exempt or not subject to qualification [*Corp. Code § 25110*].

The meaning of "offer" in the Corporate Securities Law is much broader than that term in the usual contract sense. An offer, or offer to sell, includes every attempt or offer to dispose of, or solicitation of an offer to buy a security or interest therein for value [*Corp. Code § 25017(b)*]. The meaning of "offer" as defined under this section is limited to offers to sell and does not include offers to buy. The definition of "offer" does not encompass mere business conversations preliminary to any fixed plan that have not proceeded beyond an exchange of views or general discussion of a plan of organization [Commissioner's Opinion No. 76/13C; *see also* Commissioner's Opinion No. 81/10C].

Because the term "offer" is so broadly defined, *Corp. Code § 25102(a)* expressly exempts from qualification those offers that are not made to the public [*see 10 Cal. Code Reg. § 260.102.1* for the definition of a public offering].

[2] Sales

The terms "sale" or "sell" include the following [*Corp. Code § 25017(a)*]:

- Every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value.

- An exchange of securities.

- Any change in the rights, preferences, privileges, or restrictions of or on outstanding securities. The adoption, modification or termination of a shareholders' agreement and changes in close corporation

status will generally involve a change in the rights, preferences and privileges of outstanding securities [*10 Cal. Code Reg. §§ 260.017.2, 260.017.3*].

PRACTICE TIP:

The issuance of a new series of common or preferred stock may affect the rights, preferences and privileges of outstanding stock if the new series will have a preference over the existing securities, will dilute the voting rights of existing securities, or may otherwise adversely affect the rights of existing security holders. This type of transaction, however, is not required to be qualified as a reorganization or recapitalization. The issuance of the new security will still, of course, be subject to the provisions of either *Corp. Code § 25110* or *25120* [*see 10 Cal. Code Reg. § 260.103.1*]. *Commentary by Frances E. Lossing.*

[3] Specific Transactions

The following transactions constitute an offer or sale:

- Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing [*Corp. Code § 25017(c)*].

- A purported gift of assessable stock [*Corp. Code § 25017(d)*].

- A sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer [*Corp. Code § 25017(e)*].

- A sale or offer of a security that gives the holder a present or future right or privilege to convert the security into another security of the same or another issuer includes an offer and sale of the other security (at the time of the offer or sale of the convertible security) [*Corp. Code § 25017(e)*].

PRACTICE TIP:

A "gift" of stock by an employer as an inducement for a person to become an employee or to remain an employee of a corporation will be considered to be an offer or sale of a security "for value" even if the stock is non-assessable. In the Commissioner's view, value is given by the employee by virtue of the employee's decision to remain or to become an employee of the corporation. Other "gifts" of stock may also be considered to be "for value," particularly if a number of "gifts" of stock are given and the stock is thereafter freely traded to others. *Commentary by Frances E. Lossing.*

No qualification is required, however, at the time the right to purchase, to subscribe, or to convert is exercised, or at the time securities are issued on conversion [*Corp. Code § 25017(e)*].

PRACTICE TIP:

Most state blue sky laws are the same as California in this regard. However, under federal law, the sale of the underlying security will be made at the time the right to purchase or the right to convert is exercised. *Commentary by Frances E. Lossing.*

[4] Exclusions

The statutory definition of "offer" or "sale" does not include the following [*Corp. Code § 25017(f)*]:

- A bona fide secured transaction in or loan of outstanding securities.

- Any stock dividend payable with respect to common stock of a corporation solely (except for any

cash or scrip paid for fractional shares) in shares of the common stock if the corporation has no other class of voting stock outstanding. The term "stock dividend" means the issuance of additional shares of the issuer to its existing shareholders, or to the shareholders of a class, pro rata according to the shares held, except for the payment of cash or the issuance of script in lieu of the issuance of fractional shares, without consideration other than the transfer from surplus to stated capital of an amount equal to or greater than the par, stated, or market value of the shares distributed, and not by an amendment to the articles of incorporation stating the effect on outstanding shares. The term "stock dividend" does not include a "stock split" [*10 Cal. Code Reg. § 260.017(a)*]. The term "stock split" or "reverse stock split" means the subdivision or combination of previously outstanding shares of stock (whether or not including authorized and unissued shares) into a greater or lesser number of shares of the same class, effected by an amendment to the company's articles of incorporation [*10 Cal. Code Reg. § 260.103*]. A stock dividend is not payable solely in shares of common stock within the meaning of *Corp. Code § 25017(f)* when the shareholders are given an option to accept either cash or common stock [*10 Cal. Code Reg. § 260.017(b)*]. Nor is a stock dividend payable solely in common stock if the corporation has no other class of voting securities outstanding unless the dividend is payable solely in shares of voting common stock and that voting common stock is of the same class as the class on which the dividend is paid [*10 Cal. Code Reg. § 260.017(c)*].

PRACTICE TIP:

It is recommended that counsel consult with the issuer's accountants in making the determination that a particular transaction involves the issuance of a stock dividend rather than a stock split. *Commentary by Frances E. Lossing.*

- Any act incident to a transaction or reorganization approved by a state or federal court in which securities are issued and exchanged for one or more outstanding securities, claims or property interests, or partly for an exchange and partly for cash.

- The exercise of the right to purchase or subscribe or convert securities nor the issuance of securities pursuant thereto [*Corp. Code § 25017(e)*].

- The transfer of corporate stock as part of the division of community property in a divorce settlement [*see D'Elia v. D'Elia (1997) 58 Cal. App. 4th 415, 423-426, 68 Cal. Rptr. 2d 324]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersTransfers of SharesContracts LawFormationOffersGeneral OverviewSecurities LawGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
A. Scope of California Regulation

3-6 California Legal Forms--Transaction Guide § 6.13

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.13 What Constitutes Offer or Sale "In This State"

[1] Offers and Sales in California

Only offers to sell and sales occurring in California must be qualified [*Corp. Code § 25110*]. An offer or a sale of a security is made in California when any of the following occur [*Corp. Code § 25008*]:

- An offer to sell is made or originates in California.
- An offer to sell is accepted in California [*see* [3], *below*].
- An offer to buy is accepted in California [*see* [2], *below*].
- The security is delivered to the purchaser in California and both the seller and the purchaser are domiciled in California [*see* [4], *below*].
- The offer is directed to California and is received at the place in California to which it was directed.

[2] Offers to Buy in California

Although only offers to sell and sales in California must be qualified, offers to buy made in California may still be the basis for liability for misrepresentation. An offer to buy in California is made in California when any of the following occur [*Corp. Code § 25008*]:

- An offer to buy is made in California.
- An offer originates from California.

- An offer is directed by the offeror to California and is received at the place to which directed.

[3] Accepted Offers

An offer to buy or sell is accepted in California when acceptance is communicated to the offeror there. Acceptance is communicated to an offeror in California when the offeree directs it to the offeror there reasonably believing the offeror to be in California and the offer is received at the place to which it is directed [*Corp. Code § 25008(b)*].

[4] Delivery of Securities

A security is delivered to a purchaser in California when the certificate or other evidence of the security is directed to the purchaser there and received at the place to which it is directed [*Corp. Code § 25008(b)*].

[5] Offers Deemed Not Made in California

An offer to sell or buy is not made in California merely because of the following [*Corp. Code § 25008(c)*]:

- The publisher circulates or there is circulated on the publisher's behalf in California any bona fide newspaper or other publication of general, regular, and paid circulation that has had more than two thirds of its circulation during the past twelve months outside of California; or

- A radio or television program originating outside California is received in California.

[6] Offers Made on the Internet

Offers of securities made by, or on behalf of, issuers on or through the Internet are exempt from qualification under *Corp. Code § 25110* if all of the following conditions are met [Dept. of Corps. Release No. 100-C (Nov. 5, 1996)]:

- The internet offer originates outside California.

- The offer indicates, directly or indirectly, that the securities are not being offered or sold to California residents.

- The offer is not directed to anyone in California.

PRACTICE TIP:
Internet offerings will, of course, affect the availability of exemptions that may be used. For example, the *Corp. Code §§ 25102(e), (f), (h), 25102.1(d)* exemptions would not available since there will have been the publication of an advertisement. The availability of *Corp. Code § 25102(n)* may also be affected if the general announcement standards have not been met [*see* Commissioner's Opinion No. 96/2C (use of internet in *Corp. Code § 25102(n)* transactions)]. *Commentary by Frances E. Lossing.*

- No sales of the issuer's securities will be made in California as a result of the offer without prior qualification and delivery of an appropriate prospectus, unless the security or sale is exempt.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsOffer & SaleSecurities LawBlue Sky LawsOnline TransactionsSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
A. Scope of California Regulation

3-6 California Legal Forms--Transaction Guide § 6.14

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§ 6.14 Types of Regulated Transactions

[1] Importance of Distinctions

The Corporate Securities law regulates all offers and sales of securities in California, whether the offer and sale is made by the issuer of the securities, or by a nonissuer. However, the distinction between issuer and nonissuer transactions can be significant for determining the available forms of qualification, and the availability of specific exemptions from qualification.

[2] Issuers and Issuer Transactions

An "issuer" is any person who issues or proposes to issue any security [*Corp. Code § 25010*]. *Corp. Code § 25110 et seq.* set forth the qualification requirements for issuer transactions.

[3] Nonissuer Transactions

A "nonissuer transaction" is one that does not directly or indirectly benefit the issuer [*Corp. Code § 25011*]. A transaction is indirectly for the benefit of the issuer if any portion of the purchase price of any security involved in the transaction will be received indirectly by the issuer [*Corp. Code § 25011*]. The term "purchase price" as used in *Corp. Code § 25011* does not include any remote, contingent, or incidental benefit that may accrue to the issuer, such as the inducement to a person to become or remain an employee of the issuer or perform other services for the issuer, even though a motive of the seller or the purchaser is to obtain that remote, contingent, or incidental benefit for the issuer. *Corp. Code § 25130 et seq.* set forth the requirements for qualification for nonissuer transactions.

When a transaction involves both an issuer transaction and a nonissuer transaction, it is treated as an issuer transaction for purposes of the California qualification requirements [*Corp. Code § 25011*; *see Corp. Code §§ 25110 et seq., 25130 et seq.*]. However, it is treated as two separate transactions for purposes of the California exemptions [*Corp. Code § 25011*; *see Corp. Code § 25100 et seq.* (exemptions)].

[4] Recapitalizations and Reorganizations

The Corporate Securities Law also applies to changes in the rights, preferences, privileges, or restrictions of or on outstanding securities or in any exchange of securities by the issuer with its existing security holders exclusively, in any exchange in connection with any merger or consolidation or purchase of assets in consideration wholly or in part of the issuance of securities, or in any entity conversion transaction (as defined in *Corp. Code § 25005.1*) [*Corp. Code § 25120*]. *Corp. Code § 25120 et seq.* set forth the requirements for qualification for transactions involving recapitalizations and reorganizations.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsExempt Nonissuer & Resale TransactionsSecurities LawBlue Sky LawsOffer & SaleSecurities LawRegulation of Securities MarketsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
A. Scope of California Regulation

3-6 California Legal Forms--Transaction Guide § 6.15

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§ 6.15 Federal Preemption of State Securities Regulation

[1] National Securities Markets Improvement Act of 1996

The National Securities Markets Improvement Act of 1996 (NSMIA) [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005)], which was signed into law on October 11, 1996, made significant changes to the Securities Act of 1933 [*15 U.S.C. § 77a et seq.*], the Securities Exchange Act of 1934 [*15 U.S.C. § 78a et seq.*], the Investment Company Act of 1940 [*15 U.S.C. § 80a-1 et seq.*], and the Investment Advisers Act of 1940 [*15 U.S.C. § 80b-1 et seq.*]. Most significant to California practice is NSMIA's prohibition on state regulation of certain issuers and transactions, by means of federal preemption, in many areas of securities regulation that formerly were subject to dual regulation by the states under blue sky laws and by the SEC or other federal agencies. An attorney must now take NSMIA into account when determining whether a proposed transaction is subject to the qualification provisions of the Corporate Securities Law. In many cases NSMIA will effectively eliminate applicability of the California qualification and exemption requirements in situations in which those requirements would otherwise apply.

[2] Extent of Federal Preemption

Section 18 of the Securities Act of 1933 [*15 U.S.C. § 77r*], as amended by NSMIA, provides that if the security in question is a "covered security" [*see* [5], *below*], no state may prohibit an offering or sale in the state, impose additional disclosure requirements, impose "merit" standards, require the registration or qualification of a security or transaction, or prohibit or limit the use of any offering document prepared on behalf of the issuer in an offering (including proxy statements and reports to shareholders required to be filed under Section 15A of the Exchange Act [*15 U.S.C. § 78o-3*] unless the issuer is incorporated in the state) [*15 U.S.C. § 77r(a)*]. However, as discussed in [4][b], *below*, the states may continue to impose notice filing requirements and filing fees unless the securities are listed on a national exchange, and to investigate and bring enforcement actions for fraud or unlawful conduct by a broker and dealer.

For extensive coverage of the Act and its interaction with California securities laws, see Marsh & Volk, Practice Under the California Securities Laws, Ch. 3A, *Federal Preemption of State Securities Regulation* (Matthew Bender).

[3] California Response and Implementation

California has incorporated the federal preemption provisions into the Corporations Code in the form of *Corp. Code §§ 25100.1*, *25101.1*, and 25102.1. These sections provide in essence that those categories of securities preempted by the federal legislation are "not subject to," as opposed to "exempt from," the California qualification requirements. As noted in [4][b], *below*, however, California does impose notice filing requirements that are permissible under NSMIA. For more detailed discussion of these notice filing requirements, see *§ 6.141*.

[4] Continued State Authority

[a] Fraud Enforcement Actions

Notwithstanding the preemption of state regulation of securities offerings by NSMIA, the securities commission of any state retains jurisdiction under the laws of that state to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions [*15 U.S.C. § 77r(c)(1)*].

Furthermore, notwithstanding the limitations on covered class actions based on state law brought by private parties alleging fraud in connection with the purchase or sale of a "covered security" [*see* Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (S. 1260), effective Nov. 3, 1998; *15 U.S.C. §§ 77p, 78bb(f)*; *see, e.g., Patenaude v. Equitable Life (9th Cir. 2002) 290 F.3d 1020, 1022* (removal and dismissal of state court class action held proper under SLUSA; tax-deferred variable annuities were covered securities under that act)], a state, political subdivision, or state pension plan may bring an action involving a covered security on its own behalf, or as a member of a class comprised solely of other states, political subdivisions, or state pension plans that are named plaintiffs and have authorized participation in such an action [*15 U.S.C. §§ 77p(d)(2), 78bb(f)(3)(B)*; *see* Ballantine & Sterling, California Corporation Laws, Ch. 21, *Corporate Securities* (Matthew Bender)].

[b] Notice Filing Requirements

NSMIA [*15 U.S.C. § 77r*] does not prohibit state securities regulators from requiring the filing of any document filed with the SEC pursuant to the Securities Act of 1933 [*15 U.S.C. § 77a et seq.*], together with annual or periodic reports of the value of securities sold or offered to be sold to persons located in the state (if that sales data is not included in documents filed with the Commission), solely for notice purposes, and the assessment of any fee, together with a consent to service of process and any required fee, unless the security is listed on a national securities exchange [*15 U.S.C. § 77r(c)(2)(A)*].

The states may continue to collect filing or registration fees with respect to securities or securities transactions (except for listed or to be listed securities and securities senior to them [*15 U.S.C. § 77r(c)(2)(B)*]) in amounts determined under state law as in effect on the day before October 11, 1996. Those fees will be paid, and all necessary supporting data on sales or offers for sales permitted as described above, will be reported on the same schedule that would have been applicable had the issuer not relied on the exemption provided for covered securities [*15 U.S.C. § 77r(c)(2)(B)(ii)*].

No filing or fee may be required with respect to any security that is a listed security and therefore a "covered security" [*see 15 U.S.C. § 77r(b)*] or will be a covered security upon completion of the transaction, or is a security of the same issuer that is equal in seniority or is a senior security to such a listed security [*15 U.S.C. § 77r(c)(2)(D)*]. No such fee is presently required under California law, so this provision would only apply prospectively if California attempted to impose such a fee in this situation.

Nothing in NSMIA prohibits any state securities commission or similar agency from suspending the offer or sale of securities within the state as a result of the failure to submit any filing or fee required under law and permitted under

NSMIA [*15 U.S.C. § 77r(c)(3)*].

For a guide to the applicable California notice requirements and fees relating to offerings preempted by NSMIA, see *§ 6.141*.

[5] Definition of "Covered Security"

[a] Nationally Traded Securities

Any security that is listed, or authorized for listing, on the New York Stock Exchange or the American Stock Exchange, on the National Market System of the NASDAQ Stock Market (or any other successor to those entities), or on a national securities exchange that has listing standards that the Securities Exchange Commission determines by rule are substantially similar to the listing standards applicable to those of the New York Stock Exchange, the American Stock Exchange or NASDAQ, is a "covered security" for purposes of NSMIA. A security of the same issuer that is equal in seniority or is a senior security [*see 15 U.S.C. § 77r(d)(4)* (definition)] to the securities just described is also a "covered security" [*15 U.S.C. § 77r(b)(1)*]. Equity securities senior to securities exempt under California's listing exemption have been exempted from qualification by rule of the Commissioner [*see 10 Cal. Code Reg. § 260.105.33*].

PRACTICE TIP:

As a result of a drafting "glitch," the California senior to listed exemption in *10 Cal. Code Reg. § 260.105.33*, unlike the senior to listed exemption in most other states, only applies to equity securities, not debt securities. The term "senior to listed" in NSMIA is narrowly defined to only apply to certain types of debt securities. As a result, certain types of evidences of indebtedness, such as corporate guarantees and deferred compensation plans, issued by issuers with common stock listed on a national securities exchange may not be entitled to the benefits of preemption under NSMIA or exempt under California law. *Commentary by Frances E. Lossing.*

Since the California Corporations Commissioner has certified the New York and American Stock Exchanges [*see* Dept. of Corps. Release No. 27-C (Mar. 4, 1972; revised Mar. 9, 1992) (this release has not been updated to reflect the name change of the American Stock Exchange to "NYSE AMEX LLC"); *see also* Marsh & Volk, Practice Under the California Securities laws, § 3A.04[1] (Matthew Bender)] and the NASDAQ Global Market and the NASDAQ Capital Market of the NASDAQ Stock Market LLC [*see* Dept. of Corps. Release No. 87-C (revised August 17, 2009)] under the California exemption from qualification in *Corp. Code § 25100(o)*, the federal preemption is irrelevant in California with respect to those listed securities, which are already exempt from qualification under California law. In addition, the Commissioner has certified Tier I of the Philadelphia Stock Exchange [*see* Dept. of Corps. Release No. 96-C (Sept. 12, 1995) (this release has not been updated to reflect the name change of the Philadelphia Stock Exchange to "NASDAQ OMX PHLX, Inc."); *see also* Marsh & Volk, Practice Under the California Securities laws, § 3A.04[1] (Matthew Bender)] and Tier I (Select Market Companies) of the Pacific Stock Exchange, now operated as NYSE Arca [*see* Dept. of Corps. Release No. 95-C (December 27, 1994); *see also* Marsh & Volk, Practice Under the California Securities laws, § 3A.04[1] (Matthew Bender)], so that the state exemption remains significant as to securities listed in that tier. NSMIA does not by its terms appear to cover rights or warrants to purchase nationally traded securities. As a result, the state exemption remains significant with respect to these types of transactions.

[b] Registered Investment Companies

A security issued by an investment company that is registered, or that has filed a registration statement, under the Investment Company Act of 1940, is a "covered security" for purposes of NSMIA [*15 U.S.C. § 77r(b)(2)*; *see 15 U.S.C. § 80a-1 et seq.*].

[c] Sales to Qualified Purchasers

A security is a "covered security" with respect to its offer or sale to qualified purchasers as defined by the SEC by rule. In prescribing such a rule, the SEC may define the term "qualified purchaser" differently with respect to different categories of securities, consistent with the public interest and the protection of investors [*15 U.S.C. § 77r(b)(3)*]. As of the date this text was written, the SEC had not published rules establishing categories of "qualified purchasers" for purposes of NSMIA.

[d] Exempt Offerings

A security is a "covered security" with respect to a transaction that is exempt from federal registration under any of the following exemption provisions of the Securities Act:

- Section 4(1) [*15 U.S.C. § 77d(1)*], which exempts transactions by any person other than an issuer, underwriter, or dealer, or Section 4(3) [*15 U.S.C. § 77d(3)*], which exempts dealer transactions, with certain exceptions. In order for a security to qualify as a "covered security" under this category, the issuer must be a "reporting company" that files reports with the SEC under Section 13 or 15(d) of the Exchange Act [*15 U.S.C. § 77r(b)(4)(A)*; *see 15 U.S.C. §§ 78m, 78o(d)*; for discussion of "reporting companies," *see* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*].

- Section 4(4) [*15 U.S.C. § 77d(4)*], which exempts brokers' transactions executed upon customers' orders on any exchange, or in the over-the-counter market, but does not extend to the solicitation of those orders [*15 U.S.C. § 77r(b)(4)(B)*].

- Section 3(a) [*15 U.S.C. § 77c(a)*], which exempts a large number of securities such as those of various governmental entities, financial institutions; commercial paper; and insurance endowment or annuity contracts. Certain key categories of securities that are exempt under Section 3(a) are *not* subject to NSMIA's preemption provisions, however, including securities of charitable organizations, securities issued in exchange for other securities in a case under Title 11, securities exempt by virtue of state fairness headings, and purely intrastate issues [*15 U.S.C. § 77c(a)(4), (10), (11)*] (securities of charitable organizations, exchanges of securities, and intrastate exemption). The exclusion of intrastate transactions from NSMIA's preemption provisions is particularly significant to California nonpublic corporations. In addition, a municipal security that is exempt from registration by virtue of Section 3(a)(2) [*15 U.S.C. § 77c(a)(2)*] is not a covered security with respect to its offer or sale in the state in which the issuer of the security is located [*15 U.S.C. § 77r(b)(4)(C)*].

- SEC rules or regulations issued under Section 4(2) [*15 U.S.C. § 77d(2)*], which exempts transactions by an issuer not involving any public offering, including the Rule 506 SEC Regulation D exemption [*see 17 C.F.R. § 230.506*] (but *not* the Rule 504 and 505 exemptions [*see 17 C.F.R. §§ 230.504, 230.505*], which were adopted under Section 3(b) [*15 U.S.C. § 77c(b)*] of the Securities Act). This restriction on state action does not prohibit a state from imposing notice filing requirements that are substantially similar to those required by rule or regulation under this section that were in effect on September 1, 1996 [*15 U.S.C. § 77r(b)(4)(D)*].

A transaction must actually qualify for a registration exemption in order for the subject security to be a "covered security." Filing of the necessary documents and payment of the required fees are not sufficient, since an exemption-based "covered security" under the Improvement Act is a security in "a transaction that *is exempt* from registration" [*15 U.S.C. § 77r(b)(4)* (emphasis added); *Consolidated Management Group, LLC v. Department of Corps. (2008) 162 Cal. App. 4th 598, 607-608, 75 Cal. Rptr. 3d 795]* .

[6] Practical Effect of Preemption Provisions on Nonpublic Offerings

On a practical level, the impact of NSMIA on state requirements obviously depends on the status of the particular security or transaction under the Securities Act. If the security or the transaction is a publicly traded security, or the transaction is conducted under one of the exemptions from registration that is listed in NSMIA's definition of "qualified security" [*see* [5][d], *above*], any otherwise-relevant California requirements (other than notice requirements) are inapplicable.

With respect to nonpublic offerings by California close or closely held corporations, issuers relying on the federal intrastate exemption under Rule 147 [*17 C.F.R. § 230.147*; *see Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.24*] or the federal Rule 504 or 505 exemptions under Regulation D [*17 C.F.R. §§ 230.504, 230.505*; *see Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, §§ 6A.26, 6A.27*], are unaffected by the federal preemption requirements and must still comply in full with the applicable California qualification or exemption requirements [*see* [5][d], *above*]. On the other hand, issuers relying on the Rule 506 exemption [*17 C.F.R. § 230.506*; *see Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.28*] may invoke the preemption requirements and thereby avoid any applicable California qualification or exemption requirements [*see 15 U.S.C. § 77r(b)(4)(D)*].

Thus, one of the practical effects of NSMIA has been to reduce the number of Rule 504 and 505 filings in multijurisdictional offerings, since NSMIA preemption provisions make filing under Rule 506 simpler than dealing with the requirements of multiple states. However, Rule 506 offering procedures may not always be attractive in small offerings, particularly those involving only one or a few states.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawAdditional Offerings & the Securities Exchange Act of 1934Jurisdiction & ScopeLimitations on RemediesSecurities LawBlue Sky LawsFederal PreemptionSecurities LawBlue Sky LawsOffer & SaleSecurities LawRegulation of Securities MarketsGeneral Overview



16 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
A. Scope of California Regulation

3-6 California Legal Forms--Transaction Guide §§ 6.16-6.29

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6.16[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
B. Exemptions From California Qualification Requirements

3-6 California Legal Forms--Transaction Guide § 6.30

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.30 Nature, Classes, and Importance of Exemptions

[1] Compared With Qualification

Once it has been determined that a proposed securities offering is subject to the Corporate Securities Law, the next step is usually to determine whether or not the offering comes within any of the numerous exceptions from qualification set out in the Corporate Securities Law. In some cases, it may be deemed most advantageous simply to restructure a proposed offering to come within a particular exemption. In other cases, an offering may be designed from the outset with a particular exemption in mind.

The decision to rely on an exemption instead of qualifying securities for sale in California involves weighing a number of factors, which are listed in § 6.118. As a general proposition, reliance on an exemption will save substantial time and expenses, but will subject a transaction to whatever limitations and conditions apply for that particular exemption. Many of the exemptions have very detailed and specific limitations. On the other hand, qualification ordinarily is a much more expensive and time-consuming process, but the end result is generally much less restrictive on matters such as the marketing, sale, transfer, and resale of the securities.

[2] Basic Classes of California Securities Exemptions

The California exemptions can be loosely grouped into three general categories:

- Exemptions based on the *type of security* being offered. These exemptions are specified in *Corp. Code § 25100* for all types of securities and *Corp. Code § 25101* for nonissuer securities, and the implementing regulations for these sections.

- Exemptions based on the *nature of the transaction* involved. These exemptions are specified in *Corp. Code § 25102* for issuer securities and *Corp. Code § 25104* for nonissuer securities, and the implementing regulations for these sections.

- Exemptions for reorganization, recapitalization, and exchange transactions, including changes in the rights, preferences, and restrictions on securities. These are, in effect, a specialized subcategory under the second category, above, but they are generally treated separately because of their specialized nature. These exemptions are specified in *Corp. Code § 25103* and its implementing regulations.

For discussion of the distinction between issuer and nonissuer transactions, see *§ 6.14*.

The Commissioner of Corporations is given broad authority to create additional exceptions for transactions that the Commissioner determines are not within the purposes of the Corporate Securities Law, and the qualification of which the Commissioner determines is not necessary or appropriate in the public interest or for the protection of investors [*Corp. Code § 25105*].

[3] Number and Significance

Exemptions from the California qualification requirements are numerous. *Corp. Code § 25100* contains 20 different exemptions, *Corp. Code § 25101* contains 2 different exemptions, *Corp. Code § 25102* contains 17 different exemptions, *Corp. Code § 25103* contains 8 different exemptions, and *Corp. Code § 25104* contains 9 different exemptions. This makes a total of 53 different statutory exemptions in these sections alone, not counting categories exempted by the Commissioner's rules. The sheer number of these exemtions can be confusing to a practitioner who is unfamiliar with the securities laws. However, many of these exemptions are highly specialized and will rarely be used or encountered by most practitioners in the context of closely held corporations. For example, *Corp. Code § 25100(g)* exempts mutual capital certificates and savings accounts issued by a savings and loan association, *Corp. Code § 25100(q)* exempts certain medical malpractice trust funds, and *Corp. Code § 25102(d)* deals with agreements between issuers and underwriters.

Nationally listed securities generally are exempt under *Corp. Code § 25100(o)*. Government-issued securities [*see Corp. Code § 25100(a), (b)*], bank or trust company securities [*see Corp. Code § 25100(c)*], short-term commercial paper [*see Corp. Code § 25100(l)*], and interests in employee pension and profit-sharing plans [*see Corp. Code § 25100(n)*] are among the other significant categories of exempt securities.

A detailed list of the statutory exemptions, together with the requirements applicable to each, appears in the table in § 6.200[2]. Since the majority of these exemptions are of limited application, they are not analyzed further in this publication. Rather, the analysis in this publication focusses on those few exemptions that are most often relevant to the issuance of securities by California nonpublic corporations.

[4] Exemptions Most Frequently Used by California Nonpublic Corporations and Other Similar Business Entities

In the context of nonpublic offers and sales of securities, the exemptions that are potentially applicable to the widest range of transactions, and therefore are the most commonly used, are the "limited offering exemption" (also sometimes referred to as the "nonpublic offering exemption") under *Corp. Code § 25102(f)* or *Corp. Code § 25102(d)* and the "small offering exemption" under *Corp. Code § 25102(h)*. The requirements and procedures for using these exemptions are discussed in detail in Ch. 6B, *California Limited Offering Exemptions* , and Ch. 6C, *California Small Offering Exemption* , respectively. An exemption is also available for the issuance of evidences of indebtedness in a transaction not involving a public offering under *Corp. Code § 25102(e)*.

Also of possible significance are the "institutional investor" exemption under *Corp. Code § 25102(i)*, which may be useful for nonpublic businesses seeking to raise capital from institutional investors, and the "qualified purchaser exemption" under *Corp. Code § 25102(n)*, which is somewhat more complex than the small and limited offering

exemptions, but provides more latitude in the solicitation of potential investors. These two exemptions are discussed in depth in Ch. 6D, *California Qualified Purchaser Exemptions*. An exemption is also available for certain employee option or employee purchase plans which qualify for the exemption under SEC Rule 701 [*Corp. Code § 25102(o)*].

Although the exemptions noted above are the most commonly used and the ones most likely to apply to a nonpublic offering, the attorney should stay alert to the possibility that other exemptions may also be applicable to specific situations. The table in § 6.200[2] provides a handy reference guide to the full spectrum of exemptions available under the California securities laws.

The following sections summarize the essential features of the important exemptions noted above, and offer some guidance to determining which one of them is best when there is a choice of exemptions in a given transaction.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsExempt Nonissuer & Resale TransactionsSecurities LawBlue Sky LawsExempted IssuersSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
B. Exemptions From California Qualification Requirements

3-6 California Legal Forms--Transaction Guide § 6.31

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§ 6.31 Limited Offering Exemptions

[1] Requirements

The limited offering exemption in *Corp. Code § 25102(f)* is probably relied on more than any other California exemption. The limited offering exemption is a general private offering exemption that applies to any offer or sale of any security in a transaction (except offers and sales to the issuer's pension or profit-sharing trust) that meets each of the following criteria [*Corp. Code § 25102(f)*]:

- Sales of securities are not made to more than 35 persons, excluding certain categories of purchasers who are not counted for purposes of this limitation.

- All purchasers either have a preexisting personal or business relationship with the offeror or any of certain individuals with management or oversight responsibilities, or, by reason of their business or financial experience or that of their professional advisors, who are not connected to the issuer, can be reasonably assumed to have the capacity to protect their own interests in connection with the transaction.

- Each purchaser represents that the purchaser is purchasing for the purchaser's own account (or a trust account if the purchaser is a trustee) and not with a view to or for sale in connection with any distribution of the security.

- The offer and sale of the security is not accomplished by the publication of any advertisement; and

- The issuer files a Notice of Transaction with the Commissioner of Corporations.

Although *Corp. Code § 25102(f)* exempts only issuer transactions, *10 Cal. Code Reg. § 260.103* extends the exemption to any change in the rights, preferences, privileges, or restrictions on outstanding securities by the issuer exclusively

with its existing security holder, and to bankruptcy reorganizations if the issuer files the required notice. Exchanges of securities in a merger, consolidation or sale of assets that satisfy the conditions of *Corp. Code § 25102(f)* will also be exempt if certain additional conditions are satisfied [*Corp. Code § 25103(h)*].

[2] Integration

The limited offering exemption applies to any offer or sale (except an offer or sale to an issuer's employee benefit trust) of any security in a "transaction" that meets the criteria set forth in [1], *above* [*Corp. Code § 25102(f)*]. The term "transaction" is not defined in the statute, and one of the major problems confronting an issuer concerns the identification of all offerings, past, present, and future, that will be considered a part of the transaction. The treatment of multiple offers and/or sales as a single transaction is commonly referred to as "integration."

The primary threat posed by integration is the possibility that the Commissioner may include in the transaction a past offer or sale which, either alone or in conjunction with the other offers and sales of the transaction, violates the requirements of the exemption. For example, an issuer may decide that a transaction consists entirely of a single completed sale to 35 non-excluded purchasers (the maximum permitted under the statute) [*see Corp. Code § 25102(f)(1)*]. Once the notice of transaction is filed, the Commissioner may disagree with the issuer's definition of the limited offering transaction and include a past sale that causes the transaction to exceed the maximum number of purchasers and therefore destroys the exemption. Another common problem imposed by integration is the requirement that there be no publication of any advertisement in an offering made in reliance on the exemptions under *Corp. Code §§ 25102(e), (f), (h),* or *25102.1(d).* A prior offering made publicly, including an offering that has been abandoned or in which no sales were made, may be integrated with the current offering.

For further discussion of the concepts of "single transaction" and "integration," see *Ch. 6B, California Limited Offering Exemptions, § 6B.21*.

[3] Number of Purchasers

Sales of securities may be made to a maximum of 35 non-excluded purchasers, including out-of-state purchasers, under the limited offering exemption [*Corp. Code § 25102(f)(1)*]. For purposes of the exemption, the term "purchaser" means a person who acquires the beneficial ownership of the security, whether individually or in joint ownership in the transaction under the exemption. Therefore, each person who takes in joint ownership with another is counted as one [*10 Cal. Code Reg. § 260.102.12(c)*]. However, a husband and wife, together with any custodian or trustee acting for the account of their minor children, are counted as one, and a partnership, corporation, or other organization that was not specifically formed for the purpose of purchasing the security offered in reliance upon the exemption, is counted as one [*Corp. Code § 25102(f)(4)*]. Note that there is no limit on the number of offerees [*but see* [7], *below*].

[4] Exclusions From Purchaser Count

Numerous classes of persons and entities are excluded by statute and by rules of the Commissioner from being included in the purchaser count. Some of the significant exclusions include institutional investors; directors, executive officers, and affiliates of the issuer; relatives of purchasers; promoters; individuals who purchase $150,000 or more of the securities and have sufficient business or financial experience; business investment and business development companies; and anyone classified as an "accredited investor" under SEC Rule 501 [*17 C.F.R. § 230.501(a)*] of Regulation D [*Corp. Code § 25102(f)*; *10 Cal. Code Reg. § 260.102.12*]. For a complete list of those persons excluded from the purchaser count for purposes of the limited offering exemption, see Ch. 6B, *California Limited Offering Exemptions* .

[5] Investor Suitability Requirements

Every purchaser under the limited offering exemption, except those purchasers specifically excluded from the purchaser

count by Corp. Code § 25102(f)(4) or *10 Cal. Code Reg. § 260.102.13* [*see 10 Cal. Code Reg. § 260.102.12(d)(2)*] must be a suitable purchaser by virtue of the fact that he or she satisfies either of the following conditions [*Corp. Code § 25102(f)(2)*; *see 10 Cal. Code Reg. § 260.102.12(d)*]:

- Has a preexisting personal or business relationship with the offeror or any of its partners, officers, directors or controlling persons, or managers (as appointed or elected by the members) if the offeror is a limited liability company. "Preexisting personal or business relationship" includes any relationship consisting of personal or business contacts of a nature and duration that would enable a reasonably prudent purchaser to be aware of the character, business acumen, and general business and financial circumstances of the person with whom the relationship exists [*10 Cal. Code Reg. § 260.102.12(d)(1)*]. An employer-employee relationship, or being a security holder of the issuer, or a customer of a broker-dealer, investment advisor, or other person does not necessarily establish a preexisting personal or business relationship [*10 Cal. Code Reg. § 260.102.12(d)(1)*].

- Could reasonably be assumed to have the capacity to protect his or her own interests in connection with the transaction, by reason of business or financial experience or the business or financial experience of his or her professional advisors who are unaffiliated with and who are not compensated by the issuer or any affiliate or selling agent of the issuer, directly or indirectly [*Corp. Code § 25102(f)(2)*]. This "sophisticated investor" test focuses on the potential purchaser's ability to evaluate the risks present in an offering. It is up to the issuer to make a subjective determination as to the adequacy of the potential purchaser's investment sophistication [*see Corp. Code § 25163* (burden of proving exemption); *see 10 Cal. Code Reg. § 260.102.12(g)*].

PRACTICE TIP:

A person acting as a professional adviser under *Corp. Code § 25102(f)* must generally be licensed as an investment adviser in California. The term "investment adviser" applies to any person who, for compensation, engages in the business of advising others with respect to investing in or purchasing or selling securities. A broker-dealer is excluded from this definition if the broker provides investment advice solely as an incident to the broker's business and the broker receives no special compensation for such services. It does not appear that a broker-dealer being used as a purchaser representative would fit within this exclusion, since under *Corp. Code § 25102(f)*, the professional adviser must be a person who as a regular part of his or her business is customarily relied upon by others for investment advice and who is customarily compensated for such services. Attorneys and accountants are excluded from the definition only if investment advisory services are provided solely as an incidence to the practice of their profession. *Commentary by Frances E. Lossing.*

For more detailed analysis of the investor suitability requirements of the limited offering exemption, see Ch. 6B, *California Limited Offering Exemptions* .

[6] Investment Intent

All purchasers of securities sold under the limited offering exemption must represent that they are purchasing for their own account (or a trust account if the purchaser is a trustee) and not with a view to or for sale in connection with any distribution of the security [*Corp. Code § 25102(f)(3)*; *see 10 Cal. Code Reg. § 260.102.15* (restriction inapplicable to private resales of securities to qualifying institutional buyers)]. It is advisable to require that this representation be in writing. The issuer is under no obligation to prevent the purchaser from subsequently violating this representation, and the purchase is not bound by any applicable holding period. However, if the purchaser violates the representation shortly after it is made and also violates one of the conditions of the exemption (such as the 35-purchaser maximum), then the exemption will probably be denied if it is found that the issuer should have known that the representation was false.

PRACTICE TIP:

It is customary for securities issued in transactions of this type to bear a restrictive legend stating that the securities are subject to restrictions on transferability and may not be transferred or sold except as permitted under the Securities Act of 1933 and applicable state securities laws in order to comply with federal securities laws or the blue sky laws of other states. As a general rule, this practice should be followed, even though it may not be technically required under California law, unless the securities by their very nature are not readily transferable (i.e., interests in an employer stock purchase plan in which the interests by their terms are non-transferability, other than on death). *Commentary by Frances E. Lossing.*

[7] Prohibition on Advertising

The offer or sale of securities under the limited offering exemption must not be accomplished by the publication of any advertisement [*Corp. Code § 25102(f)(4)*]. "Publication" or "publish" means to publicly issue or circulate by newspaper, mail, radio or television, or otherwise disseminate to the public [*Corp. Code § 25014*]. "Advertisement" means any written or printed communication or any communication by means of recorded telephone messages or spoken on radio, television, or similar communications media, published in connection with the offer or sale of a security [*Corp. Code § 25002*].

Private placement memoranda are not "disseminated to the public" and thus are not advertisements if the issuer limits the circulation of the private placement memorandum to persons reasonably believed to be interested in purchasing the securities or to persons the issuer reasonably believes meets the investor suitability standards of *Corp. Code § 25102(f)* and neither the issuer nor any finder acting on the issuer's behalf offers the securities by means of any general solicitation or advertising [*10 Cal. Code Reg. § 260.102.12(j)*].

For further discussion of the prohibition on advertising, see Ch. 6B, *California Limited Offering Exemptions* .

[8] Disclosure of Material Facts

The limited offering exemption does not require that an issuer disseminate information to purchasers of offerees. However, it is unlawful for any person to offer or sell a security in California by means of any written or oral communication that includes an untrue statement of a material fact or fails to state a material fact necessary to make the statements not misleading in light of the circumstances under which they were made [*Corp. Code § 25401*; *see Corp. Code § 25501* (liability for misrepresentation or nondisclosure)]. Thus, all material facts must be disclosed in any oral or written communication made in connection with any offer or sale under the limited offering exemption.

PRACTICE TIP:

It may be possible not to use an offering document if all the purchasers have a pre-existing personal or business relationship with the issuer and are actively involved in the project being financed. In this circumstance, the potential investors may already have access to all the information necessary to make a business decision. Offering materials must, however, generally be prepared if the issuer intends to rely on the sophisticated investor provisions of *Corp. Code § 25102(f)* in order for the investor to be able to make an informed decision whether to participate in the offering. Other possible means of providing investors information include data rooms containing copies of all material documents and investor conference calls. Particular care should be taken with investor conference calls to provide full and complete information. The fact that the information is provided orally will not limit the issuer's liability for supplying false or misleading information. *Commentary by Frances E. Lossing.*

[9] Notice of Transaction

[a] Copy of SEC Form

Any issuer using the limited offering exemption must file a notice of transaction if any of the offered securities are purchased [*10 Cal. Code Reg. § 260.102.14(a), (b)*]. If the issuer is filing a notice with the Securities and Exchange Commission (SEC) under Section 4(6) of the Securities Act of 1933 [*15 U.S.C. 77d(6)* (accredited investor exemption)] or Regulation D [*see 17 C.F.R. § 230.503*] in connection with the transaction, the notice of transaction may be a copy of the federal form first filed under those provisions with the Commissioner [*10 Cal. Code Reg. § 260.102.14(a)(1)*; *see Ch. 6B, California Limited Offering Exemptions, § 6B.203*].

[b] Electronic Filing; Hardship Exception

Unless the issuer files a copy of the SEC form, as set forth in [a], *above*, the notice of transaction *must be filed electronically* through the internet process made available by the Department of Corporations on www.corp.ca.gov. [*10 Cal. Code Reg. § 260.102.14(a)(2)*].

An issuer may file a paper notice in person or by mail, in the form and containing the information specified in *10 Cal. Code Reg. § 260.102.14(c), (d)*, only if the issuer claims a hardship exception for electronic filing [*10 Cal. Code Reg. § 260.102.14(a)(2), (f)*]. That exception is available if computer equipment including hardware and software is unavailable to the issuer without unreasonable burden or expense, and the issuer includes in the notice both of the following [*10 Cal. Code Reg. § 260.102.14(f)(1)*]:

- The reason(s) that the computer equipment including hardware and software is unavailable without unreasonable burden and expense; and

- The description(s) of the unreasonable burden or expense to the issuer to make the electronic filing.

Alternatively, the exception is available if the issuer cannot obtain and provide information requested on the Department's electronic notice or through the Internet filing process, and the issuer includes in the notice both of the following [*10 Cal. Code Reg. § 260.102.14(f)(2)*]:

- The reason(s) that the issuer cannot obtain and provide the requested information on the electronic notice or through the Internet filing process without unreasonable burden or expense; and

- The description(s) of the unreasonable burden or expense to the issuer to make the electronic filing.

[c] Time for Filing

The notice of transaction must be filed with the Commissioner no later than 15 calendar days after the first sale of a security in the transaction in California [*10 Cal. Code Reg. § 260.102.14(b)*]. The first sale in California occurs when the issuer has obtained a contractual commitment in California to purchase one or more of the securities the issuer intends to sell in connection with the transaction in California [*10 Cal. Code Reg. § 260.102.14(d)*]. No notice is required if none of the securities offered are purchased [*10 Cal. Code Reg. § 260.102.14(b)*].

[d] Failure to File

Failure to file the notice will not affect the availability of the limited offering exemption [*Corp. Code § 25102(f)(4)*]. On the other hand, because this failure would be a violation of a Rule of the Commissioner, it would be a violation of the Corporate Securities Law. Sanctions include the possibility of a civil penalty of up to $2,500 a day [Corp. Code § 25525(a)].

[10] Impact of National Securities Markets Improvement Act

The *Corp. Code § 25102(f)* exemption is similar to SEC Regulation D. The National Securities Markets Improvement Act (NSMIA) [*see § 6.15*] preempts state blue sky laws made in reliance on Rule 506 of Regulation D. As a result, the *Corp. Code § 25102(f)* exemption is less frequently used in multi-state transactions in which an offering document will be used in connection with sales to non-accredited investors. In order to take advantage of NSMIA preemption, the issuer must file the Form D with the Commissioner and a consent to service of process, if required [*Corp. Code § 25102.1(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsExempt Nonissuer & Resale TransactionsSecurities LawBlue Sky LawsExempted IssuersSecurities LawExemptions From RegistrationExempt TransactionsRegulation D ExemptionsSecurities LawExemptions From RegistrationExempt TransactionsU.S. Securities & Exchange Commission Rules 146 & 506Securities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
B. Exemptions From California Qualification Requirements

3-6 California Legal Forms--Transaction Guide § 6.32

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§ 6.32 Small Offering Exemption

[1] Requirements

To qualify for the small offering exemption under *Corp. Code § 25102(h)*, a transaction must meet all of the following requirements [*Corp. Code § 25102(h)*]:

- The corporation must have only one class of outstanding stock immediately after the proposed sale and issuance.
- The stock of the corporation must be beneficially owned by no more than 35 persons.
- The offer and sale of the stock may not be accompanied by the publication of any advertisement.
- No selling expenses may be given, paid, or incurred in connection with the offer or sale.
- The consideration to be received by the issuer for the stock to be issued must be of the kind prescribed by *Corp. Code § 25102(h)(2)*.
- No promotional consideration may be given, paid, or incurred in connection with the issuance.
- A notice in a form prescribed by the Commissioner [*see 10 Cal. Code Reg. § 260.102.8(a)*; *see also Ch. 6C, California Small Offering Exemption, § 6C.200*], including an opinion of counsel that the exemption is available, must be filed with the Commissioner not later than 10 business days after the issuer receives consideration for the securities.
- Each purchaser must represent that the purchaser is purchasing for the purchaser's own account, or a

> trust account if the purchaser is a trustee, and not with a view to or for sale in connection with any distribution of the stock.

The small offering exemption is only available to corporations [*Corp. Code § 25102(h)*]. A corporation incorporated under the laws of any state may use the exemption.

[2] Type of Stock

To qualify for the small offering exemption, a corporation must have only one class of stock outstanding immediately after the issue [*Corp. Code § 25102(h)*]. Obviously, a second class of common or a class of preferred shares would disqualify the offering. Debt securities are not considered a class of stock in the context of the small offering exemption even though they may be determined to be "equity" securities for the purpose of income taxes or for the purpose of priorities in bankruptcy or otherwise among creditors of the corporation [*10 Cal. Code Reg. § 260.102.4*].

Voting trust certificates should not constitute a second class of shares because the trustee, not the corporation, is normally the issuer [*see Corp. Code § 25010*]. However, a voting trust in which fewer than all of the shareholders are trustees is likely to violate the requirement that all shares have full and equal voting rights [*see* Dept. of Corps. Release No. 55-C (May 19, 1978); *see also 10 Cal. Code Reg. §§ 260.140.1, 260.140.2* (voting rights)].

If the corporation using the exemption is a close corporation [*see Corp. Code § 158*], there is a chance that a shareholder agreement will have the effect of creating more than one class of shares [*see Corp. Code § 25102(h)*; *see also* Ch. 8C, *Close Corporation Shareholder Agreements*]. Such a result will occur if an existing or planned shareholders' agreement provides (or will provide) that any of the rights, preferences, privileges, and restrictions enumerated in *Corp. Code § 25103(e)* apply or will apply to some but not all of the shares [*10 Cal. Code Reg. § 260.102.4*]. For example, a shareholder agreement that establishes profit-sharing rights that are disproportionate to share holdings will make the small offering exemption unavailable, whether or not the articles of incorporation provide for a single class of shares.

To alert the Commissioner to possible violations of the single-class requirement, the notice of issuance of shares under the small offering exemption [*see 10 Cal. Code Reg. § 260.102.8*; *see also Ch. 6C, California Small Offering Exemption, § 6C.200*] requires the signing officer to declare that to the best knowledge of the issuer, no shareholders' agreement, voting agreement, irrevocable proxy, or other arrangement that would cause the statements in the notice to be incorrect exists or is contemplated [*see 10 Cal. Code Reg. § 260.102.8(a)*]. The notice would be "incorrect" if its statements concerning the satisfaction of the single-class requirement were contradicted by a shareholders' agreement that had the effect of creating more than one class.

[3] Number of Owners

The number of owners of stock issued under the small offering exemption may not exceed 35 [*see Corp. Code § 25102(h)*]. The limitation refers to shares owned "beneficially" [*Corp. Code § 25102(h)*]. This limitation disallows individual legal owners from holding securities for large numbers of beneficial owners. In the context of the small offering exemption, shares held by a partnership or a joint venture are considered to be owned beneficially by each of the members of the group. Shares held by a trustee are considered to be owned beneficially by the trust beneficiaries, whether their interests are present, future, or contingent. However, a future or contingent beneficiary is not a beneficial owner in this context if he or she is an ancestor, descendent, or spouse of a present beneficiary or custodian or trustee for his or her account [*10 Cal. Code Reg. § 260.102.5*]. A husband and wife count as one shareholder, whether shares are in the name of either or both [*Corp. Code § 25102(h)(5)*].

Securities held by a corporation that has issued stock under the small offering exemption are considered to be held by the stockholders of that corporation [*Corp. Code § 25102(h)(5)*]. Thus, if securities will be issued to a corporation under the small offering exemption there may be no more than 35 shareholders in the issuee corporation [*see Corp. Code §*

25102(h)].

[4] Prohibition on Advertising

The offer or sale of securities under the small offering exemption must not be accompanied by the publication of any advertisement [*Corp. Code § 25102(h)(1)*]. "Publication" or "publish" means to publicly issue or circulate by newspaper, mail, radio or television, or otherwise disseminate to the public [*Corp. Code § 25014*]. "Advertisement" means any written or printed communication or any communication by means of recorded telephone messages or spoken on radio, television, or similar communications media, published in connection with the offer or sale of a security [*Corp. Code § 25002*].

[5] Prohibition on Selling Expenses

To qualify for the small offering exemption, the issuer must not pay any selling expenses [*Corp. Code § 25102(h)(1)*]. "Selling expenses" means commissions, discounts or other compensation paid to any person as remuneration for selling the securities [*10 Cal. Code Reg. § 260.102.7*].

[6] Consideration for Securities

The consideration to be received for the stock to be issued may be any of the following [*Corp. Code § 25102(h)(2)*]:

- Any legal consideration, if there will be only one owner of the stock;
- Cash or cancellation of indebtedness for money borrowed or both, on the initial organization of the issuer, if all stock is issued for the same price per share;
- Only cash, if the sale (after initial organization) is approved in writing by each of the existing shareholders and the purchaser or purchasers are existing shareholders; or
- Only assets (including cash assets) of an existing business transferred to the issuer on its initial organization.

A more stringent restriction exists in the area of transfer of assets of an existing enterprise to the corporation in return for shares. The existing business must have been in operation for a period of at least one full year immediately preceding the new stock issue, and the stock issuees must have been owners all during that year (though others may have owned also but have dropped out) and receive their shares in proportion to their ownership just before the stock issue (though ownership interests fluctuated previously) [*Corp. Code § 25102(h)(2)(A)*]. The business could have been operated for any longer time, and it need never have shown a profit. However, it is clear that no shares may be issued at any time for promotional services rendered [*Corp. Code § 25102(h)(2)(A), (3)*].

[7] Promotional Activities

With one exception, no promotional consideration may be given, paid, or incurred in connection with the issuance of securities [*Corp. Code § 25102(h)(3)*]. Promotional consideration is defined to mean "any consideration paid directly or indirectly to a person, who, acting alone or in conjunction with one or more other persons, takes the initiative in founding and organizing the business or enterprise of an issuer, for services rendered in connection with such founding or organizing" [*Corp. Code § 25102(h)(3)*]. The exception to the rule against payment for promotional services applies in the case of the sole-shareholder corporation in which any legal considerations may be paid for shares, whether before or after the initial organization [*Corp. Code § 25102(h)(2)(D)*].

In connection with other preissuance activities by promoters, the Commissioner has relaxed the prohibition against the

receipt of certain forms of consideration more than 10 days before the corporation files its notice of issuance of securities. Although stock may not be issued in consideration of promotional activities (except in the one-person corporation), stock may be issued in cancellation of loans and advances to the corporation, provided specified conditions are satisfied [*10 Cal. Code Reg. § 260.102.11*; *see* Ch. 6C, *California Small Offering Exemption*].

[8] Notice and Opinion of Counsel

The Department of Corporations itself has no provision for policing the small offering exemption in a manner equivalent to the services it performs while reviewing applications for permits, or services performed by the SEC in reviewing registrations qualifying locally by coordination and notification [*Corp. Code §§ 25102(h), 25111-25113*; Securities Act of 1933 § 6 (*15 U.S.C. § 77f*); Securities Exchange Act of 1934 § 12 (*15 U.S.C. § 78l*)]. Therefore, each Notice of Issuance of Shares required by *Corp. Code § 25102(h)(4)* must contain a signed opinion of an attorney that the exemption is available [*Corp. Code § 25102(h)(4)*]. The attorney must be on the active roster of the Bar, not on inactive status [*Corp. Code § 25102(h)(4)*].

The attorney need not be the attorney retained by the corporation for its business or even organizational affairs. The attorney's only task is to examine the facts stated in the notice and state that the facts, if true, qualify the transaction for the exemption [*see 10 Cal. Code Reg. § 260.102.8*]. The attorney has a responsibility, however, to make inquiries of his or her clients, and the extent of the investigation will depend on the facts peculiar to each transaction. As a member of the Bar and an officer of the court, the attorney is obliged to make sure that the exemption is not abused.

Failure to file the notice and the attorney's opinion required by *Corp. Code § 25102(h)* will not affect the availability of the small offering exemption if the issuer, within 15 business days after discovery of the failure to file the notice or after demand by the commissioner, whichever occurs first, files the notice and pays a fee equal to that payable had the transaction been qualified under *Corp. Code § 25110* [*Corp. Code § 25102(h)(4)*; *see Corp. Code § 25608* (schedule of fees)].

Unlike most other notice filings, which may be filed in any office maintained by the Department of Corporations, the notice for this exemption must be filed in Los Angeles.

[9] Investment Intent

All purchasers of securities sold under the small offering exemption must represent that they are purchasing for their own account (or a trust account if the purchaser is a trustee) and not with a view to or for sale in connection with any distribution of the security [*Corp. Code § 25102(h)(5)*]. It is advisable to require that this representation be in writing. The issuer is under no obligation to prevent the purchaser from subsequently violating this representation, and the purchaser is not bound by any applicable holding period. However, if the purchaser violates the representation shortly after it is made and also violates one of the conditions of the exemption (such as the 35-beneficial owner maximum), then the exemption will probably be denied.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesSecurities LawGeneral OverviewSecurities LawBlue Sky LawsExempt Nonissuer & Resale TransactionsSecurities LawBlue Sky LawsExempted IssuersSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
B. Exemptions From California Qualification Requirements

3-6 California Legal Forms--Transaction Guide § 6.33

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.33 California Qualified Purchaser Exemptions

[1] In General

The "qualified purchaser exemptions" to the qualification requirements for issuer transactions under the Corporate Securities Law are set forth in *Corp. Code § 25102(i)* and *(n)* and in *10 Cal. Code Reg. § 260.105.14*. These sections create exemptions that apply to any offer or sale of securities to purchasers meeting enumerated qualifications [*Corp. Code § 25102(i), (n)*; *10 Cal. Code Reg. § 260.105.14*]. There are two such exemptions: the "institutional investor exemption" under *Corp. Code § 25102(i)* [*see* [2], *below*] and the "limited offering qualified purchaser exemption" under *Corp. Code § 25102(n)* [*see* [3], *below*].

These exemptions are discussed in detail in Ch. 6D, *California Qualified Purchaser Exemptions* .

[2] Institutional Investor Exemption

The institutional investor exemption under *Corp. Code § 25102(i)* affords an exemption from registration for any offer or sale to a bank, savings and loan association, trust company, insurance company, registered investment company, pension or profit sharing trust (other than those of the issuer, a self-employed individual retirement plan, or individual retirement account), to other institutional investors, governmental agencies or instrumentalities that the Commissioner may designate by rule, or to a corporation with outstanding securities registered under the Securities Exchange Act of 1934 or wholly owned subsidiary of such a corporation if, after the offer and sale, that corporation will own directly or indirectly all of the outstanding capital stock of the company; provided the purchaser represents that it is purchasing for investment and not for distribution, as discussed throughout this Legal Background [*Corp. Code § 25102(i)*]. No filings or filing fees are required, and all the issuer need do is comply with the criteria stated in *Corp. Code § 25102(i)* [*see §§ 6D.22, 6D.100*].

An exemption is also available for any offer or sale of a security to the federal government, any agency or instrumentality of the Federal Government, any state, any city, city and county, or county, or any agency or

instrumentality or a state, city, city and county, or county, or any state university or state college and any retirement system for the benefit of their employees [*10 Cal. Code Reg. § 260.105.14*].

[3] Limited Offering Qualified Purchaser Exemption

The qualified purchaser exemption under *Corp. Code § 25102(n)* applies to offers and sales involving California corporations or pseudo-California corporations under *Corp. Code § 2115* and purchasers meeting the qualifications of that section [*see Corp. Code §§ 25102(n)(1)- (3)*]. With certain limited exceptions, the issuer must provide a written offering disclosure statement pursuant to *Corp. Code § 25102(n)(4)* to each natural person. The issuer may publish a general notice of proposed offering pursuant to *Corp. Code § 25102(n)(5)*, provided the general notice complies with the requirements of the statute. Each purchaser must also represent that it is purchasing for investment and not with a view to distribution. Under *Corp. Code § 25102(n)(7)*, the issuer must file a first notice of transaction and pay a $600 filing fee, and also file a second notice of transaction for which no fee is required [*see Ch. 6D, California Qualified Purchaser Exemptions, §§ 6D.23, 6D.201-6D.203*].

[4] Comparison of Exemptions

The qualified purchaser exemption under *Corp. Code § 25102(n)* exempts a broader scope of purchasers than the institutional investor exemption under *Corp. Code § 25102(i)* or the public agency exemption under *10 Cal. Code Reg. § 260.105.14*. The type of purchasers qualifying for exemption under *Corp. Code § 25102(i)*--basically, institutional investors-- are just one type of purchaser qualifying for exemption under *Corp. Code § 25102(n)*. Other purchasers qualifying under *Corp. Code § 25102(n)* include any person designated in *10 Cal. Code Reg. § 260.102.13*, specified pension or profit sharing trusts and retirement plans or accounts in which the investment decisions are made solely by persons who are qualified purchasers, and any natural person meeting enumerated financial requirements [*Corp. Code § 25102(n)*].

Issuers who intend offer or sell securities only to institutional investors qualified under *Corp. Code § 25102(i)* or *10 Cal. Code Reg. § 260.105.14*may elect to offer and sell under that exemption, and avoid having to comply with the additional requirements of *Corp. Code § 25102(n)*. On the other hand, those issuers who wish to offer and sell to a broader scope of qualified purchasers (which can include those qualified under *Corp. Code § 25102(i)* or *10 Cal. Code Reg. § 260.105.14* or other exemptions available under *Corp. Code § 25102(f)* or *(d)*) must use *Corp. Code § 25102(n)* to obtain a qualified purchaser exemption.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsExempt Nonissuer & Resale TransactionsSecurities LawBlue Sky LawsExempted IssuersSecurities LawInvestment CompaniesActivitiesSecurities LawInvestment CompaniesDistribution, Redemption & Repurchase of SharesSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
B. Exemptions From California Qualification Requirements

3-6 California Legal Forms--Transaction Guide § 6.34

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.34 Selecting the Most Appropriate California Exemption

[1] Comparison of Commonly Used Exemptions

The essential requirements of the limited offering exemption are as follows [*Corp. Code § 25102(f)*]:

- Sales must be made to no more than 35 purchasers, other than non-excluded purchasers.
- Purchasers must have either a preexisting relationship with insiders or financial sophistication, or be represented by a purchaser representative who is financially sophisticated.
- Each investor must be investing for his or her own account.
- No advertising is published.
- A notice (which may be a Form D) is filed.

The essential requirements of the small offering exemption are as follows [*Corp. Code § 25102(h)*]:

- The issuer may have no more than 35 shareholders.
- The issuer must be a corporation.
- The issuer may have only one class of outstanding stock.
- No selling expenses are paid.

- Consideration is restricted.
- No promotional consideration is paid.
- No advertising is published.
- An opinion of counsel is filed.
- Each investor must be investing for his or her own account.
- A notice is filed.

The essential requirements to take advantage of NSMIA preemption are as follows [*Corp. Code § 25102.1(d)*]:

- The issuer must have no more than 35 purchasers, other than accredited investors.
- Non-accredited investors must either have a preexisting relationship with insiders or financial sophistication or be represented by a purchaser representative who is financially sophisticated.
- Each investor must be purchasing for his or her own account.
- No advertising may be published.
- Non-accredited investors must be given a disclosure document containing specified disclosures.
- A Form D must be filed with the SEC and the Commissioner.

The essential requirements of the limited qualified purchaser exemption are as follows [*Corp. Code § 25102(n)*]:

- The issuer must be either a California corporation or a pseudo-California corporation under *Corp. Code § 2115*.
- The purchasers must be of a specified type, which includes accredited investors.
- Each investor must be investing for his or her own account.
- No advertisement, other than a general announcement, is published.
- Natural persons who are non-accredited investors must be given a disclosure document containing specified disclosures (same as that required by Regulation D).
- Two notices must be filed.

The essential requirements of the private placement exemption are as follows [*Corp. Code § 25102(e)*]:

- The security must be a debt security.
- Each investor must be investing for his or her own account.
- No advertisement is published.

[2] Analysis of Differences

In most cases, the criteria for the small offering exemption are stricter than their limited offering counterparts. For example, a corporation using the small offering exemption must issue only one class of shares [*Corp. Code § 25102(h)*], whereas the limited offering exemptions potentially apply to almost any offer or sale of any security [*Corp. Code §§ 25102(f), 25102.1(d)*]. Under the circumstances discussed in *§ 6.32[2]*, a close corporation shareholder agreement could be construed to create more than one class of shares. Furthermore, the small offering exemption requires that after the proposed sale and issuance the corporation have a total of no more than 35 shareholders [*Corp. Code § 25102(h)*]. In contrast, the limited offering exemptions permit the corporation to have a total of more than 35 shareholders, as long as the transaction in question results in sales to no more than 35 persons (other than excluded purchasers) [*Corp. Code § 25102(f)*]. Obviously, many issuers who are ineligible for the small offering exemption will be able to satisfy the less demanding limited offering criteria. Uncertainty concerning whether or not a proposed issuance qualifies for the small offering exemption may discourage an issuer from even attempting to use that exemption when a limited offering exemption is available.

On the other hand, issuers seeking to use the limited offering exemption are confronted with the possibility that an otherwise eligible transaction may be disqualified by being "integrated" with a past offer or sale that, either alone or in conjunction with the currently proposed issuance, violates the applicable criteria [*see 10 Cal. Code Reg. § 260.102.12(b)*; *see also § 6.31[2]*; *Ch. 6B, California Limited Offering Exemptions, § 6B.21*]. Furthermore, limited offering issuers are faced with the possibility that a potential shareholder will not be able to meet the purchaser suitability requirements, which are applicable solely to the limited offering exemption [*Corp. Code § 25102(f)*; *10 Cal. Code Reg. § 260.102.12*; *see* Ch. 6B, *California Limited Offering Exemptions*].

Assuming that a transaction can qualify for either exemption without difficulty, the deciding factor may the fact that the small offering exemption is relatively easy to use, with very little documentation involved [*see* Ch. 6C, *California Small Offering Exemption*]. In contrast, sound practice dictates that an attorney document several aspects of a limited offering transaction in order to demonstrate compliance with that exemption's numerous requirements [*see* Ch. 6B, *California Limited Offering Exemptions*].

The private placement exemption [*Corp. Code § 25102(e)*] and the institutional investor exemption [*Corp. Code § 25102(i)*] are the easiest to use and require no filings to perfect the exemption. The private placement exemption, however, is limited to offerings of debt securities. The institutional investor exemption is limited to a short list of institutional investors of a type that may not be interested in investing in a nonpublic corporation.

The limited qualified purchaser exemption [*Corp. Code § 25102(n)*] is only available to California corporations or pseudo-California corporations under *Corp. Code § 2115*, and has very detailed qualified purchaser requirements. The list of eligible purchasers, however, is more extensive than the institutional investor list and there is no limit on the number of purchasers, such as that contained in the exemptions under *Corp. Code § 25102(f), (h)*, or *25102.1(d)*.

Certain types of institutional investors are also "accredited investors" as defined in Regulation D. Natural persons who are accredited investors, however, are not included in the institutional investor list. Accredited investors are qualified purchasers under *Corp. Code § 25102(n)(2)(A)* and are excluded purchasers under *Corp. Code § 25102(f)* [*10 Cal. Code Reg. § 260.102.13(g)*]. The list of qualified purchasers under *Corp. Code § 25102(n)* and the list of excluded purchasers under *Corp. Code § 25102(f)*, however, is more extensive than the list of accredited investors. The most extensive list of qualified purchasers is contained in *Corp. Code § 25102(n)*.

No offering document containing specified disclosures is required in order to use the exemptions under *Corp. Code § 25102(e), (f), (h)*, or *(i)*. An offering document containing specified disclosures is, however, required for offerings to natural persons who are non-accredited investors under *Corp. Code § 25102(n)* or who are non-accredited investors under *Corp. Code § 25102.1(d)*.

Each of the exemptions requires the purchasers to be purchasing for investment only. None of the exemptions permits the publication of any advertisement, with the exception of the exemption under *Corp. Code § 25102(n)*, which permits a general announcement meeting specified requirements.

Notice filings are required to perfect the exemptions under *Corp. Code §§ 25102(f)*, *(h)*, *(n)*, and *25102.1(d)*; however, the failure to file the notice under *Corp. Code § 25102(f)* will not affect the availability of the exemption. No notice filings are required to perfect exemptions under *Corp. Code § 25102(e)* or *(i)*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsExempt Nonissuer & Resale TransactionsSecurities LawBlue Sky LawsExempted IssuersSecurities LawExemptions From RegistrationExempt TransactionsRegulation D ExemptionsSecurities LawRegulation of Securities MarketsGeneral Overview



22 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
B. Exemptions From California Qualification Requirements

3-6 California Legal Forms--Transaction Guide §§ 6.35-6.39

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§§ 6.35[Reserved]



23 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
C. Qualification of Securities

3-6 California Legal Forms--Transaction Guide § 6.40

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.40 When Qualification Is Necessary

The Corporate Securities Law sets forth three distinct qualification requirements:

- *Corp. Code § 25110* requires qualification of issuer transactions, which primarily involve sales of securities in an offering from which the issuer will obtain the proceeds.

- *Corp. Code § 25130* requires qualification of non-issuer transactions, which generally include traditional secondary market trading activities.

- *Corp. Code § 25120* requires qualification of various types of reorganization, recapitalization, or exchange transactions, including the modification of the terms of existing securities.

A security or securities transaction must be qualified in California when all of the following conditions exist [*see Corp. Code §§ 25110, 25120, 25130* (statutory requirement of qualification)]:

- The interest or instrument constitutes a *security* [*see Corp. Code § 25019*; *see also § 6.11*].

- The transaction involves an *offer or sale* for value [*see Corp. Code § 25017*; *see also § 6.12*].

- The offer or sale is made *in California* [*see Corp. Code § 25008*; *see also § 6.13*].

- Regulation under the Corporate Securities Law is not *preempted by federal law* [*see § 6.15*].

- The security or transaction is not *exempt* from qualification [*see Corp. Code §§ 25100-25105*; *see also §§ 6.30-6.33*], or the issuer has elected to qualify the transaction, even if one or more exemptions are potentially available, in order to take advantage of the benefits of qualification.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
C. Qualification of Securities

3-6 California Legal Forms--Transaction Guide § 6.41

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.41 Nature of Qualification Process

[1] Application and Review by Commissioner

Qualification requires the submission of an application to the Commissioner of Corporations setting forth specified information concerning the issuer and the security to be qualified. The Commissioner may deny qualification if the issuance or sale of a security is found not to be "fair, just and equitable" [*Corp. Code § 25140*]. The Commissioner has adopted rules which set forth the merit standards frequently used for evaluating proposed securities offerings [*see 10 Cal. Code Reg. §§ 260.140-260.140.139*]. The merit standards deal with issues that relate to whether an investor will receive a fair chance to realize the investor's investment objectives. The Commissioner has discretion to apply the merit standards in a more liberal or more stringent manner based on the circumstances of a particular offering.

[2] Merit Standards

The merit standards address the following general issues:

- Voting rights and other rights of security holders [*see 10 Cal. Code Reg. §§ 260.140.1-260.140.10*].
- Selling expenses and options to underwriters [*see 10 Cal. Code Reg. §§ 260.140.20-260.140.22*].
- Promotional shares [*see 10 Cal. Code Reg. §§ 260.140.30-260.140.33*].
- Rights, warrants and options [*see 10 Cal. Code Reg. §§ 260.140.40-260.140.46*].
- Offering price [*see 10 Cal. Code Reg. §§ 260.140.50, 260.140.51*].
- Recapitalizations and reorganizations [*see 10 Cal. Code Reg. §§ 260.140.60-260.140.63*].

- Stock dividends and stock splits [*see 10 Cal. Code Reg. § 260.140.70*].
- Nonissuer qualifications [*see 10 Cal. Code Reg. §§ 260.140.135-260.140.139*].

The merit standards also provide particular guidance for the following types of issuers or interests:

- Mutual water companies [*see 10 Cal. Code Reg. §§ 260.140.71-260.140.71.10*].
- Offerings of debt securities by churches [*see 10 Cal. Code Reg. §§ 260.140.72-260.140.72.6*].
- Investment companies [*see 10 Cal. Code Reg. §§ 260.140.80-260.140.89*].
- Real estate investment trusts [*see 10 Cal. Code Reg. §§ 260.140.90-260.140.103*].
- Real estate programs [*see 10 Cal. Code Reg. §§ 260.140.110.1-260.140.119.1*].
- Oil and gas interests [*see 10 Cal. Code Reg. §§ 260.140.120-260.140.131.9*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



25 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
C. Qualification of Securities

3-6 California Legal Forms--Transaction Guide § 6.42

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.42 Methods of Qualification

[1] Methods

There are three methods or procedures by which securities can be qualified:

- Coordination.
- Notification.
- Permit.

The applicable method of qualification under the Corporate Securities Law, as well as the exemptions available, depend on the type of transaction involved.

Qualification by coordination and qualification by notice are basically abbreviated processes, and for that reason are generally preferred by issuers over the more extensive requirements of the permit process. Qualification by coordination is designed to coordinate the California qualification with federal registration of the securities.

[2] Issuer Transactions

An issuer transaction may be qualified by any of the three methods noted in [1], *above*, depending on the circumstances of the transaction. If a registration statement has been filed under the federal Securities Act of 1933 [*15 U.S.C. § 77a et seq.*] in connection with the same offering, the transaction may be qualified by coordination [*Corp. Code § 25111*]. A nonregistered offering by a company that either has any security registered under Section 12 of the Securities Exchange Act of 1934 [*15 U.S.C. § 78l*] or is an investment company registered under the Investment Company Act of 1940 [*15 U.S.C. § 80a-1 et seq.*] may be qualified by notification [*Corp. Code § 25112*]. All other offers and sales by an issuer must be qualified by permit [*see Corp. Code § 25113*].

[3] Nonissuer Transactions

Nonissuer transactions also may be qualified by any of the three methods of qualification, again depending on the circumstances of the transaction. Nonissuer transactions involving securities registered under the Securities Act of 1933 may be qualified by coordination under *Corp. Code § 25111* [*Corp. Code § 25111(a)*]. For offerings involving securities qualified under Regulation A of the Securities Act of 1933 [*17 C.F.R. § 230.251 et seq.*], qualification must be sought by permit under *Corp. Code § 25113* [*Corp. Code § 25131(a)*]. All other nonissuer transactions may be qualified by notification under *Corp. Code § 25112* [*Corp. Code § 25131(a)*].

[4] Reorganizations and Recapitalizations

All reorganizations and recapitalizations must be qualified by permit under *Corp. Code § 25121*. Qualification by coordination or notification is not available.

[5] Qualification by Coordination

[a] Procedure

Qualification by coordination is accomplished by filing with the Commissioner of Corporations not later than the fifth business day following filing of the registration statement with the SEC, an application containing the following information and accompanied by the following documents [*Corp. Code § 25111(b)*]:

- A copy of the registration statement filed with the SEC under the Securities Act of 1933, together with all exhibits.

- An undertaking to forward to the Commissioner all future amendments to the registration statement no later than the first business day after the day such amendments are forwarded to or filed with the SEC.

- A statement of the maximum amount of securities to be offered in California [*see Corp. Code § 25160*].

- Any adverse order, judgment, or decree entered in connection with the offering by the regulatory authority in any state or by any court or by the SEC [*see Corp. Code § 25160*].

- A consent to service of process (if one is not already on file) [*see Corp. Code § 25165*].

- Other information required to evidence compliance with any rules of the Commissioner.

Abbreviated filing requirements apply to an open-ended investment company or unit investment trust that is in compliance with all terms of a prior qualification for the sale of the same securities and has made no material change in its offering [*Corp. Code § 25111(d)*]. Special procedures must be followed for offerings on Form S-3 or F-3 made on a delayed or continuous basis pursuant to SEC Rule 415 [Dept. of Corps. Release No. 70-C (June 24, 1982, as revised Nov. 5, 1982, and Dec. 31, 1983)].

[b] Effective Date

Securities qualified by coordination may be offered and sold in accordance with the terms of the application as amended at the moment the federal registration becomes effective if all of the following conditions are satisfied [*Corp. Code § 25111(c)*]:

- The Commissioner of Corporations has not issued a stop order that remains in effect [*see Corp. Code*

§ 25143(a)].

- The application for qualification by coordination has been on file with the Commissioner of Corporations for at least 10 days.

- A statement of the maximum and minimum proposed offering prices and the maximum underwriting discounts and commissions has been on file for two business with the Commissioner of Corporations and the offering is made within the filed limitations.

The applicant must promptly notify the Commissioner of Corporations by telephone or telegram of the date and time when the federal registration becomes effective and the content of the price amendment, if any, and promptly file the price amendment with the Commissioner of Corporations. The "price amendment" means the final federal amendment that includes a statement of the offering price, underwriting and selling discounts or commissions, amount of proceeds, interest, dividend or conversion rates, call prices and other matters related to the offering price.

PRACTICE TIP:
The Commissioner's processing guidelines deviate from common SEC practice in that pricing amendments are no longer required to be filed with the SEC in many circumstances. In these circumstances the final form of prospectus which contains the final pricing information should be filed with the Commissioner in lieu of the pricing amendment. *Commentary by Frances E. Lossing.*

A subsequent qualification of the sale of securities of an open-end investment company or unit investment trust becomes effective upon the day following the expiration of its prior qualification or, if that qualification has already expired, upon the first business day following the filing of the application [*Corp. Code § 25111(d)(1)*].

[6] Qualification by Notification

[a] Availability

Qualification by notification is available for any security issued by a person that is the issuer of any security that is registered under Section 12 of the Securities Exchange Act of 1934 or that is issued by an investment company registered under the Investment Company Act of 1940, and which is not eligible for qualification by coordination [*Corp. Code § 25112(a)*].

[b] Procedure

An application for qualification by notification is made by providing the Commissioner of Corporations with the information and documents required by the Commissioner's rules [*Corp. Code § 25112(b)*]. The information and documents required by the Commissioner are set forth in *10 Cal. Code Reg. § 260.112* and include information about the issuer's business, management, financial condition, ownership and information about the offering. For detailed information regarding the items that must be included in an application for qualification by notification, see *Ch. 6H, Qualification of Securities, § 6H.215*.

[c] Effective Date

Qualification by notification becomes effective at 12 o'clock noon California time of the 10th business day after the filing of the application or the last amendment, unless the Commissioner of Corporations has not issued a stop order that remains in effect [*Corp. Code § 25112(c)*; *see Corp. Code § 25143(a)*]. Qualification may be effective earlier if specifically authorized by the Commissioner [*Corp. Code § 25112(c)*].

[7] Qualification by Permit

[a] Availability

Any issuer may seek qualification of a transaction by seeking a permit from the Commissioner of Corporations. The Commissioner may refuse to issue a permit unless the Commissioner finds that the proposed plan of business of the applicant and the proposed issuance of securities are fair, just, and equitable, that the applicant intends to transact its business fairly and honestly, and that the securities that is proposes to issue and the methods to be used by it in issuing them will not work a fraud on the purchasers [*Corp. Code § 25140(b)*].

[b] Application

An issuer applies for a permit by providing the Commissioner of Corporations with the information and documents required by the applicable Commissioner's rule [*Corp. Code § 25113(b)(1)*; *see 10 Cal. Code Reg. § 260.113*]. The requirements are more extensive than those for qualification by coordination or notification. The application process is streamlined somewhat, however, for an issuer and transaction that qualifies for the "small company application" procedure available for offerings of less than $1 million that meet a series of requirements [*see Corp. Code § 25113(b)(2)*]. The application may be either for an open qualification or a limited qualification. An open qualification generally will not be approved for an issuer that is not reasonably expected to be profitable within the next two years or for unseasoned corporations with complex capital structures [*10 Cal. Code Reg. §§ 260.140.5, 260.140.9*]. For more detailed discussion of these requirements and the contents of an application for qualification by permit, see *Ch. 6H, Qualification of Securities, § 6H.220*.

Legal Topics:

For related research and practice materials, see the following legal topics:
GovernmentsState & Territorial GovernmentsLicensesSecurities LawGeneral OverviewSecurities LawAdditional Offerings & the Securities Exchange Act of 1934Registration RequirementsSecurities LawInvestment CompaniesRegistration & ReportingSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
C. Qualification of Securities

3-6 California Legal Forms--Transaction Guide §§ 6.43-6.49

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

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§§ 6.43[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
D. Overview of Federal Securities Regulation

3-6 California Legal Forms--Transaction Guide § 6.50

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.50 Relevance to Securities Sold in California

When an offer or sale of securities is made in California, that offer or sale needs to be either registered under federal securities laws or exempt from registration under those laws. Registration under the federal laws, or selection of the particular exemption used to avoid federal registration, also has an impact on the need for qualification and the availability of particular exemptions under the Corporate Securities Law.

In general, small business issuers will try to avoid having to register or qualify their securities by structuring their issuing transactions to be able to fall within an exemption. The federal exemptions used most frequently by small business issuers are the exemptions available under Regulation D of the federal securities laws [*17 C.F.R. § 230.501 et seq.*]. When planning the issuing transactions, the requirements of the appropriate exemptions should help to guide the structure of the transaction.

This chapter gives only a brief overview of the federal securities regulation scheme, an overview of Regulation D, and a contrast of the differences between Regulation D and *Corp. Code § 25102(f)*. For detailed discussion of the Regulation D exemptions and other commonly used exemptions, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsSecurities Exempt From RegistrationSecurities LawExemptions From RegistrationExempt TransactionsRegulation D ExemptionsSecurities LawRegulation of Securities MarketsGeneral Overview



28 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
D. Overview of Federal Securities Regulation

3-6 California Legal Forms--Transaction Guide § 6.51

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.51 Governing Law

[1] Statutes

Regulation of the offer and sale of securities by the federal government is basically accomplished by several key acts:

- **The Securities Act of 1933** (the "Securities Act"), codified at *15 U.S.C. §§ 77a-77aa*. The Securities Act regulates public offerings of securities by prohibiting offers and sales of securities that are either not registered with the SEC or are exempt from registration. The Securities Act also prohibits fraudulent or deceptive practices in connection with any offer or sale of securities.

- **The Securities Exchange Act of 1934** (the "Exchange Act"), codified at *15 U.S.C. §§ 78a-78mm*. The Exchange Act established the SEC and gave it the responsibility of administering the Securities Act. In addition, the Exchange Act provides for the regulation of national securities exchanges and associations, securities brokers and dealers, and other persons and entities involved in the offering and sale of securities. The Exchange Act also imposes disclosure and reporting requirements on publicly held companies and prohibits various deceptive and manipulative practices in connection with the purchase and sale of securities.

- **The Trust Indenture Act of 1939** (the "Trust Indenture Act"), codified at *15 U.S.C. §§ 77aaa-77bbbb*. The Trust Indenture Act regulates public issues of debt securities in excess of a specified amount. These issues are also regulated by the Securities Act, but the Trust Indenture Act imposes standards on the indenture trustee and provides other protections for the securities holders.

- **The Investment Company Act of 1940** (the "Investment Company Act"), codified at *15 U.S.C. § 80a-1 et seq.* The Investment Company Act regulates publicly owned companies that engage in the business of investing and trading in securities.

- **The Investment Advisers Act of 1940** (the "Investment Advisers Act"), codified at *15 U.S.C. § 80b-1 et seq.* The Investment Advisers Act regulates investment advisers and subjects them to registration.

Of the statutes listed above, the Securities Act has by far the most impact on offers and sales of securities in the context of private or closely held corporations.

[2] Administrative Authorities

Generally, the acts noted above give the SEC broad rule-making power, which the SEC has used over the years to promulgate rules providing procedures by which to comply with the acts, definitions of terms found in the acts, and substantive requirements in addition to those found in the acts. Rules promulgated pursuant to the Securities Act are found at *17 C.F.R. §§ 230.100-230.1001*. Rules promulgated pursuant to the Exchange Act are found at *17 C.F.R. §§ 240.0-1-240.36a1-2*. The SEC also adopts forms for certain uses, and these forms have the legal force of rules.

In addition to its formal rules, the SEC provides guidance as to its interpretation of the governing statutes and rules through the following vehicles:

- "Releases," which provide in an informal manner the SEC's interpretation of certain issues; and

- "No-action letters," wherein the SEC responds to individual private inquiries about whether a certain transaction could be carried out in a manner as specified in the inquiry. The responses are known as "no-action letters" because they generally state that the SEC will "take no action" regarding the transaction in question if it is carried out in the manner specified in the inquiry, with any modifications specified in the letter.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawAdditional Offerings & the Securities Exchange Act of 1934Registration RequirementsSecurities LawBlue Sky LawsSecurities Exempt From RegistrationSecurities LawExemptions From RegistrationExempt Classes of SecuritiesSecurities LawRegulation of Securities MarketsGeneral Overview



29 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
D. Overview of Federal Securities Regulation

3-6 California Legal Forms--Transaction Guide § 6.52

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.52 The Securities Act of 1933

[1] Purpose

The Securities Act [*15 U.S.C. §§ 77a-77aa*], regulating offerings of securities, most directly affects businesses trying to raise capital through the issuance of securities. Disclosure is the hallmark of the Securities Act. This regulatory scheme is based on the idea that if an investor has complete information about a transaction, including the perceived risks and the unknowns, and about the issuer, including management and financial information, the investor will be able to protect himself or herself. Disclosure required of issuers and underwriters is to be made in detailed registration statements, prospectus and offering circulars, advertising material, and notices of intent to sell prepared according to very specific guidelines. Registration is required for the offer or sale of all securities unless the offer or sale involves a security or transaction that the Act exempts from registration.

[2] Registration Requirement

The heart of the Securities Act is Section 5 [*15 U.S.C. § 77e*]. Subsection (a) of Section 5 provides that a registration statement must be on file for a security in order to use interstate transportation or communication or the mail to sell or deliver that security [*15 U.S.C. § 77e(a)*]. Subsection (c) of Section 5 similarly prohibits use of interstate transportation or communication or the mail to offer to sell an unregistered security [*15 U.S.C. § 77e(c)*]. Subsection (b) of Section 5 requires that a prospectus must be provided either prior to or concurrently with the delivery of a registered security and that the prospectus meets certain requirements [*15 U.S.C. § 77e(b)*].

[3] Exemptions From Registration Requirement

Sections 3 and 4 of the Securities Act [*15 U.S.C. §§ 77c, 77d*] set forth the types of securities and transactions involving the offer or sale of securities that are exempt from registration. Like the California Corporate Securities Law, the exemptions in the Securities Act can be loosely categorized as creating (1) exempt classes of securities and (2) exempt types of securities transactions. Section 3(a)(2)- (8) and (13)- (14) [*15 U.S.C. § 77c(a)(2)- (8), (13)-* (14)] lists type of

securities that are exempt from the requirements of Section 5. Section 3(a)(9)- (12) [*15 U.S.C. § 77c(a)(9)- (12)*] and Section 4 [*15 U.S.C. § 77d*] list *transactions* exempted from the requirements of Section 5.

Although some of the federal exemptions are similar in scope to corresponding exemptions under the California securities laws, the specific federal and state requirements rarely are identical. Eligibility for an exemption under federal law does not automatically mean that a California issuer or transaction will qualify under any analogous federal exemption, and vice versa. There are also differences between state and federal law regarding whether a security is being offered or sold for value or when the sale is deemed to take place.

[4] Exempt Categories of Securities

The Securities Act exempts the following categories of securities:

- Securities issued by the United States, any state or territory, or certain securities issued by various categories of institutional investors such as banks, insurance companies, and employee benefit plans (Section 3(a)(2)) [*15 U.S.C. § 77c(a)(2)*].

- Notes, drafts, bills of exchange, or banker's acceptances that arise out of a current transaction or the proceeds of a current transaction and have a maturity date at issuance not exceeding nine months (Section 3(a)(3)) [*15 U.S.C. § 77c(a)(3)*].

- Securities issued by religious, educational or charitable organizations that are not issued for pecuniary profit (Section 3(a)(4)) [*15 U.S.C. § 77c(a)(4)*].

- Securities issued by savings and loan associations that are supervised and examined by either federal or state authorities (Section 3(a)(5)) [*15 U.S.C. § 77c(a)(5)*].

- Securities representing an interest in a railroad equipment trust (Section 3(a)(6)) [*15 U.S.C. § 77c(a)(6)*].

- Specified securities issued by the trustee or debtor in possession in connection with a Chapter 11 bankruptcy (Section 3(a)(7)) [*15 U.S.C. § 77c(a)(7)*].

- Insurance policies or annuity contracts issued by a corporation subject to the supervision of a state insurance or bank commissioner (Section 3(a)(8)) [*15 U.S.C. § 77c(a)(8)*].

- Securities issued by certain entities excluded from the definition of investment company under Section 3(c)(14) of the Investment Company Act (Section 3(a)(13)) [*15 U.S.C. § 77c(a)(13)*].

- Any security futures products that are cleared by a clearing agency registered under *15 U.S.C. § 78q-1* or exempt from registration under *15 U.S.C. § 78q-1(b)(7)*, and traded on a national securities exchange or a national securities association registered pursuant to *15 U.S.C. § 78o-3(a)* (Section 3(a)(14)) [*15 U.S.C. § 77c(a)(14)*].

[5] Exempt Types of Transactions

The Securities Act exempts the following types of transactions from registration:

- A transaction in which the issuer of a security exchanges one security for another exclusively with existing shareholders of the security and there is no commission paid for soliciting the exchange (Section

3(a)(9)) [*15 U.S.C. § 77c(a)(9)*].

- A transaction in which securities are issued in exchange for outstanding securities, claims or property interests, and the terms and conditions of the issuance and exchange are approved, after hearing, by a federal, state or territorial authority expressly authorized to grant such approval (Section 3(a)(10)) [*15 U.S.C. § 77c(a)(10)*].

- Securities offered and sold in an intrastate offering (Section 3(a)(11)) [*15 U.S.C. § 77c(a)(11)*].

- Equity securities issued in connection with certain acquisitions by a holding company of a bank or savings and loan association (Section 3(a)(12)) [*15 U.S.C. § 77c(a)(12)*].

- Transactions by any person other than an issuer, underwriter, or dealer of securities (Section 4(1)) [*15 U.S.C. § 77d(1)*]. "Secondary trading" (trading in securities already outstanding) is largely exempted by Section 4(1) [*15 U.S.C. § 77d(1)*] and Section 4(3) [*15 U.S.C. § 77d(3)*; *see below*] operating in combination.

- Transactions by an issuer not involving any public offering (Section 4(2)) [*15 U.S.C. § 77d(2)*]. Large amounts of securities have been sold pursuant to Section 4(2). This exemption works well when large blocks of securities are sold to institutional investors, such as insurance companies or pension funds. A potential problem arises, however, for issuers who want to use the exemption provided by Section 4(2) in a promotional offering to a limited number of people. The question is when does the offering become a public one. To provide a "safe harbor" for using this exemption, the SEC has promulgated Rule 506 under Regulation D [*17 C.F.R. § 230.506*].

- Certain transactions by a dealer (Section 4(3)) [*15 U.S.C. § 77d(3)*].

- Brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders (Section 4(4)) [*15 U.S.C. § 77d(4)*].

- Certain transactions involving one or more promissory notes directly secured by a first lien on a single, improved piece of real estate (Section 4(5)) [*15 U.S.C. § 77d(5)*].

- Transactions by an issuer solely to accredited investors, when the aggregate offering price does not exceed $5 million and there is no advertising or public solicitation (Section 4(6)) [*15 U.S.C. § 77d(6)*].

[6] Small Offering Exemption

Section 3(b) of the Securities Act [*15 U.S.C. § 77c(b)*] authorizes the SEC to promulgate rules and regulations exempting offerings of up to $5,000,000 from registration. Specifically, Section 3(b) provides that registration will not be required if the SEC finds the following [*15 U.S.C. § 77c(b)*]:

- Registration of the securities is unnecessary in the public interest and unnecessary for the protection of investors by reason of the small amount involved or the limited character of the public offering; and

- The aggregate amount of the public offering does not exceed $5 million.

The SEC has promulgated two important exemptions under this subsection in Rules 504 and 505 of Regulation D [*17 C.F.R. §§ 230.504, 230.505*], as well as the Regulation A procedure, which is described in greater detail in § 6.57.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawSecurities RegulationGeneral OverviewSecurities LawGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933General OverviewSecurities LawInvestment CompaniesRegistration & ReportingSecurities LawRegulation of Securities MarketsGeneral Overview



30 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
D. Overview of Federal Securities Regulation

3-6 California Legal Forms--Transaction Guide § 6.53

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.53 Regulation D

[1] In General

Regulation D, [*17 C.F.R. §§ 230.501-230.508*], a rule adopted by the SEC, provides three distinct exemptions that are very important to smaller business trying to raise business capital [*see 17 C.F.R. §§ 230.501-230.508*]:

- The Rule 504 exemption [*17 C.F.R. § 230.504*], promulgated under Section 3(b) of the Securities Act [*15 U.S.C. § 77c(b)*].

- The Rule 505 exemption [*17 C.F.R. § 230.505*], promulgated under Section 3(b) of the Securities Act [*15 U.S.C. § 77c(b)*].

- The Rule 506 exemption [*17 C.F.R. § 230.506*], promulgated under Section 4(2) of the Securities Act [*15 U.S.C. § 77d(2)*].

Each of the three Regulation D exemptions contemplates that the offering is limited in scope and made in an appropriate manner to an appropriate group of purchasers. Because of the similarity of the exemptions, common definitions and conditions are set forth in Rules 501, 502 and 503 [*see 17 C.F.R. §§ 230.501-230.503*].

The Regulation D exemptions are discussed in detail in Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* . For convenience, they are summarized below.

[2] Accredited Investors Under Regulation D

[a] Definition and Classification

Accredited investors are investors whom the SEC has found are capable of protecting themselves with respect to

investment opportunities. The conditions the SEC places on issuers with respect to accredited investors, therefore, are less stringent than on nonaccredited investors. In addition, accredited investors generally are not counted as purchasers when the law limits the number of purchasers permitted to be able to qualify for an exemption. Rule 501(a) lists the following categories of accredited investors [*17 C.F.R. § 230.501(a)*]:

- Designated institutional investors, including banks, savings and loan associations, registered brokers and dealers, insurance companies, registered investment companies, small business investment companies licensed by the U.S. Small Business Administration, and government employee benefit plans with assets in excess of $5 million [*17 C.F.R. § 230.501(a)(1)*].

- Employee benefit plans if the plan fiduciary is a bank, savings and loan association, insurance company or registered investment advisor and has total assets in excess of $5 million or if the plan is self-directed, the investment decisions are made only by accredited investors [*17 C.F.R. § 230.501(a)(1)*].

- Business development companies (as defined in the Investment Advisers Act) [*17 C.F.R. § 230.501(a)(2)*].

- Corporations, partnerships, and certain nonprofit organizations not formed for the specific purpose of acquiring the securities offered, and with total assets in excess of $5,000,000 [*17 C.F.R. § 230.501(a)(3)*].

- Any director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer is an accredited investor [*17 C.F.R. § 230.501(a)(4)*].

- Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of the purchase exceeds $1 million [*17 C.F.R. § 230.501(a)(5)*].

- Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year [*17 C.F.R. § 230.501(a)(6)*].

- Trusts with total assets in excess of $5 million, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person [*17 C.F.R. § 230.501(a)(7)*].

- Entities in which all of the equity owners are accredited investors [*17 C.F.R. § 230.501(a)(8)*].

[b] Comparison With California Law

Accredited investors are excluded from the 35 purchaser limitation under *Corp. Code § 25102(f)* [*10 Cal. Code Reg. § 260.102.13(g)*], and are qualified investors under *Corp. Code § 25102(n)* [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(g)*]. Natural persons who are not accredited investors must receive a disclosure document containing the types of disclosures required to be provided to non-accredited investors under Regulation D [*Corp. Code 25102(n)(4)*]. Under *Corp. Code § 25102(f)*, excluded purchasers do not need to satisfy the investor suitability requirements of *Corp. Code § 25102(f)(2)* [*10 Cal. Code Reg. § 260.102.12(d)(2)*].

[3] Calculation of Number of Purchasers

[a] Federal Law

Purchasers who are not counted in calculating the total number of purchasers for purposes of any applicable Regulation D limitations are the following [*17 C.F.R. § 230.501(e)(1)*]:

- Any accredited investor [*see* [2][a], *above*].
- Any relative, spouse or relative of spouse of an accredited investor who have the same principal residence as the purchaser ("excluded relatives").
- Any trust or estate in which an accredited investor and his or her excluded relatives collectively have more than 50 percent of the beneficial interest.
- Any corporation or other organization of which an accredited and any of his or her excluded relatives collectively are beneficial owners of more than 50 percent of the equity securities or equity interest.

A corporation, partnership or other entity is counted as one purchaser, unless the entity was organized for the specific purpose of acquiring the securities offered and is not an accredited investor, in which case each beneficial owner of equity securities or equity interests in the entity count as a separate purchaser except to the extent they are excluded purchasers [*17 C.F.R. § 230.501(e)(2)*]. A noncontributory employee benefit plan as defined in ERISA is counted as one purchaser if the trustee makes all investment decisions [*17 C.F.R. § 230.501(e)(3)*].

[b] Comparison With California Law

Accredited investors are excluded from the purchaser count under both Rule 505 and 506 of Regulation D and *Corp. Code § 25102(f)* [*10 Cal. Code Reg. § 260.102.13(g)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsRegulation D ExemptionsSecurities LawExemptions From RegistrationExempt TransactionsU.S. Securities & Exchange Commission Rules 146 & 506Securities LawInitial Public Offerings & the Securities Act of 1933General OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
D. Overview of Federal Securities Regulation

3-6 California Legal Forms--Transaction Guide § 6.54

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.54 Rule 504

[1] Eligible Issuers

Rule 504 is promulgated pursuant to Section 3(b) of the Securities Act [*15 U.S.C. § 77c(b)*]. Rule 504 is available to any issuer that is *not* any of the following [*17 C.F.R. § 230.504(a)*]:

- A reporting company under Sections 13 or 15(d) of the Securities Exchange Act of 1934, *15 U.S.C. §§ 78m, 78o(d)*;
- An investment company; or
- A development stage company with no specific plan or intends to engage in mergers or acquisitions with unidentified companies.

[2] Eligible Offerings

No more that $1 million worth of securities may be sold. The aggregate offering price includes sales of any securities by the issuer that were made in the previous 12 months pursuant to an exemption afforded by Section 3(b) of the Securities Act or in violation of Section 5(a) of the Securities Act [*17 C.F.R. § 230.504(b)(2)*]. There is no limit on the number of purchasers to whom the securities may be sold to take advantage of the exemption afforded by Rule 504.

If the offering is made in at least one state where the offering must be registered under state law and a disclosure document must be delivered to purchasers before the sale, and disclosure documents are delivered to all purchasers, general solicitation with respect to the offering is permissible [*17 C.F.R. § 230.504(b)(1)*]. The issuer must file SEC Form D [*17 C.F.R. § 239.500*] for each new offering of securities with the SEC no later than 15 calendar days after the first sale of securities in the offering [*17 C.F.R. 230.503(a)(1)*]. As of March 16, 2009, a notice of sale on Form D must be filed with the SEC in electronic format by means of the Commission's EDGAR system in accordance with the rules

set forth in Regulation S-T [*17 C.F.R. § 230.503(b)*; *see* 17 C.F.R. Part 232; *see also Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.202*]. The issuer is not required to provide information to purchasers when using Rule 504 [*17 C.F.R. § 230.502(b)(1)*].

[3] Comparison to California Limited Offering Exemption and Qualified Purchaser Exemption

An offering under Rule 504 will not necessarily qualify for the exemption afforded by *Corp. Code § 25102(f)*. General solicitation and unlimited purchasers are permitted under Rule 504 but not *Corp. Code § 25102(f)*.

Corp. Code § 25102(n) permits the use of general announcements and does not limit the number of purchasers. It also requires the use of a disclosure document in connection with sales to natural persons who are non-accredited investors. It therefore may be possible to make an offering under Rule 504 and *Corp. Code § 25102(n)* if the other conditions of the *Corp. Code § 25102(n)* exemption are satisfied.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933General OverviewSecurities LawInvestment CompaniesRegistration & ReportingSecurities LawLiabilityDisclosuresGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
D. Overview of Federal Securities Regulation

3-6 California Legal Forms--Transaction Guide § 6.55

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.55 Rule 505

[1] Eligible Issuers

Rule 505 is promulgated pursuant to Section 3(b) of the Securities Act [*15 U.S.C. § 77c(b)*]. Rule 505 is available to any issuer that

- Is not an investment company [*17 C.F.R. § 230.505(a)*].

- Has not been disqualified under any of the "bad boy provisions" in *17 C.F.R. § 230.262* [*17 C.F.R. § 230.505(b)(2)(iii)*].

[2] Eligible Offerings

No more than $5 million worth of securities may be sold. The aggregate offering price includes sales of any securities by the issuer that were made in the previous 12 months pursuant to any exemption afforded by Section 3(b) of the Securities Act or in violation of Section 5(a) of the Securities Act [*17 C.F.R. § 230.505(b)(2)(i)*]. There may be no more than, or the issuer must reasonably believe there are no more than, 35 purchasers (excluding accredited investors) [*17 C.F.R. § 230.505(b)(2)(ii)*]. The issuer must file SEC Form D [*17 C.F.R. § 239.500*] for each new offering of securities with the SEC no later than 15 calendar days after the first sale of securities in the offering [*17 C.F.R. 230.503(a)(1)*]. As of March 16, 2009, a notice of sale on Form D must be filed with the SEC in electronic format by means of the Commission's EDGAR system in accordance with the rules set forth in Regulation S-T [*17 C.F.R. § 230.503(b)*; *see* 17 C.F.R. Part 232; *see also Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.202*].

Securities acquired under the exemption afforded by Rule 505 may not be offered or sold in connection with any form of general solicitation or general advertising [*17 C.F.R. § 230.505(b)(1)*; *17 C.F.R. § 230.502(c)*]. Securities acquired pursuant to an exemption under Rule 505 cannot be resold without registration under the Securities Act or an exemption from the registration requirement [*17 C.F.R. § 230.505(b)(1)*; *17 C.F.R. § 230.502(d)*].

The information an issuer must disclose under Rule 505 is set forth in *17 C.F.R. § 230.502(b)* [*17 C.F.R. § 230.505(b)(1)*; *see also Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.27*]. The issuer need not provide the information to accredited investors, but should consider providing such information to accredited investors when it provides information to nonaccredited investors in view of the anti-fraud provisions of the federal securities laws [*17 C.F.R. § 230.502(b)(1)*, note].

[3] Comparison to California Limited Offering Exemption

Offerings exempt under Rule 505 will frequently qualify for the California limited offering exemption under *Corp. Code § 25102(f)*. All purchasers, except excluded purchasers, must meet investor suitability requirements under *Corp. Code § 25102(f)(2)*, but there is no similar requirement under Rule 505. Under both Rule 505 and *Corp. Code § 25102(f)(2)*, there is a limitation of 35 counted purchasers but the excluded purchaser list is more extensive under *Corp. Code § 25102(f)*. Under *Corp. Code § 25102(f)(2)*, there *must be* no more than 35 counted purchasers, and, under Rule 505, the issuer must have a *reasonable belief* that there are no more than 35 counted purchasers.

There are no "bad boy" disqualifiers under *Corp. Code § 25102(f)*. A disclosure document satisfying the requirements of Regulation D must be provided to non-accredited investors under Rule 505, but there is no requirement for the preparation of any disclosure document under *Corp. Code § 25102(f)*. There is a limitation on the amount of the securities that may be offered under Rule 505. There is no similar restriction under *Corp. Code § 25102(f)*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsExempted IssuersSecurities LawInitial Public Offerings & the Securities Act of 1933General OverviewSecurities LawInvestment CompaniesDistribution, Redemption & Repurchase of SharesSecurities LawRegulation of Securities MarketsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
D. Overview of Federal Securities Regulation

3-6 California Legal Forms--Transaction Guide § 6.56

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.56 Rule 506

[1] Eligible Issuers

Rule 506 is similar to Rule 505, except that Rule 506 is promulgated under Section 4(2) [*15 U.S.C. § 77d(2)*] of the Securities Act instead of Section 3(b) [*17 C.F.R. § 230.506(a)*]. This is a significant distinction because, as discussed in *§ 6.15*, the federal preemption provisions of the National Securities Markets Improvement Act (NSMIA) exempt Rule 506 transactions from having to comply with California qualification requirements, whereas Rule 504 and Rule 505 transactions are not similarly exempted. Rule 506 is available to any issuer.

[2] Eligible Offerings

There is no limitation on the dollar amount of the securities an issuer may offer under Rule 506. There may be no more than, or the issuer must reasonably believe there are no more than, 35 counted purchasers purchasing securities from the issuer in the offering [*17 C.F.R. § 230.506(b)(2)(i)*]. Each purchaser who is not an accredited investor either alone or with his or her purchaser representative [*see* [3], *below*], must have such knowledge and experience in financial and business matters that he or she is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes the purchaser comes within this description [*17 C.F.R. § 230.506(b)(2)(ii)*].

The issuer must file SEC Form D [*17 C.F.R. § 239.500*] for each new offering of securities with the SEC no later than 15 calendar days after the first sale of securities in the offering [*17 C.F.R. 230.503(a)(1)*]. As of March 16, 2009, a notice of sale on Form D must be filed with the SEC in electronic format by means of the Commission's EDGAR system in accordance with the rules set forth in Regulation S-T [*17 C.F.R. § 230.503(b)*; *see* 17 C.F.R. Part 232; *see also Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.202*]. The information an issuer must disclose under Rule 506 is set forth in *17 C.F.R. § 230.502(b)* [*17 C.F.R. § 230.506(b)(1)*; *see also Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.28*]. The issuer need not provide the information to accredited investors, but should consider providing that information to accredited investors when it provides information to nonaccredited investors in view of the anti-fraud provisions of the federal securities laws [*17*

C.F.R. § 230.502(b)(1), note].

Securities acquired under the Rule 506 exemption may not be offered or sold in connection with any form of general solicitation or general advertising [*17 C.F.R. § 230.506(b)*; *17 C.F.R. § 230.502(c)*]. Securities acquired pursuant to an exemption under Rule 506 cannot be resold without registration under the Securities Act or an exemption therefrom [*17 C.F.R. § 230.506(b)*; *17 C.F.R. § 230.502(d)*].

[3] Purchaser Representative

The concept of "purchaser representative" is applicable only to Rule 506 offerings. A "purchaser representative" is any person who satisfies all of the following conditions or who the issuer reasonably believes satisfies all of the following conditions [*17 C.F.R. § 230.501(h)*]:

- Is not an affiliate, director, officer or other employee of the issuer, or beneficial owner of 10 percent or more of any class of the equity securities or 10 percent or more of the equity interest in the issuer, except when the purchaser is
  - A relative of the purchaser representative by blood, marriage or adoption and not more remote than a first cousin (a "purchaser relative");
  - A trust or estate in which the purchaser representative and any purchaser relatives collectively have more than 50 percent of the beneficial interest or of which the purchaser representative serves as trustee, executor, or in any similar capacity; or
  - A corporation or other organization of which the purchaser representative and any purchaser relatives collectively are the beneficial owners of more than 50 percent of the equity securities or equity interests.
- Has such knowledge and experience in financial and business matters that he or she is capable of evaluating, alone, or together with other purchaser representatives of the purchaser, or together with the purchaser, the merits and risks of the prospective investment.
- Is acknowledged by the purchaser in writing, during the course of the transaction, to be his or her purchaser representative in connection with evaluating the merits and risks of the prospective investment.
- Discloses to the purchaser in writing a reasonable time prior to the sale of securities to that purchaser any material relationship between the purchaser representative or its affiliates and the issuer or its affiliates that then exists, that is mutually understood to be contemplated, or that has existed at any time during the previous two years, and any compensation received or to be received as a result of that relationship [*17 C.F.R. § 230.501(h)(4)*].

[4] Comparison to California Limited Offering Exemption

An offering exempt under Rule 506 will frequently qualify for an exemption under *Corp. Code § 25102(f)*. Under both Rule 506 and *Corp. Code § 25102(f)(2)*, there is a limitation of 35 counted purchasers, but the excluded purchaser list is more extensive under *Corp. Code § 25102(f)*. Under *Corp. Code § 25102(f)(2)* there must be no more than 35 counted purchasers and under Rule 506 the issuer must have a reasonable belief that there are no more than 35 counted purchasers.

The purchaser qualification requirements under Rule 506 and under *Corp. Code § 25102(f)* are substantially similar and

under both exemptions only nonaccredited investors or nonexcluded purchasers are required to meet the purchaser suitability requirements. Issuers should be aware of the different rules that apply to purchaser representatives under federal law and professional advisors under California law when there are purchasers who qualify by virtue of their purchaser representatives and professional advisors.

Corp. Code § 25102(f)(2) employs the concept of "professional advisor," which is similar to that of a purchaser representative, but there are notable differences. *Corp. Code § 25102(f)(2)* requires that all purchasers, to the extent they are not excluded purchasers, have either a preexisting relationship with insiders or have the business or financial sophistication to protect themselves in connection with respect the transaction. Purchasers can satisfy the sophistication requirement if their "professional advisors" have the requisite experience.

Unlike a purchaser representative, a professional advisor must be an actual professional in that the professional advisor must be one of the following [*10 Cal. Code Reg. § 260.102.12(g)*]:

- An attorney.
- A certified public accountant.
- A person who, as a regular part of that person's business, is customarily relied on by others for investment recommendations or decisions, and who is customarily compensated for such services, either specifically or by way of compensation for related professional services.

"Professional advisor" includes persons licensed or registered as broker-dealers, agents, investment advisors, banks, savings and loan associations, and, with respect to those real estate securities described in *Corp. Code § 25206*, licensed real estate brokers [*10 Cal. Code Reg. § 260.102.12(g)(1)*].

A professional advisor may not be affiliated with the issuer, employed by the issuer, be an owner of more than 1 percent of the beneficial interest of the issuer, or be compensated by the issuer either directly or indirectly [*Corp. Code § 25102(f)(2)*; *10 Cal. Code Reg. § 260.102.12(h)*]. A purchaser representative may own up to 10 percent of the beneficial interest of the issuer and may receive compensation from the issuer as long as it is disclosed to the purchaser [*17 C.F.R. § 230.501(h)*].

Like a purchaser representative, the personal advisor must be designated as such by the purchaser and may not be affiliated with or compensated by the issuer [*see Corp. Code § 25102(f)(2)*; *10 Cal. Code Reg. § 260.102.12(g)*; *17 C.F.R. § 230.501(h)*].

There are no "bad boy" disqualifiers under *Corp. Code § 25102(f)*, such as those applicable to Rule 506 offerings. A disclosure document satisfying the requirements of Regulation D must be provided to non-accredited investors under Rule 506, but there is no requirement for the preparation of a disclosure document under Corp. Code § 5102(f).

An issuer with an offering that satisfies the requirements of Rule 506 will generally take advantage of the NSMIA preemption provisions and make the necessary filings under *Corp. Code § 25102.1(d)*, rather than comply with *Corp. Code § 25102(f)*, unless each of the purchasers has a preexisting relationship with the issuer so that an offering document need not be prepared. However, the provisions of Rule 508 of Regulation D, which excuse certain de minimis failures to comply with Rule 506 of Regulation D, may not be applicable to preempted offerings. In addition, it may be necessary to rely on *Corp. Code § 25102(f)* if the issuer fails to make the required filings under *Corp. Code § 25102.1(d)* as required by that section. Failure to make the required filings does not preclude reliance on the exemption afforded by *Corp. Code § 25102(f)*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsU.S. Securities & Exchange Commission Rules 146 & 506Securities LawInitial Public Offerings & the Securities Act of 1933General OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
D. Overview of Federal Securities Regulation

3-6 California Legal Forms--Transaction Guide § 6.57

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.57 Regulation A

Regulation A [*17 C.F.R. §§ 230.251-230.263*] is an exemption promulgated by the SEC pursuant to Section 3(b) of the Securities Act [*15 U.S.C. § 77c(b)*]. The Regulation A exemption is actually an exemption only from full registration because a notification of the issuance is required. Regulation A is not satisfied by finding that specified conditions exist, but only upon compliance with its procedures.

The sum of all consideration to be received for the securities (the "aggregate offering price") sold as exempt under Regulation A and any other securities offered or sold by the issuer within one year prior to the commencement of the proposed Regulation A offering pursuant to any other exemption under Section 3(b) of the Securities Act may not exceed $5 million, including no more than $1.5 million in nonissuer resales [*see 17 C.F.R. § 230.251(b)*]. Sales during that period in which the issuer relies on other exemptions, however, do not reduce the Regulation A dollar ceiling [*see 17 C.F.R. § 230.251(c)*].

Notification on Form 1-A must be filed with the SEC prior to making an offer of securities in reliance on Regulation A [*17 C.F.R. § 230.251(d)*]. A preliminary or final offering circular must be furnished to offerees at least 48 hours prior to mailing a confirmation of sale to those offerees [*17 C.F.R. § 230.251(d)(2)(i)(B)*]. The securities may not be sold until Form 1-A is qualified and the final offering circular is delivered to the purchaser [*17 C.F.R. § 230.251(d)(2)*].

All sales material must be filed with the SEC and the issuer must report all sales made under the exemption afforded by Regulation A [*17 C.F.R. § 230.256*].

The small company application procedures under California law are intended to facilitate Regulation A offerings in California [*see* Dept. of Corps. Release No. 93-C (Oct. 13, 1993)].

For additional discussion of Regulation A, see *Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.25*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsExempted IssuersSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933General OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
D. Overview of Federal Securities Regulation

3-6 California Legal Forms--Transaction Guide § 6.58

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.58 Intrastate Offerings

[1] Rule 147

Section 3(a)(11) of the Securities Act exempts any security that is part of an issue offered and sold only to persons resident within a single state or territory, if the issuer resides or is doing business in that state or territory, or, in the case of a corporation is incorporated in and doing business within that state or territory [*15 U.S.C. § 77c(a)(11)*]. SEC Rule 147 [*17 C.F.R. § 230.147*] provides objective standards, or a safe harbor, on which issuers intending to raise capital from local sources may rely in claiming the exemption under Section 3(a)(11). Rule 147 applies only to issuers, and not to other persons selling securities.

If an issuer relies on Rule 147, *all* securities of the issuer that are part of an issue must be offered or sold in accordance with all of the terms and conditions of Rule 147 [*17 C.F.R. § 230.147(b)(1)*]. In other words, the issuer cannot rely on Rule 147 for part of an issue and some other exemption for the balance.

For purposes of Rule 147, an issue is deemed not to include offers or sales that take place prior to the six month period immediately preceding or after the six month period immediately following an offer or sale made pursuant to Rule 147 if there are not offers or sales by or for the issuer of the same or similar class as those offered or sold pursuant to Rule 147 [*17 C.F.R. § 230.147(b)(2)*].

Under Rule 147, during the period that the securities are being offered and sold by the issuer and for nine months after the last sale by the issuer, all resales of any part of the issue may be made only to persons resident within the state or territory [*17 C.F.R. § 230.147(e)*].

[2] Residence/Doing Business Requirement--Issuer

For purposes of Rule 147, an issuer is deemed to be a resident of the state or territory in which it meets the following conditions [*17 C.F.R. § 230.147(c)(1)*]:

- It is incorporated or organized under the laws of that state or territory;

- Its principal office is located, if the issuer is not an organization required to be organized under state or territorial law; and

- The issuer's principal residence is located if the issuer is an individual.

For purposes of Rule 147, an issuer is deemed to be doing business within a state or territory if it meets the following conditions [*17 C.F.R. § 230.147(c)(2)*]:

- The issuer derived at least 80 percent of its gross revenues and those of its subsidiaries from that state or territory;

- The issuer had at the end of its most recent semi-annual fiscal period prior to the first offer of any part of the issue, at least 80 percent of its assets and those of its subsidiaries located within the state or territory;

- The issuer intends to use at least 80 percent of the net proceeds from the issue in connection with the operation of a business or real property, the purchase of real property in the state or territory, or the rendering of services in the state or territory; and

- The principal office of the issuer is located in the state or territory.

[3] Residence/Doing Business Requirement--Offerees and Purchasers

For purposes of Rule 147, offerees and purchasers are deemed to be residents of the state or territory if, at the time of the offer or sale, they meet the following conditions [*17 C.F.R. § 230.147(d)*]:

- The offeree or purchaser is a business entity with its principal place of business within the state or territory; or

- The offeree or purchaser is an individual with his or her principal residence in the state or territory.

If a business entity is formed specifically to acquire part of an issue exempt under Section 3(a)(11), it is deemed not a resident of the subject state or territory unless all of the beneficial owners of the entity are residents of the state or territory [*17 C.F.R. § 230.147(d)(3)*].

[4] Other Issuer Requirements for Rule 147

To satisfy the Rule 147 requirements, the issuer must also do the following [*17 C.F.R. § 230.147(f)*]:

- Place a legend regrading the restrictions on resale on the certificate or other evidencing document.

- Issue stop transfer instructions to its transfer agent.

- Obtain a written representation from each purchaser as to his or her residence.

- In connection with any offer or sale, disclose in writing the limitations on resale.

It is frequently possible to take advantage of Rule 147 in offerings made in reliance on *Corp. Code § 25102(h)* or *(n)* or by California corporations.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsOffer & SaleSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933General OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
D. Overview of Federal Securities Regulation

3-6 California Legal Forms--Transaction Guide § 6.59

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.59 Other Exemptions

Offerings made in reliance on *Corp. Code § 25102(n)* will be exempt under federal law by Regulation CE [*17 C.F.R. § 230.1001*]. Offerings made under SEC Rule 701 in connection with employee purchase or employee option plans may be exempt under *Corp. Code § 25102(o)* if certain other conditions are satisfied.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
D. Overview of Federal Securities Regulation

3-6 California Legal Forms--Transaction Guide §§ 6.60-6.69

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6.60[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
E. Special Issues in Interstate Transactions

3-6 California Legal Forms--Transaction Guide § 6.70

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.70 Interstate Offerings

Offers or sales of securities made in multiple jurisdictions present special problems. All states, as well as the District of Columbia, Guam, and Puerto Rico, have enacted some form of securities regulation. When a securities offering is made in California, and also in one or more other jurisdictions, the issuer must be aware of and comply with not only federal securities regulations but also with securities regulations in all other jurisdictions in which offers or sales are made.

As discussed in *§ 6.15*, the National Securities Markets Improvement Act (NSMIA) preempted state regulation of offerings of "covered securities" [*see § 6.15[5]*]. One of the reasons behind enactment of NSMIA was the reduction of duplicative and inconsistent regulatory requirements among individual states. Since securities qualifying for the Rule 506 [*17 C.F.R. § 230.506*; *see § 6.56*] exemption are "qualified securities" subject to the NSMIA preemption provisions, filing under Rule 506 may be simpler in many cases than dealing with the requirements of multiple states.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsOffer & SaleSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933General OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
E. Special Issues in Interstate Transactions

3-6 California Legal Forms--Transaction Guide § 6.71

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.71 Coordinated Equity Review Program

[1] California Participation

The North American Securities Administrators Association, Inc. (NASAA) has established the Coordinated Review of Equity Offerings program (CER), a pilot program designed to build on coordination efforts by NASAA. The Commissioner of Corporations has announced the participation of the California Department of Corporations in the CER program [Dept. of Corps. Release No. 111-C (Apr. 16, 1998)].

[2] Coordinated Review

The CER program provides for coordination of review among sister state securities regulators that allows each participating state to avoid the duplication of another state's regulatory efforts and resources in reviewing each application. Under CER, an issuer requests coordination of review by notifying the Department of Corporations of its intent to participate under CER. The issuer then files a complete application with the Department and any other state in which the issuer seeks to offer securities. A "lead state" is then appointed to manage the coordination process among the participating states. The Department reviews a California offering application and forwards all comments and other issues raised by the application to the lead state. The lead state has the responsibility to combine all of the relevant comments into a single letter that is then forwarded to the issuer.

Under CER, all negotiations related to a particular offering are conducted with a single state regulator. Individual state-specific comments may necessitate additional interaction with the issuer outside of the lead state relationship [Dept. of Corps. Release No. 111-C (Apr. 16, 1998)].

[3] Guidelines

States participating in CER have agreed to adhere to the guidelines promulgated by NASAA, except to the extent that the guidelines contradict state law, including rules and orders. The purpose of the guidelines is to provide a basis for

uniformity among the states without contravening state law, including rules and orders. To facilitate its participation in the pilot program, the Department has appointed an internal working group to oversee and review CER applications. This group is responsible for maintaining the consistency of the review process and insuring that each applicant is in compliance with the Corporate Securities Law of 1968. Variances from the requirements of the Commissioner's rules will be considered on an ad hoc basis, consistent with *10 Cal. Code Reg. § 260.140* [Dept. of Corps. Release No. 111-C (Apr. 16, 1998); *see 10 Cal. Code Reg. § 260.140*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART II. LEGAL BACKGROUND
E. Special Issues in Interstate Transactions

3-6 California Legal Forms--Transaction Guide §§ 6.72-6.99

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

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§§ 6.72[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6 California Legal Forms--Transaction Guide § 6.100

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.100 Facts--Issuer

1. Name, including any other names used by issuer during the past three years, address of principal executive office, and telephone number of issuer.

2. Name and address of applicant if other than issuer.

3. Form of business of issuer (corporation, partnership, trust, etc.).

4. Jurisdiction in which issuer was organized.

5. Standing of issuer with Secretary of State of California (and state authority where organized, if applicable).

6. Description of issuer's business, including history of operations, nature of products or services, program of operations, property and personnel concerned, suppliers, customers, competitors, and so on.

7. Special characteristics of issuer that might give rise to exemption such as bank, insurance company or public utility.

8. Financial history: an unseasoned or unprofitable corporation may not pass merit review standards for an open qualification.

NOTE:

An unseasoned corporation is a corporation which has not conducted bona fide business operations for at least two years or has not operated at a profit for at least one of the past

three years [*10 Cal. Code Reg.§ 260.011(g)*].

9. Details of any order, judgment, or decree entered in connection with the offering by any state or regulatory authority, court, or the SEC.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6 California Legal Forms--Transaction Guide § 6.101

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.101 Facts--Management and Shareholders

1. Name, birth date, and current post office address for all key management personnel (directors, officers, trustees, general partners, managers, other executives or persons charged with business activities and operations of issuer), and main occupation of each for preceding five years.

2. Any order, judgment, or decree of any governmental agency or administrator, or of any court:

a. Revoking or suspending for cause any license, permit, or other authority of person described in P 1, *above*, or of any corporation of which he or she is an officer or director, to engage in securities business or in sale of a particular security.

b. Temporarily or permanently restraining or enjoining any such person or corporation from engaging in or continuing in any conduct, practice, or employment in connection with purchase or sale of securities.

c. Convicting any such person of any felony or misdemeanor involving a security or any aspect of the securities industry, or of theft or of any felony.

3. Names, addresses, and telephone numbers of all shareholders or beneficial holders of 10 percent or more of any class of fully voting security, whether held individually or through voting trust or other such arrangement, with amounts held by each such holder and percentage of those holdings.

4. Description of any material or substantive contractual arrangements between issuer and any of its key management personnel, dominant shareholders, other insiders, promoters, or any company or corporation

controlled by any such person within preceding three years.

5. Compensation of whatever kind paid to each director or officer in past year by issuer or any of its subsidiaries insofar as it exceeded $30,000.

6. Total aggregate compensation paid to all officers and directors during last year.

7. Details of insider trading activities if any officer, director, or principal security holder effected more than five transactions in any security of the issuer in the preceding 12 months.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6 California Legal Forms--Transaction Guide § 6.102

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.102 Facts--Outstanding Securities

1. Classes and general descriptions of all types of outstanding securities, and whether or not publicly traded.

NOTE:
A security is publicly traded if it is listed on a national securities exchange, is traded in the over the counter market and is quoted in The Wall Street Journal or other newspaper of general circulation or is held of record beneficially by 500 or more persons [*10 Cal. Code Reg. § 260.110*, Item 5].

2. Details of any issuance of securities pursuant to intrastate offering exemption, small offering exemption or any limited offering or other private placement exemption.

3. Full details on all options, warrants, or conversion rights currently outstanding, including price at which any such right may be exercised and market value of securities underlying rights, with names of all persons holding those options or rights, together with expiration dates of any such options or rights.

4. Tally of votes or consents of shareholders to any option or stock bonus plan, with dates of votes and form in which issue was submitted for approval.

5. File number of any previous filings with Commissioner of Corporations, and general description of contents of filings.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationIntrastate Offerings & RecapitalizationsSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6 California Legal Forms--Transaction Guide § 6.103

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.103 Facts--Securities Involved in Transaction

1. Full description of securities involved in transaction, including title of class, total number of securities in each class, proposed offering price, proposed aggregate amount of funds to be raised through the issue, terms of security, or any modification of terms of any existing security.

2. Nonmonetary consideration to be received for securities (real or personal property, patents, cancellation of indebtedness, work or services performed or to be performed, etc.), together with value of consideration, per share selling price of shares based upon that value, and purchasers of shares for each category of nonmonetary consideration.

3. Proposed uses of funds to be obtained from sale of securities, together with approximate amounts to be used for each such purpose.

4. Proposed plan of distribution of securities, including identification of any underwriters, broker-dealers, or agents to be used in distribution and fees, discounts, bonuses, options, or commissions to be paid or allowed, name and address of any employee agents, and name of person supervising those employee agents.

NOTE:

If agents other than licensed broker-dealers are to be used in the distribution of securities, the applicant is required to disclose any adverse judgment, order, or decree disabling any such person from engaging in the securities business, selling securities, or relating to any theft or felony, and a surety bond must be obtained [***see*** *10 Cal. Code Reg. § 260.141.30*].

5. Calculations and computations based on earnings for last three years showing ability of issuer to pay

dividends, interest, and sinking fund obligations on all outstanding senior securities, if offering concerns any senior securities.

6. Details concerning particular types of investment arrangements.

a. Oil, gas, or mining leases [*see 10 Cal. Code Reg. § 260.140.120 et seq.*].

b. Real estate syndicates [*see 10 Cal. Code Reg. § 260.140.110.1 et seq.*].

c. Mutual water companies [*see 10 Cal. Code Reg. § 260.140.71 et seq.*].

d. Churches [*see 10 Cal. Code Reg. § 260.140.72 et seq.* (Feb. 21, 1989).

7. Recapitalization or reorganization plan or plan for exchange of securities, impact on existing shareholders, and exchange ratio

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6 California Legal Forms--Transaction Guide § 6.104

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.104 Facts--Potential Purchasers

1. Number of potential offerees and/or purchasers, if known.

2. Name and residence address of each.

3. Details of financial status.

4. Willingness to "live" with restrictions on resale of securities.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6 California Legal Forms--Transaction Guide § 6.105

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.105 Facts--Method of Publicizing Offering and Sale

1. Personal contacts.

2. Advertising

3. Broker/dealer.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6 California Legal Forms--Transaction Guide § 6.106

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.106 Documents

1. Articles of incorporation, association, or partnership, or contract for joint venture of issuer, and of each constituent corporation in a reorganization.

2. Bylaws.

3. Declarations of trust (including voting trusts).

4. Trust indenture or other master document relating to issuance of debt securities.

5. Specimen security for proposed issue.

6. Commercial contracts relating to issuer's business.

7. Contracts between or among issuer and any of its officers, directors, key managers, dominant shareholders, or other insiders, any of its marketing distributors, or any companies controlled by any of foregoing, concerning any matters related to securities, commercial operation of issuer, or related matters.

8. Contracts entered into, or proposed to be entered into, between issuer and its shareholders concerning transfer restrictions, voting, or the like affecting outstanding interests.

9. Net worth statements or investment biographies of proposed issuees when highly speculative stock issue is in offing, or for oil and gas offering or real estate syndication.

NOTE:

These matters may be given confidential treatment by the Commissioner if the offering is to be qualified [***see*** *Ch. 6H,* ***Qualification of Securities*** *§ 6H.275*]; counsel for the corporation should appraise any such statements and file them rather than have them filed directly with the Commissioner by the proposed issuee.

10. Technical appraisals by engineering, real estate valuation, or other experts evaluating nonmonetary properties to be received for securities.

11. Opinions of patent or other specialty attorneys regarding legal propriety and status of ownership of particular properties to be received for securities.

12. Tax opinions and opinions or reports of other experts.

13. Contracts, licenses, and assignments, and all other agreements directly affecting properties to be received for securities.

14. Financial statements of issuer or, if consideration is securities of another business, financial statements of the other business.

15. If applicant is not a formed and going business, an itemized budget reflecting proposed proceeds and other sources of financing, and financing requirements.

16. Option and stock bonus plans (particularly, qualified stock option and employee stock purchase plans).

17. Proxy materials to be submitted to shareholders regarding adoption of option plans.

18. Consent to service of process on Commissioner, if applicant is noncorporate entity or non-California corporation.

19. Proposed advertising material, private placement mermoranda, or other offering materials.

20. Consents of attorneys, accountants and other experts named in prospectus.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewReal Property LawSecurities RegulationGeneral OverviewSecurities LawGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



48 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6 California Legal Forms--Transaction Guide §§ 6.107-6.109

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6.107[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

NOTE:

Before any determination can be made as to the type of qualification procedure to be used, counsel must determine that there is a security offered or sold in California, that the security is not exempt or involved in an exempt transaction, and that the security is subject to qualification [***see*** *Corp. Code §§ 25110*, *25120*, *25130*; ***see also*** *Corp. Code §§ 25100.1*, *25101.1*, *25102.1*]. Because some types of qualification are dependent upon federal registration, counsel must also determine whether the security or transaction is subject to federal registration requirements.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide § 6.110

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.110 Existence of Security

1. Determine whether instrument or interest is one of following which constitutes "security" [*Corp. Code § 25019*]:

NOTE:

The list of items set forth in *Corp. Code § 25019*, enumerated below, is illustrative rather than all-inclusive [***see*** *People v. Syde (1951) 37 Cal. 2d 765, 768, 235 P.2d 601]* . In California, courts have generally used the "risk-capital test" to determine whether an investment is a "security" within the meaning of *Corp. Code § 25019*. That test states that the purposes of the Corporate Securities Law are implicated whenever investors provide capital that will be risked in the promoter's venture or enterprise [***see*** *Silver Hills Country Club v. Sobieski (1961) 55 Cal. 2d 811, 814, 13 Cal. Rptr. 186, 361 P.2d 906]* . For example, a limited partnership interest is a security under that test, notwithstanding that investor participation is contemplated or required, as long as the investor is not involved in those essential managerial efforts that affect the failure or success of the enterprise [*People v. Graham (1985) 163 Cal. App. 3d 1159, 1168-1169, 210 Cal. Rptr. 318]* .

a. Note.

NOTE:

Not every note or evidence of indebtedness, regardless of its nature and of the circumstances surrounding its execution, is a security under the statutory definition. Fractional interests in promissory notes secured by deeds of trust are not securities under

that definition without proof that they constitute securities under the California "risk capital" test or the federal test [*Leyva v. Superior Court (1985) 164 Cal. App. 3d 462, 474-475, 210 Cal. Rptr. 545]* .

b. Stock.

c. Treasury stock.

d. Membership in incorporated or unincorporated association.

e. Bond.

f. Debenture.

g. Evidence of indebtedness.

h. Certificate of interest or participation in any profit-sharing agreement.

i. Collateral trust certificate.

j. Preorganization certificate or subscription.

k. Transferable share.

l. Investment contract.

m. Viatical settlement contract or fractionalized or pooled interest therein.

NOTE:
Although the term "viatical settlement contract" is no longer used in the Insurance Code, neither *Corp. Code § 25019* nor *Corp. Code § 25023* (defining that term by reference to *Ins. Code § 10113.1*) has been amended to conform to that change.

n. Life settlement contract or fractionalized or pooled interest therein.

o. Voting trust certificate.

p. Certificate of deposit for security.

q. Interest in limited liability company, and any class or series of that interest (including any fractional or other interest), except membership interest in which person claiming exception can prove that all members are actively engaged in management of LLC.

NOTE:
Evidence that members vote or have the right to vote, or the right to information concerning the business and affairs of the limited liability company, or the right to participate in management, does not establish, without more, that all members are actively engaged in the management of the company [*Corp. Code § 25019*].

r. Certificate of interest or participation in oil, gas, or mining title or lease, or in payments out of

production under that title or lease.

s. Put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities.

t. Put, call, straddle, option, or privilege entered into on national securities exchange relating to foreign currency.

u. Beneficial interest or other security issued in connection with funded employees' pension, profit-sharing, stock bonus, or similar benefit plan.

v. Interest or instrument commonly known as "security."

w. Certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase any of above.

x. Any of items listed in PP a through w, *above*, even though not evidenced by written document.

2. Determine whether instrument or interest is one of following which by law do *not* constitute a "security" [*Corp. Code § 25019*]:

a. Beneficial interest in voluntary inter vivos trust not created for purpose of carrying on business or solely for purpose of voting [*see 10 Cal. Code Reg. §§ 260.019.1* ("voluntary inter vivos trusts" defined), 260.019.2 ("non-business trusts" defined); *see also* Commissioner's Opinion No. 06/1C (June 2, 2006)(concluding that certain beneficial interests in trusts were not securities].

b. Beneficial interest in testamentary trust.

c. Insurance or endowment policy or annuity contract under which insurance company admitted in California promises to pay sum of money either in lump sum or periodically for life or for some other specified period.

d. Franchise which is either:

(1) Subject to registration under Franchise Investment Law [*see Corp. Code §§ 31000-31516*].

(2) Exempted from registration by *Corp. Code § 31100* or *31101*.

e. Discretionary account maintained by customer with commodity broker for trading in commodities or commodity futures [*10 Cal. Code Reg. § 260.019*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide § 6.111

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.111 Existence of Offer or Sale

1. Determine whether transaction is one of following transactions classified as "sales" [*Corp. Code § 25017(a)*]:

a. Contracts of sale of, contracts to sell, or dispositions of, securities or interests in securities for value.

b. Exchange of securities.

c. Changes in rights, preferences, privileges, or restrictions of or on outstanding securities.

NOTE:
These changes include changes in the rights, preferences, privileges, or restrictions of or on outstanding securities of a corporation effected through the adoption, modification, or termination of provisions of a shareholders' agreement, when the provisions would be required to be in the articles of incorporation or bylaws to be effective [*10 Cal. Code Reg. § 260.017.2*; ***see*** *Corp. Code § 204(a)(2)* (excluded)]. These changes also include the addition to or deletion from the articles of incorporation of the provisions prescribed by *Corp. Code § 158(a)* with respect to close corporations [*10 Cal. Code Reg. § 260.017.3*].

2. Determine whether transaction constitutes any of following:

a. Attempts or offers to dispose of or solicitations of offers to buy securities or interest in securities for value.

NOTE:
These constitute an "offer" or "offer to sell" [*Corp. Code § 25017(b)*].

b. Security given or delivered with, or as bonus on account of, purchase of securities or any other thing.

NOTE:
Such a security constitutes part of the subject of the purchase and is considered to have been offered and sold for value [*Corp. Code § 25017(c)*].

c. Gift of assessable stock.

NOTE:
A purported gift of assessable stock involves an offer and sale [*Corp. Code § 25017(d)*].

d. Offer or sale of warrant or right to purchase or subscribe to another security of same or another issuer, or offer or sale of a security that gives holder present or future right or privilege to convert security into another security of same or another issuer.

NOTE:
Every such offer or sale includes an offer and sale of the underlying security only at the time of the offer or sale of the warrant, right, or convertible security. However, neither the exercise of the right to purchase, subscribe, or convert, nor issuance of securities pursuant to such an exercise constitutes an offer or sale [*Corp. Code § 25017(e)*].

3. Determine whether transaction is one of following which by law do *not* constitute offer or sale: [*Corp. Code § 25017(f)*]:

NOTE:
The following transactions are specifically excluded from the definition of "offer" and "sale" [*Corp. Code § 25017(f)*].

a. Bona fide secured transaction in, or loan of, outstanding securities.

b. Stock dividends payable with respect to common stock of corporation solely in shares of that common stock (except cash or scrip paid for fractional shares), provided corporation has no other class of voting stock outstanding.

NOTE:
For these purposes, the term "stock dividend" means the issuance of additional shares (including treasury shares) of the issuer to its existing shareholders or to the shareholders of a class, pro rata according to the shares previously held (except for any cash or scrip paid for fractional shares), without consideration other than the transfer from surplus to stated capital of an amount equal to or greater than the par, stated, or market value of the shares distributed, but without any other consideration being paid by the shareholders, and not by an amendment to the articles of incorporation stating the effect on outstanding shares. The term "stock dividend" does not include a stock split, exchange, or reclassification of shares [*10 Cal. Code Reg. § 260.017(a)*].

A stock dividend is not payable "solely in shares of such common stock" within the meaning of *Corp. Code § 25017(f)* if the shareholders have the option to accept either

cash or additional shares of common stock [*10 Cal. Code Reg. § 260.017(b)*]. A stock dividend is not payable" in shares of such common stock, if the corporation has no other class of voting stock outstanding," unless the dividend is payable in shares of voting common stock, and that stock is of the same class as the class on which the dividend is paid [*10 Cal. Code Reg. § 260.017(c)*].

"Voting stock" means any stock presently entitling the owner or holder to vote in elections of directors. It does not include any security which entitles the owner or holder to vote in elections of directors only upon the happening of an event or contingency which has not yet occurred [*10 Cal. Code Reg. § 260.017.1*].

For further discussion, see Ch. 9, ***Dividends, Reacquisitions of Shares, and Assessments*** .

c. Act incident to transaction or reorganization, approved by state or federal court, in which securities are issued and exchanged for one or more outstanding securities, claims, or property interests, or partly in exchange and partly for cash.

4. Determine whether transaction is transfer of corporate stock as part of division of community property in divorce settlement.

NOTE:

Such a transaction is not treated as a "sale" of securities for purposes of California securities laws [***see*** *D'Elia v. D'Elia (1997) 58 Cal. App. 4th 415, 423-426, 68 Cal. Rptr. 2d 324* (citing *Corp. Code § 25017*); ***see also*** Ballantine & Sterling, California Corporation Laws, Ch. 21, ***Corporate Securities*** , § 445.01 (Matthew Bender)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide § 6.112

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.112 Whether Offer to Buy or Sell Is Made in California

1. Determine whether any of following apply:

NOTE:
An offer or sale of securities is made in California in the following circumstances [*Corp. Code § 25008(a), (b)*].

a. Offer originates from California or is directed by offeror to California [*Corp. Code § 25008(a), (b)*].

b. Offeree directs acceptance to offeror in California and acceptance is received at place to which it is directed [*Corp. Code § 25008(a), (b)*].

c. Security is delivered to purchaser in California, when both seller and purchaser are domiciled in California [*Corp. Code § 25008(a), (b)*].

2. Ascertain if following circumstances are applicable:

NOTE:
Offers to sell or to buy are ***not*** made in California merely because of the following facts [*Corp. Code § 25008(c)*].

a. Publisher circulates in California publication of general, regular, and paid circulation

which has had more than two thirds of its circulation outside California during past 12 months [*Corp. Code § 25008(c)(1)*].

b. Radio or television program originating outside California is received in California [*Corp. Code § 25008(c)(2)*].



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide § 6.113

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.113 Type of Transaction

1. Does transaction benefit person who issues or proposes to issue security?

a. If so, transaction is an "issuer transaction" for purposes of the California securities laws [*Corp. Code § 25010*].

b. If transaction does not directly or indirectly benefit issuer, it is a "nonissuer transaction" [*Corp. Code § 25011*].

NOTE:
A transaction is indirectly for the benefit of the issuer if any portion of the purchase price of any security involved in the transaction will be received indirectly by the issuer [*Corp. Code § 25011*].

c. If transaction involves both an issuer transaction and a nonissuer transaction as described in PP a and b, *above*, it is treated [*Corp. Code § 25011*]:

(1) As an issuer transaction for purposes of California qualification requirements [*Corp. Code §§ 25110-25117, 25130-25134*].

(2) As two separate transactions for purposes of California exemptions [*Corp. Code §§ 25100-25105*].

2. Does transaction involve recapitalization or reorganization [*Corp. Code § 25120*]?

a. Does it involve changes in the rights, preferences, privileges, or restrictions of or on outstanding securities?

b. Does it involve exchange of securities by issuer with its existing security holders exclusively or any exchange in connection with any merger or consolidation or purchase of assets in consideration wholly or in part of issuance of securities?

c. Does it involve entity conversion transaction [*see Corp. Code § 25005.1* (definition); *see also § 6.116[3]*]?

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide § 6.114

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.114 Single or Multiple Transactions

NOTE:

One of the major problems confronting an issuer concerns the identification of all offerings--past, present, and future--that will be considered a part of the transaction. The treatment of multiple offers and/or sales as a single transaction is commonly referred to as "integration." The primary threat posed by integration is the possibility that the Commissioner may include in the transaction a past offer or sale which, either alone or in conjunction with the other offers and sales of the transaction, violates the requirements of an exemption. The variety present in securities transactions preclude a single definition of the term "transaction" or a single test for integration. The Commissioner has stated that "transaction" refers to one or more offers or sales of a security that have such a connection with each other as to be considered one transaction for statutory purposes [Dept. of Corps. Release No. 67-C (Oct. 20, 1981)]. For additional discussion of integration, see *§ 6B.21*.

1. Evaluate whether transaction and other transactions by same issuer exhibit any of following factors indicating existence of single transaction:

a. Different offerings made for same general purpose.

b. Different offerings that are part of single plan of financing.

c. Different offerings involving issuance of same class of security.

d. Different offerings made at or about the same time.

e. Same type of consideration received from different offerings.

2. Evaluate whether transaction and other transactions by same issuer exhibit any of following factors indicating existence of separate transactions:

a. Offer or sale were made more than six months before start of other offering.

b. Offer or sale were made more than six months after completion of other offering.

c. Offer or sale were pursuant to qualification effective after filing notice of transaction under limited offering exemption, or in which application for qualification discloses transaction under limited offering exemption, whether past, current or proposed.



55 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide § 6.115

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.115 Securities Exempt From Qualification

NOTE:

An exemption from qualification may exist either because the security itself is exempt [***see below***; ***see also*** *Corp. Code §§ 25100, 25101*] or because it is involved in an exempt transaction [***see*** *§ 6.116*; ***see also*** *Corp. Code § 25102*].

1. If security is issuer security [*see § 6.113*], determine whether it will qualify for any of the following exemptions for issuer securities [*see Corp. Code § 25100*]:

a. Securities (including revenue obligations) or certificates of deposit issued or guaranteed by United States, any state, city, county, city and county, public district, public authority, public corporation, public entity, political subdivision of a state, or any agency or instrumentality of the foregoing [*Corp. Code § 25100(a)*].

b. Securities or certificates of deposit issued or guaranteed by any foreign government with which United States currently maintains diplomatic relations [*Corp. Code § 25100(b)*].

c. Bank or trust company securities [*Corp. Code § 25100(c)*]:

(1) Securities issued or guaranteed by and representing interest in or direct obligation of a national bank or a bank or trust company incorporated under California law; or

(2) Securities issued by a bank to one or more other banks and representing interest in asset of issuing bank.

d. Securities issued or guaranteed by federal savings and loan associations, federal savings banks, federal land banks, joint land banks, national farm loan associations, or by savings associations [*see Fin. Code § 5102(a)* (definition)], subject to supervision and regulation of California Commissioner of Financial Institutions [*Corp. Code § 25100(d)*].

e. Securities issued subject to authorization by California Insurance Commissioner, California Public Utilities Commission, or California Real Estate Commissioner [*Corp. Code § 25100(e)*].

f. Securities consisting of interest in one or more parcels of real property that constitute subdivided lands, subdivision, or real estate development [*Corp. Code § 25100(f)*].

NOTE:

The preceding exemption does not apply to (1) any investment contract sold or offered for sale with, or as part of, any interest in subdivided land, a subdivision, or a real estate development; or (2) any person engaged in the business of selling, distributing, or supplying water for irrigation purposes or domestic use that is not a public utility. However, the exemption is applicable to any security of a mutual water company (other than an investment contract described in (1), ***above***) offered or sold in connection with subdivided lands pursuant to *Corp. Code § 14310 et seq.* [*Corp. Code § 25100(f)*].

g. Mutual capital certificates or savings accounts, as defined in Savings Association law, issued by savings association [*see Fin. Code § 5102(a)* (definition)], holding license or certificate of authority then in force from California Commissioner of Financial Institutions [*Corp. Code § 25100(g)*].

h. Securities issued or guaranteed by federal credit union or by credit union organized and supervised or regulated under Credit Union Law [*Corp. Code § 25100(h)*; *Fin. Code § 14000 et seq.*].

i. Securities issued or guaranteed by common carrier, public utility, or public utility holding company that is [*Corp. Code § 25100(i)*]:

NOTE:

Corp. Code § 25100(i) also lists a holding company or subsidiary registered with the SEC under *15 U.S.C. § 79 et seq.* The latter United States Code section, however, was repealed in 2005.

(1) Subject to jurisdiction of Interstate Commerce Commission or its successor;

(2) Regulated by governmental authority of United States, any state, Canada, or Canadian province with respect to issuance or guarantee of security.

j. Securities (except evidences of indebtedness) of an issuer [*Corp. Code § 25100(j)*]:

(1) Organized exclusively for educational, benevolent, fraternal, religious, charitable, social, or reformatory purposes and not for pecuniary profit, provided no part of net earnings of issuer inures to benefit of private shareholder or individual; or

(2) Organized as chamber of commerce or trade or professional association.

NOTE:

This exemption does not apply to the securities of a nonprofit organization if any promoter of those

securities expects or intends to profit directly or indirectly from the nonprofit organization [*Corp. Code § 25100(j)*]. An exemption may be available when a ***promoter*** expects to profit directly or indirectly from the nonprofit organization, if specified criteria are met [***see*** *10 Cal. Code Reg. § 260.105.20*].

k. Agreements commonly known as "life income contracts" [*Corp. Code § 25100(k)*].

NOTE:

Life income contracts are agreements between an issuer (1) organized exclusively for educational, benevolent, fraternal, religious, charitable, social, or reformatory purposes and not for pecuniary profit, and (2) that the Commissioner designates by rule or order, and a donor who has made an irrevocable donation of property to the issuer. These agreements provide for the payment of income or of specified periodic payments to the donor or to persons designated by the donor [*Corp. Code § 25100(k)*; *10 Cal. Code Reg. § 260.100.2*; ***see*** *10 Cal. Code Reg. §§ 260.100* (designating certain colleges entitled to exemption), 260.100.1 (prescribing form for request for exemption)].

l. Notes, drafts, bills of exchange, banker's acceptances, or renewals or guarantees of these instruments that are [*Corp. Code § 25100(l)*]:

(1) Freely transferable;

(2) Prime quality;

(3) Arising out of a current transaction (or their proceeds have been or will be used for a current transaction);

(4) Evidence of obligation to pay cash within nine months of date of issuance; and

(5) Not offered to public in aggregate amounts of less than $25,000 to any one purchaser.

NOTE:

An issuer whose short term commercial paper would be exempt from qualification by virtue of *Corp. Code § 25100(l)* but for the fact that the securities are to be offered and sold in aggregate amounts of less than $25,000 to any one purchaser may request an order of exemption [*10 Cal. Code Reg. § 260.100.3(a)*; ***see*** *10 Cal. Code Reg. § 260.100.3(b)* (request form)].

m. Securities issued by corporations organized and existing under provisions of Chapter 1 of Division 20 of Food and Agricultural Code [*Corp. Code § 25100(m)*].

n. Beneficial interests in employees' pension, profit sharing, stock bonus, or similar benefit plans that meet requirements for qualification under *I.R.C. § 401* [*Corp. Code § 25100(n)*].

o. Securities that are listed or approved for listing on a national securities exchange certified by Commissioner [*Corp. Code § 25100(o)*].

NOTE:

Detailed criteria for certification of a securities exchange are set forth in *Corp. Code § 25100(o)*. All securities listed or approved for listing on the New York Stock Exchange or the American Stock Exchange are exempt from registration [Dept. of Corps. Release No. 27-C (Revised Mar. 9, 1992)], as are Tier I securities of the Philadelphia Stock Exchange [Dept. of Corps. Release No. 96-C (Sept. 12,

1995)], the NASDAQ Global Market and the NASDAQ Capital Market [Dept. of Corps. Release No. 87-C (revised Aug. 17, 2009)], and Tier I (Select Market Companies) securities of the Pacific Stock Exchange, including any warrant or right to purchase or subscribe to those securities [Dept. of Corps. Release No. 95-C (Dec. 27, 1994)]. For further discussion of the securities exchanges under this exemption, some of which have been undergoing name changes in recent years [*see § 6.15[5][a]*], see *Marsh & Volk, Practice Under the California Securities Laws, Ch. 4, General Exemptions From Qualification, § 4.03*. The exemption does not apply to securities listed, or approved for listing on notice of issuance, in a rollup transaction unless it is an eligible rollup transaction [*Corp. Code § 25100(o)*; ***see*** *Corp. Code § 25014.7* ("eligible rollup transaction" defined)]. Equity securities that are senior to listed securities are also exempt [*10 Cal. Code Reg. § 260.105.33*].

p. Promissory notes secured by lien on real property unless note is [*Corp. Code § 25100(p)*]:

(1) One of series of notes of equal priority secured by same property; or

(2) One in which beneficial interests are sold to more than one person or entity.

q. Unincorporated interindemnity, reciprocal, or interinsurance contracts that qualify under *Ins. Code § 1280.7* and that [*Corp. Code § 25100(q)*]:

(1) Are between members of cooperative corporation, organized and operating under Part 2, Division 3, Title 1 of the Corporations Code [*Corp. Code § 12200 et seq.*], whose members consist only of physicians and surgeons licensed in California;

(2) Indemnify solely with respect to medical malpractice claims against members of cooperative corporation; and

(3) Do not collect in advance of loss moneys other than contributions by members to collective reserve trust fund or for necessary administration expenses.

r. Shares or memberships issued by cooperative corporations organized and existing pursuant to *Corp. Code § 12200 et seq.* [*see* Ch. 14, *Consumer Cooperative Corporations* , and Ch. 14A, *Agricultural Nonprofit Cooperative Associations*], provided that aggregate investment of any shareholder or member does not exceed $300 [*Corp. Code § 25100(r)*].

NOTE:

This exemption does not apply to shares or memberships if any promoter of the corporation expects or intends to profit directly or indirectly from any business or activity associated with the corporation, from the operation of the corporation, or from remuneration from the corporation, other than a reasonable salary. Further, this exemption does not apply to nonvoting shares or memberships of the corporation issued to a person who does not possess voting power [***see*** *Corp. Code § 12253* ("voting power" defined)] in the corporation and who will not acquire voting power in connection with the issuance of nonvoting shares or memberships [*Corp. Code § 25100(r)*]. Finally, this exemption does not apply to shares or memberships issued by a nonprofit cooperative corporation organized to facilitate the creation of an unincorporated interindemnity arrangement that provides indemnification for medical malpractice to its physician and surgeon members [*Corp. Code § 25100(r)*; ***see*** *Corp. Code § 25100(q)*; ***see also*** P q, ***above***].

s. Securities consisting of or representing interest in pool of mortgage loans, subject to following requirements [*Corp. Code § 25100(s)*]:

(1) Pool consists of whole mortgage loans, or participation interests in those loans, originated or acquired in ordinary course of business by:

(a) National bank, or federal savings and loan association, or federal savings bank, having principal office in California;

(b) Bank incorporated under laws of state of California; or

(c) Savings and loan association [*see Fin. Code § 5102(a)* (definition)], that is subject to supervision and regulation by Savings and Loan Commissioner.

(2) Mortgage loan at time of transfer to pool is authorized investment for originating or acquiring institution.

(3) Pool of mortgage loans is held in trust by trustee that is one of above-described financial institutions.

(4) Loans are serviced by one of above-described financial institutions.

(5) Security is not offered in aggregate amounts of less than $25,000 to any one purchaser.

(6) Security is offered pursuant to registration under Securities Act of 1933 [*15 U.S.C. § 77a et seq.*] or pursuant to exemption under either Regulation A or Section 4(2)("private offering exemption") of that Act.

t. Securities issued or guaranteed by and representing interest in or direct obligation of industrial loan company incorporated under laws of California and authorized by Commissioner of Financial Institutions to engage in industrial loan business, and any investment certificate in or issued by industrial loan company that is organized under laws of any other state that is insured by FDIC and that maintains branch office in California [*Corp. Code § 25100(t)*].

2. If security is nonissuer security [*see § 6.113*], determine whether security qualifies as exempt nonissuer security by virtue of fact that issuer has security listed on national securities exchange, which is certified by rule or order of commissioner [*Corp. Code § 25101(a)*]:

NOTE:

Corp. Code § 25101(b) specifically excludes from the nonissuer exemption nonissuer securities offered pursuant to registration under Securities Act of 1933 [*15 U.S.C. § 77a et seq.*] or pursuant to exemption under Regulation A of that Act, if the aggregate offering price of the securities exceeds $50,000 [*Corp. Code § 25101(b)*].

For further discussion of the securities exchanges under this exemption, some of which have been undergoing name changes in recent years [*see § 6.15[5][a]*], see *Marsh & Volk, Practice Under the California Securities Laws, Ch. 10, Nonissuer Transactions, § 10.03*.

a. Listed on New York Stock Exchange [*10 Cal. Code Reg. § 260.101.2(a)*].

b. Listed on American Stock Exchange [*10 Cal. Code Reg. § 260.101.2(c)*].

NOTE:

The Commissioner has certified the American Stock Exchange, but only to the extent that the securities are those of an issuer that has a security that is regularly listed on the American Stock Exchange. An issuer with securities listed on the American Stock Exchange's Emerging Company Marketplace or the AMEX/ECM is not an issuer with regularly listed securities [*10 Cal. Code Reg. § 260.101.2(c)*].

c. Listed on Tier I of Philadelphia Stock Exchange [*10 Cal. Code Reg. § 260.101.2(a)*; see Dept. of Corps. Release No. 96-C (Sept. 12, 1995)].

d. Designated as national market system security on interdealer quotation system by National Association of Securities Dealers, Inc., and certified by rule or order of Commissioner [*10 Cal. Code Reg. § 260.101.2(b)*; *see* Dept. of Corps. Release No. 88-C (Revised Aug. 17, 2009), certifying the NASDAQ Global Market and the NASDAQ Capital Market of the NASDAQ Stock Market LLC, the successor to the Nasdaq Stock Market)].

NOTE:

The Commissioner has certified the interdealer quotation system of the National Association of Securities Dealers, Inc., but only to the extent that the securities on the interdealer quotation system are those of an issuer that has a security designated as a National Market System security [*10 Cal. Code Reg. § 260.101.2(b)*].

e. Listed on Pacific Stock Exchange.

NOTE:

The Commissioner has certified the Pacific Stock Exchange; however, with regard to Small Corporate Offering Registration (SCOR) securities on the Pacific's SCOR Marketplace, only common and preferred stocks are exempt from qualification [*10 Cal. Code Reg. § 260.101.2(d)*; ***see*** *Corp. Code § 25130*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide § 6.116

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§ 6.116 Securities Transactions Exempt From Qualification

NOTE:

Transactions may be exempted by statute or by rule of the Commissioner [***see*** *Corp. Code § 25105*; *10 Cal. Code Reg. §§ 260.105-260.105.30*].

For a discussion of securities exempt from federal registration requirements under the Securities Act of 1933, see Ch. 6A, ***Federal Securities Exemptions for California Nonpublic Corporations*** .

1. If transaction is issuer transaction [*see § 6.113*], determine whether it will qualify for any of the following exemptions for issuer transactions [*see Corp. Code § 25102*]:

a. Nonpublic offers (but not sales) and the execution and delivery of agreements for sale of securities pursuant to such offers, if both of following conditions are satisfied [*Corp. Code § 25102(a)*]:

NOTE:

For purposes of this exemption, no public offering is involved in offers made to 35 or fewer persons. This number excludes institutional and registered investors and public agencies [*10 Cal. Code Reg. § 260.102.1(a)(1)*; ***see*** *Corp. Code § 25102(i)*; *10 Cal. Code Reg. §§ 260.102.10, 260.105.14*], and officers, directors, and other affiliates of the issuer [*10 Cal. Code Reg. § 260.102.1(a)(2)*; ***see*** *10 Cal. Code Reg. § 260.102.13*]. Husband and wife are counted as one person, as is a partnership, corporation, or other association not specifically formed to purchase the security offered in reliance on this exemption [*10 Cal. Code Reg. § 260.102.1(a)(3)*].

(1) Agreement contains substantially the following provision:

"The sale of the securities that are the subject of this agreement has not been qualified with the Commissioner of Corporations of the State of California and the issuance of the securities or the payment or receipt of any part of the consideration therefor prior to the qualification is unlawful, unless the sale of securities is exempt from the qualification by *Section 25100, 25102,* or *25105 of the California Corporations Code*. The rights of all parties to this agreement are expressly conditioned upon the qualification being obtained, unless the sale is so exempt."

(2) No part of purchase price is paid or received and no securities are issued until sale of securities is qualified under the Corporations Code, unless sale of securities is exempted from qualification by *Corp. Code §§ 25100* or *25105*.

b. Offers (but not sales) of securities for which registration statement has been filed under Securities Act of 1933 [*15 U.S.C. § 77a et seq.*] but has not yet become effective, or offering statement has been filed under Regulation A but has not yet been qualified, if [*Corp. Code § 25102(b)*]:

(1) No stop order or refusal order is in effect;

(2) No public proceeding or examination considering such order is pending; and

(3) No order under *Corp. Code § 25140* or under *Corp. Code § 25143(a)* is in effect.

c. Offers (but not sales) and the execution and delivery of agreements for the sale of securities pursuant to such offers if the Commissioner grants a negotiating permit [*Corp. Code § 25102(c)*].

NOTE:
Negotiating permits are seldom issued and it is recommended that issuers apply for a definitive qualification of the securities.

d. Transactions or agreements between issuer and underwriter or among underwriters, if sale of securities is qualified or exempt from qualification at time of distribution in California [*Corp. Code § 25102(d)*].

e. Offers or sales of evidence of indebtedness, secured or unsecured, and guarantees in transactions not involving public offerings [*Corp. Code § 25102(e)*].

NOTE:
The term "evidence of indebtedness" does not include a debt security that is convertible into an equity security, unless the debt security is convertible into a debt security of the same issuer and the sale of the equity security would be exempt from qualification other than under *Corp. Code § 25102(h)* [*10 Cal. Code Reg. § 260.102.2*].

For purposes of the above exemption, offers or sales do not involve public offerings if offers are not made to more than 25 persons and sales are not consummated to more than 10 of those persons, and if all offerees either have preexisting personal or business relationships with offeror or its partners, officers, directors, or controlling persons, or by reason of business or financial experience could reasonably be assumed to have the capacity to protect their own interests [*10 Cal. Code Reg. § 260.102.2*].

The number of offerees and purchasers excludes institutional and accredited investors [*Corp. Code § 25102(i)*]. In addition, husband and wife (together with custodian or trustee acting on behalf of minor children) are counted as one person [*10 Cal. Code Reg. § 260.102.2*].

Failure to comply with these limitations does not necessarily mean that the transaction involves a public offering. Guidelines for determining whether an offering constitutes a public offering have been provided by the Commissioner in Dept. of Corps. Release No. 5-C (Jan. 31, 1969).

f. Offers or sales of securities, other than offers or sales to pension or profit-sharing trusts of the issuer, if the conditions of the "limited offering" exemption are satisfied [*Corp. Code § 25102(f)*; *see 10 Cal. Code Reg. §§ 260.102.12, 260.102.13, 260.102.14*].

NOTE:

This exemption is generally known as the limited offering exemption. The requirements of this exemption are discussed in detail in Ch. 6B, ***California Limited Offering Exemptions*** .

g. Offers or sales of conditional sale agreements, equipment trust certificates, or certificates of interest or participation or partial assignments of those interests, covering purchase of railroad rolling stock or equipment, or purchase of motor vehicles, aircraft, or parts, in transactions not involving public offerings [*Corp. Code § 25102(g)*].

h. Offers or sales of voting common stock by corporations in a "small offering" transaction [*Corp. Code § 25102(h)*; *see 10 Cal. Code Reg. §§ 260.102.4-260.102.9, 260.102.11*].

NOTE:

This exemption is generally referred to as the "small offering" exemption. It is discussed in detail in Ch. 6C, ***California Small Offering Exemption*** .

i. Offers or sales for purchaser's own account (or trust account) for investment and not for sale in connection with distribution of security to [*Corp. Code § 25102(i)*; *see 10 Cal. Code Reg. § 260.102.10*]:

NOTE:

Each purchaser must represent that the purchaser is purchasing for the purchaser's own account (or a trust account if the purchaser is a trustee) and not with a view to or for sale in connection with any distribution of the security. An offer to resell or a resale under *10 Cal. Code Reg. § 260.105.13.1* is not viewed as inconsistent with this purchaser representation [*10 Cal. Code Reg. § 260.102.10.1*]. Specifically permitted under this rule are private resales of securities to qualified institutional buyers under SEC Rule 144A [*10 Cal. Code Reg. §§ 260.102.10.1, 260.105.13.1*; ***see*** *17 C.F.R. § 230.144A*].

(1) Banks, savings and loan associations, trust companies, insurance companies, investment companies registered under the Investment Company Act of 1940 [*15 U.S.C. § 80a-1 et seq.*], pension or profit-sharing trusts (other than pension or profit-sharing trusts or issuer, self-employed individual retirement plans, or individual retirement accounts), or other institutional investors or governmental agencies or instrumentalities designated by the Commissioner; or

(2) Corporations with outstanding securities registered under Section 12 of Securities Exchange Act of 1934 [*15 U.S.C. § 78l*] or wholly owned subsidiaries thereof which, after offer and sale, will own directly or indirectly 100 percent of outstanding capital stock of issuer.

j. Offers or sales of certificates of interest or participation in oil or gas titles or leases (including subsurface gas storage and payments out of production), if either of following apply [*Corp. Code § 25102(j)*]:

(1) All purchasers either:

(a) Are and have been during the preceding two years engaged primarily in business of drilling for, producing, or refining oil or gas;

(b) Are institutional investors [*Corp. Code § 25102(i)(1)*]; or

(c) Have been found by Commissioner to be substantially engaged in business of drilling for, producing, or refining oil or gas so as not to require protection afforded by Corporate Securities Law of 1968.

(2) Security is concurrently hypothecated to bank in ordinary course of business to secure loan made by bank, provided that each purchaser represents that it is purchasing for its own account for investment and not with view to or for sale in connection with distribution of security [*see Stewart v. Ragland (9th Cir. 1991) 934 F.2d 1033, 1041]* .

k. Offers or sales of securities under or pursuant to plan of reorganization under Chapter 11 of federal bankruptcy law [*11 U.S.C. § 1101 et seq.*], confirmed or subject to confirmation, by decree or order of court of competent jurisdiction [*Corp. Code § 25102(k)*].

l. Offers or sales of options, warrants, puts, calls, straddles, or guarantees thereof by nonissuers subject to such rights, if the transaction, had it involved an offer or sale of the underlying security, would not have violated *Corp. Code § 25110* or *25130* [*Corp. Code § 25102(l)*].

m. Offers or sales of stock to pension plans, stock bonus or employee stock ownership plans, provided [*Corp. Code § 25102(m)*]:

(1) Plan meets requirements for qualification under *I.R.C. § 401*; and

(2) Employees are not required or permitted individually to make any contribution to plan.

NOTE:
The above exception is not affected by whether the stock is contributed to the plan, purchased from the issuer with contributions by the issuer or an affiliate of the issuer, or purchased from the issuer with funds borrowed from the issuer, an affiliate of the issuer, or any other lender [*Corp. Code § 25102(m)*].

n. Offers or sales of securities in a qualified purchaser limited public offering [*see Corp. Code § 25102(n)*].

NOTE:
An offer or sale of a security in a limited public offering (other than in a rollup transaction) by specified issuers to certain "qualified purchasers" is exempt from the Commissioner's review and approval process if it meets statutory criteria. The exemption is designed to facilitate the ability of small companies to raise capital to finance their growth, and is unique in that it allows for the publication of a notice announcing the proposed offer [***see*** *Corp. Code § 25102(n)(5)*; Dept. of Corps. Release No. 94-C (Sept. 27, 1994); ***see also*** *10 Cal. Code Reg. §§ 260.102.16-260.102.18*; Commissioner's Opinion No. 99/1C (concluding that exemption under *Corp. Code § 25102(n)* may not be relied on by limited liability

company if it offers or sells membership interest to "qualified purchasers" as defined *Corp. Code § 25102(n)(2)(E)*, as membership interest in LLCs are not "stock")]. This exemption is discussed in detail in Ch. 6D, ***California Qualified Purchaser Exemptions*** .

o. Offers or sales of securities by a corporation or LLC issued pursuant to purchase plan or agreement, or issued pursuant to option plan or agreement, if at time of issuance or grant, securities are exempt from registration under Securities Act of 1933 pursuant to *17 C.F.R. 230.701* [*Corp. Code § 25102(o)*].

NOTE:

The terms of any option or purchase plan or agreement must comply with the substantive and disclosure requirements contained in the applicable provisions of the rules [***see*** *10 Cal. Code Reg. §§ 260.140.41, 260.140.42, 260.140.45, 260.140.46*]. The issuer must file a notice of the transaction [***see*** *10 Cal. Code Reg. § 260.102.19* (form for notice)] no later than 30 days after the initial issuance of any security in California under the plan in accordance with rules adopted by the Commissioner, accompanied by the filing fee specified in *Corp. Code § 25608(y)* [*Corp. Code § 25102(o)*]. The failure to file a notice of transaction, or the failure to file that notice within the specified time, however, will not affect the availability of the exemption. Within 15 business days after discovery of the failure to file the notice or after demand by the Commissioner, whichever occurs first, an issuer that has failed to file the notice must file it and pay the Commissioner a fee equal to the maximum aggregate fee payable had the transaction been qualified under *Corp. Code § 25110*. Offers and sales exempt under this subdivision are deemed to be part of a single, discrete offering and are not subject to integration with any other offering or sale, whether qualified as an issuer transaction [***see*** *Corp. Code § 25100 et seq.*], otherwise exempt, or not subject to qualification [*Corp. Code § 25102(o)*].

p. Offers or sales of nonredeemable securities to accredited investors [*see Corp. Code § 28031* (definition)] by persons licensed under the Capital Access Company Law [*Corp. Code § 25102(p)*; *see Corp. Code § 28000 et seq.*].

NOTE:

All nonredeemable securities must be evidenced by certificates that have stamped or printed prominently on their face a legend in a form to be prescribed by rule or order of the Commissioner restricting transfer of the securities in the manner as the rule or order provides [*Corp. Code § 25102(p)*].

q. Offers or sales of any viatical or life settlement contract or fractionalized or pooled interest therein, in transaction that meets all of following criteria [*Corp. Code § 25102(q)*]:

NOTE:

Although the term "viatical settlement contract" is no longer used in the Insurance Code, neither *Corp. Code § 25102(q)* nor *Corp. Code § 25023* (defining that term by reference to *Ins. Code § 10113.1*) has been amended to conform to that change.

(1) Sales of securities are made only to qualified purchasers, or other persons the issuer reasonably believes after reasonable inquiry to be qualified purchasers [*see Corp. Code § 25102(q)(1)* (defining "qualified purchasers")].

(2) Each purchaser represents that the purchaser is purchasing for that purchaser's own account (or trust account, if purchaser is trustee) and not with view to or for sale in connection with distribution of the security [*Corp. Code § 25102(q)(2)*].

(3) Each natural person purchaser receives certain written information at least five business days before

securities are sold to (or commitment to purchase is accepted from) purchaser [*see Corp. Code § 25102(q)(3)* (list of required information)].

r. Following transactions are exempt from *Corp. Code § 25110* if they comply with all provisions of *Bus. & Prof. Code § 10237 et seq.* (concerning exemption from securities qualification for real-property-backed notes) [*Corp. Code § 25102.5*]:

NOTE:

A real estate broker licensed by the California Real Estate Commissioner who engages in the offer and sale of notes secured directly by real property of various makers, which are a series of notes or notes in which undivided interests are offered and sold, will be deemed to be the issuer of these notes and undivided interests if the notes of the various makers are offered and sold pursuant to a plan or arrangement that is common to the various makers with respect to documentation and loan standards and that include provisions for servicing these notes on behalf of purchasers [*Corp. Code § 25102.5*].

(1) Sale of a series of notes secured directly by an interest in the same real property.

(2) Sale of undivided interest in a note secured directly by real property equivalent to a series transaction.

2. If transaction is nonissuer transaction [*see § 6.113*], determine whether it will qualify for any of the following exemptions for nonissuer transactions [*see Corp. Code § 25104*]:

a. Offer or sale of securities by bona fide owner, provided sale is not [*Corp. Code § 25104(a)*]:

(1) Accompanied by publication [*see Corp. Code § 25014* ("publish" defined)] of an advertisement [*see Corp. Code § 25002* ("advertisement" defined)]; or

(2) Effected by or through a broker-dealer in a public offering.

b. Offers of sales effected by or through licensed broker-dealers pursuant to unsolicited orders or offers to buy [*Corp. Code § 25104(b)*].

NOTE:

For purposes of the above exemption, inquiries regarding written bids for securities or written solicitations of offers to sell securities made by another broker-dealer within the previous 60 days are not considered solicitations of orders or offers to buy [*Corp. Code § 25104(b)*]. However, an order or offer to buy a security is presumed not to be unsolicited if the broker-dealer knows or has reason to know that the order or offer to buy is in response to one or more of the following activities in which the selling broker-dealer has engaged within the last 60 days [*10 Cal. Code Reg. § 260.104*]:

- Publicly quoting a bid or asked price for the security that identifies the broker-dealer other than an interdealer quotation system intended for broker-dealer use only;
- Making a direct solicitation that customers buy the security;
- Recommending the purchase of the security to customers, either directly or in a manner that would

bring its recommendation to the attention of customers;

- Volunteering information about the issuer of the security either to a particular customer who then buys the security or to customers generally; or

- Executing a transaction to buy or sell a security pursuant to its discretionary authority for a customer in a discretionary account.

A statement to the effect that the security is ineligible for purchase or sale in California, or that investment in a security is not recommended for California purchasers, included in a recommendation or other information circulated with respect to a security or an issuer does not negate this presumption [*10 Cal. Code Reg. § 260.104*].

c. Offers or sales to institutional investors, provided purchaser represents that it is purchasing for its own account for investment purposes and not for sale in connection with distribution of security [*Corp. Code § 25104(c)*].

NOTE:

For purposes of this exemption, institutional investors include banks, savings and loan associations, trust companies, insurance companies, investment companies registered under the Investment Company Act of 1940 [*15 U.S.C. § 80a-1 et seq.*], pension or profit-sharing trusts (other than pension or profit-sharing trusts of issuer, self-employed individual retirement plans, or individual retirement accounts), or such other institutional investors or governmental agencies or instrumentalities as the Commissioner may designate, whether purchaser acts for itself or as trustee [*Corp. Code § 25104(c)*; ***see*** *10 Cal. Code Reg. § 260.104.1*].

d. Transactions or agreements either between person on whose behalf offering is made and underwriter or among underwriters, provided that either [*Corp. Code § 25104(d)*]:

(1) Sale of securities is exempt from qualification at time of distribution in California; or

(2) Sale is qualified prior to distribution in California.

e. Offers or sales of securities by or for account of bona fide secured party selling security in ordinary course of business to liquidate bona fide debt [*Corp. Code § 25104(e)*; *see 10 Cal. Code Reg. § 260.104.2*].

f. Transactions by executors, administrators, sheriffs, marshals, receivers, trustees in bankruptcy, guardians, or conservators [*Corp. Code § 25104(f)*].

g. Offers (but not sales) of securities for which registration statements have been filed under Securities Act of 1933 but have not yet become effective, or for which offering statements have been filed under Regulation A but have not yet been qualified [*Corp. Code § 25104(g)*].

NOTE:

The exemption described above is not applicable if a stop order or refusal order is in effect or a public proceeding or examination considering such an order is pending under Section 8 of the Securities Act of 1933 [*15 U.S.C. § 77h*], or if an order under *Corp. Code § 25140* or *25143(a)* is in effect [*Corp. Code § 25104(g)*].

h. Offers or sales of securities if securities of the same class were qualified in either [*Corp. Code § 25104(h)*]:

NOTE:

This exemption is not applicable if a stop order under *Corp. Code §§ 25140* or *25143(a)* is in effect with respect to the qualification [*Corp. Code § 25104(h)*]. Furthermore, it is not applicable to securities offered pursuant to registration under the Securities Act of 1933 [*15 U.S.C. §§ 77a-77aa*], or pursuant to an exemption under Regulation A of that Act [*17 C.F.R. §§ 230.251-230.263*] if the aggregate offering price exceeds $50,000 [*Corp. Code § 25104(h)*]. The Commissioner may withhold this exemption, by rule or order, with respect to securities not qualified pursuant to an "open" qualification, that is, when the Commissioner has conditioned qualification in some manner, such as by restrictions regarding who may purchase the securities [*Corp. Code § 25104(h)*; ***see*** *10 Cal. Code Reg. § 260.104.4*].

(1) Issuer transaction [*see Corp. Code §§ 25110-25117*] within preceding 18 months or longer period ordered by Commissioner; or

NOTE:

Each consecutive order of the Commissioner must be for six months or less [*Corp. Code § 25104(h)*].

(2) Recapitalization or reorganization transaction [*see Corp. Code §§ 25120-25122*] or nonissuer transaction [*see Corp. Code §§ 25130-25134*] within preceding 12 months.

NOTE:

This exemption is not applicable if an order under *Corp. Code §§ 25140* or *25143(a)* is in effect. It is also inapplicable to securities offered pursuant to registration under Securities Act of 1933 [*15 U.S.C. §§ 77a-77aa*] or pursuant to exemption under Regulation A under that Act [*17 C.F.R. §§ 230.251-230.263*] if the aggregate offering price exceeds $50,000. The Commissioner may withhold this exemption in the case of securities not qualified pursuant to an "open" qualification; that is, when the Commissioner has conditioned qualification in some manner, such as by restrictions on who may purchase the securities [*Corp. Code § 25104(h)*; ***see*** *10 Cal. Code Reg. § 260.104.4*].

3. If transaction is reorganization or recapitalization transaction [*see § 6.113*, P 2], determine whether it will qualify for any of the following exemptions for reorganization and recapitalization transactions [*see Corp. Code § 25103*; *see 10 Cal. Code Reg. § 260.103*]:

a. Negotiations or agreements prior to general solicitation of approval by holders of equity securities of [*Corp. Code § 25103(a)*]:

(1) Changes in rights, preferences, privileges, or restrictions of or on outstanding securities;

(2) Mergers, consolidations, or sales of corporate assets in consideration of issuance of securities; or

(3) Entity conversion transaction.

NOTE:

"An entity conversion transaction" means a conversion pursuant to *Corp. Code §§ 1151, 1157* (general corporation law) [***see*** Ch. 11C, ***Mergers***, §§ 11C.50 et seq., for discussion of the statutes governing corporate conversions], 15677.2, 15677.8 (CRLPA, repealed 1/1/2010), *Corp. Code §§ 15911.02, 15911.08* (ULPA '08), [***see*** Ch. 16B, Conversions and Mergers of Limited Partnerships], *Corp. Code §§ 16902, 16908* (UPA '94) [***see*** *Ch.*

15, Part C, ***Conversions and Mergers of General Partnerships****, § 15.602*], 17540.2, or 17540.8 (LLCs) [***see*** *Ch. 12C,* ***Limited Liability Companies****, § 12C.26*], or a conversion that occurs entirely out of state, unless the interests in the entity resulting from the conversion to be held by the equity holders of the entity being converted as a result of the conversion are not securities. For the purposes of *Corp. Code §§ 25103* and *25120*, an entity conversion transaction is not a change in the rights, preferences, privileges, or restrictions of or on outstanding securities or an exchange of securities by the issuer with its existing security holders exclusively [*Corp. Code § 25005.1*].

b. Changes in rights, preferences, privileges, or restrictions of or on outstanding securities or any entity conversion transaction [*see* P a, NOTE, *above*], when holders of fewer than 25 percent of outstanding shares of securities affected have addresses in California [*Corp. Code § 25103(b)*].

c. Exchanges incident to mergers, consolidations, or sales of corporate assets in consideration of issuance of securities of another corporation (except rollup transactions), when fewer than 25 percent of outstanding shares, holders of which are to receive securities in exchange, are held by persons having addresses in California [*Corp. Code § 25103(c)*].

NOTE:

For purposes of PP b and c, ***above***, securities held in names of broker-dealers or nominees of broker-dealers, and securities controlled by one person controlling directly or indirectly 50 percent or more of outstanding securities of that class are not considered outstanding [*Corp. Code § 25103(d)*]. For purposes of *Corp. Code § 25103(b)* and *(c)*, the determination of whether 25 percent of outstanding securities are held by persons having addresses in California must be made as of record date for determination of security holders entitled to vote on or consent to action if approval is required, or, if not, as of date of directors' approval of action [*Corp. Code § 25103(d)*]. For purposes of P c, ***above***, this exemption is not available for a rollup transaction [*Corp. Code § 25103(c)*; ***see*** *Corp. Code § 25014.6* ("rollup transaction" defined)]. Furthermore, this exemption is unavailable if the transaction is excluded from the definition of a rollup transaction by *Corp. Code § 25014.6(b)(5)* or *(6)* if the transaction is one of a series of transactions that directly or indirectly through acquisition or otherwise involves the combination or reorganization of one or more rollup participants [*Corp. Code § 25103(c)*].

d. Changes in rights, preferences, privileges, or restrictions of or on outstanding equity securities [*Corp. Code § 25103(e)*; *see 10 Cal. Code Reg. § 260.103.1*].

NOTE:

This exemption is subject to a significant number of exceptions for changes that materially and adversely affect any class of equity securities [*Corp. Code § 25103(e)*].

e. Stock splits or reverse stock splits, except those that would [*Corp. Code § 25103(f)*; *see 10 Cal. Code Reg. §§ 260.103.2-260.103.5*]:

(1) Have material effect on proportionate interests of classes of stock as to voting, dividends, or distributions, if corporation has more than one class of shares outstanding;

(2) Create class of market-traded stock with adjusted market price of less than two dollars per share; or

(3) Substantially alter proportionate interests of existing shareholders as a result of corporation's option to pay cash for fractional shares created by reverse split.

f. Changes in rights of outstanding debt securities [*Corp. Code § 25103(g)*].

NOTE:

This exemption is subject to numerous exceptions for changes that substantially and adversely affect any class of securities [*Corp. Code § 25103(g)*].

g. Exchanges incident to merger, consolidation, or sale of assets (other than rollup transaction [*see Corp. Code § 25014.6*]) in consideration of issuance of equity securities of another entity, or any entity conversion transaction [*see* P a, NOTE, *above*] when [*Corp. Code § 25103(h)(1)*]:

NOTE:

The Commissioner, by rule, may require the acquiring or surviving entity to file a notice of transaction [***see*** *10 Cal. Code Reg. § 260.103.6*]. However, the failure to file the notice or to file it within the time specified by the rule of the Commissioner will not affect the availability of the exemption. An acquiring or surviving entity that fails to file the notice as provided by rule of the Commissioner, within 15 business days after demand by the Commissioner, must file the notice and pay to the Commissioner a fee equal to the fee payable had the transaction been qualified under *Corp. Code §§ 25110* or *25120* [*Corp. Code § 25103(h)(2)*].

(1) Exchange or entity conversion transaction, had it involved issuance of security in transaction subject to *Corp. Code § 25110* (rather than *Corp. Code § 25120*), would have been exempt from qualification by *Corp. Code § 25102(f)* (without giving effect to *Corp. Code § 25102(f)(3)*, which requires representation that purchaser is purchasing for own account, not for resale); and

(2) Either of following is applicable:

(a) Not less than 75 percent of outstanding equity securities of each constituent or converting entity entitled to vote on proposed transaction voted in favor of transaction, not more than 10 percent of outstanding equity securities of each constituent or converting entity entitled to vote voted against transaction, and each constituent or converting entity whose security holders are entitled to vote is subject to state statute with provisions for dissenters' rights for holders of equity securities entitled to vote that do not vote in favor of or voted against transaction.

(b) Transaction is solely for purposes of changing issuer's state of incorporation or organization, or form of organization, all securities of same class or series (unless all security holders of class or series consent) are treated equally, and holders of nonredeemable voting equity securities receive nonredeemable voting equity securities.

h. Exchanges in connection with any merger or consolidation or sale of corporate assets in consideration (wholly or in part) of issuance of securities or any entity conversion transaction [*see Corp. Code § 25005.1* (definition); *see also* P a, NOTE, *above*], under or pursuant to plan of reorganization that has been confirmed or is subject to confirmation by decree or order of court of competent jurisdiction pursuant to U.S. Bankruptcy Code [*Corp. Code § 25103(i)*].

4. Determine whether transaction is exempt under any exemption created by rule of Commissioner [*see Corp. Code § 25105*]:

NOTE:

The Commissioner's rules describe exemptions by reference to the specific section of the Corporations Code requiring qualification [***see*** *Corp. Code §§ 25110* (qualification of issuer transactions), 25120 (qualification of reorganization transactions), 25130 (qualification of nonissuer transactions)]. For

purposes of clarity, however, the following discussion identifies the form of transaction by name, that is, "issuer," "nonissuer," and "reorganization," rather than by section number.

a. Offers by issuer, nonissuer, or in reorganization of interests of securities when securities are sold only to institutional or registered investors [*Corp. Code §§ 25102(i), 25104(c)*], or to public agencies [*10 Cal. Code Reg. § 260.105.14*], or when securities are exempt at time of issuance under *Corp. Code § 25100* [*10 Cal. Code Reg. § 260.105*].

b. Offers or sales of interest in oil or gas title or lease by issuer, provided sole consideration for security is grant or lease of drill site or easement to produce oil or gas [*10 Cal. Code Reg. § 260.105.1*].

c. Offers or sales of securities by or through licensed broker-dealers by issuer or nonissuer to purchaser who is neither domiciled nor actually present in California, or offers or sales to licensed broker-dealers in principal transaction, or as underwriters or members of underwriting or selling group [*10 Cal. Code Reg. § 260.105.2*].

d. Transactions by issuer in which issuer allocates to its employees (or employees of its parent or subsidiary) units representing right to eventually receive cash, measured by [*10 Cal. Code Reg. § 260.105.5*]:

NOTE:

This type of plan is known as a "phantom stock plan" [***see*** *10 Cal. Code Reg. § 260.105.5*]. For an example of a phantom stock plan, see Rabkin & Johnson, Current Legal Forms with Tax Analysis, Ch. 14, ***Stock Options and Other Incentive Plans*** , Form 14.66 (Matthew Bender).

(1) Dividends paid on shares of issuer's capital stock; and/or

(2) Market value of shares of issuer's capital stock.

e. Offers or sales by issuer or in reorganization of any of following [*10 Cal. Code Reg. § 260.105.6*]:

(1) Capital stock issued by either:

(a) Professional corporation organized under Professional Corporation Act [*10 Cal. Code Reg. § 260.105.6(a)*; *see Corp. Code §§ 13400-13410*]; or

(b) Foreign professional corporation qualified to render professional services in California in accordance with requirements of Professional Corporation Act [*10 Cal. Code Reg. § 260.105.6(a)*; *Corp. Code § 13401(c)*; *see Corp. Code §§ 13400-13410*].

(2) Beneficial interests in trust established for purpose of voting shares of capital stock of professional corporation or foreign professional corporation, if trustees are (and interests are held solely by) persons entitled to hold voting shares [*10 Cal. Code Reg. § 260.105.6(b)*].

(3) Interests in partnership organized to render professional services pursuant to *Corp. Code § 13401(a)*, if all partners are entitled to hold voting shares in professional corporation or qualified foreign professional corporation [*10 Cal. Code Reg. § 260.105.6(c)*].

f. Interdealer solicitations by nonissuer regularly published and circulated to broker-dealers, in connection with which charge is made for listing solicitation [*10 Cal. Code Reg. § 260.105.7*].

NOTE:

A publication is circulated to broker-dealers within the meaning of this exemption when subscriptions are limited substantially to broker-dealers, banks, trust companies, and savings and loan associations subject to a provision that the information contained in the publication is for the private use of the subscriber. This exemption applies to the quotation services of the National Quotation Bureau and NASDAQ [*10 Cal. Code Reg. § 260.105.7*].

g. Offers or sales by issuer of incentive stock option plans, as defined in *I.R.C. § 422(b)*, if [*10 Cal. Code Reg. § 260.105.8(a)*; *see I.R.C. § 422(b)*]:

NOTE:

A similar exemption to *Corp. Code § 25120* exempts any offer or sale of incentive stock options made as a result of the amendment of outstanding options [*10 Cal. Code Reg. § 260.105.8(b)*].

(1) Company issuing options is issuer of security registered under Section 12 of Securities Exchange Act of 1934 [*see 15 U.S.C. § 78l*];

(2) Total number of shares of stock subject to incentive stock options does not exceed 10 percent of outstanding shares of same class of company; and

(3) Options granted prior to shareholder approval are by their terms:

(a) Not exercisable until approval has been obtained; and

(b) Void if approval is not obtained within time prescribed by Internal Revenue Code.

h. Offers or sales by issuer or in reorganization of beneficial interests in voluntary inter vivos trust created solely for purpose of voting, if offer or sale is result of [*10 Cal. Code Reg. § 260.105.9*]:

(1) Stock split or reverse stock split of underlying securities that is exempt from provisions of *Corp. Code §§ 25110* (issuer transactions) and 25120 (reorganizations) by virtue of *Corp. Code § 25103(f)* [*see* P 3e, *above*]; or

(2) Issuance of underlying securities as stock dividend that is not a sale as defined in *Corp. Code § 25017(f)*].

NOTE:

Beneficial interests issued pursuant to this exemption are subject to any conditions imposed by the Commissioner applicable to beneficial interests previously issued with respect to the underlying securities that are the subject of the stock split, reverse stock split, or stock dividend [*10 Cal. Code Reg. § 260.105.9*].

i. Offers or sale by nonissuers of securities, certificates of deposit, receipt, or other evidence of securities issued by corporation organized under laws of foreign country, provided one of following is met [*10 Cal. Code Reg. § 260.105.11(a)*]:

NOTE:

A broker-dealer may recommend to an investor a security that is exempted under this rule only if the broker-dealer can demonstrate that an adequate and reasonable basis exists for that recommendation [*10 Cal. Code Reg. § 260.105.11(b)*]. A broker-dealer initiating a quotation for a security that is exempt under this rule must comply with specific requirements [***see*** *10 Cal. Code Reg. § 260.105.11(c)*; *17 C.F.R. § 240.15c2-11*].

(1) The issuer is currently required to file information and reports with the SEC pursuant to Section 15(d) of the Securities and Exchange Act of 1934 [*see 15 U.S.C. § 78a et seq.*] and is not delinquent in that filing.

(2) Either [*10 Cal. Code Reg. § 260.105.11(a)(2)*]:

(a) The security appears on the most recent Federal Reserve Board List of Foreign Margin Stocks; or

(b) The security is deemed by the SEC to have a "ready market" for purposes of SEC Rule 15c3-1 [*17 C.F.R. § 240.15c3-1*].

NOTE:
A broker-dealer may rely on written "no action" or interpretive letters issued by the SEC or its staff regarding the SEC's "ready market" criteria [*10 Cal. Code Reg. § 260.105.11*].

(3) The issuer is not subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 and all of the following conditions are met:

(a) The issuer, including any predecessors, has been in continuous operation for at least five years and is a going concern actually engaged in business, and neither in the organization stage nor in bankruptcy or receivership.

(b) The number of shares outstanding is at least 2.5 million worldwide and the number of shareholders is at least 5,000 worldwide.

(c) The market value of the outstanding shares, other than debt securities and preferred stock, is at least $100 million (U.S.) worldwide.

(d) The issuer, as of the date of its most recent financial statements, which may not be more than 18 months old and which have been audited in accordance with the generally accepted accounting principles of its country of domicile, has net tangible assets of at least $100 million (U.S.) worldwide.

(e) The issuer has net income after all charges, including taxes and extraordinary losses, and excluding extraordinary gains, of either at least $50 million (U.S.) in total for its last three fiscal years, or at least $20 million (U.S.) in each of its last two fiscal years.

(f) If the security is a debt security or preferred stock, the issuer, during the past five years or during the period of its existence if shorter, has not defaulted in the payment of any dividend, principal, interest, or sinking fund installment on the security.

j. Offers to resell or resale of restricted securities to qualified institutional buyers under SEC Rule 144A [*10 Cal. Code*

Reg. 260.105.13.1; *see 17 C.F.R. § 230.144A*].

k. Offers or sales of securities to public agencies by issuer, nonissuer, or in reorganizations [*10 Cal. Code Reg. § 260.105.14*].

NOTE:
For purposes of this exemption, public agencies include the federal government and its agencies, instrumentalities, and wholly owned corporations; states, cities, cities and counties, counties, and their agencies and instrumentalities; state universities and state colleges; and retirement systems for the benefit of employees of any of these entities [*10 Cal. Code Reg. § 260.105.14*].

l. Offers and sales of securities of one entity in exchange for all securities issued by another entity ("acquired entity") except director's qualifying shares ("B" reorganizations) [*see* Marsh & Volk, Practice Under the California Securities Laws, Ch. 7, *Recapitalizations and Reorganizations* (Matthew Bender)], if [*10 Cal. Code Reg. § 260.105.15*]:

NOTE:
For a detailed discussion of "B" reorganizations, see Ch. 11D, ***Acquisition of Shares for Shares*** .

(1) Exchange is subject to approval by either of following:

(a) Public commission, board, or other state governmental authority that is expressly authorized to grant that approval, after hearing as to fairness of terms and conditions of exchange; or

(b) Not less than majority (unless requirement is increased by provision in articles of incorporation, bylaws, or applicable state law) of outstanding securities of acquired entity of the class exchanged, excluding securities owned by persons owning at least 50 percent of the outstanding securities;

(2) Holder dissenting from exchange is entitled to fair value of securities; and

(3) Less than 25 percent of outstanding securities of class exchanged are held as of record date for exchange by persons having addresses in California.

m. Offers and sales of checks, drafts, or money orders by persons licensed by Commissioner of Corporations or Superintendent of Banks to engage in those transactions [*10 Cal. Code Reg. § 260.105.16*].

n. Offers or sales by issuer, nonissuer, or in reorganization, of nonassessable common shares; warrants or rights to purchase or subscribe to those shares; or units or rights arising from compensation plan of issuer or affiliate payable in shares or cash in amount related to value of or dividends paid on shares, if on business day preceding date of sale [*10 Cal. Code Reg. § 260.105.17*]:

(1) Issuer of shares is issuer of security registered under Section 12 of Securities Exchange Act of 1934 [*15 U.S.C. § 78l*] or exempt from registration by Section 12(g)(2)(G) of that Act [*15 U.S.C. § 78l(g)(2)(G)*];

(2) One of the following applies:

(a) Shares to be offered or sold are listed or approved for listing on American Stock

Exchange or New York Stock Exchange [*see 10 Cal. Code Reg. § 260.105.17(b)*].

(b) Shareholder approval is required of employee options, rights, or plan, and issuer has no reason to believe that upon approval, shares issuable on exercise of options or rights will not be listed or approved for listing upon notice of issuance.

(c) Quotations for shares to be offered or sold are reported by quotations system operated by National Association of Securities Dealers, Inc., its subsidiary, or by another system approved by Commissioner.

(3) Shares of class offered or sold have been traded or offered for sale on each of at least 12 days within 30 days preceding sale;

(4) Shares have not been suspended from trading by Commissioner of Corporations or Securities and Exchange Commission during 30 days preceding sale;

(5) Average closing and last closing sale or bid price is at least $4 per share during 30 days preceding sale;

(6) Issuer is corporation organized under laws of United States, any state, or District of Columbia;

(7) Corporation has authorized capitalization of one class of common shares, and those shares are voting;

(8) Corporation has not, during past five years, or period of existence, if shorter, defaulted in payment of dividend or sinking fund installment on preferred shares, or in payment of principal, interest, or sinking fund installment on indebtedness for borrowed money;

(9) Corporation has consolidated net worth of at least $1 million; and

(10) Corporation has had net income of either:

(a) $500,000 for last fiscal year and $1.5 million total for last five years; or

(b) $1 million in each of last two fiscal years.

o. Offers or sales by issuer of securities (except evidences of indebtedness, whether or not interest bearing) of nonprofit organization, if all of following qualifications are met [*10 Cal. Code Reg. § 260.105.20*]:

(1) Nonprofit organization meets requirements of *Corp. Code § 25100(j)*, except that promoter intends to profit directly or indirectly from organization.

(2) Neither promoter nor affiliate of promoter is officer, director, or in control of organization, nor holds securities of organization, except for membership for social uses.

(3) Profit is derived solely from lease of real or personal property, provision of goods at fair market value, or sale of real properties within immediate geographic area, without offer of admission into organization and without active participation in any association activity.

(4) Initial offering of memberships was qualified.

(5) Terms of arrangements with promoter at time of initial qualification either remain unchanged or have become more favorable to members of organization.

(6) Organization must give notice to Commissioner and file financial statement at least 30 days prior to sale of memberships under this exemption [*see 10 Cal. Code Reg. § 260.613*].

(7) No order is issued by Commissioner under *Corp. Code § 25140* or *25143* relating to qualification obtained for sale of memberships of nonprofit organization.

(8) No order has been issued by Commissioner withholding this exemption either at time of initial offering of memberships or at any subsequent time.

p. Offers or sales by issuer of common shares issued by foreign corporations, provided [*10 Cal. Code Reg. § 260.105.22*]:

(1) After offer and sale, 100 percent of outstanding capital stock of issuer is owned directly or indirectly by corporation, in either:

(a) Its own name; or

(b) Name of nominees or other persons holding for sole benefit of that corporation;

(2) Acquiring corporation represents that securities are purchased for its own account for investment purposes only, and not with view to, or for sale in connection with, any distribution of shares; and

(3) All shares are evidenced by certificates prominently stating restrictions on sale or transfer [*see 10 Cal. Code Reg. § 260.141.11*].

q. Transactions by issuer in which money is advanced or loaned to corporate issuer with agreement or expectation that shares of issuer will be issued in exchange for, in cancellation of, or in conversion of advances or loans, provided all of following requirements are satisfied [*10 Cal. Code Reg. § 260.105.23*]:

(1) Aggregate amount of advances or loans made does not substantially exceed funds required to pay fees and expenses of organization and initial issuance of share certificates, including attorneys' fees.

(2) Advances or loans are made by:

(a) Corporation, directly or indirectly, that will have direct or indirect interest in issuer;

(b) Any officer, director, or controlling shareholder of corporation;

(c) Any partnership whose business issuer intends to acquire;

(d) Any partner of partnership described in P (c), *above*; or

(e) Any person who is or is expected to become officer or director of issuer.

(3) No more than 35 persons make advances or loans.

(4) At time advances or loans are made, issuer has not:

(a) Commenced business other than activities in connection with organization and preparation for regular business; or

(b) Issued shares.

(5) Prior to commencement of business (other than organizational activities) or issuance of shares, whichever occurs first, issuance is either qualified or exempted under *Corp. Code § 25110*.

r. Offers or sales of beneficial interest in inter vivos funeral trust meeting requirements of Division 3, Chapter 12, Article 9 of Business and Professions Code [*see Bus. & Prof. Code §§ 7735-7745*] by issuer or in reorganization [*10 Cal. Code Reg. § 260.105.26*].

s. [Reserved]

t. Offers (but not sales) by issuer or nonissuer of security for which notification on Form 1A has been filed with Securities and Exchange Commission and for which application for qualification has been filed, provided [*10 Cal. Code Reg. § 260.105.29*]:

(1) No order is in effect and no public proceeding or examination considering such order is pending under Rule 258 [*17 C.F.R. § 230.258*] pursuant to Securities Exchange Act of 1933 and no order under *Corp. Code § 25140* or *25143(a)* is in effect;

(2) Offering circular distributed pursuant to this exemption has been on file with Commissioner for not less than three business days and no order with respect thereto has been issued pursuant to *Corp. Code § 25302*;

(3) Offer and sale of securities is made by or through licensed broker-dealer; and

(4) If material changes or corrections are made in offering circular, each sale pursuant to qualification applied for, if granted, is made upon condition that purchaser may rescind within three business days after receipt of final offering circular and final offering circular states prominently upon its face that material changes and corrections have been made from preliminary offering circular.

NOTE:
This exemption allows a Regulation A "red herring" offering circular [***see** 17 C.F.R. § 230.255*; ***see also*** Sommer, Federal Securities Act of 1933, Ch. 5, ***Small Issue Exemptions Under Section 3(b) and 3(c) of the Securities Act*** (Matthew Bender)] to be distributed in California.

u. Offers or sales by issuer or nonissuer of equity securities that are senior to other securities already issued by same issuer and are [*10 Cal. Code Reg. § 260.105.33(a)*; *see Corp. Code § 25100(o)*]:

NOTE:
A security is "senior" to a listed or designated security of the same issuer if, on the issuer's liquidation or dissolution, the holders of that security are entitled to payment from, or to participate in the distribution of assets of, the issuer before any payment or distribution to the holders of the listed or designated security. However, a security is not senior to a listed or designated security of the same issuer if it is currently, or at some future time may be converted into, an evidence of indebtedness that does not or will

not satisfy the requirements for exemption under Rule 260.105.34 [*10 Cal. Code Reg. § 260.105.33(a)*; ***see*** *10 Cal. Code Reg. § 260.105.34* (exemption for debt-rated securities); ***see also*** P v, ***below***]. The issuer must file a notice of transaction on the official form with the Commissioner. However, neither the failure to file the notice nor the failure to comply with procedural filing requirements will affect the availability of the exemption [*10 Cal. Code Reg. § 260.105.33(b)* (form); ***see*** *10 Cal. Code Reg. § 260.105.33(c), (d)* (instructions)].

(1) Listed on national securities exchange certified by Commissioner; or

(2) Designated as national market system security on interdealer quotation system by National Association of Securities Dealers, Inc., certified by Commissioner.

v. Offers or sales by issuer of any evidence of indebtedness that has been rated as an "investment grade security" as defined by Standard & Poor's Rating Services, Fitch IBCA, Inc., or Moody's Investors Service, Inc. [*10 Cal. Code Reg. § 260.105.34(a)*].

NOTE:

The issuer must file a notice of transaction on the official form with the Commissioner. However, neither the failure to file the notice nor the failure to comply with procedural filing requirements will affect the availability of the exemption [*10 Cal. Code Reg. § 260.105.34(b)*; ***see*** *10 Cal. Code Reg. §§ 260.105.33(b)* (form), 260.105.33(c), (d)(instructions)].

w. Offers or sales of exchange-traded options on stock indices ("index options") or guarantees thereof, provided [*10 Cal. Code Reg. § 260.105.35(a)*]:

(1) Index options are offered or sold by The Options Clearing Corporation on an exchange, or through facilities of approved national securities association; and

NOTE:

To date, the Commissioner has approved the American Stock Exchange, the Chicago Board Options Exchange, Inc., and the New York Stock Exchange, Inc. [*10 Cal. Code Reg. § 260.105.35(b)*].

(2) Rules of The Options Clearing Corporation, exchange, or association relating to issuance, clearance, and settlement of index option transactions, and relating to processing and settlement of index option exercises, have been approved by SEC under *15 U.S.C. § 78s(b)*.

x. Offers and sales of exchange-traded options on foreign currencies ("foreign currency options") or guarantees thereof, provided [*10 Cal. Code Reg. § 260.105.36(a)*]:

(1) Foreign currency options are offered or sold by The Options Clearing Corporation on exchange approved by Commissioner; and

NOTE:

To date, the Commissioner has approved the Philadelphia Stock Exchange [*10 Cal. Code Reg. § 260.105.36(b)*].

(2) Rules of The Options Clearing Corporation and exchange relating to issuance, clearance, and settlement of foreign currency option transactions, and relating to processing and settlement of index

option exercises, have been approved by SEC under *15 U.S.C. § 78s(b)*.

y. Offers and sales of securities (or warrant or right to purchase securities) listed or approved for listing on Chicago Board Options Exchange (CBOE) pursuant to securities approval criteria for original listing adopted by CBOE [*10 Cal. Code Reg. § 260.105.37(a)*].

NOTE:

This exemption was initially effective only for a period of 36 months dating from July 28, 1992, but was extended by order of the Commissioner on July 11, 1995, for an additional 36 months from that date [***see*** *10 Cal. Code Reg. § 260.105.37(d)*].

z. Offers and sales of any guarantee, letter of credit, standby purchase agreement, or similar security obligating issuer to pay principal of and/or interest on any exempt government security [*see Corp. Code § 25100(a)*], provided [*10 Cal. Code Reg. § 260.105.38*]:

(1) Exempt security is "investment grade security" [*see 10 Cal. Code Reg. § 260.105.34(a)(1)*; *see also* P v, *above*]; or

(2) Issuer of guarantee, letter of credit, standby purchase agreement, or similar security [*10 Cal. Code Reg. § 260.105.38(b)*]:

(a) Is issuer of any security registered under *15 U.S.C. § 78l(g)* or exempted under *15 U.S.C. § 78l(g)(2)(G)*, or if issuer is bank, is member of Federal Reserve System;

(b) During past five years or during period of existence, if shorter, has not defaulted in payment of any dividend or sinking fund installment on preferred shares, or in payment of any principal, interest, or sinking fund installment on any indebtedness for borrowed money;

(c) Has net worth on consolidated basis of at least $12 million, according to most recent audited financial statement within 15 months, or most recent unaudited financial statement as of date subsequent to audited statement; and

(d) Has had average net income of at least 10 percent of net worth for five most recent fiscal years or period of existence, if shorter, and for most recent fiscal year.

aa. Offers and sales of units in any unit investment trust by sponsor of that trust, or to or through broker-dealer, provided [*10 Cal. Code Reg. § 260.105.39*]:

(1) Offer and sale was previously qualified [*see Corp. Code § 25111*] and no material change in offering has been made;

(2) Units were repurchased by broker-dealer or sponsor and are redeemable under Investment Company Act of 1940 [*see 15 U.S.C. § 80a-1 et seq.*];

(3) Offer and sale is in accordance with Securities Act of 1933 [*see 15 U.S.C. § 77a et seq.*] and Investment Company Act of 1940 [*see 15 U.S.C. § 80a-1 et seq.*]; and

(4) Sponsor or broker-dealer is licensed as broker-dealer.

bb. When offer and sale of following securities are exempt from registration under Securities Act of 1933, offers and sales of Canadian securities [*10 Cal. Code Reg. § 260.105.40*]:

NOTE:

"Canadian securities" means any security issued by an issuer organized under the laws of Canada or its provinces or territories [*10 Cal. Code Reg. § 260.105.40*].

(1) To or for "Canadian Retirement Account" [*see 17 C.F.R. § 230.237(a)(2)*; 17 C.F.R. § 7d-2(a)(2) (definitions)]; or

(2) To or for Canadian resident temporarily resident in or visiting California with whom Canadian broker-dealer had bona fide broker-dealer-client relationship before Canadian resident entered United States.

cc. Any change in rights, preferences or privileges of an outstanding security and any exchange of securities with existing security holders if transaction would have been exempt from qualification as an issuer transaction under *Corp. Code § 25102* or *10* Cal. Code Reg. § 260.105.14 if transaction had involved issuance of a new security.

NOTE:

Notice filings must be made if the transaction would have been qualified under *Corp. Code § 25102(f), (h),* or *(n)* [*10 Cal. Code Reg. § 260.103(a), (c)*].

dd. Any exchange of securities in a merger or consolidation or sale of assets pursuant to plan of reorganization adopted under U.S. Bankruptcy Code [*10 Cal. Code Reg. § 260.103(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide § 6.117

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§ 6.117 Federal Preemption

NOTE:

State registration or qualification of "covered securities," as defined by the National Securities Markets Improvement Act of 1996 [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005)], or securities that will be covered securities under that definition upon completion of the transaction, is preempted by federal law [*15 U.S.C. § 77r*]. For further discussion of preemption issues, see *§ 6.15*.

In response to the National Securities Markets Improvement Act of 1996 [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005); ***see*** *Ch. 6H,* ***Qualification of Securities****, § 6H.24*; ***see also*** *§ 6.15[1],* California legislation enacted in 1997 specifies certain securities and transactions that are not subject to *Corp. Code §§ 25110*, *25120*, and *25130* [Stats. 1997, ch. 391; ***see*** *Corp. Code §§ 25100.1*, *25101.1*, *25102.1*].

Securities subject to the federal preemption provisions generally are not required to comply with California qualification or securities exemption requirements. Notice and fee requirements, however, do apply in some cases [***see*** *§ 6.141*].

1. Determine whether security is subject to preemption provisions of National Securities Markets Improvement Act of 1996 and not subject to *Corp. Code §§ 25110*, *25120*, and *25130* by virtue of fact that it is a "covered security," which includes [*Corp. Code § 25100.1*]:

a. Is security one of the following kinds of nationally traded securities [*15 U.S.C. § 77r(b)(1)*]?

(1) Securities listed, or authorized for listing, on New York Stock exchange, American Stock Exchange, National Market System of NASDAQ.

NOTE:

Since the California Corporations Commissioner has certified the New York and American Stock Exchanges [***see*** Dept. of Corps. Release No. 27-C (Mar. 4, 1972; revised Mar. 9, 1992) (this release has not been updated to reflect the name change of the American Stock Exchange to "NYSE AMEX LLC"); *see also Marsh & Volk, Practice Under the California Securities Laws, § 3A.04[1]* (Matthew Bender)] and the NASDAQ Global Market and the NASDAQ Capital Market of the NASDAQ Stock Market LLC [*see* Dept. of Corps. Release No. 87-C (revised August 17, 2009)] pursuant to *Corp. Code § 25100(o)*, the federal preemption does not affect California treatment of securities listed on those exchanges, which are already exempt by California law. The Commissioner has also certified Tier I of the Philadelphia Stock Exchange [***see*** Dept. of Corps. Release No. 96-C (Sept. 12, 1995) (this release has not been updated to reflect the name change of the Philadelphia Stock Exchange to "NASDAQ OMX PHLX, Inc."); *see also Marsh & Volk, Practice Under the California Securities Laws, § 3A.04[1]* (Matthew Bender)] and Tier I (Select Market Companies) of the Pacific Stock Exchange, now operated as NYSE Arca [*see* Dept. of Corps. Release No. 95-C (December 27, 1994); *see also Marsh & Volk, Practice Under the California Securities Laws, § 3A.04[1]* (Matthew Bender)].

(2) Securities listed, or authorized for listing, on national securities exchange (or tier or segment of such an exchange) that has listing standards that SEC determines by rule are substantially similar to listing standards applicable to those applicable to securities described in P (1), *above*.

(3) Securities of same issuer that are equal in seniority or are senior securities [*see 15 U.S.C. § 77r(d)(4)* (definition)] to securities described in P (1) or (2), *above*.

NOTE:

Equity securities senior to securities exempt under California's listing exemption also have been exempted from qualification by rule of the Commissioner [***see*** *10 Cal. Code Reg. § 260.105.33*].

b. Is security issued by investment company that is registered, or has filed registration statement, under Investment Company Act of 1940 [*15 U.S.C. § 77r(b)(2)*; *Corp. Code § 25100.1(b)*; *see 15 U.S.C. § 80a-1 et seq.*]?

NOTE:

An issuer described in P b, ***above***, must still comply with California notice requirements and pay the required fee [*Corp. Code § 25100.1(b)*; ***see*** *§ 6.141*].

2. Determine whether transaction is subject to preemption provisions of National Securities Markets Improvement Act of 1996 and not subject to *Corp. Code §§ 25110, 25120*, and *25130* because security will be offered or sold to "qualified purchasers" as defined by SEC rule under Section 18(b)(3) of Securities Act of 1933 [*15 U.S.C. § 77r(b)(3)*; *Corp. Code § 25102.1*].

NOTE:

An issuer described in P 2, ***above***, must still comply with California notice requirements and pay the required fee [*Corp. Code § 25102.1(a)*; ***see*** *§ 6.141*].

In prescribing such a rule, the SEC may define the term "qualified purchaser" differently with respect to different categories of securities, consistent with the public interest and the protection of investors [*15 U.S.C. § 77r(b)(3)*]. The SEC has not yet adopted such a rule.

3. Determine whether security is subject to preemption provisions of National Securities Markets Improvement Act of

1996 and not subject to *Corp. Code §§ 25110, 25120,* and *25130* because it will be offered or sold under any of following exemptions from registration under Securities Act of 1933 [*15 U.S.C. § 77r(b)(4)*]:

a. Section 4(1) [*15 U.S.C. § 77d(1)*] (transactions by any person other than issuer, underwriter or dealer) or Section 4(3) [*15 U.S.C. § 77d(3)*] (with certain exemptions, transactions by dealer), provided issuer of securities files reports with SEC pursuant to Section 13 or 15(d) of Exchange Act [*15 U.S.C. § 77r(b)(4)(A)*; *Corp. Code § 25101(a)*; *see 15 U.S.C. §§ 78m, 78o(d)*].

b. Section 4(4) [*15 U.S.C. § 77d(4)*] (certain brokers' transactions executed on customer's order) [*15 U.S.C. § 77r(b)(4)(B)*; *Corp. Code § 25102.1(b)*].

c. Section 3(a) [*15 U.S.C. § 77c(a)*] (which exempts large number of securities, including those of various governmental entities, commercial paper, charitable organizations, etc.), other than offer of sale of security that is exempt from registration pursuant to Section 3(a)(4), (10), or (11) [*15 U.S.C. § 77c(a)(4), (10), (11)*] (securities of charitable organizations, exchanges of securities, and intrastate exemption) [*15 U.S.C. § 77r(b)(4)(C)*; *Corp. Code § 25102.1(c)*].

NOTE:
However, a municipal security that is exempt from registration pursuant to Section 3(a)(2) [*15 U.S.C. § 77c(a)(2)*] is not a covered security with respect to its offer or sale in the state in which the issuer of that security is located [*15 U.S.C. § 77r(b)(4)(C)*].

d. SEC rules or regulations issued under Section 4(2) [*15 U.S.C. § 77d(2)*] (transactions by issuer not involving any public offering) [*15 U.S.C. § 77r(b)(4)(D)*; *Corp. Code § 25102.1(b)*].

NOTE:
Offerings under Rule 506 of Regulation D [*17 C.F.R. § 230.506*] satisfy this criteria. An issuer described in P d, ***above***, must still comply with California notice requirements and pay the required fee [*Corp. Code § 25102.1(a)*; ***see*** *§ 6.141*].

e. Security of foreign (other country) issuer that avails itself of exemption from registration under Section 12(g)(3) of Securities and Exchange Act of 1934 [*see 15 U.S.C. § 78l(g)(3)*] if issuer is reporting company under that Act and files required reports under Section 13 or 15(d) of that Act [*Corp. Code § 25101.1(b)*; *see 15 U.S.C. §§ 78m, 78o(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawBlue Sky LawsFederal PreemptionSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide § 6.118

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.118 California Qualification

1. If one or more exemptions are available, determine whether to rely on exemption or to qualify securities in California.

NOTE:

If the security or the transaction may be eligible for an exemption from qualification, a determination must be made whether to rely on the exemption or to qualify the securities. In the case of an issuer transaction by a nonpublic corporation, the transaction usually will be structured to come within one of the exemptions and avoid the time and expense of qualification. The offer or sale of securities not eligible for an exemption [***see*** *§§ 6.114-6.116*], or not subject to the preemption provisions of federal law [***see*** *§§ 6.15, 6.117*] must be qualified under the Corporate Securities Law.

a. Advantages of relying on exemptions rather than qualifying an offer or sale of securities include:

(1) Savings of time and money.

(2) Avoidance of public disclosure.

(3) Avoidance of merit standards applicable to qualification.

b. Advantages of qualification include;

(1) Fewer restrictions on manner of offering.

(2) Fewer restrictions on potential purchasers.

(3) Fewer restrictions on resale.

(4) Availability of other benefits such as fairness hearing.

(5) Exemption from usury laws.

2. If securities are to be qualified:

NOTE:
For detailed determinations relating to the availability and selection of particular methods of qualification, see *Ch. 6H, **Qualification of Securities**, § 6H.121*.

a. Determine which forms of qualification are available for the particular transaction.

b. Select least time consuming and expensive method available.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide § 6.119

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.119 Intrastate or Interstate Offering

NOTE:

An exemption from federal registration under Section 5 of the Securities Act of 1933 is available for offers and sales made within a single state or territory [***see*** *Ch. 6A,* ***Federal Securities Exemptions for California Nonpublic Corporations****, § 6A.24*].

1. Determine whether transaction complies with requirements for intrastate offering:

a. Will offer or sale be made strictly within California?

b. Will offer or sale be made only to California residents?

c. Is offering by a California issuer?

2. If offering is interstate offering:

a. Determine states and/or territories where offer or sale will be made.

b. Determine requirements of laws of in each jurisdiction where offer or sale is made.

c. Determine whether there can be coordination of review among sister state securities regulators [*see § 6.71[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide § 6.120

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.120 Applicable Federal Requirements

1. Does the offer or sale constitute an offering under federal securities law [*see Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.21*]?

2. If so, is an exemption from registration available [*see Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.21*]?

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawBlue Sky LawsOffer & SaleSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6 California Legal Forms--Transaction Guide §§ 6.121-6.139

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

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§§ 6.121[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Compliance With Securities Laws

3-6 California Legal Forms--Transaction Guide § 6.140

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.140 Compliance With Applicable Securities Laws

1. If transaction will rely on exemption from California qualification requirements, comply with applicable requirements for specific exemption being relied on.

NOTE:

The coverage in this chapter assumes that most California nonpublic corporations that do not have to qualify their securities will rely on the California limited offering, small offering, or qualified purchaser exemptions listed below. Accordingly, separate chapters have been devoted to the requirements relating to these exemptions. In-depth coverage of all the specialized exemptions that apply to specific types of securities or securities transactions is beyond the scope of the publication. For a complete list of the exemptions from California qualification requirements, see the table in § 6.200[2].

a. For requirements under California limited offering exemptions [*Corp. Code §§ 25102(f), 25102.1(d); 10 Cal. Code Reg. §§ 260.102.12, 260.102.13, 260.102.14*], see Ch. 6B, *California Limited Offering Exemptions* .

b. For requirements under California "small offering" exemption [*Corp. Code § 25102(h)*], see Ch. 6C, *California Small Offering Exemption* .

c. For requirements under California "qualified purchaser" exemptions [*Corp. Code § 25102(i), (n); 10 Cal. Code Reg. § 260.105.14*], see Ch. 6D, *California Qualified Purchaser Exemptions* .

d. For requirements under other exemptions, see the table of exemptions in § 6.200[2].

2. If transaction will be qualified in California, comply with applicable qualification procedures [*see* Ch. 6H, *Qualification of Securities*].

3. If transaction is interstate offering and there will be coordinated review:

a. Notify Department of Corporations of intent to participate in Coordinated Equity Review.

b. File application with Department and other applicable states.

4. If transaction is subject to exemption or registration or exemption from registration from applicable federal law, take appropriate steps to comply with applicable federal requirements [*see* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*].

NOTE:

Coverage of the registration requirements of the federal securities laws is beyond the scope of this publication inasmuch as it is assumed that the typical California nonpublic corporation will be able to rely on one or more exemptions from the federal exemption requirements. The most commonly used federal exemptions from registration under the Securities Act are discussed in detail in Ch. 6A, ***Federal Securities Exemptions for California Nonpublic Corporations*** . For more detailed coverage, see Sommer, Federal Securities Act of 1933 (Matthew Bender).

5. Do not proceed with offer or sale of securities until all applicable requirements of exemption or qualification have been met.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933Registration of SecuritiesProhibitions & RestrictionsSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Compliance With Securities Laws

3-6 California Legal Forms--Transaction Guide § 6.141

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.141 Compliance With California Requirements Relating to Federally Preempted Securities and Transactions

NOTE:

In response to the National Securities Markets Improvement Act of 1996 [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005); ***see*** § 6H.125; ***see also*** Ch. 6, ***Securities Regulation Issues***], California legislation enacted in 1997 specifies certain securities and transactions that are not subject to *Corp. Code §§ 25110, 25120,* and *25130* [Stats. 1997, ch. 391; ***see*** *Corp. Code §§ 25100.1, 25101.1, 25102.1*]. In some cases, however, the issuer is still required to comply with minimal specified requirements that are not inconsistent with Federal preemption. These remaining California requirements, which are not dealt with elsewhere in this publication, are listed below.

Notwithstanding the federal preemption, an issuer may still file an application for qualification by coordination, notification, or permit pursuant to *Corp. Code § 25111, 25112, 25113, 25121, 25131,* or *25142* if it wishes to do so [*Corp. Code § 25102.1(e)*].

1. If security is issued by investment company that is registered or has filed registration statement under Investment Company Act of 1940 [*see 15 U.S.C. § 80a-1 et seq.*], and is defined as "covered security" under Section 18(b)(2) of Securities Act of 1933 [*15 U.S.C. § 77r(b)(2)*; *see §§ 6.15[5], 6.117*], satisfy following requirements [*Corp. Code § 25100.1*]:

a. File with or pay to Commissioner all of the following prior to any offer or sale in California:

(1) Notice consisting of all documents that are part of federal registration statement filed with SEC under Securities Act of 1993 (or form prescribed by Commissioner in lieu of notice).

NOTE:

The Department of Corporations will accept the Uniform Form NF [***see*** *Ch. 6H,* ***Qualification of Securities****, § 6H.209*] developed by the North American Securities Administrators Association for filing [***see*** Dept. of Corps. Release No. 109-C (Dec. 18, 1997)].

(2) Consent to service of process, which must either be filed with Commissioner or attached to notice specified in (1), *above*.

(3) Report of value of securities covered that are offered or sold in California, as necessary to compute fees.

(4) Notice filing fee [*see Corp. Code § 25608.1(a)*].

NOTE:

The notice filing fee is $200 plus one fifth of one percent of the aggregate value of the securities sought to be sold in California, up to a maximum aggregate free of $2,500 [*Corp. Code § 25608.1(a)*]. The maximum fee that may be levied on a filing pursuant to *Corp. Code § 25100.1(b)* will apply, unless the Commissioner sets the fees below the maximum level at the beginning of the fiscal year [*Corp. Code § 25608.2*; ***see also*** *Corp. Code § 25608.3* (Commissioner may set any fee at amount below maximum set forth in *Corp. Code § 25608.1*)].

b. If any offer or sale is to be made pursuant to Section 18(b)(2) of Securities Act of 1933 [*15 U.S.C. § 77r(b)(2)*] and *Corp. Code § 25100.1* more than 12 months after date notice was filed, issuer must file another notice and pay fee set forth in *Corp. Code § 25608.1(a)*.

2. If offer or sale of security will be to "qualified purchaser" as defined by SEC rule under Section 18(b)(3) of Securities Act of 1933 [*15 U.S.C. § 77r(b)(3)*; *see §§ 6.15[5], 6.117*], satisfy all of following requirements [*Corp. Code § 25102.1(a)*]:

a. File notice with Commissioner prior to offer in California, along with any documents filed with SEC in annual or periodic reports that Commissioner by rule or order deems appropriate.

NOTE:

Because the SEC has not yet adopted a rule under Section 18(b)(3) of the Securities Act of 1933 relating to "qualified purchasers," no notice under the Corporate Securities Law has been proposed at this time) [***see*** Dept. of Corps. Release No. 109-C (Dec. 18, 1997)].

b. File consent to service of process [*see Corp. Code § 25165*; *see also Ch. 6H, Qualification of Securities, § 6H.239*] along with notice.

c. Pay notice filing fee [*see Corp. Code § 25608.1(b)*].

NOTE:

The fee is $600 [*Corp. Code § 25608.1(b)*]. The maximum fee that may be levied on a filing pursuant to *Corp. Code § 25102.1(a)* will apply, unless the Commissioner sets the fees below the maximum level at the beginning of the fiscal year [*Corp. Code § 25608.2*; ***see also*** *Corp. Code § 25608.3* (Commissioner may set any fee at amount below maximum set forth in *Corp. Code § 25608.1*)].

3. If transaction is exempt from registration under Securities Act of 1933 pursuant to Section 18(b)(4)(D) of that act [*15 U.S.C. § 77r(b)(4)(D)*; *see Ch. 6H, Qualification of Securities, § 6H.24*], satisfy all of following requirements [*Corp. Code § 25102.1(d)*]:

a. File notice, consisting of copy of completed Form D [*17 C.F.R. § 239.500*] filed with SEC, with Commissioner:

NOTE:
No notice need be filed if none of the securities offered for sale under Rule 506 are sold in California [Dept. of Corps. Release No. 109-C (Dec. 18, 1997)].

(1) Within 15 days of first sale in California.

(2) Along with documents filed with SEC in annual or periodic reports that Commissioner by rule or order deems appropriate.

b. Accompany notice with letter of transmittal stating that filing is pursuant to Rule 506 and Section 18(b)(4)(D) of the Securities Act of 1933 [Dept. of Corps. Release No. 109-C (Dec. 18, 1997)].

c. File one of following with notice [Dept. of Corps. Release No. 109-C (Dec. 18, 1997)]:

(1) Consent to service of process [*see Corp. Code § 25165*; *see also Ch. 6H, Qualification of Securities, § 6H.239*]; or

(2) Statement that issuer is:
(a) A California corporation; or

(b) Already has consent to service of process on file with Commissioner.

d. Pay notice filing fee set forth in *Corp. Code § 25608.1(c)*.

NOTE:
Although the statutory filing fee is $300 [***see*** *Corp. Code § 25608.1(c)*], the Commissioner may set any fee at an amount below the maximum set forth in *Corp. Code § 25608.1* [*Corp. Code §§ 25608.2(b), 25608.3*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawBlue Sky LawsFederal PreemptionSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInvestment CompaniesRegistration & ReportingSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Compliance With Securities Laws

3-6 California Legal Forms--Transaction Guide §§ 6.142-6.199

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

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§§ 6.142[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART IV. FORMS
A. Tables of Securities Exemptions

3-6 California Legal Forms--Transaction Guide § 6.200

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.200 Table of All California Securities Exemptions

[1] Comment--Use of Table

This form is a table of all California securities exemptions, with the statutory terms and criteria that are applicable to these exemptions. It is included to assist attorneys in comparing the various exemptions available under California law, and to function as a handy guide to help determine at a glance what exemptions may be applicable to particular types of interests and transactions.

This table includes all statutory exemptions that were available in California as of the date of publication. As discussed in *§ 6.30[3]*, the majority of these exemptions are not likely to be useful in the context of issuance of corporate stock or equivalent by a corporation or other business entry. Additional exemptions established by rule of the Commissioner are *outlined in § 6.116*.

For discussion of the number and significance of California securities exemptions, see *§ 6.30*. For a chart comparing a number of the most commonly used California and federal securities exemptions, see *§ 6.201[2]*. For discussion of federal exemptions, see *§ 6.52*; see also Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* .

[2] Table

I. Exempt Issuer Securities [Corp. Code § 25100]

- **Domestic Government Securities [Corp. Code § 25100(a)].** Securities issued or guaranteed by, or certificates of deposit for, the United States, any state, any city, county, city and county, public district, public authority, public corporation, public entity, or political subdivision of a state or any agency or corporate or other instrumentality of any one or more or the foregoing.

- **Foreign Government Securities [Corp. Code § 25100(b)].** Securities issued or guaranteed, including certificates of deposit for, the Canadian federal government, any Canadian province, or any political subdivision or municipality of that province. Securities issued or guaranteed, including certificates of deposit for, other governments with which the United States currently maintains diplomatic relations.

- **Bank or Trust Company Securities [Corp. Code § 25100(c)].** Securities issued or guaranteed by, and representing an interest in or a direct obligation of, a national bank or a California bank or trust company, and any security issued by a bank to one or more other banks and representing an interest in an asset of the issuing bank.

- **Savings and Loan Association Securities [Corp. Code § 25100(d)].** Securities issued or guaranteed by federal savings associations, federal savings banks, joint land banks, national farm loan associations and by other savings associations defined in Fin. Code § 5102(a) and subject to the supervision and regulation of the California Commissioner of Financial Institutions.

- **Insurance, Public Utility, Real Estate Securities [Corp. Code § 25100(e)].** Securities (other than real estate subdivision or development) the issuance of which must be authorized by the California Insurance Commissioner, Public Utilities Commission or Real Estate Commissioner.

- **Real Estate Subdivision Securities [Corp. Code § 25100(f)].** Securities consisting of any interest in subdivided real estate or real estate development but not including any investment contract sold or offered as part of that interest or any security of an issuer supplying water for irrigation or domestic use unless it is a mutual water company.

- **Mutual Capital Certificates [Corp. Code § 25100(g)].** Mutual capital certificates or savings accounts issued by a savings association certified by the California Commissioner of Financial Institutions.

- **Credit Union Securities [Corp. Code § 25100(h)].** Securities issued or guaranteed by federal credit unions and credit unions organized and supervised or regulated by the Credit Union Law.

- **Interstate Common Carrier and Public Utility Securities [Corp. Code § 25100(i)].** Securities issued or guaranteed by railroads, other common carriers, public utilities, and public utility holding companies regulated by the Interstate Commerce Commission, registered with the SEC under the Public Utility Holding Company Act of 1935, or regulated in respect of the issuance or guarantee of the security by, and registered therewith or authorized thereby, the United States government, any state government, the Canadian government, and any Canadian provincial government.

- **Nonprofit Corporation Securities [Corp. Code § 25100(j)].** Securities, except evidences of indebtedness and so long as no promoter intends to profit from activities associated therewith, (1) of issuers organized for educational, benevolent, fraternal, religious, charitable, social, or reformatory purposes if none of the net earnings benefit private shareholders or individuals or (2) of chambers of commerce or trade or professional associations.

- **Life Income Contracts [Corp. Code § 25100(k)].** Life income contracts between (1) issuers organized exclusively for educational, benevolent, fraternal, religious, charitable, social, or reformatory purposes and designated by the Commissioner of Corporations and (2) donors of property to that issuer.

- **Short Term Commercial Paper [Corp. Code § 25100(l)].** Notes, drafts, bills of exchange or banker's acceptances that are offered to the public in amounts not less than $25,000 unless otherwise approved by the Commissioner and that are (1) freely transferable and of prime quality, (2) arise in connection with a current transaction, and (3) evidence an obligation to pay cash within nine months of issuance.

- **Agricultural Cooperative Securities [Corp. Code § 25100(m)].** Securities issued by agricultural cooperatives organized under the Food and Agricultural Code.

- **Pension or Profit Sharing Plans [Corp. Code § 25100(n)].** Beneficial interests in employees' pension, profit-sharing, stock bonus or similar benefit plans qualified under I.R.C. § 401.

- **Stock Exchange Securities [Corp. Code § 25100(o)].** Securities, and warrants or rights to purchase or subscribe to such securities, listed or approved for listing on a national securities exchange if the exchange has been certified by the Commissioner of Corporations, except securities in connection with rollup transactions are excluded unless the transaction is an eligible rollup transaction as defined in Corp. Code § 25014.7. Under this exemption, all securities listed or approved for listing on the following are exempt from qualification [see § 6.15[5], Marsh & Volk, Practice Under the California Securities Laws, Ch. 4, General Exemptions From Qualification, § 4.03, for further discussion of the securities exchanges under this exemption, some of which have undergone name changes in recent years]:
  - New York Stock Exchange or the American Stock Exchange [Dept. of Corps. Release No. 27-C (Revised Mar. 9, 1992)].

  - Tier I of the Philadelphia Stock Exchange [Dept. of Corps. Release No. 96-C (Sept. 12, 1995)].

  - Tier I (Select Market Companies) of the Pacific Stock Exchange [Dept. of Corps. Release No. 95-C (Dec. 27, 1994)].

  - NASDAQ Global Market and NASDAQ Capital Market [Dept. of Corps. Release No. 87-C (Revised Aug. 17, 2009)].

- **Secured Notes [Corp. Code § 25100(p)].** Promissory notes secured by liens on real property if such notes are not part of a series of notes of equal priority secured by the same real property nor notes in which beneficial interests are sold to more than one person.

- **Medical Malpractice Trust Funds [Corp. Code § 25100(q)].** Qualifying unincorporated interindemnity or reciprocal or interinsurance contacts, between members of qualifying cooperative corporations, that indemnify members only for medical malpractice, provided that the members of such corporations are all California-licensed physicians and surgeons and that such corporations do not collect in advance of loss for other than reserves and costs of administration.

- **Cooperatives [Corp. Code § 25100(r)].** Shares or memberships issued by cooperative consumer corporations if the aggregate investment by any shareholder or member sold pursuant to this exemption does not exceed $300 and no promoter intends to make a profit from the corporation's activities.

- **Mortgage Loan Pools [Corp. Code § 25100(s)]** Securities consisting of an interest in a pool of mortgage loans provided that: (1) the loans were acquired or originated in the ordinary course of business by designated banks or savings associations, (2) the pool is held in trust by a trustee that is a designated bank or savings association, (3) the pool is serviced by a designated bank or savings association, (4) the security is not offered in amounts less than $25,000, and (5) the security is offered pursuant to a registration under the Security Act of 1933, an exemption under Regulation A of the Security Act of 1933, or, in the opinion of counsel of the issuer, is exempt under Section 4(2) of the Securities Act of 1933.

- **Industrial Loan Company Securities [Corp. Code § 25100(t)].** (1) Securities issued or guaranteed by and representing an interest in or a direct obligation of an authorized California industrial loan company; and (2) investment certificates in or issued by industrial loan companies organized in states other than California provided that such loan companies (a) are insured by the Federal Deposit Insurance Corporation and (b) maintain a branch in California.

II. Exempt Nonissuer Securities [Corp. Code § 25101]

- **Listed Securities [Corp. Code § 25101(a)].** Securities issued by a person that is the issuer of any security listed or approved for listing on a national securities exchange if the exchange has been certified by the Corporations Commissioner; except securities offered pursuant to (1) a registration under the Securities Act of 1933; or (2) an exemption pursuant to Regulation A of the Securities Act of 1933 if the aggregate offering price of the securities offered under the exemption afforded by Regulation A exceed $50,000 [Corp. Code § 25101(b); see Dept. of Corps. Release No. 88-C (Revised Aug. 17, 2009); § 6.115, above].

III. Exempt Issuer Transactions [Corp. Code §§ 25102, 25102.5]

- **Nonpublic Offers and Agreements [Corp. Code § 25102(a)].** Offers (but not sales) not involving any public offering and the execution and delivery of any agreement for the sale of securities pursuant to the offer if:

    - The agreement contains substantially the following provision:

"The sale of the securities that are the subject of this agreement has not been qualified with the Commissioner of Corporations of the State of California and the issuance of the securities or the payment or receipt of any part of the consideration therefor prior to the qualification is unlawful, unless the sale of securities is exempt from qualification by Section 25100, 25102, or 25105 of the California Corporations Code. The rights of all parties to this agreement are expressly conditioned upon the qualification being obtained, unless the sale is so exempt"; and

- No part of the purchase price is paid or received and none of the securities are issued until the sale of securities is qualified under this law unless the sale of securities is exempt from the qualification under Corp. Code §§ 25100, 25102, or 25105.

Offers of Registered Securities [Corp. Code § 25102(b)]. Offers (but not sales) of

securities for which a registration statement has been filed under the Securities Act of 1933 but has not yet become effective, or for which an offering statement under Regulation A has been filed but has not yet been qualified, if no federal or California stop order or refusal order is in effect or anticipated.

- **Negotiating Permit Transactions [Corp. Code § 25102(c)].** Offers (but not sales) and the execution and delivery of any agreement for the sale of securities pursuant to the offer as may be permitted by the Commissioner upon application. None of the securities may be issued and none of the consideration may be received or accepted until the sale of the securities is qualified.

- **Agreements Between Issuers and Underwriters [Corp. Code § 25102(d)].** Transactions or agreements between issuers and underwriters or among underwriters if the sale of the securities is qualified, or exempt from qualification, at the time of distribution in California, if any.

- **Nonpublic Debt Securities [Corp. Code § 25102(e)].** Offers or sales of any evidence of indebtedness, whether secured or unsecured, and any guarantee thereof, in a transaction not involving any public offering. For purposes of this exemption, it is presumed that an offer or sale does not involve any public offering if offers are not made to more than 25 counted persons and sales are not consummated to more than 10 such persons, and if all the offerees have either a preexisting relationship with the issuer's insiders or are financially sophisticated. Transactions that do not satisfy the presumption criteria may still qualify under this provision if they otherwise do not involve a public offering.

- **Nonpublic Offerings and Sales of Any Securities ("Limited Offering" Exemption) [Corp. Code § 25102(f)].** Offers or sales of any securities in a transaction (other than an offer or sale to a pension or profit-sharing trust of the issuer) that meets each of the following criteria:

  - Sales of the security are not made to more than 35 persons, including persons outside California (not counting institutional or accredited investors, certain individuals with management and oversight responsibilities for the issuer and other purchasers designated by rule of the Commissioner). A husband and wife (together with any custodian or trustee acting for the account of their minor children) are counted as one person and a partnership, corporation or other organization that was not specifically formed for the purpose of purchasing the security offered in reliance upon this exemption, is counted as one person.

  - All purchasers, other than accredited investors, either have a preexisting personal or business relationship with the offeror or any of certain individuals with management or oversight responsibilities, or, by reason of their business or financial experience or that of their professional advisors, who are not connected to the issuer, could be reasonably assumed to have the capacity to protect their own interests in connection with the transaction.

  - Each purchaser represents that the purchaser is purchasing for the purchaser's own account (or a trust account if the purchaser is a trustee) and not with a view to or for sale in connection with any distribution of the security.

  - The offer and sale of the security is not accomplished by the publication of any advertisement.

  - For detailed coverage of the requirements of this exemption, see Ch. 6B, *California Limited Offering Exemptions*.

- **Nonpublic Collateral Trusts [Corp. Code § 25102(g)].** Offers or sales of conditional sale agreements, equipment trust certificates, or certificates of interest or participation therein or partial assignments thereof, covering the purchase

of railroad rolling stock or equipment or the purchase of motor vehicles, aircraft, or parts thereof, in a transaction not involving any public offering. For purposes of this exemption, an offer or sale does not involve any public offering if offers are not made to more than 25 counted persons and sales are not consummated to more than 10 such persons, and if all the offerees have either a preexisting relationship with the issuer's insiders or are financially sophisticated [10 Cal. Code Reg. § 260.102.2].

- **Thirty-Five or Fewer Shareholders ("Small Offering" Exemption) [Corp. Code § 25102(h)].** Offers or sales of voting common stock by a corporation incorporated in any state, or a pseudo-California corporation under Corp. Code § 2115, if, immediately after the proposed sale and issuance, there will be only one class of stock of the corporation outstanding that is owned beneficially by no more than 35 persons, provided all of the following requirements have been met:

    - The offer and sale of the stock is not accompanied by the publication of any advertisement.

    - No selling expenses have been given, paid, or incurred in connection with the offer or sale.

    - The consideration to be received by the issuer for the stock to be issued must consist of one of the following:

    - Only assets (which may include cash) of an existing business enterprise transferred to the issuer upon its initial organization, provided (1) the enterprise was operated for a period of not less than one year immediately preceding the proposed issuance; (2) persons who are to receive the stock to be issued pursuant to this exemption were owners during the one-year period; and (3) the ownership of the enterprise immediately prior to the proposed issuance was in the same proportions as the shares of stock are to be issued.

    - Only cash or cancellation of indebtedness for money borrowed, or both, upon the initial organization of the issuer, provided all of the stock is issued for the same price per share.

    - Only cash, provided the sale is approved in writing by each of the existing shareholders and the purchaser or purchasers are existing shareholders.

    - If after the proposed issuance there will be only one owner of the stock of the issuer, any legal consideration.

- No promotional consideration has been given, paid, or incurred in connection with the issuance. Promotional consideration means any consideration paid directly or indirectly to a person who, acting alone or in conjunction with one or more other persons, takes the initiative in founding and organizing the business or enterprise of an issuer, for services rendered in connection with the founding or organizing.

- A notice, signed by an active member of the State Bar of California, must be filed with or mailed for filing to the Commissioner not later than 10 business days after receipt of consideration for the securities by the issuer. The notice must contain an opinion of the member of the State Bar of California that the exemption provided by this subdivision is available for the offer and sale of the securities. The notice, except when filed on behalf of a California corporation, shall be accompanied by an irrevocable consent, in the form that the Commissioner by rule prescribes, appointing the Commissioner or his or her successor in office to be the issuer's attorney to receive service of any lawful process in any noncriminal suit, action, or proceeding against it or its successor that arises under this law or any rule or order hereunder after the consent has been filed, with the same force and validity as if served personally on the issuer.

- Each purchaser represents that the purchaser is purchasing for the purchaser's own account, or a trust account if the

purchaser is a trustee, and not with a view to or for sale in connection with any distribution of the stock.

- For detailed coverage of the requirements of this exemption, see Ch. 6C, *California Small Offering Exemption*.

- **Sale to Institutional and Registered Investors [Corp. Code § 25102(i)].** Offers or sales to any of the following provided purchasers represent that they are purchasing for their own account (or for a trust account) for investment and not with a view to or for sale in connection with any distribution of the security:

    - A bank, savings and loan association, trust company, insurance company, investment company registered under the Investment Company Act of 1940, pension or profit-sharing trust, with certain restrictions, or other institutional investor or governmental agency or instrumentality that the Commissioner may designate by rule, whether the purchaser is acting for itself or as trustee.

    - Any corporation with outstanding securities registered under Section 12 of the Securities Exchange Act of 1934 or any wholly owned subsidiary of such a corporation that after the offer and sale will own directly or indirectly 100 percent of the outstanding capital stock of the issuer.

    - For detailed coverage of the requirements of this exemption, see Ch. 6D, *California Qualified Purchaser Exemptions*.

- Oil or Gas Title Leases [Corp. Code § 25102(j)]. Offers or sales of any certificate of interest or participation in an oil or gas title or lease if either of following apply:

    - Each purchaser falls into one of the following categories:

        - Is or has been during the preceding two years engaged primarily in the business of drilling for, producing, or refining oil or gas;

        - Is an institutional or accredited investor; or

        - Has been found by the commissioner upon written application to be substantially engaged in the business of drilling for, producing, or refining oil or gas so as not to require the protection provided by this law; or

    - The security is concurrently hypothecated to a bank in the ordinary course of business to secure a loan made by the bank, provided that each purchaser represents that it is purchasing for its own account for investment and not with a view to or for sale in connection with any distribution of the security.

- **Bankruptcy Reorganizations [Corp. Code § 25102(k)].** Offers or sales of any security under, or pursuant to, a plan of reorganization under Chapter 11 of the federal bankruptcy law that has been confirmed or is subject to confirmation by the decree or order of a court of competent jurisdiction.

- **Option or Warrant Sale by Exempt Nonissuer [Corp. Code § 25102(l)].** Offers or sales of an option, warrant, put, call, or straddle, and any guarantee of any of these securities, by a person who is not the issuer of the security subject to the right, if the transaction, had it involved an offer or sale of the security subject to the right by the person, would not have violated Corp. Code § 25110 or 25130.

- **Stock Sale to Pension, Profit-Sharing Stock Bonus, or Employee Stock Ownership Plan [Corp. Code § 25102(m)].** Offers or sales of a stock to a pension, profit-sharing, stock bonus or employee stock ownership plan provided that (1) the plan meets the requirements for qualification under I.R.C. § 401; and (2) the employees are not

required or permitted individually to make any contributions to the plan.

- **Transactions Meeting Specified Criteria for Issuer and Purchasers [Corp. Code § 25102(n)].** Offers or sales of any security in a transaction, other than an offer or sale of a security in a rollup transaction [see Corp. Code §§ 25014.6, 25014.7], if the following criteria are met:

  - The issuer is a California corporation, a pseudo-California corporation under Corp. Code § 2115, or any other business entity.

  - All of the purchasers are qualified purchasers as defined in Corp. Code § 25102(n)(2).

  - Each purchaser represents that the purchaser is purchasing for the purchaser's own account and not with a view to reselling or distribution.

  - Each natural person and each entity formed by natural persons for the purpose of acquiring the offered securities, a written disclosure statement meeting the requirements of Regulation D at least five business days before the securities are sold or a commitment to purchase is accepted, unless the person is an accredited investor.

  - A general announcement of the proposed offering is published by written document only, which document contains all of the information required by Corp. Code § 25102(n)(5)(A) and no more information than the required information plus the optional information permitted by Corp. Code § 25102(n)(5)(B).

  - Telephone solicitation is undertaken only with respect to known qualified purchasers.

  - The issuer files a notice of transaction (1) at the earliest of concurrent with the publication of the general announcement and at the time of the initial offering and (2) within 10 business days following the close or abandonment of the offering, but in no event more than 210 days from the date of the first notice.

  - For detailed coverage of the requirements of this exemption, see Ch. 6D, *California Qualified Purchaser Exemptions*.

- **Offer or Sale of Security Issued Pursuant to Purchase or Plan or Agreement [Corp. Code § 25102(o)].** Offers or sales of any security issued by a corporation or LLC pursuant to a purchase plan or agreement, or issued pursuant to a option plan or agreement, if at the time of issuance or grant the security is exempt from registration under the Securities Act of 1933, as amended, pursuant to Rule 701 adopted pursuant to that act (17 C.F.R. 230.701); provided that:

  - The terms of any purchase plan or agreement comply with 10 Cal. Code Reg. §§ 260.140.42, 260.140.45, and 260.140.46.

  - The terms of any option plan or agreement shall comply with 10 Cal. Code Reg. §§ 260.140.41, 260.140.45, and 260.140.46.

  - The issuer files a notice of transaction in accordance with rules adopted by the Commissioner no later than 30 days after the initial issuance of any security in California (see 10 Cal. Code Reg. § 260.102.19) under that plan, accompanied by a filing fee as prescribed by Corp. Code § 25608(y). The failure to file the notice of transaction, or the failure to file it within the time specified, will not affect the availability of the exemption. Within 15 days after demand by the Commissioner, an issuer that has

failed to file the notice must file it and pay a fee equal to the maximum aggregate fee payable had the transaction been qualified under Corp. Code § 25110.

- **Nonredeemable Securities/Accredited Investors [Corp. Code § 25102(p)].** Offers or sales of nonredeemable securities to accredited investors (Corp. Code § 28031) by a person licensed under the Capital Access Company Law (Division 3 (commencing with Corp. Code § 28000) of Title 4). All nonredeemable securities must be evidenced by certificates that shall have stamped or printed prominently on their face a legend in a form to be prescribed by rule or order of the Commissioner restricting transfer of the securities in the manner as the rule or order provides.

- **Offer or Sale of Viatical or Life Settlement Contract [Corp. Code § 25102(q)].** Offers or sales of any viatical or life settlement contract [defined in Corp. Code § 25023; see § 6.116[1][q]] or fractionalized or pooled interest therein, in a transaction that meets all of the following criteria:

  - Sales of securities are made only to qualified purchasers as defined in Corp. Code § 25102(q)(1), or to other persons the issuer reasonably believes after reasonable inquiry to be qualified purchasers.

  - Each purchaser represents that the purchaser is purchasing for that purchaser's own account (or trust account, if purchaser is a trustee) and not with a view to or for sale in connection with a distribution of the security [Corp. Code § 25102(q)(2)].

  - Each natural person and each entity formed by natural persons for the purpose of acquiring the offered securities receives the written information specified in Corp. Code § 25102(q)(3) at least five business days before the securities are sold to (or a commitment to purchase is accepted from) the purchaser.

- **Exempt Sales of Series of Notes Secured by Interest in Real Property [Corp. Code § 25102.5].** The sale of a series of notes secured directly by an interest in the same real property, or the sale of undivided interests in a note secured directly by real property equivalent to a series transaction, that complies with all of the provisions of Bus. & Prof. Code § 10229. A licensed real estate broker who engages in the offer and sale of notes secured directly by real property of various makers, which are a series of notes or notes in which undivided interests are offered and sold, is deemed to be the issuer of these notes and undivided interests if the notes of the various makers are offered and sold pursuant to a plan or arrangement that is common to the various makers with respect to documentation and loan standards and that include provisions for servicing these notes on behalf of purchasers.

IV. Exempt Reorganization and Recapitalization Transactions [Corp. Code § 25103]

- **Negotiations Prior to Shareholder Approval [Corp. Code § 25103(a)].** Negotiations or agreements prior to solicitation of approval by shareholders, and subject to that approval, of (1) a change in the rights, preferences, or privileges of outstanding securities, (2) a merger, consolidation, or transfer of assets for securities, or (3) an entity conversion transaction (as defined in Corp. Code § 25005.1)

- **Nonresident Shareholders--Changes of Rights [Corp. Code § 25103(b)].** Changes in the rights, preferences, privileges of outstanding securities or an entity conversion transaction (as defined in Corp. Code § 25005.1), unless the holders of at least 25 percent of the outstanding shares or units of any class of securities which will be directly or indirectly affected substantially and adversely by such change or transaction have addresses in California.

- **Nonresident Shareholders--Mergers, etc. [Corp. Code § 25103(c)].** Exchanges incident to mergers, consolidations, or transfers of assets for securities issued by another, unless at least 25 percent of the outstanding securities of any class, any holders of which are to receive securities in the exchange,

are held by persons who have addresses in this state, according to the records of the issuer of which they are holders. This exemption is not available for a rollup transaction as defined by Corp. Code § 25014.6.

- **Changes in Rights and Preferences of Equity Securities. [Corp. Code § 25103(e)].** Changes (other than stock splits or reverse stock splits) in the rights, preferences, privileges, or restrictions of or on outstanding equity securities, *except* the following if they materially and adversely affect any class of equity securities:

    - To add, change, or delete assessment provisions.

    - To change the rights to dividends thereon.

    - To change the redemption provisions.

    - To make them redeemable.

    - To change the amount payable on liquidation.

    - To change, add, or delete conversion rights.

    - To change, add, or delete voting rights.

    - To change, add, or delete preemptive rights.

    - To change, add, or delete sinking fund provisions.

    - To rearrange the relative priorities of outstanding equity securities.

    - To impose, change, or delete restrictions upon the transfer of equity securities in the organizational documents for the entity.

    - To change the right of holders of equity securities with respect to the calling of special meetings of holders of equity securities.

    - To change, add, or delete any rights, preferences, privileges of the outstanding shares or memberships of a mutual water company or other corporation or entity organized primarily to provide services or facilities to its shareholders or members.

- **Stock Splits [Corp. Code § 25103(f)].** Stock splits or reverse stock splits, except for the following:

    - If the corporation has more than one class of shares outstanding and the split would have a material effect on the proportionate interests of the respective classes as to voting, dividends, or distributions.

    - Any stock split of a stock which is traded in the market and its market price as of the date of directors' approval of the stock split adjusted to give effect to the split was less than two dollars per share.

    - Any reverse stock split if the corporation has the option of paying cash for any fractional shares created by such reverse split and as a result of such action the

proportionate interests of the shareholders would be substantially altered.

- **Changes in Rights and Preferences of Debt Securities [Corp. Code § 25103(g)].** Changes in the rights of outstanding debt securities, except the following if they substantially and adversely affect any class of securities:

    - To change the rights to interest.
    - To change their redemption provisions.
    - To make them redeemable.
    - To extend the maturity or to change the amount payable at maturity.
    - To change their voting rights.
    - To change their conversion rights.
    - To change sinking fund provisions.
    - To make them subordinate to other indebtedness.

- **Exchange Incident to Merger, Consolidation, or Sale of Assets--Conditions [Corp. Code § 25103(h)].** Exchanges incident to mergers, consolidations, or sales of assets, other than a rollup transaction (as defined in Corp. Code § 25014.6), in consideration of the issuance of equity securities of another entity or any entity conversion transaction (as defined in Corp. Code § 25005.1), if the exchange transaction, had it involved the issuance of a security in a transaction subject to the provisions of Corp. Code § 25110, would have been exempt from qualification by Corp. Code § 25102(f)(without giving effect to Corp. Code § 25102(f)(3), which requires representation that purchaser is purchasing for own account, not for resale) and either of the following is applicable:

    - (1) Not less than 75 percent of the outstanding equity securities of each constituent or converting entity entitled to vote on the proposed transaction voted in favor of the transaction; (2) not more than 10 percent of the outstanding equity securities of each constituent or converting entity entitled to vote on the proposed transaction voted against the transaction; and (3) each constituent or converting entity whose security holders are entitled to vote on the proposed transaction is subject to a state statute that has provisions for dissenters' rights for holders of equity securities entitled to vote on the proposed transaction that do not vote in favor of or voted against the transaction; or

    - (1) The transaction is solely for the purposes of changing the issuer's state of incorporation or organization, or form of organization; (2) all the securities of the same class or series, unless all the security holders of the class or series consent, are treated equally, and (3) the holders of nonredeemable voting equity securities receive nonredeemable voting equity securities.

- **Exchange Incident to Merger, Consolidation, or Sale of Assets-Bankruptcy Confirmation [Corp. Code § 25103(i)].** Exchanges in connection with any merger or consolidation or sale of corporate assets in consideration (wholly or in part) of issuance of securities or entity conversion transaction (as defined in Corp. Code § 25005.1), under or pursuant to a plan of reorganization or arrangement which

has been confirmed or is subject to confirmation by decree or order of court of competent jurisdiction pursuant to U.S. Bankruptcy Code [Corp. Code § 25103(i)].

V. Exempt Nonissuer Transactions [Corp. Code § 25104]

- **Private Sale by Owner [Corp. Code § 25104(a)].** Offers or sales of securities by the bona fide owner thereof for his or her own account if the sale (1) is not accompanied by the publication of any advertisement; and (2) is not effected by or through a broker-dealer in a public offering.

- **Unsolicited Sale by Broker-Dealer [Corp. Code § 25104(b)].** Offers or sales effected by or through licensed broker-dealers pursuant to unsolicited orders or offers to buy.

- **Sale to Institutional Investor [Corp. Code § 25104(c)].** Offers or sales to banks, savings and loan associations, trust companies, insurance companies, investment companies registered under the Investment Company Act of 1940, pension or profit-sharing trusts (other than a pension or profit-sharing trust of the issuer, a self-employed individual retirement plan, or individual retirement account), or any other institutional investors or governmental agencies or instrumentalities that the Commissioner may designate; provided the purchaser represents that it is purchasing for its own account (or for the trust account) for investment and not with a view to or for sale in connection with any distribution of the security.

- **Agreements Between Sellers and Underwriters [Corp. Code § 25104(d)].** Transactions or agreements between persons on whose behalf an offering is made and an underwriter or among underwriters, if the sale of the securities is exempt from qualification at the time of or qualified prior to distribution in California, if any.

- Liquidation of Secured Debt [Corp. Code § 25104(e)]. Offers or sales of securities by or for the account of a bona fide secured party selling the security in the ordinary course of business to liquidate a bona fide debt.

- **Transactions by Executors, Administrators, Guardians, etc. [Corp. Code § 25104(f)].** Any transaction by an executor, administrator, sheriff, marshal, receiver, trustee in bankruptcy, guardian, or conservator.

- **Offers Pending Registration [Corp. Code § 25104(g)].** Offers (but not sales) of securities for which a registration statement has been filed under the Securities Act of 1933 but has not yet become effective, or for which an offering statement under Regulation A has been filed but has not yet been qualified, if no stop order or refusal order is in effect and no public proceeding or examination looking toward such an order is pending under Section 8 of that act and no order under Corp. Code § 25140 or Corp. Code § 25143(a) is in effect.

- **Sales Soon After Qualification [Corp. Code § 25104(h)].** Offers or sales of securities if qualification under Chapter 2 (commencing with Corp. Code § 25110) for any securities of the same class has become effective within 18 months, prior to the offer or sale or if a qualification under Chapter 3 (commencing with Corp. Code § 25120) or Chapter 4 (commencing with Corp. Code § 25130) for any securities of the same class has become effective within 12 months prior to that offer or sale, provided no order under Corp. Code § 25140 or 25143(a) is in effect with respect to the qualification and that this exemption does not apply to securities offered under a registration under the Securities Act of 1933 or pursuant to an exemption under Regulation A under that act if the aggregate offering price of the securities offered under the exemption exceeds $50,000.

VI. Transactions Exempt by Rule of Commissioner [Corp. Code § 25105]

- **Offers Prior to Sale [10 Cal. Code Reg. § 260.105].** The offer of securities is exempt from qualification under Corp. Code §§ 25110, 25120 and 25130 for securities that are actually sold in transactions exempted from qualification pursuant to Corp. Code §§ 25102(i), 25104(c), and 10 Cal. Code Reg. § 260.105.14, or if the securities are exempt at the time of issuance under Corp. Code § 25100.

- **Phantom Stock Plans [10 Cal. Code Reg. § 260.105.5].** Exempt from qualification under Corp. Code § 25110 are transactions whereby an issuer allocates to its employees "units" representing a right to receive cash but not stock in an amount measured by dividends paid on or market value of its capital stock.

- **Professional Organizations [10 Cal. Code Reg. § 260.105.6].** Offers and sales of beneficial interests in professional organizations are exempt from qualification under Corp. Code §§ 25110 and 25120.

- **Incentive Stock Plans [10 Cal. Code Reg. § 260.105.8].** Offers and sales of incentive stock options are exempt from qualification under Corp. Code § 25110 pursuant to certain restrictions including that the issuer is the issuer of any security registered under Section 12 of the Securities Exchange Act of 1934 (15 U.S.C. § 78l).

- **Securities of Foreign Issuers [10 Cal. Code Reg. § 260.105.11].** Offers and sales of securities issued by any corporation organized under the laws of a foreign country if one of three conditions is met, one of which is that the issuer is currently required to file reports with the SEC pursuant to Section 15(d) of the Securities Exchange Act of 1934.

- **Private Resales Under SEC Rule 144A [10 Cal. Code Reg. § 260.105.13.1].** Offers to resell and resales of restricted securities made in compliance with Rule 144A of the SEC [17 C.F.R. § 230.144A] are exempt from the qualification provisions of Corp. Code § 25130.

- **Certain Publicly Traded Common Shares [10 Cal. Code Reg. § 260.105.17].** Offers and sales of nonassessable common shares, and any right to purchase such shares, are exempt from qualification under Corp. Code §§ 25110, 25120, and 25130 if certain requirements are met including that the shares are issued by a person who is the issuer of any security registered under Section 12 of the Securities Exchange Act of 1934 or exempted from registration pursuant to Section 12(g)(2)(G) of that Act.

- **Nonprofit Organizations [10 Cal. Code Reg. § 260.105.20].** Offers and sales of securities (except evidences of indebtedness) of a nonprofit organization are exempt from qualification under Corp. Code § 25110 if certain conditions are met including that the person controlling the organization does not profit and the profit expectation of the security holder derives solely from a passive relationship with the organization.

- **Rated Debt Securities [10 Cal. Code Reg. § 260.105.34].** Offers and sales of any evidence of indebtedness is exempt from qualification under Corp. Code § 25110 if that security has been rated as an "investment grade security" by Standard & Poor's Rating Services, Fitch IBCA, Inc. or Moody's Investors Service, Inc.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART IV. FORMS
A. Tables of Securities Exemptions

3-6 California Legal Forms--Transaction Guide § 6.201

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.201 Chart Comparing Commonly Used California and Federal Exemptions

[1] Comment

[a] Use of Chart

This form is a chart comparing the key features of some of the more commonly used California and federal exemptions. It is designed to provide a handy comparison between the basic criteria for the exemptions indicated, and to assist in coordinating the appropriate California and federal exemption requirements.

It is important to bear in mind that the descriptions have been simplified for purpose of comparison. The attorney must review the applicable requirements in detail to ensure that a proposed transaction will qualify for the desired exemption.

[b] Exemptions Included in Table

This table compares the following exemptions:

- California Exemptions:
  - The California "limited offering exemption" [*Corp. Code § 25102(f)*; *see § 6.31*; *see also* Ch. 6B, *California Limited Offering Exemptions*].
  - The California "small offering exemption" [*Corp. Code § 25102(h)*; *see § 6.32*; *see also* Ch. 6C, *California Small Offering Exemption*].
  - The California "qualified purchaser exemption" [*Corp. Code § 25102(n)*; *see § 6.33*; *see also* Ch. 6D, *California Qualified Purchaser Exemptions*].

- Federal Exemptions:
    - The federal "intrastate offering exemption" under SEC Rule 147 [*17 C.F.R. § 230.147*; *see § 6.58*; *see also* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*].
    - The federal Regulation D under SEC Rule 504 [*17 C.F.R. § 230.504*; *see § 6.54*; *see also* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*].
    - The federal Regulation D under SEC Rule 505 [*17 C.F.R. § 230.505*; *see § 6.55*; *see also* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*].
    - The federal Regulation D under SEC Rule 506 [*17 C.F.R. § 230.506*; *see § 6.56*; *see also* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*].

For reasons of space and format, it is impossible to include all other available exemptions in a table of this type. The selected exemptions are the ones most likely to be applicable to transactions involving the equity securities of nonpublic, closely held corporations in California. The offering may also be made in reliance on Section 4(2) of the Securities Act of 1933 for federal purposes if the transaction does not satisfy all of the criteria of Regulation D, but would otherwise qualify as a non-public offering. For a complete list of the California securities exemptions, see the table in § 6.200[2].

The *Corp. Code § 25102(e)* exemption, which is similar to the Section 4(2) exemption, may also be available for offerings of debt securities. Offerings for employee purchase or employee option plans may also be made in reliance on SEC Rule 701 and *Corp. Code § 25102(o)* if the conditions of those exemptions are satisfied.

[2] Chart

(Chart begins on next page.)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART IV. FORMS
A. Tables of Securities Exemptions

3-6 California Legal Forms--Transaction Guide §§ 6.202-6.209

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6.202[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART IV. FORMS
B. Worksheets

3-6 California Legal Forms--Transaction Guide § 6.210

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.210 Worksheet for Determining Available Exemptions

[1] Comment--Use of Form

This form is a basic worksheet designed to assist the attorney in determining what exemptions might be available in connection with a proposed securities transaction. It is geared towards commonly used exemptions in connection with the offer and sale of securities by a nonpublic or closely held entity. For a chart comparing various commonly used California and federal exemptions, see *§ 6.201*. For a table containing a complete list of the California statutory exemptions from the Corporate Securities Law, see *§ 6.200*.

This form is designed to be used as a basic worksheet at the outset of a transaction. It is not intended as an investor questionnaire or representation letter, nor is it intended to contain all the information that would be needed for making a final determination as to whether or not all potential investors would qualify for a particular exemption. Investor representation forms appropriate to specific exemptions appear in the chapters on those exemptions.

[2] FORM

Worksheet for Determining Available Exemptions

WORKSHEET

1. Nature of issuer (i.e., corporation or other type of business entity):

_____

2. State of organization; location of principal business office, and amount of payroll, sales, and property in California:

_____

3. Type, class, and number of securities to be issued; description of any special characteristics of securities:

_____

4. Aggregate offering price issuer hopes to obtain:

_____

5. Anticipated use of funds:

_____

6. Other securities of issuer outstanding, date of issuance, and whether they been qualified in California and/or registered under the federal securities laws, or exception under which filed:

_____

7. Outstanding convertible securities:

_____

8. Classes of stock authorized after transaction:

_____

9. Shareholder or other agreement that might create additional class of stock:

_____

10. Whether identity of some or all of purchasers are currently known:

_____

11. Number of known or anticipated purchasers:

_____

12. Nature of purchasers (institutional investors, private individuals, current shareholders, etc.):

_____

13. Relationship of purchasers to issuer:

_____

14. Names and addresses of any known prospective purchasers, with following information for each:

_____

- Natural person or entity: _____
- Address of residence or principal place of business: _____
- If entity, type of entity: _____
- Jurisdiction of organization: _____
- Is entity regulated or licensed by any agency: _____
- Proposed amount of investment: _____
- Net worth of purchaser: _____
- Annual income of purchaser: _____

- Sophistication of purchase: _____
- Advisors of purchaser: _____

15. If identities of all prospective purchasers are not yet known, how does issuer intend to find purchasers, and what form(s) of advertising does issuer intend to use to publicize the offering:

_____

16. Anticipated number of shareholders after transaction:

_____

17. Type of consideration anticipated:

_____



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART IV. FORMS
B. Worksheets

3-6 California Legal Forms--Transaction Guide §§ 6.211-6.229

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6.211[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART IV. FORMS
C. Miscellaneous Forms

3-6 California Legal Forms--Transaction Guide § 6.230

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.230 Request for Interpretive Opinion [Corp. Code § 25618; 10 Cal. Code Reg. § 250.12]

[1] Comment

[a] Use of Form

This form is a request for issuance of an interpretive opinion from the Commissioner of Corporations. The Commissioner may grant such a request in his or her discretion [*Corp. Code § 25618*]. These opinions are issued through the Department's Office of Legislation and Policy. An interpretive opinion (including a determination and a specific ruling) sets forth a written answer to resolve an unsettled question of law within the scope of responsibility of the Department of Corporations [Dept. Of Corps. Release No. 61-C (Revised; July 16, 2007)].

A public member named in the interpretive opinion may be protected from liability for acts or omissions done in good faith reliance upon the interpretive opinion [Dept. Of Corps. Release No. 61-C (Revised; July 16, 2007); *see, e.g., Corp. Code § 25700* (no liability for reliance on official opinion)].

[b] Contents of Request

The request must satisfy the following requirements [*10 Cal. Code Reg. § 250.12(a)*; Dept. of Corps. Release No. 61-C (Revised; July 16, 2007)]:

- Be in writing and addressed to the Commissioner in care of the Office of Legislation and Policy at the Department's Sacramento Office, 1515 K St., Suite 200, Sacramento, CA 95814

- Specifically state that it is a request for an interpretive opinion (if only informal guidance is desired, the request should so indicate);

- Name the principal parties to the proposed transaction, including the parties who may rely on the

opinion (such as the proposed issuer);

- Specify each legal question presented, and describe all relevant facts and circumstances (and when appropriate, enclose relevant documents such as copies of agreements or offering materials);

- Include an objective legal analysis with a reasoned conclusion for each question (based on applicable law and regulations, previous opinions, state and federal court decisions, no-action letters issued by the SEC, and other similar documents); and

- Make any confidentiality request in accordance with *10 Cal. Code Reg. § 250.10*.

The opinion will be applicable only to the transaction identified, and may not be relied upon in connection with any other transaction [*10 Cal. Code Reg. § 250.12(a)*].

The staff of the Office of Legislation and Policy are available to answer questions concerning interpretive opinions. For further assistance, contact that office at (916) 322-3553 [Dept. Corps. Release No. 61-C (Revised; July 16, 2007)].

[c] Discretion to Render Opinion

As stated above, the Commissioner has discretion to render interpretive opinions. Depending on the request for an interpretive opinion, the Commissioner may decline to exercise that discretion. Examples of interpretive opinion requests that may be declined by the Commissioner include the following [Dept. of Corp. Release No. 61-C (Revised; July 16, 2007)]:

- The request raises an issue that may be answered by reviewing applicable law, rules of the Commissioner, previous opinions and release, or other legal resources (public members should consult with private legal counsel to assist with an interpretive opinion request).

- The request fails to specify the parties involved in the transaction.

- The request fails to set forth a legal analysis applying relevant law to the facts.

- The request fails to include relevant facts or documents.

- The request fails to set forth a specific legal question.

- The request involves primarily a question of fact.

- The request raises a question involving a past transaction, a violation of law, ongoing litigation, or an enforcement matter.

- The request is from a person who cannot rely on the interpretive opinion.

- The request raises an issue beyond the scope of laws administered by the Department.

- The request involves an advisory or hypothetical opinion.

- The request fails to include complete information.

[d] Public Access to Requests and Replies

The Department of Corporations is authorized to select certain interpretive opinions for publication based on public interest in the legal questions considered.Furthermore, subject to *10 Cal. Code Reg. § 250.12*, interpretive opinions, whether or not published, and the correspondence relating to the opinions (including the original request) are considered public records [*10 Cal. Code Reg. § 250.9.1(e)*], and as such may be inspected by members of the public [*10 Cal. Code Reg. § 250.9*].

A person requesting an interpretive opinion may desire nondisclosure of the contents of the request or reply for any number of reasons [*see Ch. 6H, Qualification of Securities, § 6H.275*]. Requests for confidentiality are processed subject to the procedures in *10 Cal. Code Reg. §§ 250.10* and *250.10*. *510 Cal. Code Reg. § 250.12(c)*; *see Ch. 6H, Qualification of Securities, § 6H.275*].

[2] FORM

Request for Interpretive Opinion [Corp. Code § 25618; 10 Cal. Code Reg. § 250.12]

TO: COMMISSIONER OF CORPORATIONS
Office of Legislation and Policy
Department of Corporations
1515 K St., Suite 200
Sacramento, CA 95814

REQUEST FOR AN INTERPRETIVE OPINION PURSUANT TO SECTION 25618 OF THE CORPORATIONS CODE

Names of Principal Parties to Transaction

The persons concerning whom an interpretive opinion is requested are as follows [*include names of all natural persons and entities involved in the proposed transaction, including parties who may rely on the opinion*]:

_____
_____
_____

Facts and Circumstances

[*State fully, e.g.*, On _____ (*date*), XYZ Corporation issued 5,000 shares each to _____ (*name*) and _____ (*name*), pursuant to the exemption provided by *Corporations Code Section 25102(h)*. No other shares of XYZ Corporation are outstanding. The certificates representing the outstanding shares bear the legend condition set forth in Rule 102.6. In addition, the transfer of these shares is restricted pursuant to the bylaws of XYZ Corporation adopted prior to their issuance. At this time, each of the two shareholders proposes to transfer _____ (his *or* her) shares to both shareholders as joint tenants with right of survivorship. XYZ Corporation and both shareholders are willing to waive their rights under the bylaws to purchase the shares prior to a transfer.]

Legal Questions

[*List, e.g.,* 1. Will the proposed transfer be exempt from the requirement of prior written consent of the Commissioner?

2. Will the transfer to the surviving shareholder upon the death of one of the joint tenants be exempt from the requirement of the prior written consent of the Commissioner?

3. Is the waiver by XYZ Corporation and the shareholders of rights to purchase shares prior to a transfer either a transfer requiring the prior written consent of the Commissioner or a change in the rights, preferences, privileges, or restrictions of or on the shares requiring qualification under *Corporations Code Section 25120*, because _____.]

Legal Analysis

[*List, e.g.,* 1. It is my opinion that the proposed transfer is exempt from the requirement of the Commissioner's written consent by virtue of Rule 102.6, which provides an exemption for the transfer of securities to holders of securities of the same class of the same issuer, because both _____ (*name*) and _____ (*name*) hold common shares of XYZ Corporation at the present time.

2. For the reason stated in 1, it is my opinion that the transfer by operation of law upon the death of either shareholder would also be exempt from the requirement of the Commissioner's written consent.

3. Further, it is my opinion that the waiver of rights to purchase shares prior to the transfer by XYZ Corporation and the shareholders would not constitute a "transfer" within the meaning of Rule 102.6, nor would it constitute a change in the rights, preferences, privileges, or restrictions on the shares which would substantially and adversely affect the shareholders and therefore require qualification under *Corporations Code Section 25120*, because _____.]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART IV. FORMS
C. Miscellaneous Forms

3-6 California Legal Forms--Transaction Guide § 6.231

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.231 Request for Designation as Exempt Life Income Contract Issuer [Corp. Code § 25100(k); 10 Cal. Code Reg. § 260.100.1]

[1] Comment--Use of Form

This form is an application for an exemption from qualification under the life income contract exemption in *Corp. Code § 25100(k)*. A "life income contract" is defined as an agreement between the issuer and a donor that, in consideration of a donation of property (which must be irrevocable) to the issuer (and only the issuer), provides for the payment to the donor or persons designated by the donor, for the life of the donor or other persons, of a variable return measured or determined either by the original value of the donated property or the return on designated assets which may be other than the donated property [*10 Cal. Code Reg. § 260.100.2*].

The life income contract exemption is restricted and exclusive. An ordinary annuity contract by a licensed insurance company is not a security and need not be qualified [*Corp. Code § 25019*]. Another type of annuity, which is an estate planning device, is a transfer of property to a nonprofit organization in exchange for the payment of an annuity by the nonprofit organization to the transferor. This type of annuity is exempt from qualification if the nonprofit organization (considered the issuer in this transaction) is organized exclusively for educational, benevolent, fraternal, religious, charitable, social, or reformatory purposes and not for pecuniary profit, and is within the class of exempt organizations designated by the Commissioner by rule or order [*Corp. Code § 25100(k)*]. The Commissioner has by rule designated only one class of nonprofit organization that automatically qualifies as an issuer under the exemption. That class includes any nonprofit college or university having total endowment funds, including annuity and life income funds, amounting, according to its most recent audited financial statement, to not less that $2 million [*10 Cal. Code Reg. § 260.100*]. Any other nonprofit organization desiring to be designated as an issuer subject to the exemption must apply to the Commissioner for an order so designating it as an issuer subject to the exemption [*10 Cal. Code Reg. § 260.100.1*]. The application for the order must be made on the form reproduced in this form [*10 Cal. Code Reg. § 260.100.1*] and must be accompanied by a filing fee of $50 [*Corp. Code § 25608(d)*; *but see Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum fee set forth in *Corp. Code § 25608*)].

[2] FORM

Request for Designation as Exempt Life Income Contract Issuer [Corp. Code § 25100(k); 10 Cal. Code Reg. § 260.100.1]

File No. _____
(Insert file number of previous filings before the Department, if any.)

Fee: $50

Date of Request: _____

DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

Request for designation as an exempt organization pursuant to Subdivision (k) of Section 25100 of the Corporate Securities Law of 1968.

1. _____
(Name of Applicant)

2. _____
(Principal business address of applicant)

3. _____
(State whether applicant is a corporation, trust or other entity)

4. Is applicant organized exclusively for educational, benevolent, fraternal, religious, charitable, social, or reformatory purposes and not for pecuniary profit?

5. _____
(Name and address of person to whom correspondence regarding this request for designation should be addressed.)

6. Describe briefly the type of activities engaged in by the applicant.

7. There are attached hereto as exhibits, if applicable, the following which are hereby incorporated by reference:

A. Financial statements, including a balance sheet of recent date and a profit and loss statement for each of the three fiscal years preceding the date of the balance sheet. The balance sheet and profit and loss statements should reflect all assets acquired from donors of property in consideration of the payment to the donor or other persons of income or specified periodic payments.

B. A list containing the complete names and other business affiliations of the directors, officers, trustees and/or other persons who will be charged with the activities and operation of the applicant.

C. A statement setting for the scope and nature of any investment advisory services that the applicant has utilized or proposes to utilize, or (if no such services are utilized) the investment experience of the persons to manage the investment portfolio.

D. An opinion of counsel with respect to the tax consequences to the prospective donors of property.

The applicant has duly caused this application to be signed on its behalf by the undersigned, thereunto duly authorized.

_____
(Applicant)

By _____

_____
(Title)

I certify (or declare) under penalty of perjury under the laws of the State of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed at _____[*place*], on _____[*date*].

_____
(Signature of Declarant)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6 SECURITIES REGULATION ISSUES
PART IV. FORMS
C. Miscellaneous Forms

3-6 California Legal Forms--Transaction Guide § 6.232

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6.232 Request for Order of Exemption for Short-Term Commercial Paper [Corp. Code § 25100(l); 10 Cal. Code Reg. § 260.100.3]

[1] Comment--Use of Form

This form is a request for exemption for short-term commercial paper. *Corp. Code § 25100(l)* exempts short-term commercial paper from the qualification requirements of *Corp. Code §§ 25110*, *25120*, and *25130*, as long as the note, draft, bill of exchange, or banker's acceptance is freely transferable and of prime quality, arises out of a current transaction (or the proceeds of the instrument are to be used or have been used for a current transaction), is payable within nine months, and is offered to the public in amounts not less than $25,000 [*Corp. Code § 25100(l)*].

An issuer may request an exemption for instruments that meet all of the conditions listed above, except that the securities are to be offered in amounts of less than $25,000 in the aggregate to any one purchaser [*10 Cal. Code Reg. § 260.100.3(a)*]. The order of exemption, if granted, is good for a period of one year (unless a different period is specified in the order), and may be renewed for additional periods upon submission and approval of subsequent requests for an order of exemption [*10 Cal. Code Reg. § 260.100.3(a)*]. The order of exemption applies only to the securities described in the request when offered and sold in the manner described in the request for the order [*10 Cal. Code Reg. § 260.100.3(a)*]. This form is used to request such an order as prescribed by *10 Cal. Code Reg. § 260.100.3(b)*.

[2] FORM

Request for Order of Exemption for Short-Term Commercial Paper [Corp. Code § 25100(l); 10 Cal. Code Reg. § 260.100.3]

File No. _____

Date of Request: _____

DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

REQUEST FOR ORDER OF EXEMPTION PURSUANT TO SUBDIVISION (*l*) OF SECTION 25100 OF THE CORPORATE SECURITIES LAW OF 1968

1. _____
(Name of Issuer)

2. _____
(Address of Principal Executive Office of Issuer)

3. a. Is Issuer a corporation, partnership, bank, trust or other entity?
_____

b. State of incorporation or jurisdiction under which organized.
_____

4. Name and address of person to whom correspondence regarding this request should be addressed:
_____

5.

(a) Title of Securities	(b) Maturities (days or months) Min.-Max.	(c) Denominations Min.-Max.	(d) Renewable (yes or no)	(e) Minimum investment
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

(f) Average dollar amount of such securities in minimum investments of less than $25,000 outstanding during previous 12 months		(g) Average dollar amount of such securities outstanding during previous 12 months	
California	Total	California	Total
$_____	$_____	$_____	$_____
_____	_____	_____	_____

6. Briefly describe the business done by the Issuer and its parent or subsidiaries.

7. Briefly describe the class or classes of persons to whom the securities will be offered and the manner in which such persons will be solicited for such offers. Explain the suitability of the security as an investment for the individuals to whom offers are made and explain any relationships between such individuals and the Issuer. Attach copies of any advertising or other information disclosing the nature of the investment that is utilized in the solicitation process.

8. Briefly describe the terms of the securities, including renewal provisions or "roll-over" features. Describe the relationship between denomination, maturity, and rate of return, and the manner in which the Issuer establishes the rate of return. Explain whether the securities are sold at a discount or whether periodic interest payments are made. Attach a

specimen certificate for each type of security to be issued pursuant to this exemption evidencing the security to be issued.

9. State the principal transactions out of which the securities arise or the principal purposes for which the net proceeds of the sales of such securities are to be used and the approximate amount intended to be used for each such transaction or purpose.

10. Attach as exhibits, if applicable, the following which are hereby incorporated by reference:

a. Financial statements of the Issuer as required by *Section 260.613 of Title 10 of the California Code of Regulations.*

b. Copies of the Issuer's most recent Form 10-K and Form 8-K filings with the Securities and Exchange Commission (or the filings of the parent if the Issuer has not made such filings).

c. Copies of each of the most recent ratings by nationally recognized statistical rating organizations of the Issuer's securities issuable pursuant to the exemption under Section 25100(l), or a description thereof if copies are not available.

d. A schedule which sets forth the Issuer's ratio of earnings to fixed charges, current ratio, quick asset ratio and inventory turnover (all based on the Issuer's most current financial information).

e. A copy of any "no action" letters issued by the Securities and Exchange Commission regarding whether the Issuer's securities are exempt from the registration requirements of the Securities Act of 1933 pursuant to Section 3(a)(3). If no such letters have been requested or received, attach an opinion of counsel that such securities are so exempt.

11. Are any of the Issuer's securities in default?

12. Describe any material changes which may have occurred subsequent to the dates of any financial statements or information submitted. Is the Issuer aware of any information which would give rise to questions regarding the ratings disclosed under Item 10c? If so, describe the information.

13. There is no adverse order, judgment or decree entered in connection with Issuer's debt securities that are exempt pursuant to Section 25100(l), or similar exemption in another jurisdiction, or Section 3(a)(3) of the Securities Act of 1933, by any state regulatory authority, any court, or the Securities and Exchange Commission, except as follows: (If none, so state)

14. Submit any additional statements or information which will assist the Commissioner in determining whether qualification of such securities is necessary or appropriate in the public interest or for the protection of investors.

15. The Issuer agrees, in the event it does not reapply for an exemption under Subdivision (l) of Section 25100, to furnish the information specified in Item 5 above for the period during which the exemption herein applied for is in effect, if granted, within 90 days after the expiration of such exemption.

The Issuer has duly caused this request to be signed on its behalf by the undersigned, thereunto duly authorized.

_____
(Issuer)

By _____

_____
(Title)

I certify (or declare) under penalty of perjury under the laws of the State of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed at _____[*place*], on _____[*date*].

_____
(Signature of Declarant)

Instruction

It is recognized that if this is the Issuer's first request for Order of Exemption, some of the information requested by this application may not be available to the Issuer. If any requested information is not available, the Issuer shall so state and explain why the information is not available. The Commissioner expects that all Issuers who intend to apply for this Order of Exemption on a continuous basis will take appropriate action subsequent to the initial request to obtain information that was unavailable for this request for submission in subsequent requests for Order of Exemption pursuant to Section 25100(l).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS

3-6A California Legal Forms--Transaction Guide 6A.syn

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.syn Synopsis to Chapter 6A: FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS

§ 6A.01 California Sources

[1] Statutes

[2] Regulations

§ 6A.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 6A.03-6A.04 [Reserved]

§ 6A.05 Law Reviews and Periodicals

§ 6A.06 Text References

§§ 6A.07-6A.19 [Reserved]

§ 6A.20 Introduction to Nonpublic Securities Transactions

[1] Private Corporation Securities Offerings

[2] Federal Laws and Regulations

§ 6A.21 Overview of Federal Registration Requirements

[1] Scope of Federal Securities Laws

[a] Securities Act

[b] Exchange Act

[2] Consequences of Going Public

[a] Benefits

[b] Burdens

[3] Registration Exemptions

[4] Securities Act Registration Process

[a] In General

[b] All Issuers: Form S-1

[c] SEC Review

§ 6A.22 Overview of Exemptions From Securities Act Registration

[1] Statutory Exemptions

[a] Intrastate Offering--Section 3(a)(11) Exemption

[b] Small Offering--Section 3(b) Exemption

[c] Private Offering--Section 4(2) Exemption

[d] Accredited Investor--Section 4(6) Exemption

[2] Regulatory Exemptions

[a] Small Offering--Regulation A Exemption

[b] Offering of $1 Million in 12 Months--Rule 504 Exemption

[c] Offering of $5 Million in 12 Months--Rule 505 Exemption

[d] Private Offering--Rule 506 Exemption

[e] Sale Through Employee Benefit Plan--Rule 701 Exemption

§ 6A.23 Coordination of Federal and California Registrations and Exemptions

[1] In General

[a] Regulation A Offering

[b] Rule 506 Offering

[2] Coordinated Offering Registrations

[a] Small Company Offering Registration (SCOR)

[b] Coordinated Equity Review (CER)

[3] Regulation CE Exemption for California Qualified-Purchaser Offering

[4] Rule 701 Offering

§ 6A.24 Intrastate Offering Under Section 3(a)(11)

[1] In General

[a] Conditions for Exemption

[b] Limited Scope of Rule 147

[2] Rule 147 Compliance

[a] Integration

[b] Qualified Issuer

[c] Qualified Buyers

[d] Resale Limitation

[e] Compliance Precautions

[3] Proof of Section 3(a)(11) Exemption Compliance

§ 6A.25 Small Offering Under Section 3(b) and Regulation A

[1] Scope of Exemption

[a] In General

[b] Eligible Issuer

[c] Limit on Aggregate Offering Price

[d] Nonintegration With Other Offerings

[e] Offers

[f] Sales

[2] Offering Circular

[a] Contents

[b] Revisions and Updates

[3] Solicitation of Interest

[a] Permitted Activity

[b] Submission of Materials to SEC

[4] Preliminary Offering Circular

[5] Filing of Sales Information

[6] Suspension of Exemption

[a] Grounds for Suspension

[b] Procedure

[7] Withdrawal or Abandonment of Offering Statement

[8] Insignificant Deviations From Requirements

[9] Disqualification

[a] Disqualifying Act by Issuer or Affiliate

[b] Disqualifying Act by Insider or Underwriter

[c] Disqualifying Act by Underwriter

§ 6A.26 $1 Million Offering Under Section 3(b) and Rule 504

[1] Scope of Exemption

[2] Eligible Issuer

[3] General Conditions for Exemption

[a] Integration

[b] Limitation on Manner of Offering

[c] Limitations on Resale

[4] Aggregate Offering Price

[5] Offering Statement and Notice of Sales

§ 6A.27 $5 Million Offering Under Section 4(6) and Rule 505

[1] Scope of Exemption

[2] Disclosure

[a] Requirement

[b] Nonreporting Company's Information

[c] Reporting Company's Information

[d] Additional Information

[3] Aggregate Offering Price

[4] Limitation on Buyers

[5] Offering Statement and Notice of Sales

[6] Disqualification

§ 6A.28 Private Offering Under Section 4(2) and Rule 506

[1] Scope of Exemption

[2] Disclosure

[a] Requirement

[b] Nonreporting Company's Information

[c] Reporting Company's Information

[d] Additional Information

[3] Aggregate Offering Price

[4] Limitations on Buyers

[5] Offering Statement and Notice of Sales

§ 6A.29 Insignificant Deviations From Requirements

§ 6A.30 Sale Through Employee Benefit Plan Under Section 3(b) and Rule 701

[1] Scope of Exemption

[a] In General

[b] Eligible Issuer

[c] Definitions

[d] Requirements for Consultants and Advisers

[e] Brother-Sister Subsidiary Employees

[f] No Limitation on Offers

[2] Limitation on Sales

[a] Computation Formula

[b] Compliance Guidance

[3] Disclosure

[a] Requirement

[b] Parent's Financial Statements

[c] Time for Disclosure

[d] Compliance Guidance

[4] Resale Limitations

§§ 6A.31-6A.99 [Reserved]

§ 6A.100 Facts

Scope

§ 6A.101 Documents

Scope

§§ 6A.102-6A.109 [Reserved]

§ 6A.110 Intrastate Offering in California Under Section 3(a)(11)

Scope

§ 6A.111 Small Offering Under Section 3(b) and Regulation A

Scope

§ 6A.112 Offerings Under Regulation D Exemptions

[1] Requirements for All Offerings

Scope

[2] Rule 504--Small or Limited Offering

Scope

[3] Rule 505--Accredited Investor Offering

Scope

[4] Rule 506--Private Offering

Scope

§ 6A.113 Complying With Filing Requirements

[1] Regulation A Offerings

Scope

[2] Regulation D Offerings

Scope

[3] Documenting Exemption Compliance

Scope

§§ 6A.114-6A.199 [Reserved]

§ 6A.200 Offering Statement Under Regulation A (SEC Form 1-A)

[1] Comment

[a] Use of Form

[b] Contents

[c] Signatures, Copies, and Filing

[d] Delaying Notation

[e] Amendments

[2] FORM

Offering Statement Under Regulation A (SEC Form 1-A)

§ 6A.201 Report of Sales Under Regulation A (SEC Form 2-A)

[1] Comment--Use of Form

[2] FORM

Report of Sales Under Regulation A (SEC Form 2-A)

§ 6A.202 Notice of Sale Under Regulation D (SEC Form D)

[1] Comment

[a] Use of Form

[b] Electronic Filing Required

[c] Amendments

[2] FORM

Notice of Sale Under Regulation D (SEC Form D)

§ 6A.203 Small Corporate Offering Registration (NASAA Form U-7)

[1] Comment--Use of Form

[2] FORM

Small Corporate Offering Registration (NASAA Form U-7)

§ 6A.204 Investment Letter for Intrastate Offerings

[1] Comment--Use of Form

[2] Form

Investment Letter for Intrastate Offerings

§ 6A.205 Investment Letter for Private Placements

[1] Comment--Use of Form

[2] Form

Investment Letter for Private Placements

§ 6A.206 Investor Questionnaire

[1] Comment--Use of Form

[2] Form

Investor Questionnaire

Frances E. Lossingn*
Practice Consultant

FOOTNOTES:

(n32)Footnote *. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS

3-6A California Legal Forms--Transaction Guide Scope

AUTHOR: Frances E. Lossing Practice Consultant

Scope

Frances E. Lossingn*
Practice Consultant Scope

This chapter covers methods commonly used by California nonpublic corporations to comply with the federal Securities Act of 1933. The chapter deals with simplified registration for small offerings under SEC Regulation A, and exemptions from federal registration, including those available under SEC Regulation D. Coordination of California and federal exemptions is also discussed.

Commonly used exemptions under California law are discussed in Ch. 6B, *California Limited Offering Exemptions* [*see Corp. Code §§ 25102(f), (d)*], Ch. 6C, *California Small Offering Exemption* [*see Corp. Code § 25102(h)*], and Ch. 6D, *California Qualified Purchaser Exemptions* [*see Corp. Code § 25102(i), (n)*]. See Ch. 6, *Securities Regulation Issues* , for a comparison of the various exemptions and guidance on determining which exemption would best serve the issuer's plan for raising capital by selling its equity securities.

For detailed discussion of federal registration requirements under the Securities Act of 1933, see Sommer, Federal Securities Act of 1933 (Matthew Bender).

FOOTNOTES:
(n33)Footnote *. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

3-6A California Legal Forms--Transaction Guide § 6A.01

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.01 California Sources

[1] Statutes

Exemptions under Corporate Securities Law of 1968. *Corp. Code § 25100 et seq.*

[2] Regulations

Rules of Corporations Commissioner. *10 Cal. Code Reg. § 250.9 et seq.*

Corporations Commissioner's Releases. The Commissioner periodically publishes releases that set forth information concerning the regulatory activities of the Commissioner, inform practitioners as to policies, or disclose interpretive opinions [*10 Cal. Code Reg. § 260.608(b)*]. Attorneys can obtain releases from the Commissioner by being placed on a mailing list for distribution of Corporate Securities law material at a cost of $10 per year [*10 Cal. Code Reg. § 260.608(c)(5)*]. Releases are also reproduced in Ballantine & Sterling, California Corporation Laws, vol. 7 (Matthew Bender), in Marsh & Volk, Practice Under the California Securities Laws, Appendix A-4 (Matthew Bender), and in the California Corporation Code(Matthew Bender). Recent releases and opinions are also posted on the Department of Corporations website which is located at http://www.corp.ca.gov.

California participation in Coordinated Equity Review (CER) program of North American Securities Administrators Association (NASAA). Dept. of Corps. Release No. 111-C (Apr. 16, 1998).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

3-6A California Legal Forms--Transaction Guide § 6A.02

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.02 Federal Sources

[1] Statutes

Securities Act of 1933. *15 U.S.C. § 77a et seq.*

Section 2: Definitions. *15 U.S.C. § 77b(a)*.

Section 3: Exempt securities. *15 U.S.C. § 77c*.

Section 4: Exempt transactions. *15 U.S.C. § 77d*.

Sections 5 and 6: Registration requirement. *15 U.S.C. §§ 77e(c), 77f*.

Section 18: Exemption from state regulation of securities offerings. *15 U.S.C. § 77r*.

Section 20: Injunctions and prosecution of offenses. *15 U.S.C. § 77t*.

Securities Exchange Act of 1934. *15 U.S.C. § 78a et seq.*

[2] Regulations

General rules and regulations under Securities Act of 1933. *17 C.F.R. § 230.100 et seq.*

SEC Regulation A: Conditional small-issues exemption from registration under Securities Act of 1933. *17 C.F.R. § 230.251 et seq.*

[Rule 251] Scope of exemption. *17 C.F.R. § 230.251*.

[Rule 252] Offering statement. *17 C.F.R. § 230.252*.

[Rule 253] Offering circular. *17 C.F.R. § 230.253*.

[Rule 254] Solicitation of interest document for use before offering statement. *17 C.F.R. § 230.254*.

[Rule 255] Preliminary offering circulars. *17 C.F.R. § 230.255*.

[Rule 256] Filing of sales material. *17 C.F.R. § 230.256*.

[Rule 257] Reports of sales and use of proceeds. *17 C.F.R. § 230.257*.

[Rule 258] Suspension of exemption. *17 C.F.R. § 230.258*.

[Rule 259] Withdrawal or abandonment of offering statements. *17 C.F.R. § 230.259*.

[Rule 260] Insignificant deviations from term, condition or requirement of Regulation A. *17 C.F.R. § 230.260*.

[Rule 261] Definitions. *17 C.F.R. § 230.261*.

[Rule 262] Disqualification provisions. *17 C.F.R. § 230.262*.

SEC Regulation D: Rules governing limited offer and sale of securities without registration under Securities Act of 1933. *17 C.F.R. § 230.501 et seq.*

[Rule 501] Definitions and terms used in Regulation D. *17 C.F.R. § 230.501*.

[Rule 502] General conditions to be met. *17 C.F.R. § 230.502*.

[Rule 503] Filing of notice of sales. *17 C.F.R. § 230.503*.

[Rule 504] Exemption for limited offerings and sales of securities not exceeding $1 million. *17 C.F.R. § 230.504*.

[Rule 505] Exemption for limited offers and sales of securities not exceeding $5 million. *17 C.F.R. § 230.505*.

[Rule 506] Exemption for limited offers and sales without regard to dollar amount of offering. *17 C.F.R. § 230.506*.

[Rule 507] Disqualifying provision relating to exemptions under Rule 504, Rule 505, and Rule 506. *17 C.F.R. § 230.507*.

[Rule 508] Insignificant deviations from term, condition or requirement of Regulation D. *17 C.F.R. § 230.508*.

Exemption for offers and sales of securities pursuant to certain compensatory benefit plans and contracts relating to compensation. *17 C.F.R. § 230.701*.

Exemption for transactions exempt from qualification under *Corp. Code § 25102(n)*. *17 C.F.R. § 230.1001*.

Documents filed under Regulation A or Regulation D must be submitted in paper form only (not eligible for electronic filing). *17 C.F.R. § 232.101(c)(6).*

SEC forms pertaining to exemptions. *17 C.F.R. § 239.90 et seq.*

Intrastate offering exemption. SEC Release No. 33-4434.

Private offering exemption. SEC Release No. 33-4552.

Rule 701. SEC Release No. 33-7645.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

3-6A California Legal Forms--Transaction Guide §§ 6A.03-6A.04

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6A.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6A California Legal Forms--Transaction Guide § 6A.05

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.05 Law Reviews and Periodicals

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6A California Legal Forms--Transaction Guide § 6A.06

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.06 Text References

Marsh & Volk, Practice Under the California Securities Laws, Ch. 3A, *Federal Preemption of State Securities Regulation* (Matthew Bender).

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6A California Legal Forms--Transaction Guide §§ 6A.07-6A.19

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6A.07[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART II. LEGAL BACKGROUND

3-6A California Legal Forms--Transaction Guide § 6A.20

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.20 Introduction to Nonpublic Securities Transactions

[1] Private Corporation Securities Offerings

There are three ways of raising money for a business: owner investing, borrowing, and retaining profits. A corporation selling equity securities--that is, shares of stock and related items (such as warrants)--is pursuing owner investing. Private corporations may sell "securities" [for California definition of "security" under *Corp. Code § 25019*, *see* Ch. 6, *Securities Regulation Issues*] subject to regulation under federal and state laws, but the transactions often are exempt from registration because they are small in dollar amount, or they are restricted to a limited number or type of investors, or both. These exempt offerings of securities may be called limited private offerings and can involve debt as well as equity securities (such as convertible debt, which would be a debt instrument entitling the holder to convert to an equity interest) [for discussion of debt securities, *see* Ch. 6J, *Issuance of Debt Securities*]. By using limited private offerings, corporations can avoid much of the cost and delay of a public offering.

[2] Federal Laws and Regulations

In this chapter "Securities Act" and "Exchange Act" are used in lieu of the longer titles for the two principal federal laws governing securities: the Securities Act of 1933 [*see 15 U.S.C. § 77a et seq.*] and the Securities Exchange Act of 1934 [*see 15 U.S.C. § 78a et seq.*], respectively.

The Securities Act imposes a registration requirement [*see 15 U.S.C. §§ 77e(c), 77f*] that must be met before securities may lawfully be offered or sold, but also specifies numerous exemptions from the registration requirement. These exemptions are contained in two sections. One section lists exempted securities (identified sometimes by type of issuer, sometimes by type of security) [*see 15 U.S.C. § 77c*]; the other section lists exempted transactions [*see 15 U.S.C. § 77d*]. These sections address the following issues [*see § 6A.22[1]*]:

- Intrastate offerings [*see 15 U.S.C. § 77c(a)(11)*];
- Small or limited offerings [*see 15 U.S.C. § 77c(b)*];

- Offerings to accredited investors [*see 15 U.S.C. § 77d(6)*]; and

- Private offerings [*see 15 U.S.C. § 77d(2)*].

The federal Securities and Exchange Commission (SEC), which enforces and interprets the securities laws, has fleshed out these statutory exemptions in the following rules and regulations:

- Intrastate offerings are covered by SEC Rule 147 [*see 17 C.F.R. § 230.147*; *see also § 6A.24*].

- SEC Regulation A [*see 17 C.F.R. § 230.251 et seq.*] covers the small-or-limited-offering exemption [*see § 6A.22[2][a]*].

- SEC Regulation D [*see 17 C.F.R. § 230.501 et seq.*] covers small offerings, offerings to accredited investors, and private offerings; and these have come to be identified with the three principal governing rules [*see § 6A.22[2][b]-[d]*]: Rules 504, 505, and 506 [*see 17 C.F.R. §§ 230.504-230.506*].

- SEC Rule 701 applies to sales through employee benefit plans [*see 17 C.F.R. § 230.701*; *see also § 6A.22[2][e]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawAdditional Offerings & the Securities Exchange Act of 1934Registration RequirementsSecurities LawBlue Sky LawsSecurities RegistrationSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART II. LEGAL BACKGROUND

3-6A California Legal Forms--Transaction Guide § 6A.21

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.21 Overview of Federal Registration Requirements

[1] Scope of Federal Securities Laws

[a] Securities Act

The Securities Act generally requires a corporation, when undertaking to sell its securities, to give potential investors full disclosure of all material facts--facts that investors would find important in making an investment decision [*see 15 U.S.C. § 77j* (information required in prospectus)]. The Act also requires the corporation to file a registration statement with the SEC that includes information for investors, unless the offering is exempt [*see 15 U.S.C. § 77e*]. The SEC does not evaluate the merits of offerings or determine whether the securities offered are good investments. The SEC's staff only reviews a registration statement and declares it "effective" if it satisfies the Act's disclosure requirements.

PRACTICE TIP:

SEC disclosure requirements may, however, impact the business of the issuer. For instance, all financial statements must be prepared in accordance with generally accepted accounting principles and Regulation S-X [*17 C.F.R. § 210.1-01 et seq.*]. These requirements may alter the manner in which the company has previously prepared its financial statements. As a result, the company may find that its revenues, earnings and assets are reduced or its liabilities increased. A company may also prefer to alter certain of its business practices regarding compensation of officers and directors, affiliate transactions or other matters rather than disclose these practices. A company may also be concerned about disclosure of sensitive business information which it believes may be of value to its competitors. *Commentary by Frances E. Lossing.*

Basically the owners of a nonpublic corporation can raise money through the sale of its securities in one of two ways: by either "going public," which requires registration with the SEC, or qualifying the sale under one of several specific statutory and regulatory exemptions from the registration requirement.

[b] Exchange Act

Under the Exchange Act, a corporation that has not filed a registration statement under the Securities Act will be required nonetheless to file an Exchange Act registration statement on Form 8-A if and when one of these conditions is satisfied:

- The corporation's securities become exchange-listed [*see 15 U.S.C. § 78l(b)*].

- The corporation has either a class of equity securities with 500 or more shareholders and has total assets exceeding $1 million at the end of its last two fiscal years or a class of equity securities with 750 or more shareholders and has total assets exceeding $1 million at the end of its last fiscal year, and the corporation is engaged in interstate commerce [*see 15 U.S.C. § 78l(g)*; *17 C.F.R. § 240.12g-1*].

A corporation that has filed an Exchange Act registration statement is subject to reporting requirements [*see 15 U.S.C. § 78m*] and is commonly known as a reporting company. Major shareholders, officers, and directors of the corporation also may be subject to reporting requirements [*see 15 U.S.C. § 78m(d)*]. In addition, the corporation will be subject to regulatory oversight of proxies and tender offers.

Each issuer that has filed a registration statement with the SEC will be subject to the reporting requirements. This duty will be suspended if, at the beginning of the fiscal year following the date of the registration statement, the issuer's securities are held of record by less than 300 holders [Exchange Act § 15(d), *15 U.S.C. § 78o(d)*]. Some issuers who fall below the 300 holder limit may nevertheless continue to file registration statements pursuant to undertakings made to shareholders in a previous offering or otherwise to assist the corporation in its capital-raising activities.

[2] Consequences of Going Public

[a] Benefits

The potential benefits of going public may include the following:

- Access to capital will increase because there will be relatively more potential investors.

- The corporation may become more widely known.

- The corporation may obtain financing more easily in the future if investor interest in the corporation grows enough to sustain a secondary market in its securities.

- Controlling shareholders, officers, and directors may have a ready market for their shares, which means that they can more easily sell their interests at retirement, for diversification, or for some other reason.

- The corporation may be able to attract and retain more highly qualified personnel if it can offer stock options, bonuses, and other incentives with a known market value.

- The image of the corporation may be improved.

[b] Burdens

However, public corporations have obligations that the owners of a nonpublic corporation might be unable or unwilling to meet. The following are some of the reasons for qualifying under an exemption in order to avoid going public:

- A public corporation must continually keep shareholders informed about business operations, financial condition, and management, thus incurring additional costs and new legal obligations.

- A public corporation must regularly file reports with the SEC (although reporting can be suspended as long as the corporation has only a few hundred shareholders), and the filed reports become public documents.

- Officers, directors, and major shareholders may become liable if the corporation does not fulfill the new legal obligations.

- Major shareholders, officers and directors may be subject to restrictions on their ability to sell stock in the company

- Major shareholders, officers, and directors may be required to file reports with the SEC, disclosing information about their share holdings and transactions; and the filed reports become public documents.

- Current shareholders, officers, and directors may lose some flexibility in managing the corporation's affairs, particularly when shareholders must approve actions.

- A public offering will take time and money to accomplish.

PRACTICE TIP:

It is recommended that counsel for the issuer prepare a memorandum for an issuer which has just gone public outlining compliance procedures which will need to be established by the issuer in order to satisfy the issuer's new obligations under the Securities Act and the Exchange Act. This type of memorandum may also be useful in helping a company decide whether the benefits of going public out weigh the burdens. *Commentary by Frances E. Lossing.*

[3] Registration Exemptions

In general, issues of securities must be registered with the SEC unless an exemption is available. Registration documents include detailed disclosure, historical financial statements, and third-party audits, which take time to prepare. The process usually requires many hours of work by attorneys, accountants, and investment bankers, and the SEC's review can last 60 days or longer. Registration alone can cost tens of thousands of dollars even before the offering yields any capital (if it ever does).

A private placement, however, is exempt from federal registration. Exemptions have always been available under the Securities Act, but the original exemption provisions contained in Sections 3(b) and 4(2) [*see 15 U.S.C. §§ 77c(b), 77d(2)*] are vague and therefore may be risky for small corporations to invoke. In 1982, the SEC adopted Regulation D [*see 17 C.F.R. § 230.501 et seq.*], which sets forth objective and quantifiable rules for exemptions from federal registration. Offerings exempt under Rule 504, Rule 505, and Rule 506 of Regulation D have become the most common methods for small and growing companies to raise capital from private investors. Other exemptions which may be available for offerings in California are the intrastate offering exemption and the Regulation CE exemption. These statutory and regulatory exemptions are discussed in this chapter and briefly described in § 6A.22.

An offering that is exempt from registration requirements of the federal securities laws may nevertheless be subject to notice and filing requirements under California law, or the offering may be exempt from those requirements as well. The California requirements for nonexempt transactions are discussed in Ch. 6H, *Qualification of Securities* . California exemptions are discussed in Ch. 6B, *California Limited Offering Exemptions* , Ch. 6C, *California Small Offering Exemption* , and Ch. 6D, *California Qualified Purchaser Exemptions* . This chapter covers coordination of

federal and California exemptions in § 6A.23.

All securities transactions, even exempt transactions, are subject to the antifraud provisions of the federal securities laws, such as Section 17(a) of the Securities Act [*15 U.S.C. § 77q(a)*], Section 10(b) of the Exchange Act [*15 U.S.C. § 78j(b)*], and *Rule 10b-5* [*17 C.F.R. § 240.10b-5*]. The corporation and responsible individuals will be liable for false or misleading statements, whether oral or written. The SEC and other agencies can enforce the antifraud provisions through criminal, civil, and administrative proceedings. Enforcement also may be pursued through private law suits. Unless all conditions of an exemption are met, the buyers of the securities may be able to obtain rescission and restitution.

[4] Securities Act Registration Process

[a] In General

If a corporation intends to make a registered public offering, the Securities Act requires the corporation to file a registration statement with the SEC before the corporation can offer the securities for sale [*see 15 U.S.C. § 77e*]. The corporation may not sell the securities covered by the registration statement until the SEC's staff has declared the registration statement to be "effective," even though the registration statement becomes public immediately on filing.

Registration statements have two principal parts [*see generally 17 C.F.R. § 230.400 et seq.*]:

- Part I is the prospectus, which is the offering document. The corporation, which is referred to as the "issuer" of the securities, must describe in the prospectus the important facts about its business operations, financial condition, and management [*see 15 U.S.C. § 77j*]. The issuer must "present the information in a prospectus in a clear, concise and understandable manner" according to specified standards [*17 C.F.R. § 230.421(b)*]. There is a requirement to "use plain English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors section" [*17 C.F.R. § 230.421(d)(1)*; *see 17 C.F.R. § 230.421(d)(2)* (six principles)]. Everyone who buys any of the securities in the new issue, as well as anyone who is solicited to buy the securities, must have access to the prospectus.

- Part II contains additional information that the issuer need not deliver to investors. However, anyone can see this information by requesting it from the SEC or by looking it up on the SEC's web site at www.sec.gov.

[b] All Issuers: Form S-1

The issuer can use SEC Form S-1 to register a public offering; or a qualified small business issuer could use a different form instead [*see* [c], *below*]. Form S-1 is not a fill-in form like a tax return but is a guide for the preparation of a narrative statement--the prospectus--containing information about the issuer's business, properties, and competition; the identities of the officers and directors and their compensation; material transactions between the issuer and the officers and directors; material legal proceedings involving the issuer or the officers and directors; the plan for distributing the securities; and the intended use of the proceeds of the offering. Information about how to describe these items is set out in the form and SEC rules in Regulation S-K. Registration statements also must include year-end financial statements that must be audited by an independent certified public accountant and must satisfy SEC requirements under Regulation S-K.

In addition to the information expressly required by the form, the issuer must provide any other information that is necessary to make the disclosure complete and not misleading. The issuer also must clearly describe any risks prominently in the prospectus, usually at the beginning. Examples of risk factors are lack of business operating history,

adverse economic conditions in the issuer's particular industry, lack of a market for the securities offered, and dependence on key personnel.

Information on filing and SEC processing requirements is contained in Regulation C and Regulation S-T.

[c] SEC Review

The SEC's staff examines a filed registration statement for compliance with disclosure requirements. If a filing appears to be incomplete or inaccurate, the issuer usually is informed by letter, and the issuer may then file correcting or clarifying amendments. Once the issuer has responded in a satisfactory manner to staff comments, the staff declares the registration statement to be "effective." The issuer may then begin to sell the securities. The SEC can suspend the effectiveness of any registration statement on determining that the document is misleading, inaccurate, or incomplete.

SEC review is no guarantee that disclosure requirements have been met and the issuer will continue to be liable for failure to fulfill these requirements notwithstanding SEC review.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawInitial Public Offerings & the Securities Act of 1933Registration of SecuritiesDisclosures & SchedulesSecurities LawInvestment CompaniesRegistration & ReportingSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART II. LEGAL BACKGROUND

3-6A California Legal Forms--Transaction Guide § 6A.22

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.22 Overview of Exemptions From Securities Act Registration

[1] Statutory Exemptions

[a] Intrastate Offering--Section 3(a)(11) Exemption

Section 3(a)(11) of the Securities Act creates what is generally known as the "intrastate offering exemption." This exemption facilitates the financing of local business operations by local investors. To qualify for the intrastate offering exemption, the issuer must be organized under California law and must (1) carry out a significant amount of its business in California, and (2) make offers and sales of securities only to residents of California [*see 15 U.S.C. § 77c(a)(11)*]. The issuer makes no filing with the SEC when using the intrastate exemption. For detailed discussion of this exemption, see *§ 6A.24*. Implicitly, the offering is subject to California qualification requirements, or may be exempt from those requirements, according to California law.

PRACTICE TIP:

Care must be taken that the intrastate offering will not be integrated with any other offering previously made by the issuer. If the issuer contemplates making additional offerings in the near-term, consideration must be given to whether these offerings might also be integrated. The intrastate offering exemption will therefore be inappropriate for an issuer that wants to maintain flexibility regarding future offerings. *Commentary by Frances E. Lossing.*

There is no statutory or regulatory limit on the size of the offering or the number of buyers. However, the issuer must verify the California residence of each buyer. If any of the securities are offered or sold to even one nonresident, the exemption will be lost, and without the exemption, the issuer could be in violation of the Securities Act registration requirements. Moreover, during a short period after the offering is complete, if a buyer resells any of the securities to a person who resides outside California, the entire transaction, including the original sales, might violate the Securities Act.

The securities in an intrastate offering seldom can be traded publicly in a secondary market because secondary markets

are rarely strictly intrastate. In short, buyers of the securities have severe limitations on how and to whom they might resell the securities. Since secondary markets for these securities rarely develop, issuers often must sell the securities at a discount.

It will be difficult for the issuer to rely on the intrastate exemption unless the major shareholders, officers, and directors (as a group) know the buyers (as a group), and the sale is directly negotiated with them. If the issuer holds some of its assets outside California, or derives a substantial portion of its revenues outside California, it could have a difficult time qualifying for the exemption.

The issuer may follow Rule 147 [*17 C.F.R. § 230.147*; *see § 6A.24[2]*], a safe-harbor rule, to ensure that it meets the requirements for this exemption. It is possible, however, that a transaction not meeting all requirements of Rule 147 may still qualify for the exemption.

[b] Small Offering--Section 3(b) Exemption

Section 3(b) of the Securities Act authorizes the SEC to exempt securities from registration "by reason of the small amount involved or the limited character of the public offering." The ceiling on "small amount" is $5 million [*15 U.S.C. § 77c(b)*]. Regulation A [*see 17 C.F.R. § 230.251 et seq.*] and Rules 504 and 701 create such exemptions [*see* [2][a], [b], [e], *below*].

[c] Private Offering--Section 4(2) Exemption

Section 4(2) of the Securities Act exempts from registration "transactions by an issuer not involving any public offering" [*15 U.S.C. § 77d(2)*]. Since the Securities Act does not define "public offering," issuers must rely on judicial decisions and SEC interpretations. Generally, a public offering would not be involved when there is no public solicitation or general advertising in connection with the offering and the issuer ensures that buyers

- Have enough knowledge and experience in finance and business matters to evaluate the risks and merits of the investment (be "sophisticated" investors) or be able to bear the investment's economic risk;
- Have access to the type of information normally provided in a prospectus; and
- Agree not to resell or distribute the securities to the public.

The precise limits of this private offering exemption are uncertain. As the number of buyers increases and their relationships to the issuer and management become more remote, it is more difficult to show that the transaction qualifies for the exemption. If the issuer offers securities to even one person who does not satisfy the necessary conditions, the entire offering may be in violation of the Securities Act. Rule 506 in Regulation D [*see 17 C.F.R. § 230.506*], a safe harbor rule, provides objective standards on which the issuer can rely to meet the requirements of this exemption [*see* [2][d], *below*].

[d] Accredited Investor--Section 4(6) Exemption

Section 4(6) of the Securities Act exempts from registration offers and sales of securities to accredited investors when the aggregate offering price is less than $5 million [*15 U.S.C. § 77d(6)*]. The definition of "accredited investor" is provided by Section 2(15) of the Securities Act [*15 U.S.C. § 77b(a)(15)(i)*] and Rule 215 [*17 C.F.R. § 230.215*; *see 15 U.S.C. § 77b(a)(15)(ii)*] and is the same as the definition provided by Rule 501 in Regulation D [*see 17 C.F.R. § 230.501(a)*; *see also § 6A.112[1]*]. This exemption does not permit any form of advertising or public solicitation. There are no document delivery requirements, but the SEC's Form D must be filed after a sale [*see 17 C.F.R. § 239.500(a)*, (b) (electronic filing required); *see also § 6A.202*]. Even though the buyers are accredited investors, all transactions are

subject to the antifraud provisions of the securities laws.

[2] Regulatory Exemptions

[a] Small Offering--Regulation A Exemption

Section 3(b) of the Securities Act gives the SEC authority to exempt from registration certain offerings when the securities to be offered involve relatively small dollar amounts [*see 15 U.S.C. § 77c(b)*]. Under this provision, the SEC has adopted Regulation A [*see 17 C.F.R. § 230.251 et seq.*], a conditional exemption for certain public offerings not exceeding $5 million in any 12-month period. This exemption is discussed in detail in *§ 6A.25*. An offering statement (consisting of a notification, offering circular, and exhibits) is filed with the SEC regional office in the region where the company's principal business activities are conducted. The Pacific Regional Office (covering California) is in Los Angeles; the address is published in the regulations [*see 17 C.F.R. § 200.11*] and on the SEC's web site at www.sec.gov.

Although Regulation A is technically an exemption from the registration requirements of the Securities Act, it is often referred to as a short-form registration since the offering circular (similar in content to a prospectus) must be supplied to each buyer, and the securities issued are freely tradable in a secondary market. There are three permitted offering circular formats under Regulation A, one of which is a simplified question-and-answer document. This style of disclosure is useful to potential investors and may offer significant savings to the issuer in both the time expended and the costs of preparation.

The principal advantages of Regulations A offerings, as opposed to full registration on Form S-1, Form SB-1, or Form SB-2 [*see § 6A.21[4][b]*, *[c]*], are as follows:

- The financial statements are simpler and do not need to be audited.

- There are no Exchange Act reporting obligations after the offering--unless the issuer otherwise becomes subject to Exchange Act reporting requirements [*see § 6A.21[1][b]*; 15 U.S.C. § 78l(g); *17 C.F.R. § 240.12g-1*].

- The issuer may select one of three formats to prepare the offering circular, and one of those is a simplified question-and-answer format.

- The issuer can "test the waters" to determine whether there is adequate interest in the securities, before incurring the expense of filing with the SEC.

In a test-the-waters case, the issuer can use general solicitation and advertising before filing an offering statement with the SEC. Thus the issuer can determine whether there is enough market interest in the securities to justify an offering, before it incurs the full legal, accounting, and other costs associated with filing an offering statement. However, the issuer may not solicit or accept money until the SEC's staff has completed review of the filed offering statement (and the issuer has delivered prescribed offering materials to investors).

Any type of corporation organized under the laws of a United States, the District of Columbia, or a Canadian province, unless disqualified pursuant to Rule 262, that does not report under the Exchange Act may use Regulation A, except

- A corporation with an unspecified business.

- An investment company registered or required to be registered under the Investment Company Act of 1940.

- A development-stage company that plans to merge with an as-yet-unidentified company or has no specific business plan or purpose--also known as a blank-check company. In most cases, shareholders may use Regulation A to resell up to $1.5 million of securities.

- An issuer of undivided interests in oil and gas or similar mineral interests.

[b] Offering of $1 Million in 12 Months--Rule 504 Exemption

Rule 504 in Regulation D [*see 17 C.F.R. § 230.504*] provides an exemption for the offer and sale of up to $1 million of securities in a 12-month period. This exemption is discussed in detail in *§ 6A.26*. Any corporation that is not a blank-check company or an investment company and is not subject to Exchange Act reporting requirements may use this exemption. Unlike Rule 505 and Rule 506 [*see* [c], [d], *below*], Rule 504 does not mandate that specified disclosure be provided to buyers. However, the issuer must take care that sufficient information is provided to meet the full-disclosure obligations under the antifraud provisions of the securities laws. There is no limit on the number of buyers, and there are no investor-sophistication standards. Prior to the adoption of the National Securities Markets Improvement Act of 1996 (NSMIA), Rule 504 was the most commonly used Regulation D exemption. Since the adoption of NSMIA, Rule 504 offerings have become less common in multijurisdictional transactions since compliance with various state blue sky laws is simplified if the offering is made in reliance on Rule 506 of Regulation D. Offerings that are exempt under Rule 504 are relatively simple to prepare, which reduces cost and delay, and can generally be underwritten by the offering company (that is, the securities can be sold by the company's own officers, directors, and employees).

In general, the issuer may not use public solicitation or advertising to market the securities, and buyers receive "restricted" securities, meaning that buyers may not sell the securities without filing a registration statement or qualifying under an applicable exemption. However, the issuer can use Rule 504 for a "public" offering of securities, and investors then will receive freely tradable securities, in any of the following circumstances [*see 17 C.F.R. §§ 230.502(d), 230.504(b)(1)*]:

- The issuer qualifies the offering in California--and in no other states except states that require a publicly filed registration statement and delivery of a substantive disclosure document to investors. California requirements are discussed in Ch. 6H, *Qualification of Securities* .

- The issuer (1) registers the offering and sells in a state--such as California--that requires registration and disclosure delivery, (2) also sells in a state without those requirements, and (3) delivers to *all buyers* the disclosure documents mandated by the state in which the offering is registered.

- The issuer sells exclusively according to state-law exemptions that permit general solicitation and advertising, as long as the issuer sells only to accredited investors as in Rule 505 and Rule 506 offerings [*see* [c], [d], *below*].

California law provides for a similar exemption [*see Corp. Code § 25102(n)*], which is discussed in Ch. 6B, *California Qualified Purchaser Exemptions* . See *§ 6A.23* for discussion of the coordination of federal and California exemptions.

Even though the issuer can make a private sale under Rule 504 exempt from specific disclosure requirements, the issuer should take care to provide sufficient information to investors to avoid violating the antifraud provisions of the securities laws. This means that any information provided to investors must be free from false or misleading statements. Similarly, the issuer should not exclude any information if the omission renders false or misleading any information that is provided to investors.

Unlike the qualification requirements of Rule 505 and Rule 506 in Regulation D (which provide exemptions from

federal registration for larger private offerings) [*see* [c], [d], *below*], Rule 504 allocates primary responsibility for the regulation of small offerings to the states. A California corporation intending to sell its securities in other states as well as in California can coordinate compliance with the several states' requirements by using the Small Corporate Offering Registration (SCOR) program developed through a joint effort by members of the American Bar Association and the North American Securities Administrators Association (NASAA), which is discussed in *§ 6A.23[2][a]*.

[c] Offering of $5 Million in 12 Months--Rule 505 Exemption

Rule 505 in Regulation D [*see 17 C.F.R. § 230.505*] provides an exemption for offers and sales of securities totaling up to $5 million in any 12-month period. This exemption is discussed in detail in *§ 6A.27*. The issuer may sell to an unlimited number of accredited investors and up to 35 other persons, who do not need to meet sophistication or wealth standards associated with other exemptions. Buyers must buy for investment only, not for resale. The issued securities are "restricted"; consequently, the issuer must inform investors that they may not sell securities without registering the transaction unless an exemption, such as Rule 144 [*17 C.F.R. § 230.144*], is available. The issuer may not use general solicitation or advertising to sell the securities. The issuer must not be subject to disqualification under Rule 262 [*17 C.F.R. § 230.262*], which sets forth certain "bad boy" disqualifiers.

The issuer may decide what information to give to accredited investors, as long as it does not violate the antifraud prohibitions of the securities laws. The issuer must give nonaccredited investors disclosure documents that generally are the same as those used in registered offerings. If the issuer provides information to accredited investors, it must make the same information available to the nonaccredited investors as well. The issuer also must arrange for someone to be available to answer questions by prospective buyers.

Financial statements generally need to be audited by an independent public accountant. If the issuer cannot obtain audited financial statements without unreasonable effort or expense, however, only a balance sheet must be audited.

California law provides for similar exemptions [*see Corp. Code § 25102(f), (n)*], which are discussed in Ch. 6B, *California Limited Offering Exemptions* , and Ch. 6D, *California Qualified Purchaser Exemptions* . (California has not adopted the Model Accredited Investor Exemption proposed by the North American Securities Administrators Association (NASAA) to exempt from state securities registration any offer or sale of securities to accredited investors as defined in Regulation D.) See *§ 6A.23* for discussion of coordination of the federal and California exemptions.

PRACTICE TIP:

California is not unusual in this regard. Few states have adopted the Model Accredited Investor Exemption without modification, thereby limiting its usefulness. This is one of the reasons for including Rule 506 of Regulation D offerings as a "covered security" entitled to the benefits of federal preemption under NSMIA. *Commentary by Frances E. Lossing.*

[d] Private Offering--Rule 506 Exemption

Rule 506 in Regulation D [*see 17 C.F.R. § 230.506*] is a safe harbor for the Section 4(2) private-offering exemption described in [1][c], *above*, for limited offers and sales without regard to the dollar amount of the offering. This exemption is discussed in detail in *§ 6A.28*. There is no ceiling on the amount that may be raised. This exemption does not limit the number of accredited investors, but the number of nonaccredited investors may not exceed 35. All nonaccredited buyers, either alone or together with a designated representative, must be sophisticated enough--must have the knowledge and experience necessary--to evaluate the merits and risks of the investment. (The issuer typically determines the sophistication of the investors with a questionnaire, which may need to be created by a securities specialist.) Buyers receive "restricted" securities. Consequently, buyers may not freely trade the securities in the secondary market after the offering, unless the sale is registered or an exemption is available.

If an issuer stays within the Rule 506 guidelines, it can be certain that the offering qualifies under the Section 4(2) exemption. The issuer may decide what information to give to accredited investors, as long as it does not violate the antifraud prohibitions. The issuer must give nonaccredited investors disclosure documents that generally are the same as those used in registered offerings. If the issuer provides information to accredited investors, it must make this information available to the nonaccredited investors as well. Someone must be available to answer questions by prospective buyers. Financial statement requirements are the same as for Rule 505 [*see* [c], *above*].

California law provides a similar exemption in *Corp. Code § 25102(f)*. Offerings made in reliance on Rule 506 may also take advantage of the federal preemption provisions of NSMIA [*see Corp. Code § 25102.1(d)* for filings that must be made in California if the issuer wishes to take advantage of NSMIA; *see also Ch. 6, Securities Regulation Issues, § 6.141*].

[e] Sale Through Employee Benefit Plan--Rule 701 Exemption

Rule 701 [*see 17 C.F.R. § 230.701*] exempts sales of securities that are made to compensate employees. This exemption, which is discussed in detail in *§ 6A.30*, is available only to a corporation that is not subject to Exchange Act reporting requirements. Securities may be sold under Rule 701 in connection with offerings made in compliance with Rule 701 even if the issuer subsequently becomes a reporting company. The issuer can sell up to $1 million of securities under this exemption, regardless of the issuer's size. The issuer can sell even more if it qualifies under certain formulas based on the issuer's assets or the number of its outstanding securities. To sell more than $5 million in securities in a 12-month period, the issuer must provide limited disclosure documents to employees. Employees receive "restricted securities" in these transactions [*see 17 C.F.R. § 230.144(a)(3)(ii)*] and may not freely offer or sell them to the public, unless the sale is registered or an exemption is available.

Rule 701 was adopted to allow nonreporting companies ("private" corporations) to sell securities to their employees without the need to file a registration statement, as public corporations do. The rule provides an exemption from the registration requirements of the Securities Act for sales of securities under certain compensatory benefit plans or written agreements relating to compensation, permitting corporations to preserve cash by using stock for compensatory purposes. The ability to reward and retain employees with securities can enable corporations to keep valuable employees without having to use other methods to compensate them, such as borrowing money or selling securities to raise cash. The exemptive scope covers securities sold under a plan or agreement between a private corporation (or its parents or majority-owned subsidiaries) and employees, officers, directors, partners, trustees, consultants, and advisers.

The SEC determined that it would be an unreasonable burden to require private corporations, many of which are small businesses, to incur the expenses and disclosure obligations of public corporations when their only "public" securities sales are to employees. Further, these sales are for compensatory and incentive purposes, rather than for capital-raising. To accommodate these corporations, the SEC used the maximum extent of its authority under Section 3(b) of the Securities Act [*see 15 U.S.C. § 77c(b)*] to exempt sales for these compensatory purposes. The SEC's goal has been to allow flexibility for corporations to compensate employees with securities and, at the same time, ensure that essential information will be delivered to them in appropriate situations and in a timely manner. The following are the important aspects of using Rule 701:

- There is no limit on the amount of securities that may be *offered* through an employee benefit plan; rather, the rule limits the amount that may be *sold* (thus, it is relatively easy for issuers to determine the exempt amount of securities transactions). The maximum amount of securities that may be sold in a year under the rule is the greatest of
    - $1 million;
    - 15 percent of the issuer's total assets; or

- 15 percent of the outstanding securities of that class.

- The issuer must provide specific disclosure to each buyer of securities if more than $5 million worth of securities are to be sold.

- The exemption extends to sales to employees of majority-owned subsidiaries of the issuer's parent, that is, brother-sister subsidiaries.

- Sales to former employees (including former directors, officers, general partners, trustees, consultants, and advisers) may be completed under Rule 701 if those persons were employees when the securities initially were offered.

- The rule specifies the manner of considering employee/consultant services in computing the aggregate sales limit.

- The rule facilitates tax and estate planning by permitting the rule to be available for option exercises by family members of employees, who may acquire Rule 701 securities from the employee through a gift or a domestic relations order.

An exemption is available in California for offerings made in reliance on Rule 701 if certain standards imposed by the Commissioner are satisfied [*see Corp. Code § 25102(o)*; *10 Cal. Code Reg. §§ 260.140.41, 260.140.42, 260.140.45, 260.140.46*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawExemptions From RegistrationIntrastate Offerings & RecapitalizationsSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART II. LEGAL BACKGROUND

3-6A California Legal Forms--Transaction Guide § 6A.23

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§ 6A.23 Coordination of Federal and California Registrations and Exemptions

PRACTICE TIP:

There are, of course, other possibilities for coordinating California and federal exemptions. The California commercial paper exemption in *Corp. Code § 25100(l)* may be coordinated with the federal commercial paper exemption in Section 3(a)(3). The private placement exemption under Section 4(2) may be coordinated with exemptions available under *Corp. Code § 25102(e), (f), (i),* or *(n)*. If the offering will be made in other jurisdictions, the issuer will also need to consider how best to coordinate the offering with the requirements of other states. *Commentary by Frances E. Lossing.*

[1] In General

[a] Regulation A Offering

When an small offering is being registered with the SEC under Regulation A [*see 17 C.F.R. § 230.251 et seq.*; *see also § 6A.25*], the issuer may qualify the offering in California by filing either a California-prescribed form or Form U-1 developed by NASAA, augmented by the addition of prescribed information, along with a copy of the SEC-filed Form 1-A, with the Commissioner of Corporations--a procedure known as coordination [*see Corp. Code § 25111(a)*; *10 Cal. Code Reg. § 260.111(a)*]. Form U-1 is illustrated in Ch. 6H, *Qualification of Securities,* § 6H.206[2].

[b] Rule 506 Offering

Securities marketed under a Rule 506 exemption are "covered securities" for purposes of the Securities Act [*see 15 U.S.C. § 77r(b)(4)(D)*]. In general, states may not force compliance with state-law qualification and registration requirements [*see generally, e.g., Corp. Code § 25110*] for transactions in "covered securities" [*see 15 U.S.C. § 77r(a)*]. However, in the case of a transaction under Rule 506, a state is "not prohibit[ed] ... from imposing notice filing requirements that are substantially similar to those required by ... [Regulation D] that are in effect on September 1, 1996" [*15 U.S.C. § 77r(b)(4)(D)*]. Accordingly, California law provides an exemption from California qualification requirements for Rule 506 transactions [*see Corp. Code § 25100.1(a)*] but imposes the following notice filing

requirements [*Corp. Code § 25102.1(d)*; *see* Dept. of Corps. Release No. 109-C (Dec. 18, 1997)]:

- A notice in the form of a copy of the completed Form D as filed with the SEC must be filed with the Commissioner of Corporations within 15 days of the first sale in California, along with documents filed with the SEC in annual or periodic reports that the Commissioner by rule or order deems appropriate. The Commissioner may allow for a notice by electronic transmission of the information in Form D.

- A consent to service of process under *Corp. Code § 25165* generally must be filed with the required notice (but this is not always necessary; *see below*). The consent may be NASAA Form U-2, which can be downloaded at the organization's web site (www.nasaa.org); pursuant to Form D [*17 C.F.R. 239.500*] filed with the Commissioner in connection with the transaction; included in an electronic submission of a filing; or in the form set forth by regulation [*10 Cal. Code Reg. 260.165*; *see* Dept. of Corps. Rel. No. 120-C (Mar. 24, 2009) (consent to service of process or Form U-2 not required if electronic Form D was filed with SEC); *see also § 6A.202[1][b]* regarding electronic filing requirements].

- The issuer must pay the filing fee provided for in *Corp. Code § 25608.1(c)* [*but see Corp. Code § 25608.3* (Commissioner may set any fee at amount below maximum set forth in *Corp. Code § 25608.1*)].

The filed notice must be accompanied by a letter of transmittal stating that the filing is pursuant to "both Rule 506 and Section 18(b)(4)(D) of the Securities Act of 1933." The consent to service of process may be omitted if the issuer submits a statement that the issuer is a California corporation or already has a consent to service of process on file with the Commissioner of Corporations. All of these notice requirements may be ignored, however, if none of the securities offered for sale under Rule 506 are sold in California [Dept. of Corps. Release No. 109-C (Dec. 18, 1997)]. Alternatively, the issuer may follow the procedures under *Corp. Code § 25102(f)*.

[2] Coordinated Offering Registrations

[a] Small Company Offering Registration (SCOR)

To facilitate small business capital formation, NASAA, in conjunction with the American Bar Association, developed the Small Company Offering Registration program, also known as SCOR. The SCOR form, called Form U-7 [*see § 6A.203*], is a simplified question-and-answer registration form designed to be completed without the need for a securities law specialist's assistance, which an issuer can use also as the disclosure document for investors. Nearly all of the states recognize SCOR, and a California corporation may use it [*see Corp. Code § 25113(b)(2)(E)*; *10 Cal. Code Reg. §§ 260.113, 260.113.1*].

SCOR was primarily designed for state registration of small business securities offerings conducted under Rule 504 (sale of securities up to $1 million within 12 months; *see § 6A.22[2][b]* for an overview). However, in addition, an issuer can use Form U-7 [*see § 6A.203*] to satisfy many of the filing requirements of the Regulation A exemption (sales of securities of up to $5 million; *see § 6A.22[2][a]* for an overview), since the issuer may file it with the SEC as part of the Regulation A offering statement.

To assist small businesses offering securities in several states, many states coordinate SCOR or Regulation A filings through a NASAA program for regional review; however, California is not one of the participating states. Issuers wanting additional information on SCOR or regional reviews should contact NASAA.

[b] Coordinated Equity Review (CER)

The NASAA Coordinated Equity Review (CER) program provides a uniform state registration procedure designed to coordinate the blue-sky registration process in all of the states in which an issuer seeks to sell equity securities. In

addition to creating uniformity in the review standards, the program is designed to expedite the registration process, saving the issuer time and money. Most of the states that register offerings eligible to use CER are participants in the program, including California [*see* Dept. of Corps. Release No. 111-C (Apr. 16, 1998)].

CER is designed to target offerings of securities that are not "covered securities" as defined in Section 18(b)(1) of the Securities Act (that is, are not nationally traded securities) [*see 15 U.S.C. § 77r(b)(1)*]. CER generally is intended only for initial public offerings of common stock, preferred stock, warrants, rights, and units of equity securities. Such offerings also must be registered (or registration must be pending) under Section 5 of the Securities Act [*see 15 U.S.C. § 77e*]; therefore, CER is not available for Regulation A offerings. CER also is not available for issuers of blind-pool or blank-check offerings, and CER may not be available on all offerings even if the offering fits within the initial screening criteria. (A blind-pool or blank-check offering is one to fund a development-stage company that has no specific business plan or purpose or that plans to merge with an as-yet-unidentified company.) More information is available on the NASAA web site at www.nasaa.org.

[3] Regulation CE Exemption for California Qualified-Purchaser Offering

Rule 1001 [*see 17 C.F.R. § 230.1001*] in Regulation CE [*see* Securities Act Release No. 7285 *(May 9, 1996), 61 Fed. Reg. 21356* (designation connotes "coordinated exemptions" under state laws)] provides an exemption from the registration requirements of the Securities Act for offers and sales of securities, in amounts up to $5 million, that satisfy the conditions of *Corp. Code § 25102(n)* [*17 C.F.R. § 230.1001(a), (b)*]. That section exempts from California registration any offering made by certain California corporations to qualified purchasers. The California exemption is discussed in Ch. 6D, *California Qualified Purchaser Exemptions* .

The California exemption combines a form of general solicitation using a test-the-waters concept with a qualified buyer concept derived in part from the Uniform Limited Offering Exemption, an official policy guideline of NASAA, which was adopted in coordination with the SEC's promulgation of Regulation D. Rule 1001 does not require an issuer to notify the SEC when relying on the California exemption, in view of the notification provisions of the California law.

Rule 1001 exists mainly because the California exemption does not fit well within any general federal exemption, other than Rule 504, which is limited to $1 million [*see 17 C.F.R. § 230.504*], or potentially the intrastate offering exemption, which is available only for offerings by issuers incorporated and doing business in California [*see 15 U.S.C. § 77c(a)(11)*; *17 C.F.R. § 230.147*]. Rule 505 and Rule 506 of Regulation D prohibit general solicitations; moreover, the California definition of "qualified purchaser" is broader than the Regulation D definition of "accredited investor." The SEC did not believe that those differences should be an impediment to the ability of small businesses to take full advantage of the California exemption. While the California "qualified purchaser" definition differs somewhat from the federal "accredited investor" definition for individuals, the California law includes additional suitability standards. Moreover, the general announcement of a proposed offering under the California law is subject to significant limitations, thereby protecting against abuse of the procedure. The provisions of the California law are consistent with investor protection and the public interest and therefore "warranted the [SEC's] full exercise of its exemptive authority under Section 3(b)" of the Securities Act (covering small or limited offerings).

PRACTICE TIP:

The CE Regulation does not exempt the offering from the blue sky laws of other states. The usefulness of the exemption is therefore of limited value in multijurisdictional transactions, unless the other jurisdictions have adopted a Model Accredited Investor Exemption or another relatively easy to use exemption, such as an institutional investor exemption which may be applicable to the transaction. *Commentary by Frances E. Lossing.*

Application of Rule 1001 is not limited to the California exemption as it existed when Rule 1001 was adopted. However, the SEC will monitor changes in the California exemption, to ensure that the investor protections are not

diminished in a fashion that would warrant modification of the federal exemption.

Securities acquired in the offering are "restricted securities" under Rule 144 [*17 C.F.R. §§ 230.144(a)(3)(iv), 230.1001(c)*], unless the sale is registered or an exemption is available. They may not be freely offered or sold to the public. This is consistent with the California exemption, since it requires an investment intent on the part of qualified buyers [*see Corp. Code § 25102(n)(3)*], and a buyer could not resell the securities under California law without qualification or some other exemption.

[4] Rule 701 Offering

Rule 701 [*17 C.F.R. § 230.701*] provides an exemption for employee benefit plan securities offered to employees of the issuer, its parent or subsidiaries. *Corp. Code § 25102(o)* provides an exemption for the offer or sale of a security issued by a corporation or limited liability company pursuant to a purchase plan or agreement or issued pursuant to an option plan or agreement, when at the time of issuance or grant when at the time of issuance or grant the security is exempt from registration under Rule 701 and the following additional conditions are satisfied:

- The terms of the purchase plan or agreement comply with *10 Cal. Code Reg. §§ 260.140.42*, *260.140.45* and *260.140.46*.

- The terms of the option plan or agreement comply with *10 Cal. Code Reg. §§ 260.140.41*, *260.140.45* and *260.140.46*.

- The issuer files a notice with the Commissioner in statutory form [*10 Cal. Code Reg. § 260.102.19*], a consent to service of process, unless the issuer is a California corporation or already has a consent to service of process on file with the Commissioner [*10 Cal. Code Reg. § 260.165*], and pays a filing fee of $200, plus one fifth of 1 percent of the aggregate value of the securities to be sold in California up to a maximum aggregate fee of $2,500 [*Corp. Code § 25608(e), (x)*; *but see Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum fee set forth in *Corp. Code § 25608*)].

The failure to file the notice of transaction, however, or the failure to file it within the time specified, will not affect the availability of the exemption. Within 15 days after discovery of the failure to file the notice or after demand by the Commissioner, whichever occurs first, an issuer that has failed to file the notice must file it and pay a fee equal to the maximum aggregate fee payable had the transaction been qualified under *Corp. Code § 25110* [*Corp. Code § 25102(o)*].

Offers and sales exempt under this subdivision are deemed to be part of a single, discrete offering and are not subject to integration with any other offering or sale, whether qualified as an issuer transaction [*see Corp. Code § 25100 et seq.*], otherwise exempt, or not subject to qualification [*Corp. Code § 25102(o)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawExemptions From RegistrationExempt TransactionsU.S. Securities & Exchange Commission Rules 146 & 506Securities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART II. LEGAL BACKGROUND

3-6A California Legal Forms--Transaction Guide § 6A.24

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§ 6A.24 Intrastate Offering Under Section 3(a)(11)

[1] In General

[a] Conditions for Exemption

The Securities Act does not apply to any "security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory" [*15 U.S.C. § 77c(a)(11)*]. This exemption is known as the intrastate exemption, or Section 3(a)(11) exemption, from Securities Act registration. The legislative history suggests that the exemption was intended to apply only to issues genuinely local in character, which in reality represent local financing by local industries, carried out through local investment. Rule 147 [*see 17 C.F.R. § 230.147*] provides more objective standards (a safe harbor) on which responsible local business persons intending to raise capital from local sources may rely in claiming the Section 3(a)(11) exemption [*17 C.F.R. § 230.147*, Preliminary Note 3]. The rule does not raise any presumption, however, that the exemption is not available for a transaction that does not satisfy all of the provisions of the rule [*17 C.F.R. § 230.147*, Preliminary Note 1].

All of the terms and conditions of Rule 147 must be satisfied in order for the rule to be available. The following are the basic terms [*17 C.F.R. § 230.147*, Preliminary Note 3]:

- The issuer must be a resident of and doing business within the state or territory in which all offers and sales are made.

- No part of the issue may be offered or sold to nonresidents within the period of time specified in the rule.

For purposes of the rule, the definition of "issuer" in Section 2(4) of the Securities Act applies [*17 C.F.R. § 230.147*, Preliminary Note 3].

[b] Limited Scope of Rule 147

Rule 147 relates to transactions exempted from the registration requirements of Section 5 of the Securities Act [*see 15 U.S.C. § 77e*] by Section 3(a)(11) of that Act. Neither the rule nor Section 3(a)(11) provides an exemption from the registration requirements of Section 12(g) of the Exchange Act [*see 15 U.S.C. § 78l(g)*], the antifraud provisions of the federal securities laws, the civil liability provisions of Section 12(2) of the Securities Act [*see 15 U.S.C. § 77l(a)(2)*], or other provisions of the federal securities laws [*17 C.F.R. § 230.147*, Preliminary Note 3].

In view of the objectives of Rule 147 and the purposes and policies underlying the Securities Act, the rule is not available to any person with respect to any offering that, although in technical compliance with the rule, is part of a plan or scheme by the person to make interstate offers or sales of securities. In that case, registration pursuant to the Securities Act is required [*17 C.F.R. § 230.147*, Preliminary Note 3].

Rule 147 provides an exemption for offers and sales by the issuer only. It is not available for offers or sales of securities by other persons. The Section 3(a)(11) exemption has been interpreted to permit offers and sales by persons controlling the issuer, if the exemption provided by that section would have been available to the issuer at the time of the offering [*see* Securities Act Release No. 4434 *(Dec. 6, 1961), 26 Fed. Reg. 11896]* . Controlling persons who want to offer or sell securities pursuant to the Section 3(a)(11) exemption may continue to do so in accordance with applicable judicial and administrative interpretations [*17 C.F.R. § 230.147*, Preliminary Note 4].

[2] Rule 147 Compliance

[a] Integration

Offers, offers to sell, offers for sale, and sales by an issuer of its securities made in accordance with all of the terms and conditions of Rule 147 will be deemed to be part of an issue offered and sold only to persons resident within a single state or territory when the issuer is a person resident and doing business within that state or territory, within the meaning of Section 3(a)(11) of the Act [*17 C.F.R. § 230.147(a)*]. For purposes of Rule 147, all securities of the issuer that are "part of an issue" must be offered, offered for sale, or sold in accordance with all of the terms and conditions of Rule 147 [*17 C.F.R. § 230.147(b)(1)*].

PRACTICE TIP:

A similar analysis must be made in California in connection with determining whether different offerings are part of the same "transaction." The safe harbor concepts adopted by the Commissioner under *Corp. Code § 25102(f)* are similar to the integration concepts adopted by the SEC [*see 10 Cal. Code Reg. § 260.102.12*]. *Commentary by Frances E. Lossing.*

All offers, offers to sell, offers for sale, and sales that are part of the same issue must meet all of the conditions of Rule 147, in order for the rule to be available. The determination of whether offers, offers to sell, offers for sale, and sales of securities are part of the same issue (that is, are deemed to be integrated) is a question of fact and will depend on the particular circumstances [*17 C.F.R. § 230.147*, Preliminary Note 3]. In determining whether offers and sales should be regarded as part of the same issue and thus should be integrated, any one or more of the following factors may be determinative [Securities Act Release No. 4434 *(Dec. 6, 1961), 26 Fed. Reg. 11896]* :

- Are the offerings part of a single plan of financing?
- Do the offerings involve issuance of the same class of securities?
- Are the offerings made at or about the same time?

- Is the same type of consideration to be received?

- Are the offerings made for the same general purpose?

Rule 147, however, is designed to provide certainty to the extent feasible by identifying certain types of offers and sales of securities that will be deemed not part of an issue, for purposes of the rule only [*17 C.F.R. § 230.147*, Preliminary Note 3]. For purposes of Rule 147 only, an issue is deemed not to include offers, offers to sell, offers for sale, and sales of securities of the issuer pursuant to the Section 3 exemption or Section 4(2) exemption (for private offerings) or pursuant to a registration statement filed under the Securities Act, that took place before the six-month period immediately preceding or after the six-month period immediately following any offers, offers for sale, or sales pursuant to Rule 147, provided that during either of those six-month periods, there are no offers, offers for sale, or sales of securities by or for the issuer, of the same or similar class as those offered, offered for sale, or sold pursuant to the rule [*17 C.F.R. § 230.147(b)(2)*]. Offerings made under Rule 701 will not be integrated with offerings made under Rule 147 even if made within 6 months of the Rule 147 offering [*17 C.F.R. § 230.701(f)*].

In the event that securities of the same or similar class as those offered pursuant to the rule are offered, offered for sale, or sold less than six months before or after any offer, offer for sale, or sale pursuant to Rule 147, the criteria listed above will be applied to determine which offers, offers to sell, offers for sale, or sales are part of an issue [*17 C.F.R. § 230.147(b)(2)*, Note].

[b] Qualified Issuer

The issuer of the securities must be, at the time of any offers and sales, a person resident and doing business within the state or territory in which all of the offers, offers to sell, offers for sale, and sales are made [*17 C.F.R. § 230.147(c)*].

The issuer is deemed to be a resident of California if the issuer is incorporated in California [*see 17 C.F.R. § 230.147(c)(1)(i)*; *see also 17 C.F.R. § 230.147(c)(1)(ii), (iii)* (general partnership or unincorporated business organization not organized under any state or territorial law is resident of state where principal office is located; individual is resident of state where principal residence is located)]. The issuer is deemed to be doing business within California if the following conditions are satisfied:

- The principal office of the issuer is located in California [*see 17 C.F.R. § 230.147(c)(2)(iv)*].

- The issuer intends to use and does use at least 80 percent of the net proceeds to the issuer from sales made pursuant to Rule 147 in connection with the operation of a business or real property located in, the purchase of real property located in, or the rendering of services within, California [*see 17 C.F.R. § 230.147(c)(2)(iii)*].

- At the end of its most recent semi-annual fiscal period before the first offer of any part of the issue, the issuer had at least 80 percent of its assets and those of its subsidiaries on a consolidated basis located within California [*see 17 C.F.R. § 230.147(c)(2)(ii)*].

- The issuer (unless too small; *see below*) derived at least 80 percent of its gross revenues and those of its subsidiaries on a consolidated basis from the operation of a business or real property located in, or from the rendering of services within, California, for either of the following periods [*see 17 C.F.R. § 230.147(c)(2)(i)*]:

    - For its most recent fiscal year, if the first offer of any part of the issue is made during the first six months of the issuer's current fiscal year; or

- For the first six months of its current fiscal year or during the 12-month fiscal period ending with that six-month period, if the first offer of any part of the issue is made during the last six months of the issuer's current fiscal year.

However, the fourth listed condition does not apply to any issuer that has not had gross revenues in excess of $5,000 from the sale of products or services or other conduct of its business for its most recent 12-month fiscal period [*17 C.F.R. § 230.147(c)(2)(i)(B)*].

[c] Qualified Buyers

Offers, offers to sell, offers for sale, and sales of securities that are part of an issue may be made only to persons resident in California [*see 17 C.F.R. § 230.147(d)*]. For purposes of determining the residence of offerees and buyers,

- An individual is deemed to be a resident of California if the individual has his or her principal residence in California at the time of the offer and sale to him or her [*see 17 C.F.R. § 230.147(d)(2)*].

- A corporation, partnership, trust, or other form of business organization, that is organized for the specific purpose of acquiring part of an issue offered pursuant to Rule 147 is deemed not to be a resident of California unless all of the beneficial owners of the entity are residents of California [*see 17 C.F.R. § 230.147(d)(3)*].

- Any other corporation, partnership, trust, or other form of business organization, is deemed to be a resident of California if it has its principal office in California at the time of the offer and sale to it [*see 17 C.F.R. § 230.147(d)(1)*].

[d] Resale Limitation

During the period in which securities that are part of an intrastate issue are being offered and sold by the issuer, and for the period of nine months from the date of the last sale of those securities by the issuer, all resales of any part of the issue, by any person, may be made only to persons resident in California [*see 17 C.F.R. § 230.147(e)*].

In the case of convertible securities, resales of either the convertible security or, once it is converted, the underlying security may be made during the limited-resale period only to persons resident California. For purposes of Rule 147, a conversion in reliance on Section 3(a)(9) of the Securities Act [*see 15 U.S.C. § 77c(a)(9)*] does not begin a new period [*17 C.F.R. § 230.147(e)*, Note 1].

Dealers must satisfy the requirements of Rule 15c2-11 under the Exchange Act [*see 17 C.F.R. § 240.15c2-11*] before publishing any quotation for a security issued under Rule 147 and before submitting any quotation for publication in any quotation medium [*17 C.F.R. § 230.147(e)*, Note 2].

[e] Compliance Precautions

The issuer, in connection with any securities it sells pursuant to Rule 147, must comply with the following requirements [*17 C.F.R. § 230.147(f)(1)*]:

- Place a legend on the certificate (or other document evidencing the security) stating that the securities have not been registered under the Securities Act and setting forth the limitations on resale contained in Rule 147(e) [*see* [d], *above*].

- Issue stop-transfer instructions to the issuer's transfer agent, if any, with respect to the securities; or,

if the issuer transfers its own securities, make a notation in the appropriate records of the issuer.

- Obtain a written representation from each buyer as to the buyer's residence [*see § 6A.204*].

The issuer, in connection with the issuance of new certificates for any of the securities that are part of the same issue and are presented for transfer during the limited-resale period, must take the first two required steps above [*17 C.F.R. § 230.147(f)(2)*].

The issuer, in connection with any offers, offers to sell, offers for sale, or sales by it pursuant to Rule 147, must disclose in writing the limitations on resale contained in Rule 147(e) [*see* [d], *above*], the first two requirements in the list above, and the requirement in the preceding paragraph [*17 C.F.R. § 230.147(f)(3)*].

[3] Proof of Section 3(a)(11) Exemption Compliance

Persons claiming the availability of Rule 147 have the burden of proving that they have satisfied all of its provisions (if and when called on to do so). However, Rule 147 does not establish exclusive standards for complying with the Section 3(a)(11) exemption. The exemption would be available if the issuer satisfied the standards set forth in relevant administrative and judicial interpretations at the time of the offering, but the issuer would have the burden of proving the availability of the exemption [*17 C.F.R. § 230.147*, Preliminary Note 3]. Those interpretations are not discussed here, since Rule 147 is the better guide to compliance with the exemption. For further discussion, see Sommer, Federal Securities Act of 1933, ch. 3, *Exempted Securities Under Section 3 of the Securities Act* (Matthew Bender).

No filing with the SEC is required for the exemption. Nothing in Rule 147 obviates the need for compliance with California law relating to the offer and sale of the securities, however [*see 17 C.F.R. § 230.147*, Preliminary Note 2].

PRACTICE TIP:

Close corporations may find the use of the intrastate offering exemption particularly attractive if the close corporation otherwise satisfies the requirements for the use of the exemption. This exemption may also be attractive in connection with the formation of a corporation by California residents if the company will do business principally in California. In these situations, it may be possible to coordinate the intrastate offering exemption at the federal level with the so-called close corporation exemption under *Corp. Code § 25102(h)* at the California level. *Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawRegulation of Securities MarketsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART II. LEGAL BACKGROUND

3-6A California Legal Forms--Transaction Guide § 6A.25

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§ 6A.25 Small Offering Under Section 3(b) and Regulation A

[1] Scope of Exemption

[a] In General

The SEC "may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed therein, add any class of securities to the securities exempted as provided in this section [Section 3 of the Securities Act], if it finds that the enforcement of this subchapter [the Securities Act] with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection [Section 3(b) of the Securities Act] where the aggregate amount at which such issue is offered to the public exceeds $5,000,000" [*15 U.S.C. § 77c(b)*].

A public offer or sale of securities that meets the terms and conditions of Regulation A [*see 17 C.F.R. § 230.251 et seq.*; *see also* [b]-[f], [2]-[9], *below*] is exempt under Section 3(b) of the Securities Act, above, from the registration requirements of the Act [*17 C.F.R. § 230.251*]. Continuous or delayed offerings may be made under Regulation A as permitted by Rule 415 [*17 C.F.R. § 230.251(d)(3)*; *see 17 C.F.R. § 230.415* (delayed or continuous offering and sale of securities)].

Terms used in Regulation A have the same meanings as in Rule 405 [*see 17 C.F.R. § 230.405* (definitions of terms in Regulation C, applicable to all Securities Act registrations)], except that all references to "registrant" in those definitions refer to the issuer of the securities to be offered and sold under Regulation A [*17 C.F.R. § 230.261*]. In addition, these terms have the following meanings:

- "Final Offering Circular" is the current offering circular contained in a qualified offering statement [*17 C.F.R. § 230.261(a)*].

- "Preliminary Offering Circular" is the offering circular described in Rule 255(a) [*17 C.F.R. §*

230.261(b); *see* [4], *below*].

[b] Eligible Issuer

The issuer of the securities to be offered and sold under Regulation A must be an entity that is organized under the laws of the United States or Canada, or any state, province, territory, or possession of the United States or Canada, or the District of Columbia, with its principal place of business in the United States or Canada [*17 C.F.R. § 230.251(a)(1)*], and that meets all of the following requirements:

- It is not subject to Section 13 or Section 15(d) of the Exchange Act [*see 15 U.S.C. §§ 78m, 78o(d)* (periodic reporting requirements)] immediately before the offering [*17 C.F.R. § 230.251(a)(2)*];

- It is not a development-stage company that either has no specific business plan or purpose or has indicated that its business plan is to merge with an unidentified company or companies [*17 C.F.R. § 230.251(a)(3)*];

- It is not an investment company registered or required to be registered under the Investment Company Act of 1940 [*17 C.F.R. § 230.251(a)(4)*; *see 15 U.S.C. § 80a-1 et seq.*];

- It is not issuing fractional undivided interests in oil or gas rights as defined in Rule 300 [*see 17 C.F.R. § 230.300*] or a similar interest in other mineral rights [*17 C.F.R. § 230.251(a)(5)*]; and

- It is not disqualified because of Rule 262 [*17 C.F.R. § 230.251(a)(6)*], which is discussed in [9], *below.*

[c] Limit on Aggregate Offering Price

The sum of all cash and other consideration to be received for the securities--the aggregate offering price--must not exceed $5 million, including no more than $1.5 million offered by all selling securities holders, less the aggregate offering price for all securities sold within the 12 months before the start of and during the offering of securities in reliance on Regulation A. No affiliate resales are permitted if the issuer has not had net income from continuing operations in at least one of its last two fiscal years [*17 C.F.R. § 230.251(b)*].

When a mixture of cash and noncash consideration is to be received, the aggregate offering price is based on the price at which the securities are offered for cash. Any portion of the aggregate offering price attributable to cash received in a foreign currency must be translated into U.S. currency at a currency exchange rate in effect on or at a reasonable time before the date of the sale of the securities. If securities are not offered for cash, the aggregate offering price is based on the value of the consideration as established by bona fide sales of that consideration made within a reasonable time or, in the absence of sales, on the fair value as determined by an accepted standard. Valuations of noncash consideration must be reasonable at the time made [*17 C.F.R. § 230.251(b)*, Note].

[d] Nonintegration With Other Offerings

Offers and sales made in reliance on Regulation A are not to be integrated with prior offers or sales of securities [*17 C.F.R. § 230.251(c)(1)*] or subsequent offers or sales of securities that satisfy any of the following conditions [*17 C.F.R. § 230.251(c)(2)*]:

- Registered under the Securities Act, except in a test-the-waters case as provided in Rule 254(d) [*see* [3][b], *below*];

- Made in reliance on Rule 701 [*see 17 C.F.R. § 230.701* (exemption for offers and sales of securities pursuant to certain compensatory benefit plans and contracts relating to compensation); *see also § 6A.22[2][e]*];

- Made pursuant to an employee benefit plan;

- Made in reliance on Regulation S [*see 17 C.F.R. § 230.901 et seq.* (exemption for foreign offers and sales)]; or

- Made more than six months after the completion of the Regulation A offering.

If the issuer offers or sells securities for which the safe-harbor rules are unavailable, those offers and sales still may not be integrated with the Regulation A offering, depending on the particular facts and circumstances [*17 C.F.R. § 230.251(c)*, Note; *see* Securities Act Release No. 4552 *(Nov. 6, 1962), 27 Fed. Reg. 11316]* .

[e] Offers

Except as allowed by Rule 254 [*see* [3], *below*], no offer of securities may be made unless an offering statement on Form 1-A [*see § 6A.200*] has been filed with the SEC [*17 C.F.R. § 230.251(d)(1)(i)*].

After the offering statement has been filed, oral offers may be made [*17 C.F.R. § 230.251(d)(1)(ii)(A)*]; written offers under Rule 255, using a Preliminary Offering Circular [*see* [4], *below*], may be made [*17 C.F.R. § 230.251(d)(1)(ii)(B)*]; and printed advertisements may be published or radio or television broadcasts may be made, if they state from whom a Preliminary Offering Circular [*see* [4], *below*] or Final Offering Circular may be obtained, and they contain no more than the following information [*17 C.F.R. § 230.251(d)(1)(ii)(C)*]:

- The name of the issuer of the security.

- The title of the security, the amount being offered, and the unit offering price to the public.

- The general type of the issuer's business.

- A brief statement as to the general character and location of the issuer's property.

PRACTICE TIP:

A similar test the waters concept is permitted under *Corp. Code § 25102(n)* [*see* Ch. 6D, *California Qualified Purchaser Exemptions*]. It may therefore be possible to coordinate offerings made under Regulation A with the qualified purchaser exemption in California in lieu of qualifying the offering in California. The securities issued in California may not, however, be freely traded if the offering is exempt under *Corp. Code § 25102(n).* As a result, the issuer will not have all of the benefits afforded Regulation A offerings if this approach is taken. On the other hand, if the offering does not satisfy the standards for qualification contained in the Commissioner's rules, it may be preferable to obtain an exemption from qualification in California, rather than qualify the offering. *Commentary by Frances E. Lossing.*

After the offering statement has been qualified, other written offers may be made, but only if accompanied or preceded by a Final Offering Circular [*17 C.F.R. § 230.251(d)(1)(iii)*].

The Final Offering Circular is the current offering circular contained in a qualified offering statement [*see* [2], *below*], and the Preliminary Offering Circular is the offering circular described in Rule 255(a) [*17 C.F.R. § 230.261*; *see* [4],

below].

[f] Sales

No sale of securities may be made until the following conditions are satisfied [*17 C.F.R. § 230.251(d)(2)(i)*]:

- The offering statement on Form 1-A [*see § 6A.200*] has been qualified.

- A Preliminary Offering Circular or Final Offering Circular is furnished to the prospective buyer at least 48 hours before the mailing of the confirmation of sale to that person.

- A Final Offering Circular is delivered to the buyer with the confirmation of sale, unless it has been delivered to that person at an earlier time.

Sales by a dealer (including an underwriter no longer acting in that capacity for the security involved in the transaction) within 90 days after the qualification of the Regulation A offering statement may be made only if the dealer delivers a copy of the current offering circular to the buyer before or with the confirmation of sale. The issuer or underwriter of the offering must provide requesting dealers with reasonable quantities of the offering circular for this purpose [*17 C.F.R. § 230.251(d)(2)(ii)*].

[2] Offering Circular

[a] Contents

An offering circular must include the narrative and financial information required by Form 1-A [*17 C.F.R. § 230.253(a)*; *see § 6A.200*]. Information in the offering circular must be presented in a clear, concise, and understandable manner and in a type size that is easily readable. Repetition of information should be avoided; cross-referencing of information within the document is permitted [*17 C.F.R. § 230.253(b)(1)*]. When an offering circular is distributed through an electronic medium, the issuer may satisfy legibility requirements applicable to printed documents by presenting all required information in a format readily communicated to investors [*17 C.F.R. § 230.253(b)(2)*].

An offering circular must be dated approximately as of the date of the qualification of the offering statement of which it is a part [*17 C.F.R. § 230.253(c)*].

The cover page of every offering circular must display the following statement in capital letters printed in boldface type at least as large as that used generally in the body of the offering circular [*17 C.F.R. § 230.253(d)*]:

> **THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION DOES NOT PASS UPON THE MERITS OF OR GIVE ITS APPROVAL TO ANY SECURITIES OFFERED OR THE TERMS OF THE OFFERING, NOR DOES IT PASS UPON THE ACCURACY OR COMPLETENESS OF ANY OFFERING CIRCULAR OR OTHER SELLING LITERATURE. THESE SECURITIES ARE OFFERED PURSUANT TO AN EXEMPTION FROM REGISTRATION WITH THE COMMISSION; HOWEVER, THE COMMISSION HAS NOT MADE AN INDEPENDENT DETERMINATION THAT THE SECURITIES OFFERED HEREUNDER ARE EXEMPT FROM REGISTRATION.**

[b] Revisions and Updates

An offering circular must be revised during the course of an offering whenever the information it contains has become false or misleading in light of existing circumstances, whenever material developments have occurred, or whenever there has been a fundamental change in the information initially presented [*17 C.F.R. § 230.253(e)(1)*].

An offering circular for a continuous offering must be updated to include, among other things, updated financial statements, 12 months after the date the offering statement was qualified [*17 C.F.R. § 230.253(e)(2)*].

Every revised or updated offering circular must be filed as an amendment to the offering statement and requalified in accordance with Rule 252 [*17 C.F.R. § 230.253(e)(3)*; *see § 6A.200[1]*].

[3] Solicitation of Interest

[a] Permitted Activity

The issuer may publish or deliver a written document to prospective buyers, or make scripted radio or television broadcasts, to determine whether there is any interest in a contemplated securities offering. Following submission of the written document or script of the broadcast to the SEC [*see* [b], *below*], oral communications with prospective investors and other broadcasts are permitted. The written documents, broadcasts, and oral communications are each subject to the antifraud provisions of the federal securities laws. No solicitation or acceptance of money or other consideration, or of any commitment, binding or otherwise, from any prospective investor is permitted. No sale may be made until qualification of the offering statement [*17 C.F.R. § 230.254(a)*].

[b] Submission of Materials to SEC

On or before the date of its first use, the issuer must submit a copy of any written document or the script of any broadcast to the SEC at the main office in Washington (marked "Attention: Office of Small Business Review"). The document or broadcast script must either bear or be accompanied by the name and telephone number of a person able to answer questions about the document or the broadcast [*17 C.F.R. § 230.254(b)(1)*]. The written document or script of the broadcast must provide the following [*17 C.F.R. § 230.254(b)(2)*]:

- State that no money or other consideration is being solicited, and if money or other consideration is sent in response, it will not be accepted.
- State that no sales of the securities will be made and no commitment to buy will be accepted until delivery of an offering circular that includes complete information about the issuer and the offering.
- State that an indication of interest made by a prospective investor involves no obligation or commitment of any kind.
- Identify the chief executive officer of the issuer and, briefly and in general, its business and products.

Only solicitation-of-interest material that contains substantive changes from or additions to previously submitted material must be submitted [*17 C.F.R. § 230.254(b)(1)*, Note]. Although the submission is required, it is not a condition to qualifying for the Regulation A exemption [*17 C.F.R. § 230.254(b)*]. Any written document may include a coupon, returnable to the issuer as an indication of interest in a potential offering, designed to reveal the name, address, and telephone number of the prospective investor [*17 C.F.R. § 230.254(c)*].

Written solicitation-of-interest materials submitted to the SEC and otherwise in compliance with Rule 254 (discussed here) will not be deemed to be a prospectus as defined in Section 2(10) of the Securities Act [*17 C.F.R. § 230.254(e)*; *see 15 U.S.C. § 77b(a)(10)*].

Solicitations of interest pursuant to Rule 254 may not be made after the filing of an offering statement [*17 C.F.R. § 230.254(b)(3)*]. Sales may not be made until 20 calendar days after the last publication or delivery of the document or

radio or television broadcast [*17 C.F.R. § 230.254(b)(4)*].

When the issuer has a bona fide change of intention and decides to register an offering after using this test-the-waters process as permitted by Rule 254, without having filed the offering statement prescribed by Rule 252 [*see § 6A.200*], the Regulation A exemption for offers made in reliance on Rule 254 will not be subject to integration with the registered offering, if at least 30 calendar days have elapsed between the last solicitation of interest and the filing of the registration statement with the SEC, and all solicitation-of-interest documents have been submitted to the SEC [*17 C.F.R. § 230.254(d)*; *see* [1][d], *above* (nonintegration with other offerings)].

[4] Preliminary Offering Circular

Before qualification of the required offering statement, but after its filing, a written offer of securities may be made if it meets the following requirements [*17 C.F.R. § 230.255(a)*]. In Regulation A (and in the securities industry) this is known as a Preliminary Offering Circular [*see 17 C.F.R. § 230.261(b)*].

The outside front cover page of the material must bear the caption "Preliminary Offering Circular," the date of issuance, and the following statement, which must run along the left margin of the page and be printed perpendicular to the other text, in boldface type at least as large as that used generally in the body of the offering circular [*17 C.F.R. § 230.255(a)(1)*]:

> **An offering statement pursuant to Regulation A relating to these securities has been filed with the Securities and Exchange Commission.**
>
> **Information contained in this Preliminary Offering Circular is subject to completion or amendment. These securities may not be sold nor may offers to buy be accepted before the time an offering circular which is not designated as a Preliminary Offering Circular is delivered and the offering statement filed with the Commission becomes qualified. This Preliminary Offering Circular shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sales of these securities in any state in which such offer, solicitation or sale would be unlawful before registration or qualification under the laws of any such state.**

The Preliminary Offering Circular must contain substantially the information required in an offering circular by Form 1-A [*see § 6A.200*], except that information may be omitted with respect to offering price, underwriting discounts or commissions, discounts or commissions to dealers, amount of proceeds, conversion rates, call prices, or other matters dependent on the offering price. The outside front cover page of the Preliminary Offering Circular must include a bona fide estimate of the range of the maximum offering price and maximum number of shares or other units of securities to be offered or a bona fide estimate of the principal amount of debt securities to be offered [*17 C.F.R. § 230.255(a)(2)*]. The material must be filed as a part of the offering statement [*17 C.F.R. § 230.255(a)(3)*], that is, along with Form 1-A.

If a Preliminary Offering Circular is inaccurate or inadequate in any material respect, a revised Preliminary Offering Circular or a complete Final Offering Circular must be furnished to all persons to whom securities are to be sold at least 48 hours before the mailing of any confirmation of sale to those persons, or it must be sent to those persons in such a way that it would normally be received by them 48 hours before receipt of confirmation of the sale [*17 C.F.R. § 230.255(b)*].

[5] Filing of Sales Information

Seven copies of any advertisement or written communication or the script of any radio or television broadcast must be filed at the main office of the SEC in Washington [*17 C.F.R. § 230.256*]. Only sales material that contains substantive changes from or additions to previously filed material must be filed [*17 C.F.R. § 230.256*, Note]. However, compliance with this requirement is not a condition to a Regulation A exemption [*17 C.F.R. § 230.256*].

The issuer and each selling security holder also must file reports concerning sales and use of proceeds, on Form 2-A [*see 17 C.F.R. § 239.91*; *see also § 6A.201*].

[6] Suspension of Exemption

[a] Grounds for Suspension

The SEC may at any time enter an order temporarily suspending a Regulation A exemption if it has reason to believe that any of the following is true:

- The exemption is not available; or any of the terms, conditions, or requirements of Regulation A have not been complied with, including failures to provide the SEC a copy of the document or broadcast script under Rule 254 [*see* [3][b], *above*], to file any sales material as required by Rule 256 [*see* [5], *above*] or to report as required by Rule 257 [*17 C.F.R. § 230.258(a)(1)*; *see § 6A.201*].

- The offering statement or any item of sales or solicitation-of-interest material contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in light of the circumstances in which they are made, not misleading [*17 C.F.R. § 230.258(a)(2)*].

- The offering is being made or would be made in violation of Section 17 of the Securities Act [*17 C.F.R. § 230.258(a)(3)*; *see 15 U.S.C. § 77q* (fraudulent interstate transactions)].

- An event has occurred after the filing of the offering statement that would have rendered the Regulation A exemption unavailable if it had occurred before the filing [*17 C.F.R. § 230.258(a)(4)*].

- Any person specified in Rule 262(a) [*see 17 C.F.R. § 230.262(a)*], discussed in [9][a], *below*, has been indicted for any crime or offense of the character specified in Rule 262(a)(3), or any proceeding has been initiated for the purpose of enjoining any person from engaging in or continuing any conduct or practice of the character specified in Rule 262(a)(4) [*17 C.F.R. § 230.258(a)(5)*].

- Any person specified in Rule 262(b) [*see 17 C.F.R. § 230.262(b)*], discussed in [9][b], *below*, has been indicted for any crime or offense of the character specified in Rule 262(b)(1), or any proceeding has been initiated for the purpose of enjoining any person from engaging in or continuing any conduct or practice of the character specified in Rule 262(b)(2) [*17 C.F.R. § 230.258(a)(6)*].

- The issuer or any promoter, officer, director, or underwriter has failed to cooperate with, or has obstructed or refused to permit the making of, an investigation by the SEC in connection with any offering made or proposed to be made in reliance on Regulation A [*17 C.F.R. § 230.258(a)(7)*].

[b] Procedure

On the entry of a suspension order, the SEC will promptly give notice to the issuer, any underwriter, and any selling security holder, that the order has been entered, together with a brief statement of the reasons for the entry of the order and that the SEC, on receipt of a written request within 30 calendar days after the entry of the order, will, within 20 calendar days after receiving the request, order a hearing at a place to be designated by the SEC [*17 C.F.R. § 230.258(b)*].

If no hearing is requested and none is ordered by the SEC, the suspension order as entered becomes permanent on the 30th calendar day after entry and remains in effect unless or until it is modified or vacated by the SEC. When a hearing

is requested or is ordered by the SEC, the SEC will, after giving notice and opportunity for the hearing, either vacate the order or enter an order permanently suspending the exemption [*17 C.F.R. § 230.258(c)*].

The SEC may, at any time after giving notice and opportunity for a hearing, enter an order permanently suspending the exemption for any reason on which it could have entered a temporary suspension order as described above; and the order will remain in effect until vacated by the SEC [*17 C.F.R. § 230.258(d)*].

All notices required by this procedure must be given by personal service or registered or certified mail to the addresses given by the issuer, any underwriter, and any selling securities holders in the offering statement [*17 C.F.R. § 230.258(e)*].

[7] Withdrawal or Abandonment of Offering Statement

Before securities that are the subject of an offering statement have been sold, and if the offering statement is not the subject of a suspension proceeding under Rule 258 [*see* [6], *above*], the offering statement may be withdrawn with the SEC's consent. The application for withdrawal must state the reason the offering statement is withdrawn, be signed by an authorized representative of the issuer, and be sent to the main office of the SEC in Washington [*17 C.F.R. § 230.259(a)*].

When an offering statement has been on file with the SEC for nine months without amendment and has not become qualified, the SEC may, in its discretion, proceed in the following manner to determine whether the offering statement has been abandoned by the issuer. If the offering statement has been amended, the nine-month period is computed from the date of the latest amendment [*17 C.F.R. § 230.259(b)*]. Notice will be sent to the issuer, and to any counsel for the issuer named in the offering statement, by registered or certified mail, return receipt requested, addressed to the most recent addresses for the issuer and issuer's counsel as reflected in the offering statement. The notice will inform the issuer and issuer's counsel that the offering statement or latest amendment is out of date and must be amended to comply with applicable requirements of Regulation A or be withdrawn within 30 calendar days after the notice [*17 C.F.R. § 230.259(b)(1)*]. If the issuer or issuer's counsel fails to respond to the notice by filing a substantive amendment or withdrawing the offering statement, or does not furnish a satisfactory explanation as to why the issuer has not done so within 30 calendar days, the SEC may declare the offering statement abandoned [*17 C.F.R. § 230.259(b)(2)*].

[8] Insignificant Deviations From Requirements

Failure to comply with a term, condition, or requirement of Regulation A will not result in the loss of the exemption for any offer or sale to a particular individual or entity, if the person relying on the exemption establishes the following facts [*17 C.F.R. § 230.260(a)*]:

- The failure to comply did not pertain to a term, condition, or requirement directly intended to protect the individual or entity receiving the offer or buying the securities.

- The failure to comply was insignificant with respect to the offering as a whole--except that any failure to comply with Rule 251(a), (b), or (d)(1) [*see* [1][b], [c], [e], *above*] or Rule 251(d)(3) [*see* [1][a], *above*] will be deemed to be significant to the offering as a whole.

- A good faith and reasonable attempt was made to comply with all applicable terms, conditions and requirements of Regulation A.

A transaction made in reliance on Regulation A must comply with all applicable terms, conditions, and requirements of the regulation. When an exemption is established only through reliance on the *de minimis* rule above, the failure to comply may nonetheless be actionable by the SEC under Section 20 of the Securities Act [*17 C.F.R. § 230.260(b)*; *see*

15 U.S.C. § 77t (injunctions and prosecution of offenses)]. The *de minimis* rule provides no relief or protection from a suspension proceeding under Rule 258 [*17 C.F.R. § 230.260(c)*; *see* [6], *above*].

[9] Disqualification

[a] Disqualifying Act by Issuer or Affiliate

Unless, on a showing of good cause and without prejudice to any other action by the SEC, the SEC determines that it is not necessary in the circumstances to deny the exemption provided by Regulation A, the exemption is not available for the offer or sale of securities if any of the following situations applies to the issuer, any of its predecessors, or any affiliated issuer [*17 C.F.R. § 230.262(a)*]:

- Has filed a registration statement that is the subject of any pending proceeding or examination under Section 8 of the Securities Act [*see 15 U.S.C. § 77h* (SEC handling of registration statements)] or has been the subject of any refusal order or stop order under that section within five years before the filing of the Regulation A offering statement [*17 C.F.R. § 230.262(a)(1)*];

- Is subject to any pending suspension proceeding under Rule 258 [*see* [6], *above*] or any similar rule adopted under Section 3(b) of the Securities Act, or to an order entered under such a rule, within five years before the filing of the Regulation A offering statement [*17 C.F.R. § 230.262(a)(2)*];

- Has been convicted, within five years before the filing of the Regulation A offering statement, of any felony or misdemeanor in connection with the buying or selling of any security or involving the making of any false filing with the SEC [*17 C.F.R. § 230.262(a)(3)*];

- Is subject to any order, judgment, or decree of any court of competent jurisdiction temporarily or preliminarily restraining or enjoining, or is subject to any order, judgment, or decree of any court of competent jurisdiction, entered within five years before the filing of the Regulation A offering statement, permanently restraining or enjoining, the person from engaging in or continuing any conduct or practice in connection with the buying or selling of any security or involving the making of any false filing with the SEC [*17 C.F.R. § 230.262(a)(4)*]; or

- Is subject to a U.S. Postal Service false representation order entered under *39 U.S.C. § 3005* (false representations and lotteries by mail) within five years before the filing of the Regulation A offering statement, or is subject to a temporary restraining order or preliminary injunction entered under *39 U.S.C. § 3007* (detention of mail for temporary periods) with respect to conduct alleged to have violated *39 U.S.C. § 3005* [*17 C.F.R. § 230.262(a)(5)*].

The entry of an order, judgment, or decree against any affiliated entity before the affiliation with the issuer arose, if the affiliated entity is not in control of the issuer and if the affiliated entity and the issuer are not under the common control of a third person who was in control of the affiliated entity at the time of the entry, does not come within the purview of the foregoing "bad boy" provisions [*17 C.F.R. § 230.262(a)(5)*].

[b] Disqualifying Act by Insider or Underwriter

Unless, on a showing of good cause and without prejudice to any other action by the SEC, the SEC determines that it is not necessary in the circumstances to deny the exemption provided by Regulation A, the exemption is not available for the offer or sale of securities if any of the following situations applies to any director or officer of the issuer, beneficial owner of 10 percent or more of any class of its equity securities, any promoter of the issuer presently connected with it in any capacity, any underwriter of the securities to be offered, or any partner, director, or officer of any underwriter [*17*

C.F.R. § 230.262(b)]:

- Has been convicted, within 10 years before the filing of the Regulation A offering statement, of any felony or misdemeanor in connection with the buying or selling of any security, involving the making of a false filing with the SEC, or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, or investment adviser [*17 C.F.R. § 230.262(b)(1)*];

- Is subject to any order, judgment, or decree of any court of competent jurisdiction temporarily or preliminarily enjoining or restraining, or is subject to any order, judgment, or decree of any court of competent jurisdiction, entered within five years before the filing of the Regulation A offering statement, permanently enjoining or restraining the person from engaging in or continuing any conduct or practice in connection with the buying or selling of any security, involving the making of a false filing with the SEC, or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, or investment adviser [*17 C.F.R. § 230.262(b)(2)*];

- Is subject to an order of the SEC entered pursuant to Section 15(b) or Section 15B(a) or (c) of the Exchange Act [*see 15 U.S.C. §§ 78o(b), 78o-4(a), (c)* (registration and regulation of brokers and dealers; registration of municipal securities dealers; discipline of municipal securities dealers)], or Section 203(e) or (f) of the Investment Advisers Act of 1940 [*17 C.F.R. § 230.262(b)(3)*; *see 15 U.S.C. § 80b-3(e), (f)* (registration and discipline of investment advisers)];

- Is suspended or expelled from membership in, or suspended or barred from association with a member of, a national securities exchange registered under Section 6 of the Exchange Act [*see 15 U.S.C. § 78f*] or a national securities association registered under Section 15A of the Exchange Act [*see 15 U.S.C. § 78o-3*], for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade [*17 C.F.R. § 230.262(b)(4)*]; or

- Is subject to a U.S. Postal Service false representation order entered under *39 U.S.C. § 3005* (false representations and lotteries by mail) within five years before the filing of the Regulation A offering statement, or is subject to a temporary restraining order or preliminary injunction entered under *39 U.S.C. § 3007* (detention of mail for temporary periods) with respect to conduct alleged to have violated *39 U.S.C. § 3005* [*17 C.F.R. § 230.262(b)(5)*].

[c] Disqualifying Act by Underwriter

Unless, on a showing of good cause and without prejudice to any other action by the SEC, the SEC determines that it is not necessary in the circumstances to deny the exemption provided by Regulation A, the exemption is not available for the offer or sale of securities if any underwriter of the securities was an underwriter or was named as an underwriter of any securities that satisfies either of the following conditions [*17 C.F.R. § 230.262(c)*]:

- Are covered by any registration statement that is the subject of any pending proceeding or examination under Section 8 of the Securities Act [*see 15 U.S.C. § 77h* (SEC handling of registration statements)] or has been the subject of any refusal order or stop order entered under that section within five years before the filing of the Regulation A offering statement [*17 C.F.R. § 230.262(c)(1)*]; or

- Are covered by any filing that is subject to any pending suspension proceeding under Rule 258 [*see* [6], *above*] or any similar rule adopted under Section 3(b) of the Securities Act, or to an order entered under such a rule, within five years before the filing of the Regulation A offering statement [*17 C.F.R. § 230.262(c)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawRegulation of Securities MarketsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART II. LEGAL BACKGROUND

3-6A California Legal Forms--Transaction Guide § 6A.26

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.26 $1 Million Offering Under Section 3(b) and Rule 504

[1] Scope of Exemption

The SEC "may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed therein, add any class of securities to the securities exempted as provided in this section [Section 3 of the Securities Act], if it finds that the enforcement of this subchapter [the Securities Act] with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection [Section 3(b) of the Securities Act] where the aggregate amount at which such issue is offered to the public exceeds $5,000,000" [*15 U.S.C. § 77c(b)*].

Offers and sales of securities by eligible issuers [*see* [2], *below*] satisfying the conditions in Rule 504 of Regulation D [*see 17 C.F.R. § 230.504*; *see also* [3], [4], *below*]--as well as Rules 501 through 503--are exempt under Section 3(b) of the Securities Act from the registration requirements of the Act [*17 C.F.R. § 230.504(a)*].

[2] Eligible Issuer

Any corporation is an eligible issuer under Rule 504 if the corporation satifiies the following conditions [*17 C.F.R. § 230.504(a)*]:

- Is not subject to the reporting requirements of Section 13 or Section 15(d) of the Exchange Act [*see 15 U.S.C. §§ 78m, 78o(d)* (periodic reporting requirements)];

- Is not an investment company; and

- Is not a development-stage company that either has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person.

[3] General Conditions for Exemption

[a] Integration

All sales that are part of the same Regulation D offering must meet all of the terms and conditions of Regulation D. Offers and sales that are made more than six months before the start of a Regulation D offering or are made more than six months after completion of a Regulation D offering will not be considered part of that Regulation D offering, as long as during those six-month periods there are no offers or sales of securities by or for the issuer that are of the same or a similar class as those offered or sold under Regulation D, other than offers or sales of securities under an employee benefit plan as defined in Rule 405 [*17 C.F.R. §§ 230.502(a), 230.504(b)(1)*; *see 17 C.F.R. § 230.405* (definitions of terms in Regulation C, applicable to all Securities Act registrations)] or Rule 701 [*17 C.F.R. § 230.701(f)*]. This integration rule is relevant to computing the aggregate offering price, which is limited as described in [4], *below*.

The term "offering" is not defined in the Securities Act or in Regulation D. If the issuer offers or sells securities for which the foregoing safe harbor rule is unavailable, the determination as to whether separate sales of securities are part of the same offering (that is, are considered integrated) depends on the particular facts and circumstances. Generally, transactions otherwise meeting the requirements of an exemption will not be integrated with simultaneous offerings being made outside the United States in compliance with Regulation S [*17 C.F.R. § 230.502(a)*, Note; *see* Securities Act Release No. 6863 (Apr. 24, 1990)]. The following factors should be considered in determining whether offers and sales should be integrated for purposes of the exemptions under Regulation D [*see* Securities Act Release No. 4552 *(Nov. 6, 1962), 27 Fed. Reg. 11316* ; *see also § 6A.24[2][a]* (identical tests are applied under Rule 147)]:

- Are the sales part of a single plan of financing?
- Do the sales involve issuance of the same class of securities?
- Have the sales been made at or about the same time?
- Is the same type of consideration being received?
- Are the sales made for the same general purpose?

[b] Limitation on Manner of Offering

In general, neither the issuer nor any person acting on its behalf may offer or sell the securities by any form of general solicitation or general advertising, including, but not limited to, (1) any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio and (2) any seminar or meeting attended by persons who have been invited by any general solicitation or general advertising. However, publication by an issuer of a notice in accordance with Rule 135c [*see 17 C.F.R. § 230.135c* (notice of certain proposed unregistered offerings)] or filing with the Commission by an issuer of a notice of sales on Form D [*17 C.F.R. § 239.500*] in which the issuer has made a good faith and reasonable attempt to comply with the requirements of that form, will not be deemed to constitute general solicitation or general advertising. If the requirements of Rule 135e [*see 17 C.F.R. § 230.135e* (offshore press conferences, meetings with issuer representatives conducted offshore, and press-related materials released offshore)] are met, then the issuer's providing any journalist with access to press conferences held outside the United States, or to meetings with the issuer's or selling security holders' representatives conducted outside the United States, or to written press-related materials released outside the United States, at or in which a present or proposed offering of securities is discussed, will not be deemed to constitute general solicitation or general advertising [*17 C.F.R. §§ 230.502(c), 230.504(b)(1)*].

PRACTICE TIP:

California law is not as flexible as federal law in this regard. A test the waters concept is available in *Corp. Code § 25102(n)*, but not in other exemptions containing private placement concepts, such as *Corp. Code § 25102(e), (f)*, and *(i)*. The publication of a Section 135c notice would likely be viewed as the publication of a prohibited advertisement for purposes of these exemptions. *Commentary by Frances E. Lossing.*

This limitation does not apply, however, to offers and sales of securities under Rule 504 that are made in any of the following situations [*17 C.F.R. §§ 230.502(c), 230.504(b)(1)*]:

- Exclusively in one or more states providing for the registration of the securities, and requiring the public filing and delivery to investors of a substantive disclosure document before sale, and the offers and sales are made in accordance with those state provisions;

- In one or more states not providing for the registration of the securities or the public filing or delivery of a disclosure document before sale, if the securities have been registered in at least one state that provides for registration, public filing, and delivery before sale, if offers and sales are made in that registration state in accordance with those provisions, and if the disclosure document is delivered before sale to all buyers (including those in the states that have no such procedure); or

- Exclusively according to state law exemptions from registration that permit general solicitation and general advertising, as long as sales are made only to "accredited investors" [*see 17 C.F.R. § 230.501(a)* (definition)].

[c] Limitations on Resale

In general, securities acquired in a transaction under Regulation D have the status of securities acquired in a transaction under Section 4(2) of the Securities Act and cannot be resold without registration under the Act or an exemption from registration. The issuer must exercise reasonable care to ensure that the buyers of the securities are not underwriters within the meaning of Section 2(11) of the Act. Reasonable care may be demonstrated by the following [*17 C.F.R. §§ 230.502(d), 230.504(b)(1)*]:

- Reasonable inquiry to determine whether the buyer is acquiring the securities for the buyer's own account or for other persons.

- Written disclosure to each buyer before sale that the securities have not been registered under the Securities Act and, therefore, cannot be resold unless they are registered under the Act or an exemption from registration is available [*see § 6A.204*].

- Placement of a legend on the certificate or other document that evidences the securities, stating that the securities have not been registered under the Securities Act and setting forth or referring to the restrictions on transferability and sale of the securities.

Although taking these steps will establish the requisite reasonable care, it is not the exclusive method to demonstrate that care. Other acts by the issuer may satisfy this condition. In addition, Rule 502 requires the delivery of written disclosure of the limitations on resale to investors in certain instances [*17 C.F.R. §§ 230.502(b)(2)(vii), (d)*, 230.504(b)(1)].

This limitation on resale does not apply, however, to offers and sales of securities under Rule 504 that are made in the same exceptional circumstances described in [b], *above* [*17 C.F.R. §§ 230.502(d), 230.504(b)(1)*].

[4] Aggregate Offering Price

The aggregate offering price [*see 17 C.F.R. § 230.501(c)* (definition)] for an offering of securities under Rule 504 may not exceed $1 million, less the aggregate offering price for all securities sold within the 12 months before the start of and during the offering of securities under Rule 504, in reliance on any exemption under Section 3(b), or in violation of Section 5(a), of the Securities Act [*17 C.F.R. § 230.504(b)(2)*].

For example, if an issuer sold $900,000 on June 1, 2001, under Rule 504 and an additional $4.1 million on December 1, 2001, under Rule 505 [*see § 6A.27*], the issuer could not sell any of its securities under Rule 504 until December 1, 2002. Until then the issuer must count the December 1, 2001, sale towards the $1 million limit within the preceding 12 months [*17 C.F.R. § 230.504(b)(2)*, Note 1].

If a transaction under Rule 504 fails to meet the limitation on the aggregate offering price, that does not affect the availability of Rule 504 for the other transactions considered in applying the limitation. For example, if an issuer sold $1 million worth of its securities on January 1, 2001, under Rule 504 and an additional $500,000 worth on July 1, 2001, then Rule 504 would not be available for the later sale but would still be applicable to the January 1, 2001, sale [*17 C.F.R. § 230.504(b)(2)*, Note 2].

[5] Offering Statement and Notice of Sales

The SEC does not require the preparation, filing, or use of any kind of offering statement to disclose material information in connection with a Rule 504 offering [*see 17 C.F.R. §§ 230.502(b)(1), 230.504*]. Nevertheless, securities experts recommend that the issuer should prepare an offering statement and use it, as in similar cases in which it is required (such as under Regulation A), if only because this will minimize the issuer's risks under statutory civil and criminal antifraud provisions. For guidance in using an offering statement, the issuer could look to Regulation A [*see § 6A.25*] and Rule 505 and Rule 506 [*see §§ 6A.27, 6A.28*]. The issuer could adapt either the SEC's Form 1-A [*see § 6A.200*] or use the Small Corporate Offering Registration (SCOR) form, Form U-7, sponsored by the NASAA [*see § 6A.203*].

PRACTICE TIP:

No notice filings must be made under California law if the issuer is relying on exemptions under *Corp. Code § 25102(e)* or *(i)*. Notice filings must be made under California law for offerings made in reliance on exemptions *Corp. Code § 25102(f)* and *(n)*, respectively. *Commentary by Frances E. Lossing.*

An issuer offering or selling securities in reliance on § 230.504, 230.505, or 230.506 must file with the SEC a notice of sale containing the information required by Form D [*17 C.F.R. § 239.500*] for each new offering of securities no later than 15 calendar days after the first sale of securities in the offering [*17 C.F.R. §§ 230.503(a)(1), 239.500(a)(1)*; *see § 6A.202[2]*]. As of March 16, 2009, a notice of sale on Form D must be filed in electronic format by means of the Commission's EDGAR system in accordance with the rules set forth in Regulation S-T [*17 C.F.R. §§ 230.503(b), 239.500(b)*; *see* 17 C.F.R. Part 232; *see also § 6A.202[1]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART II. LEGAL BACKGROUND

3-6A California Legal Forms--Transaction Guide § 6A.27

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.27 $5 Million Offering Under Section 4(6) and Rule 505

[1] Scope of Exemption

The SEC "may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed therein, add any class of securities to the securities exempted as provided in this section [Section 3 of the Securities Act], if it finds that the enforcement of this subchapter [the Securities Act] with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection [Section 3(b) of the Securities Act] where the aggregate amount at which such issue is offered to the public exceeds $5,000,000" [*15 U.S.C. § 77c(b)*].

Offers and sales of securities by any issuer, except an investment company, satisfying the conditions in Rule 505 of Regulation D [*see 17 C.F.R. § 230.505*; *see also* [2]-[5], *below*]--as well as Rules 501 through 503--are exempt under Section 3(b) of the Securities Act from the registration requirements of the Act [*17 C.F.R. § 230.505(a)*].

All sales that are part of the same Rule 505 offering must meet all of the terms and conditions of Regulation D [*17 C.F.R. §§ 230.502(a), 230.505(b)(1)*]. For a Rule 505 offering, sales would be deemed integrated (or not) as described in § 6A.26[3][a] for a Rule 504 offering. This is relevant to computing not only the aggregate offering price, which is limited as described in [3], *below*, but also the number of buyers, for purposes of the limitation described in [4], *below*.

[2] Disclosure

[a] Requirement

If the issuer sells securities to any buyer other than an "accredited investor" [*see 17 C.F.R. § 230.501(a)* (definition); *see also § 6A.112[1]*], the issuer must furnish specified information [*see* [b], [c], *below*] to the buyer a reasonable time before the sale. The issuer is not required to furnish the specified information to any accredited investor [*17 C.F.R. §§ 230.502(b)(1), 230.505(b)(1)*]. However, when the issuer provides information to nonaccredited investors, the issuer

should consider providing the same information to accredited investors as well, in view of the antifraud provisions of the federal securities laws [*17 C.F.R. § 230.502(b)(1)*, Note].

[b] Nonreporting Company's Information

If the issuer is not subject to the reporting requirements of Section 13 or Section 15(d) of the Exchange Act [*see 15 U.S.C. §§ 78m, 78o(d)* (periodic reporting requirements)]--and most small private corporations are not reporting companies--then at a reasonable time before the sale of securities, the issuer must furnish to the buyer the following information, to the extent material to an understanding of the issuer, its business, and the securities being offered [*17 C.F.R. §§ 230.502(b)(2)(i), 230.505(b)(1)*]:

- The same kind of information as would be required in Part II (the offering circular) of Form 1-A [*see § 6A.200*], if the issuer is eligible to use Regulation A, otherwise the same kind of information as required in Part I (the prospectus) of a registration statement filed under the Securities Act on the form that the issuer would be entitled to use [*17 C.F.R. § 230.502(b)(2)(i)(A)*]; and

- Appropriate financial information, according to the size of the offering, either

  - For an offering not over $2 million: the financial information required in Article 8 of Regulation S-X [*see* 17 C.F.R. § 210.8], except that only the issuer's balance sheet, which must be dated within 120 days of the start of the offering, is required to be audited [*17 C.F.R. § 230.502(b)(2)(i)(B)(1)*]; or

  - For an offering over $2 million (up to the $7.5 million exemption ceiling): the financial statement information required in Form S-1 [*see 17 C.F.R. § 239.10*], but if the issuer cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which must be dated within 120 days of the start of the offering, is required to be audited [*17 C.F.R. § 230.502(b)(2)(i)(B)(2)*].

[c] Reporting Company's Information

A small private corporation would not be a reporting company except in a rare case. If the issuer is subject to the reporting requirements of Section 13 or Section 15(d) of the Exchange Act [*see 15 U.S.C. §§ 78m, 78o(d)* (periodic reporting requirements)], however, then at a reasonable time before the sale of securities, the issuer must furnish to the buyer the following information [*17 C.F.R. §§ 230.502(b)(2)(ii), 230.505(b)(1)*]:

- Whichever of the following is appropriate in the circumstances:

  - The issuer's annual report to shareholders for the most recent fiscal year, if the annual report meets relevant regulatory requirements under the Exchange Act [*see 17 C.F.R. §§ 240.14a-3, 240.14c-3*]; the definitive proxy statement filed in connection with that annual report; and, if requested by the buyer in writing, a copy of the issuer's most recent Form 10-K under the Exchange Act [*17 C.F.R. § 230.502(b)(2)(ii)(A)*].

  - The information contained in an annual report on Form 10-K under the Exchange Act, or in a registration statement on Form S-1, or Form S-11 filed under the Securities Act, or on Form 10 filed under the Exchange Act, whichever filing is the most recent required to be filed [*17 C.F.R. § 230.502(b)(2)(ii)(B)*].

- The information contained in any reports or documents required to be filed by the issuer under

Sections 13(a), 14(a), 14(c), and 15(d) of the Exchange Act [*see 15 U.S.C. §§ 78m(a), 78n(a), (c), 78o(d)* (periodic reporting requirements)] since the distribution or filing of the report or registration statement selected above, together with a brief description of the securities being offered, the use of the proceeds from the offering, and any material changes in the issuer's affairs that are not disclosed in the documents furnished [*17 C.F.R. § 230.502(b)(2)(ii)(C)*].

[d] Additional Information

At a reasonable time before the sale of securities to any buyer other than an accredited investor, the issuer must furnish to the buyer a brief description in writing of any material written information concerning the offering that has been provided by the issuer to any accredited investor but not previously delivered to the nonaccredited buyer. The issuer must furnish any portion or all of this information to the buyer, on the buyer's written request a reasonable time before the sale [*17 C.F.R. §§ 230.502(b)(2)(iv), 230.505(b)(1)*; *see 17 C.F.R. § 230.502(b)(2)(vi)* (additional information in case of business combination or exchange offer)]. However, exhibits required to be filed with the SEC as part of a registration statement or report, other than an annual report to shareholders or parts of that report incorporated by reference in a Form 10-K report, need not be furnished to each buyer other than an accredited investor, if the contents of material exhibits are identified and the exhibits are made available to a buyer, on the buyer's written request, a reasonable time before the sale [*17 C.F.R. §§ 230.502(b)(2)(iii), 230.505(b)(1)*].

The issuer also must make available to each buyer, at a reasonable time before the sale, the opportunity to ask questions and receive answers concerning the terms and conditions of the offering and to obtain any additional information that the issuer possesses or can acquire without unreasonable effort or expense and that is necessary to verify the accuracy of information furnished as described in [b] and [c], *above* [*17 C.F.R. §§ 230.502(b)(2)(v), 230.505(b)(1)*].

At a reasonable time before the sale of securities to any buyer other than an accredited investor, the issuer must provide to the buyer a written disclosure that the securities have not been registered under the Securities Act and, therefore, cannot be resold unless they are registered under the Act or an exemption from registration is available. The disclosure may be contained in other materials required to be provided to the buyer [*17 C.F.R. §§ 230.502(b)(2)(vii), (d)(2),* 230.505(b)(1)].

[3] Aggregate Offering Price

The aggregate offering price [*see 17 C.F.R. § 230.501(c)* (definition)] for an offering of securities under Rule 505 may not exceed $5 million, less the aggregate offering price for all securities sold within the 12 months before the start of and during the offering of securities under Rule 505 in reliance on any exemption under Section 3(b) of the Securities Act or in violation of Section 5(a) of the Act [*17 C.F.R. § 230.505(b)(2)(i)*].

For example, if the issuer sold $2 million of its securities on June 1, 2001, under Rule 505 and an additional $1 million on September 1, 2001, the issuer would be permitted to sell only $2 million more under Rule 505 until June 1, 2002. Until that date the issuer must count both prior sales toward the $5 million ceiling. However, if the issuer made its third sale on June 1, 2002, the issuer could on that date sell $4 million of its securities because the June 1, 2001, sale would not be within the preceding 12 months [*17 C.F.R. § 230.505(b)(2)(i),* Example 1].

If the issuer sold $500,000 of its securities on June 1, 2001, under Rule 504 and an additional $4.5 million on December 1, 2001, under Rule 505, then the issuer could not sell any of its securities under Rule 505 until June 1, 2002; and on that date it could sell an additional $500,000 of its securities [*17 C.F.R. § 230.505(b)(2)(i),* Example 2].

[4] Limitation on Buyers

There must be no more than (or the issuer must reasonably believe that there are no more than) 35 buyers of the

securities from the issuer in any offering under Rule 505 [*17 C.F.R. § 230.505(b)(2)(ii)*], not counting buyers that are "accredited investors" [*17 C.F.R. § 230.501(e)(1)(iv)*; *see 17 C.F.R. § 230.501(a)* (definition); *see also § 6A.112[1]*]. Since there may be any number of buyers that are accredited investors (and there often are no other buyers), the Rule 505 exemption sometimes is called an "accredited investors exemption." Rule 501 specifies how to compute the number of buyers other than accredited investors, by excluding certain related individuals and entities [*see 17 C.F.R. § 230.501(e)(1)*] while aggregating the beneficial owners of other entities [*see 17 C.F.R. § 230.501(e)(2), (3)*; *see also § 6A.112[1]*].

[5] Offering Statement and Notice of Sales

The SEC does not require the preparation, filing, or use of an offering statement for the Rule 505 exemption. However, the issuer is required to disclose considerable information to buyers other than accredited investors, including, in most cases, the same kind of information as would be required in Part II (the offering circular) of Form 1-A, if the issuer is eligible to use Regulation A, otherwise the same kind of information as required in Part I (the prospectus) of a registration statement filed under the Securities Act on the form that the issuer would be entitled to use, but for the exemption [*see* [2], *above*]. Therefore, the issuer may elect to prepare an offering statement as in the case of a nonexempt offering.

PRACTICE TIP:

No notice filings must be made under California law if the issuer is relying on exemptions under *Corp. Code § 25102(e)* or *(i)*. Notice filings must be made under California law for offerings made in reliance on exemptions *Corp. Code § 25102(f)* and *(n)*, respectively. *Commentary by Frances E. Lossing.*

An issuer offering or selling securities in reliance on § 230.504, 230.505, or 230.506 must file with the SEC a notice of sale containing the information required by Form D [*17 C.F.R. § 239.500*] for each new offering of securities no later than 15 calendar days after the first sale of securities in the offering [*17 C.F.R. §§ 230.503(a)(1), 239.500(a)(1)*; *see § 6A.202[2]*]. As of March 16, 2009, a notice of sale on Form D must be filed in electronic format by means of the Commission's EDGAR system in accordance with the rules set forth in Regulation S-T [*17 C.F.R. §§ 230.503(b)(1), 239.500(b)(1)*; *see* 17 C.F.R. Part 232; *see also § 6A.202[1]*].

[6] Disqualification

No exemption under Rule 505 is available for the securities of any issuer described in Rule 262 of Regulation A [*see 17 C.F.R. § 230.262*], which is discussed in *§ 6A.25[9]*, but in the case of a Rule 505 offering, the following references there have these meanings: (1) "filing of the offering statement required by Rule 252" means the first sale of securities under Rule 505; (2) "underwriter" means a person that has been or will be paid, directly or indirectly, any remuneration for solicitation of buyers in connection with sales of securities under Rule 505 [*17 C.F.R. § 230.505(b)(2)(iii)(A), (B)*].

This disqualification does not apply, however, to any issuer if the SEC determines, on a showing of good cause, that it is not necessary in the circumstances to deny the exemption. Any such determination is without prejudice to any other action by the SEC in any other proceeding or matter with respect to the issuer or any other person [*17 C.F.R. § 230.505(b)(2)(iii)(C)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART II. LEGAL BACKGROUND

3-6A California Legal Forms--Transaction Guide § 6A.28

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.28 Private Offering Under Section 4(2) and Rule 506

[1] Scope of Exemption

The registration requirements of the Securities Act do not apply to "transactions by an issuer not involving any public offering" [*15 U.S.C. § 77d(2)*]. This is known as the Section 4(2), or private offering, exemption.

Offers and sales of securities by any issuer satisfying the conditions in Rule 506 of Regulation D [*see 17 C.F.R. § 230.506*; *see also* [2]-[5], *below*]--as well as Rules 501 through 503--are deemed to be transactions not involving any public offering within the meaning of Section 4(2) of the Securities Act and therefore are exempt from the registration requirements of the Act [*17 C.F.R. § 230.506(a)*], as well as being entitled to the preemption provisions of NSMIA [*see Ch. 6, Securities Regulation Issues, § 6.15*].

All sales that are part of the same Rule 506 offering must meet all of the terms and conditions of Regulation D [*17 C.F.R. §§ 230.502(a), 230.506(b)(1)*]. For a Rule 506 offering, sales would be deemed integrated (or not) as described in § 6A.26[3][a] for a Rule 504 offering. This is relevant to computing the number of buyers [*see 17 C.F.R. § 230.506(b)(2)(i)*, Note], for purposes of the limitation described in [4], *below*.

[2] Disclosure

[a] Requirement

If the issuer sells securities to any buyer other than an "accredited investor" [*see 17 C.F.R. § 230.501(a)* (definition); *see also § 6A.112[1]*], the issuer must furnish specified information [*see* [b], [c], *below*] to the buyer a reasonable time before the sale. The issuer is not required to furnish the specified information to any accredited investor [*17 C.F.R. §§ 230.502(b)(1), 230.506(b)(1)*]. However, when the issuer provides information to nonaccredited buyers, the issuer should consider providing the same information to accredited investors as well, in view of the antifraud provisions of the federal securities laws [*17 C.F.R. § 230.502(b)(1)*, Note].

[b] Nonreporting Company's Information

If the issuer is not subject to the reporting requirements of Section 13 or Section 15(d) of the Exchange Act [*see 15 U.S.C. §§ 78m, 78o(d)* (periodic reporting requirements)]--and most small private corporations are not reporting companies--then at a reasonable time before the sale of securities, the issuer must furnish to the buyer the following information, to the extent material to an understanding of the issuer, its business, and the securities being offered [*17 C.F.R. §§ 230.502(b)(2)(i), 230.506(b)(1)*]:

- The same kind of information as would be required in Part II (the offering circular) of Form 1-A, if the issuer is eligible to use Regulation A, otherwise the same kind of information as required in Part I (the prospectus) of a registration statement filed under the Securities Act on the form that the issuer would be entitled to use [*17 C.F.R. § 230.502(b)(2)(i)(A)*]; and

- Appropriate financial information, according to the size of the offering, either

  - For an offering not over $2 million: the financial information required in Article 8 of Regulation S-X [*see* 17 C.F.R. § 210.8], except that only the issuer's balance sheet, which must be dated within 120 days of the start of the offering, is required to be audited [*17 C.F.R. § 230.502(b)(2)(i)(B)(1)*];

  - For an offering over $2 million and not over $7.5 million: the financial statement information required in S-1 [*see 17 C.F.R. § 239.10*], but if the issuer cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which must be dated within 120 days of the start of the offering, is required to be audited [*17 C.F.R. § 230.502(b)(2)(i)(B)(2)*]; or

  - For an offering over $7.5 million: the financial statement that would be required in a registration statement filed under the Securities Act on the form that the issuer would be entitled to use, provided that if the issuer cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which must be dated within 120 days of the start of the offering, is required to be audited [*17 C.F.R. § 230.502(b)(2)(i)(B)(3)*].

[c] Reporting Company's Information

A small private corporation would not be a reporting company except in a rare case. If the issuer is subject to the reporting requirements of Section 13 or Section 15(d) of the Exchange Act [*see 15 U.S.C. §§ 78m, 78o(d)* (periodic reporting requirements)], however, then at a reasonable time before the sale of securities, the issuer must furnish to the buyer the same information as described in § 6A.27[2][c] for a Rule 505 offering [*17 C.F.R. §§ 230.502(b)(2)(ii), 230.506(b)(1)*].

[d] Additional Information

The issuer must furnish to the buyer the same additional information as described in § 6A.27[2][d] for a Rule 505 offering [*17 C.F.R. §§ 230.502(b)(2)(iii)-(vi), 230.506(b)(1)*].

[3] Aggregate Offering Price

There is no ceiling on the aggregate offering price of a Rule 506 offering.

[4] Limitations on Buyers

There must be no more than (or the issuer must reasonably believe that there are no more than) 35 buyers of securities from the issuer in any offering under Rule 506 [*17 C.F.R. § 230.506(b)(2)(i)*], not counting buyers that are "accredited investors" [*17 C.F.R. § 230.501(e)(1)(iv)*; *see 17 C.F.R. § 230.501(a)* (definition); *see also § 6A.112[1]*]. The number of buyers other than accredited investors would be computed as in the case of a Rule 505 offering [*see § 6A.27[4]*].

Each buyer other than an accredited investor, either alone or with buyer representatives [*see 17 C.F.R. § 230.501(h)* (who are representatives)], must have enough knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment, or the issuer must reasonably believe immediately before making any sale that the buyer comes within this description [*17 C.F.R. § 230.506(b)(2)(ii)*]. Such a buyer usually is described as a "sophisticated" buyer. In practice, a buyer other than an accredited buyer usually is required to complete and return to the issuer a questionnaire designed to reveal the buyer's level of investment sophistication [*see § 6A.206*].

PRACTICE TIP:

A person acting as a purchaser representative must generally be licensed as an investment adviser in California. The term "investment adviser" applies to any person who, for compensation, engages in the business of advising others with respect to investing in or purchasing or selling securities. A broker-dealer is excluded from this definition if the broker provides investment advice solely as an incident to the broker's business and the broker receives no special compensation for such services. Attorneys and accountants are excluded from this definition only if investment advisory services are provided solely as an incidence to the practice of their profession. Otherwise they need to be licensed as investment advisers. *Commentary by Frances E. Lossing.*

In a Rule 506 offering, therefore, every buyer must be either an accredited investor or a sophisticated buyer, or must be represented by a professional representative who is sophisticated, and there may be no more than 35 buyers in the second category. This is, essentially, what makes it a "private" offering.

A buyer or purchaser representative may not be affiliated with the issuer. The purchaser must acknowledge in writing that the representative is assisting the buyer in evaluating the merits and risks of the offering. In addition, the purchaser representative must disclose to the buyer a reasonable time before the sale of the securities any material relationship between him or his affiliates and the issuer that exists or has existed during the previous two years and the amount of any compensation received or to be received as a result of such relationship [*17 C.F.R. § 230.501(h)*].

[5] Offering Statement and Notice of Sales

The SEC does not require the preparation, filing, or use of an offering statement for the Rule 506 exemption. However, the issuer is required to disclose considerable information to buyers other than accredited investors, including, in most cases, the same kind of information as would be required in Part II (the offering circular) of Form 1-A, if the issuer is eligible to use Regulation A, otherwise the same kind of information as required in Part I (the prospectus) of a registration statement filed under the Securities Act on the form that the issuer would be entitled to use, but for the exemption [*see* [2], *above*]. Therefore, the issuer may elect to prepare an offering statement as in the case of a nonexempt offering.

PRACTICE TIP:

No notice filings must be made under California law if the issuer is relying on exemptions under *Corp. Code § 25102(e)* or *(i)*. Notice filings must be made under California law for offerings made in reliance on exemptions *Corp. Code § 25102(f)* and *(n)*, respectively. *Commentary by Frances E. Lossing.*

An issuer offering or selling securities in reliance on § 230.504, 230.505, or 230.506 must file with the SEC a notice of

sale containing the information required by Form D [*17 C.F.R. § 239.500*] for each new offering of securities no later than 15 calendar days after the first sale of securities in the offering [*17 C.F.R. §§ 230.503(a)(1), 239.500(a)(1)*; *see § 6A.202[2]*]. As of March 16, 2009, a notice of sale on Form D must be filed in electronic format by means of the Commission's EDGAR system in accordance with the rules set forth in Regulation S-T [*17 C.F.R. §§ 230.503(b), 239.500(b)*; *see* 17 C.F.R. Part 232; *see also § 6A.202[1]*].

Legal Topics:

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART II. LEGAL BACKGROUND

3-6A California Legal Forms--Transaction Guide § 6A.29

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.29 Insignificant Deviations From Requirements

Failure to comply with any term, condition, or requirement of Rule 504, 505, or 506 will not result in the loss of the exemption under Section 5 of the Act if the following situations apply [*17 C.F.R. § 230.508*]:

- The person relying on the exemption shows that the failure to comply did not pertain to a term, condition or requirement directly intended to protect that particular individual or entity; or

- The failure to comply was insignificant to the offering as a whole, provided that any failure to comply with Rule 502(c), 504(b)(2), 505(b)(2)(i) or (ii), or 506(b)(2)(i) will not be deemed to be insignificant.

In addition, a good faith attempt must be made to comply with all applicable requirements. A failure to comply with all applicable requirements will nevertheless remain actionable under Section 20 of the Act [*17 C.F.R. § 230.508*].

PRACTICE TIP:

If there has been a de minimis failure to comply with Rule 506, the federal preemption benefits of NSMIA may be unavailable. In this situation, the issuer may need to consider other potentially available private placement exemptions in California, such as *Corp. Code § 25102(e), (f), (i),* and *(n). Commentary by Frances E. Lossing.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART II. LEGAL BACKGROUND

3-6A California Legal Forms--Transaction Guide § 6A.30

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.30 Sale Through Employee Benefit Plan Under Section 3(b) and Rule 701

[1] Scope of Exemption

[a] In General

The SEC "may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed therein, add any class of securities to the securities exempted as provided in this section [Section 3 of the Securities Act], if it finds that the enforcement of this subchapter [the Securities Act] with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection [Section 3(b) of the Securities Act] where the aggregate amount at which such issue is offered to the public exceeds $5,000,000" [*15 U.S.C. § 77c(b)*].

Offers and sales made in compliance with all of the conditions of Rule 701 are exempt under Section 3(b) of the Securities Act from the registration requirements of the Act [*17 C.F.R. § 230.701(a)*]. Rule 701 exempts offers and sales of securities, including plan interests and guaranties [*see 17 C.F.R. § 230.701(d)(2)(ii)*], under a written compensatory benefit plan [*see* [c], *below*] (or written compensation contract) established by the issuer [*see* [b], *below*], its parents, its majority-owned subsidiaries, or majority-owned subsidiaries of the issuer's parent, for the participation of their employees, directors, general partners, trustees (when the issuer is a business trust), officers, or consultants and advisers [*see* [d], *below*], and their family members [*see* [c], *below*] who acquire the securities from those persons through gifts or domestic relations orders. Rule 701 exempts offers and sales to former employees, directors, general partners, trustees, officers, consultants, and advisers only if those persons were employed by or providing services to the issuer at the time the securities were offered. In addition, the term "employee" may include insurance agents who are exclusive agents of the issuer or its subsidiaries or parents, or who derive more than 50 percent of their annual income from such entities. [*17 C.F.R. § 230.701(c)*].

Offers and sales exempt under Rule 701 are deemed to be a part of a single, discrete offering and are not subject to integration with any other offers or sales, whether registered under the Securities Act or otherwise exempt from the

registration requirements of the Act [*17 C.F.R. § 230.701(f)*].

[b] Eligible Issuer

Rule 701 is available to any issuer that is not subject to the reporting requirements of Section 13 or Section 15(d) of the Exchange Act [*see 15 U.S.C. §§ 78m, 78o(d)*] and is not an investment company registered or required to be registered under the Investment Company Act of 1940 [*17 C.F.R. § 230.701(b)(1)*; *see 15 U.S.C. § 80a-1 et seq.*]. An issuer subject to the reporting requirements may rely on Rule 701 if it merely guaranties the payment of a subsidiary's securities that are sold under Rule 701 [*17 C.F.R. § 230.701(b)(3)*].

If an issuer becomes subject to the Exchange Act reporting requirements after it has made offers complying with Rule 701, the issuer may nevertheless rely on Rule 701 to sell the securities previously offered to the persons to whom those offers were made [*17 C.F.R. § 230.701(b)(2)*].

[c] Definitions

For purposes of Rule 701,

- A "compensatory benefit plan" is any purchase, savings, option, bonus, stock appreciation, profit sharing, thrift, incentive, deferred compensation, pension or similar plan [*17 C.F.R. § 230.701(c)(2)*];

- "Family member" includes any child, stepchild, grandchild, parent, stepparent, grandparent, spouse, former spouse, sibling, niece, nephew, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, including adoptive relationships; any person sharing the employee's household (other than a tenant or employee)--a domestic partner, for instance; a trust in which these persons have more than 50 percent of the beneficial interest; a foundation in which control of the management of assets is held by these persons (or the employee); and any other entity in which more than 50 percent of the aggregate voting interest is owned by these persons (or the employee) [*17 C.F.R. § 230.701(c)(3)*].

[d] Requirements for Consultants and Advisers

Like regular employees, consultants and advisers are eligible to receive securities under the Rule 701 exemption. Similarly, when the issuer is a reporting company, consultants and advisers may receive securities in a transaction registered on Form S-8. In the past, a flexible definition of consultants and advisers, particularly in the context of registered offerings on Form S-8, led to abuse. In many cases, that form was misused by registering shares for issuance to consultants and advisers who did not have sufficient connection and familiarity with the issuer. In some cases, those persons received the securities for capital-raising purposes rather than as compensation, and they engaged in public distributions of the securities. To foreclose such abuse, Rule 701 defines consultants and advisers narrowly. Rule 701 is available to consultants and advisers who meet the following requirements [*17 C.F.R. § 230.701(c)(1)*]:

- They are natural persons.

- They provide bona fide services to the issuer, its parents, its majority-owned subsidiaries, or majority-owned subsidiaries of the issuer's parent.

- The services are not in connection with the offer or sale of securities in a capital-raising transaction and do not directly or indirectly promote or maintain a market for the issuer's securities.

Securities promoters are excluded from the scope of persons eligible to participate under the Rule 701 exemption.

Independent agents, franchisees, and salespersons who do not have an employment relationship with the issuer are not within the scope of "consultant or adviser." (No-action letters issued before April 1999 and defining eligible consultants or advisers under Rule 701 may no longer be reliable [*see* Securities Act Release No. 7645 *(Feb. 25, 1999), 64 Fed. Reg. 11098 n.38* , for a list]).

PRACTICE TIP:

Given the concerns expressed by the SEC regarding abuses in this area, it is recommended that counsel review the most recent SEC no-action letters and, if necessary, consult with SEC staff, before including consultants and advisers in any plan which will issue securities in reliance on Rule 701. *Commentary by Frances E. Lossing.*

A person in a de facto employment relationship with the issuer, such as a nonemployee providing services that traditionally are performed by an employee, with compensation paid for those services being the primary source of the person's earned income, would qualify as an eligible person under the exemption. (However, the services must not be in connection with the offer or sale of securities in a capital-raising transaction and must not directly or indirectly promote or maintain a market for the issuer's securities.) Other persons displaying significant characteristics of "employment" (such as a professional adviser providing bookkeeping services, computer programming advice, or other valuable professional services) may qualify as eligible consultants or advisers, depending on the particular facts and circumstances.

[e] Brother-Sister Subsidiary Employees

Because it is commonplace to sell stock of a private company to employees of members of an affiliated group, including parent and affiliated subsidiaries, and because these transactions retain the envisioned compensatory character, Rule 701 extends exemption coverage to sales to employees of majority-owned subsidiaries of the issuer's parent; that is, brother-sister subsidiaries, as well as the sale of stock of the subsidiary to employees of the parent [*see 17 C.F.R. § 230.701(c)*].

[f] No Limitation on Offers

Any amount of securities may be *offered* in reliance on Rule 701. There are, however, limitations on the amount of securities which may be sold. These limitations are described in [2], *below*.

[2] Limitation on Sales

[a] Computation Formula

The aggregate sales price or amount of securities sold in reliance on Rule 701 during any consecutive 12-month period must not exceed the greatest of the following [*17 C.F.R. § 230.701(d)(2)*]:

- $1 million;

- 15 percent of the total assets of the issuer (or of the issuer's parent if the issuer is a wholly owned subsidiary and the securities represent obligations that the parent fully and unconditionally guaranties), measured at the issuer's most recent annual balance-sheet date (if no older than its last fiscal year end); or

- 15 percent of the outstanding amount of the class of securities being offered and sold in reliance on Rule 701, measured at the issuer's most recent annual balance-sheet date (if no older than its last fiscal year end).

In computing outstanding securities for purposes of the third test listed above, the issuer must treat the securities

underlying all currently exercisable or convertible options, warrants, rights, or other securities, other than those issued under Rule 701, as outstanding. In computing the amount of securities sold for other purposes of all of the foregoing tests, the issuer must count the amount of securities that would be acquired on exercise or conversion in connection with sales of options, warrants, rights, or other exercisable or convertible securities, including those to be issued under this exemption [*17 C.F.R. § 230.701(d)(3)(iii)*]. With respect to options to purchase securities, the aggregate sales price is determined when an option grant is made (without regard to when the option becomes exercisable). With respect to other securities, the computation is made on the date of sale. With respect to deferred-compensation and similar plans, the computation is made when the irrevocable election to defer is made [*17 C.F.R. § 230.701(d)(3)(ii)*].

The term "aggregate sales price" means the sum of all cash, property, notes, cancellation of debt, or other consideration received or to be received by the issuer for the sale of the securities. Noncash consideration must be valued by reference to bona fide sales of that consideration made within a reasonable time or, in the absence of sales, on the fair value as determined by an accepted standard. The value of services exchanged for securities issued must be measured by reference to the value of the securities issued. Options must be valued based on the exercise price of the option [*17 C.F.R. § 230.701(d)(3)(i)*].

Amounts of securities sold in reliance on Rule 701 do not affect aggregate offering prices in other exemptions, and amounts of securities sold in reliance on other exemptions do not affect the amount that may be sold in reliance on Rule 701 [*17 C.F.R. § 230.701(d)(3)(iv)*].

[b] Compliance Guidance

With respect to equity incentives such as restricted stock and compensatory stock purchases, plans, or 401(k) plans that permit employees to elect to purchase employer securities, the computations of exemptive amounts are to be made as of the transaction date. Deferred compensation and similar plans would make measurements based on the date of an irrevocable election to defer compensation. Limitations must be placed on these plans to prevent employees from purchasing or electing to defer compensation in an amount greater than that which would be permitted under Rule 701.

With respect to options, computations are to be made as of the date of the grant of the option, without regard to whether the option is currently exercisable or vested. This obviates the difficulty in keeping track of outstanding options, namely, when they become exercisable, and when they might be exercised. In particular, basing computations on the option exercise date could result in an unanticipated loss of the exemption if too many optionees exercised their options at the same time. Although options are offers of the underlying securities that can be made without limitation and are exempt under Rule 701, using the exercise price at the date of grant simplifies the computations of the available exemption amount and allows issuers to avoid the administrative difficulties of keeping track of outstanding options. This method of determining the available exemption should make no difference from an investor-protection point of view, since a 12-month time limit applies. However, this approach greatly simplifies the issuer's oversight of outstanding offers and perhaps benefits more employees and others who may participate in the compensatory arrangements. Rule 701 makes it clear that computations with respect to options should be based on the exercise price, since the purpose is to measure the securities that will be sold under the exemption. (In the event that exercise prices are later changed, a recomputation must be made under Rule 701.)

Rule 701 provides that the computation of the exempt amount should account for the value of both consultant services and employee services [*17 C.F.R. § 230.701(d)(3)(i)*]. In other words, compensatory arrangements should not be valued at zero or treated as a gift. Even when the employee or consultant is not required to pay additional consideration for the securities being issued, these securities typically would have some intrinsic worth, such as book value or a multiple of book value. The value of services exchanged for securities issued must be measured by reference to the value of the securities issued rather than the employee's salary or consultant's invoice.

[3] Disclosure

[a] Requirement

The issuer must deliver to investors a copy of the compensatory benefit plan or the contract, as applicable. In addition, if the aggregate sales price or amount of securities sold during any consecutive 12-month period exceeds $5 million, the issuer must deliver the following disclosure to investors a reasonable period of time before the date of sale [*17 C.F.R. § 230.701(e)*]:

- A copy of the summary plan description required by the Employee Retirement Income Security Act of 1974 [*see 29 U.S.C. §§ 1104-1107*], if the plan is subject to ERISA [*17 C.F.R. § 230.701(e)(1)*], otherwise, a summary of the material terms of the plan [*17 C.F.R. § 230.701(e)(2)*].

- Information about the risks associated with investment in the securities sold pursuant to the compensatory benefit plan or compensation contract [*17 C.F.R. § 230.701(e)(3)*].

- Financial statements required to be furnished by Part F/S of Form 1-A [*see § 6A.200*] under Regulation A [*see 17 C.F.R. § 230.251 et seq.*].

The financial statements must be as of a date no more than 180 days before the sale of securities in reliance on Rule 701 [*17 C.F.R. § 230.701(e)(4)*].

[b] Parent's Financial Statements

If the issuer is relying on the total-assets test using its parent's total assets to determine the amount of securities that may be sold [*see* [2][a], *above*], the parent's financial statements must be delivered. If the parent is subject to the reporting requirements of Section 13 or Section 15(d) of the Exchange Act [*see 15 U.S.C. §§ 78m, 78o(d)*], the financial statements of the parent required by Rule 10-01 of Regulation S-X [*see 17 C.F.R. § 210.10-01*] and Item 310 of Regulation S-B [*see 17 C.F.R. § 228.310*], as applicable, must be delivered [*17 C.F.R. § 230.701(e)(5)*].

[c] Time for Disclosure

If the sale involves a stock option or other derivative security, the issuer must deliver disclosure a reasonable period of time before the date of exercise or conversion. For deferred-compensation and similar plans, the issuer must deliver disclosure to investors a reasonable period of time before the date the irrevocable election to defer is made [*17 C.F.R. § 230.701(e)(6)*].

[d] Compliance Guidance

When the formula [*see* [2][a], *above*] permits sales in excess of $5 million in a 12-month period, and the issuer chooses to sell more than that amount, disclosure should be made to all investors before sale. In other words, an issuer is obliged to provide disclosure to all investors if the issuer believes that sales will exceed the $5 million threshold in the coming 12-month period. If disclosure has not been provided to all investors before sale, the issuer will lose the exemption for the entire offering when sales exceed the $5 million threshold.

The type and amount of disclosure needed in a compensatory securities transaction differs from that needed in a capital-raising transaction. In a bona fide compensatory arrangement, the issuer is concerned primarily with compensating the employee-investor rather than maximizing the proceeds of sale. Because the compensated individual has a business relationship with the issuer, perhaps extending over a long period of time, that individual, if a senior executive officer, will have acquired some and in many cases substantial knowledge about the enterprise. The amount and type of disclosure required for this individual is not the same as for a typical investor with no particular connection to the issuer. If the plan is available to employees generally, more disclosure may be required since a mere

employer-employee relationship may not be sufficient to assure that adequate disclosure has been provided [*see* concerns expressed by the Commissioner in *10 Cal. Code Reg. § 260.102.12(d)*, issued with respect to *Corp. Code § 25102(f)*]. In these instances, the issuer may need to provide disclosure similar to that contained in Form S-8.

The standards of financial statement disclosure in Regulation A [*see generally § 6A.25*] provide basic protections in a compensatory transaction but may not be available as a result of ordinary employment or business dealings. The standard is well-established and may be very familiar to private issuers, since these financial statements and risk-factor disclosure requirements are used not only in Regulation A but also in the private-placement exemptions in Regulation D [*see 17 C.F.R. § 230.502(b)(2)(i)(A)*]. Delivery of disclosure documents, particularly financial statements, to employee-investors could result in serious harm to the company if the information were to come into the possession of competitors. Private issuers can use certain mechanisms, such as confidentiality agreements, to protect competitive information. Alternatively, an issuer could elect to stay below the $5 million threshold, to avoid the disclosure obligations.

Compliance with the minimum disclosure standards for Rule 701 may not necessarily meet the antifraud standards of the securities laws, such as Section 17(a) of the Securities Act [*see 15 U.S.C. § 77q(a)*], Section 10(b) of the Exchange Act [*see 15 U.S.C. § 78j(b)*], and *Rule 10b-5* [*see 17 C.F.R. § 240.10b-5*]. The disclosure required will depend on the facts and circumstances.

Issuers eligible to take maximum advantage of the exemption also should be mindful of the requirements of the Exchange Act. Once an issuer exceeds 500 shareholders at the end of two fiscal years or 750 shareholders at the end of one fiscal year and $10 million in assets, it must register under Section 12(g) of the Exchange Act [*see 15 U.S.C. § 78l(g)*] and provide full disclosure as a "public" corporation.

[4] Resale Limitations

Securities issued under Rule 701 are deemed to be "restricted securities" as defined in Rule 144 [*17 C.F.R. § 230.701(g)(1)*; *see 17 C.F.R. § 230.144*]. Resales of securities issued pursuant to Rule 701 must be in compliance with the registration requirements of the Securities Act or an exemption from those requirements [*17 C.F.R. § 230.701(g)(2)*].

Ninety days after the issuer becomes subject to the reporting requirements of Section 13 or Section 15(d) of the Exchange Act [*see 15 U.S.C. §§ 78m, 78o(d)*], securities issued under Rule 701 may be resold by persons who are not affiliates (as defined in Rule 144) in reliance on Rule 144, without compliance with Rule 144(c) and (d) and by affiliates without compliance with paragraph Rule 144(d) [*17 C.F.R. § 230.701(g)(3)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawInitial Public Offerings & the Securities Act of 1933Registration of SecuritiesDisclosures & SchedulesSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART II. LEGAL BACKGROUND

3-6A California Legal Forms--Transaction Guide §§ 6A.31-6A.99

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6A.31[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6A California Legal Forms--Transaction Guide § 6A.100

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.100 Facts

NOTE:
The following facts may be necessary or helpful in preparing documents for either an exempt offering of securities or a registered offering.

1. Name, address, and telephone number of:

    a. Issuer.

    b. Each subsidiary of issuer.

    c. Predecessor to issuer.

    d. Issuer's accountant.

2. Date and place of organization of issuer and any subsidiary.

3. Information about issuer's business and business of any subsidiaries of issuer, including:

    a. Purposes and general character of business.

    b. Business activity in any other state or foreign jurisdiction.

    c. Length of continuous operation of issuer and any predecessors.

d. Property, plant, and equipment of issuer.

e. Personnel of issuer.

f. General competitive conditions in business or industry, including names of:
(1) Suppliers.

(2) Customers.

(3) Competitors.

g. Issuer's past and prospective performance.

4. Information about directors and officers of issuer:

a. Names, addresses, and telephone numbers.

b. Amount of issuer's securities held by each.

c. Amount of compensation paid to each during past fiscal year.

d. Amount of compensation proposed to be paid to each for current fiscal year.

5. If issuer was organized within past three years:

a. Name, address, and principal occupation of each promoter.

b. Amount of issuer's securities held by each promoter.

c. Amount of compensation paid or owing to each promoter.

6. Information about shareholders who own, either of record or beneficially, 10 percent or more of issuer's outstanding shares of any class, including:

a. Name and address of each shareholder.

b. Amount of issuer's securities held by each shareholder.

7. Information about issuer's equity and debt securities, including:

a. Authorized securities.

b. Issued and outstanding securities.

c. Outstanding options for securities or rights to subscribe to securities.

8. Description of each offering of issuer's securities within previous five years, including:

a. Inclusive dates of offering.

b. Class or classes of securities offered.

c. Number of shares offered and offering price per share.

d. Total amount of offering.

e. Total amount of net proceeds from offering received by issuer.

f. Exemption or form of registration under which securities were offered and sold.

9. Information about current offering, including:

a. Description of securities.

b. Amount of securities.

c. Price at which securities are to be offered for sale.

d. Par value of each share, if par stock.

e. Type of consideration to be received for securities, such as property or services.

f. Commissions or promotional fees to be paid, including:

(1) Amount of compensation to be paid to broker-dealers, agents, promoters, and others.

(2) Whether payments will be in cash, securities, or another form of compensation.

g. Amount of incidental expenses for promotion and organization services.

h. Name, address, and capacity of each person to whom issuer proposes to sell securities in current transaction and amount of securities to be sold to each.

i. States in which issuer proposes to offer securities in current transaction.

10. Issuer's purposes for proposed offering of securities, including:

a. Amount of capital issuer would like to raise from sale of securities.

b. Intended use of proceeds.

11. Amount of any funds to be raised from other sources for same purposes as offering and description of these other sources.

12. Description of any pending or threatened litigation or proceedings against issuer.

13. Any other future issuances of securities being planned.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6A California Legal Forms--Transaction Guide § 6A.101

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.101 Documents

NOTE:

The following documents may be necessary or helpful in preparing documents for either an exempt offering of securities or a registered offering.

1. Charter documents of issuer:

a. Certificate or articles of incorporation (or other charter documents) and any amendments.

b. Bylaws, with any amendments.

c. Minutes of any proceedings of directors or shareholders relating to securities.

2. Issuer's share certificate book and share record book.

3. Outstanding agreements for subscriptions to issuer's securities.

4. All documents prepared in connection with any offering of issuer's securities within past five years, including:

a. Registration statements.

b. Offering circulars.

c. Prospectuses.

d. Advertisements or other sales literature.

e. Orders related to offering issued by any governmental authority or court.

5. Any working drafts or executed documents relating to current proposed offering of securities, such as:

a. Registration statement.

b. Offering circular.

c. Prospectus.

d. Specimen or copy of securities.

e. Advertisements or other sales literature.

f. Communications given or sent to potential buyers.

g. Opinion of counsel with regard to legality of securities being registered.

h. Consent of any professional who is named as having prepared or certified any report or valuation used in connection with registration.

i. Itemized statement of commissions, remuneration, discounts, and expenses to be paid from proceeds of securities.

j. Indenture or other instrument governing issuance of securities in current transaction.

k. Underwriting or selling agreements.

l. Orders related to offering issued by any governmental authority or court.

6. Statement describing amount and nature of consideration to be paid for securities.

7. Issuer's balance sheets and income statements for preceding three fiscal years, plus any interim financial statements prepared for current fiscal year, auditor's report, and management letters from auditors.

8. If any part of proceeds will be used to acquire property, copy of documents prepared in connection with proposed acquisition, such as:

a. Purchase and sale contract.

b. Broker agreement.

9. Files of any pending or threatened litigation, administrative hearings, or other legal proceedings.

10. Schedule containing following information on directors, officers, promoters, trustees, partners, or other persons working with issuer:

a. Securities owned by each person.

b. Amount of time each person has devoted to issuer's business.

c. Amount and nature of consideration paid to each person for work.

d. Commissions, discounts, or other remuneration to be received in connection with sale of securities covered by registration.

11. Audited balance sheet for most recent fiscal year and unaudited balance sheet for completed period of current fiscal year.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6A California Legal Forms--Transaction Guide §§ 6A.102-6A.109

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6A.102[Reserved]



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CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Compliance With Federal Exemptions

3-6A California Legal Forms--Transaction Guide § 6A.110

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.110 Intrastate Offering in California Under Section 3(a)(11)

NOTE:

Rule 147 [*17 C.F.R. § 230.147*] provides objective standards for determining when an offering is exempt from registration as an intrastate offering under Section 3(a)(11) [***see*** *15 U.S.C. § 77c(a)(11)*]. The conditions for the exemption enumerated in the rule are summarized here, and it is assumed that the offering will be made within California.

1. Verify that issuer is both:

a. Incorporated in California [*17 C.F.R. § 230.147(c)(1)(i)*], and

b. Doing business within California [*17 C.F.R. § 230.147(c)(2)*]; issuer is deemed to be doing business within California if issuer either:

(1) Derived at least 80 percent of gross revenues from California (unless gross revenues did not exceed $5,000 for most recent 12-month fiscal period) during [*17 C.F.R. § 230.147(c)(2)(i)*]:

(a) Most recent fiscal year, if first offer is made during first six months of issuer's current fiscal year; or

(b) First six months of current fiscal year, or during 12-month fiscal period ending with that six-month period, if first offer is made during last six months of issuer's current fiscal year.

(2) Had at least 80 percent of its assets located within California at end of most recent semi-annual

fiscal period before first offer [*17 C.F.R. § 230.147(c)(2)(ii)*].

(3) Intends to use and uses at least 80 percent of net proceeds from sales made pursuant to this exemption in connection with [*17 C.F.R. § 230.147(c)(2)(iii)*]:

(a) Operation of business or of real property in California;

(b) Purchase of real property in California; or

(c) Rendering of services within California.

(4) Has its principal office located in California [*17 C.F.R. § 230.147(c)(2)(iv)*].

2. Verify that all offerees and buyers will be residents of California, with following criteria applied to specific categories of buyers or beneficial owners [*17 C.F.R. § 230.147(d)*]:

a. Business organization is deemed resident of state or territory where principal office is located at time of offer and sale [*17 C.F.R. § 230.147(d)(1)*];

b. Individual is deemed resident of state or territory where principal residence is located at time of offer and sale [*17 C.F.R. § 230.147(d)(2)*]; and

c. Business organization organized for purpose of acquiring part of issue offered pursuant to this exemption is deemed resident of California only if all beneficial owners of organization are residents of California [*17 C.F.R. § 230.147(d)(3)*].

3. Limit resales to persons residing within California, during period in which securities are being offered and for period of nine months from date of last sale by issuer [*17 C.F.R. § 230.147(e)*].

4. Instruct issuer to take precautions against out-of-state offers and sales [*17 C.F.R. § 230.147(f)*]:

a. Place legend on certificate stating that securities have not been registered under Securities Act and setting forth limitations on interstate resale [*17 C.F.R. § 230.147(f)(1)(i), (2)*; *see 17 C.F.R. § 230.147(e)*];

b. Issue stop-transfer instructions to issuer's transfer agent, if any, or, if issuer transfers own securities, make notation in appropriate records [*17 C.F.R. § 230.147(f)(1)(ii)*];

c. Obtain written representation from buyers as to residence [*17 C.F.R. § 230.147(f)(1)(iii)*; *see § 6A.204*]; and

d. In connection with offers or sales, disclose in writing limitations on resale under this exemption [*17 C.F.R. § 230.147(f)(3)*; *see 17 C.F.R. § 230.147(e), (f)(1)(i), (ii), (2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From

RegistrationExempt TransactionsPrivate OfferingsSecurities LawExemptions From RegistrationSmall Issue ExemptionsSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Compliance With Federal Exemptions

3-6A California Legal Forms--Transaction Guide § 6A.111

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.111 Small Offering Under Section 3(b) and Regulation A

NOTE:
The Regulation A exemption [*17 C.F.R. § 230.251 et seq.*] under Section 3(b) of Securities Act [*15 U.S.C. § 77c(b)*] is actually an exemption only from full registration since a notification of the issuance is required.

1. Verify that aggregate offering price of all securities of issuer offered or sold under Regulation A exemption, and any other securities offered or sold within 12 months before commencement of proposed Regulation A offering pursuant to any other exemption under Section 3(b) of Securities Act or in violation of Section 5(a) of that Act, will not exceed $5 million, including no more than $1.5 million in nonissuer resales [*see 17 C.F.R. § 230.251(b)*].

2. File notification on Form 1-A [*see § 6A.200*] with SEC before making offer of securities [*17 C.F.R. § 230.251(d)(1)(i)*].

NOTE:
Solicitations of interest in an offering [***see** 17 C.F.R. § 230.254*] may be made before Form 1-A is filed [*17 C.F.R. § 230.251(d)(1)(i)*].

3. Furnish preliminary or final offering circular to offeree at least 48 hours before mailing confirmation of sale to that person [*17 C.F.R. § 230.251(d)(2)(i)(B), (C)*].

4. Instruct issuer not to sell securities until Form 1-A is qualified and final offering circular [*see 17 C.F.R. § 230.261*] is delivered to buyer [*see 17 C.F.R. § 230.251(d)(2)(i)(A)*].

5. File all sales material with SEC and instruct issuer to report all sales under exemption [*17 C.F.R. §§ 230.256, 230.257*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawExemptions From RegistrationSmall Issue ExemptionsSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Compliance With Federal Exemptions

3-6A California Legal Forms--Transaction Guide § 6A.112

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.112 Offerings Under Regulation D Exemptions

[1] Requirements for All Offerings

NOTE:

Regulation D [***see*** *17 C.F.R. § 230.501 et seq.*] provides three exemptions from registration under the Securities Act for limited and private offerings of securities. In general, Rule 504 exempts offers and sales not exceeding $1 million, regardless of the number of buyers [***see*** *17 C.F.R. § 230.504*]. Rule 505 exempts offers and sales not exceeding $5 million, to no more than 35 buyers, not counting "accredited investors" [*17 C.F.R. §§ 230.501(e)(1)(iv), 230.505(b)(2)(ii)*; ***see*** *17 C.F.R. § 230.501(a)* (definition)]. Rule 506 exempts offers and sales, regardless of dollar amount, to no more than 35 buyers, not counting "accredited investors," provided the buyers other than accredited investors are sophisticated investors or are represented by professional representatives who are sophisticated [*17 C.F.R. §§ 230.501(e)(1)(iv), 230.506(b)(2)(i)*; ***see*** *17 C.F.R. § 230.501(a)* (definition)].

Offers and sales of securities that satisfy the terms and conditions set forth in Regulation D are deemed exempt from registration under Section 5 of the Securities Act by the statutory exemptions provided by Section 3(b) (Rule 504 and Rule 505) and Section 4(2) (Rule 506) of the Act [***see*** *17 C.F.R. §§ 230.504(a), 230.505(a), 230.506(a)*]. Attempted compliance with any of the Regulation D exemptions is not an exclusive election of that exemption. Hence, the issuer can also claim the availability of any other applicable exemption [*17 C.F.R. § 230.501*, Preliminary Note 3]. The following general conditions and requirements do not necessarily apply to each exemption [***see, e.g.,*** *17 C.F.R. § 230.502(b)(1)*].

Offers and sales made more than six months before start or six months after completion of Regulation D offering are not considered part of that offering, as long as during those six-month periods no offers or sales of the same or similar class of securities are made by or for issuer occur [*17 C.F.R. § 230.502(a)*].

Failure to comply with term, condition, or requirement of Rule 504, Rule 505, or Rule 506 [***see*** *17 C.F.R. §§ 230.504-230.506*] will not preclude use of exemption for any offer or sale to particular individual or entity, if person relying on exemption shows that (1) failure to comply did not pertain to term, condition, or requirement directly intended to protect that particular individual or entity; (2) failure to comply was insignificant with respect to offering as a whole; and (3) good faith and reasonable attempt was made to comply with all applicable terms, conditions, and requirements of rule [*17 C.F.R. § 230.508(a)*]. The requirement regarding the manner of offering, including aggregate offering price and number of buyers [***see*** *17 C.F.R. §§ 230.502(c), 230.504(b)(2), 230.505(b)(2)(i), (ii),* 230.506(b)(2)(i)], is deemed to be significant to the offering as a whole [*17 C.F.R. § 230.508(a)(2)*].

1. If issuer sells securities under Rule 505 or Rule 506 to any buyer who is not "accredited investor," instruct issuer to furnish specified information [*see 17 C.F.R. § 230.502(b)(2)*] to that buyer within reasonable time before sale [*17 C.F.R. § 230.502(b)(1)*; *see 17 C.F.R. § 230.501(a)* ("accredited investor" defined)].

NOTE:

The issuer is not required to furnish the specified information to buyers when it sells securities under Rule 504, or to any accredited investor [*17 C.F.R. § 230.502(b)(1)*]. Nevertheless, the issuer should consider providing that information to accredited investors, in view of the antifraud provisions of the federal securities laws [***see*** *17 C.F.R. § 230.502(b)(1),* Note].

2. Instruct issuer not to offer or sell securities by any form of general solicitation or advertising, except when offers and sales are made under Rule 504 [*17 C.F.R. §§ 230.502(c), 230.504(b)(1)*; *see 17 C.F.R. § 230.502(c)* (exception for notices of certain proposed unregistered offerings under *17 C.F.R. § 230.135c*)].

3. Inform issuer and purchaser that securities may not be resold without registration under Securities Act or exemption from that Act, except when offers and sales are made under Rule 504 [*17 C.F.R. §§ 230.502(d), 230.504(b)(1)*].

4. Instruct issuer to exercise reasonable care to ensure that buyers are not underwriters within meaning of Section 2(11) of Securities Act [*17 C.F.R. § 230.502(d)*; *see 15 U.S.C. § 77b(a)(11)*], such as:

a. Reasonable inquiry to determine whether buyer is acquiring securities for self or for other persons [*17 C.F.R. § 230.502(d)(1)*];

b. Written disclosure to each buyer before sale that securities have not been registered and therefore cannot be resold unless registered or exempted [*17 C.F.R. § 230.502(d)(2)*]; and

c. Placement of legend on certificate or other document evidencing securities, stating that securities are not registered and setting forth restrictions on transfer and sale of securities [*17 C.F.R. § 230.502(d)(3)*].

5. Instruct issuer to determine whether or not each prospective purchaser meets definition of "accredited investor" for purposes of Regulation D; person must come within one of following categories (or issuer must reasonably believe person comes within one of following categories) at time of sale of securities to

that person [*17 C.F.R. § 230.501(a)*]:

a. Bank, as defined in Section 3(a)(2) of Securities Act [*see 15 U.S.C. § 77c(a)(2)*], or savings and loan association or other institution as defined in Section 3(a)(5)(A) of Securities Act [*see 15 U.S.C. § 77c(a)(5)(A)*], whether acting in individual or fiduciary capacity.

b. Any broker or dealer registered under Section 15 of Exchange Act [*see 15 U.S.C. § 78o*].

c. Insurance company, as defined in Section 2(13) of Securities Act [*see 15 U.S.C. § 77b(a)(13)*].

d. Investment company registered under Investment Company Act of 1940 [*see 15 U.S.C. § 80a-1 et seq.*].

e. Business development company, as defined in Section 2(a)(48) of Investment Company Act of 1940 [*see 15 U.S.C. § 80a-2(a)(48)*].

f. Small business investment company licensed by Small Business Administration under Section 301(c) or (d) of Small Business Investment Act of 1958 [*see 15 U.S.C. § 681(c), (d)*].

g. Plan established and maintained by state, its political subdivisions, or any agency or instrumentality of state or its political subdivisions, that:
(1) Is for benefit of employees; and

(2) Has total assets in excess of $5 million.

h. Employee benefit plan within meaning of Title I of Employee Retirement Income Security Act of 1974 [*see 29 U.S.C. § 1002(3)*], if either:

(1) Investment decision is made by plan fiduciary, as defined in Section 3(21) of that Act [*see 29 U.S.C. § 1002(21)(A)*], which is either bank, savings and loan association, insurance company, or registered investment adviser;

(2) Employee benefit plan has total assets in excess of $5 million; or

(3) Investment decisions in self-directed plan are made solely by persons who are accredited investors.

i. Private business development company, as defined in Section 202(a)(22) of Investment Advisers Act of 1940 [*see 15 U.S.C. § 80b-2(a)(22)*].

j. Organization described in *I.R.C. § 501(c)(3)* (religious, charitable, educational, and scientific organizations), corporation, Massachusetts business trust or similar business trust, or partnership, not formed for specific purpose of acquiring securities offered, with total assets in excess of $5 million.

k. Director, executive officer, or general partner of issuer of securities being offered or sold, or director, executive officer, or general partner of general partner of issuer.

l. Natural person whose net worth, individually or together with spouse, at time of purchase exceeds $1 million.

m. Natural person who had individual income in excess of $200,000 (or joint income with spouse in excess of $300,000) in each of two most recent years, and who has reasonable expectation of same income in current year.

n. Trust with total assets in excess of $5 million, not formed for specific purpose of acquiring securities offered, whose acquisition of securities is directed by sophisticated person [*see 17 C.F.R. § 230.506(b)(2)(ii)* (definition)].

o. Entity in which all equity owners are accredited investors.

[2] Rule 504--Small or Limited Offering

NOTE:
Rule 504 [***see** 17 C.F.R. § 230.504*] is an exemption under Section 3(b) of the Securities Act [***see** 15 U.S.C. § 77c(b)*] for offers and sales not exceeding $1 million, regardless of the number of buyers.

1. Verify that aggregate offering price will not exceed $1 million, less aggregate offering price for all securities sold within 12 months before start of and during offering in reliance on any exemption under Section 3(b) of Securities Act [*see 15 U.S.C. § 77c(b)*] or in violation of Section 5(a) of that Act [*17 C.F.R. § 230.504(b)(2)*; *see 15 U.S.C. § 77e(a)*];

2. Insure that offers and sales satisfy all applicable terms and conditions of Rule 501 and Rule 502 [*17 C.F.R. § 230.504(b)(1)*; *see 17 C.F.R. §§ 230.501*, *230.502*; *see also* [1], *above*].

NOTE:
However, the issuer is not required to observe the restrictions on general solicitation and resale [*17 C.F.R. § 230.504(b)(1)*; ***see** 17 C.F.R. § 230.502(c), (d)*; ***see also*** [1], ***above***].

3. Verify that issuer is not any of following [*17 C.F.R. § 230.504(a)*]:

a. Company subject to the reporting requirements of Section 13 or Section 15(d) of Exchange Act [*see 15 U.S.C. §§ 78m*, *78o(d)*];

b. Investment company; or

c. Blank-check company (company with no specific business or plan other than to locate and acquire presently unknown business or opportunity).

[3] Rule 505--Accredited Investor Offering

NOTE:
Rule 505 [***see** 17 C.F.R. § 230.505*] is an exemption under Section 3(b) of the Securities Act [*15 U.S.C. §*

77c(b)] for offers and sales not exceeding $5 million when there are (or the issuer reasonably believes there are) no more than 35 buyers, not counting "accredited investors."

1. Verify that a offering price will not exceed $5 million, less aggregate offering price for securities sold within 12 months before start of and during offering in reliance on any exemption under Section 3(b) of Securities Act [*see 15 U.S.C. § 77c(b)*] or in violation of Section 5(a) of Securities Act [*17 C.F.R. § 230.505(b)(2)(i)*].

2. Verify that there will be (or issuer reasonably believes there are) no more than 35 buyers, *not* counting [*17 C.F.R. § 230.505(b)(2)(ii)*; *see 15 U.S.C. § 77e(a)*]:

a. Any relative, spouse, or relative of a buyer's spouse who has the same principal residence as the buyer.

b. Any trust or estate in which a buyer and any persons described in (a), *above*, collectively have more than 50 percent of beneficial interest (excluding contingent interests).

c. Any corporation or other organization of which a buyer and persons described in P a, *above*, collectively are the beneficial owners of more than 50 percent of the equity securities (excluding directors' qualifying shares) or equity interests.

d. Any "accredited investor" [*17 C.F.R. § 230.501(e)(1)(iv)*; *see 17 C.F.R. § 230.501(a)*; *see also* [1], *above*].

3. Verify that offers and sales satisfy terms and conditions of Rule 501 and Rule 502 [*17 C.F.R. § 230.505(b)(1)*; *see* [1], *above*].

4. Verify that issuer is not investment company or subject to disqualification provisions set forth in Rule 262 of Regulation A [*17 C.F.R. § 230.505(a), (b)(2)(iii)*].

[4] Rule 506--Private Offering

NOTE:
Rule 506 [***see*** *17 C.F.R. § 230.506*] is a safe harbor for the exemption under Section 4(2) of the Securities Act [***see*** *15 U.S.C. § 77d(2)*] for offers and sales when there are (or the issuer reasonably believes there are) no more than 35 buyers, not counting "accredited investors," and the buyers other than accredited investors are sophisticated buyers, or are represented by purchaser representatives who are sophisticated.

1. Verify that there will be (or that issuer reasonably believes there are) no more than 35 buyers, not counting "accredited investors" [*17 C.F.R. § 230.506(b)(2)(i)*].

NOTE:
The exclusions described in [3], ***above***, for counting the buyers in a Rule 505 offering apply also in computing the number of buyers for purposes of Rule 506 [***see*** *17 C.F.R. § 230.501(e)*].

2. Verify that each buyer other than accredited investor [*see 17 C.F.R. § 230.501(a)* (definition); *see also* [1], *above*], either alone or with a purchaser representative [*see 17 C.F.R. § 230.501(h)* (definition)], has sufficient knowledge and experience in financial and business matters to evaluate merits and risks of prospective investment (or that issuer must reasonably believes, before sale, that buyer or purchaser representative comes within this description) [*17 C.F.R. § 230.506(b)(2)(ii)*].

3. Verify that offers and sales will satisfy terms and conditions of Rule 501 and Rule 502 [*17 C.F.R. § 230.506(b)(1)*; *see* [1], *above*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawExemptions From RegistrationExempt TransactionsRegulation D ExemptionsSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Compliance With Federal Exemptions

3-6A California Legal Forms--Transaction Guide § 6A.113

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.113 Complying With Filing Requirements

[1] Regulation A Offerings

NOTE:
Regulation A [*17 C.F.R. § 230.251 et seq.*] implements the small-offering exemption authorized by Section 3(b) of the Securities Act [*15 U.S.C. § 77c(b)*]. The Regulation A exemption is actually a simplified registration procedure. Although technically an exemption from the registration requirements, it requires the filing of disclosure documents, known as offering statements, with the SEC.

1. To implement Regulation A exemption, prepare and file offering statement, Form 1-A [*see § 6A.200*], consisting of [*see 17 C.F.R. § 239.90*]:

a. Cover sheet.

b. Part I--Notification, containing:
(1) Names and addresses of significant parties to transaction, including issuer's directors, officers, general partners, and beneficial owners, as well as promoters, affiliates, counsel, and underwriters.

(2) Statement concerning application of Rule 262 to significant parties to transaction [*see 17 C.F.R. § 230.262* ("bad boy" disqualifications applying to issuers and designated persons that prevent exercise of exemption)].

(3) If proposed offering involves resale of securities by issuer's affiliates, statement

indicating that issuer has had net income from continuing operations for at least one of last two fiscal years.

(4) Jurisdiction in which securities are to be offered.

(5) Identification of unregistered securities issued or sold within one year before filing of Form 1-A.

(6) Identification of other present or proposed offerings.

(7) Description of marketing arrangements.

(8) Description of any relationship between issuers and experts named in offering statement.

(9) Indication of whether solicitation-of-interest procedure was used before filing.

c. Part II--Offering Circular, containing [*17 C.F.R. §§ 230.253, 239.90*]:

(1) Required legend, to be set in boldface type in a font at least as large as that of general body of circular:

THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION DOES NOT PASS UPON THE MERITS OF OR GIVE ITS APPROVAL TO ANY SECURITIES OFFERED OR THE TERMS OF THE OFFERING, NOR DOES IT PASS UPON THE ACCURACY OR COMPLETENESS OF ANY OFFERING CIRCULAR OR OTHER SELLING LITERATURE. THESE SECURITIES ARE OFFERED PURSUANT TO AN EXEMPTION FROM REGISTRATION WITH THE COMMISSION; HOWEVER, THE COMMISSION HAS NOT MADE AN INDEPENDENT DETERMINATION THAT THE SECURITIES OFFERED HEREUNDER ARE EXEMPT FROM REGISTRATION.

(2) Information describing offering, and disclosing risk factors and other pertinent information, including nature of company, planned uses of proceeds, tax aspects, and other relevant matters.

NOTE:

The SEC allows a certain flexibility in the format of offering circulars, including the use of a question-and-answer format, as long as specified information is clearly provided. Form 1-A sets out several detailed models. Further instructions regarding presentation are found in the regulations [***see*** *17 C.F.R. § 230.253*].

d. Part III--Exhibits.

e. Required signatures by:

(1) Issuer;

(2) Chief executive officer;

(3) Chief financial officer;

(4) Majority of board of directors; and

(5) Each person, other than issuer, for whose account any securities are to be offered.

f. Delaying notation.

NOTE:

An offering statement regularly contains a delaying notation indicating that it will only be qualified on order of the SEC, unless a subsequent amendment is filed indicating the intention to become qualified by operation of the terms of Regulation A. Without a delaying notation, an offering statement is qualified without SEC action on the twentieth day after filing or after the delaying notation is deleted by amendment.

2. If any offers will be made while qualification is pending, comply with regulations regarding issuance of Preliminary Offering Circular [*see 17 C.F.R. § 230.255*].

3. Consummate sales only after [*17 C.F.R. § 230.251(d)(2)*]:

a. Offering statement has qualified.

b. Final offering circular has been provided to offeree.

4. Revise offering circular if changes in circumstances render circular false or misleading [*17 C.F.R. § 230.253(e)*].

5. File required interim and final sales reports on Form 2-A [*17 C.F.R. § 230.257*; *see § 6A.201*]:

a. Every six months after qualification of offering statement or amendment until substantially all proceeds of sales have been applied.

b. Within 30 days after termination, completion, or final sale of securities in offering, or within 30 days after application of proceeds, whichever is later.

[2] Regulation D Offerings

1. Issuer offering or selling securities in reliance on Rule 504, Rule 505, or Rule 506 in Regulation D must file notice of sale on Form D [*see 17 C.F.R. § 239.500*; *see also § 6A.202*] as follows:

a. File Form D for each new offering of securities with the SEC no later than 15 calendar days after first sale of securities in offering [*17 C.F.R. §§ 230.503(a)(1), 239.500(a)(1)*].

NOTE:

Every such notice of sale must be signed by a person duly authorized by the issuer [*17 C.F.R. §§ 230.503(b)(2), 239.500(b)(2)*].

As of March 16, 2009, a notice of sale on Form D must be filed with the SEC in electronic format by means of the Commission's EDGAR system in accordance with the rules set forth in Regulation S-T [*17 C.F.R. §§ 230.503(b)(1), 239.500(b)(1)*; *see* 17

C.F.R. Part 232]. The SEC's guide to online filing is set forth at www.sec.gov/info/smallbus/secg/formdguide.htm. Because of a time limitation in completing the online filing after logging in to the EDGAR system, a blank paper copy of Form D may be used to compile in advance all of the information needed for the online filing. The SEC does not charge any filing fee for a Form D notice or amendment. The SEC's Division of Corporation Finance is available at (202) 551-8900 to assist small companies and others with questions on filing and amending Form D notices. The SEC's Office of Small Business Policy is also available to answer interpretive legal questions on Form D information requirements, at (202) 551-3460, or by e-mail at smallbusiness@sec.gov [*see Filing and Amending a Form D Notice: A Compliance Guide for Small Entities and Others* at www.sec.gov/info/smallbus/secg/formdguide.htm]. The Regulation D exemption will not be available if the issuer, or any of its predecessors or affiliates, is subject to any order, judgment, or decree of any court of competent jurisdiction that enjoins (whether pursuant to a temporary, preliminary, or permanent injunction) a person for failure to comply with this notice requirement [*17 C.F.R. § 230.507(a)*]. However, on a showing of good cause, the SEC may determine that the circumstances do not require denial of the exemption for failure to comply [*17 C.F.R. § 230.507(b)*].

b. If offering is made in California pursuant to Rule 506 [*17 C.F.R. § 230.506*], file Form D with Department of Corporations no later than 15 days after first sale of securities in state, accompanied by filing fee [*see Corp. Code § 25608.1(c)*; *see also Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum fee set forth in *Corp. Code § 25608.1*), consent to service of process if required [*see 10 Cal. Code Reg. § 260.165* (consent must be pursuant to Form U-2; pursuant to Form D filed with Commissioner in connection with transaction; included in electronic submission of filing; or in form set out in regulation); *see also* Dept. of Corps. Rel. No. 120-C (Mar. 24, 2009) (consent to service of process or Form U-2 not required if electronic Form D was filed with SEC)], and letter of transmittal [*Corp. Code § 25102.1(d)*; Dept. of Corps. Release No. 109-C (Dec. 18, 1997)].

[3] Documenting Exemption Compliance

1. Ensure that offering documents accurately cover all material issues.

2. Use careful language for all narrative statements in offering documents; in particular:

a. While striving to present facts in most favorable light, be realistic and conservative--do not overstate.

b. In all forward-looking statements, avoid words of promise ("The company will ...") or committal ("The company believes ...") and prefer words of mere expectation ("The company expects ...").

3. Frankly describe all material risk factors.

4. Build documentation files:

a. Maintain scrupulous records of when, how, and to whom offering documents were distributed.

b. Use investor subscription agreement so that issuer can obtain representations and warranties from investor as well as assent to conditions with respect to offering [*see § 6A.204*].

c. Create appropriate resolutions for offering and issuance of securities [*see Ch. 6I, Issuance of Equity Securities, §§ 6I.210-6I.232*; *Ch. 6J, Issuance of Debt Securities, §§ 6J.200-6J.204*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawExemptions From RegistrationSmall Issue ExemptionsSecurities LawRegulation of Securities MarketsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Compliance With Federal Exemptions

3-6A California Legal Forms--Transaction Guide §§ 6A.114-6A.199

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6A.114[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART IV. FORMS

3-6A California Legal Forms--Transaction Guide § 6A.200

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.200 Offering Statement Under Regulation A (SEC Form 1-A)

[1] Comment

[a] Use of Form

This form is the SEC's Form 1-A, which is available for viewing and printing at the SEC's website, www.sec.gov. A printed version of Form 1-A can be obtained from the SEC in Washington or at any SEC regional office [*see 17 C.F.R. § 239.0-1(b)*]. Addresses of the SEC headquarters and regional offices are published in the regulations [*see 17 C.F.R. § 200.11*] and on the SEC's web site at www.sec.gov/contact/addresses.htm. Form 1-A has blanks for inserting some of the information required for the Regulation A registration, while other required information is only described, and the issuer must provide it in attachments.

The requirements for paper, printing, language, and pagination for offering statements are the same as those specified in Rule 403 of Regulation C [*17 C.F.R. § 230.403*] for registration statements under the Securities Act [*17 C.F.R. § 230.252(b)*].

A request for confidential treatment may be made under Rule 406 of Regulation C [*17 C.F.R. § 230.406*] for information required to be filed [*17 C.F.R. § 230.252(c)*; *see 17 C.F.R. § 200.83* (request for confidential treatment for information not required to be filed)].

[b] Contents

The offering statement consists of the facing sheet of Form 1-A [*see 17 C.F.R. § 239.90*], the contents required by the form, and any additional material information necessary to make the required statements, in the light of the circumstances in which they are made, not misleading [*17 C.F.R. § 230.252(a)*].

[c] Signatures, Copies, and Filing

The issuer, the chief executive officer and chief financial officer of the issuer, a majority of the members of the board of directors, and each selling securities holder must sign the offering statement. If a signature is by a person on behalf of any other person (except by an executive officer signing for the issuer), evidence of authority to sign must be filed [*17 C.F.R. § 230.252(d)*].

Seven copies of the offering statement, at least one of which is manually signed, must be filed at the SEC's office in Washington [*17 C.F.R. § 230.252(e)*]. Electronic filing is not permitted [*17 C.F.R. § 232.101(c)(6)*].

[d] Delaying Notation

Unless there is a delaying notation (see below) or a suspension proceeding under Rule 258, an offering statement is qualified without SEC action on the 20th calendar day after filing [*17 C.F.R. § 230.252(g)(1)*].

An offering statement containing the following notation can be qualified only by order of the SEC, unless the notation is removed before SEC action as described below [*17 C.F.R. § 230.252(g)(2)*]:

> This offering statement shall only be qualified upon order of the Commission, unless a subsequent amendment is filed indicating the intention to become qualified by operation of the terms of Regulation A.

The delaying notation can be removed only by an amendment to the offering statement [*see* [e], *below*] that contains the following language [*17 C.F.R. § 230.252(g)(3)*]:

> This offering statement shall become qualified on the 20th calendar day following the filing of this amendment.

[e] Amendments

If any information in the offering statement is amended, an amendment, signed in the same manner as the initial filing, must be filed. Seven copies of every amendment must be filed at the SEC office that accepted the initial filing. Seven copies of every amendment also must be filed at the SEC's office in Washington [*17 C.F.R. § 230.252(h)(1)*]. Electronic filing is not permitted [*17 C.F.R. § 232.101(c)(6)*].

An amendment to include a delaying notation or to remove one after the initial filing of an offering statement may be made by telegram, letter, or fax. Each telegraphic amendment must be confirmed in writing within a reasonable time by filing a signed copy. The confirmation will not be deemed an amendment [*17 C.F.R. § 230.252(h)(2)*].

[2] FORM

Offering Statement Under Regulation A (SEC Form 1-A)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART IV. FORMS

3-6A California Legal Forms--Transaction Guide § 6A.201

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.201 Report of Sales Under Regulation A (SEC Form 2-A)

[1] Comment--Use of Form

This form is the SEC's Form 2-A [*see 57 Fed. Reg. 36493 (Aug. 13, 1992)]* , which is available at any SEC office or can be downloaded from the SEC's web site at www.sec.gov/smbus/forms/.

The issuer of securities offered and sold under Regulation A [*see § 6A.25*] and each selling securities holder must file seven copies of a report concerning sales and use of proceeds, on Form 2-A [*see 17 C.F.R. § 239.91*], at the SEC office in Washington every six months after the qualification of the offering statement or any amendment, until substantially all of the proceeds have been applied. Within 30 calendar days after the termination, completion, or final sale of securities in the offering, or the application of the proceeds from the offering, whichever is the latest event, the issuer and each selling securities holder must file seven copies of Form 2-A marked as the final report [*see* [2], *below*]. Electronic filing is not permitted [*17 C.F.R. § 232.101(c)(6)*]. For purposes of these reporting requirements, the temporary investment of any proceeds pending the final application of the proceeds does not constitute an application of the proceeds [*17 C.F.R. § 230.257*].

Compliance with this requirement is not a condition to a Regulation A exemption [*17 C.F.R. § 230.257*].

[2] FORM

Report of Sales Under Regulation A (SEC Form 2-A)

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CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART IV. FORMS

3-6A California Legal Forms--Transaction Guide § 6A.202

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.202 Notice of Sale Under Regulation D (SEC Form D)

[1] Comment

[a] Use of Form

This form is SEC Form D, available from the SEC at www.sec.gov/info/smallbus.shtml. An issuer offering or selling securities in reliance on *17 C.F.R. § 230.504*, *230.505*, or *230.506*, or § 4(6) of the Securities Act must file a notice of sales containing the information required by Form D [*17 C.F.R. § 239.500*] for each new offering of securities with the SEC no later than 15 calendar days after the first sale of securities in the offering. If the end of that period falls on a Saturday, Sunday, or holiday, the due date is the next business day [*17 C.F.R. §§ 230.503(a)(1), 239.500(a)(1)*].

[b] Electronic Filing Required

As of March 16, 2009, Form D must be filed with the SEC in electronic format by means of the Commission's Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) in accordance with the rules set forth in Reg. S-T [*17 C.F.R. §§ 230.503(b)(1), 239.500(b)(1)*; *see* 17 C.F.R. Part 232]. The SEC's guide to online filing is set forth at www.sec.gov/info/smallbus/secg/formdguide.htm. Because of a time limitation in completing the online filing after logging in to the EDGAR system, a blank paper copy of Form D may be used to compile in advance all of the information needed for the online filing. The SEC does not charge any filing fee for a Form D notice or amendment. The SEC's Division of Corporation Finance is available by phone at (202) 551-8900 to assist small companies and others with questions on filing and amending Form D notices. The SEC's Office of Small Business Policy is also available to answer interpretive legal questions on Form D information requirements, by phone at (202) 551-3460, or by e-mail at smallbusiness@sec.gov [*see Filing and Amending a Form D Notice: A Compliance Guide for Small Entities and Others* at www.sec.gov/info/smallbus/secg/formdguide.htm].

Every notice of sales on Form D must be signed by a person duly authorized by the issuer S-T [*17 C.F.R. §§ 230.503(b)(2), 239.500(b)(2)*].

[c] Amendments

An issuer *may* file an amendment to a previously filed notice of sales on Form D at any time [*17 C.F.R. §§ 230.503(a)(2), 239.500(a)(2)*].

An issuer *must* file an amendment to a previously filed notice of sales on Form D for an offering, as follows [*17 C.F.R. §§ 230.503(a)(3), 239.500(a)(3)*]:

- To correct a material mistake of fact or error in the previously filed notice of sales on Form D, as soon as practicable after discovery of the mistake or error [*see 17 C.F.R. § 230.503(a)(3)(i), 239.500(a)(3)(i)*].

- To reflect a change in the information provided in the previously filed notice of sales on Form D, as soon as practicable after the change. However, no amendment is required to reflect a change that occurs after the offering terminates, or a change that occurs solely in certain information [*see 17 C.F.R. § 230.503(a)(3)(ii), 239.500(a)(3)(ii)*].

- Annually, on or before the first anniversary of the filing of the notice of sales on Form D or the filing of the most recent amendment to the notice of sales on Form D, if the offering is continuing at that time [*see 17 C.F.R. § 230.503(a)(3)(iii), 239.500(a)(3)(iii)*].

An issuer that files an amendment to a previously filed notice of sales on Form D must provide current information in response to all requirements of the notice of sales on Form D, regardless of why the amendment is filed [*17 C.F.R. §§ 230.503(a)(4), 239.500(a)(4)*].

A Form D should also be filed with the Commissioner within 15 days after the first sale of securities in California if the offering will be made in reliance on *Corp. Code § 25102.1(d)* [*see* Dept. of Corps. Rel. No. 120-C (Mar. 24, 2009) (new filing requirements for Regulation D offerings)]. The Commissioner may allow for a notice by electronic transmission of the information in Form D. Form D may also be used in lieu of the California notice form for offerings made in reliance on *Corp. Code § 25102(f)*.

[2] FORM

Notice of Sale Under Regulation D (SEC Form D)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART IV. FORMS

3-6A California Legal Forms--Transaction Guide § 6A.203

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.203 Small Corporate Offering Registration (NASAA Form U-7)

[1] Comment--Use of Form

This form illustrates the first and second pages of the Small Corporate Offering Registration (SCOR) form, called Form U-7, adopted by NASAA [*see § 6A.23[2][a]*]. SCOR was primarily designed for state registration of small business securities offerings conducted under Rule 504 (sale of securities up to $1 million within 12 months). However, in addition, an issuer can use Form U-7 to satisfy many of the filing requirements of the Regulation A exemption (sales of securities of up to $5 million), since the issuer may file it with the SEC as part of the Regulation A offering statement.

Form U-7 requires significant input by the issuer's accountant. To assist issuers in completing the form, NASAA has developed a detailed "Issuer's Manual" and makes it available, along with Form U-7, on the NASAA web site at www.nasaa. org.

[2] FORM

Small Corporate Offering Registration (NASAA Form U-7)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART IV. FORMS

3-6A California Legal Forms--Transaction Guide § 6A.204

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.204 Investment Letter for Intrastate Offerings

[1] Comment--Use of Form

This form is an investment letter designed to be used in connection with offering securities pursuant to the intrastate offering exemption under Section 3(a)(11) of the Act and Rule 147 [*see § 6A.24*]. A separate copy of this letter should be signed by each buyer before he or she receives shares.

The intrastate offering exemption under Rule 147 [*see 17 C.F.R. § 230.147*] has limitations on the resale of securities sold [*see 17 C.F.R. § 230.147(e)*]. This form addresses all of the requirements of each exemption regarding the resale restrictions, including an appropriate legend and stop-transfer instructions.

Under Rule 147, during the period in which securities that are part of an issue are being offered and sold by the issuer to California residents and for a period of nine months from the date of the last sale by the issuer, all resales of any part of the issue, by any person, must be made only to persons who reside within California [*see 17 C.F.R. § 230.147(e)*]. The issuer must take the following precautions against interstate offers and sales [*17 C.F.R. § 230.147(f)(1)*]:

- A legend must be placed on the certificate or other document that evidences the securities stating that the securities have not been registered and setting forth the interstate resale prohibition.

- Stop-transfer instructions must be issued to the issuer's transfer agent, if any, with respect to the securities; or if the issuer transfers its own securities, a notation must be made in the appropriate records of the issuer.

- A written representation of each buyer's residence must be obtained.

[2] Form

Investment Letter for Intrastate Offerings

Investment Letter for Shareholder

_____ [*Name of issuer*]
_____ [*street address*]
_____ [*city, state, and zip*]

To Whom It May Concern:

The undersigned will be acquiring [Certificate No. _____ for] _____[*number*] shares of the common stock _____ [*add appropriate identification, e.g.,* no par value per share,] (the "Stock") of _____ [*name of issuer*] (the "Company"). The undersigned understands that the Securities Act of 1933 (the "Act"), as amended, exempts the issue and sale of securities from registration under the Act if the transaction is a part of an issue offered and sold only to persons residing within a single state, and the issuer is incorporated and doing business within that state (Section 3(a)(11)). In order to induce you to rely on that exemption and to issue and sell the Stock to the undersigned without registering it under the Act, this letter sets forth certain representations, warranties, and agreements.

1. The undersigned represents and warrants to the Company that he or she currently is, and at the time of the sale of the Stock to the undersigned, will be one of the following:

☐ An individual or beneficial owner in a corporation, partnership, or other business organization formed for the purpose of acquiring the Stock, whose principal place of residence is located in California.

☐ A corporation, partnership, or other form of business organization, that at the time of the offer and sale of the Stock to that organization, has its principal office within California and has not been formed for the purpose of acquiring the Stock.

2. The address of the undersigned's principal place of residence or office in California is _____[*address*].

3. Before any sale, transfer, assignment, pledge, hypothecation, or other disposition of the Stock or any part of the Stock, the undersigned agrees to deliver to the Company a written opinion of counsel, in form and substance satisfactory to the Company and the Company's counsel, that under the Act and the rules and regulations of the Securities and Exchange Commission under the Act (the "S.E.C. Rules and Regulations") the proposed disposition may occur without registration or that all registration requirements of the Act and S.E.C. Rules and Regulations have been or are being met.

4. The undersigned agrees that the Company, in the Company's sole discretion, may place a legend on the certificates evidencing the Stock, that reads as follows:

The securities evidenced by this certificate have not been registered under the Securities Act of 1933. During the period in which the securities are being offered and sold by the issuer, and for a period of nine months from the date of the last sale by the issuer of such securities, all resales of any part of the issue, by any person, shall be made only to persons resident within California.

The Company, in the Company's sole discretion, also may place a stop-transfer order against transfer of the shares in violation of the conditions stated in the legend.

5. The undersigned agrees to indemnify and hold the Company harmless from and against all liabilities, claims, damages, losses, penalties, costs, and expenses, including, without limitation, attorney's fees and costs of appeal, arising

out of any sale or other disposition of the Stock by or for the undersigned in violation of the Act or this letter.

The undersigned understands that the effect of the foregoing representations, warranties, and agreements by the undersigned is that the undersigned does not presently intend to, nor may the undersigned, sell, pledge, or otherwise dispose of any of the Stock, unless one of the conditions referred to in Paragraph 2 has occurred. The undersigned does not now anticipate my resale, pledge, or other disposition of the Stock on the occurrence or nonoccurrence of any predetermined or particular event.

The undersigned understands that the Company is relying on the truth and accuracy of the representations, warranties, and agreements set forth in this letter, to issue and sell the Stock to the undersigned without registration under the Act.

Sincerely,

[*If buyer is an individual:*]

_____ [*signature of buyer*]

[*typed name*]

[*OR, if buyer is a corporation, partnership, or other entity:*]

[*typed name of entity*]

By: _____ [*signature of authorized representative*]

[*typed name*]

Dated: _____.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART IV. FORMS

3-6A California Legal Forms--Transaction Guide § 6A.205

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.205 Investment Letter for Private Placements

[1] Comment--Use of Form

This form is an investment letter designed to be used in connection with offering securities pursuant to the Regulation D exemptions under Rule 504, Rule 505, and Rule 506 [*see §§ 6A.26-6A.28*]. A separate copy of this letter should be signed by each buyer before he or she receives shares.

The Regulation D exemptions [*see 17 C.F.R. § 230.501 et seq.*] have limitations on the resale of securities sold [*see 17 C.F.R. § 230.502(d)*]. This form addresses all of the requirements of each exemption regarding the resale restrictions, including an appropriate legend and stop-transfer instructions.

Securities acquired under Regulation D cannot be resold without registration under the Securities Act or an exemption from registration [*17 C.F.R. § 230.502(d)*]. The issuer must exercise reasonable care to ensure that the buyers of the securities are not underwriters, that is, that they are buying the securities for themselves. Some of the factors that are considered in determining whether reasonable care was exercised include, but are not limited to, the following [*17 C.F.R. § 230.502(d)*]:

- Reasonable inquiry to determine whether the buyer is acquiring the securities for himself or herself or for other persons.

- Written disclosure to each buyer before the sale that the securities have not been registered and, therefore, cannot be resold unless they are registered or an exemption from registration is available.

- Placement of a legend on the certificate or other document that evidences the securities, stating that the securities have not been registered and setting forth or referring to the restrictions on transferability and sale of the securities.

[2] Form

Investment Letter for Private Placements

Investment Letter for Shareholder
_____ [*Name of issuer*]
_____ [*street address*]
_____ [*city, state, and zip*]
To Whom It May Concern:

The undersigned will be acquiring [Certificate No. _____ for] _____[*number*] shares of the common stock _____ [*add appropriate identification, e.g.,* no par value per share,] (the "Stock") of _____ [*name of issuer*] (the "Company"). The undersigned understands that the Securities Act of 1933 (the "Act"), as amended, exempts the issue and sale of securities from registration under the Act in transactions not involving any public offering (Section 4(2)). In order to induce you to rely on that exemption and to issue and sell the Stock to the undersigned without registering it under the Act, this letter sets forth certain representations, warranties, and agreements.

1. The undersigned represents and warrants to the Company that the Stock will be acquired by the undersigned for investment, for the undersigned's own personal account, and not with a view to distribute, resell, pledge, or otherwise dispose of the Stock.

2. The undersigned represents and warrants to the Company that the undersigned is experienced in investment and business matters and has received all financial and other information that the undersigned has requested about the Company and the Company's business.

3. Before any sale, transfer, assignment, pledge, hypothecation, or other disposition of the Stock or any part of the Stock, the undersigned agrees to deliver to the Company a written opinion of counsel, in form and substance satisfactory to the Company and the Company's counsel, that under the Act and the rules and regulations of the Securities and Exchange Commission under the Act (the "S.E.C. Rules and Regulations") the proposed disposition may occur without registration or that all registration requirements of the Act and S.E.C. Rules and Regulations have been or are being met.

4. The undersigned agrees that the Company, in the Company's sole discretion, may place a legend on the certificates evidencing the Stock, that reads as follows:

The securities evidenced by this certificate have not been registered under the Securities Act of 1933, have been taken for investment, and may not be sold or offered for sale unless a registration statement under the Federal Securities Act of 1933, as amended, with respect to such shares is then in effect or an exemption from the registration requirements of such act is then in fact applicable to such offer or sale.

The Company, in the Company's sole discretion, also may place a stop-transfer order against transfer of the shares until one of the conditions set forth in the above legend has been met.

5. The undersigned agrees to indemnify and hold the Company harmless from and against all liabilities, claims, damages, losses, penalties, costs, and expenses, including, without limitation, attorney's fees and costs of appeal, arising out of any sale or other disposition of the Stock by or for the undersigned in violation of the Act or this letter.

The undersigned understands that the effect of the foregoing representations, warranties, and agreements by me is that the undersigned does not presently intend to, nor may the undersigned, sell, pledge, or otherwise dispose of any of the Stock, unless one of the conditions referred to in Paragraph 3 has occurred. The undersigned does not now anticipate

my resale, pledge, or other disposition of the Stock on the occurrence or nonoccurrence of any predetermined or particular event.

The undersigned understands that the Company is relying on the truth and accuracy of the representations, warranties, and agreements set forth in this letter, to issue and sell the Stock to the undersigned without registration under the Act.

Sincerely,

[*If buyer is an individual:*]

_____ [*signature of buyer*]

[*typed name*]

[*Or, if buyer is a corporation, partnership, or other entity:*]

[*typed name of entity*]

By: _____ [*signature of authorized representative*]

[*typed name*]

Dated: _____.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6A FEDERAL SECURITIES EXEMPTIONS FOR CALIFORNIA NONPUBLIC CORPORATIONS
PART IV. FORMS

3-6A California Legal Forms--Transaction Guide § 6A.206

AUTHOR: Frances E. Lossing Practice Consultant

§ 6A.206 Investor Questionnaire

[1] Comment--Use of Form

This form is an investor questionnaire designed to be used in connection with an offering of securities pursuant to the exemption under Rule 505 or 506 of Regulation D [*see § 6A.28*]. This questionnaire should be completed and signed by each buyer. All buyers must either be accredited investors [*see 17 C.F.R. § 230.501(a)* (Regulation D definition); *see § 6A.112[1]*, P 5 (list of categories qualifying as accredited investors)], or, either alone or together with a designated representative, must be sophisticated enough--that is, must have the knowledge and experience necessary--to evaluate the merits and risks of the investment [*17 C.F.R. § 230.506(b)(2)(ii)*; *see § 6A.28[4]*]. The issuer typically determines whether a buyer is an accredited investor, and the sophistication of investors, with a questionnaire like the one in [2], *below*.

[2] Form

Investor Questionnaire
INVESTOR SUITABILITY QUESTIONNAIRE

_____ [*Name of company*]

(ALL INFORMATION FURNISHED IN COMPLETING THIS QUESTIONNAIRE WILL BE TREATED CONFIDENTIALLY)

_____ [*Name of company*] (the "Company") will use the responses to this questionnaire to qualify prospective investors for purposes of federal and state securities laws.

If the answer to any question below is "none" or "not applicable," please so indicate.

Your answers will be kept confidential at all times. However, by signing this questionnaire, you agree that the Company may present this questionnaire to any person as it deems appropriate to establish the availability of exemptions from registration under state and federal securities laws.

PART I. INDIVIDUAL INVESTORS

Investors that are not individuals (that is, are corporations, partnerships, trusts, etc.) should start at PART II.

1. Name (as it should appear on stock certificate): _____

2. Residence address: _____

3. Home telephone: _____

4. Date of birth: _____

5. Social security number: _____

6. United States citizen:

☐ Yes ☐ No

If no, country of citizenship: _____

7. Occupation: _____

8. Number of years: _____

9. Present employer: _____

10. Position/Title: _____

11. Business address: _____

12. Business telephone: _____

13. Business fax: _____

14. Each state and foreign country in which you have maintained your principal residence during the past three years, and the dates during which you resided in each: _____

15. Are you registered to vote in, or do you have a driver's license issued by, or do you maintain a residence in any other state or country?

☐ Yes ☐ No

If yes, in which states and countries? _____

16. Do you reasonably expect that **either** your own income from all sources during the current year will exceed

$200,000 **or** the joint income of you and your spouse (if married) from all sources during the current year will exceed $300,000?

☐ Yes ☐ No

If no, please specify the amount: $_____

17. Percentage of your income (as shown above) anticipated to be derived from sources other than salary: _____

18. Was your yearly income from all sources during each of the last two years in excess of $200,000 **or** was the joint income of you and your spouse (if married) from all sources during each of those years in excess of $300,000?

☐ Yes ☐ No

If no, please specify the amount for last year: $_____ and the year before: $_____

19. Will your net worth as of the date you purchase the securities offered, together with the net worth of your spouse, be in excess of $1 million?

☐ Yes ☐ No

If no, please specify the amount: $_____

20. Please describe your educational background and degrees obtained, if any: _____

21. If you have any existing personal or business relationship with the Company or any of its officers, directors, or controlling persons, please describe the nature and duration of each relationship: _____

22. Please describe in reasonable detail the nature and extent of your business, financial, and investment experience that you believe gives you the capacity to evaluate the merits and risks of the proposed investment and the capacity to protect your interests: _____

23. Are you purchasing the securities offered for your own account and for investment purposes only?

☐ Yes ☐ No

If no, please state for whom you are investing and the reason for investing: _____

24. In evaluating this investment, will you use the services of any of the following advisors? If so, please identity, providing address and telephone number:

☐ Accountant: _____

☐ Attorney: _____

☐ Licensed investment adviser: _____

25. Anticipated amount of subscription: _____

26. Indicate type of ownership in which securities will be held:

☐ Individual

☐ Tenants in common

☐ Joint tenancy with rights of survivorship (husband and wife only)

☐ Community property

☐ Other (describe): _____

Please go to PART III on the last page and sign and date this questionnaire.

PART II. NONINDIVIDUAL INVESTORS

Please complete this PART II only if the proposed purchase is to be made by a corporation, partnership, trust, or other entity. If the investment will be made by more than one affiliated entity, please COMPLETE A COPY OF THIS QUESTIONNAIRE FOR EACH ENTITY.

1. Name (as it will appear on stock certificate): _____

2. Address of principal place of business: _____

3. Jurisdiction of formation or incorporation: _____

4. Contact person: _____

5. Telephone number: _____

6. Fax number: _____

7. Type of entity (corporation, partnership, trust, etc.): _____

8. Taxpayer identification number: _____

9. Was this entity formed for the purpose of this investment?

☐ Yes ☐ No

If yes, all shareholders, partners, or other equity owners must answer PART I of this Questionnaire.

10. Amount of your proposed investment: $_____

11. Entity's net worth at the time the securities will be purchased: $_____

12. Check the appropriate box to indicate which of the following accurately describes the nature of the business conducted by the investing entity:

☐ Private business development company as defined in Section 202(a)(22) of the Investment Advisers Act of 1940 (namely, a U.S. venture capital fund that invests primarily through private placements in nonpublicly traded securities and makes available, either directly or through coinvestors, to the portfolio companies significant guidance concerning management, operations, or business objectives);

☐ A small business investment company licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958;

☐ An investment company registered under the Investment Company Act of 1940 or a business development company as defined in Section 2(a)(48) of that Act;

☐ A bank as defined in Section 3(a)(2) of the Securities Act of 1933 or a savings and loan association or other institution defined in Section 3(a)(5)(A) of that Act, acting in either an individual or fiduciary capacity;

☐ An insurance company as defined in Section 2(13) of the Securities Act of 1933;

☐ An employee benefit plan within the meaning of Title I of the Employee Retirement Income Security Act of 1974 (1) whose investment decision is made by a fiduciary that is either a bank, a savings and loan association, an insurance company, or a registered investment advisor **or** whose total assets exceed $5 million or (2) if a self-directed plan, whose investment decisions are made solely by persons who are accredited investors;

☐ An organization described in *Internal Revenue Code Section 501(c)(3)*, a corporation, a Massachusetts or similar business trust, or a partnership, in each case not formed for the purpose of this investment, with total assets in excess of $5 million;

☐ An entity not located in the United States and whose equity owners are neither U.S. citizens nor U.S. residents;

☐ A trust with total assets in excess of $5 million whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii) under the Securities Act of 1933;

☐ Other (describe): _____

13. Please provide information detailing the business, financial, and investment experience of the entity and investment manager of the entity: _____

PART III. SIGNATURE

In signing below, you acknowledge that the information provided in this questionnaire is true and correct in all material respects and that you recognize that the Company and its counsel are relying on the truth and accuracy of that information in reliance on the exemption contained in Section 4(2) of the Securities Act of 1933, as amended, and Regulation D. You agree to notify the Company promptly of any changes in the foregoing information that occur before the investment.

Executed at _____, on _____.

If investor is an individual:

_____ [*blank line for signature*]

(Signature)

_____ [*blank line for printed/typed name*]

(Print or type name)

If investor is an entity:

_____ [*blank line for printed/typed name*]

(Print or type name)

By: _____

Title: _____



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS

3-6B California Legal Forms--Transaction Guide 6B.syn

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.syn Synopsis to Chapter 6B: CALIFORNIA LIMITED OFFERING EXEMPTIONS

§ 6B.01 California Sources

[1] Statutes

[2] Regulations

§ 6B.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 6B.03-6B.04 [Reserved]

§ 6B.05 Text References

§§ 6B.06-6B.19 [Reserved]

§ 6B.20 Nature of Limited Offering Exemption

[1] In General

[2] Unavailability in Nonissuer Transactions, Recapitalizations, and Reorganizations

[3] Use and Alternatives

[4] Importance of Compliance With Terms of Exemption

§ 6B.21 Integration

[1] Inclusion of Multiple Offers and Sales

[2] Exclusions From Definition

§ 6B.22 Number of Purchasers

[1] Statutory Limit

[2] Exclusions From Purchaser Count

§ 6B.23 Qualification of Purchasers

[1] Suitability Requirements

[2] Preexisting Relationship Test

[3] Sophisticated Investor Test

§ 6B.24 Investment Representation

§ 6B.25 Prohibition on Advertising

§ 6B.26 Disclosure of Material Facts

§ 6B.27 Notice of Transaction

[1] Requirements

[a] Electronic Filing; Hardship Exception

[b] Copy of SEC Form

[2] Time for Filing

[3] Failure to File

[4] Filing Fee

§ 6B.28 Limited Offering Exemption for Changes in Terms of Securities

§ 6B.29 Covered Security Exemption for Securities Issued Under Rule 506 of SEC Regulation D

§§ 6B.30-6B.99 [Reserved]

§ 6B.100 Facts

Scope

§ 6B.101 Documents

Scope

§§ 6B.102-6B.109 [Reserved]

§ 6B.110 Preliminary Determinations

Scope

§ 6B.111 Conducting the Transaction

Scope

§§ 6B.112-6B.199 [Reserved]

§ 6B.200 Limited Offering Investment Letter: Purchaser's Representations Concerning Suitability and Investment Intent

[1] Comment

[a] Use of Form

[b] Qualification of Purchasers

[c] Investment Representation

[2] FORM

Limited Offering Investment Letter: Purchaser's Representations Concerning Suitability and Investment Intent

§ 6B.201 Representation of Professional Advisor in Connection With Limited Offering Exemption

[1] Comment

[a] Use of Form

[b] Qualification of Purchasers in General

[c] Professional Advisor

[2] FORM

Representation of Professional Advisor in Connection With Limited Offering Exemption

§ 6B.202 Representation of Finder Used in Connection With Limited Offering

[1] Comment--Use of Form

[2] FORM

Representation of Finder Used in Connection With Limited Offering

§ 6B.203 Notice of Limited Offering Transaction [Corp. Code § 25102(f); 10 Cal. Code Reg. §§ 260.102.14(c), 260.103(a)]

[1] Comment

[a] Use of Form

[b] Time for Filing Notice

[c] Filing Fee

[d] Failure to File or Late Filing

[e] Electronic Filing

[f] Hardship Exception from Electronic Filing

[2] FORM

Notice of Limited Offering Transaction [Corp. Code § 25102(f); 10 Cal. Code Reg. §§ 260.102.14(c), 260.103(a)]

§ 6B.204 Transmittal Letter to Accompany Notice of Limited Offering Transaction

[1] Comment--Use of Form

[2] FORM

Transmittal Letter to Accompany Notice of Limited Offering Transaction

Frances E. Lossingn*
Practice Consultant

FOOTNOTES:

(n35)Footnote *. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS

3-6B California Legal Forms--Transaction Guide Scope

AUTHOR: Frances E. Lossing Practice Consultant

Scope

Frances E. Lossingn*
Practice Consultant Scope

This chapter covers the offer and sale of securities under the limited offering exemptions from qualification [*see Corp. Code § 25102(f)*] under the Corporate Securities Law of 1968. The Legal Background discusses the statute and applicable rules of the Commissioner of Corporations, and the Transaction Guide lists the steps necessary to use the exemptions. This chapter also contains the notice that must be filed in connection with certain of the exemptions, and forms related to ensuring that the conditions of the exemptions are satisfied.

For a comparison of these exemptions with other possible exemptions, and a discussion covering selection of the most appropriate exemption, see Ch. 6, *Securities Regulation Issues* . If an exemption is not available, see the discussion of qualification requirements in Ch. 6H, *Qualification of Securities* .

FOOTNOTES:
(n36)Footnote *. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART I. RESEARCH GUIDE
A. Primary Sources

3-6B California Legal Forms--Transaction Guide § 6B.01

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.01 California Sources

[1] Statutes

Corporate Securities Law of 1968. *Corp. Code § 25000 et seq.*

"Advertisement" defined. *Corp. Code § 25002.*

"Publish" defined. *Corp. Code § 25014.*

"Broker-dealer" defined. *Corp. Code § 5004.*

"Investment adviser" defined. *Corp. Code § 5009.*

"Issuer" defined. *Corp. Code § 25010.*

"Nonissuer transaction" defined. *Corp. Code § 25011.*

Limited offering exemption. *Corp. Code § 25102(f).*

"Excluded purchasers" defined. *Corp. Code § 25102(i).*

"Covered security" exemption for Rule 506 offerings. *Corp. Code § 25102.1(d).*

Qualification requirement for issuer transactions. *Corp. Code § 25110.*

Limited Offering Exemption for Business Combinations. *Corp. Code § 25103(h).*

Qualification of recapitalizations and reorganizations (issuer transactions). *Corp. Code § 25120*.

Burden of proving exemption on issuer. *Corp. Code § 25163*.

Misrepresentation of material fact. *Corp. Code § 25401*.

[2] Regulations

Rules of the Corporations Commissioner.

Phrase "indirectly for the benefit of the issuer" defined. *10 Cal. Code Reg. § 260.011*.

Non-Public Offering defined. *10 Cal. Code Reg. §§ 260.102.1, 260.102.2*.

Excluded Purchasers defined. *10 Cal. Code Reg. §§ 260.102.10, 260.102.13*.

Limited offering exemption. *10 Cal. Code Reg. §§ 260.102.12-260.102.15*.

Limited offering exemption for changes in terms of securities. *10 Cal. Code Reg. § 260.103*.

Investment Representation. *10 Cal. Code Reg. § 260.105.13.1*.

Releases and Opinions of the Corporations Commissioner. The Commissioner periodically publishes releases that set forth information concerning the regulatory activities of the Commissioner, inform practitioners as to policies, or disclose interpretive opinions [*10 Cal. Code Reg. § 260.608(b)*]. Attorneys can obtain releases from the Commissioner by being placed on a mailing list for distribution of Corporate Securities law material at a cost of $10 per year [*10 Cal. Code Reg. § 260.608(c)(5)*]. Releases are also reproduced in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, vol. 7 (Matthew Bender), in Marsh & Volk, Practice Under the California Securities Laws, Appendix A-4 (Matthew Bender), and in the CALIFORNIA CORPORATION CODE (Matthew Bender).

Qualification of purchasers. Dept. of Corps. Release No. 5-C (Jan. 31, 1969).

Limited offering exemption-- *Corp. Code § 25102(f)*. Dept. of Corps. Release No. 67-C (Oct. 20, 1981).

Proper office for filing notice or amended notice of limited offering transaction. Dept. of Corps. Release No. 13-G (Revised June 10, 2004).

Notice filing and fee payment requirements for securities offerings under SEC Rule 506. Dept. of Corps. Release No. 103-C (Dec. 12, 1996).

Opinions and policy letters interpreting *Corp. Code § 25102(f)* and former *Corp. Code § 25102(f)* and former Rule 260.102.2 (applicable prior to November 1, 1981) that may be instructive in avoiding potential problems.

Integration. Commissioner's Opinion Nos. 73/81C, 74/57C, 74/86C.

Number of purchasers. Commissioner's Opinion Nos. 83/2C, 83/3C.

Qualification of purchasers. California Commissioner Policy Letter Nos. 5 (May 28, 1969), 95 (Aug. 21, 1970), 143C

(Feb. 26, 1971), 165C (June 29, 1971); Commissioner's Opinion Nos. 31/37C, 71/88C, 72/102C, 72/177C.

Investment representation. Commissioner's Opinion No. 83/1C.

Prohibition on publication of advertising. Dept. of Corps. Release No. 5-C (Jan. 31, 1969).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART I. RESEARCH GUIDE
A. Primary Sources

3-6B California Legal Forms--Transaction Guide § 6B.02

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.02 Federal Sources

[1] Statutes

Private transaction exemption. *15 U.S.C. § 77d(2)*.

"Covered security" exemption pursuant to Rule 506. *15 U.S.C. § 77r*.

[2] Regulations

General rules and regulations, Securities Act of 1933. *17 C.F.R. § 230.100 et seq.*

Limited offering and private offering exemptions (Regulation D). *17 C.F.R. § 230.501 et seq.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART I. RESEARCH GUIDE
A. Primary Sources

3-6B California Legal Forms--Transaction Guide §§ 6B.03-6B.04

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6B.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6B California Legal Forms--Transaction Guide § 6B.05

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.05 Text References

Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 21, *Corporate Securities* , § 449.04 (Matthew Bender).

Marsh & Volk, Practice Under the California Securities Laws (Matthew Bender)

Ch. 3A, *Federal Preemption of State Securities Regulation*.

Ch. 4, *General Exemptions From Qualification*, § 4.02A.

Ch. 14, *Civil Liabilities* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6B California Legal Forms--Transaction Guide §§ 6B.06-6B.19

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6B.06[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6B California Legal Forms--Transaction Guide § 6B.20

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.20 Nature of Limited Offering Exemption

[1] In General

The basic limited offering exemption to the qualification requirements for issuer transactions under the Corporate Securities Law is set forth in *Corp. Code § 25102(f).* That subsection creates a general private offering exemption that applies to any offer or sale of any security by an issuer in a transaction (except offers and sales to the issuer's pension or profit-sharing trust) that meets the criteria discussed throughout the remainder of this Legal Background.

[2] Unavailability in Nonissuer Transactions, Recapitalizations, and Reorganizations

This exemption is not available for nonissuer transactions subject to the provisions of *Corp. Code § 25130* or for recapitalization or reorganization transactions subject to the provisions of *Corp. Code § 25120.* Exemptions are available, however, from the provisions of *Corp. Code § 25120* (recapitalizations and reorganizations) in certain circumstances if the transaction satisfies the requirements of *Corp. Code § 25102(f).* These exemptions are discussed in *§§ 6B.28*-6B.30.

Generally it is not difficult to determine the difference between an issuer and nonissuer transaction. However, a transaction which in form may be a nonissuer transaction will nevertheless be treated as an issuer transaction if a portion of the purchase price or any other benefit will be received by the issuer [*see Corp. Code § 25011* and *10* Cal. Code Reg. § 260.011]. A transaction is not considered to be a nonissuer transaction if the benefit is remote, contingent or incidental, such as an inducement for a person to become or remain an employee of the company.

PRACTICE TIP:

In some circumstances it may be beneficial for a small business owner to structure a transaction as a nonissuer transaction in order to avoid the limitations of *Corp. Code § 25102(f).* For example, suppose the owner wishes to retain certain key employees by giving the key employees an ownership interest in the business. This gift will be treated as a sale of securities for value which must be qualified under the California Corporate Securities Law unless an exemption is available. If the gift is made by the

corporation, the transaction may need to be qualified if the key employees do not meet the qualified purchaser standards of *Corp. Code § 25102(f)(2)*. Even if they do meet these standards, the owner may not want to incur the cost and expense of complying with *Corp. Code § 25102(f)* in order to make a gift. If the owner, rather than the corporation makes the gift, the transaction would not need to be qualified if the gift qualifies as a non-public offering under *Corp. Code § 25104(a)*, an exemption available for nonissuer transactions. The transaction should, in most instances, be treated as a nonissuer transaction if the owner makes the gift, rather than the corporation, since the transaction would not be for the indirect benefit of the issuer. *Commentary by Frances E. Lossing.*

[3] Use and Alternatives

The basic limited offering exemption is similar, but not identical to, Regulation D under the federal Securities Act of 1933 [*see* Ch. 6A, *Federal Securities Exemptions For California Nonpublic Corporations*]. It has been one of the most common exemptions used by small businesses to sell securities in a non-public offering since the liberalization of *Corp. Code § 25102(f)* in 1981, largely superseding the more restrictive small offering exemptions in *Corp. Code § 25102(e)* and *(h)*, which is discussed in Ch. 6C, *California Small Offering Exemption* .

Two newer exemptions, the qualified purchaser exemption in *Corp. Code § 25102(n)*, which was adopted in 1994 and is discussed in Ch. 6D, *California Qualified Purchaser Exemptions* , and the "covered security" exemption for offerings pursuant to Rule 506 of Regulation D in *Corp. Code § 25102.1(d)*, which was adopted in 1997 and is discussed in § 6B.31, may be more attractive to small businesses in certain circumstances than the provisions of *Corp. Code § 25102(f)*.

[4] Importance of Compliance With Terms of Exemption

With certain limited exceptions, the issuer will not be protected from liability on the basis that the issuer reasonably believes that the criteria set forth in *Corp. Code § 25102(f)* have been satisfied. The application of these criteria to a particular transaction may involve a number of quite difficult legal judgments, particularly with respect to whether one transaction must be integrated with another, whether a purchaser may be counted as more than one purchaser, whether the purchaser qualification standards are satisfied, whether there has been a publication of advertising and what, if any, disclosure must be made. As a result, it is generally advisable for issuers to consult counsel before using this exemption in all but the simplest of transactions.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsRegulation D ExemptionsSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6B California Legal Forms--Transaction Guide § 6B.21

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.21 Integration

[1] Inclusion of Multiple Offers and Sales

The limited offering exemption applies to any offer or sale by an issuer (except an offer or sale to an issuer's pension or profit-sharing trust) of any security in a "transaction" that meets the criteria (discussed below) set forth in *Corp. Code § 25102(f)*. The term "transaction" is not defined in the statute, and one of the major problems confronting an issuer concerns the identification of all offerings, past, present, and future, that will be considered a part of the transaction. The treatment of multiple offers and/or sales as a single transaction is commonly referred to as "integration."

The primary threat posed by integration is the possibility that the Commissioner may include in the transaction a past offer or sale which, either alone or in conjunction with the other offers and sales, violates the requirements of the exemption. For example, an issuer may decide that a transaction consists entirely of a single completed sale to the maximum number of purchasers permitted under the statute [*see Corp. Code § 25102(f)(1)*]. Once the notice of transaction is filed, the Commissioner may disagree with the issuer's definition of the limited offering transaction and include a past sale that causes the transaction to exceed the maximum number of purchasers and therefore destroys the exemption. It is also quite possible that a past issuee will not meet the purchaser suitability standards of the exemption [*see Corp. Code § 25102(f)(2)*].

PRACTICE TIP:

Abandoned public offerings may present special problems. For instance, an issuer that has filed a registration statement with the Securities and Exchange Commission and then withdrawn the filing without making any sales may be precluded from restructuring the transaction as a private offering for a period of six months, since the filing of the registration statement with the SEC may in and of itself constitute a general solicitation that would be integrated with the subsequent private offering. *Commentary by Frances E. Lossing.*

Although the Commissioner has acknowledged that the flexibility and variety present in securities transactions preclude a single definition of the term "transaction" or a single test for integration, the Commissioner has stated that

"transaction" refers to one or more offers or sales of a security that have such a connection with each other as to be considered one transaction for statutory purposes [Dept. of Corps. Release No. 67-C (Oct. 20, 1981)].

[2] Exclusions From Definition

The Commissioner has provided the following list of categories that are *not* a "transaction" for the purposes of the exemption [*10 Cal. Code Reg. § 260.102.12(b)*]:

- Any offer or sale of a security made more than six months before the start of an offering under the exemption, or made more than six months after completion of an offering under the exemption, as long as during those six month periods there are no offers or sales of securities by or for the issuer that are of the same or a similar class as those offered or sold pursuant to the exemption, other than those offers or sales of securities under any purchase, savings, option, bonus, appreciation, profit-sharing, thrift, incentive, pension, or similar plan solely for employees, directors, trustees, or officers of the issuer or a subsidiary of the issuer.

- Any offer or sale of a security pursuant to a qualification under *Corp. Code § 25110* (issuer transactions) or 25120 (recapitalizations and reorganizations) that became effective after the filing of the notice of transaction under the limited offering exemption, or in which the application for qualification discloses the transaction under the exemption, whether past, current or proposed.

There is no presumption that offers and sales that do not fall within one of the foregoing categories must be integrated for purposes of the exemption, and the integration determination as it relates to those other types of offers and sales must be made without reference to the Commissioner's nonexclusive list [*10 Cal. Code Reg. § 260.102.12(b)*]. However, the Commissioner has prepared another list containing the following factors that are relevant to this determination [Dept. of Corps. Release No. 67-C (Oct. 20, 1981), citing SEC Release 33-4552]:

- Whether the different offerings are part of a single plan of financing.

- Whether the offerings involve issuance of the same class of security.

- Whether the offerings are made at or about the same time.

- Whether the same type of consideration is to be received.

- Whether the offerings are made for the same general purpose.

According to the Commissioner, the two most important factors are whether the offerings are made for the same general purpose and whether they constitute a part of a single plan of financing. The presence of the other factors (differences in the securities, in the consideration, or in the times the offers are made), is generally an insufficient basis for concluding that distinct transactions exist. Finally, offers or sales are potential candidates for integration even if they were qualified or were conducted under another exemption [Dept. of Corps. Release No. 67-C (Oct. 20, 1981)].

PRACTICE TIP:

Sponsors of limited partnership programs may run afoul of the integration requirements if they have an ongoing program of offering and selling limited partnerships to a pool of investors even though the issuer of the limited partnership interests may technically be different. In these circumstances, the Commissioner may view the sponsor to be the issuer and integrate the various offerings for purposes of determining compliance with *Corp. Code § 25102(f). Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6B California Legal Forms--Transaction Guide § 6B.22

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.22 Number of Purchasers

[1] Statutory Limit

Sales of securities may be made to a maximum of 35 purchasers, including out-of-state purchasers, under the limited offering exemption [*Corp. Code § 25102(f)(1)*]. Except for excluded purchasers, the 35 purchaser limitation is absolute. Unlike Rule 506 of SEC Regulation D, the issuer cannot rely on a reasonable belief that this standard has been satisfied.

For purposes of the exemption, the term "purchaser" means a person who acquires the beneficial ownership of the security, whether individually or in joint ownership in the transaction under the exemption. Therefore, each person who takes in joint ownership with another is counted as one [*10 Cal. Code Reg. § 260.102.12(c)*]. However, when a person is both an "affiliate of the issuer," or a purchaser excluded from the purchaser count by *10 Cal. Code Reg. § 260.102.13* (discussed below), and a partnership, corporation, or other organization that was specifically formed for the purpose of purchasing the security offered in reliance on the exemption, each beneficial owner of the purchaser's securities will be counted unless the beneficial owner would be excluded from the count under any of the other statutory or regulatory provisions relating to the exemption [*10 Cal. Code Reg. § 260.102.12(l)*].

For the purposes of these rules, an "affiliate of the issuer" is a person controlling, controlled by, or under common control with, the issuer [*10 Cal. Code Reg. § 260.102.12(i)*]. The term "control" as used in this context means the power to direct or cause, directly or indirectly, the direction of the management, policies, or actions of another person [10 Cal. Code Reg. § 260.120.12(i)].

In addition, a husband and wife, together with any custodian or trustee acting for the account of their minor children, are counted as one, and a partnership, corporation, or other organization which was not specifically formed for the purpose of purchasing the security offered in reliance upon the exemption, is counted as one [*Corp. Code § 25102(f)(4)*]. Note that there is no limit in *Corp. Code § 25102(f)(1)* on the number of offerees [*but see § 6B.25*].

PRACTICE TIP:

The prohibition on the publication of any advertising may, however, indirectly impose a limit on the

number of offerees. If the issuer complies with the safe-harbor provisions of *10 Cal. Code Reg. 260.102.12(j)* described in § 6B.25, there is no limit placed on the number of offerees, other than the practical limitations arising out of compliance with the safe-harbor provisions. If the issuer does not comply with the safe-harbor provisions, it may be necessary to limit the number of offerees in order to insure that there has been no dissemination of the offering to the public. Many practitioners attempt to comply both with the safe-harbor provisions and non-public-offering concepts in order to protect their client from an inadvertent failure to satisfy the requirements of the safe harbor.

The Commissioner has not offered any guidance regarding what constitutes "dissemination to the public" if the offering does not satisfy the safe-harbor standards. The concept of non-public offering is, however, contained in a number of other exemptions. Interpretations of these exemptions may therefore offer some guidance. For purposes of non-public offerings under *Corp. Code § 25102(a)*, offers may be made to no more than 35 persons. For purposes of non-public offerings under *Corp. Code §§ 25102(e), (g),* and *25104(a)*, offers may be made to no more than 25 persons. Additional guidance may be found in Dept. of Corps. Release No. 5-C and interpretations of former *Corp. Code § 25102(f). Commentary by Frances E. Lossing.*

[2] Exclusions From Purchaser Count

Several types of persons and entities are excluded by rules of the Commissioner from this purchaser count, including the institutional investors designated in *Corp. Code § 25102(i)* [*see* Ch. 6D, *California Qualified Purchaser Exemptions*] or in Rule 260.102.10 [*Corp. Code § 25102(f)(4)*; *10 Cal. Code Reg. § 260.102.12(k)*]. Officers, directors, or affiliates of the issuer, or managers (as appointed or elected by the members) if the issuer is a limited liability company, are also excluded from the count in most instances [*Corp. Code § 25102(f)(4)*].

The Commissioner of Corporations has also excluded the following from the purchaser count [*10 Cal. Code Reg. § 260.102.13*]:

- The trustee of an issuer that is a trust, and the general partner of an issuer that is a partnership, who exercise managerial functions with respect to those entities, and any officer, director, or general partner of a general partner of an issuer that is a partnership.

- Any person who occupies a position with the issuer, or with a general partner of an issuer that is a partnership, with duties and authority substantially similar to those of an executive officer of a corporation.

- Any relative, spouse, or relative of the spouse of a purchaser who has the same principal residence as the purchaser. "Relative" is defined as a person related by blood, marriage, or adoption [*10 Cal. Code Reg. § 260.102.13(c)(3)*].

- Any trust or estate in which a purchaser and any of the persons related to that purchaser [*see* the third category, *above,* and the fifth category, *below*] collectively have more than 50 percent of the beneficial interest, excluding contingent interests.

- Any corporation or other organization of which a purchaser and any of the persons related to that purchaser [*see* the third and fourth categories, *above*] collectively are beneficial owners of more than 50 percent of the equity securities (excluding director's qualifying shares) or equity interests.

- Any individual who is a "promoter" of the issuer. "Promoter" is defined as a person who, acting alone or in conjunction with one or more other persons, takes the initiative in founding and organizing

the issuer's business or enterprise [*see 10 Cal. Code Reg. § 260.102.12(f)*].

- Any person who purchases $150,000 or more of the securities offered in the transaction, provided that each purchaser either meets or is reasonably believed by the issuer to meet either of the following:

    - That person, or that person's professional advisor, has the capacity to protect his or her own interests in connection with the transaction [*see Corp. Code § 25102(f)(2)*].

    - The investment (including mandatory assessments) does not exceed 10 percent of that person's net worth (or joint net worth with that person's spouse).

- A small business investment company licensed by the United States Small Business Administration under Section 301(c) or (d) of the Small Business Investment Company Act of 1958 [*see 15 U.S.C. § 681(c)*], a business development company as defined in Section 2(a)(48) of the Investment Company Act of 1940 [*see 15 U.S.C. § 80a-2(a)(48)*], and a private business development company as defined in Section 202(a)(22) of the Investment Advisors Act of 1940 [*see 15 U.S.C. § 80b-2(a)(22)*].

- A person who comes within one of the categories of an "accredited investor" in Rule 501(a) of Regulation D, adopted by the SEC under the Securities Act of 1933 [*17 C.F.R. § 230.501(a)*; *see § 6B.111*, P1a(15)]. Since Rule 501 of SEC Regulation D defines "accredited investor" to include anyone who the issuer reasonably believes comes within one of the designated categories, it is possible that the Commissioner would permit the issuer to be able to rely on the reasonable belief standard in connection with determining whether a purchaser was an "accredited investor."

- Any entity in which all of the equity owners are officers, directors, or affiliates of the issuer [*see Corp. Code § 25102(f)*], or who are institutional investors [*see Corp. Code § 25102(i)*; *see also 10 Cal. Code Reg. § 260.102.10*], or persons who are specified above (other than persons exempt under the $150,000 purchase provision).

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsRegulation D ExemptionsSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6B California Legal Forms--Transaction Guide § 6B.23

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.23 Qualification of Purchasers

[1] Suitability Requirements

Every purchaser under the limited offering exemption, except those purchasers specifically excluded from the purchaser count by *Corp. Code § 25102(f)(4)* or *10* Cal. Code Reg. § 260.102.13 [*10 Cal. Code Reg. § 260.102.12(d)(2)*; *see § 6B.22[2]*], must be a suitable purchaser by virtue of the fact that he or she either (1) has a preexisting personal or business relationship with the offeror or any of its partners, officers, directors or controlling persons, or managers (as appointed or elected by the members) if the offeror is a limited liability company; or (2) could reasonably be assumed to have the capacity to protect his or her own interests in connection with the transaction, by reason of business or financial experience or the business or financial experience of his or her professional advisors who are unaffiliated with and who are not compensated by the issuer or any affiliate or selling agent of the issuer, directly or indirectly [*Corp. Code § 25102(f)(2)*; *see 10 Cal. Code Reg. § 260.102.12(d)*].

To aid the issuer in evaluating the qualifications of potential purchasers, the Commissioner has interpreted several of the terms used in the qualification standards [*see 10 Cal. Code Reg. § 260.102.12*; Dept. of Corps. Release No. 67-C (Oct. 20, 1981)]. These interpretations are discussed in [2] and [3], *below*.

[2] Preexisting Relationship Test

The Commissioner of Corporations has interpreted the term "preexisting personal or business relationship" to include any relationship consisting of personal or business contacts of a nature and duration such as would enable a reasonably prudent purchaser to be aware of the character, business acumen, and general business and financial circumstances of the person with whom the relationship exists [*10 Cal. Code Reg. § 260.102.12(d)(1)*]. A relationship of employer-employee, or as a security holder of the issuer, or as a customer of a broker-dealer, investment advisor, or other person does not necessarily establish a preexisting personal or business relationship according to the Commissioner [*10 Cal. Code Reg. § 260.102.12(d)(1)*].

Ultimately, the courts are responsible for determining whether the relationship between a purchaser and one or more

partners, officers, directors, or controlling persons of the issuer is adequate to satisfy the preexisting relationship test [*see* Marsh & Volk, *PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, § 4.02A[2][c][ii]* (Matthew Bender); *see also People v. Simon (1995) 9 Cal. 4th 493, 500-501, 37 Cal. Rptr. 2d 278, 886 P.2d 1271* ; *People v. Graham (1985) 163 Cal. App. 3d 1159, 1169-1174, 210 Cal. Rptr. 318]* . Relationships not falling within the terms of the Commissioner's interpretation do not presumptively fail to meet the statutory preexisting relationship requirement, and any determination made by the courts concerning the adequacy of a preexisting relationship must be made without referring to the Commissioner's interpretation [*see 10 Cal. Code Reg. § 260.102.12(d)(1)*]. Issuers relying on this test should carefully document the past relationship between the issuer and the purchaser [*see § 6B.200* (form for purchaser representation)].

PRACTICE TIP:

It is not sufficient for the issuer to rely on the purchaser's representation that the purchaser has the requisite preexisting personal or business relationship or the requisite sophistication. The issuer must make this determination from the point of view of the issuer based on the facts. If the issuer is aware of additional facts relevant to a determination whether the requisite business relationship exists or the purchaser is sophisticated, it is recommended that these facts be documented as well. There are a number of Commissioner opinions that offer guidance on this issue, which are referenced in § 6B.01. *Commentary by Frances E. Lossing.*

[3] Sophisticated Investor Test

As stated above, purchasers of securities offered under the limited offering exemption who do not meet the preexisting relationship test must be reasonably assumed to be capable of protecting their own interests in connection with the exempted transaction because of their own business or financial experience or that of their unaffiliated professional advisors [*Corp. Code § 25102(f)(2)*]. This "sophisticated investor" test focuses on the potential purchaser's ability to evaluate the risks present in an offering. It is up to the issuer to make a subjective determination as to the adequacy of the potential purchaser's investment sophistication [*see Corp. Code § 25163* (burden of proving exemption); *see also § 6B.200* (form for purchaser representation)].

PRACTICE TIP:

Even though the sophisticated investor test is separate from the preexisting relationship test, it may, as a practical matter, be necessary for the issuer or a finder engaged by the issuer to have a preexisting relationship with the potential investor in order for the offering not to be disseminated to the public. Under the safe-harbor provisions of *10 Cal. Code Reg. 260.102.12(j)* described in § 6B.25, offering materials may only be distributed to potential investors that the issuer reasonably believes to have a preexisting relationship with the issuer or to be sophisticated. *Commentary by Frances E. Lossing.*

Professional advisors must not be directly or indirectly affiliated with or compensated by the issuer or any affiliate or selling agent of the issuer [*Corp. Code § 25102(f)(2)*]. The Commissioner of Corporations has defined the term "professional advisor" to mean an attorney, a certified public accountant, or a person who, as a regular part of that person's business, is customarily relied on by others for investment recommendations or decisions, and who is customarily compensated for those services, either specifically or by way of compensation for related professional services [*10 Cal. Code Reg. § 260.102.12(g)*]. This definition includes, but is not limited to, persons licensed or registered as broker-dealers, agents, investment advisors, banks, savings and loan associations, and, with respect to those real estate securities described in *Corp. Code § 25206*, licensed real estate brokers [*10 Cal. Code Reg. § 260.102.12(g)(1)*].

A person is not the professional advisor of a purchaser unless designated as such by the purchaser [*10 Cal. Code Reg. § 260.102.12(g)(2)*]. An issuer selling to purchasers who rely on professional advisors should have some form of written evidence of this required designation [*see § 6B.200* (form for purchaser representation)].

PRACTICE TIP:

A person acting as a professional adviser under *Corp. Code § 25102(f)* must generally be licensed as an investment adviser in California. The term "investment adviser" applies to any person who, for compensation, engages in the business of advising others with respect to investing in or purchasing or selling securities. A broker-dealer is excluded from this definition if the broker provides investment advice solely as an incident to the broker's business and the broker receives no special compensation for such services. It does not appear that a broker-dealer would fit within this exclusion, since under *Corp. Code § 25102(f)*, the professional advisor must be a person who as a regular part of his or her business is customarily relied upon by others for investment advice and who is customarily compensated for such services. Attorneys and accountants are excluded from the definition only if investment advisory services are provided solely as an incidence to the practice of their profession. Otherwise they need to be licensed as investment advisers. *Commentary by Frances E. Lossing.*

The Commissioner has provided the following nonexclusive list of relationships involving issuers and professional advisors that will *not* meet the "unaffiliated" requirement of *Corp. Code § 25102(f)(2)* [*10 Cal. Code Reg. § 260.102.12(h)*]:

- A present or intended relationship of employment, either as an employee, employer, independent contractor, or principal.

- Any relationship within the definition of the term "affiliate" or as an officer or director of an affiliate [*see 10 Cal. Code Reg. § 260.102.12(i)* (definition of affiliate); *see also § 6B.22[2]*].

- The beneficial ownership by the professional advisor of securities of the issurer or its affiliates or selling agent, except that the ownership of one percent or less of these securities will not cause a professional advisor to fail the "unaffiliated" requirement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6B California Legal Forms--Transaction Guide § 6B.24

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.24 Investment Representation

All purchasers of securities sold under the limited offering exemption must represent that they are purchasing for their own account (or a trust account if the purchaser is a trustee) and not with a view to or for sale in connection with any distribution of the security [*Corp. Code § 25102(f)(3)*; *see 10 Cal. Code Reg. § 260.102.15* (restriction inapplicable to private resales of securities to qualified institutional buyers under SEC Rule 144A)]. It is advisable to require that this representation be in writing [*see § 6B.200[2]* (form for purchaser representation)].

PRACTICE TIP:

It is customary for securities issued in transactions of this type to bear a restrictive legend stating that the securities are subject to restrictions on transferability and may not be transferred or sold except as permitted under the Securities Act of 1933 and applicable state securities laws in order to comply with federal securities laws or the blue sky laws of other states. As a general rule, this practice should be followed, even though it may not technically be required under California law, unless the securities by their very nature are not readily transferable (that is, interests in an employer stock purchase plan in which the interests are by their terms non-transferability other than on death). *Commentary by Frances E. Lossing.*

Unlike Rule 502 of SEC Regulation D, *Corp. Code § 25102(f)* does not address resales and the impact resales may have on the exemption. Because *Corp. Code § 25102(f)* is silent on this issue, some practitioners have suggested that the statute does not impose any duty on the purchaser to prevent resales of securities. Although this position may be technically correct, the issuer still has the burden of proving that the investment representation criteria has been satisfied. It may be difficult to satisfy this burden of proof if one or more purchasers immediately resell securities purchased pursuant to this exemption.

PRACTICE TIP:

In certain circumstances, the issuer may be aware that the purchaser intends to immediately transfer the securities to an affiliate. This type of transfer may be permissible under *Corp. Code § 25102(f)* if the affiliate makes the investment representation and otherwise meets the requirements as to suitability and

the other requirements of the exemption. *Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6B California Legal Forms--Transaction Guide § 6B.25

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.25 Prohibition on Advertising

The offer or sale of securities under the limited offering exemption must not be accomplished by the publication of any advertisement [*Corp. Code § 25102(f)(4)*].

PRACTICE TIP:

The rule does not specifically prohibit advertising to promote an issuer's products or services during the offering. Care must be taken, however, that the content and use of this type of advertising is not so closely related to the offering that it might be deemed to be part of the offering documents. Tombstone or other institutional advertising after completion of an offering may also violate the rule against dissemination of information to the public if it helps solicit investors in future offerings. *Commentary by Frances E. Lossing.*

The terms "publication" and "advertisement" are crucial to an understanding of this requirement and both are defined in the Corporate Securities Law.

PRACTICE TIP:

It may be possible to post information regarding the offering on the Internet without violating the rules against "dissemination to the public" if the site is password protected and available only to those who the issuer has determined to be qualified investors. *Commentary by Frances E. Lossing.*

Under *Corp. Code § 25002*, the term "advertisement" means any written or printed communication or any communication by means of recorded telephone messages or spoken on radio, television, or similar communications media, published in connection with the offer or sale of a security. Thus, oral communications that are not conveyed by recorded telephone messages or broadcast on one of the communications media are never considered advertisements. Of the communications listed in *Corp. Code § 25002*, only those that are published will be considered advertisements.

Because *Corp. Code § 25014* defines the term "publish" to mean "publicly to issue or circulate by newspaper, mail, radio or television, or otherwise to disseminate to the public," the question becomes whether or not a *Corp. Code §*

25002 communication has been "disseminated to the public." Clearly, any communications that are not disseminated are not subject to the statutory prohibition on advertising. According to the Commissioner, private placement memoranda, offering circulars, and similar disclosure documents are not "disseminated to the public" for purposes of the limited offering exemption if the issuer limits circulation to persons: (1) reasonably believed to be interested in purchasing the securities; or (2) believed by the issuer to meet either the preexisting relationship test or the sophisticated investor test of *Corp. Code § 25102(f)(2)* [*10 Cal. Code Reg. § 260.102.12(j)*; *see § 6B.23*]. Furthermore, with respect to this limited circulation, neither the issuer nor any person acting on its behalf may offer or sell the securities by any form of general solicitation or general advertising. General solicitation includes, but is not limited to, (1) any advertisement, article, notice, or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and (2) any seminar or meeting whose attendees have been invited by any general solicitation or general advertising. There is no presumption that any dissemination of materials not meeting these criteria is a prohibited "publication of advertising," and the publication determination in that case must be made without reference to these criteria [*10 Cal. Code Reg. § 260.102.12(j)*].

PRACTICE TIP:

The issuer should exercise appropriate controls over materials that are used in the preparation of the offering material or the conduct of due diligence by any finders that may be used in the offering to be certain that materials that are not intended to be used in the offering are not disseminated to the public. The issuer will be responsible for the use of all materials disseminated to the public even if the dissemination was inadvertent. Some investors keep a log of information provided to potential investors in response to particular questions for review by outside counsel in order to make certain that the information provided was complete and accurate and does not need to be supplemented in order to make certain that there are no material omissions. *Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6B California Legal Forms--Transaction Guide § 6B.26

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.26 Disclosure of Material Facts

There is no provision in the limited offering exemption that requires an issuer to disseminate information to purchasers or offerees. However, the Department of Corporations has stated, in Dept. of Corps. Release No. 67-C, that reliance on the exemption "will require a recognition of the necessity of furnishing investors with appropriate information." The courts, in interpreting Rule 260.102.2 [*10 Cal. Code Reg. § 260.102.2*] as applied to former *Corp. Code § 25102(f)*, held that "requisite data" must be made available to investors in sales made in reliance on the rule [*People v. Park (1978) 87 Cal. App. 3d 550, 553-554, 151 Cal. Rptr. 146]* .

PRACTICE TIP:

It may be possible not to use an offering document if all the purchasers have a preexisting relationship with the issuer and are actively involved in the project being financed. In this circumstance, the potential investors may already have access to all the information necessary to make a business decision. Offering materials generally must be prepared, however, if the issuer intends to rely on the sophisticated investor provisions of the rule in order for the investor to be able to make an informed decision whether to participate in the offering. Other possible means of providing investors information include data rooms containing copies of all material documents and investor conference calls. Particular care should be taken with investor conference calls to provide full and complete information. The fact that the information is provided orally will not limit the issuer's liability for supplying false or misleading information. *Commentary by Frances E. Lossing.*

In addition, it is unlawful for any person to offer or sell a security in California by means of any written or oral communication that includes an untrue statement of a material fact or fails to state a material fact necessary to make the statements not misleading in light of the circumstances under which they were made [*Corp. Code § 25401*; *see Corp. Code § 25501* (liability for misrepresentation or nondisclosure)].

Corp. Code §§ 25401 and *25501* are modeled on Section 12(2) of the Securities Act of 1933 [*15 U.S.C. § 77l(a)(2)*],

but also impose liability on a buyer as well as a seller who makes false or misleading statements. The question of what is a material fact has been defined by the federal courts as basically a fact that would influence the judgment or decision of the other party to the transaction. The standard of materiality under California law has been held to be the same as this federal standard [*Insurance Underwriters Clearing House, Inc. v. Natomas Co. (1986) 184 Cal. App. 3d 1520, 1526, 228 Cal. Rptr. 449]* . Although the issue of materiality generally is a mixed question of law and fact involving application of a legal standard to a particular set of facts, it may be resolved as a matter of law if reasonable minds cannot differ on the issue [*Insurance Underwriters Clearing House, Inc. v. Natomas Co. (1986) 184 Cal. App. 3d 1520, 1526-1527, 228 Cal. Rptr. 449* ; *see also Fecht v. Price Co. (9th Cir. 1995) 70 F.3d 1078, 1081-1082 , cert. denied, 517 U.S. 1136 (1996)* ; *Warshaw v. Xoma Corp. (9th Cir. 1996) 74 F.3d 955, 958-959* ; *Rosenbaum v. Syntex Corp. (In re Syntex Corp. Secs. Litig.) (9th Cir. 1996) 95 F.3d 922, 934]* . For further discussion, see Marsh & Volk, Practice Under the California Securities Laws, Ch. 14, *Civil Liabilities* (Matthew Bender).

PRACTICE TIP:

Disclosure materials used in offerings of this type frequently include confidential business information, including budgets and future projections. Before this type of information is made available to potential investors, it is customary for a confidentiality agreement to be executed by the potential investor. The issuer should also take particular care that assumptions used in preparing projections are carefully explained and that potential investors are informed of the various factors which could impact the projections in any material respect. *Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue ExemptionsSecurities LawLiabilityDisclosuresGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6B California Legal Forms--Transaction Guide § 6B.27

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.27 Notice of Transaction

[1] Requirements

[a] Electronic Filing; Hardship Exception

Any issuer using the limited offering exemption must file a notice of transaction if any of the offered securities are purchased [*10 Cal. Code Reg. § 260.102.14(a), (b)*]. Unless the issuer files a notice of exemption with the Securities and Exchange Commission (SEC), as discussed in [b], *below*, the notice of transaction must be filed electronically through the internet process made available by the Department of Corporations on [*10 Cal. Code Reg. § 260.102.14(a)(2)*].

An issuer may file a paper notice in person or by mail in the form and containing the information specified in *10 Cal. Code Reg. § 260.102.14(c),(d)* [*see § 6B.203* (form for notice)], if the issuer claims a hardship exception for electronic filing [*10 Cal. Code Reg. § 260.102.14(a)(2), (f)*]. That exception is available if computer equipment including hardware and software is unavailable to the issuer without unreasonable burden or expense, and the issuer includes in the notice both of the following [*10 Cal. Code Reg. § 260.102.14(f)(1)*]:

- The reason(s) that the computer equipment including hardware and software is unavailable without unreasonable burden and expense; and

- The description(s) of the unreasonable burden or expense to the issuer to make the electronic filing.

Alternatively, the hardship exception is available if the issuer cannot obtain and provide information requested on the Department's electronic notice or through the Internet filing process, and the issuer includes in the notice both of the following [*10 Cal. Code Reg. § 260.102.14(f)(2)*]:

- The reason(s) that the issuer cannot obtain and provide the requested information on the electronic notice or through the Internet filing process without unreasonable burden or expense; and

- The description(s) of the unreasonable burden or expense to the issuer to make the electronic filing.

[b] Copy of SEC Form

If, in connection with the transaction, the issuer files a notice with the (SEC) under Section 4(6) of the Securities Act of 1933 [*15 U.S.C. 77d(6)* (accredited investor exemption)] or Regulation D [*see 17 C.F.R. § 230.503*], the notice of transaction may be a copy of the federal form first filed pursuant to those provisions [*10 Cal. Code Reg. § 260.102.14(a)(1)*]. The fee required by *Corp. Code § 25608(c)* must accompany the form. Each issuer other than a California corporation must also file a consent to service of process form [*see 10 Cal. Code Reg. § 260.165* (consent must be pursuant to Form U-2; pursuant to Form D filed with Commissioner in connection with transaction; included in electronic submission of filing; or in form set out in regulation); *see also Ch. 6H, Qualification of Securities, §§ 6H.239, 6H.240*], unless it already has a consent to service on file with the Commissioner. The filing should be accompanied by a cover letter indicating that the filing is pursuant to *Corp. Code § 25102(f)*, and if a consent to service is not included, a statement that the issuer already has a consent to service on file with the Commissioner [*10 Cal. Code Reg. § 260.102.14(a)(1)*; *see* Dept. of Corps. Rel. No. 120-C (March 24, 2009) (new filing requirements for Reg. D offerings)]. Note that the federal and state limited offering exemptions are not identical; certain offers and sales may be exempt from registration under the federal act pursuant to Rule 506 [*17 C.F.R. § 230.506*] and yet not meet the conditions for exemption pursuant to *Corp. Code § 25102(f)* [*see*Dept. of Corps. Release No. 103-C (Dec. 12, 1996)]. For discussion of federal exemptions, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* .

[2] Time for Filing

A notice of transaction must be filed with the Commissioner no later than 15 calendar days after the first sale of a security in the transaction in California [*10 Cal. Code Reg. § 260.102.14(b)*]. The first sale in California occurs when the issuer has obtained a contractual commitment in California to purchase one or more of the securities the issuer intends to sell in connection with the transaction in California [*10 Cal. Code Reg. § 260.102.14(d)*]. No notice is required if none of the securities offered are purchased in California [*10 Cal. Code Reg. § 260.102.14(b)*].

If the notice is not filed within this 15-day period, the issuer must file it within 15 business days after discovery of the failure to file the notice or after demand by the Commissioner, whichever occurs first, and must pay a filing fee equal to the fee payable had the transaction been qualified under *Corp. Code § 25110* [*Corp. Code § 25102(f)(4); 10 Cal. Code Reg. § 260.102.14(b)*]. A late fee is not required for late filings.

[3] Failure to File

Failure to file the notice will not affect the availability of the limited offering exemption [*Corp. Code § 25102(f)(4)*]. On the other hand, because this failure would be a violation of a Rule of the Commissioner, it would also be considered a violation of the Corporate Securities Law and could result in the imposition of criminal sanctions [*see Corp. Code § 25540*]. Sanctions include the possibility of a civil penalty of up to $2,500 per violation [*Corp. Code § 25535(a)*].

PRACTICE TIP:

The Department of Corporations has taken the position that the filing of a notice of transaction will violate *Corp. Code § 25166* regarding the making of false statements to the Commissioner if in fact the claimed exemption cannot be established. *Commentary by Frances E. Lossing.*

[4] Filing Fee

Each notice must be accompanied by the filing fee set forth in *Corp. Code § 25608(c)* [*10 Cal. Code Reg. § 260.102.14(a)(1), (d)*]. The maximum fee that may be levied on a filing pursuant to *Corp. Code § 25102(f)* will apply, unless the Commissioner sets the fees below the maximum level at the beginning of the fiscal year [*Corp. Code §*

25608.2; *see Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsOnline TransactionsSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue ExemptionsSecurities LawLiabilityDisclosuresGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6B California Legal Forms--Transaction Guide § 6B.28

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.28 Limited Offering Exemption for Changes in Terms of Securities

The exemption for limited offerings has been extended to certain changes in the rights, preferences, privileges or restriction of or on outstanding securities and any exchange of securities with existing security holders exclusively [*10 Cal. Code. Reg. § 260.103(a)(1)*]. To claim the exemption, the issuer must show that the transaction would have been exempt under *Corp. Code § 25102(f)* had it involved the issuance of a new security. The notice filing requirements described under § 6B.27 must also be followed. It is unclear whether the fee suspension provisions are applicable to a filing under this exemption.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6B California Legal Forms--Transaction Guide § 6B.29

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.29 Covered Security Exemption for Securities Issued Under Rule 506 of SEC Regulation D

An exemption is also available for any offer or sale of a security which is exempt from registration under Rule 506 of SEC Regulation D [*Corp. Code § 25102.1*; *see* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*] if all of the following requirements are satisfied [*Corp. Code § 25102.1(d)*]:

- A notice in the form of the completed Form D filed with the SEC must be filed with the Commissioner within 15 days after the first sale of securities in California (or the Commissioner may allow for a notice by electronic transmission of the information in Form D);

- A consent to service of process must be filed if the issuer is not a California corporation and has not previously filed a consent in California [*see 10 Cal. Code Reg. § 260.165*; *see also* Dept. of Corps. Rel. No. 120-C (March 24, 2009) (new filing requirements for Reg. D offerings)]; and

- A notice filing fee must be paid [Dept. of Corps. Release No. 103-C].

The transmittal letter should state that the filing is being made pursuant to Section 18(b)(4)(D) of the Securities Act of 1933 and *Corp. Code § 25102.1(d)* [Dept. of Corps. Release No. 103-C].

Unlike *Corp. Code § 25102(f)*, this exemption is also available for nonissuer transactions and for reorganizations and recapitalizations.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsRegulation D ExemptionsSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6B California Legal Forms--Transaction Guide §§ 6B.30-6B.99

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6B.30[Reserved]



126 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6B California Legal Forms--Transaction Guide § 6B.100

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.100 Facts

1. Name, address of principal executive office and telephone number of issuer.

2. Full description of proposed offering.

3. Purpose of offering, including intended uses of proceeds.

4. Full description of issuer's past or contemplated offerings (including abandoned offerings) which are or may be related in any way to proposed offering, including information regarding:

a. Classes of securities.

b. Dates of offerings.

c. Plans of financing.

d. Consideration.

e. Purposes of offerings.

f. Any methods of qualification.

5. Names, addresses, and telephone numbers of all known and/or proposed offerees and of past issuers of related securities.

6. Description of all known and/or proposed offerees including:

a. Family relationship among offerees.

b. Relationship of offeree as custodian or trustee for the minor children of other offerees.

c. Description, and purpose of formation, of any proposed offeree that is not an individual.

d. Affiliation between any offeree and the issuer.

e. Net worth of any offeree purchasing $150,000 or more of the securities.

f. Net worth and income of any offeree who will be purchasing as an individual accredited investor.

g. Any other information to be used to establish that an offeree may be an excluded purchaser.

h. Description of offeree's preexisting personal or business relationship with the offeror or any of its partners, officers, directors, or controlling persons.

i. Financial and business experience, if known, of offerees, and basis for any such knowledge.

7. Description of any communications, including advertisements, proposed to be made in connection with offering(s).

8. Description of sales plan, including information on whether and on what basis finders will be used.

9. Description of "due diligence" plan.

10. Description of methods by which investors may obtain information about issuer (i.e., private placement memorandum, investor due diligence calls, data room for review by potential investors, etc.).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6B California Legal Forms--Transaction Guide § 6B.101

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.101 Documents

1. Articles of incorporation, association, or partnership, limited liability company operating agreement, contract for joint venture, or other charter documents.

2. Bylaws, if applicable.

3. Copies of any documents relating to previous or contemplated offerings, such as:

a. Permits to issue stock.

b. Notices filed pursuant to any exemptions.

4. Specimen security for proposed issue.

5. Proposed written communications for offerees.

7. Documentation to support conclusion that purchaser is an excluded purchaser, if applicable.

8. Documentation to support conclusion that offeree has a preexisting relationship with the issuer, if applicable.

9. Documentation of financial and business experience of offerees.

10. Investment representation.

11. Representation of professional adviser, if applicable.

12. Representation of finder, if applicable.

13. Offering materials log sheet (including name, mailing address and state of residence of offeree, number of offering memorandum delivered, amount of investment and date on which offering memorandum was returned if no investment made), if applicable.

14. Subscriptions accepted log, including name and address of investor, date of acceptance of offer, and amount of securities purchased.

15. Record of additional information requested by offeree, including name of offeree, name of person requesting additional information, date of request, and nature of information provided.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6B California Legal Forms--Transaction Guide §§ 6B.102-6B.109

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6B.102 [Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Compliance With Conditions of Limited Offering Exemption

3-6B California Legal Forms--Transaction Guide § 6B.110

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.110 Preliminary Determinations

1. Determine which offers or sales, including past and contemplated offerings, will be considered part of the transaction for purposes of limited offering exemption.

NOTE:

The Commissioner has listed certain factors that are relevant in determining whether multiple offers or sales should be combined in a single transaction [Dept. of Corps. Release No. 67-C (Oct. 20, 1981), citing SEC Release 33-4552]. These factors are discussed in *§ 6B.21*.

a. Exclude from consideration [*10 Cal. Code Reg. § 260.102.12(b)*]:

NOTE:

This list, which is set forth in the applicable regulations, is nonexclusive. The regulation provides that no presumption is created that other categories of offers and sales must be integrated for purposes of the limited offering exemption, and states that this determination must be made without reference to this list [*10 Cal. Code Reg. § 260.102.12(b)*]. Nevertheless, the list obviously is critical as a starting point for determining which offers or sales will be included for purposes of the exemption.

(1) Any offer or sale of a security made more than six months:
(a) Before the start of an offering under the exemption; or

(b) After completion of such an offering.

NOTE:
During these six-month periods there must be no offers or sales of securities by or for the issuer (or a related issuer if the offerings of that issuer might be integrated with those of the issuer) that are of the same or a similar class as those offered or sold pursuant to the exemption. This provision applies only to offers or sales of securities other than those under any purchase, savings, option, bonus, appreciation, profit-sharing, thrift, incentive, pension or similar plan solely for employees, directors, trustees or officers of the issuer or a subsidiary of the issuer. The limited offering exemption is not available for an offer or sale of a security to a pension or profit-sharing trust of the issuer [***see*** *10 Cal. Code Reg. § 260.102.12(b)(1)*].

(2) Any offer or sale of a security pursuant to a qualification under *Corp. Code §§ 25110* (issuer transactions) or 25120 (recapitalizations and reorganizations):

(a) That became effective after filing of notice filed under exemption; or

(b) In which application for qualification discloses transaction under exemption, whether past, current, or proposed.

b. Determine whether past offerings included in transaction violated any conditions of the exemption, thereby making exemption unavailable.

2. Determine whether transaction involves any federal exemption that requires filing notice under Securities Exchange Act of 1933 [*15 U.S.C § 77a et seq.*] as of July 1, 1997.

NOTE:
A form filed pursuant to a federal exemption may satisfy the notice requirement of the limited offering exemption [***see*** *10 Cal. Code Reg. § 260.102.14(a)(1)*; ***see also*** *§ 6B.27*]. For discussion of transactions effected pursuant to Rule 506 [*17 C.F.R. § 230.506*] and other federal exemptions, see Ch. 6A, ***Federal Securities Exemptions for California Nonpublic Corporations*** .

3. Determine whether issuer will claim hardship exception from electronic filing of notice of transaction, based on either of following [*10 Cal. Code Reg. § 260.102.14(a)(2),(f)*]:

NOTE:
The notice of transaction must be filed electronically unless the issuer claims a hardship exception [*10 Cal. Code Reg. § 260.102.14(a)(2),(f)*]. If either of these criteria apply, the issuer must describe in its notice the basis of the hardship [*10 Cal. Code Reg. § 260.102.14(c),(f)*; ***see*** *§ 6B.111[5][b]*].

a. Computer equipment (including hardware and software) is unavailable to issuer without unreasonable burden or expense; or

b. Issuer cannot obtain and provide information requested on the Department's electronic notice or through the Internet filing process.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsU.S. Securities & Exchange Commission Rules 146 & 506Securities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Compliance With Conditions of Limited Offering Exemption

3-6B California Legal Forms--Transaction Guide § 6B.111

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.111 Conducting the Transaction

1. Restrict sales of security to maximum of 35 persons, including out-of-state persons but excluding "excluded purchasers" [*Corp. Code § 25102(f)(1)*].

NOTE:
There is no express limitation on the number of offerees. The number of offerees may be limited, however, by the prohibitions on advertising. [***see*** *§§ 6B.22[1], 6B.25*].

a. In determining the purchaser count, exclude:
(1) Institutional investors [*Corp. Code § 25102(f)(4)*].

NOTE:
The types of "institutional investors" that are excluded in determining the number of purchasers are listed in *Corp. Code § 25102(i)* [***see*** *Ch. 6J,* ***Issuance of Debt Securities****, § 6J.19*] and in *10 Cal. Code Reg. § 260.102.10*.

(2) Any officer, director or affiliate of issuer, or manager (as appointed or elected by members) if issuer is a limited liability company, [*Corp. Code § 25102(f)(4)*].

NOTE:
An "affiliate" is a person controlled by, controlling, or under common control with, the issuer. A person controls another person within the meaning of this definition through the possession, direct or indirect, of the power to direct or cause the direction of the management, policies, or actions of the other person [*10 Cal. Code Reg. § 260.102.12(l)*;

see P b(2), NOTE, ***below***].

(3) Trustee of an issuer that is a trust, who exercises managerial functions [*10 Cal. Code Reg. § 260.102.13(a)*].

(4) General partner of an issuer that is a partnership, who exercises managerial control [*10 Cal. Code Reg. § 260.102.13(a)*].

(5) Any officer, director, or general partner of a general partner of an issuer that is a partnership [*10 Cal. Code Reg. § 260.102.13(a)*].

(6) Any person who occupies a position with issuer with duties and authority substantially similar to those of an executive officer of a corporation [*10 Cal. Code Reg. § 260.102.13(b)*].

(7) Any relative, spouse, or relative of spouse of purchaser who has same principal residence as purchaser [*10 Cal. Code Reg. § 260.102.13(c)(1)*].

NOTE:

"Relative" means a person related by blood, marriage, or adoption [*10 Cal. Code Reg. § 260.102.13(c)(3)*].

(8) Any trust or estate in which purchaser and any persons related to purchaser [*see* P (7), *above*; P (9), *below*] collectively have more than 50 percent of beneficial but not contingent interests [*10 Cal. Code Reg. § 260.102.13(c)(2)*].

(9) Any corporation or other organization of which purchaser and related persons are beneficial owners of more than 50 percent of equity securities, other than director's qualifying shares, or equity interests [*10 Cal. Code Reg. § 260.102.13(c)(3)*].

(10) Any promoter of the issuer [*10 Cal. Code Reg. § 260.102.13(d)*].

NOTE:

A "promoter" is a person who, acting alone or in conjunction with one or more other persons, takes the initiative in founding and organizing the issuer's business or enterprise [*10 Cal. Code Reg. § 260.102.12(f)*].

(11) Any person who purchases $150,000 or more of the securities offered, provided each such purchaser meets (or is reasonably believed by the issuer to meet) any one of the following:

(a) Person, or his or her professional advisor, has capacity to protect the person's own interests in connection with transaction, as provided in *Corp. Code § 25102(f)(2)* [*10 Cal. Code Reg. § 260.102.13(e)(1)*];

(b) Investment (including mandatory assessments) does not exceed 10 percent of the person's net worth or joint net worth with that person's spouse [*10 Cal. Code Reg. § 260.102.13(e)(2)*].

(12) Small business investment company licensed by United States Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958 [*10 Cal. Code Reg. § 260.102.13(f)*].

(13) Business development company as defined in Section 2(a)(48) of Investment Company Act of 1940 [*10 Cal. Code Reg. § 260.102.13(f)*; *see 15 U.S.C § 80a-1 et seq.*].

(14) Private business development company as defined in Section 202(a)(22) of the Investment Advisors Act of 1940 [*10 Cal. Code Reg. § 260.102.13(f)*; *see 15 U.S.C § 80b-1 et seq.*].

(15) Person who comes within one of the categories of an "accredited investor" in Rule 501(a) of Regulation D, adopted by the SEC under the Securities Act of 1933 [*17 C.F.R. § 230.501(a)*; *see* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*], which include:

(a) Any bank, savings and loan association, registered broker or dealer, or insurance company as defined in the Act; any registered investment company or business development company defined in the Act; any licensed Small Business Investment Company; and certain employee benefit plans [*17 C.F.R. § 230.501(a)(1)*].

(b) Any private business development company as defined in Section 202(a)(22) of the Investment Advisers Act of 1940 [*17 C.F.R. § 230.501(a)(2)*].

(c) Any organization described in *I.R.C. § 501(c)(3)*, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets exceeding $5 million [*17 C.F.R. § 230.501(a)(3)*].

(d) Any director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer [*17 C.F.R. § 230.501(a)(4)*].

(e) Any individual whose net worth, or joint net worth with his or her spouse, at the time of purchase exceeds $1 million [*17 C.F.R. § 230.501(a)(5)*].

(f) Any individual whose income exceeded $200,000 in each of the two most recent years or whose joint income with his or her spouse exceeded $300,000 in each of those years, and who reasonably expects to reach the same income level in the current year [*17 C.F.R. § 230.501(a)(6)*].

(g) Any trust, with total assets in excess of $5 million, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a "sophisticated person" [*17 C.F.R. § 230.501(a)(7)*; *see 17 C.F.R. § 230.506(b)(2)(ii)* (definition)].

(h) Any entity in which all the equity owners are accredited investors [*17 C.F.R. § 230.501(a)(8)*].

(16) Any entity in which all equity owners are [*10 Cal. Code Reg. § 260.102.13(h)*]:

(a) Persons specified in *Corp Code § 25102(i)*.

NOTE:
These include institutional or registered investors such as lenders, trust companies, pension or profit sharing plans, or IRAs [***see*** *Corp. Code § 25102(i)*].

(b) Institutions and agencies designated by Corporations Commissioner under *10 Cal. Code Reg. § 260.102.10* [*see Ch. 6J, Issuance of Debt Securities, § 6J.120*].

(c) Institutions or individuals specified in PP (3)-(10), (12)-(15), *above* [*see 10 Cal. Code Reg. § 260.102.13(a)-(d), (f), (g)*].

(d) Persons who are officers, directors, or affiliates of issuer [*see Corp. Code § 25102(f)*; *10 Cal. Code Reg. § 260.102.13(h)*].

b. In determining purchaser count, count as one [*Corp. Code § 25102(f)(4)*]:

(1) A husband and wife, together with any custodian or trustee acting for the account of their minor children.

(2) Partnership, corporation, or other organization not specifically formed to purchase the security being offered.

NOTE:
If a person is both an affiliate of the issuer or a purchaser excluded by *10 Cal. Code Reg. § 260.102.13* [***see*** PP [a](3)-(16), ***above***] and a partnership, corporation, or other organization that was specifically formed for the purpose of purchasing the security offered, each beneficial holder of its securities must be counted or excluded in accordance with *Corp. Code § 25102(f)* [*10 Cal. Code Reg. § 260.102.12(l)*].

2. Restrict sales to purchasers who either [*Corp. Code § 25102(f)(2)*; *see § 6B.200*]:

NOTE:
The following qualification requirements do not apply to offerees.

a. Have a preexisting personal or business relationship with offeror or any of its partners, officers, directors, or controlling persons, or managers (as appointed or elected by the members) if the offeror is a limited liability company; or

NOTE:
A preexisting personal or business relationship includes any relationship consisting of personal or business contacts of a nature and duration that would enable a reasonably prudent purchaser to be aware of the character, business acumen, and general business and financial circumstances of the person with whom that relationship exists [*10 Cal. Code Reg. § 260.102.12(d)(1)*; ***see*** *§ 6B.23* for a nonexclusive list of relationships that do not necessarily meet the "preexisting personal or business relationship" test].

b. Can be reasonably assumed to have capacity to protect their own interests because of:

(1) Their own financial and business experience; or

(2) Financial and business experience of their professional advisors who are unaffiliated with, and do not receive compensation from, issuer [*see 10 Cal. Code Reg. § 260.102.12(g), (h)*; *see also § 6B.201[2]* (form for representation)].

3. Have each purchaser represent that purchase is for purchaser's own account and not for resale [*Corp. Code § 25102(f)(3)*; *see 10 Cal. Code Reg. § 260.102.15*; *see also § 6B.200[2]* (form for representation)].

4. Do not publish any advertisement in connection with offer or sale [*Corp. Code § 25102(f)(4)*].

NOTE:

This does not preclude distribution of documents and other material that are not disseminated to the public [***see*** *10 Cal. Code Reg. § 260.102.12(j)*]. Note that any oral or written communication made in connection with the offer or sale must disclose all material facts that are necessary to prevent the communication from being misleading [***see*** *Corp. Code §§ 25401, 25501*; ***see also*** *§ 6B.26*].

5. If transaction results in sale, file notice of transaction with Commissioner of Corporations [*Corp. Code § 25102(f)(4)*; *10 Cal. Code Reg. § 260.102.14*].

NOTE:

Failure to file or a late filing will not affect the availability of the exemption [*Corp. Code § 25102(f)(4)*]. However, a failure to file is a violation of a Rule of the Commissioner and is therefore considered a violation of the Corporate Securities Law. Sanctions include the possibility of a civil penalty of up to $2,500 per violation [*Corp. Code § 25535(a)*; ***see*** *Corp. Code § 25540*].

The fee required by *Corp. Code § 25608(c)* must accompany the form. The maximum fee that may be levied on a filing pursuant to *Corp. Code § 25102(f)* will apply, unless the Commissioner sets the fees below the maximum level at the beginning of the fiscal year. [*Corp. Code § 25608.2*; ***see*** *Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum)].

a. If transaction does not come within federal exemption discussed in the NOTE, *below* [*see 10 Cal. Code Reg. § 260.102.14(a)(1)*], file notice electronically [*see 10 Cal. Code Reg. § 260.102.14(a)(2)*; *see also § 6B.203* (example of notice)], no later than 15 calendar days after first sale of a security in transaction in California [*10 Cal. Code Reg. § 260.102.14(b)*].

NOTE:

If, in connection with the transaction, the issuer files a notice with the SEC under Section 4(6) of the Securities Act of 1933 [*15 U.S.C. 77d(6)* (accredited investor exemption)] or Regulation D [*17 C.F.R. § 230.503*], the notice of transaction may be a copy of the federal form first filed pursuant to those provisions [*10 Cal. Code Reg. § 260.102.14(a)(1)*; ***see*** Ch. 6A, ***Federal Securities Exemptions for California Nonpublic Corporations***]. The fee required by *Corp. Code § 25608(c)* must accompany the form. Each issuer other than a California corporation must also file a consent to service of process form [***see*** *10 Cal. Code Reg. § 260.165* (consent must be pursuant to Form U-2; pursuant to Form D filed with Commissioner in connection with transaction; included in electronic submission of filing; or in form set out in regulation); Dept. of Corps. Rel. No. 120-C (March 24, 2009) (new filing requirements for Reg. D offerings); ***see also*** *Ch. 6H,* ***Qualification of Securities****, §§ 6H.239, 6H.240*], unless it already has a consent to service on file with the Commissioner. The filing should be accompanied by a cover letter indicating that the filing is pursuant to *Corp. Code § 25102(f)* [***see*** *§ 6B.204[2]* (form)], and, if a consent to service is not included, a statement that the issuer already has a consent to service on file with the Commissioner [*10 Cal. Code Reg. § 260.102.14(a)(1)*; ***see*** *§ 6B.27*].

The first sale in California occurs when the issuer has obtained a contractual commitment in California to purchase one or more of the securities the issuer intends to sell in connection with the transaction [*10 Cal. Code Reg. § 260.102.14(d)*].

b. If issuer claims hardship exception for electronic filing [*10 Cal. Code Reg. § 260.102.14(a)(2),(f)*; *see § 6B.110[3], above*]:

(1) File paper notice [*10 Cal. Code Reg. § 260.102.14(c)*; *see § 6B.203* (form for notice)] in person or by mail, no later than 15 calendar days after first sale of security in transaction in California [*10 Cal. Code Reg. § 260.102.14(b)*].

NOTE:
The issuer must describe in its notice the basis of the hardship [*see 10 Cal. Code Reg. § 260.102.14(c),(f)*].

(2) Accompany filing with transmittal letter [*see § 6B.204[2]* (form for transmittal letter)].

c. If notice is not filed within 15 days, file either:

(1) Before Commissioner issues demand; or

NOTE:
There is no late fee for this type of filing.

(2) Within 15 business days after discovery of the failure to file the notice or after Commissioner issues demand, whichever occurs first, and pay fee equal to fee that would have been payable had transaction been qualified under *Corp. Code § 25110* [*Corp. Code § 25102(f)(4)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsRegulation D ExemptionsSecurities LawExemptions From RegistrationSmall Issue ExemptionsSecurities LawInvestment CompaniesExclusions & Exemptions



131 of 193 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Compliance With Conditions of Limited Offering Exemption

3-6B California Legal Forms--Transaction Guide §§ 6B.112-6B.199

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6B.112[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART IV. FORMS

3-6B California Legal Forms--Transaction Guide § 6B.200

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.200 Limited Offering Investment Letter: Purchaser's Representations Concerning Suitability and Investment Intent

[1] Comment

[a] Use of Form

This form may be used to obtain the investment representation that each purchaser is required to make under the limited offering exemption [*see Corp. Code § 25102(f)(3)*], and to document a purchaser's representations concerning his or her suitability to purchase securities in a limited offering transaction [*see Corp. Code § 25102(f)(2)*]. Both of these functions are discussed below.

There is no requirement that these representations be in writing. However, as discussed below, some form of documentation is advisable to indicate that the issuer has complied with the eligibility requirements of the limited offering exemption.

[b] Qualification of Purchasers

Issuers under the limited offering exemption must determine that all purchasers meet one of two tests of suitability [*see Corp. Code § 25102(f)(2)*]. This requirement does not apply to those purchasers specifically excluded from the purchaser count by *Corp. Code § 25102(f)(4)* or *10* Cal. Code Reg. § 260.102.13 [*10 Cal. Code Reg. § 260.102.12(d)(2)*; *see § 6B.22[2]*].

Under one test, purchasers must have a preexisting personal or business relationship with the offeror or any of its partners, officers, directors or controlling persons, or managers (as appointed or elected by the members) if the offeror is a limited liability company [*Corp. Code § 25102(f)(2)*]. The Commissioner has interpreted the term "preexisting personal or business relationship" to include any relationship consisting of personal or business contacts of a nature and duration that would enable a reasonably prudent purchaser to be aware of the character, business acumen, and general business and financial circumstances of the person with whom the relationship exists [*10 Cal. Code Reg. §*

260.102.12(d)(1); *see discussion under § 6B.23[2]*, for a nonexclusive list of relationships that do not necessarily meet this standard]. Note that this is basically an objective standard that is concerned with what a "reasonably prudent purchaser" would have been aware of, rather than what the particular purchaser actually was aware of. Because the adequacy of the relationship may be challenged, issuers should use this form to document any purchaser representations that lead to the conclusion that the standard was satisfied.

This form may also be used to record similar representations made in connection with the alternative "sophisticated investor" test [*see Corp. Code § 25102(f)(2)*]. This test is discussed in *§ 6B.201* and in § 6B.23[3]. One of the methods of compliance with this test involves the designation of a professional advisor [*see 10 Cal. Code Reg. § 260.102.12(g)(2)*]. Purchasers may use this form to make that designation.

[c] Investment Representation

All purchasers of securities sold under the limited offering exemption must represent that they are purchasing the securities for their own account (or a trust account if the purchaser is a trustee) and not with a view to or for sale in connection with any distribution of the security [*Corp. Code § 25102(f)(3)*; *see 10 Cal. Code Reg. § 260.102.15* (restriction inapplicable to private resales of securities to qualifying institutional buyers)]. Although there is no requirement that this representation be in writing, completion of this form would indicate that the issuer did obtain this representation. This documentation will be particularly useful if a subsequent violation of the representation leads to questions regarding the existence or sufficiency of the representation.

[2] FORM

Limited Offering Investment Letter: Purchaser's Representations Concerning Suitability and Investment Intent

_____[*date*]

To: _____ [*Name of issuer*]
_____ [*street address*]
_____ [*city, state, zip*]

LIMITED OFFERING INVESTMENT LETTER

Purchaser's Representations Concerning Suitability and Investment Intent

In connection with my purchase of _____ [*describe securities, e.g.,* 100 common shares of your Company], I represent to you that I am a suitable purchaser of these securities because (select and complete one of the following statements):

Check the appropriate box:	Complete the appropriate entry:
☐	I have had the following _____ [personal *and/or* business] relationship with _____ [*name of issuer or specify name and position of any of the issuer's partners, officers, directors, or controlling persons, or managers*

(as appointed or elected by the members) if the offeror is a limited liability company]:

_____

☐ The following _____[business *and/or* financial] experience has provided me with the capacity to protect my interests in connection with this purchase of securities: _____

☐ I have engaged and hereby designate _____ [*name*] to serve as my professional advisor in connection with this purchase.

I further represent to you that I am purchasing these securities for investment for my own account [*or specify trust account if purchaser is a trustee*] and not with a view to or for sale in connection with any distribution of the security. I understand that these securities have not been qualified under the California Corporate Securities Law or registered under the federal Securities Act of 1933, and further understand that any resale or other transfer of these securities may require qualification and/or registration under the above statutes.

Respectfully submitted,

_____ [*signature of purchaser*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART IV. FORMS

3-6B California Legal Forms--Transaction Guide § 6B.201

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.201 Representation of Professional Advisor in Connection With Limited Offering Exemption

[1] Comment

[a] Use of Form

This form may be used by an issuer under the limited offering exemption to demonstrate the basis for its conclusion that a particular professional advisor is legally capable of protecting the interests of a client-purchaser in connection with a limited offering transaction. If a purchaser's advisor meets the standards discussed below, the purchaser suitability condition of the exemption (also discussed below) will be met.

This form is not required by the statute or the applicable Rules of the Commissioner, nor will this representation necessarily satisfy the issuer's burden of proving that the purchaser and/or advisor meets the requirements of the exemption [*see Corp. Code § 25163* (burden of proving exemption)]. However, if questions subsequently arise concerning an advisor's qualifications, this form will suggest that the issuer's determination was reasonable in that it was based on express representations of the advisor that were specifically tailored to the requirements of the statute.

[b] Qualification of Purchasers in General

Purchasers under the limited offering exemption must meet one of two alternative tests of suitability [*see Corp. Code § 25102(f)(2)*] that are designed to restrict the availability of an exempted offering to purchasers who are capable of weighing the risks involved. One of these tests requires that all purchasers must be reasonably assumed to have the capacity to protect their own interests in connection with the limited offering transaction, either because of their business or financial experience or the business or financial experience of their professional advisors who meet certain requirements [*see Corp. Code § 25102(f)(2)*]. This standard is commonly referred to as the "sophisticated investor" test [*see § 6B.23[3]*].

[c] Professional Advisor

Due to the complicated nature of many investment transactions, potential purchasers often will lack the required investment sophistication. This is particularly likely to occur when an issuer seeks to sell securities to family members or personal friends. As a result, professional advisors may be employed. These advisors must be expressly designated as such by the purchaser [*10 Cal. Code Reg. § 260.102.12(g)(2)*; *see § 6B.200*], and must not be directly or indirectly affiliated with or compensated by the issuer or any affiliate or selling agent of the issuer [*Corp. Code § 25102(f)(2)*; *see § 6B.23[3]* (nonexclusive list of relationships that fail "unaffiliated" requirement)].

The term "professional advisor" has been defined by the Commissioner of Corporations to mean an attorney, a certified public accountant, or a person who, as a regular part of that person's business, is customarily relied upon by others for investment recommendations or decisions [*10 Cal. Code Reg. § 260.102.12(g)*]. This advisor also must be customarily compensated for these services, either specifically or by way of compensation for related professional services [*10 Cal. Code Reg. § 260.102.12(g)*]. Persons and entities meeting these requirements include licensed or registered broker-dealers, agents, investment advisors, banks, savings and loan associations, and, with respect to those real estate securities described in *Corp. Code § 25206*, licensed real estate brokers [*10 Cal. Code Reg. § 260.102.12(g)(1)*]. Generally professional advisers will need to be licensed as investment advisers in California.

[2] FORM

Representation of Professional Advisor in Connection With Limited Offering Exemption

_____[*date*]

To: _____ [*Name of issuer*] _____ [*street address*] _____ [*city, state, zip*]

REPRESENTATION OF PROFESSIONAL ADVISOR

I hereby represent:

(1) I am the professional advisor of _____ [*name of purchaser*];

(2) I am not affiliated, directly or indirectly, with the issuer or any affiliate or selling agent of the issuer named above;

(3) In my position as _____ [*specify, e.g.*, a broker-dealer] I am regularly and customarily relied on by others for investment _____ [recommendations *and/or* decisions], and I am customarily compensated for these services _____ [specifically *or* by way of compensation for related services]; and

(4) Acting in the above capacity, I have given investment advice to the above-named purchaser in connection with the purchase of _____ [*specify type and amount of security, e.g.*, 100 common shares of your Company].

(5) Check one:

☐ I am licensed as an investment adviser in California.

☐ I am not required to be licensed as an investment adviser in California because

_____ [*describe basis*].

_____ [*signature of advisor*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART IV. FORMS

3-6B California Legal Forms--Transaction Guide § 6B.202

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.202 Representation of Finder Used in Connection With Limited Offering

[1] Comment--Use of Form

This form may be used by an issuer using a finder in connection with a limited offering to ensure that the finder will not engage in activities that would result in offering materials being "disseminated to the public" in violation of the prohibitions on advertising in *Corp. Code § 25102(f)(4)* or the safe harbor provisions of *10 Cal. Code Reg. § 260.102.12(j)*.

This form is not required by the statute or the applicable rules of the Commissioner. Nor will the use of this form necessarily satisfy the issuer's burden of proving that the prohibition on advertising criteria have been satisfied [*see Corp. Code § 25163*.] This form should, however, assist the issuer in complying with these criteria.

[2] FORM

Representation of Finder Used in Connection With Limited Offering

[*Letterhead of finder*]

_____[*date*]

_____ [*Name and address of issuer*]

Attention: _____

Re: _____ [*Name of issuer*] (the "Company")

In connection with the private offering (the "Offering") of _____ [*description of securities*] (the "Securities") in the Company, the undersigned hereby requests that _____[*name*] supply it with copies of the Private Offering Memorandum and related documents ("Offering Materials") being used in the Offering.

The undersigned has supplied the Company with the names and residence addresses of each of its clients to whom it proposes to transmit the Offering Materials or agrees to supply such names and addresses to the Company within three days after receipt of copies of the Offering Materials. In order to induce the Company to provide it with such Offering Materials, the undersigned hereby represents, warrants and agrees:

(1) Offering Materials will be transmitted only to _____ [*describe basis for concluding that clients meet California suitability standards*] and who are residents of the State of California;

(2) The undersigned will not engage in any form of general solicitation or general advertising with respect to the Offering;

(3) The undersigned confirms that it has been advised that it is not to make any representations or warranties or to supply information as to the Securities or the Offering except those expressly contained in the Offering Materials.

(4) The undersigned confirms that he or she is licensed as a broker-dealer in the State of California.

The undersigned understands that the Company will pay the undersigned a fee of $_____ [*describe fee arrangement*] as compensation for referring its clients to the Company, which fee is only payable in the event that a subscription from the undersigned is accepted by the Company.

The undersigned further understands that the Company is under no obligation to pay the undersigned a fee unless the undersigned's clients have consented to the fee arrangement in substantially the form attached hereto as Exhibit A.

The undersigned also understands that the Company will rely on the above-stated representations, warranties, and agreements.

Sincerely,
_____ [*signature of finder*]

[*printed name of finder*]
By: _____
Title: _____



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART IV. FORMS

3-6B California Legal Forms--Transaction Guide § 6B.203

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.203 Notice of Limited Offering Transaction [Corp. Code § 25102(f); 10 Cal. Code Reg. §§ 260.102.14(c), 260.103(a)]

[1] Comment

[a] Use of Form

This form is a notice of transaction conducted under the limited offering exemption [*see Corp. Code § 25102(f)*]. Unless a copy of a federal notice of transaction is filed, as discussed below, this form must be filed with the Commissioner of Corporations in accordance with the requirements and instructions of the Commissioner [*10 Cal. Code Reg. § 260.102.14(a)(2)*; *see 10 Cal. Code Reg. § 260.102.14(c)-(f)*], which are reproduced below along with the form.

As of July 22, 2005, the limited offering exemption notice pursuant to *Corp. Code § 25102(f) is required to be filed electronically* unless a hardship exception is claimed [*10 Cal. Code Reg. § 260.102.14(a)(2)*; *see* [e], *below*]. To file electronically, see the Department of Corporations Web site at www.corp.ca.gov/loen/loen.htm.

If, in connection with the transaction, the issuer is filing a notice with the Securities and Exchange Commission pursuant to Section 4(6) of the Securities Act of 1933 [*15 U.S.C. § 77d(6)* (accredited investor exemption)] or Regulation D of the Code of Federal Regulations [*17 C.F.R. § 230.503*], the notice of transaction may be a copy of the form first filed pursuant to those provisions [*10 Cal. Code Reg. § 260.102.14(a)(1)*]. For discussion of the applicability of and procedures for compliance with these federal regulations, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* . The fee required by *Corp. Code § 25608(c)* [*see* [d], *below*] must accompany the filing. Each issuer other than a California corporation must also file a consent to service of process form [*see 10 Cal. Code Reg. § 260.165* (consent must be pursuant to Form U-2; pursuant to Form D filed with Commissioner in connection with transaction; included in electronic submission of filing; or in form set out in regulation); Dept. of Corps. Rel. No. 120-C (March 24, 2009) (new filing requirements for Reg. D offerings); *see also Ch. 6H, Qualification of Securities, §§ 6H.239, 6H.240*], unless it already has a consent to service on file with the Commissioner [*10 Cal. Code Reg. § 260.102.14(a)(1)*]. The filing should be accompanied by a cover letter indicating that the filing is pursuant to *Corp. Code § 25102(f)*, and, if a consent to service is not included, a statement that the issuer already has a consent to

service on file with the Commissioner [*10 Cal. Code Reg. § 260.102.14(a)(1)*].

Note that the federal and state limited offering exemptions are not identical. Some offers and sales may be exempt from registration under the federal act pursuant to Rule 506 [*17 C.F.R. § 230.506*] and yet not meet the conditions for exemption pursuant to *Corp. Code § 25102(f)* [*see*Dept. of Corps. Release No. 103-C (Dec. 12, 1996)]. For further discussion of transactions effected pursuant to Rule 506, see *Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.28*.

[b] Time for Filing Notice

The notice of transaction must be filed with the Commissioner no later than 15 calendar days after the first sale of a security in the transaction in California [*10 Cal. Code Reg. § 260.102.14(b)*]. The first sale in California occurs when the issuer has obtained a contractual commitment in California to purchase one or more of the securities the issuer intends to sell in connection with the transaction [*10 Cal. Code Reg. § 260.102.14(d)*]. No notice is required if none of the securities offered are purchased in California [*10 Cal. Code Reg. § 260.102.14(b)*].

[c] Filing Fee

The fee required by *Corp. Code § 25608(c)* must accompany the form [*10 Cal. Code Reg. § 260.102.14(a)(1), (d)*]. The maximum fee that may be levied on a filing pursuant to *Corp. Code § 25102(f)* will apply, unless the Commissioner sets the fees below the maximum level at the beginning of the fiscal year [*Corp. Code § 25608.2*; *see Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum)].

[d] Failure to File or Late Filing

An issuer who fails to file this notice must, within 15 business days after discovery of the failure to file the notice or after demand by the Commissioner of Corporations, whichever occurs first, file the notice and pay to the Commissioner a fee equal to the fee payable had the transaction been qualified under *Corp. Code § 25110* [*Corp. Code § 25102(f)(4)*]. A late filing or a failure to file the required notice of transaction will not affect the availability of the limited offering exemption [*Corp. Code § 25102(f)(4)*]. However, a failure to file amounts to a violation of a Commissioner's Rule and therefore is a violation of the Corporate Securities Law. Sanctions include the possibility of a civil penalty of up to $2,500 per violation [*Corp. Code §§ 25535(a), 25540*; Dept. of Corps. Release No. 67-C (Oct. 20, 1981)].

[e] Electronic Filing

An issuer must file a notice of transaction electronically through the Internet process made available by the Department of Corporations, except as provided in *10 Cal. Code Reg. § 260.102.14(f)* for hardship exceptions [*10 Cal. Code Reg. § 260.102.14(e)*; *see* [f], *below*]. In addition to the information required by *10 Cal. Code Reg. § 260.102.14(c)* (form for notice), an issuer that files a notice electronically must provide a Federal Employer Identification Number for the issuer and, if applicable, a Federal Employer Identification Number for a representative filing on behalf of the issuer. The instructions and explanations in *10 Cal. Code Reg. § 260.102.14(d)* are applicable to the same information requested through the electronic filing. An issuer (other than a California corporation) filing a notice electronically must file electronically an irrevocable consent appointing the Commissioner to be the issuer's attorney to receive service of process under *Corp. Code § 25165*. An issuer filing the notice electronically must print a copy of the notice and manually sign and date the notice pursuant to the instructions in Item 8 of *10 Cal. Code Reg. § 260.102.14(d)*. The notice must be executed before or at the time the electronic filing is made and must be retained by the issuer for a period of five years from the date of filing. Upon request, the issuer must provide to the Commissioner the manually signed notice. An issuer filing the notice electronically must pay the filing fee electronically by credit card. A notice is not deemed filed until the filing fee is submitted [*10 Cal. Code Reg. § 260.102.14(e)*].

[f] Hardship Exception from Electronic Filing

An issuer may file a paper notice in person or by mail, in the form and containing the information specified in *10 Cal. Code Reg. § 260.102.14(c),(d)*, only if the issuer claims a hardship exception for electronic filing [*10 Cal. Code Reg. § 260.102.14(a)(2), (f)*]. That exception is available if computer equipment, including hardware and software, is unavailable to the issuer without unreasonable burden or expense, and the issuer includes in the notice both of the following [*10 Cal. Code Reg. § 260.102.14(f)(1)*]:

- The reason(s) that the computer equipment including hardware and software is unavailable without unreasonable burden and expense; and

- The description(s) of the unreasonable burden or expense to the issuer to make the electronic filing.

Alternatively, the exception if available if the issuer cannot obtain and provide information requested on the Department's electronic notice or through the Internet filing process, and the issuer includes in the notice both of the following [*10 Cal. Code Reg. § 260.102.14(f)(2)*]:

- The reason(s) that the issuer cannot obtain and provide the requested information on the electronic notice or through the Internet filing process without unreasonable burden or expense; and

- The description(s) of the unreasonable burden or expense to the issuer to make the electronic filing.

[2] FORM

Notice of Limited Offering Transaction [Corp. Code § 25102(f); 10 Cal. Code Reg. §§ 260.102.14(c), 260.103(a)]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6B CALIFORNIA LIMITED OFFERING EXEMPTIONS
PART IV. FORMS

3-6B California Legal Forms--Transaction Guide § 6B.204

AUTHOR: Frances E. Lossing Practice Consultant

§ 6B.204 Transmittal Letter to Accompany Notice of Limited Offering Transaction

[1] Comment--Use of Form

This form is a cover letter or transmittal letter to accompany a notice of transaction under the California limited offering exemption [*Corp. Code § 25102(f)*]. Since notices of transaction must be filed electronically unless the issuer qualifies for the hardship exception [*see §§ 6B.27[1][a], 6B.203[1]*], this notice should be used only when the issuer is filing a paper notice by mail under the hardship exception from electronic filing [*see 10 Cal. Code Reg. § 260.102.14(a)(2),(f)*]. Unless a hardship exception is claimed, the notice must be filed electronically on [*10 Cal. Code Reg. § 260.102.14(a)(2)*]. For the form for the Notice of Transaction itself, see *§ 6B.203*. The notice may be filed in any office of the Department of Corporations [Dept. of Corps. Release No. 13-G (Revised June 10, 2004)]. The notice must be accompanied by the proper filing fee, if applicable; for discussion of the filing fee requirements, see *§ 6B.203[1][d]*.

If the issuer is not a California corporation, it must also file a consent to service of process [*see 10 Cal. Code Reg. § 260.165*; *see also Ch. 6H, Qualification of Securities, §§ 6H.239, 6H.240* (forms)], unless it already has a consent to service of process on file with the Commissioner. If a consent to service is not included with the Notice of Transaction, the cover letter should include a statement that the issuer already has a consent to service on file with the Commissioner [*10 Cal. Code Reg. § 260.102.14(a)(1)*]. This form contains optional language for both of these situations.

To document that this form was mailed and received, it is recommended that it be sent via certified mail, return receipt requested.

[2] FORM

Transmittal Letter to Accompany Notice of Limited Offering Transaction

CERTIFIED MAIL

RETURN RECEIPT REQUESTED

Department of Corporations
State of California
_____ [*local address of Department where notice is being filed*]

Re: Notice of Transaction by _____ [*name of corporation*] pursuant to *Corporations Code § 25102(f)*

Dear Sir/Madam:

The enclosed materials are submitted for filing pursuant to *Corporations Code § 25102(f)* by _____ [*name of corporation*], a _____ [*state of incorporation, e.g.,* California] corporation [*or specify other form of business entity, e.g.*, limited partnership]:

1. Notice of Transaction Pursuant to *Corporations Code § 25102(f)*.

[*Include the following statement regarding the filing fee, if applicable; see Corp. Code §§ 25608(c), 25608.2; see also §§ 6B.111, P 5, 6B.203[1][d]:*]

2. A check in the amount of $_____ [*amount of filing fee due*] in payment of the filing fee as specified in *Corporations Code § 25608(c)*.

[*If issuer is an entity other than a California corporation and does not have a consent to service of process on file with the Commissioner:*]

3. A Consent to Service of Process (Form 260.165) by _____ [*name of issuer*].

[*Or, if issuer is an entity other than California corporation and already has a consent to service of process on file with the Commissioner:*]

3. _____ [*Name of issuer*] already has a Consent to Service of Process (Form 260.165) on file with the Commissioner and therefore does not need to file such a statement at this time.

[*Continue with the following:*]

Please stamp the enclosed copy of the notice to indicate receipt, and return it to me in the enclosed self-addressed, stamped envelope.

Sincerely,

_____
[*signature of attorney or other person filing notice*]

[*typed name and title*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION

3-6C California Legal Forms--Transaction Guide 6C.syn

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.syn Synopsis to Chapter 6C: CALIFORNIA SMALL OFFERING EXEMPTION

§ 6C.01 California Sources

[1] Statutes

[2] Regulations

§ 6C.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 6C.03- 6C.04 [Reserved]

§ 6C.05 Text References

§§ 6C.06- 6C.19 [Reserved]

§ 6C.20 Nature of Small Offering Exemption

[1] In General

[2] Contrasted With Limited Offering Exemption

[3] Effect of Shareholder Agreement

§ 6C.21 Who May Be an Issuer

§ 6C.22 What Type of Stock May Be Issued

[1] One Class of Stock

[2] Debt Securities

[3] Voting Trust Certificates

§ 6C.23 Who May Be Shareholders

§ 6C.24 What Must Be Paid for Issued Stock

§ 6C.25 What Promotional Activities Are Permissible

§ 6C.26 What Marketing Activities Are Permissible

§ 6C.27 Opinion of Counsel That Exemption Is Available

§ 6C.28 Purchaser Representation

§§ 6C.29- 6C.99 [Reserved]

§ 6C.100 Facts

Scope

§ 6C.101 Documents

Scope

§§ 6C.102- 6C.109 [Reserved]

§ 6C.110 Preliminary Determinations

Scope

§ 6C.111 Conducting the Transaction

Scope

§§ 6C.112- 6C.199 [Reserved]

§ 6C.200 Notice of Issuance of Securities Pursuant to Small Offering Exemption [Corp. Code § 25102(h)] or Exemption From Qualification of Recapitalizations and Reorganizations [10 Cal. Code Reg. § 260.103]--Official Form [10 Cal. Code Reg. § 260.102.8]

[1] Comment

[a] Use of Form

[b] Filing Requirements

[c] Filing Fee

[d] Failure to File

[2] FORM

Notice of Issuance of Securities Pursuant to Small Offering Exemption [Corp. Code § 25102(h)] or Exemption From Qualification of Recapitalizations and Reorganizations [10 Cal. Code Reg. § 260.103]--Official Form [10 Cal. Code Reg. § 260.102.8]

§ 6C.201 Consent to Service of Process--Exempt Offering by Non-California Corporation [Corp. Code § 25102(h); 10 Cal. Code Reg. § 260.102.8(b)]--Official Form

[1] Comment--Use of Form

[2] FORM

Consent to Service of Process--Exempt Offering by Non-California Corporation [Corp. Code § 25102(h); 10 Cal. Code Reg. § 260.102.8(b)]--Official Form

§ 6C.202 Proof of Mailing--Notice of Issuance of Securities Pursuant to Small Offering Exemption

[1] Comment

[a] Use of Form

[b] Proof of Mailing

[i] General Requirements

[ii] By Non-Attorney

[iii] By Non-Attorney When Placed for Collection Pursuant to Ordinary Business Practices

[iv] By Attorney

[2] FORM

Proof of Mailing--Notice of Issuance of Securities Pursuant to Small Offering Exemption

§ 6C.203 Small Offering Investment Letter: Purchaser's Representations Concerning Investment Intent

[1] Comment

[a] Use of Form

[b] Investment Representation

[2] FORM

Scope

Frances E. Lossingn*
Practice Consultant

FOOTNOTES:

(n38)Footnote *. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION

3-6C California Legal Forms--Transaction Guide Scope

AUTHOR: Frances E. Lossing Practice Consultant

Scope

Frances E. Lossingn*
Practice Consultant Scope

This chapter covers the offer and sale of shares pursuant to the small offering exemption from qualification under the Corporate Securities Law [*Corp. Code § 25102(h)*]. The Legal Background discusses the statute and applicable rules of the Commissioner of Corporations, and the Transaction Guide lists the steps used in complying with the exemption. This chapter also contains the notice that must be filed in connection with the exemption, and forms related to ensuring that the conditions of the exemption are satisfied.

Because the small offering exemption only applies to issuer transactions, Ch. 6H, *Qualification of Securities* , should be consulted for its discussion of the need to qualify later transactions involving securities originally issued under an exemption. For coverage of the California limited offering exemptions [*Corp. Code § 25102(f), (d)*], see Ch. 6B, *California Limited Offering Exemptions* . For a comparison of the small offering exemption with the California limited offering exemptions and other possible exemptions, and a discussion covering selection of the most appropriate exemption, see Ch. 6, *Securities Regulation Issues* .

FOOTNOTES:
(n39)Footnote *. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART I. RESEARCH GUIDE
A. Primary Sources

3-6C California Legal Forms--Transaction Guide § 6C.01

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.01 California Sources

[1] Statutes

Definition of "close corporation." *Corp. Code § 158*.

Definition of "advertisement." *Corp. Code § 25002*.

Small offering exemption from issuer transactions. *Corp. Code § 25102(h)*.

Definition of "publish." *Corp. Code § 25014*.

[2] Regulations

Rules of the Corporations Commissioner.

Small offering exemption. *10 Cal. Code Reg. §§ 260.102.4-260.102.9, 260.102.11*.

Releases and Opinions of the Corporations Commissioner.

NOTE:

The Commissioner periodically publishes releases that set forth information concerning the regulatory activities of the Commissioner, inform practitioners as to policies, or disclose interpretive opinions [*10 Cal. Code Reg. § 260.608(b)*]. Attorneys can obtain releases from the Commissioner by being placed on a mailing list for distribution of Corporate Securities law material at a cost of $10 per year [*10 Cal. Code Reg. § 260.608(c)(5)*]. Releases are also reproduced in Ballantine & Sterling, California Corporation

Laws, vol. 7 (Matthew Bender), in Marsh & Volk, Practice Under the California Securities Laws, Appendix A-4 (Matthew Bender), and in the California Corporation Code (Matthew Bender).

Notice of issuance of securities pursuant to close corporation exemption--Proof of mailing by statement under penalty of perjury. Dept. of Corps. Release No. 7-C (Feb. 11, 1968).

Voting trust with fewer than all shareholders as trustees likely to violate requirement that all shares have full and equal voting rights. Dept. of Corps. Release No. 55-C (May 19, 1978).

Proper office for filing notice or amended notice of small offering transaction. Dept. of Corps. Release No. 13-G (Revised; June 10, 2004).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART I. RESEARCH GUIDE
A. Primary Sources

3-6C California Legal Forms--Transaction Guide § 6C.02

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.02 Federal Sources

[1] Statutes

Small offering exemption. *15 U.S.C. § 77c(b)*.

Exempted securities transactions. *15 U.S.C. § 77d*.

Private transaction exemption. *15 U.S.C. § 77d(2)*.

Personal holding companies. *I.R.C. §§ 541*-547.

Limitations on capital losses. *I.R.C. § 1211*.

Stock loss as ordinary income deduction. *I.R.C. § 1244*.

Corporation taxed as partnership (Subchapter S corporation). *I.R.C. §§ 1361*-1379.

[2] Regulations

Small offering exemption (Regulation A notification). 19 C.F.R. §§ 230.251-230.263.

Losses on corporate stock as ordinary income deductions. *Treas. Reg. §§ 1.1244(a)-1-1.1244(e)-1*.

Small corporations taxed as partnerships (Subchapter S corporation). *Treas. Reg. §§ 1.1361-1-1.1377-3*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART I. RESEARCH GUIDE
A. Primary Sources

3-6C California Legal Forms--Transaction Guide §§ 6C.03- 6C.04

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6C.03[Reserved]



142 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6C California Legal Forms--Transaction Guide § 6C.05

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.05 Text References

Ballantine & Sterling, California Corporation Laws (Matthew Bender).

Ch. 21, *Corporate Securities*.

Ch. 22, *Corporate Franchise and Income Taxes in California*.

Ch. 23, *Tax Planning for the Closely-Held Corporation*.

Marsh & Volk, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS (Matthew Bender).

Ch. 3A, *Federal Preemption of State Securities Regulation*.

Ch. 4, *General Exemptions From Qualification*.

Cavitch, TAX PLANNING FOR CORPORATIONS AND SHAREHOLDERS, Ch. 4, *Capitalizing the New Corporation* (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6C California Legal Forms--Transaction Guide §§ 6C.06- 6C.19

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6C.06[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART II. LEGAL BACKGROUND

3-6C California Legal Forms--Transaction Guide § 6C.20

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.20 Nature of Small Offering Exemption

[1] In General

In general, a proposed sale of voting common stock must be qualified with the Commissioner of Corporations unless the security or transaction is not subject to qualification [*see Corp. Code § 25110*; *see also* Ch. 6H, *Qualification of Securities*]. However, certain transactions involving 35 or fewer proposed shareholders may be exempt from the qualification requirement under the small offering exemption [*see Corp. Code § 25102(h)*] or the limited offering exemptions [*see Corp. Code § 25102(f), (d)*; *see also* Ch. 6B, *California Limited Offering Exemptions*].

PRACTICE TIP:

Corp. Code § 25102(h) typically is used in connection with the formation of a close corporation, a wholly owned subsidiary of a corporation that has not issued shares pursuant to the small offering exemption, or other corporations that will have no more than 35 shareholders. *Corp. Code § 25102(h)* may also be useful in connection with the issuance of additional voting common stock to existing security holders of these types of corporations. *Commentary by Frances E. Lossing.*

[2] Contrasted With Limited Offering Exemption

In most cases the criteria for the small offering exemption are stricter than their limited offering counterparts. For example, a corporation utilizing the small offering exemption must issue only one class of voting common stock [*Corp. Code § 25102(h)*; *see § 6C.22*], while the limited offering exemption potentially applies to almost any offer or sale of any security [*Corp. Code § 25102(f)*]. Furthermore, the small offering exemption requires that after the proposed sale and issuance the corporation have a total of no more than 35 shareholders [*Corp. Code § 25102(h)*; *see § 6C.23*], whereas the limited offering exemption permits more than 35 shareholders of the corporation as a whole, provided that the transaction in question results in sales to no more than 35 persons, plus any purchasers that may be excluded from the 35 purchaser count. [*Corp. Code § 25102(f)*].

PRACTICE TIP:

The prohibition on the publication of any advertising may, however, indirectly impose a limit on the number of offerees in order to insure that there has been no dissemination of information regarding the offering to the public. The Commissioner has not offered any guidance regarding what constitutes "dissemination to the public." The concept of non-public offering, however, is contained in a number of other exemptions. Interpretations of these exemptions may therefore offer some guidance. For purposes of non-public offerings under *Corp. Code § 25102(a)*, offers may be made to no more than 35 persons. For purposes of non-public offerings under *Corp. Code §§ 25102(e), (g)* and *25104(e)*, offers may be made to no more than 25 persons. Additional guidance may be found in Dept. of Corps. Release No. 5-C and interpretations of former *Corp. Code § 25102(f)* prior to its amendment in November 1981. *Commentary by Frances E. Lossing.*

The small offering exemption, however, is relatively easy to use, with very little documentation involved. There is no direct limit on the number of offerees, nor are there are investor suitability requirements such as those contained in *Corp. Code § 25102(f)* or *Corp. Code § 25102(n)*. In contrast, sound practice dictates that an attorney document several aspects of a limited offering transaction in order to demonstrate good-faith compliance with that exemption's numerous requirements [*see* Ch. 6B, *California Limited Offering Exemptions*]. For further comparison between this exemption and other exemptions that might be available, see Ch. 6, *Securities Regulation Issues* .

[3] Effect of Shareholder Agreement

If the corporation using the small offering exemption is a close corporation [*see Corp. Code § 116*; *see also* Ch. 2, *Formation of Corporations*], there is a chance that a shareholders' agreement will have the effect of creating more than one class of shares, a result that would make the small offering exemption unavailable by violating the single-class requirement referred to above [*see Corp. Code § 25102(h)*; *see also* Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*]. Such a result will occur if an existing or planned shareholders' agreement provides (or will provide) that any of the rights, preferences, privileges, and restrictions enumerated in *Corp. Code § 25103(e)* apply or will apply to some but not all of the shares [*10 Cal. Code Reg. § 260.102.4(b)*; *see* Ch. 6H, *Qualification of Securities*]. For example, a shareholders' agreement that establishes profit-sharing rights that are disproportionate to shareholdings will make the small offering exemption unavailable, whether or not the articles of incorporation provide for a single class of shares.

To alert the commissioner to possible violations of the single-class requirement, the notice of issuance of shares under the small offering exemption [*see 10 Cal. Code Reg. § 260.102.8*; *see also § 6C.200*] requires the signing officer to declare that to the best knowledge of the issuer, no shareholders' agreement, voting agreement, irrevocable proxy, or other arrangement that would cause the statements in the notice to be incorrect exists or is contemplated [*see 10 Cal. Code Reg. § 260.102.8*]. The notice would be "incorrect" if its statements concerning the satisfaction of the single-class requirement were contradicted by a shareholders' agreement that had the effect of creating more than one class.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART II. LEGAL BACKGROUND

3-6C California Legal Forms--Transaction Guide § 6C.21

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.21 Who May Be an Issuer

A corporation incorporated in any state may be an issuer under the small offering exemption [*Corp. Code § 25102(h)*]. Consequently, any issuer first must be incorporated. Any corporation to be incorporated in California must have had its articles of incorporation filed and endorsed by the California Secretary of State prior to the issuance of stock pursuant to the exemption [*Corp. Code §§ 110, 209*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART II. LEGAL BACKGROUND

3-6C California Legal Forms--Transaction Guide § 6C.22

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.22 What Type of Stock May Be Issued

[1] One Class of Stock

Assuming other requirements are met, any offer or sale of voting common stock by a corporation will qualify for the small offering exemption if, immediately after the sale and issuance, *there is only one class of stock outstanding* [*Corp. Code § 25102(h)*]. Obviously, creation of a second class of common stock or a class of preferred shares would disqualify the offering.

[2] Debt Securities

Debt securities are not considered a class of stock in this context even though they may be determined to be "equity" securities for the purpose of income taxes or for the purpose of priorities in bankruptcy or otherwise among creditors of the corporation [*10 Cal. Code Reg. § 260.102.4(a)*]. However, the issuance of convertible debt securities or options, unless otherwise exempted, would require a permit since neither is "voting common stock," which is the only kind of security for which the small offering exemption is available. This does not mean that by issuing convertible debt securities or options, duly qualified or exempt from qualification, a corporation will forfeit its exemption. Since neither an option nor a debt security can be considered a "class of stock," their issuance would not violate the single class rule as long as the underlying security purchasable on exercise or conversion is common voting stock of the same class as that issued under the exemption. Nevertheless, it is likely that in determining whether the proposed number of shareholders of the corporation will be 35 or fewer, the holders of options and convertible securities will be counted because they hold rights with regard to common stock.

[3] Voting Trust Certificates

Voting trust certificates should not constitute a second class of shares because the trustee, not the corporation, usually is the issuer [*see Corp. Code § 25010*; *see also* Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*]. However, a voting trust in which fewer than all of the shareholders are trustees is likely to violate the requirement that all shares have full and equal voting rights [*see* Dept. of Corps. Release No. 55-C (May 19, 1978); *see also 10 Cal. Code Reg. §§*

260.140.1, 260.140.2 (voting rights)]. Agreements among shareholders or with the corporation regarding restrictions on shares are not considered "securities" [*see Corp. Code § 25019*]. This statement must be qualified if the share transfer restrictions are not equally applicable to all shares. In that case, the effect would be the creation of more than one class of shares [*see 10 Cal. Code Reg. § 260.102.4*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



147 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART II. LEGAL BACKGROUND

3-6C California Legal Forms--Transaction Guide § 6C.23

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.23 Who May Be Shareholders

The number of owners of stock issued under a small offering exemption may not exceed 35 [*see Corp. Code § 25102(h)*]. However, a husband and wife count as one shareholder, whether shares are in the name of either or both [*Corp. Code § 25102(h)(5)*].

PRACTICE TIP:

Corp. Code § 25102(h) has frequently been referred to as the "close corporation exemption." All of the outstanding shares of a close corporation must be held of record by no more than 35 persons and the articles of incorporation of a close corporation must state that it is a close corporation [*Corp. Code § 158*]. A corporation may have 35 or fewer shareholders, however, and yet still not be a statutory close corporation, if its articles of incorporation do not state that the corporation is intended to be a close corporation. Such a corporation may still be able to use this exemption, despite the fact that its articles of incorporation do not contain the close corporation statement.

It is also possible that a close corporation may not be able to use the exemption because it has too many shareholders. In a close corporation a partnership, corporation, or other business association owning shares is counted as one person, unless the partnership, corporation or business association was formed for the purpose of purchasing the shares. This differs from the approach taken in the small offering exemption. It is therefore possible to issue voting common stock in connection with the formation of a close corporation that does not qualify for the small offering exemption because of the difference in the methodology of counting the number of shareholders. This typically occurs when voting common stock is issued to a partnership or other business association or to a corporation that has issued stock pursuant to the small offering exemption. *Commentary by Frances E. Lossing.*

The limitation refers to shares owned "beneficially" [*Corp. Code § 25102(h)*]. Since the number of legal and beneficial owners cannot exceed the beneficial maximum, this description defines the upper limits of the class of owners and disallows individual legal owners from holding securities for large numbers of beneficial owners. In the context of the

small offering exemption, shares held by a partnership or a joint venture are considered to be owned beneficially by each of the members of the group. Shares held by a trustee are considered to be owned beneficially by the trust beneficiaries, whether their interests are present, future, or contingent. However, a future or contingent beneficiary is not a beneficial owner in this context if he or she is an ancestor, descendent, or spouse of a present beneficiary or custodian or trustee for his or her account [*10 Cal. Code Reg. § 260.102.5*].

Securities held by a corporation that has issued stock under the small offering exemption are considered to be held by the shareholders of that corporation [*Corp. Code § 25102(h)(5)*]. Thus, if securities will be issued to this type of corporation under the small offering exemption, the shareholders of that corporation must be counted against the 35-purchaser limitation [*see Corp. Code § 25102(h)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



148 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART II. LEGAL BACKGROUND

3-6C California Legal Forms--Transaction Guide § 6C.24

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.24 What Must Be Paid for Issued Stock

The consideration to be received for the stock to be issued may be the following [*Corp. Code § 25102(h)(2)*]:

- Any legal consideration, if there will be only one owner of the stock.
- Cash or cancellation of indebtedness for money borrowed or both, upon the initial organization of the issuer, if all stock is issued for the same price per share.
- Only cash, if the sale (after initial organization) is approved in writing by each of the existing shareholders and the purchaser or purchasers are existing shareholders.
- Only assets (including cash assets) of an existing business transferred to the issuer upon its initial organization.

A more stringent restriction exists in the area of transfer of assets of an existing enterprise to the corporation in return for shares. The existing business must have been in operation for a period of at least one full year immediately preceding the new stock issue; and the persons who will receive stock must have been owners all during that year (though others also may have owned stock in the existing enterprise but dropped out) and receive their shares in proportion to their ownership just before the stock issue (though ownership interests fluctuated previously) [*Corp. Code § 25102(h)(2)(A)*]. The business could have been operated for any longer time, and it need never have shown a profit. However, it is clear that no shares may be issued at any time for promotional services rendered [*Corp. Code § 25102(h)(2)(A), (3)*; *see § 6C.25*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness

& Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesBusiness & Corporate LawCorporationsShareholdersTransfers of SharesSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART II. LEGAL BACKGROUND

3-6C California Legal Forms--Transaction Guide § 6C.25

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.25 What Promotional Activities Are Permissible

With one exception, no promotional consideration may be given, paid, or incurred in connection with the issuance of securities [*Corp. Code § 25102(h)(3)*]. "Promotional consideration" is defined to mean any consideration paid directly or indirectly to a person, who, acting alone or in conjunction with one or more other persons, takes the initiative in founding and organizing the business or enterprise of an issuer, for services rendered in connection with that founding or organizing [*Corp. Code § 25102(h)(3)*]. The exception to the rule against payment for promotional services applies in the case of the sole-shareholder corporation in which any legal considerations may be paid for shares, whether before or after the initial organization [*Corp. Code § 25102(h)(2)(D)*].

In connection with other preissuance activities by promoters, the Commissioner has relaxed the prohibition against the receipt of certain forms of consideration more than 10 days before the corporation files its notice of issuance of securities. Although stock still may not be issued in consideration of promotional activities (except in the case of a one-person corporation), stock may be issued in cancellation of loans and advances to the corporation, upon the initial organization of the issuer, provided the stock is issued for the same price per share [*Corp. Code § 25102(h)(2)(B)*]. The rules in *10 Cal. Code Reg. § 260.102.11* establish a safe harbor for loans or advances that meet all of the following conditions:

- The loans or advances are made solely for the purpose of paying the expense incurred in connection with the organization of the issuer and the initial sale of its shares. Advances or loans include advances on open book accounts and loans evidenced by promissory notes or other evidences of indebtedness.

- The loans or advances are made by and owed to the "organizers"; that is, the persons instrumental in forming the issuer and the officers and directors of the issuer. In no event may the number of persons making the advances or loans exceed the number of issuees permissible under *Corp. Code § 25102(h)*.

- The loans or advances are made before the issuer has commenced business, other than activities in connection with the organization and preparation for regular business or issued shares at the time the

advances or loans are made.

- Any issuance of shares in cancellation of advances or loans must be consummated within 90 days after the filing of the articles of incorporation of the issuer [*10 Cal. Code Reg. § 260.102.11(d)*].

There is no presumption that any advances or loans that do not comply with all of the requirements of *10 Cal. Code Reg. § 260.102.11* constitute the "receipt of consideration for the securities of the issuer" [*10 Cal. Code Reg. § 260.102.11(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART II. LEGAL BACKGROUND

3-6C California Legal Forms--Transaction Guide § 6C.26

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.26 What Marketing Activities Are Permissible

An offer and sale of stock under the small offering exemption may not be made through a published advertisement [*Corp. Code § 25102(h)(1)*].

PRACTICE TIP:

Private placement memoranda and other offering material will be advertising for purposes of this rule. The rule does not specifically prohibit advertising to promote an issuer's products or services. Care must be taken, however, so that the content and use of this type of advertising is not so closely related to the offering that it might be deemed to be advertising prohibited by *Corp. Code § 25103(h). Commentary by Frances E. Lossing.*

An "advertisement" is defined to mean any written or printed communication or any communication by means of recorded telephone messages or spoken on radio, television, or similar communications media, published in connection with the offer or sale of a security [*Corp. Code § 25002*]. To "publish" advertising matter means to issue or circulate the advertisement publicly by newspaper, mail, radio or television, or otherwise disseminate it to the public [*Corp. Code § 25014*]. Thus, any advertising type of contact should be restricted to private communications or "closed circuit" types of arrangements to personally selected audiences.

In addition, no selling expenses may be given, paid, or incurred by the corporation [*Corp. Code § 25102(h)(1)*]. However, "selling expenses" for these purposes do not include all those defined in the Commissioner's Rules [*see 10 Cal. Code Reg. § 260.140.20*]. For the exemption, selling expenses involve only "commissions, discounts or other compensation paid to any person as remuneration for selling the securities" [*10 Cal. Code Reg. § 260.102.7*]. As a result, no broker-dealers or other finders may be used.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities

LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART II. LEGAL BACKGROUND

3-6C California Legal Forms--Transaction Guide § 6C.27

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.27 Opinion of Counsel That Exemption Is Available

The Department of Corporations itself has no provision for policing the small offering exemption in a manner equivalent to services it performs while reviewing applications for permits, or performed by the Securities and Exchange Commission in reviewing registrations qualifying locally by coordination and notification [*Corp. Code §§ 25102(h), 25111-25113*; Securities Act of 1933, § 6 (*15 U.S.C. § 77f*); Securities Exchange Act of 1934, § 12 (*15 U.S.C. § 78l*)]. However, each notice of issuance of securities under the small offering exemption must contain a signed opinion of an attorney that the exemption is available [*Corp. Code § 25102(h)(4)*]. The attorney must be on the active roster of the Bar, not on inactive status [*Corp. Code § 25102(h)(4)*].

The attorney need not be the attorney retained by the corporation for its business or even organizational affairs. The attorney's only task is to examine the facts stated in the notice and state that the facts, if true, qualify the transaction for the exemption [*see 10 Cal. Code Reg. § 260.102.8*; *see also § 6C.200* (form for notice)]. However, the attorney does have a responsibility to make inquiries of his or her clients, and the extent of the investigation will depend on the facts peculiar to each transaction. As a member of the Bar and an officer of the court, the attorney is obliged to make sure that the exemption is not abused.

Failure to file the notice and the attorney's opinion required by *Corp. Code § 25102(h)* will not affect the availability of the small offering exemption if the issuer, within 15 business days after discovery of the failure to file the notice or after demand by the Commissioner, whichever occurs first, files the notice and pays a fee equal to that payable had the transaction been qualified under *Corp. Code § 25110* [*Corp. Code § 25102(h)(4)*; *see Corp. Code § 25608* (schedule of fees)]. On the other hand, because this failure would be a violation of the Commissioner's rules, it would also be considered a violation of the Corporate Securities Law [*Corp. Code § 25540*]. Sanctions include the possibility of a civil penalty of up to $2,500 per violation [*Corp. Code § 25535(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewCivil ProcedureCounselGeneral OverviewSecurities LawGeneral OverviewSecurities LawBlue Sky LawsExempted IssuersSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART II. LEGAL BACKGROUND

3-6C California Legal Forms--Transaction Guide § 6C.28

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.28 Purchaser Representation

Each purchaser must represent that the purchase is made only for the purchaser's own account, or a trust account if the purchaser is a trustee, and not with a view to or for sale in connection with any distribution of the stock [*Corp. Code § 25102(h)(5)*; *see § 6C.203* (form for representation)]. A former requirement that the stock certificate contain a legend stating that the stock could not be transferred without the Commissioner's consent to the transfer [*see* former *Corp. Code § 25102(h)(1)*] was repealed in 1996 [*see* Stats. 1996, ch. 41]. Any stock previously issued with that legend will not be subject to the transfer restriction legend requirement, and an issuer may remove any legends placed on previously issued certificates pursuant to this exemption without any action by the Commissioner [*Corp. Code § 25102(h)*].



153 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART II. LEGAL BACKGROUND

3-6C California Legal Forms--Transaction Guide §§ 6C.29- 6C.99

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6C.29[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6C California Legal Forms--Transaction Guide § 6C.100

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.100 Facts

1. Name, address of principal place of business, and telephone number of issuer.

2. Date of organization of issuer.

3. State of incorporation.

4. Classes of equity securities outstanding or proposed to be issued.

5. Classes of convertible debt securities outstanding or proposed to be issued.

6. Types of options, warrants, or separate rights outstanding or proposed to be issued.

7. Date of issuance of outstanding or proposed stock.

8. Plans for advertising or otherwise promoting the stock.

9. Plans for paying expenses, salaries, commissions, or the like in connection with offer or sale of stock.

10. Plans for giving stock in any form as compensation, bonus, or gratuity in connection with promotion or distribution of the stock.

11. Plans to enter shareholders' agreement [*see Corp. Code § 186*] or voting agreement, or to grant an irrevocable proxy or other arrangement that would have the effect of creating more than one class of

shares or otherwise cause shares to be treated unequally with respect to any rights, preference, privileges, or restrictions.

12. Names, addresses, and telephone numbers of all present or proposed issuees.

13. Family relationship among issuees.

14. Relationship of issuee as custodian or trustee for account of a beneficial holder.

15. Name, address, and telephone number of beneficiary, and relationship to other issuees in or out of title, if issuee to be in title is to hold for beneficiary not in title.

16. Type of entity, if legal or beneficial issuee is an organization.

17. If legal or beneficial issuee is a noncorporate entity, names, addresses, and telephone numbers of all members of entity.

18. Exact description of any assets to be received for stock.

19. Names, addresses, and telephone numbers of all owners of any portion any existing business to be transferred or transferred during past year.

20. Name and exact degree of ownership of each owner of the business to be transferred at present time or at moment before issuance of stock in new corporation.

21. Date of organization of predecessor as a going business and period of operation as such, down to time of incorporation or issuance of stock.

22. Cancellation of indebtedness to be included in transfer to corporation.

23. Cash to be included in transfer to corporation.

24. Price per share for which stock is to be issued.

25. Other types of consideration to be received.

26. Representatives of entity issuees who will sign for their organizations.

27. Whether spouses plan to take stock jointly or in own name.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6C California Legal Forms--Transaction Guide § 6C.101

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.101 Documents

1. Organizational documents of issuer and predecessor, if any.

2. If purchasers are existing shareholders buying for cash, form giving written approval of sale by each of the other existing shareholders.

3. Any advertising, offering materials or other promotional materials to be used in the offering.



156 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6C California Legal Forms--Transaction Guide §§ 6C.102- 6C.109

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6C.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART III. TRANSACTION GUIDE
B. Procedural Guide to Forming a Corporation Entitled to Small Offering Exemption

3-6C California Legal Forms--Transaction Guide § 6C.110

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.110 Preliminary Determinations

1. Determine whether corporation is subject to federal regulation or may utilize federal exemption.
   NOTE: Since the amount of the offering is not a consideration in this exemption as it is in the federal exemptions (which do not consider the number of shareholders), a close corporation utilizing the California small offering exemption may still be subject to federal regulation [***see*** Ch. 6, ***Securities Regulation Issues***] unless it is able to take advantage of the major federal exemptions as well [***see*** Ch. 6A, ***Federal Securities Exemptions for California Nonpublic Corporations***].

PRACTICE TIP

There is no counterpart to *Corp. Code § 25102(h)* in the federal securities laws. The offering does, however, contain elements of a private placement. There may be no dissemination of advertising. The purchaser is required to make an investment representation. It is therefore likely that the issuer will be able to rely on the Section 4(2) exemption. It is customary for the issuer of securities issued without registration under the federal securities laws in reliance on Section 4(2) to place a restrictive legend on the securities stating that the securities are subject to restrictions on transferability and may not be transferred or sold except as permitted under the Securities Act of 1933 and applicable state securities laws. *Commentary by Frances E. Lossing.*

2. Determine whether corporation may utilize another California exemption.
   NOTE: If the corporation's stock is exempt by virtue of any other provision of the law [***see*** Ch. 6, ***Securities Regulation Issues***] then the small offering exemption need not be utilized. Before complying with the steps listed below, see the discussion in Ch. 6 concerning selection of the most appropriate California exemption.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsExempted IssuersSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART III. TRANSACTION GUIDE
B. Procedural Guide to Forming a Corporation Entitled to Small Offering Exemption

3-6C California Legal Forms--Transaction Guide § 6C.111

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.111 Conducting the Transaction

1. Make no commitments to pay, incur, or deliver either promotional consideration or selling expenses in connection with the issuance of corporation's stock [*Corp. Code § 25102(h)(1), (3)*; *see § 6C.25*].

a. Prohibited selling expenses include only commissions, discounts or other compensation paid to any person as remuneration for selling securities [*10 Cal. Code Reg. § 260.102.7*].

b. "Promotional consideration" is any consideration paid directly or indirectly to a person who, acting alone or in conjunction with one or more other persons, takes initiative in founding and organizing business or enterprise of an issuer, for services rendered in connection with founding or organizing the issuer [*Corp. Code § 25102(h)(3)*].

2. If shareholders plan to enter into any shareholders' agreement or voting agreement or grant irrevocable proxies to arrange for continuing corporate control, check terms for possible unequal treatment of shareholders resulting in creation of two classes of shares [*see 10 Cal. Code Reg. § 260.102.4*; *see also § 6C.22*].

3. Do not publish any advertisement in connection with either offer or the eventual sale of stock [*Corp. Code § 25102(h)(1)*; *see § 6C.26*].

4. Follow normal procedure for forming a corporation.

a. If desired, reserve corporate name [*Corp. Code § 201(c)*].

b. If going business is to be incorporated, draft agreement to transfer assets of business to corporation and comply with bulk transfer laws if applicable [*see* Ch. 2A, *Incorporating A Going Business*].
NOTE: Shares of stock must be issued in the same proportions as the business was owned immediately prior to issuance [*Corp. Code § 25102(h)(2)*].

c. Draft articles of incorporation and have them properly executed and acknowledged [*Corp. Code §§ 200(a), 202, 204*; *see* Ch. 3, *Articles of Incorporation*].
NOTE: Articles must provide for share structure limited to one class of stock, which must be voting common stock [*Corp. Code § 25102(h)*].

d. File articles with Secretary of State, accompanied by prepayment of franchise tax and filing fees [*see* Ch. 3, *Articles of Incorporation* (fee schedules and supplementary filing requirements)].

5. Keeping following limitations in mind, prepare minutes of first directors' meeting and resolutions regarding issuance of shares, identity of offerees, consideration to be received for stock, and notification of exemption [*see* Ch. 5, *Directors Meetings, Actions, and Resolutions* , and Ch. 6I, *Issuance of Equity Securities*]:

a. Only one class of voting common stock may be authorized and issued [*Corp. Code § 25102(h)*].

b. There may be no more than 35 beneficial owners of shares [*Corp. Code § 25102(h)*; *see § 6C.23*].

NOTE

NOTE: For purposes of determining the beneficial ownership of stock, husband and wife count as one owner whether or not they hold the stock jointly [*Corp. Code § 25102(h)(5)*].

c. Only one of following categories of consideration may be received in exchange for corporation's stock [*Corp. Code § 25102(h)(2)*; *see § 6C.24*]:

(1) Assets (including cash) of existing business enterprise transferred to issuer on its initial organization, if:
(a) All persons to receive stock were owners during period of not less than one year just before proposed issuance.

(b) Operation of enterprise continued for period of at least one year just before proposed issuance.

(c) Ownership of enterprise just before proposed issuance of shares was in same proportions as shares of stock to be issued.

(2) Cash, cancellation of indebtedness for money borrowed, or both, on initial organization of issuer, provided all stock is issued for same price per share.

(3) Cash, provided sale is approved in writing by all existing shareholders and any purchaser is an existing shareholder.

(4) Any legal consideration if, after proposed issuance, there will be only one owner of stock.

6. Issue stock [*see* Chapter 6I, *Issuance of Equity Securities*].

PRACTICE TIP

PRACTICE TIP: *Corp. Code § 25102(h)* does not address resales and the impact resales may have on the exemption. Because *Corp. Code § 25102(h)* is silent on this issue, some practitioners have suggested that the statute does not impose any duty on the issuer to prevent resales of securities. While this may be technically correct, the issuer still has the burden of proving that the investment representation criteria have been satisfied. It may be difficult to satisfy this burden of proof if one or more purchasers immediately resell securities purchased pursuant to this exemption. This is another reason why use of a legend noting restrictions on transferability, such as that customarily used in offerings made in reliance on Section 4(2) of the federal securities law, is recommended. *Commentary by Frances E. Lossing.*

7. Ensure that each purchaser represents that purchase is made only for purchaser's own account (or trust account if purchaser is trustee) and not with view to or for sale in connection with any distribution of stock [*Corp. Code § 25102(h)(5)*; *see § 6C.28*; *see also § 6C.203* (form for representation)].

NOTE: A former requirement that the stock certificate contain a legend stating that the Commissioner's consent was required to any transfer of the stock [***see*** former *Corp. Code § 25102(h)(1)*] was repealed in 1996 [***see*** Stats. 1996, ch. 41]. Any stock previously issued with that legend will not be subject to the transfer restriction legend requirement, and an issuer may remove any legends placed on previously issued certificates under this exemption without any action by the Commissioner [*Corp. Code § 25102(h)*].

8. Prepare notification of issuance of stock [*see 10 Cal. Code Reg. § 260.102.8(a)*; *see also § 6C.200* (form of notice)] and ensure that [*see Corp. Code § 25102(h)(4)*]:

a. Officer of corporation signs notification.

b. Notification is filed or mailed for filing no later than 10 business days after corporation receives consideration for stock [*see* P 11, *below*].

NOTE: Certain loans or advances do not constitute receipt of consideration for the securities of the issuer and, accordingly, do not trigger the 10-day filing deadline for the notice of issuance. Loans or advances by organizers solely to meet organizational expenses before beginning business must be canceled by issuance of shares within 90 days after the articles are filed [*10 Cal. Code Reg. § 260.102.11(d)*].

Failure to file the notice within the 10-day period will not affect the availability of the small offering exemption if the issuer, within 15 business days after discovery of the failure to file the notice or after demand by the Commissioner, whichever occurs first, files the notice and pays a fee equal to that payable if the transaction had been qualified pursuant to *Corp. Code § 25110* [*Corp. Code § 25102(h)(4)*]. However, this alternative should be avoided because of the amount of the qualification fees [***see*** *Corp. Code § 25608*]. The fee for filing the notice of issuance of stock is based on the value of the securities proposed to be sold in the transaction, subject to a maximum of $300 [*Corp. Code § 25608(c)*; ***see*** P 11, ***below***]. In contrast, the fee for qualification by coordination [***see*** *Corp. Code § 25111*], by notification [***see*** *Corp. Code § 25112*], or by permit [***see*** *Corp. Code § 25113*] is $200, plus one fifth of 1 percent of the aggregate value of the securities sought to be sold in California, up to a maximum aggregate fee of $2,500 [*Corp. Code § 25608(e), (f)*; ***see*** *Corp. Code § 25608(g)(1)* (valuation of securities); ***see***

also *Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum fee set forth in *Corp. Code § 25608*); Ch. 6H, ***Qualification of Securities***].

9. Prepare proof of mailing [*see 10 Cal. Code Reg. § 260.102.9*; *see also § 6C.202* (form)].

NOTE: The mailing of the notification of issuance may be proved under *Code Civ. Proc. § 1013a*, which sets forth different requirements for declarations by attorneys and non-attorneys [*10 Cal. Code Reg. § 260.102.9*; ***see*** *§ 6C.202*].

10. If corporation is incorporated in state other than California, prepare irrevocable consent to service of process [*Corp. Code § 25102(h)(4)*; *10 Cal. Code Reg. § 260.102.8(b)*; ***see*** *§ 6C.201* (form)].

NOTE: The consent to service appoints the Commissioner of Corporations as the issuer's attorney to receive service in any civil action arising under the Corporate Securities Law of 1968. It must accompany the notification but need not be filed if the issuer has previously filed such a consent in connection with a previous qualification or exemption [*Corp. Code § 25102(h)(4)*].

11. File notification [*see* P 8, *above*] and consent to service, if required [*see* P 10, *above*], and pay filing fee [*Corp. Code § 25608(c)*].

NOTE: The notice may be filed in any office of the Department of Corporations [Dept. of Corps. Release No. 13-G (Revised; June 10, 2004)]. The filing fee that will be imposed on a notice of exemption from qualification will vary from $25 to $300, depending on the value of the securities proposed to be sold in the transaction for which the notice is filed [***see*** *Corp. Code § 25608(c)*; ***see also*** *Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum fee set forth in *Corp. Code § 25608*)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsExempt Nonissuer & Resale TransactionsSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART III. TRANSACTION GUIDE
B. Procedural Guide to Forming a Corporation Entitled to Small Offering Exemption

3-6C California Legal Forms--Transaction Guide §§ 6C.112- 6C.199

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6C.112[Reserved]



160 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART IV. FORMS

3-6C California Legal Forms--Transaction Guide § 6C.200

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.200 Notice of Issuance of Securities Pursuant to Small Offering Exemption [Corp. Code § 25102(h)] or Exemption From Qualification of Recapitalizations and Reorganizations [10 Cal. Code Reg. § 260.103]--Official Form [10 Cal. Code Reg. § 260.102.8]

[1] Comment

[a] Use of Form

This form is a notice of issuance that must be filed in connection with (1) the issuance of stock under the California small offering exemption [*Corp. Code § 25102(h)*], and (2) the regulatory exemption from qualification of recapitalizations and reorganizations [*see 10 Cal. Code Reg. § 260.103*; *see also* Ch. 6H, *Qualification of Securities*]. This notice must be submitted on 81/2 -by-11-inch paper [*10 Cal. Code Reg. § 260.102.8(a)*]. It can be obtained from any office of the Department of Corporations, and is available online at the Department's website, where it can be located at http://www.corp.ca.gov/forms/srdlist.htm .

The text of this form is printed in full in *10 Cal. Code Reg. § 260.102.8(a)* and is reproduced verbatim here.

[b] Filing Requirements

This form must be filed or mailed for filing with the Department of Corporations not later than 10 business days after the corporation has received the consideration for the issuance of its shares [*Corp. Code § 25102(h)*]. A consent to service of process [*see § 6C.201[2]*] must be filed along with this form if the issuer is not a California corporation and does not have a previous consent on file [*Corp. Code § 25102(h)(4)*; *10 Cal. Code Reg. § 260.102.8(b)*]. The notice must be filed in any office of the Department of Corporations [Dept. of Corps. Release No. 13-G (Revised; June 10, 2004)].

The only acknowledgment of filing is a receipt given for the filing fee [*see Corp. Code § 25608(c)*; *see also § 6C.202* (proof of mailing)]. Otherwise there is no follow-up by the Commissioner, and no certificate or permit is issued. The Department will only reply if it finds that the notice as filed has been found formally defective or incomplete, or if the

filing fee is insufficient.

[c] Filing Fee

The filing fee for the notice of issuance of securities under a small offering exemption is determined on the basis of the value of the securities proposed to be sold in the transaction [*Corp. Code § 25608(c)*], as follows [*Corp. Code § 25608(c)*; *see Corp. Code § 25608(g)(1)* (valuation of securities); *but see Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum)]:

- If the value of the securities is $25,000 or less, the fee is $25.
- If the value of the securities is $25,001 to $100,000, the fee is $35.
- If the value of the securities is $100,001 to $500,000, the fee is $50.
- If the value of the securities is $500,001 to $1 million, the fee is $150.
- If the value of the securities exceeds $1 million, the fee is $300.

The filing fee for filings made under *10 Cal. Code Reg. § 260.103* is $25.

[d] Failure to File

The failure to file this notice within the 10-day period discussed in [b], *above*, will not affect the availability of the small offering exemption if the issuer, within 15 days after discovery of the failure to file the notice or after demand by the Commissioner, whichever occurs first, files the notice and pays a fee equal to that payable had the transaction been qualified pursuant to *Corp. Code § 25110* [*Corp. Code § 25102(h)(4)*]. However, because of the large difference in fees [*compare Corp. Code § 25608(c) with Corp. Code § 25608(e), (f)*; *see also § 6C.111*, P 8], it is important to ensure the timely filing of this notice.

PRACTICE TIP:

The Department of Corporations has taken the position that the filing of a notice of transaction will violate *Corp. Code § 25166* regarding the making of false statements to the Commissioner if in fact the claimed exemption cannot be established. Therefore, the issuer may not be protected from liability under the California Corporate Securities Law on the basis that the issuer reasonably believes that the criteria set forth in *Corp. Code § 25102(h)* have been satisfied. As a result, it is important for the issuer to document compliance with the statute, including, in particular, documentation of the number of the issuer's shareholders after consummation of the transaction if any of the shareholders are partnerships, corporations or other business associations, and documentation of the type of consideration received.

The attorney delivering the opinion should obtain factual representations from the issuer, purchasers, and existing shareholders, if necessary, to back up the attorney's legal opinion. The attorney should also review the representations made by purchasers, any offering materials used in the transaction, corporate minutes and stock records of the issuer and the stock certificates to be issued in the offering. The attorney should also discuss the offering with officers and employees of the issuer involved in the transaction. *Commentary by Frances E. Lossing.*

[2] FORM

Notice of Issuance of Securities Pursuant to Small Offering Exemption [Corp. Code § 25102(h)] or Exemption From Qualification of Recapitalizations and Reorganizations [10 Cal. Code Reg. § 260.103]--Official

Form [10 Cal. Code Reg. § 260.102.8]

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161 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART IV. FORMS

3-6C California Legal Forms--Transaction Guide § 6C.201

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.201 Consent to Service of Process--Exempt Offering by Non-California Corporation [Corp. Code § 25102(h); 10 Cal. Code Reg. § 260.102.8(b)]--Official Form

[1] Comment--Use of Form

This form is a corporate consent to service of process by a non-California corporation. In order to take advantage of the small offering exemption, a non-California corporation must submit along with its notice of issuance of shares [*see § 6C.200*] a consent to service of process appointing the Commissioner of Corporations as its agent to receive service of process [*Corp. Code § 25102(h)(4)*; *10 Cal. Code Reg. § 260.102.8(b)*]. If the issuer has previously filed a consent in connection with a prior qualification or exemption under the Corporate Securities Law is not required to file another consent [*Corp. Code § 25102(h)(4)*].

The consent to service must be in the form reproduced here. The form is specified in the California Code of Regulations [*10 Cal. Code Reg. § 260.102.8(b)*]. The official Department of Corporations online version of the notice of issuance [*see § 6C.200[2]*] includes the consent to service of process as reproduced below. The consent is also available online as a separate form. The notice and consent may be found on the Department of Corporations website, located at http://www.corp.ca.gov/forms/srdlist.htm . Since the notice will not be required in all cases, it is reproduced as a separate form in this publication.

[2] FORM

Consent to Service of Process--Exempt Offering by Non-California Corporation [Corp. Code § 25102(h); 10 Cal. Code Reg. § 260.102.8(b)]--Official Form

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162 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART IV. FORMS

3-6C California Legal Forms--Transaction Guide § 6C.202

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.202 Proof of Mailing--Notice of Issuance of Securities Pursuant to Small Offering Exemption

[1] Comment

[a] Use of Form

This form is a proof of mailing to be used in conjunction with the notice of issuance of securities pursuant to the small offering exemption [*see 10 Cal. Code Reg. § 260.102.8*; *see also § 6C.200*]. For additional discussion, and examples of various types of proof of service, *see CALIFORNIA FORMS OF PLEADING AND PRACTICE, Ch. 518, Service of Summons and Papers, §§ 518.70, 518.72* (Matthew Bender).

[b] Proof of Mailing

[i] General Requirements

The mailing of the notice of issuance may be proved in accordance with *Code Civ. Proc. § 1013a* [*10 Cal. Code Reg. § 260.102.9*], which permits proof to be made by an attorney, a person other than an attorney, or a clerk of a court [*Code Civ. Proc. § 1013a*]. However, the proof of mailing for the notice of issuance need not be filed as provided in *Code Civ. Proc. § 1013a*. Instead, it should be retained in duplicate in the records of the attorney and the issuer [*10 Cal. Code Reg. § 260.102.9*; *see Code Civ. Proc. § 1013a*; Dept. of Corps. Release No. 7-C (Feb. 11, 1969)].

[ii] By Non-Attorney

The proof of mailing by a person other than an attorney must be in the form of an affidavit [*see Code Civ. Proc. § 1013a(1)*], which is a written declaration made under oath [*Code Civ. Proc. § 2003*]. Any matter required to be proved by affidavit may be made under penalty of perjury [*Code Civ. Proc. § 2015.5*]. Most affidavits in California take the form of a declaration under penalty of perjury [*see* CALIFORNIA FORMS OF PLEADING AND PRACTICE, Ch. 15, *Affidavits, Certificates, and Declarations* (Matthew Bender)]. Consequently, this is the method used in this form.

The proof of mailing must set forth all of the following [*Code Civ. Proc. § 1013a(1)*]:

- A statement that a Notice of Issuance of Securities pursuant to *Corp. Code § 25012(h)* or *10* Cal. Code Reg. § 260.013 has been mailed.
- The name and residence or business address of the person making the mailing.
- A statement that he or she is a resident of or employed in the county where the mailing occurs.
- A statement that he or she is over the age of 18 years and is not a party to the transaction.
- The date and place of deposit in the mail.
- The name and address of the Department of Corporations.
- A statement that envelope was sealed and deposited in the mail with the postage fully prepaid.

[iii] By Non-Attorney When Placed for Collection Pursuant to Ordinary Business Practices

A person other than an attorney should use an alternative proof of mailing when he or she, pursuant to ordinary business practices, has merely placed the notice for collection to be deposited in the mail later that same day. The affidavit must set forth all of the following [*Code Civ. Proc. § 1013a(3)*]:

- A statement that a Notice of Issuance of Securities pursuant to *Corp. Code § 25012(h)* or *10* Cal. Code Reg. § 260.013 has been mailed.
- The name and residence or business address of the person making the mailing.
- A statement that he or she is a resident of or employed in the county where the mailing occurs.
- A statement that he or she is over the age of 18 years and is not a party to the transaction.
- A statement that he or she is readily familiar with the business's practice for collection and processing of correspondence for mailing with the United States Postal Service.
- A statement that the correspondence would be deposited with the United States Postal Service that same day in the ordinary course of business.
- The name and address of the Department of Corporations.
- The date and place of business where the correspondence was placed for deposit in the United States Postal Service.
- A statement that the envelope was sealed and placed for collection and mailing on that date following ordinary business practices.

Proof by mailing made in this manner will be presumed invalid if the postal cancellation date or postage meter date on the envelope is more than one day after the date of deposit for mailing contained in the affidavit [*Code Civ. Proc. 1013a(3)*].

[iv] By Attorney

The proof of mailing by an attorney is set forth as a certificate, It need not be made by affidavit or otherwise sworn under penalty of perjury [*see Code Civ. Proc. § 1013a(2)*]. It must contain all of the following [*Code Civ. Proc. § 1013a(2)*]:

- A statement that a Notice of Issuance of Securities pursuant to *Corp. Code § 25012(h)* or *10* Cal. Code Reg. § 260.013 has been mailed.
- The name and business address of the person making the mailing.
- A statement that the person making service is an active member of the State Bar of California and is not a party to the transaction.
- The date and place of deposit in the mail.
- The name and address of the Department of Corporations.
- A statement that the envelope was sealed and deposited in the mail with the postage fully prepaid.

[2] FORM

Proof of Mailing--Notice of Issuance of Securities Pursuant to Small Offering Exemption

_____[*Name of corporation*]

Department of Corporations File No. _____

DECLARATION OF MAILING NOTICE OF ISSUANCE OF SECURITIES PURSUANT TO CORPORATIONS CODE SECTION 25102(h)

[*If executed by non-attorney:*]

I, _____ [*name*] , declare:

I am, and was at the time of the service mentioned, over the age of 18 years and not a shareholder of the issuer corporation nor an actual or proposed issuee of its stock. My _____ [business *or* residence] address is _____, and I am a _____ [resident *or* employee] in _____ [*county where service occurred*] County, California.

[*Or, if executed by attorney:*]

I, _____ [*name*] , certify:

I am, and at all times mentioned herein was, an active member of the State Bar of California, not a member of the issuer corporation, and not an actual or proposed issuee of the issuer's stock. My business address is _____.

[*Continue with the following:*]

[*First alternative; use when declarant mailed notice:*]

I served the Notice of Issuance of Securities Pursuant to Subdivision (h) of *Section 25102 of the California Corporations Code* or Rule 260.103, Title 10 of the California Code of Regulations, with respect to _____ [*name of corporation*], on _____ [*date*] by depositing the original copy in the United States mail in _____ County, California in a sealed envelope, with postage fully prepaid, addressed to the Department of Corporations, 320 West 4th Street, Suite 750, Los Angeles, CA 90013-1105.

[*Second alternative; use when declarant merely placed notice for later collection and mailing:*]

I am readily familiar with _____'s [*name of business*] practice for the collection and processing of correspondence for mailing with the United States Postal Service. On _____ [*date*] , following ordinary business practices, I placed the Notice of Issuance of Securities Pursuant to Subdivision (h) of *Section 25102 of the California Corporations Code* or Rule 260.103, Title 10 of the California Code of Regulations, with respect to _____ [*name of corporation*], which was in a sealed envelope addressed to the Department of Corporations, 320 West 4th Street, Suite 750, Los Angeles, CA 90013-1105, with postage fully prepaid, for collection and mailing at _____ [*place of business*]. Correspondence placed for collection in this manner is normally deposited with the United States mail the same day in the ordinary course of business.

[*Add, if executed by non-attorney:*]

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

[*Continue with the following:*]

Dated: _____.

_____ [*signature of declarant*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6C CALIFORNIA SMALL OFFERING EXEMPTION
PART IV. FORMS

3-6C California Legal Forms--Transaction Guide § 6C.203

AUTHOR: Frances E. Lossing Practice Consultant

§ 6C.203 Small Offering Investment Letter: Purchaser's Representations Concerning Investment Intent

[1] Comment

[a] Use of Form

This form may be used to obtain the investment representation that each purchaser is required to make under the small offering exemption [*see Corp. Code § 25102(h)(5)*; *see also* [b], *below*]. Although there is no requirement that this representation be in writing, some form of documentation is advisable to indicate that the issuer has complied with the requirements of the exemption.

[b] Investment Representation

All purchasers of securities sold under the exemption must represent that they are purchasing the securities for their own account (or a trust account if the purchaser is a trustee) and not with a view to or for sale in connection with any distribution of the security [*Corp. Code § 25102(h)(5)*]. Although there is no requirement that this representation be in writing, completion of this form would indicate that the issuer did obtain this representation. This documentation will be particularly useful if a subsequent violation of the representation leads to questions regarding the existence or sufficiency of the representation.

[2] FORM

_____ [*date*]

To: _____ [*Name of issuer*]
_____ [*street address*]

_____ [*city, state, zip*]

SMALL OFFERING INVESTMENT LETTER

In connection with my purchase of _____ [*describe securities, e.g.,* 100 common shares of your Company], I represent to you that I am purchasing these securities for investment for my own account [*or specify trust account if purchaser is a trustee*] and not with a view to or for sale in connection with any distribution of the security. I understand that these securities have not been qualified under the California Corporate Securities Law or registered under the federal Securities Act of 1933, and further understand that any resale or other transfer of these securities may require qualification and/or registration under the above-listed statutes.

Respectfully submitted, _____ [*signature of purchaser*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS

3-6D California Legal Forms--Transaction Guide 6D.syn

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.syn Synopsis to Chapter 6D: CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS

§ 6D.01 California Sources

[1] Statutes

[2] Regulations

§ 6D.02 Federal Regulations

§§ 6D.03- 6D.04 [Reserved]

§ 6D.05 Text References

§§ 6D.06- 6D.19 [Reserved]

§ 6D.20 Nature of Qualified Purchaser Exemptions

[1] In General

[2] Institutional Investor Exemption

[3] Limited Offering Qualified Purchaser Exemption

[4] Comparison of These Exemptions

[5] Selecting the Most Appropriate Exemption

§ 6D.21 Integration

§ 6D.22 Qualification of Institutional Investors Under Corp. Code § 25102(i)

[1] Purchasers Enumerated by Statute

[2] Purchasers Exempted by Regulation

§ 6D.23 Qualification of Purchasers Under Corp. Code § 25102(n)

[1] General Application to Offers and Sales

[2] Issuer Requirements

[3] Sales Requirements

[4] Definition of Qualified Purchaser

[5] Purchaser Representations

[6] Written Offering Disclosure Statement

[a] Disclosure Statement Requirement in General

[b] Contents of Statement

[c] Effect of Misleading or Insufficient Filing

[7] General Announcement of Proposed Offering

[a] Authorization

[b] Mandatory Information

[c] Optional Information

[d] Dissemination to Unqualified Purchasers

[8] Restriction on Telephone Solicitation

[9] Notices of Transaction and Payment of Filing Fee

[a] Timing of Filing of Notices of Transaction

[b] Effect of Failure to File Notices or to Deliver Notice to Commissioner on Request

[c] Where to File Notices

§ 6D.24 Qualification of Government Purchasers Under 10 Cal. Code Reg. § 260.105.14

§§ 6D.25- 6D.99 [Reserved]

§ 6D.100 Facts for Institutional Investor Exemption [Corp. Code § 25102(i)]

Scope

§ 6D.101 Facts for Qualified Purchaser Exemption [Corp. Code § 25102(n)]

Scope

§ 6D.102 Facts for Government Purchaser Exemption [10 Cal. Code Reg. § 260.105.14]

Scope

§§ 6D.103- 6D.109 [Reserved]

§ 6D.110 Conducting Transaction Under Institutional Investor Exemption [Corp. Code § 25102(i)]

Scope

§ 6D.111 Conducting Transaction Under Qualified Purchaser Exemption [Corp. Code § 25102(n)]

Scope

§§ 6D.112- 6D.199 [Reserved]

§ 6D.200 General Announcement of Proposed Offering Under Qualified Purchaser Exemption Under Corp. Code § 25102(n)

[1] Comment

[a] Use of Form

[b] Mandatory Information

[c] Optional Information

[2] FORM

General Announcement of Proposed Offering Under Qualified Purchaser Exemption Under Corp. Code § 25102(n)

§ 6D.201 Cover Letter Accompanying First Notice of Transaction for Qualified Purchaser Exemption Under Corp. Code § 25102(n)

[1] Comment

[a] Use of Form

[b] Filing

[c] Consent to Service of Process

[2] FORM

Scope

§ 6D.202 First Notice of Transaction for Qualified Purchaser Exemption Under Corp. Code § 25102(n)

[1] Comment

[a] Use of Form

[b] Filing Requirements

[2] FORM

First Notice of Transaction for Qualified Purchaser Exemption Under Corp. Code § 25102(n)

§ 6D.203 Second Notice of Transaction for Qualified Purchaser Exemption Under Corp. Code § 25102(n)

[1] Comment

[a] Use of Form

[b] Filing Requirements

[2] FORM

Second Notice of Transaction for Qualified Purchaser Exemption Under Corp. Code § 25102(n)

§ 6D.204 Purchaser's Representations Concerning Suitability and Investment Intent Under Qualified Purchaser Exemption--For Institutional Investors [Corp. Code § 25102(n)]

[1] Comment--Use of Form

[2] FORM

Purchaser's Representations Concerning Suitability and Investment Intent Under Qualified Purchaser Exemption--For Institutional Investors [Corp. Code § 25102(n)]

§ 6D.205 Purchaser's Representations Concerning Suitability and Investment Intent Under Qualified Purchaser Exemption--For Natural Persons [Corp. Code § 25102(n)]

[1] Comment--Use of Form

[2] FORM

Purchaser's Representations Concerning Suitability and Investment Intent Under Qualified Purchaser Exemption--For Natural Persons [Corp. Code § 25102(n)]

§ 6D.206 Purchaser's Representations Concerning Suitability and Investment Intent Under Qualified Purchaser Exemption--Based on Suitability of Equity Owners [Corp. Code § 25102(n)]

[1] Comment

[a] Use of Form

[b] Qualified Purchaser Status Based on Classification of Individual Equity Owners

[c] Attachments

[2] FORM

Purchaser's Representations Concerning Suitability and Investment Intent Under Qualified Purchaser Exemption--Based on Suitability of Equity Owners [Corp. Code § 25102(n)]

§§ 6D.207- 6D.209 [Reserved]

§ 6D.210 Purchaser's Representations Concerning Suitability and Investment Intent Under Institutional Investor Exemption [Corp. Code § 25102(i)]

[1] Comment--Use of Form

[2] FORM

Purchaser's Representations Concerning Suitability and Investment Intent Under Institutional Investor Exemption [Corp. Code § 25102(i)]

Susan E. Firtchn*

Frances E. Lossingn**
Practice Consultant

FOOTNOTES:

(n42)Footnote *. Susan E. Firtch graduated from the University of California School of Law, Davis. She is a member of the California Bar and practices with the Oakland firm of Burnham and Brown. Prior to attending law school she was employed in stock brokerage operations for nine years, and held a broker's license (Series 7), as well as manager's and registered options principal's licenses. Since 1991, she has specialized in representing insurers in both litigated and non-litigated first and third party matters, with an emphasis on complex "personal injury," and "advertising injury" insurance coverage issues.

(n43)Footnote **. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS

3-6D California Legal Forms--Transaction Guide Scope

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

Scope

Susan E. Firtchn* Frances E. Lossingn**
Practice Consultant Scope

This chapter covers the issuance of securities under the "qualified purchaser exemptions" from qualification under the Corporate Securities Law of 1968. These exemptions are contained in *Corp. Code § 25102(i)*, (n), and *10 Cal. Code Reg. § 260.105.14*.

The Legal Background discusses the use of these exemptions and the requirements of the statutes and the applicable rules of the Commissioner of Corporations. The Transaction Guide lists the steps necessary to use the exemptions. This chapter also contains forms for the notices that must be filed in connection with one of the exemptions, and forms related to ensuring that the conditions of that exemption are satisfied.

Qualification requirements, including the circumstances under which qualification will be required for later transactions involving securities originally issued pursuant to an exemption, are discussed in Ch. 6H, *Qualification of Securities* . For a discussion of the limited offering exemptions from qualification [*see Corp. Code §§ 25102(f), 25102.1(d)*], see Ch. 6B, *California Limited Offering Exemptions* . For a discussion of the small offering exemption from qualification [*see Corp. Code § 25102(h)*], see Ch. 6C, *California Small Offering Exemption* . For a comparison of these exemptions and a discussion covering selection of the most appropriate exemption, see Ch. 6, *Securities Regulation Issues* .

FOOTNOTES:
(n44)Footnote *. Susan E. Firtch graduated from the University of California School of Law, Davis. She is a member of the California Bar and practices with the Oakland firm of Burnham and Brown. Prior to attending law school she was employed in stock brokerage operations for nine years, and held a broker's license (Series 7), as well as manager's and registered options principal's licenses. Since 1991, she has specialized in representing insurers in both litigated and non-litigated first and third party matters, with an emphasis on complex "personal injury," and "advertising injury" insurance coverage issues.

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has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



166 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART I. RESEARCH GUIDE
A. Primary Sources

3-6D California Legal Forms--Transaction Guide § 6D.01

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.01 California Sources

[1] Statutes

Foreign corporations subject to corporate laws of state; tests to determine subject corporations; laws applicable; time of application. *Corp. Code § 2115*.

Corporate Securities Law of 1968. *Corp. Code § 25000 et seq.*

"Agent" defined. *Corp. Code § 25003*.

"Broker Dealer" defined. *Corp. Code § 25004*.

Offer or sale of securities in this state; offer to buy or purchase in *California. Corp. Code § 25008*.

"Investment adviser"--Commissioner's authority over persons excepted from definition of "investment adviser" by federal law. *Corp. Code § 25009.1*.

"Investment adviser representative" or "associated person of an investment adviser" defined. *Corp. Code § 25009.5*.

"Issuer" defined. *Corp. Code § 25010*.

"Person" defined. *Corp. Code § 25013*.

"Roll-up participants" defined. *Corp. Code § 25014.5*.

"Rollup transaction" defined. *Corp. Code § 25014.6*.

"Rule" defined. *Corp. Code § 25016*.

"Offer," "offer to sell," "sale," and "sell" defined. *Corp. Code § 25017*.

"Securities" defined. *Corp. Code § 25019*.

Institutional Investor Exemption. *Corp. Code § 25102(i)*.

Qualified Purchaser Limited Public Offering Exemption. *Corp. Code § 25102(n)*.

Qualification Requirement. *Corp. Code §§ 25110, 25120, 25130*

Qualification of recapitalizations and reorganizations (issuer transactions). *Corp. Code § 25120*.

Burden of proving exemption is on person claiming it. *Corp. Code § 25163*.

[2] Regulations

Rules of the Corporations Commissioner.

No implied requirement of written findings. *10 Cal. Code Reg. § 1.8*.

Time. *10 Cal. Code Reg. § 1.9*.

Service. *10 Cal. Code Reg. § 1.10*.

Designation of institutional investors and governmental agencies and instrumentalities by class. *10 Cal. Code Reg. § 260.102.10*.

Distribution under Securities and Exchange Commission Rule 144A. *10 Cal. Code Reg. § 260.102.10.1*.

Limited offering exemption excluded purchasers. *10 Cal. Code Reg. § 260.102.13*

Limited public offering exemption notice of transaction. *10 Cal. Code Reg. § 260.102.16*.

Disclosure statement requirement for Section 25102(n)/Rule 504 Offerings. *10 Cal. Code Reg. § 260.102.17*.

Distribution under Securities and Exchange Commission Rule 144A. *10 Cal. Code Reg. § 260.102.18*.

Contribution of Securities by Issuer to pension or profit sharing plans, to which offers or sales may not be made under *Corp. Code § 25102(i)*. *10 Cal. Code Reg. § 260.105.5*.

Sales to public agencies. *10 Cal. Code Reg. § 260.105.14*.

Releases and Opinions of the Corporations Commissioner.

NOTE:

The Commissioner periodically publishes releases that set forth information concerning the regulatory

activities of the Commissioner, inform practitioners as to policies, or disclose interpretive opinions [*10 Cal. Code Reg. § 260.608(b)*]. Attorneys can obtain releases from the Commissioner by being placed on a mailing list for distribution of Corporate Securities law material at a cost of $10 per year [*10 Cal. Code Reg. § 260.608(c)(5)*]. Releases are also reproduced in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, vol. 7 (Matthew Bender), in Marsh and Volk, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS Appendix A-4 (Matthew Bender), and in the CALIFORNIA CORPORATIONS CODE (Matthew Bender). Opinions of the Commissioner are also available, along with releases and forms, on the Internet at the Department of Corporations website, located at http://www.corp.ca.gov/commiss/relcont.htm.

Offers or sales to wholly owned subsidiaries under *Corp. Code § 25102(i)*. Commissioner's Opinion No. 69/62 (June 30, 1969).

Offers or sales to holding companies under *Corp. Code § 25102(i)* and/or *10 Cal. Code Reg. § 260.102.10*. Commissioner's Policy Letter No. PL/65 (July 1, 1970).

Offers or sales to pension or profit sharing trusts under *Corp. Code § 25102(i)*. Commissioner's Opinion No. 70/96 (Aug. 7, 1970).

Offers or sales to institutional investors if they are trustees of individual retirement plans. *Corp. Code § 25102(i)*. Commissioner's Opinion No. 80/4C (May 1, 1980).

Offers of securities on the Internet under *Corp. Code 25102(n)*. Commissioner's Opinion No. 96/2C (Oct. 17, 1996, as corrected).

Offers of securities on the Internet. Dept. of Corps. Release No. 100-C (Nov. 5, 1996).

Department of Corporations authority over Internet securities offerings affirmed. Dept. of Corps. News Press Release No. 99-02 (Feb. 25, 1999).

Offices for filing notices with the Commissioner. Dept. of Corps. Release No. 13-G (Revised; June 10, 2004).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART I. RESEARCH GUIDE
A. Primary Sources

3-6D California Legal Forms--Transaction Guide § 6D.02

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.02 Federal Regulations

General rules and regulations, Securities Act of 1933. *17 C.F.R. § 230.100 et seq.*

Limited Offering and Private Offering Exemptions (Regulation D). *17 C.F.R. §§ 230.501-230.508.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART I. RESEARCH GUIDE
A. Primary Sources

3-6D California Legal Forms--Transaction Guide §§ 6D.03- 6D.04

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

[Reserved]

§§ 6D.03[Reserved]



169 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6D California Legal Forms--Transaction Guide § 6D.05

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.05 Text References

Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 21, *Corporate Securities* , §§ 449.05-449.05A (Matthew Bender).

Marsh & Volk, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS (Matthew Bender)

Ch. 3A, *Federal Preemption of State Securities Regulation*.

Ch. 4, *General Exemptions From Qualifications* .

Ch. 14, *Civil Liabilities* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6D California Legal Forms--Transaction Guide §§ 6D.06- 6D.19

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

[Reserved]

§§ 6D.06[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6D California Legal Forms--Transaction Guide § 6D.20

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.20 Nature of Qualified Purchaser Exemptions

[1] In General

The "qualified purchaser exemptions" to the qualification requirements for issuer transactions under the Corporate Securities Law are set forth in *Corp. Code § 25102(i), (n),* and *10 Cal. Code Reg. § 260.105.14*. These sections create exemptions that apply to any offer or sale of securities to purchasers meeting enumerated qualifications [*Corp. Code § 25102(i), (n)*; *10 Cal. Code Reg. § 260.105.14*]. There are two such exemptions:

- The "institutional investor exemption" under *Corp. Code § 25102(i)* [*see* [2], *below*].
- The "limited offering qualified purchaser exemption" under *Corp. Code § 25102(n)* [*see* [3], *below*].

[2] Institutional Investor Exemption

The institutional investor exemption under *Corp. Code § 25102(i)* affords an exemption from registration for any offer or sale to a bank, savings and loan association, trust company, insurance company, registered investment company, pension or profit sharing trust (other than those of the issuer, a self-employed individual retirement plan, or individual retirement account), to other institutional investors, governmental agencies or instrumentalities that the Commissioner may designate by rule, or to a corporation with outstanding securities registered under the Securities Exchange Act of 1934 or wholly owned subsidiary of such a corporation if, after the offer and sale, that corporation will own directly or indirectly all of the outstanding capital stock of the company; provided the purchaser represents that it is purchasing for investment and not for distribution [*Corp. Code § 25102(i)*]. No filings or filing fees are required, and all the issuer need do is comply with the criteria stated in *Corp. Code § 25102(i)* [*see §§ 6D.22, 6D.100*].

An exemption is also available for any offer or sale of a security to the federal government, any agency or instrumentality of the Federal Government, any state, any city, city and county, or county, or any agency or instrumentality or a state, city, city and county, or county, or any state university or state college and any retirement system for the benefit of their employees [*10 Cal. Code Reg. § 260.105.14*].

[3] Limited Offering Qualified Purchaser Exemption

The qualified purchaser exemption under *Corp. Code § 25102(n)* applies to offers and sales involving specified types of issuers and purchasers meeting the qualifications of that section [*see Corp. Code § 25102(n)(1)-(3)*]. With certain limited exceptions, the issuer must provide a written offering disclosure statement pursuant to *Corp. Code § 25102(n)(4)* to each natural person. The issuer may publish a general notice of proposed offering pursuant to *Corp. Code § 25102(n)(5)*, provided the general notice complies with the requirements of the statute. Each purchaser must also represent that it is purchasing for investment and not with a view to distribution. Under *Corp. Code § 25102(n)(7)*, the issuer must file a first notice of transaction and pay a $600 filing fee, and also file a second notice of transaction for which no fee is required [*see Corp. Code § 25608(x)*; *see also Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum fee set forth in *Corp. Code § 25608*); §§ 6D.23, 6D.201-203].

[4] Comparison of These Exemptions

The qualified purchaser exemption under *Corp. Code § 25102(n)* exempts a broader scope of purchasers than the institutional investor exemption under *Corp. Code § 25102(i)* or the public agency exemption under *10 Cal. Code Reg. § 260.105.14*. The type of purchasers qualifying for exemption under *Corp. Code § 25102(i)*--basically, institutional investors--are just one type of purchaser qualifying for exemption under *Corp. Code § 25102(n)*. Other purchasers qualifying under *Corp. Code § 25102(n)* include any person designated in *10 Cal. Code Reg. § 260.102.13*, specified pension or profit sharing trusts and retirement plans or accounts in which the investment decisions are made solely by persons who are qualified purchasers, and natural person meeting enumerated financial requirements [*Corp. Code § 25102(n)*].

Although the definition of qualified purchaser under *Corp. Code § 25102(n)* is broader than under *Corp. Code § 25102(i)* or *10 Cal. Code Reg. § 260.105.14*, *Corp. Code § 25102(n)* contains restrictions on issuers and the offering process that *Corp. Code § 25102(i)* does not [*see Corp. Code § 25102(n)(1), (3)-(7)*]. For example, *Corp. Code § 25102(n)(4)(A)* requires the issuer to provide each natural person with a disclosure statement (with certain limited exceptions) [*Corp. Code § 25102(n)(4)*]. In addition, *Corp. Code § 25102(n)(7)* requires the filing of notices of transaction and the payment of a filing fee, while *Corp. Code § 25102(i)* and *10 Cal. Code Reg. § 260.105.14* do not [*Corp. Code § 25102(n)(7)*].

[5] Selecting the Most Appropriate Exemption

Issuers who intend offer or sell securities only to institutional investors qualified under *Corp. Code § 25102(i)* or *10 Cal. Code Reg. § 260.105.14* may elect to offer and sell under that exemption, and avoid having to comply with the additional requirements of *Corp. Code § 25102(n)*. On the other hand, those issuers who wish to offer and sell to a broader scope of qualified purchasers (which can include those qualified under *Corp. Code § 25102(i)* or *10 Cal. Code Reg. § 260.102.13* or *260.105.14*) must use *Corp. Code § 25102(n)* to obtain a qualified purchaser exemption.

For a comparison of the qualified purchaser exemptions and other types of available exemptions, see Ch. 6, *Securities Regulation Issues* ; see also Marsh & Volk, *PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, Ch. 4, General Exemptions from Qualification, §§ 4.02B* (qualified purchaser limited offering exemption) and 4.04 (institutional investor exemption) (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInvestment CompaniesDistribution, Redemption & Repurchase of SharesSecurities LawInvestment CompaniesRegistration & Reporting



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6D California Legal Forms--Transaction Guide § 6D.21

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§ 6D.21 Integration

The institutional investor exemption and the qualified purchaser exemption, as well as the exemption for public agencies, apply to the offer or sale of securities in a "transaction." The term "transaction" is not defined in the statute. The issuer therefore is confronted with the problem of identifying all past, present, and future offerings that will be considered a part of the same transaction. The treatment of multiple offers and/or sales as a single transaction is commonly referred to as "integration."

The primary threat posed by integration is the possibility that the Commissioner may include a past offer or sale which, either alone or in conjunction with other offers and sales, violates the requirements of the exemption. The Commissioner has not given any guidance on the integration issue in the context of the qualified purchaser exemptions. It is likely, however, that the approach adopted by the Commissioner in offerings under the *Corp. Code § 25102(f)* exemption would be adopted here [*10 Cal. Code Reg. § 260.102.12*; Dept. of Corps. Release No. 67-C (Oct. 20, 1981); for additional guidance, *see also* SEC Release No. 33-4552 (Nov. 6, 1962)].

PRACTICE TIP:

Sponsors of limited partnership programs may run afoul of the integration requirements if they have an ongoing program of offering and selling limited partnerships to a pool of investors, even though the issuer of the limited partnership interests may technically be different. In these circumstances, the Commissioner may view the sponsor to be the issuer and integrate the various offerings for purposes of determining compliance with the qualified purchaser exemptions. Particular care should be taken that offerings made in reliance on *Corp. Code § 25102(f), (i),* or *(n)* are not integrated because of the different technical requirements of each of these exemptions which may not in each case be satisfied. *Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities

LawExemptions From RegistrationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6D California Legal Forms--Transaction Guide § 6D.22

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§ 6D.22 Qualification of Institutional Investors Under Corp. Code § 25102(i)

[1] Purchasers Enumerated by Statute

Corp. Code 25102(i), the institutional investor exemption, exempts from qualification any offer or sale to any of the following:

- Banks [*Corp. Code § 25102(i)(1)*].
- Savings and loan associations [*Corp. Code § 25102(i)(1)*].
- Trust companies [*Corp. Code § 25102(i)(1)*].
- Insurance companies [*Corp. Code § 25102(i)(1)*].
- Investment companies registered under the Investment Company Act of 1940 [*Corp. Code § 25102(i)(1)*].
- Pension or profit-sharing trusts (other than a pension or profit-sharing trust of the issuer, a self employed individual retirement plan, or individual retirement account) [*Corp. Code § 25102(i)(1)*].
- Other institutional investors, governmental agencies, or instrumentalities that the Commissioner may designate by rule, whether the purchaser is acting for itself or as a trustee [*Corp. Code § 25102(i)(1)*; *see 10 Cal. Code Reg. § 260.102.10*].
- Any corporation with outstanding securities registered under section 12 of the Securities Exchange Act of 1934 [*15 U.S.C. § 78l*], or any wholly owned subsidiary of any corporation with outstanding securities registered under Section 12 of the Securities Exchange Act of 1934, that after the offer and sale

will own directly or indirectly 100 percent of the outstanding capital stock of the issuer [*Corp. Code § 25102(i)(2)*].

The purchaser must represent that it is purchasing for its own account (or for the trust account) for investment and not with a view to or for sale in connection with any distribution of the security [*Corp. Code § 25102(i)*]. This requirement applies to every purchaser for which exemption is sought under this section, and is not limited to corporate purchasers [*Corp. Code § 25102(i)*; *see also* Marsh & Volk, *PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, Ch. 4, General Exemptions from Qualification, § 4.04* (Matthew Bender)]. The Commissioner has stated that the representation that the purchaser is purchasing for its own account (or the trust account) must be true *at the time when the securities are issued* [Commissioner's Opinion No. 71/11C (Feb. 24, 1971)].

PRACTICE TIP:

Offerings to certain of the institutional investors listed in *Corp. Code § 25102(i)* will be exempt from the federal securities laws under either Section 3(a)(2) or (3) of the Securities Act of 1933 [*15 U.S.C. § 77c(a)(2), (3)*]. For those offerings not included within these exemptions, it may be possible to rely on the Section 4(2) [*15 U.S.C. § 77d(a)(2)*] exemption, since the investors will be required to make an investment representation. It is customary for the issuer of securities issued without registration under the federal securities laws in reliance on Section 4(2) to place a restrictive legend on the securities stating that the securities are subject to restrictions on transferability and may not be transferred or sold except as permitted under the Securities Act of 1933 and applicable state securities laws. It is also recommended that the issuer obtain the investment representation in writing in order to document compliance with the exemption. *Commentary by Frances E. Lossing.*

The Commissioner of Corporations has found that a "tier" subsidiary (purchasing for its own account) that is wholly owned by a wholly owned subsidiary or by a higher tier subsidiary of a corporation with outstanding securities registered under Section 12 of the Securities Exchange Act of 1934 is an exempt investor under *Corp. Code § 25102(i)* [Commissioner's Opinion No. 69/62 (June 30, 1969)]. However, *Corp. Code § 25102(i)* exempts corporations with outstanding securities registered under Section 12 of the Securities Exchange Act of 1934 *only* if they will own 100 percent of the new stock. Accordingly the Commissioner determined that the exemption was not available to a corporation with outstanding securities registered under section 12 of the Securities Exchange Act of 1934 which would not own 100 percent of the newly issued stock [Commissioner's Policy Letter No. PL/65 (July 1, 1970)].

The Commissioner of Corporations has found that the exemption under *Corp. Code 25102(i)* was also unavailable to the following:

- The trustee of the issuer's retirement plan. The trustee may not utilize the exemption because it excludes retirement plans [Commissioner's Opinion No. 70/96 (Aug. 7, 1970)].

- Institutional investors who are trustees of self-employed individual retirement plans or individual retirement accounts [Commissioner's Opinion No. 80/4C (May 1, 1980)]. The exclusion from the institutional investor exemption for a self-employed retirement plan or individual retirement account would be meaningless unless it applied to all plans, regardless of whether their trustees happen to be institutional investors under *Corp. Code § 25102(i)* [Commissioner's Opinion No. 80/4C (May 1, 1980)].

- A Keogh retirement plan, even if set up as a trust [Commissioner's Policy Letter No. PL/113 (Oct. 30, 1970)].

[2] Purchasers Exempted by Regulation

The applicable regulation, *10 Cal. Code Reg. § 260.102.10*, broadens the scope of eligible institutional investors by

designating the following institutional investors, governmental agencies and instrumentalities by class as persons to whom an offer or sale may be made pursuant to the exemption of *Corp. Code § 25102(i)*:

- Any organization described in *I.R.C. § 501(c)(3)*, as amended December 29, 1981, which has total assets (including endowment, annuity and life income funds) of not less than $5 million according to its most recent audited financial statement [*10 Cal. Code Reg. § 260.102.10(a)*].

- Any corporation that has a net worth on a consolidated basis according to its most recent audited financial statements of not less than $14 million; provided, however, that if the securities being acquired are common stock of a corporation or are exchangeable for or convertible into common stock of a corporation, one of the following requirements must be met:

    - The holders of less than 25 percent of the outstanding shares of that common stock (including shares of common stock issuable on exchange or conversion of securities presently exchangeable for or convertible into common stock) have addresses in California as of the most recent record date, or as of three months prior to the offer or sale, whichever is most recent; or

    - The securities (plus any other similar securities held by the purchaser) will not represent more than five per cent of the total number of outstanding shares of common stock of the issuer assuming the exchange or conversion of all securities exchangeable for or convertible into common stock (unless all the shares of common stock are owned by corporations meeting the $14 million net worth test specified above; provided, however, that the foregoing limitations with respect to transactions in common shares will not apply to any transaction (1) in which the securities are offered pro rata to the holders of the outstanding common shares; or (2) that is approved by the holders of 75 percent or more of the outstanding common shares; or (3) in which there are no common shares or securities convertible into common shares outstanding prior to the transaction [*10 Cal. Code Reg. § 260.102.10(b)*].

- Any wholly owned subsidiary of an institutional investor designated in *Corp. Code § 25102(i)* or in *10 Cal. Code Reg. § 260.102.10* [*10 Cal. Code Reg. § 260.102.10(c)*].

The Commissioner has concluded that a "combined" financial statement for a parent corporation and all of its affiliate corporations, as if the group were a single company with one or more branches or divisions, met the requirement of a "consolidated" financial statement under *Corp. Code § 25102(i)*. In that instance, the only significant difference between the company's "combined" statements and a "consolidated" statement was a difference in name only [Commissioner's Opinion No. 82/3C (Oct. 13 1982)].

The Commissioner has found the California State Compensation Insurance Fund, as an agency of the state, to be an exempt investor under *10 Cal. Code Reg. § 260.102.10* [Commissioner's Opinion No. 70/32 (Mar. 18, 1970)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInvestment CompaniesGeneral OverviewSecurities LawInvestment CompaniesActivities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6D California Legal Forms--Transaction Guide § 6D.23

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.23 Qualification of Purchasers Under Corp. Code § 25102(n)

[1] General Application to Offers and Sales

Corp. Code § 25102(n) exempts from qualification any offer or sale of any security in a transaction, other than an offer or sale of a security in a rollup transaction, that meets all of the criteria set forth in that section, including issuer requirements, sales requirements, purchasers qualification requirements, and notice requirements as discussed below [*Corp. Code 25102(n)*]. The term "rollup transaction" refers to any transaction or series of transactions that directly or indirectly, through acquisition or otherwise, involves the combination or reorganization of one or more rollup participants if certain other criteria are satisfied [*Corp. Code § 25014.6*]. A limited partnership qualifies as a rollup participant if it operates as a conduit vehicle for investors to participate in the ownership of assets for a limited period of time and has a policy or purpose of distributing to investors substantially all proceeds from the sale, financing or refinancing of assets rather than reinvesting the proceeds in the business, unless the limited partnership is an investment company registered under the Investment Company Act of 1940 or a business development company under Section 2(a)(48) of the Investment Company Act of 1940 [*Corp. Code § 25014.5*; *15 U.S.C. § 80a-2(a)(48)*].

[2] Issuer Requirements

To qualify for the exemption under *Corp. Code § 25102(n)(1)*, the issuer must be one of the following [*Corp. Code § 25102(n)(1)*]:

- A California corporation or a foreign corporation that, at the time of the filing of the notice required under this subdivision, is subject to *Corp. Code § 2115* (governing application of General Corporation Law to foreign corporations). A foreign corporation is generally subject to *Corp. Code § 2115* if more than 50 percent of its outstanding voting securities are held of record by persons with California addresses appearing on the corporate books on the record date for the latest shareholder meeting held during the latest full income year (or last day of latest full income year if no meeting was held), and more than 50 percent of its property, payroll and sales for California franchise tax purposes are within California.

- Any other form of business entity, including, without limitation, a partnership or trust organized under California law.

The exemption provided by *Corp. Code § 25102(n)* is not available to a "blind pool" issuer, or to an investment company subject to the Investment Company Act of 1940 [*Corp. Code § 25102(n)(1)(B)*; *see also 10 Cal. Code Reg. § 260.102.16(b)*]. The term "blind pool issuer" refers to a company that is a development stage company and either does not have a specific business plan or purpose or has indicated that its business plan is to engage in mergers and acquisitions with unidentified other entities. The term "company" is used in a generic and comprehensive sense to include individuals, partnerships, corporations, and other forms of organization of an enterprise [*10 Cal. Code Reg. §§ 260.102.16(b), 260.113.1(b)*1].

[3] Sales Requirements

Sales of securities must be made only to qualified purchasers or other persons the issuer reasonably believes, after reasonable inquiry, to be qualified purchasers [*Corp. Code § 25102(n)(2)*.] A corporation, partnership or other organization specifically formed for the purpose of acquiring the securities offered by the issuer in reliance on this exemption may be a qualified purchaser if each of the equity owners of the corporation, partnership, or other organization is a qualified purchaser [*Corp. Code § 25102(n)(2)*].

PRACTICE TIP:

Under *Corp. Code § 25102(f),* the issuer will not be protected from liability on the basis that the issuer reasonably believes that the criteria of the exemption have been satisfied. The issuer will, however, be protected from liability under *Corp. Code § 25102(n)* if it reasonably believes the qualified purchaser standards have been satisfied. The issuer's potential liability is therefore less under *Corp. Code § 25102(n)* than under *Corp. Code § 25102(f)*. In addition, there are likely to be fewer difficult legal judgments which must be made in determining whether the exemption criteria have been satisfied under *Corp. Code § 25102(n)*, than under *Corp. Code § 25102(f)*. *Commentary by Frances E. Lossing.*

[4] Definition of Qualified Purchaser

Qualified purchasers under *Corp. Code 25102(n)* include the following:

- A person designated in *10 Cal. Code Reg. § 260.102.13*, which deals with purchasers excluded from the count of purchasers under the limited offering exemption in *Corp. Code § 25102(f)* [*Corp. Code § 25102(n)(2)(A)*; *see 10 Cal. Code Reg. § 260.102.13*; for discussion of the limited offering exemption, *see also* Ch. 6B, *California Limited Offering Exemptions*]. Qualified purchasers under this provision include the following:

  - The trustee of an issuer which is a trust and the general partner of an issuer which is a partnership, who exercises managerial functions with respect to those entities, and any officer, director or general partner of a general partner of an issuer that is a partnership.

  - Any person who occupies a position with the issuer, or with a general partner of an issuer which is a partnership, with duties and authority substantially similar to those of an executive officer of a corporation.

  - (1) Any relative, spouse or relative of the spouse of a purchaser who has the same principal residence as the purchaser; (2) any trust or estate in which a purchaser and any person described in clause (1) or (3) has more than 50 percent of the beneficial interests;

and (3) any corporation or other organization of which a purchaser and any of the persons related to the purchasers specified in (1) or (2) are beneficial owners of more than 50 percent of the equity securities.

- Any individual who is a promoter of the issuer.

- Any person who purchases $150,000 or more of the securities offered in the transaction, provided each such purchaser meets either one of the following criteria: (1) the person or the person's professional adviser has the capacity to protect such person's own interests in connection with the transaction, or (2) the investment does not exceed 10 percent of the person's net worth or joint net worth with that of that person's spouse.

- A small business investment company licensed by the Small Business Administration, a business development company under Section 2(a)(48) of the Investment Company Act of 1940 [*15 U.S.C. § 80a-2(a)(48)*] and a private business development company as defined in Section 202(a)(22) of the Investment Advisors Act of 1940 [*15 U.S.C. § 80b-2(a)(22)*].

- A person who is an "accredited investor" under SEC Rule 501(a) of Regulation D [*17 C.F.R. § 230.501(a)*].

PRACTICE TIP:
Under the Capital Access Company Law [*Corp. Code § 28000 et seq.*], which became effective on July 1, 1999, capital access companies may be formed for the purpose of providing financial or managerial assistance to small business firms in California. A company qualifies as a small business firm if it proposes to transact or transacts business in California on a regular and continuous basis, has fewer than 500 employees, is either a California corporation, partnership, limited liability company, or other entity formed under California law, or a pseudo-California corporation under *Corp. Code § 2115*, is not an investment company, and is a person that has a specific business plan or purpose or intends to acquire a company with such a plan or purpose [*Corp. Code § 28047*]. All investors in a capital access company licensed under the Capital Access Company Law must be accredited investors. Therefore, securities may be sold to capital access companies pursuant to *Corp. Code § 25102(n). Commentary by Frances E. Lossing.*

- Any entity in which all of the equity owners are officers, directors or affiliates of the issuer or persons specified in *Corp. Code § 25102(i), 10* Cal. Code Reg. § 260.102.10 or this rule, other than natural persons who fall into the category of purchasers of $150,000 or more of the securities offered in the transaction, as described above.

- A person designated in *Corp. Code § 25102(i)* or any rule of the Commissioner adopted thereunder [*Corp. Code § 25102(n)(2)(B)*; *see § 6D.22* for discussion of *Corp. Code § 25102(i)*].

- A pension or profit-sharing trust of the issuer, a self employed individual retirement plan, or an individual retirement account, if investment decisions made on behalf of the trust, plan, or account are made solely by persons who are qualified purchasers [*Corp. Code § 25102(n)(2)(C)*]. This contrasts with the exemption under *Corp. Code 25102(i),* which does not exempt these plans.

- An organization described in *I.R.C. § 501(c)(3)* (tax-exempt religious and charitable organizations), corporation, Massachusetts or similar business trust, or partnership, each with total assets in excess of $5 million according to its

most recent audited financial statements [*Corp. Code § 25102(n)(2)(D)*.].

- With respect to the offer and sale of one class of voting common stock of an issuer or of preferred stock of an issuer entitling the holder to at least the same voting rights as the issuer's one class of voting common stock, provided that the issuer has only one class of voting common stock outstanding on consummation of the offer and sale, a natural person who, either individually or jointly with the person's spouse, (1) has a minimum net worth of $250,000, a gross income in excess of $100,000 during the immediately preceding tax year, and reasonably expects gross income in excess of $100,000 during the current tax year, or (2) has a minimum net worth of $500,000 [*Corp. Code § 25102(n)(2)(E)*; *see* Commissioner's Opinion No. 99/1C (concluding that exemption under *Corp. Code § 25102(n)* may not be relied on by limited liability company if it offers or sells membership interest to "qualified purchasers" as defined in *Corp. Code § 25102(n)(2)(E)*, as membership interest in LLCs are not "stock")]. "Net worth" is determined exclusive of home, home furnishings, and automobiles. Other assets included in the computation of net worth may be valued at fair market value. A natural person must also have business and financial experience, or have an experienced professional advisor who is not compensated in any way by the issuer and who has such business and financial experience [*see* [5], *below*]. The investment may not exceed 10 percent of the natural person's net worth [*see* [6], *below*].

PRACTICE TIP:

A person acting as a professional adviser under *Corp. Code § 25102(n)* generally must be licensed as an investment adviser in California. The term "investment adviser" applies to any person who, for compensation, engages in the business of advising others with respect to investing in or purchasing or selling securities. A broker-dealer is excluded from this definition if the broker provides investment advice solely as an incident to the broker's business and the broker receives no special compensation for such services. Attorneys and accountants are excluded from this definition only if investment advisory services are provided solely as an incidence to the practice of their profession. Otherwise they need to be licensed as investment advisers. *Commentary by Frances E. Lossing.*

- Any other purchaser designated as qualified by rule of the Commissioner (*Corp. Code § 25102(n)(2)(F)*).

An issuer may have its broker-dealer make the determination as to whether or not the prospective investor is qualified [Commissioner's Opinion No. 96/2C (Oct. 17, 1996)]. The issuer, however, will remain responsible for that determination under *Corp. Code § 25102(n)* [Commissioner's Opinion No. 96/2C (Oct. 17, 1996)].

[5] Purchaser Representations

Each purchaser must represent that the purchaser is purchasing for the purchaser's own account (or trust account, if the purchaser is a trustee), and not with a view to or for sale in connection with a distribution of the security [*Corp. Code § 25102(n)(3)*].

PRACTICE TIP:

There is no requirement that this representation be in writing. It is recommended, however, that the representation be written in order to document compliance with the exemption. It is also recommended that securities issued in this type of transaction bear a restrictive legend stating that the securities are subject to restrictions on transferability and may not be transferred or sold except as permitted under the Securities Act of 1933 and applicable state securities laws for the reasons discussed above with respect to the *Corp. Code § 25102(i)* exemption. *Commentary by Frances E. Lossing.*

An offer to resell or a resale made under *10 Cal. Code Reg. § 260.105.13.1* is not inconsistent with the required purchaser representation of *Corp. Code § 25102(n)(3)* [*10 Cal. Code Reg. § 260.102.18*].

[6] Written Offering Disclosure Statement

[a] Disclosure Statement Requirement in General

The exemption provided by *Corp. Code § 25102(n)* imposes a mandatory requirement to deliver a written offering disclosure statement containing specified information if offers and sales will be made to natural persons. The disclosure statement must be sent to each natural person purchaser, including a corporation, partnership, or other organization specifically formed by natural persons for the purpose of acquiring the securities offered by the issuer. The disclosure statement must be provided at least five business days before securities are sold to, or a commitment to purchase is accepted from, the purchaser [*Corp. Code § 25102(n)(4)*].

PRACTICE TIP:

A disclosure statement need not be delivered to natural persons under any of the other qualified purchaser exemptions discussed in this chapter, the small offering exemption under *Corp. Code § 25102(h)*, or the limited offering exemption under *Corp. Code § 25102(f)*. This may be perceived as a disadvantage of the *Corp. Code § 25102(n)* exemption. The preparation of disclosure statements, however, is common in transactions of this type and may be necessary in order for investors to be willing to invest in the issuer. *Commentary by Frances E. Lossing.*

The issuer is *not* obligated to provide this disclosure statement to a natural person qualified under *10 Cal. Code Reg. § 260.102.13*, which deals with purchasers excluded from the count of purchasers under the limited offering exemption [*Corp. Code § 25102(n)(4)*; *see 10 Cal. Code Reg. § 260.102.13*; for discussion of the limited offering exemption, *see also* Ch. 6B, *California Limited Offering Exemptions*].

[b] Contents of Statement

The disclosure statement must satisfy the disclosure requirements of Regulation D and any other disclosure requirements prescribed by rule of the Commissioner. [*Corp. Code § 25102(n)(4)*; *17 C.F.R. § 230.501 et seq.*]. The Commissioner currently has not prescribed any additional rules. The implementing regulation merely specifies that the statement must consist of the information specified in *17 C.F.R. § 230.502(b)(2)* of Regulation D [*10 Cal. Code Reg. § 260.102.17*]. For more detailed discussion of the information needed in connection with a Regulation D filing, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* .

PRACTICE TIP:

Disclosure materials used in offerings of this type frequently include confidential business information, including budgets and future projections. Before this type of information is made available to investors, it is customary for a confidentiality agreement to be executed by the potential investor. The issuer should also take particular care that assumptions used in preparing projections are carefully explained and that potential investors are informed of the various factors that could impact the projections in any material respect. *Commentary by Frances E. Lossing.*

[c] Effect of Misleading or Insufficient Filing

The offer or sale of securities pursuant to a disclosure statement that violates *Corp. Code § 25401*, which generally makes false or misleading communications unlawful, or that fails to meet the disclosure requirements of Regulation D [*17 C.F.R. § 230.501 et seq.*], as discussed in [b], *above*, does not render the exemption unavailable to the issuer [*Corp. Code § 25102(n)(4)*].

[7] General Announcement of Proposed Offering

[a] Authorization

The exemption in *Corp. Code § 25102(n)* permits the issuer to publish, by written document, a general announcement

of the proposed offering [*Corp. Code § 25102(n)(5)*]. This announcement is different from the written offering disclosure statement discussed in [6], *above*, and, unlike the written offering disclosure statement, the publication of a general announcement of proposed offering is not mandatory. When a general announcement of proposed offering is published, however, its contents are specified and strictly limited by statute, as discussed in [b], *below*.

PRACTICE TIP:

General announcements may be published on the Internet. Procedural safeguards described in Commissioner's Opinion No. 96/2C (Oct. 17, 1996) must be established to be certain that other information on the Internet concerning the issuer is not linked with the general announcement. *Commentary by Frances E. Lossing.*

[b] Mandatory Information

A general announcement of proposed offering is permissible if it contains only the following [*Corp. Code § 25102(n)(5)(A), (C)*]:

PRACTICE TIP:

The general announcement concept in *Corp. Code § 25102(n)(5)* is similar to the concept of communications not deemed a prospectus under SEC Rule 134 [*17 C.F.R. § 230.134*]. It should not be necessary, however, to limit the general announcement to information permissible under SEC Rule 134 if the aggregate offering price of the securities does not exceed $5 million. In this case, the offering would be exempt under SEC Rule 1001 [*17 C.F.R. § 230.1001*]. *Commentary by Frances E. Lossing.*

- The name of the issuer of the securities.
- The full title of the security to be issued.
- The anticipated suitability standards for prospective purchasers
- A statement that:
    - No money or other consideration is being solicited or will be accepted;
    - An indication of interest made by a prospective purchaser involves no obligation or commitment of any kind; and
    - If the issuer is required to deliver a written offering disclosure statement to prospective purchasers [*see* [6], *above*], that no sales will be made or commitment to purchase will be accepted until five business days after delivery of the disclosure statement and subscription information to the prospective purchaser in accordance with the requirements of this exemption.
- Any other information required by rule of the Commissioner [*Corp. Code § 25102(n)(5)(A)(v)*].
- The following legend: "For more complete information about _____ [*name of issuer*] and _____ [*full title of security*], send for additional information from _____ [*name and address*] by sending this coupon or calling _____ [*telephone number*]."

[c] Optional Information

The general announcement of proposed offering may also set forth the following information [*Corp. Code § 25102(n)(5)(B), (C)*]:

- A brief description of the business of the issuer.
- The geographic location of the issuer and its business.
- The price of the security to be issued, or, if the price is not known, the method of its determination or probable price range as specified by the issuer, and the aggregate offering price.

[d] Dissemination to Unqualified Purchasers

Dissemination of the general announcement of proposed offering to persons who are not qualified purchasers, without more, will not disqualify the issuer from claiming the exemption under *Corp. Code § 25102(n)* [*Corp. Code § 25102(n)(5)(D)*].

PRACTICE TIP:

This eliminates the risk that is present in offerings made under *Corp. Code § 25102(f)*, that an employee, broker-dealer or other finder hired by the issuer may inadvertently distribute information to non-qualified purchasers. The issuer must still exercise care to be certain that any disclosure statement or other information not permitted to be distributed under the general announcement rules is not distributed to non-qualified persons, unless the issuer reasonably believes that such persons are qualified purchasers. *Commentary by Frances E. Lossing*.

[8] Restriction on Telephone Solicitation

No telephone solicitation is permitted until the issuer has determined that the prospective purchaser to be solicited is a qualified purchaser under *Corp. Code § 25102(n)* [*Corp. Code § 25102(n)(6)*].

[9] Notices of Transaction and Payment of Filing Fee

[a] Timing of Filing of Notices of Transaction

The issuer must file a notice of transaction both (1) concurrent with the publication of the general announcement of proposed offering [*see* [7], *above*], or at the time of the initial offer of the securities, whichever occurs first, accompanied by a filing fee [*Corp. Code § 25102(n)(7)(A)*; *10 Cal. Code Reg. § 260.102.16*], and (2) within 10 business days following the close or the abandonment of the offering, but in no case more than 210 days from the date of filing the first notice [*Corp. Code § 25102(n)(7)(B)*].

The first notice of transaction must contain an undertaking, in a form acceptable to the Commissioner, to deliver to the Commissioner, within 10 days of the Commissioner's request for the information, any disclosure statement required by *Corp. Code § 25102(n)(4)* to be delivered to prospective purchasers, and any supplement to that statement [*Corp. Code § 25102(n)(7)*]. The form and instructions for filing the First Notice of Transaction are contained in *10 Cal. Code Reg. § 260.102.16(d)* [*see § 6D.202[2]* (form)]. The fee required by *Corp. Code § 25608(x)* (currently $600) must accompany the filing [*10 Cal. Code Reg. § 260.102.16(a)(1)*; *see also Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum fee set forth in *Corp. Code § 25608*)].

An issuer that is not a California corporation must also file a consent to service of process [*10 Cal. Code Reg. § 260.165* (form); *see Ch. 6H, Qualification of Securities, §§ 6H.239, 6H.240* (form)], unless they already have a consent to service on file with the Commissioner [*10 Cal. Code Reg. § 260.102.16(a)(1)*]. The filing should be accompanied with a

cover letter indicating that the filing is pursuant to *Corp. Code § 25102(n)*, and if a consent to service is not included, a statement that the issuer already has a consent to service on file with the Commissioner [*10 Cal. Code Reg. § 260.102.16(a)(1)*; *see § 6D.201* (form)].

The claim of exemption is available on the filing of the First Notice of Transaction and the payment of the filing fee, and terminates on the close or abandonment of the offering, but in no case more than 210 days from the date of the filing of the First Notice of Transaction [*10 Cal. Code Reg. § 260.102.16(a)(1)*].

A Second Notice of Transaction must be filed within 10 business days after the close or abandonment of the proposed offering, but in not case more than 210 days from the date of the filing of the First Notice of Transaction [*10 Cal. Code Reg. § 260.102.16(a)(2)*]. The form for the Second Notice of Transaction is also prescribed by regulation [*10 Cal. Code Reg. § 260.102.16(a)(1)*; *see § 6D.203[2]* (form)].

[b] Effect of Failure to File Notices or to Deliver Notice to Commissioner on Request

The exemption from qualification afforded by *Corp. Code § 25102(n)* is unavailable if the issuer fails to file the first notice or pay the filing fee. However, the failure to file the Second Notice of Transaction will not jeopardize the availability of the exemption [*10 Cal. Code Reg. § 260.102.16(c)*].

PRACTICE TIP:

If the issuer inadvertently fails to file the exemption notice as required by *Corp. Code § 25102(n)*, the issuer will need to consider the availability of other exemptions that do not require the filing of a notice, or exemptions, such as *Corp. Code § 25102(f)*, in which the failure to file the notice does not affect the availability of the exemption. *Commentary by Frances E. Lossing.*

The Commissioner has the authority to assess an administrative penalty of up to $1,000 against an issuer that fails to timely deliver the required notice on the Commissioner's request [*Corp. Code § 25102(n)(7)*].

PRACTICE TIP:

The Department of Corporations has taken the position that the filing of a notice of transaction will violate *Corp. Code § 25166* regarding the making of false statements to the Commissioner if in fact the claimed exemption cannot be established. The factual determinations that must be made under *Corp. Code § 25102(n)*, however, are much easier to make than factual determinations that must be made under other possible exemptions, such as *Corp. Code § 25102(f)*. There is therefore less risk of liability for judgment calls that the Commissioner may assert were inappropriate. *Commentary by Frances E. Lossing.*

[c] Where to File Notices

The offices for filing with the Department of Corporations are listed in Dept. of Corps. Release No. 13-G (Revised; June 10, 2004). According to that release, the notices required under *Corp. Code § 25102(n)* may be filed in any office of the Department of Corporations [applications and notices required by any law administered by the Commissioner are validly filed when received in any offices of Department]. The offices of the Department of Corporations are located at the following addresses [Dept. of Corps. Release No. 13-G (Revised; June 10, 2004)]:

320 West 4th Street, Suite 750
Los Angeles, CA 90013-2344
Telephone: (213) 576-7500

71 Stevenson Street, Suite 2100
San Francisco, CA 94105-2980
Telephone: (415) 972-8559

1515 K Street, Suite 200
Sacramento, CA 95814-4017
Telephone: (916) 445-7205

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsRegulation D ExemptionsSecurities LawInvestment CompaniesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6D California Legal Forms--Transaction Guide § 6D.24

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.24 Qualification of Government Purchasers Under 10 Cal. Code Reg. § 260.105.14

An exemption is also available for offers or sales of securities to the federal government, any agency or instrumentality of the federal government, any corporation wholly owned by the federal government, any state, any city, any city and county, or county or any agency or instrumentality of a state, city, city and county or county, or any state university or state college or any retirement system for the benefit of any of the employees of the foregoing [*10 Cal. Code Reg. § 260.105.14*]. No investment representation need be made. There are no filing requirements for claiming this exemption. It is therefore possible to combine this exemption with other exemptions that may be available.

PRACTICE TIP:

Governmental agencies should not be overlooked as a possible source of capital. There are a number of governmental programs available to small businesses. State universities and colleges sometimes have incubator funds available for local businesses. In addition, CALPERS has expressed interest in investing in California companies. *Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawGovernmental EmployeesCounty PensionsSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInvestment CompaniesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART II. LEGAL BACKGROUND

3-6D California Legal Forms--Transaction Guide §§ 6D.25- 6D.99

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

[Reserved]

§§ 6D.25[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6D California Legal Forms--Transaction Guide § 6D.100

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.100 Facts for Institutional Investor Exemption [Corp. Code § 25102(i)]

1. Information about issuer:

    a. Name, address of principal place of business, and telephone number of issuer.

    b. Date of organization.

    c. State of incorporation or formation.

2. Title of class or classes of securities to be sold in the transaction.

3. Type of filing under Securities Act of 1933, if applicable.

4. Date of issuance of outstanding or proposed stock.

5. Plans for advertising or otherwise promoting the stock.

6. Price per share for which stock is to be issued.

7. Whether each purchaser will be one of the following:
    NOTE: The exemption for purchasers qualifying under *Corp. Code § 25102(i)* does not require the issuer to file any forms or notices. However, the issuer must ensure that the purchaser meets the requirements of *Corp. Code § 25102(i)* and *10* Cal. Code Reg. § 260.102.10 by obtaining the following information listed below.

a. Bank.

b. Savings and loan association.

c. Trust company.

d. Insurance company.

e. Investment company registered under the Investment Company Act of 1940.

f. Pension or profit-sharing trust (which is not a pension or profit-sharing trust of the issuer, a self employed individual retirement plan, or individual retirement account).

g. Organization described in *I.R.C. § 501(c)(3)* that has total assets of not less than $5 million.

h. Corporation with outstanding securities registered under Section 12 of Securities Exchange Act of 1934 [*15 U.S.C. § 78l*] or any wholly owned subsidiary of such a corporation that after offer and sale will own directly or indirectly 100 percent of outstanding capital stock of issuer, which is purchasing for its own account or trust account for investment and not with a view to or for sale in connection with any distribution of security.

i. Corporations with net worth of $14 million, or wholly owned subsidiary of such a corporation.

8. Full description of issuer's past or contemplated offerings (including abandoned offerings) which are or may be related in any way to the proposed offering, including information regarding:

a. Classes of securities.

b. Dates of offerings.

c. Plans of financing.

d. Consideration.

e. Purposes of offerings.

f. Any methods of qualification.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInvestment CompaniesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6D California Legal Forms--Transaction Guide § 6D.101

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.101 Facts for Qualified Purchaser Exemption [Corp. Code § 25102(n)]

1. Information about issuer:

    a. Name, address of principal place of business, and telephone number of issuer.

    b. Date of organization.

    c. State of incorporation or formation.

    d. Property, payroll, and sales factors for California franchise tax purposes.

    e. Whether or not issuer is either:
    (1) "Blind pool" syndicate [*see § 6D.23[2]*]; or

    (2) Investment company under Investment Company Act of 1940.

2. Title of class or classes of securities to be sold in the transaction.

3. Type of filing under Securities Act of 1933, if applicable.

4. Date of issuance of outstanding or proposed stock.

5. Plans for advertising or otherwise promoting the stock.

6. Price per share for which stock is to be issued.

7. Purpose of offering, including sufficient information to determine that offering is not "roll-up transaction."

8. Whether each purchaser will be one of the following [*Corp. Code § 25102(n)(2)*]:

a. Person designated in *10 Cal. Code Reg. § 260.102.13*, which lists purchasers excluded from purchaser count for purposes of limited offering exemption under *Corp. Code § 25102(f)* [*see* Ch. 6B, *California Limited Offering Exemptions*].

NOTE: Disclosure statements must be provided to each natural person purchaser at least five business days before the securities are sold to the purchaser, unless all purchasers fall within *10 Cal. Code Reg. § 260.102.13* [*Corp. Code § 25102(n)(4)*; ***see*** *§§ 6D.23[6], 6D.111*, P 6].

b. Person designated in *Corp. Code § 25102(i)* or any Commissioner's rule adopted thereunder.

c. One of the following, provided that its investment decisions are made solely by persons who are "qualified purchasers":

(1) Pension or profit-sharing trust of issuer; or

(2) Self-employed individual retirement plan or an individual retirement account.

d. One of the following, with total assets in excess of $5,000,000 according to its most recent audited financial statements:

(1) Organization described in *I.R.C. § 501(c)(3)*;

(2) Corporation;

(3) Massachusetts or similar business trust; or

(4) Partnership.

e. If offer and sale will be of one class of issuer's voting common stock or preferred stock entitling holder to at least same voting rights as issuer's one class of voting common stock, and issuer will have only one class of voting common stock outstanding on consummation of offer and sale, a natural person who, either individually or jointly with person's spouse, meets following requirements [*Corp. Code § 25102(n)(2)(E)*; *see* Commissioner's Opinion No. 99/1C (concluding that exemption under *Corp. Code § 25102(n)* may not be relied on by limited liability company if it offers or sells membership interest to "qualified purchasers" as defined in *Corp. Code § 25102(n)(2)(E)*, as membership interest in LLCs are not "stock")]:

(1) Meets financial criteria in *either* P (a) or (b), *below*:
(a) Meets all of following criteria:
(i) Has a minimum net worth of $250,000;

(ii) Had, during immediately preceding tax year, gross income in excess of $100,000; and

(iii) Reasonably expects gross income in excess of $100,000 during current tax year.

(b) Has minimum net worth of $500,000.

NOTE: "Net worth" is determined exclusive of home, home furnishings, and automobiles. Other assets included in the computation of net worth may be valued at fair market value [*Corp. Code § 25102(n)(2)(E)*].

(2) Purchaser, by reason of business or financial experience or business or financial experience of purchaser's professional adviser (who must be unaffiliated with and not compensated directly or indirectly by issuer, affiliate, or selling agent of issuer), can be reasonably assumed to have capacity to protect purchaser's interests in connection with transaction.

(3) Investment will not exceed 10 percent of person's net worth.

f. Corporation, partnership or other organization specifically formed for purpose of acquiring the securities in which each of its equity owners is a "qualified purchaser" under one of criteria listed in PP a-e, *above*.

9. Whether each purchaser will be able to represent that it is purchasing for purchaser's own account (or trust account, if purchaser is a trustee), not with a view to or for sale in connection with a distribution of security [*Corp. Code § 25102(n)(3)*].

10. Full description of issuer's past or contemplated offerings (including abandoned offerings) which are or may be related in any way to the proposed offering, including information regarding:

a. Classes of securities.

b. Dates of offerings.

c. Plans of financing.

d. Consideration.

e. Purposes of offerings.

f. Any methods of qualification.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInvestment CompaniesDistribution, Redemption & Repurchase of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6D California Legal Forms--Transaction Guide § 6D.102

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.102 Facts for Government Purchaser Exemption [10 Cal. Code Reg. § 260.105.14]

1. Information about issuer:

    a. Name, address of principal place of business, and telephone number of issuer.

    b. Date of organization.

    c. State of incorporation or formation.

2. Title of class or classes of securities to be sold.

3. Type of filing under Securities Act of 1933, if applicable.

4. Date of issuance of outstanding or proposed stock.

5. Plans for advertising or otherwise promoting stock to be offered.

6. Price per share for which stock is to be issued.

7. Verification that all offerees and purchasers fall within one or more of the following categories [*10 Cal. Code Reg. § 260.105.14*]:

    NOTE: The exemption for purchasers qualifying under *10 Cal. Code Reg. § 260.105.14* does not require the issuer to file any forms or notices. However, the issuer must ensure that the purchaser meets the requirements by obtaining the following information.

a. Federal government.

b. Any agency or instrumentality of federal government.

c. Any corporation wholly owned by federal government.

d. Any state.

e. Any city, any city and county, or county.

f. Any agency or instrumentality of a state, city, city and county, or county.

g. Any state university or state college.

h. Any retirement system for benefit of any employees of any entity listed in PP a-g, *above*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Pensions & Benefits LawGovernmental EmployeesCounty PensionsSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInvestment CompaniesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6D California Legal Forms--Transaction Guide §§ 6D.103- 6D.109

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

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§§ 6D.103[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Compliance With Qualified Purchaser Exemptions

3-6D California Legal Forms--Transaction Guide § 6D.110

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.110 Conducting Transaction Under Institutional Investor Exemption [Corp. Code § 25102(i)]

1. Restrict sales of security to purchasers enumerated in *Corp. Code § 25102(i)*, as listed in § 6D.100, P 7.

NOTE: For questions about qualification of purchasers under *Corp. Code § 25102(i)*, see *§ 6D.22*, which include reference to relevant Releases and Opinions of the Corporations Commissioner.

2. Obtain each purchaser's representation that it is purchasing for its own account (or for the trust account) for investment, and not with a view to or for sale in connection with any distribution of the security [*Corp. Code § 25102(i)*; *see § 6D.210[2]* (form)].

NOTE: The requirement that the purchaser represent that the purchase is for its own account (or trust account) and not with a view to or for sale in connection with any distribution of the security applies to every purchaser for which exemption is sought under this section, and is not limited to corporate purchasers [*Corp. Code § 25102(i)*; ***see also*** Marsh & Volk, *PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, ch. 4, **General Exemptions from Qualification**, § 4.04* (Matthew Bender)]. The Commissioner has stated that the representation that the purchaser is purchasing for its own account (or the trust account) must be true at the time the securities are issued [Commissioner's Opinion No. 71/11C (Feb. 24, 1971)].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Compliance With Qualified Purchaser Exemptions

3-6D California Legal Forms--Transaction Guide § 6D.111

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.111 Conducting Transaction Under Qualified Purchaser Exemption [Corp. Code § 25102(n)]

1. Ascertain that the issuer is either:

a. Corporation, partnership, trust, or other business entity organized under California law [*Corp. Code § 25102(n)(1)(A)*]; or

b. Foreign corporation subject to *Corp. Code § 2115*.
NOTE: *Corp. Code § 2115* is the basic California statute governing application of California law to foreign corporations. For discussion of *Corp. Code § 2115*, see Ch. 12B, ***Foreign Corporations and Associations*** .

2. Confirm that issuer is not "blind pool" issuer or investment company subject to Investment Company Act of 1940 [*Corp. Code § 25102(n)(1)(B)*].

NOTE: The term "blind pool issuer" refers to a company that is a development stage company and either does not have a specific business plan or purpose or has indicated that its business plan is to engage in mergers and acquisitions with unidentified other entities. The term "company" is used in a generic and comprehensive sense to include individuals, partnerships, corporations, and other forms of organization of an enterprise [*10 Cal. Code Reg. §§ 260.102.16(b), 260.113.1(b)*1].

3. Make reasonable inquiry to ascertain that each prospective purchaser is "qualified purchaser" under *Corp. Code § 25102(n)(2)*, as listed in § 6D.101, P 7 [*see §§ 6D.204-6D.206* (forms)].

NOTE: A corporation, partnership, or other organization specifically formed for the purpose of acquiring the securities offered by the issuer in reliance on this exemption may be a qualified purchaser if each of the equity owners of the corporation, partnership, or other organization is a qualified purchaser [*Corp.*

Code § 25102(n)(2)].

The *forms in §§ 6D.204-6D.206* may be used to obtain each prospective purchaser's representation that the prospective purchaser is a "qualified purchaser." The *form in § 6D.204[2]* is designed for use with institutional investors. The *form in § 6D.205[2]* is designed for use with investors who are natural persons, and also contains the representations required under P 4, ***below***. The *form in § 6D.206[2]* is for use with a qualified purchaser that qualifies on the basis of its equity owners.

4. For each purchaser or prospective purchaser who is a natural person, ascertain that [*Corp. Code § 25102(n)(2)(E)*; *see § 6D.205[2]*]:

NOTE: Investors who do not meet the following criteria may still be able to qualify under a number of other exemptions.

a. Person has requisite business and financial experience, or has an experienced professional advisor who is not compensated in any way by issuer [*see § 6D.23[5]*].

b. Investment will not exceed 10 percent of person's net worth [*see § 6D.23[6]*].

5. Obtain each purchaser's or prospective purchaser's representation that [*Corp. Code § 25102(n)(3)*; *see §§ 6D.204-6D.206* (forms)].

a. Purchaser is purchasing for purchaser's own account (or trust account, if purchaser is trustee); and

b. Purchaser is not purchasing with a view to or for sale in connection with a distribution of security.

NOTE: An offer to resell or a resale made under *10 Cal. Code Reg. § 260.105.13.1* is not inconsistent with the required purchaser representation of *Corp. Code § 25102(n)(3)* [*10 Cal. Code Reg. § 260.102.18*].

6. Prepare written offering disclosure statement if any purchasers are natural persons, including any corporation, partnership or other organization specifically formed by natural persons for purpose of acquiring the securities offered by issuer, unless natural persons are "qualified purchasers" under *10 Cal. Code Reg. § 260.102.13* [*Corp. Code § 25102(n)(4)*].

a. Include following information in written offering disclosure statement [*17 C.F.R. § 230.502(b)(2)*; *see Corp. Code § 25102(n)(4)*; *10 Cal. Code Reg. § 260.102.17*]:

NOTE: The Commissioner has not published a preprinted form for the written offering disclosure statement. The contents of the statement are governed by *Corp. Code § 25102(n)(4)* and *10* Cal. Code Reg. § 260.102.17. The latter regulation specifies that the information required in an offering of securities that is exempt under *Corp. Code § 25102(n)(4)* and also exempt from federal registration under Rule 504 of SEC Regulation D [*17 C.F.R. § 230.504*; ***see*** Ch. 6A, ***Federal Securities Exemptions for California Nonpublic Corporations***] will be the information required under Rule 502(b)(2) of Regulation D [*17 C.F.R. § 230.502(b)(2)*]. That information is itemized below.

Because the required information is very specific to each individual corporation, a sample form for the written offering disclosure statement is not included in this chapter. However, the information below will serve as a guide to the basic information that must be included in the written offering disclosure statement. For detailed content the reader will need to refer to the Code of Federal Regulations provisions cited below; for further

discussion, see Ch. 6A, ***California Securities Exemptions for Nonpublic Corporations*** .

(1) If issuer is not subject to reporting requirements of Sections 13 or 15(d) of federal Securities Exchange Act [*15 U.S.C. §§ 78m, 78o(d)*], include the following, to extent material to an understanding of issuer, its business, and securities being offered:

(a) Non-financial statement information:

(i) If the issuer is eligible to use Regulation A [*17 C.F.R. §§ 230.251-230.263*; *see* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*], include same kind of information that would be required in Part II of SEC Form 1-A [*17 C.F.R. § 239.90*; *see Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.200[2]*].

(ii) If issuer is not eligible to use Regulation A, include same kind of information as required in Part I of a registration statement filed under federal Securities Act, on form that issuer would be entitled to use.

(b) Financial statement information:

(i) For offerings up to $2 million, include information required in Item 310 of SEC Regulation S-B [*17 C.F.R. § 228.310*], except that only issuer's balance sheet, which must be dated within 120 days of start of offering, must be audited.

NOTE: If an issuer, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which must be dated within 120 days of the start of the offering, must be audited. If the issuer is a limited partnership and cannot obtain the required financial statements without unreasonable effort or expense, it may furnish financial statements that have been prepared on the basis of Federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant [*17 C.F.R. § 230.502(b)(2)(i)(B)(2)*].

These rules also apply to offerings over $7.5 million [*17 C.F.R. § 230.502(b)(2)(i)(B)(3)*; ***see*** P (ii), ***below***].

(ii) For offerings over $7.5 million, include financial statement that would be required in a registration statement filed under the Federal Securities Act of 1933, on form that issuer would be entitled to use.

(c) If issuer is foreign private issuer eligible to use Form 20-F [*17 C.F.R. § 249.220f*], include same kind of information required to be included in a registration statement filed under federal Securities Act on form that issuer would be entitled to use.

NOTE: The financial statements need be certified only to the extent required in P (b), ***above*** [*17 C.F.R. § 230.502(b)(2)(i)(C)*].

(2) If issuer is subject to reporting requirements of Sections 13 or 15(d) of federal Securities Exchange Act [*15 U.S.C. §§ 78m, 78o(d)*], include:

(a) Either:

(i) Issuer's annual report to shareholders for most recent fiscal year, if report meets

requirements of *17 C.F.R. § 240.14a-3* or *240.14c-3* under federal Securities Exchange Act, definitive proxy statement filed in connection with that annual report and, if requested by purchaser in writing, a copy of issuer's most recent Form 10-K and Form 10-KSB [*17 C.F.R. § 249.310*]; or

(ii) Information contained in an annual report on Form 10-K [*17 C.F.R. § 249.310*] or in a registration statement on Form S-1 [*17 C.F.R. § 239.11*], or S-11 [*17 C.F.R. § 239.18*], or on Form 10 [*17 C.F.R. § 249.210*], whichever filing is most recent required to be filed.

(b) Information contained in any reports or documents required to be filed by issuer under Sections 13(a), 14(a), 14(c), and 15(d) of federal Securities Exchange Act [*15 U.S.C. §§ 78m(a), 78n(a), (c), 78o(d)*] since distribution or filing of report or registration statement specified in P (a)(i) or (ii), *above*, and a brief description of securities being offered, use of proceeds from offering, and any material changes in issuer's affairs that are not disclosed in documents furnished.

(c) If issuer is foreign private issuer, issuer may provide, in lieu of information specified in P (a)(i) or (ii), *above*, the information contained in its most recent filing on Form 20-F or Form F-1 [*17 C.F.R. § 239.31*].

(3) Brief description of any material written information concerning offering that has been provided by issuer to any accredited investor but not previously delivered to unaccredited purchaser.

(4) Statement of procedures by which purchasers will be given opportunity to ask questions and receive answers concerning terms and conditions of offering and to obtain any additional information that issuer possesses or can acquire without unreasonable effort or expense that is necessary to verify accuracy of other information furnished.

(5) For business combinations or exchange offers, in addition to information required by Form S-4 [*17 C.F.R. § 239.25*], include at time plan is submitted to security holders, or, with an exchange, during course of transaction and prior to sale, written information about any terms or arrangements of proposed transactions that are materially different from those for all other security holders.

(6) Specify limitations on resale of securities.

b. Give statement to each such natural person purchaser.

NOTE: It is not necessary to give the disclosure statement to natural persons who are accredited investors or are otherwise qualified purchasers under *10 Cal. Code Reg. § 260.102.13*, which lists those purchasers excluded from purchaser count for purposes of limited offering exemption under *Corp. Code § 25102(f)* [*Corp. Code § 25102(n)(4)*; for discussion of *10 Cal. Code Reg. § 260.102.13*, ***see*** Ch. 6B, ***California Limited Offering Exemptions***].

c. Make certain that each natural person purchaser will receive disclosure statement at least five business before the securities are sold to, or a commitment to purchase is accepted from, that purchaser.

7. Prepare general written announcement of proposed offering, if one will be used [*see § 6D.200[2]* (form)].

a. Include following mandatory information [*Corp. Code § 25102(n)(5)(A)*]:

(1) Name of issuer.

(2) Full title of security to be issued.

(3) Anticipated suitability standards for prospective purchasers.

(4) Statement that:
(a) No money or other consideration is being solicited or will be accepted, and

(b) An indication of interest made by a prospective purchaser involves no obligation or commitment of any kind.

(5) If issuer is required to deliver disclosure statement to prospective purchasers [*see* P 6, *above*], statement that no sales will be made or commitment to purchase accepted until five business days after delivery of disclosure statement and subscription information to prospective purchaser.

(6) The following legend: "For more complete information about _____ [*name of issuer*] and _____ [*full title of security*], send for additional information from _____ [*name and address*] by sending this coupon or calling _____ [*telephone number*]."

b. If desired, include following optional information only; do not include any other information:

(1) Brief description of issuer's business.

(2) Geographic location of issuer and its business.

(3) Price of security to be issued or, if price is not known, method for determining price or probable price range as specified by issue, and aggregate offering price.

c. Publish general announcement of proposed offering in form of written document only.
NOTE: Dissemination of the general announcement of proposed offering to persons who are not qualified purchasers, without more, will not disqualify the issuer from claiming the exemption under *Corp. Code § 25102(n)* [*Corp. Code § 25102(n)(5)(D)*].

8. Instruct issuer not to make or allow any telephone solicitation until it has determined that prospective purchaser to be solicited is a qualified purchaser under *Corp. Code § 25102(n)* [*Corp. Code § 25102(n)(6)*].
NOTE: An issuer may have its broker-dealer make the determination as to whether or not the prospective investor is qualified [Commissioner's Opinion No. 96/2C (Oct. 17, 1996)]. However, as the statute requires that the issuer reasonably believe the purchaser to be qualified purchasers, the ultimate responsibility always lies with the issuer [Commissioner's Opinion No. 96/2C (Oct. 17, 1996)]. Although an issuer may contract with the broker-dealer to perform the necessary due diligence to determine whether potential investor is a qualified purchase, the issuer will remain responsible for that determination under *Corp. Code § 25102(n)* [Commissioner's Opinion No. 96/2C (Oct. 17, 1996)].

9. Prepare and file First Notice of Transaction [*Corp. Code § 25102(n)(7)(A)*; *10 Cal. Code Reg. § 260.102.16*].
NOTE: The claim of exemption is available on the filing of the First Notice of Transaction and payment of the filing fee, and terminates on the close or abandonment of the offering, but in no case more than 210 days from the date of the filing of the First Notice of Transaction [*10 Cal. Code Reg. § 260.102.16(a)(1)*].

a. Complete notice of transaction form [*see § 6D.202[2]*; *see also 10 Cal. Code Reg. § 260.102.16(d)*].

b. File First Notice of Transaction concurrently with earlier of:

(1) Publication of general announcement of proposed offering [*see* P 7, *above*]; or

(2) At time of initial offer of the securities.

c. Include filing fee of $600 [*Corp. Code §§ 25102(n)(7)(A), 25608(x)*; *10 Cal. Code Reg. § 260.102.16(a)(1)*; *see also* Corp. Code § 25608.3 (Commissioner may set fee at amount below maximum fee set forth in *Corp. Code § 25608*)].

NOTE: The issuer will lose the exemption under *Corp. Code § 25102(n)* if the issuer fails to file the first notice or pay the filing fee [*10 Cal. Code Reg. § 260.102.16(c)*].

d. If issuer is not a California corporation and does not already have a consent to service of process [*see Ch. 6H, Qualification of Securities, §§ 6H.239, 6H.240*] on file with Commissioner, file that consent at time of filing First Notice of Transaction [*10 Cal. Code Reg. § 260.102.16(a)(1)*].

e. Accompany filing with cover letter [*see § 6D.201[2]*] indicating that filing is pursuant to *Corp. Code § 25102(n)*, and if a consent to service is not included [*see* P d, *above*], add statement that issuer already has a consent to service on file with the Commissioner [*10 Cal. Code Reg. § 260.102.16(a)(1)*].

f. File notice in any office of Department of Corporations [Dept. of Corps. Release No. 13-G (Revised; June 10, 2004); *see § 6D.23[9][c]* (current addresses of Department offices)].

10. Prepare and file Second Notice of Transaction [*Corp. Code § 25102(n)(7)(B), 10 Cal. Code Reg. § 260.102.16(a)(2)*].

a. Complete notice of transaction form [*see § 6D.203[2]*; *see also 10 Cal. Code Reg. § 260.102.16(e)*].

NOTE: Although the issuer will lose the exemption under *Corp. Code § 25102(n)* if the issuer fails to file the first notice or pay the filing fee, the failure to file the Second Notice of Transaction will not jeopardize the availability of the exemption [*10 Cal. Code Reg. § 260.102.16(c)*].

b. File Second Notice of Transaction either [*10 Cal. Code Reg. § 260.102.16(a)(2)*]:

(1) Within 10 business days after close or abandonment of offering, but

(2) In any case, no more than 210 days from date of filing First Notice of Transaction

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsRegulation D ExemptionsSecurities LawInvestment CompaniesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Compliance With Qualified Purchaser Exemptions

3-6D California Legal Forms--Transaction Guide §§ 6D.112- 6D.199

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

[Reserved]

§§ 6D.112[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART IV. FORMS
A. Qualified Purchaser Exemption [Corp. Code § 25102(n)]

3-6D California Legal Forms--Transaction Guide § 6D.200

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.200 General Announcement of Proposed Offering Under Qualified Purchaser Exemption Under Corp. Code § 25102(n)

[1] Comment

[a] Use of Form

This form is a sample General Announcement of Proposed Offering under the qualified purchaser exemption in *Corp. Code § 25102(n)*. The issuer is not required to publish such an announcement, but if it chooses to do so, the announcement may be published by written document only [*Corp. Code § 25102(n)(5)(A)*]. The announcement must contain specified information [*Corp. Code § 25102(n)(5)(A)*; *see* [b], *below*], and may also contain certain specified optional information [*Corp. Code § 25102(n)(5)(B)*; *see* [c], *below*]. The announcement may contain *only* that mandatory and optional information [*Corp. Code § 25102(n)(5)(C)*].

Because the facts of each offering will vary, the format of this form is necessarily somewhat general.

PRACTICE TIP:

The general announcement concept in *Corp. Code § 25102(n)(5)* is similar to the concept of communications not deemed a prospectus under SEC Rule 134 [*17 C.F.R. § 230.134*]. It should not be necessary, however, to limit the general announcement to information permissible under SEC Rule 134 if the aggregate offering price of the securities does not exceed $5 million. In this case, the offering would be exempt under SEC Rule 1001 [*see 17 C.F.R. § 230.1001*]. *Commentary by Frances E. Lossing.*

[b] Mandatory Information

A general announcement of proposed offering is permissible if it contains only the following [*Corp. Code § 25102(n)(5)(A)*]:

- The name of the issuer of the securities.

- The full title of the security to be issued.

- The anticipated suitability standards for prospective purchasers. This form uses the statutory standards specified for "qualified purchasers" specified in *Corp. Code § 25102(n)(2)*. These standards should not be expanded beyond those appearing in this form, but they may be more restrictive if the issuer so desires.

- A statement that:

    - No money or other consideration is being solicited or will be accepted;

    - An indication of interest made by a prospective purchaser involves no obligation or commitment of any kind; and

    - If the issuer is required to deliver a written offering disclosure statement to prospective purchasers [*see § 6D.23[6]*], that no sales will be made or commitment to purchase will be accepted until five business days after delivery of the disclosure statement and subscription information to the prospective purchaser in accordance with the requirements of this exemption.

- Any other information required by rule of the Commissioner [*Corp. Code § 25102(n)(5)(A)(v)*]. To date, the Commissioner has not imposed any additional requirements.

- The following legend: "For more complete information about _____ [*name of issuer*] and _____ [*full title of security*], send for additional information from _____ [*name and address*] by sending this coupon or calling _____ [*telephone number*]."

[c] Optional Information

The general announcement of proposed offering may also set forth the following information [*Corp. Code § 25102(n)(5)(B)*]:

- A brief description of the business of the issuer.

- The geographic location of the issuer and its business.

- The price of the security to be issued, or, if the price is not known, the method of its determination or probable price range as specified by the issuer, and the aggregate offering price.

[2] FORM

General Announcement of Proposed Offering Under Qualified Purchaser Exemption Under Corp. Code § 25102(n)

General Announcement of Proposed Offering Under *Corporations Code Section 25102(n)*

_____ [*date*]

Name of Issuer: _____

Security to be issued: _____

Suitability standards for prospective purchasers: Sales of these securities will be made only to qualified purchasers. A corporation, partnership, or other organization specifically formed for the purpose of acquiring these securities may be a qualified purchaser if each of the equity owners of the corporation, partnership, or other organization is a qualified purchaser. Qualified purchasers include those coming within one or more of the following categories:

1. Any person designated in *Title 10, Section 260.102.13 of the California Code of Regulations*, specifically,

a. The trustee of an issuer which is a trust and the general partner of an issuer which is a partnership, who exercises managerial functions with respect to such entities, and any officer, director or general partner of a general partner of an issuer which is a partnership.

b. Any person who occupies a position with the issuer, or with a general partner of an issuer which is a partnership, with duties and authority substantially similar to those of an executive officer of a corporation.

c. Any of the following:
(1) Any relative, spouse or relative of the spouse of a purchaser who has the same principal residence as the purchaser.

(2) Any trust or estate in which a purchaser and any of the persons related to such purchaser as specified in (1), above, or (3), below collectively have more than 50 percent of the beneficial interest (excluding contingent interests).

(3) Any corporation or other organization of which a purchaser and any of the persons related to that purchaser as specified in (1) or (2), above, collectively are beneficial owners of more than 50 percent of the equity securities (excluding director's qualifying shares) or equity interests. "Relative" means a person related by blood, marriage or adoption.

d. Any individual who is a "promoter" of the issuer, as defined in *Title 10, Section 260.102.12(f) of the California Code of Regulations.* The term "promoter" means a person who, acting alone or in conjunction with others, takes the initiative in founding and organizing the business or enterprise of an issuer.

e. Any person who purchases $150,000 or more of the securities offered in the transaction, provided each such purchaser meets either one of the following, or who the issuer reasonably believes comes within either of the following:

(1) That person, or that person's professional advisor, has the capacity to protect that person's own interests in connection with the transaction, as provided in *Corporations Code Section 25102(f)(2)*.

(2) The investment (including mandatory assessments) does not exceed 10 percent of

that person's net worth or joint net worth with that person's spouse.

f. A small business investment company licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Company Act of 1958, and a business development company as defined in Section 2(a)(48) of the Investment Company Act of 1940, and a private business development company as defined in Section 202(a)(22) of the Investment Advisors Act of 1940.

g. A person who comes within one of the categories of an "accredited investor" in Rule 501(a) of Regulation D adopted by the Securities and Exchange Commission under the Securities Act of 1933 [*17 C.F.R. § 230.501(a)*].

h. Any entity in which all of the equity owners are persons specified in *Corporations Code Section 25102(i)*, or *Title 10, Section 260.102.10 of the California Code of Regulations*; or Title 10, Section 260.102.13(a), (b), (c), (d), (f) and (g) of the California Code of Regulations; or who are "officers, directors or affiliates of the issuer" as that term is used in *Corporations Code Section 25102(f)*.

2. Any person designated in *Corporations Code Section 25102(i)*, specifically,

a. Any bank, savings and loan association, trust company, insurance company, investment company registered under the Investment Company Act of 1940, pension or profit-sharing trust (other than a pension or profit-sharing trust of the issuer, a self-employed individual retirement plan, or individual retirement account), or other institutional investor or governmental agency or instrumentality that the commissioner has designated by rule, whether the purchaser is acting for itself or as trustee.

b. Any corporation with outstanding securities registered under Section 12 of the Securities Exchange Act of 1934, or any wholly owned subsidiary of such a corporation, that after the offer and sale will own directly or indirectly 100 percent of the outstanding capital stock of the issuer; provided the purchaser represents that it is purchasing for its own account (or for the trust account) for investment and not with a view to or for sale in connection with any distribution of the security.

3. A pension or profit-sharing trust of the issuer, a self-employed individual retirement plan, or an individual retirement account, if the investment decisions made on behalf of the trust, plan, or account are made solely by persons who are qualified purchasers.

4. An organization described in *Internal Revenue Code Section 501(c)(3)*, corporation, Massachusetts or similar business trust, or partnership, each with total assets in excess of $5 million according to its most recent audited financial statements.

5. Any investor designateed in *Title 10, Section 260.102.10 of the California Code of Regulations*, specifically,

a. Any organization described in *Internal Revenue Code Section 501(c)(3)*, as amended December 29, 1981, that has total assets (including endowment, annuity and life income funds) of not less than $5 million according to its most recent audited financial statement.

b. Any corporation that has a net worth on a consolidated basis according to its most recent audited financial statement of not less than $14 million [*if securities are common stock of a corporation or securities exchangeable for or convertible into common stock of a corporation, add the following unless either (1) the securities are offered pro rata to the holders of the outstanding common shares; (2) the transaction is approved by the holders of 75 percent or more of the outstanding common shares; or (3)*

there are no common shares or securities convertible into common shares outstanding prior to the transaction:; provided that (1) the holders of less than 25 percent of the outstanding shares of that common stock (computed as provided in *Corporations Code Section 25103(d)*, but deeming outstanding all shares of common stock issuable upon exchange or conversion of securities presently exchangeable for or convertible into common stock) have addresses in California according to the records of the issuer of that common stock as of the most recent record date of the issuer for any action requiring the determination of shareholders of record, or as of three months prior to the offer or sale, whichever is most recent; or (2) the securities (plus any other similar securities held by the purchaser) will not represent more than five percent of the total number of outstanding shares of common stock of the issuer assuming the exchange or conversion of all securities exchangeable for or convertible into common stock (unless all such shares of common stock are owned by corporations meeting the net worth test of this subsection (b)].

c. Any wholly owned subsidiary of any institutional investor designated in *Corporations Code Section 25102(i)* (see paragraph 2, above) or in this paragraph.

[*Include the following only if security being offered is one class of voting common stock of issuer, or preferred stock entitling holder to at least the same voting rights as issuer's one class of voting common stock, provided that issuer will have only one-class voting common stock outstanding upon consummation of the offer and sale:*]

6. A natural person who, either individually or jointly with the person's spouse, (i) has a minimum net worth of $250,000 and had, during the immediately preceding tax year, gross income in excess of $100,000 and reasonably expects gross income in excess of $100,000 during the current tax year; or (ii) has a minimum net worth of $500,000. "Net worth" will be determined exclusive of home, home furnishings, and automobiles. Other assets included in the computation of net worth may be valued at fair market value. Each natural person specified above, by reason of his or her business or financial experience, or the business or financial experience of his or her professional advisor, who is unaffiliated with and who is not compensated, directly or indirectly, by the issuer or any affiliate or selling agent of the issuer, must be reasonably assumed to have the capacity to protect his or her interests in connection with the transaction. The amount of the investment of each natural person may not exceed 10 percent of the net worth, as determined by this paragraph, of that natural person.

[*Continue with the following:*]

No money or other consideration is being solicited or will be accepted at this time. An indication of interest made by a prospective purchaser involves no obligation or commitment of any kind. [*If issuer is required to deliver a written offering disclosure statement to prospective purchasers, add:* No sales will be made or commitment to purchase accepted until five business days after delivery of a disclosure statement and subscription information to the prospective purchaser in accordance with the requirements of *Corporations Code Section 25102(n)*].

For more complete information about _____ [*name of issuer*] and _____ [*full title of security*], send for additional information from_____ [*name and address*] by sending this coupon or calling _____ [*telephone number*].

[*The remaining information in this form is optional and may be omitted if desired:*]

Issuer's Business: _____ [*Issuer's name*], the issuer of these securities, is engaged in the business of _____ _____ [*describe briefly*]. _____ [*issuer's name*] is located in _____ [*geographic location*] and does business in _____ [*geographic locations of issuer's business*].

Price of Securities: The securities described above will be offered at the price of _____ [*state price, if known, e.g.*, $25.00 per share *or, if price is not known, state method for determination or probable price range as specified by issuer*]. The aggregate amount of this offering is _____ [*specify aggregate offering price, e.g.*, $5 million].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART IV. FORMS
A. Qualified Purchaser Exemption [Corp. Code § 25102(n)]

3-6D California Legal Forms--Transaction Guide § 6D.201

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.201 Cover Letter Accompanying First Notice of Transaction for Qualified Purchaser Exemption Under Corp. Code § 25102(n)

[1] Comment

[a] Use of Form

This form is a cover letter to accompany the filing of a First Notice of Transaction under the qualified purchaser exemption provided by *Corp. Code § 25102(n)*. It is designed to accompany the First Notice of Transaction *set out in § 6D.202[2]*. The Commissioner's regulations state that a first notice of transaction "should be accompanied" by a cover letter indicating that the filing is pursuant to *Corp. Code § 25102(n)* [*10 Cal. Code Reg. § 260.102.16(a)(1)*]. For discussion of the time frame for filing the First Notice of Transaction, see *§§ 6D.23[9][a]*, *6D.202*].

The regulations do not indicate that a cover is needed for filing the Second Notice of Transaction [*10 Cal. Code Reg. § 260.102.16(a)(2)*; *see § 6D.203*]. However, if such a cover letter is desired, this form may be modified to serve that purpose.

[b] Filing

This letter, the first notice of transaction, the consent to service, if required, and the $600 filing fee [*see Corp. Code § 25608(x)*; *see also Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum fee set forth in *Corp. Code § 25608*)] must be filed with the Department of Corporations. Checks should be made payable to the "Department of Corporations" and need not be certified [*10 Cal. Code Reg. § 250.15*]. The notices required under *Corp. Code § 25102(n)* may be filed in any office of the Department of Corporations [*see* Dept. of Corps. Release No. 13-G (Revised; June 10, 2004)]. The current addresses of the Department's offices are listed in § 6D.23[9][c].

[c] Consent to Service of Process

An issuer that is not a California corporation must file a consent to service of process [*10 Cal. Code Reg. § 260.165* (form); *see Ch. 6H, Qualification of Securities, §§ 6H.239, 6H.240* (form)], unless the issuer already has a consent to service on file with the Commissioner [*10 Cal. Code Reg. § 260.102.16(a)(1)*]. If a consent to service is not included, the cover letter should include a statement that the issuer already has a consent to service on file with the Commissioner [*10 Cal. Code Reg. § 260.102.16(a)(1)*].

[2] FORM

[*Attorney's letterhead*]

_____ [*date*]

Department of Corporations
_____ [*address of office where notice is being filed*]

Re: Filing of First Notice of Transaction Pursuant to *Corporations Code § 25102(n)*

Dear Sir/Madam:

The enclosed materials are submitted for filing pursuant to *Corporations Code § 25102(n)* by _____ [*name of issuer*], a _____ [*state of incorporation, e.g.,* California *or* Delaware *or other place of incorporation*] _____ [corporation *or specify other form of business entity, e.g.,* limited partnership]:

1. First Notice of Transaction Pursuant to *Corporations Code Section 25102(n).*

2. A check in the amount of $600, payable to the Department of Corporations, in payment of the filing fee as specified in *Corporations Code Section 25608(x).*

[*If issuer is an entity other than a California corporation and does not have a consent to service of process on file with the Commissioner, add:*]

3. A Consent to Service of Process (Form 260.165) by

_____ [*name of issuer*]

[*Or, if issuer is an entity other than a California corporation and already has a consent to service of process on file with the Commissioner, add:*]

_____ [*Name of issuer*] already has a Consent to Service of Process (Form 260.165) on file with the Commissioner and therefore does not need to file such a statement at this time.

[*Continue with the following:*]

Sincerely, _____ [*signature of attorney*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART IV. FORMS
A. Qualified Purchaser Exemption [Corp. Code § 25102(n)]

3-6D California Legal Forms--Transaction Guide § 6D.202

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.202 First Notice of Transaction for Qualified Purchaser Exemption Under Corp. Code § 25102(n)

[1] Comment

[a] Use of Form

This form is a First Notice of Transaction Pursuant to *Corp Code § 25102(n)*. This form must be filed in connection with any transaction under the qualified purchaser exemption of *Corp Code § 25102(n)* [*Corp. Code § 25102(n)(7)*]. The notice is not designed to indicate whether or not the transaction complies with the requirements of the exemption, but only to provide notice to the Commissioner that the exemption is being relied on [*10 Cal. Code Reg. § 260.102.16(a)(1)*; *see Corp. Code § 25163*]. The notice must be submitted on 81/2 by 11-inch paper [*10 Cal. Code Reg. § 260.102.8(a)*]. It can be obtained from any office of the Department of Corporations, or from the Department of Corporation's website at http://www.corp.ca.gov/forms/srdlist.htm.

The text of the form, with instructions, is printed in full in *10 Cal. Code Reg. § 260.102.16(d)* and is reproduced verbatim here.

PRACTICE TIP:

It should be noted that the form is defective in that it seems to indicate that disclosure statements must be provided to all purchasers, other than purchasers listed in *10 Cal. Code Reg. § 260.102.13*. The statute only requires that disclosure statements be given to natural person purchasers or to corporations, partnerships or other organizations formed by natural persons for the purpose of acquiring the securities offered by the issuer. If relevant, the form should be corrected by the issuer in order to make certain that the notice information is correct. *Commentary by Frances E. Lossing.*

[b] Filing Requirements

A First Notice of Transaction must be filed with the Commissioner of Corporations concurrently with the earlier of (1)

publication of the general announcement of the proposed offering [*see § 6D.200[1]*] or (2) at the time of the initial offer of securities, whichever occurs first [*Corp. Code § 25102(n)(7)*; *10 Cal. Code Reg. § 260.102.16(a)(1)*]. The notice may be filed in person or by mail at any office of the Department of Corporations [*10 Cal. Code Reg. § 260.102.16(a)(1)*]. The filing fee of $600 must accompany the filing [*10 Cal. Code Reg. § 260.102.16(a)(1)*; *see Corp. Code § 25608(x)* (amount of fee); *see also Corp. Code § 25608.3* (Commissioner may set fee at amount below maximum fee set forth in *Corp. Code § 25608*)].

An issuer that is not a California corporation must also file a consent to service of process [*see 10 Cal. Code Reg. § 260.165*], unless it already has a consent to service on file with the Commissioner [*10 Cal. Code Reg. § 260.102.16(a)(1)*].

The filing should be accompanied by a cover letter indicating that the filing is pursuant to *Corp. Code § 25102(n)*, and if a consent to service is not included, a statement that the issuer already has a consent to service on file with the Commissioner [*10 Cal. Code Reg. § 260.102.16(a)(1)*; *see § 6D.201[2]* (form)].

[2] FORM

First Notice of Transaction for Qualified Purchaser Exemption Under Corp. Code § 25102(n)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART IV. FORMS
A. Qualified Purchaser Exemption [Corp. Code § 25102(n)]

3-6D California Legal Forms--Transaction Guide § 6D.203

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.203 Second Notice of Transaction for Qualified Purchaser Exemption Under Corp. Code § 25102(n)

[1] Comment

[a] Use of Form

This form is a Second Notice of Transaction Pursuant to *Corp. Code § 25102(n)* in connection with any transaction under the qualified purchaser exemption of that section. This notice must be used for transactions covered under *10 Cal. Code Reg. § 260.102.16(a)*. The notice must be submitted on 81/2 by 11 inch paper [*10 Cal. Code Reg. § 260.102.8(a)*]. It can be obtained from any office of the Department of Corporations, or from the Department of Corporation's Internet website at http://www.corp.ca.gov/forms/srdlist.htm.

The text of the form, with instructions is printed in full in *10 Cal. Code Reg. § 260.102.16(e)*, and is reproduced verbatim here.

[b] Filing Requirements

A Second Notice of Transaction must be filed within 10 business days following the close or abandonment of the proposed offering, but in any case no more than 210 days from the date of the filing of the First Notice of Transaction [*10 Cal. Code Reg. § 260.102.16(a)(2)*]. The Second Notice may be filed in person or by mail at any office of the Department [*10 Cal. Code Reg. § 260.102.16(e)*]. There is no filing fee for the Second Notice of Transaction.

[2] FORM

Second Notice of Transaction for Qualified Purchaser Exemption Under Corp. Code § 25102(n)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART IV. FORMS
A. Qualified Purchaser Exemption [Corp. Code § 25102(n)]

3-6D California Legal Forms--Transaction Guide § 6D.204

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.204 Purchaser's Representations Concerning Suitability and Investment Intent Under Qualified Purchaser Exemption--For Institutional Investors [Corp. Code § 25102(n)]

[1] Comment--Use of Form

This form may be used to document the qualification of an institutional investor in connection with an offering under the qualified purchaser exemption in *Corp. Code § 25102(n)* and to obtain the purchaser's representation that it is purchasing the securities for its own account and not for resale, as required by the terms of the exemption [*Corp. Code § 25102(n)(3)*]. The *form in § 6D.205[2]* should be used to obtain representations concerning suitability and investment intent from natural persons. The *form in § 6D.206[2]* should be used to obtain representations concerning suitability and investment intent from a qualified purchaser that qualifies on the basis of the suitability of its equity owners.

The issuer is not required to obtain written a representation of the purchaser's status as a qualified investor in order to qualify for this exemption. The issuer is only required to reasonably believe, after reasonable inquiry, that the purchaser is a qualified purchaser [*Corp. Code § 25102(n)(2)*] The use of a written representation, however, will clearly help show that the purchaser has made the required "reasonable inquiry."

Moreover, the purchaser is required to represent that it is purchasing the securities for its own account and not with a view toward resale [*Corp. Code § 25102(n)(3)*]. Although the latter representation is not required to be in writing, the use of a written representation will document the fact that the representation was in fact made. This documentation will be particularly useful if a subsequent violation of the representation leads to questions regarding the existence or sufficiency of the representation.

The categories of institutional investors who are "qualified purchasers" are listed in *Corp. Code § 25102(n)(2)(A)-(D), (F)*], which in turn incorporate the categories of investors who (1) are excluded from the purchaser count for purposes of the California limited offering exemption under *Corp. Code § 25102(f)* [*Corp. Code § 25102(n)(2)(A)*; *see 10 Cal. Code Reg. § 260.102.13* (limited offering exemption criteria); *see also* Ch. 6B, *California Limited Offering Exemptions*

] or (2) are qualified investors for purposes of the institutional investor exclusion under *Corp. Code § 25102(i)* [*Corp. Code § 25102(n)(2)(B)*; *see § 6D.22*].

[2] FORM

Purchaser's Representations Concerning Suitability and Investment Intent Under Qualified Purchaser Exemption--For Institutional Investors [Corp. Code § 25102(n)]

_____ [*date*]

To: _____ [*Name of issuer*]
_____ [*street address*]
_____ [*city, state, zip*]

QUALIFIED PURCHASER EXEMPTION INVESTMENT REPRESENTATION LETTER FOR INSTITUTIONAL INVESTORS:

Purchaser's Representations Concerning Suitability and Investment Intent

In connection with the undersigned's purchase of _____ [*describe securities, e.g.,* 100 common shares of your Company], the undersigned represents that the following accurately describes the nature of its business:

(Check the appropriate box)

☐ A bank, savings and loan association, trust company, insurance company, or investment company registered under the Investment Company Act of 1940, or a wholly owned subsidiary of any of the foregoing.

☐ A pension or profit-sharing trust (other than a pension or profit-sharing trust of the issuer, a self-employed individual retirement plan, or individual retirement account).

☐ Any corporation which has a net worth on a consolidated basis, according to its most recent audited financial statement, of not less than $14 million, or any wholly owned subsidiary of such a corporation.

☐ The Federal government, any agency or instrumentality of the Federal government, any corporation wholly owned by the Federal government, any state, any city, city and county or county, or any agency or instrumentality of a state, city, city and county or county, any state university or state college or any retirement system for the benefit of employees of any of the foregoing.

☐ A corporation with outstanding securities registered under Section 12 of the Securities Exchange Act of 1934 or any wholly owned subsidiary of such a corporation that after the offer and sale will own directly or indirectly 100 percent of the outstanding capital stock of the issuer.

☐ A pension or profit-sharing trust of the issuer, if the investment decisions made on behalf of the trust are made solely by persons who qualify under one of the other categories listed in this letter.

☐ An organization described in *Internal Revenue Code Section 501(c)(3)*, corporation, Massachusetts or similar business trust, or partnership, with total assets in excess of $5 million according to its most recent audited financial statements, or any wholly owned subsidiary of such an organization.

☐ The trustee of an issuer which is a trust and the general partner of an issuer which is a partnership, which exercises managerial functions with respect to those entities.

☐ A small business investment company licensed by the U.S. Small Business Administration under Section 301(c) of (d) of the Small Business Investment Company Act of 1958, a business development company as defined in Section 2(a)(48) of the Investment Act of 1940, or a private business development company as defined in Section 202(a)(22) of the Investment Advisors Act of 1940.

☐ Any broker-dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934.

☐ Any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary which is either a bank, savings and loan association, insurance company or registered investment adviser or if the employee benefit plan has total assets in excess of $5 million.

☐ Any trust with total assets in excess of $5 million not formed for the specific purpose of acquiring the securities offered whose purchase is directed by a person that has such knowledge and experience in financial and business matters that he or she is capable of evaluating the merits and risks of the prospective investment; please describe below in reasonable detail the nature and extent of the business, financial and investment experience of that person:

_____

_____

_____

The undersigned further represents to you that the undersigned is purchasing these securities for investment for the undersigned's own account [*or specify trust account if purchaser is a trustee*] and not with a view to or for sale in connection with any distribution of the security. The undersigned understands that these securities have not been qualified under the California Corporate Securities Law or registered under the federal Securities Act of 1933, and further understands that any resale or other transfer of these securities may require qualification and/or registration under the above statutes.

The undersigned understand that _____ [*name of issuer*] will use the representations in this letter to qualify prospective investors for purposes of federal and state securities laws. The undersigned further understands that _____ [*name of issuer*] may present this letter to such parties as it deems appropriate to establish the availability of exemptions from registration under state and federal securities laws.

_____ [*name of purchaser*]

By: _____ [*signature of purchaser's authorized representative*]
[*typed name*]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART IV. FORMS
A. Qualified Purchaser Exemption [Corp. Code § 25102(n)]

3-6D California Legal Forms--Transaction Guide § 6D.205

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.205 Purchaser's Representations Concerning Suitability and Investment Intent Under Qualified Purchaser Exemption--For Natural Persons [Corp. Code § 25102(n)]

[1] Comment--Use of Form

This form may be used to document the qualification of a purchaser in connection with an offering under the qualified purchaser exemption in *Corp. Code § 25102(n)*, and to obtain the purchaser's representation that it is purchasing the securities for its own account and not for resale, as required by the terms of the exemption [*Corp. Code § 25102(n)(3)*]. The *form in § 6D.204[2]* should be used to obtain representations concerning suitability and investment intent from institutional investors. The *form in § 6D.206[2]* should be used to obtain representations concerning suitability and investment intent from a qualified purchaser that qualifies on the basis of the suitability of its equity owners.

For discussion of the use of an investor representation form in connection with the qualified purchaser representation in *Corp. Code § 25102(n)*, see *§ 6D.204[1]* [*see Corp. Code § 25102(n)(2)(A)-(F)*; *10 Cal. Code Reg. § 260.102.13*; *see also § 6D.22*].

[2] FORM

Purchaser's Representations Concerning Suitability and Investment Intent Under Qualified Purchaser Exemption--For Natural Persons [Corp. Code § 25102(n)]

_____ [*date*]

To: _____ [*Name of issuer*]
_____ [*street address*]
_____ [*city, state, zip*]

QUALIFIED PURCHASER EXEMPTION INVESTMENT REPRESENTATION LETTER FOR NATURAL

PERSONS

Purchaser's Representations Concerning Suitability and Investment Intent

In connection with the undersigned's purchase of _____ [*describe securities, e.g.,* 100 common shares of your Company], the undersigned represents that the following categories are applicable to the undersigned:

(Check the appropriate box or boxes, if any)

☐ A self-employed individual retirement plan, or an individual retirement account, if the investment decisions made on behalf of the plan or account are made solely by persons who qualify under one of the other categories listed in this letter.

☐ A trustee of an issuer that is a trust or a general partner of an issuer that is a partnership, who exercises managerial functions with respect to those entities; and any officer, director of general partner of a general partner of an issuer that is a partnership.

☐ A person who occupies a position with the issuer, or with a general partner of an issuer which a partnership, with duties and authority substantially similar to those of an executive officer of a corporation.

☐ A relative, spouse or relative of a spouse of a purchaser who has the same principal residence as the purchaser.

☐ A person who has, whether alone or in conjunction with others, taken the initiative in founding and organizing the business or enterprise of the issuer.

In addition, please provide the following information:

(1) Business:

Occupation

_____

_____

_____

_____

_____

_____

_____

_____

Number of

Years
_____
Present Employer
_____
Position / Title
_____
Business Address
_____
Busi

ness Telephone ____ ____ ____ ____ ____ ____ ____ _

Business FAX ____ ____ ____ ____ ____ ____ ____ _

(2) Income:

Do you reasonably expect either your own income from all sources during the current year

to exceed $200,000, or the joint income of you and your spouse (if married) from all sources during the current year to exceed $300,000?

Yes _ No _ If no, please specify amount _____ _____

What percentage of your income as

shown above is anticipated to be derived from sources other than salary?

_____

_____

_____

_____

_____

_____

_____

_

Was either your yearly income from all sources during each of the last two years in excess

of $200,000 or was the joint income of you and your spouse (if married) from all sources during each of such years in excess of $300,000?

Yes _ No _ If no, please specify amount for:

Last Year ____

____

____

____

____

____

____

_

Year

Before Last ____ ____ ____ ____ ____ ____ ____ _

(3) Net Worth:

Will your net worth as of the date you purchase the securities offered, together with the net worth of your spouse, be in excess of $1 million?

Yes No _ If no, please

_ specify amount
_____
_____

Will the amount of your investment exceed 10% of your net worth, together with the net worth of your spouse?

Yes No _
_

(4) Education:

Please described your educational background and degree

s obtained, if any:

_____
_____
_____
_____
_____
_____
_____
_

(5) Affiliation:

If you have any preexisting personal or business relationship with the issuer or any of its officers, directors, or controlling persons,

please describe the nature and duration of that relationship:

_____
_____
_____
_____
_____
_____
_____
_____

(6) Business and Financial Experience:

Please describe in reasonable detail the nature and extent of your business, financial, and

in-
vest-
men
t ex-
peri-
ence
whic
h
you
be-
lieve
give
s
you
the
ca-
pa-
city
to
pro-
tect
your
in-
teres
ts:

___
___
___
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___
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___
_

The undersigned further represents to you that the undersigned is purchasing these securities for investment for the undersigned's own account [*or specify trust account if purchaser is a trustee*] and not with a view to or for sale in connection with any distribution of the security. The undersigned understands that these securities have not been qualified under the California Corporate Securities Law or registered under the federal Securities Act of 1933, and further understands that any resale or other transfer of these securities may require qualification and/or registration under the above statutes.

The undersigned understand that _____ [*name of issuer*] will use the representations in this letter to qualify prospective investors for purposes of federal and state securities laws. The undersigned further understands that _____ [*name of issuer*] may present this letter to such parties as it deems appropriate to establish the availability of exemptions from registration under state and federal securities laws.

_____ [*signature of purchaser*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART IV. FORMS
A. Qualified Purchaser Exemption [Corp. Code § 25102(n)]

3-6D California Legal Forms--Transaction Guide § 6D.206

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.206 Purchaser's Representations Concerning Suitability and Investment Intent Under Qualified Purchaser Exemption--Based on Suitability of Equity Owners [Corp. Code § 25102(n)]

[1] Comment

[a] Use of Form

This form may be used to document the qualification of a purchaser that is an entity as opposed to a natural person in connection with an offering under the qualified purchaser exemption in *Corp. Code § 25102(n)*, when the basis for qualified purchaser status is the suitability of the purchaser's equity owners. The form also may be used to obtain the purchaser's representation that it is purchasing the securities for its own account and not for resale, as required by the terms of the exemption [*Corp. Code § 25102(n)(3)*]. The *form in § 6D.204[2]* should be used to obtain representations concerning suitability and investment intent from institutional investors. The *form in § 6D.205[2]* should be used to obtain representations concerning suitability and investment intent from natural persons.

For discussion of the use of an investor representation form in connection with the qualified purchaser representation in *Corp. Code § 25102(n)*, see *§ 6D.204[1]* [*see Corp. Code § 25102(n)(2)(A)-(F)*; *10 Cal. Code Reg. § 260.102.13*; *see also § 6D.22*].

[b] Qualified Purchaser Status Based on Classification of Individual Equity Owners

There are several ways in which an entity may be classified as a qualified purchaser on the basis of the qualifications of its individual equity owners:

- First, a corporation, partnership, or other organization specifically formed for the purpose of acquiring the securities offered by the issuer in reliance on the qualified purchaser exemption in *Corp. Code § 25102(n)* is a qualified purchaser if each equity owner of the corporation, partnership, or other organization is a qualified purchaser [*Corp. Code § 25102(n)(2)*].

- Second, any entity in which *all* of the equity owners fall within one of the following categories:

  - Persons who are excluded from the purchaser count for purposes of the California limited offering exemption in Corp. Code § 25102(f) under *10 Cal. Code Reg. § 260.102.13(a), (b), (c), (d),* or *(f)* [*Corp. Code § 25102(n)(2)(A*); *10 Cal. Code Reg. § 260.102.13(h)*];

  - Persons qualifying for the institutional investor exemptions in *Corp. Code § 25102(i)* or *10 Cal. Code Reg. § 260.102.10* [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(h)*]; or

  - "Accredited investors" under Section 501(a) [*17 C.F.R. § 230.501(a)*] of federal Regulation D [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(g)*; *17 C.F.R. § 230.501(a)(8)*].

[c] Attachments

When an entity seeks qualified purchaser status based on the qualifications of its individual equity owners, it is apparent that it is necessary to ascertain the qualifications of those owners as well as of the entity itself [*see* [b], *above*]. This form addresses this issue by incorporating attachments that are to be completed by all of the individual equity owners, addressing their personal qualifications. The questions are designed to elicit information establishing the individual equity owner's qualification under the criteria noted in [b], *above*:

- Attachment 1 should be essentially identical to the *form in § 6D.204[2],* and therefore is not reproduced in full here. The *form in § 6D.204* may be appended as Attachment 1. However, the next to last paragraph in the *form in § 6D.204[2],* containing the investor representation that the purchaser is purchasing for its own account, should be deleted.

- Attachment 2 should be essentially identical to the *form in § 6D.205[2],* and therefore is not reproduced in full here. That form may be appended as Attachment 2. However, the next to last paragraph in the *form in § 6D.205[2],* containing the investor representation that the purchaser is purchasing for its own account, should be deleted.

- Attachment 3 incorporates the categories listed in 10 Cal. Code Reg. § 260.130.13, with the exception of the "accredited investor" category specified in 10 Cal. Code Reg. § 260.130.13(g).

- Attachment 4 incorporates the "accredited investor" category in 10 Cal. Code Reg. § 260.130.13(g), which in turn incorporates by reference the federal definition of "accredited investor" appearing in Rule 501(a) of Regulation D [*17 C.F.R. § 230.501(a)*].

The circumstances under which the individual attachments should be used are explained in the form itself.

[2] FORM

Purchaser's Representations Concerning Suitability and Investment Intent Under Qualified Purchaser Exemption--Based on Suitability of Equity Owners [Corp. Code § 25102(n)]

_____ [*date*]

To: _____ [*Name of issuer*]
_____ [*street address*]
_____ [*city, state, zip*]

QUALIFIED PURCHASER EXEMPTION INVESTMENT REPRESENTATION LETTER BASED ON SUITABILITY OF EQUITY OWNERS

Purchaser's Representations Concerning Suitability and Investment Intent

In connection with the undersigned's purchase of _____ [*describe securities, e.g.,* 100 common shares of your Company], the undersigned represents that one of the following categories is applicable to the undersigned:

(Check the appropriate box)

☐ The purchaser has been formed for the specific purpose of acquiring these securities. Purchaser: If this box is checked, each of the equity owners should complete and sign either Attachment 1 (to be completed by equity owners who are institutional investors) or Attachment 2 (to be completed by equity owners who are natural persons).

☐ The purchaser is a trust or estate in which 50 percent or more of the beneficial interests are owned by a natural person who is a qualified purchaser, any relative, spouse, or relative of the spouse of that person who has the same principal residence as the person or any corporation in which each of such persons own 50 percent or more of the equity securities (excluding contingent interests). Purchaser: If this box is checked, the natural person who is a qualified purchaser should complete Attachment 2.

☐ The purchaser is a corporation or other organization in which 50 percent or more of the equity interests are owned by a natural person who is a qualified purchaser, any relative, spouse or relative of the spouse of that person who has the same principal residence as that person, or any trust or estate in which 50 percent or more of the beneficial interests are owned by such persons, excluding contingent interests. Purchaser: If this box is checked, the natural person who is the qualified purchaser should complete Attachment 2.

☐ All of the equity owners of the purchaser fall within one of the following categories. Purchaser: If this box is checked, each of the equity owners should complete Attachment 3.

a. Bank, savings and loan association, insurance company, investment company registered under the Investment Company Act of 1940, business development company, Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958.

b. Plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, and having total assets in excess of $5 million.

c. Employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974, in which investment decisions are made by a plan fiduciary that is

either a bank, savings and loan association, insurance company, or registered investment adviser, or in which the plan has total assets in excess of $5 million or, if the plan is a self-directed plan, in which investment decisions are made solely by persons described in (a), above, through (j), below.

d. Private business development company as defined in Section 202(a)(22) of the Investment Advisors Act of 1940.

e. Organization described in *Internal Revenue Code Section 501(c)(3)*, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, and having total assets in excess of $5 million.

f. Director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of the issuer.

g. Natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds $1 million.

h. Natural person who had an individual income in excess of $200,000 in each of the two most recent years, or joint income with that person's spouse in excess of $300,000, in each of those years, and has a reasonable expectation of reaching the same income level in the current year.

i. Any trust, with total assets in excess of $5 million, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person; that is, a person who has such knowledge and experience in financial and business matters that the person is capable of evaluating the merits and risks of the prospective investment.

j. Any entity in which all of the equity owners are persons described in (a) through (i), above.

☐ All of the equity owners of the purchaser fall within the previous category or one of the following categories. Purchaser: If this box is checked, each of the equity owners should complete Attachment 4.

a. The trustee of an issuer that is a trust and the general partner of an issuer which is a partnership, who exercise managerial functions with respect to such entities, and any officer, director or general partner of a general partner of an issuer which is a partnership.

b. Any person who occupies a position with the issuer, or with a general partner of an issuer which is a partnership, with duties and authority substantially similar to those of an executive officer of a corporation.

c. (1) Any relative, spouse or relative of the spouse of a purchaser who has the same principal residence as the purchaser; (2) any trust or estate in which a purchaser and any of the persons related to that purchaser as specified in (1) or (3) collectively have more than 50 percent of the beneficial interest (excluding contingent interests); and (3) any corporation or other organization of which a purchaser and any of the persons related to that purchaser as specified in (1) or (2) collectively are beneficial owners of more than 50

percent of the equity securities (excluding director's qualifying shares) or equity interests. "Relative" means a person related by blood, marriage or adoption.

d. Any individual who is a "promoter" of the issuer. "Promoter" means a person who, acting alone or in conjunction with one or more other persons, takes the initiative in founding and organizing the business or enterprise of an issuer.

e. A small business investment company licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Company Act of 1958, and a business development company as defined in Section 2(a)(48) of the Investment Company Act of 1940, and a private business development company as defined in Section 202(a)(22) of the Investment Advisors Act of 1940.

f. Any entity in which all of the equity owners are persons specified in (a) through (e), above.

g. Any person who purchases $150,000 or more of the securities offered in the transaction, provided each such purchaser meets either one of the following, or who the issuer reasonably believes comes within either of the following: (1) That person, or that person's professional advisor, has the capacity to protect such person's own interests in connection with the transaction; or (2) The investment (including mandatory assessments) does not exceed 10 percent of that person's net worth or joint net worth with that person's spouse.

h. Any entity in which all of the equity owners are officers, directors or affiliates of the issuer.

i. Any entity in which all of the equity owners are one or more of the following:
(1) A bank, savings and loan association, trust company, insurance company, or investment company registered under the Investment Company Act of 1940, or a wholly owned subsidiary of any of the foregoing.

(2) A pension or profit-sharing trust (other than a pension or profit-sharing trust of the issuer, a self-employed individual retirement plan, or individual retirement account).

(3) An organization described in *Internal Revenue Code Section 501(c)(3)* which has total assets (including endowment, annuity and life income funds of not less than $5 million according to its most recent audited financial statement, or any wholly owned subsidiary of such an organization.

(4) A corporation that has a net worth on a consolidated basis, according to its most recent audited financial statement, of not less than $14 million, or any wholly owned subsidiary of such a corporation.

(5) The Federal government, any agency or instrumentality of the Federal government, any corporation wholly owned by the Federal government, any state, any city, city and county or county or any agency or instrumentality of a state, city, city and county or county, any state university or state college or any retirement system for the benefit of employees of any of the foregoing.

(6) A corporation with outstanding securities registered under Section 12 of the Securities Exchange Act of 1934 or any wholly owned subsidiary of such a corporation that after the offer and sale will own directly or indirectly 100 percent of the outstanding capital stock of the issuer.

j. Any wholly owned subsidiary of any institutional investor designated in Section (i)(1) through (6), above.

There are no equity owners of the undersigned who have not completed an attachment. To the best knowledge of the undersigned, the information provided in each of the attachments is true and correct.

The undersigned further represents to you that the undersigned is purchasing these securities for investment for the undersigned's own account [*or specify trust account if purchaser is a trustee*] and not with a view to or for sale in connection with any distribution of the security. The undersigned understands that these securities have not been qualified under the California Corporate Securities Law or registered under the federal Securities Act of 1933, and further understands that any resale or other transfer of these securities may require qualification and/or registration under the above statutes.

The undersigned understand that _____ [*name of issuer*] will use the representations in this letter to qualify prospective investors for purposes of federal and state securities laws. The undersigned further understands that _____ [*name of issuer*] may present this letter to such parties as it deems appropriate to establish the availability of exemptions from registration under state and federal securities laws.

_____ [*signature of purchaser*]
[*typed name*]

Attachment 1

[*Attach Form 6D.204[2], modified by deleting next to last paragraph containing investment representation that security is being purchased for purchaser's own account*]

Attachment 2

[*Attach Form 6D.205[2], modified by deleting next to last paragraph containing investment representation that security is being purchased for purchaser's own account*]

Attachment 3

The undersigned represents that the following categories, as indicated, correctly describe the undersigned:

(Check the appropriate box or boxes, if any)

☐ Bank, savings and loan association, insurance company, investment company registered under the Investment Company Act of 1940, business development company, Small Business Investment

Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958.

☐ Plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, and having total assets in excess of $5 million.

☐ Employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974, in which investment decisions are made by a plan fiduciary that is either a bank, savings and loan association, insurance company, or registered investment adviser, or in which the plan has total assets in excess of $5 million or, if the plan is a self-directed plan, in which investment decisions are made solely by persons described in this Attachment 3.

☐ Private business development company as defined in Section 202(a)(22) of the Investment Advisors Act of 1940.

☐ Organization described in *Internal Revenue Code Section 501(c)(3)*, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, and having total assets in excess of $5 million.

☐ Director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of the issuer.

☐ Natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds $1 million.

☐ Natural person who had an individual income in excess of $200,000 in each of the two most recent years, or joint income with that person's spouse in excess of $300,000, in each of those years, and has a reasonable expectation of reaching the same income level in the current year.

☐ Any trust, with total assets in excess of $5 million, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person; that is, a person who has such knowledge and experience in financial and business matters that the person is capable of evaluating the merits and risks of the prospective investment.

☐ Any entity in which all of the equity owners are persons described in the preceding categories.

The undersigned understand that _____ [*name of issuer*] will use the representations in this letter to qualify prospective investors for purposes of federal and state securities laws. The undersigned further understands that _____ [*name of issuer*] may present this letter to such parties as it deems appropriate to establish the availability of exemptions from registration under state and federal securities laws.

_____ [*signature of purchaser*]
[*typed name*]

Attachment 4

The undersigned represents that the following categories, as indicated, correctly describe the undersigned:

(Check the appropriate box or boxes, if any)

☐ The trustee of an issuer which is a trust and the general partner of an issuer which is a partnership, who exercise managerial functions with respect to such entities, and any officer, director or general partner of a general partner of an issuer which is a partnership.

☐ Any person who occupies a position with the issuer, or with a general partner of an issuer which is a partnership, with duties and authority substantially similar to those of an executive officer of a corporation.

☐ (1) Any relative, spouse or relative of the spouse of a purchaser who has the same principal residence as the purchaser; (2) any trust or estate in which a purchaser and any of the persons related to that purchaser as specified in (1) or (3) collectively have more than 50 percent of the beneficial interest (excluding contingent interests); and (3) any corporation or other organization of which a purchaser and any of the persons related to such purchaser as specified in (1) or (2) collectively are beneficial owners of more than 50 percent of the equity securities (excluding director's qualifying shares) or equity interests. "Relative" means a person related by blood, marriage or adoption.

☐ Any individual who is a "promoter" of the issuer. "Promoter" means a person who, acting alone or in conjunction with one or more other persons, takes the initiative in founding and organizing the business or enterprise of an issuer.

☐ A small business investment company licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Company Act of 1958, and a business development company as defined in Section 2(a)(48) of the Investment Company Act of 1940, and a private business development company as defined in Section 202(a)(22) of the Investment Advisors Act of 1940.

☐ Any entity in which all of the equity owners are persons specified in any of the above-listed categories.

☐ Any person who purchases $150,000 or more of the securities offered in the transaction, provided each such purchaser meets either one of the following, or who the issuer reasonably believes comes within either of the following: (1) That person, or that person's professional advisor, has the capacity to protect such person's own interests in connection with the transaction; or (2) The investment (including mandatory assessments) does not exceed 10 percent of that person's net worth or joint net worth with that person's spouse.

☐ Any entity in which all of the equity owners are officers, directors or affiliates of the issuer.

☐ Any entity in which all of the equity owners are one or more of the following:

(1) A bank, savings and loan association, trust company, insurance company, or investment company registered under the Investment Company Act of 1940, or a wholly owned subsidiary of any of the foregoing.

(2) A pension or profit-sharing trust (other than a pension or profit-sharing trust of the issuer, a self-employed individual retirement plan, or individual retirement account).

(3) An organization described in *Internal Revenue Code Section 501(c)(3)* which has total assets (including endowment, annuity and life income funds of not less than $5 million according to its most recent audited financial statement, or any wholly owned subsidiary of such an organization.

(4) A corporation that has a net worth on a consolidated basis, according to its most recent audited financial statement, of not less than $14 million, or any wholly owned subsidiary of such a corporation.

(5) The Federal government, any agency or instrumentality of the Federal government, any corporation wholly owned by the Federal government, any state, any city, city and county or county or any agency or instrumentality of a state, city, city and county or county, any state university or state college or any retirement system for the benefit of employees of any of the foregoing.

(6) A corporation with outstanding securities registered under Section 12 of the Securities Exchange Act of 1934 or any wholly owned subsidiary of such a corporation that after the offer and sale will own directly or indirectly 100 percent of the outstanding capital stock of the issuer.

☐ Any wholly owned subsidiary of any institutional investor designated in (1) through (6) immediately above.

The undersigned understand that _____ [*name of issuer*] will use the representations in this letter to qualify prospective investors for purposes of federal and state securities laws. The undersigned further understands that _____ [*name of issuer*] may present this letter to such parties as it deems appropriate to establish the availability of exemptions from registration under state and federal securities laws.

_____ [*signature of purchaser*]
[*typed name*]



191 of 193 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART IV. FORMS
A. Qualified Purchaser Exemption [Corp. Code § 25102(n)]

3-6D California Legal Forms--Transaction Guide §§ 6D.207- 6D.209

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

[Reserved]

§§ 6D.207[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6D CALIFORNIA QUALIFIED PURCHASER EXEMPTIONS
PART IV. FORMS
B. Institutional Investor Exemption [Corp. Code § 25102(i)]

3-6D California Legal Forms--Transaction Guide § 6D.210

AUTHOR: Susan E. Firtch Frances E. Lossing Practice Consultant

§ 6D.210 Purchaser's Representations Concerning Suitability and Investment Intent Under Institutional Investor Exemption [Corp. Code § 25102(i)]

[1] Comment--Use of Form

This form may be used to document the qualification of a purchaser in connection with an offering under the institutional investor exemption in *Corp. Code § 25102(i)*, and to obtain the purchaser's representation that it is purchasing the securities for its own account and not for resale, as required by the terms of the exemption [*Corp. Code § 25102(i)*].

The issuer is not required to obtain written a representation of the purchaser's status as a qualified investor in order to qualify for this exemption. The use of a written representation, however, will document the fact that the securities in question were sold to a qualifying entity. Moreover, the purchaser is required to represent that it is purchasing the securities for its own account and not with a view toward resale [*Corp. Code § 25102(i)*]. Although the latter representation is not required to be in writing, the use of a written representation will document the fact that the representation was in fact made. This documentation will be particularly useful if a subsequent violation of the representation leads to questions regarding the existence or sufficiency of the representation.

[2] FORM

Purchaser's Representations Concerning Suitability and Investment Intent Under Institutional Investor Exemption [Corp. Code § 25102(i)]

_____ [*date*]

To: _____ [*Name of issuer*]
_____ [*street address*]
_____ [*city, state, zip*]

INSTITUTIONAL INVESTOR INVESTMENT REPRESENTATION LETTER:

Purchaser's Representations Concerning Suitability and Investment Intent

In connection with the undersigned's purchase of _____ [*describe securities, e.g.,* 100 common shares of your Company], the undersigned represents that the following accurately describes the nature of its business:

(Check the appropriate box)

☐ A bank, savings and loan association, trust company, insurance company, or investment company registered under the Investment Company Act of 1940, or a wholly owned subsidiary of any of the foregoing.

☐ A pension or profit-sharing trust (other than a pension or profit-sharing trust of the issuer, a self-employed individual retirement plan, or individual retirement account).

☐ An organization described in *Internal Revenue Code Section 501(c)(3)* that has total assets (including endowment, annuity and life income funds, of not less than $5 million according to its most recent audited financial statement, or any wholly owned subsidiary of such an organization.

☐ A corporation that has a net worth on a consolidated basis, according to its most recent audited financial statement, of not less than $14 million, or any wholly owned subsidiary of such a corporation.

☐ The Federal government, any agency or instrumentality of the Federal government, any corporation wholly owned by the Federal government, any state, any city, city and county or county or any agency or instrumentality of a state, city, city and county or county, any state university or state college or any retirement system for the benefit of employees of any of the foregoing.

☐ A corporation with outstanding securities registered under Section 12 of the Securities Exchange Act of 1934 or any wholly owned subsidiary of such a corporation that after the offer and sale will own directly or indirectly 100 percent of the outstanding capital stock of the issuer.

The undersigned further represents to you that it is purchasing these securities for investment for its own account [*or specify trust account if purchaser is a trustee*] and not with a view to or for sale in connection with any distribution of the security. The undersigned understands that these securities have not been qualified under the California Corporate Securities Law or registered under the federal Securities Act of 1933, and further understands that any resale or other transfer of these securities may require qualification and/or registration under the above statutes.

The undersigned understands that _____ [*name of issuer*] will use the representations in this letter to qualify prospective investors for purposes of federal and state securities laws. The undersigned further understands that _____ [*name of issuer*] may present this letter to such parties as it deems appropriate to establish the availability of exemptions from registration under state and federal securities laws.

_____[*name of institutional investor/purchaser*]

By: _____ [*signature of purchaser's authorized representative*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
Chapters 6E-6G [Reserved]

3-6E California Legal Forms--Transaction Guide Chapters 6E-6G

[Reserved]

Chapters 6E[Reserved]



1 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES

3-6H California Legal Forms--Transaction Guide 6H.syn

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.syn Synopsis to Chapter 6H: QUALIFICATION OF SECURITIES

§ 6H.01 California Sources

[1] Statutes

[2] Regulations

[3] Releases of the Corporations Commissioner

[4] Opinions of the Corporations Commissioner

§ 6H.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 6H.03-6H.04 [Reserved]

§ 6H.05 Law Reviews and Periodicals

§ 6H.06 Annotations

§ 6H.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 6H.08-6H.19 [Reserved]

§ 6H.20 Qualification Under the Corporate Securities Law

[1] Qualification Requirement

[2] Initial Considerations

§ 6H.21 Methods of Qualification Under the Corporate Securities Law

[1] Basic Types of Securities Transactions

[2] Issuer Transactions

[a] Corp. Code § 25110 Qualification Requirement

[b] Methods of Qualifying Issuer Transactions

[c] Small Business Issuers

[3] Recapitalizations, Reorganizations, and Changes in Terms of Outstanding Securities

[a] Corp. Code § 25120 Qualification Requirement

[b] Method of Qualifying Recapitalizations, Reorganizations, and Changes in Terms of Outstanding Securities

[4] Nonissuer Transactions

[a] Corp. Code § 25130 Qualification Requirement

[b] Methods of Qualifying Nonissuer Transactions

[c] Standards for Qualification of Nonissuer Transactions

§ 6H.22 Qualification Procedures

[1] Facing Page

[2] Application Forms

[3] Filing and Fees

[4] Post-Filing Amendments

§ 6H.23 Standards for Qualification

[1] Application of Fair, Just, and Equitable Standard

[2] Conditions of Qualification

§ 6H.24 Federal Preemption of State Securities Regulation

§ 6H.25 NASAA's Coordinated Equity Review Program

§ 6H.26 Advertising

§§ 6H.27-6H.99 [Reserved]

Scope

§ 6H.100 Facts--Issuer

Scope

§ 6H.101 Facts--Management and Shareholders

Scope

§ 6H.102 Facts--Outstanding Securities

Scope

§ 6H.103 Facts--Securities to Be Qualified

Scope

§ 6H.104 Documents

Scope

§§ 6H.105-6H.119 [Reserved]

§ 6H.120 Determining Whether Security Must Be Qualified in California

Scope

§ 6H.121 Determining Applicable Form of Qualification

Scope

§§ 6H.122-6H.149 [Reserved]

§ 6H.150 Prefiling Procedure and Preparation of Application

Scope

§ 6H.151 Filing Procedure

Scope

§ 6H.152 Post-Filing Procedure

Scope

§§ 6H.153-6H.179 [Reserved]

§ 6H.180 Advertising Securities for Offer or Sale

Scope

§ 6H.181 General Requirements for Distribution of Qualified Securities

Scope

§ 6H.182 Selling Under Impound Condition

Scope

§ 6H.183 Compliance With, or Removal of, Commissioner's Restrictions on Securities--Escrow and Legend Conditions

Scope

§§ 6H.184-6H.199 [Reserved]

§ 6H.200 Facing Page for Applications for Qualification by Coordination, Issuer Notification, Issuer Permit, and Recapitalization or Reorganization Permit [10 Cal. Code Reg. § 260.110]

[1] Comment

[a] Use of Form

[b] Preparation of Form

[c] File Number

[d] Fees

[e] Type of Qualification

[f] Open Offering Qualification

[g] Limited Offering Qualification

[h] Body of Facing Page

[i] Filing of Applications

[j] Amendments

[2] Form

Facing Page for Applications for Qualification by Coordination, Issuer Notification, Issuer Permit, and Recapitalization or Reorganization Permit [10 Cal. Code Reg. § 260.110]

§§ 6H.201-6H.204 [Reserved]

§ 6H.205 Application for Qualification by Coordination [Corp. Code § 25111; 10 Cal. Code Reg. § 260.111]

[1] Comment

[a] Use of Form

[b] Federal Registration

[c] Federal Exemptions

[d] Preparation of Form

[e] Conditions for Qualification Becoming Effective

[f] Stop Orders by the Commissioner

[g] Amendments

[h] Nonissuer Transactions

[2] Form

Application for Qualification by Coordination [Corp. Code § 25111; 10 Cal. Code Reg. § 260.111]

§ 6H.206 Alternative Method of Qualification by Coordination: Form U-1 [Corp. Code § 25111; 10 Cal. Code Reg. § 260.111]

[1] Comment

[a] Use of Form

[b] Preparation of Form

[c] Amendment of Registration Statement

[2] Form

Alternative Method of Qualification by Coordination: Form U-1 [Corp. Code § 25111; 10 Cal. Code Reg. § 260.111]

§ 6H.207 Statement of Proposed Prices, Discounts, and Commissions [Corp. Code § 25111(c)(3)]

[1] Comment--Use of Form

[2] Form

Statement of Proposed Prices, Discounts, and Commissions [Corp. Code § 25111(c)(3)]

§ 6H.208 Notification of Effective Date, Time, and Final Price of Federal Registration [Corp. Code § 25111(c)]

[1] Comment--Use of Form

[2] Form

Notification of Effective Date, Time, and Final Price of Federal Registration [Corp. Code § 25111(c)]

§ 6H.209 Open-End Investment Companies (Form NF) [Corp. Code § 25111(d)]

[1] Comment

[a] Use of Form

[b] Effect of Federal Preemption Provisions on Qualification Procedures

[2] Form

Open-End Investment Companies (Form NF) [Corp. Code § 25111(d)]

§§ 6H.210-6H214 [Reserved]

§ 6H.215 Application for Qualification by Issuer Notification [Corp. Code § 25112; 10 Cal. Code Reg. § 260.112]

[1] Comment

[a] Use of Form

[b] Federal Registration

[c] Preparation of Form

[d] Suspensions, Stop Orders, and Conditions

[2] Form

Application for Qualification by Issuer Notification [Corp. Code § 25112; 10 Cal. Code Reg. § 260.112]

§§ 6H.216-6H.219 [Reserved]

§ 6H.220 Application for Qualification by Permit [Corp. Code § 25113; 10 Cal. Code Reg. § 260.113]

[1] Comment

[a] Use of Form

[b] Conditions on Qualification

[c] Content and Preparation of Form

[d] Small Company Applications for Qualification by Permit

[i] Qualified Corporations

[ii] Offering Requirements

[iii] Application Requirements

[2] Form

Application for Qualification by Permit [Corp. Code § 25113; 10 Cal. Code Reg. § 260.113]

§§ 6H.221-6H.224 [Reserved]

§ 6H.225 Description of Business [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131]

[1] Comment

[a] Use of Form

[b] Preparation of Form

[2] Form

Description of Business [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131]

§ 6H.226 Use of Proceeds to Issuer [10 Cal. Code Reg. §§ 260.112, 260.113]

[1] Comment--Use of Form

[2] Form

Use of Proceeds to Issuer [10 Cal. Code Reg. §§ 260.112, 260.113]

§ 6H.227 Plan of Distribution [10 Cal. Code Reg. §§ 260.112, 260.113]

[1] Comment

[a] Use of Form

[b] Selling Expenses

[c] Employment of Agents

[d] Underwriter Options

[2] Form

Plan of Distribution [10 Cal. Code Reg. §§ 260.112, 260.113]

§ 6H.228 Directors and Officers [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131]

[1] Comment

[a] Use of Form

[b] Qualification by Issuer Permit

[2] Form

Directors and Officers [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131]

§ 6H.229 Material Transactions With Affiliates During Last Three Years [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

[1] Comment--Use of Form

[2] Form

Material Transactions With Affiliates During Last Three Years [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

§ 6H.230 Outstanding Securities [10 Cal. Code Reg. §§ 260.112, 260.113]

[1] Comment--Use of Form

[2] Form

Outstanding Securities [10 Cal. Code Reg. §§ 260.112, 260.113]

§ 6H.231 Outstanding Options to Purchase Securities [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

[1] Comment

[a] Use of Form

[b] Restrictions on Issuance of Options

[i] In General

[ii] Pro Rata Rights

[iii] Options

[iv] Warrants

[2] FORM

Outstanding Options to Purchase Securities [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

§ 6H.232 Principal Security Holders [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131]

[1] Comment--Use of Form

[2] Form

Principal Security Holders [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

§ 6H.233 Remuneration of Directors, Officers, and Principal Security Holders [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

[1] Comment--Use of Form

[2] Form

Remuneration of Directors, Officers, and Principal Security Holders [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

§ 6H.234 Additional Information in Connection With Debt Securities and Options or Stock Bonuses [10 Cal. Code Reg. §§ 260.112, 260.113]

[1] Comment

[a] Use of Form

[b] Debt Securities

[c] Options or Stock Bonuses

[d] Options to Purchasers of Debt Securities

[2] Form

Additional Information in Connection With Debt Securities and Options or Stock Bonuses [10 Cal. Code Reg. §§ 260.112, 260.113]

§ 6H.235 Statement of Prior Issuances Pursuant to Corp. Code § 25102(f), (h), (n), or (o) [10 Cal. Code Reg. § 260.113]

[1] Comment--Use of Form

[2] Form

Statement of Prior Issuances Pursuant to California Small or Limited Offering Exemption [10 Cal. Code Reg. § 260.113]

§ 6H.236 Exhibits [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131]

[1] Comment--Use of Form

[2] Form

Exhibits [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121.1, 260.131]

§ 6H.237 Nonmonetary Consideration [10 Cal. Code Reg. §§ 260.112, 260.113]

[1] Comment

[a] Use of Form

[b] Valuation of Nonmonetary Consideration

[2] Form

Nonmonetary Consideration [10 Cal. Code Reg. §§ 260.112, 260.113]

§ 6H.238 Proposed Purchasers [10 Cal. Code Reg. §§ 260.112, 260.113]

[1] Comment--Use of Form

[2] Form

Proposed Purchasers [10 Cal. Code Reg. §§ 260.112, 260.113]

§ 6H.239 Consent to Service of Process--California Form [Corp. Code § 25165; 10 Cal. Code Reg. § 260.165]

[1] Comment--Use of Form

[2] Form

Consent to Service of Process--California Form [Corp. Code § 25165; 10 Cal. Code Reg. § 260.165]

§ 6H.240 Uniform Consent to Service of Process--National Form U-2

[1] Comment--Use of Form

[2] Form

Uniform Consent to Service of Process--National Form U-2

§ 6H.241 Customer Authorization of Disclosure of Financial Records [10 Cal. Code Reg. §§ 260.110, 260.111(b), 260.112, 260.113, 262.121]

[1] Comment

[a] Use of Form

[b] Requests for Disclosure

[c] Customer Authorization

[i] Requirements

[ii] Notification of Examination

[d] Records After Disclosure

[e] Preparation of Form

[2] Form

Customer Authorization of Disclosure of Financial Records [10 Cal. Code Reg. §§ 260.110, 260.111(b), 260.111.2(a), 260.112, 260.113, 262.121(a), (b)]

§ 6H.242 Management [10 Cal. Code Reg. § 260.113]

[1] Comment--Use of Form

[2] Form

Management [10 Cal. Code Reg. § 260.113]

§ 6H.243 Itemization of Budget [10 Cal. Code Reg. § 260.113]

[1] Comment--Use of Form

[2] Form

Itemization of Budget [10 Cal. Code Reg. § 260.113]

§ 6H.244 Reports of Financial Condition [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121]

[1] Comment--Use of Form

[2] Form

Reports of Financial Condition [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121.1] Item 20 (Issuer Notification)

§ 6H.245 Signature and Verification [Corp. Code § 25115]

[1] Comment--Use of Form

[2] Form

Signature and Verification [Corp. Code § 25115]

§§ 6H.246-6H.249 [Reserved]

§ 6H.250 Application for Qualification of a Recapitalization or Reorganization by Permit [Corp. Code § 25121; 10 Cal. Code Reg. § 260.121]

[1] Comment

[a] Use of Form

[b] Changes in Rights Requiring Qualification

[c] Stock Splits, Reverse Stock Splits, and Stock Dividends

[d] Mergers

[e] Shareholder Residence Test

[f] Limited Exemption From Qualification

[g] Procedure for Qualification

[h] Conditions of Qualifications

[i] Federal Registration Requirements

[j] Preparation of Form

[2] Form

Application for Qualification of a Recapitalization or Reorganization by Permit [Corp. Code § 25121; 10 Cal. Code Reg. § 260.121]

§§ 6H.251-6H.254 [Reserved]

§ 6H.255 Application for Qualification of a Nonissuer Transaction by Notification [Corp. Code § 25131; 10 Cal. Code Reg. § 260.131]

[1] Comment

[a] Use of Form

[b] Procedure for Qualification

[c] Standards for Qualification of Nonissuer Transactions

[d] Preparation of Form

[2] Form

Application for Qualification of a Nonissuer Transaction by Notification [Corp. Code § 25131; 10 Cal. Code Reg. § 260.131]

§§ 6H.256-6H.259 [Reserved]

§ 6H.260 General Legend Condition [10 Cal. Code Reg. § 260.141.11]

[1] Comment

[a] Use of Form

[b] General Legend Condition

[2] Form

General Legend Condition [10 Cal. Code Reg. § 260.141.11]

§ 6H.261 Legend Condition for Promotional Securities [10 Cal. Code Reg. § 260.141.1]

[1] Comment--Use of Form

[2] Form

Legend Condition for Promotional Securities [10 Cal. Code Reg. § 260.141.1]

§ 6H.262 Application for Consent to Transfer Securities Subject to Legend or Escrow Condition [Corp. Code § 25151; 10 Cal. Code Reg. § 260.151(a)]

[1] Comment

[a] Use of Form

[b] Consent Not Equivalent to Qualification or Exemption

[2] Form

Application for Consent to Transfer Securities Subject to Legend or Escrow Condition [10 Cal. Code Reg. § 260.151(a)]

§ 6H.263 Statement of Transferee [10 Cal. Code Reg. § 260.151(b)]

[1] Comment

[a] Use of Form

[b] Contents of Form

[2] Form

Statement of Transferee [10 Cal. Code Reg. § 260.151(b)]

§ 6H.264 Nomination of Escrow Holder or Foreign Depositary [10 Cal. Code Reg. § 260.141.3]

[1] Comment--Use of Form

[2] Form

Nomination of Escrow Holder or Foreign Depositary [10 Cal. Code Reg. § 260.141.3]

§ 6H.265 Application for Removal or Modification of Conditions [Corp. Code § 25141; 10 Cal. Code Reg. § 260.141.50]

[1] Comment--Use of Form

[2] Form

Application for Removal or Modification of Conditions [Corp. Code § 25141; 10 Cal. Code Reg. § 260.141.50]

§§ 6H.266-6H.269 [Reserved]

§ 6H.270 Application for Approval of Repurchase Offer [Corp. Code § 25507; 10 Cal. Code Reg. § 260.507]

[1] Comment--Use of Form

[2] Form

Application for Approval of Repurchase Offer [Corp. Code § 25507; 10 Cal. Code Reg. § 260.507]

§ 6H.271 Investor's Suitability Representation Letter [10 Cal. Code Reg. § 260.140.01; Dept. of Corps. Release No. 8-C]

[1] Comment--Use of Form

[2] Form

Investor's Suitability Representation Letter [10 Cal. Code Reg. § 260.140.01; Dept. of Corps. Release No. 8-C]

§ 6H.272 Employment of Agents [10 Cal. Code Reg. § 260.141.30]

[1] Comment--Use of Form

[2] Form

Employment of Agents [10 Cal. Code Reg. § 260.141.30]

§ 6H.273 Issuer's Bond [Corp. Code § 25216(e); 10 Cal. Code Reg. § 260.216.15]

[1] Comment

[a] Use of Form

[b] Undertaking/Deposit in Lieu of Bond

[c] Enforcement of Liability on Bond

[2] Form

Issuer's Bond [Corp. Code § 25216(e); 10 Cal. Code Reg. § 260.216.15]

§ 6H.274 Semiannual Reports [Corp. Code § 25146; 10 Cal. Code Reg. § 260.146]

[1] Comment

[a] Use of Form

[b] Requirement of Semiannual Reports

[c] Books, Records, and Accounts

[2] Form

Semiannual Reports [Corp. Code § 25146; 10 Cal. Code Reg. § 260.146]

§ 6H.275 Request for Confidential Treatment of Information [10 Cal. Code Reg. § 250.10]

[1] Comment

[a] Use of Form

[b] Contents of Request

[c] Denial of Request

[d] Granting of Request

[e] Disclosure of Confidential Information

[2] Form

Request for Confidential Treatment of Information [10 Cal. Code Reg. § 250.10]

§ 6H.276 Request for Refund of Filing Fee [10 Cal. Code Reg. § 250.15]

[1] Comment--Use of Form

[2] Form

Request for Refund of Filing Fee [10 Cal. Code Reg. § 250.15]

§ 6H.277 Request for Consent to Withdraw Application [10 Cal. Code Reg. § 250.16]

[1] Comment--Use of Form

[2] Form

Request for Consent to Withdraw Application [10 Cal. Code Reg. § 250.16]

Frances E. Lossingn*
Practice Consultant

FOOTNOTES:

(n1)Footnote *. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES

3-6H California Legal Forms--Transaction Guide Scope

AUTHOR: Frances E. Lossing Practice Consultant

Scope

Frances E. Lossingn*
Practice Consultant Scope

This chapter covers the qualification of securities under the Corporate Securities Law of 1968 [*Corp. Code § 25000 et seq.*]. The Legal Background discusses the qualification requirements under that law, considerations in determining whether a proposed transaction must be qualified, the basic types of securities transactions (issuer, nonissuer, and recapitalization/reorganization), and the specific methods of qualification permissible for each type. It also contains an overview of qualification procedures. The Transaction Guide sets forth a summary of information and documents that must be obtained from the client, specific criteria for determining whether a proposed transaction is subject to the provisions of the Corporate Securities Law, a procedural guide to qualification of securities, and related and subsequent procedures, including advertising securities for offer or sale, distribution of qualified securities, selling under impound conditions, and complying with or removing escrow and legend conditions. Forms in this chapter include the applicable facing pages for all types of applications for qualification; applications for qualification by coordination, issuer notification, permit, recapitalization or reorganization permit, and nonissuer notification; items and exhibits to applications; and forms related to conditions on qualification.

The Corporate Securities Law is a merit statute requiring offers and sales of securities to be fair, just, and equitable. In contrast, the federal securities laws are disclosure statutes requiring complete disclosure of material facts, but leaving questions as to the fairness of the offering to the consideration of the prospective purchasers. For an overview of federal requirements, see *Ch. 6, Securities Regulation Issues, § 6.50-.58*. For discussion of federal securities exemptions, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* . For coverage of the preemption of state requirements by federal law, see Ch. 6, *Securities Regulation Issues* . An overview of California exemptions is also contained in Ch. 6. The California limited and small offering exemptions are examined in detail in Ch. 6B, *California Limited Offering Exemptions*, and Ch. 6C, *California Small Offering Exemption*. The qualified purchaser exemptions under *Corp. Code § 25102(i)* and *(n)* are discussed in Ch. 6D, *California Qualified Purchaser Exemptions* .

FOOTNOTES:
(n2)Footnote *. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A.

and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6H California Legal Forms--Transaction Guide § 6H.01

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.01 California Sources

[1] Statutes

Bond and Undertaking Law. *Code Civ. Proc. §§ 995.010-996.560.*

Corporate Securities Law of 1968. *Corp. Code § 25000 et seq.*

Definitions. *Corp. Code §§ 25000-25022*.

Exemptions. *Corp. Code §§ 25100-25105*.

Issuer transactions. *Corp. Code §§ 25110-25117*.

Recapitalizations and reorganizations. *Corp. Code §§ 25120-25122*.

Nonissuer transactions. *Corp. Code §§ 25130-25134*.

Authority of the Commissioner. *Corp. Code §§ 25140-25151*.

General provisions pertaining to applications for qualification of securities. *Corp. Code §§ 25160-25166*.

Regulation of agents, broker-dealers, investment adviser representatives, and investment advisers. *Corp. Code § 25200 et seq.*

Advertising securities. *Corp. Code §§ 25300-25302*.

Fraudulent and prohibited practices. *Corp. Code §§ 25400-25404*.

Enforcement. *Corp. Code §§ 25500-25550*.

Administration. *Corp. Code §§ 25600-25619*.

Authority of Commissioner to cooperate with other securities agencies. *Corp. Code § 25612.5(a)*.

General provisions. *Corp. Code §§ 25700-25707*.

[2] Regulations

Rules of the Corporations Commissioner. *10 Cal. Code Reg. § 250.9 et seq.*

Administration. *10 Cal. Code Reg. §§ 250.9-250.16*.

Hearings. *10 Cal. Code Reg. §§ 250.17-250.25*.

Conflict of interest. *10 Cal. Code Reg. § 250.30*.

Limitation on licenses and certificates to aliens. *10 Cal. Code Reg. §§ 250.60, 250.61*.

Administrative penalties. *10 Cal. Code Reg. § 250.70*.

Definitions. *10 Cal. Code Reg. §§ 260.000-260.019.2*.

Exemptions from qualification. *10 Cal. Code Reg. §§ 260.100-260.105.39*.

Procedure for qualification. *10 Cal. Code Reg. §§ 260.110-260.131*.

Standards for the exercise of the Commissioner's authority. *10 Cal. Code Reg. §§ 260.140-260.140.05*.

Conditions of qualification. *10 Cal. Code Reg. §§ 260.141-260.141.50*.

Other provisions concerning exercise of the Commissioner's authority. *10 Cal. Code Reg. §§ 260.142-260.151*.

General provisions relating to qualification. *10 Cal. Code Reg. §§ 260.162-260.165*.

Licensing of broker-dealers and agents. *10 Cal. Code Reg. §§ 260.200-260.211.3*.

Regulation of broker-dealers and agents. *10 Cal. Code Reg. §§ 260.216-260.218.6*.

Licensing and regulation of investment advisers. *10 Cal. Code Reg. §§ 260.230-260.238*.

General provisions relating to agents, broker-dealers, and investment advisers. *10 Cal. Code Reg. §§ 260.240-260.242*.

Advertising securities. *10 Cal. Code Reg. §§ 260.300-260.302*.

General provisions. *10 Cal. Code Reg. §§ 260.504.2-260.617*.

[3] Releases of the Corporations Commissioner

NOTE:

The Commissioner periodically publishes releases that set forth information concerning the regulatory activities of the Commissioner, inform practitioners as to policies, or disclose interpretive opinions. Attorneys may obtain individual copies of releases from any office of the Department of Corporations at no charge [***see*** *10 Cal. Code Reg. § 260.608(b)*], or may be placed on a mailing list for distribution of Corporate Securities Law material at a cost of $10 per year [*10 Cal. Code Reg. § 260.608(c)(5)*]. Releases are also reproduced in Ballantine & Sterling, California Corporation Laws, Volume 7 (Matthew Bender); Marsh & Volk, Practice Under the California Securities Laws, Appendix A-4 (Matthew Bender); and the California Corporations Code(Matthew Bender).

Offices for filing with the Department of Corporations. Dept. of Corps. Release No. 13-G (Revised; June 10, 2004).

Participation in NASAA's Coordinated Equity Review Program. Dept. of Corps. Release No. 111-C (Apr. 16, 1998).

Acceptance of Form NF to satisfy California's notice filing requirement for offerings of investment securities. Dept. of Corps. Release No. 106-C (July 11, 1997).

Notice filing and fee payment requirements for securities offerings under SEC Rule 506. Dept. of Corps. Release No. 103-C (Dec. 12, 1996).

Procedures and requirements for qualification of securities by SEC Form S-3 or Form F-3 registrants utilizing Rule 415 for delayed or continuous offerings of securities. Dept. of Corps. Release No. 70-C (June 24, 1982, as revised Nov. 5, 1982, and Dec. 31, 1983).

Use of escrow in nonissuer transactions involving legended securities may not require Commissioner's prior written consent. Dept. of Corps. Release No. 60-C (Oct. 19, 1979).

Use of "due diligence" material as advertising. Dept. of Corps. Release No. 40-C (Jan. 3, 1975).

Repurchase offers. Dept. of Corps. Release No. 36-C (Feb. 25, 1974, as revised on Feb. 14, 1975).

Reference to tax counsel's opinion in advertisement of securities. Dept. of Corps. Release No. 23-C (Nov. 12, 1971).

Suitability of securities. Dept. of Corps. Release No. 8-C (Feb. 27, 1969).

[4] Opinions of the Corporations Commissioner

NOTE:

The Commissioner has the discretion to issue interpretive opinions through the Department's Office of Legislation and Policy to resolve unsettled questions of law within the scope of responsibility of the Department of Corporations [Dept. of Corps. Release No. 61-C (Revised; July 16, 2007)].

"Forum" event affiliated with college, at which companies present business and products to invited venture capital and other investors, and at which no advice is given as to value of securities or advisability of investing in them, may involve "offering" of securities or advertisement subject to Corporate Securities Law of 1968. Commissioner's Opinion

No. 98/1C.

Residence agreements and memberships in on-board club of passenger vessel, in which passengers purchase exclusive right for term of 50 years to occupy luxury apartment on vessel which will be constructed, owned and operated by another entity (ResidenSea), constitute securities under risk capital test for purposes of *Corp. Code § 25019*. Commissioner's Opinion No. 97/1C.

Merger of Mammoth Recreation Area Inc. into Mammoth Mountain Ski Area, with two classes of common stock, is not exempt from qualification requirements of Corporate Securities Act of 1968. Commissioner's Opinion No. 93/2C.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6H California Legal Forms--Transaction Guide § 6H.02

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.02 Federal Sources

[1] Statutes

Securities Act of 1933. *15 U.S.C. § 77a et seq.*

Federal preemption of state securities regulation. *15 U.S.C. § 77r.*

Trust Indenture Act of 1939. *15 U.S.C. §§ 77aaa et seq.*

Securities Exchange Act of 1934. *15 U.S.C. §§ 78a et seq.*

[2] Regulations

Regulation S-K. *17 C.F.R. § 229.10 et seq.*

General rules and regulations, Securities Act of 1933. *17 C.F.R. § 230.100 et seq.*

Conditional small offering exemption under Securities Act of 1933 (Regulation A). *17 C.F.R. § 230.251 et seq.*

Offers and sales of securities without registration under the Securities Act of 1933 (Regulation D). *17 C.F.R. § 230.501 et seq.*

General rules and regulations, Securities Exchange Act of 1934. *17 C.F.R. § 240.0-1 et seq.*

General rules and regulations, Trust Indenture Act of 1939. *17 C.F.R. § 260.0-1 et seq.*



5 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6H California Legal Forms--Transaction Guide §§ 6H.03-6H.04

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6H.03[Reserved]



6 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6H California Legal Forms--Transaction Guide § 6H.05

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.05 Law Reviews and Periodicals

Bloomenthal, *National Securities Markets Improvement Act and Preemption of State Securities Registration,* 20 Sec. and Fed. Corp. L. Rep. 33 (May & June 1998).

Maynard, *The Future of California's Blue Sky Law*, 30: *2 Loy. L.A. L. Rev. 1573 (June 1997).*

McGinty, *Are Interests in Limited Liability Companies Securities?* 25 Sec. Reg. L.J. 121 (Summer 1997).

Bertram, *Offers and Sales of Securities on the Internet, 42 Prac. Law. 23 (October 1996).*

Comment, *Are Limited Partnership Interests Securities? A Different Conclusion Under the California Limited Partnership Act, 18 Pac. L.J. 125 (October 1986).*

Epling & Thompson, *Securities Disclosure in Bankruptcy, 39 Bus. Law. 855 (May 1984).*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6H California Legal Forms--Transaction Guide § 6H.06

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.06 Annotations

Annot., Investigative Authority of Administrative Agencies in State Regulation of Securities, 58 A.L.R.5th 293 (1998) .

Annot., What Gives Rise to Right of Rescission Under State Blue Sky Laws, 52 A.L.R.5th 491 (1997) .

Annot., What Constitutes "Public" or "Private" Offering Within Meaning of State Securities Regulation, 84 A.L.R.3d 1009 (1978) .

Annot., Duty to Disclose Material Facts to Stock Purchaser, 80 A.L.R.3d 13 (1977) .

Annot., Attorney's Preparation of Legal Document Incident to Sale of Securities as Rendering Him Liable Under State Securities Regulation Statutes, 62 A.L.R.3d 252 (1975) .

Annot., What Amounts to Participation by Corporate Officer or Agent in Illegal Issuance of Security, in Order to Impose Liability Upon Him Under State Securities Regulations, 44 A.L.R.3d 588 (1972) .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6H California Legal Forms--Transaction Guide § 6H.07

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.07 Text References

[1] Matthew Bender Sources

Marsh & Volk, Practice Under the California Securities Laws(Matthew Bender)

Ch. 3A, *Federal Preemption of State Securities Regulation*.

Ch. 6, *Procedure for Qualification of Issuer Transactions*.

Ch. 7, *Recapitalizations and Reorganizations*.

Ch. 10, *Nonissuer Transactions*.

Ch. 11, *Transfer of Securities Subject to Legend or Escrow Condition*.

Ch. 12, *Advertising Securities*.

Ballantine & Sterling, California Corporation Laws, Ch. 21, *Corporate Securities* (Matthew Bender).

Sommer, Federal Securities Act of 1933 (Matthew Bender).

Sommer, Federal Securities Exchange Act of 1934 (Matthew Bender).

Sommer, Securities Primary Law Sourcebook (Matthew Bender).

Rabkin & Johnson, Current Legal Forms with Tax Analysis(Matthew Bender)

Ch. 16, *Corporate Reorganizations and Liquidations*.

Ch. 19, *Corporate Securities*.

[2] Additional Text References

Loss & Seligman, Fundamentals of Securities Regulation (Aspen Law & Business 1995).

Organizing Corporations in California, ch. 4, *Offering, Selling and Issuing Securities* (Cal. C.E.B. 2d ed.).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART II. LEGAL BACKGROUND

3-6H California Legal Forms--Transaction Guide § 6H.20

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.20 Qualification Under the Corporate Securities Law

[1] Qualification Requirement

The California Corporate Securities Law of 1968 [*Corp. Code § 25000 et seq.*] regulates all offers and sales [*see Corp. Code § 25017* (definition)] of securities [*see Corp. Code § 25019* (definition)] in California by requiring that every security be "qualified" with the Commissioner of Corporations unless either of the following applies:

- Either the security or the transaction is exempted by a specific section of the law or a rule of the Commissioner [*see* Ch. 6, *Securities Regulation Issues* (overview of exemptions)]; or

- The security is not subject to the requirement of qualification as a result of federal preemption [*see Corp. Code §§ 25100.1*, *25101.1*, *25102.1*; *see also § 6H.24*].

This qualification requirement applies to issuer transactions [*see Corp. Code § 25110*; *see also § 6H.21[2]*], transfers of securities by their holders, i.e., nonissuer transactions [*see Corp. Code § 25130*; *see also § 6H.21[4]*], and recapitalization or reorganization transactions, or changes in the rights and preferences of outstanding securities [*see Corp. Code § 25120*; *see also § 6H.21[3]*].

The California Corporate Securities Law embodies California's policy of protecting the public from fraud and deception in securities transactions, and was enacted to effectuate this policy by regulating securities transactions in this state. The law is a merit act which regulates the offer and sale of securities by applying a "fair, just, and equitable" standard [*see § 6H.23*; *see also* Ballantine & Sterling, California Corporation Laws, Ch. 21, *Corporate Securities* , § 443 (Matthew Bender)]. In contrast, the Federal Securities Act of 1933 [*see 15 U.S.C. § 77a et seq.*] is a disclosure act, which requires issuers and underwriters to file detailed registration statements, forms of prospectus and offering circulars, advertising, and notices of intent to sell [*see* Ballantine & Sterling, California Corporation Laws, Ch. 21, *Corporate Securities* , § 442 (Matthew Bender); *see also* Ch. 6, *Securities Regulation Issues*].

[2] Initial Considerations

To ascertain whether or not a proposed transaction must be qualified under the Corporate Securities Law, counsel must consider the following issues:

- Whether or not the interest or instrument constitutes a security [*Corp. Code § 25019*; *see Ch. 6, Securities Regulation Issues, §§ 6.11, 6.110*].

- Whether or not the transaction involves an offer or sale [*Corp. Code § 25017*; *see Ch. 6, Securities Regulation Issues, §§ 6.12, 6.111*].

- Whether or not the offer or sale is made in California [*Corp. Code § 25008*; *see Ch. 6, Securities Regulation Issues, §§ 6.13, 6.112*].

- Whether or not the security is exempt from qualification [*Corp. Code §§ 25100, 25101*; *see Ch. 6, Securities Regulation Issues, §§ 6.30, 6.115*].

- Whether or not the transaction is exempt from qualification [*Corp. Code §§ 25102-25105*; *see Ch. 6, Securities Regulation Issues, §§ 6.30, 6.116*].

- Whether the security constitutes a "covered security" for federal preemption purposes [*15 U.S.C. § 77r*; *see §§ 6H.24[4]*, 6H.125] and, as a result, is "not subject to qualification" in California [*Corp. Code §§ 25100.1, 25101.1, 25102.1*; *see Ch. 6, Securities Regulation Issues, §§ 6.15, 6.117*].

In addition, some types of qualification depend on registration under the federal securities laws [*see § 6H.21[2][b]*; *see also § 6H.205* (qualification by coordination)]. Another important consideration, therefore, is whether the security or transaction is subject to or exempt from federal registration or will be subject to or exempt from registration under the securities or blue sky laws of other states, [*see* Ch. 6, *Securities Regulation Issues* ; Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*].

PRACTICE TIP:

Frequently an issuer will have a choice as to whether to qualify a transaction or to seek an exemption by making a notice filing. Generally, qualification will generally be less advantageous since the qualification process will be more time-consuming and expensive. In addition, the offering must satisfy the fair, just and equitable standards applicable to qualified offerings. These standards may be particularly difficult for an unseasoned corporation to satisfy, may require the preparation of audited financial statements for the first time or may require the issuer to issue securities on terms that are unattractive to potential investors. On the other hand, an open qualification may be more attractive than an exemption if investors wish to receive freely tradeable securities since most exemptions that will be available, such as *Corp. Code § 25102(e), (f),* or *(n),* require investors to represent that they are not acquiring the securities for distribution. *Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawBlue Sky LawsFederal PreemptionSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933DefinitionsSecurity



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART II. LEGAL BACKGROUND

3-6H California Legal Forms--Transaction Guide § 6H.21

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.21 Methods of Qualification Under the Corporate Securities Law

[1] Basic Types of Securities Transactions

After it has been established that the Corporate Securities Law applies to a proposed transaction, that the transaction is subject to qualification, and that an exemption from qualification is not available, counsel must determine the applicable method of qualification. That method depends on the type of transaction and the type of security involved. Securities transactions can be one of three types:

- Issuer transactions [*see* [2], *below*].
- Reorganizations, recapitalizations, or changes in the terms of outstanding securities [*see* [3], *below*].
- Nonissuer transactions [*see* [4], *below*].

It is important to distinguish these types of transactions since the qualification procedures and exemptions available differ depending upon the type of transaction, unless the securities or transaction is exempt as a result of federal preemption.

[2] Issuer Transactions

[a] Corp. Code § 25110 Qualification Requirement

Issuer transactions are those in which the person that issues or proposes to issue a security distributes the issue to investors for the first time. An issuer transaction is one directly or indirectly for the issuer's benefit [*see Corp. Code § 25010*]. It is unlawful for any person to offer or sell in California any security in an issuer transaction (other than in a transaction subject to *Corp. Code § 25120* (recapitalizations, reorganizations, and changes in terms of outstanding securities) [*see* [3], *below*] whether or not by or through underwriters, unless that sale has been qualified under *Corp. Code § 25111*, *25112*, or *25113* (and no stop order under *Corp. Code § 25140* or *25143(a)* is in effect with respect to

that qualification), or unless that security or transaction is exempt [*see Corp. Code §§ 25100-25105*; *see also* Ch. 6, *Securities Regulation Issues* (exemptions)] or is not subject to qualification as a result of federal preemption [*Corp. Code § 25110*; *see Corp. Code §§ 25100.1, 25101.1, 25102.1*; *see also § 6H.24*].

There are situations in which the offering may involve both an issuer and a nonissuer transaction. For example, a corporation may offer a new issue of shares along with an offering of shares by a shareholder. This is common in an initial public offering of securities [*see* Ballantine & Sterling, California Corporation Laws, Ch. 21, *Corporate Securities* , § 452.02 (Matthew Bender)]. An offering that involves both an issuer and a nonissuer transaction will be treated for qualification purposes as an issuer transaction. In determining whether either or both portions of a combined offering are exempt from qualification, however, each portion must be considered separately [*Corp. Code § 25011*].

A special statutory rule applies to the qualification of issuer transactions. The offer or sale of a security in an issuer transaction in a manner that varies or differs from, exceeds the scope of, or fails to conform with either a material term or material condition of qualification of the offering as set forth in the permit or qualification order, or a material misrepresentation as to the manner of offering which is set forth in the application for qualification, will be an unqualified offer or sale [*Corp. Code § 25110*]. Such an offering or sale, therefore, would be unlawful [*see Corp. Code § 25540* (penalties for willful violation)].

[b] Methods of Qualifying Issuer Transactions

Three different methods exist for the qualification of issuer transactions:

- Coordination.
- Notification.
- Permit.

Qualification by coordination is available when a registration statement for a security has been filed under the Federal Securities Act of 1933 [*see 15 U.S.C. § 77a et seq.*] in connection with the same offering [*Corp. Code § 25111(a)*; *see § 6H.205* (application for qualification by coordination)]. "Registration statement" as used in *Corp. Code § 25111(a)* includes an offering statement as defined by Rule 252(a) under Regulation A [*17 C.F.R. § 230.252(a)*] under the Securities Act [*Corp. Code § 25111(a)*].

The following are the two principal objectives of the coordination procedure [*see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 6, Procedure for Qualification of Issuer Transactions, § 6.03[1]*]:

- To permit the filing of the same papers with California officials as are filed with the federal Securities and Exchange Commission (SEC); and
- To make the qualification effective simultaneously with the registration statement under the 1933 Act being declared effective by the SEC.

PRACTICE TIP:

In some cases, it will be necessary to file additional material, such as financial statements, Annual Reports on Form 10-K or employee benefit plans, with the Commissioner. This commonly occurs when a short-form SEC registration statement form, such as Form S-3 or Form S-8, is used. In these circumstances, the SEC registration statement may not contain all of the information that the Commissioner will need to make a fair, just and equitable determination. In addition, the Commissioner's processing guidelines are generally slower than SEC practice if the SEC decides not to review the

registration statement (a process which generally takes no more than a week) or a form, such as a Form S-8, is used which is automatically effective on the date it is filed with the SEC. *Commentary by Frances E. Lossing.*

The application will only be automatically effective if no stop order has been issued under *Corp. Code § 25143*, the application has been on file at least 10 days, and a statement of the maximum and minimum offering prices and maximum underwriting discounts and commissions has been on file for at least two days, or such shorter period of time as the Commissioner may approve [*Corp. Code § 25111(c)*]. Special procedures must be followed for offerings on Form S-3 or Form F-3 to made on a delayed or continuous basis pursuant to SEC Rule 415. [Dept. of Corps. Release No. 70-C (June 24, 1982, as revised Nov. 5, 1982, and Dec. 31, 1983)].

Any security issued by a person that is the issuer of any security registered under Section 12 of the Securities Exchange Act of 1934 [*15 U.S.C. § 78l*], or issued by an investment company registered under the Investment Company Act of 1940 [*15 U.S.C. § 80a-1 et seq.*], and which is not eligible for qualification by coordination may be qualified by notification [*Corp. Code § 25112*; *see § 6H.215* (application by issuer notification)]. Qualification by notification affords the applicant two advantages:

- First, the information required for notification qualification is slightly less elaborate than that required for qualification by permit.

- Second, assuming that no stop order or order under *Corp. Code § 25143(a)* has been issued by the Commissioner, qualification automatically becomes effective on the tenth business day after filing the application or the last amendment thereto, or at any earlier time that the Commissioner may direct [*Corp. Code § 25112(c)*].

All other offers and sales required to be qualified as an issuer transaction must be qualified by permit [*Corp. Code § 25113*; *see § 6H.220* (application by permit)]. The permit procedure contemplates that the Commissioner must take affirmative action in issuing a permit before the offer or sale of the securities becomes legally permissible [*see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 6, Procedure for Qualification of Issuer Transactions, § 6.05* (Matthew Bender)].

The availability of these coordination and notification procedures provides a simpler process for those transactions that do not need extensive review by the Department of Corporations. Furthermore, qualification by coordination or notification is automatically effective [*see Corp. Code §§ 25111(c), 25112(c)*]. Under either of those two methods, the Commissioner has the burden to act and make an affirmative determination that the transaction is unfair, unjust, or inequitable in order to prevent the qualification from becoming effective. In contrast, qualification by permit becomes effective only upon issuance by the Commissioner of a permit authorizing the issuance of the securities [*Corp. Code § 25113(c)*; *see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 6, Procedure for Qualification of Issuer Transactions, § 6.01* (Matthew Bender)].

[c] Small Business Issuers

An applicant may file a small company application for qualification by permit if the applicant meets all of the following conditions [*Corp. Code § 25113(b)(2)*; *10 Cal. Code Reg. § 260.113.1*]:

- The applicant is a California corporation or a foreign corporation which at the time of filing has 50 percent or more of its outstanding voting securities held of record by California residents and 50 percent or more of its property, payroll and sales for California franchise tax purposes in California (often referred to as a pseudo-California corporation).

- The applicant is not a "blind pool" company, an investment company under the Investment Company Act of 1940 or engaged in oil and gas exploration or production or mining and extractive industries. A "blind pool" company is one that is a development stage company that either does not have a specific business plan or purpose or has indicated that its business plan is to engage in mergers or acquisitions with unidentified other entities.

- The applicant is not subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934.

- The offering is for voting common stock or preferred stock.

- The total amount of securities to be sold by the issuer is $1 million or less in any 12-month period, less any securities sold by the issuer during the preceding 12-month period pursuant to SEC Rule 504 or any other exemption under Section 3(b) of the Securities Act of 1933.

- The minimum offering price is at least $2.00 per share.

- The issuer undertakes that there will be no stock splits, stock dividends, spinoffs or mergers for two years following the offering.

- The net proceeds of the offering will be expended in the operations of the business.

- The offering is made on NASAA Form U-7.

- The applicant complies with any investor suitability or due diligence investigation requirements that may be imposed by the Commissioner.

- The application is reviewed and signed by a majority or the members of the Board of Directors of the applicant.

Small business issuers may be subject to less stringent investor suitability standards [*10 Cal. Code Reg. § 260.140.01(e)*], may incur higher selling expenses [*10 Cal. Code Reg. § 260.140.20(b), (c)*], and may issue more promotional shares [*10 Cal. Code Reg. § 260.140.31(b)*].

[3] Recapitalizations, Reorganizations, and Changes in Terms of Outstanding Securities

[a] Corp. Code § 25120 Qualification Requirement

The definition of a "sale" of a security includes any exchange of securities and any change in the rights, preferences, privileges, or restrictions of or on outstanding securities [*Corp. Code § 25017*; *see § 6H.120*]. Except as provided below, it is unlawful for any person to offer or sell in California any security in an issuer transaction in connection with any change in the rights, preferences, privileges, or restrictions of or on outstanding securities, in any exchange of securities by an issuer with its existing security holders exclusively, in any exchange in connection with mergers, consolidations, or purchase of corporate assets in consideration wholly or in part for the issuance of securities, or in an entity conversion transaction [*Corp. Code § 25120(a)*; *see Corp. Code § 25005.1* (definition)]. The above-stated prohibition, however, will not apply to a security if the security is qualified for sale pursuant to *Corp. Code § 25121* (and no stop order under *Corp. Code § 25140* or *25143(a)* is in effect with respect to that qualification), or if the security or transaction is exempt [*see Corp. Code §§ 25100-25105*; *see also* Ch. 6, *Securities Regulation Issues* (exemptions)] or not subject to qualification as a result of federal preemption [*Corp. Code § 25120(b)*; *see Corp. Code §§ 25100.1, 25101.1, 25102.1*; *see also § 6H.24*].

[b] Method of Qualifying Recapitalizations, Reorganizations, and Changes in Terms of Outstanding Securities

All reorganizations, recapitalizations, and changes in the terms of outstanding securities must be qualified by permit, unless the security or transaction is exempt [*Corp. Code §§ 25100, 25103, 25105*] or the security or transaction is not subject to qualification as a result of federal preemption [*Corp. Code §§ 25100.1, 25101.1, 25102.1*]. The procedures for qualification by coordination or notification [*see* [2][b], *above*] are not available for these types of transactions [*see Corp. Code § 25121*].

The application for a permit for a reorganization transaction is not the same as the application for a permit to qualify an issuer transaction. Generally, the items of information required to be included in the reorganization permit application [*see 10 Cal. Code Reg. § 260.121*; *see also § 6H.250* (application for qualification of recapitalization or reorganization by permit)] follow the items set forth in Schedule 14A of Regulation 14A under the Securities Exchange Act of 1934 [*see 17 C.F.R. §§ 240.14a-101*], as required in a proxy statement with respect to such a transaction [*see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 7, Recapitalizations and Reorganizations, § 7.10* (Matthew Bender)].

If qualification is required, no materials designed to solicit proxies or consents from security holders should be distributed without first being filed with the Commissioner. In addition, a permit must be issued [*10 Cal. Code Reg. § 260.140.60*].

A plan of reorganization for a merger or sale of substantially all the assets of one corporation to another must fairly reflect the relative value of the two organizations. In addition, a permit issued in connection with a transaction of this type may be conditioned upon a favorable vote of a specified percentage of the outstanding voting stock (without taking into account any stock held by those who may have a conflict of interest) [*10 Cal. Code Reg. § 260.140.61*].

[4] Nonissuer Transactions

[a] Corp. Code § 25130 Qualification Requirement

Nonissuer transactions, commonly known as secondary trading, are those which neither directly nor indirectly benefit the issuer [*Corp. Code § 25011*; *see also* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 10, Nonissuer Transactions, § 10.03[2]* (distinction between issuer and nonissuer transactions) (Matthew Bender)]. A transaction is indirectly for the benefit of the issuer if any portion of the purchase price of any securities involved in the transaction will be received indirectly by the issuer [*Corp. Code § 25011*]. The term "purchase price" includes only the specific consideration bargained for in return for the securities, which may include the making of a loan to the issuer. It does not include any remote, contingent, or incidental benefit that may accrue to the issuer, such as the inducement to a person to become or remain an employee of the issuer or to perform other services for the issuer, even though a motive of the seller or purchaser is to obtain a remote, contingent, or incidental benefit for the issuer [*10 Cal. Code Reg. § 260.011*].

It is unlawful for any person to offer or sell any security in California in any nonissuer transaction unless it is qualified for sale under *Corp. Code § 25131, 25111*, or *25113* (and no stop order under *Corp. Code § 25140* or *25143(a)* is in effect with respect to that qualification) or unless the security or transaction is exempt [*see Corp. Code §§ 25100-25105*; *see also* Ch. 6, *Securities Regulation Issues* (exemptions)] or not subject to qualification as a result of federal preemption [*Corp. Code § 25130*; *see Corp. Code §§ 25100.1, 25101.1, 25102.1*; *see also § 6H.24*].

Ordinarily, securities that are subject to any of the following limitations will not be qualified for nonissuer transactions:

- Common shares that either are nonvoting or whose voting rights are disproportionate to other classes

of common shares in relation to market price or equity interest.

- Securities that are not freely transferable, unless an application seeking removal of an escrow or legend condition is filed concurrently [*see § 6H.265*].

Securities are considered "not freely transferable" if they are subject to an escrow or legend condition, a right of first refusal, or are stock purchased for investment (letter stock). If, in the class sought to be qualified, some but not all securities are subject to these limitations, the application will not be denied solely on that ground provided adequate assurances are established against a distribution of the securities subject to the limitation [*10 Cal. Code Reg. § 260.140.138*].

[b] Methods of Qualifying Nonissuer Transactions

Nonissuer transactions involving securities registered under the Securities Act of 1933 may be qualified by coordination under *Corp. Code § 25111* [*see § 6H.205* (application for qualification by coordination)]. If the offering involves securities offered in a nonissuer transaction pursuant to an exemption under Regulation A [*17 C.F.R. § 230.251 et seq.*] of the Securities Act of 1933, qualification is by permit under *Corp. Code § 25113* [*see § 6H.220* (application for qualification by permit)]. All other nonissuer transactions are qualified by notification under *Corp. Code § 25131* [*Corp. Code § 25131(a)*; *see § 6H.255* (application for qualification of nonissuer transaction by notification)].

[c] Standards for Qualification of Nonissuer Transactions

Because the availability of adequate information to the public regarding the issuer's condition is considered an essential element of the fairness inherent in any public nonissuer offer or sale, the Commissioner requires compliance with three general disclosure standards for nonissuer transactions [*10 Cal. Code Reg. § 260.140.135*; *see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 10, Nonissuer Transactions, § 10.06* (Matthew Bender)]:

- First, the transaction will not be qualified unless it appears that full, complete, and accurate information is provided on all matters required to be stated in the application. Information may not be required if it is not known to the person filing the application or the persons on whose behalf the application is being filed and cannot be furnished by them without unreasonable effort [*Corp. Code § 25131(d)*]. An affidavit to this effect must be filed with the application [*10 Cal. Code Reg. § 260.140.139*].

- Second, all information contained in the application, whether required or not, must be accurate and not misleading.

- Third, it must not appear that the market in the security will be subject to manipulation or other artificial influences.

The failure of an issuer to make available to the public on a timely basis adequate and accurate information regarding developments materially affecting its affairs or securities normally will be deemed a factor indicating that the market in the security will be subject to artificial influence [*10 Cal. Code Reg. § 260.140.135*].

Furthermore, applications to qualify securities for nonissuer transactions are subject to the standards for review applied in the qualification of issuer transactions [*see 10 Cal. Code Reg. §§ 260.140-260.140.131.9*; *see also § 6H.23*] only if the following conditions are satisfied [*10 Cal. Code Reg. § 260.140.136*]:

- An application is filed in connection with a proposed offering of the securities pursuant to a registration under the Securities Act of 1933 [*15 U.S.C. § 77a et seq.*] or pursuant to an exemption under

Regulation A of that Act [*17 C.F.R. § 230.251 et seq.*].

PRACTICE TIP:

Issuers that are required to file periodic reports under Section 12 or 15(d) of the Securities Exchange Act of 1934 will satisfy this standard. Purchasers who may need to resell securities of an issuer that is not required to file periodic reports in a transaction that is not exempt from qualification should obtain an undertaking from the issuer that the issuer will either voluntarily file periodic reports under Section 15(d) of the Securities Exchange Act of 1934 or otherwise make available to the public on a timely basis adequate and accurate information regarding developments materially affecting its affairs or securities. In addition, the purchaser should obtain an undertaking from the issuer to provide the purchaser with any additional information regarding the issuer that the purchaser may reasonably request (such as audited financial statements) in order for the purchaser to meet its disclosure obligations. *Commentary by Frances E. Lossing.*

- The issuer, within 24 months immediately preceding the date of filing the application, had a public offering which was not qualified in California or that was qualified in California as a limited offering.

- A significant market for the securities proposed to be qualified does not presently exist in California. "A significant market in the securities" will be deemed to exist if the securities are held by not less than 100 persons in California and are subject to regular quotations of prices by at least one market maker.

Finally, an application to qualify securities for nonissuer transactions should show that the issuer's assets are productively employed in the operation of an ongoing business. Ordinarily an issuer showing annual gross receipts from operations of not less than $500,000 will be deemed to meet this requirement [*10 Cal. Code Reg. § 260.140.137*]. An issuer should not normally pay any of the expenses of a nonissuer transaction, unless there was an agreement between the issuer and the purchaser at the time the securities were sold to the purchaser that the issuer would pay those expenses [*10 Cal. Code Reg. § 260.140.22(c)(1)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawAdditional Offerings & the Securities Exchange Act of 1934Registration RequirementsSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawLiabilityDisclosuresGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART II. LEGAL BACKGROUND

3-6H California Legal Forms--Transaction Guide § 6H.22

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.22 Qualification Procedures

[1] Facing Page

All applications for qualification, whether by coordination, notification, or permit, must contain a specified "facing page" as the first page of an application. This form is specified in *10 Cal. Code Reg. § 260.110* [*see § 6H.200*] for all applications other than qualification of a nonissuer transaction pursuant to *Corp. Code § 25131*, which contains its own facing page [*see § 6H.255*]. The facing page requirement arises from the Department of Corporations' records retention program. The Commissioner is authorized to destroy applications and permits after four years [*see Corp. Code § 25619(a)*], and to retain on microfilm or otherwise any portion of those records [*see Corp. Code § 25619(c)*]. Retention on microfilm of the facing page alone, which contains the applicant's basic information and Department of Corporations file number, will provide a permanent record of an applicant's basic information in the Commissioner's files [*see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 6, Procedure for Qualification of Issuer Transactions, § 6.02[1]* (Matthew Bender)].

The facing page for issuer transactions [*see § 6H.200*] requires the applicant to specify whether the application is for an open qualification or a limited offering qualification. An "open qualification" means a qualification that authorizes the offer and sale of the securities to the public generally, without restriction as to persons or class of persons [*10 Cal. Code Reg. § 260.001(f)*]. A "limited offering qualification" means a qualification that authorizes the offer and sale of securities only to persons designated therein by name or class [*10 Cal. Code Reg. § 260.001(e)*].

PRACTICE TIP:

The Commissioner frequently imposes transfer restrictions on securities issued in a limited offering qualification in order to be certain that the securities will not be immediately transferred to unsuitable purchasers. As a result, the primary benefit of qualification, the free transferability of securities, is generally not available for a limited offering. For this reason, most issuers prefer to take advantage of the limited offering exemptions, such as *Corp. Code §§ 25102(e), (f), (n),* or *25102.1(d),* or the small offering exemption in *Corp. Code § 25102(h),* rather than using the limited offering qualification procedure in most circumstances. *Commentary by Frances E. Lossing.*

The distinction is usually applicable to the permit process, as most qualifications pursuant to coordination or notification will be open qualifications. The purpose of the distinction is to permit an appropriate review by the Commissioner of the proposed transaction in light of the sophistication and financial condition of the proposed purchasers of the securities [*see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 6, Procedure for Qualification of Issuer Transactions, § 6.05[3]* (Matthew Bender)]. For example, in order to qualify for an open offering, requirements such as the filing of semiannual reports [*see Corp. Code § 25146*; *10 Cal. Code Reg. § 260.146*] must be met [*see § 6H.200[1][f]* for further discussion]. Limited offering qualifications, intended to restrict the number of potential purchasers to those familiar with the risks involved in a particular security, may be subject to legend conditions restricting transfer [*see 10 Cal. Code Reg. § 260.141.10*; *see also §§ 6H.23, 6H.200[1][g]* for further discussion].

An application for an open qualification ordinarily will not be approved if the business in which the issuer is engaged is not reasonably anticipated to produce profits within a reasonable period of time. A period of time not exceeding 24 months after the date of approval is presumptively reasonable; however a longer period of time may be authorized in light of the proposed business, including the operational norms for the industry in which the business operates. [*10 Cal. Code Reg. § 260.140.5*] In addition, unseasoned corporations selling securities pursuant to an open qualification generally must have a capital structure consisting of only common stock or common stock and other securities that are convertible into common stock on a fair and equitable basis or are fully participating and non-redeemable [*10 Cal. Code Reg. § 260.140.9*]

Limited offering qualifications may also be approved to issue securities subject to transfer restrictions if the restrictions do not unfairly prejudice the rights of the holders to receive fair value. Securities may be sold in a limited offering qualification subject to repurchase rights and rights of first refusal which meet certain specified standards [*10 Cal. Code Reg. § 260.140.8*].

A limited offering qualification may also be approved pursuant to a condition imposed by the Commissioner or a representation by the applicant confining the offering to investors meeting certain standards of experience, financial responsibility, tax status, or other specifications. Special investor suitability rules have been established by the Commissioner for small business issuers (as defined in *10 Cal. Code Reg. § 260.001(i)*) if the offering will not exceed $5 million and the price of the security will be at least $2.00 [*10 Cal. Code Reg. § 260.140.1(e)*]. The offering documents must summarize the investor suitability standards [*10 Cal. Code Reg. § 260.140.1*]. In addition, an investor suitability questionnaire may be used [Dept. of Corps. Release No. 8-C (Feb. 27, 1969); *see § 6H.271*]. The issuer will be responsibility for ensuring that all investors meet the applicable suitability standards [*10 Cal. Code Reg. § 260.140.01*].

[2] Application Forms

The application forms for coordination, notification, and permit are specified by regulation [*see 10 Cal. Code Reg. §§ 260.111* (coordination), 260.112 (issuer notification), 260.113 (issuer permit), 260.121 (recapitalization/reorganization permit), 260.131 (nonissuer notification); *see also §§ 6H.205, 6H.215, 6H.220, 6H.250, 6H.255*, respectively]. A Form U-1 may be used in lieu of the state form for qualification by coordination, in which case the California facing page is not necessary [*see 10 Cal. Code Reg. § 260.111*; *see also § 6H.206*]. The items and exhibits required by the application for the type of qualification being used must be completed and attached. In lieu of answering any item in any of the forms, the applicant may incorporate the information by reference to any attached documents or documents previously filed with the Commissioner [*10 Cal. Code Reg. § 260.110.3*].

PRACTICE TIP:

In some circumstances it may be advisable to file exhibits not expressly called for by the form in order to expedite processing of the application. For instance, an issuer seeking to qualify securities to be issued

in connection with an employee benefit plan by coordination may want to file the proposed prospectus, the ERISA summary plan description and recent financial information since the Form S-8 no longer contains this type of information. *Commentary by Frances E. Lossing.*

Every application for qualification of an issuer transaction must be signed and verified by the issuer. Every application for qualification of a nonissuer transaction must be signed and verified by the person on whose behalf the offering is being made, or by the issuer on behalf of that person [*Corp. Code § 25115*]. Verification of an application must be done in the manner provided in the Code of Civil Procedure for the verification of pleadings [*Corp. Code § 25160*; *see § 6H.245*]. A consent to service of process in any noncriminal action arising against the applicant under the Corporate Securities Law must be filed with any application for qualification, unless a consent has been filed with a previous application or with a notice filing for a "covered security" under the National Securities Markets Improvement Act. [*Corp. Code § 25165*; *see § 6H.239*]. The consent to service of process must be (1) pursuant to the Uniform Consent to Service of Process (Form U-2) [*see § 6H.240*], pursuant to Form D [*17 C.F.R. 239.500*] filed with the Commissioner in connection with the transaction, (3) included in an electronic submission of a filing, or (4) in the California form set out in the regulation [*10 Cal. Code Reg. § 260.165*]. In addition, a Customer Authorization of Disclosure of Financial Records must be filed [*see § 6H.241*].

All financial statements required to be filed must be prepared in accordance with generally accepted accounting principles, including a balance sheet as of a date within 90 days prior to the date of the application and statements of income and statements of cash flow for each of the three years preceding the date of the balance sheet; the time period is reduced to two years for small business issuers. In addition, if the aggregate proceeds of the offering and all other offerings made by the issuer during the prior 12 months do not exceed $500,000, the financial statements may be "reviewed" rather than audited [*10 Cal. Code Reg. § 260.613*]. An entity is a small business issuer if it has annual revenues of less than $12.5 million and is a California corporation or a foreign corporation that meets the pseudo-California corporation standards and is not an investment company or a blind pool company. In addition, if the issuer is a majority-owned subsidiary of another company, that company must also be a small business issuer [*10 Cal. Code Reg. § 260.001(i)*]. The applicant's auditors may also need to review any prospective financial information submitted by the applicant to establish that the applicant is reasonably likely to be profitable within a two-year period [*10 Cal. Code Reg. § 260.140.5(b)*]. A consent of the applicant's auditors, along with that of any other expert used by the applicant, must be filed with the application. If an application is being filed by coordination, the issuer may incorporate the consent filed with the SEC registration statement by reference [*10 Cal. Code Reg. § 260.504.2.2*].

[3] Filing and Fees

An application for qualification must be filed with the Department of Corporations. The current addresses of its offices are as follows [*see* Dept. of Corps. Release No. 13-G (Revised; June 10, 2004)]:

320 West 4th Street, Suite 750
Los Angeles, CA 90013-2344
Telephone: (213) 576-7500

71 Stevenson Street, Suite 2100
San Francisco, CA 94105-2980
Telephone: (415) 972-8559

1515 K Street, Suite 200
Sacramento, CA 95814-4017
Telephone: (916) 445-7205

The filing fees for qualification are set forth in *Corp. Code § 25608* [*see also Corp. Code § 25608.3* (Commissioner may set any fee at amount below maximum set forth in § 25608); § 6H.200]. Although documents are filed when received by the Commissioner, no qualification can become effective until the appropriate fee is paid [*Corp. Code § 25615*].

[4] Post-Filing Amendments

An applicant must promptly supply by amendment, prior to the effectiveness of qualification, any information based on facts occurring after the original date of filing that is necessary to supplement or correct the information contained in the original application so as to make that information not materially misleading as of the effective date of the qualification [*Corp. Code § 25160*]. An amendment to an application should contain only the information being amended by item number, and must be verified in the form prescribed for the application. Each amendment should be accompanied by a completely filled-in facing page [*see 10 Cal. Code Reg. § 260.110*], on which the applicant must insert the fact that the filing is an amendment and the number of the amendment, if more than one [*10 Cal. Code Reg. § 260.110.4*]. The amendment must include a recalculation of the fee payable resulting from the change reflected in the amended application, plus $50 for an application filed after the effective date of the original qualification [*10 Cal. Code Reg. § 260.162*]. An amendment to an application filed after the effective date of the qualification of the sale of securities, if approved by the Commissioner, will become effective on the date determined by the Commissioner based on the public interest and protection of investors [*Corp. Code § 25162*; *see also § 6H.200[1][j]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART II. LEGAL BACKGROUND

3-6H California Legal Forms--Transaction Guide § 6H.23

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.23 Standards for Qualification

[1] Application of Fair, Just, and Equitable Standard

In connection with any application for qualification, the Commission must determine whether the proposed plan of business of the applicant and the proposed issuance of securities is fair, just, and equitable. With respect to qualification by issuer permit [*Corp. Code § 25113*; *see § 6H.21[2]*], the Commissioner may refuse to issue a permit unless he or she finds that the proposed plan of business of the applicant and the proposed issuance of securities are fair, just, and equitable; that the applicant intends to transact its business fairly and honestly; and that the securities which it proposes to issue and the methods to be used by it in issuing them are not such that, in his or her opinion, will work a fraud upon the purchasers [*see Corp. Code § 25140(b)*].

PRACTICE TIP:

It may be possible to expedite processing of the application if counsel outlines the manner in which the Commissioner's processing guidelines have been satisfied and the location in the plans or contracts filed of information evidencing the satisfaction of these guidelines. This approach is particularly useful for offerings subject to detailed standards, such as employee stock option plans. *Commentary by Frances E. Lossing.*

Similarly, the Commissioner may refuse to issue a permit for recapitalization or reorganization [*Corp. Code § 25122*; *see § 6H.21[3]*] unless he or she finds that the proposed plan of recapitalization or reorganization and the proposed issuance of securities are fair, just and equitable to all security holders affected [*Corp. Code § 25140(c)*]. Furthermore, the Commissioner may suspend or revoke any permit issued pursuant to *Corp. Code § 25113* or *25122* if he or she finds (1) that the order is in the public interest, and (2) that the proposed plan of business of the issuer or the proposed issuance or sale of securities is not fair, just, or equitable; that the issuer does not intent to transact its business fairly or honestly; or that the securities proposed to be issue or the method to be used in issuing them will tend to work a fraud upon the purchaser [*Corp. Code § 25140(a)(1)*].

With respect to qualification by coordination [*Corp. Code § 25111*; *see § 6H.21[2]*] or notification [*Corp. Code §§*

25112, *25131*; *see § 6H.21[2], [4]*], the Commissioner may issue a stop order denying effectiveness to, or suspending or revoking the effectiveness of, any qualification of an underwritten offering of securities under *Corp. Code § 25111*, *25112*, or *25131* for those same reasons [*Corp. Code § 25140(a)(1)*; *see § 6H.205[1][f]*]. In the case of an offering of securities that is not underwritten, the Commissioner may issue the stop order *unless* he or she finds (1) that the stop order is not in the public interest, and (2) that the proposed plan of business of the applicant or the proposed issuance securities is fair, just, and equitable; that the issuer intends to transact its business fairly or honestly; or that the securities that the issuer proposes to issue or the method to be used in issuing them are not such that will tend to work a fraud upon the purchaser [*Corp. Code § 25140(a)(2)*]. Thus, for offerings that are underwritten, the burden of making the specific finding is on the Commissioner. For offerings that are not underwritten, the burden is shifted to the applicant [*see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 8, Standards for the Exercise of the Commissioner's Discretion, § 8.01[1]*] (Matthew Bender).

Guidelines for the exercise of the Commissioner's discretion under the fair, just, and equitable standard are set forth in *10 Cal. Code Reg. §§ 260.140-260.140.131.9* [*see §§ 6H.205*, *6H.215*]. The standards, however, do not preclude the Commissioner from imposing more stringent standards in either an open or a limited qualification, if the Commissioner believes more stringent standards are appropriate, unless otherwise expressly stated in the rules [*10 Cal. Code Reg. § 260.140*].

Securities generally must be non-assessable, unless the issuer is organized solely to provide services or property to its members on a continuing basis [*10 Cal. Code Reg. § 260.140.7*]. For a discussion of standards applicable to the issuance of debt securities generally, see Ch. 6J, *Issuance of Debt Securities* . For a discussion of standards applicable to the issuance of equity securities generally, see Ch. 6I, *Issuance of Equity Securities* . In addition, the Commissioner has established standards for the amount of selling expenses that the Commissioner deems to be reasonable [*10 Cal. Code Reg. § 260.140.20*], the amount of promotional shares, if any, that may be issued in the offering and the terms of those promotional shares [*10 Cal. Code Reg. §§ 260.140.30-260.140.32*], and the fairness of the offering price [*10 Cal. Code Reg. §§ 260.140.50*, *260.140.51*].

For extensive discussion of those rules, see Marsh & Volk, Practice Under the California Securities Laws, Ch. 8, *Standards for the Exercise of the Commissioner's Discretion* (Matthew Bender).

Specific standards applicable to nonissuer qualifications are set forth in *10 Cal. Code Reg. §§ 260.140.135-260.140.139*. Applications to qualify securities for nonissuer transactions are subject to the standards for review applied in the qualification of issuer transactions in certain circumstances [*10 Cal. Code Reg. § 260.140.136*; *see § 6H.21[4][c]*].

[2] Conditions of Qualification

Corp. Code § 25141 authorizes the Commissioner to impose conditions on the qualification of issuer transactions and reorganization transactions. These conditions may require any of the following:

- Depositing in escrow.
- Imposing a legend condition on the securities restricting transfer.
- Impounding the proceeds of sale until sufficient securities are sold.
- Limiting selling expenses.
- Waiving assets, dividends, or voting rights of promotional securities.
- Any other condition necessary to prevent the offering from being unfair, unjust, or inequitable.

The Commissioner may modify or remove any such conditions when, in his or her opinion, they are no longer necessary or appropriate [*Corp. Code § 25141*]. Violation of any of these conditions exposes the violator to both civil and criminal liability [*see Corp. Code §§ 25503, 25540*].

Forms relating to conditions of qualification are *set forth in §§ 6H.260*-6H.267. For extensive discussion of those conditions, see Marsh & Volk, Practice Under the California Securities Laws, Ch. 9, *Conditions of Qualification* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART II. LEGAL BACKGROUND

3-6H California Legal Forms--Transaction Guide § 6H.24

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.24 Federal Preemption of State Securities Regulation

The National Securities Markets Improvement Act of 1996 (NSMIA) [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005)] made significant changes to the Securities Act of 1933 [*15 U.S.C. § 77a et seq.*], the Securities Exchange Act of 1934 [*15 U.S.C. § 78a et seq.*], the Investment Company Act of 1940 [*15 U.S.C. § 80a-1 et seq.*], and the Investment Advisers Act of 1940 [*15 U.S.C. § 80b-1 et seq.*]. Most significant to California practice is NSMIA prohibition on state regulation of certain issuers and transactions, by means of federal preemption, in many areas of securities regulation that formerly were subject to dual regulation by the states under blue sky laws and by the SEC or other federal agencies. The effect of NSMIA was to eliminate or restrict application of the California securities laws, including California qualification requirements, to securities covered by NSMIA's preemption provisions.

Section 18 of the Securities Act of 1933 [*15 U.S.C. § 77r*], as amended by NSMIA, provides that no state may prohibit an offering or sale in the state, impose additional disclosure requirements, impose "merit" standards, require the registration or qualification of a security or transaction, or prohibit or limit the use of any offering document prepared on behalf of the issuer in an offering (including proxy statements and reports to shareholders required to be filed under Section 15A of the 1934 Act [*15 U.S.C. § 78o-3*] unless the issuer is incorporated in the state) if the security offered is a "covered" security [*15 U.S.C. § 77r(a)*]. However, the states may continue to impose notice filing requirements and filing fees in some circumstances, and to investigate and bring enforcement actions for fraud or unlawful conduct by a broker and dealer [*15 U.S.C. § 77r(c)(2)*]. California has adopted notice filing requirements for "covered securities" under NSMIA in *Corp. Code §§ 25100.1*, *25101.1*, and *25102.1*.

For more detailed discussion of NSMIA, and a guide to determining whether or not a particular security is subject to NSMIA preemption provisions, see Ch. 6, *Securities Regulation Issues* . For extensive coverage of the Act and its interaction with California securities laws, see Marsh & Volk, Practice Under the California Securities Laws, Ch. 3A, *Federal Preemption of State Securities Regulation* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedureFederal & State InterrelationshipsFederal Common LawPreemptionSecurities LawGeneral OverviewSecurities LawBlue Sky LawsFederal PreemptionSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART II. LEGAL BACKGROUND

3-6H California Legal Forms--Transaction Guide § 6H.25

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.25 NASAA's Coordinated Equity Review Program

In response to the NSMIA [*see § 6H.24*] and other developments in the securities markets, the North American Securities Administrators Association, Inc. (NASAA) has established the Coordinated Review of Equity Offerings program (CER), a pilot program designed to build on coordination efforts by NASAA. The Commissioner of Corporations has announced the participation of the California Department of Corporations in the CER program [Dept. of Corps. Release No. 111-C (Apr. 16, 1998)].

The CER program provides for coordination of review among sister state securities regulators that allows each participating state to avoid the duplication of another state's regulatory efforts and resources in reviewing each application. Under CER, an issuer requests coordination of review by notifying the Department of its intent to participate under CER. The issuer then files a complete application with the Department and any other state in which the issuer seeks to offer securities. A "lead state" is then appointed to manage the coordination process among the participating states. The Department reviews a California offering application and forwards all comments and other issues raised by the application to the lead state. The lead state has the responsibility to combine all of the relevant comments into a single letter that is then forwarded to the issuer. Under CER, all negotiations related to a particular offering are conducted with a single state regulator. Individual state-specific comments may necessitate additional interaction with the issuer outside of the lead state relationship [Dept. of Corps. Release No. 111-C (Apr. 16, 1998)].

States participating in CER have agreed to adhere to the guidelines promulgated by NASAA, except to the extent that the guidelines contradict state law, including rules and orders. The purpose of the guidelines is to provide a basis for uniformity among the states without contravening state law, including rules and orders. To facilitate its participation in the pilot program, the Department has appointed an internal working group to oversee and review CER applications. This group is responsible for maintaining the consistency of the review process and insuring that each applicant is in compliance with the Corporate Securities Law of 1968. Variances from the requirements of the Commissioner's rules will be considered on an ad hoc basis, consistent with Rule 260.140 [Dept. of Corps. Release No. 111-C (Apr. 16, 1998); *see 10 Cal. Code Reg. § 260.140*]. Information on the NASAA guidelines can be found online at NASAA's website, which is located at http://www.nasaa.org.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART II. LEGAL BACKGROUND

3-6H California Legal Forms--Transaction Guide § 6H.26

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.26 Advertising

No person may publish an advertisement in California concerning any security sold or offered for sale in California if the offering must be qualified in California, unless a copy of the advertisement has been on file with the Commissioner for at least three days or a shorter period of time that may be authorized by the Commissioner [*Corp. Code § 25300*]. Any permit issued by the Commissioner automatically constitutes an order waiving the three-day time period [*10 Cal. Code Reg. § 260.300*]. Preliminary prospectus distributed in connection with a nationwide offering in which a registration statement has been filed with the SEC may also be distributed as long as no stop order is in effect under either state or federal law and no proceeding is pending with respect to the issuance of any such stop order [Letter From Assistant Commissioner (Nov. 1, 1985)].

The term "advertisement" refers to any written or printed communication or any communication by means or recorded telephone messages or spoken on radio, television, or similar communications media, published in connection with the offering or sale of a security [*Corp. Code § 25002*]. An advertisement is published if it is publicly issued or circulated by newspaper, mail, radio or television or otherwise disseminated to the public [*Corp. Code § 25014*].

PRACTICE TIP:

All preliminary prospectuses or prospectuses used in connection with an offering will, of course, be advertisements. Care must be taken, however, to be certain that other materials will not inadvertently be considered advertisements. "Due diligence" material provided to underwriters in connection with an offering should not be provided to potential investors [*see* Dept. of Corps. Release No. 40-C (Jan. 3, 1975)]. Advertising to promote an issuer's product or services should not be so closely related to the offering that it might be deemed to be advertising. In addition, care should be exercised in conducting pre-offering exploratory activities to be certain that these activities do not involve the publication of an advertisement [*see* Commissioner's Opinion No. 98/1C]. *Commentary by Frances E. Lossing.*

The Commissioner has published guidelines for advertisements [*10 Cal. Code Reg. § 260.302*; *see § 6H.180* for a discussion of these guidelines]. In addition, if the advertisement refers to an exemption from or reduction in taxation

under any law, the name of counsel providing the tax opinion should be stated in the advertisement [Dept. of Corps. Release No. 23-C (Nov. 12, 1971)].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART II. LEGAL BACKGROUND

3-6H California Legal Forms--Transaction Guide §§ 6H.27-6H.99

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6H.27[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6H California Legal Forms--Transaction Guide

AUTHOR: Frances E. Lossing Practice Consultant

NOTE:

This outline is for use in collecting the information required for the most extensive (that is, permit) form of application [***see § 6H.21[2][b]***]. Not all of the information in the checklist is necessary for every form of qualification. If a less extensive form of qualification (for example, issuer notification) [***see § 6H.21[2][b]***] is available, the attorney may use that application form as a checklist for assembling the required information [***see § 6H.150*** (prefiling procedure and preparation of application)].

Because a significant amount of financial data is required for each form of qualification, the applicant's accountant should either attend the interview or supply the requisite financial statements and reports.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6H California Legal Forms--Transaction Guide § 6H.100

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.100 Facts--Issuer

1. Name (including any other names used by the issuer in its operations during the past three years), address of principal executive office, and telephone number of issuer.

2. Name and address of applicant if other than issuer, and name and address of persons on whose behalf securities will be offered if offering will not be made by the issuer

3. Form of business of issuer (e.g., corporation, partnership, trust).

4. Jurisdiction in which issuer was organized.

5. Standing of issuer with Secretary of State of California (and state authority where organized, if applicable).

6. Description of issuer's business, including history of operations, nature of products or services, program of operations, property and personnel concerned, suppliers, customers, competitors, and so on, during past three years.

NOTE:
Sufficient information must be obtained to determine whether the issuer is a seasoned or unseasoned corporation, whether the issuer is a pseudo-California corporation, if it is not a California corporation [***see*** *Corp. Code § 2115*], and whether the issuer is a small business issuer.

7. Details of any order, judgment, or decree entered in connection with the offering of securities, the

securities business, or any theft or felony, by any state or regulatory authority, court, or the SEC.

8. Financial statements of the issuer and any audit report or review made by an independent public accountant.

9. Whether any dividends are in arrears or there have been any defaults in the payment of securities.

10. If securities are publicly traded, the high and low sales prices for the securities during the past two years.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6H California Legal Forms--Transaction Guide § 6H.101

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.101 Facts--Management and Shareholders

1. Name, birth date, and current address for all key management personnel (directors, officers, trustees, general partners, managers, other executives or persons charged with business activities and operations of issuer), and main occupation of each for preceding five years.

2. Any order, judgment, or decree of any governmental agency or administrator, or of any court [*see 10 Cal. Code Reg. §§ 260.112, 260.113, 260.131*]:

a. Revoking or suspending for cause any license, permit, or other authority of person described in P 1, *above*, or of any corporation of which he or she is officer or director, to engage in securities business or in sale of particular security.

b. Temporarily or permanently restraining or enjoining that person or corporation from engaging in or continuing in any conduct, practice, or employment in connection with purchase or sale of securities.

c. Convicting that person of any felony or misdemeanor involving security or any aspect of securities industry, or of theft or of any felony.

3. With respect to shareholders or beneficial holders of 10 percent or more of any class of fully voting security, whether held individually or through voting trust or other such arrangement [*see 10 Cal. Code Reg. §§ 260.112, 260.113, 260.131*]:

a. Names, addresses, and telephone numbers.

b. Amounts held by each holder and percentage of holdings.

4. Description of any material transactions or agreements between issuer and any key management personnel, dominant shareholders, other insiders, promoters, or any company or corporation controlled by any such person within preceding three years [*see 10 Cal. Code Reg. §§ 260.112, 260.113, 260.131*].

5. Compensation paid to each director, officer, or principal security holders in past year by issuer or any of its subsidiaries to extent that it exceeded $60,000 [*see 10 Cal. Code Reg. §§ 260.112, 260.113, 260.131*].

6. Total aggregate compensation paid to all officers and directors during last year as a group [*see 10 Cal. Code Reg. §§ 260.112, 260.113, 260.131*].

7. Details of insider trading activities if any officer, director, or principal security holder effected more than five transactions in any security of the issuer in preceding 12 months [*see 10 Cal. Code Reg. § 260.131*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6H California Legal Forms--Transaction Guide § 6H.102

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.102 Facts--Outstanding Securities

1. Classes and general descriptions of all types of outstanding securities, and whether not they are publicly traded.

NOTE:
A security is publicly traded if it is listed on a national securities exchange, is traded in the overcounter market and quoted in The Wall Street Journal or other newspaper of general circulation or is held of record beneficially by 500 or more person [*10 Cal. Code Reg. § 260.110*, Item 5].

2. Details of any issuance of securities issued pursuant to either:

a. Small offering exemption [*see* Ch. 6C, *California Small Offering Exemption*].

b. Limited offering exemption [*see* Ch. 6B, *California Limited Offering Exemptions*].

3. Details on all options, warrants, or conversion rights currently outstanding, including:

a. Price at which right may be exercised.

b. Market value of securities underlying rights.

c. Names of all persons holding those options or rights.

d. Expiration dates of those options or rights.

4. Tally of votes or consents of shareholders to any option or stock bonus plan, with dates of votes and form in which issue was submitted for approval.

5. With respect to any previous filings with Commissioner of Corporations:

a. File number.

b. General description of contents of filings.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6H California Legal Forms--Transaction Guide § 6H.103

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.103 Facts--Securities to Be Qualified

1. Full description of securities to be qualified, including:

    a. Title of class.

    b. Total number of shares in each class.

    c. Proposed offering price.

    d. Proposed aggregate amount of funds to be raised through issue.

    e. Terms of securities or any modification of terms of existing securities.

2. Nonmonetary consideration to be received for securities (e.g., real or personal property, patents, cancellation of indebtedness, work or services performed or to be performed), together with:

    a. Value of consideration.

    b. Per share selling price of shares based upon that value.

    c. Purchasers of shares for each category of nonmonetary consideration.

3. Proposed uses of funds to be obtained from sale of securities and approximate amounts to be used for each purpose.

4. Proposed plan of distribution of securities, including:

a. Identification of any underwriters, broker-dealers, or agents to be used in distribution.

NOTE:
If agents other than licensed broker-dealers are to be used in the distribution of securities, the applicant is required to disclose any adverse judgment, order, or decree disabling any such person from engaging in the securities business, selling securities, or relating to any theft or felony, and a surety bond must be obtained [***see*** *10 Cal. Code Reg. § 260.141.30*].

c. Name and address of any employee agents and the name of the person supervising such employee agents.

b. Fees, discounts, bonuses, options, or commissions to be paid or allowed.

5. Calculations and computations based on earnings for past years showing ability of issuer to pay dividends, interest, and sinking fund obligations on all outstanding senior securities, if offering concerns any senior securities [*see 10 Cal. Code Reg. § 260.140.10*].

6. Details concerning particular types of investment arrangements, *e.g.*,:

a. Oil, gas, or mining leases [*see 10 Cal. Code Reg. § 260.140.120 et seq.*].

b. Real estate syndicates [*see 10 Cal. Code Reg. § 260.140.110.1 et seq.*].

c. Mutual water companies [*see 10 Cal. Code Reg. § 260.140.71 et seq.*; Dept. of Corps. Release No. 73-C (May 17, 1983)].

d. Churches [*see 10 Cal. Code Reg. § 260.140.72 et seq.*; Dept. of Corps. Release No. 86-C (Feb. 21, 1989).

7. Recapitalization or reorganization plan or plan for exchange of securities, impact on existing shareholders and exchange ratio.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6H California Legal Forms--Transaction Guide § 6H.104

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.104 Documents

1. Articles of incorporation, association, or partnership, or contract for joint venture of issuer and of each constituent corporation in a reorganization.

2. Bylaws.

3. Declarations of trust (including voting trusts).

4. Trust indenture or other master document relating to issuance of debt securities.

5. Specimen security for proposed issue.

6. Commercial contracts relating to issuer's business.

7. Contracts concerning any matters related to securities, commercial operation of issuer, or related matters between issuer and any of following:

a. Issuer's officers, directors, key managers, dominant shareholders, or other insiders.

b. Issuer's marketing distributors.

c. Any companies controlled by persons listed above.

8. Contracts entered into (or proposed to be entered into) between issuer and its shareholders concerning

transfer restrictions, voting, etc. affecting outstanding interests.

9. Net worth statements or investment biographies of proposed issuees when highly speculative stock issue is in offering, or for oil and gas offering or real estate syndication.

NOTE:

These matters may be given confidential treatment by the Commissioner [***see** § 6H.275*]. Corporate counsel should appraise any such statements and file them, rather than having the proposed issuee file them directly with the Commissioner.

10. Technical appraisals by engineering, real estate valuation, or other experts evaluating nonmonetary properties to be received for securities.

11. Opinions of patent or other attorneys regarding legal propriety and status of ownership of particular properties to be received for securities.

12. Tax opinions and opinions and reports of other experts.

13. Contracts, licenses, and assignments, and all other agreements directly affecting properties to be received for securities.

14. Financial statements of issuer or, if consideration is securities of another business, financial statements of the other business.

15. If applicant is not formed and going business, itemized budget reflecting proposed proceeds and other sources of financing, and the financing requirements [*see § 6H.243*].

16. Option and stock bonus plans (particularly, qualified stock option and employee stock purchase plans).

17. Proxy materials to be submitted to shareholders regarding adoption of option plans.

18. Consent to service of process on Commissioner, if applicant is noncorporate entity or non-California corporation [*see §§ 6H.239, 6H.240*].

19. Proposed prospectus and other advertising material [*see § 6H.180*].

20. Consents of attorneys, accountants and other experts named in prospectus or other advertisements.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral Overview



24 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6H California Legal Forms--Transaction Guide §§ 6H.105-6H.119

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6H.105[Reserved]



25 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations to Qualification of Securities

3-6H California Legal Forms--Transaction Guide § 6H.120

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.120 Determining Whether Security Must Be Qualified in California

1. Determine whether instrument or interest in question constitutes a "security" for purposes of California Corporate Securities Law [for applicable determinations, *see Ch. 6, Securities Regulation Issues, § 6.110*].

NOTE:
If the instrument is not a security, the California securities laws, including the requirement of qualification, are inapplicable. However, "security" is very broadly defined under California law [***see*** *Corp. Code § 25019*].

2. Determine whether transaction involves an "offer" or "sale" [for applicable determinations, *see Ch. 6, Securities Regulation Issues, § 6.111*; *see also Corp. Code § 25017* (statutory definitions)].

3. Determine whether offer to buy or sell is made in California [for applicable determinations, *see Ch. 6, Securities Regulation Issues, § 6.112*; *see also Corp. Code § 25008(a), (b)*].

4. If interest is a security, determine whether security or transaction are subject to preemption provisions of National Securities Markets Improvement Act of 1996 [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005)] and therefore not subject to *Corp. Code §§ 25110, 25120*, and *25130* [for applicable determinations, *see Ch. 6, Securities Regulation Issues, § 6.117*].

5. If interest is a security and regulation is not preempted by federal law, determine whether security is exempt from qualification under California law [for applicable determinations, *see Ch. 6, Securities Regulation Issues, § 6.115*].

NOTE:

Every security that is offered or sold in California must be qualified, unless the security or the transaction is exempted from qualification [***see*** *Corp. Code § 25110(a)*] or is subject to the federal preemption provisions. An exemption from qualification may exist either because the security itself is exempt or because it is involved in an exempt transaction. For a detailed discussion of California exemptions, see Ch. 6, ***Securities Regulation Issues*** .

6. If security is not exempt from qualification, determine whether specific transaction is exempt from qualification [for applicable determinations, *see Ch. 6, Securities Regulation Issues, § 6.116*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations to Qualification of Securities

3-6H California Legal Forms--Transaction Guide § 6H.121

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.121 Determining Applicable Form of Qualification

1. For issuer transactions [*see § 6H.21[2]*]:

NOTE:

Issuer transactions are those in which the person that issues or proposes to issue a security distributes the issue to investors for the first time. An issuer transaction is one directly or indirectly for the issuer's benefit [***see*** *Corp. Code § 25010*]. An offering which involves both an issuer and a nonissuer transaction [***see*** P 2, ***below***] will be treated for qualification purposes as an issuer transaction [*Corp. Code § 25011*].

a. Determine whether registration statement will have to be filed under Federal Securities Act of 1933 [*see 15 U.S.C. § 77a et seq.*] in connection with same offering, thereby allowing issuer to use qualification by coordination procedure in California.

NOTE:

If the issuer is required to file a federal registration statement under the 1933 Act, qualification by coordination is available in California [*see § 6H.205* for applicable form]. Qualification by coordination is a streamlined procedure that permits the issuer to file the same papers with California regulators as are filed with the SEC [***see*** *Corp. Code § 25111(b)*]. The qualification becomes effective simultaneously with the registration statement under the 1933 Act being declared effective by the SEC [*Corp. Code § 25111(c)*; ***see*** *§ 6H.21[2][b]*].

b. If qualification by coordination under *Corp. Code § 25111* [*see* P a, *above*] is not available, determine

whether qualification by notification is available.

NOTE:
Qualification by notification is available if the criteria specified in either P (1) or (2), ***below***, are met [*Corp. Code § 25112(a)* ***see*** *§ 6H.215* for applicable form]. The procedure for qualification by notification is less elaborate than that for qualification by permit [***see*** P c, ***below***], and becomes automatically effective on the 10th business day after the application (or the last amendment to the application) is filed, subject to satisfaction of specified conditions [***see*** *Corp. Code § 25112(c)*; ***see also*** *§ 6H.21[2][b]*].

(1) Is security issued by person who issued any security registered under Section 12 of Securities Exchange Act of 1934 [*15 U.S.C. § 78l*]?

(2) Is security issued by investment company registered under Investment Company Act of 1940 [*15 U.S.C. § 80a-1 et seq.*]?

c. If neither qualification by coordination [*see* P a, *above*] nor qualification by notification [*see* P b, *above*] is available, qualification must be made by permit [*see § 6H.220* for applicable form].

NOTE:
The permit procedure requires the Commissioner of Corporations to take affirmative action in issuing a permit before the offer or sale of the securities becomes legally permissible [***see*** *Corp. Code § 25113*; ***see also*** *§ 6H.21[2][b]*].

2. For nonissuer transactions [*see § 6H.21[4]*]:

NOTE:
Nonissuer transactions, commonly known as secondary trading, are those which neither directly nor indirectly benefit the issuer [*Corp. Code § 25011*].

a. Determine whether transaction involves securities registered under Securities Act of 1933 [*see 15 U.S.C. § 77a et seq.*], thereby allowing issuer to use qualification by coordination procedure in California [*Corp. Code § 25111(a)*; *see § 6H.205* for applicable form].

b. Determine whether offering involves securities offered in nonissuer transaction pursuant to exemption under Regulation A of Securities Act of 1933 [*17 C.F.R. § 230.251 et seq.*], thereby requiring issuer to use qualification by permit under *Corp. Code § 25113* [*Corp. Code § 25131(a)*; *see § 6H.220* for applicable form].

c. If neither (a) nor (b), *above*, is applicable, qualification must be made by notification under *Corp. Code § 25131* [*Corp. Code § 25131(a)*; *see § 6H.255* for applicable form].

3. Determine whether transaction constitutes recapitalization, reorganization, or change in terms of outstanding securities [*Corp. Code § 25120*; *see § 6H.21[3]*], thereby requiring issuer to use qualification by permit [*Corp. Code § 25121*; *see § 6H.250[2]* (form)].

NOTE:
Except as provided below, is unlawful for any person to offer or sell any security in an issuer transaction in connection with any change in the rights, preferences, privileges, or restrictions of or on outstanding

securities, in any exchange of securities by an issuer with its existing security holders exclusively, in any exchange in connection with mergers, consolidations, or purchase of corporate assets in consideration wholly or in part for the issuance of securities, or in an entity conversion transaction [*Corp. Code § 25120(a)*; ***see*** *Corp. Code § 25005.1* (definition)]. The above-stated prohibition, however, will not apply to a security if the security is qualified for sale pursuant to *Corp. Code § 25121* (and no stop order under *Corp. Code § 25140* or *25143(a)* is in effect with respect to that qualification), or if the security or transaction is exempt [***see*** *Corp. Code §§ 25100-25105*] or not subject to qualification [*Corp. Code § 25120(b)*]. Qualification must be made by permit for this type of transaction [*Corp. Code § 25121*; ***see*** *§ 6H.250* for applicable form].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral Overview



27 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations to Qualification of Securities

3-6H California Legal Forms--Transaction Guide §§ 6H.122-6H.149

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6H.122[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Qualification of Securities

3-6H California Legal Forms--Transaction Guide § 6H.150

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.150 Prefiling Procedure and Preparation of Application

1. Arrange (by telephone or letter) prefiling conference with Department of Corporations counsel to discuss any specific problems of particular application, if necessary.

NOTE:
In any proceeding before the Commissioner, an applicant may be represented by an attorney admitted to practice before either the Court of Appeals or the District Court of the United States for the District of Columbia [*10 Cal. Code Reg. § 250.11*].

2. Assemble facts and documents for prefiling conference and for application for qualification [*see §§ 6H.100-6H.104*].

3. Prepare application (or notice) either on form provided by Department of Corporations or in form prescribed by Commissioner's rules.

NOTE:
Applications must be typewritten or printed in English on one side only of legal or letter-size paper [*10 Cal. Code Reg. § 260.110.1*].

a. Prepare facing page [*see § 6H.200*].

NOTE:
A facing page is required for all applications for qualification [*10 Cal. Code Reg. § 260.110*] except nonissuer transaction, which has its own form of facing page [*10 Cal.*

Code Reg. § 260.131; ***see*** *§ 6H.255*]. However, if qualification is by coordination and the applicant substitutes Form U-1 [***see*** *§ 6H.206*] for the local form [***see*** *§ 6H.200*], the facing page is unnecessary.

b. Complete items and attach exhibits called for by form of application for qualification being used.

NOTE:

Any information required by any item or exhibit may be incorporated by reference to any information currently on file with the Commissioner [*Corp. Code § 25161*; *10 Cal. Code Reg. § 260.110.3*].

(1) For items and exhibits required for qualification by coordination, see *form in § 6H.205[2]*.

(2) For items and exhibits required for qualification by issuer notification, see *form in § 6H.215[2]*.

(3) For items and exhibits required for qualification by permit, see *form in § 6H.220[2]*.

(4) For items and exhibits required for qualification by recapitalization/reorganization permit, see *form in § 6H.250[2]*.

(5) For items and exhibits required for qualification by nonissuer notification, see *form in § 6H.255[2]*.

c. Determine fees required for form of application for qualification [*see Corp. Code § 25608*; *see also § 6H.200*] and obtain check payable to "Department of Corporations" to include with filing.

NOTE:

Documents are filed when received by the Commissioner, but no qualification can become effective until the appropriate fee is paid [*Corp. Code § 25615*].

d. Have application signed by officer or general partner of applicant [*10 Cal. Code Reg. § 260.110.2*].

NOTE:

If applicant has given power of attorney for signing to special attorney-in-fact, include as exhibit a copy of the power or corporate resolution authorizing that signing [*10 Cal. Code Reg. § 260.110.2*]. Small company applications must be reviewed and signed by each member of the board of directors [*10 Cal. Code Reg. § 260.110.2*; ***see*** *Corp. Code § 25113(b)(2)*].

e. Verify application in manner provided for verification of pleadings [*see § 6H.244*].

4. Prepare consent to service of process using California form [*see § 6H.239*] or Form U-2 [*see § 6H.240*].

NOTE:

A consent to service of process [***see*** *§ 6H.239*] or Form U-2 [***see*** *§ 6H.240*] must be filed with any application for qualification, application or notice that a security or transaction is not subject to qualification [***see*** *Corp. Code §§ 25100.1, 25101.1, 25102.1*], and any application or notice of exemption from qualification, unless such a consent has been previously filed [*Corp. Code § 25165*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral Overview



29 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Qualification of Securities

3-6H California Legal Forms--Transaction Guide § 6H.151

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.151 Filing Procedure

NOTE:

Normally, only the original must be filed. However, the Commissioner may request or require by rule additional copies. Notwithstanding any other provision of law, any application for qualification required to be signed that is filed in California as an electronic record pursuant to a nationwide central depository for qualification or registration of securities, or any electronic record filed through the Central Registration Depository or the Investment Adviser Registration Depository, will be deemed a valid original document on reproduction to paper form by the Department of Corporations [*Corp. Code § 25612.5(c)*]. "Electronic record" means a record created, generated, sent, communicated, received, or stored by electronic means [*Corp. Code § 25612.5(d)*; *Civ. Code § 1633.2(g)*].

1. File application for qualification of securities in any office of Department of Corporations [*see* Dept. of Corps. Release No. 13-G (Revised; June 10, 2004)]:

a. 320 West 4th Street, Suite 750, Los Angeles, CA 90013-2344.

b. 71 Stevenson Street, Suite 2100, San Francisco, CA 94105-2980.

c. 1515 K Street, Suite 200, Sacramento, CA 95814-4017.

2. If qualification is by coordination [*Corp. Code § 25111*]:

a. File application not later than 20th business day following filing of registration statement with SEC, except in case of Form S-3 or Form F-3 registrant using SEC Rule 415 [*17 C.F.R. § 230.415*] for offering on delayed or continuous basis, in which case

filing must be made within two business days of date of filing registration statement with SEC [*10 Cal. Code Reg. § 260.111.1*].

b. Offer securities at any time during period statement is filed with SEC so long as no stop order or refusal order is in effect federally or locally and no federal hearing on such an order is pending [*Corp. Code § 25102(b)*].

c. Do not sell securities until moment federal registration becomes effective [*Corp. Code § 25111(c)*], so long as:
(1) No stop order is in effect.

(2) Application has been on file with Commissioner for at least 10 days.

(3) Statement of maximum and minimum proposed offering prices and maximum underwriting discounts and commissions has been on file for two business days (unless time has been shortened by Commissioner), and offering is made within those limits [*Corp. Code § 25111(c)*].

3. If qualification is by issuer notification [*Corp. Code § 25112*] or nonissuer notification [*Corp. Code § 25131*], do not offer or sell securities until 12:00 P.M. (California time) of 10th business day after filing of application or last amendment to application (unless Commissioner allows an earlier time), so long as no stop order or suspension is in effect [*Corp. Code §§ 25112(c), 25131(c)*].

4. If the qualification is by issuer permit [*Corp. Code § 25113*] or by recapitalization/reorganization permit [*Corp. Code § 25121*], do not offer or sell securities until Commissioner has issued permit [*Corp. Code §§ 25113(c), 25122*].

5. If escrow is made condition in exceptional and speculative circumstances of promotional shares, select and nominate escrow holder for Commissioner's approval [*see § 6H.264*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933General OverviewSecurities LawInitial Public Offerings & the Securities Act of 1933Registration of SecuritiesFiling



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Qualification of Securities

3-6H California Legal Forms--Transaction Guide § 6H.152

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.152 Post-Filing Procedure

1. Amend pending application, if required [*see Corp. Code § 25160; 10 Cal. Code Reg. § 260.110.4*].

a. Check that all information submitted to date will be true and complete as of time qualification becomes effective.

b. Prior to qualification, promptly supply information as to facts occurring after original date of filing that is necessary to supplement or correct information contained in original so as to render it not materially misleading.

c. Prepare completely filled-in facing page, indicating by checking appropriate box whether amendment is preeffective or posteffective, and giving number of amendment if more than one; include only those other items by appropriate number that are being amended [*10 Cal. Code Reg. §§ 260.110.4, 260.162*].

d. Include recalculation of fee payable resulting from change reflected in amended application plus $50 for application filed after effective date of the original qualification [*10 Cal. Code Reg. § 260.162*].

e. Verify amendment in manner provided for original application.

f. If application is for qualification by coordination [*Corp. Code § 25111*]:
(1) Promptly notify Commissioner by telephone, telegram, or fax [*see 10 Cal. Code Reg. § 250.11.1*] of date and time federal registration became effective, and content of price

amendment, if any [*see § 6H.208*].

(2) Promptly file post effective amendment to application containing information and documents in price amendment.

NOTE:
"Price amendment" means the final federal amendment that fills in the previously permitted fluctuating or blank price figures [***see*** *Corp. Code § 25111(c)*; ***see also*** *§ 6H.208*].

PRACTICE TIP:
The Commissioner's processing guidelines deviate from common SEC practice in that pricing amendments are no longer required to be filed with the SEC in many circumstances. In these circumstances the final form of prospectus which contains the final pricing information should be filed with the Commissioner in lieu of the pricing amendment. *Commentary by Frances E. Lossing.*

(3) If conditions appear to justify request, apply to Commissioner for order shortening time required for filing application or statements or waiving requirement for filing price ranges.

(4) If fact is apparent, notify Commissioner when federal registration statement will become effective and request return collect communication as to whether all California conditions appear to have been satisfied.

(5) If conditions are not satisfied locally by time federal registration is effective, commence sale only when local conditions finally are satisfied.

2. If financial or other information is of private nature, request Commissioner to treat matter confidentially and withhold from public access [*10 Cal. Code Reg. § 250.10*; *see § 6H.275*].

3. If project calling for qualification of securities has been terminated pending application, request consent to withdraw application [*10 Cal. Code Reg. § 250.16*; *see § 6H.277*].

4. If overpayment has been made in connection with filing and refund has not automatically been made, request refund [*10 Cal. Code Reg. § 250.15*; *see § 6H.276*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Qualification of Securities

3-6H California Legal Forms--Transaction Guide §§ 6H.153-6H.179

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6H.153[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6H California Legal Forms--Transaction Guide § 6H.180

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.180 Advertising Securities for Offer or Sale

1. Do not publish [as defined in *Corp. Code § 25014*] any advertisement in California involving offer or sale of securities if true copy of advertisement [as defined in *Corp. Code § 25002*] has not been on file with Commissioner for at least three business days prior to publication, unless [*Corp. Code § 25300(a)*]:

a. Commissioner allows shorter period pursuant to rule or order; or

NOTE:
For example, an investment company with a currently effective qualification [***see*** *Corp. Code § 25111(c)*] has 10 calendar days after initial publication in California in which to file an advertisement with the Commissioner [***see*** *10 Cal. Code Reg. § 260.300.2*].

b. Advertisement is exempt [*see Corp. Code § 25300(b)*; *see also* P 2, *below*].

2. Determine whether advertisement is exempt from filing by virtue of one of following factors [*Corp. Code § 25300(b)*; *10 Cal. Code Reg. § 260.300*]:

a. Advertisement is permitted or required by § 5(b)(2) or § 2(10)(b) of Securities Act of 1933 [*see 15 U.S.C. § 77b(a)(10), 77e(b)(2)*] with respect to security registered under Securities Act of 1933 and qualified in California [*Corp. Code § 25300(b)(4)*].

b. Advertisement is by investment company or unit investment trust that has previously qualified sale of its securities or that is substantially same as previously qualified unit investment trust [*Corp. Code § 25300(b)(6)*; *10 Cal. Code Reg. § 260.300.2*; *see Corp. Code § 25111(d)*].

3. Comply with Commissioner's standards relating to all advertising, other than "tombstone" advertisements [*10 Cal. Code Reg. § 260.302*]:

NOTE:

The "tombstone" ad concept is derived from the provisions of the Securities Act of 1933, Section 2(10)(b) [*15 U.S.C. § 77b(a)(10)*], and SEC Rules 134, 256(c) [*17 C.F.R. §§ 230.134, 230.251(d)(1)(ii)(C)*], which permit a stylized form of advertisement as an exception to more stringent prospectus or offering circular requirements. Although it has a certain liberalized scope, it normally is drafted to include only the following essentials: the size of the offering; the type of security being offered; the name of the issuer; the price of the security; and the selling agents from whom a more detailed advertisement may be obtained.

a. Make no statement or inference that investment in the security is safe; that continuation of earnings or dividends is assured; that failure, default, or loss is impossible or unlikely [*see 10 Cal. Code Reg. § 260.302(a)*].

b. If reference to state qualification of securities is made, publish in capital letters of not less than 10-point type following legend, printed in contrasting color or type [*see 10 Cal. Code Reg. § 260.302(d)*]:

THE COMMISSIONER OF CORPORATIONS OF THE STATE OF CALIFORNIA DOES NOT RECOMMEND OR ENDORSE THE PURCHASE OF THESE SECURITIES.

c. If advertisement refers to exemption from or reduction in taxation under any law, state name of counsel on whose opinion statement is based [*see 10 Cal. Code Reg. § 260.302(e)*].

NOTE:

Any reference to an exemption from or reduction in taxes should be based on an opinion of counsel [*10 Cal. Code Reg. § 260.302(e)*]. Because some attorneys do not want their names published in conjunction with such an advertisement, the Commissioner will consider the name requirement satisfied if the advertisement states that (1) the counsel's name is printed in the prospectus, or (2) the counsel's name is on file with the department, if the prospectus has been filed with the Department of Corporations [***see*** Dept. of Corps. Release No. 23-C (Nov. 12, 1971)].

d. Indicate name and address of person using advertisement [*see 10 Cal. Code Reg. § 260.302(f)*].

e. If endorsement (either express or implied, *e.g.*, by photograph) of public figure is featured, fully disclose any compensation or benefit arranged for that person [*see 10 Cal. Code Reg. § 260.302(g)*].

f. State right, if reserved, to avoid payment of interest on debt securities by redemption prior to final maturity [*see 10 Cal. Code Reg. § 260.302(i)*].

g. Examine all advertisements for issuer transactions to ensure conformity with terms and conditions of qualification, and with representations in application for qualification.

NOTE:

The offer or sale of a security in an issuer transaction (other than a merger, consolidation, or assets-for-securities transaction subject to *Corp. Code § 25120*) in a manner that varies or differs from, exceeds the scope of, or fails to conform with either a material term or material condition of qualification

of the offering as set forth in the permit or qualification order, or with a material representation as to the manner of offering that is set forth in the application for qualification, is an unqualified offer or sale [*Corp. Code § 25110*].

4. Unless "tombstone" advertisement is involved [*see* P 3, *above*], disclose relevant facts concerning the following fairly and accurately, so as to make advertisement not misleading [*10 Cal. Code Reg. § 260.302*]:

a. Nature of securities.

b. Terms and conditions of securities.

c. Nature and financial condition of business enterprise.

5. Unless "tombstone" ad is used [*see* P 3, *above*], comply with following specific standards required by Commissioner [*10 Cal. Code Reg. § 260.302*]:

a. Disclose all relevant details as to promotional shares, options, warrants, and rights issued or proposed to be issued [*10 Cal. Code Reg. § 260.302(b)*].

b. Make financial data relating to current or past condition clear, intelligible, and reasonably complete [*10 Cal. Code Reg. § 260.302(c)(1)*].

c. Prepare current financial exhibits as of date reasonably close in time to advertisement; show preparation date and date to which financial condition is reflected [*10 Cal. Code Reg. § 260.302(c)(2)*].

d. Accompany past financial exhibits with current financial exhibits [*10 Cal. Code Reg. § 260.302(c)(3)*].

e. Accompany statements of average earnings for period over one year with statements of earnings for each individual year involved if variations are significant [*10 Cal. Code Reg. § 260.302(c)(4)*].

f. Do not use "pro forma" financial statements (unless in connection with recapitalizations and reorganizations) [*10 Cal. Code Reg. § 260.302(c)(5)*].

g. Base future finances exhibits only on past earnings records, project earnings for reasonable period only, and substantiate by data clearly supporting estimates [*10 Cal. Code Reg. § 260.302(c)(6)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawInvestment CompaniesActivities



33 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6H California Legal Forms--Transaction Guide § 6H.181

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.181 General Requirements for Distribution of Qualified Securities

1. Do not offer or sell securities during any period in which stop or suspension order issued by Commissioner with regard to those securities is in effect [*Corp. Code § 25114*].

NOTE:
The stop order period does not serve to extend the time of effectiveness of the qualification but in actuality cuts down the available marketing period.

2. Do not continue to offer or sell securities beyond one year from effective date of qualification, unless Commissioner allows different period [*Corp. Code § 25114*].

3. File posteffective amendment to application as necessary to deviate from plan of application as originally submitted to and approved by Commissioner [*see § 6H.200*].

a. Pay fee of $50 for filing posteffective amendment to application for qualification, plus any additional fee resulting from that amendment as affecting original filing fee factors [*Corp. Code § 25608(n)*; *see also Corp. Code § 25608.3* (Commissioner may set any fee at amount below maximum set forth in *Corp. Code § 25608*)].

b. Do not offer or sell securities under plan as proposed to be amended until qualified by Commissioner.

NOTE:
If approved by the Commissioner, an amendment to an application filed after the effective date of qualification or sale becomes effective on whatever date the Commissioner

determines, with due regard to the public interest and protection of investors [*Corp. Code § 25162*].

4. File semiannual reports to keep financial (or other specifically required) information in application to date for 18 months after qualification has become effective, if offering is subject to open qualification [*Corp. Code § 25146*; *see § 6H.274*].

5. Before sale of security, deliver prospectus or proxy statement to each offeree if [*Corp. Code § 25148*]:

a. Qualification is by notification or permit.

b. Prospectus or proxy statement is otherwise required by federal authority.

c. Delivery of prospectus is required by Commissioner of Corporations.

6. For limited offering qualification, distribute securities only to persons designated by name or class as stated in application and approved by Commissioner in qualification [*10 Cal. Code Reg. § 260.140.01*].

7. For open qualification subject to written commitment to limit distribution to suitable investors, obtain suitability representation letters from investors [*see § 6H.271*].

8. Examine offer or sale of issuer transaction to ensure conformity with terms and conditions of qualification, and with representations in application for qualification.

NOTE:

The offer or sale of a security in an issuer transaction (other than a merger, consolidation, or assets-for-securities transaction subject to *Corp. Code § 25120*) in a manner that varies or differs from, exceeds the scope of, or fails to conform with either a material term or material condition of qualification of the offering as set forth in the permit or qualification order, or with a material representation as to the manner of offering that is set forth in the application for qualification, is an unqualified offer or sale [*Corp. Code § 25110*].

9. Place legend on security if required by Commissioner or necessary to assure compliance with representations made to the Commissioner [*see* Ch. 6I, *Issuance of Equity Securities* ; Ch. 6J, *Issuance of Debt Securities*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawInvestment CompaniesActivitiesSecurities LawInvestment CompaniesDistribution, Redemption & Repurchase of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6H California Legal Forms--Transaction Guide § 6H.182

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.182 Selling Under Impound Condition

NOTE:
When the offering of securities is not firmly underwritten, the Commissioner considers that the following conditions normally require the imposition of an impound condition: (1) that a specific minimum amount of funds is necessary to finance the proposed undertaking as described in the application, and (2) that it is inadvisable for the issuer to expend any of the proceeds from the sale of securities prior to receipt of that minimum amount [*10 Cal. Code Reg. § 260.141.20*]. The procedures described below should be followed when such a condition is imposed.

1. Select one of following as depositary [*see 10 Cal. Code Reg. § 260.141.23(a)*]:

NOTE:
Funds subject to an impound condition must be placed in a separate escrow account with an approved depositary. The Commissioner may approve the use of any national bank or foreign, state-chartered bank subject to regulatory supervision similar to that of California banks if the issuer is located in another state and less than 50 percent of the securities are offered in California [*10 Cal. Code Reg. § 260.141.23(a)*].

a. National bank located in California.

b. California bank.

2. Obtain written consent of selected institution to act as depositary.

3. Apply to Commissioner of Corporations for approval of selected depositary by submitting:

a. Name and address of depositary, including identification of branch office [*10 Cal. Code Reg. § 260.141.23(b)(1)*].

b. Written consent of depositary [*see* P 2, *above*; *see also 10 Cal. Code Reg. § 260.141.23(b)(2)*].

c. Copy of agreement between issuer and depositary containing all terms and conditions under which depositary will act and providing that [*10 Cal. Code Reg. § 260.141.23(b)(3)*]:

(1) Disbursement of impounded funds will be at discretion of Commissioner only.

(2) Funds are not assets of issuer unless and until Commissioner orders release of those funds.

(3) Depositary will maintain list of specified records.

(4) Depositary cannot resign as escrow holder without approval of Commissioner.

(5) Records and reports of sales and proceeds [*see Corp. Code § 25145*] will be made and kept by depositary and that true copies of those records will be made available for inspection by Commissioner.

(6) Commissioner is authorized to inspect escrow account without obtaining further permission from issuer.

4. Do not distribute securities to purchasers until release of impound conditions [*10 Cal. Code Reg. § 260.141.21*].

NOTE:

When an impound condition is imposed, the issuer may not issue any certificates or other evidences of securities, except subscription agreements, unless and until the impound condition has been satisfied and the impounds have been released to the issuer pursuant to an order of the Commissioner [*10 Cal. Code Reg. § 260.141.21*; ***see*** *10 Cal. Code Reg. § 260.141.24*; ***see also*** § 6H.267].

5. Accept only checks made payable to depositary or to licensed broker-dealer acting as selling agent [*10 Cal. Code Reg. § 260.141.21*].

6. Deposit all amounts received from sale of securities in escrow within 48 hours after receipt [*10 Cal. Code Reg. § 260.141.21*].

NOTE:

Amounts received from the sale of securities include any amounts that will be allowed as selling expenses [*10 Cal. Code Reg. § 260.141.21*].

7. Deliver to each subscriber an approved subscription agreement containing [*10 Cal. Code Reg. § 260.141.22(a)*]:

NOTE:

When an impound condition is imposed, the issuer must deliver to each subscriber a subscription agreement in a form approved by the Commissioner. The agreement must contain the following

information at a minimum [*10 Cal. Code Reg. § 260.141.22(a)*].

a. Complete names and addresses of issuer and subscriber.

b. Complete name of agent of issuer or broker for receiving payment.

c. Number of securities purchased and total purchase price.

d. Amount of payment received.

e. Complete name and address of depositary with whom payment will be placed.

f. Date of payment.

g. Any additional information desired.

h. Following statement required by *10 Cal. Code Reg. § 260.141.22(a)* regarding qualification:

NOTE:
This statement must appear on any subscription agreement upon which an impound condition is imposed [*10 Cal. Code Reg. § 260.141.22(a)*].

"This subscription is made pursuant to, and is subject to, the terms and conditions of the qualification approved by the Commissioner of Corporations of the State of California for _____ [*name of issuer*] under date of _____ [*date of qualification*]."

8. Prepare subscription agreements in quadruplicate, number all agreements consecutively, and distribute as follows [*10 Cal. Code Reg. § 260.141.22(a)*]:

NOTE:
The Commissioner of Corporations may approve some form of subscription agreement other than that provided for in the rules of the Department of Corporations. For example, the Commissioner may require that the subscription agreements be press-numbered [*10 Cal. Code Reg. § 260.141.22(a)*].

a. Original to each subscriber.

b. First copy to depositary together with payment received.

c. Second copy to issuer.

d. Third copy to broker, if any.

9. If installment payment is made subsequent to initial payment received on delivery of subscription agreement, give each subscriber receipt setting forth [*10 Cal. Code Reg. § 260.141.22(b)*]:

a. Date of payment.

b. Amount of payment.

c. Number of subscription agreement to which payment relates.

10. If impound goal has not been met and it appears that revision of plan of offer and sale may satisfy impound purpose, apply for extension of time for impound collection [*see 10 Cal. Code Reg. § 260.141.25(b)*].

NOTE:

Such an application must be filed as an amendment in accordance with *10 Cal. Code Reg. § 260.110.4* [*10 Cal. Code Reg. § 260.141.25(b)*; ***see*** *§ 6H.152*].

11. Apply for release from depositary to issuer of impounded initial financing when quota has been reached [*10 Cal. Code Reg. § 260.141.24*; *see* § 6H.267].

NOTE:

The Commissioner will authorize the depositary to release the impounds to the issuer when the full amount of impounds specified in the impound condition has been deposited with the depositary and any other conditions to release have been satisfied, unless (1) there have been changes in the plan of operation or in other circumstances that would render that amount of impounds inadequate to finance the proposed plan of operations, or (2) circumstances have changed so that the Commissioner could no longer find that the sale of the securities was fair, just, and equitable [*10 Cal. Code Reg. § 260.141.24(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawInvestment CompaniesActivities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6H California Legal Forms--Transaction Guide § 6H.183

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.183 Compliance With, or Removal of, Commissioner's Restrictions on Securities--Escrow and Legend Conditions

NOTE:

It is unlawful to transfer securities subject to legend or escrow conditions unless and until the Commissioner has given written consent to transfer [*Corp. Code § 25133*]. Consent will be given only if the proposed transfer is found to be fair, just, and equitable to the proposed transferee [*Corp. Code § 25151*].

1. File application for consent to transfer securities subject to legend or escrow condition for proposed transfer or resale [*10 Cal. Code Reg. § 260.151(a)*; *see § 6H.262*].

NOTE:

This is a separate consideration from the necessity of qualifying securities proposed to be resold in a nonissuer transaction. If the two requirements both apply to a single situation, both applications should be filed simultaneously.

a. Pay application fee of $20 for each transferor [*Corp. Code § 25608(m)*; *see also Corp. Code § 25608.3* (Commissioner may set any fee at amount below maximum set forth in *Corp. Code § 25608*)].

b. Obtain statement of each proposed transferee and submit along with application for consent to transfer [*10 Cal. Code Reg. § 260.151(b)*; *see also § 6H.263*].

2. If securities in escrow have been transferred pursuant to court order, notify Commissioner within five

days of transfer and include copy of escrow holder's receipt [*10 Cal. Code Reg. § 260.141.14*; *see* § 6H.266].

3. When conditions warrant removal of restrictive conditions of original qualification [*10 Cal. Code Reg. § 260.141.50*; *see* § 6H.267]:

a. Apply to remove legend or other condition (including escrow).

b. Pay fee for applying for removal of restrictive conditions of $50 [*Corp. Code § 25608(j)*; *see also Corp. Code § 25608.3* (Commissioner may set any fee at amount below maximum set forth in *Corp. Code 25608*)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawInvestment CompaniesActivities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6H California Legal Forms--Transaction Guide §§ 6H.184-6H.199

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6H.184[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
A. Facing Page

3-6H California Legal Forms--Transaction Guide § 6H.200

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.200 Facing Page for Applications for Qualification by Coordination, Issuer Notification, Issuer Permit, and Recapitalization or Reorganization Permit [10 Cal. Code Reg. § 260.110]

[1] Comment

[a] Use of Form

This form is the facing page set forth in *10 Cal. Code Reg. § 260.110*. Every application for qualification and every amendment to an application, except for certain applications for qualification of nonissuer transactions [*see § 6H.255*], must contain a facing page in the form set forth in that regulation [*10 Cal. Code Reg. § 260.110*]. The purpose of the facing page is to provide pertinent information concerning the applicant and the offering. The facing page consists of the caption, containing administrative information (file number, fee, date, type of qualification, type of offering), and the body (Items 1-7) which identifies the applicant and the details of the offering.

The Commissioner ordinarily retains a copy of the facing page even though the remainder of the applicant's file may subsequently be destroyed four years after the date of filing [*Corp. Code § 25619(a)*]. The file is a public record [*see 10 Cal. Code Reg. § 250.9.1*] subject to public inspection [*10 Cal. Code Reg. § 250.9*], and the Commissioner is authorized to publish information contained in any file if he or she deems it to be in the public interest [*Corp. Code § 25605(a)*]. However, an applicant may make a formal request that the Commissioner withhold information, and the Commissioner will withhold that information for what he or she judges to be a "necessary" time if, in the Commissioner's opinion, public inspection is not necessary in the public interest or for the purposes of the law under which it is filed, and the information is reasonably shown to meet any of four specified requirements [*see § 6H.275*].

[b] Preparation of Form

The facing page may be either the printed form supplied by the Commissioner, or a typed copy of the form. In either event, the facing page must be completed in English and must be on one side only on legal or letter-size paper [*10 Cal. Code Reg. § 260.110.1*]. If the facing page is typed, it must retain the same numbering system and order as the printed

form, and must contain all seven items, and no more, that are on the printed form. In lieu of completing the information required by any item in the form, the applicant may incorporate by reference the information contained in any document attached as an exhibit or otherwise currently on file with the Commissioner by referring to the page or specific portion of the document involved [*10 Cal. Code Reg. § 260.110.3*].

Applications for qualification of securities should be verified [*Corp. Code § 25160*]. All information required to be included in an application must be true and complete as of the time the qualification of the transaction becomes effective. An applicant must promptly supply by amendment any information based on facts occurring after the original date of filing which is necessary to supplement or correct the information contained in the original application, so as to make that information not materially misleading as of the date of qualification [*Corp. Code § 25160*; *see* [j], *below*].

[c] File Number

Each applicant will be given a file number after the filing of an original application for qualification with the Commissioner. The applicant will retain this number throughout existence and should insert this number in the appropriate place in the upper right-hand corner of the facing page in all subsequent filings with the Commissioner. Although the Commissioner may destroy the contents of any file or the entire file itself if he or she considers it useless after four years from date of filing or issuance [*Corp. Code § 25619(a)*], the file number may still be revived by the original applicant.

[d] Fees

The fee for the particular form of application being filed must be calculated by the applicant and set forth in the appropriate space in the upper right-hand corner of the facing page. The fee should be paid at the time of filing since qualification cannot become effective until payment is received by the Commissioner [*Corp. Code § 25615*].

The fee may be paid by check, which need not be certified, payable to the "Department of Corporations." A refund of the fee may be obtained when appropriate [*10 Cal. Code Reg. § 250.15*; *see § 6H.276*]. Note that notwithstanding the fees set forth in *Corp. Code §§ 25608* and *25608.1*, the Commissioner may set any fee at an amount below the maximum fee set forth in those sections [*Corp. Code § 25608.3*]. Fees are computed as follows:

- Fee for qualification of issuer transactions, recapitalizations and reorganizations, except guaranties:
  - $200, plus one fifth of 1 percent of the aggregate value [*see below*] of the securities sought to be sold in California, up to a maximum aggregate fee of $2,500 in issuer permits [*Corp. Code § 25608(e)*], issuer notifications [*Corp. Code § 25608(e)*], recapitalizations and reorganizations (if consideration is involved) [*Corp. Code § 25608(h)(2)*; *see* second item, *below*], and amendments to filings (prior to the effective date of qualification), if it involves a higher proposed purchase or exchange price; or a maximum of $2,500 for coordination qualifications [*Corp. Code § 25608(f)*].
  - $2500, plus an additional amount based on processing costs in excess of $2500, up to a maximum additional amount of $1000, for a small company application for qualification by permit [*Corp. Code § 25608(e)*; *see § 6H.220*].
  - $200 for recapitalization and reorganization permits without consideration [*Corp. Code § 25608(h)(1)*; *see* second item, seventh sub-item, *below*].
  - $50 for negotiating permits [*Corp. Code § 25608(b)*], guaranties of securities [*Corp. Code § 25608(k)*], post-effective amendments (plus the fee under first sub-item, *above*, if

any excess value has been introduced since the original filing) [*Corp. Code § 25608(n)*].

- Determination of value of securities:

  - If securities are sold directly for cash, the value is the proposed sales price or the actual sales price, whichever is higher [*Corp. Code § 25608(g)(1)*].

  - If securities are sold for nonmonetary consideration, the value is the higher of the value alleged in the application, the "actual value" as determined by the Commissioner, or the value of the consideration actually received [*Corp. Code § 25608(g)(1)*].

  - If interim or voting trust certificates are used in the sale, the value is equal to the aggregate value of securities to be represented by the certificates [*Corp. Code § 25608(g)(2)*].

  - If warrants or rights are used in the sale, the value of the amount to be paid for such option, plus the amount to be paid for underlying securities (if not presently determinable, then as determined by the Commissioner) [*Corp. Code § 25608(g)(3)*].

  - If the transaction involves a share dividend when the shareholders are given an option to accept cash or additional shares of stock, the value is the maximum amount of cash that would be payable in the event that all shareholders elected to accept cash [*Corp. Code § 25608(g)(4)*].

  - If the transaction involves an exchange with existing security holders of the issuer exclusively, or in connection with merger, consolidation, or purchase of assets in consideration of issuance of securities, or any entity conversion transaction, the value is that of the securities (plus any other consideration) received in exchange for the securities being sold [*Corp. Code § 25608(h)(2)*].

  - If the transaction merely involves a change in the rights, preferences, privileges, or restrictions of or on outstanding shares, there is no value [*Corp. Code § 25608(h)(1)*].

[e] Type of Qualification

The applicant must identify each form of application by noting the type of qualification being requested in the filing. The types of qualification requiring the facing page are as follows [*see 10 Cal. Code Reg. § 260.102*]:

- Coordination under *Corp. Code § 25111* [*see § 6H.205*].

- Notification under *Corp. Code § 25112* [*see § 6H.215*].

- Permit under *Corp. Code § 25113* [*see § 6H.220*].

- Reorganization permit under *Corp. Code § 25121* [*see § 6H.250*].

- In special circumstances, a negotiating permit under *Corp. Code § 25102(c)*.

Amendments to prior applications also require use of the facing page [*see* [j], *below*].

[f] Open Offering Qualification

An open qualification is one that authorizes the offer and sale of securities to the public without restriction as to persons or class of persons [*10 Cal. Code Reg. § 260.001(f)*]. In order to qualify for an open offering, specified requirements must be met. For example, if debt securities are being issued [*see § 6H.234*], the company normally will have to distribute them under a formal trust indenture [*10 Cal. Code Reg. § 260.140.5*], and restrictions on transfer of the shares may not be imposed by any instrument under which they are issued (e.g., articles of incorporation and bylaws) [*10 Cal. Code Reg. § 260.140.8*].

If the issuer is not "seasoned," it should have a capital structure consisting of only common stock, and any senior securities should either be convertible on a fair and equitable basis or be fully participating and nonredeemable. A "seasoned" company is one that has operated (or its predecessor has operated) a going enterprise for at least two years and has had a profit during one of the last three fiscal years [*10 Cal. Code Reg. §§ 260.001(g), 260.140.9*]. Unseasoned issuers normally will not be granted an open qualification if the business is not anticipated to produce profits within a reasonable period of time. A period of time not exceeding 24 months after the date of the approval of the application is presumptively reasonable, and a longer period may be authorized in light of the nature and circumstances of the proposed business, including the operational norms for the industry in which the business will operate [*10 Cal. Code Reg. § 260.140.05(a)*; *see 10 Cal. Code Reg. § 260.140.05(b)* (financial standards), (c) (delivery of consumer guide obtainable from Department)].

Unless an issuer's securities are exempt from qualification for purposes of nonissuer transactions because of registration under Section 12(g) of the Securities Exchange Act of 1934 (and the issuer is filing reports under Section 15(d) of the Act) [*see 15 U.S.C. § 78o(d)*], an issuer selling securities under an open qualification must file semiannual reports [*see § 6H.274*]. These reports must continue to be filed until 18 months after the effective date of qualification or until the qualified securities have been qualified for nonissuer trading, whichever occurs first [*Corp. Code § 25146*; *10 Cal. Code Reg. § 260.146*]. However, the Commissioner may not require an issuer to file semiannual reports (1) after completion of the offering if a nonissuer transaction involving that security would be entitled to exemption from qualification pursuant to any exemption under *Corp. Code § 25101* [*see Corp. Code § 25146*], or (2) if the issuer is filing reports pursuant to Section 13 [*15 U.S.C. § 78m*] or Section 15(d) [*15 U.S.C. § 78o(d)*] of the Securities Exchange Act of 1934 [*10 Cal. Code Reg. § 260.146*; *see 15 U.S.C. § 78a et seq.*].

If the issue will not be firmly underwritten, the issuer should expect the Commissioner to impose an impound condition and require the circulation of subscription agreements and a prospectus [*Corp. Code §§ 25141, 25147, 25148*; *10 Cal. Code Reg. §§ 260.141.20, 260.141.22, 260.141.24*].

For an investor suitability letter for use when open qualification has been conditioned on the issuer's written commitment to limit distribution, see *§ 6H.271*.

[g] Limited Offering Qualification

A limited offering qualification is one which authorizes the offer and sale of securities only to persons designated therein by name or class [*10 Cal. Code Reg. § 260.001(e)*]. If the securities are to be issued to a designated class of persons, those persons must have some degree of sophistication as to investment, either generally or with reference to the type of business in which the corporation plans to engage, in order for the Commissioner to approve the qualification as a limited offering. A limited offering of debt securities need not have a trust indenture conforming with the federal model [Trust Indenture Act of 1939 (*15 U.S.C. § 77aaa et seq.*)] if adequate safeguards are included for the issuee's interest [*10 Cal. Code Reg. § 260.140.5*]. Nonconvertible and nonparticipating senior securities may be sold to residual equity holders on a pro rata basis under certain circumstances [*10 Cal. Code Reg. § 260.140.9*].

Since the purpose of a limited qualification is often to restrict the number of potential purchasers to those familiar with

the risks involved in a particular security, the Commissioner may impose legend conditions restricting the transfer of those securities [*10 Cal. Code Reg. § 260.141.10*; *see § 6H.260*]. The issuer of shares under such a limited offering qualification not only must place a legend on the shares, but also must deliver to each issuee or transferee of the shares a copy of *10 Cal. Code Reg. § 260.141.11* [*10 Cal. Code Reg. § 260.141.11(a)*]. Legend conditions are likely to be imposed when securities are offered pursuant to a limited qualification, and a variation from the standards for an open qualification are approved by the Commissioner based on the character or relationship to the issuer of the investors, and the Commissioner determines that there is substantial danger that subsequent transfers of those securities might be unfair regardless of the provisions of the Corporate Securities Law requiring the qualification of nonissuer transactions [*Corp. Code § 25141*; *10 Cal. Code Reg. § 260.141.10*].

[h] Body of Facing Page

The body of the facing page contains the first seven items for each of the different types of qualifications requiring a facing page. The first four items of the facing page require the following information:

- The applicant's name.
- The form of entity of the applicant (whether a corporation, partnership, joint venture, trust, association, sole proprietorship, etc.) and the state under which it was organized.
- The address of its main office.
- The name and address of the person responsible for handling the application (normally the attorney).

Item 5 of the facing page requires the applicant to set out the information in tabular form:

- The title of each class of securities which is being qualified (e.g., "no par Class A common stock," or "6 percent $20 preferred stock").
- The total number of shares of each class to be qualified under the application, or total number of units if a debt security, investment contract, or other security arrangement.
- The proposed maximum offering price for each share or unit.

The proposed maximum aggregate offering price of the securities being qualified must also be stated (Part (d) of Item 5). If the offering is interstate (registered with the Securities and Exchange Commission unless exempt), only those kinds and amounts proposed to be offered and sold in California are subject to qualification [*Corp. Code §§ 25008, 25110*]. If a "public market" exists for the class of securities offered, this fact and the CUSIP number for those securities must be listed under Part (e) of Item 5. A "public market" exists for a class of securities if it is listed on a national securities exchange, is traded in the over-the-counter market and quoted in the Wall Street Journal or other newspaper of general circulation, or is held of record or beneficially by 500 or more persons [*10 Cal. Code Reg. § 260.110*].

Item 6 requires a listing in nontabular form of any nonmonetary consideration agreed to be received in lieu of cash, with a specification of the agreed value of that consideration (such as "promotional services, $10,000") [*see § 6H.237*]. Item 7 inquires as to whether there is any official regulatory agency or court ruling directly concerned with the proposed offering, which either should be answered "none" or should be given a specific identification of any such order.

[i] Filing of Applications

Ordinarily, only the original must be filed. The addresses of the offices of the Department of Corporations where the

appropriate filings may be made are as follows [*see* Dept. of Corps. Release No. 13-G (Revised; June 10, 2004)]:

- 320 West 4th Street, Suite 750, Los Angeles, CA 90013-2344.
- 71 Stevenson Street, Suite 2100, San Francisco, CA 94105-2980.
- 1515 K Street, Suite 200, Sacramento, CA 95814-4017.

[j] Amendments

The two types of amendments to applications for qualification are preeffective amendments and posteffective amendments, each of which requires a facing page [*10 Cal. Code Reg. § 260.110.4*]. A preeffective amendment is an amendment that is filed prior to the effective date of qualification of the application being amended [*Corp. Code § 25160*]. Each amendment facing sheet should be accompanied only by the items replacing the superseded portions of the previous filing [*10 Cal. Code Reg. §§ 260.110.4*, *260.162*]. The amendments should be verified [*Corp. Code § 25160*; *10 Cal. Code Reg. § 260.110.4*].

The application must be true and complete as of the time the qualification becomes effective [*Corp. Code § 25160*]. Therefore, if there is a change in circumstances prior to that time, resulting in facts stated in the application being incorrect or incomplete, a preeffective amendment should be promptly filed in order to correct that information so that it is not materially misleading [*Corp. Code § 25160*].

A posteffective amendment, on the other hand, becomes effective only if approved by the Commissioner, and only on the date that the Commissioner determines after considering the public interest and the protection of the investors [*Corp. Code § 25162*]. When either the substance or the size of the original qualification is substantially altered, the Commissioner probably will desire a new application rather than an amendment of the original application.

[2] Form

Facing Page for Applications for Qualification by Coordination, Issuer Notification, Issuer Permit, and Recapitalization or Reorganization Permit [10 Cal. Code Reg. § 260.110]

(Department of Corporations Use Only)

Fee Paid
$_____ Receipt No.
_____ Effective Date:
_____
_____

DEPARTMENT OF CORPORATIONS FILE NO.
_____

(Insert file number of previous filings of Applicant before the Department, if any) FEE:
_____

(To be completed by Applicant) Date of Application: _____

DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

FACING PAGE

Application for qualification of the offer and sale of securities, under the Corporate Securities Law of 1968, by (check one):

( )	Coordination,	Section 25111	( )	Post-Effective	) Amendment
( )	Notification,	Section 25112			) Number _____ ____

( )	Permit,	Section 25113(b)(1)			) To Application
( )	Permit (Small Company),	Section 25113(b)(2)			) Filed Under
( )	Permit,	Section 25121			) Section _____
( )	Negotiating Permit,	Section 25102(c)	( )	Pre-Effective	) Dated _____

This application is for an ( ) open or ( ) limited offering qualification as defined in Section 260.001 of the rules (Check as applicable).

1. Name of Applicant

   _____

2. (a) Is applicant a corporation, partnership, trust or other entity? _____

   (b) State of incorporation or jurisdiction under which organized? _____

   (c) If a corporation, is applicant in good standing in the State of its incorporation? (Indicate "yes" or "no") _____

   (d) Is applicant a registered investment company? (indicate "yes" or "no") _____

3. (a) Address of principal executive office of applicant:

   Number and Street City State ZIP Code

   _____

   (b) Is the principal location of applicant's books and records at the address of the principal executive office, above? (Indicate "yes" or "no.") If "no," provide address:

   Number and Street City State ZIP Code

   _____

4. Name and address of person to whom correspondence regarding this application should be addressed.

   _____

5.

(a)	(b)	(c)	(d)	(e)
Description of Securities (See Instructions on reverse side)	Total number of shares or units of each class of securities being qualified in California (e.g., "20,000")	Proposed maximum offering price per unit (e.g., "$10")	Proposed maximum aggregate offering price for securities being qualified in California (e.g., $200,000) Note: Fee calculated on total of this	Does a public market exist for this class of securities? (Indicate "yes" or "no." If "yes" insert CUSIP number)

column.

6. Consideration to be paid for securities; if cash, state "cash," or if other than cash and the aggregate value is ascribed thereto by the board of directors of the issuer so state (e.g., "Real Property, $100,000," "Assets of a Going Business, $50,000").

7. There is no adverse order, judgment or decree entered in connection with the offering by any State regulatory authority, any court or the Securities and Exchange Commission, except as follows: (if none, so state.)

_____

Instructions:

The following instructions must be adhered to with respect to all applications for qualification by permit under Sections 25102(c), 25113 and 25121; by coordination under Section 25111, and notification by Section 25112:

Completion of Application. The facing page on the reverse side hereof, must be completed in full and in addition to the facing page, applications must continue by completion of each item of the applicable following forms:

Application for qualification by coordination, Form No. 260.111

Application for qualification by notification, Form No. 260.112

Application for permit pursuant to Section 25113, Form No. 260.113

Application for permit pursuant to Section 25121, Form No. 260.121

Application for Negotiating Permit pursuant to Section 25102(c), Form No. 260.113

The numbering sequence in the forms must be adhered to. Any item which is inapplicable should be listed by the number on the form, followed simply by the word "inapplicable."

Form of Application. The application should be typewritten or printed in the English language, on one side only of either legal or letter size paper.

Signing of Applications. An application for permit pursuant to Section 25113(b)(2) must be reviewed and signed by each member of the board of directors of the small company applicant. Any other application should be signed by an officer or general partner of the applicant; however, it may be signed by another person holding a power of attorney for such purposes from the applicant, and if signed on behalf of the applicant pursuant to such power of attorney, should

include as an additional exhibit a copy of said power of attorney or a copy of the corporate resolution authorizing the attorney to act.

Item 5--"Public Market." A "public market" exists for this class of securities if it (1) is listed on a national securities exchange, (2) is traded in the over-the-counter market and quoted in the Wall Street Journal or other newspaper of general circulation, or (3) is held of record or beneficially by 500 or more persons.

Incorporation by Reference. In lieu of answering any specific item in this form, an applicant may incorporate the information called for by reference to any attached document, or to any document currently on file with the Department. Such reference should indicate the pages or portion of the document where the information is located.

Amendments to Applications. An amendment to any application for qualification should contain only the information being amended by item number and should be verified in the form prescribed for the application. Each amendment should be accompanied by a facing page in the form prescribed by Section 260.110 of the rules on which the applicant shall insert the fact that the filing is an amendment and the number of the amendment if more than one amendment.

Filing Fee Calculation. The filing fee fixed by Section 25608 must accompany each application and the amount of filing fee paid is to be set forth on the facing page in the upper right hand corner. By way of illustration, the filing fee for qualification of securities by coordination, notification, or permit, under Sections 25113(b)(1) or 25121 is computed by taking one fifth of 1 percent of the maximum aggregate offering price of securities being qualified in California, see appropriate column on facing page, and adding $200. Thus, a qualification with an aggregate offering price of $275,250 would be computed by multiplying $275,250 by.002, equaling $550.50, and adding $200 for a total of $750.50. However, the maximum filing fee, including the $200, is $2,500 for applications filed under Sections 25111, 25112, 25113(b)(1), and 25121, except in the case of a transaction under Section 25121 involving a change in rights, preferences, privileges or restrictions. In this case, the filing fee is $200. The fee for filing a small company application for qualification of the sale of securities by permit under Section 25113(b)(2) is $2,500. In the case when the actual costs of processing a small company application under Section 25113(b)(2) exceed the $2,500 filing fee, an additional fee shall be charged, not to exceed $1,000, over and above the filing fee based on the actual amount of the salary or other compensation paid to persons processing the application plus the actual amount of expenses including overhead reasonably incurred in the performance of the work. In the case when the costs exceed the initial $2,500 filing fee, an applicant will be required to submit the additional $1,000 fee before the Department will continue processing the application. Any unexpended fee will be refunded to the applicant.

Description of Securities Being Qualified. State title of each class of securities (e.g., $10 par value common stock) and include rights, warrants, options and convertible securities and the securities to be issued upon exercise or conversion thereof.

A Customer Authorization of Disclosure of Financial Records Form (Form No. QR 500.259) must also be filed as an exhibit to the application.



38 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
A. Facing Page

3-6H California Legal Forms--Transaction Guide §§ 6H.201-6H.204

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6H.201[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
B. Qualification by Coordination

3-6H California Legal Forms--Transaction Guide § 6H.205

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.205 Application for Qualification by Coordination [Corp. Code § 25111; 10 Cal. Code Reg. § 260.111]

[1] Comment

[a] Use of Form

This form is an application for qualification by coordination. Both issuer and nonissuer transactions may be qualified by coordination if a registration statement has been filed pursuant to the Securities Act of 1933 [*15 U.S.C. § 77a et seq.*] in connection with the same offering [*Corp. Code § 25111*; *see § 6H.21[2], [4]*].

"Registration statement" as used in *Corp. Code § 25111(a)* includes an offering statement as defined by Rule 252(a) under Regulation A [*17 C.F.R. 230.252(a)*] under the Securities Act. The term "effective" as used in that section in connection with an offering statement means an offering statement that has been qualified under Regulation A [*Corp. Code § 25111(a)*]. This form is not for use by a previously qualified open-end investment company or unit investment trust, or a unit investment trust that is substantially similar to one or more investment trusts previously qualified by the same sponsor [*see Corp. Code § 25111(b)-(d)*; *see also § 6H.209*].

The form for qualification by coordination must be used in conjunction with the facing page [*see § 6H.200*]. Accordingly, the five parts of the form are numbered Items 8-12. The purpose of the form is to permit the filing of essentially the same papers with state officials as are filed with the federal Securities and Exchange Commission, and to make the qualification effective simultaneously with the effective date of the federal registration.

Automatic qualification under California law, however, is subject to certain conditions [*Corp. Code § 25111(c)*; *see* [e], *below*]. Once the issue has been qualified, the qualification is effective for 12 months from its effective date, unless the Commissioner by order or rule specifies a different period, except during the time that a stop order [*see Corp. Code § 25140*] or an order suspending the effectiveness of qualification [*Corp. Code § 25143(a)*] is in effect [*Corp. Code § 25114*].

In lieu of the official form, applicants for coordination qualification may use the Uniform Application to Register Securities (Form U-1) [*10 Cal. Code Reg. § 260.111(a)*; *see § 6H.206*].

[b] Federal Registration

Under the Securities Act of 1933 [*15 U.S.C. § 77a et seq.*], before any security may be offered or sold, it is subject to registration with the federal Securities and Exchange Commission, unless it is exempt or is involved in an exempt transaction [Securities Act of 1933 §§ 3, 4 (*15 U.S.C. §§ 77c, 77d*)]. The basic philosophy and approach of the Securities Act is to require companies to file information with the SEC and to require prospectuses or circulars to be distributed to investors for the purpose of disclosing all pertinent details of the offering [*see* Sommer, Federal Securities Act of 1933, Ch. 1, *Introduction to the Securities Act of 1933 and to the Securities and Exchange Commission*, § 1.02 (Matthew Bender)]. The SEC does not pass on the merits of the issue as does the California Corporations Commissioner, and it cannot attach protective conditions on the manner of the issue. It simply can force the most complete presentation of factual materials by the company to prospective purchasers so that the investors may consider the investment for themselves. The Securities Act provides penalties for nonregistration or fraudulent disclosure.

Securities that are not exempt under the federal securities laws [*see* [c], *below*] must be registered by filing a registration statement with the SEC [Securities Act of 1933 § 6 (*15 U.S.C. § 77f*)]. By statute, a registration statement is effective on the 20th day after filing, or after filing of the last amendment, unless the Commission has delayed or suspended the effectiveness by stop order [Securities Act of 1933 § 8 (*15 U.S.C. § 77h*)]. The SEC's primary interest is to see that an honest and clearly informative filing is put together, particularly as to the prospectus, which is required to be distributed to potential purchasers and their investment bankers and marketing personnel [Securities Act of 1933 §§ 5(b), 10 (*15 U.S.C. §§ 77e(b), 77j*)].

PRACTICE TIP:

The SEC, as a matter of practice, generally requires the issuer to request a delay of the effective date of the registration statement on the cover page of the registration statement. As a result, the 20-day statutory period has little practical significance. *Commentary by Frances E. Lossing.*

[c] Federal Exemptions

A private transaction, regardless of where the issuer or purchasers are located, that does not involve a public offering in any manner, is exempt from federal registration requirements [Securities Act of 1933 § 4(2) (*15 U.S.C. § 77d(2)*)]. This blanket exemption from federal registration for all private offerings should not be confused with the approach in California, where there is no blanket exemption and where nonpublic exemptions are available only in limited securities areas and for restricted purposes [*see Corp. Code §§ 25102(e), (f), (n), 25104(a)*].

SEC Regulation D [*17 C.F.R. §§ 230.501-230.508*] provides three exemptions for limited or private offerings of securities:

- The Rule 504 exemption for offers and sales not exceeding $1 million [*see 17 C.F.R. § 230.504*; *see also 15 U.S.C. § 77c(b)*].

- The Rule 505 exemption for offers and sales not exceeding $5 million to no more than 35 purchasers, excluding certain specified types of purchasers (or sales in which the issuer reasonably believes there are no more than 35 purchasers) [*17 C.F.R. § 230.505*; *see also 15 U.S.C. § 77c(b)*].

- The Rule 506 exemption for offers and sales to no more than 35 purchasers (or sales in which the issuer reasonably believes there are no more than 35 purchasers) regardless of the dollar amount of the offer [*17 C.F.R. § 230.506*; *see also 15 U.S.C. § 77d(2)*].

Attempted compliance with any of the Regulation D exemptions does not amount to an exclusive election of that exemption and does not raise any presumption that the statutory exemption provided by Section 4(2) of the Act [*15 U.S.C. § 77d(2)*] is not available [SEC Reg. D (*17 C.F.R. §§ 230.501-230.508*), prelim. note 3]. For more detailed discussion on the availability of these exemptions and the applicable restrictions and limitations, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* .

Federal law also exempts any issue that is offered and sold only to California residents (intrastate exemption) if the issuer is either a corporation organized under California law or is a local resident doing business in the state [Securities Act of 1933 § 3(a)(11) (*15 U.S.C. § 77c(a)(11)*); SEC Rule 147 (*17 C.F.R. § 230.147*); *see* Sommer, Federal Securities Act of 1933, Ch. 3, *Exempted Securities Under Sections 3(a)(2) Through 3(a)(8) of the Securities Act*, § 3.12 (Matthew Bender)]. Offerings made in reliance on Rule 506 of SEC Regulation D are exempt from regulation if certain permitted state filing requirements are satisfied. [*15 U.S.C. § 77r*; *Corp. Code § 25102.1(d)*; *see* Ch. 6B, *California Limited Offering Exemptions*)

A third major area in which offerings are technically exempt from federal registration procedures is the federal small offering exemption (Regulation A procedure) [Securities Act of 1933 § 3(b) (*15 U.S.C. § 77c(b)*)]. The Regulation A procedure is available if the offering does not exceed $5 million [SEC Rule 251 (*17 C.F.R. § 230.251(b)*); *see* Sommer, Federal Securities Act of 1933, Ch. 5, *Small Issue Exemptions Under Sections 3(b) and (c) of the Securities Act* (Matthew Bender)].

Other securities exempt from the federal regulatory program are primarily government-issued securities and those issued under the supervising auspices of other federal agencies or courts, such as financial institution securities, interstate carrier securities, bankruptcy matters, current commercial notes, and all genuine charitable institution securities [Securities Act of 1933 § 3(a) (*15 U.S.C. § 77c(a)*); *see* Sommer, Federal Securities Act of 1933, Ch. 3, *Exempted Securities Under Sections 3(a)(2) Through 3(a)(8) of the Securities Act* (Matthew Bender)] Transactions by persons not construed to be issuers, underwriters, or dealers are exempt as are broker's executions of unsolicited orders; dealer's transactions are exempt except when connected with new distributions [Securities Act of 1933 § 4(1), (3), (4) (*15 U.S.C. § 77d(1), (3), (4)*); *see* Sommer, Federal Securities Act of 1933, Ch. 5, *Exempted Transactions Under Sections 3(b) and 3(c) of the Securities Act* (Matthew Bender)].

Obviously, any transaction or security that is exempt from federal registration requirements is ineligible for qualification by coordination.

[d] Preparation of Form

The form for qualification by coordination consists of five parts. Item 8 requires an undertaking by the applicant to forward to the Commissioner all future amendments to the registration statement filed pursuant to the Securities Act of 1933 not later than the first business day after the day that any amendment is forwarded to or filed with the SEC [*Corp. Code § 25111(b)(2)*; *10 Cal. Code Reg. § 260.111(b)*]. This undertaking does not apply to amendments which merely delay the effective date of the registration statement, but it does apply to both preeffective and posteffective amendments [*see* [g], *below*].

Item 9 requires that a copy of the registration statement, two copies of the prospectus (or two additional copies of the registration statement), a copy of the underwriting agreement, and copies of any pension, retirement, or other deferred compensation plan, contract, or arrangement (when the securities to be issued pursuant to such a plan, contract, or arrangement are the subject of the application) be attached to the application as Exhibit A. The Commissioner has the authority to require the filing of any other document deemed necessary to evidence compliance with the Rules [*Corp. Code § 25111(b)(3)*; *10 Cal. Code Reg. § 260.111(b)*].

PRACTICE TIP:

In some cases, it will be necessary to file additional material, such as financial statements, Annual Reports on Form 10-K or employee benefit plans, with the Commissioner. This commonly occurs when a short-form SEC registration statement form, such as Form S-3 or Form S-8, is used. In these circumstances, the SEC registration statement may not contain all of the information that the Commissioner will need to make a fair, just and equitable determination. In addition, the Commissioner's processing guidelines are generally slower than SEC practice if the SEC decides not to review the registration statement (a process which generally takes no more than a week) or a form, such as a Form S-8, is used which is automatically effective on the date it is filed with the SEC. *Commentary by Frances E. Lossing.*

Item 10 is the consent to service of process required by *Corp. Code § 25165*, attached as Exhibit B [*see §§ 6H.239, 6H.241*]. Item 10 also requires that a Customer Authorization of Disclosure of Financial Records Form (Form No. QR 500.259) [*see § 6H.241*] be attached to the application as Exhibit C. California applicants need not execute the consent to service of process and may enter "not applicable" for Item 10.

Any applicant that will employ agents other than licensed broker-dealers in connection with the offering must complete Item 11 in order to comply with Rules 260.141.30 and 260.141.31 [*10 Cal. Code Reg. §§ 260.141.30, 260.141.31*; *see § 6H.272*]. Item 11 requires the following information:

- The name and business address of each person who will represent the applicant as an agent in California.

- The name and business address of the corporate officer or other official who will supervise the agents on behalf of the applicant.

- A statement that all the agents employed in California are employees of the applicant.

- A statement of the compensation to be paid to the agents and a statement of the compensation to be paid to supervisory personnel in excess of their regular salaries if they are regular employees of the applicant.

- A description of any disqualification or legal disability of any agent or supervisory person to engage in the securities business, or association of that person as an officer or director with any corporation similarly disqualified, disabled, or restrained from engaging in any conduct or practice in connection with the purchase or sale of securities, or any conviction of that person involving a security or any aspect of the securities business, or any conviction for theft or any felony.

- A surety bond complying with *10 Cal. Code Reg. § 260.216.15* [*see § 6H.273*].

Item 12 requires an undertaking to file semiannual reports in accordance with *Corp. Code § 25146* and *10* Cal. Code Reg. § 260.146 [*see § 6H.244*].

Finally, the application must be signed and verified by executing a declaration under penalty of perjury under California law [*see Code Civ. Proc. § 2015.5*].

[e] Conditions for Qualification Becoming Effective

Qualification in California is automatically effective when the federal registration statement becomes effective if certain conditions have been fulfilled. If the federal registration statement becomes effective before those conditions are

satisfied and the conditions have not been waived by the Commissioner, qualification will not occur until they have been fulfilled [*Corp. Code § 25111(c)*].

The time of filing the application should be within five business days of filing the registration statement with the SEC [*Corp. Code § 25111(b)*]. However, the Commissioner has provided that the time may be extended up to 20 business days following the federal filing, so long as the application has been on file at least 10 days before the effective date of registration [*10 Cal. Code Reg. § 260.111.1*] If securities are being registered on Form S-3 or Form F-3 in connection with an offering to be made on a delayed or continuous basis pursuant to SEC Rule 415, the application should be filed within two business days of the date on which the registration statement is filed with the SEC [Dept. of Corps. Release No. 70-C (June 24, 1982, as revised on Nov. 5, 1982, and Dec. 31, 1983)].

These time limits may be further modified by order [*Corp. Code § 25111(b)*; *10 Cal. Code Reg. § 260.111.1*; *see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 6, Procedure for Qualification of Issuer Transactions, § 6.03[3]* (Matthew Bender)].

Before the coordinated offering can become effective in California, a statement of the minimum and maximum proposed offering prices and the maximum underwriting discounts and commissions must have been on file for at least two business days with the Commissioner [*Corp. Code § 25111(c)(3)*]. Like other time limits under this form of qualification, the Commissioner is authorized to permit modifications of time by rule or order. For a form for this statement of proposed offering price range and commissions, see *§ 6H.207*.

The applicant may notify the Commissioner of the approximate prospective date of the effectiveness of the federal registration, in which case the Commissioner will promptly notify the applicant either that the conditions have been satisfied, or that the Commissioner contemplates suspending the effectiveness of the federal registration for California qualification purposes [*Corp. Code § 25111(c)*]. In any event, the applicant must notify the Commissioner of the actual effective date and time of the federal registration [*Corp. Code § 25111(c)*; *see 10 Cal. Code Reg. § 250.11.1*; *see § 6H.208*]. This notification must include any price amendments to the federal registration [*Corp. Code § 25111(c)*]. On filing this final notification, the applicant must file a posteffective amendment to the local application containing the information and documents concerning the price amendment [*Corp. Code § 25111(c)*; *see* [g], *below*].

In addition to the conditions listed above, the Commissioner is empowered to impose conditions which must be met before securities will be qualified for sale in California [*Corp. Code § 25141*; *see* Marsh & Volk, Practice Under the California Securities Laws, Ch. 9, *Conditions of Qualification* (Matthew Bender)]. These conditions are usually imposed in the case of permit qualified securities not subject to federal inspection, but may also be used in coordination or notification applications, since SEC disclosure requirements may not offer sufficient protection to California investors. These conditions include legend [*see § 6H.260*] and escrow conditions [*see § 6H.264*], impounding of subscription funds [*see 10 Cal. Code Reg. §§ 260.141.20-260.141.26*], selling expense limitations [*see § 6H.227*], and temporary waivers by promoters of liquidation, dividend, or voting rights [*see § 6H.261*]. Other conditions to prevent unfairness, injustice, or inequitability may be imposed by the Commissioner [*Corp. Code § 25141*].

[f] Stop Orders by the Commissioner

The Commissioner will inspect the application to consider whether the proposed plan of business of the issuer or the proposed issuance or sale of the securities is unfair, unjust, or inequitable, whether the issuer intends to transact its business fairly and honestly, or whether the securities proposed to be issued or the method to be used in issuing them will tend to work a fraud on the purchaser [*see Corp. Code § 25140*]. The Commissioner may issue a stop order denying effectiveness to, or suspending or revoking the effectiveness of, any coordination qualification of an underwritten offering of securities if the Commissioner finds that the order is in the public interest and finding any of the following [*Corp. Code § 25140(a)(1)*; *see Corp. Code § 25140(d)* (limitation)]:

- That the proposed plan of business of the issuer, or the proposed issuance or sale of securities, is not fair, just, or equitable;

- That the issuer does not intend to transact its business fairly and honestly; or

- That the securities proposed to be issued or the method used in issuing the securities will tend to work a fraud on the purchasers.

The Commissioner may take any of these actions with regard to an application for or qualification of securities that is not an underwritten offering unless the Commissioner finds that the stop order is not in the public interest and (1) that the proposed plan of business of the issuer, or the proposed issuance or sale of securities, is fair, just, or equitable; (2) that the issuer intends to transact its business fairly and honestly; or (3) that the securities proposed to be issued or the method used in issuing the securities are not of a type that will tend to work a fraud on the purchasers [*Corp. Code § 25140(a)(2)*]. However, in general, the Commissioner may not issue such a stop order without (1) giving appropriate prior notice to the applicant, the issuer, and the person on whose behalf the securities will or have been offered, and (2) holding a hearing [*Corp. Code § 25143(b)*].

The Commissioner also may summarily order the postponement or suspension of the effectiveness of any notification qualification pending final determination of any proceeding under *Corp. Code §§ 25140-25151* [*Corp. Code § 25143(a)*]. The Commissioner may take this action without prior notice [*see Corp. Code § 25143(b)*], but must promptly notify the applicant, the issuer, and the prospective purchaser of the entry of the order, the basis for the order, and the right to request a hearing [*Corp. Code § 25143(a)*]. On request, the Commissioner must hold a hearing under the rules established by the Administrative Procedure Act (APA) [*see Gov. Code §§ 11500-11529*] within 15 business days after receiving the written request, unless the applicant accepts a later date [*Corp. Code § 25143(a)*]. The applicant may request a departmental hearing in lieu of an APA hearing [*Corp. Code § 25702*]. If no hearing is requested or ordered, the order remains in effect until modified or vacated; if a hearing is held, the order may be modified, vacated, or extended until a final determination is reached [*Corp. Code § 25143(a)*]. The Commissioner may vacate or modify a stop order if the Commissioner finds that the conditions that caused the entry of the order have changed, or if vacation or modification is otherwise in the public interest [*Corp. Code § 25144*].

However, the Commissioner has no authority to issue a stop order on the basis that the price at which the security is to be offered is unfair, unjust, or inequitable if the security is being publicly offered for cash pursuant to the federal registration statement and the offering is the subject of a firm commitment underwriting by an underwriter or syndicate of underwriters, all of whom are registered under the Securities Exchange Act of 1934 [*see Corp. Code § 25140(d)*]. A firm commitment for these purposes means an underwriting pursuant to which the underwriter or syndicate is committed to take up and pay for the securities subject only to the usual or customary conditions, but not including any "market out" or similar condition to be operative after the time of commencement of the offering [*Corp. Code § 25140(d)*]. Nevertheless, the Commissioner may use the stop order prerogative in this area on the basis of discovering--particularly through comparison with past sales of the class by the issuer--unreasonable discounts, commissions, or other compensation to underwriters, sellers, or others; unreasonable promoters' profits or participations; or unreasonable amounts or kinds of options [*Corp. Code § 25140(d)*; *10 Cal. Code Reg. § 260.140.50*].

If the Commissioner does not receive the necessary notification by the applicant of the date of the effectiveness of the federal registration or the timely filing of the posteffective amendment concerning the final price amendment [*see* [e], *above*], the Commissioner may enter a stop order without notice or hearing retroactively denying or suspending qualification until all requirements have been complied with [*Corp. Code § 25111(c)*]. In this case, the Commissioner must promptly notify the applicant of the issuance of the order by telegram or by telephone promptly confirmed by telegram or letter. If the applicant subsequently proves actual compliance with the notification and filing requirements, the stop order is void as of the time of its entry [*Corp. Code § 25111(c)*].

[g] Amendments

The applicant must notify the Commissioner of any amendment to the federal registration statement immediately after filing the amendment with the SEC [*Corp. Code § 25111(b)(2)*; *10 Cal. Code Reg. § 260.111(b)*; *see* [d], *above*]. The notice of amendment should consist of a copy of the amendment as filed with the SEC, together with a reference to the item number of the local application for coordination qualification [*see, e.g.*, [2], Item 9, *below*], and a completed copy of the facing page [*see § 6H.200*].

At the time the federal registration becomes effective, the applicant must inform the Commissioner by telephone or telegram not only of the exact date and time but also of the content of any price amendment [*Corp. Code § 25111(c)*; *10 Cal. Code Reg. § 250.11.1* (telephone transceiving equipment accepted for notice); *see* [e] *above*; *see also § 6H.208* (notice to Commissioner)]. This notification must be followed by the prompt filing of a posteffective amendment to the local application [*Corp. Code § 25111(c)*; *see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 6, Procedure for Qualification of Issuer Transactions, § 6.03[7]* (Matthew Bender)], containing the information and documents of the price amendment. This price amendment refers to the final amendment to the federal registration statement, and includes a statement of the offering price, underwriting and selling discounts and commissions, amount of proceeds, interest, dividend or conversion rates, call prices, and other matters related to the offering price [*see Corp. Code § 25111(c)*]. Federal registrants frequently leave out all actual prices from their registration materials until all other matters have been submitted or amended to the satisfaction of the SEC, after which they proffer a final amendment filling in the figures which the promoters feel best reflect the current market [*see* Sommer, Federal Securities Act of 1933, Ch. 7A, *The Registration Process*, § 7A.05[6][g] (Matthew Bender)]. The amendment must be accompanied by a facing page [*see § 6H.200*], and the $50 fee for posteffective amendments [*10 Cal. Code Reg. § 260.162*].

[h] Nonissuer Transactions

The usual method of qualification of securities in a nonissuer transaction is by notification [*see § 6H.255*]. However, secondary distributions of securities which are registered under the Securities Act of 1933 [*15 U.S.C. § 77a et seq.*] may be qualified by coordination [*Corp. Code § 25111(a)*; *see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 10, Nonissuer Transactions, § 10.05[2][b]* (Matthew Bender)]. Registration under federal law may be required when the offeror of securities is a "control person," one who is in control of the issuer, or one who is controlled by or under common control with the issuer [*see* Securities Act of 1933, §§ 2(11), 4(1) (*15 U.S.C. §§ 77b(a)(11), 77d(1)*); *see also* Sommer, Federal Securities Act of 1933, Ch. 4, *Exempted Transactions Under Section 4 of the Securities Act*, § 4.01 (Matthew Bender)]. The exemption from qualification requirements for offerings of the same class of shares that have been qualified within the previous year does not apply to securities that are subject to registration under the Securities Act of 1933 or exempt from registration under SEC Regulation A if the aggregate offering price exceeds $50,000 [*Corp. Code § 25104(h)*; *see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 10, Nonissuer Transactions, § 10.04[1][c]* (Matthew Bender)]. Securities that are exempt from Securities Act of 1933 registration requirements because they may be qualified under Regulation A [*17 C.F.R. § 230.251*] must be qualified in California by permit [*Corp. Code § 25131(a)*]. Finally, when a designated nonissuer transaction is involved with an issuer transaction, the entire issue must be qualified in California as a single issuer transaction [*Corp. Code § 25011*].

[2] Form

Application for Qualification by Coordination [Corp. Code § 25111; 10 Cal. Code Reg. § 260.111]
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

APPLICATION FOR QUALIFICATION BY COORDINATION

(SECTION 260.111)

An applicant must comply with the requirements of subdivisions (a) and (b) of the Code when filing an application for qualification by coordination. See also, Section 260.111.1 of these rules.

(a) In lieu of the form set forth in subsection (b), the Uniform Application to Register Securities (Form U-1) recommended by the Subcommittee on Uniform Forms of the Committee on State Regulation of Securities of the American Bar Association's Section of Corporation, Banking and Business Law will be accepted for an application for qualification by coordination. If Form U-1 is utilized, it must be signed and verified as provided in the form set forth in Subsection (b) and it must contain the information required by the form set forth in Subsection (b).

(b) An application for qualification of the offer and sale of securities by coordination shall, in addition to the facing page required by Section 260.110 of these rules, continue in the following form:

8. Applicant hereby undertakes to forward to the Commissioner of Corporations all future amendments to the Registration Statement under the Securities Act of 1933 attached hereto as Exhibit A, other than an amendment which merely delays the effective date of the Registration Statement, promptly and in any event not later than the first business day after the day they are forwarded to or filed with the Securities and Exchange Commission, whichever first occurs.

9. A copy of the Registration Statement under the Securities Act of 1933, either two copies of the prospectus or two additional copies of the Registration Statement, a copy of the Underwriting Agreement, copies of any pension, retirement or other deferred compensation plan, contract or arrangement when securities to be issued pursuant to such plan, contract or arrangement are the subject of the application, is attached hereto as Exhibit A and incorporated herein by reference. Any of the exhibits (other than exhibits incorporated by reference) to the Registration Statement that are deemed necessary to evidence compliance with any of the Rules of the Commissioner contained in Title 10 of the California Code of Regulations may be required to be submitted.

10. The Consent to Service of Process if required by *Section 25165 of the California Corporations Code* is attached hereto as Exhibit B. A Customer Authorization of Disclosure of Financial Records Form (Form No. QR 500.259) is attached hereto as Exhibit C.

11. If the applicant will employ agents (other than licensed broker-dealers) in connection with the sale of securities in California, the applicant must comply with Sections 260.141.30 and 260.141.31, Title 10, California Code of Regulations, and furnish the following information.

a. The name and business address of each person who will represent the applicant as an agent in this state.

b. The name and business address of the officer or other official who will supervise such agents on behalf of the applicant.

c. A statement that all such agents employed in this state are employees of the applicant.

d. A statement of the compensation to be paid to such agents. A statement of the compensation to be paid to such supervisory personnel, other than their regular salaries if they are regular employees of the applicant.

e. Describe any order, judgment or decree of any governmental agency or administrator, or of any court of competent jurisdiction revoking or suspending for cause any license, permit or other authority of such agent or supervisory person of any corporation of which he is an officer or director, to engage in the securities business or in the sale of a particular security or temporarily or permanently restraining or enjoining any such person or any corporation of which he is an officer or director from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting such person of any felony or misdemeanor involving a security or

any aspect of the securities business, or of theft or of any felony.

f. A surety bond complying with *Section 260.216.15, Title 10, California Code of Regulations.*

12. Pursuant to *Section 25146 of the California Corporations Code* and *Section 260.146 of Title 10 of the California Code of Regulations*, applicant hereby undertakes, as long as required under the foregoing sections and subject to the exception therein contained, to file with the Commissioner: (a) within 120 days after the end of each fiscal year a report of financial condition and a related statement of income and expenses covering such fiscal year; and (b) within 90 days after the first six months of each fiscal year, a like report and statement covering such six months period.

(NOTE: The application must be signed and verified in the following manner.)

The applicant has duly caused this application to be signed on its behalf by the undersigned, thereunto duly authorized.

_____
(Applicant)

By _____

_____
(Title)

I certify (or declare) under penalty of perjury under the laws of the State of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed at _____[*place*], on _____[*date*].

_____
(Signature)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
B. Qualification by Coordination

3-6H California Legal Forms--Transaction Guide § 6H.206

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.206 Alternative Method of Qualification by Coordination: Form U-1 [Corp. Code § 25111; 10 Cal. Code Reg. § 260.111]

[1] Comment

[a] Use of Form

This form is the Uniform Application to Register Securities (Form U-1), prepared by the Subcommittee on Uniform Forms of the Committee on State Regulation of Securities of the American Bar Association's Section of Corporation, Banking, and Business Law. It may be used as an alternative to the official application form for qualification by coordination [*10 Cal. Code Reg. § 260.111(a)*; *see § 6H.205*]. Since a federally registered offering ordinarily will be sold in several states, it may be more convenient to prepare a single application form instead of completing a number of different state forms [*see* Marsh & Volk, Practice Under the California Securities Laws, Ch. 6, *Procedure for Qualification of Issuer Transactions* (Matthew Bender)]. Form U-1 has been accepted for registration in every jurisdiction that requires the registration of securities prior to sale within the state. Form U-1 is also available online at the uniform forms page of the North American Securities Administrators Association (NASAA) website, located at http://www.nasaa.org/bluesky/uniform/default.htm.

A Uniform Consent to Service of Process may be used with Form U-1 as an alternative to the service of process form prescribed by the California Commissioner of Corporations [*see 10 Cal. Code Reg. § 260.165*; *see also § 6H.239*]. Form U-2 is reproduced in this publication in § 6H.240.

[b] Preparation of Form

When using Form U-1, the applicant need not prepare a facing page [*see § 6H.200*], since the information required by Form U-1 is substantially the same as that of the facing page. However, all information required by Rule 260.111 [*10 Cal. Code Reg. § 260.111(b)*] and the verification required by that rule must accompany the application [*10 Cal. Code Reg. § 260.111(a)*]. The following is an adaptation of Form U-1, with the specific requirements for a California filing

indicated in boldface type. For a discussion of the items unique to a California filing, see *§ 6H.205[1][d]*. When a particular exhibit from among those listed at [2], P 8, *below*, is not included, the omission should be indicated by the words "none" or "inapplicable." Since use of Form U-1 may be unnecessarily elaborate for the purpose of filing amendments, applicants may file any amendments using the California facing page [*see § 6H.200*], even in cases when Form U-1 was originally used. In any event, new material or amendments should not be filed without an accompanying form of application for amendment.

[c] Amendment of Registration Statement

Although Form U-1 provides that the applicant will file any amendment to the federal registration statement with the state within two business days after filing with the Securities and Exchange Commission (SEC) [*see* [2], P 9(b), *below*], California law requires amendments to the registration statement to be filed with the Commissioner of Corporations no later than the first business day after the amendments are forwarded to or filed with the SEC, whichever occurs first [*Corp. Code § 25111(b)(2)*; *see 10 Cal. Code Reg. § 260.111(b)*].

[2] Form

Alternative Method of Qualification by Coordination: Form U-1 [Corp. Code § 25111; 10 Cal. Code Reg. § 260.111]

(Dept. Use Only)

Fee Paid
$_____

Receipt No.
_____

_____(Dept. of Corps. File No.)

Form U-1

Uniform Application to Register Securities

Application to **the Commissioner of Corporations** of the State of **California** pursuant to Section **25111** of the **Corporations Code**

1. Name and address of Issuer and principal office in this state:

   _____

2. Name, address and telephone number of correspondent to whom notices and communications regarding this application may be sent:

   _____

3. Name and address of applicant:

   _____

4. **Qualification by coordination** is sought for the following described securities in the amounts indicated:

   _____

		Total Offering _____		**Offering in This State** _____	
Description of Securities	Offering Price or Proposed Offering Price	No. of Shares or Units	Amount	No. of Shares or Units	Amount
			$		$

	Totals	$	$

Indicate the maximum commission to be charged:
_____%

5. Amount of filing and examination fees which are enclosed:
$_____$_____
_____

6. A Registration Statement was filed with the Securities and Exchange Commission on _____ (date) and (became) (will become) effective on _____ (date)

7. (a) List the states in which it is proposed to offer the securities for sale to the public.

(b) List the states, if any, in which the securities are eligible for sale to the public.

(c) List the states, if any,

which have refused, by order or otherwise, to authorize sale of the securities to the public, or have revoked or suspended the right to sell the securities or in which an application has been withdrawn.

8. Submitted herewith as a part of this application are the following documents (documents on file may be incorporated by reference):

(a) One copy of the Registration State-

ment and two copies of the Prospectus in the latest form on file under the Securities Act of 1933.

(b) Underwriting Agreement, Agreement among Underwriters, and Selected Dealers Agreement.

(c) Indenture.

(d) Issuer's charter or articles of incorpora-

tion as amended to date.

(e) Issuer's by-laws as amended to date.

(f) Signed copy of opinion of counsel filed with Registration Statement pursuant to the Securities Act of 1933.

(g) Specimen (type of security) _____ _____ _____ _____

(h) Consent

to service of process accompanied by appropriate corporate resolution,

and Customer Authorization of Disclosure of Financial Records

Form

(i) **Earnings computation exhibits required by Title 10, Section 260.140.10 of the California Code of Regulations for a seasoned corporation proposing to sell senior securities which are nonparticipating and nonconvert-**

ible.

(j) One copy of all advertising matter to be used in connection with the offering.

(k) **A copy of any pension, retirement, or other deferred compensation plan, contract, or arrangement when the securities to be issued pur-**

suant to that plan, contract, or arrangement are the subject of the application.

(l) **The information required by Title 10, Section 260.111(b) of the California Code of Regulations and the surety bond required by Title 10, Sec-**

tion 260.141.31 of the California Code of Regulations if the applicant will employ agents (other than licensed broker-dealers) in connection with the sale of securities in California.

(m) **Any other exhibit (other**

than exhibits incorporated by reference) to the Registration Statement that are deemed necessary to evidence compliance with any of the Rules of the Commissioner contained in Title 10 of the California Code of Regula-

tions.

9. The applicant hereby applies for registration or acceptance for filing of the above described securities under the law cited above and in consideration thereof agrees so long as the registration remains in effect that it will:

(a) Advise the above named state authority of any change prior to **qualification** in this state in any of the information contained herein or in any of the documents submitted with or as a part of this application.

(b) File with the above name

d state au-thor-ity within two busi-ness days after filing with the Se-curit-ies and Ex-chang e Com-mis-sion (i) any amen dment s oth-er than delay-ing amen dment s to the feder-al re-gistra-tion state-ment, desig-nating the chang ed, re-vised or ad-ded

material or information by underlining the same; and (ii) the final prospectus, or any further amendments or supplements thereto.

(c) Notify the above named state authority within two business days (i) upon the receipt of any stop order, denial, or-

der to show cause, suspension or revocation order, injunction or restraining order, or similar order entered or issued by any state or other regulatory authority or by any court, concerning the securities covered by this application or other

securities of the issuer currently being offered to the public; and (ii) upon the receipt of any notice of effectiveness of said registration by the Securities and Exchange Commission.

(d) Notify the above named state authority at least two busi-

ness days prior to the effectiveness of said registration with the Securities and Exchange Commission of (i) any request by the issuer or applicant to any other state or regulatory authority for permission to withdraw any

application to register the securities described herein; and (ii) a list of all states in which applications have been filed where the issuer or applicant has received notice from the state authority that the application does not comply

with state requirements and cannot or does not intend to comply with such requirements.

(e) **File semi-annual reports with the Corporations Commissioner in accordance with the requirements of Section 25146 of the California**

	Corporations Code and Title 10, Section 260.146 of the California Code of Regulations
(f)	Furnish promptly all such additional information and documents in respect to the issuer or the securities covered by this application as may be reques-

ted by the above name d state authority prior to **qualification** or acceptance for filing.

Date: _____.

_____
(Name of Applicant)

By: _____
(Name and Title)

I certify and declare under penalty of perjury under the laws of the State of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed at _____[*place*], on _____[***date***].

_____ **[*signature*]**

[*typed name*]

_____

_____

FOR AN ACKNOWLEDGMENT OF THE FILING OF THIS APPLICATION COMPLETE THE LEFT COLUMN BELOW

Name and address of correspondent _____	State of _____ File Number _____
Applicant	Date _____ Examiner _____
Issuer	Telephone _____



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
B. Qualification by Coordination

3-6H California Legal Forms--Transaction Guide § 6H.207

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.207 Statement of Proposed Prices, Discounts, and Commissions [Corp. Code § 25111(c)(3)]

[1] Comment--Use of Form

This form is a statement of proposed prices, discounts, and commissions to be sent to the Commissioner of Corporations. Qualification by coordination automatically becomes effective in California at the moment the federal registration statement becomes effective if three requirements are satisfied:

- First, no stop order or order of the Commissioner [*see Corp. Code § 25143(a)*] may be in effect [*Corp. Code § 25111(c)(1)*].

- Second, the application must have been on file with the Commissioner for at least 10 days [*Corp. Code § 25111(c)(2)*].

- Finally, a statement of the maximum and minimum proposed offering prices and the maximum underwriting discounts and commissions must have been on file for two business days (or whatever shorter period the Commissioner permits by rule or order) [*Corp. Code § 25111(c)(3)*].

The applicant thereafter must notify the Commissioner of the final price amendment to the SEC registration statement, and immediately file the amendment with the Commissioner [*Corp. Code § 25111(c)*; *see §§ 6H.205* (details of coordination qualification process), 6H.208 (form for final notification to Commissioner)].

The applicant should retain a copy of the statement being sent to the Commissioner. If the Commissioner fails to receive or misfiles the document, the applicant may exhibit the copy as evidence of having complied with the law, and establish that qualification was automatically effective [*Corp. Code § 25111(c)*]. Even if the exact information is already contained in the exhibits previously filed, a formal statement should be sent containing confirming figures to avoid technical obstruction.

[2] Form

Statement of Proposed Prices, Discounts, and Commissions [Corp. Code § 25111(c)(3)]

TO THE COMMISSIONER OF CORPORATIONS
OF THE STATE OF CALIFORNIA

_____ [*address to which original filing was directed*]

STATEMENT OF MAXIMUM AND MINIMUM PROPOSED OFFERING PRICES AND MAXIMUM UNDERWRITING DISCOUNTS AND COMMISSIONS

_____[*date*]

Re File Number _____
Coordinated Qualification of _____ [*name of applicant*]

Pursuant to *Corporations Code Section 25111(c)*, you are hereby notified that the following are the maximum and minimum proposed offering prices and maximum underwriting discounts and commissions in connection with the above-referenced coordination qualification:

PROPOSED OFFERING PRICES:

MAXIMUM $_____

MINIMUM $_____

MAXIMUM UNDERWRITING DISCOUNTS AND COMMISSIONS $_____.

_____ [*name of applicant*]

By _____ [*name and title*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
B. Qualification by Coordination

3-6H California Legal Forms--Transaction Guide § 6H.208

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.208 Notification of Effective Date, Time, and Final Price of Federal Registration [Corp. Code § 25111(c)]

[1] Comment--Use of Form

This form is a notification to the Commissioner of Corporations of the effective date, time and final price of federal registration. Qualification by coordination is designed to become effective as soon as the federal registration statement becomes effective [*Corp. Code § 25111(c)*]. In addition to satisfying all the other conditions for qualification becoming effective concurrently with the federal registration [*see § 6H.205*], the applicant must promptly inform the Commissioner by telephone or telegram of the date and time when the federal registration statement became effective, and the content of the final price amendment, if any [*Corp. Code § 25111(c)*; *see 10 Cal. Code Reg. § 250.11.1* (telephone transceiving equipment accepted for notice)].

PRACTICE TIP:

The Commissioner's rules deviate from common SEC practice in that pricing amendments are no longer filed with the SEC in many circumstances. In these circumstances, the final form of prospectus filed with the SEC should be filed in lieu of the pricing amendment. *Commentary by Frances E. Lossing.*

"Price amendment" means the final federal amendment which fills in the previously permitted fluctuating or blank price figures. It includes a statement of the offering price, underwriting and selling discounts or commission, amount of proceeds, interest, dividend or conversion rates, call prices, and other matters related to the offering price [*see Corp. Code § 25111(c)*]. Federal registrants frequently leave out all actual prices from their registration materials until all other matters have been submitted or amended to the satisfaction of the SEC, after which they provide a final amendment filling in the figures which the promoters feel best reflect the current market [*see § 6H.205[1][g]*].

If the Commissioner does not receive this final notification, and if the applicant fails to file a posteffective amendment detailing the final price amendment as filed with the SEC, the Commissioner may enter a stop order, without notice or hearing, retroactively denying effectiveness to or suspending the qualification until these requirements have been met [*Corp. Code § 25111(c)*].

This form is a letter to the Department of Corporations stating the required information previously conveyed by telephone. The applicant should keep a copy of the notice. In the event of misfiling by the Commissioner, this statement letter would provide evidence that the notification was made and would allow the Commissioner to void any improper stop order resulting from the apparent failure to receive the necessary materials [*Corp. Code § 25111(c)*]. A posteffective amendment following the price amendment must be sent separately [*see § 6H.205[1][g]*].

[2] Form

Notification of Effective Date, Time, and Final Price of Federal Registration [Corp. Code § 25111(c)]

TO THE COMMISSIONER OF CORPORATIONS
OF THE STATE OF CALIFORNIA

_____ [*address to which original filing was directed*]

STATEMENT OF EFFECTIVE DATE, TIME, AND FINAL PRICE OF FEDERAL REGISTRATION

_____[*date*]

Re File Number _____
Coordinated Qualification of _____ [*name of applicant*]

Pursuant to *Corporations Code Section 25111(c)*, you are hereby notified that the following is the effective date and time of the federal registration [*add if applicable:* and the following is the content of the price amendment], in connection with the above-referenced coordination qualification:

THE FEDERAL REGISTRATION IS EFFECTIVE AS OF _____ [*time, e.g.,* 3 P.M.], _____[*date*].

[*Add, if applicable:*]

THE FOLLOWING IS INFORMATION ON THE OFFERING PRICE AND UNDERWRITING DISCOUNT AND COMMISSIONS: _____ [*set forth applicable matters relating to offering price*].

[*Continue with the following:*]

_____ [*name of applicant*]

By _____ [*name and title*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
B. Qualification by Coordination

3-6H California Legal Forms--Transaction Guide § 6H.209

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.209 Open-End Investment Companies (Form NF) [Corp. Code § 25111(d)]

[1] Comment

[a] Use of Form

This form is Form NF, developed by the North American Securities Administrators Association (NASAA). The form is available on the NASAA website, and is located at http://www.nasaa.org/bluesky. It is also available from the California Department of Corporations at www.corp.ca.gov. The form may be used for open-end investment companies. An "open-end investment company" registered under the Investment Company Act [*15 U.S.C. § 80a-5(a)*] is a corporation that is (1) engaged primarily in the business of investing, reinvesting, or trading in securities; (2) operated by a board of directors; and (3) offering for sale, or has outstanding, redeemable securities issued by it. Open-end investment companies are commonly called "mutual funds" in financial and investment circles [*see* Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness* , § 127.03[5][b] (Matthew Bender)]. Open-end investment companies that have previously qualified an offering for sale in California may be eligible for the continuous registration process [*see Corp. Code § 25111(d)*]. The continuous registration process permits those companies to avoid the more burdensome filing required in connection with an ordinary application for qualification by coordination [*see § 6H.205*].

[b] Effect of Federal Preemption Provisions on Qualification Procedures

The National Securities Markets Improvement Act of 1996 (NSMIA) [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005)] preempts state registration or qualification of the offer and sale of securities issued by an investment company that has registered or filed an application for registration under the Federal Investment Company Act of 1940 [*see 15 U.S.C. § 77r*; *see also § 6H.24*]. States, however, may require that certain filings be made. California requires a notice to be filed, which may in the form of Uniform Form NF developed by NASAA, and a consent to service of process, unless a consent to service of process is already on file [*Corp. Code § 25100.1(b)*; Dept. of Corps. Release No. 106-C (July 11, 1997)]. If offers or sales are to be made more than 12 months after the filing of this notice, another notice must

be filed [*Corp. Code § 25100.1(b)(2)*].

[2] Form

Open-End Investment Companies (Form NF) [Corp. Code § 25111(d)]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
B. Qualification by Coordination

3-6H California Legal Forms--Transaction Guide §§ 6H.210-6H214

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6H.210[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
C. Qualification by Issuer Notification

3-6H California Legal Forms--Transaction Guide § 6H.215

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.215 Application for Qualification by Issuer Notification [Corp. Code § 25112; 10 Cal. Code Reg. § 260.112]

[1] Comment

[a] Use of Form

This form is an application for qualification by issuer notification. Issuer transactions may be qualified by notification under *Corp. Code § 25112* for any security issued by a person who is the issuer of any security registered under Section 12 of the Securities Exchange Act of 1934 [*15 U.S.C. § 78a et seq.*] or issued by an investment company registered under the Investment Company Act of 1940 [*15 U.S.C. § 80a-1 et seq.*], provided that the security is ineligible for qualification by coordination under *Corp. Code § 25111* [*Corp. Code § 25112(a)*]. Issuer notification qualification must be in the form prescribed by Rule 260.112 [*10 Cal. Code Reg. § 260.112*] and must be accompanied by a completed facing page [*see § 6H.100*]. This procedure for qualification by notification of issuer transactions should not be confused with the notification procedures for nonissuer transactions [*see § 6H.255*].

Qualification by notification affords the applicant two advantages. First, the information required for notification qualification is slightly less elaborate than that required for qualification by permit [*see § 6H.220*]. Second, assuming that no stop order or order under *Corp. Code § 25143(a)* has been issued by the Commissioner, qualification automatically becomes effective at 12:00 noon (California time) the tenth business day after filing the application or the last amendment thereto, or at any earlier time that the Commissioner may direct [*Corp. Code § 25112(c)*].

Once the issue has been qualified, the qualification is effective for 12 months from its effective date, unless the Commissioner by order or rule specifies a different period, except during the time that a stop order [*see Corp. Code § 25140*] or an order suspending the effectiveness of qualification [*Corp. Code § 25143(a)*] is in effect [*Corp. Code § 25114*].

[b] Federal Registration

The Securities Exchange Act of 1934 regulates trading in securities by requiring disclosure of company activities through registration [*see* Sommer, Federal Securities Exchange Act of 1934, Ch. 1, *The Securities Exchange Act of 1934 and the Securities and Exchange Commission*, § 1.01 (Matthew Bender)]. Two types of securities must be registered under the Securities Exchange Act of 1934: those traded on a national securities exchange [Securities Exchange Act of 1934 § 12(b) (*15 U.S.C. § 78l(b)*)], and those issued by companies engaged in a business affecting interstate commerce, having assets in excess of $1 million and having a class of equity security held of record by 500 or more persons [Securities Exchange Act of 1934 § 12(g) (*15 U.S.C. § 78l(g)*)]. Any company that has any security registered under Section 12 of the 1934 Act may qualify an issuer transaction by notification under the California corporate securities laws [*Corp. Code § 25112(a)*].

Issuer notification will be the only procedure ordinarily utilized by a Section 12(g) company, or an investment company with respect to issuance of securities not registered under the Securities Act of 1933.

[c] Preparation of Form

The information that is required to be submitted in connection with a qualification by issuer notification consists of 13 items, numbered Item 8 through Item 20 (Items 1-7 are contained on the facing page [*see § 6H.200*], which must be included with the application). Since nearly every item in an issuer notification application is also used in an application for qualification by permit, and the information required is rather lengthy, only a brief description of the items will be presented here. A detailed discussion of each item and examples of the information to be included can be *found in §§ 6H.225-6H.244*.

The application for qualification by issuer notification requires a description of the business (Item 8) [*see § 6H.225*], a statement of the use to which the proceeds of sale of the securities will be put (Item 9) [*see § 6H.226*], and a description of the plan of distribution, including specific information regarding any agents (other than licensed broker-dealers) who will be employed by the issuer in connection with the transaction (Item 10) [*see §§ 6H.227, 6H.272*]. Item 11 requires the names of all corporate directors and executive officers [*see § 6H.228*]. A description of transactions with affiliated companies or persons within the preceding three years is required by Item 12 [*see § 6H.229*]. Items 13, 14, 15, and 16 require tables containing information relating to outstanding securities, options to purchase securities, the principal holders of the issuer's securities, and the compensation paid to officers, directors, and principal security holders [*see §§ 6H.230-6H.233*]. Information relevant to debt securities and stock option or bonus plans is required by Item 17 [*see § 6H.234*]. Item 18 is a catchall provision and any information which is required to evidence compliance with the Commissioner's rules should be included under this item; otherwise, the words "none" or "inapplicable" should be entered.

The exhibits required by Rule 260.112 [*10 Cal. Code Reg. § 260.112*] are included under Item 19. These exhibits include charter documents of the issuer, a specimen security, copies of any contract affecting the rights, privileges, preferences, or transferability of the issuer's securities, financial statements, advertising used in connection with the offering, a description of any nonmonetary consideration to be received for the securities, and a list of the proposed purchasers if the application is for a limited offering [*see §§ 6H.236-6H.238*]. In addition, the applicant should attach a consent to service of process [*see §§ 6H.239, 6H.241*] as an exhibit under Item 19 if it is required by *Corp. Code § 25165*. Further, a Customer Authorization of Disclosure of Financial Records Form [*see § 6H.241*] must be attached as an exhibit to the application [*10 Cal. Code Reg. § 260.112*].

Finally, the applicant must execute an undertaking, included in the application as Item 20, agreeing to file the semiannual reports required by *Corp. Code § 25146* and *10* Cal. Code Reg. § 260.146 [*see § 6H.244*]. The application must be verified in the manner prescribed by Rule 260.112 [*10 Cal. Code Reg. § 260.112*; *see § 6H.245*].

[d] Suspensions, Stop Orders, and Conditions

The Commissioner may summarily order the postponement or suspension of the effectiveness of any notification qualification pending final determination of any proceeding under *Corp. Code §§ 25140-25151* [*Corp. Code § 25143(a)*]. The Commissioner may take this action without prior notice [*see Corp. Code § 25143(b)*], but must promptly notify the applicant, the issuer, and the prospective purchaser of the entry of the order, the basis for the order, and the right to request a hearing [*Corp. Code § 25143(a)*].

The Commissioner may also issue a stop order denying effectiveness to, or suspending or revoking the effectiveness of, any notification qualification of an underwritten offering of securities if the Commissioner finds that the order is in the public interest and (1) that the proposed plan of business of the issuer, or the proposed issuance or sale of securities, is not fair, just, or equitable; (2) that the issuer does not intend to transact its business fairly and honestly; or (3) that the securities proposed to be issued or the method used in issuing the securities will tend to work a fraud on the purchasers [*Corp. Code § 25140(a)(1)*; *see Corp. Code § 25140(d)* (limitation)]. The Commissioner may take any of these actions with regard to an application for or qualification of securities that is not an underwritten offering unless the Commissioner finds that the stop order is not in the public interest and (1) that the proposed plan of business of the issuer, or the proposed issuance or sale of securities, is fair, just, or equitable; (2) that the issuer intends to transact its business fairly and honestly, or (3) that the securities proposed to be issued or the method used in issuing the securities are not of a type that will tend to work a fraud on the purchasers [*Corp. Code § 25140(a)(2)*]. However, in general, the Commissioner may not issue such a stop order without (1) giving appropriate prior notice to the applicant, the issuer, and the person on whose behalf the securities will or have been offered; and (2) holding a hearing [*Corp. Code § 25143(b)*].

The Commissioner may modify or vacate a stop order, with or without a hearing, on a finding of changed conditions or for reasons that are in the public interest [*Corp. Code § 25144*].

The Commissioner is empowered to impose conditions that must be met before securities will be qualified for sale in California [*Corp. Code § 25141*; *see* Marsh & Volk, Practice Under the California Securities Laws, Ch. 9, *Conditions of Qualification* (Matthew Bender)]. These conditions are most often imposed in the case of permit qualified securities not subject to federal inspection, but may also be used in coordination or notification applications, since SEC disclosure requirements may not offer sufficient protection to California investors. These conditions include legend [*see § 6H.260*] and escrow conditions [*see § 6H.264*], impounding of subscription funds [*see 10 Cal. Code Reg. §§ 260.141.20-260.141.27*], selling expense limitations [*see § 6H.227*], and temporary waivers of liquidation, dividend, or voting rights on promotional shares [*see § 6H.261*]. Other conditions to prevent unfairness, injustice, or inequitability may be imposed by the Commissioner [*Corp. Code § 25141*].

[2] Form

Application for Qualification by Issuer Notification [Corp. Code § 25112; 10 Cal. Code Reg. § 260.112]

DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

INSTRUCTIONS FOR APPLICATION FOR QUALIFICATION OF ISSUER TRANSACTIONS BY NOTIFICATION (SECTION 260.112)

An application for the qualification of the offer and sale of securities by notification pursuant to Section 25112 of the Code shall, in addition to the facing page required by Section 260.110 of the rules, continue in the following form:

(Note: Any item which is inapplicable should be listed by number on the form followed simply by the word "inapplicable.")

ITEM 8. DESCRIPTION OF BUSINESS.

Describe the business done and intended to be done by the issuer and its subsidiaries and the general development of such business during the past three years. Indicate any other names under which the issuer or any of its subsidiaries have conducted business during such period.

ITEM 9. USE OF PROCEEDS TO ISSUER.

State the principal purposes for which the net proceeds to the applicant for the securities to be offered are intended to be used and the approximate amount intended to be used for each such purpose.

ITEM 10. PLAN OF DISTRIBUTION.

Describe the plan of distribution of securities including the names of any underwriters or agents to be employed by applicant in connection with the sale of securities and the discounts or compensation to be allowed or paid to such persons, or other consideration to be received by such persons or other persons in connection with the sale of securities.

If agents (other than licensed broker-dealers) are to be employed by the applicant in connection with the sale of securities in California, the applicant must comply with Sections 260.141.30 and 260.141.31, Title 10, California Code of Regulations, and furnish the following information:

a. The name and business address of each person who will represent the applicant as an agent in this state.

b. The name and business address of the officer or other official who will supervise such agents on behalf of the applicant.

c. A statement that all such agents employed in this state are employees of the applicant.

d. A statement of the compensation to be paid to such agents. A statement of the compensation to be paid to such supervisory personnel, other than their regular salaries if they are regular employees of the applicant.

e. Describe any order, judgment or decree of any governmental agency or administrator, or of any court of competent jurisdiction revoking or suspending for cause any license, permit or other authority of such agent or supervisory person or of any corporation of which he is an officer or director, to engage in the securities business or in the sale of a particular security or temporarily or permanently restraining or enjoining any such person or any corporation of which he is an officer or director from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting such person of any felony or misdemeanor involving a security or any aspect of the securities business, or of theft or of any felony.

f. A surety bond complying with *Section 260.216.15, Title 10, California Code of Regulations.*

ITEM 11. DIRECTORS AND EXECUTIVE OFFICERS.

List the names of all directors and officers of the issuer indicating all positions and offices held by each person named. In addition, describe any order, judgment, or decree of any governmental agency of administrator, or of any court of competent jurisdiction revoking or suspending for cause any license, permit or other authority of such person or of any corporation of which he is any officer or director, to engage in the securities business or in the sale of a particular security or temporarily or permanently restraining or enjoining any such person or any corporation of which he is an officer or director from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting such person of any felony or misdemeanor involving a security or any aspect of the

securities business or of theft or of any felony.

ITEM 12. MATERIAL TRANSACTIONS WITH AFFILIATES.

Describe any material transactions or agreements during the 3-year period immediately preceding the filing of the application between (i) the applicant or any of its affiliated companies, and (ii) any of the promoters, directors, officers, principal employees, principal security holders, underwriters or agents, or any company directly or indirectly controlled by any such person or persons.

ITEM 13. OUTSTANDING SECURITIES.

State in tabular form the title and amount of all outstanding securities and whether any of such securities are publicly traded.

ITEM 14. OUTSTANDING OPTIONS TO PURCHASE SECURITIES.

State in tabular form the title and amount of securities called for by any options, warrants or rights, including the purchase price of the securities so called for and the expiration dates of such options, together with the market value of the securities so called for as of the latest practicable date. Such statement should include the foregoing information for all options held by each officer or director of the applicant. Except for information with respect to each officer or director, information with respect to option prices and expiration dates may be furnished in ranges.

ITEM 15. PRINCIPAL SECURITY HOLDERS.

State in tabular form the voting securities of the issuer owned of record or beneficially by each person who owns of record or is known by the applicant to own beneficially more than 10 percent of the outstanding securities of any class of such voting securities. Such statement should reflect the respective amounts and percentages owned either beneficially or of record by each person and such statement should also include information as to the amounts held by, and the terms of, any voting trust or similar agreement with respect to more than 10 percent of the outstanding securities of any class voting securities of the issuer.

ITEM 16. REMUNERATION OF DIRECTORS AND OFFICERS, AND PRINCIPAL SECURITY HOLDERS.

Furnish in tabular form information as to the direct remuneration paid by the issuer and its subsidiaries during the issuer's last fiscal year for services in all capacities to each director, officer, and principal holder of securities whose aggregate direct remuneration during such year exceeded $60,000, and the aggregate remuneration paid to all officers, directors and principal holders of securities as a group.

ITEM 17. ADDITIONAL INFORMATION IN CONNECTION WITH DEBT SECURITIES AND OPTIONS OR STOCK BONUSES.

Instructions:

(i) Debt securities: (a) A copy of the trust indenture or other instrument pursuant to which the debt securities are to be issued should be attached to the application as an additional exhibit. (b) Include a calculation based upon earnings history during the past three years demonstrating the ability of applicant to meet the proposed dividends, interest and sinking fund requirements on all senior securities outstanding and proposed to be outstanding (in cases where such ability to meet the proposed dividends, interest and sinking fund requirements depends upon future earning capacity, applicant should submit calculations of such future earning capacity together with such supporting evidence as may be

necessary to demonstrate reasonable certainty in connection with such future earning capacity). (c) Such other information as may be required to comply with the rules of the Commissioner of Corporations relating to debt securities.

(ii) Options or stock bonuses: (a) A copy of the plan pursuant to which options or stock bonuses will be granted should be attached to the application as an additional exhibit together with a copy of the form of option or stock bonus agreement to be issued pursuant to the plan. (b) A copy of any proxy material submitted or to be submitted to shareholders in connection with approval of the plan. (c) If the plan has previously been approved by the shareholders, a statement of the number of shares approving and the number of shares opposing or not represented.

ITEM 18. ADDITIONAL INFORMATION. Indicate such additional information as may be required to evidence compliance with any of the rules of the Commissioner contained in Title 10 of the California Code of Regulations.

ITEM 19. EXHIBITS.

Attach and incorporate by reference the following exhibits:

NOTE: Any exhibit which is inapplicable should be listed by letter on the form followed simply by the word "inapplicable."

A. A copy of the charter documents of applicant as described in *Section 260.001 of Title 10 of the California Code of Regulations* (which may be in the form of a restated or composite copy).

B. Specimen certificate evidencing the security to be issued. (Instruction: Certificates evidencing securities of a class with currently outstanding shares or units should not be submitted.)

C. A copy of any contract made or to be made by the issuer affecting any of the rights, privileges or preferences or transferability of the securities.

D. Financial statements of the issuer and, if some or all of the consideration to be received by the issuer in the transaction is securities of another business, the financial statements of such other business, as required by *Section 260.613 of Title 10 of the California Code of Regulations.*

E. A copy of any advertisement or prospectus to be used in connection with the offer or sale of the securities.

Also include the consent of any attorney, accountant or other expert named in any such advertisement or prospectus, if required pursuant to *Section 260.504.2.2 of Title 10, California Code of Regulations*, in the form required by that section.

F. A description of the consideration to be received by applicant in exchange for the securities if other than cash.

Instructions:

If the applicant proposes to issue securities in exchange for consideration other than cash, state in tabular form the total number of shares proposed to be issued for each type of consideration, the per share selling price based on the consideration proposed to be paid and the names of the purchasers for each category. Submit an appraisal or detailed description of the valuation thereof, or if for a patent or invention for which an application for patent is pending, a copy of the patent or application together with an opinion of a patent attorney covering subjects of ownership and validity thereof and of infringement of patents of others by products as disclosed therein, and a description of all contracts, licenses and assignments of rights or interests therein.

G. A list of the names of the proposed purchasers or an identification of the class of the proposed offerees, if the application is for a limited offering qualification.

Instructions:

A list of the complete names, post office addresses and occupations of the proposed issuees and a statement as to the relationship, if any, of the proposed issuees to the promoters, officers or directors of applicant. Further information as to the financial responsibility and investment experience of the proposed purchasers, while not required as part of the original application except in connection with oil and gas or mining interests and real estate syndicates, if furnished may serve to facilitate processing by the Department. (UPON REQUEST, SUCH INFORMATION WILL BE TREATED AS CONFIDENTIAL BY THE COMMISSIONER.) If the applicant proposes to limit the offering to a class of purchasers, information concerning the financial and other qualifications which will be used to determine the class, together with the methods to be used by the applicant in qualifying purchasers within that class, should be submitted.

H. The Consent to Service of Process if required by *Section 25165 of the California Corporations Code*.

I. A Customer Authorization of Disclosure of Financial Records Form (Form No. QR 500.259).

ITEM 20. REPORTS OF FINANCIAL CONDITION.

Pursuant to *Section 25146 of the California Corporations Code* and *Section 260.146 of Title 10 of the California Code of Regulations*, applicant hereby undertakes, as long as required under the foregoing sections and subject to the exception therein contained, to file with the Commissioner: (a) within 120 days after the end of each fiscal year a report of financial condition and a related statement of income and expenses covering such fiscal year; and (b) within 90 days after the first six months of each fiscal year, a like report and statement covering such six months period.

(NOTE: The application must be signed and verified in the following manner.)

The applicant has duly caused this application to be signed on its behalf by the undersigned thereunto duly authorized.

_____
(Applicant)

By _____

_____
(Title)

I certify (or declare) under penalty of perjury under the laws of the State of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed at _____[*place*], on _____[*date*].

_____
(Signature)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
C. Qualification by Issuer Notification

3-6H California Legal Forms--Transaction Guide §§ 6H.216-6H.219

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6H.216[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
D. Qualification by Permit

3-6H California Legal Forms--Transaction Guide § 6H.220

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.220 Application for Qualification by Permit [Corp. Code § 25113; 10 Cal. Code Reg. § 260.113]

[1] Comment

[a] Use of Form

This form is an application for qualification by permit. Any nonexempt security subject to qualification that is offered or sold in California must be qualified before the transaction may be consummated [*Corp. Code § 25110*]. Qualification of any issuer transaction may be by permit [*Corp. Code § 25113*], although certain transactions may be eligible for the more streamlined procedures of qualification by coordination [*see § 6H.205*] or qualification by notification [*see § 6H.215*]. Qualification by permit requires the applicant to submit a facing page [*see § 6H.200*] and the additional items called for by *10 Cal. Code Reg. §§ 260.112* and *260.113*. Qualification becomes effective only when the Commissioner issues a permit authorizing the issuance of the securities [*Corp. Code § 25113(c)*]. Securities qualified by permit remain qualified for a period of one year from the effective date of qualification, except during the time that a stop order is in effect [*Corp. Code § 25114*].

[b] Conditions on Qualification

The Commissioner is empowered to impose conditions on the qualification if the Commissioner finds that without the conditions the offering will be unfair, unjust, or inequitable [*Corp. Code § 25141*]. The most common conditions imposed under this authority include a legend condition [*see § 6H.260*], escrow conditions [*see § 6H.264*], impound of subscription funds [*see 10 Cal. Code Reg. §§ 260.141.20-260.141.27*], selling expense limitations [*see § 6H.227*], and waivers of assets, dividends, or voting rights by the holders of promotional securities [*see § 6H.261*]. The subscription contract forms or prospectus for the sale of the securities must be approved by the Commissioner [*Corp. Code §§ 25147*, *25148*]. The Commissioner may require that special technical reports be prepared by experts [*Corp. Code § 25150*], and all issuers are required to keep adequate books and records [*Corp. Code § 25145*]. The Commissioner frequently requires semiannual reports for a period of 18 months after the issue has been qualified [*see Corp. Code § 25146*; *see also § 6H.274*].

The Commissioner may refuse to issue a permit unless he or she finds that the proposed plan of business and the proposed issuance of securities are fair, just, and equitable, that the applicant intends to transact its business fairly and honestly, and that the securities that it proposes to issue and the methods to be used in issuing them will not work a fraud on the purchasers [*Corp. Code § 25140(b)*]. The fact that a permit has been issued does not constitute a finding that any document that has been filed pursuant to the application is true, complete, and not misleading [*Corp. Code § 25164(a)*]. Every permit issued by the Commissioner recites in bold type that the issuance of the permit is permissive only and does not constitute a recommendation or endorsement of the securities permitted to be issued [*Corp. Code § 25164(c)*].

The Commissioner, by order, may summarily postpone or suspend the effectiveness of any qualification pending final determination of any proceeding under *Corp. Code §§ 25140-25151* [*Corp. Code § 25143(a)*]. Upon issuing such an order, the Commissioner must promptly notify the applicant, the issuer, and the person on whose behalf the securities are being offered, including the reasons for the order with the notice [*Corp. Code § 25143(a)*]. Any of those persons may request a hearing on the matter, which must be conducted in accordance with the provisions of the Administrative Procedure Act [*Gov. Code §§ 11500-11529*] (or if the person consents, a departmental hearing may be used [*see Corp. Code § 25702*]) and must be held within 20 days of the request [*Corp. Code § 25143(b)*]. The Commissioner may vacate or modify any stop order if he or she finds that the conditions which caused its entry have changed or that it is otherwise in the public interest to do so [*Corp. Code § 25144*].

Finally, the Commissioner may suspend or revoke a permit if the Commissioner finds that the order is in the public interest and finds any of the following [*Corp. Code § 25140(a)(1)*; *see Corp. Code § 25140(d)* (limitation)]:

- The proposed plan of business of the issuer, or the proposed issuance or sale of securities, is not fair, just, or equitable;

- The issuer does not intend to transact its business fairly and honestly; or

- That the securities proposed to be issued or the method used in issuing the securities will tend to work a fraud on the purchasers.

However, the Commissioner must give appropriate prior notice to the applicant, the issuer, and the person on whose behalf the securities will or have been offered and hold a hearing before the suspension or revocation [*Corp. Code § 25143(b)*].

[c] Content and Preparation of Form

The application for qualification by permit consists of a facing page [*see 10 Cal. Code Reg. § 260.110*; *see also § 6H.200*], Items 8-10 and 12-18 as set forth in *10 Cal. Code Reg. § 260.112*, and Items 19-23 as set forth in *10 Cal. Code Reg. § 260.113* [*10 Cal. Code Reg. § 260.113*]. Items 8-10 and 12-18 of the application for qualification by permit are identical to those items in the application for qualification by issuer notification [*10 Cal. Code Reg. §§ 260.112, 260.113*; *see § 6H.215*]. However, the information concerning directors and executive officers required in Item 11 of an application for qualification by issuer notification is incorporated into Item 21(j) of the application for qualification by permit. Consequently, in completing this form, the response concerning directors and officers should be set out in full in Item 21(j) and the response to Item 11 should merely be: "see response to Item 21(j)" [*10 Cal. Code Reg. § 260.113*; *see § 6H.242*]. For a discussion of Items 8-10 and 12-18, see *§ 6H.215*.

Item 19 requires the disclosure of any issuance of securities pursuant to the small or limited offering exemptions, or qualified purchaser exemption, or exemption for certain employee or option plans [*10 Cal. Code Reg. § 260.113*; *see Corp. Code § 25102(f), (h),* (n), (o); *see also § 6H.235*]. Item 20 requires additional information in connection with any

interest or participation in (1) oil, gas, or mining leases [*see 10 Cal. Code Reg. §§ 260.140.120-260.140.131.9*; *see also* Marsh & Volk, Practice Under the California Securities Laws, Ch. 8, *Standards for the Exercise of the Commissioner's Discretion* (Matthew Bender)]; (2) real estate syndicates [*see 10 Cal. Code Reg. §§ 260.140.110.1-260.140.119.1*]; or (3) mutual water companies or churches [*see 10 Cal. Code Reg. §§ 260.140.71-260.140.72.6*; *see also* Dept. of Corps. Release No. 86-C (Feb. 21, 1989)]. For the exhibits and reports that are required by Items 21 and 22, see *§§ 6H.236-6H.244*.

[d] Small Company Applications for Qualification by Permit

[i] Qualified Corporations

A qualified applicant may file for qualification by permit by filing a small company application under *Corp. Code § 25113(b)(2)*. The applicant must be a California corporation, or a foreign corporation that, at the time of filing the application, is subject to *Corp. Code § 2115*, which subjects a foreign corporation to the California General Corporation Law if more than 50 percent of its outstanding voting securities are held of record by persons in California and more than 50 percent of its property, payroll, and sales for California franchise tax purposes are in California. [*Corp. Code §§ 2115, 25113(b)(2)(A)*]. The corporation must also satisfy the following requirements [*Corp. Code § 25113(b)(2)(A)(i)-(iv)*]:

- The corporation must not be a blind pool company. The term "blind pool company" refers to a company that is a development stage company and that either does not have a specific business plan or purpose or has indicated that its business plan is to engage in mergers or acquisitions with unidentified entities [*10 Cal. Code Reg. § 260.113.1(b)(1)*].

- The corporation must not be engaged in oil and gas exploration or production, or mining or other extractive industries.

- The corporation must not be an investment company subject to the Investment Company Act of 1940 [*see 15 U.S.C. § 80a-1 et seq.*].

- The corporation must not be subject to the reporting requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934 [*see 15 U.S.C. §§ 78m, 78o(d)*].

[ii] Offering Requirements

In addition to the requirements noted above, two other requirements apply [*Corp. Code § 25113(b)(2)(B)*]:

- The total offering of voting common stock and preferred stock to be sold in a 12-month period, within or outside California, must be limited to $1,000,000, less the aggregate offering price for certain securities sold (within the 12 months before the start and during the offering of voting common stock or preferred stock) under SEC Rule 504 [*17 C.F.R. § 230.504*]; and

- There must be only one class of voting common stock immediately after the proposed sale and issuance.

The minimum offering price of the voting common stock and preferred stock (and the conversion price if the preferred stock is convertible into the voting common stock) to be sold must be at least $2 per share, and the applicant must file an undertaking with the Commissioner stating that there will be no stock splits, stock dividends, spinoffs, or mergers for at least two years from the close of the offering. The Commissioner may, however, approve a spinoff or merger pursuant to an application for qualification filed by an applicant [*Corp. Code § 25113(b)(2)(C)*]. The net proceeds from

the offering must be expended in the operations of the business [*Corp. Code § 25113(b)(2)(D)*].

The offering must be made pursuant to a Small Corporate Offering Registration disclosure document [NASAA Form U-7]. The Commissioner has prescribed additional requirements, which include investor suitability and due diligence investigation requirements [*Corp. Code § 25113(b)(2)(E)*; *see 10 Cal. Code Reg. § 260.113.1*].

[iii] Application Requirements

A small company application for permit must contain the information required by statute and regulation [*Corp. Code § 25113(b)(2)(G)*; *see Corp. Code § 25610*; *10 Cal. Code Reg. § 260.113*]. Currently, these requirements are coterminous with those applicable to the general application for qualification by permit [*compare Corp. Code § 25113(b)(1) with Corp. Code § 25113(b)(2)(G)*], as set forth in this form. The Commissioner may require additional information and documentation by rule [*Corp. Code § 25113(b)(2)(G)*]. In addition, the application must contain or be accompanied by a consent to service of process if required [*Corp. Code § 25113(b)(2)(G)*; *see Corp. Code § 25165*]. The application and the disclosure document [*see* [ii], *below*] must be reviewed and signed by a majority of the members of the board of directors of the applicant [*Corp. Code § 25113(b)(2)(F)*].

The fee for filing a small company application for qualification by permit is $2,500, which is the maximum aggregate fee applicable to other applications for qualification by permit. However, if the costs of processing the small company application exceed that filing fee, an additional fee of up to $1,000 will be charged. The processing fee is based on the costs of salary or other compensation paid to persons processing the application, plus overhead costs reasonably incurred in the performance of the work. In determining costs, the Commissioner may use the estimated average hourly cost for all persons processing applications for the fiscal year [*Corp. Code § 25608(e)*].

[2] Form

Application for Qualification by Permit [Corp. Code § 25113; 10 Cal. Code Reg. § 260.113]
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

INSTRUCTIONS FOR APPLICATION FOR QUALIFICATION BY PERMIT (SECTION 260.113)

An application for the qualification of the offer and sale of securities by permit pursuant to Section 25113 of the Code shall, in addition to the facing page required by Section 260.110 of these rules and items 8 through 10 and 12 through 18 specified in Section 260.112 of these rules, continue in the following form:

(NOTE: The applicant's response to Item 21(j) of the application for qualification by permit pursuant to *Corporations Code Section 25113* incorporates the information requested by Item 11 of Section 260.112 of the rules. Consequently, applicant's response to Item 11 should be "See response to Item 21(j)." In addition, the small company applicant's response to items of Section 260.112 and Section 260.113 of these rules may incorporate the information contained in the Form U-7 by referring to the appropriate page and question number of the Form U-7.)

ITEM 19. PRIOR ISSUANCES PURSUANT TO CODE SECTIONS 25102(f), (h), (n), AND (o).

If the applicant has issued securities pursuant to the exemptions from qualification provided for in Sections 25102(f),(h), (n), and (o) the Code, briefly state the details of the transactions.

ITEM 20. ADDITIONAL INFORMATION REQUIRED IN CONNECTION WITH INTEREST OR PARTICIPATION IN OIL, GAS OR MINING LEASES; REAL ESTATE SYNDICATES; AND MUTUAL

WATER COMPANIES AND CHURCHES.

(i) Interest or participation in oil, gas or mining titles or leases: The following, if appropriate:

(a) A description of the properties involved and copies of all conveyances, assignments, leases, subleases or other instruments or agreements relating to said properties together with an opinion of counsel or title policy indicating that applicant has title to such properties.

(b) A statement of the area of interest to the applicant, a description of the plan of exploration including, where available, anticipated drilling depth, the horizon or horizons in which hydrocarbon substances are expected and the nature of such hydrocarbons, the estimated costs of drilling and completing the well or wells proposed to be drilled, and the availability of a market or markets for hydrocarbons discovered.

(c) In the case of programs other than wildcat drilling, a geological report and appraisal which indicate the proposed method of development and production, a statement of the method used in preparing such report, together with supporting geological and engineering data, a table setting forth the estimated future production and the present value thereof, together with a statement of the factor or factors used in making such estimate and an estimate of the expenses to be incurred in connection with development and production of minerals as proposed in such geological report.

(d) If the securities proposed to be issued involve minerals other than oil, gas or other hydrocarbons, the applicant shall include a mineral report which indicates the area of interest to the applicant, the geological information available to such applicant with respect to such area, the results of other mineral operations in the area, if known, a description of the plan of operation including where available, the extent of ore deposits, the cost of development and production thereof, the market or markets for minerals produced and the cost of marketing such minerals.

(e) Copies of all instruments or agreements which will convey an interest in minerals to the proposed purchasers and a statement of the ownership of other interests in the same minerals. In the event that there is a relationship or an arrangement between one or more holders of such an interest in minerals and the applicant, the nature thereof shall be described.

(ii) Real Estate Syndicates: The following if appropriate: (a) A copy of an appraisal of the property of recent date should be attached hereto as an additional exhibit. In lieu of an appraisal, in cases where the property is being acquired from other than a promoter of the applicant and where no real estate commission in connection with the acquisition is being paid to anyone related to the applicant, a valuation of the property may be submitted together with a detailed description of the method of valuation. (b) Such other information as may be necessary to demonstrate compliance with Sections 260.140.110.1 through 260.140.119.1 of Title 10 of the California Code of Regulations.

(iii) Mutual Water Companies: An application for a permit to offer and sell securities of a mutual water company must demonstrate compliance with Sections 260.140.71 through 260.140.71.10 of Title 10 of the California Code of Regulations.

(iv) Church debt securities: An application for permit to offer and sell church debt securities must demonstrate compliance with Subarticle 7.2, Article 4, Subchapter 2 of these rules.

ITEM 21. EXHIBITS.

Attach and incorporate by reference the following exhibits:

NOTE: Any exhibit which is inapplicable should be listed by letter on the form followed simply by the word "inapplicable."

A. A copy (which may be in the form of a restated or composite copy) of applicant's charter documents as described in *Section 260.001 of Title 10 of the California Code of Regulations.*

B. Specimen certificate evidencing the security to be issued. (Instruction: Certificates for common stock which are to be in a standard printer's form without any additional substantive provisions should not be submitted.)

C. A copy of any contract made or to be made by the issuer affecting any of the rights, preferences, privileges or transferability of the securities.

D. Subject to the following instruction, a copy of any agreement made or to be made by or among shareholders of the issuer which materially affects, or will materially affect, any of the rights, preferences, privileges, or restrictions of or on securities of the issuer or the management of the issuer (including any voting agreement, irrevocable proxy or shareholders' agreement).

Instruction: If a copy of any agreement is not available to the issuer, so state and furnish a brief description of the agreement, including therein such information regarding the parties and terms as is known to the issuer. Nothing contained herein shall be construed as requiring the issuer to disclose information concerning agreements of which it has no knowledge.

E. Financial statements of the issuer and any other business involved in this transaction as required by *Section 260.613 of Title 10 of the California Code of Regulations.*

F. A copy of any advertisement, prospectus, or Small Corporate Offerings Registration Form (Form U-7 disclosure document as described in Section 260.113.1 of these rules) to be used in connection with the offer or sale of the securities. Also include the consent of any attorney, accountant or other expert named in any such advertisement, prospectus, or Form U-7, if required pursuant to *Section 260.504.2.2 of Title 10, California Code of Regulations*, in the form required by that section.

G. A description of the consideration to be received by applicant in exchange for the securities if other than cash.

Instructions:

If the applicant proposes to issue securities in exchange for consideration other than cash, state in tabular form the total number of shares proposed to be issued for each type of consideration, the per share selling price based on the consideration proposed to be paid and the names of the purchasers for each category. Submit an appraisal or detailed description of the valuation thereof, or if for a patent or invention for which an application for patent is pending, a copy of the patent or application together with an opinion of a patent attorney covering subjects of ownership and validity thereof and of infringement of patents of others by products as disclosed therein, and a description of all contracts, licenses and assignments of rights or interests therein.

H. A list of the names of the proposed purchasers or an identification of the class of the proposed offerees, if the application is for a limited offering qualification.

Instructions:

A list of the complete names, post office addresses and occupations of the proposed issuees and a statement as to the relationship, if any, of the proposed issuees to the promoters, officers or directors of the applicant. Further information as to the financial responsibility and investment experience of the proposed purchasers, while not required as part of the original application except in connection with oil and gas or mining interests and real estate syndicates, if furnished may serve to facilitate processing by

the Department. (UPON REQUEST, AND IN ACCORDANCE WITH RULE 250.10, SUCH INFORMATION WILL BE TREATED AS CONFIDENTIAL BY THE COMMISSIONER.) If the applicant proposes to limit the offering to a class of purchasers, information concerning the financial and other qualifications which will be used to determine the class, together with the methods to be used by the applicant in qualifying purchasers within that class, should be submitted.

I. (1) The Consent to Service of Process if required by *Section 25165 of the California Corporations Code*.

(2) A Customer Authorization of Disclosure of Financial Records Form (Form No. QR 500.259).

J. (1) A list containing the complete names of the directors, officers, trustees, and/or general partners, as the case may be, and the general managers, principal executives and/or other persons who will be charged with the business activities and operations of the applicant and with respect to each of the foregoing persons, the current post office address, age, and current occupation and principal occupation during the last five years.

(2) A statement of any order, judgment or decree of any governmental agency or administrator, or of any court of competent jurisdiction, revoking or suspending for cause any license, permit or other authority of such person or of any corporation of which he is an officer or director, to engage in the securities business or in the sale of a particular security or temporarily or permanently restraining or enjoining any such person or any corporation of which he is an officer or director from engaging in or continuing any conduct, practice or employment in connection with the purchase or sale of securities, or convicting such person of any misdemeanor involving a security or any aspect of the securities business, or of theft, or of any felony.

K. In the event applicant has not commenced business and has no assets or liabilities, in lieu of financial statements a statement should be submitted, in the form of a budget, setting forth (i) the use proposed to be made of the proceeds from the sale of the securities, including all expenditures to be made or incurred; (ii) the total projected financing requirements of the applicant for six months or, if the proposed plan of operation requires initial financing for a period longer than six months, for such longer period; and (iii) a statement setting forth the sources of all of the required funds other than from the sale of securities, including any proposed loans or contributions to capital.

ITEM 22. REPORTS OF FINANCIAL CONDITION.

Pursuant to *Section 25146 of the California Corporations Code* and *Section 260.146 of Title 10 of the California Code of Regulations*, applicant hereby undertakes, as long as required under the foregoing sections and subject of the exception therein contained, to file with the Commissioner:

(a) within 120 days after the end of each fiscal year a report of financial condition and a related statement of income and expenses covering such fiscal year; and

(b) within 90 days after the first six months of each fiscal year, a like report and statement covering such six months period.

ITEM 23. SMALL COMPANY UNDERTAKING.

For an application filed under *Section 25113(b)(2) of the California Corporations Code*, the applicant hereby undertakes that there will be no stock splits, stock dividends, spinoffs, or mergers for a period of two years from the close of the offering.

(NOTE: The application must be signed and verified in the following manner.) The applicant has duly caused this application to be signed on its behalf by the undersigned, thereunto duly authorized.

_____
(Applicant)

By _____

_____
(Title)

I certify (or declare) under penalty of perjury under the laws of the State of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed at _____[*place*], on _____[*date*].

_____
(Signature)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
D. Qualification by Permit

3-6H California Legal Forms--Transaction Guide §§ 6H.221-6H.224

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6H.221[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.225

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.225 Description of Business [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131]

[1] Comment

[a] Use of Form

This form is a description of the applicant's business. All forms for qualification of securities require some description of the business operations of the issuer. In applications for qualification by nonissuer notification [*see § 6H.255*] this information is contained at Item 7 of the application. Qualification under issuer notification [*see § 6H.215*] and permit [*see § 6H.220*] procedures require the description of the business as Item 8 of the application. An application for a reorganization permit [*see § 6H.250*] should describe the business operations of the issuer at Item 10. This form suggests a format for the major areas that might be considered when providing this description.

[b] Preparation of Form

The description of the existing or proposed plan of business must be more specific than a recital of the business purpose clause contained in the articles of incorporation [*see Ch. 3, Articles of Incorporation, §§ 3.220, 3.221* (examples of business purpose clauses in the articles)]. The statement in the application must be sufficiently detailed to convince the Commissioner that the plan of business and the sale of shares to investors is fair, just, and equitable [*see Corp. Code § 25140*]. The Commissioner's own business judgment may not be substituted for that of sophisticated shareholders of an existing corporation [*see Transportation Bldg. Co. v. Daugherty (1946) 74 Cal. App. 2d 604, 615-616, 169 P.2d 470]* , but he or she has broad discretionary authority to insure that the applicant conducts its business fairly and honestly [*Corp. Code § 25140*; *see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 8, Standards for the Exercise of the Commissioner's Discretion, § 8.01* (Matthew Bender)].

[2] Form

Description of Business [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131]

DESCRIPTION OF BUSINESS

History:

Applicant corporation was incorporated in California on _____[*date*], as a result of promotion primarily by _____[*name*], a famous inventor and investor. In the period of initial operations, our activities were limited to research and development of chemical formulations of electronic products, design of chemical processes, and fabrication of production and test equipment, as well as design and construction of a manufacturing plant in _____[*city*]. Beginning on _____[*date*], we offered products for sale, and growth of sales and profits to date have been rapid. In _____ [*year*], we merged the _____ [*name of company*] into our operations in order to provide ourselves with a ready and economical but quality supply of our basic requisite _____ [*type of supply material*]. We have hitherto restricted our operations to development, manufacture, and sale of computer, instrumentation, and _____ [*other specified*] products, all of which are manufactured by few competitors, require extensive technology and substantial capital to produce, command high prices, and are compelled to meet severe technical specifications. Industry sales of these items are estimated presently at $_____ [*figure*] and are expected to rise to $_____ [*figure*] by _____[*date*]. Management believes our current rate of sales of all product lines is second highest in our industry.

Nature of Products [*or* Nature of Services]:

Applicant's products are all precision, high quality, magnetic tapes for use in electronic data processing, instrumentation, television picture recording, and _____ [*specify other uses*]. Our primary product, digital linear computer tape or "DLT," is designed for use in information retrieval devices installed in commercial institutions or central locations serving subscribers within a designated area of geography or use. A second tape is designed especially to serve the purposes of preserving test data and other scientific information in the missile and space industries. Our third most important tape product is used in television picture recording by broadcasters and program producers in the commercial and educational television industries, with separate devices used to facilitate closed circuit picture distribution.

Manufacturing Program [*or* Service Program]:

The development and manufacture of precision magnetic tape products requires a combination of technical disciplines which are not typically available in the chemical industries. Polymer chemists in product formulation work and chemical engineers in design of processing equipment must be integrated with physicists and electrical and mechanical engineers skilled in tape recording technology. Applicant's industry success in product development and manufacturing is in large part attributable to the effective combination of these talents on our senior technical staff. Research and development is continually emphasized within our company. We have not received any government research and development contracts nor assistance and have developed all of our products and equipment at our own expense. The manufacturing technology of our industry is not protected by patent, normally. As is common in the chemical processing industries, protection is more securely obtained by the multiplicity of trade secrets of product formulations and the design and modes of operation of manufacturing processes and equipment. Even when such designs are patentable, they usually are not patented in order to avoid technical disclosure and resulting infringement or circumvention of protection.

Property and Equipment:

Applicant's existing plant is located on a _____-acre _____[*number*] site in _____[*city*] in a science-oriented industrial community. Operations are housed in a building constructed in _____ [*year*] which provides _____[*number*] square feet of office and laboratory area and _____[*number*] square feet of

factory and warehouse space. Administration is housed in a smaller, temporary building located directly in front of the main building. Manufacturing equipment consists of a complex of chemical processing, mechanical, and electronic equipment including ultrasonic film-cleaning baths, particle dispersion machines, coaters, drying and curing ovens, tape surface treating equipment, web slitters, and chemical analysis and electronic test equipment. The equipment is continuously maintained to assure the highest level of production quality. Technical obsolescence rather than wear and tear will account for any depreciation, but this is not expected to any degree for the next _____[*number*] years. Much of the equipment is unique since most of it was developed by applicant itself at an original cost of $_____. Applicant owns all its property and currently has a mortgage only on the parcel holding the administration building.

Work Force:

Applicant employs a total labor group of _____[*number*] including _____[*number*] on the research and development staff, _____[*number*] of whom hold Ph.D. degrees from reputable institutions, _____[*number*] whose sole responsibility is to function as a maintenance crew, _____[*number*] on active production operations, and _____[*number*] involved in strictly administrative and clerical duties. Approximately _____[*number*] of applicant's total personnel is union labor. Relations with the _____ [*specify*] union have been excellent in the last _____[*number*] years and there are no immediate indications of new union activity in the industry generally.

Customers:

Our computer tapes are used in the electronic data processing installations of banks, insurance companies, government agencies, and industrial corporations. Such customers total several hundred and include _____[*number*] of the 10 largest corporations in the country. Government agencies which are storage tape customers include space and defense related agencies, including _____ [*specify agency*], and also civilian agencies such as the _____ [*specify agency*]. Television company customers include _____ [*names of particular companies*]. The demand for our products is related to the growth potentials of the computer, missile and space, and television markets. Such demand is also stabilized, however, because our instruments are primarily supply items. Therefore, the demand is related not only to the number of new computers, instrumentation, and video recording devices sold each year but to the aggregate of machines in existence, similar to the way in which the demand for tires is related to, but not limited by, new automobile sales. The company only has one long-range customer contract, that with the _____[*name*] Company by which applicant agrees to supply its customer with _____ [*quantity*] of its _____ [*product*] for a _____-year _____[*number*] period, distributed roughly in an equal manner over the months, at a price ranging $_____ [*price range*] upwards over the course of the contract. This would account for _____ percent of all applicant's basic output in the product area.

Competition:

Production in our industry is dominated by _____ [*name of competitor company*] which pioneered in _____ [*specify manufacturing processes*] approximately _____[*number*] years ago. Applicant is the only effective competition to _____ [*name of competitor company*] in the sale of _____ [*specify product*] to some computer system manufacturers which specialize in _____ [*name of particular operation*]. The product line of _____ [*competitor*], unlike that of applicant, includes as well a wide range of lower-priced and quality products for _____ [*specify*] uses. Other competitors are _____ [*list names*]. There are no significant foreign manufacturers of products for our _____ [*specify*] uses. Other competitors are _____ [*list names*]. There are no significant foreign manufacturers of our _____ [*specify*] products in commercial quantities. All of the above-named competitors have been manufacturing for _____[*number*] years. In general, these companies do not possess the capability to manufacture products to the standard of quality and technical

specifications set by applicant and _____ [*major competitor*] in regard to _____ [*specify type of product and operation*], and their success in competition in this respect is based on the lower prices of their products.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.226

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.226 Use of Proceeds to Issuer [10 Cal. Code Reg. §§ 260.112, 260.113]

[1] Comment--Use of Form

This form is a statement of the issuer's use of proceeds from the sale of securities. Qualification under both issuer notification [*Corp. Code § 25112*] and permit [*Corp. Code § 25113*] procedures requires that the applicant state as Item 9 the principal purposes to which the net proceeds from the sale of securities will be put, and the approximate amount intended to be used for each such purpose [*10 Cal. Code Reg. §§ 260.112, 260.113*; *see §§ 6H.215, 6H.220*].

This form suggest several examples of various purposes for which those proceeds might be used. The financial projects themselves need not be identified in any great detail. If it appears obvious that the allocated amount would not be adequate for the purpose listed and other funds will also be used, this fact should be indicated. If several purposes are stated under a single allocation, the form should indicate the order in which the funds would be allocated in the event that the sale proceeds are inadequate to satisfy all project needs. Although the distribution of a portion of the proceeds might be left to the discretion of the board of directors, too great a portion in such a category, even if designated in the alternative for specified purposes, might raise questions of speculation.

[2] Form

Use of Proceeds to Issuer [10 Cal. Code Reg. §§ 260.112, 260.113]

ITEM 9. USE OF PROCEEDS TO ISSUER

Total cash proceeds of $_____ to applicant are expected, to be used as follows:

Research and Development: $_____ for investigative study and development of new _____ [*facilities, equipment, or program; or plan for acquisition of markets or other enterprises*];

Property and Equipment: $_____ for acquisition of new property at _____ [*address*] [*or* for new processing equipment] for _____ [*purpose, e.g.,* expansion of existing facilities (*or* relocation of all manufacturing processes to one central location)];

Supplies: $_____ for acquisition of new supplies of _____ [*material or product*] for _____ [*purpose*];

Products: $_____ to increase output of [*or* to introduce manufacture of] _____ [*product*] as element of regular business;

Personnel: $_____ to acquire new [expert *or* skilled] _____ [*type of employee*] for _____ [*purpose, e.g.,* increasing output of company's basis product];

Financing: $_____ to retire outstanding debt [*or specified class of shares*] and substitute stock of new issue in line with plans for long-range development of production;

Working Capital: $_____ for immediate or imminent needs of development and expansion, not presently identified, but as decided by the Board of Directors [*or* Executive Committee of the Board *or* shareholders];

General Funds: $_____ to be allocated by Board of Directors to any of several funds relating to company expansion as required by dictates of changing markets and competition over next several years;

Nonmonetary proceeds to be used as follows:

Assets of _____ [*existing company or enterprise*]: property consisting of _____ [*describe assets of existing company being received in trade*] to be utilized in _____ [*particular operations of applicant, e.g.,* second stage manufacturing process for applicant's basic product, *or* as vehicles for transporting applicant's supplies to manufacture center];

Patents of _____ [*name of inventor*]: patents pertaining to _____ [*describe significance of patents*] for use in _____ [*particular operations of applicant, e.g.,* expanding efficiency of basic manufacturing operation, *or* for producing product more quickly and economically];

Services of _____ [*name of promoter*]: services which have [*or* will have] resulted in _____ [*e.g.,* binding contracts for orders of applicant's basic product to _____ (*name of customer)* amounting to projected $_____ of business over next _____ (*number)* years].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.227

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.227 Plan of Distribution [10 Cal. Code Reg. §§ 260.112, 260.113]

[1] Comment

[a] Use of Form

This form is a description of the plan of distribution of offered securities. Item 10 of the application to qualify securities under issuer notification [*Corp. Code § 25112*] or permit [*Corp. Code § 25113*] procedures requires a description of the plan of distribution of the offered securities, identification of any underwriters or agents to be employed by the applicant in connection with the sale, and a statement of the discounts or compensation to be allowed or paid to those persons, or other consideration to be received by those persons in connection with the sale of the securities [*10 Cal. Code Reg. §§ 260.112, 260.113*; *see §§ 6H.215, 6H.220*].

[b] Selling Expenses

The applicant may not incur unreasonable selling expenses. Selling expenses that do not exceed 15 percent of the aggregate offering price, less discounts and commissions, are presumed to be reasonable [*10 Cal. Code Reg. § 260.140.20(a)*]. Selling expenses include the following items [*10 Cal. Code Reg. § 260.140.20(a)*]:

- All underwriting and brokerage discounts and commissions paid in connection with the offering, including attorneys' fees for the underwriters if paid by the applicant, as well as expenses incurred for printing, engraving, and mailing.

- Salaries for sales activities; charges of transfer agents, registrars, trustees, escrow holders, and depositaries.

- Fees paid to experts such as engineers or appraisers.

- All fees, charges, and expenses in connection with the qualification or registration of the securities under federal or state law.

- Any other expenses actually incurred by the issuer and directly related to the offering and sale of the securities, except for accountants' and attorneys' fees of the issuer and options given to underwriters.

Reimbursement of expenses incurred by promoters in connection with the founding or organizing of a business enterprise are also included [*10 Cal. Code Reg. § 260.140.33*]. The value of any stock acquired or to be acquired by underwriters, brokers, finders, their counsel, or related parties is also treated as a selling expense [*10 Cal. Code Reg. § 260.140.20(a)*].

[c] Employment of Agents

Any applicant that will employ agents other than licensed broker-dealers in connection with the offering must comply with Rules 260.141.30 and 260.141.31 [*10 Cal. Code Reg. §§ 260.141.30, 260.141.31*; *see § 6H.272*] and supply the following:

- The name and business address of each person who will represent the applicant as an agent in California.

- The name and business address of the corporate officer or other official who will supervise those agents on behalf of the applicant.

- A statement that all such agents employed in California are employees of the applicant.

- A statement of the compensation to be paid to those agents and the compensation to be paid to supervisory personnel in excess of their regular salaries if they are regular employees of the applicant.

- A description of any disqualification or legal disability of any such agent or supervisory person to engage in the securities business, or the association of that person as an officer or director with any corporation similarly disqualified, disabled, or restrained from engaging in any conduct or practice in connection with the purchase or sale of securities, or any conviction of that person involving a security or any aspect of the securities business, or any conviction for theft or any felony.

- A surety bond complying with the requirements of *10 Cal. Code Reg. § 260.216.15* [*see § 6H.273*].

[d] Underwriter Options

Payments made to underwriters in the form of options must also be disclosed under this item. Compensation to underwriters in the form of options will be presumed reasonable if the number of shares or units called for by those options does not exceed 10 percent of the total number of shares or units underwritten for the issuer in the offering. In addition, the options should not exceed five years in total duration and should be exercisable at a price not less than the public offering price (with a provision for an annual price increase of not less than 7 percent, or a flat price of 120 percent of the initial price of the offering). Further, the options should not be deliverable until the entire issue has been sold, and the options should be nontransferable (subject to exceptions for the death of the option holder or transfer to a partner of the underwriter). Finally, the exercise of any option, or the resale, transfer, or assignment of the shares underlying the option must be prohibited for at least one year [*10 Cal. Code Reg. § 260.140.21*; *see §§ 6H.231, 6H.234* for further discussion of options].

[2] Form

Plan of Distribution [10 Cal. Code Reg. §§ 260.112, 260.113]

ITEM 10. PLAN OF DISTRIBUTION.

The following underwriters have severally agreed to purchase [*or* to acquire on a best efforts basis] from applicant the number of shares to be sold by the company as set out by their names [and to receive the number of shares (*or* options) as set forth for each quantity of _____[*number*] shares actually sold]:

Underwriter	Address	Number of Shares Purchased	Number of Shares [*or* Options] Given as Described Above
_____[*name*]	__	__	__
_____[*name*]	__	__	__
_____[*name*]	__	__	__

_____ [*name of particular underwriter*] is serving as representative of the above-named group.

The securities will be marketed by the above stated underwriters to the public with allowances to dealers in the following manner:

Class of Securities	Offering Price to Public	Concession to Broker-Dealers [*or* Commission]	Concession to Agents or Special Selling Group [*or* Commission]
_____ [*e.g.*, Class A Shares]	$_____	$_____ [*e.g.*, $0.30]	$_____
_____	$_____	$_____	$_____
_____	$_____	$_____	$_____



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.228

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.228 Directors and Officers [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131]

[1] Comment

[a] Use of Form

This form is the list of directors and executive officers required as an exhibit to certain qualification applications.

Applications for qualification by issuer notification [*see § 6H.215*], issuer permit [*see § 6H.220*], recapitalization or reorganization permit [*see § 6H.250*], and nonissuer notification [*see § 6H.255*] must have a list of the names of all officers and directors, indicating the position held by each. This information must be set forth in Item 8 for nonissuer notification applications [*10 Cal. Code Reg. § 260.131*], Item 11 for applications under issuer notification or permit procedures [*10 Cal. Code Reg. §§ 260.112, 260.113*], and in Item 13 for recapitalization and reorganization permits (which requires the names of all directors, executive officers, or persons occupying a similar status or performing similar functions) [*10 Cal. Code Reg. § 260.121*].

In addition, the applicant must describe any order, judgment, or decree of a governmental agency or administrator, or of any court, revoking or suspending for cause any license, permit, or other authority of that person, or of any corporation of which the applicant is an officer or director, to engage in the securities business or in the sale of a particular security, or temporarily or permanently restraining that person or corporation from engaging in or continuing any conduct or employment in connection with the purchase or sale of securities. Felony or misdemeanor convictions involving any aspect of the securities business, and convictions of any offense involving theft or any felony must also be described [*see 10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131*].

[b] Qualification by Issuer Permit

Because the information required by Item 21(j) of an application for qualification by issuer permit [*see 10 Cal. Code Reg. § 260.113*; *see also § 6H.220*] incorporates the information required in this form, an applicant responding to Item

11 of the application for qualification by permit should, in lieu of completing this form, merely state, "see response to Item 21(j)." The full response should then be set forth as required by Item 21(j) in a document labeled Exhibit J [*10 Cal. Code Reg. § 260.113*; *see §§ 6H.220* (application), 6H.242 (Exhibit J)].

[2] Form

Directors and Officers [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131]

DIRECTORS AND EXECUTIVE OFFICERS

Name	Position
_____	[*e.g.*, Director, Chairman of the Board of Directors, and Chief Executive Officer]
_____	[*e.g.*, Director, President of the company]
_____	[*e.g.*, Director, Vice-President, and Secretary]
_____	[*e.g.*, Vice-President, Treasurer]

ORDERS OR JUDGMENTS

To the best of the applicant's knowledge and belief, none of the above listed officers or directors, nor any corporation of which any of them is an officer or director, has ever been the subject of any order, judgment, or decree of any governmental agency or administrator, or any court, revoking or suspending for cause any license, permit, or other authority to engage in the securities business or in the sale of a particular security, or temporarily or permanently restraining or enjoining the continuance of any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting that person of any misdemeanor involving any aspect of the securities business, or of theft, or of any felony except as follows: _____ [*specify*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.229

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.229 Material Transactions With Affiliates During Last Three Years [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

[1] Comment--Use of Form

This form is a description of material transactions with affiliates that have occurred within the last three years. Applications for qualification by issuer notification [*see § 6H.215*], permit [*see § 6H.220*], and nonissuer notification [*see § 6H.255*] require the applicant to describe as Item 12 of the application any material transactions or agreements between the applicant or any of its affiliated companies and any of the promoters, directors, officers, principal employees, principal security holders, underwriters or agents, or any company directly or indirectly controlled by any such person or persons, that have occurred during the three-year period immediately preceding the filing of the application [*10 Cal. Code Reg. §§ 260.112, 260.131*].

The purpose of the disclosures required under this item is to alert the Commissioner to possible conflicts of interest. Accordingly, transactions that involve all shareholders proportionately may not be material, but transactions that involve less than all of the shareholders, or which feature discounts or bonuses to certain individuals, may be highly material. Any acquisitions or dispositions of corporate property involving any of the persons listed above should include the relevant information regarding original costs and selling prices. This form suggests categories that might be included in completing Item 12.

[2] Form

Material Transactions With Affiliates During Last Three Years [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

ITEM 12. MATERIAL TRANSACTIONS WITH AFFILIATES.

The following transactions between applicant [*or* its affiliated companies] and the following parties during the last three

years are material:

A. Promoters:

_____ [*names*] on _____[*date*], were the owners of _____[*number*] sites in the _____[*name*] industrial park located in _____ [*geographic location*]. They had purchased the property at a probate sale in _____ [*year*] for $_____ [*price*]. After convincing the local Board of Supervisors to rezone the area for industry, they leased out half the area to other industries related in nature of products to applicant, then incorporated applicant and arranged to have applicant purchase out of its initial capital the remaining half of the acreage as the site for its principal plant. The price to applicant was $ _____, approved as the fair price by the board of directors [*or* promoters]. _____ [*names of promoters*] received _____[*number*] shares in applicant for that service to the corporation since the contract for the property gave applicant an enormous competitive advantage in placing it in a most desirable site in relationship to its customers as well as to its suppliers.

B. Directors:

In _____ [*year*], when applicant was considering before its full Board the possibility of merging with one or more of its three leading suppliers, _____ [*name of director*] proposed that applicant buy _____ [his *or* her] personal stock in _____ [*name of supplying company*], one of the choices being considered for selection, and thereby obtaining a controlling interest, though not 50 percent or over, in the corporation without having to formally consummate applicant's objectives in a more complicated manner. The decision was approved by the full Board, _____ [*name of selling director*] not voting, and _____ [*name of selling director*] was paid $_____ [*price*] for _____ [his *or* her] entire interest in the supplier. The stock was then selling for $_____ [*price*] over the counter. _____ [*name of selling director*] originally had purchased the various portions of the block between the years_____-_____ at prices ranging from _____ [*range of prices*]. The result was that applicant gained, and still retains an effective controlling interest in that supplier which has brought numerous and profitable benefits to both companies in terms of purchase and supply contracts.

C. Officers:

On its initial organization in _____ [*year*], applicant proposed to _____ [*name of officer*] that _____ [he *or* she] serve as titular head of the corporation with the office of President, but that _____ [he *or* she] was not to have any position on the Board nor any executive responsibility with respect to the company. _____ [His *or* Her] contract called for _____ [him *or* her] to be available for general consultation, to have an office at the corporation which _____ [he *or* she] was to visit for an hour on the average of every week, and to receive the salary of $_____ per year for five years, after which _____ [he *or* she] was to resign. The contract expired last year, and _____'s [*name of officer*] resignation was duly tendered and received. The entire arrangement was for public relations and publicity purposes primarily, since _____ [*name of officer*] was a semiretired preeminent figure in applicant's industry. _____ [*Name of officer*] also afforded valuable expertise on several occasions in which _____ [he *or* she] was consulted during office hours by key management personnel.

D. Principal Employees:

On _____[*date*], applicant acquired the services of _____[*name*], the then head of industrial personnel of its chief competitor, _____ [*name of corporation*]. _____'s [

Name of employee] salary at that time with _____ [*name of competitor*], and for the previous three years had been $_____. [*name of employee*] was rated by experts in applicant's industry as one of the top three industrial managers in the field. Applicant's contract with _____ [*name of employee*] provided for a starting salary of $_____ to be increased at the rate of $_____ per year until _____[*date*], at which time the contract is to expire. In addition, _____ [*name of employee*] was given _____[*number*] shares of common stock in applicant as incentive during the most recent issuance of company stock, qualified with the Department on _____[*date*], under an agreement whereby _____ [he *or* she] was to return the stock at $_____ [*price*] per share should _____ [his *or* her] services be terminated before _____[*date*]. The Board has rated _____'s [*name of employee*] performance for the company as excellent since retention.

E. Principal Security Holders:

_____[*Name*] is the holder of _____[*number*] of shares of applicant, which _____ [he *or* she] has held since _____[*date*], amounting to a _____ [*figure of 10 percent or higher*] percent interest in the company. _____ [He *or* She] also is the holder of _____[*number*] of shares in _____ [*name of other corporation*], giving _____ [him *or* her] an effective controlling interest in that corporation. Applicant steadily deals with _____ [*name of other corporation*] for all its _____ [*specify services performed by other corporation*], originally on the recommendation of _____ [*name of principal holder set out above*], but since then on the basis of the quality and dependability of performance, coupled with the most reasonable charges, which _____ [*name of other company*] continuously has rendered.

F. Underwriters or Agents:

_____ [*Name of underwriting firm*] originally was approached by applicant's management in _____ [*year*], to see about organizing a separate and independent distributor enterprise on a private subscription basis, a company which would exist at the outset on the basis of contracts to take applicant's _____ [*describe*] product and job it to awakening markets in the _____ [*location*] of the country. _____ [*name of underwriters*] worked with management to tailor the outlines of the new organization to the needs of certain institutional investors, and then arranged a private subscription, joining investors from several different lending industries, some of whose boards members of applicant's management also sat on. The project was a success, several new customer markets being stimulated into full activity, and on _____[*date*], the jobbing corporation was purchased outright by applicant to allow it to deal more directly with its purchasing markets _____ [*name of underwriters*], who had been paid selling expenses outright of $_____ for the subscription, also had been given _____[*number*] of options for shares in the company, which they exercised just prior to applicant's purchase. The option exercise price was $_____, after which they realize $_____ total after the purchase by applicant.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.230

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.230 Outstanding Securities [10 Cal. Code Reg. §§ 260.112, 260.113]

[1] Comment--Use of Form

This form is a list of outstanding securities. Item 13 of applications for qualification by issuer notification [*see § 6H.215*] or permit [*see § 6H.220*] requires a table indicating the title or class of securities outstanding, the number of shares in each such class, and whether any of the securities are publicly traded [*10 Cal. Code Reg. § 260.112*]. The term "publicly traded" relates to Item 5(e) of the facing page [*see § 6H.200*], the instructions for which state that a public market exist for a class of securities if (1) it is listed on a national securities exchange, (2) it is traded in the over-the-counter market and quoted in the Wall Street Journal or other newspaper of general circulation, or (3) it is held of record or beneficially by 500 or more persons [*see 10 Cal. Code Reg. § 260.110*]. Whether a security is publicly traded will have a bearing on whether an open or limited qualification is granted.

[2] Form

Outstanding Securities [10 Cal. Code Reg. §§ 260.112, 260.113]

Title or Class of Security	Number of Shares Outstanding	Publicly Traded
[*E.g.*, Class A common with par value of $_____]	[*E.g.*, 20,000]	[Yes *or* No]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.231

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.231 Outstanding Options to Purchase Securities [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

[1] Comment

[a] Use of Form

This form is a list of a corporation's outstanding options to purchase securities. Applications for qualification by issuer notification [*see § 6H.215*] and permit [*see § 6H.220*] require as Item 14 of the application, and applications for qualification by nonissuer notification [*see § 6H.255*] require as Item 10 of the application, a table stating the title and amount of securities called for by options, warrants, or rights, including the purchase price of the securities so called for and the expiration dates of those options, together with the market value of the securities so called for as of the latest practicable date [*10 Cal. Code Reg. §§ 260.112, 260.131*]. The statement must include that information for all options held by each officer and director of the applicant. The information presented as to all options held by persons other than officers or directors of the applicant may be stated in terms of ranges [*10 Cal. Code Reg. §§ 260.112, 260.131*].

[b] Restrictions on Issuance of Options

[i] In General

The Commissioner may refuse to issue a permit for qualification [*see Corp. Code § 25113*] unless he or she finds the proposed issuance of the securities to be fair, just, and equitable [*Corp. Code § 25140(b)*]. The Commissioner has promulgated regulations, setting forth standards for fairness, that are intended to operate as guidelines only [*see 10 Cal. Code Reg. § 260.140*; Marsh & Volk, Practice Under the California Securities Laws, Ch. 8, *Standards for the Exercise of the Commissioner's Discretion* (Matthew Bender)].

[ii] Pro Rata Rights

Rights may be issued to all the shareholders of an issuer (or to all the holders of a particular class of stock) to purchase

additional shares on a pro rata basis, with a term of no more than 90 days following the date of issuance, provided that (1) the exercise price is not so low in relation to the offering price [*see 10 Cal. Code Reg. § 260.140.50*] that it is unreasonably prejudicial to those shareholders unable to exercise or sell their rights, and (2) the relative equity positions of different classes of outstanding shares will not be unfairly prejudiced. An exercise price that is not more than 15 percent below the offering price [*see 10 Cal. Code Reg. § 260.140.40*; *see also 10 Cal. Code Reg. § 260.140.50*] is presumptively reasonable. These rights must be freely transferable [*see 10 Cal. Code Reg. § 260.140.40*]. For further discussion, see Ch. 6I, *Issuance of Equity Securities* .

[iii] Options

The standards relating to a presumption of fairness require an option plan (1) to meet criteria substantially similar to the requirements of *I.R.C. § 422* (definition of "incentive stock option") [*see 10 Cal. Code Reg. § 260.140.41*]; (2) generally to provide for annual financial statements regarding the issuer to be given to the option holders [*10 Cal. Code Reg. § 260.140.46*]; and (3) to limit the securities called for by all outstanding options, under any purchase, bonus, or similar plan, to 30 percent of the then-outstanding securities of the issuer (excluding securities subject to promotional waivers) [*10 Cal. Code Reg. § 260.140.45*; *see* Dept. of Corps. Release No. 118-C (Nov. 14, 2006) (request for variance from compensatory benefit plan regulations pending their possible amendment)]. For a discussion of those standards, see Ch. 6I, *Issuance of Equity Securities* .

[iv] Warrants

Warrants to purchase equity securities may be issued to the purchasers of debt securities if the following conditions are satisfied [*10 Cal. Code Reg. § 260.140.43*]:

- Issuance is necessary to obtain debt financing;
- The term of the warrant does not exceed the life of the debt securities or 15 years, whichever is less;
- The number of shares issuable upon exercise of the warrants does not exceed the number that could be purchased at the exercise price with the debt securities at face amount; and
- The exercise price is at least equal to the value of the equity securities [*see 10 Cal. Code Reg. § 260.140.50*] on the date the warrant is issued.

Warrants to purchase equity securities may be issued to purchasers of equity securities if the following conditions are satisfied [*10 Cal. Code Reg. § 260.140.44*]:

- Issuance is necessary to obtain equity financing;
- The term of the warrant does not exceed five years;
- The number of securities issuable upon exercise does not exceed the number of equity securities purchased with the warrants; and
- The exercise price is at least equal to the value of the equity securities [*see 10 Cal. Code Reg. § 260.140.50*] on the date the warrant is issued. For further discussion, see Ch. 6I, *Issuance of Equity Securities* .

[2] FORM

Outstanding Options to Purchase Securities [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

A. Options in General

Option Type

Type of Shares

Amount Subject to Option

Optionee Group

Issue Date(s)

Termination Date(s)

Exercise Price(s)

Latest Market [*or* Compared] Value

B. Options to Officers and Directors

Optionee and Office

Option Type

Type of Shares

Amount Subject to Option

Issue Date

Termination Date

Exercise Price

Latest Market [*or* Compared] Value



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.232

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.232 Principal Security Holders [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131]

[1] Comment--Use of Form

This form is a table listing the principal security holders. Item 15 of the application to qualify securities under issuer notification [*Corp. Code § 25112*; *see § 6H.215*] and permit [*Corp. Code § 25113*; *see § 6H.220*] procedures, Item 11 of the application for qualification by nonissuer notification [*Corp. Code § 25131*; *see § 6H.255*], and Item 14 if the application is for qualification under a recapitalization or reorganization permit [*Corp. Code § 25121*; *see § 6H.250*] require a table listing the names of all persons who are owners of record (or are known by the applicant to be beneficial owners) of more than 10 percent of any class of voting securities of the issuer [*10 Cal. Code Reg. §§ 260.112, 260.121, 260.131*].

The information provided under this item should also reflect the respective number of shares and the percentages of the class of shares having voting rights owned of record or beneficially by each such person. Since "voting stock" includes only those shares which are presently entitled to vote in elections of directors [*10 Cal. Code Reg. § 260.017.1*], any class of preferred stock or debt security which may have contingent voting rights [*see 10 Cal. Code Reg. § 260.140.2*] need not be included unless the contingency has occurred and those shares have actually vested voting rights. The calculations of percentage ownership should be made on the basis of all outstanding securities of the class and should exclude securities held by the issuer.

In addition to identifying individual shareholders who possess an interest in voting securities in excess of 10 percent, the applicant should supply information as to the amounts held by, and the terms of, any voting trust or similar agreement with respect to more than 10 percent of the outstanding securities of any class of voting securities of the issuer [*10 Cal. Code Reg. §§ 260.112, 260.121*]. Applications for qualification by nonissuer notification must also disclose insider trading activities of principal security holders, officers, and directors, if any of such persons effected more than five transacttions in the securities of the issuer within the preceding 12 months [*10 Cal. Code Reg. § 260.131*]. Because copies of all voting trust agreements must be filed with the secretary of the corporation [*Corp. Code*

§ 706(b)], the easiest way to answer this item with regard to voting trusts is to attach a copy of any voting trust agreement to the table called for by this item and to incorporate the information therein by reference in the table itself.

[2] Form

Principal Security Holders [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

ITEM 15. PRINCIPAL HOLDERS OF SECURITIES.

Name and Address of Holder	Title of Class	Type of Ownership	Amount Owned	Percentage of Class



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.233

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.233 Remuneration of Directors, Officers, and Principal Security Holders [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

[1] Comment--Use of Form

This form is a table listing the remuneration of directors, officers, and principal security holders. Item 16 of the application to qualify securities under issuer notification [*Corp. Code § 25112*; *see § 6H.215*] and permit [*Corp. Code § 25113*; *see § 6H.220*] procedures and Item 9 of the application for qualification by nonissuer notification [*Corp. Code § 25131*; *see § 6H.255*] require a table listing the amount of compensation received by directors, officers, and principal security holders of the issuer during the fiscal year preceding the filing of the application.

Only direct remuneration in excess of $60,000 to the above-listed persons need be reported. In addition, the aggregate remuneration paid during the year to all directors, officers, and principal security holders (those persons holding more than 10 percent of the outstanding shares [*see § 6H.232*]), regardless of whether that remuneration exceeded $60,000, must be listed [*10 Cal. Code Reg. §§ 260.112, 260.131*]. If a full year of operations has not been completed, the applicant should supply a projection of future payments for the remainder of the fiscal year. Applicants should note that the aggregate sum of compensation to all directors, officers, and principal security holders may be greater than the total compensation listed under Item 16, since the compensation paid to any one such person may be less than $60,000.

[2] Form

Remuneration of Directors, Officers, and Principal Security Holders [10 Cal. Code Reg. §§ 260.112, 260.113, 260.131]

REMUNERATION OF DIRECTORS, OFFICERS, AND PRINCIPAL SECURITY HOLDERS

Name	Capacity	Amount
_____	_____	_____
____	[*E.g.*, Director and Chief Exec-	____

[*Name of officer, director, etc.*]	utive Officer]	[*E.g.,* $70,000]
_____	_____	_____
_____	_____	_____
_____	_____	_____
Aggregate Remuneration paid to Directors, Officers, and Principal Security Holders		$ _____



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.234

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.234 Additional Information in Connection With Debt Securities and Options or Stock Bonuses [10 Cal. Code Reg. §§ 260.112, 260.113]

[1] Comment

[a] Use of Form

This form sets forth additional information in connection with debt securities and options or stock bonuses. Applicants who propose to issue debt securities, shares subject to options, or shares as part of a stock bonus plan must complete Item 17 if the issue is being qualified by issuer notification [*Corp. Code § 25112*] or permit [*Corp. Code § 25113*].

[b] Debt Securities

A copy of the trust indenture or other instrument pursuant to which the debt securities are to be issued should be attached to the application as an exhibit [*10 Cal. Code Reg. § 260.112*]. The requirements for the trust indenture for the issuance of nonconvertible debt securities are set out in Rule 260.140.4 [*10 Cal. Code Reg. § 260.140.4*]. Convertible debt securities proposed to be issued must be accompanied by a trust indenture or other instrument complying with Rule 260.140.6 [*10 Cal. Code Reg. § 260.140.6*]. In general, an open qualification for issuance of debt securities will not be approved unless issued under a trust indenture complying with the requirements of the Trust Indenture Act of 1939 [*15 U.S.C. § 77aaa et seq.*], whether or not the indenture is required to be qualified under that Act [*10 Cal. Code Reg. § 260.140.5*]. A limited offering qualification will be approved for the issuance of debt securities so long as the trust indenture or other instrument provides adequate protection to the holders of the debt securities under the circumstances of the particular case [*10 Cal. Code Reg. § 260.140.5*].

In addition to the trust indenture, the applicant must include a calculation based on the earnings history of the preceding three years demonstrating that the applicant can meet the proposed dividends, interest, and sinking fund requirements on all senior securities outstanding and proposed to be outstanding. In cases in which the ability to meet the dividend, interest, and sinking fund requirements depends on future earning capacity, the applicant should submit calculations of

that future earning capacity together with any supporting evidence that may be necessary to demonstrate reasonable certainty in connection with future earning capacity.

Finally, Item 17 requires that the applicant supply any information that may be required to comply with the rules of the Commissioner relating to debt securities. These rules primarily include the requirements specified by *10 Cal. Code Reg. §§ 260.140.4-260.140.6*.

[c] Options or Stock Bonuses

If the proposed issue involves options or a stock bonus plan, Item 17 must include a copy of the plan pursuant to which options or stock bonuses will be granted, together with a copy of the form of option or stock bonus agreement to be issued pursuant to the plan. In addition, a copy of all proxy materials submitted or to be submitted to shareholders in connection with the approval of any such plan should be included. Finally, if the plan has already been approved by the shareholders, the applicant must furnish a statement detailing the number of shares in favor, opposed, and not voting with respect to the option or stock bonus plan [*10 Cal. Code Reg. § 260.112*].

[d] Options to Purchasers of Debt Securities

Warrants to purchase equity securities may be issued to the purchasers of debt securities provided that their issuance is reasonably necessary to obtain the debt financing, and (1) the term of the warrant does not exceed the life of the debt securities or 15 years, whichever is less, (2) the number of equity securities issuable upon exercise of the warrants does not exceed the number that could be purchased at the exercise price with the debt securities at face amount, and (3) the exercise price is at least equal to the value of the equity securities, calculated in accordance with *10 Cal. Code Reg. § 260.140.50* on the date the warrant is issued [*10 Cal. Code Reg. § 260.140.43*].

For discussion of debt securities, see Ch. 6J, *Issuance of Debt Securities* . For a trust indenture form, see *Rabkin & Johnson, Current Legal Forms with Tax Analysis, Form 19.38* (Matthew Bender).

[2] Form

Additional Information in Connection With Debt Securities and Options or Stock Bonuses [10 Cal. Code Reg. §§ 260.112, 260.113]

ITEM 17. ADDITIONAL INFORMATION IN CONNECTION WITH DEBT SECURITIES AND OPTIONS OR STOCK BONUSES.

[*for debt securities:*]

A. A copy of the trust indenture is attached hereto as an exhibit.

B. Based on the exhibits shown below [*or* the materials contained at Exhibit D, Part(s) _____] applicant submits that there will be sufficient earnings (and acquisitions) available on approximately _____[*date*], each year [*or on dates for designated years*] to make the sinking fund payment of $_____ [*or* to make the progressive range of sinking fund payments from $_____ to $_____] and sufficient like funds available on _____ [*quarterly dates or other designated intervals*] of each year to make dividend payments of _____ percent interest on applicant's proposed issue of _____ percent notes [*or* debentures *or* bonds] for _____[*number*] years, convertible [*or* nonconvertible] and unsecured [*or* additionally secured by _____ (*e.g.*, applicant's property site at _____)]; as well as such funds appropriately available on the following senior securities presently or proposed to be outstanding:

Title of Issue	Date Due	Redeemable	Annual Interest [*percent and dollars*]	Sinking Fund Payment
_____	_____	_____	_____ %	$_____
[*E.g.*, Preferred Convertible Equity]	[*E.g., when called*]	[Yes *or* No]	$_____	
_____	_____	_____	_____ %	$_____
[*E.g.*, Debentures, convertible]			$_____	
_____	_____	_____	_____ %	$_____
			$_____	

History of Earnings [*or* Projected Earnings]

Cash In

	_____ [*Date*]	_____ [*Date*]	_____ [*Date*]
Operations			
Sales of _____ [*describe product*]	$_____	$_____	$_____
_____	$_____	$_____	$_____
_____	$_____	$_____	$_____
Nonoperational			
Sales of securities:	$_____	$_____	$_____
_____ [*e.g.*, Common, Class A]	$_____	$_____	$_____
_____	$_____	$_____	$_____
_____	$_____	$_____	$_____
Assessments	$_____	$_____	$_____

Loans:			
_____	$_____	$_____	$_____
[*Name of lender*]			
_____	$_____	$_____	$_____
Donations	$_____	$_____	$_____
Royalties	$_____	$_____	$_____
Rents, etc.	$_____	$_____	$_____
_____	$_____	$_____	$_____
Total cash in:	$_____	$_____	$_____

Cash Out

	_____	_____	_____
	[*Date*]	[*Date*]	[*Date*]
Operational			
Plant and equipment	$_____	$_____	$_____
Services	$_____	$_____	$_____
Supplies	$_____	$_____	$_____
_____	$_____	$_____	$_____
Nonoperational			
Loan payments	$_____	$_____	$_____
Selling expense for securities	$_____	$_____	$_____
Legal and accounting fees	$_____	$_____	$_____
Experts fees	$_____	$_____	$_____
Payments on options, leases, contracts for such, purchase agree-			

ments:

_____	$_____	$_____	$_____
_____	$_____	$_____	$_____
Royalties	$_____	$_____	$_____
Salaries of officers and directors	$_____	$_____	$_____
Salaries otherwise	$_____	$_____	$_____
Taxes	$_____	$_____	$_____
Dividends	$_____	$_____	$_____
_____	$_____	$_____	$_____
Total cash out	$_____	$_____	$_____
Net increase [*or* decrease] in cash during period	$_____	$_____	$_____
Cash and cash items balance:			
At beginning of period	$_____	$_____	$_____
At close of period	$_____	$_____	$_____

Calculation

[*Specify, e.g.,* As demonstrated by the approximately _____ percent growth in earnings per year established by a comparative reading of the _____ (*e.g.*, three-year) (projected) earnings (as supported by the attached opinion of _____[*name*], market analyst), there will be adequate funds available for required payments on senior securities. Attention is called to the item marked _____ (*specify*) under Operational on the Cash In statement, to a _____ percent increase yearly, which is expected to jump to _____ percent if applicant can manage to keep all customers supplied and continue to develop new markets for that product, which it intends to do.]

[*for options and stock bonuses:*]

A. A copy of the plan pursuant to which options [*or* stock bonuses] will be granted is attached hereto as an exhibit.

B. A copy of the proxy material submitted [*or* to be submitted] to the shareholders in connection with approval of the plan is attached hereto as an exhibit.

C. The proposed plan has been approved by a vote of the shareholder taken on _____[*date*]. The results of that vote were as follows:

Vote of Shareholders on Proposed Option Plan:

Total of Shares Entitled to Vote	Total Approving	Total Opposing	Total Unrepresented
_____	_____	_____	_____
_____	—	—	—



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.235

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.235 Statement of Prior Issuances Pursuant to Corp. Code § 25102(f), (h), (n), or (o) [10 Cal. Code Reg. § 260.113]

[1] Comment--Use of Form

This form is a statement of prior issuances under *Corp. Code § 25102(f), (h), (n),* or *(o)*. If the applicant for qualification by permit [*see Corp. Code § 25113*] has issued securities pursuant to the small offering exemption [*see Corp. Code § 25102(h)*; *see also* Ch. 6C, *California Small Offering Exemption*], the limited offering exemption [*see Corp. Code § 25102(f)*; *see also* Ch. 6B, *California Limited Offering Exemptions*], qualified purchaser exemption [*see Corp. Code § 25102(n)*; *see also* Ch. 6D, *California Qualified Purchaser Exemptions*] or exemption for certain employee purchase or option plans [*see Corp. Code § 25102(o)*], Item 19 of the application for qualification by permit must briefly state the details of any such transaction [*10 Cal. Code Reg. § 260.113*]. For further discussion of the requirements applicable to a completed application for qualification, see *§ 6H.220*.

The application should summarize the information contained in the original notice filed pursuant to *Corp. Code § 25102(f)* or *(h)* and need not include all the details contained in the original notice [*see 10 Cal. Code Reg. § 260.113*]. A statement summarizing information contained in a prior notice of a limited offering transaction [*see Corp. Code § 25102(f)*] may include information regarding the type of filing made under the Securities Act of 1933 in the event that any such filing was required.

[2] Form

Statement of Prior Issuances Pursuant to California Small or Limited Offering Exemption [10 Cal. Code Reg. § 260.113]

ITEM 19. PRIOR ISSUANCES PURSUANT TO SECTION 25102 _____ [(f), (h), (n), AND (o)] OF THE CORPORATIONS CODE.

[*If securities were issued pursuant to small offering exemption (Corp. Code § 25102(h)):*]

Applicant, at its present address [*or* at _____ (*address*)], formerly issued securities [under the name _____] pursuant to *Corporations Code Section 25102(h)*. It issued only a single class of common shares, without any advertisement, selling expenses, or promotional consideration, as follows, all as approved by counsel and as noticed to the Commission on _____[*date*], File No. _____:

Issuee [*including corporate position, if any*]	Number of Shares	Consideration
_____ [*name*] [*title, e.g.,* President and Secretary]	_____	$_____ [*or* assets consisting of _____ (*e.g.,* fleet of 18 pickup trucks *or* cancellation of indebtedness of $_____ *or* $_____ as approved in writing by all stockholders)]
_____	_____	$_____
_____	_____	$_____

[*Or, if securities were issued pursuant to limited offering exemption (Corp. Code § 25102(f)):*]

Applicant, at its present address [*or* at _____ (*address*)], formerly issued securities [under the name _____] pursuant to *Corporations Code Section 25102(f)*, without publication of any advertisement, to 35 or fewer persons, plus _____ [*describe excluded purchasers*], who had either a preexisting personal or business relationship with the offeror or by reason of their business or financial experience (or that of their professional adviser who was not affiliated with or compensated by the issuer) were reasonably assumed to have the capacity to protect their own interests in connection with the transaction, and who represented that the securities were purchased for the purchaser's own account. The issuance was noticed to the Commission on _____[*date*], File. No. _____. The title of the class of securities sold in the transaction was _____ [*state title*]. The number of shares sold was _____. The value of the securities sold was $_____.

[*Or, if securities were issued pursuant to Corp. Code § 25102(n) or (o), briefly state details of the transactions*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.236

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.236 Exhibits [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121, 260.131]

[1] Comment--Use of Form

This form is a list of exhibits. Item 19 of the application for qualification by issuer notification [*Corp. Code § 25112*; *see § 6H.215*], Item 21 of the application for qualification by issuer permit [*Corp. Code § 25113*; *see § 6H.220*], Item 16 of the application for a reorganization permit [10 Cal. Code Reg. § 260.121.1(a); *see § 6H.250*], Item 15 of the application for qualification by recapitalization permit [10 Cal. Code Reg. § 260.121.1(b); *see § 6H.250*], and Item 14 of the application for qualification by nonissuer notification [*Corp. Code § 25131*; *see § 6H.255*] require that various exhibits be submitted with the application. These exhibits are generally copies of documents prepared for purposes other than an application to qualify securities for offer or sale in California. This form lists some of the more commonly required exhibits along with cross-references to other areas of the text where detailed information and examples of such documents may be found.

The application should contain a separate page entitled "Exhibits," together with the appropriate item number for the form of application being submitted. This page may be used as an index of the exhibits attached and may properly include the word "inapplicable" for any exhibit, which is not required.

[2] Form

Exhibits [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121.1, 260.131]

CHARTER DOCUMENTS

[Exhibit A to applications for qualification by issuer notification or permit; Exhibit C to applications for qualification by recapitalization or reorganization permit]

A copy of the charter documents [*see 10 Cal. Code Reg. § 260.001(a)*] of the applicant (or a composite or restated copy

of the charter documents) must be attached [*see* Ch. 3, *Articles of Incorporation* ; Ch. 4, *Bylaws* ; Ch. 12C, *Limited Liability Partnerships* ; Ch. 15, Part A, *Formation of General Partnerships*].

SPECIMEN SECURITY

[Exhibit B to applications for qualification by issuer notification and permit]

A specimen certificate evidencing the security to be issued should be attached. Certificates evidencing securities of a class with currently outstanding shares should not be submitted [*10 Cal. Code Reg. § 260.112*]. Certificates for common stock which are to be in a standard printer's form without any additional substantive provisions should not be submitted [*10 Cal. Code Reg. § 260.113*; *see* Ch. 6I, *Issuance of Equity Securities* ; Ch. 6J, *Issuance of Debt Securities*].

CONTRACTS AFFECTING SECURITIES

[Exhibit C to applications for qualification by issuer notification or permit; Exhibit D to applications for qualification by reorganization permit; Exhibit E to applications for qualification by recapitalization permit]

A copy of any contract made or to be made by the issuer affecting any of the rights, preferences, privileges, or transferability of the securities should be attached [*see* Ch. 2, *Formation of Corporations* ; Ch. 2A, *Incorporating a Going Business* ; *see also* Ch. 8D, *Buy-Sell Agreements*].

SHAREHOLDERS AGREEMENTS

[Exhibit D to applications for qualification by issuer permit; Exhibit E to applications for qualification by reorganization permit; Exhibit G to applicationss for qualification by recapitalization permit]

A copy of any agreement made or to be made by or among shareholders of the issuer that materially affects the rights, preferences, privileges, or restrictions of or on securities of the issuer or the management of the issuer should be submitted as Exhibit D to an application for qualification by permit. A brief description of the agreement may be included if a copy of the agreement is unavailable. The issuer is not required to disclose information concerning agreements of which it has no knowledge [*see* Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*].

FINANCIAL STATEMENTS

[Exhibit A to applications for qualification by nonissuer notification or by recapitalization or reorganization permit; Exhibit E to applications for qualification by issuer permit; Exhibit D to applications for qualification by issuer notification]

A copy of financial statements of the issuer and of any other business involved in the transaction (prepared in accordance with Rule 260.613 [*10 Cal. Code Reg. § 260.613*]) should be attached to the application as an exhibit [*see* Ch. 7, *Corporate Records and Reports*]. If the applicant is qualifying the issue of securities by permit and has not commenced business and has no assets or liabilities, Exhibit E should be marked "inapplicable" and Exhibit K [*see § 6H.243*] should be completed and submitted with the application.

ADVERTISING, PRESS RELEASES, AND PROXY MATERIAL

A copy of any advertisement or prospectus to be used in connection with the offer or sale of securities should be attached as Exhibit E if the application is for qualification by issuer notification, and as Exhibit F if the application is for qualification by issuer permit. All press or publicity releases or other similar communications to shareholders, broker-dealers, or investment advisers by the issuer within the 12 months preceding the filing of the application for

qualification by nonissuer notification should be attached as Exhibit B. Proxy materials that have been prepared to solicit the vote or consent of security holders should be attached as Exhibit F to the application for qualification by reorganization permit and as Exhibit D to the application for qualification by recapitalization permit. Also included with any of these exhibits should be the consent of any attorney, accountant, or other expert named in any such advertisement or prospectus, if required by Rule 260.504.2.2 [*10 Cal. Code Reg. § 260.504.2.2*; *see 10 Cal. Code Reg. §§ 260.300-260.302*].

CUSTOMER AUTHORIZATION FOR DISCLOSURE OF FINANCIAL RECORDS

[Exhibit C to applications for qualification by coordination; Exhibit H to applications by recapitalization or reorganization by permit; Exhibit I to applications for qualification by issuer notification; Exhibit I(2) to applications for qualification by issuer permit]

A copy of Department of Corporations Form No. QR 500.259, executed by the applicant, must be attached [*see § 6H.241*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.237

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.237 Nonmonetary Consideration [10 Cal. Code Reg. §§ 260.112, 260.113]

[1] Comment

[a] Use of Form

This form is a list, in tabular form, of all nonmonetary consideration received by an issuer for securities qualified by issuer notification or permit. If consideration other than cash is to be received by the issuer for securities qualified by issuer notification [*Corp. Code § 25112*; *see § 6H.215*] or by permit [*Corp. Code § 25113*; *see § 6H.220*], the applicant must provide a detailed description of the consideration actually received. The applicant must indicate the names of the purchasers acquiring securities for nonmonetary consideration, the value of that consideration, and the per share selling price based on the value of the consideration. An appraisal or detailed description of the value of the consideration should be attached. If the applicant proposes to issue securities in exchange for a patent or invention for which an application for patent is pending, the applicant must attach a copy of the patent or application, together with an opinion of a patent attorney covering the subjects of its ownership, validity, and infringement of patents of others, and a description of all contracts, licenses, and assignments of rights or interests in the patent [*10 Cal. Code Reg. §§ 260.112* (Item 19F), 260.113 (Item 21G)].

[b] Valuation of Nonmonetary Consideration

The valuation of nonmonetary consideration is important because normally the Commissioner will not approve sales of a series in which the price varies among purchasers of the same offering [*10 Cal. Code Reg. § 260.140.51*]. The types of consideration acceptable at the option of the corporation may vary, however, since labor done, services actually rendered, debts or securities canceled, or tangible or intangible property actually received are valid tender for the securities [*Corp. Code § 409(a)(1)*].

Except for debts or securities canceled, the nonmonetary consideration may constitute promotional consideration if it consists of services rendered in connection with the founding or organizing of a business enterprise, or if it consists of

tangible or intangible property, the value of which has not been satisfactorily established, or when the consideration does not equal the value of the shares purchased [*10 Cal. Code Reg. § 260.140.30*]. Promoters' shares are subject to special waivers and restrictions [*10 Cal. Code Reg. § 260.141.1*; *see § 6H.261*]. In an unseasoned corporation, promotional shares not exceeding 25 percent of all common shares issued and proposed to be issued are deemed to be reasonable. Additional promotional shares may be authorized in light of services rendered and other consideration given to the issuer by the promoter, the nature and circumstances of the business enterprise being promoted and the identity of the investors. If the issuer is a small business issuer (as defined in *10 Cal. Code Reg. § 260.001(i)*) that meets the conditions for filing under *Corp. Code § 25113(b),* promotional shares not in excess of 50 percent of the common shares issued and proposed to be issued is presumptively reasonable. Normally, no promotional shares may be issued in connection with the financing of a seasoned corporation[*10 Cal. Code Reg. § 260.140.31*].

In any event, it is desirable to submit valuation reports in the form of opinions of professional experts such as engineers, appraisers, or patent attorneys [*see Corp. Code § 25150*], whose reports must disclose whether such individuals have any material relationship with the applicant [*10 Cal. Code Reg. § 260.150(b)*]. If the applicant wishes, technical reports will be prepared by state employees on prepayment of the estimated cost of preparing such reports [*see 10 Cal. Code Reg. § 260.150.1*].

[2] Form

Nonmonetary Consideration [10 Cal. Code Reg. §§ 260.112, 260.113]

Exhibit F (Issuer Notification)

Exhibit G (Permit)

Nonmonetary Consideration (Tabular Form)

_____

Name of Purchaser

Type of Consideration

Value of Consideration

Number of Shares to be Issued

Price per Share

Appraisers' statements are attached

EXHIBIT F (Issuer Notification)

EXHIBIT G (Permit)

NONMONETARY CONSIDERATION
(Long Form)

A. Labor Done

Applicant proposes to issue _____[*number*] shares of its common stock, currently being offered at the cash price of $_____ to _____ [*name of issuee*] as payment in full for labor performed on behalf of applicant in the nature of construction of a _____ [*describe*] warehouse on applicant's present business premises _____ [*name of issuee*] is the sole owner and operator of _____[*name*] construction company, which specializes in construction in applicant's industry. Attached to this exhibit is a complete itemization of construction charges, prepared exactly as they would have been on a complete cash job. Attached also is the opinion of _____ [*name of expert*], construction engineer, attesting to a valuation of that improvement at $_____, or an excess [*or* a decrease] of $_____ from the equivalent cash price for the offered securities, as well as attesting to the authenticity of preparations and figures as detailed in the attached itemization.

B. Services Actually Rendered

Applicant proposes to issue to _____ [*names of issuees*] _____[*number*] shares each [*or differing numbers, respectively*] of its common stock, currently being offered at $_____ per share, in consideration of services rendered in connection with interesting applicant's initial customer's in applicant's proposed basic product and negotiating with those customers _____[*number*] contracts containing orders for _____[*number*] units of that product over a _____-year _____[*number*] period. Those contracts, besides meaning the impetus and sustenance of applicant's initial period of business, also should account for a minimum gross return of $_____ a year for the duration. Attached is an opinion of _____[*name*], experienced business and management consultant and attorney, attesting that the value of those services performed by a competent organization and resulting in those contracts would be charged for at an approximate total of $_____. The securities will carry promotional waivers and restrictions.

C. Debts or Securities Canceled

Applicant proposes to issue to _____ [*name of issuee*] the amount of _____[*number*] shares of its _____ [*percent*] preferred stock, currently being offered at $_____ in consideration for the cancellation by _____ [*name of issuee*] of a current loan outstanding to applicant in the remaining unpaid principal amount of $_____ at _____ percent interest per year. The note calls for repayment by _____[*date*]. In addition, applicant proposes to issue to _____ [*name of issuee*] _____[*number*] shares of the same stock in return for the cancellation by _____ [*name of issuee*] of _____[*number*] of applicant's _____ year _____ percent convertible subordinated debentures issued _____[*date*], bearing a face value of $_____. In each of the above trades, the exchange of consideration represents a _____ percent loss [*or* gain] for the proposed issuee as against original consideration paid for the exchanged debt, which will be more than offset by the relative advantages flowing to issuee [*or* applicant] as a result of the transfer to equity investment by _____ [*name of issuee*].

D. Tangible or Intangible Property Actually Received

Applicant proposes to issue to _____ [*name of issuee*] the amount of _____[*number*] shares of its common stock, currently being offered at $_____, in consideration of the transfer to applicant of United States patents, Nos. _____ [*list numbers*], and exclusive rights under patents being applied for under file Nos. _____ [*list numbers*]. Each of these patents, perfected and pending, is the basis for one of the composite parts in applicant's basic product which, as previously described, gives it the competitive advantage of greater performance and economic accessibility. Under the master contract with _____ [*name of issuee*], a copy of which is attached to this exhibit, applicant would become the exclusive assignee of the present patents, and would have the exclusive right to utilize those which are pending. Applicant would propose also to license patents Nos. _____ [*identify by number*] to any competitors desirous of using them.

According to our attorneys, retention of those patents exclusively might violate certain antitrust provisions of federal law although possession of them alone by competitors still would not allow them to recreate applicant's product. Enclosed also is an opinion of a patent attorney concerning ownership, validity, and infringement possibilities of these patents which negates any problems developing in these regards; and an opinion of _____ [*name of expert*], nationally known _____ [*type of industry*] engineer, on the soundness for commercial purposes of the parts produced through these patents and the value of these patents in a technical sense to this industry, which valuation places the worth of the total patents within _____ percent under [*or* over] the comparative price of the stock being offered in trade.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.238

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.238 Proposed Purchasers [10 Cal. Code Reg. §§ 260.112, 260.113]

[1] Comment--Use of Form

This form is a list of proposed purchasers. If the application is for a limited offering qualification [*see § 6H.200*], it must contain a list of the complete names, post office addresses, and occupations of the proposed issuees [*10 Cal. Code Reg. §§ 260.112, 260.113*]. If any of the proposed issuees is related to any of the promoters, officers, or directors of the applicant, this information must be disclosed. Further information as to the financial responsibility and investment experience of the proposed purchasers, while not absolutely required as part of the original application (except in connection with oil and gas or mining interests and real estate syndicates), may serve to facilitate processing by the Department of Corporations [*10 Cal. Code Reg. §§ 260.112, 260.113*; *see § 6H.271* (investor's suitability representation letter)].

On request, any information furnished will be treated as confidential [*10 Cal. Code Reg. §§ 260.112, 260.113*; *see § 6H.275*]. In that case, it should be cross-referred to in the main exhibit and separately attached under a request for confidential treatment. In this form, the section on financial and investment background is designated as (2), whether or not treated as confidential and separated from the rest of the exhibit. If the applicant proposes to limit the offering to a class of purchasers, information concerning the financial and other qualifications which will be used to determine the class, together with the methods to be used by the applicant in qualifying purchasers within that class, should also be submitted [*10 Cal. Code Reg. §§ 260.112, 260.113*].

[2] Form

Proposed Purchasers [10 Cal. Code Reg. §§ 260.112, 260.113]

Exhibit G (Issuer Notification)

Exhibit H (Permit)

PROPOSED PURCHASERS

(1) Individual Issuees

I

Name	Address	Occupation	Relationship to Key Personnel
_____	__	__ [*E.g.*, Musician in dance band]	__ [*E.g.*, Son-in-law of President and Director (*name*) *or* friend and occasional investment associate of promoter (*name*)]
_____	__	__	__
_____	__	__	__

[*EITHER*]

(2) Financial and Investment Background

See nonpublic, confidential material accompanying application.

[*OR*]

(2) Financial and Investment Background

Mr. _____ [*last name*], for five years a professional popular pianist, has also learned to make "beautiful music" in securities, incidentally also composing a successful number entitled "Symphony of the Stock Market." He is a graduate of both the _____[*name*] School of Music and the _____[*name*] Graduate School of Business, and is an investor in the _____[*name*] band, [a limited partnership] with which he is associated. He earns approximately $_____ per year, and his net worth safely may be said to exceed $_____, finances obtained largely through participation in private investment groups in _____ [*name of state*] before moving to California.

[*Continue with the following:*]

II

(1) Class of Issuees by Financial and Other Qualifications

Since applicant manufactures and distributes a product that will tend to allow independently owned service stations to compete more competently with national service station chains which market their own parent oil company product, applicant intends to approach two specialized classes of investors to finance its enterprise: (1) proprietors of independent service stations or of small independent chains of such stations not exceeding _____[*number*] in number of branches or franchises, either of which can demonstrate it has done $_____ [*dollar volume*] business minimum in a _____ [*duration*] period; and (2) pension funds of oil companies and other manufacturers in the petroleum industry at large who supply products which are marketed through independent service stations, which funds can demonstrate control of at least $_____ in investment assets. These will be the two classes that will best understand the nature of applicant's business, will best be able to estimate its worth and evaluate its chances for success, and will be most interested in seeing that it flourishes.

(2) Methods for Qualifying Purchasers Within Class

To be admitted as an investor, intending issuees of either class will have to submit to _____ [*selling agents*] audited financial data showing that the service station on the one hand, and the pension fund as well as its underlying oil business on the other, have been in successful operation for the past three years (whether or not under current management), and have made a profit during at least one of those years; and that the trends clearly indicate future earnings sufficient to support the size of the intended investment.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.239

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.239 Consent to Service of Process--California Form [Corp. Code § 25165; 10 Cal. Code Reg. § 260.165]

[1] Comment--Use of Form

This form is a consent to service of process. Every applicant for qualification of securities under the California Corporate Securities Law of 1968, anyone who files an application or notice that a security or transaction is not subject to qualification [*see Corp. Code §§ 25100.1*, *25101.1*, *25102.1*, *25230.1*; *see also* § 6H.153], and anyone who files an application for or notice of an exemption from qualification (except California corporations and broker-dealers licensed to transact business in California) must file an irrevocable consent appointing the Commissioner of Corporations to be that person's attorney to receive service of any lawful process in any noncriminal suit, action, or proceeding arising under the Corporate Securities Law of 1968 or any rule or order thereunder against the person signing the consent form or his or her successor, executor, or administrator [*Corp. Code § 25165*]. A person who has filed a consent in connection with a previous qualification, or in connection with a notice filing under *Corp. Code §§ 25100.1, 25101.1, 25102.1*, and *25230.1*, need not file another [*see Corp. Code § 25165*].

The consent to service of process must be (1) pursuant to the Uniform Consent to Service of Process (Form U-2), (2) pursuant to Form D [*17 C.F.R. 239.500*] filed with the Commissioner in connection with the transaction, (3) included in an electronic submission of a filing, or (4) in the California form reproduced *below* [*10 Cal. Code Reg. § 260.165*]. Form U-2 is reproduced in § 6H.240.

Regardless of whether a consent has been filed, conduct which is prohibited or made actionable by the Corporate Securities Law is considered equivalent to appointment of the Commissioner as attorney for receipt of service of process for violations of that law when the person who has violated the law has attempted to avoid personal jurisdiction in California [*Corp. Code § 25550*].

[2] Form

Consent to Service of Process--California Form [Corp. Code § 25165; 10 Cal. Code Reg. § 260.165]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.240

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.240 Uniform Consent to Service of Process--National Form U-2

[1] Comment--Use of Form

This form is the Uniform Consent to Service of Process (Form U-2) developed by the North American Securities Administrators Association (NASAA). Form U-2 has been approved for use in California as an alternative to the California form illustrated in § 6H.239 [*10 Cal. Code Reg. § 260.165*]. This form is also available online at the uniform forms page of the North American Securities Administrators Association (NASAA) website, located at http://www.nasaa.org/MCI. Because this form is accepted in most or all jurisdictions, it may be preferable to the California form in cases involving multistate offerings.

[2] Form

Uniform Consent to Service of Process--National Form U-2

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.241

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.241 Customer Authorization of Disclosure of Financial Records [10 Cal. Code Reg. §§ 260.110, 260.111(b), 260.112, 260.113, 262.121]

[1] Comment

[a] Use of Form

This form is Department of Corporations Form No. QR 500.259, authorizing disclosure of a customer's financial records to the Department. Every applicant seeking qualification for the sale of securities must, upon request of the Commissioner, furnish an authorization for examination of the applicant's financial records of the sale of the securities pursuant to *Gov. Code § 7473* [*Corp. Code § 25134*; *see* [c], *below*]. All applications for qualification of securities under the Corporate Securities Law, except certain applications for qualification of nonissuer transactions [*see § 6H.255*], must include this form as an exhibit [*see 10 Cal. Code Reg. §§ 260.110* (facing page), 260.111(b) (qualification by coordination), 260.112 (qualification by notification), 260.113 (qualification by permit), 260.121 (qualification of recapitalizations and reorganizations)].

[b] Requests for Disclosure

An officer, employee, or agent of the Department of Corporations, in connection with an investigation of a customer, may request or receive copies of, or the information contained in, the financial records of any customer of a financial institution only if those records are described with particularity, are consistent with the scope and requirements of the investigations giving rise to the request, and are disclosed pursuant to a customer authorization (or other statutory method) [*Gov. Code § 7470(a)*; *see Gov. Code §§ 7474-7476*].

[c] Customer Authorization

[i] Requirements

A customer authorization of disclosure of financial records must be signed and dated, authorizing disclosure for a stated period. It must state the name of the department to which disclosure is authorized and, if possible, the statutory purpose for which the information is to be obtained. It must also state the financial records that are authorized to be disclosed [*Gov. Code § 7473(a)*].

Ordinarily, a customer authorization form must include a written notification that the customer has the right to revoke that authorization at any time. However, when the authorization is required by statute, as it is for the qualification of securities [*see Corp. Code § 25134*], no such notification is required [*Gov. Code § 7473(b)*].

[ii] Notification of Examination

The department examining the records must notify the customer in writing of the examination within 30 days of receipt of records [*Gov. Code § 7473(d)(1)*]. However, the notification requirements may be extended for additional 30 day periods by application to a court upon a showing of good cause to believe that disclosure would impede the investigation. The notice must specify the financial records that were examined and, if requested, the reason for the examination [*Gov. Code § 7473(d)(1)*].

[d] Records After Disclosure

The financial institution must maintain for five years a record of all examinations or disclosures of the financial records of a customer made pursuant to a customer authorization, including the identity of the person examining the records, the department that person represents, and a copy of the authorization. Any record so maintained must be available, within five days of request, during normal business hours for review by the customer at the office or branch where the customer's account was located when examined or disclosed. A copy of the record must be furnished to the customer upon request and payment of any reasonable costs [*Gov. Code § 7470(c)*].

[e] Preparation of Form

All information on the form, except the signature, must be typewritten. The applicant must provide a Department of Corporations file number only if known. The form must be properly executed and submitted with the application for qualification. The terms used in the form have the definitions contained in *Gov. Code § 7465* and *Corp. Code §§ 25000-25022*.

[2] Form

Customer Authorization of Disclosure of Financial Records [10 Cal. Code Reg. §§ 260.110, 260.111(b), 260.111.2(a), 260.112, 260.113, 262.121(a), (b)]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.242

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.242 Management [10 Cal. Code Reg. § 260.113]

[1] Comment--Use of Form

This form is a list of the management of a corporation. It must be attached as Exhibit J to an application for qualification and sale of securities by permit [*10 Cal. Code Reg. § 260.113*, Item 21J].

Applications for qualification by permit [*Corp. Code § 25113*; *see § 6H.220*] must identify the directors, officers, trustees, general partners, general managers, principal executives, and other persons who will be charged with the business activities and operations of the applicant [*10 Cal. Code Reg. § 260.113*]. Those persons must be identified by name, address, date of birth, current position, and principal occupation during the last five years. In addition, Exhibit J must contain a statement of any order, judgment, or decree of a governmental agency or administrator, or court, revoking or suspending any license, permit, or other authority of that person, or of any corporation of which that person is an officer or director, to engage in the securities business or in the sale of a particular security, or temporarily or permanently restraining or enjoining any such person or any corporation of which that person is an officer or director from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting that person of any misdemeanor involving a security or any aspect of the securities business, or of theft, or of any felony [*10 Cal. Code Reg. § 260.113*].

The information required in Item 21(j) of an application for qualification permit incorporates the information required in Item 11 of the application [*see 10 Cal. Code Reg. §§ 260.112, 260.113*]. Therefore, an applicant responding to Item 11 of the application for qualification by permit will merely refer to this exhibit for a full and complete list of management [*10 Cal. Code Reg. § 260.113*; *see § 6H.220*].

[2] Form

Management [10 Cal. Code Reg. § 260.113]

EXHIBIT J: MANAGEMENT

Name	Address	Age	Title	Current Occupation	Principal Occupation for Last Five Years

SUBJECTS OF ORDERS OR JUDGMENTS

None of the above-named persons is the subject of any order, judgment, or decree of any governmental agency or administrator, or court of competent jurisdiction, revoking or suspending any license, permit, or other authority of that person or of any corporation of which he or she is an officer or director to engage in the securities business or in the sale of a particular security, or temporarily or permanently restraining or enjoining that person or corporation of which he is an officer or director from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting that person of any misdemeanor involving a security or any aspect of the securities business, or of theft, or of any felony[, except as follows: _____].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.243

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.243 Itemization of Budget [10 Cal. Code Reg. § 260.113]

[1] Comment--Use of Form

This form is an itemization of budget. If the applicant for qualification by permit [*Corp. Code § 25113*; *see § 6H.220*] has not commenced business and has no assets or liabilities, a statement in the form of an itemized budget should be submitted in lieu of the financial statements required to be submitted as Exhibit E [*see § 6H.236*] to the application for qualification by permit [*10 Cal. Code Reg. § 260.113*]. This statement, labeled Exhibit K, should include the proposed use to which the proceeds from the instant issuance of securities will be put, including all expenditures to be made or incurred, the total projected financing requirements of the applicant for six months, or, if the proposed plan of operation requires initial financing for a period longer than six months, for that longer period, and a statement setting forth the sources of all the required funds other than from the sale of securities, including any proposed loans or contributions to capital [*10 Cal. Code Reg. § 260.113*].

[2] Form

Itemization of Budget [10 Cal. Code Reg. § 260.113]

Exhibit K: Itemization of Budget

Proposed Use of Proceeds From Securities Sales
(Listed in Order of Priority of Investment of Funds Where Less than Expected Total Received)

Purchase of Industrial Site [*describe property*]

Payment in full [*or* Down payment] $_____

_____

Purchase of new equipment to manufacture subcomponent B, formerly impor-

ted

[*Type parts*] $_____

[*Type parts*] $_____

Reserves for acquisition of adjacent property sites under option for _____ [*number*] years, and for expansion of plant facilities for _____-year [*number*] period $_____

Retirement of outstanding note for $_____ [*value*] at _____ percent interest from _____ [*name of lending institution*] $_____

Paid in surplus $_____

TOTAL [*corresponding to total expected financing from securities sales*] $_____

Total Projected Financing Requirements [Six Months] Property:

-- Down payment on property [*or* Security deposit on lease] $_____

-- Monthly payments on loans on property [*or* monthly rentals for property] $_____

-- Purchases of operating equipment:

_____ [*e.g.*, Assembling machines] $_____

_____ $_____

-- Alterations [*or* Construction] of facilities $_____

_____ [*e.g.*, Air conditioning system] $_____

_____ $_____

Research and development program:

-- _____ [*e.g.*, Project for discovery of costly catalytic stage of production] $_____

-- _____ $_____

Product parts purchased for integration into finished product:

-- _____ [*e.g.*, $_____

Transistorized battery units] _____

-- _____ $_____

_____

Manufacturing and maintenance supplies:

-- _____ [*e.g.*, $_____

Gasoline for trucking fleet] _____

-- _____ $_____

_____

Clerical supplies and equipment:

-- _____ [*e.g.*, $_____

Correspondence stationery] _____

-- _____[*e.g.*, $_____

Office furniture] _____

-- _____ $_____

_____

Operating expenses and services:

-- _____ [*e.g.*, $_____

Accountants, attorneys] _____

-- _____ [*e.g.*, $_____

Telephone installation, service] _____

-- _____ $_____

_____

Salaries:

-- Compensation of officers:

_____ [*e.g.*, $_____

President *or other officer to receive compensation*] _____

_____ $_____

_____

-- Managerial force:

_____ [*e.g.*, $_____

Service manager] _____

_____ $_____

_____

-- Employees:

Production $_____

_____

Clerical $_____

_____

Selling expenses on sale of securities $_____

(_____%) [*e.g.*, _____

15%]

Payments on obligations $_____

_____ [*Name of lender*]	$_____
_____	$_____
Capital Reserves	$_____
TOTAL	$_____

Sources of Funds Required for Financing (Other Than From Securities)

Loans:

_____ [*describe: e.g.*, Note from _____ (*name*) bank, $_____ at _____ percent interest, _____ (*number*) years]	$_____
_____	$_____
_____	$_____

Present Reserves:

_____ [*describe earmarked or permissible purposes*]	$_____

Donations:

_____ [*describe gifts, from whom, for what*]	$_____
_____	$_____

Grants:

_____ [*describe funding organization or means or chance of obtaining, purpose, and payoff requirements*]	$_____

Contemplated Net Profits From Present [*or* Expected] Sales Pattern [*continuous sales for cash only*]

_____ [*product*]	$_____
_____	$_____
_____	$_____

	_____
TOTAL	$_____
	_____



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.244

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.244 Reports of Financial Condition [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121]

[1] Comment--Use of Form

This form is an undertaking to prepare and file reports with the Commissioner. The undertaking to furnish the reports appears at Item 20 of the application for qualification by issuer notification, at Item 22 of the application for an issuer permit, at Item 16 if the application is for a recapitalization permit, and at Item 17 of applications for qualification by reorganization permit.

Applications for qualification by issuer notification [*Corp. Code § 25112*; *see § 6H.215*], issuer permit [*Corp. Code § 25113*; *see § 6H.220*], and recapitalization or reorganization permit [*Corp. Code § 25121*; *see § 6H.250*] must contain an undertaking to prepare and file reports with the Commissioner as required by *Corp. Code § 25146* and *10* Cal. Code Reg. § 260.146. These reports are designed to keep the Department of Corporations current on the information contained in the application for qualification [*Corp. Code § 25146*]. Reports are not required (1) after completion of the offering if a nonissuer transaction involving that security would be entitled to exemption from qualification under *Corp. Code § 25101* [*Corp. Code § 25146*; *see Corp. Code § 25101*], or (2) if the issuer is filing reports pursuant to Section 13 [*15 U.S.C. § 78m*] or Section 15(d) [*15 U.S.C. § 78o(d)*] of the Securities Exchange Act of 1934 [*10 Cal. Code Reg. § 260.146*; *see 15 U.S.C. § 78a et seq.*]. The reports must be in the form prescribed by Rule 260.146 [*see 10 Cal. Code Reg. § 260.146*; *see also § 6H.274*].

[2] Form

Reports of Financial Condition [10 Cal. Code Reg. §§ 260.112, 260.113, 260.121.1] Item 20 (Issuer Notification)

ITEM 22. ISSUER PERMIT

ITEM 16. RECAPITALIZATION PERMIT

ITEM 17. REORGANIZATION PERMIT

REPORTS OF FINANCIAL CONDITION

Pursuant to *Corporations Code Section 25146* and *Title 10, California Code of Regulations Section 260.146*, applicant hereby undertakes, as long as required under the foregoing sections and subject to the exceptions contained in those sections, to file with the Commissioner (1) within 120 days after the end of each fiscal year a report of financial condition and a related statement of income and expenses covering that fiscal year; and (2) within 90 days after the first six months of each fiscal year, a like report and statement covering that six-month period.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide § 6H.245

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.245 Signature and Verification [Corp. Code § 25115]

[1] Comment--Use of Form

This form is an issuer's signature and verification. Every application for qualification of an issuer must be signed and verified by the issuer [*Corp. Code § 25115*]. An application for the qualification of the offer and sale of securities by a small company [*see Corp. Code § 25113(b)(2)*] must be reviewed and signed by each member of the board of directors of the small company applicant [*10 Cal. Code Reg. § 260.110.2*]. Any other application for the qualification of the offer and sale of securities [*see Corp. Code §§ 25102(c), 25111, 25112, 25113(b)(1), 25121, 25131*] must be signed by (1) an officer or general partner of the applicant, or (2) a person holding a power of attorney for those purposes from the applicant, in which case a copy of the power of attorney or a copy of the corporate resolution authorizing the person to act on behalf of the applicant should be attached [*10 Cal. Code Reg. § 260.110.2*]. Verification of the application is done in the same manner as is provided in the Code of Civil Procedure for verification of pleadings [*Corp. Code § 25160*]. Verifications may be made by executing a declaration under penalty of perjury under California law [*Code Civ. Proc. § 2015.5*] for either California applicants or for applicants from other states.

Applications must not contain any untrue statement of material fact [*Corp. Code § 25166*]. Accordingly, oaths based on information or belief are inadequate.

[2] Form

Signature and Verification [Corp. Code § 25115]

The applicant has duly caused this application to be signed on its behalf by the undersigned, who is duly authorized to do so.

_____ [*name of applicant*]

By _____ [*signature*]

[*typed name and title*]

I certify [*or* declare] under penalty of perjury under the laws of the State of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed on _____[*date*], at _____[*place*].

_____ [*signature of declarant*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
E. Items and Exhibits to Applications for Qualification

3-6H California Legal Forms--Transaction Guide §§ 6H.246-6H.249

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6H.246[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
F. Qualification of Recapitalizations and Reorganizations

3-6H California Legal Forms--Transaction Guide § 6H.250

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.250 Application for Qualification of a Recapitalization or Reorganization by Permit [Corp. Code § 25121; 10 Cal. Code Reg. § 260.121]

[1] Comment

[a] Use of Form

This form is an application for qualification of a recapitalization or reorganization by permit. Except as provided below, it is unlawful for any person to offer or sell in California Securities issued in connection with any change in the rights, preferences, privileges, or restrictions of or on outstanding securities; in any exchange of securities by the issuer with its existing security holders exclusively; in any exchange in connection with any merger or consolidation or purchase of corporate assets in consideration wholly or in part of the issuance of securities, or in an entity conversion transaction [*Corp. Code § 25120(a)*; *see Corp. Code § 25005.1* (definition)]. The above-stated prohibition, however, will not apply to a security if it is qualified by permit under *Corp. Code § 25121* or if the security or the transaction is exempt or not subject to qualification [*Corp. Code § 25120(b)*]. Any application for a recapitalization or reorganization permit must include the facing page prescribed by Rule 260.110 [*10 Cal. Code Reg. § 260.110*; *see § 6H.200*] and the applicable remaining items as reproduced in this form.

The instructions to the form are divided into alternative parts, one of which must be submitted with the facing page. The first part (Part (a)) is used only when the transaction involves a merger, consolidation, purchase of corporate assets, or is an entity conversion transaction. The second part (Part (b)) is used only when the transaction involves a change in the rights, preferences, privileges, or restrictions of or on outstanding securities, or an exchange by an issuer with its existing security holders exclusively. A third part (Part (c)) is for signatures and verification and must be included with all applications [*see § 6H.245*]. If the transaction involves both an internal share change (recapitalization) and a merger (reorganization), it is recommended that two separate applications be filed rather than a single application.

In general usage the term "recapitalization" is used to connote a change in the capital structure of the issuer, whereas the term "reorganization" refers to exchanges of stock such as through mergers and consolidations [*see I.R.C. § 368* and

regulations thereunder]. The terms "recapitalization" and "reorganization" have not been precisely defined in the Corporate Securities Law and are always used in the conjunctive to refer to exchanges of securities or changes in security rights.

There is some confusion between issuer transactions and transactions involving recapitalizations and reorganizations. In both instances securities may be distributed by the issuer. Part of the confusion is generated by the fact that the federal securities regulation treats recapitalizations and reorganizations as partially within the scope of the "issuer" registration statement. The distinction is that the issuer transactions are limited to distributions of a new issue or series of securities, not directly altering existing securities, while recapitalizations and reorganizations deal with distribution of securities or security rights that directly alter existing securities or security rights.

[b] Changes in Rights Requiring Qualification

Corp. Code § 25103(e) lists the changes in the rights, preferences, privileges, or restrictions of or on outstanding equity securities that must be qualified. These include any of the following changes:

- Adding, changing, or deleting assessment provisions.
- Changing the rights to dividends on shares.
- Changing any redemption provisions.
- Making shares redeemable.
- Changing any amount payable on liquidation.
- Changing, adding, or deleting conversion rights.
- Changing, adding, or deleting voting rights.
- Changing, adding, or deleting preemptive rights.
- Changing, adding, or deleting sinking fund provisions.
- Rearranging the relative priorities of outstanding equity securities.
- Imposing, adding, or deleting restrictions upon the transfer of equity securities in the organizational documents for the entity.
- Changing the right of holders of equity securities with respect to the calling of special meetings of holders of equity securities.
- Changing, adding, or deleting any rights, preferences, privileges, or restrictions of or on the outstanding shares or memberships of a mutual water company or other corporation or entity organized primarily to provide services or facilities to its shareholders or members.

Qualification is not required for any changes in the rights, preferences, privileges, or restrictions of or on outstanding equity securities because of conversion to or termination of close corporation status, whether the conversion or termination is voluntary or involuntary [*Corp. Code § 25103(e)*]. None of the changes enumerated in *Corp. Code § 25103(e)* contemplates the issuance of a new class of stock or the issuance or sale of additional shares of an outstanding

class of stock. The creation of any new class of stock, or authorization of additional shares of an existing class, must be qualified as an issuer transaction or a corporate reorganization [*10 Cal. Code Reg. § 260.103.1*].

Any change in the rights, preferences, privileges, or restrictions of or on shares, or the issuance or exchange of securities by the issuer with its existing security holders is exempt if the transaction would have been exempt from the qualification provisions of *Corp. Code § 25110* by *Corp. Code § 25102* or by *10 Cal. Code Reg. § 260.105.14*, or is pursuant to a reorganization plan under the Bankruptcy Code [*10 Cal. Code Reg. § 260.103*].

Changes in the rights and preferences of outstanding debt securities also require qualification when the change substantially and adversely affects any class of those securities. The changes that must be qualified include any change to the right to interest; any change in redemption provisions; any change which would make the securities redeemable; any change to extend the maturity of any debt security, or to change the amount payable at maturity; any change in voting rights; any change in conversion rights; any change in sinking fund provisions; and any change that would make a debt security subordinate to any other indebtedness [*Corp. Code § 25103(g)*].

In any transaction that is exempt from qualification because it would have been exempt as an original issuance of securities under the limited offering exemption [*see Corp. Code § 25102(f)*], the issuer must file a notice of transaction in accordance with *10 Cal. Code Reg. § 260.102.14* [*10 Cal. Code Reg. § 260.103(b)*; *see* Ch. 6B, *California Limited Offering Exemptions*]. Similarly, in any transaction exempt from qualification because it would have been exempt as an original issuance under the small offering exemption [*see Corp. Code § 25102(h)*], the issuer must file a notice of transaction in accordance with *10 Cal. Code Reg. § 260.102.8* [*10 Cal. Code Reg. § 260.103(b)*; *see* Ch. 6C, *California Small Offering Exemption*].

[c] Stock Splits, Reverse Stock Splits, and Stock Dividends

Certain stock split arrangements constitute changes that are subject to qualification by permit. Although "stock split" and "reverse stock split" are defined by law [*see Corp. Code §§ 182, 188*], Rule 260.103.2 expressly identifies their meanings for purposes of regulated changes as the "subdivision" (i.e., stock split) or "combination" (i.e., reverse stock split) of previously outstanding shares of stock into a greater or lesser number of shares of the same class, effected by an amendment to the charter documents of the issuer [*10 Cal. Code Reg. § 260.103.2*]. Such a split may or may not include authorized and unissued shares or be accompanied by the transfer of surplus to stated capital pursuant to a simultaneous change in the par value of the shares through reconstruction or resolution [*10 Cal. Code Reg. § 260.103.2*].

Qualification by permit is required in the case of a stock split or reverse stock split when the corporation has more than one class of voting shares outstanding and the split would have a material effect on the proportionate interests of the respective classes as to voting, dividends, or distributions [*Corp. Code § 25103(f)*; *10 Cal. Code Reg. § 260.017.1*]. Such a permit is normally issued unless the voting power is unfairly altered [*10 Cal. Code Reg. § 260.140.70*]. A permit is needed for a stock split if the stock being split has a market price, as of the date of directors' approval of the split adjusted to give effect to the split, of less than $2 per share, when the stock is traded in the market by either being listed or admitted to trading on a national securities exchange, or when the stock is the subject of two-way quotations (bid and asked prices) regularly published by one or more broker-dealers in the National Daily Quotation Service [*Corp. Code § 25103(f)*; *10 Cal. Code Reg. § 260.103.4*]. Finally, a permit is necessary in the case of a reverse stock split if the stock is not traded in the market and the corporation has the option of paying cash for any fractional shares created by the reverse split and, as a result of that action, the proportionate interests of the shareholders would be substantially altered [*Corp. Code § 25103(f)*]. Neither of these latter two types of splits are usually approved [*10 Cal. Code Reg. § 260.140.70*].

A stock dividend in which the shareholder has an option to take stock or cash is treated as an issuer transaction [*10 Cal. Code Reg. § 260.017*; *see Corp. Code § 25017(f)(2)*], but if the issuer has more than one class of voting stock outstanding, or if the dividend is not payable with respect to, or in shares of, common stock, the stock dividend is an

exchange and must be qualified by a recapitalization and reorganization permit [*10 Cal. Code Reg. § 260.017*; *see Corp. Code § 25017(f)(2)*]. Any stock dividend that is included in the definition of "sale" is a transaction requiring qualification under *Corp. Code § 25110* or *25120*, unless it is not subject to qualification or is otherwise exempted by *Corp. Code § 25100*, *25102*, *25103*, or *25105* [*10 Cal. Code Reg. § 260.017(d)*].

Any certificate representing shares issued as a result of a stock dividend, stock split, or reverse stock split, which are exempt from qualification requirements by *Corp. Code § 25017(f)* or *25103(f)* with respect to shares subject to a legend or escrow condition, must have the same legend stamped thereon as was required with respect to the previous shares, or must be deposited in escrow in addition to or in substitution for the previous shares held in escrow [*10 Cal. Code Reg. § 260.103.5*]. Any escrow holder may accept any such dividend shares or surrender the previous shares and accept the newly issued split shares after receiving the opinion of counsel that the dividend shares have been validly issued or that the split shares have been validly substituted for the previous shares in a transaction under one of the above-mentioned exemptions [*10 Cal. Code Reg. § 260.103.5*].

[d] Mergers

When the proposed plan calls for the combination of two businesses by way of a merger, including a sale of assets at least partly in exchange for securities of the purchaser, or by way of the infrequently utilized consolidation, the plan should provide for the issuance of securities which fairly reflect the relative values of the corporations that are parties to the merger [*10 Cal. Code Reg. § 260.140.61*]. The permit authorizing the issuance of the securities may be conditioned on an affirmative vote of a specified percentage of the outstanding stock held by persons other than those who have a conflict of interest in connection with adoption of the plan [*10 Cal. Code Reg. § 260.140.61*]. It is important to note that in the case of a "B" type reorganization plan [*see I.R.C. § 368(a)(1)(B)*], in which the corporation acquiring shares of a second corporation exchanges its shares for shares held by the shareholders of the second corporation, the Commission regards such an arrangement as an issuer transaction rather than as a recapitalization or reorganization [*see* Marsh & Volk, Practice Under the California Securities Law, Ch. 7, *Recapitalizations and Reorganizations*, § 7.06[5][c]] (Matthew Bender). These transactions must be qualified by issuer permit [*see § 6H.220*], issuer notification [*see § 6H.215*], or coordination [*see § 6H.205*].

[e] Shareholder Residence Test

The Commissioner will not assert jurisdiction over any proposed reorganization or recapitalization unless the holders of at least 25 percent of the outstanding shares of securities that will be affected by the proposed reorganization or recapitalization have addresses in California [*Corp. Code § 25103(b), (c)*]. Unless this shareholder residence test is met, the transaction is exempt from the California regulatory scheme, regardless of whether the issuer is a California or foreign entity [*see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 7, Recapitalizations and Reorganizations, § 7.06[3]*] (Matthew Bender).

For purposes of *Corp. Code § 25103(c)*, however, this exemption is not available for a rollup transaction [*Corp. Code § 25103(c)*; *see Corp. Code § 25014.6* ("rollup transaction" defined)], or if the transaction is excluded from the definition of a rollup transaction by *Corp. Code § 25014.6(b)(5)* or *(6)* and the transaction is one of a series of transactions that directly or indirectly through acquisition or otherwise involves the combination or reorganization of one or more rollup participants [*Corp. Code § 25103(c)*].

In the case of changes in the rights, preferences, privileges, or restrictions of or on outstanding securities, the shareholders to be counted in the 25 percent test are those shareholders whose shares are of any class of shares which is substantially and adversely affected by the change, directly or indirectly [*Corp. Code § 25103(b)*]. In the case of exchanges incident to a merger, consolidation, or sale of corporate assets in consideration of the issuance of securities of another corporation, the shares to be counted are those shares in each class of shares which entitle their holders to receive securities of the surviving, consolidated, or purchasing corporation, and the shares must all be of an outstanding

class of securities, although not necessarily the same one [*Corp. Code § 25103(c)*].

The date for determining the residency of record holders of shares is the corporation's record date of determination of security holders entitled to vote on or consent to the plan for exchange, or if such an approval was unnecessary, then the date of actual approval by the directors [*Corp. Code § 25103(d)*]. In making the determination, two types of securities may be eliminated from the computation of outstanding shares for such purposes: (1) any securities held in the names of broker-dealers or their nominees, and (2) any securities controlled by any one person who controls directly or indirectly 50 percent or more of the outstanding securities of the particular class of securities being affected [*Corp. Code § 25103(d)*].

[f] Limited Exemption From Qualification

In general, an exchange incident to a merger or a sale of corporate assets in consideration of the issuance of securities of another corporation must be qualified for sale unless the security or transaction is exempt or not subject to qualification [*Corp. Code § 25120*]. In addition to the California residency exemption [*Corp. Code § 25103(c)*; *see* [e], *above*], an exchange incident to a merger, consolidation, or sale of assets, other than a rollup transaction [*see* Corp. Code § 25104.6], in consideration of the issuance of equity securities of another entity, or in an entity conversion transaction [*see Corp. Code § 25005.1* (definition)], is exempt if the exchange transaction or entity conversion transaction, had it involved the issuance of a security in a transaction subject to *Corp. Code § 25110* (rather than *Corp. Code § 25120*), would have been exempt from qualification by *Corp. Code § 25102(f)* without giving effect to *Corp. Code § 25102(f)(3)* (requiring purchaser representation that purchaser is purchasing for his or her own account and not for resale), and either of the following sets of criteria is applicable [*Corp. Code § 25103(h)(1)*]:

- (1) Not less than 75 percent of the outstanding equity securities of each constituent or converting entity entitled to vote on the proposed transaction voted in favor of the transaction; (2) not more than 10 percent of the outstanding equity securities of each constituent or converting entity entitled to vote on the proposed transaction voted against the transaction; and (3) each constituent or converting entity whose security holders are entitled to vote on the proposed transaction is subject to a state statute that has provisions for dissenters' rights for holders of equity securities entitled to vote on the proposed transaction that do not vote in favor of or voted against the transaction.

- (1) The transaction is solely for the purposes of changing the issuer's state of incorporation or organization, or form of organization; (2) all the securities of the same class or series, unless all the security holders of the class or series consent, are treated equally; and (3) the holders of nonredeemable voting equity securities receive nonredeemable voting equity securities.

In transactions relying on the exemption discussed above, the Commissioner may, by rule, require the acquiring or surviving entity to file a notice of transaction. However, the failure to file the notice, or to file it within the time specified by the rule of the Commissioner, will not affect the availability of the exemption. However, an acquiring or surviving entity that fails to file the notice as provided by rule of the Commissioner must, within 15 business days after demand by the Commissioner, file the notice and pay to the Commissioner a fee equal to the fee payable had the transaction been qualified under *Corp. Code §§ 25110* or *25120* [*Corp. Code § 25103(h)(2)*]. The fee for filing a notice of transaction under *Corp. Code § 25103(h)* is $600 [*Corp. Code § 25608(z)*; *see Corp. Code § 25608.3* (Commissioner may set any fee at amount below maximum set forth in *Corp. Code § 25608*)].

[g] Procedure for Qualification

Qualification must be accomplished before a general solicitation of shareholder approval (such as the sending of proxy statements) of the intended changes or merger [*10 Cal. Code Reg. § 260.140.60*]. Prior to solicitation, a negotiating permit is not required, although in rare instances one may be issued pending the shareholders' vote on the proposal [

Corp. Code § 25103(a); *10 Cal. Code Reg. § 260.140.63*; *see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 7, Recapitalizations and Reorganizations, § 7.02[3]* (Matthew Bender)].

Qualification under the recapitalization and reorganization permit procedure is not effective until the Commissioner authorizes the changes by permit [*Corp. Code § 25122*]. The Commissioner does not have to issue a permit unless the proposed plan of recapitalization or reorganization and the proposed issuance of securities are fair, just, and equitable to all security holders affected [*Corp. Code § 25140(c)*]. The Commissioner is entitled to hold a hearing on the fairness of the terms and conditions involved in a pending application for an exchange, and all the proposed issuees have the right to appear [*Corp. Code § 25142*; *see* Dept. of Corps. Release No. 102-C (Dec. 1, 1998; revised) (on request Department will hold fairness hearings irrespective of whether security is "covered security" under Federal NSMIA); Dept. of Corps. Release No. 117-C (Jan. 18, 2006) (fairness hearings and shell companies); *see also § 6H.23[1]*]. As a matter of routine, however, the Commissioner usually waits for the applicant to request a hearing, which is held under the Department's own auspices on notice (prepared by the Commissioner) [*10 Cal. Code Reg. § 260.140.62*].

The ability of the Commissioner to suspend or revoke a permit by qualification [*see Corp. Code § 25140(a)(1)*; *see also Corp. Code §§ 25113, 25122*], or to issue a stop order postponing or suspending the effectiveness of any qualification [*see Corp. Code § 25143*], in the area of recapitalizations and reorganizations is, to the extent applicable, the same as in the procedures for qualification by issuer notification. In general, the Commissioner may suspend or revoke any permit if the Commissioner finds that the action is in the public interest and finds any of the following [*Corp. Code § 25140(a)(1)*]:

- The proposed plan of business of the issuer, or the proposed issuance or sale of securities, is not fair, just, or equitable;

- The issuer does not intend to transact its business fairly and honestly; or

- The securities proposed to be issued or the method used in issuing the securities will tend to work a fraud on the purchasers.

For further discussion, see *§ 6H.215[1][d]*.

[h] Conditions of Qualifications

Except when delivery of a proxy statement or prospectus is required by federal securities laws, Commissioner may require as a condition of qualification that a proxy statement containing any designated part of the information required in the application be sent at specified intervals to each security holder to whom an offer is made [*Corp. Code § 25148*]. Various other conditions may also be imposed, such as the imposition of a legend condition to restrict transferability of shares [*Corp. Code § 25141*] and the filing of semiannual reports up to a year and a half after qualification [*Corp. Code § 25146*].

[i] Federal Registration Requirements

Under certain circumstances, changes in the rights of existing securities, exchanges of securities, mergers, or sales of assets may be subject to registration with the Securities and Exchange Commission if the transaction constitutes a "sale" as defined in Section 2(3) of the Securities Act of 1933 [*15 U.S.C. § 77b(3)*]. For a detailed discussion, see Sommer, Federal Securities Act of 1933, Ch. 2, *Applicability of the Act: "Security" and "Sale,"* § 2.02 (Matthew Bender). Qualification by coordination is not available for this type of transaction [*see Corp. Code § 25110*]; all recapitalizations and reorganizations must be qualified under *Corp. Code § 25120*, unless exempt or not subject to qualification.

[j] Preparation of Form

The application for a recapitalization and reorganization permit must be accompanied by the facing page prescribed by Rule 260.110 [*10 Cal. Code Reg. § 260.110*; *see § 6H.200*]. Many of the items required by the application [*see 10 Cal. Code Reg. § 260.121*] are similar or identical to items required by applications for issuer permits [*see § 6H.220*]. In particular, forms have been prepared and appear elsewhere in this chapter concerning employment of agents [*see § 6H.272*], description of business [*see § 6H.225*], directors and officers [*see § 6H.228*], principal security holders [*see § 6H.232*], customer authorization of disclosure of financial records [*see § 6H.241*], and reports of financial condition [*see § 6H.244*]. The application must be signed and verified in the manner prescribed by § 6H.245.

[2] Form

Application for Qualification of a Recapitalization or Reorganization by Permit [Corp. Code § 25121; 10 Cal. Code Reg. § 260.121]
DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

INSTRUCTIONS FOR APPLICATION FOR QUALIFICATION OF RECAPITALIZATIONS AND REORGANIZATIONS (SECTION 260.121)

An application pursuant to Section 25121 of the Code for the qualification of the offer and sale of securities in connection with any change in the rights, preferences, privileges, or restrictions of or on outstanding securities or in any exchange of securities by the issuer with its existing security holders exclusively or in any exchange in connection with any merger or consolidation or purchase of assets in consideration wholly or in part of the issuance of securities or in an entity conversion transaction shall, in addition to the facing page required by Section 260.110 of these rules, continue on the following form:

NOTE: Any item which is inapplicable should be listed by number on the form followed simply by the word "inapplicable."

[*Select one of the following:*]

[*If the transaction involves a merger, consolidation, purchase of assets or is an entity conversion transaction, use items 8 through 17, below:*]

ITEM 8. DESCRIPTION OF PLAN. Where applicable, describe the material features of the plan, the reasons therefor, the general effect thereof upon the rights of existing security holders, the approximate number of security holders of each entity involved, the vote needed for its approval, the proposed date for the mailing of proxies and the proposed date of the security holders' meeting.

ITEM 9. EXECUTION OF PLAN. Describe the method by which the plan described in Item 8 will be carried out, including the names of any broker-dealers or agents to be employed by each entity in effecting purchases or sales of securities pursuant to the plan and the compensation to be paid such persons, or other consideration to be received by such persons, or any other persons, in connection with the sale, purchase, or exchange of securities. If agents (other than licensed broker-dealers) are to be employed by the applicant in connection with the distribution of securities in California pursuant to the plan, the applicant is required to comply with Sections 260.141.30 and 260.141.31, Title 10, California Code of Regulations, and the following information is to be furnished:

a. The name and business address of each person who will represent the applicant as an agent in this state.

b. The name and business address of the officer or other official who will supervise such agents on behalf of the applicant.

c. A statement that all such agents are employees of the applicant.

d. A statement of the compensation to be paid to such agents. A statement of the compensation to be paid to such supervisory personnel, other than their regular salaries if they are regular employees of the applicant.

e. Describe any order, judgment or decree of any governmental agency or administrator, or of any court of competent jurisdiction revoking or suspending for cause any license, permit or other authority of such agent or supervisory person or of any entity of which he or she is an executive officer, director or person occupying a similar status or performing similar functions, to engage in the securities business or in the sale of a particular security or temporarily or permanently restraining or enjoining any such person or any entity of which he or she is an executive officer, director, or person occupying a similar status or performing similar functions from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting such person of any felony or misdemeanor involving a security or any aspect of the securities business, or of theft or of any felony.

f. A surety bond complying with *Section 260.216.15, Title 10, California Code of Regulations.*

ITEM 10. DESCRIPTION OF BUSINESS. Describe the business of the issuer and each other entity involved in the transaction.

ITEM 11. DIVIDENDS IN ARREARS OR DEFAULTS. A statement concerning any dividends in arrears or defaults in principal or interest in respect of any securities of the issuer and any other entity involved in the transaction, and concerning the effect of the plan thereon.

ITEM 12. HIGH AND LOW SALES PRICES WITHIN 2 YEARS. As to each class of securities of the issuer and of each other entity involved in the transaction which is admitted to trading on a securities exchange or with respect to which a market otherwise exists, and which will be materially affected by the plan, state the high and low sale prices (or, in the absence of such information, the range of the bid prices) for each quarterly period within two years.

ITEM 13. DIRECTORS AND EXECUTIVE OFFICERS.

(a) List the names of all directors, executive officers or persons occupying a similar status or performing similar functions of the issuer and of each other entity involved in the transaction, indicating all positions and offices held by each person named.

(b) Describe any order, judgment, or decree of any governmental agency or administrator, or of any court of competent jurisdiction revoking or suspending for cause any license, permit or other authority of such person or of any entity of which he or she is an executive officer, director, or person occupying a similar status or performing similar functions, to engage in the securities business or in the sale of a particular security or temporarily or permanently restraining or enjoining any such person or any entity of which he or she is an executive officer, director, or person occupying a similar status or performing similar functions from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting such person of any felony or misdemeanor involving a security or any aspect of the securities business, or of theft or of any felony.

ITEM 14. PRINCIPAL HOLDERS OF SECURITIES. State any material interest in the transaction of each person who, with respect to the issuer or any other entity involved in the transaction, is a director, executive officer, or person occupying a similar status or performing similar functions, or owns of record or beneficially (if known to the issuer) 10% or more of any class of outstanding equity securities, or is a promoter if the issuer or such other entity was

organized within the past three years. (Instruction: An interest of one of the specified persons which arises solely from the ownership of securities of only one of the entities involved in the transaction is not a material interest where the specified person receives no extra or special benefit not shared on a pro rata basis by all holders of securities of that class.)

ITEM 15. EXCHANGE RATIO. State the basis of the ratio for the exchange or conversion of the securities of the issuer for the securities of each constituent entity.

ITEM 16. EXHIBITS. Attach and incorporate by reference the following exhibits.

NOTE: Any exhibit which is inapplicable should be listed by letter on the form followed simply by the word "inapplicable."

A. With respect to the issuer and each other entity involved in the transaction, the financial statements required by *Section 260.613 of Title 10 of the California Code of Regulations*, and pro forma financial statements giving effect to the proposed transaction.

B. A copy of the plan of reorganization or entity conversion if it is set forth in a written document, including any request for delayed effectiveness of the filing of such document with the Secretary of State or similar authority.

C. Copies (which may be in a restated or composite form) of the current charter documents (as defined in *Section 260.001, Title 10, California Code of Regulations*) of the issuer and of each constituent entity involved in a merger or consolidation or entity conversion transaction.

D. A copy of any contract made or to be made by the issuer affecting any of the rights, preferences, privileges, or transferability of the securities.

E. Subject to the following instruction, a copy of any agreement made or to be made by or among security holders of the issuer which materially affects, or will materially affect, any of the rights, preferences, privileges, or restrictions of or on securities of the issuer or the management of the issuer (including any voting agreement, irrevocable proxy or security holders' agreement).

Instruction: If a copy of an agreement is not available to the issuer, so state and furnish a brief description of the agreement including therein such information regarding the parties and terms as is known to the issuer. Nothing contained herein shall be construed as requiring the issuer to disclose information concerning agreements of which it has no knowledge.

F. A preliminary copy of the proxy material to be used to solicit the vote or consents of security holders (amended copies of such proxy material and final copies should be submitted as supplemental information to this application), and the consent of any attorney, accountant or other expert named in such proxy material, if such expert's consent is required pursuant to *Section 260.504.2.2, Title 10, California Code of Regulations*, in the form required by that section.

G. The Consent to Service of Process if required by *Section 25165 of the California Corporations Code*.

H. A Customer Authorization of Disclosure of Financial Records Form (Form No. QR 500.259).

ITEM 17. REPORTS OF FINANCIAL CONDITION. Pursuant to *Section 25146 of the California Corporations Code* and *Section 260.146 of Title 10 of the California Code of Regulations*, applicant hereby undertakes, as long as required under the foregoing sections and subject to the exceptions therein contained, to file with the Commissioner: (a) within 120 days after the end of each fiscal year a report of financial condition and a related statement of income and expenses covering such fiscal year; and (b) within 90 days after the first six months of each fiscal year, a like report and statement covering such six-month period.

[*If the transaction involves a change in the rights, preferences, privileges or restrictions of or on outstanding securities or an exchange by an issuer with its existing security holders exclusively, include items 8 through 16, below:*]

ITEM 8. OUTSTANDING SECURITIES TO BE MODIFIED. State the title and amount of outstanding securities to be modified.

ITEM 9. DESCRIPTION OF OUTSTANDING SECURITIES AND MODIFIED SECURITIES. Describe any material differences between the outstanding securities and the modified or new securities.

ITEM 10. DESCRIPTION OF PROPOSED MODIFICATION. State the reasons for the proposed modification, the general effect thereof upon the rights of existing security holders, the basis of the ratio for the exchange of securities by an issuer with its existing security holders, the vote needed for approval, the proposed date for the mailing of proxies and the proposed date of the security holders' meeting.

ITEM 11. DIVIDENDS IN ARREARS OR DEFAULTS. A statement as to arrears in dividends or as to defaults in principal or interest with respect to outstanding securities which are to be modified, and such other information as may be appropriate in the particular case to disclose adequately the nature and effect of the proposed action.

ITEM 12. METHOD OF SELLING THE SECURITIES. If the applicant will employ broker-dealers or agents in connection with the recapitalization described in Items 9 and 10, describe the functions such persons will perform, furnish their names, and state the compensation to be paid such persons, or other consideration to be received by such persons, or any other persons, in connection with the sale or purchase of securities under the plan of recapitalization. If agents are to be employed by the applicant in connection with the distribution of securities pursuant to the plan, the applicant is required to comply with Sections 260.141.30 and 260.141.31, Title 10, California Code of Regulations, and the following information is to be furnished:

a. The name and business address of each person who will represent the applicant as an agent in this state.

b. The name and business address of the officer or other official who will supervise such agents on behalf of the applicant.

c. A statement that all such agents are employees of the applicant.

d. A statement of the compensation to be paid to such agents. A statement of the compensation to be paid to such supervisory personnel, other than their regular salaries if they are regular employees of the applicant.

e. Describe any order, judgment or decree of any governmental agency or administrator, or of any court of competent jurisdiction revoking or suspending for cause any license, permit or other authority of such agent or supervisory person or of any entity of which such person is an executive officer, director or person occupying a similar status or performing similar functions, to engage in the securities business or in the sale of a particular security or temporarily or permanently restraining or enjoining any such person or any entity of which such person is an executive officer, director or person occupying a similar status or performing similar functions from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting such person of any felony or

misdemeanor involving a security or any aspect of the securities business, or of theft or of any felony.

f. A surety bond complying with *Section 260.216.15, Title 10, California Code of Regulations.*

ITEM 13. DIRECTORS AND EXECUTIVE OFFICERS.

(a) List the names of all directors and executive officers or persons occupying a similar status or performing similar functions of the issuer indicating all positions and offices held by each person named.

(b) Describe any order, judgment, or decree of any governmental agency or administrator, or of any court of competent jurisdiction revoking or suspending for cause any license, permit or other authority of such person or of any entity of which such person is an executive officer, director or person occupying a similar status or performing similar functions, to engage in the securities business or in the sale of a particular security or temporarily or permanently restraining or enjoining any such person or any entity of which such person is an executive officer, director, or person occupying a similar status or performing similar functions from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting such person of any felony or misdemeanor involving a security or any aspect of the securities business, or of theft or of any felony.

ITEM 14. PRINCIPAL HOLDERS OF SECURITIES. State any material interest in the transaction of each executive officer or director of the issuer, or any person occupying a similar status or performing similar functions, any person owning of record or beneficially (if known to the issuer) 10% or more of the outstanding securities of any class of equity security of the issuer, and any promoter of the issuer if the issuer was organized within the past three years.

ITEM 15. EXHIBITS. Attach and incorporate by reference the following exhibits.

NOTE: Any exhibit which is inapplicable should be listed by letter on the form followed simply by the word "inapplicable."

A. With respect to the issuer, the financial statements required by *Section 260.613 of Title 10 of the California Code of Regulations.*

B. A copy of the plan of recapitalization if it is set forth in a written document, including any request for delayed effectiveness of the filing of such document with the Secretary of State or similar authority.

C. Copies (which may be in a restated or composite form) of the current charter documents (as defined in Section 260.001, Title 10, California Code of Regulations) of the issuer and of each constituent entity involved in a merger or consolidation.

D. A preliminary copy of the proxy material to be used to solicit the vote or consents of security holders (amended copies of such proxy material and final copies should be submitted as supplemental information to this application), and the consent of any attorney, accountant or other expert named in such proxy material, if such expert's consent is required pursuant to *Section 260.504.2.2, Title 10, California Code of Regulations*, in the form required by that section.

E. A copy of any contract made or to be made by the issuer affecting any of the rights, preferences, privileges, or transferability of the securities.

F. The Consent to Service of Process if required by *Section 25165 of the California Corporations Code*.

G. Subject to the following instruction, a copy of any agreement made or to be made by or among security holders of the issuer which materially affects, or will materially affect, any of the rights, preferences, privileges, or restrictions of

or on securities of the issuer or the management of the issuer (including any voting agreement, irrevocable proxy or security holders' agreement).

H. A Customer Authorization of Disclosure of Financial Records Form (Form No. QR 500.259).

Instruction: If a copy of an agreement is not available to the issuer, so state and furnish a brief description of the agreement including therein such information regarding the parties and terms as is known to the issuer. Nothing contained herein shall be construed as requiring the issuer to disclose information concerning agreements of which it has no knowledge.

ITEM 16. REPORTS OF FINANCIAL CONDITION. Pursuant to *Section 25146 of the California Corporations Code* and *Section 260.146 of Title 10 of the California Code of Regulations*, applicant hereby undertakes, as long as required under the foregoing sections and subject to the exceptions therein contained, to file with the Commissioner:

(a) within 120 days after the end of each fiscal year a report of financial condition and a related statement of income and expenses covering such fiscal year; and

(b) within 90 days after the first six months of each fiscal year, a like report and statement covering such six months period.

(c) Signatures:

The application must be signed and verified in the following form:

The applicant has duly caused this application to be signed on its behalf by the undersigned, thereunto duly authorized.

_____

(Applicant)
By _____
_____

(Title)

I certify (or declare) under penalty of perjury under the laws of the State of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed at _____[*place*], on _____, 20 _____[*date*].

_____

(Signature)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
F. Qualification of Recapitalizations and Reorganizations

3-6H California Legal Forms--Transaction Guide §§ 6H.251-6H.254

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6H.251[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
G. Qualification of Nonissuer Transactions

3-6H California Legal Forms--Transaction Guide § 6H.255

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.255 Application for Qualification of a Nonissuer Transaction by Notification [Corp. Code § 25131; 10 Cal. Code Reg. § 260.131]

[1] Comment

[a] Use of Form

This form is an application for qualification of a nonissuer transaction by notification. A nonissuer transaction is any transaction that is not directly or indirectly for the benefit of the issuer [*Corp. Code § 25011*; *see § 6H.21[4]*]. A transaction is "indirectly for the benefit of the issuer" if any portion of the purchase price of any securities involved in the transaction will be received indirectly by the issuer [*Corp. Code § 25011*]. "Purchase price" includes only the specific consideration bargained for in return for the securities (which may include the making of a loan to the issuer) but does not include any remote, contingent, or incidental benefit which may accrue to the issuer (such as the inducement to a person to become or remain an employee of the issuer or perform other services for the issuer) even though a motive of the seller or the purchaser is to obtain a remote, contingent, or incidental benefit for the issuer [*10 Cal. Code Reg. § 260.011*].

Unless the security itself is exempt [*see Corp. Code § 25101*], the transaction involving the security is exempt [*see Corp. Code § 25104*], a special exemption has been created by the Commissioner [*see Corp. Code § 25105*; *10 Cal. Code Reg. §§ 260.105-260.105.28*], or a transaction is not subject to qualification, all nonissuer transactions must be qualified before securities may be offered or sold in California [*Corp. Code § 25130*].

The usual method of qualification of securities in a nonissuer transaction is by notification, although certain secondary distributions of registered securities and certain offers of securities by control persons are properly qualified by coordination or permit. For discussion of exempt securities and transactions, see Marsh & Volk, Practice Under the California Securities Laws, Ch. 10, *Nonissuer Transactions* (Matthew Bender).

[b] Procedure for Qualification

Under the procedure for qualification of a nonissuer transaction by notification, the applicant must file the form specified by *10 Cal. Code Reg. § 260.131* together with the $100 filing fee [*see Corp. Code § 25608(i)*; *see also Corp. Code § 25608.3* (Commissioner may set any fee at amount below maximum set forth in *Corp. Code § 25608*)]. Qualification automatically becomes effective at 12:00 noon (California time) on the 10th business day after the filing of the application or the last amendment to the application or at any earlier time that the Commissioner may direct [*Corp. Code § 25131(c)*]. As with other forms of qualification, the Commissioner may prevent or suspend effectiveness of the qualification by stop order [*Corp. Code §§ 25140*, *25143(a)*].

The application must be signed and verified by the person on whose behalf the offering is being made, by the issuer, or by any broker-dealer [*Corp. Code § 25131(b)*].

The issuer may not pay or assume liability for any expenses incurred in connection with the offer, but may provide for services customarily rendered to all security holders in connection with the transfer of securities, including the services of transfer agents and registrars, the supplying of audited financial statements, and the fees or expenses pursuant to an agreement in connection with the original issue of the securities [*10 Cal. Code Reg. § 260.140.22*].

An offering that involves both an issuer and a nonissuer transaction must be treated as an issuer transaction for purposes of filing an application for qualification [*Corp. Code § 25011*], but the expenses in connection with the offering must be apportioned among the issuer and the selling security holders in accordance with the aggregate offering price of the securities being sold by each party [*10 Cal. Code Reg. § 260.140.22*].

[c] Standards for Qualification of Nonissuer Transactions

The Commissioner has promulgated a number of rules concerning the standards to be applied in the qualification of nonissuer transactions [*see § 6H.21[4][c]*]. In general, full, complete, and accurate information must be provided for all matters required to be stated in the application [*10 Cal. Code Reg. § 260.140.135*]. Information will not be required unless it is known by the person filing the application or the persons on whose behalf the distribution is to be made, or can be furnished by them without unreasonable effort or expense [*Corp. Code § 25131(d)*], in which case the applicant must supply an affidavit complying with the requirements of *10 Cal. Code Reg. § 260.140.139*. In addition, the information contained in the application, whether required or not, must be accurate and not misleading, and there must be no factor indicating that the market in the security will be subject to manipulation or artificial influence [*10 Cal. Code Reg. § 260.140.135*]. The Commissioner has also formulated rules applying issuer transaction standards to certain nonissuer transactions [*see 10 Cal. Code Reg. § 260.140.136*; *see also* Marsh & Volk, Practice Under the California Securities Laws, Ch. 10, *Nonissuer Transactions* (Matthew Bender)]. Finally, an application must show that the issuer's assets are productively employed in the operation of an ongoing business, presumptively established by a showing of annual gross receipts of $500,000 or more [*10 Cal. Code Reg. § 260.140.137*].

Securities that are nonvoting or have disproportionate voting rights or are subject to transfer restrictions or preemptive rights will not be qualified in a nonissuer transaction [*10 Cal. Code Reg. § 260.140.138*].

[d] Preparation of Form

The application for qualification of a nonissuer transaction by notification has its own facing page, consisting of six items relating to the identification of the issuer (and the applicant, if different than the issuer) and the securities sought to be qualified. The information required by the other 10 items is similar to the information required for other forms of qualification.

Item 7 is a basic description of the business [*see § 6H.225*]. The issuer's officers and directors must be identified in Item 8 [*see § 6H.228*], and the remuneration paid to them and to the issuer's principal security holders (insofar as it exceeded

$60,000 per year) must be stated at Item 9 [*see § 6H.233*]. Item 10 is a tabulation of outstanding options to purchase the issuer's securities [*see § 6H.231*]. The principal shareholders are to be identified in Item 11 [*see § 6H.232*], with the additional requirement that the applicant disclose information relating to insider trading by officers and directors of the issuer (Part B of Item 11). Material transactions of the issuer with its subsidiaries or promoters within the previous three years should be disclosed at Item 12 [*see § 6H.229*], along with a statement of the number of promotional shares [*see 10 Cal. Code Reg. § 260.140.30*] issued, the consideration for and restrictions upon any such promotional shares, and a description of any securities issued by the issuer during that three-year period.

Item 13 requires a description of the rights, preferences, privileges, and restrictions of or on outstanding securities other than common stock; a description of any class of outstanding common stock which is nonvoting, assessable, redeemable, and subject to preemptive rights or restrictions on transfer; and a brief outline of the rights, terms, and provisions of any debt security. Exhibits to the application (Item 14) properly include financial statements [*see § 6H.236*], press or publicity releases relating to the business of the issuer within the previous 12 months, a copy of any bonus plan or management contract with any officer or director of the issuer, and the consent to service of process, if required [*10 Cal. Code Reg. § 260.131*; *see §§ 6H.239, 6H.240*].

Item 15 must contain a disclosure of any adverse order, judgment, or decree entered against the issuer relating to an offering of securities, the securities business, theft, or a felony. An undertaking by the issuer (or an authorized officer of the issuer), to the effect that material information concerning the operations of the issuer will be furnished to its shareholders during the period a security is qualified pursuant to the application, is required by Item 16. The application must be signed and verified [*10 Cal. Code Reg. § 260.131*; *see* 6H.245].

[2] Form

Application for Qualification of a Nonissuer Transaction by Notification [Corp. Code § 25131; 10 Cal. Code Reg. § 260.131]

(Department of Corporations Use Only)
FEE PAID
$_____
_____

RECEIPT NO.
_____

EFFECTIVE DATE
_____

FEE: $100.00

DEPARTMENT OF CORPORATIONS FILE NO.

_____
(Insert file number of previous filings of issuer before the Department, if any.)

Date of Application: _____

DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

FACING PAGE FOR QUALIFICATION
OF NONISSUER TRANSACTION BY NOTIFICATION

NOTE: Indicate the type of filing by checking the appropriate original or amendment application heading shown below.

☐ APPLICATION FOR QUALIFICATION OF SECURITIES UNDER SECTION 25131 OF THE CORPORATE SECURITIES LAW OF 1968

☐ AMENDMENT NUMBER

_____TO AP-
PLICATION DATED
_____

(Check and complete if applicable)

1. Name of issuer
_____

2. (a) Address of principal executive office of issuer.

_____
Number and Street City State Zip Code

(b) Is the principal location of applicant's books and records at the address of the principal executive officer, above? (Indicate "yes" or "no.") If "no," provide address:

_____
Number and Street City State Zip Code

3. Name and address of applicant if other than issuer.
_____

4. Name and address of person to whom correspondence regarding this application should be addressed.
_____

5. State whether issuer is a corporation, partnership, trust or other entity and the state of incorporation or jurisdiction under which organized.
_____

6. Title and CUSIP number of each class of securities being qualified, e.g., $10 par value common stock, CUSIP 123.
_____

(Instructions: All of the foregoing information should appear on and be the only information appearing on the facing page of the application.)

INSTRUCTIONS

Completion of Application. The application should continue in the number sequence

shown below. Any item which is inapplicable should be listed by the number on the form, followed by the word "inapplicable."

7. Describe the business done by the issuer and its subsidiaries and the general development of such business during the last three years and indicate the intended development of the business in the immediate future. Indicate any other names under which the issuer or any of its subsidiaries have conducted business during such period.

8. List the names and home addresses of all directors and officers of the issuer, indicating all positions and offices held by each person named. In addition, describe any order, judgment, or decree of any governmental agency or administrator, or of any court of competent jurisdiction, revoking or suspending for cause any license, permit or other authority of such person or of any corporation of which he is an officer or director, to engage in the securities business or in the sale of a particular security or temporarily or permanently restraining or enjoining any such person or any corporation of which he is an officer or director from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting such person of any felony or misdemeanor involving a security or any aspect of the securities business or of theft or of any felony.

9. Furnish in tabular form information as to the direct remuneration paid by the issuer and its subsidiaries during the issuer's last fiscal year for services in all capacities to each director, officer, and principal holder of securities (as defined in item 11) whose aggregate direct remuneration during such year exceeded $60,000 and the aggregate remuneration paid to all officers, directors, and principal holders of securities as a group.

10. State in tabular form the title and amount of securities called for by any options, warrants or rights, including the purchase price of the securities so called for and the expiration dates of such options together with the market value of the securities so called for as of the latest practicable date. Such statements should include the foregoing information for all options held by each officer or director of the issuer. Except for information required with respect to each officer or director, information with respect to option prices and expiration dates may be furnished in ranges.

11. A. State in tabular form the voting securities of the issuer owned of record or beneficially by each person who owns of record or is known by the applicant to own beneficially more

		than 10% of the outstanding securities of any class of such voting securities. Such statement should reflect the respective amounts and percentage owned either beneficially or of record by each person and such statement should also include information as to the amounts held by, and the terms of, any voting trust or similar agreement with respect to more than 10% of the outstanding securities of any class of voting securities of the issuer.
B.		As to each principal security holder and each officer or director of the issuer who effected more than five transactions in the securities of the issuer within

the last twelve months, state the dates of all purchases and sales of securities of the issuer by such person, the prices received or paid and the number of securities bought or sold in each transaction.

12. Describe any material transactions or agreements during the 3-year period immediately preceding the filing of the applications between (i) the issuer or any of its affiliated companies, and (ii) any of their promoters, officers, directors, principal employees, principal security holders, underwriters or agents or any company directly or indirectly controlled by any such person or persons. Include a detailed statement of the number of promotional shares (as defined in Section 260.140.30 of Title 10 of the California Code of Regulations) issued, the consideration for and any restrictions on such shares. If securities were issued by the issuer during such period, briefly describe each such transaction, including any sale or distribution of the issuer's securities effected by or through a subsidiary of the issuer.

13. If the issuer has outstanding securities other than common stock, outline briefly the rights, preferences, privileges and restrictions of or on such securities. If any class of outstanding common stock is nonvoting, assessable, redeemable, or subject to preemptive, rights or restrictions on transfer, outline briefly such provisions. Outline briefly the rights, terms and provisions of any debt security or other security identified in Item 6.

14. Exhibits. Attach and incorporate by reference the following exhibits:

(NOTE: Any exhibit which is inapplicable should be listed by letter on the application followed simply by the word "inapplicable.")

A. Financial Statements: With respect

	to the issuer, the financial statements required by Section 260.613 of Title 10 of the California Code of Regulations.
B.	All press or publicity releases, communications to shareholders and communications to broker-dealers and investment advisers within the preceding twelve months by the issuer or its subsidiaries and relating to the business or intended business or to the assets or acquisitions of the issuer or its subsidiaries.
C.	Copy of any management contract or bonus plan, contract or arrangement with any officer or director named in item 9 above.
D.	The Consent

to Service of Process of required by Section 25165 of the California Corporation Code.

15. The following statement should be made and completed: There has not been and is no adverse order, judgment or decree entered in connection with the offering or trading of securities of the issuer by any state regulatory authority, any court or the Securities and Exchange Commission, except as follows: (if none, so state)

16. The following undertaking should be made by the issuer named in item 1 above and, if the issuer is not the applicant, executed by an authorized officer of the issuer on its behalf:

The issuer, if it is the applicant, hereby undertakes to furnish the Commissioner promptly copies of all current, quarterly, semi-annual or annual reports or other material information concerning its operations furnished to its shareholders during the period a security is qualified pursuant to this application.

(NOTE: The application must be signed and verified in the following manner.)

The applicant has duly caused this application to be signed on its behalf by the undersigned, thereunto duly authorized.

_____
(Applicant)

By _____

_____
(Title)

I certify (or declare) under penalty of perjury under the laws of the State of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed at _____[*place*], on _____[*date*].

_____
(Signature)

Form of Application. The application should be typewritten or written in the English language, on one side only of either legal or letter-size paper.

Signing of Applications. Application should be signed by an officer or general partner of the applicant; however, it may be signed by another person holding a power of attorney for such purposes from the applicant, and if signed on

behalf of the applicant pursuant to such power of attorney, should include as an additional exhibit a copy of said power of attorney or a copy of the corporate resolution authorizing the attorney to act.

Incorporation by Reference. In lieu of answering any specific item in this form, an applicant may incorporate the information called for by reference to any attached document, or to any document currently on file with the Department. Such reference should indicate the pages or portion of the document where the information is located.

Amendments to Applications. An amendment to any application for qualification should contain only the information being amended by item number and should be verified in the form prescribed for the application. Each amendment should be accompanied by a facing page in the form prescribed by Section 260.131 of the rules on which the applicant shall insert the fact that the filing is an amendment and the number of the amendment.



74 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
G. Qualification of Nonissuer Transactions

3-6H California Legal Forms--Transaction Guide §§ 6H.256-6H.259

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6H.256[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
H. Conditions on Qualification

3-6H California Legal Forms--Transaction Guide § 6H.260

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.260 General Legend Condition [10 Cal. Code Reg. § 260.141.11]

[1] Comment

[a] Use of Form

This form is the legend that must be placed on securities that are subject to a legend condition [*10 Cal. Code Reg. § 260.141.11*; *see § 6H.261* for legend condition for promotional securities]. The legend condition must be prominently stamped or printed on the face of the security in capital letters of not less that 10-point type. The legend must also appear on all certificates that are issued as stock dividends, stock splits or reverse splits, and stock transfers of securities that are subject to the legend condition [*Corp. Code §§ 25017(f), 25103(f)*; *10 Cal. Code Reg. § 260.103.5*].

In addition to the legend condition that must appear on the face of the stock certificate, the Commissioner requires that the issuer deliver a copy of 10 Cal. Code Reg. § 260.140.11 to each issuee and transferee of the legended stock [*10 Cal. Code Reg. § 260.141.11(a)*]. The regulation may be reproduced on the reverse side of the stock certificate in order to insure compliance with the Commissioner's requirement.

For sample share certificates and discussion of the issuance of share, see Ch. 6I, *Issuance of Equity Securities* .

[b] General Legend Condition

The Commissioner is authorized to impose a legend condition restricting the transferability of securities if he or she finds that without such a condition the offering will be unfair, unjust, or inequitable [*Corp. Code § 25141*]. The Commissioner most often applies the condition to limited offerings in which the securities are qualified for offer and sale only to persons designated by name or class [*10 Cal. Code Reg. §§ 260.001(e), 260.141.10*]. The condition may be imposed if a variation is approved from the more rigid standards normally imposed on open offering qualifications [*10 Cal. Code Reg. §§ 260.001(f), 260.141.10*]. Imposition of the condition is based on the degree of investor sophistication of the purchasers or their close relationship with the issuer, and the legend is thereafter required if the Commissioner

determines that there is a substantial danger that subsequent transfers of the securities might be unfair, unjust, or inequitable to the new purchasers despite the law requiring qualification of nonissuer transactions [*see Corp. Code § 25130*; *10 Cal. Code Reg. § 260.141.10*]. Imposition of the condition has been a common feature of the limited offering type of qualification in the past. The legend condition is authorized by rules of the Commissioner to be applied to interests in real estate syndicates [*10 Cal. Code Reg. § 260.140.118.5*] and to oil and gas securities [*10 Cal. Code Reg. § 260.140.131.4*].

Whenever the Commissioner determines that issued securities were offered or sold in violation of the qualification requirements of the Corporation Securities Law [*see Corp. Code §§ 25110, 25120, 25130*], the Commissioner may by written order to the issuer and notice to the holders of the securities require the certificates for the securities to be stamped or imprinted with a legend restricting transfer [*Corp. Code § 25534*]. Upon request, a hearing may be held to determine the propriety of the order [*Corp. Code § 25534*]. Upon issuance of such an order, the issuer of securities must comply with the requirements of *10 Cal. Code Reg. § 260.141.11* [*see 10 Cal. Code Reg. § 260.534*]. For a discussion of when securities subject to a legend condition may be transferred, see *§ 6H.262*.

[2] Form

General Legend Condition [10 Cal. Code Reg. § 260.141.11]

IT IS UNLAWFUL TO CONSUMMATE A SALE OR TRANSFER OF THIS SECURITY, OR ANY INTEREST THEREIN, OR TO RECEIVE ANY CONSIDERATION THEREFOR, WITHOUT THE PRIOR WRITTEN CONSENT OF THE COMMISSIONER OF CORPORATIONS OF THE STATE OF CALIFORNIA, EXCEPT AS PERMITTED IN THE COMMISSIONER'S RULES.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
H. Conditions on Qualification

3-6H California Legal Forms--Transaction Guide § 6H.261

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.261 Legend Condition for Promotional Securities [10 Cal. Code Reg. § 260.141.1]

[1] Comment--Use of Form

This form is the legend that must be placed on promotional securities which are being issued subject to a legend condition. The legend must be prominently stamped or printed on the face of the security in capital letters of not less than 10-point type [*10 Cal. Code Reg. § 260.141.1*; *see § 6H.260* (legend imposed on nonpromotional shares)].

Promotional shares are those issued in consideration for services rendered in connection with initiation of a business, for property of a vague value (such as patents or goodwill), or for a price lower than that charged others for such stock for reasons unrelated to market considerations [*10 Cal. Code Reg. § 260.140.30*] The shares themselves must be equity securities without any preferential rights (such as voting rights) over like shares issued for cash or its equivalent, and must carry conditions of waiver as to receipt of dividends or participation in distribution of assets on liquidation [*10 Cal. Code Reg. §§ 260.140.32, 260.141*].

A reasonable number of promotional shares will be permitted, although normally not in the case of a corporation with an established background of profitable operation. Promotional shares not exceeding 25 percent (or 50 percent if the issuer is a small business company) of the common shares issued or proposed to be issued are presumed to be reasonable [*10 Cal. Code Reg. § 260.140.31*]. No shares subject to this condition may be transferred without the prior written approval of the Commissioner, unless pursuant to the order or process of any court, provided that the transfer is on condition that any certificate evidencing the shares issued to the transferee bear a similar legend [*10 Cal. Code Reg. § 260.141.1*].

For sample share certificates and discussion of the issuance of share, see Ch. 6I, *Issuance of Equity Securities* .

[2] Form

Legend Condition for Promotional Securities [10 Cal. Code Reg. § 260.141.1]

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN RESTRICTIONS, INCLUDING WAIVERS OF DIVIDENDS AND ASSETS, AND IT IS UNLAWFUL TO CONSUMMATE A SALE OR TRANSFER OF THEM, OR ANY INTEREST THEREIN, OR RECEIVE ANY CONSIDERATION THEREFOR, WITHOUT THE PRIOR WRITTEN CONSENT OF THE COMMISSIONER OF CORPORATIONS OF THE STATE OF CALIFORNIA.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
H. Conditions on Qualification

3-6H California Legal Forms--Transaction Guide § 6H.262

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.262 Application for Consent to Transfer Securities Subject to Legend or Escrow Condition [Corp. Code § 25151; 10 Cal. Code Reg. § 260.151(a)]

[1] Comment

[a] Use of Form

This form is an application for consent to transfer securities subject to a legend or escrow condition. It is unlawful to transfer securities subject to legend or escrow conditions unless and until the Commissioner has given written consent to transfer [*Corp. Code § 25133*]. Consent will be given only if the proposed transfer is found to be fair, just, and equitable to the proposed transferee [*Corp. Code § 25151(a)*]. This form is the application for consent that must be filed with the Commissioner along with the statement of each of the proposed transferees [*10 Cal. Code Reg. § 260.151(a)*; *see § 6H.263*]. The fee for filing the application is $20 [*Corp. Code § 25608(m)*; *see Corp. Code § 25608.3* (Commissioner may set any fee at amount below maximum set forth in *Corp. Code § 25608*)]. Certain transfers of legend-bearing securities are permitted without the Commissioner's consent as long as the legend appears on any certificate evidencing the security [*see 10 Cal. Code Reg. § 260.141.11(c)*]. In any event, the transfer must not be for the benefit of the issuer [*see Corp. Code § 25011*; *10 Cal. Code Reg. § 260.011*]; if it is, the securities must be qualified, unless exempt or not subject to qualification [*Corp. Code § 25110*].

[b] Consent Not Equivalent to Qualification or Exemption

The issuance of the Commissioner's consent to transfer securities subject to legend or escrow conditions will not be deemed a qualification of the transaction pursuant to, or an exemption from, the qualification requirements of *Corp. Code §§ 25110, 25120,* or *25130* [*Corp. Code § 25151(b)*].

[2] Form

Application for Consent to Transfer Securities Subject to Legend or Escrow Condition [10 Cal. Code Reg. §

260.151(a)]

(Dept. of Corporations Use Only)

Dept. of Corporations File No.
_____
(Insert file number of previous filings of issuer before the Department, if any.)

Fee Paid
$_____

FEE:
$_____
(To be completed by applicant. The required fee is $20 per transfer (Sec. 25608(m), Corp. Code).)

Receipt No.
_____

Date of Application:

DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

APPLICATION FOR CONSENT TO TRANSFER SECURITIES PURSUANT TO SECTION 25151 OF THE CORPORATE SECURITIES LAW OF 1968

This represents (check appropriate box):

☐ The initial filing.

☐ An amendment to application dated _____.

THE SECURITIES PROPOSED TO BE TRANSFERRED ARE SUBJECT TO (CHECK APPROPRIATE BOX)

☐ LEGEND CONDITION.

☐ ESCROW CONDITION.

_____

1. (a) Name of Issuer:
_____

(b) Former Name, if any:
_____

2. Description of securities proposed to be transferred: (State title of each class of securities (e.g., Class A Common Stock). If rights, warrants and options are listed, also specify the securities to be transferred upon exercise thereof. If securities are to be pledged, so state.)

_____
_____
_____

3. Name and address of each transferor (if space is insufficient, incorporate and attach additional sheets):

Name	Address	Aggregate number or amount of securities proposed to be transferred by each transferor:
_____		
_____		
_____		

Total: _____

_____

4. Name and address of each proposed transferee (if space is insufficient, incorporate and attach additional sheets):

Name	Address	Aggregate number or amount of securities proposed to be transferred by each transferee:

Total: _____

_____

5. Address of principal executive office of Issuer:

_____

(Number and Street) (City) (State) (Zip Code)

6. Name and address of person to whom correspondence regarding this application should be directed: _____

_____

7. There are attached hereto as exhibits statements by each of the proposed transferees in the form required by Section 260.151 of Title 10 of the California Code of Regulations. (Note: Upon request, such statements will be treated as confidential by the Commissioner, subject to the provisions of Section 250.10, Title 10, California Code of Regulations.)

8. (Check appropriate box)

☐ (a) There are no restrictions upon the transfer of the securities proposed to be transferred other than the legend or escrow condition imposed by the Commissioner of Corporations.

☐ (b) There are restrictions upon the transfer of the securities proposed to be transferred other than the legend or escrow condition imposed by the Commissioner of Corporations which are described in an exhibit attached hereto and incorporated herein by reference. Such restrictions have been complied with so as to make the transfer to the proposed transferees valid and are known to the proposed transferees.

9. No portion of the consideration to be given by the transferees of the securities will be for direct or indirect benefit of the Issuer identified in Item 1. If the Issuer is to benefit from proposed transfer, see Section 25011 of Corporate Securities Law of 1968 and Section 260.011 of Title 10 of the California Code of Regulations. Qualification of the transaction may be required.

10. Execution Instructions:

If a transferor is other than an individual, the name of the entity should be typed or printed above the signature line exactly as shown in Item 3. The signature should show the name and title of the person authorized to sign for such transferor.

I/We certify (or declare) under penalty of perjury under the laws of the State of California that I/we have read this application and know the contents thereof, and that the statements therein are true and correct.

Executed at _____
[*place*], _____ [*date*].

(If the transferor is other than an individual, give the name of the entity and the name and title of the person executing the application on behalf of such entity.)

_____	_____
(Signature of Transferor)	(Signature of Transferor)
_____	_____
(Signature of Transferor)	(Signature of Transferor)
_____	_____
(Signature of Transferor)	(Signature of Transferor)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
H. Conditions on Qualification

3-6H California Legal Forms--Transaction Guide § 6H.263

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.263 Statement of Transferee [10 Cal. Code Reg. § 260.151(b)]

[1] Comment

[a] Use of Form

This form is the statement of a transferee of securities used in connection with the application for consent to transfer securities subject to a legend or escrow condition. The Commissioner's consent to such a transfer may be obtained only by filing the Department of Corporations application form for consent [*see § 6H.262*], accompanied by the statement of each transferee [*Corp. Code § 25151*; *see 10 Cal. Code Reg. § 260.151*]. For a discussion of the application for consent to transfer, see *§ 6H.262*.

[b] Contents of Form

A transferee completing this form must state the number and description of the securities he or she intends to purchase, and whether they are promotional shares. The transferee must indicate whether he or she (1) is an officer or director of the issuer, (2) is actively involved in the issuer's business, (3) has received a financial statement from the issuer sufficient for evaluating the investment, and (4) is acquiring the securities as a record and/or beneficial owner [*10 Cal. Code Reg. § 260.151(b)*]. Because the form also requires certain details relating to the transferee's finances [*see* [2], Items 5, 6, *below*], the applicant may request that the information contained in the statement be withheld from public inspection [*10 Cal. Code Reg. § 250.10(a)*; *see § 6H.275*].

[2] Form

Statement of Transferee [10 Cal. Code Reg. § 260.151(b)]
TO THE COMMISSIONER OF CORPORATIONS OF
THE STATE OF CALIFORNIA

STATEMENT OF TRANSFEREE TO ACCOMPANY APPLICATION FOR CONSENT TO TRANSFER SECURITIES SUBJECT TO LEGEND OR ESCROW CONDITION

(If securities are to be received in pledge, so state.)

The undersigned intends to purchasen*
_____ (number)
shares or units
of _____
(Description of security, e.g., $10 common, Class A common)
issued by _____
(Name of Issuer)
from _____ and
makes the following statements:

1. I have received from the issuer and/or the transferor a recent financial statement of the issuer and such additional information with respect to the issuer as I have deemed necessary to make an independent evaluation of the business prospects of the issuer and the fairness of the investment. (If answered in the negative, explain fully.) ..... Yes ☐ No ☐
2. I am a director and/or an officer of issuer ..... Yes ☐ No ☐
3. (a) I will actively participate in the operation of issuer's business and devote my full time or a substantial portion of my time thereto, with an opportunity to be fully aware of all of issuer's affairs ..... Yes ☐ No ☐
   (b) I will be compensated for such services ..... Yes ☐ No ☐
4. Are the securities being purchased promotional shares subject to waivers of assets and dividends? (See Sections 260.141 and 260.141.1 of the rules.) ..... Yes ☐ No ☐
5. If the issuer is not a partnership and all parts of questions 2 and 3 above are answered in the negative, attach a separate signed statement elaborating on the items shown below.
   (a) The length of time officers and directors of issuer have been known, and the nature of prior business dealings with any officer or director of issuer or with the issuer.
   (b) Any prior investment experience in a business of similar size and nature.
   (c) Whether the amount of the proposed investment in issuer is in excess of 10% of either the net worth or the annual income of the transferee.
   (d) Whether the transferee has received advice from any attorney, accountant or other professional adviser independent of the issuer.

(e) How transferee became aware of proposed investment.

6. If the issuer is a partnership, complete the following:

(a) My annual income is in excess of $_____.

(b) My net worth (exclusive of my home, its furnishings and my automobiles) is in excess of $_____.

7. (a) I am acquiring the securities as record and beneficial owner ..... Yes ☐ No ☐

(b) I am acquiring the securities as beneficial owner and not as record owner ..... Yes ☐ No ☐

The record owner is

_____

(c) I am acquiring the securities as record owner and have no beneficial interest therein ..... Yes ☐ No ☐

The beneficial owner is

_____

If the transferee is other than an individual, the name of the entity should be typed or printed beside the signature line exactly as shown in Item 4 of the Transferor's Application (Form 260.151). The signature should show the name and title of the person authorized to sign for the transferee.

I certify (or declare) under penalty of perjury under the laws of the State of California that I have read this Statement of Transferee and know the contents thereof, and that the statements therein are true and correct.

Executed at _____
[*place*], _____ [*date*].

_____ _____
(Name of Entity) (Signature of Transferee)

_____
(Title)

FOOTNOTES:

(n1)Footnote *. Include rights, warrants, and options and the securities to be transferred upon exercise thereof.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
H. Conditions on Qualification

3-6H California Legal Forms--Transaction Guide § 6H.264

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.264 Nomination of Escrow Holder or Foreign Depositary [10 Cal. Code Reg. § 260.141.3]

[1] Comment--Use of Form

This form is the nomination of an escrow holder or foreign depositary. In some cases the Commissioner may determine that there is an unusual danger that promotional shares might be distributed to the public despite the requirement of a legend on the certificates [*see § 6H.261* (promotional legend)]. The Commissioner, therefore, may require that the certificates representing promotional shares be deposited into an escrow [*10 Cal. Code Reg. § 260.141.3*]. The person acting as escrow holder must first be approved by a written order of the Commissioner [*10 Cal. Code Reg. § 260.141.3*].

Traditionally, the escrow holder has been selected from banks or trust companies, particularly when they are acting as transfer agents, from escrow companies, or, as in the majority of instances, from attorneys for the company who had no investment interest otherwise. The Commissioner has indicated, however, that escrow agents should be "independent," specifically stating that attorneys, accountants, or other agents representing one of the parties to the transaction should not be used as escrow agents [Dept. of Corps. Release No. 60-C (Oct. 19, 1979)]. This view has been criticized on the ground that a sale or transfer is not consummated merely by opening an escrow, and that it should make no difference who the escrow holder is [*see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 11, Transfer of Securities Subject to Legend or Escrow Condition, § 11.03[1]* (Matthew Bender)].

Fees of escrow holders have varied for initial services and for handling of subsequent transfers within escrow. The Commissioner of Corporations also may act as escrow holder [*Corp. Code § 25149*] and may be the most convenient and reasonable candidate available, charging $50 to act plus $2.50 for each new certificate deposited on transfer [*Corp. Code § 25608(l)*]. When acting as escrow holder, the Commissioner may destroy security certificates of a corporation which has been dissolved or whose charter has been suspended for at least two years [*Corp. Code § 25619(b)*].

If the Commissioner has indicated the necessity of imposing an escrow condition and if an escrow holder cannot be arranged for in conference, this form nominates a candidate. If the Commissioner has determined that an impound

condition must be imposed on the qualification [*see* § 6H.267], and the issuer is a foreign corporation and wishes to use a depositary in another jurisdiction, this same form may be used to nominate a foreign depositary for the Commissioner's approval.

[2] Form

Nomination of Escrow Holder or Foreign Depositary [10 Cal. Code Reg. § 260.141.3]

_____[*date*]

To: Commissioner of Corporations
_____ [*branch address*]

Attn: _____ [*staff member in charge of applicant's file*]

RE: _____ [*name of applicant*], File No. _____
Nomination of Escrow Holder [*or* Nomination of Foreign Depositary]

With respect to the fact that qualification of the applicant's [promotional] securities currently in process before the Department of Corporations is [to be] conditioned on deposit of security certificates with an escrow holder [*or* deposit of proceeds under an impound condition with a depositary] approved by the Commissioner, applicant nominates the following candidate at the below address to serve as escrow holder [*or* depositary] for the duration of this condition:

_____ [*name and address, e.g.,* Commissioner of Corporations, _____ (*address of particular branch office processing application*)]

Applicant requests receipt of your approval to this nomination as soon as possible, at which time the securities [*or* proceeds] concerned under this escrow [*or* impound] condition will be deposited by the issuer at once with the above escrow holder [*or* depositary]. The nominee depositary has forwarded to you separately addressed to this file number its consent to act.

_____ [*name of applicant*]

By _____ [*signature*]

[*typed name and title*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
H. Conditions on Qualification

3-6H California Legal Forms--Transaction Guide § 6H.265

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.265 Application for Removal or Modification of Conditions [Corp. Code § 25141; 10 Cal. Code Reg. § 260.141.50]

[1] Comment--Use of Form

This form is an application for removal or modification of conditions. The Commissioner has discretion to modify or remove any condition imposed on securities under to *Corp. Code §§ 25141* or *25534* [*Corp. Code § 25141*]. The Commissioner will remove conditions imposed on promotional shares when the issuer has demonstrated a satisfactory earnings record, as long as no other circumstances exist that would require the continuation of one or more of those conditions [*10 Cal. Code Reg. § 260.141.2*]. An earnings record usually will be considered satisfactory if the average annual earnings during a three-year period is equal to a reasonable return for the particular type of business on an amount determined by multiplying the total number of outstanding shares of the issuer by the average price at which the nonpromotional shares were originally issued and sold [*10 Cal. Code Reg. § 260.141.2*]. Conditions restricting transfer of shares [*see § 6H.260*] will be removed if the application discloses that circumstances no longer require the imposition of the condition and that subsequent transfers of the securities are not likely to be unfair, unjust, or inequitable to any purchaser of the securities [*10 Cal. Code Reg. § 260.141.12*].

Whenever an applicant believes that the facts and circumstances presented in its application justify a variance from any of the rules pertaining to impound conditions imposed by the Commissioner, it may submit a verified request for a variance setting forth all of the reasons that it believes justify the request [*10 Cal. Code Reg. § 260.141.27*].

The form for the application for removal or modification of conditions is specified in *10 Cal. Code Reg. § 260.141.50*. The filing fee, which must be included with the application, is $50 [*Corp. Code § 25608(j)*; *see Corp. Code § 25608.3* (Commissioner may set any fee at amount below maximum set forth in *Corp. Code § 25608*)]. Either the issuer or the holder of any shares subject to a condition may file the application [*10 Cal. Code Reg. § 260.141.50*]. This form also may be used to apply for removal of an impound condition [*see 10 Cal. Code Reg. § 260.141.26*] and for release of funds impounded pursuant to an order of the Commissioner [*10 Cal. Code Reg. § 260.141.24*].

[2] Form

Application for Removal or Modification of Conditions [Corp. Code § 25141; 10 Cal. Code Reg. § 260.141.50]

File No. _____
Insert file number of Issuer, if any

Fee: $_____
See Corp. Code Sec. 25608(i) and (j)

Date of Application
_____

DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

APPLICATION FOR REMOVAL OF CONDITIONS
Imposed Pursuant to the Corporate Securities Law of 1968

1. _____
(Name of issuer)

2. _____
(Address of principal executive office of issuer)

3. _____
(Name and address of person to whom correspondence regarding this application should be addressed)

4. Identify each condition the removal of which is requested by this application.
   a. If imposed upon a qualification pursuant to Corp. Code Sec. 25141, specify the date of the qualification.
   b. If imposed pursuant to an order issued under Corp. Code Sec. 25534, specify the date of such order.

5. State the justification for the requested removal of the condition.

6. If this is an application to remove conditions imposed upon promotional shares pursuant to Sections 260.141 and 260.141.1 of Title 10, California Code of Regulations, state the following information:
   a. The names of the present holders of the shares subject to the promotional conditions and the number of shares held by each such person subject thereto.
   b. State in tabular form the voting securities of the issuer owned of record or beneficially by each person who owns of record or is known by the applicant to own beneficially more than 10% of any class of such securities. Such statement should reflect the respective amounts and percentages owned either of record or beneficially by such person and such statement should also include information as to the amounts held by, and the terms of, any voting trust or similar agreement with respect to more than 10% of any class of voting securities of the issuer.
   c. State in tabular form the number of securities of each class of the issuer's securities which are outstanding.

7. If this is an application for the removal of a restriction on transfer imposed by the Commissioner or for the removal of promotional conditions, state in tabular form the title and amount of securities called for by any options, warrants or rights, including the purchase price of the securities so called for and the expiration dates of such options, together with the market value of the securities so

called for as of the latest practicable date. Such statement should include the foregoing information for all options held by each officer or director of the issuer.

8. If this is an application for the removal of an impound condition, furnish the information indicated by Section 260.141.24, Title 10, California Code of Regulations.

9. There are attached hereto as exhibits the following which are incorporated by reference:

   a. Financial statements of the issuer as required by Section 260.613, Title 10, California Code of Regulations.

   b. Copies (which may be in a restated or composite form) of the issuer's current charter documents (as defined in Section 260.001, Title 10, California Code of Regulations).

10. The applicant has duly caused this application to be signed on its behalf by the undersigned, thereunto duly authorized.

_____
(Applicant)

By _____

_____
(Title)

I certify (or declare) under penalty of perjury under the laws of the State of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed at _____[*place*], on _____[*date*].

_____
(Signature)

Instruction:

The application may be made and signed either by the issuer or by the holders of the shares upon which the conditions are imposed.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
H. Conditions on Qualification

3-6H California Legal Forms--Transaction Guide §§ 6H.266-6H.269

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6H.266[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
I. Miscellaneous Forms

3-6H California Legal Forms--Transaction Guide § 6H.270

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.270 Application for Approval of Repurchase Offer [Corp. Code § 25507; 10 Cal. Code Reg. § 260.507]

[1] Comment--Use of Form

This form is an application for approval of an offer to repurchase a security. Whenever securities are issued in violation of the qualification requirements of the Corporate Securities Law, the issuer, and all persons acting on behalf of the issuer, may become subject to various administrative, civil, or criminal penalties. For example, the Commissioner of Corporations has broad powers to impose legend conditions on securities that were improperly qualified [*Corp. Code § 25534*], issue desist and refrain orders [*Corp. Code § 25532*], or seek injunctive relief [*Corp. Code § 25530*; *see Corp. Code § 25530.1*]; *see Corp. Code § 25530.1* to enforce compliance with the Corporate Securities Law. Criminal penalties are provided for willful violations of the Corporate Securities Law [*see Corp. Code §§ 25540-25542*]. In addition, various acts or omissions may subject the issuer to civil liability [*see Corp. Code §§ 25500-25510*]. In addition, the purchaser may have a rescission right for a period of up to two years (or one year from discovery of the facts) [*Corp. Code §§ 25503, 25507*]. As a remedial measure, the Corporate Securities Law provides an opportunity for the issuer of securities to offer to repurchase securities that were not properly qualified or that were sold in violation of a condition imposed pursuant to *Corporations Code Section 25141* [*see Corp. Code § 25507(b)*; *10 Cal. Code Reg. § 260.507*].

The Commissioner is empowered to impose conditions on the repurchase offer [*see Corp. Code § 25507(c)*]. The repurchase offer must be accompanied by an irrevocable consent appointing the Commissioner to be the applicant's attorney to receive service of any lawful process in any noncriminal suit, action, or proceeding that arises under the Corporate Securities Laws [*see § 6H.239*]. California residents are not excluded from this provision [*see Corp. Code § 25507(d)*]. Although it appears that liability for damages under *Corp. Code § 25503* may be mitigated or extinguished by repurchase of the securities pursuant to this repurchase offer [*see 10 Cal. Code Reg. § 260.507*, Item 9(D)(4)(d)], the repurchase offer does not affect any liability that may arise under *Corp. Code §§ 25500*, *25501*, or *25502* or under common law [*see 10 Cal. Code Reg. § 260.507*, Item 9(D)(9)].

[2] Form

Application for Approval of Repurchase Offer [Corp. Code § 25507; 10 Cal. Code Reg. § 260.507]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
I. Miscellaneous Forms

3-6H California Legal Forms--Transaction Guide § 6H.271

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.271 Investor's Suitability Representation Letter [10 Cal. Code Reg. § 260.140.01; Dept. of Corps. Release No. 8-C]

[1] Comment--Use of Form

This form is an investor's suitability representation letter. Whenever the applicant proposes to issue securities in connection with a limited offering [*10 Cal. Code Reg. § 260.001(e)*], the proposed purchasers must be identified [*see § 6H.238*]. If the proposed issue involves oil and gas or mining interests or a real estate syndicate [*see § 6H.220,* Item 20], special information about the financial responsibility and investment experience of the proposed purchasers must be supplied [*see 10 Cal. Code Reg. §§ 260.140.112.1-260.140.112.4*, *260.140.123.1-260.140.126*]. It is the responsibility of the issuer (and of each person, including broker-dealers and agents, who participates in the distribution of the securities) to insure that the proposed purchasers meet the suitability standards applicable to the offering [*10 Cal. Code Reg. § 260.140.01(b)*]. Accordingly, the Commissioner has suggested this letter form, by which the proposed purchaser acknowledges the risks involved in the investment and gives a statement of his or her investment experience and financial responsibility [*see* Dept. of Corps. Release No. 8-C (Feb. 27, 1969)]. This form may be used to supply further information about the proposed purchasers in any limited offering qualification [*see § 6H.200*], and the information contained in it can be afforded confidential treatment [*see 10 Cal. Code Reg. § 250.10(a)*; *see also § 6H.275*].

[2] Form

Investor's Suitability Representation Letter [10 Cal. Code Reg. § 260.140.01; Dept. of Corps. Release No. 8-C]

To
_____[*name and address of broker-dealer or issuer*]

As a condition to investing in the securities of _____ [*name of issuer*], hereinafter referred to as the "Company," and in order to establish to _____ [*name of broker-dealer or issuer*] the suitability of that investment for me, I hereby represent as follows:

1. My occupation or profession is _____ [*specify*] [*or*] I am retired and my occupation or profession was _____.

2. I am experienced in investment and business matters. My experience includes the following: _____ [*specify*].

3. I am a person who:

a. has a net worth of $_____ or more; and

b. had during my last tax year, or estimate that I will have during this current tax year, "taxable income" as defined in *Internal Revenue Code Section 63*, some portion of which was or will be subject to federal income tax at a rate of _____ percent or more.

4. I recognize that the company is newly organized and has no history of operations or earnings and is a speculative venture. If I elect to participate therein I may lose the total amount of my investment.

5. I will rely solely upon the prospectus and investigations made by me or my representatives in making my investment decision.

6. I have been advised that if I participate in the investment offered me I may be required to make additional payments of up to $_____ at a later date. I understand that participation therefore is not considered a suitable investment for persons who may not be able to make such additional payments, if and when required.

7. I understand that the Commissioner of Corporations of the State of California has made no finding or determination relating to the fairness for public investment of the securities offered by the company and that the Commissioner has not and will not recommend or endorse these securities.

8. I recognize that prior to the proposed offering to be made there has been no public market for the securities offered by the company and there is no assurance that after the offering there will be such a market for these securities. In addition, I understand that the transferability of these securities is restricted and that I cannot expect to be able readily to liquidate my investment in case of emergency.

_____ [*signature of investor*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
I. Miscellaneous Forms

3-6H California Legal Forms--Transaction Guide § 6H.272

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.272 Employment of Agents [10 Cal. Code Reg. § 260.141.30]

[1] Comment--Use of Form

This form is a list of agents employed in connection with the sale of securities. Any applicant which will use agents other than licensed broker-dealers in connection with the sale of securities in California, whether the qualification of those securities is by coordination [*Corp. Code § 25111*; *see § 6H.205*], issuer notification [*Corp. Code § 25112*; *see § 6H.215*], issuer permit [*Corp. Code § 25113*; *see § 6H.220*], or reorganization permit [*Corp. Code § 25121*; *see § 6H.250*], must file the following information with the appropriate qualification application. Essentially, the applicant must identify the persons acting as agents, who must be employees of the issuer, identify the corporate officer who will supervise the agents, and state the terms of compensation that the agents will receive.

In addition, the applicant must furnish a bond complying with the requirements of *Corp. Code § 25216(e)* [*10 Cal. Code Reg. § 260.216.15*; *see § 6H.273*]. The bond requirement may be satisfied by an undertaking that satisfies the requirements for the bond [*see Code Civ. Proc. § 995.210(b)*].

An amendment to the qualification must be filed in connection with the employment of a person as an agent who is not named in the application for qualification. No amendment is required, however, for the termination of any agent listed in the application for qualification [*10 Cal. Code Reg. § 260.141.30(b)*].

[2] Form

Employment of Agents [10 Cal. Code Reg. § 260.141.30]
EMPLOYMENT OF AGENTS IN CONNECTION WITH THE SALE OF SECURITIES

1. The applicant has engaged the following persons to act as agents on its behalf and to market the securities covered by this application:

NAME ADDRESS

_____ _____
_____ _____
_____ _____
_____ _____

2. The following persons are officers of the applicant who will supervise the activities of the above-named agents:

NAME	TITLE	ADDRESS
_____	_____	_____
_____	_____	_____

3. All the above-named agents are employees of the applicant.

4. (a) Agents will receive the following compensation for their efforts in marketing applicant's securities:

NAME	SALARY	COMMISSIONS (per share *or* per _____ ____ [*number*] shares sold)	SHARES (*or* OPTIONS) (per _____ ____ [*number*] shares sold)
_____	$_____	_____	_____
_____	$_____	_____	_____
_____	$_____	_____	_____
_____	$_____	_____	_____

(b) The supervisory persons listed above will receive the following compensation in addition to their regular salary:

NAME	ADDITIONAL COMPENSATION
_____	_____
_____	_____

5. There is no order, judgment, or decree of any governmental agency or administrator, or of any court of competent jurisdiction revoking or suspending for cause any license, permit, or other authority of any of the above-listed agents or supervisory persons or of any corporation of which any such person is an officer or director, to engage in the securities business or in the sale of a particular security, or temporarily or permanently restraining or enjoining any such person or any corporation of which he or she is an officer or director from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting that person of any felony or misdemeanor involving a security or any aspect of the securities business, or of any offense involving theft or any felony except as follows: _____ [*specify*].

6. A _____ [surety bond complying with the requirements of *Title 10, California Code of Regulations Section 260.216.15 or* deposit in lieu of a bond, pursuant to *Code of Civil Procedure Sections 995.710*

through 995.770,] is attached.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
I. Miscellaneous Forms

3-6H California Legal Forms--Transaction Guide § 6H.273

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.273 Issuer's Bond [Corp. Code § 25216(e); 10 Cal. Code Reg. § 260.216.15]

[1] Comment

[a] Use of Form

This form is an issuer's bond. Any issuer who employs agents in connection with any security or transaction not exempted under the Corporate Securities Law [*see Corp. Code §§ 25100-25105*], in addition to supplying information about those agents [*see § 6H.272*], must furnish and maintain a surety bond in the amount of $10,000 [*Corp. Code § 25216(e)*; *10 Cal. Code Reg. § 260.216.15(a)*]. The bond must be issued by a corporate surety admitted to transact business in California and is conditioned that the issuer will comply with the provisions of the Corporate Securities Law and the rules and orders issued under it. Unless previously canceled, the bond will cover for the entire period that the qualification is in effect [*Corp. Code § 25216(e)*; *10 Cal. Code Reg. § 260.216.15(a)*].

[b] Undertaking/Deposit in Lieu of Bond

The requirement for a bond [*see Corp. Code § 25216(e)*; *10 Cal. Code Reg. § 260.216.15*] may be satisfied by an undertaking that satisfies the requirements for the bond [*see Code Civ. Proc. § 995.210(a)*]. An appropriate deposit of cash or securities in lieu of bond [*see Code Civ. Proc. § 995.710*] may be made [*Corp. Code § 25216(e)*; *see 10 Cal. Code Reg. § 260.216.15(b)* (procedure for making deposit)].

[c] Enforcement of Liability on Bond

No suit may be maintained to enforce any liability on the bond unless it is brought within two years after the contract of sale or other act upon which the suit is based [*Corp. Code § 25216(e)*]. The Commissioner has no authority to adjudicate any claim or controversy against the bond or deposit. Disputed claims must be adjudicated by a court. On the filing of suit and notice to the Commissioner, the Commissioner may turn over all or part of the deposit to the court by means of an interpleader or similar proceeding [*10 Cal. Code Reg. § 260.216.15(c)*].

[2] Form

Issuer's Bond [Corp. Code § 25216(e); 10 Cal. Code Reg. § 260.216.15]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
I. Miscellaneous Forms

3-6H California Legal Forms--Transaction Guide § 6H.274

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.274 Semiannual Reports [Corp. Code § 25146; 10 Cal. Code Reg. § 260.146]

[1] Comment

[a] Use of Form

This form is the semiannual report used to submit the financial information required by the Commissioner [*Corp. Code § 25146*; *10 Cal. Code Reg. § 260.146*; *see* Ch. 7, *Corporate Records and Reports* (forms for financial statements)].

[b] Requirement of Semiannual Reports

The Commissioner may by rule or order require an issuer who has filed an application to file reports, not more often than semiannually and up to a period of 18 months after qualification is effective, for the purpose of keeping reasonably current the information contained in the application [*Corp. Code § 25146*]. However, the Commissioner may not require an issuer to file these reports (1) after completion of the offering if a nonissuer transaction involving that security would be entitled to exemption from qualification pursuant to *Corp. Code § 25101* (issuer's securities listed on certified stock exchange) [*see Corp. Code § 25146*], or (2) if the issuer is filing reports pursuant to Section 13 [*15 U.S.C. § 78m*] or Section 15(d) [*15 U.S.C. § 78o(d)*] of the Securities and Exchange Act of 1934 [*10 Cal. Code Reg. § 260.146*; *see 15 U.S.C. § 78a et seq.*].

An issuer not exempted from filing these reports and that is selling securities pursuant to an open qualification must file the reports (1) within 90 days after the first six months of its fiscal year, and (2) within 120 days after the end of its fiscal year [*10 Cal. Code Reg. § 260.146*].

These reports must be filed until the expiration of 18 months after effectiveness of qualification or until the securities have been qualified for trading in California by nonissuer notification [*Corp. Code § 25131*], whichever occurs first [*10 Cal. Code Reg. § 260.146*].

[c] Books, Records, and Accounts

All issuers qualifying securities for sale in California, whether or not exempted from the requirement of filing semiannual reports, must at all times keep and maintain a complete set of books, records, and accounts of sales under the qualification and of the disposition of the sales proceeds. Whenever required by the Commissioner, an issuer must file a report in the Commissioner's office, setting forth (1) the securities sold by it under the qualification, (2) the proceeds from those sales, and (3) the disposition of the sales proceeds [*Corp. Code § 25145*].

[2] Form

Semiannual Reports [Corp. Code § 25146; 10 Cal. Code Reg. § 260.146]

DE-
PART-
MENT
OF
COR-
PORA-
TIONS
FILE
NO.

(Insert file number of qual-ifica-tion to which report relates.)

Date of Report: _____

DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

SEMI-ANNUAL REPORT PURSUANT TO SECTION 25146 OF THE CORPORATE SECURITIES LAW OF 1968

1. Name of Issuer
2. Address of principal executive office of issuer

   Number and Street City State Zip Code
3. Name and address of person to whom correspondence regarding this report should be addressed
4. There are attached hereto as exhibits the following which are hereby incorporated by reference:

   Financial Statements. (There should be attached to a report filed as of the end of a fiscal year a balance sheet as of that date and a profit and loss statement for the year then ended, covered by an auditor's report contain-

ing an unqualified opinion of an independent certified public accountant or an independent public accountant. There should be attached to a report filed as of the end of the first six months of a fiscal year a balance sheet as of that date and a profit and loss statement for the six-months' period then ended; such statements need not be audited but shall be prepared in accordance with generally accepted accounting principles.)

5. The issuer has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

_____

_____
(Issuer)

By _____

_____
(Title)

I certify (or declare) under penalty of perjury under the laws of the State of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed at _____[*place*], on _____[*date*].

_____
(Signature)

Instructions:

The report should be signed by an officer or general partner of the issuer; however, it may be signed by another person holding a power of attorney for such purposes from the issuer and, if signed on behalf of the issuer pursuant to such power of attorney, should include as an additional exhibit a copy of said power of attorney or a copy of the corporate resolution authorizing the person to sign on behalf of the corporation.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
I. Miscellaneous Forms

3-6H California Legal Forms--Transaction Guide § 6H.275

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.275 Request for Confidential Treatment of Information [10 Cal. Code Reg. § 250.10]

[1] Comment

[a] Use of Form

This form is a request to the Commissioner to treat certain information submitted in the application as confidential. The contents of applications, other related documents, requests for interpretive opinions, determinations, specific rulings, and related correspondence [*see 10 Cal. Code Reg. § 250.12*] are ordinarily open to public inspection during the business hours of the Department of Corporations [*Corp. Code § 25605(a)*; *10 Cal. Code Reg. §§ 250.9*, *250.9.1(a)*]. However, at the request of the applicant, the Commissioner will withhold from public inspection, for what the Commissioner judges to be a "necessary" time, information received in connection with an application (including a request for an interpretive opinion) or report if in the Commissioner's opinion public inspection is not necessary in the public interest or for the purposes of the law under which it is filed, and the information is reasonably shown to meet any of the following requirements [*10 Cal. Code Reg. § 250.10(a)*]:

- The information is of a proprietary business nature and is in fact confidential, including but not limited to trade secrets.

- The information is of a confidential business nature and is in fact confidential, and its release would be damaging or prejudicial to the business concerned.

- The information consists of the name of any present or proposed investor which is filed in an application pursuant to *Corp. Code § 25113*, *25121*, or *25133*, and the disclosure of that information may be damaging or prejudicial to that person.

- Any other information, on a showing that a public interest is served in withholding that information.

[b] Contents of Request

The request should accompany the submission of the information provided in connection with the application or request or report. The potentially confidential information must be submitted separated from other parts of the filing and must be marked "Confidential Treatment Requested." The request must be signed by the person making the application or report and contain the following [*10 Cal. Code Reg. § 250.10(b)*]:

- A statement identifying the relevant application or report and the information that is the subject of the request.

- A statement specifying the applicable provisions of *10 Cal. Code Reg. § 250.10(a)* [*see* [a], *above*].

- A statement of the grounds on which the request is made, including (if applicable) a statement as to, and measures taken to protect, its confidentiality, and a statement of the adverse consequences expected to result if that information is disclosed.

- If the request seeks to protect the name of any investor [pursuant to *10 Cal. Code Reg. § 250.10(a)(3)*; *see* [a], *above*], a statement that the investor is not required to disclose investments pursuant to the Political Reform Act of 1975 or a similar statute.

- A statement of the specific time for which the confidential treatment is necessary, and the basis for those conclusions.

- If appropriate, a statement of the extent to which that information has been or will be disclosed to present or proposed investors, or other persons appropriate under the statute pursuant to which the information is filed.

The request itself should not contain any information for which confidential treatment is desired, as requests will be available for public inspection [*10 Cal. Code Reg. § 250.10(b)(7)*].

[c] Denial of Request

Because materials submitted pursuant to such a request are not deemed filed unless the request is granted, the applicant may withdraw the material if the application is denied, unless: (1) the Commissioner has already taken an official action in reliance on that information prior to receiving the request for confidential treatment, or (2) the Commissioner determines that the withdrawal is otherwise contrary to the public interest. If withdrawn, the information will not be considered by the Commissioner in connection with the application or report [*10 Cal. Code Reg. § 250.10(c)*].

[d] Granting of Request

If the request is granted, the applicant or person making the request will be notified in writing, the information will be marked "confidential" and kept separate from the public file, and the application will be noted with the following legend: "Additional portions of this filing have been granted confidential treatment pursuant to Rule 250.10 and are contained in a separate confidential file" [*10 Cal. Code Reg. § 250.10(d)*].

[e] Disclosure of Confidential Information

Confidential information may be disclosed by the Commissioner, at any time and in the Commissioner's sole discretion, whether on the Commissioner's own motion or on the request of any person, as follows [*10 Cal. Code Reg. § 250.10.5(a)*]:

- To other state or federal regulatory agencies, in accordance with law.

- When necessary or appropriate in any proceeding or investigation pursuant to the law on which the information if filed.

- On the Commissioner's determination that continued confidential treatment is no longer justified because either the reasons for such treatment no longer exist, or the public interest in the disclosure outweighs the public interest in not doing so. Normally, the person who originally requested the confidential treatment will be given notice that such an action is under consideration and the reasons why, and will be given the opportunity to make representations promptly, within not more than five business days, concerning the continued need and justification for continued confidentiality. However, if the Commissioner concludes that the disclosure is necessary and urgent in the public interest, or that notice is impractical under the circumstances, the information may be disclosed without notice [*10 Cal. Code Reg. § 250.10.5(a)*].

Any requests to inspect confidential information based on the third ground, *above*, ordinarily must be in writing, signed by the requestor, and state the justifications for the request. A copy of the request will ordinarily be forwarded to the person who requested confidential treatment of the information. If the request itself should be held confidential, the reasons must be stated in the request, in accordance with *10 Cal. Code Reg. § 250.10(b)* [*10 Cal. Code Reg. § 250.10.5(b)*; *see* [b], *above*].

These disclosure provisions do not provide any person a right to withdraw information once the Commissioner has received it, except as provided in *10 Cal. Code Reg. § 250.10(c)* [*10 Cal. Code Reg. § 250.10.5(c)*; *see* [c], *above*].

[2] Form

Request for Confidential Treatment of Information [10 Cal. Code Reg. § 250.10]

File No. _____

Date _____

DEPARTMENT OF CORPORATIONS STATE OF CALIFORNIA

REQUEST FOR CONFIDENTIAL TREATMENT OF INFORMATION PROVIDE IN CONNECTION WITH ACCOMPANYING APPLICATION FOR QUALIFICATION [*or other type of filing or request for interpretive opinion*] OF _____ [*applicant*]

Identification of Material

Applicant requests that the attached material, marked "Confidential Treatment Requested," being provided in connection with the separately attached application for qualification by _____ [permit, notification, coordination, *or other type of filing*] be treated confidentially and handled separately from the public portion of that application by the Department. That material consists of _____ [*e.g.*, identification and profile of select customers to be contacted for service by Applicant].

Basis of Request

This request is made pursuant to *Title 10, California Code of Regulations Section 250.10(a)* in that the information which is the subject of the request _____[*specify applicable provision(s) of 10 Cal. Code Reg. § 250.10(a), e.g.*, is of a proprietary business nature and is in fact confidential].

Justification for Confidential Withholding

[*Specify, e.g.*, This list of select potential customers should remain confidential for the following reasons. The list was put together only after a year of difficult and expensive research, utilizing the services of several renowned marketing experts and statisticians familiar with Applicant's industry. The total cost of this research was approximately $_____. The contents of the list have been disclosed to a small number of authorized personnel. Any other disclosure of this valuable trade secret would be devastating in that the list could not be duplicated by any amount of original work on Applicant's part if it were to become worthless or diminished in importance because of disclosure to competitors or others. Thus a large investment in developing this list would be lost if competitors took advantage of it. In addition, it would be a humiliating circumstance for selling companies in the industry to be revealed either to have been included or excluded from the list of potential customers.

Furthermore, Applicant will attract investors because of the product it has developed. These investors will assume that this product can be easily marketed as soon as research and refinement provided by new financing from the stock issue bring the product to finished form. During that period it might be reasonably expected Applicant would attempt to solicit customers. But Applicant already has done much of its marketing homework by developing the attached customer list, a bonus to its investors and a further proof to the Commissioner that its operations are sound and promising.

Nor is disclosure necessary in the public interest in that it is not newsworthy or informative in respect to governmental matters or public affairs in any legitimate way. On the other hand, disclosure would be detrimental to the public interest in that there might be a scramble among competitors and fringe-related industrial sources to solicit the intended customers, tending to hamper development of a quality product in an area of importance to the consumer public, leading to a quick disappointment in the use of those products in the mind of the public and a discontinuance of development in the industry.]

[*Add, if request seeks to protect the name of any investor:*]

Disclosure by Investor(s) Not Required

The _____ [present *or* proposed] investor[s] _____ [is *or* are] not required to disclose investments pursuant to the Political Reform Act of 1975 [*or other statute as appropriate*].

Duration of Confidential Treatment

Applicant requests that this material remain confidential for _____ [*specify length of time*]. This time period is necessary because _____ [*specify, e.g.*, detailed presentations will be required in connection with the solicitation of customers. In view of the large number of potential customers included in this list, this time-consuming process cannot be completed in fewer than three months].

[*Add, if appropriate:*]

Disclosure to Investors

This information _____ [has been *or* will be] disclosed to _____ [present *or* proposed] investors _____ [*or other persons appropriate under the statute pursuant to which the information is filed*] in the following manner: _____ [*specify*].

_____ [*name of applicant*]

By _____ [*signature*]

[*typed name and title*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
I. Miscellaneous Forms

3-6H California Legal Forms--Transaction Guide § 6H.276

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.276 Request for Refund of Filing Fee [10 Cal. Code Reg. § 250.15]

[1] Comment--Use of Form

This is an application for a refund of a filing fee. Generally, applicants are not entitled to a refund of fees submitted with applications or requests, whether or not granted [*10 Cal. Code Reg. § 250.15*]. For example, there is no refund on abandonment or withdrawal of an application [*10 Cal. Code Reg. § 250.16*]. When an excess fee has been paid, the excess payment is generally refunded without the necessity of a request [*10 Cal. Code Reg. § 250.15*]. In certain circumstances, however, an oversight of the Department or a question of fact may be involved. Refunds also may be available when the applicant was eligible for an exemption, or when the offering was not of a security within the meaning of the Securities Law [*Corp. Code § 25019*].

The applicant is not entitled to a refund if he or she overestimates the price that the applicant will receive for the shares, or the number that the applicant could sell, since the fees for issuer transactions are calculated on the basis of the value of the securities proposed to be sold in the transaction [*see Corp. Code § 25608(c)*]. The value of the securities is the greater of any of the following [*Corp. Code § 25608(g)(1)*]:

- The price at which the company proposes to sell the securities;
- The value as alleged in the application;
- The actual value, as determined by the Commissioner, of the consideration (if other than money) to be received in exchange for the securities; or
- The actual value, as determined by the Commissioner, of the securities when sold.

Whenever a provision is made in the securities law for a collection of fees, but none is made for refund, the refund

should be made on the following grounds [*see Gov. Code § 13143*; *see also 10 Cal. Code Reg. § 250.15*]:

- The proper amount of the fee (that is, overpayment);
- The necessity of making or securing a permit, filing, examination, or inspection;
- The sufficiency of the credentials of the applicant; and
- The eligibility of the applicant for any other reason.

A request should be in the form of a letter addressed to the office that processed the filing for which the fee was paid [*10 Cal. Code Reg. § 250.15*]. A request for refund should specify all of the following [*10 Cal. Code Reg. § 250.15*]:

- The name of the applicant.
- The law under which the application was filed and the filing date.
- The number of the receipt issued for the filing fees paid to the Department, and the total amount paid.
- The amount of the refund claimed as due and the grounds on which the claim is based.

[2] Form

Request for Refund of Filing Fee [10 Cal. Code Reg. § 250.15]

_____[*date*]

Commissioner of Corporations
_____ [*address of office where fee was paid*]

RE: File No. _____
_____ [*name of applicant*]
Request for Refund of Filing Fee

This request concerns _____ [*name of applicant*], an applicant before this Department.

This _____ [*form of entity, e.g.,* corporation] filed a(n) _____ [*type of filing, e.g.,* application for qualification by permit] under Corporations Code Section _____ [*e.g.,* 25113] on _____[*date*], at the above-addressed office.

The receipt number for the filing is _____ for which filing applicant paid the sum of $_____ [*amount shown on receipt*].

Applicant claims it is due and requests a refund of that filing fee in the amount of $_____ [*amount claimed as refund only, whether whole amount paid or only portion*].

_____ [*State basis for refund claim*].

Please send the refund to _____ [*name and address*]. If there are any further questions, please call the

undersigned at the letterhead telephone number.

Sincerely, _____ [*signature*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6H QUALIFICATION OF SECURITIES
PART IV. FORMS
I. Miscellaneous Forms

3-6H California Legal Forms--Transaction Guide § 6H.277

AUTHOR: Frances E. Lossing Practice Consultant

§ 6H.277 Request for Consent to Withdraw Application [10 Cal. Code Reg. § 250.16]

[1] Comment--Use of Form

This form is a request to withdraw an application submitted to the Department of Corporations. The Department may make one or more requests of the applicant to submit further information for consideration, or to complete unanswered items on the original application. If the applicant does not respond or complete the showing within a reasonable time, the Commissioner may order the abandonment of the application by notice to the applicant [*10 Cal. Code Reg. § 250.16*].

In some cases, it may be in the applicant's interest to withdraw an application and the applicant may do so by formally requesting the Commissioner's consent to that withdrawal. In either event there can be no refund of filing fees [*10 Cal. Code Reg. § 250.16*]. Since the form is not specified in the Corporate Securities Law or the Commissioner's rules for request for consent of withdrawal, the following is a suggested form for this request. It may be possible to orally request the withdrawal.

[2] Form

Request for Consent to Withdraw Application [10 Cal. Code Reg. § 250.16]

File No. _____
[*Insert file number of pending application*]

Date of Request: _____

DEPARTMENT OF CORPORATIONS
STATE OF CALIFORNIA

REQUEST FOR WITHDRAWAL OF PENDING APPLICATION FOR QUALIFICATION BY _____ [COORDINATION *or* NOTIFICATION *or* PERMIT]

1. Name of applicant: _____.

2. Address of principal place of business: _____

3. Applicant is a _____ [corporation *or* trust *or other entity*].

4. The name and address of the person to whom correspondence regarding this request for withdrawal should be addressed is _____.

5. The grounds that justify the withdrawal of this pending application are _____.

[*Specify, e.g.,* _____ (*name*), the leading promoter of applicant corporation, who was the one party responsible for providing the expert guidance along lines of guiding the business and interesting sophisticated investors in this enterprise, recently died unexpectedly at _____ (years) of age. There is no party to replace _____ (him *or* her) presently in the contemplated enterprise, and all parties acting on behalf of applicant, including promoters, proposed underwriters and dealers, and proposed private issuees have agreed to abandon the enterprise for the present. They wish to leave the corporation an empty entity until the franchise comes up for renewal on _____ (*date*), at which time they will reconsider, at the latest, whether to continue in existence or not.]

The applicant has duly caused this application to be signed on its behalf by the undersigned, thereunto duly authorized.

_____ [*name of applicant*]

By _____ [*signature*]

[*typed name and title*]

I certify (or declare) under penalty of perjury under the laws of the State of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed at _____, California, _____[*date*].

_____ [*signature of declarant*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES

3-6I California Legal Forms--Transaction Guide 6I.syn

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.syn Synopsis to Chapter 6I: ISSUANCE OF EQUITY SECURITIES

§ 6I.01 California Sources

[1] Statutes

[2] Regulations

§§ 6I.02-6I.04 [Reserved]

§ 6I.05 Law Reviews

§ 6I.06 Annotations

§ 6I.07 Text References

[1] Matthew Bender Sources

[2] Other Sources

§§ 6I.08-6I.09 [Reserved]

§ 6I.10 "Shares" Defined

§ 6I.11 Issuance of Shares

§ 6I.12 Classes and Series of Shares

§ 6I.13 Rights, Preferences, Privileges, and Restrictions

[1] Authorization

[2] Rights

[3] Preferences

[4] Privileges

[5] Restrictions

[6] Rights of a Class

§ 6I.14 Common Shares

[1] Definition

[2] Typical Attributes

§ 6I.15 Preferred Shares

[1] Definition

[2] Typical Characteristics

[3] Liquidation Preference

[4] Comparison to Common Shares and Debt Securities

§ 6I.16 Convertible Shares

§ 6I.17 Options

§ 6I.18 Consideration for Shares

§ 6I.19 Par Value

§ 6I.20 Share Certificates

[1] Issuance

[2] Uncertificated Securities

[3] Indirect Holding System

§ 6I.21 Section 1244 Stock

[1] Tax Treatment

[2] Requirements Applicable to Issuer and Shares

[3] Only Individuals Eligible for Ordinary Loss Benefits

[4] When Loss Occurs

§§ 6I.22-6I.99 [Reserved]

§ 6I.100 Facts

Scope

§ 6I.101 Documents

Scope

§§ 6I.102-6I.109 [Reserved]

§ 6I.110 Financial Considerations

Scope

§ 6I.111 Common Stock

Scope

§ 6I.112 Preferred Stock

Scope

§ 6I.113 Consideration for Securities

Scope

§ 6I.114 Allocation of Control and Investment Risk

[1] Corporation Deriving Initial Capital Solely From Organizers

Scope

[2] Corporation That Will Seek Outside Capital for Initial Financing

Scope

§ 6I.115 Share Structure of Corporation

Scope

§ 6I.116 Issues in Connection With Qualification

Scope

§§ 6I.117-6I.129 [Reserved]

§ 6I.130 Preparing Equity Security Documents for Board of Directors

Scope

§ 6I.131 Adopting Formal Resolutions Necessary to Issuance

Scope

§ 6I.132 Issuing Shares

Scope

§§ 6I.133-6I.199 [Reserved]

§ 6I.200 Common Share Certificate

[1] Comment

[a] Use of Form

[b] Nature of Common Shares

[c] Issuance

[d] Signatures

[e] Contents of Certificate--In General

[f] Placement "On the Certificate"

[g] Close Corporation Share Certificates

[h] Limited Offering Qualification Share Certificates

[i] Professional Corporation Share Certificates

[j] Shares Subject to Assessments

[k] Promotional Shares and Limited Offering Transfer Restrictions

[l] Federal Securities Legend--In General

[m] Intrastate Offerings

[n] Regulation D Offerings

[o] Endorsement of Share Certificate

[2] FORM

Common Share Certificate

§ 6I.201 Preferred Share Certificate

[1] Comment

[a] Use of Form

[b] Difference Between Preferred and Common Shares

[2] FORM

Preferred Share Certificate

§ 6I.202 Statements on Certificate Concerning Partly Paid Shares

[1] Comment

[a] Use of Form

[b] Issuance and Liability of Issuee

[c] Lien for Unpaid Balance

[d] Share Incidents of Partly Paid Shares

[e] Liability of Transferee

[f] Liability to Corporation's Creditors

[2] FORM

Statements on Certificate Concerning Partly Paid Shares

§ 6I.203 Legend on Certificate for Assessment Lien [Corp. Code § 423(e)]

[1] Comment

[a] Use of Form

[b] Basis for Assessment

[c] Securities Requirements

[d] Assessment Levy

[e] Notification of Assessment

[f] Assessment Lien

[g] Extension of Sale Date

[h] Payment Before Sale

[i] Conduct of Sale or Extension Proceeding

[j] Surrender of Old Certificate

[k] Certificate as Evidence of Sale

[l] Effect of Errors or Omissions in Enforcement Procedure

[m] Action for Improper Sale

[n] Creditor's Pursuit of Former Shareholder's Interest

[o] Alternative Remedy of Action

[2] FORM

Legend on Certificate for Assessment Lien [Corp. Code § 423(e)]

§ 6I.204 Scrip Certificate for Fraction of a Share

[1] Comment

[a] Use of Form

[b] Fractional Shares

[c] Special Alternative in Reorganizations

[d] Nature and Incidents of Scrip for Fractional Shares

[2] FORM

Scrip Certificate for Fraction of a Share

§§ 6I.205-6I.209 [Reserved]

§ 6I.210 Resolution Authorizing Issuance, Qualification, and Sale of Shares

[1] Comment--Use of Form

[2] FORM

Resolution Authorizing Issuance, Qualification, and Sale of Shares

§ 6I.211 Resolution Identifying Offerees or Proposed Purchasers

[1] Comment--Use of Form

[2] FORM

Resolution Identifying Offerees or Proposed Purchasers

§ 6I.212 Resolution Adopting Form of Share Certificate

[1] Comment--Use of Form

[2] FORM

Resolution Adopting Form of Share Certificate

§§ 6I.213-6I.219 [Reserved]

§ 6I.220 Resolution Stating the Consideration to Be Received for Stock

[1] Comment

[a] Use of Form

[b] Price of Issuance

[c] Kinds of Consideration

[d] Liability for Payment

[e] Related Factors

[2] FORM

Resolution Stating the Consideration to Be Received for Stock

§ 6I.221 Resolution Determining the Fair Value of Consideration Other Than Money

[1] Comment

[a] Use of Form

[b] Determination of Fair Value

[c] Valuation Factors

[d] Fraudulently Overvalued Consideration

[2] FORM

Resolution Determining the Fair Value of Consideration Other Than Money

§ 6I.222 Resolution Limiting Selling Expenses [Corp. Code § 25140; 10 Cal. Code Reg. § 260.140.20]

[1] Comment--Use of Form

[2] FORM

Resolution Limiting Selling Expenses [Corp. Code § 25141; 10 Cal. Code Reg. § 260.140.20]

§ 6I.223 Resolution Allowing Issuance of Partly Paid Shares

[1] Comment--Use of Form

[2] FORM

Resolution Allowing Issuance of Partly Paid Shares

§ 6I.224 Resolutions Authorizing Promotional Shares and Expenses

[1] Comment

[a] Use of Form

[b] Definition of Promotional Shares

[c] Examples of Services for Which Promotional Securities Might Be Issued

[d] Regulation of Amount of Promotional Shares

[e] Reimbursement of Promoters' Expenses

[f] Limitations on the Rights of Promotional Shares

[g] Resolutions Regarding Promotional Shares

[2] FORM

Resolutions Authorizing Promotional Shares and Expenses

§§ 6I.225-6I.229 [Reserved]

§ 6I.230 Resolutions Authorizing Officers to File Notices of Exemption or Applications for Qualification Under California Corporate Securities Law

[1] Comment--Use of Form

[2] FORM

Resolutions Authorizing Officers to File Notices of Exemption or Applications for Qualification Under California Corporate Securities Law

§ 6I.231 Resolution Authorizing Application for Sale of Securities Under the Laws of Other States

[1] Comment--Use of Form

[2] FORM

Resolution Authorizing Application for Sale of Securities Under the Laws of Other States

§ 6I.232 Resolution Authorizing Filing of Registration Statement or Notification With the Securities and Exchange Commission

[1] Comment--Use of Form

[2] FORM

Resolution Authorizing Filing of Registration Statement or Notification With the Securities and Exchange Commission

§§ 6I.233-6I.239 [Reserved]

§ 6I.240 Incentive Stock Option Plan

[1] Comment

[a] Use of Form

[b] Authorization for Stock Option Plans

[c] Basic Tax Treatment of Incentive Stock Options

[d] Internal Revenue Code Requirements

[e] Provisions of Plan

[f] Adoption and Approval of Plan

[g] Securities Law Requirements in General

[h] Special Exemption When Issuer Has Registered Under Federal Securities Exchange Act

[i] Plan Requirements for Qualification by Permit

[j] Contents of Plan

[k] Plan Documentation

[l] Limitation on Number of Shares

[m] Acquisition and Divestment of Subsidiary Corporation

[2] FORM

Incentive Stock Option Plan

§ 6I.241 Directors' Resolution Adopting Incentive Stock Option Plan

[1] Comment

[a] Use of Form

[b] Adoption Requirement

[c] Proof of Proceedings

[2] FORM

Directors' Resolution Adopting Incentive Stock Option Plan

§ 6I.242 Resolution of Shareholders Approving Incentive Stock Option Plan

[1] Comment

[a] Use of Form

[b] Approval of Shareholders

[2] FORM

Resolution of Shareholders Approving Incentive Stock Option Plan

§§ 6I.243-6I.249 [Reserved]

§ 6I.250 Stock Purchase Warrant or Subscription Warrant

[1] Comment

[a] Use of Form

[b] Characteristics of Warrants

[c] Distinguished From Evidence of Fractional Shares

[d] Authorization for Issuing Warrants and Stock

[e] Stock Purchase Warrants in General

[f] Stock Purchase Warrants Distinguished From Convertible Securities

[g] Subscription Warrants

[h] Securities Laws Considerations

[i] Qualification Requirements

[j] Warrants to Purchasers of Equity Securities

[k] Pro Rata Subscription Rights

[l] Tax Considerations Related to Receipt of Warrants

[m] Tax Considerations Related to Disposition of Warrant Before Exercise

[2] FORM

Stock Purchase Warrant or Subscription Warrant

§ 6I.251 Resolutions Authorizing the Offer and Sale of Warrants

[1] Comment

[a] Use of Form

[b] Types of Warrants

[c] Securities Law Requirements

[d] Proof of Proceedings

[2] FORM

Resolutions Authorizing the Offer and Sale of Warrants

§§ 6I.252-6I.259 [Reserved]

§ 6I.260 Resolution Approving Form of Subscription Agreement or Sales Contract

[1] Comment--Use of Form

[2] FORM

Resolution Approving Form of Subscription Agreement or Sales Contract

§ 6I.261 Subscription Agreement for Shares in California Corporation--Purchase Price Payable in Cash on Execution of Agreement--Public Offering to California Residents

[1] Comment

[a] Use of Form

[b] When Subscription Agreement Is Required

[c] Contents of Agreement

[d] Delivery of Copies

[e] Qualification Requirement

[f] Operation of Impound Conditions

[g] Exemption From Federal Securities Regulation

[2] FORM

Subscription Agreement for Shares in California Corporation--Purchase Price Payable in Cash on Execution of Agreement--Public Offering to California Residents

§ 6I.262 Subscription Agreement for Shares in California Corporation--Purchase Price Payable in Installments--Public Offering to California Residents

[1] Comment

[a] Use of Form

[b] Requirement for Receipt

[2] FORM

Subscription Agreement for Shares in California Corporation--Purchase Price Payable in Installments--Public Offering to California Residents

§ 6I.263 Receipt for Installment Payment

[1] Comment--Use of Form

[2] FORM

Receipt for Installment Payment

Marilyn Mingern*

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FOOTNOTES:

(n5)Footnote *. Marilyn E. Minger is a sole practitioner in Oakland, California, specializing in business, personal injury, bankruptcy, and probate. Ms. Minger formerly worked for Heller, Ehrman, White & McAuliffe and Pettit & Martin in San Francisco, where she practiced corporate law.

(n6)Footnote **. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES

3-6I California Legal Forms--Transaction Guide Scope

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

Scope

Marilyn Mingern* Frances E. Lossingn**
Practice Consultant Scope

This chapter covers the issuance of common and preferred shares authorized by the articles of incorporation of a California corporation, the adoption of the necessary resolutions, and the preparation of subscription agreements and sales contracts. The Legal Background discusses classes and series of shares, the nature and incidents of common and preferred shares, convertible shares, types of consideration for shares, issuance of certificated and uncertificated securities, the concept of par value, and the incidents of "Section 1244 stock." The Transaction Guide discusses financial considerations in planning an issuance of securities, the incidents of common and preferred shares, issues in connection with securities that have to be qualified for sale in California, preparation of documents, resolutions by the board of directors, and actual issuance of the shares.

The forms include representative common and preferred share certificates, resolutions of the board of directors authorizing the issuance of securities, adopting the form of share certificate to be used by the corporation, stating the consideration to be received for stock, limiting the expenses of sale, allowing the issuance of partly paid shares or promotional shares, and authorizing the officers of the corporation to take the necessary steps to comply with the applicable securities laws. The chapter also includes forms for an incentive stock option plan and related resolutions, stock purchase or subscription warrants and related resolutions, and subscription agreements and sales contracts for shares.

For a discussion of the basic securities law considerations applicable to an issuance of shares, see Ch. 6, *Securities Regulation Issues* . For discussion of the qualification of securities in California, see Ch. 6H, *Qualification of Securities* . Commonly-used exemptions from the California qualification requirements are discussed in Ch. 6B, *California Limited Offering Exemptions* , Ch. 6C, *California Small Offering Exemption* , and Ch. 6D, *California Qualified Purchaser Exemptions* . For discussion of federal securities law and federal exemptions under the federal Securities Act of 1933, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* . The issuance of non-equity securities such as notes and debentures is discussed in Ch. 6J, *Issuance of Debt Securities* . For discussion of provisions in the corporate articles of incorporation pertaining to the securities of the corporation, see Ch. 3, *Articles of Incorporation* .

FOOTNOTES:

(n7)Footnote *. Marilyn E. Minger is a sole practitioner in Oakland, California, specializing in business, personal injury, bankruptcy, and probate. Ms. Minger formerly worked for Heller, Ehrman, White & McAuliffe and Pettit & Martin in San Francisco, where she practiced corporate law.

(n8)Footnote **. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



92 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6I California Legal Forms--Transaction Guide § 6I.01

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.01 California Sources

[1] Statutes

Investment Securities, Division 8 of California Commercial Code. *Com. Code §§ 8101-8603*.

Definitions.

Certificated security. *Corp. Code § 156.1*; *Com. Code § 8102(a)(4), (15)*.

Common shares. *Corp. Code § 159*.

Equity security in reorganization context. *Corp. Code § 168*.

Entitlements. *Com. Code §§ 8501-8511*.

Initial transaction statement and written statement. *Corp. Code § 171.1*.

Liquidation price and liquidation preference. *Corp. Code § 172*.

"On the certificate" in context of share certificate. *Corp. Code § 174*.

Preferred shares. *Corp. Code § 176*.

Redemption price. *Corp. Code § 180*.

Series in context of shares. *Corp. Code § 183*.

Shares. *Corp. Code § 184*.

Shareholder. *Corp. Code § 185*.

Uncertificated security. *Corp. Code § 191.1*; *Com. Code § 8102(a)(15), (18)*.

Articles of incorporation--contents as to corporate shares. *Corp. Code §§ 202(d), (e), 204(a)(1)-(3), (8), (b)*.

Par value procedures for nominal or special statutory purposes. *Corp. Code § 205*.

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Redeemable shares. *Corp. Code § 402*.

Convertibility of, or into, shares. *Corp. Code § 403*.

Options for shares. *Corp. Code § 404*.

Preemptive right to shares as abrogated in absence of articles provision. *Corp. Code § 406*.

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Payment for shares. *Corp. Code §§ 409(b), (d), 410(b)*.

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Exchange, reissue, and cancellation of shares. *Corp. Code §§ 419, 422*.

Transfer liabilities. *Corp. Code § 420*.

Assessment rights and procedures. *Corp. Code § 423*.

Redemption. *Corp. Code §§ 500-511*.

Penalty for refusing to register share transfer. *Corp. Code §§ 2201, 2202*.

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Commissioner of Corporations standards with respect to debt and equity offerings. *10 Cal. Code Reg. §§ 260.140.1-260.140.10*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6I California Legal Forms--Transaction Guide §§ 6I.02-6I.04

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

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§§ 6I.02[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6I California Legal Forms--Transaction Guide § 6I.05

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.05 Law Reviews

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6I California Legal Forms--Transaction Guide § 6I.06

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6I California Legal Forms--Transaction Guide § 6I.07

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

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Ch. 85, *Transfers of Property to a Controlled Corporation*.

Ch. 88, *Equity Financing*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6I California Legal Forms--Transaction Guide §§ 6I.08-6I.09

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

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AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.10 "Shares" Defined

Shares are the units into which the proprietary interests in the corporation are divided in its articles [*Corp. Code § 184*]. Subject to any limitations contained in its articles and the applicable laws, a corporation has all the powers of a natural person in the issuance of its own shares [*Corp. Code § 207(d)*]. The articles of incorporation must set forth the total number of shares the corporation is authorized to issue [*Corp. Code § 202(d), (e)(1)*; *see* Ch. 3, *Articles of Incorporation*].

The collective body of shares is popularly referred to as the "stock" of a corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

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AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.11 Issuance of Shares

The term "issuance of shares" is not defined either in the General Corporation Law or in the Corporate Securities Law, but basically refers to the act or contract of a corporation by which a person becomes the owner of new shares. The intent of the parties determines when issuance actually occurs, and their contract frequently discloses this intent [*see People v. Beber (1951) 104 Cal. App. 2d 359, 367-368, 231 P.2d 516]* .

On issuance, the purchaser becomes a shareholder; that is, one who is a holder of record of shares [*Corp. Code § 185*], if this is consistent with the parties' contractual intent [*see People v. Beber (1951) 104 Cal. App. 2d 359, 367-368, 231 P.2d 516]* .

The corporation is required to keep a record of its shareholders at its principal executive office, or at the office of its transfer agent or registrar [*Corp. Code § 1500*]. This record gives the names and addresses of all shareholders of record, and the number and class of shares held by each. The record must be either in written form or in any other form capable of being converted into written form [*Corp. Code § 1500*].

PRACTICE TIP:

Shares of public corporations are frequently held in "street name." In this instance, the record holder will be a broker dealer who holds the shares on behalf of the beneficial owner. The shares may also be held in book entry form. In this case, the record holder will be the nominee of the entity maintaining the books, such as Cede & Co., as the nominee of The Depository Trust Company ("DTC"). The records of DTC will show the name of the broker dealer or other DTC Participant who is holding the shares on behalf of the beneficial owner. Unless the beneficial owners are required to disclose their ownership interest pursuant to Sections 13(d) or 13(g) of the Securities Exchange Act of 1934 or are non-objecting beneficial owners, a public corporation will have little information regarding the beneficial owners of its securities. Additional time will also be needed to solicit votes, since proxy materials must first be sent to the record holder who in turn must send the proxy materials to the beneficial owner. *Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

3-6I California Legal Forms--Transaction Guide § 6I.12

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.12 Classes and Series of Shares

A corporation may issue shares in one or more classes or series, or in both classes and series. The characteristics attaching to each class or series are those that are stated in or authorized by the corporation's articles of incorporation. An appropriate authorizing article enables the board of directors to fix the classes or series of shares, including the size of the class or series, the rights, preferences, privileges, and restrictions attaching to each class of shares, and to issue newly designated shares of any class or series after the filing of a certificate of determination setting forth a copy of the resolution [*Corp. Code §§ 156, 401*; *see* Ch. 3, *Articles of Incorporation*].

All shares within a particular class must have the same rights, preferences, privileges, and restrictions, except to the extent that the class is further divided into series. A "series" is itself composed of shares that all have the same rights, preferences, privileges, and restrictions [*Corp. Code § 400(b)*]. Shares of different series within the same class often vary only by a single characteristic, such as time of redemption or amount of preference, and are more often found among preferred shares than common shares.

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

3-6I California Legal Forms--Transaction Guide § 6I.13

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.13 Rights, Preferences, Privileges, and Restrictions

[1] Authorization

The corporation may attach different rights, preferences, privileges, and restrictions to each class or series of shares issued by the corporation [*see Corp. Code § 400(a)*]. The specific rights, preferences, privileges and restrictions must be set forth (1) directly in the articles of incorporation; or (2) in a resolution adopted by the board of directors and authorized by the articles of incorporation [*Corp. Code § 400(a)*].

There are no definitions of the terms "rights," "preferences," "privileges," and "restrictions" concepts in the General Corporation Law, although the terms are employed throughout. Nor have the terms been precisely defined in other applicable laws. These concepts, however, impose limitations on a corporation's ability to authorize issuance of shares.

[2] Rights

A "right" typically refers to an advantage that flows to the shareholder, by virtue of holding a particular kind of share, on a routine and repeating basis. The ability to vote for management positions is a right. The entitlement to receive dividends when available and as declared is another right.

[3] Preferences

A "preference" appears to be an intensive version of a right, representing a priority of position with respect to fully taking or receiving action before similar rights may be recognized. A "liquidation preference," for example, has to do with amounts payable on certain shares on distribution of the entirety of the corporate assets in priority to amounts payable to other shares [*see Corp. Code § 172*]. Another common preference is a preference with respect to payment of dividends.

[4] Privileges

A "privilege" denotes a right that is not essential to the corporate complex, which is not granted to all security holders or exercisable by one group in the absence of another, and once granted need not be exercised to keep the underlying corporate machinery moving. An example of a privilege is the characteristic of conversion, the ability to change the nature of one's security holding on demand [*see Corp. Code § 403(a)*]. Another is the ability to cause the corporation to redeem shares [*see Corp. Code § 402*]. A shareholder might retain these privileges without ever exercising them, or by acting on them at a time independent of that chosen by other holders of the benefit. Their value and utility are more a matter of speculation, whereas the employment of voting and the distribution of dividends are of a more crucial nature to the continuous operation of the company.

[5] Restrictions

A "restriction" identifies a particular limitation that might otherwise have been included as a right--or at least some question as to that fact might have existed. A restriction creates an inability to exercise or a limitation on the exercise of a right or privilege. Limitations on voting [*see Corp. Code § 400(a)*] or on transferring shares [*see Corp. Code § 418(a)(1)*] are more common. Restrictions may be imposed by the terms of the securities, by other terms of the corporation's articles of incorporation, or by California law.

[6] Rights of a Class

The General Corporation Law specifies that all shares of an undivided class, or any series within that class, must have the same voting, conversion, and redemption characteristics (referred to within that law as a "right") as well as the same rights, preferences, privileges, and restrictions [*Corp. Code § 400(b)*]. The corporation may issue one or more classes or series with full, limited, or no voting rights. However, no denial or limitation of voting rights is effective unless at the time one or more classes or series of outstanding shares or debt securities, singly or in the aggregate, are entitled to full voting rights. Attempted denial or limitation of dividend or liquidation rights with respect to outstanding shares are treated in the same manner [*Corp. Code § 400(a)*]. Generally no redeemable common shares may be issued unless the corporation has an outstanding class of common shares that is not subject to redemption [*Corp. Code § 402(c)*]. Transfer restrictions will not be effective unless stated on the share certificate in required form [*see Corp. Code § 418(a)(1)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

3-6I California Legal Forms--Transaction Guide § 6I.14

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.14 Common Shares

[1] Definition

In California, "common shares" are technically defined as shares that have no preferences over any other shares with respect to distributions of assets on liquidation or with respect to payment of dividends [*Corp. Code § 159*]. However, they may have any complex of rights, privileges, and restrictions, whether or not any of those characteristics are possessed as well by other classes of stock. Common shares may also contain any kind of preference other than one that gives the holder a priority position for payments of dividend, whenever or however disbursed, or of assets distributed on liquidation. Lacking a financial preference, common shareholders take the greatest risk position among the various corporate investor groups.

[2] Typical Attributes

Typically the common shares carry unlimited voting power, except in times of financial crisis in which some voting power may be temporarily transferred to classes with distribution preferences to common shareholders. In addition, common shares usually are not subject to redemption by the corporation and therefore continue indefinitely. They do not normally carry conversion rights, but they may be accompanied by options for further shares or for securities of another class or representing indebtedness, possibly carrying conversion rights.

Common shares do not have a fixed dividend or dissolution rate of payment. In the case of dividends, they share in whatever amount the directors have declared, so long as the declaration is proper in the light of prohibitions against improper distributions [*see Corp. Code §§ 500-503*], and after amounts have been paid to classes having preferences. On liquidation, the common shares divide the assets after payment of all debts and liabilities, and after assets are distributed to classes entitled to preference [*see Corp. Code § 2004*].

Legal Topics:

For related research and practice materials, see the following legal topics:

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

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AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.15 Preferred Shares

[1] Definition

In California, the term "preferred shares" refers to any shares other than common shares [*Corp. Code § 176*]. Thus, preferred shares must have either a preference over any other shares with respect to distribution of assets on liquidation, or with respect to payment of dividends, or both [*see Corp. Code § 159*]. Preferred shares otherwise may have any other rights, privileges, or restrictions, or any other definable form of preference permitted by California law.

[2] Typical Characteristics

Preferred shares typically do have both kinds of preferences mentioned in [1], *above*. The dividend usually is for a fixed amount or fixed percentage annually. Usually the kind of dividend to which the preferred share is entitled is cumulative in nature. If a dividend is not declared, or if it is declared but is neither earned nor paid, the right to the dividend is carried over until it is paid before there can be any dividend on the common shares [*see Fawkes v. Farm Lands Invest. Co. (1931) 112 Cal. App. 374, 377, 380, 297 P. 47]* . If the preferred shares do not have a further claim to the dividends, they are referred to as nonparticipating in nature. If some formula is followed, however, such as allowing the preferred shares to take the remainder of dividends available equally with the common stock, or at least after the common shareholder has been paid the amount equivalent to that first allocated to the preferred by virtue of its preference, then the preferred shares are called "participating" [*see Bank of America v. West End etc. Co. (1940) 37 Cal. App. 2d 685, 690, 691, 100 P.2d 318]* .

[3] Liquidation Preference

A "liquidation preference" is the same as a "liquidation price," and means amounts payable on shares of a class on voluntary or involuntary dissolution, winding up, or distribution of the entire assets of the corporation, including any cumulative dividends accrued and unpaid, in priority to shares of some other class or classes [*Corp. Code § 172*]. This is usually for a fixed amount or a fixed percentage of payment. Although cumulative dividends remaining unpaid are brought forward for ultimate payment along with the preferred split of the assets on distribution [*see also Corp. Code §*

2004], there appears to be no entitlement to participate along with the common shares in the division of the assets remaining after payment of debts, liabilities, and then preferred distribution of assets, in the absence of an express provision to that effect, whether or not there has been contractual arrangement for participating in dividends.

[4] Comparison to Common Shares and Debt Securities

Preferred shareholders are in a more favorable position than common shareholders in terms of the priority of return on investment and the security of the investment itself. The corporation is contractually obligated to pay the rate of return on preferred shares, and preferred shareholders are entitled to dividends before common shareholders are so entitled. In contrast to the holders of debt securities, preferred shareholders have proprietary interests in the corporation that exist as long as the corporation exists unless the shareholder-corporation relationship is terminated by redemption. Commonly, preferred shares have liquidation preferences that entitle the holders to reach the corporate assets before the holders of common shares.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsShareholdersGeneral OverviewSecurities LawGeneral Overview



104 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

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AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.16 Convertible Shares

A corporation may issue shares that are convertible into shares of any class or series. Conversion may be limited to take place within a prescribed time period, or only on the happening of one or more specific events, and on such terms and conditions as are stated in the articles. Conversion may be exercised at the option of the holder of the privilege only (except in the case of certain corporations) or may occur automatically on the happening of certain events [*Corp. Code § 403(a)*]. There are also provisions for convertible debt securities to be convertible into shares [*see Corp. Code § 403(b)*; *see also* Ch. 6J, *Issuance of Debt Securities*].

PRACTICE TIP:

Prior to issuing any convertible securities, options or warrants, the corporation should make certain that it has a sufficient number of shares authorized in its articles of incorporation in order for it to be able to fulfill its contractual commitments. In addition, the corporation should reserve sufficient shares for issuance in order to make certain that the corporation does not in the future issue additional shares or commit to issue additional shares in excess of the number of shares authorized to be issued in its articles of incorporation. *Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

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AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.17 Options

An "option" is a device or product whereby the purchaser is purchasing only the right to purchase or subscribe to shares at a later time under conditions specified in the option or other controlling document. An option may be granted in connection with the issue, subscription, or sale of shares (or other securities) or independently of any of those events. Option rights may be transferable or nontransferable, and they may be separable or inseparable from the shares (or other securities) of the corporation [*Corp. Code § 404*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

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AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.18 Consideration for Shares

The consideration received for shares constitutes the basic equity funding or capital of the company, and is determined from time to time by the board of directors, or by the shareholders if the articles so provide [*Corp. Code § 409(a)(1)*]. It may take the form of money paid or labor done. It may also consist of services which in fact have been rendered to the corporation, or for its benefit, or in its formation or reorganization. Further, it may be composed of debts or securities which are thereby canceled. Finally, it may be made up of tangible or intangible property actually received, either by the issuing corporation or by its wholly owned subsidiary. In no event, however, may payment or part payment for shares be represented by future services, nor by promissory notes of the purchaser unless adequately secured by collateral other than the shares being acquired (and except for certain employee stock plans) [*Corp. Code § 409(a)*].

The board must state by resolution its determination of the fair value to the corporation in monetary terms of any consideration other than money for which shares are issued [*Corp. Code § 409(e)*]. In the absence of fraud in the transaction, their judgment as to such value is conclusive [*Corp. Code § 409(b)*].

PRACTICE TIP:

If the non-monetary consideration will be received from a director or a corporation, firm or association in which a director has a material financial interest, all material factors should be disclosed by the interested director and the determination of fair value should be made by the non-interested directors in accordance with the standards set forth in *Corp. Code §310*. *Commentary by Frances E. Lossing.*

The full, agreed consideration has to be paid prior to or concurrently with the issuance of the shares [*Corp. Code § 410(b)*]. However, the corporation may have arranged to issue shares for part payment subject to call for the remainder, in which case the consideration is paid in accordance with the controlling subscription or purchase agreement [*Corp. Code §§ 409(d), 410(b)*]. For partly paid shares, the total amount of the consideration to be paid and the amount already paid must be stated on the share certificates of those shares, or on the initial transaction statement for uncertificated securities [*Corp. Code § 409(d); see Corp. Code § 171.1*]. For discussion of the initial transaction statement and uncertificated securities generally, see *§ 6I.20[2]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesBusiness & Corporate LawCorporationsShareholdersGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

3-6I California Legal Forms--Transaction Guide § 6I.19

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.19 Par Value

Under the General Corporation Law, the concept of par value of shares is no longer legally significant. For tax purposes exclusively, if any tax is based on capitalization, all authorized shares are deemed to have a nominal value of $1. For purposes of any other statutes or regulations that require a stated par value, all shares will have the par value determined by the board of directors [*Corp. Code § 205*]. For corporations that are subject to the corporations law in effect before 1977 [*see Corp. Code § 2300*], the absence of any reference to par value in the articles is equivalent to a statement that the corporate shares have no par value [*Corp. Code § 2302.5*].

The corporation no longer need be concerned about selling shares under their nominal value, nor should it encounter problems of giving shares at discount or as bonus at improperly reflected rates. The board fixes the consideration, and the actual consideration received as assets is accounted for as a liability to shareholders. Whether or not earnings are reflected in capital accounts, the corporation is free to work with and distribute its cash and property as long as it does not violate provisions of California law designed to protect creditors and shareholders in particular positions [*see Corp Code §§ 500-503.2*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesBusiness & Corporate LawCorporationsShareholdersGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

3-6I California Legal Forms--Transaction Guide § 6I.20

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.20 Share Certificates

[1] Issuance

Unless a corporation adopts a system of issuance, recordation and transfer of its shares by electronic or other means not involving any issuance of certificates [*see* [2], *below*], a holder of shares in a corporation is entitled to have a certificate that certifies the number of shares and the class or series of shares owned by the shareholder [*Corp. Code § 416*]. The certificate must be signed in the name of the corporation by the chair or vice-chair of the board, or the president or vice-president, and by the chief financial officer or an assistant treasurer or the secretary or any assistant secretary [*Corp. Code § 416(a)*].

If the shares are classified or if any class of shares has two or more series, the certificate must contain a statement or summary of the rights, privileges, and restrictions granted or imposed on each class or series, or notification of where the shareholder may obtain that statement or summary [*Corp. Code § 417*]. If the shares are (1) subject to transfer restrictions; (2) assessable; (3) not fully paid [*see Corp. Code § 409(d)*]; (4) redeemable; (5) convertible; or (6) subject to a voting agreement [*see Corp. Code § 706(a)*], irrevocable proxy [*see Corp. Code § 705(e)*], or restrictions on voting rights contractually imposed by the corporation, the certificate must also contain notification of that fact [*Corp. Code § 418(a)*]. If the shares are dissenting shares to a merger, the certificates must contain a statement to that effect [*Corp. Code § 1302*]. For a more detailed discussion of these requirements and share certificates generally, see *§ 6I.200[1]*.

If a certificated security [*see* [2], *below*, for the distinction between "certificated" and "uncertificated" securities] has been retained by or surrendered to the issuing corporation or its transfer agent for reasons other than registration of transfer, other temporary purpose, payment, exchange, or acquisition by the issuing corporation, that security will be treated as an uncertificated security [*Com. Code § 8102(a)(15), (18)*].

[2] Uncertificated Securities

The Commercial Code makes a distinction between "certificated" and "uncertificated" securities. For purposes of these requirements, "security" means an obligation of an issuer or a share, participation, or other interest in an issuer or in

property or an enterprise of an issuer [*Com. Code § 8102(a)(15)*]. An "uncertificated security" simply means a security that is not represented by a certificate [*Com. Code § 8102(a)(18)*], in contrast to a "certificated security," which is represented by the more traditional type of share certificate discussed in [1], *above*. The manual transfer of share certificates can be a time-consuming encumbrance, especially in public tradings in which manual transfers may lag behind transactions for sizable periods of time.

A corporation may adopt a system of issuance, recordation, and transfer of its shares by electronic or other means not involving any issuance of certificates if the system satisfies any of the following conditions [*Corp. Code § 416(b)*; *see Com. Code § 8101 et seq.*]:

- Has been approved by the United States Securities and Exchange Commission;
- Is authorized in any statute of the United States; or
- Is in accordance with Division 8 of the California Commercial Code.

If a corporation adopts a certificate-free system of share issuance, that system will not become effective as to issued and outstanding certificated securities until the certificates have been surrendered to the corporation [*Corp. Code § 416(b)*].

An electronic or other system of uncertificated securities must include provisions for notice to purchasers in substitution for the required statements on certificates [*see Corp. Code §§ 417, 418, 1302*; *see § 6I.200*]. The "initial transaction statement" and "written statements" serve this purpose. An initial transaction statement is the statement, signed by or on behalf of the issuer, sent to the new registered owner or registered pledgee. "Written statements" are the written statements that are sent periodically, or at the request of the registered owner or registered pledgee, by the issuer to the registered owner or registered pledgee describing the issue of which the uncertificated security is a part [*Corp. Code § 171.1*].

[3] Indirect Holding System

Though it has little impact on the issuer, an indirect holding system for certificated securities has come to dominate transactions in publicly traded securities. The indirect holding system revolves around the concept of a "security entitlement," defined as the rights and property interest of an "entitlement holder" respecting a "financial asset" [*see Com. Code §§ 8501-8511*]. An "entitlement holder" is a person identified in the records of a securities intermediary as having a securities entitlement against that intermediary [*Com. Code § 8102(a)(7)*]. A person acquires a security entitlement in a financial asset when that person's securities account is credited with that financial asset by a "securities intermediary," an entity that holds securities or security entitlements for its customers [*see Com. Code § 8102(a)(14)*].

PRACTICE TIP:

The rights of beneficial owners will also be subject to provisions of federal law regulating these types of transactions and to any contractual provisions between the beneficial holder and his or her broker or contractual agreements between the broker and the entity, such as DTC, maintaining the book entry system, with respect to a variety of procedural matters regarding voting, distribution of notices, proxy statements, reports and other information and the payment of dividends or other distributions on securities. *Commentary by Frances E. Lossing.*

Chapter 5 of Division 8 of the California Commercial Code regulates securities intermediaries in this context, outlining the rights of holders of security entitlements with respect to securities intermediaries [*see Com. Code §§ 8501-8511*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock CertificatesCommercial Law (UCC)Investment Securities (Article 8)Issuer Duties



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

3-6I California Legal Forms--Transaction Guide § 6I.21

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.21 Section 1244 Stock

[1] Tax Treatment

Ordinarily, corporate stock is a capital asset, and any loss with respect to that stock is therefore subject to capital loss limitations [*see I.R.C. §§ 1211, 1212*]. However, *I.R.C. § 1244* permits an individual to convert what would be capital loss into ordinary loss if certain requirements are met. Ordinary loss treatment is preferable, since the capital loss limitations deny any significant tax benefit except as an offset against capital gain and are therefore a deterrent to investment in corporate stock.

[2] Requirements Applicable to Issuer and Shares

The corporation issuing *I.R.C. § 1244* stock must be a domestic corporation. To qualify stock for ordinary loss treatment, the corporation also must be a "small business corporation" at the time the stock is issued [*I.R.C. § 1244(c)(1)(A)*]. A corporation is a "small business corporation" if the aggregate amount of money and other property received by it for stock, as a contribution to capital, and as paid-in surplus does not exceed $1 million. This determination is made at the time the stock in question is issued, and includes amounts received for that stock and for all prior issues of stock [*I.R.C. § 1244(c)(3)(A)*]. For purposes of the $1 million limitation, the amount taken into account with respect to any property other than money is equal to the adjusted basis to the corporation of that property for determining gain, reduced by any liability to which the property was subject or which was assumed by the corporation. This amount is determined as of the time the property was received by the corporation [*I.R.C. § 1244(c)(3)(B)*].

To qualify as *I.R.C. § 1244* stock, the stock must be either voting or nonvoting preferred or common stock, and must have been issued by the corporation for money or other property (other than stock or securities) [*I.R.C. § 1244(c)(1)*]. In addition, the corporation must have derived more than 50 percent of its aggregate gross receipts from sources other than royalties, rents, dividends, interest, annuities, and sales or exchanges of stocks or securities during the period of its five most recent taxable years ending before the date the loss on the stock was sustained [*I.R.C. § 1244(c)(1)(C)*]. However, this requirement does not apply if the corporation's deductions (other than deductions for net operating losses and dividends) exceed its gross income [*I.R.C. § 1244(c)(2)(C)*]. If the corporation has not been in existence for five taxable

years ending before the date the loss on the stock was sustained, a lesser period is substituted for the five-year period [*see I.R.C. § 1244(c)(2)(A)*].

[3] Only Individuals Eligible for Ordinary Loss Benefits

Only individuals are entitled to the ordinary loss benefits of *I.R.C. § 1244* [*I.R.C. § 1244(d)(4)* (excluding trusts and estates); *Treas. Reg. § 1.1244(a)-1(b)* (excluding corporations)]. An individual who is a partner in a partnership at the time the partnership acquired the stock, and whose distributive share reflects loss on the stock, is eligible for the ordinary loss treatment of *I.R.C. § 1244* [*I.R.C. § 1244(a)*; *Treas. Reg. § 1.1244(a)-1(b)(2)*].

To be eligible for *I.R.C. § 1244* treatment, the individual or partnership must have continuously held the stock from the time of its issuance. Acquisition of the stock from the original shareholder destroys the ordinary loss treatment potential under the section [*I.R.C. § 1244(a)*; *Treas. Reg. § 1.1244(a)-1(b)*].

[4] When Loss Occurs

A sale or exchange of *I.R.C. § 1244* stock is not necessary to obtain an ordinary loss. If the stock becomes worthless, a loss is deemed to occur [*Treas. Reg. § 1.1244(a)-1(a)*]. The maximum amount that can be treated as ordinary loss on *I.R.C. § 1244* stock cannot exceed $50,000 for any tax year, or $100,000 in the case of a joint return [*I.R.C. § 1244(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock CertificatesBusiness & Corporate LawCorporationsShareholdersGeneral OverviewTax LawFederal Income Tax ComputationSales & ExchangesCapital Gains & Losses (IRC secs. 1201-1202, 1211-1212, 1221-1223, 1231-1260, 1271-1278, 1281-1288, 1291-1298)Treatment of LossesTax LawFederal Income Tax ComputationUnearned IncomeDividends



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART II. LEGAL BACKGROUND

3-6I California Legal Forms--Transaction Guide §§ 6I.22-6I.99

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6I.22[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6I California Legal Forms--Transaction Guide § 6I.100

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.100 Facts

1. Name of corporation.

2. State of incorporation.

3. Address of principal office, and address of principal California office if headquarters is outside California.

4. Names and addresses of officers and directors.

5. Names and addresses of promoters, if this is a new corporation.

6. Information on corporation's currently outstanding securities.

a. Classes or series of shares currently outstanding.

b. Characteristics of each class or series.

c. Number of shares of each class of corporation's stock currently outstanding.

d. Classes or series of any outstanding debt securities.

e. Status of each class or series of securities with respect to securities laws, e.g., exempt, qualified, etc.

7. Current number of shareholders.

8. If corporation is closely held, names and addresses of all current shareholders.

9. Tax status of corporation:

a. Subchapter S; or

b. Subchapter C.

10. Name and address of corporation's accountant.

11. Name and address of any broker or other person who will assist corporation with respect to proposed issuance.

12. Whether potential investors have already been contacted and, if so, number and names of those investors.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6I California Legal Forms--Transaction Guide § 6I.101

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.101 Documents

1. Articles of incorporation.

2. Bylaws of corporation.

3. Agreements among shareholders with respect to corporation's stock, e.g.:

    a. Buy-sell agreements.

    b. Shareholders' agreements.

    c. Voting agreements or voting trusts.

4. Registration statements and other documents relating to previous offerings of corporation's securities.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6I California Legal Forms--Transaction Guide §§ 6I.102-6I.109

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6I.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6I California Legal Forms--Transaction Guide § 6I.110

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.110 Financial Considerations

1. Determine corporation's immediate financial needs.

2. Determine projected needs of corporation.

3. Determine who are potentially available investors.

4. Review applicable federal and state securities laws that may dictate, among other things [*see* Ch. 6, *Securities Regulation Issues*]:

a. Number of offerees or purchasers that can be solicited.

b. Residency of offerees and purchasers.

c. Registration of securities with federal or state authorities.

d. Exemptions from registration that are available to corporation.

e. Cost resulting from compliance with applicable securities laws.

5. Determine nature and extent of investment that can be anticipated--i.e., is it likely that potential investors will be willing to invest in corporation.

6. Determine probable needs of anticipated investors in terms of desire to:

a. Minimize risk of loss.

b. Control policy and operation of corporation.

c. Participate in anticipated profits.

7. Evaluate potential for conflicts between groups of investors with respect to risk, control, and participation in profits sought to be accommodated by capital structure of corporation.

8. Determine what provisions should be made in capital structure at present time to meet anticipated future needs of corporation.

9. Determine securities that should be authorized to be issued in light of:

a. Present and future needs of corporation.

b. Present and future needs of available investors.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6I California Legal Forms--Transaction Guide § 6I.111

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.111 Common Stock

1. Consider advantages and disadvantages of using common stock (basic or residual equity securities) rather than debt securities as principal financing tool from viewpoint of corporation [*see also § 6I.200[1]*].

a. Advantages:
(1) Cost to corporation is minimal in that no fixed payments of dividends or interest at stated intervals is required; this will improve corporation's credit.

(2) Sale is absolute and final; i.e., corporation is not required to return investment as with debt securities.

(3) Use of stock for initial financing facilitates debt financing at later stage when corporation can better afford to issue debt securities.

(4) Superior to preferred stock with fixed, cumulative divided rights since obligations to meet fixed dividends may be burdensome.

(5) Minimizes risk that corporation may run of being undercapitalized or having too high a ratio of debt to equity securities.

PRACTICE TIP:
For a corporation with high growth prospects, the issuance of common stock may be a more expensive means of raising capital, from the perspective of the corporation's current shareholders, than the issuance of preferred stock or debt since the current shareholders'

percentage interest in the corporation will be reduced. On the other hand, this is likely to be the only means of raising capital for an unseasoned corporation or a corporation without an established or certain income stream. *Commentary by Frances E. Lossing.*

b. Disadvantages.

(1) Offers little attraction to prospective investors other than corporate organizers, unless corporation has high growth prospects.

(2) Dividend payments on common or preferred stocks are taxed twice while interest payments on debt securities are tax deductible to corporation.

2. If company is going to have to raise outside capital, look at advantages and disadvantages of common stock from potential investors' point of view.

a. Advantages.

(1) Unlimited right to share in residue of profits.

NOTE:
Although common shareholders have only a residual right to dividends, after payment to preferred shareholders, amount remaining for distribution may be substantially greater than that distributed to preferred shareholders.

(2) Growth in value through their right to share in accumulated assets belonging to corporation at time of dissolution.

(3) Shareholders are granted right to exercise substantial control over corporate affairs through election of corporate directors.

b. Disadvantages.

(1) Exposed to maximum risk of loss; if corporation fails, there is little likelihood of recouping investment after claims of creditors and preferred shareholders have been met.

(2) Right to share in profits; i.e., dividend rights, is less attractive than dividend rights of preferred shareholders or right to interest payment of debt securities holders.

(a) Generally, dividends may be distributed only if there are sufficient earnings, or where various accounting tests are adequately satisfied [*see Corp. Code §§ 500-503*], while debt securities must be paid when due.

(b) Claim of common shareholder to dividends may be junior to that of preferred shareholder.

NOTE:
Unless dividends are declared by the board of directors, the corporation is not obligated to pay or accumulate them for common shareholders. In the case of preferred shareholders, on the other hand, the most widespread and commonly used preferred issues are those of

cumulative preferred stock which entitles its holder to the accrual and receipt of all unpaid dividends, before any dividend distribution is made to holders of common stock.

(c) Uncertain dividend distribution.

NOTE:

Retention of profits by the corporation to foster growth is common, especially in its incipient stages with the consequence that common shareholders must ordinarily resign themselves to deferred dividend distribution. Preferred shareholders, however, are usually afforded certain protections against restrictions or deferment.

3. Determine if corporation should issue class or classes of nonvoting common stock.

NOTE:

Issuance of nonvoting common stock can be desirable because of the usefulness of nonvoting common stock in business and estate planning for the close corporation. For example, it allows the promoters to obtain additional venture capital without relinquishing control of the corporation. It is also permissible for the corporation to confer special voting rights on shares of any class, as, to confer voting rights on a particular class with respect to matters not usually subject to a shareholder vote. This kind of flexibility is especially appropriate for the closely held corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesRight to DividendsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6I California Legal Forms--Transaction Guide § 6I.112

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.112 Preferred Stock

1. Consider advantages and disadvantages of preferred stock from corporation's point of view.

NOTE:
For discussion of advantages and disadvantages from investors' point of view, see Cavitch, *Business Organizations with Tax Planning, Ch. 88, **Equity Financing**, § 88.05* (Matthew Bender); see also *§§ 6I.200*, *6I.201*.

a. Advantages.
(1) Vehicle for distribution of risk, control, and participation among corporate insiders.

NOTE:
Preferred stock is best suited to situations in which there are two groups of principals, one furnishing the capital and the other the operational skills. The first group ordinarily is interested in receiving the greater share of the profits, but is content to leave the actual operation of the business to the managing group, as long as the members of the capital group retain sufficient control to safeguard their investment. The management group will want at least an equal voice in running the business and an opportunity to share in long-range profits. The interests of these groups can be reconciled by both taking an equal amount of common stock, with the group furnishing the capital receiving, in addition, preferred shares in consideration of the greater investment. When this is done, the capital group obtains a steady return on its investment, commensurate with the amount it has invested, and since the preferred issue will have only limited (or no) voting rights, the two groups will have equal control over corporate operations.

(2) Attracts outside investors who would not be interested in common stock because of high risk factor.

NOTE:
This will also enable the corporation, if a publicly held company, to raise money from a wider circle such as institutions and trustees who are not permitted to buy common stock but who desire a higher yield than ordinarily afforded by bonds.

(3) Organizers of the corporation will retain control since preferred shares usually have limited voting rights.

PRACTICE TIP:
In certain circumstances, the holders of the preferred stock may insist on full voting rights or may insist on voting on the same matters as holders of common stock, but with a different number of votes than those of the common shareholders (i.e., each share of preferred stock may be entitled to 1/10 of a vote per share, while each share of common stock is entitled to one vote per share; or the preferred stock could be given a voting preference, such as 10 votes per share compared to one vote per share for the common stock). *Commentary by Frances E. Lossing.*

(4) Advantages over debt financing:

(a) No obligation to return money invested, unless the preferred stock is redeemable at option of holder or on occurrence of certain specified events.

(b) Paves way for later use of debt financing at a time when corporation can use it as less expensive method of capitalization.

b. Disadvantages.

(1) High dividend payments.

(2) May result in deferment of (or no) dividend distributions on common stock.

(3) Transfer of at least some control to preferred shareholders.

NOTE:
This could occur if corporation fails to pay preferred dividends. It could be detrimental, from the perspective of common shareholders, because preferred shareholders are not particularly concerned with running the business and are principally concerned with their fixed dividend payments and, therefore, are likely to sacrifice long-term growth potentialities for immediate dividend yield.

2. Consider whether corporation's contemplated earnings will be substantially higher than dividend requirements of preferred shares.

NOTE:
Preferred shares should be issued only if the corporation's contemplated earnings will be substantially higher than the dividend requirements of the preferred shares. Although dividends are to be paid only when earned, the burden on the corporation to pay the fixed dividends on preferred shares is, as a

practical matter, similar to its obligation to pay interest on debt securities, in view of the cumulative dividend feature of most preferred issues.

PRACTICE TIP:

Failure to make dividend payments on preferred stock when due is frequently treated as an event of default in debt securities or bank credit agreements. This may make the issuance of preferred stock unattractive to corporations with an uncertain income stream. One way to deal with this issue is to limit the requirement to make dividend payments to circumstances in which certain financial requirements have been met (i.e., preferred stock is entitled to payment of dividends based on a percentage of net earnings above a specified amount, but not otherwise). In this instance, preferred shareholders share many of the same risks as common shareholders, but will have a preference in payment of dividends. The amount of the dividend payment, when required to be made, will typically be higher than that payable on preferred shares with more customary terms to compensate the preferred shareholders for the greater risk of non-payment. *Commentary by Frances E. Lossing.*

3. If preferred shares are to be issued, decide on rights, preferences, privileges, and restrictions of securities to be issued.

NOTE:

The term "preferred," standing alone, means only a stock that differs from other stock in having a preference as to dividends or on liquidation of assets [***see*** *Corp. Code §§ 159, 176*] attached to it, without expressing the special nature of the stock otherwise. Thus, it is necessary that all the incidents of a given issue be expressly provided. Common shares may also be given any of these same or other incidents, except for the financial preferences [***see*** *Corp. Code § 159*].

PRACTICE TIP:

In lieu of establishing the terms of the preferred shares, the articles of incorporation may grant the directors "blanket" authority to establish the terms of preferred shares in the future. This enables the corporation to determine the features of the preferred stock in light of market conditions at the time of issuance, without obtaining approval of the corporation's shareholders. *Commentary by Frances E. Lossing.*

a. Cumulative or noncumulative dividends?

(1) If dividends are cumulative and not paid when due, all past due dividends must be paid before any dividend distributions can be made to common shareholders; nonpayment of dividends in a certain year does not destroy preferred shareholders' right to receive that dividend.

(2) If dividends are noncumulative and directors fail to declare a dividend, preferred shareholder has neither present right to claim dividend nor future right to demand payment of that unpaid dividend.

(3) Various types of hybrid arrangements exist, such as "cumulative, if earned" (provides that dividends cumulate if not paid in years in which corporation has sufficient earnings to warrant payment).

(4) If corporation decides to reinvest profits and not declare dividend, holder of preferred shares with cumulative dividend rights can safeguard his interest, while holder of shares without cumulative dividend rights is unprotected.

NOTE:
For this reason noncumulative preferred stock is seldom used in initial capitalization. If noncumulative preferred stock is used at all, it is generally in a corporate reorganization as a substitute for existing cumulative issues.

(5) If dividend is cumulative, consider insuring payment.

(a) Possible methods by which corporation can eliminate dividend arrearages at expense of preferred shareholders:
(i) Issuance of new prior preferred security in exchange for existing preferred shares.

(ii) By merger or consolidation.

PRACTICE TIP:
Changes in the rights and preferences of outstanding securities, an exchange of securities, a merger must, or entity conversion transaction be qualified in California, unless an exemption is available [*Corp. Code § 25120*]. *Commentary by Frances E. Lossing.*

(b) Preferred shareholder can best anticipate and minimize effects of merger or issuance of prior security by insisting on limited voting rights, thus necessitating preferred shareholder consent through class voting to the extent not otherwise required by California law.

(c) Corporation can grant preferred shareholders voting rights or even voting control if dividends go in arrears in excess of certain amount or for certain period of time.

b. Participating or nonparticipating?

(1) Participating preferred stock (whether or not cumulative) is entitled to share in all dividend and capital distributions, not only in its stipulated dividend.

(2) Types:

(a) Full participation on same basis as common stock.

(b) Limited participation: after receipt of fixed dividend, limited participation in further dividend distributions either with regard to number or amount.

(c) No participation; restricted solely to receipt of fixed dividend.

(3) Nonparticipating preferred stock is generally used.

NOTE:
This last alternative is usually justified on the grounds that the primary attraction of preferred stock is its relative insulation from risk, and thus should not be entitled to participation rights equal to common stock, on which the burden of risk of diminution in value due to any corporate losses first falls. This is based on the principle that preferred shareholders should not be permitted to share in excess earnings of the corporation when their risk of loss is limited.

c. Voting rights?

(1) Unless articles provide otherwise, all stock, preferred as well as common, has full voting rights [*Corp. Code § 700(a)*].

(2) If less than full voting rights are to be given, articles must expressly state the qualifications and restrictions on voting powers [*Corp. Code § 700(a)*].

(3) Nonvoting stock may not be used when:

(a) Corporation elects to be taxed as Subchapter S corporation [*see I.R.C. § 1362(a)*; *see also* Ch. 2B, *Electing Subchapter S Status*].

(b) Corporation is issuing shares under small offering exemption from qualification of local securities law [*see Corp. Code § 25102(h)*; *see also* Ch. 6C, *California Small Offering Exemption*].

(c) Corporation is organized under Investment Company Act of 1940.

NOTE:
The Investment Company Act requires, in most instances, that all new issues have voting rights [*15 U.S.C. § 80a-18(i), (j)*].

(d) Corporations reorganizing under Bankruptcy Act [*11 U.S.C. § 1101 et seq.*].

(e) Corporation intends to sell its preferred shares on a securities exchange.

NOTE:
Most securities exchanges require that certain voting rights be granted to preferred shareholders before they will agree to list the stock.

(f) Corporation must qualify shares with Commissioner of Corporations, in which case preferred shareholders ordinarily must have at least right to reasonable representation on board when cumulative default has occurred (eight quarterly dividends, not necessarily consecutive) [*see 10 Cal. Code Reg. § 260.140.2*; *see also* Ch. 6H, *Qualification of Securities*].

NOTE:
The right to elect a majority of the members of the Board is presumptively reasonable.

(4) Even nonvoting stock or stock with limited voting rights will be entitled to vote on following matters [*Corp. Code § 903(a)*]:

(a) With certain limited exceptions, any increase or decrease in authorized shares of any class of stock.

(b) Any exchange, reclassification or cancellation of all or part of the shares of any class of stock, including a reverse stock split.

(c) Any exchange or creation of a right of exchange of all or part of the shares of another class into shares of any other class of stock.

(d) Creation of a new class of shares having rights, preferences or privileges prior to shares of any other class of stock or any increase in rights, preferences or privileges or the number of authorized shares

of any class having rights, preferences or privileges prior to any other class of stock.

(e) In case of preferred stock, division of that class of preferred stock into a series having different rights, preferences, privileges or restrictions or authorizing board of the corporation to do so.

(f) Cancellation of, or otherwise affecting, dividends on shares of any class that have accrued but not been paid.

(5) California also limits ability to create supermajority voting rights.

NOTE:

A supermajority voting right refers to any requirement that a specified corporate action be approved by more than a majority of the outstanding shares or by more than a majority of the outstanding shares of any class or series [*Corp. Code § 710(b)*]. The restrictions apply to any corporation with shares held of record by 100 or more shareholders which files an amendment to its articles of incorporation or any certificate of determination after January 1, 1989, unless the corporation files the amendment after December 31, 1993 and the corporation has (1) outstanding shares of more than one class or series; (2) no class of equity securities registered under Section 12(b) or 12(g) of the Securities Exchange Act of 1934; and (3) outstanding shares held by fewer than 300 persons of record [*Corp. Code § 710(a)*]. If the supermajority vote provisions apply, no supermajority vote may be required which requires approval of more than 2/3 of the outstanding shares or more than 2/3 of the outstanding shares of any class or series [*Corp. Code § 710(b)*]. In addition, an amendment of the articles or a certificate of determination that includes a supermajority vote requirement must be approved by at least as large a proportion of the outstanding shares [Corp. Code § 152] as is required pursuant to that amendment or certificate of determination for the approval of the specified corporate action or actions [*Corp. Code § 710(c)*].

(6) Reasons for limiting vote:

(a) Avoidance of possible conflict between preferred shareholders and organizers of corporation.

NOTE:

The usual primary concern of preferred shareholders is the immediate dividend potential of the corporation, whereas the organizers of the business are interested in enhancing the corporation's long-term potential. An accommodation can be reached by giving preferred shareholders contingent voting rights that protect them in the event of defaults in dividend payment or attempts to wipe out their rights to accrued dividends.

(b) Establishment of capital structure affording equality of control to majority and minority investors and, at same time, insure receipt of proportionate share of profits by large investors.

NOTE:

This is useful when the parties who supply a substantial majority of the corporation's capital are "silent" owners, whereas the parties who have the special skills required to operate the business contribute only enough capital to purchase a minority interest. In such a case the majority investor can divide the investment between preferred and common stock so that only enough of the investment is placed in common stock to balance the minority investors' investment, and the remainder is placed in preferred stock to assure a fair return in the form of dividends.

d. Redemption and sinking funds?

(1) Determine whether to include redemption provisions.

NOTE:

Many preferred share issues contain express provisions by which the corporation is given an option to redeem the issue. The purpose of these provisions is to allow the corporation to rid itself of burden imposed in meeting a high preferential dividend. Redemption is usually sought at the time the corporation has become financially stable and can either do without the capital represented by the preferred shares or can substitute lower cost debt securities in their stead.

PRACTICE TIP:

There are, however, some disadvantages associated with mandatorily redeemable preferred stock or preferred stock that is redeemable at any time at the option of the corporation. First, investors may require a higher redemption premium than would be applicable to preferred stock with some call protection. Secondly, since this type of preferred stock is not permanent capital, creditors may not treat this type of preferred stock as equity for purposes of calculating compliance with financial covenants. This type of preferred stock may not therefore be appropriate for a thinly capitalized corporation. Third, with respect to mandatorily redeemable preferred stock, the corporation may not have the funds necessary (or legally available funds) to redeem the preferred stock at the time redemption is required [*see Corp. Code §§ 500-503*]. As a result, preferred stock that is redeemable at specified times may only be appropriate for corporations with stable income streams. *Commentary by Frances E. Lossing.*

(2) Determine whether redemption is to be:

(a) At option of board of directors (callable shares); or

(b) At specified time or occurrence of specified event, or

(c) Both.

(3) Determine redemption price, amount of which will vary depending on market requirements, and which may be reduced periodically over the years (*e.g.*, for preferred shares costing $100, redemption price of $105 for first period may be reduced to $104 after five years, $102.50 after next five years, and $101 thereafter).

NOTE:

Alternatively the redemption premium may be expressed as a "make-whole" premium. In this case, the premium is based on the difference between the rate on the preferred stock and the market rate at the time of redemption determined on the basis of a prescribed index discounted to present value based on a specified discount rate and discount period. The purpose of the "make-whole" premium is to ensure the investor that it will receive the benefit of its bargain.

(4) Determine whether shares will be subject to any call protection (i.e., shares may not be redeemed during the first five years after issuance).

NOTE:

The articles may provide that the redemption price for shares called by the board of

directors and the price for shares redeemed under a sinking fund system will vary. For preferred shares in a series, the redemption price for each series is set by the articles or the board of directors if so authorized by the articles [***see*** *Corp. Code §§ 202(e), 400(a), 402(a)*].

(5) Determine any limitations on right of corporation to redeem shares, such as when dividends on other shares have not been paid.

(6) Determine method for choosing shares for partial redemption of a class or series, such as pro rata (i.e., based on ratio that the number of shares of each holder bears to total number of shares to be redeemed), or by lot in equitable manner as determined by board of directors.

(7) Determine terms of any sinking or retirement fund provision:

NOTE:

Sinking or retirement funds are established to make redemption of shares more certain and provide a means of systematic liquidation of the class or series. Inclusion of a sinking fund provision may be required by the investment bankers who are to sell the issue in order to improve the quality of the security over the years. The articles of incorporation may provide for the setting aside of a sinking fund [***see*** *Corp. Code § 402(d)*] or funds out of earnings or otherwise for any year or years or by an amount sufficient to redeem a specified percentage or number of shares, to be applied to the purchase or redemption of shares in the manner specified for optional redemption.

(a) Year in which payments to sinking fund are to commence and payment date for each payment

NOTE:

Payment dates are usually at the beginning of the corporation's fiscal year.

(b) Amount to be contributed for each period based on percentage of net earnings of corporation or amount designed to redeem specified percentage or number of shares.

(c) Source of funds for contribution, such as any money legally available for that purpose, or more restricted source.

PRACTICE TIP:

Redemption is treated as a distribution under California law [*Corp. Code § 166*]. As a result, the tests applicable to the determination of whether dividends may be paid are also applicable to the determination of whether funds are legally available for the redemption of the company's securities [*Corp. Code §§ 500-503*]. The corporation may, however, remove the protections afforded by *Corp. Code §§ 502* and *503* in establishing the terms of the preferred stock with respect to distributions on shares junior to the series of preferred stock being created [*Corp. Code §402.5(c)*]. *Commentary by Frances E. Lossing.*

(d) Cumulative or noncumulative requirement of setting aside funds for each period.

(e) Mechanics of making payment and earmarking funds.

(f) Credit against fund for shares acquired other than through fund.

(g) Price for acquisition of shares out of sinking fund.

(h) Purposes for use of fund, such as purchase of shares on market or redemption.

(i) Date for use of funds, such as definite or indefinite period after date of payment into fund.

(j) Limitation on minimum number or percentage of shares to be acquired during each period.

e. Liquidation preference?

NOTE:

Granting of preference on liquidation can be an important inducement to investors to purchase preferred shares. Because dissolution is often brought about by the insolvency of the corporation, with few or no assets remaining after the creditors have been paid off, the right to a preference at dissolution may often be meaningless. Nevertheless, it may have a "sales value." A liquidation preference may also provide some protection to outside investors in a participating preferred stock from a voluntary dissolution of the corporation by the insiders and a formation of a new corporation to conduct the business of the dissolved corporation at a time at which the prospects of the corporation have become attractive.

(1) Determine whether or not to grant preference.

(2) Determine conditions under which preference applies (usually "voluntary or involuntary liquidation, dissolution, or winding-up of affairs of corporation") with statement of events in which preference does not apply, such as consolidation or merger, or lease or conveyance of all or part of corporation's assets.

(3) Determine extent to which preference in payment on liquidation will include dividend arrearages.

NOTE:

There is usually no liquidation preference for noncumulative shares (or, at most, dividends earned but not paid), but there is full payment of all arrearages, whether earned or not, for cumulative preferred shares [***see*** *Corp. Code § 172*].

(4) Determine liquidation price:

(a) Amount of liquidation price after dividends are paid.

(b) Whether price is to be in cash rather than property.

(c) whether there is to be distinction in amount of price depending on whether dissolution is involuntary or voluntary (latter may add premium over involuntary price).

(5) Determine extent to which, if at all, preferred shares will participate with common shares after payment of liquidation price.

NOTE:

This will usually be the same basis for participation as in the case of dividend payments,

that is,

- Full and immediate participation on a share-for-share or dollar basis;
- Full participation after common stock has received certain amount;
- Limited participation up to a dollar amount, or a percentage of the total remaining assets to be distributed; or
- No participation, which is the most common provision.

(6) Determine whether to provide for pro rata payment to various series of preferred shares if assets are not sufficient to pay full liquidation payments, in ratio of total amount due to each series for both dividend arrearages and liquidation payments.

NOTE:

If the convertible preferred stock must be qualified in California, the conversion price must be fair and equitable under the circumstances and must contain an appropriate antidilution provision providing for adjustment of the number of shares into which the preferred stock is convertible on any stock split, stock dividend or recapitalization of the corporation. Provision may also be made for an antidilution adjustment on issuance of additional shares of the class issuable on conversion by the issuer at a price less than the conversion price or less than the current market price for the class so issuable [*10 Cal. Code Reg. §260.140.6*]. Certain types of stock issuances, such as issuances of stock under employee benefit plans, may be excluded from this type of adjustment.

f. Conversion privilege?

NOTE:

"Conversion rights" of shares are rights whereby the shares may be converted into the same or a different number of shares of any other class or series. Rights of the preferred shareholders to convert their shares into common shares must be fixed by the articles [*Corp. Code § 403(a)*]. A sufficient number of common shares should initially be authorized and reserved to accommodate the conversion. The corporation should be advised, however, that the conversion privilege creates several problems with respect to compliance with federal and state securities laws and careful planning is necessary to avoid violation of those laws. Similarly, other corporate considerations must be taken into account. For example, if retention of control is a major consideration, it is important that the conversion price be determined in order to have the control remain with the original common shareholders; that is, the number of voting shares into which convertible shares are convertible should not exceed the number of voting shares outstanding at the time the convertible securities are issued.

Options may be separately considered for similar purposes. They do not affect the present shares and require consideration to procure extra securities; otherwise, they are processed with like effect as conversion [***see § 6I.240***].

(1) Determine date and duration of conversion rights.

NOTE:

Most commonly, when shares are redeemable, the time limits are between the notice of redemption and the redemption date, but other or no limitations may be specified.

(2) Determine requirements for notice to elect to convert or conditions for automatic conversion.

(3) Determine conversion price or rate, which is usually expressed as a ratio; e.g., one share of preferred stock for two shares of common stock.

(4) Determine authorization for issuance of fractional shares, scrip, or cash in event exchange does not come out even [*see § 6I.204*].

(5) Determine adjustment of conversion price when changes, such as stock-splits or exchange of securities, made in capital structure of issuer.

NOTE:

For shares that must be qualified, the Commissioner of Corporations requires that the charter documents contain an antidilution provision to protect the preferred or creditor conversion and option participants, proportionately increasing the share they are to receive in event of any additional issuance of shares to outstanding shareholders, or on sale of shares below the price to be paid by the holders of the special incidents on exercise [*10 Cal. Code Reg. § 260.140.6*].

(6) Determine status of preferred shares after conversion and whether there will be prohibition against reissuance.

NOTE:

When a corporation acquires its own shares, they are restored to the status of authorized but unissued shares. If the articles prohibit the reissue of reacquired shares, then the authorized number of shares of the kind so acquired must be reduced and a formal amendment of the articles must be appropriately effected [*Corp. Code § 510*]. If the blanket prohibition is not contained within the articles, then the corporation may wish to include specific language within the conversion contract for the permanent retirement or cancellation of the shares being reacquired on exercise of the privilege.

(7) Determine date when preferred shareholder becomes common shareholder.

NOTE:

This date is usually the date of surrender of the preferred shares.

(8) Determine manner of providing for authorization and reservation of common shares sufficient to cover conversion.

NOTE:

When shares are issued in a series, the conversion rates will usually vary from series to series and will be stated in the articles.

If, at the time the corporation grants option or conversion rights, it is not authorized by its articles to issue all the shares required to satisfy those rights, the additional number of shares required must be authorized by an amendment to the articles if and when the rights are exercised [*Corp. Code § 405(a)*].

(9) Determine whether to provide for "upstream conversions"; that is, conversion into shares having prior or superior rights and preferences as to dividends or liquidation distribution.

NOTE:
Upstream conversions are valid, if provided for by the articles [***see*** *Corp. Code § 403(a)*].

4. Determine whether to issue preferred shares in series.

a. Advantageous to corporation contemplating fulfilling its future financing needs by sale of preferred stock over long period of time under varying market conditions.

b. Assures that directors will have needed authority to sell additional preferred shares at future date without having to submit their decision to shareholders for approval.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsShareholdersGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6I California Legal Forms--Transaction Guide § 6I.113

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.113 Consideration for Securities

1. Determine types of consideration to be received for shares [*see Corp. Code § 409(a)*; *see also § 6I.220*].

NOTE:
Cash, property, work, obligations, or past services, or any combination of these, may be found acceptable as consideration. Certain types of consideration may be allowed for particular kinds of shares, and not for others.

a. Cash, including factors dictating amount as proper valuation.

NOTE:
Promissory notes normally must be secured by collateral other than the stock being purchased.

b. Work to be performed.

NOTE:
Work to be performed in the future, as opposed to services already rendered, is not acceptable consideration unless it is pursuant to an employee benefit plan [*Corp. Code § 409(a)(1)*; ***see*** *Corp. Code § 408*].

(1) Kinds desirable.

(2) Timing of performance.

(3) Investors selected to render.

c. Services already rendered.

(1) Kinds desired.

(2) Promoters involved or to be involved.

(3) Chances for binding key personnel.

d. Obligations canceled (debts or securities).

(1) Desirability of individual investors incurring obligations to be transferred to corporation.

(2) Circumstances justifying for operational or tax purposes.

e. Property, tangible or intangible.

(1) Types of property, plant, or equipment needed by corporation (or wholly owned subsidiary).

(2) Owners or controllers interested in or capable of becoming investors.

(3) Factors of depreciation and liability.

f. Installment payment plans [*see Corp. Code § 409(d)*; *see also §§ 6I.202*, *6I.223*, *6I.263*].

(1) Feasibility of delaying full payment; probability of continued payment.

(2) Effect of factors of type of consideration involved.

(3) Acceptable collateral.

2. Determine valuation of consideration.

a. Determine probable cash value of securities in terms of demands and competitive factors of similar markets.

b. Determine value of nonmonetary types of consideration [*see § 6I.221*].

(1) In terms of need of corporation.

(2) Competitive supply available to corporation.

(3) Similar factors available or operating in the marketplace.

c. Determine whether to engage technical specialists to assist in valuation of particular types of consideration, such as:

(1) Accountants.

(2) Engineers.

(3) Market analysts.

(4) Business consultants.

d. Evaluate ability of board of directors to employ good faith in valuation of property.

e. Avoid creating "watered" shares; that is, shares in return for undervalued property.

NOTE:

Creditors may rely on apparent full value received as shown in books [*Bing Crosby Minute Maid Corp. v. Eaton (1956) 46 Cal. 2d 484, 487-488, 297 P.2d 5]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6I California Legal Forms--Transaction Guide § 6I.114

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.114 Allocation of Control and Investment Risk

[1] Corporation Deriving Initial Capital Solely From Organizers

NOTE:
The formulation of a capital structure for a corporation that does not initially seek outside capital should be designed to protect the interests of its organizer-investors to the fullest extent possible with respect to risk, control, and participation in profits.

1. If minimization of investor risk of loss is goal, consider use of following:

a. Debt securities, or, less preferably, preferred shares.

NOTE:
However, Section 1244 stock [***see*** *I.R.C. § 1244*] is often better protection than debt securities because if there is a loss, it is an ordinary loss rather than a capital loss [***see*** *§ 6I.21*].

b. Shareholders' agreements [*see* Ch. 8C, *Close Corporation Shareholder Agreements*].

PRACTICE TIP:
Shareholders' agreements should be carefully drafted to take into account likely future events since changes in shareholders' agreements are changes in the rights, preferences and privileges of the stock which must be qualified under *Corp. Code § 25120*, unless the transaction is exempt [*10 Cal. Code Reg. § 260.017.2*]. *Commentary by Frances E. Lossing.*

c. Employment agreements between corporation and organizers.

d. Maintenance with organizers of means of controlling corporate affairs.

2. If assurance of control is goal, determine how to structure transaction to assure control by appropriate parties.

a. For a large corporation:

(1) Organizers will be assured of retaining control, subject to any fiduciary duties they may owe to minority shareholders, if they, as a unit, own over one half of outstanding common shares.

(2) To retain control, they must prevent dilution of unit's voting powers by:
(a) Having straight voting, rather than cumulative voting, if permitted under California law [*see Corp. Code §§ 301.5*, 708, 708.5].

(b) If corporation is private corporation, using voting trusts whenever possible [*see* Ch. 8B, *Voting Agreements and Voting Trusts*].

NOTE:
Voting trusts are uncommon if the corporation's securities are publicly traded because of market considerations and restrictions imposed by the rules of the national securities exchanges.

(c) If securities are to be sold to outsiders, selling only nonvoting securities.

b. For a moderately sized corporation:

NOTE:
The following provisions should be employed if the organizers are to invest unequal amounts but the investor of the smaller amount insists on equal control with the larger investor. Both interests ordinarily can be accommodated with these provisions.

(1) Issue preferred shares in series with limited voting rights for one series and full voting rights for the other series.

(2) Issue preferred shares with class or contingent voting rights.

(3) Issue more than one class of shares in conjunction with a disproportionate voting plan.

(4) Prepare shareholders' agreement providing for equal voting rights.

(5) Provide for preemptive rights.

NOTE:
Cumulative voting rights provided by California law are also useful in this circumstance [***see*** *Corp. Code §§ 301.5*, 708, 708.5].

3. Determine whether shares will be subject to any call protection (i.e., shares may not be redeemed for a period of five years after the date of issuance).

[2] Corporation That Will Seek Outside Capital for Initial Financing

1. Determine overall capital structure that will permit insiders to:

a. Retain fullest possible control.

b. Be assured of:
(1) Maximum participation in profits.

(2) Minimal exposure to:
(a) Risk of loss.

(b) Liability for taxes.

2. Determine what securities should be used to attract outside investors, taking into account following factors:

NOTE:
The corporation should offer for sale to outsiders only those securities that would be least likely to cause hardship either to the corporation, its organizers, or both.

a. Available market for securities.

b. Requisite compliance with federal and state securities laws.

c. Particular type of financing indicated by past, present, and anticipated earnings.

d. Whether it is feasible for owners to sacrifice any of their control (voting power) over corporate affairs.

NOTE:
If that is possible, common equity financing may be used.

e. Overall cost of each security to organizers and corporation.

f. Effect of particular type of financing on future borrowing.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesBusiness & Corporate LawCorporationsFormationPreincorporationGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6I California Legal Forms--Transaction Guide § 6I.115

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.115 Share Structure of Corporation

1. Determine aggregate number of shares that corporation will have authority to issue.

NOTE:
It is customary to authorize a much larger number of shares than the incorporators actually intend to issue.

2. Determine whether shares will constitute one class or more than one class.

NOTE:
When a single type of stock is offered, it will automatically contain the basic elements of common voting stock [***see*** *Corp. Code § 400*]. However, there are many different ways in which the board can differentiate stock into particular classes or series having different characteristics.

A combination of Class (or Series) "A" nonvoting and "B" voting is not currently favored; it is normally not allowed on a qualified offering of common stock [***see*** *10 Cal. Code Reg. § 260.140.1*]. Preferential clauses or series are still most familiar to those who wish to invest in other than stock representing risk ownership.

3. If shares are to be divided into more than one class, determine:

a. Number of shares of each class.

PRACTICE TIP:

If insufficient numbers of shares of preferred stock have been authorized by the corporation's shareholders, the corporation may wish to issue depositary receipts in lieu of issuing preferred stock directly. A depositary receipt entitles the holder to acquire less than one preferred share (i.e., the depositary receipt may represent 1/100 of a share of preferred stock). *Commentary by Frances E. Lossing.*

b. Designation of each class.

c. Distinguishing characteristics (i.e., rights, preferences privileges, and restrictions) [*see § 6I.13*].

4. If there will be shares of preferred or special classes, determine characteristics of each class, such as [*see § 6I.112*]:

a. Shares redeemable at option of corporation (but not at option of holder) at redemption price fixed by articles.

b. Shares entitling holders to cumulative, noncumulative, or partially cumulative dividends.

c. Shares having dividend preference.

d. Shares having liquidation preference.

e. Convertible shares.

5. If shares of preferred or other special class are to be divided into and issued in series, determine relative rights, preferences, privileges, and restrictions among series such as:

a. Dividend rates and payment dates.

b. Redemption rights (price, terms, and conditions).

c. Liquidation rights.

d. Sinking fund requirements.

e. Conversion privileges.

f. Voting power.

6. Decide whether to issue promotional or partially paid shares [*Corp. Code § 409(d)*].

NOTE:
"Promotional shares" are securities issued as follows [*10 Cal. Code Reg. § 260.140.30*]:

- In consideration for services rendered in connection with the founding or organizing of a business enterprise;

- To a promoter in consideration for tangible or intangible property to the extent that the value has not been satisfactorily established; or

- To a promoter in the recent past or proposed to be issued at a price substantially lower than the price at which other securities of the same class (or substantially similar class) have been or are to be sold without any change in market conditions or in the issuer's circumstances that would justify a different price.

In connection with the financing of an unseasoned corporation, a reasonable number of promotional shares may be issued; presumptively, a number that does not exceed 25 percent of all common shares issued and proposed to be issued is reasonable [*10 Cal. Code Reg. § 260.140.31(a)*; ***see*** *10 Cal. Code Reg. § 260.140.31(c)* (normally, promotional shares are prohibited in offerings by seasoned corporations)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFormationPreincorporationGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6I California Legal Forms--Transaction Guide § 6I.116

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.116 Issues in Connection With Qualification

1. If offering must be qualified in California, and preferred stock will be non-cumulative, non-participating, and will not have full voting rights, give preferred stock the following features [*10 Cal. Code Reg. § 260.140.2*]:

a. Dividends must be cumulative.

b. No dividends may be paid on common stock when payments on preferred stock are in arrears

c. Provision must be made for written consent of a specified percentage of preferred shares on any matter that would adversely affect rights of preferred shareholders and on issuance of any shares having a priority over preferred shares.

d. Restrictions must be made on payment of dividends on common stock.

e. Right to elect Board members if eight or more quarterly dividend payments are in arrears must be provided [*10 Cal. Code Reg. § 260.140.2*].

2. If corporation is seasoned corporation proposing to sell securities that are nonparticipating and nonconvertible on a fair and equitable basis, determine whether it can show ability to meet proposed dividend and sinking fund requirements, if any, on all of its securities outstanding and proposed to be issued, based on [*10 Cal. Code Reg. § 260.140.10*]:

NOTE:

A corporation is a seasoned corporation if the corporation has been conducting bona fide operations either directly or through a predecessor for a period of more than two years and has been operating at a profit for at least one of the last three years [*10 Cal. Code Reg. § 260.001(g)*]. All other corporations are unseasoned corporations.

a. Its previous earnings or cash-flow history; or

b. Demonstrated future earnings or cash flow capacity.

3. If corporation is unseasoned corporation selling securities pursuant to an open qualification, make certain that preferred stock either [*10 Cal. Code Reg. § 260.140.9*]:

NOTE:

An "open qualification" is a qualification that authorizes the offer and sale of securities to the public generally, without restriction as to persons or classes of persons [*10 Cal. Code Reg. § 260.001(f)*]. An unseasoned corporation, however, may sell preferred stock that does not meet the following standards to its existing security holders on a pro rata basis [*10 Cal. Code Reg. § 260.140.9*].

a. Is convertible into common stock on a fair and equitable basis, or

b. Is fully participating and non-redeemable.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesRight to DividendsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesBusiness & Corporate LawCorporationsShareholdersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6I California Legal Forms--Transaction Guide §§ 6I.117-6I.129

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6I.117[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Issuance of Equity Securities

3-6I California Legal Forms--Transaction Guide § 6I.130

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.130 Preparing Equity Security Documents for Board of Directors

1. Collate into appropriate format all market and other technical data reports on financing prospects.

NOTE:
All matters of expert information to be presented to the board regarding pricing of securities or valuation of property should be written out prior to the meeting, and copies distributed to all members of the board at least several days before the meeting.

2. Create program agenda of speakers placing financing proposals before board.

NOTE:
Private investors may need to make formal presentations before the board in relation to their potential investment. They may be insiders formally arguing for acceptance of their nonmonetary consideration, or arguing against or expanding on technical data to be brought before the board in regard to shares in which the investor may be interested. They may be outside sophisticated investors who have acquired information as to the possibility of participation in the new organization, who appear in order to argue for inclusion in the investment scheme. Speakers also may be professional licensed brokers or underwriters appearing in order to explain the type of contract for services they are offering, or to bid for acting as agent for the corporation in a particular capacity. The corporation's attorney may wish to outline tax or securities regulation considerations.

3. Outline proposed minutes, including alternative forms of resolutions providing for execution of complete plan of issuance [*see* Ch. 5, *Directors' Meetings, Actions, and Resolutions*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationGeneral OverviewSecurities LawGeneral Overview



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3-6I California Legal Forms--Transaction Guide § 6I.131

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.131 Adopting Formal Resolutions Necessary to Issuance

1. Take full notes of meeting for purposes of minutes.

NOTE:
The discussion that takes place during the meeting on issuance of securities can be of vital importance for management, accountants, and government regulatory supervisory agencies such as securities and taxing authorities. Securities provisions implemented by an organizing corporation may be ambiguous when viewed in the later context of development of the enterprise. It is helpful to have a clear and complete exposition of the official corporate thinking behind any particular proposal as of the date on which it was adopted.

2. Have board decide on appropriate amount of authorized shares to issue [*Corp. Code § 400(a)*; *see § 6I.210* (resolution)].

NOTE:
The amount of authorized shares designated in the articles is the highest aggregate total of any particular class or series calculated to suit the corporation's convenience for the indefinite future [***see*** Ch. 3, ***Articles of Incorporation***]. The board must calculate the most feasible amount it can presently issue and be able to sell in the market currently available, since qualification by the Commissioner is generally for a one-year period. It may also be necessary to coordinate adoption of appropriate resolutions with provisions of the articles allowing the board to determine particular preferences and other special incidents of specified classes or series [*Corp. Code § 401*; ***see*** Ch. 3, ***Articles of Incorporation***]. The board must consider all known as well as unknown investors, and

decide whether to make the offering a private or public one. Federal securities regulations are an important consideration if the offering will not be registered; the offering must be adequately controlled to assure that it will be purely directed to ultimate intrastate residents or to members of a wholly private composition [***see*** Ch. 6A, ***Federal Securities Exemptions for California Nonpublic Corporations***].

PRACTICE TIP:

If insufficient numbers of shares of preferred stock have been authorized by the corporation's shareholders, the corporation may wish to issue depositary receipts in lieu of issuing preferred stock directly. A depositary receipt entitles the holder to acquire less than one preferred share (i.e., the depositary receipt may represent 1/100 of a share of preferred stock). *Commentary by Frances E. Lossing.*

3. Have board select classes or series to be offered [*Corp. Code § 400*; *see §§ 6I.200*, *6I.201*].

NOTE:

The board must consider what special incidents should be attached to each type of series to correspond with the scheme of financing and control adopted to employ such different offerings, either by choosing certain shares authorized by the articles or through certifying its determination as to such preferences [***see*** Ch. 3, ***Articles of Incorporation***].

4. Prepare resolution authorizing issuance of shares and specifying rights, preferences, privileges, and restrictions of different types of shares to be issued [*Corp. Code § 400*; *see § 6I.210*].

5. If offerees or proposed purchasers are known, have board adopt resolution identifying them [*see § 6I.211*].

6. Have board adopt resolution approving the form of the share certificate, if one will be used [*see § 6I.212*].

7. If appropriate, have board adopt resolution authorizing issuance of appropriate options or warrants [*Corp. Code § 404*; *see §§ 6I.250*, *6I.251*].

NOTE:

For reasons related to inducing the sale, either because of a low market or a desire to minimize high-yield characteristics of securities to be offered, the board may attach various types of option rights to purchase specified securities in the future, or conversion rights to enable securities presently being sold to be exchanged for specified other securities at some future time [***see*** *§ 6I.240*].

8. Have board adopt resolution specifying type of consideration to be received [*Corp. Code § 409(a)(1)*; *see § 6I.220*].

9. If nonmonetary consideration will be accepted, have board adopt resolution determining fair value of that consideration [*Corp. Code § 409(e)*; *see § 6I.221*].

NOTE:

Different standards of evaluation may have to be applied in regard to different types of property. However, each should be translated into equivalent cash value, and where below the cash price of shares being offered, it should be required that a cash differential be included to make up the full amount of the originally slated offering price.

10. If appropriate, have board pass resolutions:

a. Limiting selling expenses [*see § 6I.222*].

b. Authorizing issuance of appropriate number of promotional shares to promoters [*see § 6I.224*].

11. If appropriate, have board adopt resolution authorizing issuance of partially paid stock [*Corp. Code § 409(d)*; *see § 6I.223*].

12. Have board adopt resolutions with respect to compliance with applicable securities laws:

a. Resolution authorizing officers to file notice of qualification or exemption under California law [*see § 6I.230*].

b. Resolution authorizing application for sale of securities under law of other states [*see § 6I.231*].

c. Resolution authorizing filing of registration statement of notification under federal securities laws with SEC [*see § 6I.232*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFormationPreincorporationGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Issuance of Equity Securities

3-6I California Legal Forms--Transaction Guide § 6I.132

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.132 Issuing Shares

1. Comply with all applicable federal and state securities laws prior to offering or selling securities [*see* Ch. 6, *Securities Regulation Issues*].

a. Federal requirements administered by Securities and Exchange Commission (SEC) [*see* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*].

b. California requirements administered by Department of Corporations [*see* Ch. 6B, *California Limited Offering Exemptions* ; Ch. 6C, *California Small Offering Exemption* ; Ch. 6D, *California Qualified Purchaser Exemptions* ; Ch. 6H, *Qualification of Securities*].

c. Requirements of other states or jurisdictions in which securities are to be offered and/or sold [*see Ch. 6, Securities Regulation Issues, §§ 6.70, 6.71*].

2. Prepare subscription agreements or sales contracts to accommodate desired stock purchasing procedures [*see §§ 6I.260-6I.263*].

3. Comply with all conditions and limitations imposed by regulatory authorities with respect to offering, selling, marketing, and advertising securities.

NOTE:
These limitations depend on the requirements of the securities laws or exemptions being relied on by the corporation, and are discussed in detail in the chapters referred to in P 1, ***above***.

4. Issue equity share certificates [*see §§ 6I.200, 6I.201*] (or initial transaction statements if alternative system of uncertificated securities is used) to purchasers on receipt of full purchase price.

NOTE:

The certificate or transaction statement must contain all appropriate legends and statements required by applicable federal and state law; for discussion, see *§§ 6I.200*, *6I.201*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsConsideration for SharesBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock CertificatesSecurities LawGeneral Overview



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3-6I California Legal Forms--Transaction Guide §§ 6I.133-6I.199

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6I.133[Reserved]



126 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
A. Share Certificates

3-6I California Legal Forms--Transaction Guide § 6I.200

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.200 Common Share Certificate

[1] Comment

[a] Use of Form

This form illustrates the face and reverse sides of a share certificate for common stock. There are no statutory requirements as to the physical character of the certificate, which may range from a simple typewritten sheet of ordinary paper to a baroquely engraved sheet of parchment. Most small companies employ printed certificates with blanks for corporate name and seal, holder's name, and the like. These are often sold as part of a "corporation kit" that includes a seal and perhaps bylaws and organizational minutes. The latter type of certificate needs to be supplemented with special provisions like transfer restrictions and other matters required to appear on the certificate in California. If the certificate is to be traded on a stock exchange, the exchange typically prescribes additional requirements as to text and physical character.

[b] Nature of Common Shares

Common shares are those that have no preference over any other shares with respect to distribution of assets on liquidation or with regard to payment of dividends [*Corp. Code § 159*]. For a discussion of common shares in general, see *§ 6I.14*. For an example of contrasting preferred shares, see *§ 6I.201*. For a common share certificate for use when only a single class of stock is being offered, the first and final paragraphs of this form may be used, including any relevant legend conditions that may be needed.

[c] Issuance

Each shareholder is entitled to have a certificate from the corporation certifying the number of shares and the class or series of shares owned [*Corp. Code § 416*]. The corporation is not required to distribute certificates unless they are expressly demanded by any particular shareholder [*see § 6I.20*]. The corporation may design a record keeping system

that does not contemplate the mass distribution of share certificates. Meanwhile, it may have adequate dealings with the shareholders based on their status as shareholders of record on the books of the corporation [*see Corp. Code §§ 185, 1500*].

A corporation may also use a completely certificate-free system of electronic processing of share ownership, under which a certificate is not even available to individual shareholders, if the system has been approved by the Securities and Exchange Commission, is authorized in any statute of the United States, or is in accordance with Division 8 of the California Commercial Code [*Corp. Code § 416(b)*; *see Com. Code § 8101 et seq.*; *see also § 6I.20[2], [3]*].

[d] Signatures

If a certificate is issued, it must be signed in the name of the corporation by a representative from each of two sets of executive personnel. A signatory from the first set will be either the chairman or vice-chairman of the board of directors, or the president or any vice-president. The other signatory comes from a group that consists of the chief financial officer, the treasurer, any assistant treasurer, the secretary, or any assistant secretary. Any or all of the above signatures may be facsimile [*Corp. Code § 416(a)*].

A particular officer, transfer agent, or registrar who has signed or whose facsimile signature has been placed on the certificate may have left his or her official capacity before issuance of the certificate. In that case, the certificate still may be issued by the corporation with the same effect as if the person were still in office at the date of issue [*Corp. Code § 416(a)*]. Even if the signatory officer has no authority to execute the certificate, it will not be invalidated as against the shareholder in the absence of actual knowledge on the shareholder's part [*Corp. Code § 313*; *see Snukal v. Flightways Manufacturing, Inc. (2000) 23 Cal. 4th 754, 786-787, 98 Cal. Rptr. 2d 1, 3 P.3d 286* (interpreting *Corp. Code § 313* in context of lease agreement to hold that signature of one person alone is sufficient to bind corporation, as long as individual holds corporate offices in both "operational group" and "financial group" described in that statute)]. The latter defense may not be available in situations of third party suits against the corporation, or certain representative actions brought by shareholders [*see Corp. Code § 208(a)*].

[e] Contents of Certificate--In General

Various informational statements are required to appear on the certificate. If the shares of the corporation are classified, or if a class is serialized, one of the following items must appear [*Corp. Code § 417*]:

- A statement of the rights, preferences, privileges, and restrictions granted to or otherwise imposed on each class or series of shares authorized to be issued, and on the holders of each.

- A summary of those rights, preferences, privileges, and restrictions with reference to the provisions of the articles and any certificates of determination establishing them.

- A statement setting forth the office or agency of the corporation from which shareholders may obtain, on request and without charge, a copy of the statement referred to above.

The following matters must also appear on the certificate, unless stated or summarized pursuant to *Corp. Code § 417(a)* or *(b)* [*Corp. Code § 418(a)*]:

- The fact that the shares are subject to restrictions on transfer. This statement (or the reference to it) must be conspicuous. Although the General Corporation Law does not furnish a definition, in the Commercial Code "conspicuous" means that a contract provision is presented so that a reasonable person against whom it is to operate ought to notice it; and using larger type, or a contrasting type, font, or color, compared to surrounding text, should be sufficient [*see* Com. Code § 1201(b)(10)].

- The fact that the shares are assessable or, if the shares are not fully paid, the certificate must recite the total amount of the consideration to be paid for the shares and the amount already paid [*see Corp. Code § 409(d)*; *see also § 6I.202*]. These statements must also be conspicuous.

- The fact that the shares are redeemable.

- The fact that the shares are convertible, and the period for conversion.

- The fact that the shares are subject to the following:

    - An agreement among shareholders of a corporation providing for a uniform voting policy binding holders of the participating shares [*see Corp. Code § 706(a)*].

    - An irrevocable proxy held by persons commanding certain positions vis-a-vis the shareholder which authorizes those persons to exercise the vote for the shares [*see Corp. Code § 705(e), (f)*].

    - Restrictions on voting rights contractually imposed by the corporation directly against the particular shares.

Unless stated on the certificate as required by *Corp. Code § 418(a)*, no restriction on transfer, no right of redemption, no control by voting agreement or prerogative of proxy, and no imposed voting restriction will be enforceable against a transferee (including a purchaser from the corporation) of the shares without actual knowledge of those matters [*Corp. Code § 418(b)*]. A transferee of the corporate shares (including a purchaser from the corporation) will not be liable for any assessment or for any unpaid portion of the subscription price unless the certificate provides otherwise [*Corp. Code § 418(b)*].

[f] Placement "On the Certificate"

The requirement that the information specified in *Corp. Code §§ 417* and *418* appear "on the certificate" means that the information must appear on the face of the certificate, or on the reverse side with a reference to it appearing on the face [*Corp. Code § 174*]. In the case of uncertificated securities, the statements required to appear "on the certificate" must appear on the initial transaction statement and written statements [*Corp. Code § 174*; *see Corp. Code §§ 417, 418*].

[g] Close Corporation Share Certificates

A certificate for a close corporation [*see Corp. Code § 158*] must contain a statement regarding the nature of the organization as a close corporation and setting forth all restrictions on the transfer of shares. The certificate must also contain a statement that the total number of shareholders may not exceed 35 [*Corp. Code § 158(a)*]. These statements must appear conspicuously on the face of the certificate and not on the reverse side. Any attempted inter vivos transfer of shares evidenced by certificates bearing these required statements is void [*Corp. Code § 418(c), (d)*]. Every shareholder to whom a certificate of this type is issued is bound by agreement not to violate the transfer restrictions [*Corp. Code § 421*].

[h] Limited Offering Qualification Share Certificates

When securities are issued under a limited offering qualification (as distinct from the limited offering exemption) [*see 10 Cal. Code Reg. § 260.001(e)*; *see also Ch. 6H, Qualification of Securities, § 6H.260*] and the Commissioner of Corporations determines that equity requires the imposition of restrictions on the transfer of the shares or the applicant

requests such restrictions, a condition may be imposed restricting subsequent transfer and requiring that a specific legend relating to the transfer restrictions be placed on the certificate [*10 Cal. Code Reg. § 260.140.8*]. For additional discussion of this legend, see *Ch. 6H, Qualification of Securities, § 6H.262*.

If the Commissioner imposes a legend condition pursuant to a limited offering qualification or otherwise, the issuer must provide the purchaser with a copy of *10 Cal. Code Reg. § 260.141.11* [*10 Cal. Code Reg. § 260.141.10*].

[i] Professional Corporation Share Certificates

Professional corporations are subject to special restrictions on share ownership and transfer. These restrictions must be noted on the certificates of those corporations under *Corp. Code § 418(a)* and under applicable administrative regulations. For a discussion of these restrictions as they apply to professional corporations in general, see "--Requirements for Directors, Officers, and Shareholders" and "--Restrictions on Issuance and Transfer of Shares" in the Legal Background to Ch. 12A, *Professional Corporations*.

[j] Shares Subject to Assessments

If a corporation is entitled to levy assessments on shares, the assessment becomes a lien on those shares. A subsequent transfer on the corporate books constitutes a waiver of the lien unless a conspicuous legend containing prescribed information has been placed on the face of the certificate issued on transfer [*Corp. Code § 423(e)*; *see § 6I.203*]. If uncertificated securities [*Corp. Code § 191.1*; *Com. Code § 8102(a)(18)*] are subject to an assessment lien, transfer of the securities will constitute waiver of the lien unless a conspicuous legend containing prescribed information appears on the initial transaction statement [*Corp. Code § 423(e)*; *see Corp. Code § 423(c)*].

[k] Promotional Shares and Limited Offering Transfer Restrictions

The Commissioner of Corporations has authority to impose a legend condition for the implementation of various regulatory requirements [*see Corp. Code § 25141*], such as for promotional shares [*see 10 Cal. Code Reg. §§ 260.140.32, 260.141, 260.141.3*], and limited offering transfer restrictions. These legends must appear on the face of the certificate in at least 10-point type [*see 10 Cal. Code Reg. §§ 260.141.1, 260.141.11*; *see also Ch. 6H, Qualification of Securities, § 6H.260-6H.263*].

Although share certificates of securities issued under the California limited offering exemption [*Corp. Code § 25102(f)*] are not required to contain disclosures of the conditions of their issuance, those disclosures will ensure that any transferees of the corporate shares will be aware of those conditions. Accordingly, this form contains a provision specifying that the original purchaser represented that the shares were purchased for purposes of investment rather than resale [*see Corp. Code § 25102(f)(3)*], and that they were not qualified in California. This provision may be combined with a statement of any transfer restrictions on the shares if any restrictions are imposed.

[l] Federal Securities Legend--In General

A securities offering may be exempt from the registration requirements of the federal Securities Act of 1933 [*15 U.S.C. §§ 77a-77aa*; *see* Sommer, Federal Securities Act of1933 (Matthew Bender)] under one of the rules discussed below. To qualify for the exemption the issuer may be required to place a legend on the share certificate regarding the status of the securities under the federal securities law and the imposition of any transfer restrictions. For detailed coverage of these exemptions from registration, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*.

[m] Intrastate Offerings

Wholly intrastate offerings of securities are exempt from federal registration requirements if certain tests are satisfied [

see 15 U.S.C. § 77c(a)(11); *17 C.F.R. § 230.147* (SEC Rule 147)]. For discussion of these tests, see *Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.24*]. One condition is that resales must be limited to residents of the state in which the securities were issued during the offering and for nine months from the date of the last exempt sale made by the issuer [*17 C.F.R. § 230.147(e)*]. The share certificates must bear a legend stating that the securities have not been registered under the Securities Act of 1933 [*15 U.S.C. §§ 77a-77aa*], and setting forth the limitations on resales [*17 C.F.R. § 230.147(f)(1)(i)*; *see* [2], *below*].

[n] Regulation D Offerings

A securities offering is also exempt from federal registration if it is issued under any of the three limited offering exemptions contained in SEC Regulation D [*see 17 C.F.R. §§ 230.501-230.508*]. Those exemptions are set forth as Rules 504, 505, and 506 [*see 17 C.F.R. §§ 230.504-230.506*; *see also 15 U.S.C. §§ 77c(b), 77d(2)*]. For detailed coverage of these exemptions from registration, see Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* .

Under Rule 504, solicitation and advertising directed to investors is allowed, and a security received under Rule 504 is freely transferable--it no longer must be imprinted with information that transfers of the security are prohibited, if certain conditions are satisfied [*17 C.F.R. § 230.504(b)(1)*; *see 17 C.F.R. § 230.502(c), (d)(2)*]. Otherwise, securities sold in Rule 504 offerings will also be "restricted securities."

Securities sold under Rule 505 or 506, however, cannot be resold without registration or exemption under the Securities Act [*17 C.F.R. § 230.502(d)*]. These securities are referred to as "restricted securities" [*17 C.F.R. § 230.144(a)(3)* (Rule 144)]. The issuer must exercise reasonable care to ensure that the purchasers of the securities are not underwriters within the meaning of Section 2(11) of the Act [*17 C.F.R. § 230.502(d)*; *see 15 U.S.C. § 77b(a)(11)* (defined as person who purchases securities with a view to distribution)]. Reasonable care may be demonstrated by (1) reasonable inquiry to determine if the purchaser is acquiring the securities for himself or herself, or for other persons; (2) written disclosure to each purchaser prior to sale that the securities have not been registered, and therefore cannot be resold unless registered or exempted; and (3) *placement of a legend on the certificate or other document evidencing the securities, stating that the securities are not registered, and setting forth the restrictions on transfer and sale of securities* [*17 C.F.R. § 230.502(d)(1)-(3)*; *see* [2], *below*]. These actions are not the exclusive means to demonstrate reasonable care; other actions by the issuer may satisfy this requirement [*17 C.F.R. § 230.502(d)*]. However, it makes sense to demonstrate compliance by using these methods and issuers relying on the Regulation D exemptions almost invariably do so.

[o] Endorsement of Share Certificate

The owner's signature on the reverse side of a share certificate constitutes an endorsement. The transferee's name is usually filled in when the transferor and transferee are dealing at arm's length, as is the usual case in a close corporation. This is a special endorsement. When the transferor is selling through a broker, as is usually the case for shares in a publicly held company, the name of the transferee is typically left blank. This constitutes an endorsement in blank and would normally make the security transferable to or by the bearer. However, an endorsement of either kind does not transfer the security until the certificate is actually delivered [*Com. Code § 8304*].

Although delivery and endorsement will normally effect a transfer, registration of the transfer by canceling the old certificate and issuing a new one in the transferee's name is necessary to record him or her as a shareholder in the corporation's books and entitle him or her to the benefits of that status, such as dividends, notices, and the like [*see Corp. Code §§ 185, 1600*; *see also Com. Code § 8102(a)(4), (13), (15)*].

The "attorney" referred to in the form does not have to be a lawyer. In transactions involving shares of a close corporation, it is typically the transferee or the transferee's agent. If it is a publicly traded stock transaction, the attorney

most often is the transferor's stockbroker. Naming an attorney can provide a safeguard against theft or loss by restricting the bearer quality of a blank endorsement since only the attorney (or a substitute) can properly give instructions for registration of transfer of the stock. However, the designated space can be left blank without impairing the transaction.

[2] FORM

Common Share Certificate

[*Face side:*]

COMMON SHARE CERTIFICATE

_____ [*Name of corporation*]

Certificate No. _____ ..... _____Shares

THIS CERTIFIES THAT _____ [*name of shareholder*] is the owner of _____[*number*] shares of the common stock of _____ [*name of issuer corporation*], a corporation organized under the laws of the State of California, transferable on the books of the corporation by the holder hereof, in person or by duly authorized attorney, on surrender of this certificate properly endorsed.

Witness the seal of the corporation and the signatures of its duly authorized officers:
_____Dated:

_____ [*name of corporation*]

By _____ [*signature or facsimile*]

[*typed name*], [Vice-]President [*or* (Vice-)Chairman of the Board]

By _____ [*signature or facsimile*]

[*typed name*], [Assistant] Treasurer [*or other chief financial officer or* (Assistant) Secretary]

_____ [*signature*]

Registrar

_____ [*signature*]

Transfer Agent

[*Add the following conspicuously on the face of the certificate if the certificate represents shares of a close corporation:*]

THIS CORPORATION IS A CLOSE CORPORATION. THE NUMBER OF HOLDERS OF RECORD OF ITS SHARES OF ALL CLASSES CANNOT EXCEED _____ [*number not in excess of 35*]. ANY ATTEMPTED VOLUNTARY INTER VIVOS TRANSFER THAT WOULD VIOLATE THIS REQUIREMENT IS VOID. REFER TO THE ARTICLES, BYLAWS, AND ANY AGREEMENTS ON FILE WITH THE SECRETARY

OF THE CORPORATION FOR FURTHER RESTRICTIONS.

[*If there is one class of shares and (as is assumed in this form) the statements required by Corp. Code § 418(a) will not be stated in full on the face of the certificate, add:*]

SEE THE REVERSE OF THIS CERTIFICATE FOR RIGHTS AND RESTRICTIONS.

[*If there are two or more classes of shares or if any class has two or more series and (as is assumed in this form) neither a statement, or summary, of rights, preferences, privileges, and restrictions, nor a statement of where that information may be obtained, appears on the face of this certificate, add one of the following.*]

[*EITHER*]

FOR A STATEMENT OF THE RIGHTS, PREFERENCES, PRIVILEGES, AND RESTRICTIONS OF EACH CLASS [*or* SERIES], SEE THE REVERSE OF THIS CERTIFICATE.

[*Or*]

FOR A SUMMARY OF THE RIGHTS, PREFERENCES, PRIVILEGES, AND RESTRICTIONS OF EACH CLASS [*or* SERIES], SEE THE REVERSE OF THIS CERTIFICATE.

[*Or*]

TO OBTAIN A COPY OF THIS STATEMENT CONCERNING THE RIGHTS, PREFERENCES, PRIVILEGES, AND RESTRICTIONS OF EACH CLASS [*or* SERIES], SEE THE REVERSE OF THIS CERTIFICATE.

[*Add the following legends, if applicable, either to the face of the certificate or to the reverse side with a reference to them on the face.*]

[*If shares are part of a limited offering qualification on which transfer restrictions have been imposed (see Ch. 6H, Qualification of Securities, § 6H.260):*]

General Restriction on Transfer

IT IS UNLAWFUL TO CONSUMMATE A SALE OR TRANSFER OF THIS SECURITY, OR ANY INTEREST THEREIN, OR TO RECEIVE ANY CONSIDERATION THEREFOR, WITHOUT THE PRIOR WRITTEN CONSENT OF THE COMMISSIONER OF CORPORATIONS OF THE STATE OF CALIFORNIA, EXCEPT AS PERMITTED BY THE COMMISSIONER'S RULES.

[*If shares are being offered to promoters for past services or certain intangible properties (see 10 Cal. Code Reg. § 260.141.1; see also Ch. 6H, Qualification of Securities, § 6H.261):*]

Promotional Securities

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN RESTRICTIONS, INCLUDING WAIVERS OF DIVIDENDS AND ASSETS, AND IT IS UNLAWFUL TO CONSUMMATE A SALE OR TRANSFER OF THEM, OR ANY INTEREST THEREIN, OR RECEIVE ANY CONSIDERATION THEREFOR, WITHOUT THE PRIOR WRITTEN CONSENT OF THE COMMISSIONER OF CORPORATIONS OF THE STATE OF CALIFORNIA.

Assessment Lien

[*If shares have been assessed and amount is presently a lien on these shares, add lien notice contained in § 6I.203 here, before issuance of certificate on registration of a transfer of these shares.*]

Transfer Restrictions

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO RESTRICTIONS ON TRANSFER CONTAINED IN _____ [*e.g.,* THE ARTICLES OF INCORPORATION *or* A SHAREHOLDERS' AGREEMENT DATED _____ (*date*)].

[*For offerings under limited offering exemption (Corp. Code § 25102(f); see Ch. 6B, California Limited Offering Exemptions), add:*]

Shares Not Purchased for Resale

THE SHARES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE CALIFORNIA SECURITIES LAWS. THE PURCHASER OF THESE SHARES HAS REPRESENTED THAT HE OR SHE PURCHASED THE SHARES FOR HIS OR HER OWN ACCOUNT, OR FOR A TRUST ACCOUNT IF THE PURCHASER IS A TRUSTEE, FOR INVESTMENT PURPOSES AND NOT WITH A VIEW TOWARD RESALE.

Partly Paid Shares

[*For statement regarding partly paid shares, see § 6I.202.*]

Assessable Shares

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE ASSESSABLE AS PROVIDED IN THE ARTICLES OF INCORPORATION.

Voting Agreement

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO THE PROVISIONS OF A VOTING AGREEMENT DATED _____[*date*].

Irrevocable Proxy

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO AN IRREVOCABLE PROXY DATED _____[*date*], CONFERRING THE RIGHT TO VOTE THE SHARES ON THE PROXY HOLDER NAMED THEREIN.

Voting Rights

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO RESTRICTIONS ON VOTING RIGHTS CONTRACTUALLY IMPOSED BY THE CORPORATION PURSUANT TO AN AGREEMENT DATED _____[*date*].

[*If shares are redeemable (see Corp. Code § 402), add:*]

Redemption

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE _____ [REDEEMABLE *or* SUBJECT TO REDEMPTION] AT THE OPTION OF _____ [THE SHAREHOLDER *or* THE CORPORATION] _____ [*describe event triggering redemption rights, if any, e.g.,* ON THE VOTE OF A MAJORITY OF THE OUTSTANDING SHARES OF _____ (*describe class or series*) *or* ON THE FIRST BUSINESS DAY OF _____ (*month*) COMMENCING _____ (*year*)].

Federal Exemptions

[*If shares are being sold pursuant to federal intrastate exemption (15 U.S.C. § 77c(a)(11); 17 C.F.R. § 230.147(e), (f)):*]

THESE SHARES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933. DURING THE PERIOD IN WHICH THESE SHARES AND THE ENTIRE ISSUE OF WHICH THEY ARE A PART ARE BEING OFFERED AND SOLD BY THE CORPORATION, AND FOR A PERIOD OF NINE MONTHS FROM THE DATE OF THE LAST SALE BY THE CORPORATION OF THE SECURITIES, ALL RESALES OF THESE SECURITIES AND ANY PART OF THE ISSUE, BY ANY PERSON, SHALL BE MADE ONLY TO PERSONS RESIDENT WITHIN THE STATE OF CALIFORNIA.

[*Or, if shares are being sold pursuant to the Rule 505 or Rule 506 exemption from federal registration under SEC Regulation D (17 C.F.R. §§ 230.501-230.508) and are subject to the Regulation D limitations on resale (see 17 C.F.R. § 230.502(d)):*]

THESE SHARES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 [OR UNDER ANY APPLICABLE STATE LAW]. THEY MAY NOT BE OFFERED FOR SALE, SOLD, TRANSFERRED, OR PLEDGED WITHOUT EITHER (1) REGISTRATION UNDER THE SECURITIES ACT OF 1933 OR (2) AN OPINION (SATISFACTORY TO THE CORPORATION) THAT THESE SHARES ARE EXEMPT FROM SUCH REGISTRATION.

Rights, Preferences, Privileges, and Restrictions

[*If the shares of the corporation are classified, or if any class of shares has two or more series, add one of the following to correspond to the reference on the face of the certificate.*]

[*EITHER*]

The following is a statement of the rights, preferences, privileges, and restrictions granted to or imposed on each class [*or* series] of shares authorized to be issued, and on the holders thereof: _____ [*describe incidents of share structure as provided in articles and any certificates of determination to date (see Ch. 3, Articles of Incorporation*)].

[*Or*]

The following is a summary of the rights, preferences, privileges, and restrictions granted to or imposed on each class [*or* series] of shares authorized to be issued, and on the holders thereof, as established by the provisions of Article _____, Section(s) _____ of the Articles of Incorporation as amended to date, and by certificate(s) of determination filed with the Secretary of State on _____[*date*], [and on _____ (*date*)], to which the holder is referred for complete details: _____ [*summarize incidents of share structure; see Ch. 3, Articles of Incorporation*].

[*Or*]

A statement of the rights, preferences, privileges, and restrictions granted to or imposed on each class [*or* series] of shares authorized to be issued, and on the holders thereof, is available from the _____ [*office or agency of corporation, e.g.*, Secretary, _____ (*full address of the principal office of the corporation*)], which the shareholders may obtain on request and without charge.

[*Add, if desired, when shares are part of limited offering qualification subject to transfer restrictions (see 10 Cal. Code Reg. §§ 260.141.10, 260.141.11).*]

Regulation Governing Transfer Restrictions

_____ [*Set forth text of 10 Cal. Code Reg. § 260.141.11 (see Ch. 6H, Qualification of Securities, § 6H.260)*].

[*Reverse side of certificate:*]

ENDORSEMENT

FOR VALUE RECEIVED, _____ [*name of shareholder exactly as appears on face of certificate*] hereby sells, assigns, and transfers to _____ [*name of transferee*] _____ [*designation of shares and number*] represented by this certificate and hereby irrevocably constitutes and appoints _____ [*name of transfer agent or equivalent*] as attorney to transfer these shares on the books of the

corporation with full power of substitution in the premises.
_____Dated:

_____ [*signature of shareholder*]

In the presence of

_____ [*signature of witness*]

NOTICE:

The signature to this assignment must correspond with the name as written on the face of this certificate in every particular without alteration or enlargement or any change whatever.

PRACTICE TIP:

As a matter of market practice, the owner's signature generally must be guaranteed by a bank or other financial institution under the Medallion signature guarantee program. *Commentary by Frances E. Lossing.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
A. Share Certificates

3-6I California Legal Forms--Transaction Guide § 6I.201

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.201 Preferred Share Certificate

[1] Comment

[a] Use of Form

This form is a certificate for preferred shares in a corporation. It is a modification of the common share certificate *set forth in § 6I.200*. For a discussion of the required contents of stock certificates in general, see *§ 6I.200[1]*.

[b] Difference Between Preferred and Common Shares

The ownership attributes of preferred shares differ somewhat from those attached to common shares. For a more detailed explanation of the ownership rights associated with these two forms of equity securities, see *§§ 6I.14, 6I.15*. A corporation may provide in its articles of incorporation for classes or series of preferred shares which are redeemable at the option of the corporation, the shareholder, or on the vote of at least a majority of the outstanding shares of the class or series to be redeemed [*Corp. Code § 402(a)*]. This form contains a redemption provision that includes alternatives covering all options for redeeming stock. Redemption may also be mandatory at specified times or on the happening of a specified event.

Unless the corporation expressly provides otherwise in its articles of incorporation, each outstanding share is entitled to one vote on each matter submitted to a vote of the shareholders [*Corp. Code § 700(a)* l]. However, holders of shares with voting rights may transfer those rights to preferred shareholders under a voting trust arrangement if the respective parties so desire. For a detailed analysis of voting trusts, and representative forms, see Ch. 8B, *Voting Agreements and Voting Trusts* .

[2] FORM

Preferred Share Certificate

[*Face side:*]

PREFERRED SHARE CERTIFICATE

Certificate No. _____ ..... _____Shares

THIS CERTIFIES THAT _____ [*name of shareholder*] is the owner of _____[*number*] fully paid and nonassessable shares of the _____ [*number, e.g.,* five] dollar [convertible] preferred stock of _____ [*name of issuer corporation*], a corporation organized under the laws of the State of California, transferable on the books of the corporation by the holder hereof, in person or by duly authorized attorney, or by the surrender of this certificate properly indorsed.

FOR INSTRUCTIONS ON HOW TO OBTAIN A COPY OF THE STATEMENT CONCERNING THE RIGHTS, PREFERENCES, PRIVILEGES, AND RESTRICTIONS OF EACH CLASS [*or* SERIES], SEE THE REVERSE SIDE OF THIS CERTIFICATE.

[*If shares are part of a limited offering qualification on which transfer restrictions have been imposed (see Ch. 6H, Qualification of Securities, § 6H.260):*]

IT IS UNLAWFUL TO CONSUMMATE A SALE OR TRANSFER OF THIS SECURITY, OR ANY INTEREST THEREIN, OR TO RECEIVE ANY CONSIDERATION THEREFOR, WITHOUT THE PRIOR WRITTEN CONSENT OF THE COMMISSIONER OF CORPORATIONS OF THE STATE OF CALIFORNIA, EXCEPT AS PERMITTED BY THE COMMISSIONER'S RULES.

[*If shares are being offered to promoters for past services or certain intangible properties add (see 10 Cal. Code Reg. § 260.141.1; see also Ch. 6H, Qualification of Securities, § 6H.261):*]

Promotional Securities

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN RESTRICTIONS, INCLUDING WAIVERS OF DIVIDENDS AND ASSETS, AND IT IS UNLAWFUL TO CONSUMMATE A SALE OR TRANSFER OF THEM, OR ANY INTEREST THEREIN, OR RECEIVE ANY CONSIDERATION THEREFOR, WITHOUT THE PRIOR WRITTEN CONSENT OF THE COMMISSIONER OF CORPORATIONS OF THE STATE OF CALIFORNIA.

[*If shares are issued by close corporation:*]

Close Corporation

THIS CORPORATION IS A CLOSE CORPORATION. THE NUMBER OF HOLDERS OF RECORD OF ITS SHARES OF ALL CLASSES CANNOT EXCEED _____ [*number not in excess of 35*]. ANY ATTEMPTED VOLUNTARY INTER VIVOS TRANSFER WHICH WOULD VIOLATE THIS REQUIREMENT IS VOID. REFER TO THE ARTICLES, BYLAWS, AND ANY AGREEMENTS ON FILE WITH THE SECRETARY OF THE CORPORATION FOR FURTHER RESTRICTIONS.

[*Continue with the following:*]

WITNESS [the seal of the corporation and] the signatures of the duly authorized corporate officers:
_____Dated:

_____ [*name of corporation*]

By _____ [*signature or facsimile*]

[*typed name*], [Vice-]President [*or* (Vice-)Chairman of the Board]

By _____ [*signature or facsimile*]

[*typed name*], [Assistant] Treasurer [*or other chief financial officer or* (Assistant) Secretary]

_____ [*signature*]

Registrar

_____ [*signature*]

Transfer Agent

Federal Exemptions

[*If shares are being sold pursuant to federal intrastate exemption (15 U.S.C. § 77c(a)(11); 17 C.F.R. § 230.147(e), (f)):*]

THESE SHARES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933. DURING THE PERIOD IN WHICH THESE SHARES AND THE ENTIRE ISSUE OF WHICH THEY ARE A PART ARE BEING OFFERED AND SOLD BY THE CORPORATION, AND FOR A PERIOD OF NINE MONTHS FROM THE DATE OF THE LAST SALE BY THE CORPORATION OF THE SECURITIES, ALL RESALES OF THESE SECURITIES AND ANY PART OF THE ISSUE, BY ANY PERSON, SHALL BE MADE ONLY TO PERSONS RESIDENT WITHIN THE STATE OF CALIFORNIA.

[Or, if *shares are being sold pursuant to the Rule 505 or Rule 506 exemption from federal registration under SEC Regulation D (17 C.F.R. §§ 230.501-230.508) and are subject to the Regulation D limitations on resale (see 17 C.F.R. § 230.502(d)):*]

THESE SHARES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 [OR UNDER ANY APPLICABLE STATE LAW]. THEY MAY NOT BE OFFERED FOR SALE, SOLD, TRANSFERRED, OR PLEDGED WITHOUT EITHER (1) REGISTRATION UNDER THE SECURITIES ACT OF 1933 OR (2) AN OPINION (SATISFACTORY TO THE CORPORATION) THAT THESE SHARES ARE EXEMPT FROM SUCH REGISTRATION.

[*Reverse side of certificate:*]

Rights, Preferences, Privileges, and Restrictions

A statement of the rights, preferences, privileges, and restrictions granted to or imposed on each class or series of shares authorized to be issued, and on the holders thereof, is available from the _____ [*office or agency of corporation, e.g.,* Secretary, c/o the principal office of the corporation, _____ (*full address*)]. Shareholders may obtain a copy of this statement on request and without charge.

[*The following statements, when appropriate, must appear on the stock certificate (see Corp. Code § 418(a)).*]

Transfer Restrictions

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO RESTRICTIONS ON TRANSFER CONTAINED IN _____ [*specify, e.g.,* THE ARTICLES OF INCORPORATION *or* THE SHAREHOLDERS' AGREEMENT DATED _____].

[*For shares sold under a limited offering exemption (Corp. Code § 25102(f); see Ch. 6B, California Limited Offering Exemptions):*]

Shares Not Purchased for Resale

THE SHARES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE CALIFORNIA SECURITIES LAWS. THE PURCHASER OF THESE SHARES HAS REPRESENTED THAT HE OR SHE PURCHASED THEM FOR HIS OR HER OWN ACCOUNT OR FOR A TRUST ACCOUNT, IF THE PURCHASER IS A TRUSTEE, FOR INVESTMENT PURPOSES AND NOT WITH A VIEW TOWARD RESALE.

Partly Paid Shares

[*For statement regarding partly paid shares, see § 6I.202[2].*]

[*If shares are assessable, see § 6I.203 and add the following:*]

Assessable Shares

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE ASSESSABLE AS PROVIDED IN THE ARTICLES OF INCORPORATION.

[*If shares are subject to an irrevocable proxy:*]

Irrevocable Proxy

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO AN IRREVOCABLE PROXY DATED _____, CONFERRING THE RIGHT TO VOTE THESE SHARES ON THE NAMED PROXY HOLDER.

[*If shares are subject to voting restrictions:*]

Voting Restrictions

These shares are subject to certain restrictions on voting rights as imposed by the corporation, by virtue of Article _____, Section _____, of the Articles of Incorporation, to which the shareholder is referred for full details.

[*If shares are redeemable, include statement regarding terms and conditions of redemption, such as:*]

Redemption

These shares are subject to redemption _____ [*terms of redemption; e.g.,* at the option of the corporation *or* at the option of the shareholder *or* on the vote of at least a majority of the outstanding preferred shares *or* on the occurrence of the events specified in Article _____, Section _____, of the Articles of Incorporation, to which the shareholder is referred for full details]. [_____ shares must be redeemed on the first business day of _____ (*month*), commencing _____ (*year*)]. The redemption price of _____ [*name of class or series*] is $_____, plus an amount equal to all dividends on such shares accumulated to date of redemption but unpaid, regardless of whether or not earned or declared. _____ [*Add redemption premium terms, if applicable*].

[*If shares are convertible, include statement regarding terms and conditions of conversion:*]

Conversion

These shares are convertible into _____ [*e.g.,* common shares] of _____ [*e.g.,* this *or* parent *or* affiliate corporation] _____ [at any time *or* within the time *or* on the occurrence of _____ (*describe events*)] on the terms and conditions stated in Article _____, Section _____, of the Articles of Incorporation, _____ [*e.g.,* at the option of the shareholder only *or* on the vote of at least a majority of the outstanding shares of this _____ (class *or* series) *or* automatically on the occurrence of the events specified in this paragraph]. At the actual time conversion takes place, surrender of the present certificate will be required. The rate of conversion will be _____[*number*] shares of _____ [*designation of stock to be received by the conversion*] for each share of _____ [*designation of stock represented by this certificate*], subject to certain adjustments under prescribed circumstances as contained in the Articles of Incorporation, to which the shareholder is referred for full details.

[*Continue with the following:*]

Endorsement

FOR VALUE RECEIVED, _____ [*name of shareholder exactly as appears on face of certificate*] hereby sells, assigns, and transfers to _____ [*name of transferee*] _____ [*designation of shares and number*] represented by this certificate, and hereby irrevocably constitutes and appoints _____ [*name of transfer agent or equivalent*] as attorney to transfer the said shares on the books of the corporation with full power of substitution in the premises.

_____Dated:

_____ [*signature of shareholder*]

In the presence of

_____ [*signature of witness*]

NOTICE:

The signature to this assignment must correspond with the name as written on the face of this certificate in every particular without alteration or enlargement or any change whatever.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
A. Share Certificates

3-6I California Legal Forms--Transaction Guide § 6I.202

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.202 Statements on Certificate Concerning Partly Paid Shares

[1] Comment

[a] Use of Form

This form is a statement designed to be included at the designated location in § 6I.200[2] or 6I.201[2] whenever the shares have been issued for part payment with the remainder to be paid as agreed.

If the corporation is issuing uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)* (definition)] instead of share certificates, the statement set forth in this form should be included on the initial transaction statement for those securities [*Corp. Code § 409(d)*; *see also Corp. Code § 418*].

[b] Issuance and Liability of Issuee

Ordinarily, shares are issued, declared, and taken to be fully paid stock, not liable to any further call; nor is the shareholder liable for any further payments under the Corporations Code. However, the corporation may issue all or any part of its shares as partly paid [*Corp. Code § 409(b), (d)*] if payment is adequately secured by collateral other than the stock being issued, or to the extent permitted in *Corp. Code § 408* with respect to employee stock purchase or stock option plans [*Corp. Code § 409(a)*]. Every subscriber to shares and every person to whom shares are originally issued is liable for the full consideration agreed to be paid. It must be paid before or when the shares are issued unless they are issued as partly paid. Partly paid shares must be paid in accordance with the agreement of subscription or purchase [*Corp. Code § 410*]. If the shares are not paid for according to contract, the corporation has the right to recover the unpaid subscription price of the remainder of the consideration to be paid [*Corp. Code § 423(a)*].

The certificate issued to represent partly paid shares must contain a statement of the total amount of the consideration to be paid, and the amount already paid [*Corp. Code § 409(d)*].

Statements required to appear "on the certificate" must appear on the face of a share certificate or on the reverse with a reference on the face, or, in the case of uncertificated securities, on the initial transaction statement and subsequent written statements [*Corp. Code § 174*; *see also Corp. Code §§ 417, 418*]. Unless the certificate, or initial transaction statement, states the total amount of the price of the shares and the amount already paid, a transferee of the shares will not be liable for any unpaid amount [*Corp. Code § 418(b)*].

[c] Lien for Unpaid Balance

If the agreement for payment of the balance includes giving the corporation a lien on the shares, then the statement of lien must appear conspicuously on the certificate [*see Corp. Code § 418(a)(2)*; *see also Com. Code § 8105(d)*]. The notice of lien may be combined with the statement of part payment, as in this form. The statement should be held to be "conspicuous" if it is presented so that a reasonable person against whom it is to operate ought to notice it; and that should be the result if the statement is in larger type than the surrounding text, or is in a contrasting type, font, or color, compared to surrounding text of the same size, or is set off from surrounding text of the same size by symbols or other marks that call attention to the statement [*see* Com. Code § 1201(b)(10)].

Whether or not provision is made in the articles for such a procedure, the agreement for subscription or purchase of partly paid shares may contain provision for giving the corporation a lien on the shares. A lien is properly created by contract of the parties [*Civ. Code § 2881*]. The lien represents a charge imposed (in a mode other than by transfer in trust) on the specific property of the shares, by which they are made security for the performance of the agreement to pay the remainder of the agreed consideration [*see Civ. Code § 2872*]. This instance constitutes a special lien, in which the corporation is entitled to enforce the lien as security for the performance only of the particular obligation of full payment, and any incidental obligations [*see Civ. Code § 2875*].

It is not clear whether the provisions of the General Corporation Law concerning partly paid shares serve to create a statutory lien on those shares in favor of the corporation if the certificate is appropriately legended. The corporation can cause such shares to be sold for the balance due when they are held by a representative or fiduciary [*see Corp. Code § 413*] and this right is certainly typical of one held by a lienholder. Furthermore, the obligation to pay the balance is enforceable against transferees with notice, another common feature of a lien [*see Corp. Code § 412*; *see also Kress v. Tooker Jordan Corp. (1930) 103 Cal. App. 275, 284-287, 284 P. 685* (indicating that an equitable lien is created when shares are properly legended as to fact of part payment)]. However, if a lien is not created by the provisions of the General Corporation Law, then the drafting of the agreement for sale of partly paid shares and the perfection of any security interest in those shares will be governed by the Secured Transactions Division of the Commercial Code [*see Com. Code § 9102(a)(47)* ("instrument" defined); *Com. Code § 9109(a)*; *see also Com. Code § 8101 et seq.*].

[d] Share Incidents of Partly Paid Shares

While the shares are being held on partly paid status, the shareholder otherwise has the full complement of rights, preferences, privileges, and restrictions. However, while the corporation must declare a dividend on partly paid shares at the same time it does on fully paid shares, the former is only on the basis of the percentage of the consideration actually paid [*Corp. Code § 409(d)*].

[e] Liability of Transferee

Unless the certificate (or the initial transaction statement and subsequent written statements in the case of uncertificated securities [*see Corp. Code § 191.1*; *see also Com. Code § 8102(a)(15), (18)*]) states the total amount of the price of the shares and the amount already paid, a transferee of the shares is not liable for any unpaid amount [*Corp. Code § 418(b)*]. If the full agreed consideration has not been paid, a transferee acquiring the shares in good faith, without knowledge that they were not paid for in full or to the extent stated on the certificate (or applicable initial transaction statement for uncertificated securities), is liable only for the amount shown on the certificate or statement to be unpaid [

Corp. Code § 411].

A transferee of partly paid shares who acquired them under a certificate showing the fact of part payment is personally liable to the corporation for installments coming due. So is a transferee of the shares who acquired them with actual knowledge that the full agreed consideration had not been paid to the extent stated on the certificate. However, the latter description does not include one who derives title through a holder in good faith without knowledge, and who is not a party to any fraud affecting the issuance. Liability ceases on transfer to another who becomes liable therefor, except that the transferor again remains personally liable if the certificate or a written agreement so provides [*Corp. Code § 412*]. These rules apply equally to information set forth on the initial transaction statement or subsequent written statements when the shares are uncertificated [*Corp. Code § 412*; *see Corp. Code §§ 171.1*, *191.1*; *see also Com. Code § 8102(a)(15), (18)*].

One holding shares in any representative or fiduciary capacity is not personally liable for any unpaid balance of the subscription price of the shares simply because the shares are so held. This includes pledgees, executors, administrators, guardians, trustees, and receivers, as well as others of the description. However, the estate and funds in the hands of such a fiduciary or representative are liable, and the shares are subject to sale for that balance [*Corp. Code § 413*].

[f] Liability to Corporation's Creditors

A creditor may bring an action to reach and apply any liability of a shareholder to the corporation for the amount due on the shareholder's shares. However, first a final judgment must have been rendered in favor of the creditor against the corporation. Second, an execution must have been returned on the judgment, and it must remain unsatisfied in whole or in part. Either of these required steps may be avoided to the extent the creditor can show that such a procedure would have been useless [*Corp. Code § 414(a)*].

All creditors of the corporation may intervene in any creditor's action to reach and apply unpaid subscriptions. Their claims need not have been reduced to judgment, and any or all shareholders who hold partly paid shares may be joined in the action. Several judgments may be rendered for and against the parties or in favor of a receiver for the benefit of the respective parties [*Corp. Code § 414(b)*].

In any such action, all amounts paid by any shareholder in that action are credited on the unpaid balance due the corporation on the shares of that shareholder [*Corp. Code § 414(c)*]. However, since the shareholder's obligation is based on a direct contract with the corporation, the creditor as equitable assignee of the judgment debtor corporation may be met with any defenses good against the original debtor. For instance, if the time limits for suit against the shareholder have run since the time a particular installment came due, the creditor also may be stopped by the statute of limitations [*see Spencer v. Anderson (1924) 193 Cal. 1, 8-14, 222 P. 355]* .

The creditors need not cite the individual shareholder only for the latter's pro rata portion of total liability to the plaintiffs. However, any shareholder who has paid more than that portion must seek to recover from other shareholders any amounts needed to equitably distribute the recovery [*Kaye v. Metz (1921) 186 Cal. 42, 46-48, 198 P. 1047]* .

[2] FORM

Statements on Certificate Concerning Partly Paid Shares
Partly Paid Shares

[*If appropriate, insert in designated location in form in § 6I.200:*]

THIS CERTIFICATE REPRESENTS SHARES ON WHICH THERE IS A REMAINING AND UNPAID BALANCE DUE THE CORPORATION. THE TOTAL AMOUNT OF CONSIDERATION TO BE PAID FOR THESE SHARES

IS $_____. THE AMOUNT PAID ON DATE OF ISSUANCE OF THIS CERTIFICATE IS $_____.

[*Optional:*]

Payment of Balance

PAYMENT OF THE BALANCE IS SUBJECT TO THE CALL OF THE BOARD OF DIRECTORS.

[*OR*]

THE BALANCE IS TO BE PAID [IN INSTALLMENTS OF $_____ ON THE _____ DAY OF EACH MONTH (*or* CALENDAR QUARTER), BEGINNING _____ (*date*), AT THE PRINCIPAL OFFICE OF THE CORPORATION AT _____ (*address*)] ACCORDING TO THE TERMS OF AN AGREEMENT ON FILE WITH THE CORPORATION UNDER NAME OF THE SHAREHOLDER NAMED HEREON, TO WHICH REFERENCE IS MADE FOR FULL DETAILS.

[*Optional:*]

Liability of Transferor

ANY SHAREHOLDER TO WHOM THESE SHARES ARE REGISTERED, WHO THEREAFTER TRANSFERS THESE SHARES, WHETHER OR NOT SUCH TRANSFER IS REGISTERED BY THE CORPORATION, REMAINS PERSONALLY LIABLE FOR THE UNPAID BALANCE OWED THE CORPORATION ON THESE SHARES [AND FOR ANY INSTALLMENTS ON SUCH BALANCE AS THEY BECOME DUE].

[*Optional:*]

Lien for Unpaid Balance

THE CORPORATION RETAINS A LIEN ON THE SHARES REPRESENTED BY THIS CERTIFICATE FOR THE UNPAID BALANCE OF THE CONSIDERATION FOR THESE SHARES, AS STATED ABOVE, AND UNTIL SUCH BALANCE IS PAID IN FULL AS SHOWN ON THE BOOKS OF THE CORPORATION.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
A. Share Certificates

3-6I California Legal Forms--Transaction Guide § 6I.203

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.203 Legend on Certificate for Assessment Lien [Corp. Code § 423(e)]

[1] Comment

[a] Use of Form

This form is a share certificate legend regarding an assessment lien on the shares represented by the certificate. Ordinarily, if assessment of shares is permitted, an assessment will be made during the time certificates for the shares involved are outstanding. The company is not required to call in the certificates for stamping with such a notice, particularly since the holder or owner of the shares is otherwise specially notified. The concern is with notice to third parties, and the law provides a procedure whereby the notice must be placed on the certificate when it is issued to a new purchaser on surrender of the former certificate for transfer purposes [*see Corp. Code § 423(e)*]. The legend takes the same form as the notification to the owner [*see Corp. Code § 423(c)*]. This form, when appropriate, is designed to be included at the indicated place on the face side of the *forms in § 6I.200[2]* or *6I.201[2]*.

If the corporation issues uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(15), (18)*], this legend must appear on the initial transaction statement [*Corp. Code § 423(e)*; *see § 6I.20[1]* et seq.].

[b] Basis for Assessment

Shares may be assessed only in the manner provided by statute. The law prescribes a precise manner in which assessment may operate, which must be first authorized by the articles of the individual company and then subject to any limitations contained within the articles. Within such authority as is given to the board or the corporation itself, the board of directors may in its discretion levy and collect assessments on all shares of any or all classes as allowed. This is a special authority, additional to the right of the corporation to recover the unpaid subscription price of shares or the remainder of the consideration to be paid for shares [*Corp. Code § 423(a)*].

Stock should usually be nonassessable unless the issuer is organized to supply property or services on a continuing basis

[*10 Cal. Code Reg. § 260.140.7*].

[c] Securities Requirements

When the company's securities must be qualified through the Commissioner of Corporations, that office normally finds the incident of assessability to be unfair, unjust, or inequitable under the circumstances. The typical exception would be an organization set up exclusively to supply services or property to its membership on a continuing basis, with an equitable assessment corresponding to the services or property supplied [*10 Cal. Code Reg. § 260.140.7*], such as a homeowners' association. However, this restriction does not apply in the case of many exemptions, such as the transaction of issuance of stock to a group of 35 or fewer purchasers [*see Corp. Code § 25102(h)*].

[d] Assessment Levy

An assessment must be levied at a formal meeting of the board, whether general or special [*Cheney v. Canfield (1910) 158 Cal. 342, 345, 111 P. 92]* . Even if properly authorized to assess, the corporation may have in fact contracted with, or represented to, purchasing shareholders that no such assessment would take place. On a subsequent assessment, the shareholder would then be entitled to a rescission of the share purchase [*see Browne v. San Gabriel River Rock Co. (1913) 22 Cal. App. 682, 684, 685, 136 P. 542]* . The motive of the directors in levying the assessment is immaterial unless the assessment was for an improper purpose. For instance, if the assessment was unnecessary but the directors were attempting to freeze out a minority shareholder, the assessment may be invalid [*Koshaba v. Koshaba (1942) 56 Cal. App. 2d 302, 313, 132 P.2d 854]* .

An assessment levy must

- Specify the amount, and to whom and where payable.

- Fix a date on which the assessment is payable--however, if proceedings or filings with any governmental or other agency for any qualification, registration, or exemption therefrom are required as a condition precedent to levy or payment of an assessment, there must be provision for establishment of such a date.

- Fix a date on which the assessment becomes delinquent if not paid--which date must be not less than 30 or more than 60 days from the date on which the assessment is payable.

- Fix a date for the sale of the delinquent shares--which date must be not less than 15 or more than 60 days from the date of first delinquency.

The information on the date of sale must also include the hour and the place. The place of sale must be in the county where the corporation is required to keep a copy of its bylaws, or if there is no such county, then in Sacramento [*Corp. Code § 423(b)*]. The county of the bylaws is the place of the corporation's principal executive office in California, or if that office is not located here, then the principal business office here [*see Corp. Code § 213*].

[e] Notification of Assessment

The notice as prescribed by law, the contents of which are illustrated in this form, should be given on or before the date the assessment is payable [*Corp. Code § 423(c)*]. It must be served personally on each holder of record of shares being assessed. However, in lieu of personal service, the notice may be mailed to each such shareholder at the last address of the shareholder appearing on the books or given by such shareholder for the purpose of notice. If there is no such address, then the notice may be addressed to the place where the principal executive office of the corporation is located. The notice being mailed also must be published in a newspaper of general circulation in the county of the principal

executive office. If there is no such newspaper, the publication is to be made in some newspaper of general circulation in an adjoining county [*Corp. Code § 423(d)*].

[f] Assessment Lien

The assessment becomes a lien on the shares assessed from the time of personal service or the publication of the notice of assessment. However, the articles may properly provide for such a lien starting at the time of the levy [*Corp. Code § 423(e)*].

Nothing in the Investment Securities Division of the Commercial Code may be construed to affect the liability of the registered owner of the shares for assessments, calls, or the like [*Com. Code § 8207(b)*]. However, Division 8 of the Commercial Code relating to investment securities is primarily designed to protect market transfers of shares, and it provides that any lien on shares in favor of the issuing corporation is valid against a purchaser only if that lien right is noted conspicuously on the security certificate itself [*see Com. Code § 8105(d)*; for translation of UCC term of "security" as "security certificate," *see Com. Code § 8102(a)(15), (16)*]. In conjunction with this requirement, the General Corporation Law prescribes a procedure in support of this policy, unless a particular provision of law provides otherwise. Thus, a transfer of the shares on the books of the corporation after the assessment lien has attached constitutes a waiver of the lien unless a conspicuous legend is placed on the face of any certificate issued on the transfer, setting forth the information contained in the notice of assessment [*Corp. Code § 423(e)*]. Similarly, if the corporation issues uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(15), (18)*], transfer of the shares on the books of the corporation after the assessment lien has attached constitutes a waiver of the lien unless the legend appears on the initial transaction statement [*Corp. Code § 423(e)*; *see § 6I.20*].

The legend should be held to be "conspicuous" if it is presented so that a reasonable person against whom it is to operate ought to notice it; and that should be the result if the legend is in larger type than the surrounding text, or is in a contrasting type, font, or color, compared to surrounding text of the same size, or is set off from surrounding text of the same size by symbols or other marks that call attention to the legend [*see* Com. Code § 1201(b)(10)].

The conspicuous legend is to be removed if the assessment on the shares evidenced by the certificate is paid. It is also removed if the shares are sold to pay the assessment, or are forfeited for nonpayment [*Corp. Code § 423(e)*].

[g] Extension of Sale Date

The date of sale of delinquent shares fixed in the levy of assessment may be extended from time to time for up to 30 days at a time. The extension may be affected either by an order of the board entered on the corporate records, or by a court order in restraint of a sale. Notice of an extension must be given by announcement by either the secretary or some person authorized to conduct the sale. It should be made at the time and place of sale most recently fixed. If the date of sale is extended for over five days, the corporation has to cause notice to be mailed to any shareholder whose shares are being sold, setting forth the date and time to which the sale date has been postponed [*Corp. Code § 423(f)*].

[h] Payment Before Sale

Payment may be made at a time after delinquency but before the sale. In such an instance, the shareholder must pay a penalty of five percent of the amount of the assessment on the shares, in addition to the assessment itself [*Corp. Code § 423(g)*].

[i] Conduct of Sale or Extension Proceeding

The procedure for the sale of the shares is as follows: An officer or agent of the corporation appears at the time and place appointed in the notice of levy. Unless otherwise ordered by the board, this agent sells the shares, or causes them to be sold, to the highest bidder for cash. The sale is of as many shares of each delinquent holder of assessed shares as

may be necessary to pay the assessment and charge on the shares according to the notice. Offers for a fraction of a share need not be accepted. At the sale, the person offering to pay the assessment and penalty for the smallest number of shares is the highest bidder. The purchased shares are then transferred to that bidder on the share register on payment of the assessment and penalty. A new certificate is issued to the highest bidder [*Corp. Code § 423(h)*].

A bid made by one who was a director at the time of the levy normally will not be disqualified. However, it may be that under the circumstances of the case there was such a relationship between the director and the holder of the delinquent shares that a bid of this type would constitute a breach of faith [*see Whitcomb v. Giannini (1919) 43 Cal. App. 229, 235, 184 P. 887]* .

If there is no bidder offering to pay the amount due together with the five percent penalty, the shares are then forfeited to the corporation in satisfaction of that amount [*Corp. Code § 423(i)*].

[j] Surrender of Old Certificate

After the sale or forfeiture, the holder or owner of the delinquent shares must surrender the certificate to the corporation for cancellation. This duty may be enforced by court order or decree, and a shareholder or owner is liable for damages to the corporation for failure to so surrender on demand without good cause or excuse. A certificate not surrendered becomes null and void. It is no longer evidence of the right or title of the holder or any transferee to the shares it purports to represent. Neither the corporation nor the purchaser of the shares incurs any liability on the shares to any such transferee. The purchaser at the sale, whenever it is made, is entitled to the issuance of a new certificate for such shares [*Corp. Code § 423(j)*].

[k] Certificate as Evidence of Sale

The certificate of the secretary or assistant secretary of the corporation serves as prima facie evidence of certain factors of the sale [*Corp. Code § 423(k)*]:

- Time and place of sale.
- Postponements.
- Quantity and particular description of shares.
- To whom sold.
- For what price sold.
- Fact of payment of the purchase money.

The certificate must be filed in the office of the corporation. Copies certified by either the secretary or assistant secretary of the corporation are also prima facie evidence of their facts [*Corp. Code § 423(k)*].

[l] Effect of Errors or Omissions in Enforcement Procedure

An assessment is not invalidated by failure to publish the notice of assessment, nor is it by the nonperformance of any act required in order to enforce the payment of the assessment. However, in event of any substantial error or omission in the course of proceedings for collection of an assessment, all previous proceedings but one are void as to the particular shares involved and must be taken anew. Only the levy of assessment may remain valid [*Corp. Code § 423(l)*].

[m] Action for Improper Sale

Certain preliminaries must be observed before any action is maintained to recover shares sold for delinquent assessment on the ground of irregularity in the assessment, irregularity or defect of the notice of sale, or defect or irregularity in the sale itself. The plaintiff must first pay or tender to the corporation, or to the party holding the shares sold, the sum for which the shares were sold. This must be accompanied by all subsequent assessments which may have been paid on the shares and by interest on all such sums from the time they were paid. The complaint must then be filed, and the summons must be issued, within six months after the sale was made [*Corp. Code § 423(m)*].

[n] Creditor's Pursuit of Former Shareholder's Interest

The sale wholly divests the former shareholder of all right or interest in the shares. It passes title from the former shareholder and terminates all liability of that person for unpaid balances on the shares. Thus, creditors may not recover on any former liability of the shareholder. This is true even where the assessment sale may have been technically defective in the absence of collusion or fraud as between the corporation and the shareholder [*see American Well etc. Co. v. Blakemore (1920) 184 Cal. 343, 351, 356-357, 193 P. 779]* .

[o] Alternative Remedy of Action

Sale or forfeiture of the shares is normally the only remedy for the collection of an assessment on fully paid shares. The only exception is remedy by action, and that must be expressly authorized in the articles and further stated as a remedy on the face of the share certificate (unless issued prior to August 21, 1933). If such a remedy is imported into the articles by amendment, it must be adopted by unanimous consent of the shareholders.

[2] FORM

Legend on Certificate for Assessment Lien [Corp. Code § 423(e)]

NOTICE OF ASSESSMENT LIEN

_____ [*Name of corporation*], _____ [*location of principal executive office*]

NOTICE IS HEREBY GIVEN THAT THE BOARD OF DIRECTORS, ON _____[*date*], HAS LEVIED AN ASSESSMENT OF $_____ PER SHARE ON THE _____ [*name or designation of class or series of shares*] OF THE CORPORATION PAYABLE TO _____ AT _____. ANY SHARES ON WHICH THIS ASSESSMENT REMAINS UNPAID ON _____[*date*], WILL BE DELINQUENT. UNLESS PAYMENT IS MADE PRIOR TO DELINQUENCY, THE SAID SHARES, OR AS MANY OF THEM AS MAY BE NECESSARY, WILL BE SOLD AT _____ ON _____[*date*], AT _____ [*time*] OF SUCH DAY, TO PAY THE DELINQUENT ASSESSMENT, TOGETHER WITH A PENALTY OF FIVE PERCENT OF THE AMOUNT OF THE ASSESSMENT ON SUCH SHARES, OR BE FORFEITED TO THE CORPORATION.

_____ [*name of secretary*]

Secretary

_____ [*office location*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
A. Share Certificates

3-6I California Legal Forms--Transaction Guide § 6I.204

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.204 Scrip Certificate for Fraction of a Share

[1] Comment

[a] Use of Form

This form is a scrip certificate representing a fraction of a share of corporate stock. When fractions of a share occur in the stock structure as a result of a share readjustment transaction such as a stock dividend or conversion of preferred into common shares, one method of dealing with the problem of resulting fractional interests is the issuance of scrip to represent the fractional portions of former whole share interests. The following form is an example of a scrip certificate that may be used in connection with fractions of a share of common stock.

[b] Fractional Shares

A corporation is not required to issue fractions of a share, although it may decide to do so [*Corp. Code § 407*]. If a corporation does not issue fractions of a share, then in connection with any original issuance of shares it must provide one of three alternatives [*Corp. Code § 407*]:

- Arrange for the disposition of fractional interests by those entitled to receive them.
- Pay in cash the fair value of fractions of a share as of the time those entitled to receive them are determined.
- Issue scrip or warrants in registered or bearer form which entitle the holder to receive a certificate for a full share on the surrender of such scrip or warrants aggregating a full share.

[c] Special Alternative in Reorganizations

In the case of a merger, conversion, or reorganization, if the fraction of a share that any person would otherwise be entitled to receive is less than one half of one percent of the total shares that person is entitled to receive, the merger, conversion, or reorganization agreement may provide that fractions of shares will be disregarded. Otherwise, it may provide that shares issuable in the merger will be rounded off to the nearest whole share [*Corp. Code § 407*].

A determination by the board of the fair value of fractions of a share will be conclusive in the absence of fraud [*Corp. Code § 407*]. However, a corporation may not pay cash for fractional shares if the action would result in the cancellation of more than 10 percent of the outstanding shares of any class [*Corp. Code § 407*]. This limitation is designed to prevent a forced "freeze-out" or cashing out of a minority or special class of shareholders.

An exemption from federal registration is available for the market plan to pay off fractional interests if the issuer must already file certain reports at the federal level, the aggregate sale proceeds will not exceed $100,000, and a prior notification is filed with the SEC [*see 15 U.S.C. § 77c(b)*; *17 C.F.R. § 230.236*].

[d] Nature and Incidents of Scrip for Fractional Shares

Unlike a certificate for a fractional share, which entitles the holder to exercise voting rights, to receive dividends, and to participate in any of the assets of the corporation in the event of liquidation [*Corp. Code § 407*], scrip or warrants do not entitle the holder to exercise voting rights, to receive dividends, or to participate in any of the assets of the corporation in the event of liquidation unless they specifically so provide [*Corp. Code § 407*].

Any scrip or warrants must be issued in registered or bearer form, entitling the holder to receive a certificate for a full share when the surrender of such scrip or warrants aggregates a full share. The board of directors may cause scrip or warrants to be issued subject to whatever conditions it desires to impose [*Corp. Code § 407*]. One such condition, for example, is the condition that the scrip or warrants will become void if not exchanged for certificates representing full shares before a specified date. Another is that the shares for which scrip or warrants are exchangeable may be sold by the corporation and the proceeds distributed to the holder of the scrip or warrants.

[2] FORM

Scrip Certificate for Fraction of a Share
_____ [*Name of corporation*]

[Interest equivalent to] _____ [*fraction*] _____ share

This is to state that _____ [*name or* Bearer] is the holder of [the equivalent of] _____ [*fraction*] interest in one share of the common stock of the _____ [*name of corporation*].

The holder, on surrender of this scrip, along with scrip aggregating [the equivalent of] a full share, will be entitled to receive a certificate for a full share, or number of full shares represented by such surrendered scrip, along with scrip for any fraction in excess of such full share or shares. Scrip must be presented for exchange at the principal office of the corporation at _____[*address*].

This scrip does not entitle the holder to exercise voting rights, to receive dividends hereon, or to participate in any of the assets of the corporation in the event of liquidation.

This scrip becomes void if not exchanged for certificates representing full shares before _____[*date*]. On or at any time after _____[*date*], the corporation may sell all [or any part] of the amount of full shares represented by the total amount of scrip outstanding at such time and will undertake to distribute the proceeds to

any then holders of scrip on a pro rata basis.

WITNESS [the seal of the corporation and] the signatures of the duly authorized corporate officers:
_____Dated:

_____ [*name of corporation*]

By _____ [*signature or facsimile*]

[*typed name and title*]

_____ [*signature or facsimile*]

[*typed name and title*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
A. Share Certificates

3-6I California Legal Forms--Transaction Guide §§ 6I.205-6I.209

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6I.205[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
B. Resolutions Authorizing Issuance of Shares

3-6I California Legal Forms--Transaction Guide § 6I.210

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.210 Resolution Authorizing Issuance, Qualification, and Sale of Shares

[1] Comment--Use of Form

This form is a resolution of the board of directors authorizing the issuance and sale of stock. This form should be used when the shares must be qualified with the Commissioner of Corporations [*see* Ch. 6H, *Qualification of Securities*]. For discussion of the form of corporate resolutions generally, see Ch. 5, *Directors Meetings, Actions, and Resolutions* .

[2] FORM

Resolution Authorizing Issuance, Qualification, and Sale of Shares
[*If the shares are to be issued for cash:*]

RESOLVED, that any officer of this corporation be, and each of them hereby is, authorized to cause to be prepared, to execute, verify, and file, for and on behalf of this corporation, an application for qualification (including any exhibits, supplements, and amendments thereto) with the Commissioner of Corporations for the sale of not to exceed _____ [*specify number*] shares of its _____ [*specify class of shares, if any, e.g.,* Class A common stock] for a purchase price of not less than $_____ per share;

RESOLVED FURTHER, that after qualification this corporation shall issue and sell not to exceed the number of shares therein authorized to the persons for the consideration and in the manner therein set forth;

RESOLVED FURTHER, that the consideration to be received on the issuance and sale of those shares be added to the appropriate capital account of the books of the corporation.

[*Or, if shares are to be issued for substantially all of the assets and business of a sole proprietorship or a partnership, use the following; if business was formerly a partnerships, set out separate paragraphs for the number of shares to be issued to each partner:*]

RESOLVED, that the officers of this corporation be and they hereby are authorized to accept the offer made by _____ [*name(s) of transferor(s)*] and arrange for the acquisition by this corporation of substantially all of the assets and business of _____ [*name of sole proprietorship or partnership*] subject to all of its liabilities in exchange for the issuance and delivery to _____ [*name(s) of transferor(s)*] of _____ [*specify number*] shares of its _____ [*specify class of shares, if any, e.g.*, Class A common stock];

RESOLVED FURTHER, that in the judgment of the Board of Directors of this corporation, the present net value of the assets and business is $_____;

RESOLVED FURTHER, that the consideration to be received on the issuance and sale of the shares be added to be appropriate capital account on the books of the corporation;

[*Continue with the following:*]

RESOLVED FURTHER, that the officers of this corporation be, and each of them hereby is, authorized and directed to execute and deliver certificates representing the aforesaid shares on the receipt of the required consideration therefor and are further authorized, directed, and empowered to execute all documents and to take such action as they may deem necessary or advisable in order to carry out and perform the purposes of these resolutions.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
B. Resolutions Authorizing Issuance of Shares

3-6I California Legal Forms--Transaction Guide § 6I.211

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.211 Resolution Identifying Offerees or Proposed Purchasers

[1] Comment--Use of Form

This form contains language for inclusion in a corporate resolution when an offering is limited to specified known purchasers. The form serves to identify the proposed purchasers or offerees. When used, it should be added to the resolution appearing in § 6I.210[2]. If the offering is to be public, the language in this form may simply be omitted. The *form in § 6I.210[2]*, authorizing the offer of designated shares unlimited by a description of the offerees, will allow the offer, subject to qualification, to be public.

An offering of stock may be to known, named individuals, or to a limited class, in which case it is referred to as a limited offering, or to the general public, in which case it is referred to as a public offering. For a detailed discussion of the various types of offerings, and qualification procedures relating to them, see Ch. 6, *Securities Regulation Issues* , and Ch. 6H, *Qualification of Securities* .

Nothing in the Corporations Code or the regulations necessitates providing in the resolution for how the shares are to be distributed among a named group, or which consideration will be provided by a designated proposed purchaser.

[2] FORM

Resolution Identifying Offerees or Proposed Purchasers

RESOLVED, that the shares be offered and sold [in accordance with that certain agreement, dated _____, and attached to these minutes as Exhibit _____] to the following persons, and only to those offerees:

[*If purchasers will be named individuals:*]

nam _____[*address*]
_____[*e*]
nam _____[*address*]
_____[*e*]

[*Or, if purchasers will be a class:*]

Any member of the following class, which is to constitute the sale class of offerees and purchasers: _____ [*describe class, e.g.*, employees on the payroll of the _____ (*name of company*) as the dates of offer and sale].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
B. Resolutions Authorizing Issuance of Shares

3-6I California Legal Forms--Transaction Guide § 6I.212

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.212 Resolution Adopting Form of Share Certificate

[1] Comment--Use of Form

This form contains language adopting a form of share certificate for use in connection with an issue of securities. It may be added to a general resolution such as that in § 6I.210[2], or passed as a separate resolution. It is customary and proper to pass a resolution adopting the form of certificate.

For share certificate forms, see *§§ 6I.200, 6I.201*. For discussion of the format for corporate resolutions, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

[2] FORM

Resolution Adopting Form of Share Certificate

RESOLVED, that the form of share certificate attached to this resolution be used by the Corporation to evidence the issuance of _____ [the stock of the Corporation *or* the shares of the corporation authorized to be issued in this resolution], and that the Secretary of the Corporation is hereby instructed to insert a copy of this form of share certificate in the Minute Book immediately following the minutes of this meeting.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
B. Resolutions Authorizing Issuance of Shares

3-6I California Legal Forms--Transaction Guide §§ 6I.213-6I.219

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6I.213[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
C. Resolutions Concerning Selling Price and Expenses

3-6I California Legal Forms--Transaction Guide § 6I.220

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.220 Resolution Stating the Consideration to Be Received for Stock

[1] Comment

[a] Use of Form

This form is a resolution of the board of directors, or a resolution as voted on by the shareholders, fixing the consideration to be received for a particular class or series of shares. A resolution determining the value of nonmonetary consideration is *set forth in § 6I.221[2]*.

[b] Price of Issuance

Shares may be issued for such consideration as is determined from time to time by the board; or the articles may provide that the shareholder may determine the consideration [*Corp. Code § 409(a)(1)*]. Typically the board makes its decision through a majority vote of those present at a meeting containing a quorum [*see Corp. Code § 307(a)(7)*]. If the articles reserve the right to determine this issue to the shareholders, the determination must be made by approval of the outstanding shares [*Corp. Code § 409(c)*; *see Corp. Code § 152*].

[c] Kinds of Consideration

Consideration may consist of any or all kinds of compensation as prescribed and limited by law for such purposes [*Corp. Code § 409(a)(1)*]:

- Money paid--but not including promissory notes of the purchaser unless these are adequately secured by collateral other than the shares acquired.

- Labor done.

- Services actually rendered to the corporation, or for its benefit, or in its formation or reorganization--but not including future services, unless the shares are issued pursuant to an employee benefit plan.

- Debts or securities canceled.

- Tangible or intangible property actually received, either by the issuing corporation or by a wholly owned subsidiary.

Inadequately secured notes and future services (other than issuance of securities to employees pursuant to an employee benefit plan) may not constitute payment or part payment for corporate shares [*Corp. Code § 409(a)(1)*].

[d] Liability for Payment

Every subscriber to shares, and every person, to whom shares are originally issued, is liable to the corporation for the full consideration agreed to be paid. The consideration must be paid prior to or concurrently with the issuance. The only exception is when the shares are issued as partly paid, in which case the subscription or purchase agreement provides for the manner of payment [*Corp. Code § 410*]. Partly paid shares present special concerns relating to the share certificate; and the general topic is discussed in *§ 6I.202*.

[e] Related Factors

When the shares must be qualified with the Commissioner of Corporations, various requirements may affect the price offering or the handling of the initial proceeds [*10 Cal. Code Reg. §§ 260.140.20-260.140.22*; *see* Ch. 6H, *Qualification of Securities*], and there may be sundry tax consequences from structuring the form of compensation for the offering [*see* Ch. 1B, *Selecting Form of Business Entity* ; Ch. 1E, *Taxation of Businesses* ; Ch. 2, *Formation of Corporations* ; Ch. 2B, *Electing Subchapter S Status*]. The related problems of proper valuation of the consideration to be received for shares is treated in § 6I.221.

[2] FORM

Resolution Stating the Consideration to Be Received for Stock
[*Optional:*]

Minutes

The Chairman then announced that the corporation has received an offer from _____[*name*] to purchase _____[*number*] of its _____ [*specify class or series of shares, if any, e.g.,* Class A common stock] for a purchase price of $_____ per share, payment to be made by _____ [*type of payment e.g.,* cash]. On motion duly made, seconded, and unanimously carried, it was:

Resolution

[*For cash:*]

RESOLVED, that this corporation is hereby authorized to issue _____ [*specify number*] of its _____ [*specify class or series, if any*] shares for a purchase price of $_____ [*per share*].

[*Or, for other consideration:*]

RESOLVED, that this corporation is hereby authorized to issue [up to] _____ [*specify number*] of its _____ [*specify class or series, if any*] shares for consideration consisting of _____ [*describe type of consideration given*]:

[*For assets consisting of tangible and intangible property, e.g.:*]

1. Those certain assets, including all property, plant, and equipment, of _____ [*name of going business*] at _____[*address*], as more fully identified on accompanying exhibit of inventory headed _____ and under terms and conditions of agreement and sale dated _____, between this corporation and _____ [*name of purchaser of shares for assets*].

[*For tangible property, e.g.:*]

2. That certain office building known as _____ and located at _____, together with the land on which it is situated, all as more formally described on the attached copy of a proposed form of deed running from the present owner and seller, _____[*name*] to this corporation.

[*For intangible property, e.g.:*]

3. Those certain copyrights in _____ [*e.g.*, the presently existing series of 24 books known as _____'s Travel Guides, plus the right to the exclusive use of the name and format of those Travel Guides as to presently published and any future works in the series], all as evidenced by attached copies of assignments of copyright and assignment of trademark, trade name, and other trade rights, from _____ [*name of proprietor*] to this corporation.

[*For debts and securities canceled, e.g.:*]

4. The cancellation of that certain obligation presently outstanding in the amount of $_____ of this corporation to _____ [*creditor*], as evidenced by a promissory note dated _____, in the amount of $_____, and _____[*number*] debentures issued on _____[*date*], by this corporation in bearer form, due _____[*date*], on both of which payment has been made to date in the amount of $_____.

[*For services actually rendered, e.g.:*]

5. Those services rendered to [*or* for the benefit of] this corporation by _____[*name*] consisting of marketing the initial issue of the securities of this corporation to investors during the period from _____[*date*], to present, and in which $_____ proceeds were produced from an issuance of _____[*number*] of _____ [*type*] shares.

[*For labor done, e.g.:*]

6. That certain construction of the principal office of this corporation on its property at _____[*address*], commenced on _____[*date*], and completed on or about _____[*date*], in which _____[*name*] acting as general contractor and carpenter, assembled and supervised the assembly of the present one-story, five-room suite of offices employed by this company for its corporate operations.

[*Continue with the following:*]

RESOLVED FURTHER, that the consideration to be received on the issuance and sale of these shares be added to the appropriate capital account on the books of the corporation.

RESOLVED FURTHER, that the officers of this corporation be and each of them hereby is, authorized, directed, and empowered to execute all documents and to take any actions that they may deem necessary or advisable in order to effectuate these resolutions.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
C. Resolutions Concerning Selling Price and Expenses

3-6I California Legal Forms--Transaction Guide § 6I.221

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.221 Resolution Determining the Fair Value of Consideration Other Than Money

[1] Comment

[a] Use of Form

This form is a corporate resolution determining the fair market value of consideration other than money that is being accepted in return for corporate stock. The board of directors must state by resolution its determination of the fair value to the corporation in monetary terms of any consideration other than money for which shares are issued [*Corp. Code § 409(e)*].

PRACTICE TIP:

A director may rely on information, opinions, reports or statements prepared by counsel, accountants or other persons as to matters which the director believes to be within such person's professional or expert competence so long as the director acts in good faith, after reasonable inquiry when the need therefor is indicated by the circumstances and without knowledge that would cause such reliance to be unwarranted [*Corp. Code § 309(b)*]. A director that does not meet this standard will not be afforded protection from liability provided by California's business judgment rule. *Commentary by Frances E. Lossing.*

[b] Determination of Fair Value

Although the directors' determination of value is conclusive in the absence of fraud [*Corp. Code § 409(b)*], the asserted value of the consideration should be substantiated by appropriate proof, such as an appraisal or a detailed description. Substantiation of the valuation will be required by the Commissioner of Corporations when a qualification permit is necessary [*10 Cal. Code Reg. § 260.112* (Item 19, Exhibit F); *see Ch. 6H, Qualification of Securities, § 6H.237*].

A minimum value may be fixed, as in the final resolution below, thereby permitting additional payment for the property or services.

[c] Valuation Factors

The less that consideration takes the form of cash exchange, the more it becomes remotely intangible and abstract in its ability to be evaluated. It becomes correspondingly more difficult to ascertain whether the corporation has agreed to accept an appropriate amount for its shares or whether it has received anything of adequate value for its purposes.

To place the corporate financial structure on a more stable foundation and to encourage investor's and creditor's confidence in the management, the board should strive to arrive at as scientific a conclusion of valuation of nonmonetary consideration as possible. If property of an existing business is turned over to the corporation, particularly if a going operation is simply being incorporated for business purposes, more conservative types of accounting analysis are in order to assure a valid reflection of the corporation's worth on its books.

Valuation may seem to mean little to a small partnership becoming incorporated since it is merely changing its form of organization. Inaccuracies of basic mathematics may return later, however, to plague its investment possibilities when in its new corporate form it increases in ownership and obligation.

Property values should not be inflated. Old assets and stale notes should be frankly and honestly depreciated or discounted. Services received or contemplated should be honestly measured against what such performance would cost to obtain in the competitive market, and how necessary or beneficial such services are to the corporation.

[d] Fraudulently Overvalued Consideration

Although with the elimination of "par value" as a legally significant concept, the doctrine of "watered stock" has become an historical curiosity. The directors of a corporation are nevertheless under a general fiduciary duty with respect to the determination of the value of consideration for shares, just as they are in connection with any other exercise of their authority. Thus, they may inflate the value of property exchanged for shares only at the risk of incurring liability to shareholders who paid proportionally more for their shares. Similarly, fraudulently overvalued consideration, if reflected on a corporate balance sheet that is distributed to creditors, could result in liability to creditors who extended credit in reliance on the misrepresentation. However, this is the only basis on which a creditor might recover.

The doctrine of liability for watered stock, which permitted a creditor to squeeze out the "water," or the difference between the true value of the consideration and the stated par value of the shares, is no longer relevant to the problem of fraudulently overvalued consideration. Shares issued as fully paid stock are not liable to further call, nor is the holder liable for any further payment for his shares [*Corp. Code § 409(b)*]. On the other hand, shareholders who are the victims of fraudulent overvaluation of consideration for shares may sue on behalf of the corporation to recover damages from, or obtain cancellation of shares held by, persons who received shares in exchange for overvalued property [*James v. Steifer Mining Co. (1918) 35 Cal. App. 778, 783-786, 171 P. 117]* . The corporation may also recover from those who have deceived the board of directors as to the value of property transferred to the corporation in exchange for shares, and the corporation is not estopped to challenge the valuation originally made by it [*Topanga Corp. v. Gentile (1967) 249 Cal. App. 2d 681, 689, 58 Cal. Rptr. 713]* .

[2] FORM

Resolution Determining the Fair Value of Consideration Other Than Money

RESOLVED, that the Board of Directors of this corporation hereby determines that the fair value in monetary terms to this corporation of _____ [*describe consideration*] is $_____. This determination of value is based on _____ [*e.g.*, the report of _____, an independent appraiser *or if no appraisal, the description of the consideration should be detailed*].

[*Or, simple resolution if all the consideration to be received is nonmonetary:*]

RESOLVED, that the Board of Directors determines that the fair value of the consideration for which said shares are to be issued is $_____.

[*Or, simple resolution if only part of consideration to be received is nonmonetary:*]

RESOLVED, that the Board of Directors determines that the fair value of _____ [*description of consideration*] is $_____.

[*Or, alternative form--minimum value:*]

RESOLVED, that the Board of Directors hereby determines that the consideration for which _____[*number*] shares of stock are to be issued _____[*name*], is worth a sum, the full amount of which cannot be fairly or accurately calculated at this time, except that the fair value of such consideration to the corporation is at least $_____ when paid in the form of stock of this corporation.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
C. Resolutions Concerning Selling Price and Expenses

3-6I California Legal Forms--Transaction Guide § 6I.222

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.222 Resolution Limiting Selling Expenses [Corp. Code § 25140; 10 Cal. Code Reg. § 260.140.20]

[1] Comment--Use of Form

This form is a corporate resolution limiting the amount of selling expenses that the corporation may incur in connection with a specified securities issuance.

The Commissioner or Corporations requires that the selling expense of stock be no more than is reasonably necessary [*Corp. Code § 25140*; *10 Cal. Code Reg. § 260.140.20*]. For a detailed discussion of the relevant statutes and regulations, see *Ch. 6H, Qualification of Securities, § 6H.23*. In planning a stock issue involving selling expenses, it is advisable to anticipate a ceiling acceptable to the Commissioner and resolve at the outset that this ceiling on selling expenses be followed. If such a resolution is passed, the officers of the corporation engaged in arranging the sale of stock will have no power or authorization to exceed the stated ceiling.

[2] FORM

Resolution Limiting Selling Expenses [Corp. Code § 25141; 10 Cal. Code Reg. § 260.140.20]

RESOLVED, that the consideration for the stock to be issued shall be subject to a selling expense of not to exceed _____ percent of the amount received in cash therefor, including the commissions payable to duly licensed brokers and agents.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
C. Resolutions Concerning Selling Price and Expenses

3-6I California Legal Forms--Transaction Guide § 6I.223

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.223 Resolution Allowing Issuance of Partly Paid Shares

[1] Comment--Use of Form

This form consists of a corporate minute entry and a resolution authorizing a corporation to issue partly paid shares.

A corporation may issue the whole or any part of its shares as partly paid and subject to call for full payment [*Corp. Code § 409(d)*]. The certificates must state the full consideration and the amount paid, at time of issue.

Although a corporation usually will prefer to have its money all at once, it may be necessary to settle for some amount of installment financing. If this occurs, the board should formally authorize partly paid type of issuance if deemed necessary, and if the charter documents so permit.

For further discussion, see *§ 6I.202*.

[2] FORM

Resolution Allowing Issuance of Partly Paid Shares
Illustrative Minute Entry

The Chair next explained the potential difficulty in the present "tight money market" of selling the authorized number of shares during the remainder of the year for which a permit has been obtained. The Chair explained that it would be more desirable to place the entire issue during this year although it would not be necessary to receive more than 50 percent of the proceeds now, with the balance over a two-year period. If purchasers were offered the ability to acquire two shares for a combined down payment of the full cost of one share, with the ability to pay the remainder of the balance over the two-year period required under applicable federal securities laws private exemption regulations, the remainder of the presently authorized issue could be sold out before the end of the current permit period. Therefore, it was:

Resolution

RESOLVED, that any or all shares of this corporation may be offered and sold as partly paid shares and paid for under terms of a written agreement to be executed between the purchaser and the corporation, which agreement is to provide, among other things, that _____ [*proportion, e.g.*, one half] of the purchase price is to be paid at the time of the purchase, and that the remainder of the consideration will be paid for in _____ [*number, e.g.*, two] equal installments promptly on formal call by the corporation, but the first call to be made no earlier than _____[*date*], and the second call no earlier than _____[*date*], these shares to be evidenced by certificates disclosing the full consideration to be received therefore and the amount paid to date of issuance;

RESOLVED FURTHER, that on the declaration of any dividend on the shares of this corporation, this corporation shall declare a dividend on partly paid shares but expressly on the basis of the percentage of the consideration actually paid on the shares with respect to any particular shares outstanding.

RESOLVED FURTHER, that the purchaser's obligation to pay the purchase price shall be secured by _____ [*describe collateral*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
C. Resolutions Concerning Selling Price and Expenses

3-6I California Legal Forms--Transaction Guide § 6I.224

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.224 Resolutions Authorizing Promotional Shares and Expenses

[1] Comment

[a] Use of Form

This form consists of a corporate resolution authorizing the issuance of promotional shares and the incurring of promotional expenses. The services and activities of promoters may be indispensable to a new corporation. However, the procedures traditionally available for compensating these organizing agents are capable of being abused to the detriment of the emerging corporation and its initial shareholders.

There are several substantial reasons why promoters are frequently paid for their contributions in corporate securities. An important reason from the corporation's perspective is that it may not have the financial wherewithal immediately to start paying large executive-type salaries and bonuses for past or contemporary performances. It is therefore most helpful if the promoter will take his or her compensation and, in effect, gamble along with his or her employer on the return for his or her accomplishments. From the standpoint of the investors, too, the promoter may appear more credible if he or she receives shares, not cash. The promoter then appears to have enough faith in the corporation to speculate along with the other shareholders rather than to take a quick profit and move out of the organization.

[b] Definition of Promotional Shares

Promotional shares are any securities that satisfy the following conditions [*10 Cal. Code Reg. § 260.140.30*]:

- Issued in consideration for services rendered in connection with the founding or organization of a business enterprise; or

- Issued to a promoter in consideration for any tangible or intangible property, such as patents, copyrights, or goodwill, to the extent that the value has not been satisfactorily established; or

- Issued to a promoter in the recent past or proposed to be issued at a price substantially lower than the price at which other securities of the same class or substantially similar class have been or are to be sold without any change in the conditions of the market or in the circumstances of the issuer which would justify such different price.

[c] Examples of Services for Which Promotional Securities Might Be Issued

Accounting.

Appraising.

Building.

Contract procuring.

Customer procuring.

Developing.

Engineering.

Furnishing.

Investor procuring.

Legal.

Manufacturing.

Option procuring.

Organizing.

Personnel procuring.

Property procuring.

Printing.

Stock selling and distributing.

Tax planning.

[d] Regulation of Amount of Promotional Shares

If the shares to be issued are promotional within the definition of the Commissioner of Corporations [*10 Cal. Code Reg. § 260.140.30*], then the corporation must take into account, in the resolutions authorizing them, the limitations on the number of promotional shares that may be issued. The basic criterion is the reasonableness of the amount of the issue. An unseasoned corporation's issuance of one promotional share for every three shares of common issued and proposed

to be issued is presumptively reasonable, while a seasoned corporation [*10 Cal. Code Reg. § 260.001(g)*] normally may not issue any promotional shares.

In addition to the foregoing presumptions, Rule 140.31 also indicates that there are a variety of factors that the Commissioner may consider in allowing a promotional issue to vary from preconceived standards of fairness [*10 Cal. Code Reg. § 260.140.31*]. Thus, the Commissioner may consider the selling expenses paid to promoters. Two inferences are possible from this criterion:

- That if the selling expenses are high, the normal allotment of promotional shares may be reduced; or
- That if the proportion of selling expenses is low compared to the allowed limit, additional promotional shares may be allowed.

Other factors that may allow the issue of additional promotional shares are the following:

- Services and other considerations warranting special treatment;
- The nature of circumstances of the business enterprise; and
- The identity of the investors; e.g., whether they are all relatives or long-time business associates.

Stock acquired or to be acquired by an underwriter in connection with an offering is considered part of the underwriter's compensation for purposes of determining whether that compensation is reasonable, and is valued for that purpose on a formula basis taking into account the difference between the cost of the stock and the public offering price and other factors [*10 Cal. Code Reg. § 260.140.20(a)*].

[e] Reimbursement of Promoters' Expenses

In addition to the maximum amount of promotional shares that a promoter may receive, the corporation may reimburse the promoter for actual and necessary expenses in connection with the founding or organizing of a business enterprise, the offering of its securities, and the acquisition of assets with which the issuer is to carry on its business. This reimbursement may be paid out of proceeds of the sale of securities, subject, however, in the case of selling expenses, to the limitation on total selling expenses contained in *10 Cal. Code Reg. § 260.140.20* [*10 Cal. Code Reg. § 260.140.33*].

[f] Limitations on the Rights of Promotional Shares

Promotional shares must be equity securities without preference as to dividends, assets, or voting rights, and must also have no greater rights per share than the securities issued for cash or equivalent [*10 Cal. Code Reg. § 260.140.32*]. For discussion of the aspects of securities regulations relating to promotional shares, see Ch. 6H, *Qualification of Securities* .

[g] Resolutions Regarding Promotional Shares

When issuing promotional shares, the corporation can either work with the Commissioner before drafting the resolution in order to see what the Commissioner will allow, or draft a resolution based on what appears reasonable from the applicable regulations, attempting to satisfy the Commissioner in the application to qualify the issue, and, if not, to issue somewhat fewer shares to the promoter. However, it is the application, or similar facts presented to the Commissioner before formal application, that proves the entitlement to the desired number of promotional shares. The resolution itself is not significant. Therefore, the resolution may be simple, unless the parties feel that the corporate records should indicate the background of the resolution.

[2] FORM

Resolutions Authorizing Promotional Shares and Expenses

RESOLVED FURTHER, that subject to qualification with the Commissioner of Corporations of the State of California, this corporation issue to _____ [*promoters*] a total of one share of common stock for every three such shares issued and sold [*or other formula or set amount*], not to exceed _____ [*number of shares*]. [Of that promotional stock, the shares are to be allocated among these named parties on the following basis:]

Name (of individual promoter)	Percent (of promotional stock to be allocated)
_____	_____
_____	_____

RESOLVED FURTHER, that the issuance of these shares shall be conditioned on the prior acceptance in writing by the issuees of any terms and conditions placed on that issuance by the Commissioner of Corporations of the State of California. [Acceptance may be indicated by the named parties subscribing their names at the conclusion of this resolution.]

RESOLVED FURTHER, that these shares are issued in consideration of _____ [*describe the services or property*], and that this promotional consideration is determined to be worth $_____ to this corporation, a fair exchange of these shares.

RESOLVED FURTHER, in addition to the above shares, this corporation reimburse _____ [*promoters*] $_____ for the actual and necessary expenses incurred in organizing this corporation [*and/or* offering the securities of this corporation *and/or* acquiring the assets of this corporation].

Subscription of Promoters

I accept the stock offered to me under, and according to the terms and conditions of, this resolution.

_____ [*signature*]

[*typed name*]

_____ [*signature*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
C. Resolutions Concerning Selling Price and Expenses

3-6I California Legal Forms--Transaction Guide §§ 6I.225-6I.229

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6I.225[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
D. Resolutions Concerning Compliance With Securities Laws Qualification

3-6I California Legal Forms--Transaction Guide § 6I.230

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.230 Resolutions Authorizing Officers to File Notices of Exemption or Applications for Qualification Under California Corporate Securities Law

[1] Comment--Use of Form

This form contains three alternative resolutions of the board of directors. The first should be used when the corporation issues shares under the small offering exemption and must file the required notice with the Commissioner [*Corp. Code § 25102(h)(4)*; *10 Cal. Code Reg. § 260.102.8*; *see* Ch. 6C, *California Small Offering Exemption*]. The second alternative should be used by a corporation that intends to avail itself of the limited offering exemption and will be filing the notice required to perfect use of that exemption [*Corp. Code § 25102(f)(4)*; *10 Cal. Code Reg. § 260.102.14*; *see* Ch. 6B, *California Limited Offering Exemptions*]. The third alternative should be used when the corporation will authorize its officers to file an application for qualification of its shares under one of the three methods authorized by the Corporate Securities Law [*Corp. Code §§ 25111-25113*; *see* Ch. 6H, *Qualification of Securities*].

[2] FORM

Resolutions Authorizing Officers to File Notices of Exemption or Applications for Qualification Under California Corporate Securities Law
[*For a corporation issuing securities under the small offering exemption, Corp. Code § 25102(h):*]

RESOLVED, that any officer of this corporation is authorized and directed to prepare or to cause to be prepared the notice required by *California Corporations Code Section 25102(h)(4)* in accordance with the requirements of that section and the applicable regulations of the Commissioner of Corporations of the State of California, and to cause the notice to be filed with or mailed for filing to the Commissioner not later than 10 days after the corporation has received the consideration for the issuance of its shares.

[*Or, for a corporation issuing securities under the limited offering exemption, Corp. Code § 25102(f):*]

RESOLVED, that any officer of this corporation is authorized and directed to prepare or cause to be prepared the notice required by *Title 10, Section 260.102.14 of the California Code of Regulations* in accordance with the provisions of that section, and to cause the notice to be filed with the California Commissioner of Corporations no later than 15 calendar days after the corporation obtains its first contractual commitment in this state to purchase one or more of the securities the corporation intends to sell in connection with the transaction.

[*Or, for a corporation that will qualify its securities:*]

RESOLVED, that any officer of this corporation is authorized and directed to prepare or cause to be prepared, verified, and filed on behalf of this corporation, an application with the Commissioner of Corporations of the State of California, including any amendments or supplements, _____ [qualifying by permit the offer and sale of those shares pursuant to *Corporations Code Section 25113 or* qualifying by coordination the offer and sale of those shares pursuant to *Corporations Code Section 25111 or* qualifying by notification the offer and sale of those shares pursuant to *Corporations Code Section 25112*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
D. Resolutions Concerning Compliance With Securities Laws Qualification

3-6I California Legal Forms--Transaction Guide § 6I.231

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.231 Resolution Authorizing Application for Sale of Securities Under the Laws of Other States

[1] Comment--Use of Form

This form is a corporate resolution for use when the corporation authorizes an application for the sale of its securities in other states.

A corporation intending to apply for authorization to sell its securities in another state may be required to appoint a public officer of that state as agent for service of process prior to the filing of the application. The requirements of each state in which securities are to be sold should be checked to determine if particular forms must be used and if certain resolutions are prescribed.

For a discussion of interstate offerings, see *Ch. 6, Securities Regulation Issues, §§ 6.70, 6.71*.

[2] FORM

Resolution Authorizing Application for Sale of Securities Under the Laws of Other States

RESOLVED, that it is desirable and in the best interests of this corporation that the sale of _____[*number*] shares of _____ [*describe type of stock*] of this corporation be properly authorized in various states when so required; that the President or any Vice-President and the Secretary be, and they hereby are, authorized to determine the states in which appropriate action shall be taken to authorize the sale of all or any part of the securities of this corporation as they may deem advisable; that they are hereby authorized to perform on behalf of this corporation any and all acts that they may deem necessary or advisable in order to comply with the applicable laws of any of those states, and, in connection therewith, to execute and file all requisite papers and documents, including, but not limited to, applications, reports, surety bonds, irrevocable consents, and appointment of attorneys for service of process; and that the execution by these officers of any paper or document or the doing by them of any act in connection with the foregoing matters shall conclusively establish their authority from this corporation to take such actions and the approval

and ratification by this corporation of the papers and documents so executed and the action so taken.

RESOLVED FURTHER, that the Secretary of this corporation is hereby authorized to certify that this corporation has adopted resolutions with respect to the matters set forth herein in such statutory form as may be required by the laws or regulations of any state.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
D. Resolutions Concerning Compliance With Securities Laws Qualification

3-6I California Legal Forms--Transaction Guide § 6I.232

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.232 Resolution Authorizing Filing of Registration Statement or Notification With the Securities and Exchange Commission

[1] Comment--Use of Form

This form is a corporate resolution authorizing the filing of an SEC registration statement in connection with a public offering of securities, together with related resolutions.

An interstate public offering of equity or debt securities may necessitate a series of resolutions, from the initial authorization to register the securities with the SEC--illustrated by the following form--to the approval of the underwriting agreement and the compensation of the underwriter. These resolutions normally will be adopted at different times and their content will be governed by the type of securities being offered. The resolutions will be furnished to the underwriter. For an example of a complete set of resolutions concerning convertible debentures with a trust indenture, see Rabkin & Johnson, Current Legal Forms with Tax Analysis, Ch. 19, *Corporate Securities* , Form 19.59 (Matthew Bender).

[2] FORM

Resolution Authorizing Filing of Registration Statement or Notification With the Securities and Exchange Commission

RESOLVED, that this corporation register for public sale through underwriters headed by _____ [*name of underwriter*] _____[*number*] shares _____ [*describe type of stock*] of this corporation, _____[*number*] shares to be sold by this corporation [and _____ (*number*) shares to be sold by certain selling shareholders, hereinafter referred to as the Selling Shareholders];

RESOLVED FURTHER, that this corporation shall bear the costs or charges in connection with that public offering [proportionately with the Selling Shareholders] and that this corporation bear all costs or charges of any transfer agent

or registrar and costs of printing or engraving stock certificates;

RESOLVED FURTHER, that the officers and directors of this corporation be, and hereby are, authorized and directed on behalf of this corporation to cause to be prepared and to execute and file with the Securities and Exchange Commission pursuant to the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder, a Registration Statement on Form _____ [*e.g.*, S-1], including a Prospectus, with all necessary amendments thereto, in connection with the proposed sale of the _____[*number*] shares of _____ [*describe type of stock*] of this corporation, all in a form approved by counsel for this corporation and the officers and directors of this corporation executing the same, and that any and all action already taken in connection therewith be, and hereby is, approved, ratified, and confirmed;

RESOLVED FURTHER, that each officer and director of this corporation who may be required to execute the Registration Statement or any amendment or amendments to that statement to be filed with the Securities and Exchange Commission be, and is hereby, authorized to execute a power of attorney appointing _____ and _____ [*names*] or any one of them alone, as true and lawful attorneys or attorney for that officer or director in his or her name, place, or stead in his or her capacity as an officer and/or director of this corporation to sign the Registration Statement and any and all amendments, and all instruments necessary or incidental or in connection with the Registration Statement and to file the same with the Securities and Exchange Commission with full power and authority to each attorney to do and perform in the name, and on behalf, of each of the officers and/or directors, each and every act whatsoever necessary or desirable in connection with this registration of _____ [*describe type of stock*] to all intents and purposes as any that officer or director might or could do in person;

RESOLVED FURTHER, that the appointment of _____ [*name of law firm*], attorneys at law, as counsel for this corporation, to perform any legal services and render any opinions that may be necessary or appropriate in connection with this registration, qualification, issuance, offer, and sale of _____ [*describe type of stock*] of this corporation as contemplated by the foregoing resolutions or the performance of all such services already rendered by this counsel be, and hereby is, approved, ratified, and confirmed.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
D. Resolutions Concerning Compliance With Securities Laws Qualification

3-6I California Legal Forms--Transaction Guide §§ 6I.233-6I.239

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6I.233[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
E. Incentive Stock Options

3-6I California Legal Forms--Transaction Guide § 6I.240

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.240 Incentive Stock Option Plan

[1] Comment

[a] Use of Form

This form is an incentive stock option plan under which the corporation may grant stock options to its employees. Incentive stock options are statutory options [*see I.R.C. § 422*; *see also* [d], *below*] that allow employees to buy stock at a discount if the option price is lower than the stock's value at exercise of the option, and to delay tax consequences of the grant and exercise of the option until disposition of the stock received pursuant to the option [*see I.R.C. §§ 422(a), 421(a)*; *see also* [c], *below*].

PRACTICE TIP:
Most stock option plans adopted by California corporations permit the corporation to issue either incentive stock options or other options not meeting all of the requirements of *I.R.C. § 422*. *Commentary by Frances E. Lossing.*

For bylaws authorizing the adoption of an incentive stock option plan and agreement, see *Ch. 4, Bylaws, § 4.243*. A resolution of the board of directors authorizing the offer and sale of stock options is *set forth in § 6I.241*. For a form setting forth shareholder approval of this incentive stock option plan, see *§ 6I.242*. An example and discussion of an incentive stock option agreement made pursuant to this plan are *set forth in Ch. 85, Employment Agreements, § 85.383*. For an overview of various types of stock options and related tax issues, see *Ch. 1D, Overview of Employee Benefits, § 1D.80* et seq. Employment contract provisions for both statutory and nonstatutory stock options are *set forth in Ch. 85, Employment Agreements, §§ 85.383-85.386*.

[b] Authorization for Stock Option Plans

A corporation may grant options to purchase shares of any class or series on any terms and conditions [*see Corp. Code*

§ 404]. Subject to any limitations contained in its articles of incorporation and compliance with applicable law, it has the power to establish and carry out share option plans for directors, officers, and employees of the corporation or of any subsidiary or affiliated corporation [*Corp. Code § 207(f)*]. An option plan may provide for the issue and sale of unissued or previously issued shares to one or more of the employees or directors of the corporation, or of its parent or subsidiary, or to a trustee on their behalf. It may provide for the consideration to be paid in installments, and may permit the corporation to aid any purchaser by compensation for services rendered, promissory notes, or otherwise [*Corp. Code §§ 315(f)(1), 408(a)*].

The plan or agreement under the plan may include, among other features, any of the following [*Corp. Code § 408(b)*]:

- Eligibility requirements for participation.
- The class and price of shares to be sold under the plan or agreement.
- The number of shares that may be subscribed for.
- The method of payment for those shares.
- The reservation of title until full payment.
- The effect of termination of employment.
- An option or obligation on the part of the corporation to repurchase the shares on termination of employment, subject to *Corp. Code §§ 500-511* (governing reacquisitions).
- Restrictions on the transfer of shares.
- The time limits and termination of the plan [*Corp. Code § 408(b)*].

The Labor Code provisions that treat any property put up by an employee as part of an employment contract as a bond, and that make illegal any investments or sale of stock in a business in connection with obtaining employment in that business [*see Lab. Code §§ 406, 407*], are inapplicable to shares issued by a corporation to an employee of the corporation or its parent or subsidiary pursuant to a stock option plan or agreement [*Corp. Code § 408(c)*].

[c] Basic Tax Treatment of Incentive Stock Options

The grant of an option does not result in taxable income to the recipient [*I.R.C. § 421(a)(1)*]. The holder of a non-qualified stock option recognizes ordinary income equal to the difference between the exercise price and the fair market value of the shares when the option is exercised. Any subsequent gain or loss is taxed to the recipient as taxable gain or loss upon disposition [*I.R.C. § 421(b)*]. For an incentive stock option, the holder recognizes no income, gain or loss, on exercise [*I.R.C. § 421(a)(1)*]. If the shares are held at least two years after grant and one year after exercise, the holder will not recognize income until the shares are disposed of [*I.R.C. § 422(a)(1)*], at which time the entire gain or loss, calculated with respect to the original exercise price will be taxed as capital gain or loss [*see I.R.C. §§ 1221*-1223 (capital gain rules); Treas. Reg. § 14A.422A-1, Answer A-1 (IRS questions and answers regarding incentive stock option rules)]. When a holder exercises an incentive stock option, the holder will be subject to alternative minimum tax if taxable income exceeds certain amounts [*see I.R.C. §§ 55, 56(b)(3)*].

The company receives a tax deduction at the time of exercise of non-qualified stock options [*I.R.C. § 421(b)*], but not on exercise of incentive stock options [*I.R.C. § 421(a)(3)*].

For further discussion of the taxation of incentive stock options, see *Ch. 85, Employment Agreements, § 85.383[1][b]*.

[d] Internal Revenue Code Requirements

To qualify as an "incentive stock option," an option must be for the purchase of stock of a corporation (or of its parent or subsidiary), must be granted to an individual for any reason connected with his or her employment by the corporation (or by its parent or subsidiary), and must meet all of the following requirements [*I.R.C. § 422(b)*]:

- The option is granted pursuant to a plan that [*I.R.C. § 422(b)(1)*; *see* [2], P 13, *below*]
  - Includes the aggregate number of shares that may be issued under options [*see* [2], P 4, *below*];
  - Includes the employees (or class of employees) eligible to receive options [*see* [2], P 3, *below*]; and
  - Is approved by the shareholders of the granting corporation within 12 months before or after the date the plan is adopted;
- The option is granted within 10 years from the date the plan is adopted, or the date the plan is approved by the shareholders, whichever is earlier [*I.R.C. § 422(b)(2)*; *see* [2], P 3, *below*];
- By its terms the option is not exercisable after the expiration of 10 years from the date it is granted, or five years from the date it is granted if the employee owns more than 10 percent of all voting power [*I.R.C. §§ 422(b)(3), (c)(5)*; *see* [2], P 6, *below*];
- The option price is not less than the fair market value of the stock [*see I.R.C. § 422(c)(7)* (determination of "fair market value")] at the time the option is granted, or not less than 110 percent of fair market value if the employee owns more than 10 percent of all voting power [*I.R.C. § 422(b)(4), (c)(5)*; *see I.R.C. § 422(c)(1)* (good faith attempt at valuation sufficient); *see also* [2], P 7, *below*];
- By its terms the option is not transferable by the employee other than by will or the laws of descent and distribution, and is exercisable during the employee's lifetime only by him or her [*I.R.C. § 422(b)(5)*; *see* [2], P 8, *below*];
- At the time the option is granted, the employee does not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of the employer corporation (or of its parent or subsidiary) [*I.R.C. § 422(b)(6)*; *see* [2], P 3, *below*]; and
- At the time the option is granted, the terms of that option do not prohibit it from being treated as an incentive stock option [*I.R.C. § 422(b)*; *see* [2], PP 1, 3, *below*].

To the extent that the aggregate fair market value of stock with respect to which incentive stock options are exercisable for the first time by any individual during any calendar year (under all plans of the employer corporation and its parent and subsidiary corporations) exceeds $100,000, the options will not be treated as incentive stock options [*I.R.C. § 422(d)(1)*; *see* [2], P 5, *below*]. For this purpose, the fair market value of any stock will be determined at the time the option with respect to that stock is granted [*I.R.C. § 422(d)(3)*].

The requirement that the plan indicate the employees or class of employees eligible to receive options [*see* [b], *above*; *see also I.R.C. § 422(b)(1)*] will be considered satisfied by a general designation of the class of employees. Therefore, a

designation such as "all salaried employees of the grantor corporation and its subsidiaries," "key employees of the grantor corporation," or "all employees of the corporation" will meet this requirement [*Treas. Reg. § 1.422-2(b)(4)*].

For a more detailed discussion of the Internal Revenue Code requirements for incentive stock options, see *Ch. 85, Employment Agreements, § 85.383[1][c]*.

[e] Provisions of Plan

The only provisions that must be included in an incentive stock option plan are clauses specifying the number of shares that may be issued under options and the employees eligible to receive options [*I.R.C. § 422(b)(1)*; *see* [d], *above*]. However, most plans enumerate all of the option requirements set forth in *I.R.C. § 422(b)* [*see* [d], *above*]. In any case, to qualify incentive stock options by permit under the California securities laws [*see Corp. Code § 25113*], the plan must contain provisions similar to those set forth in *I.R.C. § 422(b)* [*see 10 Cal. Code Reg. § 260.140.41*; *see also* [j], *below*].

In addition to the required provisions, other provisions are essential for effective management of the plan. For example, the purpose of the plan [*see* [2], P 1, *below*], the procedure for exercising the option [*see* [2], P 6, *below*], and employee rights at termination of the option [*see* [2], P 9, *below*] should be included [*see* Colvin, *Qualified "Incentive Stock Options" Under the New Law: Requirements and Advantages, 55 J. Tax'n 202 (1981)*]. In addition, the plan should describe how it will be administered. The board of directors may create a committee to administer the plan [*see* [2], P 2, *below*] pursuant to *Corp. Code § 311*. For discussion and an example of a board of directors' resolution designating a committee, see *Ch. 5, Directors' Meetings, Actions, and Resolutions, § 5.245*.

[f] Adoption and Approval of Plan

The shareholders must approve an incentive stock option plan within 12 months before or after the date the plan is adopted [*I.R.C. § 422(b)(1)*; *see § 6I.242[1][b]* (approval requirements)]. Ordinarily, shareholder approval comes after adoption of the plan by the board of directors. The date of adoption, or the date of shareholder approval, whichever is earlier, is used to compute the 10-year limitation on options that may be granted pursuant to the plan [*see I.R.C. § 422(b)(2)*].

For a board of directors' resolution adopting the plan, see *§ 6I.241*. For a form setting forth shareholder approval of the plan, see *§ 6I.242*.

[g] Securities Law Requirements in General

Because an incentive stock option plan involves the sale of securities by an issuer, the stock transactions contemplated in the plan must comply with federal and state securities laws. Under federal law, the offer or sale of a security must be registered with the SEC [*see 15 U.S.C. § 77f*], unless the security or transaction is exempt [*15 U.S.C. §§ 77c, 77d*]. For basic discussion of the federal securities laws and a list of the applicable exemptions from registration under the Securities Act of 1933, see Ch. 6, *Securities Regulation Issues* , and Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* .

Under California law, the offer or sale of a security must be qualified with the Commissioner of Corporations, unless the security or the transaction is exempt from or not subject to qualification [*Corp. Code §§ 25110, 25120, 25130*]. By definition, the offer or sale of an option to purchase a security includes the offer and sale of the security itself, so that neither the exercise of the option nor the issuance of the stock pursuant to that option is an offer or sale requiring separate qualification or exemption [*Corp. Code § 25017(e)*; *see* Marsh & Volk, Practice Under the California Securities Laws, Ch. 8, *Standards for the Exercise of the Commissioner's Discretion* (Matthew Bender)]. For a detailed discussion of the methods of qualification and types of exemptions, see Ch. 6H, *Qualification of Securities* . The two

most common California exemptions, the small offering exemption and the limited offering exemption, are covered in Ch. 6B, *California Limited Offering Exemptions* , and Ch. 6C, *California Small Offering Exemption* . For discussion of the federal Rule 701 exemption, see *Ch. 6A, Federal Securities Exemptions for California Nonpublic Corporations, § 6A.30*.

[h] Special Exemption When Issuer Has Registered Under Federal Securities Exchange Act

The offer or sale of incentive stock options is exempt from qualification under *Corp. Code § 25110* (issuer transactions) if each of the following requirements has been met [*10 Cal. Code Reg. § 260.105.8(a)*]:

- The corporation issuing the options is the issuer of any security registered under Section 12 of the Securities Exchange Act of 1934 [*10 Cal. Code Reg. § 260.105.8(a)(1)*; *see 15 U.S.C. § 78l*];

- The total number of shares of stock of the corporation subject to incentive stock options (and all other outstanding employee stock options) does not exceed 10 percent of the outstanding shares of the same class of the corporation (exclusive of shares subject to promotional waivers) [*10 Cal. Code Reg. § 260.105.8(a)(2)*]; and

- Options granted prior to shareholder approval are by their terms not exercisable until shareholder approval has been obtained, and are void if shareholder approval is not obtained within 12 months before or after the incentive stock option plan is adopted [*10 Cal. Code Reg. § 260.105.8(a)(3)*; *see I.R.C. § 422(b)(1)*].

Further, the offer or sale of incentive stock options as a result of the amendment of outstanding options to conform to the requirements for incentive stock options [*see I.R.C. § 422(b)*; *see also* [d], *above*] is exempt from qualification under *Corp. Code § 25120* (recapitalizations and reorganizations) if any of the following apply [*10 Cal. Code Reg. § 260.105.8(b)*]:

- The outstanding options were qualified under *Corp. Code § 25110* (issuer transactions);

- The transaction conforms to all of the requirements of *10 Cal. Code Reg. § 260.105.8(a)*; or

- The transaction conforms to the requirements of *10 Cal. Code Reg. § 260.105.8(a)(1)* (registered corporation), (3) (shareholder approval), and at the time the options were issued, the transaction conformed to the requirement of *10 Cal. Code Reg. § 260.105.8(a)(2)* (limitation on stock subject to options).

[i] Plan Requirements for Qualification by Permit

If the offer or sale of the incentive stock options will be qualified by permit [*see Corp. Code § 25113*; *see also* Ch. 6H, *Qualification of Securities*], the Corporations Commissioner may refuse to issue a permit unless he or she finds the proposed issuance of the securities to be fair, just, and equitable [*Corp. Code § 25140(b)*]. The Commissioner's standards regarding fairness, intended to operate as guidelines only [*see 10 Cal. Code Reg. § 260.140*; *see also* Marsh & Volk, Practice Under the California Securities Laws, Ch. 8, *Standards for the Exercise of the Commissioner's Discretion* (Matthew Bender)], contain three provisions regarding stock option plans, discussed below. For a discussion and example of the information regarding stock options that must appear in an application for qualification by permit, see *Ch. 6H, Qualification of Securities, § 6H.234*.

[j] Contents of Plan

Under the Commissioner's guidelines referred to in [i], *above*, an option plan or agreement should provide for all of the following [*10 Cal. Code Reg. § 260.140.41*; *see* Dept. of Corps. Release No. 118-C (Nov. 14, 2006) (request for variance from compensatory benefit plan regulations)]:

- The total number of securities (which may be expressed as a specific number of securities or as a percentage of the total number of securities outstanding from time to time) that may be issued and the persons eligible to receive options.

- An exercise period of not more than 10 years from the date the option is granted.

- The nontransferability of the options, provided that the plan or agreement may permit transfer by will, by the laws of descent and distribution, to a revocable trust, or as permitted by Rule 701 of the Securities Act of 1933 [*see 17 C.F.R § 230.701*].

- The proportionate adjustment of the number of securities purchasable and the exercise price under the option in the event of a stock split, reverse stock split, stock dividend, recapitalization, combination, reclassification, or other distribution of the issuer's equity securities without the receipt of consideration by the issuer, of or on the issuer's class or series of securities underlying the option.

- The right to exercise the option in the event of termination (other than for cause), to the extent the optionee is entitled to exercise on the date employment terminates, continues until the earlier of the option expiration date or (1) at least six months from the date of termination if termination was caused by death or disability, or (2) at least 30 days from the date of termination if termination was caused other than by death or disability.

- Options must be granted within 10 years from the date the plan or agreement is adopted or the date the plan or agreement is approved by the issuer's security holders, whichever is earlier.

- The plan or agreement must be approved by a majority of the outstanding securities entitled to vote by the later of (1) within 12 months before or after the date the plan is adopted or the agreement is entered into, or (2) prior to or within 12 months of the granting of any option or issuance of any security under the plan or agreement in California. Any option granted to any person in California that is exercised before security holder approval is obtained must be rescinded if security holder approval is not obtained as described above. These securities will not be counted in determining whether approval is obtained.(A foreign private issuer [see *17 C.F.R. § 240.3b-4*] is not required to comply with this requirement if the aggregate number of persons in California granted options under all option plans and agreements and issued securities under all purchase and bonus plans and agreements does not exceed 35).

- Compliance with regulations regarding information required to be received by security holders [*see 10 Cal. Code Reg. § 260.140.46*].

Historically, these requirements have basically mirrored the definition of an incentive stock option contained in *I.R.C. § 422(b)* [*see* [d], *above*].

[k] Plan Documentation

The documentation of a purchase plan must provide that employees, officers, directors, managers, advisors, or consultants receive financial statements at least annually [*see* [2], P 15, *below*]. However, the financial statements do not have to meet the requirements of *10 Cal. Code Reg. § 260.613*. Documentation need not be provided when issuance

is limited to key persons whose duties in connection with the issuer assure them access to equivalent information.This section does not apply to any plan or agreement that complies with all conditions of Rule 701 [*17 C.F.R. § 230.701*], provided that for purposes of determining compliance, any registered domestic partner is considered a "family member" as that term is defined in Rule 701 [*10 Cal. Code Reg. § 260.140.46*; *see* Dept. of Corps. Release No. 118-C (Nov. 14, 2006) (request for variance from compensatory benefit plan regulations pending their possible amendment)].

[l] Limitation on Number of Shares

A presumption of fairness is created if all the securities called for by all outstanding options, under any purchase, bonus, or similar plan or agreement, do not exceed 30 percent of the then-outstanding securities of the issuer (excluding securities subject to promotional waivers) [*10 Cal. Code Reg. § 260.140.45*]. The limitation is determined without regard to shares represented by pro rata rights issued to shareholders [*see 10 Cal. Code Reg. § 260.140.40*], shares called for by warrants issued to debt or equity purchasers [*see 10 Cal. Code Reg. §§ 260.140.43, 260.140.44*], or securities sold to employees, directors, consultants, etc. [*see 10 Cal. Code Reg. § 260.140.42*], provided the purchase plan or agreement provides that all securities will have a purchase price of 100 percent of the security's fair value [*see 10 Cal. Code Reg. § 260.140.50*] either at the time the person is granted the right to purchase securities or at the time the purchase is consummated [*10 Cal. Code Reg. § 260.140.45*; *see* Dept. of Corps. Release No. 118-C (Nov. 14, 2006) (request for variance from compensatory benefit plan regulations pending their possible amendment)]. However, the issuer should still seek qualification by permit if all of the circumstances justify exceeding the 30-percent limit, especially when the securities are not publicly traded [Marsh & Volk, *Practice Under the California Securities Laws, Ch. 8, Standards for the Exercise of the Commissioner's Discretion, § 8.06[6]* (Matthew Bender)].This section does not apply to any plan or agreement that complies with all conditions of Rule 701 [*17 C.F.R. § 230.701*], provided that for purposes of determining compliance, any registered domestic partner is considered a "family member" as that term is defined in Rule 701 [*10 Cal. Code Reg. § 260.140.45(c)*].

[m] Acquisition and Divestment of Subsidiary Corporation

When a corporation is acquired as a subsidiary, and subsequently sold by the parent corporation, questions regarding the rights of the subsidiary's employees in the parent's incentive stock option plan may arise. In the acquisition phase of such a transaction, the acquired corporation's incentive stock option plan commonly is absorbed into the parent company's plan. When the parent corporation divests itself of the subsidiary, questions can arise as to (1) what happens to the subsidiary's employees' vested options in the parent company's stock; and (2) what happens to the subsidiary's employees' rights to have nonvested options in the parent company's stock. The answers will depend on how the parent company's plan provides for the possibility of acquisition and divestment.

In one case, a plan's only pertinent provision spoke of the "termination of the Optionee's Continuous Status as an Employee" and provided that vested options must be exercised within 30 days after the termination, while nonvested option rights were forfeited. This provision was ambiguous in the circumstances, since the subsidiary employees argued that they were not terminated through the sale of the subsidiary but simply passed into the control of a different parent corporation. Therefore, they argued, they should not be forced to exercise their vested options, nor should they lose their rights to have nonvested options become vested. The court concluded that the plan's reference to "status as an employee" meant status as an employee of the parent company or one of its subsidiaries. The subsidiary employees had that status while the parent owned the subsidiary, but they lost that status when the parent sold the subsidiary [*Falkowski v. Imation Corp. (2005) 132 Cal. App. 4th 499, 510, 512, 33 Cal. Rptr. 3d 724]* .

[2] FORM

Incentive Stock Option Plan

INCENTIVE STOCK OPTION PLAN OF
_____ [*name of corporation*], a California corporation

Purpose of Plan

1. The purpose of this Plan is to strengthen _____ [*name of corporation*] (hereafter "Corporation") by providing incentive stock options as a means to attract, retain, and motivate corporate personnel.

Administration of Plan

2. This plan shall be administered by a Compensation Committee (hereafter "Committee") [*or other name of administrative organization*] composed of members selected by, and serving at the pleasure of, the Board of Directors [other than directors who are also employees]. The Committee shall have the power to make all determinations necessary for the administration of the Plan, subject to the restrictions on committee powers set forth in *Corporations Code Section 311*.

Grant of Options

3. _____ [*name of corporation*] is hereby authorized to grant incentive stock options as defined in *Internal Revenue Code Section 422* to _____ [*describe employees or class of employees eligible to receive options, e.g.*, any full-time employee]. Options may not be granted to employees who own stock possessing more than 10 percent of the total combined voting power of all classes of stock of the corporation, or of its parent or subsidiary, except pursuant to the restrictions set forth in Paragraphs 6 and 7. Any option granted under this Plan shall be granted within 10 years from the date this Plan is adopted, or the date this Plan is approved by the shareholders pursuant to Paragraph 13, whichever is earlier.

Stock Subject to Plan

4. The aggregate number of shares that may be issued pursuant to options granted under this Plan shall be _____ [*number*] shares of the Corporation's _____ [*describe stock, e.g.*, voting common stock].

Aggregate Fair Market Value

5. The aggregate fair market value of the stock, as determined in good faith by the Committee at the time the option is granted, with respect to which incentive stock options are exercisable for the first time by an employee during any calendar year (under all incentive stock option plans of the Corporation and its parent and subsidiary corporations) shall not exceed $100,000.

Exercise of Option

6. Any option granted pursuant to this Plan shall contain provisions, established by the Committee, setting forth the manner of exercising the option. However, no option granted under this Plan shall be exercisable by its terms after the expiration of 10 years from the grant of the option, and no option granted to a person who owns stock possessing more than 10 percent of the total combined voting power of all classes of the Corporation's stock shall be exercisable by its terms after the expiration of five years from the date of the grant. The option may be subject to earlier termination as provided in Paragraph 9.

The optionee shall have the right to receive property at the time of exercising the option, so long as the property is subject to inclusion in income under *Internal Revenue Code Section 83*.

Option Price

7. The price for a share of stock subject to an option granted pursuant to this Plan shall not be less than the fair market value for the stock at the time the option is granted, as determined in good faith by the Committee at the time the option is granted. However, when an option is granted to a person who owns stock possessing more than 10 percent of the total combined voting power of all classes of the Corporation's stock, the purchase price per share of the stock subject to the option shall not be less than 110 percent of the fair market value of the stock at the time the option is granted, as determined by the Committee in good faith at the time the option is granted.

Options Nontransferable

8. The terms of any option granted under this Plan shall make the option nontransferable by the optionee except by will or the laws of descent and distribution, and exercisable only by the optionee during his or her lifetime.

Termination of Employment

9. An optionee's option shall expire three months after termination of employment for reasons other than death or disability, subject to earlier termination pursuant to Paragraph 6 of this Plan. An optionee's option shall expire 12 months after termination of employment due to permanent and total disability, as defined in *Internal Revenue Code Section 22(e)(3)*, subject to earlier termination pursuant to Paragraph 6 of this Plan. If an optionee should die while employed by the Corporation, or its parent, subsidiary, or successor as defined in *Internal Revenue Code Section 424*, or within the three-month period after termination of employment, the person to whom the optionee's rights pass by will or the laws of descent and distribution may exercise the option for any of the shares not previously exercised during Employee's lifetime, within _____ [*specify period, e.g.*, one year] after the optionee's death, subject to earlier termination pursuant to Paragraph 6 of this Plan.

Stock Subject to Option

10. The Corporation shall at all times during the term of this Plan reserve the number of shares of _____ [*describe stock subject to options*] required to meet the requirements of this Plan, and shall pay all fees and expenses necessarily incurred by the Corporation in connection with the exercise of options under this Plan.

In the event of a stock split, reverse stock split, stock dividend, combination, or reclassification of the Corporation's stock, an appropriate and proportionate adjustment shall be made in the number of shares to which stock options may be granted. A corresponding change shall be made to the number and kind of shares, and the exercise price per share, of unexercised options.

Merger, Consolidation, or Dissolution of Corporation

11. Following the merger of one or more corporations into the Corporation, or any consolidation of the Corporation and one or more corporations in which the Corporation is the surviving corporation, the exercise of options under this Plan

shall apply to the shares of the surviving corporation.

PRACTICE TIP:

Many plans provide for accelerated vesting in the event of a merger in which the company will not be the surviving corporation, so that the option holders will be entitled to receive the merger consideration on the same basis as other shareholders. *Commentary by Frances E. Lossing.*

Notwithstanding any other provision of this Plan, all options under this Plan shall terminate on the dissolution or liquidation of the Corporation, or on any merger or consolidation in which the Corporation is not the surviving corporation.

Other Option Terms

12. Any option granted pursuant to this Plan shall contain any other terms that the Board of Directors, the Corporation's legal counsel, or the Committee deems necessary.

Effective Date of Plan

13. This Plan shall be effective on approval by the outstanding shares or unanimous written consent of the shareholders of the Corporation.

Amendment and Termination of Plan

14. The Board of Directors may at any time amend or terminate this plan. No option may be granted after termination. The amendment or termination of the Plan shall not, however, alter any optionee's rights or obligations under an option previously granted, unless the optionee consents to that alteration.

[*Add if options will be qualified by permit (10 Cal. Code Reg. § 260.140.46; see Corp. Code § 25113):*]

Financial Statements

15. Optionees under this Plan shall receive financial statements annually regarding the Corporation during the period the options are outstanding. The financial statements provided need not comply with *Title 10, Section 260.613 of the California Code of Regulations.*



147 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
E. Incentive Stock Options

3-6I California Legal Forms--Transaction Guide § 6I.241

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§ 6I.241 Directors' Resolution Adopting Incentive Stock Option Plan

[1] Comment

[a] Use of Form

This form is a resolution of the board of directors approving and adopting a plan to grant incentive stock options [*see I.R.C. § 422*] to corporate employees. The corporation's power to adopt a share option plan [*see Corp. Code § 408(a)*] may be exercised by the board of directors pursuant to a resolution [*see Corp. Code § 300(a)*]. Alternatively, the board may adopt the plan pursuant to unanimous written consent [*Corp. Code § 307(b)*; *see Ch. 5, Directors' Meetings, Actions, and Resolutions, § 5.10*]. For a detailed discussion of board resolutions and consents, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

For a form and discussion of an incentive stock option plan, see *§ 6I.240*. A shareholders' resolution approving the plan is *set forth in § 6I.242*. For an incentive stock option agreement, see *Ch. 85, Employment Agreements, § 85.383*. Bylaws authorizing the adoption of an incentive stock option plan and agreement are set forth Ch. 4, *Bylaws*, § 4.243. For an overview of basic types of stock-based plans and related tax issues, see *Ch. 1D, Overview of Employee Benefits, § 1D.80* et seq. Employment contract provisions for both statutory and nonstatutory stock options are *set forth in Ch. 85, Employment Agreements, §§ 85.383-85.386*.

[b] Adoption Requirement

By definition, an "incentive stock option" must be granted pursuant to a plan that is approved by the shareholders of the granting corporation within 12 months before or after the date the plan is adopted [*I.R.C. § 422(b)(1)*]. Ordinarily, a plan is adopted when it is approved by the board of directors. The date of adoption is generally used to calculate the 10-year period in which options may be granted under the plan [*see I.R.C. § 422(b)(2)*; *see also § 6I.240*].

To constitute a qualified incentive stock option, the option must be approved by shareholders within 12 months before

or after the plan is adopted [*I.R.C. § 422(b)*; *Rev. & Tax. Code § 17501*]. Shareholder approval must comply with the corporate charter and bylaws, and with state law prescribing the method and degree of shareholder approval required for the issuance of corporate stock or options. If state law does not have a governing provision, the plan must be approved by a majority of votes at a duly held shareholder's meeting or by a method that state law would treat as adequate for other action requiring shareholder approval [*Treas. Reg. § 1.422-3*].

[c] Proof of Proceedings

The original or a copy of any resolution adopted by the board of directors, certified to be a true copy by a person purporting to be the secretary or an assistant secretary of the corporation, is prima facie evidence of the adoption of that resolution [*Corp. Code § 314*].

[2] FORM

Directors' Resolution Adopting Incentive Stock Option Plan

WHEREAS, a proposed Incentive Stock Option Plan ("Plan"), attached as Exhibit A, providing for the grant to corporate employees of options to purchase stock in the Corporation, has been presented and examined at this meeting; and

WHEREAS, it is deemed to be in the best interests of the Corporation that the Plan be approved and adopted; therefore it is

RESOLVED, that the Board of Directors hereby approves and adopts the Plan in the form presented at this meeting;

RESOLVED FURTHER, that the Board of Directors is authorized and directed to submit the Plan to the shareholders of this corporation for their approval;

RESOLVED FURTHER, that the shares of _____ [*describe stock*] issued and sold by the Corporation pursuant to the Plan, on receipt of the purchase price for those shares, shall be validly issued, fully paid, and nonassessable shares, and that the consideration received for those shares shall be credited to the appropriate capital accounts of this corporation; and

RESOLVED FURTHER, that each of the officers of this corporation is authorized and directed to execute all documents, and to take all actions deemed necessary, in order to carry out and perform the purposes of these resolutions.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
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3-6I California Legal Forms--Transaction Guide § 6I.242

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.242 Resolution of Shareholders Approving Incentive Stock Option Plan

[1] Comment

[a] Use of Form

This form is a resolution to be adopted by the shareholders of a corporation approving an incentive stock option plan. By definition, an "incentive stock option" is granted pursuant to a plan that has been approved by the shareholders of the granting corporation within 12 months before or after the date the plan is adopted [*I.R.C. § 422(b)(1)*]. The date of shareholder approval is used to calculate the 10-year period in which options may be granted under the plan [*see I.R.C. § 422(b)(2)*].

For a form and discussion of an incentive stock option plan, see *§ 6I.240*. A resolution of the board of directors approving the plan is *set forth in § 6I.241*. For an incentive stock option agreement, see *Ch. 85, Employment Agreements, § 85.383*. Bylaws authorizing the adoption of an incentive stock option plan and agreement are *set forth in Ch. 4, Bylaws, § 4.243*. For an overview of basic types of stock-based plans and related tax issues, see *Ch. 1D, Overview of Employee Benefits, § 1D.80* et seq. Employment contract provisions for both statutory and nonstatutory stock options are *set forth in Ch. 85, Employment Agreements, §§ 85.383-85.386*.

[b] Approval of Shareholders

For an incentive stock option plan to be approved by the shareholders, at least a majority of the outstanding voting stock must be voted in person or by proxy at a duly held shareholders' meeting [*Rev. Rul. 75-256, 1975-2 C.B. 194* ; *see* Rabkin & Johnson, Federal Income, Gift and Estate Taxation, Ch. 14, *Employer and Employee*, § 14.16[3] (Matthew Bender)]. Under California law, "approved by the outstanding shares" means approved by the affirmative vote of a majority of the outstanding shares entitled to vote. That approval includes the affirmative vote of a majority of the outstanding shares of each class or series entitled, by any provision of the articles or the General Corporation Law [*Corp. Code §§ 100-2319*] to vote as a class or series on the subject matter being voted on, and also includes the

affirmative vote of any greater proportion of the outstanding shares of any class or series required by the articles or the General Corporation Law [*Corp. Code § 152*].

Alternatively, the plan may be approved by unanimous written consent of the shareholders without a meeting, in accordance with state law. If only majority approval is obtained by written consent, however, a meeting is required [*Rev. Rul. 80-29, 1980-1 C.B. 93* ; *see* Rabkin & Johnson, Federal Income, Gift and Estate Taxation, Ch. 14, *Employer and Employee*, § 14.16[3] (Matthew Bender)]. Under California law, any action that may be taken at any annual or special meeting may be taken without a meeting and without prior notice, if a consent in writing [*see* Corp. Code § 195 (definition)] includes the following [*Corp. Code § 603(a)*]:

- Sets forth the action taken, and

- Is provided by the holders of outstanding shares with no less than the minimum number of votes that would be necessary to authorize or take that action at a meeting at which all shares entitled to vote were present and voted.

This form reflects the vote of a majority of the shareholders pursuant to a meeting. For an example of a unanimous written consent given without a meeting, see *Ch. 8A, Shareholders' Meetings, Voting, and Agreements, §§ 8A.225*, 8A.226.

[2] FORM

Resolution of Shareholders Approving Incentive Stock Option Plan

WHEREAS, the Board of Directors of this corporation at a regular [*or* special] meeting duly held on _____[*date*], at the principal office of this corporation at _____[*address*], California, adopted a resolution approving the offer and sale of corporate shares in accordance with an employee Incentive Stock Option Plan;

WHEREAS, the above-described resolution of the Board of Directors and the Incentive Stock Option Plan have been submitted and discussed at this meeting; therefore it is

RESOLVED, that the shareholders of this corporation hereby approve, and this corporation hereby adopts, the Incentive Stock Option Plan approved by the Board of Directors of this corporation;

RESOLVED FURTHER, that the secretary of this corporation is instructed to insert a copy of the Incentive Stock Option Plan marked "Exhibit A" in the minutes of this meeting and attach a copy of that Plan to any certified copy of this resolution prepared by _____ [him *or* her]; and

RESOLVED FURTHER, that the officers and directors of this corporation are hereby authorized and directed to execute and file any instruments, and do any other acts required of them, to carry out and perform the Incentive Stock Option Plan approved in this resolution.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
E. Incentive Stock Options

3-6I California Legal Forms--Transaction Guide §§ 6I.243-6I.249

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6I.243[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
F. Stock Purchase Warrants

3-6I California Legal Forms--Transaction Guide § 6I.250

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.250 Stock Purchase Warrant or Subscription Warrant

[1] Comment

[a] Use of Form

This form is a warrant entitling the holder to purchase corporate shares by a given date. It is a basic warrant form that may be used in an offering to the public or in a distribution to existing shareholders. For examples of more complex warrants with additional features, see Rabkin & Johnson, Current Legal Forms with Tax Analysis, Ch. 19, *Corporate Securities* (Matthew Bender).

For a board resolution authorizing the offer and sale of warrants, see *§ 6I.251*. For a board resolution authorizing the issuance of warrants for a share dividend of fractional shares, see *Ch. 9, Dividends, Reacquisitions of Shares, and Assessments, § 9.230*.

[b] Characteristics of Warrants

A warrant is a contract in which a corporation makes an irrevocable offer for the warrant holder to purchase corporate shares at a specified price, usually at a discount from market price, under specified circumstances [*see* Cavitch, Business Organizations with Tax Planning, Ch. 92, *Convertible Securities, Warrants and Options* (Matthew Bender)]. Although warrants are classified as "equity securities" [*see Corp. Code § 168*], they are not stock, but are merely an option or right to buy stock. They have no voting, dividend, or distribution rights. Although most warrants are valid only for a specified time, some warrants are perpetual. Warrants are a type of option, but unlike options, they are usually transferable [Cavitch, Business Organizations with Tax Planning, Ch. 92, *Convertible Securities, Warrants and Options* (Matthew Bender)].

There are two main types of warrants. Stock purchase warrants are generally attached to corporate obligations or shares on original public issue, and are designed to make the securities to which they are attached more saleable [Ballantine &

Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness* , § 121.03[10] (Matthew Bender); *see* [e], *below*]. Subscription warrants or "rights" are granted to existing shareholders in connection with the sale of additional shares, and are used almost exclusively as a tool of financing after initial capitalization [Cavitch, Business Organizations with Tax Planning, Ch. 92, *Convertible Securities, Warrants and Options*, § 92.02 (Matthew Bender); *see* [g], *below*].

[c] Distinguished From Evidence of Fractional Shares

Scrip certificates that are issued to evidence fractional share interests are often called "warrants" [*see Corp. Code § 407*]. When a sufficient number of "warrants" representing fractional shares are accumulated to evidence at least one full share, the shareholder presents them to an issuer for the full shares represented [*Corp. Code § 407*]. Those certificates, however, are unrelated to the warrants discussed in this chapter [*see* Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness* , § 136.02 (Matthew Bender)]. For further discussion of this type of "warrant," see *Ch. 3, Articles of Incorporation, § 3.251[1][g]*.

[d] Authorization for Issuing Warrants and Stock

A corporation may grant options (which include warrants) to purchase or subscribe for shares of any class or series on any terms and conditions deemed expedient, either in connection with the issue, subscription, or sale of any of its shares, bonds, debentures, notes, or other securities, or independently. Option rights may be transferable or nontransferable, and separable or inseparable from other securities of the corporation [*Corp. Code § 404*]. No article or bylaw provisions are necessary to authorize the issuance of warrants. Warrants are authorized and issued by resolution of the board of directors [*see § 6I.251*], unless the articles or bylaws restrict issuance. No statutory constraints limit the kind of consideration that may be received for stock purchase warrants; the board of directors generally determines the adequacy of the consideration [*see* Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness* (Matthew Bender)].

When warrants are issued, a sufficient number of shares of the underlying stock should be authorized and reserved for issuance on exercise of the warrants [*see* Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness* (Matthew Bender)]. If at the time of granting option rights the corporation's articles do not authorize the issuance of all the shares required for satisfaction of the rights, if and when exercised, the additional number of shares required should be authorized by an amendment to the articles [*Corp. Code § 405(a)*]. If the corporation has obtained approval of the outstanding shares [*see Corp. Code § 152*] for the issuance of option rights, the board may amend the articles to increase the authorized shares to satisfy those rights, without further approval of the outstanding shares [*Corp. Code § 405(b)*].

[e] Stock Purchase Warrants in General

Stock purchase warrants may be detachable from the bond, debenture, or stock certificate they accompany, or issued as separate documents, so that they can be transferred without regard to the other security [Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness* , § 136.02 (Matthew Bender)]. They are issued to make existing securities more attractive to potential investors, who might not purchase them without an added inducement, to compensate promoters or underwriters and insure their continuing interest in the corporation's future, or as a direct means of raising additional funds [Cavitch, *Business Organizations with Tax Planning, Ch. 92, Convertible Securities, Warrants and Options, § 92.02[3]* (Matthew Bender)]. The warrant's exercise price is usually lower than the market price of the stock subject to the warrant. However, since the corporation's primary consideration is to attract capital, too low a price will defeat the offer's purpose. Therefore, the issuer should fix the exercise price at the highest level that will attract new investors [Cavitch, *Business Organizations with Tax Planning, Ch. 92, Convertible Securities, Warrants and Options, § 92.02[4]* (Matthew Bender)].

Regulations of the Corporations Commissioner govern warrants to purchase debt and equity securities when the offering must be qualified [*10 Cal. Code Reg. §§ 260.140.43* (debt securities), 260.140.44 (equity securities); *see* [i], *below*].

For an extensive discussion of stock purchase warrants, see Cavitch, *Business Organizations with Tax Planning, Ch. 92, Convertible Securities, Warrants and Options, § 92.02* (Matthew Bender).

[f] Stock Purchase Warrants Distinguished From Convertible Securities

Like convertible securities [*see Ch. 6J, Issuance of Debt Securities, § 6J.12*], stock purchase warrants offer the investor an opportunity to acquire corporate shares if he or she purchases other corporate securities. However, two features distinguish stock purchase warrants from convertible securities. First, because warrants are independent of the accompanying security, they must be supported by independent consideration. The conversion right in convertible securities is supported by the same consideration as the original security. Second, the holder of a warrant pays for the shares issued at the warrant's exercise price, and keeps the original security. The holder of a convertible security, however, must surrender the original security as consideration for the new shares [Cavitch, *Business ORGANIZATIONS WITH TAX PLANNING, Ch. 92, Convertible Securities, Warrants and Options, § 92.02[1]* (Matthew Bender)].

[g] Subscription Warrants

A subscription warrant or "right" may be issued to the existing shareholders of the corporation in connection with a "rights" offering. These warrants typically have a very short duration, such as two or three weeks, and represent the privilege to subscribe for additional stock to be issued. Each shareholder receives one right for each share held. The right issued should be distinguished from the form of the warrant itself; one warrant may represent all of a shareholder's rights, which together may represent the ability to purchase more or less than one new share. The rights are usually granted for free, without cash consideration, and are therefore not actually part of the corporate capitalization [Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness* , § 121.03 (Matthew Bender)].

Subscription rights may be transferable, so that to the extent that there is a difference between the subscription price of the securities and their market value, the shareholder who does not subscribe may still sell the warrant and realize something of value. For example, in a 10 to one issuance in which 10 rights are required to purchase one share, a shareholder holding only five rights may sell his or her rights in the public market, or purchase additional rights. When the rights have expired, the underwriters purchase any shares remaining unsold and resell them in a public offering.

Issuers often provide shareholders with the opportunity to buy any shares of the new additional stock that are left over after the rights expire, at the warrant exercise price, through "oversubscription." Leftover shares become available when some rights holders fail to exercise their rights to purchase.

Regulations of the Corporations Commissioner govern "rights" in offerings that must be qualified [*10 Cal. Code Reg. § 260.140.40*; *see* [k], *below*].

For further discussion of subscription warrants, see Ballantine & Sterling, California Corporation Laws, Appendix A, Forms 9.11, 9.12 (Matthew Bender).

[h] Securities Laws Considerations

Warrants are "securities" under federal securities law [*15 U.S.C. § 77b(a)(1)*], and therefore must be registered with the Securities and Exchange Commission [*see 15 U.S.C. § 77f*] unless the security or transaction is exempt [*15 U.S.C. §§*

77c, 77d]. For basic discussion of the federal securities laws, see Ch. 6, *Securities Regulation Issues* , and Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* . For a detailed discussion of federal securities laws, see Sommer, Federal Securities Act of1933 (Matthew Bender), and Sommer, Federal Securities Exchange Act of1934 (Matthew Bender).

Warrants are also "securities" under California law [*Corp. Code § 25019*], and must be qualified unless exempt or not subject to qualification [*see Corp. Code §§ 25110, 25120, 25130*]. Compliance is required at the time of the offer or sale of the warrant; neither the exercise of the right to purchase stock nor the issuance of the securities pursuant to the warrant falls within the definition of "offer" or "sale" requiring separate qualification or exemption [*Corp. Code § 25017(e)*].

[i] Qualification Requirements

If an issuer attempts to qualify the offer or sale of warrants by permit [*see Corp. Code §§ 25113, 25122*; *see §§ 6I.230-6I.232* (qualification)], the Commissioner may refuse to issue a permit unless he or she finds the proposed issuance of the securities to be fair, just, and equitable [*Corp. Code § 25140(b)*]. Similarly, the Commissioner may deny the effectiveness of qualification by coordination [*see Corp. Code § 25111*] or notification [*see Corp. Code § 25112*] for the same reason [*Corp. Code § 25140(a)*]. The Commissioner's standards regarding fairness, intended to operate as guidelines only [*see 10 Cal. Code Reg. § 260.140*; Marsh & Volk, Practice Under the California Securities Laws, Ch. 8, *Standards for the Exercise of the Commissioner's Discretion* (Matthew Bender)], contain three provisions regarding stock warrants.

Warrants to purchase equity securities may be issued to the purchasers of debt securities in an offering that must be qualified provided that the following conditions are satisfied [*10 Cal. Code Reg. § 260.140.43*]:

- Issuance is necessary to obtain debt financing;
- The term of the warrant does not exceed the life of the debt securities or 15 years, whichever is less;
- The number of shares issuable on exercise of the warrants does not exceed the number that could be purchased at the exercise price with the debt securities at face amount; and
- The exercise price is at least equal to the value of the equity securities [*see 10 Cal. Code Reg. § 260.140.50*] on the date the warrant is issued.

For further discussion of debt securities, see Ch. 6J, *Issuance of Debt Securities* .

[j] Warrants to Purchasers of Equity Securities

Warrants to purchase equity securities may be issued to purchasers of equity securities in an offering that must be qualified provided that the following conditions are satisfied [*10 Cal. Code Reg. § 260.140.44*]:

- Issuance is necessary to obtain equity financing;
- The term of the warrant does not exceed five years;
- The number of securities issuable on exercise does not exceed the number of equity securities purchased with the warrants; and
- The exercise price is at least equal to the value of the equity securities [*see 10 Cal. Code Reg. §*

260.140.50] on the date the warrant is issued.

[k] Pro Rata Subscription Rights

Rights may be issued to all the shareholders of an issuer (or to all the holders of a particular class of stock) to purchase additional shares on a pro rata basis in an offering that must be qualified, provided that the following conditions are satisfied [*10 Cal. Code Reg. § 260.140.40*]:

- The term is no more than 90 days following the date of issuance.
- The exercise price is not so low in relation to the offering price [*see 10 Cal. Code Reg. § 260.140.50*] that it is unreasonably prejudicial to those shareholders unable to exercise or sell their rights.
- The relative equity positions of different classes of outstanding shares will not be unfairly prejudiced
- The rights are freely transferable.

An exercise price that is not more than 15 percent below the offering price [*see 10 Cal. Code Reg. § 260.140.50*] is presumptively reasonable [*10 Cal. Code Reg. § 260.140.40*].

[l] Tax Considerations Related to Receipt of Warrants

When existing shareholders receive rights to purchase stock in a subscription offering, the receipt of those rights is treated as a distribution on existing shares. Distributions of a corporation's stock to its shareholders are not includible in gross income [*I.R.C. § 305(a)*], unless they are payable either in stock or property, are disproportionate, are made on preferred stock, or are composed of convertible preferred stock [*I.R.C. § 305(b)*]. The term "stock" includes the right to acquire stock [*I.R.C. § 305(d)(1)*; *see* Rabkin & Johnson, Current Legal Forms with Tax Analysis, Ch. 19, *Corporate Securities* , Form 19.13 (Matthew Bender)]. The corporation recognizes no gain or loss on its distribution of rights to acquire stock when the distribution is not made in complete liquidation [*I.R.C. § 311*]. For further discussion of the taxation of distributions, see Ch. 9, *Dividends, Reacquisitions of Shares, and Assessments* . The basis of the shareholders' existing shares is allocated between the existing shares and the rights [*I.R.C. § 307(a)*]. However, if the fair market value of the rights is less than 15 percent of the fair market value of the existing shares, the rights will have a basis of zero [*I.R.C. § 307(b)*].

In a stock purchase offering, the new shareholders pay a separate, nominal consideration for the warrant, in addition to the price of the attached security [Cavitch, *Business Organizations with Tax Planning, Ch. 92, Convertible Securities, Warrants and Options, § 92.02[2]* (Matthew Bender)]. Although the issuing corporation receives no taxable income on the receipt of consideration for a warrant, that consideration constitutes ordinary income on the warrant's expiration date if the warrant is not exercised [*Rev. Rul. 72-198, 1972-1 C.B. 223*].

[m] Tax Considerations Related to Disposition of Warrant Before Exercise

Because warrants are generally transferable [*see* [b], *above*], they may be bought and sold before exercise. Any gain or loss attributable to the sale or exchange of, or loss attributable to failure to exercise, the right to purchase stock will be considered to be capital gain or loss [*I.R.C. § 1234*; *see I.R.C. § 1221* (capital asset defined)]. Stock warrants may also be entitled to capital loss as "worthless securities" [*see I.R.C. § 165(g)(2)*]. The rate differential between capital gains and ordinary income is substantial enough to give capital gains treatment a significant advantage [*see I.R.C. § 1(a)-(e), (h)(1), (i)(2)*; *Rev. & Tax. Code § 18151*].

For California state income taxation purposes, capital gains and losses are determined in accordance with the provisions

of the Internal Revenue Code [*Rev. & Tax. Code § 18151*].

[2] FORM

Stock Purchase Warrant or Subscription Warrant

Warrant No. _____

_____ [Right to purchase _____ shares *or* Warrant for _____ rights]

_____ [*Name of corporation*]

_____ [STOCK PURCHASE *or* SUBSCRIPTION] WARRANT

THIS WARRANT entitles _____ [*name of holder*], or his or her assign, to _____ [purchase *or* subscribe for], on or before _____ [*if offering will be qualified, specify date within time period required by regulation; see comment to this form for discussion of the applicable periods*], [*add for purchase warrant:* _____ (*number*)] shares of fully paid, nonassessable common stock of this corporation [*add for subscription warrant:* on the basis of one share for each _____ rights], at $_____ [*if offer will be qualified, state price not less than 15 percent below market price*] per share, on exercise of this Warrant together with presentation of the full exercise price, subject to the conditions set forth in the Prospectus.

_____ [*corporation*]

By _____ [*signature*]

[*typed name and title*]

[*Reverse side of warrant:*]

TERMS AND CONDITIONS

1. While warrants are exercisable, this corporation shall reserve a sufficient number of shares to provide for the delivery of stock pursuant to this and other warrants.

2. Any changes in the structure of this corporation or in its outstanding stock that affect the rights and participation to which the holder of this warrant would be entitled as of the date of exercising this warrant shall result in the proportionate adjustment of the shares that may be purchased pursuant to this warrant.

3. Until the valid exercise of this warrant, the holder shall not be entitled to any shareholder rights.

4. To exercise this warrant, the exercise form below must be completed and delivered to the warrant agent, together with the exercise price.

5. This warrant is transferable with the same effect as a negotiable instrument. To transfer rights, the transfer form below must be completed.

[*Add if stock purchase warrant is detachable:*]

6. This warrant is detachable from the attached _____ [*specify the attached security*].

[*Add for subscription warrant if oversubscription is allowed:*]

6. The holder may subscribe to purchase an additional number of shares by completing the oversubscription form, below, when all rights represented by this warrant have been used.

[*Continue with the following:*]

EXERCISE OF WARRANT

I hereby irrevocably elect to exercise the purchase rights represented by this warrant for the following shares of common stock, on the terms and subject to the conditions specified in the Prospectus:

Shares subscribed for: _____

Subscription price: $_____

Total cost: $_____
_____Dated:

_____ [*signature of subscriber*]

[*typed name*]

TRANSFER OF WARRANT

For value received, I hereby assign this warrant to _____ [*name of assignee*], whose address is _____.
_____Dated:

_____ [*signature of subscriber*]

[*typed name*]

[*Add for subscription warrant if oversubscription is allowed:*]

OVERSUBSCRIPTION

I hereby subscribe to the following additional shares of common stock, on the terms and subject to the conditions

specified in the Prospectus:

Shares oversubscribed for: _____

Subscription price: $_____

Total cost: $_____
_____Dated:

_____ [*signature of subscriber*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
F. Stock Purchase Warrants

3-6I California Legal Forms--Transaction Guide § 6I.251

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.251 Resolutions Authorizing the Offer and Sale of Warrants

[1] Comment

[a] Use of Form

This form is a resolution of the board of directors authorizing the offer and sale of warrants. For a warrant form and discussion of warrants, see *§ 6I.250*.

The corporation's power to grant warrants and other types of options [*see Corp. Code § 404*] may be exercised by the board of directors pursuant to a resolution [*see Corp. Code § 300(a)*]. Alternatively, the board may adopt the plan pursuant to unanimous written consent [*Corp. Code § 307(b)*; *see Ch. 5, Directors' Meetings, Actions, and Resolutions, § 5.221*]. For a detailed discussion of board resolutions and consents, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

[b] Types of Warrants

Warrants to purchase shares in the corporation may take several forms. This form may be used to authorize the issuance of either stock purchase warrants or subscription warrants ("rights"). For further discussion of warrants generally, see *§ 6I.250[1][b]*.

[c] Securities Law Requirements

Warrants are "securities" under California law [*Corp. Code § 25019*], and an offer or sale of warrants must be qualified unless exempt or not subject to qualification [*see Corp. Code §§ 25110, 25120, 25130*]. In order for an offer to be qualified, warrants to purchasers of equity or debt securities must meet requirements regarding necessity of issuance, term of warrant, number of securities issuable, and exercise price [*10 Cal. Code Reg. §§ 260.140.43, 260.140.44*; *see* [2], *below*]. For an offer of rights to be qualified, the rights must meet the Commissioner's requirements of expiration

term, exercise price, and transferability [*10 Cal. Code Reg. § 260.140.40*]. For further discussion of securities issues relating to warrants, see *§ 6I.250[1][h]*. For a resolution authorizing the officers to take all actions necessary to comply with the securities laws, see *§ 6I.230*. For a resolution identifying the offerees in a limited offering, see *§ 6I.211*.

[d] Proof of Proceedings

The original or a copy of any resolution adopted by the board of directors, certified to be a true copy by a person purporting to be the secretary or an assistant secretary of the corporation, is prima facie evidence of the adoption of that resolution [*Corp. Code § 314*].

[2] FORM

Resolutions Authorizing the Offer and Sale of Warrants

[*For a stock purchase offering:*]

WHEREAS, _____ [*describe purpose of offering, or, if offer of warrants must be qualified:* the issuance of stock purchase warrants is necessary to obtain _____ (debt *or* equity) financing]; it is therefore

RESOLVED, that subject to the qualification or exemption of the issue with the Commissioner of Corporations of the State of California, this corporation is hereby authorized to issue warrants representing the right to purchase an aggregate of _____[*number*] shares of common stock of this corporation at $_____ [*state price not less than 15 percent below market price if offer will be qualified (10 Cal. Code Reg. § 260.140.50)*] per share.

RESOLVED FURTHER, that the term of the warrants will not exceed _____ [*if offer to purchaser of equity securities must be qualified:* five years; *or, if offer to purchaser of debt securities must be qualified:* the life of the debt securities or 15 years, whichever is less];

RESOLVED FURTHER, that the number of equity securities issued on exercise of the warrants does not exceed the number _____ [*for warrants issued with debt securities:* that could be purchased at the exercise price with the debt securities at face amount; *or, for warrants issued with equity securities:* of equity securities purchased together with the warrants];

[*Or, for a subscription offering:*]

WHEREAS, this corporation is authorized to issue _____ shares of common stock, and there are now _____ shares issued and outstanding; and

WHEREAS, it is in the Corporation's best interest that the capital of the corporation be increased through the sale and issuance of _____ shares of common stock at the cash price of $_____ [*state price not less than 15 percent below market price if offer will be qualified (10 Cal. Code Reg. § 260.140.50)*]; therefore, it is

RESOLVED, that _____ [*number stated above*] shares of common stock be offered and sold at the cash price of $_____ [*price stated above*] by the issuance of a transferable warrant to each shareholder of record at the close of business on _____[*date*], which will represent the right to subscribe until _____ [*date; if offer will be qualified, specify date within 90 days following issuance*], for the purchase of one share of common stock for each _____ share(s) owned by the shareholder on the record date;

[*Continue with the following:*]

RESOLVED FURTHER, that the form of warrant presented and considered at this meeting is adopted and approved, and that the Secretary is directed to attach a copy of that warrant to the minutes of this meeting;

RESOLVED FURTHER, that the consideration received on the sale of shares pursuant to warrants shall be credited to the appropriate capital accounts of this corporation; and

RESOLVED FURTHER, that each of the officers of this corporation is authorized and directed to execute all documents and to take all actions deemed necessary, including the procedures required for qualification or exemption of the offer and sale of warrants, in order to carry out and perform the purposes of these resolutions.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
F. Stock Purchase Warrants

3-6I California Legal Forms--Transaction Guide §§ 6I.252-6I.259

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

[Reserved]

§§ 6I.252[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
G. Subscription Agreements and Sales Contracts

3-6I California Legal Forms--Transaction Guide § 6I.260

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.260 Resolution Approving Form of Subscription Agreement or Sales Contract

[1] Comment--Use of Form

This form is a corporate resolution approving the form of a subscription agreement to be used in connection with an offering of the corporation's securities. The board should approve the exact form to be used before it is given to the sales force, in order to make certain that the agreement is consistent with the offering as authorized by the corporation. The requirements relating to use of subscription agreements are discussed in *§ 6I.261*.

[2] FORM

Resolution Approving Form of Subscription Agreement or Sales Contract

Resolution Approving Form of Subscription Agreement or Sales Contract

RESOLVED, that the attached form of subscription agreement is approved and may be used in connection with the offer or sale of the foregoing authorized issue of shares of this corporation [in accordance with the terms and conditions of the qualification of that issue of securities by the Commissioner of Corporations].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
G. Subscription Agreements and Sales Contracts

3-6I California Legal Forms--Transaction Guide § 6I.261

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.261 Subscription Agreement for Shares in California Corporation--Purchase Price Payable in Cash on Execution of Agreement--Public Offering to California Residents

[1] Comment

[a] Use of Form

This form is a subscription agreement for the purchase of shares in a California corporation. It assumes the following:

- The securities will be sold in a public offering for which no California securities exemption is available and that they therefore must be qualified with the California Commissioner of Corporations.
- The Commissioner has imposed an impound condition on the offering [*see* [b], *below*].
- The securities will be exempt from registration under the Securities Act of 1933 by virtue of the intrastate exemption [*see 15 U.S.C. § 77c(a)(11)*; *17 C.F.R. § 230.147* (SEC Rule 147)].

The form further assumes that the purchase price for the shares will be paid in a lump sum rather than in installments. For an agreement requiring the purchase price to be paid in installments, see *§ 6I.262*. Finally, it assumes that the corporation has not granted its existing shareholders any preemptive rights that would restrict its ability to make a public offering of its securities.

The subscription agreement is ordinarily disseminated to prospective purchasers as part of a package of materials that also contains a copy of the prospectus and a questionnaire to be completed by prospective purchasers. Prospective purchasers who wish to subscribe for shares are instructed to return the completed questionnaire and subscription agreement along with a check payable to the corporation, or if an impound condition is involved, to the depositary or a licensed broker-dealer acting as the selling agent [*10 Cal. Code Reg. § 260.141.21*].

This form is for use for offerings by preexisting corporations. For preincorporation agreements for use prior to formation of a corporation, see Ch. 2, *Formation of Corporations* .

[b] When Subscription Agreement Is Required

The Commissioner of Corporations will require that a subscription agreement be delivered to each subscriber whenever the Commissioner imposes an impound requirement in connection with the sale of securities [*10 Cal. Code Reg. § 260.141.22(a)*]. An impound condition normally will be imposed if the securities are not firmly underwritten and if the Commissioner determines that a specific minimum amount of funds is necessary to finance the proposed undertaking as described in the application and that it is inadvisable for the issuer to expend any of the proceeds from the sale of the securities prior to receiving that minimum amount [*10 Cal. Code Reg. § 260.141.20*].

There is no requirement that a subscription agreement be used in connection with offerings that are not subject to an impound requirement. However, such an agreement nevertheless may be useful to memorialize the agreement between the corporation and the subscriber. This form presupposes that an impound condition has been imposed, and may be modified for other situations.

[c] Contents of Agreement

When an impound condition is imposed, the form of the subscription agreement must be approved by the Commissioner [*10 Cal. Code Reg. § 260.141.22(a)*]; thus, this form is illustrative only. At a minimum, the subscription agreement must state the following [*10 Cal. Code Reg. § 260.141.22(a)*]:

- The complete names and addresses of the issuer and the subscriber.
- The complete name of the agent of the issuer or broker receiving the payments.
- The number of securities purchased and the total purchase price.
- The amount of the payment received.
- The complete name and address of the depositary with whom the payment will be placed.
- The date of the payment.

A subscription agreement must also contain the statement set forth in Paragraph 2 of this form, specifying that the offering is subject to the terms and conditions of the qualification.

[d] Delivery of Copies

Subscription agreements must be consecutively numbered and prepared in quadruplicate. The original must be given to the subscriber, the first copy to the depositary together with the payment received, the second copy to the issuer, and the third to the broker, if any. The Commissioner may approve other modifications to the form, such as requiring the subscription agreements to be press-numbered [*10 Cal. Code Reg. § 260.141.22(a)*].

[e] Qualification Requirement

Because the issuer will receive consideration from the subscribers at the time the subscription agreement is executed, the securities must be qualified for sale in California prior to the time this agreement is used [*see Corp. Code §§ 25102(a)* (exception for offers when no part of purchase price is paid or received), 25110], unless the security or transaction is not subject to qualification or unless an exemption from the qualification requirements is available. The

requirements for qualification of securities are discussed in Ch. 6H, *Qualification of Securities* . The two most commonly used exemptions from qualification, the small offering exemption [*Corp. Code § 25102(h)*] and the limited offering exemptions [*Corp. Code §§ 25102(f), 25102.1(d)*], are discussed in Ch. 6B, *California Limited Offering Exemptions* , and Ch. 6C, *California Small Offering Exemption* .

[f] Operation of Impound Conditions

If an impound condition has been imposed, the issuer may not issue any certificates or other evidence of securities, except subscription agreements, until the impound condition has been satisfied and the impound funds have been released to the issuer. All checks must be made payable to the depositary or to a licensed broker-dealer as the selling agent. All funds received from the sale, including any amounts allowed as selling expenses, must be placed in a separate escrow account with an approved depositary within 48 hours of receipt [*10 Cal. Code Reg. §§ 260.141.21, 260.141.23(a)*]. Usually, the depositary will be a national bank located in California or a California bank [*10 Cal. Code Reg. § 260.141.23(a)*; *see* 10 Cal. Code Reg. § 260.140.23(b) (contents of application for approval of depositary and minimum contents of agreement between issuer and depositary)].

The Commissioner will authorize the depositary to release the impound funds to the issuer when the full amount of impound funds specified in the impound condition has been deposited and any other conditions to the release have been satisfied, unless there have been changes in the plan of operation or in other circumstances that would render the impound funds inadequate, or circumstances have changed so that the Commissioner could no longer find that the sale would be fair, just, and equitable [*10 Cal. Code Reg. § 260.141.24(a)*; *see 10 Cal. Code Reg. § 260.141.24(b)* (contents of application by issuer to release impound funds)]. The Commissioner may approve a partial release of impound funds in unusual cases [*see 10 Cal. Code Reg. § 260.141.24(d)*].

If the specified amount of impound funds has not been obtained as of the date specified in the impound condition, or on the earlier issuance of a stop order or an order suspending or revoking the qualification permit, the Commissioner will issue an order directing the depositary to return to each subscriber the amount of each subscriber's payment [*10 Cal. Code Reg. § 260.141.25(a)*]. Extensions of time may be granted in unusual cases [*see 10 Cal. Code Reg. § 260.141.25(b)*].

The Commissioner has the discretion to grant variances from the above requirements. An issuer that desires a variance must submit a verified petition for variance [*see 10 Cal. Code Reg. § 260.141.27*].

[g] Exemption From Federal Securities Regulation

In addition to complying with the California securities requirements, a corporation that wishes to make a public offering of its securities may have to register under the Federal Securities Act of 1933 [*15 U.S.C. §§ 77a-77aa*], unless the offering comes within one or more exemptions from registration. The most commonly used exemptions are the "intrastate exemption" [*see 17 C.F.R. § 230.147* (SEC Rule 147)] and the three limited offering exemptions (SEC Rules 504, 505, and 506) set forth in SEC Regulation D [*17 C.F.R. §§ 230.501-230.508*]. These exemptions are discussed in detail in Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* .

In accordance with the intrastate exemption, Paragraph 4 of this form contains a representation that the subscriber is a bona fide resident of California and that the subscription agreement was made and delivered to the subscriber in California. The fifth paragraph requires the subscriber to declare that the shares are being purchased as an investment for the purchaser's own account and without intent to resell or distribute them to any other person.

[2] FORM

Subscription Agreement for Shares in California Corporation--Purchase Price Payable in Cash on Execution of Agreement--Public Offering to California Residents

SUBSCRIPTION AGREEMENT

.....No. _____

_____ [*Complete name of corporation*]
_____ [*address of principal office*]

Subscription

1. The undersigned [having received and read the Prospectus of _____ (*name of issuer*) dated _____,] hereby subscribe to the number of shares of the _____ [common *or* preferred] stock of _____ [*name of issuer*] set opposite their respective names, at the price of $_____ per share.

_____ [*name of issuer*] WILL NOT ACCEPT SUBSCRIPTIONS FOR LESS THAN _____ [*specify number, e.g.,* 100] SHARES. ALL APPLICATIONS MUST BE RECEIVED BY _____ [*name of issuer*] NO LATER THAN _____ [*time, e.g.,* 5:00 P.M.], PACIFIC STANDARD TIME, on _____ [*closing date of offering as specified in impound requirement*].

_____ [Payment of the purchase price is secured by _____ (*describe collateral*)].

Agreement Subject to Terms of Qualification

2. This subscription is made pursuant to, and is subject to, the terms and conditions of the qualification approved by the Commissioner of Corporations of the State of California for _____ [*name of issuer*] under date of _____ [*date of qualification*].

Rejection by Corporation

3. _____ [*Name of issuer*] reserves the right to reject this subscription in whole or in part, and to allot a lesser number of shares than are subscribed for, within a reasonable time after its date, on refunding all or the appropriate portion of the subscription price paid. _____ [*name of issuer*] further reserves the right to cancel this offering at any time and to cancel all accepted subscriptions in the event that this offering is canceled in its entirety.

Representation as to Residence

4. The undersigned represent that they are all bona fide residents of California, domiciled in this State, and that this Subscription Agreement was executed by and delivered to them in California.

Declaration of Intent Not to Resell

5. The undersigned declare that they are subscribing to these shares as an investment for their own accounts and with no present intent to divide, resell, or otherwise distribute them among or to persons not domiciled in California.

Payee of Checks

MAKE ALL CHECKS, DRAFTS, AND MONEY ORDERS, ISSUED IN PAYMENT OF THIS SUBSCRIPTION PAYABLE TO _____ [*name and address of depositary*].

Dates, Signatures, and Addresses of Subscribers

Shares purchased by the undersigned shall be registered as listed below. If certificates for shares are to be issued in the name of one person for the benefit of another, indicate whether registration should be as trustee or custodian for that other person, and if as trustee, provide full name and date of the trust.

How Shares Are to Be Registered			Number of Shares
Full Name: _____			_____
Full Name: _____			_____
☐ Individual	☐ Joint Tenants	☐ Trustee	
☐ Tenants in Common	☐ Custodian	☐ Other _____	

IN WITNESS WHEREOF, the undersigned have executed this subscription agreement on the dates set forth above their names below.

_____Dated:

_____ [*signature of purchaser*]

[*printed name of purchaser*]

_____ [*address*]

_____Dated:

_____ [*signature of purchaser*]

[*printed name of purchaser*]

_____ [*address*]

Receipt of Agent or Broker

Receipt of $_____ in full payment of the above Subscription Agreement is acknowledged _____[*date*].

_____ [*signature of agent*]

Licensed Representative,

_____ [*name of corporation*]

Acceptance by Corporation

Accepted: _____[*date*]

_____ [*name of corporation*]

By _____ [*signature*]

[*typed name and title*]

INSTRUCTIONS TO SUBSCRIBERS

This agreement is prepared in quadruplicate. You must sign all copies and retain one copy for your records. Two copies must be returned to _____ [*name of issuer*], and the remaining copy must be returned to the broker, if any.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
G. Subscription Agreements and Sales Contracts

3-6I California Legal Forms--Transaction Guide § 6I.262

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.262 Subscription Agreement for Shares in California Corporation--Purchase Price Payable in Installments--Public Offering to California Residents

[1] Comment

[a] Use of Form

This form is a subscription agreement for the purchase of shares in a California corporation. It is substantially the same as § 6I.261, and is based on the same underlying assumptions with respect to the offering of securities [*see* discussion in *§ 6I.261[1]*], except that it assumes that the purchase price for the shares will be paid in installments rather than in a lump sum.

For general information regarding the use, contents, and execution of this form, see *§ 6I.261[1]*. For preincorporation agreements for use prior to formation of a corporation, see Ch. 2, *Formation of Corporations* .

[b] Requirement for Receipt

If securities are to be paid for in installments, each subscriber must be given a receipt, in a form satisfactory to the Commissioner, for each installment payment made subsequent to the first payment [*10 Cal. Code Reg. § 260.141.22(b)*]. For a form for such a receipt, and discussion of the applicable requirements, see *§ 6I.263*.

For discussion of the law relating to issuance of partly paid shares, and a statement that must appear on the share certificate for partly paid shares, see *§ 6I.202*.

[2] FORM

Subscription Agreement for Shares in California Corporation--Purchase Price Payable in Installments--Public Offering to California Residents

SUBSCRIPTION AGREEMENT

.....No. _____

_____ [*Complete name of corporation*]
_____ [*address of principal office*]

Subscription

1. The undersigned[, having received and read the Prospectus of _____ (*name of issuer*) dated _____,] hereby subscribes to _____[*number*] shares of the _____ [common *or* preferred] stock of _____ [*name of issuer*] at the price of $_____ per share.

_____ [*name of issuer*] WILL NOT ACCEPT SUBSCRIPTIONS FOR LESS THAN _____ [*specify number, e.g.,* 100] SHARES. ALL APPLICATIONS MUST BE RECEIVED BY _____ [*name of issuer*] NO LATER THAN _____ [*time, e.g.,* 5:00 P.M.], PACIFIC STANDARD TIME, on _____ [*closing date of offering as specified in impound requirement*].

Purchase Price

2. The total purchase price of the stock shall be the sum of $_____, payable in the following manner:

The sum of $_____ on execution of this Agreement, receipt of which is hereby acknowledged by _____ [*name of issuer*] and the balance in equal installments of $_____ each on the _____ day of each and every month commencing on _____[*date*], and continuing until the full purchase price has been paid, together with interest thereon at the rate of _____ percent per annum. Each installment shall be credited first to interest on the then remaining unpaid principal balance of the purchase price and then to the reduction of principal. [None of the shares agreed to be purchased under this agreement shall be issued until the full amount of the purchase price has been paid.] [Payment of the purchase price is secured by _____ (*describe collateral*).]

Agreement Subject to Terms of Qualification

3. This subscription is made pursuant to, and is subject to, the terms and conditions of the qualification approved by the Commissioner of Corporations of the State of California for _____ [*name of issuer*] under date of _____ [*date of qualification*].

Attorneys' Fees

4. Should any litigation be commenced between _____ [*name of issuer*] and the undersigned concerning this Agreement or the rights, duties, and obligations of either _____ [*name of issuer*] or the undersigned in relation thereto, the prevailing party shall be entitled, in addition to such other relief as may be granted, to a reasonable sum for attorneys' fees in that litigation. This sum shall be fixed by the court as part of the costs of the litigation or in a separate action brought for that purpose.

Rejection by Issuer

5. _____ [*name of issuer*] reserves the right to reject this subscription in whole or in part, and to allot a lesser number of shares than are subscribed for, within a reasonable time after its date, on refunding all or the

appropriate portion of the subscription price paid. _____ [*name of issuer*] further reserves the right to cancel this offering at any time and to cancel all accepted subscriptions in the event that this offering is canceled in its entirety.

Representation as to Residence

6. The undersigned represent that they are bona fide residents of California, domiciled in this State, and that this Subscription Agreement was executed by and delivered to them in California.

Declaration of Intent Not to Resell

7. The undersigned declare that they are subscribing to these shares as an investment for their own accounts and with no present intent to divide, resell, or otherwise distribute them among or to persons not domiciled in California.

Shares purchased by the undersigned shall be registered as listed below. If certificates for shares are to be issued in the name of one person for the benefit of another, indicate whether registration should be as trustee or custodian for that other person, and if as trustee, provide full name and date of the trust.

How Shares Are to Be Registered			Number of Shares
Full Name: _____			_____
Full Name: _____			_____
☐ Individual	☐ Joint Tenants	☐ Trustee	
☐ Tenants in Common	☐ Custodian	☐ Other _____	

IN WITNESS WHEREOF, the undersigned have executed this subscription agreement on the dates set forth opposite their names below.

_____Dated:

_____ [*signature of purchaser*]

[*printed name of purchaser*]

_____ [*address*]

_____Dated:

_____ [*signature of purchaser*]

[*printed name of purchaser*]

_____ [*address*]

Receipt of Agent or Broker

Receipt of $_____ in full payment of the above Subscription Agreement is acknowledged _____[*date*].

_____ [*signature of agent*]

Licensed Representative,

_____ [*name of corporation*]

Acceptance by Corporation

Accepted: _____[*date*]

_____ [*name of corporation*]

By _____ [*signature*]

[*typed name and title*]

INSTRUCTIONS TO SUBSCRIBERS

This agreement is prepared in quadruplicate. You must sign all copies and retain one copy for your records. Two copies must be returned to _____ [*name of issuer*], and the remaining copy must be returned to the broker, if any.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6I ISSUANCE OF EQUITY SECURITIES
PART IV. FORMS
G. Subscription Agreements and Sales Contracts

3-6I California Legal Forms--Transaction Guide § 6I.263

AUTHOR: Marilyn Minger Frances E. Lossing Practice Consultant

§ 6I.263 Receipt for Installment Payment

[1] Comment--Use of Form

This form is a receipt for an installment payment for the purchase of securities. Such a receipt must be given to each subscriber for each installment made subsequent to the first payment. The receipt must be in a form satisfactory to the Commissioner of Corporations and must set forth, at a minimum, the following [*10 Cal. Code Reg. § 260.141.22(b)*]:

- The date of the payment.
- The amount of the payment.
- A reference to the number of the subscription agreement to which the payment relates.

[2] FORM

Receipt for Installment Payment

Receipt of $_____ in payment of the installment due _____[*date*], on Subscription Agreement No. _____ for shares of _____ [*name of issuer*] is hereby acknowledged. Payment has been credited toward payment of the above subscription in the following manner:

Previous unpaid balance	$_____
Credited to interest	$_____
Credited to reduction of principal	$_____
Remaining unpaid balance	$_____

_____Dated:

_____ [*name of corporation*]

By _____ [*signature of officer*]

[*typed name and title*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES

3-6J California Legal Forms--Transaction Guide 6J.syn

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.syn Synopsis to Chapter 6J: ISSUANCE OF DEBT SECURITIES

§ 6J.01 California Statutes

[1] Debt Securities

[2] Debt Securities Exempted From Qualification

[3] Securities in General

§ 6J.02 Federal Statutes

[1] Trust Indenture Act

[2] Securities Act of 1933

§ 6J.03 California Regulations

[1] Exemptions

[2] Issuance of Debt Securities

§ 6J.04 Federal Regulations

§ 6J.05 [Reserved]

§ 6J.06 Law Reviews

§ 6J.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 6J.08-6J.09 [Reserved]

§ 6J.10 Corporate Powers to Incur Indebtedness

§ 6J.11 Bonds and Debentures

§ 6J.12 Convertible Securities

[1] Nature and Authority to Issue

[2] Coupled With Warrants for Purchase of Equity Securities

§ 6J.13 Voting Rights

§ 6J.14 Validity

§ 6J.15 Self-Dealing

§ 6J.16 Secured Financing

§ 6J.17 Unsecured Financing

§ 6J.18 Protective Devices

[1] Devices for Protection of the Creditor or Investor

[2] Devices for Protection of the Borrower or Issuer

§ 6J.19 Securities Regulation

[1] California Exemptions Applicable to Debt Securities

[a] Commercial Notes

[b] Notes Secured by Real Property

[c] Evidence of Indebtedness Not Sold in Public Offering

[2] Other California Exemptions

[3] Option, Warrant, or Conversion Right Is Security Under California Law

[4] Federal Exemptions Compared

[5] Indenture or Other Instrument Ordinarily Required

§ 6J.20 Trust Indenture

§ 6J.21 Thin Incorporation--Debt to Equity Ratio

[1] Explanation and Advantages of Thinning

[2] Criteria for Determining Whether Obligation Is True Debt

[3] Methods of Forestalling Attack on Debt as Actually Equity

[4] Consequences of Debt Being Found Actually to Be Equity

§§ 6J.22-6J.99 [Reserved]

§ 6J.100 Economic Picture of Corporation

Scope

§ 6J.101 Private Sources of Financing--Names and Addresses

Scope

§ 6J.102 Sources of Security

Scope

§ 6J.103 Identification of Sources of Restrictions on Offering

Scope

§§ 6J.104-6J.109 [Reserved]

§ 6J.110 Type of Debt Security to Be Issued by Corporation

Scope

§ 6J.111 Which Protective Devices to Include in Debt Offering

[1] Devices Protecting Investors

Scope

[2] Devices Protecting Corporation

Scope

§§ 6J.112-6J.119 [Reserved]

§ 6J.120 Arranging Exempt Debt Issue to Institutional Investors, Qualified Purchasers, or Through Nonpublic Offering

Scope

§ 6J.121 Packaging Offering With Equity Securities

Scope

§ 6J.122 Processing Issuance of Debt Securities

Scope

§§ 6J.123-6J.129 [Reserved]

§ 6J.130 Interest Payments

Scope

§ 6J.131 Sinking Fund

Scope

§ 6J.132 Conversion

Scope

§ 6J.133 Redemption

Scope

§ 6J.134 Retirement

Scope

§ 6J.135 Amendment or Alteration

Scope

§ 6J.136 Reporting Requirements

Scope

§§ 6J.137-3J.199 [Reserved]

§ 6J.200 Resolution to Issue Simple Note to Identified Purchasers

[1] Comment--Use of Form

[2] Form

Resolution to Issue Simple Note to Identified Purchasers

§ 6J.201 Resolution Authorizing Issuance of Series of Complex Notes to Unidentified Purchasers

[1] Comment--Use of Form

[2] Form

Resolution Authorizing Issuance of Series of Complex Notes to Unidentified Purchasers

§ 6J.202 Resolution Authorizing Issuance of Bonds

[1] Comment--Use of Form

[2] Form

Resolution Authorizing Issuance of Bonds

§ 6J.203 Resolution Authorizing Qualification of Debt Securities

[1] Comment--Use of Form

[2] Form

Resolution Authorizing Qualification of Debt Securities

§ 6J.204 Resolution for Redemption of Outstanding Notes

[1] Comment--Use of Form

[2] Form

Resolution for Redemption of Outstanding Notes

§ 6J.205 Notice of Redemption

[1] Comment--Use of Form

[2] Form

Notice of Redemption

§§ 6J.206-6J.219 [Reserved]

§ 6J.220 Letter Soliciting Subscription Agreements for Offering of Notes to Present Shareholders of California Corporation Under Private Offering Exemption of Federal Securities Act

[1] Comment

[a] Use of Form

[b] Exemption From Qualification

[2] Form

Letter Soliciting Subscription Agreements for Offering of Notes to Present Shareholders of California Corporation Under Private Offering Exemption of Federal Securities Act

§ 6J.221 Ballot and Subscription Agreement Consenting to and Subscribing for Notes to Be Issued by California

Corporation--Form Enclosed in Solicitation Letter Sent to Present Shareholders and Owners of Prior Notes of Corporation

[1] Comment

[a] Use of Form

[b] When Consent to Issuance Is Required of Present Shareholders or Owners of Prior Indebtedness of the Corporation

[2] Form

Ballot and Subscription Agreement Consenting to and Subscribing for Notes to Be Issued by California Corporation--Form Enclosed in Solicitation Letter Sent to Present Shareholders and Owners of Prior Notes of Corporation

§ 6J.222 Notice of Closing Date of Private Subscription for Notes

[1] Comment--Use of Form

[2] Form

Notice of Closing Date of Private Subscription for Notes

§ 6J.223 Purchase Agreement for Private Offering of Notes

[1] Comment

[a] Use of Form

[b] Subscription Is Security

[c] Copies

[2] Form

Purchase Agreement for Private Offering of Notes

§§ 6J.224-6J.229 [Reserved]

§ 6J.230 Note to Single Purchaser

[1] Comment

[a] Use of Form

[b] Use With Subordination Clause for Thin Incorporation Purposes

[2] Form

Note to Single Purchaser

§ 6J.231 Registered and Privately Offered Discount Note

[1] Comment

[a] Use of Form

[b] Use for Private Placement or Incorporate Additional Terms

[2] Form

Registered and Privately Offered Discount Note

§ 6J.232 General Form for Note

[1] Comment

[a] Use of Form

[b] Obligation

[c] Medium of Payment

[d] Series Conditions

[e] Redemption

[f] Subordination

[g] Covenants of the Company

[h] Events and Consequences of Default

[i] Notices and References

[j] Transferability

[2] Form

General Form for Note

§ 6J.233 General Form for Bond Secured by Deed of Trust

[1] Comment

[a] Use of Form

[b] Consideration of Additional Provisions

[2] Form

General Form for Bond Secured by Mortgage

§ 6J.234 General Form for Debenture

[1] Comment--Use of Form

[2] Form

General Form for Debenture

§§ 6J.235-6J.249 [Reserved]

§ 6J.250 Provision for Interest to Be Dependent on Income

[1] Comment--Use of Form

[2] Form

Provision for Interest to Be Dependent on Income

§ 6J.251 Provision for Interest Rate Tied to Bank's Prime Rate

[1] Comment--Use of Form

[2] Form

Provision for Interest Rate Tied to Bank's Prime Rate

§ 6J.252 Provision for Interest Rate Tied to London Inter-Bank Offering Rate

[1] Comment--Use of Form

[2] Form

Provision for Interest Rate Tied to London Inter-Bank Offering Rate

§ 6J.253 Provision for Conversion Into Equity Securities

[1] Comment

[a] Use of Form

[b] Attachment of Election Form for Conversion

[c] Possible Need for Qualification if Debt Includes Conversion Privilege

[2] Form

Provision for Conversion Into Equity Securities

§ 6J.254 Provision for Securing Note by Real Property

[1] Comment

[a] Use of Form

[b] Advantages of Securing Note With Real Property

[2] Form

Provision for Securing Note by Real Property

§ 6J.255 Provision for Open-End Note Secured by Real Property

[1] Comment--Use of Form

[2] Form

Provision for Open-End Note Secured by Real Property

§ 6J.256 Provision for Securing Note by Personal Property (Collateral)

[1] Comment--Use of Form

[2] Form

Provision for Securing Note by Personal Property (Collateral)

§ 6J.257 Provisions for Sinking Fund

[1] Comment

[a] Use of Form

[b] Inclusion in General Form for Note

[2] Form

Provisions for Sinking Fund

§ 6J.258 Provision for Serial Redemption

[1] Comment--Use of Form

[2] Form

Provision for Serial Redemption

§ 6J.259 Provision for Investment Representation for Federal Intrastate Offering Exemption

[1] Comment

[a] Use of Form

[b] Placement of This Provision

[c] Factors That Are Determinative of Intrastate Exemption

[2] Form

Provision for Investment Representation for Federal Intrastate Offering Exemption

§ 6J.260 Provision in Note for Investment Representation for Federal Private Offering Exemption

[1] Comment--Use of Form

[2] Form

Provision in Note for Investment Representation for Federal Private Offering Exemption

Frances E. Lossingn*
Practice Consultant

FOOTNOTES:

(n10)Footnote *. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES

3-6J California Legal Forms--Transaction Guide Scope

AUTHOR: Frances E. Lossing Practice Consultant

Scope

Frances E. Lossingn*
Practice Consultant Scope

This chapter discusses the issuance of debt securities--specifically notes, bonds, and debentures--under the California Corporate Securities Law. The Transaction Guide lists things to consider in determining what type of debt security to issue, the provisions to include in the debt instruments, the people and institutions with whom the debt could be placed under the most common California exemptions from qualification for issuer offerings [*Corp. Code § 25102(i), (n)*], excluded purchasers under *Corp. Code § 25102(f)*, and accredited investors under *Corp. Code § 25102.1(d)*.

The chapter contains forms for resolutions authorizing the issuance of the debt securities, solicitation agreements, purchase agreements, and forms for debt securities, as well as optional provisions for inclusion in the debt instruments. The qualification of the issuance of debt securities is discussed in Ch. 6H, *Qualification of Securities* .

FOOTNOTES:
(n11)Footnote *. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6J California Legal Forms--Transaction Guide § 6J.01

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.01 California Statutes

[1] Debt Securities

Distribution time of negotiable debt security exchanged for shares. *Corp. Code § 166*.

Creating evidences of debt or security interests is not transacting intrastate business. *Corp. Code § 191(c)(7)*.

Articles of incorporation may confer voting rights on debt security holders. *Corp. Code § 204(a)(7)*.

Power of corporation to issue and redeem debt securities. *Corp. Code § 207(d)*.

Ability of corporation to borrow money and secure its obligations. *Corp. Code § 207(g)*.

Complex of complete voting rights may include debt securities. *Corp. Code § 400*.

Convertibility of debt securities into shares or other debt instruments. *Corp. Code § 403(b)*.

Options for equity securities may be granted on issue of debt securities. *Corp. Code § 404*.

Unless articles otherwise provide, board approval is only approval necessary to mortgage corporate property to secure obligation. *Corp. Code § 1000*.

[2] Debt Securities Exempted From Qualification

Prime quality commercial notes that arise out of current transactions, are payable in nine months, and are not offered to

public in amounts of less than $25,000 are exempt from requirement of qualification. *Corp. Code § 25100(l).*

Notes secured by real property that are not part of series nor in which beneficial interests are sold to more than one person or entity are exempt from qualification. *Corp. Code § 25100(p).*

Offer (but not sale) and execution and delivery of agreement for sale of security is exempt from qualification if made to not more than 35 persons. *Corp. Code § 25102(a).*

Offer (but not sale) and execution and delivery of agreement for sale of security is exempt from qualification if made pursuant to negotiating permit issued by Commissioner. *Corp. Code § 25102(c).*

Any offer or sale of any evidence of indebtedness, whether secured or unsecured, and any guaranty of indebtedness, is exempt from qualification as issuer transaction if it does not involve any public offering. *Corp. Code § 25102(e).*

Limited offering exemption. *Corp. Code § 25102(f).*

Exemption for offer or sale to specified institutional investors. *Corp. Code § 25102(i).*

Exemption for offer or sale to specified qualified purchasers. *Corp. Code § 25102(n).*

Exemption for sale of nonredeemable securities to accredited investors by person licensed under Capital Access Company Law. *Corp. Code § 25102(p).*

Exemption from offerings exempt under Section 3(a)(3) (commercial paper exemption) of Securities Act of 1933. *Corp. Code § 25102.1(c).*

Exemption for offerings under Rule 506 of SEC Regulation D. *Corp. Code § 25102.1(d).*

Exemption for sale of series of notes, or undivided interests in note, secured by same real property that complies with *Bus. & Prof. Code § 10237 et seq. Corp. Code § 25102.5.*

Exemption for changes in rights, preferences, privileges, or restrictions of or on outstanding securities or entity conversion transaction unless holders of at least 25 percent of outstanding shares or units to be substantially and adversely affected by proposed change or transaction have addresses in *California. Corp. Code § 25103(b).*

[3] Securities in General

Applicability of voting rights references in law to other securities. *Corp. Code § 111.*

Procedure for obtaining replacement certificate for lost security. *Corp. Code § 419.*

Nonliability for transferring securities on books to surviving joint tenant. *Corp. Code § 420(a).*

Every offer or sale of security that includes right to purchase or convert to another security is offer or sale of that other security, but exercise of right or conversion is not sale or offer. *Corp. Code § 25017(e); cf. 15 U.S.C. § 77b(a)(3).*

Definition of security. *Corp. Code § 25019.*

Qualification requirements for issuer transactions. *Corp. Code § 25110 et seq.*

Qualification requirements for issuer transactions that involve changes in rights, preferences, privileges, or restrictions of or on outstanding securities, exchanges of existing securities, exchanges in connection with merger, consolidation, or purchase of assets, or entity conversion transaction. *Corp. Code § 25120 et seq.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6J California Legal Forms--Transaction Guide § 6J.02

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.02 Federal Statutes

[1] Trust Indenture Act

Exemptions from registration for intrastate securities and private transactions. Trust Indenture Act of 1939 § 304(a)(4), (b); *15 U.S.C. § 77ddd(a)(4), (b).*

Exemptions for offerings restricted to relatively modest amounts for specified terms. Trust Indenture Act of 1939 § 304(a)(8), (9); *15 U.S.C. § 77ddd(a)(8), (9).*

Unless exempt, issuance of debt security governed by Federal Trust Indenture Act will require execution of trust indenture and appointment of trustee to independently administer on behalf of holders for duration of debt. Trust Indenture Act of 1939 §§ 305, 306; *15 U.S.C. §§ 77eee, 77fff.*

[2] Securities Act of 1933

Option to convert debt security, exercisable at future time, is not offer or sale until time of exercise. Securities Act of 1933, § 2(a)(3); *15 U.S.C. § 77b(a)(3); cf. Corp. Code § 25017(e).*

Exchange of securities between issuer and holders is exempt transaction if no professional securities personnel are involved. Securities Act of 1933, § 3(a)(9); *15 U.S.C. § 77c(a)(9).*

Exclusively intrastate offering of debt or equity securities is exempt from registration. Securities Act of 1933, § (a)3(11); *15 U.S.C. § 77c(a)(11).*

Private offering exemption. Securities Act of 1933, § 4(2); *15 U.S.C. § 77d(2).*

Registration with the Federal Securities and Exchange Commission is required for public offering. Securities Act of 1933, §§ 5, 6; *15 U.S.C. §§ 77e, 77f*.

Federal preemption of state securities regulation. Securities Act of 1933, § 18; *15 U.S.C. § 77r*.



5 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6J California Legal Forms--Transaction Guide § 6J.03

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.03 California Regulations

[1] Exemptions

Rule implementing non-public offering exemption of *Corp. Code § 25102(a). 10 Cal. Code Reg. § 260.102.1*.

Rule implementing non-public offering exemption of *Corp. Code § 25102(e)* (debt securities). *10 Cal. Code Reg. § 260.102.2*.

Definition of "evidence of indebtedness" as used in *Corp. Code § 25102(e)* (exemption for issuance of certain debt securities). *10 Cal. Code Reg. § 260.102.3*.

Rule further defining institutional investors for purpose of *Corp. Code § 25102(i)* exemption. *10 Cal. Code Reg. § 260.102.10*.

Representation required by purchaser under *Corp. Code § 25102(i)* is not inconsistent with offer or resale in accordance with S.E.C. Rule 144A (private resale to qualified institutional buyers). *10 Cal. Code Reg. §§ 260.102.10.1*, *260.105.13.1*; *see* S.E.C. Rule 144A; *17 C.F.R. § 230.144A*.

Implementing limited offering exemption of *Corp. Code § 25102(f). 10 Cal. Code Reg. § 260.102.12*.

Purchasers excluded from count in determining applicability of limited offering exemption of *Corp. Code § 25102(f). 10 Cal. Code Reg. § 260.102.13*.

Notice of transaction required to be filed with Commissioner by issuer who conducts limited offering under *Corp. Code § 25102(f)* exemption. *10 Cal. Code Reg. § 260.102.14*.

Exemption from qualification and permit requirements of *Corp. Code § 25120* (recapitalizations and reorganizations) for changes in rights, preferences, privileges, or restrictions of or on outstanding securities, and any exchange of securities by issuer with its existing security holders. *10 Cal. Code Reg. § 260.103.*

Authorization of new class of stock that does not constitute "change in the rights, preferences, privileges, or restrictions" of or on previously outstanding shares enumerated in *Corp. Code § 25103(e).*; offer and sale of such new stock is still subject to *Corp. Code § 25110* or *25120*. *10 Cal. Code Reg. § 260.103.1*.

Exemption from qualification and permit requirements of *Corp. Code §§ 25110, 25120,* and *25130*. for offers and sales to government entities or agencies. *10 Cal. Code Reg. § 260.105.14.*

Exemption for certain advances to corporation in connection with its organization. *10 Cal. Code Reg. § 260.105.23.*

[2] Issuance of Debt Securities

Provisions suggested for inclusion in indenture or other instrument governing nonconvertible debt offering. *10 Cal. Code Reg. § 260.140.4.*

Commissioner normally requires public debt offering to be issued under trust indenture complying with the provisions of the federal Trust Indenture Act of 1939; limited offering will be allowed under lesser indenture or other instrument if it adequately protects holders under circumstances of particular case. *10 Cal. Code Reg. § 260.140.5*.

Agreement or documents governing convertible debt securities should contain appropriate antidilution provisions as against future recapitalizations (dividends or splits) or issuances of shares for prices below conversion value. *10 Cal. Code Reg. § 260.140.6.*

Capital structure of unseasoned corporations. *10 Cal. Code Reg. § 260.140.9.*

Capital structure of seasoned corporations. *10 Cal. Code Reg. § 260.140.10.*

Basis for imposing legend condition on securities issued pursuant to limited offering qualification. *10 Cal. Code Reg. § 260.141.10.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6J California Legal Forms--Transaction Guide § 6J.04

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.04 Federal Regulations

Provision by which purchasers of convertible securities acquired in private placement ("restricted securities") may avoid need for registration when reselling the securities or those issued on their conversion. S.E.C. Rule 144; *17 C.F.R. § 230.144*.

Permitting private resales of securities to qualified institutional buyers. S.E.C. Rule 144A; *17 C.F.R. § 230.144A*; *see 10 Cal. Code Reg. §§ 260.102.10.1, 260.105.13.1*.

Exemption from registration under the Securities Act of 1933 for offers and sales of securities made exclusively to residents of state in which issuer is organized and does business. *17 C.F.R. § 230.147*.

Exemption from registration for limited and private offers and sales of securities under the Securities Act of 1933 (Regulation D). *17 C.F.R. §§ 230.501-230.508*.

When securities owned by subscriber require subscriber's consent be given to issuance of proposed new notes and are registered on national exchange, ballot form in subscription agreement must provide space for holder to vote for or against proposed new notes. S.E.C. Rule 14a-4(b)(1); *17 C.F.R. § 240.14a-4(b)(1)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6J California Legal Forms--Transaction Guide § 6J.05

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§ 6J.05[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6J California Legal Forms--Transaction Guide § 6J.06

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.06 Law Reviews

Quinn, *After Reves v. Ernst & Young, When Are Certificates of Deposit "Notes" Subject to Rule 10b-5 of the Securities Exchange Act? 46 Bus. Law. 173 (Nov. 1990).*

Galen, *Installment Sales; Original Issue Discount; Repurchase of Convertible Bonds*, 23 S. Cal. Tax Inst. 345 (1971).

Stutsman, *Debt Financing Upon Incorporation*, 9 S. Cal. Tax Inst. 211 (1960).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6J California Legal Forms--Transaction Guide § 6J.07

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.07 Text References

[1] Matthew Bender Sources

Ballantine & Sterling, CALIFORNIA CORPORATION LAWS (Matthew Bender).

Ch. 7, *Issuance of Shares and Indebtedness*.

Ch. 21, *Corporate Securities*.

Marsh & Volk, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS (Matthew Bender).

Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS (Matthew Bender).

Ch. 18, *Corporate Operation and Management*.

Ch. 19, *Corporate Securities*.

Rabkin & Johnson, FEDERAL INCOME, GIFT AND ESTATE TAXATION (Matthew Bender).

Ch. 35, *Creditor's Income and Deductions*.

Ch. 36, *Debtor's Income and Deductions*.

Ch. 37, *Interest, Premium, and Discount*.

Sommer, FEDERAL SECURITIES ACT OF 1933 (Matthew Bender).

[2] Additional Text References

Financing California Businesses (Cal. C.E.B. 2d ed. 1995).

Business Law Section of the State Bar of California Report on the Third-Party Legal Opinion Report of the ABA Section of Business Law (May 1992).

Third-Party Legal Opinion Report, including the Legal Opinion Accord of the Section of Business Law (American Bar Association 1991).

1989 Report of the Committee on Corporations of the Business Law Section of the State Bar of California Regarding Legal Opinions in Business Transactions (Aug. 1989).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6J California Legal Forms--Transaction Guide §§ 6J.08-6J.09

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§§ 6J.08[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

3-6J California Legal Forms--Transaction Guide § 6J.10

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.10 Corporate Powers to Incur Indebtedness

The General Corporation Law provides that a corporation has all necessary powers, subject to limitation of its articles and the law otherwise, to assume obligations, incur liabilities, borrow money, and otherwise use its credit. It also may secure any of its obligations or liabilities by mortgage or other encumbrance of all or any part of its property, franchises, and income [*Corp. Code § 207(g)*]. Any mortgage, deed of trust, pledge, or other hypothecation of property belonging to the corporation, whether real or personal, for the purpose of securing the payment or performance of any contract or obligation may be approved by the board of directors. Unless the articles provide otherwise, no approval of shareholders or the outstanding shares is necessary [*Corp. Code § 1000*]. The same requirements apply to the issuance of bonds or debentures [*Corp. Code § 207(d)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

3-6J California Legal Forms--Transaction Guide § 6J.11

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.11 Bonds and Debentures

The term "bond" generally refers to a debt instrument that is secured, while "debenture" refers to an unsecured debt. Bond and debenture offerings usually denote uniform offerings to groups rather than to single holders. The term "note" generally refers to debt securities issued to a single holder, a bank or an insurance company. However, for the purposes of the following discussion the term "note" will be used generally to refer to all types of debt securities.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

3-6J California Legal Forms--Transaction Guide § 6J.12

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.12 Convertible Securities

[1] Nature and Authority to Issue

Subject to its articles, a corporation may issue debt securities that are convertible into other debt securities or shares of the corporation, within a specified time or on the happening of one or more specified events, and on such terms and conditions otherwise as are fixed by the board [*Corp. Code § 403(b)*]. Options to purchase or subscribe for shares or any class or series, on terms and conditions that are deemed expedient, may be granted in connection with the issue, subscription, or sale of any of the corporation's bonds, debentures, notes, or other securities [*Corp. Code § 404*]. Unless the articles provide otherwise, the board may issue securities having conversion or option rights without first offering them to shareholders of any class [*Corp. Code § 406*]. Convertible securities should contain appropriate antidilution adjustments [*10 Cal. Code Reg. § 260.140.6*].

PRACTICE TIP:

A corporation may not issue equity securities in an amount greater than that authorized in its articles of incorporation. It is therefore important for an issuer to check its articles of incorporation to make certain that it has sufficient authorized capital to permit it to issue debt securities convertible into equity securities or debt securities with warrants or other to acquire equity securities. The issuer should also reserve an amount equal to the amount of equity securities that may be issued in connection with the offering, to make certain that the issuer does not inadvertently commit to issue more equity securities than it has authorized. *Commentary by Frances E. Lossing.*

If the holder of a convertible debenture is deprived, from an economic standpoint, of the right to convert the debenture to common stock because the issuing corporation is acquired by another corporation, the creditors, unlike the common shareholders, generally do not have a cause of action under the California Corporate Securities Law [*see Pittelman v. Pearce (1992) 6 Cal. App. 4th 1436, 1446-1447, 8 Cal. Rptr. 2d 359 ; Kessler v. General Cable Corp. (1979) 92 Cal. App. 3d 531, 538-540, 155 Cal. Rptr. 94* (court refused to impose fiduciary duty on corporation)]. The law in this area, however, is developing, and in certain circumstances courts in other jurisdictions have been willing to impose fiduciary type duties in this situation. Voting debt securities may also be expected to have similar rights to those of voting shares.

[2] Coupled With Warrants for Purchase of Equity Securities

Perhaps more common than the issuance of convertible debt securities is issuance of debt securities along with warrants for the purchase of equity securities. Warrants to purchase equity securities may be issued in connection with the issuance of debt securities. If the warrants will be issued in a transaction which must be qualified in California, their issuance must be necessary to obtain the debt financing and the following conditions must be met [*10 Cal. Code Reg. § 260.140.43*]:

- The term of the warrant does not exceed the life of the debt security or 15 years, whichever is less.

- The number of shares of equity securities issuable on exercise of the warrants does not exceed the number that could be purchased at the exercise price with the debt securities at face amount.

- The exercise price is at least equal to the value of the equity securities as that value is calculated in accordance with *10 Cal. Code Reg. § 260.140.50* on the date the warrant is issued.

Warrants and their issuance are discussed in Ch. 6I, *Issuance of Equity Securities* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

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AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.13 Voting Rights

A corporation's articles of incorporation may confer on the holders of any of its evidences of indebtedness, whether issued or to be issued, the right to vote in the election of directors, or on any other matter on which shareholders may vote [*Corp. Code § 204(a)(7)*]. When holders of indebtedness have been granted voting rights, all references in the General Corporation Law to the voting shares include the voting rights of those debt securities [*Corp. Code § 111*]. A corporation must have at least one class or series of securities with full voting, dividend, and rights on liquidation of the corporation [*Corp. Code § 400(a)*]. Typically a corporation's common stock satisfies this requirement so that the corporation's ability to restrict voting and liquidation rights of holders of debt securities should not be affected by this requirement.



15 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

3-6J California Legal Forms--Transaction Guide § 6J.14

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.14 Validity

Any note, mortgage, or evidence of indebtedness signed by the appropriate officers, is not invalidated as to the corporation by any lack of authority of the signing officers, in the absence of actual knowledge on the part of the other party that the signing officers had no authority to execute the evidence of indebtedness [*Corp. Code § 313*]. The appropriate officers are the chairman of the board, the president, or any vice president (as signatory) and the secretary, any assistant secretary, the chief financial officer or any assistant treasurer (as co-signatory) [*Corp. Code § 313*; *see Snukal v. Flightways Manufacturing, Inc. (2000) 23 Cal. 4th 754, 786-787, 98 Cal. Rptr. 2d 1, 3 P.3d 286* (interpreting *Corp. Code § 313* in context of lease agreement to hold that signature of one person alone is sufficient to bind corporation, as long as individual holds corporate offices in both "operational group" and "financial group" described in that statute)]. This principle may be modified in the case of certain intracorporate disputes not affecting the rights of third persons [*see Corp. Code § 208(a)*].

PRACTICE TIP:

Lenders will also typically ask for an officers' certificate in which appropriate officers of the corporation certify that (1) the corporation has been duly incorporated and is validly existing under the laws of its jurisdiction of incorporation, (2) the corporation has the corporate power and authority to enter into the transaction, (3) the transaction has been duly authorized by all necessary corporate action on the part of the corporation, and (4) the lending documents have been duly and validly executed and delivered by the corporation. Lenders may also request a copy of (1) the articles or incorporation or other charter documents of the corporation certified by the California Secretary of State or other appropriate governmental authority, (2) the bylaws of the corporation certified by an officer of the corporation to be a true and correct copy and to be in full force and effect, and (3) resolutions of the corporation authorizing the transaction certified by the secretary of the corporation. In addition, lenders frequently request an incumbency certificate certifying the names and signatures of those officers of the corporation authorized to execute the lending documents. *Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

3-6J California Legal Forms--Transaction Guide § 6J.15

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.15 Self-Dealing

A corporation is free to redeem, purchase, or otherwise acquire, hold, exchange, transfer, pledge, or otherwise dispose of its own bonds, debentures, and other securities [*Corp. Code § 207(d)*]. Shareholder approval is not necessary for a loan, or guaranty of a loan, to an officer or director of a corporation's subsidiary [*see Corp. Code § 315*]. However, a corporation should not make or guarantee loans to its own directors or officers, or those of its parent, unless the transaction (or the employee benefit plan authorizing the loan or guaranty) is approved by a "majority of the shareholders entitled to act thereon" [*Corp. Code § 315(a)*]. "Approval of a majority of the shareholders entitled to act thereon" means any of the following [*Corp. Code § 315(g)*]:

- Written consent of a majority of the outstanding shares, without counting shares owned by interested officers or directors.

- The affirmative vote of a majority of the shares present and voting at a meeting at which a quorum is present, without counting the shares owned by interested officers or directors.

- The unanimous vote or written consent of the shareholders.

The restrictions contained in *Corp. Code § 315*, discussed *above*, do not apply to employee stock purchase plans [*Corp. Code § 408*], depository institutions [*12 U.S.C. § 3201(1)*], or any corporation that makes loans or guarantees in the ordinary course of its business and whose loans to officers and directors are expressly regulated. These restrictions also do not apply to a corporation that has 100 or more shareholders of record if the corporation has a bylaw provision authorizing the board alone to approve such a transaction which has been authorized by the outstanding shares of the corporation and a majority of the board of directors determines that the transaction will reasonably benefit the corporation, without counting the vote of any interested director [*Corp. Code § 315(b), (f)*].

For further discussion of corporate loans to officers and directors, and a bylaw provision authorizing the board of directors to act alone in approving such a transaction, see *Ch. 4, Bylaws, § 4.249*.

A corporation may also not make a loan or guaranty secured by the shares of the corporation or its parent if the corporation's recourse in the event of default is limited to the security of the shares, unless the loan or guaranty is adequately secured without considering these shares or the loan or guaranty has been approved by a majority of the outstanding shares [*Corp. Code § 315(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceCorporate Ownership of StockBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

3-6J California Legal Forms--Transaction Guide § 6J.16

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.16 Secured Financing

Secured debt issues are sometimes the only type of financing that a new company can place successfully. The security very frequently consists of the main real estate, plant, and equipment of the corporation, which are especially attractive if they are located on a generally desirable site, or the inventory and accounts receivable of the company. The company may not have created a sufficient earnings record to render any other type of investment scheme attractive to potential investors. Security on the real and personal property of the company provides the investors a good deal of extra protection in that they need not look to any special degree of success of the business in order to be paid back. Secured creditors also need not share their preferred type of security with any other groups of investors.

PRACTICE TIP:

Another common source of security for lenders is a guaranty from certain of the principal shareholders of the corporation. This guaranty may be secured by the stock of the corporation, the personal residence of the shareholders, or other assets of the shareholders. *Commentary by Frances E. Lossing.*

Secured debt has certain advantages. Under the standards for the exercise of the Commissioner's discretion, in order for an unsecured non-convertible debt security to be qualified for issuance in California, the amount of additional funded debt must be restricted unless the debt securities have a rating or are of sufficient quality to make this protection unnecessary [*10 Cal. Code Reg. § 260.140.4(c)*]. Many small businesses cannot satisfy this standard. These restrictions do not apply to secured non-convertible debt securities [*see 10 Cal. Code Reg. § 260.140.4(b)*]. The corporation also usually can market a secured debt for a lower percentage of return than might otherwise be arranged if financing was not secured.

Unless the subject is otherwise provided for in the charter documents, the board of directors is given absolute discretion in the way of providing security for any debt financing. In the normal instance, a corporation may not sell, lease, convey, exchange, transfer, or otherwise dispose of all or substantially all of its property, without putting the transaction up to the vote or written consent of a majority of the corporate voting power [*Corp. Code § 1001*]. An exception is made, however, in the case of any mortgage, deed of trust, pledge, or other hypothecation of all or any part of a

corporation's property, real or personal, when the purpose is to secure the payment or performance of any contract, note, bond, or obligation, unless the corporation's articles of incorporation otherwise provide [*Corp. Code § 1000*].

PRACTICE TIP:

The ability of the corporation to issue secured debt also may be restricted by other contractual obligations of the corporation. These other obligations may restrict the corporation's ability to create liens on its assets generally (such as a negative pledge) or restrict the corporation's ability to create liens on particular assets (such as may be contained in purchase money financing arrangements for buildings or equipment used in the corporation's business). Small businesses operating in regulated industries may also need to obtain regulatory approval in order to pledge the assets or credit of the corporation. *Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

3-6J California Legal Forms--Transaction Guide § 6J.17

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.17 Unsecured Financing

Investors in an unsecured debt issue must rely on the specially included protective devices frequently found in the instrument of obligation, and attempt to bargain for as many protective features as possible. Unsecured creditors also must attempt to acquire and maintain a more informed position in regard to the corporation's earning capacity and business progress for the duration of the loan in order to continually evaluate the soundness of the investment.

From the corporation's standpoint, an unsecured debt issue is probably a more attractive type of offering than other forms of debt securities. Good security considerations restrict the amount of a secured debt offering to only a percentage of the underlying security.

The corporation may, of course, pay a higher interest rate on an unsecured issue, but this may be a welcome deductible expense for the more successful growing enterprise. Unsecured creditors generally will be more flexible and ready to accept rearranged or replacement debt packages as circumstances change, and may be more easily interested in additional or newer debt issues, whether as private or public offerings, when financing is needed for particular and newly emerging purposes.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

3-6J California Legal Forms--Transaction Guide § 6J.18

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.18 Protective Devices

[1] Devices for Protection of the Creditor or Investor

Unless the debt security is convertible, creditor investors do not have a formal proprietary interest in the corporation, and have little concrete relationship to it except as may be based on the instrument evidencing the obligation. They typically want to see all terms of that relationship, with the creator's protective terms spelled out in explicit detail in the notes themselves. The following are some of the usual considerations found in more complex debt securities, whether or not the obligation has been secured:

- **Obligation:** The exact terms of the indebtedness are recited, including the interest rate and times of repayment, the dates of incurring and finally paying off the obligation, whether amounts repaid may be reborrowed, the amount of any fees which must be paid to the lender, the types of expenses of the lender which must be paid by the borrower, and the like.

- **Medium of payment:** The tangible type of return is described, including exactly what form the payoff may take, usually in lawful money of the United States.

- **Restriction on other obligations:** A pledge is made not to create additional liens on the corporate property or to refrain from issuing other obligations, or obligations senior to or ranking *pari passu* with the obligation being created.

- **Sinking fund:** An arrangement is recited for creation and maintenance of a special fund on the part of the corporation. This fund will be earmarked for payment of the obligation, usually to be kept at a level sufficient to retire the indebtedness according to the agreed schedule. Possibly a more flexible arrangement would be one in the nature of a serial debt issue, in which the entire issue would not become due at the same remote time, but rather different series would fall due at increasingly more remote dates, the sinking fund device being available but unnecessary if the company can retire each series out of then

current earnings.

- **Antidilution provisions:** A corporation covenants and otherwise protects against any other forms of payment, such as dividends or stock splits, repurchasing securities, instituting stock plans, or increasing compensation to insiders or other key personnel, making payments to shareholders or other affiliates of the corporation in connection with related party transactions, such as the lease of a building to the corporation by its principal shareholder, and transfers of assets to subsidiaries of the corporation which would have the effect of structurally subordinating the creditor to the creditors of the subsidiary, at least until each type of payment due under the debt issue is satisfied, and only after it is ascertained that no future debt payment is otherwise threatened.

PRACTICE TIP:

Exceptions to these types of antidilution provisions are frequently negotiated. For instance, distributions to shareholders of a subchapter S corporation may be permitted to the extent necessary to enable the shareholders to pay taxes associated with the earnings of the corporation. Payments to insiders pursuant to existing contractual obligations, such as the lease of a building or equipment, may be permitted so long as the payments are not increased by more than a specified amount. *Commentary by Frances E. Lossing.*

- **Preemptive rights:** When any new debt securities are issued, or other types of securities introduced, the creditors of the particular indebtedness involved may be given right of first refusal to purchase the entire new issue and thus prevent any diversion of payments or consequential dilution of their debt securities.

- **Conversion rights:** Along with the fact that a debt issue may be made more attractive by being packaged with warrants, the investor is afforded greater security by making the note convertible into equity securities. The creditor thus may be able to avoid having its investment redeemed just when the market begins to make the business more attractive. The creditor in its capacity as shareholder will have the right to vote on certain major business decisions regarding the corporation and to participate in the election of directors; this right must, however, be carefully exercised by the creditor if the creditor is to avoid equitable subordination of its loans to the company in the event of insolvency or bankruptcy. Antidilution matters, in which adjustments are made in conversion rights if the corporation should issue dividends, create stock splits, or enter into reorganizations, typically are spelled out to protect the value of the securities into which the debt ordinarily would be converted in order to assure that the lender that there will be no material adverse changes in the corporation's business which would adversely impact the credit risk. Financial covenants are also frequently included since they may operate as a warning that there have been material changes in financial performance which adversely affect the lender's credit risk.

- **Maintenance of current operations:** A corporation may need to specifically covenant to remain in a particular type of business, to retain particular personnel or property, as well as to keep up its taxes, insurance payments, short term debt, and other obligations.

- **Restrictions on activities:** The loan documentation may restrict the corporation's business activities, such as its ability to incur additional debt or to enter into sale-leaseback transactions, to make capital expenditures, to make investments or to merge or be acquired by another entity. The purpose of these restrictions is to protect the creditor from incurring any additional credit risk. The loan documentation may also include specific undertakings regarding matters of particular concern, such as the management of environmental risks.

- **Redemption:** Debt securities may be redeemable at the option of the creditor or investor if certain

events occur which would adversely impact the credit risk, such as the acquisition of the corporation by another company, the loss of a principal customer or the loss of particular tax benefits. Redemption in these circumstances offer the lender much the same protection as provisions regarding default; redemption in these circumstances ordinarily would not, however, trigger cross-default provisions in other debt instruments, unless those cross-default provisions have been carefully worded to cover repayments prior to maturity.

- **Representations and Warranties:** The loan documents will generally require the borrower to make certain representations and warranties about its business; the lender will be relying on these representations and warranties in making its credit assessment

- **Reporting Requirements:** The loan documentation may require the borrower to furnish financial statements to the lender and to report certain events, including events of default or events which could become events of default. The lender may also request access to the borrower's properties to review ongoing operations or the right to review books and records and to discuss the borrower's business with the borrower's employees

- **Events of default**: It is usually necessary to specify exactly what situations are equivalent to a default in the obligation, and exactly what remedies the creditors might pursue in those instances. These matters are minutely described in relationship to default in matters such as payment of interest or principal on the obligation or obligations to other creditors, breaches of covenants, bankruptcy and insolvency situations, with attention to the device of acceleration of maturity on default. Details are included regarding what forms of notice are necessary and what other conditions must be fulfilled before creditors may resort to specific remedies. Certain protective conditions may be afforded to the corporation, by which defaults may be cured before particular creditors' remedies may be pursued.

- **Transferability:** Creditors frequently want specific assurance that they may be relieved of their investment relationship through personal resale or assignment, or otherwise, and the securities may be issued in negotiable or bearer form. If the security is registered, the corporation will only recognize the latest holder listed in the debt register and make all payments and respect all protective measures in relationship to that holder. An assignment and transfer on the books of the corporation will be required before the corporation has to recognize the new owner of the security.

PRACTICE TIP:

It may be necessary for the corporation to qualify the issuance of the debt securities in circumstances in which qualification would not otherwise be necessary if the lender insists that the debt securities be freely transferable. It may, however, be possible to issue the debt securities in reliance on an exemption which restricts transferability if the debt securities will only be transferred to other qualified purchasers, such as a transfer of a note by a bank to another bank or the transfer of a note by a qualified institutional buyer to another qualified institutional buyer. *Commentary by Frances E. Lossing.*

[2] Devices for Protection of the Borrower or Issuer

In addition to the protective devices discussed in [1], *above*, there are a few special protective devices that corporations frequently arrange for their own benefit:

- **Prepayment:** The corporation may wish to reserve the right to prepay any interest or principal at any time or according to a special permissive schedule, in effect allowing it to accelerate to any degree the life and substance of the debt securities; frequently the lender may require the corporation to pay a prepayment penalty in addition to the amount of principal and interest otherwise due in order to

compensate the lender for the loss of the benefit of the lender's bargain.

- **Redemption:** Many debt securities are made redeemable at the option of the corporate issuer, with a special schedule set up in the security to show exactly what price or percentage of principal repayment must be paid in order to accomplish retirement. The percentage may be geared to a figure greater than 100 percent of the ultimate repayment in order to compensate for the elimination of the creditor's long-range expectation of earning interest, a figure that decreases accordingly as the actual redemption date grows more proximate to the originally scheduled payment time. In some circumstances the lender may insist on a limited period of call protection, such as three to five years, before the debt securities may be redeemed. In other circumstances, the lender may only permit the borrower to redeem the securities if particular events occur, which are specified in the loan documents.

- **Defeasance:** Some debt securities contain defeasance provisions which permit the borrower to defease the debt, but placing in escrow funds or specified securities in an amount necessary to repay the debt securities in accordance with their terms. Defeasance is typically used in transactions in which the borrower is not permitted to prepay or redeem the debt securities, but may want to be relieved of certain covenants which restrict its business operations.

- **Subordination:** Debt security issues may be made specifically subordinate to particular types of issues, often prior in time of issuance, of like securities still outstanding, although this normally does not make the issue appear attractive from a new investment standpoint. However, subordination usually spells out only a specific kind of senior debt; that is, short-term, quick money obligations arranged with major lending institutions that will only lend short term funds on assurance that no security is prior to theirs, whether actually prior in time of obligation or not. Most junior creditors will respect this type of subordination, understanding that the special loans may be necessary to maintain the corporation and support their own long-term obligations in the long run. Precise details as to preferred payment to senior indebtedness in the particular situations of bankruptcy and insolvency may need to be spelled out, as well as the situation of a special default on any of the respective debt security obligations involved.

- **Securities regulations:** The corporation may attempt to get special promises and representations from the creditors as to their intent in purchasing the debt issues and with respect to ultimate disposition of the securities. Some assurance in these matters sometimes is desirable in order to keep the issue within exemptions from federal and state securities laws, but their efficacy is open to question.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

3-6J California Legal Forms--Transaction Guide § 6J.19

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.19 Securities Regulation

[1] California Exemptions Applicable to Debt Securities

[a] Commercial Notes

A note, draft, bill of exchange, or banker's acceptance of prime quality which evidences an obligation to pay cash within nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited, is exempt from the qualification requirements of the California Commissioner of Corporations if it is freely transferable, not offered to the public in amounts of less than $25,000 in the aggregate to any one purchaser, arises out of a current transaction, and the proceeds are used for current transactions [*Corp. Code § 25100(l)*; *cf. 15 U.S.C. § 77c(a)(3)* (federal exemption for collateral trust notes and short term commercial paper)]. The Commissioner has stated that in determining whether paper is of prime quality, the ultimate consideration is the absence of factors that may tend to raise any reasonable question as to the ability of the issuer, at the time of the determination or in the future, at least during the life of the securities, to make good its obligations [Commissioner's Opinion Nos. 73/13C, 74/33C, 76/7C; *see also* Commissioner's Policy Letter No. 107 (Oct. 7, 1970) and Corporate Securities Newsletter dated 12/75 (in which Commissioner noted that the exemption was founded in part on Section 3(a)(3) of the Securities Act and that therefore Federal Court decisions would be of assistance in defining "prime quality")]. If short term commercial notes would come within this exemption but for the fact that it is offered and sold in aggregate amounts of less than $25,000 to any one purchaser, the issuer may request an order of exemption in accordance with *10 Cal. Code Reg. § 260.100.3*. For a request for order of exemption pursuant to *10 Cal. Code Reg. § 260.100.3*, see *Ch. 6, Securities Regulation Issues, § 6.232*.

PRACTICE TIP:

The commercial paper exemptions are seldom available for small businesses since the debt securities of small businesses are not generally rated and cannot otherwise satisfy the prime quality standards. In addition, investors are only interested in purchasing the commercial paper of large established corporations. *Commentary by Frances E. Lossing.*

Federal law exempts any note, bill of exchange, or banker's acceptance that arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal the maturity of which is likewise limited [*15 U.S.C. § 77c(a)(3)*]. California exempts securities that are exempt from registration under the federal securities laws pursuant to this provision [*Corp. Code § 25102.1(c)*].

[b] Notes Secured by Real Property

A promissory noted secured by a lien on real property is exempt from California qualification requirements if it is neither one of a series of notes of equal priority secured by the same real property nor a note in which beneficial interests are sold to more than one person or entity [*Corp. Code § 25100(p)*]. The sale of a series of notes secured directly by an interest in the same real property, or the sale of undivided interests in a note secured directly by real property equivalent to a series transaction, is also exempt from qualification as an issuer transaction if the transaction complies with all of the provisions of *Bus. & Prof. Code § 10237 et seq.* (concerning exemption from securities qualification for real-property-backed notes) [*Corp. Code § 25102.5*].

[c] Evidence of Indebtedness Not Sold in Public Offering

Any offer or sale of any evidence of indebtedness, whether secured or unsecured, and any guaranty of that indebtedness, is exempt from California qualification as an issuer transaction or as a change in the rights of those debt securities if it does not involve any public offering [*Corp. Code § 25102(e)*; *see 10 Cal. Code Reg. § 260.103* (exemption for changes in rights, preferences, privileges, or restrictions of or on outstanding securities)].

PRACTICE TIP:

This exemption has certain advantages over other limited offering exemptions which may be available for issuance of debt securities to a small number of investors. No filing need be made with the Department of Corporations in order to perfect the exemption. No specific investor suitability standards must be satisfied, although there will, of course, be limitations on the types of investors that may participate in the offering imposed by the non-public offering rules outlined in Release No. 5-C [*see* Dept. of Corps. Release No. 5-C (Jan. 31, 1969)]. In addition, the debt securities need not meet the suitability standards applicable to qualified offerings. It may be particularly difficult for unseasoned corporations to structure an offering that satisfies these standards and meets the needs of potential investors. *Commentary by Frances E. Lossing.*

For purposes of this exemption, an offering is *not* a public offering if the following apply [*10 Cal. Code Reg. § 260.102.2*]:

- It is not made to more than 25 person and sales are not consummated to more than 10 of those persons; and

- All offerees either have a preexisting relationship with the offeror or its partners, officers, directors, or controlling persons or, by reason of their business or financial experience can reasonably be assumed to have the capacity to protect their own interests in connection with the transaction.

In calculating the number of offerees, institutional investors referred to in *Corp. Code § 25102(i)* are excluded. A husband and wife (together with any custodian or trustee acting for the account of their minor children) are counted as one person [*10 Cal. Code Reg. § 260.102.2*]. See Ch. 6H, *Qualification of Securities* , for discussion of qualification of securities, and more detailed treatment of nonpublic and public debt and general offerings.

This exemption does not apply to debt securities that are convertible into equity securities of the same issuer unless a

sale of that equity security would be exempt from qualification as an issuer transaction by any provision other than the small offering exemption of *Corp. Code § 25102(h)* [*10 Cal. Code Reg. § 260.102.3*; *see Corp. Code § 25102(h)* (applicable if, after sale, corporation will have only one class of stock that is owned beneficially by no more than 35 persons); *see also* [3], *below*].

10 Cal. Code Reg. § 260.102.2 does not create any presumption that a public offering is involved in offers not conforming to this section, and a determination of whether or not a transaction not covered by this section will be made without reference to the section. The Commissioner considers the following factors in determining whether securities are being offered to the public [Dept. of Corps. Release No. 5-C (Jan. 31, 1969)]:

- The number and character of offerees and investors.
- The relationship of the offerees to each other;
- The relationship between the issuer and the offerees;
- The size of the offering;
- The manner of the offering; and
- The character of the security offered.

Consideration should also be given to whether the proposed offering might be integrated with prior offerings or offerings contemplated in the future. For discussion of integration, see *Ch. 6B, California Limited Offering Exemptions, § 6B.21*.

[2] Other California Exemptions

California securities exemptions available for both debt and equity securities based on either the sophistication or number of purchasers include the following:

- The limited offering exemption in *Corp. Code § 25102(f)* [*see* Ch. 6B, *California Limited Offering Exemptions*].
- The small offering exemption of *Corp. Code § 25102(h)* [*see* Ch. 6C, *California Small Offering Exemption*].
- Sales to institutional investors listed in *Corp. Code § 25102(i)* [*see* Ch. 6D, *California Qualified Purchaser Exemptions*].
- Sales to qualified purchaser pursuant to the exemption of *Corp. Code § 25102(n)* [*see* Ch. 6D, *California Qualified Purchaser Exemptions*].
- Exemption for offerings under Rule 506 of SEC Regulation D [*Corp. Code § 25102.1(d)*].

[3] Option, Warrant, or Conversion Right Is Security Under California Law

An important difference between the federal and California exemption schemes is that under California law, any debt offering involving incidents in the form of warrants or conversion rights for equity securities must be qualified with the Commissioner of Corporations at the time of the sale of the debt unless some exemption applies to the offer and sale of

that equity security. A warrant, option, or right to subscribe to or purchase any type of security is in itself a security [*Corp. Code § 25019*], and every offer or sale of an option right simultaneously constitutes the offer and sale of the underlying or optioned security [*Corp. Code § 25017(e)*]. Thus, the offer or sale of a debt security that is convertible into an equity security amounts to an offer or sale of those equity securities; and must be qualified as such, unless a sale of that equity security would be exempt from qualification before the Commissioner of Corporations as an issuer transaction by any provision other than *Corp. Code § 25102(h)* [*10 Cal. Code Reg. § 260.102.3*]. See Ch. 6H, *Qualification of Securities* , for detailed treatment of procedures and forms for qualifying securities, including debt offerings, in California.

[4] Federal Exemptions Compared

The California exemption scheme [*see* [3], *above*] is in contrast to the federal regulatory scheme, which exempts registration of all exclusively intrastate and all private transactions, whether equity or debt securities [Securities Act of 1933, §§ 3(a)(11), 4(2) (*15 U.S.C. §§ 77c(a)(11), 77d(2)*)].

On the federal level, options for equity securities packaged with a debt offering--in the form of warrants or conversion rights--are not considered to be either offered or sold until they become exercisable, if they are not immediately effective at time of the original issue [Securities Act of 1933, § 2(a)(3) (*15 U.S.C. § 77b(a)(3)*)]. The underlying optioned securities are treated as if being offered for the first time when the option becomes fully effective. Purchasers of convertible securities acquired in a private placement ("restricted securities") may avoid classification as underwriters (and thus the need for registration) when reselling the securities or those issued on their conversion by complying with the conditions of Rule 144 [*17 C.F.R. § 230.144*]. Of course, if the straight debt or convertible debt offering can effectively be arranged to stay within California and is made by a California corporation, it is exempt from federal regulation as an intrastate security in any event [Securities Act of 1933, § 3(a)(11) (*15 U.S.C. § 77c(a)(11)*)]. In practice, however, this is often difficult to do.

[5] Indenture or Other Instrument Ordinarily Required

If the debt securities are nonconvertible, and must be qualified, the Commissioner of Corporations ordinarily expects the following provisions to be included, unless the debt securities have a rating or quality making such provisions unnecessary [*10 Cal. Code Reg. § 260.140.4*]:

- A sinking fund provision whereby all or a reasonable portion of the issue is to be retired in installments prior to maturity. The deferral of sinking fund payments and the amount of the balloon payment at maturity which will be permitted will depend on the financial condition and other circumstances of the issuer.

- An appropriate negative pledge or *equal protection clause* restricting the creation of liens on the property of the issuer.

- If the debt is unsecured, an appropriate restriction on the creation of other funded debt.

- An appropriate restriction on the payment of dividends on the stock of the issuer.

Unseasoned corporations may not generally sell non-convertible debt securities pursuant to an open qualification [*10 Cal. Code Reg. § 260.140.9*]. A seasoned corporation proposing to issue nonconvertible debt securities in an open qualification must demonstrate its ability to meet the proposed interest and sinking fund requirements on all of its securities outstanding and proposed to be issued based on its previous earnings or cashflow history or demonstrated future earnings or cash-flow [*10 Cal. Code Reg. § 260.140.10*].

Debt securities that are convertible or proposed to be issued in units with warrants or options must be fair and equitable under the circumstances and should ordinarily contain appropriate antidilution adjustments [*10 Cal. Code Reg. § 260.140.6*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationExempt Classes of SecuritiesSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsRegulation D Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

3-6J California Legal Forms--Transaction Guide § 6J.20

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.20 Trust Indenture

When a debt security is offered to the public, it has been customary for the investors to receive the special protection of an independent trustee appointed to administer the offering for their protection during the term of the debt under a trust indenture. An important feature of the trust indenture is its independent administration on behalf of the debt holders. A trust indenture is required under federal law [Trust Indenture Act of 1939 §§ 305, 306 (*15 U.S.C. §§ 77eee, 77fff*)], unless an exemption is available [Trust Indenture Act of 1939 § 304(a), (b) (*15 U.S.C. § 77ddd(a)(4), (b)*)], or unless the offering is restricted to relatively modest amounts for specified terms, again depending on whether or not it was to be accompanied by an indenture [Trust Indenture Act of 1939 § 304(a)(8), (9) (*15 U.S.C. § 77ddd(a)(8), (9)*)].

A full-fledged trust indenture can be voluminous in size and broad in scope, literally the size of a modest book. Frequently the length of the debt security itself can be decreased by simply incorporating by reference the protective measures more fully spelled out in the indenture.

PRACTICE TIP:

In 1981 [SEC Release 39-605 (Jan. 15, 1981)], the SEC approved the use of a short form indenture of only 35 pages which incorporates by reference the mandatory provisions of the Trust Indenture Act. Although the short form indenture has not been widely used, counsel may want to consider its use in circumstances in which a small business will be using the form for the first time and is not generally accustomed to forms of this length. *Commentary by Frances E. Lossing.*

The Commissioner of Corporations normally will not approve a debt offering pursuant to an open qualification unless it is issued under a trust indenture complying with the federal Trust Indenture Act of 1939, whether or not it is required under that act. However, a limited offering will be allowed under a lesser type of indenture or other accompanying instrument if it adequately provides protection to the holders under the particular circumstances [*10 Cal. Code Reg. § 260.140.5*]. A legend condition may be imposed in those circumstances [*10 Cal. Code Reg. § 260.141.10*]. A bank or trust company should be made trustee or co-trustee. Otherwise, the trustee should be appointed only with the approval of the Commissioner [*10 Cal. Code Reg. § 260.140.5*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawTrust IndenturesGeneral OverviewSecurities LawTrust IndenturesContract InterpretationSecurities LawTrust IndenturesTrustee Duties & Powers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

3-6J California Legal Forms--Transaction Guide § 6J.21

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.21 Thin Incorporation--Debt to Equity Ratio

[1] Explanation and Advantages of Thinning

Although in its broader aspects the process known as "thinning" the corporation refers to cutting the potential size of the equity structure and conversely enlarging the creditor portion of participation, the phrase generally connotes splitting up the proprietor's investment for maximum tax benefits. For example, a major shareholder, who intends to invest $100,000 in a new corporate enterprise, may divide its investment into $35,000 equity securities and $65,000 debt securities, instead of taking the entire investment in stock. The tax advantages that may be obtained through proper thinning include the following:

- The deductibility of interest payments [*see I.R.C. § 163*]. In contrast, dividends are not deductible by the corporation.
- The postponement of threat of accumulation tax.
- Participating with other creditors on insolvency.
- Tax-free withdrawal of capital, which is the most significant single advantage.

The prohibitions on the issuance of non-convertible debt by unseasoned corporations are not applicable to debt issued to the holders of the equity securities of the corporation on a pro rata basis pursuant to a limited qualification [*10 Cal. Code Reg. § 260.140.9*]. Thinning therefore should be available to these types of corporations.

[2] Criteria for Determining Whether Obligation Is True Debt

For many years, tax agencies and the courts have been attempting to isolate the authoritative indicia of form and substance in "thinning" transactions in order to determine when a genuine debt issue exists. *I.R.C. § 385(b)* sets forth five factors that should be considered in determining whether the investment is a genuine debt or is really an equity

contribution:

- The transaction and its attendant formalities (i.e., whether or not there is an unconditional promise to pay on demand or at a certain time a fixed amount in money in return for an adequate consideration in money or money's worth and to pay a fixed rate of interest).
- The status of various debt obligations (whether there are subordinations and preferences).
- The ratio of debt to equity.
- The nature of the security (whether it is convertible into stock of the corporation).
- The relationship between stock holdings and holding of the interest in question.

The best reasoned approach of the courts, labeled the "factor analysis approach" [*see Joseph Lupowitz Sons, Inc. v. C.I.R. (3rd Cir. 1974) 497 F.2d 862, 865]* , examines a particular debt-equity classification problem in terms of a set of 16 criteria in an attempt to judge the true nature of an investment which is in the form of debt [*see Fin Hay Realty Co. v. United States (3rd Cir. 1968) 398 F.2d 694, 696* ; *Tyler v. Tomlinson (5th Cir. 1969) 414 F.2d 844, 848* ; *see also* Rabkin & Johnson, *FEDERAL INCOME, GIFT AND ESTATE TAXATION, Ch. 37, Interest, Premium, and Discount, § 37.17* (Matthew Bender)].

[3] Methods of Forestalling Attack on Debt as Actually Equity

Apparently, the best way to forestall an official attack on a corporation's capital structure is to provide the transaction with sufficient incidents of both substance and form to make its character as indebtedness clear. The following factors were considered by the Ninth Circuit in reversing a Tax Court decision that the contributions at issue were capital, not loans [*Bauer v. Commissioner (9th Cir. [T.C.] 1984) 748 F.2d 1365, 1368* ; *see also Peoplefeeders, Inc. v. Commissioner (1999) 77 T.C.M. 1349, T.C. Memo. 1999-36 (Feb. 4, 1999)* (using same criteria but disallowing bad debt loss because concluding contributions were capital); *Gilbert v. Commissioner (1958) 17 T.C.M. 29, 30, T.C. Memo. 1958-8* (seven criteria, concluding contributions were capital and disallowing bad debt loss)]:

- The names given to the certificates evidencing the indebtedness.
- The presence or absence of a maturity date.
- The source of the payments.
- The right to enforce the payment of principal and interest.
- Participation in management.
- A status equal to or interior to that of regular corporate creditors.
- The intent of the parties.
- "Thin" or inadequate capitalization.
- Identity of interest between creditor and stockholder.
- Payment of interest only out of dividend money.

- The corporation's ability to obtain loans from outside lending institutions.

Additional precautions to be observed in "thinning" include the following [*see* Cavitch, *TAX PLANNING FOR CORPORATIONS AND SHAREHOLDERS, Ch. 4, Capitalizing the New Corporation, § 4.04[5]* (Matthew Bender)]:

- Shareholder debt should not exceed a respectable amount.
- Interest and principal payments should be unconditional.
- Shareholder debt should not be subordinated to general creditors.
- Shareholder debt should consistently be accounted for as debt.
- Shareholder debt should normally have long-term maturity.

[4] Consequences of Debt Being Found Actually to Be Equity

If the Internal Revenue Service is successful in pressing an attack against a thinly capitalized corporation, the result is that "interest" is held not deductible by the corporation (interest payments being deemed dividends, provided the corporation has earned surplus) and bad debts on repayment are held to be worthless stock losses.

When a purported debt security is found to be an equity security, the courts may find ways to require the holders of that debt to "stand at the back of the line," behind more genuine and less informed creditors, especially in bankruptcy and reorganization proceedings. This approach was developed through the so-called "deep rock doctrine" [*Taylor v. Standard Gas & E. Co. (1939) 306 U.S. 307, 323-324, 59 S. Ct. 543, 83 L. Ed. 669, 677]* . Ordinarily, it may not be expected to apply in situations other than those involving the dissolution of insolvent corporations [for further discussion, *see* Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 91, Debt Financing, §§ 91.04,* 9l.05 (Matthew Bender)].

Additional caution should be observed in the use of an excessive debt to equity ratio. The active corporate entrepreneur normally is not allowed to play both sides of the line, as important owner of the debtor corporation and as creditor of the enterprise, in too great a measure. The corporation may become unmistakably undercapitalized as a result of the insiders allowing too much fundamental financing through the form of debt securities rather than equity issues.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsUndercapitalizationSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART II. LEGAL BACKGROUND

3-6J California Legal Forms--Transaction Guide §§ 6J.22-6J.99

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6J.22[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6J California Legal Forms--Transaction Guide § 6J.100

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.100 Economic Picture of Corporation

1. Balance sheet, income and cash flow statements, from five years ago to most recent, whether the company is in corporate form or not; accounting analysis; professional studies; and determination whether financial statements have been audited and whether they have been prepared in accordance with generally accepted accounting principles.

2. Projected balance sheet, income and cash flow statements for next two years, with particular reference to earnings.

3. Itemized budget (exclusively, if new enterprise) for greater of two years or term of debt security.

4. Contemplated amount of indebtedness necessary at future intervals according to present plans.

5. Net worth statements and other personal financial information of promoters or key shareholders (20 percent or more of stock).

6. Description of business and operation.

7. Results of professional and informal market studies reflecting prospects for business.

8. Description of management or other key personnel.

9. Description of important customers and suppliers, including:

a. Whether those customers and suppliers have contracts with the company.

b. Amounts and time periods involved.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6J California Legal Forms--Transaction Guide § 6J.101

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.101 Private Sources of Financing--Names and Addresses

1. Professional and amateur investors--whether individual or organizational--with whom client has had previous experience.

2. Dominant shareholders or potential participants; promoters.

3. Employees likely to have access to funds for investment.

4. Investment houses, underwriters, broker-dealers, investment advisers with whom company has had contact.

5. Probable customers of the corporation, and their key personnel.

6. Probable suppliers of the corporation and their key personnel.

7. Commercial lending institutions, probably those routinely involved in company operations.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinance



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6J California Legal Forms--Transaction Guide § 6J.102

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.102 Sources of Security

1. Real property.

a. Location and general description of real property standing in name of company in fee simple, under long-term lease, or otherwise effectively under company ownership.

b. All mortgages, leases, or other obligations secured by the real property.

NOTE:
Examine all obligations relating to the real property to determine if they contain any limitations on the company's right to use the property as security for other debt.

2. Equipment or machinery.

a. Location and description of all major equipment owned by the company, outright, under long-term lease, or otherwise effectively under company ownership.

b. All loans, leases, or other obligations secured by the equipment.

NOTE:
Examine all obligations relating to the equipment to determine if they contain any limitations on the company's right to use the property as security for other debt.

3. Securities held by company.

a. Description of all securities held in the name of the company, or for the benefit of the company, whether of subsidiaries or of unrelated enterprises.

b. Whether any of the securities have been pledged to secure obligations of company, and if so, under what terms.

4. All obligations, short-term and long-term, held by company.

5. All standing inventories of products or supplies held by company; whether, and if so, under what terms, inventories have been pledged to secure obligations of company.

6. Analysis of accounts receivable.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6J California Legal Forms--Transaction Guide § 6J.103

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.103 Identification of Sources of Restrictions on Offering

1. Articles of incorporation.

2. Bylaws.

3. Terms of material contracts, including other debt instruments, leases etc.

4. Legal restrictions, particularly if issuer is in a regulated industry.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & Bylaws



28 of 189 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6J California Legal Forms--Transaction Guide §§ 6J.104-6J.109

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6J.104[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6J California Legal Forms--Transaction Guide § 6J.110

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.110 Type of Debt Security to Be Issued by Corporation

NOTE:

The main sources of credit available to a corporation are stockholders, existing creditors, institutional investors, i.e., banks, insurance companies, other asset-based lenders, pension funds, mutual funds, and the general public. A large corporation with a proven earnings record usually can obtain long-term financing by means of the public issue of debt securities. On the other hand, there is little likelihood that a small corporation will be able to market debt securities publicly at the time of initial financing. Unseasoned or speculative businesses may also have a difficult time satisfying the Commissioner's standards for qualification of securities [***see*** *10 Cal. Code Reg. §§ 260.140.5, 260.140.9*]. As a practical matter, the available sources of credit for a new corporation, besides shareholders and existing creditors, are largely institutional lenders. In the case of a newly formed smaller corporation, the institutional lender is usually a bank, a small business investment company, or other asset-based lender.

1. Determine type of financing that is needed and available.

a. Short-term financing, i.e., usually having debt maturity of less than one year [*see Corp. Code § 25100(l)* (discussed in *§ 6J.19[1][a]*)]. If notes will have a maturity of nine months or less, the notes will be of prime quality and the proceeds will be used for a current transaction.

b. Intermediate term financing, i.e., having debt maturity of from one to five years.

c. Long-term financing, i.e., having debt maturity of more than five years.

2. Determine type of debt security to be issued by corporation.

NOTE:
In a new corporation the type of debt security issued by the corporation is generally dictated by the purchaser--in other words, the bank.

a. Promissory note, secured [*see Corp. Code §§ 25100(p), 25102.5* (discussed in *§ 6J.19[1][b]*)] or unsecured, senior or subordinated.

b. Mortgage bond.

c. Income bond.

d. Debenture.

e. Subordinated debentures, sometimes with conversion features (more commonly associated with large corporations).

3. Determine whether advantages outweigh disadvantages of long-term debt securities as compared to equity securities.

a. Advantages:
(1) Cost of debt is limited; holders of debt securities do not participate in profits, if earned.

(2) Control of firm generally is not shared when debt financing is used.

(3) Interest on debt is deductible as expense for tax purposes, whereas dividends on stock are not [*see I.R.C. §§ 163, 461(e)*].

(4) Flexibility in financial structure of corporation may be achieved by inserting call, prepayment, or defeasance provisions in instrument.

(5) Debt securities may be marketable at time when equity securities are not.

(6) Certain types of debt securities are not subject to registration [*see* Ch. 6H, *Qualification of Securities*].

(7) Holder of debt securities has prior right to share in corporate assets on liquidation, thus minimizing creditor's risk of loss.

(8) Corporation is less likely to be confronted with accumulated earnings tax because retention of earnings is not objectionable if earnings will be used to pay off reasonable and legitimate debts.

(9) With long-term inflationary trend, repayment in future will be with "cheaper" dollars.

b. Disadvantages:

(1) Debt is fixed charge regardless of profitability of corporation; if corporation's profits decline at some point, corporation may be unable to meet this fixed charge.

(2) Debt generally has fixed maturity date; provision must be made for repayment of debt or for refunding.

(3) Because typically it is long-term commitment, debt involves risk that expectations and plans on which debt was issued may change.

(4) Indenture provisions are likely to include restrictions on corporate management's freedom of action (e.g., restrictions on future borrowing, dividends, salaries, etc.).

(5) Extent to which funds can be raised through debt is limited by standards of financial prudence; thus issuance of debt securities may adversely affect corporation's ability to borrow additional funds in the future

(6) If debt to equity ratio is too high, corporation may be subject to "thin capitalization" problems [*see § 6J.21*].

4. Determine whether offering of debt securities is to be public or private, and what must be done to comply with applicable federal and state securities laws.

5. Determine whether debt securities will be issued with any equity features, such as conversion, options, warrants or other rights

6. Determine whether debt will have any other special features, such as security, personal guarantees, redemption, prepayment rights, subordination, or defeasance.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationGeneral OverviewSecurities LawGeneral OverviewSecurities LawInvestment CompaniesClassification



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6J California Legal Forms--Transaction Guide § 6J.111

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.111 Which Protective Devices to Include in Debt Offering

[1] Devices Protecting Investors

NOTE:

Some of the items discussed below are mandatory and are indicated as such in the text. These items must be included in any debt issue. Others, as indicated, are discretionary. Counsel will have to consider those protective devices that will assist in the sale or placement of the issue under the particular circumstances and will best met the overall needs and goals of his or her client. Actual terms generally will be dictated by the lender, placement agent, or underwriter involved in the transaction.

1. Determine exact terms of indebtedness, including:

a. Interest rate.

b. Times of repayment.

c. Dates of incurring and paying off obligation.

d. Whether amounts may be or must be prepaid and, if so, the amount of any prepayment penalty, if any.

e. Whether amounts repaid may be reborrowed.

f. Restrictions on amounts that may be borrowed.

g. Whether amounts must be borrowed in full at time loans documents are executed or may be borrowed over a period of time.

PRACTICE TIP:
Restrictions on amounts that may be borrowed pursuant to the terms of the debt securities may be imposed either directly or indirectly through financial covenants, such as minimum net worth requirements or interest coverage or leverage ratios, or through borrowing base or security requirements. It is important for the issuer to understand these restrictions before entering into the transaction in order to be certain that the proposed terms of the transaction will enable the issuer to meet its business objectives. It is also important for the issuer to understand how these types of restrictions may impact the ability of the issuer to raise capital in the future. The issuer may want to prepare a pro forma budget to determine the impact of the proposed issuance of debt securities on the issuer's budget projections, using a variety of different assumptions, as well as the ability of the issuer to satisfy the covenants in the debt instrument. *Commentary by Frances E. Lossing.*

2. Determine medium of payment (e.g., lawful money of United States).

3. Consider including provisions restricting other corporate obligations, such as provisions designed to prohibit:

a. Creation of liens on corporate property.

b. Issuance of other obligations.

c. Financial covenants.

4. Consider creating sinking fund with required payments by corporation prior to maturity, so that debt holder will be assured of payment at maturity.

5. Consider mandatory redemption or prepayment provisions requiring debt to be prepaid if certain events occur.

6. Consider including liquidity provisions to protect debt holder against any payments or disbursements that would adversely affect working capital, including:

a. Dividends or other distributions to shareholders.

b. Increased compensation to corporate executives.

c. Payments to shareholders or other affiliates of company in related party transaction, such as building or equipment lease.

d. Transfer of earning assets to subsidiaries, which could reduce amount of working capital available to parent issuer.

7. Consider giving holders of debt securities a preemptive right of first refusal to purchase entire new debt issue and thus prevent any diversion of payments or dilution of debt securities.

8. Consider including provision creating conversion rights other than equity kickers under which debt security is convertible into shares of corporation or issue warrants or other rights to acquire shares.

NOTE:

A conversion provision generally is found in more complex debt securities associated with large corporations. Conversion rights may be advantageous to the corporation because if the right is exercised, the corporation does not have to pay off the debt in cash. Existing shareholders may, however, find the issuance of convertible debt unattractive because it may dilute their interest in the company. Corporations that have issued convertible debt may, for the same reason, find it more difficult to sell their equity securities. Other forms of equity kickers have some of the same disadvantageous. In addition, unlike convertible securities, the corporation remains obligated to pay the debt. Equity kickers may, however, be necessary to attract investors in debt securities of an unseasoned corporation.

9. Consider provision to require corporation to maintain current operations, including:

a. Remaining in same type of business.

b. Retaining particular personnel or property.

c. Meeting tax and insurance payments, as well as other similar obligations.

d. Limiting sales or other dispositions of assets.

e. Limiting acquisitions.

f. Limiting change in control of the corporation.

g. Limiting investments and capital expenditures.

h. Complying with the law, including in particular environmental laws, ERISA, and labor laws.

10. Events of default:

a. Consider provision specifying what events will constitute a default in obligation created by the debt security, such as:

(1) Breaches of covenants of debt instrument.

(2) Bankruptcy or insolvency.

(3) Breaches of representations and warranties.

b. Determine what remedies creditors will have in event default occurs.

11. Consider requiring issuer to provide periodic financial reports and to report significant events, such as litigation and environmental claims, and events of default or potential events of default.

12. Security:

a. Consider securing transaction with all or a portion of the assets of the issuer.

b. Consider obtaining guaranty, which may be secured or unsecured, from principal shareholder of issuer.

13. Determine whether or not debt security will be transferable.

NOTE:
Debt issues may be more attractive to potential investors if the debt security is readily transferable.

[2] Devices Protecting Corporation

1. Determine whether corporation will reserve right to prepay any interest or principal on obligation created by debt security, without penalty or premium, either:

a. At any time; or

b. According to special schedule.

2. Determine whether debt security will be redeemable at option of corporation.

3. Consider including provision subordinating debt security issue to other types of issues.

NOTE:
When combined with a conversion provision, resulting in a convertible subordinated debt security, this provision would be appropriate for a large corporation.

4. Consider inserting provision permitting corporation to defease debt and thereby be relieved of covenants that may restrict its business.

NOTE:
Defeasance may be appropriate in circumstances in which the lender is unwilling to permit the corporation to redeem the debt securities or insists upon a period of call protection.

5. Include special promises and representations from debt holders as to their intent in purchasing debt issue and with regard to their disposition of securities, in order to keep issue within exemptions of federal and state securities laws [*see* Ch. 6H, *Qualification of Securities ; see also §§ 6J.259, 6J.260*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6J California Legal Forms--Transaction Guide §§ 6J.112-6J.119

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6J.112[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Issuance of Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.120

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.120 Arranging Exempt Debt Issue to Institutional Investors, Qualified Purchasers, or Through Nonpublic Offering

1. Initiate preliminary discussions and negotiations with institutional investors [*Corp. Code § 25102(i)*; *10 Cal. Code Reg. § 260.102.10*] or other qualified purchasers [*Corp. Code § 25102(n)*; 12 C.F.R. § 230.1001; *10 Cal. Code Reg. § 260.102.13*]:

NOTE:

Offers and sales of any securities to the following institutional investors, governmental agencies, or qualified purchasers are exempt in most instances from all qualification, whether these investors are purchasing for themselves or their trust accounts. However, these investors must represent that they are buying for investment, not further distribution [*Corp. Code §§ 25102(i), 25102(n)(3)*]. For further discussion of the qualified purchaser exemption of *Corp. Code § 25102(n)*, see Ch. 6D, ***California Qualified Purchaser Exemptions*** .

Specifically permitted under this rule are private resales of securities to qualified institutional buyers under SEC Rule 144A [*10 Cal. Code Reg. §§ 260.102.10.1, 260.105.13.1*; ***see*** *17 C.F.R. § 230.144A*].

Offers and sales to wholly owned subsidiaries of the entities listed in PP a through g, ***below***, are also permitted [*10 Cal. Code Reg. §§ 260.102.10(c)*].

a. Banks [*Corp. Code § 25102(i)(1)*].

b. Savings and loan associations [*Corp. Code § 25102(i)(1)*].

c. Trust companies [*Corp. Code § 25102(i)(1)*].

d. Insurance companies [*Corp. Code § 25102(i)(1)*].

e. Investment companies (if registered under the Federal Investment Company Act of 1940 [*15 U.S.C. § 80a-1 et seq.*]) [*Corp. Code § 25102(i)(1)*].

f. Pension plans [*Corp. Code § 25102(i)(1)*].

g. Profit-sharing trusts [*Corp. Code § 25102(i)(1)*].

NOTE:
Pension plans and profit-sharing trusts must not include the issuer's own pension plan or profit-sharing trust, a self-employed individual retirement plan, or an individual retirement account, unless the investment decisions made on behalf of the trust, plan, or account are made solely by persons who are qualified purchasers [*Corp. Code §§ 25102(i), 25102(n)(2)(C)*].

h. Any organization described in *I.R.C. § 501(c)(3)* (tax-exempt religious and charitable organizations), such as a college or university, with total endowment funds (including annuity or life income funds) of at least $5 million, according to its most recent audited statement [*10 Cal. Code Reg. § 260.102.10(a)*].

i. An organization described in *I.R.C. § 501(c)(3)* (tax-exempt religious and charitable organizations), a corporation, a Massachusetts or similar business trust, or a partnership, each with total assets over $5 million according to its most recent audited financial statements [*Corp. Code § 25102(n)(2)(D)*].

j. Any corporation with net worth (on a consolidated basis according to its most recent audited and consolidated statement) of at least $14 million [*10 Cal. Code Reg. § 260.102.10(b)*].

NOTE:
If a security issued under this exemption is exchangeable for or convertible into common stock, (1) less than 25 percent of the outstanding shares may be held by holders with California addresses, or (2) the securities, plus similar securities held by the buyer, may not represent more than 5 percent of the total number of the issuer's outstanding shares of common stock. However, these limitations are inapplicable to transactions in which either (1) the securities are offered pro rata to the holders of outstanding common shares; (2) the securities are approved by the holders of 75 percent or more of the outstanding common shares; or (3) there are no common shares, or securities convertible into common shares, outstanding prior to the transaction [***see*** *10 Cal. Code Reg. § 260.102.10(b)*].

k. Governmental agencies and instrumentalities [*10 Cal. Code Reg. § 260.105.14*]:

(1) Federal government.

(2) Federal agency or instrumentality.

(3) Corporation wholly owned by federal government.

(4) State.

(5) City.

(6) City and county.

(7) County.

(8) Agency or instrumentality of a state, city, city and county, or county.

(9) State university or state college.

(10) Retirement system for employees of any of the foregoing.

l. Any person designated in *10 Cal. Code Reg. § 260.102.13* (purchasers excluded from the count of purchasers for purposes of the limited offering exemption) [*see* Ch. 6B, *California Limited Offering Exemptions*].

m. Trustee of an issuer that is a trust, and general partner of an issuer that is a partnership, who exercise managerial functions with respect to those entities [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(a)*].

n. Any officer, director, or general partner of a general partner of an issuer that is a partnership [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(a)*].

o. Any person who occupies a position with the issuer, or with a general partner of an issuer that is a partnership, with duties and authority substantially similar to those of an executive officer of a corporation [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(b)*].

p. Any relative, spouse, or relative of the spouse of an otherwise qualified purchaser who has same principal residence as that purchaser [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(c)(1)*].

q. Any trust or estate in which a qualified purchaser and any of the persons related to that purchaser as specified in P p, *above*, or in P r, *below*, collectively have more than 50 percent of beneficial interest (excluding contingent interests) [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(c)(2)*].

r. Any corporation or other organization of which an otherwise qualified purchaser and any of the persons related to that purchaser as specified in (p) or (q), *above*, collectively are beneficial owners of more than 50 percent of the equity securities (excluding director's qualifying shares or equity interests [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(c)(3)*].

NOTE:

"Relative" means a person related by marriage or blood [*10 Cal. Code Reg. § 260.102.13(c)(3)*].

s. Any promoter of the issuer; that is, an individual who, alone or in conjunction with one or more other persons, takes the initiative in founding and organizing the business or enterprise of issuer [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(d)*; *see 10 Cal. Code Reg. § 260.102.12(f)* (defining "promoter")].

t. Any person who purchases $150,000 or more of securities offered in transaction, provided each such purchaser either meets one of following criteria, or issuer reasonably believes that purchaser meets one of those criteria [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(e)*]:

(1) Person or person's professional advisor has capacity to protect person's own interests in connection with transaction [*see Corp. Code § 25102(f)(2)*]; or

(2) Investment (including mandatory assessments) does not exceed 10 percent of person's net worth or joint net worth with that person's spouse.

u. Business development company, either [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(f)*]:

(1) Small business investment company licensed by U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Company Act of 1958 [*15 U.S.C. § 681(c)*];

(2) Business development company as defined in Section 2(a)(48) of Investment Company Act of 1940 [*15 U.S.C. § 80a-2(a)(48)*]; or

(3) Private business development company as defined in Section 202(a)(22) of Investment Advisors Act of 1940 [*15 U.S.C. § 80b-2(a)(22)*].

v. Person who comes within one of categories of "accredited investor" in Rule 501(a) of Regulation D, adopted by SEC under Securities Act of 1933 [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(g)*; *see 17 C.F.R. § 230.501(a)*; *see also* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*].

w. Any entity in which all equity owners are [*Corp. Code § 25102(n)(2)(A)*; *10 Cal. Code Reg. § 260.102.13(h)*]:

(1) Persons specified in *Corp. Code § 25102(i)* [i.e., those listed in PP a through g, *above*];

(2) Persons specified in *10 Cal. Code Reg. § 260.102.10* [i.e., those listed in PP h and j, *above*];

(3) Persons listed in *10 Cal. Code Reg. § 260.102.13(a)-(d)*, *(f)*, and *(g)* [i.e., those listed at PP l through s, u, and v, *above*]; or

(4) "Officers, directors or affiliates of the issuer" as that term is used in *Corp. Code § 25102(f)*.

2. If debt can be placed with individuals privately, determine whether number of potential investors and their prior relationship to issuer or ability to protect their own financial interests will bring transaction under one of the exemptions for nonpublic offerings [*see Corp. Code § 25102(e), (f)*; *Corp. Code § 25102.1(d)*; *see also 10 Cal. Code Reg. §§ 260.102.2, 260.102.3, 260.102.12-260.102.14*].

NOTE:

Neither the specific exemption from qualification for evidence of indebtedness [***see*** *Corp. Code § 25102(e)*] nor the limited offering exemption [***see*** *Corp. Code § 25102(f)*] allow the publication of an advertisement of the debt security, and the exemption for qualified purchasers [***see*** *Corp. Code § 25102(n)(5)*] allows only a general announcement limited to the matters specified in the statute. Further, evidence of indebtedness that is convertible may not be sold under the *Corp. Code § 25102(e)* exemption unless the debt is convertible into an equity security of the same issuer, and the offer and sale of the equity security would be exempted from issuer qualification by a subdivision of *Corp. Code § 25102* other than subdivision (h) [*10 Cal. Code Reg. § 260.102.3*]. For further discussion of the limited offering exemptions provided under *Corp. Code §§ 25102(f)* and *25102.1(d)*, see Ch. 6B, ***California Limited Offering Exemptions*** . For further discussion of the qualified purchaser exemption of *Corp. Code § 25102(n)*, see Ch. 6D, ***California Qualified Purchaser Exemptions*** .

3. Decide whether to place entire issue with same investor or with combination of different investors.

4. Negotiate purchase agreement with single investor or investor group if debt is large or investors are more remote or relatively uninterested in the business.

PRACTICE TIP:

Another factor to be considered in determining what type of investor should be targeted is the need for future flexibility. Covenants which restrict the company's business operations or financial covenants which the company may have difficulty satisfying should not generally be included in public debt securities of unseasoned companies or companies in emerging industries because of the difficulty of obtaining consents of the public investors to amendments which may be necessary. Covenants of this type, however, are quite common in bank credit agreements or other privately placed debt instruments. In these circumstances, it may be easier to obtain investor consent to changes in the terms of the debt securities. *Commentary by Frances E. Lossing.*

5. Negotiate special security provisions to be embodied within note itself.

6. Arrange to include provision in investment representation [*see §§ 6J.259, 6J.260*], as well as separate letters or agreements restating those representations, to effect that investors will not resell in any manner that would jeopardize federal or state securities exemptions.

7. Submit final format of proposed debt issue to board of directors for adoption or revision.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawExemptions From RegistrationExempt TransactionsRegulation D Exemptions



33 of 189 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Issuance of Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.121

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.121 Packaging Offering With Equity Securities

1. Consider marketing debt securities by including equity securities in manners such as the following:

a. Outright sale of class of equity securities, in prearranged proportion to debt purchased, for full market value price (usually unavailable on market otherwise).

b. Accompanying sale of equity securities at discount price (lower than market, straight par, or fixed value, etc.).

c. Accompanying warrant to purchase class of equity securities.

d. Provision in note containing privilege to elect to convert note into class of equity securities on prearranged proportion.

2. Qualify entire debt package offering with Commissioner of Corporations [*Corp. Code § 25110*; *see* Ch. 6H, *Qualification of Securities*].

NOTE:

In California a warrant or right to purchase a security is itself a security [*Corp. Code § 25019*], and an offer or sale of a convertible note or a warrant is at that time an offer or sale of the underlying optioned security [*Corp. Code § 25017(e)*]. On the federal level, a right or privilege to convert, exercisable at a future time, is not an offer or sale until the time of exercise [Securities Act of 1933, § 2(a)(3); *15 U.S.C. § 77b(a)(3)*], whereas a straight exchange of securities between the issuer and its holders, if no professional securities personnel are involved, is an exempt one [Securities Act of 1933, § 3(a)(9); *15 U.S.C. § 77c(a)(9)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate Offerings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Issuance of Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.122

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.122 Processing Issuance of Debt Securities

1. Prepare resolution authorizing issuance of the particular debt series [*see §§ 6.200*-6.202]:

a. Specify major features of offering.

b. Authorize important formal steps to be taken in processing the issue.

2. If offering will be public offering, register offering with Federal Securities and Exchange Commission [Securities Act of 1933, § 6; *15 U.S.C. § 77f*].

3. Qualify offering with California Commissioner of Corporations if [*Corp. Code § 25110*; *see* Ch. 6H, *Qualification of Securities*]:

a. It is a public offering;

b. It is part of a package containing equity securities or warrants, rights, or options for equity securities; or

c. It fails to qualify under any of the applicable exemptions from qualification [*see § 6J.120*; for general discussion of the available securities exemptions, *see* Ch. 6, *Securities Regulation Issues* , Ch. 6B, *California Limited Offering Exemptions* , Ch. 6C, *California Small Offering Exemption* , and Ch. 6D, *California Qualified Purchaser Exemptions*].

4. Solicit the approval of any group formally connected with corporation if that approval is necessary to

authorize a debt issue, such as:

NOTE:
These approvals do not have to be obtained unless an approval requirement has been formally embodied in the articles or bylaws, or in prior agreements [***see*** *Corp. Code §§ 207(d), (g), 1000*] such as shareholder agreements or previously issued notes.

a. Holders of previously issued debt;

b. Holders of preference class securities; or

c. General shareholders.

5. Formally arrange for placement of notes.

a. If offering is private offering, either:
(1) Send letter to investor:
(a) Generally describing note.

(b) Specifying terms and method of payment.

(c) Reciting how note will be delivered on receipt of payment.

(2) Alternatively, arrange with investor to send letter of inquiry for note and send check with description of note desired.

b. If offering is public offering, send notes to underwriters in accordance with terms of agreement; or if trust indenture is involved, send securities to indenture trustee.

PRACTICE TIP:
In certain types of transactions, such as bank credit agreements, notes are frequently no longer issued. These types of bank credit agreements do, however, typically contain a provision requiring the borrower to issue a note to any lender who may request a note to evidence the indebtedness of the borrower to that lender. *Commentary by Frances E. Lossing.*

6. Prepare, or instruct transfer agent to prepare, books and records to:

a. Reflect receipt and allocation of proceeds from distribution of debt securities; and

b. Show all names and addresses, serial numbers, and denominations of notes issued to registered holders.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsPrivate OfferingsSecurities LawInitial Public Offerings & the Securities Act of 1933Registration of SecuritiesGeneral Overview



35 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Issuance of Debt Securities

3-6J California Legal Forms--Transaction Guide §§ 6J.123-6J.129

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6J.123[Reserved]



36 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6J California Legal Forms--Transaction Guide § 6J.130

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.130 Interest Payments

1. For registered notes, prepare machinery for automatic disbursements of drafts for amounts due as interest at appropriate intervals for payment to registered holders at last known addresses as shown on corporate books.

2. If issue is large enough, appoint or direct already appointed professional transfer agent to handle interest payments, subsequent processes of redemption, conversion, retirement, and amendment or alteration.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinance



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6J California Legal Forms--Transaction Guide § 6J.131

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.131 Sinking Fund

1. Determine, with company accountants, appropriate plan by which payments may be made from annual earnings into sinking fund.

2. If sinking fund provisions have been generally or explicitly described in debt instruments [*see, e.g., § 6J.257[2]*], comply with those provisions.

3. Appoint appropriate custodian to handle fund.

NOTE:
The custodian may be a corporate officer, commercial bank, trust fund, trustee of an accompanying indenture, or general transfer agent for issue.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6J California Legal Forms--Transaction Guide § 6J.132

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.132 Conversion

1. Ascertain that appropriate amount of shares, previously authorized by articles and, if required, qualified with Commissioner of Corporations (usually exempt at initial offering from federal Securities and Exchange Commission), is set aside and available for issue on conversion.

2. Prepare machinery for receipt of security documents executed with respect to election of holder to convert into other securities of corporation.

3. Arrange for exchange of conversion securities for returned notes in same manner as is usual for transfer of shares on corporate books.

4. If conversion or original note issue is large enough, appoint or direct already appointed transfer agent to process conversion exchanges.

NOTE:
If warrants are to be detached from debt instrument and surrendered with payment for security, the procedure will be handled as a regular distribution of equity shares.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewContracts LawNegotiable InstrumentsEnforcementDuties & Liabilities of PartiesConversion of InstrumentsSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6J California Legal Forms--Transaction Guide § 6J.133

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.133 Redemption

1. Determine, in consultation with accountants, refinancing investors, underwriters, or similar securities personnel, whether time is appropriate for redemption, considering following factors:

a. Whether earnings are sufficient presently to retire debt, as against speculative availability in future.

b. Whether money to finance redemption is "cheaper" (more inflationary) now.

c. Whether money is obtainable from other sources more easily, or on more favorable terms, to replace and retire present debt series.

d. Whether more important new security issues are able to prove more attractive if present debt series is retired (i.e., not further drain on company earnings, or threat to security of future investors).

e. Whether contemplated refinancing or current financial condition of company require "thinning" of present outstanding debt by partial redemption (retirement of some but not all notes of series).

f. Probability that notice of redemption will cause majority of investors to exercise conversion privilege, providing for cancellation of debt and increase of participation in equity securities (rendering healthier balance sheet for special outside creditors).

g. Whether there are any restrictions imposed on company's ability to redeem securities prior to maturity by other debt instruments of company or other contractual obligations.

2. Prepare resolution authorizing redemption as contemplated [*see § 6J.205*].

3. Notify holders.

a. Send letter notice to all registered holders of notes at last known address as shown on corporate books.

b. Publish notification in newspaper of general circulation in county where corporation's principal executive office is located at least once a week for two successive weeks, in each instance on any day of the week, or as otherwise specified in the debt instruments [*see Corp. Code § 509(b)*].

NOTE:
The letter or first publication of notice must be no earlier than 60 days, and no later than 20 days, in advance of the date resolved for redemption [***see*** *Corp. Code § 509(b), (c)*].

4. With respect to called security instruments:

a. Prepare machinery for receipt of called security instruments and for exchange of drafts representing repayment of principal.

b. Handle registered notes in same manner as transfer of shares, with draft to be made out to registered holder and sent to latest address or last address as listed on books.

5. If redemption contemplated is large enough, appoint transfer agent, or direct previously appointed transfer agent to process redemption.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6J California Legal Forms--Transaction Guide § 6J.134

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.134 Retirement

1. Prepare machinery for receipt of notes at scheduled period of maturity, and for repayment of principal plus all uncollected interest; to be handled in same manner as redemption, in § 6J.133.

NOTE:
When the issue contains a serial retirement feature, this machinery is set up to function continuously under the provided schedule for progressive retirement of the issue.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinance



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6J California Legal Forms--Transaction Guide § 6J.135

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.135 Amendment or Alteration

1. Determine, with economic advisory personnel, accountants, and counsel, necessity or feasibility of altering terms of outstanding debt issue in order to adjust instrument to current or predicted future requirements, to correct past oversight or prevent potential events of default.

2. Prepare resolution:

a. Finding necessity or desirability of altering contents of outstanding issue.

b. Specifying plan for qualifying with governmental authorities, as necessary, and otherwise arranging necessary charges with present note holders or other securities holders.

NOTE:
When the issue is accompanied by a trust indenture, that instrument generally has a special set of provisions for amendment of the debt instruments. By the express terms of the original resolution authorizing the debt issue, or in the provisions of prior debt issues, the corporation may have obligated itself to first obtain the approval of other securities holders before altering any subsequent debt offering. In some instances, the articles of incorporation may require submission of the matter to shareholder vote.

3. Check company records to determine if at least 25 percent of outstanding units (individual notes) which will be directly or indirectly affected substantially and adversely by proposed change have addresses in California [*Corp. Code § 25103(b)*].

4. Determine whether changes to be effected substantially and adversely affect note holders in any one or more of following areas:

a. Interest rights.

b. Redemption liabilities.

c. Maturity expectations.

d. Voting rights.

e. Conversion rights.

f. Sinking fund expectations.

g. Subordination rights.

5. If proposed changes in rights, preferences, privileges, or restrictions of outstanding debt securities are subject to qualification and are not exempt, qualify proposed changes by recapitalizations and reorganizations permit [*Corp. Code §§ 25120, 25121*].

6. Solicit approval of appropriate number of present note holders, prior debt issue holders, or other securities holders of corporation.

7. Notify existing securities holders of alterations of terms of document and consequent exchange of securities; prepare notices in same manner as in redemption, in § 6J.133, with respect to registered or bearer securities.

8. Prepare machinery for receipt of existing securities and exchange for reformed notes in same manner as in conversion procedure, described in § 6J.132, if necessary.

NOTE:

It is impractical simply to send out an addendum or supplement to an existing note because the old and new documents could become physically separated and subsequent good faith holders might not be aware of the later corrections or additions. Therefore, all outstanding instruments have to be exchanged for reformed versions if the terms of the note are altered.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewSecurities LawGeneral Overview



42 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6J California Legal Forms--Transaction Guide § 6J.136

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.136 Reporting Requirements

1. Calendar dates on which reports must be sent to lender.

2. Establish procedures to monitor compliance with financial and other covenants to assure that there will be no inadvertent defaults.

3. Establish procedures for reporting subsequent events required to be reported to lender.

4. Establish procedures to identify any events which potentially could become events of default so that action can be taken to prevent default, to obtain consent of lenders to amend or alter the terms of the debt security.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinance



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

3-6J California Legal Forms--Transaction Guide §§ 6J.137-3J.199

AUTHOR: Frances E. Lossing Practice Consultant

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§§ 6J.137[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
A. Resolutions and Notice for Issuance or Redemption of Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.200

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.200 Resolution to Issue Simple Note to Identified Purchasers

[1] Comment--Use of Form

This form is a corporate resolution authorizing the corporation to issue a simple note to one or more purchasers. It contains optional provisions for the following:

- A note secured by a deed of trust.
- A note secured by personal property.
- Subordination of the note to a senior indebtedness.
- Negotiation and execution of a purchase agreement in conjunction with the note.

If the corporation has been able to arrange for funding from a single purchaser or identified purchasers, such as individuals or institutional investors, the board of directors may authorize the debt transaction in terms specifically tailored to suit the special arrangement.

For general discussion of the use of directors' resolutions, see Ch. 5, *Directors Meetings, Actions, and Resolutions* .

[2] Form

Resolution to Issue Simple Note to Identified Purchasers

Resolution Authorizing Borrowing by Note From Identified Purchaser

WHEREAS, the Corporation finds it [necessary and] desirable to obtain, on a _____[short-term *or*

long-term] basis, _____[*type of funds, e.g.*, working capital] funds for the purposes of _____[*e.g.*, supplementing working capital *or* financing a particular interim project *or* acquisition of a special asset]; and

WHEREAS, _____[*name(s) of investor(s)*] _____[has *or* have] indicated interest in providing $_____ to be utilized for those purposes on the terms described below;

RESOLVED, that this corporation's note for $_____ principal amount, payable in _____ years, at _____ percent interest, payable _____[*e.g.*, semiannually], [in equal installment of principal and interest,] with provision for acceleration on default in any payment, otherwise to be in the _____[regular commercial form *or* form attached to this resolution as Exhibit A], be issued to _____[*list name(s) of individual purchasers and, if desired, their addresses*].

[*Optional provision--if note to be secured*]

RESOLVED FURTHER, that the Corporation additionally execute to _____[*title company or other trustee or* to an appropriate trustee to be selected] for the benefit of the aforementioned purchaser(s) as security for the loan described above, a deed of trust, to be in the _____[regular corporate form *or* form attached to this resolution as Exhibit B], encompassing property standing in the name of this corporation, _____[located at _____ *or* known as the _____ property], the formal and legal description to be included in the deed of trust.

[*Optional provision--if loan to be secured by personal property*]

RESOLVED FURTHER, that the Corporation execute _____[its *or* _____'s (*a named creditor*)] standard form security agreement and an appropriate financing statement to provide the purchaser(s) with security for the above-described loan in the nature of the following personal property: _____[*e.g., describe particular obligations owing to the corporation, securities of a subsidiary, particular chattels, etc.*].

[*Optional provision--for subordination to senior indebtedness*]

RESOLVED FURTHER, that the above-described note provide that the obligation is subordinate to any other indebtedness of the Corporation owing to any commercial banking institution or regular institutional investors, such as, but not limited to, insurance companies, pension funds, charitable or special trusts, and the like, no matter when nor for what terms entered into. That senior indebtedness will be entitled to prior payment on any default on the above-described loan.

[*Optional provision--if note is to be accompanied by purchase agreement*]

RESOLVED FURTHER, that the Corporation further negotiate and enter into a purchase agreement with the above-mentioned purchaser(s) to accompany the above-described note, as soon as possible, whether prior to or contemporaneously with the execution of the note, more fully detailing the arrangements for purchase of, and the terms of, or to be read into, the note itself, in which this corporation will covenant in the normal manner to maintain its ordinary operating condition and procedures, will more fully detail other covenants regarding the operation of the Company's business customary in transactions of this type, will more fully detail the events of default and the purchaser's recourse in the event of default, [will more fully detail the terms of the _____ (security

arrangement *or* subordination provisions),] and will provide for the assignability of the note.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
A. Resolutions and Notice for Issuance or Redemption of Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.201

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.201 Resolution Authorizing Issuance of Series of Complex Notes to Unidentified Purchasers

[1] Comment--Use of Form

This form is a corporate resolution authorizing the issuance of a series of complex notes to unidentified purchasers. A series of notes is a more complex debt security that the simple note authorized by the resolution in § 6J.200[2]. The loan document is longer than the typical simple note and complete within itself [s*ee* § 6J.232], and the funds ordinarily may be used for general purposes if specific purposes have not been devised by the board of directors. Only the major features of the offering, almost as they would appear in a capsulized title of the series, need to be mentioned in the resolution.

The form in [2], *below*, contains many optional provisions in brackets. Counsel may choose whichever are appropriate for the particular situation. These elaborate documents have more of the appearance of marketable securities, and if they are involved in a private placement, there is more of a danger they will be resold in what amounts to a public distribution, unless tailored to a specific type of investor, such as a credit agreement when the lenders are banks or a note purchase agreement when the lenders are insurance companies [s*ee* Ch. 6H, *Qualification of Securities*, on the nature of public offering]. Therefore, it may be necessary to take precautions to ensure the nonpublic character of the offering by obtaining a written investment representation, placing restrictive legends on the note and issuing stop transfer instructions to the transfer agent, if the company is not acting as its own transfer agent [*see §§ 6J.259, 6H.260*].

For general discussion of the use of directors' resolutions, see Ch. 5, *Directors Meetings, Actions, and Resolutions* . See Ch. 6I, *Issuance of Equity Securities* , for forms relating to the issuance of warrants, issuance of securities subject to selling expenses, and issuance of shares, all of which apply equally to issuance of shares on exchange of warrants or convertible securities.

[2] Form

Resolution Authorizing Issuance of Series of Complex Notes to Unidentified Purchasers

Resolution Authorizing Issuance of Series of Notes

WHEREAS, the Corporation finds it [necessary and] desirable to obtain on a _____[short-term *or* long-term] basis funds to carry on its business;

RESOLVED, that the Corporation issue a series of notes [on a selective, privately arranged basis with the ultimate investors] totaling in the aggregate [no more than] $_____, the individual notes to be in denominations only of $_____[*either a single figure, e.g.,* $5,000 *or a series of figures, e.g.,* $10,000, $5,000, and $1,000], the notes to draw interest at _____ percent per annum [*if bond will be an income bond, add:*, but only to the extent earnings are available for that purpose and up to that figure, on a noncumulative basis], subordinated to senior commercial or institutional lending indebtedness [carrying detachable warrant for _____ shares of the Corporation's common stock,] [convertible into _____ (*type of stock*)] shares of the Corporation on a basis of _____ (*describe basis of convertibility*)], the notes to be _____[unsecured *or* secured by _____ (*describe security*)], and to be redeemable on the basis of _____[*describe basis of redemption, either straight, partial, or total redemption at any time plus accumulated interest, or on a decreasing percentage of principal repayment*], the notes further to be in _____[registered] form [*for a nonserial issue, add:*, with appropriate provision for sinking fund arrangement], with normal warranties of the corporation as to maintenance of ordinary operating procedures, with other covenants restricting the manner in which the company's business is operated, with events of default and provision for accelerated maturity expressed in detail, and the term of the series to be _____ years [*if serial note are to be issued, add:*, with appropriately arranged series of notes within the issue to be retired on a serial basis at progressively remote intervals up to the maximum term].

PRACTICE TIP:

If a term sheet has been negotiated, this resolution can be shortened by referring to an attached term sheet. *Commentary by Frances E. Lossing.*

[*Optional provisions concerning investment representation:*]

RESOLVED, that the above-described series of notes be placed with investors in such a manner as to be entitled to the _____[private exemption provisions *or* intrastate exemption provisions] of the Federal Securities Act of 1933, and that each note itself contain a representation by the purchaser expressly describing his, her, or its intent to participate in the purchase in a manner that will take advantage of and preserve that exemption status for the offering. [Furthermore, all investors should separately sign agreements to the same effect and receive letters negotiating for placement of the debt specifying requirements of the investment representation.]

RESOLVED FURTHER, that the President and Secretary of the Corporation be, and hereby are, authorized and directed to complete, execute, and deliver whatever documents, subscription agreements, certificates, forms, letters, may be necessary to enable the Corporation to offer and to sell the above-described series of notes [in conformity with the requirements of the exemptions to registration described above].



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
A. Resolutions and Notice for Issuance or Redemption of Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.202

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.202 Resolution Authorizing Issuance of Bonds

[1] Comment--Use of Form

This form is a corporate resolution authorizing the issuance of bonds. The resolution assumes a private offering to known individuals or entities [*see, e.g., Corp. Code § 25102(e)*; *10 Cal. Code Reg. § 260.102.2*] and provides that the bond form has been submitted to the board for approval [*see § 6J.233*]. For discussion of some of the private or limited offering exemptions that may apply, see *§ 6J.19[1]* and *[2]*.

For general discussion of the use of directors' resolutions, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* . For a resolution authorizing issuance of debentures and the filing of a registration statement regarding those debentures with the Securities and Exchange Commission, see Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 19, *Corporate Securities* , Form 19.124 (Matthew Bender).

[2] Form

Resolution Authorizing Issuance of Bonds

Resolution Authorizing Issuance of Bonds

WHEREAS, the Corporation has found it necessary and desirable to obtain, on a long-term basis, funds for the purposes of _____[*specify purposes*], and to secure its obligations by mortgage of its property;

RESOLVED, that the Corporation sell to _____[*list names of individual purchasers*] _____[*number of bonds*] bonds of the Corporation, in the form submitted to the board of directors for its review and approval at this meeting, which is attached to this resolution as Exhibit A, for an aggregate sum of [no more than] $_____, the individual bonds to be in denominations of $_____;

RESOLVED FURTHER, that the Corporation execute to _____[*name of trustee*] for the benefit of the purchasers as security for the above-described bonds, a deed of trust, to be in the regular corporate form, encompassing property standing in the name of the Corporation located at _____[*location of property*], the formal and legal description to be included in the deed of trust.

RESOLVED FURTHER, that the officers of the Corporation be, and hereby are, authorized and directed to complete, execute, and deliver the bonds, the deed of trust, and any and all other documents, subscription agreements, certificates, forms, or letters, may be necessary to enable the Corporation to offer and to sell the above-described bonds.



47 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
A. Resolutions and Notice for Issuance or Redemption of Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.203

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.203 Resolution Authorizing Qualification of Debt Securities

[1] Comment--Use of Form

This form is a provision authorizing the qualification of debt securities. It may be incorporated into a resolution authorizing a debt offering when it will be necessary to qualify that offering with the Corporations Commissioner prior to sale.

Generally only public debt issues must be qualified for offer or sale [*Corp. Code § 25102(e)*], although convertible offerings and warrants packaged with debt must be qualified on first distributions as offers or sales of the underlying securities unless an exemption is available [*Corp. Code § 25017(e)*; *see § 6J.19[3]*]. The problem of determining whether a particular issue is truly a private placement, or will remain so for a sufficient period of time during distribution, may be difficult. Sometimes, it is better to qualify the issue rather than take the risk that a purportedly private offering will turn out to have been a public one. Because the appropriate application for qualification [*see* Ch. 6H, *Qualification of Securities*] states that the signer has been authorized by the corporation to submit it, the board should formally resolve that the qualification be authorized. It is not necessary in actuality to act on the resolution once it is passed if circumstances permit or dictate otherwise.

For general discussion of the use of directors' resolutions, see Ch. 5, *Directors Meetings, Actions, and Resolutions* .

[2] Form

Resolution Authorizing Qualification of Debt Securities

Provision Authorizing Qualification of Debt Securities

RESOLVED FURTHER, that any officer of the Corporation is authorized [and directed] to have the above-described offering of _____[*specify type of security, e.g.*, notes] properly qualified before the California

Commissioner of Corporations and to cause to be prepared, to execute, verify, and file, for and on behalf of the Corporation, an application for qualification (including any exhibits, supplements, and amendments thereto) necessary to render that qualification fully effective.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
A. Resolutions and Notice for Issuance or Redemption of Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.204

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.204 Resolution for Redemption of Outstanding Notes

[1] Comment--Use of Form

This form specifies that notes are being redeemed, but it can be modified to redeem bonds or debentures. See *§ 6J.205* for a notice of redemption to succeed this resolution.

Although it is often to an issuer's advantage to let long term debt securities remain outstanding until their maturity, to have the use of investors' funds for the longest period of time, there are situations that make redemption desirable. It may be advantageous to retire debt before maturity because money is easier to raise at a particular time than in the foreseeable future, because prospective investors of a contemplated new issue want the prior financing retired, or covenants in the loan documents unduly restrict the company's operations. Redemption may be required by the terms of the debt instrument. In either case, the issuer's board of directors should set a definite date for redemption, one beyond which interest will cease to accrue, but before which any conversion privilege may be exercised.

For general discussion of the use of directors' resolutions, see Ch. 5, *Directors Meetings, Actions, and Resolutions* .

[2] Form

Resolution for Redemption of Outstanding Notes

Resolution for Redemption of Outstanding Notes

[*Optional*]

WHEREAS, the Corporation has determined it is [necessary and] desirable to retire _____[the entire *or* a portion of the] issue of notes scheduled to be due on _____[*date*], known as the

_____[*e.g.*, 10 Percent 15-Year] Notes[, because _____];

RESOLVED, that the Corporation redeem _____[all *or* _____ (*specify part in percentage or face amount, e.g.*, $200,000 of principal amount) *or* _____ (*specify part according to any formula provided in the notes, e.g.*, the Notes represented by certificate Nos. 101-199)] of the issue of Notes scheduled to be due _____[*date*], known as the _____[*e.g.*, 10 Percent 15-Year] Notes [*specify hour if desired, e.g.*, at 2:00 P.M.] on _____[*date for redemption*], by paying out on the surrender of each Note, properly endorsed or accompanied by proper assignment, the amount of principal then outstanding, plus all accrued interest that may be due and owing, according to the terms and conditions contained in those Notes. Redemption shall take place at the office of the Corporation at _____[*address*]. If any holder of a Note [called for redemption] fails to surrender his or her Note on the redemption date, interest will cease to accrue on the principal amount owing on that Note and that holder will not be entitled to receive any further interest except that which accrued to the redemption date.

[*If notes are registered notes:*]

RESOLVED FURTHER, that the Secretary of the Corporation is directed to give appropriate written notice to all registered holders of the Notes [so selected to be redeemed], specifying how and when the notes are to be returned to the [transfer agent of the] corporation.

[*Or, if notes are in bearer form:*]

RESOLVED FURTHER, that the Secretary is directed to publish an appropriate notice of redemption in one or more newspapers of general circulation in _____[*county where principal executive office of corporation is located*] County, to be published on or about _____[*date, at least 20 and no more than 60 days before redemption date selected above*], and to be published once a week for _____[*at least two*] succeeding weeks afterward, informing all holders of the above Notes to be redeemed of the redemption date, and of how and when the notes should be returned to the _____[Corporation *or* transfer agent]. [*Modify as necessary to conform to terms of debt security*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
A. Resolutions and Notice for Issuance or Redemption of Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.205

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.205 Notice of Redemption

[1] Comment--Use of Form

This form is a notice stating that notes issued by a corporation are being redeemed. The form can be modified to give notice of redemption of bonds or debentures.

Debt holders need to be notified, according to the terms of their debt instrument, in advance of the date selected for redemption, so they can arrange to return the security instrument to the corporation or its appointed agent, and receive payment. Only a letter need be sent to registered holders, preferably by registered mail, at their last known addresses as reflected on the books of the corporation.

In either event, the notice should clearly state that the corporation is redeeming a particularly described series, or partially redeeming a series by only retiring a specially described set within a series or particular numbers. The notice should specify where the security instruments should be returned, and whether to the corporation or its transfer agent. Registered notes must be properly endorsed or accompanied by proper assignment. For a notice of redemption of debentures, see Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 19, *Corporate Securities* , Form 19.60 (Matthew Bender).

[2] Form

Notice of Redemption

NOTICE OF REDEMPTION

_____[*date*]

TO: All _____[registered] holders of the _____[*type, e.g.,* 10-Percent 15-Year] Notes

of the _____ Corporation, due _____[*date*];.

The _____ Corporation hereby gives notice that, according to resolution dated _____[*date*], it has elected to redeem _____[all *or* part] of the Notes of its _____[*type, e.g.,* 10-Percent 15-Year] series due _____[*date*]. [*If partial redemption, state:* The series (*or* the number) of the notes to be redeemed is as follows: _____; *if by selection process, add:* by a process of selection according to the terms and provisions of the note.]

The Notes will be redeemed on _____[*date for redemption*], at the office of the _____[Corporation *or name of transfer agent*] at _____[*address*], at which office payment will be made of the amounts due, as follows: _____[full repayment of principal together with all accrued interest *or* agreed-on amount of principal *or* agreed-on percentage of stated principal in the amount of $_____].

The Notes must be presented at the above-listed address before the close of business on the redemption date and surrendered [*if registered notes are involved, add:*, properly endorsed or accompanied by proper assignment].

_____ Corporation
By _____ [*signature*]
[*typed name*], Secretary



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
A. Resolutions and Notice for Issuance or Redemption of Debt Securities

3-6J California Legal Forms--Transaction Guide §§ 6J.206-6J.219

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6J.206[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
B. Purchase Agreements, Offers, and Representations

3-6J California Legal Forms--Transaction Guide § 6J.220

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.220 Letter Soliciting Subscription Agreements for Offering of Notes to Present Shareholders of California Corporation Under Private Offering Exemption of Federal Securities Act

[1] Comment

[a] Use of Form

This form is a letter from a California corporation to its shareholders soliciting subscription agreements for an offering of notes under the private offering exemption of the Federal Securities Act of 1933. By sending this type of letter, the directors of the corporation are attempting to do three things:

- Obtain subscriptions to new promissory notes from present shareholders of the corporation who are also holders of previously issued convertible notes;

- Obtain the consent of the holders of the previously issued notes to the issuance of the new notes; and

- Bring the sale of the new notes under the "private offering exemption" of the Federal Securities Act of 1933 [Securities Act of 1933, § 4(2); *15 U.S.C. § 77d(2)*], which is discussed in *§§ 6J.223[1]* and *6J.260[1]*.

Although the preemptive right of a shareholder to subscribe for future securities issued by a corporation has been abolished by statute in California unless expressly provided for in the corporation's articles of incorporation [*Corp. Code § 406*], a corporation may find it desirable to grant such a preemptive right to existing shareholders when the corporation seeks to issue new debt securities. In the case of an offering such as the one contemplated in this form, the corporation typically may wish to grant existing shareholders a preemptive right so that the following will ensue:

- The entire proceeds from the sale of the new notes may be "netted"; in other words, paid to the corporation without deduction of a broker's selling commission; and

- The shareholders, who are also the holders of previously issued notes, may be induced to consent to issuance of the new notes. The requirement that the holders of previously issued notes consent to the corporation incurring the debt to be evidenced by the new notes would appear in the "purchase agreement" made between the corporation and the holders of the previously issued notes when those notes were issued.

[b] Exemption From Qualification

If the sale of the new notes qualifies under the private offering exemption of the Federal Securities Act of 1933, they will not have to be registered with the Federal Securities and Exchange Commission [*15 U.S.C. § 77d(2)*]. In that case, the issuer also may avoid the necessity of appointing a trustee and executing a trust indenture for the notes as required by the Federal Trust Indenture Act of 1939 [*15 U.S.C. §§ 77aaa et seq.*].

However, the California Corporations Commissioner may require similar protections [*10 Cal. Code Reg. §§ 260.140.4*, *260.140.5*]. The proposed notes constitute a security as defined in *Corp. Code § 25019*, as do subscriptions. Thus, both will require qualification by the Commissioner of Corporations [*Corp. Code § 25110*] unless an exemption applies. Because the securities are not yet authorized by the prior note holders and cannot as yet be issued, the corporation may need to obtain a negotiating permit [*Corp. Code § 25102(c)*] from the Commissioner for the taking of subscriptions. See Ch. 6H, *Qualification of Securities* , for discussion of negotiating (issuer) permits, whether such a permit will be necessary, and how it operates.

If the offering is made to not more than 35 persons, it will be exempt from any need to qualify or obtain a negotiating permit for the subscriptions [*Corp. Code § 25102(a)*; *10 Cal. Code Reg. 260.102.1(a)*]. If the offering or subscriptions are not exempt, the solicitation must contain special language required by *Corp. Code § 25102(a)* [*see* [2], first alternative Paragraph 8, *below*]. If the Commissioner of Corporations does not impose a legend condition by virtue of the lack of a full-fledged trust indenture or evidence of financial instability, the corporation can request one to further insure the private nature of the offering [*10 Cal. Code Reg. § 260.141.10*].

For typical restrictions on transferability of securities being sold under the private offering exemption of the Securities Act of 1933, see *§§ 6J.223[2]* and *6J.260[2]*.

[2] Form

Letter Soliciting Subscription Agreements for Offering of Notes to Present Shareholders of California Corporation Under Private Offering Exemption of Federal Securities Act

_____[*Name of corporation*]
_____[*address of principal office*]

_____[*date*]

RE: Issuance of _____[*year notes are due*] Promissory Notes

Dear Shareholder:

Proposal to Issue Notes

1. On the terms and subject to the conditions of this letter, _____[*name of corporation*],

(Corporation) proposes to issue and sell $_____ principal amount of its _____ percent _____[*type of note, e.g.*, 15-Year Unsecured] Promissory Notes due _____[*date*] (referred to in this letter as the "_____[*year notes are due*] Notes"). The sale of any _____[*year notes are due*] Notes is conditioned on the sale of all _____[*year notes are due*] Notes.

Preemptive Right to Subscribe

2. The holders of _____[*e.g.*, Series A common] stock of the Corporation are entitled to subscribe for and purchase $_____ principal amount of _____[*year notes are due*] Notes for each _____[*number*] shares of _____[*e.g.*, Series A common] stock owned by them. Your preemptive entitlement is therefore $_____ principal amount of _____[*year notes are due*] Notes. You may purchase all or any part of your entitlement. Please indicate the amount of your desired subscription on the enclosed ballot and subscription form. Your preemptive right is not assignable but may be exercised by your personal representative in the event of your death.

Sale of Unsubscribed Notes

3. The Corporation will place all _____[*year notes are due*] Notes not subscribed for by shareholders pursuant to their preemptive rights described in Paragraph 2 of this letter with persons, firms, or corporations selected by the Board of Directors. Those persons, firms, or corporations may include present holders of the Corporation's _____[*year previously issued notes are due*] Notes. If you wish to subscribe for more than your preemptive entitlement, please indicate the amount of your desired oversubscription on the enclosed ballot and subscription form.

Summary of Terms of New Notes

4. The terms of the proposed _____[*year notes are due*] Notes may be summarized as follows:

(a) Maturity date: _____.

(b) Interest rate: _____ percent per annum payable _____[*e.g.*, semiannually on the first days of April and October of each year commencing _____ (April 1 *or* October 1), _____ (*year*)].

(c) Prepayment: The _____[*year notes are due*] Notes will be prepayable in _____[*e.g.*, any amount selected by the Corporation, *or* in multiples of $500]. [*Specify any prepayment penalty*].

(d) Net working capital maintenance covenant: From and after _____[*date*], the Corporation will maintain net working capital at, or in excess of, $_____.

(e) Other terms: The other terms of the _____[*year notes are due*] Notes will be substantially the same as the terms of the _____[*year previously issued notes are due*] Notes, [some of which you hold,] with the following exceptions: _____[*set forth exceptions, e.g.*]

(1) Paragraph _____ as included in the _____ [*year notes are due*] Notes will be modified to reflect the Corporation's present address of _____ Street, _____, California.

(2) _____ [*State any other exceptions*].

Restrictions on Transferability

5. The restrictions on transferability of the _____[*year previously issued notes are due*] Notes contained in Paragraph _____ of the Purchase Agreement governing those Notes shall also be applicable to the _____[*year notes are due*] Notes. As in the case of the _____[*year previously issued notes are due*] Notes, the California Commissioner of Corporations will require the _____[*year notes are due*] Notes to be subject to legend condition. The restrictions on the transferability of those Notes are required to assure that the proposed sale of the notes qualifies for the private offering exemption of the Securities Act of 1933.

Approval of Holders of Old Notes Required

6. For the Corporation to create, issue, and sell the _____[*year notes are due*] Notes, holders of _____ percent in principal amount of the _____[*year previously issued notes are due*] Notes must approve the creation by the Corporation of the debt to be evidenced by the _____[*year new notes are due*] Notes. Therefore, we request you please sign and return the enclosed ballot and subscription form whether or not you elect to purchase _____[*year new notes are due*] Notes.

Warranties by Corporation and Purchaser

7. The Corporation warrants that the character of the offering of the _____[*year notes are due*] Notes is as described in Paragraph _____ of the Purchase Agreement governing the _____[*year previously issued notes are due*] Notes. By your acceptance of this offer, you make the same representations and warranties to the Corporation with respect to the _____[*year new notes are due*] Notes to be purchased by you as are contained in Paragraph _____ of the Purchase Agreement and were made by you upon your purchase of _____[*year previously issued notes are due*] Notes.

[*EITHER*]

Compliance With Negotiating Permit or Qualification

8. The _____[offer *or* sale] of _____[*year new notes are due*] Notes contained in this letter is made pursuant to a _____[negotiating permit *or* qualification] dated effective _____[*date*], as procured through the California Commissioner of Corporations. That _____[permit *or* qualification] requires the following statements to be contained in this letter and brought to your attention: _____.

The purchases and sales contemplated by this letter cannot be consummated and no consideration for any purchase or sale can be accepted by the Corporation until the Corporation receives from the California Commissioner of Corporations a definitive form of qualification as required by *California Corporations Code Section 25110*, authorizing it to issue and sell the _____[*year new notes are due*] Notes.

[*Or, for an exempt private offering:*]

Qualification or Exemption Required

8. The sale of the Notes that are the subject of this Agreement has not been qualified with the Commissioner of

Corporations of the State of California and unless the sale of the Notes is exempt from qualification, the issuance of those Notes or the payment or receipt of any part of the consideration therefor prior to qualification is unlawful. The rights of all parties to this Agreement are expressly conditioned on qualification, or an exemption from the need for qualification, being obtained.

[*Continue with the following:*]

Time of Closing

9. The time of closing of the purchases and sales contemplated by this letter will be fixed by the Corporation and will be on a date not more than _____ days from the date of this letter. At least _____ days prior to the closing date, the Corporation will notify you if you have elected to purchase _____[*year new notes are due*] Notes of the time, place, and details respecting the closing of those purchases and sales. Please send no money to the Corporation until you have received a notice of closing.

Acceptance of Preemptive Offer

10. The preemptive offer contained in this letter will remain open until 5:00 P.M. _____[*specify*, Pacific Standard Time] time on _____[*date*]. To accept the offer contained in this letter, you must sign the enclosed ballot and subscription form and return it to the Corporation at _____[*street address*], _____[*city*], California, in sufficient time for it to be received by the Corporation prior to said 5:00 P.M. on _____[*date*]. Send no money at this time. A stamped envelope addressed to the Corporation is enclosed for your convenience.

Instructions for Accepting Offer

If you wish to subscribe for _____[*year new notes are due*] Notes, please write in the spaces provided on the enclosed ballot and subscription form, in dollar amounts, the amount of your preemptive share for which you wish to subscribe and the amount, if any, of any desired oversubscription.

AGAIN, PLEASE SIGN AND RETURN THE ENCLOSED BALLOT AND SUBSCRIPTION FORM WHETHER OR NOT YOU WISH TO PURCHASE ANY _____[*year new notes are due*] NOTES. By so doing, you will make it possible for the Corporation to fulfill the requirements for issuance of those Notes and thereby to obtain financing which is essential to the progress of its operations.

Sincerely, _____ [*name of corporation*]
_____ [*signature of officer*]
[*typed name and title*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
B. Purchase Agreements, Offers, and Representations

3-6J California Legal Forms--Transaction Guide § 6J.221

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.221 Ballot and Subscription Agreement Consenting to and Subscribing for Notes to Be Issued by California Corporation--Form Enclosed in Solicitation Letter Sent to Present Shareholders and Owners of Prior Notes of Corporation

[1] Comment

[a] Use of Form

This form is a ballot and subscription agreement designed for inclusion with the letter *form in § 6J.220[2]* when that letter is sent to shareholders of the corporation or owners of prior notes issued by the corporation. A self-addressed, stamped envelope should be enclosed with the solicitation letter so that all the shareholder or note owner has to do is sign this form and deposit it in the nearest mail box. As indicated in both Paragraph 6 and the final paragraph of the *form in § 6J.220[2]*, the signature of the shareholder or note owner on this form, whether he or she subscribes for the new notes or not, constitutes his or her consent to the issuance of the new notes.

[b] When Consent to Issuance Is Required of Present Shareholders or Owners of Prior Indebtedness of the Corporation

If the subscriber owns previously issued securities that require his or her consent to issuance of the proposed new notes and the previously issued securities are federally registered for trading purposes, the Federal Securities Exchange Act of 1934, Section 14(a) [*15 U.S.C. § 78n(a)*] and regulations of the Securities and Exchange Commission [*see* SEC Rule 14a-4(b)(1); *17 C.F.R. § 240.14a-4(b)(1)*] will probably require that space be provided on the ballot part of this form for the subscriber to vote for or against issuance of the proposed note. The appropriate alternative Paragraph 1 of this form should be used in such a case.

[2] Form

Ballot and Subscription Agreement Consenting to and Subscribing for Notes to Be Issued by California

Corporation--Form Enclosed in Solicitation Letter Sent to Present Shareholders and Owners of Prior Notes of Corporation

BALLOT AND SUBSCRIPTION FORM

Address

TO: _____[*Name of corporation*]
_____[*address*]

Preamble

In response to your letter "RE: Issuance of _____[*year notes will be due*] Promissory Notes" dated _____[*date*], I declare:

Approval of Debt

1. I approve of the creation by _____[*name of corporation*], herein called "the Corporation," of an indebtedness in the principal amount of $_____ to be evidenced by the _____ percent _____[*type of notes, e.g.,* 15-year Unsecured] Promissory Notes due _____[*date*], _____, herein called "_____[*year notes will be due*] Notes" described in the letter mentioned above.

[*Or, use following if required; may be required if corporation's securities are registered on a national securities exchange (see 15 U.S.C. § 78n(a); SEC Rule 14(a)-4(b)(1); 17 C.F.R. § 240.14a-4(b)(1)):*]

1. The creation by _____[*name of corporation*], herein called "the Corporation," of an indebtedness in the principal amount of $_____ to be evidenced by the _____ percent _____[*type of notes, e.g.,* 15-Year Unsecured] Promissory Notes due _____[*date*], herein called "_____[*year notes will be due*] Notes," described in said letter is hereby

_____ Approved by me

_____ Not Approved by me

[*Continue with the following:*]

Subscription Under Preemptive Entitlement

2. Pursuant to the terms and conditions stated in your letter, I hereby exercise my preemptive right and pursuant to my preemptive entitlement as set forth in Paragraph _____ of your letter subscribe for $_____ (if you do not wish to subscribe, write word "none") principal amount of _____[*year notes will be due*] Notes.

Oversubscription

3. Pursuant to the terms and conditions stated in your letter, I further subscribe for $_____ (if you do not wish to subscribe for more than your preemptive entitlement write word "none") principal amount of _____[*year notes will be due*] Notes over and above my preemptive entitlement set forth in Paragraph _____ of your letter.

Declaration of Stock and Note Ownership

4. I am the owner of _____ shares of _____[*e.g.*, Series A common] stock of the Corporation and the holder of $_____ principal amount of _____[*year previously issued notes are due*] Notes.

Date and Signature

_____ Dated:

_____ [*signature of subscriber*]
_____ [*address*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
B. Purchase Agreements, Offers, and Representations

3-6J California Legal Forms--Transaction Guide § 6J.222

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.222 Notice of Closing Date of Private Subscription for Notes

[1] Comment--Use of Form

This letter is designed to announce the closing date for a private offering of notes initiated by the solicitation letter in § 6J.220[2], "Letter Soliciting Subscription Agreements for Offering of Notes to Present Shareholders of California Corporation."

[2] Form

Notice of Closing Date of Private Subscription for Notes

NOTICE OF CLOSING DATE

[*Letterhead of corporation*]

_____[*date*]

_____[*Name of subscriber*]
_____[*address*]

RE: Issuance of _____[*year notes will be* due] Promissory Notes

Dear _____[*name of subscriber*]:

Preamble

As you were advised in my letter dated _____[*date*], "RE: Issuance of _____[*year notes will be due*] Promissory Notes," _____[*name of corporation*], herein called "Corporation," is selling to you $_____ principal amount of its _____ percent _____[*type of notes, e.g.,* 15-Year Unsecured] Promissory Notes due _____[*date*], herein called "_____[*year notes will be due*] Notes," in accordance with the terms and conditions set forth in that letter. A specimen copy of a _____[*year notes will be due*] Note is enclosed.

Closing Date and Instructions

The closing of the sale of the _____[*year notes will be due*] Notes will take place on _____[*day of the week, e.g.,* Wednesday], _____[*date*], or on any subsequent date not later than _____[*date*], to which the Corporation may from time to time postpone the closing, at the principal offices of _____[*name of bank or financial institution*], herein called the "Bank," at _____ Street, _____, California. You should send a certified or official bank check in the amount of the purchase price of the Notes being purchased by you, to wit the sum of $_____, payable to _____[*name of corporation*], to _____[*name of bank*], Corporate Trust Department, _____ Street, _____, California, Attention: _____[*name*]. That check must reach the Bank prior to the closing date of _____[*date*]. An envelope properly addressed to the Bank is enclosed for your convenience. It is suggested you send your check to the Bank by registered mail, return receipt requested.

Delivery of Note

The _____[*year notes will be due*] Note sold to you will be delivered by the Corporation to you at the time of closing by return mail or at the most reasonable and earliest opportunity and will be transmitted to you.

Representations and Warranties

By acceptance of the offer contained in my letter dated _____ "RE: Issuance of _____[*year notes will be due*] Notes," you and the Corporation made, and, by the purchase and sale of _____[*year notes will be due*] Notes as described above, you and the Corporation make, the same representations and warranties with regard to the _____[*year notes will be due*] Notes as are contained in Paragraphs _____ and _____ of the "Purchase Agreement" dated _____, covering the _____[*prior issue*] Notes. You will note that those representations and warranties have been incorporated by reference in the new _____[*year notes will be due*] Notes.

Sincerely, _____ [*signature of officer*]
[*typed name and title*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
B. Purchase Agreements, Offers, and Representations

3-6J California Legal Forms--Transaction Guide § 6J.223

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.223 Purchase Agreement for Private Offering of Notes

[1] Comment

[a] Use of Form

This form is a sample purchase agreement for a private offering of notes. Before purchasing an unsecured obligation, purchasers want not only assurance that the corporate issuer is presently in a sound financial condition, but also assurance that it will remain in a sound financial condition and be capable of paying the obligations when they mature. Further, if the corporation is attempting to issue its securities under the private offering exemption of the Federal Securities Act of 1933 [*15 U.S.C. § 77d(2)*] or the intrastate exemption to that Act [*15 U.S.C. § 77c(a)(11)*; *see* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*], the corporation itself will want assurances from the original purchasers of its securities that they are not purchasing the securities for resale and will not attempt to resell the securities in a manner that will destroy the securities' private offering or intrastate exemption under the Federal Securities Act. Thus, it is customary for the corporation to execute a "purchase agreement" with each original purchaser of unsecured securities.

The agreement in [2], *below*, is in the form of a letter from the issuer to the purchaser with a place for the purchaser to accept and execute the agreement. A subscription agreement can also take the form of a letter from the purchaser to the issuer. For such a subscription agreement (in the context of the purchase of equity securities), including more extensive representations by the purchaser and representations to allow the offering to qualify for exemptions based on the purchaser's wealth and sophistication, see Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 19, *Corporate Securities* , Form 19.114 (Matthew Bender).

This form is designed as a purchase agreement for the promissory notes described in § 6J.232[2]. The purchase agreements signed with each purchaser of a particular issue of securities are usually identical, prepared in letter form, and incorporated by reference in the note or other evidence of the unsecured obligation. The provisions of this form, including those governing subordination, redemption, conversion, and the separate elements of the covenants of the

corporation, are optional [*see generally, §§ 6J.232[2], 6J.250* et seq.]; those elements that will actually be terms of the notes should be noted in the subscription agreement.

[b] Subscription Is Security

A subscription agreement is itself a security, and may have to be qualified if not otherwise exempt [*Corp. Code § 25019*; *see* Ch. 6H, *Qualification of Securities*]. A subscription agreement is exempt from qualification as a nonpublic offering [*Corp. Code § 25102(a)*] if it is not made to more than 35 people [*10 Cal. Code Reg. § 260.102.1(a)*].

[c] Copies

Two copies of the purchase agreement are delivered to each subscriber just prior to the time set for the consummation or "closing" of the purchase and sale of the securities. The subscriber retains one copy, signed by the corporation, of the purchase agreement delivered to that purchaser, signs the acceptance form at the bottom of the second copy, and returns that second signed copy to the corporation.

[2] Form

Purchase Agreement for Private Offering of Notes

Purchase Agreement--Private Offering of Notes

PURCHASE AGREEMENT

_____ [*Name of corporation*]
_____ [*address of corporation*]

_____[*date*]

_____[*Name of purchaser*]
_____[*address of purchaser*]

Dear _____[*name of purchaser*]:

The undersigned, _____[*name of corporation*], herein called the "Corporation," agrees with you _____[*name of purchaser*] herein called the "Purchaser," as follows.

Authorization to Issue Notes

1. The Corporation has authorized the issuance of $_____ aggregate principal amount of its _____ percent _____[*type of notes, e.g.,* 15-Year Unsecured] Promissory Notes to mature _____[*date*], and to be substantially in the form attached to this letter as Exhibit A. The term "Notes" as used in this letter shall include each Promissory Note delivered pursuant to the provisions of Paragraph 2 of any of the Agreements defined in Paragraph 2 of this letter, and each Promissory Note delivered in substitution for any Note pursuant to any of the Agreements, and if applicable, shall include the singular number as well as the plural. The term "Note" shall mean one of the Notes.

Sale and Purchase of Notes

2. The Corporation hereby agrees to sell to Purchaser and, subject to the terms and conditions herein set forth, Purchaser agrees to purchase from the Corporation a principal amount of Notes equal to the amount set forth opposite your name in Exhibit B attached to this letter, at _____[percent of the principal amount thereof *or* the price set forth opposite your name in Exhibit B]. Substantially simultaneously with the execution and delivery of this Agreement, the Corporation is entering into Agreements with _____[*number*] other purchasers named in Exhibit B, herein called "Other Purchasers," substantially identical with this Agreement in all respects except as to the identity of the purchaser and the amount to be purchased. The aggregate principal amount of Notes to be purchased pursuant to this Agreement and the Agreements with the Other Purchasers is $_____, but the purchase by each purchaser is a separate and several purchase. This Agreement and the Agreements with other purchasers are referred to herein collectively as the "Agreements."

Closing

3. The closing of the sale and purchase of the Notes to be purchased by Purchaser, herein called the "closing," shall take place at the office of _____[*name of bank or broker*], herein called the _____["Bank" *or* "Broker"], at _____ Street, _____, California, at _____[*time*] on _____[*date*], or at any subsequent time and date, not later than 5:00 P.M., _____[*date*], to which the Corporation may from time to time postpone the closing. Should the Corporation postpone the closing as herein authorized, it will immediately notify Purchaser by telephone or telegraph of the postponement and shall notify Purchaser by telephone, telegraph, or mail, at least _____[*e.g., 48*] hours prior thereto, of the new time and date fixed for closing. At the closing Purchaser shall deliver to the Corporation a certified check or official bank check, payable to the Corporation, in the amount of the purchase price to be paid by Purchaser for the Notes being purchased by Purchaser, and the Notes being purchased by Purchaser shall be delivered by the Corporation to Purchaser by return mail or as soon thereafter as reasonably possible.

Warranties by Corporation

4. The Corporation represents and warrants:

Duly Organized and Existing Corporation

(a) It is a Corporation duly organized and existing under the laws of the State of California, has all the requisite corporate powers to carry on its business as conducted and as proposed to be conducted, and has power to enter this Agreement and to issue the Notes contemplated by this Agreement.

Qualified to Do Business

(b) It is duly qualified to transact business and in good standing in each jurisdiction in which the nature of the business transacted by the Corporation makes qualification necessary.

Information Memorandum Furnished Purchaser

(c) It has previously delivered to Purchaser, or will on request deliver to Purchaser, a memorandum containing, among other things, a description of the activities proposed to be conducted by the Corporation, a statement of its capital requirements, a statement of its financing, and a statement of its financial goals. The materials and statements contained in that memorandum are, in the opinion of the Corporation's Board of Directors and officers, true, accurate, soundly based, and reasonable.

Liens and Encumbrances

(d) The Corporation has good and marketable title to its properties and assets subject to no lien, mortgage, pledge,

encumbrance, or charge of any kind except liens for taxes not yet due and payable or which are being contested in good faith by appropriate proceedings [; other liens, charges, and encumbrances incidental to the conduct of the Corporation's business, or the business of a subsidiary of the corporation, or the ownership of its property and assets which were not incurred in connection with the borrowing of money or the obtaining of advances or credit, and which do not in the aggregate materially detract from the value of its property or assets or materially impair the use thereof in the operation of its business; and mortgages or other liens on property or assets of a subsidiary of the Corporation to secure obligations of the subsidiary to the Corporation or to another subsidiary].

Litigation

(e) There is no litigation, action, or proceeding pending or, to the knowledge of the Corporation, threatened against the Corporation before any court or administrative agency which might result in any material adverse change in the business or condition of the Corporation or substantially affect its ability to pay the Notes.

No Other Restrictions

(f) The Corporation is not a party to any contract or agreement or subject to any charges or other corporate restriction that will materially and adversely affect its business, property, assets, or financial condition. Neither the execution nor delivery of the Agreements, nor of the Notes, nor the performance of and compliance with the terms, provisions, and conditions of those instruments will conflict with, or result in a breach of, any of the terms, provisions, or conditions of any charter, bylaw, mortgage, indenture, lease, instrument, franchise, permit, judgment, decree, order, statute, rule, regulation, or lawfully enforceable contract or agreement applicable to the Corporation.

Taxes

(g) All tax returns and reports of the Corporation required by law to be filed have been duly filed, and all taxes, assessments, fees and other governmental charges on the Corporation or any of its properties, assets, income, or franchises that are due and payable have been paid [except those listed on an inventory attached to this letter as Exhibit C, which are being contested in good faith by appropriate proceedings].

Governmental Consent

(h) All consents, approvals, and authorizations of, or registrations, declarations, or filings with, any governmental or public body or authority required in connection with the valid execution, delivery, and performance of the Agreements, or in connection with any of the transactions incident to the sale of the Notes have been procured or performed by the Corporation.

Offering of Securities

(i) Neither the Corporation nor anyone acting on its behalf has, directly or indirectly, offered any of the Notes, or any similar securities, for sale to, or solicited any offers to buy any thereof, from, or otherwise negotiated with respect thereto, with any person or persons in any manner as to require the securities to be registered under the provisions of the Federal Securities Act of 1933 as amended.

Agreement Authorized

(j) This Agreement has been duly authorized by all necessary corporate action and has been duly executed by authorized officers of the Corporation. On being duly executed by Purchaser, this Agreement is valid and binding on the Corporation, enforceable against the Corporation in accordance with its terms. The Note to be issued to Purchaser in accordance with the terms of this Agreement will be, on Purchaser's due payment therefor, validly issued and fully paid.

Conditions Precedent

5. Purchaser's agreement to purchase and pay for the Note to be issued to Purchaser pursuant to the terms of this Agreement is subject to the fulfillment, to Purchaser's reasonable satisfaction, prior to or at the closing of the following conditions:

Opinion of Counsel

PRACTICE TIP:

Both the American Bar Association (ABA) and the California Bar Association have published guidance on a variety of legal opinion issues. Although the Silverado Accord proposed by the ABA in 1991 has not been widely used, the ABA Accord publications nevertheless provide useful guidance for counsel in negotiating legal opinions. *Commentary by Frances E. Lossing.*

(a) The delivery to Purchaser by _____[*name of attorneys*], counsel for the Corporation, of their written opinion, dated the date of closing, satisfactory to Purchaser as to

(1) The due organization and existence of the Corporation.

(2) The qualification of the Corporation to transact business in each jurisdiction in which the nature of the business transacted by it makes qualification necessary, naming those jurisdictions.

(3) The fact that this Agreement has been duly authorized by all necessary corporate action on the part of the Corporation, has been duly executed and delivered by duly authorized officers of the Corporation, and constitutes a valid and legally binding obligation of the Corporation, enforceable against the corporation in accordance with its terms.

(4) The fact that the Note has been duly authorized by all necessary corporate action on the part of the Corporation, the Note has been duly executed and delivered by duly authorized officers of the Corporation, that on due payment therefor by Purchaser it will be validly issued as fully paid and will be enforceable against the corporation in accordance with its terms except as enforcement may be limited by bankruptcy, insolvency, and other similar laws affecting the enforcement of creditor's rights.

(5) The offering, issue, sale, and delivery of the Notes, under the circumstances contemplated by this Agreement, constitutes a transaction exempt from qualification under the California Corporate Securities Law.

(6) The offering, issue, sale, and delivery of the Notes, under the circumstances contemplated by this Agreement, constitutes an exempt transaction under the Federal Securities Act of 1933, as amended, and the regulations adopted by the Securities and Exchange Commission pursuant thereto, and the fact that it is not necessary to register the Notes under that Act or regulations.

(7) The absence, so far as known to counsel, of any litigation, action, proceeding, or investigation, pending or threatened, that might result in any materially adverse change in the business, prospects, or condition, financial or otherwise, of the Corporation or any of its properties or assets, or that questions the validity of the issuance of the Notes, or that might substantially affect the Corporation's ability to pay the Notes or perform the provisions of this Agreement to be performed by it.

(8) The execution and delivery of this Agreement and the issuance and sale of the Notes not conflicting with or resulting in any violation or default under, or resulting in the creation of any lien pursuant to, the terms or provisions of any charter or bylaw of the Corporation, or of any agreement or instrument, or of any judgment, decree, or order, known to counsel to which the Corporation is a party.

(9) Any other matters incident to the transactions contemplated by this Agreement as Purchaser or Purchaser's counsel may reasonably request.

It is understood that counsel may, in rendering his or her opinion, rely on public records, certificates of public officials, and certificates of any officers of the Corporation as to factual matters not disclosed by the public records.

Warranties and Performance by Corporation

(b) The representations and warranties of the Corporation contained in this Agreement shall be true on and as of the time of closing, except to the extent of changes caused by the transactions herein contemplated, and the Corporation shall have performed and complied with all agreements and conditions contained in this Agreement required to be performed or complied with by it prior to or at the closing. Further the Corporation shall deliver to Purchaser at the closing a certificate dated the date of the closing, signed by its President or Vice President and by its Secretary, certifying in detail reasonably satisfactory to Purchaser that the Corporation has performed or complied with all representations and warranties are true and that all agreements and conditions.

Sale of All Notes

(c) The Corporation shall simultaneously sell to the other purchasers, and shall simultaneously receive payment for, a principal amount of Notes which when added to the principal amount of Notes to be purchased by Purchaser at the closing shall total $_____[*amount of notes to be issued*].

Proceeding and Documents

(d) All proceedings to be taken in connection with the transactions contemplated by this Agreement and all documents incidental thereto shall be satisfactory in form and substance to Purchaser and Purchase's counsel, and Purchaser shall have received copies of all documents or other evidence as Purchaser may reasonably request in order to establish the consummation of these transactions and the taking of all corporate proceedings in connection therewith, in form, as to certification and otherwise, in form and substance satisfactory to Purchaser and Purchaser's counsel.

Miscellaneous Agreements by Corporation

6. The Corporation agrees that so long as the Notes, or any of them, remain outstanding and until full and final payment of all indebtedness incurred under this Agreement or the Notes, it will

Proceeds of Notes

(a) Use the proceeds of the Notes for working capital and other [short-term] general corporate purposes.

Pay Notes

(b) Pay the Notes in accordance with their terms.

Maintain Current Assets

(c) Maintain current assets in an amount at least equal to _____[*number, e.g.,* two] times current liabilities and for the first _____[*number, e.g.,* two] years following the date of this Agreement, or not less than $_____ in excess thereof, and thereafter not less than $_____ in excess thereof; current assets and current liabilities to be determined in accordance with generally accepted accounting principles and practices consistently followed.

Maintain Net Worth

(d) Maintain net worth, determined in accordance with generally accepted accounting principles and practices consistently followed, of not less than $_____ and a ratio of total debt similarly determined to net worth of not more than _____[*number, e.g.,* 3.5] to _____[*number, e.g.,* 1].

Maintain Corporate Assets

(e) Maintain and preserve its corporate existence and all rights, privileges, and franchises now enjoyed, conduct its business in an orderly, efficient, and customary manner, keep all its properties in good working order and condition, and from time to time make all needed repairs, renewals, or replacements, so that the efficiency of all the Corporation's property shall be fully maintained and preserved.

Notices of Actions and Disputes

(f) To deliver to Purchaser

(1) Written notice within _____ [*e.g.,* 10] days after the date of service of process on the Corporation of the filing of any litigation against the Corporation involving the possibility of any judgment or liability in excess of $_____ [*e.g.,* 25,000] not covered by insurance, or the possibility of any judgment or liability which might result in any material adverse change in the business, financial or otherwise, of the Corporation[, and of any proceeding for an injunction or other equitable relief].

(2) Copies of any notices or communications within _____ [*e.g.,* 10] days after received by the Corporation relating to funded debt or current indebtedness of the Corporation and charging or claiming a default with respect to any of those obligation.

(3) Written notice within _____ [*e.g.,* 10] days after it has come to the attention of the Board of Directors or President of the Corporation of the existence of any substantial dispute between the Corporation and any governmental regulatory body or law enforcement authority.

Pay Obligations

(g) Pay all obligations, including tax claims, at maturity, except those that may be contested in good faith or as to which a bona fide dispute exists.

Maintain Insurance

(h) Maintain and keep in force with good and responsible insurance companies in adequate amounts fire, casualty, workmen's compensation, public liability, property damage, and any other insurance as is usual in the type of business conducted by the Corporation.

Maintain Financial Records

(i) Maintain adequate books, accounts, and records in accordance with generally accepted accounting principles and practices consistently applied, and in compliance with the regulations of any governmental regulatory body having jurisdiction over those books, accounts, and records.

Permit Inspections

(j) Permit at any reasonable time and as often as Purchaser may reasonably request any authorized representatives designated by Purchaser in writing to inspect at Purchaser's expense any of the books, accounts, records, and property of the Corporation, to make extracts from those books, accounts, and records, and to discuss the Corporation's affairs, finances, and accounts with its officers; provided, however, that nothing herein contained shall be deemed to require the Corporation to permit any inspection that would reveal or divulge trade secrets or matters required to be treated as restricted security information by any law or governmental regulation or order applicable to that information at the time of any inspection.

Furnish Financial Statements

(k) Deliver the following to Purchaser, in the number of copies Purchaser may reasonably request:

(1) Within _____ [*number*] days after the close of each of the first _____ [*e.g.*, three quarters] of each fiscal year of the Corporation, its balance sheet as of the close of that quarter, its profit and loss statement, surplus reconciliation, and statement of sources and uses of funds for that quarter, and for that portion of the fiscal year ending with that quarter, certified as correct by a responsible officer of the Corporation and showing in each case comparative figures for the corresponding periods of the previous fiscal year.

(2) Within _____ [*number*] days after the close of each fiscal year of the Corporation a complete copy of its audit report, which shall include at least its balance sheet as of the close of that year, its profit and loss statement, surplus reconciliation, and statement of sources and uses of funds for that year, prepared on both a consolidated and consolidating basis should the Corporation acquire any subsidiaries, setting forth in each case comparative figures for the previous fiscal year, and certified by an independent public accountant selected by the Corporation and licensed by the State of California. Certificate shall not be qualified or limited because of restricted or limited examination by the accountant of any material portion of the Corporation's records, and shall include or be accompanied by a written statement by the accountant that as the result of making his or her examination of the Corporation's books, records, and accounts, he or she is aware of no violation by the Corporation of any of the terms of the Notes, articles of incorporation, or this Agreement.

(3) Promptly on transmission thereof, copies of all financial statements, reports, notices, and proxy statements sent by the Corporation to any of its shareholders, and all reports, if any, filed by the Corporation with the Securities and Exchange Commission, the California Commissioner of Corporations, or any governmental authority succeeding to the functions of that Commission or Commissioner.

(4) With reasonable promptness, other information and data relating to the business, affairs, and financial condition of the Corporation as from time to time Purchaser may reasonably request.

Maintain Corporate Existence

(l) Not liquidate or dissolve, or enter into any consolidation, merger, pool, joint venture, syndicate, or other combination, or sell, lease, or dispose of its business or assets as a whole or as in the opinion of a majority of the holders of the Notes constitutes a substantial portion of the Corporation's business or assets.

Not Incur Indebtedness

(m) Except as is provided in this Agreement, not create or incur any indebtedness for borrowed money, or become liable as a surety, guarantor, accommodation endorser, or otherwise, for or on the obligation of any other person, firm, or corporation, or purchase, acquire, or incur liability for the purchase of the assets or business of any other person, firm, or corporation. Provided, however, nothing in this subsection shall be deemed to prohibit (1) the acquisition of goods, supplies, or merchandise on credit by the Corporation; (2) the execution of bonds, undertakings, or contracts by

the Corporation in the usual course of its business; (3) the endorsement by the Corporation of negotiable instruments received in the usual course of its business; or (4) the incurring by the Corporation of bank and trade credit maturing in not more than _____[*e.g.*, 12] months and incurred in the usual course of its business.

Limit Capital Expenditures

(n) Not expend or incur obligations in any single fiscal year of the Corporation, commencing with the fiscal year of _____[*year*], of more than $_____ for the acquisition of fixed or capital assets. Provided, however, if any fixed or capital assets are acquired as replacements of presently held or hereafter acquired capital assets the amount of expenditures made or obligations incurred by the Corporation in acquiring new assets shall be determined, for the purposes of this paragraph, by deducting from the purchase price for those assets agreed to be paid by the Corporation the amount of cash or credit received by the Corporation for the assets replaced. The leasing of any capital asset for a period of one year or longer shall, for the purpose of this paragraph, be deemed to be an acquisition of that asset by the Corporation and the total amount of rent payable by the Corporation under any lease shall be considered the amount of expenditure made or obligation incurred by the Corporation in acquiring the related asset. This paragraph and the limitations herein contained shall not, however, apply to lease obligations of the Corporation outstanding on the date of this Agreement.

Pay Costs of Transaction

(o) To pay the following, to the extent incurred and whether or not the transactions contemplated by this Agreement are consummated:

(1) All the costs and expenses involved in preparing and issuing Purchaser's Note.

(2) All taxes payable on the issuance of the Note.

(3) The costs of furnishing all opinions by counsel for the Corporation regarding this Agreement and the transactions herein contemplated, including any opinions requested by Purchaser as to any legal matters arising under this Agreement.

(4) All costs and expenses of preparing and furnishing any certificates required to be furnished on behalf of the Corporation under this Agreement.

(5) The costs of performing or complying with all provisions and conditions of this Agreement to be performed or complied with by the Corporation.

(6) The costs of enforcing compliance with all provisions and conditions of this Agreement to be performed or complied with by the Corporation.

Warranties and Agreements of Purchaser

7. Purchaser makes the following warranties, representations, and agreements:

Declaration of Intent Not to Resell

(a) Purchaser represents and warrants that he or she or it is purchasing his or her or its Note as an investment for Purchaser's own account and without any present intention of dividing it with others or reselling or otherwise distributing it. In making this warranty, Purchaser acknowledges that the Corporation has advised Purchaser that

(1) The Note is not being registered under the Federal Securities Act of 1933, as amended, on the ground that this

transaction does not involve any public offering and therefore is exempt under Section 4(2) of that Act.

(2) The Corporation's reliance on that exemption is predicated in part on Purchaser's representation and warranty that Purchaser has no present intention of dividing his or her or its Note with others or of reselling or otherwise distributing it.

(3) Although Purchaser has the right to dispose of Purchaser's own property when and as Purchaser sees fit, in the view of the United States Securities and Exchange Commission the exemption under Section 4(2) of the Securities Act of 1933 is not available to the Corporation if Purchaser has in mind, notwithstanding Purchaser's representation and warranty, merely acquiring the Note for resale on the occurrence or nonoccurrence of some predetermined event, such as passage of the capital gains holding period for the Note, a market rise, a sale if the market does not rise, or any other fixed or determinable event.

Warranty of No Present Intent to Make Future Transfer

(b) Purchaser further warrants that Purchaser does not intend to dispose of all or any part of his or her or its Note unless and until Purchaser determines at some future date that changed circumstances, not now in contemplation by Purchaser, make disposition advisable, and that in that event Purchaser nevertheless will comply with the restrictions set forth in Subparagraph (c) of this Paragraph 7.

Restrictions on Transfers by Purchaser

(c) Purchaser agrees that no transfer of his or her or its Note shall be effected until

(1) Purchaser has obtained either an opinion of counsel satisfactory to counsel for the Corporation that the proposed transfer will not result in a violation of the Securities Act of 1933, as then amended, or a letter from the Securities and Exchange Commission to the effect that the Commission will take no action with respect to that transfer; or

(2) A registration statement with respect to the Note shall have become effective under the Securities Act of 1933 as then amended.

Restrictions Binding on Transferees

(d) The restrictions contained in Subparagraph (c) of this Paragraph 7 shall be binding on all subsequent transferees of Purchaser's Note.

Payments

8. The Corporation agrees that all payments of principal and interest on any Notes held by Purchaser will be made by check duly mailed or delivered to Purchaser at the address set forth under Purchaser's name on Exhibit B attached, or any other address Purchaser may from time to time designate in writing, any contrary provision of the Note notwithstanding. Purchaser agrees that, before disposing of his or her or its Note, Purchaser will make a notation thereon of [all principal payments previously made thereon and of] the date to which interest thereon has been paid, and will notify the Corporation of the name and address of the transferee of that Note.

Amendments and Consents

9. This Agreement may be amended and the Corporation may be authorized to take any action herein prohibited or to omit to perform any act herein required to be performed by it by the written consent of the holders of _____ percent of the principal amount of the Notes outstanding at the time the consents are given. Provided, however, no amendment to this Agreement shall extend the maturity of any Note, reduce the principal amount

thereof, or reduce the rate or extend the time for payment of interest thereon unless the holders of all Notes outstanding at the time of the adoption of that amendment consent thereto in writing. Any amendment, action, or omission to act adopted or authorized by written consent of holders of Notes as provided in this paragraph shall be binding on the holders of all Notes outstanding at the time those consents are given whether or not those Notes are marked to indicate that amendment or authorization, and all Notes thereafter issued shall bear a notation referring to that amendment or authorization.

Survival of Agreements and Warranties

10. All agreements, representations, and warranties contained in this Agreement or made in writing by the Corporation in connection with any transaction contemplated by this Agreement shall survive the execution and delivery of this Agreement, the sale and delivery of the Note to Purchaser, Purchaser's payment therefor, and any investigations made by Purchaser or on Purchaser's behalf. All statements contained in any report, memorandum, or certificate delivered to Purchaser by or on behalf of the Corporation pursuant to the terms of this Agreement or in connection with any transaction contemplated by this Agreement shall be construed to be representations and warranties made in writing by the Corporation in connection with transactions contemplated by this Agreement and shall be subject to this paragraph.

Binding on Successors

11. All covenants, agreements, and conditions contained in this Agreement shall bind and inure to the benefit of the respective successors and assigns of the parties hereto.

Partial Invalidity

12. Should any of the provisions of this Agreement be held to be invalid or unenforceable, that invalidity or unenforceability shall not affect the validity or enforceability of any other provision of this Agreement, and to this end the provisions of this Agreement are declared to be severable.

Entire Agreement

13. This instrument contains the entire agreement between Purchaser and the Corporation concerning the Notes and supersedes all prior agreements and understandings relating to the Notes. No provision of this Agreement may be changed, waived, discharged, or terminated except as provided in Paragraph 9 of this Agreement.

Communications

14. All notices, consents, statements, and other communications required or permitted to be served or delivered hereunder shall be in writing and shall be deemed properly served or delivered when deposited in the United States mail, first-class postage prepaid, and, if to Purchaser, addressed to Purchaser at the address set forth under Purchaser's name on Exhibit B hereto attached, or if to the Corporation, addressed to the Corporation at _____ Street, _____, California, Attention: _____. Either party to this Agreement, Purchaser or the Corporation, may change his or her or its address for the purpose of this paragraph by giving proper written notice of the change of address to the other party hereto in the manner provided in this paragraph. [*If desired, add provision regarding any other acceptable methods of communication such as fax, e-mail, or messenger service.*]

Attorneys' Fees

15. Should any litigation be commenced between Purchaser and the Corporation regarding this Agreement, the Notes, or any other transaction contemplated by this Agreement, the party, Purchaser or the Corporation, prevailing in that litigation shall be entitled, in addition to any other relief that may be awarded, to a reasonable sum as and for

Purchaser's or Corporation's attorneys' fees in that litigation which shall be fixed by the court in that litigation or in a separate proceeding brought for that purpose.

Law Governing Agreement

16. This Agreement is being delivered and is intended to be performed in the State of California, and shall be construed and enforced in accordance with, and the rights of the parties shall be governed by, the law of California.

Counterparts

17. This Agreement may be executed simultaneously in two or more counterparts, each of which shall be deemed an original, and it shall not be necessary in making proof of this Agreement to produce or account for more than one counterpart.

Closing Statement

If Purchaser agrees with the above, please sign the form of acceptance on the enclosed counterpart of this letter and return the counterpart to the Corporation. On receipt by the Corporation of the enclosed counterpart with the form of acceptance thereon duly signed by Purchaser, this letter shall become a binding agreement between Purchaser and the Corporation.

Sincerely, _____ [*name of corporation*]
_____ [*signature of officer*]
[*typed name and title*]
_____ [*signature of officer*]
[*typed name and title*]

Acceptance

The above Agreement is hereby accepted as of the date thereof.

_____ [*signature of purchaser*]

EXHIBIT A

[*Attach sample of promissory note. See § 6J.232[2].*]

EXHIBIT B

Names and Addresses of Purchasers	Principal Amount of Notes to Be Purchased
_____	_____
_____	_____
_____	_____



55 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
B. Purchase Agreements, Offers, and Representations

3-6J California Legal Forms--Transaction Guide §§ 6J.224-6J.229

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6J.224[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
C. Complete Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.230

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.230 Note to Single Purchaser

[1] Comment

[a] Use of Form

This form is a relatively uncomplicated promissory note. It may be used in many situations in a flexible financing program. It should not be overlooked when all other funding sources are temporarily dried up. In the reverse situation, when the corporation has almost adequate equity capitalization and simply desires a small additional allowance for interim purposes but without the formalities of a full-fledged debt issue, it offers a convenient solution. The terms can remain simple when the investor is recruited from the ranks of controlling shareholders or close commercial acquaintances, such as other companies involved in a symbiotic business relationship with the issuer. If more detailed provisions are required to satisfy either the issuer or the investor, those provisions may be incorporated from the general note in § 6J.232 or from any of the optional provisions in § 6J.250 et seq.

[b] Use With Subordination Clause for Thin Incorporation Purposes

This note, including the subordination clause, may be used for thin incorporation purposes, when the shareholders wish to take part of their investment in the form of a note rather than all in securities, in the event there are any tax advantages [*see § 6J.21[1]*]. Except when a commercial bank or institutional investor is involved, a subordination clause is frequently included to make the note rank second to senior indebtedness. For a more detailed subordination provision, substitute the one in the note in § 6J.232[2]. This note typically belongs in a private placement transaction, unqualified before the Commissioner [*see* Ch. 6H, *Qualification of Securities*].

[2] Form

Note to Single Purchaser

Note to Single Purchaser

No. _____ .....$_____

_____ [*Name of corporation*]
_____ Percent [Subordinated] Note

Obligation

_____[*Name of corporation*], a corporation organized and existing under the laws of the State of California, hereinafter called "Corporation," for value received, promises to pay to the order of _____[*name of purchaser*], hereinafter called "Purchaser," on _____[*date*], the principal sum of $_____ and to pay interest on the principal sum from the date of issue at the rate of _____ percent per annum, [based on a 360-day year] until payment of principal. Interest payments must be made _____[*specify interval and dates, e.g.,* quarterly on March 31, June 30, September 30, and December 31 of each year] commencing _____[*date*]. All payments of principal and interest and redemption premium, if any, in respect of this Note shall be made in lawful money of the United States at the address of the registered holder of this Note on the books of the Corporation. Whenever any payment on this Note shall be stated to be due on a day which is not a business day, that payment shall be made on the next succeeding business day and such an extension of time shall be included in the computation of the payment of interest on the Note.

Acceleration of Maturity

In the event of the failure of the Corporation to pay any installment of interest when due and payable [and the continued failure to pay that interest for a period of _____ days], Purchaser, by notice in writing to the Corporation, may declare the principal of, and all accrued interest on, this note immediately due and payable without further notice or demand. The Corporation hereby promises to pay all costs and expenses, including reasonable attorneys' fees incurred in the collection and enforcement of this Note. Company and any endorsees of this Note hereby consent to renewals and extensions of time at or after maturity hereof, without notice, and hereby waive diligence, presentment, protest, demand and notice of every kind and, to the full extent permitted by law, the right to plead any statute of limitations as a defense to any demand hereunder.

[*Optional:*]

Subordination

The payment of principal and interest on this note (and any holder, by his or her acceptance of this note, so agrees) is expressly subordinated to any indebtedness of Corporation for money borrowed from _____[banks *or* persons, firms, or corporations which engage in the business of lending money including, but without limitation, banks, trust companies, insurance companies and other financing institutions (hereinafter called "bank debt" even if not owing to a bank)] which may at any time and from time to time be outstanding. On any receivership, insolvency, bankruptcy, assignment for the benefit of creditors, reorganization, sale of all or substantially all of the assets, dissolution, liquidation, or other marshaling of the assets of Corporation, no amount is to be paid by Corporation of the principal or interest on this note unless and until all bank debt has been paid in full, together with all interest and all other amounts that may be payable in connection with any outstanding bank debt. To the extent necessary to accomplish the purposes

of this paragraph, all sums payable as a result of the receivership, insolvency, bankruptcy, assignment, reorganization, sale, dissolution, liquidation, or marshaling, to the holder of this note will be paid to the holders of bank debt until that bank debt is paid in full. In the event of any default in payment of principal (including any sinking fund payments) of, or interest on, any bank debt, and during its continuance, no amount will be paid by Corporation of the principal or interest on this note while that default continues.

[*Continue with the following:*]

Witness, _____[*name of corporation*] has caused this note to be executed by its duly authorized officers this _____ day of _____[*month*], _____[*year*].

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
C. Complete Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.231

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.231 Registered and Privately Offered Discount Note

[1] Comment

[a] Use of Form

This form is a registered and privately offered discount note. Regular notes sometimes may be sold at discount if they are not readily marketable under then prevailing commercial conditions at a percentage of the stated principal. However, in some instances, a corporation deliberately chooses to issue notes at a discount. This type of note represents a speculative type of offering, is generally for a medium term, such as 10 years, and frequently is not burdened with any special security provisions. One advantage to the corporation is that it does not have to pay out interest periodically. For the investor, a discount note is like a savings bond in that the investor may not expect any realized return for several years. Unless held in a tax deferred account, the investor will be required to pay taxes annually on a portion of the original issue discount, even though no cash is received by the investor.

The simple plan of a discount note is that it is issued for a base figure, after which, on a fixed progressive schedule, the corporation is free to redeem the note at an increasingly higher figure during each prescribed term, until the stated maturity figure is reached. The base purchase figure is considered a discount on the final maturity amount. Generally it would be in the interest of the corporation to redeem the note at the earliest opportunity; while for the investor, the closer the redemption reaches toward maturity, the more profitable it is. For a form for a registered debenture issued at a discount, see Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 19, *Corporate Securities* , Form 19.49 (Matthew Bender). For a corporate bond issued at a discount or premium with principal payable periodically, see Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 19, *Corporate Securities* , Form 19.69 (Matthew Bender).

[b] Use for Private Placement or Incorporate Additional Terms

This note contemplates a private placement transaction in California, without qualification before the Commissioner of

Corporations. Otherwise, it will be necessary to supplement it with more protective provisions, such as those found in the general note *form in § 6J.232[2]*.

[2] Form

Registered and Privately Offered Discount Note

Discount Note--Registered and Privately Offered

No. _____ .....$_____

_____ [*Name of company*]
_____ [*address of company*]

_____ [*term, e.g.,* 15-YEAR] REGISTERED DISCOUNT NOTE

Obligation

1. _____[*Name of company*], a California corporation (herein referred to as the "Company"), for value received, hereby promises to pay to _____[*name*] or registered assigns on _____[*date*], in lawful money of the United States, the principal sum of $_____ on presentment of this note on or after that maturity date at the offices of the Company at _____[*location*] or at any other office the Company may from time to time designate unless this Note has been duly called for redemption and payment of the redemption price has been made or provided for.

Series Conditions

2. This Note is one of a duly authorized series of Notes of the Company issued contemporaneously ("Notes"), with an aggregate principal amount of $_____ due _____[*date*], and issued in denominations of _____[*e.g.,* $10,000]. All Notes have the same provisions, terms, and conditions as this Note, except for variations necessary to express the number and principal amount of each Note.

Redemption

3. All [or any of the] Notes are redeemable at the election of the Company[, its successors or assigns,] at any time prior to maturity on payment of the redemption price as below described:

Table of Redemption Values

[*Insert redemption values below. The values below are illustrative only. For each succeeding year or group of years, the value rises progressively until the full maturity value is reached.*]

Maturity Value $_____ [*e.g.,* $10,000]	Discount Value $_____ [*e.g.,* $4,150]
Time of Redemption	Value of Redemption
Redemption within 1st year	$ 4,150

1 to 2 years	$ 4,400
2 to 3 years	$ 4,650
3 to 4 years	$ 4,950

Notice of Redemption

4. Notice of redemption will be given to registered holders of the Notes by registered mail, directed to the holder at his or her address on the Company's books at least _____[*e.g.*, 20] days prior to the date of redemption. If the registered holder or holders of this Note fail to present this Note for redemption at the time and place specified in the notice of redemption, the redemption price nevertheless shall remain fixed as of the time specified in the notice of redemption.

Transfer

5. No transfer of this Note shall be valid unless made on the Company's books at its office located at _____[*location*] or at any other office the Company may from time to time designate, by presentment of the Note together with appropriate credentials for registration in the name of the transferee. Prior to the registration of the transfer of this Note, the Company may deem and treat the holder hereof as the absolute owner hereof (notwithstanding any notation of ownership or other writing hereon made by anyone other than the Company) for the purpose of receiving payment of the principal hereof on redemption or at maturity.

Execution

The Company has caused this Note to be signed by its Chairman of the Board, President, or one of its Vice Presidents and by its Secretary, one of its Assistant Secretaries, its Chief Financial Officer, or one of its Assistant Treasurers, has caused its corporate seal to be affixed hereto or a facsimile thereof imprinted hereon, and to be dated as of _____[*date*].

[*Corporate seal*]

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]
Attest: _____ [*signature*]
[*typed name and title*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
C. Complete Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.232

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.232 General Form for Note

[1] Comment

[a] Use of Form

This is a general form for a note. It is designed for general use as part of a larger debt security offering although one capable of managing to remain exempt from federal registration [*see §§ 6J.259*, *6J.260*; s*ee also* § 6J.19]. The form contains many of the standard protective provisions for an offering of moderate to larger size to a relatively small group of investors and without the involvement of a formal trust indenture. Not all of the protective provisions in this note will be necessary. Therefore any provision should be considered optional or subject to modification. For instance, Paragraph 8, Events and Consequences of Default, may be shortened or excluded. On the other hand, it may be desirable, under the circumstances of financing requirements or availability of other devices, to add or replace any provision in this note with one of the select group of the more popularly included kinds of provisions in § 6J.250 et seq. The following is a description of the provisions composing this general form.

[b] Obligation

The note should begin with a general description of the principal amount of the note, the amount of interest it bears, the life of the note, the times of payment of interest, and a description of the holder of the note. The terms should be for a period long enough to allow the corporation conveniently to accumulate sufficient income term (anywhere from five to 20 years) and to allow an investor to accumulate a healthy return on its investment. In the popular form among smaller growth corporations principal is not repaid until maturity or earlier redemption, so that interest is paid on the entire original amount of principal outstanding at all times. For a variation in the manner of payment of interest as dependant on available earnings, see *§ 6J.250[2]*.

The accompanying form is designed to be made out to a registered holder, and is handled in the manner of an equity security which also is registered.

[c] Medium of Payment

Although failure to consider what tangible form of payment is contemplated by any particular debt offering was once considered a potential source of difficulty, it is now primarily a formalism. For the assurance of investors, the note may indicate that United States money, implicitly in check form, will be distributed at the corporation's offices. The medium and place of payment may be combined with the obligation paragraph, as in the note in § 6J.231.

[d] Series Conditions

This provision somewhat duplicates the first paragraph in that it shows that the entire series of notes, of which the individual holder's is a single part, is identical in description and form with each other note. The featured provision in the following general form indicates, by omission, a note that is unsecured, and should indicate by specific reference any other important feature, such as the fact that the note is convertible [*see § 6J.253*] or subordinated. If provisions concerning convertibility or subordination are included, they also should be included in the title of the notes and described as a feature in this Series paragraph.

Other features that should be described in Paragraph 3, if applicable, are the fact that the notes are secured by real property [*see § 6J.254*] or by a lien on real property on an open-ended basis [*see § 6J.255*], or that the notes are to be secured by personal property [*see § 6J.256*]. When any of the foregoing features are included, a clause or paragraph to that effect should be added at the end of Paragraph 3.

[e] Redemption

Notes are strictly a contractual obligation arranged between the corporation and its creditors [*see Corp. Code § 207(d), (g)*]. Thus, they may provide, and in any manner, for redemption of the outstanding notes before maturity. Small growth corporations normally provide for redemption solely at the option of the corporation; and while normally intending to let the principal remain outstanding until maturity or earlier redemption time, the company may provide for voluntary partial prepayment at any time before that date. The most attractive method from an investor's standpoint is the promise to pay a percentage bonus above the principal due, the earlier the redemption is made before maturity date. In some cases a period of call protection, such as 3-5 years, may be provided before the note may be redeemed. However, it is quite permissible to provide for straight redemption of principal plus all accrued interest to date. For a serial redemption provision, see *§ 6J.258*

Redemption requires special notice to the holders, usually 20 to 30 days before the time for redemption. Thus, whichever type of redemption schedule is chosen, Item 4 must contain the paragraph regarding notice of redemption. Local customs or special market requirements may provide the framework for redemption provisions in a particular offering.

[f] Subordination

The funds of commercial banks and a whole host of institutional investors--such as insurance companies, governmental pension funds, charitable trusts, and the like--have become increasingly available for short-term and interim financing. Intermediate and long-term holders of series notes may be willing from time to time to take junior positions to the institutional investors providing those short-term or interim financing. Thus, the optional subordination provision is included in this note to specify which loans will take precedence over the note series, no matter when the short-term or interim loans are made. For a shorter subordination clause, see *§ 6J.230*. For a checklist of elements to consider in negotiating or drafting a subordination provision, see Ballantine & Sterling, CALIFORNIA CORPORATION LAW, ch. 7, *Issuance of Shares and Indebtedness*, § 133 (Matthew Bender).

[g] Covenants of the Company

The company normally tries to assure the note holders that it will maintain adequate working capital, and that it will give proper notice to any registered holder of any disputes that might lead to a drain on the company's finances or earnings (Paragraph 6). The company also should provide in some manner for protection of any option, warrant, or conversion privilege by negatively covenanting not to dilute the value of the optioned stock by draining off cash resources into dividends, or through purchasing its shares, or by increasing the outstanding stock through some form of dividend or recapitalization process (Paragraph 7). If there are no warrants, options, or conversion privileges associated with the Notes, the title of Paragraph 7 should not mention antidilution considerations and should be limited to actions that generally maintain working capital, liquidity, and a debt to equity ratio similar to that existing at the time the notes are issued.

[h] Events and Consequences of Default

Investors are interested in seeing in express and specific terms just what constitutes default so that the maturity of the note may be accelerated and the right to repayment instantly be made enforceable. Events of default include not only failure to observe any of the major requirements of the note, but usually any kinds of situations which normally represent a credit crisis, such as insolvency, attachment, receivership, or bankruptcy. Another advantage of holding a note in registered form is that the holders may negotiate for the right to receive notices of the occurrences of any events of default.

[i] Notices and References

The note normally may confirm any addresses to which notices may be sent between the company or any registered holder, and a reference to the fact that California law is to govern the instrument.

[j] Transferability

The modern debt securities market provides for registration of the notes. With a registered note, there is no necessity of detaching coupons, safeguarding them, or entrusting them to the mails. As in the case of registered securities, when the corporation has an interest payment to make, it simply has a check sent off to the registered holder, as his or her name appears on its books and to the holder's last known address. The interest payments once received, of course, are negotiable. Registered notes are transferred in the same manner as registered equity securities [*see* Ch. 6I, *Issuance of Equity Securities*].

[2] Form

General Form for Note

General Form for Note

$_____ .....No. _____ ..... _____ [*date*]

_____ [*Name of corporation*]

_____ Percent [_____ (*additional descriptive term, if any, e.g.,* Subordinated)]
Promissory Note
Due _____ [*date*]

Obligation

1. _____[*name*], a corporation organized and existing under the laws of the State of California (hereinafter called the "Company"), for value received, hereby promises to pay to _____[*name*] or registered assigns] on _____[*date*], the principal sum of $_____ and to pay interest on the principal sum from the date hereof at the rate of _____ percent per annum [based on a 360-day year, 30-day month] until payment in full of principal[, unless this Note has been duly called for redemption and payment of the redemption price has been made or provided for]. Interest payments will be made semiannually on the first days of _____ and _____[*months*] in each year, commencing _____[*date*].

Medium of Payment

2. The principal of, and interest on this note, are payable in lawful money of the United States at the office of the Company at _____[*location*] or at any other office of the Company as it may from time to time designate.

Series Conditions

3. The note is one of a duly authorized series of _____ percent [_____ (*additional descriptive term, if any, e.g.,* Subordinated)] Promissory Notes due _____[*date*], of the Company issued contemporaneously, with an aggregate principal amount of $_____ due _____[*date*], hereinafter called the "Notes," all of which are subject to the terms and conditions of this document[, except for variations necessary to express the number and principal amount of each Note].

[*If notes are to be redeemable before maturity, chose either the straight method, the decreasing premium method, or a series redemption method set forth in § 6J.258.*]

Redemption--Straight Method

4. This Note will be redeemable at the option of the Company, in whole or in part, [at any time *or* at any time after _____ (*specify date*)] after giving of appropriate notice. The redemption price for this Note will be the principal amount of this Note plus interest accrued to the date fixed for redemption. In the event that less than all of the Notes are to be redeemed, redemption will be [, to the extent possible, pro rata] [by lot]. This Note will become due and payable and will cease to bear interest on the date fixed for redemption, and the amount then payable to the holder will be paid on the surrender to the Company of this Note.

[*Or*]

Redemption--Decreasing Premium

4. The corporation has the right to redeem this Note at any time on or after _____[*date*], on the following terms:

(a) On or after _____[*last date above*], and prior to _____[*one year later*], at _____[*e.g.,* 105] percent of the face value of this Note, together with all accrued and unpaid interest;

(b) On or after _____[*last date above*], in (a) and prior to _____[*one year later*], at _____[*e.g.,* 104] percent of the face value of this Note, together with all accrued and unpaid interest.

[*Continue with the premium decreasing progressively on a fixed basis until the redemption equals 100 percent plus*

interest.]

[*Or*]

[*A decreasing premium may also be set out in the following alternative tabular form:*]

4. This Note may be redeemed at the option of the Company at any time prior to maturity [*or* on or after _____ (*date*),] at the following redemption prices (expressed in percentages of the principal amount) together with accrued interest to the date fixed for redemption:

If redeemed during the 12-month period ending on the last day of _____[*month*]:

Year	Percentage
_____	_____
_____	_____

and thereafter at 100 percent.

[*Continue with the following:*]

Notice of Redemption to Registered Holders

Before redeeming the Notes, the Company will notify any registered holder of this Note of its intention so to redeem and of the redemption date at least _____[*e.g.,* 20] days prior to the redemption date, by registered mail, addressed to the registered holder at his or her last address as it appears on the registration books of the Company kept for that purpose at the office of the _____[Secretary *or* Registrar]. On giving that notice, the liability of the Company for interest on this Note will cease on the date of redemption fixed in the notice unless the Company fails to redeem this Note when it is presented for redemption on or after that redemption date.

[*Optional subordination provision:*]

Subordination

5. The payment of principal and interest on this Note is subordinated in right of payment to the prior payment in full of all senior indebtedness of the Company, whether outstanding on this date or thereafter. Senior indebtedness is defined as the principal of and premium and interest on indebtedness of the Company for money borrowed from, or the payment of which has been guaranteed to, persons, firms, or corporations which engage in lending money including, but without limitation, banks, trust companies, insurance companies and other financing institutions, and charitable trusts, pension trusts, and other investing organizations, evidenced by notes or similar obligations. [*Optional:* Senior indebtedness does not include payments of principal, premium, and interest on $_____ principal amount of _____ percent (_____ (*additional descriptive term, if any, e.g.,* Subordinated)) Promissory Notes due _____ (*date*), being issued contemporaneously with this Note.] The subordination of this Note is on the terms as set forth here:

Insolvency, Dissolution, or Related Proceeding

(a) In the event of any insolvency or bankruptcy proceedings, or any receivership, liquidation, reorganization, or other similar proceedings relative to the Company, or to its property, or in the event of any proceedings for voluntary liquidation, dissolution, or other winding up of the Company, then the holders of senior indebtedness will be entitled to receive payment in full of all principal and interest on all senior indebtedness before the holders of the Notes are entitled to receive any payment on account of principal or interest on the Notes and to that end the holders of senior indebtedness will be entitled to receive on application any payment or disbursement of any kind or character, whether in cash or in property or securities which may be payable or deliverable in any of the aforementioned proceedings in respect to the Notes, except securities of the Company as reorganized or readjusted or securities of the Company, or any other company, provided for by a plan of reorganization or readjustment, the payment of which is subordinate to the payment of all senior indebtedness which may at the time be outstanding.

Accelerated Maturity

(b) In the event that any of the Notes are declared due and payable before the express maturity for the occurrence of an event of default as defined here (under circumstances that the provisions of Subparagraph (a) are not applicable), the holder will be entitled to payment only after there is first paid in full on the senior indebtedness outstanding at the time this Note becomes due and payable because of that event of default all principal and interest becoming due and payable by acceleration or otherwise, or payment has been provided for in a manner satisfactory to the holders of the senior indebtedness.

No present or future holder of senior indebtedness will be prejudiced in his or her right to enforce subordination of this Note by any act or failure to act on the part of the Company. The provisions of this Paragraph 5. are solely for the purpose of defining the relative rights of the holders of senior indebtedness on the one hand, and the holder of this Note on the other hand and nothing in this Note will impair as between the Company and the holder of this Note the obligation of the Company, which is unconditional and absolute, to pay to the holder the principal and interest in accordance with its terms, nor will anything in this Note prevent the holder from exercising all remedies otherwise permitted by applicable law on default hereunder subject only to the rights, if any, under this paragraph of holders of senior indebtedness to receive cash, property, or securities otherwise payable or deliverable to the holder.

[*Continue with the following:*]

Positive Covenants--Capital; Notices

6. Company covenants and agrees that, as long as any of the Notes are outstanding, it will do all of the following [unless the registered holders of not less than _____ (*e.g.,* 75) percent in principal amount of Notes outstanding, waive compliance in writing]:

[*Optional:*]

Notice

(a) Promptly give written notice to the registered holder or holders of this Note of any dispute, controversy, or litigation involving the Company with regard to patents, inventions, or labor controversies, and any disputes, controversies, or litigation with any governmental regulatory body;

[*Continue with the following:*]

Continuation in Business

(b) Continue to engage in the business of _____;

Working Capital

(c) Maintain net working capital (as hereinafter defined) from and after the date of this Note, in an amount of not less than $_____;

For the purposes of this Paragraph 6, "net working capital" means the excess of current assets, that is (1) readily available unrestricted cash and cash items in United States currencies; (2) good and collectible accounts receivable less adequate reserves for losses; (3) inventories taken at cost or their fair market value, whichever is lower; (4) unrestricted securities of the United States Government; (5) other assets, which in the regular course of business will be readily realized within one year of the computation of net working capital, together with additional assets as may readily be converted into cash within one year thereof, over current liabilities, that is, obligations due and payable within one year of the computation of net working capital, including (1) notes and accounts payable; (2) accrued liabilities; (3) deferred revenue or income; and (4) installment amounts due on long-term debt; [*continue, if desired, with optional exclusion from current liabilities portion of definition of working capital:* excluding from current liabilities any amounts due on the term loan dated _____, in the amount of $_____ and on the secured term loan dated _____, in the amount of $_____ and any equal amounts which may become due on any loans which renew and supersede those loans].

Negative Covenants-Antidilution Considerations

7. The Company further covenants and agrees that so long as any of the Notes are outstanding, it will not do any of the following [without the prior written consent of the holders of not less than _____ (*e.g.*, 85) percent of the principal amount of the Notes outstanding]:

Dividends and New Issues

(a) Declare or pay any dividends in cash, property, or shares of its capital stock, or make any other distribution on its capital stock, or take, perform[, or allow to be taken or performed, any act which would have the effect of diluting the value of the _____ (option *or* warrant *or* conversion privilege) granted the holder]; or

Stock Splits

(b) Combine or subdivide its capital stock [unless the conversion price and number of shares into which the Notes are thereafter convertible are adjusted as hereinafter set forth. In the event that the Company elects to combine or subdivide its capital stock, the ratio used to determine the number of new shares to be issued in exchange for the existing shares will be applied to the number of shares into which the Notes may be converted as provided in this Note, and the conversion price will be appropriately adjusted]; or

Purchasing Own Shares

(c) Purchase, redeem, or otherwise acquire for value any of its capital stock, or create any sinking fund in relation thereto, or issue any shares of capital stock of any class in addition to the _____[shares *or* shares of Series _____ stock and _____ shares of Series _____ stock] issued and outstanding on this date, or any other securities which may be convertible into or carry the right to purchase shares of capital stock of any class, except that the Company may

[*Include any of the following that are applicable:*]

Convertible Notes

(1) Issue shares of its _____ [*type*] stock on conversion of the _____ [*other outstanding debt, e.g.,* the six percent convertible subordinated promissory notes due _____ (*date*)];

Employee Purchase Plans

(2) Grant stock options qualifying as employee stock purchase under *Internal Revenue Code Section 423* to its employees to purchase an aggregate of not to exceed _____ shares of its Series _____ stock and to issue shares of Series _____ stock on the exercise of those options;

Merger

(3) Issue shares of its Series _____ stock on consummation of any merger agreement, purchase of assets in exchange for stock, acquisition of stock of another corporation in exchange for stock, and split-up of stock of the Company, with respect to which the Board of Directors of the Company has in good faith determined that consummation of the transaction would not have the effect of diluting the value of the conversion privilege granted the holder.

[*Continue with the following:*]

Events and Consequences of Default

8. (a) Without notice, except as expressly provided here, the following will be deemed to be events of default:

Interest

(1) Default in the payment of any installment of interest on any of the Notes as and when the interest becomes due and payable and the continued failure to pay that interest for a period of _____ days; or

Principal

(2) Default in the payment of the principal of any of the Notes as and when the principal becomes due and payable, either at maturity, on redemption, by declaration as authorized in the Notes, or otherwise; or

Covenants

(3) Failure on the part of the Company to observe or perform any other of the covenants or agreements on the part of the Company contained in the Notes, and written notice of that failure, requiring the Company to remedy the failure, has

been given to the Company by the holders of at least _____ [*e.g.*, 15] percent in the aggregate principal amount of the Notes at the time outstanding, and that failure has continued unremedied for a period of _____ [*e.g.*, 60] days after the date of the Company's receipt of the notice; or

Insolvency

(4) The decree or order by a court having jurisdiction in the matter has been entered adjudging the Company a bankrupt or insolvent, or approving a petition seeking reorganization of the Company under the National Bankruptcy Act, or any other similar applicable federal or state law, and that decree or order has continued undischarged or unstayed for a period of _____ [*e.g.*, 60] days; or

Receivership

(5) A decree or order of a court having jurisdiction in the matter for the appointment of a receiver or liquidator, or trustee, or assignee in bankruptcy or insolvency of the Company, or of all or substantially all of its property or for the winding up or liquidation of its affairs, has been entered and that decree or order has continued in force undischarged or unstayed for a period of _____ [*e.g.*, 60] days; or

Bankruptcy

(6) The Company institutes proceedings to be adjudged a voluntary bankrupt, or consents to the filing of bankruptcy proceedings against it, or files a petition or answer or consent seeking reorganization under the National Bankruptcy Act or any other similar or applicable federal or state law, or consents to the filing of any petition, or consents to the appointment of a receiver, liquidator, or trustee in bankruptcy, or makes a general assignment for the benefit of creditors, or admits in writing its inability to pay its debts generally as they become due; or

Attachment

(7) Any judgment, writ, or warrant of attachment or of any similar process in an amount in excess of $_____ is entered or filed against the Company or against any of its property or assets and remains unpaid, unvacated, unbonded, or unstayed for a period of _____ [*e.g.*, 60] days; or

Outstanding Default

(8) In the event of a default, as defined in any indenture, trust agreement, or other instrument securing or protecting any part of any outstanding debt of the Company, now or hereafter outstanding, and a maturity of any part of the debt has then been accelerated pursuant to the provisions of any indenture, trust agreement, or other instrument, and acceleration has not been rescinded or annulled prior to the expiration of _____ [*e.g.*, 10] days after the date of acceleration.

Acceleration of Maturity

(b) If any one or more of the foregoing events of default occurs, the holders of not less than _____[*e.g.*, 15] percent principal amount of the then outstanding Notes, by notice in writing to the Company, may declare the principal of, and all accrued interest on, all Notes then outstanding immediately due and

payable without further notice or demand; provided, however, that at any time within _____[*e.g.,* 15] days after that declaration the same may be rescinded and the event of default may be waived by the holders of not less than _____[*e.g.,* 85] percent principal amount of the Notes then outstanding by written notice from them to the Company.

Payment on Acceleration

(c) On any acceleration of the maturity of the Notes, the Company will within _____[*e.g.,* 30] days pay to the holders of the Notes then outstanding the entire principal balance unpaid on the Notes, together with accrued interest thereon to the date of payment, plus any redemption premium which would have been payable thereon if the Notes had been redeemed on that date.

Failure to Pay

(d) If the Company fails to make payment to the holders of the Notes as provided in the preceding Subparagraph (c), the holders of each of the Notes will be entitled and empowered to take appropriate measures to enforce the Company's obligations under the Notes held by each holder, by judicial proceedings or otherwise. In the event suit is brought to enforce payment of this Note, the Company promises to pay reasonable attorneys' fees to be fixed by the court.

[*Subparagraph 8(e) and Paragraphs 9 and 10 are optional provisions for use in registered notes:*]

Notification of Holders

(e) Within _____[*e.g.,* 10] days after receipt of each notice of default received by the Company pursuant to Subparagraph (a)(3) or (8) of this paragraph, the Company will transmit a copy of that notice of default by first-class mail, postage prepaid, to each registered holder of the Notes at his or her address as shown on the register maintained by the Company.

Notices

9. Any communication or notices may be delivered or mailed to the offices of the Company at _____[*address*] [and to the registered holder at his or her address below set forth], or to other addresses the Company [or registered holder] may designate in writing from time to time.

Transferability

10. This Note, when registered, is transferable by any registered holder in person or by his or her attorney duly authorized in writing on a register maintained by the Company, only on the surrender of this Note, duly endorsed without recourse, and the Company will not be required to make any transfer unless and until it receives this Note duly and properly endorsed without recourse by the registered holder or by his or her attorney duly authorized in writing. On the surrender of this Note for transfer of registration of this Note, the Company will issue a new Note in its place. The Company may treat the registered holder as the absolute owner for the purpose of receiving payment of or on account of principal and interest due[, for the purpose of effecting the conversion of this Note into shares of _____ (*type*) stock of the Company,] and for all other purposes, and may require guaranty of authenticity of signatures with respect to endorsements.

[*Continue with the following:*]

Governing Law

11. This Note is to be governed by and construed under the laws of the State of California.

Execution

Executed on _____[*date*], at _____[*city and state*].

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]

[*Optional assignment clause to be completed in event note is subsequently assigned by purchaser:*]

ASSIGNMENT

For value received _____[*transferor(s)*] sell(s), assign(s), and transfer(s) to _____[*transferee*] the within Note standing in _____[my *or* our] name on the books of the Company, and irrevocably constitute(s) and appoint(s) _____ attorney to transfer this Note on the books of the Company, with full power of substitution.
_____ Dated:

_____ [*signature of transferor*]

[*Optional--list of registered holders:*]

REGISTRANTS

Name	Dates Held	
From	To	
_____	_____ ___ [*date*]	_____ ____ [*date*]
_____	_____ ___ [*date*]	_____ ____ [*date*]
_____	_____ ___ [*date*]	_____ ____ [*date*]
_____	_____ ___ [*date*]	_____ ____ [*date*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
C. Complete Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.233

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.233 General Form for Bond Secured by Deed of Trust

[1] Comment

[a] Use of Form

This is a general form for a bond secured by a deed of trust. It provides for periodic payment of principal and interest and contains an optional redemption provision which is fairly abbreviated. Other redemption provisions may be found in the *form in § 6J.232*, and a serial redemption provision may be *found in § 6J.258*. For discussion of the advantages of securing a debt instrument with real property and for another "security" provision, drafted for use in a series of notes, see *§ 6J.254*.

Generally, a bond is defined as an obligation secured by a mortgage, deed of trust, or other security device and is distinguished from a debenture [*see § 6J.234*], which is unsecured.

[b] Consideration of Additional Provisions

There are numerous combinations of provisions that can be used to express the terms of a bond. One example is a conversion provision whereby the holder may exchange the bond for shares in the corporation [*see § 6J.253*]. Counsel may desire to add to this basic form provisions restricting the interest obligation to available net income [*see § 6J.250*], subordinating the interest and redemption rights to those of a prior series of bonds, or any other appropriate provisions. For other complete forms of bond, as well as forms of optional provisions including those for conversion, redemption, and subordination, see Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, ch. 19, *Corporate Securities* , Forms 19.66-19.81 (Matthew Bender).

[2] Form

General Form for Bond Secured by Mortgage

General Form for Bond Secured by Deed of Trust

No. _____ .....$ _____

_____ [*Name of corporation*]
_____ [*address of corporation*]

_____ PERCENT BOND SECURED BY DEED OF TRUST
Due _____ [*date*]

Obligation

_____[*Name of corporation*], a California corporation, (hereinafter called the "Company") for value received, hereby promises to pay to _____[*name*], or registered assigns, in lawful money of the United States, the principal sum of $_____ plus interest at the rate of _____ percent per annum on unpaid principal until the principal is paid in full[, unless this Bond has been duly called for redemption and payment of the redemption price has been made or provided for]. Principal and accrued interest will be paid in equal installments of $_____, _____[*specify interval and dates, e.g.*, semiannually, on the first days of _____ and _____ (*months*) each year], commencing _____[*date*].

Address for Payments

The principal and interest payments on this Bond are payable at _____[*specify location, e.g.*, the principal office of the Company] [or any other place the Company may designate in writing from time to time]. The _____[*specify interval, e.g.*, semiannual] payments will be mailed to the registered holder of this bond at his or her address last furnished to the Company in writing.

Series

This bond is one of a duly authorized series of bonds of the Company, with an aggregate principal amount of $_____, bearing interest at the rate of _____ percent per annum, issued by the Company in connection with, and secured by, the deed of trust described, _____ Percent Bonds Secured by Deed of Trust, due _____[*date*], hereinafter called the "Bonds," all of which are subject to the terms and conditions of this document and of the deed of trust[, except for variations necessary to express the number and principal amount of each Bond].

Security

This bond is secured by the deed of trust, dated as of _____[*date*], executed and delivered by the Company to _____[*name and address of trustee*], as Trustee, for the benefit of the holders of this bond, on certain real property standing in the name of Company in the County of _____, State of _____. Reference is made to the deed of trust for a description of the property encumbered, the nature and extent of the security interest of the Trustee in the property encumbered, the terms and conditions under which the

Bonds are issued, the rights and restrictions of the Company and of the bondholders, and the rights, duties, and immunities of the Trustee. All the terms of the deed of trust are incorporated by reference herein.

[*Optional redemption and notice of redemption provisions:*]

Redemption

This Bond will be redeemable at the option of the Company at any time after the giving of appropriate notice. The redemption price for this bond will be the principal amount of this bond, [plus _____ percent of the principal amount,] plus interest accrued to the date fixed for redemption. In the event that less than all of the Bonds are to be redeemed, redemption will be, to the extent possible, pro rata in proportion to the aggregate amount of Bonds held by each bondholder. This Bond will become due and payable and will cease to bear interest on the date fixed for redemption, and the amount then payable to the holder will be paid on the surrender to the Company of this Bond.

Notice of Redemption

Before redeeming this Bond, the Company will notify any registered holder of this bond of its intention to redeem and of the redemption date at least _____[*e.g.*, 20] days prior to that date, by registered mail, addressed to the registered holder at his or her last address as it appears on the books of the Company kept for that purpose at the _____[*e.g.*, its principal office]. On the giving of notice, the liability of the Company for interest on this Bond will cease as of the date of redemption fixed in the notice unless the Company fails to redeem this Bond when it is presented for redemption on or after the redemption date.

[*Continue with the following:*]

Default

In the event of a default, as defined in the deed of trust, the principal of, and any accrued interest on, plus any redemption premium which would have been payable thereon if the Notes had been redeemed on such date, this Bond may be declared due and payable at once.

Transferability

This Bond is registered as to both principal and interest and is transferable by any registered holder in person or by his or her attorney duly authorized in writing only on a register maintained by the Company, and only on surrender of this Bond, duly endorsed without recourse. The Company will not be required to make any transfer unless and until it receives this Bond duly and properly endorsed without recourse by the registered holder or holders or by his, her, or their attorney duly authorized in writing. The Company may treat the registered holder as the absolute owner for the purpose of receiving payment of or on account of principal and interest due, for the purpose of effecting the redemption of this Bond, and for all other purposes, and may require guaranty of authenticity of signatures with respect to endorsements.

Authentication

This Bond shall not be valid until the Trustee has signed the certificate of authentication.

IN WITNESS WHEREOF, the Company has caused this bond to be signed by its Chairman of the Board, President, or one of its Vice Presidents and by its Secretary, one of its Assistant Secretaries, its Chief Financial Officer, or one of its Assistant Treasurers, and has caused its corporate seal to be affixed hereto this _____ day of _____[*month*], _____[*year*].

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]

[*Corporate seal*]

Trustee's Certificate of Authentication

It is hereby certified that this Bond is one of the issue of Bonds described in the aforementioned deed of trust.

Trustee
_____ [*name of trustee*]
By _____ [*signature of officer*]
[*typed name and title*]

[*Optional assignment clause to be completed in event note is subsequently assigned by purchaser:*]

ASSIGNMENT

For value received _____[*transferor(s)*] sell(s), assign(s), and transfer(s) to _____[*transferee*] the within Bond standing in _____[my *or* our] name on the books of the Company, and irrevocably constitute(s) and appoint(s) _____ attorney to transfer this Bond on the books of the Company, with full power of substitution.
_____ Dated:

_____ [*signature of transferor*]

[*Optional--list of registered holders:*]

REGISTRANTS

Name	Dates Held
From	To

_____	_____ ___ [*date*]	_____ ____ [*date*]
_____	_____ ___ [*date*]	_____ ____ [*date*]
_____	_____ ___ [*date*]	_____ ____ [*date*]
_____	_____ ___ [*date*]	_____ ____ [*date*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
C. Complete Debt Securities

3-6J California Legal Forms--Transaction Guide § 6J.234

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.234 General Form for Debenture

[1] Comment--Use of Form

This is a general form for a debenture. A debenture is often used by a corporation rather than making another public offering of its common stock. It is an unsecured obligation of the corporation and is used primarily because of its attractiveness to investors [*see 10 Cal. Code Reg. §§ 260.140.4, 260.140.5* (discussed in *§§ 6J.19[5], 6J.20*)]. For other debenture forms, see Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 19, *Corporate Securities* , Forms 19.47-19.58 (Matthew Bender)

This form, although it contains a summary of its provisions, refers to the "indenture" for details. An indenture is generally a lengthy agreement between the corporation and the trustee, which is usually a bank with trust powers, and contains the full statement of the rights of the debenture holder. Most banks provide their own indenture form. The American Bar Association also provides a model indenture. For another form of indenture, see Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 19, *Corporate Securities* , Form 19.59 (Matthew Bender).

[2] Form

General Form for Debenture

General Form for Debenture

No. _____ .....$_____

_____ [*Name of company*]
_____ [*address of company*]

_____ [*term, e.g.,* 20-YEAR] _____ PERCENT DEBENTURE

Obligation

_____[*Name of company*], a California corporation (herein referred to as the "Company"), for value received, hereby promises to pay to _____[*name of debenture holder*], or registered assigns, at the office or agency of the Company for that purpose in the City of _____, State of _____, the principal sum of $_____ on _____[*date*], in lawful money of the United States of America[, unless this Debenture has been duly called for redemption and payment of the redemption price has been made or provided for].

Company furthers promises to pay interest on the principal sum from time to time remaining on this Debenture, at the rate of _____ percent per annum, at its office or agency, from _____[*specify, e.g.,* the date hereof], payable _____[*specify frequency and dates of payments, e.g,,* semiannually on April 1 and October 1 of each year] until payment of the principal sum has been made or duly provided for. The interest so payable is subject to certain terms, conditions, and exceptions provided in the Indenture referred to below, and will be paid to the person in whose name this Debenture is registered at the close of business on the _____[*specify dates of record, e.g.,* March 15, or September 15, as the case may be, next preceding April 1 or October 1, or, if March 15 or September 15 is not a business day, the business day next preceding March 15 or September 15].

Reference is hereby made to the further provisions of this Debenture set forth on the reverse hereof and those further provisions shall for all purposes have the same effect as though fully set forth here.

Authorization and Indenture

This Debenture is one of a duly authorized issue of Debentures of the Company, designated as its _____[*term, e.g.*, 20-Year] _____ Percent Debentures, due _____[*date*] (herein referred to as the "Debentures"), limited to the aggregate principal amount of _____[*e.g.*, $2 million], all issued or to be issued under and pursuant to an Indenture dated as of _____[*date*] (herein referred to as the "Indenture"), duly executed and delivered by the Company to _____[*name of trustee*], _____[*trustee's type of entity and status, e.g.,* a national banking association duly incorporated and existing under the laws of the United States of America], Trustee, which Indenture and all indentures supplemental thereto are hereby incorporated by reference in and made a part of this instrument and are hereby referred to for a description of the rights, limitation of rights, obligations, duties, and immunities thereunder of the Trustee, the Company, and the holders (the words "holders" or "holder" meaning the registered holders or designated holder) of the Debentures.

Denomination

The Debentures are issuable as registered Debentures without coupons in denominations of _____[*e.g.*, $1,000] and any multiple of _____[*e.g.*, $1,000]. At the office or agency referred to on the face hereof, and in the manner and subject to the limitations provided in the Indenture, Debentures may be exchanged without charge for a like aggregate principal amount of Debentures of other authorized denominations.

Authentication

This Debenture shall not be valid or become obligatory for any purpose until the certificate of authentication hereon shall have been executed by or on behalf of the Trustee under the Indenture referred to above.

IN WITNESS WHEREOF, _____ Company has caused this Debenture to be signed by its Chairman of the Board, President, or one of its Vice-Presidents by a facsimile of his or her signature and by its Secretary, one of its Assistant Secretaries, its Chief Financial Officer, or one of its Assistant Treasurers, by a facsimile of his or her signature and has caused its corporate seal to be affixed hereto or a facsimile thereof imprinted hereon.

Dated: _____.

[*Corporate seal*]

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]
Attest: _____ [*signature*]
[*typed name and title*]

Certificate of Authentification

This is one of the Debentures described in the aforementioned Indenture.

_____ [*signature of trustee*], Trustee
By _____ [*signature of officer*]
[*title*]

[*Reverse side:*]

_____ [*term, e.g.*, 20-YEAR] _____ PERCENT DEBENTURE

Default

In case Default, as defined in the Indenture, occurs and continues, the principal hereof may be declared, and on that declaration shall become, due and payable, in the manner, with the effect, and subject to the conditions provided in the Indenture.

Supplemental Indentures

The Indenture contains provisions permitting the Company and the Trustee, with the consent of the holders of not less than _____[*e.g.*, 662/3 percent] in aggregate principal amount of the Debentures at the time outstanding, evidenced as in the Indenture provided, to execute supplemental indentures adding any provisions to or

changing in any manner or eliminating any of the provisions of the Indenture or of any supplemental indenture or modifying in any manner the rights of the holders of the Debentures; provided, however, that no supplemental indenture shall (1) extend the fixed maturity of any Debentures, or reduce the principal amount thereof, or reduce the rate or extend the time of payment of interest thereon, or reduce any premium payable on the redemption thereof, without the consent of the holder of each Debenture so affected; or (2) reduce the above described percentage of Debentures, the consent of the holders of which is required for any such supplemental indenture, without the consent of the holders of all Debentures then outstanding. It is also provided in the Indenture that prior to any declaration accelerating the maturity of the Debentures on account of Default, the holders of a majority in aggregate principal amount of the Debentures at the time outstanding may, on behalf of the holders of all the Debentures, waive any past default under the Indenture and its consequences, except a default in the payment of the principal of or interest on any of the Debentures. Any consent or waiver by the holder of this Debenture (unless revoked as provided in the Indenture) shall be conclusive and binding on that holder and on all future holders and owners of this Debenture and of any Debenture issued in exchange or substitution therefor, irrespective of whether or not any notation of that consent or waiver is made on this Debenture.

Payment

No reference herein to the Indenture and no provision of this Debenture or of the Indenture shall alter or impair the obligation of the Company, which is absolute and unconditional, to pay the principal of and interest on this Debenture at the place, at the respective times, at the rate and in the lawful money herein prescribed.

Redemption

The Debentures may be redeemed, at the option of the Company, as a whole or from time to time in part (selected in any manner the Trustee deems appropriate and fair), at any time prior to maturity, on not less than 30 nor more than 60 days' prior notice, given as provided in the Indenture, at the following redemption prices (expressed in percentages of the principal amount) together with accrued interest to the date fixed for redemption: If redeemed during the 12- month period beginning October 1:

[*Start with the year of issuance, so the "premium" for redemption decreases the closer to full term the redemption occurs. Use as many years as is necessary for the specific issue. The table below assumes a 20-year maturity, with redemption possible in any of those years.*]

Year	Redemption Price
_____	1061/4 %
_____	
_____	106
_____	
_____	1053/4
_____	
_____	1051/4
_____	
_____	105
_____	
_____	1043/4

_____
_____ 1041/4
_____
_____ 104
_____
_____ 1033/4
_____
_____ 1031/4
_____
_____ 103
_____
_____ 1023/4
_____
_____ 1021/4
_____
_____ 102
_____
_____ 1013/4
_____
_____ 1011/4
_____
_____ 101
_____
_____ 1003/4
_____
_____ 1001/4
_____
_____ 100
_____

Transfer

On due presentment for registration of transfer of this Debenture at the above-mentioned office or agency of the Company, a new Debenture or Debentures, of authorized denominations, for a like aggregate principal amount, will be issued to the transferee as provided in the Indenture. No service charge shall be made for any transfer, but the Company may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto.

Prior to the registration of transfer of this Debenture, the Company, the Trustee, any paying agent, and any Debenture registrar may deem and treat the holder hereof as the absolute owner hereof (whether or not this Debenture shall be overdue, and notwithstanding any notation of ownership or other writing hereon made by anyone other than the Debenture registrar) for the purpose of receiving payment of or on account of the principal hereof (and premium, if any) and interest hereon, and for all other purposes, and neither the Company nor the Trustee nor any paying agent nor any

Debenture registrar shall be affected by any notice to the contrary.

Limited Liability

The holder or holders hereof shall not have any recourse for the payment of the principal of (or premium, if any), or the interest on, this Debenture, or for any claim based hereon, or otherwise in respect hereof, or based on, or in respect of, the Indenture or any indenture supplemental thereto, against any incorporator, shareholder, officer, or director, or attorney, past, present, or future, of the Company or of any successor corporation, whether by virtue of any constitution, statute, or rule of law, or by the enforcement of any assessment or penalty or otherwise. The holder or holders hereof, by the acceptance hereof and as part of the consideration therefor, expressly waive all liability and release an claims against the foregoing persons in connection with this Debenture.



61 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
C. Complete Debt Securities

3-6J California Legal Forms--Transaction Guide §§ 6J.235-6J.249

AUTHOR: Frances E. Lossing Practice Consultant

[Reserved]

§§ 6J.235[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
D. Optional Provisions for General Form for Debt Security

3-6J California Legal Forms--Transaction Guide § 6J.250

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.250 Provision for Interest to Be Dependent on Income

[1] Comment--Use of Form

This form is a provision for interest to be dependent on income. A corporation may wish to pay interest on outstanding debt only from income and not to be committed to pay interest unless there is income available at the time any particular interest payment is due. This can be achieved by providing that interest is dependent on income. Under this provision, the corporation promises to pay interest up to a specified percent of the principal amount per year, but only when, and to the extent, net earnings are available from its previous fiscal year.

For investors to speculate on this type of an offering, the maximum percentage at which interest is payable should be higher than would normally be offered, even if the investor is given many of the other protective provisions of a general debt issue, and whether the debt is secured or unsecured. The most common use of a provision making interest dependent on income is in connection with the reorganization of a previously existing corporation, when restructuring of the corporation may be under the protective auspices of a special governmental agency, and when the investors will be sophisticated and possibly specialized or related. Interest payments on a debt obligation are not substantially different than the dividend obligation of the issuer's preferred stock, therefore, one risk with making interest dependent on income is that the debt obligation may be deemed an equity security with attendant loss of deductibility of interest [*see § 6J.21[4]*]. For a complete income debenture, see Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, ch. 19, *Corporate Securities* , Form 19.58 (Matthew Bender).

The following provision may be substituted for paragraph or paragraphs labeled "Obligation" in the forms of note, bond, or debenture in §§ 6J.230, 6J.232, 6J.233, and 6J.234, except that when using this provision in the debenture *form in § 6J.234*, the last two sentences of the Obligation provision (referring to the "record date" for determining holders to whom interest payments will be made and referring to the terms on the reverse side of the debenture) should be retained, with modification of the "record dates." If the debt offering will be accompanied by a trust indenture, the portions of this provision defining net income may be omitted from the debt instrument itself and instead make reference to the

indenture for necessary definitions.

[2] Form

Provision for Interest to Be Dependent on Income

Provision for Interest as Dependent on Income

_____[*Name of company*], (hereinafter "the Company"), a corporation organized and existing under the laws of _____[*state*], for value received, promises to pay to _____[*name*] [or registered assigns] on _____[*date*], the principal sum of $_____. The Company also promises to pay interest on that principal sum from this date at the rate of not to exceed _____ percent per annum from the net income of the Company in accordance with the following terms. All of the Company's net income for each fiscal year in which it occurs will first be utilized up to the maximum percentile of interest of this _____[*specify type of debt security, e.g.*, Note] to pay the holders on a pro rata basis semi-annually, on the first day of _____[*month*] and of _____[*month*] during the subsequent fiscal year after determination of that net income. Only when all holders are paid the maximum percentage of interest as set forth on this _____[*specify type of debt security, e.g.*, Note] will net income be available for other purposes as the Board of Directors determines, such as the payment of dividends to shareholders. Any percentage interest figures not achieved in any particular year will not accumulate to any subsequent year, nor will more than the maximum percentage figure be paid during any one year, nor on other than a pro rata basis among all holders of these _____[*specify type of debt security, e.g.*, Notes].

The Company's net income for each fiscal year will be determined in the regular course of business by the Company's duly appointed certified public accountants as embodied in their annual report of audit and by consistent application of generally accepted accounting principles. Expenses of the Company are all of its existing and continuing obligations, including taxes, set asides for customary reserves, funds, or accounts, and other proper charges for any new, customary, and nonextraordinary obligations occurring in the normal course of doing business, and determined by the application of generally accepted accounting principles.

PRACTICE TIP:

In some circumstances, it may be appropriate to disregard certain expenses which would be proper expenses under generally acceptable accounting principles. For instance, the lender may want to disregard general and administrative expenses which exceed a certain amount or disregard expenses for certain operations which the lender believes are draining the company's capital resources. Limitations of this type are quite common in work-out situations. *Commentary by Frances E. Lossing.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
D. Optional Provisions for General Form for Debt Security

3-6J California Legal Forms--Transaction Guide § 6J.251

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.251 Provision for Interest Rate Tied to Bank's Prime Rate

[1] Comment--Use of Form

This provision is for use when the interest rate on the debt security is tied to a specific bank's prime rate. Although, theoretically, this provision could be substituted in any of the forms of note, bond, or debenture in §§ 6J.230, 6J.232, 6J.233, 6J.234 [*see* directions in § 6J.250[1]], it is most likely to be used in the note to single purchaser [*see § 6J.230*] when that purchaser is the bank to whose prime rate the loan rate is tied. If the investor is a bank, the optional sentence capping the loan rate at the maximum legal rate is not necessary, because the bank is exempt from California usury law [*Cal. Const., art. XV, § 1*; *Fin. Code § 1504*; *see, e.g., Jones v. Wells Fargo Bank (2003) 112 Cal. App. 4th 1527, 1534-1535, 5 Cal. Rptr. 3d 835* (loan and forbearance agreement made by national bank fell within *Fin. Code § 1504* exemption)]. For a secured note using an interest rate tied to prime rate, see Banking Law, Ch. 251, *Forms*, § 251.02[16] (Matthew Bender).

PRACTICE TIP:

There are a variety of other interest rates that are commonly used as an index for floating rate debt, including the federal funds rate, a certificate of deposit rate, and rates based other governmental indices such as treasury rates. *Commentary by Frances E. Lossing.*

If this provision is used when the holder is not the bank whose prime rate is used to determine the loan rate, counsel may wish to add additional provisions clarifying the who, when, and the way in which the determination of the bank whose prime rate is applicable will furnish its determination of, and changes in, its prime rate to the parties.

[2] Form

Provision for Interest Rate Tied to Bank's Prime Rate

Provision for Interest Rate Tied to Bank's Prime Rate

_____[*Name of company*], (hereinafter "Company"), a corporation organized and existing under the laws of _____[*state*], for value received, promises to pay to _____[*name; if a bank, add:* (hereinafter "Bank")] [or registered assigns] on _____[*date*], in lawful money of the United States, the principal sum of $_____ and to pay interest on the principal sum from the date of issue at the Loan Rate, which is defined as _____ percent per annum above _____'s [*name of bank, or if that bank is the holder* Bank] [*add if appropriate the office at which that prime rate is determined, e.g.,* main Los Angeles loan office] Prime Rate [as reflected in its books and records] until payment of principal. Interest payments must be made _____[*specify interval and dates, e.g.,* quarterly on March 31, June 30, September 30, and December 31 of each year] commencing _____[*date*].

The Loan Rate shall change when and as Prime Rate changes. Interest shall be calculated on a daily basis at the Loan Rate on the outstanding principal amount, divided by 360, on the actual days elapsed from the date hereof or from the last interest payment, as is applicable. [The Loan Rate shall never exceed the maximum lawful rate of interest applicable to this _____ (*specify type of debt security, e.g.,* Note).]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
D. Optional Provisions for General Form for Debt Security

3-6J California Legal Forms--Transaction Guide § 6J.252

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.252 Provision for Interest Rate Tied to London Inter-Bank Offering Rate

[1] Comment--Use of Form

This provision is for use when the interest rate on the debt security is tied to the London Interbank Offered Rate (LIBOR) for US dollar deposits. Although theoretically this provision could be substituted in any of the forms of note, bond, or debenture in §§ 6J.230, 6J.232, 6J.233, 6J.234 [*see* directions in § 6J.250[1]], it is most likely to be used in the note to single purchaser [*see § 6J.230*] when that purchaser is a bank. In fact, the bank is likely to have its own form of note, which defines LIBOR and fixes the manner in which the interest rate will change: how often and when. If the investor is a bank, the optional sentence capping the loan rate at the maximum legal rate is not necessary, because the bank is exempt from California usury law [*Cal. Const., art. XV, § 1*; *Fin. Code § 1504*; *see, e.g., Jones v. Wells Fargo Bank (2003) 112 Cal. App. 4th 1527, 1534-1535, 5 Cal. Rptr. 3d 835* (loan and forbearance agreement made by national bank fell within *Fin. Code § 1504* exemption)]. For a provision tying the interest rate on a line of credit to LIBOR, see Banking Law, Ch. 251, *Forms*, § 251.02[19] (Matthew Bender).

[2] Form

Provision for Interest Rate Tied to London Inter-Bank Offering Rate

Provision for Interest Rate Tied to London Inter-Bank Offering Rate

_____[*Name of company*], (hereinafter "Company"), a corporation organized and existing under the laws of _____[*state*], for value received, promises to pay to _____[*name; if a bank, add:* (hereinafter "Bank")] [or registered assigns] on _____[*date*], in lawful money of the Unites States, the principal sum of $_____ and to pay interest on the principal sum from the date of issue at the Loan Rate, which is defined as _____ percent per annum above the London Interbank Offered Rate (hereinafter "LIBOR") until payment of principal. Interest payments must be made _____[*specify interval and dates, e.g.*, quarterly on March 31, June 30, September 30, and December 31 of each year] commencing

_____[*date*].

The Loan Rate shall be changed for each _____[*specify interval for which interest payments are to be made, e.g.,* quarter] based on LIBOR, as determined by _____[*name or* Bank], on its first business day of each _____[*specify interval for which interest payments are to be made, e.g.,* quarter]. LIBOR is the rate of interest determined by _____[*name or* Bank] as being the rate at which United States Dollar deposits for the amount of outstanding principal are available to _____[*name or* Bank] for a calendar quarter in the Eurodollar Interbank Market in London [at or about _____ (*time, e.g.,* 11:00 A.M.) London time].

Interest shall be calculated on a daily basis at the Loan Rate on the outstanding principal amount, divided by 360, on the actual days elapsed from the date hereof or in each _____[*specify interval for which interest payments are to be made, e.g.,* quarter], as is applicable. [The Loan Rate shall never exceed the maximum lawful rate of interest applicable to this _____ (*specify type of debt security, e.g.,* Note).]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
D. Optional Provisions for General Form for Debt Security

3-6J California Legal Forms--Transaction Guide § 6J.253

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.253 Provision for Conversion Into Equity Securities

[1] Comment

[a] Use of Form

This form is a provision for conversion into equity securities. It may be added as an optional provision to the general note *form in § 6J.232* or incorporated into any other debt security that is convertible into an equity security. The paragraphs describing the rates of conversion, the notice of conversion, and the mechanics of surrender of the note, bond, or debenture should be incorporated in the note, bond, or debenture, while the portion of the form for use to exercise the right of conversion should be added at the end of the note, bond, or debenture.

As with redemption, two methods are generally utilized for conversion. One encourages the holder to convert sooner, rather than simply to wait for a rising market value of the underlying securities, by giving more shares in exchange for the note, bond, or debenture at the earlier time, and decreasing that number as time progresses and the market value (hopefully) rises. Alternatively, exchange for a fixed number of shares for the debt security at all times may also be utilized. There is no problem of notice because the option is strictly that of the holder. If the debt security also carries a redemption feature, a cutoff period for conversion should be arranged for after any notice of redemption is sent by the company, in which the holder is allowed a last chance to convert before the company takes back the note, bond, or debenture. There should also be a cutoff date for interest that ordinarily would have accrued after the time of election to convert.

The Commissioner of Corporations does not require stricter protection, particularly a sinking fund provision [*see § 6J.257*], when the debt instrument is convertible [*10 Cal. Code Reg. § 260.140.4*]. However, the instrument governing the debt should provide antidilution protection against recapitalizations (dividends or splits) so that conversion rights will be adjusted to the new situation, and may provide for that adjustment on new issues of common stock for less than the conversion or then market value [*10 Cal. Code Reg. § 260.140.6*]. Antidilution provisions may be found in Paragraph 7 of the general *form in § 6J.232*.

[b] Attachment of Election Form for Conversion

A form for exercising the election to convert should be attached to a convertible debt security just after the execution, and preceding any attached forms of assignment. That form should be presented to the company along with any related necessary documentation at the time the holder desires to exercise his or her right to convert the note, bond, or debenture into equity securities of the company. For placement of any warrants that may be detachable that may be included, or featured in lieu of conversion, see coverage of warrants in Ch. 6I, *Issuance of Equity Securities*.

[c] Possible Need for Qualification if Debt Includes Conversion Privilege

Convertibility of a debt security into preference or plain voting equity shares of the issuer may be an attractive feature for investors in small growth companies, particularly when the debt is unsecured. Because the feature of convertibility can transform a debt issue of less popular appeal into an equity issue of probably greater marketability and value, convertible debt securities have been a source of much apprehension for both the local and federal regulatory authorities. In California, a conversion feature renders a debt offering immediately subject to qualification, as an offering of the underlying or optioned security, unless an exemption is available for the issuance of the equity securities [*Corp. Code § 25017(e)*]. The issuer must obtain qualification of those equity securities unless a sale of the equity security would be exempt from qualification before the Commissioner of Corporations as an issuer transaction by any provision other than *Corp. Code § 25102(h)* [*10 Cal. Code Reg. § 260.102.3*; *see § 6J.19[3]*].

On the federal level, a conversion feature raises the possibility of the need to resort to the investment representation device or pledge for future registration [*see § 6J.19[4]* and *forms in §§ 6J.259, 6J.260*].

[2] Form

Provision for Conversion Into Equity Securities

Provision for Conversion into Equity Securities

[*EITHER*]

[Straight] Conversion

This _____[*specify type of debt security, e.g.*, Note] will be convertible at the option of the registered holder at any time from and after _____[*date*], and prior to its maturity[, or, if this _____[*specify type of debt security, e.g.*, Note] is called for redemption at any time from and after the date of its issuance and prior to its maturity, then this _____[*specify type of debt security, e.g.*, Note] will be so convertible at any time prior to the close of business on the _____ day preceding the date fixed for redemption]. This _____[*specify type of debt security, e.g.*, Note] will be convertible into fully paid and nonassessable shares of _____[*type*] stock _____[($_____) par value *or* without par value] of the Company at the rate of one share for each $_____ principal amount to be converted. In order to exercise the conversion privilege granted, the holder of this _____[*specify type of debt security, e.g.*, Note] will surrender this _____[*specify type of debt security, e.g.*, Note] to the Company with the form of conversion hereinafter provided duly executed. [*If debt security is in registered form, add:* If the _____ (*type*) stock into which this _____ (*specify type of debt security, e.g.*, Note) is convertible is to be issued in a name or names other than that of the registered holder of this _____ (*specify type of debt security, e.g.*, Note), the _____ (*specify type of debt security, e.g.*, Note) must bear or be accompanied by proper endorsement or assignment of the _____ (*specify type of debt security, e.g.*, Note).]

[*Or*]

Conversion at Increasing Price

This _____[*specify type of debt security, e.g.,* Note] is convertible at the option of its holder, on or at any time prior to maturity [or, if called for redemption at a prior time, then at any time up to and including the date fixed for redemption,] but not after, into fully paid shares of the capital stock of the Company as follows:

(1) If converted on or after _____[*date*], and prior to _____[*date*], into fully paid shares of the capital stock of the Company on the basis of _____[*e.g.,* one share of capital stock for each $_____ principal amount of this _____ (*specify type of debt security, e.g.,* Note)].

(2) If converted on or after _____[*date*], and prior to _____[*date*], into fully paid shares of the capital stock of the Company on the basis of _____[*e.g.,* one share of capital stock for each $_____ principal amount of this _____ (*specify type of debt security, e.g.,* Note)].

[*Continue, with the value decreasing progressively according to the best estimate of the anticipated increase in fair value of the securities.*]

[*Continue with the following:*]

Notice of Conversion and Right

A holder desiring to convert this _____[*specify type of debt security, e.g.,* Note] into capital stock must give written notice to the Company and, simultaneously with the giving of notice, surrender this _____[*specify type of debt security, e.g.*, Note] [*if debt security is in registered form, add:*, together with a duly executed instrument of assignment and transfer in blank,] at the principal office of the Company in _____[*location*]. The Company will promptly issue to the holder the shares of stock into which this _____[*specify type of debt security, e.g.*, Note] is to be convertible. Shares of the capital stock of the Company issued on the conversion of this _____[*specify type of debt security, e.g.,* Note] will not be entitled to any dividend declared on the stock prior to the date of receipt by the Company of the notice of election to convert and of this _____[*specify type of debt security, e.g.,* Note] accompanied by any instrument of assignment and transfer, and on conversion the holder will not be entitled to any interest on this _____[*specify type of debt security, e.g.*, Note] not due and payable at or prior to the date notice of conversion is received by the Company.

Surrender and Cancellation of Notes

This _____[*specify type of debt security, e.g.*, Note] will be deemed to have been surrendered for conversion and converted at the close of business on the date on which it is received by the Company or a designated agent of the Company with the form of election to convert duly executed, and on receipt the Company will promptly issue and deliver to the person or persons entitled a certificate or certificates of its _____[*type*] stock

evidencing the number of shares into which this _____[*specify type of debt security, e.g.*, Note] will have been converted. The Company will then cancel this _____[*specify type of debt security, e.g.*, Note], and, in the event that less than the entire principal amount is so converted, will issue a new _____[*specify type of debt security, e.g.*, Note] for the balance not so converted, together with an escrow receipt evidencing any new _____[*specify type of debt security, e.g.*, Note] if it is then required to be placed in escrow. The Company agrees to reserve for issuance sufficient shares of its authorized but unissued _____[*type*] stock _____[($_____) par value *or* without par value] as will be necessary to satisfy its obligation to issue stock on conversion of this _____[*specify type of debt security, e.g.*, Note] in accordance with its terms.

[*Place at end of note, bond, or debenture:*]

Form for Exercising Election to Convert

The undersigned holder of _____[Certificate No._____ *if any*] percent [_____ (*description of debt security, e.g.*, Convertible Subordinated Promissory Note] due _____[*date*], of _____[*corporation*] surrenders $_____ aggregate principal amount of that _____[*description of debt security, e.g.*, Note] for conversion on the terms and conditions set forth in the _____[*description of debt security, e.g.*, Note], and requests that the shares issuable on conversion be issued to the following person or persons:

Name	Address
_____	_____
_____	_____

_____ [*signature of registered owner*]

NOTE:

In the event that the aggregate principal amount of the within _____ [*description of debt security, e.g.*, Note] which is being surrendered for conversion has not been specified, it is agreed that the entire aggregate principal amount evidenced by the within _____ [*description of debt security, e.g.* Note] will be deemed to have been so surrendered for conversion into shares of _____ [*type*] stock of the Company.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
D. Optional Provisions for General Form for Debt Security

3-6J California Legal Forms--Transaction Guide § 6J.254

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.254 Provision for Securing Note by Real Property

[1] Comment

[a] Use of Form

This form is a provision for securing a note by real property. A note secured by a lien on real property is distinguished from other debt financing by being called a bond when it is one of a series of notes on the same security [*see § 6J.233* (bond secured by deed of trust)]. If the financing is private, a standard corporate deed of trust may be used to embrace all the security provisions pertaining to the property and the creditor's claim on it. If the investors' group is relatively large, particularly when it involves a public offering, the deed of trust is expanded into a form of quite elaborate proportions to become a full-fledged trust indenture.

Unless a large series of financing notes is likely, the deed of trust, as in the present form, will be "closed" so that no future issues may constitute a lien on the same property. If the investors want extra protection under the circumstances, the deed of trust could also include all after-acquired property in the description of the property which is subject of the security lien. If the corporation has limited real property assets, or if it needs to secure an exceptionally large issue, it originally may give a blanket deed of trust to cover all property it then owns, which also may be coupled with the after-acquired clause. In a closed-end deed of trust, however, adding newly acquired property to a present lien is simply strengthening a prior issue without affording the corporation a means of financing the new acquisition.

To issue new debt securities on the same property, the issuer would either have to have included an open-ended provision in the note and deed of trust [*see § 6J.255*] or provide for the securities issued later to take a junior position in terms of the security to the notes of the former issue.

This provision may be added to the end of Paragraph 3 of the general note *form in § 6J.232[2]*.

For a bond that is one in a series, payable to a single individual, and secured by a mortgage or deed of trust given to a

bank, as trustee, see Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 19, *Corporate Securities* , Form 19.71 (Matthew Bender).

[b] Advantages of Securing Note With Real Property

Real property is considered prime security, and it may attract investors into a debt market in which they might otherwise fear the investment was too speculative. Corporations that hold much property as an integral part of their business, such as utility and transportation companies, have been most disposed to issue debt secured by real property.

Corporations ordinarily may issue notes secured by real property at a lower interest rate because of the improved prospects of repayment.

[2] Form

Provision for Securing Note by Real Property

Provision in Note Secured by Real Property

All Notes of this series are secured by a deed of trust executed concurrently, dated _____, by Company, as trustor, to _____[*title company, or if trust indenture accompanies the note, bank or corporate trust company*] as trustee, for the benefit of the holders of this series of Notes, on certain real property standing in the name of Company in the County of _____, State of California. That deed of trust should be consulted for a description of the property and all rights and obligations of the parties with respect to that property. All the terms of the deed of trust are incorporated here by reference.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
D. Optional Provisions for General Form for Debt Security

3-6J California Legal Forms--Transaction Guide § 6J.255

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.255 Provision for Open-End Note Secured by Real Property

[1] Comment--Use of Form

This form is a provision for an open-ended note secured by real property. If a corporation wants to offer debt instruments secured by real property [*see § 6J.254[1]*], while still reserving the right to issue future series of notes secured by the same real property, this "open-ended" provision should be included in the initial notes and indenture or deed of trust.

The open-end provision is designed to allow all present and future creditors within the financing plan to share equally in the lien arrangement. The value of the land, of course, should adequately support all the loans with an adequate surplus remaining. The only other alternative would be to relegate the investors in any subsequent offering secured by the same real property to junior or subordinate positions. Junior lien financing is, of course, less desirable and more difficult to market, and ordinarily must be offered at a higher rate of interest.

Provision for this arrangement needs to be placed expressly in the body of the note as well as in the deed of trust. The following provision is designed to be added to the end of the provision in § 6J.254[2], which itself is added at the end of Paragraph 3 of the note *form in § 6J.232[2]*.

[2] Form

Provision for Open-End Note Secured by Real Property

Provision for Open-End Note Secured by Real Property

The Company may issue further notes, in different amounts and series from those of the series containing this Note, up to an aggregate principal amount [outstanding at any one time] for all series combined of $_____, and any or all further series may be secured by the same real property and under the same deed of trust as is the present

Note and series, and the holders of the future series Notes will share on an equal basis with the holders of the present series as to all rights and obligations among the parties with respect to the real property that secures all series. All other terms and conditions of later series, including rate of interest, times and manner of payment, and maturity dates, may be determined by the Board of Directors and embodied in Notes of those later series.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
D. Optional Provisions for General Form for Debt Security

3-6J California Legal Forms--Transaction Guide § 6J.256

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.256 Provision for Securing Note by Personal Property (Collateral)

[1] Comment--Use of Form

This form is a provision for security a note by personal property. A less protective and familiar type of security for a note is personal property collateral. In most instances, a corporation does not have enough machinery and equipment apart from that which is already attached to its real property to provide the basis of an independent lien on personalty. The most familiar type of equipment collateral offering is that of the railroads, which have developed specialized types of provisions for handling equipment financing. Normally, a collateral trust indenture accompanies the offering and handles the bulk of the protective machinery of the loan. Purchase money financing of office or other machinery and equipment is also quite common. Personal property may also be included if the lender requests a blanket lien on all property of the borrower.

Most corporations offering a loan secured by personal property offer as security obligations or securities of their own subsidiaries, accounts receivable, or inventories on hand. In a larger public offering, a note secured by personal property is accompanied by a collateral trust indenture, which may run to an elaborate size and may detail several security provisions. In private financing, a bank or small personal property lender is frequently interested in the collateral type of loan on a short-term basis. It should not be overlooked as a supplemental means of financing when other sources have been utilized to their limits.

This provision may be added at the end of paragraph 3 of the general note *form in § 6J.232[2]*.

[2] Form

Provision for Securing Note by Personal Property (Collateral)

Provision for Note to Be Secured by Personal Property (Collateral)

All Notes of this series are equally secured by particular personal property under a collateral trust indenture, dated _____[*date*], executed by the Company as trustor to _____[*any department designation, such as corporate trust section or banking trust department, and name*] as trustee, for the benefit of all holders of this series of Notes. That indenture and all supplemental instruments should be consulted for description of the pledged property, and for all the terms and conditions relating to all rights and obligations of the parties to these Notes and that indenture. The provisions of the indenture are here incorporated by reference.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
D. Optional Provisions for General Form for Debt Security

3-6J California Legal Forms--Transaction Guide § 6J.257

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.257 Provisions for Sinking Fund

[1] Comment

[a] Use of Form

This form is a provision for a sinking fund. On a moderate-to-long-term issue, investors usually want some kind of provision for a sinking fund arrangement to insure that the corporation retains enough of the income it is earning to be able to pay off the principal when it becomes due. The Commissioner of Corporations, in qualifying public offerings, considers a sinking fund an important element of fairness of nonconvertible offerings [*10 Cal. Code Reg. § 260.140.4(a)*]. When a trust indenture accompanies the note, the sinking fund payments may be made to the trustee, who will have responsibility for supervising the maintenance of the fund. The corporation usually has a right to make redemption payments out of the sinking fund or to credit any redemptions or purchases of outstanding notes of the issue against payments to be made to the sinking fund. For other sinking fund provisions, see Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 19, *Corporate Securities* , Forms 19.59 and 19.74 and (Matthew Bender).

Although failure to make a sinking fund payment is usually an event of default, the consequences of default are not usually decisively enforced when a corporation fails to make a particular sinking fund payment. The investors are less likely to declare the note, or series, immediately due than to negotiate some other remedy.

[b] Inclusion in General Form for Note

If this provision is desired to be added to the general note *form in § 6J.232[2]*, it may be inserted anywhere after Paragraph 3 and before Paragraph 6. Preferably, however, it should become a new Paragraph 4, and the subsequent paragraphs should all be renumbered one figure higher than their present designations. Failure to maintain the fund or to make an individual payment to the fund is an element of default already provided for in the general language of Paragraph 8(a)(3) of that note, but the second portion of the following provision may also be added as a new

Subparagraph (a)(3) of that Paragraph 8 (which is likely to be renumbered 9 if the sinking fund provision has been previously inserted), with all the remaining subparagraphs being renumbered one figure higher than their present designations.

[2] Form

Provisions for Sinking Fund

Provisions for Sinking Fund

[*Provision setting up sinking fund:*]

The Company agrees to establish and administer a sinking fund by _____[*date*], into which each year thereafter, the Company, on or before _____[*e.g.*, July 1] according to the advice of its accountants using modern securities principles of accountancy, will deposit an amount of cash sufficient so that, on a cumulative annual basis, the fund will be sufficient to retire all outstanding Notes of the issue at maturity as provided in the terms of the Notes. Each annual deposit will be the equivalent at least of _____[*e.g.*, 1] percent of the aggregate principal amount of the issue then outstanding, although this amount may be increased to cover certain contingencies of the market then in existence, or may be diminished in any particular year by retirement during that year by the Company of any Notes through redemption or other purchase. This sinking fund may be utilized only to redeem or retire at maturity or thereafter any Notes of this series until all Notes have been retired.

[*Optional provision defining instance of default to be inserted in general note as subparagraph(a)(3) for form in § 6J.232:*]

Sinking Fund Payments

[9 (a)] (3) Default in the maintenance of the sinking fund, as provided in this Note, or in the payment of any installment to that fund at the time it becomes due, or in the failure to increase the payment at any appropriate interval when an increase is called for under modern principles of accountancy; or

[*Continue by renumbering other subparagraphs, starting with the subparagraph originally numbered (a)(3) in form in § 6J.232.*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
D. Optional Provisions for General Form for Debt Security

3-6J California Legal Forms--Transaction Guide § 6J.258

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.258 Provision for Serial Redemption

[1] Comment--Use of Form

This form is provision for serial redemption. Instead of maintaining a sinking fund [*see § 6J.257*], a debt issue may be provide for retirement by portions at progressively remote intervals. This allows for a wider choice among investors who wish to invest for shorter, more moderate, or longer portions of the ultimate term of the general issue. It also allows a corporation to immediately begin retiring its debt out of present income, so that the formal establishment of a sinking fund is not necessary, although a sinking fund still may be provided for, as long as it is coordinated with the serial redemption program. Usually the securities are numbered or lettered so that the earlier numbers or letters are the first to be retired. The break off points among the series may be determined anywhere and varied among the different portions to be retired. Default is immediately actionable, of course, as to each separate series on the failure of the corporation to immediately retire that portion of the notes when due.

This provision may substitute for one of the alterative redemption provisions in Paragraph 4 of the note *form in § 6J.232[2]*. It would be used in place of Paragraphs 3 and 4 of that note.

[2] Form

Provision for Serial Redemption

Provisions for Serial Redemption

Series Conditions

3. This Note is one of a duly authorized issue of Notes of the Company classified into different series, the total of all series together being in an aggregate principal amount of $_____ of _____ percent [_____ (*additional descriptive term, if any, e.g.,* Subordinated)] Promissory Notes, hereinafter

called the "Notes," all of which are subject to the terms and conditions of this document[, except for variations necessary to express the number, principal amount, and due date of each Note].

Serial Redemption

4. Each of the different series of the Notes matures at progressively more remote intervals as set forth below:

Serial Numbers	Amount of Principal Represented	Denominations of Notes	Date Due
_____ to _____ [*e.g.*, 101 to 130]	$_____	$_____	_____ [*date*]
_____ to _____	$_____	$_____	_____ [*date*]

[*Continue as necessary; "Series" may be used instead of "Serial Numbers," such as Series A, Series B, and so on.*]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
D. Optional Provisions for General Form for Debt Security

3-6J California Legal Forms--Transaction Guide § 6J.259

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.259 Provision for Investment Representation for Federal Intrastate Offering Exemption

[1] Comment

[a] Use of Form

This form is a provision for investment representation for the federal intrastate offering exemption. Any kind of security, including a debt offering, is exempt from federal registration requirements if it is part of an issue offered and sold only to persons resident within the state, and the corporation or other issuer is incorporated or otherwise resident and doing business in the same state [Securities Act of 1933, § 3(a)(11); *15 U.S.C. § 77c(a)(11)*; *17 C.F.R. § 230.147* (hereinafter "Rule 147"), discussed in Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* ; *see also* Sommer, FEDERAL SECURITIES ACT OF 1933, ch. 3, *Exempted Securities Under Sections 3(a)(2) Through 3(a)(8) of the Securities Act*, § 3.12 (Matthew Bender)]. This is one of the federal exemptions that specifically does not preempt state regulation [*see 15 U.S.C. § 77r(b)(4)(C)*, discussed in *§ 6J.19[4]*].

The intrastate issue of securities itself should not be part of a larger multistage offering [*see* SEC Securities Act Release 4434 (discussed in [c], *below*)]. The entire distribution should come to rest within the hands of residents [*17 C.F.R. § 230.147(d)*]; or if resales are involved, they should be made to other residents only [*17 C.F.R. § 230.147(e)*], and appropriate restrictions on transfer, including the placement of a legend on the note, bond, or debenture, may need to be included in the issue to insure this feature [*17 C.F.R. § 230.147(f)(1)(i), (ii), (f)(2)*]. The issuer must obtain written representation from each purchaser as to his or her residence [*17 C.F.R. § 230.147(f)(1)(iii)*] (Paragraph 1) and must, in connection with any offers, disclose in writing the limitations on resale contained in *17 C.F.R. § 230.147(e)* and the provisions of *17 C.F.R. § 230.147(f)(1)(i)* and *(ii)* and *17 C.F.R. § 230.147(f)(2)* [*17 C.F.R. § 230.147(f)(3)*].

The form in [2], *below*, is designed as a provision to be inserted in a note. The paragraphs in the provision should be renumbered to fit in proper sequence wherever they are inserted in the note. The form may be modified for use in a bond or other type of debt security. It may also be modified to be used as a separate letter from the investor. For a letter representation form, see *Ch. 6B, California Limited Offering Exemptions, § 6B.200*.

[b] Placement of This Provision

The notice of restrictions on transfers must be conspicuously placed in the note or other security in order to bind a subsequent transferee as intended by Paragraph 4. A restriction on transfer of a certificated security imposed by the issuer, even if otherwise lawful, is ineffective against a person without knowledge of the restriction unless the restriction is noted conspicuously on the security certificate [*Com. Code § 8204(1)*]. For general discussion of legends, see *Ch. 6H, Qualification of Securities, § 6H.260*.

[c] Factors That Are Determinative of Intrastate Exemption

In determining whether the offering is part of a larger interstate issue, any one or more of the following factors may be determinative of the point [SEC Securities Act Release 4434]:

- The offerings are part of a single plan of multistate financing.
- The offerings involve issuance of the same class of security on a multistate basis.
- The offerings in more than one state are made at or about the same time.
- The same type of consideration is received in the multistate offerings.
- The offerings in the several states are made for the same general purpose.

The time differential among any of these factors is only a single item to be considered in determining whether an integrated interstate offering has been effected or is contemplated [*see 17 C.F.R. § 230.147(b)(2)*].

[2] Form

Provision for Investment Representation for Federal Intrastate Offering Exemption

Provision for Investment Representation for Federal Intrastate Offering Exemption [Securities Act of 1933, § 3(a)(11); 15 U.S.C. § 77c(a)(11)]

Purchaser's Representations and Restrictions on Transfers to Maintain Federal Intrastate Offering Exemption

1. By the acceptance of this Note, the initial payee of this Note represents and warrants that he or she is purchasing his or her Note for investment for either his or her own account or, if with any present intent of dividing his or her participation with others or reselling or otherwise distributing it, then only to persons who are proved--by virtue of credible, authenticated evidence, documented in a reasonable manner appropriate under the circumstances--to be bona fide residents of California.

2. Initial payee has represented to the Company, and continually warrants during the time period of the complete distribution of the series of which this Note is a part,

(a) That he or she is a bona fide resident of the State of California.

(b) That should his or her residence change during the immediate future during which it is reasonably foreseeable that the distribution of the series of which this Note is a portion is still being completed, he or she will resell, or will make arrangement with the Company [or any of its underwriters of this issue] to resell this Note to another California resident.

3. Initial payee understands and acknowledges that the Company has advised him or her that the Note has not been

registered under the Securities Act of 1933, as amended, on the ground that this security and transaction is exempt under Section 3(a)(11)of that Act [*15 U.S.C. § 77c(a)(11)*], as not involving any interstate offering, and that the Company's reliance on that exemption is predicated in part on his or her representation and warranty as contained in this Note. Initial payee further understands and acknowledges that the Company has advised him or her that while he or she has the right to dispose of his or her own property when and as he or she sees fit, it is important that he or she realize that in the view of the Securities and Exchange Commission, the statutory basis for exemption in cases of securities or transactions not involving any interstate offering would not be present, if, notwithstanding the foregoing representation, warranty, and agreement, he or she had in mind merely acquiring the Note for resale, consciously or not, to anyone who might be a non-California resident, on the occurrence or nonoccurrence of any event or set of circumstances. By the acceptance of this Note, initial payee confirms that the effect and intention of the representation and warranty set forth above is that he or she does not now intend to dispose of all or any part of the Note to be issued to him or her to anyone other than a true California resident; and that, should his or her residence change, or should other circumstances occur that lead him or her to resell the Note, and he or she cannot reasonably procure its purchase by another genuine California resident, he or she now intends that he or she would then apply to the Company [or to one of its underwriters] for purposes of having a sale to a bona fide California resident arranged. By the acceptance of this Note, initial payee agrees that the transfer of this Note [and the transfer of any shares of _____ (*type, e.g,* common) stock of the Company into which this Note may be converted] will be subject to the restriction that no transfers will be effected until either

(a) The holder of the Note or shares has obtained either an opinion of counsel satisfactory to counsel for the Company to the effect that the proposed transfer will not result in a loss of the intrastate offering exemption or a violation of the Securities Act of 1933, as then amended, or a letter from the Securities and Exchange Commission to the effect that no action will be taken with respect to the transfer; or

(b) A registration statement with respect to this Note [or the shares of _____ (*type, e.g,* common) stock of the Company into which this Note may be converted] is then effective in current form under the Securities Act of 1933, as then amended.

4. These representations, warranties, and restrictions on transfers to only bona fide residents of California will be binding on all subsequent transferees of this Note [or the shares of _____ (*type, e.g.,* common) stock into which this Note may be converted].

Company's Representation

5. Neither the Company nor anyone acting on its behalf has, directly or indirectly, offered any of the Notes, or any similar securities, for sale to, nor solicited any offers to buy the Notes or any similar securities, from, nor otherwise negotiated, with any person or persons in any manner as to bring the offering, issue, or sale of these securities under the registration provisions of the Federal Securities Act of 1933, as amended.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6J ISSUANCE OF DEBT SECURITIES
PART IV. FORMS
D. Optional Provisions for General Form for Debt Security

3-6J California Legal Forms--Transaction Guide § 6J.260

AUTHOR: Frances E. Lossing Practice Consultant

§ 6J.260 Provision in Note for Investment Representation for Federal Private Offering Exemption

[1] Comment--Use of Form

This form is a provision in a note for an investment representation for the federal private offering exemption. A debt offering is exempt from federal registration requirements if it complies with Section 4(2) or one of the three exemptions for limited and private offerings commonly referred to as Regulation D [Securities Act of 1933, §§ 3(b), 4(2); *15 U.S.C. §§ 77c(b), 77d(2)*; *17 C.F.R. §§ 230.501-230.508*, discussed in Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations* ; *see also* Sommer, FEDERAL SECURITIES ACT OF 1933, Ch. 4, *Exempted Securities Under Sections 3(a)(9) Through 3(a)(11) and Section 4 of the Securities Act*, § 4.02 (Matthew Bender)]. Regulation D, at least the exemption provided by *17 C.F.R. § 230.506*, is one of the federal exemptions that does preempt state regulation, specifically *Corp. Code § 25102(f)* [*see 15 U.S.C. § 77r(b)(4)(D)*, discussed at *§ 6J.19[4]*; *see also* Dept. of Corps. Release No. 103-C (Dec. 12, 1996); Ch. 6B, *California Limited Offering Exemptions*; Marsh & Volk, *PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, ch. 3A, Federal Preemption of State Securities Regulation, § 3A.01[2][d]* (Matthew Bender)].

Unless the offer and sale are made under Rule 504, securities offered under the Regulation D exemption cannot be resold without registration under Securities Act of 1933 or exemption from that Act [*17 C.F.R. §§ 230.502(d), 230.504(b)(1)*]. To maintain the Regulation D exemption, the issuer must exercise reasonable care to ensure that purchasers are not underwriters within the meaning of Section 2(11) of the Securities Act of 1933 (*15 U.S.C. § 77b(a)(11)*) [*17 C.F.R. § 230.502(d)*]. Reasonable care may be demonstrated by the following:

- Reasonable inquiry to determine if a purchaser is acquiring securities for his or her self or for other persons [*17 C.F.R. § 230.502(d)(1)*] (Paragraph 1);

- Written disclosure to each purchaser prior to sale that securities have not been registered, and therefore cannot be resold unless registered or exempted [*17 C.F.R. § 230.502(d)(2)*] (Paragraphs 1 and

3); and

- Placement of a legend on the certificate or other document evidencing securities, stating that the securities are not registered and setting forth restrictions on transfer and sale of securities [*17 C.F.R. § 230.502(d)(3)*] (Paragraphs 1 and 3).

The form in [2], *below*, is designed as a provision to be inserted in a note. The paragraphs in the provision should be renumbered to fit in proper sequence wherever they are inserted in the note. The form may be modified for use in a bond or other type of debt security. It may also be modified to be used as a separate letter from the investor. For a letter representation form, see *Ch. 6B, California Limited Offering Exemptions, § 6B.200*.

The notice of restrictions on transfers must be conspicuously placed in the note or other security in order to bind a subsequent transferee as intended by Paragraph 4 [*see Com. Code § 8204(1)*]. For a general discussion of legends, see *Ch. 6H, Qualification of Securities, § 6H.260*.

[2] Form

Provision in Note for Investment Representation for Federal Private Offering Exemption

Provision in Note for Investment Representations for Federal Private Offering Exemption [Securities Act of 1933, § 4(2); 15 U.S.C. § 77d(2)]

Purchaser's Representation and Restrictions on Transfers to Maintain Federal Private Offering Exemption

1. By the acceptance of this Note, the initial payee of this Note represents and warrants that he or she is purchasing his or her Note for investment for his or her own account and with no present intention of dividing his or her participation with others, or reselling or otherwise distributing it. Initial payee understands and acknowledges that the Company has advised him or her that this Note has not been registered under the Securities Act of 1933, as amended, on the ground that this transaction is exempt under Section 4(2) of that Act, as not involving any public offering, and that the Company's reliance on this exemption is predicated in part on initial payee's representation and warranty contained in this Note.

2. Initial payee further understands and acknowledges that the Company had advised him or her that while he or she has the right to dispose of his or her own property when and as he or she sees fit, it is important that he or she realize that in the view of the Securities and Exchange Commission, the statutory basis for exemption in case of transactions not involving any public offering would not be present, if, notwithstanding the foregoing representation, warranty, and agreement, he or she had in mind merely acquiring the Note for resale on the occurrence or nonoccurrence of some predetermined event, such as, for example, after holding the Note for the applicable capital gains period of the tax statutes, or for a market rise, or for sale if the market does not rise, or for a fixed or determinable period in the future. By the acceptance of this Note, initial payee confirms that the effect and intention of his or her representation and warranty set forth above is that he or she does not now intend to dispose of all or any part of this Note.

3. By the acceptance of this Note, the initial payee agrees that the transfer of this Note[and the transfer of any shares of _____ (*type*) stock of the Company into which this Note may be converted] will be subject to the restriction that no transfers will be effected until either

(a) The holder of the Note or shares has obtained either an opinion of counsel satisfactory to counsel for the Company to the effect that the proposed transfer will not result in a violation of the Securities Act of 1933, as then amended, or a letter from the Securities and Exchange Commission to the effect that no action will be taken with respect to the transfer; or

(b) A registration statement with respect to this Note [or the shares of _____ (*type*) stock of the Company into which this Note may be converted] is then effective in current form under the Securities Act of 1933, as then amended.

4. This provision shall be binding on all subsequent transferees of this Note [or the shares of _____ (*type*) stock into which this Note may be converted].

Company's Representation

5. Neither the Company nor anyone acting on its behalf has, directly or indirectly, offered any of the Notes, or any similar securities, for sale to, or solicited any offers to buy such, from, or otherwise negotiated, with any person or persons in any manner that would require registration under the provisions of the Federal Securities Act of 1933, as amended.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES

3-6K California Legal Forms--Transaction Guide 6K.syn

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.syn Synopsis to Chapter 6K: NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES

§ 6K.01 California Sources

[1] Statutes

[2] Regulations

§§ 6K.02-6K.04 [Reserved]

§ 6K.05 Law Reviews and Periodicals

§ 6K.06 Annotations

§ 6K.07 Text References

§§ 6K.08-6K.09 [Reserved]

§ 6K.10 Uniform Commercial Code--Investment Securities

[1] Regulation of Property Rights

[2] Methods of Holding Securities

[3] Prior Law and Transitional Provisions

§ 6K.11 Definitions

[1] In General

[2] Financial Asset

[3] Security

[4] Issuer

[5] Certificated Security

[6] Bearer Form of Certificated Security

[7] Registered Form of Certificated Security

[8] Uncertificated Security

[9] Securities Entitlement

[10] Entitlement Holder

[11] Securities Account

[12] Securities Intermediary

[13] Clearing Corporation

[14] Endorsement

[15] Instruction

[16] Entitlement Order

[17] Appropriate Person

[18] Protected Purchaser

[19] Control

[a] Effect of Having Control

[b] Certificated Security in Bearer Form

[c] Certificated Security in Registered Form

[d] Uncertificated Security

[e] Security Entitlement

[20] Overissue

§ 6K.12 Acquisition of Security

§ 6K.13 Acquisition of Financial Asset Other Than Security

§ 6K.14 Right of Ownership

§ 6K.15 Validity of Security

[1] Lack of Genuineness

[2] Validity of Signature on Certificate

[3] Assertion by Issuer That Security Is Not Valid

[4] After Trigger of Right to Immediate Performance

§ 6K.16 Effective Transfer

[1] Authorization

[a] Endorsement

[b] Instruction

[c] Entitlement Order

[2] Delivery

§ 6K.17 Effect of Transfer

§ 6K.18 Registration

[1] Request to Register Transfer

[2] Assurance of Genuineness of Endorsement or Instruction

[3] Warranties of Guarantor of Signature

[a] Person Reasonably Believed to Be Responsible

[b] Guaranty of Signature

[4] Demand to Not Register A Security

[5] Liability of Issuer for Wrongful Registration of Transfer

§ 6K.19 Lost Certificate

§ 6K.20 Security Entitlement

[1] Securities Intermediary's Obligation to Maintain Asset

[2] Entitlement Holder's Property Interest

[3] Enforcement of Property Interest Against Securities Intermediary

[4] Enforcement of Property Interest Against Purchaser

§ 6K.21 Warranties of Transferror

[1] Certificated Security

[2] Uncertificated Security

[3] Entitlement Order

§ 6K.22 Adverse Claims

[1] Adverse Claim

[2] Purchaser for Value

[3] Notice of Adverse Claim

[4] Not Sufficient to Constitute Notice of Adverse Claim

[5] Action Against Issuer Regarding Certificated Security

[6] Liability of Transaction "Conduit"

§ 6K.23 Creditors' Rights

[1] Certificated Security

[2] Uncertificated Security

[3] Security Entitlement

§ 6K.24 Statute of Frauds

§ 6K.25 Governing Law

[1] Jurisdiction of Organization of Issuer

[2] Jurisdiction of Securities Intermediary

[3] Jurisdiction in Which Security Certificate Is Located

§§ 6K.26-6K.39 [Reserved]

§ 6K.40 Offer or Sale of Securities in Nonissuer Transactions in California

[1] Qualification Requirement

[2] Qualification by Notification

[a] Requirement

[b] Application

§ 6K.41 Securities Exempt From Qualification in Nonissuer Transactions

[1] All Transactions

[2] Nonissuer Transactions

§ 6K.42 Exempt Nonissuer Transactions

[1] Private Sale by Owner

[2] Unsolicited Sale by Broker-Dealer

[3] Sale to Institutional Investor

[4] Agreement With Underwriter

[5] Liquidation of Secured Debt

[6] Transactions by Executors, Administrators, Guardians

[7] Offer Pending Registration

[8] Sales Soon After Qualification

[9] Out-of-State Sales and Sales to Broker-Dealers

[10] Other Exemptions by Rule of Commissioner

§§ 6K.43-6K.99 [Reserved]

§ 6K.100 Facts--Entitlement

Scope

§ 6K.101 Facts--Control of Entitlement

Scope

§ 6K.102 Facts--Notice of Adverse Claims

Scope

§ 6K.103 Facts--Nonissuer Transaction

Scope

§ 6K.104 Documents

Scope

§§ 6K.105-6K.109 [Reserved]

§ 6K.110 Existence of Financial Asset

Scope

§ 6K.111 Existence of Security

Scope

§ 6K.112 Effective Endorsement

Scope

§ 6K.113 Effective Instruction

Scope

§ 6K.114 Effective Entitlement Order

Scope

§ 6K.115 Adverse Claim

Scope

§ 6K.116 Validity of Security

Scope

§ 6K.117 Securities Exemptions--General Determinations for Nonissuer Transactions

Scope

§ 6K.118 Availability of Private Sale Exemption

Scope

§§ 6K.119-6K.139 [Reserved]

§ 6K.140 Transfer of Certificated Security in Registered Form

Scope

§ 6K.141 Transfer of Uncertificated Security

Scope

§§ 6K.142-6K.199 [Reserved]

§ 6K.200 Assignment Separate From Certificate

[1] Comment

[a] Use of Form

[b] Warranties of Endorser

[2] Form

Assignment Separate From Certificate

§ 6K.201 Instruction for Transfer of Uncertificated Securities

[1] Comment

[a] Use of Form

[b] Warranties of Originator of Instruction

[2] Form

Instruction for Transfer of Uncertificated Securities

§ 6K.202 Entitlement Order

[1] Comment

[a] Use of Form

[b] Warranties of Originator of Entitlement Order

[2] Form

Entitlement Order

§ 6K.203 Demand Not to Register Transfer

[1] Comment--Use of Form

[2] Form

Demand Not to Register Transfer

§ 6K.204 Indemnification Agreement Regarding Replacement Shares

[1] Comment--Use of Form

[2] Form

Indemnification Agreement Regarding Replacement Shares

§ 6K.205 Pledge Agreement for Certificated Securities

[1] Comment--Use of Form

[2] Form

Pledge Agreement for Certificated Securities

§ 6K.206 Pledge Agreement for Uncertificated Securities

[1] Comment--Use of Form

[2] Form

Pledge Agreement for Uncertificated Securities

§ 6K.207 Pledge Agreement for Securities Held in Securities Account

[1] Comment--Use of Form

[2] Form

Pledge Agreement for Securities Held in Securities Account

§§ 6K.208-6K.219 [Reserved]

§ 6K.220 Application for Qualification by Notification in Nonissuer Transaction

[1] Comment--Use of Form

[2] Form

Application for Qualification by Notification in Nonissuer Transaction

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FOOTNOTES:

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(n15)Footnote **. Frances E. Lossing has been a corporate lawyer with O'Melveny & Myers LLP for over 20 years. She specializes in financing transactions and mergers and acquisitions and heads the firm's blue sky practice. She has a B.A. and M.A. from the University of Michigan and a J.D. from the University of California at Los Angeles.



74 of 189 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES

3-6K California Legal Forms--Transaction Guide Scope

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

Scope

Marilyn Mingern*
AuthorFrances E. Lossingn**
Practice Consultant Scope

This chapter covers Division 8 of the California Commercial Code, which addresses ownership interests in investment securities and the transfer of those interests. Division 8, which is essentially Article 8 of the Uniform Commercial Code, attempts to provide clear and concise rules to guide the business community in dealing with the issuance, purchase, transfer and registration of investment securities. Those rules are discussed in this chapter. This chapter also discusses issues arising under the Corporate Securities Law of 1968 with respect to nonissuer transactions, including exemptions that are specifically applicable to such transactions and are not discussed elsewhere in this publication.

Forms included in this chapter include forms for assignment separate from certificate, instructions for transfer of uncertificated securities, entitlement orders, demand not to register a transfer of securities, an indemnification agreement regarding replacement shares, and pledge agreements for certificated securities, uncertificated securities, and securities held in a securities account. The statutory form for an application for qualification in nonissuer transactions is also included.

FOOTNOTES:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6K California Legal Forms--Transaction Guide § 6K.01

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.01 California Sources

[1] Statutes

Commercial Code Rules Governing Investment Securities (UCC Division 8)
Adverse claim. *Com. Code §§ 8102(a)(1), 8105.*
Bearer form. *Com. Code § 8102(a)(2).*
Broker. *Com. Code § 8102(a)(3).*
Certificated security. *Com. Code § 8102(a)(4).*
Clearing corporation. *Com. Code §§ 8102(a)(5), 8111.*
Communicate. *Com. Code § 8102(a)(6).*
Entitlement holder. *Com. Code § 8102(a)(7).*
Entitlement order. *Com. Code § 8102(a)(8).*
Financial asset. *Com. Code § 8102(a)(9).*
Endorsement. *Com. Code § 8102(a)(11).*
Instruction. *Com. Code § 8102(a)(12).*
Registered form. *Com. Code § 8102(a)(13).*
Securities intermediary. *Com. Code § 8102(a)(14).*
Security. *Com. Code § 8102(a)(15).*
Security certificate. *Com. Code § 8102(a)(16).*
Security entitlement. *Com. Code § 8102(a)(17).*
Uncertificated security. *Com. Code § 8102(a)(18).*
Investment company security. *Com. Code § 8103(b).*
Acquisition of security interest. *Com. Code § 8104(a).*
Acquisition of financial asset. *Com. Code § 8104(b).*
Control. *Com. Code § 8106.*
Appropriate person. *Com. Code § 8107(a).*

Effective endorsement, instruction, or entitlement order. *Com. Code § 8107(b)*.
Warranties. *Com. Code §§ 8108, 8109, 8208*.
Choice of law. *Com. Code § 8110*.
Jurisdiction. *Com. Code § 8110*.
Creditors' rights. *Com. Code § 8112*.
Statute of frauds. *Com. Code § 8113*.
Issuer. *Com. Code § 8201*.
Overissue. *Com. Code § 8210*.
Delivery. *Com. Code § 8301*.
Protected purchaser. *Com. Code § 8303*.
Signature guarantee. *Com. Code § 8306*.
Registration. *Com. Code § 8401*.
Securities account. *Com. Code § 8501*.
Securities intermediary obligations. *Com. Code §§ 8504-8509*.
Transition. *Com. Code § 8603*.

Nonissuer Transactions Under Corporate Securities Law
"Advertisement" defined. *Corp. Code § 25002*.
"Nonissuer transaction" defined. *Corp. Code § 25011*.
"Publish" defined. *Corp. Code § 25014*.
Qualification requirements for the offer or sale of securities in nonissuer transactions. *Corp. Code § 25130*.
Methods of qualification of the offer or sale of securities in nonissuer transactions. *Corp. Code § 25131*.
Terms of qualification for the offer or sale of securities in nonissuer transactions. *Corp. Code § 25132*.

[2] Regulations

Nonpublic offering and sale in nonissuer transactions. *10 Cal. Code Reg. § 260.102.2*.

Unsolicited orders in nonissuer transactions. *10 Cal. Code Reg. § 260.104*.

Bona fide secured parties in the offer or sale of securities in nonissuer transactions. *10 Cal. Code Reg. § 260.104.2*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART I. RESEARCH GUIDE
A. Primary Sources

3-6K California Legal Forms--Transaction Guide §§ 6K.02-6K.04

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§§ 6K.02[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6K California Legal Forms--Transaction Guide § 6K.05

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§ 6K.05 Law Reviews and Periodicals

Gillette and Maher, *Revised article 8: Issuers Beware! 15 UCC L.J. 146 (1982).*

Halpern, *Defining the "Validity" of a "Security" Under Article 8, 12 U.C.C. L.J. 195* (1980).

Coogan, *Security Interests in Investment Securities Under Revised Article 8 of the Uniform Commercial Code, 92 Harv. L. Rev. 1013 (1979).*

Aronstein, *Security Interests in Securities: Code Revision, 10 U.C.C. L.J. 289 (1978).*

Israels and Guttman, *The Transfer Agent and the Uniform Commercial Code, 21 Bus. Law. 981 (1966).*

Wozencraft, *Investment Securities Under the Uniform Commercial Code--Guidelines for Business Lawyers, 44 Tex. L. Rev. 669 (1966).*

Folk, *Some Problems Under Article 8 of the Uniform Commercial Code, 5 Ariz. L. Rev. 193 (1963).*

Guttman, *Investment Securities, 17 Rutgers L. Rev. 136 (1962).*

Israels, *Investment Securities as Negotiable Paper--Article 8 of the Uniform Commercial Code, 13 Bus. Law. 676 (1958).*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6K California Legal Forms--Transaction Guide § 6K.06

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.06 Annotations

Annot., Construction and Effect of UCC § 8-207(1)Allowing Issuer of Investment Security to Treat Registered Owner as Entitled to Owner's Rights Until Presentment for Registration of Transfer, 21 A.L.R.4th 879 (1983) .

Annot., What Is a "Security" Under UCC Art. 8, 11 A.L.R.4th 1036 (1982).

Annot., Who Is "Bona Fide Purchaser" of Investment Security Under UCC § 8-302, 88 A.L.R.3d 949 (1978) .

Annot., Construction and Effect of UCC Art. 8, *Dealing With Investment Securities, 21 A.L.R. 962 (1968)* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6K California Legal Forms--Transaction Guide § 6K.07

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.07 Text References

Marsh & Volk, Practice Under the California Securities Laws, ch. 10, *Nonissuer Transactions* (Matthew Bender).

Ballantine & Sterling, California Corporation Laws (Matthew Bender).
Ch. 10, *Transfer and Registration of Securities*.
Ch. 21, *Corporate Securities*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

3-6K California Legal Forms--Transaction Guide §§ 6K.08-6K.09

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[Reserved]

§§ 6K.08[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.10

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§ 6K.10 Uniform Commercial Code--Investment Securities

[1] Regulation of Property Rights

The transfer of securities by a nonissuer invokes several overlapping but distinct regulatory schemes. First are securities regulations, federal and state, dictating which securities can be transferred and under what conditions. For a general discussion of state blue sky regulation see Ch. 6, *Securities Regulation Issues* ; for discussion of some of the specific California securities law requirements applicable to secondary transfers of securities ("nonissuer transaction"), see *§§ 6K.40-6K.42*. The other key set of applicable laws is Article 8 of the Uniform Commercial Code, Investment Securities, adopted as Division 8 of the California Commercial Code [*see §§ 6K.10-6K.25*].

Division 8 of the Commercial Code, cited as Uniform Commercial Code--Investment Securities [*Com. Code § 8101*], regulates the transfer of the property rights represented by securities and financial assets and the establishment of those rights against the issuer and other parties [Official Comment to UCC § 8-101]. It does not set forth specific disclosure requirements regarding the nature of the property interest represented by the security, as do the federal securities regulations and state blue sky laws. It does not set forth general rules defining rights that accrue to the holders of securities like a corporations code or contract law. Nor is Division 8 a comprehensive statutory scheme governing the relationship between a broker-dealer or other securities professional and its customers. Most of the law governing the latter relationship is the common law of contract and agency, as modified by regulation.

Division 8 provides a legal structure for the holding and transfer of the rights that constitute investment securities. It simplifies the transfer of investment securities by limiting the transferor's liability when the formalities of Division 8 are complied with.

[2] Methods of Holding Securities

Financial assets can be held either directly or indirectly. If an asset is held directly, the holder has a specific property interest in the financial asset. If the asset is held indirectly, through an intermediary, the holder has a package of

personal rights against the intermediary and a general interest in the property held by the intermediary.

The direct holding system includes "certificated" and "uncertificated" securities. If the securities of a corporation are held through the direct system, the owner will either (1) have a security certificate representing the shares and be listed in the records of the issuer as the owner of shares or (2) not have a certificate but be listed in the records of the issuer as the owner of the shares. The indirect holding system deals with security entitlements. If the shares are held through the indirect system, they will be held by a securities intermediary and the name of the owner will not be registered on the books of the issuer.

PRACTICE TIP:

It may be helpful in understanding Division 8 to consider how a variety of common financial products fit into the Division 8 statutory scheme. Stock in a closely held corporation is typically held in certificated form through the direct holding system. Publicly traded stocks and bonds are typically held in certificated form through the indirect holding system. Mutual fund shares are typically held in uncertificated form through the direct holding system. Treasury securities are held in uncertificated form either through the Treasury Direct system, which is a direct holding system, or through financial intermediaries, such as banks or broker-dealers, which is an indirect holding system. Other common types of financial products, such as bank accounts, trusts and partnership or limited liability interests that are not publicly traded, are not Division 8 securities. Division 8, therefore, typically is not applicable to these types of financial products, although the indirect holding rules will apply to partnership and limited liability interests held in a securities account, regardless of whether such interests are publicly traded. *Commentary by Frances E. Lossing.*

[3] Prior Law and Transitional Provisions

The original version of Division 8 was based on possession and delivery of physical certificates. It was assumed that each time securities were sold, physical certificates would be transferred from seller to buyer. The buyer then would surrender the transferred certificate to the issuer or its transfer agent for registration of transfer. Modern electronic systems for recording ownership of securities and the transfer of ownership were subsequently developed to simplify the transfer process. These developments led to a revision to Division 8 in 1984 to deal with uncertificated securities.

The 1984 revision of Division 8, however, did not deal adequately with the indirect system of holding securities through securities intermediaries that has developed over the last several decades. The revision to Division 8 that became effective in 1997 is intended to address these inadequacies. The latter revision made major substantive changes to Division 8. It is not merely an amendment to the prior version. California adopted these changes effective January 1, 1997 [*see Com. Code § 8601*].

Security interests perfected prior to January 1, 1997, in a manner that would suffice to perfect them under the post-1997 laws continue to be perfected under the latter laws [*Com. Code § 8603(b)*]. Security interests perfected prior to January 1, 1997, in a manner that would not suffice to perfect them under the post-1997 laws remained perfected for four months after January 1, 1997, and continue to be perfected thereafter if appropriate action pursuant to the post-1997 laws was taken within that four month period [*Com. Code § 8603(b)*]. If a security interest was perfected prior to 1997 and that interest could be perfected by filing under Division 9 of the Commercial Code, the filing of a financing statement signed by the secured party rather than the debtor during that four month period would be sufficient to continue perfection or thereafter to perfect, as long as the financing statement contained a statement that it was being filed pursuant to *Com. Code § 8603* [*Com. Code § 8603(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:

Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.11

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§ 6K.11 Definitions

[1] In General

Many of the terms used in Division 8 have broader meanings as used therein than they may have in other contexts. Other terms used may be unique to Division 8. Many of the terms used in Division 8 are defined in *Com. Code § 8102(a)*. Other important definitions are referenced in *Com. Code § 8102(b)*. The definitions in the remainder of this section are key to an understanding of Division 8.

[2] Financial Asset

PRACTICE TIP:

The indirect holding system rules set forth in Chapter 5 of Division 8 apply to financial assets held in a securities account. The interest of the person who holds the financial asset in a securities account is a securities entitlement. A "securities entitlement" is the package of rights that an investor has under the indirect holding system rules. An understanding of these three definitions, "financial asset," "securities account," and "securities entitlement" therefore is key to understanding the scope of the indirect holding system rules. *Commentary by Frances E. Lossing.*

"Financial asset" is the broadest category of investment securities. Financial assets can be held either directly or indirectly. The term "financial asset" is used to refer both to the underlying asset and the particular means by which ownership of that asset is evidenced. For example, with respect to a certificated security, the term "financial asset" may refer either to the interest or obligation of the issuer or to the certificate itself [Official Comment No. 9 to *UCC § 8102*]. A "financial asset" is any of the following [*Com. Code § 8201(a)(9)*]:

- A security.
- An obligation of a person or a share, participation, or other interest in a person or in property or an

enterprise of a person, that is, or is of a type, dealt in or traded on financial markets, or that is recognized in any area in which it is issued or dealt in as a medium for investment.

- Any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this division. As the context requires, the term means either the interest itself or the means by which a person's claim to it is evidenced, including a certificated or uncertificated security, a security certificate, or a security entitlement.

- Options issued by a clearing corporation to its participants [*Com. Code § 8103(e)*].

Even if they are not securities for purposes of Division 8, the following are financial assets for purposes of Division 8 if they are held in securities accounts:

- Partnership interests or limited liability company interests [*Com. Code § 8103(c)*].

- Negotiable instruments governed by Division 3 of the California Commercial Code (beginning with *Com. Code § 3101* [*Com. Code § 8103(d)*].

A commodity contract is not a financial asset for purposes of Division 8 [*Com. Code § 8103(f)*; *see Com. Code § 9102(a)(15)* ("commodity contract" defined)]. A document of title is not a financial asset unless Com. Code § 8102(a)(9)(c) applies [Com. Code § 8103(g)] (which concerns property held by a securities intermediary for another person pursuant to an agreement to treat the property as a financial asset).

[3] Security

PRACTICE TIP:

One of the major changes made by the revisions to Division 8 is that the term "security" plays a different and more limited role than under the prior version. Under the prior version, the definition of "security" determined the coverage of all of the substantive provisions of Division 8. Under the revisions to Division 8, interests and obligations that fall within the definition of "security" are governed by all of the provisions of Division 8, including the direct holding system rules in Chapters 2, 3 and 4. The indirect holding system rules in Chapter 5, however, apply to a broader class of interests and obligations, namely "financial assets." *Commentary by Frances E. Lossing.*

A security is an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer that has all of the following characteristics [*Com. Code § 8102(a)(15)*]:

- It is represented by a security certificate, or the transfer of it may be registered on books maintained for that purpose by or on behalf of the issuer;

- It is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests or obligations; and

- It is either of the following:

    - It is, or is of a type, dealt in or traded on securities exchanges or securities markets.

    - It is a medium for investment and by its terms expressly provides that it is a security governed by Division 8.

The following are securities:

- An equity interest issued by a corporation, business trust, joint stock company or similar entity [*Com. Code § 8103(a)*].

- An equity interest issued by an entity that or a unit investment trust, such as a closed-end mutual fund, is registered under the federal investment company laws as an investment company [*Com. Code § 8103(b)*]. Such an equity interest is called an "investment company security" [*Com. Code § 8103(b)*].

- Shares of stock of close corporations even though they are not usually dealt in or traded in, since they are a *type* of security that is commonly traded.

The Division 8 rules do not apply to interests or obligations in circumstances so unrelated to the securities markets that parties would be unlikely to have thought that they might apply to them. For purposes of Division 8, an interest in a partnership or limited liability company is *not* a security unless [*Com. Code § 8103(c)*]:

- It is traded on a securities exchange or securities market;

- Its terms expressly provide that it is a security governed by Division 8; or

- It is an investment company security.

Even if it is not a security, a partnership interest or limited liability company interest may be a financial asset [*see* [2], *above*].

The following are not securities for purposes of Division 8:

- Commodity contracts [*Com. Code § 8103(f)*; *see Com. Code § 9102(a)(15)* ("commodity contract" defined)].

- Options issued by a clearing corporation to its participants [*Com. Code § 8103(e)*].

PRACTICE TIP:

The term "security" in Division 8 is not the same as the definition of "security" for federal and state securities laws purposes. The scope of the term "security" for securities law purposes is determined by the need for market regulation and disclosure. The scope of the term "security" for Division 8 purposes is determined primarily by the need and suitability of the rules applicable to the obligations of issuers, transfer mechanisms and registration of transfer set forth in Chapters 2, 3 and 4 of Division 8. *Commentary by Frances E. Lossing.*

[4] Issuer

An issuer, with respect to an obligation on or a defense to a security, is a person that does any of the following [*Com. Code § 8201(a)*]:

- Places or authorizes its name to be placed on a security certificate as an issuer to evidence an interest in its property or an enterprise or its duty to perform an obligation represented by the certificate.

- Creates an interest in its property or in an enterprise or undertakes an obligation, that is an

uncertificated security.

- Creates a fractional interest in its rights or property that is represented by a security certificate.

- Becomes responsible for, or in place of another person described as an issuer. With respect to an obligation or a defense to a security, a guarantor is an issuer to the extent of the guaranty, whether or not the obligation of the guarantor is noted on the certificate. A guarantor will not be an issuer, however, with respect to the maintenance of transfer books.

PRACTICE TIP:
The definition of "issuer" functions primarily to describe the persons whose defenses may be cut off under Chapter 2 of Division 8. For this reason, a guarantor is included in the definition of "issuer" to the extent of its obligations under the guaranty. *Commentary by Frances E. Lossing.*

With respect to a registration or transfer, an issuer is a person on whose behalf transfer books are maintained [*Com. Code § 8201(c)*].

[5] Certificated Security

A certificated security is a security that is represented by a certificate [*Com. Code § 8102(a)(4)*]. A writing that is a security certificate is governed by Division 8 rather than Division 3 (negotiable instruments) even if the writing meets the requirements of Division 3 [*Com. Code § 8103(d)*].

[6] Bearer Form of Certificated Security

Bearer form is a form of certificated security in which the security is payable to the bearer of the certificate according to the terms of the security, but not because of an endorsement [*Com. Code § 8102(a)(2)*].

PRACTICE TIP:
The primary function of the concepts of "registered form" and "bearer form" is to distinguish obligations covered by the provisions of Division 8 from other types of instruments governed by the provisions of Division 3. *Commentary by Frances E. Lossing.*

[7] Registered Form of Certificated Security

Registered form is a form of certificated security in which the certificate specifies a person entitled to the security and a transfer of the security may be registered upon the issuer's books maintained for that purpose [*Com. Code § 8102(a)(13)*].

[8] Uncertificated Security

An uncertificated security is a security that is not represented by a certificate [*Com. Code § 8102(a)(18)*]. The ownership interest is recorded in books maintained by the issuer for that purpose. Uncertificated securities are part of the direct holding system.

[9] Securities Entitlement

A securities entitlement is an entitlement to the rights and property interest of a person who holds securities or other financial assets though a securities intermediary [*Com. Code § 8102(a)(17)*]. Issuance of a security does not establish a securities entitlement [*Com. Code § 8501(e)*]. A securities entitlement is both a package of personal rights against the securities intermediary and an interest in the property held by the securities intermediary. It is not, however, a specific

property interest in any financial asset held by the securities intermediary or clearing corporation [Official Comment No. 17 to UCC § 8-102].

PRACTICE TIP:

It is important to distinguish a "security" and a "securities entitlement." A "security" is an obligation that is intended to be traded. A "securities entitlement," on the other hand, defines the rights and duties of a "securities intermediary" to an "entitlement holder." There are a number of relationships that involve the holding of securities by another that do not create securities entitlements. For example, a customer may transfer possession of a security to his or her broker for safekeeping without endorsing the certificate to the broker. In this circumstance, no securities entitlement is created. Likewise, a trustee may hold an interest in underlying assets, such as an interest in a pool of mortgages, an interest in a basket of other securities, such as the NASDAQ 100 trust that holds interests in the 100 largest non-financial securities traded on the NASDAQ national market system, or American Depositary Receipts that represent an interest in securities of a foreign issuer. Again, no securities entitlement is created by the interests unless they are held in a securities account. *Commentary by Frances E. Lossing.*

A person acquires a securities entitlement if a securities intermediary does any of the following, even if the securities intermediary does not itself hold the financial asset [*Com. Code § 8501(b), (c)*]:

- Makes a book entry that a financial asset has been credited to that person's securities account.

- Receives a financial asset from the person or on behalf of the person and accepts the financial asset for credit to the person's securities account.

- Becomes obligated under other law, regulation, or rule to credit a financial asset to the person's securities account.

If any condition listed above has been met, a person has a securities entitlement even if the securities intermediary itself does not hold the financial asset [*Com. Code § 8501(c)*].

If a securities intermediary holds a financial asset for another person but the financial asset has not been endorsed to the securities intermediary, the person is considered to hold the financial asset directly [*Com. Code § 8501(d)*].

[10] Entitlement Holder

An entitlement holder is a person who holds financial assets through intermediaries in the indirect holding system and is identified in the records of a securities intermediary as the person having the securities entitlement [*Com. Code § 8102(a)(7)*].

[11] Securities Account

A securities account is an account to which a financial asset is or may be credited pursuant to agreement that the person for whom the account is maintained is entitled to exercise the rights comprising the financial asset [*Com. Code § 8501(a)*].

[12] Securities Intermediary

A securities intermediary is either a clearing corporation or a person that in the ordinary course of its business maintains securities accounts for others [*Com. Code § 8102(a)(14)*]. Securities intermediaries include banks and brokers when they are acting in a securities intermediary capacity [*Com. Code § 8102(a)(14)*]. A securities intermediary that receives a financial asset and establishes a security entitlement to the financial asset in favor of an entitlement holder is a

purchaser for value of the financial asset [*Com. Code § 8116*]. A securities intermediary owes duties only to its own entitlement holders [Official Comment No. 4 to UCC § 8-115].

[13] Clearing Corporation

A clearing corporation is any of the following [*Com. Code § 8102(a)(5)*]:

- A person registered as a clearing agency under federal securities laws.
- A person that acts as a clearing agency but is exempt from registration under federal securities laws, if such person's activities as a clearing agency are subject to federal or state regulation.
- A federal reserve bank.

Clearing corporations are subject to a rigorous regulatory framework.

A rule adopted by a clearing corporation governing rights and obligations among the clearing corporation and its participants is effective even if the rule conflicts with Division 8 and affects another party who does not consent to the rule [*Com. Code § 8111*].

[14] Endorsement

An endorsement is a signature on a security certificate in registered form or on a separate document made for the purpose of assigning, transferring, or redeeming the security [*Com. Code § 8102(a)(11)*].

[15] Instruction

An instruction is a communication to the issuer of an uncertificated security directing that the transfer of the security be registered or that the security be redeemed [*Com. Code § 8102(a)(12)*]. It may be in the form of a writing signed by the registered owner or in any other form agreed on by the issuer and the registered owner [Official Comment No. 1 to UCC § 8-305].

[16] Entitlement Order

An entitlement order is a communication to a securities intermediary directing the transfer or redemption of a financial asset to which the entitlement holder has a securities entitlement [*Com. Code § 8102(a)(8)*]. It need not be initiated by the entitlement holder to be effective, as long as the entitlement holder has authorized the initiating party to do so. [Official Comment No. 8 to UCC § 8-102].

[17] Appropriate Person

An appropriate person is one who is entitled to transfer a security or financial asset and is the following with respect to the various methods of holding securities or financial assets:

- With respect to an endorsement, the person specified by a security certificate or by an effective special endorsement to be entitled to the security [*Com. Code § 8107(a)(1)*].
- With respect to an instruction, the registered owner of an uncertificated security [*Com. Code § 8107(a)(2)*].
- With respect to an entitlement order, the entitlement holder [*Com. Code § 8107(a)(3)*].

- The successor or personal representative of a deceased appropriate person [*Com. Code § 8107(a)(4)*].

- The guardian, conservator or similar representative of an appropriate person who lacks capacity [*Com. Code § 8107(a)(5)*].

[18] Protected Purchaser

A protected purchaser is a purchaser of a security who gives value, does not have notice of any adverse claim, and obtains control of the security [*Com. Code § 8303(a)*]. A protected purchaser acquires the interest of the seller, and acquires that interest free of any adverse claims [*Com. Code § 8303(b)*].

[19] Control

[a] Effect of Having Control

Obtaining control means that a purchaser has taken whatever steps are necessary, given the manner in which the securities or financial assets are held, to place itself in a position where it can have the securities or financial assets sold without further action by the owner [Official Comment No. 1 to UCC § 8-106].

PRACTICE TIP:

The concept of "control" plays a key role in various provisions of Division 8 and Division 9, including *Com. Code §§ 8303* (protected purchaser), 8503(a) (purchasers from securities intermediaries), 8510 (purchasers of securities entitlements from entitlement holders), 9312 (perfection of security interests in investment property), and 9328 (priorities among conflicting security holders). The concept is not to be interpreted by reference to similar concepts in other bodies of law. In particular, the requirements for "possession" derived from the common law of pledges are not to be used as a basis determining when an uncertificated security has been delivered or pledged, a purchaser has become the entitlement holder or a securities entitlement has been pledged. *Commentary by Frances E. Lossing.*

[b] Certificated Security in Bearer Form

A purchaser has control of a certificated security in bearer form if the certificate is delivered to the purchaser [*Com. Code § 8106(a)*]. See *§ 6K.16[2]* for a discussion of the concept of delivery of a certificated security.

[c] Certificated Security in Registered Form

A purchaser has control of a certificated security in registered form if the certificate is delivered to the purchaser and the certificate is endorsed to the purchaser or in blank by an effective endorsement or the certificate is registered in the name of the purchaser [*Com. Code § 8106(b)*]. See *§ 6K.16[2]* for a discussion of the concept of delivery of a certificated security.

[d] Uncertificated Security

A purchaser has control of an uncertificated security if the uncertificated security is delivered to the purchaser or the issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner [*Com. Code § 8106(c)*]. The issuer may not enter into an agreement to comply with instructions originated by the purchaser without the consent of the registered owner [*Com. Code § 8106(g)*]. The issuer is not required to enter into such an agreement, however, even if the registered owner so directs [*Com. Code § 8106(g)*]. The purchaser has control of the security if the issuer has agreed that it will comply with instructions originated by the purchaser even if the registered owner retains the right to make substitutions for the uncertificated security, to originate

instructions, or otherwise deal with the uncertificated security [*Com. Code § 8106(f)*]. See *§ 6K.16[2]* for discussion of the concept of delivery of an uncertificated security.

[e] Security Entitlement

A purchaser has control of a security entitlement if the purchaser becomes the entitlement holder, or the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder, or another person has control of the security entitlement on behalf of the purchaser or, having previously acquired control of the security entitlement, acknowledges that it has control on behalf of the purchaser [*Com. Code § 8106(d)*]. If an interest in a security entitlement is granted by the holder to the holder's own securities intermediary, the securities intermediary has control [*Com. Code § 8106(e)*]. The securities intermediary may not enter into an agreement to comply with entitlement orders originated by the purchaser without the consent of the entitlement holder [*Com. Code § 8106(g)*]. The securities intermediary is not required to enter into such an agreement, however, even if the entitlement holder so directs [*Com. Code § 8106(g)*]. The purchaser has control of the entitlement if the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser even if the entitlement holder retains the right to make substitutions for the security entitlement, to originate entitlement orders, or otherwise deal with the security entitlement [*Com. Code § 8106(f)*].

[20] Overissue

"Overissue" means the issue of securities in excess of the amount the issuer has corporate power to issue [*Com. Code § 8210(a)*]. An overissue does not occur if appropriate action has cured the overissue [*Com. Code § 8210(c)*]. The provisions of Division 8 that validate a security or compel its issue or reissue do not apply to the extent that validation, issuance, or reissuance would result in overissue [*Com. Code § 8210(b)*].

PRACTICE TIP:

Corporation codes universally require that a corporation's articles of incorporation or other charter document state maximum limits of capital stock that may be issued. If a corporation issues stock in excess of these limits, the purchaser has no authority to require the issuer to amend its articles of incorporation or other charter documents to increase the amount of its authorized capital. *Commentary by Frances E. Lossing.*

If an identical security not constituting an overissue is reasonably available for purchase, a person entitled to issue or validation may compel the issuer to purchase the security and deliver it or register its transfer [*Com. Code § 8210(c)*]. If an identical security not constituting an overissue is not reasonably available for purchase, a person entitled to issue or validation may recover from the issuer the price the person or the last purchaser for value paid for it with interest from the date of the person's demand [*Com. Code § 8210(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)Entitlement HoldersCommercial Law (UCC)Investment Securities (Article 8)Securities IntermediariesCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.12

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§ 6K.12 Acquisition of Security

A person acquires a security or an interest therein under Division 8 if [*see Com. Code § 8104(a)*]:

- The person is a purchaser to whom a security is delivered [*see § 6K.17[2]*]; or
- The person acquires a security entitlement to the security.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)DeliveryCommercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



84 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.13

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§ 6K.13 Acquisition of Financial Asset Other Than Security

A person acquires a financial asset or an interest therein, other than a security, under Division 8 if the person acquires a security entitlement to the financial asset [*Com. Code § 8104(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)Security EntitlementsCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.14

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§ 6K.14 Right of Ownership

The issuer may treat the registered owner as the person exclusively entitled to vote, receive notifications and otherwise exercise all the rights and powers of an owner until due presentment for registration of transfer of a certificated security in registered form or of an instruction requesting registration of transfer of an uncertificated security [*Com. Code § 8207*].

PRACTICE TIP:

Division 8 does not provide rules regarding the manner in which a securities intermediary will be permitted to vote or the manner in which the securities intermediary will be required to distribute dividend or other distributions or to deliver notices from the issuer to the holders of its securities. These types of rules are generally set forth in standing rules of the clearing corporation, contracts between the securities intermediary and the entitlement holder, or in federal or state securities regulations. *Commentary by Frances E. Lossing.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)DeliveryCommercial Law (UCC)Investment Securities (Article 8)Entitlement HoldersCommercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)Security EntitlementsCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.15

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§ 6K.15 Validity of Security

[1] Lack of Genuineness

Lack of genuineness of a certificated security is a complete defense, even against a purchaser for value, unless there is an unauthorized signature on the certificate that is effective [*Com. Code § 8202(c)*].

[2] Validity of Signature on Certificate

An unauthorized signature on a security certificate is ineffective, but not in the case of a purchaser for value if the signing has been done by an authenticating trustee, registrar, transfer agent, or other person entrusted by the issuer to sign the certificate or an employee of the issuer responsible for handling the security certificate [*Com. Code § 8205*].

[3] Assertion by Issuer That Security Is Not Valid

If an issuer asserts that a particular security of that issuer is not valid, the following rules apply:

- Even though issued with a defect going to its validity, a security not issued by a government or governmental subdivision, agency or instrumentality is valid in the hands of a purchaser for value without notice of the defect [*Com. Code § 8202(b)(1)*]. If the defect involves a violation of a constitutional provision of the issuer, the security is still valid in the hands of a purchaser for value without notice unless the purchaser obtained the security by original issue [*Com. Code § 8202(b)(1)*].

- Even though issued with a defect going to its validity, the security of a government or governmental subdivision, agency or instrumentality is valid in the hands of a purchaser for value without notice of the defect only if there has been substantial compliance with the legal requirements governing the issue or the issuer has received substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow the money or issue the

security [*Com. Code § 8202(b)(2)*].

[4] After Trigger of Right to Immediate Performance

All purchasers are charged with notice of any defect in the issue of a certificated security or defense of the issuer after an act or event (other than a call that has been revoked) creating a right to immediate performance of the principal obligation represented by a certificated security, or setting a date on or after which the security is to be presented or surrendered for redemption or exchange, if the act or event occurred more than [*Com. Code § 8203*]

- One year prior if the obligation included the payment of money, delivery of a certificated security, or registration of transfer of an uncertificated security.

- Two years in all other cases.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.16

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§ 6K.16 Effective Transfer

[1] Authorization

[a] Endorsement

An endorsement of a security certificate involves signing a statement on the back of the security or in a separate document transferring the property rights represented by the certificate. An endorsement is effective if [*Com. Code § 8107(b)*]

- It is made by an appropriate person or an appropriate person's agent; or
- The appropriate person has ratified it or is precluded from ratifying it.

The endorsement is effective even if made by a representative who failed to comply with the controlling instrument or the law of the state having jurisdiction of the representative relationship, or who otherwise breached a fiduciary duty in the endorsement or in the use of the proceeds [*Com. Code § 8107(c)*].

An endorsement is effective if made by a representative who appears to have authority to do so because the security is registered to or endorsed to that representative, even when that representative no longer has that authority [*Com. Code § 8107(d)*].

The effectiveness of an endorsement is determined by the circumstances at the time of the endorsement and does not become ineffective because those circumstances later change [*Com. Code § 8107(e)*].

[b] Instruction

An instruction is similar to an endorsement in effect, except that it applies to uncertificated securities held directly

rather than certificated securities that are held directly. An instruction is presented to the issuer. The issuer must comply with an effective order. An instruction is effective if [*Com. Code § 8107(b)*]

- It is made by an appropriate person or an appropriate person's agent; or
- The appropriate person has ratified it or is precluded from ratifying it.

The instruction is effective even if made by a representative who failed to comply with the controlling instrument or the law of the state having jurisdiction of the representative relationship, or who otherwise breached a fiduciary duty in the instruction or in the use of the proceeds [*Com. Code § 8107(c)*]. An instruction is effective if made by a representative who appears to have authority to do so because the security is registered to or endorsed to that representative, even when that representative no longer has that authority [*Com. Code § 8107(d)*].

The effectiveness of an instruction is determined by the circumstances at the time of the endorsement, instruction or entitlement order and does not become ineffective because those circumstances later change [*Com. Code § 8107(e)*].

[c] Entitlement Order

An entitlement order is also similar to an endorsement in effect, except that it applies to securities entitlements rather than securities that are held directly. It is given to a securities intermediary regarding a financial asset. An entitlement order is effective if [*Com. Code § 8107(b)*]

- It is made by an appropriate person or an appropriate person's agent; or
- The appropriate person has ratified it or is precluded from ratifying it.

An entitlement order, like an instruction, is effective even if made by a representative who failed to comply with the controlling instrument or the law of the state having jurisdiction of the representative relationship, or who otherwise breached a fiduciary duty in the entitlement order or in the use of the proceeds [*Com. Code § 8107(c)*]. An entitlement order is effective if made by a representative who appears to have authority to do so because the security is registered to or endorsed to that representative, even when that representative no longer has that authority [*Com. Code § 8107(d)*].

The effectiveness of an entitlement order, like that of an instruction, is determined by the circumstances at the time of the entitlement order and does not become ineffective because those circumstances later change [*Com. Code § 8107(e)*].

[2] Delivery

Delivery is used in Division 8 to describe the formal steps necessary for a purchaser to acquire a direct interest in a security under Division 8 [Official Comment No. 1 to UCC § 8-301]. Delivery refers to the implementation of a transaction, not the legal categorization of the transaction which is consummated by deliver. Issuance and transfer are different kinds of transactions, though both may be implemented by delivery. Likewise, sales and pledges are different types of transfers, but both may be implemented by delivery.

PRACTICE TIP:

Although *Com. Code § 8302* states that a security may be acquired by delivery, it does not state that delivery is the only means of acquiring security. For example, the grant of a security interest is a transfer of a property interest, but the steps necessary to implement the transfer are governed by Division 9, not Division 8. Under Division 9 a security interest may be created by execution of a security agreement and the filing of a financing statement. It need not be perfected by delivery. In addition, a property interest in a security may be acquired by operation of the law of gifts and trusts or through the exercise of equitable

remedies rather than by delivery. *Commentary by Frances E. Lossing.*

Delivery of a security to a purchaser occurs as follows:

- Delivery of a certificated security occurs when [*Com. Code § 8301(a)*]
  - The purchaser acquires possession of the security certificate;
  - Another person, other than a securities intermediary, acquires possession of the security certificate on behalf of the purchaser or acknowledges that it holds the security certificate for the purchaser; or
  - A securities intermediary acquires possession of a security certificate in registered form that has been effectively endorsed to the purchaser;
- Delivery of an uncertificated security occurs when [*Com. Code § 8301(b)*]
  - The issuer registers the purchaser as the registered owner; or
  - Another person, other than a securities intermediary, becomes the registered owner on behalf of another person or acknowledges that it holds the security for the purchaser.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)DeliveryCommercial Law (UCC)Investment Securities (Article 8)Indorsement, Instructions & Entitlement OrdersCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.17

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.17 Effect of Transfer

On delivery of a certificated or uncertificated security to a purchaser, the purchaser acquires all rights in the security that the transferor had power to transfer [*Com. Code § 8302(a)*]. A protected purchaser acquires the rights free of adverse claims [*Com. Code § 8303(b)*]. A purchaser of a certificated security who as a previous holder had notice of an adverse claim does not improve its position by taking from a protected purchaser [*Com. Code § 8302(c)*].

Even against a purchaser for value, however, and without other notice, the terms of a certificated security include terms stated on the certificate and terms made part of the security by reference on the certificate to a controlling document or a controlling law [*Com. Code § 8202(a)*]. The terms of an uncertificated security include those stated in any instrument or law pursuant to which the security is issued [*Com. Code § 8202(a)*; *see also Com. Code § 8204*].

A lien in favor of an issuer on a certificated security is valid against a purchaser only if the right of the issuer to the lien is noted conspicuously on the security certificate [*Com. Code § 8209*]. The text of the lien provisions need not be set forth in full.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.18

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§ 6K.18 Registration

[1] Request to Register Transfer

An issuer must register the transfer of (1) a certificated security in registered form upon presentment of the certificate and a request to register transfer, and (2) an uncertificated security upon presentment of an instruction with a request to register a transfer, if the following conditions are met [*Com. Code § 8401*]:

- The person seeking registration of transfer is eligible to have the security registered in its name;
- The endorsement or instruction is made by an appropriate person or by an agent with authority to act;
- Reasonable assurance is given that the endorsement or instruction is genuine and authorized;
- Any applicable law relating to the payment of taxes has been complied with;
- The transfer does not violate any restriction on transfer imposed by the issuer, if the security is certificated and the restriction is noted conspicuously on the certificate or the security is uncertificated and the registered owner has been notified of the restriction [*Com. Code § 8204*];
- A demand that the issuer not register the transfer has not become effective [*see § 6K.19[4]*]; and
- The transfer is rightful or to a protected purchaser.

If an issuer is under a duty to register a transfer as set forth above, the issuer is liable to the person requesting the transfer or the person's principal for loss resulting from undue delay in registering the transfer [*Com. Code § 8401(b)*].

[2] Assurance of Genuineness of Endorsement or Instruction

An issuer may seek assurance that each necessary endorsement or each instruction is genuine and authorized by requiring the following [*Com. Code § 8402*]:

- A guaranty of the signature of the person making the endorsement or originating the instruction.
- Appropriate assurance that a signing agent has authority to sign.
- Appropriate evidence of appointment or incumbency of a signing fiduciary and all who are required to sign under that appointment have done so.

[3] Warranties of Guarantor of Signature

[a] Person Reasonably Believed to Be Responsible

"Guaranty of the signature" means a guaranty signed by or on behalf of a person reasonably believed by the issuer to be responsible [*Com. Code § 8402(c)(1)*]. An issuer may adopt its own standards with respect to responsibility if the standards are not unreasonable [*Com. Code § 8402(c)(1)*]. Regulations under the federal securities laws place limits on the requirements transfer agents may impose concerning the responsibility of signature guarantors [*see 17 C.F.R. § 240.17Ad-15*].

[b] Guaranty of Signature

A person who guarantees a signature of an endorser of a security certificate or of a signature of an originator of an instruction warrants that at the time of signing all of the following were true [*Com. Code § 8306*]:

- The signature was genuine.
- The signer was an appropriate person to endorse the security.
- If the signature was by an agent, the agent had actual authority to act on behalf of the appropriate person.
- The signer had legal capacity to sign.

A person that specially guarantees the signature of an originator of an instruction also warrants that at the time the instruction is presented to the issuer that the person specified in the instruction as the registered owner will be the registered owner and that the transfer will be registered free from encumbrances other than those specified in the instruction [*Com. Code § 8306(c)*].

[4] Demand to Not Register A Security

A person who is an appropriate person to make an endorsement or originate an instruction may demand that the issuer not register a transfer of a security by communicating that demand to the issuer and identifying in the demand the registered owner and the issue of which the security is a part, and providing an address for communications directed to the person making the demand [*Com. Code § 8403(a)*]. A demand is effective only if it has been received by the issuer at a time and in a manner affording the issuer a reasonable opportunity to act on it.

PRACTICE TIP:

Com. Code § 8403(a) is intended to alleviate the problems faced by registered owners of certificated securities who have lost or misplaced their certificates. The registered owner may report the fact that the

certificates for the securities have been lost or misplaced. This notice would constitute a demand that the issuer not transfer the securities. *Commentary by Frances E. Lossing.*

If a request to register transfer is received after a demand to not register transfer has been effectively received by the issuer, the issuer must communicate to the person demanding no registration of transfer and to the person requesting the registration of transfer that a registration for transfer has been made, that a demand not to register has been received, and that the issuer will withhold registration for a period of up to 30 days while the person demanding no registration of transfer obtains legal process [*Com. Code § 8403(b)*].

[5] Liability of Issuer for Wrongful Registration of Transfer

An issuer is not liable to an owner or other person suffering loss as a result of the registration of a transfer if the registration was made pursuant to an effective endorsement or instruction [*Com. Code § 8404(c)*]. An issuer is liable for wrongful registration of a transfer of a security, however, if the issuer registered a transfer to a person not entitled to it and it was registered under any of the following circumstances, unless a security has been lost, apparently destroyed, or wrongfully taken, and the owner fails to notify the issuer within a reasonable time after the owner has notice of that fact [*Com. Code §§ 8404(a), 8406*]:

- The endorsement or instruction was ineffective.

- The issuer registered the transfer after a demand to not transfer was effectively received by the issuer but the issuer did not comply with the notification process and the delay in registration of transfer.

- The issuer had been served with legal process enjoining it from registering the transfer.

- The issuer acted in collusion with the wrongdoer.

PRACTICE TIP:
An issuer that registers a transfer of securities on the basis of a forged endorsement is liable to the registered owner. The fact that the issuer had no reason to suspect that the endorsement was forged or that the issuer obtained signature guarantees and other assurances under *Com. Code § 8402* does not relieve the issuer from liability. On the other hand, the issuer is not liable to adverse claimants merely on the basis of notice assuming the issuer follows the procedures set forth in *Com. Code § 8403* after receipt of a demand not to register a security. *Commentary by Frances E. Lossing.*

An issuer that has wrongfully registered a transfer must provide, on demand, to the person entitled to the security, a like security and any payments or distributions that the person did not receive as a result of the wrongful registration [*Com. Code § 8404(b)*], unless there would be an overissuance as a result, in which event the procedures applicable to overissuances should be followed [*see § 6K.11[19]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)RegistrationCommercial Law (UCC)Investment Securities (Article 8)TransfersCommercial Law (UCC)Investment Securities (Article 8)WarrantiesSecurities LawGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.19

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§ 6K.19 Lost Certificate

If an owner of a certificated security claims that the certificate has been lost, destroyed or wrongfully taken, the issuer must issue a new certificate if the owner does all of the following [*Com. Code § 8405(a)*]:

- Request reissuance before the issuer has notice that the certificate has been acquired by a protected purchaser.
- Files with the issuer a sufficient indemnity bond.
- Satisfies other reasonable requirements of the issuer.

If, after the new security certificate is issued, a protected purchaser of the original certificate presents it for registration, the issuer must register the transfer [*Com. Code § 8405(b)*], unless there would be an overissuance, in which case the overissuance rules apply [*see § 6K.11[19]*].

If a security certificate is lost, destroyed, or wrongfully taken, the owner does not notify the issuer within a reasonable time after the owner has notice, and the issuer registers a transfer of the security before receiving notification, the owner may not assert a claim against the issuer for registering the transfer or a claim for a new security [*Com. Code § 8405*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)RegistrationCommercial Law (UCC)Investment Securities (Article 8)Security CertificatesCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.20

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.20 Security Entitlement

[1] Securities Intermediary's Obligation to Maintain Asset

A securities intermediary has an obligation to maintain a sufficient quantity of a financial asset to satisfy all of the entitlements it has established with respect to that financial asset [*Com. Code § 8504*]. The securities intermediary may maintain those financial assets either directly or through other securities intermediaries [*Com. Code § 8504*].

In general, if a securities intermediary does not have a sufficient quantity of a financial asset to satisfy both its obligations to entitlement holders and to creditors of the securities intermediary who have a security interest in that financial asset, the claims of the entitlement holders have priority, unless the securities intermediary is a clearing corporation, the creditor has control of the securities or the securities have been pledged at the request of the entitlement holder, and the entitlement holder agreed to the rehypothecation by the securities intermediary pursuant to the terms of the agreement between the entitlement holder and securities intermediary regarding margin loans [*Com. Code § 8511*].

[2] Entitlement Holder's Property Interest

An entitlement holder's property interest with respect to a particular financial asset is a pro rata property interest in all interests in that financial asset held by the securities intermediary [*Com. Code § 8503(b)*].

[3] Enforcement of Property Interest Against Securities Intermediary

An entitlement holder may enforce its property interest against the securities intermediary only if one of the following occurs [*Com. Code § 8503(c)*]:

- The securities intermediary does not take action to obtain a payment or distribution made by the issuer of the financial asset in accordance with the terms of the agreement between the securities intermediary and the entitlement holder or, in the absence of an agreement, fails to exercise due care in

accordance with reasonable commercial standards in doing so; if the securities intermediary actually receives the dividend payment or other distribution, the securities intermediary is obligated to deliver that payment or other distribution to the entitlement holder [*see Com. Code § 8505*].

- The securities intermediary does not exercise rights with respect to the financial asset after being directed to do so by the entitlement holder in accordance with the terms of the agreement between the securities intermediary and the entitlement holder or, in the absence of an agreement, fails to exercise due care in accordance with reasonable commercial standards in following the instructions of the entitlement holder [*see Com. Code § 8506*].

- The securities intermediary does not comply with an effective entitlement order in accordance with the terms of the agreement between the securities intermediary and the entitlement holder, or, in the absence of an agreement, fails to exercise due care in accordance with reasonable commercial standards in complying with the entitlement order. If the securities intermediary transfers a financial asset pursuant to an ineffective entitlement order, the securities intermediary must reestablish the securities entitlement or pay or credit the security account of the entitlement holder with the amount of payments or other distributions that the entitlement holder did not receive as a result of the wrongful transfer. In addition, if the securities intermediary does not reestablish the securities entitlement, the securities intermediary is liable to the entitlement holder for damages [*see Com. Code § 8507*].

- The securities intermediary does not act at the direction of the entitlement holder to change a security entitlement into another available form of holding for which the entitlement holder is eligible in accordance with the terms of the agreement between the securities intermediary and the entitlement holder, or, in the absence of an agreement, fails to exercise due care in accordance with reasonable commercial standards in following the direction of the entitlement holder [*see Com. Code § 8508*].

- The securities intermediary does not, at the request of the entitlement holder, cause the financial asset to be transferred to a securities account with a different securities intermediary in accordance with the terms of the agreement between the securities intermediary and the entitlement holder, or, in the absence of an agreement, fails to exercise due care in accordance with reasonable commercial standards in following the direction of the entitlement holder [*see Com. Code § 8508*].

PRACTICE TIP:

These provisions of Division 8 are intended to identify what it means to have a securities entitlement and are not intended to specify the details of the manner in which the duties of the securities intermediary must be performed. For many securities intermediaries, various regulations specify in great detail the intermediary's obligations on such matters as safekeeping of customer property, distribution of dividends and distributions of proxy materials and other notices and information from the issuer of the securities. Other details governing the nature of the securities intermediary's obligations may be set forth in a contract between the securities intermediary and the entitlement holder. In addition, other laws, such as the Securities Investor Protection Act (which protects customers against losses of up to $500,000 for cash and securities held at member brokerage firms), offer protections to entitlement holders from wrongful actions of securities intermediaries. *Commentary by Frances E. Lossing.*

[4] Enforcement of Property Interest Against Purchaser

The property interest may be enforced with respect to a particular asset against a purchaser only if all of the following conditions have been met [*Com. Code § 8503(d)*]:

- The securities intermediary is involved in insolvency proceedings.

- The securities intermediary does not have sufficient interests in the financial asset to satisfy all of the entitlements of all of the entitlement holders of that asset.

- The securities intermediary transferred the financial asset or interest therein to the purchaser in violation of its obligation to maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements it has established with respect to that financial asset to the extent provided in *Com. Code § 8504*.

- The purchaser did not achieve all of the following:

    - Give value;

    - Obtain control; and

    - Did not act in collusion with the securities intermediary in violation of the securities intermediary's obligation.

An entitlement holder may not maintain an action against a purchaser who gives value, obtains control, and does not act in collusion with the securities intermediary in violating the securities intermediary's obligations under *Com. Code § 8504* [*Com. Code § 8503(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)Entitlement HoldersCommercial Law (UCC)Investment Securities (Article 8)Security EntitlementsCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



92 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.21

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.21 Warranties of Transferror

[1] Certificated Security

Unless modified by agreement [*see* Com. Code § 1302], a person who transfers a certificated security to a purchaser for value warrants all of the following to any subsequent purchaser [*Com. Code § 8108(a)*]:

- The certificate is genuine and has not been materially altered.
- The transferor does not know of any fact that might impair the validity of the security.
- There is no adverse claim to the security.
- The transfer does not violate any restriction on transfer.
- The transfer is otherwise effective and rightful.

A person who delivers a security certificate to a securities intermediary for credit to a securities account thereby makes the same warranties listed above [*Com. Code § 8109(b)*].

If the transfer is by endorsement, the transferor also warrants that the endorsement is made by an appropriate person and if the endorsement is made by an agent, that the agent has authority to so transfer [*Com. Code § 8108(a)(5)*]. The person endorsing the security also warrants to the issuer that there is no adverse claim to the security and that the endorsement is effective [*Com. Code § 8108(d)*].

A person who presents a certificated security to the issuer warrants to the issuer that the person is entitled to receive the benefit for which the certificated security is being presented to the issuer [*Com. Code § 8108(f)*]. A purchaser for value

without notice of adverse claims, however, only warrants that such purchaser has no knowledge of any unauthorized signature in a necessary endorsement [*Com. Code § 8108(f)*].

[2] Uncertificated Security

Unless modified by agreement [*see* Com. Code § 1302], a person who originates an instruction for registration of transfer of an uncertificated security to a purchaser for value warrants to the purchaser that [*Com. Code § 8108(b)*]

- The instruction is made by an appropriate person or an agent with actual authority.
- The security is valid.
- There are no adverse claims.
- At the time the instruction is presented to the issuer,
  - The purchaser will be entitled to registration of transfer;
  - The transfer will be registered free from all encumbrances other than those specified in the instruction;
  - The transfer will not violate any restrictions on transfer; and
  - The transfer will otherwise be effective and rightful.

The person originating the instruction also warrants to the issuer that the instruction is effective and that, at the time the instruction is presented to the issuer, the purchaser is entitled to the registration of transfer [*Com. Code § 8108(e)*].

If an uncertificated security is transferred to a purchaser for value without an instruction, the transferror warrants all of the following [*Com. Code § 8108(c)*]:

- The uncertificated security is valid.
- There is no adverse claim.
- The transfer does not violate any restrictions on transfer.
- The transfer is otherwise effective and rightful.

[3] Entitlement Order

Unless modified by agreement [*see* Com. Code § 1302], a person who originates an entitlement order to a securities intermediary warrants that [*Com. Code § 8109(a)*]

- The entitlement order is made by an appropriate person or an authorized agent.
- There is no adverse claim.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)Security CertificatesCommercial Law (UCC)Investment Securities (Article 8)TransfersCommercial Law (UCC)Investment Securities (Article 8)WarrantiesSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.22

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.22 Adverse Claims

[1] Adverse Claim

An adverse claim is a claim that a claimant has a property interest in a financial asset and that it is a violation of the rights of the claimant for another person to hold, transfer or deal with the financial asset [*Com. Code § 8102(a)(1)*]. The term only refers to property interests such as ownership interests and security interests. Breach of a contractual promise to deliver securities does not create an adverse claim against the securities [Official Comment No. 1 to UCC § 8-102].

An adverse claim does not include all circumstances in which a third party has a property interest in securities, but only in those situations in which a security is transferred in violation of the claimant's property interest [Official Comment No. 2 to *UCC § 8105*].

[2] Purchaser for Value

An adverse claim may not be asserted against a protected purchaser [*Com. Code § 8303*]. An adverse claim also may not be asserted against a person who acquires a security entitlement to a financial asset by indication of a book entry or credit to a securities account with a securities intermediary, gives value and is without notice of the adverse claim [*Com. Code § 8502*]. Such a claim also may not be asserted against one who purchases that entitlement or an interest therein from the entitlement holder [*Com. Code § 8510(b)*]. An action based on an adverse claim also may not be asserted against a person who purchases a security entitlement if the purchaser gives value, does not have notice of the adverse claim and obtains control of the security entitlement [*Com. Code § 8510(a)*].

In a case not covered by the priority rules of Division 9, a purchaser for value of a security entitlement, or an interest therein, who obtains control has priority over the purchaser of a security entitlement who does not obtain control. A securities intermediary who has obtained control has priority over other purchasers for value of a security entitlement even if they have obtained control, unless otherwise agreed [*Com. Code § 8510(c)*].

[3] Notice of Adverse Claim

A person has notice of an adverse claim if the person knows of the adverse claim, is aware of facts indicating that there is a significant probability that an adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim, or has a duty imposed by statute or regulation to investigate whether an adverse claim exists and the investigation would establish the existence of the adverse claim [*Com. Code § 8105(a)*].

A purchaser of a certificated security has notice of an adverse claim it the security certificate has been endorsed for collection or surrender or some other purpose not involving transfer or is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor [*Com. Code § 8105(d)*]. The definition of notice in *Com. Code § 1202(a)(3)* (which provides that a person has notice if from all the facts and circumstances known to that person at the time in question he or she has reason to know that certain facts exist) does not apply in these circumstances. Instead there must be actual knowledge of an adverse claim, absent willful blindness [*Com. Code § 8105*, Comments 1 and 3].

A person who knows that a representative has transferred a financial asset in breach of that representative's duty has notice of an adverse claim [*Com. Code § 8105(b)*].

[4] Not Sufficient to Constitute Notice of Adverse Claim

The following alone are not sufficient to constitute notice of an adverse claim and do not impose a duty to inquire further:

- Knowledge that a financial asset has been transferred by a representative [*Com. Code § 8105(b)*]; or

- Filing of a financing statement under Division 9 of the California Commercial Code [*Com. Code § 8105(e)*]; or

- Any act or event that creates a right to immediate performance of the principal obligation represented by the security certificate or sets a date after which the certificate is to be presented or surrendered for redemption or exchange, unless [*Com. Code § 8105(c)*]

    - More than one year has passed after a date set for presentment or surrender; or

    - More than six months have passed after a date set for payment of money against presentation or surrender of the certificate if money was available for payment on that date.

[5] Action Against Issuer Regarding Certificated Security

In an action on a certificated security against the issuer, each signature on a security certificate or in a necessary endorsement is admitted unless specifically denied in the pleadings [*Com. Code § 8114(a)*]. If signatures on a certificate are admitted or established, production of the certificate entitles the holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security [*Com. Code § 8114(c)*].

[6] Liability of Transaction "Conduit"

A securities intermediary that has transferred a financial asset pursuant to an effective entitlement order, or a broker or other agent that has dealt with a financial asset at the direction of its customer or principal, is not liable to a person having an adverse claim to the financial asset unless the security intermediary, broker or agent has done one of the

following [*Com. Code § 8115*]:

- Took the action after it was served with legal process enjoining it from doing so and had a reasonable opportunity to act on the injunction;

- Acted in collusion with the wrongdoer in violating the rights of the adverse claimant; or

- In the case of a stolen security certificate, acted with notice of the adverse claim.

A securities intermediary that receives a financial asset and establishes a security entitlement to that financial asset on behalf of an account holder is deemed a purchaser for value [*Com. Code § 8116*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)Security CertificatesCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.23

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.23 Creditors' Rights

[1] Certificated Security

A creditor may reach the interest of a debtor in a certificated security only by actual seizure of the certificate by the officer making the attachment or levy [*Com. Code § 8112(a)*]. If the certificate has been surrendered to the issuer, however, the creditor may reach it by legal process on the issuer [*Com. Code § 8112(a)*]. If the certificate is held by a secured party, the creditor can reach the debtor's interest only by legal process on the secured party [*Com. Code § 8112(d)*].

[2] Uncertificated Security

A creditor may reach the interest of a debtor in an uncertificated security only by legal process on the issuer at its chief executive office in the United States [*Com. Code § 8112(b)*]. If the security is registered to a secured party, the creditor can reach the debtor's interest only by legal process on the secured party [*Com. Code § 8112(d)*].

[3] Security Entitlement

A creditor may reach the interest of a debtor in a security entitlement only by legal process on the securities intermediary with whom the debtor's securities account is maintained. [*Com. Code § 8112(c)*]. If the security entitlement is maintained in the name of a secured party, the creditor can reach the debtor's interest only by legal process on the secured party [*Com. Code § 8112(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)Security

EntitlementsCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



95 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.24

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.24 Statute of Frauds

A contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is a writing signed or record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year of its making [*Com. Code § 8113*]. With the increasing use of electronic means of communication, the statute of frauds is unsuited to the realities of the securities business [Official Comment to UCC § 8-1113].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Sales (Article 2)Form, Formation & ReadjustmentStatutes of FraudsExceptionsStatutory ExceptionsCommercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)TransfersContracts LawStatutes of FraudsRequirementsPerformanceSecurities LawGeneral Overview



96 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide § 6K.25

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.25 Governing Law

[1] Jurisdiction of Organization of Issuer

The local law of the jurisdiction of organization of the issuer governs the following [*Com. Code § 8110(a)*]:

- The validity of a security.
- The rights and duties of the issuer with respect to registration of transfers.
- The effectiveness of registration of transfer by the issuer.
- Whether the issuer owes any duties to an adverse claimant to the security.
- Whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security.

If the local law of the jurisdiction under which the issuer is organized permits the issuer to specify that the laws of another jurisdiction govern the above questions, the laws of the specified jurisdiction govern [*Com. Code § 8110(d)*]. An issuer organized pursuant to the laws of the State of California may specify another jurisdiction to govern the above questions [*Com. Code § 8110(d)*].

[2] Jurisdiction of Securities Intermediary

The local law of the jurisdiction of a securities intermediary governs the following [*Com. Code § 8110(b)*]:

- Acquisition of a security entitlement from the securities intermediary.

- The rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement.

- Whether the securities intermediary owes any duties to an adverse claimant to a security entitlement.

- Whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement from an entitlement holder.

The jurisdiction of a securities intermediary may be determined by agreement between the securities intermediary and the entitlement holder, the location of the securities account, the location of the office of the securities intermediary identified in an account statement, or the jurisdiction in which the chief executive offices of the issuer are located [*see Com. Code § 8110*((e)]. The jurisdiction of a securities intermediary is not determined by the physical location of securities certificates, the jurisdiction under which the issuer is organized, or the location of the securities intermediary's record keeping facilities [*Com. Code § 8110(f)*].

[3] Jurisdiction in Which Security Certificate Is Located

The local law of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim can be asserted against a person to whom the security certificate is delivered [*Com. Code § 8110(c)*]. The choice of law provisions governing security interests in securities or securities entitlements are set forth in *Com. Code § 9305*. To the extent that neither Division 8 nor 9 applies to the issue, general choice of law rules apply.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)Choice of LawCommercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)Security CertificatesCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
A. Commercial Code Rules Governing Investment Securities

3-6K California Legal Forms--Transaction Guide §§ 6K.26-6K.39

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§§ 6K.26[Reserved]



98 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
B. Nonissuer Transactions Under the California Securities Laws

3-6K California Legal Forms--Transaction Guide § 6K.40

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.40 Offer or Sale of Securities in Nonissuer Transactions in California

[1] Qualification Requirement

Corp. Code § 25130 provides that any person that offers or sells any security in California in a nonissuer transaction must qualify that offer or sale unless the offer or sale is exempt from qualification or not subject to qualification. A "nonissuer transaction" is one that is not directly or indirectly for the benefit of the issuer [*see Corp. Code § 25011*].

The offer or sale may be qualified by coordination pursuant to *Corp. Code § 25111*, permit pursuant to *Corp. Code § 25113*, or notification pursuant to *Corp. Code § 25131*. For a discussion of qualification by coordination, or permit, see Ch. 6H, *Qualification of Securities* . For discussion of offers and sales of securities not subject to qualification, see generally *§§ 6K.41*, *6K.42*; see also Ch. 6, *Securities Regulation Issues* .

[2] Qualification by Notification

[a] Requirement

Securities that are offered or sold in a nonissuer transaction that are not eligible for qualification under *Corp. Code § 25111* must be qualified under *Corp. Code § 25131*, except that securities offered in a nonissuer transaction pursuant to an exemption under Regulation A of the Securities Act of 1933 must be qualified under *Corp. Code § 25113* [*Corp. Code § 25131(a)*].

[b] Application

Qualification by notification must be sought by application [*Corp. Code § 25131(b)*]. The application must be signed and verified by any of the following [*Corp. Code § 25131(b)*]:

- The person on whose behalf the offering is being made.

- The issuer.
- Any broker-dealer.

The instructions to the application details the information that must be contained in and the documents that must accompany the application. See *§ 6K.220* for the application form and instructions promulgated by the Commissioner of Corporations.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral OverviewSecurities LawBlue Sky LawsExempted IssuersSecurities LawExemptions From RegistrationExempt TransactionsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
B. Nonissuer Transactions Under the California Securities Laws

3-6K California Legal Forms--Transaction Guide § 6K.41

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§ 6K.41 Securities Exempt From Qualification in Nonissuer Transactions

[1] All Transactions

Corp. Code § 25100 exempts certain classes of securities from all qualification requirements, including when those securities are sold or offered in a nonissuer transaction. For a list of the exemptions under *Corp. Code § 25100, see Ch. 6, Securities Regulation Issues, § 6.200[2]*. A security defined as a "covered security" under the National Securities Markets Improvement Act of 1996 will also be exempt from qualification [*Corp. Code § 25100.1(a)*; *see* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*].

[2] Nonissuer Transactions

Corp. Code § 25101 exempts an additional class of securities from qualification requirements when those securities are sold or offered in a nonissuer transaction. That class consists of securities issued by a person that is the issuer of any security listed on a national securities exchange, if the exchange is certified by rule or order of the Commissioner [*Corp. Code § 25101(a)*]. This exemption does not apply to the following [*Corp. Code § 25101(b)*]:

- Securities offered pursuant to a registration under the Securities Act of 1933.

- Securities offered under the exemption afforded by federal Regulation A under the Securities Act of 1933 if the aggregate offering price of the securities pursuant to that exemption exceeds $50,000.

The Commissioner has certified the following exchanges and systems [see *§ 6.15[5]*; *Marsh & Volk, Practice Under the California Securities Laws, Ch. 10, Nonissuer Transactions, § 10.03*, for further discussion of these securities exchanges, some of which have undergone several name changes in recent years]:

- The New York Stock Exchange [*10 Cal. Code Reg. § 260.101.2(a)*].

- Tier I of the Philadelphia Stock Exchange [*10 Cal. Code Reg. § 260.101.2(a)*].

- The interdealer quotation system of the National Association of Securities Dealers, Inc. to the extent that the securities are those of an issuer that has a security designated as a National Market System security [*10 Cal. Code Reg. § 260.101.2(b)*; *see* Dept. of Corps. Release No. 88-C (Revised Aug. 17, 2009), certifying the NASDAQ Global Market and the NASDAQ Capital Market of the NASDAQ Stock Market LLC, the successor to the Nasdaq Stock Market)].

- The American Stock Exchange to the extent that the securities are those of an issuer that has a security that is regularly listed on the American Stock Exchange [*10 Cal. Code Reg. § 260.101.2(c)*].

- The Pacific Stock Exchange with some limitations [*see 10 Cal. Code Reg. § 260.101.2(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
B. Nonissuer Transactions Under the California Securities Laws

3-6K California Legal Forms--Transaction Guide § 6K.42

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.42 Exempt Nonissuer Transactions

[1] Private Sale by Owner

The offer or sale of a security by the bona fide owner of the security is exempt from qualification if [*Corp. Code § 25104(a)*]

- The offer or sale is for the owner's own account;
- The offer or sale is not accompanied by the publication of any advertisement; and
- The offer or sale is not made by or through a broker-dealer in a public offering.

The term "advertisement" is broadly defined to include the publication of any written or printed communication or any communication by means of recorded telephone messages or spoken on radio, television or a similar communications media [*Corp. Code § 25002*] An advertisement is "published" if it is disseminated by any means to the public [*Corp. Code § 25014*].

This exemption eliminates any qualification requirement in a private transaction except in the situation in which a public market is created in outstanding securities. If a broker-dealer acts as a finder or agent of the owner in connection with the transaction, the exemption is still available as long as it is not in a public offering.

PRACTICE TIP:
This is the exemption most commonly used to sell securities of a closely held corporation or securities acquired in a private placement pursuant to the so-called "Section 4-1/2 exemption." *Commentary by Frances E. Lossing.*

An offer or sale does not involve a public offering if offers are made to no more than 25 persons, each of whom either

had a preexisting personal or business relationship with the offeror or could reasonably be expected to have the capacity to protect their interests by reason of their experience, and sales are not consummated to more than 10 persons [*10 Cal. Code Reg. § 260.102.2*]. It may be possible, in some circumstances, to determine that a transaction not complying with these conditions is nevertheless not a public offering.

[2] Unsolicited Sale by Broker-Dealer

The offer or sale of a security made by or through a licensed broker-dealer pursuant to an unsolicited order or offer to buy [*Corp. Code § 25104(b)*]. An inquiry by the selling broker-dealer in response to a written bid or written solicitation made by another broker-dealer within the prior 60 days is not considered a solicitation [*Corp. Code § 25104(b)*].

PRACTICE TIP:

This is the exemption most commonly used to trade securities of a public corporation. Securities sold on a national securities exchange through a broker-dealer can be made in reliance on this exemption. *Commentary by Frances E. Lossing.*

An order or offer to buy a security is presumed not to be "unsolicited" if the selling broker-dealer knows that the order or offer to buy by the other broker-dealer is in response to certain solicitation activities in which the selling broker-dealer engaged in the previous 60 days [*see 10 Cal. Code Reg. § 260.104*].

[3] Sale to Institutional Investor

Qualification is not needed for the offer or sale of securities to a bank, savings and loan association, trust company, insurance company, investment company registered under the Investment Company Act of 1940, pension or profit-sharing trust, and the types of investors listed in *10 Cal. Code Reg. § 260.102.10* (institutional investors) and *10 Cal. Code Reg. § 260.105.14* (public agencies) [*Corp. Code § 25104(c)*]. These exemptions are similar to the issuer exemptions for similar offers and sales discussed in Ch. 6D, *Qualified Purchaser Exemptions* .

[4] Agreement With Underwriter

Any transaction or agreement between a person on whose behalf an offering is made and an underwriter or underwriters is exempt from the nonissuer qualification provisions if the contemplated sale is exempt from qualification at the time of or qualified prior to any distribution in California [*Corp. Code § 25104(d)*].

[5] Liquidation of Secured Debt

Qualification is not needed for the offer or sale of a security by or for the account of a bona fide secured party selling the security in the ordinary course of business to liquidate a bona fide debt [*Corp. Code § 25104(e)*]. A bona fide secured party does not include a secured party who takes a pledge of a security merely as a step in the distribution of the security to the public [*10 Cal. Code Reg. § 260.104.2*].

[6] Transactions by Executors, Administrators, Guardians

Qualification is not needed for any offer or sale by an executor, administrator, sheriff, marshal, receiver, trustee in bankruptcy, guardian or conservator [*Corp. Code § 25104(f)*]. This exemption is premised on the fact that offers and sales executed by government officers and court-appointed fiduciaries generally are supervised by the court.

[7] Offer Pending Registration

Qualification is not needed for the offer (but is needed for the sale) of a security for which a registration statement has been filed under the Securities Act of 1933 but has not yet become effective, or for which an offering statement under

Regulation A has been filed but has not yet been qualified, if no stop order or refusal order is in effect and no public proceeding or examination looking toward such an order is pending under Section 8 of the Securities Act of 1933 and no order under *Corp. Code §§ 25140* or *25143(a)* is in effect [*Corp. Code § 25104(g)*].

[8] Sales Soon After Qualification

No qualification is needed for the offer or sale of a security if a qualification of any security of the same class has become effective within the time periods noted below [*Corp. Code § 25104(h)*]:

- Under *Corp. Code § 25110 et seq.* (issuer transaction), has become effective within the prior 18 months; or

- Under *Corp. Code § 25120 et seq.* (recapitalization or reorganization) or *Corp. Code § 25130 et seq.* (nonissuer transaction), has become effective within the prior 12 months.

This exemption does not apply if there is a stop order in effect, if the securities are offered pursuant to a registration statement under the Securities Act of 1933, or if the securities are offered pursuant to an exemption under Regulation A if the aggregate offering price exceeds $50,000 [*Corp. Code § 25104(h)*].

[9] Out-of-State Sales and Sales to Broker-Dealers

The offer or sale of securities in a nonissuer transaction is exempt from the qualification provisions if the offer or sale is effected by or through a licensed broker-dealer to a person that is not a resident of California [*10 Cal. Code Reg. § 260.105.2*]. For this exemption to apply, the offer or sale must comply with the laws of the jurisdiction where the purchaser is domiciled [*10 Cal. Code Reg. § 260.105.2*].

[10] Other Exemptions by Rule of Commissioner

The Commissioner is authorized by *Corp. Code § 25105* to exempt other nonissuer transactions from the qualification requirements. Exempt transactions are set forth in *10 Cal. Code Reg. §§ 260.105-260.105.30*, *260.105.2*, *260.105.7*, *260.105.11*, *260.105.13.1*, *260.105.14*, *260.105.17*, *260.105.29*, *260.105.33*, *260.105.35*, *260.105.36*, *260.105.37*, and *260.105.38*. Most of these exemptions are quite specialized in nature. Several, however, are commonly used. One of the most important of these is an exemption for the private resale of restricted securities made to a qualified institutional buyer pursuant to Rule 144A [*10 Cal. Code Reg. § 260.105.13.1*].

An exemption also is available for certain commonly traded public shares, or any right or warrant to purchase such shares if the following conditions are satisfied [*10 Cal. Code Reg. § 260.105.17*]:

- The issuer has securities registered under Section 12(g) of the Securities Exchange Act of 1934.

- The shares are traded on the New York Stock Exchange of the American Stock Exchange.

- There has been trading in such shares for at least 12 days during the preceding 30 calendar days.

- The trading price for the shares has been at least $4 per share,

- The issuer has only one outstanding class of voting securities,

- The issuer has not during the prior 5 years, or the period of its existence if shorter, defaulted in the payment of any dividend or sinking fund payment,

- The issuer has a net worth on a consolidated basis of at least $1 million.

- The issuer has had net income after charges, including taxes and extraordinary losses, and excluding extraordinary gains, of either (1) at least $500,000 for its last fiscal year and at least $1.5 million in total for its last five fiscal years, or (2) at least $1 million in its last two fiscal years.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART II. LEGAL BACKGROUND
B. Nonissuer Transactions Under the California Securities Laws

3-6K California Legal Forms--Transaction Guide §§ 6K.43-6K.99

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§§ 6K.43[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6K California Legal Forms--Transaction Guide § 6K.100

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.100 Facts--Entitlement

1. Type of security or financial interest (corporate stock, debenture, qualifying partnership interest, etc.).

2. Evidence of entitlement (certificate, endorsement, notice of registration, etc.).

3. Name and address of issuer, including other names used by issuer during the past three years, address of principal executive office, and telephone number of issuer.

4. Name of signatory on certificate.

NOTE:
If a security certificate contains the signatures necessary to its issue or transfer but is incomplete in any other respect, any person may complete it by filling in the blanks as authorized [*Com. Code § 8206*].

5. Name and address of registered owner.

6. Terms of certificated security stated on certificate.

7. Terms of uncertificated security as set forth in any instrument pursuant to which security was issued.

8. Jurisdiction of organization of issuer.

9. Name and address of securities intermediary holding entitlement.

10. Jurisdiction of organization of securities intermediary (as stated in agreement, jurisdiction where agreement specified account to be held, jurisdiction of office identified on account statement, jurisdiction of chief executive office of securities intermediary).

11. Details of agreement between purchaser and securities intermediary.

12. Name and address of owner of securities account to which securities intermediary has credited securities entitlement.

13. Person entitled to exercise rights of ownership of entitlement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)Security EntitlementsCommercial Law (UCC)Investment Securities (Article 8)TransfersContracts LawNegotiable InstrumentsNegotiationIndorsementQualified IndorsementsSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6K California Legal Forms--Transaction Guide § 6K.101

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.101 Facts--Control of Entitlement

1. Name and address of person who has possession of certificated security in bearer form.

2. Description of delivery of possession of certificated security in bearer form.

3. Name and address of person who has possession of certificated security in registered form.

4. Text of endorsement appearing on certificated security in registered form.

5. Name of endorser.

6. Name of person to whom endorsement is made.

7. Name of person to whom certificate is registered with issuer.

8. Status of person who has possession of certificated security.

9. Claims of person with possession of certificated security to that security.

10. Claim against securities intermediary for breach of duty (not maintaining sufficient entitlements, not seeking to obtain payment or distribution of issuer, not acting according to agreement, law or reasonable commercial standards, etc.).

11. Details of communications of any entitlement orders, including originator of order.

12. Agreement among issuer, purchaser and registered owner.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6K California Legal Forms--Transaction Guide § 6K.102

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.102 Facts--Notice of Adverse Claims

1. Description of any assertion by any other person of claim to entitlement.

2. Description of facts regarding any potential adverse claim.

3. Status of client (government official, insider, etc.).

4. Relationship of client to issuer.

5. Relationship of client to holder of entitlement.

6. Occurrence of act or event creating right to immediate performance of the principal obligation represented by the security, including date set for presentment or payment after occurrence of act or event.

7. Statement on certificate indicating potential for adverse claim (endorsed "for collection" or "for surrender," other statement indicating certificate in bearer form belongs to another person).

8. Separate document assigning, transferring or redeeming the security.

9. Financing statement filed under Division 9.

Legal Topics:

For related research and practice materials, see the following legal topics:

Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)RegistrationCommercial Law (UCC)Investment Securities (Article 8)Security CertificatesCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6K California Legal Forms--Transaction Guide § 6K.103

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.103 Facts--Nonissuer Transaction

NOTE:
For a general listing of all California securities exemptions, and the basic criteria for qualification for those exemptions, see *Ch. 6, **Securities Regulation Issues**, § 6.100*.

1. All consideration to be tendered for securities.

2. Distribution of consideration.

3. Manner of contacting potential purchasers.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6K California Legal Forms--Transaction Guide § 6K.104

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.104 Documents

1. Security certificate (in the case of certificated securities).

2. Agreement, if any, restricting transfer of security or financial asset.

3. Agreement, if any, governing holding of security by third party.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

3-6K California Legal Forms--Transaction Guide §§ 6K.105-6K.109

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

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§§ 6K.105[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6K California Legal Forms--Transaction Guide § 6K.110

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.110 Existence of Financial Asset

1. Determine whether entitlement to some right is any of the following and therefore constitutes a financial asset:

NOTE:
A commodity contract [*see* Com. Code § 9102(a)(15)] is not a financial asset [Com. Code 8103(f)]. Further, a document of title is not a financial asset unless Com. Code § 8102(a)(9)(c) applies [Com. Code § 8103(g); *see* P c, below].

a. Security [*Com. Code § 8102(a)(9)(A)*].

b. Obligation of type dealt in or traded on financial markets or recognized in area in which it is issued or dealt as medium for investment [*Com. Code § 8102(a)(9)(B)*].

c. Property held by securities intermediary for another after express agreement that property is to be treated as financial asset under Division 8 [*Com. Code § 8102(a)(9)(C)*].

d. Option issued by clearing corporation to its participants [*Com. Code § 8103(e)*].

NOTE:
An option or similar obligation issued by a clearing corporation to its participants is not a security, but is a financial asset [*Com. Code § 8103(e)*].

e. The following if held in securities accounts:

(1) Partnership interests or limited liability company interests [*Com. Code § 8103(c)*].

(2) Negotiable instruments governed by Division 3 of California Commercial Code [*Com. Code § 8103(d)*].

2. Determine whether entitlement is a commodity contract [*see Com. Code § 9102(a)(15)* (definition)] and therefore does *not* constitute a "financial asset" for purposes of Division 8 [*Com. Code § 8103(f)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)General OverviewCommercial Law (UCC)Investment Securities (Article 8)AuthenticationCommercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6K California Legal Forms--Transaction Guide § 6K.111

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.111 Existence of Security

1. Determine whether entitlement is a share or similar equity interest issued by one of the following and therefore a security [*Com. Code § 8103*]:

a. Corporation.

b. Business trust.

c. Joint stock company.

d. Entity registered as an investment company.

2. Determine whether entitlement not listed in (1), *above*, has the following characteristics and therefore still constitutes a security [*Com. Code § 8102(a)(15)*]:

NOTE:
For purposes of Division 8, the term "security" includes almost every type of investment actively traded. It is an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer that meets the criteria listed below [*Com. Code § 8102(a)(15)*].

a. Represented by certificate or transfer of entitlement may be registered on books maintained for that purpose.

b. One of a class or series, or is divisible into class or series.

c. Of a type dealt in or traded on securities exchanges or securities markets, or a medium for investment expressly providing it is to be governed by Division 8.

NOTE:
For purposes of Division 8, the following are securities: an equity interest issued by a corporation, business trust, joint stock company or similar entity [*Com. Code § 8103(a)*]; and an equity interest issued by an entity that is registered under the federal investment company laws as an investment company [*Com. Code § 8103(b)*].

3. Determine whether entitlement has one of following characteristics and therefore does not constitute a security for purposes of Division 8:

a. Interest in a partnership or limited liability company that meets all of the following criteria [*Com. Code § 8103(c)*]:

NOTE:
Even if it is not a security, a partnership interest or limited liability company interest may be a financial asset [***see*** *Com. Code § 8102(a)(9)* (definition of "financial asset"); ***see also*** *§ 6K.11[2]*].

(1) It is not traded on securities exchange or securities market.

(2) Its terms do not expressly provide it is to be governed by Division 8.

(3) The issuer is not investment company.

b. Commodity contract [*Com. Code § 8103(f)*; *see Com. Code § 9102(a)(15)* (definition)].

c. Options issued by clearing corporation to its participants [*Com. Code § 8103(e)*].

NOTE:
Such an option is a financial asset, even though it is not a security [*Com. Code § 8103(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)AuthenticationCommercial Law (UCC)Investment Securities (Article 8)Entitlement HoldersCommercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6K California Legal Forms--Transaction Guide § 6K.112

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.112 Effective Endorsement

1. Determine if endorser is person specified by security certificate or by effective special endorsement.

2. Determine if endorser is not specified person that specified person has ratified the endorsement or is precluded from ratifying it.

3. Determine if endorsement made effectively by representative of person specified by security certificate or by an effective special endorsement (representative appears to have authority, security is registered or endorsed to representative, representative is representative of estate of specified person, etc.).



111 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6K California Legal Forms--Transaction Guide § 6K.113

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.113 Effective Instruction

1. Determine if originator of instruction is registered owner of uncertificated security [*see Com. Code § 8107(a)(2),(b)(1)*].

2. If originator is someone other than registered owner, determine whether instruction is effective [*see Com. Code § 8107(b)*]:

a. Is person the "appropriate person" to give instruction [*see Com. Code § 8107(a)*]?

b. Does person have power under the law of agency to transfer security or financial asset on behalf of appropriate person?

c. Has appropriate person ratified instruction or is appropriate person otherwise precluded from asserting its effectiveness?



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6K California Legal Forms--Transaction Guide § 6K.114

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.114 Effective Entitlement Order

1. Determine if originator of entitlement order is entitlement holder [*see Com. Code § 8107(a)(3), (b)(1)*].

2. If originator is someone other than entitlement holder, determine whether entitlement order is effective [*see Com. Code § 8107(b)*]:

a. Is person the "appropriate person" to make entitlement order [*see Com. Code § 8107(a)*]?

b. Does person have power under the law of agency to transfer security or financial asset on behalf of appropriate person?

c. Has appropriate person ratified entitlement order or is appropriate person otherwise precluded from asserting its effectiveness?

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)Entitlement HoldersCommercial Law (UCC)Investment Securities (Article 8)Indorsement, Instructions & Entitlement OrdersCommercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)Security EntitlementsCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6K California Legal Forms--Transaction Guide § 6K.115

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.115 Adverse Claim

1. Determine if purchaser gave value.

2. Determine if purchaser had notice of adverse claim [*see Com. Code § 8105*].

a. Did purchaser have actual notice [*Com. Code § 8105(a)(1)*]?

b. Did purchaser know of facts indicating significant probability of adverse claim [*Com. Code § 8105(a)(2)*]?

c. Did purchaser have a duty to investigate whether adverse claim exists [*Com. Code § 8105(a)(3)*]?

d. Was there an act or event creating the right to immediate performance of principal obligation represented by security, or setting a date on or after which certificate is to be presented or surrendered for redemption or exchange, and a transfer more than [*Com. Code § 8105(c)*]:
(1) One year subsequent to date set for presentment, or

(2) Six months subsequent to date set for payment of money.

e. Is there a statement on certificate indicating potential for adverse claim [*Com. Code § 8105(d)*]?

NOTE:
Filing of a financing statement under Division 9 of the California Commercial Code does not provide

notice of an adverse claim to a financial asset [*Com. Code § 8105(e)*].

3. Determine who controls entitlement [*see Com. Code § 8106(d)*; *see also § 6K.11[19]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6K California Legal Forms--Transaction Guide § 6K.116

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.116 Validity of Security

1. Determine if holder has all of the following characteristics and is therefore a "protected purchaser" [*see Com. Code § 8303*; *see also § 6K.11[18]*]:

a. Purchaser gave value for security.

b. Purchaser did not have notice of any adverse claim.

c. Purchase obtained control of the security.

NOTE:
A protected purchaser acquires its interest free of an adverse claim [*Com. Code § 8303(b)*]. A protected purchaser takes even though the security is issued with a defect going to its validity [*Com. Code § 8202(b)(1)*].

An otherwise protected purchaser is not protected if more than one year has passed after the security requires the payment of money, delivery of certificated security, or registration of transfer of an uncertificated security on presentment. An otherwise protected purchaser also is not protected if more than two years have passed after an act or event creating a right to immediate performance of the principal obligation or after a date set for presentment [***see*** *Com. Code § 8203* (purchaser charged with notice of any defect in issue or defense of the issuer)].

2. Determine if act or event triggers presentment date or payment date.

3. Determine if presentment date or payment date are prescribed by security.

4. Determine available defenses if purchaser is not a protected purchaser.

5. Determine if restrictions noted on certificate.

6. Determine if certificated security is genuine.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)Security CertificatesCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6K California Legal Forms--Transaction Guide § 6K.117

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.117 Securities Exemptions--General Determinations for Nonissuer Transactions

1. Determine if any portion of purchase price for securities will be received directly or indirectly by issuer.

2. Determine if nonissuer transaction is part of an issuer transaction.

NOTE:

An offering that involves both an issuer transaction and a nonissuer transaction is treated as an issuer transaction [*Corp. Code § 25011*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6K California Legal Forms--Transaction Guide § 6K.118

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.118 Availability of Private Sale Exemption

1. Determine if sale is made on account of bona fide owner.

2. Determine if sale is not accompanied by publication of any advertisement.

3. Determine if sale is not effected by or through a broker-dealer in a public offering.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

3-6K California Legal Forms--Transaction Guide §§ 6K.119-6K.139

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

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§§ 6K.119[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

3-6K California Legal Forms--Transaction Guide § 6K.140

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.140 Transfer of Certificated Security in Registered Form

1. Obtain security certificate.

NOTE:
The certificate should be examined for any restrictions, liens or other encumbrances.

2. Have appropriate person execute endorsement.

NOTE:
The endorsement can be executed either on the back of the security certificate or in the form of an assignment separate from certificate [*see Com. Code § 8102(a)(11)*].

The "appropriate person" is the person specified by the security certificate or by an effective special endorsement [*Com. Code § 8107(a)(1)*]. The successor or personal representative of a deceased appropriate person [*Com. Code § 8107(a)(4)*] or the guardian, conservator or similar representative of an appropriate person who lacks capacity [*Com. Code § 8107(a)(5)*] may also execute the endorsement.

3. Deliver security certificate and, if applicable, assignment separate from certificate, to issuer.

NOTE:
The issuer will then issue a new certificate for the shares in the name of the transferee.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)Security CertificatesCommercial Law (UCC)Investment Securities (Article 8)TransfersContracts LawNegotiable InstrumentsNegotiationIndorsementSpecial IndorsementsSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

3-6K California Legal Forms--Transaction Guide § 6K.141

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.141 Transfer of Uncertificated Security

1. Prepare instruction to transfer security.

NOTE:
The appropriate person to originate an instruction is the registered owner of the uncertificated security [*Com. Code § 8107(a)(2)*]. The successor or personal representative of a deceased appropriate person [*Com. Code § 8107(a)(4)*] and the guardian, conservator or similar representative of an appropriate person who lacks capacity [*Com. Code § 8107(a)(5)*] also may originate an instruction.

2. Deliver instruction to issuer.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Investment Securities (Article 8)PurchasersCommercial Law (UCC)Investment Securities (Article 8)Security CertificatesCommercial Law (UCC)Investment Securities (Article 8)TransfersSecurities LawGeneral Overview



120 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

3-6K California Legal Forms--Transaction Guide §§ 6K.142-6K.199

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

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§§ 6K.142[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART IV. FORMS
A. Transfers and Pledges of Securities

3-6K California Legal Forms--Transaction Guide § 6K.200

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.200 Assignment Separate From Certificate

[1] Comment

[a] Use of Form

This form may be used to transfer ownership of certificated securities. It is a form of endorsement. While similar language is generally found printed on the back of a certificate, an assignment separate from certificate made be used instead. An assignment separate from certificate is generally used when a transfer is being made to multiple parties.

[b] Warranties of Endorser

By executing an endorsement or assignment separate from certificate, a person warrants to the purchaser all of the following [*Com. Code § 8108*]:

- That the associated certificate is genuine and has not been materially altered.
- That the transferor does not know of any fact that might impair the validity of the security.
- That there is no adverse claim to the security.
- That the transfer does not violate any restriction on transfer.
- That the transfer is otherwise effective and rightful.
- That the endorsement is made by an appropriate person.
- If the endorsement is made by an agent, that the agent has authority to so transfer the security.

The endorser also warrants to the issuer that there is no adverse claim to the security and that the endorsement is effective [*Com. Code § 8108(d)*].

[2] Form

Assignment Separate From Certificate

FOR VALUE RECEIVED, _____[*name of transferor*] hereby sell(s), assign(s), and transfer(s) to _____[*name of transferee*] _____[*number of shares*] shares of the _____[*type of stock, i.e., common, preferred*] stock of _____[*name of corporation*] standing in _____[*name of person in whose name shares are on books*] name on the books of that corporation, represented by Certificate No. _____[*number of certificate*] delivered with this assignment and do hereby irrevocably constitute and appoint _____[*name of attorney in fact*] as my attorney in fact to transfer the said stock on the books of the said corporation with full power of substitution in the premises.

_____ Dated:

Signed: _____
Signed: _____



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART IV. FORMS
A. Transfers and Pledges of Securities

3-6K California Legal Forms--Transaction Guide § 6K.201

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.201 Instruction for Transfer of Uncertificated Securities

[1] Comment

[a] Use of Form

This form is an instruction for the transfer of uncertificated securities. It should be used to communicate to the issuer of an uncertificated security that a transfer of the security should be registered.

[b] Warranties of Originator of Instruction

A person who originates an instruction for registration of transfer of an uncertificated security to a purchaser for value warrants all of the following to the purchaser [*Com. Code § 8108(b)*]:

- The instruction is made by an appropriate person or an agent with actual authority.
- The security is valid.
- There are no adverse claims.
- That, at the time the instruction is presented to the issuer,
  - The purchaser will be entitled to registration of transfer;
  - The transfer will be registered free from all encumbrances other than those specified in the instruction;
  - The transfer will not violate any restrictions on transfer;

- The transfer will otherwise be effective and rightful.

The person originating the instruction also warrants to the issuer that the instruction is effective and that, at the time the instruction is presented to the issuer, the purchaser is entitled to the registration of transfer [*Com. Code § 8108(e)*].

[2] Form

Instruction for Transfer of Uncertificated Securities

_____[*date*]
_____[*Name and address of issuer*]

Re: _____ [*identify securities being transferred*]
To whom it may concern:

_____[*Name of registered owner prior to current transfer*] hereby instructs you to register a transfer forthwith on your books of the above-referenced securities to _____[*name of new registered owner*]. The address [and other contact information] of _____[*name of new registered owner*] are as follows: _____[*provide contact information*].

Sincerely, _____ [*signature*]
_____ [*name, and capacity of signer if transferor is not a natural person*]



123 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART IV. FORMS
A. Transfers and Pledges of Securities

3-6K California Legal Forms--Transaction Guide § 6K.202

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.202 Entitlement Order

[1] Comment

[a] Use of Form

This form is an entitlement order. It is used to communicate to a securities intermediary the request to redeem a financial asset to which the entitlement holder has a securities entitlement. The entitlement order need not be initiated by the entitlement holder to be effective, as long as the entitlement holder has authorized the initiating party to do so. [Official Comment No. 8 to UCC § 8-102].

[b] Warranties of Originator of Entitlement Order

A person who originates an entitlement order to a securities intermediary warrants both of the following [*Com. Code § 8109(a)*]:

- The entitlement order is made by an appropriate person or an authorized agent.
- There is no adverse claim.

[2] Form

Entitlement Order

_____[*date*]
_____[*Name and address of securities intermediary*]

Re: _____ [*identify securities being transferred*]

To whom it may concern:

I hereby request [*add if request not being made by entitlement holder:* on behalf of _____ (*name of entitlement holder*)] that you redeem forthwith the above-referenced security entitlement. Please make the proceeds payable to _____[*name of payee*] to _____[*address where proceeds should be sent*].

Sincerely, _____ [*signature of originator*]
_____ [*name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART IV. FORMS
A. Transfers and Pledges of Securities

3-6K California Legal Forms--Transaction Guide § 6K.203

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.203 Demand Not to Register Transfer

[1] Comment--Use of Form

This form is a demand not to register a transfer of securities. It is used to demand that the issuer of a security not register a transfer of that security.

[2] Form

Demand Not to Register Transfer

_____[*date*]
_____[*Name and address of issuer*]

Re: _____ [*identify securities being transferred, including the issue of which the securities are a part*]
To whom it may concern:

I hereby demand that you not register any transfer of the above-referenced securities. _____[*Name of registered owner of securities*] is the registered owner of those securities. You may contact me at _____[*provide contact address*].

Sincerely, _____ [*signature of person making demand*]
_____ [*name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART IV. FORMS
A. Transfers and Pledges of Securities

3-6K California Legal Forms--Transaction Guide § 6K.204

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.204 Indemnification Agreement Regarding Replacement Shares

[1] Comment--Use of Form

This form is used to indemnify the issuer when an owner of certificated securities requests a duplicate certificate for one that has been lost or destroyed. It is also customary for an indemnity bond to be delivered to the issuer or its transfer agent [*see Ch. 79, Suretyship, Guaranty, and Indemnity, § 79.230* (form for lost securities bond)].

[2] Form

Indemnification Agreement Regarding Replacement Shares

The undersigned hereby represents and warrants to and agrees with _____[*name of corporation*], a California corporation (the "Company") as follows:

1. The undersigned has lost or misplaced the following outstanding certificate[s] representing shares of the Company: _____[*describe, including certificate number(s) and number of shares*].

2. The undersigned has not transferred, or offered to transfer, or agreed to transfer the above-described _____[security *or* securities] or any interest therein to any person.

3. The undersigned will forward to the outstanding certificate[s] to the Company immediately on finding or otherwise obtaining _____[it *or* them].

4. The undersigned hereby requests that the Company issue _____[a new certificate *or* new certificates] replacing the lost or misplaced certificate[s]. As inducement to cause the Company to so issue, the undersigned agrees to indemnify, defend and hold harmless the Company from any and all losses of any kind arising out of the issuance of the replacement certificate[s], including without limitation all attorney's fees incurred in connection with that indemnification or defense. The undersigned further agrees to cooperate with the Company in all respects in

connection with any such defense.

IN WITNESS WHEREOF, the undersigned has executed this agreement on _____[*date*], at _____, California.

_____ [*signature*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART IV. FORMS
A. Transfers and Pledges of Securities

3-6K California Legal Forms--Transaction Guide § 6K.205

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.205 Pledge Agreement for Certificated Securities

[1] Comment--Use of Form

This form is used to pledge shares of stock as security for a loan. The proceeds of the stock are also pledged, but are to be paid to the debtor as long as there is no event of default.

A pledge agreement generally is used in conjunction with a loan agreement. It contemplates that share certificates will be delivered to a custodian for keeping pursuant to a custodian agreement.

[2] Form

Pledge Agreement for Certificated Securities

PLEDGE AGREEMENT

THIS PLEDGE AGREEMENT ("Agreement") is entered into this _____ day of _____[*month*], _____[*year*], by _____ ("Debtor"), whose address is _____, and _____ ("Secured Party"), whose address is _____.

Recitals

A. Debtor and Secured Party are parties to a certain loan agreement [*name and/or description of agreement if necessary*] dated _____ ("Loan Agreement"). [A copy of the Loan Agreement is attached to this Pledge Agreement.]

B. As security for the performance of Debtor's obligations to the Secured Party under the Loan Agreement, it is Debtor's intent to cause to be created and granted to the Secured Party a security interest in certain property of Debtor,

as provided in this Pledge Agreement.

Agreement

[In consideration of the above recitals and for other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged,] Debtor and Secured Party agree as follows:

1. Collateral. "Collateral" means _____[*number of shares*] shares of stock of _____[*name of issuer*], currently represented by certificate no[s]. _____.

2. Grant of Security Interest. Debtor hereby grants to Secured Party a security interest in the Collateral to secure payment and performance of the obligations of Debtor to the Secured Party, as defined in Paragraph 3 below (referred to collectively and severally as the "Obligations"). Contemporaneously with the execution of this Agreement, Debtor is executing a Custody Agreement and delivering to the custodian named therein (the "Custodian") a stock certificate representing the Collateral, along with appropriate transfer forms executed in blank, which the Custodian shall hold in trust for the Secured Party pursuant to the Custody Agreement. So long as an Event of Default as defined in Paragraph 6 of this Pledge Agreement has not occurred, all dividends and distributions with respect to the Collateral shall be paid to Debtor.

3. Obligations. The Obligations of Debtor secured by this Agreement shall consist of the obligations of Debtor set forth in the Loan Agreement.

4. Covenants of Debtor. Debtor hereby agrees to do all of the following:

(a) Procure, execute and deliver from time to time any endorsements, assignments and other writings deemed necessary or appropriate by the Secured Party to perfect, maintain and protect the security interest created hereunder and the priority thereof, and pay promptly all related filing fees, stamp taxes or similar costs and expenses;

(b) Not to sell, encumber, or otherwise dispose of or transfer any Collateral or tight or interest therein;

(c) Keep the Collateral free of all levies and security interests or other liens or charges; and

(d) Provide the Secured Party promptly, and in any event within three days, after the occurrence of each Event of Default, or each event that with the lapse of time or giving or notice or both would constitute an Event of Default, the statement of Debtor setting forth details of that Event of Default or event and the action that Debtor proposes to take with respect to that event.

5. Authorized Action by Secured Party. Debtor hereby irrevocably appoints Secured Party as its attorney in fact to do any act that Debtor is obligated by this Agreement to do and to exercise such rights and powers as Debtor might exercise with respect to the Collateral. Immediately and without further notice, upon the occurrence of an Event of Default, Secured Party or its nominee shall have the right to exercise all voting rights and all other rights pertaining thereto, and Debtor hereby grants an irrevocable proxy to Secured Party with respect to the Collateral.

6. Event of Default. Debtor shall be deemed in default under this Agreement upon the occurrence of a breach by Debtor of any of its material obligations under the Loan Agreement. Each such occurrence shall be termed an Event of Default.

7. Remedies on Default. On the occurrence of any Event of Default, the following shall apply:

(a) Secured Party shall have the right, to the full extent permitted by law, and Debtor shall take all actions that may be necessary or appropriate to give effect to that right, to vote and to give consents, ratifications and waivers and to take

any other action with respect to the Collateral with the same force and effect as if the Secured Party were the absolute and sole owner thereof.

(b) Secured Party may exercise all the rights and remedies of a secured party under applicable law and, in addition, Secured Party may, without being required to give any notice, except as hereinafter provided, or as may be required by mandatory provisions of law, do either or both of the following:

(1) Apply the cash, if any, then held by it as Collateral hereunder to the Obligations; and

(2) If there is no such cash, or if such cash is insufficient to pay all the Obligations in full, sell all or any part of the Collateral at public or private sale, for cash, on credit or for future delivery, and at any price or prices that Secured Party may deem satisfactory.

(c) Secured Party may be the purchaser of any or all of the Collateral sold at any public or private sale under subparagraph (b)(2), above, and thereafter hold the Collateral so purchased absolutely free from any right or claim of any kind. On any such sale, Secured Party shall have the right to deliver, assign and transfer to the purchaser the shares of Collateral so sold. Secured Party shall give Debtor at least seven days written notice of its intention to make any such public or private sale. Secured Party shall not be obligated to make any such sale following any such notice. Secured Party, instead of exercising the power of sale herein conferred on it, may proceed by a suit or suits at law or in equity to foreclose the security interests granted in this Pledge Agreement, and sell all or any part of the Collateral under a judgment or decree of a court or courts of competent jurisdiction.

8. Termination and Release of Collateral. When all of the Obligations have been fully and completely discharged, Secured Party shall procure the return to Debtor of the Collateral then held by the Custodian under this Agreement, whereupon Secured Party's duties and responsibilities with respect to the Collateral and this Agreement shall cease and terminate.

9. Cumulative Rights. The rights, powers and remedies of Secured Party under this Agreement shall be in addition to all rights, powers and remedies given to Secured Party by virtue of any statute or rule of law, [a shareholders agreement], or any other agreement between Debtor and Secured Party, all of which rights, powers and remedies shall be cumulative and may be exercise successively or concurrently without impairing Secured Party's security interest in the Collateral.

10. Waiver. (a) Any forbearance, failure or delay by Secured Party in exercising any right, power or remedy shall not preclude the further exercise thereof, and every right, power and remedy of Secured Party shall continue in full force and effect until that right, power or remedy is specifically waived in a writing executed by Secured Party.

(b) Debtor waives any right to require Secured Party

(1) To proceed against any person, firm or corporation;

(2) To exhaust any Collateral it may hold at any time;

(3) To apply any Collateral in any order; or

(4) To pursue any other remedy whatsoever in Secured Party's power.

(c) Debtor further waives, to the full extent permitted by law, all rights to notice or a judicial hearing prior to the time Secured Party takes possession or disposes of the Collateral upon default as provided in Paragraph 7.

11. Binding on Successors. All rights of the parties under this Agreement shall inure to the benefit of their heirs,

executors, administrators, successors and permitted assigns, and all obligations of the parties under this Agreement shall bind their heirs, executors, administrators, successor and permitted assigns. Except as expressly provided herein, nothing in this Agreement is intended to provide any rights or remedies to any person other than the parties to this Agreement and their heirs, executors, administrators, successors and permitted assigns.

12. Entire Agreement; Severability. This Agreement constitutes a final written expression of all of the terms of the agreement among the parties regarding the subject matter of this Agreement, is a complete and exclusive statement of those terms and supersedes all prior agreements, understandings and representations between or among the parties relating the subject matter of this Agreement. If any of the provisions of this Agreement shall be held invalid or unenforceable, this Agreement shall be construed as if not containing those provisions, and the rights and obligations of the parties to this Agreement shall be construed and enforced accordingly.

13. Notices. Any notice or other communication under or in connection with this Agreement shall be made in writing and shall be delivered personally or sent by courier or certified mail return receipt requested as follows:

Secured Party: _____
_____ [*address*]

Debtor: _____
_____ [*address*]

Any party may specify a different address to which notice may be sent by giving notice in writing to the other party. In the absence of evidence of earlier receipt, any notice or other communication shall be deemed to have been duly given,

(a) If delivered personally, on the date when left at the address.

(b) If sent by courier, three days after posting it.

(c) If sent by mail, seven days after posting it.

14. References. Whenever required by the context of this Agreement, the singular number shall include the plural, and vice versa; and the neuter gender shall include the masculine and feminine genders. As used in this Agreement, the work "including" shall not be deemed to be a words of limitation, and accordingly shall be deemed to be followed by the words "without limitation." As used in this Agreement, the term "person" shall be deemed to refer to any individual, entity (including corporation, joint stock company, limited liability company, general partnership, limited partnership or joint venture), government (or political subdivision thereof) or governmental agency, authority or instrumentality.

15. Choice of Law. This Agreement shall be governed by and construed in accordance with the laws of the State of California, without giving effect to California's principles of conflict of laws.

16. Amendment. This Agreement may not be modified except in a writing signed by the parties. This Agreement may not be modified by an oral agreement, even if supported by new consideration.

17. Venue and Jurisdiction. If any legal proceeding or other legal action relating to this Agreement is brought or otherwise initiated, the venue shall be in _____[*name of city or county*], California (which shall be deemed a convenient forum) or, at the election of the party initiating the action, the county in which the other party resides or has located its principle place of business. The parties to this Agreement expressly and irrevocable consent and submit to the jurisdiction of the courts of the State of California.

18. Interpretation of Agreement. Each party to this Agreement acknowledges that it has participated in the drafting of this Agreement, and any applicable rule of construction to the effect that ambiguities are to be resolved against the drafting party shall not be applied in connection with the construction or interpretation of this Agreement.

19. Headings. The underlined headings contained in this Agreement are for convenience or reference only, shall not be deemed to be a part of this Agreement, and shall not be referred to in connection with the construction or interpretation of this Agreement.

20. Counterparts. This Agreement may be executed in any number of counterparts, each of which when executed and delivered shall be an original, and all the counterparts together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the parties have executed this Pledge Agreement on the date written at the beginning of the Agreement.

DEBTOR:
_____ [*signature of debtor*]
[*typed name*]
SECURED PARTY:
_____ [*signature of secured party*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART IV. FORMS
A. Transfers and Pledges of Securities

3-6K California Legal Forms--Transaction Guide § 6K.206

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.206 Pledge Agreement for Uncertificated Securities

[1] Comment--Use of Form

This form is used to pledge uncertificated securities as security for a loan. The proceeds of the uncertificated securities are also pledged, but are to be paid to the debtor as long as there is no event of default.

A pledge agreement generally is used in conjunction with a loan agreement.

[2] Form

Pledge Agreement for Uncertificated Securities

PLEDGE AGREEMENT

THIS PLEDGE AGREEMENT ("Agreement") is entered into this _____ day of _____[*month*], _____[*year*], by _____ ("Debtor"), whose address is _____, and _____ ("Secured Party"), whose address is _____.

Recitals

A. Debtor and Secured Party are parties to a certain loan agreement [*name and/or description of agreement if necessary*] dated _____ ("Loan Agreement"). [A copy of the Loan Agreement is attached to this Pledge Agreement.]

B. As security for the performance of Debtor's obligations to the Secured Party under the Loan Agreement, it is Debtor's intent to cause to be created and granted to the Secured Party a security interest in certain property of Debtor, as provided in this Pledge Agreement.

Agreement

[In consideration of the above recitals and for other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged,] Debtor and Secured Party agree as follows:

1. Collateral. "Collateral" means _____[*number of shares*] shares of stock of _____[*name of mutual fund*] (the "Fund").

2. Grant of Security Interest. Debtor hereby grants to Secured Party a security interest in the Collateral to secure payment and performance of the obligations of Debtor to the Secured Party, as defined in Paragraph 3, below (referred to collectively and severally as the "Obligations"). Contemporaneously with the execution of this Agreement, Debtor is executing (1) a UCC-1 financing statement with respect to the Collateral, and (2) instructions to the Fund to register the pledge of the Collateral to Secured party. So long as an Event of Default as defined in Paragraph 6 of this Pledge Agreement has not occurred, all dividends and distributions with respect to the Collateral shall be paid to Debtor.

3. Obligations. The Obligations of Debtor secured by this Agreement shall consist of the obligations of Debtor set forth in the Loan Agreement.

4. Covenants of Debtor. Debtor hereby agrees to do all of the following:

(a) Procure, execute and deliver from time to time any financing statements, including amendments thereto and continuations thereof, instructions, assignments, and other writings deemed necessary or appropriate by the Secured Party to perfect, maintain and protect the security interest created hereunder and the priority thereof, and pay promptly all related filing fees, stamp taxes or similar costs and expenses;

(b) Not to sell, encumber, or otherwise dispose of or transfer any Collateral or tight or interest therein;

(c) Keep the Collateral free of all levies and security interests or other liens or charges; and

(d) Provide the Secured Party promptly, and in any event within three days, after the occurrence of each Event of Default, or each event that with the lapse of time or giving or notice or both would constitute an Event of Default, the statement of Debtor setting forth details of that Event of Default or event and the action that Debtor proposes to take with respect to that event.

5. Authorized Action by Secured Party. Debtor hereby irrevocably appoints Secured Party as its attorney in fact to do any act that Debtor is obligated by this Agreement to do and to exercise such rights and powers as Debtor might exercise with respect to the Collateral. Immediately and without further notice, upon the occurrence of an Event of Default, Secured Party or its nominee shall have the right to exercise all voting rights and all other rights pertaining thereto, and Debtor hereby grants an irrevocable proxy to Secured Party with respect to the Collateral.

6. Event of Default. Debtor shall be deemed in default under this Agreement upon the occurrence of a breach by Debtor of any of its material obligations under the Loan Agreement. Each such occurrence shall be termed an Event of Default.

7. Remedies on Default. On the occurrence of any Event of Default, the following shall apply:

(a) Secured Party shall have the right, to the full extent permitted by law, and Debtor shall take all actions that may be necessary or appropriate to give effect to that right, to vote and to give consents, ratifications and waivers and to take any other action with respect to the Collateral with the same force and effect as if the Secured Party were the absolute and sole owner thereof.

(b) Secured Party may exercise all the rights and remedies of a secured party under applicable law and, in addition, Secured Party may, without being required to give any notice, except as hereinafter provided, or as may be required by mandatory provisions of law, do either or both of the following:

(1) Apply the cash, if any, then held by it as Collateral hereunder to the Obligations; and

(2) If there is no such cash, or if such cash is insufficient to pay all the Obligations in full, sell all or any part of the Collateral at public or private sale, for cash, on credit or for future delivery, and at any price or prices that Secured Party may deem satisfactory.

(c) Secured Party may be the purchaser of any or all of the Collateral sold at any public or private sale under subparagraph (b)(2), above, and thereafter hold the Collateral so purchased absolutely free from any right or claim of any kind. On any such sale, Secured Party shall have the right to deliver, assign and transfer to the purchaser the shares of Collateral so sold. Secured Party shall give Debtor at least seven days written notice of its intention to make any such public or private sale. Secured Party shall not be obligated to make any such sale following any such notice. Secured Party, instead of exercising the power of sale herein conferred upon it, may proceed by a suit or suits at law or in equity to foreclose the security interests granted in this Pledge Agreement, and sell all or any part of the Collateral under a judgment or decree of a court or courts of competent jurisdiction.

8. Termination and Release of Collateral. When all of the Obligations have been fully and completely discharged, Secured Party shall deliver instructions to the fund to register the transfer of the Collateral to Debtor free and clear of the security interest of Secured Party, whereupon Secured Party's duties and responsibilities with respect to the Collateral and this Agreement shall cease and terminate.

9. Cumulative Rights. The rights, powers and remedies of Secured Party under this Agreement shall be in addition to all rights, powers and remedies given to Secured Party by virtue of any statute or rule of law, [a shareholders agreement], or any other agreement between Debtor and Secured Party, all of which rights, powers and remedies shall be cumulative and may be exercise successively or concurrently without impairing Secured Party's security interest in the Collateral.

10. Waiver. (a) Any forbearance, failure or delay by Secured Party in exercising any right, power or remedy shall not preclude the further exercise thereof, and every right, power and remedy of Secured Party shall continue in full force and effect until that right, power or remedy is specifically waived in a writing executed by Secured Party.

(b) Debtor waives any right to require Secured Party

(1) To proceed against any person, firm or corporation;

(2) To exhaust any Collateral it may hold at any time;

(3) To apply any Collateral in any order; or

(4) To pursue any other remedy whatsoever in Secured Party's power.

(c) Debtor further waives, to the full extent permitted by law, all rights to notice or a judicial hearing prior to the time Secured Party takes possession or disposes of the Collateral upon default as provided in Paragraph 7.

11. Binding on Successors. All rights of the parties under this Agreement shall inure to the benefit of their heirs, executors, administrators, successors and permitted assigns, and all obligations of the parties under this Agreement shall bind their heirs, executors, administrators, successor and permitted assigns. Except as expressly provided herein, nothing in this Agreement is intended to provide any rights or remedies to any person other than the parties to this

Agreement and their heirs, executors, administrators, successors and permitted assigns.

12. Entire Agreement; Severability. This Agreement constitutes a final written expression of all of the terms of the agreement among the parties regarding the subject matter of this Agreement, is a complete and exclusive statement of those terms and supersedes all prior agreements, understandings and representations between or among the parties relating the subject matter of this Agreement. If any of the provisions of this Agreement shall be held invalid or unenforceable, this Agreement shall be construed as if not containing those provisions, and the rights and obligations of the parties to this Agreement shall be construed and enforced accordingly.

13. Notices. Any notice or other communication under or in connection with this Agreement shall be made in writing and shall be delivered personally or sent by courier or certified mail return receipt requested as follows:

Secured Party: _____
_____ [*address*]

Debtor: _____
_____ [*address*]

Any party may specify a different address to which notice may be sent by giving notice in writing to the other party. In the absence of evidence of earlier receipt, any notice or other communication shall be deemed to have been duly given,

(a) If delivered personally, on the date when left at the address.

(b) If sent by courier, three days after posting it.

(c) If sent by mail, seven days after posting it.

14. References. Whenever required by the context of this Agreement, the singular number shall include the plural, and vice versa; and the neuter gender shall include the masculine and feminine genders. As used in this Agreement, the work "including" shall not be deemed to be a words of limitation, and accordingly shall be deemed to be followed by the words "without limitation." As used in this Agreement, the term "person" shall be deemed to refer to any individual, entity (including corporation, joint stock company, limited liability company, general partnership, limited partnership or joint venture), government (or political subdivision thereof) or governmental agency, authority or instrumentality.

15. Choice of Law. This Agreement shall be governed by and construed in accordance with the laws of the State of California, without giving effect to California's principles of conflict of laws.

16. Amendment. This Agreement may not be modified except in a writing signed by the parties. This Agreement may not be modified by an oral agreement, even if supported by new consideration.

17. Venue and Jurisdiction. If any legal proceeding or other legal action relating to this Agreement is brought or otherwise initiated, the venue shall be in _____[*name of city or county*], California (which shall be deemed a convenient forum) or, at the election of the party initiating the action, the county in which the other party resides or has located its principle place of business. The parties to this Agreement expressly and irrevocable consent and submit to the jurisdiction of the courts of the State of California.

18. Interpretation of Agreement. Each party to this Agreement acknowledges that it has participated in the drafting of this Agreement, and any applicable rule of construction to the effect that ambiguities are to be resolved against the drafting party shall not be applied in connection with the construction or interpretation of this Agreement.

19. Headings. The underlined headings contained in this Agreement are for convenience or reference only, shall not be deemed to be a part of this Agreement, and shall not be referred to in connection with the construction or

interpretation of this Agreement.

20. Counterparts. This Agreement may be executed in any number of counterparts, each of which when executed and delivered shall be an original, and all the counterparts together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the parties have executed this Pledge Agreement on the date written at the beginning of the Agreement.

DEBTOR:

_____ [*signature of debtor*]

[*typed name*]

SECURED PARTY:

_____ [*signature of secured party*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART IV. FORMS
A. Transfers and Pledges of Securities

3-6K California Legal Forms--Transaction Guide § 6K.207

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.207 Pledge Agreement for Securities Held in Securities Account

[1] Comment--Use of Form

This form is used to pledge shares of stock held in a securities account as security for a loan. The proceeds of the stock are also pledged, but are to be paid to the debtor as long as there is no event of default.

[2] Form

Pledge Agreement for Securities Held in Securities Account

PLEDGE AGREEMENT

THIS PLEDGE AGREEMENT ("Agreement") is entered into this _____ day of _____[*month*], _____[*year*], by _____ ("Debtor"), whose address is _____, and _____ ("Secured Party"), whose address is _____.

Recitals

A. Debtor and Secured Party are parties to a certain loan agreement [*give name and/or description of agreement if necessary*] dated _____ ("Loan Agreement"). [A copy of the Loan Agreement is attached to this Pledge Agreement.]

B. As security for the performance of Debtor's obligations to the Secured Party under the Loan Agreement, it is Debtor's intent to cause to be created and granted to the Secured Party a security interest in certain property of Debtor, as provided in this Pledge Agreement.

Agreement

[In consideration of the above recitals and for other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged,] Debtor and Secured Party agree as follows:

1. Collateral. "Collateral" means _____[*number of shares*] shares of stock of _____[*name of issuer*], currently held in securities account no. _____ with _____[*name of broker*].

2. Grant of Security Interest. Debtor hereby grants to Secured Party a security interest in the Collateral to secure payment and performance of the obligations of Debtor to the Secured Party, as defined in Paragraph 3 below (referred to collectively and severally as the "Obligations"). Contemporaneously with the execution of this Agreement, Debtor is executing (1) a UCC-1 financing statement with respect to the Collateral, and (2) an entitlement order to the Broker to register the pledge of the Collateral to Secured Party. So long as an Event of Default as defined in Paragraph 6 of this Pledge Agreement has not occurred, all dividends and distributions with respect to the Collateral shall be paid to Debtor.

3. Obligations. The Obligations of Debtor secured by this Agreement shall consist of the obligations of Debtor set forth in the Loan Agreement.

4. Covenants of Debtor. Debtor hereby agrees to do all of the following:

(a) Procure, execute and deliver from time to time any financing statements, including amendments thereto and continuations thereof, entitlement orders, assignments, and other writings deemed necessary or appropriate by the Secured Party to perfect, maintain and protect the security interest created hereunder and the priority thereof, and pay promptly all related filing fees, stamp taxes or similar costs and expenses;

(b) Not to sell, encumber, or otherwise dispose of or transfer any Collateral or tight or interest therein;

(c) Keep the Collateral free of all levies and security interests or other liens or charges; and

(d) Provide the Secured Party promptly, and in any event within three days, after the occurrence of each Event of Default, or each event that with the lapse of time or giving or notice or both would constitute an Event of Default, the statement of Debtor setting forth details of that Event of Default or event and the action that Debtor proposes to take with respect to that event.

5. Authorized Action by Secured Party. Debtor hereby irrevocably appoints Secured Party as its attorney in fact to do any act that Debtor is obligated by this Agreement to do and to exercise such rights and powers as Debtor might exercise with respect to the Collateral. Immediately and without further notice, upon the occurrence of an Event of Default, Secured Party or its nominee shall have the right to exercise all voting rights and all other rights pertaining thereto, and Debtor hereby grants an irrevocable proxy to Secured Party with respect to the Collateral.

6. Event of Default. Debtor shall be deemed in default under this Agreement on the occurrence of a breach by Debtor of any of its material obligations under the Loan Agreement. Each such occurrence shall be termed an Event of Default.

7. Remedies on Default. On the occurrence of any Event of Default, the following shall apply:

(a) Secured Party shall have the right, to the full extent permitted by law, and Debtor shall take all actions that may be necessary or appropriate to give effect to that right, to vote and to give consents, ratifications and waivers and to take any other action with respect to the Collateral with the same force and effect as if the Secured Party were the absolute and sole owner thereof.

(b) Secured Party may exercise all the rights and remedies of a secured party under applicable law and, in addition, Secured Party may, without being required to give any notice, except as hereinafter provided, or as may be required by mandatory provisions of law, do either or both of the following:

(1) Apply the cash, if any, then held by it as Collateral hereunder to the Obligations; and

(2) If there is no such cash, or if such cash is insufficient to pay all the Obligations in full, sell all or any part of the Collateral at public or private sale, for cash, on credit or for future delivery, and at any price or prices that Secured Party may deem satisfactory.

(c) Secured Party may be the purchaser of any or all of the Collateral sold at any public or private sale under subparagraph (b)(2), above, and thereafter hold the Collateral so purchased absolutely free from any right or claim of any kind. On any such sale, Secured Party shall have the right to deliver, assign and transfer to the purchaser the shares of Collateral so sold. Secured Party shall give Debtor at least seven days written notice of its intention to make any such public or private sale. Secured Party shall not be obligated to make any such sale following any such notice. Secured Party, instead of exercising the power of sale herein conferred upon it, may proceed by a suit or suits at law or in equity to foreclose the security interests granted in this Pledge Agreement, and sell all or any part of the Collateral under a judgment or decree of a court or courts of competent jurisdiction.

8. Termination and Release of Collateral. When all of the Obligations have been fully and completely discharged, Secured Party shall deliver entitlement orders to the Broker to register the transfer of the Collateral to Debtor free and clear of the security interest of Secured Party, whereupon Secured Party's duties and responsibilities with respect to the Collateral and this Agreement shall cease and terminate.

9. Cumulative Rights. The rights, powers and remedies of Secured Party under this Agreement shall be in addition to all rights, powers and remedies given to Secured Party by virtue of any statute or rule of law, [a shareholders agreement], or any other agreement between Debtor and Secured Party, all of which rights, powers and remedies shall be cumulative and may be exercise successively or concurrently without impairing Secured Party's security interest in the Collateral.

10. Waiver. (a) Any forbearance, failure or delay by Secured Party in exercising any right, power or remedy shall not preclude the further exercise thereof, and every right, power and remedy of Secured Party shall continue in full force and effect until that right, power or remedy is specifically waived in a writing executed by Secured Party.

(b) Debtor waives any right to require Secured Party

(1) To proceed against any person, firm or corporation;

(2) To exhaust any Collateral it may hold at any time;

(3) To apply any Collateral in any order; or

(4) To pursue any other remedy whatsoever in Secured Party's power.

(c) Debtor further waives, to the full extent permitted by law, all rights to notice or a judicial hearing prior to the time Secured Party takes possession or disposes of the Collateral upon default as provided in Paragraph 7.

11. Binding on Successors. All rights of the parties under this Agreement shall inure to the benefit of their heirs, executors, administrators, successors and permitted assigns, and all obligations of the parties under this Agreement shall bind their heirs, executors, administrators, successor and permitted assigns. Except as expressly provided herein, nothing in this Agreement is intended to provide any rights or remedies to any person other than the parties to this

Agreement and their heirs, executors, administrators, successors and permitted assigns.

12. Entire Agreement; Severability. This Agreement constitutes a final written expression of all of the terms of the agreement among the parties regarding the subject matter of this Agreement, is a complete and exclusive statement of those terms and supersedes all prior agreements, understandings and representations between or among the parties relating the subject matter of this Agreement. If any of the provisions of this Agreement shall be held invalid or unenforceable, this Agreement shall be construed as if not containing those provisions, and the rights and obligations of the parties to this Agreement shall be construed and enforced accordingly.

13. Notices. Any notice or other communication under or in connection with this Agreement shall be made in writing and shall be delivered personally or sent by courier or certified mail return receipt requested as follows:

Secured Party: _____
_____ [*address*]

Debtor: _____
_____ [*address*]

Any party may specify a different address to which notice may be sent by giving notice in writing to the other party. In the absence of evidence of earlier receipt, any notice or other communication shall be deemed to have been duly given,

(a) If delivered personally, on the date when left at the address.

(b) If sent by courier, three days after posting it.

(c) If sent by mail, seven days after posting it.

14. References. Whenever required by the context of this Agreement, the singular number shall include the plural, and vice versa; and the neuter gender shall include the masculine and feminine genders. As used in this Agreement, the work "including" shall not be deemed to be a words of limitation, and accordingly shall be deemed to be followed by the words "without limitation." As used in this Agreement, the term "person" shall be deemed to refer to any individual, entity (including corporation, joint stock company, limited liability company, general partnership, limited partnership or joint venture), government (or political subdivision thereof) or governmental agency, authority or instrumentality.

15. Choice of Law. This Agreement shall be governed by and construed in accordance with the laws of the State of California, without giving effect to California's principles of conflict of laws.

16. Amendment. This Agreement may not be modified except in a writing signed by the parties. This Agreement may not be modified by an oral agreement, even if supported by new consideration.

17. Venue and Jurisdiction. If any legal proceeding or other legal action relating to this Agreement is brought or otherwise initiated, the venue shall be in _____[*name of city or county*], California (which shall be deemed a convenient forum) or, at the election of the party initiating the action, the county in which the other party resides or has located its principle place of business. The parties to this Agreement expressly and irrevocable consent and submit to the jurisdiction of the courts of the State of California.

18. Interpretation of Agreement. Each party to this Agreement acknowledges that it has participated in the drafting of this Agreement, and any applicable rule of construction to the effect that ambiguities are to be resolved against the drafting party shall not be applied in connection with the construction or interpretation of this Agreement.

19. Headings. The underlined headings contained in this Agreement are for convenience or reference only, shall not be deemed to be a part of this Agreement, and shall not be referred to in connection with the construction or

interpretation of this Agreement.

20. Counterparts. This Agreement may be executed in any number of counterparts, each of which when executed and delivered shall be an original, and all the counterparts together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the parties have executed this Pledge Agreement on the date written at the beginning of the Agreement.

DEBTOR:

_____ [*signature of debtor*]

[*typed name*]

SECURED PARTY:

_____ [*signature of secured party*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART IV. FORMS
A. Transfers and Pledges of Securities

3-6K California Legal Forms--Transaction Guide §§ 6K.208-6K.219

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

[Reserved]

§§ 6K.208[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 6K NONISSUER TRANSACTIONS IN INVESTMENT SECURITIES
PART IV. FORMS
B. Securities Forms

3-6K California Legal Forms--Transaction Guide § 6K.220

AUTHOR: Marilyn Minger AuthorFrances E. Lossing Practice Consultant

§ 6K.220 Application for Qualification by Notification in Nonissuer Transaction

[1] Comment--Use of Form

This form is the facing page to be used to apply to the Department of Corporations for qualification by notification of the sale or offer a security in a nonissuer transaction under *Corp. Code § 25131*. The format of this form is set out in *10 Cal. Code Reg. § 260.131*. The form is available on the forms page of the Department of Corporations, which is located at www.corp.ca.gov/forms/formslist.htm.

Detailed instructions for completing the application and the information and documents to be included in the application are part of the form and are reproduced below.

For general discussion of qualification by notification, and the qualification process in general, see Ch. 6H, *Qualification of Securities* . For discussion of qualification of nonissuer transactions, see *§ 6K.40*; see also *§ 6H.21[4]*.

[2] Form

Application for Qualification by Notification in Nonissuer Transaction

Click here to view image.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS

4-7 California Legal Forms--Transaction Guide 7.syn

§ 7.syn Synopsis to Chapter 7: CORPORATE RECORDS AND REPORTS

§ 7.01 California Sources

[1] Statutes

[2] Regulations

§ 7.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 7.03-7.04 [Reserved]

§ 7.05 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 7.06-7.09 [Reserved]

§ 7.10 Corporations Subject to Record Keeping and Reporting Requirements

[1] Domestic Corporations

[2] Foreign Corporations

[3] Close Corporations

§ 7.11 Minutes

[1] Corporations Subject to Requirement

[2] Contents

[3] How Kept

[4] Effect of Noncompliance

§ 7.12 Books of Account, Bylaws, Record of Shareholders

§ 7.13 Civil Penalties and Liabilities

[1] For Failure to Keep or Maintain Books and Records

[a] Domestic Corporations

[b] Foreign Corporations

[2] For Failure to Enter Share Transfer or Issue Share Certificate

[3] For False Statements or Entries on Corporate Books

[a] Domestic Corporations

[b] Foreign Corporations

[4] Enforcement by Attorney General

§ 7.14 Criminal Penalties and Liabilities

[1] Foreign Incorporation No Defense

[2] For Falsification of Reports

[3] For Falsification of Books or Securities

[4] For Exhibition of False Documents to Public Officer or Board

[5] For False Subscription or Insertion of Name

§§ 7.15-7.19 [Reserved]

§ 7.20 Inspection Rights of Shareholders

[1] Accounting Books and Records; Minutes

[a] Corporations Subject to Requirement

[b] Right to Inspect

[c] Limitations on Right to Inspect

[2] Bylaws

[3] Record of Shareholders

[a] Right to Inspect--In General

[b] Absolute Right to Inspect

[4] Other Corporate Records

[5] Corporate Property

§ 7.21 Inspection Rights of Directors

§ 7.22 Inspection Rights of Local Assessors

§ 7.23 Enforcement of Inspection Rights

[1] Refusal of Demand for Inspection

[a] Court Action

[b] Action by Attorney General

[2] Delay in Delivering Shareholder Record or List

§ 7.24 Rights to Results of Shareholder Vote

§§ 7.25-7.29 [Reserved]

§ 7.30 Corporations Required to Report to Shareholders

§ 7.31 Annual Report to Shareholders

[1] In General

[2] Additional Requirement for Corporations With 100 or More Shareholders

[3] Timing

[4] Delivery

[5] Definitions of Common Accounting Terms

[a] As Used in General Corporation Law

[b] Financial Statements

[c] Balance Sheet

[d] Income Statement

[e] Statement of Cashflows

[f] Statement of Retained Earnings

[g] Consolidated Statement

§ 7.32 Financial Reports Requested by Shareholders

[1] Quarterly Reports

[2] Financial Statements in Lieu of Annual Report

§ 7.33 Enforcement of Shareholders' Rights to Annual Report and Financial Statements

§§ 7.34-7.39 [Reserved]

§ 7.40 Statement of Information by Domestic Stock Corporation and Corporate Disclosure Statement

[1] In General

[2] Filing Procedure

[3] Contents of Forms

§ 7.41 Failure to File Statement of Information by Domestic Stock Corporation

[1] Notification and Certification Procedures; Penalty

[2] Suspension by Secretary of State; Revivor

[3] Suspension by Franchise Tax Board; Revivor

[4] Suspension by Secretary of State and Franchise Tax Board; Revivor

§ 7.42 Updated Statement of Information by Domestic Stock Corporation

§ 7.43 Annual Statement by Foreign Corporation

§§ 7.44-7.49 [Reserved]

§ 7.50 Agent for Service of Process--In General

§ 7.51 Natural Person as Agent

§ 7.52 Corporation as Agent

§ 7.53 Resignation of Agent; Appointment of New Agent

§§ 7.54-7.99 [Reserved]

§ Client Interview

[1] Facts

Scope

[2] Documents

Scope

§§ 7.101-7.109 [Reserved]

§ 7.110 Corporations Subject to Statutory Recordkeeping and Reporting Requirements

Scope

§ 7.111 Checklist of Required Records, Shareholder Reports, and Annual Statements Filed With Secretary of State

Scope

§§ 7.112-7.119 [Reserved]

§ 7.120 Corporate Records

[1] General Record Keeping Requirements

Scope

[2] Civil Penalties and Liabilities

Scope

[3] Criminal Penalties and Liabilities

Scope

§ 7.121 Inspection Rights

[1] Shareholders and Holders of Voting Trust Certificate

Scope

[2] Directors

Scope

[3] Local Assessors

Scope

[4] Enforcement Actions

Scope

§ 7.122 Right to Result of Shareholder Vote

Scope

§ 7.123 Reports to Shareholders

[1] Annual Report

Scope

[2] Financial Reports Requested by Shareholders

Scope

[3] Enforcement Actions; Penalties

Scope

§ 7.124 Statement of Information by Domestic Stock Corporation

[1] Required and Optional Filings

Scope

[2] Failure to File; Suspension and Revivor

Scope

§ 7.125 Agent for Service of Process

Scope

§§ 7.126-7.199 [Reserved]

§ 7.200 Shareholder's Request for Delinquent Annual Report

[1] Comment

[a] Use of Form

[b] Enforcement of Shareholders' Rights to Annual Report

[2] FORM

Shareholder's Request for Delinquent Annual Report

§ 7.201 Shareholder's Request for Financial Statements in Lieu of Annual Report

[1] Comment

[a] Use of Form

[b] Corporations Subject to Requirement

[2] FORM

Shareholder's Request for Financial Statements in Lieu of Annual Report

§ 7.202 Shareholder's Request for Quarterly Financial Statements

[1] Comment

[a] Use of Form

[b] Corporations Subject to Requirement

[2] FORM

Shareholder's Request for Quarterly Financial Statements

§ 7.203 Shareholder's Demand to Inspect Corporate Records

[1] Comment

[a] Use of Form

[b] Right to Inspect

[c] Corporations Subject to Requirement

[2] FORM

Shareholder's Demand to Inspect Corporate Records

§ 7.204 Certain Shareholders' Demand to Inspect Record of Shareholders

[1] Comment

[a] Use of Form

[b] Absolute Right to Inspect

[c] Corporations Subject to Requirement

[2] FORM

Certain Shareholders' Demand to Inspect Record of Shareholders

§ 7.205 Shareholders' Demand on Transfer Agent for List of Shareholders

[1] Comment

[a] Use of Form

[b] Absolute Right to List

[c] Corporations Subject to Requirement

[2] FORM

Shareholders' Demand on Transfer Agent for List of Shareholders

§ 7.206 Director's Notice of Inspection of Corporate Records or Property

[1] Comment

[a] Use of Form

[b] Inspection Rights of Directors

[2] FORM

Director's Notice of Inspection of Corporate Records or Property

§ 7.207 Statement of Information by Domestic Stock Corporation--Initial Statement or Change to Previously Filed Statement

[1] Comment

[a] Use of Form

[b] Initial and Annual Filings

[c] Optional Filings

[d] Change of Agent or Agent's Address

[e] Contents of Form

[f] Statement Subject to Public Inspection

[2] FORM

Statement of Information by Domestic Stock Corporation--SOS Form SI-200C

§ 7.207A Statement of Information by Domestic Stock Corporation--Complete or No-Change Annual Statement

[1] Comment

[a] Use of Form

[b] Annual Filing Procedure

[c] "No Change" Filings

[d] Change in Agent for Service of Process

[2] FORM

INSTRUCTIONS FOR COMPLETING FORM Si-200 N/C

§ 7.207B Corporate Disclosure Statement--Publicly Traded Companies

[1] Comment

[a] Use of Form

[b] Contents of Form

[c] Filing and Execution

[2] FORM

Corporate Disclosure Statement--Publicly Traded Companies

§ 7.208 Application for Certificate of Revivor

[1] Comment

[a] Use of Form

[b] Suspension by Secretary of State for Failure to File Statement of Information by Domestic Stock Corporation; Revivor

[c] Suspension by Franchise Tax Board for Failure to Pay Taxes or File Tax Return; Revivor

[d] Suspension by Secretary of State and Franchise Tax Board; Revivor

[2] FORM

Application for Certificate of Revivor

§ 7.209 Resignation of Agent for Service of Process

[1] Comment--Use of Form

[2] FORM

Resignation of Agent for Service of Process



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS

4-7 California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter discusses the requirements imposed by California law on a domestic or foreign corporation to keep and maintain books of account, records of proceedings of shareholders, boards of directors, and board committees, and of share transactions. It covers the rights of shareholders and directors to inspect corporate records and distinguishes the statutory rights of each group. This chapter also includes reports required to be filed by a corporation with the California Secretary of State, as well as an application to revive a suspended corporation.

Reporting and record keeping requirements imposed on corporations by licensing or regulatory agencies or by federal law, including federal securities law, are not covered here. Filings required by a corporation qualifying its securities under the California Corporate Securities Law of 1968 also are not covered here. For an overview of the relevant securities issues, see Ch. 6, *Securities Regulation Issues* .

As used in this chapter, "corporation" refers to a domestic corporation incorporated under the General Corporation Law, and a "foreign corporation," unless otherwise stated, refers to a corporation organized under the laws of a jurisdiction other than California, excluding a corporation chartered under federal law.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-7 California Legal Forms--Transaction Guide § 7.01

§ 7.01 California Sources

[1] Statutes

English language required; writing defined to include electronic transmission by and to corporations. *Corp. Code § 8.*

Electronic transmission by corporation. *Corp. Code § 20.*

Electronic transmission to corporation. *Corp. Code § 21*.

General Corporation Law. *Corp. Code § 100 et seq.*

Definitions.

Independent accountant. *Corp. Code § 115*.

Close corporation. *Corp. Code § 158*.

Corporation. *Corp. Code § 162*.

Domestic corporation. *Corp. Code § 167*.

Parent. *Corp. Code § 175*.

Proper county for action in superior court. *Corp. Code § 177*.

Subsidiary. *Corp. Code § 189.*

Transacting intrastate business. *Corp. Code § 191*.

Foreign corporation subject to record keeping and reporting requirements. *Corp. Code § 2115(a), (e)*.

Preparation of financial statements. *Corp. Code § 114*.

Restrictions on names of domestic corporations. *Corp. Code § 201*.

Bylaws. *Corp. Code § 213*.

Directors' meetings. *Corp. Code § 307*.

Minutes of meeting as evidence. *Corp. Code § 314*.

Shareholders' meetings. *Corp. Code § 600*.

Notice of meetings; mailing of reports. *Corp. Code § 601*.

Required records and reports. *Corp. Code §§ 1500-1502*.

General requirements. *Corp. Code § 1500*.

Annual report; quarterly financial reports; financial statements in lieu of annual report. *Corp. Code § 1501*.

Annual filing by domestic corporation with Secretary of State. *Corp. Code § 1502*.

Annual filing by publicly traded corporation. *Corp. Code § 1502.1*.

Agent for service of process for domestic corporations. *Corp. Code §§ 1502-1505*.

Liability for false records and reports. *Corp. Code § 1507*.

Enforcement of record keeping requirements by Attorney General. *Corp. Code § 1508*.

Shareholders' right to result of shareholder vote. *Corp. Code §§ 1509-1512*.

Right to result of shareholder vote. *Corp. Code § 1509*.

Applicability to resident shareholders of foreign corporations. *Corp. Code §§ 1509, 1510*.

Shareholder defined. *Corp. Code § 1512*.

Inspection rights. *Corp. Code §§ 1506, 1600-1605*.

Inspections rights of local assessors. *Corp. Code § 1506*.

Inspection rights of shareholders. *Corp. Code §§ 1600, 1601*.

Inspection rights of directors. *Corp. Code § 1602*.

Remedies for refusal of lawful demand for inspection. *Corp. Code §§ 1603, 1604*.

Requirement that records be in written form. *Corp. Code § 1605*.

Agent for service of process for foreign corporations. *Corp. Code §§ 2114, 2117*.

Applicability of record keeping and reports requirements to foreign corporations. *Corp. Code § 2115(b)*.

Annual statement filed by foreign corporation with Secretary of State. *Corp. Code § 2117*.

Annual statement filed by publicly traded foreign corporation. *Corp. Code § 2117.1*.

Penalties for failure to keep required records and reports. *Corp. Code § 2200*.

Penalties for failure to file annual statement with Secretary of State. *Corp. Code §§ 2204-2206*.

Penalties for domestic corporations for failure to file. *Corp. Code § 2204*.

Suspension. *Corp. Code § 2205*.

Penalties for foreign corporations for failure to file. *Corp. Code § 2206*.

Criminal penalties. *Corp. Code §§ 2254-2257*.

Foreign incorporation no defense in prosecution of violations of *Corp. Code §§ 2254-2257*. *Corp. Code § 2260*.

Suspension of corporate powers. *Rev. & Tax. Code §§ 23301-23305*.

Suspension for nonpayment. *Rev. & Tax. Code § 23301*.

Suspension for failure to file. *Rev. & Tax. Code § 23301.5*.

Notice requirements. *Rev. & Tax. Code § 23302*.

Procedure for relief from suspension. *Rev. & Tax. Code § 23302*.

Certificate of revivor. *Rev. & Tax. Code § 23305a*.

Monetary penalty for failure to file annual statement with Secretary of State. *Rev. & Tax. Code § 25936*.

Punishment for misdemeanors. *Penal Code § 19*.

[2] Regulations

Semiannual report required of issuers of securities. *10 Cal. Code Reg. § 260.146*.

Financial statement requirements for issuers of securities. *10 Cal. Code Reg. § 260.613*.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-7 California Legal Forms--Transaction Guide § 7.02

§ 7.02 Federal Sources

[1] Statutes

Securities Act of 1933. *15 U.S.C. §§ 77a-77aa*.

Registration of securities. *15 U.S.C. § 77f*.

Securities Exchange Act of 1934. *15 U.S.C. §§ 78a-78kk*.

Registration requirements for securities. *15 U.S.C. § 78l*.

[2] Regulations

Required annual report. *17 C.F.R. §§ 240.13a-1*, 240.15d- 1.

Required current report. *17 C.F.R. §§ 240.13a-11, 240.15d-11*.

Required quarterly report. *17 C.F.R. §§ 240.13a-13, 240.15d-13*.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-7 California Legal Forms--Transaction Guide §§ 7.03-7.04

[Reserved]

§§ 7.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-7 California Legal Forms--Transaction Guide § 7.05

§ 7.05 Text References

[1] Matthew Bender Sources

Ballantine & Sterling, California Corporation Laws, Ch. 13, *Records, Reports and Inspection Rights* (Matthew Bender).

Cavitch, Business Organizations (Matthew Bender).

Ch. 62A, *Periodic Reporting Requirements*.

Ch. 83, *Corporate Financial Accounting*.

Pt. 15 (Chs. 93-99), *Securities Regulations*.

Ch. 116, *Shareholders' Right of Inspection*.

Ch. 125, *Board Meetings*.

Ch. 126, *Board Committees*.

[2] Additional Text References

Witkin, Summary of California Law, vol. 9, *Corporations*, §§ 65-239 (10th ed. 2005).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-7 California Legal Forms--Transaction Guide §§ 7.06-7.09

[Reserved]

§§ 7.06[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
A. Corporate Records

4-7 California Legal Forms--Transaction Guide § 7.10

§ 7.10 Corporations Subject to Record Keeping and Reporting Requirements

[1] Domestic Corporations

The General Corporation Law requires that every corporation keep adequate and correct books and records of account; minutes of the proceedings of its shareholders, board of directors, and committees of the board; records of share transactions; a record of shareholders [*Corp. Code § 1500*]; and bylaws [*Corp. Code § 213*]. The corporation must also keep a record the names and addresses of all shareholders and the number and class of shares held by each, at its principal executive office or at the office of its transfer agent or registrar. These minutes and other books and records must be kept in written form or another form capable of being converted into clearly legible tangible form [*Corp. Code § 1500*; *see § 7.11[3]*]. The use of English is obligatory for any required report, record, notice, or statement [*Corp. Code § 8*].

[2] Foreign Corporations

Certain foreign corporations are subject to the record keeping and reporting requirements of the General Corporations Code. A foreign corporation meeting the minimum contacts requirement [*see Corp. Code § 2115(a)*] will be subject unless it is a foreign corporation [*Corp. Code § 2115(b), (c)*]:

- With outstanding securities listed on the New York or American Stock Exchanges; or

- With outstanding shares designated as qualified for trading on the NASDAQ National Market (or successor) to the NASDAQ Stock Market operated by the NASDAQ Stock Market, Inc.; or

- That is wholly owned (except for directors' qualifying shares), directly or indirectly by a corporation or corporations not subject to *Corp. Code § 2115*.

Detailed discussion of the tests to determine whether a foreign corporation has the requisite minimum contacts with California to subject it to certain provisions of the General Corporation Law, including those relating to record keeping and reporting [*see Corp. Code § 2115(b)*], is beyond the scope of this chapter. For discussion of these requirements, see

Ch. 12B, *Foreign Corporations* .

As used in this chapter, "foreign corporation" refers to the foreign corporations subject to the California record keeping and reporting requirements, unless otherwise defined.

[3] Close Corporations

If a corporation is a statutory close corporation [*see Corp. Code § 158* ("close corporation" defined)], the shareholders may execute a shareholders' agreement dispensing with the statutory requirements regarding board and shareholder meetings [*Corp. Code § 300(e)*]. Under these circumstances, the record keeping requirements of the General Corporation Law relating to these meetings would not apply [*see Corp. Code § 300(e)*].

The purpose of a close corporation is to allow the shareholders to manage the corporation's business informally, in a partnership-manner, without incurring personal liability for corporate debts and other obligations [*see Corp. Code § 300(b)-(e)*]. Thus, if the shareholders manage the corporation according to the provisions of their agreement, the mere failure to observe the statutory rules that usually govern shareholder and board meeting requirements, voting rights and other control relationships, and the relative economic rights of shareholders will not be a factor tending to establish that shareholders have personal liability [*Corp. Code § 300(e)*]. However, the relevant provisions of the General Corporation Law relating to close corporations [*see Corp. Code §§ 158, 300(e)*] have not been the subject of much litigation, and case law does not establish the extent of the statutory protection. Therefore, it is advisable to observe corporate formalities and record keeping requirements or, at the very least, to carefully compare the possible adverse consequences of ignoring them to the advantages of informality of management.

Close corporations are discussed in greater detail in Ch. 2, *Formation of Corporations*, Ch. 3, *Articles of Incorporation*, and Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
A. Corporate Records

4-7 California Legal Forms--Transaction Guide § 7.11

§ 7.11 Minutes

[1] Corporations Subject to Requirement

Every domestic corporation and every foreign corporation subject to California record keeping requirements must comply with the minute keeping requirements of the General Corporation Law [*Corp. Code §§ 1500, 2115(b)*].

[2] Contents

Minutes document the proper holding of a meeting and record actions taken at the meeting, such as directors elected, officers appointed, resolutions passed, reports received, and contracts approved. Generally, minutes also indicate the time and place of a meeting, the type of meeting (special or regular) [*see Corp. Code §§ 307(a)(2)* (directors' special meetings), 600(d) (shareholders' special meetings)] and how it is authorized and noticed (if special) [*see Corp. Code §§ 307* (directors' meetings), 600(d) (shareholders' meetings)], and the issues considered. Minutes of meetings of directors and board committees customarily include the names of those present and those absent and indicate participation by conference call or other communication devices. Minutes of shareholder meetings customarily indicate the number of shares represented in person or by proxy. For detailed discussion of the purpose and contents of corporate minutes, as well as sample forms, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* , and Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

Written consents to actions taken, approvals of minutes or waivers of notice, signed by absent directors or shareholders to validate proceedings at meetings from which they were absent, must be made part of the minutes or filed with the corporate records [*Corp. Code §§ 307(a)(3)* (directors' meetings), 600(d) (shareholders' meetings)]. For shareholder meetings, an affidavit, or declaration under penalty of perjury [*Code Civ. Proc. § 2015.5*], of the mailing of the meeting's notice should be executed and, with a copy of the notice, attached as an exhibit to the minutes or otherwise made part of the corporate records [*Corp. Code § 601(b)*].

[3] How Kept

A corporation must keep minutes of the proceedings of its shareholders, board of directors, and board committees. The

minutes must be kept in written form or in another form capable of being converted into clearly legible tangible form [*Corp. Code § 1500*]. Commonly, a corporate officer, often the corporate secretary, takes and maintains the minutes. However, the taking and maintenance of minutes by a corporate officer is not a statutory requirement. For convenience, the minutes are usually kept in "minute books," which include incorporation documents, bylaws, and minutes of meetings of the board, committees of the board, and shareholders.

When minutes are kept in a form capable of being converted into clearly legible paper form, that clearly legible paper form is admissible in evidence, and acceptable for all other purposes, to the same extent as an original paper record of the same information would be, provided the paper form accurately portrays the record [*Corp. Code § 1500*].

[4] Effect of Noncompliance

Although a record of corporate actions is required by the General Corporation Law [*Corp. Code § 1500*], failure to take or maintain minutes will not invalidate the actions of the board of directors or shareholders [*Bank of Napa v. Ferguson Burns Estate (1920) 48 Cal. App. 319, 326, 192 P. 66]* . However, the original or a copy (in writing or any other form capable of being converted into clearly legible tangible form) certified by the corporate secretary, assistant corporate secretary, or a person purporting to be either, of the minutes of any meeting of directors, shareholders, or board committees is prima facie evidence of the holding of the meeting and of the approval of actions taken at the meeting [*Corp. Code § 314*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
A. Corporate Records

4-7 California Legal Forms--Transaction Guide § 7.12

§ 7.12 Books of Account, Bylaws, Record of Shareholders

Every domestic corporation and every foreign corporation described in *Corp. Code § 2115(a)* must maintain adequate and correct books and records of account in writing or in a form capable of being converted into a clearly legible tangible form [*Corp. Code §§ 1500, 2115(b)*].

Every corporation [*see Corp. Code §§ 162* ("corporation" defined), 167 ("domestic corporation" defined)] must also keep the original or a copy of its bylaws, as amended to date, at its principal executive office [*Corp. Code § 213*]. If a corporation has no office in California, it must, on written request, provide any shareholder with a copy of the bylaws, as amended to date [*Corp. Code § 213*]. For detailed discussion of the purpose and content of bylaws, see Ch. 4, *Bylaws* .

Further, every domestic corporation and every foreign corporation described in *Corp. Code § 2115(a)* must keep a record of its shareholders, including each shareholder's name, address, and the number and class of shares held [*Corp. Code §§ 1500, 2115(b)*]. This record must be in writing or in a form capable of being converted into a clearly legible tangible form [*Corp. Code § 1500*]. It must be kept at the corporation's principal executive office or at the office of its transfer agent or registrar [*Corp. Code § 1500*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
A. Corporate Records

4-7 California Legal Forms--Transaction Guide § 7.13

§ 7.13 Civil Penalties and Liabilities

[1] For Failure to Keep or Maintain Books and Records

[a] Domestic Corporations

The General Corporation Law imposes a penalty on a corporation that neglects, fails, or refuses to keep or maintain records of shareholders and books of account, as required [*Corp. Code § 2200*; *see Corp. Code § 1500* (statutory requirements)]. However, a failure to make entries in the minutes is not subject to the penalty provisions [*see Corp. Code § 2200*]. The penalty for failure to comply is $25 a day for each day of noncompliance, beginning 30 days after a receipt of a written request to comply, up to a maximum of $1,500 [*Corp. Code § 2200*]. However, the maximum daily penalty for failure to comply with any number of separate requests made on the same day or related to the same act is $250 [*Corp. Code § 2200*]. The court in which an action for the penalty is brought may also reduce or suspend the penalty when it appears that the neglect, failure, or refusal was inadvertent or excusable [*Corp. Code § 2202*]. These penalties are in addition to all other available remedies [*Corp. Code § 2202*].

[b] Foreign Corporations

Foreign corporations do not appear to be subject to the monetary penalties of *Corp. Code § 2200*. That section refers to "corporations," a term that does not apply to foreign corporations unless expressly stated [*see Corp. Code § 162*] and *Corp. Code § 2115(b)* does not expressly provide that *Corp. Code § 2200* applies to foreign corporations [*see Corp. Code § 2115(b)*]. However, *Corp. Code § 2200* has been amended to impose a penalty on the failure to satisfy a statutory notice requirement that is solely applicable to foreign corporations [*Corp. Code § 2200*]. Further, on complaint that the corporation is not complying with the record keeping and reporting requirements of the General Corporation Law, foreign corporations are subject to enforcement actions by the California Attorney General [*Corp. Code § 1508*; *see* [4], *below*].

For further discussion, see Ch. 12B, *Foreign Corporations and Associations* .

[2] For Failure to Enter Share Transfer or Issue Share Certificate

Any corporate officer obliged to enter a transfer of shares on the corporation's books and issue a share certificate, or obliged to enter and issue an initial transaction statement or written statements relating to uncertificated securities, who unreasonably neglects, fails, or refuses to do so after written request, by any person entitled to make a request, is subject to a penalty of $100, plus $10 for each day of default, beginning five days after receiving the request, up to a maximum of $500 [*Corp. Code § 2201*; *see Corp. Code §§ 171.1* ("initial transaction statement," "written statements" explained), 191.1 ("uncertificated security" defined)]. The penalty must be paid to each injured person and may be enforced by judicial action [*Corp. Code § 2201*]. However, the court in which an action for the penalty is brought may reduce or suspend the penalty when it appears that neglect, failure, or refusal was inadvertent or excusable [*Corp. Code § 2202*]. The penalty is in addition to any remedies otherwise available [*Corp. Code § 2202*].

Any director or other officer who unreasonably causes the neglect, failure, or refusal to enter a transfer of shares on the corporate books or to issue a certificate for shares to a person entitled to receive it, or to enter or issue an initial transaction statement or written statements relating to uncertificated securities, is subject to the same penalty [*Corp. Code § 2201*]. The penalty may be reduced or suspended as described above [*Corp. Code § 2202*]. It may be enforced by judicial action and is in addition to all other remedies, including an injunction, action for damages, or writ of mandate [*Corp. Code § 2202*].

[3] For False Statements or Entries on Corporate Books

[a] Domestic Corporations

Joint and several liability is imposed for all damages sustained by a corporation or other party who relied on the prohibited action, on an officer, director, employee, or agent of a corporation who does any of the following [*Corp. Code § 1507*]:

- Makes, issues, delivers, or publishes any prospectus, report, circular, certificate, financial statement, balance sheet, public notice, or document regarding the corporation or its shares, assets, liabilities, capital, dividends, business, earnings, or accounts that is false, knowing it to be false, or participates in any of the above-mentioned actions.

- Makes or causes to be made in the corporate books, minutes, records, or accounts any material entry that is false, knowing it to be false.

- Removes or alters any entry in any of the corporate books or records, with intent to deceive.

[b] Foreign Corporations

The directors of a foreign corporation transacting intrastate business [*see Corp. Code § 191* ("transacting intrastate business" defined)] in California are liable to the corporation, its shareholders, creditors, receiver, liquidator, or trustee in bankruptcy for making false reports, certificates, or public notices [*Corp. Code § 2116*].

[4] Enforcement by Attorney General

On complaint that a domestic or foreign corporation is not complying with the statutory provisions relating to recordkeeping and reporting requirements [*Corp. Code §§ 1500-1512*], the California Attorney General may send a notice of the complaint to the corporation's principal executive office. If the response is unsatisfactory, the Attorney General may institute an action for relief to protect the rights of shareholders or to remedy the consequences of failure to comply with the statutory requirements [*Corp. Code § 1508*]. Remedies include injunction, dissolution, appointment of receiver, or any other relief, as appropriate [*Corp. Code § 1508*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock Certificates



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
A. Corporate Records

4-7 California Legal Forms--Transaction Guide § 7.14

§ 7.14 Criminal Penalties and Liabilities

[1] Foreign Incorporation No Defense

In a prosecution for any of the violations set forth in [2]-[5], *below*, the fact that a corporation was a foreign corporation is not a defense, if it was carrying on business or keeping an office for business in California [*Corp. Code § 2260*].

[2] For Falsification of Reports

A director, officer, or agent of a corporation, domestic or foreign, is guilty of a felony who [*Corp. Code § 2254*]:

- Knowingly concurs in making, publishing, or posting either generally or privately to the shareholders or other persons (a) any written report, exhibit, statement of its affairs, or pecuniary condition or notice containing any material statement which is false; (b) any untrue or willfully or fraudulently exaggerated report, prospectus, account, statement of operations, values, business profits, expenditures, or prospects; or (c) any other paper or document intended to produce or give, or having a tendency to produce or give, the shares of stock in the corporation a greater value or a less apparent or market value than they really possess; or

- Refuses to make any book entry or post any notice as required by law in the manner required by law.

A failure to make entries in the minutes is not subject to these penalty provisions [*see Corp. Code § 2254*].

[3] For Falsification of Books or Securities

A director, officer, or agent of a corporation, domestic or foreign, is guilty of a public offense who [*Corp. Code § 2255(a), (b)*]:

- Knowingly acquires possession of corporate property, otherwise than in payment of a just demand, and, with intent to defraud, omits to make or cause to be made, a full and true entry of it into the

corporation's books or accounts; or

- With intent to defraud, destroys, mutilates, or falsifies any of the corporation's books or securities, or makes or concurs in omitting to make any material record in book of account or record kept by the corporation.

In both cases, the public offense is punishable by imprisonment in a state prison, or by imprisonment in a county jail for not more than one year, or by a fine not exceeding $1,000, or by both a fine and imprisonment [*Corp. Code § 2255(c)*].

[4] For Exhibition of False Documents to Public Officer or Board

Every officer, agent, or clerk of a corporation, domestic or foreign, or any person proposing to organize a corporation or to increase its capital stock, who, with intent to deceive, knowingly exhibits any false, forged, or altered book, security, or other instrument to any public officer or board authorized by law to examine the corporation's organization or to investigate its affairs or to allow an increase of its capital, may be punished by imprisonment in a state prison or by imprisonment in a county jail for not more than one year [*Corp. Code § 2256*].

[5] For False Subscription or Insertion of Name

A person is guilty of a misdemeanor who, without authorization, subscribes the name of another or inserts the name of another in any prospectus, circular, or other advertisement or announcement of any corporation, domestic or foreign, including one intended to be formed, with intent to permit the document to be published and to lead persons to believe that the person whose name is subscribed is an officer, agent, shareholder, or promoter of the corporation, when in fact no such relationship exists to the knowledge of such person [*Corp. Code § 2257*; *see Penal Code § 19* (punishment of misdemeanors)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Criminal Law & ProcedureCriminal OffensesFraudSecurities FraudPenaltiesBusiness & Corporate LawAgency RelationshipsDuties & LiabilitiesKnowledge & NoticeGeneral OverviewCriminal Law & ProcedureCriminal OffensesFraudSecurities FraudElementsBusiness & Corporate LawForeign BusinessesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
A. Corporate Records

4-7 California Legal Forms--Transaction Guide §§ 7.15-7.19

[Reserved]

§§ 7.15[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
B. Inspection Rights

4-7 California Legal Forms--Transaction Guide § 7.20

§ 7.20 Inspection Rights of Shareholders

[1] Accounting Books and Records; Minutes

[a] Corporations Subject to Requirement

A shareholder's statutory right to inspect the corporation's accounting books, records, and minutes of the proceedings of shareholders, board of directors, and board committees extends to every domestic corporation, to any foreign corporation described in *Corporations Code Section 2115(a)*, and to any other foreign corporation that keeps such records in California or has its principal executive office in California [*Corp. Code § 1601(a)*]. The right of inspection also extends to subsidiaries of the above-described corporations [*Corp. Code § 1601(a)*; *see Corp. Code § 189* ("subsidiary" defined)].

[b] Right to Inspect

Any shareholder or holder of a voting trust certificate, on written demand and "for a purpose reasonably related to such holder's interests as a shareholder or as the holder of such voting certificate" [*see* [c], *below*, for discussion of this limitation], may inspect, copy, or make extracts from the corporation's accounting books and records and minutes of the proceedings of shareholders, board of directors, and board committees [*Corp. Code § 1601(a)*].

Inspection, copying, and extracting may be made in person or by agent or attorney [*Corp. Code § 1601(b)*], at any time during usual business hours [*Corp. Code § 1601(a)*]. These inspection rights may not be limited by the articles of incorporation or bylaws [*Corp. Code § 1600(b)*]. The corporation may not thwart the exercise of these rights by failing to respond to proper requests, by sending communications that make further requests futile, or by actions impeding the inspection process [*Jara v. Suprema Meats, Inc. (2004) 121 Cal. App. 4th 1238, 1264, 18 Cal. Rptr. 3d 187]* .

On demand for inspection, any records not maintained in written form must be made available in writing, at the corporation's expense [*Corp. Code § 1605*].

[c] Limitations on Right to Inspect

The right to inspect, copy, or make extracts of accounting books and records and minutes of the proceedings of shareholders, board of directors, and board committees is limited to a purpose reasonably related to the holder's interests as a shareholder or as a holder of a voting trust [*Corp. Code § 1601(a)*]. Courts have held that this limitation includes ascertaining the financial condition of the corporation, the propriety of dividends, or the value of stock [*Capron v. Pacific S.W. Discount Corp. (1935) 6 Cal. App. 2d 436, 439, 44 P.2d 629]* . Any one of the following reasons for an inspection have also been held to be sufficient [*see Private Investors v. Homestake Min. Co. (1936) 11 Cal. App. 2d 488, 496, 54 P.2d 535]* :

- To examine the disparity in value between the market value of the corporation's outstanding stock and the value given in the annual report;

- To determine if the outstanding stock was held by a few shareholders who dictated the corporation's accounting policies;

- To determine if the relation of the directors conflicted with interests of minority shareholders;

- To ascertain the present value of the stock owned by the plaintiff.

Moreover, the corporation is required only to allow inspection at corporate offices. It is not required to mail or otherwise provide copies, and is not required to respond to demands for disclosure falling outside scope of what is required by statute [*Jara v. Suprema Meats, Inc. (2004) 121 Cal. App. 4th 1238, 1263-1265, 18 Cal. Rptr. 3d 187]* .

[2] Bylaws

The original or a copy of the corporate bylaws maintained at the corporation's principal executive office must be available to shareholders to inspect at all reasonable times during office hours [*Corp. Code § 213*]. If the corporation's principal executive office is outside California and it has no principal business office in this state, the corporation must provide any shareholder, on written request, a copy of the bylaws as amended to date [*Corp. Code § 213*]. For further discussion of the purpose and content of bylaws, see Ch. 4, *Bylaws* .

[3] Record of Shareholders

[a] Right to Inspect--In General

Each domestic or foreign corporation must keep at its principal executive office, or at the office of its transfer agent or registrar, a record of shareholders, listing the names and addresses of all shareholders and the number and class of shares held by each shareholder [*Corp. Code §§ 1500, 2115(b)*]. Any shareholder or holder of a voting trust certificate, on written request, in person or by agency or attorney, during usual business hours, may inspect and copy the record of shareholders. However, inspection or copying must be for a purpose reasonably related to the holder's interest as a shareholder or holder of a voting trust certificate [*Corp. Code § 1600(c)*; *see* [1][c], *above*].

These inspection rights extend to the shareholders of record of any domestic corporation and any foreign corporation that has its principal executive office in California or that customarily holds meetings of its board of directors in California [*Corp. Code § 1600(d)*].

[b] Absolute Right to Inspect

A shareholder or group of shareholders holding at least 5 percent of the outstanding voting shares, or who hold at least 1 percent of the voting shares subject to certain federal regulations and have filed a Schedule 14A with the Securities and Exchange Commission (or, if the corporation is a bank with deposits insured under the Federal Deposit Insurance Act, a

Form F-6 with the appropriate federal bank regulatory agency), has an absolute right to inspect and copy the record of shareholders during usual business hours on five days' prior written demand [*see Corp. Code § 1600(a)*]. Similarly, this shareholder or group of shareholders has an absolute right, on written request and tender of the usual charges, to obtain from the corporation's transfer agent a list of the names, addresses, and holdings of the shareholders entitled to vote for directors [*Corp. Code § 1600(a)*].

Any inspection or copying of the record of shareholder may be made in person or by agent or attorney. These absolute rights may not be limited by the articles of incorporation or bylaws and extend to holders of the requisite shares of a foreign corporation that has its principal executive office in California or that customarily holds meetings of its board of directors in California [*Corp. Code § 1600(d)*].

[4] Other Corporate Records

The General Corporation Law expressly gives shareholders the right to inspect corporate accounting books and records [*Corp. Code § 1601(a)*], minutes of shareholder, board, and board committee proceedings [*Corp. Code § 1601(a)*], the record of shareholders [*Corp. Code § 1600(c)*], and corporate bylaws [*Corp. Code § 213*]. It does not expressly provide statutory rights of inspection of other kinds of corporate records or documents [*cf. Corp. Code § 1602* (directors' absolute right "to inspect and copy all books, records, and documents of every kind")]. Furthermore, shareholder status does not in and of itself entitle an individual to unfettered access to corporate confidences and secrets, such as documents protected by the attorney-client privilege [*see, e.g., NFL Properties Inc. v. Superior Court (1998) 65 Cal. App. 4th 100, 107-108, 75 Cal. Rptr. 2d 893* (Raiders football club, as plaintiff in shareholder's suit against National Football League, did not have right to inspect NFL merchandising corporation's documents protected by attorney-client privilege)]. However, a shareholder has a common law right to inspect other corporate records, provided that the shareholder's purpose is a proper and reasonable one, relating to interests as a shareholder [*Most v. Nat'l Bank of San Diego (1966) 246 Cal. App. 2d 425, 428, 431, 54 Cal. Rptr. 669* ; *see Mooney v. Bartenders Union Local No. 284 (1957) 48 Cal. 2d 841, 843, 313 P. 857*].

[5] Corporate Property

The General Corporation Law does not give shareholders the express right to inspect the corporation's physical properties [*cf. Corp. Code § 1602* (directors' absolute right to do so)]. However, at common law, the right of inspection extends to corporate property as well as to the corporation's books. The reasoning is that it makes little sense to allow a stockholder the right to examine the corporation's books to ascertain its condition, but then deny the stockholder an inspection of the property to verify the statements contained in the books [*Hobbs v. Tom Reed Gold Min. Co. (1913) 164 Cal. 497, 502, 129 P. 781]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
B. Inspection Rights

4-7 California Legal Forms--Transaction Guide § 7.21

§ 7.21 Inspection Rights of Directors

Every director has an absolute right at any reasonable time, in person or by agent or attorney, to inspect, copy, or make extracts of all books, records, and documents of every kind and to inspect the physical properties of the corporation and its domestic and foreign subsidiaries [*Corp. Code § 1602*; *see Corp. Code § 189* ("subsidiary" defined)]. This provision extends to the directors of any foreign corporation having its principal executive office in California or customarily holding meetings of its board of directors in California [*Corp. Code § 1602*; *see Havlicek v. Coast-to-Coast Analytical Services, Inc. (1995) 39 Cal. App. 4th 1844, 1854-1856 , 46 Cal. Rptr. 2d 696* (*Corp. Code § 1602* does not violate Commerce Clause or Full Faith and Credit Clause); *but see NFL Properties Inc. v. Superior Court (1998) 65 Cal. App. 4th 100, 109-110, 75 Cal. Rptr. 2d 893* (if director sues in capacity as shareholder rather than director, attorney-client and work product privileges are properly upheld by corporation)].

Although a court may impose just and proper conditions on this "absolute right" of inspection in an egregious case [*see Havlicek v. Coast-To-Coast Analytical Services, Inc. (1995) 39 Cal. App. 4th 1844, 1854-1856, 46 Cal Rptr. 2d 606] ,* this principle should only be applied in extreme circumstances in which a preponderance of the evidence establishes a director's clear intent to use documents to commit a tort against the corporation [*Saline v. Superior Court (2002) 100 Cal. App. 4th 909, 915-916, 122 Cal. Rptr. 2d 813* (holding that trial court failed to make findings necessary to justify limitation on director's right to corporate documents, and that there was no legal basis for prior restraint on his right to discuss corporate documents with persons other than board members)].

A corporate director does not have the right to access documents that are covered by the attorney-client privilege and were generated in defense of a suit for damages that the director filed against the corporation [*Tritek Telecom, Inc. v. Superior Court (2009) 169 Cal. App. 4th 1385, 1391-1392, 87 Cal. Rptr. 3d 455] .*

On demand for inspection, any records not maintained in written form must be made available in writing, at the corporation's expense [*Corp. Code § 1605*].

No written demand is required of a director before inspecting corporate records. However, it may save the time of the director and the corporate employees responsible for record keeping if the director notifies the corporation in advance,

in writing, of his or her intent to inspect the records [*see § 7.206* (director's notice of inspection of corporate records or property)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsDirectors



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
B. Inspection Rights

4-7 California Legal Forms--Transaction Guide § 7.22

§ 7.22 Inspection Rights of Local Assessors

On request of a local assessor, a domestic or foreign corporation must make available at its principal office in California, or at a place mutually acceptable to the assessor and the corporation, a true copy of business records relevant to the amount, cost, and value of all property that the corporation owns, claims, possesses, or controls within the county [*Corp. Code § 1506*]. The requirement applies to any domestic or foreign corporation owning, claiming, possessing, or controlling property in California that is subject to local assessment [*Corp. Code § 1506*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesPersonal Property TaxGeneral OverviewTax LawState & Local TaxesReal Property TaxGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsGeneral OverviewTax LawState & Local TaxesReal Property TaxAssessment & ValuationAssessment Methods & TimingBusiness & Corporate LawForeign BusinessesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
B. Inspection Rights

4-7 California Legal Forms--Transaction Guide § 7.23

§ 7.23 Enforcement of Inspection Rights

[1] Refusal of Demand for Inspection

[a] Court Action

Inspection rights may be enforced by action in the superior court of the proper county [*Corp. Code § 1603(a)*; *see Corp. Code §§ 1600-1602* (rights of inspection)]. The proper county is the county in which the corporation has its principal executive office or, if its principal executive office is not located in California or it has no such office, in Sacramento county [*Corp. Code § 177*].

The court may enforce the right of inspection with "just and proper conditions" or may, for good cause shown, appoint inspectors or accountants to audit the books and records kept in California and investigate the property, funds, and affairs of any domestic corporation or any foreign corporation keeping its accounting records in California or any subsidiaries, domestic or foreign, keeping records in California [*Corp. Code § 1603(a)*].

All corporate officers and agents must provide the appointed inspectors or accountants with all books and documents in their custody or power, under penalty of punishment for contempt of court [*Corp. Code § 1603(b)*].

In an action to enforce shareholder inspection rights, the court may award the shareholder or holder of a voting trust certificate expenses incurred in connection with the action, including attorneys' fees. To award expenses, the court must find that the corporation's failure to comply with a proper demand for inspection was not justified [*Corp. Code § 1604*; *see Corp. Code §§ 1600, 1601*].

[b] Action by Attorney General

On complaint that a domestic or foreign corporation is not complying with the statutory provisions relating to rights of inspection [*Corp. Code §§ 1600-1605*; *see Corp. Code § 2115(b)*], the California Attorney General may send a notice of the complaint to the corporation's principal executive office. If the response is unsatisfactory, the Attorney General may institute an action for relief to protect the rights of shareholders or to remedy the consequences of failure to comply with

the statutory requirements [*Corp. Code § 1508*]. Remedies include injunction, dissolution, appointment of receiver, or any other relief, as appropriate [*Corp. Code § 1508*].

[2] Delay in Delivering Shareholder Record or List

If a corporation or its transfer agent fails, within the specified time limits, to respond to the request of a shareholder with an absolute right to inspect the shareholder record [*see § 7.20[3][b]*], the inspection rights may be enforced by action in the superior court of the proper county [*Corp. Code § 1603(a)*; *see* [1][a], *above*], or by action by the Attorney General [*Corp. Code § 1508*; *see* [1][b], *above*]. After a hearing, shareholders may also obtain a court order postponing a noticed shareholder meeting for a period equal to the delay [*Corp. Code §§ 1600(b), 2115(b)*]. This remedy is in addition to any legal or equitable remedy otherwise available [*Corp. Code §§ 1600(b), 2115(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsRemedies



148 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
B. Inspection Rights

4-7 California Legal Forms--Transaction Guide § 7.24

§ 7.24 Rights to Results of Shareholder Vote

For a period of 60 days after the conclusion of an annual, regular, or special meeting of shareholders, a corporation must provide the results of any vote of shareholders taken at that meeting to any shareholder, on written request [*Corp. Code § 1509*; *see Corp. Code § 1512* ("shareholder" defined for purposes of this section)]. The results must include the number of shares that voted for or against a proposal and the number abstaining or withheld from voting. If the matter voted on was the election of directors, the corporation must report the number of shares (or votes, if voted cumulatively) cast for each nominee. If more than one class or series of shares voted, the report must state the appropriate numbers by class and series of shares [*Corp. Code § 1509*].

Any foreign corporation qualified to transact intrastate business in California [*Corp. Code § 1510(a)*] or any foreign corporation not qualified to transact business in California, but having one or more subsidiaries, domestic or foreign, qualified to transact business in this state [*Corp. Code § 1511*] must provide the information specified above, at the request of a shareholder resident in this state [*see Corp. Code §§ 1510(b)* ("shareholder resident in this state" defined), 1512 ("shareholder" defined for purposes of *Corp. Code §§ 1509-1511*)].

For further discussion and examples of a request and written report of a shareholder vote, see Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
B. Inspection Rights

4-7 California Legal Forms--Transaction Guide §§ 7.25-7.29

[Reserved]

§§ 7.25[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
C. Reports to Shareholders

4-7 California Legal Forms--Transaction Guide § 7.30

§ 7.30 Corporations Required to Report to Shareholders

The preparation and distribution of the reports to shareholders *set forth in §§ 7.31-7.33* are required of all domestic corporations and every foreign corporation having its principal executive office in California or customarily holding meetings of its board of directors in California [*Corp. Code § 1501(g)*]. These reporting requirements also apply to foreign corporations described in *Corp. Code § 2115(a)*, unless [*Corp. Code § 2115(c)*; *see* Ch. 12B, *Foreign Corporations*]:

- The foreign corporation has outstanding securities listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market, or

- All of its voting shares (other than directors' qualifying shares) are owned directly or indirectly by a corporation or corporations not subject to *Corp. Code § 2115*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
C. Reports to Shareholders

4-7 California Legal Forms--Transaction Guide § 7.31

§ 7.31 Annual Report to Shareholders

[1] In General

Except for corporations with fewer than 100 shareholders whose bylaws expressly waive this requirement, each domestic or foreign corporation required to comply [*see § 7.30*] must send its shareholders an annual report [*Corp. Code § 1501(a)(1), (g)*; *but see Corp. Code § 1501(a)(4)* (option to post statement on Internet for some corporations subject to SEC filing requirements)]. This requirement cannot be waived in a close corporation's shareholders' agreement [*Corp. Code § 300(c)*].

The General Corporation Law specifies only that the annual report be sent to the corporation's "shareholders" [*Corp. Code § 1501(a)(1), (2)*]. Normally, the annual report is sent to shareholders of record for purposes of the annual shareholders' meeting in the fiscal year following that of the annual report [*see Corp. Code § 605* ("shares held of record" defined)]. It is also typically given on request to persons who become shareholders after the required distribution of the annual report within 120 days of the close of the fiscal year.

The annual report must contain (1) a balance sheet as of the end of the fiscal year, (2) an income statement as of the end of the fiscal year, and (3) a statement of cashflows for that fiscal year [*Corp. Code § 1501(a)(1)*; *see* [5], *below*]. A fourth statement, a statement of retained earnings, is also customarily prepared. The financial statements must be accompanied by a report of independent accountants [*see Corp. Code § 115* ("independent accountants" defined)], if any, or by the certificate of an authorized corporate officer that the financial statements were prepared without audit of the corporation's books and records [*Corp. Code § 1501(a)(1)*].

In an annual report, all financial statements, including balance sheets, income statements, statements of cashflows, assets, liabilities, retained earnings, and similar accounting items must be prepared in conformity with generally accepted accounting principles, subject to any specific accounting treatment required by a particular section of the General Corporation Law [*Corp. Code § 114*]. A corporation with fewer than 100 shareholders of record, determined as provided in *Corp. Code § 605*, is not subject to this requirement provided the corporation's financial statements (1) reasonably set forth the corporation's assets, liabilities, income, and expenses, and (2) disclose the accounting basis used

in their preparation [*Corp. Code § 1501(a)(3)*].

[2] Additional Requirement for Corporations With 100 or More Shareholders

If a domestic or foreign corporation [*see § 7.30*] has 100 or more shareholders of record (determined as provided in *Corp. Code § 605*), and is either exempt from the reporting requirements of Section 13 of the Securities Exchange Act of 1934 [*15 U.S.C. § 78l* (securities exchanges)] or from the registration requirements of Section 12(g)(2) of the Act [*15 U.S.C. § 78l(g)(2)* (registration by issuer; exemptions)], its annual report must include two items in addition to the required financial statements [*see Corp. Code § 1501(b)*; *see also Corp. Code § 1501(a)*, discussed in [1], *above*].

First, the report must briefly describe any transaction (excluding compensation of officers and directors) during the previous fiscal year involving an amount in excess of $40,000 (other than contracts let at competitive bid or services rendered at prices regulated by law) to which the corporation or its parent or subsidiary was a party and in which any director or officer of the corporation or of a subsidiary or any holder of more than 10 percent of the outstanding voting shares of the corporation had a direct or indirect material interest [*Corp. Code § 1501(b)(1)*; *see Corp. Code §§ 175* ("parent" defined), 189 ("subsidiary" defined)]. The description of this transaction should include the name of person and his or her relationship to the corporation, the nature of the person's interest in the transaction, and the amount of the interest, when practicable [*Corp. Code § 1501(b)(1)*]. If the transaction was with a partnership of which the person having a material interest is a partner, only the partnership's interest need be reported [*Corp. Code § 1501(b)(1)*]. Further, any transaction approved by the shareholders is exempt from this reporting requirement [*Corp. Code § 1501(b)(1)*; *see Corp. Code § 153* ("approved by the shareholders" defined)].

Second, the report must briefly describe the amount and circumstances of any indemnification or advances aggregating more than $10,000 paid during the fiscal year to any officer or director in accordance with *Corp. Code § 317* [*Corp. Code § 1501(b)(2)*]. However, a report is not required in the case of indemnification approved by the shareholders under *Corp. Code § 317(e)(2)* (indemnification deemed proper by legal counsel in written opinion) [*Corp. Code § 1501(b)(2)*; *see Corp. Code § 153* ("approved by the shareholders" defined)].

[3] Timing

The annual report must be sent to shareholders no later than 120 days after the close of the fiscal year [*Corp. Code § 1501(a)(1)*], except for corporations with fewer than 100 shareholders (determined as provided in *Corp. Code § 605*]) whose bylaws expressly waive this requirement [*Corp. Code § 1501(a)(1)*]. The 120 day period, however, may be extended for good cause by a court [*Corp. Code § 1501(e)*]. Unless waived, the report must be sent to shareholders at least 15 days before the annual shareholders' meeting if sent by first class mail, or at least 35 days before the meeting if sent third-class [*Corp. Code § 1501(a)(2)*].

[4] Delivery

Except as noted below with regard to some corporations subject to SEC registration requirements, the annual report must be sent by first or third-class mail delivered personally, or transmitted electronically by the corporation [*see Corp. Code § 20*], to every shareholder at the shareholder's address listed on the corporation's books or at the address provided by the shareholder for purpose of notice [*Corp. Code §§ 1501(a), 601(b)*]. If neither address appears in the corporate records, the report must be sent to the corporation's principal executive office [*Corp. Code § 601(b)*].

The annual report is considered to be sent at the time it is deposited in the mail, delivered personally, or electronically transmitted by the corporation [*Corp. Code § 601(b)*]. An affidavit of mailing or electronic transmission by the corporation executed by the corporate secretary, assistant corporate secretary, or corporate transfer agent is prima facie evidence of the sending of the report [*Corp. Code § 601(b)*].

If an annual report, addressed as provided above, is returned to the corporation by the United States Postal Service, marked as undeliverable, all future reports to that shareholder are considered to have been sent, without mailing, if they are available to the shareholder, on written demand, at the corporation's principal executive office for one year from the date the annual report was sent to all shareholders [*Corp. Code § 601(b)*].

A corporation that is registered under Section 12 of the Securities Exchange Act of 1934 [*see 15 U.S.C. § 78l*] may satisfy the delivery requirement by posting its annual report on an Internet website and providing its shareholders with written notice of the availability of the report [*see Corp. Code § 1501(a)(4)*; see also *17 C.F.R. § 240.14a-16*].

[5] Definitions of Common Accounting Terms

[a] As Used in General Corporation Law

As used in the General Corporation Law, "financial statements," and their components ("balance sheets," "income statements," "statements of cashflows," "assets," "liabilities," "earnings," "retained earnings"), refer to financial statements or items prepared and presented in conformity with generally accepted accounting principles [*Corp. Code § 114*]. If a corporation has subsidiaries [*see Corp. Code § 189* ("subsidiary" defined)], its "financial statements" are the consolidated statements of the corporation and of its subsidiaries as are required to be included in the consolidated statements under generally accepted accounting principles [*Corp. Code § 114*]. Generally accepted definitions of standard accounting terms are enumerated in [b]-[g], *below*.

Accountants long have recognized that "generally accepted accounting principles" (GAAP) are far from being a canonical set of rules that will ensure identical accounting treatment of identical transactions. Instead, GAAP will tolerate a range of reasonable treatments, leaving the choice among alternatives to management [*Thor Power Tool Co. v. Commissioner (1979) 439 U.S. 522, 544, 99 S. Ct. 773, 58 L. Ed. 2d 785]* . In the United States, GAAP are an amalgam of statements issued by the American Institute of Certified Public Accountants through the successive groups that it has established to promulgate accounting principles: the Committee on Accounting Procedure, the Accounting Principles Board, and the Financial Accounting Standards Board. GAAP include broad statements of accounting principles amounting to aspirational norms as well as more specific guidelines and illustrations. The lack of an official compilation allows for some debate over whether particular announcements are encompassed within GAAP [*Bily v. Arthur Young & Co. (1992) 3 Cal. 4th 370, 382, 11 Cal. Rptr. 2d 51, 834 P.2d 745* (observing that one standard text purporting to restate comprehensively GAAP includes 90 major sections and more than 500 pages)]. GAAP are found in "a hodgepodge of accounting sources, which [in the United States] find their respective places in the hierarchical structure established by the American Institute of Certified Public Accountants" [*Bolt v. Merrimack Pharms., Inc. (9th Cir. 2007) 503 F.3d 913, 2007 U.S. App. LEXIS 21717, at *10 n.6* (describing that hierarchy)].

When a court must determine whether a particular financial-accounting result is in accordance with generally accepted accounting principles, the court should not try to apply those principles but should defer to the professional judgment of the accountant who audited or prepared the financial statements "unless a GAAP authority *demands* a contrary accounting treatment" [*Bolt v. Merrimack Pharms., Inc. (9th Cir. 2007) 503 F.3d 913, 2007 U.S. App. LEXIS 21717, at *11-*12, *20-*21* (original emphasis; corporation's net worth, as disclosed on audited balance sheet, was determined in accordance with GAAP)].

[b] Financial Statements

Financial statements summarize the accounting transactions of a business. They present the financial position of a company at a given time (balance sheet) and the results of its operations for a given period (statement of income and retained earnings). Financial statements conventionally cover a one year period, but statements are often prepared at more frequent intervals.

[c] Balance Sheet

A balance sheet reports the financial status of a business enterprise on a specific date. It illustrates the fundamental accounting equation that assets equal liabilities plus owners' equity. Ordinarily, the balance sheet lists assets on the left side of the statement and liabilities and stockholders' equity on the right.

[d] Income Statement

The income statement, often referred to as the statement of income and retained earnings, shows a company's operating results over a defined accounting period, often one year, and measures the net change in assets and liabilities resulting from operations during the accounting period. Thus, the income statement links successive balance sheets and shows the reason for changes in the owners' equity resulting from operations during the accounting period.

[e] Statement of Cashflows

Generally accepted accounting practices require that when financial statements purporting to present both financial position (balance sheet) and results of operations (statement of income and retained earnings) are issued, a statement summarizing this information be presented for each period for which an income statement is presented. Consistent with this practice, the General Corporation Law requires that the annual report of every corporation include a statement of cashflows [*Corp. Code § 1501(a)(1)*]. This statement generally provides information on all financing and investing activities of a business, shows the funds generated from operations and other sources, shows the uses and application of funds, and discloses the amounts and causes of all other financial changes during the period.

[f] Statement of Retained Earnings

Retained earnings are income earned by a corporation since its inception that have not been distributed to stockholders as dividends. The statement of retained earnings reconciles the amount shown on the balance sheet at the beginning of the accounting period with the amount shown at the end of the period. In addition, it links the income statement to the balance sheet by including the amount of net income as one of the reconciling items in the statement.

[g] Consolidated Statement

A "consolidated statement" is a corporate report in the form of a balance sheet, income statement, or statement of retained earnings that combines the separate statements of a parent corporation and its subsidiaries [*see Corp. Code § 114*; *see also Corp. Code §§ 175* ("parent" defined), 189 ("subsidiary" defined)]. Such consolidated statements eliminate all intercompany accounts, and show the entire group of companies as a single enterprise.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawLiabilityDisclosuresGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
C. Reports to Shareholders

4-7 California Legal Forms--Transaction Guide § 7.32

§ 7.32 Financial Reports Requested by Shareholders

[1] Quarterly Reports

A shareholder or any group of shareholders that owns at least five percent of the outstanding shares of any class of stock is entitled to receive, on written request, a balance sheet and an income statement for the three-month, six-month, or nine-month period of the current fiscal year ended at least 30 days before the request [*Corp. Code §§ 1501(c), (d)*]. These quarterly reports must be mailed or delivered to the requesting shareholder within 30 days of the request [*Corp. Code § 1501(c)*]. The corporation is further required to keep a copy of its quarterly financial statements at its principal office for 12 months and to exhibit these reports (or mail copies of them) to any shareholder on demand [*Corp. Code § 1501(c)*].

If a report of independent accounts is available [*see Corp. Code § 115* ("independent accountants" defined)], the report must accompany the quarterly financial reports; otherwise the reports must be accompanied by the certificate of an authorized corporate officer that the financial statements were prepared without audit of the corporation's books and records [*Corp. Code § 1501(d)*].

[2] Financial Statements in Lieu of Annual Report

If no annual report for the fiscal year has been sent to shareholders, the corporation must provide the financial statements required in the annual report [*see Corp. Code § 1501(a)*; *see also § 7.31[1]*] to any shareholder, on written request made more than 120 days after the close of the fiscal year [*Corp. Code § 1501(c)*]. The financial information must be mailed or delivered to the requesting shareholder within 30 days of the request [*Corp. Code § 1501(c)*].

The corporation is further required to keep a copy of these financial statements at its principal office for 12 months and to exhibit these reports (or mail copies of them) to any shareholder on demand [*Corp. Code § 1501(c)*].

Like the quarterly financial reports [*see* [1], *above*], the financial statements of corporations with fewer than 100 shareholders of record need not conform with generally accepted accounting principles if they reasonably set forth the corporation's assets and liabilities and income and expenses and disclose the accounting principles used in their

preparation [*Corp. Code § 1501(3)*; *see Corp. Code § 605* (determining shareholders of record)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral Overview



153 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
C. Reports to Shareholders

4-7 California Legal Forms--Transaction Guide § 7.33

§ 7.33 Enforcement of Shareholders' Rights to Annual Report and Financial Statements

The shareholders' right to information and financial statements may be enforced by suit in the superior court of the proper county [*Corp. Code § 1501(e)*; *see Corp. Code § 177* ("proper county" defined)]. If the court finds the corporation's failure to comply with the requirements of the General Corporation law is without justification, the court may award reasonable expenses, including attorneys' fees, to the shareholder [*Corp. Code § 1501(f)*].

In addition, failure to prepare the information and financial statements required by the General Corporation Law [*see Corp. Code § 1501*] may subject the corporation to monetary penalties [*Corp. Code § 1501(e)*; *see Corp. Code § 2200* (penalties); *see also § 7.13[1]*].

Unlike the apparent nonapplicability of *Corp. Code § 2200* to foreign corporations that do not comply with the general record keeping requirements of *Corp. Code § 1500* [*see Corp. Code §§ 162, 2115(b)*; *see also § 7.13[1][b]*], *Corp. Code § 2200* applies to foreign corporations that (1) have their principal executive office in California or that customarily holds meetings of its board in California and (2) violate *Corp. Code § 1501*, regarding annual reports to shareholders [*see Corp. Code § 1501(e), (g)*; *see also Corp. Code § 2115(b)*]. This conclusion results from the application of *Corp. Code § 1500* to such foreign corporations [*Corp. Code § 1501(g)*], combined with the provision that "[i]n addition to the penalties provided for in Section 2200, the superior court of the proper county shall enforce the duty of making and mailing or delivering the information and financial statements required by this section and, for good cause shown, may extend the time therefor" [*Corp. Code § 1501(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsRemediesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
C. Reports to Shareholders

4-7 California Legal Forms--Transaction Guide §§ 7.34-7.39

[Reserved]

§§ 7.34[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
D. Statements Filed With Secretary of State

4-7 California Legal Forms--Transaction Guide § 7.40

§ 7.40 Statement of Information by Domestic Stock Corporation and Corporate Disclosure Statement

[1] In General

Every domestic corporation must file a Statement of Information by Domestic Stock Corporation with the Secretary of State [*Corp. Code § 1502(a)*]. The statement provides current information regarding the corporation's directors, officers, principal business addresses, type of business, and agent for service of process [*see Corp. Code § 1502(a), (b)*; *see also* [3], *below*]. The Secretary of State prescribes the form for this annual statement [*Corp. Code § 1502(a)*; *see §§ 7.207, 7.207A, 7.207B,* for official forms and further discussion of their use].

If the information in the statement last filed with the Secretary of State has not changed, the corporation may merely check the box indicating that no changes have occurred during the applicable filing period, instead of completing the entire statement [*Corp. Code § 1502(c)*].

Changes to the information contained in the last filed statement may be made at any time by filing a new complete statement. In addition, in order to change its agent for service of process, or the agent's address, the corporation *must* file a current complete statement. When an updated statement is filed, it supersedes any previously filed statement and the statement in the articles of incorporation as to the agent for service of process and the address of the agent [*Corp. Code § 1502(e)*].

It is important to bear in mind that this statement will be available and open to the public for inspection. The Secretary of State is required to provide access to all information contained in this statement by means of an online database [*Corp. Code § 1502(h)*]. In addition, the corporation must certify that the information it provides in this statement is true and correct. No claim may be made against the state for inaccurate information contained in this statement [*Corp. Code § 1502(j)*].

[2] Filing Procedure

The Statement of Information by Domestic Stock Corporation is due within 90 days of filing a corporation's original articles of incorporation and annually thereafter [*Corp. Code § 1502(a)*]. The statement must be filed during the

calendar month during which the original articles were filed or during the five months immediately preceding the filing month [*Corp. Code § 1502(d)*]. In addition to the regular applicable filing fee [*see Gov. Code § 12183(g)*; *see also §§ 7.207[2]*, *7.207A[2]*], the corporation must pay a $5 disclosure fee when filing this statement [*Corp. Code § 1502(i)*; *see Corp. Code § 1502.5*].

Approximately three months before the annual Statement of Information by Domestic Stock Corporation is due, the Secretary of State will mail a notice reminding a corporation of its obligation to comply with the annual filing requirement and of the due date for filing. The notice must be mailed to the corporation's most recent address according to the Secretary's records. Failure to receive the notice is no excuse for failing to file the Statement on time [*Corp. Code § 1502(d)*].

[3] Contents of Forms

The Statement of Information by Domestic Stock Corporation must set forth the following [*Corp. Code § 1502(a)*]:

- The street address of the corporation's principal executive office.
- The corporation's mailing address, if different from the street address of its principal executive office.
- If the corporation's principal executive office is not in California, the street address of its principal business office in California, if any.
- The names and complete business or residential addresses of its chief executive officer, secretary, and chief financial officer.
- The names and complete business or residential addresses of the incumbent directors.
- The number of vacancies on the board of directors, if any.
- A statement of the general type of business that constitutes the corporation's principal business activity.

The statement must also designate an agent for service of process [*see Corp. Code § 1502(b)*]. The agent designated must be either a natural person residing in California or a corporation that has complied with the statutory requirements [*Corp. Code § 1502(b)*; *see Corp. Code § 1505* (requirements)]. If a natural person is designated, the statement must include the person's complete business or residential street address. If a corporate agent is designated, no address is required [*Corp. Code § 1502(b)*]. For further discussion on designating an agent for service of process, see *§§ 7.50-7.53*.

It is important to bear in mind that this statement will be available and open to the public for inspection. The Secretary of State is required by statute to provide access to all information contained in this statement by means of an online database [*Corp. Code § 1502(h)*]. In addition, the corporation must certify that the information it provides in this statement is true and correct. No claim may be made against the state for inaccurate information contained in this statement [*Corp. Code § 1502(j)*].

In addition, every publicly traded corporation must file a separate corporate disclosure form containing the following information [*Corp. Code § 1502.1(a)*; *Corp. Code § 1502.1(b)(1)*]:

- The name of the independent auditor that prepared the most recent auditor's report on the

corporation's annual financial statements.

- A description of other services, if any, performed for the corporation during its two most recent fiscal years and the period between the end of its most recent fiscal year and the date of the statement by the independent auditor, by its parent corporation, or by a subsidiary or corporate affiliate of the independent auditor or its parent corporation.

- The name of the independent auditor employed by the corporation on the date of the statement, if different from the independent auditor referred to above.

- The compensation for the most recent fiscal year paid to each member of the board of directors and to each of the five most highly compensated executive officers of the corporation who are not members of the board, including the number of any shares issued, options for shares granted, and similar equity-based compensation granted to each of those persons (and if the chief executive officer is not among the five most highly compensated executive officers of the corporation, the compensation paid to the chief executive officer must be included anyway).

- A description of any loan, including the amount and terms of the loan, made to any member of the board by the corporation during the corporation's two most recent fiscal years at an interest rate lower than the interest rate available from unaffiliated commercial lenders generally to a similarly situated borrower.

- A statement indicating whether an order for relief has been entered in a bankruptcy case with respect to the corporation, its executive officers, or members of the board of directors during the 10 years preceding the date of the statement.

- A statement indicating whether any member of the board of directors or executive officer was convicted of fraud during the 10 years preceding the date of the statement, if the conviction has not been overturned or expunged.

- A description of any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the corporation or any of its subsidiaries is a party or of which any of their property is the subject, as specified by Item 103 of SEC Regulation S-K [*see* 12 C.F.R. § 229.103].

- A description of any material legal proceeding during which the corporation was found legally liable by entry of a final judgment or final order that was not overturned on appeal during the five years preceding the date of the statement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



156 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
D. Statements Filed With Secretary of State

4-7 California Legal Forms--Transaction Guide § 7.41

§ 7.41 Failure to File Statement of Information by Domestic Stock Corporation

[1] Notification and Certification Procedures; Penalty

If a corporation fails to file its Statement of Information by Domestic Stock Corporation, the Secretary of State will mail a notice of delinquency to the corporation [*Corp. Code § 2204(a)*]. The notice must advise the corporation of the penalty for failure to file within 60 days after the mailing of the notice. In addition, it must advise the corporation of its right to request relief from the Secretary of State for failure to file resulting from reasonable cause or unusual circumstances, or, if the Secretary does not grant relief, its right to pay the penalty under protest and to file a claim with the Franchise Tax Board requesting relief [*Corp. Code § 2204(a)*]. The penalty for failure to file is $250, imposed by the Franchise Tax Board after the Secretary of State has certified the corporation's name to the Franchise Tax Board [*Corp. Code § 2204(a), (b)*; *Rev. & Tax. Code § 19141*].

If, after certification, the Secretary of State discovers that the statement was filed before the expiration of the 60 day period, or that the Secretary did not provide notice of delinquency, as required, it must promptly decertify the name. The Franchise Tax Board must then promptly abate any assessed penalty [*Corp. Code § 2204(e)*].

If the Secretary of State determines that the failure to file the Statement of Information by Domestic Stock Corporation is excusable because of reasonable cause or justifiable circumstances, it may waive the penalty and must decertify the corporation [*Corp. Code § 2204(f)*].

The penalty does not apply to a corporation that has dissolved or merged with another corporation on or before the date of certification [*Corp. Code § 2204(c)*]. It also does not apply to a corporation that has been suspended by the Franchise Tax Board [*Corp. Code § 2204(d)*; *see* Rev. & Tax. Code §§ 22301 (suspension of corporate powers for nonpayment), 23301.5 (suspension of corporate powers for failure to file return), 23775 (suspension and forfeiture of corporate powers by exempt organization)], on or before, and remains suspended on, the last day of the filing period [*see Corp. Code § 1502(a), (d)* (filing period)]. In addition, the Secretary is not required to mail a form to a corporation that has been suspended by the Franchise Tax Board on or before, and remains suspended on, the day the Secretary of State prepares the forms for mailing [*Corp. Code § 2204(d)*; *see § 7.40[2]*].

[2] Suspension by Secretary of State; Revivor

If a corporation fails to file its Statement of Information by Domestic Stock Corporation [*see Corp. Code § 1502*] for an applicable filing period, has not filed the statement during the preceding 24 months, and was certified for a penalty [*see Corp. Code § 2204*] for the same filing period, the Secretary of State may suspend the corporation's powers, rights, and privileges [*Corp. Code § 2205(a)*]. The Secretary must notify the corporation, by mail, that it will be suspended in 60 days if the statement is not filed [*Corp. Code § 2205(b)*]. If a corporation is suspended, the Secretary must notify the Franchise Tax Board and mail a notice of suspension to the corporation [*Corp. Code § 2205(c)*].

On suspension, the corporation may take no action other than to file the statement or to amend its articles of incorporation to change its name [*Corp. Code § 2205(c), (d)*; *see Palm Valley Homeowners Assn., Inc. v. Design MTC (2000) 85 Cal. App. 4th 553, 560-561, 102 Cal. Rptr. 2d 350* (trial court did not abuse its discretion in imposing sanctions on law firm for continuing litigation activities on behalf of corporation that it knew to be suspended under *Corp. Code § 2205* for failure to file information statement required by *Corp. Code § 1502*)]. In addition, a suspended corporation may file an application for exempt status and amend its articles of incorporation as necessary to perfect that application [*Corp. Code § 1502(c)*; *see* Ch. 13, *Nonprofit Corporations*].

The filing of its Statement of Information by Domestic Stock Corporation [*Corp. Code § 2205(d)*], the payment of any assessed penalty [*Rev. & Tax. Code §§ 23305, 25936*; *see* [1], *above*], and a request in writing to the Franchise Tax Board by any stockholder, creditor, majority of surviving trustees or directors, officer, or any person having an interest in relief from suspension [*Rev. & Tax. Code § 23305*] will revive a corporation, provided the corporation meets the statutory requirements relating to available corporate names unless the corporation is held in suspension by the Franchise Tax Board under *Rev. & Tax. Code §§ 23301, 23301.5,* or *23775* [*Corp. Code § 2205(d)*; *see Rev. & Tax. Code § 23305a*; *see also Corp. Code §§ 201* (names available to domestic corporations), 2106 (names available to foreign corporations); *see* [3], *below*]. The name of a suspended corporation may be reserved and adopted by another corporation during the period of suspension. In that situation, the suspended corporation's application for a certificate of revivor may be denied [*see Boyer v. Jones (2001) 88 Cal. App. 4th 220, 221-222, 105 Cal. Rptr. 2d 824* (trial court properly denied suspended corporation's petition for writ of mandate seeking restoration of its name)]. The Secretary of State must certify the fact of the filing to the Franchise Tax Board, and the Franchise Tax Board will restore the corporation's powers by issuing a certificate of revivor (unless the corporation has been suspended by the Franchise Tax Board) [*Corp. Code § 2205(d)*; *see Rev. & Tax. Code §§ 23301, 23301.5, 23305a*; *see also* [3], *below*]. Thus, it appears that the Secretary of State is not reviving the corporation's powers, but merely informing the Franchise Tax Board that it may do so [*see Corp. Code § 2205(d)*; *Rev. & Tax. Code § 23305a* (requiring Secretary of State's endorsement)].

For a procedural guide to reviving a suspended corporation, see *§ 7.124[2]*. For an Application for Certificate of Revivor, see *§ 7.208*.

[3] Suspension by Franchise Tax Board; Revivor

If the corporation was suspended for nonpayment of franchise taxes or failure to file tax returns, its powers will not be revived, notwithstanding the filing of the required annual statement [*Rev. & Tax. Code §§ 23301, 23301.5, 23775*; *see Corp. Code § 1502*; [2], *above*; *see also Timberline v. Jaisinghani (1997) 54 Cal. App. 4th 1361, 1368-1369, 64 Cal. Rptr. 2d 4* (suspended corporation that failed to revive powers by paying delinquent taxes cannot renew judgment obtained while in good standing)]. Under these circumstances, the corporation's powers may be revived by writing to the Franchise Tax Board for a certificate of revivor, filing all tax returns required under the Bank and Corporation Tax Law, and paying all taxes, additions to taxes, deficiencies, interest, and penalties due [*Rev. & Tax. Code §§ 23305, 23305a*; *see also Rev. & Tax. Code § 23305b* (revivor without payment of full amount due)].

[4] Suspension by Secretary of State and Franchise Tax Board; Revivor

The procedure for reviving a corporation that has been suspended by both the Secretary of State and the Franchise Tax Board is a combination of the two procedures described in [2] and [3], *above*. When all the requirements of both agencies have been met, the corporation may apply, directly to the Franchise Tax Board, for a revivor from both the Secretary of State and Franchise Tax Board suspensions [*see Corp. Code §§ 2204, 2205*; *Rev. & Tax. Code §§ 19141, 23301, 23301.5, 23305-23305b, 23775*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsFinanceFranchise TaxPenalties for NoncomplianceBusiness & Corporate LawCorporationsFinanceFranchise TaxReinstatementBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



157 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
D. Statements Filed With Secretary of State

4-7 California Legal Forms--Transaction Guide § 7.42

§ 7.42 Updated Statement of Information by Domestic Stock Corporation

A corporation must file an updated Statement of Information by Domestic Stock Corporation to designate a new agent for service of process or to change the agent's address [*Corp. Code § 1502(e)*]. This statement supersedes any previously filed statement, as well as any statement in the articles of incorporation relating to the agent or its address [*Corp. Code § 1502(e)*; *see Corp. Code § 202(c)*].

A corporation may, but is not required to, file an updated Statement of Information by Domestic Stock Corporation, between filing periods, if there are other changes to the information provided on the statement [*Corp. Code § 1502(e)*; *see § 7.40[3]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents

158 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
D. Statements Filed With Secretary of State

4-7 California Legal Forms--Transaction Guide § 7.43

§ 7.43 Annual Statement by Foreign Corporation

Every foreign corporation, other than a foreign association [*see Corp. Code § 170* ("foreign association" defined)], qualified to transact intrastate business [*see Corp. Code § 191* ("transact intrastate business" defined)] and every foreign parent corporation subject to *Corp. Code § 2115* [*see Corp. Code § 175* ("parent" defined); *see also § 7.10[1][b]*] must file an annual statement (statement of information) with the Secretary of State [*Corp. Code § 2117(a)*]. Publicly traded foreign corporations must additionally file a corporate disclosure statement [*Corp. Code § 2117.1*]. For a detailed discussion of these statements and copies of the forms prescribed by the Secretary of State, see Ch. 12B, *Foreign Corporations* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawForeign BusinessesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
D. Statements Filed With Secretary of State

4-7 California Legal Forms--Transaction Guide §§ 7.44-7.49

[Reserved]

§§ 7.44[Reserved]



160 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
E. Agent for Service of Process

4-7 California Legal Forms--Transaction Guide § 7.50

§ 7.50 Agent for Service of Process--In General

As an artificial entity, a corporation cannot be served with process; it can be served only through one of its officers or agents or a party designated by law to receive service on its behalf [*Cannon v. American Hydrocarbon Corp. (1970) 4 Cal. App. 3d 639, 652, 84 Cal. Rptr. 575* ; *see Code Civ. Proc. §§ 416.10-416.30* (persons who may be served on behalf of corporation; *but see Gamet v. Blanchard (2001) 91 Cal. App. 4th 1276, 1285-1286, 111 Cal. Rptr. 2d 439* (notices sent to director's residence did not constitute notice on corporation when corporation had filed a different address with the court)].

The articles of incorporation of a California domestic corporation must designate the name and California address of the corporation's initial agent for service of process [*Corp. Code § 202(c)*; *see Corp. Code § 1502(b)* (requirements)]. The annual statement of information filed by a domestic corporation must also designate the corporation's agent for service of process [*Corp. Code § 1502(b)*; *see §§ 7.207, 7.207A* (statements of information for domestic corporations)].

Foreign corporations are required to designate an agent for service of process on the statement and designation that such corporations must file with the Secretary of State [*Corp. Code § 2105(a)(4), (5)*; *see Ch. 12B, Foreign Corporations, §§ 12B.201-12B.201B* (forms)]. The annual statement of information that foreign corporations must file with the Secretary of State must also designate the corporation's agent for service of process [*Corp. Code § 2117(b)*; *see Ch. 12B, Foreign Corporations, § 12B.210* (form)]. For general discussion of these requirements as applied to foreign corporations, see Ch. 12B, *Foreign Corporations* .

The agent must be either a natural person residing in California [*see § 7.51*], or a corporation that has filed a certificate containing specified information [*see Corp Code § 1505* (required certificate); *see also Ch. 3, Articles of Incorporation, § 3.211*; *Ch. 12B, Foreign Corporations, § 12B.204* (forms)] and whose capacity to act as an agent has not been terminated [*Corp. Code §§ 1502(b)* (domestic corporation), 2117(b) (foreign corporation); *see § 7.52*].

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawForeign BusinessesQualificationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
E. Agent for Service of Process

4-7 California Legal Forms--Transaction Guide § 7.51

§ 7.51 Natural Person as Agent

Any natural person residing in California may be designated agent for service of process [*Corp. Code §§ 1502(b), 2117(b)*]. If a natural person is designated, the statement must set forth that person's complete business or residential street address [*Corp. Code §§ 1502(b), 2117(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
E. Agent for Service of Process

4-7 California Legal Forms--Transaction Guide § 7.52

§ 7.52 Corporation as Agent

Any domestic or foreign corporation authorized to do business in California and in good standing on the Secretary of State's records may be designated agent for service of process for another corporation, either domestic or foreign [*Corp. Code § 1505(a), (c)*]. However, the corporate agent first must file with the Secretary of State a certificate setting forth all of the following [*Corp. Code § 1505(a)*; *see Corp. Code § 2105(c)* (foreign corporations)]:

- The complete address of the corporation's office or offices in California where process may be served.
- The name of each employee at each office to whom the corporation authorizes delivery of process.
- The corporation's consent that delivery to any designated employee at the office where the person is employed constitutes delivery of the process to it as agent.

Because this certificate sets forth the corporation's address, its address is not required on the Statement of Information by Domestic Stock Corporation [*see Corp. Code § 1502(b)*; *see also §§ 7.207, 7.207A*] or on the Annual Statement of Information by Foreign Corporation with the Secretary of State [*see Corp. Code § 2117(b)*; *see also Ch. 12, Foreign Corporations, § 12B.210*]. For detailed discussion of the certificate and sample certification forms, see *Ch. 3, Articles of Incorporation, § 3.211* (domestic corporations) and Ch. 12B, *Foreign Corporations*, § 12B.204.

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
E. Agent for Service of Process

4-7 California Legal Forms--Transaction Guide § 7.53

§ 7.53 Resignation of Agent; Appointment of New Agent

An agent for service of process may resign by filing a signed, acknowledged written statement of resignation with the Secretary of State [*Corp. Code § 1503(a)*]. The Secretary of State then must mail written notice of the filing of the statement of resignation to the corporation at its principal executive office [*Corp. Code § 1503(a)*]. The corporation must appoint another agent for service of process on receipt of the notice [*Corp. Code § 1504*].

Further, if a natural person designated as agent dies or no longer resides in California, or if a corporate agent dissolves, withdraws from California, forfeits its right to transact intrastate business, has its corporate franchise suspended, or ceases to exist, the corporation must also designate a new agent [*Corp. Code §§ 1504, 2117(e)* (foreign corporations)]. The designation of a new agent must conform to the statutory requirements [*Corp. Code § 1504*; *see Corp. Code §§ 1502(b), 2117(b)* (statutory requirements); *see also §§ 7.51-7.52*].

In addition, in order to change its agent for service of process, or the agent's address, the corporation must file a current complete Statement of Information by Domestic Stock Corporation [*Corp. Code § 1502(e)*; *see § 7.207[2]*]. When an updated statement is filed, it supersedes any previously filed statement and the statement in the articles of incorporation as to the agent for service of process and the address of the agent [*Corp. Code § 1502(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART II. LEGAL BACKGROUND
E. Agent for Service of Process

4-7 California Legal Forms--Transaction Guide §§ 7.54-7.99

[Reserved]

§§ 7.54[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-7 California Legal Forms--Transaction Guide §

§ Client Interview

NOTE:

Facts and documents obtained from the client aid the attorney in determining whether the domestic or foreign corporation, or corporation's subsidiary, is subject to the record keeping and reporting requirements and inspection rights enumerated in the Corporations Code [***see*** *Corp. Code §§ 1500-1512*]. In addition, facts and documents provide the attorney with the general information necessary to any attorney-client relationship.

[1] Facts

1. General information relating to domestic or foreign corporation, or subsidiary of corporation:

a. Name, mailing address, and telephone number.

b. Street address of principal executive office.

c. Street address of principal business office in California, if any.

d. Names, titles, addresses, and telephone numbers of officers.

e. Names, titles, addresses, and telephone numbers of directors.

f. Name, address, and telephone number of agent for service of process.

g. Name, address, and telephone number of transfer agent.

h. Name, address, and telephone number of accountant or accountancy firm.

i. Name, address, and telephone number of party responsible for paying attorneys' fees.

j. Place and date of incorporation.

k. Principal business activity.

l. Usual business hours.

m. Location of board and shareholder meetings.

n. Location of corporate accounting books, records, minutes, bylaws, and record of shareholders.

o. Whether corporation is in good standing in California.

p. Whether corporation has any securities registered under Section 12 of the Securities and Exchange Act of 1934 or exempt from registration under Section 12(g)(2).

q. Whether corporation is agent for service of process for another.

r. Whether corporation has elected close corporation status.

2. General information relating to foreign corporation:

a. Whether foreign corporation has requisite minimum contacts with California (specified in *Corp. Code § 2115(a)*) to subject corporation to record keeping and reporting requirements.

NOTE:
For detailed discussion of *Corp. Code § 2115(a)*, see Ch. 12B, ***Foreign Corporations*** .

b. Whether foreign corporation transacts, or intends to transact, intrastate business in California.

c. Date foreign corporation intends to begin transacting intrastate business in California, if applicable.

3. Specific facts relating to corporate client:

a. Number of shareholders of record.

b. Names and addresses of all shareholders.

c. Number and class of shares held by each shareholder.

d. Meetings of board of directors:

(1) Date, time, and location of first meeting of directors, if newly incorporated.

(2) Frequency and location of regular directors' meetings.

4. Specific facts relating to shareholder client:

a. Name and address of shareholder or holder of voting trust certificate.

b. Number and class of shares held by shareholder.

c. Percentage of total outstanding voting shares of corporation held by shareholder.

d. Name of any agent of shareholder or holder of voting trust certificate.

e. Names and addresses of all shareholders.

f. Number and class of shares held by each shareholder.

g. Date and location of annual meeting of shareholders.

[2] Documents

1. To be obtained from corporate client:

a. Articles of incorporation.

b. Bylaws, as amended to date.

c. Shareholder agreements, if close corporation.

d. Minutes of proceedings of shareholders, board of directors, and board committees.

e. Any notices of meetings of shareholders, board of directors, or board committees.

f. Copy of latest annual report, including:
(1) Balance sheet.

(2) Income statement.

(3) Statement of cashflows.

(4) Report of independent accountant, if any, or certificate of authorized corporate officer that annual report was prepared without audit.

g. Copy of any quarterly income statements or balance sheets.

h. Copy of any financial statements prepared in lieu of annual report.

i. Record of shareholders.

j. Copy of latest complete annual statement filed with Secretary of State, either:

(1) Statement of Information by Domestic Stock Corporation; or

(2) Statement of Information by Foreign Corporation.

k. Copy of any subsequent statement filed with Secretary of State designating different agent for service of process or changing agent's address.

l. Any statement of resignation by agent for service of process.

m. Copy of any certificate designating corporation as agent for service of process.

n. Any notice of delinquency issued by Secretary of State against corporation for failure to file annual statement with Secretary of State.

o. Copy of any shareholder demands to inspect corporate records.

p. Copy of any corporate record or report alleged by any party to be false in material regard.

q. Copy of any California local property tax assessments.

2. To be obtained from shareholder client:

a. Certificate of shareholdings.

b. Voting trust certificate.

c. Copy of any demand made on corporation or transfer agent for inspection or receipt of corporate records.

d. Copy of any correspondence received from corporation in response to demand for inspection or receipt of corporate records.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-7 California Legal Forms--Transaction Guide §§ 7.101-7.109

[Reserved]

§§ 7.101[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-7 California Legal Forms--Transaction Guide § 7.110

§ 7.110 Corporations Subject to Statutory Recordkeeping and Reporting Requirements

1. Classify corporation as domestic or foreign.

NOTE:

Every domestic corporations and certain foreign corporations are subject to the recordkeeping and reporting requirements of the General Corporation Law [*Corp. Code §§ 1500, 2115*; ***see*** *Corp. Code §§ 1500-1512*].

2. If foreign, ascertain whether corporation is subject to statutory recordkeeping and reporting requirements.

NOTE:

A foreign corporation meeting the minimum contacts requirement [see *Corp. Code § 2115(a)*] will be subject to the general recordkeeping and reporting requirements of the Corporations Code unless: (1) it is a foreign corporation with outstanding securities listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market, or (2) all its voting shares (other than directors' qualifying shares) are owned directly or indirectly by a corporation or corporations not subject to *Corp. Code § 2115* [*Corp. Code § 2115(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-7 California Legal Forms--Transaction Guide § 7.111

§ 7.111 Checklist of Required Records, Shareholder Reports, and Annual Statements Filed With Secretary of State

1. Determine whether corporation's records include, as required:

    a. Minutes of meetings of shareholders, board of directors, and board committees [*Corp. Code §§ 1500, 2115(b)*].

    b. Accounting books and records [*Corp. Code §§ 1500, 2115(b)*].

    c. Record of shareholders [*Corp. Code §§ 1500, 2115(b)*].

    d. Bylaws, as amended to date [*Corp. Code § 213*].

2. Determine whether corporation has sent following reports to shareholders, as required:

    a. Annual report [*Corp. Code §§ 1501, 2115(b)*].

    b. Quarterly financial reports [*Corp. Code §§ 1501(c), (d), 2115(b)*].

    c. Financial statements in lieu of annual report [*Corp. Code §§ 1501(c), 2115(b)*].

3. Determine whether domestic or foreign corporation has filed appropriate annual statement, either:

    a. Statement of Information by Domestic Stock Corporation [*Corp. Code § 1502(a)*]; or

    b. Statement of Information by Foreign Corporation [*Corp. Code § 2117(a)*].

NOTE:
Publicly traded domestic and foreign corporations must also file a corporate disclosure statement [*Corp. Code §§ 1502.1, 2117.1*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-7 California Legal Forms--Transaction Guide §§ 7.112-7.119

[Reserved]

§§ 7.112[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-7 California Legal Forms--Transaction Guide § 7.120

§ 7.120 Corporate Records

NOTE:

Although the corporation's attorney usually is not involved in keeping and maintaining the corporation's financial and other records, the attorney should be aware of the general requirements and should be prepared to advise the client accordingly. The attorney should also be alert to any areas in which legal assistance may be needed.

[1] General Record Keeping Requirements

NOTE:

The General Corporation Law requires that every domestic corporation maintain adequate and correct books and records of account, minutes of the proceedings of its shareholders, board of directors, and committees of the board, records of share transactions, a record of shareholders [*Corp. Code § 1500*], and bylaws [*Corp. Code § 213*]. Certain foreign corporations are also subject to the record keeping and reporting requirements of the General Corporation Law [***see*** *Corp. Code § 2115*]. To determine whether a foreign corporation is subject to these requirements, see *§ 7.110*.

1. Advise client that every corporation subject to statutory record keeping requirements must keep and maintain following records:

a. Adequate and correct books and records of account [*Corp. Code §§ 1500, 2115(b)*].

b. Minutes of proceedings of its shareholders, board of directors, and board committees [*Corp. Code §§ 1500, 2115(b)*].

NOTE:

Although a record of corporate actions is required by the General Corporation Law [*Corp. Code § 1500*], failure to take or maintain minutes will not invalidate the actions of the board of directors or shareholders [*Bank of Napa v. Ferguson Burns Estate (1920) 48 Cal. App. 319, 326, 192 P. 66]* . However, the original or a copy (in writing or in any other form capable of being converted into clearly legible tangible form) certified by the corporate secretary, assistant corporate secretary, or a person purporting to be either, of the minutes of any meeting of directors, shareholders, or board committees is prima facie evidence of the holding of the meeting and of the approval of actions taken at the meeting [*Corp. Code § 314*]. For a general discussion of the contents of minutes, see *§ 7.11 [2]*. See Ch. 5, ***Director's Meetings, Actions, and Resolutions*** **,** and Ch. 8A, ***Shareholder's Meetings, Voting, and Agreements*** **,** for more detailed coverage and examples of keeping and maintaining corporate minutes.

c. Record of shareholders [*Corp. Code §§ 1500, 2115(b)*].

NOTE:

Each domestic or foreign corporation must keep at its principal executive office, or at the office of its transfer agent or registrar, a record of shareholders, listing the names and addresses of all shareholders and the number and class of shares held by each shareholder [*Corp. Code §§ 1500, 2115(b)*].

d. Bylaws [*Corp. Code § 213*].

NOTE:

A corporation [***see*** *Corp. Code §§ 162* ("corporation" defined), 167 ("domestic corporation" defined)] must keep the original or a copy of its bylaws, as amended to date, at its principal executive office [*Corp. Code § 213*]. If a corporation has no office in California, it must, on written request, provide any shareholder with a copy of the bylaws, as amended to date [***see*** *Corp. Code § 213*; ***see also*** *Corp. Code § 2115*]. For detailed discussion of the purpose and content of bylaws, see Ch. 4, ***Bylaws*** **.**

2. Advise client that minutes and other books and records must be kept in writing or other form capable of being converted into clearly legible tangible form [*Corp. Code § 1500*; *see Corp. Code § 1605*].

3. Advise client that use of English is obligatory for any required report, record, notice, or statement [*Corp. Code § 8*].

[2] Civil Penalties and Liabilities

1. Advise client, if domestic corporation or shareholder of corporation, that failure to keep or maintain records (excluding minutes) as required, may result in monetary penalties [*Corp. Code § 2200*; *see Corp. Code § 1500* (statutory requirements)].

NOTE:

The penalty for failing to comply is $25 a day for each day of noncompliance, beginning 30 days after a reciept of a written request to comply, up to a maximum of $1,500 [*Corp. Code § 2200*]. However, the maximum daily penalty for failure to comply with any number of separate requests made on the same day or related to the same act is $250. In addition, the court in which an action for the penalty is brought may reduce or suspend the penalty when it appears that neglect, failure, or refusal was inadvertent or excusable [*Corp. Code § 2202*]. These penalties are in addition to all other available remedies [*Corp. Code § 2202*]. It is not entirely clear whether these penalties apply to foreign

corporations. *Corp. Code § 2200* is not listed in *Corp. Code § 2115(b)*, but has been amended to include a separate penalty solely applicable to foreign corporations. However, on complaint that the corporation is not complying with the record keeping and reporting requirements of the General Corporation Law, foreign corporations are subject to enforcement actions by the California Attorney General [*Corp. Code § 1508*; ***see*** P 5, ***below***]. For further discussion, see *§ 7.13[1][b]* and Ch. 12B, ***Foreign Corporations and Associations*** .

2. Advise client that failure or refusal to enter share transaction or issue share certificate by officer obliged to do so (or failure or refusal caused by officer or director), after written request, may result in monetary penalties [*Corp. Code §§ 2201*, *2202*].

NOTE:

The penalty is $100, in addition to $10 for each day of default, beginning five days after receiving the request, up to a maximum of $500 [*Corp. Code § 2201*]. It must be paid to each injured person and may be enforced by judicial action [*Corp. Code § 2201*]. However, the court in which an action for the penalty is brought may reduce or suspend the penalty when it appears that neglect, failure, or refusal was inadvertent or excusable [*Corp. Code § 2202*]. The penalty is in addition to any remedies otherwise available [*Corp. Code § 2202*]. This penalty also applies to those obliged to enter and issue an initial transaction statement or written statements relating to uncertificated securities [*Corp. Code § 2201*; ***see*** *Corp. Code §§ 171.1* ("initial transaction statement," "written statements" explained), 191.1 ("uncertificated security" defined)].

3. Advise client, if domestic corporation or shareholder of corporation, that joint and several liability for damages is imposed on officer, director, employee, or agent who does any of following [*Corp. Code § 1507*]:

a. Makes, issues, delivers, or publishes any prospectus, report, circular, certificate, financial statement, balance sheet, public notice, or document regarding corporation or its shares, assets, liabilities, capital, dividends, business, earnings, or accounts, that is false, knowing it to be false, or participates in any of these actions.

b. Makes or causes to be made in corporate books, minutes, records, or accounts any material entry that is false, knowing it to be false.

c. Removes or alters any entry in any of corporate books or records, with intent to deceive.

4. Advise client, if foreign corporation or shareholder of corporation, that directors of foreign corporation transacting intrastate business [*see Corp. Code § 191* ("transacting intrastate business" defined)] in California are liable to corporation, its shareholders, creditors, receiver, liquidator, or trustee in bankruptcy for making false reports [*Corp. Code § 2116*].

5. Advise client that California Attorney General may enforce recordkeeping requirements of domestic and foreign corporations [*Corp. Code §§ 1508*, *2115(b)*].

NOTE:

On complaint that a domestic or foreign corporation is not complying with the statutory provisions relating to recordkeeping and reporting requirements [*Corp. Code §§*

1500-1512], the California Attorney General may send a notice of the complaint to the corporation's principal executive office, and, if the response is unsatisfactory, may institute an action for relief to protect the rights of shareholders or to remedy the consequences of not complying with the statutory requirements [*Corp. Code § 1508*]. Remedies include injunction, dissolution, appointment of receiver, or any other relief, as appropriate [*Corp. Code § 1508*]. For further discussion, see *§ 7.13[1][b]* and Ch. 12B, ***Foreign Corporations and Associations*** .

[3] Criminal Penalties and Liabilities

1. Advise client that corporate director, officer, or agent commits a felony if he or she [*Corp. Code § 2254*]:

a. Knowingly concurs in making, publishing, or posting to shareholders or other persons any one of following [*Corp. Code § 2254*]:
(1) Written report, exhibit, statement of its affairs, or pecuniary condition or notice containing any material statement that is false.

(2) Untrue or willfully or fraudulently exaggerated report, prospectus, account, statement of operations, values, business profits, expenditures, or prospects.

(3) Other paper or document intended to produce or give, or having tendency to produce or give, shares of stock in corporation a greater value or a less apparent or market value than they really possess.

b. Refuses to make any book entry or post any notice as required by law in manner required by law.

NOTE:
Failing to make entries in the minutes is not subject to these penalty provisions [***see*** *Corp. Code § 2254*].

2. Advise client that corporate director, officer, or agent is guilty of a public offense who [*Corp. Code § 2255(a), (b)*]:

a. Knowingly acquires corporate property, other than in payment of just demand, and, intending to defraud, does not make complete, true entry of transaction on corporation's books; or

b. Intending to defraud, destroys, mutilates, or falsifies corporate books or securities, or omits, or concurs in omitting, any material record in corporate books.

NOTE:
In both cases, the public offense is punishable by imprisonment in a state prison, imprisonment in a county jail for not more than one year, or by a fine not exceeding $1,000, or by both a fine and imprisonment [*Corp. Code § 2255(c)*].

3. Advise client that knowing exhibition of false documents to public officer, with intent to deceive, by any officer, agent, or clerk of domestic or foreign corporation may be punished by imprisonment in state prison or in county jail for not more than one year [*Corp. Code § 2256*].

NOTE:
This prohibition extends to any person proposing to organize a corporation or to increase its capital stock

[*Corp. Code § 2256*].

4. Advise client that one is guilty of a misdemeanor who, without authorization, subscribes name of another not affiliated with corporation, intending to lead others to believe that this person is officer, agent, shareholder, or promoter of corporation, when no such relationship exists to that person's knowledge [*Corp. Code § 2257*; *see Penal Code § 19* (punishment of misdemeanors)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-7 California Legal Forms--Transaction Guide § 7.121

§ 7.121 Inspection Rights

[1] Shareholders and Holders of Voting Trust Certificate

NOTE:

A shareholder's statutory rights of inspection extend to (1) every domestic corporation, (2) any foreign corporation described in *Corp. Code § 2115(a)* [*Corp. Code § 2115(b)*; ***see*** *Corp. Code § 2115(a)*; ***see also*** *§ 7.10[2]*], and (3) any other foreign corporation that keeps records in California or has its principal executive office in California [*Corp. Code § 1601(a)*]. The right of inspection also extends to subsidiaries of the above-described corporations [*Corp. Code § 1601(a)*; ***see*** *Corp. Code § 189* ("subsidiary" defined)]. Shareholder status, however, does not entitle an individual to unfettered access to corporate confidences and secrets, such as documents protected by the attorney-client privilege [***see, e.g.,*** *NFL Properties Inc. v. Superior Court (1998) 65 Cal. App. 4th 100, 107-108, 75 Cal. Rptr. 2d 893* (Raiders football club, as plaintiff in shareholder's suit against National Football League, did not have right to inspect NFL merchandising corporation's documents protected by attorney-client privilege)].

1. Advise client that following records must be open to inspection, on written demand, at any time during usual business hours, for purpose reasonably related to interests of shareholder or holder of voting trust certificate [*Corp. Code §§ 1600(c), 1601(a), 2115(b)*]:

NOTE:

The client also should be advised that the corporation may not thwart the exercise of these rights by failing to respond to proper requests, by sending communications that make further requests futile, or by actions impeding the inspection process. Conversely, the corporation is required only to allow inspection at corporate offices. It is not required to mail or otherwise provide copies, and is not required to respond to demands for disclosure falling outside scope of what is required by statute [*Jara v. Suprema Meats,*

Inc. (2004) 121 Cal. App. 4th 1238, 1263-1265, 18 Cal. Rptr. 3d 187] .

a. Accounting books and records [*Corp. Code § 1601(a)*].

b. Minutes of proceedings of shareholders, board of directors, and board committees [*Corp. Code § 1601(a)*].

c. Record of shareholders [*Corp. Code § 1600(c)*].

2. Advise client of common law right to inspect other corporate records for purpose reasonably related to interests as shareholder or holder of voting trust certificate [*Most v. Nat'l Bank of San Diego (1966) 246 Cal. App. 2d 425, 428, 431, 54 Cal. Rptr. 669* ; *see Mooney v. Bartenders Union Local No. 284(1957) 48 Cal. 2d 841, 843, 313 P. 857*].

3. Advise client of absolute right of shareholder or group of shareholders holding at least 5 percent of outstanding voting shares, or at least 1 percent of voting shares subject to certain federal regulations [*Corp. Code §§ 1600(a), 2115(b)*]:

NOTE:

Corp. Code § 1600(a) refers to shareholders who have filed a Schedule 14A or, in the case of banks with deposits insured under Federal Deposit Insurance Act, shareholders who have filed a Form F-6 [***see*** *17 C.F.R. § 240.14a-11(c)*].

a. To inspect and copy record of shareholders:

(1) In person or by agent or attorney.

(2) On five days prior written demand.

b. To obtain from corporation's transfer agent list of names, addresses, and holdings of shareholders entitled to vote for directors:

(1) On written request.

(2) On payment of usual charges.

4. Advise client that if records requested are not in writing, request is not complied with until corporation, at its expense, makes records available in writing [*Corp. Code §§ 1605, 2115(b)*].

5. Advise client that inspection and copying may be made in person or by agent or attorney [*Corp. Code §§ 1600(a), 1601(b), 2115(b)*].

6. Advise client that right may not be limited by articles of incorporation or bylaws [*Corp. Code §§ 1600(d), 1601(b), 2115(b)*].

7. Advise client that bylaws must be open to inspection at all reasonable times during office hours [*Corp. Code § 213*].

8. Advise client of common law right to inspect corporate property to verify statements in corporate records [*Hobbs v. Tom Reed Gold Min. Co. (1913) 164 Cal. 497, 502, 129 P. 781]* .

[2] Directors

NOTE:

The right of inspection by a director applies to every domestic corporation and to any foreign corporation having its principal executive office in California or customarily holding meetings of its board of directors in this state [*Corp. Code §§ 1602, 2115(b)*; ***see*** *Havlicek v. Coast-To-Coast Analytical Services, Inc. (1995) 39 Cal. App. 4th 1844, 1854-1856, 46 Cal. Rptr. 2d 696* (*Corp. Code § 1602* does not violate Commerce Clause or Full Faith and Credit Clause); ***but see*** *NFL Properties Inc. v. Superior Court (1998) 65 Cal. App. 4th 100, 109-110, 75 Cal. Rptr. 2d 893* (if director sues in capacity as shareholder rather than director, attorney-client and work product privileges are properly upheld by corporation)]. Although a court may impose just and proper conditions on a director's "absolute right" of inspection in an egregious case [***see*** *Havlicek v. Coast-To-Coast Analytical Services, Inc. (1995) 39 Cal. App. 4th 1844, 1854-1856, 46 Cal Rptr. 2d 606]* , this principle should only be applied in extreme circumstances in which a preponderance of the evidence establishes a director's clear intent to use documents to commit a tort against the corporation [*Saline v. Superior Court (2002) 100 Cal. App. 4th 909, 915-916, 122 Cal. Rptr. 2d 813]* .

A corporate director does not have the right to access documents that are covered by the attorney-client privilege and were generated in defense of a suit for damages that the director filed against the corporation [*Tritek Telecom, Inc. v. Superior Court (2009) 169 Cal. App. 4th 1385, 1391-1392, 87 Cal. Rptr. 3d 455]* .

1. Advise client that director has absolute right at any reasonable time to [*Corp. Code §§ 1602, 2115(b)*]:

a. Inspect and copy all documents.

NOTE:

On demand for inspection, any records not maintained in written form must be made available in writing, at the corporation's expense [*Corp. Code §§ 1605, 2115(b)*].

b. Inspect physical properties of corporation of which person is director and of its subsidiary corporations, domestic or foreign.

2. Advise client that inspection may be made in person or by agent or attorney [*Corp. Code §§ 1602, 2115(b)*].

[3] Local Assessors

NOTE:

The inspection right of a local assessor applies to a domestic or foreign corporation owning, claiming, possessing, or controlling property in California that is subject to local assessment [*Corp. Code § 1506*].

1. Advise client that domestic or foreign corporation must make available, on request of county assessor, all business records relating to amount, cost, and value of corporation's property within county [*Corp. Code § 1506*].

2. Advise client that records must be made available at corporation's principal office or at mutually agreed on location [*Corp. Code § 1506*].

[4] Enforcement Actions

1. Advise client that lawful demand for inspection may be enforced in superior court of proper county [*Corp. Code § 1603(a)*; *see Corp. Code § 177* ("proper county" defined)].

NOTE:

The court may enforce the right of inspection with "just and proper conditions" [*Corp. Code § 1603(a)*]. Alternatively, the court may, for good cause shown, appoint inspectors or accountants to audit the books and records kept in California and investigate the property, funds, and affairs of any domestic corporation or any foreign corporation keeping its accounting records in California or any subsidiaries, domestic or foreign, keeping records in California [*Corp. Code § 1603(a)*]. In an action under *Corp. Code § 1600* (shareholders' rights to inspect shareholder record) or *Corp. Code § 1601* (shareholders' rights to inspect corporate accounts, books, records, and minutes), the court may award the shareholder or holder of a voting trust certificate expenses incurred in connection with the action, including attorneys' fees. To award expenses, however, the court must find that the corporation's failure to comply with a proper demand for inspection was without justification [*Corp. Code § 1604*].

2. Advise client that inspection rights may be enforced by Attorney General [*Corp. Code §§ 1508, 2115(b)*].

NOTE:

On complaint that a domestic or foreign corporation is not complying with the statutory provisions relating to rights of inspection [*Corp. Code §§ 1600-1605*], the California Attorney General may send a notice of the complaint to the corporation's principal executive office. If the response is unsatisfactory, the Attorney General may institute an action for relief to protect the rights of shareholders or to remedy the consequences of failure to comply with the statutory requirements [*Corp. Code § 1508*]. Remedies include injunction, dissolution, appointment of receiver, or any other relief, as appropriate [*Corp. Code §§ 1508, 2115(b)*].

3. Advise client that if corporation, domestic or foreign, delays beyond required time limits in delivering shareholder record, on lawful demand, shareholder may [*Corp. Code §§ 1600(b), 2115(b)*]:

a. Obtain court order postponing noticed shareholder meeting for period equal to delay in opening shareholder record.

b. Pursue all other legal and equitable remedies available.

NOTE:

A shareholder or group of shareholders holding at least 5 percent of the outstanding voting shares, or at least 1 percent of the voting shares subject to certain federal regulations [***see*** *§ 7.121[1]*, P 3, ***above***] has an absolute right (without stating a purpose) to inspect and copy the record of shareholders, in person or by agent or attorney on five days prior written demand [*Corp. Code § 1600(a)*]. Likewise, such a shareholder or group

of shareholders has an absolute right to obtain from the corporation's transfer agent a list of the names, addresses, and holdings of the shareholders entitled to vote for directors, on written request and tender of the usual charges [*Corp. Code § 1600(a)*]. These additional inspection rights extend to holders of the requisite shares of a foreign corporation that has its principal executive office in California or that customarily holds meetings of its board of directors in California [*Corp. Code § 1600(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesReal Property TaxAssessment & ValuationGeneral OverviewTax LawState & Local TaxesPersonal Property TaxGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsRemediesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsDirectorsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-7 California Legal Forms--Transaction Guide § 7.122

§ 7.122 Right to Result of Shareholder Vote

NOTE:

Every domestic corporation and any foreign corporation qualified to transact intrastate business in California [*Corp. Code § 1510(a)*] or any foreign corporation not qualified to transact business in California, but having one or more subsidiaries, domestic or foreign, qualified to transact business in this state [*Corp. Code § 1511*] must provide the information specified below, at the request of a shareholder resident in this state [***see*** *Corp. Code §§ 1510(b)* ("shareholder resident in this state" defined), 1512 ("shareholder" defined for purposes of *Corp. Code §§ 1509-1511*)].

1. Advise client that for period of 60 days after shareholder meeting, on written request, corporation must provide shareholder [*see Corp. Code § 1512* ("shareholder" defined for purposes of *Corp. Code §§ 1509-1511*)] with following results of any shareholder vote taken at shareholder meeting [*Corp. Code § 1509*]:

NOTE:

If more than one class or series of shares voted, the report must state the appropriate numbers by class and series of shares [*Corp. Code § 1509*].

a. Number of shares voted for or against proposal.

b. Number of shares withheld from voting.

c. Number of shares or votes cast for each nominee, if election of directors voted on.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawForeign BusinessesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-7 California Legal Forms--Transaction Guide § 7.123

§ 7.123 Reports to Shareholders

NOTE:

The preparation and distribution of the reports to shareholders enumerated in [1], [2], below, are required of (1) all domestic corporations, (2) foreign corporations having their principal executive office in California or customarily holding meetings of their board of directors in California [*Corp. Code § 1501(g)*], and (3) foreign corporations described in *Corp. Code § 2115(a)*, except for (a) foreign corporations with outstanding securities listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market, or (b) foreign corporations all of the voting shares of which (other than directors' qualifying shares) are owned directly or indirectly by a corporation or corporations not subject to *Corp. Code § 2115* [*Corp. Code § 2115(c)*].

[1] Annual Report

NOTE:

Except for corporations with fewer than 100 shareholders whose bylaws expressly waive this requirement, every corporation, domestic or foreign, as defined above, must send its shareholders an annual report [*Corp. Code §§ 1501(a)(1), (g), 2115(b)*]. This requirement may not be waived in a close corporation's shareholders' agreement [*Corp. Code § 300(c)*]. The General Corporation Law specifies only that the annual report be sent to the corporation's "shareholders" [*Corp. Code § 1501(a)*]. Normally, the annual report is sent to shareholders of record for purposes of the annual shareholders' meeting in the fiscal year following that of the annual report [***see*** *Corp. Code § 605* ("shares held of record" defined)] and given on request to persons who become shareholders after the required distribution of the annual report within 120 days of the close of the fiscal year.

1. Advise client that annual report must include all of following for fiscal year [*Corp. Code §§ 1501(a)(1), 2115(b)*]:

a. Balance sheet.

b. Income statement.

c. Statement of cashflows.

d. Accompanying report of independent accountants, if any, or certificate of authorized corporate officer stating that statements were prepared without audit from corporation's books and records [*see Corp. Code § 115* ("independent accountants" defined)].

NOTE:
In an annual report, all financial statements, including balance sheets, income statements, statements of cashflows, and similar accounting items must be prepared in conformity with generally accepted accounting principles, subject to any specific accounting treatment required by a particular section of the General Corporation Law [*Corp. Code § 114*]. A corporation with fewer than 100 shareholders of record, determined as provided in *Corp. Code § 605*, is not subject to this requirement provided the corporation's financial statements (1) reasonably set forth the corporation's assets, liabilities, income, and expenses, and (2) disclose the accounting basis used in their preparation [*Corp. Code §§ 1501(a)(3), 2115(b)*].

2. Advise client that corporations with 100 or more shareholders of record (determined as provided in *Corp. Code § 605*), with no class of securities registered under Securities Exchange Act of 1934, Section 12, or exempt from registration under Section 12(g)(2), must also include brief description of following for fiscal year:

NOTE:
A report is not required in the case of indemnification approved by the shareholders under *Corp. Code § 317(e)(2)* (indemnification deemed proper by legal counsel in written opinion) [*Corp. Code §§ 1501(b)(2), 2115(b)*; ***see*** *Corp. Code § 153* ("approved by the shareholders" defined); ***see also*** *Corp. Code § 317* (indemnification of corporate agent)].

a. Any transaction (excluding officer and director compensation) involving amount exceeding $40,000 (other than competitive bid contracts or regulated services) [*Corp. Code §§ 1501(b)(1), 2115(b)*]:

(1) To which corporation, its parent or subsidiary was party; and

(2) In which any director, officer, or holder of more than 10 percent of corporation's outstanding voting shares had material interest.

NOTE:
A description of this transaction should include the person's name, his or her relationship to the corporation, the nature of the person's interest in the transaction, and the amount of the interest, when practicable [*Corp. Code §§ 1501(b)(1), 2115(b)*]. If the transaction was with a partnership of which the person having a material interest is a partner, only the interest of the partnership need be reported [*Corp. Code §§ 1501(b)(1), 2115(b)*]. Further, any transaction approved by the shareholders is exempt from this reporting requirement [*Corp. Code §§ 1501(b)(1), 2115(b)*; ***see*** *Corp. Code § 153* ("approved by the shareholders" defined)].

b. Amount and circumstances of any indemnification or advances aggregating more than $10,000 paid to any officer or director under *Corp. Code § 317* (indemnification of directors, officers, and others) [*Corp. Code §§ 1501(b)(2), 2115(b)*].

3. Advise client that annual report must be sent to shareholders to address on corporate books or address of notice provided by shareholder in accordance with following requirements [*Corp. Code §§ 1501(a)(1), 601(b), 2115(b)*]:

NOTE:

If a corporation has fewer than 100 shareholders (determined as provided in *Corp. Code § 605*), its bylaws may expressly waive these requirements [*Corp. Code §§ 1501(a)(1), 2115(b)*].

a. No later than 120 days after close of fiscal year [*Corp. Code § 1501(a)(1)*].

b. By first or third class mail or electronic transmission by corporation, or delivered personally [*Corp. Code §§ 1501(a)(1), 601(b)*].

NOTE:

A corporation that is registered under Section 12 of the Securities Exchange Act of 1934 [***see*** *15 U.S.C. § 78l*] may satisfy the delivery requirement by posting its annual report on an Internet website and providing its shareholders with written notice of the availability of the report [***see*** *Corp. Code § 1501(a)(4)*; ***see also*** *17 C.F.R. § 240.14a-16*].

[2] Financial Reports Requested by Shareholders

1. Advise client that corporation must send following to shareholder or group of shareholders owning at least five percent of outstanding shares of any class, within 30 days of written request:

a. Balance sheet for three, six, or nine month periods of current fiscal year ended at least 30 days before request [*Corp. Code §§ 1501(c), 2115(b)*].

b. Income statement for three, six, or nine month periods of current fiscal year ended at least 30 days before request [*Corp. Code §§ 1501(c), 2115(b)*].

c. Report of independent accountants, if any, or certificate of authorized corporate officer stating that financial statements were prepared without audit of corporation's books and records [*Corp. Code §§ 1501(d), 2115(b)*; *see Corp. Code § 115* ("independent accountants" defined)].

2. Advise client that corporation must keep copies of quarterly reports at its principal office for 12 months and exhibit or mail copies to shareholders on demand [*Corp. Code §§ 1501(c), 2115(b)*].

3. If no annual report for last fiscal year has been sent, advise client that corporation must send financial statements required in annual report to any shareholder, within 15 days of written request made more than 120 days after close of fiscal year [*Corp. Code §§ 1501(c), 2115(b)*; *see* [1], P 1, *above* (financial statements required in annual report)].

NOTE:

This provision refers only to the "financial statements" and not to the entire annual report required by *Corp. Code § 1501(a)* [*Corp. Code §§ 1501(c), 2115(b)*].

4. Advise client that corporation must keep copies of required financial statements at its principal office for 12 months and exhibit or mail copies to shareholders on demand [*Corp. Code §§ 1501(c), 2115(b)*].

5. Advise client that corporations with fewer than 100 shareholders, determined as provided in *Corp. Code § 605*, need not conform their financial statements with general accounting principles, provided those statements [*Corp. Code §§ 1501(a)(3), 2115(b)*]:

a. Reasonably set forth the corporation's assets, liabilities, income, and expenses; and

b. Disclose the accounting principles used in their preparation.

[3] Enforcement Actions; Penalties

1. Advise client that corporation's duties to make and deliver required information and financial statements may be enforced by suit in superior court in proper county [*Corp. Code §§ 1501(e), 2115(b)*; *see Corp. Code §§ 177* ("proper county" defined), 1501 (required information and financial statements)].

NOTE:
If the court finds the corporation's failure to comply with the requirements of the General Corporation Law is without justification, the court may award reasonable expenses, including attorneys' fees, to the shareholder [*Corp. Code §§ 1501(f), 2115(b)*].

2. Advise client that corporation may face monetary penalties for failure to prepare annual report or financial statements, as required [*Corp. Code §§ 1501(e), 2115(b)*; ***see*** *Corp. Code § 2200* (penalties)].

NOTE:
The penalty for failure to comply is $25 a day for each day of noncompliance, beginning 30 days after a receipt of a written request to comply, up to a maximum of $1,500 [*Corp. Code § 2200*]. However, the maximum daily penalty for failure to comply with any number of separate requests made on the same day or related to the same act is $250 [*Corp. Code § 2200*]. Further, the court in which an action for the penalty is brought may reduce or suspend the penalty when it appears that neglect, failure, or refusal was inadvertent or excusable [*Corp. Code § 2202*]. These penalties are in addition to all other available remedies [*Corp. Code § 2202*]. Unlike the apparent nonapplicability of *Corp. Code § 2200* to foreign corporations that do not comply with the general record keeping requirements of the General Corporation Law [***see*** *Corp. Code §§ 162, 2115(b)*; ***see also*** *§ 7.13[1][b]*], *Corp. Code § 2200* appears to apply to a foreign corporation that has its principal executive office in California or that customarily holds meetings of its board in California and that violates *Corp. Code § 1501*, regarding annual reports to shareholders [***see*** *Corp. Code § 1501(e), (g)*; ***see also*** *§ 7.33*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords &

Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsRemediesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-7 California Legal Forms--Transaction Guide § 7.124

§ 7.124 Statement of Information by Domestic Stock Corporation

NOTE:

A similar requirement is applicable to foreign corporations. Every foreign corporation, other than a foreign association [***see*** *Corp. Code § 170* ("foreign association" defined)], qualified to transact intrastate business [***see*** *Corp. Code § 191* ("transact intrastate business" defined)] and every foreign parent corporation subject to *Corp. Code § 2115* [***see*** *Corp. Code § 175* ("parent" defined); ***see also*** *§ 7.10[1][b]*] must file an annual statement with the Secretary of State [*Corp. Code § 2117(a)*]. For a detailed discussion of this statement and copies of the forms prescribed by the Secretary of State, see Ch. 12B, ***Foreign Corporations*** **.** If the corporation is a publicly traded company, the corporation must also file a corporate disclosure statement [***see*** *Corp. Code § 1502.1* ***see also*** *§ 7.207B*].

[1] Required and Optional Filings

1. Advise client, if domestic corporation, that it must file Statement of Information by Domestic Stock Corporation [*Corp. Code § 1502(a)*]:

a. Containing following information:

NOTE:

The corporation must certify that the information it provides in this statement is true and correct. No claim may be made against the state for inaccurate information contained in this statement [*Corp. Code § 1502(j)*].

This statement will be available and open to the public for inspection. The Secretary of State is required by statute to provide access to all information contained in this statement by means of an online database [*Corp. Code § 1502(h)*].

(1) Street address of corporation's principal executive office.

(2) If principal executive office is not in California, street address of principal business office in California, if any.

(3) Corporation's mailing address, if different from street address of principal executive office.

(4) Names and complete business or residential addresses of chief executive officer, secretary, and chief financial officer.

(5) Names and complete business or residential addresses of incumbent directors.

(6) Number of vacancies on board of directors, if any.

(7) Statement of general type of business activity.

(8) Designation of agent for service of process.

NOTE:
If a natural person is designated as agent for service of process, the statement must include the person's complete business or residential street address. If a corporate agent is designated, no address is required [*Corp. Code § 1502(b)*]. For further discussion of agent for service of process, see *§§ 7.50-7.53* and *7.125*.

b. Within 90 days of filing its original articles of incorporation [*Corp. Code § 1502(a)*], by using Secretary of State Form SI 200 C [*see § 7.207[2]*].

NOTE:
Nonprofit corporations use a different form, Secretary of State Form SI 100, for all filings.

c. Annually thereafter [*Corp. Code § 1502(a)*], by using Secretary of State form SI 200 N/C [*see § 7.207A[2] see also § 7.207B* (corporate disclosure statement for publicly held corporations)].

NOTE:
The statement must be filed during the calendar month during which the original articles were filed or during the five months immediately preceding the filing month [*Corp. Code § 1502(a)*].

If the required information has not changed since the date of the last filed statement, the corporation may file a "no change" statement with the Secretary of State using Form SI 200 N/C [*Corp. Code § 1502(c)*; ***see*** *§ 7.207A[1][c]*].

d. Whenever corporation wants to change either its agent for service of process, or address of that agent, using [*Corp. Code § 1502(e)*], using Secretary of State form SI 200 C [*see § 7.207[2]*].

2. Advise client that corporation may file new complete statement, at corporation's option, whenever any information in current filed statement changes [*Corp. Code § 1502(e)*], using Secretary of State form SI 200 C [*see § 7.207[2]*].

3. Advise client that if domestic corporation is publicly traded, it must annually:

NOTE:

A "publicly traded corporation" is a corporation [*see Corp. § 162*] that (1) is an issuer as defined in Section 3 of the Securities Exchange Act [*see 15 U.S.C. § 78c*] and (2) has at least one class of securities listed or admitted for trading on a national securities exchange, on the OTC Bulletin Board, or the electronic service operated by Pink OTC Markets Inc. [*Corp. Code § 1502.1(b)(1)*].

a. Complete corporate disclosure statement containing following information [*Corp. Code § 1502.1(a)*; *see § 7.207B*]:

(1) Name of independent auditor that prepared most recent auditor's report on corporation's annual financial statements.

(2) Description of other services, if any, performed for corporation during its two most recent fiscal years and period between end of its most recent fiscal year and date of statement by independent auditor, by its parent corporation, or by or corporate affiliate of independent auditor or its parent corporation.

(3) Name of independent auditor employed by corporation on the date of the statement, if different from independent auditor referred to above.

(4) Compensation for most recent fiscal year paid to each board member and to each of five most highly compensated executive officers of corporation who are not board members, including number of any shares issued, options for shares granted, and similar equity-based compensation granted to each of those persons.

NOTE:

The term "executive officer" means means the chief executive officer, the president, any vice president in charge of a principal business unit, division, or function, any other officer of the corporation who performs a policy-making function, or any other person who performs similar policy-making functions for the corporation [*Corp. Code § 1502.1(b)(2)*]. The term "compensation" means all plan and nonplan compensation awarded to, earned by, or paid to the person for all services rendered in all capacities to the corporation and to its subsidiaries, as specified by Item 402 of SEC Regulation S-K [*Corp. Code § 1502.1(b)(3)*; ***see*** *17 C.F.R. § 229.402*]. If the chief executive officer is not among the five most highly compensated executive officers, the statement must include the compensation paid to chief executive officer anyway [*Corp. Code § 1502.1(a)(4)*].

(5) Description of any loan, including amount and terms, made to any board member by corporation during corporation's two most recent fiscal years at interest rate lower than interest rate available from unaffiliated commercial lenders generally to similarly situated borrower.

NOTE:

The term "loan" does not include an advance for reimbursable expenses, certain premium payments for life insurance, and any advance of litigation expenses [*Corp. Code § 1502.1(b)(4)*; ***see*** *Corp. Code §§ 315(d),(e), 317*].

(6) Statement indicating whether order for relief has been entered in bankruptcy case with respect to corporation, executive officers, or board members during 10 years preceding date of statement.

(7) Statement indicating whether any board member or executive officer was convicted of fraud during 10 years preceding date of statement, if conviction has not been overturned or expunged.

(8) Description of any material pending legal proceedings, other than ordinary routine litigation incidental to tusiness, to which corporation or any of its subsidiaries is party or of which any of their property is subject, as specified by Item 103 of SEC Regulation S-K [*see* 12 C.F.R. § 229.103].

(9) Description of any material legal proceeding during which corporation was found legally liable by entry of final judgment or final order that was not overturned on appeal during five years preceding date of statement.

b. File statement within 150 days after end of corporation's fiscal year [*Corp. Code § 1502.1(a)*], using prescribed forms [*see § 7.207B*].

[2] Failure to File; Suspension and Revivor

1. Advise client of following penalties for failure to file statement:

a. Within 60 days of Secretary of State's mailing of notice of deficiency: $250 [*Corp. Code § 2204(a), (b)*; *Rev. & Tax. Code § 19141*].

NOTE:
The penalty for failure to file is imposed by the Franchise Tax Board after the Secretary of State has certified the corporation's name to the Franchise Tax Board [*Corp. Code § 2204(a), (b)*; *Rev. & Tax. Code § 19141*].

b. For two successive years (if certified for penalty in filing period year): suspension of corporate powers [*Corp. Code § 2205(a)*].

NOTE:
On suspension, the corporation may take no action other than to file the statement or to amend its articles of incorporation to change its name [*Corp. Code § 2205(c), (d)*; ***see*** *Palm Valley Homeowners Assn., Inc. v. Design MTC (2000) 85 Cal. App. 4th 553, 560-561, 102 Cal. Rptr. 2d 350* (trial court did not abuse its discretion in imposing sanctions on law firm for continuing litigation activities on behalf of corporation that it knew to be suspended under *Corp. Code § 2205* for failure to file information statement required by *Corp. Code § 1502*)]. In addition, a suspended corporation may file an application for exempt status, and amend its articles of incorporation as necessary to perfect that application [*Corp. Code § 1502(c)*; ***see*** Ch. 13, ***Nonprofit Corporations***].

2. Advise client to take following steps to revive corporation on suspension by Secretary of State:

a. Satisfy monetary penalty assessed by Franchise Tax Board [*Corp. Code § 2204(b)*; *Rev. & Tax. Code § 19141*].

NOTE:
The corporation may request relief from the Secretary of State for failure to file resulting from reasonable cause or unusual circumstances. If the Secretary determines that failure to file was due to either of the two, it may waive the penalty and must decertify the corporation [*Corp. Code § 2204(a)*]. If the Secretary does not grant relief, the corporation has the right to pay the penalty under protest and to file a claim with the Franchise Tax

Board requesting relief [*Corp. Code § 2204(a)*].

b. File current Statement of Information by Domestic Stock Corporation with Secretary of State [*Corp. Code §§ 1502, 2205(d)*].

NOTE:
After the filing is completed, a proposed relief of suspension letter will be sent to the corporation. The corporation may provide this letter to the Franchise Tax Board and at the same time make a request for a revivor.

c. Apply to Franchise Tax Board for revivor:

(1) Application must be writing [*Rev. & Tax. Code § 23305*].

(2) Use form provided by Franchise Tax Board [*see* § 2.208].

(3) Application may be made by any of following [*Rev. & Tax. Code § 23305*]:
(a) Stockholder.

(b) Creditor.

(c) Majority of surviving trustees or directors.

(d) Officer.

(e) Other person having interest in relief from suspension.

d. Advise client that revivor may be denied if Franchise Tax Board has suspended corporation under *Rev. & Tax. Code § 23301, 23301.5,* or *23775* [*see § 7.42[4]*].

e. Advise client that revivor may be denied if corporation's name is no longer available.

NOTE:
On approval of the application for Certificate of Revivor, the Franchise Tax Board will forward to the Secretary of State a request that the corporation be revived [*Rev. & Tax. Code § 23305a*]. If the name is still available for corporate use, the Secretary of State notifies the Franchise Tax Board that the corporation has been revived. If the name is no longer available because of a conflict with the name of an active corporation, the revivor is denied and the Franchise Tax Board is notified of the denial [*Rev. & Tax. Code § 23305a*; ***see*** *Boyer v. Jones (2001) 88 Cal. App. 4th 220, 221-222, 105 Cal. Rptr. 2d 824* (holding that name of suspended corporation may be reserved and adopted by another corporation during period of suspension, and affirming trial court's denial of suspended corporation's petition for writ of mandate seeking restoration of its name)]. The Franchise Tax Board then notifies the corporation of the denial and suggests contacting the Secretary of State.

f. If corporate name is no longer available, advise client to [*see Rev. & Tax. Code § 23305a*]:

(1) Amend corporate name [*see Corp. Code § 201* (names available to domestic corporations)].

(2) Submit new revivor request to Franchise Tax Board.

NOTE:

Amendment of the corporate name, filed with the Secretary of State, enables the corporation to solicit the Franchise Tax Board to send a new revivor request to the Secretary of State under the changed corporate name [***see*** *Rev. & Tax. Code §§ 23305a, 23305c*]. See Ch. 2, ***Formation of Corporations*** **,** for procedures to amend the corporate name.

g. Advise client that Certificate of Revivor issued by Franchise Tax Board is prima facie evidence that corporation has been revived [*Rev. & Tax. Code § 23305a*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawCorporationsFinanceFranchise TaxPenalties for NoncomplianceBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-7 California Legal Forms--Transaction Guide § 7.125

§ 7.125 Agent for Service of Process

1. Advise domestic corporate client or foreign corporate client transacting intrastate business that it must designate agent for service of process [*Corp. Code §§ 202(c), 1502(b), 2117(b)*; *see Corp. Code § 191* ("transact intrastate business" defined)].

NOTE:
As an artificial entity, a corporation cannot be served with process; it can be served only through one of its officers or agents or a party designated by law to receive service on its behalf [*Cannon v. American Hydrocarbon Corp. (1970) 4 Cal. App. 3d 639, 652, 84 Cal. Rptr. 575* ; ***see*** *Code Civ. Proc. §§ 416.10-416.30* (persons who may be served on corporation's behalf)].

2. Advise corporate client that agent may be either:

a. Natural person residing in California [*Corp. Code § 1502(b)*]; or

NOTE:
If a natural person is designated, the statement must set forth that person's complete business or residential street address [*Corp. Code § 1502(b)*].

b. Corporation that [*Corp. Code §§ 1502(b), 1505(c)*]:

(1) Is authorized to do business in California.

(2) Is in good standing on Secretary of State's records.

(3) Has filed certificate containing specified information [*see Corp Code § 1505*

(required certificate); *see also Ch. 3, Articles of Incorporation, § 3.211*; *Ch. 12B, Foreign Corporations, § 12B.204* (forms)] and capacity to act as an agent has not been terminated [*Corp. Code §§ 1502(b)* (domestic corporation), 2117(b) (foreign corporation)].

3. Advise corporate client to make designation of agent for service of process as follows:

a. For domestic corporation:

(1) Articles of incorporation must designate name and California address of corporation's initial agent for service of process [*Corp. Code § 202(c)*; *see Corp. Code § 1502(b)* (requirements)].

(2) Annual Statement of Information by Domestic Corporation must designate corporation's agent for service of process [*Corp. Code § 1502(b)*; *see §§ 7.207, 7.207A* (statements of information for domestic corporations)].

b. For foreign corporations:

(1) Agent for service of process must be designated in statement and designation that foreign corporations must file with Secretary of State [*Corp. Code § 2105(a)(4), (5)*; *see Ch. 12B, Foreign Corporations, §§ 12B.201-12B.201B* (forms)].

(2) Annual Statement of Information by Foreign Corporation filed with Secretary of State must also designate corporation's agent for service of process [*Corp. Code § 2117(b)*; *see Ch. 12B, Foreign Corporations, § 12B.210* (form)].

4. Advise corporate client that if agent resigns or is unable to serve, it must appoint new agent [*Corp. Code § 1504*].

NOTE:

If the natural person designated as agent for service of process dies, resigns, or no longer resides in California, or if the corporate agent resigns, dissolves, withdraws from California, forfeits its right to transact intrastate business, has its corporate rights, powers, and privileges suspended, or ceases to exist, the corporation must file a designation of a new agent conforming to the statutory requirements [*Corp. Code §§ 1504, 2107* (foreign corporations); ***see*** *Corp. Code § 1502(b)* (requirements)]. If the agent for service of process resigns, the Secretary of State must mail written notice of the filing of the statement of resignation to the corporation at its principal executive office [*Corp. Code § 1503(a)*]. The corporation must appoint another agent for service of process on receipt of the notice [*Corp. Code §§ 1504, 2107*].

5. Advise corporate client that if it wants to change either its agent for service of process, or address of that agent, it must file new Statement of Information by Domestic Stock Corporation [*Corp. Code § 1502(e)*], using Secretary of State form SI 200 C [*see § 7.207[2]*].

6. Advise corporate client that if corporation itself is agent for service of process, it must file certificate with Secretary of State, setting forth all of following [*Corp. Code § 1505(a)*; *see also Corp. Code § 2105(c)* (foreign corporations)]:

a. Complete address of corporation's California office(s) where process may be served.

b. Names of employees at each office to whom the corporation authorizes delivery of process.

c. Corporation's consent that delivery to any designated employee at office where the person is

employed constitutes delivery of process.

NOTE:

Because this certificate sets forth the corporation's address, its address is not required on the Statement of Information by Domestic Stock Corporation [***see*** *Corp. Code § 1502(b)*] or on the annual statement filed by foreign corporation with the Secretary of State [***see*** *Corp. Code § 2117(b)*]. Refer to Ch. 3, ***Articles of Incorporation,*** (domestic corporations) and to Ch. 12B, ***Foreign Corporations,*** for detailed discussion and a sample of the certification form.

7. Advise any corporate client serving as agent for service of process that it may resign by filing signed, acknowledged written statement of resignation with Secretary of State [*Corp. Code § 1503(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawForeign BusinessesQualificationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-7 California Legal Forms--Transaction Guide §§ 7.126-7.199

[Reserved]

§§ 7.126[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART IV. FORMS

4-7 California Legal Forms--Transaction Guide § 7.200

§ 7.200 Shareholder's Request for Delinquent Annual Report

[1] Comment

[a] Use of Form

This form is a written request for a corporation's annual report. It is to be used if the corporation is delinquent in sending the report to shareholders. Except for corporations with fewer than 100 shareholders whose bylaws expressly waive this requirement, every domestic corporation and any foreign corporation subject to California record keeping requirements must send its shareholders an annual report [*Corp. Code §§ 1501(a)(1), (g), 2115(b)*]. This requirement may not be waived in a close corporation's shareholders' agreement [*Corp. Code § 300(c)*].

The annual report must be sent to shareholders no later than 120 days after the close of the fiscal year [*Corp. Code § 1501(a)(1)*]. The 120 days may be extended for good cause by a court [*Corp. Code § 1501(e)*]. Further, the report must be sent to shareholders at least 15 days before the annual shareholders' meeting if sent by first- class mail, or at least 35 days before the meeting if sent by third-class mail [*Corp. Code § 1501(a)(1)*].

For a form requesting a corporation's financial statements under *Corporations Code Section 1501(c)*, see *Section 7.201*.

[b] Enforcement of Shareholders' Rights to Annual Report

The shareholders' right to financial statements may be enforced by suit in the superior court of the proper county [*Corp. Code § 1501(e)*; *see Corp. Code § 177* ("proper county" defined)]. If the court finds the corporation's failure to comply with the requirements of the General Corporation Law is without justification, the court may award reasonable expenses, including attorneys' fees, to the shareholder [*Corp. Code § 1501(f)*].

In addition, failure to prepare the information and financial statements required by the General Corporation Law may subject the corporation to monetary penalties [*Corp. Code § 1501(e)*; *see Corp. Code §§ 1501* (required information and statements), 2200 (penalties)]. For further discussion of penalties, see *Sections 7.13[1]* and *7.120[2]*.

[2] FORM

Shareholder's Request for Delinquent Annual Report

SHAREHOLDER'S REQUEST FOR DELINQUENT ANNUAL REPORT
_____[*date*]
_____[*name of corporation*]
_____[*street address*]
_____[*city, state, zip*]

Re: Annual Report for _____ [*name of corporation*] for fiscal year ended _____ [*date*]
To whom it may concern:

I, the undersigned, am a shareholder of _____[*name of corporation*], holding [*number*] shares of its [common *or* preferred] stock.

I have determined that the corporation has sent no annual report to shareholders for the fiscal year ended _____[*date*]. Further, more than 120 days have elapsed since the close of that fiscal year.

Therefore, in accordance with *California Corporations Code Section 1501(a)*, I request that you deliver or mail to me the required Annual Report for _____[*name of corporation*] for the fiscal year ended _____[*date*].

A shareholder's right to the Annual Report may be enforced by suit in superior court. If the court finds the corporation's failure to comply with the requirements of the General Corporation Law is without justification, the court may award reasonable expenses, including attorneys' fees, to the shareholder. Failure to prepare the Annual Report may also subject the corporation to monetary penalties.

I look forward to your prompt response.

Very truly yours,
_____ [*signature of shareholder*]
_____ [*typed name*]
_____ [*street address*]
_____ [*city, state, zip code*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsRemediesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsFinanceFranchise TaxPenalties for NoncomplianceBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersActions Against CorporationsCosts & Attorney Fees



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART IV. FORMS

4-7 California Legal Forms--Transaction Guide § 7.201

§ 7.201 Shareholder's Request for Financial Statements in Lieu of Annual Report

[1] Comment

[a] Use of Form

This form is a written request by a shareholder for the required financial statements for the preceding fiscal year when no annual report has been sent to the shareholders. If no annual report for the preceding fiscal year has been sent to shareholders, the corporation must, on written request of any shareholder, deliver or mail to the person making the request the financial statements required in the annual report [*Corp. Code § 1501(c)*; *see Corp. Code § 1501(a)*; *see also § 7.32 [2]*]. The request must, however, be made more than 120 days after the close of the fiscal year for which no annual report was sent to shareholders. The corporation has 30 days after the request is made to send the financial information [*Corp. Code § 1501(c)*].

[b] Corporations Subject to Requirement

The requirements of sending financial statements under *Corporations Code Section 1501(c)* apply to every domestic corporation and to any foreign corporation having its principal executive office in California or customarily holding board of director meetings in California [*Corp. Code § 1501(g)*].

[2] FORM

Shareholder's Request for Financial Statements in Lieu of Annual Report

SHAREHOLDER'S REQUEST FOR FINANCIAL STATEMENTS IN LIEU OF ANNUAL REPORT
_____[*date*]
_____[*name of corporation*]
_____[*street address*]
_____[*city, state, zip*]

Re: Financial Statements in Lieu of Annual Report for _____ [*name of corporation*] for fiscal year

ended _____ [*date*]
To whom it may concern:

I, the undersigned, am a shareholder of _____[*name of corporation*], holding [*number*] shares of its [common *or* preferred] stock.

I have determined that the corporation has sent no annual report to shareholders for the fiscal year ending _____[*date*]. Further, more than 120 days have elapsed since the close of that fiscal year.

Therefore, in accordance with *California Corporations Code Section 1501(c)*, I request that you deliver or mail to me, within 30 days, the financial statements required by *California Corporations Code Section 1501(a)* for the fiscal year ending _____[*date*]. These financial statements should include a balance sheet and income statement as of the end of the fiscal year, a statement of cashflows for that fiscal year, and a report of independent accountants, if any, or a certificate of an authorized corporate officer that the financial statements were prepared without audit of the corporation's books and records.

Thank you for your prompt attention.

Sincerely,
_____ [*signature*]
_____ [*typed name*]
_____ [*street address*]
_____ [*city, state, zip code*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsRemediesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART IV. FORMS

4-7 California Legal Forms--Transaction Guide § 7.202

§ 7.202 Shareholder's Request for Quarterly Financial Statements

[1] Comment

[a] Use of Form

This form is a shareholder's request for quarterly financial statements. It should be used only by a shareholder or group of shareholders holding at least 5 percent of the outstanding shares of any class of stock to request certain financial statements that are not required to be routinely issued to all shareholders [*see Corp. Code § 1501(c)*]. These financial statements include a balance sheet and an income statement for the three-month, six-month or nine-month period of the current fiscal year ended at least 30 days before the request [*Corp. Code § 1501(c), (d)*]. The quarterly reports must be mailed or delivered to the requesting shareholder within 30 days of the request [*Corp. Code § 1501(c)*].

If a report of independent accounts is available [*see Corp. Code § 115* ("independent accountants" defined)], the report must accompany the quarterly financial reports; otherwise the reports must be accompanied by the certificate of an authorized corporate officer that the financial statements were prepared without audit of the corporation's books and records [*Corp. Code § 1501(d)*].

[b] Corporations Subject to Requirement

The requirements of sending quarterly financial statements under *Corporations Code Section 1501(c)* apply to every domestic corporation and to any foreign corporation having its principal executive office, or customarily holding meetings of its board of directors, in California [*Corp. Code § 1501(g)*].

[2] FORM

Shareholder's Request for Quarterly Financial Statements

SHAREHOLDER'S REQUEST FOR QUARTERLY FINANCIAL STATEMENTS
_____[*date*]
_____[*name of corporation*]

_____[*street address*]
_____[*city, state, zip*]

Re: Quarterly Financial Statements for _____ [*name of corporation*] for fiscal year ended _____ [*date*]

To whom it may concern:

The undersigned are shareholders of _____[*name of corporation*], holding at least 5 percent of its outstanding shares.

You are requested to prepare and mail or deliver to the undersigned, within 30 days of the date of this notice, the following:

1. An income statement of the corporation for the [three-month *or* six-month *or* nine-month] period between the end of the preceding fiscal year and the end of _____[*calendar month preceding date of written request*].

2. A balance sheet of the corporation for the [three-month *or* six-month *or* nine-month] period between the end of the preceding fiscal year and the end of _____[*calendar month preceding date of written request*].

3. A report of any independent accountants engaged by the corporation, or if there is no such report, a certificate of an authorized officer of the corporation that the balance sheet and income statement were prepared without audit from the books and records of the corporation.

Thank you for your prompt attention.

Very truly yours,

[*For each shareholder, use:*]

_____ [*signature*]
_____ [*typed name*]
_____ [*number of shares held*]
_____ [*street address*]
_____ [*city, state, zip code*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART IV. FORMS

4-7 California Legal Forms--Transaction Guide § 7.203

§ 7.203 Shareholder's Demand to Inspect Corporate Records

[1] Comment

[a] Use of Form

This form is a demand to inspect records. It should be used by a shareholder or holder of a voting trust certificate to demand inspection of the record of shareholders, the corporate accounting books and records, or the minutes of the corporate proceedings. The demand should specify the corporate records requested for inspection and the reason for inspection since inspection must be for a purpose reasonably related to the interests of the shareholder or holder of a voting trust certificate [*see Corp. Code §§ 1600(c), 1601(a)*].

[b] Right to Inspect

On written demand and "for a purpose reasonably related to such holder's interests as a shareholder or as the holder of such voting certificate" [*Corp. Code § 1601(a)*; *see § 7.20[1][c]* (discussion of limitations)], any shareholder or holder of a voting trust certificate may inspect, copy, or make extracts from the corporation's accounting books and records and minutes of the proceedings of shareholders, board of directors, and board committees [*Corp. Code § 1601*]. Shareholder status, however, does entitle an individual to unfettered access to corporate confidences and secrets, such as documents protected by the attorney-client privilege [*see, e.g., NFL Properties Inc. v. Superior Court (1998) 65 Cal. App. 4th 100, 107-108, 75 Cal. Rptr. 2d 893* (Raiders football club, as plaintiff in shareholder's suit against National Football League, did not have right to inspect NFL merchandising corporation's documents protected by attorney-client privilege)].

Inspection, copying, and extracting may be made in person or by an agent or attorney [*Corp. Code § 1601(b)*], at any time during usual business hours [*Corp. Code § 1601(a)*]. These rights of inspection may not be limited by the articles of incorporation or bylaws [*Corp. Code § 1600(b)*], and the corporation may not thwart the exercise of these rights by failing to respond to proper requests, by sending communications that make further requests futile, or by actions impeding the inspection process. However, the corporation is required only to allow inspection at corporate office. It is not required to mail or otherwise provide copies, and is not required to respond to demands for disclosure falling outside scope of what is required by statute [*Jara v. Suprema Meats, Inc. (2004) 121 Cal. App. 4th 1238, 1263-1265, 18 Cal.*

Rptr. 3d 187] .

On demand for inspection, any records not maintained in written form must be made available in writing, at the corporation's expense [*Corp. Code § 1605*].

[c] Corporations Subject to Requirement

A shareholder's statutory right to inspect accounting books, records, and minutes of the proceedings of shareholders, board of directors, and board committees extends to every domestic corporation and to any foreign corporation described in *Corp. Code § 2115(a)*, and any other foreign corporation that keeps such records in California, or has its principal executive office in California [*Corp. Code § 1601(a)*]. The right of inspection also extends to subsidiaries of the above-described corporations [*Corp. Code § 1601(a)*; *see Corp. Code § 189* ("subsidiary" defined)].

A shareholder's statutory right to inspect the shareholder record extends to any domestic corporation and any foreign corporation that has its principal executive office in California or that customarily holds meetings of its board of directors in California [*Corp. Code § 1600(d)*].

[2] FORM

Shareholder's Demand to Inspect Corporate Records

SHAREHOLDER'S DEMAND TO INSPECT CORPORATE RECORDS
_____[*date*]
_____[*name*]
[*title*]
_____[*name of corporation*]
_____[*street address*]
_____[*city, state, zip*]

Re: Demand to Inspect _____ [*name of corporate record*] of _____ [*name of corporation*]
Dear _____ [*name of corporate agent*]:

I, the undersigned, am a shareholder of _____[*name of corporation*] holding [*number*] shares of the [common *or* preferred] stock represented by certificates numbered _____.

I wish to inspect the [*describe corporate record, e.g.,* record of shareholders] on _____[*date*], at [*time*], at the address listed above.

The purpose of this inspection is _____[*e.g.,* to determine the number of outstanding shares and the names and addresses of holders in order to give notice of a special shareholders' meeting].

I request that you comply with the demand for inspection in accordance with *California Corporations Code Sections 1600* and *1601*. If the inspection cannot be made at the above time and place, you are requested to notify me by return mail of the time and place at which the inspection can be made.

Thank you for your prompt attention.

Sincerely,
_____ [*signature*]

[*typed name*]
_____ [*number of shares held*]
_____ [*street address*]
_____ [*city, state, zip code*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART IV. FORMS

4-7 California Legal Forms--Transaction Guide § 7.204

§ 7.204 Certain Shareholders' Demand to Inspect Record of Shareholders

[1] Comment

[a] Use of Form

This form is a demand on the corporation to inspect the corporation's record of shareholders. It should be used only by a shareholder or group of shareholders meeting the requisite requirements [*see* [b], *below*] to make a demand to inspect or copy the record of shareholders. The demand must be made in writing at least five business days before the date the shareholder desires to inspect or copy the record of shareholders [*see Corp. Code § 1600(a)*]. Although this form is drafted for use by several shareholders who, in the aggregate, hold at least 5 percent of the outstanding voting shares of a corporation, it may be easily adapted for use by an individual shareholder.

[b] Absolute Right to Inspect

A shareholder or group of shareholders holding at least 5 percent of the outstanding voting shares, or at least 1 percent of the voting shares subject to certain federal regulations, has an absolute right to inspect and copy the record of shareholders, in person or by agent or attorney on five days' prior written demand [*Corp. Code § 1600(a)*]. *Corp. Code § 1600(a)* refers to shareholders who have filed a Schedule 14A or, in the case of banks with deposits insured under the Federal Deposit Insurance Act, a Form F-6 [*see 17 C.F.R. § 240.14a-11(c)*]. In contrast, inspection by a shareholder who does not meet the requirements set forth above must be for a purpose reasonably related to the interests of the shareholder [*see Corp. Code § 1600(c)*; *see also §§ 7.20[3][a]*, *7.205*].

The absolute right to inspect the record of shareholders may not be limited by a corporation's articles of incorporation or bylaws [*Corp. Code § 1600(d)*]. If a corporation delays in complying with a lawful demand for inspection, the shareholder may seek a court order postponing any shareholders' meeting previously noticed for a period equal to the period of the delay [*see Corp. Code § 1600(b)*].

[c] Corporations Subject to Requirement

The requirements regarding a demand on the corporation for inspecting the record of shareholders applies to any

domestic corporation and to any foreign corporation having its principal executive office in California or customarily holding meetings of its board of directors in this state [*Corp. Code § 1600(d)*].

[2] FORM

Certain Shareholders' Demand to Inspect Record of Shareholders

CERTAIN SHAREHOLDERS' DEMAND TO INSPECT RECORD OF SHAREHOLDERS
_____[*date*]
_____[*name*]
[*title*]
_____[*name of corporation*]
_____[*street address*]
_____[*city, state, zip*]

Re: Demand to Inspect Record of Shareholders of _____ [*name of corporation*]
Dear _____ [*name of corporate agent*]:

[*Choose one of following paragraphs:*]

[*If shareholders hold 5 percent in aggregate of outstanding stock, use:*]

We, the undersigned, are shareholders of _____[*name of corporation*], and hold at least 5 percent in the aggregate of the outstanding voting shares of this corporation.

[*OR*]

[*If shareholders hold 1 percent in aggregate of outstanding stock and Schedule 14A has been filed with Securities and Exchange Commission, use:*]

We, the undersigned, are shareholders of _____[*name of corporation*], and hold at least 1 percent of the outstanding voting shares of this corporation and have filed a Schedule 14A with the United States Securities and Exchange Commission.

[*OR*]

[*If shareholders hold 1 percent in aggregate of outstanding stock of corporation that is a bank with federally insured deposits, use:*]

We, the undersigned, are shareholders of _____[*name of corporation*], and hold at least one percent of the outstanding voting shares of this corporation and have filed a Form F-6 with the appropriate federal bank agency.

[*CONTINUE*]

This letter provides notice that _____[*name of shareholder, agent, or attorney*], on behalf of the undersigned, will inspect and copy the record of shareholders on _____[*date at least five business days after date of demand*], at _____[*time during usual business hours*], at the above address.

This demand for inspection is made in accordance with *Corporations Code Section 1600(a)*.

Thank you for your attention.

Very truly yours,
[*For each shareholder, use:*]
_____ [*signature*]
[*typed name*]
_____ [*number of shares held*]
_____ [*street address*]
_____ [*city, state, zip code*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART IV. FORMS

4-7 California Legal Forms--Transaction Guide § 7.205

§ 7.205 Shareholders' Demand on Transfer Agent for List of Shareholders

[1] Comment

[a] Use of Form

This form is a demand on a corporation's transfer agent for the corporation's list of shareholders. It should be used only by a shareholder or group of shareholders meeting the requisite requirements [*see* [b], *below*] to make a written demand on the transfer agent for the names, addresses, and shareholdings of shareholders who are entitled to vote for the election of directors. Although this form is drafted for use by shareholders who, in the aggregate, hold at least 5 percent of the outstanding voting shares of a corporation, it may be easily adapted for use by an individual shareholder.

[b] Absolute Right to List

A shareholder or group of shareholders holding at least 5 percent of the outstanding voting shares, or at least 1 percent of the voting shares subject to certain federal regulations [*see § 7.204[1][b]*], has an absolute right to obtain from the corporation's transfer agent a list of the names and addresses of the shareholders who are entitled to vote for the election of directors, and their shareholdings as of the most recent record date for which it has been compiled or as of a date specified by the shareholder subsequent to the date of demand [*Corp. Code § 1600(a)*].

The shareholder must make a written demand on the transfer agent for the list and pay the required fee [*see Corp. Code § 1600(a)*]. The list must be made available on or before the later of five business days after the date the demand is received or the date specified in the demand as the date as of which the list is to be compiled [*Corp. Code § 1600(a)*]. A corporation is responsible for causing its transfer agent to comply with this requirement [*Corp. Code § 1600(a)*]. If the corporation or its transfer agent delays in complying with a lawful demand beyond the specified time limit, the shareholder may seek a court order postponing any shareholders' meeting previously noticed for a period equal to the period of the delay [*see Corp. Code § 1600(b)*].

[c] Corporations Subject to Requirement

The requirements regarding a demand on the corporate transfer agent for inspecting the record of shareholders applies to

any domestic corporation and to any foreign corporation having its principal executive office in California or customarily holding meetings of its board of directors in this state [*Corp. Code § 1600(d)*].

[2] FORM

Shareholders' Demand on Transfer Agent for List of Shareholders

SHAREHOLDERS' DEMAND ON TRANSFER AGENT FOR LIST OF SHAREHOLDERS
_____[*date*]
_____[*name of transfer agent*]
[*title*]
_____[*name of corporation*]
_____[*street address*]
_____[*city, state, zip code*]

Re: Demand for List of Shareholders of _____ [*name of corporation*]
Dear _____ [*name of transfer agent*]:

[*Choose one of following paragraphs:*]

[*If shareholders hold 5 percent in aggregate of outstanding stock, use:*]

We, the undersigned, are shareholders of _____[*name of corporation*], and hold at least 5 percent in the aggregate of the outstanding voting shares of this corporation.

[*OR*]

[*If shareholders hold 1 percent in aggregate of outstanding stock and Schedule 14A has been filed with Securities and Exchange Commission, use:*]

We, the undersigned, are shareholders of _____[*name of corporation*], and hold at least 1 percent of the outstanding voting shares of this corporation and have filed a Schedule 14A with the United States Securities and Exchange Commission.

[*OR*]

[*If shareholders hold 1 percent in aggregate of outstanding stock of corporation that is a bank with federally insured deposits, use:*]

We, the undersigned, are shareholders of _____[*name of corporation*], and hold at least 1 percent of the outstanding voting shares of this corporation and have filed a Form F-6 with the appropriate federal bank agency.

[*CONTINUE*]

We request a list of the names, addresses, and shareholdings of the shareholders of _____[*name of corporation*] who are entitled to vote for the election of directors, compiled as of _____[*specify most recent record date for which list has been complied or any other date after date of demand*].

We further request that this list be made available to the undersigned on or before _____[*specify date as of which list is to be compiled, at least five business days after demand will be received by transfer agent*].

Payment of $_____ is enclosed as the required fee for the list.

This demand for the list of shareholders is made in accordance with *Corporations Code Section 1600(a)*.

Thank you for your prompt attention.

Very truly yours,
[*For each shareholder, use:*]
_____ [*signature*]
[*typed name*]
_____ [*number of shares held*]
_____ [*street address*]
_____ [*city, state, zip code*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART IV. FORMS

4-7 California Legal Forms--Transaction Guide § 7.206

§ 7.206 Director's Notice of Inspection of Corporate Records or Property

[1] Comment

[a] Use of Form

This form is a director's notice to inspect corporate records or property. Although no written demand is required of a director before inspecting corporate records, it may conserve the time of both the director and management if the director sends a written demand specifying the date and time of inspection and the records to be inspected. This assures that the records will be readily available to the director and this form is designed for that purpose. Because there is no statutory requirement of notice or written demand on the director's part, there is no designated person to whom the notice should be addressed. However, a corporate officer, often the corporate secretary, commonly is responsible for keeping and maintaining the minutes and other corporate records.

[b] Inspection Rights of Directors

Every director has the absolute right, at any reasonable time, to inspect and copy all books, records, and documents of every kind, and to inspect the physical properties of the corporation of which that person is a director, and also of its domestic and foreign subsidiaries [*Corp. Code § 1602*; *but see NFL Properties Inc. v. Superior Court (1998) 65 Cal. App. 4th 100, 109-110, 75 Cal. Rptr. 2d 893* (if director sues in capacity as shareholder rather than director, attorney-client and work product privileges are properly upheld by corporation)]. This inspection by a director may be made in person, by agent, or by attorney, and the right of inspection includes the right to made extracts [*Corp. Code § 1602*]. This right of inspection extends to the directors of any foreign corporation having its principal executive office in California or customarily holding meetings of its board in this state [*Corp. Code § 1602*].

Although a court may impose just and proper conditions on a director's "absolute right" of inspection in an egregious case [*see Havlicek v. Coast-To-Coast Analytical Services, Inc. (1995) 39 Cal. App. 4th 1844, 1854-1856, 46 Cal Rptr. 2d 696]* , this principle should only be applied in extreme circumstances in which a preponderance of the evidence establishes a director's clear intent to use documents to commit a tort against the corporation [*Saline v. Superior Court (2002) 100 Cal. App. 4th 909, 915-916, 122 Cal. Rptr. 2d 813]* .

A corporate director does not have the right to access documents that are covered by the attorney-client privilege and were generated in defense of a suit for damages that the director filed against the corporation [*Tritek Telecom, Inc. v. Superior Court (2009) 169 Cal. App. 4th 1385, 1391-1392, 87 Cal. Rptr. 3d 455]* .

[2] FORM

Director's Notice of Inspection of Corporate Records or Property

DIRECTOR'S NOTICE OF INSPECTION OF CORPORATE RECORDS OR PROPERTY
_____[*date*]
_____[*Name of corporate agent*]
[*Title*]
_____[*Name of corporation*]
_____[*street address*]
_____[*city, state, zip code*]

Re: Demand to Inspect [*specify corporate record or* records *or* property] of _____ [*name of corporation*]
Dear _____ [*name of corporate agent*]:

[*If inspection of corporate records is desired:*]

Please take notice that I, the undersigned, _____[*name*], will inspect the corporate books and records relating to [*e.g.*, the financial transactions of the corporation during the past six months], on _____[*date*] at [*time*] at the above address. [*If appropriate, add:* The inspection will include all of the books, records, and documents, of every kind relating to the above matter.] You are requested to have these records available at the above time and place.

[*OR*]

[*If inspection of corporate property is desired:*]

Please take notice that I, the undersigned, _____[*name*], will inspect [*specify corporate property*], on _____[*date*] at [*time*] at _____[the above address *or specify other location*].

[*Continue with following:*]

Thank you for your attention.

Sincerely,
_____ [*signature*]
_____ [*typed name*]
Director of [*name of corporation*]
_____ [*street address*]
_____ [*city, state, zip code*]
_____ [*telephone number*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsDirectors



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART IV. FORMS

4-7 California Legal Forms--Transaction Guide § 7.207

§ 7.207 Statement of Information by Domestic Stock Corporation--Initial Statement or Change to Previously Filed Statement

[1] Comment

[a] Use of Form

This form is Secretary of State Form SI 200 C, Statement of Information by Domestic Stock Corporation, also sometimes referred to as the Statement of Officers. This form should be used by a corporation that is filing an initial statement or changing information in a previously filed statement *other than during the annual filing period* [*see Corp. Code § 1502(a), (e)*]. The form is reproduced here, along with the text of the Secretary of State's official instructions. If the corporation is a publicly traded company, the corporation must also file a corporate disclosure statement [*see Corp. Code § 1502.1*; *see also § 7.207B*].

A corporation that is filing either a complete or "no change" annual statement [*see Corp. Code § 1502(a), (c)*] should use Secretary of State Form SI 200 N/C, which is reproduced in this publication in § 7.207A.

This form should not be used by nonprofit corporations. Nonprofit corporations should use Secretary of State Form SI 100. Separate filing requirements apply to foreign corporations. For discussion of those requirements, and appropriate forms, see Ch. 12B, *Foreign Corporations* .

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.sos.ca.gov/business/bpd_forms.htm#corp . You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 3405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 7.207. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Initial and Annual Filings

A Statement of Information by Domestic Stock Corporation is due within 90 days after the corporation's original articles of incorporation are filed [*Corp. Code § 1502(a)*; *see Gov. Code § 12183(g) (fee)*; *see also Corp. Code § 1502(i) (fee)*]. This form should be used to make the initial filing. Thereafter, a statement must be filed annually [*Corp. Code § 1502(a), (d)*; *see Gov. Code § 12183(g) (fee)*; *see also Corp. Code § 1502(i) (fee)*]. This form should *not* be used for subsequent annual filings, and Form SI 200 N/C [*see § 7.207A*] must be used instead. For additional discussion of the annual filing requirements, see *§ 7.207A[2]*.

[c] Optional Filings

Changes to the information contained in the last filed statement may be made at any time (other than during the annual filing period) by filing a new complete statement. This form should be used to make such a filing. Such a statement supersedes any previously filed statement [*see Corp. Code § 1502(e)*].

[d] Change of Agent or Agent's Address

To change its agent for service of process or the agent's address, the corporation *must* file a current complete statement. Unlike the optional nature of the filing process noted in [c], *above*, this filing is mandatory; the corporation should not wait for its usual annual filing to update this information. This form should be used to make such a filing. When an updated statement is filed, it supersedes any previously filed statement and the statement in the articles of incorporation as to the agent for service of process and the address of the agent [*Corp. Code § 1502(e)*].

[e] Contents of Form

The Statement of Information by Domestic Stock Corporation must set forth the following [*Corp. Code § 1502(a)*]:

- The street address of the corporation's principal executive office.
- The corporation's mailing address, if different from the street address of its principal executive office.
- If the corporation's principal executive office is not in California, the street address of the corporation's principal business office in California, if any.
- The names and complete business or residential addresses of the corporation's chief executive officer, secretary, and chief financial officer.
- The names and complete business or residential addresses of the incumbent directors.
- The number of vacancies on the board of directors, if any.
- A statement of the general type of business that constitutes the corporation's principal business activity.

The statement must also designate an agent for service of process. The designation may be of a natural person residing in California or a corporation that has complied with the statutory requirements [*Corp. Code § 1502(b)*; *see Corp. Code § 1505* (requirements)]. If a natural person is designated, the statement must include the person's complete business or residential street address. If a corporate agent is designated, no address is required [*Corp. Code § 1502(b)*].

If the information in the statement last filed with the Secretary of State has not changed, the corporation may merely check the box indicating that no changes have occurred during the applicable filing period, instead of completing the entire statement [*Corp. Code § 1502(c)*].

For further discussion of agent for service of process, see *§§ 7.50-7.53*.

A corporation may, but is not required to, file an updated Statement of Information by Domestic Stock Corporation, between filings, if there are other changes to the information provided on the statement [*Corp. Code § 1502(e)*; *see* [c], *above*].

[f] Statement Subject to Public Inspection

Statements of Information by Domestic Stock Corporations will be held available and open to the public for inspection. The Secretary of State is required by statute to provide access to all information contained in this statement by means of an online database [*Corp. Code § 1502(h)*].

[2] FORM

Statement of Information by Domestic Stock Corporation--SOS Form SI-200C

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsMinimum Requirements for Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsGeneral OverviewCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART IV. FORMS

4-7 California Legal Forms--Transaction Guide § 7.207A

§ 7.207A Statement of Information by Domestic Stock Corporation--Complete or No-Change Annual Statement

[1] Comment

[a] Use of Form

This form is Secretary of State Form SI 200 N/C, Statement of Information by Domestic Stock Corporation, also sometimes referred to as the Statement of Officers. This form should be used by a corporation when filing either a complete or "no change" annual statement [*see* Corp. Code. § 1502(a), (c)]. The form is reproduced here, along with the text of the Secretary of State's official instructions.

A corporation that is filing an initial statement or changing information in a previously filed statement, *other than during the annual filing period*, should use Secretary of State Form SI 200 C, which is reproduced in this publication in § 7.207.

This form should not be used by nonprofit corporations. Nonprofit corporations should use Secretary of State Form SI 100 [*see Ch. 13, Nonprofit Corporations, § 13.248*]. Separate filing requirements apply to foreign corporations. For discussion of those requirements, and appropriate forms, see Ch. 12B, *Foreign Corporations* .

For additional discussion of the contents and requirements governing the Statement of Information by Domestic Stock Corporations, see *§ 7.207*.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.sos.ca.gov/business/bpd_forms.htm#corp . You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 7.207A. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Annual Filing Procedure

The time period and procedure for filing the initial Statement of Information by Domestic Stock Corporation is discussed in *§ 7.207*. After the initial filing, a statement must be filed annually thereafter [*Corp. Code § 1502(a)*; *see Gov. Code § 12183(g) (fee)*; *see also Corp. Code § 1502(i) (fee)*]. The statement must be filed in the calendar month during which the original articles were filed or during the five months immediately preceding the filing month [*Corp. Code § 1502(d)*].

Approximately three months before the annual Statement of Information by Domestic Stock Corporation is due, the Secretary of State will mail a notice reminding a corporation of it's obligation to comply with the annual filing requirement, and of the due date for filing. The notice must be mailed to the corporation's most recent address according to the Secretary's records. Failure to receive the notice is no excuse for failing to file the Statement on time [*Corp. Code § 1502(d)*]. For discussion of failure to file the Statement of Information by Domestic Stock Corporation, see *§§ 7.41* and *7.208* (Application for Certificate of Revivor).

[c] "No Change" Filings

If there has been no change in the information in the last filed statement, the corporation, in lieu of filing a new annual statement, may advise the Secretary of State, on a form prescribed by the Secretary, that no changes in the required information have occurred during the applicable filing period [*Corp. Code § 1502(c)*]. To implement this requirement, this form includes a box that may be checked to indicate that there have been no changes. When this is the case, the remainder of the form, with the exception of the declaration at the end, need not be completed.

[d] Change in Agent for Service of Process

To change its agent for service of process or the address of its current agent, a corporation must file an updated statement [*Corp. Code § 1502(e)*]. Secretary of State Form SI 200 C, reproduced in § 7.207, instead of this form, should be used for that purpose. For additional discussion, see the comment to § 7.207.

[2] FORM

INSTRUCTIONS FOR COMPLETING FORM Si-200 N/C

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



186 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART IV. FORMS

4-7 California Legal Forms--Transaction Guide § 7.207B

§ 7.207B Corporate Disclosure Statement--Publicly Traded Companies

[1] Comment

[a] Use of Form

This form is Secretary of State Form SI-PT, Corporate Disclosure Statement and Form SI-PTA. Every domestic stock and foreign corporation that is a publicly traded company must complete this form and include it when filing either a complete statement of information or a statement changing information on a previously filed statement [*see Corp. Code § 1502.1*; *see also §§ 7.207, 7.207A, 12B.210,* 12B.210A]. A "publicly traded corporation" is a corporation [*see Corp. § 162*] that (1) is an issuer as defined in Section 3 of the Securities Exchange Act [*see 15 U.S.C. § 78c*], and (2) has at least one class of securities listed or admitted for trading on a national securities exchange, on the OTC Bulletin Board, or the electronic service operated by Pink OTC Markets Inc. [*Corp. Code § 1502.1(b)(1)*]. The text of the Secretary of State's official instructions are also reproduced along with the form below.

For further discussion of filing requirements for foreign corporations, see *Ch. 12B, Foreign Corporations and Associations, §§ 12B.210, 12B.211*.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.sos.ca.gov/business/bpd_forms.htm#corp . You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 3405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 7.207B. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Contents of Form

The Corporate Disclosure Statement must set forth the following information [*Corp. Code § 1502.1(a)*]:

- The name of the independent auditor that prepared the most recent auditor's report on the corporation's annual financial statements.

- A description of other services, if any, performed for the corporation during its two most recent fiscal years and the period between the end of its most recent fiscal year and the date of the statement by the independent auditor, by its parent corporation, or by a subsidiary or corporate affiliate of the independent auditor or its parent corporation.

- The name of the independent auditor employed by the corporation on the date of the statement, if different from the independent auditor referred to above.

- The compensation for the most recent fiscal year paid to each member of the board of directors and to each of the five most highly compensated executive officers of the corporation who are not members of the board, including the number of any shares issued, options for shares granted, and similar equity-based compensation granted to each of those persons (and if the chief executive officer is not among the five most highly compensated executive officers of the corporation, the compensation paid to the chief executive officer must be included anyway).

- A description of any loan, including the amount and terms of the loan, made to any member of the board by the corporation during the corporation's two most recent fiscal years at an interest rate lower than the interest rate available from unaffiliated commercial lenders generally to a similarly situated borrower.

- A statement indicating whether an order for relief has been entered in a bankruptcy case with respect to the corporation, its executive officers, or members of the board of directors during the 10 years preceding the date of the statement.

- A statement indicating whether any member of the board of directors or executive officer was convicted of fraud during the 10 years preceding the date of the statement, if the conviction has not been overturned or expunged.

- A description of any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the corporation or any of its subsidiaries is a party or of which any of their property is the subject, as specified by Item 103 of SEC Regulation S-K [*see* 12 C.F.R. § 229.103].

- A description of any material legal proceeding during which the corporation was found legally liable by entry of a final judgment or final order that was not overturned on appeal during the five years preceding the date of the statement.

Form SI-PTA, an optional attachment to the corporate disclosure statement, is for use when additional directors, loans to members of the board, and any other supplemental information must be stated that exceeds the space allowed by Form SI-PT (or Form SI-PTA itself).

CAUTION:

This statement will be available and open to the public for inspection. The Secretary of State must provide access to all information contained in this statement by means of an online database no later than December 31, 2004 [*Corp. Code § 1502.1(e)*].

[c] Filing and Execution

A publicly traded domestic stock corporation must file this form within 150 days after the end of its fiscal year, and annually thereafter [*Corp. Code § 1502.1(a)*]. There is no fee to file this form [*Gov. Code § 12186(j)*].

The corporation must certify that the information it provides in this statement is true and correct. No claim may be made against the state for inaccurate information contained in this statement [*Corp. Code § 1502.1(d)*].

[2] FORM

Corporate Disclosure Statement--Publicly Traded Companies

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Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawBlue Sky LawsSecurities RegistrationBusiness & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART IV. FORMS

4-7 California Legal Forms--Transaction Guide § 7.208

§ 7.208 Application for Certificate of Revivor

[1] Comment

[a] Use of Form

This form is the Application for Certificate of Revivor for use by a domestic corporation that has had its powers suspended and seeks revivor from that suspension. Although the same form is used by a foreign corporation seeking revivor from forfeiture, the attorney should refer to Ch. 12B, *Foreign Corporations*, for detailed discussion of forfeiture and application for revivor in the foreign corporation context [*see § 12B.261*]. Suspension of a domestic corporation can be due to failure to file its Statement of Information by Domestic Stock Corporation for two successive years, if the corporation was certified for penalty by the Secretary of State for the preceding filing period [*Corp. Code § 2205(a)*; *see* [b], *below*], or to failure to pay taxes [*Rev. & Tax. Code § 23301*; *see* [c], *below*], or to a combination of these transgressions [*Corp. Code §§ 2204, 2205*; *Rev. & Tax. Code §§ 19141, 23301, 23301.5, 23305-23305b, 23775*; *see* [d], *below*].

The form illustrated here is the official Franchise Tax Board form (FTB Form 3557-BC). The FTB will accept applications only on the official form. Telephone numbers are provided on the form for obtaining further information on using the Application for Certificate of Revivor. This form can be obtained at any FTB office, the FTB website [*see below*], or by contacting the FTB at (800) 852-5711.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Franchise Tax Board, which is locate at http://www.ftb.ca.gov. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 7.208. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Application on behalf of a corporation that has been suspended may be made by any stockholder, creditor, majority of

surviving trustees or directors, officer, or any person having an interest in relief from suspension [*Rev. & Tax. Code § 23305*].

A different form, FTB Form 3557-LLC, is used by domestic and foreign limited liability companies. For further discussion of the procedures for seeking a certificate of revivor by these entities, see Ch. 12C, *Limited Liability Companies* .

[b] Suspension by Secretary of State for Failure to File Statement of Information by Domestic Stock Corporation; Revivor

If a corporation fails to file its Statement of Information by Domestic Stock Corporation [*see Corp. Code § 1502*] for an applicable filing period, has not filed the statement during the preceding 24 months, and was certified for a penalty [*see Corp. Code § 2204*] for the same filing period, the Secretary of State may suspend the corporation's powers, rights, and privileges [*Corp. Code § 2205(a)*]. The Secretary must notify the corporation, by mail, that it will be suspended after 60 days if the statement is not filed [*Corp. Code § 2205(b)*]. If a corporation is suspended, the Secretary must notify the Franchise Tax Board and mail a notice of suspension to the corporation [*Corp. Code § 2205(c)*]. On suspension, the corporation may take no action other than to file the statement or to amend its articles of incorporation to change its name [*Corp. Code § 2205(c), (d)*; *see Palm Valley Homeowners Assn., Inc. v. Design MTC (2000) 85 Cal. App. 4th 553, 560-561, 102 Cal. Rptr. 2d 350* (trial court did not abuse its discretion in imposing sanctions on law firm for continuing litigation activities on behalf of corporation that it knew to be suspended under *Corp. Code § 2205* for failure to file information statement required by *Corp. Code § 1502*)]. In addition, a suspended corporation may file an application for exempt status and amend its articles of incorporation as necessary to perfect that application [*Corp. Code § 1502(c)*; *see* Ch. 13, *Nonprofit Corporations*].

The filing of its Statement of Information by Domestic Stock Corporation [*see Corp. Code § 2205(d)*], the payment of any assessed penalty [*see Rev. & Tax. Code §§ 23305, 25936*], and a request in writing to the Franchise Tax Board by any stockholder, creditor, majority of surviving trustees or directors, officer, or any person having an interest in relief from suspension [*see Rev. & Tax. Code § 23305*] will revive a corporation, provided the corporation meets the statutory requirements relating to available corporate names [*Corp. Code § 2205(d)*; *see Rev. & Tax. Code § 23305a*; *see also Corp. Code §§ 201* (names available to domestic corporations), 2106 (names available to foreign corporations)]. The name of a suspended corporation may be reserved and adopted by another corporation during the period of suspension. In that situation, the suspended corporation's application for a certificate of revivor may be denied [*see Boyer v. Jones (2001) 88 Cal. App. 4th 220, 221-222, 105 Cal. Rptr. 2d 824* (trial court properly denied suspended corporation's petition for writ of mandate seeking restoration of its name)]. The Secretary must certify the fact of the filing to the Franchise Tax Board, and the Franchise Tax Board will restore the corporation's powers by issuing a certificate of revivor unless the corporation is held in suspension by the Franchise Tax Board under *Rev. & Tax. Code §§ 23301, 23301.5*, or *23775* [*Corp. Code § 2205(d)*; *see Rev. & Tax. Code § 23305a*; *see also* [c], *below*].

[c] Suspension by Franchise Tax Board for Failure to Pay Taxes or File Tax Return; Revivor

If the corporation was suspended for nonpayment of franchise taxes or failure to file tax returns, its powers will not be revived, notwithstanding the filing of the required annual statement [*Rev. & Tax. Code §§ 23301, 23301.5, 23775*; *see Corp. Code § 1502*; *see also Timberline v. Jaisinghani (1997) 54 Cal. App. 4th 1361, 1368-1369, 64 Cal. Rptr. 2d 4* (suspended corporation that failed to revive powers by paying delinquent taxes cannot renew judgment obtained while in good standing)]. Under these circumstances, the corporation's powers may be revived by writing to the Franchise Tax Board for a certificate of revivor, filing all tax returns required under the Bank and Corporation Tax Law, and paying all taxes, additions to taxes, deficiencies, interest, and penalties due [*Rev. & Tax. Code §§ 23305, 23305a*; *see also Rev. & Tax. Code § 23305b* (revivor without payment of full amount due)].

[d] Suspension by Secretary of State and Franchise Tax Board; Revivor

The procedure for reviving a corporation that has been suspended by both the Secretary of State and the Franchise Tax Board is a combination of the two procedures as addressed in [b] and [c], *above*. When all the requirements of both agencies have been met, the corporation may apply, directly to the Franchise Tax Board, for a revivor from both the Secretary of State and Franchise Tax Board suspensions [*see Corp. Code §§ 2204, 2205*; *Rev. & Tax. Code §§ 19141, 23301, 23301.5, 23305-23305b, 23775*].

[2] FORM

Application for Certificate of Revivor

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsFinanceFranchise TaxReinstatementBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistence



188 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 7 CORPORATE RECORDS AND REPORTS
PART IV. FORMS

4-7 California Legal Forms--Transaction Guide § 7.209

§ 7.209 Resignation of Agent for Service of Process

[1] Comment--Use of Form

This form is the California Secretary of State's official form (Form RA-100) for resignation of agents for service of process. This form should be used by an agent to resign as a designated agent for service of process. An agent designated for service of process pursuant to *Corp. Code §§ 202*, *1502*, *2105*, or *2117* may file a signed and acknowledged written statement of resignation in accordance with *Corp. Code § 1503*.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.sos.ca.gov/business/bpd_forms.htm#corp . You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 7.209. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Resignation of agent forms must be mailed or hand delivered for over-the-counter processing to the Sacramento office; these forms are not filed in branch offices. There is no fee for filing this form by mail; however, a special handling fee applies for processing documents delivered in person.

The Secretary of State will endorse file a copy of the Resignation of Agent form without charge, provided that the copy is submitted to the Secretary of State along with the original to be filed [*see* instructions for Form RA-100].

[2] FORM

Resignation of Agent for Service of Process

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Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
Chapter 8 [Reserved]

4-8 California Legal Forms--Transaction Guide Chapter 8

[Reserved]

Chapter 8[Reserved]



1 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS

4-8A California Legal Forms--Transaction Guide 8A.syn

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.syn Synopsis to Chapter 8A: SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS

§ 8A.01 California Sources

[1] Statutes

[2] Regulations

§ 8A.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 8A.03-8A.04 [Reserved]

§ 8A.05 Law Reviews and Periodicals

§ 8A.06 Annotations

§ 8A.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 8A.08-8A.09 [Reserved]

§ 8A.10 Shareholders' Meeting and Voting Rights--In General

§ 8A.11 Shareholders' Voting Rights

[1] Statutory Rights

[2] Provisions in Articles

§ 8A.12 Applicability to Close Corporations

§§ 8A.13-8A.19 [Reserved]

§ 8A.20 Types of Meetings

[1] Annual Meetings

[a] Purpose

[b] Remedy for Failure to Hold Annual Meeting

[2] Special Meetings

[a] Purpose

[b] Remedy for Failure to Call Special Meeting

[3] Adjourned Meetings

§ 8A.21 Place of Meetings

§ 8A.22 Date and Time of Meetings

[1] Annual Meeting

[2] Special Meeting

§ 8A.23 Notice of Meeting

[1] When Given

[2] How Given

[3] To Whom Given

[4] Contents

[5] Procedure When Notice of Special Meeting Is Requested but Not Given

[6] Special Requirements for Adjourned Meetings

[7] Informally Noticed Meetings

§ 8A.24 Waiver of Notice and Consent to Hold Meeting; Approval of Actions Taken at Meeting

§ 8A.25 Record Date

§ 8A.26 Quorum

§ 8A.27 Meeting Procedures

§ 8A.28 Action by Written Consent Without Meeting

[1] In General

[2] Special Rules for Written Consents for Corporations With 100 or More Shareholders

§ 8A.29 Meetings Using Electronic Transmission

§§ 8A.30-8A.39 [Reserved]

§ 8A.40 Noncumulative Voting of Shares

§ 8A.41 Cumulative Voting for Directors

§ 8A.42 Voting by Fiduciaries, Receivers, Pledgees, Minors, and Attorneys in Fact

§ 8A.43 Voting by Corporate Shareholders

§ 8A.44 Voting of Jointly Held Shares

§ 8A.45 Voting by Proxy

§ 8A.46 Voting by Voting Agreement or Voting Trust

[1] Voting Agreement and Voting Trust Defined

[2] Voting Trust, Voting Agreement, and Proxy Distinguished

§§ 8A.47-8A.59 [Reserved]

§ 8A.60 Form of Proxy

[1] Contents

[2] Failure to Comply With Requirements

§ 8A.61 Duration of Proxies

§ 8A.62 Revocation of Proxies

§ 8A.63 Irrevocable Proxies

§§ 8A.64-8A.69 [Reserved]

§ 8A.70 Voting Record Rights and Disclosure Requirements

[1] Shareholder's Right to Voting Results

[2] Voting Record Disclosure Requirements

§ 8A.71 Inspectors of Election

§ 8A.72 Judicial Enforcement of Voting Rights

§§ 8A.73-8A.99 [Reserved]

Scope

§ 8A.100 Facts

[1] The Corporation

Scope

[2] Each Shareholder

Scope

[3] Annual or Special Meetings

Scope

§ 8A.101 Documents

Scope

§§ 8A.102-8A.109 [Reserved]

§ 8A.110 Written Consents Without Meeting

Scope

§ 8A.111 Annual Meetings

Scope

§ 8A.112 Special Meetings

Scope

§ 8A.113 Adjourned Meetings

Scope

§§ 8A.114-8A.119 [Reserved]

§ 8A.120 Written Consents Without Meeting

Scope

§ 8A.121 Call and Notice of Annual Meeting

Scope

§ 8A.122 Call and Notice of Special Meetings

Scope

§ 8A.123 Preparation for Annual or Special Meetings

Scope

§ 8A.124 Holding Annual or Special Meetings

Scope

§ 8A.125 Holding Adjourned Meetings

Scope

§§ 8A.126-8A.139 [Reserved]

§ 8A.140 Obtaining Court Order to Hold Annual Meeting

Scope

§ 8A.141 Obtaining Court Order to Hold Special Meeting

Scope

§ 8A.142 Filing Action on Denial of Right to Vote

Scope

§ 8A.143 Obtaining Results of Vote Taken at Meeting

Scope

§ 8A.144 Disclosing Voting Record to Beneficial Owners of Shares

Scope

§§ 8A.145-8A.199 [Reserved]

§ 8A.200 Letter Advising Corporation to Hold Annual Shareholders' Meeting

[1] Comment

[a] Use of Form

[b] Contents of Meeting Notice

[c] Place, Date, and Time of Meeting

[d] Purpose of Annual Meeting

[e] Determination of Record Date

[f] Annual Report

[2] Form

Letter Advising Corporation to Hold Annual Shareholders' Meeting

§ 8A.201 Letter Advising Corporation to Hold Special Shareholders' Meeting

[1] Comment

[a] Use of Form

[b] Persons Authorized to Call Special Meetings

[c] Remedy for Failure to Call Special Meeting

[d] Shareholders' Voting Rights

[2] Form

Letter Advising Corporation to Hold Special Shareholders' Meeting

§ 8A.202 Notice of Annual Shareholders' Meeting

[1] Comment

[a] Use of Form

[b] Contents of Notice

[c] Approval of Special Proposals at Meeting

[d] Procedure for Giving Notice

[i] When Given

[ii] How Given

[iii] To Whom Given

[2] Form

Notice of Annual Shareholders' Meeting

§ 8A.203 Call of Special Shareholders' Meeting by Shareholders

[1] Comment

[a] Use of Form

[b] Persons Authorized to Call Special Meetings

[c] Call Procedure

[d] Remedies for Failure to Give Notice After Receipt of Call

[e] Effect of Irregularly Called or Noticed Meeting

[2] Form

Call of Special Shareholders' Meeting by Shareholders

§ 8A.204 Call of Special Shareholders' Meeting by President or Chair of Board

[1] Comment

[a] Use of Form

[b] Call Procedure

[2] Form

Call of Special Shareholders' Meeting by President or Chair of Board

§ 8A.205 Notice of Special Shareholders' Meeting

[1] Comment

[a] Use of Form

[b] Contents of Notice

[c] Procedure for Giving Notice

[i] When Given

[ii] How Given

[iii] To Whom Given

[d] Evidence of Giving Notice

[e] Procedure When Notice of Special Meeting Is Not Given

[2] Form

Notice of Special Shareholders' Meeting

§ 8A.206 Notice of Adjourned Shareholders' Meeting

[1] Comment

[a] Use of Form

[b] When Notice Is Required

[c] What Business May Be Transacted

[2] Form

Notice of Adjourned Shareholders' Meeting

§ 8A.207 Affidavit of Mailing Notice of Shareholders' Meeting

[1] Comment--Use of Form

[2] Form

Affidavit of Mailing Notice of Shareholders' Meeting

§ 8A.208 Declaration of Mailing Notice of Shareholders' Meeting

[1] Comment--Use of Form

[2] Form

Declaration of Mailing Notice of Shareholders' Meeting

§§ 8A.209-8A.219 [Reserved]

§ 8A.220 Waiver of Notice, Consent to Holding, and Approval of Minutes of Shareholders' Meeting

[1] Comment

[a] Use of Form

[b] Effect of Waiver; Statutory Requirements

[2] Form

Waiver of Notice, Consent to Holding, and Approval of Minutes of Shareholders' Meeting

§ 8A.221 Letter to Shareholders Regarding Shareholders' Written Consent to Action Without Meeting

[1] Comment--Use of Form

[2] Form

Letter to Shareholders Regarding Shareholders' Written Consent to Action Without Meeting

§ 8A.222 Shareholders' Action by Written Consent for Use by Corporation With Fewer than 100 Shareholders

[1] Comment

[a] Use of Form

[b] Uses; Statutory Requirements

[2] Form

Shareholders' Action by Written Consent for Use by Corporation With Fewer than 100 Shareholders

§ 8A.223 Shareholders' Action by Written Consent Distributed to 10 or More Shareholders by Corporation With 100 or More Shareholders

[1] Comment

[a] Use of Form

[b] Statutory Requirements of Form

[2] Form

Shareholders' Action by Written Consent Distributed to 10 or More Shareholders by Corporation With 100 or More Shareholders

§ 8A.224 Revocation of Written Consent by Shareholder

[1] Comment--Use of Form

[2] Form

Revocation of Written Consent by Shareholder

§ 8A.225 Notice to Shareholders of Action by Written Consent Without Meeting

[1] Comment

[a] Use of Form

[b] California Notice Requirements

[c] Federal Notice Requirements

[2] Form

Notice to Shareholders of Action by Written Consent Without Meeting

§§ 8A.226-8A.239 [Reserved]

§ 8A.240 Ballot--Noncumulative Voting for Directors and Other Matters

[1] Comment

[a] Use of Form

[b] Use of Ballot

[c] Noncumulative Voting

[2] Form

Ballot--Noncumulative Voting for Directors and Other Matters

§ 8A.241 Ballot--Cumulative Voting for Directors

[1] Comment

[a] Use of Form

[b] Cumulative Voting for Directors

[2] Form

Ballot--Cumulative Voting for Directors

§ 8A.242 Shareholder's Request for Vote Results

[1] Comment--Use of Form

[2] Form

Shareholder's Request for Vote Results

§ 8A.243 Report of Vote Results to Shareholders

[1] Comment

[a] Use of Form

[b] Contents of Report

[c] When Report Must Be Given

[2] Form

Report of Vote Results to Shareholders

§ 8A.244 Report of Inspectors of Election

[1] Comment--Use of Form

[2] Form

Report of Inspectors of Election

§§ 8A.245-8A.249 [Reserved]

§ 8A.250 Proxy for Particular Meeting of Private Corporation With Fewer Than 100 Shareholders

[1] Comment

[a] Use of Form

[b] Voting by Proxy

[c] Duration and Revocation

[d] Execution and Transmission

[2] Form

Proxy for Particular Meeting of Private Corporation With Fewer Than 100 Shareholders

§ 8A.251 Proxy With Limitation of Authority for Private Corporation With Fewer Than 100 Shareholders

[1] Comment--Use of Form

[2] Form

Proxy With Limitation of Authority for Private Corporation With Fewer Than 100 Shareholders

§ 8A.252 Irrevocable Proxy [Corp. Code § 705(e)]

[1] Comment

[a] Use of Form

[b] When Proxies Are Irrevocable

[c] Exceptions to Irrevocability

[d] Use of Irrevocable Proxy May Make Small Offering Exemption Unavailable

[2] Form

Irrevocable Proxy [Corp. Code § 705(e)]

§ 8A.253 Proxy for Private Corporation With 100 or More Shareholders When Proxy Is Distributed to 10 or More Shareholders

[1] Comment

[a] Use of Form

[b] Statutory Requirements of Form

[c] Failure to Comply With Requirements

[2] Form

Proxy for Private Corporation With 100 or More Shareholders When Proxy Is Distributed to 10 or More Shareholders

§ 8A.254 Revocation of Proxy

[1] Comment

[a] Use of Form

[b] Revocation of Proxies

[2] Form

Revocation of Proxy

§§ 8A.255-8A.259 [Reserved]

§ 8A.260 Minutes of Shareholders' Annual Meeting

[1] Comment

[a] Use of Form

[b] Contents of Minutes

[c] Liability for Making False Entries in Minutes

[2] Form

Minutes of Shareholders' Annual Meeting

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS

4-8A California Legal Forms--Transaction Guide Scope

AUTHOR: Marilyn E. Minger Practice Consultant

Scope

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Practice Consultant Scope

This chapter discusses the statutory requirements and the procedures for holding shareholders' meetings, including setting the place, date, and time; giving notice; waivers of notice; record date; and quorum requirements. This chapter also covers actions by written consent without a meeting. It discusses statutory shareholder voting rights; the exercise of voting rights through proxies or through voting agreements or voting trusts; and methods of voting shares, including noncumulative and cumulative voting, as well as the special statutory rules governing voting by particular types of shareholders (fiduciaries, attorneys-in-fact, representatives, receivers, pledgees, minors, shares held by corporations, and jointly held shares). The chapter discusses voting record disclosure requirements and judicial enforcement of voting rights.

Forms include notices of annual, special, and adjourned meetings; calls of special meetings; written waivers of notice; consents to hold, and approvals of meeting minutes; ballots for noncumulative and cumulative voting for directors; a request for and report of shareholder vote results; and proxies (both revocable and irrevocable) for various purposes.

Voting agreements and voting trusts are discussed in Ch. 8B, *Voting Agreements and Voting Trusts* . Close corporation shareholder agreements are covered in Ch. 8C, *Close Corporation Shareholder Agreements* . Directors' meetings and voting are discussed in Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8A California Legal Forms--Transaction Guide § 8A.01

AUTHOR: Marilyn E. Minger Practice Consultant

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Proxy defined. *Corp. Code § 178*.

Proxyholder defined. *Corp. Code § 179*.

Creation of additional voting rights or imposition of additional voting requirements as optional provisions in articles of incorporation. *Corp. Code § 204(a)(5), (9)*.

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Election of director by shareholders to fill vacancy. *Corp. Code § 305*.

Transactions in which directors have financial interest. *Corp. Code § 310*.

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Annual meeting of shareholders. *Corp. Code § 600(b), (c)*.

Special meeting of shareholders. *Corp. Code § 600(d)*.

Written notice of meetings of shareholders. *Corp. Code § 601*.

Adjourned meeting of shareholders. *Corp. Code § 601(d)*.

Waiver of notice and consent to holding of meeting of shareholders. *Corp. Code § 601(e)*.

Quorum at meeting of shareholders. *Corp. Code § 602*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8A California Legal Forms--Transaction Guide § 8A.02

AUTHOR: Marilyn E. Minger Practice Consultant

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5 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8A California Legal Forms--Transaction Guide §§ 8A.03-8A.04

AUTHOR: Marilyn E. Minger Practice Consultant

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§§ 8A.03[Reserved]



6 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8A California Legal Forms--Transaction Guide § 8A.05

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8A California Legal Forms--Transaction Guide § 8A.06

AUTHOR: Marilyn E. Minger Practice Consultant

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8A California Legal Forms--Transaction Guide § 8A.07

AUTHOR: Marilyn E. Minger Practice Consultant

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8A California Legal Forms--Transaction Guide §§ 8A.08-8A.09

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§§ 8A.08[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
A. Overview: Shareholders' Meeting and Voting Rights

4-8A California Legal Forms--Transaction Guide § 8A.10

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.10 Shareholders' Meeting and Voting Rights--In General

Shareholders have the right to meet in order to act on certain corporate matters. Action by the shareholders may be taken at annual [*see § 8A.20[1]*] or special [*see § 8A.20[2]*] meetings of shareholders or by the written consent of shareholders without a meeting [*see § 8A.28*]. The matters on which a shareholder's vote is required are enumerated in § 8A.11. The exact nature of the vote required depends on statutory requirements and any special voting provisions in the articles [*see § 8A.11[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
A. Overview: Shareholders' Meeting and Voting Rights

4-8A California Legal Forms--Transaction Guide § 8A.11

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.11 Shareholders' Voting Rights

[1] Statutory Rights

Action on fundamental and extraordinary corporate matters usually requires the approval of the shareholders. Fundamental matters generally include acts such as the election of directors or their removal without cause; extraordinary matters generally include acts such as mergers and reorganizations, sale of assets, amending the articles of incorporation or the bylaws, approving loans to officers, directors, or shareholders, or dissolving the corporation. In addition to requiring a shareholder vote to accomplish certain corporate actions, a shareholders' vote is permitted, in certain cases, to accomplish a specific transaction.

The following actions *require* a shareholders' vote, with certain exceptions specified by statute:

- Amending the articles of incorporation to establish [*Corp. Code § 158(b)*] or eliminate [*Corp. Code § 158(c)*] close corporation status.

- Electing directors [*Corp. Code § 301(a)*] or removing directors without cause [*Corp. Code § 303*].

- Changing the number of directors on a fixed board, or the maximum or minimum number on a variable board, or from a fixed to a variable board (or vice versa) [*Corp. Code § 212(a)*].

- Approving loans, or guaranteeing the obligations of officers, directors, or shareholders of the corporation or of its parent; or approving employee benefit plans authorizing loans or guarantees to officers or directors [*Corp. Code § 315(a)-(c)*; *see Corp. Code § 315(b), (f)* (exceptions)].

- Amending the articles of incorporation after shares have been issued [*Corp. Code § 902(a)*], with certain exceptions permitting approval by the board alone [*Corp. Code § 902(b)-(d)*].

- Amending the articles of incorporation by class vote if the proposed amendment will affect the class in specified ways, regardless of voting restrictions [*Corp. Code § 903*].

- Amending the articles of incorporation to make shares assessable or to authorize remedy by action for the collection of an assessment on fully paid shares [*Corp. Code § 904*].

- Selling or transferring all, or substantially all, of the corporation's assets, unless the transaction is in the usual and regular course of the corporation's business [*Corp. Code § 1001(a)*].

- Reorganizing the corporation, resulting in any of the following (note that only the principal terms of the reorganization need to be approved [*Corp. Code § 1201*]):

    - The dilution of more than one sixth of the voting power of the shareholders of the corporation that is a party to the reorganization [*see Corp. Code § 1201(a), (b)*].

    - Any amendment to the articles of the surviving corporation of a merger reorganization, if approval of the shareholders is otherwise required (to be approved by the outstanding shares of the surviving corporation [*Corp. Code § 1201(c)*].

    - Any change in the rights, preferences, privileges, or restrictions of a class of outstanding shares of a constituent corporation. In this situation, the principal terms of the reorganization must be approved by the outstanding shares of this class [*Corp. Code § 1201(d)*].

    - The shareholders of a close corporation receiving shares of a corporation that is not a close corporation. In this situation, the principal terms of the reorganization must be approved by the affirmative vote of at least two thirds of each class of the outstanding shares of any close corporation so affected [*Corp. Code § 1201(e)*].

    - The shareholders of any class will receive interests of a surviving other business entity pursuant to a merger. In this situation, the principal terms of the reorganization must be approved by the outstanding shares of any class or series that would receive such interests [*Corp. Code § 1201(f)*].

    - The shareholders of a class or series become personally liable, as a result of the reorganization, for any obligations of a party to the reorganization. In this situation, the principal terms of the reorganization must approved by *all* the holders of this class or series, unless all holders of that class have dissenters' rights [*Corp. Code § 1201(f)*; *see Corp. Code § 1300 et seq.*].

- Requiring the corporation to purchase dissenting shares in certain reorganizations, in compliance with the provisions governing compensation of dissenting shareholders [*Corp. Code § 1300*].

- Voluntarily dissolving the corporation, with specified exceptions [*Corp. Code § 1900(a)*; *see Corp. Code § 1900(b)* (exceptions)].

- Distributing corporate assets, other than money, in a manner that does not accord with the liquidation rights of preferred shares as specified in the articles, if the corporation is in the process of winding up [*Corp. Code § 2007(a)*].

The shareholders' voting rights may be exercised, in some cases, by "approval of the outstanding shares," that is, by a majority of the outstanding shares entitled to vote [*Corp. Code § 152*]. In other cases these rights may be exercised by the "approval of the shareholders"; that is, the affirmative vote of a majority of the shares represented and voting at a meeting at which a quorum is present [*Corp. Code § 153*]. In still other cases, these rights may be exercised by specified percentages of outstanding shares or classes or series or by individual shareholders [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 9, *Shareholders' Meetings and Voting* , § 162 (Matthew Bender)].

[2] Provisions in Articles

The corporation's articles may create additional voting rights or impose additional voting requirements [*see Corp. Code § 204(a)(5), (9)*; *see also Corp. Code § 300(c)* (close corporation shareholder agreements)]. The articles may require a shareholder vote on any matter, even though such a vote is not otherwise required by the General Corporation Law [*Corp. Code § 204(a)(9)*]. The articles may also require a larger portion of shares of any or all classes or series than is otherwise required by a particular statute [*Corp. Code § 204(a)(5)*], or provide for supermajority votes (that is, approval by a larger portion of outstanding shares than a majority, subject to specified limitations) by the corporation's directors or shareholders on various matters [*see Corp. Code § 710*; Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 61.03[2] (Matthew Bender)].

The corporation may also control shareholder voting rights by issuing one or more classes or series of shares, or both, with full, limited, or no voting rights [*Corp. Code § 400*].

For further discussion of supermajority voting, additional voting requirements, and voting and non-voting shares, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , §§ 62.03[3][a], [b], 62.04[3] (Matthew Bender). For discussion of voting procedure, see *§§ 8A.40-8A.46*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
A. Overview: Shareholders' Meeting and Voting Rights

4-8A California Legal Forms--Transaction Guide § 8A.12

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.12 Applicability to Close Corporations

All of the provisions of the General Corporation Law [*Corp. Code §§ 1-2319*] may be waived or altered in a shareholder agreement, as between the parties to that agreement, except for the required filing of any document with the Secretary of State, or for specified chapters and sections of the law [*see Corp. Code § 300(c)*]. The enumerated chapters and sections do not include those that generally govern shareholders' meetings [*see Corp. Code § 600 et seq.*] and voting of shares [*see Corp. Code § 700 et seq.*]. As a result, the provisions governing shareholders' meetings and voting may be waived, for the most part, by close corporations. For further discussion of the waiver of these provisions in close corporation shareholder agreements, see Ch. 8C, *Close Corporation Shareholder Agreements* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresGeneral OverviewBusiness & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



13 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
A. Overview: Shareholders' Meeting and Voting Rights

4-8A California Legal Forms--Transaction Guide §§ 8A.13-8A.19

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.13[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
B. Shareholders' Meetings and Actions by Written Consent Without Meetings

4-8A California Legal Forms--Transaction Guide § 8A.20

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.20 Types of Meetings

[1] Annual Meetings

[a] Purpose

Except when directors are elected by unanimous written consent (or by the written consent of a majority of the outstanding shares if the election is to fill a vacancy not created by removal) [*see Corp. Code § 603(a), (d)*]; *see also § 8A.28[1]*, an annual meeting of shareholders must be held for the election of directors on a date and at a time stated in or fixed in accordance with the bylaws [*Corp. Code § 600(b)*; *see Corp. Code § 301* (election of directors); *cf. Corp. Code § 600(b)* (special rules for regulated management companies)]. In addition to the election of directors at the annual meeting, the shareholders may take action on any other proper matter [*Corp. Code § 600(b)*; *see § 8A.11*]. However, no action may be taken (other than by the unanimous approval of the shares entitled to vote) on the following matters, unless prior written notice of the general nature of these proposals has been given to the shareholders [*Corp. Code § 601(f)*]:

- Approval or ratification of a contract or other transaction between a corporation and one or more of its directors, or between a corporation and another corporation, firm, or association in which one or more of the directors has a material financial interest [*see Corp. Code § 310*].

- Amendments to the articles of incorporation requiring the approval of the outstanding shares [*Corp. Code § 152*] in accordance with *Corp. Code § 902*.

- Approval of a corporate conversion [*Corp. Code § 1152*].

- Approval of the principal terms of reorganization by the outstanding shares [*Corp. Code § 152*] in accordance with *Corp. Code § 1201*.

- Approval of the voluntary dissolution of the corporation in accordance with *Corp. Code § 1900*.

- Approval of a plan to distribute corporate assets, other than money, which is not in accordance with the liquidation rights of preferred shares as specified in the articles [*Corp. Code § 2007(a)*].

For the above-listed actions to be valid when taken at a meeting for which waiver of written notice is obtained, the waiver must specifically note that such matters were considered [*Corp. Code § 601(f)*].

Notice requirements are further discussed in *§ 8A.23*. For a form for minutes of a shareholders annual meeting, see *§ 8A.260*.

PRACTICE TIP:

Typically, a corporation holds its annual meeting three to four months after the end of each fiscal year so that the financial statements for the past year are available. *Commentary by Marilyn E. Minger.*

[b] Remedy for Failure to Hold Annual Meeting

Neither the bylaws nor the articles of incorporation may eliminate the requirement of an annual meeting [*see Corp. Code § 600*]. The annual meeting is usually held within 120 days after the close of the corporation's fiscal year, at a time and place set by the board of directors [*see §§ 8A.21, 8A.22*]. If it is not held within 60 days after the designated date for the meeting, or if no date has been designated within 15 months after the organization of the corporation or after the last annual meeting, any shareholder may apply to the superior court of the proper county for a court order compelling the meeting [*Corp. Code § 600(c)*; *see Corp. Code § 177* (proper county defined)]. The statutory requirement that an annual report be sent to the shareholders at least 15 (or, if sent by third-class mail, 35) days before the annual meeting does not limit the requirement of holding the meeting [*Corp. Code § 1501(a)(2)*].

After notice to the corporation giving it an opportunity to be heard, the court may order an annual meeting to be held and may issue any appropriate orders including, but not limited to, those designating the time and place of the meeting, the record date for determination of shareholders entitled to vote, and the form of notice [*Corp. Code § 600(c)*]. The court's orders, however, are limited to the procedures for holding shareholders' meetings and may not trespass on substantive matters confided to the directors and shareholders [*see Johnson v. Tago, Inc. (1986) 188 Cal. App. 3d 507, 515-516, 233 Cal. Rptr. 503* (court does not have authority to order corporation to pay proxy expenses and attorneys' fees of shareholders engaged in proxy fight and demanding that board call annual meeting)]. The shares represented and entitled to vote, either in person or by proxy, at a court-ordered annual meeting constitute a quorum, notwithstanding any provision of the articles of incorporation, bylaws, or General Corporation Law [*Corp. Code § 600(c)*].

[2] Special Meetings

[a] Purpose

Special meetings of the shareholders may be called at any time, for any reason, by the board of directors, the chair of the board [*see § 8A.204*], the president [*see § 8A.204*], shareholders representing at least 10 percent of the shares entitled to vote at the meeting [*see § 8A.203*], or by other persons as provided in the articles or bylaws [*Corp. Code § 600(d)*]. A special meeting may also be called by the shareholders (or shareholder) of at least five percent of the outstanding shares entitled to vote for directors if, after the filling of any vacancy by the directors, the directors in office who have been elected by the shareholders constitute less than a majority of the directors in office [*Corp. Code § 305(c)(1)*; *see § 8A.203*]. Shareholders (or a single shareholder) holding at least five percent of the outstanding shares entitled to vote for directors may also apply to the superior court of the proper county, which will then summarily order a special meeting of shareholders to elect the entire board [*Corp. Code § 305(c)(2)*].

PRACTICE TIP:

Some corporations include provisions in their bylaws authorizing persons other than those named in the statute, such as the secretary or the chief financial officer, to call special meetings. *Commentary by Marilyn E. Minger.*

Written notice of a special meeting must designate the general nature of the business to be transacted, and no other business may be transacted at the meeting [*Corp. Code § 601(a)(1)*]. However, subject to the limitations of *Corp. Code § 601(f)* [*see § 8A.20[1][a]*], and unless otherwise provided in the articles or bylaws, a written waiver of notice or consent to the holding of the meeting does not need to specify either the business to be transacted or the purpose of the meeting [*Corp. Code § 601(e)*]. Notice requirements are further discussed in *§ 8A.23*.

[b] Remedy for Failure to Call Special Meeting

If the notice of the meeting is not given within 20 days after receipt of the request to the chair of the board, president, vice president, or secretary [*see § 8A.22[2]*], the person or persons entitled to call the meeting may give the notice, or in the alternative, apply to the superior court of the proper county for an order requiring that the notice be given [*Corp. Code § 601(c)*]. The court may issue any appropriate orders, including, but not limited to, orders designating the time and place of the meeting, the record date for determination of shareholders entitled to vote, and the form for notice of the meeting [*Corp. Code § 601(c)*]. Notice requirements are discussed further in § 8A.23.

[3] Adjourned Meetings

At any adjourned meeting, the corporation may transact any business that might have been transacted at the original meeting, either annual or special, if the time and place of the adjourned meeting were announced at the original meeting [*Corp. Code § 601(d)*]. Special notice requirements for adjourned meetings are discussed in *§ 8A.23[6]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersActions Against CorporationsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



15 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
B. Shareholders' Meetings and Actions by Written Consent Without Meetings

4-8A California Legal Forms--Transaction Guide § 8A.21

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.21 Place of Meetings

Shareholders' meetings may be held at any place inside or outside of California as stated in or fixed in accordance with the bylaws [*Corp. Code § 600(a)*]. If no other place is stated or so fixed, the meetings must be held at the principal executive office of the corporation [*Corp. Code § 600(a)*].

Shareholders' meetings may be conducted, in whole or in part, by electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*], or by electronic video screen communication [*see Corp. Code § 600(e)*]. For further discussion, see *§ 8A.29*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



16 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
B. Shareholders' Meetings and Actions by Written Consent Without Meetings

4-8A California Legal Forms--Transaction Guide § 8A.22

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.22 Date and Time of Meetings

[1] Annual Meeting

The annual meeting must be held on a date and at a time stated in or fixed in accordance with the bylaws [*Corp. Code § 600(b)*; *see also 15 U.S.C. § 80a-16* (date and time of annual meeting of regulated management company must be in accordance with Federal Investment Company Act of 1940 (*15 U.S.C. § 80a-1 et seq.*), not in accordance with corporation's bylaws). For discussion of the importance of setting the *time* of meetings, see *§ 8A.23[4]*]. Thus, the bylaws may specify a fixed date (for example, April 21) or a specific day of the month (for example, the third Tuesday in April), or simply may authorize the board to fix the date each year, sometimes specifying the time frame during which the date must be set. For example, the bylaws may permit the directors to fix the date during the months of April through June of each year.

[2] Special Meeting

The notice calling a special meeting must specify the date and time of the meeting [*see Corp. Code § 601(a), (c)*]. For discussion of the importance of setting the meeting *time*, see *§ 8A.23[4]*. On written request to the corporation addressed to the attention of the chair of the board, president, vice president, or secretary, by any person (other than the board) entitled to call a special meeting of shareholders, the officer must give notice [*see § 8A.205*] to the shareholders entitled to vote that a meeting will be held at a time requested by the person or persons calling the meeting, as long as the requested date is at least 35 but not more than 60 days after receipt of the request [*Corp. Code § 601(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
B. Shareholders' Meetings and Actions by Written Consent Without Meetings

4-8A California Legal Forms--Transaction Guide § 8A.23

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.23 Notice of Meeting

[1] When Given

Whenever shareholders are required or permitted to take any action at a meeting, a written notice of the meeting must be given at least 10 but not more than 60 days before the date of the meeting [*Corp. Code § 601(a)*]. A corporation with outstanding shares held of record by 500 or more persons [*see Corp. Code § 605* (shares held of record by 100 or more persons defined)] is permitted to send notice of a meeting by third class mail, in which case the minimum time for the notice is 30 days before the date of the meeting [*Corp. Code § 601(a), (b)*].

If a special meeting is requested by any person (other than the board) entitled to call a special meeting of shareholders, the notice must be given no later than 20 days after the request [*Corp. Code § 601(c)*; *see § 8A.22[2]*]. The meeting must be held not less than 35 nor more than 60 days after the receipt of the request for a special meeting [*Corp. Code § 601(c)*].

[2] How Given

Notice of meetings must be given personally, or by electronic transmission by the corporation [*see Corp. Code § 20*], or by first-class mail (postage pre-paid [*see Corp. Code § 113*]), except when shares are held of record by 500 or more persons, in which case third-class mail or some other means of written communication is permitted [*Corp. Code § 601(b)*]. Notice must be addressed to the shareholder at the address appearing for the shareholder on the corporation's books, or at another address given to the corporation for notice purposes. If no such address is given, notice must be given at the principal executive office or by publication at least once in a newspaper of general circulation in the county in which the office is located [*Corp. Code § 601(b)*].

Notice given by electronic transmission by the corporation is not valid unless it complies with the requirements of *Corp. Code § 20* [Corp. Code § 601(b)]. "Electronic transmission by the corporation" means a communication (1) delivered by facsimile telecommunication or electronic mail when directed to the recipient's facsimile number or electronic mail

address on record with the corporation, or (2) posted on an electronic message board or network designated by the corporation for those communications, together with a separate notice of the posting sent to the recipient, or (3) delivered by other electronic means to a recipient who has provided an unrevoked consent to the use of that means of communication transmission. The electronic transmission must create a record that can be retained, retrieved, and reviewed, and can be rendered into clearly legible tangible form. In the case of an electronic posting, the posting will be validly delivered on the later date of the posting or the delivery of the separate notice [*Corp. Code § 20*].

PRACTICE TIP:

Notice may not be given by electronic transmission by the corporation after the corporation has been unable to deliver two consecutive notices to the shareholder by that means or if the inability to deliver notices by electronic transmission becomes known to the secretary, any assistant secretary, the transfer agent, or any other person responsible for giving notice [*Corp. Code § 601(b)*]. Further, an electronic transmission by the corporation to an individual shareholder is not authorized unless the transmission additionally satisfies the requirements applicable to consumer consent to electronic records under the Electronic Signatures in Global and National Commerce Act [*Corp. Code § 20*; *see 15 U.S.C. § 7001(c)*].

Notice is considered to have been given when delivered personally, or sent by electronic transmission by the corporation, or deposited in the mail, or sent by other means of written communication [*Corp. Code § 601(b)*]. An affidavit of mailing of any notice, or of electronic transmission by the corporation of any notice, executed by the corporate secretary, assistant corporate secretary, or any transfer agent, is prima facie evidence of the giving of notice [*Corp. Code § 601(b)*].

If notice, properly addressed to the shareholder, [*see Corp. Code § 601(b)*] is returned to the corporation and marked as undeliverable by the United States Postal Service, all future notices will be considered to have been given without further mailing if the notices are available to the shareholder, on the shareholder's written demand, at the corporation's principal executive office for one year from the date the notice was given to all other shareholders [*Corp. Code § 601(b)*].

[3] To Whom Given

Notice of any meeting, annual or special, must be given to each shareholder entitled to vote at the meeting [*Corp. Code § 601(a)*]. The identity and shareholdings of these shareholders are determined from the corporate records as of a predetermined date, known as the "record" date. The procedure for fixing the record date is discussed in *§ 8A.25*.

[4] Contents

The notice must state the place, date, and hour of the meeting [*Corp. Code § 601(a)*]. In *San Buenaventura Mfg. Co. v. Vassault* [*San Buenaventura Mfg. Co. v. Vassault (1875) 50 Cal. 534]* , the court held that a statement in the bylaws (under a statute permitting constructive notice) of the day only (the third Monday in April) was insufficient notice, since it did not state the time of day [*San Buenaventura Mfg. Co. v. Vassault (1875) 50 Cal. 534, 537-538* (holding reaffirmed in *Spencer v. Older (1982) 133 Cal. App. 3d 95, 102, 183 Cal. Rptr. 722* , discussed in [6], *below*)]. Similarly, in *Grant v. Hartman Ranch Co.* [*Grant v. Hartman Ranch Co. (1961) 193 Cal. App. 2d 497, 14 Cal. Rptr. 531]* , the court held that notice of a shareholder meeting that failed to specify the hour of the meeting was defective, and, therefore, the meeting was invalid [*Grant v. Hartman Ranch Co. (1961) 193 Cal. App. 2d 497, 501, 14 Cal. Rptr. 531* (although decided under former *Corp. Code § 2207*, the holding was reaffirmed in *Spencer v. Older (1982) 133 Cal. App. 3d 95, 102, 183 Cal. Rptr. 722* , discussed in [6], *below*)].

The notice must also state the means of electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication, if any, by which shareholders may participate in the meeting [*Corp. Code §*

601(a)]. For further discussion, see *§ 8A.29*.

If the meeting is a special meeting, the notice [*see § 8A.205*] must also state the general nature of the business to be transacted; and no business other than that specified in the notice may be transacted at the meeting [*Corp. Code § 601(a)*].

If the meeting is an annual meeting, the notice [*see § 8A.202*] must state, in addition to the place, date, and hour of the meeting, the matters which the board intends, at the time of the notice, to present for shareholder action [*Corp. Code § 601(a)*]. However, any other proper matter may be presented at the meeting when shareholder discussion is required or appropriate [*see Corp. Code § 601(a)*]. No shareholder approval at an annual meeting, however, other than the unanimous approval by those entitled to vote, is valid unless the general nature of the proposal was stated in the notice (or any written waiver of notice of the meeting) if the action to be taken involves one of the following [*Corp. Code § 601(f)*; *see § 8A.20[1][a]*]:

- Transactions in which a director has a financial interest [*Corp. Code § 310*].
- Amendments to the articles of incorporation after shares have been issued [*Corp. Code § 902*].
- Approval of a corporate conversion [*Corp. Code § 1152*].
- Approval of the principal terms of reorganization [*Corp. Code § 1201*].
- Dissolution of the corporation [*Corp. Code § 1900*].
- Approval of a plan of distribution of corporate assets upon dissolution not in accordance with the liquidation rights of the preferred shares [*Corp. Code § 2007*].

The notice of any meeting, annual or special, at which directors are to be elected must also include the names of nominees that the board, at the time of the notice, intends to present for election [*Corp. Code § 601(a)*]. Shareholders, however, are not so restricted and may nominate directors at a meeting [*see Corp. Code § 601(a)*].

[5] Procedure When Notice of Special Meeting Is Requested but Not Given

If notice of a special meeting is not given by the officer requested to do so within 20 days after receipt of the request, the persons entitled to call the meeting may, themselves, give notice [*Corp. Code § 601(c)*]. In the alternative, they may apply to the superior court of the proper county, which must "summarily" order that notice be given, after the corporation has had the opportunity to be heard [*Corp. Code § 601(c)*]. For further discussion, see *§ 8A.20[2][b]*.

[6] Special Requirements for Adjourned Meetings

When a shareholders' meeting is adjourned to another time or place, notice of the adjourned meeting generally does not need to be given if the time and place of that meeting (or the means of electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication, if any, by which shareholders may participate in that meeting [*Corp. Code § 601(a)*]) are announced at the original meeting, unless the bylaws require otherwise [*see Corp. Code § 601(d)*]. In order to avoid the need to give additional notice of an adjourned meeting, however, both a specific time and place for the adjourned meeting must be announced; an announcement that the adjourned meeting will take place in conjunction with a future event is not sufficiently specific. The shareholder attending the original meeting, or the absent shareholder who needs the meeting minutes, must be able to determine the time and place of the adjourned meeting from the announcement alone [*Spencer v. Older (1982) 133 Cal. App. 3d 95, 101-102, 183 Cal. Rptr. 722]* .

Notice to each shareholder of record entitled to vote at the meeting [*see § 8A.206*], however, is required if the adjournment is longer than 45 days or if, after the adjournment, a new record date is fixed for the adjourned meeting [*Corp. Code § 601(d)*].

[7] Informally Noticed Meetings

In practice, small closely held corporations often dispense with formal written notice to the shareholders entitled to vote at the meeting and call meetings by informal notice, using a waiver of notice and consent to holding the meeting or a written approval of the minutes of the meeting [*see § 8A.220*], signed by any shareholders not present and filed with the corporate records [*Corp. Code § 601(e)*]. Waivers of notice and approvals to actions taken at a meeting are further discussed in *§ 8A.24*. Shareholder action may also be taken by written consent without a meeting [*Corp. Code § 603*; *see §§ 8A.28, 8A.222, 8A.223*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
B. Shareholders' Meetings and Actions by Written Consent Without Meetings

4-8A California Legal Forms--Transaction Guide § 8A.24

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.24 Waiver of Notice and Consent to Hold Meeting; Approval of Actions Taken at Meeting

The actions taken at a shareholder meeting held without formal notice are valid provided the following conditions are met [*Corp. Code § 601(e)*]:

- A quorum must be present either in person or by proxy; and

- Either before or after the meeting, each of the persons entitled to vote, but not present in person or by proxy, provides a written waiver of notice, consent to the holding of the meeting, or an approval of the minutes [*see § 8A.220* (form)] of the meeting [*Corp. Code § 601(e)*]. These waivers, consents, and approvals must be filed with the corporate records or incorporated in the meeting minutes [*Corp. Code § 601(e)*].

A shareholder's attendance at a meeting constitutes a waiver of notice, except when the shareholder objects at the beginning of the meeting to the transaction of any business because the meeting is not lawfully called [*Corp. Code § 601(e)*]. Attendance at a meeting, however, is not a waiver of any right to object to the consideration of matters required to be included in the notice, but not included, provided an objection is expressly made at the meeting [*Corp. Code § 601(e)*].

Unless otherwise required by the corporation's articles of incorporation or bylaws, neither the business to be transacted nor the purpose of any regular or special meeting must be stated in any written waiver of notice, consent to hold the meeting, or approval of the minutes [*Corp. Code § 601(e)*], unless the action to be taken involves one of the following [*Corp. Code § 601(f)*; *see § 8A.20[1][a]*]:

- Transactions in which a director has a financial interest [*Corp. Code § 310*].

- Amendments to the articles of incorporation after shares have been issued [*Corp. Code § 902*].

- Approval of a corporate conversion [*Corp. Code § 1152*].
- Approval of the principal terms of reorganization [*Corp. Code § 1201*].
- Dissolution of the corporation [*Corp. Code § 1900*].
- Approval of a plan of distribution of corporate assets upon dissolution not in accordance with the liquidation rights of the preferred shares [*Corp. Code § 2007*].

In the circumstances listed above, any shareholder approval at a meeting other than by the unanimous approval of all shares entitled to vote is valid only if the general nature of the transaction approved was stated in the meeting's notice or in any written waiver of notice [*Corp. Code § 601(f)*; *see § 8A.20[1][a]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
B. Shareholders' Meetings and Actions by Written Consent Without Meetings

4-8A California Legal Forms--Transaction Guide § 8A.25

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.25 Record Date

A corporation determines the shareholders who are entitled to notice of any meeting, to vote, and to exercise any other lawful rights as of a specified date, known as the record date. The record date may be

- Fixed in advance by the board of directors [*Corp. Code § 701(a)*], or
- Prescribed by statute [*Corp. Code § 701(b)*].

A record date fixed by the board must not be more than 60 nor less than 10 days before the date of any meeting nor more than 60 days before any other action [*Corp. Code § 701(a)*].

If no record date is fixed by the board of directors, the record date for determining shareholders entitled to notice of or to vote at a meeting of shareholders is at the close of business on the business day next preceding the day notice is given [*see Corp. Code § 118* ("time a notice is given" defined) or, if notice is waived [*see § 8A.24*], at the close of business on the business day next preceding the day the meeting is held [*Corp. Code § 701(b)(1)*]. The record date for determining shareholders entitled to give consent to corporate action in writing without a meeting, if no prior action by the board has been taken, is the day on which the first written consent is given, if no other record date has been fixed by the board of directors [*Corp. Code § 701(b)(2)*]. The record date for determining shareholders for any other purpose (for example, to receive dividends or other distributions) is the close of business day on the day the board adopts the resolution relating to that matter, or the 60th day prior to the date of the other action, whichever is later [*Corp. Code § 701(b)(3)*].

The record date for an adjourned meeting is the same as the record date for the original meeting, unless the board fixes a new record date for the adjourned meeting or the original meeting is adjourned for more than 45 days, in which case the board must fix a new record date [*Corp. Code § 701(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
B. Shareholders' Meetings and Actions by Written Consent Without Meetings

4-8A California Legal Forms--Transaction Guide § 8A.26

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.26 Quorum

Unless otherwise provided in the articles of incorporation, a majority of the shares entitled to vote, represented at a meeting in person or by proxy, constitutes a quorum [*Corp. Code § 602(a)*]. However, a quorum may never consist of less than one-third (or, in the case of a mutual water company, 20 percent) of the shares entitled to vote at the meeting or, except in the case of a close corporation [*see Corp. Code § 158* (close corporation defined)], of more than a majority of the shares entitled to vote at the meeting [*Corp. Code § 602(a)*]. Shares disqualified from voting on a matter will not be considered outstanding for the purposes of determining a quorum at a meeting to act on that matter [*Corp. Code § 112*].

If a quorum is present, the affirmative vote of the majority of the shares represented at the meeting and entitled to vote on any matter is the act of the shareholders, unless the vote of a greater number or voting by classes is required by the General Corporation Law or the articles of incorporation [*Corp. Code § 602(a)*].

If a quorum is present at the commencement of a meeting, but shareholders withdraw to leave less than a quorum, the remaining shareholders may continue to transact business and take any action if approved by at least a majority of the shares required to constitute a quorum or, if required by law or the articles, the vote of a greater number or voting by classes [*Corp. Code § 602(b)*]. In the absence of a quorum, however, the meeting may be adjourned by the vote of only a majority of the shares represented either in person or by proxy [*Corp. Code § 602(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
B. Shareholders' Meetings and Actions by Written Consent Without Meetings

4-8A California Legal Forms--Transaction Guide § 8A.27

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.27 Meeting Procedures

Either the corporation's president or its chair of the board usually conducts a shareholders' meeting, unless the bylaws designate another person [*see Corp. Code § 212(b)(2)*].

PRACTICE TIP:

In both small, closely held corporations and larger, publicly held corporations, the chair frequently relies on the assistance of an attorney, often functioning as corporate secretary, to determine the existence of a quorum, record the minutes of the meeting, tally the votes, and determine the required number of shares for approval [*see §§ 8A.40, 8A.41*]. Because shareholders are entitled to receive a report of the exact voting of shares at a shareholders' meeting, [*Corp. Code § 1509*; *see* Ch. 7, *Corporate Records and Reports*] each shareholder's vote must be carefully tallied. Informal counting is not adequate. *Commentary by Marilyn E. Minger.*

The usual procedure at a shareholders' meeting is as follows:

- Call the meeting to order;
- Determine whether a quorum is present or represented at the meeting; or
- Determine the number of shares each shareholder is entitled to vote.

For further discussion see *§§ 8A.26, 8A.40, 8A.41, 8A.71*. See *§ 8A.260[2]* for minutes for a shareholders annual meeting.

The formality with which the meeting is conducted depends on the size of the corporation and the relationships of its participants. Further proceedings at the meeting depend on the type of meeting, annual or special, and the kind of

business to be transacted. For further discussion of these issues, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 9, *Shareholders' Meetings and Voting* , § 167 (Matthew Bender), and Wetzel, *Conduct of a Stockholders' Meeting, 22 Bus. Law. 303 (1967)*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
B. Shareholders' Meetings and Actions by Written Consent Without Meetings

4-8A California Legal Forms--Transaction Guide § 8A.28

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.28 Action by Written Consent Without Meeting

[1] In General

Unless otherwise provided in the articles of incorporation, action that may be taken by the shareholders at any annual or special meeting may be taken without a meeting and without prior notice, by a consent in writing [*Corp. Code § 603(a)*; *see §§ 8A.222, 8A.223*]. This consent must (1) set forth the action taken and (2) be signed by the holders of outstanding shares having at least the minimum number of votes necessary to take that action at a meeting at which all shares entitled to vote on that particular matter were present and voted [*Corp. Code § 603(a)*].

In general, directors may only be elected by written consent by the unanimous written consent of all shares entitled to vote for the election of directors [*Corp. Code § 603(d)*]. The purpose of this provision is to protect the right of cumulative voting in the election of the entire board. However, shareholders may elect a director to fill a vacancy not filled by the board of directors (other than a vacancy created by removal) by the written consent of a majority of the outstanding shares entitled to vote. Filling vacancies created by removal requires the unanimous written consent of all shares entitled to vote for the election of directors [*Corp. Code §§ 305(b), 603(d)*].

Although there is no statutory requirement that all shareholders entitled to vote be solicited in writing for consents, if this is not done, the nonconsenting shareholders entitled to vote must be given the following notice [*Corp. Code § 603(b)*]:

- Notice of any shareholder approval without a meeting by less than unanimous written consent, related to (1) transactions in which a director has a financial interest [*Corp. Code § 310*]; (2) indemnification of corporate agents [*Corp. Code § 317*]; (3) corporate conversions [*Corp. Code § 1152*]; (4) the principal terms of reorganization [*Corp. Code § 1201*]; or (5) a plan of distribution of corporate assets upon dissolution not in accordance with the liquidation rights of the preferred shares [*Corp. Code § 2007*]. Notice must be given at least 10 days before the consummation of the approved action [*Corp.*

Code § 603(b)(1); *see Corp. Code § 601(b)* (notice procedure)].

- "Prompt" notice of the taking of any other corporate action approved by shareholders without a meeting by less than unanimous written consent [*Corp. Code § 603(b)(2)*; *see Corp. Code § 601(b)* (notice procedure); *see also § 8A.120*, P 5].

PRACTICE TIP:
"Prompt" notice probably means within, at the most, a couple of days from the date the action was taken. *Commentary by Marilyn E. Minger.*

Any written consent may be revoked by the consenting shareholder, the shareholder's proxyholders, a transferee of the shares, a shareholder's personal representative, or their respective proxyholders. Any revocation [*see § 8A.254*] must be in writing and must be received by the corporation before the written consents representing the number of shares required to authorize the proposed action have been filed with the corporation's secretary [*Corp. Code § 603(c)*]. The revocation of consent is effective on receipt by the corporation's secretary [*Corp. Code § 603(c)*].

[2] Special Rules for Written Consents for Corporations With 100 or More Shareholders

Special rules apply to the form of any written consent distributed to 10 or more shareholders of a corporation with outstanding shares held of record by 100 or more persons [*see Corp. Code § 605* (shares held of record by 100 or more persons defined)] if the corporation has no outstanding class of securities registered or exempted from registration under § 12 of the Securities and Exchange Act [*Corp. Code § 604*; *see 15 U.S.C. §§ 78l, 78l(g)(2)*]. These written consents must include the following [*Corp. Code § 604(a)*]:

- A choice between approval and disapproval of each matter (or group of related matters), other than elections; and

- A provision, subject to reasonable, specified conditions, that the shares will be voted in accordance with the shareholder's choice.

Failure of a subject corporation to comply with the statutory requirements for a form of proxy, which are similar to those for a form of written consent, does not invalidate any corporate action taken, but may be the basis for challenging noncompliance in the superior court [*Corp. Code § 604(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
B. Shareholders' Meetings and Actions by Written Consent Without Meetings

4-8A California Legal Forms--Transaction Guide § 8A.29

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.29 Meetings Using Electronic Transmission

Shareholders' meetings may be conducted, in whole or in part, by electronic transmission by and to the corporation, or by electronic video screen communication if [*Corp. Code § 600(e)*]:

- The corporation implements reasonable measures to provide shareholders (in person or by proxy) a reasonable opportunity to participate in the meeting and to vote on matters submitted to the shareholders, including an opportunity to read or hear the proceedings concurrently; and

- A record of any vote or other action is maintained by the corporation if any shareholder votes or acts by means of electronic transmission to the corporation or electronic video screen communication.

Any request by a corporation to a shareholder for consent to conduct a shareholders' meeting by electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*] must include a notice stating that the meeting will be held at a physical location absent the shareholders' consent [*Corp. Code § 600(e)*; *see § 8A.21*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral Overview



24 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
B. Shareholders' Meetings and Actions by Written Consent Without Meetings

4-8A California Legal Forms--Transaction Guide §§ 8A.30-8A.39

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.30[Reserved]



25 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
C. Shareholder Voting Procedures

4-8A California Legal Forms--Transaction Guide § 8A.40

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.40 Noncumulative Voting of Shares

Except as otherwise provided in the articles [*see § 8A.11[2]*] and except for cumulative voting for directors [*see § 8A.41*], each outstanding share, regardless of class, is entitled to one vote on each matter submitted to a vote of the shareholders [*Corp. Code § 700(a)*; *see Corp. Code §§ 400, 401* (power of corporation to limit voting rights), 407 (voting rights of fractional shares)]. A shareholder entitled to vote on any matter may vote part of his or her shares in favor of the proposal and refrain from voting the remaining shares or vote them against the proposal (except for elections to office) [*Corp. Code § 700(b)*]. However, if the shareholder fails to specify the number of shares he or she is voting affirmatively, it is conclusively presumed that the shareholders approving vote is with respect to all the shares he or she is entitled to vote [*Corp. Code § 700(b)*]. For discussion of voting fractional shares, see Ballantine & Sterling, California Corporation Laws, Ch. 9, *Shareholders' Meetings and Voting* , § 171.03 (Matthew Bender). For discussion of special rules applying to particular types of shareholders, see *§§ 8A.42-§ 8A.44*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
C. Shareholder Voting Procedures

4-8A California Legal Forms--Transaction Guide § 8A.41

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.41 Cumulative Voting for Directors

Except as otherwise provided in the articles or bylaws of a listed corporation [*see Corp. Code § 301.5(d)* ("listed corporation" defined); *see also* Corp. Code § 708.5] or in the shareholder agreement of a close corporation [*Corp. Code § 300(b)*], every shareholder complying with *Corp. Code § 708(b)* (*see below*) may cumulate his or her votes for the election of directors [*Corp. Code § 708(a)*]. Using cumulative voting, a shareholder may cast a number of votes equal to the number of votes to which he or she is normally entitled multiplied by the number of directors to be elected [*Corp. Code § 708(a)*]. The shareholder then may cast all votes for one candidate or may divide votes between multiple candidates [*Corp. Code § 708(a)*]. Thus, for example, minority shareholders may elect their candidate to the board of directors by casting all their cumulated votes for that one candidate.

Corp. Code § 708(b) restricts shareholder cumulative voting to situations where the candidates' names have been placed in nomination before the meeting and any shareholder has given notice at the meeting prior to the voting of the intent to cumulate votes at the meeting.

The candidates for director who receive the highest number of affirmative votes, up to the number of directors to be elected, are elected [*Corp. Code § 708(c)*; *but see* Corp. Code § 708.5]. A negative or a withheld vote against a director has no legal effect [*Corp. Code § 708(c)*]. Elections for directors are not required to be by ballot, unless a shareholder demands election by ballot at the meeting, before the voting begins, or unless required by the bylaws [*Corp. Code § 708(e)*; *see §§ 8A.240, 8A.241*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & Removals



27 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
C. Shareholder Voting Procedures

4-8A California Legal Forms--Transaction Guide § 8A.42

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.42 Voting by Fiduciaries, Receivers, Pledgees, Minors, and Attorneys in Fact

Shares held by an administrator, executor, guardian, conservator, or custodian may be voted by that holder, either in person or by proxy, without a transfer of shares into the holder's name, subject to *Corp. Code § 703(c)* (voting of shares held by issuing corporation in fiduciary capacity) [*Corp. Code § 702(a)*]. Similarly, shares held by an attorney in fact authorized to vote the shares by the appointing power of attorney may be voted by that attorney in fact, either in person or by proxy, without a transfer of shares into his or her name [*Corp. Code § 702(e)*]. A trustee, however, may not vote shares, either in person or by proxy, unless the shares have been transferred into the trustee's name [*Corp. Code § 702(a)*].

Shares standing in the name of a receiver may be voted by that receiver, and shares held by or under the control of a receiver may be voted by that receiver without a transfer into his or her name, if the court order appointing the receiver contains that authority [*Corp. Code § 702(b)*].

Subject to *Corp. Code § 705* (voting by proxy), and except as otherwise agreed in writing, a shareholder whose shares are pledged is entitled to vote those shares until they have been transferred into the name of the pledgee. Thereafter, the pledgee is entitled to vote the transferred shares [*Corp. Code § 702(c)*].

Shares held by a minor may be voted, in person or by proxy, whether or not the corporation has notice, actual or constructive, of the nonage, unless a guardian of the minor's property has been appointed and the corporation has been given written notice of that appointment [*Corp. Code § 702(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewCivil

ProcedureRemediesReceivershipsReceiversGeneral Overview



28 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
C. Shareholder Voting Procedures

4-8A California Legal Forms--Transaction Guide § 8A.43

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.43 Voting by Corporate Shareholders

Shares held by another foreign or domestic corporation may be voted by any officer, agent, or proxyholder prescribed by the other corporation's bylaws [*Corp. Code § 703(a)*]. In the absence of a bylaw provision, the shares may be voted as determined by the board of the other corporation [*Corp. Code § 703(a)*]. If the board has not made a determination, the shares may be voted by the chair of the board, the president, or any vice president of the other corporation, or by any other person authorized to vote by one of those officers [*Corp. Code § 703(a)*]. Shares that are voted or proxies that are executed in the name of a corporation are presumed to have been voted or executed in compliance with the General Corporation Law, unless evidence indicates otherwise [*Corp. Code § 703(a)*]. Shares of a corporation owned by its subsidiary are not entitled to vote on any matter [*Corp. Code § 703(b)*]. Shares held by the issuing corporation (and by its subsidiary) in a fiduciary capacity also are not entitled to vote on any matter, with specified exceptions [*Corp. Code § 703(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
C. Shareholder Voting Procedures

4-8A California Legal Forms--Transaction Guide § 8A.44

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.44 Voting of Jointly Held Shares

Jointly held shares, for purposes of the general rules for voting these shares, include shares in the names of two or more persons, as fiduciaries (including persons with the same fiduciary relationship to the same shares), partners, joint tenants, tenants in common, husband and wife as community property, tenants by the entirety, voting trustees, persons entitled to vote under a shareholder voting agreement, or otherwise [*Corp. Code § 704*]. Rules for voting jointly held shares are as follows:

- If only one vote is cast, that vote binds all.

- If more than one vote is cast, the majority voting binds all [*see, e.g., Edwards v. Edwards (1998) 61 Cal. App. 4th 599, 602-603, 71 Cal. Rptr. 2d 653* (power of cotrustees of inter vivos trust to vote shares of stock held in trust is governed by *Corp. Code § 704*], providing that the act of the majority of the cotrustees is binding, rather than by *Prob. Code § 15620*, providing that cotrustees may exercise their powers only by unanimous action)].

- If more than one vote is cast, but the vote is evenly split on any particular matter, each fraction may vote the shares proportionately [*Corp. Code § 704*].

To avoid these rules, the joint holders must furnish the corporate secretary with written notice and a copy of any instrument or order appointing them joint tenants or creating their joint ownership [*see Corp. Code § 704*]. If that instrument or the share registration shows that the shareholders' ownership interest is unequal, then for purposes of voting jointly held shares, a majority will be a majority in interest and an even split will be an even split in interest [*Corp. Code § 704*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



30 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
C. Shareholder Voting Procedures

4-8A California Legal Forms--Transaction Guide § 8A.45

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.45 Voting by Proxy

A proxy [*see §§ 8A.250-8A.253*] is a written authorization given by a shareholder to another party to vote the shareholder's shares [*Corp. Code § 178*]. Every person entitled to vote shares may authorize another person (or persons) (the "proxy holder" [*Corp. Code § 179*]) to vote or take other action on those shares by proxy [*Corp. Code § 705(a)*]. The shareholder's name must be "signed" on the proxy by the shareholder or the shareholder's attorney in fact. "Signed" means the placing of the shareholder's name or other authorization on the proxy, whether by manual signature, typewriting, telegraphic, or electronic transmission or otherwise [*Corp. Code § 178*]. A proxy may be transmitted orally over the telephone if it is submitted with information from which it may be determined that the proxy was authorized by the shareholder or the shareholder's attorney in fact [*Corp. Code § 178*].

Any proxy purporting to be executed according to the provisions of the General Corporation Law is presumptively valid [*Corp. Code § 705(a)*; *see Corp. Code § 604* (required form of proxy to be distributed to shareholders of corporation with outstanding shares held by 100 or more persons); *see also § 8A.253*]. Proxies are discussed further in §§ 8A.60-8A.63.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
C. Shareholder Voting Procedures

4-8A California Legal Forms--Transaction Guide § 8A.46

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.46 Voting by Voting Agreement or Voting Trust

[1] Voting Agreement and Voting Trust Defined

Voting agreements and voting trusts are common arrangements for controlling how shares will be voted. A voting agreement is a written agreement between two or more shareholders requiring that the shares held by them be voted as provided in the agreement [*Corp. Code § 706(a)*]. In a voting agreement, shareholders may vote their own shares (in accordance with the agreement) or may transfer title to their shares to third parties, who will vote the shares as agreed [*see* Ch. 8B, *Voting Agreements and Voting Trusts*].

A voting trust ordinarily is created by a written agreement between two or more shareholders, irrevocably transferring title to their shares (for a definite period of time not exceeding ten years) to voting trustees, who, in return, issue to the shareholders certificates of beneficial interest ("voting trust certificates"). A duplicate of the voting trust agreement must be filed with the corporation's secretary [*Corp. Code § 706(b)*; *see also* Note, *The Voting Trust, 34 N.Y.U. L. Rev. 290, 290*-292 (1959)].

[2] Voting Trust, Voting Agreement, and Proxy Distinguished

A voting trust differs from a voting agreement or proxy in that with a voting trust, legal title must be transferred to a trustee, who has the right to vote the shares, according to the terms of the trust agreement [*see* [1], *above*]. A voting trust imposes a fiduciary duty on the trustees exercising the voting power [*see Corp. Code § 706(b)*; *see also* Ch. 8B, *Voting Agreements and Voting Trusts* ; Gose, *Legal Characteristics and Consequences of Voting Trusts, 20 Wash. L. Rev. 129, 139 (1945)*]. In a voting agreement, on the other hand, each shareholder may retain the power to vote his or her shares, but must agree to do so as provided in the voting agreement, or may transfer the shares to third parties with the authority to vote the shares as provided in the agreement [*see Corp. Code § 706(a)*; *see also* Ch. 8B, *Voting Agreements and Voting Trusts*]. A voting agreement imposes a contractual obligation, rather than a fiduciary obligation, on those exercising the voting power [*see* O'Neal & Thompson, O'Neal's Close Corporations, Ch. 5, *Control Distribution Devices: Shareholders' Agreements, Voting Trusts, Irrevocable Proxies, and Management Contracts*, §

5.37 (West 3d ed.)]. A proxy, however, creates an agency relationship and is governed by agency rules [*see* O'Neal & Thompson, O'Neal's Close Corporations, Ch. 5, *Control Distribution Devices: Shareholders' Agreements, Voting Trusts, Irrevocable Proxies, and Management Contracts*, § 5.13 (West 3d ed.)]. Under this arrangement, the shareholder retains legal title to the shares, but, as principal, gives an agent the power to vote the shares. For further discussion of proxies, see *§§ 8A.60-8A.63*.

For detailed discussion of voting agreements and voting trusts and an overview of other types of agreements and control devices, see Ch. 8B, *Voting Agreements and Voting Trusts* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
C. Shareholder Voting Procedures

4-8A California Legal Forms--Transaction Guide §§ 8A.47-8A.59

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.47[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
D. Proxies

4-8A California Legal Forms--Transaction Guide § 8A.60

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.60 Form of Proxy

[1] Contents

Special rules apply to the form of proxies distributed to 10 or more shareholders of a corporation with outstanding shares held of record by 100 or more persons [*see Corp. Code § 605* (shares held of record by 100 or more persons defined)], if the corporation has no outstanding class of securities registered or exempted from registration under § 12 of the Securities Exchange Act [*Corp. Code § 604*; *see 15 U.S.C. §§ 78l, 78l(g)(2)*]. These proxies must include the following [*Corp. Code § 604(a)*]:

- A choice between approval and disapproval of each matter (or group of related matters), other than elections; and

- A provision, subject to reasonable, specified conditions, that the shares will be voted in accordance with the shareholder's choice.

In any election of directors, a proxy may not be voted for the election of any named candidates for director if the proxy is marked "withhold," or otherwise marked to indicate that the authority to vote for the election of directors is withheld [*Corp. Code § 604(b)*].

Proxies of corporations subject to federal securities reporting requirements (and federal proxy rules) must meet detailed requirements that are outside the scope of this chapter [*see 17 C.F.R. § 240.14a-1 et seq.* (Regulation 14A; solicitation of proxies)]. In general, however, federal proxy regulations cover proxy solicitations by corporations whose stock is publicly traded or listed on a national stock exchange [*see 17 C.F.R. § 240.14a-2* (general exemptions to federal proxy solicitation rules)]. For detailed discussion of federal proxy rules, see FEDERAL SECURITIES EXCHANGE ACT OF 1934, Ch. 7, *Proxy Regulation* (Matthew Bender).

[2] Failure to Comply With Requirements

A failure to comply with the proxy rules [*see Corp. Code § 604*; [1], *above*] for the form of proxies distributed to 10 or more shareholders of a corporation with outstanding shares held of record by 100 or more persons, if the corporation has no outstanding class of securities registered or exempted from registration under the § 12 of the Securities and Exchange Act [*15 U.S.C. §§ 78l, 78l(g)(2)*], does not invalidate any action taken, but may be the basis for challenging any proxy at a shareholders' meeting, and for shareholder suit in the superior court to compel compliance [*see Corp. Code § 604(c)*].

Proxy contests, which usually develop when shareholders try to solicit proxies voting for an opposition slate of directors or for a counterproposal, are subject to special procedures if the corporation must comply with federal proxy regulations [*see 15 U.S.C. § 78n*; *see* [1], *above*]. Proxy contests are discussed further in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 9, *Shareholders' Meetings and Voting* , § 173 (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawAdditional Offerings & the Securities Exchange Act of 1934ProxiesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & Removals



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
D. Proxies

4-8A California Legal Forms--Transaction Guide § 8A.61

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.61 Duration of Proxies

A proxy is valid only for a period of 11 months from its date, unless otherwise provided in the proxy [*Corp. Code § 705(b)*]. In practice, most proxies are granted for a specific meeting [*see § 8A.250*; Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 9, *Shareholders' Meetings and Voting* , § 172.01[4] (Matthew Bender)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
D. Proxies

4-8A California Legal Forms--Transaction Guide § 8A.62

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.62 Revocation of Proxies

A proxy continues in effect until revoked by the person executing it, before the vote pursuant to the proxy, with specified exceptions [*Corp. Code § 705(b)*]. These exceptions include the following:

- Revocation because of the death or incapacity of the maker of proxy if corporation receives written notice before vote is counted [*see Corp. Code § 705(c)*];

- Revocation of a proxy held by a pledgee, purchaser, creditor, or employee if the purpose for which the proxy was given no longer exists [*see Corp. Code § 705(e)*; § 8A.63]; or

- Revocation by a transferee of shares with no knowledge of irrevocable provision of proxy, subject to specified limitations [*see Corp. Code § 705(f)*; § 8A.63].

A proxy may be revoked by any of the following [*Corp. Code § 705(b)*]:

- A written notice to the corporation [*see § 8A.254*].

- A subsequent proxy (determined by the dates on the proxy forms, not the postmark date) executed by the same shareholder and presented to the meeting.

- As to any one meeting, attendance at that meeting and voting in person.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
D. Proxies

4-8A California Legal Forms--Transaction Guide § 8A.63

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.63 Irrevocable Proxies

In some circumstances, a proxy that states that it is irrevocable [*see § 8A.252*] is irrevocable for a specified period and is not revoked by giving written notice to the corporation of the death or incapacity of the proxy maker [*see Corp. Code § 705(e)*]. These circumstances include the following [*Corp. Code § 705(e)*]:

- The giving of a proxy to secure the performance of a duty or to protect a legal or equitable title, until the happening of events which, by the proxy's terms, discharge the obligations secured by it.

- The giving of a proxy to any of the following:

    - A pledgee (or the pledgee's nominee).

    - A person (or that person's nominee) who has purchased, agreed to purchase, or holds an option to purchase the shares, or a person who has sold a portion of his or her shares to the proxy maker.

    - A creditor of the corporation, a shareholder who extended or continued credit to the corporation, or a shareholder, in consideration of the proxy, if the proxy states both that it was given in consideration of extending or continuing credit and the name of the creditor.

    - A person who has contracted to perform services as an employee of the corporation, if a proxy is required by the employment contract and if the proxy states all of the following: that it was given in consideration of that contract, the employee's name, and the period of employment.

    - A person designated under a voting agreement or a voting trust [*see Corp. Code §*

706].

- A beneficiary of a trust with respect to shares held by the trust.

These proxies become revocable, despite the period of irrevocability specified in the proxy, when the purpose for which the proxy was given no longer exists, that is, when any of the following occur [*Corp. Code § 705(e)*]:

- The pledge is redeemed.
- The option or agreement to purchase is terminated or the seller no longer owns any shares of the corporation or dies.
- The debt of the corporation or the shareholder is paid.
- The period of employment provided for in the contract of employment has terminated.
- The voting agreement or voting trust has terminated.

An irrevocable proxy may also be revoked by a transferee of shares with no knowledge of the irrevocable provision, unless the existence of the proxy and its irrevocability appears either (1) on the certificate representing the shares, in the case of certified securities or (2) if the securities are uncertificated [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)*], on the initial transaction statement and written statements [*Corp. Code § 705(f)*; *see Corp. Code § 171.1* (definition)]. For a discussion of those statements and uncertificated securities generally, see Ch. 6I, *Issuance of Equity Securities* .

Unless otherwise provided by written agreement of the parties, the recordholder of shares which belong to another or are held as a pledge or security, must issue a proxy to the pledgor or owner of those shares, upon demand and payment of necessary expenses [*Corp. Code § 705(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



37 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
D. Proxies

4-8A California Legal Forms--Transaction Guide §§ 8A.64-8A.69

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.64[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
E. Voting Record Rights and Disclosure Requirements; Enforcement of Voting Rights

4-8A California Legal Forms--Transaction Guide § 8A.70

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.70 Voting Record Rights and Disclosure Requirements

[1] Shareholder's Right to Voting Results

For 60 days after any shareholder meeting, a corporation must immediately inform any shareholder [*see Corp. Code § 1512* (shareholder defined for this purpose)], on written request [*see § 8A.242*], of the result of any shareholder vote taken at that meeting [*Corp. Code § 1509*]. The report [*see § 8A.243*] must include the number of shares that voted for, against, and abstained from voting [*Corp. Code § 1509*]. If directors were elected, the report must include the number of shares, or votes, if voted cumulatively, cast for each nominee [*Corp. Code § 1509*]. If more than one class or series of shares voted, the report must also state the numbers by class and series of shares [*Corp. Code § 1509*].

[2] Voting Record Disclosure Requirements

Every person who has the power to vote shares of stock on behalf of another must maintain a record of the manner in which the shares were voted. This record must be kept for 12 consecutive months from the effective date of the vote [*Corp. Code § 711(d)*].

On request, a person having the power to vote shares on behalf of another, or a designated agent of the person holding that power, must disclose, to the beneficial owners of the shares, the voting record with respect to any matter involving one or more specific securities [*Corp. Code § 711(e)*]. Disclosure must be made to the requesting party on presentation of identification sufficient to identify him or her as a person on whose behalf the shares were voted [*Corp. Code § 711(e)(1)*]. Disclosure may also be made to the party who has entered into an agreement designating another to vote his or her shares, rather than to the requesting party, if the requesting party is not the person on whose behalf the shares were voted [*Corp. Code § 711(e)(2)*].

Unless a governing instrument provides otherwise, a person holding the power to vote shares on behalf of another may designate an agent to maintain and disclose records [*Corp. Code § 711(h)*]. Signing a proxy on another's behalf and forwarding it for disposition or receiving voting instructions does not constitute the power to vote. However, a person

forwarding proxies or receiving instructions must disclose the identity of the person having the power to vote shares on reasonable written request by a person entitled to request a voting record [*Corp. Code § 711(g)*]. The person disclosing a record may assess a reasonable charge in order to defray disclosure expenses [*Corp. Code § 711(i)*], unless disclosure is made to a party other than the person making the request [*see Corp. Code § 711(e)(2)*] or is otherwise limited by law or the corporation's governing instruments [*Corp. Code § 711(i)*].

A "person on whose behalf shares are voted" includes the following individuals [*Corp. Code § 711(b)*]:

- A participant or beneficiary of an employee benefit plan, with regard to shares held for the benefit of the participant or beneficiary; and

- A shareholder, beneficiary, or contract owner of any "investment company" (as defined in the Investment Company Act of 1940) [*see 15 U.S.C. § 80a-3(a)* (defined as issuer primarily engaged in business of investing, reinvesting, or trading in securities)] or any portfolio of an investment company, to the extent that the investment company (or portfolio) holds the shares for which the record is requested.

A "person on whose behalf shares are voted" does *not* include the following individuals [*Corp. Code § 711(c)*]:

- A person who possesses the right to terminate or withdraw from the shareholder, contract owner, participant, or beneficiary relationship with any investment company [*see 15 U.S.C. § 80a-3(a)* (investment company defined)] (or portfolio of an investment company);

- A person entitled to receive information about a trust [*see Prob. Code § 16061*]; or

- A beneficiary, participant, contract owner, or shareholder whose interest is funded through the general assets of a life insurance company authorized to conduct business in California.

A person whose request is not complied with may file a petition to enforce disclosure. The court may award costs and reasonable attorneys' fees if it finds that the defendant willfully failed to comply with the disclosure requirements [*Corp. Code § 711(j)*].

If a statute or regulation pursuant to the federal Employee Retirement Income Security Act of 1974 (ERISA) [*29 U.S.C. § 1001 et seq.*] imposes disclosure duties on investment managers that are substantially the same as the California requirements described above, compliance with the federal statute or regulation will be considered sufficient [*Corp. Code § 711(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
E. Voting Record Rights and Disclosure Requirements; Enforcement of Voting Rights

4-8A California Legal Forms--Transaction Guide § 8A.71

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.71 Inspectors of Election

Before any shareholder meeting, the board of directors may appoint either one or three inspectors of election to act at that meeting, or at any adjourned meeting [*Corp. Code § 707(a)*]. If inspectors of election are not appointed, or if those appointed fail to appear or to act, the meeting's chair may, and on the request of any shareholder or shareholder's proxy must, appoint (or replace) inspectors of election at the meeting [*Corp. Code § 707(a)*]. If appointed at a meeting on the request of the shareholders or their proxies, the majority of shares represented in person or by proxy determines the number of inspectors (either one or three) to be appointed [*Corp. Code § 707(a)*].

The inspectors of election must do all of the following [*Corp. Code § 707(b)*]:

- Determine
    - The number of shares outstanding and the voting power of each;
    - The number of shares represented at the meeting;
    - The existence of a quorum; and
    - The authenticity, validity, and effect of proxies.
- Receive votes, ballots, or consents.
- Hear and determine all challenges and questions arising in connection with the right to vote.
- Tabulate all votes or consents.

- Determine when the polls will close.

- Determine the result and do any acts required to properly conduct the election or vote with fairness to all shareholders.

The inspectors of election must perform their duties impartially, in good faith, to the best of their ability, and as expeditiously as practical [*Corp. Code § 707(c)*]. If there are three inspectors of election, the decision, act, or certificate of a majority is effective [*Corp. Code § 707(c)*]. Any report or certificate made by the inspectors of election is prima facie evidence of the facts stated therein [*Corp. Code § 707(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesFiduciary ResponsibilitiesDuty of Good FaithBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
E. Voting Record Rights and Disclosure Requirements; Enforcement of Voting Rights

4-8A California Legal Forms--Transaction Guide § 8A.72

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.72 Judicial Enforcement of Voting Rights

Any shareholder or person who claims to have been denied the right to vote [*e.g., Haah v. Kim (2009) 175 Cal. App. 4th 45, 55, 95 Cal. Rptr. 3d 515* (persons with standing include those who have entered into agreements to take shares in corporation but whose shares have not yet been issued)] may file a complaint in the superior court of the proper county to determine the validity of the election or appointment of any director [*see Corp. Code § 709(a)*; *see also Corp. Code § 177* ("proper county" defined)]. This judicial enforcement of voting rights applies to foreign corporations as well, if the election was held or the appointment made in California [*Corp. Code § 709(a)*]. After proper notice has been given to the corporation and a hearing has been held [*see Corp. Code § 709(b)*], the court may determine the person entitled to the office of director, order that a new election be held or appointment made, determine the right of persons to vote, and direct any other just and proper relief [*see Corp. Code § 709(c)*]. This recourse procedure is available to persons seeking to uphold, as well as to those seeking to challenge, the election of directors [*Shahin v. Wawro (1982) 136 Cal. App. 3d 749, 753, 186 Cal. Rptr. 446* ; *see Boericke v. Weise (1945) 68 Cal. App. 2d 407, 411, 156 P.2d 781]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersActions Against CorporationsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



41 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART II. LEGAL BACKGROUND
E. Voting Record Rights and Disclosure Requirements; Enforcement of Voting Rights

4-8A California Legal Forms--Transaction Guide §§ 8A.73-8A.99

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.73[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-8A California Legal Forms--Transaction Guide

AUTHOR: Marilyn E. Minger Practice Consultant

NOTE:

For a preincorporation planning checklist, see Ch. 2, ***Formation of Corporations*** .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-8A California Legal Forms--Transaction Guide § 8A.100

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.100 Facts

[1] The Corporation

1. Name and address of principal executive office of corporation.

2. Date of incorporation.

3. State of incorporation.

4. Tax year of corporation.

5. Employer identification number.

6. Principal business.

7. Number of shareholders.

NOTE:

Special rules apply to the form of proxies distributed to 10 or more shareholders of a corporation with outstanding shares held of record by 100 or more persons [***see*** *Corp. Code § 605* (shares held of record by 100 or more persons defined)], if the corporation has no outstanding class of securities registered or exempted from registration under § 12 of the Securities and Exchange Act [*Corp. Code § 604*; ***see*** *15 U.S.C. §§ 78l, 78l(g)(2)*; ***see also*** *§ 8A.60[1]*].

8. Total number of shares issued.

9. Number, class, and series of shares.

10. Voting rights of each class or series of shares [*see §§ 8A.11, 8A.40*].

11. Approximate fair market value of shares, if known.

12. Whether corporation is a professional corporation.

NOTE:

No shareholder of a professional corporation [***see*** *Corp. Code § 13401(b)* (professional corporation defined)] or a foreign professional corporation [***see*** *Corp. Code § 13401(c)*] qualified to do business in California may enter into a voting trust, proxy, or any other arrangement vesting another person (other than another person who is a shareholder of the same corporation) with the authority to exercise the voting power of any shares. Any arrangement attempting to circumvent this prohibition is void [*Corp. Code § 13406(a)*].

13. Whether corporation has elected Subchapter S status.

NOTE:

The Subchapter S provisions of the Internal Revenue Code [*I.R.C. § 1361* et seq.] provide that certain trusts, including trusts created primarily to exercise the voting power of stock transferred to them, may be shareholders of S corporations [*I.R.C. § 1361(c)(2)(A)(iv)*]. For discussion of the effect of voting agreements and voting trusts on S corporation status, see Ch. 8B, ***Voting Agreements and Voting Trusts*** .

14. Names, addresses, and telephone numbers of directors.

15. Names, addresses, telephone numbers, and titles of officers.

16. Name, address, and telephone number of accountant.

17. Name and address of corporation's transfer agent, if any.

[2] Each Shareholder

NOTE:

If voting agreement or voting trust agreement will be used, see Ch. 8B, ***Voting Agreements and Voting Trusts*** , for additional information to be solicited in the client interview.

1. Names and addresses of shareholders:

NOTE:

A record of shareholders, giving the names and addresses of shareholders and the number and shares held by each, is required to be kept at the corporation's principal executive office or at the office of its transfer agent or registrar [*Corp. Code § 1500*]. This record may be kept in written form or in another form capable of being converted into clearly

legible tangible form. When records are kept in a form capable of being converted into clearly legible paper form, the form into which the record is converted is admissible in evidence, and acceptable for all other purposes, to the same extent as an original paper record of the same information would be, provided the paper form accurately portrays the record [*Corp. Code § 1500*].

a. Individual shareholders and spouses.

b. Entities.

2. Capacity in which individual holds shares:

a. Owner.

b. Trustee.

c. Executor or administrator.

d. Guardian.

e. Custodian under Uniform Gift to Minors Act.

3. Number, class, and series of shareholder's shares.

4. Basis of shareholder's stock.

[3] Annual or Special Meetings

1. Place of shareholders' meetings, if stated in bylaws [*see Corp. Code § 600(a)*].

NOTE:
If no place is fixed by the bylaws, the meetings must be held at the principal executive office of the corporation [*Corp. Code § 600(a)*]. Shareholders' meeting may be conducted in whole or in part by electronic transmission by and to the corporation [***see*** *Corp. Code §§ 20, 21*] or electronic video screen communication [*Corp. Code § 600(e)*; ***see*** *§ 8A.29*].

2. For any proposed shareholders' meeting:

a. Date and time.

NOTE:
A shareholders' meeting may be conducted in whole or in part by electronic transmission by and to the corporation [***see*** *Corp. Code §§ 20, 21*] or electronic video screen communication [*Corp. Code § 600(e)*; ***see*** *Corp. Code § 601(a)* (notice requirements); § 8A.29].

b. Action proposed to be taken by shareholder vote or written consent.

c. If directors will be elected at meeting, names of nominees management intends to present for election.

d. If original meeting has been adjourned:

(1) Date of original meeting.

(2) Business intended to be transacted at original meeting.

(3) Time and place of adjourned meeting, as announced at original meeting.

(4) Number of days between original and adjourned meetings.

NOTE:

Although no notice of the adjourned meeting is required if the time and place of that meeting (or the means of electronic transmission by and to the corporation [***see*** *Corp. Code §§ 20, 21*] or electronic video screen communication, if any, by which shareholders may participate in that meeting [*Corp. Code § 601(a)*]) are announced at the original meeting, notice to each shareholder of record entitled to vote at the meeting [***see*** *§ 8A.207*] is required if the adjournment is longer than 45 days or, if after the adjournment, a new record date is fixed for the adjourned meeting [*Corp. Code § 601(d)*]. For further discussion of adjourned meetings, see *§§ 8A.20[3], 8A.23[6]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-8A California Legal Forms--Transaction Guide § 8A.101

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.101 Documents

1. Articles of incorporation.

2. Bylaws.

3. Any shareholder agreements imposing transfer restrictions on corporate shares.

4. Any documents regarding qualification, registration or exemption of corporate shares.

5. Share certificates.

6. Shareholder list.

7. Any instrument under which corporation's stock is held, including:

   a. Trust instruments for trusts holding corporation's shares.

   b. Will under which any deceased shareholder's corporate stock is held by estate.

   c. Bankruptcy court order under which bankrupt shareholder's stock is held by bankrupt's estate.

   d. Court order for guardianship.

e. Voting trust or other voting or shareholder agreement [*see* Ch. 8B, *Voting Agreements and Voting Trusts*].

8. Corporate minutes, including any resolutions relating to meetings or voting rights.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



45 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-8A California Legal Forms--Transaction Guide §§ 8A.102-8A.109

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.102[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8A California Legal Forms--Transaction Guide § 8A.110

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.110 Written Consents Without Meeting

1. Determine whether articles restrict use of written consents without meeting.

NOTE:

Unless the articles provide otherwise [***see*** *Corp. Code § 204(d)* (articles may set forth any provision, not in conflict with law, for management of business and for conduct of corporate affairs)], any action that may be taken at any annual or special shareholders' meeting may be taken without a meeting and without prior notice, if the requisite number of shares sign a written consent to the action [*Corp. Code § 603(a)*; ***see*** P 3, ***below***].

2. Determine whether action by written consent is preferable to vote at shareholders' meeting.

NOTE:

In practice, corporate actions can be taken more quickly using written consents than at a shareholders' meeting, since a shareholders' meeting requires setting a record date [***see*** *§ 8A.25*] and giving prior notice of the meeting [***see*** *§ 8A.23*].

3. Determine likelihood of obtaining required number of written consents to authorize action without meeting as follows [*see Corp. Code § 603*]:

a. For action other than election of directors, written consent of holders of outstanding shares having not less than minimum number of votes necessary to authorize that action at meeting at which all shares entitled to vote were present and voted [*Corp. Code § 603(a)*].

b. For election of directors (other than filling vacancy), unanimous written consent of all

shares entitled to vote for election of directors [*Corp. Code § 603(d)*].

c. For filling vacancy on board of directors (other than one created by removal), if vacancy not filled by directors themselves [*see Corp. Code § 305(a)*], consent of majority of outstanding shares entitled to vote [*Corp. Code §§ 305(b), 603(d)*].

d. For filling vacancy on board created by removal, unanimous written consent of all shares entitled to vote for election of directors [*Corp. Code §§ 305(b), 603(d)*].

NOTE:
The articles or a bylaw adopted by the shareholders may permit the board to fill vacancies caused by removal without the approval of the shareholders [*Corp. Code § 305(a)*].

4. Determine whether record date for identifying shareholders entitled to vote by written consent is to be:

a. Date fixed in advance by board, not more than 60 nor less than 10 days before meeting [*Corp. Code § 701(a)*]; or

b. If board has not fixed record date and has not taken prior action, day on which first written consent is given [*Corp. Code § 701(b)(2)*].

NOTE:
Shareholders at the close of business on the record date are entitled to vote, notwithstanding any transfer of shares on the corporate books after the record date, except as otherwise provided in the articles or by agreement [*Corp. Code § 701(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8A California Legal Forms--Transaction Guide § 8A.111

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.111 Annual Meetings

1. Determine date and time of annual meeting [*Corp. Code § 600(b)*]:

   a. For corporation that is regulated investment company [*see Rev. & Tax. Code § 23701m*], a meeting of shareholders must be held as required by the Federal Investment Company Act of 1940 [*see 15 U.S.C. § 80a-1 et seq.*].

   b. For all other corporations, in accordance with bylaws [*see § 8A.100[3]*, P 1].

2. Determine business to be conducted at meeting [*see Corp. Code § 600(b)*]:

   a. Election of directors.

   b. Any of following [*Corp. Code § 601(a), (f)*]:

   NOTE:
   Although any proper matter may be presented for action at the meeting, non-unanimous shareholder approval of the following matters is valid only if the general nature of the proposal was stated in the notice of meeting or in any written waiver of notice [*Corp. Code § 601(a), (f)*; ***see*** *§ 8A.121*, P 2].

   (1) Contract or transaction between corporation and one or more of its directors [*see Corp. Code § 310*; *see also* Ch. 5, *Directors' Meetings, Actions, and Resolutions*].

(2) Amendment of articles after shares have been issued [*see Corp. Code § 902*; *see also* Ch. 10, *Amendment of Articles*].

(3) Approval of a corporate conversion [*Corp. Code § 1152*].

(4) Principal terms of reorganization [*see Corp. Code § 1201*; *see also* Ch. 11, *Merger and Acquisition Issues*].

(5) Authorization for voluntary dissolution [*see Corp. Code § 1900*; *see also* Ch. 12, *Winding Up and Dissolution*].

(6) Plan of distribution in dissolution [*see Corp. Code § 2007*; *see also* Ch. 12, *Winding Up and Dissolution*].

c. Any other proper business.

3. Determine record date [*see § 8A.110*].

4. Determine number of shares that will constitute quorum at meeting, either [*Corp. Code § 602(a)*]:

a. Number specified by articles, but:

(1) Not less than one-third (or in case of mutual water company, 20 percent) of shares entitled to vote at meeting; or

(2) Not more than majority of shares entitled to vote at meeting, except in close corporations; or

b. If articles do not specify number of shares that constitute quorum, majority of shares entitled to vote.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8A California Legal Forms--Transaction Guide § 8A.112

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.112 Special Meetings

1. Determine whether party requesting meeting is one of following eligible to call special meeting:

    a. Board of directors [*Corp. Code § 600(d)*].

    b. Chair of the board [*Corp. Code § 600(d)*].

    c. President [*Corp. Code § 600(d)*].

    d. Shareholders entitled to cast not less than 10 percent of votes at meeting [*Corp. Code § 600(d)*].

    e. Any other persons as provided in articles or bylaws [*Corp. Code § 600(d)*].

    f. Shareholders representing at least five percent of outstanding shares entitled to vote for directors when, after the filling of any vacancy by directors, directors in office who have been elected by shareholders constitute less than majority of directors in office [*see Corp. Code § 305(c)(1)*].

2. Determine whether request for special meeting was made to one of following authorized persons [*Corp. Code § 601(c)*]:

    a. Chair of the board.

b. President.

c. Vice president.

d. Secretary.

3. If meeting is called by party other than board, determine whether date set for meeting is [*Corp. Code § 601(c)*]:

a. Not less than 35 days after receipt of request; and

b. Not more than 60 days after receipt of request.

4. Determine record date for meeting [*Corp. Code § 701*; *see § 8A.111*, P 3].

5. Determine number of shares required for quorum [*Corp. Code § 602(a)*; *see § 8A.111*, P 5].

6. Determine business to be conducted at meeting [*Corp. Code § 601(a)*].

NOTE:

The general nature of all business to be transacted must be determined before giving notice of the meeting, because no business other than that specified in the notice [***see** § 8A.122*, P 2] may be transacted at a special meeting [*Corp. Code § 601(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8A California Legal Forms--Transaction Guide § 8A.113

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.113 Adjourned Meetings

1. Determine whether notice of meeting is required, as result of any of following [*Corp. Code § 601(d)*]:

NOTE:
Notice is not required to be given for a meeting adjourned to another time or place, except in the circumstances listed in PP a through d, ***below*** [*Corp. Code § 601(d)*].

a. Bylaws require notice.

b. Time and place of adjourned meeting were not announced at meeting at which adjournment was taken.

NOTE:
An announcement that the adjourned meeting will take place in conjunction with a future event is not sufficiently specific to constitute an announcement of the time and place. The shareholder attending the meeting at which the adjournment is taken, or the absent shareholder who reads the minutes of the meeting, must be able to determine the time and place of the adjourned meeting from the announcement alone [*Spencer v. Older (1982) 133 Cal. App. 3d 95, 102-102, 183 Cal. Rptr. 722* ; ***see*** *Corp. Code § 601(d)*].

c. Adjournment is longer than 45 days.

d. After adjournment, new record date is fixed for adjourned meeting.

2. Determine record date [*Corp. Code § 701(c)*].

NOTE:

A new record date is required if the meeting is adjourned more than 45 days from date set for original meeting. If the meeting is adjourned for less than 45 days from the date set for original meeting, however, the board may, but is not required to, set new record date [*Corp. Code § 701(c)*].

3. Determine business intended to be transacted at original meeting.

NOTE:

At an adjourned meeting, a corporation may transact any business that might have been transacted at the original meeting [*Corp. Code § 601(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral Overview



50 of 189 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8A California Legal Forms--Transaction Guide §§ 8A.114-8A.119

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.114[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Shareholders' Meetings and Voting

4-8A California Legal Forms--Transaction Guide § 8A.120

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.120 Written Consents Without Meeting

1. Prepare appropriate form for written consent [*see, e.g., §§ 8A.222, 8A.223*.

2. Send consent form to each shareholder entitled to give consent [*see § 8A.110*, P 4].

3. Contact any shareholder who fails to return consent form within specified time period.

4. Tabulate consents and revocations of consent to determine whether proposed action received required number of votes [*see § 8A.110*, P 3; *see also §§ 8A.40-8A.41*].

NOTE:
Any shareholder giving a written consent (or the shareholder's proxyholder, transferee, personal representative, or their respective proxyholders) may revoke that consent personally or by proxy in writing until the time in which written consents of the number of shares required to authorize the proposed action have been filed with the corporation's secretary. A revocation of written consent is effective on its receipt by the secretary [*Corp. Code § 603(c)*; ***see*** *§ 8A.254*].

5. If consents of all shareholders entitled to vote were not solicited in writing, and proposed action was approved by less than unanimous written consent, send notice [*see § 8A.222*] in following manner to each shareholder entitled to vote who did not sign written consent [*Corp. Code § 603(b)*]:

a. If shareholder approval was given for one of following matters, at least 10 days before consummation of action [*Corp. Code § 603(b)(1)*]:
(1) Contract or transaction between corporation and one or more of its directors, or

between corporation and another corporation in which one or more of its directors has interest or serves as director [*see Corp. Code § 310*; *see also* Ch. 5, *Directors' Meetings, Actions, and Resolutions*].

(2) Indemnification of corporate agent [*see Corp. Code § 317*; *see also* Ch. 5, *Directors' Meetings, Actions, and Resolutions*].

(3) Corporate conversions [*see Corp. Code § 1152*; *see also* Ch. 11C, *Mergers*].

(4) Principal terms of reorganization [*see Corp. Code § 1201*; *see also* Ch. 11, *Mergers and Acquisition Issues*].

(5) Plan of distribution in dissolution [*see Corp. Code § 2007*; *see also* Ch. 12, *Winding Up and Dissolution*].

b. If shareholder approval was given on any other action, "promptly" and in accordance with *Corp. Code § 601(b)*, (governing notice of meetings) [*Corp. Code § 603(b)(2)*; *see § 8A.121*, P 3[b], [c]].

6. Have corporate secretary file following as part of corporate records:

a. Written consents.

b. Revocations of consent.

c. Copies of any notices sent to shareholders.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsDirectors & OfficersGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersBusiness & Corporate LawCorporationsDissolution & ReceivershipGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Shareholders' Meetings and Voting

4-8A California Legal Forms--Transaction Guide § 8A.121

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.121 Call and Notice of Annual Meeting

1. Prepare reminder letter to appropriate corporate officer, usually corporate secretary [*see § 8A.200* (form)].

2. Prepare notice of meeting [*see § 8A.202* (form)], including:

NOTE:
As a practical matter, proxies are often included with the meeting notice, if the proxy will be solicited by management [***see, e.g.,*** *§ 8A.253*].

a. Place of meeting [*Corp. Code § 601(a)*; *see § 8A.21*].

b. Date and time of meeting [*Corp. Code § 601(a)*; *see § 8A.22*].

NOTE:
The notice must also identify any means of electronic transmission by and to the corporation [***see*** *Corp. Code §§ 20, 21*] or electronic video screen communication by which shareholders may participate in that meeting [*Corp. Code § 601(a)*].

c. Record date of shareholders entitled to vote [*Corp. Code § 701*; *see §§ 8A.25, 8A.111,* P 3].

d. Matters that board, at time of mailing notice, intends to present for action by shareholders [*Corp. Code § 601(a)*; *see § 8A.11*].

NOTE:

Although any proper matter may be presented for action at the meeting, non-unanimous shareholder approval of any of the following will be valid only if the general nature of the proposal was stated in the notice of meeting or in any written waiver of notice [*Corp. Code § 601(f)*]: (1) a contract or transaction between the corporation and one or more of its directors [***see*** *Corp. Code § 310*; ***see also*** Ch. 5, ***Directors' Meetings, Actions, and Resolutions***]; (2) amendment of the articles after shares have been issued [***see*** *Corp. Code § 902*]; (3) Corporate conversions [***see*** *Corp. Code § 1152*; ***see also*** Ch. 11C, ***Mergers***]; (4) the principal terms of reorganization [***see*** *Corp. Code § 1201*; ***see also*** Ch. 11C, ***Mergers***]; (5) authorization for voluntary dissolution [***see*** *Corp. Code § 1900*; ***see also*** Ch. 12, ***Winding Up and Dissolution***]; or (6) a plan of distribution in dissolution [***see*** *Corp. Code § 2007*; ***see also*** Ch. 12, ***Winding Up and Dissolution***].

e. Names of nominees to be presented by board for election of directors [*Corp. Code § 601(a)*].

3. Ensure that written notice is given to each shareholder entitled to vote at meeting [*see § 8A.23*]:

a. Not less than 10 days (30 days if sent by third-class mail as permitted for certain corporations [*see* P b(3), *below*]) nor more than 60 days before date of meeting [*Corp. Code § 601(a)*].

b. By one of following means [*Corp. Code § 601(b)*]:

NOTE:

Notice is considered to have been given at the time when delivered personally, or sent by electronic transmission by the corporation, or deposited in the mail, or sent by other means of written communication [*Corp. Code § 601(b)*]. Notice given by electronic transmission by the corporation is not valid unless it complies with the requirements of *Corp. Code § 20* [*Corp. Code § 601(b)*].

(1) Personally;

(2) By electronic transmission by corporation [*see Corp. Code § 20*];

NOTE:

Notice may not be given by electronic transmission by the corporation after the corporation has been unable to deliver two consecutive notices to the shareholder by that means or if the inability to deliver notices by electronic transmission becomes known to the secretary, any assistant secretary, the transfer agent, or any other person responsible for giving notice [*Corp. Code § 601(b)*].

(3) By first-class mail;

(4) By third-class mail, if corporation has outstanding shares held of record by 500 or more persons [*see Corp. Code § 605* (determination of shares "held of record")]; or

(5) By other means of written communication.

c. Addressed to each shareholder [*Corp. Code § 601(b)*]:

(1) At address appearing on corporation's books;

NOTE:

If any notice addressed to a shareholder at his or her address appearing on the corporation's books is returned to the corporation by the United States Postal Service as undeliverable, all future notices will be considered to have been given without further mailing if the notices are available to the shareholder on his or her written demand at the corporation's principal executive office for a period of one year from the date the notice was given to all other shareholders [*Corp. Code § 601(b)*].

(2) At address given by shareholder to corporation for purposes of notice; or

(3) If neither address in P (1) or (2), *above*, is available:

(a) At place where principal executive office of corporation is located; or

(b) By publication at least once in newspaper of general circulation in county in which principal executive office is located.

4. Prepare affidavit of mailing notice of meeting, for execution by any of following [*Corp. Code § 601(b)*; *see § 8A.207*]:

NOTE:

An affidavit of mailing or electronic transmission by the corporation [***see*** *Corp. Code § 20*] of any notice or report, properly executed, constitutes prima facie evidence of the giving of the notice [*Corp. Code § 601(b)*].

a. Secretary.

b. Assistant secretary.

c. Any transfer agent.

5. Draft written ballot for election of directors [*see §§ 8A.70, 8A.240, 8A.241*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Shareholders' Meetings and Voting

4-8A California Legal Forms--Transaction Guide § 8A.122

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.122 Call and Notice of Special Meetings

1. Prepare appropriate call of meeting [*see §§ 8A.203, 8A.204* (forms)].

NOTE:
See *§ 8A.112*, PP 1, 2, for a list of persons entitled to call and receive call of meeting.

2. Prepare written notice of meeting, including [*see § 8A.205 [2]*]:

a. Place of meeting [*Corp. Code § 601(a)*; *see § 8A.21*].

b. Date and time of meeting [*Corp. Code § 601(a)*; *see § 8A.22[2]*].

c. Record date of shareholders entitled to vote [*Corp. Code § 701*; *see §§ 8A.25, 8A.111*, P 3].

d. General nature of business to be transacted [*Corp. Code § 601(a)*; *see §§ 8A.20, 8A.112*, P 6].

NOTE:
No business may be transacted at a special meeting other than the business specified in the notice of meeting [*Corp. Code § 601(a)*].

e. Means of electronic transmission by and to corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication, if any, by which shareholders may participate in meeting [*Corp. Code § 601(a)*; *see § 8A.29*].

3. Ensure that written notice is given to each shareholder entitled to vote at meeting [*Corp. Code § 601(a), (b)*; *see § 8A.121*, P 3].

NOTE:

If a special meeting is called other than by the board, and the officer to whom the call is directed fails to give notice within 20 days after receiving the request, the person requesting the meeting may petition the superior court for an order that the special meeting be held [*Corp. Code § 601(c)*; ***see*** *§ 8A.20[2][b]*].

4. Prepare affidavit of mailing notice of meeting [*see §§ 8A.121*, P 4, 8A.207[2]].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Shareholders' Meetings and Voting

4-8A California Legal Forms--Transaction Guide § 8A.123

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.123 Preparation for Annual or Special Meetings

1. If proxies will be solicited by management, prepare and send appropriate form [*see §§ 8A.250-8A.253* (forms)].

NOTE:
As a practical matter, proxies solicited by management are often sent with the meeting's notice.

2. If desired, prepare and send written waiver of notice, consent to holding of meeting, or approval of minutes to shareholders before meeting [*Corp. Code § 601(e)*; *see §§ 8A.24*; *8A.124*, P 5; *see also § 8A.220* (form)].

NOTE:
The transactions at any meeting, however called and noticed, are as valid as though held at a regularly called and noticed meeting if (1) either before or after the meeting, each person entitled to vote who is not present at the meeting in person or by proxy provides a written waiver of notice, a consent to the holding of the meeting, or an approval of the meeting's minutes; and (2) a quorum is present at the meeting [*Corp. Code § 601(e)*].

3. Have board of directors appoint inspectors of election, if desired [*Corp. Code § 707(a)*].

NOTE:
In advance of any shareholder meeting, the board may appoint inspectors of election to act at the meeting and any adjournment of the meeting. If inspectors are not appointed in advance by the board, or if any appointee fails to appear or refuses to act, the meeting

chair may, on the request of any shareholder or shareholder's proxy, appoint inspectors at the meeting [*Corp. Code § 707(a)*].

4. Have forms prepared to tabulate votes at meeting.

5. Plan agenda for meeting.

6. If practical, prepare minutes of meeting in advance [*see* Ch. 7, *Corporate Records and Reports*].

NOTE:

In closely held corporations, minutes are frequently prepared in advance when unanimous approval to proposed actions is anticipated.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Shareholders' Meetings and Voting

4-8A California Legal Forms--Transaction Guide § 8A.124

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.124 Holding Annual or Special Meetings

1. Determine whether quorum is present [*Corp. Code § 602(a)*]:

NOTE:
Unless the articles specify the number of shares that constitute a quorum, a majority of the shares entitled to vote will constitute a quorum at a shareholders' meeting [*Corp. Code § 602(a)*; ***see*** *§ 8A.26*].

a. In person; or

b. By proxy.

NOTE:
A proxy is valid for 11 months after its date of execution or for any other time period specified in the proxy, unless the proxy is revoked before the vote by the person executing it. A proxy may be revoked by (1) a writing delivered to the corporation [***see*** *§ 8A.254*], (2) the execution of a subsequent proxy, or (3) attendance at the meeting and voting by the person executing the proxy [*Corp. Code § 705(b)*].

2. If quorum is not present, have majority of shares represented in person or by proxy vote to adjourn meeting [*Corp. Code § 602(c)*; *see § 8A.125* (procedures applicable to adjourned meetings)].

NOTE:
In the absence of a quorum, any meeting of shareholders may be adjourned by the vote of a majority of

the shares represented in person or by proxy, but no other business may be transacted [*Corp. Code § 602(c)*]. However, if an initial quorum is present at the meeting, but enough shareholders withdraw to leave less than a quorum, the remaining shareholders may continue to transact business if any action taken is approved by at least a majority of the shares required to constitute a quorum or, if required by law or the articles, the vote of a greater number or voting by classes [*Corp. Code § 602(b)*].

3. Record and tabulate vote on specific proposals.

4. After business has been transacted, have shareholders adjourn meeting.

5. If meeting was irregularly called or noticed:

a. Send a waiver of notice of meeting, consent to hold meeting or approval of minutes of meeting to shareholders entitled to vote, (if not previously sent prior to meeting) [*Corp. Code § 601(e)*; *see § 8A.123*, P 2].

NOTE:

Subject to the statutory provisions on voting by representatives, fiduciaries, receivers, pledgees, corporate shareholders, and voting by shares standing in joint names [***see*** *Corp. Code §§ 702-704*; ***see also*** *§§ 8A.42-8A.44*], consents or waivers of notice, or approval of meeting minutes may be given, either before or after the meeting, by the shareholders entitled to vote or by the shareholder's proxy [***see*** *Corp. Code § 601(e)*; ***see also*** *§ 8A.24*].

PRACTICE TIP:

Some practitioners recommend that small, closely held corporations make it a practice to have all shareholders sign this type of form even though call and notice of the meeting were regularly given, in the event of a possible irregularity. *Commentary by Marilyn E. Minger.*

b. File any waivers, consents, or approvals with corporate records or make them part of minutes of meeting [*Corp. Code § 601(e)*].

6. Have corporate officer prepare, sign, and file minutes [*see* Ch. 7, *Corporate Records and Reports*].

NOTE:

A corporation is required to keep written minutes of the proceedings of its shareholders, in written form or in another form capable of being converted into clearly legible tangible form [*Corp. Code § 1500*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Shareholders' Meetings and Voting

4-8A California Legal Forms--Transaction Guide § 8A.125

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.125 Holding Adjourned Meetings

1. If notice of meeting is required [*Corp. Code § 601(d)*; *see §§ 8A.23[6], 8A.113*], prepare and serve notice of adjourned meeting [*see § 8A.206*] to each shareholder of record entitled to vote at meeting [*Corp. Code § 601(d)*; *see § 8A.121* P 2 (applicable notice procedures)].

2. Transact any business that might have been transacted at original meeting [*see Corp. Code § 601(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Shareholders' Meetings and Voting

4-8A California Legal Forms--Transaction Guide §§ 8A.126-8A.139

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.126[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8A California Legal Forms--Transaction Guide § 8A.140

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.140 Obtaining Court Order to Hold Annual Meeting

1. Confirm that corporation has failed to hold its annual meeting within applicable time period [*Corp. Code § 600(c)*; *see § 8A.20[1]*]:

a. Sixty days after date designated for annual meeting; or

b. If no date was designated for annual meeting, 15 months after either:
(1) Organization of corporation; or

(2) Corporation's last annual meeting.

2. File shareholder petition in superior court for order that meeting be held [*Corp. Code § 600(c)*].

NOTE:

The superior court of the proper county [***see*** *Corp. Code § 177* (proper county defined)] may summarily order a meeting to be held on the application of any shareholder, after notice to the corporation giving it an opportunity to be heard. The court may issue any appropriate orders, including orders designating the time and place of the meeting, the record date for determination of shareholders entitled to vote, and the form of notice of the meeting. The shares represented at the meeting, either in person or by proxy, that are entitled to vote constitute a quorum for purposes of the meeting, notwithstanding any provisions of the articles or bylaws or the General Corporation Law [*Corp. Code § 600(c)*; ***see*** *§ 8A.20[1][b]*]. For the applicable forms, see *CALIFORNIA FORMS OF PLEADING AND PRACTICE, Ch. 166,* ***Corporations: Shareholders' Meetings and Voting****, §§ 166.70-166.72* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersActions Against CorporationsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8A California Legal Forms--Transaction Guide § 8A.141

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.141 Obtaining Court Order to Hold Special Meeting

NOTE:
If an officer who is required to give notice of a special meeting, on receipt of a written request from a person entitled to call a meeting, fails to do so, the procedures enumerated in (1)-(3), ***below***, should be followed [***see*** *Corp. Code § 601(c)*].

1. Verify that person requesting meeting was entitled to call special meeting [*see Corp. Code § 600(d)*; *see also § 8A.112*, P 1].

2. Confirm that at least 20 days have elapsed since officer received written request to give notice [*see Corp. Code § 601(c)*; *see also § 8A.20[2][b]*].

3. Advise person requesting meeting that he or she may either [*Corp. Code § 601(c)*]:

a. Personally give notice of meeting; or

NOTE:
This type of notification is practical only in small, closely held corporations.

b. File petition in superior court for order requiring notice to be given [*Corp. Code § 601(c)*; *see Corp. Code § 305(c)* (procedure)].

NOTE:
For applicable forms, see *California Forms Of Pleading And Practice Ch. 166, Corporations: Shareholders' Meetings and Voting, §§ 166.73-166.78* (Matthew Bender). For further discussion, see *§*

8A.20[2][b].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8A California Legal Forms--Transaction Guide § 8A.142

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.142 Filing Action on Denial of Right to Vote

1. Verify that person claiming denial of right to vote at election of directors was entitled to that right [*see Corp. Code §§ 185, 701* (who are shareholders entitled to vote, discussed in *§ 8A.25*); *e.g., Haah v. Kim (2009) 175 Cal. App. 4th 45, 55, 95 Cal. Rptr. 3d 515* (persons with standing include those who have entered into agreements to take shares in corporation but whose shares have not yet been issued)].

2. File action in superior court for determination of validity of election [*Corp. Code § 709(a)*].

NOTE:

When such an action is filed, the superior court of the proper county [***see*** *Corp. Code § 177*] will determine the validity of any election or appointment of a director of a domestic corporation, or of any foreign corporation if the election was held or the appointment was made in California [*Corp. Code § 709(a)*].

For applicable forms, see *CALIFORNIA FORMS OF PLEADING AND PRACTICE, Ch. 166, Corporations: Shareholders' Meetings and Voting, §§ 166.84-166.87* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & Removals



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8A California Legal Forms--Transaction Guide § 8A.143

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.143 Obtaining Results of Vote Taken at Meeting

1. Determine whether person who wants to obtain written results of any vote taken at shareholder meeting [*Corp. Code § 1509*] is "shareholder" for purposes of disclosure:

a. Person has shareholder status when person [*Corp. Code § 1512(a)*]:
(1) Is named as shareholder on share certificate.

(2) Is named as shareholder on records of central depository, bank, or broker-dealer with respect to shares that are subject to control of central depository, bank, or broker-dealer.

b. Person does not have shareholder status when person is [*Corp. Code § 1512(b)*]:

(1) Beneficiary of trust, with respect to shares standing in name of trust.

(2) Beneficiary of estate of decedent, with respect to shares standing in name of decedent or estate.

(3) Employee, with respect to shares standing in name of pension, retirement, or health care trust or fund.

2. If representing shareholder, advise shareholder to take the following actions:

a. Make written request to corporation within 60 days following conclusion of meeting at which vote was taken [*Corp. Code § 1509*; *see § 8A.242*].

b. If named as shareholder on records of central depository, bank, or broker-dealer with respect to shares that are subject to control of that depository, bank, or broker-dealer [*see* P 1a, *above*], attach photocopy of statement from depository, bank, or broker-dealer showing shareholder status [*see Corp. Code § 1512(c)*].

NOTE:
The corporation must accept the photocopy as sufficient evidence of the person's status as a shareholder [*Corp. Code § 1512(c)*].

3. If representing corporation that has received timely written request from shareholder for voting results [*see Corp. Code § 1509*; P 2, *above*], advise corporation to take following actions:

a. Prepare written report that includes all of following [*Corp. Code § 1509*; *see § 8A.243*]:

NOTE:
If more than one class or series of shares voted, the report must state the appropriate numbers by class and series of shares [*Corp. Code § 1509*].

(1) If matter voted on was not election of directors:
(a) Number of shares voting for matter.

(b) Number of shares voting against matter.

(c) Number of shares abstaining or withheld from voting.

(2) If matter voted on was election of directors, number of shares (or votes, if voted cumulatively) cast for each nominee.

b. Mail report to shareholder.

NOTE:
There is no specific statutory time limit within which the corporation must provide the shareholder with the required information after receipt of the initial request. The statute specifies only that the shareholder must be informed "forthwith" [***see*** *Corp. Code § 1509*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8A California Legal Forms--Transaction Guide § 8A.144

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.144 Disclosing Voting Record to Beneficial Owners of Shares

NOTE:

Many shareholders are the beneficial owners of shares that are legally owned and voted by employee benefit plans or investment companies. The procedures set forth in this section are designed to protect those beneficial owners by ensuring that the legal owners maintain and disclose their voting records, and thus are accountable in their exercise of corporate power [***see*** *Corp. Code § 711(a)* (legislative declaration of intent)]. For discussion of the record maintenance requirements [*Corp. Code § 711(d)*], see *§ 8A.70*.

1. Determine whether person requesting voting record is "person on whose behalf shares are voted," using following criteria [*see Corp. Code § 711*].

a. Person has required status if he or she is [*Corp. Code § 711(b)*]:

(1) Participant or beneficiary of employee benefit plan, with regard to shares held for person's benefit.

(2) Shareholder, beneficiary, or contract owner of any investment company (or portfolio of any investment company) [*see 15 U.S.C. § 80a-3(a)* ("investment company" defined as issuer primarily engaged in business of investing, reinvesting, or trading in securities)], to extent that investment company (or portfolio) holds shares for which record is requested)].

b. Person does not have required status if person is [*Corp. Code § 711(c)*]:

(1) One who possesses right to terminate or withdraw from shareholder, contract owner, participant, or beneficiary relationship with any investment company.

NOTE:
This exclusion does not apply if the right of termination or withdrawal cannot be exercised without automatic imposition of a tax penalty. The right of termination or withdrawal does not include the right to substitute a relationship with the investment company (or portfolio), if its shares are voted by or subject to the direction of the investment advisor [***see*** *15 U.S.C. § 80a-2(a)(20)* ("investment advisor" defined)] of the prior investment company (or portfolio), or an affiliate of the investment advisor [*Corp. Code § 711(c)(1)*].

(2) One who, as trust beneficiary, is entitled to receive information about trust [*see Prob. Code § 16061*].

(3) Beneficiary, participant, contract owner, or shareholder whose interest is funded through general assets of life insurance company authorized to conduct business in California.

2. Confirm that vote which shareholder desires to check was taken within previous 12-month period.

NOTE:
A person voting shares on behalf of another is required to maintain the voting record only for a period of 12 consecutive months from the effective date of the vote [*Corp. Code § 711(d)*].

3. Prepare reasonable written request of report of voting record with respect to any matter involving specific security or securities [*Corp. Code § 711(e)*].

4. Send request (or verify that request was sent) to party possessing power to vote shareholder's shares.

NOTE:
Signing a proxy on another's behalf and forwarding it for disposition, or receiving voting instructions, does not constitute the power to vote. A person forwarding proxies or receiving voting instructions must disclose the identity of the person having the power to vote shares on reasonable written request by a person entitled to request a voting record [*Corp. Code § 711(g)*].

5. Ensure that any disclosure satisfies following requirements [*Corp. Code 711(e)*]:

NOTE:
If a statute or regulation pursuant to the federal Employee Retirement Income Security Act of 1974 (ERISA) [*29 U.S.C. § 1001 et seq.*] imposes disclosure duties on investment managers that are substantially the same as the following California requirements, compliance with that federal statute or regulation will be deemed sufficient [*Corp. Code § 711(a)*].

a. Disclosure must be made by:

(1) Person possessing power to vote shares [*Corp. Code § 711(e)*]; or

NOTE:
If the disclosing entity is a unit investment trust [***see*** *15 U.S.C. § 80a-4(2)* (defined as

investment company organized under trust indenture without board of directors, issuing only redeemable securities)], the open-ended investment companies underlying the unit investment trust must promptly make available their proxy voting records to the unit investment trust on evidence of a bona fide request for voting record information [*Corp. Code § 711(f)*].

(2) Designated agent, unless governing instrument provides otherwise [*Corp. Code § 711(e), (h)*].

b. Disclosure must be made to:

(1) Person making request [*Corp. Code § 711(e)(1)*]; or

(2) If disclosing party holds voting power according to agreement entered into with someone other than requesting shareholder, other party to agreement [*Corp. Code § 711(e)(2)*].

NOTE:

Disclosure to the other party to the agreement will be deemed to comply with the disclosure requirements of *Corp. Code § 711*. In this case, the disclosing party is not entitled to charge a fee [*Corp. Code § 711(e)*; ***see*** *Corp. Code § 711(i)*; ***see also*** P d, ***below***]. However, the two parties may enter into an agreement between themselves for the payment or assessment of a reasonable charge to defray expenses of disclosing the record [*Corp. Code § 711(e)(2)*].

c. Any demand for identification of person making request as "person on whose behalf shares were voted" [*Corp. Code § 711(e)(1)*]:

(1) Must be reasonable.

(2) Must be made promptly.

(3) May include request for social security number.

d. If person making disclosure assesses fee [*Corp. Code § 711(i)*]:

NOTE:

These fee provisions are subject to any restrictions imposed by law or a governing instrument [*Corp. Code § 711(i)*].

(1) Fee must be reasonable and used to defray expenses of disclosing record.

(2) Disclosure must be made within reasonable period after fee payment is received.

6. If person with voting power fails to comply with request, have shareholder file petition to enforce disclosure (or advise non-shareholder client that petition to enforce disclosure may be filed) [*Corp. Code § 711(j)*].

NOTE:

The court may award costs and reasonable attorneys' fees if the court finds that the defendant willfully failed to comply with the disclosure requirements [*Corp. Code § 711(j)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsSecurities LawInvestment CompaniesUnit Investment TrustsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8A California Legal Forms--Transaction Guide §§ 8A.145-8A.199

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.145[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
A. Preliminary Reminders, Calls, and Notices

4-8A California Legal Forms--Transaction Guide § 8A.200

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.200 Letter Advising Corporation to Hold Annual Shareholders' Meeting

[1] Comment

[a] Use of Form

This form is a letter from an attorney, addressed to the appropriate corporate officer (the corporate secretary is often responsible for organizing the annual meeting), doing all of the following:

- Reminding that officer that the annual shareholders' meeting must be scheduled;
- Listing the matters generally addressed at the meeting (election of directors, overview of corporation's financial statements and operations) [*see § 8A.200[1][d]*];
- Inquiring whether there are additional matters requiring shareholder approval that should be addressed at the meeting [*see § 8A.200[1][d]*]; and
- Including the place, date, and time of the meeting [*see § 8A.200[1][c]*].

The board of directors is not required to call the annual meeting, since it is required to be held by statute [*see Corp. Code § 600(b)*]. However, this letter will remind the corporation to schedule the meeting and will provide information that must be included in the meeting's notice [*see § 8A.200[1][b]*].

[b] Contents of Meeting Notice

The notice of the annual meeting [*see § 8A.202*] must state the following [*Corp. Code § 601(a)*]:

- The place, date, and hour of the meeting;

- Any means of electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication by which shareholders may participate in the meeting [*Corp. Code § 601(a)*];

- Any matters the board of directors intends at the time of the mailing of the notice to present for action by the shareholders; and

- The names of the nominees for director that management intends, at the time of the notice, to present.

For further discussion of the meeting notice, see *§ 8A.202[1]*.

[c] Place, Date, and Time of Meeting

The annual shareholders' meeting may be held at any place inside or outside California that is stated in or fixed in accordance with the bylaws; if no other place is stated or so fixed, the meeting must be held at the corporation's principal executive office [*Corp. Code § 600(a)*; *see 15 U.S.C. § 80a-16* (exception for regulated management companies)]. The date and time of the annual meeting is usually stated in the bylaws or determined in accordance with bylaw provisions [*see Corp. Code § 600(b)*; *see also §§ 8A.22[1], 8A.23[4]*]. However, if the annual meeting is not held within 60 days after the date designated in the bylaws, within 15 months after the organization of the corporation, or within 15 months after the corporation's last annual meeting, any shareholder may apply to the superior court of the proper county for an order compelling the meeting [*Corp. Code § 600(c)*].

The annual shareholders' meeting may be conducted in whole or in part by electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication [*Corp. Code § 600(e)*]. For further discussion, see *§ 8A.29*.

[d] Purpose of Annual Meeting

The shareholders must elect directors at the annual meeting and may transact any other proper business [*Corp. Code § 600(b)*; *see § 8A.11* (matters requiring shareholder vote)]. Ordinarily, the directors use the annual meeting to report on the corporation's financial condition, its operations, and its plans for the next year.

[e] Determination of Record Date

A corporation determines the shareholders who are entitled to notice of any meeting, to vote, and to exercise any other lawful rights as of a specified date, known as the record date. The record date may be (1) fixed in advance by the board of directors [*Corp. Code § 701(a)*], (2) fixed by the articles of incorporation or by agreement [*Corp. Code § 701(d)*], or (3) prescribed by statute [*Corp. Code § 701(b)*]. A record date fixed by the board, by the articles of incorporation, or by agreement must not be more than 60 nor less than 10 days before the date of any meeting, or more than 60 days before any other action [*Corp. Code § 701(a), (b)*].

The record prescribed by statute is the close of business on the business day immediately preceding the day notice is given [*see Corp. Code § 118* (time notice is given defined) or, if notice is waived [*see §§ 8A.24, 8A.220*], the close of business on the business day preceding the day the meeting is held [*Corp. Code § 701(b)(1)*].

[f] Annual Report

An annual report must be sent to the shareholders no later than 120 days after the close of the fiscal year, unless this requirement is waived in the bylaws of a corporation with fewer than 100 shareholders of record [*Corp. Code §*

1501(a)(1); *see Corp. Code § 605* (determination of shareholders of record)].

Unless waived, the annual report also must be sent to shareholders at least 15 days (35 days if sent by third class mail) before the annual shareholders' meeting held during the next fiscal year. This requirement does not limit the requirement of holding the annual meeting, however [*Corp. Code § 1501(a)(2)*].

Unless otherwise provided by the articles or bylaws, and if approved by the board of directors, the annual report and any accompanying materials may be sent by electronic transmission by the corporation [*Corp. Code § 1501(a)(1)*; *see Corp. Code § 20*; *see also § 8A.23[2]*].

For discussion of the required contents of the annual report, see Ch. 7, *Corporate Records and Reports* .

[2] Form

Letter Advising Corporation to Hold Annual Shareholders' Meeting

LETTER ADVISING CORPORATION TO HOLD ANNUAL SHAREHOLDERS' MEETING
_____[*date*]
_____[*Name of appropriate corporate officer*]
_____[*Officer's title*]
_____[*Name of corporation*]
_____[*Corporation's address*]

Re: Need to Hold _____ [*year, e.g.*, 2001] Annual Shareholders' Meeting
Dear _____ [*name of appropriate corporate officer*]:

According to the bylaws of _____[*name of corporation*], the annual shareholders' meeting must _____[be held on _____ (*date*), at _____ (*hour*) *or* scheduled for a date and time during _____ (*time frame, e.g.*, the months of April through June)]. The meeting must be held at _____[*address*].

[*Add, if applicable:*]

The annual report must be sent to the shareholders [at least 15 (or, if sent by third-class mail, 35) days before the annual meeting *or* not later than _____[*date*].

[*Continue with the following:*]

Directors must be elected at the annual meeting. In addition, any other business that requires (or permits) shareholder action may be transacted. If you anticipate requiring shareholder approval of any other matters, these matters must be included in your notice of the annual meeting to the shareholders. Ordinarily, the annual meeting also includes an overview of the corporation's financial statements and operations [*add, if applicable:* contained in the annual report].

A corporation determines the shareholders who are entitled to notice of and to vote at the annual meeting as of a specified date, known as the record date.

[*Choose one of the following:*]

The record date for _____[*name of corporation*] may be fixed in advance by the board of directors.

[*Or*]

The record date for _____[*name of corporation*] is _____[*date*], as fixed by the articles of incorporation.

[*Or*]

The record date for _____[*name of corporation*] is _____[*date*], as fixed by agreement.

[*Or*]

If the record date is not fixed in advance by the board of directors or is not fixed by _____'s [*name of corporation*] articles of incorporation or by agreement, then the record date for the annual meeting will be the close of business on the business day _____[immediately preceding the day notice is given *or* preceding the day the meeting is held, if notice is waived.]

[*Continue with the following:*]

Notice of the meeting must be sent to the shareholders of record _____[by _____ (*date*;) *or* at least 10 but not more than 60 days before the date of the meeting].

Please call me so that we can discuss the date and time of the meeting, any additional matters to be included in the meeting's agenda, the record date, [and] the meeting and notice procedures [*add, if applicable:*, and the requirements of the annual report].

Sincerely, _____ [*attorney's signature*]
[*printed name*]

cc: Directors of _____[*name of corporation*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
A. Preliminary Reminders, Calls, and Notices

4-8A California Legal Forms--Transaction Guide § 8A.201

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.201 Letter Advising Corporation to Hold Special Shareholders' Meeting

[1] Comment

[a] Use of Form

This form is a letter from a corporation's attorney, addressed to the appropriate corporate officer, advising the corporation of the need to hold a special shareholders' meeting. The first alternative advises the corporation to call a special meeting because a proposed corporate transaction either requires or permits shareholder approval [*see § 8A.11* (shareholders' voting rights)]. The second alternative advises the corporation to call a special meeting because the corporation has received a written demand for a special meeting from a person authorized to call it [*see* [b], *below*].

For a form to be used by shareholders to call a special meeting, see *§ 8A.203*. For a form to be used by the chair of the board or the president to call a special meeting, see *§ 8A.204*. For a form for notice of special shareholders' meeting, see *§ 8A.205*. For discussion of and forms for obtaining shareholder approval without a meeting, see *§§ 8A.28, 8A.221-8A.223*.

[b] Persons Authorized to Call Special Meetings

Special meetings of the shareholders may be called at any time, for any reason, by the board of directors, the chair of the board, the president [*see § 8A.204*], the shareholders entitled to vote at least 10 percent of the corporation's shares [*see § 8A.203*], or other persons as provided in the articles or bylaws [*Corp. Code § 600(d)*]. A special meeting may also be called by the shareholder(s) representing five percent or more of the outstanding shares entitled to vote for directors when, after the filling of any vacancy by the directors, the directors in office who have been elected by the shareholders constitute less than a majority of the directors in office [*see Corp. Code § 305(c)(1)*; § 8A.203; *see also Corp. Code § 305(c)(2)* (shareholders' option to apply to superior court for order to compel meeting)].

[c] Remedy for Failure to Call Special Meeting

If the notice of the special meeting is not given within the required time frame [*see Corp. Code § 601*; *see also § 8A.205[1][c][i]*], the person entitled to call the meeting may give the notice, or in the alternative, apply to the superior court of the proper county for an order requiring that the notice be given [*Corp. Code § 601(c)*]. The court may issue any appropriate orders, including, but not limited to, orders designating the time and place of the meeting, the record date for determination of shareholders entitled to vote, and the form of notice of the meeting [*Corp. Code § 601(c)*].

[d] Shareholders' Voting Rights

In addition to electing directors, the shareholders have other statutory voting rights. In some cases, a shareholders' vote is required to accomplish certain corporate actions, with specified exceptions. In others, a shareholder vote is permitted to accomplish a specific transaction as an alternative to authorization by the board of directors [*see § 8A.11*]. When a shareholders' vote is required or permitted by statute, the exact nature of the vote required must be determined, since the shareholders' voting rights may be exercised, in some cases, by "approval of the outstanding shares"; that is, a majority of the outstanding shares entitled to vote [*Corp. Code § 152*], and in other cases by the "approval of the shareholders"; that is, the affirmative vote of majority of the shares represented and voting at a meeting at which a quorum is present [*Corp. Code § 153*], and in still other cases, by specified percentages of outstanding shares or classes or series or by individual shareholders [*see § 8A.11*]. In addition, the corporation's articles may create additional voting rights or impose additional voting requirements [*see Corp. Code § 204(a)(5), (9)*; *Corp. Code § 300(c)* (close corporation shareholder agreements); *see also § 8A.11[2]*].

[2] Form

Letter Advising Corporation to Hold Special Shareholders' Meeting

LETTER ADVISING CORPORATION TO HOLD SPECIAL SHAREHOLDERS' MEETING
_____[*date*]
_____[*Name of appropriate corporate officer*]
_____[*Officer's title*]
_____[*Name of corporation*]
_____[*Corporation's address*]

Re: Need to Hold Special Shareholders' Meeting
Dear _____ [*name of appropriate corporate officer*]:

[*If proposed corporate transaction requires or permits shareholder approval, use:*]

I have been informed that the corporation wishes to _____[*specify action*]. This action will require formal shareholder approval. The _____[nature *or* percentage] of the vote required to approve this action is _____[*specify nature of vote, e.g.,* a majority of the outstanding shares, or, in excess of 50 percent of the outstanding shares or the shares represented at the meeting (a simple majority)].

I recommend that the corporation hold a special shareholders' meeting to approve this proposed transaction. Please call me so that we can review the requirements and procedures for holding a special meeting. At that time, we can also determine whether it is appropriate to obtain shareholder approval by written consent without a meeting.

[*Or, if corporation has received a written demand for a special meeting from a shareholder or other person authorized to call a special meeting, use:*]

I have been informed that the corporation has received a written demand for a special shareholders' meeting from _____[*names of shareholders*], who are _____[shareholders entitled to vote at least 10 percent of the corporation's shares *or* persons authorized by the corporation's bylaws or articles of incorporation to call such a meeting *or* shareholders representing five percent or more of the outstanding shares entitled to vote for directors when, after the filling of any vacancy by the directors, the directors in office who have been elected by the shareholders constitute less than a majority of the directors in office]. The purpose of this meeting is to: _____[*specify purpose*].

The California Corporations Code requires this corporation to hold the special meeting at the time requested, but not less than 35, or more than 60, days after the receipt of the request. If notice of this special meeting is not given to the shareholders within 20 days after receipt of the request, the shareholders may apply to the court for an order compelling the meeting. It is important, therefore, that we call and hold this meeting properly. We should also discuss how management will respond to any anticipated shareholder demands.

The relevant dates for this meeting are the following:

Written demand received on _____ [*date*]

Period during which meeting must be held: _____ [*dates, e.g.*, June 1-June 25]

Notice
must be given by _____ [*date*]

[*Continue with the following:*]

I look forward to hearing from you at your earliest convenience.

Sincerely, _____ [*attorney's signature*]
[*printed name*]

cc: Directors of _____[*name of corporation*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
A. Preliminary Reminders, Calls, and Notices

4-8A California Legal Forms--Transaction Guide § 8A.202

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.202 Notice of Annual Shareholders' Meeting

[1] Comment

[a] Use of Form

This form is a general notice form for an annual shareholders' meeting. It includes an optional provision if proxies will be solicited. Whenever shareholders are required or permitted to take any action at a meeting, a written notice of the meeting must be given to each shareholder entitled to vote [*Corp. Code § 601(a)*].

For a proxy with an optional provision when solicitation of proxies is by management, see *§ 8A.253*. For further discussion of proxies, see *§§ 8A.60-8A.63*. For a letter reminding the corporation to schedule its annual meeting, see *§ 8A.200*. If the directors will be elected by the unanimous written consent of the shareholders [*see Corp. Code § 603(d)*], the *form in § 8A.222[2]* should be used instead of this form.

[b] Contents of Notice

The notice of the annual meeting must state the following information:

- The place, date, and hour of the meeting [*see §§ 8A.21, 8A.22[1]*];

- Any means of electronic transmission by and to corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication by which shareholders may participate in the meeting [*Corp. Code § 601(a)*];

- Any matters the board of directors intends at the time of the mailing of the notice to present for action by the shareholders; and

- The names of the nominees for director that management intends, at the time of the notice, to present [*see Corp. Code § 601(a)*].

See *§ 8A.200[1]* for discussion of the purpose of the annual meeting, the place, date, and time requirements, the determination of the shareholders entitled to notice (the record date), and the annual report.

[c] Approval of Special Proposals at Meeting

The matters that the board of directors intends to present for action at the annual meeting must be stated in the notice of the meeting [*see* [b], *above*]. However, any other proper matter may be presented at the meeting when shareholder discussion is required or appropriate [*see Corp. Code § 601(a)*].

No shareholder approval at the meeting, other than the unanimous approval by those entitled to vote, is valid unless the general nature of the proposal was stated in the notice (or any written waiver of notice of the meeting [*see § 8A.220*]) if the action to be taken involves any of the following [*Corp. Code § 601(f)*; *see § 8A.20[1][a]*]:

- Transactions in which a director has a financial interest [*Corp. Code § 310*].
- Amendments to the articles of incorporation after shares have been issued [*Corp. Code § 902*].
- Approval of a corporate conversion [*Corp. Code § 1152*].
- Approval of the principal terms of reorganization [*Corp. Code § 1201*].
- Dissolution of the corporation [*Corp. Code § 1900*].
- Approval of a plan of distribution of corporate assets upon dissolution not in accordance with the liquidation rights of the preferred shares [*Corp. Code § 2007*].

[d] Procedure for Giving Notice

[i] When Given

A written notice of the annual meeting must be given at least 10 but not more than 60 days before the date of the meeting [*Corp. Code § 601(a)*]. A corporation with outstanding shares held of record by 500 or more persons [*see Corp. Code § 605* (shares held of record by 100 or more persons defined)] may send notice of a meeting by third class mail, in which case the minimum time for the notice is 30 days before the date of the meeting [*Corp. Code § 601(a), (b)*].

[ii] How Given

The meeting notice must be given either personally or by electronic transmission by the corporation [*see Corp. Code § 20*] or by first-class mail (postage prepaid) [*see Corp. Code § 113*], except when shares are held of record by 500 or more persons, in which case third-class mail is permitted, or by some other means of written communication [*Corp. Code § 601(b)*]. Notice must be addressed to the shareholder at the address appearing for the shareholder on the corporation's books or at another address given to the corporation for notice purposes. If no such address is given, notice must be given at the principal executive office or by publication at least once in a newspaper of general circulation in the county in which the office is located [*Corp. Code § 601(b)*].

Notice given by electronic transmission by the corporation is not valid unless it complies with *Corp. Code § 20* [*Corp. Code § 601(b)*; *see § 8A.23[2]*]. Notice may not be given by electronic transmission by the corporation after the corporation has been unable to deliver two consecutive notices to the shareholder by that means or if the inability to

deliver notices by electronic transmission becomes known to the secretary, any assistant secretary, the transfer agent, or any other person responsible for giving notice [*Corp. Code § 601(b)*].

Notice is considered to have been given when delivered personally, or sent by electronic transmission by the corporation, or deposited in the mail, or sent by other means of written communication [*Corp. Code § 601(b)*].

If notice, properly addressed to the shareholder [*see Corp. Code § 601(b)*], is returned to the corporation and marked as undeliverable by the United States Postal Service, all future notices will be considered to have been given without further mailing if the notices are available to the shareholder, on the shareholder's written demand, at the corporation's principal executive office for one year from the date the notice was given to all other shareholders [*Corp. Code § 601(b)*].

[iii] To Whom Given

Notice of any meeting must be given to each shareholder entitled to vote at the meeting [*Corp. Code § 601(a)*]. The identity and shareholdings of these shareholders are determined from the corporate records as of a specified date, known as the "record" date. The procedure for fixing the record date is discussed in *§ 8A.25*.

[2] Form

Notice of Annual Shareholders' Meeting

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS OF _____ [*name of corporation*]

TO: Shareholders of _____[*name of corporation*]

NOTICE IS HEREBY GIVEN that the annual meeting of the shareholders of _____[*name of corporation*], a California corporation, will be held at _____[*street address and city*], California, on _____[*date*], at _____[*hour*], to consider and act on the following:

1. To elect directors of the corporation. The Board of Directors intends at the time of this notice to present the following nominees for election:

_____ [*nominee name*]
_____ [*nominee name*]
_____ [*nominee name*]

[*Repeat as required*]

2. To consider reports of the affairs of the corporation *or* to present the annual report to shareholders.

[*If other specific proposals are to be considered, include the following for each such proposal:*]

_____. To _____[*describe specific proposal to be considered at the annual meeting*].

_____. To transact any other business that is within the powers of the shareholders.

[*Continue with the following:*]

Only the shareholders of record at the close of business on _____[*specify date of business day preceding day notice is given unless another record date has been fixed by directors, articles, or agreement*], will be entitled to vote at the meeting.

[*If proxies will be solicited, use:*]

Shareholders who do not expect to be present personally at the meeting are urged to read the proxy statement and to complete, date, sign, and return the proxy in the enclosed envelope.

[*Continue with the following:*]

_____ Dated:

_____ [*signature*]
[*printed name*]
_____ [*title, e.g.,* Corporate Secretary]
_____ [*name of corporation*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
A. Preliminary Reminders, Calls, and Notices

4-8A California Legal Forms--Transaction Guide § 8A.203

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.203 Call of Special Shareholders' Meeting by Shareholders

[1] Comment

[a] Use of Form

This form is a written demand for a special meeting of shareholders by a shareholder authorized to call such a meeting [*see* [b], *below*]. If a non-shareholder is authorized by the corporation's articles of incorporation or bylaws to call a special shareholders' meeting [*see Corp. Code § 600(d)*], this form should be modified accordingly. For a form to be used to call a special shareholders meeting by the president, the chair of the board, or the board, see *§ 8A.204*. For a letter advising the corporation to hold a special meeting, see *§ 8A.201*. For a notice of a special meeting and a discussion of notice procedures, see *§ 8A.205*.

[b] Persons Authorized to Call Special Meetings

Special meetings of the shareholders may be called at any time, for any reason, by the board of directors, the chair of the board, the president [*see § 8A.204*], the shareholders representing at least 10 percent of the corporation's shares [*see* [2], *below*], or other persons as provided in the articles or bylaws [*Corp. Code § 600(d)*]. A special meeting may also be called by the shareholder(s) representing five percent or more of the outstanding shares entitled to vote for directors when, after the filling of any vacancy by the directors, the directors in office who have been elected by the shareholders constitute less than a majority of the directors in office [*see Corp. Code § 305(c)(1)*; [2], *below*; *see also Corp. Code § 305(c)(2)* (shareholders' option to apply to superior court for order to compel meeting)].

[c] Call Procedure

The call of a special shareholders' meeting by any authorized person, other than the board of directors, must be in writing, directed to the chair of the board, president, vice president, or secretary of the corporation [*Corp. Code § 601(c)*]. The call should state the place, date, and time of the meeting [*see Corp. Code §§ 600(a), 601(c)*]. Shareholders'

meetings may be conducted in whole or in part by electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication [*Corp. Code § 600(e)*; *see § 8A.29*]; and if any such method will be used, the call must also identify the electronic means by which the shareholders will participate [*Corp. Code §§ 600(a), (e), 601(a)*]. The call should also state the specific matters to be addressed at the meeting, because no business other than that stated in the notice may be transacted at the meeting [*see Corp. Code § 601(a)*].

The corporate officer receiving the call of the meeting must give notice "forthwith," but in no event later than 20 days after the request [*Corp. Code § 601(c)*; *see § 8A.205*; *see also § 8A.205[1][c][i]* (when notice must be given for special meeting called by board)]. The notice must be given to the shareholders entitled to vote. It must state that a special meeting will be held on the date requested by the shareholders calling the meeting, provided that the date must be at least 35 but not more than 60 days after the call is received by the corporate officer [*Corp. Code § 601(c)*]. The time of the meeting must be the time requested by the person calling it [*see Corp. Code § 601(c)*]. The meeting must be held at any place in California or elsewhere, as stated in or fixed in accordance with the bylaws. If no other place is stated or fixed, special meetings are held at the principal executive office of the corporation [*Corp. Code § 600(a)*].

[d] Remedies for Failure to Give Notice After Receipt of Call

If the notice of the special meeting is not given within 20 days after receipt of the request to the chair of the board, president, vice president, or secretary [*see § 8A.23[5]*], the person entitled to call the meeting may give the notice, or in the alternative, apply to the superior court of the proper county for an order requiring that the notice be given [*Corp. Code § 601(c)*]. The court may issue any appropriate orders, including, but not limited to, orders designating the time and place of the meeting, the record date for determination of shareholders entitled to vote, and the form of notice of the meeting [*Corp. Code § 601(c)*].

[e] Effect of Irregularly Called or Noticed Meeting

The actions taken at a shareholders' meeting that is irregularly called (or held without formal notice) are valid if a quorum is present either in person or by proxy, and if, either before or after the meeting, each of the persons entitled to vote, not present in person or by proxy, provides a written waiver of notice, or a consent to the holding of the meeting, or an approval of the minutes of the meeting [*Corp. Code § 601(e)*]. For a waiver, consent, and approval, see *§ 8A.220*.

[2] Form

Call of Special Shareholders' Meeting by Shareholders

CALL OF SPECIAL MEETING BY SHAREHOLDERS OF _____ [*name of corporation*]

TO: _____[*Name of appropriate corporate official*], _____[Chair of the Board *or* President *or* Vice-President *or* Secretary] of _____[*name of corporation*]:

_____[I *or* We] hereby call a special meeting of the shareholders of this corporation on _____[*date, at least 35, but not more than 60, days after call for meeting will be received*], at _____[*time*], at _____[*place*], for the following purposes:

[*Specify each proposed action to be considered at the special meeting:*]

1. _____[*specify proposed action*].

2. _____[*specify proposed action*].

[*Continue with the following:*]

The undersigned _____ shareholder[s] of _____[*name of corporation*], represent[s] at least_____[10 percent of the shares entitled to vote at that meeting *or* five percent of the outstanding shares entitled to vote for directors and, after the filling of a vacancy by the directors on _____ (*date*), the directors in office who have been elected by the shareholders constitute less than a majority of the directors in office].

You are requested to cause notice of the special meeting to be given within 20 days after you receive this call.

This call is authorized by [California Corporations Code Section _____ 305(c)(1) *or* 600 *or* 601].

[*Repeat, as required:*]

_____ Dated:

_____ [*shareholder's signature*]
[*printed name*]
_____ [*address*]
Number of shares owned as of this date: _____

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersActions Against CorporationsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
A. Preliminary Reminders, Calls, and Notices

4-8A California Legal Forms--Transaction Guide § 8A.204

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.204 Call of Special Shareholders' Meeting by President or Chair of Board

[1] Comment

[a] Use of Form

This form should be used to call a special shareholders' meeting by the president or the chair of the board [*see Corp. Code § 600(d)*]. Although the call of a special meeting by the board of directors does not need to be in writing [*see Corp. Code § 601(c)*], the better practice is to make the request in writing. In the latter case, this form may be modified accordingly.

For a call of a special shareholders' meeting by the shareholders, see *§ 8A.203*. For a letter advising the corporation to hold a special meeting, see *§ 8A.201*. For a notice of a special shareholders' meeting and a discussion of notice procedures, see *§ 8A.205*.

[b] Call Procedure

The call of a special shareholders' meeting by any authorized person other than the board of directors must be in writing, directed to the chair of the board, president, vice president, or secretary of the corporation (as appropriate) [*Corp. Code § 601(c)*].

The call should state all of the information required for giving notice of the meeting [*see § 8A.205*], including the following [*Corp. Code § 601(a)*]:

- The place, date, and time of the meeting [*see Corp. Code §§ 600(a), 601(c)*];

- Any means of electronic transmission by and to corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication by which shareholders may participate in the meeting [*Corp. Code § 601(a)*

];

- The specific matters to be addressed at the meeting [*see Corp. Code § 601(a)*]; and

- The record date for determining the shareholders entitled to notice of the meeting [*see Corp. Code § 601(a)*].

No business other than that stated in the notice may be transacted at the meeting [*Corp. Code § 601(a)*]. For the procedure for fixing a record date, *see § 8A.25*. For further discussion of the call procedure, the persons authorized to call the meeting, the remedies for failure to call the meeting, and the effect of an irregularly called meeting, see *§ 8A.203[1][b]-[e]*.

[2] Form

Call of Special Shareholders' Meeting by President or Chair of Board

CALL OF SPECIAL MEETING BY _____ [PRESIDENT ***or*** CHAIR OF THE BOARD] OF _____ [*name of corporation*]

TO: _____[*Name*], Secretary of _____[*name of corporation*]:

I call a special meeting of the shareholders of this corporation on _____[*date, at least 35 but not more than 60 days after call for meeting will be received*], at _____[*time*], at _____[*place*], for the following purposes:

[*Specify each proposed action to be considered at the special meeting*:]

1. _____[*specify proposed action*].

2. _____[*specify proposed action*].

[*Continue with the following:*]

You are requested to cause notice of the special meeting to be given within 20 days after you receive this call.

The record date for determining shareholders entitled to receive notice of, and to vote at, this meeting is _____[*date*], as fixed by _____[*California Corporations Code Section 701(b)(1) or* the Board of Directors *or* the articles of incorporation *or* agreement].

This call is authorized by [*California Corporations Code* _____ *Section 600(d) or* Sections 600(d) and 601(c)], pursuant to a call by shareholders received by me on _____[*date*].
_____ Dated:

_____ [*signature*]
[*printed name*]
_____ [*title*]

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
A. Preliminary Reminders, Calls, and Notices

4-8A California Legal Forms--Transaction Guide § 8A.205

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.205 Notice of Special Shareholders' Meeting

[1] Comment

[a] Use of Form

This form is a general notice form for a special shareholders' meeting, with an optional provision if proxies are to be solicited. Whenever shareholders are required or permitted to take any action at a meeting, a written notice of the meeting must be given to each shareholder entitled to vote [*Corp. Code § 601(a)*].

For a proxy with an optional provision when solicitation of proxies is by management, see *§ 8A.253*. For further discussion of proxies, see *§§ 8A.60-8A.63*. For a letter advising the corporation to schedule a special meeting, see *§ 8A.201*.

If action will be taken by the unanimous written consent of the shareholders, the *forms in §§ 8A.222* or *8A.223* should be used instead of this form. For a list of the persons authorized to call a special meeting, see *§ 8A.203[1][b]*.

[b] Contents of Notice

The notice of the special meeting must state the following information [*see Corp. Code § 601(a)*]:

- The place, date, and hour of the meeting [*see §§ 8A.21, 8A.22[2]*];
- Any means of electronic transmission by and to corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication by which shareholders may participate in the meeting [*Corp. Code § 601(a)*; *see § 8A.29*]; and
- The general nature of the business to be transacted.

No business other than that stated in the notice may be transacted at the meeting [*Corp. Code § 601(a)*].

[c] Procedure for Giving Notice

[i] When Given

If a special meeting is called by the board of directors, a written notice of the meeting must be given at least 10 but not more than 60 days before the date of the meeting [*Corp. Code § 601(a)*]. A corporation with outstanding shares held of record by 500 or more persons [*see Corp. Code § 605* (shares held of record by 100 or more persons defined)] may send notice of a meeting by third class mail, in which case the minimum time for the notice is 30 days before the date of the meeting [*Corp. Code § 601(a), (b)*].

If a special meeting is called by any person other than the board, however, the notice must be given "forthwith," but in no event later than 20 days after the request [*Corp. Code § 601(c)*]. Caution should be exercised in ascertaining that the notice is sent in a timely manner.

[ii] How Given

The meeting notice must be given either personally or by electronic transmission by the corporation [*see Corp. Code § 20*] or by first-class mail (postage prepaid) [*see Corp. Code § 113*], except when shares are held of record by 500 or more persons, in which case third-class mail is permitted, or by some other means of written communication [*Corp. Code § 601(b)*]. Notice must be addressed to the shareholder at the address appearing for the shareholder on the corporation's books or at another address given to the corporation for notice purposes. If no such address is given, notice must be given at the principal executive office or by publication at least once in a newspaper of general circulation in the county in which the office is located [*Corp. Code § 601(b)*].

Notice given by electronic transmission by the corporation is not valid unless it complies with *Corp. Code § 20* [*Corp. Code § 601(b)*; *see § 8A.23[2]*]. Notice may not be given by electronic transmission by the corporation after the corporation has been unable to deliver two consecutive notices to the shareholder by that means or if the inability to deliver notices via electronic transmission becomes known to the secretary, any assistant secretary, the transfer agent, or any other person responsible for giving notice [*Corp. Code § 601(b)*].

Notice is considered to have been given when delivered personally, or sent by electronic transmission by the corporation, or deposited in the mail, or sent by other means of written communication [*Corp. Code § 601(b)*].

If notice, properly addressed to the shareholder, [*see Corp. Code § 601(b)*] is returned to the corporation and marked as undeliverable by the United States Postal Service, all future notices will be considered to have been given without further mailing if the notices are available to the shareholder, on the shareholder's written demand, at the corporation's principal executive office for one year from the date the notice was given to all other shareholders [*Corp. Code § 601(b)*].

[iii] To Whom Given

Notice of any meeting must be given to each shareholder entitled to vote at the meeting [*Corp. Code § 601(a)*]. The identity and shareholdings of these shareholders are determined from the corporate records as of a specified date, known as the "record" date. The procedure for fixing the record date is discussed in *§ 8A.25*.

[d] Evidence of Giving Notice

An affidavit of mailing or electronic transmission by the corporation of any notice executed by the corporate secretary,

assistant corporate secretary, or any transfer agent, is prima facie evidence of the giving of notice [*Corp. Code § 601(b)*; *see § 8A.207*].

[e] Procedure When Notice of Special Meeting Is Not Given

If notice of a special meeting is not given by the officer requested to so within the required time frame [*see* [c][i], *above*], the persons entitled to call the meeting may, themselves, give notice [*Corp. Code § 601(c)*]. In the alternative, they may apply to the superior court, which must "summarily" order that notice be given, after the corporation has had the opportunity to be heard [*Corp. Code § 601(c)*]. For further discussion of this issue, see *§ 8A.20[2][b]*.

[2] Form

Notice of Special Shareholders' Meeting

NOTICE OF SPECIAL MEETING OF SHAREHOLDERS OF _____ [*name of corporation*]

TO: Shareholders of _____[*name of corporation*]

Pursuant to a call made by the _____[*title, e.g.,* President] of [*name of corporation*], notice is hereby given that a special meeting of the shareholders of _____[*name of corporation*], a California corporation, will be held at _____[*street address and city*], California, on _____[*date*], at _____[*hour*], to act on the following matters:

[*Specify each proposed action to be considered at the special meeting:*]

1. _____[*specify proposed action*].

2. _____[*specify proposed action*].

[*Continue with the following:*]

Only the shareholders of record at the close of business on _____[*specify date of business day preceding day notice is given unless another record date has been fixed by directors, articles, or agreement*], will be entitled to vote at the meeting.

[*If proxies will be solicited, add:*]

Every shareholder is invited to attend the meeting in person. Shareholders who do not expect to be present personally at the meeting are urged to read the proxy statement, and to complete, date, sign, and return the proxy in the enclosed envelope.

[*Continue with the following:*]

_____ Dated:

_____ [*signature*]
[*printed name*]
_____ [*title, e.g.,* Corporate Secretary]
_____ [*name of corporation*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersActions Against CorporationsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
A. Preliminary Reminders, Calls, and Notices

4-8A California Legal Forms--Transaction Guide § 8A.206

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.206 Notice of Adjourned Shareholders' Meeting

[1] Comment

[a] Use of Form

This form is a notice of an adjourned meeting. The circumstances in which notice must be given are discussed in [b], *below*. The procedure for giving the notice is the same as that for giving notice of an annual or special meeting of shareholders [*see §§ 8A.23, 8A.202[1], 8A.205[1]*].

[b] When Notice Is Required

When a shareholders' meeting is adjourned to another time or place, notice of the adjourned meeting generally does not need to be given if the time and place of that meeting (or the means of electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication, if any, by which shareholders may participate in that meeting [*Corp. Code § 601(a)*]) are announced at the original meeting, unless the bylaws require otherwise [*see Corp. Code § 601(d)*]. In order to avoid the need to give notice of an adjourned meeting, however, both a specific time and place for the adjourned meeting must be announced. An announcement that the adjourned meeting will take place in conjunction with a future event is not sufficiently specific. The shareholder attending the original meeting, or the absent shareholder, must be able to determine the time and place of the adjourned meeting from the announcement alone [*Spencer v. Older (1982) 133 Cal. App. 3d 95, 101-102, 183 Cal. Rptr. 722]* .

Notice to each shareholder of record entitled to vote at the meeting, however, is required if the adjournment is longer than 45 days or if, after the adjournment, a new record date is fixed for the adjourned meeting [*Corp. Code § 601(d)*].

[c] What Business May Be Transacted

The corporation may transact any business at the adjourned meeting that might have been transacted at the original

meeting [*Corp. Code § 601(d)*].

[2] Form

Notice of Adjourned Shareholders' Meeting

NOTICE OF ADJOURNED SHAREHOLDERS' MEETING OF _____ [*name of corporation*]

TO: Shareholders of _____[*name of corporation*]

A[n] _____[annual *or* special] meeting of the shareholders of _____[*name of corporation*], a California corporation, was held at _____[*street address and city*], California, on _____[*date*], at _____[*hour*]. That meeting was properly adjourned.

NOTICE IS HEREBY GIVEN that this _____[annual *or* special] meeting of the shareholders of _____[*name of corporation*], a California corporation, will be reconvened at _____[*street address and city*], California, on _____[*date*], at _____[*hour*], to act on the following matters:

[*Specify each proposed action to be considered at the reconvened meeting:*]

1. _____[*specify proposed action*].

2. _____[*specify proposed action*].

[*Continue with the following:*]

_____. To transact any other business which is within the powers of the shareholders.
_____ Dated:

_____ [*signature*]
[*printed name*]
_____ [*title, e.g.,* Corporate Secretary]
_____ [*name of corporation*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
A. Preliminary Reminders, Calls, and Notices

4-8A California Legal Forms--Transaction Guide § 8A.207

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.207 Affidavit of Mailing Notice of Shareholders' Meeting

[1] Comment--Use of Form

This form is an affidavit of the mailing of any meeting notice [*see § 8A.23[2]*]. It should be executed by the secretary, assistant secretary, or transfer agent of the corporation. An affidavit of mailing of any notice, executed by any of these persons, is prima facie evidence of the giving of the notice [*Corp. Code § 601(b)*].

A declaration under penalty of perjury may be used instead of the sworn affidavit [*see Code Civ. Proc. § 2015.5*].

For notices of annual, special, and adjourned meetings, see *§§ 8A.202*, *8A.205*, and *8A.206*, respectively.

[2] Form

Affidavit of Mailing Notice of Shareholders' Meeting

AFFIDAVIT OF MAILING NOTICE OF SHAREHOLDERS' MEETING OF _____ [*name of corporation*]

	)	
State of California	)	ss.
County of _____	)	

I, _____[*name of secretary, assistant secretary, or transfer agent*], swear that the following is true and correct:

1. That I am, and at all times mentioned in this affidavit was, the _____[Secretary *or* Assistant Secretary *or* Transfer Agent] of _____[*name of corporation*], a California corporation;

2. That, on _____[*date*], I caused a written notice of the [annual *or* special] shareholders' meeting of the corporation to be sent, by _____[first-class *or* third-class] mail, postage prepaid, addressed to each shareholder of the corporation entitled to vote as of the close of business on _____[*specify date of business day preceding day notice is given unless another record date was fixed by directors, articles, or other agreement*], at the address appearing for the shareholder on the records of the corporation, or at the address given to the corporation for notice purposes.

A copy of the notice is attached to this affidavit and incorporated by this reference.

_____ [*signature*]
[*printed name*]
_____ [*title*]

Executed and sworn to before me on _____[*date*].

_____ [*signature*]
[*printed name*]
Notary Public

[*Notarial seal*]

[*Attach copy of notice*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
A. Preliminary Reminders, Calls, and Notices

4-8A California Legal Forms--Transaction Guide § 8A.208

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.208 Declaration of Mailing Notice of Shareholders' Meeting

[1] Comment--Use of Form

This form is a declaration of mailing of any meeting notice [*see § 8A.23[2]*]. It should be executed by the secretary, assistant secretary, or transfer agent of the corporation. An affidavit of mailing of any notice, executed by any of these persons, is prima facie evidence of the giving of the notice [*Corp. Code § 601(b)*]. A declaration under penalty of perjury may be used instead of a sworn affidavit [*see Code Civ. Proc. § 2015.5*].

For notices of annual, special, and adjourned meetings, see *§§ 8A.202*, *8A.205*, and *8A.206*, respectively.

[2] Form

Declaration of Mailing Notice of Shareholders' Meeting

DECLARATION OF MAILING NOTICE OF SHAREHOLDERS' MEETING OF _____ [***name of corporation***]

The undersigned, _____[*name of secretary, assistant secretary, or transfer agent*], declares as follows:

1. I am, and at all times mentioned in this affidavit, was the _____[Secretary *or* Assistant Secretary *or* Transfer Agent] of _____[*name of corporation*], a California corporation;

2. On _____[*date*], I caused a written notice of the [annual *or* special] shareholders' meeting of the corporation to be sent, by _____[first-class *or* third-class] mail, postage prepaid, addressed to each shareholder of the corporation entitled to vote as of the close of business on _____[*specify date of business day preceding day notice is given unless another record date was fixed by directors, articles, or other agreement*], at the address appearing for the shareholder on the records of the corporation, or at the address given to the

corporation for notice purposes.

3. A true and correct copy of the notice is attached to this declaration and incorporated by this reference.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.
Executed on _____[*date*], at _____[*city*, *state*].

_____ [*signature*]
[*printed name*]
_____ [*title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
A. Preliminary Reminders, Calls, and Notices

4-8A California Legal Forms--Transaction Guide §§ 8A.209-8A.219

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.209[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
B. Waivers and Consents

4-8A California Legal Forms--Transaction Guide § 8A.220

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.220 Waiver of Notice, Consent to Holding, and Approval of Minutes of Shareholders' Meeting

[1] Comment

[a] Use of Form

This form is to be used by a shareholder to waive written notice, consent to the holding, and approve the minutes of any shareholder meeting at which the shareholder was or will not be present, either in person or by proxy. Any one of the segments of this form may be used separately.

PRACTICE TIP:
Some practitioners recommend that small, closely held corporations require their shareholders to sign this type of form even if call and notice of the meeting were regularly given, as a protection against any possible irregularity in the call or notice. *Commentary by Marilyn E. Minger.*

The optional paragraph in this form must be included in either of the following situations:

- The business transacted (or to be transacted) at the meeting involves any of the actions enumerated in *Corp. Code § 601(f)* [*see* [b], *below*]; or

- The corporation's articles of incorporation or bylaws require that any written waiver of notice specify the business to be transacted and/or the purpose of any regular or special meeting [*see Corp. Code § 601(e)*].

This form may be signed either before or after the meeting, and must be filed with the corporate records or made a part of the minutes of the meeting [*see* [b], *below*].

[b] Effect of Waiver; Statutory Requirements

The actions taken at a shareholder meeting held without formal notice are valid if the following conditions are met [*Corp. Code § 601(e)*]:

- A quorum must be present either in person or by proxy; and

- Either before or after the meeting, each of the persons entitled to vote, but not present in person or by proxy, must sign a written waiver of notice, consent to the holding of the meeting, or an approval of the minutes of the meeting [*Corp. Code § 601(e)*; *see § 8A.24*]. All waivers (or consents or approvals) must be filed with the corporate records or incorporated in the minutes of the meeting [*Corp. Code § 601(e)*].

Unless otherwise required by the corporation's articles of incorporation or bylaws, neither the business to be transacted nor the purpose of any regular or special meeting must be stated in any written waiver of notice (or in any consent to hold the meeting, or approval of the minutes) [*Corp. Code § 601(e)*], unless the action to be taken involves one of the following [*Corp. Code § 601(f)*; *see § 8A.20[1][a]*]:

- Transactions in which a director has a financial interest [*Corp. Code § 310*];

- Amendments to the articles of incorporation after shares have been issued [*Corp. Code § 902*];

- Approval of a corporate conversion [*Corp. Code § 1152*];

- Approval of the principal terms of reorganization [*Corp. Code § 1201*];

- Dissolution of the corporation [*Corp. Code § 1900*]; or

- Approval of a plan of distribution of corporate assets upon dissolution not in accordance with the liquidation rights of the preferred shares [*Corp. Code § 2007*].

In these circumstances, any shareholder approval at a meeting, other than by the unanimous approval of all shares entitled to vote, is valid only if the general nature of the transaction approved was stated in the meeting's notice or in any written waiver of notice [*Corp. Code § 601(f)*; *see § 8A.20[1][a]*].

For discussion of when attendance at a meeting constitutes a waiver of notice, see *§ 8A.24*.

[2] Form

Waiver of Notice, Consent to Holding, and Approval of Minutes of Shareholders' Meeting

WAIVER, CONSENT, AND APPROVAL OF MINUTES OF [ANNUAL ***or*** SPECIAL] SHAREHOLDERS' MEETING OF _____ [*name of corporation*]

The undersigned shareholders of _____[*name of corporation*], a California corporation, entitled to vote their shares at the _____[annual *or* special] meeting of shareholders _____[to be held *or* held] on _____[*date*], at _____[*time*], at _____[*location*], hereby waive written notice, consent to the holding of, and approve the minutes of this meeting.

The undersigned shareholders agree that any business transacted at this meeting _____[will be *or* was] as valid as if transacted at a meeting regularly called and noticed.

[*If meeting will involve shareholder approval of actions specified in Corp. Code §§ 310, 902, 1201, 1900, or 2007, or if the articles or bylaws require that any approval of minutes of a shareholders' meeting specify the business to be transacted and/or the purpose of any regular or special meeting, add:*]

The following proposal[s] _____[will be considered *or* _____ (was *or* were) approved] at this meeting:

1. _____[*specify approved action*].

2. _____[*specify aproved action*].

[*Continue with the following:*]

Dated: _____.

[*Repeat for each shareholder:*]

_____ [*shareholder's signature*]
[*printed name*]
Number of shares owned: _____

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
B. Waivers and Consents

4-8A California Legal Forms--Transaction Guide § 8A.221

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.221 Letter to Shareholders Regarding Shareholders' Written Consent to Action Without Meeting

[1] Comment--Use of Form

This form is a letter to the shareholders explaining management's request for the shareholders' written consent to a proposed action that requires shareholder approval [*see § 8A.11*]. For discussion of shareholder action by written consent, see *§§ 8A.28* and *8A.222[1]*.

[2] Form

Letter to Shareholders Regarding Shareholders' Written Consent to Action Without Meeting

LETTER SOLICITING SHAREHOLDERS' WRITTEN CONSENT
_____[*date*]
_____[*Shareholder's name*]
_____[*Address*]

Re: Written Consent by Shareholders of _____ [*name of corporation*] to Action Without Meeting
Dear Shareholder:

I hope you will take the time to read the important information attached, which requests your written consent to _____[*proposed action(s)*]. The Board of Directors and the management of _____[*name of corporation*] have approved _____[this *or* these] action[s] and believe that _____[it is *or* they are] in the best interests of _____[*name of corporation*] for the following reason[s]: _____[*specify*].

The California Corporations Code requires shareholder approval of _____[this *or* these] action[s]. If

you consent, please sign and date the enclosed form and return it by _____[*date*]. An addressed envelope, with postage prepaid, is enclosed for your convenience.

Please call me if you have any questions about this matter. I look forward to receiving your consent.

Sincerely, _____ [*signature*]
[*printed name*]
_____ [*title*]

Encl.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
B. Waivers and Consents

4-8A California Legal Forms--Transaction Guide § 8A.222

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.222 Shareholders' Action by Written Consent for Use by Corporation With Fewer than 100 Shareholders

[1] Comment

[a] Use of Form

This form is a shareholders' action by written consent, for use by a corporation with fewer than 100 shareholders. For a written consent for use by a corporation with more than 100 shareholders if the consent is distributed to 10 or more shareholders, see *§ 8A.223*. The executed written consents should be filed in the corporation's minute book.

[b] Uses; Statutory Requirements

Unless otherwise provided in the articles of incorporation, any action that may be taken by the shareholders at any annual or special meeting may be taken without a meeting and without prior notice by a consent in writing [*Corp. Code § 603(a)*]. Directors, however, may be elected by written consent only on the unanimous consent of all shares entitled to vote for the election of directors [*Corp. Code § 603(d)*; *see § 8A.28*], unless the election is to fill a vacancy on the board (other than a vacancy created by removal). If the election is to fill a vacancy on the board of directors, the written consent of a majority of the outstanding shares entitled to vote is all that is required [*Corp. Code §§ 305(b), 603(d)*; *see Corp. Code § 152* (majority of the outstanding shares entitled to vote defined); *see also § 8A.28[1]*]. Filling vacancies created by removal, however, requires the unanimous written consent of all shares entitled to vote for the election of directors [*Corp. Code §§ 305(b), 603(d)*]. Actions other than the election of directors may be taken by written consent without a meeting, provided that the consent of the same number of shares as would be necessary to authorize that action at a meeting are obtained [*Corp. Code § 603(a)*].

The consent must [*Corp. Code § 603(a)*]

- Set forth the action taken, and

- Be signed by the required number of shareholders.

Written consent may also be given by facsimile, telegraphic communication, or other electronic communication as authorized by statute, including an electronic transmission by the corporation [*Corp. Code § 195*; *see Corp. Code § 20*].

Not all shareholders entitled to vote need to be solicited for written consents. Nonconsenting shareholders entitled to vote must be given a special notice of the action taken [*Corp. Code § 603(b)*; *see § 8A.222*].

The written consent may be revoked [*see § 8A.224*] if the corporation receives the written revocation before the written consents representing the number of shares required to authorize the proposed action have been filed with the corporation's secretary [*Corp. Code § 603(c)*].

[2] Form

Shareholders' Action by Written Consent for Use by Corporation With Fewer than 100 Shareholders

_____ [*Name of corporation*]

SHAREHOLDERS' ACTION BY WRITTEN CONSENT

The undersigned shareholders of _____[*name of corporation*], a California corporation, do hereby consent to the following _____[action *or* actions] of the corporation:

_____[*Insert text of corporate resolution*].

This consent is given in accordance with *California Corporations Code Section 603*, with respect to all shares of the undersigned entitled to vote on _____[this matter *or* these matters].

Dated: _____.

[*Repeat for each signing shareholder:*]

_____ [*shareholder's signature*]
[*printed name*]
Number of shares owned: _____

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
B. Waivers and Consents

4-8A California Legal Forms--Transaction Guide § 8A.223

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.223 Shareholders' Action by Written Consent Distributed to 10 or More Shareholders by Corporation With 100 or More Shareholders

[1] Comment

[a] Use of Form

This form is a shareholder's written consent for use by a corporation that is not subject to the federal Securities and Exchange Act and that has more than 100 shareholders, if the consent is distributed to 10 or more shareholders [*Corp. Code § 604*; *see Corp. Code § 604(d)* (exceptions); *see also 15 U.S.C. §§ 78l, 78l(g)(2)*]. For a written consent to be used by a corporation with fewer than 100 shareholders, see *§ 8A.222*. Written consent may also be given by facsimile, telegraphic communication, or other electronic communication as authorized by statute, including an electronic transmission by the corporation [*Corp. Code § 195*; *see Corp. Code § 20*]. The executed written consents should be filed in the corporation's minute book.

[B] Statutory Requirements of Form

These written consents must include the following [*Corp. Code § 604(a)*]:

- A choice between approval and disapproval of each matter (or group of related matters), other than elections; and

- A provision, subject to reasonable, specified conditions, that the shares will be voted in accordance with the shareholder's choice.

Failure of a subject corporation to comply with the statutory requirements for a proxy form, which are similar to those for a written consent, does not invalidate any corporate action taken, but may be the basis for challenging noncompliance in the superior court [*Corp. Code § 604(c)*].

For further discussion of written consents in general, see *§§ 8A.28, 8A.222*.

[2] Form

Shareholders' Action by Written Consent Distributed to 10 or More Shareholders by Corporation With 100 or More Shareholders

_____ [*Name of corporation*]

SHAREHOLDERS' ACTION BY WRITTEN CONSENT

The undersigned shareholder of _____[*name of corporation*], a California corporation, votes his or her shares as indicated below:

[*Repeat, as required:*]

_____[*Insert text of corporate resolution*].

FOR: _____

AGAINST: _____

ABSTAIN: _____

[*Continue with the following:*]

THE SHARES REPRESENTED BY THIS WRITTEN CONSENT WILL BE VOTED AS MARKED ABOVE. A PROPOSAL MARKED "ABSTAIN" WILL NOT BE VOTED EITHER FOR OR AGAINST THAT PROPOSAL.

This consent is given in accordance with *California Corporations Code Section 604*, with respect to all shares of the undersigned entitled to vote on _____[this *or* these] matter[s].
_____ Dated:

_____ [*shareholder's signature*]
[*printed name*]
Number of shares owned: _____

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
B. Waivers and Consents

4-8A California Legal Forms--Transaction Guide § 8A.224

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.224 Revocation of Written Consent by Shareholder

[1] Comment--Use of Form

This form is a revocation of written consent [*see §§ 8A.222, 8A.223*] by a shareholder. It may be used by any shareholder, the shareholder's proxy holder, transferee or personal representative, or their respective proxy holders [*see Corp. Code § 603(c)*].

The revocation must be in writing and must be received by the corporation before the written consents representing the number of shares required to authorize the proposed action have been filed with the corporation's secretary [*Corp. Code § 603(c)*]. The revocation of consent is effective on receipt by the corporation's secretary [*Corp. Code § 603(c)*].

For further discussion of written consents in general, see *§§ 8A.28, 8A.221*.

[2] Form

Revocation of Written Consent by Shareholder

REVOCATION BY SHAREHOLDER OF WRITTEN CONSENT TO CORPORATE ACTION

TO: The Secretary of _____[*name of corporation*]

The undersigned shareholder of _____[*name of corporation*], a California corporation, hereby revokes _____[his *or* her] written consent dated _____ to the following action[s] of the corporation:

[*Repeat, as required:*]

1. _____[*specify action previously consented to*].

2. _____[*specify action previously consented to*].

[*Continue with the following:*]

_____ Dated:

_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
B. Waivers and Consents

4-8A California Legal Forms--Transaction Guide § 8A.225

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.225 Notice to Shareholders of Action by Written Consent Without Meeting

[1] Comment

[a] Use of Form

This form is a notice by the corporation of any corporate action approved by shareholders without a meeting by less than unanimous written consent. This notice must be given to any shareholders who have not signed the written consent [*see Corp. Code § 603(b)*; *see also* [b], *below*].

The optional clause in the form should be included when giving notice of any shareholder approval of the following actions [*Corp. Code § 603(b)(1)*]:

- Transactions in which a director has a financial interest [*Corp. Code § 310*].
- Indemnification of corporate agents [*Corp. Code § 317*].
- Corporate conversions [*Corp. Code § 1152*].
- The principal terms of reorganization [*Corp. Code § 1201*].
- A plan of distribution of corporate assets on dissolution not in accordance with the liquidation rights of the preferred shares [*Corp. Code § 2007*].

For further discussion of written consents in general, see *§§ 8A.28, 8A.221*.

[b] California Notice Requirements

Unless the consents of all shareholders entitled to vote have been solicited in writing, notice of any corporate action approved by shareholders without a meeting by less than unanimous written consent must be given to those shareholders entitled to vote who have not signed the consent [*see Corp. Code § 603(b)*]. The notice must be given at least 10 days before the consummation of the action authorized by that approval, if the shareholder approval was pursuant to *Corp. Code § 310, 317, 1152, 1201,* or *2007* [*Corp. Code § 603(b)(1)*; *see* [a] *above*]. It must be given "promptly" after the approval of any other action [*Corp. Code § 603(b)(2)*].

The procedure for giving the notice is the same as that for giving notice of an annual or special meeting of shareholders [*see Corp. Code § 603(b)*; *see also Corp. Code § 601(b)* (notice procedure); §§ 8A.23, 8A.202[1], 8A.205[1]].

[c] Federal Notice Requirements

In some circumstances, federal SEC regulations under the Securities Exchange Act of 1934 require the giving of an "information statement" if there has not been proxy solicitation by a corporation subject to that act [*see 17 C.F.R. § 240.14c-2*]. For further discussion, see *§ 8A.60[1]*.

[2] Form

Notice to Shareholders of Action by Written Consent Without Meeting

NOTICE OF ACTION BY WRITTEN CONSENT WITHOUT MEETING

_____ [*Name of corporation*]

To: Shareholders of _____[*name of corporation*]

Notice is given pursuant to *Corporations Code § 603(b)* that, on _____[*date*], the holders of _____[*specify percentage, e.g.* a majority] of the shares entitled to vote consented in writing to the following action[s]:

[*Repeat, as required:*]

1. _____[*specify action*].

2. _____[*specify action*].

[*If shareholder approval was pursuant to Corp. Code § 310, 317, 1152, 1201, or 2007, add:*]

_____[This *or* these] action[s] will be consummated on _____[*specify date at least 10 days after date of notice*].

[*Continue with the following:*]

_____ Dated:

_____ [*signature*]
[*typed name*]
_____ [*title, e.g.*, Corporate Secretary]
_____ [*name of corporation*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewSecurities LawAdditional Offerings & the Securities Exchange Act of 1934ProxiesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



80 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
B. Waivers and Consents

4-8A California Legal Forms--Transaction Guide §§ 8A.226-8A.239

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.226[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
C. Voting by Shareholders

4-8A California Legal Forms--Transaction Guide § 8A.240

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.240 Ballot--Noncumulative Voting for Directors and Other Matters

[1] Comment

[a] Use of Form

This form is a ballot to be used when directors are elected by *noncumulative* voting. If the shareholders will vote on matters other than the election of directors, this ballot may be used for that purpose as well. For a ballot to be used when directors are elected by cumulative voting, see *§ 8A.241*.

[b] Use of Ballot

Elections for directors are not required to be by ballot, unless a shareholder demands election by ballot at the meeting, before the voting begins, or unless required by the bylaws [*Corp. Code § 708(e)*]. As a practical matter, in a closely held corporation with few shareholders, votes are often cast by voice or a show of hands. However, since any shareholder is entitled to receive a report of the exact voting of shares at any shareholders' meeting [*see Corp. Code § 1509*; *see also Corp. Code § 711* (disclosure requirements); § 8A.70], each shareholder's vote should be tallied and recorded.

[c] Noncumulative Voting

Except as otherwise provided in the articles [*see § 8A.11[2]*], and except for cumulative voting for directors [*see § 8A.241[1][b]*], each outstanding share, regardless of class, is entitled to one vote on each matter submitted to a vote of the shareholders [*Corp. Code § 700(a)*; *see Corp. Code §§ 400* (power of corporation to limit voting rights), 407 (voting rights of fractional shares)]. A shareholder entitled to vote on any matter may vote part of his or her shares in favor of the proposal and refrain from voting the remaining shares, or may vote them against the proposal (except for elections to office) [*Corp. Code § 700(b)*]. However, if the shareholder fails to specify the number of shares he or she is voting affirmatively, it is conclusively presumed that the shareholder's approving vote is with respect to all the shares he or she is entitled to vote [*Corp. Code § 700(b)*]. For discussion of voting fractional shares, see Ballantine & Sterling,

CALIFORNIA CORPORATION LAWS, Ch. 9, *Shareholders' Meetings and Voting* , § 171.03 (Matthew Bender). For discussion of special rules applying to particular types of shareholders, see *§§ 8A.42-8A.44*.

[2] Form

Ballot--Noncumulative Voting for Directors and Other Matters

BALLOT FOR ELECTION OF DIRECTORS [***if other matters will be voted on, add:*** AND OTHER MATTERS]

_____ [*Name of corporation*]

ANNUAL MEETING OF SHAREHOLDERS

_____ [*date*]

1. Name of shareholder:

_____

2. Number of votes entitled to be cast:

_____ [*number of shares for which shareholder is entitled to vote*].

3. Name of voter if other than owner of shares:

_____

4. Capacity of voter if other than shareholder:

_____ [*e.g.*, proxy holder *or* trustee]

BALLOT FOR ELECTION OF DIRECTORS

INSTRUCTIONS

PLEASE ENTER THE NUMBER OF VOTES YOU DESIRE TO CAST FOR EACH CANDIDATE OPPOSITE SUCH CANDIDATE'S NAME BELOW. YOU MAY CAST A TOTAL NUMBER OF VOTES EQUAL TO THE NUMBER IN PARAGRAPH 2, ABOVE, MULTIPLIED BY _____[*number of directors to be elected*]. YOU MAY DIVIDE YOUR VOTES AMONG VARIOUS CANDIDATES BUT IN NO EVENT MAY YOU CAST MORE VOTES FOR ANY ONE CANDIDATE THAN THE NUMBER SET FORTH IN PARAGRAPH 2, ABOVE.

[*Repeat for each nominee:*]

Name of Nominee	Number of Votes Cast, if any

_____ [*name of nominee; management should provide this information*] _____

_____ [*name of nominee*] _____

_____ [*name of nominee*] _____

[*If other matters will be put to a shareholder vote, add:*]

INSTRUCTIONS FOR VOTING ON MATTERS OTHER THAN THE ELECTION OF DIRECTORS

FOR EACH PROPOSED ACTION SET FORTH BELOW, YOU ARE ENTITLED TO CAST THE NUMBER OF VOTES SPECIFIED IN PARAGRAPH 2, ABOVE. YOU MAY CAST ALL OF YOUR VOTES IN FAVOR OF THE PROPOSAL, AGAINST THE PROPOSAL, OR YOU MAY ABSTAIN FROM VOTING WITH RESPECT TO THE PROPOSAL, HOWEVER YOU DESIRE.

[*Repeat for each proposal:*]

_____. Approval of the following proposed action by management _____[*insert full text of resolution*]:

FOR: _____[*number of votes cast, if any*]

AGAINST: _____[*number of votes cast, if any*]

ABSTAIN: _____[*number of votes cast, if any*]

[*Continue with the following:*]

UNLESS OTHERWISE MARKED ABOVE, THIS BALLOT WILL BE CONSIDERED TO BE THE VOTE OF ALL OF THE SHARES THAT THE SHAREHOLDER IS ENTITLED TO VOTE. A VOTE MARKED "ABSTAIN" WILL NOT BE VOTED EITHER FOR OR AGAINST.

ALL BALLOTS MUST BE SIGNED.

For shareholders voting in person:

_____ [*signature*]
[*printed name exactly as on stock certificate*]

For shares being voted by proxy:

[*printed name of proxy holder*]
[*printed name of holder of record certificate*]

_____
By: _____ [*signature*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
C. Voting by Shareholders

4-8A California Legal Forms--Transaction Guide § 8A.241

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.241 Ballot--Cumulative Voting for Directors

[1] Comment

[a] Use of Form

This form is a ballot that may be used when directors are elected by *cumulative* voting. Elections for directors are not required to be by ballot, unless a shareholder demands election by ballot at the meeting, before the voting begins, or unless required by the bylaws [*Corp. Code § 708(e)*; *see § 8A.240[1][b]*]. For a ballot to be used when directors are elected by noncumulative voting, see *§ 8A.240*.

[b] Cumulative Voting for Directors

Except as otherwise provided in the articles or bylaws of a listed corporation [*see Corp. Code § 301.5(d)* (listed corporation defined); *see also* Corp. Code § 708.5] or in the shareholder agreement of a close corporation [*Corp. Code § 300(b)*], shareholders have the right to cumulate their votes for the election of directors [*Corp. Code § 708(a)*]. Using cumulative voting, a shareholder may cast the number of votes to which he or she is normally entitled, multiplied by the number of directors to be elected [*Corp. Code § 708(a)*]. A shareholder may cast all his or her votes for one candidate or may vote for as many candidates as he or she thinks fit [*Corp. Code § 708(a)*]. Thus, for example, minority shareholders may elect their candidate to the board of directors by casting all their cumulated votes for that candidate.

The candidates for director who receive the highest number of affirmative votes, up to the number of directors to be elected, are elected [*Corp. Code § 708(c)*; *but see* Corp. Code § 708.5]. A negative or withheld vote against a director has no effect [*Corp. Code § 708(c)*].

If the candidates' names have been placed in nomination before the meeting and if any shareholder has given notice, before the voting, of the shareholder's intention to cumulate votes at the meeting, all shareholders may cumulate their votes for candidates in nomination [*Corp. Code § 708(b)*].

[2] Form

Ballot--Cumulative Voting for Directors

BALLOT FOR ELECTION OF DIRECTORS BY CUMULATIVE VOTING

_____ [*Name of corporation*]

ANNUAL MEETING OF SHAREHOLDERS

_____ [*date*]

1. Name of shareholder:

_____

2. Number of directors to be elected:

_____ [*management should provide this information*]

3. Number of votes entitled to be cast:

_____ [*multiply number of shares by number of votes to which each share is entitled by number of directors to be elected; management should provide this information*]

4. Name of voter if other than owner of shares:

_____

5. Capacity of voter if other than shareholder:

_____ [*e.g.,* proxy holder *or* trustee]

INSTRUCTIONS FOR ELECTION OF DIRECTORS

YOU ARE ENTITLED TO CAST THE NUMBER OF VOTES SPECIFIED IN PARAGRAPH 3, ABOVE. YOU MAY CAST ALL OF YOUR VOTES FOR ONE NOMINEE, OR YOU MAY SPLIT YOUR VOTES BETWEEN SOME OR ALL OF THE NOMINEES, HOWEVER YOU DESIRE. VOTES AGAINST A NOMINEE AND VOTES WITHHELD WILL HAVE NO LEGAL EFFECT.

[*Repeat for each nominee:*]

Name of Nominee	Number of Votes Cast, if any
_____ [*name of nominee; management should*	_____ _____

provide this information] _____

_____ [*name* _____
of nominee] _____
_____

_____ [*name* _____
of nominee] _____
_____

[*Continue with the following:*]

For shareholders voting in person:

_____ [*signature*]
[*printed name exactly as on stock certificate*]

For shares being voted by proxy:

[*printed name of proxy holder*]
[*printed name of holder of record certificate*]
_____
By: _____ [*signature*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersTerms in OfficeElectionsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
C. Voting by Shareholders

4-8A California Legal Forms--Transaction Guide § 8A.242

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.242 Shareholder's Request for Vote Results

[1] Comment--Use of Form

This form is a written request by a shareholder for the results of a vote taken at a shareholder meeting. When a shareholder makes this request within 60 days after any shareholders' meeting, the corporation is required to provide the requested information [*Corp. Code § 1509*]. For further discussion of the shareholder's right to voting results, see *§ 8A.70[1]*. For discussion and an example of the report the corporation must provide in response to this request, see *§§ 8A.70[2]* and *8A.243*.

[2] Form

Shareholder's Request for Vote Results

REQUEST FOR VOTE RESULTS

_____[*date*]
_____[*Name of appropriate corporate officer*]
_____[*Officer's title*]
_____[*Name of corporation*]
_____[*Corporation's address*]

Re: Request for vote results of _____ [annual *or* regular *or* special] shareholders' meeting held on _____ [*date*]
Dear _____ [*name of corporate officer*]:

Pursuant to *Corporations Code Section 1509*, I request a written report of the result of the shareholders' vote regarding _____[*describe matter voted on at meeting*], taken at the shareholders' meeting held on

_____[*date*].

Please send that report to me at _____[*address*].

As a shareholder (as defined in *Corporations Code Section 1512*), I am entitled to this report.

[*If shareholder is named on the records of a central depository, bank, or broker-dealer with respect to shares subject to control of the depository, bank, or broker-dealer, add:*]

I have enclosed a photocopy of a statement from _____[*name of applicable depository, bank, or broker-dealer*] showing my status as a shareholder.

[*Continue with the following:*]

Sincerely, _____ [*signature of shareholder*]
[*printed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
C. Voting by Shareholders

4-8A California Legal Forms--Transaction Guide § 8A.243

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.243 Report of Vote Results to Shareholders

[1] Comment

[a] Use of Form

This form is a report by a corporation, in response to a written shareholder request, of the results of a vote taken at a shareholder meeting. For discussion and an example of a shareholder request for vote results, see *§§ 8A.70[2]* and *8A.242*.

[b] Contents of Report

The report must include the number of shares that voted for, against, and abstained from voting [*Corp. Code § 1509*]. If directors were elected, the report must include the number of shares, or votes, if voted cumulatively, cast for each nominee [*Corp. Code § 1509*]. If more than one class or series of shares voted, the report must also state the numbers by class and series of shares [*Corp. Code § 1509*].

[c] When Report Must Be Given

There is no specific statutory time limit within which the corporation must provide the shareholder with the information after receipt of the initial request. The only requirement is that the shareholder be informed "forthwith" [*see Corp. Code § 1509*].

[2] Form

Report of Vote Results to Shareholders

REPORT OF VOTING RESULTS AT SHAREHOLDERS' MEETING OF _____ [***date***]

_____ [*Name of corporation*]

The following is a summary of the vote taken at the shareholders' meeting held on _____[*date*] with respect to the following matter[s].

[*Repeat as required:*]

1.

_____ [*Matter on which shareholder requested vote results*]:

[*If vote was not for election of directors:*]

Class of Stock [*specify class and series, as applicable*]	Voted For	Voted Against	Withheld or Abstained
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
TOTALS	_____	_____	_____

[*Or, if vote was for election of directors:*]

[*Repeat as needed:*]

[*Candidate's name*]	[*Class of stock, e.g.,* Common *or* Preferred Series A]	[*Class of stock*]	**TOTALS**
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

[*Continue with the following:*]

_____ Dated:

_____ [*signature of appropriate officer, e.g., Corporate Secretary*]
[*printed name*]
_____ [*title, e.g.,* Corporate Secretary]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
C. Voting by Shareholders

4-8A California Legal Forms--Transaction Guide § 8A.244

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.244 Report of Inspectors of Election

[1] Comment--Use of Form

This form is for use by inspectors of elections to report results of an election for directors. The form may be adapted to report other actions voted upon in an election for which inspectors have been appointed. Before any shareholder meeting, the board of directors may appoint inspectors of election to act at that meeting, or at any adjourned meeting [*Corp. Code § 707(a)*]. For further discussion, see *§ 8A.71*.

[2] Form

Report of Inspectors of Election

REPORT OF INSPECTOR[S] OF ELECTION OF _____ [***name of corporation***]

The undersigned, the duly appointed inspector[s] of election at the annual meeting of shareholders of the above named corporation, a California corporation, held on _____[*date*], [do hereby report *or* hereby reports] as follows:

1. The number of shares of the corporation that were issued and outstanding on the record date established by the board of directors of the corporation for determining shareholders entitled to vote at the above meeting of shareholders, and therefore the number of shares entitled to vote at that meeting, was as follows:

Name of Class or Series	Number of Shares
_____	_____
_	_____
_____	_____
_	_____

_____ _____
_ _____

2. Each of the above shares was entitled to one vote.

3. There were present in person or by proxy at the above meeting shareholders holding _____ Common Shares, representing _____ percent of the total number of share outstanding and entitled to vote at the meeting, that percentage being a quorum.

4. [I *or* We] received and tabulated the votes of the shareholders at said meeting.

5. The following persons received the number of votes for election as directors set opposite their respective names:

Name	Number of Votes
_____	_____ _____
_____	_____ _____
_____	_____ _____

6. The following persons were duly elected as directors of the corporation at the above-referenced meeting:

Name of Director
_____ __
_____ __
_____ __

7. _____[*report any other voting supervised by the inspectors*]

_____ Dated:

_____ [*signature of inspector*]
_____ [*signature of inspector*]
_____ [*signature of inspector*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
C. Voting by Shareholders

4-8A California Legal Forms--Transaction Guide §§ 8A.245-8A.249

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.245[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
D. Proxies

4-8A California Legal Forms--Transaction Guide § 8A.250

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.250 Proxy for Particular Meeting of Private Corporation With Fewer Than 100 Shareholders

[1] Comment

[a] Use of Form

This form is a proxy under which the shareholder selects a proxy for a particular meeting and grants the proxy holder general authority to act at that meeting. If management recommends a proxy holder, the optional paragraph naming that proxy holder should be included. If the proxy holder's authority is not limited to a particular meeting, this form may be modified accordingly [*see also § 8A.253*].

The maker of the proxy may want to limit the authority of the proxy holder by granting the proxy holder power to vote only on specific proposals, or by denying the proxy holder authority to vote on specified proposals. For a proxy (for a corporation with fewer than 100 shareholders) that limits this authority, see *§ 8A.251*. For a proxy distributed to 10 or more shareholders of a corporation with outstanding shares held of record by 100 or more persons [*see Corp. Code § 605* (shares held of record by 100 or more persons defined)], if the corporation is not subject to the federal Securities and Exchange Act [*see Corp. Code § 604*; *see also 15 U.S.C. §§ 78l, 78l(g)(2)*], see *§ 8A.253*. For an irrevocable proxy, see *§ 8A.252*.

[b] Voting by Proxy

A proxy is a written authorization given by a shareholder to another party to vote the shareholder's shares [*Corp. Code § 178*]. Every person entitled to vote shares may authorize another person (or persons) (the "proxy holder" [*Corp. Code § 179*]) to vote or take other action on those shares by proxy [*Corp. Code § 705(a)*].

Any proxy purporting to be executed according to the provisions of the General Corporation Law is presumptively valid [*Corp. Code § 705(a)*; *see Corp. Code § 604* (required form of proxy to be distributed to shareholders of corporation with outstanding shares held by 100 or more persons); *see also § 8A.253*].

[c] Duration and Revocation

A proxy is valid only for a period of 11 months from its date, unless otherwise provided in the proxy [*Corp. Code § 705(b)*]. However, in practice, most proxies are granted for a specific meeting [*see* [2], *below*; *see also* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 9, *Shareholders' Meetings and Voting* , § 172.01[4] (Matthew Bender)].

A proxy continues in effect until revoked, with specified exceptions [*Corp. Code § 705(b)*; *see Corp. Code § 705(c)* (revocation because of death or incapacity of maker of proxy if corporation receives written notice), (e) (revocation of proxy held by pledgee, purchaser, creditor, or employee if the purpose for which the proxy was given no longer exists), or (f) (revocation by transferee of shares with no knowledge of irrevocable provision of proxy, subject to specified limitations)]. For further discussion and a form for revocation of a proxy, see *§§ 8A.62* and *8A.254*. For discussion of irrevocable proxies, see *§§ 8A.63* and *8A.252*.

[d] Execution and Transmission

The shareholder's name may be signed on the proxy by the shareholder or the shareholder's attorney in fact manually, by typewriter, by telegraphic or electronic transmission, or otherwise [*Corp. Code § 178*]. A proxy may be transmitted orally over the telephone if it is submitted with information from which it may be determined that the proxy was authorized by the shareholder or the shareholder's attorney in fact [*Corp. Code § 178*].

[2] Form

Proxy for Particular Meeting of Private Corporation With Fewer Than 100 Shareholders

PROXY

_____ [*Name of corporation*]

Certificate No(s).	Number of _____ [Shares *or* Votes]	Class and Series
_____	_____	_____
_____	_____	_____
_____	_____	_____

The undersigned, as record holder of the shares of stock of _____[*name of corporation*] described above, revokes any previous proxies and appoints _____[*name*] as the undersigned's proxy to attend the _____[annual *or* special] shareholders' meeting on _____[*date*], and any adjournment of that meeting.

The proxy holder is entitled to cast a total number of votes equal to, but not exceeding _____[the number of shares *or* the votes to which each share is entitled] which the undersigned would be entitled to cast if the undersigned were personally present.

The undersigned authorizes the undersigned's proxy holder to vote and otherwise represent the undersigned with regard to any business that may come before this meeting in the same manner and with the same effect as if the undersigned were personally present.

THIS PROXY MAY BE REVOKED AT ANY TIME

[*Add, if desired:*]

The management of the corporation recommends that you appoint _____[*name*] as your proxy holder.

[*Continue with the following:*]

ALL PROXIES MUST BE SIGNED. PLEASE SIGN EXACTLY AS YOUR NAME APPEARS ON YOUR STOCK CERTIFICATE. JOINT SHAREHOLDERS MUST EACH SIGN THIS PROXY. IF SIGNED BY AN ATTORNEY IN FACT, THE POWER OF ATTORNEY MUST BE ATTACHED.

For shareholders signing in person:

_____ [*signature*]
[*printed name exactly as on stock certificate*]

For proxy being signed by attorney in fact:

[*printed name of attorney in fact:*]
[*printed name of holder of record certificate*]
_____
By: _____ [*signature*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
D. Proxies

4-8A California Legal Forms--Transaction Guide § 8A.251

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.251 Proxy With Limitation of Authority for Private Corporation With Fewer Than 100 Shareholders

[1] Comment--Use of Form

This form is a proxy to be used by a shareholder to limit the authority of the shareholder's proxy holder. The first alternative authorizes the proxy holder to vote only on the matters specifically stated in the proxy, for or against a particular proposal or director. The second alternative denies the proxy holder the authority to approve a specific action, merger or consolidation, for example.

This form contains an optional provision making the proxy irrevocable until a specified date, or as required by *Corp. Code § 705(e)*. For further discussion of irrevocable proxies, see *§§ 8A.63* and *8A.252*. For a form for revocation of a proxy, see *§ 8A.254*. For discussion of proxies in general, see *§§ 8A.60-8A.63* and *8A.250*.

[2] Form

Proxy With Limitation of Authority for Private Corporation With Fewer Than 100 Shareholders

PROXY

_____ [*Name of corporation*]

Certificate No(s).	Number of [Shares *or* Votes]	Class and Series
_____	_____	_____
_____	_____	_____

___
_____ _____ _____
___

The undersigned, as record holder of the shares of stock of _____[*name of corporation*] described above, revokes any previous proxies and appoints _____[*name*] as the undersigned's proxy to attend _____[all shareholders' meetings of the corporation *or* the shareholders' meeting on _____ (*date*),] and any adjournment of _____[those *or* that] meeting[s].

The proxy holder is entitled to cast a total number of votes equal to, but not exceeding, the number of votes which the undersigned would be entitled to cast if the undersigned were personally present.

The undersigned authorizes the undersigned's proxy holder to vote and otherwise represent the undersigned in the same manner and with the same effect as if the undersigned were personally present, but with the following limitations:

[*If proxy holder is authorized to vote only for or against a particular proposal or director, include the following:*]

The authority granted by this proxy is limited to representing the undersigned for the purposes of determining a quorum and to voting or executing consents representing the undersigned with regard to the following matter[s]:

1.

_____ [*specify matter, e.g.,* The election of

_____ (*name of nominee*) to the corporation's Board of Directors.]

2.

_____ [*specify matter, e.g.,* The

_____ (*specify proposals to be voted on*).]

[*Or, if proxy holder is denied the authority to approve a specific action:*]

The authority granted by this proxy is limited and the proxy holder will have no authority to vote for or consent to any of the following proposals:

_____. _____ [*specify restrictions, e.g.,* For merger, consolidation, sale of corporate assets, winding up and dissolution of the corporation.]

[*Continue with the following:*]

[*For a revocable proxy:*]

THIS PROXY MAY BE REVOKED AT ANY TIME.

[*Or, for a revocable proxy for a specified term:*]

IF NOT PREVIOUSLY REVOKED, THIS PROXY WILL TERMINATE ON _____[*date*].

[*Or, for an irrevocable proxy:*]

THIS PROXY IS IRREVOCABLE UNTIL _____[*date*] OR _____[*specify event, as required by Corp. Code § 705(e)*], WHICHEVER IS EARLIER.

[*Continue with the following:*]

ALL PROXIES MUST BE SIGNED. PLEASE SIGN EXACTLY AS YOUR NAME APPEARS ON YOUR STOCK CERTIFICATE. JOINT SHAREHOLDERS MUST EACH SIGN THIS PROXY. IF SIGNED BY AN ATTORNEY IN FACT, THE POWER OF ATTORNEY MUST BE ATTACHED.

For shareholders signing in person:
_____ [*signature*]
[*printed name exactly as on stock certificate*]

For proxy being signed by attorney in fact:
[*printed name of attorney in fact:*]
[*printed name of holder of record certificate*]
_____
By: _____ [*signature*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy Agreements



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
D. Proxies

4-8A California Legal Forms--Transaction Guide § 8A.252

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.252 Irrevocable Proxy [Corp. Code § 705(e)]

[1] Comment

[a] Use of Form

This form is an irrevocable proxy to be used when shares belong to another or are held as a pledge or security [*see Corp. Code §§ 705(d), (e)*; *see also* [b], *below*]. For discussion of the procedure by which a proxy may be revoked and a form for revocation, see *§ 8A.254*. For revocable proxies, see *§§ 8A.250, 8A.251, 8A.253*.

[b] When Proxies Are Irrevocable

In some circumstances, a proxy that states that it is irrevocable is irrevocable for a specified period and is not revoked by giving written notice to the corporation of the death or incapacity of the proxy maker [*see Corp. Code § 705(e)*]. These circumstances include the following [*Corp. Code § 705(e)*]:

- The giving of a proxy to secure the performance of a duty or to protect a legal or equitable title, until the happening of events which, by the proxy's terms, discharge the obligations secured by it.

- The giving of a proxy to any of the following:

  - A pledgee (or the pledgee's nominee).

  - A person (or that person's nominee) who has purchased, agreed to purchase, or holds an option to purchase the shares, or a person who has sold a portion of his or her shares to the proxy maker.

  - A creditor of the corporation, a shareholder who extended or continued credit to the

corporation, or a shareholder, in consideration of the proxy, if the proxy states both that it was given in consideration of extending or continuing credit and the name of the creditor.

- A person who has contracted to perform services as an employee of the corporation, if a proxy is required by the employment contract and if the proxy states all of the following: that it was given in consideration of that contract, the employee's name, and the period of employment.

- A person designated under a voting agreement or a voting trust [*see Corp. Code § 706*].

- A beneficiary of a trust with respect to shares held by the trust.

Unless otherwise provided by written agreement of the parties, the recordholder of shares that belong to another or that are held as a pledge or security must issue a proxy to the pledgor or owner of those shares, on demand and payment of necessary expenses [*Corp. Code § 705(d)*].

[c] Exceptions to Irrevocability

The proxies granted in the circumstances discussed in [b], *above*, become revocable, despite the period of irrevocability specified in a proxy, when the purpose for which the proxy was given no longer exists, that is, when any of the following occur [*Corp. Code § 705(e)*]:

- The pledge is redeemed.

- The option or agreement to purchase is terminated or the seller no longer owns any shares of the corporation or dies.

- The debt of the corporation or the shareholder is paid.

- The period of employment provided for in the contract of employment has terminated.

- The voting agreement of voting trust has terminated.

An irrevocable proxy may also be revoked by a transferee of shares with no knowledge of the irrevocable provision, unless the existence of the proxy and its irrevocability appear either (1) on the certificate representing the shares, in the case of certified securities; or (2) if the securities are uncertificated [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)*], on the initial transaction statement and written statements [*Corp. Code § 705(f)*; *see Corp. Code § 171.1* (definition)]. The transferee does not need to be a purchaser of the shares. For a discussion of transaction and other written statements, and uncertificated securities generally, see Ch. 6I, *Issuance of Equity Securities* .

[d] Use of Irrevocable Proxy May Make Small Offering Exemption Unavailable

Caution should be exercised if an irrevocable proxy will be used to implement a voting agreement in accordance with *Corp. Code § 706(a)*. Agreements are authorized under this statute between two or more members of a corporation for the purpose of exercising any voting rights of the parties to the agreement [*Corp. Code § 706(a)*]. Since the shareholder who signs a voting agreement which designates an irrevocable proxy no longer possesses "voting stock," the existence of the agreement at the time the corporation issues its shares, or the fact that it is presently intended to be entered into, may make unavailable the small offering exemption from qualification of securities [*see Corp. Code § 25102(h)*]. The form for notice of that exemption [*see 10 Cal. Code Reg. § 260.102.8*; *see also* Ch. 6C, *California Small Offering*

Exemption] requires the signer to declare affirmatively that there is no irrevocable proxy in existence or contemplated that would render incorrect the statements in the notice, including the one that there will be only one class of voting common shares outstanding.

[2] Form

Irrevocable Proxy [Corp. Code § 705(e)]

IRREVOCABLE PROXY

_____ [*Name of corporation*]

Certificate No(s).	Number of [Shares *or* Votes]	Class and Series
_____	_____	_____
_____	_____	_____
_____	_____	_____

The undersigned, as record holder of the shares of stock of _____[*name of corporation*] described above, revokes any previous proxies and irrevocably appoints _____[*name*] as the undersigned's proxy to attend all shareholders' meetings and to vote, execute consents, and otherwise represent those shares in the same manner and with the same effect as if the undersigned were personally present until _____[*date*].

[*Add, if desired:*]

The proxy holder will have the full power of substitution and revocation.

[*Continue with the following:*]

This proxy is made pursuant to an agreement of _____[*e.g.*, sale, pledge, assignment, *or other*], dated _____, in which shares described above have been _____[*e.g.*, sold, pledged, assigned, *or other*] to _____[*name*]; and this proxy is given as part of this _____[*e.g.*, sale, pledge, *etc.*].

This proxy will be revocable, notwithstanding the period of irrevocability specified above, when _____[*specify event that would make proxy revocable under Corp. Code § 705(e), e.g.*, the pledge is redeemed *or* the option or agreement to purchase is terminated].

ALL PROXIES MUST BE SIGNED. PLEASE SIGN EXACTLY AS YOUR NAME APPEARS ON YOUR STOCK CERTIFICATE. JOINT SHAREHOLDERS MUST EACH SIGN THIS PROXY. IF SIGNED BY AN ATTORNEY IN FACT, THE POWER OF ATTORNEY MUST BE ATTACHED.

For shareholders signing in person:

_____ [*signature*]
[*printed name exactly as on stock certificate*]

For proxy being signed by attorney in fact:

[*printed name of attorney in fact:*]
[*printed name of holder of record certificate*]
_____
By: _____ [*signature*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
D. Proxies

4-8A California Legal Forms--Transaction Guide § 8A.253

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.253 Proxy for Private Corporation With 100 or More Shareholders When Proxy Is Distributed to 10 or More Shareholders

[1] Comment

[a] Use of Form

This form is a proxy to be used when the proxy will be distributed to 10 or more shareholders of a corporation with outstanding shares held of record by 100 or more persons, if the corporation is not subject to the federal Securities and Exchange Act [*see Corp. Code § 604*; *15 U.S.C. §§ 78l, 78l(g)(2)*; *see also* [b], *below*].

For discussion of the procedure by which a proxy may be revoked, and a form for revocation, see *§ 8A.254*. For other forms for revocable proxies, see *§§ 8A.250-8A.251*. For an irrevocable proxy, see *§ 8A.252*.

[b] Statutory Requirements of Form

Special rules apply to the form of proxies distributed to 10 or more shareholders of a corporation with outstanding shares held of record by 100 or more persons [*see Corp. Code § 605* (shares held of record by 100 or more persons defined)], if the corporation has no outstanding class of securities registered or exempted from registration under Section 12 of the Securities and Exchange Act [*Corp. Code § 604*; *see 15 U.S.C. §§ 78l, 78l(g)(2)*]. These proxies must include the following [*Corp. Code § 604(a)*]:

- A choice between approval and disapproval of each matter (or group of related matters), other than elections; and

- A provision, subject to reasonable, specified conditions, that the shares will be voted in accordance with the shareholder's choice.

In any election of directors, a proxy may not be voted for the election of any named candidates for director if the proxy is marked "withhold," or otherwise marked to indicate that the authority to vote for the election of directors is withheld [*Corp. Code § 604(b)*].

Proxies of corporations subject to federal securities reporting requirements (and federal proxy rules) must meet detailed requirements that are outside the scope of this chapter [*see 17 C.F.R. § 240.14a-1 et seq.* (Regulation 14A; solicitation of proxies)]. In general, however, federal proxy regulations cover proxy solicitations by corporations whose stock is publicly traded or listed on a national stock exchange [*see 17 C.F.R. § 240.14a-2* (general exemptions to federal proxy solicitation rules)]. For detailed discussion of federal proxy rules, see FEDERAL SECURITIES EXCHANGE ACT OF 1934, Ch. 7, *Proxy Regulation* (Matthew Bender).

[c] Failure to Comply With Requirements

A failure to comply with the proxy rules [*see Corp. Code § 604*; *see also* [b], *above*] for the form of proxies distributed to 10 or more shareholders of a corporation with outstanding shares held of record by 100 or more persons, if the corporation is not subject to the federal Securities and Exchange Act [*see 15 U.S.C. §§ 78l, 78l(g)(2)*], does not invalidate any action taken, but may be the basis for challenging any proxy at a shareholders' meeting, and for shareholder suit in the superior court to compel compliance [*see Corp. Code § 604(c)*].

[2] Form

Proxy for Private Corporation With 100 or More Shareholders When Proxy Is Distributed to 10 or More Shareholders

PROXY

_____ [*Name of corporation*]

[*If solicitation is by management:*]

THIS PROXY IS SOLICITED ON BEHALF OF MANAGEMENT. MANAGEMENT RECOMMENDS THAT YOU APPOINT _____[*name*] AS YOUR PROXY HOLDER.

[*Continue with the following:*]

Certificate No(s).	Number of [Shares *or* Votes]	Class and Series
_____	_____	_____
_____	_____	_____
_____	_____	_____

The undersigned, as record holder of the shares of stock of _____[*name of corporation*], described above, revokes any previous proxies and appoints _____[*name*] as the undersigned's proxy to attend

the _____[annual *or* special] shareholders' meeting on _____[*date*], and any adjournment of that meeting.

The proxy holder is entitled to cast a total number of votes equal to, but not exceeding, the number of votes the undersigned would be entitled to cast if the undersigned were personally present.

The undersigned authorizes the undersigned's proxy holder to vote and otherwise represent the undersigned with regard to any business that may come before this meeting in the same manner and with the same effect as if the undersigned were personally present.

THIS PROXY MAY BE REVOKED AT ANY TIME.

[*If a revocable proxy for a specified term is desired, add:*]

IF NOT PREVIOUSLY REVOKED, THIS PROXY WILL TERMINATE ON _____[*date*].

[*Continue with the following:*]

INSTRUCTIONS FOR SHAREHOLDERS:

IF YOU WANT TO INSTRUCT YOUR PROXY HOLDER ON HOW TO VOTE YOUR SHARES, COMPLETE THE FORM BELOW. IF YOU WANT TO WITHHOLD AUTHORITY TO VOTE FOR ANY INDIVIDUAL NOMINEE FOR DIRECTOR, CROSS OUT THAT NOMINEE'S NAME. A VOTE MARKED "ABSTAIN" WILL NOT BE VOTED EITHER FOR OR AGAINST.

YOUR SHARES WILL BE VOTED ACCORDING TO YOUR INSTRUCTIONS. HOWEVER, IF YOU DO NOT INDICATE HOW YOU WANT TO VOTE THE SHARES REPRESENTED BY THIS PROXY, THEY WILL BE VOTED AT THE DISCRETION OF THE PROXY HOLDERS WITH REGARD TO THE MATTERS LISTED BELOW.

1. Election of directors for _____[*specify period of office, e.g.*, the coming year]:

YOU MAY VOTE ONLY FOR _____[*number of directors to be elected*].

[*Repeat for each nominee included in proxy:*]

_____[*Name of nominee*].

FOR: _____[*number of votes cast in favor, if any*]

[*If other matters will be put to a shareholder vote, repeat for each item to be covered by proxy:*]

_____. Approval of the following proposed action by management _____[*insert full text of resolution*]:

FOR: _____[*number of votes cast, if any*]

AGAINST: _____[*number of votes cast, if any*]

ABSTAIN: _____[*number of votes cast, if any*]

[*Continue with the following:*]

ALL PROXIES MUST BE SIGNED AND DATED. PLEASE SIGN EXACTLY AS YOUR NAME APPEARS ON YOUR STOCK CERTIFICATE. JOINT SHAREHOLDERS MUST EACH SIGN THIS PROXY. A CORPORATION SHOULD SIGN ITS NAME BY ITS PRESIDENT OR OTHER AUTHORIZED OFFICER, INDICATING THE OFFICE HELD. IF SIGNED BY AN ATTORNEY IN FACT, THE POWER OF ATTORNEY MUST BE ATTACHED.

PLEASE RETURN THE PROXY IN THE ENCLOSED ENVELOPE.
_____ Dated:

For shareholders signing in person:
_____ [*signature*]
[*printed name exactly as on stock certificate*]

For proxy being signed by attorney in fact:
[*printed name of attorney in fact*]

_____
BY: _____ [*signature*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
D. Proxies

4-8A California Legal Forms--Transaction Guide § 8A.254

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.254 Revocation of Proxy

[1] Comment

[a] Use of Form

This form may be used by a shareholder to revoke all previous proxies. It must be given to the corporation before the vote pursuant to the most recent proxy being revoked [*see* [b], *below*]. For discussion of proxies in general, see *§§ 8A.60-8A.63*.

[b] Revocation of Proxies

A proxy is valid only for a period of 11 months from its date, unless otherwise provided in the proxy [*Corp. Code § 705(b)*]. A proxy continues in effect until revoked by the person executing it, before the vote pursuant to the proxy, with specified exceptions [*Corp. Code § 705(b)*]. These exceptions include the following:

- Revocation because of the death or incapacity of the maker of proxy if corporation receives written notice before vote is counted [*see Corp. Code § 705(c)*].

- Revocation of a proxy held by a pledgee, purchaser, creditor, or employee if the purpose for which the proxy was given no longer exists [*see Corp. Code § 705(e)*; *see also § 8A.252[1][c]*].

- Revocation by a transferee of shares with no knowledge of irrevocable provision of proxy, subject to specified limitations [*see Corp. Code § 705(f)*; *see also § 8A.252[1][c]*].

For discussion of the circumstances in which a proxy may be made irrevocable, see *§ 8A.252[1][b]*.

A proxy may be revoked by any of the following methods [*Corp. Code § 705(b)*]:

- A written notice to the corporation [*see* [2], *below*].

- A subsequent proxy (determined by the dates on the proxy forms, not the postmark date) executed by the same shareholder and presented to the meeting; or

- As to any one meeting, attendance at that meeting and voting in person.

[2] Form

Revocation of Proxy

_____ [*Name of corporation*]

REVOCATION OF PROXY

Certificate No(s).	Number of [Shares *or* Votes]	Class and Series
_____	_____	_____
_____	_____	_____
_____	_____	_____

_____[*Name of shareholder*], as record holder of the shares described above, revokes all previous proxies and substitutions of proxies including, but not limited to, the proxy executed on _____[*date*].

I further revoke any authority previously given to _____[*name of proxy holder for proxy executed on date specified in above paragraph*], and to any other person or persons, to attend meetings, vote, consent, or otherwise act on _____[my *or* our behalf] with regard to these shares.

_____ Dated:

_____ [*signature of shareholder*]
[*printed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy Agreements



92 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
D. Proxies

4-8A California Legal Forms--Transaction Guide §§ 8A.255-8A.259

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8A.255[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8A SHAREHOLDERS' MEETINGS, VOTING, AND AGREEMENTS
PART IV. FORMS
E. Minutes

4-8A California Legal Forms--Transaction Guide § 8A.260

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8A.260 Minutes of Shareholders' Annual Meeting

[1] Comment

[a] Use of Form

This form is a set of sample minutes for a shareholders' annual meeting. A corporation is required to keep written minutes of the proceeding of its shareholders. The minutes may be kept in written form or in another form capable of being converted into clearly legible tangible form [*Corp. Code § 1500*]. The form should be adapted to reflect the actual course of the meeting. If practical, minutes of meeting may be prepared in advance [*see* Ch. 7, *Corporate Records and Reports*].

Minutes are open to inspection by any shareholder or holder of a voting trust certificate [*Corp. Code § 1600(a)* (delineating terms of inspection rights)].

When records are kept in a form capable of being converted into clearly legible paper form, the form into which a record is converted is admissible in evidence, and acceptable for all other purposes, to the same extent as an original paper record of the same information would be, provided the paper form accurately portrays the record [*Corp. Code § 1500*].

For a waiver of notice, consent to holding, and approval of the minutes of a shareholders' meeting, see *§ 8A.220*.

[b] Contents of Minutes

The precise contents of the minutes are not specified by statute. However, *Corp. Code § 314* provides that the original or a copy in writing or other form capable of being converted into clearly legible tangible form of the minutes of specified corporate meetings, including shareholders' meetings, certified by a person purporting to be the secretary or assistant secretary of the corporation, is prima facie evidence of the due holding of that meeting and of the matters

stated therein. This provision suggests that, at a minimum, the minutes should contain information showing that the meeting was validly held (notice, quorum) and should specify any actions proposed, taken, or approved by the shareholders at that meeting, with a record of that approval. The following specific matters should be included:

- The fact that the meeting was duly noticed.
- Number of shares present either in person or by proxy, and the existence of a quorum for the meeting.
- Approval of the minutes of the last meeting.
- Distribution, presentation, and discussion of the corporaion's annual report [*see Corp. Code § 1501* (annual report requirement)].
- Nomination of directors.
- Tabulation of votes and election of directors.
- A description of any other action or proposal taken at the meeting, including a tabulation of the vote and a copy of any resolution passed by the shareholders at the meeting.

[c] Liability for Making False Entries in Minutes

Corporate officers and directors who knowingly make any entry in the minutes which is false in any material particular are jointly and severally liable to the corporation and to any party who relied on the entry for all resulting damages [*Corp. Code § 1507*].

[2] Form

Minutes of Shareholders' Annual Meeting

MINUTES OF ANNUAL MEETING OF THE SHAREHOLDERS OF _____ [*name of corporation*]

The following are the minutes of the annual meeting of the shareholders of _____[*name of corporation*], a California corporation, held at _____[*place where meeting was held*] on _____[*date*], pursuant to written notice given by the Secretary of the corporation.

Presiding Officer and Secretary

_____[*Name and title of presiding officer, e.g.,* John Q. Smith, President of the Corporation], acted as Chair and presided over the meeting, and _____[*name and title, e.g.,* Sally Jones, Secretary of the Corporation] acted as the secretary of the meeting.

Notice

The Secretary presented a declaration establishing that notice of the meeting had been duly given to each shareholder of this corporation. The Chair instructed the Secretary to attach the declaration to the minutes of the meeting.

Attendance and Quorum

The Secretary reported that the following shareholders were present at the meeting either in person or by proxy:

NAME	PERSON/PROXY
_____	_____
_____	_____
_____	_____

[*If inspectors of election were appointed:*]

At the request of the shareholders present at the meeting, the Chair appointed _____[*names of one to three persons, as determined by a majority of shares present*] as inspector[s] of election, pursuant to the Bylaws of the corporation and *California Corporations Code Section 707*. The inspector[s] _____[was *or* were] asked to report as to the number of shares outstanding and shares represented at the meeting, and the existence of a quorum. The inspector[s] thereupon reported that of the _____[*number of shares outstanding*] shares outstanding and entitled to vote on the record date for the meeting, _____[*number of shares present*] shares were present in person or by proxy at the meeting and, accordingly, a quorum was present.

[*Or, if no inspectors of election were appointed:*]

The Chair then asked the Secretary to report the number of shares represented either in person or by proxy in the meeting. The Secretary reported that of the _____[*number of shares outstanding*] shares outstanding and entitled to vote on the record date for the meeting, _____[*number of shares represented*] were represented either in person or by proxy and, accordingly a quorum was present.

[*Continue with the following:*]

Approval of Prior Minutes

The Secretary then distributed the minutes of the previous _____[*annual or special*] meeting of shareholders held on _____[*date*]. A discussion then ensued and, upon motion duly made and seconded, it was unanimously

RESOLVED, that the minutes of the _____[*annual or special*] meeting of the shareholders of this corporation held on _____[*date*], are hereby adopted and approved.

Annual Report

The Chair next presented and distributed to the shareholders this corporation's balance sheet and income statement for

the fiscal year ending _____[*date*]. The Chair and other officers present at the meeting then discussed the financial condition and prospects of this corporation and plans for the ensuing fiscal year.

Nomination and Election of Directors

The meeting then proceeded to the election of Directors, as successors to the Directors whose terms expire with this annual meeting, to hold office for a term extending to the next annual meeting and until their successors have been duly elected and qualified. The following persons were nominated to be Directors:

_____ _____[*name*]

_____ _____[*name*]

_____ _____[*name*]

There were no other nominations and the nominations were closed.

The Chair announced that under applicable California law shareholders are not entitled to cumulate votes in the election of Directors unless a candidate's or candidates' names have been placed in nomination prior to the voting and the shareholder has given notice at the meeting prior to the voting of the shareholder's intention to cumulate the shareholder's votes. The Chair explained that cumulative voting entitles a shareholder to a number of votes equal to the number of Directors to be elected multiplied by the number of votes to which the shareholder's shares are entitled. Those votes may then be tendered for a single candidate or distributed among as many candidates as the shareholder thinks fit. The Chair asked if any shareholder intended to cumulate his or her votes. The Chair then announced that voting would proceed with[out] cumulative voting and then asked the shareholders to mark their ballots in accordance with the foregoing instruction.

The Chair asked the _____[inspector(s) of election *or* Secretary] to count the votes. After doing so, the _____[inspector(s) of election *or* Secretary] reported that the following nominees for director had received the number of votes indicated opposite their names below, and that they had accordingly been duly elected as directors of this corporation until the next annual meeting and until their successors are duly elected and qualified:

Directors	Number of Votes Received	Number of Shares Voted Against
_____	_____	_____
_____	_____	_____
_____	_____	_____

Other Actions or Proposals

[*Describe other actions or proposals introduced or adopted at meeting, e.g.:*]

The chair introduced the following resolution:

RESOLVED, that _____ [*text of resolution*]

After discussion, the Chair called for a vote of the shareholders on this resolution. The Secretary reported that _____ votes were cast in favor of adoption of this resolution and _____ votes were cast agsinst adoption. Accordingly, the Chair declared that the resolution _____[had *or* had not] been adopted by the shareholders.

[*Continue with the following:*]

Adjournment

There being no further business to come before the meeting, the Chair ordered the meeting adjourned.

_____ [*signature of secretary*]
[*printed name and title*]
APPROVED: _____ [*signature of chair*]
[*printed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS

4-8B California Legal Forms--Transaction Guide 8B.syn

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.syn Synopsis to Chapter 8B: VOTING AGREEMENTS AND VOTING TRUSTS

§ 8B.01 California Sources

[1] Statutes

[2] Regulations

[3] Releases

§ 8B.02 Federal Statutes

§§ 8B.03-8B.04 [Reserved]

§ 8B.05 Law Reviews and Periodicals

§ 8B.06 Annotations

§ 8B.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

[3] Legal Encyclopedias

§§ 8B.08-8B.09 [Reserved]

§ 8B.10 Voting Agreements and Voting Trusts--In General

§ 8B.11 Use of Voting Agreement in Close Corporations

[1] In General

[2] Voting Agreement and Close Corporation Shareholder Agreement Distinguished

§§ 8B.12-8B.19 [Reserved]

§ 8B.20 Voting Agreement Defined

§ 8B.21 Purposes of Voting Agreement

§ 8B.22 Enforcing Voting Agreements

§§ 8B.23-8B.29 [Reserved]

§ 8B.30 Voting Trust Defined

§ 8B.31 Purposes of Voting Trust

§ 8B.32 Voting Trust, Voting Agreement, and Proxy Distinguished

§ 8B.33 Transfer of Shares to Trustees; Issuance of Trust Certificates

§ 8B.34 Filings With Corporation

§ 8B.35 Duration of Voting Trust

[1] Term; Extension of Term

[2] Revocation; Termination

§ 8B.36 Application of Securities Laws

[1] California Corporate Securities Law

[a] In General

[b] Voting Trust Distinguished From Other Securities

[c] Small Offering Exemption May Not Be Available

[2] Federal Securities Law

§ 8B.37 Rights and Duties of Certificate Holders

§ 8B.38 Powers and Duties of Voting Trustees

[1] In General

[2] Limitations on Voting Powers

[3] Fiduciary Duties

[4] Removal of Trustees

§§ 8B.39-8B.49 [Reserved]

§ 8B.50 Effect of Voting Agreements and Voting Trusts on S Corporation Status

§ 8B.51 Restrictions on Voting Trusts for Professional Corporations

§§ 8B.52-8B.99 [Reserved]

§ 8B.100 Client Interview

[1] Facts

[a] Each Shareholder

Scope

[b] The Corporation

Scope

[c] Voting Trustees, if Voting Trust Will Be Used

Scope

[d] Securities and Security Holders, if Voting Trust Will Be Used

Scope

[2] Documents

[a] Each Shareholder

Scope

[b] The Corporation

Scope

§§ 8B.101-8B.109 [Reserved]

§ 8B.110 Identifying Conflicts of Interest

§ 8B.111 Determining Scope of Work to Be Performed by Attorney

Scope

§ 8B.112 Selecting Appropriate Type of Agreement

Scope

§ 8B.113 Making Preliminary Determinations if Voting Trust Agreement Is Selected

[1] Transfer of Shares to Trustee

Scope

[2] Trustees

Scope

[3] Effective Date, Duration, and Termination of Trust

Scope

§§ 8B.114-8B.119 [Reserved]

§ 8B.120 Legend Requirements; Filings With Corporation

Scope

§ 8B.121 Amending Voting Agreements and Voting Trust Agreements

Scope

§§ 8B.122-8B.129 [Reserved]

§ 8B.130 Securities Considerations for Voting Trusts

Scope

§ 8B.131 Taxation of Voting Trust

Scope

§§ 8B.132-8B.199 [Reserved]

§ 8B.200 Voting Agreement

[1] Comment

[a] Use of Form

[b] Statutory Requirements of Voting Agreement

[c] Voting Agreement and Shareholder Agreement Distinguished

[2] Form

Voting Agreement

§ 8B.201 Voting Agreement by Shareholders to Grant Irrevocable Proxy

[1] Comment--Use of Form

[2] Form

Voting Agreement by Shareholders to Grant Irrevocable Proxy

§§ 8B.202-8B.209 [Reserved]

§ 8B.210 Voting Trust Agreement for Benefit of Shareholders

[1] Comment

[a] Use of Form

[b] Effective Date of Agreement

[c] Qualification With Commissioner of Corporations

[d] Restrictions on Transfer; Share Buy-Sell Provisions

[e] Trustees' Voting Rights

[f] Termination of Trust

[g] Extension of Term

[h] Filing Duplicate With Corporate Secretary

[i] Additional Provisions

[2] Form

Voting Trust Agreement for Benefit of Shareholders

§ 8B.211 Voting Trust Certificate

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[c] Execution of Certificate

[d] Securities Law Considerations

[2] Form

Voting Trust Certificate

§ 8B.212 Voting Trust Provisions--Limitations on Trustees' Voting Power

[1] Comment

[a] Use of Form

[b] Methods of Limiting Voting Power

[2] Form

Voting Trust Provisions--Limitations on Trustees' Voting Power

§ 8B.213 Voting Trust Extension Agreement

[1] Comment

[a] Use of Form

[b] Filing Duplicate With Corporate Secretary

[2] Form

Voting Trust Extension Agreement

Marilyn E. Mingern*
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FOOTNOTES:

(n22)Footnote *. Marilyn E. Minger is a sole practitioner in Oakland, California, specializing in business law, personal injury, bankruptcy, and probate. Ms. Minger formerly worked for Heller, Ehrman, White & McAuliffe and Pettit & Martin in San Francisco, where she practiced corporate law.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS

4-8B California Legal Forms--Transaction Guide Scope

AUTHOR: Marilyn E. Minger Practice Consultant

Scope

Marilyn E. Mingern*
Practice Consultant Scope

This chapter discusses the fundamental rules applicable to voting agreements and voting trust agreements for shareholders of corporations. It explains the nature and purposes of these agreements and typical matters regulated by them. It briefly discusses close corporation management alternatives to voting agreements and voting trust agreements, distinguishing them from close corporation shareholder agreements and proxies. The chapter covers implementation of voting agreements and voting trust agreements, including securities considerations. It discusses rights and duties of voting trust certificate holders and powers and duties of trustees.

The Transaction Guide covers the ethical considerations that relate to drafting or reviewing either type of agreement, and the conflicts of interest the attorney must avoid. It contains a checklist to assist in selecting the appropriate type of control arrangement and a list of preliminary issues to be resolved if a voting trust agreement is selected.

The forms include a voting agreement, a voting agreement to grant an irrevocable proxy, a voting trust agreement for the benefit of the shareholders, voting trust certificates, and a voting trust extension agreement.

Shareholders' meetings and voting are discussed in Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* . Statutory shareholder agreements are covered in Ch. 8C, *Close Corporation Shareholder Agreements* . Nonstatutory shareholder agreements are discussed in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 62.02[2] (Matthew Bender). Buy-sell agreements for small, closely held corporations are discussed in Ch. 8D, *Buy-Sell Agreements* .

FOOTNOTES:
(n23)Footnote *. Marilyn E. Minger is a sole practitioner in Oakland, California, specializing in business law, personal injury, bankruptcy, and probate. Ms. Minger formerly worked for Heller, Ehrman, White & McAuliffe and Pettit & Martin in San Francisco, where she practiced corporate law.



96 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8B California Legal Forms--Transaction Guide § 8B.01

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.01 California Sources

[1] Statutes

Arbitration statutes. *Code Civ. Proc. § 1280 et seq.*

Close corporation defined; election, revocation, and involuntary loss of close corporation status. *Corp. Code § 158.*

"On the certificate" defined. *Corp. Code § 174.*

Shareholder agreement defined. *Corp. Code § 186.*

"Written" and "in writing" defined. *Corp. Code § 195.*

Statutory provisions applicable to shareholder agreements not applicable to agreement authorized by *Corporations Code § 706(a). Corp. Code § 300(b).*

Indemnification of corporate agent. *Corp. Code § 317.*

Required legend on share certificates regarding transfer restrictions. *Corp. Code § 418(a)(1), (c).*

Enforcement of voting restrictions against transferees. *Corp. Code § 418(b).*

Implied consent of holder of legended certificates not to transfer shares illegally. *Corp. Code § 421.*

Irrevocable proxies. *Corp. Code § 705(e).*

Voting agreements. *Corp. Code § 706(a)*.

Voting trusts. *Corp. Code § 706(b)*.

Right of voting trust certificate holders to inspect voting trust agreement. *Corp. Code § 706(b)*.

Right of voting trust certificate holders to maintain derivative actions. *Corp. Code § 800*.

Corporate books and records. *Corp. Code § 1500 et seq.*

Right of voting trust certificate holders to inspect record of shareholders. *Corp. Code § 1600(c)*.

Right of voting trust certificate holders to inspect corporate books, records, and meeting minutes. *Corp. Code § 1601*.

Right of voting trust certificate holder to bring action for involuntary dissolution. *Corp. Code § 1800*.

Right of voting trust certificate holder to purchase other shareholders' shares to avoid involuntary dissolution. *Corp. Code § 2000*.

Issuer defined. *Corp. Code § 25010*.

Sale of securities defined. *Corp. Code § 25017(a)*.

Security defined. *Corp. Code § 25019*.

Qualification of sale of securities. *Corp. Code § 25100 et seq.*

Limited offering exemption. *Corp. Code § 25102(f)*.

Small offering exemption. *Corp. Code § 25102(h)*.

Issuer transaction securities qualification requirements. *Corp. Code § 25110*.

Rescission or damages for failure to qualify securities. *Corp. Code § 25503*.

Modification and termination of trusts in general. *Prob. Code § 15400 et seq.*

Trustee's duties in general. *Prob. Code § 16000 et seq.*

Trustee's duty of loyalty. *Prob. Code § 16002*.

Trustee's liability for breach of trust. *Prob. Code § 16400 et seq.*

Right of voting trust beneficiaries to seek removal of trustee for breach of trust *Prob. Code § 16420(a)(5)*.

S corporation income tax treatment. *Rev. & Tax Code § 23800 et seq.*

[2] Regulations

Limited offering qualification defined. *10 Cal. Code Reg. § 260.001(e).*

Open qualification defined. *10 Cal. Code Reg. § 260.001(f).*

Small offering exemption. *10 Cal. Code Reg. § 260.102.12*.

Exemption of certain stock splits or reverse stock splits in voting trust's beneficial interests. *10 Cal. Code Reg. § 260.105.9.*

Signing application for qualification. *10 Cal. Code Reg. § 260.110.2*.

[3] Releases

When voting trusts, voting agreements, and irrevocable proxies create more than one class of shares. Dept. of Corps. Releases Nos. 50-C, 55-C.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8B California Legal Forms--Transaction Guide § 8B.02

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.02 Federal Statutes

Security defined. *15 U.S.C. §§ 77b(a)(1), 78c(a)(10).*

Exemptions from registration of securities. *15 U.S.C. §§ 77c, 78c(a)(12).*

One class of stock requirement for S corporation. *I.R.C. § 1361(b)(1)(D).*

Voting trusts may be S corporation shareholders. *I.R.C. § 1361(c)(2)(A)(iv).*

Differences in common stock voting rights do not create more than one class of stock for S corporation purposes. *I.R.C. § 1361(c)(4).*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8B California Legal Forms--Transaction Guide §§ 8B.03-8B.04

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§§ 8B.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8B California Legal Forms--Transaction Guide § 8B.05

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.05 Law Reviews and Periodicals

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8B California Legal Forms--Transaction Guide § 8B.06

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.06 Annotations

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8B California Legal Forms--Transaction Guide § 8B.07

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.07 Text References

[1] Matthew Bender Sources

Ballantine & Sterling, CALIFORNIA CORPORATION LAWS (Matthew Bender)

Ch. 4, *Close Corporations*.

Ch. 9, *Shareholders' Meetings and Voting*.

Ch. 21, *Corporate Securities*.

Appendix A, Form 8.22, *Voting Trust Agreement*.

CALIFORNIA LEGAL FORMS (Matthew Bender)

Ch. 1A, *Role of Counsel in Starting a New Business*.

Ch. 1B, *Selecting Form of Business Entity*.

Ch. 1E, *Taxation of Businesses*.

Ch. 2, *Formation of Corporations*.

Ch. 2B, *Electing Subchapter S Status* .

Ch. 3, *Articles of Incorporation* .

Ch. 6, *Securities Regulation Issues* .

Ch. 8C, *Close Corporation Shareholder Agreements* .

Ch. 8D, *Buy-Sell Agreements* .

Ch. 9, *Dividends, Reacquisitions of Shares, and Assessments* .

Ch. 12A, *Professional Corporations* .

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Ch. 108, *Distribution of Corporate Control*.

Ch. 111, *Voting Trusts*.

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[2] Additional Text References

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[3] Legal Encyclopedias

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8B California Legal Forms--Transaction Guide §§ 8B.08-8B.09

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§§ 8B.08[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
A. Agreements and Devices for Corporate Control

4-8B California Legal Forms--Transaction Guide § 8B.10

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.10 Voting Agreements and Voting Trusts--In General

The shareholders of a corporation may want to allocate control of the corporation in a way that is disproportionate to the ownership of shares of the corporation. Toward that end, they may want to ensure that their shares will be voted in a certain way. For example, they may want to vote their shares for specified persons as directors, vote as a majority of shareholders in the group may decide, or vote to effect a particular corporate policy. Common devices to accomplish these purposes are (1) voting agreements (or pooling agreements), in which the shareholders agree to vote their shares as provided in a voting agreement, and (2) voting trusts, in which legal title to the shares is transferred to a trustee, to be voted as provided in a trust agreement. Voting agreements are discussed in *§§ 8B.20-8B.22*; voting trusts are further discussed in *§§ 8B.30-8B.38*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
A. Agreements and Devices for Corporate Control

4-8B California Legal Forms--Transaction Guide § 8B.11

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.11 Use of Voting Agreement in Close Corporations

[1] In General

Voting agreements may be used in a close corporation to permit the shareholders to control the management of the corporation. Several management alternatives to voting agreements and voting trusts exist. These include a close corporation shareholder agreement [*see Corp. Code § 158* (close corporation defined); *see also* [2], *below*; Ch. 8C, *Close Corporation Shareholder Agreements*] or a provision in the corporation's articles of incorporation for super-majority votes by the corporation's directors or shareholders on various matters [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 61.03[2] (Matthew Bender)]. In addition, a corporation's capital structure can be designed to give some shareholders control that is disproportionate to their dollar investment, either by providing for voting and nonvoting shares or shares with special voting rights [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 62.04[3] (Matthew Bender)]. This result can also be obtained by issuing debt securities for a portion of the corporation's initial financing, instead of issuing voting shares for that financing [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 62.04[4](Matthew Bender)].

A group of majority shareholders in a close corporation can also use a holding company, instead of a shareholder's voting agreement or voting trust, to consolidate their voting power. Further, shareholders may sometimes find it useful to create a partnership to hold their shares, or, on rare occasions, to cause the corporation to issue stock to several persons to be held jointly.

[2] Voting Agreement and Close Corporation Shareholder Agreement Distinguished

A voting agreement differs from a shareholder agreement in three significant respects. First, the use of a voting agreement is not limited to shareholders of a close corporation, as is a shareholder agreement [*Cf. Corp. Code §§ 300(b), 706(a)*]. Second, a voting agreement may be among less than all of the shareholders [*Corp. Code § 706(a)*]. Third, a voting agreement covers only the exercise of shareholder voting rights [Assem. Select Comm. Rpt. 86 (Dec. 1,

1975)] and does not change the role of the shareholders with respect to the directors [*see Corp. Code § 300(b)* (this subdivision does not apply to voting agreement authorized by *Corp. Code § 706(a)*)]. Thus, if the shareholders of a close corporation want to enter into an agreement that extends beyond how their shares will be voted, and controls functions that are traditionally within the realm of the directors (for example, appointing officers and setting corporate policies), a shareholder agreement, not a voting agreement, should be used. For discussion of shareholder agreements, see Ch. 8C, *Close Corporation Shareholder Agreements* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsBusiness & Corporate LawClosely Held CorporationsFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
A. Agreements and Devices for Corporate Control

4-8B California Legal Forms--Transaction Guide §§ 8B.12-8B.19

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§§ 8B.12[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
B. Voting Agreements

4-8B California Legal Forms--Transaction Guide § 8B.20

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.20 Voting Agreement Defined

The General Corporation Law [*Corp. Code § 100 et seq.*] expressly authorizes shareholders' voting agreements (and irrevocable proxies to effect those agreements) [*see Corp. Code § 706* (applying to voting agreements entered into, amended, or extended after January 1, 1977); *Corp. Code § 705* (proxies)]. A voting agreement is a written agreement between two or more shareholders of a corporation requiring that the shares held by them be voted as provided in the agreement [*Corp. Code § 706(a)*]. To ensure the shares are voted in accordance with the agreement, the agreement may provide for the grant of an irrevocable proxy to a third party to vote the shares. An irrevocable proxy given under a voting agreement becomes revocable when the agreement terminates [*Corp. Code § 705(e)*].

The statute specifies that no voting agreement will be invalid because it fails to satisfy the statutory requirements of a voting trust, or because it is a proxy that fails to satisfy the statutory requirements for a proxy [*Corp. Code § 706(c)*; *see Corp. Code §§ 705* (proxies), 706(b) (voting trusts); *see also § 8B.30*]. It also specifies that *Corp. Code § 706(a)* does not invalidate any voting or other shareholder agreement (or irrevocable proxy complying with statutory requirements [*see Corp. Code § 705(e)*]) that is not otherwise illegal [*Corp. Code § 706(d)*].

The fact that shares are subject to a voting agreement must be stated on the face of the share certificates, or on the reverse, with a reference on the face [*Corp. Code §§ 174, 418(a)(3)*]. Unless so stated, the agreement will be unenforceable against a transferee of the shares who does not have actual knowledge of the agreement or proxy [*Corp. Code §§ 418(b), 705(f)*].

For discussion of the law governing voting agreements entered into before January 1, 1977, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 9, *Shareholders' Meetings and Voting* , § 174.01[1] (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
B. Voting Agreements

4-8B California Legal Forms--Transaction Guide § 8B.21

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.21 Purposes of Voting Agreement

A voting agreement generally is considered valid (and enforceable) if it is for a reasonable business purpose, does not intend or effect fraud, oppression, or wrong to minority shareholders, or otherwise have an illegal purpose [*see* Gelb, *Close Corporation Control and the Voting Agreement, 16 Land & Water L. Rev. 225 (1981)*]. However, a voting agreement is invalid if a shareholder enters into the agreement to vote his or her shares according to another's directions and the consideration for the agreement is some personal benefit to the shareholder [*see Palmbaum v. Magulsky (1914) 217 Mass. 306, 104 N.E. 746, 747* ; *Stott v. Stott (1932) 258 Mich. 547, 242 N.W. 747, 748* (finding agreement unenforceable when debtor-shareholder promised creditor-shareholder to vote his shares as directed by creditor to induce creditor to forgive debt); *Brady v. Bean (1921) 221 Ill. App. 279, 283-284* (finding agreement unenforceable when shareholder agreed to vote for sale of assets in return for "kickback" of part of sale proceeds)]. In essence, this means that shareholders may enter into an agreement to vote their shares in a specified manner as long as the agreement does not contemplate or effect a breach of the shareholders' fiduciary duty to the corporation or to the minority shareholders.

In practice, a voting agreement often contains provisions requiring the shareholders to do some or all of the following [*see § 8B.212*]:

- Vote their shares for specified persons as directors.
- Vote as a majority of shareholders in the group may decide.
- Vote as directed by an arbitrator, in the event of disagreement.
- Vote to effect a particular corporate policy.

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawDefensesIllegal BargainsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
B. Voting Agreements

4-8B California Legal Forms--Transaction Guide § 8B.22

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.22 Enforcing Voting Agreements

Failure to abide by a valid voting agreement gives rise to a breach of contract action. However, such an action is often impractical because damages are generally speculative. Suits based on voting agreements are much more likely to result in a judicial order of specific performance than to result in damages. The statute provides for the remedy of specific performance in the event of breach of a voting agreements [*Corp. Code § 706(a)*]. Shareholders may try to ensure that shares will be voted in accordance with a voting agreement by granting irrevocable proxies in conjunction with the voting agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawRemediesSpecific PerformanceContracts LawRemediesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
B. Voting Agreements

4-8B California Legal Forms--Transaction Guide §§ 8B.23-8B.29

AUTHOR: Marilyn E. Minger Practice Consultant

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§§ 8B.23[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
C. Voting Trusts

4-8B California Legal Forms--Transaction Guide § 8B.30

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.30 Voting Trust Defined

A voting trust provides another method of allocating control among shareholders. A voting trust ordinarily is created by a written agreement between two or more shareholders, irrevocably transferring title to their shares (for a definite period of time not exceeding ten years) to voting trustees, who, in return, issue to the shareholders certificates of beneficial interest ("voting trust certificates"), and file a duplicate of the voting trust agreement with the corporation's secretary [*see Corp. Code § 706(b)*; *see also* Note, *The Voting Trust, 34 N.Y.U. L. Rev. 290, 290*-292 (1959)].

Although in the classic voting trust, certificate holders retain a beneficial interest in the stock, voting trust certificate holders are not necessarily the beneficiaries of the voting trust. The trust may be created by common shareholders transferring their shares to the trustees in order to confer on them voting power for the protection of bondholders or holders of preferred shares [*Mackin v. Nicollet Hotel (8th Cir. 1928) 25 F.2d 783, 787-788 , cert. denied, 278 U.S. 618]* .

Voting trusts entered into, amended, or extended after January 1, 1977, are governed primarily by *Corporations Code § 706(b)*. Voting trusts entered into before that date are regulated by prior law [*see Corp. Code § 2301*; Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 9, *Shareholders' Meetings and Voting* . § 174.02[2] (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
C. Voting Trusts

4-8B California Legal Forms--Transaction Guide § 8B.31

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.31 Purposes of Voting Trust

Subject to limitations imposed by statute [*see Corp. Code § 706(b)*] and public policy [*see Mackin v. Nicollet Hotel (8th Cir. 1928), 25 F.2d 783, 787-788 , cert. denied, 278 U.S. 618* (voting trusts may be used for any purpose that is not illegal or improper)], a voting trust is an extremely flexible device for implementing control arrangements in a corporation. Voting trusts frequently have been used in corporate reorganizations to give control of the corporation to those who hold its senior securities, such as bond holders or debenture holders. They are also useful to assure that the present management or certain corporate policies will continue to retain control with a relatively small capital investment by permitting others to purchase only a beneficial interest in the trust, and to protect minority interests by providing a unified minority vote. For further discussion of the uses of the voting trust, see Note, *The Voting Trust, 34 N.Y.U. L. Rev. 290, 290*-292 (1959).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
C. Voting Trusts

4-8B California Legal Forms--Transaction Guide § 8B.32

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.32 Voting Trust, Voting Agreement, and Proxy Distinguished

A voting trust differs from a voting agreement or proxy in that legal title must be transferred to trustees, who have the right to vote the shares according to the terms of the trust agreement [*see § 8B.30*]. A voting trust imposes a fiduciary duty on the trustees exercising the voting power [*see § 8B.38[3]*; *see also* Gose, *Legal Characteristics and Consequences of Voting Trusts*, *20 Wash. L. Rev. 129, 139 (1945)*].

In a voting agreement, on the other hand, each shareholder may retain the power to vote his or her shares, but must agree to do so as provided in the voting agreement, or may give the authority to vote the shares to a third party as provided in the agreement [*see § 8B.20*]. A voting agreement imposes a contractual obligation, rather than a fiduciary obligation, on those exercising the voting power.

A proxy creates an agency relationship and is governed by agency rules. A proxy is an authorization given by a shareholder to another party to vote his or her shares [*see Corp. Code §§ 178*, *705(a)*]. Under this arrangement, the shareholder retains legal title to the shares, but, as principal, gives an agent the power to vote the shares. For further discussion of proxies, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations*, § 62.04[2], Ch. 9, *Shareholders' Meetings and Voting*, § 172 (Matthew Bender). For discussion of other types of agreements and control devices, *see § 8B.11*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
C. Voting Trusts

4-8B California Legal Forms--Transaction Guide § 8B.33

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.33 Transfer of Shares to Trustees; Issuance of Trust Certificates

The Corporations Code requires that the shares constituting the voting trust be transferred, by written agreement, to the trustees [*Corp. Code § 706(b)*; *see § 8B.30*]. Shareholders ordinarily deposit their shares with the trustee and receive in exchange trust certificates issued in the trustee's name, as trustee of the voting trust. These certificates evidence the shareholders' beneficial interest in the trust. The mechanics of this procedure may vary depending on the circumstances. For discussion of this issue, including the use of depositories, see Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 111, Voting Trusts, § 111.03[3]* (Matthew Bender).

Voting trust certificates are generally transferable and negotiable to the same extent as stock certificates. Consequently, as a practical matter, a corporation's voting trust agreement often contains some restriction on the transferability of the trust certificates [*see, e.g., § 8B.211[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
C. Voting Trusts

4-8B California Legal Forms--Transaction Guide § 8B.34

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.34 Filings With Corporation

Duplicates of the voting trust agreement and any extensions must be filed with the corporation's secretary for inspection by a shareholder, a holder of a voting trust certificate, or the agent of either [*Corp. Code § 706(b)*; *see Corp. Code § 1600 et seq.* (rights of inspection)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
C. Voting Trusts

4-8B California Legal Forms--Transaction Guide § 8B.35

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.35 Duration of Voting Trust

[1] Term; Extension of Term

A voting trust is limited to a term not exceeding 10 years [*Corp. Code § 706(b)*]. However, at any time within two years prior to the trust's expiration date, one or more beneficiaries under the voting trust agreement may, by written agreement and with the written consent of the voting trustee or trustees, extend the duration of the voting trust with respect to their shares for an additional term not exceeding 10 years from the expiration date of the trust as originally fixed or as last extended according to this procedure [*Corp. Code § 706(b)*].

The validity of an otherwise lawful voting trust agreement will not be affected during its original 10-year period or any additional 10-year extension by the fact that, under its terms, it will or may last beyond any of these 10-year periods [*Corp. Code § 706(b)*]. However, the agreement will be invalid at the expiration of any of these periods unless its term is extended in accordance with the statutory procedure described above within two years before its expiration [Assem. Select Com. Rpt. 87 (Dec. 1, 1975)].

[2] Revocation; Termination

There is no provision in the General Corporation Law for the *revocation* of voting trusts [*see Corp. Code § 706(b)*]. A voting trust terminates when its term expires, unless properly extended [*Corp. Code § 706(b)*; *see* [1], *above*]. The provisions in the Probate Code governing modification and termination of trusts in general provide that unless expressly made irrevocable by the trust instrument, the trust is revocable by the trustor [*Prob. Code § 15400*; *see Prob. Code § 15401* (methods of revocation)]. However, as a rule, voting trusts are irrevocable. Nevertheless, a voting trust may be terminated on equitable grounds, as, for example, when its purpose has been frustrated [*see* Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 111, Voting Trusts, § 111.04[3]* (Matthew Bender)].

For discussion of the maximum term and revocability of voting trusts entered into before January 1, 1977, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 9, *Shareholders' Meetings and Voting* , §

174.02[1][b], [c], [2] (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsEstate, Gift & Trust LawTrustsModification & Termination



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
C. Voting Trusts

4-8B California Legal Forms--Transaction Guide § 8B.36

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.36 Application of Securities Laws

[1] California Corporate Securities Law

[a] In General

Beneficial interests in voting trusts and voting trust certificates are securities under the California Corporate Securities Law of 1968 [*Corp. Code § 25019*]. Therefore, the offer and sale of certificates in a voting trust must be qualified unless expressly exempted from qualification [*see, e.g., Corp. Code §§ 25110, 25102(f)* (no more than 35 beneficial owners in trust); *10 Cal. Code Reg. § 260.102.12*; *see also* [c], *below*].

After the voting trust certificates have been issued, however, certain stock splits or reverse stock splits in the beneficial interests of the voting trust are exempt from qualification. This exemption, however, is limited to a split or reverse split occurring as a result of a stock split or a reverse stock split of the underlying securities that are exempt in a reorganization transaction [*Corp. Code § 25103(f)*] or a stock dividend that is not a sale [*Corp. Code § 25017(f)*; *see 10 Cal. Code Reg. § 260.105.9*]. Further, any beneficial interests issued in accordance with this exemption are subject to all conditions imposed by the Commissioner applicable to the beneficial interests previously issued with respect to the underlying securities that are the subject of the stock split, reverse stock split, or dividend [*10 Cal. Code Reg. § 260.105.9*].

If nonexempt securities are issued without qualification, the shareholders may rescind the transfer, thus creating a revocable voting trust agreement, provided the action is brought within the statute of limitations [*see Corp. Code § 25503*].

[b] Voting Trust Distinguished From Other Securities

Voting trust certificates are distinct from other types of securities because the trustees, rather than the corporation, are the issuers [*see Corp. Code § 25010* ("issuer" defined)]. Consequently, the trustees must sign the application for

qualification of the certificates [*see 10 Cal. Code Reg. § 260.110.2*].

[c] Small Offering Exemption May Not Be Available

A voting trust entered into or contemplated at the time of original issuance of shares is likely to be incompatible with the requirement of the small offering exemption from qualification that there be only one class of stock outstanding immediately after the proposed sale [*see Corp. Code § 25102(h)*]. The reason for this is that to the extent that they have the effect of rearranging the relative voting power of shareholders holding nominally the same class of stock, voting trusts, voting agreements, and irrevocable proxies create more than one class of shares [*see* Dept. of Corps. Releases Nos. 50-C, 55-C]. Consequently, the regulations require the person signing the notice of issuance of shares under that exemption to affirm that no shareholder agreement, voting agreement, irrevocable proxy, or other arrangement has been or will be entered into by the shareholders that would have the effect of rendering incorrect the statement that only one class of voting common shares will be outstanding [*10 Cal. Code Reg. § 260.102.8*].

If the small offering exemption contained in *Corp. Code § 25102(h)* is not available, the limited offering exemption in *Corp. Code § 25102(f)* ordinarily should apply. For further discussion of the requirements for exemption from qualification of securities as a small or limited offering, see Ch. 6B, *California Limited Offering Exemptions* and Ch. 6C, *California Small Offering Exemption* .

[2] Federal Securities Law

Voting trust certificates are also securities under the Securities Act of 1933 [*see* Securities Act of 1933, § 2; *15 U.S.C. § 77b(a)(1)*] and the Securities Exchange Act of 1934 [*see* Securities Exchange Act of 1934 § 3(a)(10); *15 U.S.C. § 78c(a)(10)*]. Consequently, they are subject to federal registration requirements and other regulations, unless an exemption applies [*see* Securities Act of 1933, § 3; *15 U.S.C. § 77c*; Securities Exchange Act of 1934 § 3(a)(12); *15 U.S.C. § 78c(a)(12)*]. For further discussion of federal securities regulation, see FEDERAL SECURITIES ACT OF 1933 (Matthew Bender), and Gadsby, FEDERAL SECURITIES EXCHANGE ACT OF 1934, ch. 4, *Exchange Act Registration and Reporting Requirements*, § 4.01 (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawExemptions From RegistrationExempt Classes of SecuritiesSecurities LawExemptions From RegistrationGeneral OverviewSecurities LawBlue Sky LawsExempted IssuersSecurities LawBlue Sky LawsSecurities RegistrationSecurities LawBlue Sky LawsExcluded TransactionsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
C. Voting Trusts

4-8B California Legal Forms--Transaction Guide § 8B.37

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.37 Rights and Duties of Certificate Holders

Holders of voting trust certificates generally have the rights (other than voting rights) of shareholders, unless the voting trust agreement provides otherwise. Certificate holders ordinarily are entitled to receive dividends, although some agreements permit the trustee to deduct his or her expenses from the dividends before distributing them to certificate holders. Certificate holders usually also are entitled to the return of their stock on the termination of the voting trust [*see* Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 111, Voting Trusts, § 111.06[5]* (Matthew Bender)].

The General Corporation Law accords specific rights to certificate holders, including the rights to bring a derivative action [*see Corp. Code § 800*], to inspect the record of shareholders [*see Corp. Code § 1600(c)*], to inspect the corporation's accounting books, records, and meeting minutes [*see Corp. Code § 1601*], to bring an action for involuntary dissolution [*see Corp. Code § 1800*], and to purchase shares to avoid involuntary dissolution [*see Corp. Code § 2000*].

Certificate holders are bound by acts performed in good faith by the trustees, provided those acts are within the scope of the trustees' authority [Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 111, Voting Trusts, § 111.06[4]* (Matthew Bender)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersActions Against CorporationsDerivative ActionsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersActions Against CorporationsStandingGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
C. Voting Trusts

4-8B California Legal Forms--Transaction Guide § 8B.38

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.38 Powers and Duties of Voting Trustees

[1] In General

The voting trust agreement determines the qualifications, powers, and duties of the trustees, provided its provisions are not contrary to the statute authorizing voting trusts [*see Corp. Code § 706(b)*] or to public policy [*see Mackin v. Nicollet Hotel (8th Cir. 1928), 25 F.2d 783, 787-788 , cert. denied, 278 U.S. 618, 49 S. Ct. 22, 73 L. Ed. 541 (1928)* (holding that voting trusts may be used for any purpose that is not illegal or improper)].

[2] Limitations on Voting Powers

The trust agreement should expressly state any limitations on the trustees' voting powers. Examples of common limitations include the following:

- Requirements that the trustees vote for certain persons as directors, or vote in a certain way on a particular issue.

- Requirements that the trustees vote only for the election of directors and for other routine matters normally handled at the shareholders' annual meeting.

- Directions that the trustees submit extraordinary matters to the certificate holders and vote only as directed by the majority of holders.

Extraordinary matters generally include such matters as mergers and reorganizations, sales of assets, amending the articles of incorporation or the bylaws, reducing the corporation's capital, increasing the authorized number of shares, creating new classes of stock, or dissolving the corporation.

[3] Fiduciary Duties

The statutes governing trusts generally have been applied to voting trusts [*see Olincy v. Merle Norman Cosmetics, Inc. (1962) 200 Cal. App. 2d 260, 274, 19 Cal. Rptr. 387* (applying former *Civ. Code § 2288*)] and, except as modified by statute, the common law governing trusts also applies to voting trusts [Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 111, Voting Trusts, § 111.05[6][b]* (Matthew Bender)]. Thus, trustees owe a strict duty of loyalty to certificate holders and must administer the trust solely in the interests of the beneficiaries [*Prob. Code § 16002*; *see Prob. Code § 16000 et seq.* (trustee's duties in general); *see also* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 9, *Shareholders' Meetings and Voting* , § 174.02[5] (Matthew Bender). Further, the trustee must not exercise his or her power to further the trustee's interest to the detriment of some or all of the beneficiaries [*Moore v. Bowes (1937) 8 Cal. 2d 162, 165, 64 P. 2d 423* (trustee may not appropriate corporate property held in trust for trustee's own use)].

[4] Removal of Trustees

The beneficiaries of the voting trust have the right to seek the removal of the trustees for fraud and misconduct [*Prob. Code § 16420(a)(5)*; *see Prob. Code § 16400 et seq.* (trustee's liability for breach of trust)]. Although courts rarely exercise their equity power to remove voting trustees [*see* Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 111, Voting Trusts, § 111.05[4]* (Matthew Bender)], the courts will remove a trustee if removal is necessary to preserve the trust property [*Moore v. Bowes (1937) 8 Cal. 2d 162, 165, 64 P. 2d 423]* . In *Moore v. Bowes*, the California Supreme Court noted that trustees are subject to removal whenever it appears that their private interests conflict with their trust duties, and when it appears that trust property has been appropriated for the trustee's own use [*Moore v. Bowes (1937) 8 Cal. 2d 162, 165, 64 P. 2d 423]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Estate, Gift & Trust LawTrustsTrusteesDuties & PowersGeneral OverviewEstate, Gift & Trust LawTrustsTrusteesDuties & PowersStandards of CareBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewEstate, Gift & Trust LawTrustsTrusteesRemoval & Resignation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
C. Voting Trusts

4-8B California Legal Forms--Transaction Guide §§ 8B.39-8B.49

AUTHOR: Marilyn E. Minger Practice Consultant

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§§ 8B.39[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
D. Special Considerations for Subchapter S and Professional Corporations

4-8B California Legal Forms--Transaction Guide § 8B.50

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.50 Effect of Voting Agreements and Voting Trusts on S Corporation Status

A small business corporation may elect to be an S corporation [*I.R.C. § 1362(a)*]. Unlike a C corporation, which is a separate tax-paying entity [*see I.R.C. § 11*], an S corporation is generally treated as a conduit of income, loss, deductions, and credits to shareholders [*see I.R.C. §§ 1363, 1366*]. To qualify as an S corporation, a corporation must have no more than one class of stock [*I.R.C. § 1361(b)(1)(D)*]. Differences in common stock voting rights do not cause a corporation to be treated as having more than one class of stock [*I.R.C. § 1361(c)(4)*]. Prior to enactment of the latter rule, the Tax Court held that alteration of voting power brought about by an agreement among corporate shareholders and including an irrevocable proxy to vote the shares of parties to the agreement did not cause a corporation to be treated as having more than one class of stock outstanding [*Parker Oil Co. v. Commissioner (1972) 58 T.C. 985, 990]* . The Subchapter S provisions of the Internal Revenue Code [*I.R.C. § 1361* et seq.] also provide that certain trusts, including trusts created primarily to exercise the voting power of stock transferred to them, may be shareholders of S corporations [*I.R.C. § 1361(c)(2)(A)(iv)*]. Thus, neither a voting agreement nor a voting trust will cause the corporation to lose its income tax status as an S corporation.

For further discussion of the criteria which a corporation must meet to be eligible for Subchapter S status and consideration of the advisability of electing to be taxed as an S corporation, see Ch. 1B, *Selecting Form of Business Entity* . For discussion of the procedures to be used in electing or terminating Subchapter S status, see Ch. 2B, *Electing Subchapter S Status* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)General OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)RequirementsTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)EffectsBusiness & Corporate LawCorporationsShareholdersMeetings &

VotingVoting SharesGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
D. Special Considerations for Subchapter S and Professional Corporations

4-8B California Legal Forms--Transaction Guide § 8B.51

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.51 Restrictions on Voting Trusts for Professional Corporations

No shareholder of a professional corporation [*see Corp. Code § 13401(b)* (professional corporation defined)] or a foreign professional corporation qualified to do business in this state may enter into a voting trust, proxy, or any other arrangement vesting another person (other than another person who is a shareholder of the same corporation) with the authority to exercise the voting power of any shares. Any arrangement attempting to circumvent this prohibition is void [*Corp. Code § 13406(a)*].

For a list of professions permitted to incorporate under the Professional Corporations Act, see Ch. 1B, *Selecting Form of Business Entity* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART II. LEGAL BACKGROUND
D. Special Considerations for Subchapter S and Professional Corporations

4-8B California Legal Forms--Transaction Guide §§ 8B.52-8B.99

AUTHOR: Marilyn E. Minger Practice Consultant

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§§ 8B.52[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-8B California Legal Forms--Transaction Guide § 8B.100

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.100 Client Interview

NOTE:
For a preincorporation planning checklist, see Ch. 2, ***Formation of Corporations*** .

[1] Facts

[a] Each Shareholder

1. Names and addresses of shareholders:

    a. Individual shareholders and spouses.

    b. Entities.

2. Capacity in which individual holds shares:

    a. Owner.

    b. Trustee.

    c. Executor or administrator.

    d. Guardian.

    e. Custodian under Uniform Gift to Minors Act.

3. Basis of shareholder's stock.

4. Tax identification number.

5. Tax year.

6. If shareholder is an individual:

a. Marital status.

b. Age.

c. Gross and net income for last three years.

d. Estimated net worth.

e. Projected annual income.

f. Relationship to other participants.

g. Affiliations with other businesses.

h. Percentage interest in business.

i. If voting agreement or voting trust agreement will have buy-sell provision likely to be funded with life insurance:

(1) Name, address, and telephone number of corporation's insurance agent or broker.

(2) Type and amount of existing policies owned by corporation and by individual shareholders.

(3) Name of current beneficiaries.

(4) Amount of premiums.

(5) Premium payment terms.

j. If agreement has buy-sell provision likely to be funded with life insurance, and participant has been denied insurance coverage:

(1) Type of coverage denied.

(2) Reason for denial.

(3) Date of denial.

NOTE:

Whether an individual shareholder is likely to be insurable is an essential consideration in determining how to fund a buy-sell provision in a voting agreement or voting trust

agreement.

k. Whether shareholder is employee of corporation; if so position or title.

l. Estate plan for shares.

NOTE:

Transfer restrictions in a voting agreement or voting trust agreement may affect an estate plan [***see*** Ch. 8D, ***Buy-Sell Agreements***].

[b] The Corporation

1. Name and address of corporation.

2. Date of incorporation.

3. State of incorporation.

4. Tax year of corporation.

5. Employer identification number.

6. Principal business.

7. Number of shareholders.

NOTE:

Voting agreements are no longer limited to shareholders of close corporations [***see*** *Corp. Code § 706(a)*]. However, if the corporation is a close corporation [***see*** *Corp. Code § 158(a)* (number of shareholders limited to 35)], the voting agreement should also state that the corporation is a close corporation.

8. Total number of shares issued.

9. Approximate fair market value of shares, if known.

10. Whether the corporation is a professional corporation.

NOTE:

No shareholder of a professional corporation [***see*** *Corp. Code § 13401(b)* (professional corporation defined)] or a foreign professional corporation qualified to do business in California may enter into a voting trust, proxy, or any other arrangement vesting another person (other than another person who is a shareholder of the same corporation) with the authority to exercise the voting power of any shares. Any arrangement attempting to circumvent this prohibition if void [*Corp. Code § 13406(a)*].

For a list of professions permitted to incorporate under the Professional Corporations Act, see Ch. 1B, ***Selecting Form of Business Entity*** .

11. Whether corporation has elected Subchapter S status.

NOTE:

The Subchapter S provisions of the Internal Revenue Code [*I.R.C. § 1361* et seq.] provide that certain trusts, including trusts created primarily to exercise the voting power of stock transferred to them, may be shareholders of S corporations [*I.R.C. § 1361(c)(2)(A)(iv)*]. For discussion of the effect of voting agreements and voting trusts on S corporation status, see *§ 8B.50*.

12. Names, addresses, and telephone numbers of directors.

13. Names, addresses, telephone numbers, and titles of officers.

14. Name, address, and telephone number of accountant.

15. Name and address of corporation's transfer agent, if any.

[c] Voting Trustees, if Voting Trust Will Be Used

1. Names, addresses, and telephone numbers of trustees, if any have been selected, or of candidates for trustee.

2. Past, present, and anticipated relationship with corporation, other shareholders, and other trustees or trustee-candidates.

3. Percentage of securities to be placed in trust, if any, owned by any trustees or trustee-candidates.

4. Trustees' or trustee-candidates' business background and present business.

5. Length of time known by other principals of voting trust.

6. Nature of any other agreement by which trustees or trustee-candidates represent shareholders of corporation.

[d] Securities and Security Holders, if Voting Trust Will Be Used

1. Identification by type, class, and series of all securities to be placed in trust.

2. For each shareholder to deposit shares in trust:

a. Name as it appears on share certificate.

b. Number of shares to be deposited.

c. Certificate numbers of shares to be deposited.

d. Number of shares not to be deposited in trust.

3. Voting rights of each class or series of securities to be placed in trust.

[2] Documents

[a] Each Shareholder

1. Estate plan for corporate shares.

2. Most recent financial statement.

3. Most recent income tax return.

[b] The Corporation

1. Articles of incorporation.

2. Bylaws.

3. Any shareholder agreements imposing transfer restrictions on corporate shares.

4. Any documents regarding qualification or exemption of corporate shares.

5. Share certificates.

6. Most recent financial statement.

7. Most recent income tax return.

8. Schedules of any liabilities, showing:

    a. Creditors' names and addresses.

    b. Amount of indebtedness to each creditor.

9. Any security instruments relating to secured indebtedness.

10. Shareholder list.

11. Any instrument under which corporation's stock is held, including:

    a. Trust instruments for trusts holding corporation's shares.

    b. Will under which any deceased shareholder's corporate stock is held by estate.

    c. Bankruptcy court order under which bankrupt shareholder's stock is held by bankrupt's estate.

d. Court order for guardianship.

12. Any corporate buy-sell agreement.

13. Any buy-sell agreement between any shareholder and any member of shareholder's family.

14. Insurance policies.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewBusiness & Corporate LawProfessional Associations & CorporationsBusiness & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsTax LawFederal Taxpayer GroupsS CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-8B California Legal Forms--Transaction Guide §§ 8B.101-8B.109

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8B.101[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8B California Legal Forms--Transaction Guide § 8B.110

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.110 Identifying Conflicts of Interest

PRACTICE TIP:

In drafting a voting agreement or voting trust agreement, it is not uncommon for the parties to request that one attorney represent all of the individual participants. Under the right circumstances, having one attorney represent all parties can result in a simpler, less expensive, and more harmonious transaction than if each party were represented by separate counsel. However, an attorney who is asked to represent multiple parties to a single transaction must first identify any actual or potential conflict and then determine whether the conflict may be waived. If the conflict may be waived, a suitable waiver must be obtained [*see* Cal. Rules *Prof. Cond., Rule 3-310(C)*]. *Commentary by Marilyn E. Minger.*

NOTE:

For further discussion of this topic, see *Ch. 1A,* ***Role of Counsel in Starting a New Business****, §§ 1A.33-1A.37, 1A.113*. For waivers of conflicts of interest, see *§§ 1A.203[2], 1A.204[2]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of InterestBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



126 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8B California Legal Forms--Transaction Guide § 8B.111

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.111 Determining Scope of Work to Be Performed by Attorney

1. Determine tasks attorney will perform.

NOTE:
The procedural aspects of formation of a corporation are covered in Ch. 2, ***Formation of Corporations*** .

2. Determine whether consultation or association of specialist or other professional is required [*see* Ch. 8D, *Buy-Sell Agreements*].

NOTE:
Drafting (or reviewing) a voting agreement or voting trust can involve areas of law, including business, tax, and community property considerations, particularly if the agreement contains buy-sell provisions. The drafting attorney has the duty to refer the client to a specialist or recommend the retention of a specialist if the attorney lacks the requisite skill or knowledge [***see*** Ch. 8D, ***Buy-Sell Agreements***]. The drafting attorney often relies heavily on the advice of other professionals, such as accountants, financial planners, and trust officers.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8B California Legal Forms--Transaction Guide § 8B.112

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.112 Selecting Appropriate Type of Agreement

1. Determine purpose or purposes of proposed control device, including following information:

a. Nature of situation to be changed, or nature of anticipated situation to be avoided.

b. How long situation has existed.

c. Reason situation exists.

d. Persons responsible for situation.

2. Determine which type of control arrangement is most appropriate for situation at hand, considering following control arrangements:

NOTE:
For an overview of voting agreements, voting trust agreements, and proxies, see *§§ 8B.10* and *8B.32*. For discussion of alternative control devices, see *§ 8B.11*. For more detailed discussion and forms for close corporation shareholders agreements, see Ch. 8C, ***Close Corporation Shareholder Agreements*** .

a. Arrangements with respect to stock, such as:
(1) Cumulative voting;

(2) Preemptive rights;

(3) Issuance of non-voting stock.

b. Use of proxies.

c. Changes in articles, bylaws, or other corporate documents relating to voting rights of security holders.

d. Contracts, such as:

(1) Voting agreements;

(2) Voting trust agreements;

(3) Other shareholder agreements.

3. Details of any other attempts to accomplish purposes for which new control arrangement is sought.

4. Reasons for failure of these attempts to accomplish desired purpose.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8B California Legal Forms--Transaction Guide § 8B.113

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.113 Making Preliminary Determinations if Voting Trust Agreement Is Selected

[1] Transfer of Shares to Trustee

1. Determine procedure by which certificate holders transfer their shares to trustees.

    a. Will trustee be designated to receive participating shares?

    b. Will depository (bank or trust company) be designated to receive participating shares?

    c. Will registrar be designated to receive participating shares?

2. If registrar or depository is used, determine following:

NOTE:

A voting trust agreement may contain provisions appointing a registrar to act as an agent for the trustees [***see*** Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Appendix A, Form 8.22, ***Voting Trust Agreement*** (Matthew Bender)].

a. Will bond be required; if so, how much?

b. Will registrar or depository be granted authority to receive and disburse money?

c. Must disbursements be countersigned by trustees?

d. Will independent accountant or auditor be employed to audit financial transactions involving registrar or depository?

3. Select physical location of stock certificates of securities held in trust.

a. Will stock certificates be placed in depository (bank or trust company)?

b. Will stock certificates be placed in safe deposit box?

c. If placed in safe deposit box, who will have access?

[2] Trustees

1. Determine any qualifications or limitations on who may be appointed voting trustee.

PRACTICE TIP:
Any qualifications or limitations on who may be a trustee should be set out in the voting trust agreement. In California, where there are no statutory rules regarding the qualification of a trustee, the trustee may be a shareholder of the corporation, who may or may not be a participant in the trust, a director, or a creditor. In the case of a professional corporation, the trustee or trustees must be shareholders of the corporation. *Commentary by Marilyn E. Minger*.

2. Select number of trustees.

3. Determine voting procedure if there are two or more trustees.

NOTE:
If there are two or more trustees, the agreement should establish a voting procedure. The agreement might provide, for example, that the required vote be unanimous, or a majority; or the agreement might provide a method to break any deadlock. The provision in § 8B.210[2] provides for a majority vote and requires that the matter be put to a vote of the shareholders in the event that the trustees are equally divided on a matter [***see § 8B.210[2]***, P 4.08].

4. Determine any limitations on trustees' voting powers [*see § 8B.38[1], [2]; § 8B.212*].

a. Will trustees be required to vote for certain individuals as directors or vote in certain way on any particular issue?

b. Will trustees be restricted to voting for election of directors and on matters ordinarily arising at shareholder's annual meeting?

c. Will trustees submit extraordinary matters to voting trust certificate holders and vote only as approved by majority of certificate holders?

5. Determine trustees' duties.

a. Will trustees issue voting trust certificates to shareholders who are parties to

agreement?

PRACTICE TIP:
Although not required by statute, in practice most voting trust agreements provide for the issuance of voting trust certificates because they are tangible evidence of the participating shareholder's interest in the stock and facilitate the transfer of these rights. Voting trust certificates are transferable in the same manner as stock certificates [*see § 8B.33*]. *Commentary by Marilyn E. Minger*.

b. Will trustees be permitted to institute court action on behalf of trust certificate holders?

c. Will agreement grant any additional powers to trustee to administer trust?

d. Trustees must file executed copy of agreement with corporation's secretary [*see Corp. Code § 706(b)*; § 8B.34].

NOTE:
The agreement may grant additional powers to the trustee, provided that the exercise of those powers does not violate the governing statute or public policy [***see*** *§§ 8B.31, 8B.38*].

6. Determine whether trust agreement will limit trustees' personal liability?

NOTE:
Some trust agreements limit the personal liability of trustees [***see*** *§ 8B.210[2]*. The trust agreement may not, however, exonerate the trustee for deliberate acts of malfeasance [***see*** Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 111,* ***Voting Trusts****, § 111.05[6]* (Matthew Bender)].

7. Determine amount and source of compensation to be paid to trustees.

8. Determine source of reimbursement of trustees' administrative expenses.

NOTE:
Reimbursement for the trustees' administrative expenses should not be paid from corporate funds because the corporation is not a party to the agreement; the costs should be paid by the certificate holders. A voting trust often provides that the trustee may deduct their administrative expenses before distributing dividends received by them as record holder to the trust certificate holders [***see*** *§ 8B.210[2]*].

Furthermore, courts will usually require reimbursement of expenses of a trustee who has successfully defended a suit demanding the trustee's removal [***see*** *Moore v. Bowes (1937) 8 Cal. 2d 162, 166-167, 64 P. 2d 423* (lawyer's fees allowed to defendant trustee who was found not to have violated his duties and not subject to removal)].

9. Select terms of trustees, if necessary.

10. Determine how successor trustee will be appointed, if desired.

NOTE:
If the certificate holders want input in choosing a successor voting trustee (if a trustee dies, resigns, or is removed), the agreement should so specify, or the agreement may provide that any vacancies will be

filled by the remaining trustees [***see*** *§ 8B.210[2]*].

[3] Effective Date, Duration, and Termination of Trust

1. Select effective date of trust (assuming permit has been issued by Commissioner of Corporations approving issuance of trust certificates, if required) [*see § 8B.36*; *see also* Ch. 6, *Securities Regulation Issues*].

NOTE:

An effective date might be a fixed date, the date on which the voting trust agreement is signed by all or a fixed percentage of participating shareholders, or on the filing of a copy of the voting trust agreement with corporation's secretary.

2. Determine duration of trust.

NOTE:

A voting trust is limited to a maximum period of ten years, with additional extensions not to exceed 10 years permitted at any time within two years prior to the time of expiration [*Corp. Code § 706(b)*; ***see*** *§ 8B.35*].

3. Determine any rights of trustees or certificate holders to terminate voting trust agreement.

NOTE:

There is no provision in the General Corporation Law for the ***revocation*** of voting trusts [***see*** *Corp. Code § 706(b)*]. A voting trust terminates when its term expires, unless properly extended [*Corp. Code § 706(b)*; ***see*** *§ 8B.35[1]*]. The provisions in the Probate Code governing modification and termination of trusts in general provide that unless expressly made irrevocable by the trust instrument, the trust is revocable by the trustor [*Prob. Code § 15400*; ***see*** *Prob. Code § 15401* (methods of revocation)]. However, voting trusts are generally irrevocable, although a voting trust may be terminated on equitable grounds, as for example, when its purpose has been frustrated [***see*** Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 111,* ***Voting Trusts****, § 111.04[3]* (Matthew Bender)].

4. Determine events that will cause trust to terminate, if voting trust is not irrevocable, such as:

a. When annual corporate earnings after taxes are reduced to a specified amount.

b. When corporate debts rise above a specified amount.

c. Death or resignation of any or all trustees.

5. Determine termination procedure, if voting trust is not irrevocable.

a. Will termination be by vote and notice by trustees?

b. Will termination be by vote, consent, or agreement of trust certificate holders, with or without meeting, and notice to trustees?

6. Determine mechanics of final accounting or report by trustees.

    a. When and to whom will final accounting be given?

    b. How will unpaid expenses for trust be collected from trust certificate holders?

7. Determine time period in which trust certificates must be exchanged for securities held by trustees.

Legal Topics:

For related research and practice materials, see the following legal topics:
Estate, Gift & Trust LawTrustsModification & TerminationEstate, Gift & Trust LawTrustsTrusteesDuties & PowersCompensationEstate, Gift & Trust LawTrustsTrusteesDuties & PowersLimitationsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsEstate, Gift & Trust LawTrustsTrusteesDuties & PowersGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8B California Legal Forms--Transaction Guide §§ 8B.114-8B.119

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8B.114[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures
1. Voting Agreements and Voting Trust Agreements

4-8B California Legal Forms--Transaction Guide § 8B.120

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.120 Legend Requirements; Filings With Corporation

1. Make sure that the certificates of shares subject to voting agreement under *Corp. Code § 706(a)*, irrevocable proxy under *Corp. Code § 705(e)*, or restrictions on voting rights contractually imposed by corporation have been stamped with legend indicating that fact [*see Corp. Code § 418(a)*].

2. Make sure that copy of any voting trust agreement has been filed with secretary of corporation for inspection by any shareholder, holder of voting trust certificate, or either's agent [*see Corp. Code § 706(b)*; *see also § 8B.34*].

3. Make sure that copy of voting agreement or voting trust agreement has been given to each person to whom shares or certificates of beneficial interest have been transferred.

PRACTICE TIP:
Although not a statutory requirement, providing each transferee of shares or certificates with a copy of the agreement ensures that the transferee has actual knowledge of the agreement. *Commentary by Marilyn E. Minger.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock CertificatesBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting

TrustsBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures
1. Voting Agreements and Voting Trust Agreements

4-8B California Legal Forms--Transaction Guide § 8B.121

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.121 Amending Voting Agreements and Voting Trust Agreements

1. Prepare proposed amendment in accordance with agreement.

2. Call and notice meeting of participating shareholders (voting agreement) or certificate holders (voting trust agreement), if required by terms of voting agreement or voting trust agreement.

3. Close trust records, if required.

4. Obtain signatures, consents, or votes of participating shareholders (voting agreement) or certificate holders (voting trust agreement) to amendment.

5. Prepare and file application for permit with Commissioner of Corporations, if required as result of amendment of voting trust agreement [*see Corp. Code §§ 25103(e), 25110, 25113*; *see also § 8B.36*; Ch. 6, *Securities Regulation Issues ;* Ch. 6H, *Qualification of Securities*].

6. Prepare and file registration pursuant to federal securities laws if required as result amendment of voting trust agreement.

7. File copy of amendment with secretary of corporation.

8. Mail copy of amendment to all participating shareholders (voting agreement) or certificate holders (voting trust agreement).

9. Cancel and reissue voting trust certificates, if necessary.

Legal Topics:

For related research and practice materials, see the following legal topics:
Estate, Gift & Trust LawTrustsModification & TerminationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures
1. Voting Agreements and Voting Trust Agreements

4-8B California Legal Forms--Transaction Guide §§ 8B.122-8B.129

AUTHOR: Marilyn E. Minger Practice Consultant

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§§ 8B.122[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures
2. Voting Trust Agreements

4-8B California Legal Forms--Transaction Guide § 8B.130

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.130 Securities Considerations for Voting Trusts

1. Determine whether offer and sale of certificates in voting trust constitutes sale of securities subject to federal registration or state qualification requirements, or is exempted from registration or qualification [*see 10 Cal. Code Reg. § 260.100*; *Corp. Code § 25110*; *15 U.S.C. § 77c*; *15 U.S.C. § 78c(a)(12)*]].

NOTE:

Beneficial interests in voting trusts and voting trust certificates are securities under the California Corporate Securities Law of 1968 [*Corp. Code § 25019*] and under the Securities Act of 1933 [***see*** Securities Act of 1933, § 2; *15 U.S.C. § 77b(a)(1)*] and the Securities Exchange Act of 1934 [***see*** Securities Exchange Act of 1934, § 3(a)(10); *15 U.S.C. § 78c(a)(10)*]. Therefore, the offer and sale of certificates in a voting trust must be qualified unless expressly exempted from qualification [***see*** P 2, ***below***].

2. Prepare and file appropriate exemption or qualification and registration applications [*see* Ch. 6, *Securities Regulation Issues* , for discussion of the available exemptions and determinations regarding whether qualification of the securities is required].

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawBlue Sky LawsSecurities Exempt From RegistrationSecurities LawBlue Sky LawsExempted IssuersSecurities LawBlue Sky LawsExcluded Transactions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures
2. Voting Trust Agreements

4-8B California Legal Forms--Transaction Guide § 8B.131

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.131 Taxation of Voting Trust

1. Ascertain that appropriate individual has been selected to prepare and file Internal Revenue Service Form SS-4 to obtain federal tax identification number for voting trust.

2. Ascertain that appropriate individual has been selected to prepare and file trust's annual income tax returns (Internal Revenue Service Form 1041 and California Franchise Tax Board Form 541) [*see I.R.C. § 6012(a)(4)*; *Rev. & Tax. Code § 18505(e), (f)* (requiring filing of returns)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Tax Administration & ProcedureAdministrationIdentification Numbers & Information Returns (IRC secs. 6031-6065)General OverviewTax LawFederal Tax Administration & ProcedureAdministrationTax Payment & Tax Return Requirements (IRC secs. 6071-6091, 6151-6167)General OverviewTax LawFederal Taxpayer GroupsIncome Taxation of Estates, Trusts & BeneficiariesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures
2. Voting Trust Agreements

4-8B California Legal Forms--Transaction Guide §§ 8B.132-8B.199

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8B.132[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART IV. FORMS
A. Voting Agreements

4-8B California Legal Forms--Transaction Guide § 8B.200

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.200 Voting Agreement

[1] Comment

[a] Use of Form

This form is voting or pooling agreement among shareholders of a corporation. This agreement covers all matters subject to a vote of the shareholders.

Corp. Code § 706(a) permits two or more shareholders to make an agreement in writing to exercise any voting rights attached to the shares. For a voting agreement that is implemented by an irrevocable proxy, see *§ 8B.201*. For further discussion of the distinctions between voting agreements and voting trust agreements, as well as other control arrangements, see [c], *below*, and §§ 8B.10, 8B.11, 8B.32.

[b] Statutory Requirements of Voting Agreement

The General Corporation Law requires that a voting agreement between two or more shareholders of a corporation must be in writing and signed by the parties to the agreement.

Unlike a voting trust, a voting agreement need not be renewed every 10 years, nor must it be filed with the corporate secretary and made available for inspection.

[c] Voting Agreement and Shareholder Agreement Distinguished

A voting agreement differs from a shareholder agreement in three significant respects. First, the use of a voting agreement is not limited to shareholders of a close corporation as is a shareholder agreement [*cf. Corp. Code §§ 300(b), 706(a)*]. Second, a voting agreement may be among less than all of the shareholders [*Corp. Code § 706(a)*]. Third, a voting agreement covers only the exercise of shareholder voting rights [Assem. Select Comm. Rpt. 86 (Dec. 1, 1975)]

and does not change the role of the shareholders with respect to the directors [*see Corp. Code § 300(b)* (this subdivision does not apply to voting agreement authorized by *Corp. Code § 706(a)*)]. Thus, if the shareholders of a close corporation want to enter into an agreement that extends beyond how their shares will be voted and controls functions that are traditionally within the realm of the directors (appointing officers and setting corporate policies, for example), a shareholder agreement, and not a voting agreement, should be used. For discussion of shareholder agreements, see Ch. 8C, *Close Corporation Shareholder Agreements* .

[2] Form

Voting Agreement

VOTING AGREEMENT

THIS AGREEMENT, dated _____, is among _____[*names of participating shareholders*] (collectively Shareholders; individually Shareholder).

RECITALS

The Shareholders are all shareholders of _____[*name of corporation*] (Corporation), _____[*if corporation is not a close corporation:* a California corporation *or, if corporation is a close corporation:* a California close corporation as defined by *California Corporations Code Section 158*].

The Shareholders desire to enter into a Voting Agreement, prepared in accordance with *California Corporations Code Section 706(a)*, to provide for the voting of their shares on _____[*specify matters covered by the agreement, e.g., all matters subject to shareholder vote or to elect certain parties as directors*].

The Shareholders hereby agree as follows:

ARTICLE 1 SHARES SUBJECT TO AGREEMENT

1.01. **Shares Subject to Agreement.** The shares subject to this agreement are shares of the Corporation as listed on Exhibit A attached to this Agreement (Shares) opposite the name of each Shareholder.

ARTICLE 2 VOTING SHARES

2.01. **Voting of Shares.** For the duration of this Agreement, each Shareholder will vote the Shares that Shareholder owns as follows: _____[*list matters included in agreement*].

2.02. **Excluded Matters.** The following matters are not subject to this agreement: _____[*list matters excluded from agreement*].

ARTICLE 3 TERMINATION OF AGREEMENT

3.01. **Events Triggering Termination.** This Agreement will terminate on the occurrence of the first of the following events:

(1) On _____[*date*].

(2) When all Shareholders consent in writing to the termination of this Agreement.

ARTICLE 4 MISCELLANEOUS PROVISIONS

4.01. **Necessary Acts.** All parties to this Agreement will perform any acts, including executing any documents, that may be reasonably necessary to fully carry out the provisions and intent of this Agreement.

4.02. **Notices.** All notices, demands, requests, or other communications required or permitted by this Agreement will be in writing and will be deemed duly served when personally delivered to the party or to an officer or agent of the party, or when deposited in the United States mail, first-class postage prepaid, addressed to the party at the address appearing for him or her on the books and records of the Corporation, or at any other address the party may designate by written notice to the others.

4.03. **Remedies.** The parties will have all the remedies available to them for breach of this Agreement by law or in equity. The parties further agree that in addition to all other remedies available at law or in equity, the parties will be entitled to specific performance of the obligations of each party to this Agreement and immediate injunctive relief. The parties also agree that if an action is brought in equity to enforce a party's obligations, no party will assert as a defense that there is an adequate remedy at law.

4.04. **Attorneys' Fees.** In the event of any litigation concerning this Agreement between the parties to this Agreement the prevailing party shall be entitled, in addition to any other relief that may be granted, to reasonable attorneys' fees.

4.05. **Binding on Successors and Assigns.** This Agreement will be binding on the parties to the Agreement and on each of their heirs, executors, administrators, successors, and assigns.

4.06. **Severability.** If any provision is unenforceable or invalid for any reason, the remaining provisions will be unaffected by such a holding.

4.07. **Governing Law.** This Agreement will be construed according to and governed by the laws of the State of California.

4.08. **Entire Agreement.** This instrument [*for each exhibit attached, add:* and Exhibit _____] constitutes the entire agreement of the Shareholders and correctly sets forth the rights, duties, and obligations of each party and of each party to the other. Any prior agreements, promises, negotiations, or representations concerning the Agreement's subject matter not expressly set forth in this Agreement are of no force or effect.

Executed on _____[*date*], at _____[*city*], _____[*county*], California.

THE SHAREHOLDERS
[*Repeat as required:*]
_____ [*signature*]
[*typed name*]

EXHIBIT A

[*List all shareholders who are party to the agreement, the number of shares each party commits to the agreements, and the numbers of the certificates representing those shares.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate

LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART IV. FORMS
A. Voting Agreements

4-8B California Legal Forms--Transaction Guide § 8B.201

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.201 Voting Agreement by Shareholders to Grant Irrevocable Proxy

[1] Comment--Use of Form

This form is a voting agreement providing for the delivery of an irrevocable proxy to a specified person to vote the shares as specified in the agreement.

Voting agreements designating persons other than the shareholder to vote shares may be implemented by granting an irrevocable proxy to these persons [*Corp. Code §§ 705(e)(5), 706(a)*; *see* [2], *below*] or by creating a voting trust.

In this form, the proxy holders are authorized to vote the shares subject to this agreement for the limited purposes of electing specified persons to the corporation's board of directors and voting affirmatively for specified proposals. These provisions, however, may be modified, as needed.

For further discussion of the use of irrevocable proxies and voting agreements, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 62.04 (Matthew Bender). For a voting agreement, see *§ 8B.200*. For a voting trust agreement, see *§ 8B.210*.

[2] Form

Voting Agreement by Shareholders to Grant Irrevocable Proxy

VOTING AGREEMENT

THIS AGREEMENT, dated _____, is among _____[*names of participating shareholders*], shareholders of _____[*name of corporation*], a California corporation (collectively Shareholders; individually Shareholder).

RECITALS

The Shareholders are shareholders of _____[*name of corporation*] (Corporation), _____[*if corporation is not a close corporation:* a California corporation *or, if corporation is a close corporation:* a California close corporation as defined by *California Corporations Code Section 158*].

The Shareholders desire to enter into a Voting Agreement, prepared in accordance with *California Corporations Code Section 706(a)*, for the purpose of granting an irrevocable proxy to exercise specified voting rights of shares of stock of _____[*name of corporation*].

ARTICLE 1 SHARES SUBJECT TO AGREEMENT

1.01. **Shares Subject to This Agreement.** The undersigned shareholders agree that the number of shares of stock of the Corporation listed _____[in Exhibit A *or* opposite their names below] will be subject to the proxy granted in Article 2]. [*Add if necessary:* Exhibit A is attached to and incorporated by reference into this Agreement].

ARTICLE 2 GRANT OF PROXY

2.01. **Grant of Proxy.** On the execution of this Agreement, the Shareholders agree to grant to _____[*name of proxy holder*] an irrevocable proxy to vote the shares subject to this Agreement for the sole and limited purposes of electing _____[*names of persons to be elected to the board*] to the Board of Directors of the Corporation and of passing the proposals concerning _____[*nature of proposals to be passed*]. The proxy shall be in substantially the following form:

IRREVOCABLE PROXY

The undersigned shareholders, holders of _____ [*specify number*] shares of _____ [*description*] stock of the Corporation, represented by the share certificates listed _____ [in Exhibit A *or* opposite their names below], by this Agreement revoke all proxies dated before the date this Agreement is executed, and irrevocably appoint _____ [*names of proxy holders*] as proxies to vote and otherwise represent the above-listed shares for the following matters:

(1) For the election of _____ [*name(s)*] to the Board of Directors of the Corporation.

(2) For _____ [*insert proposals for which affirmative vote will be cast*].

The proxy holders named in this Agreement or any of them will represent the undersigned for the purpose of determining a quorum at any shareholders' meeting that they attend. However, their authority is specifically limited to an affirmative vote or written consent to the particular matters stated above.

ARTICLE 3 TERMINATION OF AGREEMENT

3.01. **Termination of Agreement.** This Agreement will terminate once the shares have been voted for the particular purposes stated in this Agreement, regardless of the outcome of the election of directors and other matters.

ARTICLE 4 MISCELLANEOUS PROVISIONS

4.01. **Necessary Act.** All parties to this Agreement will perform any acts, including executing any documents, that

may be reasonably necessary to fully carry out the provisions and intent of this Agreement.

4.02. **Notices.** All notices, demands, requests, or other communications required or permitted by this Agreement will be in writing and shall be deemed duly served when personally delivered to the party or to an officer or agent of the party, or when deposited in the United States mail, first-class postage prepaid, addressed to the proxy holders at _____[*address*], or to a Shareholder at the address appearing for him or her on the books and records of the Corporation, or at any other address the party may designate by written notice to the others.

4.03. **Remedies.** The parties will have all the remedies available to them for breach of this Agreement by law or in equity. The parties further agree that in addition to all other remedies available at law or in equity, the parties will be entitled to specific performance of the obligations of each party to this Agreement and immediate injunctive relief. The parties also agree that if an action is brought in equity to enforce a party's obligations, no party will assert as a defense that there is an adequate remedy at law.

4.04. **Attorneys' Fees.** In the event of any litigation concerning this Agreement between the parties to this Agreement the prevailing party will be entitled, in addition to any other relief that may be granted, to reasonable attorneys' fees.

4.05. **Binding on Successors and Assigns.** This Agreement will be binding on the parties to the Agreement and on each of their heirs, executors, administrators, successors, and assigns.

4.06. **Severability.** If any provision is unenforceable or invalid for any reason, the remaining provisions will be unaffected by such a holding.

4.07. **Governing Law.** This Agreement will be construed according to and governed by the laws of the State of California.

4.08. **Entire Agreement.** This instrument [*for each exhibit attached, add:* and Exhibit _____] constitutes the entire Voting Agreement of the Shareholders and correctly sets forth the rights, duties, and obligations of each party and of each party to the other. Any prior agreements, promises, negotiations, or representations concerning the Agreement's subject matter not expressly set forth in this Agreement are of no force or effect.

Executed on _____[*date*], at _____[*city*], _____[*county*], California.

THE SHAREHOLDERS
[*Repeat as required:*]
_____ [*signature*]
[*typed name*]

EXHIBIT A

[*List all shareholders who are party to the agreement, the number of shares each party commits to the agreements, and the numbers of the certificates representing those shares.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART IV. FORMS
A. Voting Agreements

4-8B California Legal Forms--Transaction Guide §§ 8B.202-8B.209

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8B.202[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART IV. FORMS
B. Trust Agreements and Certificates

4-8B California Legal Forms--Transaction Guide § 8B.210

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.210 Voting Trust Agreement for Benefit of Shareholders

[1] Comment

[a] Use of Form

This form is a voting trust agreement for a group of shareholders who wish to consolidate their voting power by pooling their votes. It transfers all voting power from the shareholders to trustees who will represent the interests of these shareholders.

[b] Effective Date of Agreement

The effective date might be a fixed date (following the qualification of the voting trust certificates with the California Commissioner of Corporations, if required), or the date on which the voting trust agreement is signed by all or a stated percentage of participating shareholders and the other parties to the agreement, or on the filing of a copy of the voting trust agreement with corporation's secretary.

[c] Qualification With Commissioner of Corporations

Voting trust certificates are securities subject to regulation by the Commissioner of Corporations [*Corp. Code § 25019* (security defined)]. The offer and sale of securities must be qualified unless they fall within an exempt classification [*Corp. Code § 25110*; *see Corp. Code §§ 25017(a)* (sale defined), 25100 et seq. (exemptions)]. Securities listed or approved for listing on a national securities exchange that has been certified by rule or order of the Commissioner, and warrants or rights to purchase those securities are exempted from the qualification requirement [*Corp. Code § 25100(o)*]. Offers or sales of voting common stock by corporations may be exempt from qualification if, for example, there are no more than 35 beneficial owners in trust [*see Corp. Code § 25102(f)*; *10* Cal. Code Reg. § 260.102.12; *see also § 8B.36*].

Voting trust certificates are also securities under the Securities Act of 1933 [*see* Securities Act of 1933 § 2; *15 U.S.C. § 77b(a)(1)*] and the Securities Exchange Act of 1934 [*see* Securities Exchange Act of 1934, § 3(a)(10); *15 U.S.C. § 78c(a)(10)*]. Consequently, they are subject to federal registration requirements and other regulations unless an exemption applies [*see* Securities Act of 1933, § 3; *15 U.S.C. § 77c*], as well as to the Securities Exchange Act of 1934 [*see* Securities Exchange Act of 1934 § 3(a)(12); *15 U.S.C. § 78c(a)(12)*]. For further discussion of state and federal securities regulations, see *§ 8B.36*. For a more detailed guide to securities regulation issues, see Ch. 6, *Securities Regulation Issues* . Detailed coverage of specific exemptions and qualification requirements appears in Chs. 6A-6H.

The issuance of certificates in a voting trust without qualification, unless exempt, gives the shareholders the right to rescind the transfer [*Corp. Code § 25503*], thus creating a revocable trust. The action to rescind, however, must be brought before the earlier of the expiration of two years after the issuance without qualification or the expiration of one year after the plaintiff discovers the facts constituting any issuance without qualification [*Corp. Code § 25507(a)*].

[d] Restrictions on Transfer; Share Buy-Sell Provisions

As securities [*see* [c], *above*], voting trust certificates are transferable, just like shares in the corporation. However, the original parties to the voting trust often wish to maintain the integrity of their membership by restricting the transfer of shares to outsiders. The restrictions on transfer of corporate shares or share voting certificates can take several forms [*see* Ch. 8D, *Buy-Sell Agreements*]. Voting trust agreements generally contain an obligation on the part of each certificate holder to offer the other certificate holders a first right to purchase the shares. Provisions to implement restrictions on transfer may be included in the voting trust agreement or in a separate buy-sell agreement. No specific implementing provisions are recommended in this form because of the great variety of buy-sell arrangements. The issues to be considered in drafting buy-sell agreements, including methods of share valuation and payment for shares (such as deferred payment or installment payments), as well as form provisions for various types of buy-sell agreements, are covered in detail in Ch. 8D, *Buy-Sell Agreements* .

[e] Trustees' Voting Rights

Voting trustees are record holders of the shares of stock held in trust and, thus, are entitled to vote the shares on all matters [*see Corp. Code §§ 702(a), 706(b)*]. However, their voting power may be limited in the voting trust agreement to exclude the right to vote on specified matters (such as reorganizations, mergers, sale of assets, amendments to the articles of incorporation), without the prior written direction of the owners of a specified percentage of shares subject to the voting trust agreement. For provisions modifying the trustees' voting power, see *§ 8B.212*. The agreement may also provide that the trustees must vote at all times in compliance with the prior written direction of the owners of a specified percentage of shares.

PRACTICE TIP:

If it is intended that the voting powers of the trustee be limited to certain matters, these should be clearly spelled out in the voting trust agreement. *Commentary by Marilyn E. Minger.*

[f] Termination of Trust

A voting trust is limited to a term not exceeding 10 years [*Corp. Code § 706(b)*]. However, at any time within two years prior to the trust's expiration date, one or more beneficiaries under the voting trust agreement may, by written agreement and with the written consent of the voting trustee or trustees, extend the duration of the voting trust with respect to their shares for an additional term not exceeding 10 years from the expiration date of the trust as originally fixed or as last extended according to this procedure [*Corp. Code § 706(b)*]. For discussion of revocability of voting trusts, see *§ 8B.35[2]*.

This form creates a voting trust for a specific term. However, it provides alternative paragraphs that have the effect of making the trust revocable by (1) permitting the early termination of the agreement on the written consent of a specified

percentage of the certificate holders, and (2) permitting shareholders who deposit shares in the trust to withdraw any number of shares from the trust at any time.

[g] Extension of Term

At any time within two years prior to the expiration of a voting trust agreement as originally fixed or as last extended, one or more certificate holders may extend the duration of the agreement for a period not to exceed 10 years. This extension must be in writing and the trustees must consent in writing [*Corp. Code § 706(b)*]. An extension binds only those shareholders that are parties to it. This form contains a provision for extension of the trust's term. For a representative extension agreement, see *§ 8B.213*.

[h] Filing Duplicate With Corporate Secretary

Duplicate copies of the voting trust agreement and any extensions must be filed with the secretary of the corporation and are open for inspection by a shareholder, a holder of a voting trust certificate, or the agent of either on the same terms as the record of the corporation's shareholders. [*Corp. Code § 706(b)*].

[i] Additional Provisions

A voting trust agreement may contain provisions appointing a registrar to act as an agent for the trustees [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Appendix A, Form 8.22, *Voting Trust Agreement* (Matthew Bender)].

For provisions governing meetings of trustees and of certificate holders, see *§ 8B.212* and Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Appendix A, Form 8.22, *Voting Trust Agreement* (Matthew Bender).

[2] Form

Voting Trust Agreement for Benefit of Shareholders

VOTING TRUST AGREEMENT

THIS AGREEMENT, effective on _____[*specify when agreement will become effective, e.g., fixed date or* the date on which this agreement is signed *or* on filing of a duplicate copy of this agreement with the Corporation], is among _____[*names of participating shareholders*] (Shareholders; also Certificate Holders) and _____[*names of trustees*] (Trustees).

RECITALS

The Shareholders are shareholders of [*name of corporation*] (Corporation), a California corporation.

The Shareholders desire to enter into a Voting Trust Agreement, prepared in accordance with *California Corporations Code Section 706(b)*, _____[*specify purpose, e.g.,* to unite the voting power of the shareholders to provide for the efficient management of the Corporation].

ARTICLE 1 EXCHANGE OF SHARES FOR VOTING TRUST CERTIFICATES

1.01. **Exchange of Shares for Voting Trust Certificates.** Simultaneously with the execution of this Agreement, the Shareholders will assign and deliver to the Trustees properly endorsed certificates representing the number of shares of stock in the Corporation listed opposite their respective names below. The Trustees will hold the shares in trust for

the Shareholders and cause the shares to be transferred to the Trustees on the books of the Corporation and, on qualification with the Commissioner of Corporations, if required, will issue and deliver to each of the shareholders Voting Trust Certificates for the number of shares transferred to the Trustees.

1.02. **Form of Voting Trust Certificate.** The Voting Trust Certificates shall be in substantially the form of Exhibit A. Exhibit A is attached to this Agreement and incorporated by reference.

1.03. **Fractional Trust Certificates.** If the interest in this Trust owned by any Certificate Holder cannot be fully represented by whole Voting Trust Certificates, the Trustees may issue fractional share certificates, scrip, or other evidence of ownership of the fractional part of one Voting Trust Certificate. No fractional interest will have greater rights or lesser liabilities than any other Voting Trust Certificate provided under this Agreement.

1.04. **Replacement of Certificates.** If a Voting Trust Certificate is lost, stolen, mutilated, or destroyed, the Trustees, at their discretion, may issue a duplicate of the Certificate.

ARTICLE 2 RESTRICTIONS ON TRANSFER

2.01. **Restrictions on Transfer.** To accomplish the purposes of this Voting Trust Agreement, any transfer, sale, assignment, hypothecation, encumbrance, or alienation of any of the voting trust certificates issued under this Agreement, other than according to the terms of _____[this Agreement *or* the provisions of the Buy-Sell Agreement of _____ (*name of corporation*), dated _____], is void and transfers no right, title, or interest in or to those certificates to the purported transferee, buyer, assignee, pledgee, or encumbrance holder.

2.02. **Right to Receive Dividends.** Each Certificate Holder will have the right to receive dividends paid on the underlying shares until the certificates are sold or transferred as provided in _____[this Agreement *or* the provisions of the Buy-Sell Agreement of _____ (*name of corporation*), dated _____], subject to Paragraph 4.07 of this Agreement. Trustees shall not be bound by any notice to the contrary.

2.03. **Right of First Refusal to Other Certificate Holders.** No Certificate Holder (or Certificate Holder's estate) will sell, assign, transfer, or otherwise dispose of any of his or her certificates, or of any interest in those certificates, without first offering those certificates to the other Certificate Holders, as provided in [this Agreement *or* the provisions of the Buy-Sell Agreement of _____ (*name of corporation*), dated _____].

2.04. **Purchase by Other Certificate Holders.** The non-selling Certificate Holders will have the option, but not the obligation, to purchase the offered certificates at the price determined _____[according to Paragraph _____ of this Agreement *or* the provisions of the Buy-Sell Agreement of _____ (*name of close corporation*), dated _____].

[*Add, if mandatory buy-sell provisions will be enumerated in the voting trust agreement:*]

ARTICLE _____
MANDATORY BUY-SELL PROVISIONS

[*Add appropriate provisions from Ch. 8D, Buy-Sell Provisions, imposing transfer restrictions on occurrence of the following events: (1) voluntary lifetime sale of certificates, (2) involuntary transfer of certificates due to bankruptcy or assignment for the benefit of creditors, and (3) employee-certificate holder's termination of employment, disability, retirement, or death. If these provisions are added, the remaining articles below should be renumbered accordingly.*]

[*CONTINUE*]

ARTICLE 3 NUMBER, TERM, AND REPLACEMENT OR REMOVAL OF TRUSTEES

3.01. **Number and Term of Trustees.** There will be _____[*number*] Trustees of this trust. The first Trustees will be those named above; their successors will be appointed as provided in this Agreement. In the absence of their removal, resignation, or death, the Trustees will serve for the entire term of this trust.

3.02. **Death of Trustees.** The rights and duties of the Trustees will terminate on their deaths and no interest in any of the property owned or held by the trust nor any of the rights or duties of the Trustees may be transferred by will, devise, succession, or in any manner except as provided in this Agreement. The heirs, administrators, and executors of the Trustees shall, however, have the right and duty to convey any property held by the Trustees to the remaining or successor Trustees.

3.03. **Resignation.** Any Trustee may resign by giving notice of his or her resignation to the remaining Trustees. On the resignation of any Trustee, the remaining Trustees will settle any account or transaction with the resigning Trustee.

3.04. **Removal.** Any of the Trustees may be removed for cause at any time by a _____[*specify percentage, e.g.,* majority] vote of the Trustees, or a _____[*specify percentage, e.g.,* two-thirds] vote of the Certificate Holders.

[*If agreement will provide for the appointment of successor trustees by the trustees:*]

3.05. **Successor Trustees.** In the event of the death, resignation, removal, or incapacity to act of any Trustee or Trustees, a successor or successors may be appointed by the remaining Trustee or Trustees. If there are no remaining trustees, a successor or successors will be elected by _____[*specify percentage, e.g.,* majority *or* two-thirds] vote of the Certificate Holders, with each Certificate Holder having a number of votes in proportion to his or her respective interest.

[*OR, if agreement will provide for the election of successor trustees by the certificate holders:*]

3.05. **Successor Trustees.** In the event of the death, resignation, removal, or incapacity to act of any Trustee or Trustees, a successor or successors will be elected by _____[*specify percentage, e.g.,* majority *or* two-thirds] vote of the Certificate Holders, with each Certificate Holder having a number of votes in proportion to his or her respective interest.

[*CONTINUE*]

ARTICLE 4 RIGHTS AND DUTIES OF TRUSTEES

4.01. **Voting of Shares.** During the period of this Voting Trust, the Trustees will have the exclusive right to vote the shares or give written consent, in person or by proxy, at all meetings of the shareholders of the Corporation, and in all proceedings in which the vote or written consent of shareholders may be required or authorized by law. The Trustees will have all the rights, powers, and privileges of shareholders, except as otherwise provided in this Agreement.

4.02. **Voting at Direction of Certificate Holders.** If, before any shareholders' meeting or before the taking of any corporate action requiring an affirmative vote or consent of shareholders, the owners of a _____[*specify percentage, e.g.,* majority] of the shares deposited under this Agreement direct the Trustees to vote all the shares in a certain way, the Trustees must comply with that direction. Any such direction by the Certificate Holders owning a majority of the shares deposited under this Agreement must be in writing, signed by all of these Certificate Holders.

4.03. **Dividends.** If the Corporation issues dividends, the Trustees shall receive and distribute the dividends to the Certificate Holders, in proportion to their holdings [*add if applicable:*, subject to the provisions of Paragraph 4.07 of this Agreement]. If the dividends are in the form of share certificates having voting rights, the share dividends shall be held by the Trustees, as provided in Article 1 of this Agreement.

4.04. **No Sale of Shares.** the Trustees shall have no authority to sell or otherwise dispose of or encumber any of the stock deposited under this Agreement.

4.05. **Trustees as Shareholders, Directors, or Employees.** The Trustees and their successors may be parties to this Agreement as Certificate Holders and, to the extent of the shares deposited by them, they will be entitled in all respects to the same rights and benefits as other Certificate Holders. The Trustees may serve the Corporation or any of its subsidiaries as a director or officer or in any other capacity, and in any such capacity receive compensation from the Corporation.

4.06. **Trustees' Liability.** No Trustee will be liable for acts or omissions of any other Trustee or Trustees or for acts or omissions of any employee or agent of any other Trustee or Trustees. The Trustees, and each of them, will not be liable in acting on any notice, request, consent, certificate, declaration, or other paper or document, or signature believed by them to be genuine and to have been signed by the proper party or parties. The Trustees shall not be liable for any error of judgment or for any act or omission done in good faith, except for each Trustee's own willful default or gross negligence. The Trustees may consult with legal counsel, and any act or omission under this Agreement done in good faith in accordance with the opinion of legal counsel will be binding on the parties to this Agreement and will not subject the Trustees to any liability.

[*If trustees will serve without compensation:*]

4.07. **Payment of Trustees' Expenses and Compensation.** The Trustees will serve without compensation of any kind except that their expenses lawfully incurred in the administration of their duties as Trustees will be reimbursed to them by the Certificate Holders. Each Certificate Holder severally agrees to reimburse the Trustees for any such expenses in proportion to that Certificate Holder's beneficial interest in the trust created by this Agreement. Any such expenses may be deducted from the dividends or other monies received by the Trustees on the shares deposited under this Agreement.

[*OR, if trustees will serve with compensation:*]

4.07. **Payment of Trustees' Expenses and Compensation.** The Trustees are entitled to reasonable compensation for their services as Trustees under this Agreement. Each Certificate Holder severally agrees to pay this compensation in proportion to that Certificate Holder's beneficial interest in the Trust created by this Agreement. Each Certificate Holder severally agrees to reimburse the Trustees for any expenses lawfully incurred in the administration of their duties as Trustees in proportion to the Certificate Holder's beneficial interest in the trust created by this Agreement. Any such expenses may be deducted from the dividends or other monies received by the Trustees on the shares deposited under this Agreement.

[*CONTINUE*]

4.08. **Co-Trustees to Act by Majority Vote.** At any time that there are two or more trustees serving under this instrument, they shall act by majority vote, and any exercise of a power or discretion by a majority of the trustees shall have the same effect as an exercise by all of them. In the event that the vote of the Trustees is evenly divided with respect to a particular action or matter, that action or matter shall be put to a vote of the Certificate Holders, and the Trustees thereafter must vote on that action or matter in accordance with the vote of the owners of a _____[*specify percentage as stated in Paragraph 4.02, e.g.,* majority] of the shares deposited under this Agreement.

ARTICLE 5 DEPOSIT OF ADDITIONAL SHARES; WITHDRAWAL OF SHARES

5.01. **Deposit of Additional Shares.** At any time after this Agreement becomes effective, the Certificate Holders and any other shareholders of the corporation may deposit additional certificates for shares of the Corporation with the Trustees, if the deposit is approved by the Trustees and the Certificate Holders representing a _____[*specify percentage, e.g.*, majority] of the shares currently on deposit; however, no Certificate Holder will be required to deposit certificates for all his shares in the Corporation unless he or she elects so to do. Any shareholder who is not a party to this agreement and wishes to deposit shares with the Trustees in accordance with this agreement must become a party to this agreement.

[*If certificate holders may withdraw shares:*]

5.02. **Withdrawal of Shares.** Any Certificate Holder may withdraw his or her shares at any time by giving the Trustees written notice at least _____[*number*] days before the effective date of the withdrawal and returning his or her Voting Trust Certificates to the Trustees. The Trustees will deliver the share certificates to the Certificate Holder, properly endorsed for transfer, as provided in Article 7.

[*OR, if certificate holders may not withdraw shares:*]

5.02. **Withdrawal of Shares.** A Certificate Holder may not withdraw his or her shares at any time before the termination of this Agreement, as provided in Article 7.

[*CONTINUE*]

ARTICLE 6 BOOKS AND RECORDS

6.01. **Maintenance of Records.** The Trustees will maintain adequate records of the Trust, including, but not limited to, a record of shares (showing all share certificates transferred to the Trustees, the name in which the stock was held, the date of issuance, the class and series of the stock, the number of shares, the number of the certificates representing those shares, the date of transfer to the Trustees); a record of trust certificates (showing the number of Voting Trust Certificates held by each person; the total number of the Voting Trust Certificates held by each person; the dates on which the Voting Trust Certificates were issued, canceled, transferred, or replaced); and a book of accounts (showing all money received by the Trustees, all disbursements made by the Trustees, and all unpaid obligations incurred by the Trustees).

6.02. **Inspection of Records.** The books and records of this Trust will be open to inspection by any of the parties to this Agreement or their successors at any reasonable time. The inspection will be made at the office of the Corporation's secretary and will include the right to make copies of the books and records. However, any inspection or copying requires that reasonable notice be given to the Corporation's secretary. In the event of a dispute, the Trustees will determine the reasonableness of the request for inspection and copying.

ARTICLE 7 TERMINATION OF AGREEMENT

7.01. **Irrevocability of Trust.** Except as otherwise provided in this Agreement, the Trust created by this Agreement is irrevocable.

7.02. **Termination.** This Agreement will terminate _____[*number not exceeding 10*] years after the date of this Agreement or on any later date to which its term is extended, as provided in Paragraph 8.01, without notice by or to, or action on the part of, the Trustees or the Certificate Holders, unless the term is extended as provided in Paragraph 8.01. [*Add if optional earlier termination by the certificate holders is desired:* This Agreement may be terminated at an earlier date by the written consent of the Certificate Holders representing _____ (*specify percentage, e.g.,* a majority *or* two-thirds) of the shares subject to this Agreement.]

7.03. **Exchange of Voting Trust Certificates for Share Certificates.** On termination of this Agreement, the Certificate Holders will surrender their Voting Trust Certificates to the Trustees, together with payment of money sufficient to cover any expenses, including taxes, relating to the transfer or delivery of the certificates; and the Trustees will deliver to the Certificate Holders shares of the Company properly endorsed for transfer, equivalent to the amount of shares represented by the Voting Trust Certificates surrendered. If any Certificate Holder cannot be located, or fails to surrender certificates in exchange for shares, the Trustees may deliver the shares to the Corporation or to any bank or trust company in California for the benefit of the person entitled to those shares. On delivery, the Trustees will have discharged their duty with respect to those share certificates.

7.04. **Final Accounting.** Within _____[*number*] days after termination of this Trust, the Trustees will render a final accounting to the Certificate Holders and to the Corporation and will distribute any funds or other assets held by them to the parties entitled to those funds or assets.

ARTICLE 8 EXTENSION OF AGREEMENT

8.01. **Extension of Agreement.** The term of this Agreement may be extended from its original termination date or the termination date as last extended as provided in this paragraph, provided that within two years before the expiration date as originally fixed or last extended, one or more Certificate Holders by written agreement, with the Trustee's written consent, extend the duration of this Agreement with respect to their shares for an additional period not exceeding ten years from the expiration date then in effect. However, no extension agreement will affect the rights or obligations of persons not parties to the extension agreement.

8.02. **Filing Duplicate of Extension With Corporation.** In the event of extension, the Trustees will file duplicate copies of this extension agreement with the Corporation's secretary. These copies will be available for inspection on the same terms as the Corporation's record of shareholders.

ARTICLE 9 NOTICES FROM CORPORATION

9.01. **Notices From Corporation.** The Trustees will promptly forward copies of all notices, reports, statements, and other communications received from the Corporation to each Certificate Holder, stamped with the date of receipt.

ARTICLE 10 MERGER OR CONSOLIDATION

10.01. **Merger or Consolidation.** If the Corporation is merged into or consolidated with another corporation, or all or substantially all of the assets of the Corporation are transferred to another corporation, then the term "Corporation" will be construed to include the successor corporation; and the Trustees will receive and hold under this Agreement any shares of the successor corporation received by them as a result of their ownership as trustees of shares held by them under this Agreement before the merger, consolidation, or transfer. Certificates issued and outstanding under this Agreement at the time of the merger, consolidation, or transfer may remain outstanding, but the Trustees may, in their discretion, substitute for these voting certificates new certificates in appropriate form.

ARTICLE 11 MISCELLANEOUS PROVISIONS

11.01. **Necessary Acts.** All parties to this Agreement will perform any acts, including executing any documents, that may be reasonably necessary to fully carry out the provisions and intent of this Agreement.

11.02. **Notices.** All notices, demands, requests, or other communications required or permitted by this Agreement will be in writing and shall be deemed duly served when personally delivered to the party or to an officer or agent of the party, or when deposited in the United States mail, first-class postage prepaid, addressed to the Trustees at _____[*address*], or to a Certificate Holder at the address appearing for him or her on the books and records of the Corporation, or at any other address the party may designate by written notice to the others.

11.03. **Remedies.** The parties will have all the remedies available to them for breach of this Agreement by law or in equity. The parties further agree that in addition to all other remedies available at law or in equity, the parties will be entitled to specific performance of the obligations of each party to this Agreement and immediate injunctive relief. The parties also agree and if an action is brought in equity to enforce a party's obligations, no party will assert as a defense that there is an adequate remedy at law.

11.04. **Attorneys' Fees.** In the event of any litigation concerning this Agreement between the parties to this Agreement or the parties to this Agreement and the estate of any deceased Beneficiary, the prevailing party will be entitled, in addition to any other relief that may be granted, to reasonable attorneys' fees.

11.05. **Binding on Successors and Assigns.** This Agreement will be binding on the parties to the Agreement and on each of their heirs, executors, administrators, successors, and assigns.

11.06. **Severability.** If any provision is unenforceable or invalid for any reason, the remaining provisions will be unaffected by such a holding.

11.07. **Governing Law.** This Agreement will be construed according to and governed by the laws of the State of California.

11.08. **Entire Agreement.** This instrument [*for each exhibit attached, add:* and Exhibit _____] constitutes the entire agreement of the parties, and correctly sets forth the rights, duties, and obligations of each party and of each party to the other. Any prior agreements, promises, negotiations, or representations concerning the Agreement's subject matter not expressly set forth in this Agreement are of no force or effect.

11.09. **Amendment of Agreement.** The Trustees or Certificate Holders must submit any desired amendment to the Certificate Holders for their approval. The proposed amendment must be approved by the affirmative vote of _____[*specify percentage, e.g.*, a majority *or* two-thirds] of the Certificate Holders; and, if so approved, will become a part of this Agreement.

Executed on _____[*date*], at _____[*city*], _____[*county*], California.

THE CERTIFICATE HOLDERS

Signatures	No. Shares Deposited	
_____		_____
____ [*signature*]		_____ [*typed name*]
_____		_____
____ [*signature*]		_____ [*typed name*]
_____		_____
____ [*signature*]		_____ [*typed name*]

THE TRUSTEES
[*Repeat, as required:*]
_____ [*signature*]
[*typed name*]

[*Add, if necessary:*]

EXHIBIT A

[*Attach any separate voting trust certificate form as Exhibit A.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsSecurities RegistrationEstate, Gift & Trust LawTrustsModification & TerminationEstate, Gift & Trust LawTrustsTrusteesDuties & PowersGeneral OverviewSecurities LawExemptions From RegistrationExempt Classes of SecuritiesSecurities LawBlue Sky LawsExempted IssuersBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART IV. FORMS
B. Trust Agreements and Certificates

4-8B California Legal Forms--Transaction Guide § 8B.211

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.211 Voting Trust Certificate

[1] Comment

[a] Use of Form

A voting trust certificate may be incorporated in a voting trust agreement or attached as an exhibit to the agreement. This form is designed to be attached as an exhibit.

[b] Contents of Certificate

The voting trust certificate should incorporate by reference the terms of the voting trust agreement it represents. If the voting trust agreement contains restrictions on the transfer of the certificates, these restrictions should also be incorporated by reference in the certificate. The certificate should recite the number of shares for which it is issued, and each certificate should be numbered.

[c] Execution of Certificate

The certificate should be signed in the same manner as the voting trust agreement [*see § 8B.210[2]*].

[d] Securities Law Considerations

Beneficial interests in voting trusts and voting trust certificates are securities under California law [Corp. Code § 25109] and under federal securities laws. Therefore, the offer and sale of certificates in a voting trust must be qualified or registered unless expressly exempted from qualification or registration. For further discussion of state and federal securities regulations, see *§ 8B.36*.

[2] Form

Voting Trust Certificate

_____ [*name of corporation*]

VOTING TRUST CERTIFICATE NO. _____

This certifies that the undersigned Trustees have received certificates representing _____[*number*] shares of _____[*name of corporation*] (Corporation) from _____[*name of shareholder*]; and that the Trustees hold these shares subject to the terms of a voting trust agreement dated _____, between _____[*names of shareholder*] (Shareholders; also Certificate Holders), each of who owns shares of stock in the Corporation, and _____[*name of trustees*] (Trustees).

This certificate is Exhibit _____ to the voting trust agreement, a copy of which is on file with the secretary of the Corporation.

Rights of Certificate Holders

During the term of the Voting Trust Agreement, the Certificate Holder shall be entitled to rights of ownership of the shares covered by this Certificate only as provided in the Voting Trust Agreement.

Voting Rights of Trustees

During the term of the Voting Trust Agreement, the Trustees shall be entitled to vote the shares covered by this Certificate and to exercise only those rights and powers as provided in the Voting Trust Agreement. No additional voting rights of the shares covered by this Certificate are granted by this Voting Trust Certificate.

Dividends and Distributions

The Certificate Holder shall be entitled to receive, subject to the limitations in the Voting Trust Agreement, all dividends or other distributions of the Corporation received by the Trustees, except that the Trustees shall receive and hold any share dividends according to the terms of the Voting Trust Agreement and shall issue to the Certificate Holder additional Voting Trust Certificates representing any such shares.

[*Add if applicable:*]

Transfer of Certificates

The Voting Trust Certificate shall be subject to the restrictions on transfer applicable to the shares deposited with the Trustees as stated in the Corporation's _____[Voting Trust Agreement dated _____ *or* Buy-Sell Agreement dated _____]. Any transfer shall be on the books of the Trustees or their agent and shall be made only on the surrender of this Certificate by the Certificate Holder or the Certificate Holder's attorney, endorsed to the transferee. The Trustees may treat the registered Certificate Holder, or when presented duly endorsed in blank, the bearer of the Certificate, as the absolute owner of the Certificate, and the Trustees shall not be bound by any

notice to the contrary.

[*CONTINUE*]

Termination

On termination of the Voting Trust Agreement, and subject to the terms of the Agreement, the Trustees shall deliver to the Certificate Holders properly endorsed share certificates representing the number of shares owned by each Certificate Holder. The Certificate Holders shall surrender to the Trustees their properly endorsed voting trust certificates, with an amount of money sufficient to cover any expenses, including taxes, relating to the transfer or deliver of the share certificates or to the administration of the Trustees' duties, not previously reimbursed.

Executed on _____[*date*], at _____[*city*], _____[*county*], California.

THE TRUSTEES
[*Repeat, as required:*]
_____ [*signature*]
[*typed name*]

[*If an assignment form is desired, add the following on the reverse side of voting trust certificate:*]

For value received, the undersigned sells, assigns, and transfers to _____[*name of assignee*] this voting certificate and the interests it represents, and directs that this certificate be transferred on the books of the Trustees.
_____ Dated:

_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawExemptions From RegistrationGeneral OverviewSecurities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawBlue Sky LawsExempted IssuersBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsSecurities LawBlue Sky LawsExcluded Transactions



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART IV. FORMS
B. Trust Agreements and Certificates

4-8B California Legal Forms--Transaction Guide § 8B.212

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.212 Voting Trust Provisions--Limitations on Trustees' Voting Power

[1] Comment

[a] Use of Form

Voting trustees are record holders of shares in the trust. Therefore, they or their proxies are exclusively entitled to vote the shares on all questions [*Corp. Code §§ 702(a), 706(b)*].

Provisions governing the voting rights of trustees are among the most important provisions in a voting trust agreement. These provisions should be explicit regarding the trustee's voting powers. If there any limitations on those voting powers, the limitations should be specifically noted in the agreement. This form provides alternative provisions limiting the voting powers of the voting trustees and is designed for use in a voting trust agreement. Limitations on the voting powers of trustees are discussed further in § 8B.38[2].

[b] Methods of Limiting Voting Power

A voting trust agreement frequently confers broad voting powers on the trustee. A typical provision grants the trustees the voting powers that the shareholders are entitled to exercise at any shareholders' meeting, without requiring consultation with or approval by the voting trust certificate holders. There are, however, various methods of permitting the certificate holders to have some control over the voting of the shares, including the following:

- Authorizing the trustees, in their discretion, to call a meeting of the trust certificate holders to ascertain their wishes on particular questions [*see* [2], *below*].

- Authorizing the trustees to vote the shares in any manner unless directed otherwise by the certificate holders [*see* [2], *below*].

- Authorizing the trustees to vote only on particular questions (e.g., the election of directors) without the direction of certificate holders, who will determine how the shares will be voted on all other matters [*see* [2], *below*].

- Prohibiting the trustees from voting on certain specific proposals (e.g., extraordinary or fundamental changes) without obtaining the vote of a certain percentage of certificate holders [*see* [2], *below*].

- Prohibiting the trustees from voting on any proposal without the direction of a certain percentage of certificate holders [*see* [2], *below*].

[2] Form

Voting Trust Provisions--Limitations on Trustees' Voting Power

VOTING TRUST PROVISIONS--LIMITATIONS ON TRUSTEES' VOTING POWERS

[*Choose one of the following:*]

_____. **Approval of All Votes.** At all shareholders' meetings, the Trustees will vote the shares held by them in the manner designated by the affirmative vote or written consent of the Certificate Holders representing at least _____[*specify percentage, e.g.,* a majority *or* two-thirds] of the outstanding shares of stock held in the Voting Trust.

[*OR*]

_____. **Approval of Election of Directors.** At all elections of directors, the Trustees will vote the shares held by them for the election of the persons designated by the affirmative vote or written consent of the Certificate Holders representing at least _____[*specify percentage, e.g.,* a majority *or* two-thirds] of the outstanding shares of stock held in this Voting Trust.

[*OR*]

_____. **Approval of All Votes Other Than Election of Directors.** The Trustees will have the power to vote for the election of directors of the Corporation, but for all other matters arising at any meeting of shareholders, the Trustees will vote the shares held in their names in the manner determined by the Certificate Holders representing at least _____[*specify percentage, e.g.,* a majority *or* two-thirds] of the shares of stock held in the Voting Trust.

[*OR*]

_____. **Approval of Specific Proposals.** The Trustees will not vote the shares held by them on any of the following proposals without obtaining the vote or written consent of at least _____[*number*] percent of the Certificate Holders approving the vote:

(1) A proposal to sell, lease, convey, exchange, transfer, or otherwise dispose of all or substantially all of the property or assets of the Corporation.

(2) A proposal to merge or consolidate with another corporation, domestic or foreign.

(3) A proposal to amend the articles of incorporation.

(4) A proposal to wind up and dissolve the Corporation.

(5) A proposal to adopt a plan of distribution of shares, securities, or any consideration other than money in the process of winding up.

[*OR*]

ARTICLE _____
MEETINGS CALLED BY TRUSTEES TO OBTAIN OPINION OF CERTIFICATE HOLDERS

_____.01. **Purpose of Meetings.** If the Trustees desire the opinion of the Certificate Holders on a particular issue, they may call a meeting for that purpose, as provided in Section _____.02 of this Agreement. At this meeting, the owners of at least _____[*specify percentage, e.g.,* a majority *or* two-thirds] of the shares subject to this Agreement may determine how they desire the Trustees to act; and the Trustees will be bound to act on that issue in the manner designated. The Trustees, however, will be fully indemnified against any loss, damage, claim, or injury to which they might be subjected as a result of any action taken at the direction of the Trustees under this Agreement.

_____.02. **Notice of Meeting.** Written notice of each meeting between Trustees and Certificate Holders must be given to each Certificate Holder not less than 10 nor more than 60 days prior to the date of the meeting. The notice must state the place, date, and hour of the meeting and the general nature of the business to be transacted. No business other than that specified in the notice may be transacted. Notice may be given either personally or by mail or by other means of written communication, addressed to the Certificate Holder at his or her address as it appears on the records of the Trustees or as given by the Certificate Holder to the Trustees for the purpose of notice. The notice will be deemed to have been given when delivered personally or deposited in the mail or sent by other means of written communication.

_____.03. **Waiver of Notice.** Waiver of notice is permitted and the transactions of any such meeting of Certificate Holders are valid, if a quorum is present either in person or by proxy, and if, either before or after the meeting, each of the persons entitled to vote, not present in person or by proxy, signs a written waiver of notice or a consent to the holding of the meeting or an approval of the meeting's minutes.

_____.04. **Consent to Action Without Meeting.** Any action of the Certificate Holders may be taken without a meeting and without prior notice if a consent in writing, setting forth the actions taken, is signed by the Certificate Holders having not less than the minimum number of votes necessary to authorize or take this action at a meeting at which all Certificate Holders entitled to vote were present and voted.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesEstate, Gift & Trust LawTrustsTrusteesDuties & PowersGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsEstate, Gift & Trust LawTrustsTrusteesDuties & PowersLimitationsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8B VOTING AGREEMENTS AND VOTING TRUSTS
PART IV. FORMS
B. Trust Agreements and Certificates

4-8B California Legal Forms--Transaction Guide § 8B.213

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8B.213 Voting Trust Extension Agreement

[1] Comment

[a] Use of Form

This form is a voting trust extension agreement. A voting trust is limited to a term not exceeding 10 years [*Corp. Code § 706(b)*]. However, at any time within two years prior to the trust's expiration date, one or more beneficiaries under the voting trust agreement, by written agreement and with the written consent of the voting trustee or trustees, may extend the duration of the voting trust with respect to their shares for an additional term not exceeding 10 years from the expiration date of the trust as originally fixed or as last extended according to this procedure [*Corp. Code § 706(b)*]. For further discussion of the extension of a voting trust agreement, see *§ 8B.35[1]*.

[b] Filing Duplicate With Corporate Secretary

A duplicate of any extension must be filed with the secretary of the corporation and is open to inspection by a shareholder, a holder of a voting trust certificate, or the agent of either, on the same terms as the record of shareholders of the corporation is open to inspection [*Corp. Code § 706(b)*].

[2] Form

Voting Trust Extension Agreement

_____ [*name of corporation*]

EXTENSION AGREEMENT

THIS AGREEMENT, dated _____, is between _____[*names of voting certificate holders*] (Certificate Holders) and _____[*names of voting trustees*] (Trustees) and relates to shares of stock of _____[*name of corporation*] (Corporation) held in trust under the Voting Trust Agreement dated _____ (Voting Trust Agreement).

Extension of Term

The undersigned Certificate Holder(s) agree to extend the duration of the Voting Trust Agreement for an additional period of _____[*period not exceeding 10 years*] with respect to the number of shares of the Corporation set forth opposite each Certificate Holder's name below.

Amendment of Voting Trust Agreement and Certificate

The Voting Trust Agreement and the Voting Trust Certificate _____[set forth in *or* attached to] it are deemed amended to reflect this extension of term of the Voting Trust Agreement.

Delivery of Certificates Not Covered by Extension Agreement

The Trustee(s) will deliver to [each of] the undersigned Certificate Holder(s) the shares certificates, if any, presently on deposit with the Trustee(s) with respect to which the Voting Trust Agreement is not extended, on surrender to the Trustee(s) of the properly endorsed Voting Trust certificate(s) representing those shares.

Legend on Voting Trust Certificates

The Certificate Holder(s) to whom the extension applies will make all _____[his *or* her *or* their] Voting Trust Certificate(s) available to the Trustee(s), and the Trustee(s) will endorse the following legend on each Certificate:

"BY EXTENSION AGREEMENT DATED _____, THE VOTING TRUST AGREEMENT REFERRED TO IN THIS VOTING TRUST CERTIFICATE WAS EXTENDED FOR AN ADDITIONAL PERIOD OF _____ [*specify time period*], ENDING _____ [*date*]."

Filing With Corporation

The Trustee(s), prior to the expiration of the Voting Trust Agreement, will file with the secretary of the Corporation a duplicate of this Extension Agreement.

Executed on _____[*date*], at _____[*city*], _____[*county*], California.

THE
CERTI-
FICATE
HOLD-

ERS

Signatures	No. Shares Deposited
_____ ____ [*signature*]	_____ _____ [*typed name*]
_____ ____ [*signature*]	_____ _____ [*typed name*]
_____ ____ [*signature*]	_____ _____ [*typed name*]

CONSENT OF TRUSTEES

The undersigned Trustees under the Voting Agreement consent to this Extension Agreement.

Executed on _____[*date*], at _____[*city*], _____[*county*], California.

THE TRUSTEES
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsEstate, Gift & Trust LawTrustsModification & Termination



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS

4-8C California Legal Forms--Transaction Guide 8C.syn

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.syn Synopsis to Chapter 8C: CLOSE CORPORATION SHAREHOLDER AGREEMENTS

§ 8C.01 California Sources

[1] Statutes

[2] Regulations

§ 8C.02 Federal Sources

[1] Statutes

[2] Regulations

§ 8C.03 Rules of Professional Conduct

[1] American Bar Association Model Rules of Professional Conduct

[2] California Rules of Professional Conduct

§ 8C.04 [Reserved]

§ 8C.05 Law Reviews and Periodicals

§ 8C.06 Annotations

§ 8C.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 8C.08-8C.09 [Reserved]

§ 8C.10 Shareholder Agreement Defined

§ 8C.11 Purpose of Shareholder Agreements

§ 8C.12 Effect of Shareholder Agreement

§ 8C.13 Management Alternatives to Shareholder Agreements

[1] In General

[2] Shareholder Agreement and Voting Agreement Distinguished

[3] Shareholder Agreement and Management Agreement Distinguished

§ 8C.14 Matters Regulated by Shareholder Agreements--In General

[1] Permissible Provisions

[2] Impermissible Provisions

[3] Commonly Regulated Matters

§ 8C.15 Provisions Regulating Corporate Management

[1] In General

[2] Providing Veto Power Through Supermajority Voting

[3] Providing Additional Voting Rights

[4] Disproportionate Voting Rights and Subchapter S Considerations

[5] Delegating Management Functions

§ 8C.16 Provisions Designating Corporate Officers and Setting Employment Terms

§ 8C.17 Provisions Controlling Division of Profits

[1] Regulating Dividend Payments and Distributions of Corporate Profits and Assets

[2] Statutory Limitations on Distributions

[a] In General

[b] Retained Earnings Test

[c] Remaining Assets Test

[d] Solvency Test

[e] Liquidation Preference and Dividend Preference Tests

[3] Disguised Dividends

[4] Unequal Division of Profits

[a] Subchapter S Status Destroyed

[b] Small Offering Exemption Unavailable

§ 8C.18 Provisions Controlling Dissolution Distributions

[1] In General

[2] Subchapter S Considerations

[3] Small Offering Exemption Unavailable

§ 8C.19 Provisions Governing Merger and Reorganization

§ 8C.20 Provisions Restricting Share Transfer

[1] In General

[2] Scope of Transfer Restrictions

[3] S Corporation Considerations

§ 8C.21 Provisions to Avoid Dissension and Deadlock

[1] Buyouts

[2] Voluntary Dissolution

[3] Arbitration

§ 8C.22 Provisions to Protect Minority Shareholders From Unwanted Partners

§§ 8C.23-8C.29 [Reserved]

§ 8C.30 Binding Transferees of Shares

§ 8C.31 Modifying the Agreement; Securities Considerations

§ 8C.32 Remedies for Breach of Agreement

§§ 8C.33-8C.39 [Reserved]

§ 8C.40 Shareholder Liability Under Agreement

§§ 8C.41-8C.99 [Reserved]

§ 8C.100 Client Interview

[1] Facts

[a] Each Shareholder

Scope

[b] The Corporation

Scope

[2] Documents

[a] Each Shareholder

Scope

[b] The Corporation

Scope

§§ 8C.101-8C.109 [Reserved]

§ 8C.110 Identifying Conflicts of Interest

§ 8C.111 Determining Scope of Work to Be Performed by Attorney

Scope

§ 8C.112 Selecting Appropriate Type of Agreement

Scope

§ 8C.113 Checklist of Statutory Provisions That May Not Be Altered or Waived by Agreement

Scope

§§ 8C.114-8C.119 [Reserved]

§ 8C.120 Statutory Requirements for Form of Shareholder Agreement

Scope

§§ 8C.121-8C.129 [Reserved]

§ 8C.130 Binding Transferees of Shares

Scope

§ 8C.131 Securities Considerations

Scope

§ 8C.132 S Corporation Considerations

Scope

§§ 8C.133-8C.199 [Reserved]

§ 8C.200 Shareholder Agreement Providing for Management of Corporation, Employment of Shareholders, Restriction on Stock Transfers, and Noncompetition

[1] Comment

[a] Use of Form

[b] Statutory Requirements Related to Form of Agreement

[c] Whether to Include Provisions in Shareholder Agreement or in Articles or Bylaws

[d] Board of Directors

[e] S Corporation Considerations

[f] Employment of Shareholders

[g] Regulating Dividend Payments and Distributions of Corporate Profits and Assets

[h] Dissolution

[i] Restrictions on Voluntary Dissolution

[ii] Distribution of Assets on Dissolution

[i] Restrictions on Transfer; Share Buy-Sell Provisions

[j] Noncompetition; Trade Secrets

[k] Spousal Consent

[2] Form

Shareholder Agreement Providing for Management of Corporation, Employment of Shareholders, Restriction on Stock Transfers, and Noncompetition OA

§ 8C.201 Shareholder Agreement for Sole Shareholder Close Corporation

[1] Comment--Use of Form

[2] Form

Shareholder Agreement for Sole Shareholder Close Corporation

§ 8C.202 Provisions Ensuring S Corporation Tax Treatment

[1] Comment--Use of Form

[2] Form

Provisions Ensuring S Corporation Tax Treatment

§ 8C.203 Spousal Consent to Shareholder Agreement

[1] Comment

[a] Use of Form

[b] Importance of Characterization of Stock as Community, Quasi-Community, or Separate Property Interests

[c] Management and Control of Community Personal Property

[d] Ethical Considerations

[2] Form

Spousal Consent to Shareholder Agreement

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Practice Consultant

FOOTNOTES:

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144 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS

4-8C California Legal Forms--Transaction Guide Scope

AUTHOR: Marilyn E. Minger Practice Consultant

Scope

Marilyn E. Mingern*
Practice Consultant Scope

This chapter examines the fundamental rules applicable to statutory shareholder agreements for close corporations. It discusses the nature and purposes of shareholder agreements, typical matters regulated by these agreements, and statutory provisions that may not be waived or altered by shareholder agreements. It discusses management alternatives to shareholder agreements, distinguishing shareholder agreements from voting and management agreements. The chapter covers implementation of shareholder agreements, including binding transferees of shares covered by the agreement and securities considerations in modifying the agreement. It briefly discusses shareholder liability under the agreement.

The Transaction Guide covers the ethical considerations that arise when an attorney drafts or reviews a shareholder agreement, and the conflicts of interest the attorney must avoid. It contains a checklist of typical provisions and a checklist of impermissible provisions.

Forms include a shareholder agreement providing for management of the corporation, employment of the shareholders, restriction on stock transfers, and noncompetition, and a shareholder agreement providing for the management of the business of a close corporation by the corporation's sole shareholder. Also included are provisions ensuring S corporation tax treatment, and a form for spousal consent to the shareholder agreement.

Voting trusts and agreements are covered in Ch. 8B, *Voting Trusts and Agreements* . Nonstatutory shareholder agreements are discussed in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 62.02[2] (Matthew Bender). Buy-sell agreements for small, closely held corporations are discussed in Ch. 8D, *Buy-Sell Agreements* .

FOOTNOTES:
(n26)Footnote *. Marilyn E. Minger is a sole practitioner in Oakland, California, specializing in business law, personal injury, bankruptcy, and probate. Ms. Minger formerly worked for Heller, Ehrman, White & McAuliffe and Pettit & Martin in San Francisco, where she practiced corporate law.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8C California Legal Forms--Transaction Guide § 8C.01

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.01 California Sources

[1] Statutes

Arbitration statutes. *Code Civ. Proc. § 1280 et seq.*

"Approval of outstanding shares" defined. *Corp. Code § 152*.

"Approval of shareholders" defined. *Corp. Code § 153*.

Close corporation defined; election, revocation, and involuntary loss of close corporation status. *Corp. Code § 158*.

"Distribution to shareholders" defined. *Corp. Code § 166*.

"Shareholder agreement" defined. *Corp. Code § 186*.

"Written and in writing" defined. *Corp. Code § 195*.

Optional provisions in shareholder agreements. *Corp. Code § 204*.

Requirements for shareholder agreement. *Corp. Code § 300(b)*.

Statutory provisions that may not be altered or waived by shareholder agreement. *Corp. Code § 300(c)*.

Shareholder liability for corporate obligations under shareholder agreement. *Corp. Code § 300(d), (e)*.

Removal of directors without cause. *Corp. Code § 303*.

Indemnification of corporate agents. *Corp. Code § 317*.

Required legend on share certificates regarding transfer restrictions. *Corp. Code § 418(a)(1), (c)*.

Consent of holder of legended certificates not to transfer shares illegally. *Corp. Code § 421*.

Financial tests required for corporate distributions. *Corp. Code §§ 500-503*.

Exception from distribution financial tests for redemption of deceased shareholder's shares. *Corp. Code § 503.1*.

Exception from distribution financial tests for redemption of disabled shareholder's shares. *Corp. Code § 503.2*.

Voting agreement among shareholders of close corporation. *Corp. Code § 706*.

Required approval of shareholders for mergers or other reorganizations. *Corp. Code §§ 1111, 1201(e)*.

Corporate records and reports. *Corp. Code § 1500 et seq.*

Inspection rights of shareholders and directors. *Corp. Code § 1600 et seq.*

Involuntary dissolution of corporation. *Corp. Code § 1800 et seq.*

Recovery of improper corporate distributions. *Corp. Code §§ 2009-2011*.

Criminal sanctions. *Corp. Code § 2200 et seq.*

Sale of securities defined. *Corp. Code § 25017(a)*.

Limited offering exemption. *Corp. Code § 25102(f)*.

Small offering exemption. *Corp. Code § 25102(h)*.

Issuer transaction securities qualification requirements. *Corp. Code § 25110*.

S corporation income tax treatment. *Rev. & Tax. Code § 23800 et seq.*

[2] Regulations

"Limited offering qualification" defined. *10 Cal. Code Reg. § 260.001(e)*.

"Open qualification" defined. *10 Cal. Code Reg. § 260.001(f)*.

Changes effected through shareholder agreements. *10 Cal. Code Reg. § 260.017.2*.

Change in close corporation status. *10 Cal. Code Reg. § 260.017.3*.

One class of stock. *10 Cal. Code Reg. § 260.102.4*.

Regulation of transfer restrictions imposed by charter documents. *10 Cal. Code Reg. § 260.140.8*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8C California Legal Forms--Transaction Guide § 8C.02

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.02 Federal Sources

[1] Statutes

Exempted securities. *15 U.S.C. § 77c(a)*.

Security defined. *15 U.S.C. § 78c(a)(10)*.

Income tax deduction for reasonable compensation. *I.R.C. § 162(a)(1)*.

Subchapter S corporations. *I.R.C. § 1361* et seq.

[2] Regulations

Compensation for personal services. *Treas. Reg. § 1.162-7*.

Treatment of excessive compensation. *Treas. Reg. § 1.162-8*.

Classes of stock; determination whether stock confers identical rights to distribution and liquidation proceeds. *Treas. Reg. § 1.1361-1(l)(1), (2)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8C California Legal Forms--Transaction Guide § 8C.03

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.03 Rules of Professional Conduct

[1] American Bar Association Model Rules of Professional Conduct

Competence. A.B.A. Model Rules Prof. Cond., Rule 1.1.

Scope of responsibility. A.B.A. Model Rules Prof. Cond., Rule 1.2.

Diligence. A.B.A. Model Rules Prof. Cond., Rule 1.3.

Communication. A.B.A. Model Rules Prof. Cond., Rule 1.4.

Fees. A.B.A. Model Rules Prof. Cond., Rule 1.5.

Confidentiality of information. A.B.A. Model Rules Prof. Cond., Rule 1.6.

Conflict of interest: general rule. A.B.A. Model Rules Prof. Cond., Rule 1.7.

Conflict of interest: prohibited transactions. A.B.A. Model Rules Prof. Cond., Rule 1.8.

Conflict of interest: former client. A.B.A. Model Rules Prof. Cond., Rule 1.9.

[2] California Rules of Professional Conduct

Rules of professional conduct in general. Cal. Rules *Prof. Cond., Rule 1-100*.

Failing to act competently. Cal. Rules *Prof. Cond., Rule 3-110*.

Avoiding adverse interests. Cal. Rules *Prof. Cond., Rule 3-300*.

Avoiding representation of adverse interests. Cal. Rules *Prof. Cond., Rule 3-310*.

Communication. Cal. Rules *Prof. Cond., Rule 3-500*.

Organization as client. Cal. Rules *Prof. Cond., Rule 3-600*.

Fees for legal services. Cal. Rules *Prof. Cond., Rule 4-200*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8C California Legal Forms--Transaction Guide § 8C.04

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[Reserved]

§ 8C.04[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8C California Legal Forms--Transaction Guide § 8C.05

AUTHOR: Marilyn E. Minger Practice Consultant

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8C California Legal Forms--Transaction Guide § 8C.06

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.06 Annotations

Annot., Validity of Stockholders' Agreement Allegedly Infringing on Directors' Management Powers-- Modern Cases, 15 A.L.R.4th 1078 (1982) .

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8C California Legal Forms--Transaction Guide § 8C.07

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.07 Text References

[1] Matthew Bender Sources

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CALIFORNIA LEGAL FORMS (Matthew Bender).

Ch. 1A, *Role of Counsel in Starting a New Business*.

Ch. 1B, *Selecting Form of Business Entity*.

Ch. 1E, *Taxation of Businesses*.

Ch. 2, *Formation of Corporations*.

Ch. 2B, *Electing Subchapter S Status*.

Ch. 3 *Articles of Incorporation*.

Ch. 6, *Securities Regulation Issues*.

Ch. 8D, *Buy-Sell Agreements*.

Ch. 9, *Dividends, Reacquisition of Shares, and Assessments*.

Ch. 12A, *Professional Corporations*.

Ch. 85, *Employment Contracts*.

Cavitch, BUSINESS ORGANIZATIONS (Matthew Bender).

Ch. 108, *Distributions of Corporate Control*.

Ch. 108A, *Appendix*.

Ch. 114, *Shareholder Agreements*.

Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 15, *Shareholders' Agreements* (Matthew Bender).

[2] Additional Text References

Report of Assembly Select Committee on the Revision of the Corporate Code (Dec. 1, 1975).

Witkin, Summary of California Law, vol. 9, *Corporations*, §§ 139-149, 231-239 (10th ed. 2005).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8C California Legal Forms--Transaction Guide §§ 8C.08-8C.09

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8C.08[Reserved]



153 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
A. Nature and Purpose of Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.10

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.10 Shareholder Agreement Defined

A shareholder agreement is a written agreement among all of the shareholders of a statutory close corporation [*see Corp. Code § 158* ("close corporation" requires provision in articles limiting shareholders to 35 and specifically identifying corporation as close corporation)] relating to the affairs and management of the corporation [*Corp. Code §§ 186, 204(a), 300(b)*; *see §§ 8D.13-8D.20*]. If the close corporation has only one shareholder, the shareholder agreement is between the shareholder and the corporation [*Corp. Code § 186*].

PRACTICE TIP:

The attorney preparing a shareholder agreement should make clear to the shareholders that the attorney is representing the corporation and not any of the individual shareholders. Because of the potential for conflict over the shareholder agreement the attorney should disclose potential conflicts to the party shareholders and obtain written conflict waivers, which can be done in the shareholder agreement [*see § 8C.110*; *see also Ch. 1A, Role of Counsel in Starting a New Business, §§ 1A.33-1A.37, 1A.113*; for appropriate waiver of conflict forms, *see Ch. 1A, §§ 1A.203[2], 1A.204[2]*]. *Commentary by Marilyn E. Minger*.

The General Corporation Law [*Corp. Code § 300(b)*] provides that no shareholder agreement that relates to any phase of the corporation's affairs will be invalid as between the parties to it on any of the following grounds:

- It relates to the conduct of the affairs of the corporation so as to interfere with the discretion of the directors;

- It is an attempt to treat the corporation as if it were a partnership; or

- It is an attempt to arrange relationships among the shareholders in a manner that would be appropriate only between partners.

Thus, in practice, a shareholder agreement permits shareholders to do the following:

- Manage the close corporation informally, according to the provisions of the agreement, without observing corporate formalities related to director and shareholder meetings [*see also Corp. Code § 300(e)*; and

- Make decisions in areas usually reserved for the board of directors, such as dividend policy [*see* § 8D.16], distribution of assets on liquidation [*see* § 8D.17], selection of officers, and determination of their compensation and tenure [*see Corp. Code § 300(b), (e)*; *see also* § 8D.15].

Unless otherwise provided in the shareholder agreement, the agreement may not be modified, extended, or revoked by less than unanimous agreement of the parties [*Corp. Code § 300(b)*; *see* § 8D.31]. A shareholder agreement terminates when the corporation ceases to be a close corporation, or on the original issuance of shares by the corporation to a new shareholder who does not become a party to the agreement [*Corp. Code § 300(b)*], unless the agreement provides that it will continue to the extent it is enforceable apart from *Corp. Code § 300(b)* [*Corp. Code § 300(b)*].

PRACTICE TIP:

It may be desirable to include a provision requiring review of certain provisions to reflect changed conditions. An example would be a provision requiring buyout prices to be increased based on the success of the business as determined by a quantifiable measure. Such reviewing provisions can be mandated to occur on a certain date or can be triggered by the occurrence of specified events. *Commentary by Marilyn E. Minger.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewLegal EthicsClient RelationsConflicts of InterestBusiness & Corporate LawClosely Held CorporationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
A. Nature and Purpose of Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.11

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.11 Purpose of Shareholder Agreements

Shareholders in close corporations frequently want to manage the corporation in a partnership-like manner, determining among themselves who will manage the corporation's business and how that management will be exercised, while retaining the limitation on personal liability and the other benefits of the corporate form. An important objective in many shareholder agreements is to protect a minority shareholder from the majority's power by giving the minority shareholder a voice in the corporation's management, either as a member of the board of directors or otherwise. Other shareholder agreements protect shareholder-employees by ensuring continued employment, and protect shareholder-investors by assuring a specified return of capital through dividends. A shareholder agreement may provide a mechanism requiring the corporation to buy back a shareholder's shares on the occurrence of certain events such as the shareholder's death, disability or termination of employment. The price for the buy back can be determined by a formula set forth in the shareholder agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
A. Nature and Purpose of Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.12

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.12 Effect of Shareholder Agreement

When the shareholders of a close corporation enter a shareholder agreement that controls the discretion or power of the board of directors with respect to the boards management of corporate affairs the directors are relieved of liability for managerial acts and the liability falls upon the shareholders who are party to the shareholder agreement [*Corp. Code § 300(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
A. Nature and Purpose of Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.13

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.13 Management Alternatives to Shareholder Agreements

[1] In General

Several management alternatives to shareholder agreements exist. These include provisions in the corporation's articles of incorporation for supermajority votes by the corporation's directors or shareholders on various matters [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 61.03[2] (Matthew Bender)]; voting or pooling agreements, and voting trusts [*see* Ch. 8B, *Voting Agreements and Voting Trusts* ; Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 62.04[2] (Matthew Bender); *see also* [2], *below*]. In addition, a corporation's capital structure can be designed to give some shareholders control that is disproportionate to their dollar investment, either by providing for voting and nonvoting shares, or for shares with special voting rights [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 61.03[3] (Matthew Bender)]. This result can also be obtained by issuing debt securities for a portion of the corporation's initial financing, instead of issuing voting shares for that financing [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 61.03[4] (Matthew Bender)].

A group of majority shareholders in a close corporation can also use a holding company, instead of a shareholder voting agreement or voting trust, to consolidate their voting power. Further, shareholders may sometimes find it useful to create a partnership to hold their shares, or, on rare occasions, to cause the corporation to issue stock to several persons to be held jointly.

[2] Shareholder Agreement and Voting Agreement Distinguished

Although voting agreements and shareholder agreements are both agreements among corporate shareholders, a voting agreement differs from a shareholder agreement in three significant respects. First, the use of a voting agreement is not limited to shareholders of a close corporation as is a shareholder agreement [*cf. Corp. Code §§ 300(b), 706(a)*]. Second, a voting agreement may be among less than all of the shareholders [*Corp. Code § 706(a)*]. Third, a voting agreement covers only the exercise of shareholder voting rights [Assem. Select Comm. Rpt. 86 (Dec. 1, 1975)], and does not

change the role of the shareholders with respect to the directors [*see Corp. Code § 300(b)* (this subdivision does not apply to voting agreements authorized by *Corp. Code § 706(a)*)]. Thus, if the shareholders want to limit the powers of the directors, a shareholder agreement, and not a voting agreement, should be used.

[3] Shareholder Agreement and Management Agreement Distinguished

Management agreements are agreements, to which the corporation is a party, under which all or substantial management powers are vested in another corporation or an individual, usually a key executive or creditor [*see Corp. Code § 300(a)*]. Management agreements themselves are distinct from arrangements by the directors under which they delegate part of their functions to an executive committee or to corporate officers [*see Corp. Code §§ 309(b), 312*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawClosely Held CorporationsGeneral Overview



157 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
B. Matters Regulated by Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.14

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.14 Matters Regulated by Shareholder Agreements--In General

[1] Permissible Provisions

A shareholder agreement may contain provisions relating to any phase of the affairs of a close corporation, including, but not limited to, the management of its business, the division of its profits, or the distribution of its assets on liquidation [*Corp. Code § 300(b)*]. As between the parties to the agreement, it may alter or waive all provisions of the General Corporation Law, except those that are specifically exempt from alteration or waiver [*Corp. Code § 300(c)*; *see* [2], *below*].

[2] Impermissible Provisions

A shareholder agreement may not alter or waive the provisions of the General Corporation Law [*Corp. Code § 300(c)*]

- Relating to the attainment and loss of close corporation status [*see Corp. Code § 158*].
- Altering required legends on share certificates [*see Corp. Code §§ 417, 418*].
- Relating to retained earnings, remaining assets and solvency requirements to be met before distributions to shareholders permitted [*see Corp. Code §§ 500-501*].
- Requiring approval of shareholders for mergers or other reorganization [*see Corp. Code §§ 1111, 1201(e)*].
- Relating to the recovery of certain improper distributions [*see Corp. Code § 2009*].
- Relating to the obligation to keep adequate corporate records [*see Corp. Code § 1500 et seq.*], and to the inspection rights of shareholders and directors [*see Corp. Code § 1600 et seq.*].

- Authorizing involuntary dissolution of the corporation [*see Corp. Code § 1800 et seq.*].

- Dealing with criminal sanctions [*see Corp. Code § 2200 et seq.*].

In addition, a shareholder agreement may not alter or waive the required filing under the General Corporation Law of any document with the California Secretary of State [*Corp. Code § 300(c)*].

[3] Commonly Regulated Matters

Matters frequently regulated by shareholder agreements include the following:

- Providing veto power to one or more shareholders [*see § 8D.13[2]*].

- Providing additional voting rights to certain shareholders [*see § 8D.13[3]*].

- Selecting corporate officers and setting their compensation and tenure [*see* § 8D.15].

- Determining the amount of time, if any, that each shareholder will devote to the business [*see § 8D.200[2]*].

- Paying dividends or making other distributions [*see* § 8D.16].

PRACTICE TIP:

To the extent a shareholder agreement provides different rights to different shareholders with regard to dividends and distributions the shareholder agreement has effectively created more than a single class of stock. This renders the corporation ineligible for Subchapter S election and the California small offering exemption under *Corp. Code § 25102(h)* [*see § 8C.17[4]*]. *Commentary by Marilyn E. Minger.*

- Providing for dissolution distributions [*see* § 8D.17].

- Restricting share transfers [*see* § 8D.19].

- Regulating merger and reorganization [*see* § 8D.18].

- Establishing noncompetition requirements and restrictions on use of trade secrets and customer lists [*see § 8D.200[2]*].

- Providing a method of resolving corporate disputes, such as buyout, arbitration, or a procedure for voluntary dissolution, in the case of dissension and deadlock [*see § 8D.20*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsDissolution & Winding UpBusiness & Corporate LawClosely Held CorporationsManagement Duties & Liabilities



158 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
B. Matters Regulated by Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.15

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.15 Provisions Regulating Corporate Management

[1] In General

The California close corporation statute expressly validates shareholder agreements of statutory close corporations that regulate the management of its business [*Corp. Code § 300(b)*].

[2] Providing Veto Power Through Supermajority Voting

One way a shareholder agreement may control the management of a close corporation is by requiring a supermajority or unanimous vote of shareholders or directors [*see* Cavitch, *BUSINESS ORGANIZATIONS, Ch. 108, Distributions of Corporate Control, § 108.05[4][c]* (Matthew Bender)]. This gives each shareholder or director the power to veto management acts proposed by the other shareholders or directors [*see Corp. Code §§ 204(a)(5), (9), 300(c)*]. Thus, for example, a shareholder agreement that provides for a supermajority vote on the removal or election of a director or the voluntary dissolution of the corporation will protect minority shareholders from being ousted from the business, either by removal from the board or by premature termination of the business intended to freeze out minority interests [*see Corp. Code § 300(c)*].

Actions that may be the subject of veto provisions include the following:

- Amending bylaws;
- Paying dividends or making other distributions; Incurring debt;
- Making or guaranteeing loans;
- Setting compensation levels;

- Removing minority shareholders as officers or directors;
- Issuing securities;
- Changing bank signatories; and
- Spending in excess of specified dollar amounts.

For discussion of whether a shareholder agreement that establishes direct shareholder management of the corporation may eliminate the board of directors entirely, with the shareholders assuming the powers, responsibilities, and liabilities of the directors, *see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 62.03[3][c] (Matthew Bender).

[3] Providing Additional Voting Rights

A shareholder agreement may also contain a provision requiring the approval by the shareholders [*see Corp. Code § 153*] or the approval by the outstanding shares [*see Corp. Code § 152*] for any management action, even though approval for such an action is not otherwise required by the General Corporation Law [*Corp. Code § 204(a)(9)*].

[4] Disproportionate Voting Rights and Subchapter S Considerations

To qualify as a Subchapter S corporation, a corporation must have no more than one class of stock [*I.R.C. 1361(b)(1)(D)*]. However, differences in common stock voting rights do not cause a corporation to be treated as having more than one class of stock [*I.R.C. 1361(c)(4)*]. For discussion of the criteria a corporation must meet to be eligible for Subchapter S status, and the tax effect of the election on both the corporation and its shareholders, see Ch. 2B, *Electing Subchapter S Status* .

[5] Delegating Management Functions

In addition to controlling management decisions through a shareholder agreement by providing the shareholders with veto power or additional affirmative voting rights, a shareholder agreement may delegate some or all management functions to one or more shareholders, or to a non-shareholder manager [*see Corp. Code § 300(a)*]. Provisions designating corporate officers and the terms and conditions of their employment are further discussed in *§ 8C.16*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesTax LawFederal Taxpayer GroupsS CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)



159 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
B. Matters Regulated by Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.16

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.16 Provisions Designating Corporate Officers and Setting Employment Terms

Many shareholder agreements in close corporations contain provisions either designating the individuals to serve as corporate officers or granting one or more shareholders the right to name corporate officers. Such an agreement may be necessary in order to hire a key executive, or bring into the business a necessary patent holder. The special close corporation statutes of the General Corporation Law permit shareholders to designate officers by agreement [*see Corp. Code § 300(b), (c)*].

In many close corporations, the shareholders themselves often serve as officers or employees. Shareholders of close corporations often invest significant amounts of money, skill, and time in the business of the corporation and thus, have significant interests in assuring that they will continue to participate in its management and decision-making processes and enjoy the benefits of permanent or long-term employment. Further, if a corporation distributes corporate earnings in the form of salaries, rather than dividends, fair return on the shareholder's investment will necessarily be dependent on continued employment. A minority shareholder has a particular interest in protecting himself or herself against arbitrary salary reductions (or termination) and disproportionate increases in the salaries of other shareholder-employees.

The interests of shareholders as employees or officers may be protected either by an employment agreement or by employment provisions in a shareholder agreement. For discussion of employment agreements in general, see Ch. 85, *Employment Contracts* (Matthew Bender). For discussion of the pertinent provisions of a shareholder agreement that embodies employment provisions, see *§ 8C.200[2]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawClosely Held CorporationsGeneral OverviewLabor & Employment LawEmployment RelationshipsEmployment ContractsGeneral OverviewLabor & Employment LawEmployment RelationshipsEmployment ContractsConditions &

TermsGeneral Overview



160 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
B. Matters Regulated by Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.17

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.17 Provisions Controlling Division of Profits

[1] Regulating Dividend Payments and Distributions of Corporate Profits and Assets

The California close corporation statute expressly authorizes shareholder agreements of statutory close corporations to regulate the declaration and payment of dividends or the division of corporate profits [*Corp. Code § 300(b)*]. The agreement may require corporate profits to be distributed in a manner other than according to the number of shares held by each shareholder [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 62.03[4][a] (Matthew Bender)]. For example, distribution could be based on the amount of time devoted to the corporation's business, the amount of business generated for the corporation, or the agreement could merely specify that one shareholder is to receive a disproportionate share of profits.

[2] Statutory Limitations on Distributions

[a] In General

Although California law authorizes shareholders in close corporations to enter into shareholder agreements to regulate the declaration and payment of dividends or the division of corporate profits [*Corp. Code § 300(b)*; *see* [1], *above*], no shareholder agreement may alter or waive the provisions of the General Corporation Law providing that distributions may be made only if a retained earnings or remaining assets test is met and the distribution does not render the corporation insolvent [*Corp. Code § 300(c)*; *see Corp. Code §§ 500, 501* (distributions to shareholders)].

To make any valid distribution to its shareholders, a corporation must be able to pass either the retained earnings or remaining assets test [*Corp. Code § 500*; *see* [b], [c], *below*], the general solvency test [*Corp. Code § 501*; *see* [d], *below*], and, when applicable, the liquidation preference and dividend preference tests [*Corp. Code §§ 502, 503*; *see* [e], *below*]. However, a corporation licensed as a broker-dealer under *Corp. Code § 25210 et seq.* is not required to pass either the retained earnings or remaining assets test [*see Corp. Code § 500(a), (b)*] if, immediately after any distribution, it is in compliance with the net capital rules of the Commissioner of Corporations [*see 10 Cal. Code Reg. § 260.216.12*]

and the Securities and Exchange Commission [*Corp. Code § 500(e)*; *see 17 C.F.R. § 240.15c3-1*].

For a further discussion of these tests, see *Ch. 9, Dividends, Reacquisitions of Shares, and Assessments, §§ 9.11-9.12,* and Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 8, *Dividends and Reacquisition of Shares* , § 141 (Matthew Bender).

[b] Retained Earnings Test

The retained earnings requirement provides that a corporation may make a distribution if its retained earnings, immediately prior to the distribution, equal or exceed the amount of the proposed distribution [*Corp. Code § 500(a)*]. "Retained earnings" means the balance of net profits, after the deduction of distributions to shareholders and transfer to capital accounts under generally accepted accounting principles [*see Corp. Code § 114*; Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 8. *Dividends and Reacquisition of Shares* , § 141.06[3] (Matthew Bender)].

[c] Remaining Assets Test

A corporation with insufficient retained earnings may still make a distribution if it meets the remaining assets test. This test provides for purchase of shares if both of the following conditions are met, immediately after the distribution:

- Corporate assets (excluding goodwill, capitalized research and development expenses and deferred charges) equal at least 125 percent of corporate liabilities (excluding deferred taxes, deferred income and other deferred credits) [*Corp. Code § 500(b)(1)*], and

- Current assets equal current liabilities. However, current assets must equal 125 percent of current liabilities if the average earnings of the corporation before income taxes and interest expenses were less than the average interest expenses for the two preceding fiscal years [*Corp. Code § 500(b)(2)*].

The second part of this test [*Corp. Code § 500(b)(2)*] does not apply to a corporation that is not required to classify its assets into current and fixed under generally accepted accounting principles [*Corp. Code § 500(b)(2)*].

For the purpose of applying *Corp. Code § 500* to a distribution by a corporation of cash or property in payment for the purchase of its shares [*see § 8C.21[1]*], the corporation must add to its retained earnings all amounts previously deducted from retained earnings upon any repurchase of the corporation's shares and reflected on the corporation's balance sheet. The corporation also must deduct from liabilities all amounts added to liabilities upon any repurchase of the corporation's shares and reflected on the corporation's balance sheet [*see Corp. Code § 500(d)*].

[d] Solvency Test

The solvency test requires that a corporation not make any distribution to the corporation's shareholders if, as a result, the corporation is or would be likely to be unable to meet its liabilities as they mature [*Corp. Code § 501*]. This test must be met even if the corporation satisfies the retained earnings or remaining assets test [*see Flynn v. California Casket Co. (1951) 105 Cal. App. 2d 196, 207, 233 P.2d 131]* .

[e] Liquidation Preference and Dividend Preference Tests

A corporation may not make distributions to junior shares that affect the liquidation or dividend preferences of senior shares [*see Corp. Code §§ 502, 503*].

[3] Disguised Dividends

In a Subchapter S corporation, a shareholder agreement might provide for shareholders to receive monthly draws against their respective share earnings, based on the percentage of shares owned at the end of the fiscal year [*see I.R.C. §§ 1366*-1368 (pass-through of items to shareholders)], whereas many close corporations taxed as C corporations pay salaries to shareholder-employees that minimize corporate income [*see I.R.C. § 162(a)(1)*; *see also § 8C.16*]. However, the amounts claimed as a corporate deduction for compensation must be reasonable in comparison with amount that would ordinarily be paid for like items by similar enterprises under similar circumstances [*I.R.C. § 162*; *Treas. Reg. § 1.162-7(b)(3)* (deductibility of reasonable compensation payments); *Rutter v. Commissioner (1986) 52 T.C.M. 326, 337-339, T.C. Memo. 1986-407* (excessive executive compensation treated as dividend when paid to shareholder-employee)].

The Internal Revenue Service may question salary or draw arrangements that appear to be a means of distributing profits rather than payments for services [*see, e.g., O.S.C. & Associates Inc. v. C.I.R. (9th Cir. 1999) 187 F.3d 1116, 1120-1121* (deductions for payments to shareholder-employees of closely held corporation, ostensibly as compensation for services, disallowed as disguised dividends); *Elliotts, Inc. v. C.I.R. (9th Cir. 1983) 716 F.2d 1241, 1243* ; *see also Labelgraphics, Inc. v. Commissioner (9th Cir. 2000) 221 F.3d 1091, 1100* (five-factor test set forth in *Elliotts, Inc. v. C.I.R.*, used to determine amount of reasonable, deductible compensation, was properly applied to bonus paid to president of closely held, single-shareholder corporation)]. Similarly, bonus payments that are not tied to a preset formula, that are distributed in proportion to share holdings, and that reduce the corporation's taxable income to zero may be viewed as disguised dividends, even though the total amount received by the shareholder is admittedly reasonable as salary [*Nor-Cal Adjusters v. C.I.R. (9th Cir. 1974) 503 F.2d 359, 362]* .

[4] Unequal Division of Profits

[a] Subchapter S Status Destroyed

A corporation does not qualify under the Internal Revenue Code as an S corporation if it has more than one class of shares outstanding [*I.R.C. § 1361(b)(1)(D)*].

When one share is not identical to every other share with respect to control, profits, and assets of the corporation, the corporation is considered to have more than one class of shares outstanding [*see Treas. Reg. § 1.1361-1(l)(1), (2)*]. A corporation is not treated as having more than one class of stock, however, solely because there are differences in voting rights among shares of common stock [*I.R.C. 1361(c)(4)*; *see § 8C.16[4]*]. Thus, an agreement that provides for the division of corporate profits among shareholders other than according to their respective shareholdings appears to destroy the corporation's S corporation status for income tax purposes [*see Treas. Reg. § 1.1361-1(l)(2)*; *Parker Oil Co. v. Commissioner (1972) 58 T.C. 985, 990* ; *see also* Blau, *Shareholder Agreements and the Single Class of Stock Requirement, 68 J. Tax'n 238 (1988)*].

[b] Small Offering Exemption Unavailable

For a corporation's shares to be exempt from the qualification requirements of the Corporate Securities Law [*Corp. Code § 25000 et seq.*] under the small offering exemption [*Corp. Code § 25102(h)*], the corporation must have only one class of shares [*Corp. Code § 25102(h)*]. A shareholder agreement that provides for different distributions of corporate profits for different shares will prevent the corporation from issuing its shares under the small offering exemption [*10 Cal. Code Reg. § 260.102.4(b)*]. The limited offering exemption [*Corp. Code § 25102(f)*], however, contains no requirement that the corporation have only one class of shares, and, thus, may be available when the small offering exemption is not because a shareholder agreement creates additional classes of shares.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesConstructive DividendsBusiness &

Corporate LawClosely Held CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsEarnings & Profits (IRC secs. 312, 316)General OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)General OverviewTax LawFederal Taxpayer GroupsS CorporationsDistributions (IRC secs. 1361, 1368)Tax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
B. Matters Regulated by Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.18

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.18 Provisions Controlling Dissolution Distributions

[1] In General

Although the articles of incorporation ordinarily must either set forth the shareholders' rights and preferences, or grant authority to the board of directors to determine the shareholders' rights and preferences, on dissolution [*see Corp. Code § 202(e)(3)*], California close corporations may regulate the distribution of their assets on dissolution [*Corp. Code § 300(b)*]. A shareholder agreement, however, may not waive or alter the statutory provisions [*Corp. Code § 300(c)*]:

- Relating to the recovery of improper corporate distributions made during winding up of the corporate affairs after dissolution [*Corp. Code § 2009*].

- Regulating the obligations of a dissolved corporation while winding up its affairs [*Corp. Code § 2010*].

- Authorizing suits against shareholders on causes of action against the corporation arising before dissolution [*Corp. Code § 2011(a)(1)(B)*].

In addition, an agreement may not waive or alter any of the provisions of the General Corporation Law [*Corp. Code § 1800 et seq.*] relating to involuntary dissolution [*Corp. Code § 300(c)*].

[2] Subchapter S Considerations

A shareholder agreement that gives shareholders unequal rights in the corporation's assets on dissolution and provides for liquidation rights different from a shareholder's dividend rights, other than according to their respective share holdings, appears to violate the single class of stock requirement [*see I.R.C. § 1361(b)(1)(D)*; *Treas. Reg. § 1.1361-1(l)(1), (2)*] and, therefore, may destroy the corporation's S status for income tax purposes [*see* Blau, *Shareholder Agreements and the Single Class of Stock Requirement, 68 J. Tax'n 238 (1988)*; *see also § 8C.17[4][a]*].

[3] Small Offering Exemption Unavailable

A shareholder agreement giving shareholders of a new corporation different rights in the corporation's assets on dissolution will prevent the corporation from issuing its shares under the small offering exemption [*see 10 Cal. Code Reg. § 260.102.4(b)*]. The limited offering exemption [*Corp. Code § 25102(f)*], however, should apply in most cases. For further discussion of these exemptions and the qualification of securities in general, see Ch. 6, *Securities Regulation Issues* , Ch. 6B, *California Limited Offering Exemptions* , and Ch. 6C, *California Small Offering Exemption* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsS CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsDistributions (IRC secs. 1361, 1368)Business & Corporate LawClosely Held CorporationsDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
B. Matters Regulated by Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.19

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.19 Provisions Governing Merger and Reorganization

Absent a contrary provision in the corporation's articles of incorporation or in a shareholder agreement, approval of a merger or reorganization must be by two thirds of each class of outstanding shares when the surviving corporation is not a close corporation, or when the reorganization will result in the shareholders of a close corporation receiving shares in a non-close corporation [*Corp. Code §§ 1111, 1201(e)*]. The articles or a shareholder agreement, however, may reduce the required vote for termination of close corporation status by merger or reorganization to a majority of the outstanding shares of each class or may increase that vote up to 100 percent [*Corp. Code §§ 204(a)(5), 300(c), 1111, 1201(e)*].

For further discussion of mergers and reorganizations, see Ch. 11, *Merger and Acquisition Issues* , and CALIFORNIA FORMS OF PLEADING AND PRACTICE, Ch. 169, *Corporations: Reorganizations* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewBusiness & Corporate LawClosely Held CorporationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
B. Matters Regulated by Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.20

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.20 Provisions Restricting Share Transfer

[1] In General

Although share transfer restrictions are not enumerated in the close corporation statute as an appropriate subject of a shareholder agreement [*see Corp. Code § 300(b)*], transfer restrictions are commonly included. A shareholder agreement, filed with the secretary of the corporation, is binding on all transferees with actual knowledge of the agreement or whose share certificates contain a legend giving notice of the existence of the agreement [*Corp. Code § 300(b)*; *see Corp. Code § 418* (additional required restrictions on certificates)].

[2] Scope of Transfer Restrictions

The following are typically restricted transfers:

- Lifetime transfers by sale or gift to outsiders.
- Lifetime transfers between shareholders.
- Transfers by will.
- Transfers by intestacy.
- Transfers through operation of law, including voluntary and involuntary alienation (an encumbrance or judicial sale, for example).

In addition to a proposed transfer, shares may be subject to the restriction that the shareholder continue to be employed by the corporation. Thus, if a shareholder-employee is terminated, either involuntarily or voluntarily, the transfer restriction may require sale of the shareholder's shares to the corporation, to the other shareholders, or to a combination

of the two. Buy-sell agreements are discussed in detail in Ch. 8D, *Buy-Sell Agreements* .

[3] S Corporation Considerations

A Subchapter S corporation election may be revoked if shareholders holding more than one half of the corporation's shares on the day on which the revocation is made consent to the revocation [*I.R.C. § 1362(d)(1)(B)*]. Thus, it may be desirable to restrict the transfer of shares to shareholders who will not consent to termination of the S election, to prohibit transfers without prior approval of the remaining shareholders (if consent is expressly related to preserving Subchapter S status), or to provide for the right of first refusal in favor of the shareholders and/or the corporation. Transfer restrictions should also remain in effect at the time of death and should bind an administrator or heir.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Termination (IRC sec. 1362)Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)RequirementsTax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)Business & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
B. Matters Regulated by Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.21

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.21 Provisions to Avoid Dissension and Deadlock

[1] Buyouts

Although buyout arrangements are not enumerated in the close corporation statute as an appropriate subject of a shareholder agreement [*see Corp. Code § 300(b)*], these arrangements, like share transfer restrictions, are often included in shareholder agreements. Buyout arrangements can be an effective way to resolve disputes or deadlock without causing dissolution or otherwise interrupting the corporation's business. A buyout may provide for the right of first refusal to the corporation, the shareholders, or a combination of the two. These kinds of arrangements are discussed in Ch. 8D, *Buy-Sell Agreements* .

[2] Voluntary Dissolution

Although a shareholder agreement may not waive or alter the statutory provisions related to involuntary dissolution [*Corp. Code § 300(c)*], the agreement may contain provisions that alter or waive the statutory right to seek *voluntary* dissolution [*see Corp. Code § 300(c)*]. Thus, the agreement may provide for the dissolution of the corporation in the event of deadlock among the shareholders, or on the happening of certain specified events, different from those that would justify dissolution under the statutes [*see, e.g., Corp. Code § 1900 et seq.*]. Conversely, the agreement may forbid initiation of an action for voluntary dissolution.

[3] Arbitration

Since arbitration is an increasingly popular method of dispute resolution [*see* Cavitch, *BUSINESS ORGANIZATIONS, Ch. 114, Shareholder Agreements, § 114.02[5]* (Matthew Bender)], it is a technique that should be considered in drafting a shareholder agreement. If arbitration produces a workable solution to a deadlock, the dissident shareholders may be spared either abandonment or forced sale of a satisfactory investment. Arbitration may be particularly useful in setting a price for the purchase of shares in a buyout, or in settling disputes regarding voting, employment, of the payment of dividends. For further discussion of the use of arbitration to resolve corporate dissolution and deadlock, see

Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 108A, Close Corporations, § 108A.04[4]* (Matthew Bender). For discussion of arbitration generally, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 65.02[3] (Matthew Bender).

PRACTICE TIP:

Arbitration provisions should include some kind of mechanism for challenging a patently unsupported finding or unfair award. *Commentary by Marilyn E. Minger.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesCivil ProcedureAlternative Dispute ResolutionArbitrationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
B. Matters Regulated by Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.22

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.22 Provisions to Protect Minority Shareholders From Unwanted Partners

Often in a close corporation, shareholders work closely together, and, in many close corporations, the shareholders initially have joined the enterprise because of particular working relationships. To prevent a situation in which the majority shareholder or shareholders sell the majority interest to someone with whom the minority shareholder does not wish to work, a shareholder agreement might contain a provision giving the minority shareholder a right of first refusal when the majority shareholder intends to shell his or her shares or a provision requiring any buyer of the majority shareholder's shares to buy the minority shareholders shares as well.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & Liabilities



166 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
B. Matters Regulated by Shareholder Agreements

4-8C California Legal Forms--Transaction Guide §§ 8C.23-8C.29

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8C.23[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
C. Implementation of Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.30

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.30 Binding Transferees of Shares

A transferee of shares covered by a shareholder agreement is bound by its provisions under the following conditions [*Corp. Code § 300(b)*]:

- The agreement is filed with the secretary of the corporation for inspection by an potential purchaser of shares, and

- Legends on share certificates have given transferee actual notice that there is a shareholder agreement [*Corp. Code § 418(a)*].

A transferee of shares who is bound by the agreement covering the shares becomes liable in the same manner as an original party to the agreement [*Corp. Code § 300(b)*; *see Corp. Code § 300(d)*; *see also § 8C.40*]. The transferor ceases to be bound by the agreement on ceasing to be a shareholder of the corporation [*Corp. Code § 300(b)*].

After a transfer of shares to a transferee bound by an agreement, the agreement may not be modified, extended, or revoked without the transferee's consent, unless the agreement contains a provision to the contrary [*Corp. Code § 300(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
C. Implementation of Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.31

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.31 Modifying the Agreement; Securities Considerations

California permits modification, extension, or revocation of a shareholder agreement by less than unanimous agreement of the parties, if the agreement itself so provides [*Corp. Code § 300(b)*]. However, a modification may be a "sale" of securities under the California Securities Law [*Corp. Code § 25000 et seq.*] if it constitutes a change in the rights, preferences, privileges, or restrictions of or on outstanding securities, including changes of one of the types listed in *Corp. Code § 204(a)*, effected through the adoption, modification, or termination of a provision of a shareholder agreement [*10 Cal. Code Reg. §§ 260.017.2, 260.017.3*; *see Corp. Code § 25017(a)*; *see also Corp. Code § 204(a)* (providing that certain special types of provisions, such as preemptive rights, power of assessment, and supermajority votes, must be in articles to be effective, but permitting such provisions to be effective if embodied in a shareholder agreement)]. Because all sales of shares that are considered securities must either meet federal registration and state qualification requirements, or be eligible for a federal or state exemption [*15 U.S.C. §§ 77c(a)* (exempted securities), 78c(a)(10) (security defined); *Corp. Code §§ 25101-25105* (exempt transactions), 25110 (qualification requirement), 25120 (qualification requirement based on changes in rights, exchanges, mergers), 25130 (qualification requirement by nonissuer)], or not be subject to qualification requirements [*see, e.g., Corp. Code §§ 25100.1, 25101.1, 25102.1*], the requirement of registration and qualification must be addressed whenever a shareholder agreement is modified.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
C. Implementation of Shareholder Agreements

4-8C California Legal Forms--Transaction Guide § 8C.32

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.32 Remedies for Breach of Agreement

Although the breach of a valid shareholder agreement gives rise to an action in contract, an order to pay damages generally is not a satisfactory remedy because the damages are often speculative. Moreover, the injuries resulting from the breach may be injuries to the corporation, rather than to the shareholder litigants. Accordingly, suits based on shareholder agreements are much more likely to result in an injunction or a judicial order for specific performance than in a judgment for damages.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesContracts LawRemediesSpecific PerformanceContracts LawBreachGeneral Overview



170 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
C. Implementation of Shareholder Agreements

4-8C California Legal Forms--Transaction Guide §§ 8C.33-8C.39

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8C.33[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
D. Shareholder Liability Under Agreement

4-8C California Legal Forms--Transaction Guide § 8C.40

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.40 Shareholder Liability Under Agreement

A shareholder in a close corporation in which the discretion and powers of the board are controlled by a shareholder agreement and the shareholder is a party to the agreement, is subject to personal liability for managerial acts performed or omitted by that shareholder [*Corp. Code § 300(d)*]. In that case, any directors of the corporation are relieved of liability for such actions [*Corp. Code § 300(d)*].

This does not mean, however, that a shareholder in a close corporation operated under a shareholder agreement is personally liable for the debts of the corporation. A corporation exists as a separate legal entity, independent of its directors, officers, and shareholders [*see Corp. Code § 200(c)*]. As a separate legal entity, a corporation is liable for its own obligations [*see Corp. Code § 204(a)*], and its directors, officers, and shareholders ordinarily are not liable for corporate debts and other obligations [*see Corp. Code § 309(c)*]. In fact, the failure of a close corporation to observe corporate formalities relating to directors' and shareholders' meetings in connection with the management of its affairs, as provided in a shareholder agreement, will not be considered a factor tending to establish that the shareholders have personal liability for corporate actions [*Corp. Code § 300(e)*].

Shareholders who undertake to exercise the power and duties of the directors, however, also assume the directors' responsibility for the faithful exercise of those powers and duties [*Corp. Code § 300(d)*]. Directors may be personally liable for breach of duty to corporate creditors, the corporation itself, or its shareholders [*see Corp. Code §§ 309, 316(a)-(d), 506(b)*; *see also Jones v. H.F. Ahmanson & Co. (1969) 1 Cal. 3d 93, 110-112, 81 Cal. Rptr. 592, 460 P. 2d 464]* . Thus, shareholders of a close corporation who exercise the powers of a board of directors under a shareholder agreement may be personally liable to the same extent that the directors would have been [*Corp. Code §§ 300(d), 316(c), (d), 506(b)*]. The directors would have had no liability for their actions if they performed their duties in good faith, in the best interest of the corporation and its shareholders, with care, including reasonable inquiry, of the ordinarily prudent person in a like position under similar circumstances [*Corp. Code § 309(a)*].

The liability of corporate directors to corporate creditors and shareholders for improper actions approved by the

directors is discussed in greater detail in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 6, *Duties and Liabilities of Management* , § 102.01[3] (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawClosely Held CorporationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART II. LEGAL BACKGROUND
D. Shareholder Liability Under Agreement

4-8C California Legal Forms--Transaction Guide §§ 8C.41-8C.99

AUTHOR: Marilyn E. Minger Practice Consultant

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§§ 8C.41[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-8C California Legal Forms--Transaction Guide § 8C.100

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.100 Client Interview

NOTE:
For a preincorporation planning checklist, see Ch. 2, ***Formation of Corporations*** .

[1] Facts

[a] Each Shareholder

1. Names and addresses of shareholders.

    a. Individual shareholders and spouses.

    b. Entities.

2. Capacity in which individual holds shares:

    a. Owner.

    b. Trustee.

    c. Executor or administrator.

    d. Guardian.

    e. Custodian under Uniform Transfers to Minors Act.

3. Basis of shareholder's stock.

4. Tax identification number.

5. Tax year.

6. If shareholder is an individual:

a. Marital status.

b. Age.

c. Gross and net income for last three years.

d. Estimated net worth.

e. Projected annual income.

f. Relationship to other participants.

g. Affiliations with other businesses.

h. Percentage interest in business.

i. If agreement has a buy-sell provision likely to be funded with life insurance:
(1) Name, address, and telephone number of corporation's insurance agent or broker.

(2) Type and amount of existing policies owned by corporation and by individual shareholders.

(3) Name of current beneficiaries.

(4) Amount of premiums.

(5) Premium payment terms.

j. If agreement has a buy-sell provision likely to be funded with life insurance, whether participant has been denied insurance coverage and, if so:

(1) Type of coverage denied.

(2) Reason for denial.

(3) Date of denial.

NOTE:
Whether an individual shareholder is likely to be insurable is an essential consideration in determining how to fund a buy-sell provision in a shareholder agreement.

k. Whether shareholder is employee of corporation and, if so, position or title.

l. Estate plan for shares.

NOTE:
Transfer restrictions in a shareholder agreement may affect an estate plan [***see*** Ch. 8D, ***Buy-Sell Agreements***].

[b] The Corporation

1. Name and address of corporation.

2. Date of incorporation.

3. State of incorporation.

4. Tax year of corporation.

5. Employer identification number.

6. Principal business.

7. Number of shareholders, not to exceed 35.

NOTE:
All shares held of record in a close corporation must be held by not more than 35 persons [*Corp. Code § 158(a)*].

8. Total number of shares issued.

9. Approximate fair market value of shares, if known.

10. Whether the corporation is a professional corporation.

NOTE:
A "professional corporation" is a regular business corporation that renders professional services in a single profession under a certificate of registration issued by the governing board that regulates the profession [***see*** *Corp. Code § 13401(b)*; ***but see*** *Corp. Code § 13401.5* (allied professionals)]. "Professional services" are any services that may lawfully be rendered pursuant to a license, certification, or registration authorized by the California Business and Professions Code, the Osteopathic Act, or the Yacht and Ship Brokers Act or the Chiropractic Act [*Corp. Code §§ 13401(a), 13401.3*], although there are no longer any certification requirements for medical, osteopathic, dental, pharmacy, veterinary, architectural, registered nursing, optometry, behavioral sciences, speech-language pathology and audiology, or court reporter corporations [***see*** *Corp. Code §§ 13401(b), 13402(a)*; *Bus. & Prof. Code § 2406*]. With these exceptions, a professional corporation must have its own Certificate of Registration to do business as a corporation [*Corp. Code § 13401(b)*; ***see*** *Corp. Code § 13402(b)*].

Whether a corporation is a professional corporation is a consideration in selecting the buyers if there is a buy-sell provision in the shareholder agreement, since a license is required to render services.

For a list of professions that are permitted to incorporate under the Professional Corporations Act, see Ch. 1B, ***Selecting Form of Business Entity*** . For detailed discussion of the formation of professional corporations, see Ch. 12A, ***Professional Corporations*** .

11. Whether corporation has elected Subchapter S status.

NOTE:

A small business corporation may elect to be an S corporation [*I.R.C. § 1362(a)*]. Unlike a C corporation, which is a separate tax-paying entity [***see*** *I.R.C. § 11*], an S corporation is generally treated as a conduit of income, loss, deductions, and credits to shareholders [***see*** *I.R.C. §§ 1363, 1366*]. For discussion of the advisability of electing to be taxed as an S corporation, see Ch. 1B, ***Selecting Form of Business Entity*** . For discussion of the procedures to be used in electing or terminating Subchapter S status, see Ch. 2B, ***Electing Subchapter S Status*** .

Whether or not a corporation has elected S corporation status will affect whether the agreement may provide for the division of corporate profits among shareholders other than according to their respective share holdings [***see*** *Treas. Reg. § 1.1361-1(l)(2)*; *Parker Oil Co. v. Commissioner (1973) 58 T.C. 985, 990* ; ***see also*** Blau, ***Shareholder Agreements and the Single Class of Stock Requirement***, *68 J. Tax'n 238 (1988)*; § 8C.17[4][a]] or whether the agreement may give shareholders unequal rights in the corporation's assets on dissolution, or provide for liquidation rights different from a shareholder's dividend rights, other than according to their respective share holdings [***see*** *I.R.C. § 1361(b)(1)(D)*; *Treas. Reg. § 1.1361-1(l)(2)*; Blau, ***Shareholder Agreements and the Single Class of Stock Requirement***, *68 J. Tax'n 238 (1988)*; ***see also*** *§ 8C.18[2]*].

12. Names, addresses, and telephone numbers of directors, if any.

13. Names, addresses, telephone numbers, and titles of officers.

14. Name, address, and telephone number of accountant.

[2] Documents

[a] Each Shareholder

1. Estate plan for corporate shares.

2. Most recent financial statement.

3. Most recent income tax return.

[b] The Corporation

1. Articles of incorporation.

2. Bylaws.

3. Any shareholder agreements imposing transfer restrictions on corporate shares.

4. Any documents regarding qualification or exemption of corporate shares.

5. Share certificates.

6. Most recent financial statement.

7. Most recent income tax return.

8. Any documents reflecting original cost and present worth of corporate assets.

9. Schedules of any liabilities, showing:

a. Creditors' names and addresses.

b. Amount of indebtedness to each creditor.

10. Any security instruments relating to secured indebtedness.

11. Shareholder list.

12. Any instrument under which corporation's stock is held, including:

a. Trust instruments for trusts holding corporation's shares.

b. Will under which any deceased shareholder's S corporation stock is held by estate.

c. Bankruptcy court order under which bankrupt shareholder's stock is held by bankrupt's estate.

d. Court order for guardianship.

13. Any document under which corporation's stock can be transferred such as employee stock plan.

14. Any employment contracts or proposed contracts.

15. Any corporate buy-sell agreement.

16. Any buy-sell agreement between any shareholder and any member of shareholder's family.

17. Insurance policies.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)RequirementsTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-8C California Legal Forms--Transaction Guide §§ 8C.101-8C.109

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8C.101[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8C California Legal Forms--Transaction Guide § 8C.110

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.110 Identifying Conflicts of Interest

NOTE:

An attorney representing an entity may also represent its constituents provided that attorney makes a written disclosure to the clients in accordance with *California Rules of Professional Conduct, Rule 3-310(B)*. Dual representation of clients whose interests conflict is permitted, under certain circumstances, if the attorney obtains the written consent of each client [Cal. Rules *Prof. Cond., Rule 3-600(E)*]. Caution should be exercised in dual representation, however, if an actual conflict of interest exists [***see*** *Ch. 8D,* ***Buy-Sell Agreements****, § 8D.12*]. Even without an actual conflict, under some circumstances, an attorney should not undertake multiple representation [***see*** *Ch. 8D,* ***Buy-Sell Agreements****, § 8D.13*].

For further discussion of this topic, see *Ch. 1A,* ***Role of Counsel in Starting a New Business****, §§ 1A.33-1A.37*, and *§ 1A.113*. For appropriate waiver of conflict forms, see *Ch. 1A,* ***Role of Counsel in Starting a New Business****, §§ 1A.203[2], 1A.204[2]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of Interest



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8C California Legal Forms--Transaction Guide § 8C.111

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.111 Determining Scope of Work to Be Performed by Attorney

1. Determine tasks attorney will perform.

NOTE:
The procedural aspects of formation of a close corporation are covered in Ch. 2, ***Formation of Corporations*** .

2. Determine whether consultation or association of specialist or other professional is required [*see* Ch. 8D, *Buy-Sell Agreements*, § 8D.19].

NOTE:
Drafting (or reviewing) a shareholder agreement can involve many areas of law, including business, tax, and community property considerations. The drafting attorney has the duty to refer the client to a specialist or recommend the association of a specialist if the attorney lacks the requisite skill or knowledge [***see*** Ch. 8D, ***Buy-Sell Agreements***, § 8D.19[2]]. The drafting attorney often relies heavily on the advice of other professionals, such as life insurance agents, accountants, financial planners, and trust officers. Because life insurance is the most common way to provide funds to purchase the shares of a deceased shareholder, life insurance agents are frequently consulted. The wide variety of life insurance products and forms of ownership make such a consultation important when drafting a shareholder agreement with buy-sell provisions.

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawClosely Held CorporationsGeneral OverviewLegal EthicsClient RelationsAccepting RepresentationBusiness & Corporate LawClosely Held CorporationsFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8C California Legal Forms--Transaction Guide § 8C.112

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.112 Selecting Appropriate Type of Agreement

NOTE:

A shareholder agreement may contain provisions governing many phases of the affairs of a close corporation (including the management of its business, the division of its profits, and the distribution of its assets on dissolution) that infringe on the powers of the board and call for partnership-like relations among the shareholders [***see*** *Corp. Code § 300(b)*]. Shareholder agreements commonly contain provisions that (1) designate certain persons as employees, officers, or directors of the corporation; (2) specify long-term employment arrangements; (3) set profit distributions; (4) set liquidation distributions and procedures for winding up on dissolution; (5) adopt day-to-day operational and managerial policies; (6) establish voting requirements; (7) restrict the transfer of shares; (8) establish noncompetition requirements and restrictions on trade secrets and customer lists; and (9) prescribe rules for resolving deadlocks.

Because the factual circumstances relating to any particular close corporation will vary, depending on the number of shareholders, whether shareholders are primarily investors or employees, and the tax status of corporation, each agreement must be adapted to the appropriate circumstances. This section enumerates the more common provisions that counsel should consider in the preparation of a shareholder agreement. Section 8C.113 enumerates the statutory provisions that may ***not*** be altered or waived by a shareholder agreement.

1. Determine whether agreement will include provisions governing corporate management [*see § 8C.15*]:

a. Will agreement require supermajority or unanimous vote of shareholders or directors for approval of certain actions [*see Corp. Code §§ 204(a)(5), (9), 300(b), (c)*; § 8C.15[2]],

including [*see Corp. Code § 204*]:

NOTE:
Corp. Code § 204(a) permits all of the provisions that section would otherwise require in the articles to be in a shareholder agreement of a close corporation. In drafting a shareholder agreement, caution should be exercised to ensure that the articles and bylaws do not contain provisions that are inconsistent with the shareholder agreement [***see § 8C.200[1][c]***].

(1) Removal of directors?

NOTE:
This matter may not be included in the articles to change a vote required by the General Corporation Law [*Corp. Code §§ 204(a)(5), 303*] and therefore must be included in the shareholder agreement if desired. The percentage required for approval of voluntary winding up and dissolution may not exceed 66 2/3 percent [*Corp. Code § 402.5*].

(2) Election of directors?

NOTE:
This matter may not be included in the articles to change a vote required by the General Corporation Law [*Corp. Code §§ 204(a)(5), 708(c)*] and therefore must be included in the shareholder agreement if desired.

(3) Voluntary dissolution of corporation?

NOTE:
This matter may not be included in the articles to change a vote required by the General Corporation Law [*Corp. Code § 204(a)(5), 1900*] and therefore must be included in the shareholder agreement if desired.

(4) Amendment or repeal of either:

(a) Articles of incorporation?

(b) Bylaws?

(5) Merger or consolidation of corporation? [*see § 8C.19*]

(6) Transfer of all or substantially all corporate assets?

(7) Issuance of shares, options, or similar rights relating to issuance of shares?

b. Will agreement require shareholder approval [*see Corp. Code § 152*] or approval of outstanding shares [*see Corp. Code § 153*] for any corporate action when that approval is not otherwise required by statute [*Corp. Code §§ 204(a)(9), 300(b), (c)*]?

NOTE:
The shareholder agreement rather than the articles of incorporation should contain the provisions requiring shareholder approval when that approval appears to infringe on the managerial powers of the

board [***see*** *Corp. Code § 300(b)*].

c. Will agreement delegate managerial responsibilities to managing shareholder, or limit board's powers [*see Corp. Code § 300(b), (c)*]?

d. Will agreement confer voting rights on shareholders disproportionate to their share holdings? [*see § 8C.15[2], [3]*]

2. Determine whether agreement will provide for division of corporate profits other than according to number of shares held by each shareholder [*see Corp. Code § 300(b)*; *see also § 8C.17*].

NOTE:

A shareholder agreement may not alter or waive *Corp. Code §§ 500, 501*, providing that neither a corporation nor any of its shareholders may make any distribution to the corporation's shareholders unless the corporation is able to pass either the retained earnings or remaining assets tests specified in the statute [***see*** *Corp. Code § 500*], and the distribution is not likely to make the corporation, or the subsidiary making the distribution, unable to meet its liabilities as they mature [*Corp. Code § 501*]. For further discussion of the statutory limitations on distributions, see *§ 8C.17[2]*.

a. Will distribution take form of salary or draw?

b. Will distribution take form of dividends?

c. Will distribution take combined form of salary or draw and dividends [*see § 8C.17[3]*]?

3. Determine whether agreement will establish rights and preferences of shareholders on dissolution [*see Corp. Code § 300(b)*; *see also § 8C.18*].

NOTE:

The shareholder agreement may not alter or waive provisions of the General Corporation Law [*Corp. Code § 300(c)*] (1) relating to the recovery of improper corporate distributions made during windup after dissolution [*Corp. Code § 2009*]; (2) regulating the continuation and obligations of a dissolved corporation while winding up its affairs [*Corp. Code § 2010*]; or (3) authorizing suits against shareholders on causes of action against the corporation arising prior to its dissolution [*Corp. Code § 2011*].

4. Determine whether agreement will provide for employment of shareholders [*see § 8C.16*], including:

NOTE:

The interests of shareholders who are employees may be protected either by an employment agreement or employment provisions in the shareholder agreement [***see*** *§ 8C.200[2]*]. For employment contract forms, see Ch. 85, ***Employment Contracts*** .

a. Position and title.

b. Tenure.

c. Salary and other forms of compensation.

d. Termination of employment [*see § 8C.200[2]*], as result of:

NOTE:
Termination of employment may be made effective on events such as those enumerated in PP (1)-(7), ***below***, or on the adoption by all of the other shareholders of a written resolution setting forth a required ground for termination.

(1) Voluntary resignation.

(2) Dissolution of corporation.

(3) Bankruptcy, death, or physical incapacity.

(4) Misconduct or willful breach of shareholder agreement.

(5) Conviction of felony involving moral turpitude.

(6) Declaration by court order of unsoundness of mind or incompetency in terms of management of shareholders' affairs.

(7) Other conduct constituting legal cause for termination of employment.

NOTE:
The shareholder agreement should provide for a mandatory buyout of the terminated employee-shareholder's shares [***see*** *§ 8C.20[2]*; ***see also*** Ch. 8D, ***Buy-Sell Agreements***].

5. Determine whether agreement will restrict transfer of shares, including restrictions on following transfers [*see § 8C.20[2]*]:

NOTE:
A shareholder agreement filed with the corporation's secretary is binding on all transferees with actual knowledge of the agreement or whose shares certificates contain a legend giving notice of the existence of the agreement [*Corp. Code § 300(b)*; ***see*** *§ 8C.20[1]*; ***see also*** Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, ***Close Corporations*** , § 62.03[8][b] (Matthew Bender) (reasonableness of restrictions)].

a. Lifetime transfers by sale or gift to outsiders.

b. Transfers by sale or gift between shareholders.

c. Transfers by will, intestacy, or operation of law.

d. Any other form of voluntary or involuntary alienation, such as pledge or judicial sale resulting from bankruptcy decree.

6. Determine whether agreement will include provision relating to books, records, and reports of corporation or rights of inspection [*see Corp. Code §§ 1500 et seq.* (records and reports), 1600 et seq. (inspection rights)].

NOTE:

Although a shareholder agreement may not alter or waive the provisions of Chapters 15 and *16 of the Corporations Code* relating to books, records, and reports of corporation or rights of inspection [*Corp. Code § 300(c)*], restatement of these duties may be desirable to remind the shareholders of these responsibilities.

7. Determine whether agreement will eliminate board of directors.

NOTE:

One commentator has suggested that there is at least a minimal advantage in continuing a standby board to carry out board functions that cannot be waived [*e.g., Corp. Code §§ 500, 1501(a), 1502*] and general functions required when a corporation continues after losing its status as a close corporation [***see*** Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, ***Close Corporations*** , § 62.03[3][c] (Matthew Bender)].

For discussion about whether a shareholder agreement that establishes direct shareholder management of the corporation may eliminate the board of directors entirely, with the shareholders assuming the powers, responsibilities, and liabilities of the directors, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, ***Close Corporations*** , § 62.03[3][c] (Matthew Bender)].

8. Determine whether agreement will regulate elections and meetings of board of directors, if any.

a. Will agreement waive or alter requirements relating to annual and other elections of directors [*see Corp. Code § 600(b)*]?

b. Will agreement waive or alter requirements relating to board meetings, including:

(1) Annual meetings?

(2) Regular meetings?

(3) Special meetings?

NOTE:

Failure of the close corporation to observe corporate formalities relating to meetings of directors, pursuant to a shareholder agreement, will not be considered a factor tending to establish that the shareholders have personal liability for corporate obligations [*Corp. Code § 300(e)*; ***see*** *§ 8C.40*].

9. Determine whether agreement will regulate shareholder meetings.

NOTE:

The failure of a close corporation to observe corporate formalities relating to meetings of shareholders in connection with the management of its affairs, according to a shareholder agreement, will not be considered a factor tending to establish that the shareholders have personal liability for corporate obligations [*Corp. Code § 300(e)*; ***see*** *§ 8C.40*].

a. Will agreement waive or alter statutory provisions relating to the place of the meetings, the failure to hold meetings, and special meetings [*see Corp. Code § 600(a),(c),(d)*]?

b. Will agreement waive or alter statutory provisions governing notice and consents [*see Corp. Code § 601*]?

10. Determine whether agreement will establish noncompetition requirements and restrictions on trade secrets and customer lists [*see § 8C.200[2]*].

11. Determine whether agreement will control voluntary dissolution and winding up of corporation [*see § 8C.21*].

NOTE:

Although a shareholder agreement may not waive or alter the statutory provisions relating to involuntary dissolution [*Corp. Code § 300(c)*], the agreement may contain provisions that alter or waive the statutory right to seek voluntary dissolution [***see*** *Corp. Code § 300(c)*]. Thus, the agreement may provide for the dissolution of the corporation in the event of deadlock among the shareholders or on the happening of certain specified events, different from those that would justify dissolution under the statutes [***see, e.g.,*** *Corp. Code § 1900 et seq.*]. Conversely, the agreement may forbid initiation of an action for voluntary dissolution.

a. Will agreement change statutory requirements permitting voluntary dissolution by vote of shareholders holding shares representing 50 percent or more of voting power [*see Corp. Code § 1900(a)*]?

b. Will agreement change statutory provisions authorizing any of following corporations to wind up and dissolve [*Corp. Code § 1900(b)*]:

(1) Corporation that has been adjudicated bankrupt?

(2) Corporation that has disposed of all of its assets and has not conducted any business for five years immediately preceding adoption of resolution electing to dissolve corporation?

(3) Corporation that has not issued shares?

12. Determine whether agreement will include provision for arbitration to resolve disputes within corporation [*see § 8C.22[3]*], including:

a. Events giving rise to arbitration, such as:

(1) Claims or controversies arising out of breach of shareholder agreement.

(2) Rights, duties, or obligations of:
(a) Shareholders.

(b) Employees of the corporation.

(c) Directors.

(d) Officers.

b. Place where arbitration is to be conducted.

c. Rules of procedure to be followed or incorporation by reference of established rules, such as Rules of American Arbitration Association.

NOTE:

For further discussion of the use of arbitration to resolve corporate dissolution and deadlock, see Cavitch, BUSINESS ORGANIZATION WITH TAX PLANNING, Ch. 108A, ***Close Corporations***, § 108A.04[4] (Matthew Bender). For discussion of arbitration generally, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, ***Close Corporations*** , § 65.02[3] (Matthew Bender).

13. Determine whether agreement will include provision controlling modification, extension, or revocation of shareholder agreement [*see § 8C.31*].

14. Determine whether agreement will include provision that it will continue in effect to extent enforceable apart from *Corp. Code § 300(b)* on occurrence of following events:

NOTE:

A shareholder agreement is terminated (1) when the corporation ceases to be a close corporation, or (2) by the original issuance of shares by the corporation to a new shareholder who does not become a party to the agreement, unless the agreement provides that it may continue in effect to the extent it is enforceable apart from *Corp. Code § 300(b)* [*Corp. Code § 300(b)*].

a. Will agreement continue to extent permitted by statute when the corporation ceases to be a close corporation?

b. Will agreement continue to extent permitted by statute when corporation issues original shares to new shareholder who does not become party to agreement?

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8C California Legal Forms--Transaction Guide § 8C.113

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.113 Checklist of Statutory Provisions That May Not Be Altered or Waived by Agreement

NOTE:

A shareholder agreement may alter or waive all the provisions of the General Corporation Law as between the parties to the agreement with the exception of the provisions enumerated in this section [***see*** *Corp. Code § 300(c)*].

1. Provisions defining close corporation and covering election, revocation, and involuntary loss of close corporation status [*see Corp. Code § 158*].

2. Provisions requiring corporation to comply with retained earnings or remaining assets test and solvency test when making distributions to shareholders [*see Corp. Code §§ 500, 501*].

3. Provisions requiring two-thirds approval of outstanding shares when disappearing corporation in merger is close corporation and surviving corporation is not [*see Corp. Code § 1111*].

4. Provisions requiring two-thirds approval of outstanding shares for reorganization with corporation that is not close corporation [*see Corp. Code § 1201(e)*].

5. Provisions relating to recovery of improper distributions [*see Corp. Code §§ 2009-2011*].

6. Provisions relating to corporate records and reports [*see Corp. Code § 1500 et seq.*].

7. Provisions relating to right of directors and shareholders to inspect corporate books, records, and physical properties [*see Corp. Code § 1600 et seq.*].

8. Provisions relating to involuntary dissolution of corporation [*see Corp. Code § 1800 et seq.*].

9. Provisions governing certain crimes and penalties [*see Corp. Code § 2200 et seq.*].

10. Provisions requiring filing of any document with California Secretary of State [*Corp. Code § 300(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawClosely Held CorporationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8C California Legal Forms--Transaction Guide §§ 8C.114-8C.119

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8C.114[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8C California Legal Forms--Transaction Guide § 8C.120

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.120 Statutory Requirements for Form of Shareholder Agreement

NOTE:

The General Corporation Law imposes only two requirements related to the form of a shareholder agreement: (1) the agreement must be in writing [*Corp. Code § 186*]; and (2) the agreement must be either (a) among all of the shareholders of a close corporation, or (b) between the sole shareholder and the corporation, if the close corporation has only one shareholder [*Corp. Code § 186*]. See *§ 8C.112* for provisions commonly included in a shareholder agreement. See *§ 8C.113* for an enumeration of the statutory provisions that may be neither altered nor waived by the agreement.

1. Put shareholder agreement in writing.

2. Draft agreement among either:

a. All shareholders; or

b. Between sole shareholder and corporation, if close corporation has only one shareholder.

PRACTICE TIP:

It is a good practice to make the corporation a party to the agreement at least to the extent there are provisions that require the corporation's compliance, such as putting legends on the stock certificate and not recording a stock transfer not made in compliance with the shareholder agreement. *Commentary by Marilyn E. Minger.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawClosely Held CorporationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8C California Legal Forms--Transaction Guide §§ 8C.121-8C.129

AUTHOR: Marilyn E. Minger Practice Consultant

[Reserved]

§§ 8C.121[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8C California Legal Forms--Transaction Guide § 8C.130

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.130 Binding Transferees of Shares

1. Verify that certificates of shares subject to shareholder agreement have been stamped with legend indicating that fact [*see Corp. Code § 300(c)*; *see also Corp. Code § 418(a)*].

NOTE:

A transferee of shares covered by a shareholder agreement is bound by its provisions when (1) the agreement is filed with the secretary of the corporation for inspection by an potential purchaser of shares, and (2) the transferee has actual knowledge of the agreement or notice that there is such an agreement because the share certificates are stamped with a legend indicating that fact [*Corp. Code § 300(b)*; ***see*** *Corp. Code § 418(a)* (required legend)].

2. Verify that copy of shareholder agreement has been filed with secretary of corporation for inspection by prospective purchasers [*see Corp. Code § 300(c)*].

NOTE:

For discussion of whether a transferee of shares subject to a shareholder agreement not filed with the corporation's secretary is bound by the agreement, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, ***Close Corporations*** , § 62.03[10] (Matthew Bender).

3. Verify that copy of shareholder agreement has been given to each person to whom shares have been transferred.

NOTE:

Although not a statutory requirement, providing each transferee of shares with a copy of the agreement ensures that they have actual knowledge of the agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8C California Legal Forms--Transaction Guide § 8C.131

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.131 Securities Considerations

1. Determine whether adoption, modification, or termination of any provisions in shareholder agreement constitutes a sale of securities subject to registration or qualification requirements [*see 10 Cal. Code Reg. §§ 260.017.2*, *260.017.3*; *Corp. Code § 25017*; § 8C.31].

2. Determine whether issuance of securities of close corporation is exempt from qualification as small [*Corp. Code § 25102(h)*] or limited [*Corp. Code § 25102(f)*] offering [*see Corp. Code § 116*].

3. Ascertain whether issuance of securities of close corporation is exempt from registration under the federal securities laws.

NOTE:

Because securities law exemptions do not match close corporation requirements, some close corporations may not come within the small offering exemption [*Corp. Code § 25102(h)*]. However, the less restricted limited offering exemption [*Corp. Code § 25102(f)*] will likely apply. For further discussion, see *§ 8C.31*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawExemptions From RegistrationExempt TransactionsGeneral OverviewSecurities LawExemptions From RegistrationSmall Issue ExemptionsSecurities LawBlue Sky LawsSecurities Exempt From RegistrationBusiness & Corporate LawClosely Held CorporationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8C California Legal Forms--Transaction Guide § 8C.132

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.132 S Corporation Considerations

1. If corporation has elected S corporation tax treatment [*see I.R.C. § 1361* et seq.; *Rev. & Tax. Code § 23800 et seq.*], ascertain that agreement does not provide for division of corporate profits among shareholders other than according to their respective share holdings.

NOTE:

A corporation does not qualify under the Internal Revenue Code as an S corporation if it has more than one class of shares outstanding [*I.R.C. 1361(b)(1)(D)*]. Although a corporation is not treated as having more than one class of stock solely because there are differences in voting rights among shares of common stock [*I.R.C. 1361(c)(4)*; ***see*** *§ 8C.15[4]*], with this exception, when one share is not identical to every other share with respect to control, profits, and assets of the corporation, the corporation is considered to have more than one class of shares outstanding [*Treas. Reg. § 1.1361-1(l)(2)*]. Thus, an agreement that provides for the division of corporate profits among shareholders other than according to their respective share holdings appears to destroy the corporation's S corporation status for income tax purposes [***see*** *Treas. Reg. § 1.1361-1(l)(2)*; *Parker Oil Co. v. Commissioner (1972) 58 T.C. 985, 990* ; ***see also*** Blau, ***Shareholder Agreements and the Single Class of Stock Requirement***, *68 J. Tax'n 238 (1988)*].

2. If corporation has elected S corporation tax treatment [*see I.R.C. § 1361* et seq.; *Rev. & Tax. Code § 23800 et seq.*], ascertain that agreement does not provide for liquidation rights different from a shareholder's dividend rights, other than according to their respective share holdings.

NOTE:

A shareholder agreement that gives shareholders unequal rights in the corporation's assets

on dissolution and provides for liquidation rights different from a shareholder's dividend rights, other than according to their respective share holdings, appears to violate the single class of stock requirement [***see*** *I.R.C. § 1361(b)(1)(D)*; *Treas. Reg. § 1.1361-1(l)(2)*] and, therefore, may destroy the corporation's S corporation status for income tax purposes [***see*** Blau, ***Shareholder Agreements and the Single Class of Stock Requirement***, *68 J. Tax'n 238 (1988)*; ***see also*** *§ 8C.17[4][a]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Termination (IRC sec. 1362)Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)General OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Taxpayer GroupsS CorporationsDistributions (IRC secs. 1361, 1368)Tax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)



185 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8C California Legal Forms--Transaction Guide §§ 8C.133-8C.199

AUTHOR: Marilyn E. Minger Practice Consultant

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§§ 8C.133[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART IV. FORMS

4-8C California Legal Forms--Transaction Guide § 8C.200

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.200 Shareholder Agreement Providing for Management of Corporation, Employment of Shareholders, Restriction on Stock Transfers, and Noncompetition

[1] Comment

[a] Use of Form

This form is a close corporation shareholder agreement in which all shareholders will be employed by the corporation. The form provides for the management of the corporation, the employment of the shareholders, grounds for termination of employment, and a mandatory buy-out arrangement for the shares of any shareholder whose employment with the corporation is terminated. It contains provisions regulating the distribution of income, the voluntary dissolution of the corporation, winding up, the distribution of corporate assets on liquidation, and the amendment and termination of the agreement. It also includes transfer restrictions, a noncompetition clause, and a provision for arbitration. It specifies the wording of the legend on the share certificates, indicating that the corporation is a close corporation.

This form makes the following assumptions:

- All shareholders will be employees of the corporation.
- The corporation has already issued a single class of shares, without series.
- The shareholders want to keep at a minimum the paperwork involved in running the corporation.
- The shareholders want to ensure their continued employment.
- The shareholders want to control the future membership of the shareholder group.
- The shareholders will be entitled to receive distributions in proportion to the number of corporate shares they own.

- Important management decisions will be put to a vote of all shareholders; however, to avoid deadlock, the vote of two thirds of the outstanding shares of the Corporation entitled to vote will control.

Since the factual circumstances of any particular close corporation will vary, this form should be adapted accordingly. For a close corporation shareholder agreement for a sole shareholder corporation, see *§ 8C.201*.

This form is a statutory shareholder agreement, drafted in accordance with the statutory provisions authorizing the use of shareholder agreements in California [*see Corp. Code § 300(b), (c)*]. For a discussion of nonstatutory shareholder agreements in California, see Ballantine & Sterling, California Corporation Laws, Ch. 4, *Close Corporations* § 62.02[2] (Matthew Bender).

[b] Statutory Requirements Related to Form of Agreement

There are only two requirements imposed by the General Corporation Law [*Corp. Code § 100 et seq.*] related to the form of a shareholder agreement:

- The agreement must be in writing [*Corp. Code § 186*], and

- The agreement must be either among all of the shareholders of a close corporation, or between the sole shareholder and the corporation, if the close corporation has only one shareholder [*Corp. Code § 186*]. The corporation may be a party to the agreement even when there is more than one shareholder.

[c] Whether to Include Provisions in Shareholder Agreement or in Articles or Bylaws

Corp. Code § 204(a) permits all the provisions that it would otherwise require in the articles of incorporation to be in a shareholder agreement, if the corporation is a statutory corporation [*Corp. Code § 204(a)*; *see Corp. Code § 158* (close corporation defined)]. Care should be taken in drafting a shareholder agreement to make certain that the corporation's articles and bylaws do not contain provisions inconsistent with the shareholder agreement. The better approach may be to duplicate in the articles the protective provisions of the shareholder agreement, so that those provisions will survive any termination of the shareholder agreement. Of course, duplicate provisions should be included in the articles only if permitted by *Corp. Code § 204(a)* [*see § 8C.112*]. If the corporation loses its status as a close corporation, provisions other than those permitted in the articles in accordance with *Corp. Code § 204(a)* may no longer be valid if not expressly authorized by another section of the General Corporation Law or if not otherwise a lawful agreement not otherwise contrary to public policy [*see Corp. Code § 204(a)*].

[d] Board of Directors

This form establishes a board of directors consisting of all of the shareholders. Some commentators argue that a shareholder agreement that establishes direct shareholder management of the corporation may eliminate the board of directors entirely, with the shareholders assuming the powers, responsibilities, and liabilities of the directors. However, there is at least a minimal advantage in continuing a standby board to carry out board functions that cannot be waived [*see, e.g., Corp. Code §§ 500, 1501(a), 1502*], as well as general required functions if the corporation continues after losing its status as a close corporation [*see* Ballantine & Sterling, California Corporation Laws, Ch. 4, *Close Corporations* , § 62.03[3][c] (Matthew Bender)].

[e] S Corporation Considerations

The dividend provisions and the provisions that alter the right to manage the corporation and to vote shares contained in this form may violate the single class of stock requirement for being taxed as an S corporation [*see I.R.C. § 1361(b)(1)(D)*; *Treas. Reg. § 1.1361-1(l)(2)*; *see also §§ 8C.15[4], 8C.17[4][a]*]. In addition, an S corporation is

limited in the number of shareholders it may have (no more than 100) [*I.R.C. § 1361(b)(1)(A)*] and in the type of shareholders (neither corporations nor foreign persons may be shareholders) [*I.R.C. § 1361(b)(1)(B), (C)*]. Consequently, if the shareholders wish to elect S corporation treatment, or to assure themselves of continued S corporation treatment, this form should be modified accordingly [*see §§ 8C.15[4], 8C.17[4][a]*; *see also § 8C.201[2]*].

[f] Employment of Shareholders

The drafter may chose to use a separate employment agreement, entered into concurrently with the shareholder agreement, since the corporation, rather than the shareholders, will employ the individuals. The shareholders may also make the corporation a party to the agreement. If a separate employment agreement is used, some of the provisions in Sections 1.05 and 1.06 of this form may be set forth in that agreement, rather than in the shareholder agreement. For employment contracts, see Ch. 85, *Employment Contracts* . For considerations when drafting those agreements, see *§ 8C.16*.

[g] Regulating Dividend Payments and Distributions of Corporate Profits and Assets

The California close corporation statute expressly authorizes shareholder agreements of statutory close corporations to regulate the declaration and payment of dividends or the division of corporate profits [*Corp. Code § 300(b)*]. No shareholder agreement, however, may alter or waive the provisions of the General Corporation Law requiring that the corporation pass certain financial tests before making any corporate distributions to shareholders [*Corp. Code § 300(c)*; *see Corp. Code §§ 500, 501* (distributions to shareholders); *see also § 8C.17[2]*].

This form shows only one of the many possible approaches to dividing the profits of a close corporation, basing the dividends on the number of shares owned by each shareholder. The agreement might provide that the profits of the corporation be distributed based on the amount of time devoted to the corporation's business, the amount of business generated for the corporation, or the agreement could merely specify that one shareholder is to receive more profits than another.

If the corporation does not prepare financial statements in accordance with generally accepted accounting principles, those references in this form should be modified accordingly.

[h] Dissolution

[i] Restrictions on Voluntary Dissolution

Although a shareholder agreement may not waive or alter the statutory provisions relating to involuntary dissolution [*Corp. Code § 300(c)*; *see § 8C.18*], the agreement may contain provisions that alter or waive the statutory right to seek voluntary dissolution [*see Corp. Code § 300(c)*]. Thus, the agreement may provide for the dissolution of the corporation in the event of deadlock among the shareholders, on the happening of certain specified events, different from those that would justify dissolution under the statutes [*see, e.g., Corp. Code § 1900 et seq.*]. Conversely, as in this form, the agreement may forbid initiation of an action for voluntary dissolution by fewer than all of the shareholders.

[ii] Distribution of Assets on Dissolution

The General Corporation Law expressly permits the shareholders of a close corporation to include in a shareholder agreement provisions relating to distribution of the corporate assets on liquidation or dissolution [*Corp. Code § 300(b)*; *see § 8C.18*]. This form designates which of the shareholders is to conduct any winding up procedures on dissolution of the corporation, and the manner in which the assets of the corporation are to be distributed on liquidation or dissolution. To avoid loss of any Subchapter S status [*see I.R.C. § 1361(b)(1)(D)*; *Treas. Reg. § 1.1361-1(l)(2)*; *see also § 8C.18[2]*], this form treats all shareholders equally with respect to liquidation distributions. If Subchapter S status is not

a consideration, this form may be modified accordingly.

[i] Restrictions on Transfer; Share Buy-Sell Provisions

The permissible restrictions on transfer can take several forms [*see § 8C.20*; *see also* Ch. 8D, *Buy-Sell Agreements*]. This form contains in substance an obligation on the part of each shareholder to offer the corporation and the other shareholders a first right to purchase the shares. Provisions to implement these restrictions (buy-sell provisions) may be included in the shareholder agreement or in a separate buy-sell agreement. No specific provisions are recommended in this form because of the great variety of buy-sell arrangements. The issues to be considered in drafting buy-sell agreements, including methods of share valuation and payment for shares (such as deferred payment or installment payments), as well as form provisions for a cross-purchase, entity purchase, or hybrid agreement, are covered in detail in Ch. 8D, *Buy-Sell Agreements*.

[j] Noncompetition; Trade Secrets

Agreements not to compete or to divulge trade secrets may be included in a shareholder agreement, an employment agreement, or in a separate noncompetition agreement. This form includes a simple noncompetition provision. For discussion of covenants not to compete, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, *Appendix (Forms)*, Form 13.09 (Matthew Bender).

[k] Spousal Consent

For discussion of the importance of obtaining spousal consent and appropriate form provisions, see *§ 8C.203*.

[2] Form

Shareholder Agreement Providing for Management of Corporation, Employment of Shareholders, Restriction on Stock Transfers, and Noncompetition OA

SHAREHOLDER AGREEMENT OF _____ [***name of close corporation***]

THIS AGREEMENT, dated _____, is among _____[*names of all of the shareholders*] (referred to collectively as "Shareholders" and individually as "Shareholder")

[*If the corporation will also be a party to specified provisions of the agreement, add:*]

and _____[*name of corporation*], a California close corporation (the "Corporation") to the extent of provisions _____[*list provisions to which corporation is bound*], below.

[*CONTINUE*]

RECITALS

The Shareholders are all the shareholders of _____[*name of close corporation*] (referred to as "Corporation"), a California close corporation as defined by *California Corporations Code Section 158*.

The Shareholders desire to enter into a Shareholder Agreement, as defined in *California Corporations Code Section 186*, prepared in accordance with *California Corporations Code Section 300(b)*, to provide for the management and

control of the affairs of the Corporation, including but not limited to, the management of its business, the division of its profits, and the distribution of its assets on liquidation.

The Shareholders believe that it is important to provide for the continuity of employment of each Shareholder, to restrict the transfer of shares of the Corporation, to define the participation of each Shareholder in the business and the management of the Corporation, and to make other provisions among themselves with respect to the Corporation and their relationship to it, as contained in this Agreement.

[*If corporation's articles either duplicate or augment the provisions of this agreement, add:*]

The articles of incorporation contain provisions that _____[duplicate *or* augment] some of the provisions of this Agreement, which, to be effective, must be in the articles of incorporation or in a shareholder agreement of a close corporation. In the event of any inconsistencies between this Agreement and the articles of incorporation, the provisions of this Agreement will control. However, if this Agreement terminates, the provisions in the articles of incorporation will continue in effect, until amended as provided by law.

[*If the repurchase or shares by the corporation on the death of the shareholder is going to be funded by life insurance on that shareholder, add:*]

The Shareholders contemplate that certain purchases of the shares of the capital stock of the corporation held by each Shareholder will be wholly or partially funded by a policy or policies of life insurance with respect to such Shareholder.

[*CONTINUE*]

AGREEMENT

ARTICLE 1 SHARES SUBJECT TO THIS AGREEMENT

Each of the Shareholders owns the number of shares of common stock listed below:

Name	Shares Owned
_____	_____
_____	_____
_____	_____

The shares listed above constitute all of the issued and outstanding capital stock of the Corporation. The Corporation acknowledges receipt from each Shareholder of the full consideration for the respective shares purchased by said Shareholder, and each Shareholder acknowledges receipt of certificates representing his or her shares. All of the shares listed above and any additional shares of the capital stock of the Corporation that may be acquired by the Shareholders in the future shall be subject to this Agreement.

ARTICLE 2 CERTAIN DISCLOSURES, WAIVERS AND INDEMNIFICATIONS

2.01. **Representations.** Each of the Shareholders acknowledges and represents that:

(a) This Agreement was prepared with his or her knowledge and consent by legal counsel for the Corporation;

(b) He or she was advised by that counsel to consider seeking independent legal counsel to review this Agreement on his or her behalf;

(c) He or she had adequate time to seek the advice of independent counsel and to review this Agreement;

(d) He or she either obtained such advice or knowingly and intentionally chose not to seek such advice;

(e) He or she fully understands this Agreement and all of its terms and provisions, including, but not limited to, those provisions which significantly restrict his or her ability to sell, transfer or otherwise dispose of his or her shares; and

(f) The restrictions imposed upon his or her shares pursuant to this Agreement are reasonable.

2.02. **Shares Acquired for Investment.** Each of the Shareholders further acknowledges and represents that he or she has obtained and accepted his or her shares in good faith, for investment and for his or her own account, and not with a view to distribution or resale.

2.03. **Title.** Each of the Shareholders represents and warrants that he or she is the record and beneficial owner of the shares referred to in Article 1 above and that he or she has not sold, transferred, pledged or otherwise encumbered any of those shares or his or her interest in those shares.

2.04. **Indemnity.** Each Shareholder agrees to indemnify and hold the Corporation and the other Shareholders harmless from and against any and all liabilities, costs or expenses, including reasonable attorneys' fees, resulting from or arising out of any sale, transfer or other disposition of his or her shares otherwise than in accordance with the terms and provisions of this Agreement.

ARTICLE 3 MANAGEMENT AND CONTROL

3.01. **Board of Directors.** Subject to termination in accordance with Section 3.06 of this Agreement, each Shareholder will be a director of the Corporation. All elections of directors (annual or otherwise) and all meetings of directors and Shareholders (annual, regular, or special) are waived. Any act or decision made by the directors or the shareholders may be evidenced by a writing, executed by the requisite number of shareholders as provided in this Agreement, or otherwise, as the Shareholders agree in writing. Each Shareholder, however, as a member of the Board, agrees to vote in favor of any resolutions required by individuals or institutions with whom the Corporation may have business dealings to evidence corporate authorization. Any Shareholder may authorize any other Shareholder to act as that Shareholder's proxy, according to the general or specific written instructions of the authorizing Shareholder and may _____[not appoint any other *or* instead appoint another] person to act as proxy.

During the term of this Agreement, the directors will, when appropriate,

(a) Determine in good faith the "current assets" of the Corporation for purposes of corporate distributions as required by the California Corporations Code;

(b) Cause an annual report to be sent to the Shareholders not later than 120 days after the close of the fiscal year, unless this requirement is expressly waived in the Bylaws of the Corporation;

(c) After filing the Corporation's original Articles of Incorporation, file any informational certificates that may be required by the California Secretary of State;

(d) Cause the Corporation to maintain the books, records, and other documents required by *California Corporations Code Section 1500*;

(e) Use best efforts to cause the business of the corporation in accordance with sound business practices.

3.02. **President and Managing Officer; Certain Voting Requirements.** The President of the Corporation will be its managing officer. The President will control the day-to-day operations of the business and affairs of the Corporation, with the exception of the following actions, which will require the written approval of the holders of not less than _____[*number, e.g.,* two thirds] of the outstanding shares of the Corporation entitled to vote:

(a) Employment of officers as set forth in Section 1.05 of this Agreement;

(b) Execution of contracts that cannot be performed within one year from the date of execution or involve extraordinary commitments on the part of the Corporation;

(c) Change of the general type of business activity of the Corporation;

(d) Entry into a partnership or similar business relationship;

(e) Indemnification in accordance with *California Corporations Code Section 317*;

(f) _____[*Other actions involving day-to-day operations of the corporation that the parties wish to restrict*].

3.03. **Approval of All Shareholders.** Notwithstanding the provisions in Sections 3.01 and 3.02 of this Agreement, the written consent of all of the Shareholders is required to approve the following actions:

(a) Mergers or consolidations involving the Corporation;

(b) Amendment or repeal of the Articles of Incorporation of the Corporation;

(c) Issuance of shares of any class or other rights relating to the issuance of shares of the Corporation;

(d) Transfer of all, or substantially all, the assets of the Corporation;

(e) Amendment of this Agreement;

(f) Voluntary dissolution of the Corporation pursuant to *California Corporations Code Section 1900*;

(g) _____[*Other actions that the shareholders wish to restrict*].

3.04. **Shareholder Meetings.** Although there will be no required shareholder meetings, as provided in Section 3.01 of this Agreement, a special meeting may be called at any time in accordance with *California Corporations Code Section 600(d)* or the Corporation's bylaws.

3.05. **Employment of Shareholders.** Subject to any employment agreements executed concurrently with this Agreement, and amended from time to time, and to the provisions of Section 3.06 of this Agreement relating to termination of employment, the Shareholders will be employed as officers of the Corporation, in the capacity specified below, as long as they hold shares of stock of the Corporation, are active in its business, do not engage in any competing business, and, in a satisfactory manner, perform their duties and responsibilities as set forth in this Agreement, their individual employment contracts, and the Articles of Incorporation and the Bylaws of the Corporation:

[*Repeat, as required:*]

NAME _____

TITLE _____
[*e.g.,* President]

The title, duties, and the other terms of employment, including the annual salary, may be altered only by the unanimous written consent of the Shareholders.

3.06. **Grounds for Termination.** Notwithstanding any contrary provisions in any employment agreement, any Shareholder may be terminated as an officer and as a director of the Corporation by the action of the other Shareholders, as provided in this paragraph. Termination will be effective on the adoption by all of the other Shareholders, at a meeting held after _____[*period of time, e.g.,* 10 days'] written notice has been given to the Shareholders, of a written resolution finding that the Shareholder has

(a) Left the Corporation's employment, ceased to engage actively in its business, or voluntarily resigned from its employment;

(b) Filed a voluntary petition in bankruptcy, been adjudged a bankrupt, or made or attempted to make an assignment for the benefit of creditors;

(c) Become physically incapacitated relative to satisfactory performance of the Shareholder's duties;

(d) Willfully breached this Agreement;

(e) Been convicted of a felony involving moral turpitude;

(f) Been declared by a court of law to be mentally unsound or incompetent;

(g) Transferred, sold, pledged, hypothecated, assigned, or otherwise disposed of the Corporation's shares, in accordance with Section 6.01 of this Agreement;

(h) Engaged in other conduct constituting legal cause for termination; or,

(i) _____[*other grounds for termination of employment as an officer and removal of director*].

The Shareholders waive the provisions of *California Corporations Code Section 303* to the extent that they are inconsistent with these provisions.

3.07. **Mandatory Share Buy-Out on Termination.** In the event of termination, the terminated Shareholder agrees to sell his or her shares, as provided _____[in Article 7 of this Agreement *or* in the Buy-Sell Agreement of _____ (*name of close corporation*) dated _____].

ARTICLE 4 DISTRIBUTIONS

4.01. **Determination of Net Income and Loss.** The net profits or net losses of the Corporation for each fiscal year will be determined on an accrual basis in accordance with generally accepted principles of accounting.

4.02. **Retaining Net Income.** The Corporation will retain _____[percent *or dollar amount*] of its net income, plus any additional amount the President reasonably believes necessary to meet financial needs of the Corporation, including, but not limited to the development or expansion of its business.

4.03. **Regular Distributions of Net Income.** Subject to any retained earnings and to the statutory requirements related to corporate distributions, the net income of the Corporation will be distributed _____[*specify time period, e.g.,* monthly *or* quarterly *or* semiannually *or* annually] to the Shareholders in proportion to the number of

shares of the Corporation owned by them.

ARTICLE 5 DISSOLUTION

5.01. **Restrictions on Voluntary Dissolution.** All Shareholders must consent to voluntary dissolution; and each Shareholder waives any right to take that action by approval or vote of a lesser percentage.

5.02. **Procedures During Winding Up.** On commencement of dissolution proceedings (either by election of all Shareholders or otherwise), the Corporation will cease to carry on business except as necessary to wind up its business and distribute its assets. The President, or any Shareholder or Shareholders appointed by the President, will perform the following acts, as necessary, to wind up the affairs of the Corporation:

(a) Employ agents and attorneys to liquidate and wind up the affairs of the Corporation;

(b) Continue the business as necessary for the winding up of the affairs of the Corporation;

(c) Carry out contracts and collect, pay, compromise, and settle debts and claims for or against the Corporation;

(d) Defend suits brought against the Corporation;

(e) Sue, in the name of the Corporation, for all sums due to the Corporation or recover any of its property;

(f) Collect any amounts owing on subscriptions to shares or recover unlawful distributions;

(g) Sell at public or private sale, exchange, convey, or otherwise dispose of all or any part of the assets of the Corporation for cash in an amount considered reasonable by the President, or his or her appointee(s); and

(h) Make contracts and take any steps in the name of the Corporation that are necessary or convenient in order to wind up the affairs of the Corporation.

5.03. **Distribution of Assets on Dissolution.** The President, or the President's appointee(s), will apply the assets of the Corporation in the following order:

(a) To all debts and liabilities of the Corporation in accordance with the law, including the expenses of dissolution and liquidation, but excluding any debts to a Shareholder;

(b) To all senior debts to a Shareholder in accordance with the terms of any subordination agreement;

(c) To the accrued and unpaid interest on unsubordinated debts to a Shareholder;

(d) To the principal of unsubordinated debts to a Shareholder;

(e) To undistributed net profits of the Corporation, subject to the provisions of Section 4.01 of this Agreement;

(f) To repayment of the purchase price of the shares of the Corporation actually paid by each Shareholder; and, finally,

(g) To the Shareholders in proportion to the number of shares of the Corporation held by each.

For the purposes of this paragraph, assets distributed in kind will be valued at their fair market value as of the date of the proposed distribution, determined in good faith by the President or the President's appointee(s).

ARTICLE 6 RESTRICTIONS ON TRANSFER

6.01. **Restrictions on Transfer.** To accomplish the purposes of this Agreement, any transfer, sale, assignment, hypothecation, encumbrance, or alienation of any of the shares of the Corporation, other than according to the terms of _____[this Agreement *or* the provisions of the Buy-Sell Agreement of _____ (*name of close corporation*) dated _____], is void and transfers no right, title, or interest in or to those shares to the purported transferee, buyer, assignee, pledgee, or encumbrance holder. Each Shareholder shall have the right to vote shares held of record and to receive dividends paid on them until the shares are sold or transferred in accordance with this Agreement.

[*See Ch. 8D, Buy-Sell Agreements, for appropriate provisions restricting transfer of shares on the following events: the voluntary lifetime sale of shares, the involuntary transfer of shares due to bankruptcy or assignment for the benefit of creditors, and the shareholder's termination of employment, disability, retirement, or death.*]

6.02. **Permitted Transfers.** A Shareholder may transfer all or any part of his or her shares to a spouse, ancestors or lineal descendants (whether natural or adopted) or the spouses of any of such persons, or to any trust solely for the benefit of the Shareholder or any of the foregoing persons, provided that each such permitted transferee shall first agree in writing to be bound by the terms and provisions of this Agreement.

ARTICLE 7 MANDATORY BUY-SELL PROVISIONS

7.01. **Mandatory Buy-Sell Provisions.** _____. [*See Ch. 8D, Buy-Sell Provisions, for buy-sell provisions for small, closely held corporations.*]

ARTICLE 8 NONCOMPETITION; TRADE SECRETS

8.01. **Noncompetition.** Each Shareholder agrees that as long as he or she is the owner, or in control of, any of the Corporation's shares, the Shareholder will not be employed, concerned, or financially interested, either directly or indirectly, in the same or a similar business as that conducted by the Corporation, or compete with the Corporation. The business of the Corporation is defined as _____[*specify corporation's business*]. However, it is not a breach of this Agreement for any Shareholder to own, as a passive investment, not more than five percent of the outstanding stock of any publicly held company engaged in the business of the Corporation, as defined in this paragraph.

8.02. **Trade Secrets.** Each Shareholder acknowledges that the customer lists, trade secrets, processes, methods, and technical information of the Corporation and any other matters designated by the President or by the written consent of all Shareholders are valuable assets. Unless he or she obtains the written consent of each of the other Shareholders, each Shareholder agrees never to disclose to any individual or organization, except in authorized connection with the business of the Corporation, any customer list, or any name on that list, or any trade secret, process, or other matter referred to in this paragraph while the Shareholder holds, or has the control of, any shares of the Corporation, or at any later time.

ARTICLE 9 LEGEND ON SHARE CERTIFICATES

9.01. **Legend on Share Certificates.** Each share certificate, whether presently owned or subsequently acquired, shall have the following statement conspicuously printed on its face:

"This is a close corporation. The number of holders of record of its shares of all classes may not exceed _____ [*number not more than 35*]; this corporation is restricted in the types of shareholders in may have. The securities evidenced by this certificate may not be sold, transferred, assigned, pledged, hypothecated or otherwise disposed of except in accordance with, and are subject to transfer upon certain events described in, a shareholder agreement, dated _____ between the issuer and the registered holder hereof, a copy of which agreement is on file at the principal office of the issuer. Any attempted transfer that would violate these

limitations is void."

[*Add, if applicable:*]

9.02. **Stamping of Certificates.** Immediately on execution of this Agreement, each of the Shareholders shall present his or her share certificates to the Secretary of the Corporation and cause the Secretary to stamp on each certificate in a prominent manner the statement *set forth in Section 7.01* of this Agreement.

[*Add, if desired:*]

9.03. **Deposit of Shares With Corporation.** Concurrently with the execution of this Agreement, each Shareholder has endorsed stock assignment forms, in addition to his or her share certificates, and has deposited both the assignment forms and the share certificates with the Secretary of the Corporation. Despite the endorsement and deposit, each Shareholder shall have the right to vote shares held of record and to receive dividends paid on them until the shares are sold or transferred, as provided in this Agreement.

[*CONTINUE*]

ARTICLE 10 ARBITRATION

10.01. **Arbitration.** Any claim or controversy arising out of or relating to this Agreement, or arising out of or relating to the Corporation, or the rights or obligations of the Shareholders as shareholders, directors, officers, or employees of the Corporation will be determined and settled by arbitration in _____[*county*], according to the California Arbitration Statutes (*California Code of Civil Procedure Section 1280 et seq.*) in effect at the time. Each party involved in an arbitration proceeding in accordance with this section will pay its own expenses. The cost of conducting the arbitration proceeding itself will be born by each party to it in proportion to the number of shares of the Corporation owned prior to the commencement of the proceeding. The Shareholders intend that any court in which an action for involuntary dissolution is filed will consider the extent to which the party filing the action reasonably and in good faith attempted to negotiate or arbitrate, prior to filing, the _____[dispute *or* disputes] leading to filing.

ARTICLE 11 TERMINATION AND AMENDMENT

11.01. **Termination of Agreement.** This Agreement will remain in effect until the Corporation ceases to be a close corporation as defined in *California Corporations Code Section 158*, or until all the Shareholders agree in writing to termination. Notwithstanding any such termination, the provisions in Articles 6 (restrictions on transfer), 7 (mandatory buy-sell provisions), 8 (noncompetition; trade secrets), and 10 (arbitration) will remain in effect until all Shareholders agree in writing to a termination, or until they expire by their terms. Further, notwithstanding an original issuance of shares by the Corporation to a new Shareholder who does not become a party to this Agreement, this Agreement will continue to the extent it is enforceable apart for *California Corporations Code Section 300(b).*

11.02. **Amendment of Agreement.** This Agreement may be amended only by written consent of all parties to the Agreement.

ARTICLE 12 MISCELLANEOUS PROVISIONS

12.01. **Necessary Acts.** All parties to this Agreement will perform any acts, including executing any documents, that may be reasonably necessary to fully carry out the provisions and intent of this Agreement.

12.02. **Notices.** All notices, demands, requests, or other communications required or permitted by this Agreement shall be in writing and shall be deemed duly served when personally delivered to the party or to an officer or agent of the party, or when deposited in the United States mail, first-class postage prepaid, addressed to the Corporation at

_____[*address of Corporation's principal office*], or to a Shareholder at the address appearing for him or her on the books and records of the Corporation, or at any other address the party may designate by written notice to the others.

12.03. **Remedies.** The parties will have all the remedies available to them for breach of this Agreement by law or in equity. The parties further agree that in addition to all other remedies available at law or in equity, the parties will be entitled to specific performance of the obligations of each party to this Agreement and immediate injunctive relief. The parties also agree and that if an action is brought in equity to enforce a party's obligations, no party will argue, as a defense, that there is an adequate remedy at law.

12.04. **Attorneys' Fees.** In the event of any litigation concerning this Agreement between the parties to this Agreement or the parties to this Agreement and the estate of any deceased Shareholder, the prevailing party shall be entitled, in addition to any other relief that may be granted, to reasonable attorneys' fees.

12.05. **Binding on Successors and Assigns.** This Agreement will be binding on the parties to the Agreement and on each of their heirs, executors, administrators, successors, and assigns.

12.06. **Severability.** If any provision is unenforceable or invalid for any reason, the remaining provisions shall be unaffected by such a holding.

12.07. **Governing Law.** This Agreement shall be construed according to and governed by the laws of the State of California.

12.08. **Entire Agreement.** This instrument [*for each exhibit attached, add:* and Exhibit _____] constitutes the entire Shareholder Agreement of the Corporation and correctly sets forth the rights, duties, and obligations of each Shareholder and of each Shareholder to the other. Any prior agreements, promises, negotiations, or representations concerning the Agreement's subject matter not expressly set forth in this Agreement are of no force or effect.

12.09. **Agreement Available for Inspection.** An original copy of this Agreement duly executed by each of the Shareholders shall be delivered to the Secretary of the Corporation and maintained by the Secretary at the principal office of the Corporation available for inspection by any person requesting to see it.

Executed on _____[*date*], at _____[*city*], _____[*county*], California.

THE SHAREHOLDERS
[*Repeat, as required:*]
_____ [*signature*]
[*typed name*]

[*Add, if necessary:*]

EXHIBIT _____

[*Attach any separate employment agreements as Exhibit* _____]

EXHIBIT _____

[*Attach any separate buy-sell agreement*]

EXHIBIT _____

[*Attach any spousal consent form*]

[*If attorney is representing multiple parties, attach waiver of conflict of interest, if appropriate; see Ch. 1A, Role of Counsel in Starting a New Business, §§ 1A.33-1A.37, 1A.113. For waiver of conflict language, see Ch. 1A, Role of Counsel in Starting a New Business, §§ 1A.203[2], 1A.204[2].*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawClosely Held CorporationsDissolution & Winding UpBusiness & Corporate LawClosely Held CorporationsManagement Duties & Liabilities



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART IV. FORMS

4-8C California Legal Forms--Transaction Guide § 8C.201

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.201 Shareholder Agreement for Sole Shareholder Close Corporation

[1] Comment--Use of Form

This form is a shareholder agreement providing for the management of the business of a close corporation by the corporation's sole shareholder. Its primary purpose is to enable the shareholder to manage the corporation's business without satisfying the corporate formalities related to director and shareholder meetings [*see Corp. Code § 300(e)*]. For a shareholder agreement providing for management of the corporation, employment of the shareholders, restriction on stock transfers, and noncompetition, see *§ 8C.200*.

For a discussion of the importance of obtaining spousal consent and appropriate form provisions, see *§ 8C.203*.

[2] Form

Shareholder Agreement for Sole Shareholder Close Corporation

SHAREHOLDER AGREEMENT OF _____ [***name of close corporation***]

THIS AGREEMENT, dated _____, is between _____[*name of sole shareholder*] (referred to as "Shareholder") and _____[*name of close corporation*] (referred to as "Corporation"), a California close corporation as defined by *California Corporations Code Section 158*.

RECITALS

The Shareholder is the sole shareholder of the Corporation and is the owner of _____[*number*] shares of the capital stock of the Corporation, constituting all the issued and outstanding shares of the Corporation.

The Shareholder desires to enter into a shareholder agreement to provide for the management of the business of the

Corporation, as permitted by *Corporations Code Section 300*.

[*If corporation's articles either duplicate or augment the provisions of this Agreement, add:*]

The articles of incorporation contain provisions that _____[duplicate *or* augment] some of the provisions of this Agreement, which, to be effective, must be in the articles of incorporation or in a shareholder agreement of a close corporation. In the event of any inconsistencies between this Agreement and the articles of incorporation, the provisions of this Agreement will control. However, if this Agreement terminates, the provisions in the articles of incorporation will continue in effect, until amended as provided by law.

[*CONTINUE*]

AGREEMENT

1. **Management and Control.** The Shareholder will be the sole director of the Corporation and will be President and Chairman of the Board. All elections of directors (annual or otherwise) and all meetings of directors and Shareholders (annual, regular, or special) are waived. Notwithstanding the Bylaws of the Corporation and except as provided in the California Corporations Code, the business and affairs of the Corporation and all corporate powers will be exercised by or under the direction of the Shareholder as the sole shareholder of the Corporation. Any action or decision made by the Board or the Shareholder may be evidenced by any writing executed by the Shareholder.

2. **Corporate Records.** The Shareholder will maintain or cause the Corporation to maintain the books, records, and other documents as required by *Corporations Code Section 1500*.

Executed on _____[*date*], at _____[*city*], _____[*county*], California.

THE CORPORATION

_____
[*typed name of corporation*]
_____ [*address of principal office of corporation*]
_____ [*signature of president*]
[*typed name and title*]

THE SHAREHOLDER
_____ [*signature*]
[*typed name*]

[*Add, if necessary:*]

EXHIBIT A

[*Attach spousal consent form*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawClosely Held CorporationsManagement Duties & Liabilities



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART IV. FORMS

4-8C California Legal Forms--Transaction Guide § 8C.202

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.202 Provisions Ensuring S Corporation Tax Treatment

[1] Comment--Use of Form

Because the requirements for close corporation status under the General Corporation Law [*Corp. Code § 100 et seq.*] are not the same as the requirements for S corporation tax treatment [*see I.R.C. § 1361* et seq.; *Rev. & Tax. Code § 23800 et seq.*], some of the provisions in the shareholder agreement in § 8C.200[2], particularly the dividend provisions and the provisions that alter the right to manage the corporation and to vote shares, may violate one of the requirements to be taxed as an S corporation, particularly the single class of stock requirement [*see I.R.C. § 1361(b)(1)(D)*; *Treas. Reg. § 1.1361-1(l)(2)*; *see also § 8C.15[4]*, *8C.17[4][a]*]. In addition, an S corporation is limited in the number of shareholders it may have (no more than 100) [*I.R.C. § 1361(b)(1)(A)*] and in the type of shareholders (neither corporations nor foreign persons may be shareholders) [*I.R.C. § 1361(b)(1)(B), (C)*]. Consequently, if the shareholders wish to elect S corporation treatment, or to assure themselves of continued S corporation treatment, the provisions in this form should be inserted in the shareholder agreement. For discussion of the advisability of electing to be taxed as a S corporation, see Ch. 1B, *Selecting Form of Business Entity* . For discussion of the procedures to be used in electing or terminating Subchapter S status, see Ch. 2B, *Electing Subchapter S Status* .

[2] Form

Provisions Ensuring S Corporation Tax Treatment

AGREEMENT ON SUBCHAPTER S ELECTION

_____. **Subchapter S Election.**

[*If shareholders wish to elect S corporation treatment:*]

The Shareholders have determined that the Corporation, with the consent of the Shareholders, should elect to be taxed

as a small business corporation under Subchapter S of the Internal Revenue Code.

[*OR, if shareholders wish to assure continued qualification as an S corporation:*]

The Shareholders wish to ensure that the Corporation, having qualified as a small business corporation under Subchapter S of the Internal Revenue Code, will continue to qualify for Subchapter S treatment.

[*CONTINUE*]

Consequently, the Shareholders wish to ensure that the S corporation election, once made, will terminate or be revoked only as determined by the Shareholders.

Therefore, in order to protect that election and to prevent its inadvertent termination by transfer of the Corporation's stock into the hands of more than 100 shareholders or into the hands of an unqualified shareholder, the Shareholders agree to vote their shares, execute any necessary documents, and take any other required action in good faith _____[to qualify and maintain *or* to maintain] that election. The Shareholders also agree to bind their successors, executors, administrators, heirs, and assigns, in accordance with this paragraph.

If any Shareholder is unable or unwilling to execute any document required to effect or maintain the election under any provisions of the Internal Revenue Code or otherwise, that Shareholder irrevocably appoints the corporation's Secretary, or any other officer of the Corporation, to act as the Shareholder's attorney-in-fact to execute any necessary documents or take any necessary actions in that Shareholder's place.

No Shareholder will sell, assign, or transfer any shares of the Corporation to any person or in any manner that would cause the Corporation's S election to be terminated or revoked, without the prior written consent of each Shareholder.

Each Shareholder agrees to indemnify the Corporation and each other Shareholder for any S corporation benefits lost to them as a result of any act (or omission to act) of that Shareholder, resulting in the disqualification of the Corporation's S election or the loss of any benefit of that election. Each Shareholder agrees on behalf of that Shareholder's successors, executors, administrators, heirs, and assigns, that those persons will not consent to a revocation of the Corporation's S election on any transfer of shares. Each Shareholder further agrees that any such transferee will be required to indemnify the Corporation and each other Shareholder for any loss or expense arising from any consent to revoke the election, unless all Shareholders of the Corporation consent otherwise in writing.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)General OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)RequirementsTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Termination (IRC sec. 1362)Tax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewBusiness & Corporate LawClosely Held CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsDistributions (IRC secs. 1361, 1368)Tax LawFederal Taxpayer GroupsS CorporationsConditions & Restrictions (IRC sec. 1361)



189 of 189 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8C CLOSE CORPORATION SHAREHOLDER AGREEMENTS
PART IV. FORMS

4-8C California Legal Forms--Transaction Guide § 8C.203

AUTHOR: Marilyn E. Minger Practice Consultant

§ 8C.203 Spousal Consent to Shareholder Agreement

[1] Comment

[a] Use of Form

This consent form is intended to conform to the somewhat ambiguous language of *Fam. Code § 1100(a)*, which, with certain exceptions, provides that either spouse has the management and control of their community personal property (including stock) with the same absolute power of disposition, other than testamentary, that the spouse has over his or her separate property [*see* [c], *below*]. This consent is intended to enable a married shareholder to act alone with respect to all matters specified in the shareholder agreement [*see § 8C.200*], with the exception of the purchase by the shareholder of additional shares, as provided in the agreement. Nonparty spouses of married shareholders who become shareholders and parties to the agreement should sign a similar consent at that time.

In the case of a nonmarital partner who is not a party to the agreement, any rights that person may have in the stock acquired by a party to the agreement is based on contract [*Marvin v. Marvin (1976) 18 Cal. 3d 660, 673-674, 134 Cal. Rptr. 815, 557 P.2d 106]* . The attorney, therefore, should determine whether any such contract exists, establishing the ownership of the stock subject to the shareholder agreement. Any spousal consent forms attached to the agreement may be modified to reflect the nature of ownership of the nonmarital partner.

[b] Importance of Characterization of Stock as Community, Quasi-Community, or Separate Property Interests

All parties to a shareholder agreement, as well as nonparty spouses and nonmarital partners, have an interest in establishing or ascertaining the property nature of the stock subject to the agreement. Characterization of stocks as community, quasi-community, or separate property, or a combination of the three, is required in order to determine the rights and liabilities of the parties with respect to the stock. Problems involving characterization generally arise in the context of the following:

- Determining interspousal rights of management and control of the stock during the marriage.
- Dividing stock on marital dissolution, separation, or annulment.
- Distributing stock on the death of one or both spouses.
- Determining the rights of third party creditors with respect to the stock, either during marriage or on termination of marriage.

For example, non-owner shareholders will want to ensure the enforceable transfer of stock, as specified in the agreement, on the death or divorce of the owner shareholder. Owner shareholders who are married or have nonmarital partners will want to establish the community or separate property nature of the stock for purposes of management and control, as well as for income, estate and gift tax planning. Nonparty spouses and partners have similar interests.

Detailed discussion of property interests is outside the scope of this chapter. See Ch. 8D, *Buy-Sell Agreements* , for an overview of community property, quasi-community and separate property principles and the transmutation of the property nature of the stock. For additional coverage of property principles, see Ch. 120, *Complete Marital Settlement Agreements* , Ch. 121, *Provisions for Division of Property* , and CALIFORNIA FORMS OF PLEADING AND PRACTICE, Ch. 122, *Community Property* (Matthew Bender). For discussion of related estate planning considerations, see Ch. 60, *Estate Planning* .

Confirmation of the nature of the stock as community or separate property may be made part of the shareholder agreement or may be the subject of a separate agreement. To reduce the risk of a nonparty spouse claiming a community property interest in the stock in a marital dissolution proceeding (or the spouse's heirs making a similar claim on that spouse's death), some practitioners recommend the use of a property agreement separate from the shareholder agreement, covering all material assets of the spouses.

[c] Management and Control of Community Personal Property

With certain exceptions, either spouse has management and control of community personal property, with the absolute power of disposition, other than testamentary, that he or she has of his or her separate property [*Fam. Code § 1100(a)*]. As a corollary to equal management and control, the community property is generally liable for the debts and torts of both spouses [*Fam. Code §§ 910* (debts), 1000(b) (torts)]. One problem with equal management and control is the potential for conflicting independent decisions make by each spouse concerning specific community property [*see* [b], *above*]. The exceptions to and qualifications of the equal management and control rule may mitigate this potential problem.

The exception most germane to the shareholder agreement is provided for management and control of a community property business: Except for gifts of community property [*see Fam. Code § 1100(b)*], the disposition of household furnishings and clothes [*see Fam. Code § 1100(c)*], or the sale or lease of community real property [*see Fam. Code § 1102*], a spouse who is operating or managing a business or an interest in a business that is all or substantially all community personal property has the primary management and control of the business or interest [*Fam. Code § 1100(d)*]. Primary management and control means that the managing spouse may act alone in all transactions, except that the managing spouse must give prior written notice to the other spouse of any sale, lease, exchange, encumbrance, or other disposition of all (or substantially all) of the personal property used in the operation of the business, whether or not title to that property is held in the name of only one spouse [*Fam. Code § 1100(d)*], and must act with respect to the other spouse according to the rules governing fiduciary relationships that control the actions of persons occupying confidential relations with each other [*Fam. Code § 1100(e)*]. This fiduciary duty of management and control includes the obligation to fully disclose all material facts and information on the existence, characterization, and valuation of all assets in which the community has (or may have) an interest and all debts for which the community is (or may be) liable

[*Fam. Code § 1100(e)*]. Each spouse must also provide the other, on request, with equal access to all information and records that pertain to those assets and debts [*Fam. Code § 1100(e)*].

[d] Ethical Considerations

An attorney who drafts a spousal consent form or who is consulted by clients who wish to enter into a transmutation or confirmation agreement must remember his or her ethical responsibility to avoid conflicts of interest. Spousal consents, as well as transmutation and confirmation agreements, almost always raise actual or potential conflicts between spouses. An attorney cannot represent two clients who have conflicting (or potentially conflicting) interests, unless the attorney first explains the facts giving rise to the conflict and obtains written authorization from the clients to proceed with the dual representation [*Cal. Rules Prof. Conduct, Rule 3-310(B)*; *see § 8C.110*]. For general coverage of the ethical responsibilities of business attorneys, see Ch. 1A, *Role of Counsel in Starting a New Business* . For similar coverage for estate planning attorneys, see CALIFORNIA WILLS AND TRUSTS, Ch. 4, *Ethical Considerations and Professional Responsibility* (Matthew Bender).

[2] Form

Spousal Consent to Shareholder Agreement

CONSENT TO SHAREHOLDER AGREEMENT

The undersigned are the spouses (referred to individually as "spouse" or collectively as "spouses") of _____[*names of shareholders*] (referred to individually as "shareholder-spouse" or collectively as "shareholder-spouses"), respectively. Each spouse acknowledges that he or she has read and understood the Shareholder Agreement between _____[*names of shareholders*] and _____[*name of corporation*] (referred to as "corporation"], dated _____[*date of shareholder agreement*]. Each spouse understands that, according to the provision of the Shareholder Agreement, _____[he *or* she] and _____[his *or* her] shareholder-spouse have agreed to sell or transfer their interests in _____[*name of corporation*], including any community property interest, in accordance with the provisions of the Agreement. Each spouse agrees to be bound by the provisions of this Agreement in its entirety, including, but not limited to, the sale or transfer of interests in the Corporation. Each spouse further agrees not to devise whatever community property interest he or she may have in the shares or assets of the corporation in violation of this Agreement, if any shareholder-spouse predeceases his or her spouse while still owning an interest in the Corporation.

[*If undersigned is spouse of shareholder-employee, add:*]

Each spouse understands and acknowledges that the shareholder-spouse is operating or managing the business of _____[*name of corporation*] to the extent provided in the Agreement and that the shareholder has and will have the primary management and control of the business to the extent provided in the Agreement and to the extent that the shareholder-spouse may lawfully do so.

Executed on _____[*date*], at _____[*city*], _____[*county*], California.

THE SPOUSES
[*Repeat, as required:*]
_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesFamily LawMarital Duties & RightsProperty RightsCharacterizationSeparate PropertyFamily LawMarital Duties & RightsProperty RightsCharacterizationCommunity Property



1 of 141 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS

4-8D California Legal Forms--Transaction Guide 8D.syn

§ 8D.syn Synopsis to Chapter 8D: BUY-SELL AGREEMENTS

§ 8D.01 California Sources

[1] Statutes

[2] Regulations

§ 8D.02 Federal Sources

[1] Internal Revenue Code

[2] Regulations

[3] Rulings

§ 8D.03 Rules of Professional Conduct

[1] American Bar Association Model Rules of Professional Conduct

[2] California Rules of Professional Conduct

§ 8D.04 [Reserved]

§ 8D.05 Law Reviews and Periodicals

§ 8D.06 Annotations

§ 8D.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 8D.08-8D.09 [Reserved]

§ 8D.10 Buy-Sell Agreement Defined

§ 8D.11 Purposes of Buy-Sell Agreement

§ 8D.12 Types of Buy-Sell Agreements

§ 8D.13 Types of Buy-Sell Agreements Compared

[1] In General

[2] Advantages and Disadvantages of Entity Purchase Agreements

[a] Business Considerations

[b] Tax Considerations

[3] Advantages and Disadvantages of Cross-Purchase Agreements

[a] Advantages

[b] Disadvantages

[4] Advantages and Disadvantages of Hybrid Agreements

[a] Corporation's Purchase Based on Favorable Income Tax Consequences

[b] "Wait and See' Agreement

§§ 8D.14-8D.19 [Reserved]

§ 8D.20 Potential Conflicts of Interest in Context of Buy-Sell Agreement--In General

§ 8D.21 Identifying Conflicts of Interest

[1] Identifying the Client

[2] Representing the Corporation

[a] Nature of Representation

[b] Disclosure Required When Constituents Also Represented

§ 8D.22 Representing Multiple Parties

[1] Duty to Identify Conflict

[2] Duty to Inform Client

§ 8D.23 When Multiple Representation is Inadvisable

§ 8D.24 Representing One Client

§ 8D.25 Prior Representation--Conflict of Interest Considerations

§ 8D.26 Representing Party to Buy-Sell Agreement and Nonparty Spouse

§ 8D.27 Other Roles of Attorney--Conflict of Interest Considerations

[1] Attorney as Investor

[2] Attorney as Corporate Agent, Director, or Officer

[3] Attorney as Witness

§ 8D.28 Minimizing Risk of Conflict of Interest

[1] Disclosure Letter Tailored to Specific Conflicts

[2] Conflict-Identification System

§ 8D.29 Duty to Perform Competently

[1] In General

[2] Specialist Standard

[3] Duty to Refer

§§ 8D.30-8D.39 [Reserved]

§ 8D.40 Taxation of Seller under Entity Purchase Agreement

[1] Characterization of Distribution as Redemption or Dividend

[2] Tax Treatment of Dividends and Capital Gains Distinguished

[3] Characterization of Distribution as Deductible Expense

§ 8D.41 Taxation of Seller under Cross-Purchase Agreement

§ 8D.42 Taxation of Seller under Hybrid Agreement

§ 8D.43 Installment Sale Treatment

[1] Waiver of Family Attribution Rules

[2] Deferral of Income Tax Liability

§ 8D.44 Taxation of Purchaser under Cross-Purchase Agreement

§ 8D.45 Taxation of Purchaser under Entity Purchase Agreement

§ 8D.46 Taxation of Remaining Shareholders under Entity Purchase Agreement

§ 8D.47 Effect of Insurance Funding on Taxation--In General

§ 8D.48 Taxation of Entity Purchase Agreements Funded With Life Insurance

[1] Taxation of Premiums

[2] Taxation of Policy Proceeds

[3] Alternative Minimum Tax Considerations for C Corporations

[4] Accumulated Earnings Tax Considerations for C Corporations

§ 8D.49 Taxation of Shareholders under Cross-Purchase Agreement Funded by Life Insurance

[1] Taxation of Premiums

[2] Taxation of Policy Proceeds

§ 8D.50 California Income Tax Consequences of Agreement

§§ 8D.51-8D.59 [Reserved]

§ 8D.60 Estate Taxation of Policy Proceeds

[1] In General

[2] "Incidents of Ownership"

[3] Valuation of Shares

[4] Cross-Purchase Agreements

§ 8D.61 Valuation of Shares at Purchase Price for Federal Estate Tax Purposes

[1] Basic Issues

[2] Fixing Estate Tax Valuation at Agreement Price

[a] Effect of Agreement Price in Determining Value for Federal Estate Tax Purposes

[b] Requirements for Agreements Between Unrelated Persons

[c] Additional Requirements for Agreements Between Related Persons

[d] Requirements Agreements Entered Into Before October 9, 1990

§ 8D.62 California Estate Tax Consequences of Agreement

§§ 8D.63-8D.69 [Reserved]

§ 8D.70 Importance of Business Law Considerations

§ 8D.71 Funding Buy-Sell Agreements

[1] Types of Funding

[a] Cross-Purchase Agreement

[b] Entity Purchase Agreement

[c] Both Types of Agreements

[2] Life Insurance Funding

[a] Advantages

[b] Cost of Insurance

[c] Alternate Insurance Possibilities

[d] Adequate Amount for Funding

[e] Type of Life Insurance Product

[f] Importance of Funding Agreement Through Purchase of Insurance

§ 8D.72 Restrictions on Corporate Purchases

[1] Statutory Tests

[a] In General

[b] Retained Earnings Test

[c] Remaining Assets Test

[d] Solvency Test

[e] Liquidation or Dividend Preferences

[2] Exception for Agreements Funded with Insurance

§ 8D.73 Triggering Events

§ 8D.74 Securities Regulations Considerations

[1] Exemptions to Qualification

[2] Effect of Transfer Restrictions on Qualification

§ 8D.75 Valuation of Shares

[1] Valuation Methods--In General

[2] Book Value

[3] Capitalization of Earnings

[4] Mutual Agreement

[5] Appraisal

§ 8D.76 Reviewing, Amending, and Enforcing the Agreement

§§ 8D.77-8D.89 [Reserved]

§ 8D.90 Characterization of Stock as Community, Quasi-community, or Separate Property

[1] Importance of Characterization

[2] Types of Property

[a] Community Property

[b] Separate Property

[c] Quasi-Community Property

[3] Community Property Interest in Separate Property Investment

[4] Management and Control of Community Personal Property

[5] Agreement Confirming or Transmuting Property Nature of Stock Subject to Buy-Sell Agreement

[a] Use of Transmutation Agreements

[b] Issues Involving Nonmarital Partners

[c] Ethical Considerations

§§ 8D.91-8D.99 [Reserved]

§ 8D.100 Client Interview

[1] Facts

[a] Each Shareholder

Scope

[b] The Corporation

Scope

[c] Trustee Administrator

Scope

[2] Documents

Scope

§§ 8D.101-8D.109 [Reserved]

§ 8D.110 Identifying Conflicts of Interest

Scope

§ 8D.111 Determining Scope of Work to be Performed by Attorney

Scope

§ 8D.112 Selecting Appropriate Type of Agreement

Scope

§ 8D.113 Selecting Type and Amount of Funding

Scope

§ 8D.114 Selecting Buyers

Scope

§ 8D.115 Selecting Triggering Events and Their Effect on Buyer's Obligations to Repurchase Shares

Scope

§ 8D.116 Selecting Valuation Methods

Scope

§ 8D.117 Complying with Valuation Requirements for Federal Estate Tax Purposes

Scope

§ 8D.118 Selecting Agreement's Administrator

Scope

§§ 8D.119-8D.129 [Reserved]

Scope

§ 8D.130 Introductory Provisions

Scope

§ 8D.131 Transfer Restrictions

Scope

§ 8D.132 Mandatory Sale-Purchase on Death

Scope

§ 8D.133 Sale of Shares During Lifetime

Scope

§ 8D.134 Share Valuation Method

Scope

§ 8D.135 Funding Purchase of Shares

Scope

§ 8D.136 Trustee Provisions

Scope

§ 8D.137 Amendment and Termination of Agreement

Scope

§ 8D.138 Binding Nature of Agreement

Scope

§ 8D.139 Miscellaneous Standard Contract Provisions

Scope

§ 8D.140 Exhibits

Scope

§§ 8D.141-8D.149 [Reserved]

§ 8D.150 Representing Multiple Parties to Agreement

Scope

§ 8D.151 Agreement Confirming or Transmuting Character of Stock Subject to Agreement

Scope

§ 8D.152 Reviewing and Amending Agreement

Scope

§§ 8D.153-8D.199 [Reserved]

§ 8D.200 Entity Purchase Buy-Sell Agreement--Not Funded by Insurance

[1] Comment

[a] Use of Form

[b] Restrictions Applicable to New or Transferred Shares

[c] Legend Requirement

[d] Deposit of Share Certificates with Corporation

[e] Permitted Transfers

[f] Restrictions on Voluntary Lifetime Transfers of Shares

[g] Tax Effect of Installment Payment Provisions

[h] Obligations of Transferees

[i] Sale of Shares on Death of Shareholder

[j] Sale of Shares on Total Disability

[k] Sale on Termination of Employment

[l] Tax Effect of Employment-Related Restrictions

[m] Formula for Determining Purchase Price

[n] Transfer of Title and Change in Shareholder Status

[o] Waiver of Duties to Minority Shareholders Void

[2] Form

Entity Purchase Buy-Sell Agreement--Not Funded by Insurance

§§ 8D.201-8D.209 [Reserved]

§ 8D.210 Cross-Purchase Buy-Sell Agreement- Not Funded by Insurance

[1] Comment

[a] Use of Form

[b] Restrictions Applicable to New or Transferred Shares

[c] Legend Requirement

[d] Deposit of Share Certificates with Corporation

[e] Permitted Transfers

[f] Restrictions on Voluntary Lifetime Transfers of Shares

[g] Tax Effect of Installment Payment Provisions

[h] Obligations of Transferees

[i] Sale of Shares on Death of Shareholder

[j] Sale of Shares on Total Disability

[k] Sale on Termination of Employment

[l] Tax Implication of Employment-Related Restrictions

[m] Formula for Determining Purchase Price

[n] Transfer of Title and Change in Shareholder Status

[o] Termination of Agreement

[p] Waiver of Duties to Minority Shareholders Void

[2] Form

Cross-Purchase Buy-Sell Agreement- Not Funded by Insurance

§§ 8D.211-8D.219 [Reserved]

§ 8D.220 Life Insurance Funding Provisions for Entity Purchase Agreement

[1] Comment

[a] Use of Form

[b] Life Insurance Funding

[i] Advantages

[ii] Potential Disadvantages of Funding Entity Purchase Agreement with Life Insurance

[2] Form

Life Insurance Funding Provisions for Entity Purchase Agreement

§ 8D.221 Life Insurance Funding Provisions for Cross-Purchase Agreement

[1] Comment

[a] Use of Form

[b] Life Insurance Funding

[i] Advantages

[ii] Potential Disadvantages of Funding Cross-Purchase Agreement with Life Insurance

[2] Form

Life Insurance Funding Provisions for Cross-Purchase Agreement

§§ 8D.222-8D.229 [Reserved]

§ 8D.230 Provision for Termination of Seller's Rights as Shareholder Immediately Upon Occurrence of Event Triggering Buy-Sell Agreement

[1] Comment

[a] Use of Form

[b] Practical Effect of Form

[c] Legal Effect of Form

[2] Form

Provision for Termination of Seller's Rights as Shareholder Immediately Upon Occurrence of Event Triggering Buy-Sell Agreement



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS

4-8D California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter examines the fundamental rules applicable to buy-sell agreements for small, closely held corporations. It discusses the nature and types of buy-sell agreements, including the entity purchase agreement, the cross-purchase agreement, and the hybrid agreement. It discusses the income tax consequences of the various types of agreements, including the taxation of sellers, purchasers, and other shareholders (not purchasers), and the tax effects of insurance funding. It also discusses the valuation of shares for estate tax purposes. The chapter covers business law considerations, including selecting the triggering events, setting the shares' purchase price, and funding the agreement. It briefly discusses securities regulations considerations and statutory restrictions on corporate purchases. It considers the impact of the community property laws on the ownership of the stock subject to the agreement and who should sign the agreement, either as a party to the agreement or as a nonparty who acknowledges the agreement. The ethical considerations related to an attorney's drafting or reviewing buy-sell agreements and the conflicts of interest the attorney must avoid are also covered.

The Transaction Guide contains a checklist and drafting guide for a buy-sell agreement.

Forms include entity purchase and cross-purchase agreements and insurance provisions for each.

For an example and discussion of a buy-sell agreement for a professional corporation, see Ch. 12A, *Professional Corporations* . For examples and discussion of buy-sell provisions for general partnerships, see Ch. 15, *General Partnerships* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8D California Legal Forms--Transaction Guide § 8D.01

§ 8D.01 California Sources

[1] Statutes

Close corporation defined. *Corp. Code § 158*.

Distribution to shareholders defined. *Corp. Code § 166*.

Shareholder agreement defined. *Corp. Code § 186*.

Requirements for shareholder agreement. *Corp. Code § 300(b)*.

Required legend on share certificates regarding transfer restrictions. *Corp. Code § 418(a)(1),(c)*.

Financial tests required for corporate distributions. *Corp. Code §§ 500-503*.

Exception from distribution financial tests for redemption of deceased shareholder's shares. *Corp. Code § 503.1*.

Exception from distribution financial tests for redemption of disabled shareholder's shares. *Corp. Code § 503.2*.

Limited offering exemption. *Corp. Code § 25102(f)*.

Small offering exemption. *Corp. Code § 25102(h)*.

Issuer transaction securities qualification requirements. *Corp. Code § 25110*.

Quasi-Community property defined. *Fam. Code § 125*.

Division of quasi-community property on dissolution of marriage. *Fam. Code §§ 125, 2550*.

Separate property defined. *Fam. Code §§ 130, 770(a).*

Rules applicable to property contracts between husband and wife. *Fam. Code §§ 721, 852.*

Management and control of community personal property. *Fam. Code § 1100(a)-(d).*

Fiduciary duty of management and control. *Fam. Code § 1100(e).*

Community property defined. *Fam. Code § 760.*

Division of community property on dissolution of marriage. *Fam. Code § 2550.*

Disposition of quasi-community property on death of spouse. *Prob. Code §§ 66, 101, 6101(c).*

Disposition of community property on death of spouse. *Prob. Code §§ 100, 6101(b).*

Rules applicable to contracts waiving property rights between husband and wife at death. *Prob. Code §§ 141-143.*

Disposition of separate property on death of spouse. *Prob. Code § 6101(a).*

Restriction on gift or estate taxes imposed on death. *Rev. & Tax. Code § 13301.*

"Pick-up" estate tax. *Rev. & Tax. Code § 13302 et seq.*

Taxation of corporate distributions and adjustments under Subchapter C of Internal Revenue Code. *Rev. & Tax. Code §§ 17321 et seq.*

Taxation of capital gains and losses under Subchapter P of Internal Revenue Code. *Rev. & Tax. Code §§ 18151 et seq., 24990 et seq.*

Limited recognition of gain on sale or exchange of qualified small business stock. *Rev. & Tax. Code § 18152.5.*

[2] Regulations

"Open qualification" defined. *10 Cal. Code Reg. § 260.001(f).*

"Limited offering qualification" defined. *10 Cal. Code Reg. § 260.001(e).*

Regulation of transfer restrictions imposed by charter documents. *10 Cal. Code Reg. § 260.140.8.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8D California Legal Forms--Transaction Guide § 8D.02

§ 8D.02 Federal Sources

[1] Internal Revenue Code

Alternative Minimum Tax for corporations. *I.R.C. § 55*.

Insurance proceeds are taxable to extent they exceed consideration and premiums paid by recipient when policy is transferred for consideration to recipient (transfer-for-value rule). *I.R.C. § 101(a)(2)*.

Corporate deduction for ordinary and necessary business expenses. *I.R.C. § 162(a)*.

Treatment of redemption as sale rather than dividend. *I.R.C. § 302(a)*.

Redemptions not equivalent to dividends. *I.R.C. § 302(b)(1)*.

Substantially disproportionate redemptions. *I.R.C. § 302(b)(2)*.

Termination of shareholder's interest in corporation. *I.R.C. § 302(b)(3)*.

Redemptions in connection with partial liquidation of corporation. *I.R.C. § 302(b)(4)*.

Constructive ownership of stock. *I.R.C. § 302(c)*.

Redemption to pay death taxes treated as exchange. *I.R.C. § 303*.

Taxability of corporation on distribution. *I.R.C. § 311*.

Effect of distribution on corporate earnings and profits. *I.R.C. § 312(a)*.

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Proportionate increase in shareholders' shares resulting from the redemption not taxed. *Treas. Reg. § 1.305-3(e)*, Ex. 13.

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Effect of price specified in buy-sell agreement on valuation of shares for federal estate tax purposes. *Treas. Reg. § 20.2031-2(h)*.

Additional guidelines used to determine value of shares for estate tax purposes in buy-sell agreements between related persons. *Treas. Reg. § 25.2703-1*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8D California Legal Forms--Transaction Guide § 8D.03

§ 8D.03 Rules of Professional Conduct

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-8D California Legal Forms--Transaction Guide § 8D.04

[Reserved]

§ 8D.04[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8D California Legal Forms--Transaction Guide § 8D.05

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8D California Legal Forms--Transaction Guide § 8D.06

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8D California Legal Forms--Transaction Guide § 8D.07

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-8D California Legal Forms--Transaction Guide §§ 8D.08-8D.09

[Reserved]

§§ 8D.08[Reserved]



11 of 141 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
A. Nature and Types of Buy-Sell Agreements

4-8D California Legal Forms--Transaction Guide § 8D.10

§ 8D.10 Buy-Sell Agreement Defined

A buy-sell agreement (also known as a buyout agreement) is a contract, particularly important in the case of a close or closely held corporation [*see Corp. Code § 158(a)*], under which the shareholders or owners of a business agree to purchase the interests of a withdrawing or deceased shareholder [Black's Law Dictionary (5th ed. 1979), at 181]. The agreement describes the conditions (usually death, disability, or termination of employment) and the terms under which shareholders may or must transfer their shares [Black's Law Dictionary (5th ed. 1979), at 181].

A buy-sell agreement is merely an executory contract to buy and sell personal property (that is, an employee's shares) if and when a particular event such as termination of employment occurs. A shareholder under such an executory contract is entitled to the benefits of ownership until delivery is made or tendered to the buyer, unless the buy-sell agreement specifies or implies a different intention [*Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1173, 69 Cal. Rptr. 2d 764, 947 P.2d 1301* (holding that agreement at issue did not imply any intention by parties to deny shareholder his rights during the post-employment period used to determine share value)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawTypes of ContractsGeneral OverviewContracts LawTypes of ContractsExecutory Contracts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
A. Nature and Types of Buy-Sell Agreements

4-8D California Legal Forms--Transaction Guide § 8D.11

§ 8D.11 Purposes of Buy-Sell Agreement

Generally, a buy-sell agreement provides the corporation and the shareholders with the certainty of a legally binding transfer plan well in advance of the actual events, facilitating agreement on the terms and manner of transfer [*see* Jacobs, *Back to Basics Post TRA- 76 Stock Interest Terminations in Closely Held Corporations*, 36 N.Y.U. Tax. Inst. 3, 6 (1978)]. It ensures the uninterrupted continuation of the business entity in the event of the death or withdrawal of a participant, prevents "outsiders" from becoming transferees of corporate shares upon a shareholder's death, disability, or retirement from the corporation, and enables the shareholders to sell their shares for a fair price despite the lack of a public market [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 63.02 (*Matthew Bender); Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1173, 69 Cal. Rptr. 2d 764, 947 P.2d 1301* (citing Ballantine & Sterling, § 63.02)]. Further, if the agreement is properly drafted, the value of the shares of a deceased shareholder specified in the agreement will be controlling for federal estate tax purposes [*see I.R.C. § 2703*; *Treas. Reg. §§ 25.2703-1,* 20.2031-2; *see also § 8D.61*].

In addition to its other functions, a buy-sell agreement provides for the orderly liquidation of a deceased shareholder's interest in the corporation, and ensures that his or her estate will receive the liquid assets it may need for taxes, creditors' claims, or probate expenses. An agreement may also give the remaining shareholders an option to dissolve the corporation upon the death of a major shareholder.

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawTypes of ContractsExecutory ContractsBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
A. Nature and Types of Buy-Sell Agreements

4-8D California Legal Forms--Transaction Guide § 8D.12

§ 8D.12 Types of Buy-Sell Agreements

There are two principal types of buy-sell agreements:

- The "entity purchase" plan (also referred to as the "stock" or "redemption" plan), and
- The "cross-purchase" plan (also referred to as the "stock purchase" agreement.

Under an entity purchase plan, a corporation redeems or purchases a shareholder's stock upon the occurrence of a triggering event, usually withdrawal, death, or severance of employment of the shareholder. Under a cross purchase plan, the remaining shareholders purchase a shareholder's stock directly from the shareholder or the shareholder's estate in proportion to their existing ownership interests.

A combination entity purchase and cross-purchase ("hybrid") agreement may provide for shareholder purchase after the corporation's failure to purchase, or corporate purchase after failure of the remaining shareholders to purchase [*see, e.g., § 8D.200[2],* § 3.08]. Other hybrid arrangements provide that some of the shares will be offered to the corporation and some to the shareholders. For example, such an agreement might provide that the remaining shareholders be given the first option to purchase the shares of the withdrawing shareholder, but if they decline to exercise the option, the corporation will have the option to purchase, and if it fails to purchase all the shares, the remaining shareholders will purchase any unsold shares.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
A. Nature and Types of Buy-Sell Agreements

4-8D California Legal Forms--Transaction Guide § 8D.13

§ 8D.13 Types of Buy-Sell Agreements Compared

[1] In General

Selecting the appropriate type of buy-sell agreement requires evaluation of complex business and tax issues, as well as consideration of the shareholders' desires and circumstances.

Historically, entity purchase agreements were generally preferred because they were simpler to fund and to administer [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 63.03 (Matthew Bender)]. However, changes in the tax laws have increased the popularity of cross-purchase agreements as a result of the potential adverse tax consequences of an entity purchase, particularly when the purchase is funded with insurance [*see, e.g.*, Sugar, *Cross-Purchase Agreements Now Are Often More Beneficial than Redemption Agreements*, *18 Taxation for Lawyers 370 (May/June 1990)*; Apfel & Wolfe, *AMT Increases Advantage of Cross-Purchase Agreements over Redemption Agreements*, 18 Taxation for Lawyers (May/June 1990); Wolf & Kupferberg, *What is the Best Form for Structuring Corporate Buy-Out Agreements Now?*, 16 Estate Planning 2 (Jan/Feb 1989)]. Some practitioners favor a hybrid agreement, under which the corporation buys the shares that it can purchase without adverse tax consequences, and the shareholders purchase the remaining shares.

The advantages and disadvantages of the entity purchase, the cross-purchase, and the hybrid agreements are discussed in [2]-[4], *below*.

[2] Advantages and Disadvantages of Entity Purchase Agreements

[a] Business Considerations

Under an entity purchase agreement, the corporation, not the remaining shareholders, purchases its own shares from the departing shareholder [*see § 8D.12*].

The primary business advantage of an entity purchase is that it is a simpler arrangement than a cross-purchase. An entity purchase will be enforceable after a shareholder's death or withdrawal, while a cross-purchase agreement may have to

be rewritten after those events to redefine the responsibilities of the remaining shareholders. When the agreement is funded with insurance [*see, e.g., §§ 8D.220, 8D.221*], an entity purchase agreement requires the corporation to acquire only one life insurance policy for each shareholder, while a cross-purchase agreement may require each shareholder to purchase a policy on the life of every other shareholder, resulting in increased administrative costs and considerable expenditures on insurance premiums [*see* [3], *below*].

Except for entity purchase agreements adequately funded by life or disability insurance (which covers only the death or disability of the shareholder and not other triggering events) [*see Corp. Code §§ 503.1, 503.2*], the primary business disadvantage of an entity purchase agreement is that it may be unenforceable at the time the shareholder withdraws from the corporation. A corporation is prohibited from repurchasing its shares unless, at the time of the shareholder's death or withdrawal, it can meet certain statutory financial tests that do not apply to a cross-purchase agreement [*see Corp. Code §§ 166, 500-503*; *see also § 8D.72*; Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 8, *Dividends and Reacquisition of Shares* (Matthew Bender) (enforcement and validity of contracts by corporations to repurchase their shares)]. This potential disadvantage, however, may be mitigated by requiring the shareholders to take whatever actions are necessary to enable the corporation to repurchase its shares by either revaluing corporate assets or making a capital contribution.

[b] Tax Considerations

The primary income tax advantage of an equity purchase agreement is that it generally avoids the double taxation of corporate income used to purchase the shares of the departing shareholder [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* § 63.03[2][a] (Matthew Bender)]. Although the corporation cannot claim a deduction for the amount used to redeem a shareholder's shares as an ordinary and necessary business expense [*Rev. Rul. 69-546, 1969-2 C.B. 24* ; *see I.R.C. § 162(a)*], the shareholders do not pay taxes on the proportionate increase in their shares resulting from the redemption [*see Treas. Reg. § 1.305-3(e)*, Ex. 13; *Rev. Rul. 58-614, 1958-2 C. B. 920* ; *see also § 8D.46*]. Under a cross-purchase agreement, however, the funds used to purchase the shares of the departing shareholder are subject to double taxation when the remaining shareholders withdraw these funds from the corporation as dividends. The double taxation results because the dividends, taxed once as income to the corporation [*I.R.C. § 11(a)*], are not deductible by the corporation [*see I.R.C. § 311*] and are taxed again when received by the shareholders [*I.R.C. §§ 1(a)-(e), (h)(11)* (capital gains treatment for qualifying dividends), (i)(2), 61(a)(7), 301, 305(b); *see I.R.C. § 316* (dividend defined); [3], *below*].

Entity purchase agreements have several significant tax disadvantages:

- An accumulated earnings tax may be imposed if the agreement is funded with insurance with substantial cash surrender values that accumulate beyond the reasonable needs of the business [*see I.R.C. § 531* et seq.; § 8D.48[4]].

- The alternative minimum tax [*I.R.C. § 55*] may be imposed if the entity purchase agreement is funded with life insurance [*see I.R.C. §§ 56(g)(4)(B)(ii)*; § 8D.48[3]; *see also* Apfel & Wolfe, *AMT Increases Advantage of Cross-Purchase Agreements over Redemption Agreements*, 18 Taxation for Lawyers (May/June 1990)].

- Income will be recognized by the corporation if it distributes property to the shareholder to redeem the shares, if the property's fair market value exceeds its adjusted basis [*I.R.C. § 311(b)*].

- Depreciation deductions and investment tax credits may have to be recaptured if the corporation distributes appreciated property to redeem the shares [*I.R.C. §§ 179, 280F(b)(2), 1231, 1245, 1250, 1252, 1254, 1255* (recapture of depreciation deductions); *I.R.C. § 50(a)* (recapture of investment tax credit)].

- The corporation's distribution of property in exchange for the acquisition of stock from a shareholder (a "redemption distribution") will be treated as a dividend unless the redemption is either:
    - Not essentially equivalent to a dividend,
    - Substantially disproportionate,
    - In complete termination of the selling shareholder's interest, or
    - In partial liquidation of stock held by a noncorporate shareholder in the distributing corporation [*I.R.C. § 302(b)*], unless the stock attribution rules impute constructive ownership of additional, unredeemed shares to the shareholder [*see I.R.C. § 318*].

[3] Advantages and Disadvantages of Cross-Purchase Agreements

[a] Advantages

A major advantage of the cross-purchase agreement is the avoidance of the business and tax problems associated with entity purchase agreements. Since the shareholders, and not the corporation, are personally obligated to purchase the shares of the deceased or withdrawing shareholders, the uncertainty about whether the corporation can meet the financial tests required before it may redeem its shares [*see* [2], *above*] is inconsequential. The potential adverse effect of the alternative minimum tax generally can be avoided because the insurance policies used to fund a cross-purchase agreement belong to the individual shareholders, and therefore the cash surrender values of the policies do not constitute assets or retained earnings of the corporation [*see* Sugar, *Cross-Purchase Agreements Now Are Often More Beneficial than Redemption Agreements, 18 Taxation for Lawyers 370, 373 (May/June 1990)*].

In addition to avoiding the adverse tax consequences of an entity purchase agreement, the remaining shareholders may benefit under the cross-purchase agreement because they get a step-up in basis in the shares they purchase from the selling shareholder, making the basis of the purchased shares equal to their purchase price [*I.R.C. § 1012*]. Under an entity purchase agreement, the basis in shares remains fixed, despite any increase in value [*Treas. Reg. § 1.305-3(e),* Ex. 13; *Rev. Rul. 58-614, 1958-2 C.B. 920* ; *see § 8D.46*]. Of course, the impact of an increase in basis depends on the type of business entity involved, and the likelihood that the shareholder will sell his or her interest. An increased basis results in lower taxes if the shares are sold or if losses are generated by an S corporation. However, the basis increase will be of little benefit to a profitable family corporation if the surviving members retain the shares.

Under a cross-purchase agreement funded with insurance, the shareholders are likely to pay insurance premiums with after-tax dollars at a lower tax rate than would the corporation under an entity purchase agreement [*see I.R.C. §§ 1* (individual tax rates), 11(b) (corporate tax rates)].

Unlike an entity purchase agreement, a cross-purchase agreement can be structured to ensure that the balance of power between groups in the corporation will remain the same, by providing for the purchase of shares by shareholders in same group as the departing or deceased shareholder [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 63.03[3][a] (Matthew Bender)]. Further, the transfer of shares between shareholders is generally treated as the sale or exchange of a capital asset, subject to taxation as capital gains [*see I.R.C. §§ 1(h), 1001(a), 1221*; *see also § 8D.41*]. The sale proceeds in an entity purchase may, under certain circumstances, be treated as a dividend, in which case the entire amount, and not just the profit on the sale of the shares, is taxed to the shareholder [*see I.R.C. §§ 1(h)(11), 61(a)(1), 301, 305(b), 316(a)*; *see also § 8D.40*]. Even for years in which dividends are taxed a capital gains rates (generally tax years beginning after December 31, 2002, and before January 1, 2009) [*see* I.R.C. § (h)(11); Pub. Law No. 108-27, §§ 302(f)(1), 303 (effective date and sunset provisions for dividend taxation at

capital gains rates)], the amount of gain from the sale proceeds in an entity purchase will be greater. For other years, the discrepancy between ordinary income and capital gains rates may result in significantly higher tax liability if sale proceeds are treated as a dividend [*see I.R.C. § 1(a)-(e), (h), (i)(2)*].

In addition, when insurance funding is used and there is a disparity in either ages or ownership percentages of shareholders, a cross-purchase agreement is likely to be more equitable than an entity purchase agreement. Although the younger or smaller percentage shareholder pays a disproportionately larger premium on the older or larger percentage shareholder, the shareholder paying the larger premium will derive the benefits of the proceeds. In an entity purchase arrangement, however, the entity (and thus the owners proportionately) bears the higher cost.

[b] Disadvantages

The major disadvantage of a cross-purchase agreement for most shareholders is that they must use their own money to purchase the shares of the departing shareholder. If the remaining shareholders have to withdraw funds from the corporation in the form of dividends to fund the buy-out, these funds will be subject to double taxation--once as income to the corporation [*see I.R.C. §§ 11(a), 311*] and again when received by the shareholder [*I.R.C. §§ 1(h)(11), 61(a)(7), 301, 305(b)*; *see I.R.C. §§ 316* ("dividend" defined); § 8D.44]. This double taxation, however, may not occur when the funds are withdrawn as compensation, provided the amount is reasonable, taking into account the shareholder's overall compensation [*see I.R.C. § 162(a)(1)*; *Treas. Reg. § 1.162-8*], or if the corporation is a subchapter S corporation [*see I.R.C. § 1366*; *see also* Ch. 1E, *Taxation of Businesses* ; Ch. 2B, *Electing Subchapter S Status*].

Another disadvantage of a cross-purchase agreement is its complexity when funded with insurance. For example, because each shareholder must own a policy on the life of every other shareholder, two policies are required for two shareholders, six policies are required for three shareholders, and 12 are needed for four. Not only are these additional policies cumbersome, but they also result in increased premium costs, as well as costs attributable to the issuance of the policy itself, and require continued tracking to ensure than the policies do not lapse.

Another potential drawback to a cross-purchase agreement funded by insurance is that the proceeds may be taxed under the transfer-for-value rule. Insurance proceeds received on a life insurance policy are not taxable to the recipient [*I.R.C. § 101(a)(1)*]. However, under the transfer-for-value rule, when the insurance policy is transferred for valuable consideration to the recipient, the policy proceeds are taxable to the extent they exceed the consideration and any premiums paid by the recipient [*I.R.C. § 101(a)(2)*], unless the transfer for consideration was to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer [*I.R.C. § 101(a)(2)(B)*]. Thus, the policy proceeds are taxable if the policy is transferred for its cash surrender value to a remaining shareholder (not the insured) of the corporation in which the insured and the deceased policy holder were shareholders [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 63.03[3][a] (Matthew Bender)].

The following scenario describes the typical situation: As each shareholder dies, his or her estate is left as owner of the policies insuring the lives of the remaining shareholders. At the same time, each of the remaining shareholders acquires additional insurance on the life of each of the other shareholders as a result of their respective succession to part of the decedent's interest in the corporation. Thus, as a practical matter, the agreement usually provides for the purchase, at their cash surrender values, by the remaining shareholders of the policies on the lives of the other shareholders owned by the decedent's estate. Unless an exception can be found [*see, e.g.*, Wolf & Kupferberg, *What is the Best Form for Structuring Corporate Buy-Out Agreements Now?*, 16 Estate Planning 2, 6 (Jan/Feb 1989), the transfer-for-value rule will then apply, making the proceeds of those policies taxable on the death of another shareholder.

[4] Advantages and Disadvantages of Hybrid Agreements

[a] Corporation's Purchase Based on Favorable Income Tax Consequences

One of the most common hybrid agreements is the arrangement under which the corporation buys as much of the stock of a deceased shareholder as the corporation may redeem with favorable income tax consequences under *Internal Revenue Code Sections 303* (distributions in redemption of stock to pay death taxes) and 302(b) (redemptions as exchanges), and the shareholders purchase the remaining shares. Although this type of agreement may be the best solution in a difficult tax planning situation, it requires that the decedent's estate provide the corporation with detailed and accurate information on its size and holdings, so that the corporation's attorney or accountant may determine the proportionate number of shares to be purchased by the corporation and by the remaining shareholders. This type of agreement is germane only to C corporations, since the taxation of S corporations is unaffected by *Internal Revenue Code Sections 303* and *302(b)*, since, except for federal income taxes on certain built-in gains [*see I.R.C. § 1374*], the S corporation's federal tax consequences are passed through to the shareholders [*see I.R.C. § 1366(a)(1)*].

[b] "Wait and See' Agreement

Another type of hybrid agreement is the "wait and see" agreement. It defines the triggering events and the purchase price, but lets the remaining shareholders determine who will buy the shares at the time the triggering event occurs. This type of agreement permits the shareholders to delay this decision until a time when the financial and tax situations of the affected parties can be better evaluated, and to make each decision on a case by case basis. It is not, however, without its disadvantages.

First, if the shareholders cannot agree on the percentage of shares to be purchased by the corporation, the agreement is effectively converted into a cross-purchase agreement, even when an entity purchase would have been more beneficial to the majority of shareholders. This problem may be averted by providing in the agreement that all shareholders must vote in favor of a corporate redemption if requested to do so by a given percentage of shareholders.

Second, it is difficult to finance a decedent's interest with life insurance if it is unclear who will be purchasing the shares. (If funding other than life insurance is used, however, this will not present a problem.) This issue also may be avoided if the agreement requires the corporation which owns the policies to lend money to any shareholder who elects to purchase any of the available shares.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawCorporationsFinanceGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsAccumulated Earnings Tax (IRC secs. 531-537)Reasonable Needs of BusinessTax LawFederal Taxpayer GroupsC CorporationsStock Redemptions (IRC secs. 302-304)Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Stock Redemptions



15 of 141 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
A. Nature and Types of Buy-Sell Agreements

4-8D California Legal Forms--Transaction Guide §§ 8D.14-8D.19

[Reserved]

§§ 8D.14[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
B. Professional Responsibility Considerations

4-8D California Legal Forms--Transaction Guide § 8D.20

§ 8D.20 Potential Conflicts of Interest in Context of Buy-Sell Agreement--In General

Clients commonly ask a single attorney to draft a corporate buy-sell agreement. In such a situation, the attorney represents the corporation and at least two shareholders [*see §§ 8D.21[2]* (representing the corporation), 8D.22 (representing multiple parties)]. Buy-sell agreements almost always raise actual or potential conflicts between shareholders because the shareholders' ages, business or technical expertise, capital investments, liquidity needs, income tax and estate planning objectives, and other factors vary. Other conflicts may arise if the attorney represents the shareholder and the shareholder's spouse (or nonmarital partner), who may or may not be involved in the business [*see § 8D.26*]. Further, an attorney representing multiple parties in a buy-sell agreement may have a conflict of interest if the attorney has a prior relationship with one of the parties, or if the attorney is asked, in the future, to enforce the buy-sell agreement against one of the parties represented in the initial transaction [*see § 8D.25*].

Additional conflicts of interest may also arise if the attorney invests in the corporation or accepts shares in the corporation in lieu of legal fees [*see § 8D.27[1]*], serves as a corporate officer or director [*see § 8D.27[2]*], or is called as a witness in any litigation before a jury [*see § 8D.27[3]*].

The duty to perform competently, the duty to refer, and the specialist standard, are discussed in *§ 8D.29*. Other legal malpractice and ethical considerations, including the relationship between malpractice and ethics, are discussed in *Ch. 1A, Role of Counsel in Starting a New Business, §§ 1A.30-1A.38*. For general coverage of the ethical responsibilities of estate planning attorneys, *see* CALIFORNIA WILLS TRUSTS, Ch. 4, *Ethical Considerations and Professional Responsibility* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of InterestLegal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsAttorney FeesFee Splitting



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
B. Professional Responsibility Considerations

4-8D California Legal Forms--Transaction Guide § 8D.21

§ 8D.21 Identifying Conflicts of Interest

[1] Identifying the Client

An attorney who is asked to draft a corporate buy-sell agreement must first ascertain which party the attorney represents: the corporation itself, a single participant, some or all of the participants, or a combination of these parties. Unless the attorney chooses only to represent one party [*see § 8D.24*], an initial conflict of interest disclosure letter should identify those represented. For an example of this type of letter, *see Ch. 1A, Role of Counsel in Starting a New Business, § 1A.203*.

[2] Representing the Corporation

[a] Nature of Representation

In representing a corporation, the attorney representation must conform to the concept that the client is "the organization itself, acting through its highest authorized officer, employee, body, or constituent overseeing the particular engagement" [Cal. Rules *Prof. Cond., Rule 3-600(A)*; *see Meehan v. Hopps (1956) 144 Cal. App. 2d 284, 290, 301 P.2d 10* (attorney for corporation represents corporation and its shareholders and officers in their representative capacity; attorney does not represent corporation's officers personally)]. Whenever it becomes apparent that the corporation's interests are, or may become, adverse to those of its directors, officers, employees, members, shareholders, or other constituents, the attorney must identify the client for whom the attorney is acting [Cal. Rules *Prof. Cond., Rule 3-600(D)*; *see* A.B.A. Model Rules Prof. Cond., Rule 1.13].

[b] Disclosure Required When Constituents Also Represented

An attorney representing a corporation may also represent its constituents if the attorney makes a written disclosure to the client in accordance with The *California Rules of Professional Conduct 3-310(B)* and discloses his or her relationship to the entity [Cal. Rules *Prof. Cond., Rule 3-600(E)*]. Dual representation of clients whose interests conflict is permitted, under certain circumstances, if the attorney obtains the written consent of each client [Cal. Rules *Prof. Cond., Rule 3-600(E)*]. Caution should be exercised, however, in dual representation if an actual conflict of interest

exists [*see § 8D.22[1]*].

Even without an actual conflict, under some circumstances an attorney should not undertake multiple representation [*see § 8D.23*]. For discussion of the conflict of interest issues that may arise should the attorney desire to represent a client for whom the attorney drafted a buy-sell agreement, *see § 8D.25*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of InterestLegal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
B. Professional Responsibility Considerations

4-8D California Legal Forms--Transaction Guide § 8D.22

§ 8D.22 Representing Multiple Parties

[1] Duty to Identify Conflict

In drafting a business buy-sell agreement, it is not uncommon for the parties to request that one attorney represent the corporation as well as the individual participants. Under the right circumstances, having one attorney represent all parties can result in a simpler, less expensive, and more harmonious transaction than if each party were represented by separate counsel. However, an attorney who is asked to represent multiple parties to a single transaction must first identify any actual or potential conflict and then determine whether the conflict may be waived. If the conflict may be waived, a suitable waiver must be obtained [*see* Cal. Rules *Prof. Cond., Rule 3-310(C)*; *see also Ch. 1A, Role of Counsel in Starting a New Business, §§ 1A.203, 1A.204* for waiver forms].

Under the California Rules of Professional Conduct, it appears that an attorney may represent clients with actual or potential conflicting interests, provided each client gives its informed, written consent [Cal. Rules *Prof. Cond., Rule 3-310(C)*]. However, California courts have held that joint representation is not permitted in litigation if actual conflicts exist [*see Klemm v. Superior Court (1977) 75 Cal. App. 3d 893, 898, 142 Cal. Rptr. 509]* . If the conflict is merely potential, there may be multiple representation at a hearing or trial, provided there is full disclosure to, and informed consent of, all clients [*Klemm v. Superior Court (1977) 75 Cal. App. 3d 893, 899, 142 Cal. Rptr. 509]* .

Joint representation is permitted in a nonlitigation context provided all parties give their informed, written consent [*Klemm v. Superior Court (1977) 75 Cal. App. 3d 893, 898, 142 Cal. Rptr. 509]* .

[2] Duty to Inform Client

An attorney seeking to represent multiple parties must inform the client of the relevant circumstances and of the actual and foreseeable adverse consequences to the client [Cal. Rules *Prof. Cond., Rule 3-310(A)*]. Generally, an attorney must disclose in understandable terms all facts and circumstances that, in the judgment of an attorney of ordinary skill and capacity, will enable the client to make an intelligent decision regarding the attorney's multiple representation [*Lysick v. Walcom (1968) 258 Cal. App. 2d 136, 147, 65 Cal. Rptr. 406* (decided before amendment of Rule 3-310)]. The attorney should caution the client that multiple representation limits the attorney client communications privilege,

because communications by one client to an attorney on issues that affect multiple representation are not privileged when the communication is offered in a civil action between those clients [*Evid. Code § 962*; *Wortham & Van Liew v. Superior Court (1987) 188 Cal. App 3d 927, 933*].

Even if the attorney identifies no current conflicts of interest, potential conflicts may exist because the parties' interests, even if identical at the time the buy-sell agreement is drafted, may differ as the business progresses. The attorney must anticipate and disclose any reasonably foreseeable adverse consequences of representation of adverse interests [Cal. Rules *Prof. Cond., Rule 3-310(A)*]. Moreover, if the potential conflict should become actual, the attorney must obtain the further informed written consent of the client [Cal. Rules *Prof. Cond., Rule 3-310*, Discussion]. See *Ch. 1A, Role of Counsel in Starting a New Business, § 1A.203* for a form disclosing the possibility of a potential conflict when no actual conflict exists.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of Interest



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
B. Professional Responsibility Considerations

4-8D California Legal Forms--Transaction Guide § 8D.23

§ 8D.23 When Multiple Representation is Inadvisable

Even when the disclosure and consent requirements of the California Rules of Professional Conduct [*see* Cal. Rules *Prof. Cond., Rule 3-310*] have been met, it may be inadvisable for an attorney to represent more than one party to the transaction. For example, unless the attorney is careful to distinguish between the business entity and its participants, the attorney risks representing the business inadequately. Furthermore, when multiple parties are involved, difficulties in communication and consensus may make multiple representation impractical.

If there exists an actual conflict that is likely to be litigated, or if the participants' interests will likely conflict in the future, the attorney may be required (when an actual present conflict exists at hearing or at trial) to withdraw, and may be disqualified from representing any of the parties, even if disclosure was made and consent properly obtained [*see Klemm v. Superior Court (1977) 75 Cal. App. 3d 893, 898, 142 Cal. Rptr. 509]* . Under these circumstances, the best interests of both the client and the attorney may dictate that the attorney avoid multiple representation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of Interest



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
B. Professional Responsibility Considerations

4-8D California Legal Forms--Transaction Guide § 8D.24

§ 8D.24 Representing One Client

Attorneys sometimes choose to avoid potential or actual conflicts of interest, or the practical problems of multiple representation [*see § 8D.23*], by representing only one party to the transaction. In these circumstances, it is important to advise both the client and the other parties to the transaction that the attorney represents only a designated client and will not provide legal advice or services to the other parties. The attorney should also advise nonclients that they are free to retain independent counsel [*see Ch. 1A, Role of Counsel in Starting a New Business, § 1A.201* for an appropriate form]. Written confirmation of the attorney's limited role and advice to nonclients to seek independent counsel will help protect both the attorney and nonclients from problems arising from uncertainty or misunderstandings about the attorney's role in the transaction.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of InterestLegal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
B. Professional Responsibility Considerations

4-8D California Legal Forms--Transaction Guide § 8D.25

§ 8D.25 Prior Representation--Conflict of Interest Considerations

It is not uncommon for an attorney who represented the business or one of its participants in drafting or reviewing a buy-sell agreement to be asked to represent the business or some or all of the participants in another matter. In this situation, the attorney must fully disclose, in writing, to the current client any previous relationships (legal, business, financial, professional, or personal) that the attorney had with any party in the same matter, or any party affected by the resolution of the matter or by the attorney's representation [Cal. Rules *Prof. Cond., Rule 3-310(B)(2),(3)*]. "Full disclosure" means informing of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences of such representation to the client (or former client) [Cal. Rules *Prof. Cond., Rule 3-310(A)*].

The attorney must also obtain the current client's written consent to representation [Cal. Rules *Prof. Cond., Rule 3-310(C)*]. The attorney's written disclosure and the client's written consent are required regardless of whether the interests of the current client conflict with those of the parties with whom the attorney has had a relationship, and/or whether the attorney has obtained confidential information related to the current representation [*see* Cal. Rules *Prof. Cond., Rule 3-310(B),(C)*]. The disclosure must be made to, and the consent obtained from, the client to be currently represented, and not clients or former clients with whom the attorney has had a relationship [Cal. Rules *Prof. Cond., Rule 3-310(B)*], unless the proposed representation is either:

- Adverse to a current or a former client and relates to a matter for which the attorney has obtained confidential information [*see* Cal. Rules *Prof. Cond., Rule 3-310(E)*], or

- The prior relationships are with current clients [*see* Cal. Rules *Prof. Cond., Rule 3-310(B)*].

In these circumstances, the attorney must not only obtain the informed, written consent of the current client [*see* Cal. Rules *Prof. Cond., Rule 3-310(B)*], but also the informed, written consent of the former or current clients whose interests are adverse to the anticipated representation [Cal. Rules *Prof. Cond., Rule 3-310(E)*]. "Informed consent" means the client's or former client's written agreement to the representation following written disclosure [Cal. Rules *Prof. Cond., Rule 3-310(A)*]. The failure to obtain consent may result in the attorney's disqualification in the event of litigation [*Civil Serv. Comm'n v. Superior Court (1984) 163 Cal. App. 3d 70, 82-83, 209 Cal. Rptr. 159]* , as well as

possible disciplinary action or malpractice.

Whether a relationship exists between an individual and an attorney, and what constitutes "representation" can be difficult to define [*Civil Serv. Comm'n v. Superior Court (1984) 163 Cal. App. 3d 70, 76-77, 209 Cal. Rptr. 159]* , and a court may have to make that determination [*see* Meehan v. Hopps (1956) *144 Cal. App. 2d, 284, 293* , *301 P.2d 10* (no relationship existed between corporate counsel and former president/principal stockholder); *but see* *Woods v. Superior Court (1983) 149 Cal. App. 3d 931, 936, 197 Cal. Rptr. 185* (corporate counsel for family-run business could not represent shareholder husband in marital dissolution action where corporation was primary focus of dispute)].

For a sample disclosure letter addressing the issues raised by prior representation and a sample disclosure letter requesting consent to represent a party whose interests are adverse to those of a current or former client, *see Ch. 1A, Role of Counsel in Starting a New Business, §§ 1A.203, 1A.204*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of InterestCivil ProcedureCounselDisqualificationsLegal EthicsClient RelationsConfidentiality of Information



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
B. Professional Responsibility Considerations

4-8D California Legal Forms--Transaction Guide § 8D.26

§ 8D.26 Representing Party to Buy-Sell Agreement and Nonparty Spouse

Buy-sell agreements generally require that the spouse of each married individual shareholder sign a consent to the agreement, specifying that the spouse's community property interest in the corporate shares are subject to sale on the occurrence of the triggering events, and are subject to the other provisions of the agreement [*see* Ch. 8C, *Close Corporation Shareholder Agreements* , for a consent form]. Conflicts of interest may arise from dual representation by the attorney as a result of the spouses' disparate property rights and different desires. The ethical considerations and rules discussed in *§§ 8D.21-8D.25* apply to the dual representation of spouses. The proper characterization of the stock subject to a buy-sell agreement is discussed in *§ 8D.90*. The property rights of nonmarital partners are discussed in *§ 8D.90[5]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of InterestFamily LawMarital Duties & RightsProperty RightsCharacterizationCommunity Property



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
B. Professional Responsibility Considerations

4-8D California Legal Forms--Transaction Guide § 8D.27

§ 8D.27 Other Roles of Attorney--Conflict of Interest Considerations

[1] Attorney as Investor

An attorney who represents clients in a buy-sell agreement could become an investor by accepting an interest in the venture in lieu of all or part of the attorney's fees, or by simply making an investment in the client's business independent of any compensation received. An attorney who invests in a business venture with a client must comply with the following requirements [Cal. Rules *Prof. Cond., Rule 3-300*; *see* A.B.A. Model Rules Prof. Cond., Rule 1.8]:

- The terms of the transaction must be fair and reasonable to the client and fully disclosed in writing to the client in a reasonably understandable manner.

- The client must be advised in writing that the client may seek independent legal advice and be given a reasonable opportunity to do so.

- The client must consent in writing to the transaction.

Although the advisability of investing in a client's business is outside the scope of this chapter, conflict of interest issues may be intensified in a dispute if the attorney is involved as both investor and counsel. If the attorney does decide to invest, the investment should be at the same price and on the same terms as other investors to help establish its fair and reasonable terms [*see* Cal. Rules *Prof. Cond., Rule 3-300(A)*]. As a practical matter, if an attorney is to receive a share in the business as compensation for services, it is advisable to bill the client at the attorney's regular rates and then, separately, to invest in the business at the same price and terms as the other investors. Moreover, an attorney who accepts stock in lieu of fees should bear in mind the tax consequences of such a transaction [*see I.R.C. § 61*; *Treas. Reg. § 1.61-2(d)(4)* (stock received as compensation taxed at fair market value at time of transfer)].

[2] Attorney as Corporate Agent, Director, or Officer

An attorney might be asked to serve as a director or officer of a corporation for which the attorney has drafted a buy-sell agreement. Serving as an officer or director of a corporation under these circumstances can present several problems for

the attorney. It may increase the possibility of conflicts of interest [*see § 8D.21*]. It may result in the waiving of the attorney-client communication privilege [*see § 8D.22[2]*]. It may increase the attorney's malpractice exposure, either by establishing a higher standard of conduct for the attorney than for a non-attorney, or through the reliance of others on the attorney's statements as legal advice where those statements were not so intended. Further, if the attorney is compensated for acting as a corporate director or officer, the California Rules of Professional Conduct may require fairness to the client, full disclosure in writing, and the consent of the client in writing [*see* Cal. Rules *Prof. Cond., Rule 3-300*; A.B.A. Model Rules Prof. Cond., Rule 1.8; [1], *above*].

[3] Attorney as Witness

Even if the client's informed, written consent has been obtained, an attorney may decide to decline representation if the attorney is likely to be called as a witness in any litigation in which there will be a jury [*see* Cal. Rules *Prof. Cond., Rule 5-210* (with limited exceptions, attorney cannot act as advocate before jury that will hear testimony from that attorney); *see also* Cal. Rules *Prof. Cond., Rule 5-210*, Comment (rule inapplicable when attorney in advocate's firm will be witness)]. For example, an attorney who drafts a corporate buy-sell agreement might later be called as a witness in a dispute among the parties to the agreement to testify regarding the meaning of a section of the agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of InterestEvidencePrivilegesAttorney-Client PrivilegeWaiverLegal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
B. Professional Responsibility Considerations

4-8D California Legal Forms--Transaction Guide § 8D.28

§ 8D.28 Minimizing Risk of Conflict of Interest

[1] Disclosure Letter Tailored to Specific Conflicts

To minimize the risk of conflict of interest, an attorney must abide by the California Rules of Professional Conduct. These rules generally require [*see* Cal. Rules *Prof. Cond., Rules 3-110-3-400* (Professional Relationship with Clients); §§ 8D.21-8D.27]:

- Fairness to the client.

- Full disclosure in writing of areas of actual or potential conflict among the parties, the potential risks associated with multiple representation, and the attorney's relationships to and representation of current as well as former clients whose interests are actually adverse to the proposed representation, or relate to a matter on which the attorney has obtained confidential information related to the representation.

- The client's written consent.

In practice, a client's written consent to multiple representation is binding only if full disclosure of the relevant circumstances, as well as actual and reasonably foreseeable adverse consequences, has been made. Thus, to be effective, the disclosure letter must address the specific conflict issues of each representation. As a practical matter, the attorney should assume that a conflict disclosure letter and a signed consent form are necessary in the context of a buy-sell agreement, unless the attorney represents only one party to the venture.

An attorney representing only one party should advise nonclients who are parties to the transaction that the attorney represents only a designated client [*see § 8D.24*]. Additionally, if the attorney represents the business entity, it is a good idea to obtain from the business a signed letter, listing the names of parties whose directions the attorney should follow.

[2] Conflict-Identification System

The attorney must have an adequate conflict identification system including, at a minimum, the names of clients and

other parties to the transaction, and the subject matter of the representation, to determine whether conflicts of interest exist with current or former clients before the attorney undertakes any proposed representation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of InterestLegal EthicsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
B. Professional Responsibility Considerations

4-8D California Legal Forms--Transaction Guide § 8D.29

§ 8D.29 Duty to Perform Competently

[1] In General

An attorney has the duty to perform legal services competently [Cal. Rules of *Prof. Cond., Rule 3-110*; A.B.A. Model Rules Prof. Cond., Rules 1.1, 1.3 (1983)]. Drafting or reviewing a buy-sell agreement can involve many areas of law, including not only corporations law, but also federal and state taxation law related to corporate and individual income taxation, estate planning, property law, contract law, and federal and state securities regulations. The attorney should become fully informed regarding the legal and procedural aspects of each task undertaken and should consult with an expert when appropriate [*see* [2], *below*].

[2] Specialist Standard

A general practitioner has the duty to refer a client to a specialist or to recommend the assistance of a specialist if a reasonably careful, skillful practitioner would do so under similar circumstances. Alternatively, the general practitioner has the duty to perform with the knowledge, care, and skill required of specialist under similar circumstances [*see Horne v. Peckham (1979) 97 Cal. App. 3d 404, 414, 158 Cal. Rptr. 714* ; *see also* [3], *below*]. A defense based on the argument that the attorney's conduct met the standard of care expected of a general practitioner when a specialist was required will not suffice in a legal malpractice case [*see Horne v. Peckham (1979) 97 Cal. App. 3d 404, 415, 158 Cal. Rptr. 714* ; *Wright v. Williams (1975) 47 Cal. App. 3d 802, 809-810, 121 Cal. Rptr. 194]* .

[3] Duty to Refer

If an attorney encounters a problem requiring the expertise of a specialist, the attorney should associate such a specialist or refer the matter to a specialist [*see Horne v. Peckham (1979) 97 Cal. App. 3d 404, 414-415, 158 Cal. Rptr. 714]* . However, the attorney must exercise due care in referring to or associating another attorney. The attorney who decides to associate other counsel may be deemed liable to the extent that he or she does not adequately investigate the qualifications of the associated attorney [*Tormo v. Yorkmark (1975) 398 F.Supp. 1159, 1171-1172* (attorney could be liable for negligent referral because he did not investigate qualifications of associated attorney who subsequently embezzled client's funds)]. Furthermore, if the client is referred to another attorney, the original attorney must take care

to warn the client of any deadline or other time-related exigencies [*see Muller v. Metzinger (1979) 91 Cal. App. 3d 31, 42, 154 Cal. Rptr. 22* (initially consulted attorney who referred client to specialist attorney could be liable for failure to warn client of eight day deadline on statute of limitations)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsEffective RepresentationTortsMalpractice & Professional LiabilityAttorneysLegal EthicsClient RelationsAccepting RepresentationTortsNegligenceStandards of CareSpecial CareHighly Skilled Professionals



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
B. Professional Responsibility Considerations

4-8D California Legal Forms--Transaction Guide §§ 8D.30-8D.39

[Reserved]

§§ 8D.30[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
C. Income Tax Considerations

4-8D California Legal Forms--Transaction Guide § 8D.40

§ 8D.40 Taxation of Seller under Entity Purchase Agreement

[1] Characterization of Distribution as Redemption or Dividend

Under an entity purchase agreement, the corporation's acquisition of stock from a shareholder in exchange for property is treated as a redemption for tax purposes [*I.R.C. § 317(b)*; *see I.R.C. § 317(a)* ("property" defined)].

The seller is treated as having made a sale or exchange of a capital asset (as in a cross-purchase agreement) if the redemption is either:

- Not essentially equivalent to a dividend [*I.R.C. § 302(b)(1)*].
- A substantially disproportionate redemption of that shareholder's shares [*I.R.C. § 302(b)(2)(A)*].
- A complete redemption of all shares owned by a shareholder [*I.R.C. § 302(b)(3)*].
- Made in partial liquidation of the distributing corporation [*I.R.C. § 302(b)(4)(B)*].

Further, the redemption of shares from a deceased shareholder's estate constitutes a sale or exchange to the extent the redemption is required to pay death taxes or funeral and administration expenses [*I.R.C. § 303(a)*].

Because buy-sell agreements are designed to create a market for shares that otherwise may have no ready market [*see § 8D.11*], agreements generally provide for the redemption of all of a shareholder's shares. Consequently, redemptions are normally treated as the purchase and sale of a capital asset. However, a redemption may be treated as a dividend if the stock attribution rules impute constructive ownership of additional, unredeemed shares to the shareholder [*see I.R.C. § 318(a)*]. For purposes of determining whether a redemption is a "complete" redemption [*see I.R.C. § 302(b)(3)*], the family attribution rules that attribute stock owned by an individual's spouse, children, grandchildren, and parents to that individual, are waivable [*I.R.C. § 302(c)(2)*; *see I.R.C. § 318(a)(1)*].

[2] Tax Treatment of Dividends and Capital Gains Distinguished

Characterization of a distribution as a redemption rather than a dividend traditionally had important tax consequences, especially for high income taxpayers, both individuals and estates. The difference in capital gain tax rates [*see I.R.C. § 1(h)*] and ordinary income rates [*see I.R.C. § 1(a)-(e), (i)(2)*] traditionally has been a primary reason for favoring tax treatment of a distribution as a redemption (taxable at capital gains rates) rather than as a dividend (traditionally taxable as ordinary income rates) [*see I.R.C. §§ 301(a), (c), 302, 316, 317*]. For years in which dividends are taxed at capital gains rates (generally tax years beginning after December 31, 2002, and before January 1, 2009) [*see I.R.C. § 1(h)(11)*; Pub. Law No. 108- 27, §§ 302(f)(1), 303 (effective date and sunset provisions for dividend taxation at capital gains rates)], however, this distinction is not a factor in favoring either redemption or dividend classification.

Apart from tax rate considerations, the method of calculating taxable gain (or income) is more favorable if the distribution is treated as a redemption, rather than as a dividend. In a redemption, the seller's taxable gain is the amount by which the purchase price exceeds the adjusted basis of the shares sold [*I.R.C. § 1001(a)*; *see I.R.C. § 1221* ("capital asset" defined); *I.R.C. § 1011* (adjusted basis for determining gain or loss)]. For a shareholder or estate receiving a step-up in the basis of its stock to its fair market value at the date of death [*see I.R.C. §§ 1014(a), 2032* (assets includable in decedent's estate for federal income tax purposes acquire new basis equal to their fair market value on date of death or, at estate's election, on alternate valuation date, generally six month's from decedent's death)], any gain is likely to be minimal. For decedents dying after 2009, a modified carryover basis regime generally applies for property received from those decedents, under which recipients of property transferred at the decedent's death receive a basis equal to the lesser of the adjusted basis of the decedent in the property or the fair market value of the property on the date of the decedent's death [*I.R.C. § 1022(a)*]. Nevertheless, a step up in basis of up to $1.3 million ($4.3 million for certain property transferred to a surviving spouse) is allowed for each decedent's estate [*I.R.C. § 1022(b)(1), (2)(B), (c)(2)(B)*]. This limited step up in basis may also minimize any gain [*see I.R.C. § 1022*].

On the other hand, if the distribution is characterized as a dividend, the entire amount of the distribution, not just the profit the shareholder makes on the sale of the shares, is taxable [*I.R.C. § 301(c)(1)*; *see I.R.C. § 316(a)* ("dividend" defined)]. If any portion of the distribution is not made out of earnings and profits, that portion is treated as a tax-free return of capital, thereby reducing the shareholder's adjusted basis in the shares [*I.R.C. § 301(c)(2)*]. Any portion of the distribution exceeding the adjusted basis of the stock is then treated as gain from the sale or exchange of property [*I.R.C. § 301(c)(3)*] and is taxed at capital gain rates to the extent it exceeds the basis of the shares [*see I.R.C. § 1001(a)*].

[3] Characterization of Distribution as Deductible Expense

Although characterization of a distribution as a redemption may have favorable tax consequences [*see* [2], *above*], it may be more cost effective to characterize the distribution as some form of compensation (termination payments, deferred compensation, for example), particularly for personal service corporations. In that case, although the employee must report the payments as ordinary income [*see I.R.C. § 61(a)(1)*], the corporation may deduct the payments as compensation [*see I.R.C. § 162(a)(1)*; *but see I.R.C. § 162(k)*]. The compensation, however, must be reasonable, taking into account the employee's overall compensation [*see Treas. Reg. § 1.162-8*]. Characterization of the distribution as compensation or another type of deductible expense may be challenged by the Internal Revenue Service, depending on the particular circumstances of the transaction.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsStock Redemptions (IRC secs. 302-304)Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewTax LawFederal Estate & Gift TaxesBasis of Property Acquired From Decedents (IRC sec. 1014)General OverviewTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Stock

RedemptionsTax LawFederal Taxpayer GroupsC CorporationsEarnings & Profits (IRC secs. 312, 316)Distributions From Earnings & ProfitsTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)General OverviewTax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)Stock & Other SecuritiesTax LawFederal Estate & Gift TaxesBasis of Property Acquired From Decedents (IRC sec. 1014)Decedent's Death



28 of 141 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
C. Income Tax Considerations

4-8D California Legal Forms--Transaction Guide § 8D.41

§ 8D.41 Taxation of Seller under Cross-Purchase Agreement

Under a cross-purchase agreement, the selling party (either the shareholder or the shareholder's estate) is treated as having made a sale or exchange of a capital asset. Thus, any gain on the sale of shares to other shareholders generally is treated as a capital gain, subject to capital gains tax on the amount the purchase price exceeds the adjusted basis of the shares sold [*I.R.C. § 1001(a)*; *see I.R.C. § 1221* ("capital asset" defined); *I.R.C. § 1011* (adjusted basis for determining gain or loss); *but see* former *I.R.C. § 341(a)*, before repeal by Pub. Law No. 108-27, §§ 302(f)(1), 303 (gain on sale of stock of collapsible corporation taxed at ordinary income rates)]. Any loss is treated as a capital loss [*see I.R.C. § 1001(a)*]. If shares are sold at the shareholder's death, tax liability will be further reduced because of the step-up in basis [*see I.R.C. §§ 1014(a), 2032* (assets includable in decedent's estate for federal income tax purposes acquire new basis equal to their fair market value on date of death or, at estate's election, on the alternate valuation date, which is generally six month's from decedent's death); for decedents dying after 2009, a modified carryover basis regime generally applies, so a step-up basis does not apply (*I.R.C. § 1022*), as described in [1], *above*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Estate & Gift TaxesBasis of Property Acquired From Decedents (IRC sec. 1014)Stepped-Up BasisMergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral Overview



29 of 141 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
C. Income Tax Considerations

4-8D California Legal Forms--Transaction Guide § 8D.42

§ 8D.42 Taxation of Seller under Hybrid Agreement

Because a corporation is unable to redeem its shares unless, at the time of redemption, it can meet the tests specified by the General Corporation law [*see Corp. Code §§ 166, 500-503*; § 8D.72], at least one commentator has suggested that every well-drafted entity purchase agreement in California should include back-up provisions requiring the remaining shareholders to purchase any shares that the corporation is unable to redeem [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 63.04[3][c] (Matthew Bender); *see, e.g., § 8D.200[2]*, § 3.08]. The Internal Revenue Service has contended that a combination redemption by the corporation and cross-purchase by the remaining shareholders is not a complete redemption of all the shares of the withdrawing shareholder, and therefore is taxable as ordinary income. However, the Sixth Circuit has held that when a redemption is combined with a cross-purchase of part of the shareholder's shares by the other shareholders (or by a third party, for that matter), the redemption is not essentially equivalent to a dividend, but is a sale or exchange, at least when the redemption follows the cross-purchase, because the redemption completely terminated the shareholder's interest in the corporation [*Zenz v. Quinlivan (6th Cir. 1954) 213 F.2d 914, 916]* .

Although the *Zenz* court did not hold that a redemption followed by a cross-purchase of shares constitutes a complete redemption (subject to treatment as a sale of shares and not as a dividend), the IRS has conceded that a redemption may not be properly treated as a distribution, even if it precedes the sale of the remaining shares, when the two steps were components of a single plan [*U.S. v. Carey (8th Cir. 1961) 289 F.2d 531, 538]* . Further, a 1975 Revenue Ruling held that the sequence of events is irrelevant if both are clearly part of "an overall plan" [*Rev. Rul. 75-447, 1975-2 C.B. 113* ; *Rev. Rul. 77-226, 1977-2 C.B. 90* ; *see Arthur D. McDonald (1969) 52 T.C. 82, 88-89* (redemption of petitioner's preferred stock held not separate from transfer of remaining shares in corporate reorganization and, therefore, not essentially equivalent to dividend)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Stock RedemptionsTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)General OverviewBusiness & Corporate

LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewTax LawFederal Income Tax ComputationOrdinary Income (IRC sec. 64)Business & Corporate LawCorporationsShareholdersGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



30 of 141 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
C. Income Tax Considerations

4-8D California Legal Forms--Transaction Guide § 8D.43

§ 8D.43 Installment Sale Treatment

[1] Waiver of Family Attribution Rules

A corporation may use an installment note, or debt financing, to pay for stock that qualifies for sale or exchange treatment in a complete redemption [*see I.R.C. § 302(b)(3)*], without the stock attribution rules imputing constructive ownership of additional, unredeemed shares to the shareholder. These attribution rules may be waived for purposes of determining whether a complete redemption has taken place when payment is made by a note, because the shareholder's only interest in the corporation following the sale of his or her stock is that of a creditor [*see I.R.C. § 302(c)(2)(A)*]. However, a shareholder's status as a creditor will be lost if the payments on the note are dependent on the corporation's future earnings, and are subordinate to the claims of the corporation's general creditors [*Treas. Reg. § 1.302-4(d)*; *see Rev. Rul. 77-467, 1077-2 C.B. 92*].

[2] Deferral of Income Tax Liability

The tax liability resulting from a stock redemption that qualifies for sale or exchange treatment may be deferred by using the installment method of reporting income if at least one payment is received in the year after the distribution occurs [*I.R.C. § 453(b)(1)*], unless the notes are payable on demand or are readily marketable [*I.R.C. § 453(f)(4)*]. In addition, the installment method may not be used for sales of stock or securities traded on an established market [*I.R.C. § 453(k)(2)(A)*].

The installment method allows the seller to prorate and report the profit on the installment sale over the period in which the payments are actually received, thus matching tax impact with available cash flow [*see I.R.C. § 453(c)*; *but see I.R.C. § 453(e), (g)* (rules for installment sales to related persons)]. Unless the taxpayer elects otherwise, the installment method of reporting automatically applies to installment sales [*I.R.C. § 453(d)(1)*].

Imputed interest rules may apply to the deferred payments if the interest rate on the notes is below the applicable minimum federal rate [*I.R.C. §§ 483, 1274*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationSales & ExchangesInstallment Sales (IRC secs. 1001, 1031, 1231)General OverviewBusiness & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsPersonal Holding Companies (IRC secs. 541-558)Stock Ownership RulesTax LawFederal Income Tax ComputationSales & ExchangesInstallment Sales (IRC secs. 1001, 1031, 1231)Installment Method



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
C. Income Tax Considerations

4-8D California Legal Forms--Transaction Guide § 8D.44

§ 8D.44 Taxation of Purchaser under Cross-Purchase Agreement

In a cross-purchase agreement, the remaining shareholders receive a cost basis in the purchased shares [*I.R.C. § 1012*]. Under an entity purchase agreement, however, the basis in purchased shares remains fixed, despite any increase in value [*see Treas. Reg. § 1.305-3(e)*, Ex. 13; *Rev. Rul. 58-614, 1958-2 C.B. 920*]. Of course, the impact of an increase in basis depends on the type of business entity involved, and the likelihood that the shareholder will sell his or her interest [*see § 8D.13[3]*]. If the remaining shareholders have to withdraw funds from the corporation in the form of dividends to fund the buy-out in a cross-purchase agreement, these funds will be subject to double taxation--once as income to the corporation [*see I.R.C. §§ 11(a), 311*], and again when received by the shareholder [*I.R.C. §§ 1(h)(11), 61(a)(7), 301, 305(b)*; *see I.R.C. § 316* ("dividend" defined)]. This double taxation, however, does not occur when the funds are withdrawn as compensation, provided the amount is reasonable, taking into account the shareholder's overall compensation [*see I.R.C. § 162(a)(1)*; *Treas. Reg. § 1.162-8*], or if the corporation is a subchapter S corporation [*see I.R.C. § 1366*; *see also* Ch. 1E, *Taxation of Businesses* ; Ch. 2B, *Electing Subchapter S Status*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Stock RedemptionsTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Stock & Stock RightsTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Distributions of PropertyTax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)General OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General OverviewTax LawFederal Income Tax ComputationSales & ExchangesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
C. Income Tax Considerations

4-8D California Legal Forms--Transaction Guide § 8D.45

§ 8D.45 Taxation of Purchaser under Entity Purchase Agreement

A corporation's acquisition of its own shares from a shareholder in exchange for property is not, in general, a taxable event [*see I.R.C. § 317(a)* "property" defined)]. Property distributions, whether characterized as dividends or redemptions of shares, are not deductible [*I.R.C. § 162(k)(1)*; *see I.R.C. § 162(k)(2)* (exceptions); *Treas. Reg. § 1.305-3(e)*, Ex. 13], and generally do not result in gain or loss to the corporation [*I.R.C. § 311(a)*]. However, distributions of certain types of property may result in recognition of taxable gain by the corporation. For example, any distribution of appreciated property (other than obligations of the corporation) results in taxable gain to the corporation [*I.R.C. § 311(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsStock Redemptions (IRC secs. 302-304)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
C. Income Tax Considerations

4-8D California Legal Forms--Transaction Guide § 8D.46

§ 8D.46 Taxation of Remaining Shareholders under Entity Purchase Agreement

In an entity purchase agreement, the remaining shareholders do not pay income taxes on the amount paid by the corporation to redeem the shares, even though the fact that there are fewer shares outstanding increases their proportionate interest in assets or earnings and profits of the corporation [*see Treas. Reg. § 1.305-3(e)*, Ex. 13; *Rev. Rul. 58-614, 1958-2 C.B. 920*]. In addition, the basis of the remaining shareholders' stock is unchanged.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Stock RedemptionsTax LawFederal Taxpayer GroupsC CorporationsStock Redemptions (IRC secs. 302-304)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
C. Income Tax Considerations

4-8D California Legal Forms--Transaction Guide § 8D.47

§ 8D.47 Effect of Insurance Funding on Taxation--In General

Using life insurance to fund a buy-sell agreement, as opposed to borrowing or using cash reserves, requires consideration of various tax factors, discussed in *§§ 8D.48, 8D.49*. Business factors to consider in determining whether life insurance should be used to fund a buy-out, including the non-tax cost of acquiring the insurance, alternate insurance possibilities, the adequate amount and appropriate life insurance product for funding, and the importance of actually funding the agreement through the purchase of insurance, are discussed in *§ 8D.71[2]*. For further discussion of estate planning considerations in the use of life insurance, see Ch. 60, *Estate Planning* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesEstate & Gift TaxLife InsuranceInsurance LawLife InsuranceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
C. Income Tax Considerations

4-8D California Legal Forms--Transaction Guide § 8D.48

§ 8D.48 Taxation of Entity Purchase Agreements Funded With Life Insurance

[1] Taxation of Premiums

A corporation may not deduct the payment of insurance premiums for federal income tax purposes if the corporation is, directly or indirectly, a beneficiary of the life insurance policy [*I.R.C. § 264(a)(1)*]. A policy used to fund a corporate buy-sell agreement is considered to be for the corporation's benefit because the proceeds are used to acquire a capital asset, the corporation's stock [*Rev. Rul. 70-117, 1970-1 C.B. 30*]. Premiums paid by the corporation are not taxed to the shareholders, unless the shareholders own the policy [*Rev. Rul. 59-184, 1959-1 C.B. 65* ; *Paramount-Richard Theatres, Inc. v. Commissioner (5th Cir. 1946) 153 F.2d 602, 604]* . In that case, the premiums are treated as a dividend distribution to the shareholder and are taxable as ordinary income [*Rev. Rul. 59-184, 1959-1 C.B. 65*].

[2] Taxation of Policy Proceeds

A corporation generally is not taxed on insurance proceeds it receives on the death of a shareholder [*I.R.C. § 101(a)(1)*]. This is true whether the proceeds are paid to the corporation, which then purchases the decedent's shares, or whether the proceeds are paid directly to the shareholder's estate to satisfy the corporation's obligation to purchase the decedent' shares [*Mushro v. Commissioner (1968) 50 T.C. 43* , nonacq. 1970-2 C.B. xxii]. However, caution should be exercised because the Commissioner has not acquiesced to this result.

The better practice is to have the proceeds under a corporate buy-sell agreement paid directly to the owner of the policy, rather than to the insured's estate. Life insurance proceeds received by the corporation may be subject to the corporate alternative minimum tax [*I.R.C. § 55*; *see* [3], *below*]. The increased value of the shareholders' shares resulting from the corporation's purchase of the decedent's shares is not taxed to the surviving shareholders as a constructive dividend so long as the corporation is not satisfying the obligation of the shareholders to purchase the shares from the decedent's estate [*Rev. Rul. 58-614, 1958-2 C.B. 920*].

[3] Alternative Minimum Tax Considerations for C Corporations

Receipt of life insurance proceeds may subject the corporation to the alternative minimum tax [*I.R.C. § 55*]. Tax

planning should be done with this risk in mind. The alternative minimum tax for corporations is similar to the alternative minimum tax for individuals. It is a tax on alternative minimum income, which is calculated by adding certain tax preference items and adjustments to regular taxable income, and is taxed at a rate of 20 percent [*I.R.C. § 55*]. If the alternative minimum tax is higher than the tax on regular taxable income, the corporation must pay a minimum tax equal to that difference, in addition to its regular tax [*I.R.C. § 55*]. This potential minimum tax problem does not affect small corporations [*see I.R.C. § 55(e)*] or corporations and noncorporate pass-through entities, such as S corporations. However, because the alternative minimum tax applies to noncorporate taxpayers, pass-through entities may nonetheless be indirectly affected [*see I.R.C. §§ 55*-59; *see also Rev. & Tax. Code §§ 17062*, *17063*, *23400*]. For further discussion of the alterative minimum tax and the distinction between C and S corporations, see Ch. 1E, *Taxation of Businesses* .

[4] Accumulated Earnings Tax Considerations for C Corporations

Life insurance may subject the corporation to the accumulated earnings tax. The accumulated earnings tax is a penalty tax imposed on corporations that accumulate earnings above their reasonable business need for the purpose of avoiding the income tax imposed on shareholders if the earnings were distributed as dividends [*see I.R.C. § 531*]. Although many practitioners believe that life insurance ownership will seldom present an accumulated earnings problem, a corporation that owns life insurance policies with large cash surrender values should keep this risk in mind in its tax planning [*see Lamark Shipping Agency, Inc. v. Commissioner, T.C. Memo 1981-284* (accumulating funds to buy out corporate shareholder justifiable as furthering corporate purpose in appropriate circumstances); *Mountain State Steel Foundaries, Inc. v. Commissioner (4th Cir. 1960) 284 F.2d 737* (life insurance funds justifiable if buy-sell agreement necessary to avoid shareholder disputes); *but see Pelton Steel Casting v. Commissioner (7th Cir. 1958) 251 F.2d 278* (corporation improperly accumulated earnings to redeem 80 percent of shares to prevent sale to outsider); *Boshwit Bros., T.C. Memo 1982-156* (reasonable business need to redeem majority shareholder's interest to continue family ownership not established absent formal, written redemption plan); *Cadillac Textiles, Inc., T.C. Memo 1975-46* (reasonable business need not established absent specific, definite, feasible plan for redemption)]. For further discussion of the corporate accumulated earnings tax, *see* Chs. 1E, *Taxation of Businesses* , and 1B, *Selecting Form of Business Entity* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawLife InsuranceBeneficiariesGeneral OverviewTax LawFederal Income Tax ComputationUnearned IncomeDividendsTax LawFederal Taxpayer GroupsC CorporationsAccumulated Earnings Tax (IRC secs. 531-537)Imposition of TaxesTax LawFederal Taxpayer GroupsC CorporationsStock Redemptions (IRC secs. 302-304)Tax LawFederal Estate & Gift TaxesTaxable PropertyLife Insurance (IRC sec. 2042)General OverviewTax LawFederal Income Tax ComputationAlternative Minimum Tax (IRC secs. 55-59)Tax LawFederal Taxpayer GroupsC CorporationsAccumulated Earnings Tax (IRC secs. 531-537)General OverviewTax LawFederal Taxpayer GroupsIndividualsAnnuities & Life Insurance (IRC sec. 72)General Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
C. Income Tax Considerations

4-8D California Legal Forms--Transaction Guide § 8D.49

§ 8D.49 Taxation of Shareholders under Cross-Purchase Agreement Funded by Life Insurance

[1] Taxation of Premiums

The premiums on life insurance policies funding a shareholder cross-purchase agreement (ordinarily paid by the shareholders who own the policies) are not deductible for income tax purposes [*I.R.C. § 264(a)*]. If the corporation pays the premiums on the life insurance, the payments are dividends to the shareholder who owns the policy and, as such, are taxable to the shareholder and not deductible by the corporation [*see I.R.C. §§ 1(h)(11), 61(a)(7), 301, 311, 316*; *Young, Jr et al v. Commr., T.C. Memo. 1995-379* ; *Lynch v. Commr., T.C. Memo. 1983- 173]* . Split dollar insurance, under which the corporation pays a portion of the premium and the shareholder pays the remainder, is an option to consider to reduce the cost to the shareholders of funding a cross-purchase agreement. The portion of the premium paid by the corporation, however, may be treated as a constructive dividend to the shareholder [*Johnson v. Commr. (1980) 74 T.C. 1316]* . For further discussion of split dollar insurance, *see* California Insurance Law Practice, Ch. 70, *Insurance Considerations in Business Planning*, § 70.12 (Matthew Bender).

[2] Taxation of Policy Proceeds

Insurance proceeds received by a shareholder to fund a cross-purchase agreement are not taxable income to the shareholder, unless there was a previous transfer to the shareholder for valuable consideration [*I.R.C. § 101(a)(2)*]. If insurance policies held by a deceased shareholder are transferred to the remaining shareholders for valuable consideration, the policy proceeds are taxable to the extent they exceed the consideration and any premiums paid by the transferee shareholder [*I.R.C. § 101(a)(2)*; *see § 8D.13[3][b]*].

Under some circumstances, if the corporation pays the premiums, receives the proceeds, and distributes them to the remaining shareholders to satisfy their obligation to purchase the shares under the cross-purchase agreement, the distribution may be taxable as a dividend [*Rev. Rul. 61-134, 1961-2 C. B. 250* ; *see Golden v. Commissioner (3d Cir. 1940) 113 F.2d 590, 592-593]* . In addition, if the corporation receives the insurance proceeds and directly purchases the decedent's shares in satisfaction of the remaining shareholders' obligations under the agreement, the amount used to satisfy each shareholder's obligation may be taxable to the shareholder as a dividend [*Wall v. United States (4th Cir. 1947) 164 F.2d 462, 464]* . However, if the purchase is not made in satisfaction of any obligation of the remaining

shareholders, the corporation's purchase of the shares of a deceased shareholder does not result in taxable income to the remaining shareholders, nor does it result in taxable income as a result of the increase in value of the remaining shareholder's shares [*see Holsey v. Commissioner (3d Cir. 1958) 258 F.2d 865, 868-869* ; *Rev. Rul. 58-614, 1958-2 C.B. 920* ; *see also § 8D.46*].

For discussion of the tax issues that may arise if the insured's estate is designated as the beneficiary of the policy under a cross-purchase agreement, *see § 8D.60*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationTaxable Income (IRC sec. 63)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
C. Income Tax Considerations

4-8D California Legal Forms--Transaction Guide § 8D.50

§ 8D.50 California Income Tax Consequences of Agreement

California income tax consequences of a buy-sell agreement generally are the same as those under federal law. The taxation of corporate distributions and adjustments is determined under Subchapter C of the Internal Revenue Code [*I.R.C. §§ 301* et seq.], with some exceptions [*see Rev. & Tax. Code § 17321*]. The taxation of capital gains and losses is determined under Subchapter P of the Internal Revenue Code [*I.R.C. §§ 1201* et seq.], with some exceptions [*see Rev. & Tax. Code §§ 18151 et seq., 24990 et seq.*]. Under California law, but not under the Internal Revenue Code, gross income does not include half of any gain from the sale or exchange of qualified business stock [*see Rev. & Tax. Code § 18152.5(c)* ("qualified business stock" defined)] held more than five years [*Rev. & Tax. Code § 18152.5(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of TaxBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
C. Income Tax Considerations

4-8D California Legal Forms--Transaction Guide §§ 8D.51-8D.59

[Reserved]

§§ 8D.51[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
D. Estate Tax Consequences of Agreement

4-8D California Legal Forms--Transaction Guide § 8D.60

§ 8D.60 Estate Taxation of Policy Proceeds

[1] In General

When a shareholder dies, the value of the stock owned by the shareholder is included in the decedent's gross estate for estate tax purposes [*I.R.C. § 2031*; *Treas. Reg. § 20.2031-2(h)*]. Conversely, life insurance proceeds ordinarily are not included in the decedent's estate, regardless of whether the proceeds are paid to the corporation or to the decedent's estate, if they are paid under a bona fide stock purchase agreement [*I.R.C. § 2042*; *Treas. Reg. § 20.2042-1(c)(6)*]. However, if the decedent possesses "incidents of ownership" in the insurance policy, the policy proceeds are included in the decedent's gross estate for estate tax purposes [*I.R.C. § 2042(2)*].

Caution should be exercised to avoid double taxation of the insurance proceeds (that is, the inclusion of both the full value of the stock and the insurance proceeds in the decedent's gross estate) by ensuring that a shareholder does not have any incidents of ownership in an insurance policy held by the corporation on the shareholder's life [*see I.R.C. § 2042(2)*]. This problem arises in connection with entity purchase agreements; cross-purchase agreements are discussed in [4], *below*.

[2] "Incidents of Ownership"

Incidents of ownership can include the power to change beneficiaries, to assign the policy or to revoke an assignment, to surrender or to cancel the policy, or to borrow against the policy [*Treas. Reg. § 20.2042-1(c)(2)*; *Chase National Bank v. United States (1929) 278 U.S. 327, 334-338, 49 S. Ct. 126, 73 L. Ed. 405* ; *Estate of Riefberg v. Comm. (1982) T.C. Memo 1982-70]* . A controlling shareholder possesses incidents of ownership if he or she has the ability to control an insurance policy owned by a corporation [*I.R.C. § 2042*; *Treas. Reg. § 20.2042-1(c)*]. In that case, a controlling shareholder's incidents of ownership result in both the stock's value and the insurance proceeds being included in his or her gross estate for estate tax purposes [*see I.R.C. §§ 2031, 2042*].

If the corporation is the beneficiary of any portion of the proceeds on the life of the controlling shareholder, that portion of the proceeds will not be included in the decedent's gross estate [*see I.R.C. § 2042*], but will be a factor in valuing the shares for estate tax purposes [*Treas. Reg. § 20.2042-1(c)(6)*; *see I.R.C. § 2031*]. The proceeds, however, must be

payable to the corporation or to a third party for a valid corporate purpose. This regulation does not apply if the proceeds are payable to the decedent's estate or to a trustee [*Treas. Reg. § 20.2042-1(c)(6)*].

The Internal Revenue Service has argued that when insurance policy proceeds are payable to the deceased shareholder's estate to purchase the decedent's shares, or when the shareholder possesses incidents of ownership in the policy, both the insurance proceeds and the value of the shares must be included in the decedent's gross estate for estate tax purposes. However, the Tax Court has rejected this position if the insurance proceeds must be credited against the shares' purchase price under the buy-sell agreement [*Estate of Ray E. Tompkins (1949) 13 T.C. 1054 , acq., 1950-1 C. B. 5*].

[3] Valuation of Shares

The risk of double taxation of insurance proceeds also exists if the buy-sell agreement does not set a value on the shares that will be accepted by the Internal Revenue Service for estate tax purposes. If the value is not accepted, the estate may be subject to a higher estate tax valuation than the amount actually paid for the shares [*see I.R.C. § 2703*]. This problem may be avoided by ensuring that the value of shares set by the buy-sell agreement will be accepted by the Internal Revenue Service for estate tax purposes [*see I.R.C. § 2703(b)*; *Treas. Reg. §§ 20.2031-2*, 25.2703-1 (requirements); § 8D.61].

[4] Cross-Purchase Agreements

Under a cross-purchase agreement, if a remaining shareholder who owns the policy is the policy's beneficiary, the policy proceeds are not included in the deceased shareholder's gross estate for estate tax purposes, whether they are paid directly to the insured's estate or to a trustee [*I.R.C. § 2042(2)*]. Although the value of the stock is included in the decedent's gross estate, it will not be increased by the policy proceeds to the extent that the proceeds do not exceed the shares' value [*see I.R.C. § 2031*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Estate & Gift TaxesTaxable PropertyLife Insurance (IRC sec. 2042)General OverviewTax LawFederal Estate & Gift TaxesGeneral OverviewContracts LawThird PartiesBeneficiariesGeneral OverviewTax LawFederal Estate & Gift TaxesTaxable PropertyLife Insurance (IRC sec. 2042)Proceeds Receivable by ExecutorsTax LawFederal Estate & Gift TaxesTaxable PropertyGeneral OverviewInsurance LawLife InsuranceBeneficiariesChangesTax LawFederal Estate & Gift TaxesTaxable PropertyLife Insurance (IRC sec. 2042)Incidents of Ownership



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
D. Estate Tax Consequences of Agreement

4-8D California Legal Forms--Transaction Guide § 8D.61

§ 8D.61 Valuation of Shares at Purchase Price for Federal Estate Tax Purposes

[1] Basic Issues

A primary goal of many buy-sell agreements is to establish the value of the shareholders' shares for federal estate tax purposes [*see* Weyher & Noall, Providing for Succession Through Buy-Sell Agreements and Recapitalizations," 21 N.Y.U. Tax. Inst. 445, 465 (1963)]. The share purchase price specified in the agreement will generally be the value at which the shares are taxed for estate tax purposes if specified requirements are met [*I.R.C. § 2703*; *Treas. Reg. §§ 20.2031-2*, 25.2703-1; *Rev. Rul. 59-60, 1959-1 C.B. 237, 243-244* ; *see Roth v. United States (1981) 511 F. Supp. 653, 654-655* ; *Slocum v. Unites States (1966) 256 F. Supp. 753, 755-756* ; *Estate of Orville B. Littick (1958) 31 T.C. 181* , acq. in *1959-2 C.B. 5*]. If the purchase price stated in a buy-sell agreement is not accepted for estate tax purposes, the shares of the deceased shareholder will be assessed at their fair market value, which may be substantially higher than the value fixed by the buy-sell agreement [*see I.R.C. § 2703*; *Treas. Reg. § 20.2031-2(a),(f)*]. The requirements discussed in [2], *below*, affect this determination. Valuation methods are *covered in § 8D.75*.

[2] Fixing Estate Tax Valuation at Agreement Price

[a] Effect of Agreement Price in Determining Value for Federal Estate Tax Purposes

The effect of the price specified in the buy-sell agreement in determining the value of the shares for estate tax purposes depends on the circumstances of the particular case [*Treas. Reg. § 20.2031-2(h)*; *see Rev. Rul. 83-120, 1983-2 C.B. 170*]. In *Worcester County Tr. Co. v. Commissioner (1st Cir. [T.C.] 1943) 134 F.2d 578* , for example, the court of appeal held that even if the share value for estate tax purposes is not fixed by the agreement, the agreement price should be considered as one of the "relevant factors" having a bearing on the value of the stock [*Worcester County Tr. Co. v. Commissioner (1st Cir. [T.C.] 1943) 134 F.2d 578, 582]* .

[b] Requirements for Agreements Between Unrelated Persons

To effectively fix the stock purchase price for estate tax purposes, a buy-sell agreement between unrelated persons who are not the natural objects of each other's bounty must meet three requirements [*Treas. Reg. § 20.2031-2*]:

- The agreement must prevent the decedent from disposing of the decedent's shares during his or her lifetime without first offering them to the corporation or to the other shareholders at the price fixed in the agreement.

- The decedent's estate must sell the shares at the stipulated price.

- The selling price must be specifically determined by the agreement according to a formula or by reference to a designated price.

An agreement between unrelated persons is presumed to be a bona fide business arrangement, entered into at arm's length with the corporation or the other shareholders, [*see I.R.C. § 2703(b)(1),(3)*], and not a device to pass the decedent's shares to the natural objects of his or her bounty for less than adequate consideration in money or money's worth under *Internal Revenue Code § 2703(b)(2)* [*see Treas. Reg. § 25.2703-1(b)(1)*; *see also [c], below*].

[c] Additional Requirements for Agreements Between Related Persons

In addition to the three requirements enumerated in [b], *above* [*see Treas. Reg. §§ 20.2031-2*, 20.2031-3], a buy-sell agreement among persons who are related or who are the natural objects of each other's bounty must also comply with the following three requirements to be effective at fixing the value of stock at the agreement price for federal estate tax purposes:

- The agreement must be a bona fide business arrangement [*I.R.C. § 2703(b)(1)*; *Treas. Reg. §§ 25.2703-1(b)(1)(i)*, 20.2031-2].

- The agreement must not be a device to pass the decedent's shares to the natural objects of his or her bounty for less than adequate consideration in money or money's worth [*I.R.C. § 2703(b)(2)*; *Treas. Reg. §§ 25.2703-1(b)(1)(ii)*, 20.2031-2].

- The agreement's terms must be comparable to similar arrangements entered into in arm's length transactions [*I.R.C. § 2703(b)(3)*; *Treas. Reg. §§ 25.2703-1(b)(1)(iii)*, 20.2031-2]. Each of these three requirements is a separate test [*Treas. Reg. § 25.2703-1(b)(2)*].

One commentator has noted that the practical effects of these requirements is that stock prices under buy-sell agreements between related persons are likely to be close to fair market value [Business Buy-Sell Agreements, Ch. 5, *Estate Planning Considerations*, § 2.52 (Cal. C.E.B. 1992)].

If there are both related and unrelated persons to the agreement, the requirements enumerated above [*see I.R.C. § 2703(b)(1)-(3)*; *Treas. Reg. § 25.2703-1(b)(1)(i)*-(iii)] will be considered met if more than 50 percent by value of the interests subject to the rights and restrictions is owned, directly or indirectly, by individuals who are not members of the transferor's family, provided, further, that the stock owned by the unrelated persons is subject to the restrictions to the same extent as the transferor [*Treas. Reg. § 25.2703-1(b)(3)*; *see Treas. Reg. § 25.2703-1(b)(5)* ("members of transferor's family" defined)].

For discussion of agreements entered into before October 9, 1990, *see* [d], *below*.

[d] Requirements Agreements Entered Into Before October 9, 1990

Buy-sell agreements entered into before October 9, 1990 are subject to the requirements of *Treasury Regulations Section 20.2031-2*, as well as to the cases and regulations clarifying these requirements [*see* [b], *above*], and not to the

additional requirements of *Internal Revenue Code Section 2703* and *Treas. Reg. § 25.2703-1* [*see* [c], *above*], unless the agreements are substantially modified after October 8, 1990 [*Treas. Reg. § 25.2703-2*].

"Substantial modification" means any discretionary modification of a right or restriction under an agreement that results in other than a de minimis change to the quality, value, or timing of the rights of any party with respect to property that is subject to the right or restriction [*Treas. Reg. § 25.2703-1(c)(1)*]. For example, if the terms of the right or restriction require periodic updating, the failure to update is presumed to substantially modify that right or restriction. Further, the addition of any family member as a party to a right or restriction is considered a substantial modification unless either:

- The addition is mandatory under the terms of the agreement, or

- The added family member is assigned to a generation (determined under the rules of *Internal Revenue Code § 2651*) no lower than the lowest generation occupied by individuals already party to the right or restriction [*see Treas. Reg. § 25.2703-1(c)(1),(d)*; *see also Treas. Reg. § 25.2703-1(c)(2)* (list of modifications not considered substantial)].

Caution should be exercised in modifying a pre-October 9, 1990 buy-sell agreement between related persons because it is likely that the additional requirements of *Internal Revenue Code § 2703* and *Treasury Regulation 25.2703-1* will be more difficult to meet than the requirements of *Treasury Regulation 20.2031-2*, governing pre-October 9, 1990 agreements [*see* [b], [c], *above* ; *see also § 8D.76*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Estate & Gift TaxesAlternative & Special Use Valuation (IRC secs. 2032, 2032A, 2701-2704)Special Use ValuationGeneral OverviewTax LawFederal Estate & Gift TaxesGeneral OverviewTax LawFederal Estate & Gift TaxesDefinition of Gross EstateTax LawFederal Income Tax ComputationValuationCorporate Securities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
D. Estate Tax Consequences of Agreement

4-8D California Legal Forms--Transaction Guide § 8D.62

§ 8D.62 California Estate Tax Consequences of Agreement

Although a California estate "pick-up" tax imposes a tax liability equal to the portion, if any, of the maximum credit for state death taxes allowable under the federal estate tax law that is attributable to property located in California, a decedent's estate may not have a greater combined tax liability to the state and federal government than the total tax liability to the federal government [*Rev. & Tax. Code § 13302*]. *See* Ch. 60, *Estate Planning* , for further discussion of California taxation of estates.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesEstate & Gift TaxEstate TaxImposition of TaxTax LawState & Local TaxesEstate & Gift TaxEstate TaxCredits



42 of 141 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
D. Estate Tax Consequences of Agreement

4-8D California Legal Forms--Transaction Guide §§ 8D.63-8D.69

[Reserved]

§§ 8D.63[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
E. Business Considerations

4-8D California Legal Forms--Transaction Guide § 8D.70

§ 8D.70 Importance of Business Law Considerations

Great attention is often paid to the tax consequences of a buy-sell agreement, without adequate attention being given to non-tax or business law considerations, including limitations on the corporation's repurchase of its shares [*see § 8D.72*], securities regulations [*see § 8D.74*], purchase price [*see § 8D.75*], triggering events [*see § 8D.73*], funding [*see § 8D.71*], and the purchasers.

The decision about who will purchase the shares involves selecting the appropriate type of agreement, whether entity purchase, cross-purchase, or hybrid agreement. Tax considerations affecting the choice of agreement are discussed in Part C, §§ 8D.40-8D.62. Business law considerations are discussed in this part, §§ 8D.71-8D.76. Community property considerations are addressed in Part E, § 8D.90.

The business law considerations for entity purchase and cross purchase agreements are generally the same [*see § 8D.73-8D.75*], with the exception of funding requirements [*see § 8D.71*], and the limitations on a corporation's repurchase of its shares [*see § 8D.72*]. Cross-purchase agreements are ordinarily funded by the remaining shareholders individually or by life insurance. Therefore, whether the corporation is able to meet certain specified statutory financial tests (required before it may redeem its own shares) is not germane to this type of agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
E. Business Considerations

4-8D California Legal Forms--Transaction Guide § 8D.71

§ 8D.71 Funding Buy-Sell Agreements

[1] Types of Funding

[a] Cross-Purchase Agreement

Under a cross-purchase agreement, the shareholders may opt to use their own funds to purchase the shares, paying either in a lump sum or a series of installment payments on a promissory note. In fact, the major disadvantage of a cross-purchase agreement for most shareholders is that they must use their own money to purchase the shares of the departing shareholder. If the remaining shareholders have to withdraw funds from the corporation in the form of dividends to fund the buy-out, these funds will be subject to double taxation--once as income to the corporation [*see I.R.C. §§ 11(a), 311*], and again when received by the shareholder [*I.R.C. §§ 1(h)(11), 61(a)(7), 301, 305(b)*; *see I.R.C. § 316* ("dividend" defined); § 8D.41]. This double taxation, however, does not occur when the funds are withdrawn as compensation, provided the amount is reasonable, taking into account the shareholder's overall compensation [*see I.R.C. § 162(a)(1)*; *Treas. Reg. § 1.162-8*], or if the corporation is a subchapter S corporation [*see I.R.C. § 1366*; *see also* Ch. 1E, *Taxation of Businesses* ; Ch. 2B, *Electing Subchapter S Status*].

[b] Entity Purchase Agreement

In an entity purchase agreement, the corporation may opt to use its own capital, either corporate surplus or reserves, to fund the purchase. However, a corporation is prohibited from redeeming or purchasing its own shares unless it can meet certain statutory financial tests when the triggering event occurs [*see Corp. Code §§ 166, 500-503*; § 8D.72].

[c] Both Types of Agreements

Both entity and cross-purchase agreements may use life insurance purchased on the life of each shareholder to fund the purchase of shares on death [*see* [2], *below*], or disability insurance to fund the purchase of shares when the agreement requires purchase and sale on a shareholder's permanent disability.

[2] Life Insurance Funding

[a] Advantages

Life insurance funding provides a corporation or its shareholders with ready cash to meet their obligations under the agreement. Life insurance may be especially useful during the early years of the corporation's existence, when other funds may not be readily available for share purchase in the event of a shareholder's death [*see* Sarner, *Uses of Life Insurance in Buy-Sell Agreements: Stockholder-Corporation Obligations in Buy-Sell Agreements*, 24 N.Y.U. Tax. Inst. 591 (1966)]. Permanent insurance with a cash equity buildup feature may provide the funds for a lifetime purchase of shares upon such events as a shareholder's disability, retirement, desire to sell, or termination from employment, while term life insurance will provide funding only for purchase upon death [*see* [d], *below*]. Without insurance funding, a shareholder selling shares during his or her lifetime must often accept promissory notes and rely on the financial responsibility of the purchaser [*see* Sexton, *Providing Security for the Outgoing Stockholder and Avoiding Tax Disadvantages to Selling and Remaining Stockholders*, 24 N.Y.U. Tax. Inst. 555, 560 (1966)].

[b] Cost of Insurance

The cost of using life insurance to fund a buy-sell agreement must be compared with the cost of borrowing money or using the business' own capital. There are many assumptions to be made in this comparison, including the future value of the business, its future need for capital, future interest rates, and the length of life of the insureds. The uninsurability of any of the owners of the business or the increased cost of insuring an owner with medical problems may rule out funding a buy-sell agreement with life insurance. In either case, alternate insurance possibilities [*see* [c], *below*], as well as other funding methods, should be considered.

[c] Alternate Insurance Possibilities

Alternate insurance possibilities include:

- The use of "guaranteed issue" life insurance, which may obtained without regard to the insured's health.

- Group life insurance that includes "guaranteed issue" insurance.

- Transfer of the policy owner's personal life insurance policy to the business to fund the buy-sell agreement.

Each alternatives has a possible downside to consider. With "guarantee issue" insurance, the coverage is often limited. With group life insurance, covering an otherwise uninsurable partner or shareholder may require insuring all employees for a large amount or risk failing to meet the Internal Revenue Service's antidiscrimination tests to qualify as group insurance [*see I.R.C. § 79(d)*]. Finally, an uninsurable person may be unwilling to transfer a personal policy to the business, and if such a sale or transfer does occur, the policy should not be transferred or sold to a corporation without careful consideration of the transfer-for-value tax rule [*see I.R.C. § 101(a)(2)(B)*].

[d] Adequate Amount for Funding

The simplest way to assure adequate liquid capital to finance the purchase of a business interest under a buy-sell agreement is to obtain life insurance in an amount equal to the value of the interest to be redeemed or purchased. For discussion of valuation methods, *see § 8D.75*.

[e] Type of Life Insurance Product

Many types of life insurance products may be used to fund the agreement. The correct vehicle for funding a buy-sell

agreement should be selected in consultation with a life insurance agent. The type chosen will depend primarily on the length of time a buy-sell agreement is to be in effect, and the cost of premiums. For example, if the existence of the business is deemed perpetual, the cost of maintaining term insurance on older individuals may not be cost effective, if not actually prohibitive. Permanent insurance, also referred to as whole life, straight life, ordinary life, universal life, or executive protection, provides a level premium, with increasing cash surrender values. All permanent insurance has a buildup of cash value; term insurance has no cash value or equity buildup. Because of the cash buildup in permanent insurance, its premiums can be substantially reduced after a specified period, possibly to the point where the permanent insurance will be less expensive than term insurance in the later years of the policy. In addition, permanent insurance has special features, such as the cash equity buildup mentioned above, tax-free cash borrowing (under most circumstances), with favorable interest rates, the ability to cash in the policy if the business is in serious need, and may include an option to convert the equity portion of the policy to an annuity. For further discussion of the features of term and permanent insurance, *see* Ch. 1F, *Insurance Considerations in Business Formation* .

[f] Importance of Funding Agreement Through Purchase of Insurance

Regardless of the type of buy-sell agreement chosen or the insurance product selected for funding, it is important to make sure the client does, in fact, purchase the insurance. The most frequent flaw found in businesses with buy-sell agreements is the lack of insurance coverage to fund the buyout. Failure to take the time to establish that the client has actually funded the agreement may subject the client to the worst of both worlds: a mandatory buyout with a contractually-obliged buyer and seller at a crucial juncture in the life of the business, coupled with no funds available to carry out the agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Insurance LawLife InsuranceInsurable InterestsGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
E. Business Considerations

4-8D California Legal Forms--Transaction Guide § 8D.72

§ 8D.72 Restrictions on Corporate Purchases

[1] Statutory Tests

[a] In General

A corporation must satisfy certain statutory financial tests to purchase or redeem its shareholders' shares under an entity purchase agreement not funded by insurance. Under the General Corporation Law, the purchase or redemption by a corporation of its shares for cash or property is a "distribution to its shareholders" [*Corp. Code § 166*]. To make any valid distribution to its shareholders, a corporation must be able to pass either the retained earnings or remaining assets test [*Corp. Code § 500*], the general solvency test [*Corp. Code § 501*], and, when applicable, the liquidation preference and dividend preference tests [*Corp. Code §§ 502, 503*].

A corporation licensed as a broker-dealer under *Corporations Code § 25210 et seq.* is not required to pass either the retained earnings or remaining assets test [*see Corp. Code § 500(a),(b)*] if, immediately after any distribution, it is in compliance with the net capital rules of the Commissioner of Corporations [*see 10 Cal. Code Reg. § 260.216.12*] and the Securities and Exchange Commission [*Corp. Code § 500(e)*; *see 17 C.F.R. § 240.15c3-1*].

For more detailed discussion of these tests, *see Ch. 9, Dividends, Reacquisitions of Shares, and Assessments, §§ 9.11-9.12* and Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 8, *Dividends and Reacquisition of Shares* , § 141 (Matthew Bender).

[b] Retained Earnings Test

The retained earnings requirement provides that a corporation may purchase its own shares if its retained earnings, immediately prior to the distribution, equal or exceed the amount of the proposed distribution [*Corp. Code § 500(a)*]. "Retained earnings" means the balance of net profits, after the deduction of distributions to shareholders and transfer to capital accounts under generally accepted accounting principles [*see Corp. Code § 114*; Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 8. *Dividends and Reacquisition of Shares* , § 141.06[3] (Matthew Bender)].

[c] Remaining Assets Test

A corporation with insufficient retained earnings may still purchase its own shares if its meets the remaining assets test. This test provides for purchase of shares if, immediately after the distribution:

- Corporate assets (excluding goodwill, capitalized research and development expenses and deferred charges) equal at least 125 percent of corporate liabilities (excluding deferred taxes, deferred income and other deferred credits), and

- Current assets equal current liabilities.

However, current assets must equal 125 percent of current liabilities if the average earnings of the corporation before income taxes and interest expenses were less than the average interest expenses for the two preceding fiscal years [*Corp. Code § 500(b)(2)*]. The second part of this test [*Corp. Code § 500(b)(2)*] does not apply to a corporations that is not required to classify its assets into current and fixed under generally accepted accounting principles [*Corp. Code § 500(b)(2)*].

For the purpose of applying *Corp. Code § 500* to a distribution by a corporation of cash or property in payment by the corporation in connection with the purchase of its shares, there must be added to retained earnings all amounts that had been previously deducted from retained earnings with respect to obligations incurred in connection with the corporation's repurchase of its shares and reflected on the corporation's balance sheet, but not in excess of the principal of the obligations that remain unpaid immediately prior to the distribution. In addition, there must be deducted from liabilities all amounts that had been previously added to liabilities with respect to the obligations incurred in connection with the corporation's repurchase of its shares and reflected on the corporation's balance sheet, but not in excess of the principal of the obligations that will remain unpaid after the distribution, provided that no addition to retained earnings or deduction from liabilities under *Corp. Code § 500(b)(2)* may occur on account of any obligation that is a distribution to the corporation's shareholders [*see Corp. Code § 166* (when distribution is made)] at the time the obligation is incurred [*Corp. Code § 500(d)*].

[d] Solvency Test

The solvency test requires that a corporation not make any distribution to the corporation's shareholders if, as a result, the corporation is or would be likely to be unable to meet its liabilities as they mature [*Corp. Code § 501*]. This test must be met even if the corporation satisfies the retained earnings or remaining assets test [*Flynn v. California Casket Co. (1951) 105 Cal. App. 2d 196, 205-206, 233 P.2d 131]* .

[e] Liquidation or Dividend Preferences

Finally, a corporation may not make distributions to junior shares that affect the liquidation or dividend preferences of senior shares [*see Corp. Code §§ 502, 503*].

[2] Exception for Agreements Funded with Insurance

When the entity purchase agreement is funded with insurance, the statutory tests are partially inapplicable. They do not apply to a purchase or redemption of shares of a deceased shareholder from the proceeds of life insurance on that shareholder in excess of the total amount of all premiums paid by the corporation for the insurance, if the shares are purchased to carry out the provisions of an agreement between the corporation and the shareholder to purchase or redeem the shares upon the death of the shareholder [*Corp. Code § 503.1*]. A similar rule applies to the proceeds of disability insurance used to purchase a disabled shareholder's shares [*see Corp. Code § 503.2*]. Even if the proceeds exceeding the premiums paid by the corporation are inadequate for the redemption, those proceeds received by the

corporation should increase its retained earnings and enable it to pass the statutory balance sheet tests [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 63.03[b][i] (Matthew Bender)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionMergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
E. Business Considerations

4-8D California Legal Forms--Transaction Guide § 8D.73

§ 8D.73 Triggering Events

The "triggering events"are the occurrences that require a shareholder to offer his or her shares for sale to the other parties to the agreement. These events typically include lifetime voluntary transfers (gifts and sales to outsiders, for example), involuntary transfers (divorce, division of community property, encumbrances, loss of license), transfers at death or disability, transfers resulting from a change in employment (retirement or other termination of employment), and special occurrences such as voluntary or involuntary attempts at corporate dissolution, mergers, or sales of substantially all of the business.

The corporation under an entity purchase agreement, or the remaining shareholders under a cross-purchase agreement, usually retain a right of first refusal on the same terms as a third party offer or a price established in the buy-sell agreement. Under an entity purchase agreement, if the corporation is unable or unwilling to purchase the shares, the other shareholders ordinarily are given the option to purchase them in proportion to their interests [*see Groves v. Prickett (9th Cir. 1970) 420 F.2d 1119, 1122* (corporate bylaw reserving right of first refusal in other shareholders does not unreasonably restrict right of alienation of stock or deprive shareholder of substantial right)]. The selling shareholder generally may sell his or her shares to outsiders only if neither the corporation nor the remaining shareholders purchase the interest. Further, such a sale to outsiders must generally be completed within a specified time, or the rights of the corporation and remaining shareholders are renewed.

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawFormationRights of First RefusalBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
E. Business Considerations

4-8D California Legal Forms--Transaction Guide § 8D.74

§ 8D.74 Securities Regulations Considerations

[1] Exemptions to Qualification

All corporations are prohibited from offering or selling securities in California unless the offer or sale has been qualified, or the security or transaction is exempt from qualification or not subject to qualification [*see Corp. Code § 25110*]. A corporation with 35 or fewer shareholders may be exempt from qualification based on the small offerings exemption [*see Corp. Code § 25102(h)*; *see also* Ch. 6C, *California Small Offering Exemption*], or the limited offering exemption [*see Corp. Code § 25102(f)*; *see also* Ch. 6B, *California Limited Offering Exemptions*].

Special attention should be paid to ensure that a corporation that relies on the small offerings exemption meets the requirements of that exemption. Not only must the corporation have 35 or fewer shareholders, it also must have only one class of stock [*Corp. Code § 25102(h)*]. A corporation does not have only one class of stock if, at the time its shares are issued, a shareholder's agreement exists, or is intended to exist, that gives some shares rights, preferences, privileges, or restrictions [*see Corp. Code § 25103(e)*] that are not applicable to other shares [*10 Cal. Code Reg. § 260.102.4(b)*]. In that case, caution should be exercised in drafting the terms of a buy-sell agreement to ensure that the agreement does not create more than one class of stock.

[2] Effect of Transfer Restrictions on Qualification

In the event that a close or closely held corporation is ineligible for either the small offering or the limited offering exemption, and must qualify its securities, the Corporations Commissioner determines whether an "open" qualification [*see 10 Cal. Code Reg. § 260.001(f)*] or "limited" qualification [*see 10 Cal. Code Reg. § 260.001(e)*] should be granted, depending on, among other things, the presence of transfer restrictions [*see* Marsh & Volk, *PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, Ch. 6, Procedure for Qualification of Issuer Transactions, § 6.05[3]* (Matthew Bender)].

No open qualification will be approved for securities subject to transfer restrictions imposed by the charter documents of the issuer [*10 Cal. Code Reg. § 260.140.8(a)*]; and as a statutory shareholder's agreement [*see Corp. Code § 186* ("shareholder agreement" defined)], a buy-sell agreement among all of the shareholders of a close corporation is a

charter document [*see 10 Cal. Code Reg. § 260.001(a),(h)*]. A limited offering qualification, however, may be approved for those securities subject to transfer restrictions, as long as the restrictions do not unfairly prejudice the security holder's opportunities to realize a reasonable price [*10 Cal. Code Reg. § 260.140.8(b)*].

The price in a buy-sell agreement is presumptively reasonable if it is based on an offer from a third party, on the appraised value of the securities, or on the book value (unless it is not a significant indication of value) [*10 Cal. Code Reg. § 260.140.8(b)(1),(2)*]. Provisions are not presumptively unreasonable if they either [*10 Cal. Code Reg. § 260.140.8(b)(3)*]:

- Absolutely prohibit the transfer of securities,
- Permit transfer only on consent of the issuer or other holder, or
- Give an option to the issuer or to the other holder to purchase, regardless of the desire of the selling holder to sell, and will be permitted only when justified by the issuer, except as otherwise permitted [*see 10 Cal. Code Reg. §§ 260.140.41, 260.140.42* (exceptions)].

Provisions giving an issuer the right to repurchase securities upon termination of employment are presumptively reasonable if the repurchase price [*10 Cal. Code Reg. § 260.140.8(b)(4)*]:

- Is not less than the fair value of the securities to be repurchased on the date of termination of employment, and (1) the right to repurchase will be exercised for cash or cancellation of purchase money indebtedness for the securities within six months of termination of employment (or in the case of securities issued upon exercise of options after the date of termination, within six months after the date of exercise), and (2) the right terminates when the issuer's securities become publicly traded; or
- Is at the original purchase price, provided that (1) the right to repurchase at the original price lapses at the rate of at least 20 percent of the securities per year over five years from the date the option is granted (without respect to the date the option was exercised or became exercisable), and (2) the right to repurchase must be exercised for cash or cancellation of purchase money indebtedness for the securities within six months of termination of employment (or in the case of securities issued upon exercise of options after the date of termination, within six months after the date of the exercise).

In addition, the securities held by an officer, director, general partner, trustee (when the issuer is a business trust), manager, advisor, or consultant of the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer's parents, or an affiliate of the issuer may be subject to additional or greater restrictions [*10 Cal. Code Reg. § 260.140.8*].

For a detailed discussion of the qualification of securities subject to transfer restrictions, *see* Marsh and Volk, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, Ch. 8, *Standards for the Exercise of the Commissioner's Discretion* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawExemptions From RegistrationGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsExempt Nonissuer & Resale Transactions



48 of 141 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
E. Business Considerations

4-8D California Legal Forms--Transaction Guide § 8D.75

§ 8D.75 Valuation of Shares

[1] Valuation Methods--In General

In a close or closely held corporation, fixing the price of the shares to be purchased in an buy-sell agreement can be difficult, since there is no public market for the shares and, therefore, no standard by which to judge their value. Several methods are commonly used to fix the price of corporate shares.

The "book value formula" reflects the original cost of the corporation's assets [*see* [2], *below*]. The "capitalization of earnings formula" determines the corporation's value by its earnings and profits [*see* [3], *below*]. The "mutual agreement formula" is a method by which the shareholders agree on a fixed value for their shares [*see* [4], *below*]. Appraisal or arbitration by an outside party is also used [*see* [5], *below*]. Often a combination of these methods is utilized [*see, e.g., Alternate Form at* § 8D.200[2], § 10.02 (mutual agreement and arbitration)]. Other valuation methods include the comparison of a privately owned company with publicly held companies in businesses with similar attributes; the excess earnings formula [*see Rev. Rul. 68-609, 1968-2 C.B. 327*]; and formulas developed by various industries for valuing individual companies for purchase and sale.

A corporation that is ineligible for exemption from qualification of its securities must also set the purchase price in accordance with the criteria set forth in the California Code of Regulations [*see 10 Cal. Code Reg. § 260.140.8*; *see also § 8D.74[2]*].

[2] Book Value

The book value formula is one of the most frequently used methods of evaluating stock. It reflects the original cost of the corporation's assets, and ordinarily has no relationship to corporate earnings. Book value is an accounting term, rather than a form of valuing assets. Thus, in law, the term may mean market value, cost minus depreciation, or some other concept of value recognized by sound accounting practices and used by a particular corporation to record its financial transactions [*see Lassallette v. Parisian Baking Co. (1952) 110 Cal. App. 2d 375, 377, 242 P.2d 671]* . Therefore, the term must be explicitly defined when it is used in a buy-sell agreement. Further, the date on which the book value will be determined must also be specified in the agreement.

Book value is not an accurate guide to a corporation's worth or to the value of its shares unless most of the corporation's assets are liquid and are reflected on the corporation's books at close to their fair market value. Even when the book value accurately reflects market value, that value usually represents only what others would pay for the separate assets of the corporation, thus excluding many valuable elements, such as the corporations's earning capacity, which may be the most important measure of its value, goodwill, or the market value of assets that have been totally depreciated for tax purposes [*see* Schaefer, *The Fallacy of Weighing Asset Value and Earnings Value in the Appraisal of Corporate Stock*, 55 S. Ca. L. Rev. 1031, 1051 (1982)]. As a result, this method is frequently altered by fixing the purchase price at some percentage of the book value, or by using it in combination with other valuation methods [*see* Cavitch, *BUSINESS ORGANIZATIONS, Ch. 148, Stock Buy-Out Agreements, § 148.04[2]* (Matthew Bender)].

[3] Capitalization of Earnings

The "capitalization of earnings formula" determines the corporation's value by its continuing ability to earn profits, rather than by the worth of its assets. Under this method, the per-share earnings over a particular time period are determined and then divided by the per-share rate of return on each shareholder's investment, resulting in the valuation per share. The earnings used in the formula should cover a time period long enough to counter unusual fluctuations, and should exclude nonrecurring items of income or expense. The formula assumes that future earnings will continue at least at the same rate as earnings during the time period used.

Although this method is based on the corporation's earning power, which is one of the best measures of the value of a business, it may not accurately determine future profitability when the deceased or selling shareholder was important to the success of the corporate business. Furthermore, the calculations required to determine the per-share earnings, including any necessary adjustments to earnings over the period in which the earnings are measured, and per-share rate of return, can be quite complex. For further discussion of the capitalization formula, *see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, *Close Corporations* , § 63.05[3] (Matthew Bender).

[4] Mutual Agreement

Under the "mutual agreement method," the shareholders set the value of their own shares. They agree among themselves on either a fixed dollar amount or a formula that will be used to determine share value. Since a corporation's owners are often best able to determine its value, in light of their knowledge of the company and its business, this method often results in a price that is acceptable to all shareholders, provided that the shareholders have approximately equal bargaining power and that they periodically reevaluate the purchase price. Some practitioners suggest that a provision in the buy-sell agreement for periodic review of the purchase price be coupled with a provision for appraisal if the parties fail to agree on a price at any period.

[5] Appraisal

Appraisal may be a more suitable method of valuation than a formula, if the business has a substantial number of fixed assets that can be objectively valued and that may be either over or under valued on the corporation's balance sheet, and if a capitalization of earning will not reflect the earning potential of the business.

The buy-sell agreement may specify the name of an appraiser or the method by which appraisers will be chosen, and how the appraisal fee will be allocated. It may provide that if all parties are unable to agree on one appraiser, each party will select that party's own appraiser. The agreement may also specify that if there is a substantial difference between appraisals, a third appraiser will be selected by either the parties of the appraisers. Although the cost of hiring appraisers makes this method somewhat expensive, it ensures that experts will determine a fair value for those assets that can be reliably appraised by outsiders.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsGeneral OverviewBusiness & Corporate LawClosely Held CorporationsValuationTax LawFederal Income Tax ComputationValuationBusiness InterestsTax LawFederal Income Tax ComputationValuationCorporate Securities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
E. Business Considerations

4-8D California Legal Forms--Transaction Guide § 8D.76

§ 8D.76 Reviewing, Amending, and Enforcing the Agreement

A buy-sell agreement may need to be amended periodically if the personal or financial circumstances of the shareholders change, if the financial condition of the corporation changes, or if there is a change in the statutory provisions that regulate the agreement or control its tax aspects. In addition, because the purchase price or valuation method specified in the buy-sell agreement may be used for the first time years after the agreement is drafted, any agreed price or valuation formula should be reevaluated periodically, especially with respect to changing business conditions and changes in the tax law. In particular, an agreement that sets a fixed price for sale of the shares should be reviewed at reasonably frequent intervals [*see § 8D.200[2], § 10.01* (alternate provision)]. Most buy-sell agreements provide that the agreement may be amended only by the written consent of all parties.

Caution should be exercised in modifying a pre-October 9, 1990 buy-sell agreement among related persons if the modification affects the quality, value, or timing of a right or restriction. This is because the requirements for fixing the value of stock for estate tax purposes for pre-October 9, 1990 agreements among related persons [*see Treas. Reg. § 20.2031-2*; § 8D.61[2][d]] are generally easier to meet than the additional requirements [*see I.R.C. § 2703*] that apply to agreements among related persons that are substantially modified after October 8, 1990 [*see Treas. Reg. § 25.2703-2*; *see § 8D.61[2][b],[c]*].

Buy-sell agreements may be enforced by specific performance when the stock is unique [*see* Witkin, Summary of California Law, vol. 13, *Equity* §§ 30(a), 37 (10th ed. 2005)]. A contract to sell stock that is not obtainable on the open market is specifically enforceable, since the stock is unique, with a peculiar value to the purchaser that cannot be compensated by a money judgment [*Glascock v. Sukumlyn (1955) 131 Cal. App. 2d 587, 593, 281 P.2d 90* ; *see Polinsky v. Vaughan (1968) 268 Cal. App. 2d 183, 73 Cal. Rptr. 764* (option contract for purchase of shares upon termination of employment)]. For examples of complaints for specific performance of buy-sell agreements, *see* CALIFORNIA FORMS OF PLEADING PRACTICE, Ch. 163, *Corporations: Transfers of Shares*, §§ 163.43, 163.44, and Ch. 528, *Specific Performance*, § 528.130 (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawRemediesSpecific Performance



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
E. Business Considerations

4-8D California Legal Forms--Transaction Guide §§ 8D.77-8D.89

[Reserved]

§§ 8D.77[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
F. Community Property Considerations

4-8D California Legal Forms--Transaction Guide § 8D.90

§ 8D.90 Characterization of Stock as Community, Quasi-community, or Separate Property

[1] Importance of Characterization

All parties to a buy-sell agreement, as well as nonparty spouses and nonmarital partners, have an interest in establishing or ascertaining the property nature of the stock subject to the agreement. Characterization of stock as community, quasi-community, or separate property, or a combination of the three, is required in order to determine the rights and liabilities of the parties with respect to the stock. Problems involving characterization generally arise in the context of the following:

- Determining interspousal rights of management and control of the stock during the marriage.
- Dividing stock on marital dissolution, separation, or annulment.
- Distributing stock on the death of one or both spouses.
- Determining the rights of third party creditors with respect to the stock, either during marriage or on termination of marriage.

For example, non-owner shareholders will want to ensure the enforceable transfer of stock, as specified in the agreement, on the death or divorce of the owner shareholder. Owner shareholders who are married or have nonmarital partners will want to establish the community or separate property nature of the stock for purposes of management and control, as well as for income, estate and gift tax planning. Nonparty spouses and partners have similar interests.

Although detailed discussion of property interests is outside the scope of this chapter, [2]-[4], *below*, provide an overview of community property, quasi-community and separate property principles, and the transmutation of the property nature of the stock. For additional coverage of property principles, see Ch. 120, *Complete Marital Settlement Agreements* , Ch. 121, *Provisions for Division of Property* , and CALIFORNIA FORMS OF PLEADING AND PRACTICE, Ch. 122, *Community Property* (Matthew Bender). For discussion of related estate planning

considerations, see Ch. 60, *Estate Planning* .

[2] Types of Property

[a] Community Property

Stock may be a spouse's community property, separate property, or quasi-community property, or a combination of the two.

Community property is generally "all property, real or personal, wherever located, acquired by a married person during marriage while domiciled in California", except as otherwise provided by statute [*Fam. Code § 760*; *see Civ. Code § 687*; *Fam. Code § 65*; *see also Fam. Code § 761*]. This definition is not an exclusive statement describing all property classified as community property. Rather, it is a general statement of the basic rule that all property acquired during marriage is community property, unless it is a spouse's separate property [*Fam. Code §§ 130, 770*] or the spouses agree to the contrary [*Fam. Code § 850*; *see* 23 Cal. Law Rev. Comm. 1 (1993)].

For purposes of disposition of property on the death of a spouse, community property includes all real property in California, and all personal property, wherever located, acquired during marriage:

- That is community property or a substantially equivalent type of marital property under the laws of the place where the acquiring spouse was domiciled when the property was acquired [*Prob. Code § 28(b)*], and

- In exchange for real or personal property, wherever located, that is community property or a substantially equivalent type of marital property under the laws of the place where the acquiring spouse was domiciled when the exchanged property was acquired [*Prob. Code § 28(c)*].

For example, unless otherwise characterized by agreement [*see* [5], *below*], stock purchased by a spouse with earnings during marriage is community property [*see In re Marriage of Rosan (1972) 24 Cal. App. 3d 885, 889, 101 Cal. Rptr. 295]* .

On dissolution of marriage, community property must be divided equally between spouses [*Fam. Code § 2550*]. On a spouse's death, one-half of the community property belongs to the surviving spouse and one-half belongs to the decedent; each spouse has the power of testamentary disposition over his or her half [*Prob. Code §§ 100(a), 6101(b)*]. Alternatively, spouses may agree in writing to divide their community property on the basis of a non pro rata division of the aggregate value of the community property, on the basis of a division of each individual item or asset of community property, or partly on each basis. Furthermore, the statutory authorization for a non pro rata division of community property does not *require* a written agreement in order to permit or recognize a non pro rata division of community property, it merely *authorizes* such a division [*Prob. Code § 100(b)*]. Therefore, an oral non pro rata division of community property is also valid if otherwise allowed or recognized by applicable case or statutory law.

[b] Separate Property

Separate property generally includes the following [*Fam. Code §§ 130, 770(a)*; *Cal. Const., art. I, § 21*]:

- All property owned before marriage.

- All property acquired after marriage by gift, bequest, devise, or descent.

- The rents, issues, and profits of separate property.

Under some circumstances, however, the community may acquire an interest in a separate property business [*see* [3], *below*].

On dissolution of marriage, separate property must be awarded to the spouse whose property it is [*Barker v. Barker (1956) 139 Cal. App. 2d 206, 210 293 P.2d 85]* . A spouse has the power of testamentary disposition over his or her separate property [*see Prob. Code § 6101(a)*].

[c] Quasi-Community Property

For purposes of division of property on marital dissolution, quasi-community property consists of all real or personal property, wherever located, acquired during the marriage in one of the following ways [*Fam. Code § 125*]:

- By either spouse while domiciled elsewhere, if the property would have been characterized as community property had the acquiring spouse been domiciled in California at the time of its acquisition.

- In exchange for property, wherever located, that would have been characterized as community property, had the spouse who acquired the property been domiciled in California when the exchanged property was acquired.

For purposes of disposition of property on the death of a spouse, quasi-community property consists of the following [*Prob. Code § 66*]:

- All personal property wherever located, and all California real property that would have been characterized as community property had the decedent been domiciled in California at the time of its acquisition.

- All personal property, wherever located, and all California real property acquired in exchange for property that would have been characterized as community property had the decedent been domiciled in California at the time of acquisition of the exchanged property.

Current law treats quasi-community personal property (such as corporate stock) as community property for purposes of division on marital dissolution or separation [*see Fam. Code §§ 125, 2550*] and disposition on death [*see Prob. Code §§ 66, 101, 6101(c)*; *see also* [a], *above*]. For example, a stock option acquired by a husband in consideration for his employment while he was domiciled outside California is quasi-community property after the spouses move to California [*Cooper v. Cooper (1969) 269 Cal. App. 2d 6, 11-12, 74 Cal. Rptr. 439]* .

As with community property, on the death of one spouse, one-half of the quasi-community property belongs to the surviving spouse and one-half belongs to the decedent [*Prob. Code § 101(a)*]. Alternatively, spouses may agree in writing to divide their quasi-community property on the basis of a non pro rata division of the aggregate value of the quasi-community property, on the basis of a division of each individual item or asset of quasi-community property, or partly on each basis. Furthermore, the statutory authorization for a non pro rata division of quasi-community property does not *require* a written agreement in order to permit or recognize a non pro rata division of quasi-community property, it merely *authorizes* such a division [*Prob. Code § 101(b)*]. Therefore, an oral non pro rata division of quasi-community property is also valid if otherwise allowed or recognized by applicable case or statutory law.

[3] Community Property Interest in Separate Property Investment

Under some circumstances, the community may acquire an interest in a separate property business. For example, when one spouse owns a business interest as separate property, and either spouse participates in the business during marriage,

California courts have determined that the interest so created is part separate and part community property [*see Beam v. Bank of America (1971) 6 Cal. 3d 12, 17, 98 Cal. Rptr. 137, 490 P.2d 1378* ; *Estate of Neilson (1962) 57 Cal. 2d 733, 740, 22 Cal. Rptr. 1, 371 P.2d 745]* . The time, energy, and skill contributed by either spouse during marriage is a community asset [*Beam v. Bank of America (1971) 6 Cal. 3d 12, 17, 98 Cal. Rptr. 137, 490 P.2d 1378]* . Thus, when either spouse's community property efforts during marriage combine with a separate property investment to produce income, that income will be apportioned according to the relative separate and community property contributions [*see Beam v. Bank of America (1971) 6 Cal. 3d 12, 17, 98 Cal. Rptr. 137, 490 P.2d 1378]* .

California courts have developed two different approaches to apportioning appreciation and profits between separate and community property interests when clear evidence of the relative interests do not exist. The court may apply whichever allocation approach it believes is the most appropriate and equitable, depending on whether the chief contributing factor in the realization of income and profits is either of the following [*Beam v. Bank of America (1971) 6 Cal. 3d 12, 18, 98 Cal. Rptr. 137, 490 P.2d 1378]* :

- The character of the capital investment in the separate property, or
- The personal activity, ability, and capacity of the spouse.

One method, frequently called the *Pereira* approach, involves the allocation of a fair return on the spouse's separate property investment as separate income, and then the allocation of any excess to the community. If there is no evidence of what a fair rate of return would be, the court may use the legal interest rate [*Beam v. Bank of America (1971) 6 Cal. 3d 12, 18-19, 98 Cal. Rptr. 137, 490 P.2d 1378* ; *see Pereira v. Pereira (1909) 151 Cal. 1, 11-12, 103 P. 488* ; *see Civ. Code § 3289* (interest)].

The alternative approach, commonly called the *Van Camp* approach, takes the opposite tack. Under this approach, the court determines a reasonable value of the spouse's services, allocates that amount to the community, and treats the balance as separate property [*Beam v. Bank of America (1971) 6 Cal. 3d 12, 18, 98 Cal. Rptr. 137, 490 P.2d 1378* ; *see Van Camp v. Van Camp (1921) 53 Cal. App. 17, 27-28, 199 P. 885]* .

The business profit apportionment principles were first developed in cases involving a separate property farm or business [*see Beam v. Bank of America (1971) 6 Cal. 3d 12, 17, 98 Cal. Rptr. 137, 490 P.2d 1378* (listing cases)], but have since been applied in other contexts, including real estate and securities investments [*Beam v. Bank of America (1971) 6 Cal. 3d 12, 17, 98 Cal. Rptr. 137, 490 P.2d 1378* ; *Estate of Neilson (1962) 57 Cal. 2d 733, 740, 22 Cal. Rptr. 1, 371 P.2d 745]* , including stock options [*see Marriage of Hug (1984) 154 Cal. App. 3d 780, 787-788, 794, 201 Cal. Rptr. 676* (stock options granted during marriage but exercisable after separation are community property asset)].

[4] Management and Control of Community Personal Property

With certain exceptions, either spouse has management and control of community personal property, with the absolute power of disposition, other than testamentary, that he or she has of his or her separate property [*Fam. Code § 1100(a)*]. As a corollary to equal management and control, the community property is generally liable for the debts and torts of both spouses [*Fam. Code §§ 910* (debts), 1000(b) (torts)]. One problem with equal management and control is the potential for conflicting independent decisions made by each spouse concerning specific community property [*see* [1], *above*]. The exceptions to and qualifications of the equal management and control rule may mitigate this potential problem.

The exception most germane to a buy-sell agreement is provided for management and control of a community property business. Except for gifts of community property [*see Fam. Code § 1100(b)*], the disposition of household furnishings and clothes [*see Fam. Code § 1100(c)*], or the sale or lease of community real property [*see Fam. Code § 1102*], a spouse who is operating or managing a business or an interest in a business that is all or substantially all community

personal property has the primary management and control of the business or interest [*Fam. Code § 1100(d)*]. Primary management and control means that the managing spouse may act alone in all transactions, except that the managing spouse must give prior written notice to the other spouse of any sale, lease, exchange, encumbrance, or other disposition of all (or substantially all) of the personal property used in the operation of the business, whether or not title to that property is held in the name of only one spouse [*Fam. Code § 1100(d)*], and must act with respect to the other spouse according to the rules governing fiduciary relationships that control the actions of persons occupying confidential relations with each other [*Fam. Code § 1100(e)*]. This fiduciary duty of management and control includes the obligation to fully disclose all material facts and information on the existence, characterization, and valuation of all assets in which the community has (or may have) an interest, and all debts for which the community is (or may be) liable [*Fam. Code § 1100(e)*]. Each spouse must also provide the other, on request, with equal access to all information and records that pertain to those assets and debts [*Fam. Code § 1100(e)*].

For a spousal consent form that conforms to *Fam. Code § 1100*, see *Ch. 8C, Close Corporation Shareholder Agreements, § 8C.203[2]*.

[5] Agreement Confirming or Transmuting Property Nature of Stock Subject to Buy-Sell Agreement

[a] Use of Transmutation Agreements

Some practitioners recommend that the attorney advise spouses to confirm, or transmute if necessary, the character of the stock subject to the agreement.

Although confirmation and transmutation agreements are generally governed by the same rules as other contracts, they are subject to additional contract rules applicable to property contracts between a husband and wife [*see Fam. Code § 721(b)*]. Transactions between a husband and wife are subject to the general rules governing fiduciary relationships that control the actions of persons occupying confidential relations with each other [*Fam. Code § 721(b)*]. Most transmutation and confirmation agreements must be in writing and signed by the spouse whose interest in the property is adversely affected [*Fam. Code § 852(a)*; *see Fam. Code § 852(c)* (exceptions)]. Further, to be enforceable against a surviving spouse, contractual agreements waiving certain rights at death (including community and quasi-community rights [*Prob. Code § 141(a)(7)*]) must be in writing and must be signed by the spouse who waives the right [*Prob. Code § 142*], after fair and reasonable disclosure of the property or financial obligation of the other spouse, or waiver of disclosure after advice of independent counsel [*Prob. Code § 143(a)(1)*]. Even when these statutory requirements are met, the court may find enforcement of all or part of the waiver unconscionable in the circumstances existing at the time enforcement is sought [*Prob. Code § 144*].

Confirmation of the nature of the stock as community or separate property may be made part of the buy-sell agreement, or may be the subject of a separate agreement. To reduce the risk of a nonparty spouse claiming a community property interest in the stock in a marital dissolution proceeding (or the spouse's heirs making a similar claim on that spouse's death), some practitioners recommend the use of a property agreement separate from the buy-sell agreement, covering all material assets of the spouses.

The statutory requirements governing transmutation agreements are discussed in detail in *Ch. 112, Postnuptial Agreements, §§ 112.15, 112.16*. For a basic transmutation agreement form, see *Ch. 112, Postnuptial Agreements, § 112.201*.

[b] Issues Involving Nonmarital Partners

In the case of a nonmarital partner who is not a party to the agreement, any rights that person may have in the stock acquired by a party to the agreement is based on contract [*Marvin v. Marvin (1976) 18 Cal. 3d 660, 673-674, 134 Cal. Rptr. 815]* . The attorney, therefore, should determine whether any such contract exists, establishing the ownership of

the stock subject to the buy-sell agreement. Any spousal consent forms attached to the agreement may be modified to reflect the nature of ownership of the nonmarital partner.

[c] Ethical Considerations

An attorney who is consulted by clients who wish to enter into a transmutation or confirmation agreement must remember his or her ethical responsibility to avoid conflicts of interest. Transmutation and confirmation agreements almost always raise actual or potential conflicts between spouses. An attorney cannot represent two clients who have conflicting (or potentially conflicting) interests, unless the attorney first explains the facts giving rise to the conflict, and obtains written authorization from the clients to proceed with the dual representation [*Cal. Rules Prof. Conduct, Rule 3-310(B)*; *see §§ 8D.12*-8D.16]. For general coverage of the ethical responsibilities of business attorneys, *see* Ch. 1A, *Role of Counsel in Starting a New Business* . For similar coverage for estate planning attorneys, *see* CALIFORNIA WILLS AND TRUSTS, Ch. 4, *Ethical Considerations and Professional Responsibility* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of InterestFamily LawMarital Duties & RightsProperty RightsCharacterizationSeparate PropertyFamily LawMarital Duties & RightsProperty RightsCharacterizationCommunity PropertyFamily LawMarital Duties & RightsProperty RightsCharacterizationGeneral OverviewBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART II. LEGAL BACKGROUND
F. Community Property Considerations

4-8D California Legal Forms--Transaction Guide §§ 8D.91-8D.99

[Reserved]

§§ 8D.91[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-8D California Legal Forms--Transaction Guide § 8D.100

§ 8D.100 Client Interview

[1] Facts

[a] Each Shareholder

1. Names and addresses of shareholders:

    a. Individual shareholders and spouses.

    b. Entities.

2. Capacity in which individual holds shares:

    a. Owner.

    b. Trustee.

    c. Executor or administrator.

    d. Guardian.

    e. Custodian under Uniform Transfers to Minors Act.

3. Basis of shareholder's stock.

4. Tax identification number.

5. Tax year.

6. If shareholder is individual:

a. Marital status.

b. Age.

c. Gross and net income for last three years.

d. Estimated net worth.

e. Projected annual income.

f. Relationship to other participants.

g. Affiliations with other businesses.

h. Percentage interest in business.

i. If agreement is likely to be funded with life insurance:
(1) Name, address, and telephone number of corporation's insurance agent or broker.

(2) Type and amount of existing policies owned by corporation and by individual shareholders.

(3) Name of current beneficiaries.

(4) Amount of premiums.

(4) Premium payment terms.

j. Whether participant has been denied insurance coverage; if so:

(1) Type of coverage denied.

(2) Reason for denial.

(3) Date of denial.

NOTE:
Whether an individual shareholder is likely to be insurable is an essential consideration in determining how to fund the buy-sell agreement.

k. Whether shareholder is employee of corporation; if so position or title.

l. Estate plan for shares.

NOTE:
An estate plan may affect a buy-sell agreement [***see*** *§ 8D.90*]. Conversely, the execution of a buy-sell

agreement can significantly affect a preexisting estate plan.

[b] The Corporation

1. Name and address of corporation.

2. Date of incorporation.

3. State of incorporation.

4. Tax year of corporation.

5. Employer identification number.

6. Principal business.

7. Total number of shares issued.

8. Approximate fair market value of shares, if known.

9. Whether the corporation is a professional corporation.

NOTE:

A "professional corporation" is a regular business corporation that renders professional services in a single profession under a Certificate of Registration issued by the governing board that regulates the profession [***see*** *Corp. Code § 13401(b)*; ***but see*** *Corp. Code § 13401.5* (allied professionals)]. "Professional services" are any services that may lawfully be rendered pursuant to a license or certificate of registration authorized by the California Business and Professions Code, the Osteopathic Act, the Yacht and Ship Brokers Act, or the Chiropractic Act [*Corp. Code § 13401(a)*, *13401.3*], although there is no longer any certification requirements for medical, osteopathic, dental, pharmacy, veterinary, architectural, registered nursing, optometry, behavioral sciences, speech-language pathology and audiology, or court reporter corporations [***see*** *Corp. Code §§ 13401(b)*, *13402(a)*; *Bus. & Prof. Code § 2406*]. With these exceptions, a professional corporation must have its own Certificate of Registration to do business as a corporation [*Corp. Code § 13401(b)*; ***see*** *Corp. Code § 13402(b)*].

Whether a corporation is a professional corporation is a consideration in selecting the buyers in a buy-sell agreement, since a license is required to render services.

For a list of professions permitted to incorporate under the Professional Corporations Act, see Ch. 1B, ***Selecting Form of Business Entity*** . For further discussion, see Ch. 12A, ***Professional Corporations*** .

10. Whether corporation has elected Subchapter S status.

NOTE:

A small business corporation may elect to be an S corporation [*I.R.C. § 1362(a)*]. Unlike a C corporation which is a separate tax-paying entity [***see*** *I.R.C. § 11*], an S corporation is

generally treated as a conduit of income, loss, deductions, and credits to shareholders [***see*** *I.R.C. §§ 1363, 1366*]. For discussion of the advisability of electing to be an S corporation, see Ch. 1B, ***Selecting Form of Business Entity*** . For discussion of the procedures to be used in electing or terminating Subchapter S status, see Ch. 2B, ***Electing Subchapter S Status*** .

Whether a corporation has elected S corporation status will affect the determination of the tax impact of a life insurance funded buy-sell agreement [***see*** *§§ 8D.48-8D.49*].

11. Names, addresses, and telephone numbers of directors.

12. Names, addresses, telephone numbers, and titles of officers.

13. Name, address, and telephone number of accountant.

[c] Trustee Administrator

1. If trust company will administer agreement:

    a. Name and address of company.

    b. Trust company's principal place of business.

    c. Telephone number of responsible individual.

2. If individual trustee will administer agreement, name, address, and telephone number of trustee.

[2] Documents

1. Articles of incorporation.

2. Bylaws.

3. Any shareholder agreements imposing transfer restrictions on corporate shares.

4. Any documents regarding qualification or exemption of corporate shares.

5. Most recent financial statement.

6. Most recent income tax return.

7. Any documents reflecting original cost and present worth of corporate assets.

8. Shareholder list.

9. Any instrument under which corporation's stock is held, including:

a. Trust instruments for trusts holding corporation's shares.

b. Will under which any deceased shareholder's S corporation stock is held by estate.

c. Bankruptcy court order under which bankrupt shareholder's stock is held by bankrupt's estate.

d. Court order for guardianship.

10. Any corporate buy-sell agreement.

11. Any buy-sell agreement between any shareholder and any member of shareholder's family.

12. Insurance policies.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-8D California Legal Forms--Transaction Guide §§ 8D.101-8D.109

[Reserved]

§§ 8D.101[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8D California Legal Forms--Transaction Guide § 8D.110

§ 8D.110 Identifying Conflicts of Interest

1. Ascertain which party attorney represents.

NOTE:

An attorney representing an entity may also represent its constituents provided the attorney makes a written disclosure to the client in accordance with The *California Rules of Professional Conduct 3-310(B),* and discloses his or her relationship to the entity [Cal. Rules *Prof. Cond., Rule 3-600(E)*]. Dual representation of clients whose interests conflict is permitted under certain circumstances if the attorney obtains the written consent of each client [Cal. Rules *Prof. Cond., Rule 3-600(E)*]. Caution should be exercised, however, in dual representation where an actual conflict of interest exists [***see*** *§ 8D.22*]. Even without an actual conflict, under some circumstances, an attorney should not undertake multiple representation [***see*** *§ 8D.23*].

a. Will attorney represent corporation? [*See § 8D.21 [2]*]

b. Will attorney represent single shareholder?

c. Will attorney represent some or all shareholders?

d. Will attorney represent a combination of subsections a-c, *above* [*See § 8D.21[2][b]*]?

2. Ascertain whether attorney represents clients with adverse interests [*see* Cal. Rules *Prof. Cond., Rule 3-310; §§ 8*D.22-8D.25].

a. Does attorney have legal, business, financial, professional, or personal relationship

with party or witness in same matter?

b. Does attorney know (or reasonably should know) that:
(1) Attorney previously had legal, business, financial, professional, or personal relationship with party or witness in same matter; and

(2) Previous relationship will substantially affect attorney's representation?

c. Does (or did) attorney have legal, business, financial, professional, or personal relationship with party or entity that would be substantially affected by resolution of matter?

d. Does (or did) attorney have legal, business, financial, or professional interest in subject matter of representation?

e. Has attorney obtained confidential information related to representation from client or former client?

3. Ascertain whether attorney has provided written disclosure, and obtained informed written consent from each client (or former client) whose interests actually or potentially conflict [*see* Cal. Rules Prof. Cond., Rule 3- 310; §§ 8D.22-8D.25].

4. Ascertain whether attorney's other roles present conflict of interest issues [*see* Cal. Rules *Prof. Cond., Rule 3-300; § 8*D.27].

a. Will attorney invest in client's business [*See § 8D.27[1]*]?

b. Will attorney serve as corporate agent, director, or officer [*See § 8D.27[2]*]?

c. Is attorney likely to be called as witness in any litigation with jury [*See § 8D.27[3]*]?

5. Ascertain whether attorney has adequate conflict- identification system [*see § 8D.28[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
EvidencePrivilegesAttorney-Client PrivilegeWaiverLegal EthicsClient RelationsConflicts of InterestLegal EthicsClient RelationsConfidentiality of Information



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8D California Legal Forms--Transaction Guide § 8D.111

§ 8D.111 Determining Scope of Work to be Performed by Attorney

1. Determine tasks attorney will perform.

2. Determine whether consultation or association of specialist or other professional is required [*see § 8D.29*].

NOTE:

Drafting (or reviewing) a buy-sell agreement can involve many areas of law [***see** § 8D.29 [1]*]. The drafting attorney has the duty to refer the client to a specialist or recommend the association of a specialist if the attorney lacks the requisite skill or knowledge [***see** § 8D.29[2]*]. The drafting attorney often relies heavily on the advice of other professionals, such as life insurance agents, accountants, financial planners, and trust officers. Since life insurance is the most common way to provide funds to purchase the shares of a deceased shareholder, life insurance agents are frequently consulted. The wide variety of life insurance products and forms of ownership make such a consultation important when drafting the agreement. Accountants, financial planners, and trust officers often participate in the preparation of buy-sell agreements. Business accountants usually have better and more current financial data about the business. Financial planners and trust officers often have a better knowledge of the shareholders' personal finances and long-range financial needs than do the shareholders themselves.

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsEffective RepresentationLegal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8D California Legal Forms--Transaction Guide § 8D.112

§ 8D.112 Selecting Appropriate Type of Agreement

1. Determine whether entity purchase, cross-purchase, or hybrid agreement is preferable, based on following business (non-tax) factors:

a. Simplicity of arrangement.

NOTE:
The primary business advantage of an entity purchase is that it is a simpler arrangement than a cross-purchase. It will be enforceable after a shareholder's death or withdrawal, while a cross- purchase agreement may have to be rewritten after those events to redefine the responsibilities of the remaining shareholders [***see*** *§ 8D.13[2][a]*.

When the agreement is funded with insurance [***see*** *§ 8D.71[2]*], an entity purchase agreement requires the corporation to acquire only one life insurance policy for each shareholder, while a cross-purchase agreement requires each shareholder to purchase a policy on the life of every other shareholder, resulting in increased administrative costs and considerable expenditures on insurance premiums [***see*** *§ 8D.13[2][a]*].

b. Enforceability of agreement.

NOTE:
Except for entity purchase agreements adequately funded by life or disability insurance (which covers only the death or disability of the shareholder and not other events that may trigger the sale of shares) [***see*** *Corp. Code §§ 503.1*, *503.2*], the primary business disadvantage of an entity purchase agreement is that it may be unenforceable at the time the shareholder withdraws from the corporation. A corporation is prohibited from repurchasing its shares unless, at the time of the shareholder's death or withdrawal, it can meet certain statutory financial tests that do not apply to a cross-purchase agreement [***see*** *Corp. Code §§*

166, 500-503; § 8D.72; ***see also*** Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 8, ***Dividends and Reacquisition of Shares*** (Matthew Bender) (enforcement and validity of contracts by corporations to repurchase their shares)]. This potential disadvantage, however, may be mitigated by requiring the shareholders to take whatever actions are necessary to enable the corporation to repurchase its shares by revaluing corporate assets or making a capital contribution [***see*** *§ 8D.13[2]*]. A cross-purchase agreement, on the other hand, does not have the potential problem of unenforceability, since the corporation itself does not purchase any shares [***see*** *§ 8D.13[3]*].

c. Desirability of maintaining balance of power between groups of shareholders.

NOTE:

A cross-purchase agreement can be structured to ensure that the balance of power between groups in the corporation will remain the same, by providing for the purchase of a departing or deceased shareholder's shares by shareholders in his or her same group [***see*** Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 4, ***Close Corporations*** , § 63.03[3][a] (Matthew Bender)].

d. Ease of funding.

NOTE:

The major disadvantage of a cross-purchase agreement for most shareholders is that they must use their own money to purchase the shares of the departing shareholder. If the remaining shareholders have to withdraw funds from the corporation in the form of dividends to fund the buy-out, these funds will be subject to double taxation--once as income to the corporation [***see*** *I.R.C. §§ 11(a), 311*] and again when received by the shareholder [*I.R.C. §§ 1(h)(11), 61(a)(7), 301*; ***see*** *I.R.C. § 316* ("dividend" defined); § 8D.13[3][b]]. This is not a problem under an entity purchase agreement, because the corporation, and not the shareholders, is obligated to repurchase the shares [***see*** *§ 8D.13[2][a]*].

Another disadvantage of a cross-purchase agreement is its complexity when funded with insurance. An insurance-funded entity purchase agreement requires the corporation to acquire only one life insurance policy for each shareholder, while a cross-purchase agreement requires each shareholder to purchase a policy on the life of every other shareholder, resulting in increased administrative costs and considerable expenditures on insurance premiums [***see*** *§ 8D.13[2][a]*].

2. Determine whether entity purchase, cross-purchase, or hybrid agreement is preferable, based on following tax factors:

a. Possible double taxation of corporate income used to purchase shares.

NOTE:

In a cross-purchase agreement, the funds used to purchase the shares may be taxed as a dividend to the shareholders, and will not be deductible to the corporation [***see*** *§ 8D.13[3][b]*].

b. Taxation of sale proceeds as either capital gains or ordinary income [*see §§ 8D.40-8D.42*].

c. Possible imposition of accumulated earnings tax on corporation [*see I.R.C. §§ 531*-537].

NOTE:

In an insurance-funded entity purchase agreement, an accumulated earnings tax penalty may be imposed on the corporation if the agreement is funded by insurance with substantial cash surrender values that accumulate beyond the reasonable needs of the business [*I.R.C. §§ 531*-537; ***see*** *§ 8D.48[4]*].

d. Possible imposition of alternative minimum tax on corporation [*see I.R.C. §§ 55*-58].

NOTE:
The alternative minimum tax [*I.R.C. § 55*] may be imposed if the entity purchase agreement is funded with life insurance [***see** I.R.C. §§ 56(g)(4)(B)(ii)*; § 8D.48[3]].

e. Possible recapture of depreciation deductions and investment tax credits by corporation under entity purchase agreement [*see I.R.C. § 311(b)*; § 8D.13[2][b]].

f. Possible recognition of income by the corporation [*see I.R.C. § 311(b)*; § 8D.13[2][b]].

NOTE:
Under an entity purchase agreement, the corporation will recognize income if it distributes property to the shareholder to redeem the shareholder's shares, if the property's fair market value exceeds its adjusted basis [*I.R.C. § 311(b)*; ***see** § 8D.13[2][b]*].

g. Possible taxation of insurance proceeds used to purchase shares under agreement under the transfer-for-value rule [*see I.R.C. § 101(a)(2)*; § 8D.13[3][b]].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8D California Legal Forms--Transaction Guide § 8D.113

§ 8D.113 Selecting Type and Amount of Funding

1. Determine how buy-sell agreement will be funded.

NOTE:
For a discussion of possible funding options, see *§ 8D.71[1]*.

a. For an entity purchase agreement:
(1) Life insurance.

(2) Disability insurance.

(3) Corporate surplus.

(4) Corporate reserves.

(5) Distribution of corporate assets.

b. For a cross-purchase agreement:

(1) Life insurance.

(2) Disability insurance.

(3) Personal assets.

(4) Withdrawals from corporation.

2. If agreement will be funded with life insurance, determine type of insurance for funding.

NOTE:

The correct vehicle for funding a buy-sell agreement should be selected in consultation with a life insurance agent. For discussion of the types of life insurance products that may be used to fund the agreement, see *§ 8D.71[2][e]*.

3. If any owner is uninsurable, determine whether alternate insurance may be obtained to fund buy- sell agreement [*see § 8D.71[2][c]*].

4. Determine appropriate amount of funding.

NOTE:

The simplest way to assure adequate liquid capital to finance the purchase of shares under a buy- sell agreement is to obtain life insurance in an amount equal to the value of the interest to be redeemed or purchased. For discussion of valuation methods, see *§ 8D.75*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8D California Legal Forms--Transaction Guide § 8D.114

§ 8D.114 Selecting Buyers

1. Determine parties entitled to purchase shares under buy-sell agreement:

NOTE:
For most planners, the key decision of any buy-sell agreement is the identity of the buyers. An entity purchase agreement is used if the buyer will be the corporation. A cross-purchase agreement is used if the buyers are to be the other shareholders. A hybrid agreement is used if there are reasons for the corporation to buy the offered shares in some cases and the other shareholders to buy them in other cases.

a. Remaining shareholders (cross-purchase agreement).

b. Corporation (entity purchase agreement).

c. Corporation and/or remaining shareholders (hybrid agreement).

2. Determine business and tax consequences of each option.

NOTE:
For a discussion of the business and tax factors to be considered in making the decision about buyers, see *§ 8D.13*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation &

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8D California Legal Forms--Transaction Guide § 8D.115

§ 8D.115 Selecting Triggering Events and Their Effect on Buyer's Obligations to Repurchase Shares

1. Determine events that will trigger repurchase of shares, such as:

a. Voluntary lifetime transfers to third parties, including:
(1) Gifts.

(2) Sales.

b. Involuntary lifetime transfers, including:

(1) Encumbrances.

(2) Bankruptcy or assignment for creditors' benefit.

(3) Marital dissolution.

(4) Division of community property.

c. Death.

d. Permanent disability.

e. Retirement.

f. Termination of shareholder's employment with corporation.

g. Other special events, such as:

(1) Mergers.

(2) Sale of substantially all of corporation's assets.

2. Determine effect of occurrence of triggering event on buyer's obligations to repurchase shares, either:

a. Mandatory duty to purchase shares; or

b. Optional right to purchase shares (right of first refusal).

NOTE:

The forms in this chapter require the corporation or remaining shareholders to purchase a deceased shareholder's shares [***see, e.g.,*** *§ 8D.200[2], §§ 5.01, 5.02* (entity purchase); § 8D.210[2], § 5.01 (cross-purchase)]. They require a shareholder to offer his or her stock back to the corporation or remaining shareholders when making a lifetime sale or when leaving the corporation because of retirement, disability, or termination of employment[***see, e.g.,*** *§ 8D.200[2]*, Articles 3, 4, 6, 7 (entity purchase); § 8D.210[2], Articles 3, 4, 6, 7 (cross-purchase)].

Whether the obligation to repurchase is mandatory or optional affects the determination of whether or not the valuation stated in a buy-sell agreement will be controlling for federal estate tax valuation purposes [***see*** *§ 8D.61*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawFormationRights of First RefusalBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDisposition of Reacquired SharesBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8D California Legal Forms--Transaction Guide § 8D.116

§ 8D.116 Selecting Valuation Methods

1. Determine which valuation method, or combination of methods, will be used to determine purchase price under buy-sell agreement [*see § 8D.75*]:

a. Book value formula.

NOTE:
Book value reflects the original cost and adjusted worth of assets; it does not take into account corporate earnings. It is the most appropriate valuation method when a business plans to sell or liquidate its assets in the near future, and its liquidating value is close to or exceeds its earning power value. It may also be useful in combination with other methods [***see*** *§ 8D.75[2]*].

b. Capitalization of earnings formula.

NOTE:
Capitalization of earnings determines the corporation's value by its continuing ability to earn profits, rather than by the worth of its assets. This method, however, may not accurately determine future profitability if the deceased or selling shareholder was vital to the success of the corporate business [***see*** *§ 8D.75[3]*].

c. Mutual agreement periodically reviewed.

NOTE:
Mutual agreement requires the shareholders to agree among themselves on a fixed share value [***see*** *§ 8D.75[4]*]. If the bargaining power of the shareholders is approximately equal, and the shareholders are required to regularly reevaluate the purchase price, this method will often result in a fair price that is

acceptable to all the parties. This method may be coupled with a provision for appraisal [***see*** *§ 8D.116[1][d]*], or arbitration [***see, e.g.,*** *§ 8D.200[2]*, alternate § 8.02] if the parties fail to agree or cannot agree to periodically review the price.

d. Appraisal.

NOTE:

Appraisal may be a more suitable method of valuation than a formula if the business has a substantial number of fixed assets that can be objectively valued and that may be either over or under valued on the corporation's balance sheet, and if a capitalization of earning will not reflect the business's earning potential. It may, however, involve considerable expense [***see*** *§ 8D.75[5]*].

2. Determine whether corporation is required by statute to set its purchase price in accordance with criteria set forth in California Code of Regulations.

NOTE:

A corporation that is ineligible for exemption from qualification of its securities [***see*** *Corp. Code § 25102*; § 8D.74 [1]] must set the purchase price in accordance with the criteria set forth in the California Code of Regulations [***see*** *10 Cal. Code Reg. § 260.140.8*; ***see also*** *§ 8D.74[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8D California Legal Forms--Transaction Guide § 8D.117

§ 8D.117 Complying with Valuation Requirements for Federal Estate Tax Purposes

NOTE:
The value of the shares, or the price set in the buy-sell agreement, will be accepted by the Internal Revenue Service to establish the value of the shares for federal estate tax purposes if specific requirements are met [*I.R.C. § 2703(a), (b)*; *Treas. Reg. § 25.2703-1*; ***see*** *§ 8D.61*].

1. Determine whether agreement is among related persons and those who are the natural objects of each other's bounty, or among persons who are neither related nor the natural objects of each other's bounty.

NOTE:
More exacting requirements apply to agreements between related persons and persons who are the natural object of each other's bounty than to agreements between unrelated persons who are not the natural object of each other's bounty [***see*** *§§ 8D.61[2][b], [c], 8D.117,* § 3].

2. If reviewing or revising agreement, determine if agreement was entered into before October 9, 1990.

NOTE:
The three requirements set forth in *Internal Revenue Code § 2703(b)* and amplified in *Treasury Regulations Section 25.2703-1* apply to agreements between related persons and persons who are the natural object of each other's bounty entered into or substantially modified after October 8, 1990 [*Treas. Reg. § 25.2703-2*; ***see*** *§ 8D.61[2][d]*]. Caution should be exercised in modifying a pre-October 9, 1990 buy-sell agreement among related persons because it is likely that these additional requirements will be more difficult to meet than the requirements of *Treasury Regulations Section 20.2031-2*.

3. Determine whether agreement complies with following requirements for valuation of shares for estate tax purposes:

NOTE:

Agreements among related persons and persons who are the natural objects of each other's bounty must meet the six requirements discussed in [a]-[f], ***below*** [***see*** *I.R.C. § 2703(b)*; *Treas. Reg. § 25.2703-1*; *Treas. Reg. § 20.2031-2*]. Agreements among unrelated persons who are not the natural object of each other's bounty are presumed to comply with the three requirements of *Internal Revenue Code § 2703(b)* and *Treasury Regulations Section 25.2703-1* [*Treas. Reg. § 25.2703-1(b)(3)*; ***see*** [a]-[c], ***below***]: These agreements are presumed to be bona fide business arrangements that are comparable to similar arrangements entered into in arms' length transactions [***see*** *I.R.C. § 2703(b)(1), (b)(3)*]; and agreements between unrelated persons are not devices to transfer an interest within a family for less than adequate consideration [***see*** *I.R.C. § 2703(b)(2)*]. Agreements between unrelated persons, however, must presumably comply with the requirements of *Treasury Regulations Section 20.2031-2* [*see* [d]-[f], below]. These requirements also apply to agreements entered into or substantially modified after October 8, 1990 [*Treas. Reg. § 25.2703-2*]. Each requirement is a separate test [*Treas. Reg. § 25.2703-1(b)(2)*].

a. Is agreement bona fide business arrangement [*I.R.C. § 2703(b)(1)*; *Treas. Reg. §§ 20.2031-2*, 25.2703-1(b)(1)(i)]?

b. Does agreement avoid being mere device to transfer property to decedent's family for inadequate consideration [*I.R.C. § 2703(b)(2)*; *Treas. Reg. §§ 25.2703-1(b)(1)(ii)*, 20.2031-2]?

c. Are agreement's terms comparable to similar agreements negotiated at arm's length at the time right or restriction is created [*I.R.C. § 2703(b)(3)*; *Treas. Reg. § 25.2703-1(b)(1)(iii)*]?

d. Does agreement restrict transfer of shares to agreement price during lifetime and at death [*Treas. Reg. § 20.2031-2(h)*]?

e. Is decedent's estate bound by agreement to sell shares at agreement price [*Treas. Reg. § 20.2031-2*]?

f. Does agreement specify either a sales price for shares or formula or other method for determining price [*Treas. Reg. § 20.2031-2*]?

NOTE:

To be effective for estate tax purposes, the sales price specified by the agreement must be reasonable when the agreement is signed; later appreciation resulting in increased value at the time of the shareholder's death is irrelevant. However, later changes in the business, without corresponding changes in method for determining price under the buy- sell agreement may make the agreement price ineffective for estate tax purposes, if changes are warranted [*St. Louis County Bank v. U.S. (8th Cir. 1982) 674 F.2d 1207, 1210-1211]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8D California Legal Forms--Transaction Guide § 8D.118

§ 8D.118 Selecting Agreement's Administrator

1. Determine who will administer buy-sell agreement.

NOTE:
For a discussion of considerations in using a trustee, see Ch. 8C, ***Close Corporation Shareholder Agreements*** .

2. If trustee will administer agreement, determine:

a. Trustee's duties.

b. Trustee's compensation.

NOTE:
When a trustee is used, the agreement should include the amount of compensation to be paid to the trustee, often a percentage of the proceeds paid on a shareholder's death.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-8D California Legal Forms--Transaction Guide §§ 8D.119-8D.129

[Reserved]

§§ 8D.119[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide

NOTE:

The following provisions apply to both entity purchase and cross-purchase agreements, except as otherwise noted.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide § 8D.130

§ 8D.130 Introductory Provisions

1. Identify parties to agreement [*see, e.g,* § 8D.200[2], Preamble (entity purchase); § 8D.210[2], Preamble (cross-purchase)]:

a. Corporation. b. Shareholders. c. Trustee, if any.

2. State business purposes of agreement [*see, e.g., § 8D.200,* §§ 1.02, 1.03 (entity purchase); § 8D.210, §§ 1.02, 1.03 (cross-purchase)].

NOTE:
The agreement is ordinarily entered into to ensure continuity of management and to establish a fair value and provide a market for shares held by a selling shareholder or a deceased shareholder's estate that otherwise might have no ready market. For further discussion of the purposes of a buy-sell agreement, see *§ 8D.11*.

3. List all share certificates [*see, e.g., § 8D.200,* § 1.01 (entity purchase); § 8D.210, § 1.01 (cross-purchase)].

NOTE:
The agreement should provide the share certificate date and number, the number of shares represented by the certificate, and the owner. This information will be used to determine the number of shares each shareholder may purchase from a deceased or selling shareholder, since shareholders will purchase shares in proportion to their current holdings. The agreement may also include an optional provision stating that the number of shares owned by a shareholder on the date the agreement becomes operative will be controlling if there is a discrepancy between that number and the stated number of shares.

4. Specify consideration that parties receive for their rights and obligations under agreement.

NOTE:

Be certain that all shareholders and the corporation, if agreement is either entity purchase or hybrid, are parties to the agreement and are bound by it. Although, under a cross-purchase agreement, the corporation is not a necessary party, some practitioners believe that the corporation should always be a party to the agreement to protect against any corporate actions, including the subsequent issuance of shares not subject to the agreement, which might defeat the purposes of the agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawCorporationsFinanceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide § 8D.131

§ 8D.131 Transfer Restrictions

1. Include restrictions on transfer [*see, e.g., § 8D.200, § 2.01* (entity purchase); § 8D.210, § 2.01 (cross-purchase)].

NOTE:
If the corporation issues uncertificated securities [***see*** *Corp. Code § 191.1*; *Com. Code § 8102(a)(18)*], the transfer restrictions must appear on the initial transaction statement and subsequent written statements [*Corp. Code § 418(b)*; ***see*** *Corp. Code § 171.1* (definition)]. For further discussion of uncertificated securities, see Ch. 6I, ***Issuance of Equity Securities*** , and Ch. 6K, ***Nonissuer Transactions in Investment Securities*** .

2. Provide for legend to be placed on each certificate, stating that shares which certificates represent are subject to agreement's terms.

NOTE:
No transfer restriction is enforceable against a transferee without knowledge of the restriction unless the transfer restrictions appear on the share certificate [*Corp. Code § 418(b)*; ***see*** *§ 8D.200[1][b][ii]* (entity purchase); § 8D.210[1][b][2] (cross-purchase)]. The restriction on transfer and the legend on the certificates noting the restriction are also important in ensuring that the valuation placed on the shares for estate tax purposes is not greater than the price the decedent's estate receives under the agreement [***see*** *Estate of Matthews v. Commissioner (1944) 3 T.C. 525]* . For discussion of the effect of restrictions on the valuation of shares for estate tax purposes, see *§ 8D.61*.

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide § 8D.132

§ 8D.132 Mandatory Sale-Purchase on Death

1. Include requirement for mandatory sale and purchase at death and/or disability and/or involuntary termination of employment.

a. Provide that on the death of a shareholder [see *§ 8D.200[2]*, Article 5 (entity purchase); § 8D.210[2], Article 5 (cross-purchase)]:
(1) All shareholder's shares are to be sold and transferred to corporation (entity purchase agreement) or to other shareholders (cross-purchase agreement) by decedent's representative; and

(2) Corporation (entity purchase agreement) and/or other shareholders (cross-purchase agreement) are obligated to purchase shares at a price either fixed in or determined by the agreement.

b. If appropriate or desirable, include similar provision requiring either mandatory or optional buyout when a shareholder employee becomes disabled or his or her employment with the corporation is involuntarily terminated [see *§ 8D.200[2]*, Articles 6, 7 (entity purchase); § 8D.210[2], Articles 6, 7 (cross-purchase)].

2. For entity purchase agreements, consider including requirement that if corporation is unable to redeem all of deceased shareholder's shares within specified period [*see, e.g., § 8D.200, § 5.01*], the surviving shareholders must purchase all of deceased shareholder's shares not purchased by corporation [*see § 8D.200[2], § 5.02*].

NOTE:
Because a corporation may not redeem shares unless it passes certain statutory financial tests [***see*** *§ 8D.72*], most entity purchase agreements require the remaining shareholders to purchase a deceased shareholder's shares if the corporation is unable to do so. The forms in this chapter require each

shareholder to purchase any such shares in proportion to their existing ownership interests [***see*** *§ 8D.200[2], § 5.02*]. As an alternative to this requirement, the shareholders may prefer to revalue capital assets or make a capital contribution to the corporation.

3. If desired, add optional provision giving corporation and shareholders (entity purchase) or shareholders (cross-purchase) option to either:

a. Purchase shares of deceased shareholders; or

b. Dissolve corporation.

NOTE:

Except in the case of very small, closely held corporations, most corporations will generally find mandatory dissolution as a result of the nonpurchase of a decedent's shares too extreme a measure. Furthermore, a minority shareholder may wish to insert provisions limiting the ability of the majority shareholders to dissolve the corporation, and, thus, avoid the agreement.

This provision is designed to replace Section 5.02 of § 8D.200[2] (entity purchase) and Section 5.01 of § 8D.210[2] (cross-purchase). It is not intended for use in agreements funded with life insurance.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersTransfers of SharesBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide § 8D.133

§ 8D.133 Sale of Shares During Lifetime

1. If desired, include optional provision for mandatory or optional sale of shares on any of following events [*see § 8D.200[2]*, Articles 6, 7 (entity purchase); § 8D.210[2], Articles 6, 7 (cross-purchase)]:

a. Voluntary termination of employment;

b. Termination of employment for cause;

c. Permanent disability; or

d. Retirement.

2. For entity purchase agreements, include [*see, e.g., § 8D.200[2]*, Sections 3.05 -3.10]:

a. Option of corporation to purchase all shares.

b. Option of remaining shareholders to purchase shares when corporation fails to exercise option.

c. Right of selling shareholder to sell to outside parties if options are not exercised.

3. For cross-purchase agreements, include option of remaining shareholders to purchase shares offered through lifetime sale [*see, e.g., § 8D.210[2]*, Section 3.03].

Legal Topics:

For related research and practice materials, see the following legal topics:

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide § 8D.134

§ 8D.134 Share Valuation Method

1. Clearly set forth valuation method to be used to determine purchase price of shares, either:

a. Book value formula [*see § 8D.75[2]*].

b. Capitalization of earnings formula [*see § 8D.75[3]*].

c. Mutual agreement periodically reviewed [*see § 8D.75[4]*].

d. Appraisal [*see § 8D.75[5]*].

e. Arbitration [*see, e.g., § 8D.200[2],* (alternate) § 10.02].

f. Combination of any of above [*see, e.g,* § 8D.200[2], (alternate) Article 10 (combining mutual agreement with arbitration)].

NOTE:
The agreement should indicate the desired valuation method. If the method selected, such as book value, involves any discretionary decisions, the extent of these decisions should be spelled out in unambiguous terms. The agreement can provide that the parties must set a value on the shares at the end of each fiscal quarter, or year, and that the value last fixed will bind the corporation and the decedent's estate, or the agreement can provide that the shares will be valued after a shareholder dies. If the agreement provides for valuation by an appraiser, that arrangement should be clearly explained.

2. If corporation is ineligible for exemption from qualification for its securities, specify that purchase price must be set according to criteria in California Code of Regulations [*see 10 Cal. Code Reg. § 260.140.8*; *see also § 8D.74[2]*].

3. Do not attempt to waive fiduciary duties of directors or majority shareholder to minority shareholders with respect to adequacy of consideration.

NOTE:

A waiver of corporate directors' and majority shareholders' fiduciary duties to minority shareholders in private close corporations is against public policy, and a contract provision in a buy-sell agreement purporting to effect such a waiver is void [*Neubauer v. Goldfarb (2003) 108 Cal. App. 4th 47, 54-57, 133 Cal. Rptr. 2d 218* (provision in buy-sell agreement purporting to waive any fiduciary duty with respect to fairness of overall consideration held void)].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide § 8D.135

§ 8D.135 Funding Purchase of Shares

1. Set forth in detail the manner in which the purchase of shares is to be funded.

NOTE:
A common method of funding is by purchasing life insurance on each insurable shareholder. If a shareholder is uninsurable at the time of the execution of the agreement, other arrangements must be made [***see*** *§ 8D.71[1], [2][c]*]. It is a good idea to provide that the amount of life insurance should be increased periodically, if the business grows and the shares increase in value.

2. If agreement will be funded by insurance [*see, e.g., § 8D.220* (entity purchase); § 8D.221 (cross-purchase)], include:

a. Name of insured.

b. Name of owner of policy.

c. Face amount of policy.

d. Beneficiary of policy.

e. Method of collection and payment of proceeds.

f. Owner's right to procure additional insurance to achieve parity with share value.

g. Method for paying remainder of purchase price if price exceeds insurance proceeds.

h. Method for disposition of any excess of insurance proceeds over value of decedent's shares.

i. Optional provision for payment of insurance premiums by insured when necessary to maintain policy.

NOTE:
For a form containing insurance provisions for use in a cross-purchase agreement, see *§ 8D.221[2]*, § 1.03.

j. Method for disposing of insurance policies on death of shareholder [*see, e.g., § 8D.220[2]*, § 1.05 (entity purchase); § 8D.221[2], § 1.07 (cross-purchase)].

NOTE:
The forms in this chapter allow each shareholder to purchase the policy on his or her own life from the decedent's estate. This method avoids the imposition of any "transfer for value" tax on the insurance proceeds when that shareholder later dies [*I.R.C. § 101(a)(2)*; ***see*** *§ 8D.13[3][b]*].

3. If agreement will be funded by promissory notes or other securities, set forth exact terms of these notes or securities [*see, e.g., § 8D.200[2], § 3.11* (lifetime purchase, entity purchase agreement); § 8D.210[2], § 3.06 (lifetime purchase, cross-purchase agreement)].

4. Specify when selling shareholder's status as shareholder will terminate; either:

NOTE:
Title to shares governed by buy-sell agreement ordinarily does not pass until the shares are delivered or tendered to the buyer, unless there is something in the agreement that specifies or implies a different intention [*Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1173-1174, 69 Cal. Rptr. 2d 764, 947 P.2d 1301* ; *Gilfallan v. Gilfallan (1914) 168 Cal. 23, 31, 141 P. 23]* . Thus, unless the agreement specifies otherwise, the shareholder ordinarily will remain a shareholder, and have all the rights and privileges of a shareholder, until the shares are actually transferred to the new owner or owners under the agreement.

The parties do have the power to agree that a shareholder loses his or her shareholder status upon some event other than actual transfer of the shares to another. However, such a term will not be automatically implied simply by virtue of the existence of a mandatory repurchase provision [*Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1174, 69 Cal. Rptr. 2d 764, 947 P.2d 1301* (holding that agreement at issue did not imply any intention by parties to deny shareholder his rights during the post-employment period used to determine share value)]. Thus, if the parties contemplate that the shareholder's rights and status as such will terminate on occurrence of the event triggering the repurchase obligation (such as death, retirement, or termination of employment), that intention must be clearly and expressly specified in the agreement.

a. Upon payment by the purchaser of the consideration for the shares and endorsement of the share certificates by the seller [*see § 2.200[2]*, Section 8.03; *§ 8D.210*, Section 8.03]; or

b. Immediately upon occurrence of any event or specified events triggering buy-sell agreement [*see § 8D.230[2]*].

NOTE:
Use of such a provision makes sense only when the purchase of shares under a buy-sell

agreement is mandatory. When the agreement provides only for a ***right--*** but not a ***duty--*** on the part of the corporation or other shareholders to purchase the shares under specified circumstances [***see, e.g.,*** *§ 8D.200[2],* Sections 4.01, 7.01; *§ 8D.210[2],* Sections 4.01, 7.01], it would be inappropriate to provide for an immediate termination of shareholder status on occurrence of those circumstances, because there is no guarantee at that point that a transfer of shares under the agreement will actually occur. Similarly, if the agreement does not specify the precise number or percentage of the shares that each purchaser is required to buy, use of this provision would not make sense because the exact interest of each purchaser will not be known at the time of the event triggering the buy-sell agreement. Thus, when the above provision is used, its application should be limited to circumstances under which the purchase of shares is mandatory, or the remainder of the agreement should be modified to provide for mandatory rather than optional purchase of the shares.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide § 8D.136

§ 8D.136 Trustee Provisions

NOTE:
These provisions apply only to those agreements to be administered by a trustee. For discussion of the administration of shareholder agreements by a trustee, see Ch. 8C, ***Close Corporation Shareholder Agreements*** .

1. State name and address of trust company.

2. Designate trustee as beneficiary of insurance policies.

3. Require deposit of insurance policies with trustee.

4. Specify trustee's duties.

5. Specify trustee's compensation.

6. Specify procedure for registration and replacement of trustee.

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide § 8D.137

§ 8D.137 Amendment and Termination of Agreement

1. Include provision allowing amendment of agreement only under stated circumstances.

NOTE:
The forms in this chapter require the written consent of each shareholder in both entity and cross-purchase agreements [***see*** *§ 8D.200[2], § 12.02* (entity purchase); § 8D.200[2], § 12.02 (cross-purchase)], and an optional provision requiring the majority vote by the board of directors in entity purchase agreements [***see*** *§ 8D.200[2], § 12.02*].

2. Include provision requiring termination of agreement on stated circumstances, including, for example [*see, e.g., § 8D.200[2]*, Article 11 (entity purchase); § 8D.210[2], Article 11 (cross- purchase)]:

a. Bankruptcy, receivership, or dissolution of corporation.

NOTE:
A minority shareholder may wish to insert provisions limiting the ability of the majority shareholders to avoid the agreement by dissolving the corporation.

b. Written agreement of corporation and each shareholder.

c. Execution of new agreement by all parties to initial agreement terminating initial agreement.

d. If agreement is funded by insurance, election of any shareholder upon lack or impaired value of insurance policy [*see, e.g., § 8D.220[2]*, § 1.04 (entity purchase); § 8D.221[2], § 1.06 (cross-purchase)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewContracts LawContract ModificationsGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



74 of 141 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide § 8D.138

§ 8D.138 Binding Nature of Agreement

1. Provide that agreement will bind all of following [*see, e.g., § 8D.200[2], § 12.05* (entity purchase); § 8D.211[2], § 12.05 (cross-purchase)]:

a. Shareholders

b. Corporation, if agreement is entity purchase or hybrid.

c. Shareholders's heirs, administrators, executors, and assigns.

d. Corporation's successor's and assigns.

2. Provide that agreement will apply to all of following [*see, e.g., § 8D.200[2]*, Preamble (entity purchase); § 8D.211[2], Preamble (cross-purchase)]:

a. All shares of stock currently owned by shareholders.

b. All shares of stock of corporation acquired by any shareholder while party to agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide § 8D.139

§ 8D.139 Miscellaneous Standard Contract Provisions

1. Specify applicable notice requirements [*see, e.g., § 8D.200[2],* § 12.03 (entity purchase); § 8D.211[2], § 12.03 (cross-purchase)].

2. Include provision for payment of attorneys' fees [*see, e.g., § 8D.200[2],* § 12.04 (entity purchase); § 8D.211[2], § 12.04 (cross- purchase)].

NOTE:

For a case discussing attorneys' fees in the context of share purchase agreement, see *Thompson v. Miller (2003) 112 Cal. App. 4th 327, 329, 4 Cal. Rptr. 3d 905* . In that case, the minority shareholders in a closely-held corporation sued the majority shareholder and others, alleging that defendant committed a breach of fiduciary duty, fraud, and elder abuse in convincing plaintiffs to sell their shares pursuant to a share purchase agreement, which provided that the prevailing party in any dispute under the agreement would be entitled to reasonable attorney fees incurred in the dispute. The court of appeal held that defendant was entitled to recover an award of attorney fees because he used a provision of the agreement to defend against plaintiffs' claims, creating a "dispute" under the agreement.

3. Do not include any provision waiving duties of directors and majority shareholders to minority shareholders.

NOTE:

A waiver of corporate directors' and majority shareholders' fiduciary duties to minority shareholders in private close corporations is against public policy, and a contract provision in a buy-sell agreement purporting to effect such a waiver is void [*Neubauer v. Goldfarb (2003) 108 Cal. App. 4th 47, 54-57, 133 Cal. Rptr. 2d 218* (provision in

buy-sell agreement purporting to waive any fiduciary duty with respect to fairness of overall consideration held void)].

4. Include severability clause [*see, e.g., § 8D.200[2], § 12.06* (entity purchase); § 8D.211[2], § 12.06 (cross-purchase)].

5. Specify governing law [*see, e.g., § 8D.200[2], § 12.07* (entity purchase); § 8D.211[2], § 12.07 (cross-purchase)].

6. Include "sole agreement" clause [*see, e.g., § 8D.200[2],* § 12.08 (entity purchase); § 8D.211[2], § 12.08 (cross-purchase)].

7. Include appropriate signature blocks and line for date and place of execution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide § 8D.140

§ 8D.140 Exhibits

1. Attach exhibit listing all of following when agreement is funded with insurance [*see, e.g., § 8D.200[2]* (entity purchase); § 8D.211[2] (cross-purchase)]:

a. Name of insurance company.

b. Policy number.

c. Name of insured.

d. Amount of policy.

e. Date of purchase.

f. Name of owner.

g. Signature of owner.

2. If purchase price is set by mutual agreement subject to periodic review [*see, e.g., § 8D.200[2]* (entity purchase); § 8D.210[2] (cross-purchase)]:

a. Attach appendix stating value of shares on specified date; and

b. Include space for:
(1) Signatures of parties.

(2) Date and place of execution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
C. Drafting Guide

4-8D California Legal Forms--Transaction Guide §§ 8D.141-8D.149

[Reserved]

§§ 8D.141[Reserved]



78 of 141 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8D California Legal Forms--Transaction Guide § 8D.150

§ 8D.150 Representing Multiple Parties to Agreement

1. If attorney represents more than one party to agreement, initial conflict of interest letter should identify those represented [for appropriate form, *see* Ch. 1A, *Role of Counsel in Starting a New Business*].

NOTE:

Clients commonly ask a single attorney to draft a corporate buy-sell agreement. In this situation, the attorney represents the corporation and at least two shareholders.

2. If attorney represents more than one party to agreement and actual or potential conflict exists which may be waived [*see §§ 8D.13*-8D.15], suitable waiver must be obtained [for form, *see* Ch. 1A, *Role of Counsel in Starting a New Business*].

NOTE:

Although, under the California Rules of Professional Conduct, it appears that an attorney may represent clients with actual or potential conflicting interests, provided each client gives its informed, written consent [Cal. Rules *Prof. Cond., Rule 3-310(C)*], California courts have held that joint representation is not permitted in litigation, if actual conflicts exist [***see*** *Klemm v. Superior Court (1977) 75 Cal. App. 3d 893, 898, 142 Cal. Rptr. 509]* . However, if the conflict is merely potential, then with full disclosure to and informed consent of all clients, there may be multiple representation at a hearing or trial [*Klemm v. Superior Court (1977) 75 Cal. App. 3d 893, 899, 142 Cal. Rptr. 509]* . Joint representation is also permitted, in a nonlitigation context, provided all parties give their informed, written consent [*Klemm v. Superior Court (1977) 75 Cal. App. 3d 893, 898, 142 Cal. Rptr. 509]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of Interest



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8D California Legal Forms--Transaction Guide § 8D.151

§ 8D.151 Agreement Confirming or Transmuting Character of Stock Subject to Agreement

NOTE:

All parties to a buy-sell agreement, as well as nonparty spouses and nonmarital partners, have an interest in establishing or ascertaining the property nature of the stock subject to the agreement. For example, non-owner shareholders will want to ensure the enforceable transfer of stock, as specified in the agreement, on the death or divorce of the owner shareholder. Owner shareholders (including those who are widowed, no longer married, or have nonmarital partners) will want to establish the community or separate property nature of the stock for purposes of management and control, as well as for income, estate and gift tax planning. Nonparty spouses and partners have similar interests. For further discussion of community property considerations, see *§ 8D.90*.

1. Determine character of stock subject to agreement [*see § 8D.90*]:

a. Community property.

b. Separate property.

c. Quasi-community property.

d. Combination of (a)-(c).

2. If any shares are held as community property, obtain consent of shareholders' spouses to agreement [*see* Ch. 8C, *Close Corporation Shareholder Agreements* for a spousal consent form].

3. If nonmarital partner who is not party to agreement has rights in stock, obtain consent of partner.

NOTE:

In the case of a nonmarital partner who is not a party to the agreement, any rights that person may have in the stock acquired by a party to the agreement is based on contract [*Marvin v. Marvin (1976) 18 Cal. 3d 660, 673-674, 134 Cal. Rptr. 815, 557 P.2d 106]* . The attorney, therefore, should determine whether any such contract exists, establishing the ownership of the stock subject to the buy-sell agreement. Any spousal consent forms attached to the agreement may be modified to reflect the nature of ownership of the nonmarital partner.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of SharesFamily LawMarital Termination & Spousal SupportDissolution & DivorceProperty DistributionClassificationStocksFamily LawMarital Duties & RightsProperty RightsCharacterizationCommunity PropertyFamily LawMarital Duties & RightsProperty RightsCharacterizationSeparate Property



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8D California Legal Forms--Transaction Guide § 8D.152

§ 8D.152 Reviewing and Amending Agreement

1. Review buy-sell agreement:

a. At required intervals if agreement terms require periodic review of purchase price [*see, e.g. § 8D.200[2]*, (alternate) § 10.01 (entity purchase); § 8D.210[2], (alternate) § 10.01 (entity purchase)].

b. On occurrence of any of following events:

NOTE:
A cross-purchase agreement may need to be rewritten after the occurrence of any of these events:

(1) Death of any party to agreement.

(2) Transfer of shares.

(3) Retirement or disability of party to agreement.

(4) Termination of employment of party to agreement.

(5) Voluntary proposed sale of shares.

(6) Change in applicable law.

(7) Change in corporation's economic situation.

2. Amend agreement, as specified in § 8D.137.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewContracts LawContract ModificationsGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-8D California Legal Forms--Transaction Guide §§ 8D.153-8D.199

[Reserved]

§§ 8D.153[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART IV. FORMS
A. ENTITY PURCHASE AGREEMENT

4-8D California Legal Forms--Transaction Guide § 8D.200

§ 8D.200 Entity Purchase Buy-Sell Agreement--Not Funded by Insurance

[1] Comment

[a] Use of Form

This form is a basic entity purchase agreement. For insurance funding provisions, see *§ 8D.220*. For provisions providing for the administration of the agreement by a trustee, see Ch. 8C, *Close Corporation Shareholder Agreements* .

This form covers the purchase of a shareholder's shares by the corporation, or by the remaining shareholders if the corporation does not exercise its option to purchase all the offered shares [*see* [2], *below*, Section 3.08,] or is legally unable to do so [*see* [2], *below*, Section 5.02; *see also § 8D.72*] on the following events: the voluntary lifetime sale of shares [*see* [2], *below*, Article 3], the involuntary transfer of shares due to bankruptcy or assignment for the benefit of creditors [*see* [2], *below*, Article 4], and the shareholder's termination of employment, disability, retirement, or death [*see* [2], *below*, Articles 5-7].

Additional provisions may be added to this form, including a provision giving shareholders the right to encumber their stock [*see* Ch. 8C, *Close Corporation Shareholder Agreements*], a consent to attorney representation despite potential conflicts of interest [*see* Ch. 1A, *Role of Counsel in Starting a New Business*], or a spousal consent to the agreement for community property purposes [*see* Ch. 8C, *Close Corporation Shareholder Agreements*].

For discussion of the business and tax considerations in selecting an entity purchase agreement over a cross- purchase agreement, see *§ 8D.13*.

[b] Restrictions Applicable to New or Transferred Shares

This form makes no distinction between the shareholders who initially sign the agreement and subsequent transferees [*see* [2], *below*, Preamble]. The transferees should be required to execute an amendment to the agreement. The form provides, however, that a transferee's failure or refusal to sign an amendment does not relieve the transferee of any

obligation or restriction under the agreement [*see* [2], *below*, Section 3.13]. If a trustee will administer the agreement, the trustee should be named as a party to the agreement, or made a party by an amendment to the agreement.

[c] Legend Requirement

This provision, requiring that a legend restricting transfer of the shares subject to the agreement be printed on the shares themselves, conforms to the statutory requirement [*see Corp. Code § 418(a)(1)*; [2], *below*, Section 2.02] and ensures that any transferee will have notice that the shares are subject to a buy-sell agreement. The precise language of the legend condition is set forth in the agreement to specify the applicable transfer restrictions [*see* [2], *below*, Section 2.02]. If the required statement does not appear on the certificate, transfer restrictions imposed by the corporation will be unenforceable against a transferee without actual knowledge of the restrictions [*Corp. Code § 418(b)*]. Furthermore, a shareholder agreement (defined as a written agreement among all the shareholders of a close corporation [*Corp. Code § 186*]) must be filed with the secretary of the corporation for inspection by any prospective purchaser of shares [*see Corp. Code § 300(b)*; *see also* [2], *below*, Section 2.02]. A transferee of shares covered by a shareholder agreement who has actual knowledge of the restrictions imposed by the agreement, or notice of those restrictions by a notation on the certificate, as provided by statute [*see Corp. Code § 418*], is bound by provisions of the agreement [*Corp. Code § 300(b)*]. If the shares have been issued to the shareholders before the buy-sell agreement is executed, optional Section 2.03 requires the shareholders to present their certificates to the secretary of the corporation, who will then stamp on each certificate the legend conditions restricting transfer.

If the corporation issues uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)*], the transfer restrictions must appear on the initial transaction statement and on subsequent written statements [*Corp. Code § 418*; *see Corp. Code § 171.1* (definition)]. For further discussion of uncertificated securities, see Ch. 6I, *Issuance of Equity Securities* .

[d] Deposit of Share Certificates with Corporation

The optional paragraph [*see* [2], *below*, Section 2.04] providing that the shareholders deposit their share certificates and assignment forms with secretary of the corporation is designed to ensure against unauthorized transfers of shares. If the shareholders prefer to retain possession of their share certificates, this provision should be omitted.

[e] Permitted Transfers

A shareholder may want to have the right to transfer his or her shares to family members to reduce the shareholder's taxable estate or to equalize the income of family members [*see* [2], *below, Section 3.01*]. Whether such a transfer provision will interfere with the management and control of the business should be carefully considered before including it in the agreement.

[f] Restrictions on Voluntary Lifetime Transfers of Shares

This agreement provides that a shareholder may not sell his or her shares to a third party without offering them first to the corporation and then to the other shareholders [*see* [2], *below*, Article 3]. In an entity purchase agreement, the corporation, rather than the remaining shareholders, purchases the shareholder's stock [*see § 8D.12*]. However, because a corporation is prohibited from redeeming its shares unless it can meet certain financial tests when the triggering event occurs [*Corp. Code §§ 166, 500-503*; *see § 8D.72*], it is prudent for a corporate buy-sell agreement to include a back-up cross-purchase provision requiring the remaining shareholders to purchase and shares the corporation is unable to redeem. Although the Internal Revenue Service has challenged this combination redemption and cross-purchase procedure because the redemption is not technically a termination of the shareholder's interest when it is followed by a cross-purchase, it has conceded that the sequence of events is irrelevant if both are clearly part of "an overall plan" [*Rev. Rul. 75-447, 1975-2 C.B. 113* ; *Rev. Rul. 77-226, 1977-2 C.B. 90* ; *see § 8D.42*].

If the corporation or other shareholders choose to exercise their option to purchase the shares, they are entitled to pay not the price offered by the third party, but the price specified in the agreement [*see* [2], *below*, Sections 3.07, 3.08]. This provision is necessary to fix the value of the shares for federal estate tax purposes [*see I.R.C. § 2703*; *Treas. Reg. § 20.2031-2(h)*; *see also § 8D.61*]. If the purchase price stated in a buy-sell agreement is not accepted for estate tax purposes, the decedent's shares will be assessed at their fair market value, which may be substantially higher than the value fixed by the buy-sell agreement [*see I.R.C. § 2703*; *Treas. Reg. § 20.2031-2(a),(f)*].

Under the terms of this agreement, the corporation and the shareholders have the option, but not the obligation, to purchase the offered shares [*see* [2], *below*, Sections 3.07, 3.08]. These provisions may be modified to require the mandatory purchase by the corporation and/or the remaining shareholders, if the shareholders anticipate that they will not want to sell only a portion of their shares.

Alternative provisions of this agreement require that the purchase price be paid either in installments or in a lump sum [*see* [2], *below*, *Section 3.11*]. Shareholders should consider whether, without insurance funding, the corporation will be able to pay the purchase price in one lump sum without liquidating assets and, thus, jeopardizing its continuing existence after the withdrawal of one shareholder. Similarly, the remaining shareholders may be unable to provide the amount of cash necessary to make a lump sum payment. Even when life insurance is used to fund a corporation's purchase of a deceased shareholder's shares [*see, e.g., § 8D.220*], it may not be available to fund a lifetime purchase of shares. Permanent life insurance with a cash equity buildup feature may provide the funds for a lifetime purchase. Term life insurance, however, because it has does not build up a cash value, will provide funding only for purchase on death [*see § 8D.71[e]*].

This form specifies the terms for lifetime purchase when the payments will be in installments [*see* [2], *below*, *Section 3.11*]. It requires the purchaser to give the selling shareholder a percentage of the purchase price as a down payment, with the balance to be repaid with interest over a stated period of time, as provided in a negotiable promissory note. However, while installment payments provide some financial security to the seller, the payment obligations of the purchaser are general obligations, subject to prior claims of other creditors [*see* Jacobs, *Back to Basics Post TRA- 76 Stock Interest Terminations in Closely Held Corporations*, 36 N.Y.U. Corp. Tax. Inst. 3, 36 (1978)]. For a discussion of the tax consequences of installment payments, see [g], *below*.

If the shareholders opt for a lump sum payment, however, they should carefully consider all the circumstances and decide whether any potential hardship to the corporation and to the remaining shareholders is a risk that they are willing to bear.

[g] Tax Effect of Installment Payment Provisions

This agreement provides optional provisions for payment of the purchase price in installments [*see* [2], *below*, *Sections 3.11*, *5.06*]. A corporation may use an installment note or debt financing to pay for stock that qualifies for sale or exchange treatment in a complete redemption [*see I.R.C. § 302(b)(3)*], without the stock attribution rules imputing constructive ownership of additional, unredeemed shares to the shareholder. These attribution rules may be waived for purposes of determining whether a complete redemption has taken place when payment is made by a note because the shareholder's only interest in the corporation following the sale of his or her stock is that of a creditor [*see I.R.C. § 302(c)(2)(A)*]. However, a shareholder's status as a creditor will be lost if the payments on the note are dependent on the corporation's future earnings, and are subordinate to the claims of the corporation's general creditors [*Treas. Reg. § 1.302-4(d)*; *see Rev. Rul. 77-467, 1077-2 C.B. 92*].

For discussion of the deferral of income tax liability by using the installment method of reporting income, see *§ 8D.43[2]*.

[h] Obligations of Transferees

This essential provision [*see* [2], *below, Section 3.13*] ensures that the purposes of the agreement will not be defeated if the shares are transferred to persons other than the original parties to the agreement. The parties may, however, approve limited exceptions when all of the offered shares are not purchased by the corporation or by the shareholders [*see* [2], *below, Section 3.10*].

[i] Sale of Shares on Death of Shareholder

The drafter must determine whether to provide for the mandatory or optional purchase of the decedent's shares by the corporation. This agreement requires the corporation to purchase all of the shares of a deceased shareholder [*see* [2], *below, Section 5.01*]. However, if the corporation is legally unable to purchase all of the decedent's shares because it cannot pass the required statutory financial tests [*Corp. Code §§ 500-503*; *see § 8D.72*], the surviving shareholders are required to purchase any shares not purchased by the corporation, in proportion to their existing ownership interests [*see* [2], *below, Section 5.02*]. If the drafter determines that the optional purchase of shares first by the corporation and then by the surviving shareholders is preferable, this section should be modified accordingly [*see* [2], *below*, Articles 3, 4, 6, 7 (optional purchase on occurrence of events other than shareholder's death)].

If the corporation is required to purchase the shares, the corporation must have the necessary consideration. The funding considerations discussed in [f], *above*, related to lifetime purchases, are also relevant when the triggering event is the shareholder's death.

In the event of the death of a shareholder who owns any shares as community property, this section may be modified to provide for the purchase of the community property interest of the surviving spouse.

[j] Sale of Shares on Total Disability

If the corporation's business requires the active participation of all of its shareholders, the agreement should provide for the sale of a shareholder's shares when a shareholder is no longer able to participate [*see* Harmelin, *Disability The Oft-Overlooked Hazard in Buy and Sell Agreements*, *11 Prac. Law. 75 (May 1965)*]. The term "disability" should be defined in the agreement to avoid later disputes over its meaning. This form defines disability as the determination of a physician [*see* [2], Section 6.02, *below*]. In addition, the term may include loss of a professional license when the shareholder requires that license to perform his or her duties in the corporation. For an example of a provision requiring sale if a shareholder becomes unable to practice his or her designated profession, see Ch. 12A, *Professional Corporations* .

[k] Sale on Termination of Employment

When all of the shareholders in a corporation are actively participating in the corporation's business, or if a shareholder owns shares only because of his or her employment with the corporation, it is important to provide for the disposition of a shareholder's shares when he or she leaves the business. The remaining shareholders ordinarily will not want a former employee to continue participating in the corporate business; and departing shareholders will usually want a ready market for their shares when the employment relationship ends. This provision requires a shareholder to offer to sell his or her shares on retirement, voluntary termination, or termination of employment for cause [*see* [2], Section 7.01, *below*]. Termination "for cause" is defined to avoid possible arbitrary termination of a shareholder for the sole purpose of acquiring his or her shares [*see* Note, *Exercising Options to Repurchase Employee-Held Stock: A Question of Good Faith*, *68 Yale L. J. 773 (1959)*; *see also* [2], Section 7.02, *below*]. For further discussion of termination for cause, see Ch. 85, *Employment Agreements* .

[l] Tax Effect of Employment-Related Restrictions

Shares owned during employment that must be sold on termination of employment constitute property received in

connection with the performance of services [*see I.R.C. § 83(a)*]. The receipt of property in connection with the performance of services results in the recognition of ordinary income in the year the shares are issued, on the excess of the fair market value of the shares over the amount paid for them [*see I.R.C. § 83(a)*]. If the shares are subject to a substantial risk of forfeiture or are nontransferable, recognition is deferred until they become transferable or the risk of forfeiture ceases [*I.R.C. § 83(a)*]. Shares subject to buy-sell provisions requiring the sale of the shares on termination of employment are not subject to a substantial risk of forfeiture to the extent that the purchaser is required to pay fair market value for them [*see Treas. Reg. § 1.83-3(c)*].

The shareholder may elect to include in gross income, for the taxable year in which the shares are received, the difference between the fair market value of the shares at the time of transfer and the amount paid for them [*I.R.C. § 83(b)(1)*]. The election must be made no later than 30 days after transfer [*I.R.C. § 83(b)(2)*]. If the election is made, any subsequent appreciation in the value of the shares is not taxable as compensation to the electing shareholder [*Treas. Reg. § 1.83-2(a)*].

[m] Formula for Determining Purchase Price

This agreement includes four alternate provisions for fixing the purchase price of the shares [*see* [2], Article 10, *below*]:

- Book value.
- Capitalization of earnings.
- Appraisal.
- Mutual agreement, periodically reviewed, with arbitration.

These are four of several formulas that may be used to determine the purchase price of shares subject to a buy-sell agreement [*see § 8D.75[1]*]. The most suitable valuation method depends on the facts and circumstances of the particular business; the valuation provisions included here are examples only, and may need to be tailored to the particular business at hand.

For example, capitalization of earnings determines the corporation's value by its continuing ability to earn profits, rather than by the worth of its assets, and assumes that future earnings will continue at least at the same rate as earnings during the time period used. This method, therefore, would not be useful if the deceased or selling shareholder were vital to the success of the business. Further, the value of shares determined by using the capitalization of earning method may vary dramatically, depending on the capitalization rate selected [*see* [2], alternate Section 10.02, *below* , using a rate of four times the average net profit] and the number of years used to determine the average net profit.

For further discussion of the valuation methods used in this form's alternative provisions, see *§ 8D.75*.

This form assumes that the close or closely-held corporation is exempt from the qualification of its securities [*see Corp. Code § 25102*; *see also § 8D.74[1]*]. If the corporation does not obtain an exemption from securities qualification, it must also follow the pricing criteria set forth in the California Code of Regulations [*see 10 Cal. Code Reg. § 260.140.8*; § 8D.74[2]], and this form must be modified accordingly.

[n] Transfer of Title and Change in Shareholder Status

Section 8.03 of this form provides that a selling shareholder will remain a shareholder until payment of the consideration for the shares and transfer of the share certificates as provided in Section 8.01. The effect of this provision is to entitle the selling shareholder to continue to exercise the rights and privileges of a shareholder until the payment

and endorsement have occurred. This provision merely restates the law as it would exist in the absence of such a provision, as announced by the California Supreme Court in *Stephenson v. Drever* [*Stephenson v. Drever (1997) 16 Cal. 4th 1167, 69 Cal. Rptr. 2d 764, 947 P.2d 1301]* . In *Stephenson*, the court held that a buy-sell agreement is merely an executory contract to buy and sell personal property (i.e., an employee's shares) if and when a particular event (such as termination of employment) occurs. Unless the buy-sell agreement specifies or implies a different intention, a shareholder under such an executory contract is entitled to the benefits of ownership until delivery is made or tendered to the buyer [*Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1173-1174, 69 Cal. Rptr. 2d 764, 947 P.2d 1301* (holding that agreement at issue did not imply any intention by parties to deny shareholder his rights during the post-employment period used to determine share value)]. The Court in *Stephenson v. Drever* recommended that buy-sell agreements specify when shareholder status will terminate, noting that the inclusion of such a provision "one way or the other on this question in a buy-sell agreement would advance the purposes of the agreement" [*Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1175* (majority opinion), 1186 n.2 (dissenting opinion), *69 Cal. Rptr. 2d 764, 947 P.2d 1301]* .

The rule discussed above, and the language of Section 8.03 of this form, tends to benefit the selling shareholder by permitting him or her to continue to exercise his or her rights, including the entitlement to dividends, while the buyout is in progress. Conversely, it can operate to the disadvantage of the corporation or remaining shareholders by increasing "the risk of disruption from a dissident, disaffected [shareholder]" during the buyout period [*see Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1185* (dissenting opinion), *69 Cal. Rptr. 2d 764, 947 P.2d 1301]* .

The Court in *Stephenson v. Drever* specifically indicated that a buy-sell agreement could expressly provide for termination of shareholder status upon immediately upon occurrence of the event triggering the buy-sell agreement [*Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1175* (majority opinion), 1186 n.2 (dissenting opinion), *69 Cal. Rptr. 2d 764, 947 P.2d 1301]* . For further discussion, and a sample provision for immediate termination of shareholder status upon occurrence of a triggering event, see *§ 8D.230*. When a provision such as the one in § 8D.230[2] is used, however, its application should be limited to circumstances under which the purchase of shares is mandatory rather than optional, or the remainder of the agreement [*see, e.g., Sections 4.01, 7.01* of this form] should be modified to provide for mandatory rather than optional purchase of the shares [*see* discussion in *§ 8D.230[1]*].

[o] Waiver of Duties to Minority Shareholders Void

A buy-sell agreement may not include a provision waiving the fiduciary duties of the minority shareholders in a private close corporation. Such a waiver is against public policy and void [*Neubauer v. Goldfarb (2003) 108 Cal. App. 4th 47, 54-57, 133 Cal. Rptr. 2d 218* (provision in buy-sell agreement purporting to waive any fiduciary duty with respect to fairness of overall consideration held void)].

[2] Form

Entity Purchase Buy-Sell Agreement--Not Funded by Insurance

PREAMBLE

THIS BUY-SELL AGREEMENT, is entered into on _____[*date*], at _____[*location*], California, between _____[*name of corporation*] ("Corporation"), a California corporation, and _____[*names of shareholders*] (collectively "Shareholders" and individually "Shareholder") with regard to all of the Corporation's stock outstanding now or at any later date. The Corporation and the Shareholders agree as follows:

ARTICLE 1. PARTIES AND PURPOSES

[*EITHER*]

1.01. **Identity of Parties.** The Shareholders named above own all the outstanding shares of the Corporation as shown in Exhibit _____.

[*OR*]

1.01. **Identity of Parties.** The Shareholders named own all the outstanding shares of the Corporation, as follows:

Shareholder	Number of Shares
_____	_____
_____	_____

[*Add if applicable:*]

The number of shares owned by each of the Shareholders on the date this Agreement becomes operative will be controlling in the event of a discrepancy between that number and the number of shares stated above.

[*Continue with the following:*]

1.02. **Protective Purpose of Agreement.** The purpose of this Agreement is to ensure that the Corporation's shares remain closely held, to protect the Corporation's management and control from persons not acceptable to all Shareholders.

1.03. **Market Purpose of Agreement.** The purpose of this Agreement is also to provide a ready market for the Corporation's shares in the event of the death of a Shareholder or the lifetime transfer of shares by a Shareholder.

ARTICLE 2. ENFORCEMENT

2.01. **Restriction on Transfer.** To accomplish the purposes of this Agreement, any transfer, sale, assignment, hypothecation, encumbrance, or alienation of any of the shares of the Corporation, other than according to the terms of this Agreement, is void and transfers no right, title, or interest in or to those shares to the purported transferee, buyer, assignee, pledgee, or encumbrance holder. Each Shareholder shall have the right to vote shares held of record and to receive dividends paid on them until the shares are sold or transferred in accordance with this Agreement.

2.02. **Legend on Share Certificates.** Each share certificate, whether presently owned or subsequently acquired, shall have the following statement conspicuously printed on its face:

"The transfer, sale, assignment, hypothecation, encumbrance, or alienation of the shares represented by this certificate is restricted by a Buy-Sell Agreement among all the Shareholders and the Corporation, dated _____ [*date of buy-sell agreement*]. A copy of the Buy-Sell Agreement is available for inspection during normal business hours at the principal office of the Corporation. All the terms and provisions of the Buy-Sell Agreement are incorporated by this reference and made a part of this certificate."

[*Add if applicable:*]

2.03. **Stamping of Certificates.** Each of the Shareholders shall, immediately on execution of this Agreement, present his or her share certificates to the Secretary of the Corporation, and the Secretary shall stamp on each certificate

in a prominent manner the statement *set forth in Section 2.02* of this Agreement.

[*Add, if desired:*]

2.04. **Deposit of Shares with Corporation.** Concurrently with the execution of this Agreement, each Shareholder has endorsed stock assignment forms, in addition to his or her share certificates, and has deposited both the assignment forms and the share certificates with the Secretary of the Corporation. Despite the endorsement and deposit, each Shareholder shall have the right to vote shares held of record and to receive dividends paid on them until the shares are sold or transferred, as provided in this Agreement.

[*Continue with the following:*]

ARTICLE 3. VOLUNTARY LIFETIME TRANSFER OF SHARES

3.01. **Permitted Transfers.** Despite any provisions in this Agreement to the contrary, each Shareholder has the right to transfer shares subject to this Agreement to _____[*specify permitted transferees, e.g.* another Shareholder or a trust for the benefit of any other Shareholder]. A permitted transferee shall hold the transferred shares subject to all the provisions of this Agreement, as provided in Section 3.12.

3.02. **Notice of Proposed Sale.** Except as provided in Section 3.01, no Shareholder shall sell, assign, transfer, or otherwise dispose of any of his or her shares in the Corporation, or of any interest in those shares, without first obtaining the prior written consent of the Corporation and all other Shareholders. This prior written consent is unnecessary if the transferor gives written notice ("Notice of Proposed Sale") to the Corporation in the manner prescribed in Section 12.03. The notice must specify:

(1) The name and address of each proposed transferee.

(2) The number of shares, or the interest in shares, to be transferred.

(3) The price per share.

(4) The terms of the proposed sale, assignment, or transfer.

3.03. **Copies of Notice to Shareholders.** Promptly on receipt of any notice given according to Section 3.02, _____[*specify responsible party, e.g.* the Secretary of the Corporation] shall send a copy of this notice to each Shareholder and to each member of the Corporation's Board of Directors, in the manner prescribed in Section 12.03.

3.04. **Director's Meeting.** Within _____[*e.g.*, 21] days after the receipt of any notice given according to Section 3.02, a special meeting of the Corporation's Board of Directors shall be properly called, noticed, and held to consider the proposed transfer.

3.05. **Corporation's Option to Purchase.** For a period of _____[*e.g.*, 30] days after notice is given according to Section 3.02, the Corporation shall have the option, but not the obligation, to purchase all or a portion of the shares at the price determined according to Article 11 of this Agreement. The Corporation's right to exercise this option and to redeem its shares is subject to the restrictions of the *California Corporations Code Section 501 et seq.*, and to any other applicable statutory restrictions on the right of a corporation to purchase its own shares.

3.06. **Exercise of Option by Corporation.** If the Corporation, within the time specified in Section 3.05, elects to exercise its option, it shall give written notice of that fact to the selling Shareholder. The Corporation shall pay the purchase price, as provided in Section 3.11.

3.07. **Failure of Corporation to Exercise Option**. If the Corporation fails to exercise its option to purchase all the shares specified in any Notice of Proposed Sale given according to Section 3.02 within the time and in the manner specified in Sections 3.05 and 3.06, the Corporation shall promptly give written notice ("the rejection notice") of that fact to each of the Shareholders other than the selling Shareholder ("the remaining Shareholders"). The rejection notice shall be given in the same form as the Notice of Proposed Sale and in accordance with Section 12.03. The rejection notice shall also specify the number of shares ("offered shares") specified in the Notice of Proposed Sale and the number of offered shares the Corporation has elected to purchase.

3.08. **Purchase by Remaining Shareholders.** If the Corporation does not elect to purchase all of the offered shares, the remaining Shareholders have the option, but not the obligation, to purchase any offered shares not purchased by the Corporation at the price determined according to Article 10 of this Agreement. Within _____[*e.g.*, 20] days after the date the Corporation mails to him or her the rejection notice described in Section 3.07, any Shareholder who desires to purchase all or a portion of the offered shares shall serve written notice on the Secretary of the Corporation of the Shareholder's election to purchase a specified number of the offered shares.

3.09. **Excessive Offers to Purchase.** (a) If the total number of offered shares the remaining Shareholders have elected to purchase exceeds the number of offered shares specified in the rejection notice, each of the remaining Shareholders shall have a priority right to purchase, up to the number of shares specified in his or her notice to the Corporation, described in Section 3.08, the same proportion of the offered shares not purchased by the Corporation as the number of shares already owned by that Shareholder bears to the total number of shares in the Corporation already owned by the remaining Shareholders electing to purchase offered shares. If all of the offered shares are not purchased on such a priority basis, those shares remaining shall be allocated in one or more successive allocations to those Shareholders electing to purchase more than the number of offered shares for which they have a priority right, up to the number of shares specified in their respective notices to the Corporation, in the proportion that the number of shares held by each of them bears to the number of shares held by all the Shareholders electing to purchase offered shares.

(b) Within _____[*specify number of days*] days after the mailing of the rejection notice to the Shareholders, as specified in Section 3.07, the Secretary of the Corporation shall notify each of the remaining Shareholders electing to purchase shares of the number of offered shares he or she may purchase, the date set for the purchase of these offered shares, and the terms and conditions of the purchase. Each Shareholder must meet the terms and conditions of the purchase within _____ *specify number of days, e.g,* 10] days after the Shareholder receives the Secretary's notification. Transfer of any payment for the offered shares shall occur as provided in Section 3.11.

3.10. **Default of Option by Shareholders.** If the Corporation and the remaining Shareholders do not purchase all the shares specified in the Notice of Proposed Sale, the selling Shareholder is under no obligation to sell any of the offered shares to the Corporation or to any of the remaining Shareholders. Instead, the selling Shareholder may sell them to the proposed transferee specified in the Notice of Proposed Sale on the terms specified in that notice. The transferee will hold the shares _____[subject to *or* free of] the provisions of this Agreement. The selling Shareholder may not, however, sell any or all of the offered shares to any other person or firm, or at any other price or on any other terms and conditions than those specified in the Notice of Proposed Sale given by him or her to the Corporation, without giving a new Notice of Proposed Sale in accordance with Section 3.02, and complying with the further requirements of Article 3. Any sale or transfer by any Shareholder in violation of Article 3 shall be null and void.

[*If payment is to be made in installments:*]

3.11. **Method of Payment of Purchase Price.** The purchase price for a lifetime purchase of shares shall be paid to the selling Shareholder in installments. On acceptance of the offer, the purchaser shall pay the selling Shareholder a cash downpayment equal to at least _____[*specify percentage, e.g.*, 25] percent of the total purchase price. If the downpayment is less than the total purchase price, the purchaser shall pay the balance of the purchase price

in _____[*specify number and frequency of payments, e.g.,* 24 consecutive monthly] payments, beginning _____[*state time, e.g.,* three months] after the downpayment. Simple interest will be charged on the outstanding principal balance at the annual rate of _____[*specify percentage*] percent. The unpaid balance of the purchase price shall be evidenced by a negotiable promissory note. The note shall provide that in the event of default in payment of principal, the note will become due and payable immediately. The purchaser may prepay the note in whole or in part at any time without penalty. The purchase price of the shares shall be determined in accordance with Article 10.

[*Or, if lump sum payment is made:*]

3.11. **Method of Payment of Purchase Price.** The purchase price for a lifetime purchase of shares shall be paid to the selling Shareholder in a lump sum. The purchase price of the shares shall be determined in accordance with Article 10.

[*Continue with the following:*]

3.12. **Obligations of Transferees.** Unless this Agreement expressly provides otherwise, each transferee and any subsequent transferee of the shares of this Corporation, or of any interest in those shares, shall hold the shares or interest subject to the provisions of this Agreement and shall make no transfers except as provided in this Agreement. The Secretary of the Corporation shall record these transfers on the books of the Corporation until an amended copy of this Agreement has been executed by the transferee. A transferee's failure or refusal to sign an amended copy of this Agreement does not relieve the transferee of any obligation or restriction under this Agreement.

ARTICLE 4. INVOLUNTARY LIFETIME TRANSFER OF SHARES

4.01. **Option in Event of Involuntary Transfer.** If a Shareholder's shares are transferred involuntarily or by operation of law (other than as a result of the Shareholder's death) for any of the following reasons: _____[*specify reasons, e.g.,* bankruptcy, assignment of substantially all property for creditors' benefit], within _____[*e.g.,* 60] days after notice of the event, the Corporation and the other Shareholders shall have the option, but not the obligation, to purchase all or some of the shares owned by the Shareholder at the price and on the terms provided in this Agreement. The option shall be exercisable first by the Corporation and then by the Shareholders, according to the provisions of Article 3. If the option is not exercised with regard to all of the shares owned by the Shareholder, the Shareholder or the Shareholder's successor in interest will shall hold the remaining shares _____[subject to *or* free of] this Agreement.

ARTICLE 5. SALE OF SHARES ON DEATH

5.01. **Purchase by Corporation.** Within _____[*e.g.,* 60] days after the death of any Shareholder, the Corporation shall, at the price and on the terms and conditions specified in this Agreement, purchase from the decedent's estate all the shares owned by the decedent. The Corporation shall give notice to the decedent's estate in accordance with Section 12.03.

5.02. **Purchase by Surviving Shareholders.** If the Corporation is legally unable to purchase all the decedent's shares, as provided in Section 5.01, the surviving Shareholders shall purchase from the decedent's estate, at the price and on the terms and conditions specified in this Article, all the decedent's shares that the Corporation is unable to purchase. The obligation of the surviving Shareholders to the decedent's estate under this Article shall be joint and several. However, each surviving Shareholder shall have the right and obligation to purchase the available shares in proportion to his or her existing ownership interests (excluding the decedent's shares) at the date of the decedent's death. The surviving Shareholders shall give notice to the decedent's estate in accordance with Section 12.03.

5.03. **Decedent's Estate Defined.** The term "decedent's estate" as used in this Article means:

(a) The duly appointed and qualified personal representative of the decedent's estate.

(b) The surviving joint tenant of the decedent when shares are owned as joint tenants by the decedent and a person who is not active in the business of the Corporation.

(c) Any other person who may, because of the community property or other law of any jurisdiction, acquire without formal probate proceedings any right, title, or interest in or to the shares of the decedent in the Corporation by reason of the decedent's death.

5.04. **Death of Shareholder's Spouse.** The death of a Shareholder's spouse who has never been active in or devoted his or her full working time to the business of the Corporation shall not be considered the death of a Shareholder for purposes of this Article, requiring the purchase by the Corporation and the sale by the decedent's estate of the decedent's shares in the Corporation.

[*If decedent's estate is to pay costs:*]

5.05. **Costs of Share Transfer**. The decedent's estate, not the Corporation, shall pay all costs and filing fees required to secure any court orders, court decrees, court approvals, and tax clearances required to enable the decedent's estate to transfer to the Corporation, or to the Corporation and surviving Shareholders, full legal and equitable tax-free title to the decedent's shares.

[*Or, if corporation is to pay costs:*]

5.05. **Costs of Share Transfer.** The Corporation, not the decedent's estate, shall pay all costs and filing fees required to secure any court orders, court decrees, court approvals, and tax clearances required to enable the decedent's estate to transfer to the Corporation, or to the Corporation and surviving Shareholders, full legal and equitable tax-free title to the decedent's shares.

[Select one of the following:]

[*If payment is to be made in installments:*]

5.06. **Method of Payment of Purchase Price.** The purchase price for the decedent's shares shall be paid to the decedent's estate or the decedent's successor in interest in installments. On acceptance of the offer, the purchaser shall pay the decedent's estate or the decedent's successor in interest a cash downpayment equal to at least _____[*specify percentage, e.g.,* 25] percent of the total purchase price. The purchaser shall pay the balance of the purchase price in _____[*specify number and frequency of payments, e.g.,* 24 consecutive monthly] payments, beginning _____[*state time, e.g.,* three months] after the downpayment. Simple interest will be charged on the outstanding principal balance at the annual rate of _____ percent. The unpaid balance of the purchase price shall be evidenced by a negotiable promissory note. The note shall provide that in the event of default in payment of principal, the note will become due and payable immediately. The purchaser may prepay the note in whole or in part at any time without penalty. The purchase price of the shares shall be determined in accordance with Article 10.

[*Or, if lump sum payment is to be made:*]

5.06. **Method of Payment of Purchase Price**. The purchase price for the decedent's shares shall be paid to the decedent's estate or the decedent's successor in interest in a lump sum. The purchase price of the shares shall be determined in accordance with Article 10.

[*Or, if insurance is used to fund the agreement:*]

5.06. **Method of Payment of Purchase Price.** The purchase price shall be paid in cash to the decedent's estate from the proceeds of any insurance policies promptly after their receipt. The purchase price shall not be less than the amount of the life insurance in force on the Shareholder's life under the terms of this Agreement. If the insurance policy proceeds are less than the purchase price, the balance shall be paid _____[in cash *or* under a promissory note]. [*If a promissory note is used, add:* The purchaser shall pay the balance of the purchase price in _____ (*specify number and frequency of payments, e.g.,* 24 consecutive monthly) payments, beginning _____ (*state time, e.g.,* three months) after the initial payment of the insurance proceeds. Simple interest will be charged on the outstanding principal balance at the annual rate of _____ percent. The unpaid balance of the purchase price shall be evidenced by a negotiable promissory note. The note shall provide that in the event of default in payment of principal, the note will become due and payable immediately. The purchaser may prepay the note in whole or in part at any time without penalty.]

[*Continue with the following:*]

ARTICLE 6. TRANSFER ON TOTAL DISABILITY

6.01. **Transfer on Disability of Shareholder.** If a Shareholder becomes either physically or mentally disabled for a period of _____[*specify time period, e.g.,* 90 days], and the disability is likely, in the opinion of a physician mutually designated by the Shareholder and the Corporation, to continue for _____[*specify time period, e.g.,* one year], the Corporation and the remaining Shareholders shall have the option, but not the obligation, within _____[*specify time period, e.g.,* 90 days] after receiving notice of the determination of disability, to purchase _____[all *or* a portion of] the shares of the disabled Shareholder. Notice shall be given to the Corporation and the remaining Shareholders in accordance with Section 12.03. The Corporation shall have the first option to purchase the shares of the disabled Shareholder, at the price and on the terms provided in this Agreement, and in the manner described in Article 3. If the Corporation does not exercise it option with regard to [all of] the disabled Shareholders shares, then the remaining Shareholders shall have the option, but not the obligation, to purchase any remaining shares, at the price and on the terms provided in this Agreement, and in the manner described in Article 3. If the option is not exercised with regard to all the shares of the disabled Shareholder, the Shareholder (or the Shareholder's successor in interest) shall hold the shares _____[subject to *or* free of] the provisions of this Agreement.

6.02. **Meaning of "Disabled."** For the purposes of this Agreement, a Shareholder is "disabled" if he or she is determined by a physician mutually designated by the Shareholder and the Corporation to be physically or mentally unable to perform his or her regular corporate duties for the period specified in Section 6.01. Each Shareholder consents to examination by a mutually designated physician and waives any physician-patient privilege arising from the examination or examinations.

ARTICLE 7. TRANSFER ON TERMINATION OF EMPLOYMENT

7.01. **Termination of Employment.** If the employment of a Shareholder with the Corporation is terminated for any of the following reasons: _____[*specify reasons, e.g.,* termination for cause, voluntary termination, retirement], the Corporation and the remaining Shareholders shall have the option, but not the obligation, within _____[*specify time period, e.g.,* 90 days] days after receiving notice of this event to purchase _____[all *or* a portion of] the shares of the terminated Shareholder. Notice shall be given to the Corporation and the remaining Shareholders in accordance with Section 12.03. The Corporation shall have the first option to purchase the shares of the terminated Shareholder, at the price and on the terms provided in this Agreement, and in the manner described in Article 3. If the Corporation does not exercise its option with regard to [all of] the terminated Shareholder's shares, then the remaining Shareholders shall have the option, but not the obligation, to purchase any remaining shares, at the price and on the terms provided in this Agreement, and in the manner described in

Article 3. If the option is not exercised with regard to all the shares of the terminated Shareholder, the Shareholder shall hold the shares [subject to *or* free of] the provisions of this Agreement.

[*If termination for cause is an event triggering sale of shares, add:*]

7.02. **"Termination for Cause" Defined.** For the purposes of this Agreement, termination of employment "for cause" means termination due to a willful breach of duty by the employee in the course of employment, or the habitual neglect of duties by the employee in the course of employment, or the employee's continued incapacity to perform the duties of employment.

ARTICLE 8. PAYMENT FOR AND TRANSFER OF SHARES

8.01. **Delivery and Endorsement of Shares.** The purchaser (the Corporation) or purchasers (the Corporation and the Shareholders) shall deliver the consideration for the shares as soon as practicable to the selling Shareholder or to his or her estate. Concurrently with the delivery of the consideration, the selling Shareholder, or the personal representative of the deceased Shareholder, shall properly endorse the certificates representing the shares for transfer to the Corporation and/or the purchasing Shareholders and shall deliver them to the purchasers.

8.02. **Method of Payment.** The method of payment shall be in accordance with Section 3.12 (lifetime purchase of shares) or Section 5.06 (sale of shares on death).

8.03. **Transfer of Title.** On any transfer of shares under this agreement, title to the shares shall pass from the seller to the purchaser upon payment by the purchaser of the consideration for the shares and endorsement of the share certificates by the seller as provided in Section 8.01. The seller's status as a shareholder thereupon shall cease. Until payment by the purchaser of the consideration for the shares and endorsement of the share certificates by the seller as provided in Section 8.01, the seller shall remain a shareholder of the corporation, with all the rights and privileges concomitant with that status.

ARTICLE 9. GOVERNMENTAL AND ADMINISTRATIVE APPROVALS

9.01. **Obtaining Required Approvals.** The Corporation agrees to promptly and in good faith apply for any governmental or administrative approvals required in connection with the sale or purchase of its shares in accordance with this Agreement. Concurrently, the Shareholders agree to cooperate and to execute any documents needed to obtain these approvals. If the purchase follows the death of any Shareholder, the decedent's personal representative shall promptly obtain any required court approval or confirmation of the sale of the decedent's shares as provided in this Agreement. [*If insurance is used to fund the agreement, add:* If the purchase follows the death of any Shareholder, the Corporation or the surviving Shareholders shall promptly file all necessary documentation and collect the insurance proceeds of any outstanding insurance policies owned by the Corporation or the surviving Shareholders on the life of the decedent.]

ARTICLE 10. DETERMINATION OF PURCHASE PRICE

[*If book value is used to fix purchase price, include the following versions of Sections 10.01 through 10.04:*]

10.01. **Purchase Price Set by Book Value**. The purchase price of the shares subject to this Agreement shall be the book value of the shares on the last day of the fiscal quarter preceding the month in which the event occurs requiring the determination of purchase price.

10.02. **Computation of Book Value.** The book value of the shares shall be computed by the independent certified public accountant (CPA), regularly used by the Corporation or, if the Corporation has no CPA, by a CPA selected by the Corporation for this purpose. The book value of the shares shall be determined in accordance with the regular financial statements prepared by the Corporation and in accordance with generally accepted accounting principles,

applied consistently with the accounting principles previously applied by the Corporation, adjusted to reflect the following:

(a) All inventory, valued _____[using *or* at] _____[*specify valuation method, e.g.,* FIFO, cost, or market value].

(b) All real property, leasehold improvements, equipment, and furnishings and fixtures _____[, valued at the valuation appearing on the Corporation's books as adjusted for depreciation *or* with a useful life of greater than five years, as defined for tax purposes on the Corporation's books, valued at their fair market value].

(c) The amount of any cash surrender value of any insurance policies owned by the Corporation on the life of any person.

(d) The face amount of any accounts payable.

(e) The face amount of any accounts receivable, with a reasonable reserve for bad debts.

(f) Any accrued taxes or assessments, deducted as liabilities.

(g) All usual fiscal year-end accruals and deferrals (including depreciation), prorated over the fiscal year.

[*Optional:* (h) The reasonable fair market value of any good will or other intangible assets.]

To arrive at the per-share price, the book value computed according to this Section shall be divided by the number of shares of the Corporation's stock then outstanding. The Corporation shall provide any information the CPA deems necessary or useful in determining the purchase price of the shares.

10.03. **Cost of Determination.** The Corporation shall pay the expenses in determining the valuation under this Article.

10.04. **Binding Nature of Determination.** The value of the shares computed according to this Article is binding on all persons.

[*Or, if capitalization of earnings method is used to fix purchase price, include the following versions of Sections 10.01 through 10.04:*]

10.01. **Purchase Price Set by Capitalization of Earnings.** The purchase price of the shares subject to this Agreement shall be the value of the shares set by capitalization of earnings averaged over the most recent _____[*specify number of years, e.g.,* three *or* five] years on the last day of the fiscal quarter preceding the month in which the event occurs requiring the determination of purchase price.

10.02. **Computation.** The purchase price of the shares shall be computed by the independent certified public accountant (CPA) regularly used by the Corporation or, if the Corporation has no CPA, by a CPA selected by the Corporation for this purpose. The price of the Corporation's stock shall be the sum of the Corporation's net profits for the most recent five years, divided by _____[*specify number of years, e.g.,* three *or* five] years. This average net profit shall be multiplied by _____[*specify figure, e.g.,* four], and the result shall be divided by the number of shares then outstanding. The Corporation's net profits shall be determined in accordance with the regular financial statements prepared by the Corporation and in accordance with generally accepted accounting principles, applied consistently with the accounting principles previously applied by the Corporation, adjusted to reflect the following:

(a) The elimination of any earnings as a result of the receipt of any life insurance proceeds on the life of a Shareholder whose shares were or are being purchased as a result of his or her death.

(b) The calculation of depreciation using the straight line method.

(c) The deduction of any amortization of goodwill or other intangibles.

(d) The valuation of any inventory _____[using *or* at] _____[*specify valuation method, e.g.*, FIFO, cost, or market value].

(e) The deduction of any past contributions to pension or profit sharing plans.

(f) The deduction of any nonrecurring capital gains enjoyed by the Corporation because of the sale of major corporate assets.

(g) The deduction of any amounts required to amortize and pay according to their terms any long-term debts of the Corporation.

(h) The addition of any nonrecurring capital losses suffered by the Corporation because of the sale of major corporate assets.

(I) The addition of any losses, to the extent not compensated by insurance, suffered by the Corporation from disasters.

The Corporation shall provide any information the CPA deems necessary or useful in determining the purchase price of the shares.

10.03. **Cost of Determination.** The Corporation shall pay the expenses in determining the valuation under this Article.

10.04. **Binding Nature of Determination.** The value of the shares computed according to this Article is binding on all persons.

[*Or, if appraisal is used to used to fix purchase price, include the following versions of Sections 10.01 through 10.05:*]

10.01. **Purchase Price Set by Appraisal**. The purchase price of the shares subject to this Agreement shall be the value of the shares set by appraisal.

10.02. **Selection of Appraiser.** Within _____[*e.g.*, 10] days after the event requiring the determination of purchase price, the Corporation and the _____[selling Shareholder *or* selling Shareholder's representative] shall mutually select a qualified appraiser to appraise the Corporation and set a value on its stock. If the Corporation and the _____[selling Shareholder *or* selling Shareholder's representative] cannot agree on a mutually acceptable appraiser, each party shall have _____[*e.g.*, seven] days after the expiration of the previous period to appoint that party's own qualified appraiser. If either party fails to appoint a qualified appraiser within the _____[*e.g.*, seven]-day period, the other party's appraiser, alone, shall have _____[*e.g.*, 21] days to appraise the value of the Corporation's shares. If both parties have each selected appraisers, these appraisers shall have _____[*e.g.*, 21] days to appraise the value of the Corporation's shares. If the two appraisers cannot come to agreement on the appraised value of the shares, they shall both select another qualified appraiser who will, then, determine the value of the shares. For the purposes of this section, "event requiring the determination of purchase price" means any of the following: the act of seeking the consent of the Shareholders to a sale, assignment, transfer, or other disposition of shares, or the giving of a Notice of Proposed Sale as provided in Section 3.02; the involuntary transfer of shares under Section 4.01; the death of a Shareholder under

Section 5.01; the certification by a physician that a Shareholder is totally disabled as provided in Sections 6.01 and 6.02; or the termination of a Shareholder's employment with the Corporation for any of the reasons specified in Section 7.01.

10.03. **Considerations in Making Appraisal.** The appraisers shall consider the following factors in making their appraisals:

(a) The value of comparable companies, if known.

(b) The fair market value, or replacement value, as appropriate, of any real property, leasehold improvements, equipment, and furnishings and fixtures.

(c) The face amount of any accounts payable, or other corporate liabilities.

(d) The face amount of any accounts receivable, with a reasonable reserve for bad debts.

10.04. **Cost of Determination.** The Corporation shall pay the expenses in determining the valuation under this Article.

10.05. **Binding Nature of Determination.** The value of the shares computed according to this Article is binding on all persons.

[*Or, if purchase price is fixed by agreement, to be reviewed periodically (with arbitration, if needed), include the following versions of Sections 10.01 through 10.04:*]

10.01. **Purchase Price Set by Agreement, Periodically Reviewed.** The purchase price of the shares subject to this Agreement shall be the value of the shares set by mutual agreement of the Shareholders. The initial value of the corporation is _____[*specify dollar value or* the dollar amount stated in Exhibit _____]; the initial value of each share is _____[*specify dollar value of each share or* the dollar amount stated in Exhibit _____], which equals the total value of the Corporation divided by the number of shares outstanding. By _____[*date, e.g.,* March 15th] of each year, the Shareholders shall, by mutual agreement, revalue the Corporation and its shares. This fair market value of the Corporation and its shares shall be the agreed on value until another value is either agreed on or otherwise established as provided in this Agreement. Any mutually agreed on value shall be noted in a timely manner in the Corporation's minute book.

10.02. **Arbitration.** If the Shareholders have not agreed on the purchase price, as required by Section 10.01, within _____[*specify time period, e.g.,* two years] prior to the occurrence of an event requiring agreement on the purchase price, the selling Shareholder (or the Shareholder's successor in interest) and the other Shareholders shall have a period of _____[*specify time period, e.g.,* 21 days] after occurrence of the event requiring an agreement on the purchase price within which to agree on the purchase price for the selling Shareholder's shares. If they cannot come to agreement within that time, the purchase price shall be determined by arbitration. If the selling Shareholder and the other Shareholders cannot agree on the selection of an arbitrator, then each shall appoint his or her own arbitrator. If these two arbitrators cannot agree on a purchase price, they shall appoint a third arbitrator, and the decision of the majority shall establish the purchase price. The arbitration shall be governed by the rules of the American Arbitration Association. For the purposes of this section, "event requiring agreement on the purchase price" means any of the following: the act of seeking the consent of the Shareholders to a sale, assignment, transfer, or other disposition of shares, or the giving of a Notice of Proposed Sale as provided in Section 3.02; the involuntary transfer of shares under Section 4.01; the death of a Shareholder under Section 5.01; the certification by a physician that a Shareholder is totally disabled as provided in Sections 6.01 and 6.02; or the termination of a Shareholder's employment with the Corporation for any of the reasons specified in Section 7.01.

10.03. **Cost of Determination.** The Corporation shall pay the expenses in determining the valuation under this Article.

10.04. **Binding Nature of Determination.** The value of the shares computed according to this Article is binding on all persons.

[*Continue with the following:*]

ARTICLE 11. TERMINATION OF AGREEMENT

11.01. **Events Causing Termination.** This Agreement shall terminate on any of the following:

(a) The written consent of all parties to the Agreement.

(b) The dissolution, bankruptcy, or insolvency of the Corporation.

(c) One Shareholder becoming the owner of all the shares.

[*If the agreement is funded with insurance, add:* (d) Any Shareholder's election to terminate the Agreement for lack of insurance on the life of any Shareholder.]

ARTICLE 12. MISCELLANEOUS PROVISIONS

12.01. **Necessary Acts.** All parties to this Agreement shall perform any acts, including executing any documents, that may be reasonably necessary to fully carry out the provisions and intent of this Agreement.

[*If amendment requires consent of all parties:*]

12.02. **Amendments.** This Agreement may be amended only by written consent of all parties to the Agreement.

[*Or, if amendment requires consent of all Shareholders and a majority of Board of Directors:*]

12.02. **Amendments.** This Agreement may be amended only by written consent of each of the Shareholders and majority vote of the Board of Directors of the Corporation.

[*Continue with the following:*]

12.03. **Notices.** All notices, demands, requests, or other communications required or permitted by this Agreement shall be in writing and shall be deemed duly served when personally delivered to the party or to an officer or agent of the party, or when deposited in the United States mail, first-class postage prepaid, addressed to the Corporation at _____[*address of Corporation's principal office*], or to a Shareholder at the address appearing for him or her on the books and records of the Corporation, or at any other address the party may designate by written notice to the others.

12.04. **Attorneys' Fees.** In the event of any litigation concerning this Agreement between the parties to this Agreement or the parties to this Agreement and the estate of any deceased Shareholder, the prevailing party shall be entitled, in addition to any other relief as may be granted, to reasonable attorneys' fees.

12.05. **Binding on Successors and Assigns.** This Agreement shall be binding on the parties to the Agreement, and on each of their heirs, executors, administrators, successors, and assigns.

12.06. **Severability.** If any provision is unenforceable or invalid for any reason, the remaining provisions shall be unaffected by such a holding.

12.07. **Governing Law.** This Agreement shall be construed according to and governed by the laws of the State of California.

12.08. **Sole Agreement.** This instrument constitutes the only Agreement of the parties regarding the sale and purchase of their shares in the Corporation, and correctly sets forth the rights, duties, and obligations of each to the other. Any prior agreements, promises, negotiations, or representations concerning the Agreement's subject matter not expressly set forth in this Agreement are of no force or effect.

12.09. **Agreement Available for Inspection.** An original copy of this Agreement duly executed by the Corporation and by each of the Shareholders shall be delivered to the Secretary of the Corporation and maintained by the Secretary at the principal office of the Corporation available for inspection by any person requesting to see it.

Executed on _____[*date*], at _____[*city*], _____[*county*], California.

THE CORPORATION

_____
[*typed name of corporation*]

[*address of principal office of corporation*]

_____
[*signature of president*]
[*typed name and title*]

_____
[*signature of secretary*]
[*typed name and title*]
THE SHAREHOLDERS

[*Repeat as required:*]

_____
[*signature*]
[*typed name*]

[*Add, if necessary:*]

EXHIBIT _____

[*If all parties to the Agreement and their share holdings are not enumerated in the Preamble, add this information as Exhibit _____:*]

EXHIBIT _____

[*If the initial value of the Corporation is to be set by mutual agreement and the dollar amount is not specified in Section 10.02, add this information as Exhibit _____:*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART IV. FORMS
A. ENTITY PURCHASE AGREEMENT

4-8D California Legal Forms--Transaction Guide §§ 8D.201-8D.209

[Reserved]

§§ 8D.201[Reserved]



84 of 141 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART IV. FORMS
B. Cross-Purchase Agreements

4-8D California Legal Forms--Transaction Guide § 8D.210

§ 8D.210 Cross-Purchase Buy-Sell Agreement- Not Funded by Insurance

[1] Comment

[a] Use of Form

This form is a basic cross-purchase buy-sell agreement. For insurance provisions, see *§ 8D.221*; for provisions providing for the administration of the agreement by a trustee, see Ch. 8C, *Close Corporation Shareholder Agreements* .

This form covers the purchase of a shareholder's shares by the remaining shareholders on the voluntary lifetime sale of shares [*see* [2], Article 3, *below*], the involuntary transfer of shares due to bankruptcy or assignment for the benefit of creditors [*see* [2], Article 4, *below*], and the shareholder's termination of employment, disability, retirement, or death [*see* [2], Articles 5-7 *below*].

Additional provisions may be added to this form, including a provision giving shareholders the right to encumber their stock [*see* Ch. 8C, *Close Corporation Shareholder Agreements*], a consent to attorney representation despite potential conflicts of interest [*see* Ch. 1A, *Role of Counsel in Starting a New Business*], or a spousal consent to the agreement for community property purposes [*see* Ch. 8C, *Close Corporation Shareholder Agreements*].

For discussion of the business and tax considerations in selecting a cross-purchase agreement over an entity purchase agreement, see *§ 8D.13*.

[b] Restrictions Applicable to New or Transferred Shares

This form makes no distinction between the shareholders who initially sign the agreement and subsequent transferees [*see* [2], Preamble, *below*]. The transferees should be required to execute an amendment to the agreement. The form provides, however, that a transferee's failure or refusal to sign an amendment does not relieve the transferee of any obligation or restriction under the agreement [*see* [2], Section 3.13, *below*].

Although, under a cross-purchase agreement, the corporation is not a necessary party, some practitioners believe that the corporation should always be a party to the agreement to protect against any corporate actions, including the subsequent issuance of shares not subject to the agreement, that might defeat the purposes of the agreement. This agreement is drafted to include the corporation. If the corporation is to be omitted as a party, the Preamble, signature block, and other relevant references should be modified accordingly. If a trustee will administer the agreement, the trustee should be named as a party to the agreement, or made a party by an amendment to the agreement.

[c] Legend Requirement

This provision requiring that a legend restricting transfer of the shares subject the agreement be printed on the shares themselves conforms to the statutory requirement [*see Corp. Code § 418(a)(1)*; [2], Section 2.02, *below*] and ensures that any transferee will have notice that the shares are subject to a buy-sell agreement. The precise language of the legend condition is set forth in this agreement to specify the applicable transfer restrictions [*see* [2], Section 2.02, *below*]. If the required statement that the shares are subject to restrictions on transfer does not appear on the certificate, transfer restrictions imposed by the corporation will be unenforceable against a transferee without actual knowledge of the restrictions [*Corp. Code § 418(b)*]. Furthermore, a shareholder agreement (defined as a written agreement among all the shareholders of a close corporation [*Corp. Code § 186*]) must be filed with the secretary of the corporation for inspection by any prospective purchaser of shares [*see Corp. Code § 300(b)*; *see also* [2], Section 2.02, *below*]. A transferee of shares covered by a shareholder agreement who has actual knowledge of the restrictions imposed by the agreement, or notice of those restrictions by a notation on the certificate as provided by statute [*see Corp. Code § 418*, is bound by provisions of the agreement [*Corp. Code § 300(b)*].

If the shares have been issued to the shareholders before the buy-sell agreement is executed, optional Section 2.03 requires the shareholders to present their certificates to the secretary of the corporation, who will then stamp on each certificate the legend conditions restricting transfer.

If the corporation issues uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)*], the transfer restrictions must appear on the initial transaction statement and on subsequent written statements [*Corp. Code § 418*; *see Corp. Code § 171.1* (definition)]. For further discussion of uncertificated securities, see Ch. 6I, *Issuance of Equity Securities* .

[d] Deposit of Share Certificates with Corporation

The optional paragraph providing that the shareholders deposit their share certificates and assignment forms with the secretary of the corporation is designed to ensure against unauthorized transfers of shares. If the shareholders prefer to retain possession of their share certificates, this provision should be omitted.

[e] Permitted Transfers

A shareholder may want to have the right to transfer his or her shares to family members to reduce the shareholder's taxable estate, or to equalize the income of family members. Whether such a transfer provision will interfere with the management and control of the business should be carefully considered before including it in the agreement.

[f] Restrictions on Voluntary Lifetime Transfers of Shares

This agreement provides that a shareholder may not sell his or her shares to a third party without offering them first to the other shareholders [*see* [2], Article 3, *below*]. Under a cross-purchase plan, the shareholder's stock is purchased directly from the shareholder or the shareholder's estate by the remaining shareholders in proportion to their existing ownership interests [*see § 8D.12*].

If the other shareholders choose to exercise their option to purchase the shares, they are entitled to pay the price

specified in the agreement [*see* Sections 3.07, 3.08 of form], and not the price offered by the third party. This provision is necessary to fix the value of the shares for federal estate tax purposes [*see I.R.C. § 2703*; *Treas. Reg. § 20.2031-2(h)*; *see also § 8D.61*]. If the purchase price stated in a buy-sell agreement is not accepted for estate tax purposes, the decedent's shares will be assessed at their fair market value, which may be substantially higher than the value fixed by the buy-sell agreement [*see I.R.C. § 2703*; *Treas. Reg. § 20.2031-2(a),(f)*].

Under the terms of this agreement, the shareholders have the option, but not the obligation, to purchase the offered shares [*see* Sections 3.07, 3.08 of form]. These provisions may be modified to require the mandatory purchase by the remaining shareholders, if the shareholders anticipate that they will not want to sell only a portion of their shares.

Alternative provisions of this agreement require that the purchase price be paid either in installments or in a lump sum [*see Section 3.11* of form]. Shareholders should consider whether, without insurance funding, they will be able to pay the purchase price in one lump sum. Even when life insurance is used to fund the surviving shareholders' purchase of a deceased shareholder's shares [*see, e.g., §§ 8D.220, § 8D.221*], it may not be available to fund a lifetime purchase of shares. Permanent life insurance with a cash equity buildup feature may provide the funds for a lifetime purchase. Term life insurance, however, because it has does not build up a cash value, will provide funding only for purchase on death [*see § 8D.71[e]*].

This form specifies the terms for lifetime purchase when the payments will be in installments [*see Section 3.11* of form]. It requires the purchaser to give the selling shareholder a percentage of the purchase price as a down payment, with the balance to be repaid with interest over a stated period of time, as provided in a negotiable promissory note. However, while installment payments provide some financial security to the seller, the payment obligations of the purchaser are general obligations, subject to prior claims of other creditors [*see* Jacobs, *Back to Basics Post TRA- 76 Stock Interest Terminations in Closely Held Corporations*, 36 N.Y.U. Corp. Tax. Inst. 3, 36 (1978)]. For a discussion of the tax consequences of installment payments, see [g], *below*.

If the shareholders opt for a lump sum payment, however, they should carefully consider all the circumstances and decide whether any potential hardship to the remaining shareholders is a risk that they are willing to bear.

[g] Tax Effect of Installment Payment Provisions

This agreement provides optional provisions for payment of the purchase price in installments [*see, e.g., Sections 3.11, 5.06* of form]. A corporation may use an installment note or debt financing to pay for stock that qualifies for sale or exchange treatment in a complete redemption [*see I.R.C. § 302(b)(3)*], without the stock attribution rules imputing constructive ownership of additional, unredeemed shares to the shareholder. These attribution rules may be waived for purposes of determining whether a complete redemption has taken place when payment is made by a note because the shareholder's only interest in the corporation following the sale of his or her stock is that of a creditor [*see I.R.C. § 302(c)(2)(A)*]. However, a shareholder's status as a creditor will be lost if the payments on the note are dependent on the corporation's future earnings, and are subordinate to the claims of the corporation's general creditors [*Treas. Reg. § 1.302-4(d)*; *see Rev. Rul. 77-467, 1077-2 C.B. 92*].

For discussion of the deferral of income tax liability by using the installment method of reporting income, see *§ 8D.43[2]*.

[h] Obligations of Transferees

This essential provision ensures that the purposes of the agreement will not be defeated if the shares are transferred to persons other than the original parties to the agreement. The parties may, however, approve limited exceptions when all of the offered shares are not purchased by the corporation or by the shareholders [*see Section 3.10* of form].

[i] Sale of Shares on Death of Shareholder

The drafter must determine whether to provide for the mandatory or optional purchase of the decedent's shares by the surviving shareholders. This agreement requires the surviving shareholders to purchase all of the shares of any deceased shareholder, in proportion to their existing ownership interests. Their obligation is joint and several [*see Section 5.02* of form]. If the drafter determines that the optional purchase of shares by the surviving shareholders is preferable, this section should be modified accordingly [*see* Articles 3, 4, 6, 7 (optional purchase on occurrence of events other than shareholder's death)].

If the surviving shareholders are required to purchase the shares, they must have the necessary consideration. The funding considerations discussed in [f], *above*, related to lifetime purchases, are also relevant when the triggering event is the shareholder's death.

In the event of the death of a shareholder who owns any shares as community property, this section may be modified to provide for the purchase of the community property interest of the surviving spouse.

This section may also be altered to provide for the termination of the agreement between the surviving shareholders after the death of the first shareholder to die, if, for example, the shareholders anticipate that the business could not effectively continue under these circumstances.

[j] Sale of Shares on Total Disability

If the corporation's business requires the active participation of all of its shareholders, the agreement should provide for the sale of a shareholder's shares when a shareholder is no longer able to participate [*see* Harmelin, *Disability The Oft-Overlooked Hazard in Buy and Sell Agreements, 11 Prac. Law. 75 (May 1965)*]. The term "disability" should be defined in the agreement to avoid later disputes over its meaning. This form defines disability as the determination of a physician. In addition, the term may include loss of a professional license when the shareholder requires that license to perform his or her duties in the corporation. For an example of a provision requiring sale if a shareholder becomes unable to practice his or her designated profession, see Ch. 12A, *Professional Corporations* .

[k] Sale on Termination of Employment

When all of the shareholders in a corporation are actively participating in the corporation's business, or if a shareholder owns shares only because of his or her employment with the corporation, it is important to provide for the disposition of a shareholder's shares when he or she leaves the business. The remaining shareholders ordinarily will not want a former employee to continue participating in the corporate business; and departing shareholders will usually want a ready market for their shares when the employment relationship ends. This provision requires a shareholder to offer to sell his or her shares on retirement, voluntary termination, or termination of employment for cause. Termination "for cause" is defined to avoid possible arbitrary termination of a shareholder for the purpose of acquiring his or her shares [*see* Note, *Exercising Options to Repurchase Employee-Held Stock: A Question of Good Faith, 68 Yale L. J. 773 (1959)*]. For further discussion of termination for cause, see Ch. 85, *Employment Agreements* .

[l] Tax Implication of Employment-Related Restrictions

Shares owned during employment that must be sold on termination of employment constitute property received in connection with the performance of services [*see I.R.C. § 83(a)*]. The receipt of property in connection with the performance of services results in the recognition of ordinary income in the year the shares are issued, on the excess of the fair market value of the shares over the amount paid for them [*see I.R.C. § 83(a)*]. If the shares are subject to a substantial risk of forfeiture or are nontransferable, recognition is deferred until they become transferable or the risk of forfeiture ceases [*I.R.C. § 83(a)*]. Shares subject to buy-sell provisions requiring the sale of the shares on termination of

employment are not subject to a substantial risk of forfeiture to the extent that the purchaser is required to pay fair market value for them [*see Treas. Reg. § 1.83-3(c)*].

The shareholder may elect to include in gross income for the taxable year in which the shares are received the difference between the fair market value of the shares at the time of transfer and the amount paid for them [*I.R.C. § 83(b)(1)*]. The election must be made no later than 30 days after transfer [*I.R.C. § 83(b)(2)*]. If the election is made, any subsequent appreciation in the value of the shares is not taxable as compensation to the electing shareholder [*Treas. Reg. § 1.83-2(a)*].

[m] Formula for Determining Purchase Price

This agreement includes four alternate provisions for fixing the purchase price of the shares:

- Book value [*see § 8D.75[2]*].
- Capitalization of earnings [*see § 8D.75[3]*].
- Appraisal [*see § 8D.75[5]*].
- Mutual agreement, periodically reviewed, with arbitration [*see § 8D.75[4]*].

These are four of several formulas that may be used to determine the purchase price of shares subject to a buy-sell agreement [*see § 8D.75[1]*]. The most suitable valuation method depends on the facts and circumstances of the particular business; the valuation provisions included here are examples only and may need to be tailored to the particular business at hand.

For example, capitalization of earnings determines the corporation's value by its continuing ability to earn profits, rather than by the worth of its assets, and assumes that future earnings will continue at least at the same rate as earnings during the time period used. This method, therefore, would not be useful if the deceased or selling shareholder were vital to the success of the business. Further, the value of shares determined by using the capitalization of earning method may vary dramatically, depending on the capitalization rate selected [*see* Section 8.02 of form, using a rate of four times the average net profit] and the number of years used to determine the average net profit.

For further discussion of the valuation methods used in this form's alternative provisions, see *§ 8D.75*.

This form assumes that the close or closely-held corporation is exempt from the qualification of its securities [*see Corp. Code § 25102*; § 8D.74[1]]. If the corporation does not obtain an exemption from securities qualification, it must also follow the pricing criteria set forth in the California Code of Regulations [*see 10 Cal. Code Reg. § 260.140.8*; § 8D.74[2]], and this form must be modified accordingly.

[n] Transfer of Title and Change in Shareholder Status

Section 8.03 of this form provides that a selling shareholder will remain a shareholder until payment of the consideration for the shares and transfer of the share certificates as provided in Section 8.01. For a discussion of the importance and effect of this provision, the California Supreme Court's decision in *Stephenson v. Drever* [*Stephenson v. Drever (1997) 16 Cal. 4th 1167, 69 Cal. Rptr. 2d 764, 947 P.2d 1301]* , and the modification of this provision to provide for a termination of shareholder rights and status immediately upon occurrence of the event triggering the buy-sell agreement, see *§ 8D.200[1][n]*. For a provision terminating shareholder status immediately on occurrence of the triggering event, and discussion of the use of such a provision as well as modifications to this form in the event that it is used, see *§ 8D.230*.

[o] Termination of Agreement

If this agreement is modified to provide for termination on the death of the first shareholder to die [*see* [h], *above*], the section governing termination of the agreement should be modified as well.

[p] Waiver of Duties to Minority Shareholders Void

A buy-sell agreement may not include a provision waiving the fiduciary duties of the minority shareholders in a private close corporation. Such a waiver is against public policy and void [*Neubauer v. Goldfarb (2003) 108 Cal. App. 4th 47, 54-57, 133 Cal. Rptr. 2d 218* (provision in buy-sell agreement purporting to waive any fiduciary duty with respect to fairness of overall consideration held void)].

[2] Form

Cross-Purchase Buy-Sell Agreement- Not Funded by Insurance

PREAMBLE

THIS BUY-SELL AGREEMENT, is entered into on _____[*date*], at _____[*location*], California, between _____[name of corporation] ("Corporation"), a California corporation, and _____[names of shareholders] (collectively "Shareholders" and individually "Shareholder") with regard to all of the Corporation's stock outstanding now or at any later date. The Corporation and the Shareholders agree as follows:

ARTICLE 1. PARTIES AND PURPOSES

[*EITHER*]

1.01. **Identity of Parties.** The Shareholders named above own all the outstanding shares of the Corporation as shown in Exhibit A.

[*OR*]

1.01. **Identity of Parties.** The Shareholders named own all the outstanding shares of the Corporation, as follows:

Shareholder .....Number of Shares

_____ ..... _____

_____ ..... _____

[*Add if applicable:*]

The number of shares owned by each of the Shareholders on the date this Agreement becomes operative will be controlling in the event of a discrepancy between that number and the number of shares stated above.

[*Continue with the following:*]

1.02. **Protective Purpose of Agreement.** The purpose of this Agreement is to ensure that the Corporation's shares remain closely held, to protect the Corporation's management and control from persons not acceptable to all

shareholders.

1.03. **Market Purpose of Agreement.** The purpose of this Agreement is also to provide a ready market for the Corporation's shares in the event of the death of a Shareholder or the lifetime transfer of shares by a Shareholder.

ARTICLE 2. ENFORCEMENT

2.01. **Restriction on Transfer.** To accomplish the purposes of this Agreement, any transfer, sale, assignment, hypothecation, encumbrance, or alienation of any of the shares of the Corporation, other than according to the terms of this Agreement, is void and transfers no right, title, or interest in or to those shares to the purported transferee, buyer, assignee, pledgee, or encumbrance holder. Each Shareholder shall have the right to vote shares held of record and to receive dividends paid on them until the shares are sold or transferred in accordance with this Agreement.

2.02. **Legend on Share Certificates.** Each share certificate, whether presently owned or subsequently acquired, shall have the following statement conspicuously printed on its face:

"The transfer, sale, assignment, hypothecation, encumbrance, or alienation of the shares represented by this certificate is restricted by a Buy-Sell Agreement among all the Shareholders and the Corporation dated _____ [*date of buy-sell agreement*]. A copy of the Buy-Sell Agreement is available for inspection during normal business hours at the principal office of the Corporation. All the terms and provisions of the Buy-Sell Agreement are incorporated by this reference and made a part of this certificate."

[*Add if applicable:*]

2.03. **Stamping of Certificates.** Each of the Shareholders shall, immediately on execution of this Agreement, present his or her share certificates to the Secretary of the Corporation and cause the Secretary to stamp on each certificate in a prominent manner the statement *set forth in Section 2.02* of this Agreement.

[*Add if desired:*]

2.04. **Deposit of Shares with Corporation.** Concurrently with the execution of this Agreement, each Shareholder has endorsed stock assignment forms, in addition to his or her share certificates, and has deposited both the assignment forms and the share certificates with the Secretary of the Corporation. Despite the endorsement and deposit, each Shareholder shall have the right to vote shares held of record and to receive dividends paid on them until the shares are sold or transferred, as provided in this Agreement.

[*Continue with the following:*]

ARTICLE 3. VOLUNTARY LIFETIME TRANSFER OF SHARES

3.01. **Permitted Transfers.** Despite any provisions in this Agreement to the contrary, each Shareholder has the right to transfer shares subject to this Agreement to [*specify permitted transferees, e.g.,* another Shareholder, or a trust for the benefit of any other Shareholder]. A permitted transferee shall hold the transferred shares subject to all the provisions of this Agreement, as provided in Section 3.07.

3.02. **Notice of Proposed Sale.** Except as provided in Section 3.01, no Shareholder shall sell, assign, transfer, or otherwise dispose of any of his or her shares in the Corporation, or of any interest in those shares, without first obtaining the prior written consent of all other Shareholders. This prior written consent is unnecessary if the transferor gives written notice ("Notice of Proposed Sale") to the other Shareholders in the manner prescribed in Section 12.03. The notice must specify:

(1) The name and address of each proposed transferee.

(2) The number of shares, or the interest in shares, to be transferred.

(3) The price per share.

(4) The terms of the proposed sale, assignment, or transfer.

3.03. **Purchase by Remaining Shareholders.** The remaining Shareholders have the option, but not the obligation, to purchase the offered shares at the price determined according to Article 10 of this Agreement. Within _____[*e.g.*, 20] days after the date the selling Shareholder gives to him or her the Notice of Proposed Sale, any Shareholder who desires to purchase all or a portion of the offered shares shall serve written notice on the Secretary of the Corporation of the Shareholder's election to purchase a specified number of the offered shares.

3.04. **Excessive Offers to Purchase.** (a) If the total number of offered shares the remaining Shareholders have elected to purchase exceeds the number of offered shares specified in the Notice of Proposed Sale, each of the remaining Shareholders shall have a priority right to purchase, up to the number of shares specified in his or her notice to the Corporation, described in Section 3.03, the same proportion of the offered shares as the number of shares already owned by that Shareholder bears to the total number of shares in the Corporation already owned by the remaining Shareholders electing to purchase offered shares. If all of the offered shares are not purchased on such a priority basis, those shares remaining shall be allocated in one or more successive allocations to those Shareholders electing to purchase more than the number of offered shares for which they have a priority right, up to the number of shares specified in their respective notices to the Corporation, in the proportion that the number of shares held by each of them bears to the number of shares held by all the Shareholders electing to purchase offered shares.

(b) Within _____[*e.g.*, five] days after the deadline for receipt by the Secretary of the Corporation of the written notice of election, described in Section 3.03, the Secretary of the Corporation shall notify each of the remaining Shareholders electing to purchase shares of the number of offered shares he or she may purchase, the date set for the purchase of these offered shares, and the terms and conditions of the purchase. Each Shareholder must meet the terms and conditions of the purchase within _____[*e.g.*, 10] days after the Shareholder receives the Secretary's notification. Transfer of any payment for the offered shares shall occur as provided in Section 3.06.

3.05. **Default of Option by Shareholders.** If the remaining Shareholders do not purchase all the shares specified in the Notice of Proposed Sale, the selling Shareholder is under no obligation to sell any of the offered shares to any of the remaining Shareholders. Instead, the selling Shareholder may sell them to the proposed transferee specified in the Notice of Proposed Sale on the terms specified in that notice. The transferee will hold the shares _____[subject to *or* free of] the provisions of this Agreement. The selling Shareholder may not, however, sell any or all of the offered shares to any other person or firm or at any other price or on any other terms and conditions than those specified in the Notice of Proposed Sale given by him or her to the other Shareholders, without giving a new Notice of Proposed Sale in accordance with Section 3.02 and complying with the further requirements of Article 3. Any sale or transfer by any Shareholder in violation of Article 3 shall be null and void.

[*If payment is to be made in installments:*]

3.06. **Method of Payment of Purchase Price.** The purchase price for a lifetime purchase of shares shall be paid to the selling Shareholder in installments. On acceptance of the offer, the purchaser shall pay the selling Shareholder a cash down payment equal to at least _____[*e.g.*, 25] percent of the total purchase price. If the down payment is less than the total purchase price, the purchaser shall pay the balance of the purchase price in _____[*specify number and frequency of payments, e.g.*, 24 consecutive monthly] payments, beginning _____[*state time, e.g.*, three months] after the down payment. Simple interest will be charged on the outstanding principal balance at the annual rate of _____ percent. The unpaid balance of the purchase price shall be evidenced by a negotiable promissory note. The note shall provide that in the event of default in payment

of principal, the note will become due and payable immediately. The purchaser may prepay the note in whole or in part at any time without penalty. The purchase price of the shares shall be determined in accordance with Article 10.

[*Or, if lump sum payment is made:*]

3.06. **Method of Payment of Purchase Price.** The purchase price for a lifetime purchase of shares shall be paid to the selling Shareholder in a lump sum. The purchase price of the shares shall be determined in accordance with Article 10.

[*Continue with the following:*]

3.07. **Obligations of Transferees.** Unless this Agreement expressly provides otherwise, each transferee and any subsequent transferee of the shares of this Corporation, or of any interest in those shares, shall hold the shares or interest subject to the provisions of this Agreement and shall make no transfers except as provided in this Agreement. The Secretary of the Corporation shall record these transfers on the books of the Corporation until an amended copy of this Agreement has been executed by the transferee. A transferee's failure or refusal to sign an amended copy of this Agreement does not relieve the transferee of any obligation or restriction under this Agreement.

ARTICLE 4. INVOLUNTARY LIFETIME TRANSFER OF SHARES

4.01. **Involuntary Transfer.** If a Shareholder's shares are transferred involuntarily or by operation of law (other than as a result of the Shareholder's death) for any of the following reasons: _____[*specify reasons, e.g.*, bankruptcy, assignment of substantially all property for creditors' benefit], within _____[*e.g.*, 60] days after notice of the event, the other Shareholders shall have the option, but not the obligation, to purchase all or some of the shares owned by the Shareholder at the price and on the terms provided in this Agreement. The option shall be exercisable by the Shareholders, according to the provisions of Article 3. If the option is not exercised with regard to all of the shares owned by the Shareholder, the Shareholder or the Shareholder's successor in interest will shall hold the remaining shares _____[subject to *or* free from] this Agreement.

ARTICLE 5. SALE OF SHARES ON DEATH

5.01. **Purchase by Surviving Shareholders.** Within _____[*e.g.*, 60] days after the death of any Shareholder, the surviving Shareholders shall, at the price and on the terms and conditions specified in this Agreement, purchase from the decedent's estate all the shares owned by the decedent. The obligation of the surviving Shareholders to the decedent's estate under this Article shall be joint and several. However, each surviving Shareholder shall have the right and obligation to purchase the available shares in proportion to his or her existing ownership interests (excluding the decedent's shares) at the date of the decedent's death. The surviving Shareholders shall give notice to the decedent's estate in accordance with Section 12.03.

5.02. **Decedent's Estate Defined.** The term "decedent's estate" as used in this Article means:

(a) The duly appointed and qualified personal representative of the decedent's estate.

(b) The surviving joint tenant of the decedent when shares are owned as joint tenants by the decedent and a person who is not active in the business of the Corporation.

(c) Any other person who may, because of the community property or other law of any jurisdiction, acquire without formal probate proceedings any right, title, or interest in or to the shares of the decedent in the Corporation by reason of the decedent's death.

5.03. **Death of Shareholder's Spouse.** The death of a Shareholder's spouse who has never been active in or devoted his or her full working time to the business of the Corporation shall not be considered the death of a

Shareholder for purposes of this Article requiring the purchase by the surviving Shareholders and the sale by the decedent's estate of the decedent's shares in the Corporation.

[*If decedent's estate is to pay costs:*]

5.04. **Costs of Share Transfer.** The decedent's estate, not the Corporation, shall pay all costs and filing fees required to secure any court orders, court decrees, court approvals, and tax clearances required to enable the decedent's estate to transfer full legal and equitable tax-free title to the decedent's shares.

[*Or, if corporation is to pay costs:*]

5.04. **Costs of Share Transfer.** The Corporation, not the decedent's estate, shall pay all costs and filing fees required to secure any court orders, court decrees, court approvals, and tax clearances required to enable the decedent's estate to transfer full legal and equitable tax-free title to the decedent's shares.

[*Select one of the following:]*

[*If payment is to be made in installments:*]

5.05. **Method of Payment of Purchase Price.** The purchase price for the decedent's shares shall be paid to the decedent's estate or the decedent's successor in interest in installments. On acceptance of the offer, the purchaser shall pay the decedent's estate or the decedent's successor in interest a cash down payment equal to at least _____[*e.g.*, 25] percent of the total purchase price. If the down payment is less than the total purchase price, the purchaser shall pay the balance of the purchase price in _____[*specify number and frequency of payments, e.g.*, 24 consecutive monthly] payments, beginning _____[*state time, e.g.*, three months] after the down payment. Simple interest will be charged on the outstanding principal balance at the annual rate of _____ percent. The unpaid balance of the purchase price shall be evidenced by a negotiable promissory note. The note shall provide that in the event of default in payment of principal, the note will become due and payable immediately. The purchaser may prepay the note in whole or in part at any time without penalty. The purchase price of the shares shall be determined in accordance with Article 10.

[*Or, if lump sum payment is made:*]

5.05. **Method of Payment of Purchase Price.** The purchase price for the decedent's shares shall be paid to the decedent's estate or the decedent's successor in interest in a lump sum. The purchase price of the shares shall be determined in accordance with Article 10.

[*Or, if insurance is used to fund agreement:*]

5.05. **Method of Payment of Purchase Price.** The purchase price shall be paid in cash to the decedent's estate from the proceeds of any insurance policies promptly after their receipt. The purchase price shall not be less than the amount of the life insurance in force on the Shareholder's life under the terms of this Agreement. If the insurance policy proceeds are less than the purchase price, the balance shall be paid _____[in cash *or* under a promissory note]. [*If a promissory note is used, add:* The purchaser shall pay the balance of the purchase price in _____ (*specify number and frequency of payments, e.g.*, 24 consecutive monthly) payments, beginning _____ (*state time, e.g.*, three months) after the initial payment of the insurance proceeds. Simple interest will be charged on the outstanding principal balance at the annual rate of _____ percent. The unpaid balance of the purchase price shall be evidenced by a negotiable promissory note. The note shall provide that in the event of default in payment of principal, the note will become due and payable immediately. The purchaser may prepay the note in whole or in part at any time without penalty.]

[*Continue with the following:*]

ARTICLE 6. TRANSFER ON TOTAL DISABILITY

6.01. **Transfer on Disability of Shareholder.** If a Shareholder becomes either physically or mentally disabled for a period of _____[*e.g.*, 90 days], and the disability is likely, in the opinion of a physician mutually designated by the Shareholder and the other Shareholders to continue for _____[*e.g.*, one year], the remaining Shareholders shall have the option, but not the obligation, within _____[*e.g.*, 90 days] after receiving notice of the determination of this disability, to purchase _____[all *or* a portion of] the shares of the disabled Shareholder, at the price and on the terms provided in this Agreement, and in the manner described in Article 3. Notice shall be given to the other Shareholders in accordance with Section 12.03. If the option is not exercised with regard to all the shares of the disabled Shareholder, the Shareholder (or the Shareholder's successor in interest) shall hold the shares _____[subject to *or* free of] the provisions of this Agreement.

6.02. **Meaning of "Disabled."** For the purposes of this Agreement, a Shareholder is "disabled" if he or she is determined by a physician mutually designated by the Shareholder and the Corporation to be physically or mentally unable to perform his or her regular corporate duties for a period specified in Section 6.01. Each Shareholder consents to examination by a mutually designated physician and waives any physician-patient privilege arising from the examination or examinations.

ARTICLE 7. TRANSFER ON TERMINATION OF EMPLOYMENT

7.01. **Termination of Employment.** If the employment of a Shareholder with the Corporation is terminated for any of the following reasons: _____[*specify reasons, e.g.*, termination for cause, voluntary termination, retirement], the remaining Shareholders shall have the option, but not the obligation, within _____[*e.g.*, 90 days] after receiving notice of this event, to purchase _____[all *or* a portion of] the shares of the terminated Shareholder, at the price and on the terms provided in this Agreement, and in the manner described in Article 3. Notice shall be given to the remaining Shareholders in accordance with Section 12.03. If the option is not exercised with regard to all the shares of the terminated Shareholder, the Shareholder shall hold the shares _____[subject to *or* free of] the provisions of this Agreement.

[*If termination for cause is an event triggering sale of shares, add:*]

7.02. **"Termination for Cause"Defined.** For the purposes of this Agreement, termination of employment "for cause" means termination due to a willful breach of duty by the employee in the course of employment, or the habitual neglect of duties by the employee in the course of employment, or the employee's continued incapacity to perform the duties of employment.

ARTICLE 8. PAYMENT FOR AND TRANSFER OF SHARES

8.01. **Delivery and Endorsement of Shares.** The purchaser shall deliver the consideration for the shares as soon as practicable to the selling Shareholder or to his or her estate. Concurrently with the delivery of the consideration, the selling Shareholder, or the personal representative of the deceased Shareholder, shall properly endorse the certificates representing the shares for transfer to the purchasing Shareholders and shall deliver them to the purchasers.

8.02. **Method of Payment.** The method of payment shall be in accordance with Section 3.06 (lifetime purchase of shares) or Section 5.05 (sale of shares on death).

8.03. **Transfer of Title.** On any transfer of shares under this agreement, title to the shares shall pass from the seller to the purchaser upon payment by the purchaser of the consideration for the shares and endorsement of the share certificates by the seller as provided in Section 8.01. The seller's status as a shareholder thereupon shall cease. Until

payment by the purchaser of the consideration for the shares and endorsement of the share certificates by the seller as provided in Section 8.01, the seller shall remain a shareholder of the corporation, with all the rights and privileges concomitant with that status.

ARTICLE 9. GOVERNMENTAL AND ADMINISTRATIVE APPROVALS

9.01. **Obtaining Required Approvals.** The Corporation agrees to promptly and in good faith apply for any governmental or administrative approvals required in connection with the sale or purchase of its shares in accordance with this Agreement. Concurrently, the Shareholders agree to cooperate and to execute any documents needed to obtain these approvals. If the purchase follows the death of any Shareholder, the decedent's personal representative shall promptly obtain any required court approval or confirmation of the sale of the decedent's shares as provided in this Agreement. [*If insurance is used to fund the agreement, add:* If the purchase follows the death of any Shareholder, the Corporation or the surviving Shareholders shall promptly file all necessary documentation and collect the insurance proceeds of any outstanding insurance policies owned by the Corporation or the surviving Shareholders on the life of the decedent.]

ARTICLE 10. DETERMINATION OF PURCHASE PRICE

[*If book value is used to fix purchase price, include the following versions of Sections 10.01 through 10.04:*]

10.01. **Purchase Price Set by Book Value.** The purchase price of the shares subject to this Agreement shall be the book value of the shares on the last day of the fiscal quarter preceding the month in which the event occurs requiring the determination of purchase price.

10.02. **Computation of Book Value.** The book value of the shares shall be computed by the independent certified public accountant (CPA), regularly used by the Corporation or, if the Corporation has no CPA, by a CPA selected by the Corporation for this purpose. The book value of the shares shall be determined in accordance with the regular financial statements prepared by the Corporation and in accordance with generally accepted accounting principles, applied consistently with the accounting principles previously applied by the Corporation, adjusted to reflect the following:

(a) All inventory, valued _____[using *or* at] _____[*specify valuation method, e.g.,* FIFO, cost, or market value].

(b) All real property, leasehold improvements, equipment, and furnishings and fixtures _____[, valued at the valuation appearing on the Corporation's books as adjusted for depreciation *or* with a useful life of greater than five years, as defined for tax purposes on the Corporation's books, valued at their fair market value].

(c) The amount of any cash surrender value of any insurance policies owned by the Corporation on the life of any person.

(d) The face amount of any accounts payable.

(e) The face amount of any accounts receivable, with a reasonable reserve for bad debts.

(f) Any accrued taxes or assessments, deducted as liabilities.

(g) All usual fiscal year-end accruals and deferrals (including depreciation), prorated over the fiscal year.

[*Optional:* (h) The reasonable fair market value of any good will or other intangible assets.]

To arrive at the per-share price, the book value computed according to this Section shall be divided by the number of shares of the Corporation's stock then outstanding. The Corporation shall provide any information the CPA deems necessary or useful in determining the purchase price of the shares.

10.03. **Cost of Determination.** The Corporation shall pay the expenses in determining the valuation under this Article.

10.04. **Binding Nature of Determination.** The value of the shares computed according to this Article is binding on all persons.

[*Or, if capitalization of earnings method is used to fix purchase price, include the following versions of Sections 10.01 through 10.04:*]

10.01. **Purchase Price Set by Capitalization of Earnings.** The purchase price of the shares subject to this Agreement shall be the value of the shares set by capitalization of earnings averaged over the most recent _____[*specify number of years, e.g.,* three *or* five] years on the last day of the fiscal quarter preceding the month in which the event occurs requiring the determination of purchase price.

10.02. **Computation.** The purchase price of the shares shall be computed by the independent certified public accountant (CPA) regularly used by the Corporation or, if the Corporation has no CPA, by a CPA selected by the Corporation for this purpose. The price of the Corporation's stock shall be the sum of the Corporation's net profits for the most recent five years, divided by _____[*specify number of years, e.g.,* three *or* five] years. This average net profit shall be multiplied by _____[*specify figure, e.g.,* four], and the result shall be divided by the number of shares then outstanding. The Corporation's net profits shall be determined in accordance with the regular financial statements prepared by the Corporation and in accordance with generally accepted accounting principles, applied consistently with the accounting principles previously applied by the Corporation, adjusted to reflect the following:

(a) The elimination of any earnings as a result of the receipt of any life insurance proceeds on the life of a Shareholder whose shares were or are being purchased as a result of his or her death.

(b) The calculation of depreciation using the straight line method.

(c) The deduction of any amortization of goodwill or other intangibles.

(d) The valuation of any inventory _____[using *or* at] _____[*specify valuation method, e.g.,* FIFO, cost, or market value].

(e) The deduction of any past contributions to pension or profit sharing plans.

(f) The deduction of any nonrecurring capital gains enjoyed by the Corporation because of the sale of major corporate assets.

(g) The deduction of any amounts required to amortize and pay according to their terms any long-term debts of the Corporation.

(h) The addition of any nonrecurring capital losses suffered by the Corporation because of the sale of major corporate assets.

(I) The addition of any losses, to the extent not compensated by insurance, suffered by the Corporation from disasters.

The Corporation shall provide any information the CPA deems necessary or useful in determining the purchase price of the shares.

10.03. **Cost of Determination.** The Corporation shall pay the expenses in determining the valuation under this Article.

10.04. **Binding Nature of Determination.** The value of the shares computed according to this Article is binding on all persons.

[*Or, if appraisal is used to used to fix purchase price, include the following versions of Sections 10.01 through 10.05:*]

10.01. **Purchase Price Set by Appraisal**. The purchase price of the shares subject to this Agreement shall be the value of the shares set by appraisal. start here

10.02. **Selection of Appraiser.** Within _____[*e.g.*, 10] days after the event requiring the determination of purchase price, the Corporation and the _____[selling Shareholder *or* selling Shareholder's representative] shall mutually select a qualified appraiser to appraise the Corporation and set a value on its stock. If the Corporation and the _____[selling Shareholder *or* selling Shareholder's representative] cannot agree on a mutually acceptable appraiser, each party shall have _____[*e.g.*, seven] days after the expiration of the previous period to appoint that party's own qualified appraiser. If either party fails to appoint a qualified appraiser within the _____[*e.g.*, seven]-day period, the other party's appraiser, alone, shall have _____[*e.g.*, 21] days to appraise the value of the Corporation's shares. If both parties have each selected appraisers, these appraisers shall have _____[*e.g.*, 21] days to appraise the value of the Corporation's shares. If the two appraisers cannot come to agreement on the appraised value of the shares, they shall both select another qualified appraiser who will then determine the value of the shares. For the purposes of this section, "event requiring the determination of purchase price" means any of the following: the act of seeking the consent of the Shareholders to a sale, assignment, transfer, or other disposition of shares, or the giving of a Notice of Proposed Sale as provided in Section 3.02; the involuntary transfer of shares under Section 4.01; the death of a Shareholder under Section 5.01; the certification by a physician that a Shareholder is totally disabled as provided in Sections 6.01 and 6.02; or the termination of a Shareholder's employment with the Corporation for any of the reasons specified in Section 7.01.

10.03. **Considerations in Making Appraisal.** The appraisers shall consider the following factors in making their appraisals:

(a) The value of comparable companies, if known.

(b) The fair market value, or replacement value, as appropriate, of any real property, leasehold improvements, equipment, and furnishings and fixtures.

(c) The face amount of any accounts payable, or other corporate liabilities.

(d) The face amount of any accounts receivable, with a reasonable reserve for bad debts.

10.04. **Cost of Determination.** The Corporation shall pay the expenses in determining the valuation under this Article.

10.05. **Binding Nature of Determination.** The value of the shares computed according to this Article is binding on all persons.

[*Or, if purchase price is fixed by agreement, to be reviewed periodically (with arbitration, if needed), include the following versions of Sections 10.01 through 10.04:*]

10.01. **Purchase Price Set by Agreement, Periodically Reviewed.** The purchase price of the shares subject to this Agreement shall be the value of the shares set by mutual agreement of the Shareholders. The initial value of the corporation is _____[*specify dollar value or* the dollar amount stated in Exhibit _____]; the initial value of each share is _____[*specify dollar value of each share or* the dollar amount stated in Exhibit _____], which equals the total value of the Corporation divided by the number of shares outstanding. By _____[*date, e.g.,* March 15th] of each year, the Shareholders shall, by mutual agreement, revalue the Corporation and its shares. This fair market value of the Corporation and its shares shall be the agreed on value until another value is either agreed on or otherwise established as provided in this Agreement. Any mutually agreed on value shall be noted in a timely manner in the Corporation's minute book.

10.02. **Arbitration.** If the Shareholders have not agreed on the purchase price, as required by Section 10.01, within _____[*specify time period, e.g.,* two years] prior to the occurrence of an event requiring agreement on the purchase price, the selling Shareholder (or the Shareholder's successor in interest) and the other Shareholders shall have a period of _____[*specify time period, e.g.,* 21 days] after occurrence of the event requiring an agreement on the purchase price within which to agree on the purchase price for the selling Shareholder's shares. If they cannot come to agreement within that time, the purchase price shall be determined by arbitration. If the selling Shareholder and the other Shareholders cannot agree on the selection of an arbitrator, then each shall appoint his or her own arbitrator. If these two arbitrators cannot agree on a purchase price, they shall appoint a third arbitrator, and the decision of the majority shall establish the purchase price. The arbitration shall be governed by the rules of the American Arbitration Association. For the purposes of this section, "event requiring agreement on the purchase price" means any of the following: the act of seeking the consent of the Shareholders to a sale, assignment, transfer, or other disposition of shares, or the giving of a Notice of Proposed Sale as provided in Section 3.02; the involuntary transfer of shares under Section 4.01; the death of a Shareholder under Section 5.01; the certification by a physician that a Shareholder is totally disabled as provided in Sections 6.01 and 6.02; or the termination of a Shareholder's employment with the Corporation for any of the reasons specified in Section 7.01.

10.03. **Cost of Determination.** The Corporation shall pay the expenses in determining the valuation under this Article.

10.04. **Binding Nature of Determination.** The value of the shares computed according to this Article is binding on all persons.

[*Continue with the following:*]

ARTICLE 11. TERMINATION OF AGREEMENT

11.01. **Events Causing Termination.** This Agreement shall terminate on any of the following:

(a) The written consent of all parties to the Agreement.

(b) The dissolution, bankruptcy, or insolvency of the Corporation.

(c) One Shareholder becoming the owner of all the shares.

[*If the agreement is funded with insurance, add:* (d) Any Shareholder's election to terminate the Agreement for lack of insurance on the life of any Shareholder.]

ARTICLE 12. MISCELLANEOUS PROVISIONS

12.01. **Necessary Acts.** All parties to this Agreement shall perform any acts, including executing any documents, that may be reasonably necessary to fully carry out the provisions and intent of this Agreement.

12.02. **Amendments.** This Agreement may be amended only by written consent of all parties to the Agreement.

12.03. **Notices.** All notices, demands, requests, or other communications required or permitted by this Agreement shall be in writing and shall be deemed duly served when personally delivered to the party or to an officer or agent of the party, or when deposited in the United States mail, first-class postage prepaid, addressed to the Corporation at _____[*address of Corporation's principal office*], or to a Shareholder at the address appearing for him or her on the books and records of the Corporation, or at any other address the party may designate by written notice to the others.

12.04. **Attorneys' Fees.** In the event of any litigation concerning this Agreement between the parties to this Agreement or the parties to this Agreement and the estate of any deceased Shareholder, the prevailing party shall be entitled, in addition to any other relief that may be granted, to reasonable attorneys' fees.

12.05. **Binding on Successors and Assigns.** This Agreement shall be binding on the parties to the Agreement, and on each of their heirs, executors, administrators, successors, and assigns.

12.06. **Severability.** If any provision is unenforceable or invalid for any reason, the remaining provisions shall be unaffected by such a holding.

12.07. **Governing Law.** This Agreement shall be construed according to and governed by the laws of the State of California.

12.08. **Sole Agreement.** This instrument constitutes the only Agreement of the parties regarding the sale and purchase of their shares in the Corporation, and correctly sets forth the rights, duties, and obligations of each to the other. Any prior agreements, promises, negotiations, or representations concerning the Agreement's subject matter not expressly set forth in this Agreement are of no force or effect.

12.09. **Agreement Available for Inspection.** An original copy of this Agreement duly executed by the Corporation and by each of the Shareholders shall be delivered to the Secretary of the Corporation and maintained by the Secretary at the principal office of the Corporation available for inspection by any person requesting to see it.

Executed on _____[*date*], at _____[*city*], _____[*county*], California.

THE CORPORATION

_____
[*typed name of corporation*]
[*address of principal office of corporation*]

_____
[*signature of president*]
[*typed name and title*]
_____ [*signature of secretary*]
[*typed name and title*]
THE SHAREHOLDERS
[*Repeat as required:*]

_____
[*signature*]
[*typed name*]

[*Add, if necessary:*]

EXHIBIT _____

[*If all parties to the Agreement and their share holdings are not enumerated in the Preamble, add this information as Exhibit _____:*]

EXHIBIT _____

[*If the initial value of the Corporation is to be set by mutual agreement and the dollar amount is not specified in Section 10.02, add this information as Exhibit _____:*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART IV. FORMS
B. Cross-Purchase Agreements

4-8D California Legal Forms--Transaction Guide §§ 8D.211-8D.219

[Reserved]

§§ 8D.211[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART IV. FORMS
C. Life Insurance Funding Provisions

4-8D California Legal Forms--Transaction Guide § 8D.220

§ 8D.220 Life Insurance Funding Provisions for Entity Purchase Agreement

[1] Comment

[a] Use of Form

This form includes provisions for funding an entity purchase agreement with life insurance. These provisions may be inserted, when appropriate, into an entity purchase agreement. For an example of a basic entity purchase agreement, see *§ 8D.200*. For an example and discussion of an entity purchase agreement for a professional corporation that includes an insurance funding provision, see Ch. 12A, *Professional Corporations* .

If an agreement funded with life insurance is administered by a trustee, the corporation remains the owner of the policies. However, the trustee is then the designated beneficiary. For further discussion of the use of a trustee in Shareholder agreements, see Ch. 8C, *Close Corporation Shareholder Agreements* .

[b] Life Insurance Funding

[i] Advantages

Life insurance funding provides a corporation or its shareholders with ready cash to meet their obligations under the agreement. Life insurance may be especially useful during the early years of the corporation's existence, when other funds may not be readily available for share purchase in the event of a shareholder's death [*see* Sarner, *Uses of Life Insurance in Buy-Sell Agreements: Stockholder-Corporation Obligations in Buy-Sell Agreements*, 24 N.Y.U. Tax. Inst. 591 (1966)]. Permanent insurance with a cash equity buildup feature may provide the funds for a lifetime purchase of shares upon such events as a shareholder's disability, retirement, desire to sell, or termination from employment, although term life insurance, however, will provide funding only for purchase on death [*see § 8D.71[2][d]*]. Without insurance funding, a shareholder selling shares during his or her lifetime must often accept promissory notes and rely on the financial responsibility of the purchaser [*see* Sexton, *Providing Security for the Outgoing Stockholder and Avoiding Tax Disadvantages to Selling and Remaining Stockholders*, 24 N.Y.U. Tax. Inst. 555, 560 (1966)].

Types of life insurance products and alternate insurance possibilities are discussed in *§ 8D.71*.

[ii] Potential Disadvantages of Funding Entity Purchase Agreement with Life Insurance

The corporation generally is not taxed on the life insurance proceeds it receives on the death of a shareholder [*I.R.C. § 101(a)(1)*], whether the proceeds used to purchase the decedent's stock are paid to the corporation, which then pays them to the decedent's estate, or to the shareholder's estate in satisfaction of the corporation's obligation to purchase the decedent's stock [*see Victor G. Mushro (1968) 50 T.C. 43* , nonacq. 1970-2 C.B. xxii; § 8D.48 [2]]. However, the corporation's receipt of life insurance proceeds may be subject to alternative minimum tax [*see I.R.C. § 55*; § 8D.48[3]].

In addition, an accumulated earnings tax penalty [*see I.R.C. § 531* et seq.] may be imposed on the corporation if the entity purchase agreement is funded by permanent insurance that generates substantial cash surrender values [*I.R.C. § 535(a)*; *see § 8D.48[4]*]].

Further, if the corporation receives the insurance proceeds and directly purchases the decedent's shares in satisfaction of the remaining shareholders' obligations under the agreement, the amount used to satisfy each shareholder's obligation may be taxable to the shareholder as a constructive dividend [*Wall v. United States (4th Cir. 1947) 164 F.2d 462, 464* ; *see Holsey v. Commissioner (3d Cir. 1958) 258 F.2d 865, 868-869* ; *Rev. Rul. 58-614, 1958-2 C.B. 920* ; *see also § 8D.49[2]*]. Therefore, caution should be exercised in drafting the agreement to avoid the realization of taxable income by the shareholders.

For discussion of the income and estate tax consequences of funding entity purchase agreements with life insurance, see *§§ 8D.48, 8D.60*.

[2] Form

Life Insurance Funding Provisions for Entity Purchase Agreement

PURCHASE OF INSURANCE ON SHAREHOLDERS' LIVES

1.01. **Purchase Obligation**. In order to assure that all or a substantial part of the purchase price for the shares of a deceased shareholder will be available immediately in cash upon his or her death, the Corporation shall purchase and maintain in full force and effect a life insurance policy on the life of each other Shareholder in the amounts specified in Exhibit _____. Each life insurance policy is described in Exhibit _____ and made a part of this Agreement by this reference.

1.02. **Beneficiary and Owner of Policies.** The Corporation shall be the beneficiary and sole owner of all policies issued to it subject to this Agreement. As long as this Agreement is in effect, the Corporation agrees to maintain that insurance in full force and effect and pay all premiums on all policies issued to it subject to this Agreement.

1.03. **Additional or Substituted Insurance.** The Corporation shall have the right to procure additional policies on the lives of the Shareholders and make those policies subject to this Agreement in order to keep the value of the life insurance policies owned by the Corporation and subject to this Agreement substantially equal to the value of the shares subject to this Agreement. All additional policies for this purpose shall be owned by the Corporation and made payable to it. Other policies may be substituted for any policies made subject to this Agreement, and any policies subject to this Agreement may be withdrawn. Any addition, substitution, or withdrawal of policies shall be endorsed and signed by the Corporation and Shareholders and attached to this Agreement as Exhibit _____.

1.04. **Election to Terminate in Absence of Insurance.** The Corporation and the Shareholders agree that if at any time there is no insurance subject to this Agreement on the life of any Shareholder who is a party to the Agreement, or if any insurance made subject to this Agreement is impaired in value so that it would not provide at any time proceeds at

least equal to _____[*specifiy percentage, e.g.,* 100] percent of the face amount of that insurance, any Shareholder may at that time elect to terminate this Agreement by giving written notice to that effect to the Corporation and to the other Shareholders in the manner prescribed in _____[*notice provision elsewhere in agreement, e.g. (for agreement in § 8D.200[2])* Section 12.03].

1.05. **Disposition of Unneeded Insurance Policies.** If this Agreement is terminated for any of the reasons described in _____[*e.g. (for agreement in § 8D.200[2]),* Article 11], each Shareholder shall have an option for _____[*e.g.*, 60] days after termination to purchase any life insurance policies on his or her own life owned by the Corporation that at the time of termination were subject to this Agreement. Any shareholder who sells all of his or her shares in the Corporation under the terms and conditions set forth in _____[*e.g. (for agreement in § 8D.200[2]),* Articles 3, 4, 6, 7] shall also have an option for _____[*e.g.*, 60] days after that sale to purchase any policies on his or her own life owned by the Corporation that at the time of sale were subject to this Agreement. This option shall be exercised by serving written notice on the Corporation, as prescribed in _____[*notice provision elsewhere in agreement, e.g. (for agreement in § 8D.200[2])* Section 12.03], and paying the purchase price in cash. The purchase price shall be a price equal to the amount of the cash surrender value of the policy, reduced by any unpaid loans made against the policy. Any policy not purchased by the Shareholders within the _____[*e.g.*, 60]-day time period may be surrendered for its cash value or otherwise disposed of by the Corporation.

[*Add following additional exhibit at end of agreement:*]

EXHIBIT _____

[*Attach description of life insurance policies, or the attach copies of policies. If actual policies are not attached, add:*]

The following life insurance policies are made subject to this Agreement:

[*For each policy, provide name of insurer, policy number, name of insured, amount of policy, date of purchase, name of owner, and signature of owner*]

The following life insurance policies have been withdrawn from, and are no longer subject to, this Agreement:

[*For each withdrawn policy, provide name of insurer, policy number, name of insured, amount of policy, date of purchase, name of owner, and signature of owner*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsShareholdersTransfers of SharesTax LawFederal Taxpayer GroupsC CorporationsAccumulated Earnings Tax (IRC secs. 531-537)Imposition of TaxesTax LawFederal Income Tax ComputationAlternative Minimum Tax (IRC secs. 55-59)Tax LawFederal Income Tax ComputationDeductions for Business ExpensesGeneral OverviewInsurance LawLife InsuranceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART IV. FORMS
C. Life Insurance Funding Provisions

4-8D California Legal Forms--Transaction Guide § 8D.221

§ 8D.221 Life Insurance Funding Provisions for Cross-Purchase Agreement

[1] Comment

[a] Use of Form

This form includes provisions for funding a cross-purchase agreement with life insurance. These provisions may be inserted, when appropriate, into a cross-purchase agreement. For an example of a basic cross-purchase agreement, see *§ 8D.210*.

If an agreement funded with life insurance is administered by a trustee, the corporation remains the owner of the policies. However, the trustee is then the designated beneficiary. For further discussion of the use of a trustee in shareholder agreements, see Ch. 8C, *Close Corporation Shareholder Agreements* .

[b] Life Insurance Funding

[i] Advantages

Life insurance funding provides a corporation or its shareholders with ready cash to meet their obligations under the agreement. Life insurance may be especially useful during the early years of the corporation's existence, when other funds may not be readily available for share purchase in the event of a shareholder's death [*see* Sarner, *Uses of Life Insurance in Buy-Sell Agreements: Stockholder-Corporation Obligations in Buy-Sell Agreements*, 24 N.Y.U. Tax. Inst. 591 (1966)]. Permanent insurance with a cash equity buildup feature may provide the funds for a lifetime purchase of shares on such events as a shareholder's disability, retirement, desire to sell, or termination from employment, although term life insurance will provide funding only for purchase on death [*see § 8D.71[2][d]*]. Without insurance funding, a shareholder selling shares during his or her lifetime must often accept promissory notes and rely on the financial responsibility of the purchaser [*see* Sexton, *Providing Security for the Outgoing Stockholder and Avoiding Tax Disadvantages to Selling and Remaining Stockholders*, 24 N.Y.U. Tax. Inst. 555, 560 (1966)].

Types of life insurance products and alternate insurance possibilities are discussed in *§ 8D.71*.

[ii] Potential Disadvantages of Funding Cross-Purchase Agreement with Life Insurance

Although the proceeds of an insurance policy generally are not includable in the gross income of the recipient [*I.R.C. § 101(a)(1)*], if there has been a previous transfer of the policy to the shareholder, the proceeds of the policy exceeding the amount paid for transfer and subsequent premiums and other amounts paid by the transferee will be subject to ordinary income tax on the death of the insured shareholder, unless the transfer is made to the person whose life is insured by the policy or to the corporation [*I.R.C. § 101(a)(2)*; *see § 8D.13[3][b]*]. Such a result occurs when the recipient was not the original purchaser of the policy, but purchased it from another shareholder who died or left the corporation. This form avoids this problem by allowing remaining shareholders to purchase from a departing or deceased shareholder only those policies on his or her own life [*see* Section 1.07, *below*]. Before modifying this paragraph, the drafter should carefully consider the tax consequences of transfers of insurance policies.

For further discussion of the income and estate tax consequences of funding cross-purchase agreements with life insurance, see *§§ 8D.49, 8D.60[4]*.

[2] Form

Life Insurance Funding Provisions for Cross-Purchase Agreement

PURCHASE OF INSURANCE ON SHAREHOLDERS' LIVES

1.01. **Purchase Obligation.** To assure that all or a substantial part of the purchase price for the shares of a deceased shareholder will be available immediately in cash upon his or her death, each Shareholder shall purchase and maintain in full force and effect a life insurance policy on the life of each other Shareholder in the amounts specified in Exhibit _____, which is attached to and made part of this Agreement. Each life insurance policy is listed in Exhibit _____; and any additional life insurance policies acquired under this Agreement shall also be listed in Exhibit _____ and shall be subject to the terms of this Agreement.

1.02. **Shareholders as Beneficiaries of Policies.** Each Shareholder shall be the beneficiary of all policies procured by him or her on the life of the other Shareholders and made subject to this Agreement.

1.03. **Shareholders as Owners of Policies.** Each Shareholder shall be the owner of all policies purchased by him or her on the life of the other Shareholders, and each Shareholder agrees to pay the premiums on the policies owned by him or her as they become due for as long as this Agreement is in effect. Each Shareholder shall give proof of payment of each premium on a policy owned by him or her to the insured at least _____[*e.g.,* 10] days before the due date of each premium. If any premium is not paid within _____[*e.g.,* 10] days after its due date, the insured Shareholder shall have the right to pay that premium and be reimbursed by the Owner-Shareholder.

1.04. **Shareholders' Rights under Policies.** Each Shareholder agrees that he or she will not exercise any of the rights, privileges, and benefits accruing under the policies owned by him or her except as otherwise provided in this Agreement, or assign, encumber, borrow against, or otherwise dispose of the policies without first obtaining the written consent of the insured Shareholder. Each Shareholder authorizes the insurance carrier insuring the life of a Shareholder to give the insured, on his or her written request, any information with respect to the status of the policies on his or her life.

1.05. **Additional or Substituted Insurance.** Each Shareholder shall have the right to procure additional policies on the lives of the other Shareholders and make those policies subject to this Agreement in order to keep the value of the life insurance policies subject to this Agreement substantially equal to the value of the shares subject to this Agreement. Any additional policies shall be owned by the Shareholder procuring them and shall designate that Shareholder the beneficiary of the policy. Other policies may be substituted for any policies subject to this Agreement, and any policies subject to this Agreement may be withdrawn. Any addition, substitution, or withdrawal of policies

shall be endorsed and signed by the Corporation and Shareholders and attached to this Agreement as Exhibit _____.

1.06. **Election to Terminate in Absence of Insurance.** The Shareholders agree that if at any time there is no insurance subject to this Agreement on the life of any Shareholder who is a party to the Agreement, or if any insurance made subject to this Agreement is impaired in value so that it would not provide at any time proceeds at least equal to _____[*specify percentage, e.g.*, 100] percent of the face amount of that insurance, any Shareholder may at that time elect to terminate this Agreement by giving written notice to that effect to the other Shareholders in the manner prescribed in _____[*notice provision elsewhere in agreement, e.g. (for agreement in § 8D.210[2])* Section 12.03].

1.07. **Disposition of Unneeded Insurance Policies.** On the death of any Shareholder, each of the surviving Shareholders shall have the option for _____[*e.g.*, 60] days after the date of death, to purchase the policy or policies of life insurance on his or her own life owned by the estate of the deceased Shareholder. Each Shareholder shall also have the right to purchase the policies on his or her own life within _____[*e.g.*, 60] days after the sale or transfer of all of that Shareholder's shares in the Corporation during his or her lifetime, as provided in this Agreement, or after termination of this Agreement, as provided in _____[*e.g. (for agreement in § 8D.210[2]),* Article 11]. This option shall be exercised by paying in cash to the Shareholder who owns the policy, or to the decedent's estate, a purchase price equal to the cash surrender value of the policy, reduced by any unpaid loans made against the policy. If the option is not exercised within _____[*e.g.*, 60] days after the event permitting this purchase, the policy owner may surrender the policy for its cash value or dispose of it in any other lawful manner.

[*Add following additional exhibit at end of agreement:*]

EXHIBIT _____

[*Attach description of life insurance policies, or the attach copies of policies. If actual policies are not attached, add:*]

The following life insurance policies are made subject to this Agreement:

[*For each policy, provide name of insurer, policy number, name of insured, amount of policy, date of purchase, name of owner, and signature of owner*]

The following life insurance policies have been withdrawn from, and are no longer subject to, this Agreement:

[*For each withdrawn policy, provide name of insurer, policy number, name of insured, amount of policy, date of purchase, name of owner, and signature of owner*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART IV. FORMS
C. Life Insurance Funding Provisions

4-8D California Legal Forms--Transaction Guide §§ 8D.222-8D.229

[Reserved]

§§ 8D.222[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 8D BUY-SELL AGREEMENTS
PART IV. FORMS
D. Miscellaneous Provisions

4-8D California Legal Forms--Transaction Guide § 8D.230

§ 8D.230 Provision for Termination of Seller's Rights as Shareholder Immediately Upon Occurrence of Event Triggering Buy-Sell Agreement

[1] Comment

[a] Use of Form

This form is a provision specifying that a selling shareholder's status as a shareholder will terminate immediately on occurrence of an event triggering a buy-sell agreement, rather than at the subsequent point in time when the consideration for the shares is paid and the shares are actually transferred. This form is intended to be substituted for Section 8.03 of the form in § 8D.201. When this form is used, other modifications to the complete agreement may also be appropriate [*see, e.g., § 8D.200[2],* Sections 4.01, 7.01; *§ 8D.210[2],* Sections 4.01, 7.01, and discussion *below*]. In the absence of a provision such as this form, legal title to the shares ordinarily will *not* pass to the purchaser until consideration is paid or delivery is made to the buyer; thus the seller will remain a shareholder, and may exercise all the rights and privileges of a shareholder, until that time [*Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1173-1174, 69 Cal. Rptr. 2d 764, 947 P.2d 1301* ; *see § 8D.200[2],* Section 8.03 of Form].

Use of a provision such as this form makes sense only when the purchase of shares under a buy-sell agreement is mandatory. When the agreement provides only for a *right*-- but not a *duty*-- on the part of the corporation or other shareholders to purchase the shares [*see, e.g., § 8D.200[2],* Sections 4.01, 7.01; *§ 8D.210[2],* Sections 4.01, 7.01], it would be inappropriate to provide for an immediate termination of shareholder status on occurrence of the event triggering the provisions of the buy-sell agreement, because there is no guarantee at that point that a transfer of shares under the agreement will actually occur. Similarly, if the agreement does not specify the precise number or percentage of the shares that each purchaser is required to buy, use of this provision would not make sense because the exact interest of each purchaser will not be known at the time of the event triggering the buy-sell agreement. Thus, when this provision is used, its application should be limited to circumstances under which the purchase of shares is mandatory, or the remainder of the agreement should be modified to provide for mandatory rather than optional purchase of the shares.

[b] Practical Effect of Form

This form benefits the corporation rather than the selling shareholder. Since the shareholder's status as such is terminated immediately upon occurrence of the event triggering the buy-sell agreement, the selling shareholder thereafter will have no say in the management of the corporation and will have less leverage against potential neglect or overreaching by management [*see Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1177-1178, 69 Cal. Rptr. 2d 764, 947 P.2d 1301]* . Conversely, the corporation will be afforded greater protection against "the risk of disruption from a dissident, disaffected ex-[shareholder]" [*see Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1185* (dissenting opinion), *69 Cal. Rptr. 2d 764, 947 P.2d 1301]* .

[c] Legal Effect of Form

The California Supreme Court has clearly stated that buy-sell agreements may provide that a seller's rights and status as a shareholder terminate immediately upon occurrence of an event triggering the provisions of the agreement [*Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1175 n. 5, 69 Cal. Rptr. 2d 764, 947 P.2d 1301]* . What is somewhat less clear, however, is the exact legal status of the ex-shareholder between the time of occurrence of the event triggering the buy-sell agreement and the time when the consideration is paid for the shares and actual transfer of those shares occurs. Specifically, it is not entirely clear whether, in this situation, title would actually pass upon occurrence of the triggering event, rendering the former shareholder at that point simply a creditor of the corporation [*see Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1186* (dissenting opinion), *69 Cal. Rptr. 2d 764, 947 P.2d 1301* (shareholder should have exercised rights as a creditor of corporation)], or whether the shareholder remains a shareholder but without a shareholder's rights [*see Stephenson v. Drever (1997) 16 Cal. 4th 1167, 1177, 69 Cal. Rptr. 2d 764, 947 P.2d 1301* (stating that such status would be an "anomaly" and noting that some rights of shareholders cannot be limited by corporation's articles or bylaws)]. With this uncertainty in mind, this form intentionally fails to specify whether or not title to the shares will actually pass on occurrence of the triggering event, instead stating merely that the shareholder's rights as such will cease at that time. In addition, the form contains language designed to limit its application in the event it should be held that anything in the provision conflicts with any other provision of law respecting shareholder rights.

[2] Form

Provision for Termination of Seller's Rights as Shareholder Immediately Upon Occurrence of Event Triggering Buy-Sell Agreement

Termination of Shareholder Status. Upon _____[the occurrence of any event that will result in a transfer of shares under this agreement *or specify particular event(s) triggering repurchase obligation under buy-sell agreement, e.g.*, Shareholder's retirement *or* termination of Shareholder's employment with the corporation], Shareholder's status as a shareholder in the corporation thereupon shall immediately terminate, and Shareholder's rights and privileges as a shareholder in the corporation shall immediately cease. Thereafter, during the time between _____[*event triggering purchase and sale obligation under buy-sell agreement, e.g.*, the event resulting in transfer of the shares under this agreement *or* the Shareholder's retirement *or* termination of Shareholder's employment with the corporation] and the actual transfer of Shareholder's shares to Shareholder's successor or successor(s) as provided in this agreement, Shareholder shall be entitled to receive only the value of _____[his *or* her] shares as determined under the provisions of this agreement, and shall no longer be entitled to participate in the corporation or enjoy any of the rights and privileges of a shareholder, including but not limited to the rights to participate in corporate affairs and to receive dividends declared after _____[*event triggering purchase and sale obligation under buy-sell agreement, e.g.*, the event resulting in transfer of the shares under this agreement *or* the Shareholder's retirement *or* termination of Shareholder's employment with the corporation]. This provision shall be inapplicable if, and only to the extent that, it is in conflict with any applicable provision or provisions of law defining or respecting the rights and privileges of shareholders, and, in the event of its partial invalidity, this provision shall continue to apply to the extent that it is not invalid under the applicable provision or provisions of law.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS

4-9 California Legal Forms--Transaction Guide 9.syn

§ 9.syn Synopsis to Chapter 9: DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS

§ 9.01 California Sources

[1] Statutes

[2] Regulations

§ 9.02 Federal Statutes

§§ 9.03-9.04 [Reserved]

§ 9.05 Law Reviews and Periodicals

§ 9.06 Annotations

§ 9.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 9.08-9.09 [Reserved]

§ 9.10 Corporate "Distributions"

[1] Definition

[2] "Dividend"

[3] "Repurchase"

[4] "Redemption"

[5] Determination of Time Distribution Was Made

[6] Amount of Distribution

§ 9.11 Restrictions on Distributions

[1] In General

[2] Retained Earnings Test

[3] Remaining Assets Test

[4] Payment of Obligation Incurred for Share Purchase

[5] General Solvency Test

[6] Tests Protecting Liquidation and Dividend Preferences

[7] Restrictions Imposed by Corporate Instrument

§ 9.12 Exceptions to Financial Tests

[1] Broker-Dealers

[2] Regulated Investment Companies

[3] Real Estate Investment Trusts

[4] Deceased or Disabled Shareholders

[5] Holders in Due Course

§ 9.13 Generally Accepted Accounting Principles and Terms

[1] In General

[2] Corporations With Subsidiaries

[3] "Financial Statements"

[4] "Assets"

[5] "Liabilities"

§ 9.14 Shareholders' Civil Liability for Receiving Improper Distributions

[1] In General

[2] Right to Bring Suit

[3] Non-Exclusive Liability

§ 9.15 Directors' Civil Liability for Making Improper Distributions

[1] In General

[2] Exceptions to General Rule

[3] Persons Entitled to Enforce Liability

[4] Damages, Contribution, and Subrogation

§ 9.16 Directors' Criminal Liability for Improper Distributions

§ 9.17 Other Transactions Affecting Shares

[1] Share Dividends

[2] Share Assessments

§§ 9.18-9.99 [Reserved]

§ 9.100 Dividends, Reacquisition of Shares, and Assessments

[1] Facts

Scope

[2] Documents

Scope

§§ 9.101-9.109 [Reserved]

§ 9.110 General Determinations

Scope

§ 9.111 Determinations Regarding Cash or Property Dividend

Scope

§ 9.112 Determinations Regarding Redemption or Repurchase of Shares

Scope

§ 9.113 Determinations Regarding Share Dividends

Scope

§ 9.114 Determinations Regarding Assessments on Shares

Scope

§§ 9.115-9.119 [Reserved]

§ 9.120 Cash or Property Dividend

[1] Preparing for Declaration of Dividend

Scope

[2] Declaring and Paying Dividend

Scope

§ 9.121 Redemption or Repurchase of Shares

[1] Preparing for Redemption or Repurchase

Scope

[2] Redeeming Shares

Scope

[3] Repurchasing Shares

Scope

§ 9.122 Share Dividend

[1] Drafting Resolution Declaring Dividend

Scope

[2] Declaring and Paying Dividend

Scope

§ 9.123 Assessment of Shares

[1] Levying Assessment

Scope

[2] Giving Notice of Assessment

Scope

[3] Collecting Assessment Before Delinquency Date

Scope

[4] Extending Date for Sale of Delinquent Shares

Scope

[5] Selling Delinquent Shares

Scope

§§ 9.124-9.139 [Reserved]

§ 9.140 Advising Corporation Regarding Tax Consequences of Distribution

Scope

§ 9.141 Effectuating Stock Split

Scope

§§ 9.142-9.199 [Reserved]

§ 9.200 Resolution Declaring Cash Dividend From Retained Earnings

[1] Comment

[a] Use of Form

[b] Board's Declaration of Dividends

[i] Power to Act

[ii] Statutory Financial Limitations

[iii] Limitations Imposed by Corporate Instruments

[iv] Limitations Imposed by Duty of Good Faith

[v] Method of Making Declaration

[c] Shareholders' Right to Dividends

[i] In General

[ii] Record Date

[iii] Vesting of Right

[iv] Preferred Shares

[d] Income Tax Consequences of Cash Dividend

[e] Federal Securities Laws

[2] Form

Resolution Declaring Cash Dividend From Retained Earnings

§ 9.201 Resolution Declaring Cash Dividend From Source Other Than Retained Earnings

[1] Comment

[a] Use of Form

[b] Financial Tests

[c] Notice Requirement

[d] Effect of Dividend Source on Tax Treatment

[2] Form

Resolution Declaring Cash Dividend From Source Other Than Retained Earnings

§ 9.202 Notice to Shareholders of Dividend Paid From Source Other Than Retained Earnings

[1] Comment

[a] Use of Form

[b] Notice Requirement

[2] Form

Notice to Shareholders of Dividend Paid From Source Other Than Retained Earnings

§ 9.203 Resolution Declaring Property Dividend

[1] Comment

[a] Use of Form

[b] Amount of Property Distribution

[i] In General

[ii] Financial Tests

[iii] Federal Income Tax

[2] Form

Resolution Declaring Property Dividend

§ 9.204 Resolution Designating Executive Committee With Power to Declare Dividends

[1] Comment

[a] Use of Form

[b] Designation of Committees

[c] Committee Meetings

[2] Form

Resolution Designating Executive Committee With Power to Declare Dividends

§§ 9.205-9.219 [Reserved]

§ 9.220 Resolution Declaring Redemption of Shares

[1] Comment

[a] Use of Form

[b] Nature of "Redemption"

[c] Issuance of Redeemable Shares

[d] Restrictions on Redemption

[i] Financial Tests

[ii] Corporate Instruments

[iii] Directors' Duty of Good Faith

[e] Use of Sinking Fund for Redemption

[f] Terms of Redemption

[g] Record Date

[h] Redemption Procedures

[i] In General

[ii] Giving Notice

[iii] Deposit of Redemption Price

[i] Status of Redeemed Shares

[j] Income Taxation of Redemption

[2] Form

Resolution Declaring Redemption of Shares

§ 9.221 Notice of Redemption

[1] Comment

[a] Use of Form

[b] Statutory Procedure for Redeeming Shares

[c] Contents of Notice

[d] Giving Notice

[2] Form

Notice of Redemption

§ 9.222 Resolution Authorizing Repurchase of Shares

[1] Comment

[a] Use of Form

[b] Share Repurchases

[i] In General

[ii] Restrictions

[iii] Professional Corporations

[iv] Income Taxation

[v] Status of Repurchased Shares

[2] Form

Resolution Authorizing Repurchase of Shares

§§ 9.223-9.229 [Reserved]

§ 9.230 Resolution Declaring Share Dividend--Corporation With One Class of Shares

[1] Comment

[a] Use of Form

[b] Share Dividend

[i] Definition

[ii] Purpose

[iii] Valuation of Shares

[c] Tax Treatment

[i] Receipt of Share Dividend

[ii] Sale of Shares Received as Dividend

[d] Number of Authorized Shares

[e] Record Date

[f] Fractional Shares

[g] Application of Corporate Securities Law

[i] In General

[ii] Stock Dividends That Are Not an "Offer" or "Sale"

[iii] Stock Dividends Subject to Qualification

[2] Form

Resolution Declaring Share Dividend--Corporation With One Class of Shares

§ 9.231 Resolution Declaring Share Dividend--Corporation With More Than One Class of Shares

[1] Comment

[a] Use of Form

[b] Classes and Series

[c] Corporate Securities Law Requirement

[d] Income Taxation of Share Dividends

[2] Form

Resolution Declaring Share Dividend--Corporation With More Than One Class of Shares

§ 9.232 Resolution Declaring Share Dividend and Approving Amendment to Articles--Corporation With One Class of Shares

[1] Comment

[a] Use of Form

[b] Amendment of Articles

[c] Share Dividend Distinguished From Stock Split

[i] In General

[ii] Accounting Treatment

[iii] Shareholder Approval Requirements

[iv] Securities Law Implications

[2] Form

Resolution Declaring Share Dividend and Approving Amendment to Articles--Corporation With One Class of Shares

§§ 9.233-9.239 [Reserved]

§ 9.240 Resolution Levying Assessment

[1] Comment

[a] Use of Form

[b] Power to Levy Assessment

[c] Application of Securities Laws

[d] Levy and Sale Procedures

[e] Notice of Assessment

[f] Transfer of Shares

[2] Form

Resolution Levying Assessment

§ 9.241 Notice of Assessment

[1] Comment

[a] Use of Form

[b] Contents of Notice

[c] Service of Notice

[2] Form

Notice of Assessment

§ 9.242 Extension of Sale Date

[1] Comment

[a] Use of Form

[b] Extension of Sale Date

[2] Form

Extension of Sale Date

§ 9.243 Certificate of Sale of Delinquent Shares

[1] Comment

[a] Use of Form

[b] Sale as Remedy

[c] Sale or Forfeiture of Delinquent Shares

[i] In General

[ii] Surrender and Reissuance of Share Certificates

[iii] Surrender of Uncertificated Securities

[iv] Securities Issues

[d] Certificate of Sale

[e] Effect of Sale Irregularity

[2] Form

Certificate of Sale of Delinquent Shares



91 of 141 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS

4-9 California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter covers corporate distributions to shareholders, including cash and property dividends, share redemptions, and share repurchases. It also discusses the related topics of share dividends and assessments. The Legal Background examines the laws generally applicable to different types of corporate distributions, and considers the accounting concepts and terms applicable to those distributions. The Transaction Guide provides lists of information and documents needed to make a corporate distribution, determinations that the attorney should make with respect to the distribution, and procedures for effectuating the distribution or related transaction. The Forms section includes board resolutions and related notices to shareholders. Each form comment covers the issues specifically applicable to that type of corporate distribution or transaction.

For discussion of corporate distributions upon dissolution, see Ch. 12, *Winding Up and Dissolution* . For coverage of the procedures the board of directors must follow to take corporate action, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* . For general discussion of corporate shares, see Ch. 6, *Securities Regulation Issues* , and Ch. 6I, *Issuance of Equity Securities* . For basic coverage of corporate accounting and financial procedures, see Ch. 7, *Corporate Records and Reports* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-9 California Legal Forms--Transaction Guide § 9.01

§ 9.01 California Sources

[1] Statutes

Accounting statements required to be prepared in accordance with generally accepted accounting principles. *Corp. Code § 114.*

"Certificated security" defined. *Corp. Code § 156.1.*

"Distribution to its shareholders" defined. *Corp. Code § 166.*

"Redemption price" defined. *Corp. Code § 180.*

"Reverse stock split" defined. *Corp. Code § 182.*

"Stock split" defined. *Corp. Code § 188.*

"Uncertificated security" defined. *Corp. Code § 191.1.*

Corporation's power to repurchase its outstanding shares. *Corp. Code § 207(d).*

Board of directors' exercise of corporate powers. *Corp. Code § 300.*

Directors' duties and liabilities. *Corp. Code § 309.*

Designation of board committees. *Corp. Code § 311.*

Civil liability of corporate directors for improper corporate distributions. *Corp. Code § 316.*

Redeemable shares. *Corp. Code § 402*.

Issuance of fractional shares and alternatives. *Corp. Code § 407*.

Authority for issuance of share dividends. *Corp. Code § 409(a)(2)*.

Assessment of shares. *Corp. Code § 423*.

Restrictions on corporate distributions. *Corp. Code §§ 500-511*.

Retained earnings and remaining assets tests. *Corp. Code § 500*.

General insolvency test. *Corp. Code § 501*.

Liquidation preference test. *Corp. Code § 502*.

Dividend preference test. *Corp. Code § 503*.

Exemption to distribution restrictions for purchase or redemption of shares funded by life or disability insurance proceeds. *Corp. Code §§ 503.1-503.2*.

Exemption to distribution restrictions for regulated investment company and registered open-end investment company. *Corp. Code § 504*.

Restrictions on distribution imposed by articles, bylaws, or agreement. *Corp. Code § 505*.

Civil liability of shareholders for receiving improper distribution. *Corp. Code § 506*.

Notice of dividend from source other than retained earnings. *Corp. Code § 507*.

Distribution in liquidation or dissolution exempt from distribution restrictions. *Corp. Code § 508*.

Procedure for redemption of shares. *Corp. Code § 509*.

Status of redeemed or repurchased shares. *Corp. Code § 510*.

Rights of holder in due course of instrument issued for purchase or redemption. *Corp. Code § 511*.

Record date for determining shareholders of record. *Corp. Code § 701*.

Amendment of articles of incorporation. *Corp. Code §§ 900-911*.

Criminal liability of corporate directors for dishonest or fraudulent distribution to shareholders. *Corp. Code § 2253*.

Corporate Securities Law of 1968. *Corp. Code §§ 25000-25706*.

Certain stock dividends excluded from definition of "offer" or "sale" of securities. *Corp. Code § 25017(f)*.

Certain stock splits exempt from qualification. *Corp. Code § 25103(f)*.

[2] Regulations

Definition of stock dividend. *10 Cal. Code Reg. § 260.017*.

Definition of voting stock. *10 Cal. Code Reg. § 260.017.1*.

Definition of stock split. *10 Cal. Code Reg. § 260.103.2*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-9 California Legal Forms--Transaction Guide § 9.02

§ 9.02 Federal Statutes

Securities Act of 1933. *15 U.S.C. §§ 77a-77aa*.

Securities Exchange Act of 1934. *15 U.S.C. §§ 78a-78ll*.

Amount of corporate distribution. *I.R.C. § 301*.

Stock redemptions. *I.R.C. § 302*.

Taxation of shareholders' receipt of stock dividends. *I.R.C. § 305*.

Sale of shares received as dividends. *I.R.C. § 306*.

Effect of distribution on corporation. *I.R.C. § 311*.

Effect of distribution on earnings and profits. *I.R.C. § 312*.

Definition of dividend. *I.R.C. § 316*.

Definition of property and redemption. *I.R.C. § 317*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART I. RESEARCH GUIDE
A. Primary Sources

4-9 California Legal Forms--Transaction Guide §§ 9.03-9.04

[Reserved]

§§ 9.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-9 California Legal Forms--Transaction Guide § 9.05

§ 9.05 Law Reviews and Periodicals

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-9 California Legal Forms--Transaction Guide § 9.06

§ 9.06 Annotations

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-9 California Legal Forms--Transaction Guide § 9.07

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART I. RESEARCH GUIDE
B. Secondary Sources

4-9 California Legal Forms--Transaction Guide §§ 9.08-9.09

[Reserved]

§§ 9.08[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART II. LEGAL BACKGROUND

4-9 California Legal Forms--Transaction Guide § 9.10

§ 9.10 Corporate "Distributions"

[1] Definition

A corporation's "distribution to its shareholders" is defined as either of the following: [*Corp. Code § 166*]

(1) The transfer of cash or property by a corporation to its shareholders without consideration, whether by way of a dividend or otherwise [*see* [2], *below*], except for a dividend in shares of that corporation [*see § 9.17[1]*]; or

(2) The purchase or redemption by a corporation of its own shares for cash or property [*see* [3], [4], *below*].

Such a transfer, purchase, or redemption by a subsidiary of the corporation also falls within the definition of a "distribution" [*Corp. Code § 166*; *see Corp. Code § 189* ("subsidiary" defined as corporation in which parent corporation owns shares possessing more than 50 percent of voting power)].

The following transactions are specifically excluded from the definition of "distribution" [*Corp. Code § 166*]:

(1) Satisfaction of a final judgment of a court or tribunal of appropriate jurisdiction ordering the rescission of the issuance of shares;

(2) The rescission by a corporation of the issuance of its shares, if the board determines that (a) it is reasonably likely that the holder or holders of the shares in question could legally enforce a claim for the rescission, (b) the rescission is in the best interests of the corporation, and (c) the corporation is likely to be able to meet its liabilities (except those for which payment is otherwise adequately provided) as they mature; and

(3) The repurchase by a corporation of shares issued by it under an employee stock purchase plan [*see Corp. Code § 408*], if the board determines that (a) the repurchase is in the best interests of the

corporation, and (b) the corporation is likely to be able to meet its liabilities (except those for which payment is otherwise adequately provided) as they mature.

Throughout this chapter, the term "distribution" has the meaning described in *Corporations Code Section 166*.

[2] "Dividend"

The General Corporation Law does not define the term "dividend." However, that term generally refers to a corporation's payment to its shareholders of corporate profits, as a return on their investment [*see Estate of Talbot (1969) 269 Cal. App. 2d 526, 535, 74 Cal. Rptr. 920]* . Shareholders have no vested right to a dividend until it has been declared by the corporation's board of directors pursuant to resolution [*Miller v. McColgan (1941) 17 Cal. 2d 432, 436, 110 P.2d 419* ; *see § 9.200*]. Although a dividend may take the form of cash or other property, a dividend in the form of the corporation's own shares [*see § 9.17 [1], below*] does not constitute a distribution subject to statutory financial tests [*Corp. Code §§ 166, 500-503*; *see § 9.11*]. For further discussion of dividends, see *§ 9.200*.

[3] "Repurchase"

The term "repurchase" is not defined in the General Corporation Law, either. It traditionally means a corporation's acquisition of its outstanding shares for value, or a subsidiary's acquisition of the parent corporation's shares for value [*see* Ballantine & Sterling, California Corporation Laws, vol. 1, Ch. 8, *Dividends and Reacquisition of Shares*]. *Corporations Code Section 207(d)* specifically grants corporations the power to purchase their own shares, bonds, debentures, and other securities. However, the articles of incorporation, the bylaws, or corporate agreements may limit a corporation's repurchase of its shares [*see Corp. Code § 505*; *see also § 9.11[7]*]. See *§ 9.222[1]* for further discussion of issues specifically applicable to the repurchase of shares.

[4] "Redemption"

Although the General Corporation Law does not define the term "redemption" [*see Corp. Code § 180* ("redemption price" defined)], that term generally means a corporation's reacquisition of outstanding shares pursuant to a right of redemption or repurchase held by the corporation that is one of the rights, preferences, privileges, or restrictions of those particular shares [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares* (Matthew Bender)]. Corporations are specifically authorized to redeem any or all redeemable shares upon proper notice and payment [*see Corp. Code § 509*]. For coverage of issues unique to the redemption of shares, see *§ 9.220[1]*.

[5] Determination of Time Distribution Was Made

A distribution in the form of a dividend is deemed to be made on the date it is declared [*Corp. Code § 166*]. A distribution in the form of a purchase or redemption of shares is deemed to be made on the date that the corporation transfers cash or property to the shareholders, regardless of whether the distribution is made pursuant to a preexisting contract [*Corp. Code § 166*]. However, if the corporation issues securities [*see Comm. Code § 8102* (definition)] in exchange for shares, the distribution is made on the date that the corporation acquires the shares in the exchange [*Corp. Code § 166*]. In the case of a sinking fund payment [*see § 9.220[1][e]*], the corporation is deemed to have transferred cash or property when it delivers the cash or property to a trustee for the holders of preferred shares to be used for the redemption of the shares, or when the corporation physically segregates cash or property in trust for that purpose [*Corp. Code § 166*].

[6] Amount of Distribution

For purposes of the General Corporation Law provisions regarding distributions [*see Corp. Code §§ 500 et seq.*], the amount of any distribution payable in property is determined on the basis of the value at which the property is carried on the corporation's financial statements in accordance with generally accepted accounting principles [*Corp. Code § 500*

; *see Corp. Code § 114* (definition); *see also § 9.13*]. The amount of a distribution, however, may be different for income tax purposes [*see § 9.203[1][b][iii]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesConstructive DividendsBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART II. LEGAL BACKGROUND

4-9 California Legal Forms--Transaction Guide § 9.11

§ 9.11 Restrictions on Distributions

[1] In General

California law no longer restricts the sources from which a corporation may pay dividends [*see* former *Corp. Code § 1500* (repealed by Stats 1975, ch. 682, effective Jan. 1, 1977)], but instead requires the corporation to meet the requirements of several financial tests set forth in the General Corporation Law [*see Corp. Code §§ 500-503*] before it may make any valid "distribution to its shareholders" [*see Corp. Code § 166* (definition); *see also § 9.10[1]*]. First, a corporation must meet either of two basic financial tests, known as the "retained earnings" test [*see Corp. Code § 500(a)*; *see also § 9.11[2]*] and the "remaining assets" test [*see Corp. Code § 500(b)*; *see also § 9.11[3]*]. In addition to these two basic tests, a corporation must meet other tests related to general solvency and liquidation and dividend preferences [*see Corp. Code §§ 501-503*; *see also §§ 9.11[5], [6]*]. However, various exclusions from these financial tests exist [*see § 9.12*]. Whether or not a corporation satisfies these tests is determined in accordance with generally accepted accounting principles [*see Corp. Code §§ 114, 500 et seq.*; *see also § 9.12*].

Since 1977, California law also has not required that in order to make a valid contract for the repurchase of shares, the corporation must meet a financial test at the time the contract is made. The General Corporation Law requires only that a distributions test must be met at the time of making a payment pursuant to such a contract [*Corp. Code §§ 166, 500*]. Cases applying pre-1977 law are no longer apposite insofar as they support the superseded requirement for the corporation to meet a financial test as of the time a repurchase contract is made [*Maudlin v. Pacific Decision Sciences Corp. (2006) 137 Cal. App. 4th 1001, 1009-1012, 40 Cal. Rptr. 3d 724* (contract for stock repurchase through installment payments extending over 10 years was enforceable as and when each installment came due, provided corporation could meet *Corp. Code § 500* distributions test, at that time, for payment of that installment)].

These General Corporation Law restrictions are necessary to impose some control over the corporation's ability to pay dividends to its shareholders. Before the enactment of statutes governing corporate distributions, the United States Supreme Court held that the capital stock of an incorporated company is a fund set apart for the payment of its debts, and substitutes for the personal liability of the owners of an unincorporated business [*Sanger v. Upton (1875) 91 U.S. 56, 60, 23 L. Ed. 220]* . Although this "trust fund" theory has been criticized [*see* Ballantine & Hills, *Corporate Capital and Restrictions Upon Dividends Under Modern Corporation Laws, 23 Calif. L. Rev. 229, 231*-235 (1935)], the capital

of a corporation nonetheless remains the primary source for payment of corporate debts [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares*]. In addition to protecting the corporation's creditors, restrictions on distribution protect preferred shareholders with dividend or liquidation preferences against junior shareholders, and protect all shareholders against mismanagement and impairment of their investment [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares ;* Ballantine & Hills, *Corporate Capital and Restrictions Upon Dividends Under Modern Corporation Laws, 23 Calif. L. Rev. 229, 233 (1935)*].

[2] Retained Earnings Test

A corporation or one of its subsidiaries may make a distribution to the corporation's shareholders if the amount of the retained earnings of the corporation immediately prior to the distribution equals or exceeds the amount of the proposed distribution [*Corp. Code § 500(a)*]. The term "retained earnings" means the accumulated net income earned by a corporation from the date of incorporation or reorganization, less distributions made to shareholders and other charges [*see* H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 5, *Income Statement* (Matthew Bender)].

To determine a corporation's retained earnings, an accountant first obtains the amount of retained earnings as of the beginning of the accounting period from the balance sheet dated on the day preceding the accounting period. He or she then takes the net income or net loss for that period from the income statement for that period, and either adds or subtracts that amount to or from earnings. Finally, the accountant subtracts any extraordinary losses sustained by the corporation during its current accounting period but not reflected on its income statement for that period, and subtracts any dividends declared by the corporation during its current accounting period. The balance remaining is the amount of retained earnings at the end of the accounting period [Z. Cavitch, Business Organizations With Tax Planning, Ch. 95, *Corporate Accounting (Matthew Bender); see* H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 11, *Corporation Accounting* (Matthew Bender)].

[3] Remaining Assets Test

A corporation or one of its subsidiaries may make a distribution to the corporation's shareholders if, immediately after giving effect to the distribution, both of the following apply [*Corp. Code § 500(b)*; *see § 9.13* (accounting terms of art defined)]:

> (1) The sum of the corporation's assets (excluding goodwill, capit alized research and development expenses, and deferred charges) would be at lea st equal to 1 1/4 times its liabilities (not including deferred taxes, deferred income, and other deferred credits); and
>
> (2) The corporation's current assets would be at least equal to its current liabilities; or at least equal to 1 1/4 times its current liabilities, if the average of the corporation's earnings before taxes on income and before interest expense for the two preceding fiscal years was less than the average of the interest expense of the corporation for those fiscal years.

The second half of this test, however, does not apply to a corporation that does not classify its assets into current and fixed under generally accepted accounting principles [*Corp. Code § 500(b)*; *see Corp. Code § 114*; *see also § 9.13[1]*].

In determining the amount of corporate assets, profits derived from an exchange of assets will not be included unless the assets received are currently realizable in cash [*Corp. Code § 500*]. Furthermore, the term "current assets" [*see § 9.13[4]*] may include net amounts that the board has determined in good faith may reasonably be expected to be received from customers during the 12-month period used in calculating current liabilities pursuant to existing contractual relationships that obligate those customers to make fixed or periodic payments (or, in the case of a public utility corporation, pursuant to service connections with customers), after giving effect to future costs not then included

in current liabilities but reasonably expected to be incurred by the corporation in performing those contracts (or providing service to utility customers) [*Corp. Code § 500*].

[4] Payment of Obligation Incurred for Share Purchase

When applying either of the two basic tests to a distribution of cash or property as payment (in whole or in part) of an obligation incurred in connection with the purchase of its shares, any amount deducted from retained earnings at the time the obligation was incurred (not exceeding the principal of the obligation remaining unpaid immediately prior to the distribution) must be added to retained earnings. Similarly, any amount added to liabilities at the time the obligation was incurred (not exceeding the principal of the obligation that will remain unpaid after the distribution) must be deducted from liabilities [*Corp. Code § 500*].

[5] General Solvency Test

In addition to passing either the retained earnings or remaining assets test, a corporation must pass a "general solvency" test before making a distribution to the shareholders. Under that test, neither a corporation nor any of its subsidiaries may make a distribution to the corporation's shareholders if the corporation or subsidiary making the distribution is, or as a result of the distribution would be, likely to be unable to meet its liabilities as they mature, except those liabilities whose payment is otherwise adquately provided for [*Corp Code § 501*].

[6] Tests Protecting Liquidation and Dividend Preferences

Neither a corporation nor any of its subsidiaries may make a distribution to the corporation's shareholders on any shares of its stock of any class or series that are junior to outstanding shares of any other class or series with respect to distribution of assets on liquidation unless, after giving effect to the distribution, the excess of its assets over its liabilities would equal or exceed the liquidation preference of all shares having a preference on liquidation over the class or series to which the distribution is made [*Corp. Code § 502*; *see § 9.200[1]*]. For purposes of this test, "assets" do not include goodwill, capitalized research and development expenses, and deferred charges; "liabilities" do not include deferred taxes, deferred income, and other deferred credits [*Corp. Code § 502*; *see § 9.13[4], [5]*]. However, with respect to a distribution by a corporation of cash or property in payment by the corporation in connection with the purchase of its shares, the corporation must deduct from liabilities all amounts that had been previously added with respect to the obligations incurred in connection with the corporation's repurchase of its shares and reflected on the corporation's balance sheet, but not exceeding the principal of the obligation that will remain unpaid after the distribution; further, the corporation may not deduct from liabilities for any obligation that is a distribution to its shareholders when the obligation is incurred [*Corp. Code § 502*].

Similarly, neither a corporation nor any of its subsidiaries may make a distribution to the corporation's shareholders on any shares of its stock of any class or series that are junior to outstanding shares of any other class or series with respect to payment of dividends, and as to which senior class or series the corporation has cumulative dividends in arrears, unless the amount of the retained earnings of the corporation immediately before the distribution equals or exceeds the sum of (1) the amount of the proposed distribution and (2) the aggregate amount of the cumulative dividends in arrears on all shares having a preference with respect to payment of dividends over the class or series to which the distribution is made [*Corp. Code § 503*]. With respect to a distribution of cash or property in payment by the corporation in connection with the purchase of its shares, the corporation must add to retained earnings all amounts that had been previously deducted with respect to the obligations incurred in connection with the corporation's repurchase of its shares and reflected on the corporation's balance sheet, but not exceeding the principal of the obligation that remain unpaid immediately prior to distribution; further, the corporation may not add to retained earnings on account of any obligation that is a distribution to its shareholders when the obligation is incurred [*Corp. Code § 503*].

However, the rights, preferences, privileges, and restrictions of preferred shares [*see Corp. Code § 176* (definition)] may

provide that the restrictions described above [*see Corp. Code §§ 502, 503*] do not apply in whole or part with respect to distributions on shares junior to the class or series [*Corp. Code § 402.5(c)*]. That provision permits flexibility for proposed issuees of preferred stock who are willing to forgo the statutory protections [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares* (Matthew Bender)].

[7] Restrictions Imposed by Corporate Instrument

The General Corporation Law permits a corporation to provide additional restrictions on the declaration of dividends or the purchase or redemption of the corporation's own shares, pursuant to provisions (1) in its articles, (2) in its bylaws, or (3) in any indenture or other agreement entered into by the corporation [*Corp. Code § 505*]. For example, senior preferred shares and corporate debt instruments often contain specific contractual restrictions on distributions [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares* (Matthew Bender)].

Legal Topics:

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART II. LEGAL BACKGROUND

4-9 California Legal Forms--Transaction Guide § 9.12

§ 9.12 Exceptions to Financial Tests

[1] Broker-Dealers

The retained earnings and remaining assets tests [*see Corp. Code § 500*; *see also § 9.11[2], [3]*] do not apply to a corporation licensed as a broker-dealer [*see Corp. Code §§ 25210-25220*] if the corporation, immediately after giving effect to any distribution, is in compliance with the net capital rules of the Commissioner of Corporations [*see 10 Cal. Code Reg. § 260.216.12*] and the Securities and Exchange Commission [*Corp. Code § 500(c)*; *see 17 C.F.R. § 240.15c3-1*]. Those rules require broker-dealers to limit aggregate indebtedness to a certain percentage of his or her net capital [*see 17 C.F.R. § 240.15c3-1*; *10 Cal. Code Reg. § 260.216.12*].

[2] Regulated Investment Companies

The retained earnings and remaining assets tests [*see Corp. Code § 500*; *see also § 9.11[2], [3]*] do not apply to any dividend declared by a regulated investment company [*see I.R.C. § 851* (definition)] to the extent that the dividend is necessary to maintain the status of the corporation as a regulated investment company under the provisions of the Internal Revenue Code [*Corp. Code § 504(a)(1)*; *see I.R.C. §§ 851-855*]. None of the restrictions on "distributions" [*see Corp. Code §§ 500-511*] apply to any purchase or redemption of shares redeemable at the option of the holder by a registered open-end investment company [*see 15 U.S.C. § 80a-5(b)*] under the United States Investment Company Act of 1940 [*see 15 U.S.C. §§ 80a-1-80a-64*], as long as the right of redemption remains unsuspended under the provision of that Act and the corporation's articles and bylaws [*Corp. Code § 504(b)*].

[3] Real Estate Investment Trusts

The retained earnings and remaining assets tests [*see Corp. Code § 500*; *see also § 9.11[2], [3]*] do not apply to any dividend declared by a real estate investment trust [*see I.R.C. § 856* (definition)] to the extent that the dividend is necessary to maintain the status of the corporation as a real estate investment trust under the provisions of the Internal Revenue Code [*Corp. Code § 504(a)(2)*; *see I.R.C. § 856 et seq.*].

[4] Deceased or Disabled Shareholders

None of the statutory financial tests [*see Corp. Code §§ 500-503*; *see also § 9.11 [2]*] apply to the purchase or redemption of shares of a deceased or disabled shareholder from the proceeds of life or disability insurance, respectively, on that shareholder in excess of the total amount of all premiums paid by the corporation for that insurance, in order to carry out the provisions of an agreement between the corporation and that shareholder to purchase or redeem those shares on the death or disability (as defined in the policy) of the shareholder [*Corp. Code §§ 503.1*, *503.2*]. For these purposes, "disability insurance" means an agreement of indemnification against the insured's loss of the ability to work due to accident or illness [*Corp. Code § 503.2*].

[5] Holders in Due Course

Notwithstanding the General Corporation Law provisions governing corporate distributions [*see Corp. Code §§ 500-511*], a holder in due course [*see Com. Code § 3302* (defined as a holder who takes an instrument for value, in good faith, without notice that it is overdue, dishonored, or subject to defenses or claims)] of a negotiable instrument issued by a corporation for the purchase or redemption of shares, or a person who acquired the instrument through that holder, may enforce the instrument if he or she did not receive notice that it was issued for that purpose [*Corp. Code § 511*]. Rather than providing an actual exception from the restrictions on corporate distribution, *Corp. Code § 511* deprives the corporation of the defense to payment based on its inability to make a distribution at the time the instrument is payable [*see Corp. Code §§ 500-503* (financial tests)]. It eliminates conflicts between the restrictions on distributions set forth in the Corporations Code and the rights of holders in due course set forth in the Commercial Code [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares* (Matthew Bender)].

Legal Topics:

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART II. LEGAL BACKGROUND

4-9 California Legal Forms--Transaction Guide § 9.13

§ 9.13 Generally Accepted Accounting Principles and Terms

[1] In General

The General Corporation Law provides that all references in its provisions to financial statements, balance sheets, income statements, and statements of cash flows of a corporation, as well as all references in it to assets, liabilities, earnings, retained earnings, and similar accounting items, mean the financial statements prepared and accounting items determined in accordance with "generally accepted accounting principles" then applicable, subject to any specific accounting treatment set forth in the General Corporation Law. Financial statements other than annual statements may be condensed or otherwise presented as permitted by authoritative accounting pronouncements [*Corp. Code § 114*]. Regarding how a court may be expected to deal with the reference to generally accepted accounting principles, see *Ch. 7, Corporate Records and Reports, § 7.31[5][a]*.

"Generally accepted accounting principles" is a term of art used to describe the financial accounting rules and procedures generally acceptable at a given time [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares* (Matthew Bender)]. There is no single authoritative source used to determine generally accepted accounting principles. Those principles are simply accounting practices that have evolved over the years, and, through repeated use, have become generally accepted among accountants. The Financial Accounting Standards Board (FASB) and, before 1973, boards of the American Institute of Certified Public Accountants (AICPA), have given these practices greater authority through their pronouncements [*see* H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 1, *Financial Statements: Objectives and Components; Auditor's Opinion* (Matthew Bender)]. The FASB issues "Statements" and "Interpretations" that have a binding effect on accountants [*see* Cavitch, Business Organizations with Tax Planning, Ch. 95, *Corporate Financial and Tax Accounting* (Matthew Bender)].

In applying generally accepted accounting principles to determine whether a corporation is able to meet the required financial tests [*see Corp. Code §§ 500-503; see also § 9.11*] and thus entitled to make a valid distribution to its shareholders [*see Corp. Code § 166*], the board of directors should use only financial data prepared by an accountant. Furthermore, the board should rely on the accountant's determination of whether or not the corporation meets all applicable financial tests. These practices are necessary in light of the rapidly changing standards of accounting [*see* Ballantine & Sterling, California Corporation Laws, vol. 1, Ch. 8, *Dividends and Reacquisition of Shares*].

[2] Corporations With Subsidiaries

With respect to corporations with subsidiaries [*see Corp. Code § 189(a)* ("subsidiary" defined as corporation in which parent corporation owns shares possessing more than 50 percent of voting power)], the General Corporation Law provides that (1) any reference to financial statements means the consolidated statements of the corporation and any of its subsidiaries that are required to be included under generally accepted accounting principles then applicable, and (2) any reference to accounting items means those items as determined on a consolidated basis in accordance with those consolidated financial statements, unless otherwise expressly stated [*Corp. Code § 114*]. A consolidated financial statement is a financial statement that covers the operations of both the parent corporation and its wholly owned subsidiaries [H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 1, *Financial Statements: Objectives and Components; Auditor's Opinion* (Matthew Bender)].

An accurate presentation of the financial condition of the economic unit as a whole can only be made in consolidated financial statements prepared from the data of both parent and subsidiary corporations. The preparation of a consolidated financial statement involves a process of adjustment that essentially cancels out the effects of any intercorporate transactions [*see* Z. Cavitch, Business Organizations With Tax Planning, Ch. 95, *Corporate Financial and Tax Accounting* (Matthew Bender)]. Because accounting items of a parent corporation and all subsidiary corporations included in a consolidated financial statement are combined, a liability of one corporation might prevent another corporation from being able to make a distribution to its shareholders. For example, a tort judgment against a subsidiary corporation would reduce the retained earnings and assets of the parent corporation on its consolidated financial statements, and possibly render it unable to pass either the retained earnings or remaining assets test [*see § 9.11*] and thus unable to make a distribution to its shareholders.

[3] "Financial Statements"

Financial accounting is intended to provide a full economic disclosure regarding a business to its owners and creditors. The final product of financial accounting is the financial statement, which includes a balance sheet (listing assets and liabilities on a specified date), an income statement (reporting the corporation's performance over a given period of time), a statement of retained earnings (stating accumulated net income earned from the date of incorporation or reorganization, less distributions), and a statement of cash flow [*see* Z. Cavitch, Business Organizations With Tax Planning, Ch. 95, *Corporate Financial and Tax Accounting* (Matthew Bender)].

[4] "Assets"

A corporation's assets are basically its economic resources, obtained as a result of past transactions [*see* H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 4, *Balance Sheet: Owners' Equity* (Matthew Bender); Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisitions of Shares*]. Assets are classified as either current or noncurrent assets. "Current assets" are assets that are reasonably expected to be realized in cash or sold or consumed during one year, or within the normal operating cycle of the enterprise if it is longer than one year. "Currently realizable in cash" means the asset is capable of being sold into a market [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisitions of Shares*]. Items that are ordinarily considered current assets of a business are cash, marketable securities, notes and accounts receivable, inventories, and prepaid expenses [*see* H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 2, *Balance Sheet: Assets* (Matthew Bender)]. "Noncurrent assets" are all other assets, and are generally further divided into "fixed assets" and "other assets." Fixed assets are those assets that are used in the corporation's business, are not held for sale in the ordinary course of business, and have a useful life of more than one year. Fixed assets include machinery, equipment, and real property. Other noncurrent assets are investments, intangibles, and deferred charges [*see* Z. Cavitch, Business Organizations With Tax Planning, Ch. 95, *Corporate Financial and Tax Accounting* (Matthew Bender)].

The remaining assets test excludes three types of assets from the sum of corporate assets [*see Corp. Code § 500(b); §*

9.11 [3]]. The first type, "goodwill," refers to the difference between the fair market value of a business and the value of its net assets. Goodwill is an intangible asset, derived from favorable attributes such as customer loyalty [*see* Ballantine & Sterling, California Corporation Laws, vol. 1, Ch. 8, *Dividends and Reacquisitions of Shares;* Z. Cavitch, Business Organizations With Tax Planning, Ch. 95, *Corporate Financial and Tax Accounting* (Matthew Bender)]. Because, however, the value of business goodwill is only determined upon sale and may not even appear in the corporate books, it is not considered to be a corporate asset for purposes of determining the corporation's ability to make a distribution to its shareholders [*see Corp. Code § 500(b)*]. The second type of excluded asset is "deferred charges," which are prepayments made prior to the receipt of goods or services. These items will eventually be charged to expenses, that is, amortized over a period of years. Typical deferred charges are insurance premiums, prepaid leases and wages, and organizational expenses. For example, a corporation's organizational charges should not be allocated to any one accounting period, but should be charged over an extended period because the value derived has a long-term benefit [*see* Ballantine & Sterling, California Corporation Laws, vol. 1, Ch. 8, *Dividends and Reacquisitions of Shares;* Z. Cavitch, Business Organizations, With Tax Planning, Ch. 95, *Corporate Financial and Tax Accounting* (Matthew Bender)]. Capitalized research and development expenses, which are often included as part of "deferred charges," are the costs of conducting a planned search for new and useful knowledge that will eventually result in a usable business plan. Because these costs have not yet produced an asset of value, they are charged to expenses as incurred, and excluded from the computation of corporate assets for purposes of the remaining assets test [*see* Ballantine & Sterling, California Corporation Laws, vol. 1, Ch. 8, *Dividends and Reacquisitions of Shares*].

[5] "Liabilities"

A corporation's liabilities are the economic obligations that are recognized and measured in conformity with generally accepted accounting principles, and certain deferred credits [*see* Z. Cavitch, Business Organizations With Tax Planning, Ch. 95, *Corporate Financial and Tax Accounting* (Matthew Bender), citing AICPA § 1025.19]. "Current liabilities" are obligations maturing within one year from the balance sheet date or within the operating cycle of the entity [*see* H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 3, *Balance Sheet: Liabilities* (Matthew Bender); Z. Cavitch, Business Organizations with Tax Planning, Ch. 95, *Corporate Financial and Tax Accounting* (Matthew Bender)]. "Noncurrent liabilities" are those long-term liabilities that mature more than one year after the date of the financial statement [*see* H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 3, *Balance Sheet: Liabilities* (Matthew Bender)].

The remaining assets test excludes three types of liabilities from the sum of corporate liabilities [*see* Corp. Code § 500(b); *see also § 9.11 [3]*]. First, the term "deferred taxes," refers to the difference between the amount of tax ultimately payable for an accounting period and the amount actually paid. Because financial accounting and tax accounting are different [*see* H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 3, *Balance Sheet: Liabilities* (Matthew Bender); Z. Cavitch, Business Organizations with Tax Planning, Ch. 95, *Corporate Financial and Tax Accounting* (Matthew Bender)], a discrepancy between actual taxable income and the amount of income reported for financial accounting purposes may result. Although deferred taxes are a liability, they constitute only an estimate based on current tax law. Changes in the account due to legal or corporate operations are reflected in the year in which they occur [*see* Z. Cavitch, Business Organizations With Tax Planning, Ch. 95, *Corporate Financial and Tax Accounting* (Matthew Bender)]. Second, the terms "deferred income" and "deferred credits" are used interchangeably in accounting to describe obligations resulting from income received for goods or services not yet sold or rendered by the corporation. Prepaid magazine subscriptions, prepaid rentals, and prepaid interest are examples of deferred credits of unearned income. These credits are listed as current or noncurrent liabilities, depending on whether performance of the obligation will take place within one year of the balance sheet date or within the corporation's current operating cycle. When the corporation performs its obligation, that amount is transferred to the retained earnings account [*see* Z. Cavitch, Business Organizations With Tax Planning, Ch. 95, *Corporate Financial and Tax Accounting* (Matthew Bender); Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisitions of Shares*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART II. LEGAL BACKGROUND

4-9 California Legal Forms--Transaction Guide § 9.14

§ 9.14 Shareholders' Civil Liability for Receiving Improper Distributions

[1] In General

Any shareholder who receives a "distribution" [*see Corp. Code § 166* (definition); *see also § 9.10[1]*] prohibited by the General Corporation Law [*see Corp. Code §§ 500-511*], with knowledge of facts indicating the impropriety of the distribution, is liable to the corporation for the benefit of all the creditors or shareholders entitled to bring an action [*see* [2], *below*] for the amount received plus interest at the legal rate on judgments [*see Cal. Const., art. XV, § 1*; *Code Civ. Proc. § 685.010*] until paid [*Corp. Code § 506(a)*]. The shareholder need only know the "facts" that render the distribution improper; he or she need not actually know or believe that the distibution is in fact illegal [*England v. Christensen (1966) 243 Cal. App. 2d 413, 431, 52 Cal. Rptr. 402* (interpreting prior law)]. The shareholder's liability, however, cannot exceed the corporation's liabilities to nonconsenting creditors at the time of the violation, or the injury suffered by nonconsenting shareholders, as the case may be [*Corp. Code § 506(a)*; *see* [2], *below*].

[2] Right to Bring Suit

Any one or more creditors of the corporation (1) whose debts or claims arose prior to the time of the distribution, and (2) who have not consented to the distribution, may bring suit in the name of the corporation to enforce the liability to creditors arising from a violation of *Corporations Code Section 500* or *501* (retained earnings or remaining assets test, or general insolvency test) [*Corp. Code § 506(b)*; *see § 9.11*]. It is irrelevant whether or not the creditors have reduced their claims to judgment [*Corp. Code § 506(b)*].

Any one or more shareholders (1) who hold preferred shares outstanding at the time of distribution, and (2) who have not consented to the distribution, may bring suit in the name of the corporation to enforce the corporation's liability to shareholders arising from a violation of *Corporations Code Section 502* or *503* (prohibiting distribution to shares junior to shares with liquidation or dividend preferences) [*Corp. Code § 506(b)*; *see § 9.11 [6]*]. Shareholders bringing suit need not comply with the requirements normally imposed on shareholder derivative actions, which require shareholders to attempt to have the board bring the action, and to furnish a bond [*Corp. Code § 506(b)*; *see Corp. Code § 800*].

Any shareholder sued for receiving an improper distribution may implead all other shareholders who are liable, and may compel contribution either in the same action or in an independent action against shareholders not joined in the action [

Corp. Code § 506(c)].

For an example and discussion of the complaint used in an action for damages against the shareholders for receiving an improper distribution, see *California Forms of Pleading and Practice, Ch. 164, Corporations: Dividends and Reacquisitions of Shares § 164.51* (Matthew Bender). For an example and discussion of the cross-complaint used to implead other shareholders in the main action to recover damages, see *California Forms of Pleading and Practice, Ch. 164, Corporations: Dividends and Reacquisitions of Shares § 164.52* (Matthew Bender).

[3] Non-Exclusive Liability

The General Corporation Law provisions imposing shareholder liability for receiving improper distributions do not affect any liability that a shareholder may have under the Uniform Fraudulent Transfer Act [*Corp. Code § 506(d)*; *see Civ. Code §§ 3439-3439.12* (applicable to transfers made or obligations incurred after Jan. 1, 1987)]. Under that Act, a creditor is entitled to any of the following remedies for a fraudulent transfer or obligation [*Civ. Code § 3439.07(a)*; *see Civ. Code § 3439.08* (limitations)]:

(1) Avoidance of the transfer or obligation to the extent necessary to satisfy the creditor's claim;

(2) Attachment or other provisional remedy against the asset transferred or its proceeds, in accordance with the procedures set forth in *Code of Civil Procedure Sections 481.010-493.060* [*see* California Forms of Pleading and Practice, Ch. 62, *Attachment* (Matthew Bender)]; or

(3) An injunction against further disposition of the asset, appointment of a receiver, or any other relief required under the circumstances.

Under the Act, there are three main types of fraudulent transfers. The first is a transfer or obligation that the debtor made with actual intent to hinder, delay, or defraud any creditor [*Civ. Code § 3439.04(a)*]. The second is a transfer or obligation that a debtor made without receiving a reasonably equivalent value in the exchange, if the debtor (1) was engaged or about to engage in a business or transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction, or (2) intended to incur (or reasonably should have believed that he or she would incur) debts beyond his or her ability to pay as they became due [*Civ. Code § 3439.04(b)*]. Finally, a transfer or obligation is fraudulent to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor (1) did not receive a reasonably equivalent value in exchange, and (2) was insolvent at that time or became insolvent as a result of the transfer or obligation [*Civ. Code § 3439.05*]. Because the term "transfer" includes every payment of money [*see Civ. Code § 3439.01(i)*], it includes corporate "distributions" [*see Corp. Code § 166* (definition); Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares*].

For further discussion of the Uniform Fraudulent Transfer Act and the types of transfers that are fraudulent as to creditors, see California Forms of Pleading and Practice, Ch. 270, *Fraudulent Conveyances* , (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesPersonal LiabilityBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesRight to Dividends



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART II. LEGAL BACKGROUND

4-9 California Legal Forms--Transaction Guide § 9.15

§ 9.15 Directors' Civil Liability for Making Improper Distributions

[1] In General

The directors of a corporation who approve a "distribution to its shareholders" [*see Corp. Code § 166* (definition); *see also § 9.10 [1]*] that fails to meet the financial tests set forth in the General Corporation Law [*see Corp. Code §§ 500-503*; *see also § 9.11*], are jointly and severally liable to the corporation for the benefit of all creditors or shareholders entitled to enforce that liability [Corp. Code §§ 316(a), (c), 506(b); *see* [3], *below*]. A director who is present at a board or committee meeting at which action authorizing the distribution is taken and who abstains from voting is considered to have approved the distribution [*Corp. Code § 316(b)*].

This general rule imposing liability, however, is subject to two exceptions [*see Corp. Code § 309*; *see also* [2], *below*].

[2] Exceptions to General Rule

A director's civil liability for approving an improper distribution is subject to the exculpatory provisions of *Corporations Code Section 309* [*Corp. Code § 316(a)*]. That section first provides that a director who performs his or her duties in accordance with its provisions [*see* discussion, *below*] will not be liable for any alleged failure to discharge his or her obligations as a director [*Corp. Code § 309(c)*]. Furthermore, it provides that the corporate articles may limit or eliminate a director's liability for monetary damages, to the extent provided in *Corporations Code Section 204(a)(10)* (which prohibits limiting or eliminating personal liability for certain improper actions) [*Corp. Code § 309(c)*]. For an example and discussion of such an article provision, see *Ch. 3, Articles of Incorporation, § 3.280*.

Under *Corporations Code Section 309*, a director must perform his or her duties as a director, including the duties as a member of any committee on which he or she serves, (1) in good faith, (2) in a manner that he or she believes to be in the best interest of the corporation and its shareholders, and (3) with the care (including reasonable inquiry) that an ordinarily prudent person in a like position would use under similar circumstances [*Corp. Code § 309(a)*]. In performing these duties, a director is entitled to rely on information, opinions, reports, or statements (including financial statements and other financial data) that have been prepared or presented by any of the following [*Corp. Code § 309(b)*]:

(1) One or more officers or employees of the corporation whom the director believes to be reliable and competent in the matters presented;

(2) Counsel, independent accountants [*see Corp. Code § 115*], or other persons, as to matters that the director believes to be within that person's professional or expert competence; or

(3) A committee of the board on which the director does not serve, as to matters within its designated authority, which the director believes to merit confidence.

The director may rely on information furnished by the above, however, only when acting in good faith, after reasonable inquiry when the need is indicated by the circumstances, and without knowledge that would cause that reliance to be unwarranted [*Corp. Code § 309(b)*].

[3] Persons Entitled to Enforce Liability

The following persons may bring suit in the name of the corporation against any or all directors liable for approving an improper distribution [*Corp. Code §§ 316(c), 506(b)*]:

(1) Any one or more creditors of the corporation whose debts or claims arose prior to the time of the distribution to shareholders and who have not consented to that distribution, whether or not they have reduced their claims to judgment; or

(2) Any one or more holders of preferred shares outstanding at the time of the distribution who have not consented to the distribution.

Shareholders bringing suit need not comply with the requirements normally imposed on shareholder derivative actions [*Corp. Code §§ 316(c), 506(b)*; *see Corp. Code § 800*; *see also § 9.14[2]*].

For an example and discussion of the complaint used in an action for damages against the directors for approving an improper distribution, see *California Forms of Pleading and Practice, Ch. 164, Corporations: Dividends and Reacquisitions of Shares, § 164.50* (Matthew Bender).

[4] Damages, Contribution, and Subrogation

The damages recoverable from a director are the amount of the illegal distribution. If the illegal distribution consists of property, the recoverable damages are the fair market value of that property at the time of the illegal distribution. In addition, damages include interest (at the legal rate applicable to judgments) on the amount of the distribution or the fair market value of the property, from the date of the distribution until paid, plus any reasonably incurred costs of appraisal or other valuation. However, damages may not exceed (1) the liabilities of the corporation owed to nonconsenting creditors at the time of the violation, and (2) the injury suffered by nonconsenting shareholders, as the case may be [*Corp. Code § 316(d)*].

A director who is sued for approving an improper distribution may implead all other directors who are liable, and may compel contribution either in the same action or in an independent action against directors not joined as parties in that action [*Corp. Code § 316(e)*]. Any director who is held liable for approving an improper distribution is entitled to be subrogated to the rights of the corporation against shareholders who received the distribution [*Corp. Code § 316(f)(1)*]. He or she or may proceed against the person or persons who are liable to the director as a result of the subrogation by either (1) filing a cross-complaint against them in the same action, or (2) bringing an independent action against them [*Corp. Code § 316(f)*].

For examples and discussion of the cross-complaints used for impleading other parties and for subrogation, see *California Forms of Pleading and Practice, Ch. 164, Corporations: Dividends and Reacquisitions of Shares, §§ 164.52, 164.53* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesFiduciary ResponsibilitiesDuty of Good FaithBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesRight to DividendsBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesCauses of ActionMisappropriation of FundsBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesDefensesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersActions Against CorporationsDirect Actions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART II. LEGAL BACKGROUND

4-9 California Legal Forms--Transaction Guide § 9.16

§ 9.16 Directors' Criminal Liability for Improper Distributions

Any director of a corporation who concurs, knowingly and with a dishonest or fraudulent purpose, in any vote or act of the directors to make any dividend or distribution of assets except as permitted by law is guilty of a misdemeanor if the improper dividend or distribution of assets was designed either to defraud creditors or shareholders or to give a false appearance of the value of the corporation's stock, thereby defrauding subscribers or purchasers. The misdemeanor is punishable by a fine up to $1,000, imprisonment for up to one year, or both [*Corp. Code § 2253*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewCriminal Law & ProcedureCriminal OffensesFraudSecurities FraudGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesCauses of ActionFraud



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART II. LEGAL BACKGROUND

4-9 California Legal Forms--Transaction Guide § 9.17

§ 9.17 Other Transactions Affecting Shares

[1] Share Dividends

Normally, a corporation pays dividends to shareholders from its earnings. However, if a corporation has reinvested its earnings in expansion of its plant, equipment, or stock in trade, it may be unable to declare a cash dividend. Instead, it may make a book adjustment to reflect this increase in the shareholders' investment by declaring a "share dividend." Such an adjustment involves issuing new shares of the corporation to the shareholders in proportion to the number of shares each of them already owns in the corporation, and transferring the amount of the dividend from retained earnings to the corporation's capital stock account. Thus, a portion of the corporation's retained earnings are "capitalized" [*see Eisner v. Macomber (1920) 252 U.S. 189, 210, 40 S. Ct. 189, 64 L. Ed. 521]* . A share dividend takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders [*see Eisner v. Macomber (1920) 252 U.S. 189, 202-203, 40 S. Ct. 189, 64 L. Ed. 521]* . Therefore, share dividends do not constitute a "distribution to its shareholders" [*see Corp. Code § 166* (definition); *see also § 9.10 [1]*] requiring compliance with the financial tests set forth in the General Corporation Law [*see Corp. Code §§ 500-503*; *see also § 9.11*]. However, share dividends must comply with the Corporate Securities Law [*see Corp. Code §§ 25000-25706*; *Corp. Code § 25017(f)* (exemption from qualification for "stock dividend"); *see also* Ch. 6I, *Issuance of Equity Securities*]. For further discussion of share dividends, see *§§ 9.230-9.232*.

[2] Share Assessments

In contrast to paying a dividend on its outstanding shares, a corporation may levy an assessment on those shares. The articles of incorporation may grant, with or without limitations, the power to levy assessments on the shares of any class [*see Corp. Code § 204(a)(1)*; *see also* Ch. 6I, *Issuance of Equity Securities*]. When the articles expressly confer that power on the corporation or the board, the board may levy and collect assessments on those shares, subject to any stated limitations [*see Corp. Code § 423(a)*]. That authority is in addition to the corporation's right to recover the unpaid subscription price of the shares, or the remainder of the consideration to be paid [*see Corp. Code § 423(a)*]. Upon notice of the assessment to the shareholder, the assessment becomes a lien upon the shares assessed [*Corp. Code § 423(e)*; *see* Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness*]. For further coverage of share assessments, see *§§ 9.240-9.243*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART II. LEGAL BACKGROUND

4-9 California Legal Forms--Transaction Guide §§ 9.18-9.99

[Reserved]

§§ 9.18[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-9 California Legal Forms--Transaction Guide § 9.100

§ 9.100 Dividends, Reacquisition of Shares, and Assessments

[1] Facts

1. Name of corporation.

2. Date and place of incorporation.

3. Address of principal executive office.

4. Principal business activity.

5. Name, address, and telephone number of each officer and director.

6. Type of corporation:

   a. Close corporation.

   NOTE:
   A "close corporation" is a corporation whose articles of incorporation include the provision that it will have no more than 35 shareholders, and the statement "This corporation is a close corporation" [*Corp. Code § 158(a)*; ***see*** Ballantine & Sterling, California Corporation Laws, vol. 1, Ch. 4, ***Close Corporations***].

   b. Closely held corporation.

   c. Publicly owned corporation.

d. Professional corporation [*see Corp. Code § 13401(b)* (defined)].

7. With respect to outstanding shares:

a. Classes, series, and number of shares in each.

b. Features of each class and series:

(1) Redeemable.

(2) Subject to dividend preferences.

(3) Subject to liquidation preferences.

(4) Assessable.

8. Whether shares are "certificated" or "uncertificated" securities.

NOTE:
"Certificated securities" are shares that are represented by a certificate [*Com. Code § 8102(a)(4)*; ***see*** *Corp. Code § 156.1*; ***see also*** *Com. Code § 8102(a)(15)* (obligations of issuers)]. "Uncertificated securities" are shares that are not represented by a certificate [*Com. Code § 8102(a)(18)*; ***see*** *Corp. Code § 191.1*; ***see also*** *Com. Code § 8102(a)(15)* (obligations of issuers)]. For further coverage, see the discussion under "Share Certificates--Issuance" and subsequent headings in the Legal Background to Ch. 6I, *Issuance of Equity Securities*.

9. Financial requirements of corporate business.

NOTE:
For example, a growing business may need to retain earnings for expansion, while a stable business may not require retained earnings.

10. Name, address, and telephone number of corporation's accountant.

NOTE:
The accountant may be an independent accountant [***see*** *Corp. Code § 115* (definition)], or an employee or officer, such as comptroller, of the corporation.

11. Whether corporation is subsidiary of another corporation, or has subsidiaries.

12. Whether corporation is licensed as broker-dealer in California [*see Corp. Code §§ 25210-25220*; *see also § 9.111*, P 3].

13. Accounting procedures used by corporation in preparing financial statements [*see § 9.13*]:

a. Accounting period:

(1) Fiscal year.

(2) Calendar year.

b. Period used for determining current assets and liabilities.

c. Method of valuing inventory.

d. Method of classifying and valuing accounts receivable.

e. Value, if any, placed on goodwill and other intangible assets.

f. Method used in depreciating fixed and other depreciable corporate assets.

g. Any departures from "generally accepted accounting principles."

14. Proposed corporate action:

a. Cash or property dividend [*see § 9.120*].

b. Repurchase or redemption of shares [*see § 9.121*].

c. Share dividend [*see § 9.122*].

d. Assessment of shares [*see § 9.123*].

e. Stock split [*see § 9.141*].

[2] Documents

1. Articles of incorporation.

2. Bylaws.

3. Most recent financial statement or consolidated financial statement.

NOTE:
In the General Corporation Law, all references to financial statements mean consolidated statements for corporations with subsidiaries [***see*** *Corp. Code § 114*; ***see also*** *§ 9.13[2]*].

4. Record showing both of following with respect to shareholders:

NOTE:
This information is required to be kept at the corporation's principal executive office or at the office of its transfer agent or registrar [*Corp. Code § 1500*].

a. Names, addresses, and telephone numbers.

b. Number and class of shares held by each.

5. Any agreements executed by corporation requiring or limiting:

a. Declaration and payment of dividends.

b. Redemptions.

c. Repurchases.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesConstructive Dividends



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-9 California Legal Forms--Transaction Guide §§ 9.101-9.109

[Reserved]

§§ 9.101[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-9 California Legal Forms--Transaction Guide § 9.110

§ 9.110 General Determinations

1. Determine whether proposed transaction is either of following, constituting a "distribution" to corporation's shareholders [*see Corp. Code § 166*; *see also § 9.10[1]*]:

NOTE:
A corporation cannot make a valid "distribution" to its shareholders unless it is able to pass a series of financial tests [*Corp. Code §§ 500-503*; ***see*** II(B)(2)-(5), ***below***].

a. Transfer of cash or property by corporation to shareholders without consideration.

NOTE:
A dividend of the corporation's own shares is excluded from this category [***see*** *Corp. Code § 166*].

b. Purchase or redemption of shares for cash or property.

NOTE:
The transfer, purchase, or redemption by a subsidiary of the corporation is included in this category [***see*** *Corp. Code § 166*].

2. Determine whether proposed transaction is one of following that is exempt from definition of "distribution" [*Corp. Code § 166*]:

a. Satisfaction of final judgment of court or tribunal of appropriate jurisdiction ordering rescission of share issuance.

b. Rescission by corporation of share issuance, if board determines that:

(1) It is reasonably likely that holder or holders of shares in question could legally enforce claim for rescission;

(2) Rescission is in best interests of corporation; and

(3) Corporation is likely to be able to meet its liabilities (except those for which payment is otherwise adequately provided) as they mature.

c. Repurchase by corporation of shares issued by it under employee stock purchase plan [*see Corp. Code § 408*; *see also* Ch. 3, *Articles of Incorporation*], if board determines that:

(1) Repurchase is in best interests of corporation; and

(2) Corporation is likely to be able to meet its liabilities (except those for which payment is otherwise adequately provided) as they mature.

3. Determine whether board itself or board committee will take proposed action.

NOTE:

A corporation's board of directors may, by resolution adopted by a majority of the authorized number of directors, designate one or more committees to exercise all of the board's authority, with the exception of certain designated powers [*Corp. Code § 311*]. For example, the board cannot empower a committee with the authority to make a distribution except at a rate, in a periodic amount, or within a price range, set forth in the articles of incorporation or determined by the board [*Corp. Code § 311(f)*].

For an example and discussion of a board resolution authorizing an executive committee to declare and pay dividends subject to those limitations, see *§ 9.204*. For applicable procedures, see *§ 9.120[1]*, Paragraph 1.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesConstructive Dividends



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-9 California Legal Forms--Transaction Guide § 9.111

§ 9.111 Determinations Regarding Cash or Property Dividend

NOTE:
These determinations apply to distributions of cash or property other than the corporation's own shares. For determinations applicable to distributions of a corporation's own shares, see *Section 9.113*.

1. Determine proposed amount of dividend to be paid:

a. For purposes of General Corporation Law.

NOTE:
The amount of any distribution payable in property is the value at which the property is carried on the corporation's financial statements, in accordance with generally accepted accounting principles [*Corp. Code § 500*].

b. For federal income tax purposes.

NOTE:
The amount of property distributed to the shareholders is the fair market value of the property on the distribution date, reduced by the amount of liabilities attached or assumed [*I.R.C. § 301(b)*]. The amount treated as a "dividend" is the amount deemed to be paid from the corporation's earnings and profits [*I.R.C. § 301(a), (c), 316(a)*; ***see*** *§ 9.203[1]*].

2. Determine whether corporation can pass either "retained earnings" or "remaining assets" test [*see Corp. Code § 500*]:

NOTE:
Neither a corporation nor its subsidiary may make a valid "distribution" unless it satisfies either one of

these tests [***see*** *Corp. Code § 500*]. Whether or not a corporation satisfies these and the other statutory tests [***see*** PP 3-5, ***below***] is determined in accordance with generally accepted accounting principles [***see*** *Corp. Code §§ 114, 500-511*]. For a discussion of those principles, and coverage of applicable accounting terms of art, see *Section 9.13*.

To ensure that the corporation is able to comply with these and the other statutory financial tests, the corporation should select a competent accountant to make a professional determination of the issue [***see*** *§ 9.120 [1],* P 2]. The board of directors may rely on his or her professional opinion [***see*** *Corp. Code § 309(b)*].

a. Determine whether amount of retained earnings of corporation immediately prior to distribution equals or exceeds amount of proposed distribution [*see Corp. Code § 500(a)*; *see § 9.11 [3]*].

b. Determine whether, immediately after distribution [*see Corp. Code § 500(b)*; *see § 9.11[2]*]:

(1) Sum of corporation's assets would equal at least 1 1/4 times its liabilities; and

NOTE:
For purposes of this test, "assets" do not include goodwill, capitalized research and development expenses, and deferred charges, and "liabilities" do not include deferred taxes, deferred income, and other deferred credits [*Corp. Code § 500(b)*].

(2) Corporation's current assets would at least equal:

NOTE:
The term "current assets" may include net amounts that the board has determined in good faith may reasonably be expected to be received from customers during the 12-month period used in calculating current liabilities pursuant to existing contractual relationships that obligate those customers to make fixed or periodic payments (or, in the case of a public utility corporation, pursuant to service connections with customers), after giving effect to future costs not then included in current liabilities but reasonably expected to be incurred by the corporation in performing those contracts (or providing service to utility customers) [*Corp. Code § 500*].

(a) Its current liabilities; or

(b) If average of corporation's earnings before taxes on income and before interest expense for two preceding fiscal years was less than average of corporation's interest expense for those fiscal years, 1 1/4 times its current liabilities.

NOTE:
The second half of the remaining assets test, this Paragragh (2), however, does not apply to a corporation that does not classify its assets into current and fixed under generally accepted accounting principles [*Corp. Code § 500(b)*; ***see*** *Corp. Code § 114*; ***see also*** *§ 9.13*].

3. Determine whether corporation (or subsidiary making distribution) is, or as result of distribution would be, likely to be unable to meet its liabilities as they mature, other than those for which payment is adequately provided [*Corp. Code § 501*; *see § 9.11[5]*].

NOTE:

Neither the corporation nor its subsidiary may make a valid "distribution" unless it satisfies this test [***see*** *Corp. Code § 501*].

4. Determine whether corporation can pass the liquidation preference test [*see Corp. Code § 502*; § 9.11[6]]:

NOTE:

Neither the corporation nor its subsidiary may make a valid "distribution" unless it satisfies this test [***see*** *Corp. Code § 502*]. The rights, preferences, privileges, and restrictions of preferred shares [***see*** *Corp. Code § 176* (definition)], however, may provide that the liquidation and dividend preference tests [***see*** *Corp. Code §§ 502, 503*; ***see also*** P 5,***below***] do not apply in whole or part with respect to distributions on shares junior to that class or series [*Corp. Code § 402.5(c)*].

a. Determine whether proposed distribution will be made to outstanding shares of any class or series that is junior to another class or series with preference on distribution of assets on liquidation.

b. Determine whether, after giving effect to distribution, excess of corporation's assets over its liabilities would equal or exceed liquidation preference of all shares having preference on liquidation over class or series to which distribution is made.

NOTE:

A corporation can only make a distribution on shares that are junior to shares with a liquidation preference under these circumstances [*Corp. Code § 502*]. For purposes of this test, "assets" do not include goodwill, capitalized research and development expenses, and deferred charges, and "liabilities" do not include deferred taxes, deferred income, and other deferred credits [*Corp. Code § 502*].

With respect to a distribution by a corporation of cash or property in payment in whole or in part of an obligation incurred by the corporation in connection with the purchase of its shares, the corporation must deduct from liabilities any amount that has been added to liabilities at the time the obligation was incurred, but not exceeding the principal of the obligation that will remain unpaid after the distribution [*Corp. Code § 502*].

5. Determine whether corporation can pass the dividend preference test [*see Corp. Code § 503*; § 9.11[6]]:

NOTE:

Neither the corporation nor its subsidiary may make a valid "distribution" unless it satisfies this test [***see*** *Corp. Code § 503*]. The rights, preferences, privileges, and restrictions of preferred shares [***see*** *Corp. Code § 176* (definition)], however, may provide that the liquidation and dividend preference tests [***see*** *Corp. Code §§ 502, 503*; ***see also*** P 4, ***above***] do not apply in whole or part with respect to distributions on shares junior to that class or series [*Corp. Code § 402.5(c)*].

a. Determine whether proposed distribution will be made to outstanding shares of any class or series that is junior to another class or series with preference on payment of dividends and as to which senior class or series the corporation has cumulative dividends in arrears.

b. Determine whether amount of corporation's retained earnings immediately before distribution equals or exceeds sum of:

(1) Amount of proposed distribution; and

(2) Aggregate amount of cumulative dividends in arrears on all shares having preference with respect to payment of dividends over class or series to which distribution is made.

NOTE:
A corporation can only make a distribution on shares that are junior to shares with a dividend preference under these circumstances [*Corp. Code § 503*]. With respect to a distribution of cash or property in payment in whole or in part of an obligation incurred by the corporation in connection with the purchase of its shares, any amount that had been deducted from retained earnings at the time the obligation was incurred, not exceeding the principal of the obligation that remains unpaid immediately prior to the distribution, must be added to retained earnings [*Corp. Code § 503*].

6. Determine whether corporation is subject to any of following exemptions from statutory financial tests [*see Corp. Code §§ 500-503*; *see also* PP 2-5, *above*]:

a. Exemption from retained earnings and remaining assets tests [*see Corp. Code § 500*; *see also* P 2, *above*], applicable when [*Corp. Code § 500(c)*]:

(1) Corporation is licensed as broker-dealer [*see Corp. Code §§ 25210-25220*]; and

(2) Corporation, immediately after giving effect to any distribution, is in compliance with net capital rules of Commissioner of Corporations [*see 10 Cal. Code Reg. § 260.216.12*] and Securities and Exchange Commission [*Corp. Code § 500(c)*; *see 17 C.F.R. § 240.15c3-1*].

NOTE:
Those rules require broker-dealers to limit aggregate indebtedness to a certain percentage of his or her net capital [***see*** *10 Cal. Code Reg. § 260.216.12*; *17 C.F.R. § 240.15c3-1*].

b. Exemption from retained earnings and remaining assets tests [*see Corp. Code § 500*; P 2, *above*], applicable to any dividend declared by regulated investment company [*see I.R.C. § 851* (definition)] to extent that dividend is necessary to maintain its status as regulated investment company under Internal Revenue Code [*Corp. Code § 504(a)(1)*; *see I.R.C. §§ 851*-855].

c. Exemption from retained earnings and remaining assets tests [*see Corp. Code § 500*; *see also* P 2, *above*] applicable to any dividend declared by real estate investment trust [*see I.R.C. § 856* (definition)] to extent that dividend is necessary to maintain its status as real estate investment trust under Internal Revenue Code [*Corp. Code § 504(a)(2)*; *see I.R.C. § 856* et seq.].

d. Exemption from all statutory financial tests [*see Corp. Code §§ 500-503*; *see also* P 2-5, *above*], applicable to any purchase or redemption of shares redeemable at option of the holder by registered open-end investment company [*see 15 U.S.C. § 80a-5(b)*] under the United States Investment Company Act of 1940 [*see 15 U.S.C. §§ 80a-1-80a-64*] when right of redemption remains unsuspended under provision of that Act and corporation's articles and bylaws [*Corp. Code § 504(b)*].

e. Exemption from all statutory financial tests [*see Corp. Code §§ 500-503*; *see also* PP 2-5, *above*], applicable to

purchase or redemption of shares of deceased shareholder from proceeds of insurance on life of that shareholder in excess of total amount of all premiums paid by corporation for that insurance, in order to carry out provisions of agreement between corporation and that shareholder to purchase or redeem those shares on shareholder's death [*Corp. Code § 503.1*].

f. Exemption from all statutory financial tests [*see Corp. Code §§ 500-503*; *see also* PP 2-5, *above*], applicable to purchase or redemption of shares of disabled shareholder from proceeds of disability insurance for that shareholder in excess of total amount of all premiums paid by corporation for that insurance, in order to carry out provisions of agreement between corporation and that shareholder to purchase or redeem those shares on shareholder's disability [*Corp. Code § 503.2*].

NOTE:

For purposes of this exemption, "disability insurance" means an agreement of indemnification against the insured's loss of the ability to work due to accident or illness [*Corp. Code § 503.2*].

g. Exemption from all statutory financial tests [*see Corp. Code §§ 500-503*; *see also* PP 2-5, *above*], applicable to enforcement of negotiable instrument issued by corporation for purchase and redemption of shares, by holder in due course [*see Com. Code § 3302* (defined as a holder who takes an instrument for value, in good faith, without notice that it is overdue, dishonored, or subject to defenses or claims)] or person who acquired instrument through that holder who did not receive notice that it was issued for that purpose [*Corp. Code § 511*].

NOTE:

Rather than providing an actual exception from the restrictions on corporate distribution, *Corporations Code Section 511* deprives the corporation of the defense to payment based on inability to make a distribution at the time the instrument is payable [***see*** *Corp. Code §§ 500-503* (financial tests); § 9.12[4]].

7. Determine whether corporation is subject to any additional restrictions on distributions, imposed pursuant to [*see Corp. Code § 505*; *Corp. Code § 204(d)* (permissive article provisions), 212(b) (permissive bylaw provisions); *see also § 9.11[7]*]:

a. Articles of incorporation.

b. Bylaws.

c. Indenture or other agreement entered into by corporation.

8. Determine whether board's proposed declaration of dividend meets duty of good faith [*see Corp. Code § 309(a)*; *see also § 9.200[1]*].

NOTE:

The directors must perform all of their duties in good faith, in the best interests of the corporation, and with reasonable care [***see*** *Corp. Code § 309(a)*].

9. If board has relied on specified information in deciding to make a dividend, determine whether source was one of following justifying that reliance [*Corp. Code § 309(b)*; *see also § 9.200[1]*]:

NOTE:

The directors are entitled to rely on information, opinions, reports, or statements (including financial statements and other financial data) prepared by any of the following, as long as the directors act in good faith, after reasonable inquiry when indicated by the circumstances, and without knowledge that would

cause that reliance to be unwarranted [*Corp. Code § 309(b)*].

a. Officers or employees of corporation whom directors believe to be reliable and competent in matters presented.

b. Counsel, independent accountants, or other persons as to matters that directors believe to be within those persons' professional or expert competence.

c. Committees of board on which directors do not serve, as to matters within committees' designated authority, which directors believe to merit confidence.

10. Determine whether distribution will be paid from retained earnings or from other source.

NOTE:
A dividend from a source other than retained earnings must be identified in a notice to shareholders [***see*** *Corp. Code § 507*; ***see also*** *§ 9.120 [2]*, P 2]. For an example of a cash or property dividend paid from retained earnings, see *§ 9.200[2]*. For an example of a cash or property dividend paid from retained earnings, see *§ 9.201[2]*.

11. Determine class or series of shares on which dividend will be paid.

12. Determine record date for dividend [*see Corp. Code § 701*]:

NOTE:
Only those persons who are shareholders at the close of business on the record date are entitled to receive notice and to receive the dividend or distribution, notwithstanding any transfer of any shares on the corporation's books after the record date but before the payment date, except as provided by the articles or agreement [*Corp. Code § 701(d)*; ***see*** *Corp. Code § 185* (shareholder defined)].

a. Date specified by [*see Corp. Code § 701(d)*]:

(1) Articles of incorporation.

(2) Agreement.

b. If fixed by board in advance, date that is not more than 60 days nor less than 10 days before date for payment of dividend [*Corp. Code § 701(a)*].

c. If not fixed by board in advance, close of business on whichever day is later [*Corp. Code § 701(b)(3)*]:

(1) Day that board adopts resolution declaring dividend; or

(2) Sixtieth day before the dividend payment date.

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesConstructive Dividends



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-9 California Legal Forms--Transaction Guide § 9.112

§ 9.112 Determinations Regarding Redemption or Repurchase of Shares

NOTE:

Share redemptions and repurchases are related transactions, which both involve a corporation's reacquisition of its shares [***see*** *§ 9.10[3], [4]*]. Like a dividend, a share redemption or repurchase constitutes a "distribution" to the corporation's shareholders that must comply with statutory financial tests [***see*** *Corp. Code §§ 166, 500-503*].

1. For redemption of redeemable shares, determine [*Corp. Code § 402(c)*]:

NOTE:

A corporation may provide in its articles for one or more redeemable classes or series of shares [***see*** *Corp. Code § 402(a)*]. Generally, a corporation is prohibited from issuing or redeeming redeemable common shares except in either of the following circumstances [*Corp. Code § 402(c)*]. For further discussion of redeemable shares, see Ch. 3, ***Articles of Incorporation*** .

a. Whether corporation has class of non-redeemable common shares outstanding; or

b. Whether corporation:
(1) Is open end investment company registered under Investment Company Act of 1940 [*see 15 U.S.C. §§ 80a-1-80a-64*].

(2) Meets both of following criteria:
(a) Has license or franchise from governmental agency to conduct its business, or is member corporation of national securities exchange registered under Securities Exchange

Act of 1934 [*see 15 U.S.C. §§ 78a-78ll*]; and

(b) Its license, franchise, or membership is conditioned on some or all of shareholders possessing prescribed qualifications, to extent necessary to reinstate or prevent loss of license, franchise, or membership.

(3) Is professional corporation [*see Corp. Code § 13401(b)* (definition); *see also* Ch. 12A, *Professional Corporations*].

2. For share repurchase, determine:

a. Whether articles of incorporation limit corporation's power to repurchase outstanding shares [*see Corp. Code § 207(d)*].

b. Whether corporation has entered into buy-sell agreement with shareholders governing terms of repurchase [*see* Ch. 8D, *Buy-Sell Agreements*].

c. Whether corporation is professional corporation subject to Moscone-Knox Professional Corporation Act [*see* Corp. Code §§ 13400-13410 (applicable to corporations engaged in providing services in a single profession)].

NOTE:
A corporation subject to that Act may purchase its own shares without regard to the restrictions set forth in *Corp. Code §§ 500-511* [***see*** PP 4-6, ***below***], if at least one share remains issued and outstanding [*Corp. Code § 13407*]. For coverage of share repurchase by professional corporations, see Ch. 12A, ***Professional Corporations*** .

3. Determine terms of share reacquisition:

a. For share redemption, terms set forth in articles of incorporation [*Corp. Code § 402(b)*].

NOTE:
A share redemption must be made at the price, at the time, and on the terms and conditions stated in the articles of incorporation [*Corp. Code § 402(b)*].

b. For share repurchase, terms set forth in buy-sell agreement with shareholders, if applicable [*see* Ch. 8D, *Buy-Sell Agreements*].

4. Determine whether corporation can pass all financial tests set forth in General Corporation Law [*see Corp. Code §§ 500-503*; *see also § 9.111*, PP 2-5].

NOTE:
The corporation should have a competent accountant make a professional determination of this issue [***see*** *§ 9.121 [1],* P 2].

5. Determine whether corporation is subject to any exemptions from statutory financial tests [*see Corp. Code §§ 500-511*; *see also § 9.111*, P 6].

6. Determine whether corporation is subject to any additional restrictions on distributions set forth in corporate instruments [*see Corp. Code § 505*; *see also § 9.111*, P 7].

7. Determine whether board's proposed declaration of dividend is proper exercise of its discretion [*see Corp. Code § 309(a)*; *see also § 9.111*, P 8].

8. If board has relied on specified information in deciding to redeem or repurchase shares, determine whether reliance is justified [*Corp. Code § 309(b)*; *see also § 9.111*, P 9].

9. Determine source of funds used for redemption or repurchase:

a. Sinking fund [*see § 9.220[1]*].

b. Insurance [*see § 9.222[1]*].

c. Retained earnings [*see § 9.200[1]*].

d. Other source [*see § 9.201[1]*].

10. Determine date for redemption or repurchase.

11. Determine record date for redemption or repurchase [*see Corp. Code § 701*; *see also § 9.111*, P 12].

12. Determine status that shares will have after purchase or redemption [*see Corp. Code § 510*; *see also §9.220[1]*]:

a. Authorized but unissued shares, if articles do not prohibit reissuance of shares.

b. Cancelled shares, if articles prohibit reissuance [*see § 9.121[2]*, P 7].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesConstructive DividendsBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-9 California Legal Forms--Transaction Guide § 9.113

§ 9.113 Determinations Regarding Share Dividends

1. Determine whether corporation has more than one class of voting shares outstanding.

NOTE:
This determination will affect whether or not the corporation needs to qualify or exempt the share dividend [***see*** *Corp. Code § 25017(f)*; ***see also*** P 12, ***below***].

2. Determine whether corporation intends to pay share dividend in shares of the same class or series on which dividends will be declared.

NOTE:
Dividends of a different class or series than the shares on which they are declared are rare, and are beyond the scope of this chapter.

3. Determine approximate amount of retained earnings that corporation wishes to "capitalize."

NOTE:
In order to meet the demands of a growing business, a corporation may have reinvested its earnings in expansion of its plant, equipment, or stock in trade. These reinvested earnings represent accumulated earnings of the corporation, and appear on its balance sheet under "retained earnings." The corporation may make a book adjustment by declaring a share dividend, and transferring the amount of the share dividend [***see*** P 8, ***below***] from retained earning to capital [***see*** *Eisner v. Macomber (1920) 252 U.S. 189, 210, 40 S. Ct. 189, 64 L. Ed. 521* ; ***see also*** *§ 9.230[1]*].

4. Determine whether purpose of transaction is actually to make "stock split" rather than share dividend.

NOTE:

A share dividend and a stock split are similar transactions, to the extent that both increase the number of shares held by shareholders without increasing their equity. However, a share dividend is a method of "capitalizing" retained earnings [***see*** *§ 9.230[1][b][ii]*], while the purpose of a stock split is to increase the number of shares to reduce the price per share without affecting the corporation's financial structure [***see*** *§ 9.232[1][c]*].

If the corporation's intent is, in fact, to effectuate a stock split, the procedures *set forth in § 9.141*.

5. Determine value that each share issued in dividend will have.

NOTE:

This value is generally the fair market value of the share [***see*** *§ 9.230[1]*].

6. Determine number of shares that corporation intends to issue as share dividend.

NOTE:

This number is computed by dividing the value that each new share will have [***see*** P 5, ***above***] into the amount of retained earnings to be capitalized [***see*** P 3, ***above***].

7. Determine whether articles of incorporation authorize number of additional shares to be issued as share dividend.

NOTE:

The articles of incorporation set forth the total number of shares of each class that the corporation is authorized to issue [***see*** *Corp. Code § 202(d), (e)*; ***see also*** *§ 9.230[1][d]*]. If the shares to be issued exceed the number specified in the articles, the board will have to amend the articles of incorporation [***see*** *§ 9.232*].

8. Determine total fair market value of share dividend to be issued.

NOTE:

This amount is the value per share [***see*** P 5, ***above***] multiplied by the number of shares to be issued [***see*** P 6, ***above***].

9. Determine number of outstanding shares for which new dividend share will be issued.

NOTE:

This number is determined by dividing the number of shares that are to be issued as a dividend [***see*** P 6, ***above***] into the number of outstanding shares of the class on which the dividend is to be declared. Ordinarily, the number of dividend shares to be issued is less than the number of outstanding shares of stock on which the dividend will be declared. For example, if 250 new shares are to be issued as a dividend on a class of shares of which there are now 1,000 shares, the corporation will issue a share dividend of one share for every four outstanding shares.

10. Determine which of the following methods will be used to compensate shareholders for any fractional shares due as part of share dividend [*see Corp. Code § 407*]:

NOTE:

Unless a dividend of one new share for each outstanding share is declared [***see*** P 9, ***above***], some shareholders will become entitled to fractions of a share. For example, if a dividend of one new share for every four outstanding shares is declared, a person holding three shares is entitled to three fourths of a share, a person holding two shares is entitled to one half of a share, and a person owning one is entitled to one fourth of a share [***see*** *§ 9.230[1][f]*].

a. Issuance of fractional shares.

NOTE:
A certificate for a fractional share must entitle the owner to exercise voting rights, to receive dividends, and to participate in any of the assets of the corporation in the event of liquidation [***see*** *Corp. Code § 407*].

b. Payment of fair value of fractional shares in cash.

NOTE:
The corporation, however, may not pay cash for fractional shares if that action would result in the cancellation of more than 10 percent of the outstanding shares of any class. A determination by the board of the fair value of fractions of a share will be conclusive in the absence of fraud [***see*** *Corp. Code § 407*].

c. Issuance of scrip or warrants for fractional shares entitling holder to redeem them for full shares upon surrender of scrip or warrants aggregating a full share.

NOTE:
The corporation may issue scrip or warrants subject to the condition that they will become void if not exchanged for full shares before a specified date, to the condition that the shares for which scrip or warrants are exchangable may be sold by the corporation and the proceeds distributed to the holder of the scrip or warrants, or to any other condition that the board imposes [*Corp. Code § 407*]. For an example and discussion of a scrip certificate for a fraction of a share, see *Ch. 6I, Issuance of Equity Securities, § 6I.204* .

11. Determine whether board's proposed declaration of dividend is proper exercise of its discretion [*see Corp. Code § 309(a)*; *see also § 9.111*, P 8].

12. Determine whether proposed share dividend must be qualified under Corporate Securities Law [*see Corp. Code §§ 25000-25706*; *see also* Ch. 6H, *Qualification of Securities*].

a. Determine whether share dividend is excluded from definition of "offer" or "sale" of securities under all of following criteria [*Corp. Code § 25017(f)*]:

NOTE:
Even if the share dividend meets all of the following criteria and therefore is not an offer or sale requiring qualification, shares issued in any stock dividend will be subject to any conditions previously imposed by the Commissioner on the shares with respect to which they are issued [*Corp. Code § 25017(f)*].

(1) It meets following definition of "stock dividend" used for purposes of Corporate

Securities Law [*10 Cal. Code Reg. § 260.017(a)*]:

(a) It is issuance of additional shares (including treasury shares) of issuer to existing shareholders, or to shareholders of a class, pro rata according to shares previously held (except for cash or scrip paid for fractional shares);

(b) No consideration is paid, other than transfer from surplus to stated capital of an amount equal to or greater than par, stated, or market value of shares distributed;

(c) It is not effected by amendment to articles of incorporation stating effect on outstanding shares; and

NOTE:

For discussion of a share dividend effected by an amendment to the articles, see *§ 9.232[1]*.

(d) It is not a stock split [*see 10 Cal. Code Reg. § 260.103.2*; *see also § 9.232[1]*], exchange, or reclassification of shares.

(2) It is payable with respect to common stock solely (except for any cash or scrip paid for fractional shares) in shares of that common stock; and

NOTE:

A stock dividend does not satisfy this requirement if the shareholders are given an option to accept either cash or additional shares of common stock [*10 Cal. Code Reg. § 260.017(b)*].

(3) Corporation has no other class of voting stock outstanding.

NOTE:

"Voting stock" means any stock presently entitling the owner or holder to vote in elections of directors. It does not include any security that entitles the owner or holder to vote in elections of directors only upon the happening of an event or contingency that has not yet occurred [*10 Cal. Code Reg. § 260.017.1*]. A stock dividend will not meet this requirement unless the dividend is payable in shares of voting common stock, and that stock is of the same class as the class upon which the dividend is paid [*10 Cal. Code Reg. § 260.017(c)*].

b. If share dividend is not excluded from definition of "offer" or "sale" of securities under (a), determine whether it must be either [10 Cal. Code Reg. § 260.107(d)]:

(1) Qualified under *Corp. Code §§ 25110* (issuer transactions) or 25120 (recapitalizations and reorganizations); or

NOTE:

For a discussion of qualification, see Ch. 6H, ***Qualification of Securities*** **,**.

(2) Exempted by *Corp. Code §§ 25100, 25102* (exempt issuer securities and transactions), 25103 (exempt recapitalizations and reorganizations), or 25105 (transactions exempt by rule).

NOTE:

For a discussion of these exemptions, see Ch. 6H, ***Qualification of Securities*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesConstructive DividendsBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesStock Splits



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-9 California Legal Forms--Transaction Guide § 9.114

§ 9.114 Determinations Regarding Assessments on Shares

1. Determine whether corporation's articles of incorporation expressly authorize corporation to levy and collect assessments.

NOTE:
Shares are not assessable unless the articles expressly confer the authority to levy and collect assessments [*Corp. Code § 423(a)*].

2. Determine whether corporation's articles contain any limitations on assessment.

NOTE:
The board's authority to levy and collect assessments is subject to any limitations set forth in the articles [*Corp. Code § 423(a)*].

3. Determine whether board's decision to levy assessment is made in good faith, in best interests of corporation.

NOTE:
The directors must perform their duties in good faith, in a manner believed to be in the best interests of the corporation and its shareholders, with the care that an ordinarily prudent person in a like position would use under similar circumstances [*Corp. Code § 309(a)*; ***see*** Ch. 5, ***Directors' Meetings, Actions, and Resolutions***].

4. If more than one class or series of shares is assessable, determine which shares will be assessed.

5. Determine amount of proposed assessment.

6. Ascertain when notice of assessment will be given.

7. Determine date on which levy becomes lien on assessed shares [*Corp. Code § 423(e)*]:

a. Time of levy itself, if provided in articles of incorporation.

b. Time of personal service or publication of notice of assessment [*see Corp. Code § 423(d)*; *see also § 9.123[2]*].

8. Determine date (or process for establishing date if agency proceedings or filings are required for assessment) when assessment will become payable [*see Corp. Code § 423(b)*].

9. Determine date on which assessment becomes delinquent, which is [*see Corp. Code § 423(b)*]:

a. Not less than 30 days from payment date [*see* P 8, *above*]; and

b. Not more than 60 days from payment date.

10. Determine date for sale of delinquent shares, which is [*see Corp. Code § 423(b)*]:

a. Not less than 15 days from delinquency date [*see* P 9, *above*]; and

b. Not more than 60 days from delinquency date.

11. Determine whether sale date will be extended (postponed) for either of following reasons [*Corp. Code § 423(f)*]:

a. Sale is restrained by court order.

b. Board resolves to postpone date for any other reason.

NOTE:
The board may extend the sale date from time to time, subject to certain time restrictions [*Corp. Code § 423(f)*; ***see*** *§ 9.123[4]*].

12. Determine place of sale of delinquent shares [*Corp. Code § 423(b)*; *see Corp. Code § 213*]:

NOTE:
The place fixed for the sale must be in the county where the corporation is required to keep a copy of its bylaws [*Corp. Code § 423(b)*; ***see*** *Corp. Code § 213*].

a. County where corporation's principal executive office in California is located.

b. County where corporation's principal business office in California is located, if principal executive office is outside California.

c. County of Sacramento, if corporation has neither principal executive office nor principal business office in California.

13. Determine time of sale of delinquent shares [*Corp. Code § 423(b)*].

14. Determine whether corporation has remedy other than sale or forfeiture of delinquent shares [*Corp. Code § 423(n)*]:

NOTE:
The only remedy for collection of an assessment on unpaid shares is sale or forfeiture, unless both of the following conditions exist [*Corp. Code § 423(n)*].

a. Ascertain if either of following expressly authorize remedy by action:

(1) Original articles or amendment of articles adopted before August 21, 1933; or

(2) Amendment of articles adopted after August 21, 1933 by unanimous shareholder consent.

b. Determine whether statement of remedy appears on face of any share certificate issued after August 21, 1933.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-9 California Legal Forms--Transaction Guide §§ 9.115-9.119

[Reserved]

§§ 9.115[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-9 California Legal Forms--Transaction Guide § 9.120

§ 9.120 Cash or Property Dividend

[1] Preparing for Declaration of Dividend

1.If board wishes to delegate its power to make distributions to executive committee [*see Corp. Code § 311*; *see § 9.204[2]*]:

NOTE:
For further coverage of board committees, see *Ch. 5,* ***Directors' Meetings, Actions, and Resolutions****, § 5.245*.

a. Have majority of authorized number of directors adopt resolution designating committee to exercise board's authority to make distributions.

b. Ensure that resolution includes one of following limitations on amount of distribution:

NOTE:
The board cannot empower a committee with the authority to make a distribution [***see*** *Corp. Code § 166* (definition); ***see also*** *§ 9.10 [1]*], unless it limits the committee's authority to make a distribution [*Corp. Code § 311(f)*].

(1) Limitation on rate of distribution.

(2) Limitation on periodic amount of distribution.

(3) Limitation on distribution to price range set forth in articles or determined by board.

c. Ensure that committee consists of at least two directors.

2. Have corporation's accountant give determination as to whether corporation can make valid "distribution to its shareholders" pursuant to statutory financial tests [*see Corp. Code §§ 166, 500-503*; *see also § 9.111*, PP 2-5].

NOTE:

Because of the constant changes taking place in accounting practices, the board should obtain the professional opinion of an accountant regarding the application of "generally accepted accounting principles" to these financial tests [***see*** Ballantine & Sterling, California Corporation Laws, Ch. 8, ***Dividends and Reacquisition of Shares ;*** § 9.13 (Matthew Bender)]. The board of directors may rely on his or her professional opinion [***see*** *Corp. Code § 309(b)*; ***see also*** *§ 9.111*, P 9].

3. If corporation is able to make valid "distribution to its shareholders" [*see* P 2, *above*], draft board resolution that includes all of following:

NOTE:

There is no prescribed form for board resolutions [***see*** *Ch. 5,* ***Directors' Meetings, Actions, and Resolutions****, § 5.240*].

a. Board's receipt of financial statement from independent certified public accountant or other person [*see, e.g., § 9.200[2]*].

b. Board's determination that corporation is able to pay dividend without violating statutory financial tests [*see Corp. Code §§ 500-503*] or other corporate restrictions set forth in articles, bylaws, or agreements [*see, e.g., § 9.200[2]*; *see Corp. Code § 505*].

c. Board's reliance on professional opinion of accountant regarding corporation's financial status [*see, e.g., § 9.200[2]*].

d. Board's determination that declaration of dividend is in best interests of corporation [*see, e.g., § 9.200[2]*].

e. Declaration of dividend, including:

(1) Class or series of shares on which dividend is declared [*see, e.g., § 9.200[2]*].

(2) Either:

(a) For cash dividend, amount of dividend per share [*see, e.g., § 9.200[2]*].

(b) For property dividend, description of property [*see, e.g., § 9.203[2]*].

(3) Date and place dividend is payable [*see, e.g., § 9.200[2]*].

f. Source from which dividend will be paid:

(1) Retained earnings [*see, e.g., § 9.200[2]*].

(2) Other source [*see, e.g., § 9.201[2]*].

g. Record date for determining shareholders entitled to dividend [*see Corp. Code § 701*; *see also § 9.111*, P 12; *see, e.g., § 9.200[2]*].

h. Authority for corporate officers to take any actions necessary to carry out resolution [*see, e.g., § 9.200[2]*].

i. If corporation must give notice to shareholders regarding dividend [*see Corp. Code § 507*; § 9.111, P 10], authority for corporate officer to give notice separately or with dividend payment [*see, e.g., § 9.201[2]*].

[2] Declaring and Paying Dividend

1. Have corporation's board of directors adopt resolution declaring dividend [*see §§ 9.200[2], 9.201[2], 9.203[2]*; *see also § 9.120[1]*].

NOTE:
The resolution must be adopted by a majority of the directors present at a duly held meeting at which a quorum is present, or by written consent [*Corp. Code § 307(a)(8), (b)*; ***see*** *Corp. Code §§ 310, 317(e)*; ***see also*** Ch. 5, ***Directors' Meetings, Actions, and Resolutions***].

2. If corporation will pay dividend from source other than retained earnings [*Corp. Code § 507*]:

a. Prepare notice that states [*see § 9.202*]:
(1) That dividend is made from source other than retained earnings; and

(2) Accounting treatment of dividend.

b. Give notice:

(1) Together with dividend check; or

(2) Within three months after end of fiscal year in which divided is paid.

3. Have corporate officers pay dividend to shareholders on record date [*see Corp. Code § 701*; *see also § 9.111*, P 12].

4. Ensure that corporate officers reflect payment of dividend from appropriate source on corporate books.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesConstructive Dividends



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-9 California Legal Forms--Transaction Guide § 9.121

§ 9.121 Redemption or Repurchase of Shares

[1] Preparing for Redemption or Repurchase

1.If applicable, have board delegate its power to make distribution to executive committee [*see Corp. Code § 311*; *see also § 9.120[1]*, P 1].

2. Have corporation's accountant give determination as to whether corporation can make valid "distribution to its shareholders" pursuant to statutory financial tests [*see Corp. Code §§ 166, 500-503*; *see also § 9.112*, PP 4, 5].

NOTE:
The board of directors may rely on his or her professional opinion [***see*** *Corp. Code § 309(b)*; ***see also*** *§ 9.111*, P 9].

[2] Redeeming Shares

NOTE:
Subject to statutory financial restrictions [***see*** *§ 9.120[1]*, P 2, ***above***] and any other restrictions imposed by corporate instrument [***see*** *Corp. Code § 505*; ***see also*** *§ 9.112*, P 6], a corporation may redeem its redeemable shares according to the procedures set forth in its articles, or, if none, according to statutory procedures [***see*** *Corp. Code § 509*]. This Subsection is a guide to the statutory procedures.

1. Draft board resolution for redemption of shares that states all of following [*see Corp. Code § 509*; § 9.220[2]]:

NOTE:
There is no prescribed form for board resolutions [***see*** *Ch. 5,* ***Directors' Meetings, Actions, and Resolutions****, § 5.240*].

a. Description of redeemable shares.

b. Board's receipt of financial statement from independent certified public accountant or other person.

c. Board's determination that corporation is able to pay dividend without violating statutory financial tests [*see Corp. Code §§ 500-503*] or other corporate restrictions set forth in articles, bylaws, or agreements [*see Corp. Code § 505*].

d. Board's reliance on professional opinion of accountant regarding corporation's financial status.

e. Board's determination that redemption is in best interests of corporation.

f. Declaration of redemption, including:
(1) Class or series of shares subject to redemption.

(2) Redemption price per share.

(3) Redemption date.

(4) Place for surrender of certificated securities [*see Corp. Code § 156.1*; *Com. Code § 8102(a)(4)*].

g. Record date for determining shareholders of shares to be redeemed [*see Corp. Code § 701*; *see also § 9.112*, P 11].

h. Authorization for giving notice of redemption [*see* P 2, *below*].

i. Authorization for deposit of redemption funds and payment instructions with selected bank or trust company.

j. Authorization for corporate officers to take any actions necessary to carry out resolution.

2. Have board adopt resolution.

NOTE:
The resolution must be adopted by a majority of the directors present at a duly held meeting at which a quorum is present, or by written consent [*Corp. Code § 307(a)(8), (b)*; ***see*** *Corp. Code §§ 310, 317(e)*; ***see also*** Ch. 5, ***Directors' Meetings, Actions, and Resolutions***].

3. Draft notice of redemption, setting forth all of following [*see Corp. Code § 509(b)*; *see also § 9.221*]:

a. Class or series of shares or part of any class or series to be redeemed.

b. Date fixed for redemption.

c. Redemption price.

d. If shares are certificated securities [*see Corp. Code § 156.1*; *Com. Code § 8102(a)(4), (15)* (defined as shares evidenced by certificate)], place at which shareholders may obtain payment of redemption price upon surrender of their share certificates.

4. If shares to be redeemed are uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)* (defined as shares not represented by certificate)], draft officer's certificate setting forth following information, as shown on corporate books [*Corp. Code § 509(d)(2)*]:

NOTE:
An officer's certificate is a certificate signed and verified by the chairman of the board, the president or any vice president, and by the secretary, chief financial officer, or any assistant secretary or assistant treasurer [*Corp. Code § 173*].

a. Holders of uncertificated securities registered on books of corporation; and

b. Number of shares held by each shareholder.

5. Have board or trust company give notice to shareholders as follows:

a. Publish notice in newspaper of general circulation in county where corporation's principal executive office is located [*Corp. Code § 509(b)*]:

(1) At least once a week for two successive weeks.

(2) On any day of each week.

(3) Beginning no earlier than 60 days and no later than 20 days before date fixed for redemption.

b. Mail copy of notice no earlier than 60 days and no later than 20 days before date fixed for redemption to each person that, as of date of mailing or record date, held shares to be redeemed [*Corp. Code § 509(c)*; *see Corp. Code § 701* (record date)], to:

NOTE:
However, failure to comply with this mailing requirement does not invalidate the share redemption [*Corp. Code § 509(c)*].

(1) Address appearing on corporate books;

(2) Address given by shareholder for purposes of notice; or

(3) If neither of above applies, principal executive office.

6. Have corporation deposit with selected bank or trust company all of following, on or before redemption date [*Corp.*

Code § 509(d)]:

NOTE:
The shares will be redeemed and the dividends on those shares will cease to accrue as of the date of deposit, if the corporation deposits the following with any bank or trust company, as a trust fund [*Corp. Code § 509(d)*].

a. Sum sufficient to redeem, on date fixed for redemption, shares called for redemption.

b. In case of any uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)* (defined)], officer's certificate [*see Corp. Code § 173* (defined)] setting forth [*see* P 4, *above*]:

NOTE:
In determining the holders of uncertificated securities, the bank or trust company is entitled to rely on any officer's certificate deposited pursuant to the above procedure [*Corp. Code § 509(d)*].

(1) Holders of those securities registered on corporate books; and

(2) Number of shares held by each.

c. Irrevocable instructions and authority to bank or trust company to:

(1) Publish notice of redemption (or to complete publication if already begun); and

(2) Pay before, on, or after date fixed for redemption, redemption price of shares to their respective holders, upon:
(a) With respect to certificated securities [*see Corp. Code § 156.1*; *Com. Code § 8102(a)(4), (15)* (defined as shares evidenced by certificate)], surrender of share certificates; or

(b) With respect to uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)*] delivery of officer's certificate [*see* P 4, *above*].

7. On acquisition of redeemed shares, if articles prohibit reissuance of acquired shares [*see § 9.112*, P 12], have corporation [*Corp. Code § 510(b), (c)*]:

NOTE:
If the articles do not prohibit reissuance, the redeemed shares are restored to the status of authorized but unissued shares [*Corp. Code § 510(a)*].

a. Amend articles to reflect elimination of, or reduction in, authorized shares.

NOTE:
See *§ 9.220[1]* for discussion of the status of the redeemed shares after reacquisition.

b. If all authorized shares of any class or series are acquired, or board determines to eliminate class or

series, amend articles to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that class or series.

c. File certificate of amendment in same manner as any other amendment to articles [*see Corp. Code §§ 900-911*; *see also* Ch. 10, *Amendment of Articles*].

NOTE:
However, the approval of the outstanding shares [***see*** *Corp. Code §§ 152* (definition), 903 (approval requirement)] is not required [*Corp. Code § 510(f)*].

[3] Repurchasing Shares

NOTE:
Subject to any limitations in its articles [***see*** *Corp. Code § 505*; ***see also*** *§ 9.111*, P 7] and its ability to pass the statutory financial tests [***see*** *Corp. Code §§ 166, 500-503*; ***see also*** *§ 9.121[1]*, P 2], a corporation may repurchase its own shares [*Corp. Code § 207(d)*]. It may enter into a buy-sell agreement with its shareholders before any repurchase [***see*** *Corp. Code § 402(d)*]. This subsection assumes that the corporation has entered into a buy-sell agreement and that the repurchase will be accomplished pursuant to its terms. For considerations involved in drafting a buy-sell agreement, see Ch. 8D, ***Buy-Sell Agreements*** .

1. Draft board resolution for repurchase of shares, including all of following [*see § 9.222*]:

NOTE:
There is no prescribed form for board resolutions [***see*** *Ch. 5,* ***Directors' Meetings, Actions, and Resolutions*** *§ 5.240[1]*].

a. Board's receipt of financial statement from independent certified public accountant or other person.

b. Board's determination that corporation is able to repurchase shares without violating statutory financial tests [*see Corp. Code §§ 500-503*] or other corporate restrictions set forth in articles, bylaws, or agreements [*see Corp. Code § 505*].

c. Board's reliance on professional opinion of accountant regarding corporation's financial status.

d. Board's determination that repurchase is in best interests of corporation.

e. Declaration of repurchase.

f. Terms of repurchase.

g. Record date for determining shareholders of shares to be repurchased [*see Corp. Code § 701*; *see also § 9.112*, P 12].

h. Authority for corporate officers to take any actions necessary to carry out resolution.

2. Have board adopt resolution.

NOTE:
The resolution must be adopted by a majority of the directors present at a duly held meeting at which a quorum is present, or by unanimous written consent [*Corp. Code § 307(a)(8), (b)*; ***see*** *Corp. Code §§ 310, 317(e)*; ***see also*** Ch. 5, ***Directors' Meetings, Actions, and Resolutions***].

3. Have corporate officers obtain funds for repurchase according to terms of buy-sell agreement.

4. Have corporate officers purchase shares upon surrender of share certificates, for certificated securities [*see Corp. Code § 156.1*; *Com. Code § 8102(a)(4), (15)* (defined as shares represented by certificate)].

5. Upon acquisition of repurchased shares, if articles prohibit reissuance of acquired shares [*see § 9.112*, P 12], have corporation take appropriate actions to reflect reduction in authorized shares [*see Corp. Code § 510(b)*].

NOTE:
For a list of applicable procedures, see *§ 9.121[2]*, P 7.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDisposition of Reacquired SharesBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-9 California Legal Forms--Transaction Guide § 9.122

§ 9.122 Share Dividend

[1] Drafting Resolution Declaring Dividend

NOTE:

For examples of resolutions declaring share dividends, see *§ 9.230 et seq*.

If the number of shares issued in a stock dividend is so great that it materially reduces the market value of the outstanding shares, it may be considered a "stock split" rather than a "share dividend" for accounting purposes [***see*** Ballantine & Sterling, California Corporation Laws, Ch. 8, ***Dividends and Reacquisitions of Shares*** (Matthew Bender); ***see also*** *§ 9.232[1][c][iv]*]. If, however, the corporation actually intends to effectuate a stock split rather than a share dividend [***see*** *§ 9.113*, P 4], the procedures *set forth in § 9.141*, rather than those in this subsection, should be used.

1. State board's determination that declaration of dividend is in best interests of corporation [*see Corp. Code § 309(a)*; *see also § 9.113*, P 11].

2. Set forth declaration of dividend, including [*see § 9.113*, PP 6, 8, 9]:

a. Number of outstanding shares on which one dividend share will be issued [*see, e.g., § 9.230*].

b. If applicable, class of outstanding shares on which dividend is declared [*see, e.g., § 9.231*].

c. Number of new shares to be issued [*see, e.g., § 9.230*].

d. If applicable, class of new shares to be issued [*see, e.g., § 9.231*].

3. State record date for dividend, which must be [*see Corp. Code § 701*; *see also § 9.230[1]*]:

a. If fixed by board in advance, not more than 60 days nor less than 10 days prior to date dividend is payable [*Corp. Code § 701(a)*].

b. If board has not fixed date in advance, close of business on whichever is later [*Corp. Code § 701(b)(3)*]:

(1) Date that board of directors adopts resolution declaring dividend; or

(2) Sixtieth day prior to date fixed for payment of dividend.

4. Specify date on which dividend is payable.

5. Set forth estimated fair market value of each dividend share, and total fair market value of entire share dividend [*see § 9.113*, PP 5, 8].

6. State manner in which corporation will compensate shareholders for fractional shares [*Corp. Code § 407*; *see § 9.113*, P 10; *see, e.g., § 9.230*]:

a. Issuance of fractional shares.

b. Cash payment.

c. Scrip or warrants.

7. If qualification of dividend shares by Commissioner of Corporations (or exemption from qualification) is required [*see § 9.113*, P 12], add provision directing and authorizing corporate officers to apply for that qualification or exemption [*see, e.g., § 9.231*].

8. Include provision directing and authorizing chief financial officer to transfer total fair market value of share dividend [*see § 9.113*, P 8] from retained earnings to capital account [*see, e.g., § 9.230*].

9. Add provision directing and authorizing corporate officer to take any other actions necessary to effectuate share dividend [*see, e.g., § 9.230*].

10. If corporation must amend articles to authorize shares to be issued in share dividend [*see § 9.113*, P 7], add following [*see, e.g., § 9.232*]:

a. Provision stating reason that additional shares must be authorized.

b. Provision setting forth and approving proposed amendment of articles of incorporation.

NOTE:
For the procedures required to amend articles [***see*** *Corp. Code § 900-911*], see Ch. 10, ***Amendment of Articles*** .

c. Provision calling special meeting of shareholders to approve amendment of articles, and authorizing secretary to give notice of meeting [*see Corp. Code § 903*; *see also* Ch. 8A, *Shareholders' Meetings*,

Voting, and Agreements].

d. Provision directing and authorizing corporate officers, on approval of amendment by shareholders, to file certificate of amendment of articles [*see Corp. Code § 905*; *see also* Ch. 10, *Amendment of Articles*, § 10.202.

[2] Declaring and Paying Dividend

1. Have board of directors adopt resolution declaring share dividend [*see §§ 9.122[1], 9.230-9.232*].

NOTE:
The resolution must be adopted by a majority of the directors present at a duly held meeting at which a quorum is present, or by unanimous written consent [*Corp. Code § 307(a)(8), (b)*; ***see*** *Corp. Code §§ 310, 317(e)*; ***see also*** Ch. 5, ***Directors' Meetings, Actions, and Resolutions***].

2. If share dividend must be qualified by the Commissioner of Corporations under the Corporate Securities Law [*see Corp. Code §§ 25000-25706*; *see also § 9.113*, P 12], prepare and process necessary applications and papers for qualification of dividends [*see* Ch. 6H, *Qualification of Securities* ,].

3. Supervise issuance and distribution of dividend shares to shareholders of record on record date [*see § 9.122[1]*, P 3].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesConstructive DividendsBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesStock Splits



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-9 California Legal Forms--Transaction Guide § 9.123

§ 9.123 Assessment of Shares

[1] Levying Assessment

NOTE:
This subsection assumes that some or all of the corporation's shares are assessable [***see*** *Corp. Code § 423(a)*; ***see also*** *§ 9.114*, P 1].

1. Draft board resolution that [*Corp. Code § 423(b)*; *see § 9.240*]:

NOTE:
There is no prescribed form for board resolutions [***see*** *Ch. 5,* ***Directors' Meetings, Actions, and Resolutions****, § 5.240[1][b]*]].

a. States amount of assessment per share.

b. States where and to whom assessment is payable.

c. Either [*see § 9.114*, P 8]:
(1) Fixes date on which assessment is payable; or

(2) Provides for establishing date on which assessment is payable, if proceedings or filings with governmental or other agency for qualification, permit, registration, or exemption are required as condition precedent to levy or payment of assessment.

d. Fixes date on which assessment becomes delinquent if not paid [*see § 9.114*, P 9].

e. Fixes date for sale of delinquent shares [*see § 9.114*, P 10].

f. Fixes hour and place of sale [*see § 9.114*, PP 12, 13].

2. Have board of directors adopt resolution levying assessment.

NOTE:
The resolution must be adopted by a majority of the directors present at a duly held meeting at which a quorum is present, or by unanimous written consent [*Corp. Code § 307(a)(8), (b)*; ***see*** *Corp. Code §§ 310, 317(e)*; ***see also*** Ch 5, ***Directors' Meetings, Actions, and Resolutions***].

[2] Giving Notice of Assessment

1. Draft notice of assessment, including all of following in substantially the form set forth by statute [*Corp. Code § 423(c)*; *see § 9.241* (statutory format)]:

a. Corporation's name.

b. Location of corporation's principal executive office.

c. That board has levied specified amount per share on designated classes.

d. Delinquency date [*Corp. Code § 423(b)*; see *§ 9.114*, P 9].

e. That delinquent shares will be sold.

f. Sale date, time, and place [*Corp. Code § 423(b)*; *see § 9.114*, PP 10, 12, 13].

g. Delinquency penalty.

2. Ensure that notice is served on each holder of record of assessed shares on or before date assessment is payable [*Corp. Code § 423(c)*; *see § 9.114*, P 8], either [*Corp. Code § 423(d)*]:

a. By personal service.

b. By both:
(1) First class mail [*see Corp. Code § 113*], addressed to shareholder at:
(a) Last address appearing on books of corporation;

(b) Address given by shareholder to corporation for purpose of notice; or

(c) If no address specified in (a) or (b), *above*, appears or is given, address of corporation's principal executive office.

(2) Publication in newspaper of general circulation in:

(a) County where corporation's principal executive office is located; or

(b) Adjoining county, if there is no newspaper in county specified in (a), *above*.

[3] Collecting Assessment Before Delinquency Date

1. Instruct corporate officers to accept assessment payments from shareholders.

2. Instruct corporate officers to collect penalty of 5 percent of assessment amount from any shareholder who pays assessment after delinquency date [*see Corp. Code § 423(g)*; *see also § 9.123[1],* P 1(d)].

[4] Extending Date for Sale of Delinquent Shares

NOTE:
The corporation may extend (postpone) the sale date fixed in the levy of assessment [***see*** *§ 9.123[1],* P 1(e)] from time to time, or when the sale is restrained by court order [*Corp. Code § 423(f)*].

1. If corporation intends to postpone sale [*Corp. Code § 423(f)*]:

a. Advise board that new date must be 30 days or less after sale date last fixed.

b. Have board enter order for new sale date on records of corporation.

2. Have secretary or other person authorized to conduct sale announce postponement at time and place of sale last fixed [*Corp. Code § 423(f)*].

3. If sale date is postponed for more than five days after date last fixed [*Corp. Code § 423(f)*]:

a. Draft notice to shareholders, setting forth date and time to which sale has been postponed [*see § 9.242[1]*].

b. Mail notice to shareholders whose shares are subject to the sale.

[5] Selling Delinquent Shares

NOTE:
As used in this Subsection, the term "delinquent shares" means those shares that are subject to an assessment that was not paid by the delinquency date [***see*** *Corp. Code § 423(b), (c)*]. An assessment on shares becomes a lien on those shares [***see*** *Corp. Code § 423(e)*]. Generally, the corporation's only remedy for the collection of the assessment is the sale or forfeiture of the shares [***see*** *Corp. Code § 423(n)*; ***see also*** *§ 9.114,* P 14].

1. At date and time appointed for sale, have corporate officer or agent [*see Corp. Code § 423(h)*]:

NOTE:

The sale date may be the date specified in the notice of levy [***see*** *§ 9.123[2]*], or the date to which the sale was postponed [***see*** *§ 9.123[4]*].

a. Determine highest bidder on delinquent shares.

NOTE:
The "highest bidder" is the person offering to pay the assessment and penalty of 5 percent of the assessment amount for the smallest number of shares. The corporation is not required to accept any offer for a fraction of a share [***see*** *Corp. Code § 423(h)*].

If no bidder offers to pay the assessment amount and penalty, the shares will be forfeited to the corporation in satisfaction of the assessment and penalty [***see*** *Corp. Code § 423(h)*].

b. Sell or cause to be sold to highest bidder for cash as many shares of each delinquent holder as necessary to pay assessment and penalty.

2. Have corporation transfer shares to highest bidder on corporation's share register, upon his or her payment of assessment and penalty [*Corp. Code § 423(h)*].

3. If shares are certificated securities [*see Corp. Code § 156.1*; *Com. Code § 8102(a)(4), (15)* (defined as shares evidenced by certificate)]:

a. Have shareholder surrender certificate to corporation for cancellation [*Corp. Code § 423(j)*].

NOTE:
This duty may be enforced by court order or decree, and the holder or owner will be liable for damages to the corporation for failure to surrender the certification for cancellation upon demand without good cause or excuse [*Corp. Code § 423(j)*]. Any certificate not so surrendered becomes null and void, and ceases to be evidence of the right or title of the holder or any transferee to the shares purporting to be represented thereby. Neither the corporation nor the purchaser of those shares incurs any liability to any such tranferee [*Corp. Code § 423(j)*].

b. Have corporation issue new share certificate to highest bidder [*Corp. Code § 423(h)*].

NOTE:
The purchaser of any shares at a sale for delinquent assessments is entitled to the issuance of a new certificate representing the shares purchased [*Corp. Code § 423(j)*].

4. If shares are uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(14)* ("security" defined), (18) ("uncertificated security" defined)]:

NOTE:
For coverage of uncertificated securities, see *Ch. 6I, Issuance of Equity Securities, § 6I.20[2]*.

a. Inform holder or owner of delinquent shares that he or she has no further rights with respect to those shares [*Corp. Code § 423(j)*].

b. Have corporation issue new initial transaction statement [*see Corp. Code § 171.1*; (defined as

statement describing uncertificated securities)] to highest bidder [*Corp. Code § 423(h)*].

5. Prepare certificate of sale, setting forth all of following [*Corp. Code § 423(k)*; *see § 9.243*]:

a. Time and place of sale, and any postponement of sale.

b. Quantity and particular description of shares sold.

c. Person to whom shares were sold.

d. Price for which shares were sold.

e. Fact of payment of purchase money.

6. Have secretary (or assistant secretary) execute certificate.

NOTE:

The certificate of the secretary or assistant secretary of the corporation is prima facie evidence of all of the following facts. Copies of the certificate, certified by the secretary or an assistant secretary, are prima facie evidence of the facts stated on that certificate [*Corp. Code § 423(k)*].

7. Instruct secretary (or assistant secretary) to file certificate in office of the corporation [*Corp. Code § 423(k)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsShareholdersGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-9 California Legal Forms--Transaction Guide §§ 9.124-9.139

[Reserved]

§§ 9.124[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-9 California Legal Forms--Transaction Guide § 9.140

§ 9.140 Advising Corporation Regarding Tax Consequences of Distribution

NOTE:

For discussion of the income tax consequences of a particular distribution to the corporation's shareholders, see *§§ 9.200[1][d]* (cash dividend), 9.203[1][b][iii] (proprty dividend), 9.220[1][j] (share redemption dividend), 9.230[1][c] (share dividend). For income tax procedures applicable to shareholders upon repurchase of their shares pursuant to a buy-sell agreement, see Ch. 8D, ***Buy-Sell Agreements*** .

1. With respect to recognition of gain or loss, advise corporation that:

a. It will not recognize any gain or loss as a result of following transactions [*I.R.C. § 311(a)*; *see I.R.C. § 317(a)*; *see also § 9.200[1]*]:

(1) Distribution of its own stock.

(2) Distribution of cash.

(3) Distribution of unappreciated property.

(4) Redemption of its stock for cash or unappreciated property.

b. It must recognize gain as if it had sold property to shareholders as result of following transactions [*I.R.C. § 311(b)*; *see § 9.200[1]*]:

(1) Distribution of appreciated property.

(2) Redemption of its stock for appreciated property.

2. Advise corporation that its earnings and profits will be affected as follows:

a. On distribution of cash or unappreciated property, reduced by [*I.R.C. § 312(a)*]:

(1) Amount of cash.

(2) Principal amount of obligations.

(3) Adjusted basis of property.

b. On distribution of appreciated property [*I.R.C. § 312(b)*]:

(1) Increased by excess of fair market value over basis.

(2) Decreased by fair market value of property.

c. On redemption treated as distribution to shareholders [*see I.R.C. § 302(d)*], reduced in same manner as distribution [*see I.R.C. §§ 302(d), 312(a)*; *see* P a, *above*].

d. On redemption treated as exchange of property to shareholders [*see I.R.C. § 302(a), (b)*], reduced by ratable share attributable to redeemed stock [*see I.R.C. § 312(n)(7)*].

e. Unaffected, on tax-free distribution of its own stock [*I.R.C. § 312(d)(1)*; *see I.R.C. § 305* (tax effect on shareholders)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsEarnings & Profits (IRC secs. 312, 316)Effects of Distributions of PropertyTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Stock RedemptionsTax LawFederal Taxpayer GroupsC CorporationsStock Redemptions (IRC secs. 302-304)Tax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)General OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-9 California Legal Forms--Transaction Guide § 9.141

§ 9.141 Effectuating Stock Split

NOTE:

In certain circumstances, an intended share dividend effectuated pursuant to an amendment to the articles may be considered a stock split rather than a share dividend [***see*** *§ 9.232[1]*]. If, however, the original intent of the transaction is effectuate a stock split (i.e., increase the number of outstanding shares and thereby reduce the price per share, without affecting the corporation's financial structure [***see*** *§ 9.113*, P 4]), the corporation should use the procedures set forth in this section, rather than those *set forth in § 9.122*.

A "stock split" is the pro rata division, by means other than a share dividend, of all the outstanding shares of a class into a greater number of shares of the same class by an amendment to the articles stating the effect on the outstanding shares [*Corp. Code § 188*]. It is not a "distribution" [***see*** *Corp. Code § 166*], requiring compliance with statutory financial tests [***see*** *Corp. Code §§ 500-503*].

For further comparison of share dividends and stock splits, see *§ 9.232*.

1. Determine all of following:

a. Present market price of outstanding shares.

b. Number of shares required to be issued to achieve intended market price per share.

c. Whether proposed stock split requires qualification under Corporate Securities Law [*see Corp. Code §§ 25000-25706, 25103(f)* (exemption for certain stock splits); *see also* Ch. 6, *Securities Regulation Issues* ; Ch. 6H, *Qualification of Securities*].

d. Effect of proposed stock split on all outstanding shares [*see Corp. Code § 907(b)* (requiring amended articles to state effect)].

2. Draft resolution authorizing stock split and amending articles.

NOTE:
A stock split may be effected only by an amendment of the articles stating the effect on the outstanding shares [*Corp. Code §§ 188, 907(b)*]. For an example and discussion of such a resolution, see Ch. 10, ***Amendment of Articles*** .

3. Have board and outstanding shares approve amendment [*Corp. Code § 902(a)*; *see Corp. Code § 152*].

NOTE:
However, if the corporation has only one class of shares outstanding, an amendment effecting only a stock split may be adopted by approval of the board alone [*Corp. Code § 902(c)*].

4. Prepare and file certificate of amendment [*see Corp. Code §§ 905-909*; Ch. 10, *Amendment of Articles*].

5. If necessary, obtain qualification of share issuance [*see Corp. Code §§ 25103(f), 25110, 25120*; *see also* Ch. 6H, *Qualification of Securities*].

6. Direct corporate officers to issue new shares and cancel old outstanding shares of same class [*see* Ch. 6I, *Issuance of Equity Securities*].

7. Notify holders of certificated securities [*see Corp. Code § 156.1*; *Com. Code § 8102(a)(4), (15)*] on record date to exchange share certificates for new certificates representing shares issued under stock split.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesConstructive DividendsBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesStock Splits



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-9 California Legal Forms--Transaction Guide §§ 9.142-9.199

[Reserved]

§§ 9.142[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
A. Cash or Property Dividends

4-9 California Legal Forms--Transaction Guide § 9.200

§ 9.200 Resolution Declaring Cash Dividend From Retained Earnings

[1] Comment

[a] Use of Form

This form is a resolution of the board of directors declaring a cash dividend on its outstanding shares. It provides that the dividend will be paid from the corporation's retained earnings.

For an example and discussion of a resolution declaring a dividend to be paid from a source other than retained earnings, see *§ 9.201[2]*. For an example and discussion of a resolution declaring a dividend to be paid in property, such as shares of another corporation, see *§ 9.203[2]*.

[b] Board's Declaration of Dividends

[i] Power to Act

Subject to any limitations in the articles or in the General Corporation Law [*see Corp. Code §§ 100-2319*], the board of directors may exercise all corporate powers, including the power to deal in and with the corporation's own shares and securities [*Corp. Code § 300(a)*; *see Corp. Code § 207(d)* (corporate powers)]. The board may delegate its power to declare dividends to an executive committee, with certain restrictions [*see Corp. Code § 311*; *§ 9.204[2]*].

The board's discretionary power over the disposition of the corporation's surplus funds is absolute, to the extent it is exercised legally [*see Mulcahy v. Hibernia S. & L. Soc. (1904) 144 Cal. 219, 223, 77 P. 910* ; *see also* [ii], *below*]. Therefore, a shareholder, in the absence of a showing of abuse of discretion, does not have any right to compel the board of directors of a corporation to declare and pay a dividend [*Carew v. Hibernia Bank (1960) 186 Cal. App. 2d 764, 769, 9 Cal. Rptr. 905]* . The board's action in setting surplus funds aside as a reserve instead of using them to pay a dividend is not subject to court control [*Mulcahy v. Hibernia S. & L. Soc. (1904) 144 Cal. 219, 223, 77 P. 910* ; *see* [c], *below*].

[ii] Statutory Financial Limitations

California law no longer restricts the sources from which dividends may be paid [*see* former *Corp. Code § 1500* (repealed by Stats 1975, ch. 682, effective Jan. 1, 1977)]. Instead, the primary limitation on the board's discretion to declare a dividend is the requirement that the corporation pass the financial tests set forth in *Corp. Code §§ 500-503*. To make a valid "distribution to its shareholders" [*see Corp. Code § 166*], a corporation first must meet either the "retained earnings" [*see Corp. Code § 500(a)*] or the "remaining assets" test [*see Corp. Code § 500(b)*]. The retained earnings test requires the corporation's retained earnings immediately prior to a distribution to equal or exceed the amount of the proposed distribution [*Corp. Code § 500(a)*]. The term "retained earnings" means the accumulated net income earned by a corporation from the date of incorporation or reorganization, less distributions made to shareholders and other charges [*see* H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 5, *Income Statement* (Matthew Bender)]. For further discussion, see *§ 9.11[2]*. This resolution is designed to meet that test. For a form designed to meet the remaining assets test, see *§ 9.201*.

In addition to the initial financial tests, a corporation must meet other tests relating to general solvency [*see Corp. Code § 501*] and liquidation and dividend preferences [*see Corp. Code §§ 502-503*]. For discussion, see *§ 9.11[5], [6]*.

Whether or not a corporation satisfies the financial tests is determined in accordance with generally accepted accounting principles [*see Corp. Code §§ 114, 500-511*; *see also § 9.13*]. However, a corporation may be exempt from one or more of these tests pursuant to a statutory exemption [*see Corp. Code §§ 500(c)* (broker-dealers), *503.1, 503.2* (deceased and disabled shareholders), *504* (regulated investment companies and real estate investment trusts), 511 (holders in due course); *see also § 9.12*].

[iii] Limitations Imposed by Corporate Instruments

The General Corporation Law specifically permits the corporation's articles, bylaws, or agreements to impose additional restrictions on the board's discretion to declare dividends [*Corp. Code § 505*; *see Corp. Code § 204(d)* (permissive article provisions), *212(b)* (permissive bylaw provisions)]. Such limitations are particularly common with respect to preferred shares [*see* [1][c] [iv], *below*]. For example, the board may be required to pay dividends "when earned" [*see* Business Organizations with Tax Planning, Ch. 141, *Rights and Duties of Directors and Shareholders With Respect to Dividends* (Matthew Bender)].

[iv] Limitations Imposed by Duty of Good Faith

The directors must perform their duties in good faith, in the best interests of the corporation, and with the care, including reasonable inquiry, that an ordinarily prudent person in a like position would use under like circumstances [*see Corp. Code § 309(a)*; *see also* Ch. 5, *Directors' Meetings, Actions, and Resolutions*]. In performing their duties, the directors are entitled to rely on information, opinions, reports, or statements (including financial statements and other financial data) prepared by any of the following, as long as the directors act in good faith, after reasonable inquiry when indicated by the circumstances, and without knowledge that would cause that reliance to be unwarranted [*Corp. Code § 309(b)*]:

- Officers or employees of the corporation whom the directors believe to be reliable and competent in the matters presented.

- Counsel, independent accountants, or other persons regarding matters that the directors believe to be within those persons' professional or expert competence.

- Committees of the board on which the directors do not serve, regarding matters within the committees' designated authority that the directors believe to merit confidence.

The board's declaration of a dividend generally requires reliance on an accountant, regarding the corporation's financial ability to pay the dividend [*see* Form].

[v] Method of Making Declaration

Every act or decision done or made by a majority of the directors present at a duly held meeting at which a quorum is present is the act of the board [*Corp. Code § 300(a)(8)*; *see Corp. Code §§ 310, 317(e)* (exceptions)]. At board meetings, a majority of the authorized number of directors constitutes a quorum of the board for the transaction of business [*Corp. Code § 300(a)(7)*]. The board authorizes corporate actions by resolution, which need not follow any prescribed form [*see Ch. 5, Directors' Meetings, Actions, and Resolutions, § 5.240*].

[c] Shareholders' Right to Dividends

[i] In General

The shares of a corporation represent the holders' proprietary interest in the corporation [*see Corp. Code § 184*]. However, a corporation has a legal personality that is separate and distinct from that of its shareholders. Shareholders, through their ownership of corporate shares, own an interest in that separate legal personality, rather than any vested ownership rights in either the corporate earnings or the corporate property. Therefore, shareholders' rights in corporate earnings and property are merely an expectancy [*Miller v. McColgan (1941) 17 Cal. 2d 432, 436, 110 P.2d 419]* . The shareholder becomes the owner of a portion of the corporate earnings or property only when the board declares a dividend and sets aside a portion of the earnings for dividend payments, or liquidates the corporation [*Miller v. McColgan (1941) 17 Cal. 2d 432, 436, 110 P.2d 419]* .

[ii] Record Date

In order for the corporation to determine the shareholders who are entitled to receive payment of any dividend or other distribution, the board may fix a record date in advance. That date must not be more than 60 days nor less than 10 days prior to the date for payment of the dividend [*Corp. Code § 701(a)*]. If the board does not fix a record date in advance, the record date for determining shareholders entitled to receive a dividend is at the close of business on the day that the board adopts the resolution declaring the dividend, or the 60th day prior to the dividend payment date, whichever is later [*Corp. Code § 701(b)*].

Only those persons who are shareholders at the close of business on the record date are entitled to receive notice and to receive the dividend or distribution, notwithstanding any transfer of any shares on the corporation's books after the record date but before the payment date, except as otherwise provided (1) in the articles, (2) by agreement, or (3) in the General Corporation Law [*Corp. Code § 701(d)*; *see Corp. Code § 185* (shareholder defined)]. With respect to transfers between the declaration date and record date, it appears that the right to receive the dividend vests [*see* [iii], *below*] in the person who appears on the books of the corporation on the record date. If the transfer is recorded on the corporation's books before the record date, the transferee of the shares is entitled to receive the dividend. However, if the transfer is not recorded on the books by that date, the transferor retains the right to receive the dividend [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisitions of Shares* , § 142.05[4]]. The rules of the applicable market govern the payment of dividends on shares traded on a securities exchange [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisitions of Shares* , § 142.05[4]; Business Organizations with Tax Planning, Ch. 141, *Rights and Duties of Directors and Shareholders With Respect to Dividends* (Matthew Bender)]. This form assumes that the shares are not publicly traded.

[iii] Vesting of Right

Upon the declaration of a dividend by the corporation's board of directors, the share of the dividend payable to each

shareholder vests in that shareholder as an individual [*Meyers v. El Tejon Oil & Refining Co. (1946) 29 Cal. 2d 184, 188, 174 P.2d 1* ; *Smith v. Taecker (1933) 133 Cal. App. 351, 352, 24 P.2d 182]* . The mere declaration of a dividend creates a debt owed by the corporation to the shareholders on whose shares the dividend was declared [*Smith v. Taecker (1933) 133 Cal. App. 351, 352, 24 P.2d 182]* . After the dividend is declared, a shareholder's vested right to the dividend cannot be revoked without his or her consent [*Meyers v. El Tejon Oil & Refining Co. (1946) 29 Cal. 2d 184, 188, 174 P.2d 1]* . To be irrevocable, however, the dividend must be fully declared [Maloney v. Western Cooperage Co. (9th Cir. [Ore.] 1939) *103 F.2d 992, 994]* . A declaration of a dividend that does not create a definite, final, irrevocable, and enforceable debt against the corporation in favor of its shareholders is not a fully declared dividend and may be revoked by the corporation [Maloney v. Western Cooperage Co. (9th Cir. [Ore.] 1939) *103 F.2d 992, 994* ; United States v. Southwestern Portland Cement Co. (9th Cir. [Cal.] 1938) *97 F.2d 413, 415]* . For example, a dividend was not fully declared and was revocable when the resolution declaring it gave the president of the corporation the power to reduce it if, in his discretion, he deemed it advisable [United States v. Baldy (9th Cir. [Ore.] 1939) *108 F.2d 591, 591-592]* .

For further coverage of shareholders' rights to dividends, see Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares* , § 142.05.

[iv] Preferred Shares

A corporation may issue classes or series of shares, or both, with any rights, preferences, privileges, and restrictions that it sets forth in its articles [*Corp. Code § 400(a)*]. If a corporation is authorized to issue more than one class of shares, or if any class will have two or more series, the articles of incorporation must set forth the number of shares of each class or series, the designation of each class or series, and the rights, preferences, privileges, and restrictions for each class or series [*Corp. Code § 202(e)*; *see* Ch. 3, *Articles of Incorporation*].

The class of shares known as "preferred shares" usually has a preference over common shares with respect to payment of dividends, distribution of assets on liquidation, or both [*see Corp. Code §§ 159, 176* (definition of "common" and "preferred" shares)]. A dividend preference is the right to receive dividends in any period before other classes or series of shares. It often provides for a regular periodic dividend. A "cumulative" preference entitles the preferred shareholders to receive the dividends for a given period and all prior dividend periods before the common shareholders are entitled to receive any dividends. A "noncumulative" preference entitles the preferred shareholders only to declared dividends, i.e., their right to dividends in a given period does not carry forward to subsequent periods [*see* Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness* , § 127.03 [3]]. "Participating" preferred shares are those that are entitled to further dividend distributions after they have received their fixed dividend. "Nonparticipating" preferred shares are not entitled to any additional dividends paid on common shares [*see* Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness* , § 127.03[3]].

For further discussion of the nature of preferred shares, see *Ch. 6I, Issuance of Equity Securities, § 6I.15*. For examples and discussion of article provisions regarding dividend preferences on preferred shares, see *Ch. 3, Articles of Incorporation, §§ 3.240-3.242*.

[d] Income Tax Consequences of Cash Dividend

A corporate distribution may or may not be treated as a "dividend" for purposes of federal tax law, regardless of its treatment for purposes of California law [*see* Cavitch, Business Organizations with Tax Planning, Ch. 142, *General Tax Considerations in Connection With Declarations and Payments of Dividends* (Matthew Bender)]. For tax purposes, a "dividend" is any distribution of property made by a corporation to its shareholders out of its current or accumulated earnings and profits [*I.R.C. § 316(a)*]. Every distribution is deemed to be made out of earnings and profits to the extent of the distribution, and is made from the most recently accumulated earnings and profits [*I.R.C. § 316(a)*]. The term "property" includes money, securities, and any property other than the corporation's own stock or right to

acquire that stock [*I.R.C. § 317(a)*].

A corporation recognizes no gain or loss on the distribution of cash with respect to its stock [*I.R.C. § 311(a)(2)*]. Its earnings and profits, to the extent of the distribution, are decreased by the amount of money distributed [*I.R.C. § 312(a)(1)*]. With respect to the shareholder receiving the distribution, the portion of the distribution that is a "dividend" (that is, paid from the corporation's earnings and profits) must be included in gross income [*I.R.C. §§1(h)(11), 61(a)(7), 301(a), (c)*; *see I.R.C. § 316(a)*]. Qualifying dividends received by individuals are taxable at capital gains rates, effective generally for tax years beginning after December 31, 2002, and before January 1, 2009 [*see* I.R.C. § (h)(11); Pub. Law No. 108-27, §§ 302(f)(1), 303 (effective date and sunset provisions for dividend taxation at capital gains rates)]. The portion, if any, of the distribution that is not a dividend is first applied against the shareholder's basis of the stock, and any portion that exceeds the basis is treated as gain from the sale or exchange of property [*I.R.C. § 301(c)(2), (3)*].

The taxation of distributions in California is determined in accordance with federal law, except as otherwise provided [*see Rev. & Tax. Code § 17321*].

For further coverage of the tax consequences of dividends, see Business Organizations with Tax Planning, Ch. 142, *General Tax Considerations in Connection With Declarations and Payments of Dividends* (Matthew Bender).

[e] Federal Securities Laws

If a corporation's shares are publicly traded, additional rules and regulations imposed by the Securities Exchange Act of 1934 [*see 15 U.S.C. § 78a et seq.*] and the applicable stock exchange may apply to corporate distributions and dividends [*see, e.g., 17 C.F.R. § 240.10b-17* (requiring announcement of dividend 10 days before record date)]. The forms in this chapter assume that the corporation's securities are not publicly traded. For further coverage of qualification and exemption under federal securities laws, see Ch. 6H. *Qualification of Securities* .

[2] Form

Resolution Declaring Cash Dividend From Retained Earnings

RESOLUTION DECLARING CASH DIVIDEND

WHEREAS, on examination of the report, including a financial statement of this corporation [for the period of _____ (*date*) to _____ (*date*) *or* for the fiscal year ending _____ (*date*)] prepared by _____[*name*], an independent certified public accountant retained by the Board of Directors for that purpose, the Board finds that this corporation has retained earnings in the sum of $_____ as of the close of business on _____ [*last date of accounting period covered by financial statement*];

WHEREAS, based on that report, the Board of Directors finds that the corporation is able to pay from retained earnings a dividend of $_____ per share on the outstanding _____ [*specify number and class of shares, e.g.*, 1,000 common] shares of the corporation, for a total of $_____;

WHEREAS, based on that report, the Board of Directors finds that the proposed dividend would comply with the requirements set forth in Corporations Code Sections 500-503, and with any other requirements set forth in the corporation's articles or bylaws and in any agreements entered into by the corporation;

WHEREAS, the Board believes that its reliance on the accuracy of that report is merited based on _____ [*name of certified public accountant*]'s professional competence in accounting; and

WHEREAS, the Board of Directors deems it advisable, in the best interests of the corporation and its shareholders, to

declare a dividend in the amount set forth above;

IT IS THEREFORE RESOLVED, that a dividend of $_____ per share is declared on the _____ [*specify class, e.g.*, common *or* preferred] shares of this corporation;

RESOLVED FURTHER, that $_____ of the corporation's retained earnings as of the close of business on _____ [*last date of accounting period covered by financial statement*] is hereby set aside for payment of the dividend declared in this resolution.

RESOLVED FURTHER, that the dividend is payable on _____[*date*], to shareholders of record on the record date set forth in this resolution;

RESOLVED FURTHER, that the close of business on _____ [*date no more than 60 days prior to dividend payment date*] is fixed pursuant to *Corporations Code Section 701* as the record date for the dividend declared in this resolution;

RESOLVED FURTHER that the Chief Financial Officer of this corporation is directed to pay the dividend declared by this resolution in the manner specified in this resolution; and

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to take any other actions that are necessary to carry out the purpose and intent of this resolution, including the execution, acknowledgment, and filing of any documents, certificates, writings, or book entries that may be required to car ry out this resolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesRight to DividendsTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsImposition of TaxTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
A. Cash or Property Dividends

4-9 California Legal Forms--Transaction Guide § 9.201

§ 9.201 Resolution Declaring Cash Dividend From Source Other Than Retained Earnings

[1] Comment

[a] Use of Form

This form is a resolution declaring a cash dividend from a source other than the corporation's retained earnings. This comment covers only those topics that are unique to this form. Discussion of the issues generally applicable to the declaration of dividends is *set forth in § 9.200*.

For the notice that must be given to the shareholders when a dividend is declared from a source other than retained earnings, see *§ 9.202[2]*. For an example and discussion of a resolution declaring a cash dividend to be paid from retained earnings, see *§ 9.201[2]*. For a resolution declaring a property dividend payable in shares of another corporation, see *§ 9.203[2]*.

[b] Financial Tests

Before a corporation may make a valid "distribution to its shareholders," it must meet the requirements of several financial tests set forth in the General Corporation Law. First, it must meet either the "retained earnings" [*see Corp. Code § 500(a)*; Form 9.200 and comment] or the "remaining assets" test [*see Corp. Code § 500(b)*]. Because the dividend declared in this form is from a source other than retained earnings, it must meet the remaining assets test. Under that test, a corporation or one of its subsidiaries may make a distribution to the corporation's shareholders if, immediately after giving effect to the distribution, both of the following apply [*Corp. Code § 500(b)*; *see § 9.13* (accounting terms of art defined)]:

(1) The sum of the corporation's assets (excluding goodwill, capitalized research and development expenses, and deferred charges) would be at least equal to 1 1/4 times its liabilities (not including deferred taxes, deferred income, and other deferred credits); and

(2) The corporation's current assets would be at least equal to its current liabilities; or at least equal to

11/4 times its current liabilities, if the average of the corporation's earnings before taxes on income and before interest expense for the two preceding fiscal years was less than the average of the interest expense of the corporation for those fiscal years. However, this aspect of the test does not apply to a corporation that does not classify its assets into current and fixed under generally accepted accounting principles [*Corp. Code § 500(b)*; *see Corp. Code § 114*]. For further discussion, see *§ 9.11[3]*.

The remaining assets test may be used, for example, by a "wasting assets" corporation such as a mining corporation. Because this type of corporation must deplete its natural resource assets to produce income, and reflect that depletion pursuant to a depletion deduction or expense, it generally has no retained earnings from which to pay dividends [*see* H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 4, *Balance Sheet: Owners' Equity* (Matthew Bender); former *Corp. Code § 1503* (definition)]. It may, however, have sufficient assets to comply with the remaining assets test and therefore make a valid distribution to its shareholders [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisitions of Shares* , § 142.02 (Matthew Bender)].

In addition to the initial financial tests, a corporation must meet other tests relating to general solvency [*see Corp. Code § 501*], liquidation and dividend preferences [*see Corp. Code §§ 502-503*], and any other requirements set forth in the corporate articles, bylaws, or agreements [*see Corp. Code § 505*; *§ 9.11[5]-[7]*]. Whether or not a corporation satisfies these financial tests is determined in accordance with generally accepted accounting principles [*see Corp. Code §§ 114*, *500-511*; *§ 9.13*]. However, a corporation may be exempt from one or more of these tests pursuant to a statutory exemption [*see Corp. Code §§ 500(c)* (broker-dealers), 503.1, 503.2 (deceased and disabled shareholders), *504* (regulated investment companies and real estate investment trusts), 511 (holders in due course); *see also § 9.12*].

[c] Notice Requirement

When the board declares a dividend from a source other than retained earnings, it must give notice to the shareholders of that fact [*Corp. Code § 507*; *see § 9.202[2]*]. This form requires a corporate officer to prepare and give such a notice [*see* [2], *below*]. For further discussion, see *§ 9.202[1]*.

[d] Effect of Dividend Source on Tax Treatment

For federal income tax purposes, a distribution is not treated as a taxable "dividend" unless it is made from earnings and profits [*see I.R.C. §§ 301(a), (c), 316(a)*; *see also § 9.200[1][d]*]. This form declares a dividend from a source other than the corporation's earnings. Nonetheless, for tax purposes, every distribution is deemed to be made from earnings and profits to the extent of the distribution [*I.R.C. § 316(a)*]. Therefore, regardless of the source of the distribution specified by the board of directors for purposes of California law, the distribution will nonetheless be taxed to the shareholders as a dividend to the extent of any earnings and profits [*see I.R.C. § 316(a)*; *see also* Business Organizations with Tax Planning, Ch. 142, *General Tax Considerations in Connection With Declarations and Payments of Dividends* (Matthew Bender)].

[2] Form

Resolution Declaring Cash Dividend From Source Other Than Retained Earnings

RESOLUTION DECLARING CASH DIVIDEND

WHEREAS, on examination of the report, including a financial statement of this corporation [for the period of _____ (*date*) to _____ (*date*) *or* for the fiscal year ending _____ (*date*)] prepared by _____[*name*], an independent certified public accountant retained by the Board of Directors for that purpose, the Board finds that the corporation is able to pay a dividend of $_____ per share on the _____ [*number of shares*] outstanding [*add if applicable*: _____ (*specify class or series of shares, e.g.,* common)] shares of the corporation, for a total of $_____;

WHEREAS, based on that report, the Board of Directors finds that the proposed dividend would comply with the requirements set forth in *Corporations Code Sections 500-503*, and with any other requirements set forth in the corporation's articles or bylaws and in any agreements entered into by the corporation;

WHEREAS, the Board believes that its reliance on the accuracy of that report is merited based on _____ [*name of certified public accountant*]'s professional competence in accounting; and

WHEREAS, the Board of Directors deems it advisable, in the best interests of the corporation and its shareholders, to declare a dividend in the amount set forth above;

IT IS THEREFORE RESOLVED, that a dividend of $_____ per share is declared on the outstanding [*add if applicable:* _____ (*specify class or series, e.g.,* common *or* preferred)] shares of this corporation;

RESOLVED FURTHER, that the dividend is payable on _____[*date*], to shareholders of record on the record date set forth in this resolution;

RESOLVED FURTHER, that the close of business on _____ [*date no more than 60 days prior to payment date*] is fixed pursuant to *Corporations Code Section 701* as the record date for the dividend declared in this resolution;

RESOLVED FURTHER, that the Chief Financial Officer of this corporation is authorized and directed to charge the dividend declared in this resolution on the corporate books to _____ [*specify, e.g.,* a reduction of the corporation's capital];

RESOLVED FURTHER, that the Chief Financial Officer of this corporation is authorized and directed to pay the dividend declared by this resolution in the manner specified in this resolution;

[*If all shareholders are entitled to dividend:*]

RESOLVED FURTHER, that the _____ [*specify corporate officer, e.g.,* Chief Financial Officer] shall cause the payment of the dividend declared in this resolution to each shareholder to be accompanied by a notice stating that the dividend was made from a source other than retained earnings, and will be treated for accounting purposes as _____ [*specify, e.g.,* a reduction of corporate capital]; and

[*Or, if dividend is payable on only one class or series of shares:*]

RESERVED FURTHER, that on the date set for payment of the dividend declared in this resolution, the _____ [*specify corporate officer, e.g.,* Chief Financial Officer] of this corporation is directed to mail notice to each shareholder of this corporation, at his or her address as it appears on the corporation's records, that the dividend declared by this resolution is being made from a source other than retained earnings and will be treated for accounting purposes as _____ [*specify, e.g.,* a reduction of the capital of this corporation]; and

[*Continue with the following:*]

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to take any other actions that are necessary to carry out the purpose and intent of this resolution, including the execution, acknowledgment, and filing

of any documents, certificates, writings, or book entries that may be required to carry out this resolution.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
A. Cash or Property Dividends

4-9 California Legal Forms--Transaction Guide § 9.202

§ 9.202 Notice to Shareholders of Dividend Paid From Source Other Than Retained Earnings

[1] Comment

[a] Use of Form

This form is a notice to the corporation's shareholders that the board of directors has declared a dividend that will be chargeable to a corporate account other than retained earnings. It contains alternatives for use when the notice is sent to shareholders with their dividend payments, or when it is sent separately.

For general coverage of the declaration of dividends, see *§ 9.200*. For a board resolution declaring a dividend that requires use of this notice, see *§ 9.201[2]*.

[b] Notice Requirement

A corporation must give notice to its shareholders of every dividend that is not chargeable to retained earnings [*Corp. Code § 507*]. The notice must (1) identify the source from which the dividend will be paid, and (2) state the accounting treatment that the dividend will receive [*Corp. Code § 507*]. The notice must either accompany the dividend, or be given within three months after the end of the fiscal year in which the dividend is paid [*Corp. Code § 507*; *see* form (alternatives)].

[2] Form

Notice to Shareholders of Dividend Paid From Source Other Than Retained Earnings
NOTICE TO SHAREHOLDERS

TO SHAREHOLDERS OF _____ [*name of corporation*]:

NOTICE IS HEREBY GIVEN that on _____[*date*], this corporation's Board of Directors declared a dividend of $_____ per share on the _____ [*specify class or series, e.g.*, common]

shares of this corporation, payable _____[*date*] to _____ [*specify class or series, e.g.,* common] shareholders of record as of the close of business on _____[*date*].

[*Add if notice accompanies dividend payment:*]

The enclosed check represents payment of the dividend described above.

[*Continue with the following:*]

NOTICE IS FURTHER GIVEN that the dividend so declared is being made from a source other than the corporation's retained earnings, and will be treated for accounting purposes as _____ [*specify, e.g.*, a reduction of corporate capital].

_____Dated:

_____ [*name of corporation*]

By _____ [*signature*]

[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsDividends (IRC secs. 316, 561-565)Tax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)General OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & Distribution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
A. Cash or Property Dividends

4-9 California Legal Forms--Transaction Guide § 9.203

§ 9.203 Resolution Declaring Property Dividend

[1] Comment

[a] Use of Form

This form is a resolution declaring a property dividend on the outstanding shares. It provides that the dividend is payable in shares of another corporation. General coverage of the declaration of dividends is set forth in t§ 9.200. This form assumes that the dividend will be declared from retained earnings. Discussion of the notice requirement applicable to dividends made from a source other than retained earnings [*see Corp. Code § 507*] is included in § 9.201. This comment covers only the topics that are unique to this form.

For an example and discussion of a resolution declaring a cash dividend from retained earnings, see *§ 9.200[2]*. For a resolution declaring a cash dividend from a source other than retained earnings, and the notice required to be given to shareholders under those circumstances, see *§§ 9.02[2]* and 9.03[2].

[b] Amount of Property Distribution

[i] In General

Unlike a cash dividend, the amount of a property dividend is not readily apparent. That amount must be determined for purposes of the corporation's ability to meet the financial tests set forth in the General Corporation Law [*see* [ii], *below*], and for federal income tax purposes [*see* [iii], *below*].

[ii] Financial Tests

For purposes of the financial tests applicable to distributions [*see Corp. Code §§ 500-503*; § 9.200[1][b] [ii]], the amount of any corporate distribution payable in property is determined on the basis of the value at which the distributed property is carried on the corporation's financial statements, in accordance with generally accepted accounting principles [*Corp. Code § 500*]. Generally accepted accounting principles usually require a corporation to carry the

shares of another corporation on its financial statements as current assets, which are normally valued at their cost [*see* H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 2, *Balance Sheet: Assets* (Matthew Bender); *see also § 9.13*].

[iii] Federal Income Tax

For federal income tax purposes, the distribution of stock in another corporation is treated as a property distribution, rather than as a stock dividend [*Treas. Reg. § 1.61-9(b)*; *see I.R.C. § 305*]. For tax coverage of stock dividends, see *§ 9.230*.

A corporation recognizes neither gain nor loss on the distribution of unappreciated property to its shareholders [*I.R.C. § 311(a)*; *see § 9.200[1][d]*]. However, if a corporation distributes appreciated property to its shareholders, and the fair market value of exceeds its adjusted basis, the corporation must recognize gain to the same extent as if it had sold that property to the shareholder at fair market value [*I.R.C. § 311(b)(1)*].

If the distributed property has not appreciated, the corporation's earnings and profits are decreased by the adjusted basis of the property [*I.R.C. § 312(a)(3)*]. If the property has appreciated, earnings and profits are increased by the excess of the fair market value over the adjusted basis [*I.R.C. § 312(b)(1)*], and decreased by the fair market value of the property [*I.R.C. § 312(b)(2)*; *see I.R.C. § 312(a)(3)*].

The amount of the property distribution to the shareholders is the fair market value of the property on the distribution date, reduced by the amount of liabilities attached or assumed [*I.R.C. § 301(b)*]. The portion that is a "dividend" (i.e., paid from the corporation's earnings and profits) must be included in gross income [*I.R.C. §§ 61(a)(7), 301(a), (c)*; *see I.R.C. § 316(a)*]. The portion, if any, of the distribution that is not a dividend is first applied against the shareholder's basis of the stock, and any portion that exceeds the basis is treated as a gain from the sale or exchange of property [*I.R.C. § 301(c)(2), (3)*; *see § 9.200[1][d]*].

The taxation of distributions in California is determined in accordance with federal law, except as otherwise provided [*see Rev. & Tax. Code § 17321*].

[2] Form

Resolution Declaring Property Dividend

RESOLUTION DECLARING PROPERTY DIVIDEND

WHEREAS, on examination of the report, including a financial statement of this corporation [for the period of _____ (*date*) to _____ (*date*) *or* for the fiscal year ending _____ (*date*)] prepared by _____[*name*], an independent certified public accountant retained by the Board of Directors for that purpose, the Board finds that the corporation has retained earnings in the sum of $_____ as of the close of business on _____ [*last date of accounting period covered by financial statement*];

WHEREAS, based on that report, the Board of Directors finds that the corporation is able to pay a dividend of $_____ per share on the _____ [*number and class or series of shares, e.g.*, 1,000 common)] shares of the corporation, for a total of $_____; and

WHEREAS, based on that report, the Board of Directors finds that the proposed dividend would comply with the requirements set forth in *Corporations Code Sections 500-503*, and with any other requirements set forth in the corporation's articles or bylaws and in any agreements entered into by the corporation;

WHEREAS, the Board believes that its reliance on the accuracy of that report is merited based on

_____ [*name of certified public accountant*]'s professional competence in accounting;

WHEREAS, the Board of Directors deems it advisable, in the best interests of the corporation and its shareholders, to declare a dividend in the amount set forth above;

WHEREAS, this corporation owns _____[*number*] _____ [*specify class or series, e.g.,* preferred] shares of _____ [*name of issuing corporation*], with a cost basis of $_____ per share, which it may distribute to the shareholders as a dividend;

IT IS THEREFORE RESOLVED, that a dividend of _____[*number*] _____ [*specify class or series, e.g.,* preferred] shares of _____ [*name of issuing corporation*] is hereby declared on each _____[*number*] _____ [*specify class or series, e.g.,* preferred] shares of this corporation;

RESOLVED FURTHER, that _____ [*specify appropriate corporate officers, e.g.,* the Chief Financial Officer] of this corporation is directed on _____[*date*] to transfer and deliver on a pro rata basis to the holders of record of _____ [*specify class or series, e.g.,* preferred] shares of this corporation on the record date specified in this resolution the dividend described in this resolution;

RESOLVED FURTHER, that pursuant to *Corporations Code Section 701*, the close of business on _____ [*date no more than 60 days prior to payment date*] is hereby fixed as the record date for the dividend declared in this resolution;

RESOLVED FURTHER that the Chief Financial Officer of this corporation is hereby directed to charge the dividend declared by this resolution against the retained earnings of this corporation; and

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to take any other actions that are necessary to carry out the purpose and intent of this resolution, including the execution, acknowledgment, and filing of any documents, certificates, writings, or book entries that may be required to carry out this resolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesConstructive DividendsTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
A. Cash or Property Dividends

4-9 California Legal Forms--Transaction Guide § 9.204

§ 9.204 Resolution Designating Executive Committee With Power to Declare Dividends

[1] Comment

[a] Use of Form

This form is a resolution by the board of directors creating an executive committee with the power to declare dividends and make distributions to the shareholders. It should be used when the board intends that a committee, rather than the entire board, handle matters related to shareholder dividends.

For coverage of resolutions in general, see *§ 9.200*. For board resolutions declaring dividends, see *§§ 9.200[2]-9.202[2]*. For an example and discussion of a board resolution designating a board committee, see *Ch. 5, Directors' Meetings, Actions, and Resolutions, § 5.245*.

[b] Designation of Committees

The directors must perform their duties, including the adoption of resolutions, in good faith, in the best interests of the corporation, and with reasonable care [*see Corp. Code § 309(a)*; Ch. 5, *Directors' Meetings, Actions, and Resolutions*]. To the extent consistent with that rule, a corporation's board of directors may, by resolution adopted by a majority of the authorized number of directors, designate one or more committees to exercise all of the board's authority, with the exception of certain specified powers [*Corp. Code § 311*]. The board cannot empower a committee with the authority to make a distribution [*see Corp. Code § 166* (definition); *§ 9.10[1]*], except at a rate, in a periodic amount, or within a price range, set forth in the articles of incorporation or determined by the board [*Corp. Code § 311(f)*].

The committee appointed by the board must consist of at least two directors to serve on the committee at the pleasure of the board. The board may also designate one or more directors as alternate members of any committee, who may replace any absent members at any meeting of the committee. The appointment of members or alternate members of a committee requires the vote of a majority of the authorized number of directors [*Corp. Code § 311*].

The resolution in this form appoints two or more directors as members of the committee, and appoints other directors as

alternate members of the committee. It also contains limitations on the committee's authority to declare a dividend [*see* Form].

[c] Committee Meetings

The General Corporation Law provisions governing meetings of the board of directors also apply to committees of the board [*Corp. Code § 307(c)*]. Those provisions, which are subject to any specific article or bylaw provisions [*see Corp. Code § 307(a)*], govern the manner of calling and holding a meeting, notice, adjournment, quorums, and action taken without a meeting [*see Corp. Code § 307(a), (b)*]. For further coverage of those topics, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

[2] Form

Resolution Designating Executive Committee With Power to Declare Dividends

RESOLUTION CREATING EXECUTIVE COMMITTEE

WHEREAS, it is in the best interests of this corporation to have matters relating to dividends, that would otherwise come before the entire Board of Directors, brought before and acted upon by a lesser number of directors constituting a committee, with the same effect as if acted on by the entire Board;

WHEREAS, the bylaws of this corporation do not limit the Board's power to delegate its authority to committees;

IT IS THEREFORE RESOLVED, that a committee of _____ [*number not less than two*] directors, to be called "the Executive Committee of the Board of Directors," is hereby created to serve _____ [*specify time, e.g.*, until further resolution of the Board];

RESOLVED FURTHER, that the first Directors appointed to the Executive Committee created by this resolution are _____ [*list names*];

RESOLVED FURTHER, that Directors _____ [*list names*] are hereby appointed as alternate members of the Executive Committee created by this resolution, to replace and act for any absent member of the committee at any meeting of the committee;

RESOLVED FURTHER, that each member of the Executive Committee shall serve until he or she resigns, ceases to be a Director of the corporation, or is replaced by a successor appointed by the Board;

RESOLVED FURTHER, that the first meeting of the Executive Committee shall be held on _____[*date*], at _____[*time*], at _____[*address*];

RESOLVED FURTHER, that future regular or special meetings of the Executive Committee shall be held in accordance with *Corporations Code Section 307*, subject to any applicable article or bylaw provisions;

RESOLVED FURTHER, that the Executive Committee created by this resolution is hereby granted all of the power and authority authorized by *Corporations Code Section 311* that a corporation's Board of Directors may delegate to a committee. The Executive Committee specifically is granted the power to cause this corporation to make a "distribution to its shareholders" as that term is defined in *Corporations Code Section 166*, as long as the distribution to its shareholders is _____ [at a rate of $_____ per share *or* a regularly quarterly dividend of $_____ per share *or* within the range of $_____-$_____ per share *or* within the range specified in Article _____ of the Articles of Incorporation].

RESOLVED FURTHER, that _____ [*number that constitutes a majority of the members*] members of the Executive Committee shall constitute a quorum for the transaction of business;

RESOLVED FURTHER, that transactions of any meeting of the Executive Committee, however called and noticed or wherever held, shall be as valid as though had at a meeting duly held after regular call and notice, if a quorum is present, and if any member who did not receive notice either attends the meeting without protesting the lack of notice, or either before or after the meeting signs a written waiver of notice or consent to the holding of the meeting or an approval of its minutes, and all such waivers, consents, or approvals are filed with the corporate records or are made a part of the minutes of the meeting;

RESOLVED FURTHER, that the Executive Committee shall keep minutes of all of its proceedings, and distribute copies of the minutes to all members of the Executive Committee; and

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to take any other actions that are necessary to carry out the purpose and intent of this resolution, including the execution, acknowledgment, and filing of any documents, certificates, writings, or book entries that may be required to carry out this resolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & Distribution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
A. Cash or Property Dividends

4-9 California Legal Forms--Transaction Guide §§ 9.205-9.219

[Reserved]

§§ 9.205[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
B. Reacquisitions of Shares

4-9 California Legal Forms--Transaction Guide § 9.220

§ 9.220 Resolution Declaring Redemption of Shares

[1] Comment

[a] Use of Form

This form is a resolution of the board of directors declaring a redemption of its shares. Board resolutions generally are discussed in *§ 9.200[1]*.

For a notice of redemption, see *§ 9.221*. For a resolution authorizing the repurchase of shares pursuant to a buy-sell agreement, see *§ 9.222*. For coverage of redemptions made in liquidation of the corporation, see Ch. 12, *Winding Up and Dissolution* .

[b] Nature of "Redemption"

The General Corporation Law [*see Corp. Code §§ 100-2319*] does not define the term "redemption." However, "redemption of shares" generally means a corporation's reacquisition of shares pursuant to authorization set forth in its articles (and on the share certificate itself) to repurchase the shares at a stated price [*see* Ballantine & Sterling, California Corporation Laws, Ch. 9, *Dividends and Reacquisition of Shares* , § 144 (Matthew Bender); Cavitch, Business Organizations with Tax Planning, Ch. 147, *Acquisition by a Corporation of Its Own Shares* (Matthew Bender)].

[c] Issuance of Redeemable Shares

A corporation may provide in its articles of incorporation for one or more classes or series of shares that are redeemable, in whole or in part, (1) at the option of the corporation, or (2) to the extent and upon the happening of one or more specified events [*Corp. Code § 402(a)*; *see* Ch. 3, *Articles of Incorporation*]. The corporation may also provide in its articles for one or more classes or series of preferred shares that are redeemable, in whole or in part, (1) as provided above, (2) at the option of the holder, or (3) upon the vote of at least a majority of the outstanding shares of the class or series to be redeemed [*Corp. Code § 402(a)*]. If the articles permit partial redemption of a class or series of shares, they

must prescribe whether the method of selecting the shares to be redeemed will be (1) pro rata, (2) by lot, (3) at the discretion of the board, (4) in a manner approved by the board, or (5) as set forth in the articles [*Corp. Code § 402(b)*]. For examples of share certificates that set forth redemption options, see Ch. 6I, *Issuance of Equity Securities* .

Generally, a corporation is prohibited from issuing or redeeming redeemable common shares unless it has outstanding a class of common shares that is not subject to redemption [*Corp. Code § 402(c)*]. However, there are three exceptions from this general prohibition. The first is for shares issued by an open end investment company registered under the Investment Company Act of 1940[*Corp. Code § 402(c)*; *see 15 U.S.C. §§ 80a-1-80a-64*]. The second exception is for shares of a corporation that has a license or franchise from a governmental agency to conduct its business or that is a member corporation of a national securities exchange registered under the Securities Exchange Act of 1934 [*see 15 U.S.C. §§ 78a-78ll*], and whose license, franchise, or membership is conditioned on some or all of the shareholders possessing prescribed qualifications, to the extent necessary to reinstate or prevent the loss of the license, franchise, or membership [*Corp. Code § 402(c)*]. Finally, professional corporations are exempt from the general prohibition [*Corp. Code § 402(c)*; *see Corp. Code § 13401(b)* (definition); *see also* Ch. 12A, *Professional Corporations*].

For further discussion of redeemable shares, see Ch. 3, *Articles of Incorporation* . The remainder of this comment discusses the redemption process.

[d] Restrictions on Redemption

[i] Financial Tests

A redemption of shares for cash or property (including the redemption by a subsidiary of the corporation) constitutes a "distribution" to the corporation's shareholders [*Corp. Code § 166*; *see § 9.10[1]*]. A corporation's unlimited right to repurchase its own shares, like the unlimited right to pay dividends, could result in a depletion of the corporation's assets to the detriment of creditors and shareholders whose shares were not redeemed [*see* Z. Cavitch, Business Organizations with Tax Planning, Ch. 147, *Acquisition by a Corporation of Its Own Shares* (Matthew Bender); § 9.11[1]]. The corporation, therefore, is subject to the financial tests set forth in the General Corporation Law [*Corp. Code § 402(d)*; *see Corp. Code §§ 500-503*], unless it is subject to a statutory exemption. For a discussion of those tests and exemptions, see *§ 9.200*.

[ii] Corporate Instruments

Even when the corporation satisfies the financial requirements of *Corp. Code §§ 500-503*, it nonetheless may be prohibited from making a "distribution" to its shareholders [*see Corp. Code § 166*]. The General Corporation Law permits additional restrictions on a corporation's right to declare dividends or repurchase, or redeem shares, to be set forth in the corporation's articles, bylaws, or agreements [*Corp. Code § 505*].

[iii] Directors' Duty of Good Faith

The directors must perform their duties, including the declaration of "distributions" to the shareholders [*see Corp. Code § 166*], in good faith, in the best interests of the corporation, and with reasonable care [*see Corp. Code § 309(a)*; Ch. 5, *Directors' Meetings, Actions, and Resolutions*]. Thus, their discretion to redeem shares is limited by the corporation's best interests, even when the corporation satisfies the financial requirements of *Corp. Code §§ 500-503*. For example, it would be an abuse of the directors' discretion to improperly discriminate between one class or series of redeemable shares and another [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares* , § 144.04 (Matthew Bender)]. For further discussion of the directors' duties of good faith, see *§ 9.200[1][b]*.

[e] Use of Sinking Fund for Redemption

A "sinking fund" is a special fund of money used to extinguish a long-term debt or other obligation, which a corporation

may create by either (1) periodically setting aside an amount to be used for the specified purpose, or (2) delivering an amount to a third party trustee to be held for that purpose [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares* , § 144.04 (Matthew Bender)]. For an example of an article provision creating a sinking fund from retained earnings for redemption purposes, see Ch. 3, *Articles of Incorporation* .

A corporation may create a sinking fund for the redemption or repurchase of its shares only if it passes the financial tests set forth in the General Corporation Law [*Corp. Code § 402(d)*; *see Corp. Code §§ 500-503*; *see also* [1][d] [i], *above*]. Generally, a corporate "distribution" requiring compliance with those tests takes place at the time that the corporation transfers cash or property to its shareholders [*Corp. Code § 166*]. In the case of a sinking fund payment, the corporation "transfers cash or property to its shareholders" when it (1) delivers the cash or property to a trustee for the holders of preferred shares to be used for the redemption of the shares, or (2) physically segregates the cash or property in trust for that purpose [*Corp. Code § 166*]. Therefore, a corporation cannot make a valid payment to a sinking fund unless, at the time of that payment, it is able to pass the required financial tests [*see Corp. Code §§ 166*, *402(d)*]. If the corporation does not comply with the financial tests, the holder of shares to be purchased or redeemed will not become a creditor of the corporation [*Corp. Code § 402(d)*].

[f] Terms of Redemption

The redemption must be made at the price, at the time, and upon the terms and conditions, stated in the articles of incorporation [*Corp. Code § 402(b)*]. The term "redemption price" is defined as the amount payable, in cash, property, securities, or any combination of these, on shares of any class or series upon the redemption of those shares [*Corp. Code § 180*]. Unless otherwise provided, the redemption price is payable in cash [*Corp. Code § 180*].

[g] Record Date

To determine the shareholders whose shares are subject to redemption, the board may fix a record date in advance, which must not be more than 60 nor less than 10 days prior to the date of redemption [*Corp. Code § 701(a)*]. If the board does not fix a date in advance, the record date is the close of business on the day that the board adopts the resolution authorizing the redemption, or the 60th day prior to the redemption date, whichever is later [*Corp. Code § 701(a)(3)*; *see § 9.200[1][c][ii]*].

[h] Redemption Procedures

[i] In General

A corporation may redeem any or all shares that are redeemable at its option by (1) giving notice of redemption and (2) paying or depositing the redemption price, in the manner specified either in its articles or by statute [*Corp. Code § 509(a), (b)*]. The following discussion covers only the statutory procedures set forth in the General Corporation Law. This form is designed to comply with those procedures, and should be modified if the corporation's articles contain alternative notice and deposit provisions.

[ii] Giving Notice

The corporation must give notice of the redemption to its shareholders. That notice must set forth specific information regarding the shares to be redeemed, the redemption date and price, and manner of obtaining payment [*see Corp. Code § 509(b)*]. The corporation must publish the notice and mail a copy to affected shareholders [*see Corp. Code § 509(b), (c)*]. For further discussion of applicable procedures, and an example of the notice of redemption, see *§ 9.221[2]*.

[iii] Deposit of Redemption Price

From the date of deposit, the shares called for redemption will be redeemed and the dividends on those shares will cease

to accrue after the date fixed for redemption, if the corporation deposits the following with any bank or trust company as a trust fund, on or prior to the date fixed for redemption [*Corp. Code § 509(d)*]:

- A sum sufficient to redeem, on the date fixed for redemption, the shares called for redemption;

- In the case of any uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)* (defined as shares not represented by certificate)], an officer's certificate [*see Corp. Code § 173* (defined)] setting forth the holders of those securities registered on the corporation's books, and the number of shares held by each; and

- Irrevocable instructions and authority to the bank or trust company to publish the notice of redemption (or to complete publication if already begun) [*see* alternatives in Form], and to pay before, on, or after the date fixed for redemption, the redemption price of the shares to their respective holders, upon (a) surrender of their share certificates, for certificated securities [*see Corp. Code § 156.1*; *Com. Code § 8102(a)(4)* (defined as shares evidenced by certificate)], or (b) delivery of an officer's certificate, for uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)*].

In determining the holders of uncertificated securities, the bank or trust company is entitled to rely on any officer's certificate deposited pursuant to the above procedure [*Corp. Code § 509(d)*].

The deposit will constitute full payment of the shares to their holders. Beginning on the date of the deposit, the shares will no longer be outstanding. The holders of those shares will cease to be shareholders with respect to the shares, and will have no rights with respect to the shares, except (1) the right to receive from the bank or trust company payment of the redemption price of the shares without interest, upon surrender of their certificates in the case of certificated securities, and (2) any right to convert the shares for the period fixed [*Corp. Code § 509(d)*].

[i] Status of Redeemed Shares

When a corporation reacquires (that is, purchases, redeems, acquires by way of conversion to another class or series, or otherwise acquires) its own shares [*see Corp. Code § 510(d)*], those shares are restored to the status of authorized but unissued shares unless the articles prohibit their reissuance [*Corp. Code § 510(a)*]. If a corporation reacquires all authorized shares of a class or series and the articles prohibit reissuance of those shares, that class or series is automatically eliminated; if all authorized shares of a series are reacquired, the authorized number of shares of the class to which the shares belonged is reduced by the number of shares so reacquired; and the articles must be amended to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to the eliminated class or series [*Corp. Code § 510(b)(1)*]. If less than all authorized shares but all issued and outstanding shares of a class or series are reacquired and may not be reissued, the authorized number of shares of that class or series is automatically reduced by the number of shares so reacquired. The board must decide either (1) to eliminate that class or series, in which case the articles must be amended to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to the eliminated class or series, or (2) not to eliminate that class or series, in which case the articles must be amended to reflect the reduction of the number of authorized shares of that class or series by the number of the shares so reacquired [*Corp. Code § 510(b)(2)*]. If less than all authorized shares and less than all issued and outstanding shares of a class or series are reacquired, the authorized number of shares of that class or series is automatically reduced by the number of shares reacquired, and the articles must be amended to reflect that reduction [*Corp. Code § 510(b)(3)*]. These provisions are subject to any contrary or inconsistent provision in the articles [*Corp. Code § 510(e)*].

If a corporation reacquires all authorized shares of a series of shares and the articles only prohibit the reissuance of those shares as shares of the same series, then that series is automatically eliminated. The articles must be amended to eliminate any statement of rights, preferences, privileges and restrictions relating solely to that series. The board must determine either (1) to return those shares to the status of authorized but undesignated (and unissued) shares of the class

to which they belong, or (2) to eliminate those shares entirely. In either case, the articles must be amended to reflect the reduction in the authorized shares of that series and the effect, if any, on the class to which that series belongs [*Corp. Code § 510(c)(1)*]. If all issued and outstanding shares but not all authorized shares of a series are reacquired and those shares may not be reissued as shares of that series, the board must decide either (1) to eliminate that series, in which case the articles must be amended to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that series, or (2) not to eliminate that series, in which case the articles must be amended to reflect the return of the reacquired shares to the status of authorized but undesignated (and unissued) shares of the class to which they belong [*Corp. Code § 510(c)(2)*]. If less than all issued and outstanding shares of a series are reacquired and may not be reissued as shares of that series, the authorized number of shares of that series is automatically reduced by the number of shares reacquired. The board must determine either (1) to return those shares to the status of authorized but undesignated (and unissued) shares of the class to which they belong, or (2) to eliminate those shares entirely. In either case, the articles must be amended to reflect the reduction in the authorized shares of that series and the effect, if any, on the class to which that series belongs [*Corp. Code § 510(c)(3)*]. These provisions are subject to any contrary or inconsistent provision in the articles [*Corp. Code § 510(e)*].

The corporation must file a certificate of amendment in the same manner as any other amendment to the articles [*see Corp. Code §§ 900-911*; *see also* Ch. 10, *Amendment of Articles*], except that approval by the outstanding shares [*see Corp. Code §§ 152* (definition), 903 (approval requirement)] is not required [*Corp. Code § 510(f)*].

[j] Income Taxation of Redemption

For tax purposes, a redemption occurs whenever a corporation acquires its own stock from a shareholder in exchange for property, whether or not the stock is cancelled, retired, or held as treasury stock [*I.R.C. § 317(b)*]. "Property" is defined as money, securities, or any other property except for the corporation's own shares or the right to acquire its own shares [*I.R.C. § 317(a)*].

The corporation realizes no gain or loss on the redemption of its shares for cash, regardless of the tax consequences to the shareholders [*I.R.C. § 311(a)*; *see* Treas. Reg. § 1.311-1(a); discussion *below*]. However, it must recognize gain when it distributes appreciated property [*see I.R.C. § 311(b)*; *§ 9.203[1][b][iii]*]. If the redemption is essentially equivalent to a dividend as to the shareholders [*see I.R.C. § 302(d)*; discussion *below*], earnings and profits are reduced in the same manner as a distribution [*see I.R.C. § 312(a)*; *see also § 9.200[1]*]. If the redemption is treated as a sale or exchange as to the shareholders [*see I.R.C. § 302(a)*; discussion *below*], the part of the distribution that is properly chargeable to earnings and profits cannot exceed the ratable share attributable to the stock redeemed [*see I.R.C. § 312(n)(7)*].

The shareholders are taxed as though they had received a payment in exchange for stock (i.e., they recognize gain or loss on the difference between the amount of the distribution and basis) if any one of the following apply [*I.R.C. § 302(a), (b)*]:

- The redemption is not essentially equivalent to a dividend.
- The redemption is substantially disproportionate in relation to the voting stock held by the shareholder.
- The redemption is in complete termination of the shareholder's interest in the corporation.
- The redemption is made in partial liquidation of a noncorporate shareholder's interest.

If the redemption does not fall within one of these categories, it will be treated as a distribution of property [*I.R.C. § 302(d)*; *see I.R.C. § 301*]. For discussion, see *Section 9.200[1][d]*.

The taxation of distributions in California is determined in accordance with federal law, except as otherwise provided [*see Rev. & Tax. Code § 17321*].

For further coverage of the taxation of redemptions, see Z. Cavitch, Business Organizations With Tax Planning, Chapter 149A, *Tax Effects of Redemption of Stock* (Matthew Bender).

[2] Form

Resolution Declaring Redemption of Shares

RESOLUTION AUTHORIZING SHARE REDEMPTION

WHEREAS, this corporation has outstanding _____[*number*] of _____ [*specify class or series, e.g.,* preferred] shares that are redeemable at the option of the corporation at a redemption price of $_____ per share, pursuant to Section _____ of Article _____ of the Articles of Incorporation;

WHEREAS, on examination of the reports, including a financial statement of this corporation [for the period of _____ (*date*) to _____ (*date*) *or* for the fiscal year ending _____ (*date*)] prepared and submitted to this meeting by _____[*name*], an independent certified public accountant retained by the Board of Directors for that purpose, the Board finds that the corporation is able to expend $_____ for the redemption of its _____[*number*] outstanding _____ [*specify class or series of shares, e.g.,* preferred] shares;

WHEREAS, based on that report, the Board finds that the proposed redemption would comply with the requirements of *Corporations Code Sections 500-503,* and with any requirements set forth in the corporation's articles or bylaws and in any agreements entered into by the corporation;

WHEREAS, the Board believes that its reliance on the accuracy of that report is merited based on _____ [*name of certified public accountant*]'s professional competence in accounting;

WHEREAS, the Board of Directors deems it advisable, in the best interests of the corporation and its shareholders, to redeem [*specify, e.g.*, all of the preferred shares];

IT IS THEREFORE RESOLVED, that all outstanding _____ [*specify class or series, e.g.,* preferred] shares of this corporation are hereby called for redemption in accordance with their terms and the provisions of Section _____ of Article _____ of the Articles of Incorporation;

RESOLVED FURTHER, that the date fixed for redemption of the shares is _____[*date*], and the redemption price is $_____ per share, plus all accrued and unpaid dividends that have accrued on those shares to the date fixed for redemption;

RESOLVED FURTHER, that the close of business on _____ [*date no more than 60 days prior to redemption date*] is hereby fixed pursuant to *Corporations Code Section 701* as the record date for the redemption called by this resolution;

RESOLVED FURTHER, that _____ [*specify place, e.g.,* the office of the Stock Transfer Division of ABC Trust Company] at _____[*address*] is hereby designated as the place at which, on or after the date fixed for redemption as specified in this resolution, shareholders of certificated securities may obtain payment of the redemption price on surrender of their share certificates for _____ [*specify class or series, e.g.,* preferred] shares of this corporation properly endorsed for transfer to the corporation;

[*Add if corporate officer will give notice of redemption:*]

RESOLVED FURTHER, that the _____ [*specify corporate officer, e.g.*, Secretary] of this corporation is hereby directed to publish a notice of redemption, containing the matters specified in *Corporations Code Section 509(b)*, at least once a week on any day for two successive weeks, in _____ [*name of newspaper*], a newspaper of general circulation published in _____ County, where the principal executive office of this corporation is located, beginning no earlier than 60 days and no later than 20 days before the date fixed for redemption;

RESOLVED FURTHER, that the Secretary of this corporation is hereby directed to mail a copy of the notice of redemption to each holder of shares described in the notice on the record date fixed in this resolution, no earlier than 60 days and no later than 20 days before the date fixed for redemption, by depositing a copy of the notice, with first-class postage prepaid, in the United States mail, addressed to each holder at either (1) the address appearing for the holder on the books of this corporation, (2) the address given by the holder to this corporation for the purpose of notice, or (3) if no address appears for the holder on the books of this corporation and no address has been given by the holder to this corporation for the purpose of notice, _____ [*address of principal executive office*], the place where the principal executive office of this corporation is located;

[*Continue with the following:*]

RESOLVED FURTHER, that the officers of this corporation are hereby directed to deposit, on or before the date fixed for redemption specified in this resolution, with _____ [*specify, e.g.*, the Stock Transfer Department of ABC Trust Company] at _____[*address*], as a trust fund, all of the following:

(1) Funds sufficient to redeem the shares called for redemption.

(2) With respect to uncertificated securities, an officer's certificate setting forth the holders of those securities registered on the books of the corporation, and the number of shares held by each.

(3) Irrevocable instructions and authority for _____ [*specify, e.g.*, the Stock Transfer Department of ABC Trust Company] to pay, before, on, or after the date fixed in this resolution for redemption, the redemption price for the shares called for redemption to their respective holders, upon surrender of the share certificates properly endorsed for transfer to the corporation, for certificated securities, or delivery of the officer's certificate, for uncertificated securities]; [and]

[*Add if trust company will give (or complete) notice of redemption:*]

(4) Irrevocable instructions and authority for [*specify, e.g.*, the Stock Transfer Department of ABC Trust Company] to do all of the following:

(a) Publish (or complete publication if already begun) a notice of redemption containing the matters specified in *Corporations Code Section 509(b)* at least once a week on any day of the week for two successive weeks, in _____ [*name of newspaper*], a newspaper of general circulation published in _____ County, where the principal executive office of this corporation is located, beginning no earlier than 60 days and no later than 20 days before the date fixed for redemption;

(b) Mail a copy of the notice of redemption to each holder of shares described in the notice on the record date fixed in this resolution, no earlier than 60 days and no later than 20 days before the date fixed for redemption, by depositing a

copy of the notice, with first-class postage prepaid, in the United States mail, addressed to each holder at either (i) the address appearing for the holder on the books of this corporation, or (ii) the address given by the holder to this corporation for the purpose of notice, or (iii) if no address appears for the holder on the books of this corporation and no address has been given by the holder to this corporation for the purpose of notice, _____ [*address of principal executive office*], the place where the principal executive office of this corporation is located; and

(c) Pay, from the money deposited with it, all expenses of publishing and mailing notice of redemption as required by this resolution; and

[*Continue with the following:*]

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to take any other actions that are necessary to carry out the purpose and intent of this resolution, including the execution, acknowledgment, and filing of any documents, certificates, writings, or book entries that may be required to carry out this resolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesFiduciary ResponsibilitiesDuty of Good FaithBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDisposition of Reacquired SharesBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
B. Reacquisitions of Shares

4-9 California Legal Forms--Transaction Guide § 9.221

§ 9.221 Notice of Redemption

[1] Comment

[a] Use of Form

This form is the statutory notice of redemption, for use when the corporation's articles do not provide for any different form of notice. For a resolution authorizing redemption, and discussion of redemption generally, see *§ 9.220*.

For a notice of redemption of debt securities, see *Ch. 6J, Issuance of Debt Securities, § 6J.205*.

[b] Statutory Procedure for Redeeming Shares

A corporation may redeem any or all shares that are redeemable at its option by (1) giving notice of redemption, and (2) paying or depositing the redemption price [*Corp. Code § 509(a)*]. The corporation must follow the procedures set forth in its articles, if any. Otherwise, it must follow the statutory procedures [*see Corp. Code § 509(a), (b)*]. For coverage of the statutory payment or deposit procedures, see *Section 9.220*.

[c] Contents of Notice

If the articles of incorporation do not provide otherwise, the notice of redemption must set forth all of the following [*Corp. Code § 509(b)*]:

- The class or series of shares or part of any class or series to be redeemed.
- The date fixed for redemption.
- The redemption price.
- If the shares are certificated securities [*see Corp. Code § 156.1*; *Com. Code § 8102(a)(4)* (defined as

shares evidenced by certificate)], the place at which the shareholders may obtain payment of the redemption price upon surrender of their share certificates.

This form is drafted according to the statutory requirements. It should be modified if the articles set forth other notice requirements.

[d] Giving Notice

Subject to any alternative provisions in the articles, the corporation may give notice of the redemption by publishing the notice in a newspaper of general circulation in the county where the principal executive office of the corporation is located. The notice must appear at least once a week for two successive weeks, on any day of each week, beginning no earlier than 60 days and no later than 20 days before the date fixed for redemption [*Corp. Code § 509(b)*].

If the corporation gives notice in accordance with the statutory procedure set forth above, it must also mail a copy of the notice to each person that, as of the date of the mailing or record date, held shares to be redeemed [*Corp. Code § 500(c)*; *see Corp. Code § 701* (record date); *§ 9.200[1][c] [ii]*]. The notice must be addressed to the shareholder at (1) the address appearing on the books of the corporation, (2) the address given by the shareholder for the purposes of notice, or (3) if neither of the above applies, the principal executive office. The notice must be given no earlier than 60 days and no later than 20 days before the date fixed for redemption. However, failure to comply with this mailing requirement does not invalidate the share redemption [*Corp. Code § 509(c)*].

[2] Form

Notice of Redemption

NOTICE OF REDEMPTION

TO THE HOLDERS OF _____ [*name of corporation*]'s _____ [*state class or series, e.g.,* PREFERRED] SHARES:

NOTICE IS HEREBY GIVEN that _____ [*name of corporation*] will redeem all of its _____ [*specify class, series, or part of class or series of shares to be redeemed, e.g.,* preferred] shares.

The date fixed for redemption is _____[*date*] at _____[*time*].

The redemption price is $_____ per share, plus all accrued but unpaid dividends accruing on each share to the date fixed for redemption.

On or after the date fixed for redemption, shareholders of certificated securities may obtain payment of the redemption price upon surrender of their share certificates for the shares to be redeemed at [*specify, e.g.,* the office of the Stock Transfer Division of ABC Trust Company], located at _____[*address*].

_____Dated:

_____ [*name of corporation*]

By _____ [*signature*]

[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
B. Reacquisitions of Shares

4-9 California Legal Forms--Transaction Guide § 9.222

§ 9.222 Resolution Authorizing Repurchase of Shares

[1] Comment

[a] Use of Form

This form is a resolution of the board of directors declaring a repurchase of its shares. Discussion of board resolutions generally is set forth in the comment to § 9.200.

For a resolution authorizing the redemption of shares, see *§ 9.220*. For a notice of redemption, see *§ 9.221*.

[b] Share Repurchases

[i] In General

Subject to any limitations contained in its articles, a corporation has the power to purchase its own outstanding shares [*Corp. Code § 207(d)*]. For example, a corporation may wish to purchase its shares to eliminate fractional shares [*see § 9.230[1][e]*] or to exercise its rights under a repurchase agreement, among other reasons [*see* former Corp. Code § 1706 (listing purposes of share repurchase); Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares* , § 143 (Matthew Bender)].

A corporation may enter into an agreement with its shareholders for the repurchase of its shares, subject to the financial restrictions of *Corp. Code §§ 500-503* [*Corp. Code § 402(d)*; *see* [ii], *below*]. For coverage of buy-sell agreements, see Ch. 8D, *Buy-Sell Agreements* . This form assumes that the corporation has entered into such an agreement with its shareholders. The remainder of this comment covers only the repurchase of shares pursuant to the terms of that agreement.

[ii] Restrictions

A purchase of shares for cash or property (including the purchase by a subsidiary of the corporation) constitutes a

"distribution" to the corporation's shareholders [*Corp. Code § 166*; *see § 9.10 [1]*]. The corporation, therefore, is subject to the financial tests set forth in the General Corporation Law [*Corp. Code § 402(d)*; *see Corp. Code §§ 500-503*], unless it is subject to a statutory exemption. For discussion of those tests, which include the "retained earnings" test [*see Corp. Code § 500(a)*], the "remaining assets" test [*see Corp. Code § 500(b)*], the general solvency test [*see Corp. Code § 501*], and the liquidation and dividend preference tests [*see Corp. Code §§ 502-503*], and the statutory exemptions [*see Corp. Code §§ 500-511*], see *§ 9.11*.

Furthermore, even when the corporation satisfies the financial requirements of *Corp. Code §§ 500-503*, it may be prohibited from making a "distribution" to its shareholders pursuant to restrictions set forth in the corporation's articles, bylaws, or agreements [*see Corp. Code § 505*; *§ 9.11 [7]*]. Moreover, in authorizing the repurchase of shares, the directors are restricted by their duty to make corporate decisions in good faith, in the best interests of the corporation, and with reasonable care [*see Corp. Code § 309(a)*; *see § 9.200[1][b]*].

[iii] Professional Corporations

A corporation subject to the Moscone-Knox Professional Corporation Act [*see Corp. Code §§ 13400-13410* (applicable to corporations engaged in providing services in a single profession)] may purchase its own shares without regard to the statutory restrictions discussed above, if at least one share remains issued and outstanding [*Corp. Code § 13407*]. For coverage of share repurchase by professional corporations, see Ch. 12A, *Professional Corporations* .

[iv] Income Taxation

For purposes of federal income tax law, a corporation's stock is considered to be "redeemed" when the corporation acquires that stock from a shareholder in exchange for property, whether or not the stock acquired is cancelled, retired, or held as treasury stock [*I.R.C. § 317(b)*]. For discussion of the taxation of redemptions, see *§ 9.220[2]*. For discussion of the federal estate tax implications of a buy-sell agreement, Ch. 8D, *Buy-Sell Agreements*.

The taxation of distributions in California is determined in accordance with federal law, except as otherwise provided [*see Rev. & Tax. Code § 17321*].

[v] Status of Repurchased Shares

After the corporation has repurchased its shares, the reacquired shares are restored to the status of authorized but unissued shares, unless the articles prohibit their reissuance [*see Corp. Code § 510*]. For further discussion, see *§ 9.220[1][i]*.

[2] Form

Resolution Authorizing Repurchase of Shares

RESOLUTION DECLARING REPURCHASE OF SHARES

WHEREAS, on examination of the report, including a financial statement of this corporation [for the period of _____ (*date*), to_____ (*date*), *or* for the fiscal year ending _____ (*date*),] prepared by _____[*name*], an independent certified public accountant retained by the Board of Directors for that purpose, the Board finds that the corporation is able to expend $_____ to repurchase the outstanding _____ [*specify number and class or series of shares*] shares of the corporation;

WHEREAS, based on that report, the Board of Directors finds that the proposed repurchase would comply with the requirements set forth in *Corporations Code Sections 500-503*, and with any requirements set forth in the corporation's articles or bylaws and in any agreements entered into by the corporation;

WHEREAS, the Board believes that its reliance on the accuracy of that report is merited based on _____'s [*name of certified public accountant*] professional competence in accounting; and

WHEREAS, the Board of Directors deems it advisable, in the best interests of the corporation and its shareholders, to repurchase the shares described above;

IT IS THEREFORE RESOLVED, that the Board hereby authorizes the repurchase of the _____ [*specify number and class or series*] shares of this corporation in accordance with the terms set forth in _____ [*specify, e.g.,* the Buy-Sell Agreement dated _____]; and

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to take any other actions that are necessary to carry out the purpose and intent of this resolution, including the execution, acknowledgment, and filing of any documents, certificates, writings, or book entries that may be required to carry out this resolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Stock RedemptionsBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & Redemption



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
B. Reacquisitions of Shares

4-9 California Legal Forms--Transaction Guide §§ 9.223-9.229

[Reserved]

§§ 9.223[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
C. Share Dividends

4-9 California Legal Forms--Transaction Guide § 9.230

§ 9.230 Resolution Declaring Share Dividend--Corporation With One Class of Shares

[1] Comment

[a] Use of Form

This form is a resolution of the board of directors declaring a dividend in authorized but unissued shares. It covers only dividends paid in shares of the same class or series of shares on which the dividends were declared. Dividends of different classes or series, which are rarely declared, are beyond the scope of this chapter.

For general discussion of board resolutions, see *§ 9.200*. For a resolution declaring a share dividend in a corporation with more than one class of shares, see *§ 9.231*. For a resolution that declares a share dividend in unauthorized shares and approves an amendment to the articles that authorizes issuance of dividend shares, see *§ 9.232*.

[b] Share Dividend

[i] Definition

A corporation has the power to issue shares as a "share dividend" to its shareholders [*Corp. Code § 409(a)(2)*]. The General Corporation Law does not define the term "share dividend," but does distinguish it from a "stock split" [*see Corp. Code § 188* (definition of "stock split" excludes "share dividends"); *see § 9.232*]. Furthermore, it expressly excludes share dividends from the definition of "distribution" [*see Corp. Code § 166*; § 9.10[1]]. Therefore, the restrictions on corporate distributions [*see Corp. Code §§ 500-503*; § 9.11] do not apply to share dividends. These dividends are excluded from the financial restrictions because they do not decrease the corporate assets [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares* ; *see also* [ii], *below*]. The term "stock dividend," however, is defined for purposes of the Corporate Securities Law [*10 Cal. Code Reg. § 260.017*; *see Corp. Code §§ 25000-25706*; [g], *below*].

[ii] Purpose

Normally, a corporation pays dividends from its earnings for the current year and its retained earnings from past years [*see § 9.200*]. However, the profits of a corporation as shown on the balance sheet at the end of the year are not always in the form of money or property easily distributable among the shareholders. In order to meet the demands of a growing business, a corporation may have reinvested its earnings in expansion of its plant, equipment, or stock in trade. These reinvested earnings represent accumulated earnings of the corporation, and appear on its balance sheet under "retained earnings" [*see § 9.11[2]*]. Therefore, even if a corporation conducts a successful business for a period of years, it may be unable to declare dividends in the amount of its profits due to expansion of its operations. At some point, reinvested retained earnings may equal or exceed the amount of capital shown on its balance sheet as contributed by its shareholders for the shares of the corporation [*see Eisner v. Macomber (1920) 252 U.S. 189, 209-210, 40 S. Ct. 189, 64 L. Ed. 521]* .

The corporation may make a book adjustment to reflect the increase in the shareholders' investment due to an accumulation of profits by the corporation by declaring a "share dividend." Such an adjustment involves (1) issuing new shares of the corporation to the shareholders in proportion to the number of shares each of them already owns in the corporation, and (2) transferring the amount of the dividend from retained earnings to the corporation's capital stock account. Thus, a portion of the corporation's retained earnings are "capitalized" [*see Eisner v. Macomber (1920) 252 U.S. 189, 210, 40 S. Ct. 189, 64 L. Ed. 521]* .

A share dividend does not affect the proportionate interest of the shareholders, nor increase the value of their interests. It merely increases the number of shares, and concurrently dilutes the value of each share. It takes nothing from the property of the corporation and adds nothing to the interests of the shareholders [*see Eisner v. Macomber (1920) 252 U.S. 189, 212, 40 S. Ct. 189, 64 L. Ed. 521]* . For example, if before a $100,000 share dividend each shareholder owned a proportional part of the corporation's $200,000 capital stock account and $120,000 worth of retained earnings, after the dividend each shareholder owns a proportional part of the corporation's $300,000 capital stock account and $20,000 worth of retained earnings. The total shareholders' equity in the corporation after the dividend is still, as it was before the dividend, $320,000 [*see* H. Sellin, ed., Attorney'S Handbook of Accounting, Ch. 4, *Balance Sheet: Owners' Equity* (Matthew Bender)].

[iii] Valuation of Shares

For purposes of "capitalizing" the corporation's earnings upon issuance of the new shares [*see* [ii], *above*], the value of those new shares must be determined. Former law required an amount equal to "par value" or fair market value for no-par shares to be transferred to the capital account [*see* former *Corp. Code § 1506*]. The concept of par value of shares is no longer used in California [*see Corp. Code § 205*; discussion in *Ch. 6I, Issuance of Equity Securities, § 6I.19*]. However, generally accepted accounting principles require transfer of an amount equal to the fair market value of those shares [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares* ; H. Sellin, ed., Attorney'S Handbook of Accounting, Ch. 11, *Corporation Accounting* (Matthew Bender)].

[c] Tax Treatment

[i] Receipt of Share Dividend

A corporation does not recognize any gain or loss on the distribution of its own stock with respect to its outstanding shares [*I.R.C. § 311(a)(1)*]. Furthermore, it is not required to adjust its earnings and profits on the tax-free distribution of its own stock [*I.R.C. § 312(d)*; *see I.R.C. § 305(a)*; discussion below]. However, if the shareholders receiving the distribution recognize gain or are subject to tax upon receipt [*see I.R.C. § 305(b)*; discussion below], the corporation is required to adjust its earnings and profits in the same manner as if it had made a distribution of cash or property [*see I.R.C. § 312(a), (b)*; § 9.203].

Because a shareholder receives nothing of value as a result of a share dividend [*see* [b][ii], *above*], he or she ordinarily

is not required to include the amount of the dividend in gross income for purposes of federal or state income taxation [*I.R.C. § 305(a)*]. Over the years, however, corporations have devised various ways of using the tax-free status of share dividends to transfer corporate earnings to their shareholders without concomitant taxation on those earnings [*see* Cavitch, Business Organizations with Tax Planning, Ch. 142, *General Tax Considerations in Connection With Declarations and Payments of Dividends* (Matthew Bender)]. As a result, Congress attempted to close those loopholes by specifying that the following five types of share dividends are treated as property distributions that are taxable to the shareholders who receive them [*I.R.C. § 305(b)*; *see I.R.C. § 301*; *see also § 9.200[1][d]* (taxation of cash dividends)]:

(1) A distribution payable, at the election of the shareholder, in either stock or property.

(2) A distribution that results in the receipt of property by some shareholders, and an increase in the proportionate interest of other shareholders in the corporation's assets or earnings and profits.

(3) A distribution that results in the receipt of preferred shares by some common shareholders and the receipt of common shares by other common shareholders.

(4) A distribution on the preferred shares of the corporation, other than an increase in the conversion ratio of convertible preferred stock made solely to take account of a stock dividend or stock split with respect to the stock into which the convertible stock is convertible.

(5) A distribution of convertible preferred shares, unless it is established to the satisfaction of the Internal Revenue Service and the California Franchise Tax Board that the dividend will not, in fact, result in some shareholders receiving property and others increasing their proportionate interests in the corporation. Thus, a distribution of common stock on convertible preferred stock that is made to offset dilution due to a stock dividend paid on the common shares is treated as a distribution of property that is includible in the gross income of the preferred shareholders [*Rev. Rul. 83-42, 1983-1 C.B. 76* ; *see I.R.C. §§ 301, 305(b)(4)*], whereas an increase in the conversion ratio of convertible preferred shares to eliminate dilution of the conversion right will not be treated as income to the shareholders [*Rev. Rul. 83-42, 1983-1 C.B. 76* ; *see I.R.C. § 305(b)(4)*; *see* (4), *above*].

The taxation of distributions in California is determined in accordance with federal law, except as otherwise provided [*see Rev. & Tax. Code § 17321*].

For further discussion of the tax treatment of stock dividends, see Cavitch, Business Organizations with Tax Planning, Ch. 142, *General Tax Considerations in Connection With Declarations and Payments of Dividends* (Matthew Bender).

[ii] Sale of Shares Received as Dividend

If a shareholder sells shares received as a share dividend, other than common shares paid as a dividend on common shares, the sale proceeds received are treated as ordinary income [*I.R.C. § 306(a)(1), (c)(1)(A)*]. For tax years beginning after December 31, 2002, and before January 1, 2009, however, amounts treated as a dividend will be taxed at capital gains rates [*I.R.C. §§ 1(h)(11), 306(a)(1)(D)*; *see* Pub. Law No. 108-27, §§ 302(f)(1), 303 (effective date and sunset provisions)].

If a corporation pays a dividend to its common shareholders in preferred nonvoting shares, the common shareholders may sell the preferred shares without losing control of the corporation, but they must pay the same taxes on the sale proceeds as they would have paid on a cash dividend [*see I.R.C. § 306(a), (c)(1)(A)*]. Again, however, for tax years beginning after December 31, 2002, and before January 1, 2009, qualifying dividends paid to individuals are taxed at capital gains rates, and amounts treated as a dividend under *I.R.C. § 306* will also be taxed at capital gains rates for those years [*I.R.C. §§ 1(h)(11), 306(a)(1)(D)*; *see* Pub. Law No. 108-27, §§ 302(f)(1), 303 (effective date and sunset

provisions)].

For years in which dividends are taxed at ordinary income tax rates [generally tax years beginning before January 1, 2003, and after December 31, 2008, the "taint" that applies to Section 306 stock is meant to prevent a corporation from declaring a dividend in preferred nonvoting shares to its common shareholders and thereby, in effect, distributing its earnings to shareholders who would receive favorable capital gain treatment when they sold the shares [*see* Cavitch, Business Organizations with Tax Planning, Ch. 142, *General Tax Considerations in Connection With Declarations and Payments of Dividends* (Matthew Bender)].

Capital gains of noncorporate taxpayers are taxed at a lower rate than ordinary income. [*I.R.C. § 1(a)-(e), (h), (i)(2)*]. It should be noted that the maximum tax rate for individuals is significantly lower than the 35 percent tax rate that applies to capital gains of C corporations [*see I.R.C. §§ 1(h), 1201(a)*].

[d] Number of Authorized Shares

The corporation's articles of incorporation are required to state the total number of shares that the corporation is authorized to issue when there is only one class of shares [*Corp. Code § 202(d)*; *see* Ch. 3, *Articles of Incorporation*]. This form assumes that issuance of the share dividend will not exceed that number. For discussion of the amendment of articles to authorize issuance of additional shares to be distributed as a share dividend, see *§ 9.232*.

[e] Record Date

In order for the corporation to determine the shareholders who are entitled to receive payment of any dividend or other distribution, the board may fix a record date in advance. That date must not be more than 60, nor less than 10, days prior to the date for payment of the dividend [*Corp. Code § 701(a)*]. If the board does not fix a record date in advance, the record date is at the close of business on the day that the board adopts the resolution declaring the dividend, or the 60th day prior to the dividend payment date, whichever is later [*Corp. Code § 701(b)*].

For further discussion of the record date applicable to distributions, see *§ 9.200*.

[f] Fractional Shares

When a corporation declares a share dividend in an amount less than one new share for each existing outstanding share, some shareholders become entitled to fractional shares. For example, if the board declared a share dividend of one new share for every four outstanding shares, a shareholder owning one share would be entitled to an additional one-fourth of a share, a shareholder owning two shares would be entitled to an additional one-half of a share, and a shareholder owning three shares would be entitled to an additional three fourths of a share.

A corporation is not required to issue fractional shares, however [*Corp. Code § 407*]. If it does not do so in connection with any original issuance of shares, it must compensate shareholders entitled to fractional share interests in one of the following alternative ways [*Corp. Code § 407*]:

- Arrange for the disposition of fractional share interests by those shareholders entitled to fractional share interests;

- Pay in cash the fair value of fractions of a share as of the time that the shareholders entitled to receive fractions of a share are determined; or

- Issue scrip or warrants, either in registered form as certificated securities [*see Corp. Code § 156.1*; *Com. Code § 8102(a)(4)* (defined as shares evidenced by certificate)] or uncertificated securities [*see*

Corp. Code § 191.1; *Com. Code § 8102(a)(18)* (defined as shares not represented by certificate)], or in bearer form as certificated securities, entitling the holder to receive a certificate for a full share on surrender of scrip or warrants aggregating a full share.

If a corporation issues certificates for fractional shares, they must entitle the holder to exercise voting rights, to receive dividends, and to participate in any of the assets of the corporation in the event of liquidation [*Corp. Code § 407*].

A corporation cannot pay cash in lieu of fractional shares if that action would result in the cancellation of more than 10 percent of the outstanding shares of any class [*Corp. Code § 407*]. A determination by the board of directors of the fair value of fractions of a share is conclusive in the absence of fraud [*Corp. Code § 407*].

If a corporation issues scrip or warrants for fractional shares, its board of directors may impose a condition that they will become void if not exchanged for certificates representing full shares before a specified date, that the shares for which they are exchangeable may be sold by the corporation and the sale proceeds distributed to the holders of the scrip or warrants, or any other condition [*Corp. Code § 407*]. Scrip or warrants will not, unless otherwise provided, entitle the holder to exercise voting rights, to receive dividends, or to participate in any of the assets of the corporation in the event of liquidation [*Corp. Code § 407*]. For an example and discussion of a scrip certificate for a fraction of a share, see Ch. 6I, *Issuance of Equity Securities*, § 6I.204.

This form provides alternatives for payment in fractional shares, cash, or issuance of redeemable warrants to any shareholder entitled to a fractional share as part of the share dividend. The alternative providing for redeemable warrants also specifies that if the shareholder fails to redeem the warrant by a specified date, the shares represented by the outstanding warrants will be sold and the sale proceeds distributed among the warrant holders [*see* [2], *below*].

For further coverage of fractional shares, see Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness* .

[g] Application of Corporate Securities Law

[i] In General

The Corporate Securities Law of 1968 [*Corp. Code §§ 25000-25706*] regulates the "offer" and "sale" of "securities" in California. It provides that any offer or sale of a security in California must be qualified by the California Commissioner of Corporations, unless the transaction or security is expressly exempted by statute, or is not subject to qualification [*Corp. Code §§ 25110, 25120, 25130*; *see, e.g., Corp. Code §§ 25101.1, 25102.1*]. A "security" is defined as including any stock, treasury stock, or transferable share [*Corp. Code § 25019*; *see* Ch. 6, *Securities Regulation Issues* , [iii], *below*].

[ii] Stock Dividends That Are Not an "Offer" or "Sale"

The terms "offer" and "sale" do not include a "stock dividend," if (1) the dividend is payable on common shares solely (except for any cash or script paid for fractional shares) [*see* [f], *above*] in shares of that common stock, and (2) the corporation has no other class of voting shares outstanding [*Corp. Code § 25017(f)*]. For purposes of that definition, the term "stock dividend" means the issuance of additional shares (including treasury shares) of the issuer to its existing shareholders or to shareholders of a class, pro rata according to the shares previously held (except for any cash or scrip paid for fractional shares), without consideration other than the transfer from surplus to stated capital of an amount equal to or greater than the par, stated, or market value of the shares distributed, but without any other consideration being paid to the shareholders, and not by an amendment to the articles of incorporation stating the effect on outstanding shares. The term does not include a stock split [*see 10 Cal. Code Reg. § 260.103.2*; § 9.232], or exchange or reclassification of shares [*10 Cal. Code Reg. § 260.017(a)*]. For purposes of that definition, the terms "voting stock" and

"voting shares" mean any stock presently entitling the owner or holder to vote in elections of directors [*10 Cal. Code Reg. § 260.017.1*]. They do not include any security that entitles the owner or holder to vote in those elections only upon the happening of an event or contingency that has not yet occurred [*10 Cal. Code Reg. § 260.017.1*].

A stock dividend is not payable "solely" in shares of common stock if shareholders are given an option to accept either cash or additional shares of common stock [*10 Cal. Code Reg. § 260.017(b)*]. Furthermore, a stock dividend is not payable "in shares of that common stock" unless the dividend is payable in shares of voting common stock that is of the same class as the class upon which the dividend is paid [*10 Cal. Code Reg. § 260.017(c)*].

Even though a stock dividend is not an "offer" or a "sale" requiring qualification, the shares issued in that dividend are subject to any conditions previously imposed by the Commissioner of Corporations applicable to the shares with respect to which they are issued [*Corp. Code § 25017(f)*].

[iii] Stock Dividends Subject to Qualification

A stock dividend that falls within the definition of "sale" [*see Corp. Code § 25017*] must be qualified under *Corporations Code Section 25110* (issuer transactions) or 25120 (recapitalizations), as appropriate, before it can be paid, unless it is otherwise exempt under *Corporations Code Section 25100, 25102* (exempt issuer securities and transactions), 25103 (exempt reorganization and recapitalization transactions), or 25105 (transactions exempt by rule) [*10 Cal. Code Reg. § 260.017(d)*]. For discussion of qualification and examples of applicable forms, see Ch. 6H, *Qualification of Securities* ,. For coverage of the various exemptions from qualification, see the Transaction Guide in that chapter.

[2] Form

Resolution Declaring Share Dividend--Corporation With One Class of Shares

RESOLUTION DECLARING SHARE DIVIDEND

WHEREAS, the Board of Directors deems it advisable, in the best interests of the corporation and its shareholders, to declare a share dividend;

IT IS THEREFORE RESOLVED, that a dividend of one share of this corporation for every _____ [*number of shares*] outstanding shares of this corporation is hereby declared on the outstanding shares of common stock of this corporation, payable on _____[*date*] to the shareholders of record on the record date fixed in this resolution;

RESOLVED FURTHER, that pursuant to *Corporations Code Section 701*, the close of business on _____[*date*] is hereby fixed as the record date for the dividend declared in this resolution;

RESOLVED FURTHER, that the sum of $_____ per share is declared to be the estimated fair value of each share to be issued as part of the dividend declared in this resolution, making $_____ the estimated total fair value of all the shares to be issued as part of the dividend declared in this resolution;

[*If fractional shares will be issued:*]

RESOLVED FURTHER, that fractional shares shall be issued as part of the dividend declared in this resolution.

[*Or, if cash will be paid for fractional shares:*]

RESOLVED FURTHER, that no fractional shares shall be issued as part of the dividend declared in this resolution. Any shareholder who shall be entitled to a fractional share as part of the dividend declared in this resolution shall be paid in cash the fair value of that fraction. That value shall be determined by dividing the fraction of a share to which he or she is entitled into the estimated fair value of each share to be issued as part of the dividend declared in this resolution;

[*Or, if redeemable warrants will be issued for fractional shares:*]

RESOLVED FURTHER, that no fractional shares shall be issued as part of the dividend declared in this resolution. Any shareholder who shall be entitled to a fractional share as part of the dividend declared in this resolution shall be issued instead a warrant in _____ [registered *or* bearer] form, entitling that shareholder to a full share upon surrender of that and similar warrants aggregating a full share on or before 5:00 P.M. on _____[*date*];

RESOLVED FURTHER, that after 5:00 P.M. on _____ [*date specified in preceding paragraph*], all warrants issued pursuant to this resolution shall become void. The corporation shall sell the shares represented by any unsurrendered warrants on the open market and distribute the aggregate proceeds of the sale proportionately to the holders of record on that date of the unsurrendered warrants;

[*Continue with the following:*]

RESOLVED FURTHER, that the Chief Financial Officer of this corporation is directed to transfer the sum of $_____, which is the estimated total fair value of all the shares to be issued as part of the dividend declared in this resolution, from retained earnings to capital on the books and financial records of this corporation.

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to issue and deliver in the manner, proportions, and to the persons specified in this resolution the shares required for the dividend declared in this resolution; and

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to take any other actions that are necessary to carry out the purpose and intent of this resolution, including the execution, acknowledgment, and filing of any documents, certificates, writings, or book entries that may be required to carry out this resolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsDividends (IRC secs. 316, 561-565)Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Distributions of Property



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
C. Share Dividends

4-9 California Legal Forms--Transaction Guide § 9.231

§ 9.231 Resolution Declaring Share Dividend--Corporation With More Than One Class of Shares

[1] Comment

[a] Use of Form

This form is a resolution of the board of directors declaring a dividend in authorized but unissued shares to shareholders of a specific class or series of outstanding shares. This comment discusses only the issues that are unique to this form. All other topics generally applicable to resolutions declaring share dividends are *set forth in § 9.230*.

For a resolution declaring a share dividend in a corporation with only one class of shares, see *§ 9.230*. For a resolution that declares a share dividend in unauthorized shares and approves an amendment to the articles authorizing issuance of dividend shares, see *§ 9.232*.

[b] Classes and Series

A corporation may issue one or more classes and/or series of shares with whatever characteristics are stated or authorized in the articles [*Corp. Code § 400(a)*]. Unless a class is divided into series, all shares of any one class have the same voting, conversion, and redemption rights, and the same preferences, privileges, and restrictions. When a class is divided into series, all the shares of any one series have the same voting, conversion, and redemption rights, and the same preferences, privileges, and restrictions [*Corp. Code § 400(b)*].

For further coverage of the issuance of classes and series of shares, see Ch. 6I, *Issuance of Equity Securities* .

[c] Corporate Securities Law Requirement

A stock dividend constitutes an "offer" or "sale" of a security requiring qualification with the Commissioner of Corporations or exemption from qualification, if (1) it is not payable in common shares on common shares, or (2) the corporation has more than one class of voting shares outstanding [*Corp. Code § 25017(f); see § 9.230[1][g]*]. Because this form is designed for a corporation with more than one class or series of shares, whose dividend may be subject to

qualification under the above requirement, it provides that the stock dividend will be paid only after qualification or exemption of the securities when required [*see* Form]. For discussion of qualification and examples of applicable forms, see Ch. 6I, *Issuance of Equity Securities* . For coverage of the various exemptions from qualification, see the Transaction Guide in that chapter.

[d] Income Taxation of Share Dividends

Although a share dividend is ordinarily not taxable to the shareholders [*see I.R.C. § 305(a)*], a distribution on preferred shares (other than an increase in the conversion ratio of convertible preferred stock made solely to take account of a stock split with respect to the stock into which the convertible stock is convertible) is taxed in the same manner as a cash or property dividend [*I.R.C. § 305(b)(4)*; *see I.R.C. § 301*]. For further discussion, see *Section 9.230[1][c][i]*.

[2] Form

Resolution Declaring Share Dividend--Corporation With More Than One Class of Shares

RESOLUTION DECLARING SHARE DIVIDEND

WHEREAS, the Board of Directors deems it advisable, in the best interests of the corporation and its shareholders, to declare a share dividend;

IT IS THEREFORE RESOLVED, that a dividend of one _____ [*specify type, e.g.*, common] share of this corporation for every _____ [*number of shares*] _____ [*specify type, e.g.*, common] outstanding shares of this corporation is hereby declared on the outstanding _____ [*specify type, e.g.*, common] shares of this corporation.

FURTHER RESOLVED, that the dividend is payable on _____[*date*] to the shareholders of record of the _____ [*specify type, e.g.*, common] shares of this corporation on the record date fixed in this resolution;

RESOLVED FURTHER, that pursuant to *Corporations Code Section 701*, the close of business on _____[*date*] is hereby fixed as the record date for the dividend declared in this resolution;

RESOLVED FURTHER, that the sum of $_____ per share is declared to be the estimated fair value of each share to be issued as part of the dividend declared in this resolution, making $_____ the estimated total fair value of all the shares to be issued as part of the dividend declared in this resolution;

[*If fractional shares will be issued:*]

RESOLVED FURTHER, that fractional shares shall be issued as part of the dividend declared in this resolution.

[*Or, if cash will be paid for fractional shares:*]

RESOLVED FURTHER, that no fractional shares shall be issued as part of the dividend declared in this resolution. Any shareholder who shall be entitled to a fractional share as part of the dividend declared in this resolution shall be paid in cash the fair value of that fraction. That value shall be determined by dividing the fraction of a share to which he or she is entitled into the estimated fair value of each share to be issued as part of the dividend declared in this resolution;

[*Or, if redeemable warrants will be issued for fractional shares:*]

RESOLVED FURTHER, that no fractional shares shall be issued as part of the dividend declared in this resolution. Any shareholder who shall be entitled to a fractional share as part of the dividend declared in this resolution shall be issued instead a warrant in _____ [registered *or* bearer] form, entitling that shareholder to a full share upon surrender of that and similar warrants aggregating a full share on or before 5:00 P.M. on _____[*date*];

RESOLVED FURTHER, that after 5:00 P.M. on _____ [*date specified in preceding paragraph*], all warrants issued pursuant to this resolution shall become void. The corporation shall sell the shares represented by any unsurrendered warrants on the open market and distribute the aggregate proceeds of the sale proportionately to the holders of record on that date of the unsurrendered warrants;

[*Continue with the following:*]

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to execute and file on behalf of this corporation any application or notice for qualification or exemption from qualification of the shares issued as part of the dividend declared in this resolution that is required under federal or California law with the Securities and Exchange Commission or the California Commissioner of Corporations.

RESOLVED FURTHER, that upon qualification or exemption from qualification under the Corporate Securities Law of the dividend declared by this resolution, the Chief Financial Officer of this corporation is directed to transfer the sum of $_____, which is the estimated total fair value of all the shares to be issued as part of the dividend declared in this resolution, from retained earnings to the capital represented by its outstanding _____ [*specify type, e.g.*, common *or* preferred] shares on the books and financial records of this corporation.

RESOLVED FURTHER, that upon qualification or exemption from qualification under the Corporate Securities Law of the dividend declared by this resolution, the officers of this corporation are authorized and directed to issue and deliver in the manner, proportions, and to the persons specified in this resolution the shares required for the dividend declared in this resolution; and

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to take any other actions that are necessary to carry out the purpose and intent of this resolution, including the execution, acknowledgment, and filing of any documents, certificates, writings, or book entries that may be required to carry out this resolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsDividends (IRC secs. 316, 561-565)Tax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Stock & Stock RightsBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & DistributionBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of Stock



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
C. Share Dividends

4-9 California Legal Forms--Transaction Guide § 9.232

§ 9.232 Resolution Declaring Share Dividend and Approving Amendment to Articles--Corporation With One Class of Shares

[1] Comment

[a] Use of Form

This form is a resolution of the board of directors declaring a dividend in unauthorized and unissued shares, and providing for amendment of the articles of incorporation to authorize those shares. This comment discusses only the issues that are unique to this form. All other topics generally applicable to resolutions declaring share dividends are *set forth in § 9.230*.

For a resolution declaring a share dividend in authorized but unissued shares, in a corporation with one class of shares, see *§ 9.230*. For a similar resolution in a corporation with more than one class of shares, see *§ 9.231*.

[b] Amendment of Articles

A corporation may amend its articles from time to time, as long as its articles as amended contain only provisions that would be lawful to insert in original articles filed at the time the amendment is filed [*Corp. Code § 900(a)*]. After shares have been issued, amendments generally must be approved by the board and by the outstanding shares [*see Corp. Code § 152* (definition)] either before or after board approval [*Corp. Code § 902(a)*]. A proposed amendment must be approved by the outstanding shares of a class, whether or not the class is entitled by the articles to vote on it, if the amendment would increase or decrease the aggregate number of authorized shares of that class, other than an increase as provided in *Corporations Code Section 405(b)* (relating to amendment to increase authorized number of shares to satisfy option or conversion rights previously approved by the outstanding shares), or an increase incident to a stock split [*Corp. Code § 903(a)(1)*; *see Corp. Code §§ 188* (stock split defined), 902(c); [c], *below*].

The most common manner of approving an amendment is by the adoption of a resolution setting forth the proposed amendment. The resolution may be worded so that it can be adopted verbatim by the outstanding shares as their resolution [*see Ch. 10, Amendment of Articles, § 10.240* , for alternative resolution provisions]. For amendments

adopted after the corporation has issued any shares, the corporation must file a certificate of amendment [*Corp. Code § 905*; *see Corp. Code § 907* (contents of certificate)].

For further discussion of the amendment of articles and applicable forms, see Chapter 10, *Amendment of Articles* .

[c] Share Dividend Distinguished From Stock Split

[i] In General

If the number of shares issued in a share dividend is so great that it materially reduces the market value of the outstanding shares, it may be considered a "stock split" for accounting purposes rather than a share dividend [*see* Ballantine & Sterling, California Corporation Laws, vol. 1, Ch. 8, *Dividends and Reacquisitions of Shares; see* [ii], *below*]. Furthermore, a dividend effectuated pursuant to an amendment to the articles may be considered a stock split for purposes of the Corporate Securities Law [*see 10 Cal. Code Reg. § 260.017(a)*; *Corp. Code §§ 25000-25706*; [iv], *below*].

The term "share dividend" is not defined under the General Corporation Law, but is generally understood to mean the issuance of additional shares of stock in proportion to shareholders' holdings, by transfer of retained earnings to capital [*see* H. Sellin, ed., Attorney'S Handbook of Accounting, Ch. 11, *Corporation Accounting* (Matthew Bender); § 9.230[1][b] [i]]. Under the General Corporation Law, a "stock split" is defined as the pro rata division, other than by a share dividend, of all the outstanding shares of a class into a greater number of shares of the same class by an amendment to the article stating the effect on outstanding shares [*Corp. Code § 188*]. A "reverse stock split" means the pro rata combination of all the outstanding shares of a class into a smaller number of shares of the same class by an amendment to the articles stating the effect on outstanding shares [*Corp. Code § 182*].

Stock dividends and stock splits are similar, to the extent that they increase the number of shares held by shareholders without increasing their equity [*see* H. Sellin, ed., Attorney'S Handbook of Accounting, Ch. 11, *Corporation Accounting* (Matthew Bender)]. Furthermore, neither involves the distribution of cash or property (except for cash paid for fractional shares) and therefore neither is subject to the financial tests required for corporate "distributions" [*see Corp. Code §§ 166, 500-503*; § 9.11]. The difference between a share dividend and a stock split, however, is in the purpose of the action. A share dividend is a method of capitalizing retained earnings--that is, transferring funds on the books of the corporation from the retained earnings account to the capital stock account [*see § 9.230[1][b][ii]*]. The purpose of a stock split is simply to increase the number of outstanding shares of a class of shares, thereby reducing the price per share in order to provide improved marketability. It generally has no effect on the corporate financial structure [H. Sellin, ed., Attorney's Handbook of Accounting, Ch. 11, *Corporation Accounting* (Matthew Bender)]. A reverse stock split is intended to increase the market value per share of a corporation, or to freeze out minority shareholders [*see* Ballantine & Sterling, California Corporation Laws, Ch. 8, *Dividends and Reacquisition of Shares* (Matthew Bender)].

This form is designed as a resolution amending the articles to effect a stock dividend. For a resolution amending the articles to effect a stock split, see Chapter 10, *Amendment of Articles* .

[ii] Accounting Treatment

The corporation's accountant must treat a stock dividend or a stock split differently. A dividend requires transfer of an appropriate amount from retained earnings to capital. A stock split generally requires no changes in the corporate accounts other than the number of outstanding shares [*see* H. Sellin, ed., Attorney'S Handbook of Accounting, Ch. 4, *Balance Sheet: Owners' Equity* (Matthew Bender 3d ed.)].

To determine whether a transaction is a dividend or a split, the accountant must consider the intent of the transaction and its effect on the price of the outstanding shares [Z. Cavitch, Business Organizations with Tax Planning, Ch. 140,

Permissible Sources of Dividends (Matthew Bender); *see* [i], *above*]. The American Institute of Certified Public Accountants has stated that generally accepted accounting principles require a stock dividend of 20-25 percent or less to be treated as a true stock dividend, and require amounts above that to be treated as stock splits [*see* H. Sellin, ed., Attorney'S Handbook of Accounting, Ch. 11, *Corporation Accounting* (Matthew Bender 3d ed.)].

[iii] Shareholder Approval Requirements

If an amendment to the articles of incorporation effects a stock split (including a proportional increase in the authorized number of shares), the board may adopt the amendment if the corporation has only one class of shares outstanding [*Corp. Code § 902(c)*]. In contrast, an amendment pursuant to a share dividend requires the approval of the outstanding shares [*see Corp. Code § 902(a)*; *see also* [b], *above*].

[iv] Securities Law Implications

A share dividend must be qualified (or exempt from qualification) under the Corporate Securities Law only if it constitutes an "offer" or "sale" of securities. A share dividend is not an offer or sale of securities if it is a dividend payable with respect to common shares solely in common shares, and the corporation has no other class of voting shares outstanding [*Corp. Code § 25017(f)*; *see § 9.230[1][g][i]*]. A stock split or reverse stock split must be qualified (or exempt from qualification) if (1) the corporation has more than one class of voting shares outstanding and the stock split would materially affect the proportionate interests of the respective classes as to voting, dividends, or distributions, (2) the stock split is of shares traded on a market, and the market price as of the date of the directors' approval of the split adjusted to give effect to the split was less than $2, or (3) in a reverse stock split, the corporation has the option of paying cash for any fractional shares created by the reverse split, and as a result of that action, the proportionate interests of the shareholders would be substantially altered [*Corp. Code § 25103(f)*].

For purposes of this rule, a stock split is defined as the subdivision or combination of previously outstanding shares of stock (whether or not including authorized and unissued shares) into a greater or lesser number of shares of the same class, effected by an amendment to the charter documents of the issuer. A stock split may or may not be accompanied by the transfer of surplus to stated capital pursuant to a simultaneous change in the par value of the shares as constituted after the stock split or pursuant to resolution of the board of directors or shareholders [*10 Cal. Code Reg. § 260.103.2*].

This resolution is designed to effect a share dividend of common shares on common shares, in a corporation with only one class of shares outstanding. Thus, whether the resolution in this form is considered as declaring a share dividend or a stock split, ordinarily it will not be necessary to qualify the shares with the Commissioner of Corporations. In the rare case that the resolution in this form would require qualification, it may be modified to include a provision, such as that *set forth in § 9.231[2]*, regarding qualification and exemption.

[2] Form

Resolution Declaring Share Dividend and Approving Amendment to Articles--Corporation With One Class of Shares

RESOLUTION DECLARING SHARE DIVIDEND AND AUTHORIZING AMENDMENT OF ARTICLES

WHEREAS, on examination of the financial reports submitted to this meeting by _____[*name*], _____ [Chief Financial Officer of this corporation *or* a Certified Public Accountant], the Board of Directors finds that this corporation has retained earnings as of the close of business on _____[*date*], of $_____; and

WHEREAS, because of expansion of the corporation's business, $_____ of its retained earnings have become invested in fixed assets that should remain permanent capital of the corporation; and

WHEREAS, the Board of Directors deems it advisable in the best interests of the corporation and its shareholders, to declare a share dividend on the outstanding shares of this corporation, but the corporation is not authorized by its Articles of Incorporation to issue additional shares;

IT IS THEREFORE RESOLVED, that Section _____ of Article _____ of the Articles of Incorporation of this corporation be amended to increase the number of shares authorized to be issued by this corporation and to read as follows:

_____ [*Section or paragraph number*]. "This corporation is authorized to issue a total of _____[*number*] shares";

RESOLVED FURTHER, that a special meeting of the shareholders of this corporation is hereby called for _____ o'clock _____ [A.M. *or* P.M.], on _____[*date*], at the office of the corporation at _____[*address*], for the purpose of approving the amendment of the Articles of Incorporation described in this resolution;

RESOLVED FURTHER, that the Secretary of this corporation is hereby directed to give notice, in the manner required by law, of the special meeting of shareholders called in this resolution;

RESOLVED FURTHER, that the President and Secretary of this corporation are hereby authorized and directed, on approval of the outstanding shares of the amendment of the Articles of Incorporation, to execute, acknowledge, and file with the Secretary of State a Certificate of Amendment amending the Articles of Incorporation in the manner approved in this resolution, and to take all other actions reasonably required to perfect the amendment of the Articles of Incorporation approved in this resolution;

RESOLVED FURTHER, that subject to perfection of the amendment of the Articles of Incorporation approved in this resolution, a dividend of one share of this corporation for every _____ [*number of shares*] outstanding shares of this corporation is hereby declared on the outstanding shares of common stock of this corporation, payable on _____[*date*], to the shareholders of record on the record date fixed in this resolution;

RESOLVED FURTHER, that pursuant to *Corporations Code Section 701*, the close of business on _____[*date*], is hereby fixed as the record date for the dividend declared in this resolution;

RESOLVED FURTHER, that the sum of $_____ per share is declared to be the estimated fair value of each share to be issued as part of the dividend declared in this resolution, making $_____ the estimated total fair value of all the shares to be issued as part of the dividend declared in this resolution;

[*If fractional shares will be issued:*]

RESOLVED FURTHER, that fractional shares shall be issued as part of the dividend declared in this resolution.

[*Or, if cash will be paid for fractional shares:*]

RESOLVED FURTHER, that no fractional shares shall be issued as part of the dividend declared in this resolution. Any shareholder who shall be entitled to a fractional share as part of the dividend declared in this resolution shall be paid in cash the fair value of that fraction. That value shall be determined by dividing the fraction of a share to which he or she is entitled into the estimated fair value of each share to be issued as part of the dividend declared in this resolution;

[*OR, if redeemable warrants will be issued for fractional shares:*]

RESOLVED FURTHER, that no fractional shares shall be issued as part of the dividend declared in this resolution. Any shareholder who shall be entitled to a fractional share as part of the dividend declared in this resolution shall be issued instead a warrant in _____ [registered *or* bearer] form, entitling that shareholder to a full share upon surrender of that and similar warrants aggregating a full share on or before 5:00 P.M. on _____[*date*];

RESOLVED FURTHER, that after 5:00 P.M. on _____ [*date specified in preceding paragraph*], all warrants issued pursuant to this resolution shall become void. The corporation shall sell the shares represented by any unsurrendered warrants on the open market and distribute the aggregate proceeds of the sale proportionately to the holders of record on that date of the unsurrendered warrants;

[*CONTINUE*]

RESOLVED FURTHER, that the Chief Financial Officer of this corporation is directed to transfer the sum of $_____, which is the estimated total fair value of all the shares to be issued as part of the dividend declared in this resolution, from retained earnings to capital on the books and financial records of this corporation;

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to issue and deliver in the manner, proportions, and to the persons specified in this resolution the shares required for the dividend declared in this resolution, to reflect the transfer of shares in the corporate books of account; and

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to take any other actions that are necessary to carry out the purpose and intent of this resolution, including the execution, acknowledgment, and filing of any documents, certificates, writings, or book entries that may be required to carry out this resolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDeclaration & Distribution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
C. Share Dividends

4-9 California Legal Forms--Transaction Guide §§ 9.233-9.239

[Reserved]

§§ 9.233[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
D. Assessment of Shares

4-9 California Legal Forms--Transaction Guide § 9.240

§ 9.240 Resolution Levying Assessment

[1] Comment

[a] Use of Form

This form is a resolution of the board of directors levying an assessment on outstanding shares. It is intended for use when the corporation has issued assessable shares. The issuance of securities is covered in Ch. 6I, *Issuance of Equity Securities* .

For a notice of levy given by the corporate secretary to the shareholders, see *§ 9.241*. For a notice that the corporation has extended the date of sale of delinquent shares, see *§ 9.242*. The certificate of sale of delinquent shares is *set forth in § 9.243*.

[b] Power to Levy Assessment

Corporate shares are not assessable, except as provided in the General Corporation Law or in any other statute [*Corp. Code § 423(a)*; *see, e.g., Corp. Code §§ 5351* (public benefit corporations), 7351 (mutual benefit corporations), 9351 (religious corporations)]. Under the General Corporation Law, if a corporation's articles of incorporation expressly confer the authority to levy and collect assessments on the corporation or the board of directors [*see Corp. Code § 204(a)(1)* (optional article provision)], the board has the discretion to levy and collect assessments on all the shares of any or all classes made subject to assessment [*Corp. Code § 423(a)*]. For an example of an article provision authorizing the corporation to assess its shares, see Ch. 3, *Articles of Incorporation* .

The directors must exercise their discretion, however, in good faith, in the best interests of the corporation, and with reasonable care [*see Corp. Code § 309*; § 9.200[1][b][iv]; *see also* Ch. 5, *Directors' Meetings, Actions, and Resolutions*]. The board must levy and collect the assessment in accordance with any limitations set forth in the articles, as well as with the generally applicable levy requirements [*Corp. Code § 423(a)*; *see* [d], *below*]. This right to levy assessments is in addition to the corporation's right to recover the unpaid subscription price, or remainder of the price, of the shares [*Corp. Code § 423(a)*; *see Corp. Code § 410(a)* (subscribers' liability for subscription price)].

[c] Application of Securities Laws

Generally, the Commissioner of Corporations will not qualify for issuance [*see Corp. Code § 25110* (qualification requirement)] shares that are made subject to assessment. However, issuers organized solely to supply services or property to their members on a continuing basis may provide for an equitable assessment according to the services or property supplied [*10 Cal. Code Reg. § 260.140.8*]. Furthermore, the Commissioner may allow a variance from the general standard when justified by the circumstances, or, in the case of a limited offering [*see Corp. Code § 25102(f)*], when the offer and sale will not be unfair, unjust, or inequitable to the initial purchasers [*10 Cal. Code Reg. § 260.140*; *see* Ch. 6I, *Issuance of Equity Securities*].

Under the Securities Act of 1933 [*see 15 U.S.C. §§ 77a-77aa*], the levy of an assessment constitutes an offer and sale of securities requiring qualification or exemption [*see 17 C.F.R. § 230.136*]. The Corporate Securities Law [*see Corp. Code §§ 25000-25706*] and its regulations do not contain an equivalent provision [*see* Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness*]. However, the sale of assessable securities, to pay a delinquent assessment or otherwise [*see § 9.243[1]*], requires the same compliance with the Corporate Securities Law as any other sale of securities.

For further discussion of the qualification and exemption of securities under federal and state law, see Ch. 6, *Securities Regulation Issues* ,.

[d] Levy and Sale Procedures

In order to take the steps necessary to levy an assessment, the board of directors must adopt appropriate resolutions that authorize those actions and formally set forth the levy itself [*see* Ballantine & Sterling, California Corporation Laws, Ch. 7, *Issuance of Shares and Indebtedness* (Matthew Bender)]. For a discussion of corporate resolutions generally, see *§ 9.200[1][b][i]*.

Every levy of an assessment must do the following [*Corp. Code § 423(b)*]:

- Specify the amount of the assessment (per share), and specify to whom and where it is payable;
- Fix a date on which the assessment is payable; or, if proceedings or filings with any governmental or other agency for any qualification, permit, registration, or exemption therefrom are required as a condition precedent to the levy or payment of an assessment, provide for the establishment of a date on which the assessment is payable;
- Fix a date, not less than 30 nor more than 60 days from the date the assessment is payable, on which the assessment becomes delinquent if not paid;
- Fix a date, not less than 15 nor more than 60 days from the date on which the unpaid assessment becomes delinquent, for the sale of delinquent shares; and
- Fix the hour and place of sale of delinquent shares.

The place fixed for the sale must be in the county where the corporation is required to keep a copy of its bylaws, i.e., the county where the corporation's principal executive office in California is located, or the county where its principal business office in California is located when the principal executive office is outside California [*Corp. Code § 423(b)*;*see Corp. Code § 213*]. If the corporation has neither a principal executive office nor a principal business office in California, the place fixed for the sale of delinquent shares must be in the county of Sacramento [*Corp. Code § 423(b)*]. For further coverage of the sale of delinquent shares [*see Corp. Code § 423(f)-(k)*], see *Section 9.243[1]*.

[e] Notice of Assessment

After the board has made a levy of assessment on assessable shares, the secretary must give notice of the levy to the shareholders [*Corp. Code § 423(c), (d)*]. The assessment becomes a lien on the shares assessed from the time of personal service or publication of that notice of assessment, or from the time of levy itself if the articles so provide [*Corp. Code § 423(e)*]. For an example and discussion of the notice, see *Section 9.241*.

[f] Transfer of Shares

Unless otherwise provided by law, a transfer of the shares on the books of the corporation after the lien of an assessment has attached is a waiver of the lien, unless a conspicuous legend is placed on the face of any certificate issued upon the transfer, or, with respect to uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)* (defined as shares not represented by certificate or other instrument)], on the initial transaction statement [*Corp. Code § 423(e)*; *see Corp. Code § 171.1* (definition); *see also Ch. 6I, Issuance of Equity Securities, § 6I.20[2]*]. The legend must contain the same information as the notice to shareholders regarding the assessment [*Corp. Code § 423(e)*; *see Corp. Code § 423(c)*; § 9.241]. The corporation must remove the legend if the assessment on the shares evidenced by the certificate is paid, if the shares are sold to pay the assessment, or the shares are forfeited for nonpayment [*Corp. Code § 423(e)*]. For an example and discussion of that legend, see *Ch. 6I, Issuance of Equity Securities, § 6I.203*. For coverage of legend conditions generally, see *§ 6I.200* in that chapter.

Similarly, the Commercial Code provisions governing investment securities [*see Com. Code § 8101 et seq.*] provide that an issuer's lien is valid against a purchaser only if (1) for certificated securities, the right of the issuer is noted conspicuously on the certificate [*Com. Code § 8209*; *see Corp. Code § 174* (definition)]; or (2) for uncertificated securities, a notation of the issuer's right to the lien is contained on the initial transaction statement sent to the purchaser, or on any instrument, indenture, or document (or in any constitution, statute, ordinance, rule, regulation, order or the like) pursuant to which the security is issued [*Com. Code § 8209*; *see* Ch. 6I, *Issuance of Equity Securities*].

[2] Form

Resolution Levying Assessment

RESOLUTION LEVYING ASSESSMENT ON SHARES

WHEREAS, Article _____ of the Articles of Incorporation of this corporation expressly confers on the Board of Directors the authority to levy and collect assessments on the corporation's outstanding _____ [*class or series, e.g.*, preferred] shares; and

WHEREAS, this Board of Directors deems it advisable, in the best interests of the corporation and in order to beneficially conduct the corporation's business and financial affairs, to levy an assessment on the corporation's outstanding _____ [*class or series, e.g.*, preferred] shares;

IT IS THEREFORE RESOLVED, that an assessment of $_____ per share is levied on all of this corporation's outstanding _____ [*class or series, e.g.*, preferred] shares;

RESOLVED FURTHER, that the assessment is payable to this corporation at its principal office located at _____[*address*],

[*If there are no conditions precedent to levy or payment of assessment:*]

on or before _____[*date*];

[*Or, if proceedings or filings with agency for qualification, permit, registration, or exemption are condition precedent to levy or payment of assessment:*]

_____ [*provide for establishment of date on which assessment is payable, e.g.,* on the date determined by the board after it has taken all actions to comply with applicable laws and regulations];

[*Continue with the following:*]

RESOLVED FURTHER, that _____ [*specify date not less than 30 nor more than 60 days from date assessment is payable, or* _____ (*number between 30 and 60*) days from the date on which the assessment is payable] is fixed as the day on which any part of the assessment levied by this resolution remaining unpaid shall become delinquent;

RESOLVED FURTHER, that _____[*time*] _____ [A.M. *or* P.M.] on _____ [*date not less than 15 nor more than 60 days from delinquency date, or* _____ (*number between 15 and 60*) days from the delinquency date] is fixed as the time and date, and _____ [*specify place and county in California where bylaws are kept or, if none, in Sacramento*] is fixed as the place, for the sale of delinquent shares;

RESOLVED FURTHER, that the board may extend the sale date from time to time, for not more than 30 days at a time, by order of the board entered on the records of the corporation;

RESOLVED FURTHER, that if a shareholder submits payment of the assessment levied on any shares by this resolution to the corporation after the date on which it becomes delinquent under the terms of this resolution, but before the hour and date specified in this resolution for sale of delinquent shares, he or she must pay a penalty of five percent of the assessment imposed on the shares in addition to the assessment levied on the shares;

RESOLVED FURTHER, that the Secretary of this corporation is authorized and directed to give notice of the levy of the assessment levied by this resolution in the manner and form specified in *Corporations Code Section 423*;

RESOLVED FURTHER, that at the time and place appointed in this resolution for sale of delinquent shares, _____ [*designate officer or agent of corporation*] is directed and authorized to sell, or cause to be sold, to the highest bidder for cash, as many shares of the assessed shares of each delinquent shareholder as are necessary to pay the assessment and penalty on the shares of that holder, according to the notice of assessment served pursuant to *Corporations Code Section 423*;

RESOLVED FURTHER, that the person who, at the sale of delinquent shares, offers to pay the assessment and penalty levied against a delinquent holder in return for the smallest number of shares shall be the highest bidder. Upon payment of the assessment and penalty, the shares purchased shall be transferred to the highest bidder and a new certificate issued for them;

RESOLVED FURTHER, that if no bidder at the sale of delinquent shares offers to pay the assessment amount due on any delinquent shares plus a penalty of five percent of that amount, the shares shall be forfeited to the corporation in satisfaction of the assessment and penalty imposed on them;

RESOLVED FURTHER, that on completion of the sale of delinquent shares, the Secretary [*or* Assistant Secretary] of this corporation is authorized and directed to execute and file the certificate described in *Corporations Code Section 423(k)* in the manner and form specified in that statute; and

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to take any other actions that are necessary to carry out the purpose and intent of this resolution, including the execution, acknowledgment, and filing of any documents, certificates, writings, or book entries that may be required to carry out this resolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsShareholdersTransfers of Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
D. Assessment of Shares

4-9 California Legal Forms--Transaction Guide § 9.241

§ 9.241 Notice of Assessment

[1] Comment

[a] Use of Form

This form is a notice to the shareholders of the levy of an assessment on their corporate shares. It is designed for use by a corporation subject to the General Corporation Law [*see Corp. Code §§ 100-2319*] whose articles of incorporation authorize it to levy and collect assessments on any or all of its shares [*see Corp. Code § 423(a)*; § 9.240]. For coverage of the applicable assessment requirements under the Nonprofit Corporation Law [*see Corp. Code §§ 5351* (public benefit corporations), 7351 (mutual benefit corporations), 9351 (religious corporations)], see Ch. 13, *Nonprofit Corporations* .

For an example of the board resolution levying an assessment, see *§ 9.240[2]*. For a notice that the corporation has extended the date of sale of delinquent shares, see *§ 9.242[2]*. For the certificate of sale of delinquent shares, see *§ 9.243[2]*.

[b] Contents of Notice

On or before the date that an assessment is payable [*see Corp. Code § 423(b)* (board must set payment date); *see also § 9.240*], the secretary of the corporation must give notice of the assessment. The notice must state: (1) the corporation's name and the location of its principal executive office, (2) that the board has levied a specified amount per share on designated classes, (3) the delinquency date, (4) that delinquent shares will be sold, (5) the sale date, time, and place, and (6) the delinquency penalty [*Corp. Code § 423(c)*]. For coverage of the statutory restrictions on the payment, delinquency, and sale dates, and the required place of sale [*see Corp. Code § 423(b)*], see *Section 9.240[1][d]*.

The notice must set forth the above information in substantially the form specified in *Corporations Code Section 423(c)*. This form complies with that statutory format.

[c] Service of Notice

The notice must be personally served on each holder of record of shares assessed, or mailed and published [*Corp. Code § 423(d)*]. If the notice is mailed, it must be addressed to the shareholder at (1) the last address for that shareholder appearing on the books of the corporation, (2) the last address given by him or her to the corporation for the purpose of notice, or (3) if no such address appears or is given, the place where the principal executive office of the corporation is located [*Corp. Code § 423(d)*]. When the notice is mailed, it must also be published once in a newspaper of general circulation in the county where the principal executive office of the corporation is located. If there is no such newspaper in that county, the publication must be made in a newspaper of general circulation in an adjoining county [*Corp. Code § 423(d)*]. However, the assessment is not invalidated by a failure to publish the notice [*Corp. Code § 423(l)*].

[2] Form

Notice of Assessment

NOTICE OF ASSESSMENT

[_____ *State full name of corporation*],
A California corporation
Principal executive office: _____ [*address*].

NOTICE IS HEREBY GIVEN that the Board of Directors on _____[*date*] has levied an assessment of $_____ [*amount*] per share upon the _____ [*name or designation of class or series of shares, e.g.*, common *or* preferred] shares of the corporation payable to _____ [*specify, e.g.*, the corporation] at _____[*address*], California. Any shares upon which this assessment remains unpaid on _____ [*specify date*] will be delinquent. Unless payment is made prior to delinquency, the delinquent shares (or as many of them as necessary) either will be sold at _____ [*specify place*], on _____[*date*], at _____[*time*] _____ [A.M. *or* P.M.] to pay the delinquent assessment together with a penalty of 5 percent of the amount of the assessment on those shares, or will be forfeited to the corporation.

_____Dated:

SECRETARY

_____ [*signature of secreta ry*]

[*typed name*]

_____ [*location of office*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
D. Assessment of Shares

4-9 California Legal Forms--Transaction Guide § 9.242

§ 9.242 Extension of Sale Date

[1] Comment

[a] Use of Form

This form is a notice that the corporation has extended the date of sale of delinquent shares. It should be used when the date is extended for more than five days [*see Corp. Code § 423(f)*; [b], *below*].

For a board resolution levying an assessment on corporate shares, see *§ 9.240[2]*. For a notice of levy given by the corporate secretary to the shareholders, see *§ 9.241[2]*. For the certificate of sale of delinquent shares, see *§ 9.243[2]*.

[b] Extension of Sale Date

The corporation may extend the date of sale of delinquent shares that was fixed in any levy of an assessment [*see Corp. Code § 423(b)*; § 9.240], either (1) from time to time, for not more than 30 days at a time, by order of the board entered on the records of the corporation, or (2) when the sale is restrained by court order [*Corp. Code § 423(f)*]. The secretary or other person authorized to conduct the sale must announce the extension at the time and place of the sale last fixed [*Corp. Code § 423(f)*]. Furthermore, if the sale date is extended for more than five days after the date last fixed, the corporation must mail a notice to the shareholders whose shares are subject to the sale. The notice must set forth the new date and time of the sale [*Corp. Code § 423(f)*].

[2] Form

Extension of Sale Date

NOTICE OF EXTENSION OF SALE DATE

[_____ *State full name of corporation*],
A California corporation
Principal executive office: _____ [*address*].

NOTICE IS HEREBY GIVEN that _____ [pursuant to court order *or* pursuant to order of the board entered on the records of the corporation], the sale of shares that are delinquent due to nonpayment of the assessment levied on _____[*date*], which was originally scheduled for _____[*date*], at _____[*time*] _____ [A.M. *or* P.M.], as set forth in _____ [*specify, e.g.,* the Notice of Assessment dated _____], has been extended.

The sale will now take place on _____ [*date more than five days later*], at _____[*time*] _____ [A.M. *or* P.M.]. The location of the sale _____ is _____ [*specify address*].

_____Dated:

SECRETARY

_____ [*signature of secreta ry*]

[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral Overview



141 of 141 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 9 DIVIDENDS, REACQUISITIONS OF SHARES, AND ASSESSMENTS
PART IV. FORMS
D. Assessment of Shares

4-9 California Legal Forms--Transaction Guide § 9.243

§ 9.243 Certificate of Sale of Delinquent Shares

[1] Comment

[a] Use of Form

This form is a certificate of sale of delinquent corporate shares, given by the secretary or assistant secretary of the corporation. When the board of directors levies an assessment on shares, and the shareholder fails to pay that amount by a specified date, the assessment becomes delinquent [*see Corp. Code § 423(b)-(e)*]. The sale or forfeiture of the shares is usually the sole remedy for the collection of an assessment on fully paid shares [*see Corp. Code § 423(n)*; [b], *below*]. The secretary's certificate is prima facie evidence of the sale of those shares [*see Corp. Code § 423(j)*; [d], *below*].

For a board resolution levying an assessment on corporate shares, see *§ 9.240[2]*. For a notice of levy given by the corporate secretary to the shareholders, see *§ 9.241[2]*. For a notice that the corporation has extended the date of sale of delinquent shares, see *§ 9.242[2]*.

[b] Sale as Remedy

The sale or forfeiture of fully paid shares subject to a delinquent assessment generally is the only remedy for collection of the assessment. However, a corporation is entitled to a remedy by action if (1) the original articles or an amendment adopted before August 21, 1933, or an amendment adopted by unanimous shareholder consent after August 21, 1933, expressly authorizes that remedy, and (2) a statement of that remedy appears on the face of any share certificate issued on or after August 21, 1933[*Corp. Code § 423(n)*].

[c] Sale or Forfeiture of Delinquent Shares

[i] In General

At the time and place of sale specified in the notice of levy [*see Corp. Code § 423(b)*; § 9.241] or extension of sale date [*see Corp. Code § 423(f)*; *see also § 9.242*], any officer or agent of the corporation must, unless otherwise ordered by

the board, sell or cause to be sold to the highest bidder for cash as many shares of each delinquent holder of the assessed shares as necessary to pay the assessment and charges specified in the notice [*Corp. Code § 423(h)*]. The corporation is not required to accept an offer for a fraction of a share. The person at the sale who offers to pay the assessment and 5 percent penalty for the smallest number of shares is the highest bidder [*Corp. Code § 423(h)*]. The corporation must transfer the shares on the corporation's share register to the highest bidder when he or she pays the assessment and penalty [*Corp. Code § 423(h)*].

If no bidder offers to pay the amount due on the shares together with the 5 percent penalty, the shares will be forfeited to the corporation in satisfaction of the assessment and penalty [*Corp. Code § 423(i)*].

[ii] Surrender and Reissuance of Share Certificates

After a sale or forfeiture of shares for nonpayment of an assessment, the holder or owner of delinquent certificated securities [*see Corp. Code § 156.1*; *Com. Code § 8102(a)(4), (15)* (defined as shares evidenced by certificate)] must surrender the certificate to the corporation for cancellation [*Corp. Code § 423(j)*]. This duty may be enforced by court order or decree, and the holder or owner will be liable for damages to the corporation for failure to surrender the certification for cancellation upon demand without good cause or excuse [*Corp. Code § 423(j)*]. Any certificate not so surrendered becomes null and void, and ceases to be evidence of the right or title of the holder or any transferee to the shares purporting to be represented thereby. Neither the corporation nor the purchaser of those shares incurs any liability to any such transferee [*Corp. Code § 423(j)*].

The purchaser of any shares at a sale for delinquent assessments is entitled to the issuance of a new certificate representing the shares purchased [*Corp. Code § 423(j)*]. The corporation therefore must issue a new share certificate to him or her upon transfer of the shares on the corporate records [*Corp. Code § 423(h)*].

[iii] Surrender of Uncertificated Securities

After a sale or forfeiture of shares for nonpayment of an assessment, the holder or owner of delinquent uncertificated securities [*see Corp. Code § 191.1*; *Com. Code § 8102(a)(18)* (defined as shares not represented by certificate)], has no further rights with respect to those shares [*Corp. Code § 423(j)*]. The corporation is required to issue a new initial transaction statement [*see Corp. Code § 171.1* (defined as written statement describing uncertificated securities)] to the highest bidder after transfer of the shares on the corporate records [*Corp. Code § 423(h)*].

For further coverage of uncertificated securities, see *Ch. 6I, Issuance of Equity Securities, § 6I.20*.

[iv] Securities Issues

The sale of assessable securities are subject to the same qualification and exemption requirements set forth in the Corporate Securities Law [*see Corp. Code §§ 25000-25706*] as any other sale of securities. For coverage of securities issues, see Ch. 6, *Securities Regulation Issues* .

[d] Certificate of Sale

A certificate of sale given by the secretary or assistant secretary of the corporation [this form] is prima facie evidence of all of the following [*Corp. Code § 423(k)*]:

- The time and place of sale and any postponement of that sale;
- The quantity and particular description of the shares sold;
- The person to whom the shares were sold;

- The price for which the shares were sold; and
- The fact of payment of the purchase money.

The certificate must be filed in the office of the corporation. Copies of the certificate, certified by the secretary or an assistant secretary, are prima facie evidence of the facts stated on that certificate [*Corp. Code § 423(k)*].

[e] Effect of Sale Irregularity

An assessment on shares is not invalidated by the corporation's failure to publish the notice of assessment [*see Corp. Code § 423(d)*; *see also § 9.241*], nor by the nonperformance of any act required to enforce the payment of the assessment. However, in the case of any substantial error or omission in the course of proceedings for collection of an assessment on any shares, all previous proceedings other than the levy of the assessment are void as to those shares, and must be reinstituted [*Corp. Code § 423(l)*].

A party may not maintain an action to recover shares sold for delinquent assessments upon the ground of irregularity in the assessment, irregularity or defect of the notice of sale, or defect or irregularity in the sale, unless the party seeking to maintain the action first pays or tenders to the corporation or the party holding the shares sold: (1) the sale price, (2) all subsequent assessments paid, and (3) all interest on those amounts from the time they were paid. No such action may be maintained unless it is commenced by the filing of a complaint and the issuing of a summons within six months after the sale was made [*Corp. Code § 423(m)*].

[2] Form

Certificate of Sale of Delinquent Shares

SECRETARY'S [*or* ASSISTANT SECRETARY'S] CERTIFICATE OF SALE OF DELINQUENT SHARES

[_____ *State full name of corporation*],
A California corporation
Principal executive office: _____ [*address*].

I, _____ [*name of secretary or assistant secretary*], hereby certify that:

1. I am now, and at all times mentioned in this certificate was, the duly elected, qualified, and acting Secretary [*or* Assistant Secretary] of _____ [*name of corporation*] ("the corporation").

2. The Board of Directors of the corporation, at a meeting duly held on _____[*date*], levied an assessment of $_____ per share on the outstanding _____ [*class or series, e.g.,* common *or* preferred] shares of the corporation.

3. On _____[*date*], upon adoption of the assessment resolution by the Board of Directors, I served a true and correct copy of the Notice of Assessment, attached as Exhibit A, in the manner described in the declaration of mailing, attached as Exhibit B, on each holder of record of assessed shares of the corporation.

4. At the time and place specified in the _____ [Notice of Assessment attached as Exhibit A *or* the Notice of Extens ion of Sale Date attached as Exhibit C], _____ [*name of corporate officer or agent*] offered to the highest bidder for cash as many shares of each of the delinquent holders of assessed shares named in the following schedule as necessary to pay the assessment and 5 percent penalty owing on the assessed shares:

Name of

Delinquent Holder	Number of Shares	Class of Shares	Amount of Unpaid Assessment	Amount of Penalty
_____	_____	_____	$_____	$_____
_____	_____	_____	_____	
_____	_____	_____	$_____	$_____
_____	_____	_____	_____	

[*If any shares were sold to highest bidder:*]

5. On the sale date, the following shares were sold to the following highest bidders:

Name of Delinquent Holder	Number and Class of Shares Owned	Number of Shares Sold	Total Price Paid for Shares	Name of Purchaser
_____	_____	_____	$_____	_____
_____	_____	_____	_____	
_____	_____	_____	$_____	_____
_____	_____	_____	_____	

[*If any shares were forfeited to corporation:*]

6. On the sale date, no bidder offered to pay the assessment plus 5 percent penalty owing on the following shares, and all of those shares were forfeited to the corporation in satisfaction of the assessment and penalty on them:

Name of Delinquent Holder	Number of and Class of Assessed Shares	Amount of Unpaid Assessment	Amount of Penalty
_____	_____	$_____	$_____
_____	_____	_	
_____	_____	$_____	$_____
_____	_____	_	

I declare under penalty of perjury that the foregoing is true and correct.

EXECUTED at _____, California on _____[*date*].

_____ [*signature of secretary (or assistant secretary)*]

[*typed name*]

SECRETARY [*or* ASSISTANT SECRETARY]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesDisposition of Reacquired SharesBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock Certificates



1 of 168 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES

4-10 California Legal Forms--Transaction Guide 10.syn

§ 10.syn Synopsis to Chapter 10: AMENDMENT OF ARTICLES

§ 10.01 California Sources

[1] Constitution

[2] Statutes

[3] Regulations

§ 10.02 Rules of Professional Conduct

[1] American Bar Association Model Rules of Professional Conduct

[2] California Rules of Professional Conduct

§§ 10.03-10.04 [Reserved]

§ 10.05 Law Reviews and Periodicals

§ 10.06 Annotations

§ 10.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 10.08-10.09 [Reserved]

§ 10.10 Amendment of Articles--In General

§ 10.11 Management Alternatives to Amendment of Articles

[1] In General

[2] Bylaws

[3] Statutory Shareholder Agreements

[a] Close Corporation Shareholder Agreement Defined

[b] Voting Agreement Defined

[c] Voting Trust Defined

[4] Nonstatutory Shareholder Agreements

§ 10.12 Power to Amend Articles

[1] Statutory Authority

[2] Special Provisions Applicable to Corporations Existing Before January 1, 1977

[a] In General

[b] Amendment Procedure

§ 10.13 Limitations on Power to Amend

[1] Statutory Limitations

[a] In General

[b] Prohibited Provisions

[2] Equitable Limitations

§§ 10.14-10.19 [Reserved]

§ 10.20 Mandatory Amendments and Corporate Acts Requiring Amendment of Articles

§§ 10.21-10.29 [Reserved]

§ 10.30 Requirements for Approval of Amendments by Directors and Shareholders

[1] Before Shares Are Issued

[2] After Shares Are Issued

[a] By Directors and Shareholders--In General

[b] By Directors Alone

[c] Additionally by Class or Series of Shares Affected

§ 10.31 Specific Amendments Requiring Additional Shareholder Approval

[1] Amendment Affecting Class of Outstanding Shares Under Corp. Code § 903(a)

[2] Amendment Adversely Affecting Series of Class of Outstanding Shares

[3] Amendment to Make Shares Assessable

[4] Amendment Classifying Board and Eliminating Cumulative Voting

[5] Amendment Electing or Terminating Close Corporation Status

[6] Amendment to Convert to Nonprofit or Cooperative Status

[7] Amendment to Reduce Number of Directors to Less than Five

§ 10.32 Additional Voting Rights or Requirements Imposed by Articles of Incorporation

[1] In General

[2] Special Requirements Applicable to Large Publicly Held Corporations

§ 10.33 Greater than Statutory Vote Requirement Imposed by Commissioner of Corporations

§§ 10.34-10.39 [Reserved]

§ 10.40 Procedures for Action by Directors

[1] In General

[2] At Board Meetings

[3] By Unanimous Written Consent Without Meeting

§ 10.41 Procedures for Action by Shareholders At Meeting or By Written Consent

§ 10.42 Certificate of Amendment

[1] Before Shares Are Issued

[2] After Shares Are Issued

[3] Filing Requirements

[4] Filing and Certification Fees

[5] Effect of Filing; Proof

§ 10.43 Restated Articles

[1] Restated but Not Amended

[2] Restated and Amended

[3] Effect of Filing Restated Articles

§§ 10.44-10.49 [Reserved]

§ 10.50 Amendments Requiring Qualification By Corporations Commissioner

[1] Qualification of Issuer Transactions

[2] Qualification of Recapitalization or Reorganization Transactions

§ 10.51 Amendments Changing Share Rights Exempted from Qualification By Corp. Code § 25103(e); Exceptions

§ 10.52 Amendments Effectuating Stock Splits and Reverse Stock Splits Exempted From Qualification by Corp. Code § 25103(f); Exceptions

§ 10.53 Amendments Changing Rights of Debt Securities Exempted from Qualification By Corp. Code § 25103(g); Exceptions

§§ 10.54-10.59 [Reserved]

§ 10.60 Certificates of Correction

§ 10.61 Exchange of Share Certificates

§ 10.62 Amendment of Articles as Part of Merger Agreements

§§ 10.63-10.99 [Reserved]

§ 10.100 Client Interview

[1] Facts

[a] The Corporation

Scope

[b] Each Shareholder

Scope

[c] Directors' Meetings

Scope

[d] Shareholders' Meetings

Scope

[e] The Amendment

Scope

[2] Documents

Scope

§§ 10.101-10.109 [Reserved]

§ 10.110 Identifying Conflicts of Interest

Scope

§ 10.111 Determining Scope of Work to be Performed by Attorney

Scope

§ 10.112 Lawfulness of Amendment of Articles; Alternative Procedures

Scope

§ 10.113 Requirements for Approval of Amendment

Scope

§ 10.114 Procedures for Approval of Amendment

Scope

§ 10.115 Restating and Amending Articles

Scope

§ 10.116 Filing Requirements Other Than Certificate of Amendment

Scope

§ 10.117 Timetable for Amendment of Articles

Scope

§§ 10.118-10.129 [Reserved]

Scope

§ 10.130 The Amendment

Scope

§ 10.131 Adoption of Amendment Before Shares Are Issued

Scope

§ 10.132 Adoption of Amendment By Board of Directors After Shares Have Been Issued

Scope

§ 10.133 Adoption of Amendment by Outstanding Shares

Scope

§ 10.134 Filing Certificate of Amendment

Scope

§§ 10.135-10.139 [Reserved]

§ 10.140 Restated Articles of Incorporation

Scope

§ 10.141 Notice and Reporting Requirements

Scope

§ 10.142 Correction of Mistakes of Fact or Errors in Execution

Scope

§ 10.143 Legends on Share Certificates

Scope

§§ 10.144-10.199 [Reserved]

§ 10.200 Certificate of Amendment Before Shares Are Issued

[1] Comment

[a] Use of Form

[b] "Issued" Defined for Purposes of Corp. Code § 901

[c] Amendment by Incorporators

[d] Amendment by Directors

[e] Required Certificate of Amendment

[f] Contents of Certificate

[g] Verification of Certificate

[h] Wording of Amendment

[i] Statutory Requirements

[ii] Drafting Requirements of Secretary of State

[i] Filing

[j] Certification

[k] Format Requirements for Certificate

[l] Copies

[m] Fees

[2] Form

Certificate of Amendment Before Shares Are Issued

§ 10.201 Certificate of Amendment After Shares Are Issued--Amendment Approved By Board Alone

[1] Comment

[a] Use of Form

[b] Approval By Board Alone

[c] Amendments That May Be Approved by Board Alone

[d] Director Action at Meeting or by Written Consent

[e] Form of Certificate of Amendment

[f] Contents of Certificate

[i] Required Statements

[ii] Prohibited Statements

[g] Drafting Requirements for Amendments Affecting Outstanding Shares

[h] Securities Considerations

[i] Filing

[2] Form

Certificate of Amendment After Shares Are Issued--Amendment Approved By Board Alone

§ 10.202 Certificate of Amendment After Shares Are Issued--Amendment Approved by Board and Outstanding Shares

[1] Comment

[a] Use of Form

[b] Approval by Board and Outstanding Shares

[c] Additional Approval by Class or Series of Shares

[d] Director and Shareholder Action at Meetings or By Written Consent

[e] Required Form of Certificate of Amendment

[f] Contents of Certificate

[i] Required Statements

[ii] Prohibited Statements

[g] Securities Considerations

[h] Filing

[2] Form

Certificate of Amendment After Shares Are Issued--Amendment Approved by Board and Outstanding Shares

§§ 10.203-10.209 [Reserved]

§ 10.210 Certificate of Amendment To Extend Term of Corporate Existence, or To Provide for Perpetual Existence

[1] Comment

[a] Use of Form

[b] Amendment to Extend Corporate Existence

[c] Prohibited Name

[d] Contents of Certificate

[2] Form

Certificate of Amendment To Extend Term of Corporate Existence, or To Provide for Perpetual Existence

§ 10.211 Certificate of Amendment To Make Corporation a Close Corporation

[1] Comment

[a] Use of Form

[b] Close Corporation Defined; Required Provision in Articles

[c] Required Approval of Amendment

[d] Name of Corporation

[e] Exchange of Share Certificates

[2] Form

Certificate of Amendment To Make Corporation a Close Corporation

§ 10.212 Certificate of Amendment To Terminate Close Corporation Status

[1] Comment

[a] Use of Form

[b] Termination of Close Corporation Status; Required Approval of Amendment

[c] Exchange of Share Certificates

[2] Form

Certificate of Amendment To Terminate Close Corporation Status

§ 10.213 Certificate of Amendment to Effectuate Stock Split

[1] Comment

[a] Use of Form

[b] Stock Split and Reverse Stock Split Defined

[c] Contents of Certificate

[d] Required Approval of Amendment

[e] Effect of Filing Amendment

[f] Permit from Corporations Commissioner

[2] Form

Certificate of Amendment to Effectuate Stock Split

§ 10.214 Certificate of Amendment to Reclassify Shares to Create Senior Class

[1] Comment

[a] Use of Form

[b] Special Drafting Requirements for Amendments Reclassifying Shares

[c] Required Approval of Amendment

[d] Exchange of Share Certificates

[2] Form

Certificate of Amendment to Reclassify Shares to Create Senior Class

§ 10.215 Certificate of Amendment to Classify Board of Directors and Eliminate Cumulative Voting

[1] Comment

[a] Use of Form

[b] "Listed Corporation" Defined

[c] When Corporation Is Not Listed Corporation

[d] When Corporation Ceases to Be Listed Corporation

[2] Form

Certificate of Amendment to Classify Board of Directors and Eliminate Cumulative Voting

§§ 10.216-10.219 [Reserved]

§ 10.220 Restated Articles of Incorporation

[1] Comment

[a] Use of Form

[b] Form of Certificate of Restated Articles

[i] After Shares Are Issued

[ii] Before Shares Are Issued

[c] Contents of Certificate of Restated Articles

[d] Approval of Certificate of Restated Articles

[e] Filing Certificate of Restated Articles

[2] Form

Restated Articles of Incorporation

§ 10.221 Certificate of Restated and Amended Articles of Incorporation

[1] Comment

[a] Use of Form

[b] Form of Certificate of Restated and Amended Articles

[i] After Shares Are Issued

[ii] Before Shares Are Issued

[c] Contents of Certificate of Restated and Amended Articles

[d] Approval of Certificate of Restated and Amended Articles

[e] Filing Certificate of Restated and Amended Articles

[2] Form

Certificate of Restated and Amended Articles of Incorporation

§§ 10.222-10.229 [Reserved]

§ 10.230 Certificate of Correction of Certificate of Amendment

[1] Comment

[a] Use of Form

[b] Restrictions on Use of Certificate of Correction

[c] Form of Certificate of Correction

[d] Contents of Certificate of Correction

[e] Required Identification and Wording of Article Provisions

[f] Signature and Verification Requirements

[g] Filing and Filing Fees

[2] Form

Certificate of Correction of Certificate of Amendment

§§ 10.231-10.239 [Reserved]

§ 10.240 Director Action at Meeting: Minutes of Board Meeting Approving Amendment to Articles of Incorporation

[1] Comment

[a] Use of Form

[b] Directors' Participation in Meeting

[c] Duty to Keep Minutes

[d] Certification of Minutes

[e] Contents of Minutes

[f] Use of Resolutions in Minutes to Approve Amendment to Articles

[2] Form

Director Action at Meeting: Minutes of Board Meeting Approving Amendment to Articles of Incorporation

§ 10.241 Director Action by Unanimous Written Consent Approving Amendment to Articles of Incorporation

[1] Comment

[a] Use of Form

[b] Statutory Requirements; Effect

[2] Form

Director Action by Unanimous Written Consent Approving Amendment to Articles of Incorporation

§ 10.242 Shareholder Action at Meeting: Resolution Adopting Amendment to Articles of Incorporation

[1] Comment

[a] Use of Form

[b] Required Approval of Amendment; Wording of Resolution

[2] Form

Shareholder Action at Meeting: Resolution Adopting Amendment to Articles of Incorporation

§ 10.243 Shareholder Action by Written Consent Approving Amendment to Articles of Incorporation For Use By Corporation with Fewer than 100 Shareholders

[1] Comment

[a] Use of Form

[b] Use of Written Consents; Statutory Requirements

[c] Required Approval of Amendment; Wording of Resolution

[2] Form

Shareholder Action by Written Consent Approving Amendment to Articles of Incorporation For Use By Corporation with Fewer than 100 Shareholders



2 of 168 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES

4-10 California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter discusses the statutory requirements and procedures for amending the articles of incorporation of a domestic corporation, including the power to amend, statutory and equitable limitations on that power, and alternative procedures. It discusses requirements for approval of amendments by the directors and the outstanding shares, and additional voting rights and requirements imposed by statute, by the articles themselves, and by the Commissioner of Corporations. It covers procedural requirements for filing the certificate of amendment, the certificate of restated articles, and the certificate of correction. It also discusses amendments that may require qualification by the Commissioner of Corporations.

The Transaction Guide includes procedural guides for obtaining the approval of the directors and shareholders, and for filing the amendment. Forms include certificates of amendment (both general forms and those affecting specific changes), restated articles of incorporation, restated and amended articles of incorporation, and certificates of correction. Also included are minutes, resolutions, and written consents approving amendments to the articles by the directors and shareholders.

Preincorporation planning is covered in Ch. 2, *Formation of Corporations* . Adoption of the articles generally is covered in Ch. 3, *Articles of Incorporation* . Directors' meetings and resolutions are further discussed in Ch. 5, *Directors' Meetings, Actions, and Resolutions* . Corporate records and reports are further discussed in Ch. 7, *Corporate Records and Reports* . Shareholders' meetings, voting, and agreements are further discussed in Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* . Voting agreements and voting trusts are discussed in Ch. 8B, *Voting Agreements and Voting Trusts* . Close corporation shareholder agreements are covered in Ch. 8C, *Close Corporation Shareholder Agreements* . Corporate securities issues are covered in detail in Ch. 6, *Securities Regulation Issues* . Foreign, nonprofit, and cooperative corporations are discussed in Chs. 12B, *Foreign Corporations and Associations* , Ch. 13, *Nonprofit Corporations* , Ch. 14, *Consumer Cooperative Corporations* , and Ch. 14A, *Agricultural Nonprofit Cooperative Associations* , respectively.



3 of 168 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART I. RESEARCH GUIDE
A. Primary Sources

4-10 California Legal Forms--Transaction Guide § 10.01

§ 10.01 California Sources

[1] Constitution

Reserve power of state over corporations. *Cal. Const., art. XX, § 24*.

[2] Statutes

Amendment of articles in general. *Corp. Code § 900 et seq.*

Permissible amendments in general. *Corp. Code § 900(a)*.

Prohibited amendments. *Corp. Code § 900(b)*.

Amendment procedure.

Before shares are issued. *Corp. Code § 901*.

After shares are issued. *Corp. Code § 902(a), (e), (f)*.

By board approval alone. *Corp. Code §§ 158(e), 401(c), 405(b), 510(f), 902(b), (c), (d), 2302*.

Required approval by shareholders. *Corp. Code §§ 903, 904*.

Amendment extending period of corporate existence. *Corp. Code § 909*.

Amendment of articles on merger. *Corp. Code § 1101(b)*.

Articles of Incorporation generally.

Execution of articles initiates corporate existence. *Corp. Code § 200*.

Prohibited names; reservation of names. *Corp. Code § 201*.

Required provisions. *Corp. Code § 202*.

Distinction between classes and series of shares. *Corp. Code §§ 203, 203.5*.

Optional provisions. *Corp. Code § 204*.

Liability of directors for monetary damages. *Corp. Code § 204.5*.

Par value. *Corp. Code § 205*.

Permitted business activities. *Corp. Code § 206*.

Corporate powers. *Corp. Code § 207*.

Ultra vires acts. *Corp. Code § 208*.

Certified articles as proof of corporate existence. *Corp. Code § 209*.

Actions by incorporators in lieu of initial directors. *Corp. Code § 210*.

Bylaw provisions. *Corp. Code § 212*.

Certificate of amendment.

Before shares are issued. *Corp. Code § 906*.

After shares are issued. *Corp. Code § 905*.

Wording of amendment. *Corp. Code § 907*.

Effect of filing. *Corp. Code § 908*.

Certification by Secretary of State. *Corp. Code § 908*.

Certificate of correction. *Corp. Code § 109*.

Certificate of determination. *Corp. Code §§ 154, 156, 401, 910(c)*.

Certificate of restated articles of incorporation. *Corp. Code § 910*.

Certificate of revocation. *Corp. Code § 110(c)*.

Corporate Securities Law.

"Security" defined. *Corp. Code § 25019*.

"Issuer" defined. *Corp. Code § 25010*.

Qualification of offers and sales of securities (issuer transactions). *Corp. Code § 25110 et seq.*

Recapitalizations and reorganizations. *Corp. Code § 25120 et seq.*

Qualification of offers and sales of securities (nonissuer transactions). *Corp. Code § 25130 et seq.*

Limited offering exemption. *Corp. Code § 25102(f)*.

Small offering exemption. *Corp. Code § 25102(h)*.

"Sale of securities" defined. *Corp. Code § 25017(a)*.

Issuer transaction securities qualification requirements. *Corp. Code § 25110*.

Authority of Corporations Commissioner to refuse, suspend, or revoke permit. *Corp. Code § 25140*.

Rescission or damages for failure to qualify securities. *Corp. Code § 25503*.

Definitions.

Electronic transmission by corporation. *Corp. Code § 20*.

Electronic transmission to corporation. *Corp. Code § 21*.

Approved by (or approval of) board. *Corp. Code § 151*.

Approved by (or approval of) outstanding shares. *Corp. Code § 152*.

Approved by (or approval of) shareholders. *Corp. Code § 153*.

Articles. *Corp. Code § 154*

Board. *Corp. Code § 155*.

Certificate of determination. *Corp. Code § 156*.

Close corporation. *Corp. Code § 158*.

Common shares. *Corp. Code § 159*.

Corporation. *Corp. Code § 162*.

Directors. *Corp. Code § 164*.

Domestic corporation. *Corp. Code § 167*.

Filed. *Corp. Code § 169*.

Foreign corporation. *Corp. Code § 171*.

Officers' certificate. *Corp. Code § 173*.

On the certificate. *Corp. Code § 174*.

Preferred shares. *Corp. Code § 176*.

Proxy. *Corp. Code § 178*.

Proxyholder. *Corp. Code § 179*.

Redemption price. *Corp. Code § 180*.

Reverse stock split. *Corp. Code § 182*.

Series. *Corp. Code § 183*.

Shares. *Corp. Code § 184*.

Shareholder. *Corp. Code § 185*.

Shareholders' agreement. *Corp. Code § 186*.

Stock split. *Corp. Code § 188*.

Verified. *Corp. Code § 193*.

Vote includes authorization by written consent. *Corp. Code § 194*.

Voting power. *Corp. Code § 194.5*.

Written or in writing. *Corp. Code § 195*.

Involuntary dissolution action by attorney general may not be maintained if corporate matter or act that is ground of action can be corrected by amendment of articles, if specified conditions are met. *Corp. Code § 1801(b)*.

Secretary of State.

Fee for filing certificate of amendment or correction. *Corp. Code §§ 108, 1401*; *Gov. Code § 12186(p)*.

Filing instruments with. *Corp. Code § 110*.

Cancellation of articles for nonpayment of filing fees. *Corp. Code § 110.5*.

Certification and other fees. *Gov. Code §§ 12182, 12183, 12185*.

Shares in general.

References in general corporation law to voting of shares includes voting of other securities given voting rights by articles. *Corp. Code § 111*.

Effect of provision in articles providing for more or less than one vote for any share on any matter. *Corp. Code § 112*.

Articles may provide for redeemable shares. *Corp. Code § 402*.

Voting rights of preferred shares. *Corp. Code § 402.5*.

Articles may provide for convertible shares and debt securities. *Corp. Code § 403*.

Options. *Corp. Code § 404*.

Articles may authorize additional shares for options and conversion rights. *Corp. Code § 405*.

Required statements on share certificates. *Corp. Code §§ 417, 418*.

Surrender of share certificates affected by amendment. *Corp. Code § 422*.

Assessment of shares. *Corp. Code § 423*.

Specific amendments.

Of articles of close corporation. *Corp. Code §§ 158, 902(f)*.

Reducing number of directors. *Corp. Code § 212(a)*.

To divide board into classes or eliminate cumulative voting for listed corporations. *Corp. Code § 301.5*.

Increasing or decreasing number of shares of series set forth in certificate of determination and incorporated in restated articles of incorporation. *Corp. Code § 401(c)*.

Increasing number of shares authorized to satisfy option or conversion rights. *Corp. Code § 405(b)*.

To make shares assessable. *Corp. Code §§ 423, 904*.

To reflect reduction in number of shares authorized when shares reacquired by corporation and their reissue is prohibited. *Corp. Code § 510(b)-(f)*.

Adding supermajority voting requirements. *Corp. Code § 710*.

Deleting names and addresses of first directors or name and address of initial agent for service of process. *Corp. Code §§ 901, 902(d)*.

Effectuating stock split. *Corp. Code § 902(c)*.

Having adverse effect on outstanding shares. *Corp. Code § 903*.

To extend corporate existence. *Corp. Code § 909*; *see Corp. Code § 902(b)*.

To convert corporation into nonprofit mutual benefit, nonprofit religious, or cooperative corporation. *Corp. Code § 911*.

In connection with proceeding initiated under federal law relating to reorganizations or arrangements of corporations. *Corp. Code § 1400(b)*.

Transition provisions. *Corp. Code §§ 2300-2319*.

[3] Regulations

"Limited offering qualification" defined. *10 Cal. Code Reg. § 260.001(e)*

"Open qualification" defined. *10 Cal. Code Reg. § 260.001(f)*.

Small offering exemption, notice. *10 Cal. Code Reg. § 260.102.8*.

Limited offering exemption--interpretations. *10 Cal. Code Reg. § 260.102.12*.

Limited offering exemption, notice. *10 Cal. Code Reg. § 260.102.14*.

Neither amendment of articles authorizing issuance of new class of shares, nor issuance and sale of those shares, constitutes change in rights, preferences, privileges, or restrictions of or on previously outstanding shares; shares, however, are subject to qualification requirements unless exempt. *10 Cal. Code Reg. § 260.103.1*.

Stock split. *10 Cal. Code Reg. § 260.103.2*.

Signing application for qualification. *10 Cal. Code Reg. § 260.110.2*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART I. RESEARCH GUIDE
A. Primary Sources

4-10 California Legal Forms--Transaction Guide § 10.02

§ 10.02 Rules of Professional Conduct

[1] American Bar Association Model Rules of Professional Conduct

Competence. A.B.A. Model Rules Prof. Cond., Rule 1.1.

Scope of responsibility. A.B.A. Model Rules Prof. Cond., Rule 1.2.

Diligence. A.B.A. Model Rules Prof. Cond., Rule 1.3.

Communication. A.B.A. Model Rules Prof. Cond., Rule 1.4.

Fees. A.B.A. Model Rules Prof. Cond., Rule 1.5.

Confidentiality of information. A.B.A. Model Rules Prof. Cond., Rule 1.6.

Conflict of interest: general rule. A.B.A. Model Rules Prof. Cond., Rule 1.7.

Conflict of interest: prohibited transactions. A.B.A. Model Rules Prof. Cond., Rule 1.8.

Conflict of interest: former client. A.B.A. Model Rules Prof. Cond., Rule 1.9.

[2] California Rules of Professional Conduct

Rules of professional conduct, in general. Cal. Rules *Prof. Cond., Rule 1-100*.

Failing to act competently. Cal. Rules *Prof. Cond., Rule 3-110*.

Avoiding adverse interests. Cal. Rules *Prof. Cond., Rule 3-300*.

Avoiding representation of adverse interests. Cal. Rules *Prof. Cond., Rule 3-310*.

Communication. Cal. Rules *Prof. Cond., Rule 3-500*.

Organization as client. Cal. Rules *Prof. Cond., Rule 3-600*.

Fees for legal services. Cal. Rules *Prof. Cond., Rule 4-200*.

Member as witness. Cal. Rules *Prof. Cond., Rule 5-210*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART I. RESEARCH GUIDE
A. Primary Sources

4-10 California Legal Forms--Transaction Guide §§ 10.03-10.04

[Reserved]

§§ 10.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART I. RESEARCH GUIDE
B. Secondary Sources

4-10 California Legal Forms--Transaction Guide § 10.05

§ 10.05 Law Reviews and Periodicals

Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments, 102 Harv. L. Rev. 1820 (June 1989).*

Halloran, *Equitable Limitations on the Power to Amend Articles of Incorporation, 4 Pac. L.J. 47 (1973).*

Note, *Articles and Bylaws--Statutory Requirements of Consistency with the Law--Contractual Enforcement of Inconsistent Articles and Bylaws, 31 Notre Dame L. Rev. 699 (1956).*

Buxbaum, *Preferred Stock Law and Draftsmanship, 42 Calif. L. Rev. 243, 298 (1954)* (alteration of rights).

Comment, *Corporations Certificate Amendment Restricting Preemptive Rights Allowed Under Delaware Corporation Law, 4 Stan. L. Rev. 449 (1952).*

Comment, *Corporations Statutory Revival of Corporate Existence, 28 Calif. L. Rev. 195 (1940).*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART I. RESEARCH GUIDE
B. Secondary Sources

4-10 California Legal Forms--Transaction Guide § 10.06

§ 10.06 Annotations

Annot., *One share-one vote rule, validity of variations from one share-one vote rule under modern corporate law*, 3 A.L.R.4th 1204 (1981) .

Annot., *Construction and effect of corporate bylaws or articles relating to change in number of directors*, 3 A.L.R.3d 623 (1965) .

Annot., *Power of corporation to change existing redemption rights of common stock shareholders*, 70 A.L.R.2d 843 (1959) .

Annot., *Reinstatement of repealed, forfeited, expired, or suspended corporate charter as validating acts in interim*, 13 A.L.R.2d 1220 (1949) .

Annot., *Power of corporation to amend its charter in such a way as to change its obligations to stockholder, 105 A.L.R. 1452 (1936)* ; *117 A.L.R. 1290 (1938)* .

Annot., *Power of corporation to amend its charter in respect of character or kind of business, 111 A.L.R. 1525 (1937)* .

Annot., *Extension or renewal of period of corporate existence, 108 A.L.R. 59 (1936)* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART I. RESEARCH GUIDE
B. Secondary Sources

4-10 California Legal Forms--Transaction Guide § 10.07

§ 10.07 Text References

[1] Matthew Bender Sources

Ballantine & Sterling, CALIFORNIA CORPORATION LAWS (4th Ed.)

Ch. 3, *Formation of Corporations*

Ch. 4, *Close Corporations*

Ch. 5 *Management: Functions of Directors, Officers, and Committees*

Ch. 6, *Management: Duties and Liabilities of Controlling Shareholders*

Ch. 7, *Issuance of Shares and Indebtedness*

Ch. 8, *Dividends and Reacquisition of Shares*

Ch. 9, *Shareholders' Meetings and Voting*

Ch. 11, *Amendment of Articles and Bylaws*

Appendix, Forms 5.01 et seq.

CALIFORNIA LEGAL FORMS

Ch. 1A, *Role of Counsel in Starting a New Business*

Ch. 1B, *Selecting Form of Business Entity*

Ch. 2, *Formation of Corporations*

Ch. 2B, *Electing Subchapter S Status*

Ch. 3, *Articles of Incorporation*

Ch. 4, *Bylaws*

Ch. 5, *Directors' Meetings, Actions, and Resolutions*

Ch. 6, *Securities Regulation Issues*

Ch. 7, *Corporate Records and Reports*

Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*

Ch. 8B, *Voting Agreements and Voting Trusts*

Ch. 8C, *Close Corporation Shareholder Agreements*

Ch. 9, *Dividends, Reacquisitions of Shares, and Assessments*

Ch. 11, *Merger and Acquisition Issues*

Ch. 12, *Winding Up and Dissolution*

Ch. 12B, *Foreign Corporations and Associations*

Ch. 13, *Nonprofit Corporations*

Ch. 14, *Consumer Cooperative Corporations*

Ch. 14A, *Agricultural Nonprofit Cooperative Associations*

Cavitch, BUSINESS ORGANIZATIONS

Ch. 201, *Statutory Citations*

Gadsky, BUSINESS ORGANIZATIONS--FEDERAL SECURITIES EXCHANGE ACT OF 1934

Ch. 4, *Exchange Act Registration and Reporting Requirements*

Rabkin & Johnson, CURRENT LEGAL FORMS

Ch. 15, *Shareholders' Agreements*

Ch. 18, *Corporate Operation and Management*.

Rabkin & Johnson, FEDERAL INCOME, GIFT, AND ESTATE TAXATION

Ch. 31, *Exchange for Securities*

[2] Additional Text References

Corporations Checklist (State of California, Office of Secretary of State, 1990).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART I. RESEARCH GUIDE
B. Secondary Sources

4-10 California Legal Forms--Transaction Guide §§ 10.08-10.09

[Reserved]

§§ 10.08[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
A. Power and Limitations on Power to Amend; Alternatives

4-10 California Legal Forms--Transaction Guide § 10.10

§ 10.10 Amendment of Articles--In General

Amending a corporation's articles of incorporation is the statutory method to change, add, delete, or restate certain information contained in the articles [*see* Corporations Checklist (State of California, Office of Secretary of State, 1990, p. 37)]. After a corporation has been formed [*see Corp. Code § 200* (corporate existence begins on filing articles of incorporation)], certain financial or operational changes, such as a modification of capital structure, changes in the corporate purposes or powers, the number of directors, the location of the principal office, or the corporate name, require amendment of the articles of incorporation in order to become effective [*see § 10.20*]. Fear of a hostile takeover may also prompt amendment of the articles. For example, an amendment to stagger the terms of the directors may preclude hostile persons from filling all of the vacant directorships at one time. Requiring a supermajority vote to approve a merger, or entering into transactions that will make the corporation unattractive to potential offerors are other devices that may require amendment of the articles.

An amendment cannot be filed unless the corporation is in good standing, except for filing an application for exempt status or amending the articles of incorporation as necessary to perfect that application or to set forth a new name [*see Rev. & Tax. Code §§ 23301, 23775*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
A. Power and Limitations on Power to Amend; Alternatives

4-10 California Legal Forms--Transaction Guide § 10.11

§ 10.11 Management Alternatives to Amendment of Articles

[1] In General

Several management alternatives exist that may affect some of the same financial or operational changes accomplished by amending the articles. These include:

- A voluntary share exchange plan [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , § 252.04 (Matthew Bender)],

- A merger or sale of assets [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , §§ 252.02, 252.03 (Matthew Bender)],

- A repurchase of shares [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 7, *Issuance of Shares and Indebtedness* , § 127.03[5] (Matthew Bender)], or

- A reorganization under the bankruptcy laws [*see Corp. Code § 1400 et seq.*; *11 U.S.C. § 1101 et seq.*; Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , § 263 (Matthew Bender)].

In addition, bylaws approved by the shareholders [*see Corp. Code § 212*; [2], *below*], and various types of shareholder agreements, including a voting or pooling agreement [*see Corp. Code § 706(a)*; *see also* [3][b], *below*], a voting trust [*see Corp. Code § 706(b)*; *see also* [3][c], *below*], or a close corporation shareholder agreement [*see Corp. Code §§ 186, 300(b)*; *see also* [3][a], *below*], may, in certain circumstances, be used instead of the amendment of the articles.

If a right is guaranteed by statute and, as a result, may not be modified by amending the articles, a shareholder agreement may be the only way to modify this right [*see Sensabaugh v. Polson Plywood Company (Montana, 1959) 342 P.2d 1064, 1067* (although shareholders could not modify or eliminate constitutional right to vote cumulatively by amendment of bylaws, they could validly contract not to vote cumulatively)]. However, one commentator has noted that

the California corporation statutes [*see Corp. Code §§ 202-205*] appear to have established a norm that certain changes in corporate structure should be accomplished by amendment of the articles, rather than by a private agreement or by provisions in the bylaws. This commentator recommends using the amendment process, provided the amendment is valid, if a shareholder agreement would substantially interfere with a statutory norm and is not specifically authorized by statute [*see, e.g., Corp. Code §§ 158, 186, 300(b)*; *see also Corp. Code § 705(e)(5), 706(a), (c)* (pertaining to close corporations)]. For discussion of the validity of shareholder agreements outside the close corporation context, see [4], *below*.

[2] Bylaws

Bylaws (or amendments to bylaws) may contain any provision related to the management of the business or the affairs of the corporation that does not conflict with the law or the articles of incorporation [*Corp. Code § 212(b)*]. Within these parameters, the range of corporate actions that may be taken by bylaw or amendment of the bylaws is considerable [*see Corp. Code § 212(b)*]. For discussion of the statutes that may be varied by the bylaws, see Ch. 4, *Bylaws* .

[3] Statutory Shareholder Agreements

[a] Close Corporation Shareholder Agreement Defined

A shareholder agreement is a particularly useful alternative to amendment of the articles in a statutory close corporation [*see Corp. Code § 158(a)* (close corporation requires provision in articles limiting shareholders to 35 and specifically identifying corporation as close corporation)] because the close corporation statutes expressly sanction the use of shareholder agreements to implement changes in corporate structure that are generally accomplished by amendment of the articles [*see Corp. Code §§ 158, 186, 300(b)*; *see also Corp. Code § 705(e)(5), 706(a), (c)*].

A statutory shareholder agreement is a written agreement among all of the statutory close corporation shareholders (or if a close corporation has only one shareholder, between that shareholder and the corporation), relating to the affairs and management of the corporation [*Corp. Code §§ 186, 204(a), 300(b)*]. No shareholder agreement that relates to any phase of the corporation's affairs will be invalid "as between the parties to it" on the ground that it [*Corp. Code § 300(b)*]:

- Relates to the conduct of the affairs of the corporation so as to interfere with the discretion of the directors,
- Is an attempt to treat the corporation as if it were a partnership, or
- Is an attempt to arrange relationships among the shareholders in a manner that would be appropriate only between partners.

Thus, in practice, a shareholder agreement permits shareholders to [*see Corp. Code § 300(b), (e)*]:

- Manage the close corporation informally, according to the provisions of the agreement, without observing corporate formalities related to directors and shareholder meetings, and
- Make decisions in areas usually reserved for the board of directors, such as dividend policy, distribution of assets on liquidation, selection of officers, and determination of their compensation and tenure.

For further discussion of close corporation shareholder agreements, see Ch. 8C, *Close Corporation Shareholder Agreements* .

[b] Voting Agreement Defined

The General Corporation Law [*Corp. Code § 1 et seq.*] also expressly authorizes shareholder voting agreements (and irrevocable proxies to effectuate those agreements) [*see Corp. Code § 706* (applying to voting agreements entered into, amended, or extended after January 1, 1977); *Corp. Code § 705* (proxies)]. A "voting agreement" is a written agreement between two or more shareholders of a corporation requiring that their shares be voted as provided in the agreement [*Corp. Code § 706(a)*]. The statute permits transfer of the shares covered by the agreement to third parties with the authority to vote them as provided in the agreement [*Corp. Code § 706(a)*]. It also provides for specific performance of voting agreements [*Corp. Code § 706(a)*].

The statute specifies that no voting agreement will be invalid because it fails to satisfy the statutory requirements of a voting trust [*Corp. Code § 706(c)*; *see Corp. Code § 706(b)*; *see also* [c], *below*] or because it is a proxy that does not satisfy proxy requirements [*Corp. Code § 706(c)*; *see Corp. Code § 705*]. It also specifies that *Corp. Code § 706(a)* does not invalidate any voting or other shareholder agreement (or irrevocable proxy complying with statutory requirements [*see Corp. Code § 705(e)*]) that is not otherwise illegal [*Corp. Code § 706(d)*; *see* [4], *below*]. For further discussion of voting agreements, see Ch. 8B, *Voting Agreements and Voting Trusts* .

[c] Voting Trust Defined

A shareholder agreement sometimes takes the form of a voting trust. A voting trust is ordinarily created by a written agreement between two or more shareholders, irrevocably transferring title to their shares (for a definite period of time not exceeding 10 years) to voting trustees, who, in return, issue to the shareholders certificates of beneficial interest ("voting trust certificates"), and file a duplicate of the voting trust agreement with the corporation's secretary [*see Corp. Code § 706(b)*.

Although in the classic voting trust, certificate holders retain a beneficial interest in the stock, voting trust certificate holders are not necessarily the beneficiaries of the voting trust. The trust may be created by common shareholders transferring their shares to the trustees in order to confer on them voting power for the protection of bondholders or holders of preferred shares [*Mackin v. Nicollet Hotel (8th Cir. 1928) 25 F.2d 783, 787-788* , cert. denied *278 U.S. 618 (1928)]* .

Voting trusts entered into, amended, or extended after January 1, 1977 are governed primarily by *Corp. Code § 706(b)*. Voting trusted entered into before that date are regulated by prior law [*see Civ. Code § 2331*; Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 9, *Shareholders' Meetings and Voting* , § 174.02[2] (Matthew Bender)]. For further discussion of voting trusts, see Ch. 8B, *Voting Agreements and Voting Trusts* .

[4] Nonstatutory Shareholder Agreements

Shareholder agreements have been enforced outside the close corporation context. *Corp. Code § 706(d)* specifies that *Corp. Code § 706(a)* does not invalidate any voting or other shareholder agreement (or irrevocable proxy complying with statutory requirements [*see Corp. Code § 705(e)*]) that is not otherwise illegal [*Corp. Code § 706(d)*]. *Corp. Code § 204(a)* further provides that a court may enforce shareholder agreements (other than statutory shareholder agreements) among the shareholders who are parties to the agreement if the court does not find the agreement contrary to public policy [*Corp. Code § 204(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate

LawCorporationsFinanceDividends & Reacquisition of SharesCancellation & RedemptionBusiness & Corporate LawCorporationsGoverning Documents & ProceduresGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesVoting TrustsMergers & Acquisitions LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
A. Power and Limitations on Power to Amend; Alternatives

4-10 California Legal Forms--Transaction Guide § 10.12

§ 10.12 Power to Amend Articles

[1] Statutory Authority

The amendment of articles of incorporation is governed generally by Corp. Code *§§ 900 et seq.Corp. Code* § 900(a) provides broad authority for a corporation to amend its articles, provided the amended articles contain only provisions that could be lawfully inserted in original articles on the date of the amendment, or provisions necessary to effectuate a change, exchange, reclassification, or cancellation of the shares or rights of shareholders resulting from the amendment [*Corp. Code § 900(a)*; *but see § 10.13[2]*]. The statute further authorizes any amendment of the articles regardless of whether the amendment was permissible at the time the original articles were filed, if the amendment could lawfully be included in original articles on the date of the amendment [*Corp. Code § 900(a)*]. *Corp. Code §§ 902-904* specify the votes required for certain amendments [*see §§ 10.30-10.31*].

Other sections of the Corp. Code also govern the amendment of the articles. *Corp. Code §§ 202-204* specify required and optional provisions in the original articles; *Corp. Code §§ 402-405* specify certain provisions related to classes and series of shares that may be included in the articles. In addition, the articles themselves [*see Corp. Code § 204(a)(5)*; Ch. 3, *Articles of Incorporation*], or a close corporation shareholder agreement [*see Corp. Code § 300(b)*; § 10.11[3][a]] may contain provisions governing amendment. A domestic corporation's power to amend its articles in connection with a reorganization under federal bankruptcy laws is governed by *Corp. Code § 1400(b)*. For a corporation's right, by amendment of its articles, to avoid actions by the California Attorney General for involuntary dissolution based on acts or omissions curable by amendment, see *Corporation Code § 1801(b)* [*see* CALIFORNIA LEGAL FORMS, Ch. 12, *Winding Up and Dissolution*].

[2] Special Provisions Applicable to Corporations Existing Before January 1, 1977

[a] In General

Although the provisions of *Corp. Code §§ 900 et seq.* apply to corporations existing before January 1, 1977 [*Corp. Code §§ 102, 162, 2301*], certain other provisions of the Corp. Code regarding articles of incorporation (or bylaws) do not apply to pre-1977 corporations unless or until their articles are amended [*see Corp. Code § 2302*; [b], *below*]. These

provisions include *Corp. Code §§ 202* (required provisions in the articles), 204(b), (c), (d) (optional provisions in the articles), and 205 (par value) [*Corp. Code § 2302*]. In addition, *Corp. Code § 204(a)* (providing that specified provisions will not be effective unless expressly contained in the articles) does not apply to valid bylaws in effect on January 1, 1977, until the corporation files an amendment to its articles electing to be governed by all the provisions not otherwise applicable to it under the transition provisions [*Corp. Code § 2302.1*; *see Corp. Code § 2303*; [b], *below*].

Although *Corp. Code §§ 206* and *207* (purposes and powers of corporations) are applicable to pre-1977 corporations, any statement in the articles regarding purposes and powers is not to be construed as a limitation [*see Corp. Code § 204(a)(6)*], unless it is expressly stated as such, until the articles are amended pursuant to *Corp. Code § 2302* [*Corp. Code § 2303*].

A conflict between the articles and bylaws in the number of directors will not be governed by *Corp. Code § 212(a)* for a pre-1977 corporation. Instead, that corporation will continue to be governed by prior law, until the corporation elects to amend its articles pursuant to *Corp. Code § 2302* [*Corp. Code § 2304*].

Corp. Code §§ 417 and *418* (statements required on share certificates) apply to share certificates of corporations existing on January 1, 1977, only if the shares are originally issued after that date. However, prior law continues to govern certificates representing shares originally issued before that date, until the articles are amended pursuant to *Corp. Code § 2302*, and the certificate is presented for transfer [*Corp. Code § 2307*].

[b] Amendment Procedure

The board of directors alone may approve an amendment, if the amendment makes a change in the articles [*Corp. Code § 2302*]:

- Conforming the statement of purposes and powers to *Corp. Code § 202(b)*,
- Deleting references to par value and location of principal office, or
- Deleting any statement regarding the number of directors or conforming any statement to *Corp. Code § 212* (subject to any shareholder approval required by *Corp. Code § 2304* for changes in the makeup of the board).

However, if the amendment makes any other changes, it must be approved by the outstanding shares, if their approval is otherwise required [*Corp. Code § 2302*; *see Corp. Code § 152* (approved by (or approval of) the outstanding shares defined)].

To make a *Corp. Code § 2302* election (to be governed by all the provisions of the Corp. Code not otherwise applicable to a pre-1977 corporation under the transition provisions), language substantially similar to the following should be included in a separate article in the certificate of amendment: "This corporation elects to be governed by all the provisions of the General Corporation Law of 1977 not otherwise applicable to it under Chapter 23 of the new law" [*see Corporations Checklist* (State of California, Office of Secretary of State, 1990, p. 40)]. The Secretary of State takes the position that if the corporation is amending its articles to include the election, the articles must also be amended to conform their contents to the requirements of the present law [*see Corporations Checklist* (State of California, Office of Secretary of State, 1990, p. 40)]. As a practical matter, because of the extensive changes generally resulting from a *Corp. Code § 2302* election, it may be advisable to make the election by amending and restating the entire articles of incorporation [*see §§ 10.43, 10.221*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePowersGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
A. Power and Limitations on Power to Amend; Alternatives

4-10 California Legal Forms--Transaction Guide § 10.13

§ 10.13 Limitations on Power to Amend

[1] Statutory Limitations

[a] In General

Amended articles may contain only those provisions that could be lawfully included in original articles on the date of the amendment [*Corp. Code § 900(a)*]. The original articles may include any lawful provision for the management of the business or the conduct of the corporation's affairs [*Corp. Code § 204(d)*]. Amendments that are specifically required or prohibited by statute are discussed in *§ 10.20* and *[b], below*, respectively. For discussion of limitations that may be contained in the articles themselves, refer to § 10.32.

Courts may be willing to disregard inconsistencies between the law and article provisions that are imposed by the shareholders themselves, when those provisions deal with a shareholder's rights as an individual, including the transferability of shares, if it can be shown that the shareholder was a party to the adoption of the provision, or agreed to it [Note, *Articles and Bylaws--Statutory Requirements of Consistency With the Law--Contractual Enforcement of Inconsistent Articles and Bylaws, 31 Notre Dame L. Rev. 699, 703 (1956)*]. However, courts tend to give less weight to this contractual consent, and tend to enforce the law when the article provisions are imposed by the corporation and deal with the rights of shareholders as a group or with the management of the corporation [*see* Note, *Articles and Bylaws--Statutory Requirements of Consistency With the Law--Contractual Enforcement of Inconsistent Articles and Bylaws, 31 Notre Dame L. Rev. 699, 705*-706 (1956)].

[b] Prohibited Provisions

Certain sections of the Corporations Code expressly prohibit their variation by specific provisions in the articles. Although not an exhaustive list, the examples discussed here illustrate a number of the significant statutory provisions that may not be varied in the articles. For example, a corporation may not amend its articles to alter the names and addresses of the first directors or of the initial agent for service of process, if any, in the original articles, except to correct an error or to delete the information after the corporation has filed the annual statement with Secretary of State required under *Corp. Code § 1502* [*Corp. Code § 900(b)*].

Because the articles may not limit the rights of shareholders to inspect and copy the record of shareholders' names, addresses, and shareholdings [*Corp. Code § 1600(c)*] and the corporation's accounting books, records, and minutes [*Corp. Code § 1601(b)*], the articles may not be amended to impose any such limitations [*see also Corp. Code § 1602* (directors' absolute right of inspection)].

Corp. Code § 307(a)(7) expressly prohibits the articles from providing that a quorum at a meeting of directors will be less than one third the authorized number of directors, or less than two, whichever is larger, unless the authorized number of directors is one, in which case one director constitutes a quorum. Therefore, an amendment to the articles may not contain such a provision [*see Corp. Code § 900(a)*].

Any corporation may elect voluntarily to wind up and dissolve by the vote of shareholders representing at least 50 percent of the voting power [*Corp. Code § 1900(a)*], and specified corporations may elect to do so by approval of the board of directors [*Corp. Code § 1900(b)*]. The vote required by these sections may not be decreased or (with one exception) increased by the articles because to do so would make the articles conflict with the law [*Corp. Code § 204(a)(5)*; *see Corp. Code § 900(a)*; *see also Corp. Code § 402.5(b)* (exception providing that rights of class or series of preferred shares may provide for voluntary dissolution only on vote of specified percentage not exceeding 662/3 of that class or series)].

Similarly, although corporations may provide in their original articles for one or more classes or series of shares with full, limited, or no voting rights, and may by implication amend their articles to provide for those voting rights [*see Corp. Code §§ 202(e)(3), 400(a), 900(a)*], a corporation may not completely eliminate share voting rights because the Corporations Code grants voting rights to nonvoting shares in certain circumstances, including approval of certain amendments of the articles [*Corp. Code §§ 903, 904*; *see Corp. Code § 117* (vote of each class of outstanding shares defined); *see also § 10.31*]; reorganizations [*Corp. Code § 1201*]; and a plan of distribution of assets on dissolution [*Corp. Code § 2007*].

Since variation of the voting provisions discussed above may not be accomplished in the articles, a voting agreement among shareholders, an irrevocable proxy, or a close corporation shareholder agreement may be the only means to affect changes on those matters [*see § 10.11[3]*].

[2] Equitable Limitations

In addition to the statutory limitations on the amendment of articles [*see* [1], *above*] and any limitations contained in the articles themselves [*see § 10.32*], courts have imposed equitable limitations on the amendment of articles that change the rights of minority shareholders, even when the amendment is adopted by the requisite statutory majority of shares, together with any required class vote [*see DeMello v. Dairyman's Co-op. Creamery (1946) 73 Cal. App. 2d 746, 750, 167 P.2d 226* ; *see also Bixby v. Pierno (1971) 4 Cal. 3rd. 130, 93 Cal. Rptr. 231, 481 P.2d 242* ; Tu-Vu Drive-In *Corp. v. Ashkins (1964) 61 Cal. 2d 283, 38 Cal. Rptr. 348, 391 P.2d 828* ; *Silva v. Coastal Plywood & Timber Co. (1954) 124 Cal. App. 2d 276, 268 P. 2d 510]* . In *DeMello v. Dairyman's Co-op. Creamery (1946) 73 Cal. App. 2d 746, 751, 167 P.2d 226* , the court, quoting Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 11, *Amendment of Articles and Bylaws* , § 231.04[3] (Matthew Bender, 1938 ed.), held that:

> Changes in the rights of outstanding shares may be valid if they can be justified by an exercise of fair business discretion in meeting the needs and exigencies of the corporate enterprise. The more urgent the need or emergency, the more drastic the amendment or adjustments which fairness will permit, as in changing preferences and financial arrangements according to what the enterprise will carry. The facts and circumstances of each case will enter into the determination of the validity of the exercise of power in that case.

One commentator has argued that the rule enunciated in *DeMello* is too generalized, and that subsequent California decisions have turned on the balancing of several factors, in addition to the business need or exigency of the amendment. These factors include [*see* Halloran, *Equitable Limitations on the Power to Amend Articles of Incorporation, 4 Pac. L.J. 47, 52*-61 (1973)]:

- The degree of discrimination among or proportionate treatment of classes or groups of shareholders;
- The size of the vote approving the amendment and percentage of objecting shares;
- Available alternatives to the amendment that do less harm to minority shareholders; and
- Compensation (in terms of other rights) granted to shareholders whose rights have been diminished.

On the duty owed by majority shareholders to minority shareholders generally, *see Jones v. H.F. Ahmanson & Co. (1969) 1 Cal. 3d 93, 108, 81 Cal. Rptr. 592, 460 P.2d 464* . For further discussion of this duty, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 11, *Amendment of Articles and Bylaws* , § 231.04[4], [5] (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityLimitationsBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposePowersGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsShareholdersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
A. Power and Limitations on Power to Amend; Alternatives

4-10 California Legal Forms--Transaction Guide §§ 10.14-10.19

[Reserved]

§§ 10.14[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
B. Mandatory Amendments

4-10 California Legal Forms--Transaction Guide § 10.20

§ 10.20 Mandatory Amendments and Corporate Acts Requiring Amendment of Articles

In certain instances, a corporation is required by statute to amend its articles. For example:

- An amendment to increase the number of authorized shares is mandatory if the corporation is not authorized by its articles to issue all the shares required to satisfy option or conversion rights, when the option or conversion rights are exercised [*Corp. Code § 405(a)*].

- An amendment to decrease the number of authorized shares is also mandatory if the corporation reacquires shares but is prohibited from reissuing them [*Corp. Code § 510(b)*].

- If the corporation reacquires all of the authorized shares of a class or series, the articles must also be amended to eliminate any statement of rights, preferences, privileges, and restrictions relating solely to that class or series [*Corp. Code § 510(b)*].

- An amendment to the articles to delete the special provisions relating to a close corporation [*see Corp. Code § 158(a)*] is mandatory if the number of shareholders exceeds 35, the maximum number of close corporation shareholders permitted by statute [*Corp. Code § 158(e)*].

In addition to authorizing any amendment that is consistent with the law *Corp. Code § 900(a)* specifies that "if a change in shares or the rights of shareholders or an exchange, reclassification or cancellation of shares or rights of shareholders is to be made," the articles must contain the provisions necessary to effectuate that change, exchange, reclassification, or cancellation [*Corp. Code § 900(a)*; *see Corp. Code §§ 202-205, 402-405, 903, 904*]. Examples of common changes in shares or the rights of shareholders requiring the amendment of the articles include assessments on shares [*see Corp. Code §§ 204(a)(1), 423, 904*], the elimination of preemptive rights or of a right of first refusal applying to all of the common shares of a corporation [*see Corp. Code §§ 204(a)(2), 900(a)*], or the creation or a change in the requirements for a supermajority vote [*see Corp. Code §§ 152, 204(a)(5), 902(e)*]. An example of a reclassification of shares is the division of a preferred class into series or the designation of an existing preferred class as a specific series of a new preferred class [*see Corp. Code § 903(a)(6)*].

In addition to mandatory amendments, there are certain corporate actions that can be accomplished only by amendment of the articles. For example, a stock split (a pro rata division, other than a share dividend, of all of the outstanding shares of a class into a greater number of shares of the same class) [*Corp. Code § 188*] or a reverse stock split (a pro rata combination of all of the outstanding shares of a class into a smaller number of the share of the same class) [*Corp. Code § 182*] is accomplished by an amendment to the articles stating the effect on the outstanding shares. An amendment to the articles is required to elect to be governed by the new General Corporation Law [*see Corp. Code § 2300* (new law defined)], not otherwise applicable to corporations existing before January 1, 1977 under the transition provisions [*Corp. Code § 2302*; *see Corp. Code § 2300 et seq.* (transition provisions)]. Further, *Corp. Code § 204* specifies actions that will not be effective unless expressly contained in the articles [*see also Corp. Code § 202* (required article provisions)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesStock SplitsBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



16 of 168 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
B. Mandatory Amendments

4-10 California Legal Forms--Transaction Guide §§ 10.21-10.29

[Reserved]

§§ 10.21[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
C. Requirements for Approval

4-10 California Legal Forms--Transaction Guide § 10.30

§ 10.30 Requirements for Approval of Amendments by Directors and Shareholders

[1] Before Shares Are Issued

Any amendment of the articles before shares are issued may be adopted by a writing signed by a majority of the incorporators, if directors were not named in the articles and have not been elected, or if directors were named in the articles and have been elected, by a majority of the directors [*Corp. Code § 901*]. The writing must be a certificate of amendment, signed and filed as provided in *Corp. Code § 906* [*see Corp. Code § 906*; § 10.200], or, if the directors were named or have been elected, they may file a certificate of amendment as provided in *Corp. Code § 905* [*Corp. Code § 906*; *see § 10.201*].

This approval procedure may be used only if no shares have been issued. Shares are probably issued, for the purposes of *Corp. Code § 901*, when the corporation receives payment for its shares [*see Garretson v. Pacific Crude Oil Co. (1905) 146 Cal. 184, 188, 79 P. 838]* .

[2] After Shares Are Issued

[a] By Directors and Shareholders--In General

After shares have been issued, amendments generally may be adopted only if approved by both the board of directors and by the outstanding shares, either before or after board approval [*Corp. Code § 902(a)*]. Certain amendments, however, may be adopted by board approval alone [*see* [b], *below*].

"Approved by (or approved of) the board" means approved by the vote of the board of directors [*Corp. Code §§ 151, 155*]. Except when a greater proportion is required by statute or the articles, or, if the articles so permit, by the bylaws, approval is indicated by the vote of a majority of the directors present at a meeting at which a quorum is present [*see Corp. Code §§ 204(a)(5), 307(a)(8)*], or by the unanimous written consent of the directors without a meeting [*see Corp. Code §§ 194, 195, 307(b)*]. When board approval alone of an amendment of the articles is permitted, that approval must be by the board as a whole, and not by a committee of the board [*Corp. Code §§ 151, 311(a)*].

"Approved by (or approval of) the outstanding shares" means approved by the affirmative vote of a majority of the outstanding shares entitled to vote; it includes the affirmative vote of a majority of the outstanding shares of each class or series entitled, by any provision of the articles or of the Corporations Code, to vote as a class or series on the subject matter being voted on, as well as the affirmative vote of any greater proportion (including all) of the outstanding shares of any class or series if a greater proportion is required in the articles [*see Corp. Code § 204(a)(5)*], a shareholder agreement [*see Corp. Code §§ 154, 186, 300(b)*], or the Corporations Code [*Corp. Code § 152*]. Nonvoting shares, or shares not permitted by the articles to vote on certain amendments, are not considered outstanding shares, and are not entitled to vote on amendments governed by *Corp. Code § 902(a)* [*see Corp. Code § 112*].

"Approved by (or approval of) the shareholders" means approved by the affirmative vote of a majority of the shares entitled to vote, represented [*Corp. Code § 153*]:

- At a duly held meeting at which a quorum is present,
- By the written consent of shareholders [*see Corp. Code § 603*], or
- By the affirmative vote or written consent of any greater proportion (including all) of the shares of any class or series, if a greater proportion is required for any specified shareholder action in the articles [*see Corp. Code § 204(a)(5)*; § 10.32], or in a shareholder agreement [*see Corp. Code §§ 154, 186, 300(b)*; § 10.11[3]] or in the Corporations Code [*see Corp. Code §§ 194, 195*].

"Vote" includes authorization by written consent subject to the statutory provisions relating to consent of directors [*see Corp. Code § 307(b)*] and to election of directors by shareholders [*Corp. Code §§ 194, 195*; *see Corp. Code § 603(d)*].

For discussion of voting procedures for shareholders, *see* Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* . For discussion of voting procedures for directors, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

[b] By Directors Alone

Amendments that may be adopted by the board alone include:

- An amendment to delete close corporation status when the number of close corporation shareholders exceeds 35 [*Corp. Code § 158(e)*].
- An amendment authorizing a change in the number of outstanding shares (if the directors are authorized by the articles to take this action [*see Corp. Code § 202(e)*]), after a certificate of determination has been filed as part of the restated articles, as provided in *Corp. Code § 910* [*Corp. Code § 401(c)*].
- An amendment to increase the authorized shares to satisfy option or conversion rights, after the issue of options or convertible securities has been approved by the outstanding shares [*Corp. Code § 405(b)*].
- An amendment to reflect the reduction in authorized shares if the corporation has reacquired shares that may not be reissued [*Corp. Code § 510(b)*].
- An amendment to extend or to make perpetual the term of corporate existence of a corporation organized before August 14, 1929 [*Corp. Code § 902(b)*].
- An amendment effectuating a stock split [*see Corp. Code § 188* (stock split defined)], including an

increase in the number of authorized shares in proportion to the split, when the corporation has only one class of shares outstanding [*Corp. Code § 902(c)*].

- An amendment deleting the names and addresses of the first directors or of the initial agent for service of process after the corporation has filed the annual statement with Secretary of State required under *Corp. Code § 1502* [*Corp. Code § 902(d)*; *see Corp. Code § 900(b)*].

- An amendment changing the name of the surviving corporation in a short-form merger of a parent corporation and a 90 percent (or more) owned subsidiary [*Corp. Code § 1110(a), (d)*].

- An amendment accomplishing a reorganization when specified share ownership requirements are met [*Corp. Code § 1201(b)*].

- Certain amendments to the articles of a corporation existing on January 1, 1977 [*Corp. Code § 2302*; *see § 10.12[2]*].

Further, certificates filed with the Secretary of State that do not amend the articles, such as a certificate of correction [*see Corp. Code § 109*], a certificate of determination [*see Corp. Code §§ 156, 401*], or a certificate restating but not amending the articles of incorporation [*see Corp. Code § 910*], may be approved by the board alone.

In addition, certain amendments adopted to effect a reorganization under federal bankruptcy laws may be approved by appointed trustees, by designated corporate officers, or by a court-appointed master or other representative, rather than by the board and shareholders of the corporation [*see Corp. Code § 1400*].

[c] Additionally by Class or Series of Shares Affected

A separate vote of approval by a class or series of shares affected by a proposed amendment or supermajority vote is required only

- If required by the articles [*see Corp. Code § 152*; *see § 10.32*] or by shareholder agreement [*see Corp. Code §§ 300(b), 706(a), (c)*; *see also § 10.11[3]*],

- Under certain circumstances enumerated in the Corporations Code, including, for example, *Corp. Code §§ 903(a), (b),* and *904* [*see § 10.31*], or

- If required by the Commissioner of Corporations [*see 10 Cal. Code Reg. 260.140.63*; § 10.33].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
C. Requirements for Approval

4-10 California Legal Forms--Transaction Guide § 10.31

§ 10.31 Specific Amendments Requiring Additional Shareholder Approval

[1] Amendment Affecting Class of Outstanding Shares Under Corp. Code § 903(a)

In addition to approval by the outstanding shares [*Corp. Code § 903(c)*] and by the board [*Corp. Code § 902(a)*], a proposed amendment must be approved by the outstanding shares of a class, whether or not it is otherwise entitled to vote, if the amendment would do any of the following [*Corp. Code § 903(a)*]:

- Increase or decrease the number of authorized shares of the class, other than an increase required to satisfy option or conversion rights under *Corp. Code § 405(b)* or incident to a stock split [*see Corp. Code § 902(c)*].

- Exchange, reclassify, or cancel all or part of the shares of the class, including a reverse stock split but excluding a stock split.

- Exchange, or create a right of exchange, of all or part of the shares of another class into the shares of the class.

- Change the rights, preferences, privileges, or restrictions of the shares of the class.

- Create a class of shares senior to the subject class, or increase the rights, preferences, and privileges of a class senior to the subject class.

- Divide (or authorize the board to divide) the preferred class into series with different rights, privileges, or restrictions.

- Cancel or otherwise affect accrued (but unpaid) dividends on the shares of the class.

[2] Amendment Adversely Affecting Series of Class of Outstanding Shares

If a series [*see Corp. Code § 183* (series defined)] of a class of outstanding shares will be adversely affected by an amendment of the articles in a different manner than other outstanding shares of the same class, the proposed amendment must be approved by the series voting as if it were a separate class [*Corp. Code § 903(b)*].

[3] Amendment to Make Shares Assessable

In addition to the vote of outstanding shares and of the board, the unanimous vote of all the outstanding shares affected, regardless of limitations and restrictions on their voting rights, is required to amend the articles to authorize a corporation to make shares assessable or to authorize action for collection of an assessment on fully paid shares [*Corp. Code § 904(a)*; *see Corp. Code § 423(n)*].

An amendment of the articles of a mutual water company [*see Pub. Util. Code § 2705* (mutual water company defined)] to make shares assessable or to amend article provisions authorizing assessment of shares requires only a two-thirds vote of the outstanding shares [*Corp. Code § 904(b)*]. An amendment authorizing action against a shareholder for the collection of an assessment on fully paid shares, however, requires unanimous consent [*Corp. Code § 904(b)*].

[4] Amendment Classifying Board and Eliminating Cumulative Voting

A listed corporation may amend its articles to divide its board into two or three classes of directors, or to eliminate cumulative voting, or both, subject to certain limitations [*Corp. Code § 301.5(a)*; *see Corp. Code § 301.5(b), (c)* (limitations); *see also § 10.215*]. A corporation is "listed" if it has outstanding shares listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market [*Corp. Code § 301.5(d)*].

A corporation that has issued shares but is not yet a listed corporation may adopt an amendment for this purpose to become effective when it becomes listed [*Corp. Code § 301.5(a)*]. An amendment classifying the board and/or eliminating cumulative voting requires the approval of the board and the outstanding shares voting as a single class, notwithstanding the provisions of *Corp. Code § 903* (additional shareholder approval of amendments) [*Corp. Code § 301.5(a)*].

[5] Amendment Electing or Terminating Close Corporation Status

A corporation may elect close corporation status [*see Corp. Code § 158(a)* (close corporation requires provision in articles limiting shareholders to 35 and specifically identifying corporation as close corporation)] and include the required identifying provision in an amendment to its articles of incorporation [*Corp. Code § 158(b)*; *see § 10.211*]. After shares have been issued, however, such an amendment may be adopted only by the affirmative vote of all the issued and outstanding shares of all classes [*Corp. Code § 158(b)*]. The amendment must also be approved by the board [*Corp. Code § 902(a)*].

A corporation may terminate its close corporation status or change the number of shareholders specified in its articles of incorporation by an amendment to the articles [*Corp. Code § 158(c)*; *see § 10.212*]. After shares have been issued, however, such an amendment may be adopted only by the affirmative vote of at least two-thirds of each class of outstanding shares, although the articles may reduce the required vote to not less than a majority of the outstanding shares, or may deny a vote to any class, or both [*Corp. Code § 158(c)*]. The amendment must also be approved by the board [*Corp. Code § 902(a)*].

An amendment reducing the vote required under *Corp. Code § 158(c)* requires the approval of two-thirds of each class of outstanding shares or of such other vote as specified in the articles of incorporation [*Corp. Code § 902(f)*]. Thus, unless the articles originally provided for a lower vote to approve termination of close corporation status or a change in the number of specified shareholders, the minority shareholders may not be deprived of the two-thirds vote requirement by a later amendment to the articles, unless that amendment is approved by a two-thirds vote. Such an amendment must

also be approved by the board [*Corp. Code § 902(a)*].

[6] Amendment to Convert to Nonprofit or Cooperative Status

A corporation may convert to a nonprofit public benefit corporation, a nonprofit religious corporation, or a cooperative corporation by the amendment of its articles in accordance with *Corp. Code § 911(a)* [*Corp. Code § 911(a)*].

If shares have been issued, an amendment of the articles to convert to a nonprofit corporation must be unanimously approved by the outstanding shares of all classes, regardless of limitations or restrictions on their voting rights [*Corp. Code § 911(c)*], with one exception. If a corporation is a mutual water company [*see Pub. Util. Code § 2705* (mutual water company defined)], an amendment to convert to a nonprofit mutual benefit corporation requires only approval by the outstanding shares, regardless of limitations or restrictions on their voting rights, if each outstanding share will be converted to a membership of the new nonprofit corporation [*Corp. Code § 911(e)*]. Approval by the outstanding shares can, but usually does not, require unanimous approval.

If shares have been issued, an amendment to convert to a cooperative corporation must also be approved only by the outstanding shares of each class, regardless of limitations or restrictions on their voting rights [*Corp. Code § 911(c)*].

[7] Amendment to Reduce Number of Directors to Less than Five

An amendment of the articles reducing the fixed number, or, in the case of a variable board, the minimum number of directors to a number less than five may not be adopted if more than 16 2/3 percent of the outstanding shares entitled to vote are voted against its adoption, either at a shareholders' meeting or by written consent [*Corp. Code § 212(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsDissolution & Winding UpBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
C. Requirements for Approval

4-10 California Legal Forms--Transaction Guide § 10.32

§ 10.32 Additional Voting Rights or Requirements Imposed by Articles of Incorporation

[1] In General

The corporation's articles may create additional voting rights or impose additional voting requirements [*see Corp. Code § 204(a)(5), (9)*; *see Corp. Code §§ 303, 402.5(b), 708(c)*, 708.5(b), *1900* (exceptions); *see also Corp. Code § 300(c)* (close corporation shareholder agreements)]. The articles may require a shareholder vote on any matter, ever though not otherwise required by the Corporations Code [*Corp. Code § 204(a)(9)*]. The articles also may require a larger portion of shares of any or all classes or series to take corporate action than is otherwise required by a particular statute [*Corp. Code § 204(a)(5)*], or may provide for supermajority votes by the corporation's directors or shareholders on various matters [*see Corp. Code § 710*]. A supermajority vote provision protects minority shareholders and holders of preferred shares from adverse action against their interests by the majority shareholders, and may protect against takeover attempts. For further discussion of supermajority voting, see Ballantine & Sterling, California Corporation Laws, Ch. 4, *Close Corporations* , § 61.03[2] (Matthew Bender).

An amendment to the articles is required to create or change requirements for a supermajority vote, and any change in those provisions must be approved by the required supermajority vote, unless the articles provide otherwise [*Corp. Code §§ 204(a)(5), 902(e)*]. Similarly, if a provision of the articles requires a shareholder vote on a matter that is not otherwise required to be voted upon by the Corporations Code, an amendment to the articles is required to change this requirement, and any change must be approved by the required vote, unless the articles provide otherwise [*Corp. Code §§ 204(a)(9), 902(e)*].

[2] Special Requirements Applicable to Large Publicly Held Corporations

If a corporation has 100 or more shareholders, special requirements apply to an amendment of the articles or a certificate of determination [*see Corp. Code § 156* (certificate of determination defined)], which include a supermajority vote requirement [*see Corp. Code § 710*]. The supermajority vote provisions may not require a vote greater than 66 2/3 percent of the outstanding shares or of a class or series of outstanding shares [*Corp. Code § 710(b)*]. Further, any change in the supermajority vote provisions must be approved by at least the required supermajority vote [*Corp. Code § 710(c)*]. These requirements, however, do not apply to a corporation filing an amendment or a certificate of

determination on or after January 1, 1994 that has (1) outstanding shares of more than one class or series of stock; (2) no class of equity securities registered under Section 12(b) or 12(g) of the Securities Exchange Act of 1934; (3) outstanding securities held of record by fewer than 300 persons [*see Corp. Code § 605*]; and (4) no supermajority vote provision, and has never had a supermajority vote provision, subject to the requirement of readoption [*see former Corp. Code § 710(a)*; *see also Corp. Code § 710(c)*]. In 2002, this statute was amended to delete the fourth condition [*see Corp. Code § 710(a)*], but this amendment does not affect the existing rights of minority shareholders [*Corp. Code § 710(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
C. Requirements for Approval

4-10 California Legal Forms--Transaction Guide § 10.33

§ 10.33 Greater than Statutory Vote Requirement Imposed by Commissioner of Corporations

Regardless of the statutory vote requirement for the approval of an amendment, in any proposed plan of recapitalization or reorganization, and the proposed issuance of qualified securities [*see Corp. Code § 25122* (qualification of securities becomes effective on Commissioner issuing permit authorizing issuance of those securities)], the Commissioner of Corporations may impose conditions to ensure that the offering will be fair, just and equitable [*Corp. Code §§ 25140(c), 25141*]. These conditions may include a vote requirement greater than that imposed by statute [*see Corp. Code § 25141*]. For example, the Commissioner may condition the required permit on obtaining the affirmative vote of a specified percentage of the outstanding shares held by persons who do not have a conflict of interest in connection with the reorganization or recapitalization [*10 Cal. Code Reg. § 260.140.63*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
C. Requirements for Approval

4-10 California Legal Forms--Transaction Guide §§ 10.34-10.39

[Reserved]

§§ 10.34[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
D. Amendment Procedures

4-10 California Legal Forms--Transaction Guide § 10.40

§ 10.40 Procedures for Action by Directors

[1] In General

Action by the directors to amend the articles of incorporation may be taken at annual, regular, or special meetings of directors [*Corp. Code §§ 307, 311*; *see* [2], *below*], or by the unanimous written consent of the directors without a meeting [*Corp. Code § 307(b)*; *see* [3], *below*].

[2] At Board Meetings

Directors may participate in meetings either in person or by conference telephone, electronic video screen communication, or electronic transmission by and to the corporation [*Corp. Code § 307(a)(6)*; *see Corp. Code §§ 20, 21* (definitions)]. Participation in a meeting through use of a conference telephone call or electronic video screen communication constitutes presence in person at that meeting as long as all members participating in the meeting are able to hear one another. Participation in a meeting through electronic transmission by and to the corporation (other than a conference telephone call and electronic video screen communication) constitutes presence in person at that meeting if both of the following are true [*Corp. Code § 307(a)(6)*]:

- Each member participating in the meeting can communicate with all of the other members concurrently.

- Each member is provided the means of participating in all matters before the board, including, without limitation, the capacity to propose, or to interpose an objection to, a specific action to be taken by the corporation.

Unlike shareholders, however, directors may not attend a meeting or vote by proxy [*see Corp. Code § 307* (requiring physical or audio presence); *see also* Cavitch, *Business Organizations, Ch. 125, Board Meetings, § 125.02[3]* (Matthew Bender)].

In close corporations, directors may dispense with the corporate formalities relating to directors' (and shareholders')

meetings, if so authorized by a close corporation shareholder agreement [*see Corp. Code § 300(b), (e)*]. Moreover, it has been held that the directors of small corporations may transact their business by conversation and without formal vote, especially when informality has become customary to the corporation [*American Center for Educ. v. Cavnar (1978) 80 Cal. App. 3d 476, 491, 145 Cal. Rptr. 736]* . Director action may also be taken by unanimous written consent without a meeting [*Corp. Code § 307(b)*; *see* [3], *below*].

Formal meeting procedures, including persons authorized to call a meeting [*Corp. Code § 307(a)(1)*], the place of the meeting [*Corp. Code § 307(a)(5)*; *see Corp. Code § 212(b)(2)*], notice [*Corp. Code § 307(a)(2), (3)*], quorum [*Corp. Code § 307(a)(8)*], record requirements (minutes) of the proceedings [*Corp. Code § 1500*], and the relaxation of rules related to directors' meetings for close corporations [*see Corp. Code §§ 300(c), (e)*] are discussed in Ch. 5, *Directors' Meetings, Actions, and Resolutions* . For a form for meeting minutes, see *§ 10.240*.

[3] By Unanimous Written Consent Without Meeting

The directors may act by written consent without a meeting. However, an action by written consent requires the consent of *all* members of the board. In addition, the number of board members serving at the time of the action must constitute a quorum [*Corp. Code § 307(b)*].

For purposes of unanimous board action without a meeting, the term "all members of the board" includes an "interested director" [*see Corp. Code § 310(a)*] or a "common director" [*see Corp. Code § 310(b)*] who abstains in writing from providing consent, when [*Corp. Code § 307(b)*]:

- The disclosures required by *Corp. Code § 310* (generally requiring full disclosure of the material facts regarding the transaction and the director's interest) [*see Ch. 4, Bylaws, § 4.200[2]*, Section 2.23] have been made to the noninterested or noncommon directors, as applicable, before their execution of the written consent or consents;

- The specified disclosures are conspicuously included in the written consent or consents executed by the noninterested or noncommon directors; and

- The noninterested or noncommon directors, as applicable, approve the action by a vote that is sufficient without counting the votes of the interested or common directors.

If the directors give written consent in accordance with the preceding rule, but the disclosures made regarding the action that is the subject of the consent do not satisfy statutory requirements [*see Corp. Code § 310*], the action that is the subject of the consent will be deemed approved. However, in any suit brought to challenge the action, the party asserting the validity of the action has the burden of proof in establishing that the action was just and reasonable to the corporation at the time it was approved [*Corp. Code § 307(b)*].

The requisite consent may be in the form of individual consents or one collective consent, a facsimile of either type of consent, or by telegraphic or other electronic communication authorized by the Corporations Code [*see Corp. Code §§ 195, 307(b)*]. The consents must be filed with the minutes of the board's proceedings [*Corp. Code § 307(b)*]. For a form for unanimous written consent, see *§ 10.241*. For further discussion and additional forms, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate

LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
D. Amendment Procedures

4-10 California Legal Forms--Transaction Guide § 10.41

§ 10.41 Procedures for Action by Shareholders At Meeting or By Written Consent

Action by the shareholders to amend the articles of incorporation may be taken at a shareholders' meeting [*Corp. Code § 600(b), (d)*], or by the written consent of the shareholders without a meeting [*Corp. Code § 603(a)*].

Close corporations may dispense with the corporate formalities relating to shareholders' meetings, if so authorized by a close corporation shareholder agreement [*see Corp. Code § 300(b), (e)*]. Furthermore, in practice, small or medium-sized corporations often dispense with formal meetings and obtain shareholder consent in writing, without a meeting, since most amendments to the articles of incorporation are initiated by the board of directors, who then solicit shareholder approval, as required.

Unless otherwise provided in the articles of incorporation, action that may be taken by the shareholders at any annual or special meeting may be taken without a meeting and without prior notice, by a consent in writing [*see Corp. Code § 603(a)*]. This consent must set forth the action taken, and be signed by the holders of outstanding shares having at least the minimum number of votes necessary to take that action at a meeting at which all shares entitled to vote on that particular matter were present and voted [*Corp. Code § 603(a)*; *see Corp. Code § 604* (special rules applicable to form of written consent distributed to ten or more shareholders of certain corporations with outstanding shares held of record by 100 or more persons)].

Although there is no statutory requirement that all shareholders entitled to vote be solicited in writing for consents, if this is not the case, then the nonconsenting shareholders entitled to vote must be given [*Corp. Code § 603(b)*]:

- Notice, at least 10 days before the consummation of the approved action, of any shareholder approval without a meeting by less than unanimous written consent, related to:
  - Transactions in which a director has a financial interest [*Corp. Code § 310*],
  - Indemnification of corporate agents [*Corp. Code § 317*],

- Corporate conversions [*see Corp. Code § 1152*],
- The principal terms of reorganization [*Corp. Code § 1201*], or
- A plan of distribution of corporate assets, other than money, in specified circumstances [*Corp. Code § 2007*].

- "Prompt" notice of the taking of any other corporate action approved by shareholders without a meeting by less than unanimous written consent [*see Corp. Code § 601(b)* (notice procedure)].

The written consent may be revoked by the consenting shareholder, the shareholder's proxyholders, a transferee of the shares, a shareholder's personal representative, or their respective proxyholders. Any revocation must be in writing, and must be received by the corporation before the written consents representing the number of shares required to authorize the proposed action have been filed with the corporation's secretary [*Corp. Code § 603(c)*]. The revocation of consent is effective on receipt by the corporation's secretary [*Corp. Code § 603(c)*].

For a resolution amending the articles of incorporation to be adopted at a shareholders' meeting, see *§ 10.242*. For a written consent approving the amendment of the articles for use by a corporation with fewer than 100 shareholders, see *§ 10.243*.

For discussion of the statutory requirements and the procedures for holding shareholders' meetings, including the place [*Corp. Code § 600(a)*], date, and time [*Corp. Code § 600(b)* (annual meetings); *Corp. Code § 601(a), (c)* (special meetings); *see 15 U.S.C. § 80a-16* (annual meetings of regulated management company)], notice requirements [*Corp. Code § 601(a)*], waivers of notice [*Corp. Code § 601(e)*], record date [*Corp. Code § 701*], and quorum requirements [*Corp. Code § 602(a)*], see Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* . Unlike directors, shareholders are entitled to vote by proxy [*see Corp. Code § 705(a)*]. For discussion of voting by proxy, see also Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
D. Amendment Procedures

4-10 California Legal Forms--Transaction Guide § 10.42

§ 10.42 Certificate of Amendment

[1] Before Shares Are Issued

A certificate of amendment sets forth the amendment and the facts showing that the amendment was approved as required [*see Corp. Code §§ 905-907*]. If the amendment is adopted before any shares are issued by the corporation, and no directors have been elected, the certificate must be signed by at least a majority of the incorporators and must state that [*Corp. Code § 906*]:

- The signers constitute a majority of the incorporators,
- The corporation has issued no shares,
- The incorporators adopt the amendment(s) set forth in the certificate, and
- The directors were not named in the original articles, and have not been elected.

For a certificate of amendment before shares are issued, *see § 10.200*.

If directors were elected by the incorporators or named in the original articles, the certificate must be signed by at least a majority of the directors, and must state that [*Corp. Code § 906*]:

- The signers constitute a majority of the directors,
- The corporation has issued no shares, and
- The directors adopt the amendment(s) set forth in the certificate.

In lieu of this procedure, a board adopting amendments before shares have been issued may file a certificate of

amendment in accordance with *Corp. Code § 905* [*Corp. Code § 906*]. For a certificate of amendment after shares are issued, *see § 10.201*.

The certificate of amendment filed by either the incorporators or the directors must be verified [*Corp. Code § 906*]. Verification may be by declaration under penalty of perjury, stating the date and place of execution [*see Corp. Code § 193(b)*]. Verification by declaration may be used both within or outside California [*Corp. Code § 193(b)*]. Verification may also be by notarized affidavit [*see Corp. Code § 193(a)*], but this procedure is less likely to be used, since it requires notarization.

[2] After Shares Are Issued

If an amendment is adopted after any shares have been issued by the corporation, the certificate of amendment must state the following:

- The wording of the amendment as required by *Corp. Code § 907* [*Corp. Code § 905(a)*]; *see §§ 10.200[1][h], 10.201[1][g]*],
- That the amendment has been approved by the board [*Corp. Code § 905(b)*],
- If the amendment required shareholder approval [*Corp. Code § 905(c)*; *see §§ 10.30-10.31*],
    - That the amendment was approved by the required vote [*see Corp. Code § 194* (vote includes authorization by written consent)], in accordance with *Corp. Code § 902* [*see § 10.30[2][a]*], *Corp. Code § 903* [*see § 10.31[1], [2]*], or *Corp. Code § 904* [*see § 10.31[3]*],
    - The total number of outstanding shares of each class (if there is more than one class) entitled to vote on the amendment,
    - The percentage vote required of each class (if there is more than one class) of shares entitled to vote [*Corp. Code § 905(c)*; *see Corp. Code § 111*], and
    - That the number of shares (of each class) voting in favor of the amendment equaled or exceeded the required vote.
- If the amendment required only board approval, a statement of facts entitling the board alone to adopt the resolution [*Corp. Code § 905(d)*],
- If the amendment effectuates a stock split [*see Corp. Code § 188*] or a reverse stock split [*see Corp. Code § 182*] or reclassifies, cancels, exchanges, or otherwise changes outstanding shares, the change or effect on outstanding shares [*Corp. Code § 907(b)*; *see Corp. Code § 907(c), (d)* (exceptions); § 10.201[1][g]], and
- If the corporation is a listed corporation [*see Corp. Code § 301.5(d)* ("listed corporation" defined)] and amends its articles to classify its board or eliminate cumulative voting, a statement of facts showing that the corporation is a listed corporation or a statement that the provision will become effective only when the corporation becomes listed [*Corp. Code § 301.5(j)*; *see § 10.31[4]*; *see also § 10.215*].

The certificate must be an "officers' certificate," signed and verified by two officers (the chairman of the board, the president, or any vice president and by the secretary, the chief financial officer, the treasurer, or any assistant secretary

or assistant treasurer) [*Corp. Code § 173*; *see Corp. Code § 193* (verification); *see also* [1], *above*].

If the amendment is a result of a merger, then neither a certificate of amendment nor a certificate of restated articles should be filed [*see Corp. Code § 905*]. Instead, the filing of an officers's certificate and the merger agreement in accordance with *Corp. Code § 1103* or, for a short-form merger, the certificate of ownership in accordance with *Corp. Code § 1110(d)* takes the place of any filing required by *Corp. Code §§ 900 et seq.* [*Corp. Code § 905*].

An amendment to convert to nonprofit or cooperative status must revise the statement of purpose, and delete the authorization for shares and any other provisions related to authorized or issued shares [*see Corp. Code § 911(b)*]. If shares have been issued, the amendment must also provide either for their cancellation or their conversion into memberships of the new nonprofit or cooperative corporation [*Corp. Code § 911(b)*]. If such an amendment is included in a merger agreement, the provisions for cancellation or conversion of shares must be included in the merger agreement, rather than in the amendment of the articles [*Corp. Code § 911(d)*].

Certificates of amendment adopted to effectuate a reorganization under federal bankruptcy laws are governed by *Corp. Code § 1401*.

For certificates of amendment for use after shares have been issued, see *§§ 10.201* and *10.202*.

[3] Filing Requirements

The certificate of amendment, signed and verified [*see* [1], [2], *above*], must be filed in the office of the Secretary of State [*Corp. Code §§ 905, 906*].

The Secretary of State must file the certificate on the date it is received, if the Secretary determines that the amendment conforms to the law, unless the filing [*Corp. Code § 110(a)*] or the effectiveness [*Corp. Code § 110(c)*] is delayed by the party submitting the certificate or by the Secretary of State [*see Corp. Code § 110(a)*]. The filing may be delayed no more than 90 days after its receipt [*Corp. Code § 110(a)*], and the effectiveness may be delayed no more than 90 days after filing [*Corp. Code § 110(c)*]. The requested filing day may be a Saturday, Sunday, or legal holiday [*Corp. Code § 110(a)*].

If the Secretary of State's office determines that the certificate of amendment does not conform to the law, it will return the certificate to the person submitting it [*Corp. Code § 110(b)*; *see Pratt-Low Preserving Co. v. Jordan (1933) 217 Cal. 292, 295, 18 P.2d 676* (in determining whether certificate conforms to law, inquiry by Secretary of State appears limited to ascertaining whether corporation complied with required formalities in adopting amendment)]. The certificate may be resubmitted, accompanied by the written opinion of a member of the California Bar stating that the specific provision objected to by the Secretary of State does conform to the law, and the points and authorities on which this opinion is based. With few exceptions, the Secretary of State must rely on that written opinion [*Corp. Code § 110(b)*]. The date of filing of a resubmitted certificate is the date it was received on resubmission [*Corp. Code § 110(b)*].

[4] Filing and Certification Fees

The Secretary of State's fee for filing a certificate of amendment is set forth in *Gov. Code § 12186(p)*. Special handling fees, such as a fee when a customer waits at an office for immediate confirmation of filing, may also apply regardless of whether the documents are filed or rejected [*2 Cal. Code Reg. § 21903(a)(1), (2)*].

The Secretary of State will compare and certify up to two copies of the certificate without charge, provided the copies are submitted to the Secretary of State with the original certificate to be filed [*Gov. Code § 12185*; *see Gov. Code §§ 12182, 12183*].

[5] Effect of Filing; Proof

The articles are amended, and any stock split, reverse stock split, reclassification, cancellation, exchange, or other change in shares is effectuated on the filing of the certificate of amendment [*Corp. Code § 908*]. A copy of the certificate, certified by the Secretary of State, is prima facie evidence of the performance of the conditions required to adopt the amendment [*Corp. Code § 908*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
D. Amendment Procedures

4-10 California Legal Forms--Transaction Guide § 10.43

§ 10.43 Restated Articles

[1] Restated but Not Amended

A corporation may restate (without alteration or amendment), in a single certificate, its entire articles of incorporation, as amended to the date of filing of the certificate [*Corp. Code § 910(a)*]. Restatement is useful if the articles are poorly written, or if numerous amendments make their use cumbersome. A corporation may also restate and amend its articles [*Corp. Code § 910(a)*; *see* [2], *below*].

Restated articles must set forth the entire text of the articles, as amended, except that the following must be omitted [*Corp. Code § 910(a)*]:

- The signatures and acknowledgments of the articles by the incorporators.
- Any statements of the effects of prior amendments on outstanding shares.
- Any provisions of agreements of merger, other than amendments to the articles of the surviving corporation.
- The names and addresses of the initial director and any initial agent for service of process (unless the corporation has not yet filed a statement under *Corp. Code § 1502*, in which case this information must be included in the restated articles).

The omissions listed above are not alterations or amendments of the articles [*Corp. Code § 910(a)*].

A certificate of restated articles that does not alter or amend the articles may be approved by the board alone, if the board has been elected, or by a majority of the incorporators if shares have not been issued and directors have not been elected [*Corp. Code § 910(b)*]. The certificate is subject to the statutory provisions governing an amendment to the articles not requiring approval of the outstanding shares [*see Corp. Code § 910(b)*; § 10.30[2][b]]. For a certificate of

restated articles, see *§ 10.220*.

[2] Restated and Amended

A certificate of restated articles may also amend, as well as restate, the articles [*Corp. Code § 910(a)*]. A certificate of restated and amended articles is subject to the statutory provisions related to the particular amendment(s) made [*Corp. Code § 910(b)*; *see Corp. Code § 905-907*]. In addition, except for certificates approved by a majority of the incorporators, the certificate must also state that the board has approved the restated articles [*Corp. Code § 910(b)*; *see Corp. Code §§ 905(b), 906*]. For a certificate of restated and amended articles, see *§ 10.221*.

Certificates of determination (of rights, preferences, privileges, and restrictions [*see Corp. Code §§ 156, 401(a)*]) are considered part of the articles of incorporation [*Corp. Code § 910(c)*; *see Corp. Code § 154*]. Therefore, the provisions of any certificates of determination, designated as articles, must also be included in the restated articles [*Corp. Code § 910(c)*].

[3] Effect of Filing Restated Articles

Properly filed, restated articles supersede for all purposes the original articles and any previously filed amendments and certificates of determination [*Corp. Code § 910(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsInterpretation of Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
D. Amendment Procedures

4-10 California Legal Forms--Transaction Guide §§ 10.44-10.49

[Reserved]

§§ 10.44[Reserved]



27 of 168 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
E. Securities Considerations

4-10 California Legal Forms--Transaction Guide § 10.50

§ 10.50 Amendments Requiring Qualification By Corporations Commissioner

[1] Qualification of Issuer Transactions

Any amendment to the articles increasing the authorized number of shares in order to sell more shares (an "issuer transaction") requires qualification by the Commissioner of Corporations before the shares are offered or sold, unless the offer or sale is exempt [*see Corp. Code § 25110*; *10 Cal. Code Reg. § 260.103.1*]. In this case, qualification may be by [*Corp. Code § 25110*]:

- Coordination if a registration statement under the Securities Act of 1933 has been filed for the securities [*Corp. Code § 25111(a)*],

- Notification if any securities of the issuer are registered under Section 12 of the Securities Exchange Act of 1934 [*Corp. Code § 25112(a)*], or

- Permit [*Corp. Code § 25113(a)*].

Commonly used exemptions from the qualification of issuer transactions include the small [*Corp. Code § 25102(h)*] and limited offering exemptions [*Corp. Code § 25102(f)*; *see Corp. Code § 25102* (exempt issuer transactions)]. For further discussion of the requirements for exemption from qualification of securities as a small or limited offering, and appropriate forms, see Ch. 6B, *California Limited Offering Exemptions* , and Ch. 6C, *California Small Offering Exemption* .

[2] Qualification of Recapitalization or Reorganization Transactions

An amendment to the articles that would result in an offer or sale of securities in connection with a change in the rights, preferences, privileges, or restrictions of or on outstanding securities (a "recapitalization or reorganization" transaction) also requires qualification by the Commissioner of Corporations, unless the transaction is exempt [*Corp. Code §§ 25017(a), 25120*]. Qualification must be by permit even if the transaction requires registration of the new security under the Securities Exchange Act of 1933 [*see 15 U.S.C. § 77c(a)*]. Qualification by coordination may not be used in

connection with transactions subject to *Corp. Code § 25120* [*see Corp. Code §§ 25110, 25120, 25121*]. The permit must be obtained before seeking approval of the amendment by the outstanding shares, but not before entering into negotiations or agreements that are subject to the shareholders' approval [*see Corp. Code § 25103(a)*]. Consequently, the qualification by permit must be obtained before the certificate of amendment can be filed.

Exemptions from this qualification requirement include the following transactions:

- All changes in rights, preferences, privileges, or restrictions of outstanding shares, except those enumerated in *Corp. Code § 25103(e)* [*Corp. Code § 25103(e)*; *see § 10.51*].

- All stock splits [*Corp. Code § 188*] and reverse stock splits [*Corp. Code § 182*], except those enumerated in *Corp. Code § 25103(f)* [*see Corp. Code § 25103(f)*; § 10.52].

- Any changes in rights, preferences, privileges, or restrictions of or on outstanding securities, or any entity conversion transaction, unless the holders of at least 25 percent of the outstanding shares or units of any class of securities that will be directly or indirectly affected substantially and adversely by that change or transaction have California addresses according to the issuer's records [*Corp. Code § 25103(b)*].

- All changes in the rights of outstanding debt securities, except those enumerated in *Corp. Code § 25103(f)* [*see Corp. Code § 25103(g)*; § 10.53].

- Transactions involving specified types of securities of enumerated types of entities, such as governmental entities, national and California banks and similar financial institutions, common carriers, public utilities, and regulated railroads [*see Corp. Code § 25100*].

- Transactions exempted by the rules of the Commissioner of Corporations, such as shares in professional corporations, and pensions and profit sharing plans [*Corp. Code §§ 25105*; *see 10 Cal. Code Reg. §§ 260.103(a), 260.105 et seq.*].

The Commissioner of Corporations may refuse to issue a permit for the offer or sale of securities in connection with a proposed plan of recapitalization or reorganization unless he or she finds the proposed plan and issuance of securities are fair, just, and equitable to all affected security holders [*Corp. Code § 25140(c)*; *see § 10.33*]. If the Commissioner's ruling is supported by substantial evidence and does not constitute an abuse of discretion, the courts will uphold it [*see Bixby v. Pierno (1971) 4 Cal. 3d 130, 93 Cal. Rptr. 234, 481 P.2d 242* ; *see also Western Air Lines, Inc. v. Sobieski (1961) 191 Cal. App. 2d 399, 12 Cal. Rptr. 719]* .

For further discussion, and forms for a permit to issue securities in connection with a proposed plan of recapitalization or reorganization, refer to Ch. 6J, *Issuance of Debt Securities*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawExemptions From RegistrationExempt Classes of SecuritiesSecurities LawExemptions From RegistrationSmall Issue Exemptions



28 of 168 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
E. Securities Considerations

4-10 California Legal Forms--Transaction Guide § 10.51

§ 10.51 Amendments Changing Share Rights Exempted from Qualification By Corp. Code § 25103(e); Exceptions

Corp. Code § 25103(e) exempts from the qualification requirements any change in the rights, preferences, privileges, or restrictions of or on outstanding shares (other than a stock split [*Corp. Code § 188*] or reverse stock split [*Corp. Code § 182*]), except the following enumerated changes, if they materially and adversely affect any class of shareholders [*Corp. Code § 25103(e)*]:

- Changes, additions, or deletions of assessment provisions.
- Changes in dividend rights.
- Changes in redemption provisions.
- Changes to make the shares redeemable.
- Changes in the amount payable on liquidation.
- Changes, additions, or deletions of conversion rights.
- Changes, additions, or deletions of voting rights.
- Changes, additions, or deletions of preemptive rights.
- Changes, additions, or deletions of sinking fund provisions.
- Rearrangements of the relative priorities of outstanding shares.
- Additions, changes, or deletions of share transfer restrictions in the articles of incorporation or

bylaws.

- Changes in the right of shareholders with respect to the calling of special shareholders' meetings.

- Changes, additions, or deletions of any rights, preferences, privileges, or restrictions of, or on, the outstanding shares or memberships of a mutual water company or other corporation organized primarily to provide services or facilities to its shareholders or members.

Changes in the rights, preferences, privileges, or restrictions do not materially affect any class of shareholders if they arise from amendment of the articles to adopt or terminate close corporation status, involuntary cessation of close corporation status, or termination of a close corporation shareholder agreement [*Corp. Code § 25103(e)*; *see Corp. Code § 300(b)* (statutory shareholder agreement)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsSecurities Registration



29 of 168 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
E. Securities Considerations

4-10 California Legal Forms--Transaction Guide § 10.52

§ 10.52 Amendments Effectuating Stock Splits and Reverse Stock Splits Exempted From Qualification by Corp. Code § 25103(f); Exceptions

Corp. Code § 25103(f) exempts from the qualification requirements any stock split or reverse stock split, except the following [*Corp. Code § 25103(f)*]:

- Any stock split or reverse stock split if the corporation has more than one class of voting shares outstanding and the split would have a material effect on the proportionate interests of the respective classes related to voting, dividends, or distributions.

- Any stock split of a stock that is traded in the market if its market price on the date of the directors' approval of the split (adjusted to give effect to the split) was less than $2.

- Any reverse stock split if the corporation has the option of paying cash for any fractional shares created by the reverse split and, if, as a result, the proportionate interests of the shareholders would be substantially altered.

Any shares issued on a stock split or reverse stock split that are exempted from qualification are nevertheless subject to any conditions previously imposed by the Commissioner applicable to the shares with respect to which these new shares are issued [*Corp. Code § 25103(f)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Securities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsSecurities Registration



30 of 168 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
E. Securities Considerations

4-10 California Legal Forms--Transaction Guide § 10.53

§ 10.53 Amendments Changing Rights of Debt Securities Exempted from Qualification By Corp. Code § 25103(g); Exceptions

Corp. Code § 25103(g) exempts from the qualification requirements any change in the rights of outstanding debt securities, except the following enumerated changes, if they materially and adversely affect any class of securities [*Corp. Code § 25103(g)*]:

- Changes in rights to interest.
- Changes in redemption provisions.
- Changes making the securities redeemable.
- Changes extending maturity or changing the amount payable at maturity.
- Changes in voting rights.
- Changes in conversion rights.
- Changes in sinking fund provisions.
- Changes subordinating the securities to other indebtedness.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsSecurities Registration



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
E. Securities Considerations

4-10 California Legal Forms--Transaction Guide §§ 10.54-10.59

[Reserved]

§§ 10.54[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
F. Post-Amendment Procedures

4-10 California Legal Forms--Transaction Guide § 10.60

§ 10.60 Certificates of Correction

A certificate of correction may be used to correct any misstatement of fact or other error, including a defect in execution, of a certificate of amendment [*see Corp. Code § 109(a)*; *see § 10.230*]. A certificate of correction, however, may not be filed to alter the wording of any resolution or written consent that was adopted by the board or the shareholders [*Corp. Code § 109(a)*]. The only way to correct this type of error is to adopt a new amendment and file a new certificate [*see §§ 10.200-10.202*]. A certificate of amendment may also not be used to affect a corrected amendment of articles if the amendment, as corrected, would not in all respects have complied with the law in effect when the certificate being corrected was filed [*Corp. Code § 109(a)*].

The certificate of correction may be filed at any time after the original filing [*see Corp. Code § 109(a)*], and must be filed and verified in the same manner as the certificate of amendment [*see Corp. Code § 109(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
F. Post-Amendment Procedures

4-10 California Legal Forms--Transaction Guide § 10.61

§ 10.61 Exchange of Share Certificates

When the articles are amended in any way affecting the statements on the certificates for outstanding shares, the board of directors may, at its discretion, order that the old certificates be exchanged for new certificates [*Corp. Code § 422(a)*]. In practice, however, unless the exchange of certificates is required (for example, as in the case of an amendment adding or changing any required statement or legend on the share certificate [*see Corp. Code §§ 417, 418*]), alternative procedures that provide for the exchange of certificates on transfer of ownership may be more cost effective than requiring the all old certificates be exchanged for new ones. For example, if the amendment increased the number of shares outstanding, share certificates representing the additional shares could be issued, leaving the old certificates outstanding. New certificates could then be issued when those certificates were presented for transfer, in the normal course of business.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock CertificatesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
F. Post-Amendment Procedures

4-10 California Legal Forms--Transaction Guide § 10.62

§ 10.62 Amendment of Articles as Part of Merger Agreements

A merger agreement must include any amendments to the articles of the surviving corporation to be affected by the merger [*Corp. Code §§ 1101(b), 1113(b)(3)*]. For a detailed discussion of mergers, *see* Ch. 11C, *Mergers* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock CertificatesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingMergers & Acquisitions LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART II. LEGAL BACKGROUND
F. Post-Amendment Procedures

4-10 California Legal Forms--Transaction Guide §§ 10.63-10.99

[Reserved]

§§ 10.63[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-10 California Legal Forms--Transaction Guide § 10.100

§ 10.100 Client Interview

[1] Facts

[a] The Corporation

1. Name and address of principal executive office of corporation.

2. Date of incorporation.

3. State of incorporation.

4. Tax year of corporation.

5. Employer identification number.

6. Principal business.

7. Number of shareholders.

8. Total number of shares issued.

9. Number, class, and series of shares.

10. Voting rights of each class or series of shares.

11. Approximate fair market value of shares, if known.

12. Financial condition, including:

a. Dividend history.

b. Growth history.

13. Names, addresses, and telephone numbers of incorporators or directors.

14. Names, addresses, telephone numbers, and titles of officers who may sign certificates of amendment [*see Corp. Code § 173*].

15. Name, address, and telephone number of accountant.

16. Name and address of corporation's transfer agent, if any.

17. Whether corporation is "listed corporation" [*see Corp. Code § 301.5(d)*].

NOTE:
A listed corporation may amend its articles to divide its board of directors into classes, or to eliminate cumulative voting, or both [*Corp. Code § 301.5(a)*; ***see*** *§ 10.31[4]*; ***see also*** *§ 10.215*].

[b] Each Shareholder

NOTE:
If the proposed amendment requires approval of the outstanding shares, the following additional information should be solicited in the client interview.

1. Names and addresses of shareholders:

NOTE:
A record of shareholders, containing the names and addresses of shareholders, and the number and shares held by each, is required to be kept at the corporation's principal executive office or at the office of its transfer agent or registrar [*Corp. Code § 1500*].

a. Individual shareholders and spouses.

b. Entities.

2. Capacity in which individual holds shares:

a. Owner.

b. Trustee.

c. Executor or administrator.

d. Guardian.

e. Custodian under Uniform Transfers to Minors Act [*Prob. Code § 3900 et seq.*].

3. Number, class, and series of shareholder's shares.

4. Basis of shareholder's stock.

[c] Directors' Meetings

1. Place of directors' meetings, if stated in bylaws or fixed by board resolution [*see Corp. Code § 307(a)(5)*].

NOTE:
Meetings may be held at any place within or outside California that has been designated in the meeting's notice [*Corp. Code § 307(a)(5)*]. If the meeting place is not stated in the notice, or there is no notice, the meeting may be held at any place designated in the bylaws or by resolution of the board [*Corp. Code § 307(a)(5)*; ***see*** *Corp. Code § 212(b)(2)*].

2. For any proposed directors' meeting:

a. Type of meeting (annual, regular, or special).

b. Date and time.

c. Place [*see* 1, *above*].

d. Procedure for calling and noticing meeting [*see* Ch. 5, *Directors' Meetings, Actions, and Resolutions*].

3. Date of last directors' meeting.

[d] Shareholders' Meetings

NOTE:
If the proposed amendment requires shareholder approval [***see*** *§§ 10.30-10.31*], the following additional information should be solicited in the client interview.

1. Place of shareholders' meetings, if stated in bylaws [*see Corp. Code § 600(a)*].

NOTE:
If no place is fixed by the bylaws, the meetings must be held at the principal executive office of the corporation [*Corp. Code § 600(a)*].

2. For any proposed shareholders' meeting:

a. Type of meeting (regular or special).

b. Date and time.

c. Place.

d. Procedure for calling and noticing meeting [*see* Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*].

3. Date of last shareholders' meeting.

[e] The Amendment

1. General corporate objective precipitating proposed amendment.

2. Specific result anticipated.

3. Date for completion.

4. Any history of attempts, successful or unsuccessful, to amend articles.

[2] Documents

1. Any preincorporation subscription agreements.

2. Any shareholder agreements [*see § 10.11[3], [4]*; Ch. 8C, *Close Corporation Shareholder Agreements*].

3. Articles of incorporation.

4. Any certificates of amendment previously filed.

5. Bylaws.

6. Any documents related to qualification or exemption of corporate shares.

7. Share certificates.

8. Shareholder list.

9. Any instrument under which corporation's stock is held, including:

a. Trust instrument for trust holding corporation's shares.

b. Will under which any deceased shareholder's corporate stock is held by estate.

c. Bankruptcy court order under which bankrupt shareholder's stock is held by bankrupt's estate.

d. Court order for guardianship.

e. Voting trust or other voting agreement [*see* Ch. 8B, *Voting Agreements and Voting Trusts*].

10. Corporate minutes, including any resolutions relating to:

a. Amendments of articles.

b. Directors' or shareholders' meetings.

c. Shareholder voting rights.

11. Copies of any documents to be presented at any scheduled meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

4-10 California Legal Forms--Transaction Guide §§ 10.101-10.109

[Reserved]

§§ 10.101[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-10 California Legal Forms--Transaction Guide § 10.110

§ 10.110 Identifying Conflicts of Interest

NOTE:

When amending the articles of incorporation, an attorney may be asked to represent the corporation, one shareholder, some or all of the shareholders, or (in the case of a close corporation) a combination of these parties. Shareholders, especially institutional shareholders, are increasingly likely to retain legal counsel when asked to approve amendments to the articles, particularly amendments further limiting the liability of officers and directors, or extending the indemnification of these and other corporate agents. For further discussion of appropriate forms related to conflict of interest issues, see Ch. 1A, ***Role of Counsel in Starting a New Business*** .

1. Ascertain which party attorney represents.

NOTE:

An attorney representing an entity may also represent its constituents, provided the attorney makes a written disclosure to the client in accordance with the *California Rules of Professional Conduct, Rule 3-310(B),* and discloses his or her relationship to the entity [Cal. Rules *Prof. Cond., Rule 3-600(E)*]. Dual representation of clients whose interests conflict is permitted under certain circumstances if the attorney obtains the written consent of each client [Cal. Rules *Prof. Cond., Rule 3-600(E)*]. Caution should be exercised, however, in dual representation if an actual conflict of interest exists [***see*** Cal. Rules *Prof. Cond., Rule 3-310; § 8*D.22]. Even without an actual conflict, under some circumstances, an attorney should not undertake multiple representation [***see*** Cal. Rules *Prof. Cond., Rule 3-310(A)*; § 8D.23].

a. Will attorney represent corporation [*see § 8D.21[2]*]?

b. Will attorney represent single shareholder?

c. Will attorney represent some or all shareholders?

d. Will attorney represent a combination of subsections a-c [*see § 8D.21[2][b]*]?

2. Ascertain whether attorney represents clients with adverse interests [*see* Cal. Rules *Prof. Cond., Rule 3-310; §§ 8*D.22-8D.25].

a. Does attorney have legal, business, financial, professional, or personal relationship with party or witness in same matter?

b. Does attorney know (or reasonably should know) that:
(1) Attorney previously had legal, business, financial, professional, or personal relationship with party or witness in same matter; and

(2) Previous relationship will substantially affect attorney's representation?

c. Does (or did) attorney have legal, business, financial, professional, or personal relationship with party or entity that would be substantially affected by resolution of matter?

d. Does (or did) attorney have legal, business, financial, or professional interest in subject matter of representation?

e. Has attorney obtained confidential information related to representation from client or former client?

3. Ascertain whether attorney has provided written disclosure, and obtained informed written consent from each client (or former client) whose interests actually or potentially conflict [*see* Cal. Rules Prof. Cond., Rule 3- 310; §§ 8D.22-8D.25].

4. Ascertain whether attorney's other roles present conflict of interest issues [*see* Cal. Rules *Prof. Cond., Rule 3-300; § 8*D.27].

a. Will attorney invest in client's business [*see § 8D.27[1]*]?

b. Will attorney serve as corporate agent, director, or officer [*see § 8D.27[2]*]?

c. Is attorney likely to be called as witness in any litigation with jury [*see § 8D.27[3]*]?

5. Ascertain whether attorney has adequate conflict- identification system [*see § 8D.28[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationLegal EthicsClient RelationsAccepting RepresentationLegal EthicsClient RelationsConflicts of Interest



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-10 California Legal Forms--Transaction Guide § 10.111

§ 10.111 Determining Scope of Work to be Performed by Attorney

1. Determine tasks attorney will perform.

2. Determine whether consultation or association of specialist or other professional is required.

NOTE:

Amending the articles of a corporation can involve many areas of law, including not only corporation law, but also federal and state taxation law, contract law, federal and state securities regulation, and reporting requirements in foreign jurisdictions. The drafting attorney has the duty to refer the client to a specialist, or recommend the association of a specialist if the attorney lacks the requisite skill or knowledge [Cal. Rules of *Prof. Cond., Rule 3-110*; A.B.A. Model Rules Prof. Cond., Rules 1.1, 1.3 (1983)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationLegal EthicsClient RelationsAccepting Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-10 California Legal Forms--Transaction Guide § 10.112

§ 10.112 Lawfulness of Amendment of Articles; Alternative Procedures

1. Determine if amendment to articles is required to accomplish proposed corporate action [*see § 10.20*].

2. Determine if proposed amendment is lawful.

a. Is amendment expressly prohibited [*see § 10.13[1][b]*]?

b. If not prohibited, is amendment consistent with law [*see Corp. Code § 900(a)*; § 10.12]?

c. Is amendment equitable to minority shareholders [*see § 10.13[2]*]?
(1) What is anticipated degree of discrimination of classes or groups of shareholders?

(2) What is anticipated size of shareholder vote approving amendment and percentage of objecting shares?

(3) Are there alternatives to amendment that are less harmful to minority shareholders?

(4) Will there be any compensation to shareholders whose rights have been diminished?

3. If amendment is not mandatory [*see § 10.20*], determine whether alternative procedures might better accomplish desired result, considering:

a. Bylaws or amendment to bylaws [*see § 10.11[2]*].

b. Shareholder agreements, including:

(1) Voting or pooling agreement [*see § 10.11[3][b]*].

(2) Close corporation shareholder agreement [*see § 10.11[3][a]*].

(3) Nonstatutory shareholder agreement [*see § 10.11[4]*].

(c) Reorganization under bankruptcy laws [*see Corp. Code § 1401*].

(d) Voluntary share exchange plan [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , § 252.04 (Matthew Bender)].

(e) Merger or sale of assets [*see* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , §§ 252.02, 252.03 (Matthew Bender)].

(f) Repurchase of shares.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-10 California Legal Forms--Transaction Guide § 10.113

§ 10.113 Requirements for Approval of Amendment

1. Determine whether shares have been issued.

NOTE:

The approval procedure for amendment to the articles differs, depending on whether shares have been issued [***see*** *Corp. Code §§ 901, 902(a)*]. Shares are probably issued, for the purposes of *Corp. Code § 901*, when the corporation receives payment for its shares [***see*** *Garretson v. Pacific Crude Oil Co. (1905) 146 Cal. 184, 188, 79 P. 838]* .

2. If shares have not been issued, determine whether amendment will be adopted by incorporators or by directors.

NOTE:

If the first directors were not named in the articles and have not been elected, any amendment must be adopted by a majority of the incorporators; otherwise, by a majority of the directors [*Corp. Code § 901*; *see* [4][a], *below*; *§ 10.200*].

3. If shares have been issued [*see* P 1, *above*], determine requirements for approval of amendment.

a. May amendment be adopted by board of directors alone [*see Corp. Code § 902(b), (d)*; §§ 10.30[2][b], 10.201]?

b. Must amendment be approved by both board and outstanding shares [*see Corp. Code § 902(a)*; §§ 10.30[2][a], 10.202]?

c. Must amendment also be approved by class of shares affected by proposed amendment or by supermajority vote [*see Corp. Code §§ 152, 300(b), 706(a), (c), 903(a), (b), 904*; *10 Cal. Code Reg. § 260.140.63*; §§ 10.30[2][c], 10.202]?

4. Determine minimum number of affirmative votes required for approval of amendment by:

a. Incorporators or directors, before shares are issued [*see Corp. Code § 901* (requiring majority of incorporators or directors)].

b. Board of directors, after shares have been issued.

NOTE:
The affirmative vote of a majority of the directors present at a meeting at which a quorum is present is sufficient to adopt an amendment to the articles [***see*** *Corp. Code § 307(a)(8)*], unless a greater number is required by the articles themselves [***see*** *Corp. Code § 204(a)(5)*] or by statute [*see Corp. Code § 151*]. If approval is to be obtained by written consent without a meeting, the approval must be unanimous [*Corp. Code § 307(c)*].

c. Outstanding shares [*see Corp. Code §§ 152, 902(a)*; § 10.30[2][a].

d. Any class or series of shares, whether or not that class or series otherwise has voting rights [*see Corp. Code § 903(a)*; § 10.31[1], [2]].

NOTE:
In this case, the amendment must also be approved by the outstanding voting shares [*Corp. Code § 903(c)*; ***see*** *Corp. Code § 902(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-10 California Legal Forms--Transaction Guide § 10.114

§ 10.114 Procedures for Approval of Amendment

1. Determine whether director approval should be obtained at meeting or by written consent.

NOTE:

The affirmative vote of a majority of the directors present at a meeting at which a quorum is present is sufficient to adopt an amendment to the articles [***see*** *Corp. Code § 307(a)(8)*], unless a greater number is required by the articles themselves [***see*** *Corp. Code § 204(a)(5)*] or by statute [*see Corp. Code § 151*]. If approval is to be obtained by written consent without a meeting, however, the approval must be unanimous [*Corp. Code § 307(c)*].

2. If shareholder approval of the amendment is required, determine whether action on proposed amendment will be taken by shareholder vote at shareholder meeting, or by written consent [*see* Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-10 California Legal Forms--Transaction Guide § 10.115

§ 10.115 Restating and Amending Articles

1. Determine whether amendment and restatement of articles is preferable to amendment alone.

    a. Is substantial change in articles required to accomplish desired corporate action [e.g., make Section 2302 election (*see § 10.12[2]*)]?

    b. Do numerous other certificates of amendment make articles difficult to use?

2. Determine requirements for approval of certificate of restated and amended (or restated) articles by:

    a. Board of directors [*see Corp. Code § 910(b)*].

    b. Outstanding shares [*see Corp. Code § 910(b)*; *see also Corp. Code §§ 903-907*].

    c. Additional classes or series of shares [*see Corp. Code § 903, 904*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-10 California Legal Forms--Transaction Guide § 10.116

§ 10.116 Filing Requirements Other Than Certificate of Amendment

1. Determine whether any certificate (other than certificate of amendment [*see Corp. Code §§ 905, 906*]), notice, or other document describing amendment must be filed with appropriate governmental agency.

a. Does amendment require filings in other states where corporation is qualified?

NOTE:
Amendments to the articles of incorporation may need to be filed in, or notice given to, the Secretary of State, the Commissioner of Corporations, or other agencies in states in which the corporation is qualified to do business as a foreign corporation. In addition to reviewing the laws of each state in which the corporation is qualified to do business, the attorney may want to consult with local counsel or a local corporate agent to determine any required filings.

b. Does amendment require permit under California Corporate Securities Law before shareholder approval is solicited [*see § 10.50*]?

c. Does amendment require permit, registration, or qualification under securities laws of states (other than California) where any corporate shareholders reside?

d. Does amendment require filing registration statement with Securities and Exchange Commission, or delivering prospectus to shareholders?

e. Does amendment require permit from governing authority for specialized corporations within California [*see, e.g., Ins. Code §§ 707, 713-714* (insurance companies), *Fin. Code §§ 600* (banks or trust companies), 5650-5651 (savings and loan associations)], or outside California?

f. If corporation is professional corporation [*see Corp. Code §§ 13400 et seq.*], does amendment require approval of regulatory agency governing profession?

g. If corporation is tax-exempt, does amendment require filings with appropriate federal and state taxing authorities?

h. If amendment changes corporation's name, does amendment require other filings within or outside California (*see, e.g., Bus. & Prof. Code § 17913* (fictitious business name)]?

i. If corporation's securities are listed on securities exchange, does exchange or Securities and Exchange Commission require notification [*see, e.g.*, New York Stock Exchange Listed Company Manual, §§ 204.03 et seq. (required filing of copies of material to be sent to shareholders related to amendment); 17 C.F.R. § 240.10b-7 (required notice to SEC of stock split or reverse stock split)]?

2. Determine whether advance tax ruling from Internal Revenue Service regarding tax effect of amendment (e.g., recapitalizations or changes in rights, preferences, privileges, or restrictions of outstanding shares) is desirable.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesSecurities LawBlue Sky LawsSecurities RegistrationSecurities LawExemptions From RegistrationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-10 California Legal Forms--Transaction Guide § 10.117

§ 10.117 Timetable for Amendment of Articles

1. Establish dates for various steps required for approval, including:

    a. Date for approval by directors.

    b. Date for filing application for permit with Corporations Commissioner, if required [*see § 10.50*].

    c. Dates for filings other than certificate of amendment, if required [*see § 10.113*].

    d. Date for approval by shares, if required [*see §§ 10.30-10.31*].

    e. Date for filing certificate of amendment.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

4-10 California Legal Forms--Transaction Guide §§ 10.118-10.129

[Reserved]

§§ 10.118[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-10 California Legal Forms--Transaction Guide

NOTE:

For a procedural guide to directors' meetings, resolutions, and actions by written consent, ***see*** Ch. 5, ***Directors' Meetings, Actions, and Resolutions*** . For a procedural guide to shareholders' meetings and actions by written consent, see Ch. 8A, ***Shareholders' Meetings, Voting, and Agreements*** . For a procedural guide to the qualification of securities, see Ch. 6H, ***Qualification of Securities*** .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-10 California Legal Forms--Transaction Guide § 10.130

§ 10.130 The Amendment

1. Draft text of proposed amendment.

2. Draft certificate of amendment [*see Corp. Code § 907* (required wording, provisions in certificate); §§ 10.200-10.202].

3. Draft resolutions to be approved by board of directors and by shareholders, if required, at board or shareholder meetings, or by written consent [*see §§ 10.240-10.243*].

NOTE:

These resolutions may be drafted using the wording of the proposed amendment in the certificate of amendment.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-10 California Legal Forms--Transaction Guide § 10.131

§ 10.131 Adoption of Amendment Before Shares Are Issued

1. Obtain signatures of at least majority of incorporators or majority of directors [*see Corp. Code §§ 901, 906*].

2. If amendment affects stock structure, reevaluate necessity of obtaining securities qualification or exemption [*see §§ 10.50-10.53*; *see also* Ch. 6, *Securities Regulation Issues*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-10 California Legal Forms--Transaction Guide § 10.132

§ 10.132 Adoption of Amendment By Board of Directors After Shares Have Been Issued

1. Call, or have appropriate officer [*see Corp. Code § 307(a)(1)*] call, special meeting, if director consent will be obtained at special, rather than regular, meeting.

NOTE:
The appropriate officer, usually the corporate secretary, must give notice of the time and place of a special meeting to each director at least four days before the meeting, if the notice is by mail, or 48 hours before the meeting, if notice is delivered personally or by telephone, including a voice messaging system, or by electronic transmission by the corporation [*Corp. Code § 307(a)(2)*; ***see*** *Corp. Code § 118*], unless notice will be waived [***see*** *Corp. Code § 307(a)(3)*], or director action will be by unanimous written consent without a meeting [*Corp. Code § 307(c)*].

2. Hold meeting [*see § 10.240*] or draft written consents [*see § 10.241*].

3. If board acted at meeting, review minutes to determine that resolution was properly adopted.

a. Was quorum present [*Corp. Code § 307(a)(7)*]?

b. Was waiver of notice signed, if appropriate [*Corp. Code § 307(a)(3)*]?

c. Was resolution adopted by required number of board members present [*see Corp. Code § 307(a)(8)*]?

4. If board acted by written consent, review written consents to determine that [*see Corp. Code § 307(b)*; *see also* Ch. 5, *Directors' Meetings, Actions, and Resolutions*]:

a. Approval was unanimous; and

b. Number of board members then serving constituted quorum

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-10 California Legal Forms--Transaction Guide § 10.133

§ 10.133 Adoption of Amendment by Outstanding Shares

1. Draft resolution approving amendment of articles by outstanding shares at regular or special meeting of shareholders, or by their written consent [*see §§ 10.242, 10.243*].

2. If approval is by vote at shareholder meeting:

NOTE:
For a more complete discussion of shareholders' meetings, ***see*** Ch. 8A, ***Shareholders' Meetings, Voting, and Agreements*** .

a. Have appropriate officer call special meeting, if applicable [*see Corp. Code § 600(d)*].

b. Give notice of regular or special meeting [*Corp. Code § 601(a), (f)*], containing:

NOTE:
The notice must be given either personally or by first-class mail or electronic transmission by the corporation to each shareholder entitled to vote at the meeting [*Corp. Code § 601(b)*]. However, notice of a special meeting to obtain approval of an amendment by the outstanding shares may be sent by third-class mail if the corporation has 500 or more shareholders of record on the record date for the meeting [*Corp. Code § 601(b)*; ***see*** *Corp. Code §§ 605* (determination of number of shareholders), 701 (determination of record date)]. The notice must be given not less than 10 (or, if sent by third-class mail, not less than 30), nor more than 60 days before the date of the meeting [*Corp. Code § 601(a)*; ***see*** *Corp. Code § 118* (determination of when notice is given)].

(1) Place, date, and time of meeting; and

(2) General nature of proposed amendment.

c. After meeting, review minutes to determine that required formalities were observed [*see Corp. Code §§ 600 et seq.*].

3. If approval of amendment is by written consent [*see § 10.243*], deliver to each voting shareholder or shareholder's proxy [*see Corp. Code § 705*], copy of written consent, with instructions for completing and returning it.

4. Determine that vote or written consent of requisite number of outstanding shares approving amendment has been obtained.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-10 California Legal Forms--Transaction Guide § 10.134

§ 10.134 Filing Certificate of Amendment

1. Obtain signatures of appropriate officers [*see Corp. Code § 173*; Secretary of State's information packet]:

a. Chair of board, president, or any vice president; and

b. Secretary, chief financial officer, treasurer, or any assistant secretary or treasurer.

2. Obtain verification of appropriate officers by declaration under penalty of perjury [*see Corp. Code § 193(b)*].

NOTE:
Verification by affidavit is also permitted, but is rarely used because notarization is required [***see*** *Corp. Code § 193(a)*]. A certificate of amendment may be verified by declaration under penalty of perjury within or outside California [*Corp. Code § 193(b)*].

3. Mail or hand deliver following to Secretary of State's Sacramento headquarters office [*see Corp. Code § 908*; *see also* Secretary of State's information packet]:

NOTE:
The articles are amended on the filing of the certificate of amendment [*Corp. Code § 908*; ***see*** *Corp. Code § 169* ("file" means to file in Secretary of State's office, unless otherwise specified)].

a. Original certificate of amendment.

b. Copies to be certified.

NOTE:
The Secretary of State will compare and certify up to two copies of the amendment at no charge if the copies are submitted with the original to be filed [*Gov. Code § 12185*]. A fee is imposed for certifying additional copies [***see*** *Gov. Code §§ 12182, 12183*]. A copy certified by the Secretary of State is prima facie evidence of the performance of the conditions necessary to adopt the amendment [*Corp. Code § 908*].

c. Filing fee [*see Gov. Code § 12186(p)*].

d. Self-addressed envelope and cover letter referencing corporate name and corporate number and identifying filer's name, telephone number, and return address [Secretary of State's information packet].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
C. Procedural Guide

4-10 California Legal Forms--Transaction Guide §§ 10.135-10.139

[Reserved]

§§ 10.135[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-10 California Legal Forms--Transaction Guide § 10.140

§ 10.140 Restated Articles of Incorporation

NOTE:

A corporation may restate the entire text of its articles in an officers' certificate [***see*** *Corp. Code §§ 173* (definition), 910]. This certificate will supersede for all purposes the original articles and all amendments and certificates of determination previously filed [*Corp. Code § 910(d)*]. The certificate may also amend or alter the articles [*Corp. Code § 910(a)*].

1. Draft certificate of restated (or restated and amended) articles [*Corp. Code § 910(a), (c)*; *see §§ 10.220, 10.221*].

2. Obtain required approval [*Corp. Code § 910(b)*; *see §§ 10.220[1][d], 10.221[1][d]*].

3. Obtain declaration of officers or directors signing certificate [*see Corp. Code §§ 173, 193(b)*; § 10.200[2]].

4. File certificate of restated articles with Secretary of State [*Corp. Code § 910(a)*; *see § 10.134*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-10 California Legal Forms--Transaction Guide § 10.141

§ 10.141 Notice and Reporting Requirements

1. Notify any governmental agency (e.g., licensing agency), other than Secretary of State, that requires certificate, notice, or other document describing amendment to be filed [*see § 10.116*].

2. Obtain advance tax ruling from Internal Revenue Service regarding tax effect of amendment (e.g., recapitalizations or changes in rights, preferences, privileges, or restrictions of outstanding shares), if desired.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-10 California Legal Forms--Transaction Guide § 10.142

§ 10.142 Correction of Mistakes of Fact or Errors in Execution

1. File certificate of correction to correct any misstatement of fact or other error in certificate of amendment or certificate of restated articles that has been filed with Secretary of State [*Corp. Code § 109*; *see § 10.230*].

2. File certificate of correction to correct any error in execution in original articles of incorporation [*Corp. Code § 109*; *see § 10.230*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-10 California Legal Forms--Transaction Guide § 10.143

§ 10.143 Legends on Share Certificates

1. Amend legend on share certificates if corporation amends its articles of incorporation to establish or terminate close corporation status [*see Corp. Code § 418(c)*; § 10.211, 10.212].

2. Amend legend on share certificates if corporation amends its articles to establish or change rights, preferences, privileges, or restriction of any class or series of shares [*see Corp. Code § 417(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock CertificatesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

4-10 California Legal Forms--Transaction Guide §§ 10.144-10.199

[Reserved]

§§ 10.144[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
A. Certificates of Amendment--General Forms

4-10 California Legal Forms--Transaction Guide § 10.200

§ 10.200 Certificate of Amendment Before Shares Are Issued

[1] Comment

[a] Use of Form

This form is a certificate of amendment for use by the incorporators or, if directors were named in the original articles or were elected, by the directors, to amend the articles of incorporation before the corporation has issued any shares [*see Corp. Code § 906*]. If the directors were named or have been elected, they may file a certificate of amendment as provided in *Corp. Code § 905*, instead of this certificate [*Corp. Code § 906*; *see § 10.201*].

[b] "Issued" Defined for Purposes of Corp. Code § 901

This approval procedure may be used only if no shares have been issued. Shares are probably issued, for the purposes of *Corp. Code § 901*, when the corporation receives payment for its shares [*see Garretson v. Pacific Crude Oil Co. (1905) 146 Cal. 184, 188, 79 P. 838]* .

[c] Amendment by Incorporators

If no directors have been elected, any amendment to the articles before shares have been issued may be adopted by a majority of the incorporators [*Corp. Code § 901*]. If there are only two incorporators, both must consent to the amendment. The incorporator may be one or more natural persons, partnerships, associations, or domestic or foreign corporations [*Corp. Code § 200(a)*].

[d] Amendment by Directors

If directors were named in the original articles of incorporation or were elected by the incorporators, and no shares have been issued, any amendment to the articles may be adopted by a majority of the directors [*Corp. Code § 901*]. If there are only two directors [*see Corp. Code § 212(a)*], both must approve the amendment. For discussion of director action by meeting or by written consent, see *§§ 10.40*, *10.240*, and *10.241*.

[e] Required Certificate of Amendment

Any amendment to the articles before shares have been issued may be adopted by a writing executed by a majority of the incorporators or the directors [*Corp. Code § 906*; *see Corp. Code § 901*; [b], [c], *above*]. The writing must be a certificate of amendment, signed and filed as provided in *Corp. Code § 906* [*see Corp. Code § 906*; [2], *below*], or, if the directors were named or have been elected, they may file a certificate of amendment as provided in *Corp. Code § 905* [*Corp. Code § 906*; *see § 10.201*].

[f] Contents of Certificate

The certificate of amendment contains the text of the amendment and a statement of facts showing that the amendment has been adopted as required by statute [*see Corp. Code §§ 905-907*]. If no directors have been elected, the certificate must state that the signors constitute at least a majority of the incorporators, and that directors were not named in the original articles and have not been elected [*Corp. Code § 905*]; or, if directors were named in the original articles or were elected, the certificate must be state that the signors constitute at least a majority of the board [*Corp. Code § 905*]. In either case, the certificate must also state that the corporation has issued no shares, and that the directors or incorporators adopt the amendment or amendments set forth in the certificate [*Corp. Code § 905*].

If the corporation is listed--i.e., has outstanding shares listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market--and amends its articles to divide its board into classes or eliminate cumulative voting, or both, the certificate must also state facts showing that the corporation is a listed corporation or that the article provision will become effective only when the corporation becomes listed [*Corp. Code § 301.5(j)*; *see Corp. Code § 301.5(d)*; *see also § 10.215*].

A corporation may not amend its articles to alter the names and addresses of the first directors, or the name and address of the initial agent for service of process, except to correct an error or to delete either after the corporation has filed the identification statement required by *Corp. Code § 1502* [*Corp. Code § 900(b)*; *see Corp. Code § 902(d)*].

Amended articles may contain only those provisions that could be lawfully included in original articles on the date of the amendment [*Corp. Code § 900(a)*]. The original articles may include any lawful provision for the management of the business or the conduct of the corporation's affairs [*Corp. Code § 204(d)*]. Amendments that are specifically required or prohibited by statute are discussed in *§§ 10.13[1][b]* and *10.20*, respectively. Equitable limitations on the power to amend are discussed in *§ 10.13[2]*.

[g] Verification of Certificate

The certificate of amendment filed by either the incorporators or the directors must be verified [*Corp. Code § 906*]. Verification may be by declaration under penalty of perjury, stating the date and place of execution [*see Corp. Code § 193(b)*]. Verification by declaration may be used both within or outside *California Corp. Code § 193(b)*]. Verification may also be by notarized affidavit [*see Corp. Code § 193(a)*], but this procedure is less likely to be used, since it requires notarization. An affidavit sworn to outside California before a notary public or a judge or clerk of a court of record having an official seal does not need to be further authenticated [*Corp. Code § 193*].

If the incorporator is a corporation or other entity [*see Corp. Code § 200(a)*], this form should be modified to reflect the fact that signature and verification will be by an officer of the incorporating entity.

[h] Wording of Amendment

[i] Statutory Requirements

Corp. Code § 907(a) prescribes the general wording of the amendment. It states that the certificate must establish the

wording of the amendment or amended articles by one or more of the following means [*Corp. Code § 907(a)*]:

- By stating that the articles shall be amended to read as therein set forth in full.

- By stating that any provision of the articles, which must be identified by the numerical or other designation given it in the articles, or by stating its wording, shall be stricken from the articles or shall be amended to read as set forth in the certificate.

- By stating that the provisions set forth in the certificate shall be added to the articles.

If an existing provision of the articles will be stricken or amended, the statute specifies that the provision must be identified in the amendment, either by referring to the numerical or letter designation given to it in the articles, or by quoting the entire existing provision. If the provision will be stricken from the articles, the amendment must state that fact [*Corp. Code § 907(a)(2)*]. If an existing provision is being amended, the amendment must state that the provision will be amended to read as set forth in the amendment [*Corp. Code § 907(a)(2)*]. The amended provision must then be set forth, in its entirety, in the amendment [*Corp. Code § 907(a)(2)*]. Similarly, if a new provision is added to the articles, that provision must be set forth in full in the amendment, and the amendment must state that the new provision is added to the articles [*Corp. Code § 907(a)(3)*].

Common mistakes to avoid in the wording of amendments include:

- Striking or amending an existing provision by referring to a particular word or phrase in the provision (instead, the provision must be referred to by its numerical or letter designation [*see Corp. Code § 907(a)(2)*]).

- Adding a word or phrase to an existing provision by stating that the word or phrase is to be inserted in a certain place in the provision (instead, the amended provision must be set forth in its entirety, incorporating the new word or phrase [*see Corp. Code § 907(a)(2)*]).

Additional drafting requirements for amendments affecting the outstanding shares are discussed in *§ 10.201[1][g]*.

[ii] Drafting Requirements of Secretary of State

In addition to the statutory requirements for drafting certificates of amendment [*see Corp. Code § 907(a)*; [i], *above*; *§ 10.201[1][g]*], the Secretary of State has provided information and a sample amendment that meets those requirements for most filings. The sample (AMDT-Stock) may be accessed by going to the Forms, Samples & Fees page of the Secretary's Business Programs Division website at http://www.sos.ca.gov/business/bpd_forms.htm#corp and following the appropriate link.

[i] Filing

The original and at least two copies of the certificate of amendment, together with the applicable fee(s), must be mailed or hand delivered to the Secretary of State's office in Sacramento. Certificates of amendment are not filed in the branch offices. To facilitate the processing of documents mailed to the office, a self-addressed envelope and a letter referencing the corporate name and number, as well as the name, return address, and telephone number of the person filing the amendment should also be submitted.

The certificate is filed by the Secretary of State on the day it is received, unless the filing or the effectiveness is delayed by the party submitting the certificate, or by the Secretary of State [*see Corp. Code § 110*]. The filing may be delayed no more than 90 days after its receipt [*Corp. Code § 110(a)*], and the effectiveness may be delayed no more than 90

days after filing [*Corp. Code § 110(c)*]. Upon their filing, the articles are amended in accordance with the certificate [*Corp. Code § 908*].

[j] Certification

A copy of the certificate, certified by the Secretary of State, is prima facie evidence of the performance of the conditions necessary to adopt the amendment [*Corp. Code § 908*].

[k] Format Requirements for Certificate

The Secretary of State's Office has provided the following general guidelines for submitting documents (including certificates of amendment) for filing:

- Submit originally signed documents. Copies cannot be substituted for an original.
- Document should be typed on white letter-size bond paper using only one side of the page. (Fax paper is not acceptable.)
- Document must be legible. Documents with poor black and white contrast, blue ink, pencil, illegible handwriting, etc. will not be accepted for filing.
- A space, preferably in the upper right hand corner of proposed filings, must be left for the Secretary of State file stamp. This space should be about three inches square.

[l] Copies

Copies of the certificate of amendment should be prepared, as follows:

- The original certificate and at least two copies of the certificate should be included in the submission to the Secretary of State's office. The original certificate will be microfilmed and destroyed, unless counsel requests its return and provides a postage-prepaid, self-addressed envelope.
- Conformed copy for certification by the Secretary of State. This copy should be filed in the corporation's record book.
- File copy to be retained in the corporation's record book until return of the original (if requested) and certified copies from the Secretary of State's office.
- Other copies as required for use by corporation.

[m] Fees

The Secretary of State's fee for filing a certificate of amendment is set forth in *Gov. Code § 12186(p)*. The Secretary will compare and certify up to two copies at no charge if they are submitted with the original to be filed [*Gov. Code § 12185*; *see Gov. Code §§ 12182, 12183* (other fees)].

Additional fees apply for documents delivered in person at the public counter in the Sacramento headquarters office, and for preclearance or expedited filing [*see* http://www.sos.ca.gov/business/precexp.htm].

[2] Form

Certificate of Amendment Before Shares Are Issued

CERTIFICATE OF AMENDMENT OF THE ARTICLES OF INCORPORATION OF _____
[***name of corporation***]

_____[*Name*] certifies [*or* _____ (*Names*) certify]:

1. _____ [_____ (He *or* She *or* It) is the sole incorporator *or* They constitute at least a majority of the incorporators] of _____[*name*], a California corporation.

2. _____ [_____ (He *or* She *or* It) adopts *or* They adopt] the following _____ [amendment *or* amendments] to the articles of incorporation of the corporation:
_____ [*insert text of amendment(s)*]

3. The corporation has issued no shares.

[*If the amendment is by the incorporators:*]

4. No directors were named in the original articles of incorporation of the corporation and no directors have been elected.

[*If a delayed effective date is desired:*]

5. The amendment will become effective on _____ [*date, not later than 90 days after date of filing certificate*].

[*Continue with the following:*]

Dated: _____

[*Repeat, as required:*]

_____ [*incorporator's or director's signature*]
_____ [*printed name*]
_____ [*title, i.e.,* Incorporator *or* Director]

[*Choose one of the following forms of verification, either:*]

We declare under penalty of perjury that the statements set forth in this certificate are true and correct of our own knowledge and that this declaration was executed on _____[*date*], at _____ [*city and state*].

[*Repeat, as required:*]

_____ [*incorporator's or director's signature*]
_____ [*printed name*]

[*OR*]

[*Acknowledgments taken in California must be in the following form (Civ. Code § 1189(a)):*]

	)
State of California	)
County of _____	)
	)

On _____[*date*], before me, _____ [*name and title of officer taking acknowledgment*], personally appeared _____ [*name(s) of person(s) signing instrument*], personally known to me (or proved to me on the basis of satisfactory evidence) to be the _____ [person *or* persons] whose _____ [name is *or* names are] subscribed to the within instrument and acknowledged to me that _____ [he *or* she *or* they] executed the same in _____ [his *or* her *or* their] authorized _____ [capacity *or* capacities], and that by _____ [his signature *or* her signature *or* their signatures] on the instrument the _____ [person *or* persons], or the entity upon behalf of which the _____ [person *or* persons] acted, executed the instrument.

WITNESS my hand and official seal.

Signature: _____ .....[*Seal*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



60 of 168 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
A. Certificates of Amendment--General Forms

4-10 California Legal Forms--Transaction Guide § 10.201

§ 10.201 Certificate of Amendment After Shares Are Issued--Amendment Approved By Board Alone

[1] Comment

[a] Use of Form

This form is a certificate of amendment for use by the board of directors to amend the articles of incorporation after the corporation has issued shares, when board approval alone is required [*see* [b], [c], *below*]. For a certificate to be used after the corporation has issued shares, when the amendment must be adopted by both the board and the shareholders, see *§ 10.202*.

For discussion of drafting requirements in general, verification of the certificate, format specifications, the number of copies to prepare, and the Secretary of State's fees, see *§ 10.200[1][b]-[m]*.

For a certificate of amendment for use by the directors (or incorporators) before the corporation has issued any shares, see *§ 10.200[2]*.

For certificates of amendment accomplishing specified changes, see *§§ 10.210-10.214*.

[b] Approval By Board Alone

After shares have been issued, amendments generally may be adopted only if approved by both the board of directors and by the outstanding shares, either before or after board approval [*Corp. Code § 902(a)*]. Certain amendments, however, may be adopted by board approval alone [*see* [c], *below*].

"Approved by (or approved of) the board" means approved by the vote of the board of directors [*Corp. Code §§ 151, 155*]. Except when a greater proportion is required by statute, by the articles, or, if the articles so permit, by the bylaws, approval is indicated by the vote of a majority of the directors present at a meeting at which a quorum is present [*see Corp. Code §§ 204(a)(5), 307(a)(8)*], or by the unanimous written consent of the directors without a meeting [*see Corp. Code §§ 194, 195, 307(b)*]. When board approval alone of an amendment of the articles is permitted, that approval must

be by the board as a whole, and not by a committee of the board [*Corp. Code § 151*; *see Corp. Code § 311(a)*].

[c] Amendments That May Be Approved by Board Alone

Amendments that may be adopted by the board alone include the following:

- An amendment to delete close corporation status when the number of close corporation shareholders exceeds 35 [*Corp. Code § 158(e)*; *see § 10.212*].

- An amendment authorizing a change in the number of outstanding shares (if the directors are authorized by the articles to take this action [*see Corp. Code § 202(e)*]), after a certificate of determination has been filed as part of the restated articles, as provided in *Corp. Code § 910* [*Corp. Code § 401(c)*].

- An amendment to increase the authorized shares to satisfy option or conversion rights, after the issue of options or convertible securities has been approved by the outstanding shares [*Corp. Code § 405(b)*].

- An amendment to reflect the reduction in authorized shares, if the corporation has reacquired shares that may not be reissued [*Corp. Code § 510(b)*].

- An amendment to extend or to make perpetual the term of corporate existence of a corporation organized before August 14, 1929 [*Corp. Code § 902(b)*; *see § 10.210*].

- An amendment effectuating a stock split [*see Corp. Code § 188* (stock split defined)] (including an increase in the number of authorized shares in proportion to the split), when the corporation has only one class of shares outstanding [*Corp. Code § 902(c)*; *see § 10.213*].

- An amendment deleting the names and addresses of the first directors or of the initial agent for service of process after the corporation has filed the annual statement with Secretary of State required under *Corp. Code § 1502* [*Corp. Code § 902(d)*; *see Corp. Code § 900(b)*].

- An amendment changing the name of the surviving corporation in a short-form merger of a parent corporation and a 90 percent (or more) owned subsidiary [*Corp. Code § 1110(a), (d)*].

- An amendment accomplishing a reorganization when specified share ownership requirements are met [*see Corp. Code § 1201(b)*].

- Certain amendments to the articles of a corporation existing on January 1, 1977 [*see Corp. Code § 2302*; § 10.12[2]].

Further, certificates filed with the Secretary of State that do not amend the articles, such as a certificate of correction [*see Corp. Code § 109*], a certificate of determination [*see Corp. Code §§ 156, 401*], or a certificate restating but not amending the articles of incorporation [*see Corp. Code § 910*] may be approved by the board alone.

[d] Director Action at Meeting or by Written Consent

Action by the directors to amend the articles of incorporation may be taken at annual, regular, or special meetings of directors [*Corp. Code § 307(a)*; *see §§ 10.40[2], 10.240*], or by the unanimous written consent of the directors without a meeting [*Corp. Code § 307(b)*; *see §§ 10.40[3], 10.241*].

[e] Form of Certificate of Amendment

When a certificate of amendment is adopted after the corporation has issued shares, the certificate must be an "officers' certificate," signed and verified by two officers (the chairman of the board, the president, or any vice president and by the secretary, the chief financial officer, the treasurer, or any assistant secretary or assistant treasurer) [*Corp. Code § 173*; *see Corp. Code § 193* (verification); § 10.200[1][g]].

[f] Contents of Certificate

[i] Required Statements

When a certificate of amendment is adopted by the board of directors alone after the corporation has issued shares, it must state the following:

- The wording of the amendment in accordance with the provisions of *Corp. Code § 907* [*Corp. Code § 905(a)*; § 10.200[1][h]];
- That the amendment has been approved by the board [*Corp. Code § 905(b)*];
- A statement of facts entitling the board alone to adopt the resolution [*Corp. Code § 905(d)*].
- If the amendment effects a stock split [*see Corp. Code § 188*] or a reverse stock split [*see Corp. Code § 182*], or reclassifies, cancels, exchanges, or otherwise changes outstanding shares, the effect of the amendment on the outstanding shares [*Corp. Code § 907(b)*; *see also Corp. Code § 907(c), (d)* (exceptions); [g], *below*; *§ 10.213*].

[ii] Prohibited Statements

The amended articles may contain only those provisions that could be lawfully included in original articles on the date of the amendment [*Corp. Code § 900(a)*]. The original articles may include any lawful provision for the management of the business or the conduct of the corporation's affairs [*Corp. Code § 204(d)*]. Amendments that are specifically required or prohibited by statute are discussed in *§§ 10.13[1][b]* and *10.20*, respectively. Equitable limitations on the power to amend are discussed in *§ 10.13[2]*.

[g] Drafting Requirements for Amendments Affecting Outstanding Shares

Corp. Code § 907(b) provides that if the purpose of the amendment is to effectuate a stock split [*see Corp. Code § 188*] or a reverse stock split [*see Corp. Code § 182*], or to reclassify, cancel, exchange, or otherwise change outstanding shares, the amended articles must state the effect on outstanding shares. Thus, if the amendment changes or affects the outstanding shares, the change or effect must be set forth in the amendment. For example, if the amendment will accomplish a two-for-one stock split, the amendment must state that each outstanding share is divided into two shares [*see Corp. Code §§ 407, 907(b)*]. If the amendment effectuates a two-for-one reverse stock split, the amendment must state that each outstanding share is combined and changed into one-half of one share, and must also include a statement regarding the treatment of fractional shares [*see Corp. Code §§ 407, 907(b)*].

In two cases, the effect of the changes on outstanding shares is automatic, unless the amendment itself states the effect. First, if an amendment reclassifies a single class of shares into two classes, and does not state the effect on the outstanding shares, *Corp. Code § 907(c)* provides that the shares outstanding immediately before the amendment are automatically considered to be the same number of shares of the common stock class. If the amendment designates both classes or neither class as "common," but one of the two classes created by the amendment has limited or no voting rights, the class whose voting rights are not limited is the common stock [*Corp. Code § 907(c)*]. Second, *Corp. Code §*

907(d) provides that an amendment that adds, eliminates, or changes a stated par value, and does not also state the effect on outstanding shares is not subject to the requirement of *Corp. Code § 907(b)* that the effect or change actually be set forth in the amendment itself [*Corp. Code § 907(d)*]. In the absence of any other change, the effect of a change in par value is obvious.

[h] Securities Considerations

Filing the certificate of amendment effectuates any stated change in the shares [*Corp. Code § 908*; *see* [i], *below*]. Thus, before filing the amendment, counsel should determine whether the change requires qualification by the Commissioner of Corporations [*see § 10.50*] or notice to, or a permit from, another agency [*see § 10.116*].

[i] Filing

The original and at least two copies of the certificate of amendment, together with the applicable fee(s), must be mailed or hand delivered to the Secretary of State's office in Sacramento. Certificates of amendment are not filed in the branch offices. To facilitate the processing of documents mailed to the office, a self-addressed envelope and a letter referencing the corporate name and number, as well as the name, return address, and telephone number of the person filing the amendment should also be submitted [*see Corp. Code §§ 169*, *906*].

The certificate is filed by the Secretary of State on the day it is received, unless the filing or the effectiveness is delayed by the party submitting the certificate or by the Secretary of State [*see Corp. Code § 110*]. The filing may be delayed no more than 90 days after its receipt [*Corp. Code § 110(a)*], and the effectiveness may be delayed no more than 90 days after filing [*Corp. Code § 110(c)*]. On its filing, the articles are amended in accordance with the certificate [*Corp. Code § 908*].

For further discussion of the Secretary of State's filing requirements and the applicable filing fees, see *§ 10.200[1][i]*, *[l]*, and *[m]*.

[2] Form

Certificate of Amendment After Shares Are Issued--Amendment Approved By Board Alone

CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF
_____ [*name of corporation*]

_____[*name*] and _____[*name*] certify that:

1. They are the _____ [President *or* the Chairman of the Board of Directors *or* a Vice President] and _____ [the Secretary *or* the Chief Financial Officer *or* the Treasurer *or* an Assistant Secretary *or* an Assistant Treasurer], respectively, of _____[*name*], a California corporation.

2. The Board of Directors of _____ [*name of corporation*] has approved the following amendment to the articles of incorporation: _____ [*insert text of amendment, e.g.:* Article _____ (*number or letter designation, e.g.,* III) of the articles of incorporation is amended to read in its entirety as follows: The corporation is authorized to issue only one class of shares, with a total number of _____ (*existing number of shares, e.g.,* 10,000) shares. On the amendment of this article, each outstanding share is split up and converted into _____ (*number of shares, e.g.,* 10) shares].

3. This amendment may be adopted with approval by the Board of Directors alone because _____ [*insert appropriate facts, e.g.:* the corporation has one class of shares outstanding; and the amendment effectuates only a stock split, as defined in *Corporations Code Section 188*. *Corporations Code Section 902(c)* authorizes the adoption of this type of amendment with approval by the Board alone.]

[*If a delayed effective date is desired, use:*]

4. The amendment will become effective on _____ [*date, not later than 90 days after date of filing certificate*].

[*Continue with the following:*]

We declare under penalty of perjury that the statements set forth in this certificate are true and correct of our own knowledge and that this declaration was executed on _____[*date*] at _____ [*city and state*].

Dated: _____

[*Repeat, as required:*]

_____ [*signature*]

_____ [*printed name*]

_____ [*title*]

[*For another verification, see § 10.200[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesStock SplitsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
A. Certificates of Amendment--General Forms

4-10 California Legal Forms--Transaction Guide § 10.202

§ 10.202 Certificate of Amendment After Shares Are Issued--Amendment Approved by Board and Outstanding Shares

[1] Comment

[a] Use of Form

This form is a certificate of amendment for use after shares have been issued, when the amendment must be adopted by both the board of directors and the outstanding shares. Optional paragraphs are included for use if the amendment must be approved by more than one class of shares or by a supermajority vote [*see* [b], [c], *below*]. For a certificate to be used after shares have been issued, when the amendment may be adopted by the board alone, *see § 10.201*.

For discussion of drafting requirements in general, verification of the certificate, format specifications, the number of copies to prepare, and the Secretary of State's fees, see *§ 10.200[1][b]-[m]*. For discussion of drafting requirements for amendments affecting the outstanding shares, see *§ 10.201[1][g]*. For a certificate of amendment for use by the directors (or incorporators) before the corporation has issued any shares, see *§ 10.200[2]*. For certificates of amendment accomplishing specified changes, see *§§ 10.210-10.214*.

[b] Approval by Board and Outstanding Shares

After shares have been issued, amendments generally may be adopted only if approved by both the board of directors and by the outstanding shares, either before or after board approval [*Corp. Code § 902(a)*]. "Approval of the outstanding shares" means approval by the affirmative vote of a majority of the outstanding shares entitled to vote [*Corp. Code § 153*; *see Corp. Code § 902(a)*]. Certain amendments, however, may be adopted by board approval alone [*see § 10.201[1][c]*], while other amendments may require additional shareholder approval, or approval by specified percentages of outstanding shares or classes or series [*see* [c], *below*].

[c] Additional Approval by Class or Series of Shares

A separate vote of approval by a class or series of shares affected by a proposed amendment or supermajority vote is

required only:

- If required by the articles [*see Corp. Code § 152*; § 10.32] or by shareholder agreement [*see Corp. Code §§ 300(b), 706(a), (c)*; *see also § 10.11[3]*];

- Under certain circumstances enumerated in the Corporations Code, including, for example, *Corp. Code §§ 903(a), (b),* and *904* [*see § 10.31*]; or

- If required by the Commissioner of Corporations [*see 10 Cal. Code Reg. 260.140.63*; § 10.33].

[d] Director and Shareholder Action at Meetings or By Written Consent

Action by the directors to amend the articles of incorporation may be taken at annual, regular, or special meetings of directors [*Corp. Code § 307(a)*; *see §§ 10.40[2], 10.240*], or by the unanimous written consent of the directors without a meeting [*Corp. Code § 307(b)*; *see §§ 10.40[3], 10.241*]. For further discussion of directors' meetings, resolutions, and written consents, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* ,

Similarly, action by the shareholders to amend the articles of incorporation may be taken at a shareholders' meeting [*Corp. Code § 600(b), (d)*; *see § 10.242*], or by the written consent of the shareholders without a meeting [*Corp. Code § 603(a)*; *see § 10.243*]. Further, close corporations may dispense with the corporate formalities relating to shareholders' meetings, if so authorized by a close corporation shareholder agreement [*see Corp. Code § 300(b), (e)*; § 10.11[3][a]]. For further discussion of shareholders' meetings and action by written consent, see Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

[e] Required Form of Certificate of Amendment

Any amendment to the articles after shares have been issued must be an "officers' certificate," signed and verified by two officers (the chairman of the board, the president, or any vice president and by the secretary, the chief financial officer, the treasurer, or any assistant secretary or assistant treasurer) [*Corp. Code § 173*; *see Corp. Code § 193* (verification); § 10.200[1][g]].

Special filing requirements apply if the amendment is the result of a merger [*see Corp. Code § 905*]. In this case, neither a certificate of amendment nor a certificate of restated articles should be filed [*see Corp. Code § 905*]. Instead, the filing of an officer's certificate and the merger agreement in accordance with *Corp. Code § 1103* or, for a short-from merger, the certificate of ownership in accordance with *Corp. Code § 1110(d)* takes the place of any filing required by *Corp. Code §§ 900 et seq.* [*Corp. Code § 905*].

[f] Contents of Certificate

[i] Required Statements

When a certificate of amendment is adopted by the board of directors and the outstanding shares, it must state:

- The wording of the amendment in accordance with the requirements of *Corp. Code § 907* [*Corp. Code § 905(a)*; §§ 10.200[1][h], 10.201[1][g]; *see* Paragraph 2 of Form].

- That the amendment has been approved by the board [*Corp. Code § 905(b)*; *see* Paragraph 3 of Form].

- That the amendment was approved by the required shareholder vote [*see Corp. Code § 194* (vote includes authorization by written consent)], in accordance with *Corp. Code §§ 902* [*see § 10.30[2][a]*],

903 [*see § 10.31[1], [2]*], or 904 [*Corp. Code § 905(c)*; *see § 10.31[3]*; *see* Paragraph 4 of Form].

- The total number of outstanding shares of each class (if there is more than class) entitled to vote on the amendment [*Corp. Code § 905(c)*; *see* Paragraph 4 of Form].

- The percentage vote required of each class (if there is more than one class) of shares entitled to vote [*Corp. Code § 905(c)*; *see Corp. Code § 111*; *see* Paragraph 4 of Form].

- That the number of shares (of each class) voting in favor of the amendment either equaled or exceed the required vote [*Corp. Code § 905(c)*; *see* Paragraph 4 of Form].

- If the amendment effectuates a stock split [*see Corp. Code § 188*] or a reverse stock split [*see Corp. Code § 182*], or reclassifies, cancels, exchanges, or otherwise changes outstanding shares, the change or effect on outstanding shares [*Corp. Code § 907(b)*; *see Corp. Code § 907(c), (d)* (exceptions); § 10.201[1][g]].

- If the corporation is a listed corporation [*see Corp. Code § 301.5(d)* (listed corporation defined)] and amends its articles to classify its board or eliminate cumulative voting, a statement of facts showing the corporation is a listed corporation or a statement that the provision will become effective only when the corporation becomes listed [*Corp. Code § 301.5(j)*; *see § 10.31[4]*; *see also § 10.215*].

Special rules apply to an amendment to convert from a for-profit corporation to nonprofit or cooperative status [*see Corp. Code § 911(b)*; *see also § 10.42[2]*]. Special rules also apply to an amendment permitting assessments of shares of a mutual water company [*see Corp. Code § 904(b)*; *Pub. Util. Code § 2705* (mutual water company defined)].

[ii] Prohibited Statements

The amended articles may contain only those provisions that could be lawfully included in original articles on the date of the amendment [*Corp. Code § 900(a)*]. The original articles may include any lawful provision for the management of the business or the conduct of the corporation's affairs [*Corp. Code § 204(d)*]. Amendments that are specifically required or prohibited by statute are discussed in *§§ 10.13[1][b]* and *10.20*, respectively. Equitable limitations on the power to amend are discussed in *§ 10.13[2]*.

[g] Securities Considerations

Filing the certificate of amendment effects any stated change in the shares [*Corp. Code § 908*; *see* [h], *below*]. Thus, before filing the amendment, counsel should determine whether the change requires qualification by the Commissioner of Corporations [*see § 10.50*], or notice to, or a permit from, another agency [*see § 10.116*].

[h] Filing

The original and at least two copies of the certificate of amendment, together with the applicable fee(s), must be mailed or hand delivered to the Secretary of State's office in Sacramento. Certificates of amendment are not filed in the branch offices. To facilitate the processing of documents mailed to the office, a self-addressed envelope and a letter referencing the corporate name and number, as well as the name, return address, and telephone number of the person filing the amendment should also be submitted [*see Corp. Code §§ 169, 906*].

The certificate is filed by the Secretary of State on the day it is received, unless the filing or the effectiveness is delayed by the party submitting the certificate, or by the Secretary of State [*see Corp. Code § 110*]. The filing may be delayed no more than 90 days after its receipt [*Corp. Code § 110(a)*], and the effectiveness may be delayed no more than 90

days after filing [*Corp. Code § 110(c)*]. Upon their filing, the articles are amended in accordance with the certificate [*Corp. Code § 908*].

For further discussion of filing requirements and the applicable filing fees, see *§ 10.200[1][i]*, *[l]*, and *[m]*.

[2] Form

Certificate of Amendment After Shares Are Issued--Amendment Approved by Board and Outstanding Shares

CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF
_____ [***Name of corporation***]

The undersigned certify that

1. They are the _____ [President *or* the Chairman of the Board of Directors *or* a Vice President] and _____ [the Secretary *or* the Chief Financial Officer *or* the Treasurer or an Assistant Secretary or an Assistant Treasurer], respectively, of _____[*name*], a California corporation.

2. _____ [*Insert text of amendment and statement of effect on shares, if required, e.g.:* Article _____ (*number or letter designation, e.g.,* III) of the articles of incorporation is amended to read in its entirety as follows:

(a) The corporation is authorized to issue two classes of stock, designated respectively, "common shares" and "preferred shares." The number of authorized common shares is _____ (*number*); the number of authorized preferred shares is _____ (*number*). On the amendment of this Article _____ (*number or letter designation, e.g.,* III) to read as set forth above, each outstanding share is reclassified and converted to one common share.

(b) A statement of the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes of shares or on their holders is as follows: The Board of Directors will fix the number of shares of each class or series and will determine or alter the rights, preferences, privileges, and restrictions granted to or imposed on any wholly unissued series of that class of shares. The Board may increase or decrease (but not below the number of outstanding shares of the series before this change) the number of shares of any wholly unissued series subsequent to the issue of those shares.]

3. The foregoing amendment of Articles of Incorporation has been duly approved by the board of directors.

[*Choose one of the following paragraphs:*]

[*If a majority vote of the outstanding shares is required, use:*]

4. The foregoing amendment of Articles of Incorporation has been duly approved by the required vote of shareholders in accordance with *Section 902 of the California Corporations Code*. The total number of outstanding shares of the corporation is _____. The number of shares voting in favor of the amendment equaled or exceeded the vote required. The voting percentage required was more than 50 percent.

[*If vote of more than one class of shares or supermajority vote is required in accordance with Corp. Code § 903, use:*]

4. The foregoing amendment of Articles of Incorporation has been duly approved by the required vote of shareholders in accordance with *Section 903 of the California Corporations Code*. The total number of outstanding shares of each class entitled to vote on this amendment was _____ [*specify number of shares, broken*

down by class or series if more than one class or series was entitled to vote]. The percentage vote required [of each class entitled to vote] was _____ [*specify number of shares, broken down by class or series, e.g.,* 500 shares of common and 200 shares of preferred stock]. The favorable vote of _____ [*specify required favorable vote of shares, broken down by class or series, e.g.,* a majority of the common shares and 75 percent of the preferred shares] was required to approve this amendment. The number of shares of each class voting in favor of the amendment equaled or exceeded the required vote [of that class].

[*If vote of all outstanding shares, regardless of limitations on voting rights, is required in accordance with Corp. Code § 904 (amendments permitting assessments), use:*]

4. The foregoing amendment of Articles of Incorporation has been duly approved by the required vote of shareholders in accordance with *Section 904 of the California Corporations Code*. The total number of outstanding shares affected by the amendment, regardless of limitation or restrictions on their voting rights, was _____ [*specify number of shares broken down by class or series if more than one class or series exists*]. The favorable vote of all of the outstanding shares affected, regardless of their voting rights, was required to approve this amendment. The number of shares of each class voting in favor of the amendment equaled the required vote [of that class].

[*If a delayed effective date is desired, use:*]

5. The amendment will become effective on _____ [*date, not later than 90 days after date of filing certificate*].

[*Continue with the following:*]

We declare under penalty of perjury that the statements set forth in this certificate are true and correct of our own knowledge and that this declaration was executed on _____[*date*] at _____ [*city and state*].

Dated: _____

[*Repeat, as required:*]

_____ [*signature*]

_____ [*printed name*]

_____ [*title*]

[*For another verification, see § 10.200[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
A. Certificates of Amendment--General Forms

4-10 California Legal Forms--Transaction Guide §§ 10.203-10.209

[Reserved]

§§ 10.203[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
B. Certificates of Amendment--Effectuating Specified Changes

4-10 California Legal Forms--Transaction Guide § 10.210

§ 10.210 Certificate of Amendment To Extend Term of Corporate Existence, or To Provide for Perpetual Existence

[1] Comment

[a] Use of Form

This form is a certificate of amendment to provide for perpetual existence of a corporation originally formed for a limited period.

For discussion of drafting requirements in general, verification of the certificate, format specifications, the number of copies to prepare, and the Secretary of State's fees, see *§ 10.200[1][b]-[m]*. For a certificate of amendment for use by the directors (or incorporators) before the corporation has issued any shares, see *§ 10.200[2]*. For certificates of amendment accomplishing other changes, see *§§ 10.210-10.214*.

[b] Amendment to Extend Corporate Existence

A California corporation formed for a limited period [*see Corp. Code § 204(a)(4)*] may, at any time before the expiration of that period, amend its articles either to extend its term, or to delete the limitation (and, thus, provide for perpetual existence) [*see Corp. Code § 900(a)*]. Further, any California corporation may, at any time after the expiration of its term of corporate existence, extend the term of its existence by amending its articles to remove the limiting provision and to provide for perpetual existence, provided the corporation has continuously acted and done business as a corporation [*Corp. Code § 909*].

The amendment may be adopted with the approval of the board [*see Corp. Code § 151*] and of the outstanding shares [*see Corp. Code § 152*], either before or after approval by the board [*Corp. Code § 902(a)*], or if the amendment extends or makes perpetual the corporate existence of a corporation organized before August 14, 1929, it may be adopted with the approval of the board alone [*Corp. Code § 902(b)*]. For the purpose of adopting this type of amendment, persons who have been functioning as the corporation's directors are considered to have been validly elected even if their election occurred after the expiration of the original term of the corporate existence [*Corp. Code § 909*].

[c] Prohibited Name

If the corporation's term of existence has expired, and the filing of the certificate of amendment providing for perpetual existence would be prohibited by *Corp. Code § 201* (relating to prohibited names) if the certificate were the original articles, the Secretary of State must not file the certificate unless the articles of the corporation are amended by the same or a concurrently filed certificate of amendment to adopt a new available name [*Corp. Code § 909*].

With this in mind, counsel should request a name check and a reservation of name from the Secretary of State's office [*see Corp. Code § 201(c)*] before preparing the resolutions approving the amendment.

[d] Contents of Certificate

In addition to the matters required by *Corp. Code § 905* [*see § 10.42[2]*] to be set forth in the certificate of amendment, if the corporation's term of existence has expired, the certificate must also state that the corporation has continuously acted as a corporation and done business as such from the expiration of the term of its corporate existence to the date of the amendment [*Corp. Code § 909*].

[2] Form

Certificate of Amendment To Extend Term of Corporate Existence, or To Provide for Perpetual Existence

CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF
_____ [*name of corporation*]

_____[*name*] and _____[*name*] certify that:

1. They are the _____ [President *or* the Chairman of the Board of Directors *or* a Vice President] and _____ [the Secretary *or* the Chief Financial Officer *or* the Treasurer *or* an Assistant Secretary *or* an Assistant Treasurer], respectively, of _____[*name*], a California corporation.

2. The Board of Directors of _____ [*name of corporation*] has approved the following amendment to the articles of incorporation: _____ [*insert text of amendment, e.g.:* Article _____ (*number or letter designation, e.g.,* III) of the articles of incorporation is amended to read in its entirety as follows:

(*EITHER*)

The period of duration of this corporation is perpetual.

(*OR*)

The term of existence of this corporation is extended to _____ (*date*)].

[*Continue with the following and choose one of the following paragraphs:*]

[*If the amendment may be adopted by board approval alone, use:*]

3. This amendment may be adopted with approval by the Board of Directors alone because the amendment _____ [extends *or* makes perpetual] the corporate existence of a corporation organized before August 14, 1929.

[*Or, if the amendment requires shareholder approval, use:*]

3. The amendment was approved by the required vote of the shareholders in accordance with *Corporations Code Section 902*. The total number of outstanding shares of each class entitled to vote on this amendment was: _____ [*number, broken down by class or series, if applicable*]. The favorable vote [*e.g.*, a simple majority] of these shares is required to approve the amendment. The number of shares voting in favor of the amendment equaled or exceeded the required vote; and the amendment was approved by the affirmative vote of _____[*number, broken down by class or series, if applicable*] shares, or _____ [*percentage, broken down by class or series, if applicable*] percent of the outstanding voting shares.

[*Continue with the following:*]

4. The corporation has continuously acted as a corporation and done business as such from _____[*date*], the date its corporate existence expired, to the date of this amendment.

We declare under penalty of perjury that the statements set forth in this certificate are true and correct of our own knowledge and that this declaration was executed on _____[*date*] at _____ [*city and state*].

Dated: _____

[*Repeat, as required:*]

_____ [*signature*]

_____ [*printed name*]

_____ [*title*]

[*For another verification, see § 10.200[2].*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistenceBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
B. Certificates of Amendment--Effectuating Specified Changes

4-10 California Legal Forms--Transaction Guide § 10.211

§ 10.211 Certificate of Amendment To Make Corporation a Close Corporation

[1] Comment

[a] Use of Form

This form is a certificate of amendment of the articles of a corporation to establish close corporation status. It assumes that the corporation has issued shares. If shares have not been issued, the requirements for approval should be modified accordingly [*see* [c], *below*]. For discussion of drafting requirements in general, verification of the certificate, format specifications, the number of copies to prepare, and the Secretary of State's fees, see *§ 10.200[1][b]-[m]*. For a certificate of amendment for use by the directors (or incorporators) before the corporation has issued any shares, see *§ 10.200[2]*. For a certificate of amendment to terminate close corporation status, see *§ 10.212*.

[b] Close Corporation Defined; Required Provision in Articles

A close corporation is a corporation organized under the Corporations Code, whose articles contain, in addition to the provisions required by *Corp. Code § 202*, a provision that all of the corporation's issued shares of all classes will be held of record by not more than a specified number of persons, not exceeding 35, and the statement, "This corporation is a close corporation" [*Corp. Code § 158(a)*]. For the manner of determining the number of shareholders, see *Corp. Code § 158(d)*. For discussion of the advantages of close corporation status, see *§ 10.11[3][a]* and Ch. 8C, *Close Corporation Shareholder Agreements* .

[c] Required Approval of Amendment

The provisions required by *Corp. Code § 158(a)* [*see* [b], *above*], establishing close corporation status, may be included in the articles by amendment [*Corp. Code § 158(b)*]. However, if shares have been issued, the amendment may be adopted only by the affirmative vote of all of the issued and outstanding shares of all classes [*Corp. Code § 158(b)*], regardless of limitations or restrictions on their voting rights [*Corp. Code § 117*].

[d] Name of Corporation

A close corporation's name must contain the word "corporation," "incorporated," or "limited," or an abbreviation of one of these words [*Corp. Code § 202(a)*]. If the name of the corporation electing close corporation status does not contain one of these words or abbreviations, the articles must also to be amended to include one. In this case, counsel should request a name check and a reservation of name from the Secretary of State's office before preparing the resolutions approving the amendment [*see Corp. Code § 201(c)* (reservation of name); *see also Corp. Code § 201(a), (b)* (prohibited names)].

[e] Exchange of Share Certificates

The old shares certificates should be exchanged for new certificates. The new certificates must contain the statements required by *Corp. Code § 417*.

[2] Form

Certificate of Amendment To Make Corporation a Close Corporation

CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF
_____ [*name of corporation*]

_____[*name*] and _____[*name*] certify that:

1. They are the _____ [President *or* the Chairman of the Board of Directors *or* a Vice President] and _____ [the Secretary *or* the Chief Financial Officer *or* the Treasurer *or* an Assistant Secretary *or* an Assistant Treasurer], respectively, of _____[*name*], a California corporation.

2. The Board of Directors of _____ [*name of corporation*] has approved the following amendment to the articles of incorporation: _____ (*insert text of amendment, e.g.:* Article _____ (*number or letter designation, e.g.,* III) of the articles of incorporation is amended to read in its entirety as follows:

The corporation's issued shares [of all classes] will be held of record by not more than _____ [*number not exceeding 35*] persons. This corporation is a close corporation.

3. The amendment has been approved by the required vote of the shareholders in accordance with *Corporations Code Section 902*. The corporation has _____ [*e.g.,* only one class of shares. Each outstanding share is entitled to one vote. The total number of shares issued and outstanding is 1,000 shares]. *Corporations Code Section 158(b)* requires a unanimous vote of all outstanding shares for the adoption of this amendment. The number of shares voting in favor of the amendment equaled the vote required; the amendment was approved by the affirmative vote of _____ [*number, e.g.,* 1,000] shares, that is, by the affirmative vote of one hundred percent of all the issued and outstanding shares.

We declare under penalty of perjury that the statements set forth in this certificate are true and correct of our own knowledge and that this declaration was executed on _____[*date*] at _____ [*city and state*].

Dated: _____

[*Repeat, as required:*]

_____ [*signature*]

_____ [*printed name*]

_____ [*title*]

[*For another verification, see § 10.200[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsFormationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsStock CertificatesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
B. Certificates of Amendment--Effectuating Specified Changes

4-10 California Legal Forms--Transaction Guide § 10.212

§ 10.212 Certificate of Amendment To Terminate Close Corporation Status

[1] Comment

[a] Use of Form

This form is a certificate of amendment to terminate close corporation status.

For discussion of drafting requirements in general, verification of the certificate, format specifications, the number of copies to prepare, and the Secretary of State's fees, see *§ 10.200[1][b]-[m]*. For a certificate of amendment for use by the directors (or incorporators) before the corporation has issued any shares, see *§ 10.200[2]*. For a certificate of amendment to establish close corporation status, see *§ 10.211*.

[b] Termination of Close Corporation Status; Required Approval of Amendment

A corporation ceases to be a close corporation on the filing of an amendment to its articles in accordance with *Corp. Code § 158(c)*, deleting the special provisions required for close corporations [*Corp. Code § 158(c)*; *see Corp. Code § 158(a)* (required provisions)]. If shares have been issued, the amendment may be adopted only by the affirmative vote of at least two-thirds of each class of the outstanding shares, regardless of limitations or restrictions on their voting rights [*Corp. Code § 117*], or by another vote as provided in the articles [*Corp. Code § 158(c)*; *see Corp. Code § 902(f)*]. The articles may provide for a lesser vote, but not less than a majority of the outstanding shares, or may deny a vote to any class, or both [*Corp. Code § 158(c)*].

A corporation also ceases to be a close corporation if it has more than the maximum number of shareholders specified in its articles as a result of [*Corp. Code § 158(e)*]:

- An inter vivos transfer of shares that is not void under *Corp. Code § 418(d)*,
- The transfer of shares by will or according to the laws of descent and distribution,

- The dissolution of a partnership, corporation, or business association, or the termination of a trust that holds shares,

- Court decree on dissolution of a marriage, or

- Otherwise by operation of law.

Promptly on acquiring more than the specified number of shareholders, a close corporation must execute and file an amendment to its articles deleting the provisions referred to in *Corp. Code § 158(a)*, and deleting any other provision not permissible for a corporation that is not a close corporation [*Corp. Code § 158(e)*]. The amendment must be promptly approved and filed by the board of directors [*Corp. Code § 158(e)*]; in this case, it does not need to be approved by the outstanding shares [*Corp. Code § 158(e)*].

[c] Exchange of Share Certificates

The old shares certificates should be exchanged for new certificates. The new certificates must contain the statements required by *Corp. Code § 417*.

[2] Form

Certificate of Amendment To Terminate Close Corporation Status

CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF
_____ [*name of corporation*] _____ [*name*] and _____ [*name*] certify that:

1. They are the _____ [President *or* the Chairman of the Board of Directors or a Vice President] and _____ [the Secretary *or* the Chief Financial Officer *or* the Treasurer *or* an Assistant Secretary or an Assistant Treasurer], respectively, of _____[*name*], a California corporation.

2. The Board of Directors of _____ [*name of corporation*] has approved the deletion of the following provisions from Article _____ [*number or letter designation, e.g.,* III] of the articles of incorporation:

The corporation's issued shares [of all classes] shall be held of record by not more than _____ [*number not exceeding 35*] persons. This corporation is a close corporation.

[*Choose one of the following paragraphs:*]

[*If the amendment requires shareholder approval, use:*]

3. This amendment has been approved by the required vote of the shareholders in accordance with *Corporations Code Section 902*. The corporation has _____ [*e.g.,* two classes of shares, designated common and preferred, respectively. Each outstanding common share is entitled to one vote and preferred shares are entitled to no votes. The total number of common shares issued and outstanding is 3,040 shares. The total number of preferred shares issued and outstanding is 3,000 shares. Both classes of shares voted on the amendment. The number of shares of each class voting in favor of the amendment exceeded the vote required, which was the affirmative vote of at least two-thirds of each class of the outstanding shares, regardless of limitations or restrictions on their voting rights. The number of common shares voting for the amendment was 2,502 shares, or in excess of 82 1/2 percent, and the number of preferred shares voting for the amendment was 2,478, or in excess of 82 1/2 percent].

[*Or, if the amendment may be adopted by board approval alone, use:*]

4. The corporation ceased to be a close corporation on its having more than the maximum number of holders of record of its shares specified in its articles, as follows: _____ [*specify reason, e.g.*, by the will of Charles S. Zumwalt, 210 of the outstanding common shares of the corporation were transferred on _____ (*date*) to his seven children, 30 shares to each, thereby increasing the number of holders of record of the corporation's shares from 10 to 36]. This amendment is required by *Corporations Code Section 158(e)* to be promptly approved and filed by the Board of Directors; it need not be approved by the outstanding shares. [*Continue with the following:*]

We declare under penalty of perjury that the statements set forth in this certificate are true and correct of our own knowledge and that this declaration was executed on _____[*date*] at _____ [*city and state*].

Dated: _____

[*Repeat, as required:*]

_____ [*signature*]

_____ [*printed name*]

_____ [*title*]

[*For another verification, see§ 10.200[2]* .]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsDissolution & Winding UpBusiness & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
B. Certificates of Amendment--Effectuating Specified Changes

4-10 California Legal Forms--Transaction Guide § 10.213

§ 10.213 Certificate of Amendment to Effectuate Stock Split

[1] Comment

[a] Use of Form

This form is a certificate of amendment of the articles of a corporation to effectuate a stock split by approval of the board alone [*see* [d], *below*]. If approval of the outstanding shares, or of the additional shares affected is required [*see, e.g., § 10.202[2]*], or a reverse stock split is desired [*see* [b], *below*], this form should be modified accordingly.

For discussion of drafting requirements in general, verification of the certificate, format specifications, the number of copies to prepare, and the Secretary of State's fees, see *§ 10.200[1][b]-[m]*. For certificates of amendment accomplishing other changes, see *§§ 10.210*, *10.212*, and *10.214*.

[b] Stock Split and Reverse Stock Split Defined

A stock split is the pro rata division, other than a share dividend, of all the outstanding shares of a class, into a greater number of shares of the same class [*Corp. Code § 188*]. A reverse stock split is the pro rata combination of all the outstanding shares of a class into a smaller number of shares of the same class [*Corp. Code § 182*].

A stock split or a reverse stock split may be effectuated only by amending the articles of incorporation [*Corp. Code §§ 182*, *188*].

[c] Contents of Certificate

When a certificate of amendment is adopted by the board of directors alone after the corporation has issued shares, it must state:

- The wording of the amendment in accordance with the requirements of *Corp. Code § 907* [*Corp. Code § 905(a)*; § 10.200[1][h]].

- That the amendment has been approved by the board [*Corp. Code § 905(b)*].

- A statement of facts entitling the board alone to adopt the resolution [*Corp. Code § 905(d)*].

- If the amendment effects a stock split [*see Corp. Code § 188*] or a reverse stock split [*see Corp. Code § 182*], or reclassifies, cancels, exchanges, or otherwise changes outstanding shares, the change or effect on outstanding shares [*Corp. Code § 907(b)*; *see Corporations Checklist* (State of California, Office of Secretary of State, 1990, p. 39); *see also Corp. Code § 907(c), (d)* (exceptions)].

For example, if the amendment will accomplish a two-for-one stock split, the amendment must state that each outstanding share is divided into two shares [*see Corp. Code §§ 407, 907(b)*]. If the amendment effectuates a two-for-one reverse stock split, the amendment must state that each outstanding share is combined and changed into one-half of one share, and must also include a statement regarding the treatment of fractional shares [*see Corp. Code §§ 407, 907(b)*].

[d] Required Approval of Amendment

An amendment of the articles effectuating a stock split or a reverse stock split generally may be adopted only if approved by the board of directors and by the outstanding shares [*Corp. Code § 902(a)*; *see Corp. Code § 903(a)* (additional approval of outstanding shares of affected class, whether or not that class has voting rights); § 10.30[2][c]]. However, if the corporation has only one class of shares outstanding, an amendment effectuating only a stock split (including any increase in the authorized number of shares required in connection with it and taking account of shares then reserved for future issuance) may be adopted with approval by the board alone [*Corp. Code § 902(c)*].

[e] Effect of Filing Amendment

Filing the amendment automatically, without any further action by the shareholders or the corporation, splits the shares [*see Corp. Code § 908*]. The exchange of share certificates simply memorializes the conversion that the filing has effectuated.

[f] Permit from Corporations Commissioner

Stock splits and reverse stock splits are exempt from the qualification requirements of the Corporate Securities Law of 1968, with certain exceptions [*Corp. Code § 25103(f)*; *see § 10.52*]. If a permit from the Commissioner of Corporations is required, it must be obtained before seeking approval of the amendment by the outstanding shares, but not before entering into negotiations or agreements that are subject to the shareholders' approval [*see Corp. Code § 25103(a)*]. Consequently, the qualification by permit must be obtained before the certificate of amendment can be filed.

[2] Form

Certificate of Amendment to Effectuate Stock Split

CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF
_____ [*name of corporation*]

_____[*name*] and _____[*name*] certify that:

1. They are the _____ [President *or* the Chairman of the Board of Directors *or* a Vice President] and _____ [the Secretary *or* the Chief Financial Officer *or* the Treasurer *or* an Assistant Secretary *or* an Assistant Treasurer], respectively, of _____[*name*], a California corporation.

2. The Board of Directors of _____ [*name of corporation*] has approved the following amendment to the articles of incorporation:

Article _____ [*number or letter designation, e.g.*, III] of the articles of incorporation is amended to read in its entirety as follows: The corporation is authorized to issue only one class of shares, with a total number of _____ [*existing number of shares, e.g.*, 10,000] shares. On the amendment of this article, each outstanding share is split up and converted into _____ [*number of shares, e.g.*, 10] shares].

3. This amendment may be adopted with approval by the Board of Directors alone because the corporation has one class of shares outstanding; and the amendment effectuates only a stock split, as defined in *Corporations Code Section 188*. *Corporations Code Section 902(c)* authorizes the adoption of this type of amendment with approval by the Board alone.

We declare under penalty of perjury that the statements set forth in this certificate are true and correct of our own knowledge and that this declaration was executed on _____[*date*] at _____ [*city and state*].

Dated: _____[*date*]

[*Repeat, as required:*]

_____ [*signature*]

_____ [*printed name*]

_____ [*title*]

[*For another verification, see § 10.200[2]* .]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceDividends & Reacquisition of SharesStock SplitsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
B. Certificates of Amendment--Effectuating Specified Changes

4-10 California Legal Forms--Transaction Guide § 10.214

§ 10.214 Certificate of Amendment to Reclassify Shares to Create Senior Class

[1] Comment

[a] Use of Form

This form is a certificate of amendment to reclassify a single class of shares into two classes, one with rights and privileges senior to the other. Reclassification commonly occurs when the shares originally authorized and issued are unclassified, and the corporation wants to issue and sell preferred shares and to designate the outstanding shares as common shares.

For discussion of drafting requirements in general, verification of the certificate, format specifications, the number of copies to prepare, and the Secretary of State's fees, see *§ 10.200[1][b]-[m]*. For discussion of the required contents of a certificate of amendment when the certificate is adopted by the board of directors and the outstanding shares, see *§ 10.202[1][f]*.

[b] Special Drafting Requirements for Amendments Reclassifying Shares

Corp. Code § 907(b) provides that if the purpose of the amendment is to reclassify, cancel, exchange, or otherwise change outstanding shares, the amended articles must state the effect of the reclassification, cancellation, or exchange on the outstanding shares. However, in certain cases, the effect of the changes on outstanding shares is automatic, unless the amendment itself states the effect. If an amendment reclassifies a single class of shares into two classes, and does not state the effect on the outstanding shares, *Corp. Code § 907(c)* provides that the shares outstanding immediately before the amendment are automatically considered to be the same number of shares of the common stock class. If the amendment designates both classes or neither class as "common," but one of the two classes created by the amendment has limited or no voting rights, the class whose voting rights are not limited is the common stock [*Corp. Code § 907(c)*].

When shares are divided into classes, a preference statement must also be added to the articles of incorporation, if different rights, privileges, or preferences are granted to or restrictions imposed on the respective classes or series of shares [*see Corp. Code § 202(e)(3)*]. This statement may be added to the article being amended [*see* [2], *below*], or

added as a separate article. For articles with preference statements, see Ch. 3, *Articles of Incorporation* .

[c] Required Approval of Amendment

After shares have been issued, an amendment to reclassify shares may be adopted, only if approved by both the board of directors and by the outstanding shares, either before or after board approval [*Corp. Code § 902(a)*]. Proposed amendments to reclassify shares also must be approved by the outstanding shares of any affected class, whether or not it is entitled to vote on the amendment by the provisions of the articles [*see Corp. Code § 903(a)*], if the amendment would create a new class of shares having rights, preferences, or privileges prior to the shares of that class, or increase the rights, preferences, or privileges or the number of authorized shares of any class having rights, preferences, or privileges prior to the shares of that class [*Corp. Code § 903(a)(5)*; *see § 10.31[1]*]. This requirement is in addition to the requirement that the proposed amendment must be approved by the outstanding voting shares [*Corp. Code § 903(c)*].

[d] Exchange of Share Certificates

The old shares certificates should be exchanged for new certificates. The new certificates must contain the statements required by *Corp. Code § 417*.

[2] Form

Certificate of Amendment to Reclassify Shares to Create Senior Class

CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF
_____ [*name of corporation*]

_____[*name*] and _____[*name*] certify that:

1. They are the _____ [President *or* the Chairman of the Board of Directors *or* a Vice-President] and _____ [the Secretary *or* the Chief Financial Officer *or* the Treasurer *or* an Assistant Secretary *or* an Assistant Treasurer], respectively, of _____[*name*], a California corporation.

2. The Board of Directors of _____ [*name of corporation*] has approved the following amendment to the articles of incorporation:

Article _____ [*number or letter designation, e.g.*, III] of the articles of incorporation is amended to read in its entirety as follows:

(a) The corporation is authorized to issue two classes of stock, designated respectively, "common shares" and "preferred shares." The number of authorized common shares is _____ [*number*]; the number of authorized preferred shares is _____ [*number*]. On the amendment of this Article _____ [*number or letter designation, e.g.*, III] to read as set forth above, each outstanding share is reclassified and converted to one common share.

(b) A statement of the rights, preferences, privileges, and restrictions granted to or imposed on the respective classes of shares or on their holders is as follows:

The Board of Directors will fix the number of shares of each class or series and will determine or alter the rights, preferences, privileges, and restrictions granted to or imposed on any wholly unissued series of that class of shares. The Board may increase or decrease (but not below the number of outstanding shares of the series before this change) the number of shares of any wholly unissued series subsequent to the issue of those shares.

[*Choose one of the following paragraphs:*]

[*If a majority vote of the outstanding shares is required, use:*]

3. The amendment was approved by the required vote of the shareholders in accordance with *Corporations Code Section 902*. The total number of outstanding shares of each class entitled to vote on this amendment was: _____[*number*]. The favorable vote of a simple majority of these shares is required to approve the amendment. The number of shares voting in favor of the amendment equaled or exceeded the required vote.

[*OR, if vote of more than one class of shares or supermajority vote is required in accordance with Corp. Code § 903, use:*]

3. The amendment was approved by the required vote of the shareholders in accordance with *Corporations Code Section 903*. The total number of outstanding shares of each class entitled to vote on this amendment was _____ [*specify number of shares broken down by class or series if more than one class or series was entitled to vote*]. The percentage vote required [of each class entitled to vote] was _____ [*specify number of shares broken down by class or series, e.g.,* 500 shares of common and 200 shares of preferred stock]. The favorable vote of _____ [*specify required favorable vote of shares broken down by class or series, e.g.,* a majority of the common shares and 75 percent of the preferred shares] was required to approve this amendment. The number of shares of each class voting in favor of the amendment equaled or exceeded the required vote [of that class].

[*If a delayed effective date is desired, use:*]

4. The amendment will become effective on _____ [*date, not later than 90 days after date of filing certificate*].

[*CONTINUE*]

We declare under penalty of perjury that the statements set forth in this certificate are true and correct of our own knowledge and that this declaration was executed on _____[*date*], at _____ [*city and state*].

Dated: _____.

[*Repeat, as required:*]

_____ [*signature*]

_____ [*printed name*]

_____ [*title*]

[*For another verification, see § 10.200[2]* .]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
B. Certificates of Amendment--Effectuating Specified Changes

4-10 California Legal Forms--Transaction Guide § 10.215

§ 10.215 Certificate of Amendment to Classify Board of Directors and Eliminate Cumulative Voting

[1] Comment

[a] Use of Form

This form is a certificate of amendment to divide the board of directors into two or three classes to serve for terms of two or three years respectively, and to eliminate cumulative voting. The form is primarily for use by listed corporations [*see* [b], *below*], but may be used by a corporation that is not listed, provided that the amendment will not take effect until the corporation becomes a listed corporation [*Corp. Code § 301.5(a)*; *see* [c], *below*]. Alternatively, a listed corporation may, when appropriate, effect these changes by amending its bylaws [*Corp. Code § 301.5(a)*; *see* Ch. 4, *Bylaws*]. Notwithstanding *Corp. Code § 903*, an article (or bylaw) amendment providing for the division of the board of directors into classes, or any change in the number of classes, or the elimination of cumulative voting may only be adopted by the approval of the board and the outstanding shares [*Corp. Code § 152*] voting as a single class [*Corp. Code § 301.5(a)*].

If the board of directors is divided into two classes, the authorized number of directors must be no less than six, and one half of the directors (or as close an approximation as possible) must be elected at each annual meeting of shareholders. If the board of directors is divided into three classes, the authorized number of directors must be no less than nine, and one third of the directors (or as close an approximation as possible) must be elected at each annual meeting of shareholders. Directors of a listed corporation may be elected by classes at a meeting of shareholders at which such an amendment is approved; however, the extended terms for directors are contingent on that approval, and in the case of an amendment to the articles, the filing of any necessary amendment to the articles [*Corp. Code § 301.5(b)*; *see Corp. Code §§ 905, 910*].

If directors for more than one class are to be elected by the shareholders at any one meeting of shareholders, and the election is by cumulative voting pursuant to *Corp. Code § 708*, votes may be cumulated only for directors to be elected within each class [*Corp. Code § 301.5(c)*].

Whenever an article amendment classifying directors or eliminating cumulative voting is adopted by a listed

corporation, the certificate of amendment must include a statement of the facts showing that the corporation is a listed corporation [*Corp. Code § 301.5(j)*].

[b] "Listed Corporation" Defined

A "listed corporation" is a corporation with outstanding shares listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market [*Corp. Code § 301.5(d)*].

[c] When Corporation Is Not Listed Corporation

After the issuance of shares, a corporation that is not a listed corporation [*see* [b], *above*], by amending its articles or bylaws, may adopt provisions to be effective when the corporation becomes a listed corporation to divide the board of directors into two or three classes to serve for terms of two or three years respectively, or to eliminate cumulative voting, or both [*Corp. Code § 301.5(a)*]. In general, when a corporation that is not a listed corporation adopts amendments to its articles of incorporation (or bylaws) to divide its board of directors into classes, to eliminate cumulative voting, or both, and then becomes a listed corporation, the amendments become effective for the next election of directors after the corporation becomes a listed corporation at which all directors are to be elected unless the articles of incorporation or bylaws provide for those provisions to become effective at some other time and, when classes of directors are provided for, identify the directors who, or the directorships that, are to be in each class or the method by which those directors or directorships are to be identified [*Corp. Code § 301.5(g)*]. However, if the corporation becomes a listed corporation on or after the record date for a shareholders' meeting but before the conclusion of the meeting, including the conclusion of the meeting after an adjournment or postponement that does not require or result in the setting of a new record date, then, solely for purposes of the amendment, the corporation is not deemed to have become a listed corporation until the conclusion of the meeting of shareholders [*Corp. Code § 301.5(i)*].

Whenever an article amendment classifying directors or eliminating cumulative voting is adopted by a corporation that is not a listed corporation, the amendment must include the following statement or its substantial equivalent [*Corp. Code § 301.5(j)*]: "This provision shall become effective only when the corporation becomes a listed corporation within the meaning of *Section 301.5 of the Corporations Code*."

[d] When Corporation Ceases to Be Listed Corporation

Ordinarily, when a listed corporation with a board of directors divided into classes ceases to be a listed corporation for any reason, the board of directors ceases to be divided into classes as to each class of directors as of the date of the expiration of the term of the directors in that class unless the articles of incorporation or bylaws of the corporation provide for the elimination of classes of directors at an earlier date or dates [*Corp. Code § 301.5(e)*; *but see Corp. Code § 301.5(h)*]. Similarly, the term of each director serving at the time the corporation ceases to be a listed corporation (and the term of each director elected to fill a vacancy resulting from the death, resignation, or removal of any of those directors) continues until its expiration as if the corporation had not ceased to be a listed corporation, unless the articles of incorporation or bylaws of the corporation provide for the elimination of classes of directors at an earlier date or dates [*Corp. Code § 301.5(e)*; *but see Corp. Code § 301.5(h)*]. Further, when the articles or bylaws of a listed corporation contain a provision eliminating cumulative voting, or a provision permitting noncumulative voting in the election of directors, or both, and the corporation ceases to be a listed corporation for any reason, the shareholders are entitled to cumulate their votes [*Corp. Code § 708*] at any election of directors occurring while the corporation is not a listed corporation notwithstanding that provision in its articles of incorporation or bylaws [*Corp. Code § 301.5(f)*; *but see Corp. Code § 301.5(h)*]. However, if the corporation ceases to be a listed corporation on or after the record date for a shareholders' meeting but before the conclusion of the meeting, including the conclusion of the meeting after an adjournment or postponement that does not require or result in the setting of a new record date, then, solely for purposes of the amendment, the corporation is not deemed to have ceased to be a listed corporation until the conclusion of the meeting of shareholders [*Corp. Code § 301.5(h)*].

[2] Form

Certificate of Amendment to Classify Board of Directors and Eliminate Cumulative Voting

CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF
_____ [*Name of corporation*]
_____ [*File number*]

The undersigned certify that

1. They are _____ [the President *or* the Chairman of the Board of Directors *or* a Vice-President] and _____ [the Secretary *or* the Chief Financial Officer *or* the Treasurer *or* an Assistant Secretary *or* an Assistant Treasurer], respectively, of _____ [*corporate name*], a California corporation.

2. The Board of Directors of _____ [*corporate name*] has approved the following amendment(s) to the articles of incorporation: _____ [*insert text of amendment; select from among the following, as appropriate*]

[*If authorized number of directors is at least six and board will be divided into two classes:*]

The board of directors is divided into two classes, and one half of the directors (or as close an approximation as possible) will be elected at each annual meeting of shareholders.

[*If authorized number of directors is at least nine and board will be divided into three classes:*]

The board of directors is divided into three classes, and one third of the directors (or as close an approximation as possible) will be elected at each annual meeting of shareholders.

[*To change number of classes of board:*]

The board of directors, which was divided into _____ [two *or* three] classes, will be divided into _____ [three *or* two] classes. _____ [One-third *or* one-half] (or as close an approximation as possible) will be elected at each annual meeting of shareholders.

[*To eliminate cumulative voting:*]

The corporation does not permit cumulative voting.

[*CONTINUE*]

3. The amendment(s) _____ [is *or* are] adopted with the approval of the majority of the Board of Directors.

4. The amendment(s) _____ [is *or* are] adopted with the approval of the requisite vote of the outstanding shares voting as a single class. The total number of issued and outstanding shares is _____. The favorable vote of _____ [a majority of the outstanding shares *or specify higher percentage required by articles of incorporation*] is required to approve the amendment. The number of shares voting for the amendment equaled or exceeded the requisite vote; the amendment(s) [was *or* were] approved by the affirmative vote of _____ [number] shares.

[*If corporation is listed, include the following (Corp. Code § 301.5(j)):*]

5. _____ [*Name of corporation*] is a listed corporation within the meaning of *Corp. Code § 301.5(d)* because _____ [*state facts showing that corporation is a listed corporation, e.g.,* the corporation has outstanding shares listed on the New York Stock Exchange].

[*OR, if corporation is not yet listed, include the following (Corp. Code § 301.5(j)):*]

5. The amendment(s) stated above will take effect only when the corporation becomes a listed corporation within the meaning of *Section 301.5 of the Corporations Code*.

[*CONTINUE*]

We declare under penalty of perjury that the statements set forth in this certificate are true and correct of our own knowledge and that this declaration was executed on _____[*date*], at _____ [*city and state*].

_____Dated:

_____ [*signature*]

[*printed name*]

[*title*]

_____ [*signature*]

[*printed name*]

[*title*]

[*For another verification, see § 10.200[2].*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersTerms in OfficeGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
B. Certificates of Amendment--Effectuating Specified Changes

4-10 California Legal Forms--Transaction Guide §§ 10.216-10.219

[Reserved]

§§ 10.216[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
C. Restated Articles of Incorporation

4-10 California Legal Forms--Transaction Guide § 10.220

§ 10.220 Restated Articles of Incorporation

[1] Comment

[a] Use of Form

This form restates in a single certificate the entire text of a corporation's articles of incorporation as amended to the date of filing of the certificate, but does not include any new amendments. It is drafted as an officer's certificate, and is for use by the corporation after shares have been issued or by the directors of the corporation before shares have been issued. For discussion of the verification of the certificate, format specifications, the number of copies to prepare, and the Secretary of State's fees, see *§ 10.200[1][b]-[m]*. For discussion of and an example of the certificate to be used by incorporators (and, optionally, by directors) before shares have been issued, see *§ 10.200*.

The Secretary of State has provided information and a sample of restated articles that meets those requirements for most filings. The sample (REST-STOCK) may be accessed by going to the Forms, Samples & Fees page of the Secretary's Business Programs Division website at: http://www.sos.ca.gov/business/bpd_forms.htm#corp and following the appropriate link.

Restatement is useful if the articles are poorly written, or if numerous amendments make their use cumbersome. A corporation may also restate and amend its articles [*Corp. Code § 910(a)*]. For a certificate that restates and amends the articles, see *§ 10.221*.

[b] Form of Certificate of Restated Articles

[i] After Shares Are Issued

After shares have been issued, a corporation may restate (without alteration or amendment) in a single certificate its entire articles of incorporation, as amended to the date of filing of the certificate, by filing an officers' certificate entitled, "Restated Articles of Incorporation of _____ (name of corporation)" [*Corp. Code § 910(a)*; *see Corp. Code § 173* (officers' certificate defined); *see also §§ 10.201[2], 10.202[2]*]. This certificate must be signed

and verified by two officers (the chairman of the board, the president, or any vice president and by the secretary, the chief financial officer, the treasurer, or any assistant secretary or assistant treasurer) [*Corp. Code § 173*; *see Corp. Code § 193* (verification); § 10.200[1][g]].

[ii] Before Shares Are Issued

Before shares have been issued, the corporation may restate in a single certificate its entire articles of incorporation, by filing a certificate entitled "Restated Articles of Incorporation of _____ (*name of corporation*)" [*Corp. Code § 910(a)*; *see Corp. Code §§ 901, 906* (amendments before issuance of shares)]. This certificate must be signed and verified by a majority of the incorporators, or if the board was named in the original articles or have been elected, by a majority of the board [*Corp. Code § 910(a)*; *see Corp. Code § 193* (verification); § 10.200[1][g]]. For discussion of and an example of this certificate, see *§ 10.200*.

When the board of directors restates and amends the articles, the corporation may file the officer's certificate prescribed by *Corp. Code § 905* (normally used after issuance of shares), rather than the certificate prescribed by *Corp. Code § 906* [*Corp. Code § 906*; *see Corp. Code § 910*; [i], *above*].

[c] Contents of Certificate of Restated Articles

Restated articles must set forth the entire text of the articles, as amended to the date of filing of the certificate, except that the following must be omitted [*Corp. Code § 910(a)*]:

- The signatures and acknowledgements of the articles by the incorporators;
- Any statements of the effects of prior amendments on outstanding shares;
- Any provisions of agreements of merger, other than amendments to the articles of the surviving corporation; and
- The names and addresses of the initial directors and any initial agent for service of process (unless the corporation has not yet filed a statement under *Corp. Code § 1502*, in which case, this information must be included in the restated articles).

The omissions listed above are not alterations or amendments of the articles [*Corp. Code § 910(a)*]. The omitted information is either no longer relevant to the corporation's current operations, or is provided separately in another required filing [*see Corp. Code § 1502* (required annual informational filing)].

Certificates of determination (of rights, preferences, privileges, and restrictions [*see Corp. Code §§ 156, 401(a)*; *see also* Ch. 3, *Articles of Incorporation*]) are considered part of the articles of incorporation [*Corp. Code § 910(c)*; *see Corp. Code § 154*]. Therefore, the provisions of any certificates of determination, designated as articles, must also be included in the restated articles [*Corp. Code § 910(c)*].

[d] Approval of Certificate of Restated Articles

A certificate of restated articles that does not alter or amend the articles may be approved by the board alone if the board has been elected, or by a majority of the incorporators if shares have not been issued and directors have not been elected [*Corp. Code § 910(b)*]. The certificate is subject to the statutory provisions governing an amendment to the articles not requiring approval of the outstanding shares [*Corp. Code § 910(b)*; *see Corp. Code § 152* (approval of the outstanding shares defined); *Corp. Code § 900 et seq.* (governing provisions); § 10.201].

"Approved by (or approved of) the board" means approved by the vote of the board of directors [*Corp. Code §§ 151, 155*]. Except when a greater proportion is required by statute, or by the articles, or, subject to the articles, by the bylaws, approval is indicated by the vote of a majority of the directors present at a meeting at which a quorum is present [*see Corp. Code §§ 204(a)(5), 307(a)(8)*], or by the unanimous written consent of the directors without a meeting [*see Corp. Code §§ 194, 195, 307(b)*]. When board approval alone of an amendment of the articles is permitted, that approval must be by the board as a whole, and not by a committee of the board [*Corp. Code § 151*; *see Corp. Code § 311(a)*]. For discussion of amendment procedure by the incorporators, see *§ 10.200[1][c]*.

[e] Filing Certificate of Restated Articles

The original and at least two copies of the certificate, together with the applicable fee(s), must be mailed or hand delivered to the Secretary of State's office in Sacramento. Restated articles are not filed in the branch offices. To facilitate the processing of documents mailed to the office, a self-addressed envelope and a letter referencing the corporate name and number, as well as the name, return address, and telephone number of the person filing the certificate should also be submitted [*see Corp. Code §§ 169, 906*].

The applicable filing fee is set forth in *Gov. Code § 12186(p)*. Additional fees apply for documents delivered in person at the public counter in the Sacramento headquarters office, and for preclearance or expedited filing [*see* http://www.sos.ca.gov/business/precexp.htm].

Properly filed, restated articles supersede for all purposes the original articles and any previously filed amendments and certificates of determination [*Corp. Code § 910(d)*].

[2] Form

Restated Articles of Incorporation

RESTATED ARTICLES OF INCORPORATION OF
_____ [***name of corporation***]

The undersigned certify:

1. They are the _____ [President *or* the Chairman of the Board of Directors *or* a Vice President] and _____ [the Secretary *or* the Chief Financial Officer *or* the Treasurer *or* an Assistant Secretary *or* an Assistant Treasurer], respectively, of _____[*name*], a California corporation.

2. The articles of incorporation of the corporation are restated to read in full as follows:

_____ [*Insert restated articles*].

3. This Certificate, which does not alter or amend the articles of incorporation, has been approved by the Board of Directors.

We declare under penalty of perjury that the statements set forth in this certificate are true and correct of our own knowledge and that this declaration was executed on _____[*date*], at _____ [*city and state*].

_____Dated:

[*Repeat, as required:*]

_____ [*signature*]

_____ [*printed name*]

_____ [*title*]

[*For another verification, see § 10.200[2]* .]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFormationPreincorporationIncorporators & PromotersBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
C. Restated Articles of Incorporation

4-10 California Legal Forms--Transaction Guide § 10.221

§ 10.221 Certificate of Restated and Amended Articles of Incorporation

[1] Comment

[a] Use of Form

This form is a certificate of restated articles of incorporation that amends and restates the articles. It is drafted as an officer's certificate, and is for use by the corporation after shares have been issued, or by the directors of the corporation before shares have been issued.

For discussion of and an example of the certificate to be used by incorporators (and, optionally, by directors) before shares have been issued, see *§ 10.200*. The Secretary of State has provided information and a sample of restated articles that meets those requirements for most filings. The sample (REST-STOCK) may be accessed by going to the Forms, Samples & Fees page of the Secretary's Business Programs Division website at: http://www.sos.ca.gov/business/bpd_forms.htm#corp and following the appropriate link.

Restatement is useful at the same time as amendment if the articles are poorly written, or if numerous amendments make their use cumbersome. For a certificate that restates the articles without amendment, see *§ 10.220*. For discussion of the wording of an amendment, verification of the certificate, format specifications, the number of copies to prepare, and the Secretary of State's fees, see *§ 10.200[1][b]-[m]*.

[b] Form of Certificate of Restated and Amended Articles

[i] After Shares Are Issued

After shares have been issued, the corporation may restate and amend in a single certificate its entire articles of incorporation by filing an officers' certificate entitled, "Restated Articles of Incorporation of _____ (name of corporation)" [*Corp. Code § 910(a)*; *see Corp. Code § 173* (officers' certificate defined); *see also §§ 10.201[2]*, *10.202[2]*]. This certificate must be signed and verified by two officers (the chairman of the board, the president, or any vice president and by the secretary, the chief financial officer, the treasurer, or any assistant secretary

or assistant treasurer) [*Corp. Code § 173*; *see Corp. Code § 193* (verification); § 10.200[1][g]].

[ii] Before Shares Are Issued

Before shares have been issued, the corporation may restate and amend in a single certificate its entire articles of incorporation by filing a certificate entitled, "Restated Articles of Incorporation of _____ (name of corporation)" [*Corp. Code § 910(a)*; *see Corp. Code §§ 901, 906* (amendments before issuance of shares)]. This certificate must be signed and verified by a majority of the incorporators, or if the board was named in the original articles or have been elected, by a majority of the board [*Corp. Code § 910(a)*; *see Corp. Code § 193* (verification); § 10.200[1][g]]. For discussion of and an example of this certificate, see *§ 10.200*.

When the board of directors restates and amends the articles, the corporation may file the officer's certificate prescribed by *Corp. Code § 905* (normally used after issuance of shares), rather than the certificate prescribed by *Corp. Code § 906* [*Corp. Code § 906*; *see Corp. Code § 910*; [i], *above*].

[c] Contents of Certificate of Restated and Amended Articles

The required statements and omissions of a certificate of restated and amended articles include all of the statements and omissions required in a certificate that restates, but does not alter or amend the articles [*see Corp. Code § 910(a)*; § 10.220]. In addition, a certificate that amends as well as restates the articles must comply with *Corp. Code §§ 905* (certificate after issuance of shares) or 906 (certificate before issuance of shares), and with *Corp. Code § 907* (required provisions in certificate) [*Corp. Code § 910(b)*; *see §§ 10.200-10.202*; *see also Corp. Code § 301.5* (additional requirements for listed corporations amending articles to classify board or eliminate cumulative voting)]; and, except for certificates approved by a majority of the incorporators, the certificate must also state that the board has approved the restated articles [*Corp. Code § 910(b)*; *see Corp. Code §§ 905(b), 906*].

[d] Approval of Certificate of Restated and Amended Articles

A certificate that restates and amends the articles is subject to the statutory provisions related to the particular amendment(s) made [*Corp. Code § 910(b)*]. Thus, if no directors have been elected, any certificate restating and amending the articles before shares have been issued may be adopted by a majority of the incorporators [*see Corp. Code §§ 901, 906*]. If there are only two incorporators, both must consent to the amendment. If directors were named in the original articles of incorporation or were elected by the incorporators and no shares have been issued, a certificate restating and amending the articles may be adopted by a majority of the directors [*see Corp. Code §§ 901, 906*]. If there are only two directors [*see Corp. Code § 212(a)*], both must approve the amendment. For discussion of director action by meeting or by written consent, see *§§ 10.240* and *10.241*.

After shares have been issued, a certificate restating and amending the articles may be adopted generally only if approved by both the board of directors and by the outstanding shares, either before or after board approval [*see Corp. Code §§ 902(a), 905, 910(a)*; § 10.202].

Certain amendments, however, may be adopted by the board alone [*see § 10.201*], or may require additional shareholder approval [*see § 10.202*].

[e] Filing Certificate of Restated and Amended Articles

The original and at least two copies of the certificate, together with the applicable fee(s), must be mailed or hand delivered to the Secretary of State's office in Sacramento. Restated articles are not filed in the branch offices. To facilitate the processing of documents mailed to the office, a self-addressed envelope and a letter referencing the corporate name and number, as well as the name, return address, and telephone number of the person filing the certificate should also be submitted [*see Corp. Code §§ 169, 906*].

The applicable filing fee is set forth in *Gov. Code § 12186(p)*. Additional fees apply for documents delivered in person at the public counter in the Sacramento headquarters office, and for preclearance or expedited filing [*see* http://www.sos.ca.gov/business/precexp.htm].

The certificate is filed by the Secretary of State on the day it is received, unless the filing or the effectiveness is delayed by the party submitting the certificate or by the Secretary of State [*see Corp. Code § 110*]. The filing may be delayed no more than 90 days after its receipt [*Corp. Code § 110(a)*], and the effectiveness may be delayed no more than 90 days after filing [*Corp. Code § 110(c)*]. Properly filed, restated articles supersede for all purposes the original articles and any previously filed amendments and certificates of determination [*Corp. Code § 910(d)*].

[2] Form

Certificate of Restated and Amended Articles of Incorporation

CERTIFICATE OF RESTATED AND AMENDED ARTICLES OF INCORPORATION OF
_____ [*name of corporation*]

The undersigned certify that:

1. They are _____ [the President *or* the Chairman of the Board of Directors *or* a Vice President] and _____ [the Secretary *or* the Chief Financial Officer *or* the Treasurer *or* an Assistant Secretary *or* an Assistant Treasurer], respectively, of _____[*name*], a California corporation.

2. The articles of incorporation of the corporation are amended and restated to read in their entirety as follows:

_____[*insert restated articles; include any amended provisions*].

3. This Certificate, restating and amending the articles of incorporation, has been approved by the Board of Directors.

[*Choose appropriate paragraph 4, below:*]

[*If shareholder approval is not required, use:*]

4. The amendment[s] may be adopted with approval by the Board of Directors alone because _____ [*insert appropriate facts, e.g.:* the corporation has one class of shares outstanding; and the amendment effects only a stock split, as defined in *Corporations Code Section 188*. *Corporations Code Section 902(c)* authorizes the adoption of this type of amendment with approval by the Board alone].

[*If shareholder approval is required, choose one of the following paragraphs:*]

[*If a majority vote of the outstanding shares is required, use:*]

4. The amendment was approved by the required vote of the shareholders in accordance with *Corporations Code Section 902*. The total number of outstanding shares of each class entitled to vote on this amendment was: _____[*number*]. The favorable vote of a simple majority of these shares is required to approve the amendment. The number of shares voting in favor of the amendment equaled or exceeded the required vote.

[*Or, if vote of more than one class of shares or supermajority vote is required in accordance with Corp. Code § 903, use:*]

4. The amendment was approved by the required vote of the shareholders in accordance with *Corporations Code Section 903*. The total number of outstanding shares of each class entitled to vote on this amendment was _____ [*specify number of shares broken down by class or series if more than one class or series was entitled to vote*]. The percentage vote required [of each class entitled to vote] was _____ [*specify number of shares broken down by class or series, e.g.,* 500 shares of common and 200 shares of preferred stock]. The favorable vote of _____ [*specify required favorable vote of shares broken down by class or series, e.g.,* a majority of the common shares and 75 percent of the preferred shares] was required to approve this amendment. The number of shares of each class voting in favor of the amendment equaled or exceeded the required vote [of that class].

[*Or, if vote of all outstanding shares, regardless of limitations on voting rights, is required in accordance with Corp. Code § 904, use:*]

4. The amendment was approved by the required vote of the shareholders in accordance with *Corporations Code Section 904*. The total number of outstanding shares affected by the amendment, regardless of limitation or restrictions on their voting rights, was _____ [*specify number of shares broken down by class or series if more than one class or series exists*]. The favorable vote of all of the outstanding shares affected, regardless of their voting rights, was required to approve this amendment. The number of shares of each class voting in favor of the amendment equaled the required vote [of that class].

[*If a delayed effective date is desired, continue with the following:*]

5. The amendment will become effective on _____ [*date not later than 90 days after date of filing certificate*].

[*Continue with the following*:]

We declare under penalty of perjury that the statements set forth in this certificate are true and correct of our own knowledge and that this declaration was executed on _____[*date*] at _____ [*city and state*].

Dated: _____

[*Repeat, as required:*]

_____ [*signature*]

_____ [*printed name*]

_____ [*title*]

[*For another verification, see § 10.200[2]* .]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to

Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
C. Restated Articles of Incorporation

4-10 California Legal Forms--Transaction Guide §§ 10.222-10.229

[Reserved]

§§ 10.222[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
D. Certificates of Correction

4-10 California Legal Forms--Transaction Guide § 10.230

§ 10.230 Certificate of Correction of Certificate of Amendment

[1] Comment

[a] Use of Form

This form is a certificate of correction to be used to correct a misstatement of fact in or a defect in the execution of a previously filed certificate of amendment of articles of incorporation.

This form is drafted as an officer's certificate, and is for use by the corporation after shares have been issued, or by the directors of the corporation before shares have been issued. For discussion of and an example of the certificate to be used by incorporators (and, optionally, by directors) before shares have been issued, see *§ 10.200*, as well as the following discussion.

[b] Restrictions on Use of Certificate of Correction

A certificate of correction may be used to correct a misstatement of fact contained in the articles of incorporation or in any previously filed certificate of amendment, any defect in execution, or any other error or defect contained in the articles or a certificate of amendment [*see Corp. Code § 109(a)*]. However, the certificate of correction must not alter the wording of any resolution or written consent that was adopted by the board of directors or the shareholders [*Corp. Code § 109(a)*]. The only way to correct this type of error is to hold another directors' meeting (and, if required, another shareholders' meeting), adopt a new amendment, and file a new certificate of amendment.

A certificate of correction may not be used to effectuate a corrected amendment of the articles if the amendment as corrected would not have complied with the requirements of the Corporations Code at the time the certificate being corrected was filed [*Corp. Code § 109(a)*]. Thus, in practice, a certificate of correction may be used only when the wording of the resolution adopted by the board or the shareholders differs from the wording of the amendment in the certificate, or when the error is in something other than the wording of the amendment.

The filing of the certificate of correction does not alter the effective time of the certificate that is being corrected.

Further, the filing does not affect any right accrued or liability incurred before the filing, although any such right or liability resulting from the error or defect being corrected is extinguished by the filing, if there was no detrimental reliance on that error or defect [*Corp. Code § 109(e)*; *see, e.g., Catalina Investments, Inc. v. Jones (2002) 98 Cal. App. 4th 1, 8-9, 119 Cal. Rptr. 2d 256* (corporation's certificate of dissolution, even if erroneously filed, could not be corrected nunc pro tunc pursuant to certificate of correction; limitation on relief available under *Corp. Code § 109* is necessary to protect integrity of public records on which third parties might have relied)].

[c] Form of Certificate of Correction

If the certificate of correction corrects original articles, the certificate must be either an officer's certificate [*see Corp. Code § 173*], or a certificate signed and verified by at least a majority of the incorporators [*Corp. Code § 109(b)*]. If the certificate of correction corrects a certificate of amendment, the certificate must be either an officers' certificate, or a certificate signed and verified in the manner required for the particular instrument being corrected [*Corp. Code § 109(b)*]. The required form for an officer's certificate is discussed in *§§ 10.201* and *10.202*. The form for a certificate signed and verified by the incorporators in discussed in *§ 10.200*.

[d] Contents of Certificate of Correction

The certificate must be entitled, "Certificate of Correction of _____ [articles of incorporation *or* certificate of amendment] of _____ [*name of corporation*]" [*Corp. Code § 109(a)*].

A certificate of correction must contain the following [*Corp. Code § 109(c)*]:

- The name or names of the corporation.
- The date of filing of the certificate or original articles.
- If a provision was defective, the corrected provision.
- If the execution was defective, an explanation of how it was defective.
- If applicable, a statement that the certificate does not alter the wording of any resolution or written consent that was adopted by the board or the shareholders.

[e] Required Identification and Wording of Article Provisions

If a provision of the articles, amended articles, restated articles [*see Corp. Code § 910*], or certificate of determination [*see Corp. Code § 156*] is being corrected, the certificate of correction must identify that provision in accordance with the requirements for a certificate of amendment [*Corp. Code § 109(d)*; *see Corp. Code § 907(a)*; § 10.200[1][h]]. The certificate of correction must also establish the wording of the provision as required by statute for a certificate of amendment [*see Corp. Code § 907(a)*; §§ 10.200[1][h], 10.201[1][g]].

[f] Signature and Verification Requirements

A certificate of correction is signed and verified in the same manner as a certificate of amendment [*Corp. Code § 109(b)*; *see Corp. Code § 905* (certificate of amendment after issuance of shares requires officers' certificate), § 10.201[1][e]; *Corp. Code § 906* (certificate of amendment before issuance of shares requires signature of majority of incorporators or board of directors), § 10.200[1][c], [d]]. Verification is discussed in *§ 10.200[1][g]*.

[g] Filing and Filing Fees

The certificate of correction is filed in the office of the Secretary of State [*Corp. Code §§ 109(a), 169*].

The filing fee is set forth in the Government Code [*Corp. Code § 108*; *see Gov. Code § 12186(p)*]. The Secretary of State will compare and certify two copies at no charge when they are submitted with the original to be filed [*Gov. Code § 12185*]. A fee is charged for additional copies [*see Gov. Code §§ 12182, 12183*].

[2] Form

Certificate of Correction of Certificate of Amendment

CERTIFICATE OF CORRECTION OF CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF

_____ [***name of corporation***]

The undersigned certify:

1. They are the _____ [President *or* the Chairman of the Board of Directors *or* a Vice-President] and _____ [the Secretary *or* the Chief Financial Officer *or* the Treasurer *or* an Assistant Secretary or an Assistant Treasurer], respectively, of _____ [*name of corporation*], a California corporation.

2. The name of the corporation filing this certificate is _____ [*name of corporation*]; it is a California corporation.

3. The instrument being corrected is entitled "CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF _____ [*name of corporation*]." It was filed in the office of the Secretary of State of the State of California on _____[*date*].

[*Choose either paragraph 4 or alternative paragraph 4 and paragraph 5:*]

[*If the certificate corrects a defect in the execution of the certificate of amendment:*]

4. The instrument was improperly executed because _____ [*describe how the execution was defective*].

[*Or, if the certificate corrects an error in a provision in certificate of amendment:*]

4. Paragraph _____ [*specify number or letter*] of the CERTIFICATE OF AMENDMENT is corrected to read as follows: _____ [*insert text of corrected paragraph in its entirety*].

5. Paragraph _____ [*specify number or letter*], as corrected and set forth above, conforms the wording of amendment to the wording of the amendment in the resolution or written consent approving the amendment adopted by the board of directors [and the shareholders].

[*Continue with the following:*]

We declare under penalty of perjury that the statements set forth in this certificate are true and correct of our own knowledge and that this declaration was executed on _____[*date*], at _____ [*city and state*].

_____Dated:

[*Repeat, as required:*]

_____ [*signature*]

_____ [*printed name*]

_____ [*title*]

[*For another verification, see § 10.200[2].*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
D. Certificates of Correction

4-10 California Legal Forms--Transaction Guide §§ 10.231-10.239

[Reserved]

§§ 10.231[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
E. Minutes, Resolutions, and Written Consents Approving Amendments

4-10 California Legal Forms--Transaction Guide § 10.240

§ 10.240 Director Action at Meeting: Minutes of Board Meeting Approving Amendment to Articles of Incorporation

[1] Comment

[a] Use of Form

This form is an example of the minutes of a regular or special board meeting. It includes optional resolutions customarily adopted at the same time as the amendment to the articles of incorporation, if the amendment requires approval of the outstanding shares or a permit from the Commissioner of Corporations. If action will be taken by written consent, rather than at a meeting, the *form in § 10.241* should be used.

The directors' participation in the meeting, the corporation's duty to keep minutes, the effect of certification of the minutes, and their general contents are discussed below.

For further discussion of directors' meetings, including types of meetings, meeting procedure, and forms of notice, see Ch. 5, *Directors, Meetings, Actions, and Resolutions* .

[b] Directors' Participation in Meeting

Unless the articles or bylaws provide otherwise, directors may participate in directors' meetings in person, or by conference telephone, electronic video screen communication, or electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*]. Participation in a meeting through use of conference telephone or electronic video screen communication constitutes presence in person at that meeting, provided that all members participating in the meeting are able to hear one another. Participation in a meeting through electronic transmission by and to the corporation (other than conference telephone and electronic video screen communication) constitutes presence in person at that meeting if: (1) each member participating in the meeting can communicate with all of the other members concurrently; and (2) each member is provided the means of participating in all matters before the board, including, without limitation, the capacity to propose, or to interpose an objection to, a specific action to be taken by the corporation [*Corp. Code § 307(a)(6)*].

A quorum (or requisite number of directors) is required to validly transact corporate business, subject to special rules applicable to transactions involving an interested director [*Corp. Code § 307(a)(8)*; *see Corp. Code §§ 310, 317(e)*]. If a quorum is not present, any acts taken at the meeting are voidable by the corporation or its shareholders [*see Olincy v. Merle Norman Cosmetics, Inc. (1962) 200 Cal. App. 2d 260, 273, 19 Cal. Rptr. 387]* , although a majority of the directors present may adjourn the meeting to another time and place [*Corp. Code § 307(a)(4)*].

[c] Duty to Keep Minutes

Each corporation must keep minutes of the proceedings of its board of directors and committees of the board [*see Corp. Code § 1500*]. The minutes and other required books and records must be kept in written form or in another form capable of being converted into clearly legible tangible form [*Corp. Code § 1500*].

Minutes are ordinarily kept in a "minute book," a loose leaf binder or a special book, available from legal stationers. The minutes of directors' meetings are filed chronologically, along with any actions taken by the directors or committees of the board by unanimous written consent without a meeting [*see Corp. Code § 307(b)*], waivers of notice, consents to the holding of directors' meetings, and approvals of the minutes [*see Corp. Code § 307(a)(3)*]. Minute books also frequently contain the articles of incorporation, certificates of amendment, restated articles, certificates of determination, bylaws and amendments to the bylaws, and copies of the annual filing required by the California Secretary of State [*see Corp. Code §§ 1502, 1502.1*].

[d] Certification of Minutes

The original or a copy of the minutes of a meeting of the board of directors or of committees of the board (or any resolution adopted the board or board committee), if (1) in writing or in any other form capable of being converted into clearly legible tangible form and (2) certified to be a true copy by a person purporting to be the corporate secretary or assistant corporate secretary, is prima facie evidence of the adoption of the resolution or the due holding of the meeting and of the matters stated in the minutes [*Corp. Code §§ 314, 1502.1*].

[e] Contents of Minutes

The statute is silent on the contents of the minutes. It requires only that they contain the "proceedings" of the meeting [*see Corp. Code § 1500*]. Although there is no consensus on what minutes should contain, there are certain items that corporate custom (and common sense) suggest should be put into the minutes:

- The date, time, and place of the meeting.
- The type of meeting (regular, special, or adjourned), and whether notice was required, given, or waived.
- The names of those present, including directors and individuals who are not directors, and the existence of a quorum of directors.
- The names of the presiding officer and the person taking the minutes.
- A statement whether the minutes of the last meeting were approved as distributed or as amended.
- The actions taken at the meeting, with or without the directors' rationale for each action.
- Adjournment, and if necessary, the date, time, and location of the next meeting.

Notice of a regular directors' meeting does not need to be given if the time and place of the meeting have been established either by the bylaws or by the board of directors [*Corp. Code § 307(a)(2)*].

[f] Use of Resolutions in Minutes to Approve Amendment to Articles

After shares have been issued, amendments may be adopted generally only if approved by both the board of directors and by the outstanding shares, either before or after board approval [*Corp. Code § 902(a)*]. In practice, however, shareholder approval ordinarily is obtained after the amendment has been adopted by the board, unless the amendment is promulgated by the shareholders without substantial board support. Certain amendments, however, may also be adopted by board approval alone [*see § 10.30[2][b]*].

The board of directors ordinarily approves the amendment by adopting a resolution setting forth the proposed amendment. A resolution adopted by the board of directors should be worded so that it can be adopted verbatim by the outstanding shares. It is also helpful to use, in the text of resolution, the exact wording of the amendment as prescribed by statute and interpreted by the Secretary of State [*see §§ 10.200[1][h], 10.201[1][g]*], so that it may be copied directly into the certificate of amendment. Any preamble to the resolution explaining its purpose [*see* Ch. 5, *Directors Meetings, Actions, and Resolutions*], or any wording other than the text of the amendment itself [*see* optional paragraphs in [2], *below*], should not be copied into the certificate [*see Corp. Code § 905(a)*]. It is customary to state that an amendment is "adopted and approved," since both words are used in *Corp. Code § 900 et seq.* [*see Corp. Code §§ 902* ("adopted if approved"), 905 ("adopted"), 905(b), (c) ("approved"), 906 ("adopted")].

[2] Form

Director Action at Meeting: Minutes of Board Meeting Approving Amendment to Articles of Incorporation

MINUTES OF [REGULAR *or* **SPECIAL] MEETING OF BOARD OF DIRECTORS OF _____ [*name of corporation*]**
A California Corporation

Date: _____.
Place: _____[*address*].
Type of meeting: _____ [regular *or* special].

[*Add, if applicable:*]

Meeting called by: _____ [*name or names, e.g.*, President].

[*Continue with the following:*]

Notice was: _____ [*e.g.*, not required and not given or given by mail to each director on _____ (*date at least four days before date of meeting*)].

Directors present:

[*Repeat, as required:*]

_____[*name*]

[*Add, if applicable:*]

Directors present:

[*Repeat, as required:*]

_____[*name*]

[*Add, if applicable:*]

Others present:

[*Repeat, as required:*]

_____ [*names and capacities*].

1. Call to Order

The meeting was called to order at _____[*time*] by the _____ [*person presiding, e.g.,* Chairman of the Board] who announced that a quorum was present.

2. Approval of Minutes of Last Meeting

The minutes of the Board meeting held on _____[*date*] were _____ [*specify, e.g.,* read and approved as read or approved or read and the statement that _____ (*specify matter as originally stated*) was corrected to read _____ (*specify correction*), and the minutes were then approved as corrected].

3. Resolution to Amend Articles of Incorporation

[*Repeat, as required:*]

The following resolution was considered by the Board and adopted and approved by _____ [majority *or* unanimous] vote of the directors present:

RESOLVED, _____ [*insert text of resolution, e.g.,* Article _____ [*number or letter designation, e.g.,* III] of the articles of incorporation is amended to read in its entirety as follows: The corporation is authorized to issue only one class of shares, with a total number of _____ [*existing number of shares, e.g.,* 10,000] shares. On the amendment of this article, each outstanding share is split up and converted into _____ [*number of shares, e.g.,* 10 shares].

Voting for:

[*Repeat, as required:*]

_____[*name*]

Voting against:

[*Repeat, as required:*]

_____[None *or name*]

Abstaining:

[*Repeat, as required:*]

_____[None *or name*]

[*OPTIONAL:*]

The following resolution was considered by the Board and adopted and approved by _____ [majority *or* unanimous] vote of the directors present:

4. Resolution to Authorize Officers to Complete Amendment Process

RESOLVED FURTHER, any officer of this corporation is authorized and directed to obtain the approval of the amendment(s) to the Articles of Incorporation set forth above by the _____ [*e.g.*, majority] vote or written consent of _____ [the outstanding shares *or* the outstanding shares of the _____ (*class or series*)] of this corporation; and the _____ [President *or* Chairman of the Board of Directors *or* any Vice President] and _____ [the Secretary *or* the Chief Financial Officer *or* the Treasurer *or* any Assistant Secretary *or* any Assistant Treasurer] are authorized and directed to sign, verify, and file an officers' certificate containing the amendment(s), as required by statute, and to do whatever else is necessary to effectuate the amendment(s).

Voting for:

[*Repeat, as required:*]

_____ [name]

Voting against:

[*Repeat, as required:*]

_____ [None *or name*]

Abstaining:

[*Repeat, as required:*]

_____ [None *or name*]

[*Optional*]

The following resolution was considered by the Board and adopted and approved by _____ [majority *or* unanimous] vote of the directors present:

5. Resolution to Obtain Permit from Commissioner of Corporations

RESOLVED FURTHER, the _____ [*specify appropriate officer or officers*] of this corporation _____ [is *or* are] authorized, directed, and empowered to file any necessary application or applications for permits with the Department of Corporations of the State of California required as a result of the adoption of the amendment(s).

Voting for:

[*Repeat, as required:*]

_____[*name*

Voting against:

[*Repeat, as required:*]

_____ [None *or name*]

Abstaining:

[*Repeat, as required:*]

_____ [None *or name*]

[*Continue with the following:*]

6. Adjournment

Meeting adjourned at _____[*time*].

_____: [*date*]

_____ [*signature*]

_____ [*printed name*]

_____ [*title, e.g.,* Corporate Secretary *or* Assistant Corporate Secretary]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
E. Minutes, Resolutions, and Written Consents Approving Amendments

4-10 California Legal Forms--Transaction Guide § 10.241

§ 10.241 Director Action by Unanimous Written Consent Approving Amendment to Articles of Incorporation

[1] Comment

[a] Use of Form

This form is a unanimous written consent, to be used by the directors to approve an amendment to the corporation's articles of incorporation without a meeting. In practice, directors of small, closely held corporations often act without a meeting, using a written consent. Individual waivers may be signed, or a single waiver may be signed collectively [*see* [2], *below*]. The wording of a resolution to be approved by the directors in an action by written consent is usually in the same form as it would appear in the minutes of a board meeting, had one been held [*see § 10.240*]. For further discussion of the wording of resolutions, see *§§ 10.200[1][h]* and *10.201[1][g]*.

[b] Statutory Requirements; Effect

The directors may act by written consent without a meeting. However, an action by written consent without a meeting requires the consent of all the members of the board. In addition, the number of board members serving at the time the action is taken must constitute a quorum [*Corp. Code § 307(b)*; *see Corp. Code § 194* (vote includes authorization by written consent)].

For purposes of unanimous board action without a meeting, the term "all members of the board" includes an "interested director" [*see Corp. Code § 310(a)*] or a "common director" [*see Corp. Code § 310(b)*] who abstains in writing from providing consent, when [*Corp. Code § 307(b)*]:

- The disclosures required by *Corp. Code § 310* (generally requiring full disclosure of the material facts regarding the transaction and the director's interest) [*see Ch. 4, Bylaws, § 4.200[2]*, Section 2.23] have been made to the noninterested or noncommon directors, as applicable, before their execution of the written consent or consents;

- The specified disclosures are conspicuously included in the written consent or consents executed by

the noninterested or noncommon directors; and

- The noninterested or noncommon directors, as applicable, approve the action by a vote that is sufficient without counting the votes of the interested or common directors.

If the directors give written consent in accordance with the preceding rule, but the disclosures made regarding the action that is the subject of the consent do not satisfy statutory requirements [*see Corp. Code § 310*], the action that is the subject of the consent will be deemed approved. However, in any suit brought to challenge the action, the party asserting the validity of the action has the burden of proof in establishing that the action was just and reasonable to the corporation at the time it was approved [*Corp. Code § 307(b)*].

The requisite consent may be in the form of individual consents or one collective consent, or a facsimile, telegraphic, or other authorized electronic communication, including an electronic transmission by a corporation [*see Corp. Code §§ 20, 195, 307(b)*]. The consents must be filed with the minutes of the board's proceedings [*Corp. Code § 307(b)*].

[2] Form

Director Action by Unanimous Written Consent Approving Amendment to Articles of Incorporation

ACTION BY UNANIMOUS WRITTEN CONSENT OF DIRECTORS OF _____ [*name of corporation*]

The undersigned _____ [director *or* directors] _____ [*name of corporation*] _____ [adopts, approves and consents *or* unanimously adopt, approve, and consent] to the following [action *or* actions] by the board of directors without a meeting by unanimous written consent:

[*Repeat, as required:*]

#. _____ [*insert descriptive title and text of resolution for corporate action, e.g.,* **Amendment of Article** _____ (*number or letter designation*) **of the Articles of Incorporation**. Article _____ (*number or letter designation*) is amended to read in its entirety as follows: This corporation is authorized to issue _____ (*number*) shares of capital stock. On amendment of the articles to read as set forth above, each outstanding share is split up and converted into two shares of capital stock].

[*Continue with the following:*]

This action is authorized by *Corporations Code Section 307(b)*.

Dated: _____

[*Repeat, as required:*]

_____ [*signature*]

_____ [*printed name*]

_____ [*title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
E. Minutes, Resolutions, and Written Consents Approving Amendments

4-10 California Legal Forms--Transaction Guide § 10.242

§ 10.242 Shareholder Action at Meeting: Resolution Adopting Amendment to Articles of Incorporation

[1] Comment

[a] Use of Form

This form is a resolution to be adopted by the shareholders, for use at a shareholders' meeting. Shareholders may act at meeting or by written consent [*see Corp. Code § 604(a)*]. The statutory requirements and the procedures for holding shareholders' meetings, including the place, date, and time, giving notice, waivers of notice, record date and quorum requirements, and the exercise of shareholder voting rights through proxies or through voting agreements or voting trusts are discussed in Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

[b] Required Approval of Amendment; Wording of Resolution

After shares have been issued, amendments may be adopted generally only if approved by both the board of directors and by the outstanding shares, either before or after board approval [*Corp. Code § 902(a)*]. In practice, however, shareholder approval is ordinarily obtained after the amendment has been adopted by the board, unless the amendment is promulgated by the shareholders without substantial board support. Certain proposed amendments affecting a class of shares must be approved by the outstanding shares of that class, whether or not the class is entitled to vote on the amendment by the provisions of the articles [*see Corp. Code § 903(a)*; § 10.30[2][c]], as well as by the outstanding voting shares [*Corp. Code § 903(c)*]. If the amendment would make shares assessable or authorize judicial action against a shareholder to collect an assessment on fully paid shares, it must be approved by all of the outstanding shares, regardless of limitations or restrictions on their voting rights [*Corp. Code § 904*; *see Corp. Code § 423(n)*; § 10.31[3]]. Certain amendments may also be adopted by board approval alone [*see § 10.30[2][b]*].

The board of directors ordinarily approves the amendment by adopting a resolution setting forth the proposed amendment. A resolution adopted by the board of directors should be worded so that it can be adopted verbatim by the outstanding shares (or vice versa). It is also helpful to use, in the text of resolution, the exact wording of the amendment, as prescribed by statute and interpreted by the Secretary of State [*see §§ 10.200[1][h], 10.201[1][g]*], so that it may be copied directly into the certificate of amendment. Any preamble to the resolution, explaining its purpose [

see Ch. 5, *Directors Meetings, Actions, and Resolutions*], or any wording other than the text of the amendment itself, [*see* optional paragraphs in [2], *below*] should not be copied into the certificate [*see Corp. Code § 905(a)*]. It is customary to state that an amendment is "adopted and approved," since both words are used in *Corp. Code § 900 et seq.* [*see Corp. Code §§ 902* ("adopted if approved"), 905 ("adopted"), 905(b), (c) ("approved"), 906 ("adopted")]. For further discussion of the wording of amendments, see *§§ 10.200[1][h]* and *10.201[1][g]*.

[2] Form

Shareholder Action at Meeting: Resolution Adopting Amendment to Articles of Incorporation

[*Repeat, as required:*]

_____ [*printed name*]. The Shareholders adopt and approve the following amendment to the articles of incorporation: _____ [*insert text of amendment*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 10 AMENDMENT OF ARTICLES
PART IV. FORMS
E. Minutes, Resolutions, and Written Consents Approving Amendments

4-10 California Legal Forms--Transaction Guide § 10.243

§ 10.243 Shareholder Action by Written Consent Approving Amendment to Articles of Incorporation For Use By Corporation with Fewer than 100 Shareholders

[1] Comment

[a] Use of Form

This form is a shareholder's written consent approving an amendment to the articles of incorporation, to be used by a corporation with fewer than 100 shareholders. If the corporation has more than 100 shareholders and the consent will be distributed to 10 or more shareholders, the written consent must also include options for disapproval or abstention from voting [*Corp. Code § 604(a)*; *see* Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*]. The executed written consents should be filed in the corporation's minute book.

[b] Use of Written Consents; Statutory Requirements

Unless otherwise provided in the articles of incorporation, any action (other than the election of directors) that may be taken by the shareholders at any annual or special meeting may be taken without a meeting and without prior notice, by a consent in writing, provided that the consent of the same number of shares as would be necessary to authorize that action at a meeting is obtained [*Corp. Code § 603(a)*; *see Corp. Code § 603(d)* (rules related to election of directors)].

The consent must set forth the action taken and be signed by the required number of shareholders [*see Corp. Code § 603(a)*]. Written consent may also be given by facsimile, telegraphic, and other authorized electronic communication, including an electronic transmission by the corporation [*see Corp. Code §§ 20, 195*].

Although there is no statutory requirement that all shareholders entitled to vote be solicited in writing for consents, if this is not the case, then the nonconsenting shareholders entitled to vote must be given a special notice of the action [*Corp. Code § 603(b)*; *see* Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*].

The written consent may be revoked if the corporation receives the written revocation before the written consents representing the number of shares required to authorize the proposed action have been filed with the corporation's

secretary [*Corp. Code § 603(c)*]. For a revocation, see Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

[c] Required Approval of Amendment; Wording of Resolution

After shares have been issued, amendments may be adopted generally only if approved by both the board of directors and by the outstanding shares, either before or after board approval [*Corp. Code § 902(a)*]. In practice, however, shareholder approval ordinarily is obtained after the amendment has been adopted by the board, unless the amendment is promulgated by the shareholders without substantial board support. Certain proposed amendments affecting a class of shares must be approved by the outstanding shares of that class, whether or not it is entitled to vote on the amendment by the provisions of the articles [*see Corp. Code § 903(a)*; § 10.30[2][c]], as well as by the outstanding voting shares [*Corp. Code § 903(c)*]. If the amendment would make shares assessable or authorize judicial action against a shareholder to collect an assessment on fully paid shares, it must be approved by all of the outstanding shares, regardless of limitations or restrictions on their voting rights [*Corp. Code § 904*; *see Corp. Code § 423(n)*; 10.31[3]]. Certain amendments may also be adopted by board approval alone [*see § 10.30[2][b]*].

The board of directors ordinarily approves the amendment by adopting a resolution setting forth the proposed amendment. A resolution adopted by the board of directors should be worded so that it can be adopted verbatim by the outstanding shares (or vice versa). It is also helpful to use, in the text of resolution, the exact wording of the amendment, as prescribed by statute and interpreted by the Secretary of State [*see §§ 10.200[1][h], 10.201[1][g]*], so that it may be copied directly into the certificate of amendment. Any preamble to the resolution, explaining its purpose [*see* Ch. 5, *Directors Meetings, Actions, and Resolutions*], or any wording other than the text of the amendment itself [*see* optional paragraphs in [2], *below*] should not be copied into the certificate [*see Corp. Code § 905(a)*]. It is customary to state that an amendment is "adopted and approved," since both words are used in *Corp. Code § 900 et seq.* [*see Corp. Code §§ 902* ("adopted if approved"), 905 ("adopted"), 905(b), (c) ("approved"), 906 ("adopted")]. For further discussion of the wording of amendments, see *§§ 10.200[1][h]* and *10.201[1][g]*.

[2] Form

Shareholder Action by Written Consent Approving Amendment to Articles of Incorporation For Use By Corporation with Fewer than 100 Shareholders

SHAREHOLDERS' ACTION BY WRITTEN CONSENT

_____ [*name of corporation*]

The undersigned shareholders of _____ [*name of corporation*], a California corporation, adopt, approve and consent to the following _____ [amendment *or* amendments] to the articles of incorporation of the corporation:

[*Repeat, as required:*]

_____ [*printed name*]. _____ [*insert text of amendment*].

[*Continue with the following:*]

This consent is given in accordance with *Corporations Code Section 603*, with respect to all shares of the undersigned entitled to vote on [this matter or these matters].

[*Repeat, as required:*]

_____ [*shareholder's signature*]

_____ [*printed name*]

_____ [*number of shares owned*]:

Number of shares owned ..... _____ [*date*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES

5-11 California Legal Forms--Transaction Guide 11.syn

§ 11.syn Synopsis to Chapter 11: MERGER AND ACQUISITION ISSUES

§ 11.01 California Sources

[1] Statutes

[2] Regulations

§ 11.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 11.03-11.04 [Reserved]

§ 11.05 Law Reviews and Periodicals

§ 11.06 Annotations

§ 11.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 11.08-11.19 [Reserved]

§ 11.20 Mergers and Acquisitions

[1] Terminology

[2] Five Basic Acquisition Methods

§ 11.21 Governing Law

[1] California Corporation Law

[a] Generally

[b] Sale of Assets for Cash

[c] Statutory Merger

[d] Exchange of Shares for Shares or Assets for Shares

[e] Dissenters' Rights in Reorganizations

[2] Internal Revenue Code

[a] Tax-Free Reorganizations Generally

[b] "Reorganizations" for Federal Tax Purposes

§ 11.22 Purposes Underlying State and Federal Treatment of Reorganizations

[1] In General

[2] California Corporation Law

[a] Codification of De Facto Merger Doctrine

[b] Development of Doctrine

[3] Internal Revenue Code

§ 11.23 Meaning of "Reorganization"

[1] California Corporation Law

[a] Statutory Merger

[b] Shares for Shares Exchange

[c] Assets for Shares Exchange

[2] Internal Revenue Code

[a] Statutory Merger or Consolidation

[b] Shares for Shares Exchange

[c] Assets for Shares Exchange

[d] Business Purpose, Continuity of Business Enterprise, and Continuity of Interest

§ 11.24 Nontax Factors in Selecting Acquisition Method

[1] In General

[2] Shareholder Approval

[3] Rights of Target Corporation Shareholders

[4] Securities Laws

[5] Assumption of Liabilities

[6] Number of Shareholders and Assets

§ 11.25 Tax Factors in Selecting Acquisition Method

[1] Overview

[2] Income Tax Basis

[a] In General

[b] Obtaining New Basis for Assets

[c] Special Basis Rule for Assumption of Liabilities

[3] Income Tax Loss Carryover Deduction

[a] In General

[b] Obtaining Carryover of Acquired Corporation

[c] Restrictions on Use of Carryover

[4] California Sales and Use Tax Considerations

[a] Applicability to Certain Acquisition Methods

[b] Cash Purchase of Assets

[c] Cash Purchase of Shares

[d] Statutory Mergers

[e] Acquisition of Shares for Shares

[f] Acquisition of Assets for Shares

§ 11.26 Accounting Treatment of Corporate Acquisition

[1] Accounting Methods

[2] Former Pooling of Interest Method

[3] Purchase Method

[4] Effect on Financial Position

[a] Future Earnings

[b] Income Tax Returns

§§ 11.27-11.99 [Reserved]

Scope

§ 11.100 Facts--Acquiring Corporation

Scope

§ 11.101 Facts--Corporation Sought to Be Acquired

Scope

§ 11.102 Facts--Proposed Acquisition

Scope

§ 11.103 Documents

Scope

§§ 11.104-11.109 [Reserved]

Scope

§ 11.110 Determining Whether to Structure Transaction as Cash Purchase of Shares

Scope

§ 11.111 Determining Whether to Structure Transaction as Cash Purchase of Assets

Scope

§ 11.112 Determining Whether to Structure Transaction as Merger

Scope

§ 11.113 Determining Whether to Structure Transaction as Acquisition of Shares for Shares

Scope

§ 11.114 Determining Whether to Structure Transaction as Acquisition of Assets for Shares

Scope

§§ 11.115-11.129 [Reserved]

§ 11.130 Performing Transaction

Scope

§§ 11.131-11.199 [Reserved]

§ 11.200 Table Comparing Acquisition Methods

[1] Comment

[2] Table



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES

5-11 California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter discusses and compares the five basic methods by which one corporation may acquire another corporation:

- The purchase of all assets of one corporation by another corporation for cash or promissory notes.
- The purchase of all the outstanding shares of one corporation by another corporation for cash or promissory notes.
- The statutory merger of corporations.
- The exchange of all shares of one corporation for shares of the acquiring corporation.
- The exchange of all assets of one corporation for shares of the acquiring corporation.

The chapter is intended to guide attorneys in structuring a corporate acquisition in a manner that will be most appropriate to the goals of the corporations involved. The Legal Background covers both California law and federal tax law governing the various acquisition methods, and examines both tax and non-tax factors in selecting an acquisition method. It also discusses the accounting treatment of corporate acquisitions. The Research Guide lists primary and secondary sources applicable to the five acquisition methods. The Transaction Guide lists basic facts and documents used in the client interview, sets forth preliminary determinations used to select the appropriate acquisition method, and provides cross-references to the five specific chapters containing in-depth coverage of each specific acquisition methods. Finally, this chapter contains a chart comparing the requirements of the various acquisition methods.

This chapter focuses on comparing the features, advantages, and disadvantages of each of the acquisition methods to assist counsel in determining which method is best suited to the client. Once that method has been determined, the following chapters contain in-depth coverage of the mechanics of the five acquisition methods:

- Ch. 11A, *Cash Purchase of Shares*.

- Ch. 11B, *Cash Purchase of Assets*.
- Ch. 11C, *Mergers*.
- Ch. 11D, *Acquisition of Shares for Shares*.
- Ch. 11E, *Acquisition of Assets for Shares*.

Additional detailed discussion of corporate acquisition methods is contained in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* (Matthew Bender). Other applicable forms are set forth in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Appendix A, Forms 13.01-13.28 (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART I. RESEARCH GUIDE
A. Primary Sources

5-11 California Legal Forms--Transaction Guide § 11.01

§ 11.01 California Sources

[1] Statutes

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"Approval of outstanding shares" defined. *Corp. Code § 152*.

"Reorganization" defined. *Corp. Code § 181*.

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Reorganizations. *Corp. Code §§ 1200-1203*.

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Qualification by coordination under Securities Act of 1933. *Corp. Code § 25111*.

Qualification by permit. *Corp. Code § 25113*.

Share exchange not included as recapitalization for qualification purposes. *Corp. Code § 25120*.

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Transfer of employer's reserve account. Unemp. Ins. Code §§ 1051-1061.

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART I. RESEARCH GUIDE
A. Primary Sources

5-11 California Legal Forms--Transaction Guide § 11.02

§ 11.02 Federal Sources

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Williams Act regulating tender offers. *15 U.S.C. §§ 78l, 78m(d), (e), 78n(d)*-(f).

Internal Revenue Code.

Net operating loss deduction allowed. *I.R.C. § 172(a)*.

No gain to parent on liquidation of subsidiary. *I.R.C. § 332*.

Parent takes income tax basis for assets of dissolved subsidiary. *I.R.C. § 334(b)(1)*.

Determining gain or loss to subsidiary upon *I.R.C. § 332* liquidation. *I.R.C. § 337*.

Purchase of subsidiary's stock treated as purchase of assets with grossed-up basis. *I.R.C. § 338*.

No gain on exchange of shares of one corporation to reorganization for shares of another corporation to reorganization. *I.R.C. § 354(a)*.

Basis for shares received in exchange between corporations to reorganization. *I.R.C. § 358*.

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Basis for property received by corporation in exchange for its shares in tax-free exchange. *I.R.C. § 362*.

Statutory merger as tax-free reorganization. *I.R.C. § 368(a)(1)(A)*.

Corporate acquisition by means of share exchange as form of tax-free reorganization. *I.R.C. § 368(a)(1)(B)*.

Assets-for-shares exchange as tax-free reorganization. *I.R.C. § 368(a)(1)(C)*.

Party to tax-free reorganization defined. *I.R.C. § 368(b)*.

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Special allocation rules for asset acquisitions. *I.R.C. § 1060*.

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[2] Regulations

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART I. RESEARCH GUIDE
A. Primary Sources

5-11 California Legal Forms--Transaction Guide §§ 11.03-11.04

[Reserved]

§§ 11.03[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11 California Legal Forms--Transaction Guide § 11.05

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11 California Legal Forms--Transaction Guide § 11.06

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11 California Legal Forms--Transaction Guide § 11.07

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Ch. 11C, *Mergers*

Ch. 11D, *Acquisition of Shares for Shares*

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Ch. 165, *Sales of Stock*.

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Ch. 168, *Investigation Required to Be Made by Each Party to Mergers and Acquisitions*.

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Ch. 170, *Negotiation and Payment*.

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11 California Legal Forms--Transaction Guide §§ 11.08-11.19

[Reserved]

§§ 11.08[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART II. LEGAL BACKGROUND

5-11 California Legal Forms--Transaction Guide § 11.20

§ 11.20 Mergers and Acquisitions

[1] Terminology

The terms "merger" and "acquisition" are commonly used interchangeably in the business community. To an attorney, however, a "merger" is the statutory process of combining the acquired corporation into the acquiring corporation, often referred to as a "statutory merger" [Fox & Fox, Corporate Acquisitions and Mergers, Ch. 1, *The Business Setting of Corporate Acquisitions and Mergers*, § 1.01[1] (Matthew Bender); *see § 11.23[1][a]*]. Unless the context otherwise clearly indicates, the word "merger" is used in that sense throughout this chapter.

Despite any differences in terminology, the substantive result of either a merger or acquisition is the same: one corporation obtains ownership of another corporation [Fox & Fox, Corporate Acquisitions and Mergers, ch. 1, *The Business Setting of Corporate Acquisitions and Mergers*, § 1.01[1] (Matthew Bender)].

[2] Five Basic Acquisition Methods

One corporation can obtain ownership of another corporation by any of the following methods [*see* Cavitch, *Business Organizations With Tax Planning, ch. 160, Review of Methods of Buying and Selling Corporate Businesses, § 160.02* (Matthew Bender); Fox & Fox, Corporate Acquisitions and Mergers, Ch. 5A, *Summary of Acquisition Methods*, § 5A.01 (Matthew Bender)]:

- The purchase of all the outstanding shares of one corporation by another corporation for cash or promissory notes [*see* Ch. 11A, *Cash Purchase of Shares*].

- The purchase of all assets of one corporation by another corporation for cash or promissory notes [*see* Ch. 11B, *Cash Purchase of Assets*].

- The statutory merger of corporations [*see* Ch. 11C, *Mergers*].

- The exchange of all shares of one corporation for shares of the other, acquiring, corporation [*see* Ch. 11D, *Acquisition of Shares for Shares*].

- The exchange of all assets of one corporation for shares of another corporation [*see* Ch. 11E, *Acquisition of Assets for Shares*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawSales of AssetsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART II. LEGAL BACKGROUND

5-11 California Legal Forms--Transaction Guide § 11.21

§ 11.21 Governing Law

[1] California Corporation Law

[a] Generally

Four of the five principal methods by which one corporation can obtain ownership of another corporation are regulated by statute in California. The statutes regulating those four methods are contained in four consecutive chapters, Chapters 10-13, of the General Corporation Law [*see*Corp. Code §§ 1000-1313; *see also* [b]-[e], *below*]. The fifth method, a cash purchase of shares, is not subject to specific statutory regulation [*see Ch. 11A, Cash Purchase of Shares, § 11A.21[1]*].

[b] Sale of Assets for Cash

The General Corporation Law does not treat the sale of all assets by one corporation to another corporation for cash or promissory notes as a method of corporate acquisition, or define it as a form of "reorganization," as are the other regulated acquisition methods [*see Corp. Code § 181*; *§ 11.23[1]*]. However, the sale of all assets by one corporation to another corporation for cash or promissory notes is regulated by the provisions of Chapter 10 of that law [*Corp. Code § 1001(a)*], which imposes special requirements on the sale or attempted sale by a corporation of all or substantially all of its property and assets [*see Corp. Code §§ 1000-1002*; *see Ch. 11B, Cash Purchase of Assets, § 11B.20[2]*]. An exchange of all assets of one corporation for *shares* of another corporation, however, is defined as a "reorganization" [*see* [d], *below*] and is excluded from the requirements of Chapter 10 of the General Corporation Law, even though it may be considered a sale of assets for some purposes [*Corp. Code § 1001(a)*].

[c] Statutory Merger

The merger of two or more corporations into one corporation [*see Corp. Code § 1100*], commonly known as a "statutory merger," is defined by California's General Corporation Law as a form of "reorganization" called a "merger reorganization" [*see Corp. Code § 181(a)*; *see also § 11.23[1][a]*]. The procedural requirements and effect of a statutory merger of corporations are set forth in Chapter 11 of the General Corporation Law [*Corp. Code §§ 1100-1113*]. The shareholder consent requirements for a valid statutory merger or "merger reorganization" are set forth

in *Corp. Code §§ 1200* and *1201*. Short-form mergers, or mergers of wholly owned or 90-percent-owned subsidiary corporations into their parent corporations, are expressly excluded from the statutory definition of a "reorganization" [*see Corp. Code § 181(a)*]. They are governed in their entirety by *Corp. Code § 1110* [*see Ch. 11C, Mergers, § 11C.29*].

[d] Exchange of Shares for Shares or Assets for Shares

The third and fourth types of corporation acquisition methods regulated by statute in California are the exchange of all shares of one corporation for shares of another corporation, and the exchange of all assets of one corporation for shares of another corporation. Prior to 1977, these methods of corporate acquisition were often used to circumvent the shareholder consent requirements for a valid statutory merger [*see § 11.22[2]*]. In order to prevent this, the present General Corporation Law defines both of these types of corporate acquisition methods as well as statutory mergers as "reorganizations" [*see Corp. Code § 181(b), (c)*; *see also § 11.23[1][b],[c]*]. That law subjects all reorganizations to the same shareholder consent requirements, which are set forth in Chapter 12 of the General Corporation Law [*Corp. Code §§ 1200, 1201*; *see* § Ch. 11C, *Mergers*, § 11C.122[4]-[6]].

[e] Dissenters' Rights in Reorganizations

Acquisitions defined as "reorganizations" are subject to Chapter 13 of the General Corporation Law, entitled "Dissenters' Rights" [Corp. Code §§ 1300-1313]. Those sections also apply to short-form mergers. They do not apply, however, to the sale of all assets by one corporation to another corporation for cash or promissory notes [*see Corp. Code § 1300(a)*].

Generally, Corp. Code §§ 1300-1313 provide a procedure by which a "dissenting shareholder" in a corporation that is a party to a "reorganization" or short-form merger, and who is entitled to vote on the transaction, may require the corporation to purchase his or her "dissenting shares" for cash at the fair market value they had on the day preceding announcement of the proposed "reorganization" or short-form merger [*Corp. Code § 1300(a)*]. Each shareholder of a disappearing corporation in a short-form merger is also entitled to require the purchase of his or her dissenting shares [*Corp. Code § 1300(a)*]. "Dissenting shareholder" and "dissenting shares" are terms of art expressly defined by statute [*see* Corp. Code § 1300(b), (c); *see also* Ch. 11C, *Mergers*, § 11C.150].

[2] Internal Revenue Code

[a] Tax-Free Reorganizations Generally

Transactions involving the purchase or sale of some or all of the business of a corporation can be a complicated areas of corporate practice. While these transactions involve considering a number of legal and non-legal factors that bear on the structuring and consequences of these transactions [Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 160, *Review of Methods of Buying and Selling Corporate Businesses*, § 160.01 (Matthew Bender)], the tax consequences of the transaction usually are of primary concern [Fox & Fox, CORPORATE ACQUISITIONS and MERGERS, ch. 2A, *General Considerations in Corporate Acquisitions and Mergers*, § 2A.01 (Matthew Bender)]. The most obvious distinction between a taxable and tax-free transaction is that gain or loss is recognized in the former but not in the latter [Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 173, *Choosing the Method of Transferring the Ownership of a Corporate Business*, § 173.02 (Matthew Bender)].

I.R.C. § 354 provides that no gain or loss will be recognized for federal income tax purposes when stock or securities in a corporation that is a party to a "reorganization" is exchanged, pursuant to the plan of reorganization, solely for stock or securities of the corporation or another corporation that is a party to the reorganization [*I.R.C. § 354(a)*]. *I.R.C. § 361* provides that no gain or loss will be recognized for federal income tax purposes when a corporation that is a party to a "reorganization" exchanges property, pursuant to the plan of reorganization, solely for stock or securities in another corporation that is a party to the reorganization [*I.R.C. § 361(a)*]. The receipt of other property ("boot"), however, that is

not distributed pursuant to the reorganization will result in the recognition of gain equal to the fair market value of the property (or the amount of money received) [*I.R.C. § 361(b)*].

The key word in both sections is "reorganization." The transaction is tax-free under either section (that is, no gain or loss is recognized for federal income tax purposes), only when the corporations involved are parties to a "reorganization" and the exchange of shares for shares [*I.R.C. § 354(a)*] or property for shares [*I.R.C. § 361(a)*] is made pursuant to a plan of "reorganization" [*see I.R.C. § 368(a)* (definition of reorganization); *see also* [b], *below*].

[b] "Reorganizations" for Federal Tax Purposes

I.R.C. § 368 defines "party to a reorganization" and "reorganizations" for purposes of *I.R.C. §§ 354* and *361* [*see I.R.C. § 368(a)(1), (b)*]. A "party to a reorganization" is defined as including a corporation resulting from a reorganization, and both corporations when the reorganization results from the acquisition by one corporation of shares or property of another corporation [*I.R.C. § 368(b)*].

I.R.C. § 368(a)(1) lists seven types of corporate transactions that will be considered "reorganizations" for purposes of the tax-free provisions of the federal income tax law [*see I.R.C. § 368(a)(1)*]. The first three types of transactions on the list are acquisition methods by which one corporation seeks to obtain ownership of another corporation and are similar to the acquisition methods defined as "reorganizations" by California's General Corporation Law [*see I.R.C. § 368(a)(1)(A)-(C)*; *see also Corp. Code § 181*]. The fourth type of transaction on the list is a method of dividing a corporation, and the fifth and sixth types of transactions are corporate recapitalization methods [*see I.R.C. § 368(a)(1)(D)-(F)*]. The final type of transfer qualifying as a "reorganization" basically involves a transfer of all a corporation's assets to another corporation in a Title 11 bankruptcy or similar case, and a corresponding distribution of stock of the corporation to which the assets are transferred in a transaction that qualifies under *I.R.C. §§ 354*-356 [*see I.R.C. § 368(a)(3)(G)*].

Because the types of transactions set forth in *I.R.C. § 368(a)(1)* are lettered with capital letters, the three acquisition methods discussed in this chapter have come to be known as "A reorganizations," "B reorganizations," and "C reorganizations" [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 3, *Tax Factors in Corporate Acquistions and Mergers*, § 3.03 (Matthew Bender)]. They may be described as follows [*see I.R.C. § 368(a)(1)*; *see also § 11.23[2]*]:

- A statutory merger ("A" reorganization).
- An exchange of shares of one corporation for shares of another corporation ("B" reorganization).
- An exchange of all assets of one corporation for shares of another corporation ("C" reorganization).

Although the same three general types of acquisition methods are also defined as "reorganizations" by California's General Corporation Law [*see Corp. Code § 181*; *see § 11.23[1]*], the requirements a particular acquisition transaction must meet before it can be treated as a "reorganization" under the General Corporation Law of California or as a tax-free "reorganization" under *I.R.C. § 368* are somewhat different. Therefore, understanding the purpose and meaning of the "reorganization" definition contained in the General Corporation Law and in *I.R.C. § 368* is important; those subjects are covered below [*see §§ 11.22* (purpose of definition), *11.23* (meaning of reorganization)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawMergersGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Mergers & Acquisitions

LawMergersShort-Form MergersMergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentMergersMergers & Acquisitions LawTax-Free Acquisitions



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART II. LEGAL BACKGROUND

5-11 California Legal Forms--Transaction Guide § 11.22

§ 11.22 Purposes Underlying State and Federal Treatment of Reorganizations

[1] In General

Both the General Corporation Law of California and the Internal Revenue Code define the term "reorganization" to include certain acquisition methods used by one corporation to gain ownership and control of another corporation [*see Corp. Code § 181*; *I.R.C. § 368(a)(1)*; *see also § 11.21*]. The two definitions differ, however, as to the requirements a transaction involving one of the included acquisition methods must meet before it constitutes a "reorganization" within the meaning of the definition.

The purpose of the General Corporation Law is to regulate the organization, operation, reorganization, and eventual liquidation of corporations in California. The purpose of the Internal Revenue Code is to impose taxes and raise revenues for the federal government. Because the fundamental purpose of these two sets of statutes is different, the definitions of the term "reorganization" contained in them [*see* § 11.23, *below*] and the purposes sought to be served by those definitions also differ.

[2] California Corporation Law

[a] Codification of De Facto Merger Doctrine

The Report of the Assembly Select Committee on the Revision of the Corporations Code dated December 1, 1975 (cited in this chapter as "Assembly Select Comm. Rep."), explains that the definition and use of the term "reorganization" in the General Corporation Law was intended to codify the so-called "de facto merger" doctrine [Assembly Select Comm. Rep., at 27]. That doctrine was developed by the Pennsylvania Supreme Court in 1958 [*see Farris v. Glen Alden Corp. (1958) 393 Pa. 427, 143 A.2d 25, 31]* and named (although rejected) one year later by the Supreme Court of Delaware [*see Heilbrunn v. Sun Chem. Corp. (1959) 38 Del. Ch. 321, 150 A.2d 755, 757* ; *see* [b], *below*].

In order to codify the de facto merger doctrine, the drafters of the present General Corporation Law (effective January 1, 1977) defined statutory mergers and all other transactions that have, or can have, the same practical result as a statutory merger as "reorganizations" as that term is used in the General Corporation Law [*Corp. Code § 181*; *see* Assembly Select Comm. Rep., at 27]. They also drafted the General Corporation Law to impose the same shareholder approval

requirements on all reorganizations and to make any reorganization subject to the right of a dissenting shareholder to force the purchase of his or her shares [*see* Corp. Code §§ 1200-1313; *see also* Assembly Select Comm. Rep., at 27].

[b] Development of Doctrine

In a statutory merger, two or more corporations combine in the manner prescribed by statute, one of the corporations continues to exist as the same legal entity it was before the merger, and the other corporation or corporations to the merger are "merged" or absorbed into it [Cavitch, *Business Organizations With Tax Planning, Ch. 162, Mergers, § 162.01* (Matthew Bender)]. Under California's General Corporation Law, the corporations in a statutory merger are called the "constituent corporations" [*Corp. Code § 161*], the corporation that continues to exist and into which the other corporations are "merged" or absorbed is called the "surviving corporation" [*Corp. Code § 190*], and each corporation that is merged or absorbed into the surviving corporation is called a "disappearing corporation" [*Corp. Code § 165*]. On perfection of a statutory merger all the assets and properties of each of the disappearing corporations become the property of the surviving corporation [Corp. Code § 1107], and the shareholders of each disappearing corporation exchange their shares in the disappearing corporation for shares of the surviving corporation [*see Corp. Code § 1101*; *see also* Ch. 11, *Mergers*].

Practically the same result can be achieved by having one corporation exchange all its assets and properties for shares of another corporation and then dissolve, distributing the shares it receives from the acquiring corporation to its own shareholders in return for surrender of its own shares for cancellation. As a result of either a statutory merger or an exchange of assets for shares followed by dissolution of the selling corporation, the surviving corporation becomes owner of all the assets of the selling or disappearing corporation and the shareholders of the disappearing or selling corporation have exchanged their shares in it for shares of the surviving corporation [*see* Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares, 19 Cal. L. Rev. 349 (1931)*]. Either type of transaction, if properly conducted, should be an income tax-free reorganization to both corporations and their shareholders [*see* Rabkin & Johnson, FEDERAL INCOME, GIFT AND ESTATE TAXATION, ch. 32, *Reorganization Patterns*, § 32.03 (Matthew Bender)]. The result achieved by perfection of a statutory merger can also be achieved by having one corporation acquire all or at least 90 percent of the outstanding shares of another corporation in exchange for shares of its own, and then having it perfect a short-form merger with the corporation whose shares have been acquired [*see Corp. Code § 1110*]. A short-form merger is a merger of a wholly owned or 90-percent-owned subsidiary corporation into its parent corporation and does not require approval by the shareholders of the parent corporation [*Corp. Code § 1110*]. The corporation whose shares are acquired in exchange for shares of the acquiring corporation will become either a wholly owned or 90-percent-owned subsidiary of the acquiring corporation.

Prior to 1977 in California, shareholders of constituent corporations to a statutory merger had more protective rights than did shareholders of corporations that were parties to an assets-for-shares exchange or a straight share exchange. Although an assets-for-shares exchange had to be approved by the shareholders of the corporation whose assets were being acquired, it was not required to be approved by the shareholders of the acquiring corporation. Similarly, the shareholders of the corporation whose shares were being acquired had to approve a straight share exchange by tendering their shares for shares of the acquiring corporation to make the exchange successful. There was no requirement in California that the shares-for-shares exchange had to be approved by shareholders of the acquiring corporation. However, in either an assets-for-shares exchange or a shares-for-shares exchange the ownership and control of the acquiring corporation by its existing shareholders was bound to be diluted by the issuance of additional of its shares to the shareholders of the acquired corporation in exchange for the assets or shares of that corporation [Assembly Select Comm. Rep., at 94]. In contrast, a statutory merger had to be approved in California by shareholders of all the constituent corporations to the merger, that is, by both the disappearing corporations and the surviving corporation [*see* former Corp. Code § 4107].

The protective right afforded shareholders of constituent corporations to a statutory merger that raised the greatest furor, however, was the right of a dissenting shareholder to force purchase of his or her shares, because it was not also

afforded to shareholders of a corporation that was a party to an assets-for-shares exchange [*see* Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares*, *19 Cal. L. Rev. 349 (1931)*]. When a statutory merger was approved by the required vote of shareholders of a corporation, a dissenting shareholder who had not voted for the merger could force the corporation to purchase his or her shares for their fair market value on the day before shareholder approval of the merger [*see* former Corp. Code §§ 4300-4317]. A dissenting shareholder of a corporation that was exchanging all its assets for shares of another corporation and which planned to dissolve after the exchange and distribute the shares it had received in the exchange to its shareholders had no such right to require the purchase of his or her shares by either the corporation that was selling its assets or the corporation that was acquiring them [*see* Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares*, *19 Cal. L. Rev. 349 (1931)*].

The absence of this right of a dissenting shareholder in an assets-for-shares exchange caused the Pennsylvania Supreme Court to develop the de facto merger doctrine. The court held that an assets-for-shares exchange in which the selling corporation planned to dissolve after the exchange and distribute the shares it received in the exchange to its shareholders was in effect a "merger" subject to the dissenting shareholder statute of that state applicable to mergers [*Farris v. Glen Alden Corp. (1958) 393 Pa. 427, 143 A.2d 25, 31]* . A year later the Supreme Court of Delaware, although refusing to apply it in favor of a dissenting shareholder of the asset-acquiring corporation, labeled the doctrine pronounced by the Pennsylvania court the "doctrine of de facto merger" [*Heilbrunn v. Sun Chem. Corp. (1959) 38 Del. Ch. 321, 150 A.2d 755, 757]* . The label has since been used more or less consistently to identify the doctrine [*see* Fox & Fox, Corporate Acquisitions and Mergers, Ch. 5C, *Acquisitions of Assets*, § 5C.06 (Matthew Bender)].

[3] Internal Revenue Code

The underlying purpose of the Internal Revenue Code definition of "reorganization" [*see § 11.23[2]*] is different from the California Corporations Code purpose. Under general federal income tax principles, gain or loss must be accounted for upon the exchange of property [*I.R.C. §§ 61, 1001*]. In imposing income tax on the gross income of persons and entities subject to its provisions, the Internal Revenue Code provides that any gain or profit from the sale or exchange of property constitutes income and must be included in gross income. On the sale or exchange of property, the entire amount of the gain or loss is recognized as income, or the loss of income, for income tax purposes [I.R.C. § 1001(a), (c)].

In the Internal Revenue Code, the term "reorganization" is defined to provide the parties to an exchange reorganization with an exemption that will enable them to avoid recognizing income on exchanges incident to "qualified reorganizations." These qualified reorganizations must meet a business purpose requirement, and ordinarily also must meet a continuity of business enterprise requirement [*Treas. Reg. § 1.368-1(b)*; *see Treas. Reg. 1.368-1(d)* (defining continuity of business enterprise requirement)] and a continuity of interest requirement [*Treas. Reg. § 1.368-1(b)*; *see Treas. Reg. § 1.368-1(e)* (defining continuity of interest requirement); *but see* I.R.C. § 368(a)(1)(D) (exception). However, for transactions occurring on or after February 25, 2005, a continuity of the business enterprise and a continuity of interest are not required for the transaction to qualify as a reorganization in the case of a recapitalization [*see* I.R.C. § 368(a)(1)(E)] or a mere change in identity, form, or place of organization of one corporation [*Treas. Reg. 1.368-1(b)*; *see* I.R.C. § 368(a)(1)(F)].

I.R.C. § 368 is the definitional section that sets forth the requirements that a reorganization must meet in order to allow the parties to that reorganization to qualify for nonrecognition treatment. Thus, the Internal Revenue Code definition is intended to be *limiting*, because it allows an exception to the general rule that income will be recognized on all exchanges [*see I.R.C. §§ 61, 1001*]. In contrast, the purpose of the California Corporation Code is to *include* certain de facto merger type transactions in the requirements specified in the General Corporation Law that are normally applied to mergers [Assembly Select Comm. Rep., at 27]. In most instances, because of these differing purposes, the Internal Revenue Code definition generally is more restrictive and more strictly construed than is the General Corporation Law definition.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Mergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART II. LEGAL BACKGROUND

5-11 California Legal Forms--Transaction Guide § 11.23

§ 11.23 Meaning of "Reorganization"

[1] California Corporation Law

[a] Statutory Merger

The first type of acquisition method defined in the General Corporation Law as a "reorganization" is a statutory merger, also referred to in the code as a "merger reorganization" [*Corp. Code § 181(a)*]. Statutory mergers are discussed in detail in Ch. 11C, *Mergers* .

"Short-form mergers" (see below) under *Corp. Code § 1110* are specifically excluded from this definition [*Corp. Code § 181(a)*; *see Corp. Code § 187*, which defines "short-form merger" with reference to *Corp. Code § 1110*]. A short-form merger is a merger of a wholly owned or 90-percent-owned subsidiary corporation into its parent corporation [*Corp. Code §§ 187*, *1110*]. Short-form mergers are excluded from the definition of "reorganization" because shareholders involved in a short-form merger do not need the protection intended to be afforded by that definition. The relative rights of the shareholders of the disappearing corporation and the shareholders of the surviving corporation are not materially altered by a short-form merger. Because no more than 10 percent of the shares of the disappearing corporation in a short-form merger can be owned by persons other than the surviving corporation's shareholders in the surviving corporation, shareholder ownership interests are not greatly diluted by a short-form merger. For the same reason, disapproval of the short-form merger by the minority (10 percent or fewer) shareholders of the disappearing corporation could not prevent the merger even if it were defined as a "reorganization."

[b] Shares for Shares Exchange

The second type of acquisition defined by the General Corporation Law as a "reorganization" is a shares-for-shares exchange, also referred to in the Corporations Code as an "exchange reorganization" [*Corp. Code § 181(b)*]. An exchange reorganization is the acquisition by one domestic corporation, foreign corporation, or other business entity [*see Corp. Code § 174.5* ("other business entity" defined; basically includes limited liability companies, general and limited partnerships, business trusts, and other noncorporate entities)] of the shares of a second domestic corporation, foreign corporation, or other business entity in exchange (in whole or in part) for the equity securities of the acquiring corporation (or other entity) or a corporation in control of the acquiring corporation if, immediately after the acquisition,

the acquiring corporation has control of the other corporation or entity [*Corp. Code § 181(b)*]. For purposes of the reorganization definition, one corporation is in or has "control" of another corporation when it owns, directly or indirectly, shares or equity securities of the other corporation having the power to elect more than 50 percent of the other corporation's directors [*Corp. Code §§ 160(b), 194.5*]. Equity securities are shares or membership of a domestic or foreign corporation; partnership interests, membership interests, or equivalent equity interests in an other business entity; securities convertible with or without consideration into, and warrants or rights to subscribe to or purchase, any of the above [*Corp. Code § 168*].

A related type of acquisition that is not included in the definition of "reorganization" [*see Corp. Code § 181*] is a share exchange tender offer. That term includes any acquisition by one corporation in exchange in whole or in part for its equity securities (or the equity securities of a corporation that is in control of the acquiring corporation) of shares of another corporation, other than an "exchange reorganization" [*Corp. Code § 183.5*]. For further discussion, see *Ch. 11D, Acquisition of Shares for Shares, § 11D.22*.

[c] Assets for Shares Exchange

The third type of acquisition method defined by the General Corporation Law as a "reorganization" is an assets-for-securities exchange, also referred to in the Corporations Code as a "sale-of-assets reorganization" [*Corp. Code § 181(c)*]. A "sale-of-assets reorganization" is defined in *Corp. Code § 181(c)* as the acquisition by one domestic corporation, foreign corporation, or other business entity [*see Corp. Code § 174.5* ("other business entity" defined; basically includes limited liability companies, general and limited partnerships, business trusts, and other noncorporate entities)] of all or substantially all of the assets of another domestic corporation, foreign corporation, or other business entity, in exchange in whole or in part for one of the following:

- Its equity securities, or the equity securities of a domestic corporation, foreign corporation, or other business entity which is in control of the acquiring entity;

- Its debt securities, or the debt securities of a domestic corporation, foreign corporation, or other business entity which is in control of the acquiring entity, that are not adequately secured and have a maturity date in excess of five years after consummation of the reorganization; or

- Both of the above [*Corp. Code § 181(c)*].

Inadequately secured debt securities having a maturity date in excess of five years involve a degree of risk to the shareholders of an acquired corporation who are to receive them in a "sale-of-assets reorganization" similar to that of equity securities [Assembly Select Comm. Rep., at 28, 29]. Accordingly, an exchange of all assets of one corporation for those inadequately secured debt securities is included in the definition of a "reorganization" and the shareholders receiving them are afforded the same protection as shareholders receiving equity securities in such a transaction [Assembly Select Comm. Rep., at 28, 29].

[2] Internal Revenue Code

[a] Statutory Merger or Consolidation

The first method of corporate acquisition defined in the Internal Revenue Code as a "reorganization" for income tax purposes is "a statutory merger or consolidation" [*I.R.C. § 368(a)(1)(A)*]. Historically, in a consolidation, two or more corporations combined to form a new corporation that took over their assets and liabilities and carried on their activities. None of the old corporations survived the consolidation. In contrast, in a merger, one of the original corporations to the merger survives and the other corporations to the merger are combined or merged into it [*see* Cavitch, Business Organizations With Tax Planning, Ch. 162, *Mergers*, § 162.01 (Matthew Bender)]. California has eliminated the

concept of consolidation as an "outmoded procedure" [*see* Assembly Select Comm. Rep., at 91].

[b] Shares for Shares Exchange

The second method of corporate acquisition defined in the Internal Revenue Code as a "reorganization" for income tax purposes is a shares-for-shares exchange, called a "B reorganization" [*I.R.C. § 368(a)(1)(B)*]. Two statutory requirements are imposed on a shares-for-shares exchange before it can qualify as a "reorganization" under the Internal Revenue Code:

- First, the acquiring corporation must acquire stock of another corporation solely in exchange for all or a part of its own voting stock or the voting stock of a corporation that is in control of the acquiring corporation [*I.R.C. § 368(a)(1)(B)*].

- Second, immediately after the acquisition the acquiring corporation must be in control of the corporation whose stock it has acquired [*I.R.C. § 368(a)(1)(B)*].

Whether the acquiring corporation was or was not in control of the corporation whose stock it acquired before the acquisition qualifying as a "B reorganization" is immaterial [*I.R.C. § 368(a)(1)(B)*]. Control for purposes of the "reorganization" definitions means ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock of a corporation entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation [*I.R.C. § 368(c)*].

[c] Assets for Shares Exchange

The third method of corporate acquisition defined in the Internal Revenue Code as a "reorganization" for income tax purposes is an assets-for-shares exchange, called a "C reorganization" [*I.R.C. § 368(a)(1)(c)*]. For an assets-for-shares exchange to qualify as a "reorganization" under the Internal Revenue Code, the acquiring corporation must acquire substantially all the property of another corporation solely in exchange for all or a part of the acquiring corporation's voting stock or the voting stock of a corporation in control of the acquiring corporation [*I.R.C. § 368(a)(1)(c)*]. Furthermore, the acquired corporation must distribute the stock, securities, and other properties it receives, as well as its other properties, pursuant to the reorganization plan [*I.R.C. § 368(a)(2)(G)* (waiver available)].

In determining whether the exchange was solely for stock of the acquiring corporation or its parent, the assumption by the acquiring corporation of a liability of the acquired corporation will be disregarded [*I.R.C. § 368(a)(1)(c)*].

If a corporation acquires substantially all the property of another corporation for a combination of voting shares and money or other property, the exchange will still be considered a "reorganization" under the Internal Revenue Code if the property acquired solely in exchange for voting shares has a fair market value equal to at least 80 percent of the fair market value of all the property of the acquired corporation [*I.R.C. § 368(a)(2)(B)*]. In that case, however, if the property was acquired for a combination of shares and money, any assumption of liability by the acquiring corporation will be treated as money paid for the property [*I.R.C. § 368(a)(2)(B)*].

[d] Business Purpose, Continuity of Business Enterprise, and Continuity of Interest

In addition to the requirements imposed by statute, two additional requirements have been imposed by the courts and Treasury Regulations on corporate acquisitions before they can qualify as tax-free "reorganizations" under the definition contained in the Internal Revenue Code. First, there must be a "business purpose" for the merger, share exchange, or assets-for-shares exchange sought to be qualified as a reorganization. This requirement means that a bona fide business purpose for the reorganization must exist for the transaction and that a reorganization that meets all facial statutory requirements may not qualify for nonrecognition treatment if it done simply to avoid tax [*see* Gregory v. Helvering

(1935) 293 U.S. 465, 55 S. Ct. 266, 79 L. Ed. 596 (1935); Treas. Reg. § 1.368-1(b); *see also* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 176, *Tax-Free Reorganizations: General Rules*, § 176.02 (Matthew Bender)].

The second general requirement to qualify as a reorganization is "continuity of business enterprise" and "continuity of interest" [*see Treas. Reg. § 1.368-1(b)*; *but see* **Practice Tip**, *below* (exceptions)]. The continuity of business enterprise requirement means the acquiring corporation must either continue the acquired corporation's historic business or use a significant portion of the acquired corporation's historic business assets in a business [*Treas. Reg. § 1.368-1(d)(1)*]. Continuing the acquired corporation's business is satisfied if the acquiring corporation continues the historic business (typically the acquired corporation's last business before the reorganization). The fact that the acquiring corporation is in the same line of business tends to establish the requisite continuity, but is not alone sufficient [Treas. Reg. § 1.368-1(d)(2)(i)]. If the acquired corporation had more than one line of business, the acquiring corporation must only continue one significant line of business to satisfy the continuity of business interest requirement [*Treas. Reg. § 1.368-1(d)(2)(ii)*].

Using a significant portion of the acquired corporation's historic business assets in a business may also satisfy the continuity of business enterprise requirement. The acquired corporation's historic business assets are the assets used in its historic business. Business assets may include stock and securities and intangible operating assets such as good will, patents, and trademarks, whether or not they have a tax basis. In general, the determination of the portion of a corporation's assets considered "significant" is based on the relative importance of the assets to operation of the business. All other facts and circumstances, however, such as the net fair market value of those assets, will be considered. [*Treas. Reg. § 1.368-1(d)(3)(i)*-(iii)].

The continuity of interest requirement means that some proprietary interest of the acquired corporation must be preserved so that transactions that resemble sales do not qualify for nonrecognition treatment available to qualified reorganizations [*Treas. Reg. § 1.368-1(e)*]. For an extensive discussion of the business purpose, continuity of business enterprise, and continuity of interest requirements, see Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 176, *Tax-Free Reorganizations: General Rules*, § 176.02 (Matthew Bender).

PRACTICE TIP:

For transactions occurring on or after February 25, 2005, a continuity of the business enterprise and a continuity of interest are not required for the transaction to qualify as a reorganization in the case of a recapitalization [*see* I.R.C. § 368(a)(1)(E)] or a mere change in identity, form, or place of organization of one corporation [*Treas. Reg. 1.368-1(b)*; *see* I.R.C. § 368(a)(1)(F)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawTax-Free AcquisitionsTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART II. LEGAL BACKGROUND

5-11 California Legal Forms--Transaction Guide § 11.24

§ 11.24 Nontax Factors in Selecting Acquisition Method

[1] In General

The method used by a corporation to acquire ownership of another corporation depends on a number of factors. In most cases, final determination of the form in which a corporate acquisition should be made will be influenced primarily by income tax considerations [*see* Fox & Fox, Corporate Acquisitions and Mergers, Ch. 3, *Tax Factors in Corporate Acquisitions and Mergers*, § 3.01 (Matthew Bender); Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 173, *Choosing the Method of Transferring the Ownership of a Corporate Business*, § 173.02 (Matthew Bender); *see* 11.25].

Nevertheless, counsel should advise corporate clients and their shareholders regarding the business, financial, and legal problems involved in each of the acquisition methods. Even when tax factors alone dictate the form a particular corporate acquisition should take, the other factors involved in the acquisition method are still important and should be taken into account by the attorney handling the legal aspects of the acquisition [*see* Fox & Fox, CORPORATE ACQUISITIONS and MERGERS, Ch. 3, *Tax Factors in Corporate Acquisitions and Mergers*, § 3.01 (Matthew Bender); Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 173, *Choosing the Method of Transferring the Ownership of a Corporate Business*, § 173.02 (Matthew Bender)].

[2] Shareholder Approval

In California, any acquisition method coming within the definition of the term "reorganization" contained in the General Corporation Law [*Corp. Code § 181*; *see § 11.23[1]*] will require the approval by majority vote of the outstanding shares [*see* Corp. Code § 152] of each class of each corporation involved in the reorganization [*Corp. Code § 1201*]. Furthermore, when the acquisition comes within the definition of a reorganization contained in the General Corporation Law, dissenting shareholders who do not vote in favor of the proposed reorganization will have the right to force the corporations to purchase their dissenting shares for cash at their appraised fair market value on the day before the first announcement of the terms of the proposed reorganization [*Corp. Code § 1300*; *see* § 11.21[1][e]].

Shareholder approval, at least by the outstanding shares of the acquiring corporation, is not usually required for an acquisition *not* coming within the definition of a reorganization contained in the General Corporation Law [*see §*

11.22[2]]. However, the shareholders of the acquiring corporation in a "share exchange tender offer" [*see Corp. Code § 183.5* (definition)] are required to approve the principal terms of the offer in a manner similar to that in a "reorganization" [*see Corp. Code § 1201.5*; *see also Ch. 11D, Acquisition of Shares for Shares, § 11D.22*].

Dissenting shareholders ordinarily have no right to force the purchase of their shares in an acquisition not defined as a "reorganization" by the General Corporation Law.

[3] Rights of Target Corporation Shareholders

When an interested party makes a tender offer (including a share exchange tender offer [*see Corp. Code § 183.5* (definition); *see also Ch. 11D, Acquisition of Shares for Shares, § 11D.22*]) or a written proposal (an "interested party proposal") for approval of a "reorganization" [*see Corp. Code §§ 181, 1200*] or a sale of assets [*see Corp. Code § 1001(a)*] to some or all of a corporation's shareholders, that party must deliver an affirmative opinion in writing regarding the fairness of the consideration to those shareholders [*Corp. Code § 1203(a)*]. For purposes of this requirement, an "interested party" is a person who is a party to the transaction and meets any of the following criteria [*Corp. Code § 1203(a)*]:

- Directly or indirectly controls the corporation that is the subject of the tender offer or proposal;
- Is (or is controlled by) an officer or director of the subject corporation; or
- Is an entity in which a material financial interest [*see Corp. Code § 310(a)*] is held by any director or executive officer of the subject corporation.

The written opinion referred to above must be provided by a person who is not affiliated with the offeror and who, for compensation, engages in the business of advising others about the value of properties, businesses, or securities. The fact that the person giving the opinion previously has provided services to the offeror or a related entity, or is simultaneously engaged in providing advice or assistance regarding the proposed transaction in a manner that makes his or her compensation contingent on the success of the proposed transaction, is not deemed to affiliate that person with the offeror [*Corp. Code § 1203(a)*].

The opinion must be delivered to the shareholders in the following manner [*Corp. Code § 1203(a)*]:

- If no shareholder approval or acceptance is required for the reorganization or sale of assets, the opinion must be delivered to the corporation's board of directors no later than the time that consummation of the transaction is authorized and approved by the board of directors.
- If a tender offer is made to the corporation's shareholders, the opinion must be delivered to the shareholders when the tender offer is first made in writing to the shareholders. However, if the tender offer is commenced by publication and tender offer materials are subsequently mailed or otherwise distributed to the shareholders, the opinion may be omitted in that publication if it is included in the materials distributed to the shareholders.
- If a shareholders' meeting will be held to vote on approval of the transaction, the opinion must be delivered to the shareholders with the notice of the meeting [*see Corp. Code § 601*].
- If consents of all the shareholders entitled to vote are solicited in writing [*see Corp. Code § 603(a)*], the opinion must be delivered at the same time as the solicitation.
- If the consents of all shareholders are not solicited in writing, the opinion must be delivered to each

solicited shareholder before his or her consent is given, and to each nonsolicited shareholder when he or she is given notice of shareholder approval without a meeting [*see Corp. Code § 603(b)* (notices required for actions taken without a meeting)].

These requirements do not apply if the target corporation does not have shares held of record by 100 or more persons [*see Corp. Code § 605* (determination of shareholders of record)], or if the transaction has been qualified pursuant to *Corp. Code § 25113* (qualification of issuer transaction by permit) or *Corp. Code § 25121* (qualification of recapitalization or reorganization by permit), and no stop order [*see Corp. Code §§ 25140, 25143(a)*] is in effect regarding that qualification [*Corp. Code § 1203(a)*]. Further, these requirements do not apply to the cash purchase of shares [*Corp. Code §§ 181, 1203*; *see* Ch. 11A, *Cash Purchase of Shares*]. That acquisition method may be preferable, therefore, when the acquisition proposal is made by an interested party, because of the lack of reporting requirements [*see Corp. Code § 1203*].

A "later proposal" is a subsequent tender offer or written proposal for a reorganization subject to board approval [*see Corp. Code § 1200*], or a sale of assets [*see Corp. Code § 1001(a)*] that would require the vote or written consent of shareholders to the corporation or its shareholders [*Corp. Code § 1203(b)*]. If another person makes a "later proposal" at least 10 days before the date for acceptance of the tendered shares or the vote or notice of shareholder approval on the earlier interested party proposal, two requirements apply [*Corp. Code § 1203(b)*]:

- First, the shareholders must be informed of the later proposal, and the later offeror must forward any written material for this purpose to the shareholders at his or her expense [*Corp. Code § 1203(b)(1)*].

- Second, the shareholders must be given a reasonable opportunity to withdraw any vote, consent, or proxy previously given before the vote or written consent on the interested party proposal becomes effective, or a reasonable time to withdraw any tendered shares before the purchase of the shares pursuant to the interested party proposal [*Corp. Code § 1203(b)(2)*]. A delay of 10 days from the notice or publication of the later proposal will be deemed to provide a reasonable opportunity or time to effect that withdrawal [*Corp. Code § 1203(b)(2)*].

[4] Securities Laws

Another nontax factor that must be taken into account in selecting the method of conducting a corporate acquisition is the California Corporate Securities Law of 1968 [*Corp. Code § 25000 et seq.*]. Generally, any acquisition method coming within the definition of the term "reorganization" contained in the General Corporation Law will require qualification of the acquisition with the California Commissioner of Corporations [*Corp. Code §§ 25120-25122*], since those methods require the issuance and offer or sale of shares or securities by the acquiring corporation [*see Corp. Code § 181*; *see also § 11.23[1]*].

However, any change in the rights, preferences, privileges, or restrictions of or on outstanding securities, and any exchange of securities by the issuer with its existing security holders exclusively, will be exempt from the qualification requirement contained in *Corp. Code § 25120* if the transaction, had it involved the issuance of a new security containing the changed rights, preferences, privileges, or restrictions, or a new issuance of the exchange security, would have been exempt from qualification [*see Corp. Code § 25110*] as an issuer transaction [*10 Cal. Code Reg. § 260.103(a)*; *see Corp. Code § 25102*]. For example, the exchange of shares by an acquiring corporation exclusively with its existing shareholders will be exempt from qualification if the transaction, had it been a new issuance rather than an exchange, would have been exempt as a limited offering [*see Corp. Code § 25102(f)*] or a small offering [*see Corp. Code § 25102(h)*]. An acquisition method that does not require the issuance and offer or sale of securities by the acquiring corporation, such as the purchase of all assets for cash or the purchase of shares of the corporation sought to be acquired for cash does not require qualification of the acquisition with the Corporations Commissioner [*see Corp. Code § 25120*].

For a detailed discussion of the qualification and exemption of securities, including the preemption of state qualification or registration of "covered securities" as defined by the National Securities Markets Improvement Act of 1996 [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005); *see 15 U.S.C. § 77r*], see Ch. 6, *Securities Regulation Issues* ; *see also* Marsh & Volk, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS (Matthew Bender).

[5] Assumption of Liabilities

Another important nontax factor that should be considered in connection with a proposed corporate acquisition is whether the acquiring corporation is willing to assume the acquired corporation's liabilities [*see* Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 161, Review of Factors to Be Considered in Selecting Form of Acquisition, § 161.02* (Matthew Bender)]. Officers and shareholders of an acquiring corporation may be willing to assume the liabilities of the corporation being acquired that appear on the books and records of that corporation. They may not be willing to assume unknown and contingent liabilities, especially tort liabilities, of the acquired corporation. With the extension of products liability to business successors under certain circumstances, the scope of unknown liabilities can be substantial [*see Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 28, 136 Cal. Rptr. 574, 560 P.2d 3* ; *Fisher v. Allis-Chalmers Corp. (2002) 95 Cal. App. 4th 1182, 1188-1190, 116 Cal. Rptr. 2d 310* (manufacturer's successor in interest was not entitled to summary judgment because it failed to establish that its agreement to assume liabilities excluded plaintiff's product liability claim); *see also Ch. 11E, Acquisition of Assets for Shares, § 11E.24[4]*].

An acquiring corporation, by reason of the acquisition method used, may be required to assume the liabilities of an acquired corporation directly or indirectly. When, as in a statutory merger, it must assume the liabilities of the acquired corporation directly, it becomes liable for those liabilities itself. An acquiring corporation is said to have indirectly assumed the liabilities of an acquired corporation when, though it does not become liable for the acquired corporation's obligations itself, they may render the property or shares it purchased worthless. If one corporation acquires the shares of another corporation, either for cash or in a shares-for-shares exchange, the acquiring corporation is said to have indirectly assumed the obligations of the acquired corporation. In such a case, the acquiring corporation itself does not become liable for the obligations of the acquired corporation but the acquired corporation remains liable for them. A large undisclosed liability against the acquired corporation, possibly unknown at the time of the share purchase or share exchange, could render the acquired corporation insolvent and its shares, for which the acquiring corporation gave good value either in cash or shares of its own, valueless [*see* Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, Ch. 2A, General Considerations in Corporate Acquisitions and Mergers, § 2A.03* (Matthew Bender)].

[6] Number of Shareholders and Assets

Another nontax factor that may affect the method by which a corporate acquisition is consummated is the number of shareholders in the corporation sought to be acquired, and the mechanical convenience of perfecting the acquisition in a certain way. For example, if there are only a few shareholders of the corporation sought to be acquired, a simple purchase of their shares by the acquiring corporation may be the easiest and most convenient way to perfect the corporate acquisition. If the corporation sought to be acquired is a public corporation with a large number of shareholders, acquisition of their shares may be most difficult and expensive. In such a case, a purchase of its assets or a statutory merger is usually considered more practical.

Similarly, purchase of a corporation's assets or an exchange of its assets for shares of the acquiring corporation may require drafting, in addition to the agreement of sale and escrow instructions, separate conveyances for almost every asset being transferred [*see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.122[4]*]. In contrast, a statutory merger will require the drafting of relatively few, if any, instruments of conveyance [*see Corp. Code § 1107(a)*]. The surviving corporation in a statutory merger, however, must take all the assets and liabilities of each of the disappearing corporations. This may involve some unwanted assets of the disappearing corporations and perhaps onerous union contracts or sales agreements [see Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING,

Ch. 162, *Mergers*, § 162.05[3]. If the acquiring corporation is purchasing assets or acquiring assets in exchange for its own shares, it can usually specify certain assets or contracts of the acquired corporation that are not to be included in its purchase [*see* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 163, *Sales of Assets Transactions*, § 163.02 (Matthew Bender)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersRights of Dissenting ShareholdersMergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawSales of AssetsRights of Dissenting ShareholdersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsRights of Dissenting ShareholdersMergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART II. LEGAL BACKGROUND

5-11 California Legal Forms--Transaction Guide § 11.25

§ 11.25 Tax Factors in Selecting Acquisition Method

[1] Overview

A variety of income tax factors influences the selection of a corporate acquisition method. The acquiring corporation should determine whether it will receive a new income tax basis for the assets of the acquired corporation [*see* [2], *below*], and whether it will obtain the benefit of any "loss carryover" belonging to the acquired corporation [*see* [3], *below*]. The acquired corporation will be concerned with the immediate taxability of any gain or profit realized in the transaction [Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 173, Choosing the Method of Purchasing and Selling a Corporate Business, § 173.02* (Matthew Bender); *see § 11.21[2]*], and, if its assets are sold, the recapture of depreciation [*see Ch. 11B, Cash Purchase of Assets, § 11B.21[1]*] and the applicability of state sales and use tax [*see* [4], *below*].

[2] Income Tax Basis

[a] In General

The ability of the acquiring corporation to receive a new income tax basis for the assets of the acquired corporation is important for two reasons. First, basis determines the amount of gain realized that will be subject to income taxes when the taxpayer sells or otherwise disposes of the property. The gain a taxpayer realizes from the sale or other disposition of property is the excess of the amount realized from the sale over the taxpayer's adjusted income tax basis for the property [*I.R.C. § 1001(a)*].

Second, a taxpayer's income tax basis in a particular item of property used in the trade or business or held for the production of income determines the amount of the annual depreciation deduction the taxpayer may take for the property each year [*I.R.C. §§ 167(c), 168*]. A depreciation deduction is a deduction for the decrease in value of those types of property due to exhaustion, wear, and tear, and obsolescence [*I.R.C. § 167(c)*]. It is based on the presumption that property wears out, because of its use, over a period of years and must be replaced periodically [*see* Rabkin & Johnson, FEDERAL INCOME, GIFT AND ESTATE TAXATION, Ch. 45, *Depreciation and Credits on Real Estate*, § 45.01 (Matthew Bender)]. The taxpayer is allowed to deduct from otherwise taxable income a portion of the original income tax basis for the property each year until the full amount of that basis has been deducted. [*see I.R.C. §§ 167(a),*

168(a)]. If the subject property was placed in service after 1980, the number of years over which the depreciation allowance is spread is determined with reference to the statutory Accelerated Cost Recovery System (ACRS) or Modified Accelerated Cost Recovery System (MACRS) [*I.R.C. § 168*; *see also Ch. 53, Personal Property Leasing, § 53.20[8]*]. The higher a taxpayer's original basis for property, the greater the annual depreciation deduction [Rabkin & Johnson, FEDERAL INCOME, GIFT AND ESTATE TAXATION, Ch. 45, *Depreciation* and Credits on Real Estate, § 45.01 (Matthew Bender)].

[b] Obtaining New Basis for Assets

A taxpayer's income tax basis for property is generally its original cost [*I.R.C. § 1012*]. An acquiring corporation can obtain a new cost basis in the acquired corporation's assets through a taxable purchase of either assets or stock. If it purchases another corporation's assets, it receives a cost basis equal to the purchase price [*see Ch. 11B, Cash Purchase of Assets, § 11B.21[1]*]. If it purchases another corporation's shares, it receives a cost basis for those shares equal to their purchase price, but may also elect to step-up the basis of the acquired corporation's assets [*see I.R.C. § 338*; *see also Ch. 11A, Cash Purchase of Shares, § 11A.22[2], [3]*].

Different basis rules, however, apply to assets acquired in a "tax-free" reorganization [*see I.R.C. § 368*; *see also § 11.21[2][a]*]. The transferor of assets or shares in a tax-free acquisition receives a "substituted basis" for the shares received from the transferee (acquiring corporation) equal to its former basis in those assets or shares [*see I.R.C. § 358(a)*]. This amount is decreased by (1) the fair market value of any other property other than money received by the taxpayer, (2) the amount of money received by the taxpayer [*see I.R.C. § 358(d)* (assumption of liability)], and (3) the amount of loss recognized by the taxpayer on the exchange [*I.R.C. § 358(a)(1)(A)*]; the resulting amount is then increased by (1) any amount treated as a dividend, and (2) the amount of gain recognized by the taxpayer on the exchange other than amounts treated as a dividend [*I.R.C. § 358(a)(1)(B)*]. The acquiring corporation receives a "carry-over" basis in the assets or shares, equal to the transferor's former basis in those assets or shares [*see I.R.C. § 362*; *see also* Cavitch, Business Organizations With Tax Planning, Ch. 173, *Choosing the Method of Transferring the Ownership of a Corporate Business*, § 173.02 (Matthew Bender)]. The result of these basis rules is that any gain from property received in the reorganization is deferred until the property or stock is later disposed of or sold.

The transferor's basis, which is its original cost reduced by any depreciation deductions that were taken or could have taken during the period of ownership [*see I.R.C. § 1016*], may be far less than the fair market value that an acquiring corporation will generally pay in an acquisition. In those circumstances, an acquiring corporation may desire to obtain a new, higher income tax basis for the assets of the acquired corporation by structuring the acquisition as a taxable purchase rather than a tax-free reorganization. If, however, the basis of the assets in the hands of the transferor exceeds their present fair market value, the acquiring corporation may want to structure its acquisition as a tax-free reorganization in order to inherit the transferee's high basis [*see* Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, Ch. 3, Tax Factors in Corporate Acquisitions and Mergers, § 3.02[2]* (Matthew Bender)].

[c] Special Basis Rule for Assumption of Liabilities

If a transferee corporation assumes a liability of the transferor in a Section 351 transaction, the amount of liability assumed is treated as money received by the transferor [*I.R.C. § 358(d)(1)*], and the basis of the stock received by the transferor is reduced by this amount [*I.R.C. § 358(a)(1)*].

A special statutory rule applies, however, to prevent duplication or acceleration of loss through the assumption of liabilities [*I.R.C. § 358(h)*]. If the basis of the stock received by the transferor exceeds the fair market value of that stock, then the basis of the stock received is reduced (but not below its fair market value) by the amount of any liability that is assumed by another person as part of the exchange and did not otherwise reduce the transferor's basis of the stock by reason of the assumption [*I.R.C. § 358(h)(1)*]. Except as otherwise provided by regulation, this rule does not apply if the trade or business with which the liability is associated is transferred to the corporation as part of the exchange or if

substantially all of the assets with which the liability is associated are transferred to the corporation as part of the exchange [*I.R.C. § 358(h)(2)*].

For the above purposes, the term "liability" includes fixed or contingent obligations to make payment, without regard to whether they are otherwise taken into account under other provisions of the Internal Revenue Code [*I.R.C. § 358(h)(3)*]. The determination of whether a liability has been assumed is determined under *I.R.C. § 357(d)(1)*. Under that provision, a recourse liability is treated as assumed if, based on all facts and circumstances, the transferee has agreed to and is expected to satisfy that liability (or portion of it), whether or not the transferor has been relieved of the liability [*I.R.C. § 357(d)(1)(A)*].

A nonrecourse liability generally is treated as assumed by the transferee of any asset subject to that liability [*I.R.C. § 357(d)(1)(B)*]. The amount treated as assumed, however, is reduced by the lesser of two amounts. The first amount comes into play if the owner has other assets that are not transferred to the corporation and which are subject to that same recourse liability. The amount of that reduction is any amount of the liability which the owner has agreed with the transferee to, and is expected to, satisfy [*I.R.C. § 357(d)(2)(A)*]. The second amount is the fair market value of those assets retained by the owner (which may be less that the amount of the nonrecourse indebtedness to which the property is subject) [*I.R.C. § 357(d)(2)(B)*; *see I.R.C. § 7701(g)*].

[3] Income Tax Loss Carryover Deduction

[a] In General

Another important tax consideration in the choice of a method of corporate acquisition is the ability of the acquiring corporation to obtain the benefit of any "loss carryover" belonging to the acquired corporation [Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, Ch. 4, Tax-Free Acquisitions, § 4.07* (Matthew Bender)]. That tax attribute, among others [*see I.R.C. § 381(c)*], may survive changes in the ownership and structure of the corporation [*see I.R.C. § 381(a)*]. A corporation has a "net operating loss" in any taxable year if, subject to certain modifications [*see I.R.C. § 172(d)*], its deductions exceed its gross income [*see I.R.C. § 172(c)*]. It is allowed to "carry back" the loss and deduct it from the income attributable to each of its preceding two tax years, starting with the earliest of those years, until the entire amount of the loss has been deducted [*I.R.C. § 172(b)(1)(A)(i), (2)*; *see* I.R.C. § 172(b)(1)(H) (special rule for 2008 net operating losses); *see also* Rabkin & Johnson, FEDERAL INCOME, GIFT AND ESTATE TAXATION, Ch. 4, *Deductions: Taxes and Losses* , § 4.15[3] (Matthew Bender)]. If any amount of the loss still remains, the corporation can "carry over" the remainder of the loss and deduct it in turn from each of the 20 tax years following the loss until the full amount of the loss has been deducted [*I.R.C. § 172(b)(1)(A)(ii), (2)*]. The deduction is the aggregate of the carrybacks and carryforward to that year [*I.R.C. § 172(a)*].

[b] Obtaining Carryover of Acquired Corporation

An acquiring corporation will automatically succeed to the net operating loss carryover of an acquired corporation if it obtains the acquired corporation's assets in either (1) a tax-free "A," "C," "D," "F," or "G" reorganization [*I.R.C. § 381(a)(2)*; *see* Ch. 11C, *Mergers* ("A" reorganizations), Ch. 11E, *Acquisition of Assets for Shares* ("C" reorganizations)], or (2) a tax-free liquidation of a controlled subsidiary pursuant to *I.R.C. § 332* [*I.R.C. § 381(a)*]. However, *I.R.C. § 381* was not intended to affect the carryover treatment of tax attributes in corporate transactions that are not specified in that section [S. Rep. No. 83-1622, at 277 (1954); *see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 4, *Tax-Free Acquisitions*, § 4.07 (Matthew Bender)]. Therefore, it does not apply to the purchase of assets [*see* Ch. 11B, *Cash Purchase of Assets*], the purchase of shares [*see* Ch. 11A, *Cash Purchase of Shares*], or stock-for-stock ("B") reorganizations [*see I.R.C. § 381(a)(2)*; *see also* Ch. 11D, *Acquisition of Shares for Shares*]. However, in every case (that is, whether the reorganization or acquisition is tax-free or taxable), the amount of carried-over net operating loss that may be deducted annually by the receiving corporation is limited, and certain requirements must be met (such as continuing the loss corporation's business for two years) before any deduction may

be taken [*see I.R.C. § 382*].

In a taxable purchase of assets [*see* Ch. 11B, *Cash Purchase of Assets*], the transferor remains a completely separate entity that retains all of its own tax attributes. The acquiring corporation does not obtain the stock "control" of the corporation required for an *I.R.C. § 332* liquidation [*see I.R.C. § 381(a)(1)*; *see also I.R.C. § 332(b)(1)* (stock ownership requirements)], and therefore has no means of obtaining any loss carryover. It may wish to avoid structuring its acquisition as a taxable asset purchase if the corporation to be acquired has substantial favorable tax attributes, such as a large net operating loss carryover, but will want to do so if the transferor has substantial disadvantageous tax attributes [*see* Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, ch. 4, Tax-Free Acquisitions, § 4.07* (Matthew Bender)].

In a taxable purchase of stock [*see* Ch. 11A, *Cash Purchase of Shares*], if the acquiring corporation obtains stock having at least 80 percent of the total voting power of the stock of the acquired corporation and aggregate value equal to at least 80 percent of the total value of the stock of the acquired corporation (excluding, for each test, certain nonvoting, preferred, redeemable, nonconvertible stock) [*see I.R.C. §§ 332(b)(1), 1504(a)(2), (4)*], it may obtain any loss carryover of the acquired corporation by liquidating it [*I.R.C. § 381(a)(1)*; *see I.R.C. § 332*]. However, it cannot obtain the loss carryover through liquidation if it has already made an *I.R.C. § 338* election to step-up the basis of the acquired corporation's assets [Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, ch. 4, Tax-Free Acquisitions, § 4.07* (Matthew Bender); *see Ch. 11A, Cash Purchase of Shares, § 11A.22[5]*].

In order to accomplish a "B" reorganization [*see* Ch. 11D, *Acquisition of Shares for Shares*], the acquiring corporation must meet the same 80 percent "control" test that is required for an *I.R.C. § 332* liquidation [*see I.R.C. §§ 332(b)(1), 368(a)(1)(B), (c)*]. Therefore, the acquiring corporation may obtain the tax attributes of the acquired corporation through liquidation [*see I.R.C. § 332*]. The acquiring corporation is not dependent on *I.R.C. § 381* for preservation of its own tax attributes, since that section deals only with the tax characteristics of the transferor corporation [*see* Bittker & Eustice, Federal Income Taxation of Corporations and Shareholders, Ch. 16, *Corporate Tax Attributes: Survival and Transfer*, § 16.10 (Warren, Gorham & Lamont 4th ed. 1979)].

[c] Restrictions on Use of Carryover

In order to prevent the trafficking of corporate shells for the sole purpose of acquiring their loss carryovers to shelter income, the use of loss carryovers is restricted. First, *I.R.C. § 381* divides the taxable years of the transferor and transferee into a preacquisition and post-acquisition part year [*I.R.C. § 381(b)(1), (c)(1)(C)*]. The transferor's net operating loss carryover is first applied against any earnings from its pre-acquisition part year [*Treas. Reg. § 1.381(c)(1)-1(e)(3)*]. Any remainder is applied, to a limited extent, to the income of the transferee in its post-acquisition part year [*I.R.C. § 381(c)(1)*].

Second, the amount of taxable income of any "new loss corporation" that may be offset by "pre-change losses" in taxable years after a change in ownership may be limited [*I.R.C. § 382(a)*]. A "new loss corporation" is a corporation that, after an ownership change, is entitled to use a net operating loss carryover or has a net operating loss for the taxable year in which the ownership change occurs [*I.R.C. § 382(k)(1), (3)*; *see I.R.C. § 172(b)*]. An "old loss corporation" is a corporation that has undergone an ownership change and was a loss corporation before the change [*I.R.C. § 382(k)(1), (2)*]. An "ownership change" occurs when, after either a statutory reorganization [*see I.R.C. § 368(a)(1)(A), (B), (C)*] or a change in stock ownership affecting the percentage of stock owned by any person who is a 5-percent shareholder before or after the change, the percentage of stock of the loss corporation owned by one or more 5-percent shareholders has increased by more than 50 percent over the lowest percentage of stock in the loss corporation owned by those shareholders during the three-year period ending on the date of the reorganization or change in stock ownership [*I.R.C. 382(g)*; *see I.R.C. § 382(i)*]. A "pre-change loss" is (1) any net operating loss carryover of the old loss corporation to the taxable year ending with the ownership change or in which the ownership change occurs, and (2) the net operating loss of the loss corporation for the taxable year in which the ownership change occurs, to the extent the

loss is allocable to the period on or before the change date [*I.R.C. § 382(d)*].

The limitation on the net operating loss carryover for a post-change year equals the value of the stock of the old loss corporation immediately before the ownership change, multiplied by the highest federal long-term rate in effect for any month in the three-calendar-month period ending with the month of ownership change [*I.R.C. § 382(b)(1)*; *see I.R.C. § 382(e), (f)*]. If the limitation exceeds the taxable income of the new loss corporation for one post-change taxable year, the limitation for the next taxable year will be increased by the amount of the excess [*I.R.C. § 382(b)(2)*].

No net operating loss carryover may be used by a new loss corporation that does not continue the business enterprise of the old loss corporation at all times during the two-year period following the change date [*I.R.C. § 382(c)(1)*]. Exceptions apply for certain gains [*see I.R.C. § 382(c)(2), (h)*].

Finally, a subjective test imposed under *I.R.C. § 269*, based on the acquiring corporation's motives in making the acquisition, may result in complete disallowance of the loss carryover deduction [*see I.R.C. § 269*]. The deduction may not be allowed if (1) one or more persons acquires control of a corporation directly or indirectly, or a corporation acquires property from another corporation, in a transaction in which the basis of the acquired property is determined by reference to the basis of the property to the transferor corporation, and (2) the principal purpose of the acquisition is the avoidance of federal income tax by obtaining a deduction that the person or corporation would otherwise not obtain [*I.R.C. § 269(a)*].

"Control" is the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock [*I.R.C. § 269(a)*]. Special rules apply to purchases of stock in which the acquiring corporation elects to step-up the basis of the acquired assets pursuant to *I.R.C. § 338* and then liquidates the acquired corporation [*I.R.C. § 269(b)*; *see Ch. 11A, Cash Purchase of Shares, § 11A.22[5]*]. However, *I.R.C. § 382* occupies the principal role in the loss-carryover area, and *I.R.C. § 269* will not be applied to cases in which part or all of the loss is permitted under *I.R.C. § 382* unless a device or scheme to circumvent the latter section appears to be present [S. Rep. No. 94-938, at 206 (1976)].

[4] California Sales and Use Tax Considerations

[a] Applicability to Certain Acquisition Methods

The application of the California Sales and Use Tax Law [*see Rev. & Tax. Code §§ 6001-7176*] may also affect a corporation's choice of method to acquire ownership of another corporation. That law imposes a tax on the gross receipts of a retailer from the sale of tangible personal property sold at retail in the state [Rev. & Tax. Code § 6051 et seq.; *see* Ch. 17, *Buying and Selling a Business or Professional Practice*, § 17.12]. Whether or not this tax will be imposed depends on the type of merger.

[b] Cash Purchase of Assets

The sale of all assets by one corporation to another for cash or promissory notes [*see* Ch. 11B, *Cash Purchase of Assets*] is a de facto merger for franchise tax purposes, and the proceeds of those assets that are tangible personal property sold at retail are subject to the California sales tax. Even if the transferor corporation immediately dissolves, the sale is still taxable [S.T.C. Rule 395.2120 (Mar. 9, 1966)]. For further discussion of the imposition of sales tax on the transaction, see Ch. 11B, *Cash Purchase of Assets*, § 11B.22[3]; Ch. 17, *Buying and Selling a Business or Professional Practice*, § 17.12.

[c] Cash Purchase of Shares

The purchase of one corporation's shares by another acquiring corporation [*see* Ch. 11A, *Cash Purchase of Shares*] has no sales tax consequences. Shares of stock are not tangible personal property [*see Rev. & Tax. Code § 6016*

(definition)], and thus are not subject to the sales or use tax [*see Rev. & Tax. Code § 6051*].

[d] Statutory Mergers

A transfer of property of a constituent corporation to a surviving or new corporation pursuant to a "statutory merger" is not subject to the state sales or use tax [*18 Cal. Code Reg. § 1595(b)(3)*]. For purposes of the regulation, a statutory merger includes one made under Corp. Code § 1100 et seq. [see 18 Cal. Code Reg. § 1595(b)(3)].

[e] Acquisition of Shares for Shares

A reorganization in which all of the shares of a corporation are exchanged for the shares of an acquiring corporation is not subject to sales tax liability. In this type of merger, known as a "B-type" reorganization under the federal income tax statutes [*see I.R.C. § 368(a)(1)(B)*; *see also § 11.23[2][b]*] and an "exchange reorganization" under California law [*see Corp. Code § 181(b)*; § 11.23[1][b]; *see also* Ch. 11D, *Acquisition of Shares for Shares*], the only property transferred is stock, which is not tangible personal property [*see Rev. & Tax. Code § 6016* (definition of tangible personal property)].

[f] Acquisition of Assets for Shares

A reorganization in which all of the assets of a corporation are acquired for the stock of another corporation, known as a "C-type" reorganization under the federal income tax statutes [*see I.R.C. § 368(a)(1)(C)*; *see also § 11.23[2][c]*] and a "sale of assets" reorganization under the California Corporations Code [*see Corp. Code § 181(c)*; § 11.23[1][c] is subject to the California sales tax unless the transaction is otherwise exempt [*see* Ch. 11E, *Acquisition of Assets for Shares*, § 11E.112; *see also* Ch. 17, *Buying and Selling a Business or Professional Practice*, § 17.12].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Tax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)Changes in Corporate OwnershipTax LawFederal Taxpayer GroupsC CorporationsLiquidations (IRC secs. 331-338)Tax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)General OverviewTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)CarrybacksTax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)General OverviewTax LawFederal Income Tax ComputationDeductions for Amortization, Depletion & DepreciationAmortization, Cost Recovery & Depreciation (IRC secs. 167-169, 171, 178, 194-195, 197, 216, 248, 280F)Accelerated Cost Recovery SystemTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)Carryforwards



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART II. LEGAL BACKGROUND

5-11 California Legal Forms--Transaction Guide § 11.26

§ 11.26 Accounting Treatment of Corporate Acquisition

[1] Accounting Methods

The selection of the method to be used in a corporate acquisition historically was governed to some extent by the accounting treatment given to the results of the acquisition method used [Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 161, Review of Factors to Be Considered in Selecting Form of Acquisition, § 161.15* (Matthew Bender)]. The method used by accountants in preparing the financial statements for a corporate merger or fusion was the subject of some controversy [Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, Ch. 31, Accounting for an Acquisition, § 31.02[1]* (Matthew Bender); *see* [4], *below*]. Historically, two methods of accounting were used to reflect the results of a corporate acquisition: the pooling of interest method and the purchase method.

However, the Financial Accounting Standards Board (FASB), the ruling body of the American Institute of Certified Public Accountants (AICPA), eliminated "pooling" accounting [described in [2], *below*], in business combinations effective July 1, 2001 [*see* FASB Statement No. 141, *Business Combinations*; *see also* Fox & Fox, CORPORATE ACQUISITIONS and MERGERS, ch. 31, *Accounting for an Acquisition*, § 31.02 (Matthew Bender); Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 161, *Review of Factors to Be Considered in Selecting Form of Acquisition*, § 161.15]. Although under the FASB's new rule pooling accounting is eliminated, the impact of this change is not as significant as it might seem, because goodwill will not generally have to be amortized. Companies may continue to reflect goodwill on their books as long as the goodwill maintains its value [*see* Fox & Fox, CORPORATE ACQUISITIONS and MERGERS, ch. 31, *Accounting for an Acquisition*, § 31.02 (Matthew Bender); *see also* [4], *below*].

[2] Former Pooling of Interest Method

In the pooling of interest method of accounting, the assets and liabilities of the acquired corporation as they appeared on the books of that corporation on the date of its acquisition were simply carried over to the books of the acquiring corporation and "pooled" with its assets and liabilities [Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, Ch. 31, Accounting for an Acquisition, § 31.02[2]* (Matthew Bender)]. The amount the acquiring corporation paid for the acquired corporation and its assets was immaterial. The assets of the acquired corporation were simply transferred to the account books of the acquired corporation at the same value they had on the books of the acquired corporation [*see*

Note, *Accounting for Business Combinations: A Critique of APB Opinion Number 16, 23 Stan. L. Rev. 330, 339 (1971)*]. The Financial Accounting Standards Board (FASB), the ruling body of the American Institute of Certified Public Accountants (AICPA) eliminated "pooling" accounting in mergers and acquisitions effective July 1, 2001 [*see* FASB Statement No. 141, *Business Combinations*]. For further discussion of this former accounting method, see Fox & Fox, CORPORATE ACQUISITIONS and MERGERS, ch. 31, *Accounting for an Acquisition*, § 31.03 (Matthew Bender).

[3] Purchase Method

In the purchase method of accounting, the assets and liabilities of the acquired corporation are treated on the accounting books of the acquiring corporation as if they had been purchased by the acquiring corporation. Each asset of the acquired corporation is entered on the books of the acquiring corporation at the price the acquiring corporation paid, or is presumed to have paid, to the acquired corporation or its shareholders for that asset [Note, *Accounting for Business Combinations: A Critique of APB Opinion Number 16, 23 Stan. L. Rev. 330, 338 (1971)*]. The price the acquiring corporation is presumed to have paid for each of the tangible assets of the acquired corporation is not the value at which that asset was carried on the books of the acquired corporation, but the fair market value of the asset on the date of the corporate acquisition [Note, *Accounting for Business Combinations: A Critique of APB Opinion Number 16, 23 Stan. L. Rev. 330, 338 (1971)*]. If the cost of acquisition is greater than the sum of the amounts allocated to assets less liabilities assumed, the remainder is to be recorded as goodwill. If the costs figure is less than the sum of the values allocated, negative goodwill may result [Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, ch. 31, Accounting for an Acquisition, § 31.04[2]* (Matthew Bender)].

For a detailed discussion of the purchase method, see Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, ch. 31, Accounting for an Acquisition, § 31.04* (Matthew Bender)].

[4] Effect on Financial Position

[a] Future Earnings

Use of the purchase method generally has an adverse effect on future earnings. Because the tangible assets of the acquired corporation are listed on the books and financial statements of the acquiring corporation at their fair market value on the date of the corporate acquisition, which is usually higher than the value at which they were carried on the books of the acquired corporation, accounting principles require that value be used in depreciating them on the books of the acquiring corporation. Thus, the earnings of the acquiring corporation will be reduced each year on its books and financial statements by a higher charge for depreciation of the tangible assets received from the acquired corporation under the purchase method of accounting than they would under the pooling of interests method of accounting [Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, ch. 31, Accounting for an Acquisition, § 31.02[3]* (Matthew Bender)].

Prior to the FASB's new rule, the negative effect on earnings was compounded by the goodwill factor in purchase accounting. Each year earnings would be reduced on the books and financial statements of the acquiring corporation by a depreciation or amortization charge for the price paid by it for the goodwill of the acquired corporation. Under the pooling method of accounting, no value or only a nominal value having been entered on the books of the acquired corporation for its goodwill, no value or only a nominal value was listed on the books of the acquiring corporation for the goodwill of the acquired corporation [Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, ch. 31, Accounting for an Acquisition, § 31.02[3]* (Matthew Bender)].

The adoption of purchase accounting as the only permissible method for reporting mergers and acquisitions [*see* [1], *above*], however, has altered the way in which goodwill is treated. Under the new rule, companies are not permitted to amortize goodwill at all until it becomes impaired [*see* FASB Statement No. 142, *Goodwill and Other Intangible Assets*

]. Assuming there is no impairment, the purchaser does not have to amortize goodwill and reflect on its books a charge against its earnings. Since earnings are the principal measure of stock prices, it was thought that the new rule would, on balance, be beneficial. That has not been the case recently as many companies, particularly in technology areas, found they could not generate sufficient cash flow to sustain the goodwill on their books (*i.e.*, impairment resulted under the new rule). From the standpoint of performing adequate due diligence investigations, lawyers representing the parties in an acquisition or merger need to determine, with the help of accountants and other financial experts, whether there is the need to consider a write-off of impaired goodwill or whether such a write-off is likely in the near future [Fox & Fox, CORPORATE ACQUISITIONS and MERGERS, ch. 31, *Accounting for an Acquisition*, §§ 31.02[3], 31.03, 31.05 (Matthew Bender)].

[b] Income Tax Returns

Use of either the purchase method or pooling of interests method will have little or no effect on the amount of earnings of the acquiring corporation appearing on its income tax returns. Goodwill is not depreciable for income tax purposes and the amount of depreciation the acquiring corporation may claim for the tangible assets it received from the acquired corporation will depend on its income tax basis for those assets which, in turn, will depend on the method by which its acquisition of those assets and the acquired corporation was consummated [*see § 11.25[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset Acquisitions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART II. LEGAL BACKGROUND

5-11 California Legal Forms--Transaction Guide §§ 11.27-11.99

[Reserved]

§§ 11.27[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11 California Legal Forms--Transaction Guide

NOTE:

This guide provides a general listing of facts and documents geared toward making the types of determinations that are the focus of this chapter; specifically, the selection of the most advantageous method of acquisition. Detailed facts and documents for each specific type of acquisition method, for use in actually carrying out the type of transaction selected, are set forth in Ch. 11A, *Cash Purchase of Shares* , throughCh. 11E, *Acquisition of Assets for Shares* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11 California Legal Forms--Transaction Guide § 11.100

§ 11.100 Facts--Acquiring Corporation

1. Exact name as it appears on its articles of incorporation as last amended.

2. State and date of incorporation.

3. Address and telephone number of principal executive office.

4. Name, address, and telephone number of officers and directors.

5. Name, address, and telephone number of accountant.

6. Date, time, and place where board of directors will meet to consider acquisition.

7. Credit rating and financial standing.

8. Type of business in which corporation is engaged.

9. Brief business history.

10. Fiscal and tax year.

11. Number of shares of each class and series that corporation is authorized to issue.

12. Number of shares of each class and series outstanding.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11 California Legal Forms--Transaction Guide § 11.101

§ 11.101 Facts--Corporation Sought to Be Acquired

1. Exact name as it appears on its articles of incorporation as last amended.

2. State and date of incorporation.

3. Address and telephone of principal executive office.

4. Name and address of stock transfer agent, if any.

5. Name, address, and telephone number of officers.

6. Any connections or affiliations officers have with acquiring corporation.

7. Telephone numbers of corporate secretary and other corporate officers negotiating transaction.

8. Type of business or types of businesses in which corporation is engaged.

    a. Type of business subject to Uniform Commercial Code--Bulk Sales Division [*see Com. Code §§ 6101-6111*].

    b. Type of business requiring license from State of California or federal government.

9. Brief business history.

10. All business names and addresses used within the past three years.

11. Whether a state sales tax permit has been obtained from California State Board of Equalization.

12. Number and types of shareholders:

a. Classes and series of shares outstanding.

b. Classes and series of shares outstanding that are entitled to vote for directors.

c. Number of shares of each class and series that are outstanding.

d. Number of shareholders owning corporate shares.

13. Present approximate market value of shares of corporation of each class and series.

14. Name, address, and telephone number of accountant.

15. Fiscal and tax year.

16. Any securities exchanges on which shares of corporation sought to be acquired are listed.

17. Known liabilities, if any, of corporation sought to be acquired that are to be assumed by its shareholders or principal shareholders.

18. General solvency and financial condition.

19. Any pending actions, litigation, or other proceedings.

20. Whether corporation was validly formed and is still in good standing.

a. Whether articles of incorporation were properly filed [*see* Ch. 3, *Articles of Incorporation*].

b. Whether corporation has been suspended for failing to pay franchise tax or file franchise tax returns [*see Rev. & Tax. Code §§ 23301, 23301.5*].

c. Whether corporation has filed required annual statement of officers and directors with Secretary of State [*see Corp. Code § 1502*].

21. Whether any requirements or limitations regarding share transfer are contained in articles of incorporation or bylaws of corporation sought to be acquired.

22. Whether any restrictions on acquisition of corporate control, transfer of shares, or tender offers are imposed by any stock exchange on which shares of corporation sought to be acquired are listed.

23. Accounting treatment of goodwill on books after proposed acquisition, and whether write-off of impaired goodwill is likely [*see* § 11.26[4], *above*].

Legal Topics:

For related research and practice materials, see the following legal topics:

Mergers & Acquisitions LawTaxable AcquisitionsStock Acquisitions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11 California Legal Forms--Transaction Guide § 11.102

§ 11.102 Facts--Proposed Acquisition

1. Acquiring corporation's principal reason for purchasing corporation sought to be acquired:

    a. To acquire all or particular assets of corporation.

    b. To acquire net operating loss carryover deduction of corporation.

    c. To acquire name, goodwill, and reputation of corporation.

    d. Other reasons.

2. Whether specific type of acquisition method already has been selected:

    a. Cash purchase of shares.

    b. Cash purchase of assets.

    c. Merger.

    d. Acquisition of shares for shares.

    e. Acquisition of assets for shares.

3. Whether any negotiations have taken place concerning proposed acquisition with management or principal shareholders of corporation sought to be acquired.

a. Names and telephone numbers of persons or corporate officers who conducted negotiations for acquiring corporation.

b. Names and addresses and telephone numbers of persons or officers who conducted negotiations for corporation sought to be acquired or its shareholders.

c. Results of negotiations.

d. Attitude of management and board of directors of corporation sought to be acquired toward proposed acquisition.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11 California Legal Forms--Transaction Guide § 11.103

§ 11.103 Documents

1. Articles or certificates of incorporation (as most recently amended) of both corporations.

NOTE:
If the management of the corporation sought to be acquired is not cooperative, copies of the articles of incorporation as most recently amended can be obtained from the Secretary of State's office in Sacramento.

2. Bylaws (as most recently amended) of both corporations.

3. Stock certificate book and stock record book of corporation sought to be acquired.

4. Any stock subscription or stock purchase agreements.

5. Latest available financial statements of both acquiring and selling corporations.

6. Any recorded deeds of trust or other instruments encumbering any of assets of corporation sought to be acquired.

7. Any financing statements filed with Secretary of State in which corporation sought to be acquired is named as debtor.

8. Any loan agreements, mortgages, or other executory contracts.

9. Leases to which corporation to be acquired is party, either as lessee or lessor.

10. Deed for each piece of real property owned by corporation to be acquired.

11. Collective bargaining agreements between corporation to be acquired and any labor unions.

12. Any franchise or licensing agreements to which corporation to be acquired is party, whether as franchisor, franchisee, licensor, or licensee.

13. All employment contracts to which corporation to be acquired is party.

14. All employment benefit contracts and profit-sharing plan agreements of corporation to be acquired.

15. Any other instruments obtainable relating to financial affairs or properties of corporation sought to be acquired.

16. Securities permit to issue shares or notices of issuance under exemption.

17. Any orders, judgments, or decrees of any court or administrative agency restricting or suspending authority of corporation or officers to issue or sell securities.

18. Most recent financial statements and balance sheets.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11 California Legal Forms--Transaction Guide §§ 11.104-11.109

[Reserved]

§§ 11.104[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11 California Legal Forms--Transaction Guide

NOTE:

The following sections provide a basic list of the advantages and disadvantages of each of the five acquisition methods, to aid in selecting the most advantageous method for a particular transaction. For a chart comparing the primary features of each method, see *§ 11.200*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11 California Legal Forms--Transaction Guide § 11.110

§ 11.110 Determining Whether to Structure Transaction as Cash Purchase of Shares

1. Evaluate advantages of cash purchase of shares:

NOTE:
For a detailed list, see *Ch. 11A, **Cash Purchase of Shares**, § 11A.111*.

a. Approval by shareholders of purchasing corporation is not required.

b. Formal meeting of shareholders of corporation sought to be acquired to approve sales of shares is not required.

c. Approval by board of directors of corporation sought to be acquired is not needed.

d. Consideration to be paid for shares, as agreed on by purchasing corporation and selling shareholders, may consist of cash or cash and other combinations of cash, notes, debt securities, shares, etc.

e. Acquiring corporation is not liable for debts or liabilities of acquired corporation.

f. Name and reputation of acquired corporation may be continued as separate entity.

g. Shareholders of acquiring corporation are not subject to dilution of ownership interest.

h. Acquired corporation may continue to use its net operating loss carryforward in certain circumstances.

i. Mechanics of transfer are simple if shareholders are few in number:
(1) Uniform Commercial Code--Bulk Sales Division is not applicable [*see Com. Code § 6101 et seq.*].

(2) Purchase price is not withheld until sales tax and employment contribution clearance are received [*see Rev. & Tax. Code § 6811*; *Unemp. Ins. Code § 1731*; *see also Ch. 11B, Cash Purchase of Assets, § 11B.112[5]*].

(3) Separate instruments of conveyance are not needed for personal and real property.

(4) Leases and contracts belonging to acquired corporation do not need to be assigned.

j. Transaction is not subject to California Sales and Use Tax.

2. Evaluate disadvantages of cash purchase of shares:

NOTE:
For a detailed list, see *Ch. 11A, **Cash Purchase of Shares,** § 11A.112*.

a. Shareholders of acquired corporation must pay income tax on any gain realized on sale of their shares to acquiring corporation [*see I.R.C. § 1001*].

b. Acquiring corporation does not automatically receive new income tax basis for assets of acquired corporation.

c. Acquiring corporation normally cannot use net operating loss carryover income tax deduction of acquired corporation to reduce its own income.

d. Unknown and contingent liabilities of acquired corporation may reduce value of its shares below purchase price paid by acquiring corporation.

e. Minority shareholders of acquired corporation who refuse to sell their shares may hinder future corporate operations.

f. Securing purchase of all, or substantially all, shares of corporation sought to be acquired may be unduly expensive and burdensome if shareholders are numerous and geographically scattered, or its management opposes purchase.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawTax-Free Acquisitions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11 California Legal Forms--Transaction Guide § 11.111

§ 11.111 Determining Whether to Structure Transaction as Cash Purchase of Assets

1. Evaluate advantages of cash purchase of assets:

NOTE:
For a detailed list, see Ch. 11B, ***Cash Purchase of Assets***, § 11B.111.

a. Acquiring corporation gets new income tax basis for assets purchased from selling corporation.

b. Acquiring corporation is not required to assume any liabilities of selling corporation, except strict liability in tort for defective products.

c. Shareholder approval of purchase by shareholders of acquiring corporations is not required.

d. Neither dissenting shareholders of acquiring corporation nor dissenting shareholders of selling corporation have right to require purchase of shares.

e. Acquiring corporation may reject obsolete or worthless assets of selling corporation, including long overdue accounts receivable.

f. Transaction is not subject to California securities laws.

2. Evaluate disadvantages of cash purchase of assets:

NOTE:

For a detailed list, see Ch. 11B, ***Cash Purchase of Assets***, § 11B.112.

a. Sale proceeds may be subject to tax at both corporate and shareholder level if proceeds are distributed to shareholders [*I.R.C. § 61, 301, 1001*].

b. California state sales tax must be paid on portion of sale proceeds received for fixtures and equipment used in activity requiring sales tax permit from California State Board of Equalization [*see Rev. & Tax. Code § 6051 et seq.*].

c. Acquiring corporation is not entitled to benefit of net operating loss carryover income tax deduction belonging to selling corporation [*see I.R.C. § 381*].

d. Sale may require compliance with requirements of Uniform Commercial Code--Bulk Sales Division [*see Com. Code § 6101-6111*].

e. Sales proceeds must be withheld in escrow to protect acquiring corporation from liability under successor liability statutes for amounts owed by selling corporation for sales tax or unemployment compensation insurance contributions [*see Rev. & Tax. Code §§ 6811, 6812*; *see also Unemp. Ins. Code §§ 1731, 1732*].

f. Acquiring corporation may be subject to products liability claims for injuries subsequently caused by products originally sold by the selling corporation.

g. Separate documents of conveyance or transfer must be drafted, executed, and registered or recorded for personal and real property.

h. Sale may require obtaining consent from third person or corporation to assign or transfer lease or other contracts.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsMergers & Acquisitions LawSales of AssetsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11 California Legal Forms--Transaction Guide § 11.112

§ 11.112 Determining Whether to Structure Transaction as Merger

1. Evaluate advantages of merger:

NOTE:
For a detailed list, see *Ch. 11C, **Mergers,** § 11C.100[1]*.

a. Mechanical simplicity.
(1) Filing merger agreement with Secretary of State perfects merger [*Corp. Code § 1103*].

(2) On perfection, surviving corporation succeeds without further transfer to all rights and properties of each disappearing corporation to merger [*Corp. Code § 1107(a)*].

(3) Surviving corporation need not pay any local agency transfer fees for licenses, permits, registrations, and other privileges if merger does not result in a change of ownership [*Corp. Code § 1107(b).*

b. Minority shareholders' only method of objecting to merger is sale of shares back to corporation [*see Corp. Code § 1312(a)*].

c. Effective date of merger can be controlled [*see Corp. Code § 110(c)*].

d. Income tax advantages, including:

(1) No taxable gain to shareholders or surviving corporation [*I.R.C. § 354(a)(1)*].

(2) No requirement that only voting shares of surviving corporation can be exchanged for shares and assets of disappearing corporations in tax-free merger [*see I.R.C. § 368(a)(1)(A)*; *cf. I.R.C. § 368(a)(1)(B)* (shares-for-shares exchange), (C) (assets-for-shares exchange)].

(3) Surviving corporation succeeds to any net operating loss carryover belonging to disappearing corporation [*see I.R.C. § 381(a)(2), (c)(1)*].

(4) Transaction is not subject to California Sales and Use Tax [*see 18 Cal. Code Reg. § 1595(b)(3)*].

2. Evaluate disadvantages of merger:

NOTE:
For a detailed list, see Ch. 11C, ***Mergers***, § **11C.100[2]**.

a. Surviving corporation automatically becomes liable for debts and liabilities of each disappearing corporation [*see Corp. Code §§ 1107(a), 1110(a)*].

b. Outstanding shares of each class of each constituent corporation must usually approve principal terms of merger [*Corp. Code § 1201*].

c. Dissenting shareholders may require that corporation purchase their shares at fair market value on day preceding first announcement of terms of proposed merger [*Corp. Code § 1300*].

d. Offer or sale of securities to be issued or exchanged in merger must comply with securities laws [*see Corp. Code § 25120*].

e. Disappearing corporation will lose name and identity in merger, unless surviving corporation changes its name to that of disappearing corporation [*see Corp. Code § 1101(b)*].

f. Surviving corporation will not obtain new income tax basis for assets of disappearing corporation [*I.R.C. § 362(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersRights of Dissenting ShareholdersMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11 California Legal Forms--Transaction Guide § 11.113

§ 11.113 Determining Whether to Structure Transaction as Acquisition of Shares for Shares

1. Evaluate advantages of acquisition of shares for shares:

NOTE:
For a detailed list, see *Ch. 11D, **Acquisition of Shares for Shares**, § 11D.111*.

a. Mechanical simplicity:
(1) Compliance with escrow and notice requirements of Uniform Commercial Code--Bulk Sales Division is not required [*see Com. Code § 6101 et seq.*].

(2) Separate instruments of conveyance need not be drafted, executed, and recorded for various assets of acquired corporation.

b. Approval of board of directors and management of corporation sought to be acquired is not needed.

c. Acquiring corporation is not liable after share exchange for debts, liabilities, and obligations of acquired corporation.

d. Separate identity and goodwill of acquired corporation are preserved after share exchange.

e. Dissenting shareholders of corporation sought to be acquired have no right to require their shares to be purchased for cash at their appraised fair market value.

f. Income tax advantages:

(1) Share exchange can be arranged as income tax-free reorganization [*I.R.C. §*

368(a)(1)(B)].

(2) By dissolving or merging acquired corporation into itself, acquiring corporation can obtain net operating loss carryover deduction belonging to acquired corporation.

g. Transaction is not subject to California Sales and Use Tax.

2. Evaluate disadvantages of acquisition of shares for shares:

NOTE:
For a detailed list, see *Ch. 11D, **Acquisition of Shares for Shares**, § 11D.112*.

a. Permit must be obtained from California Commissioner of Corporations qualifying shares to be issued in exchange by acquiring corporation [*Corp. Code § 25110*; see Ch. 6H, *Qualification of Securities*].

b. Acquiring corporation cannot acquire new income tax basis for assets of acquired corporation, even by dissolving or merging with acquired corporation after exchange [*see I.R.C. § 362(b)*].

c. Proposed share exchange must be approved by affirmative vote of majority of all outstanding shares of each class of acquiring corporation, regardless of any restrictions on their voting rights.

d. Undisclosed and unknown liabilities of acquired corporation may render shares of acquired corporation worthless.

e. When corporation sought to be acquired has large number of shareholders geographically scattered, cost and effort required to obtain their acceptance of share exchange offer may be prohibitive.

f. Shareholders of acquiring corporation who do not approve of proposed exchange may require their shares to be purchased for cash at their appraised fair market value.

g. Shareholders of acquired corporation who refuse to exchange their shares may constitute group of minority shareholders hampering effective management of acquired corporation by acquiring corporation after exchange.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewMergers & Acquisitions LawTax-Free AcquisitionsMergers & Acquisitions LawTakeovers & Tender OffersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11 California Legal Forms--Transaction Guide § 11.114

§ 11.114 Determining Whether to Structure Transaction as Acquisition of Assets for Shares

1. Evaluate advantages of acquisition of assets for shares:

NOTE:
For a detailed list, see Ch. 11E, ***Acquisition of Assets for Shares***, § 11E.111.

a. Acquiring corporation does not automatically become liable for debts and liabilities of selling corporation, with possible exception of products liability claims.

b. There is no minority interest to harass acquiring corporation in managing business and assets acquired from selling corporation.

c. Assets-for-shares exchange can be arranged to be income-tax-free [*see I.R.C. §§ 354, 361, 368(a)(1)(C)*].

d. Acquiring corporation succeeds to any net operating loss carryover of acquired corporation [*see I.R.C. § 381(a)(2), (c)(1)*].

2. Evaluate disadvantages of acquisition of assets for shares:

NOTE:
For a detailed list, see Ch. 11E, ***Acquisition of Assets for Shares***, § 11E.112.

a. Proposed exchange must be approved by boards of directors, and principal terms of proposed exchange must be approved by outstanding shares of each class of both

acquiring and selling corporations [*Corp. Code §§ 117, 152, 1200(c), 1201(a)*].

b. Permit qualifying shares to be issued by qualifying corporation or its parent in exchange generally must be obtained from California Commissioner of Corporations [*Corp. Code § 25120*].

c. Dissenting shareholders of either acquiring or selling corporation have right to require that their shares be purchased by their corporation for cash at appraised fair market value of shares on day preceding first announcement of terms of proposed assets-for-shares exchange [*Corp. Code § 1300*].

d. Acquiring corporation does not obtain new income tax basis for assets it is acquiring from selling corporation in assets-for-shares exchange [*see I.R.C. §§ 358, 362*].

e. Tangible personal property transferred for stock may be subject to California sales tax.

f. Transfer of assets from selling corporation to acquiring corporation may require compliance with Uniform Commercial Code--Bulk Sales Division [*see Com. Code §§ 6101-6111*].

g. To protect acquiring corporation from liability under successor liability statutes for sales taxes and unemployment compensation insurance contributions owed by selling corporation, exchange of shares for assets cannot be consummated until selling corporation obtains [*see Rev. & Tax. Code §§ 6811, 6812*; *Unemp. Ins. Code § 1731, 1732*]:
(1) Sales tax clearance from California State Board of Equalization.

(2) Statement from California State Department of Benefit Payments that no amounts are due from selling corporation for unemployment compensation insurance contributions.

h. Acquiring corporation may become liable for products liability claims arising from sales of defective products by predecessor business.

i. Separate documents of conveyance or transfer must be drafted, executed, and registered or recorded for property or contracts being assigned or conveyed.

j. May require obtaining consent from third party for assignment of lease or other contracts.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsMergers & Acquisitions LawTax-Free AcquisitionsMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11 California Legal Forms--Transaction Guide §§ 11.115-11.129

[Reserved]

§§ 11.115[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Mergers and Acquisitions

5-11 California Legal Forms--Transaction Guide § 11.130

§ 11.130 Performing Transaction

1. After determining appropriate acquisition method [*see §§ 11.110-11.114*], comply with applicable procedures to effectuate transaction:

a. For requirements applicable to a cash purchase of shares, see Ch. 11A, *Cash Purchase of Shares*, § 11A.110 et seq.

b. For requirements applicable to a cash purchase of assets, see Ch. 11B, *Cash Purchase of Assets*, § 11B.110 et seq.

c. For requirements applicable to mergers, see *Ch. 11C, Mergers, § 11C.120* et seq.

d. For requirements applicable to acquisitions of shares for shares, see Ch. 11D, *Acquisition of Shares for Shares*, § 11D.120 et seq.

e. For requirements applicable to acquisition of assets for shares, see Ch. 11E, *Acquisition of Assets for Shares*, § 11E.120 et seq.

2. Perform all related and subsequent procedures required for applicable transaction [*see* Chs. 11A-11E for specific procedures].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART III. TRANSACTION GUIDE
C. Procedural Guide to Mergers and Acquisitions

5-11 California Legal Forms--Transaction Guide §§ 11.131-11.199

[Reserved]

§§ 11.131[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11 MERGER AND ACQUISITION ISSUES
PART IV. FORMS

5-11 California Legal Forms--Transaction Guide § 11.200

§ 11.200 Table Comparing Acquisition Methods

[1] Comment

This table compares the key features of the five acquisition methods discussed in this chapter. It is designed to provide a handy comparison between the basic features of the various methods. It is important to bear in mind that the descriptions have been simplified for purpose of comparison. Each acquisition method is covered in detail in a separate chapter [*see* Chs. 11A-11E], which should be consulted prior to selecting, structuring, and carrying out the transaction.

This table compares the following acquisition methods:

- The cash purchase of shares [*see* Ch. 11A, *Cash Purchase of Shares*].
- The cash purchase of assets [*see* Ch. 11B, *Cash Purchase of Assets*].
- Mergers [*see* Ch. 11C, *Mergers*].
- Acquisitions of shares for shares [*see* Ch. 11D, *Acquisition of Shares for Shares*].
- Acquisitions of assets for shares [*see* Ch. 11E, *Acquisition of Assets for Shares*].

Issues such as shareholder approval [*see § 11.24[2]*], dilution of interests, and purchase of dissenting interests [*see §§ 11.21[1][e]*] are encompassed in the first factor listed in the table below.

[2] Table

	Cash Purchase of Shares	Cash Purchase of Assets	Merger	Exchange Shares--Shares	Exchange Assets--Shares
Corp. Reorg.	no	no	yes	yes	yes

(Corp. Code § 181)					
Tax-free Reorg. (I.R.C. § 368)	no	no	yes ("A" Reorg.)	yes ("B" Reorg.)	yes ("C" Reorg.)
Mechanical Simplicity	maybe	no	yes	yes	no
Cal. Securities Law Applicable	no	no	yes	yes	yes
Cal. Sales Tax Applicable	no	yes	no	no	yes
Assumption of Liability	indirect	indirect	direct	indirect	indirect
Basis for Acquired Assets I.R.C. § 381	step-up may be elected	new cost basis	carryover basis	carryover basis	carryover basis
Loss Carryover	not automatic	no	yes	not automatic	yes

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawTax-Free AcquisitionsMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES

5-11A California Legal Forms--Transaction Guide 11A.syn

§ 11A.syn Synopsis to Chapter 11A: CASH PURCHASE OF SHARES

§ 11A.01 California Sources

§ 11A.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 11A.03-11A.04 [Reserved]

§ 11A.05 Law Reviews and Periodicals

§ 11A.06 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 11A.07-11A.19 [Reserved]

§ 11A.20 Cash Purchase of Shares Generally

§ 11A.21 Governing Law

[1] California General Corporation Law

[2] Internal Revenue Code

[3] Securities Law

§ 11A.22 Tax Factors

[1] Income Tax on Sale of Shares

[a] Sale of Property by Shareholders

[b] Double Taxation Avoided

[c] Capital Gain or Ordinary Income

[d] Installment Sale Treatment

[2] Income Tax Basis for Purchases

[3] Requirements for New Income Tax Basis

[a] Election

[b] Deemed Election

[c] Effect of Election

[4] Net Operating Loss Carryforward Deduction

[5] Limitations on Use of Carryforward

§ 11A.23 Assumption of Liabilities of Acquired Corporation

§ 11A.24 Other Advantages and Disadvantages of Cash Share Purchase

[1] Shareholder Approval Not Required

[2] Management Approval Not Required

[3] No Sales Tax Consequences

[4] Dangling Minority Interests

§§ 11A.25-11A.99 [Reserved]

§ 11A.100 Facts

Scope

§ 11A.101 Documents

Scope

§§ 11A.102-11A.109 [Reserved]

§ 11A.110 Preliminary Determinations

Scope

§ 11A.111 Advising Parties of Advantages of Cash Purchase of Shares

Scope

§ 11A.112 Advising Parties of Disadvantages of Cash Purchase of Shares

Scope

§ 11A.113 Procedures for Making Acquisition Without Tender Offer

Scope

§ 11A.114 Procedures for Making Acquisition Through Tender Offer

Scope

§§ 11A.115-11A.129 [Reserved]

§ 11A.130 Obtaining New Income Tax Basis for Acquired Corporation's Assets

Scope

§ 11A.131 Transferring Acquired Corporation's Net Operating Loss Carryover to Acquiring Corporation

Scope

§ 11A.132 Reporting Statutory Change in Ownership

Scope

§§ 11A.133-11A.199 [Reserved]

§ 11A.200 Contract for the Cash Purchase of Shares--Purchase Price Payable in Installments Pursuant to Promissory Note

[1] Comment

[a] Use of Form

[b] Warranties and Indemnifications by Sellers

[c] Covenant Not to Compete

[2] Form

Contract for the Cash Purchase of Shares--Purchase Price Payable in Installments Pursuant to Promissory Note

§ 11A.201 Resolution of Board of Directors of Acquiring Corporation Authorizing Cash Purchase of Shares of Another Corporation and Execution of Contract of Sale for Share Purchase

[1] Comment--Use of Form

[2] Form

Resolution of Board of Directors of Acquiring Corporation Authorizing Cash Purchase of Shares of Another Corporation and Execution of Contract of Sale for Share Purchase

§ 11A.202 Tender Offer for Cash Purchase of Shares--Offering Letter From Acquiring Corporation Directly to Shareholders of Corporation Sought to Be Acquired

[1] Comment

[a] Use of Form

[b] Use of Tender Offers

[c] Regulation of Tender Offers

[2] Form

Tender Offer for Cash Purchase of Shares--Offering Letter From Acquiring Corporation Directly to Shareholders of Corporation Sought to Be Acquired



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES

5-11A California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter discusses the oldest and simplest method by which one corporation can acquire ownership and control of another corporation--the purchase of the second corporation's shares directly from its shareholders for cash or a combination of cash and debt securities. The Legal Background discusses the legal and tax requirements for an advantageous corporate acquisition by the cash purchase of shares, and the relative advantages and disadvantages of this method as compared to other methods of corporate acquisition. The Transaction Guide contains procedures for the cash purchase of shares, and includes related procedures for obtaining a new income tax basis for acquired assets and transferring a net operating loss carryover to the acquiring corporation. The forms in this chapter include a contract for the cash purchase of shares, a resolution of the board of the acquiring corporation authorizing the purchase, and a tender offer for the cash purchase of shares.

For a discussion and comparison of the various methods of corporate acquisition, see Ch. 11, *Merger and Acquisition Issues* . These methods are covered individually in Ch. 11B, *Cash Purchase of Assets* ; Ch. 11C, *Mergers;* Ch. 11D, *Acquisition of Shares for Shares* ; and Ch. 11E, *Acquisition of Assets for Shares* .

Further detailed discussion of the sale of assets is contained in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* (Matthew Bender). Applicable forms are set forth in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Appendix A, Forms 13.08, 13.09 (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART I. RESEARCH GUIDE
A. Primary Sources

5-11A California Legal Forms--Transaction Guide § 11A.01

§ 11A.01 California Sources

Covenant not to compete by shareholder selling all shares. *Bus. & Prof. Code § 16601*.

Sale of all assets to parent corporation, special shareholder requirements. *Corp. Code § 1001(d)*.

Short-form merger of corporations. *Corp. Code § 1110*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART I. RESEARCH GUIDE
A. Primary Sources

5-11A California Legal Forms--Transaction Guide § 11A.02

§ 11A.02 Federal Sources

[1] Statutes

Williams Act regulating tender offers. *15 U.S.C. §§ 78l, 78m(d), (e), 78n(d)-(f).*

Internal Revenue Code.

No gain to parent on liquidation of subsidiary. *I.R.C. § 332*.

Determining gain or loss to subsidiary upon *I.R.C. § 332* liquidation. *I.R.C. § 337*.

Parent takes income tax basis for assets of dissolved subsidiary. *I.R.C. § 334(b)(1)*.

Purchase of subsidiary's stock treated as purchase of assets with grossed-up basis. *I.R.C. § 338*.

Net operating loss carryforward deduction, when available to acquiring corporation. *I.R.C. § 381*.

Limitation on net operating loss carryforwards for acquired corporation. *I.R.C. § 382*.

Installment sales of property, method of reporting income tax gain. *I.R.C. § 453*.

Determination of gain or loss on sale. *I.R.C. § 1001*.

Adjusted income tax basis for property defined. *I.R.C. § 1011*.

Basis for income tax purposes of property as cost. *I.R.C. § 1012*.

Special allocation rules for asset acquisitions. *I.R.C. § 1060*.

Net long-term capital gain defined. *I.R.C. § 1222(7)*.

[2] Regulations

Gain or loss on deemed sale of affected target stock. Temp. Treas. Reg. § 1.338-6T.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART I. RESEARCH GUIDE
A. Primary Sources

5-11A California Legal Forms--Transaction Guide §§ 11A.03-11A.04

[Reserved]

§§ 11A.03[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11A California Legal Forms--Transaction Guide § 11A.05

§ 11A.05 Law Reviews and Periodicals

Nichols & Bradford, *Corporate Acquisitions and Successor Liability (With Forms)*, 44(5) Prac. Law. 21 (1998).

Malak, *The Attorney's Role in Small Business Acquisitions*, 43(5) Prac. Law. 71 (1997).

Stein, *How to Use Defined Terms to Make Transactional Documents Work Better*, 43(7) Prac. Law. 15 (1997).

Stong, *A User's Guide to Alternative Dispute Resolution in Business Cases*, 43(4) Prac. Law. 15 (1997).

Report, *Purchasing the Stock of a Privately Held Company: The Legal Effect of an Acquisition Review, 51 Bus. Law. 479 (1996).*

Gotts & Mann, *Ten "Don'ts" for Acquisition Documents*, 41(2) Prac. Law. 15 (1995).

Broadwin, *How to Draft Letters of Intent for Business Acquisitions (With Forms), 37 Prac. Law. 13 (Mar. 1991).*

Kennedy, *Tender Moments, 23 Bus. Law. 1091 (1968).*

Cohen, *Tender Offers and Takeover Bids, 23 Bus. Law. 611 (1968).*

Cohen, A *Note on Takeover Bids and Corporate Purchases of Stock, 22 Bus. Law. 149 (1966).*

Wolfen, *Tax Effects of Covenants Not to Compete, 10 S. Cal. L. Rev. 667 (1960).*

Cardwell, *Current Problems in Taxable and Tax-Free Reorganizations: Contingent and Unliquidated Items*, 18 N.Y.U. Tax. Inst. 781 (1960).

Stinson, *Sale of a Business Through the Sale of Stock for Cash-Problems of the Seller in Deferred Payment and Installment Sales*, 15 N.Y.U. Tax. Inst. 643 (1957).

Schwartz, *Acquisition of Stock of Another Corporation in Order to Acquire Assets*, 9 S. Cal. Tax. Inst. 45 (1957).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11A California Legal Forms--Transaction Guide § 11A.06

§ 11A.06 Text References

[1] Matthew Bender Sources

Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* (Matthew Bender).

CALIFORNIA LEGAL FORMS (Matthew Bender).

Ch. 12, *Winding Up and Dissolution*.

Ch. 17, *Buying and Selling a Business or Professional Practice*.

Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 5, *Sales of Stock and Business Assets* , Forms 5.35-5.54 (Matthew Bender).

Rabkin & Johnson, *FEDERAL INCOME, GIFT AND ESTATE TAXATION, § 4.12* (Matthew Bender).

Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING (Matthew Bender).

Ch. 160, *Review of Methods of Buying and Selling Corporate Businesses*.

Ch. 161, *Review of Factors to Be Considered in Selecting Form of Acquisition*.

Ch. 165, *Sales of Stock*.

Ch. 171, *The Acquisition Agreement*.

Ch. 173, *Choosing the Method of Transferring the Ownership of a Corporate Business*.

Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS (Matthew Bender).

Ch. 1, *The Business Setting of Corporate Acquisitions and Mergers*.

Ch. 2, *The Legal Setting of Corporate Acquisitions and Mergers*.

Ch. 2A, *General Considerations in Corporate Acquisitions and Mergers*.

Ch. 3, *Tax Factors in Corporate Acquisitions and Mergers*.

Ch. 4, *Tax-Free Acquisitions*.

Ch. 5, *Taxable Transactions*.

Ch. 5A, *Summary of Acquisition Methods*.

Ch. 5D, *Acquisitions of Stock.*

[2] Additional Text References

Drafting Agreements for the Sale of Businesses, ch. 1, *Collecting Information*, ch. 2, *Checklist of Tax Factors*; ch. 3, *Agreement: Sale of Stock* (Cal. C.E.B. 1971).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11A California Legal Forms--Transaction Guide §§ 11A.07-11A.19

[Reserved]

§§ 11A.07[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART II. LEGAL BACKGROUND

5-11A California Legal Forms--Transaction Guide § 11A.20

§ 11A.20 Cash Purchase of Shares Generally

The purchase by one corporation of a second corporation's shares directly from its shareholders is the oldest and simplest method of acquiring ownership and control of the second corporation. This type of purchase is simple when the corporation sought to be acquired has relatively few shareholders who all wish to sell their shares. This type of acquisition, however, is more complicated when one or more of the larger shareholders of the corporation sought to be acquired refuses to sell his or her shares, or when the management of the corporation sought to be acquired actively opposes the purchase of its shares by the acquiring corporation and the acquiring corporation is forced to make a contested "tender offer" to the shareholders of the corporation it seeks to acquire [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5D, *Acquisitions of Stock* (Matthew Bender)].

The cash purchase of shares, like the cash purchase of assets [*see* Ch. 11B, *Cash Purchase of Assets*], may take many forms. Share acquisitions as a method of obtaining ownership of a corporation are sometimes classified simply as either taxable or nontaxable share acquisitions [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 5D, *Acquisitions of Stock* (Matthew Bender)]. A nontaxable share acquisition is a shares-for-shares exchange that comes within the definition of a tax-free reorganization contained in the Internal Revenue Code [*see* Ch. 11, *Mergers and Acquisitions Issues*]. A taxable share acquisition is in effect a cash purchase of shares, but the consideration paid for shares in a taxable acquisition may be any of the following [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5D, *Acquisitions of Stock* (Matthew Bender)]:

- All cash.
- Part cash and part either shares, notes, or securities of the acquiring corporation or its parent.
- All convertible or nonconvertible debt securities of the acquiring corporation or its parent.
- Cash sufficient to enable each selling shareholder to pay income taxes on the sale and the balance in notes or shares of the acquiring corporation.
- Some other combination of cash, shares, notes, and securities.

A cash purchase of shares may also take the form of either an installment sale or a "deferred payout arrangement." In an installment sale, the purchase price of the shares is to be paid in installments for income tax or other purposes. In a "deferred payout arrangement," the amount of the purchase price to be paid for the shares is determined by the future earnings of the acquired corporation [*see* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 165, *Sales of Stock* (Matthew Bender); Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5D, *Acquisitions of Stock* (Matthew Bender)].

All of these forms of taxable share acquisitions or cash purchases of shares have their own tax and nontax requirements and consequences. Certain requirements and consequences and advantages and disadvantages, however, are generally applicable to all of them.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewMergers & Acquisitions LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART II. LEGAL BACKGROUND

5-11A California Legal Forms--Transaction Guide § 11A.21

§ 11A.21 Governing Law

[1] California General Corporation Law

One of the advantages of acquiring another corporation by means of a cash purchase of its shares is the relative freedom of the transaction from California statutory regulation. The transaction is not defined as a "reorganization" by the California General Corporation Law [*see* Ch. 11, *Merger and Acquisition Issues*] because there is no need to subject it to the same statutory shareholder approvals that are required in the case of a statutory merger of corporations [*see Ch. 11C, Mergers, § 11C.22[5]*]. There is no need for a statute requiring the proposed purchase of shares to be approved by formal vote of either shareholders of the acquiring corporation or shareholders of the acquired corporation. The interests of the shareholders of the acquiring corporation in their corporation are not being diluted as they might be in a shares-for-shares exchange [*see* Ch. 11, *Merger and Acquisition Issues* ; Ch. 11D, *Acquisition of Shares for Shares*]. Due to the nature of the transaction, the shareholders of the corporation sought to be acquired must approve the proposed transaction in a more binding manner than a formal vote at a shareholders' meeting-they must actually accept the acquiring corporation's offer and tender their shares to the acquiring corporation for purchase [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 5D, *Acquisitions of Stock* (Matthew Bender)].

[2] Internal Revenue Code

The acquiring corporation must satisfy federal income tax requirements in order to make the most advantageous income tax use of its acquired corporation. These income tax requirements are set forth in *I.R.C. §§ 332*, *337*, *338*, and *381*. *I.R.C. § 332* deals with the taxation or nontaxation of gains received by a parent corporation on dissolution and liquidation of a subsidiary. *I.R.C. § 337* provides for the gain or loss to the subsidiary upon liquidation pursuant to *I.R.C. § 332*. *I.R.C. § 338* is a special provision allowing or requiring a corporation that has acquired all the shares of another corporation for cash to obtain a new income tax basis for the acquired corporation's assets. *I.R.C. § 381* describes the circumstances under which a net operating loss carryover income tax deduction available to an acquired corporation may be transferred to and used by an acquiring corporation. For further discussion of these income tax requirements, see *§ 11A.22*.

[3] Securities Law

Another federal statute affecting the cash purchase of shares is the Williams Act, consisting of Sections 13(d), (e), and 14(d)-(f) of the Securities Exchange Act of 1934 [*15 U.S.C. §§ 78m(d),(e), 78n(d)*-(f)]. It applies generally to the acquisition of shares listed on a national securities exchange. It imposes filing, disclosure, antifraud, and other requirements on persons or corporations seeking to acquire corporate control through the purchase of those shares [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 5E, *Tender Offers and Takeovers* (Matthew Bender)]. This chapter discusses the Act in connection with tender offers for the cash purchase of shares [*see §§ 11A.110[5], [6], 11A.202*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawTax-Free Acquisitions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART II. LEGAL BACKGROUND

5-11A California Legal Forms--Transaction Guide § 11A.22

§ 11A.22 Tax Factors

[1] Income Tax on Sale of Shares

[a] Sale of Property by Shareholders

For federal income tax purposes, the purchase by one corporation of the shares of another corporation for cash or any combination of cash and promissory notes is simply a taxable sale of property by the shareholders of the corporation that is being acquired [*see I.R.C. § 1001(a)*]. Any gain or loss resulting from the sale or exchange of property, unless otherwise expressly provided by provisions of the Internal Revenue Code, must be "recognized" and reported by the seller on his or her federal income tax return [*see I.R.C. § 1001(c)*]. Shares and securities of a corporation are a form of property [*see* Ch. 11, *Merger and Acquisition Issues*]. No provision of the Internal Revenue Code makes a cash sale to corporate securities or shares tax-free, and therefore any gain or loss realized by a shareholder on the sale of shares in a corporation for cash is "recognized" and must be reported on the shareholder's federal income tax return [*see I.R.C. §§ 61, 1001(c)*].

[b] Double Taxation Avoided

Because income tax is imposed on any gain or profit received by the seller, both a cash purchase by one corporation of the shares of another corporation and a cash purchase by one corporation of all the assets of another corporation are classified as taxable transactions and taxable methods of corporate acquisition [*see I.R.C. §§ 61, 1001(c)*]. However, there is an important difference between the tax treatment of a cash purchase of shares and of a cash purchase of corporate assets, which is due to the difference in tax status of the sellers in the two types of transactions.

When one corporation purchases all or substantially all the assets of another corporation for cash, or for cash and promissory notes, the seller of the corporate assets is the acquired corporation itself. Ordinarily, the acquired corporation, as seller of the assets, must pay income taxes on any gain or profit it received on the sale of those assets [*see I.R.C. §§ 61, 1001(c)*]. Tax may be due at the shareholder level if the gain is distributed to the shareholders as a dividend [*see I.R.C. § 301*] or as gain or loss on the liquidation of the corporation [*see I.R.C. § 331*]. Care must be taken to avoid double taxation of the sale proceeds [*see Ch. 11B, Cash Purchase of Assets, § 11B.112*].

The issue of possible double taxation of the sale proceeds does not arise when one corporation purchases the shares of another corporation for cash. The seller in such a transaction is not the acquired corporation; rather, the sellers are the shareholders of the acquired corporation. Therefore, there is no sale or exchange by the acquired corporation from which it may realize a gain or profit on which it must pay income tax. The sale is made by the shareholders of the acquired corporation, the cash purchase price of the shares is paid directly to them, and they are the only ones who therefore may realize a gain or profit from the sale on which they must pay income taxes.

[c] Capital Gain or Ordinary Income

The taxable gain or profit each shareholder of the acquired corporation will realize on the cash sale of shares to the acquiring corporation is the amount by which the purchase price paid for the shares exceeds his or her cost or other income tax basis for those shares [*I.R.C. §§ 1001, 1011, 1012*; *see* Ch. 11, *Mergers and Acquisition Issues*]. Ordinarily, a corporate shareholders's taxable gain on the cash sale will be a long-term capital gain if the corporation has owned the shares of the acquired corporation for more than 12 months before the sale, and a short-term capital gain if not [*I.R.C. § 1222*].

Difficulties may arise, however, when a principal corporate shareholder of the acquired corporation gives the acquiring corporation, as part of the sale of shares in the acquired corporation, a covenant not to compete with it or with the acquired corporation. The Internal Revenue Service may claim that part of the purchase price received from the acquiring corporation was really in payment of the covenant not to compete and is taxable as ordinary income and not as a long-term capital gain [*see I.R.C. § 1221*; *see also I.R.C. § 1060(e)* (allocation of basis when 10 percent shareholder makes covenant not to compete)].

[d] Installment Sale Treatment

If the acquired corporation's shares are not traded on an established securities market, a shareholder of that corporation may defer, or in some cases reduce, income tax liability on any gain or profit realized from the sale of his or her shares for cash to the acquiring corporation by arranging for payment in installments. To receive installment sale treatment, at least one payment must be received after the close of the taxable year in which the sale occurs [*see I.R.C. § 453*]. In an installment sale, the taxpayer is required to recognize income from payments received in any taxable year only in the proportion that the gross profit bears to the total contract price [*I.R.C. § 453(c)*]. Because the federal income tax is progressive (that is, the tax rate imposed on a large income is greater than on a small income), a shareholder may pay less tax if gain can be reported on an installment basis over several years rather than all in one year, depending on his or her other income during the years the installment payments are made. The tax benefits of an installment sale, however, are unavailable if the stock or securities sold are traded on an established securities market. In that case, all payments to be received from the sale will be treated as received in the year of disposition [*I.R.C. § 453(k)*].

[2] Income Tax Basis for Purchases

The biggest disadvantage to the purchase of shares as a method of obtaining ownership is that the change in ownership of the corporation does not result in a step-up in the basis of the acquired corporation's assets [*see I.R.C. § 1012*; *but see I.R.C. § 338* (step-up in basis of assets may be elected in certain circumstances); *see also* [3], *below*].

[3] Requirements for New Income Tax Basis

[a] Election

An acquiring corporation that makes a "qualified stock purchase" may elect to step up the basis of the acquired ("target") corporation's assets [*I.R.C. § 338(a)*]. A "qualified stock purchase" is the purchase, in one transaction or a series of transactions, of stock that (1) constitutes 80 percent of the total voting power of the stock of the target corporation, and (2) has a value equal to at least 80 percent of the total value of the stock of the target corporation [*see*

I.R.C. § 1504(a)(2)], during a 12-month "acquisition period." That period begins on the date of the first acquisition by purchase [*see I.R.C. § 338(h)(3)*] of stock included in a qualified stock purchase [*I.R.C. § 338(d)(3)*; *see I.R.C. § 338(h)(1)*].

The election is made by filing a timely statement of election on an official form with the Internal Revenue Service no later than the 15th day of the 9th month beginning after the month in which the "acquisition date" occurs [*I.R.C. § 338(g)*; *see* Temp. Treas. Reg. § 1.338-1T(c)-(e)]. The "acquisition date" is the first day on which there is a "qualified stock purchase" from the target corporation [*I.R.C. § 338(h)(2)*]. If a series of stock purchases are made over a period of time, the acquisition date is the first day on which the acquiring corporation owns the necessary percentages of stock of the target corporation [Temp. Treas. Reg. § 1.338-1T; *see I.R.C. § 338(d)(3)*]. The election is irrevocable [*I.R.C. § 338(g)(3)*].

[b] Deemed Election

A corporation will be deemed to have made an election if it directly acquires any asset of the target corporation at any time during an extended "consistency period" that starts a year before the first stock purchase and ends a year after the date on which the purchasing corporation acquired 80 percent control [*I.R.C. § 338(e)(1)*; *see I.R.C. § 338(h)(4)*]. This rule is intended to prevent acquiring corporations from separately purchasing those target assets whose bases exceed fair market value, and stepping up the bases of other low-basis assets through a stock purchase and *I.R.C. § 338* election. However, the deemed election does not apply to an asset acquisition if any of the following apply [*I.R.C. § 338(e)(2)*]:

- It was made pursuant to a sale by the target corporation in the ordinary course of trade or business.
- The basis of the property acquired is wholly determined by reference to the adjusted basis of that property in the hands of the target corporation.
- It was made before September 1, 1982.

The regulations may also make other exceptions.

[c] Effect of Election

On an election or deemed election, the target corporation is treated as if it had sold its assets at fair market value and become a "new" corporation that purchased those same assets [*I.R.C. § 338(a)*]. This conceptual scheme results in a step-up in basis of the assets without actual liquidation of the target. The "new" corporation also loses its former tax attributes, including any net operating loss carryovers that it was entitled to utilize [*see* [4], *below*].

The target's assets receive a new basis determined by the acquiring corporation's basis in the target corporation's stock. They are treated as having been purchased for the sum of the "grossed-up" basis of the purchasing corporation's recently purchased target stock and the basis of the purchasing corporation's nonrecently purchased target stock, adjusted for liabilities of the target [*I.R.C. § 338(b)(1)*]. "Recently purchased stock" is any stock in the target corporation that the purchasing corporation holds on the acquisition date and that was purchased during the 12-month acquisition period [*I.R.C. § 338(b)(6)*]. "Grossed-up basis" is the basis of the acquiring corporation's recently purchased stock, multiplied by a fraction in which (1) the numerator is 100 percent less the percentage that the value of the nonrecently purchased stock is of the total value of all target stock, and (2) the denominator is the percentage that the value of recently purchased stock is of the total value of all target stock [*I.R.C. § 338(b)(4)*]. The new basis is to be allocated among the various assets of the target according to regulation [*I.R.C. § 338(b)(5)*]. The purchase price under temporary IRS regulations [Temp Treas. Reg. 1.338-6T(b)] is allocated first to cash and cash equivalent assets, then to assets other than goodwill or going concern in proportion to the asset's fair market value on the date of acquisition value and decreasing liquidity, and finally to goodwill or going concern values, first to those eligible for amortization under *I.R.C. § 197*, and

finally to those that are not eligible for amortization.

[4] Net Operating Loss Carryforward Deduction

An acquiring corporation may obtain the net operating loss carryforward of an acquired corporation only pursuant to *I.R.C. § 381* [*see* Ch. 11, *Merger and Acquisition Issues*]. Although a taxable purchase of assets is not one of the acquisition methods enumerated in that section that automatically result in the transfer of any net operating loss carryforward of the acquired corporation to the acquiring corporation [*see I.R.C. § 381(a)(1), (c)(1)*], an acquiring corporation that has not made or been deemed to have made an *I.R.C. § 338* election [*see* [3], *above*] may obtain the carryforward by liquidating the acquired corporation pursuant to *I.R.C. § 332* [*see I.R.C. § 381(a)*]. Such a liquidation does not result in the recognition of any gain or loss [*I.R.C. § 332(a)*] or in the step-up in basis of assets received [*see I.R.C. § 334(b)(1)*]. A corporation may also obtain any carryforward through a tax-free merger with the acquired corporation [*see I.R.C. § 381(a)(2)*; *see also* Ch. 11C, *Mergers*]. If an *I.R.C. § 338* election has been made or deemed made, however, the target corporation is treated as having undergone a liquidation and become a "new corporation" [*see I.R.C. § 338(a)(1)*], thereby losing any loss carryforwards to which it was entitled. Therefore, its carryforwards cannot be transferred pursuant to a tax-free liquidation or merger [*see I.R.C. § 381(a)*]. The acquiring corporation may face the choice of obtaining a new basis for the acquired corporation's assets by making an election pursuant to *I.R.C. § 338* or obtaining its net operating loss carryforward by liquidation or merger.

[5] Limitations on Use of Carryforward

If the acquired corporation has not lost any net operating loss carryforwards pursuant to a Section 338 election [*see I.R.C. § 338*; *see also* [4], *above*], the amount of carryforward available for its own use (or for the use of the acquiring corporation obtaining the carryforward after a tax-free liquidation or tax-free merger) may nonetheless be substantially reduced or disallowed [*I.R.C. § 382*].

The amount of taxable income of a new loss corporation for any taxable year after an ownership change that may be offset by pre-change losses is limited to the value of the stock of the old loss corporation immediately before the ownership change, multiplied by the highest federal long-term rate in effect for any month in the three-calendar-month period ending with the month of ownership change [*I.R.C. § 382(b)(1)*; *see I.R.C. § 382(e), (f)*]. An "ownership change" occurs when, after a change in stock ownership affecting the percentage of stock owned by any person who is a five-percent shareholder before or after the change, the percentage of stock of the loss corporation owned by one or more five-percent shareholders has increased by more than 50 percent over the lowest percentage of stock in the old loss corporation owned by those shareholders during the three-year period ending on the change in stock ownership [*I.R.C. § 382(g)*; *see I.R.C. § 382(i)*].

A net operating loss carryforward will be disallowed to a new loss corporation that does not continue the business enterprise of the old loss corporation at all times during the two-year period following the change date [*I.R.C. § 382(c)(1)*]. Special rules for determining the allowable carryforward apply if unrealized built-in gains or losses exceed 25 percent of the value of the old loss corporation's assets before the ownership change [*see I.R.C. § 382(c)(2), (h)*; *see* Ch. 11, *Merger and Acquisition Issues* (discussion of rules regarding use of net operating loss carryforward, and definitions applicable to that rule)].

Even if a carryforward is not reduced pursuant to *I.R.C. § 382(a)*, it may be completely disallowed pursuant to *I.R.C. § 269(b)* if the acquiring corporation purchases at least 50 percent of the total combined voting power of all classes of voting stock or at least 50 percent of the total value of all stock of the acquired corporation, for the principal purpose of avoiding income tax [*see I.R.C. § 269(a)*; *see also* Ch. 11, *Merger and Acquisition Issues*]. Furthermore, the carryforward may be disallowed if the acquiring corporation [*I.R.C. § 269(b)*]:

- Makes a "qualified stock purchase" [*see I.R.C. § 338(d)(3)*; *see also* [3], *above*];

- Does not make an election pursuant to *I.R.C. § 338* [*see* [3], *above*];

- Liquidates the acquired corporation pursuant to a plan of liquidation adopted not more than two years after the acquisition date, and

- Has as its principal purpose for the liquidation the evasion or avoidance of federal income tax by securing the benefit of a deduction that it would not otherwise enjoy.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationSales & ExchangesSecurities & Other Instruments (IRC secs. 1058, 1081-1083, 1091-1092, 1233-1234A, 1236, 1256, 1259, 1271-1278, 1281-88)General OverviewTax LawFederal Taxpayer GroupsC CorporationsShareholders (IRC secs. 301-307)Stock & Stock RightsTax LawFederal Income Tax ComputationSales & ExchangesInstallment Sales (IRC secs. 1001, 1031, 1231)General OverviewTax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)Adjusted Basis for Determination of Gains & LossesTax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)Cost Basis of PropertyTax LawFederal Income Tax ComputationOrdinary Income (IRC sec. 64)Tax LawFederal Income Tax ComputationSales & ExchangesCapital Gains & Losses (IRC secs. 1201-1202, 1211-1212, 1221-1223, 1231-1260, 1271-1278, 1281-1288, 1291-1298)Long Term & Short Term Gains & LossesMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsTax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)Stock & Other Securities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART II. LEGAL BACKGROUND

5-11A California Legal Forms--Transaction Guide § 11A.23

§ 11A.23 Assumption of Liabilities of Acquired Corporation

An acquiring corporation may be required to assume the liabilities of the corporation being acquired. An assumption of liabilities occurs automatically in a statutory merger [*see Ch. 11C, Mergers, § 11C.27*]. In the sole area of products liability claims, the assumption of liabilities may occur in a purchase of assets if the purchaser continues to operate the business and the selling corporation dissolves [*see* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 161, *Review of Factors to Be Considered in Selecting Form of Acquisition* (Matthew Bender)*; see also* Ch. 11E, *Acquisition of Assets for Shares*]. Although acquisition by purchase of a corporation's shares avoids such an assumption of liabilities, the corporation purchasing shares of another corporation runs the risk of having unknown or contingent liabilities of the acquired corporation reduce its value [*see* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 161, *Review of Factors to Be Considered in Selecting Form of Acquisition* (Matthew Bender)]. For this reason, counsel should always examine (and have the acquiring corporation's accountants examine) the balance sheets and account ledgers of the corporation whose shares are to be acquired. Unknown and inchoate liabilities, however, such as liability for injuries caused or to be caused by a defective product that the acquired corporation manufactured or sold, cannot be disclosed by books and records. The purchaser of corporate shares assumes the risk that the price it pays for shares of another corporation may be excessive if that corporation has unknown and undisclosed liabilities [*see* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 161, *Review of Factors to Be Considered in Selecting Form of Acquisition* (Matthew Bender)].

To protect its investment, an acquiring corporation often requires selling shareholders of the corporation being acquired to sign an agreement to indemnify it against unknown liabilities of the corporation being acquired. It also usually requires them to personally warrant that the financial statements and books of the corporation being acquired are correct and that it has no known liabilities not shown on those statements and books [*see* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 161, *Review of Factors to Be Considered in Selecting Form of Acquisition* (Matthew Bender)]. These indemnity agreements and warranties are easier to obtain from the shareholders of a small closely owned corporation than from the shareholders of a large publicly held corporation. In the latter case, however, it may be possible to obtain indemnity agreements and warranties from the major selling shareholders of the corporation being acquired. It would be most difficult to obtain indemnity and warranty agreements if acquisition of the shares of the corporation sought to be acquired was opposed by its management and could be achieved only by means of a contested tender offer made to its other shareholders.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewMergers & Acquisitions LawLiabilities & Rights of SuccessorsSuccessor Liability Doctrine



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART II. LEGAL BACKGROUND

5-11A California Legal Forms--Transaction Guide § 11A.24

§ 11A.24 Other Advantages and Disadvantages of Cash Share Purchase

[1] Shareholder Approval Not Required

The greatest advantages of acquiring a corporation by the cash purchase of its shares may be that shareholder approval in a formal manner is not required and there are few, if any, instruments of conveyance to be drafted. Approval of the purchase by shareholders of the acquiring corporation is not required because their interests in the acquiring corporation are not being diluted by the purchase [*see § 11A.21[1]*]. Shareholders of the corporation sought to be acquired approve the transaction by tendering their shares for purchase, so the formal calling of a shareholders' meeting of that corporation for approval of the transaction is not necessary. The only instruments of conveyance required are share certificates originally issued by the corporation sought to be acquired properly endorsed for transfer to the acquiring corporation by each of the selling shareholders of the corporation sought to be acquired [*see* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 161, *Review of Factors to Be Considered in Selecting Form of Acquisition* (Matthew Bender)].

[2] Management Approval Not Required

Another advantage of a cash purchase of shares is that it does not require approval of the management or board of directors of the corporation sought to be acquired. In fact, many corporations have successfully acquired all or substantially all the shares of another corporation by means of public tender offers over the vigorous opposition of the acquired corporation's management [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 5D, *Acquisitions of Stock* (Matthew Bender)]. Conversely, however, a disadvantage that may hinder an attempt to purchase the shares of a corporation may be the fact that it has many shareholders that are scattered geographically, and that its management is uncooperative and opposes the acquisition. In such a situation, the solicitation of the purchase of each shareholder's shares may be too expensive and too time-consuming to make the acquisition feasible.

[3] No Sales Tax Consequences

A further advantage of a cash purchase of shares is that it has no sales tax consequences. Shares of stock are not tangible personal property [*see Rev. & Tax. Code § 6016* (definition)], and thus are not subject to the imposition of the Sales and Use Tax Law [*Rev. & Tax. Code §§ 6001-7176*]. For a discussion of the types of reorganizations that are subject to the

sales and use tax, see Ch. 11, *Merger and Acquisition Issues* .

[4] Dangling Minority Interests

"Dangling minority interests" may impede the acquiring corporation when it is unable to obtain all the shares of the acquired corporation. Minority remaining shareholders of the acquired corporation may have ideas quite different than those of the acquiring corporation and work as a hindrance to management by the acquiring corporation of the affairs of the acquired corporation [*see* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 165, *Sales of Stock* (Matthew Bender)]. These dangling minority interests probably can be eliminated either by a statutory or short-form merger of the acquired corporation into the acquiring corporation. They cannot be eliminated, however, by a sale of all assets of the acquired corporation to the acquiring corporation for an unreasonable price [*Corp. Code § 1001(d)*]. They must be allowed the rights of a dissenting shareholder to a merger or short-form merger to have their shares purchased for their appraised fair market value on the date before merger of the acquired corporation into the acquiring corporation was first announced [*Corp. Code §§ 1300-1312*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawTax-Free AcquisitionsMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART II. LEGAL BACKGROUND

5-11A California Legal Forms--Transaction Guide §§ 11A.25-11A.99

[Reserved]

§§ 11A.25[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11A California Legal Forms--Transaction Guide § 11A.100

§ 11A.100 Facts

1. Identity of acquiring corporation.

a. Exact name of acquiring corporation as it appears on its articles of incorporation as last amended.

b. Address of principal executive office of acquiring corporation.

c. Names of principal officers of acquiring corporation.

d. Date, time, and place where board of directors will meet to consider and authorize share purchases.

e. Telephone numbers of corporate officers involved in planning share purchases.

2. Identity of corporation sought to be acquired.

a. Name of corporation sought to be acquired.

b. Address of principal executive officers of corporation sought to be acquired.

c. Name and address of stock transfer agent, if any, for corporation sought to be acquired.

d. Any connections or affiliations officers of corporation sought to be acquired have with acquiring corporation.

e. Number and types of shareholders of acquiring corporation.
(1) Classes and series of shares outstanding.

(2) Number of shares of each class and series that are outstanding.

(3) Number of shareholders owning shares of each class and series that are outstanding.

(4) Total number of shareholders owning outstanding shares.

f. Names and addresses of shareholders.

3. Purchase price to be paid for shares of corporation sought to be acquired.

a. Specified price per share if only one class of shares.

b. Different specified prices for different classes of shares.

c. Price dependent on future earnings of corporation after its shares have been sold to acquiring corporation [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 5D, *Acquisitions of Stock* (Matthew Bender)].

4. Manner in which purchase price of shares is to be paid by acquiring corporation:

a. Cash on closing of purchase and tender of shares for purchase.

b. Cash in installments according to the terms of:

(1) Unsecured promissory note to each shareholder.

(2) Secured promissory note to each shareholder.

(3) Contract between acquiring corporation and selling shareholders of corporation sought to be acquired.

(4) Some other instrument.

c. Part cash and part shares or securities of acquiring corporation at closing of purchase and tender of shares for transfer.

d. Convertible or nonconvertible debt securities of acquiring corporation or its parent.

e. Cash sufficient to enable selling shareholders to pay income tax on sale and remainder in shares, notes, or debt securities of acquiring corporation or its parent.

f. Other manner or combination.

5. Identity of principal shareholders of corporation sought to be acquired.

a. Names and addresses.

b. Occupations.

c. Number of shares owned by each.

d. Attitude toward proposed purchase of their shares by acquiring corporation, if known.

6. Whether negotiations have taken place concerning proposed purchase of shares with management of principal shareholders of corporation sought to be acquired.

a. Names and telephone numbers of persons or corporate officers who conducted negotiations for acquiring corporation.

b. Names and addresses and telephone numbers of persons or officers who conducted negotiations for corporation sought to be acquired or its shareholders.

c. Results of negotiations.

d. Attitude of management and board of directors of corporation sought to be acquired toward proposed purchase of its shares by acquiring corporation.

NOTE:
This factor will determine whether a tender offer for its shares must be made directly to the shareholders of the corporation sought to be acquired and whether such a tender offer will be actively opposed by the directors and management of that corporation.

7. Type of business conducted by corporation sought to be acquired.

NOTE:
This factor will indicate the likelihood of the corporation having unknown contingent liabilities that cannot be shown on its accounting books and financial statements. For example, a corporation that manufactures automobiles is more likely to be held liable for injuries caused by a defective product it placed on the market than is a corporation engaged in the business of operating an apartment building.

8. Whether shares of corporation sought to be acquired are listed on any national or regional securities exchanges:

a. New York Stock Exchange.

b. American Stock Exchange.

c. Pacific Stock Exchange.

d. Other.

9. Principal motive of acquiring corporation for purchasing shares of corporation sought to be acquired:

a. To acquire assets of corporation sought to be acquired.

b. To acquire net operating loss carryover deduction of corporation sought to be acquired.

c. To acquire name, goodwill, and reputation of corporation sought to be acquired.

d. To acquire particular asset of corporation sought to be acquired.

e. Other reasons.

10. Willingness of principal shareholders of corporation sought to be acquired to agree to personally indemnify acquiring corporation against unknown liabilities of corporation sought to be acquired.

11. Known liabilities, if any, of corporation sought to be acquired that are to be assumed by its shareholders or principal shareholders.

12. General solvency and financial condition of corporation sought to be acquired.

13. Any noncompetition or other special clauses desired in contract between acquiring corporation and shareholders of corporation sought to be acquired.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsStock Acquisitions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11A California Legal Forms--Transaction Guide § 11A.101

§ 11A.101 Documents

1. Articles of incorporation (as most recently amended) of corporation sought to be acquired.

NOTE:
If the management of the corporation sought to be acquired is not cooperative, copies of the articles of incorporation as most recently amended can be obtained from the Secretary of State's office in Sacramento.

2. Bylaws (as most recently amended) of corporation sought to be acquired.

3. Stock certificate book and stock record book of corporation sought to be acquired.

4. Latest available financial statements of corporation sought to be acquired and acquiring corporation.

5. Any recorded deeds of trust or other instruments encumbering any of assets of corporation sought to be acquired.

6. Any financing statements filed with Secretary of State in which corporation sought to be acquired is named as debtor.

7. Any other instruments obtainable relating to financial affairs or properties of corporation sought to be acquired.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsStock Acquisitions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11A California Legal Forms--Transaction Guide §§ 11A.102-11A.109

[Reserved]

§§ 11A.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Shares

5-11A California Legal Forms--Transaction Guide § 11A.110

§ 11A.110 Preliminary Determinations

1. Determine whether share purchase is best method of acquisition under circumstances [*see §§ 11A.111* (advantages), *11A.112* (disadvantages)].

NOTE:
For a discussion of the factors used to determine the most appropriate acquisition method, see Ch. 11, ***Merger and Acquisition Issues*** .

2. Determine whether corporation sought to be acquired was validly formed and is still in good standing.

a. Determine whether articles of incorporation were properly filed.

NOTE:
For a discussion of filing requirements, see Ch. 3, ***Articles of Incorporation*** .

b. Determine whether corporation has been suspended for failing to pay franchise tax or file franchise tax returns [*see Rev. & Tax. Code §§ 23301, 23301.5*].

c. Determine whether corporation has filed required annual statement of officers and directors with Secretary of State [*see Corp. Code § 1502*].

3. Determine whether any requirements or limitations regarding share transfer are contained in articles of incorporation or bylaws of corporation sought to be acquired.

4. Determine whether any restrictions on acquisition of corporate control, transfer of shares, or tender offers are imposed by any stock exchange on which shares of corporation sought to be acquired are listed.

5. Determine which of following methods should be used to accomplish share acquisition:

a. Agreement with shareholders of corporation to be acquired.

NOTE:
This method is generally used when the management of the corporation sought to be acquired is cooperative with regard to the acquisition [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5E, ***Tender Offers and Takeovers*** (Matthew Bender)].

b. Tender offer.

NOTE:
This method is generally used if the acquisition is actively opposed by the management of the corporation sought to be acquired [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5E, ***Tender Offers and Takeovers*** (Matthew Bender)]. For a detailed discussion of tender offers, see Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 166A, ***Tender Offers*** (Matthew Bender).

6. If share acquisition might be accomplished by tender offer [*see* P 5b, *above*], determine whether tender offer must meet requirements of federal Williams Act based on following [*15 U.S.C. § 78n(d)-(f)*; *see § 11A.114*]:

a. Person making offer, after consummation of offer, would be beneficial owner of more than five percent of that class of securities [*15 U.S.C. § 78n(d)(1)*]; and

b. One of following applies [*15 U.S.C. § 78n(d)(1)*]:

(1) Shares of corporation sought to be acquired are registered on national securities exchange pursuant to *15 U.S.C. § 78l.*

(2) Corporation sought to be acquired is insurance corporation that would be required to register its securities on national exchange [*see* P (1), *above*] except for exemption granted under 15 U.S.C. § 78(g)(2)(G).

(3) Corporation sought to be acquired is registered closed-end investment company [*see 15 U.S.C. §§ 80a-1-80a-64*].

7. With respect to basis of assets, determine whether acquiring corporation:

NOTE:
If the acquiring corporation steps-up the basis of the acquired corporation's assets, any net operating loss carryover of the acquired corporation will become unavailable for either corporation to use [***see § 11.22[5]***].

a. May elect to step-up basis of acquired corporation's assets [*I.R.C. § 338(a)*; *see § 11A.130*].

NOTE:
The acquiring corporation must make a "qualified stock purchase" [***see*** *I.R.C. § 338(d)(3)*] in order to make the election [*I.R.C. § 338(a)*].

(1) Determine whether corporation has purchased from target corporation, in one transaction or series of transactions [*I.R.C. § 338(d)(3)*; *see I.R.C. § 1504(a)(2)*]:

(a) At least 80 percent of total voting power of target corporation's stock; and

(b) At least 80 percent of total value of target corporation's stock.

(2) Determine whether stock purchase [*see* P (1), *above*] was made during one 12-month period beginning with date of first acquisition [*see I.R.C. § 338(h)(1)*].

b. Will be deemed to have elected step-up in basis of acquired corporation's assets [*I.R.C. § 338(e)*].

NOTE:

This rule is intended to prevent acquiring corporations from separately purchasing those target assets whose bases exceed fair market value, and stepping up the bases of other low-basis assets through a stock purchase and election pursuant to *I.R.C. § 338* [***see*** Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 175, ***Transferring Corporate Ownership in a Taxable Transaction*** (Matthew Bender)].

(1) Determine whether corporation has made qualified stock purchase [*see* P a, *above*].

(2) Determine whether corporation has directly acquired any asset of target corporation at any time during:

NOTE:

An asset acquisition is excluded from the application of this rule if (1) it was made pursuant to a sale by the target corporation in the ordinary course of trade or business, (2) the basis of the property acquired is wholly determined by reference to the adjusted basis of that property in the hands of the target corporation, or (3) if it was made before September 1, 1982 [*I.R.C. § 338(e)(2)*].

(a) One-year period before beginning of acquisition period.

(b) Acquisition period.

NOTE:

The "acquisition period" is the 12-month period beginning with the date of the first acquisition by purchase of stock included in a qualified stock purchase [*I.R.C. § 338(h)(1)*].

(c) One-year period beginning on day after acquisition date.

NOTE:

The "acquisition date" is the first day on which the acquiring corporation makes a qualified stock purchase [*I.R.C. § 338(h)(2)*; ***see*** P a(1), ***above***].

8. With respect to net operating loss carryovers, determine whether acquiring corporation should:

NOTE:

Any carryover of the acquired corporation available for its own use or the use of the acquiring corporation after dissolution or merger, however, may be reduced or disallowed [***see*** *I.R.C. §§ 269, 382(a)*; ***see*** *§ 11A.22[5]*].

a. Merge with or liquidate acquired corporation in order to obtain any net operating loss carryover [*I.R.C. § 381(a), (c)(1)*; *see I.R.C. § 332*].

NOTE:

For the procedures required to obtain the carryover, see *§ 11A.131*. That option is not available when the acquiring corporation has made or been deemed to have made an election pursuant to *I.R.C. § 338* [***see*** *§ 11A.110[7]*].

b. Allow acquired corporation to continue in existence as separate legal entity.

NOTE:

If the acquired corporation is not liquidated or merged, it will retain its own net operating loss carryover.

9. Determine whether any litigation for damages or violation of any laws or regulations is pending against corporation sought to be acquired.

10. Determine probable risk of unknown and inchoate liabilities reducing value of acquired corporation's shares [*see § 11A.23*].

11. Determine following information [*see I.R.C. § 1060(e)*]:

NOTE:

If both of the following requirements are satisfied, the transferor and the transferee may be subject to additional IRS reporting requirements [*I.R.C. § 1060(e)*].

a. Whether any transferor is a 10-percent owner [*see I.R.C. § 1060(e)(2)*].

b. Whether any 10-percent owner or related person enters into employment contract, covenant not to compete, royalty or lease agreement, or other agreement with transferee [*see I.R.C. § 1060(e)(3)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsLiquidations (IRC secs. 331-338)Tax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawTakeovers & Tender OffersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Shares

5-11A California Legal Forms--Transaction Guide § 11A.111

§ 11A.111 Advising Parties of Advantages of Cash Purchase of Shares

1. Shareholder approval by shareholders of purchasing corporation is not required.

2. Formal meeting of shareholders of corporation sought to be acquired to approve sales of shares is not required.

3. Approval of proposed purchase by board of directors of corporation sought to be acquired is not needed.

4. Consideration to be paid for shares, as agreed on by purchasing corporation and selling shareholders, may consist of:

a. All cash.

b. Part cash and part shares or debt securities of acquiring corporation or its parent.

c. Part cash and part promissory notes of acquiring corporation.

d. Cash enough to pay income taxes on sale due from selling shareholders and remainder in shares of acquiring corporation.

e. Other combinations of cash, notes, debt securities, shares, etc.

5. Acquiring corporation is not personally liable for debts or liabilities of acquired corporation.

6. Name and reputation of acquired corporation may be continued as separate entity.

7. No dilution of ownership interest occurs in acquiring corporation of shareholders of acquiring corporation.

8. Acquired corporation may continue to use its net operating loss carryforward if:

NOTE:
That carryforward, however, may be reduced or disallowed [***see*** *I.R.C. §§ 269(b), 382*]. For further discussion, see *§ 11A.22[5]*.

a. It is continued as separate entity; and

b. Acquiring corporation has not made election to step up basis of assets pursuant to *I.R.C. § 338* [*see § 11A.130*].

NOTE:
When such an election is made, the acquired corporation becomes a "new" corporation for tax purposes, thereby losing its old tax attributes [***see*** *I.R.C. § 338(a)(2)*; ***see*** *§ 11A.22[5]*].

9. Mechanics of transfer are simple if shareholders are few in number.

a. Requirements of Uniform Commercial Code--Bulk Sales Division are not applicable [*see Com. Code § 6101 et seq.*].

NOTE:
For a discussion of those requirements, see *Ch. 11B,* ***Cash Purchase of Assets****, § 11B.20[1][c]*.

b. Purchase price is not withheld until sales tax and employment contribution clearance are received [*see Rev. & Tax. Code § 6811*; *Unemp. Ins. Code § 1731*; *see also Ch. 11B, Cash Purchase of Assets, § 11B.112[5]*].

NOTE:
For a discussion of the withholding requirements, see *Ch. 17,* ***Buying and Selling a Business or Professional Practice****, § 17.14.*

c. Separate instruments of conveyance are not needed for each motor vehicle, corporate security, or parcel of real property owned by acquired corporation [*see Ch. 11B, Cash Purchase of Assets, § 11B.112[7]*].

d. Leases and contracts belonging to acquired corporation do not need to be assigned [*see Ch. 11B, Cash Purchase of Assets, § 11B.112[8]*].

(1) Consent to assignment of lease or contract does not need to be obtained from other party to lease or contract.

(2) Lease or contract continues to belong to acquired corporation as separate entity.

10. Transaction is not subject to California Sales and Use Tax.

NOTE:

The Sales and Use Tax [*Rev. & Tax. Code §§ 6001-7176*] imposes tax on the transfer of property in other types of reorganizations. For a discussion of the application of this tax to mergers and acquisitions, see Ch. 11, ***Merger and Acquisition Issues*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Mergers & Acquisitions LawTakeovers & Tender OffersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Shares

5-11A California Legal Forms--Transaction Guide § 11A.112

§ 11A.112 Advising Parties of Disadvantages of Cash Purchase of Shares

1. Shareholders of acquired corporation must pay income tax on any gain realized on sale of their shares to acquiring corporation [*see I.R.C. § 1001*].

NOTE:

Gain from the sale of shares, will be treated as long-term capital gain if the shares are held for more than one year [***see*** *I.R.C. § 1222(3)*].

Capital gains will be taxed at a lower rate than ordinary income. The maximum tax rate applicable to capital gains is generally 15 percent [*I.R.C. § 1(h)(1)*, effective generally for tax years ending on or after 5/16/03 and before 2009; see Pub. Law No. 108-27, §§ 301, 303], while the maximum rate applicable to ordinary income is 35 percent after 2002 [*I.R.C. § 1(a)-(d), (h), (i)(2)*]. Subject to certain additional taxes for taxable income over certain amounts, the maximum tax rate imposed on corporate income is 35 percent [*I.R.C. §§ 11(b), 1201(a)*; ***see*** Ch. 11, ***Merger and Acquisition Issues***].

a. Gain is taxed as long-term capital gain if shareholder has held shares for more than 12 months [*I.R.C. § 1222*].

b. Tax may be deferred, or possibly reduced, by having acquiring corporation pay purchase price for shares in installments [*I.R.C. § 453*].

NOTE:

An installment sale is a disposition of property in which at least one payment will be received after the close of the taxable year in which the disposition occurs [*I.R.C. § 453(b)*; ***see*** *§ 11A.22[1]*]. However, the tax benefits of an installment sale are unavailable

if the stock or securities sold are traded on an established securities market. In those circumstances, all payments to be received from the sale will be treated as received in the year of disposition [*I.R.C. § 453(k)*].

2. Acquiring corporation does not automatically receive new income tax basis for assets of acquired corporation [*see § 11A.22[2]*].

a. It receives new income tax basis for shares of acquired corporation [*I.R.C. § 1012*].

b. Its purchase of shares does not affect basis of acquired corporation's assets.

c. It may elect to step-up basis of assets [*I.R.C. § 338(a)*].

NOTE:
For a list of the procedures required to make that election, see *§ 11A.130*.

d. It will be deemed to have elected step-up in basis of assets under certain circumstances [*I.R.C. § 338(e)*; *see § 11A.110[7]*].

3. Acquiring corporation normally cannot use net operating loss carryover income tax deduction of acquired corporation to reduce its own income.

a. Deduction may be used only against income of acquired corporation even on consolidated income tax return [*see Treas. Reg. §§ 1.1502-15*, 1.1502-21(c)].

b. Deduction may be used to reduce acquiring corporation's income only if acquired corporation is liquidated pursuant to *I.R.C. § 332* or merged into acquiring corporation [*I.R.C. § 381(a), (c)(1)*; *see* Ch. 11C, *Mergers*].

NOTE:
An acquiring corporation that has made an election pursuant to *I.R.C. § 338* to step-up the basis of the acquired corporation's assets, however, cannot obtain the carryover through a tax-free merger with the acquired corporation or liquidation pursuant to *I.R.C. § 332*, since that election is deemed to result in a liquidation, after which the acquired corporation becomes a "new" corporation without its old loss carryovers [***see*** *I.R.C. § 338(a)(2)*]. Therefore, the corporation may have to choose between the benefits of a new basis for assets or a loss carryover [***see*** *§ 11A.22[4]*].

4. Unknown and contingent liabilities of acquired corporation may reduce value of its shares below purchase price paid by acquiring corporation [*see § 11A.23*].

5. Minority shareholders of acquired corporation who refuse to sell their shares may hinder future corporate operations [*see § 11A.24*].

a. May be eliminated by statutory or short-form merger of acquired corporation into acquiring corporation.

b. Cannot be eliminated by sale of all assets of acquired corporation to acquiring corporation.

6. Securing purchase of all, or substantially all, shares of corporation sought to be acquired may be unduly expensive

and burdensome if [*see § 11A.24*]:

a. Shareholders of corporation sought to be acquired are numerous and geographically scattered.

b. Management of corporation sought to be acquired actively and vigorously oppose proposed purchase of shares.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of ShareholdersTax LawFederal Income Tax ComputationSales & ExchangesInstallment Sales (IRC secs. 1001, 1031, 1231)General OverviewTax LawFederal Income Tax ComputationSales & ExchangesCapital Gains & Losses (IRC secs. 1201-1202, 1211-1212, 1221-1223, 1231-1260, 1271-1278, 1281-1288, 1291-1298)Treatment of GainsTax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Shares

5-11A California Legal Forms--Transaction Guide § 11A.113

§ 11A.113 Procedures for Making Acquisition Without Tender Offer

NOTE:
These procedures are generally used when the management of the corporation to be acquired is cooperative with regard to the acquisition [***see*** *§ 11A.110[5]*].

1. Prepare contract for purchase of shares to be executed by acquiring corporation and selling shareholders of corporation sought to be acquired [*see § 11A.200*].

a. Make copies for each of following:
(1) Office of acquiring corporation.

(2) Each director of acquiring corporation.

(3) Each shareholder of corporation sought to be acquired.

(4) Attorneys of each corporation.

b. If desired, obtain and include following from shareholders of corporation sought to be acquired:

(1) Personal indemnity agreement.

(2) Covenant not to compete with acquiring or acquired corporation.

2. Prepare resolution for adoption by board of directors of acquiring corporation [*see § 11A.201*]:

a. Approving contract for purchase of shares, and

b. Authorizing execution of contract by appropriate corporate officers on behalf of acquiring corporation.

3. Submit contract for purchase of shares and resolution approving it to acquiring corporation's board of directors.

4. Have shareholders of corporation sought to be acquired execute contract for purchase of shares.

NOTE:

Each shareholder should receive a copy of the contract executed by acquiring corporation.

As an alternative procedure, the board of directors of the corporation being acquired may send its shareholders proxy statements soliciting shareholder approval of the sale. A proxy statement must not contain any statement that, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact necessary to present the statements that are made from being false or misleading [***see*** *15 U.S.C. § 78n(a)*; *17 C.F.R. § 240.14a-9(a)*].

5. Fix closing date for consummation of share purchase and notify following persons of time and place of closing:

a. All parties.

b. Appropriate officers of acquiring corporation.

c. Selling shareholders of corporation to be acquired.

6. Prior to closing date:

a. Prepare promissory notes or other instruments required to evidence or secure any deferred portion of agreed purchase price for shares of corporation to be acquired.

b. Have appropriate officers of acquiring corporation execute instruments.

7. At closing of purchase:

a. Have selling shareholders of corporation sought to be acquired endorse and surrender share certificates to acquiring corporation.

b. Have acquiring corporation deliver payment to selling shareholders upon transfer of shares.

NOTE:

The payment for the shares may include promissory notes or other instruments evidencing or securing any deferred portion of the purchase price, in addition to cash [***see*** Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 165, ***Sales of Stock*** (Matthew Bender)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsStock Acquisitions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Shares

5-11A California Legal Forms--Transaction Guide § 11A.114

§ 11A.114 Procedures for Making Acquisition Through Tender Offer

NOTE:
These procedures are generally used when the management of the corporation to be acquired opposes the acquisition [***see*** *§ 11A.110[5]*].

1. Obtain list of names and addresses of shareholders of corporation sought to be acquired.

NOTE:
For a discussion of the inspection rights set forth below, see *Ch. 7,* ***Corporate Records and Reports****, § 7.20* et seq.

a. Director of corporation who is not opposed to acquisition may supply list [*see Corp. Code § 1602*].

b. Shareholder holding at least five percent in aggregate of corporation's outstanding voting shares has absolute right to [*Corp. Code § 1600(a)*]:
(1) Inspect and copy record of shareholders' names and addresses during usual business hours, on five business days' prior written demand on corporation.

(2) Obtain list of names and addresses of shareholders who are entitled to vote for election of directors, from corporation's transfer agent upon written demand and tender of usual charges.

c. Record of shareholders must be open to inspection and copying by any shareholder at any time during usual business hours on written demand to corporation [*Corp. Code § 1600(c)*].

(1) Inspection and copying may be done in person by shareholder or by agent or attorney [*Corp. Code § 1600(d)*].

(2) Right may not be limited by corporation's articles of incorporation or bylaws [*Corp. Code § 1600(d)*].

2. Draft offering letter to shareholders of corporation sought to be acquired [*see § 11A.202*]:

a. Include all of following [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5E, *Tender Offers and Takeovers* (Matthew Bender)]:

(1) Name, identity, and background of corporation making offer.

(2) Name of security for which offer is made.

(3) Price to be paid for shares.

(4) Date of payment.

(5) Date and hour at which right to tender shares will expire.

(6) Number of shares that must be tendered to bind acquiring corporation to consummate offer.

(7) Whether and when shareholders may withdraw tender of shares.

(8) Full disclosure of any "inside" status of acquiring corporation in connection with corporation sought to be acquired, and number of shares that corporation already holds.

(9) Instructions for tendering shares.

b. If tender offer is subject to federal Williams Act [*see § 11A.110[6]*], include information required by federal rules [*15 U.S.C. § 78n(d)(1), (4)*; *see 17 C.F.R. § 240.14d-1 et seq.*].

NOTE:

Coverage of the federal requirements is beyond the scope of this chapter. For discussion of tender offers subject to the Williams Act, see Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5E, ***Tender Offers and Takeovers*** (Matthew Bender).

3. Submit draft of offering letter to board of directors of acquiring corporation.

4. Prepare resolution approving offering letter for adoption by board of directors of acquiring corporation.

5. If tender offer is subject to federal Williams Act [*see § 11A.110[6]*], have officers of acquiring corporation complete and file Schedule 14D-1 with federal Securities Exchange Commission [*15 U.S.C. §§ 78m(d), 78n(d)*; *see 17 C.F.R. § 240.14d-3*; *see also* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5E, *Tender Offers and Takeovers* (Matthew Bender)].

6. Send copy of offering letter to each shareholder of corporation sought to be acquired.

7. Have officers and agent of acquiring corporation make any calls necessary to solicit shareholder acceptance of offering letter.

8. On date specified for payment in offering letter:

a. Have acquiring corporation deliver checks for purchase price of tendered shares to selling shareholders.

b. Ensure that share certificates are properly tendered and endorsed for transfer to acquiring corporation.

c. Submit share certificates to transfer agent of corporation sought to be acquired with written instructions to transfer them to acquiring corporation on corporation's books.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of ShareholdersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Offerors



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Shares

5-11A California Legal Forms--Transaction Guide §§ 11A.115-11A.129

[Reserved]

§§ 11A.115[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures

5-11A California Legal Forms--Transaction Guide § 11A.130

§ 11A.130 Obtaining New Income Tax Basis for Acquired Corporation's Assets

NOTE:
The following election procedures are available only to those corporations that have acquired control of the subsidiary ("target") corporation by making a "qualified stock purchase" [*I.R.C. § 338(a)*; ***see*** *§ 11A.110[7]*]. If the acquiring corporation makes the election, it cannot obtain any net operating loss carryover of the acquired corporation [***see*** *§ 11A.131*].

1. Prepare statement of election, including all of following [*I.R.C. § 338(g)(2)*; Temp. Treas. Reg. § 1.338-1T(d)]:

NOTE:
The statement must be made on IRS Form 8023, which is available from the Internal Revenue Service [Temp. Treas. Reg. § 1.338-2T(d)].

a. Name, address, and employer identification number of purchasing corporation and target.

b. Identification of election pursuant to *I.R.C. § 338*.

c. Acquisition date.

NOTE:
The acquisition date is the first day on which the acquiring corporation has completed a qualified stock purchase [*I.R.C. § 338(h)(2)*].

d. Statement that election is not barred by reason of *I.R.C. § 338(f)(2)*.

NOTE:

I.R.C. § 338(f)(2) prohibits the acquiring corporation from making an election for a qualified stock purchase with respect to a target and target affiliates if no election was made for a prior purchase during the "consistency period" [*I.R.C. § 338(f)(2)*; ***see*** *I.R.C. § 338(h)(4)*]. It prevents the acquiring corporation from structuring its acquisition as part stock purchase and part asset purchase to achieve the highest basis for each asset [S. Rep. No. 97-494, at 192].

e. Signature of person who states under penalty of perjury that he or she is authorized to make election on behalf of purchasing corporation.

2. Attach schedule providing following information [*I.R.C. § 338(g)(2)*; Temp. Treas. Reg. § 1.338-2T(d)]:

a. Name, address, and employer identification number of each corporation subject to statement of election by reason of *I.R.C. § 338(f)(1)* as of day statement of election is filed.

NOTE:

I.R.C. § 338(f)(1) causes the election to be deemed made with respect to target affiliates [*I.R.C. § 338(f)(1)*; ***see*** *I.R.C. § 338(h)(6)*].

b. Fair market value of consideration paid by purchasing corporation for stock of each target corporation.

c. Portion of consideration represented by following:

(1) Cash.

(2) Purchase money debt.

(3) Other components of consideration separately stated.

d. Liabilities of each target.

NOTE:

The amount must be as of the close of the target's acquisition date, with the tax liability resulting from the deemed sale of assets under *I.R.C. § 338(a)(1)* separately stated [Temp. Treas. Reg. § 1.338-4T(d)(1), (2)].

e. If election under *I.R.C. § 338(h)(10)* is made regarding elective recognition of gain or loss by target corporation, identification of each listed corporation that is subject to that election.

NOTE:

When an election is made under *I.R.C. § 338(h)(10)*, the acquiring corporation and the common parent of the selling consolidated group must report to the Internal Revenue Service, as required, (1) any amount of the purchase price allocated to goodwill or going concern value, (2) any modifications in the allocated amounts, and (3) any other information deemed necessary [***see*** *I.R.C. § 338(h)(10)(C)*; ***see also*** *I.R.C. § 6724(d)*].

3. File IRS Form 8023 with Internal Revenue Service Center where acquiring corporation files income tax returns, no later than 15th day of 9th month beginning after month in which "acquisition date" occurs [*I.R.C. § 338(g)(1)*].

NOTE:

The acquisition date is the first day on which the acquiring corporation has completed a qualified stock purchase [*I.R.C. § 338(h)(2)*]. The election is irrevocable [*I.R.C. § 338(g)(3)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Mergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)Changes in Corporate OwnershipTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)Affiliated CorporationsTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)CarryforwardsTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures

5-11A California Legal Forms--Transaction Guide § 11A.131

§ 11A.131 Transferring Acquired Corporation's Net Operating Loss Carryover to Acquiring Corporation

NOTE:
The procedure discussed in this section is only available to an acquiring corporation that has not made an election pursuant to *I.R.C. § 338* [***see*** *§ 11A.130*].

1. Advise acquiring corporation that obtaining carryover precludes obtaining new income tax basis for acquired corporation's assets.

NOTE:
The only means by which an acquiring corporation may step up the basis of the acquired corporation's assets is to make an election pursuant to *I.R.C. § 338* [***see*** *§ 11A.130*]. That election, however, is deemed to result in a liquidation of the acquired corporation with the emergence of a "new" corporation that does not retain any of its loss carryovers [***see*** *§ 11A.22[4]*].

2. Take one of following actions:

NOTE:
An acquiring corporation may obtain the loss carryover of an acquired corporation only pursuant to a tax-free liquidation of a subsidiary or a tax-free reorganization [***see*** *I.R.C. § 381(a)*].

a. Liquidate corporation pursuant to *I.R.C. § 332* [*see I.R.C. § 381(a)(1)*].

NOTE:
For a discussion of California dissolution procedures, see Ch. 12, ***Winding Up and***

Dissolution . For a tax discussion of the liquidation of subsidiaries, see Rabkin & Johnson, FEDERAL INCOME, GIFT AND ESTATE TAXATION, Ch. 23, ***Complete Liquidation*** (Matthew Bender).

b. Merge acquired corporation into acquiring corporation [*see I.R.C. § 381(a)(2)*; *see also* Ch. 11C, *Mergers*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawTax-Free AcquisitionsTax LawFederal Taxpayer GroupsC CorporationsLiquidations (IRC secs. 331-338)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures

5-11A California Legal Forms--Transaction Guide § 11A.132

§ 11A.132 Reporting Statutory Change in Ownership

1. Prepare and file change in ownership statement [*Rev. & Tax. Code § 480.1*].

NOTE:

Real property subject to local property taxation is reassessed when a change in ownership occurs [***see*** Cal. Const., arts. XIII, XIIIA]. A change in ownership is a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest [*Rev. & Tax. Code § 60*]. Real property owned by a corporation undergoes a change in ownership when one corporation obtains control, i.e., direct or indirect ownership or control of more than 50 percent of the voting stock of another corporation, through the purchase or transfer of that stock [*Rev. & Tax. Code § 64(c)(1)*]. For purposes of obtaining control, any purchase or transfer of 50 percent or less of the ownership interest through which control or a majority ownership interest is obtained is included [*Rev. & Tax. Code § 64(c)(1)*]. That change requires the acquiring corporation to file a change in ownership statement [*Rev. & Tax. Code § 480.1*]. For discussion, and an example of a change in ownership statement for the transfer of real property [***see*** *Rev. & Tax. Code § 480*], see *Ch. 23,* ***Real Property Sales Agreements*** *, § 23.306*.

a. Complete official form [*see Rev. & Tax. Code §§ 480.1, 480.2*].

NOTE:

A form may be obtained from the district office of the State Board of Equalization for the area in which the acquired corporation's real property is located.

b. Obtain signature of either [*Rev. & Tax. Code §§ 480.1(c), 480.2(c)*]:

(1) Officer of corporation; or

(2) Employee or agent designated in writing by board of directors to sign change in ownership statement on behalf of corporation.

c. File statement within 45 days from date of change in control with Sacramento office of State Board of Equalization [*Rev. & Tax. Code §§ 480.1(b), 480.2(b)*].

NOTE:

A change in ownership statement must also be filed whenever the State Board of Equalization makes a written request for that statement [*Rev. & Tax. Code §§ 480.1(b), 480.2(b)*].

2. Advise corporation that Board of Equalization will impose monetary penalty of 10 percent of taxes for [*Rev. & Tax. Code § 482(b)*]:

NOTE:

Rev. & Tax. Code § 64(e) establishes a procedure under which a corporation's tax return must indicate whether control was transferred or sold during the year. Changes are then reported to the State Board of Equalization. This is one source of information that is used as the basis for the issuance of a written request by the Board. By filing the statement within 45 days from the date of change in ownership, the corporation avoids incurring a penalty following a written request from the Board.

a. Failing to file statement within 45 days from earlier of:

(1) Date of change in control or change in ownership; or

(2) Date of written request by Board of Equalization.

b. Failing to file missing information after filing incomplete statement and receiving second request for information.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsReal Property LawOwnership & TransferBusiness & Corporate Entities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART III. TRANSACTION GUIDE
C. Related and Subsequent Procedures

5-11A California Legal Forms--Transaction Guide §§ 11A.133-11A.199

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§§ 11A.133[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART IV. FORMS

5-11A California Legal Forms--Transaction Guide § 11A.200

§ 11A.200 Contract for the Cash Purchase of Shares--Purchase Price Payable in Installments Pursuant to Promissory Note

[1] Comment

[a] Use of Form

This form is a simple contract for the cash purchase of all shares of a specified corporation for cash, payable in installments according to the terms of a promissory note to be given by the purchasing corporation to the selling shareholders. Because the shares of the corporation sought to be acquired are owned by the shareholders, rather than by the corporation itself, a contract for the sale of those shares must be made by its shareholders as sellers. This contract, therefore, is between the acquiring corporation and the shareholders of the corporation sought to be acquired rather than the acquired corporation itself. It is most useful when the corporation sought to be acquired is a closely owned corporation having only a few shareholders.

For a resolution to be adopted by the board of directors of the acquiring corporation authorizing the execution of the contract set forth in this form, see *§ 11A.201*. For a discussion of the income tax advantages of having the cash purchase price of shares paid in installments, see *§ 11A.22*.

[b] Warranties and Indemnifications by Sellers

One of the principal disadvantages of acquiring a corporation by purchasing its outstanding shares instead of its assets is the risk of unknown liabilities of the corporation being acquired. Every purchaser of shares runs the risk that unknown liabilities of the corporation that issued the shares will make his or her purchase worthless [*see* discussion in *§ 11A.23*].

A purchaser of all shares of a corporation cannot protect himself or herself completely against unknown inchoate liabilities of the corporation being acquired. He or she may meticulously examine the books and financial statements of the corporation for any liabilities against it that should be known. Those books and financial statements, however, are prepared under the direction and at the behest of the persons selling the buyer the shares of the corporation. Thus, a contract for the sale of shares ordinarily contains detailed warranties of the selling shareholders as to the accuracy of their corporation's financial statements and as to the solvency of the corporation they are selling. In addition, when the

purchase price for their shares is payable in installments, the buyer may also insist on an indemnity provision allowing him or her to deduct any damage suffered because of breach of warranty of the sellers from the remaining unpaid purchase price of their shares. The contract set forth in this form contains both of those warranties and indemnity agreement provisions by the sellers of the shares subject to this contract.

[c] Covenant Not to Compete

At common law, covenants not to compete were disfavored as being in restraint of trade [*see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.19*]. They were authorized and approved by statute in California as long as they were made by a person as part of his or her sale of the goodwill of a business. The sale of all the shares of a corporation was not considered to be the sale of the goodwill of a business, and consequently could not support a covenant by the seller not to compete. The statute was amended in 1945 to validate covenants not to compete when made either by a person selling the goodwill of a business or by a shareholder of a corporation selling all his or her shares in the corporation [*Bus. & Prof. Code § 16601*; *but see Hill Medical Corp. v. Wycoff (2000) 86 Cal. App. 4th 895, 897, 906-908, 103 Cal. Rptr. 2d 779* (holding that noncompetition provision in radiologist's stock redemption agreement was void under *Bus. & Prof. Code § 16600* and did not fall within exception of *Bus. & Prof. Code § 16601*, when business goodwill was not a factor in purchase of shares); *see also* Ch. 17, *Buying and Selling a Business or Professional Practice*]. The statute was again amended in 2002 to extend the authorization for noncompetition covenants to any owner's sale or other disposition of the ownership interests or assets, together with the goodwill, of a business entity or a subsidiary or division of a business entity [*Bus. & Prof. Code § 16601*].

A covenant not to compete, however, may raise an income tax problem to a selling shareholder and afford a benefit to the acquiring corporation. Ordinarily, the profit a shareholder receives on the sale of his or her shares in a corporation is a capital gain. If he or she has held the shares for more than 12 months, only one-half of that capital gain is subject to income taxation [*see I.R.C. § 1222*; *see also § 11A.22[1]*]. If, as part of his or her sale of shares, the seller covenants not to compete with the buyer or the business of the corporation the buyer is purchasing, the covenant not to compete may have an independent value in itself. The buyer may be paying one amount for the selling shareholder's shares and an additional amount for the covenant not to compete. The amount the selling shareholder receives for the covenant not to compete is not a capital gain but replaces the amount he or she would have earned by competing and is taxed as ordinary taxation [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5D, *Acquisitions of Stock* (Matthew Bender)].

The benefit that may be conferred on the buyer of shares by a covenant not to compete having such an "independent value" is the right to depreciate the amount paid for the covenant. Ordinarily, a shareholder cannot depreciate shares of a corporation, that is, take an annual depreciation deduction for the aging or wearing out of his or her shares. Shares of a corporation presumably never wear out and therefore do not depreciate. A covenant not to compete, however, usually is limited to a given number of years, after which the covenant will expire. When it is determined that the covenant not to compete made by a selling shareholder has an independent value, that is, that part of the purchase price paid for the shareholder's shares was really paid for the covenant not to compete, two consequences result. First, the portion of the purchase price found to have been paid for the covenant not to compete instead of the shares is taxed to the selling shareholder as ordinary income [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5D, *Acquisitions of Stock* (Matthew Bender)]. Second, the purchaser is allowed to depreciate over the term of years the covenant is to last the amount of the purchase price he or she is found to have paid for the covenant by taking income tax depreciation deductions for a portion of that price each year during the term of the covenant [*see O'Dell & Co. (1974) 61 T.C. 461, 468-469]* .

[2] Form

Contract for the Cash Purchase of Shares--Purchase Price Payable in Installments Pursuant to Promissory Note

STOCK PURCHASE AGREEMENT

THIS AGREEMENT is made and entered into, by, and between _____[*names of all of the shareholders of the corporation*], collectively referred to as "Sellers," and _____[*name of buyer*], referred to as "Buyer."

WHEREAS, Sellers are the owners and holders of all of the outstanding stock of _____[*name of corporation*], referred to as "Company"; and

WHEREAS, Sellers desire to sell to Buyer, and Buyer desires to purchase from Sellers, all of the shares of stock of Company upon the terms and conditions and for the consideration set forth below;

NOW, THEREFORE, in consideration of the mutual covenants contained in this agreement, the parties agree as follows:

ARTICLE 1 PURCHASE

Section 1.01. For the purchase price, and on the terms and subject to the conditions set forth in this agreement, Sellers hereby sell, assign, transfer, and deliver to Buyer, and Buyer hereby purchases from Sellers, all of their right, title, and interest in and to the capital stock of the Company now owned by each of the Sellers respectively. [*State further whether stock is being delivered to the buyer, or is retained as security by the sellers for payment of the balance of the purchase price, or will be transferred as soon as a permit to transfer the stock in escrow is obtained from the Commissioner of Corporations.*]

ARTICLE 2 PURCHASE PRICE

Section 2.01. The purchase price to be paid by Buyer to Sellers for the capital stock of Company is $_____[*amount of purchase price*].

Payment

Section 2.02. Sellers hereby acknowledge receipt of $_____ as part payment of the purchase price. The balance of the purchase price of $_____[*balance of purchase price*], plus interest at the rate of _____ percent per annum from the date hereof, shall be paid in equal monthly installments of $_____[*amount of installment*] until the entire balance of the purchase price, plus interest, has been paid in full. The initial installment shall be due and payable on _____[*due date for initial installment*], and the remainder of the equal monthly installments shall be due and payable on the same day of each succeeding month until paid in full.

Reduction

Section 2.03. The purchase price shall be subject to reduction as provided in Article 9 below.

Promissory Note

Section 2.04. The balance of the purchase price shall be evidenced by a negotiable promissory note of Buyer and shall provide in part that, on default in any payment of principal or interest the entire amount of principal and interest, at the

option of the holder of the note, shall become immediately due; that if action is instituted on the note, the Buyer agrees to pay all reasonable costs and attorneys' fees, and that Buyer shall have the option to prepay, without penalty, all or any portion of the unpaid balance.

Security

Section 2.05. The promissory note shall be secured by _____[*set forth the manner of securing payment of the promissory note*].

ARTICLE 3 WARRANTIES OF SELLERS

Section 3.01. Sellers hereby jointly and severally warrant, represent, and covenant to Buyer, and this agreement is made in reliance on the following, each of which is deemed to be a separate covenant, representation, and warranty:

Ownership of Stock

(a) Each Seller owns, beneficially and of record, free and clear of all liens, charges, claims, equities, restrictions, or encumbrances, the shares of capital stock of the Company set forth opposite his or her name in Exhibit _____, which is attached to and incorporated in this agreement, and has the full right, power, and authority to sell, transfer, and deliver to the Buyer, in accordance with this agreement, the number of shares of common stock of the Company so set forth, free and clear of all liens, charges, claims, equities, restrictions, and encumbrances. The sale by each Seller of those shares does not constitute a breach or violation of, or default under, any will, deed or trust, agreement, or other instrument by which that Seller is bound.

Liens Created by Sale

(b) The execution and carrying out of the provisions of this agreement and compliance with its provisions by the Sellers, will not violate any provision of law and will not conflict with or result in any breach of any of the terms, conditions, or provisions of, or constitute a default under, or result in the creation of, any lien, charge, or encumbrance upon any of the properties or assets of the Company pursuant to the articles of incorporation, bylaws, or any indenture, mortgage, deed of trust, agreement or other instrument to which the Company is a party or by which it is bound or affected.

Duly Organized

(c) Company is a corporation duly organized, validly existing, and in good standing under the laws of the State of California, and has its principal place of business at _____[*location of principal place of business*]. A copy of the articles of incorporation and all amendments to the articles, certified by the Secretary of State of California, and a copy of the bylaws, certified by the Secretary of the Company, have been delivered to the Buyer and are complete and correct as of the date of this agreement.

Authorized Capital

(d) Company has an authorized capital of _____[*number*] shares of common stock, par value of $_____ per share [*or* no-par value], of which _____[*number*] shares are validly issued and outstanding, fully paid and nonassessable, all of which are held by Sellers. There are no outstanding stock options or warrants with respect to, or privileges or rights to purchase or subscribe for, any capital stock of Company, obligations or securities issued by Company convertible into shares of capital stock of Company, agreements provided for or relating to any options, warrants, purchase rights, privileges, convertible obligations, or securities to which the Company is a party, or any agreements by Company to issue, sell, or acquire any of its capital stock.

Officers and Directors

(e) The following constitute the present officers and directors of the Company: _____[*list the names of all the directors and officers*].

Financial Statements

(f) Attached to and incorporated in this agreement as Exhibit _____ are statements of income and retained earnings of the Company for the fiscal years ending _____, and _____, and a balance sheet of the Company as of _____, referred to respectively as the "balance sheet" and the "date of the balance sheet." Each of the financial statements have been certified by _____[*names of accountants*], independent certified public accountants. All such financial statements are correct and complete, have been prepared in accordance with generally accepted accounting principals consistently applied throughout the periods involved, and present fairly the financial condition and the results of operation of the Company.

Statement

(g) Sellers have delivered to the Buyer a true and complete list, as of the date of this agreement and certified by the Company's Treasurer, showing

(1) The names of all persons whose compensation from the Company for the fiscal year _____ [*present fiscal year of company*] will equal or exceed $_____, together with a statement of the full amount paid or payable to each such person for services rendered in the 12 months ending _____ [*date of balance sheet*], and the basis therefor;

(2) The name of each bank in which the Company has an account or safe-deposit box, and the names of all persons authorized to draw on it or to have access to it; and

(3) The names of all persons, if any, holding tax or other powers of attorney from the Company and a summary statement of the terms of those powers.

Undisclosed Liabilities

(h) Except as, and to the extent reflected or reserved against, in the balance sheet, the Company, as of the date of the balance sheet, had no liabilities of any nature, whether accrued, absolute, contingent, or otherwise, and whether due or to become due, known or unknown, including without limitation tax liabilities due or to become due, and incurred in respect of or measured by the Company's income for any period up to that date, or arising out of transactions entered into, or any state of facts existing prior to it.

Acts by Company

(i) Since _____[*date of balance sheet*], the Company has not

(1) Incurred any obligation or liability, absolute or contingent, known or unknown, except current liabilities incurred in the ordinary course of business.

(2) Discharged or satisfied any lien or encumbrance, or paid any obligation or liability, absolute or contingent, other than current liabilities shown on the balance sheet, and current liabilities incurred since that date in the ordinary course of business.

(3) Declared or paid any dividends, made any payment or distribution of any kind to shareholders, or purchased or redeemed or otherwise acquired any shares of capital stock.

(4) Mortgaged, pledged, or subjected to lien, charge, or other encumbrance, any of its assets, tangible or intangible.

(5) Sold or transferred any of its tangible assets, or canceled any debts or claims, except in the ordinary course of business.

(6) Sold, assigned, transferred, or granted licenses or rights in any patents, trademarks, trade names, copyrights, or other intangible assets.

(7) Engaged in any transactions affecting its business or properties not in the ordinary course of business, or suffered any extraordinary losses or waived any rights of substantial value.

(8) Made or authorized any change in its outstanding stock, or in its certificate of incorporation or bylaws.

(9) Granted or agreed to grant any increase in compensation to, or paid or agreed to pay any bonus to, or made any similar arrangement with any of its directors, officers, employees, or agents.

(10) Suffered any damage, destruction, or loss (whether or not covered by insurance) materially and adversely affecting its properties or business, or of any item carried in its property account at more than $1,000.

(11) Experienced any labor trouble, or any event or condition of any character, materially and adversely affecting its business or properties.

Change in Business

(j) Since _____[*date of balance sheet*], there have been no material changes in the assets, liabilities, business, or condition of the Company other than changes in the ordinary course of business, which changes have not adversely affected its business, properties, prospects, or condition.

Contracts

(k) Except in each case as listed in Exhibit _____, attached to and made a part of this agreement, the Company is not a party to any written or oral

(1) Contract for the employment of any officer or individual employee.

(2) Contract with any labor union.

(3) Contract for the purchase of materials, supplies, services, machinery, or equipment involving payment by the Company of more than $_____ in each case, or more than $_____ in the aggregate.

(4) Contract continuing over a period of more than one year from the date of this agreement.

(5) Contract not terminable on 30 days' notice or less without liability on the part of the Company.

(6) Distributor, sales agency, or advertising contract, or contract for the sale of its products or services.

(7) Lease.

(8) Contract with any subcontractor.

(9) Bonus, pension, profit-sharing, retirement, stock purchase, stock option, hospitalization, insurance, or similar plan or practice, formal or informal, in effect with respect to its employees or others.

(10) Contract not made in the ordinary course of business.

Obligations

(l) The Company has performed all obligations required to be performed by it to date, and is not in default under any contract, agreement, lease, commitment, indenture, mortgage, deed of trust, or other document to which it is a party.

Warranty of Product

(m) The Company has not made or given any warranty or guarantee with respect to its products except as set forth in Exhibit _____, attached to and incorporated in this agreement.

Taxes

(n) The Company has filed all federal and state tax returns which are required to be filed, and has paid all taxes which have become due pursuant to those returns or pursuant to any assessment received by the Company. The amounts set up as a provision for taxes on the balance sheet are sufficient for the payment of all accrued and unpaid federal, state, county, and local taxes of the Company for the period ending on the date, and for all fiscal years prior to it. The Seller does not have any knowledge of any tax deficiency proposed or threatened against the Company.

Restrictions on Operations

(o) The Company is not a party to any contract or agreement, or subject to any charter or other corporate restriction, which materially and adversely affects its business, property, assets, operations, or conditions, financial or otherwise.

Compliance With Laws

(p) The Company has complied with, and is complying with, all applicable laws, orders, rules, and regulations promulgated by any federal, state, municipal, or other governmental authority relating to the operation and conduct of the property and business of the Company, and there are no material violations of any such law, order, rule, or regulation existing or threatened, except as shown on Exhibit _____, which is attached to and incorporated in this agreement. The Company has not received any notices of violation of any applicable zoning regulation or order, or other law, order, regulation, or requirement relating to the operation of its business or to its properties, except as shown on Exhibit _____, attached to and incorporated in this agreement.

Litigation

(q) There are no actions, suits, claims, proceedings, investigations, or litigation pending, or to the knowledge of the Sellers threatened against or affecting the Company, at law or in equity or admiralty, or before any federal, state, municipal, or other governmental department, commission, board, bureau, agency, or instrumentality, domestic or foreign, except as disclosed in Exhibit _____, attached to and incorporated in this agreement. The Company is not in default with respect to any order, writ, injunction, or decree of any court or federal, state, municipal, or other governmental department, commission, board, bureau, agency, or instrumentality, domestic or foreign.

Title to Assets

(r) The Company has good and sufficient title in and to all of the assets listed on the balance sheet or acquired by it after that date, other than inventories sold or otherwise disposed of in the ordinary course of business subsequent to that date; and those assets are in each case free and clear of all mortgages, liens, charges, encumbrances, equities, pledges, conditional sales agreements, or claims of any nature whatsoever, except as stated in the balance sheet.

Condition of Assets

(s) The assets of the Company are in good operating condition and repair, and conform with all applicable ordinances regulations, zoning, and other laws. [*If applicable, add:* Finished goods are up to normal commercial standards.]

Inventories if Applicable

(t) The inventory of the Company is in good merchantable condition, is not obsolete, and represents more than a three months' supply as to any item measured by the volume of sales or use for the fiscal year _____[*present fiscal year of the Company*], except as set forth in Exhibit _____, attached to and incorporated in this agreement.

Accounts Receivable

(u) All accounts receivable reflected in the balance sheet are current and collectible, except to the extent of the reservation for bad debts included in it, and to the extent that they have been collected since the date of the balance sheet. All accounts receivable arising since the date of the balance sheet, to the extent remaining unpaid as of the date of this agreement, are current and collectible, except to the extent of a reservation for bad debts in the amount of _____ percent of the aggregate of all accounts so arising.

Insurance

(v) Attached to and incorporated in this agreement, as Exhibit _____, is a list and brief description of all policies of fire, liability, and other forms of insurance held by the Company. Those policies are in amounts deemed by the management of the Company to be sufficient.

Patents and Trademarks

(w) Attached to this agreement and incorporated in it as Exhibit _____ is a list and brief description of all patents, patent applications, trademarks, trade names, and copyrights used, owned by, or registered in the name of the Company or in which the Company has any rights; all such patents, patent applications, trademarks, trade names, and copyrights are believed to be valid and in good standing, and are not involved in any interference, opposition, or cancellation proceedings. The Company is not a licensor or licensee with respect to any patents, trademarks, trade names, copyrights, or applications therefor, except as stated in Exhibit _____. The Company owns or possesses adequate licenses or other rights to use all patents, trademarks, trade names, processes, and copyrights necessary to conduct its business as now operated, and within _____[*number*] years immediately past, has not received any notice of conflict with the asserted rights of others, which, if unsuccessfully defended, would have a material adverse effect upon its business. Company has the right to conduct the business which it now conducts without any limitations or restrictions of any kind, and to the best of the knowledge of Sellers, the products manufactured and sold by the Company may continue to be manufactured and sold by the Company without infringing upon or violating any patents, patent applications, trademarks, trade names, copyrights, or processes of others.

Disclosures

(x) No representation or warranty contained in this agreement, and no statement made in any certificate or schedule furnished in connection with or attached to this agreement, contains any untrue statement of a material fact or omits to state any material fact necessary to make any such representation, warranty, or statement not misleading to a prospective purchaser of all of the capital stock of Company.

ARTICLE 4 WARRANTIES OF BUYER

Section 4.01. Buyer hereby warrants, represents, and covenants to Seller, and this agreement is made in reliance on the following, each of which is deemed to be a separate covenant, representation, and warranty:

[*Add, if buyer is a corporation:*]

Authorization to Purchase if Buyer

(a) Buyer is a duly organized and existing corporation under the laws of the State of _____, has all of the corporate powers and authority necessary to carry on the business it now conducts, and has the power and authority to purchase all of the capital stock of Company from Sellers on the terms, conditions, and for the purchase price set forth in this agreement.

[*Continue with the following:*]

Other Warranties

(b) _____[*List all other warranties required by sellers of buyer, if any, such as agreement not to sell, contract to sell, or encumber buyer's interest in the capital stock of company*].

ARTICLE 5 CLOSING DATE AND SURVIVAL OF WARRANTIES

Time and Place of Closing

Section 5.01. The purchase and sale described in this agreement shall be consummated, unless delayed to another date by agreement of the parties in writing, at _____ A.M. Pacific Standard [*or* Daylight Saving] Time, on _____[*date*], called "closing date," at the offices of _____[*name*], Attorney at Law, _____ Street, _____, California, called "closing place."

Obligations at Closing

Section 5.02. On the closing date, or on any other date as consummation of the purchase and sale of shares described in this agreement may be delayed by agreement of the parties in writing, at the closing place specified in this agreement,

(a) Buyer shall deliver to Sellers or their agent or agents all instruments, properly executed by Buyer, required to evidence Buyer's obligation to pay any deferred portion of the purchase price of Sellers' shares and all instruments, properly executed and acknowledged by Buyer, required to secure payment of the deferred portion of the purchase price of Sellers' shares; and

(b) Sellers shall each deliver to Buyer the certificate representing their shares in Company duly endorsed for immediate transfer to Buyer.

Survival of Warranties

Section 5.03. The warranties, representations, and covenants of each of the parties to this agreement, Buyer and Sellers, shall survive the execution of this agreement and the consummation of the purchase and sales described in this agreement.

ARTICLE 6 BOOKS AND RECORDS; RESIGNATIONS

Section 6.01. The Sellers have delivered to the Buyer all of the books and records of the Company [*add, if applicable:* and the written resignations of all of its officers and Directors].

ARTICLE 7 COVENANT NOT TO COMPETE

Covenant

Section 7.01. Each Seller agrees that he or she will not, directly or indirectly, own, manage, operate, join, control, or participate in the ownership, management, operation, or control of, or be employed or connected in any manner with or by, any business under any name similar to the name of the Company or which competes in any similar business in _____[*area in which sellers are restricted from competition*] for a period of _____[*number*] years from the date of this agreement, unless that Seller obtains the prior written consent of Buyer.

Injunctive Relief

Section 7.02. Sellers agree that the remedy at law for any breach by any of them of any provision of this paragraph will be inadequate and that, in addition to any other remedies it may have, Buyer shall be entitled to temporary and permanent injunctive relief without the necessity of proving actual damage to either the Company or to Buyer.

ARTICLE 8 BROKERAGE

Section 8.01. Each party to this agreement represents, warrants, and agrees that all negotiations relative to this agreement have been carried on by him or her, or his or her representative, directly with the other party without the intervention of any person; that no broker brought about this sale on his or her behalf; and that each party will indemnify and hold the other party harmless from any and all claims, suits, and actions for brokerage or other commissions, and from and against all expenses of any character, including reasonable attorneys' fees incurred by the other by reason of any claim by any person or broker claiming to have been engaged by, or on behalf of, the indemnifying party, or with whom the indemnifying party is claimed to have made any agreement for compensation.

ARTICLE 9 INDEMNITY

Section 9.01. Subject to the provisions of Article 10 of this agreement, Buyer shall be entitled to deduct from the unpaid balance of the purchase price the amount of damage resulting from the breach of any warranty, representation, or covenant by the Sellers and, if the amount of that damage exceeds the unpaid balance of the purchase price, Sellers shall be jointly and severally liable for, and shall pay, the amount of that excess.

ARTICLE 10 LIMITATION OF INDEMNITY

Section 10.01. Notwithstanding any other term or provision of this agreement, Sellers shall not be liable to Buyer for any breaches of any warranty, representation, or covenant set forth herein, unless those breaches exceed in the aggregate an amount equal to $_____.

ARTICLE 11 MISCELLANEOUS

Nonassignability

Section 11.01. Neither this agreement, nor any interest in this agreement, shall be assignable by the Buyer without the prior written consent of all of the Sellers.

Notices

Section 11.02. All notices required or permitted to be given under this agreement shall be in writing and shall be sent by first-class mail, postage prepaid, deposited in the United States mail in California, and if intended for the Sellers, shall be given to each of the Sellers and shall be addressed: _____[*names and addresses of sellers*], and if intended for the Buyer, shall be addressed: _____[*name and address of buyer*]. Any party to this agreement may change the address for notices to be sent to him or her by written notice to the other parties.

Governing Law

Section 11.03. All questions with respect to the construction of this agreement, and the rights and liabilities of the parties to this agreement, shall be governed by the laws of the State of California.

Inurement

Section 11.04. Subject to the restrictions against assignment as contained in this agreement, this agreement shall inure to the benefit of, and shall be binding upon, the assigns, successors in interest, personal representatives, estates, heirs, and legatees of each of the parties to this agreement.

Attorneys' Fees

Section 11.05. In the event of any controversy, claim or dispute between the parties to this agreement, arising out of or relating to this agreement or the breach of this agreement, the prevailing party shall be entitled to recover from the losing party reasonable expenses, attorneys' fees, and costs.

Entire Agreement

Section 11.06. This agreement contains the entire agreement of the parties to it, and supersedes any prior written or oral agreements between them concerning the subject matter contained in this agreement. There are no representations, agreements, arrangements, or understandings, oral or written, between and among the parties to this agreement, relating to the subject matter contained in this agreement, which are not fully expressed in it.

Executed on _____[*date*], at _____[*city and state*].

SELLERS
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]
BUYER
_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawLiabilities & Rights of SuccessorsSuccessor Liability DoctrineMergers & Acquisitions LawMergersDuties & Liabilities of Shareholders



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART IV. FORMS

5-11A California Legal Forms--Transaction Guide § 11A.201

§ 11A.201 Resolution of Board of Directors of Acquiring Corporation Authorizing Cash Purchase of Shares of Another Corporation and Execution of Contract of Sale for Share Purchase

[1] Comment--Use of Form

This form is a simple resolution that may be adopted by the board of directors of a California corporation authorizing that corporation to purchase for cash all the outstanding shares of another corporation. The resolution in this form authorizes the transaction described in the contract for cash purchase of shares contained in § 11A.200. The matters discussed in the comment to that form, therefore, apply to the resolution contained in this form directing execution of that contract.

If the acquiring corporation is to pay the purchase price of shares in installments and the installments are to be secured by a mortgage or deed of trust, a subsequent board of directors resolution expressly authorizing execution of the mortgage or deed of trust may be required by counsel for the stock sellers or a title company. The resolution in that case would simply describe the mortgage or deed of trust, the property to be encumbered by it, the obligation to be secured by it, and authorize the appropriate officers of the acquiring corporation to execute it and acknowledge it before a notary public.

For detailed discussion regarding the form of corporate resolutions, see Ch. 5, *Directors Meetings, Actions, and Resolutions* .

[2] Form

Resolution of Board of Directors of Acquiring Corporation Authorizing Cash Purchase of Shares of Another Corporation and Execution of Contract of Sale for Share Purchase

RESOLUTION

WHEREAS, a report by _____ and _____[*names or titles, e.g.*, president and executive vice-president of this corporation] regarding the proposed acquisition by this corporation of _____[*name of corporation to be acquired*], a California corporation, has been presented to and

considered by this Board of Directors at this meeting; and

WHEREAS, the report presented to and considered at this meeting recommends, after thorough examination of the matter, the acquisition of _____[*name of corporation to be acquired*] by this corporation for a total consideration of $_____; and

WHEREAS, the report presented to and considered at this meeting further recommends the acquisition of _____[*name of corporation to be acquired*] be made by means of the cash purchase of its outstanding shares; and

WHEREAS, a proposed Contract of Sale between this corporation and shareholders of _____[*name of corporation to be acquired*] for the cash purchase by this corporation for the price of $_____ per share, making a total purchase price of $_____, of all the outstanding shares of _____[*name of corporation to be acquired*] has been submitted to and examined by this Board of Directors at this meeting; and

WHEREAS, after duly considering the proposal, this Board of Directors agrees with the report submitted to it at this meeting and deems it in the best interests of this corporation to purchase all the outstanding shares of _____[*name of corporation to be acquired*] in accordance with the terms of the proposed Contract of Sale submitted to this meeting;

NOW, THEREFORE, IT IS RESOLVED that this corporation shall purchase all the outstanding shares of _____[*name of corporation to be acquired*], a California corporation, for the price of $_____ per share on the terms specified in the proposed Contract of Sale submitted to this meeting;

RESOLVED FURTHER that the president and secretary of this corporation are hereby authorized and directed to execute in the name and on behalf of this corporation the proposed Contract of Sale submitted to this meeting for the purchase by this corporation of the outstanding shares of _____[*name of corporation to be acquired*] at the price of $_____ per share;

RESOLVED FURTHER that the secretary is hereby directed to insert in the minutes of this meeting following this resolution a verbatim copy of the Contract of Sale marked "Exhibit A" submitted to this meeting for the purchase by this corporation of the outstanding shares of _____[*name of corporation to be acquired*] at the price of $_____ per share; and

RESOLVED FURTHER that after execution by this corporation and the shareholders of _____[*name of corporation to be acquired*] of the proposed Contract of Sale submitted to this meeting and described in this resolution, the officers and employees of this corporation are authorized and directed to do all acts and take all steps reasonably necessary to perform on behalf of this corporation all the terms and provisions of that contract.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawMergersDuties & Liabilities of Directors & Officers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11A CASH PURCHASE OF SHARES
PART IV. FORMS

5-11A California Legal Forms--Transaction Guide § 11A.202

§ 11A.202 Tender Offer for Cash Purchase of Shares--Offering Letter From Acquiring Corporation Directly to Shareholders of Corporation Sought to Be Acquired

[1] Comment

[a] Use of Form

This form is an offering letter that one corporation may send directly to the shareholders of another corporation offering to purchase their shares for a designated price. The form of transaction initiated by this type of letter is known as a "tender offer." When it is actively opposed by the management of the corporation sought to be acquired, it is sometimes labeled a "take-over bid" [*see* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 165, *Sales of Stock* (Matthew Bender)]. It is sometimes also published in financial newspapers and is usually followed by personal solicitation of the principal shareholders of the corporation sought to be acquired.

This type of offering letter is an alternative to the contract for the cash purchase of shares, such as that contained in § 11A.200, for use when the signatures of all shareholders of the corporation sought to be acquired cannot be obtained on such a contract, or execution by them of such a contract is opposed by management of their corporation. The letter offer in this form does not comply with requirement of the federal Williams Act [*see* [c], *below*].

[b] Use of Tender Offers

When one corporation seeks to acquire ownership of another corporation by means of a statutory merger or the purchase of the other corporation's assets, either for cash or for its own shares, acquiescence of the other corporation's management and board of directors is essential. This is not the case, however, when one corporation seeks to acquire ownership of another corporation by the purchase of all its outstanding shares. In fact, if has become increasingly common for a corporation seeking to acquire another corporation to make a direct proposal to the shareholders of the second corporation for the purchase of their shares-sometimes over the vigorous opposition of the second corporation's management. These direct offers to the shareholders are known as "tender offers" because they invite the shareholders to "tender" their shares for purchase by the acquiring corporation [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5E, *Tender Offers and Takeovers* (Matthew Bender)].

A tender offer for purchase of the shares of a corporation is usually made by means of an "offering letter" sent to the shareholders of the corporation sought to be acquired. The names and addresses of the shareholders can usually be obtained through a friendly shareholder of the corporation, that is, a shareholder who favors selling his or her shares to the acquiring corporation. Every shareholder has the right, in person or by agent or attorney, to inspect and copy a corporation's record of shareholders at any time during usual business hours on written demand of the corporation [*Corp. Code § 1600(c)*].

In addition to being sent by mail to all known shareholders of the corporation sought to be acquired, the offering letter often will be published in financial newspapers. Sometimes the offering letter also will offer to pay a commission to any members of a national securities exchange who cause shares to be tendered under the offer. This causes independent stock brokers to solicit shareholders of the corporation sought to be acquired to tender their shares.

[c] Regulation of Tender Offers

This offering letter is not drafted to comply with any federal statutes regulating offering letters or tender offers. One of the major federal statutes regulating the making of tender offers is the Williams Act set forth as Sections 13 and 14 of the federal Securities Exchange Act of 1934 [*15 U.S.C. §§ 78m(d), (e), 78n(d)*-(f)]. It applies to any person making a tender offer that, if successful, would result in his or her beneficial ownership of more than 5 percent of any class of shares of the following:

- A corporation registered on a national securities exchange as described in Section 12 of the Securities Exchange Act of 1934 [*15 U.S.C. §§ 78l, 78n(d)*];

- An insurance company required to be registered under the Securities Exchange Act of 1934 except for the exemption of insurance companies expressly contained in that Act [*see 15 U.S.C. §§ 78l(g)(2)(G), 78n(d)*]; or

- A registered closed end investment company [*15 U.S.C. § 78n(d)*].

The Act requires the person or corporation making the tender offer to file eight copies of a schedule obtainable from the federal Securities Exchange Commission and eight copies of his or her proposed offering letter or advertisement with the Securities Exchange Commission before making the tender offer [*15 U.S.C. § 78n(d)*]. In addition, it requires the offering letter or advertisement to contain certain specific items [*see 15 U.S.C. § 78n(d)(1)*; *17 C.F.R. §§ 240.14d-1-240.14d-9*; *see also § 11A.114*]. Those items should be carefully examined if the corporation whose shares are sought to be acquired is registered on a national securities exchange.

[2] Form

Tender Offer for Cash Purchase of Shares--Offering Letter From Acquiring Corporation Directly to Shareholders of Corporation Sought to Be Acquired

OFFERING LETTER

TO THE SHAREHOLDERS OF _____[*name of corporation sought to be acquired*]:

_____[*name of acquiring corporation*], called "Offeror," hereby offers to purchase all outstanding shares of _____[*name of corporation sought to be acquired*], a California corporation, called "the corporation," on the following terms and conditions:

1. Offeror will pay the price of $_____ per share net of brokerage commission and transfer taxes for shares of the common stock of the corporation in cash;

2. Offeror will pay the price of $_____ per share net of brokerage commissions and transfer taxes for shares of the preferred stock of the corporation;

3. This offer will expire on _____[*date*], and Offeror will purchase all shares tendered before _____ P.M. Pacific Standard Time on that date;

4. Payment for tendered shares will be made as soon as practicable after expiration of this offer on _____[*date specified in Paragraph 3 of letter*];

5. Tenders may be withdrawn at anytime before _____ P.M. Pacific Standard Time on _____[*date*], and will thereafter be irrevocable;

6. A total of _____ shares of the common stock of the corporation and _____ shares of the preferred stock of the corporation, being 80 percent of all outstanding common and preferred shares of the corporation, must be tendered pursuant to this offer irrevocably by the time specified in this letter for expiration of this offer before Offeror is obligated to purchase any shares, either common or preferred, of the corporation pursuant to the terms of this offer;

7. Shareholders wishing to accept this offer and tender their shares for purchase pursuant to it should fill out and execute the enclosed LETTER OF ACCEPTANCE AND ASSIGNMENT and return it to one of the depositories named below together with either the certificate issued by the corporation for their shares in the corporation or the guaranty of their signature on that Letter of Acceptance and Assignment by a bank or trust company or a member of the New York Stock Exchange or Pacific Coast Stock Exchange. The Letter of Acceptance and Assignment must bear the signature of each tendering shareholder and clearly set forth the name of the stockholder, the number of shares he or she is tendering for purchase, and the serial number of the share certificate evidencing those shares.

8. A tender will be deemed to have been duly made when the enclosed Letter of Acceptance and Assignment duly completed and executed together with attached share certificate or signature guaranty as described in Paragraph 7 of this letter is received at one of the depositories named below.

9. _____[*name*] is acting as dealer manager in connection with this offer and Offeror will pay them the customary reasonable fee for those services.

10. The stock transfer department of the _____ Bank at _____ Street, _____, California and the stock transfer department of the _____ Bank at _____ Street, _____, California have and are hereby designated as depositories for this offer.

11. Offeror is a California corporation having its principal executive offices at _____ Street, _____, California and is primarily engaged in the principal business of _____[*designate, e.g.*, operating radio and television broadcasting stations].

12. Offeror desires to purchase all outstanding shares of the corporation and to operate it as a wholly owned subsidiary of Offeror.

13. Neither Offeror, any of its directors, nor any of its officers own any shares or interest in the corporation or have any rights to acquire any shares or interest in the corporation.

14. The decision of the officers of the depositories named in this letter as to the validity, form, and time of receipt

of any tenders made pursuant to this letter shall be final, conclusive, and binding both on Offeror and all shareholders of the corporation.
Dated: _____.

_____ [*name of acquiring corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewSecurities LawAdditional Offerings & the Securities Exchange Act of 1934Tender OffersPublic AnnouncementSecurities LawAdditional Offerings & the Securities Exchange Act of 1934Tender OffersDisclosuresMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of ShareholdersSecurities LawAdditional Offerings & the Securities Exchange Act of 1934Tender OffersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS

5-11B California Legal Forms--Transaction Guide 11B.syn

§ 11B.syn Synopsis to Chapter 11B: CASH PURCHASE OF ASSETS

§ 11B.01 California Sources

§ 11B.02 Federal Sources

§§ 11B.03-11B.04 [Reserved]

§ 11B.05 Law Reviews and Periodicals

§ 11B.06 Annotations

§ 11B.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 11B.08-11B.19 [Reserved]

§ 11B.20 Non-Tax Factors in Cash Purchase of Assets

[1] Overview of Statutory Requirements

[a] In General

[b] California General Corporation Law

[c] Bulk Sales Provisions

[d] Successor Liability Provisions

[2] Directors' and Shareholders' Approval

[a] Noncompliance Renders Sale Voidable

[b] Authorization for Sale

[c] Approval of Sale Terms

[3] Transactions Subject to Approval Requirements

[4] Exemptions From Shareholder Approval Requirements

[a] "Reorganizations"

[b] Sales in Usual Course of Business

[5] Opinion of Independent Appraiser

[6] Special Requirements for Sales by Subsidiaries

[a] Proposed Buyer in Control of Selling Corporation

[b] Purpose of Requirements

[c] Exchange of All Assets Is "Reorganization"

[7] Corporate Creditors

[8] Abandonment of Proposed Sale

§ 11B.21 Tax Factors in Cash Purchase of Assets

[1] Allocation of Purchase Price

[2] Net Operating Loss Carryforward Deduction

§ 11B.22 Advantages and Disadvantages of Sale

[1] Nonassumption of Liabilities

[2] Other Advantages

[a] Approval of Acquiring Corporation's Shareholders Not Required

[b] No Dissenting Shareholder Issues

[c] No Securities Law Compliance

[d] Selection of Assets

[3] Disadvantages

§§ 11B.23-11B.99 [Reserved]

§ 11B.100 Facts

Scope

§ 11B.101 Documents

Scope

§§ 11B.102-11B.109 [Reserved]

§ 11B.110 Preliminary Determinations

Scope

§ 11B.111 Advising Parties of Advantages of Cash Asset Sale

Scope

§ 11B.112 Advising Parties of Disadvantages of Cash Asset Sale

Scope

§ 11B.113 Preparing Instruments

Scope

§ 11B.114 Procedure When Selling Corporation Will Dissolve

Scope

§ 11B.115 Procedure When Selling Corporation Will Not Dissolve

Scope

§§ 11B.116-11B.199 [Reserved]

§ 11B.200 Contract for Cash Sale of Assets--All Assets of Selling Corporation to Be Sold to Acquiring Corporation for Cash Payable at Close of Escrow

[1] Comment

[a] Use of Form

[b] Fixing Responsibility for Contingent Liabilities

[2] Form

Contract for Cash Sale of Assets--All Assets of Selling Corporation to Be Sold to Acquiring Corporation for Cash Payable at Close of Escrow

§ 11B.201 Resolution of Board of Directors of Selling Corporation Approving Sale of All Corporate Assets

[1] Comment--Use of Form

[2] Form

Resolution of Board of Directors of Selling Corporation Approving Sale of All Corporate Assets

§ 11B.202 Resolution of Shareholders of Selling Corporation Approving Sale of All Corporate Assets for Cash

[1] Comment

[a] Use of Form

[b] Vote Required for Resolution

[c] Opinion of Independent Appraiser

[2] Form

Resolution of Shareholders of Selling Corporation Approving Sale of All Corporate Assets for Cash

§ 11B.203 Written Consent of Shareholders of Selling Corporation Approving Sale of All Corporate Assets for Cash

[1] Comment--Use of Form

[2] Form

Written Consent of Shareholders of Selling Corporation Approving Sale of All Corporate Assets for Cash



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS

5-11B California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter covers the most direct method by which one corporation can gain ownership and control over the business and affairs of another corporation--the purchase of assets for cash or for cash and debt securities. The Legal Background discusses the requirements of the California General Corporation Law and other applicable statutes, the income tax ramifications, and the tax and nontax advantages and disadvantages of this type of transaction. The Transaction Guide contains a procedural guide to the cash purchase of assets. It covers procedures that apply when the selling corporation will dissolve, as well as those applicable when it will not dissolve. This chapter also includes a contract for the cash sale of assets, resolutions of the board of directors and shareholders of the selling corporation approving the sale, and the written consent of the shareholders of the selling corporation approving the sale.

The cash sale or purchase of all assets of a corporation may also be a method for winding up the affairs and dissolving the acquired corporation. For further discussion, see Ch. 12, *Winding Up and Dissolution* . The cash sale or purchase of all assets of a corporation is simply another sale of a business for purposes of the Uniform Commercial Code--Bulk Sales Division [*Com. Code § 6101 et seq.*], the California Sales and Use Tax Law [*Rev. & Tax. Code § 6001 et seq.*], the Bradley-Burns Uniform Local Sales and Use Tax Law [*Rev. & Tax. Code § 7200 et seq.*] and provisions of the Unemployment Insurance Code concerning the liability of successors, officers, and fiduciaries [*Unemp. Ins. Code § 1731 et seq.*]. For detailed escrow instructions relating to the sale of businesses generally, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

For a discussion and comparison of the various methods of corporate acquisition, see Ch. 11, *Merger and Acquisition Issues* . These methods are covered individually in Ch. 11A, *Cash Purchase of Shares* ; Ch. 11C, *Mergers;* Ch. 11D, *Acquisition of Shares for Shares* ; and Ch. 11E, *Acquisition of Assets for Shares* .

Further detailed discussion of the sale of assets is contained in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* (Matthew Bender). Forms relating to the sale of a business are set forth in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Appendix A, Forms 13.01-13.06 (Matthew Bender).



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART I. RESEARCH GUIDE
A. Primary Sources

5-11B California Legal Forms--Transaction Guide § 11B.01

§ 11B.01 California Sources

General invalidity of contract restraints on practice of lawful profession, trade, or business. *Bus. & Prof. Code § 16600*.

Permissible use of noncompetition agreements on sale of all corporate assets. *Bus. & Prof. Code § 16601*.

Bulk sales, requirements for notice. *Com. Code §§ 6101-6111*.

"Approval of outstanding shares" defined. *Corp. Code § 152*.

Sale of all corporate assets, approval by directors and shareholders required. *Corp. Code § 1001(a)*.

Sale of all assets, abandonment after approval. *Corp. Code § 1001(b)*.

Sale of all assets, permissible terms. *Corp. Code § 1001(c)*.

Sale to parent corporation of all assets, special shareholder approval required. *Corp. Code § 1001(d)*.

Sale to parent corporation of all assets, commissioner approval as excusing special shareholder approval. *Corp. Code § 1001(e)*.

Sale by corporation, form of deed or conveyance required. *Corp. Code § 1002*.

Requirements applicable to reorganization proposal made by person controlling or involved in management of target corporation. *Corp. Code § 1203*.

Sale of subsidiary assets, approval as to fairness by Corporations Commissioner after hearing. *Corp. Code § 25142*.

Sale of subsidiary assets to parent, approval by Insurance Commissioner after hearing. *Ins. Code § 838.5*.

Sale of subsidiary assets to parent, approval by Public Utilities Commission. *Pub. Util. Code § 822*.

Sales and use tax, successor liability statute. *Rev. & Tax. Code §§ 6811, 6812*.

Unemployment compensation insurance contribution.

Successor liability statutes. *Unemp. Ins. Code §§ 1731-1736*.

Transfer of employer's reserve account. *Unemp. Ins. Code §§ 1051-1060*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART I. RESEARCH GUIDE
A. Primary Sources

5-11B California Legal Forms--Transaction Guide § 11B.02

§ 11B.02 Federal Sources

Availability of net operating loss carryover deduction to acquiring corporation. *I.R.C. § 381*.

Determination of gain or loss on sale of property. *I.R.C. § 1001*.

Adjusted income tax basis for property defined. *I.R.C. § 1011*.

Income tax basis for property as cost. *I.R.C. § 1012*.

Net long-term capital gain defined. *I.R.C. § 1222(7)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART I. RESEARCH GUIDE
A. Primary Sources

5-11B California Legal Forms--Transaction Guide §§ 11B.03-11B.04

[Reserved]

§§ 11B.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11B California Legal Forms--Transaction Guide § 11B.05

§ 11B.05 Law Reviews and Periodicals

Nichols & Bradford, *Corporate Acquisitions and Successor Liability (With Forms)*, 44(5) Prac. Law. 21 (1998).

Malak, *The Attorney's Role in Small Business Acquisitions*, 43(5) Prac. Law. 71 (1997).

Stein, *How to Use Defined Terms to Make Transactional Documents Work Better*, 43(7) Prac. Law. 15 (1997).

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Gotts & Mann, *Ten "Don'ts" for Acquisition Documents*, 41(2) Prac. Law. 15 (1995).

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Note, *Corporations: Sale of Assets or De Facto Merger? 47 Cal. L. Rev. 180 (1959).*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11B California Legal Forms--Transaction Guide § 11B.06

§ 11B.06 Annotations

Annot., What Constitutes Violation of § 208 of Employee Retirement Income Security Act (ERISA) (*29 U.S.C. § 1058*), *Prohibiting Certain Mergers, Consolidations, and Transfers Involving Pension Plans, 103 A.L.R. Fed. 390 (1991)* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11B California Legal Forms--Transaction Guide § 11B.07

§ 11B.07 Text References

[1] Matthew Bender Sources

Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , §§ 251.01, 252.01 (Matthew Bender).

CALIFORNIA LEGAL FORMS (Matthew Bender).

Ch. 12, *Winding Up and Dissolution*.

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Ch. 160, *Review of Methods of Buying and Selling Corporate Businesses*.

Ch. 161, *Review of Factors to Be Considered in Selecting Form of Acquisition*.

Ch. 162, *Mergers*.

Ch. 163, *Sales of Assets Transactions*.

Ch. 171, *The Acquisition Agreement*.

Ch. 173, *Choosing the Method of Transferring the Ownership of a Corporate Business*.

Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS (Matthew Bender).

Ch. 1, *The Business Setting of Corporate Acquisitions and Mergers*.

Ch. 2, *The Legal Setting of Corporate Acquisitions and Mergers*.

Ch. 2A, *General Considerations in Corporate Acquisitions and Mergers*.

Ch. 3, *Tax Factors in Corporate Acquisitions and Mergers*.

Ch. 4, *Tax-Free Acquisitions*.

Ch. 5, *Taxable Transactions*.

Ch. 5A, *Summary of Acquisition Methods*.

Ch. 5C, *Acquisitions of Assets*.

[2] Additional Text References

Witkin, Summary of California Law, vol. 9, *Corporations*, §§ 187-191 (10th ed. 2005).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11B California Legal Forms--Transaction Guide §§ 11B.08-11B.19

[Reserved]

§§ 11B.08[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART II. LEGAL BACKGROUND

5-11B California Legal Forms--Transaction Guide § 11B.20

§ 11B.20 Non-Tax Factors in Cash Purchase of Assets

[1] Overview of Statutory Requirements

[a] In General

California's General Corporation Law does not contain any requirements applicable to a purchasing corporation that acquires the assets of another corporation for cash, or for cash and promissory notes. The selling corporation, however, must comply with various explicit requirements in that law before it can sell, lease, convey, exchange, transfer, or otherwise dispose of all or substantially all of its assets [*Corp. Code § 1001*; *see* [b], *below*]. Other statutes concerning bulk sales and successor liability may apply as well [*see* [c], [d], *below*]. Provisions of the Internal Revenue Code applicable for income tax purposes to the cash purchase of assets are discussed separately [*see § 11B.21*].

[b] California General Corporation Law

The statutory requirements of the General Corporation Law, relating to the director and shareholder approval required for the sale of all or substantially all assets of a corporation, are contained in Chapter 10 of the General Corporation Law [*Corp. Code §§ 1000-1002*]. Although these requirements are imposed on the sale rather than the purchase of the selling corporation's assets, counsel for both the acquiring and selling corporation will be equally interested in seeing that they are duly observed. For further discussion, see [2]-[4], *below*.

[c] Bulk Sales Provisions

The Uniform Commercial Code-Bulk Sales Division (UCC Division 6) [*see Com. Code §§ 6101-6111*] applies to any firm whose principal business is the sale of inventory from stock, including firms that manufacture what they sell, or is that of restaurant owner [*Com. Code § 6103(a)*; *see Com. Code § 6103(c)* (exceptions)]. Unless specifically exempted, a buyer must give public notice of the bulk sale [*see Com. Code §§ 6104(b), 6105*] if the sale is not in the ordinary course of the firm's business and constitutes more than half of the firm's inventory and equipment [*Com. Code § 6102(a)(3)*]. For further discussion, see *Ch. 17, Buying and Selling a Business or Professional Practice, § 17.20*.

[d] Successor Liability Provisions

In consummating the purchase, the acquiring corporation must comply with the requirements of the successor liability requirements under the California Sales and Use Tax Law [*Rev. & Tax. Code §§ 6811, 6812*], the Bradley-Burns Uniform Local Sales and Use Tax law [*see Rev. & Tax. Code § 7202(b), (h)(2)*], and the Unemployment Insurance Code [*Unemp. Ins. Code § 1731 et seq.*]. The Sales and Use Tax Law makes the acquiring corporation liable for any sales taxes due from the selling corporation unless it withholds the purchase price of the selling corporation's assets until it receives a sales tax clearance for the selling corporation from the California State Board of Equalization [*Rev. & Tax. Code §§ 6811, 6812*]. The Unemployment Insurance Code makes the acquiring corporation liable for any unemployment compensation insurance contributions due from the selling corporation unless, before paying the selling corporation, it receives a statement from the Department of Benefit Payments showing that no such contributions are due [*Unemp. Ins. Code §§ 1731, 1732*]. Similarly, when the selling corporation is discontinuing business, its reserve account for unemployment compensation insurance purposes may be transferred to the acquiring corporation in certain cases [*see Unemp. Ins. Code §§ 1051-1060*]. For further discussion, see *Ch. 17, Buying and Selling a Business or Professional Practice, § 17.14*.

[2] Directors' and Shareholders' Approval

[a] Noncompliance Renders Sale Voidable

California's General Corporation Law contains explicit provisions specifying under what conditions a corporation subject to its provisions may sell, lease, convey, exchange, transfer, or otherwise dispose of all or substantially all of its assets [*see Corp. Code §§ 1001, 1002*]. Those include shareholder approval [*see* [b], [c], *below*]. The first California statute requiring shareholder approval for a sale of all or substantially all of a corporation's assets stated that a sale without that shareholder approval was void. Subsequent California statutes, including the present General Corporation Law, do not contain this provision. Therefore, a sale of all or substantially all the assets of the corporation without compliance with provisions of the General Corporation Law requiring it to be approved by the outstanding shares of the corporation is only voidable and not void [Long Constr. Co. v. Empire Drive-In *Theatres, Inc. (1962) 208 Cal. App. 2d 726, 735, 25 Cal. Rptr. 509* ; *Solorza v. Park Water Co (1948) 86 Cal. App. 2d 653, 658-660, 195 P.2d 523]* .

[b] Authorization for Sale

A corporation may sell, lease, convey, exchange, transfer, or otherwise dispose of all of its assets under the General Corporation Law on the terms and conditions and for the consideration that its board of directors may deem in the best interests of the corporation [*Corp. Code § 1001(c)*]. The consideration for the sale or other disposition may be money, property or securities of any other domestic or foreign corporation, or may be a combination of money and property and securities [*Corp. Code § 1001(c)*].

[c] Approval of Sale Terms

The principal terms of any sale, lease, conveyance, exchange, transfer, or other disposition of all or substantially all of its assets by a corporation must be (1) approved by the corporation's board of directors, and (2), unless the transaction is in the usual and regular course of its business, "approved by the outstanding shares" of the corporation [*Corp. Code § 1001(a)*].

"Approved by the outstanding shares" is a term of art as used in the General Corporation Law and is expressly defined to mean that the principal terms of the transaction must be approved by the affirmative vote of a majority of the outstanding shares of the corporation entitled to vote [*Corp. Code § 152*]. Approval of the terms by the affirmative vote of a majority of the voting shares represented at a shareholders' meeting at which a quorum is present is not sufficient. The matter must be approved by the affirmative vote of a majority of all outstanding shares of the corporation entitled to vote [*see Corp. Code §§ 152, 153*].

The term "approved by the outstanding shares" also means a matter must be approved by (1) the affirmative vote of a majority of the outstanding shares of each class or series entitled by any provision of the corporations's articles of incorporation to vote as a class or series on the matter and (2) the affirmative vote of that greater proportion, including all, of the outstanding shares of any class or series in which that greater vote is required by the corporation's articles of incorporation [*Corp. Code § 152*].

The principal terms of a sale or other disposition of all or substantially all of its assets by a corporation may be approved by the outstanding shares of the corporation either before or after their approval by the corporation's board of directors and either before or after the transaction [*Corp. Code § 1001(a)*].

[3] Transactions Subject to Approval Requirements

A corporation may sell or otherwise dispose of "all or substantially all of its assets" when the principal terms of the transaction are approved by its board of directors and are "approved by the outstanding shares" of the corporation [*Corp. Code § 1001(a)*; Assembly Select Com. Rep., at 90]. The issue then arises as to what constitutes "all or substantially all of its assets" for purposes of these statutes. The California Supreme Court answered this question by examining the purpose and history of the sale of asset approval statutes [*see Jeppi v. Brockman Holding Co. (1949) 34 Cal. 2d 11, 15, 206 P.2d 847]* . At common law the rule was that in the absence of special authority, the owners of a majority of the shares of an ordinary business corporation that was a going and profitable company had no power to authorize the corporation or the board of directors of the corporation to sell all or substantially all of the corporate assets [*Geddes v. Anaconda Copper Mining Co. (1920) 254 U.S. 590, 595-596, 41 S. Ct. 209, 65 L. Ed. 425]* . The consent of all the shareholders of an ordinary business corporation was required in order to authorize the corporation to sell all its assets [*Jeppi v. Brockman Holding Co. (1949) 34 Cal. 2d 11, 15, 206 P.2d 847]* . The reasoning behind the common law rule was based on contract.

Every business corporation is organized for the purpose of doing business of some kind. That purpose is required to be stated, in general terms at least, in the corporation's articles of incorporation [*see Corp. Code § 202(b)*]. The corporation's articles of incorporation, as the corporation issues and sells its shares, creates a contractual relationship between the corporation and its shareholders as well as between the shareholders themselves [*Fawkes v. Farm Lands Inv. Co. (1931) 112 Cal. App. 374, 378-379, 297 P. 47]* . An implied contract therefore exists between the corporation and its shareholders and among the shareholders themselves that the corporation will pursue the purpose for which it was organized [*Geddes v. Anaconda Copper Mining Co. (1920) 254 U.S. 590, 596, 41 S. Ct. 209, 65 L. Ed. 425]* . In other words, the shareholders have a contractual right to insist that the corporation continue for the purpose for which it was organized [*Jeppi v. Brockman Holding Co. (1949) 34 Cal. 2d 11, 16, 206 P.2d 847]* .

Because the purpose for which a business corporation is organized is to conduct a business of some kind, a sale of all or so much of the corporate property as prevents the corporation from conducting that business constitutes a violation of the corporation's contract with its shareholders to continue to pursue the purpose for which it was organized [*Jeppi v. Brockman Holding Co. (1949) 34 Cal. 2d 11, 15, 206 P.2d 847* ; *Bickston v. Federal Firearms Corp. (1964) 227 Cal. App. 2d 574, 580, 38 Cal. Rptr. 793]* . The California statutes authorizing a corporation to sell or otherwise dispose of all or substantially all its assets when the principal terms of the transaction are approved by majority vote of its outstanding shares are simply a modification and relaxation of the common law rule [*Jeppi v. Brockman Holding Co. (1949) 34 Cal. 2d 11, 15, 206 P.2d 847]* . A corporation, therefore, is selling or otherwise disposing of "all or substantially all of its assets" and must comply with the statutes if it is attempting to sell or otherwise dispose of all its assets or as much of its assets as will prevent it from continuing in business and pursuing the purpose for which it was organized [*Bickston v. Federal Firearms Corp. (1964) 227 Cal. App. 2d 574, 580, 38 Cal. Rptr. 793]* .

If a corporation is organized for the sole or principal purpose of converting its assets into cash, a sale by the corporation of all or substantially all its assets at a profitable price will not be subject to the statute. For example, when a corporation is organized for the sole purpose of managing and disposing of the property of a decedent's estate, a sale by

the corporation of a principal asset of the estate is in reality in furtherance of the very purpose for which the corporation was organized. Therefore, the sale will not violate the corporation's implied contract with its shareholders. That sale is in the normal course of the corporation's business, and is not subject to the restrictive provisions of the General Corporation Law requiring the sale to be approved by a majority vote of the corporation's outstanding shares [*Jeppi v. Brockman Holding Co. (1949) 34 Cal. 2d 11, 16, 206 P.2d 847]* .

[4] Exemptions From Shareholder Approval Requirements

[a] "Reorganizations"

Three types of transactions are expressly exempted from the shareholder approval requirements imposed by the General Corporation Law on the sale by a corporation of all or substantially all of its assets [*Corp. Code § 1001(a)*]. The first exclusion is for transactions, such as assets-for-shares exchanges, coming within the definition of the term "reorganization" contained in the General Corporation Law [*Corp. Code § 1001(a)*]. Those transactions are subjected instead to the generally stricter shareholder approval requirements imposed on statutory and de facto mergers [*Corp. Code §§ 1001(a), 1200, 1201*; *see Ch. 11C, Mergers, § 11C.22[5]*]. The second exclusion from the shareholder approval requirements is for transactions constituting conversions [*Corp. Code § 1001(a)*; *see Corp. Code § 161.9* ("conversion")]. These transactions are instead subject to the provisions of *Corp. Code § 1150 et seq.* [*Corp. Code § 1001(a)*].

[b] Sales in Usual Course of Business

The third exclusion from the shareholder approval requirements is for sales in the usual and regular course of the corporation's business [*Corp. Code § 1001(a)*]. These need not be "approved by the outstanding shares" of the corporation [*Corp. Code § 1001(a)*; *see* [2], *above*]. The term "usual and regular course" of the corporation's business is not defined in the General Corporation Law. However, the drafters of the General Corporation Law, as revised effective January 1, 1977, stated that its insertion into the shareholder approval statute was to eliminate the necessity of obtaining shareholder approval of asset sales in certain appropriate situations. For instance, a sale of major corporate assets in connection with a program for modernization of the corporation's capital assets, although not an everyday occurrence, is generally considered by the business community as within the corporation's power and should not require shareholder approval [Assembly Select Com. Rep., at 90, 91].

[5] Opinion of Independent Appraiser

When a tender offer (including a share exchange tender offer) or a written proposal for approval of a sale of assets [*Corp. Code § 1001(a)*] or "reorganization" [*see Corp. Code §§ 181, 1200*] is made to some or all of a corporation's shareholders by a party to the transaction who has control of or a financial interest in that corporation, an affirmative opinion in writing regarding the fairness of the consideration to the shareholders must be provided to the shareholders or the corporation [*Corp. Code § 1203(a)*]. This requirement does not apply if the target corporation does not have shares held of record by 100 or more persons [*see Corp. Code § 605* (determination of shareholders of record)], or if the transaction has been qualified pursuant to *Corp. Code § 25113* (qualification of issuer transaction by permit) or 25121 (qualification of recapitalization or reorganization by permit), and no stop order [*see Corp. Code §§ 25140, 25143(a)*] is in effect regarding that qualification [*Corp. Code § 1203(a)*]. For further discussion, see Ch. 11, *Merger and Acquisition Issues* .

[6] Special Requirements for Sales by Subsidiaries

[a] Proposed Buyer in Control of Selling Corporation

A special statutory requirement is imposed on a sale in which the proposed buyer of all or substantially all the assets of a corporation is either in control of or under common control with the selling corporation [*Corp. Code § 1001(d)*]. In

such a case, the principal terms of the sale must be approved by at least 90 percent of the voting power of the selling corporation, unless the sale is to a domestic or foreign corporation or other business entity in consideration of the nonredeemable common shares or nonredeemable equity securities of the acquiring party or its parent [*Corp. Code § 1001(d)*]. The purchasing corporation will be in control of the selling corporation for purposes of the statutory requirement if it owns, directly or indirectly, shares entitled and having the power to elect more than 50 percent of the directors of the selling corporation [*Corp. Code §§ 160(a), 194.5*]. The buyer will be under common control with the seller if some other corporation or person owns shares having the power to elect more than 50 percent of the directors of both the buying and selling corporations [*Corp. Code §§ 160(a), 194.5*].

[b] Purpose of Requirements

The purpose of the statutory requirement with respect to subsidiaries is to prevent a single majority shareholder from "cashing out" minority shareholders of a subsidiary [*see* State Bar Committee on Corporations, Report of the Drafting Subcommittee 3 (May 10, 1976)]. Otherwise, a parent corporation owning 51 percent of the voting shares of a subsidiary could force out the subsidiary's minority shareholders by having the subsidiary's board of directors approve a sale of all the subsidiary's assets to it at a price selected by it. Except for the special subsidiary requirements for such a sale, it would be sure to be approved by majority vote of the subsidiary's outstanding shares [*see* [2], *above*]. Under the special statutory requirements for sales by subsidiaries to parents, however, the sale must be approved by 90 percent of the shares entitled to vote for directors of the subsidiary corporation [*Corp. Code §§ 194.5, 1001(d)*].

If a parent corporation owns 90 percent of all outstanding shares of a subsidiary, it can effectively "cash out" the minority shareholders of the subsidiary by means of a short-form merger [*Corp. Code § 1110(a), (b)*]. In such a case, the minority shareholders cannot prevent the merger and can only require the parent corporation to purchase their shares in the subsidiary at their fair market value [*Corp. Code §§ 1300-1312*]. Thus there is no need to provide for protecting minority shareholders of a 90 percent owned subsidiary from being "cashed out" by a purported sale of all the subsidiary's assets to its parent corporation.

[c] Exchange of All Assets Is "Reorganization"

Any exchange of all or substantially all assets of a subsidiary for securities of the purchasing corporation, or the purchasing corporation's parent, is a "reorganization" as that term is defined in the General Corporation Law [*see* Ch. 11, *Merger and Acquisition Issues*]. Such a "reorganization" could, however, be used to involuntarily "cash out" minority shareholders of the subsidiary when the subsidiary's assets are exchanged for either redeemable or debt securities of the purchasing corporation or its parent. Thus, an assets-for-shares "reorganization," with one exception, is not exempt from the special subsidiary sale requirement and requires the approval of at least 90 percent of the subsidiary's voting power [*Corp. Code § 1001(a), (d)*]. If all or substantially all assets of a subsidiary are exchanged for nonredeemable common shares of the purchasing corporation or its parent, the minority shareholders of the subsidiary are not "cashed out." They have a continuing interest in the prosperous use of the assets and the transaction is, in effect, a de facto merger of the subsidiary and the purchasing corporation [*see* Ch. 11, *Mergers and Reorganization Issues*]. Consequently, a "reorganization" whereby all or substantially all assets of a subsidiary are exchanged for nonredeemable common shares of its parent or another subsidiary of the parent is exempted from the special subsidiary sale requirement and need not be approved by at least 90 percent of the subsidiary's voting power [*Corp. Code § 1001(d)*].

When the exemption is not applicable, one minority shareholder owning more than 10 percent of the subsidiary's voting power could arbitrarily block the sale of the subsidiary's assets to its parent corporation. That shareholder could, in effect, blackmail the parent corporation into "buying" his or her approval at his or her price. To prevent this, in 1977 the Legislature enacted an alternative manner of protecting rights of the subsidiary's minority shareholders. The assets of the subsidiary may be sold to its parent, or to another subsidiary of the parent, when the terms and conditions of the transaction and their fairness have been approved by the Corporations Commissioner, the Commissioner of Financial

Institutions, the Insurance Commissioner, or the Public Utilities Commission [*Corp. Code § 1001(e)*]. The parent may petition the Corporations Commissioner, the Commissioner of Financial Institutions, the Insurance Commissioner, or the Public Utilities Commission when it is regulated by one of those agencies, to determine the fairness of the proposed transaction and the Commissioner may hold a hearing on the fairness of the terms and conditions [*Corp. Code § 25142*; *see Fin. Code § 696.5*; *Ins. Code § 838.5*; *Pub. Util. Code § 822*].

[7] Corporate Creditors

Statutes requiring shareholder approval of a sale of all or substantially all corporate assets have been said to protect both shareholders and creditors of the selling corporation [*see Solorza v. Park Water Co. (1948) 86 Cal. App. 2d 653, 658, 195 P.2d 523]* . At least one case, however, has held that corporate creditors have no rights under the statute and that the statutory requirements were enacted for the benefit of corporate shareholders alone [Long Constr. Co. v. Empire Drive-In *Theatres, Inc. (1962) 208 Cal. App. 2d 726, 735, 25 Cal. Rptr. 509]* . Although that case was decided before the effective date of the present General Corporation Law, the statute it construed was similar to the provisions of the present law requiring approval of the outstanding shares for the sale of all or substantially all the assets of a corporation.

The court noted that noncompliance with the statutory requirements did not prevent immediate vesting of title to all the corporate assets in the transferee of the corporation although his or her title might be terminated because the transfer is voidable [Long Constr. Co. v. Empire Drive-In *Theatres, Inc. (1962) 208 Cal. App. 2d 726, 735, 25 Cal. Rptr. 509]* . The statute, however (like the present General Corporation Law), gave the shareholders of the selling corporation the right to approve the transfer either before or after it had been approved by the selling corporation's board of directors and "before or after the transaction" [*Corp. Code § 1001(a)*]. Therefore, when the transaction is approved by the outstanding shares of the selling corporation after it has already been consummated and title to the corporate assets has vested in the transferee, the right to set aside the transfer as voidable ceases and a creditor of the selling corporation who attached the property after it was transferred finds himself or herself with a writ of attachment on property that absolutely and irrevocably belongs to the transferee. Thus, the courts have determined that the statute was enacted for the benefit of the selling corporation's shareholders alone [Long Const. Co. v. Empire Drive-In *Theatres, Inc. (1962) 208 Cal. App. 2d 726, 735, 25 Cal. Rptr. 509]* .

This conclusion agrees with the common law rule prohibiting a sale of all corporate assets as a violation of the corporation's contract with its shareholders [*see* [3], *above*]. It also appears to agree with the purposes behind the bulk sales laws in California and particularly the requirements of the Uniform Commercial Code--Bulk Sales Division [*see Com. Code §§ 6101-6111*; *see also Ch. 17, Buying and Selling a Business or Professional Practice, § 17.20*]. Under that law, if the buyer fails to comply with the notice of intended transfer requirements [*see Com. Code § 6105*], the buyer may be liable in the amount of any claims against the seller, less any amount that the claimant would not have realized if the buyer had complied with the notice requirements [*see Com. Code § 6107(a)*; *see also Com. Code § 6107(c)* (good faith effort at compliance), (d) (limitations of liability)]. However, the transaction will not be fraudulent and void as against any of the seller's creditors.

[8] Abandonment of Proposed Sale

The board of directors of the selling corporation may abandon a proposed sale or transfer of all or substantially all the corporation's assets at any time before it is actually consummated [*Corp. Code § 1001(b)*; *see* [2], *above*]. When it is made after approval of the sale by the corporation's outstanding shares, no further action by the shareholders is required [*Corp. Code § 1001(b)*]. The abandonment is subject to the contractual rights of any third parties [*Corp. Code § 1001(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:

Mergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeGeneral OverviewCommercial Law (UCC)Bulk Sales (Article 6)General OverviewMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsMergers & Acquisitions LawLiabilities & Rights of SuccessorsSuccessor Liability Doctrine



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART II. LEGAL BACKGROUND

5-11B California Legal Forms--Transaction Guide § 11B.21

§ 11B.21 Tax Factors in Cash Purchase of Assets

[1] Allocation of Purchase Price

The purchase by one corporation of all or substantially all the assets of another corporation for cash or for cash and debt securities is treated the same as any other purchase and sale for income tax purposes. It is a taxable transaction and a taxable sale [*I.R.C. §§ 61(3), 1001*]. This means that any gain realized by the selling corporation as a result of the sale of its assets will be subject to income taxation at least once and perhaps twice in the year in which the sale is made [*I.R.C. §§ 61(3), 61(7), 301*]. This is usually considered by taxpayers to be a disadvantage of a cash sale. An offsetting factor is the fact that the purchasing corporation will obtain a new income tax basis equal to its actual cost for the assets it purchases from the selling corporation for cash or cash and short-term debt securities [*I.R.C. § 1012*; *see* Ch. 11, *Merger and Acquisition Issues*]. This is usually regarded as an advantage of a cash purchase of assets to the purchasing corporation [*see I.R.C. § 167, 168* (depreciation deduction increased with increase in basis)].

For income tax purposes, a corporation or other business actually is never considered to be selling all or substantially all its assets. Instead, it is treated as making a separate sale of each of its individual assets, including goodwill [*Williams v. McGowan (2d Cir. 1945) 152 F.2d 570, 572]* . For those purposes, therefore, the selling corporation must compute the amount of taxable gain or deductible loss it received for each of its individual assets as a result of the cash purchase and sale [*see I.R.C. § 1001*; *Treas. Reg. § 1.61-6*; *but see I.R.C. § 1060* (*I.R.C. § 338* gain or loss allocation rules apply when assets constituting trade or business are acquired)]. Similarly, the purchasing corporation receives a new income tax basis equal to the purchase price paid by it for each asset, including goodwill, it purchased from the selling corporation [*I.R.C. § 1001*; *see I.R.C. § 1060* (*I.R.C. § 338* basis allocation rules apply when assets constituting trade or business are acquired)]. When all the assets of the selling corporation have been purchased for a single sum, the purchase price must be allocated among the various assets sold by the selling corporation and purchased by the acquiring corporation [*see I.R.C. § 1060*].

Ordinarily, the burden is on the taxpayers to establish the part of the purchase price that was paid for each of the assets of the selling corporation involved in the purchase and sale [Rabkin & Johnson, FEDERAL INCOME, GIFT AND ESTATE TAXATION, § 34.01B(2) (Matthew Bender)]. The amount allocated to each asset, including intangible assets such as goodwill, should bear a reasonable relation to the asset's fair market value [Fox & Fox, CORPORATE

ACQUISITIONS AND MERGERS, Ch. 5C, *Acquisitions of Assets* (Matthew Bender)]. It is good practice for the acquiring and selling corporations to agree in their contract of sale as to the amount of the total purchase price that is being paid for each asset of the selling corporation. Such an agreement is also prudent for purposes of the California sales and use tax on fixtures and equipment of the selling corporation if the selling corporation has a sales tax permit from the California State Board of Equalization [*see* Ch. 17, *Buying and Selling a Business or Professional Practice*].

Allocating the purchase price to different assets, inventory, depreciable assets, and goodwill is less adversarial than in years past because there is no tax rate advantage to characterizing gain as capital gain rather than ordinary income for corporate taxpayers [*see I.R.C. §§ 11, 1060, 1201*]. Goodwill that is purchased or created after August 10, 1993, is eligible for amortization deductions under *I.R.C. § 197* and is not eligible for capital gain treatment [*I.R.C. § 197(f)(7), 1221(a)(2)*] except to the extent that it otherwise qualifies under *I.R.C. § 1231*. The selling corporation, therefore, has no tax rate motivation to allocate a higher proportion of the selling price to goodwill or other assets for which it might obtain capital gains treatment. It might, however, need capital gains to offset previously incurred capital losses, which only are allowed to the extent of capital gains [*I.R.C. § 1211(a)*].

[2] Net Operating Loss Carryforward Deduction

Net operating loss carryforwards are transferred from an acquired corporation to an acquiring corporation only pursuant to *I.R.C. § 381* [*see* Ch. 11, *Mergers and Acquisition Issues*]. Since a taxable purchase of assets is not one of the acquisition methods enumerated in that section [*see I.R.C. § 381(a)(2)*], and the acquiring corporation cannot liquidate the selling corporation pursuant to *I.R.C. § 332* [*see I.R.C. §§ 332(b)(1)* (stock control required), *381(a)(1)*], the acquiring corporation therefore has no means of obtaining any loss carryforward from the selling corporation. If the selling corporation continues in existence as a private investment corporation, it may continue to use any net operating loss carryforward [*see I.R.C. § 172*; *see also* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 174, *The Carryover and Use of Tax Attributes in a Corporate Acquisition* (Matthew Bender)]. That carryforward is not subject to the provisions that reduce or eliminate carryforwards in other acquisition methods [*see* Ch. 11, *Merger and Acquisition Issues*]. However, if sufficient investment income is produced through the corporation, it could be classified as a personal holding company subject to additional taxation [*see I.R.C. §§ 541*-547].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)Carryforwards



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART II. LEGAL BACKGROUND

5-11B California Legal Forms--Transaction Guide § 11B.22

§ 11B.22 Advantages and Disadvantages of Sale

[1] Nonassumption of Liabilities

One of the most notable and sought-after advantages of a cash purchase of corporate assets is the freedom from assuming liabilities of the selling corporation. Ordinarily, if the purchase is correctly made in accordance with local bulk sales statutes [*see § 11.20[1][c]*], the purchaser of the assets of a business assumes no liability for debts of the seller that are not expressly assumed [Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 163, *Sales of Assets Transactions* (Matthew Bender)]. However, a corporation that acquires all the assets of another corporation, either for cash or in an assets-for-shares exchange, may be liable for injuries caused by defective products manufactured by its predecessor corporation [*see* Ch. 11E, *Acquisition of Assets for Shares*].

With respect to ordinary debts, however, the cash sale of assets by a corporation (or by any other type of business organization) may be subject to two sets of "debtor protection" statutes. The first set of statutes, designed for protection of creditors in general and particularly creditors who have supplied inventory merchandise to a wholesale or retail merchandising business, is contained in the Uniform Commercial Code--Bulk Sales Division [*see Com. Code §§ 6101-6111*; *see also § 11B.20[1][c]*]. The second set of statutes, designed to protect the State of California and generally called "successor liability statutes," is contained in California's Sales and Use Tax Law [*Rev. & Tax. Code §§ 6811, 6812*] and Unemployment Insurance Code [*Unemp. Ins. Code §§ 1731-1736*; *see also § 11B.20[1][d]*]. These debtor protection statutes are applied to the sale of assets by a corporation in California in the same manner they are applied in California to the sale of assets by any other business organization. For further discussion, see *Ch. 17, Buying and Selling a Business or Professional Practice, § 17.14*.

[2] Other Advantages

[a] Approval of Acquiring Corporation's Shareholders Not Required

Another advantage of a purchase of assets is the fact that approval of the transaction by shareholders of the acquiring corporation is not required [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5A, *Summary of Acquisition Methods* (Matthew Bender)]. Their interests in the acquiring corporation are not diluted by the transaction and thus their consent is not required by statute.

[b] No Dissenting Shareholder Issues

One advantage of a cash purchase and sale of corporate assets is that the problem of purchasing the shares of dissenting shareholders is avoided. Under the present General Corporation Law, dissenting shareholders of a corporation that is a party to a statutory merger or an assets-for-shares exchange can force their corporation to purchase their shares at their appraised fair market value [*Corp. Code §§ 1300-1312*; *see Ch. 11C, Mergers, § 11C.28[2][b]*]. Neither the shareholders of the acquiring corporation nor the shareholders of the selling corporation have that right when the acquiring corporation is purchasing all the assets of the selling corporation for cash or cash and debt securities [Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 163, *Sales of Assets Transactions* (Matthew Bender)].

[c] No Securities Law Compliance

Another advantage to the cash purchase of assets is that this method of acquisition is not subject to the securities laws. Other types of reorganizations require qualification of the acquisition under the Corporate Securities Law [*Corp. Code §§ 25000-25706*; *see* Ch. 11, *Merger and Acquisition Issues*].

[d] Selection of Assets

A further advantage of a cash purchase of assets is that the acquiring corporation usually has the power to reject any assets of the selling corporation that are worthless or that it simply does not want. This power is not available in a statutory merger or purchase of shares of the corporation to be acquired [Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 163, S*ales of Assets Transactions* (Matthew Bender)].

[3] Disadvantages

The main disadvantage of a cash sale of assets is the complexity of the transaction. Separate instruments of conveyance may have to be drawn for every automobile, lease, parcel of real property, or corporate security being transferred. Under a statutory merger, one instrument (the merger agreement) serves the same purpose as all these instruments of conveyance plus a general bill of sale for the other nonregistered assets of the selling corporation [*see Corp. Code § 1106*; *see also Ch. 11C, Mergers, § 11C.22[1]*].

A cash sale of assets also requires compliance with the Uniform Commercial Code--Bulk Sales Division [*Com. Code §§ 6101-6111*; *see § 11.20[1][c]*]. Furthermore, it requires payment of sales tax on the fixtures and equipment being sold [*see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.12*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawSales of AssetsRights of Dissenting ShareholdersMergers & Acquisitions LawLiabilities & Rights of SuccessorsSuccessor Liability DoctrineMergers & Acquisitions LawTaxable AcquisitionsAsset Acquisitions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART II. LEGAL BACKGROUND

5-11B California Legal Forms--Transaction Guide §§ 11B.23-11B.99

[Reserved]

§§ 11B.23[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11B California Legal Forms--Transaction Guide § 11B.100

§ 11B.100 Facts

1. Identity of acquiring corporation.

a. Exact name of acquiring corporation as it appears in its articles of incorporation.

b. Address of principal executive offices of acquiring corporation:
(1) Main executive office if outside California.

(2) Principal executive office in California.

c. Names of president, secretary, and other principal officers.

d. Telephone numbers of corporate secretary and other corporate officers involved in negotiating transaction.

e. Date, time, and place where board of directors will meet to consider purchase.

f. State and date of incorporation.

g. Credit rating and financial standing.

2. Identity of selling corporation.

a. Exact name of selling corporation as it appears in its articles of incorporation.

b. Address of principal executive offices of selling corporation:

(1) Main executive office if outside California.

(2) Principal executive office in California.

c. Names of president, secretary, and other principal corporate officers.

d. Any connections or affiliations officers of selling corporation have with acquiring corporation.

e. Telephone numbers of corporate secretary and other corporate officers negotiating transaction.

f. State and date of incorporation.

g. Type of business or types of businesses in which selling corporation is engaged.

(1) Type of business subject to Uniform Commercial Code--Bulk Sales Division [*see Com. Code §§ 6101-6111*]:
(a) Baker.

(b) Cafe or restaurant owner.

(c) Garage owner.

(d) Cleaner and dyer.

(e) Retail or wholesale merchant.

(2) Type of business requiring license from State of California or federal government [*see* Ch. 1A, *Role of Counsel in Starting a New Business*].

h. Whether selling corporation has obtained state sales tax permit from California State Board of Equalization.

NOTE:
This will determine, in part at least, whether a sales tax will be due on the sale of the selling corporation's fixture and equipment to the acquiring corporation.

i. Number and types of shareholders of selling corporation:

(1) Classes and series of shares outstanding.

(2) Classes and series of shares outstanding that are entitled to vote for directors.

(3) Number of shares of each class and series that are outstanding.

(4) Number of shareholders owning corporate shares.

NOTE:
If the corporation has few shareholders, a sale of their shares to the acquiring corporation might be more advisable than a sale of the corporate assets to the selling corporation. If there are a large number of shareholders, however, it might be impractical to arrange for

the sale of all their shares to the acquiring corporation [***see*** Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 161, ***Review of Factors to Be Considered in Selecting Form of Acquisition*** (Matthew Bender)].

j. Dates, times, and places of meetings of board of directors.

k. Usual place for holding shareholder meetings.

l. All business names and addresses used by selling corporation within past three years.

NOTE:

These are required by the Uniform Commercial Code--Bulk Sales Division [***see*** *Com. Code § 6101 et seq.*; ***see also*** *Ch. 17,* ***Buying and Selling a Business or Professional Practice****, § 17.20*].

3. Types of assets being sold:

a. Inventory.

b. Fixtures and equipment.

(1) Fixtures and equipment used in business requiring retail sales tax permit.

(2) Fixtures and equipment not used in business requiring retail sales tax permit.

c. Depreciable assets.

d. Leases of real or personal property:

(1) Location of leased premises.

(2) Name and address of lessor.

(3) Whether consent to assignment of lease is required by lease.

e. Real property:

(1) Title company acquiring corporation wishes to handle transfer.

(2) Any encumbrances or restrictions on title acquiring corporation is unwilling to accept.

NOTE:

An acquiring corporation may be reluctant to accept any covenants or conditions restricting the use of the property, such as a condition prohibiting its use for the sale of alcoholic beverages. The acquiring corporation may wish to free the capital it has invested in the real property by selling the property to an insurance or investment company and leasing it back. The insurance or investment company, however, may be unwilling to buy the property unless it can re-rent the property for any business or for any use according to the best rental offer made, if the acquiring corporation defaults on its leaseback.

f. Automobiles and other motor vehicles requiring a transfer of registration with Department of Motor Vehicles.

g. Corporate stock and securities to be transferred on books of their issuer.

h. Other assets needing a transfer of registration or a recorded conveyance.

4. Assets, if any, of selling corporation excluded from sale.

a. Accounts receivable:

(1) All accounts receivable.

(2) Accounts receivable more than 90 or 120 days old.

b. Particular real property.

c. Other assets.

5. Total purchase price to be paid for assets of selling corporation.

6. Portion of total purchase price being paid for assets of selling corporation that is being paid for each asset of selling corporation.

NOTE:

Determination of the purchase price being paid for each asset of the selling corporation will probably require a detailed analysis of the selling corporation's assets by the accountants and officers of both the acquiring and selling corporations. If that analysis will take a great deal of time, counsel should at least try to discover the amount of the total purchase price that is being paid for the total fixtures and equipment of the selling corporation whose sale proceeds will be subject to California sales tax [***see*** Ch. 17, ***Buying and Selling a Business or Professional Practice***].

7. Locations of all inventory and equipment included in sale of assets, and location of seller's place of business or chief executive office.

NOTE:

The Uniform Commercial Code--Bulk Sales Division [***see*** *Com. Code § 6101 et seq.*], if applicable to the sale, requires the publication, in a newspaper of general circulation, of a notice of intended transfer in the judicial district in which the property being transferred is located and, if different, in the judicial district in which the seller is located [*Com. Code § 6105(b)(2)*; ***see*** *Com. Code § 6103(b)*]. If no newspaper of general circulation exists in the judicial district, the notice must be published in a newspaper of general circulation in the county in which the judicial district is located [*Com. Code § 6105(b)(2)*]. If the property is located in more than one judicial district, the notice must be published where a greater portion of the property is located [*Com. Code § 6105(b)*]. In addition, the notice must be recorded in the county or counties in which the tangible assets are located and, if different, in the county in which the seller is located [*Com. Code § 6105(b)(1)*]. Further, the notice must be delivered, or sent by registered or certified mail, to the county tax collector in the county or counties in which the tangible assets are located. If the notice is delivered or sent during the period from January 1 to May 7, inclusive, the notice must be accompanied by a completed business property statement with respect to the property involved in the bulk sale [*Com. Code § 6105(b)(3)*; ***see*** *Rev. & Tax. Code § 414* (procedure for filing

property statements)].

8. Identities of corporate officers who will execute contract of sale and other instruments.

9. Name, address, and telephone number of person or firm who is to serve as escrow holder for sale.

a. Attorney for the acquiring corporation.

NOTE:
This is probably the preferred person or firm to serve as escrow.

b. Attorney for selling corporation.

c. Escrow department of a particular bank or trust company.

d. Commercial escrow corporation.

10. Name, address, and telephone number of accountants for acquiring and selling corporations and their principal shareholders.

11. Liabilities, if any, of selling corporation that are to be assumed by acquiring corporation.

12. General solvency and financial condition of selling corporation.

NOTE:
Although the acquiring corporation generally does not assume the liabilities of the selling corporation as a result of its purchase of the selling corporation's assets for cash, unless it agrees to do so, this information is important in determining the difficulty that may be encountered in consummating the sale. It will help the acquiring corporation and its attorneys determine whether any creditors of the selling corporation are likely to levy a writ of attachment on its assets and delay or prevent the closing of escrow and consummation of the sale.

13. Whether nature of business might create a risk of products liability claims, and whether seller is likely to continue to have assets for payment of those claims for a period approaching useful life of products sold.

NOTE:
An exception to the general rule permitting assets to be purchased free of liabilities exists in the products liability area, in which the successor can be held liable under certain circumstances, if the original operator of the business no longer has the assets to satisfy claims brought after the sale [***see*** Ch. 11E, ***Acquisition of Assets for Shares***].

14. Any noncompetition or other special clauses parties wish to be included in contract for sale of selling corporation's assets.

15. Whether selling corporation is to be dissolved after sale.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsCommercial Law (UCC)Bulk Sales (Article 6)General OverviewMergers &

Acquisitions LawSales of AssetsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11B California Legal Forms--Transaction Guide § 11B.101

§ 11B.101 Documents

1. Articles of incorporation, as most recently amended, of both acquiring and selling corporations.

2. Bylaws, as most recently amended, of both acquiring and selling corporations.

3. Stock certificate book and stock record book of selling corporation.

4. Leases to which selling corporation is a party, either as lessee or lessor.

5. Deed for each piece of real property owned by selling corporation.

6. Collective bargaining agreements between selling corporation and any labor unions.

7. Any franchise or licensing agreements to which selling corporation is a party, whether as franchisor, franchisee, licensor, or licensee.

8. All employment contracts to which selling corporation is a party.

9. All employment benefit contracts and profit-sharing plan agreements of selling corporation.

10. All other executory contracts to which selling corporation is a party.

11. Any loan agreements or other instruments on which selling corporation is obligated to pay money.

12. Any deeds of trust or other instruments encumbering any assets or property of selling corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsLabor Laws



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11B California Legal Forms--Transaction Guide §§ 11B.102-11B.109

[Reserved]

§§ 11B.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Assets

5-11B California Legal Forms--Transaction Guide § 11B.110

§ 11B.110 Preliminary Determinations

1. Determine (with assistance of accountant) and advise shareholders of selling corporation of particular income tax consequences of proposed sale on each of them:

a. When selling corporation is to be dissolved.

b. When selling corporation is not to be dissolved.

2. Determine and advise parties whether acquisition of selling corporation should be consummated as purchase of its assets for cash, or as some other acquisition method, e.g., merger or purchase of shares [*see* Ch. 11, *Merger and Acquisition Issues*].

3. Determine whether selling corporation should be dissolved or kept in existence as private investment corporation.

NOTE:
This decision must be made by the officers and shareholders of the selling corporation. The determination, like the determination of the matters set forth in P 2, ***above***, will largely depend on the tax determinations made pursuant to P 1, ***above***.

4. Determine whether proposed sale of assets is subject to Uniform Commercial Code--Bulk Sales Division [*see Com. Code § 6101 et seq.*; *see also § 11B.112[4]*].

5. If proposed sale is subject to Uniform Commercial Code-Bulk Sales Division [*see Com. Code § 6101 et seq.*; *see* [4], *above*], determine following information [*see Com. Code § 6105*]:

a. Address of office of county recorder in county or counties in which tangible assets of seller are

located and, if different, where seller is located.

b. Address of county tax collector in county or counties in which tangible assets of seller are located.

c. Judicial districts in which seller is located and seller's assets are located.

d. Name and address of newspaper of general circulation in judicial districts in which seller is located and seller's assets are located:
(1) Publication dates of newspaper; and

(2) Newspaper's deadlines for accepting legal notices.

6. Determine whether sales proceeds received by selling corporation for any of its fixtures and assets will be subject to California state sales tax.

7. Determine instruments of conveyance that will be required to consummate transfer of all assets of selling corporation that are being sold to acquiring corporation.

8. Determine what consents or other instruments must be obtained from third persons in order to consummate sale.

9. Determine what governmental licenses, if any, must be transferred to consummate the sale.

a. Alcoholic beverage license [*see* Ch. 18, *Buying and Selling a Retail Alcoholic Beverage License and Business*].

b. Federal Communications Commission license.

c. Other license [*see* Ch. 1A, *Role of Counsel in Starting a New Business*].

10. Determine date, time, and place for calling and holding following:

a. Meeting of board of directors of selling corporation to approve sale.

b. Meeting of shareholders of selling corporation to approve sale.

NOTE:
Shareholder approval, required by statute, may be obtained by means of written consent instead of a shareholders' meeting vote [*Corp. Code § 603*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral OverviewCommercial Law (UCC)Bulk Sales (Article 6)General OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset Acquisitions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Assets

5-11B California Legal Forms--Transaction Guide § 11B.111

§ 11B.111 Advising Parties of Advantages of Cash Asset Sale

1. Acquiring corporation gets new income tax basis for assets purchased from selling corporation.

2. Acquiring corporation is not required to assume any liabilities of selling corporation, except strict liability in tort for defective products.

NOTE:
See Ch. 11E, ***Acquisition of Assets for Shares*** .

3. Shareholder approval of purchase by shareholders of acquiring corporations not required [*see § 11B.22[2][a]*].

4. Neither dissenting shareholders of acquiring corporation nor dissenting shareholders of selling corporation have right to require either corporation to purchase their shares at appraised fair market value of those shares on date preceding announcement of proposed sale of assets.

5. Acquiring corporation may reject obsolete or worthless assets of selling corporation, including long overdue accounts receivable.

6. Transaction is not subject to California securities laws.

NOTE:
Certain other acquisition methods require registration of the transaction with the Corporations Commissioner [***see*** Ch. 11, ***Merger and Acquisition Issues***].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Shareholders



160 of 168 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Assets

5-11B California Legal Forms--Transaction Guide § 11B.112

§ 11B.112 Advising Parties of Disadvantages of Cash Asset Sale

1. Sale proceeds may be subject to tax at both corporate and shareholder level if proceeds are distributed to shareholders [*I.R.C. §§ 61, 301, 1001*]:

a. Double taxation applies unless corporation is liquidated pursuant to *I.R.C. § 331*.

b. Sales proceeds are taxed to selling corporation at time of receipt.
(1) Amount paid for inventory assets is taxed as ordinary income [*see I.R.C. § 1221(a)(3)*].

(2) Gain from property, used in corporation's trade or business, of character that is subject to allowance for depreciation, or real property used in its trade or business, is taxed as ordinary income [*see I.R.C. § 1221(a)(2)*].

(3) Amount paid for goodwill or other capital assets not used in corporation's trade or business [*see I.R.C. § 1221(a)*].

c. Taxed to shareholders of selling corporation at time of distribution to them [*see I.R.C. § 301*].

2. California state sales tax must be paid on portion of sale proceeds received for fixtures and equipment used in activity requiring sales tax permit from California State Board of Equalization [*see Rev. & Tax. Code § 6051 et seq.*].

NOTE:
For further discussion, see *Ch. 17, **Buying and Selling a Business or Professional Practice**, § 7.12.*

3. Acquiring corporation is not entitled to benefit of net operating loss carryover income tax deduction belonging to selling corporation [*see I.R.C. § 381*; *see also § 11B.21[2]*].

4. Sale may require compliance with requirements of Uniform Commercial Code-Bulk Sales Division under following circumstances:

NOTE:

If the Uniform Commercial Code--Bulk Sales Division applies [***see*** *Com. Code § 6101-6111*], the buyer must give public notice of the bulk sale, essentially to provide notice to the seller's creditors. The buyer may be required to record, publish, and deliver notice of the intended transfer in several jurisdictions [***see*** *Com. Code § 6105(b)*]. These requirements are discussed further in Ch. 17, ***Buying and Selling a Business or Professional Practice***, § 17.20.

a. Selling firm's principal business is sale of inventory from stock, including those who manufacture what they sell, or is that of restaurant owner [*Com. Code § 6103(a)(1)*; *see Com. Code § 6103(c)* (exceptions)];

NOTE:

Many transactions are specifically exempted from the bulk sales law [***see*** *Com. Code § 6103(c)*], including a sale of assets with a value of less than $10,000, or a value of more than $5 million [*Com. Code § 6103(c)(12)*].

b. On date of bulk sale agreement, selling firm is located in California or is located in jurisdiction outside United States but has its major American executive office in California [*Com. Code § 6103(a)(2)*; *see Com. Code § 6103(b)*]; and

c. Sale of assets is not in ordinary course of selling firm's business and constitutes more than half of firm's inventory and equipment [*Com. Code § 6102(a)(3)*; *see Com. Code § 6102(a)(8), (15)*].

NOTE:

In determining the percentage of the seller's inventory and equipment being transferred, the assets are valued at their fair market value as of the date of the bulk sale agreement [*Com. Code § 6102(a)(3), (8), (15)*]. If the consideration for the sale of assets is $2 million or less and is substantially all in cash and/or an obligation of the buyer to pay cash in the future, the buyer or escrow agent may have to settle claims against the seller before paying the seller [***see*** *Com. Code §§ 6106.2, 6106.4*].

5. Sales proceeds must be withheld in escrow to protect acquiring corporation from liability under successor liability statutes for amounts owed by selling corporation for sales tax or unemployment compensation insurance contributions [*see Rev. & Tax. Code §§ 6811, 6812*; *see also Unemp. Ins. Code §§ 1731, 1732*].

NOTE:

See *Ch. 17,* ***Buying and Selling a Business or Professional Practice****, § 17.14.*

a. Must obtain sales tax clearance for selling corporation from California State Board of Equalization.

b. Must obtain statement from California State Department of Benefit Payments that no amounts are due from selling corporation for unemployment compensation insurance contributions.

6. Acquiring corporation may be subject to products liability claims for injuries subsequently caused by products originally sold by the selling corporation.

NOTE:

See Ch. 11E, ***Acquisition of Assets for Shares*** .

7. Separate documents of conveyance or transfer must be drafted, executed, and registered or recorded for every:

a. Automobile or motor vehicle being transferred.

b. Lease being assigned.

c. Piece of real property being conveyed.

d. Corporate shares or securities being transferred.

e. Other asset whose ownership is registered or recorded with some governmental, corporate, or other agency.

8. Sale may require obtaining from third person or corporation:

a. Consent to assignment of leases.

b. Title insurance policy for real property included in sale.

c. Consent to transfer of mortgaged or encumbered automobiles or other assets.

d. Consent to assignment of collective bargaining, employment, or other contracts.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersTax LawFederal Income Tax ComputationOrdinary Income (IRC sec. 64)Mergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewCommercial Law (UCC)Bulk Sales (Article 6)NoncomplianceCommercial Law (UCC)Bulk Sales (Article 6)Notice to Claimants



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Assets

5-11B California Legal Forms--Transaction Guide § 11B.113

§ 11B.113 Preparing Instruments

1. Prepare preliminary "Letter of Intent" or tentative draft of contract of sale [*see* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 163, *Sales of Assets Transactions* (Matthew Bender)].

NOTE:
This document is usually prepared and executed by officers of the selling and acquiring corporation, if at all, after preliminary negotiations for the sale are completed. It simply sets forth their understandings of the results of the negotiations. It is almost always drafted not to be binding on the parties. Its use is discouraged by some attorneys experienced in handling corporate acquisitions, who consider it a handicap to further negotiations and prefer instead of preparing a tentative agreement or letter of intent to immediately start work on preliminary drafts of the formal contract of sale that will be binding when approved by the shareholders of the selling corporation and executed by the corporations [***see*** Herzel, ***Analysis of the Negotiation of an Acquisition Agreement***, 27 Bus. Law. 1223, 1233-1234 (1972)]. Because the use of a letter or tentative agreement is discouraged by many experienced attorneys, a form for such an instrument is not included in this chapter.

2. Prepare contract for purchase and sale of assets of selling corporation.

a. First preliminary draft is usually prepared by attorney for acquiring corporation [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5C, *Acquisitions of Assets* (Matthew Bender); Herzel, *Analysis of the Negotiation of an Acquisition Agreement, 27 Bus. Law. 1223, 1234 (1972)*].

b. Sufficient copies of the final formal contract should be prepared so that one copy can

be:

(1) Retained by attorney for each corporation as office copy.

(2) Retained by secretary of each corporation.

(3) Retained as part of minutes of board of directors of each corporation.

(4) Used by and retained by escrow holder handling purchase and sale.

(5) Delivered to and examined by any governmental regulatory or taxing agencies, such as California State Board of Equalization, concerned with the sale.

NOTE:

Personnel of the California State Board of Equalization may be interested in examining a copy of the contract if there is any question as to the amount being paid for the fixtures and equipment of the selling corporation and a sales tax is due on the sale of those fixtures and equipment [***see*** Ch. 17, ***Buying and Selling a Business or Professional Practice***].

3. If selling corporation is to be dissolved after sale and proceeds distributed to its shareholders, prepare:

a. Resolution of board of directors of selling corporation adopting plan of liquidation and authorizing, as part of plan, sale of corporation's assets to acquiring corporation.

b. Resolution of shareholders of selling corporation, or form of written consent to be signed by shareholders of selling corporation, adopting plan of liquidation approved by its board of directors and approving, as part of plan, principal terms of sale of corporation's assets to acquiring corporation.

c. Resolution of board of directors of acquiring corporation approving purchase of assets of selling corporation and authorizing execution and consummation of sale.

4. If selling corporation is not to be dissolved after sale, prepare:

a. Resolution of board of directors of selling corporation approving principal terms of sale of corporation's assets to acquiring corporation and authorizing both execution and performance of contract of sale for those assets.

b. Resolution of shareholders of corporation's assets to acquiring corporation.

c. Resolution of board of directors of acquiring corporation authorizing execution and performance of contract of sale for sale to it of assets of selling corporation.

5. Prepare escrow instructions, to be executed by officers of both corporations, for conducting sale of assets of selling corporation to acquiring corporation [*see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.250*].

6. Prepare bills of sale and other instruments of conveyance that may be necessary to transfer title and possession of all assets of selling corporation to acquiring corporation, including:

a. Bill of sale for all general, unregistered, tangible, and intangible assets, including goodwill and accounts receivables, of selling corporation.

b. Grant deed for each piece of real property of selling corporation.

c. Assignment of lease for each lease to which selling corporation is party, either as lessee or lessor.

d. Consent to assignment of lease, to be executed by lessor for each lease in which selling corporation is lessee.

e. Consent to assignment to be executed by franchisor or licensor of each franchise or license agreement under which selling corporation is franchisee or licensee.

f. Any other instruments that may be required to transfer any other assets of selling corporation to acquiring corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Directors & Officers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Assets

5-11B California Legal Forms--Transaction Guide § 11B.114

§ 11B.114 Procedure When Selling Corporation Will Dissolve

1. Have board of directors of selling corporation, at regular or special meeting, pass resolution adopting plan of complete liquidation and approving, as part of plan, principal terms of sale of corporate assets to acquiring corporation.

a. Resolution should:
(1) Approve proposed contract of sale with acquiring corporation.

(2) Authorize secretary of corporation, or other appropriate corporate officer, to call special meeting of shareholders to approve plan of liquidation or obtain written consent of shareholders approving plan of liquidation.

(3) Authorize corporate officers, on approval by shareholders, to execute and perform contract of sale with acquiring corporation.

b. Make sufficient copies of resolution:

(1) To deliver to acquiring corporation.

(2) To give to Internal Revenue Service or file with selling corporation's final income tax return.

2. Obtain approval by shareholders of selling corporation of plan of liquidation and principal terms of proposed sale of assets by either [*Corp. Code § 1001(a)*]:

a. Calling special meeting of shareholders to adopt resolution adopting plan of liquidation and approving

principal terms of sale of all corporate assets.

(1) Give written notice of meeting to each shareholder entitled to vote, stating general nature of business to be transacted [*Corp. Code § 601(a)*].

NOTE:
The notice may be given personally, or by electronic transmission by the corporation, or by mail addressed to the shareholder's address appearing on the books of the corporation or the address given to the corporation for purposes of notice. Except as noted below, notice must be given not less than 10 nor more than 60 days before the meeting [*Corp. Code § 601(a), (b)*].

If the corporation has 500 or more shareholders of record (as determined under *Corp. Code § 605*) as of the record date for the meeting, notice may be sent by third-class rather than first-class mail. However, in that case, notice must be sent not less than 30 days prior to the meeting (only 10 days notice is required if first-class mail is used) [*Corp. Code § 601(a), (b)*].

(2) Plan of liquidation must be approved by shareholders holding shares representing 50 percent or more of voting power (power to vote for election of directors) of selling corporation [*Corp. Code §§ 194.5, 1900(a)*].

(3) Principal terms of sale of assets to acquiring corporation, unless sale is to be entirely for cash, must be approved by affirmative vote of majority of outstanding shares entitled to vote, including [*Corp. Code §§ 152, 1001(a)*]:

(a) Affirmative vote of majority of outstanding shares of each class or series entitled by provisions of corporation's articles of incorporation to vote on matter as class or series, and

(b) Affirmative vote of all or greater than majority proportion of outstanding shares of any class or series if required by corporation's articles of incorporation.

b. Obtaining written consent to plan of liquidation and sale of assets by shareholders with enough voting power to adopt plan of liquidation and approve principal terms of proposed sale [*Corp. Code § 603(a)*].

3. If party with control of or financial interest in corporation makes tender offer (including share exchange tender offer) or written proposal for approval of sale of assets to shareholders ("interested party proposal"), ensure that affirmative written opinion regarding fairness of consideration to shareholders is provided in following manner [*Corp. Code § 1203(a)*]:

NOTE:
This requirement does not apply if the target corporation does not have shares held of record by 100 or more persons [***see*** *Corp. Code § 605* (determination of shareholders of record)], or if the transaction has been qualified pursuant to *Corp. Code § 25113* (qualification of issuer transaction by permit) or 25121 (qualification of recapitalization or reorganization by permit), and no stop order [***see*** *Corp. Code §§ 25140, 25143(a)*] is in effect regarding that qualification [*Corp. Code § 1203(a)*].

If a subsequent tender offer or written proposal is made by another person at least 10 days before the date for acceptance of the tendered shares or the vote or notice of shareholder approval on the interested party

proposal, additional shareholder notification and withdrawal requirements apply [*Corp. Code § 1203(b)*].

For further discussion, see Ch. 11, ***Merger and Acquisition Issues*** .

a. If shareholders' meeting is held to vote on approval of transaction, opinion must be delivered to shareholders with notice of meeting [*Corp. Code § 1203(a)*; *see Corp. Code § 601* (notice of meeting)].

b. If consents of all shareholders entitled to vote are solicited in writing [*see Corp. Code § 603*], opinion must be delivered at same time as solicitation [*Corp. Code § 1203(a)*].

4. Have board of directors of acquiring corporation, at regular or special meeting, pass resolution approving contract of sale to it of assets of selling corporation and authorizing its officers to execute and perform contract [*see Corp. Code § 1001(a)*].

5. Have officers of selling corporation execute and file with Secretary of State certification of election to dissolve [*Corp. Code § 1901*; *see* Ch. 12, *Winding Up and Dissolution*].

NOTE:

In general, the corporation must file a certificate evidencing the election with the Secretary of State [*Corp. Code § 1901(a)*]. However, the separate filing of a certificate of election is not required if (1) the election to dissolve is made by the vote of all the outstanding shares and (2) a statement to that effect is inserted in the certificate of dissolution [*Corp. Code § 1901(c)*]. Further, the separate filing of a certificate of election is not required if winding up and dissolution are mandatory because the term of corporate existence has expired [*Corp. Code § 1906*].

6. Have officers of selling and acquiring corporation execute:

a. Contract for sale of assets to acquiring corporation.

b. Escrow instructions for handling sale of assets to acquiring corporation.

c. Notice of intended transfer if required by Uniform Commercial Code--Bulk Sales Division [*see Com. Code §§ 6101-6111*; *see also Ch. 17, Buying and Selling a Business or Professional Practice, § 17.20*].

7. Distribute executed copy of contract of sale and escrow instructions to:

a. Secretary of each corporation.

b. Escrow holder appointed to handle sale of assets.

8. Conduct (or supervise) sale of assets in same manner as sale of any similar incorporated or unincorporated business [*see* Ch. 17, *Buying and Selling a Business or Professional Practice*].

NOTE:

The same notices must be given and the same tax clearances obtained from the California State Board of Equalization and Employment Development Department that would be required in the sale of any similar business. Discussion of the requirements for, forms for, and a Transaction Guide for the sale of a business are set forth in Ch. 17, ***Buying and Selling a Business or Professional Practice*** .

9. On consummation of sale, have selling corporation distribute sale proceeds among its shareholders and complete process of being dissolved [*see* Ch. 12, *Winding Up and Dissolution*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsCommercial Law (UCC)Bulk Sales (Article 6)General OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Directors & OfficersTax LawFederal Taxpayer GroupsC CorporationsLiquidations (IRC secs. 331-338)Mergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset Acquisitions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Assets

5-11B California Legal Forms--Transaction Guide § 11B.115

§ 11B.115 Procedure When Selling Corporation Will Not Dissolve

1. Have board of directors of selling corporation, at regular or special meeting, pass resolution approving principal terms of sale of corporate assets to acquiring corporation and authorizing [*Corp. Code § 1001(a)*]:

a. Corporate officers to either:
(1) Call special meeting of shareholders to approve principal terms of proposed sale, or

(2) Obtain written consent of shareholders approving principal terms of sale.

b. Corporate officers, after shareholder approval of principal terms of sale, to execute and fully perform contract of sale submitted to board of directors.

2. Obtain approval by shareholders of principal terms of proposed sale by either [*see Corp. Code § 1001(a)*]:

a. Calling special meeting of shareholders and having them adopt resolution approving principal terms of proposed sale.

(1) Written notice of meeting stating general nature of business to be transacted must be given personally, or by electronic transmission by corporation, or by mail to each shareholder entitled to vote not less than 10 nor more than 60 days before date of meeting [*Corp. Code § 601(a), (b)*].

NOTE:
If the corporation has 500 or more shareholders of record (as determined pursuant to *Corp. Code § 605*) on the record date for the meeting, notice may be sent by third-class rather than first-class mail. However, in that case, notice must be sent no less than 30 days

before the meeting [*Corp. Code § 601(a), (b)*].

(2) Principal terms of sale must be approved by affirmative vote of majority of outstanding shares entitled to vote, including [*Corp. Code §§ 152, 1001(a)*]:

(a) Affirmative vote of majority of outstanding shares of each class or series entitled by articles to vote on matter as class or series, and

(b) Affirmative vote of all or greater than majority proportion of outstanding shares of any class or series, if required by articles of incorporation.

b. Obtaining written consent to principal terms of sale from shareholders holding number of shares required at shareholders' meeting to approve principal terms of sale [*Corp. Code § 603*].

3. If party with control of or financial interest in corporation makes tender offer (including a share exchange tender offer) or written proposal for approval of sale of assets to shareholders ("interested party proposal"), ensure that affirmative written opinion regarding fairness of consideration to shareholders is provided to shareholders [*Corp. Code § 1203(a)*].

NOTE:

For the applicable procedures, and the exceptions to the opinion requirement, see *§ 11B.114[3]*.

4. Have board of directors of acquiring corporation, at regular or special meeting, approve contract of sale to it of assets of selling corporation and authorize execution and performance of contract by acquiring corporation's officers and employees.

5. Have officers of selling and acquiring corporations execute:

a. Contract of sale.

b. Escrow instructions for escrow handling sale of assets.

c. Notice required by Uniform Commercial Code--Bulk Sales Division [*see Com. Code § 6101 et seq.; see also Ch. 17, Buying and Selling a Business or Professional Practice, § 17.20*].

6. Distribute executed copies of contract of sale and escrow instructions to:

a. Secretary of each corporation.

b. Escrow holder appointed to handle sale of assets.

7. Conduct (or supervise) sale of assets in same manner as sale of any similar incorporated or unincorporated business [*see* Ch. 17, *Buying and Selling a Business or Professional Practice*].

NOTE:

The same notices must be given and the same tax clearances obtained from the California State Board of Equalization and Employment Development Department that would be required in the sale of any similar business. The requirements, forms, and transaction guide for the sale of a business are set forth in Ch. 17, ***Buying and Selling a Business or Professional Practice*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Directors & Officers



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART III. TRANSACTION GUIDE
B. Procedural Guide to Cash Purchase of Assets

5-11B California Legal Forms--Transaction Guide §§ 11B.116-11B.199

[Reserved]

§§ 11B.116[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART IV. FORMS

5-11B California Legal Forms--Transaction Guide § 11B.200

§ 11B.200 Contract for Cash Sale of Assets--All Assets of Selling Corporation to Be Sold to Acquiring Corporation for Cash Payable at Close of Escrow

[1] Comment

[a] Use of Form

This form is a simple contract for the sale of all assets of one corporation to another corporation for cash payable at close of escrow. It specifies that the sale will be conducted in compliance with the requirements of the Uniform Commercial Code--Bulk Sales Division [*Com. Code § 6101 et seq.*] and names an escrow holder through whom the sale is to be consummated. This chapter does not contain escrow instructions for the sale of the corporate assets. The escrow instructions required in connection with this form, however, are similar to those for the sale of other businesses [*see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.250*].

Because it involves the sale of all corporate assets, the principal terms of the contract of sale set forth in this form must be approved by the board of directors and then by the outstanding shares of the selling corporation [*Corp. Code § 1001(a)*; *see § 11B.20[2]*]. A resolution of the board of directors of the selling corporation approving the principal terms of the sale is *set forth in § 11B.201*. Another resolution by the board of directors of the selling corporation approving the principal terms of the sale is set forth in Ch. 12, *Winding Up and Dissolution*, § 12.32. Either resolution may be used in connection with this form, and may be modified by deleting the provisions relating to the plan of liquidation or dissolution if the selling corporation is not to dissolve but will continue in existence.

A resolution by the shareholders of the selling corporation approving the principal terms of the contract set forth in this form is contained in § 11C.202. As an alternative to that resolution, the written consent of the shareholders approving the principal terms of this contract is *set forth in § 11B.203*. Other forms for resolution and written consent by shareholders of the selling corporation approving sale of all the corporate assets are set forth in Ch. 12, *Winding Up and Dissolution*, §§ 12.33 and 12.34.

If proceedings for dissolution of the selling corporation have already begun before this contract is drafted, the sale under this contract being for cash only, the contract need be approved only by the board of directors and not the shareholders of the selling corporation [*Corp. Code § 2001(g)*]. If the acquiring corporation, however, is in control of the selling

corporation or under control of the same owners as the selling corporation, special shareholder approval of the sale of assets of the selling corporation is required in all cases. It makes no difference that the sale is strictly for cash or is made after the selling corporation has elected to wind up its affairs and dissolve [*see § 11B.20[6]*].

[b] Fixing Responsibility for Contingent Liabilities

Section 6.01 of this form is an indemnity agreement that contains alternative provisions regarding who accepts the risk of liabilities of the business that are based on operations conducted before the sale. The first provision assigns responsibility to the seller for all liabilities not expressly assumed by the buyer. The alternative provision excepts products liability claims from the seller's liabilities and makes the buyer responsible for them.

In a small business, the seller normally will be aware of potential liabilities, and therefore would have no objection to the indemnity provision making the seller responsible for those liabilities, assuming that the purchase price reflects those obligations. However, the law of products liability has introduced some unpredictability into certain transactions, since an action for injuries caused by a defective product may arise years after the sale of the product. Liability can extend to a manufacturer, wholesaler, retailer, lessor, and perhaps even a licensor or franchisor, as long as the firm supplied the product in the firm's normal course of business and contributed to the placing of the product on the market [*see Vandermark v. Ford Motor Co. (1964) 61 Cal. 2d 256, 262-263, 37 Cal. Rptr. 896, 391 P.2d 168* (manufacturer and retailer); *Canifax v. Hercules Powder Co. (1965) 237 Cal. App. 2d 44, 52, 46 Cal. Rptr. 552* (wholesaler); *Price v. Shell Oil Co. (1970) 2 Cal. 3d 245, 253, 85 Cal. Rptr. 178, 466 P.2d 722* (lessor of personal property); *Kasel v. Remington Arms Co. (1972) 24 Cal. App. 3d 711, 725-726, 101 Cal. Rptr. 314* (licensor; dictum on franchisor)].

Not only are potential products liability claims unknown at the time of sale, but the matter of who may be held liable will also be unclear in the absence of a governing contractual provision. The seller will remain liable [*Rawlings v. D.M. Oliver, Inc. (1979) 97 Cal. App. 3d 890, 901, 159 Cal. Rptr. 119]* , assuming that the seller still exists. If, however, a plaintiff has no practical remedy against the seller because it was a corporation and has since dissolved or because the seller lacks sufficient assets to satisfy the claim, liability may be imposed on the successor to the business [*Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 136 Cal. Rptr. 574, 560 P.2d 3* (seller dissolved); *Rawlings v. D.M. Oliver, Inc. (1979) 97 Cal. App. 3d 890, 900, 159 Cal. Rptr. 119* (individual seller with insufficient assets); *see* Ch. 11E, *Acquisition of Assets for Shares*]. The rationale of these cases makes it appear that liability of a successor will be conditioned on other factors as well, such as the goodwill of the business being one of the assets sold and some reasonable level of continuity in the types of products handled by the business. Since the buyer's liability is contingent on the condition of the seller at some future point, in many situations neither party can foresee at the time of sale who would be responsible at the time of later tort litigation.

This unforeseeability can be eliminated with indemnity provisions by which one party undertakes to cover the other for losses for which it may be held liable [*see Rossmoor Sanitation, Inc. v. Pylon, Inc. (1975) 13 Cal. 3d 622, 633, 119 Cal. Rptr. 449, 532 P.2d 97* (parties may bargain for one to make good the other's future losses)]. The question of who should undertake responsibility is a business decision to be made in negotiations between the seller and the buyer of the business. The answer may affect the price of the business, and it may depend on whether the seller will continue to be in a position to insure or self-insure against products liability loss. Either party can purchase insurance, assuming that coverage is available for a reasonable premium. Companies that insure businesses typically sell both discontinued operations or discontinued products liability insurance (for the seller), as well as products liability insurance with coverage for products sold by the insured's predecessor in the business. If the buyer does consider it prudent to insure against liability for defective products sold by the seller, it is to the advantage of both parties to make the buyer's responsibility explicit and exclusive in the contract of sale. There is no reason for both parties to have to provide for uncertain liabilities, and presumably the seller's relief from potential liability or insurance expense can be reflected in the price of the business assets.

Other alternatives exist for meeting a purchaser's concerns if there is a potential for substantial products liability claims.

If the business being sold has been incorporated, the transaction can be structured as a sale of shares rather than a sale of assets [*see* Ch. 11B, *Cash Purchase of Shares* ; Ch. 11D, *Acquisition of Shares for Shares*]. Another alternative is to set up a wholly owned subsidiary corporation to run the acquired business as a separate entity, although such a decision would obviously involve other important legal, tax, and business considerations. In either case, the assets of the business itself will be subject to products liability claims, but those of the parent corporation will not, assuming that circumstances do not justify "piercing the corporate veil" [*see Annot., Liability of Corporation for Torts of Subsidiary, 7 A.L.R.3d 1343* ; Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 14, *Litigation Involving Corporations and Shareholders* , §§ 295-298.02 (Matthew Bender)]. Sometimes the seller is willing to put part of the purchase price in escrow for a specified time, to secure an agreement to indemnify the purchaser against future claims [*see* Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 16, *Corporate Reorganizations and Liquidations*]. Sometimes major stockholders of the seller will sign an indemnity agreement with the buyer, when the seller corporation is to be liquidated. For a discussion of the relative advantages for the seller and the buyer of various arrangements, see Heitland, *Survival of Products Liability Claims in Assets Acquisitions, 34 Bus. Law. 489, 497*-499 (1979).

[2] Form

Contract for Cash Sale of Assets--All Assets of Selling Corporation to Be Sold to Acquiring Corporation for Cash Payable at Close of Escrow

CONTRACT OF SALE

_____[*name of acquiring corporation*], a California corporation ("Buyer")
and_____[*name of selling corporation*], a California corporation ("Seller") agree as follows:

ARTICLE 1 PURCHASE AND SALE OF ASSETS

Assets Being Purchased

Section 1.01. Seller shall sell to Buyer and Buyer shall purchase from Seller, on the terms specified in this agreement, all the assets, both real and personal and both tangible and intangible, of Seller, herein called "the assets," including, but without limitation,

(a) All the assets shown on the attached schedules marked "Exhibit A" through "Exhibit D";

(b) All the shares and securities of any subsidiary corporation or corporations, as that term is defined in the California General Corporation Law, owned by Seller; and

(c) All other assets of Seller, including the goodwill, business, and trade names of Seller, not expressly excluded in this contract or in the attached schedules marked "Exhibit A" though "Exhibit D."

Purchase Price

Section 1.02. Buyer shall pay to Seller on close of the escrow described in Section 1.04 of this contract the sum of $_____ in cash in lawful money of the United States in full payment of the purchase price of all of the assets described in Section 1.01 of this contract.

Conditions of Sale

Section 1.03. The purchase and sale described in and covered by this contract shall be conducted and consummated in full compliance with all the requirements of the Uniform Commercial Code--Bulk Sales Division and the General Corporation Law of the State of California.

Escrow

Section 1.04. The sale and purchase described in this contract shall be consummated through an escrow to be established by the parties to this contract immediately after execution by them of this contract with _____[*name of attorney*], whose address is _____ Street, _____, California, as escrow holder. The escrow shall be conducted in accordance with the attached escrow instructions marked "Exhibit E" and shall be closed on or after _____[*date*], which is hereby specified as the date on or after which the purchase and sale described in this agreement is to be consummated.

ARTICLE 2 WARRANTIES BY SELLER

Due Organization

Section 2.01. Seller warrants to Buyer that it, Seller, is a corporation duly organized and existing under the General Corporation Law of the State of California and that its powers as a corporation have never been and are not now suspended or limited in any way.

Subsidiaries

Section 2.02. Seller warrants to Buyer that it, Seller, has _____[*e.g.*, three] subsidiary corporations as that term is defined in California's General Corporation Law and that they are

(a) _____[*Name of first subsidiary*], a corporation duly organized and existing under the General Corporation Law of the State of California; all of whose outstanding shares are owned by Seller; and whose corporate powers have never been and are not now suspended;

(b) _____[*Name of second subsidiary*], a corporation duly organized and existing under the General Corporation Law of the State of California; whose corporate powers have never been and are not now suspended; and whose shares are all owned by Seller except _____[*set forth exceptions, e.g.*, 325 common voting shares owned by the _____ (*name*) Corporation and 100 cumulative six percent preferred shares owned by _____ (*name*) Corporation];

(c) _____[*Name of third subsidiary*], a corporation duly organized and existing under the corporation laws of the State of _____[*e.g.*, Delaware]; all of whose outstanding shares are owned by Seller; and whose corporate powers have never been and are not now suspended.

Number of Voting Shares

Section 2.03. Seller warrants that it has only one class and series of shares outstanding; that the total number of shares it has outstanding is _____[*number*], and that each such outstanding share is entitled to cast one vote for the election of each director or for approval of the sale described in this contract.

Title of Assets

Section 2.04. Seller warrants that it has good and marketable title to all assets covered by this contract, except any stock in trade or inventory items that it may sell in the ordinary course of business between the date of this agreement and close of the escrow described in Section 1.04 of this contract. Seller further warrants that its title to all the assets is free and clear of any liens, encumbrances, or other defects except as shown on the attached schedule marked "Exhibit F."

Authority to Sell

Section 2.05. Seller warrants and represents it has complied with all the requirements of the General Corporation Law of the State of California relative to the sale of assets described in this contract and that the principal terms of the sale as set forth in this contract were duly and legally

(a) Approved by Seller's board of directors on _____[*date*], and

(b) Approved by the outstanding shares of Seller, as that term is defined in California's General Corporation Law, on _____[*date*].

Financial Statements

Section 2.06. Seller represents and warrants to Buyer that all financial statements and accounting records pertaining to Seller exhibited to and examined with its approval by Buyer and the officers of Buyer were current, correct, complete, and prepared in accordance with generally accepted accounting principles. Seller further warrants that, except for the sale described in this contract, it and its Board of Directors have taken no action and will take no action prior to the close of the escrow described in Section 1.04 of this contract to materially change the financial condition of Seller as shown on the financial statements and accounting records mentioned in this section.

Defaults and Violations

Section 2.07. Seller warrants that it is not in default or material violation of any contracts, agreements, leases, or other instruments or obligations to be sold and transferred to Buyer pursuant to this contract.

Taxes

Section 2.08. Seller warrants that all tax returns and payments that have become due from it to the date of this contract have been filed and paid by it including any returns or taxes due for (1) state or federal income or franchise tax, (2) personal or real property tax levied on any of the assets, (3) sales tax, or (4) other tax.

Litigation

Section 2.09. Seller warrants and represents that there is now no litigation pending against it of which it or its officers are aware that will, might, or could affect consummation of the sale described in this contract or transfer of title of any of the assets in good and marketable condition to Buyer.

Survival of Warranties

Section 2.10. Seller agrees that all warranties made by it in this contract shall survive the consummation of the sale and the close of the escrow described in this contract. [Further, the officers and shareholders of Seller who countersign this contract agree to be personally bound and personally liable, jointly and severally, on those warranties if Seller is dissolved within four years from and after the date of this contract.]

ARTICLE 3 WARRANTIES BY BUYER

Due Organization

Section 3.01. Buyer warrants to Seller that Buyer is a corporation duly organized and existing under the General Corporation Law of the State of California and that its power as a corporation has never been and is not now suspended.

Authority to Buy

Section 3.02. Buyer further warrants to Seller that this contract has been approved by its Board of Directors and that Buyer has full power and authority to both execute and perform this contract.

ARTICLE 4 OPERATION OF BUSINESS

Seller to Continue Business

Section 4.01. Seller shall continue to operate its business and the business of its subsidiaries until consummation of the sale described in this contract in the manner specified in the attached escrow instructions marked "Exhibit E." Any and all risk of loss or damages to the assets during that period from any and all causes except the fault or negligence of Buyer shall be assumed and borne by Seller. Should any of the assets be damaged during that period by any cause the fault of Buyer the purchase price specified in this contract shall be reduced accordingly.

ARTICLE 5 CONDITIONS OF SALE

Conditions to Buyer's Performance

Section 5.01. Buyer shall be under no obligation to perform any provision of this contract to be performed by it and may cancel the sale and purchase described in this contract if, at the time set for the close of the escrow described in Section 1.04 of this contract, any of the following conditions exist:

(a) All the conditions of this contract and the attached escrow instructions attached marked "Exhibit E" to be performed by Seller have not been fully performed.

(b) All the warranties and representations of Seller contained in this contract are not true and correct.

(c) Seller is in violation of any state, federal county, city, or other governmental law or regulation.

(d) There has been any material change in the condition of the assets, or any of them, requiring more than $_____ to repair in the judgment of the _____[*name*] Association.

Proration of Taxes and Rents

Section 5.02. All taxes levied on or assessed against any of the assets described in this contract and any rents becoming due on any leases in which Seller is lessee shall be prorated between Buyer and Seller as of 12:01 A.M. Pacific Standard Time on the date of close of the escrow specified in Section 1.04 of this contract. Provided, however, any and all California sales tax becoming due because of the purchase and sale described in this contract shall be paid by Seller.

Costs and Expenses of Sale

Section 5.03. All costs and expenses of the sale or escrow described in this contract shall be borne by Buyer and Seller in the proportions and manner specified in the attached escrow instructions marked "Exhibit E."

ARTICLE 6 MISCELLANEOUS PROVISIONS

Indemnity Agreement

[*EITHER, if seller will remain in existence and will accept responsibility for products liability claims arising out of past sales:*]

Section 6.01. Except as otherwise expressly provided in this contract or any attachment to this contract, Seller shall indemnify and hold Buyer and the property of Buyer, including the assets, free and harmless from any and all claims, liability, loss, damage, or expense resulting from Seller's ownership of the assets or Seller's operation of the assets, including any claim, liability, loss, or damage arising by reason of the injury to or death of any person or persons, or the damage of any property, caused by Seller's use of the assets, the condition of the assets when owned by Seller, or the defective design or manufacture by Seller of any product or products. Provided, however, Seller shall incur no liability under this section until and unless the aggregate amount of any and all claims, liability, loss, damage, or expense equals or exceeds $_____.

[*OR, if buyer will insure or self-insure against products liability claims arising out of past sales by seller:*]

Section 6.01. Except as otherwise expressly provided in this contract or any attachment to this contract, Seller shall indemnify and hold Buyer and the property of Buyer, including the assets, free and harmless from any and all claims, liability, loss, damage, or expense resulting from Seller's ownership of the assets, including any claim, liability, loss, or damage arising by reason of the injury to or death of any person or persons, or the damage of any property, caused by Seller's use of the assets or the condition of the assets when owned by Seller. Provided, however, Seller shall incur no liability under this section until and unless the aggregate amount of any and all claims, liability, loss, damage, or expense equals or exceeds $_____. Provided further, that Seller has no duty to indemnify Buyer when both of the following conditions are true: (1) the liability is for injury or damage caused by a defect in the design or manufacture of a product sold by Seller in the course of Seller's operation of the business, and (2) Seller has no actual knowledge of the liability or potential liability at the time when the sale of the assets is consummated. Under those conditions, Buyer agrees to indemnify and hold Seller and the property of Seller free and harmless from liability or expense.

[*Continue with the following:*]

Entire Agreement

Section 6.02. This instrument with its attachments constitutes the entire agreement between Buyer and Seller respecting the assets or the sale of the assets to Buyer by Seller, and any agreements or representation respecting the assets or their sale by Seller to Buyer not expressly set forth in this instrument is null and void.

Notices

Section 6.03. Any and all notices or other communications required or permitted by this contract or by law to be served on or given to either party, Buyer or Seller, by the other party or by the escrow holder named in this contract, shall be, unless otherwise required by law, in writing and deemed duly served and given when personally delivered to the party to whom directed or any of its officers or, in lieu of personal service, when deposited in the United States mail, first-class postage prepaid, addressed to Buyer at _____ Street, _____, California or Seller at _____ Street, _____, California.

Attorneys' Fees

Section 6.04. If any litigation is commenced between the parties, Buyer and Seller, concerning this contract, the sale and purchase described in this contract, or the rights and duties of either in relation to this contract, the party prevailing in that litigation shall be entitled, in addition to any other relief that may be granted, to a reasonable sum as and for its attorneys' fees in that litigation which shall be determined by the court in that litigation or in a separate action brought for that purpose.

Assignment

Section 6.05. Neither this contract nor any right or interest in it may be assigned by either party to any other person or corporation without the express written consent of the other party to this contract.

Governing Law

Section 6.06. This contract shall be governed and all rights and liabilities under it determined in accordance with the laws of the State of California in effect on this date.

EXECUTED on _____[*date*], at _____, _____ County, California.

BUYER
_____ [*name of acquiring corporation*]
By _____ [*signature*]
[*typed name and title*]
SELLER
_____ [*name of selling corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral

OverviewMergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Directors & Officers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART IV. FORMS

5-11B California Legal Forms--Transaction Guide § 11B.201

§ 11B.201 Resolution of Board of Directors of Selling Corporation Approving Sale of All Corporate Assets

[1] Comment--Use of Form

This form is a resolution that may be adopted by the board of directors of a corporation that wishes to sell all its assets of cash, pursuant to an offer it has received from another corporation, and dissolve. It is drafted to comply with the requirements of the California General Corporation Law requiring the principal terms of any proposed sale or other disposal of all or substantially all of the assets of a corporation to be approved by the corporation's board of directors and by the corporation's outstanding shares [*Corp. Code § 1001(a)*; *see § 11B.20[2]*]. This resolution approves the principal terms of the proposed sale of corporate assets and authorizes the corporate officers to secure the necessary shareholder approval of such a sale.

Under California law, the board of directors of a corporation cannot elect to voluntarily dissolve the corporation unless it has issued no shares, has already disposed of all its assets and not conducted business for five years, or has been adjudicated a bankrupt [*Corp. Code § 1900*]. The election to voluntarily wind up and dissolve a solvent, going corporation that has issued shares can be made only by the corporation's shareholders [*Corp. Code § 1900*]. This resolution recommends to the shareholders that the corporation be dissolved, and conditionally approves the sale of all corporate assets pursuant to a designated proposed contract of sale.

A form for the contract of sale referred to in this form is *set forth in § 11B.200*. A resolution by shareholders of the selling corporation approving the principal terms of the asset sale described in the resolution in this form is *set forth in § 11B.202*. A form to be used in obtaining the written consent of shareholders and approving the principal terms of the asset sale is *set forth in § 11B.203*.

For a discussion of sale transactions that must be approved by directors and shareholders of a selling corporation, see *§ 11B.20[2]*. For the special rules applicable to asset sales when the selling corporation is a subsidiary of the buying corporation or both are owned by the same people, see *§ 11B.20[6]*.

[2] Form

Resolution of Board of Directors of Selling Corporation Approving Sale of All Corporate Assets

RESOLUTION OF THE BOARD OF DIRECTORS

WHEREAS, this Board of Directors deems it to be in the best interests of the shareholders of this corporation that this corporation be dissolved, its assets sold, its affairs wound up, and the proceeds from the sale of its assets distributed to its shareholders in redemption and cancellation of their shares; and

WHEREAS, an offer has been received from _____[*name of acquiring corporation*] to purchase all assets of this corporation on the terms set forth in a proposed Contract of Sale ("the Contract of Sale") this day submitted to this Board of Directors; now, therefore, be it

RESOLVED that this corporation be dissolved and that this corporation adopt a plan of complete liquidation under which

(1) Its assets shall be sold to _____[*name of acquiring corporation*] pursuant to the terms of the Contract of Sale,

(2) Its affairs shall be wound up and all its known debts and liabilities paid, and

(3) The proceeds of the sale of its assets shall be, within _____[*specify number, e.g.,* 12] months after adoption by it of the plan of complete liquidation, distributed in complete liquidation of the corporation among its shareholders in the proportion the shares owned by each bears to the total number of issued and outstanding shares of the corporation; and

RESOLVED FURTHER that the secretary of this corporation is hereby ordered and instructed to insert a copy of the Contract of Sale, the proposed Contract of Sale this day submitted to this Board of Directors, word for word in the minutes of this meeting immediately following this resolution; and

RESOLVED FURTHER that the principal terms of the sale of all assets of this corporation to _____[*name of acquiring corporation*] pursuant to the Contract of Sale after adoption of the plan of complete liquidation described in this resolution by shareholders of this corporation, and as part of that plan of complete liquidation, is hereby approved by this Board of Directors; and

RESOLVED FURTHER that the officers of this corporation are hereby authorized and directed to take appropriate action to obtain the vote or written consent of shareholders of this corporation necessary for adoption of the plan of complete liquidation described in this resolution and approval of the principal terms of the sale of all assets of this corporation to _____[*name of acquiring corporation*] pursuant to the Contract of Sale; and

RESOLVED FURTHER that on adoption by the shareholders of this corporation of the plan of complete liquidation described in this resolution and approval by the shareholders of this corporation of the principal terms of the sale of all assets of this corporation to _____[*name of acquiring corporation*] pursuant to the Contract of Sale, the president and secretary of this corporation are authorized and directed

(1) To execute and file, or cause to be executed and filed, in the manner prescribed by the General Corporation Law of California the certificate described in *Corporations Code Section 1901* evidencing the election of this corporation to wind up and dissolve; and then

(2) To execute on behalf and in the name of this corporation the contract of sale and appropriate escrow instructions, approved by legal counsel for this corporation, to carry out the provisions of the Contract of Sale; and

RESOLVED FURTHER that after the shareholders of this corporation have adopted the plan of complete liquidation described in this resolution and approved the principal terms of the sale of all assets of this corporation pursuant to the

Contract of Sale, the officers and directors of this corporation are hereby authorized and directed to do and to cause to be done all things reasonably necessary to perfect the sale of all assets of this corporation to _____[*name of acquiring corporation*] pursuant to the Contract of Sale and to perform fully the plan of complete liquidation described in this resolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawSales of AssetsGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionMergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Directors & Officers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART IV. FORMS

5-11B California Legal Forms--Transaction Guide § 11B.202

§ 11B.202 Resolution of Shareholders of Selling Corporation Approving Sale of All Corporate Assets for Cash

[1] Comment

[a] Use of Form

This form is a resolution to be adopted by shareholders of a selling corporation electing to dissolve the corporation and approving the sale of all of its assets. It is designed to be used in connection with the resolution of the board of directors of a selling corporation contained in § 11.201 and the contract of sale *set forth in § 11.200*. Because shareholders of a corporation may do almost anything they could do by vote at a shareholders' meeting by written consent without a meeting, an alternative form that may be used to obtain the written consent of the shareholders of the selling corporation to an election to dissolve the corporation and approval of the principal terms of the sale of all corporate assets is *set forth in § 11B.203*.

Approval of both the board of directors and the outstanding shares of the selling corporation is required for the sale of all or substantially all of its assets other than in the ordinary course of its business [*Corp. Code § 1001(a)*]. For further discussion, see *§ 11B.20[2]*.

[b] Vote Required for Resolution

This resolution attempts to accomplish two different results authorized by California's General Corporation Law: (1) to validly exercise the shareholders' election to dissolve the selling corporation, and (2) to have the shareholders approve the principal terms of a cash sale of all the corporation's assets. The General Corporation Law, however, imposes different voting requirements on a shareholders' election to dissolve a corporation and shareholders' approval of the principal terms of the sale of all or substantially all the assets of a corporation. When, as in this form, a resolution of the shareholders attempts to accomplish both results, it must meet both requirements.

The election to voluntarily wind up and dissolve a corporation must be made by the vote of shareholders holding shares representing 50 percent or more of the "voting power" of the corporation [*Corp. Code § 1900(a)*]. The "voting power" of a corporation, as that term is used in the General Corporation Law, means the power to vote for the election of directors at the present time, not at some time in the future, on the happening of some defined condition [*Corp. Code §*

194.5]. If different classes of shares are entitled to vote as separate classes for different members of the board, the percentage of voting power represented by the shares voting for dissolution must be determined on the basis of the percentage of the total number of authorized directors those shares have the power to elect in an election in which all shares entitled to vote for the election of directors are voted [*Corp. Code § 194.5*].

The shareholder approval of the principal terms of a proposed sale or all or substantially all the assets of a corporation required by the General Corporation Law is that they be "approved by the outstanding shares" of the selling corporation [*Corp. Code § 1001(a)*; *see § 11B.20[2]*]. Generally it means approval by the affirmative vote of a majority of all outstanding shares of the corporation entitled to vote on the matter in question [*Corp. Code § 152*]. However, if the corporation's articles of incorporation so provide, it may mean the affirmative vote of a majority of the outstanding shares of each class or series of shares of the corporation or the affirmative vote of a greater than majority proportion of the shares of all or some classes of the corporation [*see § 11B.20[2]*].

In most cases, therefore, the shareholder vote required to elect to dissolve the selling corporation and the shareholder vote required to approve the principal terms of the sale of all or substantially all the corporate assets will be the same or nearly the same. However, in some cases they may be different and counsel should be careful to examine the situation to determine any differences in the voting requirements before submitting this resolution to a general or special shareholders' meeting of the selling corporation.

[c] Opinion of Independent Appraiser

When a tender offer or a written proposal for approval of a sale of assets [*Corp. Code § 1001(a)*] or "reorganization" [*see Corp. Code §§ 181, 1200*] is made to some or all of a corporation's shareholders by a party to the transaction who has control of or a financial interest in that corporation (an "interested party"), an affirmative opinion in writing regarding the fairness of the consideration to the shareholders must be provided to the shareholders or the corporation [*Corp. Code § 1203(a)*; *see* Ch. 11, *Merger and Acquisition Issues*]. For purposes of the written opinion requirement, the term "tender offer" includes a share exchange tender offer [*Corp. Code § 1203(a)*; *see Corp. Code § 183.5* (definition)]. For further discussion, see Ch. 11D, *Acquisition of Shares for Shares* .

[2] Form

Resolution of Shareholders of Selling Corporation Approving Sale of All Corporate Assets for Cash

RESOLUTION OF SHAREHOLDERS

WHEREAS, the Board of Directors of this corporation at a regular [*or* special] meeting duly held on _____[*date*], at the principal office of this corporation at _____ Street, _____, California adopted resolutions approving a plan of complete liquidation for this corporation and approving the principal terms of the sale, as part of the plan of complete liquidation, of all assets of this corporation to _____[*name of acquiring corporation*] pursuant to the terms of a proposed Contract of Sale ("Contract of Sale") submitted to the Board of Directors on that day; and

WHEREAS the above-described resolutions of the Board of Directors and the Contract of Sale have been submitted to and discussed at this meeting; now therefore be it

RESOLVED that the shareholders of this corporation hereby elect to wind up and dissolve this corporation; and

RESOLVED FURTHER that the shareholders of this corporation hereby approve and this corporation hereby adopts the plan of complete liquidation approved by the Board of Directors of this corporation under which:

(1) All the corporation's assets shall be sold to _____[*name of acquiring corporation*] pursuant to

the terms of the Contract of Sale,

(2) The corporation's affairs shall be wound up and all its known debts and liabilities paid, and

(3) The proceeds of the sale of the corporation's assets shall be, within _____[*specify number, e.g.*, 12] months after adoption by the corporation of this plan of liquidation, distributed in complete liquidation of the corporation among its shareholders in the proportion the shares owned by each bears to the total number of issued and outstanding shares of the corporation; and

RESOLVED FURTHER that the principal terms of the sale of all assets of this corporation to _____[*name of acquiring corporation*] pursuant to the Contract of Sale as part of the plan of complete liquidation adopted by this resolution is hereby approved by the outstanding shares of this corporation as that term is defined in the General Corporation Law of California; and

RESOLVED FURTHER that the secretary of this corporation is instructed to insert a copy of the Contract of Sale marked "Exhibit A" in the minutes of this meeting and attach a copy of the Contract of Sale marked "Exhibit A" to any certified copy of this resolution prepared by him or her; and

RESOLVED FURTHER that the officers and directors of this corporation are hereby authorized and directed to execute and file any instruments and do any other acts as may be required of them, or any of them, to carry out and perform the plan of complete liquidation approved in this resolution or the sale of the assets of this corporation pursuant to the Contract of Sale.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawSales of AssetsGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionMergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Directors & Officers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11B CASH PURCHASE OF ASSETS
PART IV. FORMS

5-11B California Legal Forms--Transaction Guide § 11B.203

§ 11B.203 Written Consent of Shareholders of Selling Corporation Approving Sale of All Corporate Assets for Cash

[1] Comment--Use of Form

This form is the written consent of shareholders of the selling corporation to the principal terms of a sale of all the corporation's assets. Unless the corporation's articles of incorporation provide otherwise, any action that may be taken at an annual or special meeting of shareholders may be taken without a meeting by written consent of shareholders holding outstanding shares having not less than the minimum number of votes necessary to authorize the action at a meeting [*Corp. Code § 603(a)*].

This form is an alternative to the resolution of shareholders of a selling corporation *set forth in § 11B.202*. It may be used most easily when the selling corporation has only a few shareholders. If all the shareholders of the selling corporation are also members of its board of directors, this form may be circulated for signature the same day and at the same meeting the resolution of the board of directors [*see § 11B.201*] is adopted by the board. For further discussion applicable to this form, see *§ 11B.202[1]*.

[2] Form

Written Consent of Shareholders of Selling Corporation Approving Sale of All Corporate Assets for Cash

WRITTEN CONSENT OF SHAREHOLDERS

WE, the undersigned, are shareholders of _____[*name of selling corporation*], a California corporation, and each own the number and type of share in that corporation ("the corporation") set forth opposite our signatures at the end of this instrument;

WHEREAS, the Board of Directors of the corporation at a regular [*or* special] meeting duly held on _____[*date*], at the principal office of the corporation at _____ Street, _____, California adopted a resolution, a copy of which is attached and marked "Exhibit A," approving a plan of complete liquidation for the corporation and approving the principal terms of the sale as part of the

plan of complete liquidation of all assets of the corporation to _____[*name of acquiring corporation*] pursuant to the terms of a proposed Contract of Sale, a copy of which is attached and marked "Exhibit B," submitted to the Board of Directors on that day;

NOW, THEREFORE, WE HEREBY CONSENT and elect to wind up and dissolve the corporation; and

WE FURTHER CONSENT, approve, and adopt for the corporation the plan of complete liquidation approved by the Board of Directors of the corporation in the attached resolution marked "Exhibit A" under which plan:

(1) All the corporation's assets shall be sold to_____[*name of acquiring corporation*] pursuant to the terms of the attached Contract of Sale marked "Exhibit B,"

(2) The corporation's affairs shall be wound up and all its known debts and liabilities paid, and

(3) The proceeds of the sale of the corporation's assets, within _____[*specify number, e.g.,* 12] months after adoption by the corporation of this plan of complete liquidation, shall be distributed in complete liquidation of the corporation among its shareholders in the proportion the shares owned by each bears to the total number of issued and outstanding shares of the corporation; and

WE FURTHER CONSENT and approve the principal terms of the sale of all assets of the corporation to _____[*name of acquiring corporation*] pursuant to the terms of the attached Contract of Sale marked "Exhibit B" as part of the plan of complete liquidation adopted by this consent;

WE FURTHER CONSENT and authorize and direct the officers and directors of the corporation to execute and file any instrument and do any other acts that may be required of them, or any of them, to carry out and perform the plan of complete liquidation described in this instrument and the sale of all assets of the corporation in the manner described in this instrument.

IN WITNESS WHEREOF we sign our names:

Name	Date	Number and Type of Shares
_____	_____	_____
_____ [*signature*]		
_____	_____	_____
_____ [*signature*]		
_____	_____	_____
_____ [*signature*]		

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawSales of AssetsGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Shareholders



1 of 197 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS

5-11C California Legal Forms--Transaction Guide 11C.syn

§ 11C.syn Synopsis to Chapter 11C: MERGERS

§ 11C.01 California Sources

[1] Statutes

[2] Regulations

§ 11C.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 11C.03-11C.04 [Reserved]

§ 11C.05 Law Reviews and Periodicals

§ 11C.06 Annotations

§ 11C.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 11C.08-11C.19 [Reserved]

§ 11C.20 Governing Law

[1] The Concept of a Merger

[2] General Corporation Law

[a] Chapter 11--"Merger"

[b] Chapter 12--"Reorganizations"

[3] Internal Revenue Code

[4] Corporate Securities Law

§ 11C.21 Definitions and Distinctions Applicable to Mergers

§ 11C.22 California Statutory Requirements

[1] Merger Agreement

[a] Contents

[b] Articles Amended by Merger

[2] Reference to Other Agreements

[3] Agreement as to Conversion of Shares

[a] Manner of Conversion

[b] Equal Treatment of Shares

[c] Fractional Shares

[4] Directors' Approval

[5] Shareholders' Approval

[a] Outstanding Shares of Each Class

[b] Close Corporations

[c] Nonprofit Corporations

[d] Foreign Corporations

[6] Conditions Excusing Shareholders' Approval

[a] Rights Unchanged by Merger

[b] Control Not Diluted by Merger

[c] Exceptions to Nondilution Rule

[7] Report by Independent Appraiser

[8] Signing, Amending, and Abandoning Merger Agreement

[9] Filing Agreement and Perfecting Merger

[a] Role of Surviving Corporation

[b] Officer's Certificate

[c] Date of Merger

[d] Effect of Merger

§ 11C.23 Mergers of Domestic and Foreign Corporations

[1] In General

[2] Effect of Merger

[a] Domestic Surviving Corporation

[b] Foreign Surviving Corporation

[c] Filing With County Recorder

[3] Shareholders' Rights

§ 11C.24 Recordable Evidence of Merger of Two Foreign Corporations

§ 11C.25 Corporate Securities Law Requirements

[1] Qualification Requirement

[2] Exemptions From Qualification

[3] Permits

§ 11C.26 Income Tax Factors and Requirements

[1] Tax-Free Exchange

[2] Business Purpose, Continuity of Business Enterprise, and Continuity of Interest Requirements

[3] Income Tax Basis for Acquired Assets

[4] Net Operating Loss Carryforward Deduction

§ 11C.27 Assumption of Disappearing Corporation's Liabilities

[1] Automatic Assumption of Debts and Liabilities

[2] Limitations on Liability

§ 11C.28 Other Advantages and Disadvantages of Merger

[1] Advantages

[a] Simplicity

[b] Protection Against Dilution of Interests

[c] Effective Date Controlled

[d] No Sales and Use Tax

[2] Disadvantages

[a] Shareholder Approval/Assumption of Liabilities

[b] Payment to Dissenting Shareholders

§ 11C.29 Requirements for Short-Form Merger

[1] In General

[2] Resolution or Plan of Merger

[3] Certificate of Ownership Perfecting Merger

[4] Short-Form Merger With Foreign Corporation

§ 11C.30 Mergers Between Corporations and Other Business Entities

[1] Overview

[2] Agreement of Merger

[3] Conversion of Securities

[4] Filing Requirements of Surviving Corporation

[5] Filing Requirements of Surviving Other Business Entity

[a] Certificate of Merger

[b] Merger Effective on Filing

[c] Copy of Merger Agreement

[6] Effect of Merger

[7] Mergers Involving Foreign Other Business Entities

[a] Compliance With Applicable Law

[b] Effective Date

[c] Surrender of Right to Transact Intrastate Business

[8] Evidence of Effectiveness of Merger

[9] Abandonment of Merger

§§ 11C.31-11C.89 [Reserved]

Scope

§ 11C.90 Facts

Scope

§ 11C.91 Documents

Scope

§§ 11C.92-11C.99 [Reserved]

§ 11C.100 Form of Merger

Scope

§ 11C.101 Foreign Corporations

Scope

§ 11C.102 Conversion of Shares

Scope

§ 11C.103 Shareholder Approval and Notice of Approval

Scope

§ 11C.104 Securities Laws Requirements

Scope

§ 11C.105 Change in Ownership

Scope

§§ 11C.106-11C.119 [Reserved]

Scope

§ 11C.120 Merger Agreement

Scope

§ 11C.121 Complying With Securities Laws

Scope

§ 11C.122 Shareholder Approval and Notice

Scope

§ 11C.123 Officers' Certificate

Scope

§ 11C.124 [Reserved]

§ 11C.125 Perfecting Merger

Scope

§§ 11C.126-11C.129 [Reserved]

Scope

§ 11C.130 Resolution or Plan of Merger

Scope

§ 11C.131 [Reserved]

§ 11C.132 Notice to Shareholders

Scope

§ 11C.133 Securities Requirements

Scope

§ 11C.134 Certificate of Ownership

Scope

§§ 11C.135-11C.139 [Reserved]

Scope

§ 11C.140 Foreign Law Procedures

Scope

§ 11C.141 California Procedures

Scope

§§ 11C.142-11C.149 [Reserved]

Scope

§ 11C.150 Evaluating Dissenting Shareholder Status

Scope

§ 11C.151 Exercising Shareholder Rights

Scope

§ 11C.152 Bringing Action to Enforce Payment

Scope

§§ 11C.153-11C.159 [Reserved]

§ 11C.160 Filing With County Recorder

Scope

§ 11C.161 Statutory Change in Ownership

Scope

§ 11C.162 Amending Merger Agreement

Scope

§ 11C.163 Referenced Agreements

Scope

§§ 11C.164-11C.199 [Reserved]

§ 11C.200 Merger Agreement--General Form

[1] Comment

[a] Use of Form

[b] Parties to Agreement

[c] Contents of Merger Agreement

[d] Amendment of Articles

[2] FORM

Merger Agreement--General Form

§ 11C.201 Merger Agreement With Specific Detailed Plan of Reorganization

[1] Comment

[a] Use of Form

[b] Execution of Agreement

[2] FORM

Merger Agreement With Specific Detailed Plan of Reorganization

§ 11C.202 Resolution of Board of Directors of Surviving Corporation Approving Merger Agreement and Calling Special Shareholders' Meeting to Approve Merger

[1] Comment

[a] Use of Form

[b] Purpose of Resolution

[c] Call of Special Shareholders' Meeting--Notice and Call

[d] Fixing Record Date for Meeting

[2] FORM

Resolution of Board of Directors of Surviving Corporation Approving Merger Agreement and Calling Special Shareholders' Meeting to Approve Merger

§ 11C.203 Resolution of Board of Directors of Disappearing Corporation Approving Merger Agreement and Calling Special Shareholders' Meeting to Approve Merger

[1] Comment--Use of Form

[2] FORM

Resolution of Board of Directors of Disappearing Corporation Approving Merger Agreement and Calling Special Shareholders' Meeting to Approve Merger

§ 11C.204 Application to Commissioner of Corporations for Permit Qualifying Securities to Be Issued in Merger or Exchange of Shares for Assets of Another Corporation

[1] Comment

[a] Use of Form

[b] Transactions Covered by Form

[c] General Requirements

[d] Contents of Application

[e] Requirements for Issuance of Permit

[f] Supplemental Filings and Incorporation by Reference

[g] Public Hearings

[h] Collateral Jurisdiction

[i] Fees

[2] FORM

Application to Commissioner of Corporations for Permit Qualifying Securities to Be Issued in Merger or Exchange of Shares for Assets of Another Corporation

§ 11C.205 Notice to Shareholders of Special Meeting of Shareholders to Consider and Vote on Proposed Merger

[1] Comment

[a] Use of Form

[b] Manner of Giving Notice of Special Meeting

[c] Report by Independent Appraiser

[2] FORM

Notice to Shareholders of Special Meeting of Shareholders to Consider and Vote on Proposed Merger

§ 11C.206 Proxy Statement Soliciting Proxies for Shareholders' Meeting Called to Approve Merger

[1] Comment

[a] Use of Form

[b] Smaller Reporting Companies

[2] FORM

Proxy Statement Soliciting Proxies for Shareholders' Meeting Called to Approve Merger

§ 11C.207 Proxy From Shareholder Authorizing Vote for or Against Merger

[1] Comment

[a] Use of Form

[b] Proxy Requirements

[2] FORM

Proxy From Shareholder Authorizing Vote for or Against Merger

§ 11C.208 Resolution of Shareholders Approving Principal Terms of Merger

[1] Comment--Use of Form

[2] FORM

Resolution of Shareholders Approving Principal Terms of Merger

§ 11C.209 Resolution of Board of Directors of Constituent Corporation Abandoning Merger

[1] Comment

[a] Authority to Abandon

[b] Circumstances for Abandonment

[2] FORM

Resolution of Board of Directors of Constituent Corporation Abandoning Merger

§ 11C.210 Officers' Certificate of Constituent Corporation Perfecting Merger--Certificate for Corporation Whose Shares Have Approved Merger

[1] Comment--Use of Form

[2] FORM

Officers' Certificate of Constituent Corporation Perfecting Merger--Certificate for Corporation Whose Shares Have Approved Merger

§ 11C.211 Officers' Certificate of Constituent Corporation Perfecting Merger--Certificate for Corporation Whose Shareholders Were Not Required to Approve Merger

[1] Comment--Use of Form

[2] FORM

Officers' Certificate of Constituent Corporation Perfecting Merger--Certificate for Corporation Whose Shareholders Were Not Required to Approve Merger

§§ 11C.212-11C.299 [Reserved]

§ 11C.300 Resolution by Board of Directors of Parent Corporation for Short-Form Merger of Subsidiary Into Parent--Wholly Owned Subsidiary

[1] Comment--Use of Form

[2] FORM

Resolution by Board of Directors of Parent Corporation for Short-Form Merger of Subsidiary Into Parent--Wholly Owned Subsidiary

§ 11C.301 Resolution by Board of Directors for Short-Form Merger of Subsidiary Into Parent Corporation--90-Percent-Owned Subsidiary

[1] Comment

[a] Use of Form

[b] Merger of 90-Percent-Owned Subsidiary Into Parent

[2] FORM

Resolution by Board of Directors for Short-Form Merger of Subsidiary Into Parent Corporation--90-Percent-Owned Subsidiary

§ 11C.302 Additional Provision for Short-Form Merger of Parent Into Subsidiary

[1] Comment--Use of Form

[2] FORM

Additional Provision for Short-Form Merger of Parent Into Subsidiary

§ 11C.303 Certificate of Ownership Merging Wholly Owned Subsidiary Into Parent Corporation

[1] Comment

[a] Use of Form

[b] Officers' Certificate

[c] Merger of Wholly Owned or 90-Percent-Owned Subsidiary Into Parent

[2] FORM

Certificate of Ownership Merging Wholly Owned Subsidiary Into Parent Corporation

§ 11C.304 Notice of Effective Date of Short-Form Merger of 90-Percent-Owned Subsidiary Into Parent Corporation

[1] Comment--Use of Form

[2] FORM

Notice of Effective Date of Short-Form Merger of 90-Percent-Owned Subsidiary Into Parent Corporation

§§ 11C.305-11C.399 [Reserved]

§ 11C.400 Notice to Shareholders by Corporation of Approval of Merger by Outstanding Shares and Right of Dissenting Shareholders to Require Corporation to Purchase Their Dissenting Shares

[1] Comment

[a] Use of Form

[b] Rights of Dissenting Shareholders in General

[c] Corporations That Must Purchase Dissenting Shares

[d] Dissenting Shares That Must Be Purchased

[e] Procedure for Enforcing Dissenting Shareholder Rights

[f] Payment for Dissenting Shares

[g] Suit to Enforce Dissenters' Rights

[2] FORM

Notice to Shareholders by Corporation of Approval of Merger by Outstanding Shares and Right of Dissenting Shareholders to Require Corporation to Purchase Their Dissenting Shares

§ 11C.401 Demand by Shareholder in Merger or Short-Form Merger for Purchase of Dissenting Shares

[1] Comment--Use of Form

[2] FORM

Demand by Shareholder in Merger or Short-Form Merger for Purchase of Dissenting Shares

§§ 11C.402-11C.499 [Reserved]

§ 11C.500 Notice of Exchange Transaction Under Corp. Code § 25103(h)

[1] Comment

[a] Use of Form

[b] Exemption From Qualification for Exchanges Incident to Merger, Consolidation, or Sale of Assets

[c] Failure to File Notice

[2] FORM

Notice of Exchange Transaction Under Corp. Code § 25103(h)



2 of 197 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS

5-11C California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter covers the merger of corporations, or corporations and other business entities, pursuant to provisions of California's General Corporation Law. The Legal Background discusses California statutory requirements and the effect of a merger on the affected corporations and their shareholders. It discusses the income tax factors relative to a merger of corporations under California law. It examines the requirements for making a merger a tax-free reorganization under the Internal Revenue Code, and also examines tax issues including the income tax basis for assets acquired in a merger and the availability to the survivor of a net operating loss carryover deduction. The Legal Background covers the various advantages and disadvantages of mergers as a form of reorganization. In addition, it examines the requirements of the California Corporate Securities Law of 1968 applicable to mergers. The Transaction Guide lists procedures for effectuating statutory mergers, short-form mergers, and foreign law mergers. It also contains a procedural guide for dissenting shareholders. This chapter contains forms for merger reorganizations and short-form mergers, as well as forms for enforcing rights of dissenting shareholders.

For a discussion and comparison of the various methods of corporate acquisition, see Ch. 11, *Merger and Acquisition Issues* . These methods are covered individually in Ch. 11A, *Cash Purchase of Shares* , Ch. 11B, *Cash Purchase of Assets* ; Ch. 11D, *Acquisition of Shares for Shares* ; and Ch. 11E, *Acquisition of Assets for Shares* . For a discussion of corporate conversions, see Ch. 11F, *Corporate Conversions* . Further detailed discussion of mergers is contained in Ballantine & Sterling, California Corporation Laws, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* (Matthew Bender). Additional forms are set forth in Ballantine & Sterling, California Corporation Laws, Appendix A, Forms 13.10-13.20 (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART I. RESEARCH GUIDE
A. Primary Sources

5-11C California Legal Forms--Transaction Guide § 11C.01

§ 11C.01 California Sources

[1] Statutes

Merger agreement terms dependent on other facts or documents. *Corp. Code § 109.5*.

Vote of each class of outstanding shares means vote of each class regardless of limitations on voting rights. *Corp. Code § 117*.

"Approval of outstanding shares" defined. *Corp. Code § 152*.

"Constituent other business entity" defined. *Corp. Code § 161.7*.

"Limited liability company" defined. *Corp. Code § 171.3*.

Merger considered to be form of corporate "reorganization." *Corp. Code § 181(a)*.

Corporation need not issue fractional shares in merger. *Corp. Code § 407*.

Written consent of outstanding shares same as vote of shares. *Corp. Code § 603*.

Authority of board of directors to fix record date for shareholders' meeting. *Corp. Code § 701(a)*.

Record date for shareholders' meeting, when not fixed by board of directors. *Corp. Code § 701(b)*.

Statutory authority for merger of two or more corporations. *Corp. Code § 1100*.

Merger agreement.
Approval by board of directors. *Corp. Code § 1101*.

Required contents. *Corp. Code § 1101*.
Persons who must sign execution. *Corp. Code § 1102*.
Filing with officers' certificate. *Corp. Code § 1103*.
Adopting and approving amendments. *Corp. Code § 1104*.
Effect of certified copy as evidence. *Corp. Code § 1106*.

Perfecting merger, filing of agreement and certificates with Secretary of State. *Corp. Code § 1103*.

Abandoning merger, after shareholders' approval. *Corp. Code § 1105*.

Effect of merger.
Automatic transfer of property to and assumption of liabilities by surviving corporation. *Corp. Code § 1107(a)*.
Rights of creditors of disappearing corporations preserved. *Corp. Code § 1107(c)*.
Pending actions against disappearing corporations. *Corp. Code § 1107(d)*.

Merger of foreign and domestic corporations.
Statutory authority. *Corp. Code § 1108(a)*.
When surviving corporation is domestic corporation. *Corp. Code § 1108(b), (c)*.
When surviving corporation is foreign corporation. *Corp. Code § 1108(d)*.

Recording of merger agreement or merger certificate transfers real property of disappearing corporation or other business entity. *Corp. Code § 1109*.

Short-form merger.
With wholly owned subsidiary corporation. *Corp. Code § 1110(a)*.
With 90-percent-owned subsidiary corporation. *Corp. Code § 1110(a), (b)*, (h).
Short-form merger of parent into subsidiary corporation. *Corp. Code § 1110(c)*.
Parent's right to change name to that of subsidiary. *Corp. Code § 1110(d)*.
Perfecting short-form merger, filing certificate of ownership. *Corp. Code § 1110(e), (f)*.
Short-form mergers involving foreign corporations. *Corp. Code § 1110(g)*.
Short-form merger shareholder notice requirements. *Corp. Code § 1110(h)*.
Filing agreement of merger in short-form merger. *Corp. Code § 1110(i)*.

Vote requirement for close corporation to a merger. *Corp. Code § 1111*.

Merger of domestic corporations with domestic or foreign other business entities. *Corp. Code § 1113*.

Approval of board of directors of each constituent corporation to a merger required. *Corp. Code § 1200(a)*.

Approval of board of directors of "parent party" to a merger required. *Corp. Code § 1200(d)*.

Approval of outstanding shares of each class of corporation party to a merger required. *Corp. Code § 1201(a)*.

Conditions excusing approval by shareholders to a merger. *Corp. Code § 1201(b)*.

Exceptions to conditions excusing shareholder approval of merger.
Amendment to surviving corporation's articles of incorporation. *Corp. Code § 1201(c)*.
Exchange of shares for shares having different rights, including those of foreign corporation. *Corp. Code § 1201(d)*.
Exchange of close corporation shares for shares of corporation not a close corporation. *Corp. Code §§ 1111, 1201(e)*.

Exchange of corporate shares for interests in surviving other business entity. *Corp. Code § 1201(f)*.

Shareholder approval may be obtained before or after approval by board of directors. *Corp. Code § 1201(g)*.

Shareholder approval requirements when shares are canceled without consideration, or receive less consideration than required by articles. *Corp. Code § 1202*.

Requirements applicable to reorganization proposal made by person controlling or involved in management of target corporation. *Corp. Code § 1203*.

Rights of dissenting shareholders.
Right to require purchase at value on day before announcement of proposed merger. *Corp. Code § 1300(a)*.
Dissenting shares to which right applicable. *Corp. Code § 1300(b)*.
Statutory requirement for notice of shareholder approval. *Corp. Code § 1301(a)*.
Demand for purchase of shares, statutory requirement and time when required. *Corp. Code § 1301(b)*.
Contents of demand for purchase of shares. *Corp. Code § 1301(c)*.
Submission of shares for endorsement. *Corp. Code § 1302*.
Agreement for share purchase by corporation, amount and time of payment. *Corp. Code § 1303*.
Suit for enforcement of dissenting shareholder's rights, joinder, court and time within which must be commenced. *Corp. Code § 1304(a), (b)*.
Suit for enforcement of dissenters' rights, determined by court. *Corp. Code § 1304(c)*.

Qualification of securities required by merger.

Permit for negotiations prior to shareholder solicitation not required. *Corp. Code § 25103(a)*.

No permit required unless 25 percent of shareholders California residents. *Corp. Code § 25103(c)*.

Determination of residence of shareholders. *Corp. Code § 25103(d)*.

No permit required if majority of acquiring corporation's income is active and corporation being acquired has no more than 20 equity security holders. *Corp. Code § 25103(h)*.

Necessity for qualification of shares. *Corp. Code § 25120*.

Qualification to be by permit. *Corp. Code § 25121*.

Effective date of qualification. *Corp. Code § 25122*.

Secretary of State's fees.

Filing merger agreement and certificates. *Gov. Code § 12186(k)*, (*l*).

Certifying copies of merger documents. *Gov. Code § 12185*.

[2] Regulations

Negotiation permits for mergers not generally issued. *10 Cal. Code Reg. § 260.140.63*.

Application for qualification of shares required by merger. 10 Cal. Code Reg. § 260.121.1.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART I. RESEARCH GUIDE
A. Primary Sources

5-11C California Legal Forms--Transaction Guide § 11C.02

§ 11C.02 Federal Sources

[1] Statutes

Net operating loss carryover income tax deduction allowed. *I.R.C. § 172(a)*.

No gain on exchange of shares of one corporation to reorganization for shares of another corporation to reorganization. *I.R.C. § 354(a)*.

Basis for shares received in exchange between corporations to reorganization. *I.R.C. § 358*.

No gain on exchange of assets by corporation to reorganization for shares of another corporation to reorganization. *I.R.C. § 361*.

Basis for property received by corporation in exchange for its shares in tax-free exchange. *I.R.C. § 362*.

Statutory merger as tax-free reorganization. *I.R.C. § 368(a)(1)(A)*.

Use of subsidiaries as part of merger. *I.R.C. § 368(a)(2)(C)*.

Use of parent's stock in statutory merger. *I.R.C. § 368(a)(2)(D)*.

Party to tax-free reorganization defined. *I.R.C. § 368(b)*.

Net operating loss carryover deduction available to surviving corporation. *I.R.C. § 381*.

Limitation on net operating loss carryforwards for surviving corporation. *I.R.C. § 382*.

[2] Regulations

Purpose of making tax-free reorganizations. *Treas. Reg. § 1.368-1(b)*.

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5 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART I. RESEARCH GUIDE
A. Primary Sources

5-11C California Legal Forms--Transaction Guide §§ 11C.03-11C.04

[Reserved]

§§ 11C.03[Reserved]



6 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11C California Legal Forms--Transaction Guide § 11C.05

§ 11C.05 Law Reviews and Periodicals

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11C California Legal Forms--Transaction Guide § 11C.06

§ 11C.06 Annotations

Annot., What Constitutes Violation of § 208 of Employee Retirement Income Security Act (ERISA)(*29 USCS § 1058*), *Prohibiting Certain Mergers, Consolidations, and Transfers Involving Pension Plans, 103 A.L.R. Fed. 390 (1991)* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11C California Legal Forms--Transaction Guide § 11C.07

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Ch. 170, *Negotiation and Payment*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11C California Legal Forms--Transaction Guide §§ 11C.08-11C.19

[Reserved]

§§ 11C.08[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART II. LEGAL BACKGROUND

5-11C California Legal Forms--Transaction Guide § 11C.20

§ 11C.20 Governing Law

[1] The Concept of a Merger

The term "merger" is not defined in California's General Corporation Law. However, it generally refers to the combination of two or more existing corporations by the absorption into one of them of all of the others, with the former continuing in existence [*see* Ballantine & Sterling, California Corporation Laws, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , § 252.03 (Matthew Bender)]. A merger is a purely statutory procedure, prescribed in detail by the General Corporation Law.

In recent years, the concept of merger has been expanded to include not only combinations of corporations with each other [*see § 11C.23*], but also combinations among various types of business entities [*see § 11C.30*]. The General Corporation Law now permits mergers among domestic and foreign corporations and other business entities, which include general partnerships, business trusts, real estate investment trusts, unincorporated associations (other than a nonprofit association), limited partnerships, domestic or foreign limited liability companies, and certain domestic reciprocal insurers organized to provide medical malpractice insurance, provided that the particular merging party is permitted under the law governing it to merge with a corporation [*Corp. Code §§ 174.5, 1113*; *see § 11C.30*].

[2] General Corporation Law

[a] Chapter 11--"Merger"

Two chapters of the General Corporation Law govern the procedures required to effectuate a merger in California. Chapter 11 [*Corp. Code §§ 1100-1113*] governs mergers specifically. *Corp. Code § 1100* provides that any two or more corporations may be merged into one of those corporations, and that a corporation may merge with one or more domestic corporations, foreign corporations, or other business entities. The next four sections of Chapter 11 of the General Corporation Law describe the contents and method of adoption and amendment of a merger agreement among corporations [*see Corp. Code §§ 1101-1104*]. *Corp. Code § 1105* specifies how and when a merger may be abandoned, and *Corp. Code § 1106* specifies the evidentiary effect of a certified copy of the filed merger agreement. *Corp. Code § 1107* describes the resulting effect of a merger, and *Corp. Code § 1108* provides for the merger of domestic California corporations and foreign corporations. *Corp. Code § 1109* governs the manner in which real property of a disappearing

corporation or disappearing other business entity may be transferred of record in each county to the surviving corporation or surviving other business entity of a merger. *Corp. Code § 1110* governs short-form mergers, and *Corp. Code § 1111* contains special requirements applicable to a merger when one of the constituent corporations is a "close corporation" [*see Corp. Code § 158* (definition)]. *Corp. Code § 1112* contains special requirements applicable to a merger in which the surviving corporation is a nonprofit, and *Corp. Code § 1113* sets forth special requirements applicable to a merger involving one or more domestic corporations and one or more domestic or foreign other business entities. These statutory requirements are discussed below [*see §§ 11C.122, 11C.23*].

[b] Chapter 12--"Reorganizations"

Because a merger pursuant to Chapter 11 (other than a short-form merger) is defined in *Corp. Code § 181* as a "reorganization" [*Corp. Code § 181(a)*; *see* Ch. 11, *Merger and Acquisition Issues*], a merger is also governed by Chapter 12 governing reorganizations [*Corp. Code §§ 1200-1203*]. *Corp. Code § 1200* specifies what types of "reorganizations" (as that term is used in the General Corporation Law) must be approved by the boards of directors of the various corporations that are a party to the reorganization. *Corp. Code § 1201* specifies the shareholder approval required for a proposed reorganization such as a merger. *Corp. Code § 1202* sets forth shareholder approval requirements applicable when shares are canceled without consideration [*Corp. Code § 1202(a)*] or with less consideration than that required by the articles [*Corp. Code § 1202(b)*], and requires the application of foreign law to shareholder approval requirements when a parent party is a foreign corporation [*Corp. Code § 1202(c)*]. *Corp. Code § 1203* requires the report of an independent appraiser if the merger proposal is made by a controlling party [*see* Ch. 11, *Merger and Acquisition Issues*]. These statutory requirements are discussed below [*see § 11C.122[4]-[6]*].

[3] Internal Revenue Code

In addition to the relevant provisions of the General Corporation Law governing mergers, provisions of the Internal Revenue Code granting nonrecognition (postponement of recognition) of gain resulting from the exchange of shares for shares or property for shares as part of a plan of "reorganization" and provisions defining the term "reorganization" must be considered in connection with any proposed merger of corporations. *I.R.C. §§ 354(a)(1)* and *361(a)* grant nonrecognition of gain in those transactions [*see § 11C.26[1]*]. *I.R.C. § 368(a)(1)* and *(b)* define the terms "reorganization" and "parties to a reorganization." *I.R.C. §§ 358* and *362(b)* specify the income tax basis of the property or shares received in a tax-free organization. For further discussion, see *§ 11C.26.*

[4] Corporate Securities Law

The impact of federal and state securities laws on a business combination always must be considered [*see* Ballantine & Sterling, California Corporation Laws, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , § 253.12 (Matthew Bender). The provisions of the Corporate Securities Law of 1968 relevant to a California merger of corporations are *Corp. Code §§ 25120-25122*, requiring any securities issued in a merger to be qualified by application to the California Corporations Commissioner. *Corp. Code § 25103* states the various exceptions to the rule that securities issued as part of a merger or reorganization be "qualified" with the California Corporations Commissioner. These provisions are implemented by regulations issued by the Corporations Commissioner and set forth in *10 Cal. Code Reg. §§ 260.103, 260.140.63*, and *260.121*. For further discussion, see *§ 11C.25*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersShort-Form MergersTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART II. LEGAL BACKGROUND

5-11C California Legal Forms--Transaction Guide § 11C.21

§ 11C.21 Definitions and Distinctions Applicable to Mergers

A "statutory merger or consolidation" is the first activity defined in the Internal Revenue Code as a tax-free corporate "reorganization" [*I.R.C. § 368(a)(1)(A)*]. The drafters of California's present General Corporation Law, as revised effective January 1, 1977, stated that they eliminated the concept of "consolidation" in California as an outmoded procedure [Assembly Select Committee on the Revision of the Corporation Code, dated December 1, 1975, at 91 (hereafter cited in this chapter as "Assembly Select Comm. Rep."); *see* Ballantine & Sterling, California Corporation Laws, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , § 252.03 n.7 (Matthew Bender)]. As discussed in *§ 11C.20[1]*], the term "merger" is not defined in California's General Corporation Law. That law merely provides that any two or more corporations may be merged into one of those corporations, and that a corporation may merge with one or more domestic corporations, foreign corporations, or other business entities pursuant to Ch. 11 of the law [*see Corp. Code § 1100*]. It also provides that any one or more corporations may merge with one or more other business entities [*see Corp. Code § 1113*].

The corporation into which one or more other corporations or one or more other business entities are merged is the "surviving corporation" [*Corp. Code § 190*]. If the survivor is a limited partnership, that partnership is the "surviving limited partnership" [*Corp. Code § 190.5*]. If the survivor is not a corporation or a limited partnership, the survivor is referred to as the "surviving other business entity" [*Corp. Code § 190.7*]. The corporations and other business entities that are merged into the survivor and do not continue in existence after the merger are known as "disappearing corporations," "disappearing limited partnerships," "disappearing other business entities," respectively [*Corp. Code §§ 165, 165.5, 167.8*]. A "constituent corporation," "constituent limited partnership," or "constituent other business entity" is an entity that is merged with one or more other corporations, limited partnerships, or other business entities and includes the surviving corporation, limited partnership, or other business entity [*Corp. Code §§ 161, 161.5, 161.7*].

A merger, therefore, consists of a combination in which constituent corporations, limited partnerships, or other business entities are merged into a surviving corporation, limited partnership, or other business entity [*see J.C. Peacock, Inc. v. Hasko (1960) 184 Cal. App. 2d 142, 150, 7 Cal. Rptr. 490]* . Merger is an organic change that does not involve liquidation but does involve the incidental dissolution or disappearance of the merged or disappearing entities [*see J.C. Peacock, Inc. v. Hasko (1960) 184 Cal. App. 2d 142, 150, 7 Cal. Rptr. 490]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART II. LEGAL BACKGROUND

5-11C California Legal Forms--Transaction Guide § 11C.22

§ 11C.22 California Statutory Requirements

[1] Merger Agreement

[a] Contents

The first step required by the California statutes to perfect a merger of two or more corporations into one corporation is the approval of an agreement of merger by the board of directors of each of the corporations [*Corp. Code §§ 1100, 1101*]. The constituent corporations to the merger *must* be parties to the merger agreement; other persons, including a parent party corporation [*see Corp. Code § 1200(e)*], *may* be parties to the agreement [*Corp. Code § 1101*].

The agreement of merger is the basic document in the merger transaction [Cavitch, *Business Organizations with Tax Planning, Ch. 162, Mergers, § 162.02[1]* (Matthew Bender)]. It must state all of the following [*Corp. Code § 1101*]:

- The terms and conditions of the merger.

- The amendments, subject to *Corp. Code §§ 900, 907* (limitations on amendments) [discussed *below*], to the articles of incorporation of the surviving corporation that are to be effected by the merger.

- The name and place of incorporation of each constituent corporation to the merger, and which of them is to be the surviving corporation.

- The manner of converting the shares of each of the constituent corporations into shares or other securities of the surviving corporation [*see* [3], *below*].

- Any other details or provisions that are desired, including a provision for the payment of cash in lieu of fractional shares or for any other arrangement consistent with the provisions of *Corp. Code § 407* (fractional shares) [*see* [3], *below*].

[b] Articles Amended by Merger

If the merger will amend the articles of incorporation of the surviving corporation, the merger agreement must either (1) set forth in full the articles of incorporation as so amended; (2) state that a provision of the articles identified by number or other designation will be stricken from the articles or amended to read as set forth in the agreement; or (3) state that a provision set forth in the agreement will be added to the articles [*Corp. Code §§ 907(a), 1101(b)*]. The articles as amended must contain only provisions that could be lawfully inserted in original articles of incorporation filed on the date the amendment becomes effective [*Corp. Code §§ 900, 1101*].

If the amendment to the surviving corporation's articles changes the name of the corporation, its new name may be the same as or similar to the name of a disappearing domestic or foreign corporation to the merger [*Corp. Code § 1101(b)*]. However, the surviving corporation is still subject to the limitations imposed by *Corp. Code § 201(b)* [*Corp. Code § 1101(b)*]. Therefore, it can adopt a name that is the same as or similar to the name of a constituent corporation, but cannot adopt a name that conflicts with that of an existing corporation that is not a party to the merger [*see* Assembly Select Com. Rep., at 92]. For further discussion, see Ballantine & Sterling, California Corporation Laws, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , § 258.02 (Matthew Bender).

[2] Reference to Other Agreements

Any of the terms of a merger agreement pursuant to *Corp. Code § 1101* may be made dependent on facts ascertainable outside that agreement, if the manner in which those facts will operate on the terms of the agreement is clearly and expressly set forth [*Corp. Code § 109.5(a)*]. If any terms are made dependent on facts ascertainable outside the merger agreement through a reference to another document, the corporation filing the merger agreement must (1) maintain a copy of the referenced document and all amendments at its principal executive office; and (2) provide a copy of the document and all amendments to the shareholders of any constituent corporation on written request, without charge [*Corp. Code § 109.5(b)*; *see § 11C.163[1]*].

If the reference is to a contract to which the corporation is a party, any amendment or revision of the referenced contract requires shareholder approval, in addition to approvals otherwise required, in the following circumstances only [*Corp. Code § 109.5(c)*; *see § 11C.163[2]*]:

- If the amendment or revision would result in a material change in the rights, preferences, privileges, or restrictions of a class or series of shares, it must be approved by the outstanding shares [*see Corp. Code § 152*] of that class or series [*Corp. Code § 109.5(c)(1)*].

- If the amendment or revision would result in a material change in the rights or liabilities of any class or series of shares with respect to the optional article provisions described in *Corp. Code § 204(a)(1)-(3), (5), (9)* [*see* Ch. 3, *Articles of Incorporation*], it must be approved by the outstanding shares [*see Corp. Code § 152*] of that class or series [*Corp. Code § 109.5(c)(2)*].

- If the amendment or revision would result in a material change in the restrictions on transfer or hypothecation of any class or series of shares, it must be approved by the outstanding shares [*see Corp. Code § 152*] of that class or series [*Corp. Code § 109.5(c)(3)*].

- If the amendment or revision would result in a change of any of the principal terms of the merger agreement, it must be approved in the same manner as required by *Corp. Code § 1104* for a change in the principal terms of a merger agreement [*Corp. Code § 109.5(c)(4)*; *see* [8], *below*].

[3] Agreement as to Conversion of Shares

[a] Manner of Conversion

The manner of converting the shares of each constituent corporation into shares or other securities of the surviving corporation is one of the matters that must be set forth in the merger agreement [Corp. Code § 1101(d)]. If any shares of any of the constituent corporations are not to be converted solely into shares or other securities of the surviving corporation, the merger agreement must also state the cash, rights, securities, or other property of another corporation the holders of those shares are to receive in exchange for their shares. That cash, rights, securities, or other property of another corporation may be given to those holders either in addition to or in lieu of shares or other securities of the surviving corporation [*Corp. Code § 1101(d)*]. If the shares will be canceled without consideration, the merger agreement must so state [*Corp. Code § 1101(d)*].

[b] Equal Treatment of Shares

Each share of the same class or series of any constituent corporation (other than the cancellation of shares held by a constituent corporation or its parent or a wholly owned subsidiary of either in another constituent corporation), unless all shareholders of that class or series consent, must be treated equally with respect to any distribution of cash, rights, securities, or other property [*Corp. Code § 1101*].

Except in a short-form merger and its "downstream" equivalent, the nonredeemable common shares of a constituent corporation may be converted only into nonredeemable common shares of the surviving corporation (or a parent party) if a constituent corporation (or a parent party) directly or indirectly owns shares of another constituent corporation representing more than 50 percent of the voting power of the other constituent corporation before the merger. This rule does not apply when all shareholders of the class consent, or as provided in *Corp. Code § 407* with respect to fractional shares [*Corp. Code § 1101*].

Despite the general rule requiring equal treatment of shares, however, *Corp. Code § 1101.1* permits unequal treatment of shares of the same class or series, and permits the conversion of common shares into other securities or cash even when one constituent corporation owns shares representing more than 50 percent of the voting power of the other constituent corporation if the terms and conditions of the transaction, and the fairness of those terms and conditions, have been approved by the Commissioner of Corporations, the Commissioner of Financial Institutions, the Insurance Commissioner, or the Public Utilities Commission [*Corp. Code § 1101.1*; *see Corp. Code § 25142*; *see also Fin. Code §§ 696.5, 5750, 5802*; *Ins. Code § 838.5*; *Pub. Util. Code § 822*]. This approval exception to the general rule requiring equal treatment also applies in the context of mergers involving limited partnerships. The purpose of this exception to the generally applicable rules on conversion (which preclude dilution or cashing-out of shareholders' interests without their consent) is to permit transactions that are essentially fair to the minority shareholders to go forward and to prevent a small minority from blocking a transaction found to be fair by the appropriate state commissioner or agency [*see Corp. Code § 1101.1*; *see also § 11C.30*].

[c] Fractional Shares

With respect to the creation of fractional shares on conversion, *Corp. Code § 407* modifies the general rules requiring equality of treatment between shares and conversion of nonredeemable common shares into like shares of the surviving corporation. Ordinarily, the surviving corporation to a merger is not required to issue fractions of a share to persons who would become entitled to fractional shares at the conversion ratio specified in the merger agreement [*Corp. Code §§ 407, 1101*]. Instead, if the merger agreement so provides, it can do any of the following [*Corp. Code § 407*]:

- Arrange for the disposition of fractional shares by those entitled to them;

- Pay in cash the fair value of fractions of a share as of the time when those entitled to receive fractions are determined; or

- Issue scrip or warrants in registered form, as certificated securities [*see Corp. Code § 156.1*; *Com.*

Code § 8102(a)(4), (15) (defined)] or uncertificated securities [*Corp. Code § 191.1*; *Com. Code § 8102(a)(18)* (defined)], or bearer form as certificated securities, entitling the holder to receive a certificate for a full share on the surrender of the scrip or warrants aggregating a full share.

It may also issue scrip or warrants for fractional shares subject to the following conditions [*Corp. Code § 407*]:

- That they will become void if not exchanged for full shares before a specified date; or
- That the shares for which the scrip or warrants are exchangeable may be sold by the corporation and the sale proceeds distributed to the scrip or warrant holders; or
- Other conditions the board of directors may impose.

Furthermore, if the fraction of a share any person would otherwise be entitled to receive in a merger is less than one half of one percent of the total number of shares he or she is entitled to receive, the merger agreement may provide that fractions of a share will be disregarded or that shares issuable in the merger will be rounded off to the nearest whole share [*Corp. Code §§ 407, 1101*]. However, a corporation cannot pay cash for fractional shares if that would result in the cancellation of more than 10 percent of the outstanding shares of any class [*Corp. Code § 407*].

[4] Directors' Approval

A merger agreement must be approved by the board of directors of each constituent corporation to the merger and by any parent party of a corporation to the merger [*Corp. Code §§ 1101, 1113(b), 1200(a), (e)*]. A "parent party" is a corporation that is in control of a constituent corporation to the merger and whose own equity securities are to be issued or transferred in the merger [*Corp. Code § 1200(e)*]. An "equity security" is a share, a security convertible with or without consideration into shares, or any warrant or right to subscribe to or purchase any share or security convertible into shares [*Corp. Code § 168*]. "Control" means owning, directly or indirectly, shares or equity securities possessing more than 50 percent of the voting power of a constituent corporation or other business entity [*Corp. Code § 160(b)*]. "Voting power" means the power to elect directors of the constituent corporation [*Corp. Code § 194.5*].

Approval by the board of directors means approval by the board itself, and not a committee of the board [*Corp. Code § 151*].

[5] Shareholders' Approval

[a] Outstanding Shares of Each Class

The principal terms of the proposed merger also must be approved by the outstanding shares of each class of each constituent corporation or parent party to the merger [*Corp. Code § 1201(a)*; *see Corp. Code § 1200*]. Approval may occur either before or after the merger agreement has been approved by the corporation's board of directors [*Corp. Code § 1201(h)*]. "Approval by the outstanding shares" requires approval by the affirmative vote of a majority of the outstanding shares entitled to vote, unless the articles require a greater than majority vote [*Corp. Code §§ 117, 152*]. If the articles of incorporation of a corporation require that the matter be approved by a greater than majority vote, including (a unanimous vote) of the outstanding shares of any class or series of its shares, the principal terms of the merger must be approved by that required vote [*Corp. Code § 152*; Assembly Select Comm. Rep., at 94].

If a corporation has two classes of common shares differing only as to voting rights, they will be considered a single class of shares [*Corp. Code § 1201(a)*]. In that case, neither class of common shares is considered to have interests requiring special protection and their votes may be counted together as one class [Assembly Select Comm. Rep., at 94].

No approval of the merger is required by any class of outstanding preferred shares of the surviving corporation or its parent party if the rights, preferences, privileges, and restrictions granted to or imposed on that class of shares will remain unchanged by the merger [*Corp. Code § 1201(a)*]. Their approval may be required, however, for some amendments to the articles of incorporation of the surviving corporation that will be made by the merger [*Corp. Code § 1201(a), (c)*]. If an amendment will be made by the merger to the articles of incorporation of the surviving corporation, the principal terms of the merger must be approved by the outstanding shares of the surviving corporation that would be required, without the merger, to approve the proposed amendment to its articles of incorporation [*Corp. Code § 1201(c)*].

In addition to the approval requirements imposed by *Corp. Code § 1201*, the principal terms of a merger reorganization must be approved by *all* of the outstanding shares of a corporation if the merger agreement provides that all of the outstanding shares of that corporation are canceled without consideration in the merger [*Corp. Code § 1202(a)*]. Furthermore, if the terms of the merger reorganization provide that a class or series of preferred shares will have distributed to it a lesser amount than would be required by applicable provisions in the articles, the principal terms must be approved by the same percentage of outstanding shares of that class or series as would be required to approve an amendment of the article provisions to provide for the distribution of that lesser amount [*Corp. Code § 1202(b)*; *see* Ch. 10, *Amendment of Articles*].

[b] Close Corporations

If any constituent corporation to a merger is a close corporation [*see Corp. Code § 158*], the affirmative vote of a majority of its outstanding shares of each class may be insufficient to approve the merger. If the shares of the close corporation are to be exchanged in the merger for shares of a surviving corporation that is not a close corporation, the principal terms of the merger must be approved by the affirmative vote of at least two thirds of each class of outstanding shares of the close corporation [*Corp. Code §§ 1111, 1201(e)*]. The articles of incorporation of the close corporation may provide for a lesser vote but not for less than a majority vote of the outstanding shares of each class [*Corp. Code §§ 1111, 1201(e)*]. If the holders of any class of outstanding shares of a corporation that is a party to a merger reorganization will receive interests in a surviving other business entity, the principal terms of the reorganization must be approved by the shareholders [*Corp. Code § 1201(f)*].

[c] Nonprofit Corporations

If any disappearing corporation in a merger is governed by the General Corporation Law and the surviving corporation is a nonprofit public benefit corporation, a nonprofit mutual benefit corporation, or a nonprofit religious corporation, the merger must be approved by all of the disappearing corporation, regardless of any limitations or restrictions on the voting rights, and notwithstanding *Corp. Code §§ 1200-1203* [*Corp. Code § 1112*].

[d] Foreign Corporations

When a parent party [*Corp. Code § 1200*] is a foreign corporation, other than one subject to the General Corporation Law [*see Corp. Code § 2115(a)*; *see also* Ch. 12B, *Foreign Corporations and Associations*], any requirement or lack of requirement for approval by the outstanding shares of the foreign corporation is not governed by *Corp. Code §§ 1200* and *1201*, discussed above. Instead, the law of the state or place of incorporation of the foreign corporation will apply [*Corp. Code § 1202(c)*].

[6] Conditions Excusing Shareholders' Approval

[a] Rights Unchanged by Merger

The requirement that each constituent corporation obtain the approval of its outstanding shares to a proposed merger is intended to prevent any significant change in the rights or interests of the shareholders without their consent. It seems

only fair that their investment should not be changed without their consent [Assembly Select Comm. Rep., at 93]. Therefore, when the rights, ownership, or control of the shareholders of a particular corporation are not to be diminished or diluted in any way by a merger, their consent to the merger would seem unnecessary [Assembly Select Comm. Rep., at 93, 94]. For this reason, no approval of a proposed merger is required by any class of outstanding preferred shares of the surviving corporation or its parent party when the rights, preferences, privileges, and restrictions granted to or imposed on that class of shares will be unchanged by the merger [*Corp. Code § 1201(a)*; *but see Corp. Code § 1201(g)*].

For shareholder approval requirements in the context of a merger involving one or more corporations and one or more other business entities, see *§ 11C.30*.

[b] Control Not Diluted by Merger

The General Corporation Law provides that approval of a proposed merger by the outstanding shares of any corporation will not be required when the control of the shareholders of that corporation is not to be diluted by the merger [Assembly Select Comm. Rep., at 94]. Specifically, no approval of a proposed merger is required by the outstanding shares of any corporation when that corporation or its shareholders, immediately after the merger, will own equity securities possessing more than five sixths of the voting power of the surviving corporation or its parent party [*Corp. Code § 1201(b)*; *but see Corp. Code § 1201(g)*]. The term equity securities, for purposes of the voting exemption, means shares of the surviving corporation or its parent party that are convertible into shares with or without consideration [*Corp. Code § 168*]. For purposes of the voting exemption, it does not include mere warrants or rights to subscribe to or purchase shares or convertible securities of the surviving corporation or its parent party [*Corp. Code § 1201(b)*]. Voting power means the power to elect directors of the surviving corporation or its parent party [*Corp. Code § 194.5*].

For purposes of determining under the voting exemption test whether the shareholders of a particular constituent corporation to a merger will, immediately after the merger, own equity securities possessing five sixths of the voting power of the surviving corporation or its parent party, equity securities the shareholders own prior to the merger as shareholders of another party to the merger are disregarded [*Corp. Code § 1201(b)*]. Otherwise, a shareholder who owned 80 percent of the shares of the surviving corporation and 20 percent of the shares of a disappearing corporation to a two-corporation merger might claim that approval of the merger by shareholders of the disappearing corporation was not required. When the merger contemplated the exchange of each share of the disappearing corporation for a share of the surviving corporation, immediately after the merger the shareholders of the disappearing corporation would own shares possessing five sixths of the voting power of the surviving corporation. The voting power, however, of the other shareholders in the disappearing corporation would obviously be changed and diluted by the merger. To prevent such a change and dilution without their consent, the General Corporation Law requires that in determining whether, under the voting exemption test, the merger must be approved by outstanding shares of the disappearing corporation, the shares already owned by a double shareholder in the surviving corporation must be disregarded [*Corp. Code § 1201(b)*].

For purposes of the voting exemption test, the voting power of a corporation will be calculated by assuming that all securities of the corporation that are convertible, either immediately or at some future time, into voting shares have been converted [*Corp. Code § 1201(b)*]. It will not be assumed, however, that any mere warrants or rights to subscribe to or purchase voting shares has been exercised [*Corp. Code § 1201(b)*].

Notwithstanding the provisions of *Corp. Code § 1201(a)* and *(b)* discussed above, the principal terms of a reorganization must be approved by all shareholders of any class or series if, as a result of the reorganization, the holders of that class or series become personally liable for any obligations of a party to the reorganization, unless all holders of that class or series have dissenters' rights [*Corp. Code § 1201(g)*; *see Corp. Code § 1300 et seq.*].

[c] Exceptions to Nondilution Rule

There are several situations in which, although the shareholders of a constituent corporation to a merger will immediately after the merger own shares possessing five-sixths of the voting power of the surviving corporation, they must still approve the merger. The first is when they are to receive shares of the surviving corporation having different rights, preferences, privileges, or restrictions than those they owned prior to the merger. The principal terms of a merger must be approved by the outstanding shares of any class of a corporation that is a party to a merger when shares of that class are to be exchanged in the merger for shares of the surviving corporation having different rights, preferences, privileges, or restrictions [*Corp. Code § 1201(d)*]. Shares of a foreign corporation received in exchange for shares in a domestic California corporation in a merger are considered as being shares of the surviving corporation having different rights, preferences, privileges, and restrictions than the exchanged shares [*Corp. Code § 1201(d)*].

The second situation is when they are shareholders of the surviving corporation and its articles of incorporation are to be amended by the merger [*Corp. Code § 1201(c)*]. In such a situation, the principal terms of the merger must be approved by shareholders of the surviving corporation in the same way the amendment to its articles of incorporation would be required to be approved by them without a merger [*Corp. Code § 1201(c)*].

The third situation is when they are shareholders of a close corporation. The principal terms of a merger must be approved by the affirmative vote of at least two thirds of each class of the outstanding shares of a close corporation, as that term is defined in the General Corporation Law [*Corp. Code § 158(a)*], if the merger would result in their receiving shares of a corporation that is not a close corporation [*Corp. Code § 1201(e)*]. The articles of incorporation of the close corporation may provide for a lesser vote but not for less than a majority vote of the outstanding shares of each class [*Corp. Code §§ 1111, 1201(e)*].

The fourth situation in which the shareholders must approve the merger, regardless of whether or not they will immediately after the merger own five sixths of the voting power of the surviving corporation, is when any disappearing corporation is governed by the General Corporation Law and the surviving corporation is a nonprofit public benefit corporation, a nonprofit mutual benefit corporation, or a nonprofit religious corporation. In this situation, the merger must be approved by all of the disappearing corporation, regardless of any limitations or restrictions on the voting rights, and notwithstanding *Corp. Code §§ 1200-1203* [*Corp. Code § 1112*].

[7] Report by Independent Appraiser

When a tender offer, including a share exchange tender offer, or a written proposal for approval of a statutory merger, other "reorganization" [*see Corp. Code §§ 181(a), 183.5, 1200*], or a sale of assets [*see Corp. Code § 1001(a)*] is made to some or all of a corporation's shareholders by a party to the transaction who has control of or a financial interest in that corporation, an affirmative opinion in writing regarding the fairness of the consideration to the shareholders must be provided to the shareholders or the corporation [*Corp. Code § 1203(a)*]. This requirement does not apply, however, if the target corporation does not have shares held of record by 100 or more persons [*see Corp. Code § 605* (determination of shareholders of record)], or if the transaction has been qualified pursuant to *Corp. Code § 25113* (qualification of issuer transaction by permit) or 25120 (qualification of recapitalization or reorganization by permit), and no stop order [*see Corp. Code §§ 25140, 25143(a)*] is in effect regarding that qualification [*Corp. Code § 1203(a)*]. For further discussion, see Ch. 11, *Merger and Acquisition Issues* .

[8] Signing, Amending, and Abandoning Merger Agreement

After a merger agreement has been approved by the board of directors of each constituent corporation, it must be signed on behalf of each corporation by two people: (1) the chairman of the board of directors, the president, or a vice-president, and (2) the secretary or an assistant secretary of the corporation [*Corp. Code § 1102*].

Any amendment to a merger agreement may be adopted and the agreement as so amended may be approved by the board of directors and, if the amendment changes any of the principal terms of the agreement, by the outstanding shares

of any constituent corporation in the same manner as the original agreement [*Corp. Code § 1104*]. When the agreement as so amended is approved by the board of directors and outstanding shares, when required, of each of the constituent corporations to the merger and any parent party of a constituent corporation, the agreement as so amended constitutes the agreement of merger [*Corp. Code § 1104*].

The board of directors of a constituent corporation to a proposed merger, in its discretion, may abandon a merger without further approval of the outstanding shares of the corporation [*Corp. Code § 1105*]. The abandonment will be subject to the contractual rights, if any, of third parties including other constituent corporations to the merger [*Corp. Code § 1105*].

[9] Filing Agreement and Perfecting Merger

[a] Role of Surviving Corporation

After a merger agreement has been approved by the board of directors of each constituent corporation and parent party, and after it has also been approved by the outstanding shares when required of each constituent corporation and parent party, a copy of the agreement must be filed with the California Secretary of State. This duty is placed on the surviving corporation [*Corp. Code § 1103*].

[b] Officer's Certificate

An officers' certificate for each constituent corporation to the merger must be attached to the copy of the merger agreement filed with the Secretary of State [*Corp. Code § 1103*]. An officers' certificate is a certificate signed and verified by (1) the chairman of the board of directors, the president, or any vice-president of the corporation and (2) the secretary, the chief financial officer, the treasurer, or any assistant secretary or assistant treasurer of the corporation [*Corp. Code § 173*].

The officers' certificate for each constituent corporation to the merger that must be attached to the copy of the merger agreement filed with the Secretary of State must state the following [*Corp. Code § 1103*]:

- The total number of outstanding shares of each class of the corporation entitled to vote on the merger.
- Either of the following:
  - That the principal terms of the merger agreement in the form attached, instead of the merger agreement itself, were approved by that corporation by a vote of a number of shares of each class equal to or exceeding the vote required, specifying each class entitled to vote and the percentage vote required of each class; or
  - That the merger agreement can be and was approved by the board of directors of the corporation alone [*see Corp. Code § 1201*, discussed in *§ 11C.103*, which sets forth the very limited circumstance in which shareholder approval is not required].
- If equity securities of a parent of a constituent corporation are to be issued in the merger, the officers' certificate of that constituent corporation must also state either that no vote of the shareholders of the parent was required or that the required vote of the parent's shareholders was obtained.

[c] Date of Merger

Unless the merger agreement states a delayed effective date or the surviving corporation is a foreign corporation, a

merger and any amendments made to the surviving corporation's articles of incorporation by the merger agreement become effective on the filing of the merger agreement with attached officers' certificates for the constituent corporations with the Secretary of State [*Corp. Code § 1103*].

The agreement of merger, or any instrument filed with the Secretary of State with respect to a corporation other than original articles, may provide that it is to become effective at a time not more than 90 days subsequent to its filing date [*Corp. Code § 110(c)*]. In case a filed instrument specifies a delayed effective date, the instrument may be prevented from becoming effective by a certificate stating that by appropriate corporate action it has been revoked. The revocation certificate must be executed in the same manner as the original instrument and filed with the Secretary of State before the specified effective date of the instrument it revokes [*Corp. Code § 110(c)*]. In the case of a merger agreement, the certificate revoking it need only be executed on behalf of one of the constituent corporations [*Corp. Code § 110(c)*]. If no revocation certificate is filed, the agreement of merger containing the specified delayed effective date becomes effective on that date [*Corp. Code § 110(c)*].

[d] Effect of Merger

When the merger becomes effective, the separate existence of the disappearing corporations ceases and the surviving corporation succeeds, without other transfer, to all the rights and property of each of the disappearing corporations [*Corp. Code § 1107(a)*]. The surviving corporation may succeed without paying any local agency transfer fees applicable to all licenses, permits, registrations, and other privileges granted by any local agency when the merger does not result in a change of ownership, such as a merger between a corporation and its wholly owned subsidiary, a merger between a corporation and the wholly ownedsubsidiary of that corporation's wholly owned subsidiary, or two wholly owned subsidiaries of the same parent [*Corp. Code § 1107(b)*; *see Corp. Code § 1107(e)* (tax assessor may reassess real property on title transfer); *see also Corp. Code § 1107(g)* ("local agency" defined)]. The surviving corporation is subject to the same duties and obligations with regard to any license, permit, registration, or other privileges acquired from the disappearing corporation [*Corp. Code § 1107(b)*; *see Corp. Code § 1107(f)* (local agency may reevaluate privileges when necessary for public health, safety, or welfare)].

The surviving corporation also becomes subject to all the debts and liabilities of the disappearing corporation in the same manner as if it had incurred them itself [*Corp. Code § 1107(a)*]. All rights of creditors and all liens on the property of each of the constituent corporations are preserved unimpaired [*Corp. Code § 1107(c)*]. However, liens on property of a disappearing corporation are limited to the property affected by them immediately prior to the time the merger is effective [*Corp. Code § 1107(c)*].

Any action or proceeding pending by or against any disappearing corporation may be prosecuted to judgment in the name of, or against, the disappearing corporation, and the judgment will bind the surviving corporation [*Corp. Code § 1107(d)*]. In the alternative, the surviving corporation may be proceeded against for a liability of a disappearing corporation or substituted in the place of a disappearing corporation in a pending action [*Corp. Code § 1107(d)*]. At least one California appellate case states, however, that an action cannot be brought in the name of a disappearing corporation after the effective date of a merger [*J.C. Peacock, Inc. v. Hasko (1960) 184 Cal. App. 2d 142, 151-152, 7 Cal. Rptr. 490]* .

The filing for record in the office of the county recorder of any county in which a disappearing corporation owns real property of either (1) a certificate prescribed by the Secretary of State or (2) a copy of the merger agreement, certificate of ownership, or certificate of merger, certified by the Secretary of State, evidences record ownership of the real property in the surviving corporation [*Corp. Code § 1109*].

Legal Topics:

For related research and practice materials, see the following legal topics:

Mergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersMergers & Acquisitions LawMergersRights of Dissenting Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART II. LEGAL BACKGROUND

5-11C California Legal Forms--Transaction Guide § 11C.23

§ 11C.23 Mergers of Domestic and Foreign Corporations

[1] In General

Any number of domestic California corporations may be merged with any number of foreign out-of-state corporations if the foreign corporations are authorized by the laws under which they are formed to effect such a merger [*Corp. Code § 1108(a)*]. The surviving corporation of the merger may be either one of the domestic or foreign constituent corporations to the merger and will continue to exist under the laws of the state or place of its incorporation [*Corp. Code § 1108(a)*].

When the surviving corporation is a domestic California corporation, the merger proceedings with respect to it and any domestic disappearing corporations, must be conducted in accordance with California law applicable to the merger of domestic corporations [*Corp. Code § 1108(b)*; *see § 11C.22* et seq.]. When the surviving corporation is a foreign corporation, the merger proceedings may be conducted in accordance with the law of the state or place of its incorporation [*Corp. Code § 1108(b)*].

[2] Effect of Merger

[a] Domestic Surviving Corporation

When the surviving corporation to a merger is a domestic California corporation, the merger becomes effective in the same manner and at the same time as would a merger between strictly domestic California corporations [*Corp. Code § 1108(c)*; *see Corp. Code § 110(c)*]. A copy of the merger agreement and an officers' certificate for each domestic and foreign corporation stating the same things that would be required were the merger strictly between domestic corporations [*see Corp. Code § 1103*], or the certificate of ownership [*see Corp. Code § 1110(e)* (short-form merger of 90-percent-owned subsidiary)] must be filed with the California Secretary of State [*Corp. Code § 1108(c)*]. When the merger becomes effective, each foreign disappearing corporation that is qualified to transact intrastate business in California automatically surrenders its right to transact intrastate business in California [*Corp. Code § 1108(c)*].

[b] Foreign Surviving Corporation

When the surviving corporation is a foreign corporation, the merger becomes effective in accordance with the laws of

the jurisdiction in which it is organized [*Corp. Code § 1108(d)*]. In general, the merger becomes effective as to any California disappearing corporation as of the time of effectiveness in the foreign jurisdiction, provided that one of the following documents is filed in California [*Corp. Code § 1108(d)*]:

- A copy, certified by the public officer having custody of the original, of the merger agreement, certificate, or other document filed by the surviving foreign corporation in the state or place of its incorporation to effect the merger;

- An executed counterpart of the merger agreement, certificate, or other document filed by the surviving foreign corporation in the state or place of its incorporation to effect the merger;

- A copy of the merger agreement, together with an attached officer's certificate of the surviving foreign corporation and of each constituent domestic corporation [*see Corp. Code § 1103*]; or

- A certificate of ownership [*see Corp. Code § 1110(e)* (short-form merger of 90-percent-owned subsidiary)].

However, if a document is filed in California pursuant to the above requirement more than six months after the time of effectiveness of the merger in the foreign jurisdiction, or if the powers of the domestic corporation are suspended at the time of effectiveness in the foreign jurisdiction, the merger becomes effective as to the domestic disappearing corporation or corporations as of the date of filing in California [*Corp. Code § 1108(e)*]. Any foreign disappearing corporation that is qualified to transact intrastate business and files a document pursuant to the above requirement automatically surrenders this right as of the California filing date, regardless of the time of the effectiveness of the merger as to a domestic disappearing corporation [*Corp. Code § 1108(e)*].

[c] Filing With County Recorder

When the state of incorporation, including California, of any disappearing corporation provides that the making and filing of the merger document vests in the surviving corporation all the real property of the disappearing corporation, the merger effectively transfers the interest of the disappearing corporation in any California real property to the surviving corporation. The surviving corporation should file for record in the office of the county recorder of any county in California in which the disappearing corporation owned any interest in real property a copy of the merger or consolidation agreement, certificate of ownership, or a certificate of merger, certified by the public official of the state or place under whose laws the merger was effected [*Corp. Code § 1109*]. This recording will evidence record ownership in the surviving corporation of any interest owned by the disappearing corporation in real property in that county [*Corp. Code § 1109*].

[3] Shareholders' Rights

The rights of shareholders of any constituent domestic California corporations involved in the merger and the rights of shareholders of any domestic corporation that is a parent party of any foreign constituent corporation are governed by the California General Corporation Law [*Corp. Code § 1108(f)*; *see Corp. Code §§ 1100-1111*]. For example, this type of merger must be approved by the same vote of the outstanding shares of the domestic disappearing corporation as if it were merging with only a domestic corporation [*Corp. Code § 1108(f)*; *see Corp. Code §§ 1200-1203*]. Each share of the same class or series of any domestic disappearing corporation (other than shares held by the surviving corporation, its parent, or a wholly owned subsidiary of either in another constituent corporation) must be treated equally, unless all shareholders of the class or series consent [*Corp. Code § 1108(f)*; *see Corp. Code § 1101(e)*; *but see Corp. Code § 407*]. Similarly, in a merger of a corporation into its subsidiary in which it owns at least 90 percent of the outstanding shares of each class, other than a short-form merger, the nonredeemable common shares of a domestic disappearing corporation may only be converted into nonredeemable shares of the surviving corporation (or a parent party if a

constituent corporation or its parent owns shares of another constituent corporation representing more than 50 percent of the voting power of the other constituent before the merger) if all of the shareholders of the class consent [*Corp. Code § 1108(f)*; *see Corp. Code § 1101(e)*; *but see Corp. Code §§ 407*, *1101(d)*]. Dissenting shareholders of the domestic disappearing corporation also have the same right to force purchase of their shares as they would in a merger between strictly domestic corporations [*Corp. Code § 1108(f)*; *see Corp. Code §§ 1300-1312*; *see also § 11C.150* et seq.].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesDomesticationMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART II. LEGAL BACKGROUND

5-11C California Legal Forms--Transaction Guide § 11C.24

§ 11C.24 Recordable Evidence of Merger of Two Foreign Corporations

When two foreign corporations merge and one of them owns real property in California, a special problem of evidencing the merger in California arises. The California Secretary of State has no instrument showing the merger that can be certified or on which a certificate may be issued for recording in the county in which the foreign corporation's California real property is located. To alleviate this problem, California law provides for the recording of a copy of the merger agreement, certified by an authorized public official of the state pursuant to whose law the merger was effected, in the county where the real property is located [*Corp. Code § 1109*]. In some states, however, the merger agreement, especially in a short-form merger, is not filed with any public official and therefore cannot be certified. Instead, in some states a "certificate of ownership" evidencing the merger, or a "certificate of merger," is filed by the merging corporations. Consequently, either a certified copy of the merger or consolidation agreement, a certificate of ownership, or a certificate of merger may be recorded in the California county where the disappearing corporation owns real property. The recording of the instrument evidences record ownership in the surviving corporation of all interest of the disappearing corporation in real property in the county where the instrument is recorded [*Corp. Code § 1109*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART II. LEGAL BACKGROUND

5-11C California Legal Forms--Transaction Guide § 11C.25

§ 11C.25 Corporate Securities Law Requirements

[1] Qualification Requirement

In most mergers, the surviving corporation will have to issue new shares to effectuate the merger, and allow conversion, pursuant to the manner specified in the merger agreement [*see § 11C.22[1]*], of existing shares of each disappearing corporation for shares or securities of the surviving corporation. However, it is unlawful for any person to offer or sell in California any security in an issuer transaction in connection with any change in the rights, preferences, privileges, or restrictions of or on outstanding securities, or in any exchange of securitiesbetween the issuer and existing shareholders, exclusively or in connection with any merger, consolidation, or asset purchase or in any entity conversion transaction, unless the security is qualified for sale, or the security or transaction is exempt or not subject to qualification [*Corp. Code § 25120*]. This rule precludes the solicitation of shareholder approval for the merger until it has been qualified by permit with the California Commissioner of Corporations [*Corp. Code § 25120*]. However, no qualification or permit is required for general merger negotiations taking place before any general solicitation of holders of equity securities for approval of the merger [*Corp. Code § 25103(a)*].

An application for qualification to issue securities pursuant to a merger agreement is set forth § 11C.204, and the requirements for such a qualification are more fully discussed in that section. For a detailed discussion of the qualification and exemption of securities, including the preemption of state qualification or registration of "covered securities" as defined by the National Securities Markets Improvement Act of 1996 [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005); *see 15 U.S.C. § 77r*], see *Ch. 6, Securities Regulation Issues, § 6.15*, and Marsh & Volk, Practice Under the California Securities Laws, Ch. 3A, *Federal Preemption of State Securities Regulation* (Matthew Bender).

[2] Exemptions From Qualification

Any exchange incident to a merger is exempt from qualification requirements [*see Corp. Code §§ 25110, 25120*] unless 25 percent or more of the outstanding shares of any class, any holders of which will receive securities in the exchange, are California residents according to the records of the corporation [*Corp. Code § 25103(c)*]. However, this exemption is not available for a rollup transaction [*Corp. Code § 25103(c)*; *see Corp. Code § 25014.6* ("rollup transaction" defined)], or if the transaction is excluded from the definition of a rollup transaction by *Corp. Code § 25014.6(b)(5)* or *(6)* if the transaction is one of a series of transactions that directly or indirectly through acquisition or otherwise

involves the combination or reorganization of one or more rollup participants [*Corp. Code § 25103(c)*].

Any change in the rights, preferences, privileges, or restrictions of or on outstanding securities, and any exchange of securities between the issuer and its existing holders of equity securities exclusively, is exempt from qualification if the transaction, had it involved the issuance of a new security containing the changed rights, preferences, privileges, or restrictions or a new issuance of the exchange security, would have been exempt from qualification [*see Corp. Code § 25110*] as an issuer transaction [*10 Cal. Code Reg. § 260.103(a)*; *see Corp. Code § 25102*]. In addition, exchanges incident to merger, consolidation, or sale of assets (other than rollup transaction [*see Corp. Code § 25014.6*]) in consideration of issuance of equity securities of another entity or any entity conversion transaction that meets specified conditions are exempt from qualification [*see Corp. Code § 25103(h)*; *10 Cal. Code Reg. § 260.103.6*; *see also Corp. Code § 25005.1* ("entity conversion transaction" defined); § 11C.104(1)].

[3] Permits

Normally, application is made for a permit, called a "definitive permit," authorizing issuance of the shares required in the merger prior to solicitation of shareholder approval of the merger. Ordinarily the definitive permit will be issued prior to solicitation of shareholders' approval of the merger [*10 Cal. Code Reg. § 260.140.63*]. When there appears to be any active opposition to approval of the merger or some other obstacle to its approval, the definitive permit may be conditioned on obtaining, before issuing securities under the merger agreement, an affirmative vote of a specified percentage of the outstanding shares held by persons not having a conflict of interest in connection with approval of the merger [*10 Cal. Code Reg. § 260.140.63*]. In extraordinary cases, though application is made for a definitive permit authorizing issuance of the merger securities prior to shareholder approval, the Commissioner may delay a decision on the definitive permit until after shareholder approval has been obtained and issue merely a negotiating permit to obtain that approval [*see* Marsh & Volk, *Practice Under the California Securities Laws, Ch. 7, Recapitalizations and Reorganizations, §§ 7.02[2][a], [b], 7.03* (Matthew Bender)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsSecurities Registration



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART II. LEGAL BACKGROUND

5-11C California Legal Forms--Transaction Guide § 11C.26

§ 11C.26 Income Tax Factors and Requirements

[1] Tax-Free Exchange

No taxable gain or loss is recognized upon an exchange of stock or securities of a corporation that is a party to a reorganization if the exchange is made solely for stock or securities of another corporation that is a party to the reorganization and is made in pursuance of a plan of reorganization [*I.R.C. § 354(a)(1)*]. Six types of transactions that are applicable here qualify as "reorganizations" under the tax-free provision [*I.R.C. § 368(a)(1)*]. The first of the transactions defined as constituting a reorganization for purposes of the tax-free securities exchange provision is "a statutory merger or consolidation" [*I.R.C. § 368(a)(1)(A)*; *see* 26 C.F.R. § 1.368-2(b)(1)(ii) ("statutory merger or consolidation" defined)].

One of the income tax advantages of a statutory merger over the other types of acquisition methods defined as tax-free reorganizations by the Internal Revenue Code is that voting shares need not be exchanged solely for voting shares in a merger [*see* Fox & Fox, Corporate Acquisitions and Mergers, Ch. 2A, *General Considerations in Corporate Acquisitions and Mergers* (Matthew Bender)]. The acquisition of one corporation by another corporation by means of a share exchange or an exchange of assets for shares is also defined in the Internal Revenue Code as tax-free reorganizations. In each case, however, the shares-for-shares or assets-for-shares exchange qualifies as a tax-free reorganization only ifthe shares or assets of the acquired corporation were exchanged solely for voting shares of the acquiring corporation [*I.R.C. § 368(a)(1)(B), (C)*]. There is no such restriction on a statutory merger that may qualify under the Internal Revenue Code definition as a tax-free reorganization. Subject to California state law, shares of a disappearing corporation may be exchanged for either voting shares or other securities of the surviving corporation and the merger remains a tax-free reorganization under the definition contained in the Internal Revenue Code [*I.R.C. § 368(a)(1)(A)*; Fox & Fox, Corporate Acquisitions and Mergers, Ch. 5B, *The Statutory Merger* (Matthew Bender)].

A statutory merger, however, has been called a deceptively simple type of tax-free reorganization because of two nonstatutory requirements that the courts have imposed on all types of tax-free reorganizations, and on mergers in particular [Rabkin & Johnson, *Federal Income, Gift and Estate Taxation, Ch. 31, Exchanges for Securities, § 31.07* (Matthew Bender)]. These are the so-called "business purpose" requirement [*see* [2], *below*], and the "continuity of interest" requirement [*see* [3], *below*].

[2] Business Purpose, Continuity of Business Enterprise, and Continuity of Interest Requirements

A statutory merger under *I.R.C. § 368(a)(1)(A)* must meet the general business purpose and continuity of business enterprise and interest requirements applicable to all reorganizations [*see Treas. Reg. § 1.368-1(c), (d), (e)*]. Therefore, to obtain the nonrecognition treatment of a qualified reorganization, the transaction must have a bona-fide business purpose and may not be a device simply to avoid taxes [*Treas. Reg. § 1.368-1(c)*].

The continuity of business enterprise requirement means that the acquiring corporation must either continue the acquired corporation's historic business or use a significant portion of the acquired corporation's business assets in a business after the reorganization [*Treas. Reg. § 1.368-1(d)(1)*]. The continuity of interest requirement means that some proprietary interest of the acquired corporation must be preserved so that transactions that resemble sales do not qualify for nonrecognition treatment available to qualified reorganizations [*Treas. Reg. § 1.368-1(e)*]. For further discussion, see Ch. 11, *Merger and Acquisition Issues* .

[3] Income Tax Basis for Acquired Assets

In "tax-free" reorganizations generally, recognition of gain is deferred pursuant to basis substitution provisions [*see* Fox & Fox, Corporate Acquisitions and Mergers, Ch. 4, *Tax-Free Acquisitions* (Matthew Bender)]. In a statutory merger, a former shareholder of the disappearing corporation has a substituted basis in shares received in the surviving corporation equal to his or her basis in the shares of the disappearing corporation [*see I.R.C. § 358(a)*]. The surviving corporation has a "carry-over" basis in the assets acquired from the disappearing corporation equal to the disappearing corporation's basis in those assets [*see I.R.C. § 362(b)*]. If the fair market value of the shares or assets received exceeds their substituted or carryover basis, gain on the transaction is postponed until those shares or assets are disposed of or sold [*I.R.C. § 354*; *see § 11C.26[1]*]. For a detailed discussion of the basis rules for the various acquisition methods, see Ch. 11, *Merger and Acquisition Issues* .

[4] Net Operating Loss Carryforward Deduction

In a statutory merger that is a qualified reorganization, the acquiring corporation automatically succeeds to any net operating loss carryforward of the acquired corporation, and may deduct it against income earned after the acquisition [*I.R.C. § 381(a)(2), (c)(1)*; *see* Ch. 11, *Merger and Acquisition Issues*]. Any carryforward will be limited, however, if after the reorganization, the percentage of stock in the acquiring corporation owned by one or more 5-percent shareholders has increased by more than 50 percentage points over the lowest percentage of stock of the acquired corporation owned by those shareholders at any time during the three-year period ending on the reorganization date [*I.R.C. § 382*]. The carryforward will be disallowed if the acquiring corporation does not continue the business enterprise of the acquired corporation at all times during the two-year period beginning on the reorganization date [*see I.R.C. § 382(c)*], or if the acquiring corporation's principal purpose in making the acquisition is the avoidance of federal income tax by obtaining a deduction that it would not obtain otherwise [*see I.R.C. § 269(a)*]. For a detailed discussion of the net operating loss carryforward and the restrictions on its use, see Ch. 11, *Merger and Acquisition Issues* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)General OverviewTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)CarryforwardsTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)Changes in Corporate OwnershipTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART II. LEGAL BACKGROUND

5-11C California Legal Forms--Transaction Guide § 11C.27

§ 11C.27 Assumption of Disappearing Corporation's Liabilities

[1] Automatic Assumption of Debts and Liabilities

Before 1977, more corporate combinations were consummated by means of so-called "de facto mergers" (that is, an exchange of the acquired corporation's assets for shares of the acquiring corporation followed by dissolution of the acquired corporation) than by means of statutory mergers [*see* Ch. 11, *Merger and Acquisition Issues*]. One major reason, which attracted the attention of the drafters of the present California General Corporation Law, was the fact that a de facto merger did not need shareholder approval as did a statutory merger. The General Corporation Law of California eliminated this reason effective January 1, 1977 [*see* Ch. 11, *Merger and Acquisition Issues*].

The second major reason was the fact that traditionally the acquiring or surviving corporation in a de facto merger did not automatically assume the debts and liabilities of the acquired or disappearing corporation, as did the surviving corporation in a statutory merger [*see Ortiz v. South Bend Lathe (1975) 46 Cal.App. 3d 842, 846, 120 Cal. Rptr. 556]* . When a statutory merger becomes effective, the surviving corporation automatically succeeds, without further transfer, to all the rights and property of each of the disappearing corporations [*Corp. Code § 1107(a)*]. The surviving corporation also automatically becomes subject to all the debts and liabilities of each of the disappearing corporations in the same manner as if it had incurred them itself [*Corp. Code § 1107(a)*]. The surviving corporation, therefore, becomes liable for all the liabilities, both known and unknown, of each disappearing corporation [*see* Cavitch, Business Organizations with Tax Planning, Ch. 161, *Review of Factors to Be Considered in Selecting Form of Acquisition* (Matthew Bender)]. Theoretically, an unknown inchoate liability of one of the disappearing corporations to a statutory merger, such as the tort liability for injuries caused or to be caused by a defective product manufactured by the disappearing corporation, could bankrupt the surviving corporation to the merger. Here, too, the differences between "de facto" and statutory mergers are less than they once were. In the single area of products liability, an acquisition by means of purchase of assets is also likely to lead to successor liability if the acquirer continues the business in basically the same form and the selling corporation dissolves [*see Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 136 Cal. Rptr. 574* ; *see also* Ch. 11E, *Acquisition of Assets for Shares*].

[2] Limitations on Liability

To some extent a surviving corporation may gain protection against unknown liabilities of a disappearing corporation

through personal guaranties or warranties of the disappearing corporation [*see* Cavitch, Business Organizations with Tax Planning, Ch. 161, *Review of Factors to Be Considered in Selecting Form of Acquisition* (Matthew Bender)]. It cannot gain protection, however, simply by obtaining warranties or guaranties by the disappearing corporation because they, like the disappearing corporation itself, will not survive a merger [*see* Fox & Fox, Corporate Acquisitions and Mergers, Ch. 5A, *Summary of Acquisition Methods* (Matthew Bender)]. Few shareholders will be willing to guarantee a surviving corporation against all liability for injuries that might be caused by a defective product manufactured or placed on the market by a disappearing corporation to a merger.

One limitation on a surviving corporation's liability for debts of a disappearing corporation is made by statute for liens on the property of a disappearing corporation at the time of the merger. All rights of creditors and all liens on the property of each of the constituent corporations to a statutory merger are preserved unimpaired throughout the merger [*Corp. Code § 1107(c)*]. However, liens on the property of a disappearing corporation are limited after the merger to the property affected by the lien immediately before the time the merger is effective [*Corp. Code § 1107(c)*]. A pre-merger lien on property of a particular disappearing corporation, therefore, although it survives the merger, remains a lien only on the property contributed to the surviving corporation by that particular disappearing corporation. It does not affect any property already owned before the merger by the surviving corporation or contributed to the surviving corporation by another disappearing corporation to the merger [*Corp. Code § 1107(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewMergers & Acquisitions LawLiabilities & Rights of SuccessorsDe Facto MergersMergers & Acquisitions LawMergersDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART II. LEGAL BACKGROUND

5-11C California Legal Forms--Transaction Guide § 11C.28

§ 11C.28 Other Advantages and Disadvantages of Merger

[1] Advantages

[a] Simplicity

The greatest advantage of a statutory merger over any other acquisition method is its mechanical simplicity. Once a copy of the merger agreement with required officers' certificates for each constituent corporation is filed with the Secretary of State [*Corp. Code § 1103*], the surviving corporation automatically succeeds without other transfer to all the rights and property of each disappearing corporation [*Corp. Code § 1107(c)*]. No other instruments of conveyance are required as they would be in a purchase of assets or an exchange of shares for assets of the disappearing corporations. Furthermore, there is no need for soliciting proper signatures and endorsements of share certificates of a disappearing corporation. In addition, the requirements of the Uniform Commercial Code--Bulk Sales Division [*see Com. Code §§ 6101-6111*], governing the normal sale of a business and its assets [*see* Ch. 17, *Buying and Selling a Business or Professional Practice*], need not be observed. The merger and transfer of the properties of the disappearing corporations is completed on the filing of the merger agreement with required officers' certificates with the Secretary of State [*see § 11C.22[9]*]. The only further act that might be considered to be required is the recording of a certified copy of the merger agreement in each county where a disappearing corporation owned any interest in real property [*Corp. Code § 1109*; *see § 11C.22[9]*] and notifying the Department of Motor Vehicles of the change in registered owners of any motor vehicles licensed to a disappearing corporation.

[b] Protection Against Dilution of Interests

Another advantage of a statutory merger is the ability to eliminate or change the interests of minority shareholders of a constituent corporation without their consent. A tax-free merger can be effectuated even though nonvoting shares or securities are to be exchanged in the merger for voting shares of a constituent corporation [Cavitch, *Business Organizations with Tax Planning, Ch. 178, Tax-Free Statutory Mergers or Consolidations: A Reorganizations, § 178.01[1]* (Matthew Bender)]. It can be provided, therefore, that certain types of shares of a constituent corporation to the merger will be converted by the merger into nonvoting shares or securities of the surviving corporation. If the minority shareholders holding those types of shares object, their right to have their sharesappraised and purchased for their appraised fair market value on the day preceding first announcement of the merger is their only remedy [*Corp.*

Code § 1312(a)].

This ability to change or eliminate minority shareholder interests allows a merger agreement to protect shareholders of the surviving corporation against undue dilution of their interests in the surviving corporation by the merger. In contrast, when a corporation is acquired by means of a share exchange or an exchange of shares for its assets, for the transaction to be tax-free, only voting shares of the acquiring corporation can be given to the acquired corporation or its shareholders [*see I.R.C. § 368(a)(1)(B), (C)*]. This type of transaction, therefore, cannot be structured like a statutory merger to protect shareholders of the acquiring or surviving corporation against undue dilution of their ownership interests in the acquiring or surviving corporation [Cavitch, *Business Organizations with Tax Planning, Ch. 161, Review of Factors to Be Considered in Selecting Form of Acquisition Summary, § 161.10* (Matthew Bender)].

[c] Effective Date Controlled

A further advantage of a merger is that the effective date of the merger can be controlled. This may be important for tax and other fiscal purposes [Fox & Fox, Corporate Acquisitions and Mergers, Ch. 5B, *The Statutory Merger* (Matthew Bender)]. In fact, California's General Corporation Law even allows a delayed effective date not more than 90 days after it is filed with the Secretary of State to be specified in the merger agreement as the date the merger, unless revoked, will become effective [*Corp. Code § 110(c)*; *see § 11C.22[9]*].

[d] No Sales and Use Tax

Another advantage of a statutory merger is that it is not subject to the California sales and use tax [*see 18 Cal. Code Reg. § 1595(b)(3)*; *see also Rev. & Tax. Code § 6001 et seq.* (Sales and Use Tax Law)]. For further discussion of the sales and use tax in the context of mergers and acquisitions, see Ch. 11, *Merger and Acquisition Issues* .

[2] Disadvantages

[a] Shareholder Approval/Assumption of Liabilities

The two biggest disadvantages to a merger are the need for shareholder approval of the merger by the shareholders of each corporation to the merger, and assumption by the surviving corporation of all known and unknown debts and liabilities of each disappearing corporation. These issues are discussed in *§§ 11C.22[4], [5], 11C.27*].

[b] Payment to Dissenting Shareholders

Another major disadvantage of a statutory merger or other form of "reorganization" as defined in the California General Corporation Law [*see* Ch. 11, *Merger and Acquisition Issues*] is the right of dissenting shareholders to demand payment for their shares. If the approval of the outstanding shares of a corporation is required for a reorganization, each shareholder who is entitled to vote on the transaction may require the corporation to purchase his or her "dissenting shares" for cash at the fair market value they had on the day preceding announcement of the proposed "reorganization" or short-form merger [*Corp. Code § 1300(a)*; *see § 11C.401*]. Each shareholder of a disappearing corporation in a short-form merger also is entitled to require the purchase of his or her dissenting shares [*Corp. Code § 1300(a)*]. For a procedural guide for dissenting shareholders, see *§ 11C.150* et seq. Forms applicable to dissenting shareholders are *set forth in §§ 11C.400, 11C.401*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersMergers & Acquisitions LawMergersRights of Dissenting Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART II. LEGAL BACKGROUND

5-11C California Legal Forms--Transaction Guide § 11C.29

§ 11C.29 Requirements for Short-Form Merger

[1] In General

The term "short-form merger" is used in California's General Corporation Law to describe the special, abbreviated procedure that may be followed to merge a wholly owned or 90-percent-owned subsidiary corporation into its parent corporation, or a parent and any other subsidiary into a subsidiary corporation [*Corp. Code §§ 187, 1110*].

If a domestic corporation owns all of the outstanding shares, or owns less than all but at least 90 percent of the outstanding shares of each class, of a corporation or corporations, whether domestic or foreign, the merger of the subsidiary corporation or corporations into the parent corporation, or the merger into the subsidiary corporation of the parent corporation and any other subsidiary corporations, may be effected by a resolution or plan of merger adopted and approved by the board of the parent corporation and the filing of a certificate of ownership [*Corp. Code § 1110(a)*].

After the required approvals of the resolution or plan of merger [*see* [2], *below*], a certificate of ownership [*see* [3], *below*] must be filed to effectuate the merger [*Corp. Code § 1110(e)*, (f)].

If all of the outstanding shares of a subsidiary domestic corporation that is a party to short-form merger are not owned by the parent corporation immediately before the merger, the parent corporation, before filing the certificate of ownership that perfects the merger with the Secretary of State, must give notice to each shareholder of the subsidiary corporation that the merger will become effective on or after a specified date [*Corp. Code § 1110(h)*]. The notice must be given at least 20 days before the effective date of the merger, and must be sent by mail addressed to each shareholder at the address appearing for him or her on the records of the corporation [*Corp. Code § 1110(h)*]. The notice must contain acopy of the merger resolution or plan of merger [*Corp. Code § 1110(h)*]. It must also contain a statement of the price determined by the corporations to represent the fair market value of dissenting shares of the subsidiary and a brief description of the procedure to be followed if the shareholder wishes to exercise his or her rights as a dissenting shareholder to require his or her shares to be purchased at their fair market value [*Corp. Code §§ 1110(h), 1301(a)*]. The shareholder receiving the notice has the same right to require that his or her shares in the subsidiary be purchased for their appraised fair market value on the date preceding announcement of the merger as a dissenting shareholder of a corporation involved in a regular statutory merger [*Corp. Code §§ 1110(h), 1300*].

[2] Resolution or Plan of Merger

The resolution or plan of merger must provide for the merger and also provide that the surviving parent corporation assumes all the liabilities of each disappearing corporation [*Corp. Code § 1110(a)*]. In addition, the resolution or plan may provide for the amendment of the articles of incorporation of the surviving corporation to change its name [*Corp. Code § 1110(d)*; *see Corp. Code §§ 201, 907(a)(2)*]. The new name may be the same as or similar to that of one of the disappearing corporations [*Corp. Code § 1110(d)*].

If the merger is with a 90-percent-owned subsidiary, the resolution or plan of merger must set forth the securities, cash, property, or rights to be issued, paid, delivered, or granted on surrender of each outstanding share of the subsidiary corporation not owned by the parent corporation. The entire resolution or plan, as well as the consideration to be received for each share of the subsidiary corporation not owned by the parent corporation, must be approved by the board of the subsidiary corporation [*Corp. Code § 1110(b)*].

If the parent corporation will be merged into one of its subsidiary corporations, the resolution or plan must also provide for the pro rata conversion of the outstanding shares of the parent corporation into shares of the surviving subsidiary corporation. The entire resolution or plan must be approved by the board of the surviving corporation [*Corp. Code § 1110(c)*]. Further, if the merger, but for the operation of *Corp. Code § 1110*, would be a merger reorganization [*see Corp. Code § 181(a)*], such that the principal terms of the merger would be required to be approved by the outstanding shares [*see Corp. Code § 152*] of any class of the parent corporation [*see Corp. Code § 1201(d)*], the principal terms of the merger or plan must be approved by the outstanding shares of that same class of the parent corporation [*Corp. Code § 1110(c)*; *see § 11C.22[4]*].

If an agreement of merger is entered into between a parent corporation and one or more of its subsidiary corporations, and the minimum 90 percent share ownership requirements are met, the agreement of merger may be filed as a plan of merger with a certificate of ownership in accordance with the short-form merger requirements [*Corp. Code § 1110(i)*]. In this situation, *Corp. Code §§ 1101, 1102, 1103, 1200, 1201*, and *1202* are inapplicable [*Corp. Code § 1110(i)*]. Alternatively, the agreement of merger may be filed pursuant to *Corp. Code § 1103*, and the short-form merger requirements of *Corp. Code § 1110* are inapplicable [*Corp. Code § 1110(i)*].

[3] Certificate of Ownership Perfecting Merger

A short-form merger is perfected by and becomes effective when a certificate of ownership is filed with the Secretary of State [*Corp. Code § 1110(f)*]. The required "certificate of ownership" is an officers' certificate of the parent corporation [*Corp. Code § 1110(e)*]. An "officers' certificate" is a certificate signed and verified by a corporation's (1) chairman of the board of directors, president, or any vice-president and (2) secretary, chief financial officer, treasurer, or any assistant secretary or assistant treasurer [*Corp. Code § 173*].

The officers' certificate of the parent corporation used as a "certificate of ownership" perfecting a short-form merger must do all of the following [*Corp. Code § 1110(e)*]:

- Identify the parent and subsidiary corporation or corporations being merged.

- Set forth the share ownership by the parent corporation of each subsidiary corporation as 100 percent of the outstanding shares or as at least 90 percent of the outstanding shares of each class, as the case may be.

- Set forth the resolution or plan of merger adopted by the board of directors of the parent corporation for the merger, including the resolution for change of the parent's name if applicable.

- Set forth approval of the resolution or merger by the board of the parent corporation.

- Set forth any other required approvals of the resolution or plan of merger [*see Corp. Code § 1110(b), (c)*; *see also* [2], *above*].

A copy of the certificate of ownership must be filed with the Secretary of State for the parent corporation and for each domestic and qualified foreign disappearing subsidiary corporation to the merger [*Corp. Code § 1110(e)*]. However, the certificate cannot be filed until after the required approval or approvals of the resolution or plan of merger [*Corp. Code § 1110(e)*; *see* [2], *above*].

The filing of the certificates of ownership perfects the merger and any amendments of the articles of incorporation of the surviving parent corporation in the manner set forth in the certificate [*Corp. Code § 1110(f)*].

[4] Short-Form Merger With Foreign Corporation

A short-form merger may be effected if the parent corporation involved is aforeign corporation and if at least one of the disappearing subsidiary corporations is a domestic California corporation [*Corp. Code § 1110(g)*]. In such a case, the certificate of ownership required to perfect a short-form merger will be filed with the California Secretary of State as to each domestic subsidiary corporation, and each foreign subsidiary corporation qualified to transact intrastate business in California [*Corp. Code §§ 1108(d)(4)*, 1110(g)]. In lieu of filing a certificate of ownership, any one of the following documents may be filed as to each disappearing domestic corporation [*Corp. Code § 1108(d)(1)- (3)*; *see Corp. Code § 1103* (officer's certificates)]:

- A certified copy, or an executed counterpart, of the merger agreement, certificate, or other document filed by the surviving foreign corporation to effect the merger; or

- A copy of the agreement of merger, with an attached officer's certificate of the surviving foreign corporation and of each domestic constituent corporation.

No filing is made as to the foreign parent corporation [*Corp. Code § 1110(g)*].

A foreign subsidiary corporation may not be merged pursuant to California's short-form merger provisions, nor may a foreign parent corporation act under those provisions, unless the laws of the state or place of its incorporation permit that action [*Corp. Code § 1110(g)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART II. LEGAL BACKGROUND

5-11C California Legal Forms--Transaction Guide § 11C.30

§ 11C.30 Mergers Between Corporations and Other Business Entities

[1] Overview

One or more corporations may merge with one or more other business entities [*Corp. Code § 1113(a)*; *see Corp. Code § 174.5* ("other business entity" defined)]. One or more domestic corporations not organized under the General Corporation Law and one or more foreign corporations may be parties to the merger [*Corp. Code § 1113(a)*]. Any one or more corporations and any one or more other business entities may merge with or into a corporation, which may be any one of the constituent corporations, or they may merge with or into an other business entity, which may be any one of the constituent other business entities [*see Corp. Code § 1113(a)*; *see also Corp. Code §§ 161, 161.5, 161.7*]. This type of merger may be effected only if the following requirements are satisfied [*Corp. Code § 1113(a)*]:

- In a merger in which a domestic corporation not organized under the General Corporation Law or a domestic other business entity is a party, that entity must be authorized by the laws under which it is organized to effect the merger [*Corp. Code § 1113(a)(1)*].

- In a merger in which a foreign corporation is a party, that corporation must be authorized by the laws under which it is organized to effect the merger.

- In a merger in which a foreign other business entity is the surviving other business entity [*see Corp. Code §§ 190.5, 190.7*], the laws of the jurisdiction under which it is organized must authorize the merger.

- In a merger in which a foreign other business entity is a disappearing entity [*see Corp. Code §§ 165.5, 167.8*], the laws under which that entity is organized must not prohibit it from effecting the merger.

Each corporation and each other party that desires to merge must approve and be a party to an agreement of merger [*Corp. Code § 1113(b)*; *see* [2], *below*]. The board of each corporation desiring to merge, and, if required, the shareholders, must approve an agreement of merger; the agreement must be approved on behalf of each party by those persons required to approve the merger by the laws under which it is organized [*Corp. Code § 1113(a)*]. The conversion

of securities or other interests in the disappearing entity to interests or securities in the surviving entity are discussed in [3], *below*. The filing requirements to effectuate the merger are discussed in [4] and [5], *below*.

[2] Agreement of Merger

Each corporation and each other business entity must approve an agreement of merger: for each constituent corporation, the board must approve the agreement [*see Corp. Code § 151*]; for each constituent other business entity, those persons required to approve the merger by the laws under which the entity is organized must approve the agreement [*Corp. Code § 1113(b)*]. The constituent corporations and constituent other business entities must be parties to the agreement of merger. Other persons, such as a parent party corporation, may be parties to the agreement [*Corp. Code § 1113(b)*]. The agreement of merger must be signed by each constituent corporation's chairman of the board, president, or a vice-president and by its secretary or an assistant secretary acting on behalf of their respective corporations [*Corp. Code § 1113(f)*].

The agreement of merger must state all of the following [*Corp. Code § 1113(b)*]:

- The terms and conditions of the merger.

- The name and place of incorporation or organization of each party to the merger and the identity of the surviving party.

- Any amendments [*see Corp. Code §§ 900, 907*] to the articles of incorporation of the surviving corporation, if applicable, to be effected by the merger; if an amendment changes the name of the surviving corporation, if applicable, the new name may be the same as or similar tothe name of a disappearing domestic or foreign corporation [*but see Corp. Code § 201(b)* (prohibited names)].

- The manner of converting the shares of each of the constituent corporations into shares, interests, or other securities of the surviving entity. If any shares of any constituent corporation will not be converted solely into shares, interests, or other securities of the surviving entity, the cash, rights, securities, or other property of any corporation or other business entity that the holders of those shares will receive in exchange for the shares, or that the shares are to be canceled without consideration; cash, property, rights, interests, or securities of any corporation or other business entity may be in addition to or in lieu of shares, interests, or other securities of the surviving corporation or surviving other business entity.

- Any other details or provisions that are required by the laws under which any party to the merger is organized, including *Corp. Code § 15678.2(a)* or 15911.12 governing the contents of a merger agreement for a California limited partnership that is a party to the merger or *Corp. Code § 17551(a)* governing the contents of a merger agreement for a California limited liability company that is a party to the merger.

- Any other details or provisions that are desired, including a provision for the payment of cash in lieu of fractional shares, or any other arrangement consistent with the provisions of *Corp. Code § 407* governing fractional shares.

Notwithstanding its prior approval, an agreement of merger may be amended before the filing of the agreement of merger or the certificate of merger, as applicable [*Corp. Code § 1113(d)*; *see Corp. Code § 1113(g)*]. The amendment must be approved by the board of any constituent corporation [*Corp. Code § 1113(d)*; *see Corp. Code § 151*]; if the amendment changes any of the principal terms of the agreement, it must also be approved by the outstanding shares, if required, in the same manner as the original agreement of merger [*Corp. Code § 1113(d)*; *see Corp. Code §§ 152, 1200-1203*]. If the agreement of merger as amended is approved by (1) the board and (if required) the outstanding

shares of each constituent corporation, and (2) each constituent other business entity, the agreement of merger as amended constitutes the agreement of merger [*Corp. Code § 1113(d)*].

[3] Conversion of Securities

Each share of the same class or series of any constituent party (other than the cancellation of shares held by a constituent party, its parent, or a wholly owned subsidiary of either in another constituent corporation) must be treated equally with respect to any distribution of cash, property, rights, or securities unless (1) all the shareholders of the class or series consent, or (2) *Corp. Code § 407*, regarding fractional shares, applies [*Corp. Code § 1113(c)*]. Notwithstanding *Corp. Code § 1113(b)(4)* [*see* [2], *above*], the nonredeemable common shares of a constituent corporation may be converted only into nonredeemable common shares of a surviving corporation or a parent party [*see Corp. Code § 1200(e)*], or nonredeemable equity securities of a surviving party other than a corporation if another party to the merger or its parent directly or indirectly owns, before the merger, shares of that corporation representing more than 50 percent of the voting power of that corporation, unless all of the shareholders of the class consent, and except as provided in *Corp. Code § 407*, regarding fractional shares [*Corp. Code § 1113(c)*].

The provisions of *Corp. Code § 1113(c)* discussed above do not apply to any transaction if the Commissioner of Corporations, the Commissioner of Financial Institutions, the Insurance Commissioner, or the Public Utilities Commission has approved the terms and conditions of the transaction and their fairness [*Corp. Code § 1101.1*; *see Corp. Code § 25142*; *Fin. Code §§ 696.5, 5750, 5802*; *Ins. Code § 838.5*; *Pub. Util. Code § 822*].

[4] Filing Requirements of Surviving Corporation

If the surviving entity is a corporation, after approval of the merger by the constituent corporations through the approval of the board [*see Corp. Code § 151*] and the outstanding shares (if required) [*see Corp. Code § 152*; *Corp. Code §§ 1200-1203*], and after approval by the constituent other business entities, the surviving corporation must file a copy of the agreement of merger and an attached officers' certificate of each constituent corporation with the Secretary of State [*Corp. Code § 1113(g)(1)*; *see* Gov. Code § 121886(k)]. The officers' certificates must state the following as to each constituent corporation [*Corp. Code § 1113(g)(1)*; *see Corp. Code § 173*]:

- The total number of outstanding shares or membership interests of each class entitled to vote on the merger (and identifying any other person(s) whose approval is required); and

- That the agreement of merger in the attached form or its principal terms (as required) were approved by that corporation by a vote of the number of shares or membership interests of each class that equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class, and, if applicable, by any other persons whose approval is required, or that the merger agreement was entitled to be and was approved by the board alone [*see Corp. Code § 1201*].

If equity securities of a parent party [*see Corp. Code § 1200(e)*] are to be issued in the merger, the officer's certificate of that controlled party must state either thatno vote of the shareholders of the parent was required or that the required vote was obtained [*Corp. Code § 1113(g)(1)*].

For any constituent other business entities, a certificate of merger (on a form prescribed by the Secretary of State must be filed in lieu of an officer's certificate [*Corp. Code § 1113(g)(1)*]. If a vote of the shareholders, members, partners, or other holders of interests of the constituent other business entity was required, the certificate must (1) contain a statement setting forth the total number of outstanding interests of each class entitled to vote on the merger, and (2) state that the agreement of merger in the attached form or its principal terms (as required) were approved by a vote of the number of interests of each class that equaled or exceeded the vote required, specifying each class entitled to vote, the percentage vote required of each class, and any other information required to be included under the laws pursuant to

which the constituent other business entity is organized [*Corp. Code § 1113(g)(1)*; *see Corp. Code §§ 15678.4(a)*, (CRLPA, repealed January 1, 2010); *Corp. Code § 15911.14* (ULPA '08), *16915(b)*, *17552(a)*]. The certificate of merger must be executed and acknowledged by each constituent other business entity by those persons required to execute the certificate of merger under the laws pursuant to which the entity is organized. If applicable, the certificate must also be executed and acknowledged on behalf of each constituent corporation by the chairperson of the board, president, or a vice-president and secretary or an assistant secretary of the respective corporation [*Corp. Code § 1113(g)(1)*].

These filing requirements also apply whenever a public benefit corporation, mutual benefit corporation, religious corporation, or consumer cooperative corporation is a party to the merger [*Corp. Code § 1113(g)(1)*; for general discussion of these types of corporations, see Ch. 13, *Nonprofit Corporations*].

When these requirements are satisfied, the merger and any amendments of the articles of the surviving corporation contained in the agreement of merger are effective, subject to *Corp. Code § 110(c)* regarding delayed effective dates and *Corp. Code § 1113(j)* regarding governing law for foreign entities [*Corp. Code § 1113(g)(1)*].

[5] Filing Requirements of Surviving Other Business Entity

[a] Certificate of Merger

If the surviving entity is an other business entity (and no public benefit corporation, mutual benefit corporation, religious corporation, or consumer cooperative corporation is a party to the merger), after approval of the merger by the constituent corporations through approval of the board [*see Corp. Code § 151*] and the outstanding shares (if required) [*see Corp. Code § 152*; *Corp. Code § 1200 et seq.*], and after approval by the other parties to the merger, the parties to the merger must file a certificate of merger with the Secretary of State on a form prescribed by the Secretary [*Corp. Code § 1113(g)(2)*; *see Gov. Code § 12186* (*l*)]. The certificate of merger must set forth all of the following [*Corp. Code § 1113(g)(2)*]:

- The name, place of incorporation or organization, and the Secretary of State's file number, if any, of each party to the merger, separately identifying the disappearing parties and the surviving party.

- If the approval of the outstanding shares [*see Corp. Code § 152*] of a constituent corporation was required [*see Corp. Code § 1200 et seq.*], a statement setting forth the total number of outstanding shares of each class entitled to vote on the merger, and that the principal terms of the agreement of merger were approved by a vote of the number of shares of each class entitled to vote, and the percentage vote required of each class.

- If the merger is not to become effective on the filing of the certificate of merger with the Secretary of State, the future effective date or time, not more than 90 days subsequent to the date of filing of the merger.

- A statement by each party to the merger that is a domestic corporation not organized under the General Corporation Law, a foreign corporation, or an other business entity, of the statutory or other basis under which that party is authorized by the laws under which it is organized to effect the merger.

- Any other information required to be stated in the certificate of merger by the laws under which each party to the merger is organized, including the information in *Corp. Code § 15678.4(a)*, (CRLPA, repealed January 1, 2010) or *Corp. Code § 15911.14(a)* (ULPA '08), if a domestic limited partnership is a party to the merger, the information in *Corp. Code § 16915(b)* is a domestic partnership is a party to the merger, or the information in *Corp. Code § 17551(a)* if a domestic limited liability company is a

party to the merger.

- Any other desired details or provisions.

[b] Merger Effective on Filing

Unless a future effective date or time is provided in a certificate of merger, a merger is effective on the filing of the certificate of merger in the office of the Secretary of State, and at that time the parties to the merger become one entity. The certificate of merger, however, will not be filed until a certificate of satisfaction from the Franchise Tax Board, showing that all taxes imposed by the Bank and Corporation Tax Law [*see Rev. & Tax Code § 23001 et seq.*] have been paid or secured, has been filed by or on behalf of each disappearing party taxed under that law [*Corp. Code § 1113(g)(2)*].

[c] Copy of Merger Agreement

The surviving entity must keep a copy of the agreement of merger at its principal place of business [*Corp. Code § 1113(g)(2)*; *see Corp. Code §§ 15614(a)* or *15901.14(a)* (office of domestic limited partnership), 15678.4(a)(5) or 15909.02(a)(3) (office of foreign limited partnership), 16403 (domestic general partnerships), 16911(f) (foreign general partnerships), 17057 (office of domestic limited liability company), 17552(a)(5) (office of foreign limited liability company)]. On the request of a holder of equity securities of a party to the merger, a person with authority to do so on behalf of the surviving other business entity must promptly deliver to the holder of shares of a constituent corporation or a holder of interests of a constituent other business entity a copy of the agreement of merger. A waiver by a shareholder, partner, or member of that right is unenforceable [*Corp. Code § 1113(g)(2)*]. If a domestic reciprocal insurer organized after 1974 to provide medical malpractice insurance [*see Corp. Code § 174.5*; *Ins. Code § 1550 et seq.*] is a party to the merger, the agreement of merger or certificate of merger may not be filed until a certificate issued by the Insurance Commissioner approving the merger has been filed [*Corp. Code § 1113(g)(2)*; *see Ins. Code § 1555*].

[6] Effect of Merger

On a merger of corporations and other business entities, the separate existence of the disappearing parties to the merger ceases and the surviving party succeeds, without other transfer, to all the rights and property of each of the disappearing corporations and disappearing parties. The surviving entity is subject to all the debts and liabilities of each in the same manner as if the surviving entity had itself incurred them [*Corp. Code § 1113(i)(1)*].

All rights of creditors and all liens on the property of each of the constituent corporations and other parties are preserved unimpaired, provided that those liens on property of a disappearing party are limited to the property affected by the liens immediately before the time the merger is effective [*Corp. Code § 1113(i)(2)*].

Any action or proceeding pending by or against any disappearing corporation or disappearing party to the merger may be prosecuted to judgment, and the judgment will bind the surviving party. Alternatively, the surviving party may be proceeded against or substituted in place of the disappearing party [*Corp. Code § 1113(i)(3)*].

If a limited or general partnership is a party to the merger, none of the rules set forth above is intended to affect the liability of a general partner of a disappearing partnership in connection with the debts and liabilities of the disappearing partnership existing before the merger becomes effective [*Corp. Code § 1113(i)(4)*].

[7] Mergers Involving Foreign Other Business Entities

[a] Compliance With Applicable Law

The merger of any number of domestic corporations with any number of foreign corporations or foreign other business

entities in a merger in which one or more other business entities is a party must comply with the requirements discussed above [*Corp. Code § 1113(j)(1)*; *see Corp. Code § 1113(a)*]. If the surviving party is a domestic corporation or domestic other business entity, the merger proceedings with respect to that corporation or other business entity and any domestic disappearing corporation must conform to the provisions described above [*Corp. Code § 1113(j)(2)*]. If the surviving party is a foreign corporation or foreign other business entity, the merger proceedings may be conducted in accordance with the laws of the state or place of incorporation of the surviving corporation or the laws of the state or place of organization of the surviving other business entity, subject to the requirements regarding effective dates [*see Corp. Code § 1113(j)(4)*], conversion of securities [*see Corp. Code § 1113(c)*], fractional shares [*see Corp. Code § 407*], reorganizations [*see Corp. Code §§ 1200-1203*], and dissenters' rights [*Corp. Code §§ 1300-1312*] with respect to any domestic corporations, domestic limited partnerships [*Corp. Code § 15679.1 et seq.* (CRLPA, repealed January 1, 2010); *Corp. Code § 15911.20 et seq.* (ULPA '08)], domestic general partnerships [*Corp. Code § 16601 et seq.*], or domestic limited liability companies [*Corp. Code § 1113(j)(2)*; *see Corp. Code § 17600 et seq.*]. If applicable, corresponding provisions of the Nonprofit Corporation Law or the Consumer Cooperative Corporation Law must also be satisfied [*Corp. Code § 1113(j)(2)*].

[b] Effective Date

If the surviving party is a domestic corporation or domestic other business entity, the certificate of merger or the agreement of merger with attachments must be filed [*Corp. Code § 1113(j)(3)*; *see Corp. Code § 1113(g)*]. The merger becomes effective as to each domestic constituent corporation and domestic constituent other business entity on the filing of the agreement of merger, subject to the requirements regarding effective dates [*see Corp. Code §§ 110(c), 1113(g)(2)*], as applicable [*Corp. Code § 1113(j)(3)*].

If the surviving party is a foreign corporation or foreign other business entity, the merger becomes effective in accordance with the law of the jurisdiction in which that corporation or other business entity is organized. However, except as described below, the merger is effective as to any domestic disappearing corporation as of the time of effectiveness in the foreign jurisdiction on the filing in California of a copy of the agreement of merger with an officers' certificate of each constituent corporation, and a certificate of merger of each constituent other business entity, attached [*Corp. Code § 1113(j)(4)*; *see Corp. Code § 1113(g)(1)*]. If one or more domestic other business entities is a disappearing party in a merger in which a foreign other business entity is the surviving entity, a certificate of merger as required by the laws under which that domestic other business entity is organized, including *Corp. Code § 15678.4* (CRLPA, repealed January 1, 2010) or *Corp. Code § 15911.14(a)* (ULPA '08), *16915(b)*, or 17752(a), must also befiled at the same time as the filing of the agreement of merger [*Corp. Code § 1113(j)(4)*].

If the date of the filing in California is more than six months after the time of the effectiveness in the foreign jurisdiction, or if the powers of a disappearing domestic corporation are suspended at the time of effectiveness in the foreign jurisdiction, the merger is effective as to the domestic disappearing corporation as of the date of filing in California [*Corp. Code § 1113(j)(5)*].

[c] Surrender of Right to Transact Intrastate Business

In a merger between domestic and foreign entities, each foreign disappearing corporation that is qualified for the transaction of intrastate business in California will automatically, by the merger filings, surrender its right to transact intrastate business in California as of the date of filing in California or, if later, the effective date of the merger. With respect to each foreign disappearing other business entity previously registered for the transaction of intrastate business in California, the filing of the agreement of merger or certificate of merger, as applicable, automatically cancels the registration for that foreign other business entity without the necessity of the filing of a certificate of cancellation [*Corp. Code § 1113(j)(6)*; *see Corp. Code § 110(c)*].

Although these provisions regarding surrender of the right to transact intrastate business in California are intended to be

helpful and reduce paperwork, they should be viewed with caution. It would be unwise to make a filing that causes surrender while the surrendering entity is in fact transacting intrastate business in California. This could occur if the filing in California preceded a foreign filing, and the foreign filing were the one that caused the merger to become effective and the surrendering entities to disappear as such. In addition, if the surviving entity is not qualified to do business in California and is required to be qualified by virtue of its succession to the businesses of the disappearing entities, the surviving entity should qualify in anticipation of the effectiveness of the merger.

[8] Evidence of Effectiveness of Merger

A copy of an agreement of merger certified on or after the effective date by an official having custody of the agreement has the same force in evidence as the original. Except as against the state, a certified copy is conclusive evidence of (1) the performance of all conditions precedent to the merger, (2) the existence on the effective date of the surviving party, and (3) the performance of the conditions necessary to the adoption of any amendment to the articles, if applicable, contained in the agreement of merger [*Corp. Code § 1113(h)(1)*]. The Secretary of State may certify a copy of the agreement of merger separately from the officers' certificates and certificates of merger attached to it [*Corp. Code § 1113(g)(1)*].

A copy of a certificate of merger duly certified by the Secretary of State is, for all purposes for a merger in which the surviving entity is a domestic other business entity, conclusive evidence of the merger of the constituent corporations, either by themselves or together with constituent other business entities, into the surviving other business entity [*Corp. Code § 1113(h)(2)*].

The laws of many states provide substantially that the making and filing of an agreement of merger, a certificate of ownership, or a certificate of merger vest in the surviving or consolidated corporation or surviving other business entity all of the real property of any disappearing corporation or other business entity. If a disappearing domestic or foreign corporation or a disappearing domestic or foreign other business entity has any real property in California, and if the state or place of its incorporation or organization (including California) has such a law, one of the following should be filed for record in the office of the county recorder of every county in California in which real property of the disappearing party to the merger is located: a copy of the agreement of merger or consolidation, certificate of ownership, or certificate of merger, certified by the Secretary of State or an authorized public official of the state or place under which the merger or consolidation is effected. That filing evidences record ownership in the surviving or consolidated party to the merger, of all interest of the disappearing party to the merger in and to the real property located in that county [*Corp. Code § 1109*].

[9] Abandonment of Merger

The board of a constituent corporation, in its discretion, may abandon a merger without further approval by the outstanding shares [*see Corp. Code § 152*] at any time before the merger is effective. However, that action is subject to the contractual rights, if any, of third parties, including other constituent corporations and constituent other business entities [*Corp. Code § 1113(e)*]. Similarly, the general partners of a constituent limited partnership may abandon a merger [*Corp. Code § 15678.2(d)*], as may the members of a constituent limited liability company [*Corp. Code § 17551(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesDomesticationMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART II. LEGAL BACKGROUND

5-11C California Legal Forms--Transaction Guide §§ 11C.31-11C.89

[Reserved]

§§ 11C.31[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11C California Legal Forms--Transaction Guide

NOTE:

Throughout this Transaction Guide, the term "constituent corporation" will be used to identify a corporation that is being merged with one or more other corporations. This term includes the surviving corporation [***see*** *Corp. Code §§ 161, 1101*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistence



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11C California Legal Forms--Transaction Guide § 11C.90

§ 11C.90 Facts

1. Information regarding each constituent corporation:

a. Exact name as it appears in:
(1) Articles; or

(2) Certificate of incorporation as last amended.

b. Date and place of incorporation.

c. Address and telephone number of principal executive office.

d. Name, address, and telephone number of officers, including:

NOTE:
In order to qualify the shares issued by the surviving corporation as part of the merger under California securities laws [***see*** *Corp. Code § 25121*; ***see*** *§ 11C.121[2]*], the names and addresses of all officers are required [*10 Cal. Code Reg. § 260.121*; ***see*** *§ 11C.204[2]* (Item 13)].

(1) Chairman of board of directors;

(2) President;

(3) Executive vice-president or vice-president;

(4) Secretary and assistant secretary; and

(5) Treasurer and assistant treasurer or other chief fiscal officer.

e. Names and addresses of directors.

f. Name and address of each person who, with respect to surviving corporation or other constituent corporation [*see 10 Cal. Code Reg. § 260.121* (Item 14)]:

(1) Is officer, director, or person occupying similar status or performing similar functions;

(2) Owns 10 percent or more of outstanding shares of any class of equity securities; or

(3) Is promoter, if corporation was organized within past three years.

g. Type of business in which corporation is engaged.

h. Types, classes, and series of shares outstanding, including:

(1) Rights, preferences, privileges, and restrictions applicable to each class or series.

(2) Voting rights of each class or series of shares.

(3) Number of shares of each class or series outstanding.

(4) Number of shareholders owning each class or series.

(5) Total number of shares of all classes and total number of shareholders.

i. All other outstanding securities, such as bonds or debentures.

j. Any securities exchanges on which shares are listed.

k. Any order, judgment, or decree suspending, revoking, or enjoining sale or right to engage in securities business of [*10 Cal. Code Reg. § 260.121* (Item 13)]:

(1) Constituent corporation;

(2) Officer or director; or

(3) Corporation in which officer or director of constituent corporation was an officer or director.

l. Any dividends due on shares or any payments of interest or principal due on other securities that are in default.

m. Fiscal and tax year.

n. Name, address, and telephone number of accountant or accounting officer.

o. Usual place for holding special shareholders' meetings.

p. Counties and states in which corporation owns any interest in real property.

q. Any actions, litigation, or other proceedings pending against any of constituent corporations, including:

(1) Nature of action, litigation, or proceedings.

(2) Court or administrative tribunal in which action, litigation, or proceeding is pending.

(3) Name and address of attorney handling action, litigation, or proceeding.

(4) Whether liability of constituent corporation alleged in action, litigation, or proceeding is funded by insurance or other source.

2. Which constituent corporation will be surviving corporation.

NOTE:
If a foreign corporation will be the surviving corporation, the merger may be conducted under foreign law instead of California law [***see*** *Corp. Code § 1108(b)*; ***see*** *§ 11C.101*].

The merged corporation must cease to exist after the merger or the merger will not qualify as a type A reorganization [*Rev. Rul. 2000-5, 2000-5 I.R.B. 436* ; ***see*** *I.R.C. § 368(a)(1)(A)*].

3. Projected date on which merger will become effective.

4. Whether surviving corporation will issue fractional shares as result of merger.

5. Whether name of surviving corporation will be changed.

NOTE:
A change in name is made pursuant to amendment of the articles [*Corp. Code § 1101(b)*]. The new name may be the same as or similar to name of a disappearing corporation, but cannot be the same or similar to the name of any other existing corporation [*Corp. Code §§ 201(b), 1101*].

6. Any amendments, other than change of name, to be effected by merger in surviving corporation's articles of incorporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesDomesticationMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11C California Legal Forms--Transaction Guide § 11C.91

§ 11C.91 Documents

NOTE:
The following documents should be obtained from each constituent corporation.

1. Articles or certificates of incorporation as last amended.

2. Bylaws as last amended.

3. Stock certificate book and stock record book.

4. Any stock subscription or stock purchase agreements.

5. License, franchise agreements, and patents.

6. All deeds or leases for premises or property held by corporation as lessee.

7. All loan agreements, mortgages, and other executory contracts.

8. Securities permit to issue shares or notices of issuance under exemption.

9. Any orders, judgments, or decrees of any court or administrative agency restricting or suspending authority of any constituent corporation or officers to issue or sell securities.

10. Most recent financial statements and balance sheets.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



25 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11C California Legal Forms--Transaction Guide §§ 11C.92-11C.99

[Reserved]

§§ 11C.92[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11C California Legal Forms--Transaction Guide § 11C.100

§ 11C.100 Form of Merger

1. Determine whether following advantages of statutory merger indicate that it is best acquisition method to use:

NOTE:
For a discussion of the relative advantages and disadvantages of a statutory merger, see *§ 11C.28*. For a detailed discussion of the factors used to determine the most appropriate acquisition method, see Ch. 11, ***Merger and Acquisition Issues*** .

a. Mechanical simplicity.

NOTE:
A merger is perfected by filing the merger agreement, with an attached officers' certificate for each constituent corporation, with the Secretary of State [*Corp. Code § 1103*; ***see*** *§ 11C.125*]. On perfection of the merger, the surviving corporation succeeds without further transfer to all the rights and properties of each disappearing corporation to merger [*Corp. Code § 1107(a)*]. Further, the surviving corporation need not pay any local agency transfer fees for licenses, permits, registrations, and other privileges if the merger does not result in a change of ownership [*Corp. Code § 1107(b)*; ***see*** *§ 11C.22[9]*].

b. Minority shareholders' only method of objecting to merger is sale of shares back to corporation [*see Corp. Code § 1312(a)*; *see also §§ 11C.150* et seq.].

c. Effective date of merger can be controlled [*see Corp. Code § 110(c)*].

d. Income tax advantages, including:

NOTE:
For discussion of the taxation of a statutory merger, see *§ 11C.26*.

(1) No taxable gain to shareholders or surviving corporation [*I.R.C. § 354(a)(1)*].

(2) No requirement that only voting shares of surviving corporation can be exchanged for shares and assets of disappearing corporations in tax-free merger [*see I.R.C. § 368(a)(1)(A)*; *cf. I.R.C. § 368(a)(1)(B)* (shares-for-shares exchange), (C)(assets-for-shares exchange)].

(3) Surviving corporation succeeds to any net operating loss carryforward belonging to disappearing corporation [*see I.R.C. § 381(a)(2), (c)(1)*].

NOTE:
That carryforward, however, may be reduced or disallowed [***see*** *I.R.C. §§ 269(b), 382*]. For a detailed discussion of these restrictions, see Ch. 11, ***Merger and Acquisition Issues*** .

(4) Transaction is not subject to California Sales and Use Tax [*see 18 Cal. Code Reg. § 1595(b)(3)*].

NOTE:
The Sales and Use Tax [*Rev. & Tax. Code §§ 6001 et seq.*] is imposed on other types of reorganizations [***see*** Ch. 11, ***Merger and Acquisition Issues***].

2. Determine whether following disadvantages of merger outweigh benefits:

a. Surviving corporation automatically becomes directly liable for debts and liabilities of each disappearing corporation [*see Corp. Code §§ 1107(a), 1110(a)*].

NOTE:
However, any liens on the property of a disappearing corporation will be limited after the merger to the property affected by the lien immediately prior to the time the merger is effective [***see*** *Corp. Code § 1107(c)*].

b. Outstanding shares of each class of each constituent corporation must usually approve principal terms of merger [*Corp. Code § 1201*; *see § 11C.122[1]*].

NOTE:
Shareholder approval is not required if the shareholders' rights are not affected by the merger [*Corp. Code § 1201*; ***see*** *§ 11C.22[6]*], or in a short-form merger [***see*** *Corp. Code § 1110*; ***see also*** *§ 11C.130* et seq.].

c. Dissenting shareholders may require that corporation purchase their shares at fair market value on day preceding first announcement of terms of proposed merger [*Corp. Code § 1300*; *see § 11C.150* et seq.].

d. Offer or sale of securities to be issued or exchanged in merger must comply with securities laws [*see Corp. Code § 25120*; *see also §§ 11C.121, 11C.133*].

e. Disappearing corporation will lose name and identity in merger, unless surviving corporation changes

its name to that of disappearing corporation [*see Corp. Code § 1101(b)*].

f. Surviving corporation will not obtain new income tax basis for assets of disappearing corporation [*I.R.C. § 362(b)*; *see § 11C.26[3]*].

3. Determine whether "short-form merger" may be used [*Corp. Code §§ 187, 1110*; *see § 11C.130* et seq.], based on either of following:

NOTE:

A short-form merger is an abbreviated procedure used to merge a subsidiary into its parent corporation [***see*** *Corp. Code §§ 187, 1110*].

a. Corporation that will be surviving corporation owns 100 percent of outstanding shares of disappearing corporation(s) [*Corp. Code § 1110(a)*]; or

b. Corporation that will be surviving corporation owns less than 100 percent but at least 90 percent of outstanding shares of disappearing corporation(s) [*Corp. Code § 1110(a), (b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersMergers & Acquisitions LawMergersRights of Dissenting Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11C California Legal Forms--Transaction Guide § 11C.101

§ 11C.101 Foreign Corporations

NOTE:

For purposes of the California Corporations Code, a "domestic" corporation is a corporation formed under California law [*Corp. Code § 167*]. A "foreign" corporation is any corporation other than a domestic corporation [*Corp. Code § 171*].

1. If foreign corporation will be surviving corporation [*see* § 11C.50[2]], determine whether merger will be conducted under foreign law.

NOTE:

When the surviving corporation will be foreign, the merger proceedings may be conducted under the law of the place where that corporation was incorporated, subject to the rules regarding shareholder and board approval [***see*** *Corp. Code §§ 1200, 1201*; ***see also*** *§§ 11C.120, 11C.122*] and dissenters' rights [*Corp. Code § 1108(b)*; ***see*** *Corp. Code §§ 1300-1312*; ***see also*** *§ 11C.150* et seq.]. However, the disappearing domestic corporations must still file the merger documents in California [*Corp. Code § 1108(d)*; ***see*** *§ 11C.140*].

2. If any disappearing corporation is foreign [*see* § 11C.50 (2)], determine:

NOTE:

When the surviving corporation will be a domestic corporation, the merger proceedings or short-form merger proceedings are conducted pursuant to California law, regardless of whether any disappearing corporations are foreign [*Corp. Code § 1108(b)*].

a. Whether laws under which it was formed authorize merger with California corporation [*see Corp. Code § 1108(a)*].

b. Whether foreign corporation is authorized to transact intrastate business [*see Corp. Code § 191*] in California.

NOTE:
"Transact intrastate business" means entering into repeated and successive transactions of business in California, excluding intrastate or foreign commerce [*Corp. Code § 191(a)*]. For a discussion of qualification of foreign corporations to conduct intrastate business [***see*** *Corp. Code § 2105*], see Ch. 12B, ***Foreign Corporations and Associations*** . A qualified foreign corporation automatically surrenders its right to transact intrastate business on perfection of a merger conducted under California law [*Corp. Code § 1108(c)*].

c. With respect to corporation's real property [*Corp. Code § 1109*; *see § 11C.160*]:

(1) Whether foreign corporation owns real property in California.

(2) Whether laws under which foreign corporation was incorporated provide that perfection of merger vests all real property of disappearing corporation in surviving corporation.

3. If any parent party is foreign corporation, determine shareholder approval requirements under parent party's state or place of incorporation.

NOTE:
A "parent party" is a corporation in control of any constituent or acquiring corporation whose equity securities are issued or transferred in the reorganization [*Corp. Code § 1200(e)*]. If a parent party [*Corp. Code § 1200(e)*] is a foreign corporation (other than one subject to the General Corporation Law [***see*** *Corp. Code § 2115(a)*]), any requirement or lack of a requirement for approval by the outstanding shares of the foreign corporation is determined by the laws of the state or place of incorporation, rather than by *Corp. Code §§ 1200* and *1201* [*Corp. Code § 1202(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesDomesticationBusiness & Corporate LawForeign BusinessesQualificationsMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11C California Legal Forms--Transaction Guide § 11C.102

§ 11C.102 Conversion of Shares

NOTE:
The merger agreement must state the manner of converting shares of the constituent corporations into securities or other property of the surviving corporation [*Corp. Code § 1101(d)*; ***see*** *§ 11C.120*].

1. Determine whether shares of disappearing corporation will be converted into [*see Corp. Code § 1101(d)*]:

a. Shares or other securities of surviving corporation.

b. Shares or other securities of parent of surviving corporation.

c. Cash, property, rights, and/or securities of any corporation.

NOTE:
Consideration other than securities of the surviving corporation may be given in addition to or in lieu of securities of the surviving corporation [*Corp. Code § 1101(d)*].

Every share of the same class or series of any constituent corporation must be treated equally with respect to any distribution of cash, property, rights, or securities, unless all shareholders of the class or series consent and except as provided for fractional shares [*Corp. Code § 1101*; ***see*** *Corp. Code §§ 407* (fractional shares), 1101.1 (exception for certain public agency-approved transactions)].

The shares of the disappearing corporation may also be canceled without consideration [*Corp. Code § 1101(d)*].

2. If shares of disappearing corporation will be converted solely into shares of surviving corporation or its parent, determine exchange ratio for conversion.

NOTE:

Outstanding shares may be converted into a different number of shares of the same class or series, or into the same or a different number of shares of a different class or series [***see*** Ballantine & Sterling, California Corporation Laws, Ch. 12, ***Corporate Acquisitions, Mergers, and Reorganizations*** (Matthew Bender)].

3. Determine whether constituent corporation or its parent owns, directly or indirectly, shares of another constituent corporation representing more than 50 percent of voting power of other constituent corporation prior to merger [*Corp. Code § 1101*].

NOTE:

Under these circumstances (other than in a short-form merger [***see*** *Corp. Code § 187*; ***see also*** *§ 11C.130* et seq.]), the nonredeemable common shares must be converted into nonredeemable common shares of the surviving corporation or its parent, unless all of the shareholders of the class consent, and except as provided for fractional shares [*Corp. Code § 1101*; ***see*** *Corp. Code §§ 407* (fractional shares), 1101.1 (exception for certain public agency-approved transactions)].

4. With respect to fractional shares, determine whether corporation will [*see Corp. Code §§ 407, 1101*]:

NOTE:

The surviving corporation is not required to issue fractions of a share to shareholders who would, at the conversion ratio specified in the agreement, become entitled to fractional shares [*Corp. Code §§ 407, 1101*].

a. Issue fractional shares;

b. Arrange for disposition of fractional shares by those shareholders entitled to them;

c. Pay fair value of fractional shares in cash at time when shareholders entitled to receive them are determined [*see Corp. Code § 1101(e)*];

NOTE:

For an example and discussion of a bylaw provision requiring fractional shares to be paid in cash, see *Ch. 4, **Bylaws**, § 4.241*.

d. Issue scrip or warrants entitling holder to receive one full share on surrender of scrip or warrants aggregating full share; or

NOTE:

For an example and discussion of a scrip certificate for a fraction of a share, see *Ch. 6I, **Issuance of Equity Securities**, § 6I.204*.

e. If fraction of share that any person would otherwise be entitled to receive in merger is less than one half of one percent of total shares the person is entitled to receive, either [*Corp. Code § 407*]:

(1) Disregard fractions of a share; or

(2) Provide that shares issuable in merger will be rounded off to nearest whole share.

5. Determine whether any other details or provisions regarding conversion are desired in merger agreement [*Corp. Code § 1101(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsClasses of StockMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11C California Legal Forms--Transaction Guide § 11C.103

§ 11C.103 Shareholder Approval and Notice of Approval

1. Determine whether approval of outstanding shares is required to perfect merger [*Corp. Code § 1103*]:

NOTE:

If approval of the outstanding shares of the constituent corporations must be obtained for a merger [***see*** *Corp. Code §§ 1200(a), 1201(a)*], the merger cannot be perfected until that approval has been obtained [*Corp. Code § 1103*]. "Approval of the outstanding shares" means approved by the affirmative vote of a majority of the outstanding shares entitled to vote, unless the articles require unanimous or greater than majority vote [*Corp. Code § 152*].

a. Determine whether proposed merger will be a "reorganization" requiring board approval [*Corp. Code §§ 1200(a), 1201(a)*; *see Corp. Code § 181* ("reorganization" defined)].

NOTE:

The principal terms of a reorganization must be approved by the outstanding shares of each class of a corporation the approval of whose board is required [*Corp. Code § 1200*], subject to several exceptions [*Corp. Code § 1201(a)*; ***see*** P 1(b), ***below***]. All statutory mergers, other than short-form mergers [*Corp. Code § 1110*; ***see*** *§ 11C.130* et seq.], are "reorganizations" requiring board approval of each constituent corporation and any corporation in control of a constituent corporation whose equity securities are issued in the reorganization ("parent party") [***see*** *Corp. Code §§ 181(a), 1200*; ***see also*** Ballantine & Sterling, California Corporation Laws, Ch. 12, ***Corporate Acquisitions, Mergers, and Reorganizations*** , § 260.02 (Matthew Bender)].

b. Determine whether either of following exceptions to shareholder approval requirement applies [*Corp. Code § 1201(a), (b)*]:

(1) Any of following will own, immediately after merger, equity securities of surviving corporation or parent party possessing more than five-sixths of voting power of surviving corporation or parent [*Corp. Code § 1201(b)*]:

NOTE:
However, approval is nonetheless required (1) by a class if holders of that class will receive shares of the surviving or parent corporation that have different rights, preferences, privileges, or restrictions than those surrendered [*Corp. Code § 1201(d)*], or (2) by the outstanding shares of the surviving corporation if any amendment to the articles would otherwise require approval of those outstanding shares [*Corp. Code § 1201(c)*].

Further, the principal terms of a reorganization must be approved by all shareholders of any class or series if, as a result of the reorganization, the holders of that class or series become personally liable for any obligations of a party to the reorganization, unless all holders of that class or series have dissenters' rights [*Corp. Code § 1201(g)*; ***see*** *Corp. Code § 1300 et seq.*].

In determining ownership by the shareholders of equity securities immediately after the reorganization, equity securities owned immediately before the reorganization as shareholders of another party to the transaction must be disregarded. For these purposes, voting power of the corporation will be calculated by assuming the conversion of all equity securities that are convertible into shares entitled to vote [*Corp. Code § 1201(b)*].

(a) Constituent corporation;

(b) Shareholders immediately before reorganization; or

(c) Both of above.

(2) Rights, preferences, privileges, and restrictions granted to or imposed on class of outstanding preferred shares of surviving or parent corporation are unchanged by merger [*Corp. Code § 1201(a)*].

NOTE:
No approval of such a class is required [*Corp. Code § 1201(a)*], unless an amendment to the articles of the surviving corporation would otherwise require approval of the outstanding shares of that corporation [*Corp. Code § 1201(c)*]. Two classes of common shares differing only as to voting rights will be considered a single class of shares [*Corp. Code § 1201(a)*].

c. Determine whether reorganization would result in shareholders of disappearing "close corporation" receiving shares of surviving corporation that is not "close corporation" [*Corp. Code §§ 1111, 1201(e)*].

NOTE:
A "close corporation" is a corporation whose articles (1) require that all of the corporation's issued shares of all classes be held by 35 or fewer persons, and (2) contain a statement that it is a close corporation [*Corp. Code § 158(a)*].

This type of reorganization always requires the approval of the outstanding shares [*Corp. Code §§ 1111, 1201(e)*; ***see*** *§ 11C.122*].

d. Determine whether merger agreement will result in cancellation without consideration of all outstanding shares of that corporation [*Corp. Code § 1202(a)*].

NOTE:

The principal terms of a merger reorganization must be approved by all of the outstanding shares of a corporation if the merger agreement provides that all of the outstanding shares of that corporation are canceled without consideration in the merger [*Corp. Code § 1202(a)*].

e. Determine whether reorganization would result in distribution to class or series of preferred shareholders of a lesser amount than would be required by applicable article provisions [*Corp. Code § 1202(b)*].

NOTE:

If the terms of a merger reorganization provide that a class or series of preferred shares will have distributed to it a lesser amount than would be required by applicable article provisions, the principal terms of the reorganization must be approved by the same percentage of outstanding shares of that class or series that would be required to approve an amendment of the article provisions to provide for the distribution of that lesser amount [*Corp. Code § 1202(b)*].

2. Determine whether surviving corporation is required to mail notice of shareholders' rights to sell dissenting shares [*see § 11C.122*] to shareholders [*Corp. Code §§ 1300(a), 1301(a)*].

NOTE:

If the approval of the outstanding shares is required for a reorganization [***see*** *Corp. Code § 1201(a), (b), (e), (f)*; ***see also*** P (1)(a), (c), ***above***], the corporation must provide notice to any shareholders that are entitled to vote on the transaction [***see*** *Corp. Code §§ 1300(a), 1301(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersMergers & Acquisitions LawMergersRights of Dissenting Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11C California Legal Forms--Transaction Guide § 11C.104

§ 11C.104 Securities Laws Requirements

1. Determine whether securities issued in merger must be qualified under Corporate Securities Law [*see Corp. Code §§ 25120-25122*; *see also § 11C.121*]:

NOTE:

State qualification or registration of "covered securities," as defined by the National Securities Markets Improvement Act of 1996 [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005)] (or securities that will be covered securities under that definition upon completion of the transaction), is now preempted by federal law [*15 U.S.C. § 77r*]. For discussion, see *Ch. 6*, ***Securities Regulation Issues***, *§ 6.15*. For issues specific to acquisitions and reorganizations, see *§ 6.14* in that chapter.

Under California law, it is unlawful to offer or sell any security in California in (1) any issuer transaction in connection with any change in the rights, preferences, privileges, or restrictions of or on outstanding securities; (2) any exchange of securities by the issuer with its existing security holders exclusively; (3) any exchange in connection with any merger or consolidation or purchase of assets in consideration wholly or in part of the issuance of securities; and (4) any entity conversion transaction unless the offering is qualified by permit (and no stop order) or exempt from or not subject to qualification [*Corp. Code §§ 25120*, *25121*; ***see*** *Corp. Code §§ 25100-25105* (exemptions); ***see also*** *Corp. Code §§ 25100.1*, *25101.1*, *25102.1*].

a. Determine whether short-form merger of 100-percent-owned subsidiary will be used [*see Corp. Code § 1110*; *see also § 11C.100[3]*].

NOTE:

If a parent corporation owns all of a subsidiary's outstanding stock, then a short-form merger of the two corporations does not involve any exchange of securities constituting a "sale" that must comply with the Corporate Securities Law [***see*** *Corp. Code § 25017(a)* (definition of "sale"); ***see also*** Marsh & Volk, *Practice Under the California Securities Laws, Ch. 7,* ***Recapitalizations and Reorganizations****, § 7.02[2][a]* (Matthew Bender)].

b. Determine whether either of following residency exemptions apply [*Corp. Code § 25103(b), (c)*]:

NOTE:

For purposes of these exemptions, the residence of shareholders is determined by the addresses appearing in the corporate books [*Corp. Code § 25103(b), (c)*]. The purpose of the 25 percent test is to assure that California has a substantial interest in the transaction sufficient to warrant regulation by the California Commissioner of Corporations [***see*** Ballantine & Sterling, California Corporation Laws, Ch. 21, ***Corporate Securities*** , § 459.02[2] (Matthew Bender)].

(1) Holders of less than 25 percent of outstanding shares receiving securities in exchange incident to merger have addresses in California [*Corp. Code § 25103(c)*].

(2) Holders of less than 25 percent of outstanding shares of class that will be substantially and adversely affected by changes in outstanding securities have addresses in California [*Corp. Code § 25103(b)*].

c. Determine whether exchange of securities satisfies limited 35-shareholder exemption [*Corp. Code § 25103(h)*]:

NOTE:

The Commissioner requires the acquiring entity to file a notice of transaction [*10 Cal. Code Reg. § 260.103.6(a)* (requirement), (b)(form for giving notice); ***see*** *Corp. Code § 25103(h)(2)* (statutory authority permitting Commissioner to require acquiring or surviving entity to file notice); ***see*** § 11.500 (form)]. However, the failure to file the notice, or to file it within the time specified by the Commissioner's rule, does not affect the availability of the exemption. An acquiring or surviving entity that fails to file the notice as provided by rule must, within 15 business days after demand by the Commissioner, file the notice and pay a fee equal to the fee payable had the transaction been qualified under *Corp. Code §§ 25110* or *25120* [*Corp. Code § 25103(h)(2)*; ***see*** *Corp. Code § 25608 (fee)*].

(1) Exchange is incident to merger, consolidation, or sale of assets (other than rollup transaction [*see Corp. Code § 25014.6*]) in consideration of issuance of equity securities of another entity or any entity conversion transaction;

(2) Exchange, had it involved issuance of security in transaction subject to *Corp. Code § 25110* (rather than *Corp. Code § 25120*), would have been exempt from qualification by *Corp. Code § 25102(f)* (without giving effect to *Corp. Code § 25102(f)(3)*, which requires representation that purchaser is purchasing for own account, not for resale); and

(3) Either of following applies:

(a) Not less than 75 percent of outstanding equity securities of each constituent or converting entity entitled to vote on proposed transaction voted in favor of transaction, not more than 10 percent of outstanding equity securities of each constituent or converting entity entitled to vote voted against proposed transaction, and each constituent or converting entity whose security holders are entitled to vote is subject to state statute with provision for dissenter's rights for holders of equity securities entitled to vote that do not vote in favor of or voted against transaction; or

(b) Transaction is solely for purpose of changing issuer's state of incorporation or organization, or form of organization, all securities of same class or series (unless all security holders of class or series consent) are treated equally, and holders of nonredeemable voting equity securities receive nonredeemable voting equity securities.

d. Determine whether merger will cause any of following changes in rights, preferences, privileges, or restrictions of or on outstanding equity securities that materially and adversely affect any class of holders of equity securities [*Corp. Code § 25103(e)*]:

NOTE:

These changes require qualification by permit, unless the change is otherwise exempt [*Corp. Code §§ 25103(e), 25120*; ***see*** Marsh & Volk, *Practice Under the California Securities Laws, Ch. 7, **Recapitalizations and Reorganizations**, § 7.03* (Matthew Bender)]. Such a change must be described with particularity in the merger agreement and the amendments to the articles [***see*** *Corp. Code §§ 907(b), 1101(b)*; ***see also*** *§ 11C.120*].

(1) Adding, changing, or deleting assessment provisions.

(2) Changing rights to dividends.

(3) Changing redemption provisions.

(4) Making securities redeemable.

(5) Changing amount payable on liquidation.

(6) Changing, adding, or deleting conversion rights.

(7) Changing, adding, or deleting voting rights.

(8) Changing, adding, or deleting preemptive rights.

(9) Changing, adding, or deleting sinking fund provisions.

(10) Rearranging relative priorities of outstanding equity securities.

(11) Imposing, changing, or deleting restrictions on transfer of equity securities in organizational documents for entity.

(12) Changing right of holders of equity securities with respect to calling of special meetings of holders of equity securities.

(13) Changing, adding, or deleting any rights, preferences, privileges, or restrictions of or on outstanding shares or memberships of mutual water company or other corporation or entity organized primarily to provide services or facilities to its shareholders or members.

e. Determine whether exchange of securities or change in outstanding securities is exempt because it would have been exempt as issuer transaction [*see Corp. Code §§ 25110* (qualification requirement), 25102 (exemptions)] if it had involved issuance of new security [*10 Cal. Code. Reg. § 260.103*; *see Corp. Code § 25105* (exemption pursuant to rule of Commissioner)].

NOTE:

For a list of exemptions from qualification, see *Ch. 6,* ***Securities Regulation Issues****, § 6.200*.

If the transaction would have been exempt as a limited offering [***see*** *Corp. Code § 25102(f)*], small offering [***see*** *Corp. Code § 25102(h)*], or qualified purchaser limited offering [***see*** *Corp. Code § 25102(n)*], the applicable notices of issuance pursuant to those exemptions must be filed [*10 Cal. Code Reg. § 260.103(b)*; ***see*** *§ 11C.121*].

f. Determine whether exchange of securities is exempt because exchange is pursuant to plan of reorganization that has been confirmed (or is subject to confirmation) by decree or order of court of competent jurisdiction pursuant to United States Bankruptcy Code [*see Corp. Code § 25103(i)*].

2. Determine whether securities issued in merger must be registered with federal Securities and Exchange Commission [*see 15 U.S.C. § 77f*].

NOTE:

Under federal law, the offer or sale of a security must be registered with the Securities and Exchange Commission [***see*** *15 U.S.C. § 77f*], unless the security or transaction is exempt [*15 U.S.C. §§ 77c, 77d*]. For a basic discussion of the federal securities laws and the threshold requirements for federal registration, see *Ch. 6,* ***Securities Regulation Issues****, § 6.50* et seq. For a list of the most frequently applicable exemptions from registration, see Ch. 6A, ***Federal Securities Exemptions for California Nonpublic Corporations*** . For discussion of the federal preemption of state qualification or registration of "covered securities" as defined by the National Securities Markets Improvement Act of 1996 [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005); ***see*** *15 U.S.C. § 77r*], see *Ch. 6,* ***Securities Regulation Issues****, § 6.15*; ***see also*** Marsh & Volk, Practice Under the California Securities Laws, Ch. 3A, ***Federal Preemption of State Securities Regulation*** (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawMergersGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsSecurities Registration



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11C California Legal Forms--Transaction Guide § 11C.105

§ 11C.105 Change in Ownership

NOTE:

A "change in ownership" is a transfer of a present interest in real property, including the beneficial use of that property, the value of which is substantially equal to the value of the fee interest [*Rev. & Tax. Code § 60*]. When a change in ownership occurs, a change in ownership statement must be filed [*Rev. & Tax. Code § 480.1*; ***see*** *§ 11C.161*]. Real property subject to local property taxation is then reassessed [***see*** Cal. Const. arts. XIII, XIIIA; ***see also*** *Ch. 23,* ***Real Property Sales Agreements****, §§ 23.203, 23.204*; California Real Estate Law and Practice, Ch. 401, ***Real Property Valuation and Assessment*** (Matthew Bender)].

1. Determine whether disappearing corporation owns real property located in California [*see* § 11C.50[1]].

2. Determine whether "change in ownership" will occur as result of merger [*Rev. & Tax. Code § 64*]:

a. Determine whether one corporation will obtain "control," i.e., direct or indirect ownership or control of more than 50 percent of voting stock, of another corporation through purchase or transfer of stock [*Rev. & Tax. Code § 64(c)*].

NOTE:

This form of transfer is a "change in ownership" for property tax purposes [*Rev. & Tax. Code § 64(c)*]. For purposes of obtaining control, any purchase or transfer of 50 percent or less of the ownership interest through which control or a majority ownership interest is obtained is included [*Rev. & Tax. Code § 64(c)(1)*].

b. Determine whether merger meets following criteria [*Rev. & Tax. Code § 64(b)*]:

NOTE:
This type of reorganization does not constitute a "change in ownership" [*Rev. & Tax. Code § 64(b)*].

(1) Merger qualifies as "reorganization" under *I.R.C. § 368*;

NOTE:
For a discussion of the type of corporate transactions that are considered to be "reorganizations" under federal income tax law, ***see*** Ch. 11, ***Merger and Acquisition Issues*** .

(2) Merger qualifies as nontaxable event under California law; and

(3) All corporations involved are members of "affiliated group" meeting following requirements [*Rev. & Tax. Code § 64(b)*]:

NOTE:
The phrase "members of an affiliated group" refers to affiliation from the beginning to the end of a transaction. Therefore, for the transaction to avoid classification as a "change in ownership," the parties to the merger must remain affiliated after, as well as before, the reorganization [*Pueblos del Rio South v. City of San Diego (1989) 209 Cal. App. 3d 893, 907, 257 Cal. Rptr. 578]* .

(a) One or more chains of corporations connected through stock ownership with common parent corporation;

(b) 100 percent of voting stock, excluding shares owned by directors, of each corporation other than parent is owned by one or more of other corporations; and

(c) Common parent corporation directly owns 100 percent of voting stock, excluding any shares owned by directors, of at least one of other corporations in affiliated group.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewReal Property LawPriorities & RecordingRecording ActsTax LawState & Local TaxesReal Property TaxAssessment & ValuationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11C California Legal Forms--Transaction Guide §§ 11C.106-11C.119

[Reserved]

§§ 11C.106[Reserved]



33 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Statutory Mergers

5-11C California Legal Forms--Transaction Guide

NOTE:

This guide contains the procedures for a statutory merger, other than a short-form merger [***see*** *Corp. Code § 1110*]. For the procedures applicable to short-form mergers, see *§ 11C.130* et seq.

These procedures apply to the merger of California ("domestic") corporations [***see*** *Corp. Code § 167*], as well as to the merger of domestic and non-California ("foreign") corporations [***see*** *Corp. Code § 171*] in which the surviving corporation will be a domestic corporation [***see*** *Corp. Code § 1108(b)*]. If the surviving corporation will be a foreign corporation, the merger proceedings are made in accordance with the laws of the place of incorporation of that foreign corporation [*Corp. Code § 1108(b)*], although some California procedures must still be followed for disappearing domestic corporations [***see*** *§ 11C.140* et seq.].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergers



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Statutory Mergers

5-11C California Legal Forms--Transaction Guide § 11C.120

§ 11C.120 Merger Agreement

NOTE:
For a detailed discussion of merger agreements, see *§ 11C.22[1]*.

1. Draft merger agreement, including all of following [*Corp. Code § 1101*; *see §§ 11C.200, 11C.201*]:

NOTE:
Any of the terms of a merger agreement may be made dependent upon facts ascertainable outside that agreement, if the manner in which those facts will operate upon the terms of the agreement is clearly and expressly set forth [*Corp. Code § 109.5(a)*]. When any terms are made dependent upon facts ascertainable outside the merger agreement through a reference to another document, the corporation must make that agreement available to its shareholders [***see*** *Corp. Code § 109.5(b)*; ***see also*** *§ 11C.163*]. If the referenced agreement is a contract to which the corporation is a party, the corporation must obtain shareholder approval to amend or revise that referenced contract [*Corp. Code § 109.5(c)*; ***see*** *§ 11C.163*].

a. Terms and conditions of merger.

b. Amendments, if any, to be made to articles of incorporation of surviving corporation [*Corp. Code § 1101*; *see Corp. Code § 900* (limitations on amendments)].

NOTE:
An amendment must either set forth in full the articles as amended or identify the portion to be amended and set it forth as amended [*Corp. Code §§ 907, 1101*]. If the purpose of

the amendment is to reclassify, cancel, exchange, or otherwise change outstanding shares, the amended articles must state the effect on the outstanding shares [*Corp. Code § 907(b)*]. If the amendment changes the name of the surviving corporation, the new name may be the same as or similar to the name of a disappearing corporation in the merger, but cannot be the same or similar to the name of any other existing corporation [*Corp. Code § 1101(b)*; ***see*** *Corp. Code § 201* (limitations on name)].

c. Name and place of incorporation of each constituent corporation.

d. Identification of surviving corporation.

e. Manner of converting shares of each constituent corporation into shares or other securities of surviving corporation [*see § 11C.102*].

f. If shares of any constituent corporation will not be converted solely into shares or other securities of surviving corporation, the cash, property, rights, or corporate securities that holders of those shares will receive in exchange for their shares [*see § 11C.102*].

NOTE:
If the shares will be canceled without consideration, that fact must be stated instead [*Corp. Code § 1101(d)*].

g. Any other details or provisions that are desired, including provision for payment of cash in lieu of fractional shares or for any other arrangement consistent with restrictions on fractional shares [*see Corp. Code § 407*; *see also § 11C.102*]].

2. Have board of directors of following corporations approve merger agreement [*Corp. Code § 1200*; *see §§ 11C.202* (surviving corporation), 11C.203 (disappearing corporation)]:

NOTE:
The agreement must be approved by the board of directors itself, rather than by a committee of the board [*Corp. Code §§ 151, 311(a)*; ***see*** *Corp. Code § 1201(a)*; ***see also*** *§ 11C.22[4], [5]*].

a. Each constituent corporation.

b. Any parent party.

NOTE:
A "parent party" to the merger is a corporation in control of a constituent corporation whose shares are being issued or transferred in the merger [*Corp. Code § 1200(e)*].

3. Have agreement signed by following persons from each constituent corporation [*Corp. Code § 1102*]:

a. Chairman of board of directors, president, or vice-president; and

b. Secretary or assistant secretary.

Legal Topics:

For related research and practice materials, see the following legal topics:

Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawMergersGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsSecurities Registration



35 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Statutory Mergers

5-11C California Legal Forms--Transaction Guide § 11C.121

§ 11C.121 Complying With Securities Laws

NOTE:

It is unlawful to offer or sell any security in California in connection with any merger, unless the security is qualified by permit, or exempt from or not subject to qualification [*Corp. Code §§ 25120, 25121*]. For a discussion of the separate requirements under federal securities laws, see *Ch. 6,* ***Securities Regulation Issues****, § 6.50* et seq.

State qualification or registration of "covered securities," as defined by the National Securities Markets Improvement Act of 1996 [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005)] (or securities that will be covered securities under that definition upon completion of the transaction), is now preempted by federal law [*15 U.S.C. § 77r*]. For discussion, see *Ch. 6,* ***Securities Regulation Issues****, § 6.15*.

1. If securities are exempt from qualification [*see § 11C.104*], prepare statutory notices appropriate to exemption being relied on [*see 10 Cal. Code Reg. § 260.103(b)*]:

NOTE:

If the offer or sale of securities in a merger is exempt because it would have been exempt as an initial transaction under the limited, small, or qualified purchaser exemption [***see*** *Corp. Code § 25102(f)* (limited offering), (h)(small offering), (n)(qualified purchaser)] pursuant to *10 Cal. Code Reg. § 260.103*, the issuer must file the notices of issuance required for those exemptions [*10 Cal. Code Reg. § 260.103(b)*]. A filing fee must be paid on filing [***see*** *Corp. Code § 25608(c)*].

a. Small offering exemption [*10 Cal. Code Reg. § 260.102.8*].

NOTE:

For an example and discussion of the notice of issuance under the small offering exemption, see *Ch. 6C, **Small Offering Exemption**, § 6C.200*.

b. Limited offering exemption [*10 Cal. Code Reg. § 260.102.14(c)*].

NOTE:

For an example and discussion of the notice of issuance under the limited offering exemption, see *Ch. 6B, **Limited Offering Exemption**, § 6B.203*.

c. If transaction qualifies as an exchange under *Corp. Code § 25103(h)*, prepare notice of exchange transaction and file notice within 15 days after first sale of securities in transaction in California [*see § 11C.500* (form); *see also 10 Cal. Code Reg. § 260.103.6(a)*].

NOTE:

For discussion of this exemption, see *§ 11C.104*, P 1(c); ***see also** § 11C.500[1][a]*.

2. If securities must be qualified under Corporate Securities Law [*see § 11C.104*]:

a. Prepare application for permit [*see 10 Cal. Code Reg. § 260.121*; *see also § 11C.204*].

NOTE:

The permit must be issued by the Corporations Commissioner and received by the surviving corporation, or its parent party, before approval of the proposed merger by the holders of equity securities of any of the constituent corporations to the merger can be solicited [*Corp. Code §§ 25103(a), 25120*; ***see** § 11C.122* (shareholder approval)]. In a short-form merger [***see** § 11C.130* et seq.], since no shareholder approval is required, the permit may be obtained prior to the approval of the parent corporation's board of directors [***see*** Marsh & Volk, Practice Under the California Corporate Securities Laws, Ch. 7, ***Recapitalizations and Reorganizations***, § 7.02 [2] (Matthew Bender)].

For more detailed discussion of the qualification of Securities in California, see Ch. 6H, ***Qualification of Securities*** .

b. File application with Commissioner of Corporations.

c. Pay filing fee of $200, plus one fifth of 1 percent of [*Corp. Code § 25608(h)(2)*]:

NOTE:

Qualification will not be effective until the fee has been paid [*Corp. Code § 25615*]. The maximum aggregate fee is $2,500 [*Corp. Code § 25608(h)(2)*].

(1) Value of shares alleged in application; or

(2) Actual value determined by Commissioner.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions

LawMergersGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsSecurities Registration



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Statutory Mergers

5-11C California Legal Forms--Transaction Guide § 11C.122

§ 11C.122 Shareholder Approval and Notice

NOTE:

The following procedures apply only to a statutory merger that must be approved by the outstanding shares of a corporation [***see*** *§ 11C.103*]. For further discussion of shareholder approval requirements, see *§ 11C.22[5], [6]*.

1. Have principal terms of proposed merger approved as follows [*Corp. Code §§ 1200, 1201(a)*; *see § 11C.208* (shareholder resolution approving terms)]:

NOTE:

Shareholder approval may be obtained at a shareholders' meeting [***see*** *Corp. Code § 600(d)*], or by written consent [***see*** *Corp. Code § 603*]. For an example and discussion of the notice of a special shareholders' meeting [***see*** *Corp. Code § 601*], see *§ 11C.205*. For an example and discussion of a written consent [***see*** *Corp. Code § 603*], see *Ch. 8A, **Shareholders' Meetings, Voting, and Agreements**, §§ 8A.222, 8A.223*.

When a tender offer (including a share exchange tender offer [***see*** *Corp. Code § 183.5* (definition); ***see also*** Ch. 11D, ***Acquisition of Shares for Shares***]) or a written proposal for approval of a statutory merger or other "reorganization" [***see*** *Corp. Code §§ 181, 1200*] or sale of assets [***see*** *Corp. Code § 1001(a)*] is made to some or all of a corporation's shareholders by a party to the transaction who has control of or a financial interest in that corporation (an "interested party proposal"), an affirmative opinion in writing regarding the fairness of the consideration to the shareholders of the corporation must be provided to the shareholders or the corporation. This requirement does not apply if the target corporation does not have shares held of record by 100 or more persons [***see*** *Corp. Code § 605* (determination of shareholders of record)], or if the transaction has

been qualified pursuant to *Corp. Code § 25113* (qualification of issuer transaction by permit) or 25121 (qualification of recapitalization or reorganization by permit), and no stop order [***see*** *Corp. Code §§ 25140, 25143(a)*] is in effect regarding that qualification [*Corp. Code § 1203(a)*]. If a subsequent tender offer or written proposal is made by another person at least 10 days before the date for acceptance of the tendered shares or the vote or notice of shareholder approval on the interested party proposal, additional shareholder notification and withdrawal requirements apply [***see*** *Corp. Code § 1203(b)*].

For further discussion, see Ch. 11, ***Merger and Acquisition Issues*** .

a. If disappearing corporation is close corporation [*see Corp. Code § 158*], and reorganization would result in a surviving corporation that is not a close corporation [*see § 11C.103*], by affirmative vote of at least two thirds of each class of outstanding shares required to approve [*Corp. Code §§ 1111, 1201(e)*].

NOTE:
The corporation's articles may, however, provide for a lesser vote as small as a majority of the outstanding shares of each class [*Corp. Code § 1201(e)*].

b. If constituent corporation is not "close corporation" [*see Corp. Code § 158*; § 11C.103], by outstanding shares of each class of constituent and parent parties required to approve [*Corp. Code § 1201(a)*; *see § 11C.103*].

NOTE:
"Approved by the outstanding shares" means approved by the affirmative vote of a majority of the outstanding shares entitled to vote, unless the articles require unanimous or a greater than majority vote [*Corp. Code § 152*]. A "parent party" is the corporation in control of any constituent corporation whose equity securities are issued in the reorganization [*Corp. Code § 1200(e)*].

For the purposes of merger approval, two classes of common shares differing only as to voting rights will be considered as only one class of shares for voting on merger [*Corp. Code § 1201(a)*].

c. If merger agreement provides that all outstanding shares of corporation are canceled without consideration [*see § 11C.103*] by all outstanding shares [*Corp. Code § 1202(a)*].

d. If terms of agreement provide that class or series of preferred shares will receive lesser amount than would be required by applicable article provisions, by same percentage of outstanding shares of that class or series as would be required to approve amendment of article provisions to provide for distribution of that lesser amount [*Corp. Code § 1202(b)*].

NOTE:
For a discussion of the approval required to amend articles of incorporation, see Ch. 10, ***Amendment of Articles*** .

2. Prepare notice that meets each of following requirements [*Corp. Code §§ 1300, 1301(a)*; *see § 11C.400*]:

NOTE:
A separate notice should be prepared for each constituent corporation or parent party because of the

nature of the material that must be contained in the notice.

a. States that proposed merger has been approved by outstanding shares of each class of corporation as required by law;

b. Specifies price determined by corporation to represent fair market value of dissenting shares;

NOTE:

The statement of price constitutes an offer by the corporation to purchase any dissenting shares [***see*** *Corp. Code § 1300(b)* (definition)] at the stated price, unless the shares lose their status as dissenting shares [*Corp. Code § 1301(a)*; ***see*** *Corp. Code § 1309* (loss of status)].

c. Contains brief description of procedure for shareholder to follow in order to exercise rights [*see § 11C.150* et seq.]; and

d. Contains copy of *Corp. Code §§ 1300-1304*.

3. Mail notice to each shareholder entitled to vote on reorganization within 10 days after principal terms of proposed merger have been approved by outstanding shares.

4. For each shareholder that complies with procedures to exercise rights [*see Corp. Code §§ 1301, 1302*; *see also § 11C.151*], instruct corporation to either:

a. Purchase dissenting shares at fair market value, plus interest at legal rate on judgments, within later of following [*Corp. Code § 1303*]:

NOTE:

However, the corporation may not purchase the shares unless it is able to pass the balance sheet tests required to make a distribution to its shareholders [*Corp. Code §§ 1303(b), 1306*; ***see*** *Corp. Code § 500(a)*; ***see also*** *§ 11C.151[4][a]*]. If the corporation is unable to make the purchase, the dissenting shareholder becomes a creditor of the corporation [*Corp. Code § 1306*; ***see*** *§ 11C.151[4][b]*]. The distribution restrictions set forth in *Corp. Code § 500* do not apply to a corporation licensed as a broker-dealer [***see*** *Corp. Code §§ 25210-25220*] if the corporation, immediately after giving effect to any distribution, is in compliance with the net capital rules of the Commissioner of Corporations [***see*** *10 Cal. Code Reg. § 260.216.12*] and the Securities and Exchange Commission [*Corp. Code § 500(c)*; ***see*** *17 C.F.R. § 240.15c3-1*].

(1) 30 days after amount of fair market value has been agreed on; or

(2) 30 days after any statutory or contractual conditions to reorganization are satisfied.

b. Refuse to purchase shares, based on [*Corp. Code § 1304(a)*]:

(1) Denial by corporation of dissenting share status [*see § 11C.150*]; or

(2) Failure of corporation and shareholder to agree on fair market value of shares.

5. If corporation refuses purchase of shares [*see* (4)(b), *above*], advise corporation that it may [*Corp. Code § 1304(a)*]:

NOTE:

When the corporation refuses to purchase a shareholder's purportedly dissenting shares, either the shareholder or the corporation may take the following actions [*Corp. Code § 1304(a)*]. The corporation may choose not to take any action, thus forcing the shareholder to attempt to enforce payment.

a. File complaint to determine disputed issues [*see § 11C.152[1]*].

b. File intervention in existing action pending to determine disputed issues [*see § 11C.152[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersMergers & Acquisitions LawMergersRights of Dissenting Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Statutory Mergers

5-11C California Legal Forms--Transaction Guide § 11C.123

§ 11C.123 Officers' Certificate

1. Draft officers' certificate for each constituent corporation to merger, stating all of following [*Corp. Code § 1103*]:

NOTE:
An "officers' certificate" is a certificate that is signed and verified by specified corporate officers [*Corp. Code § 173*; ***see*** (2), ***below***].

a. Total number of outstanding shares of each class entitled to vote on merger.

b. Either of following:
(1) That principal terms of merger agreement in attached form were approved by that corporation by vote of number of shares of each class that equaled or exceeded vote required, specifying [*see § 11C.210*]:
(a) Each class entitled to vote.

(b) Percentage vote required of each class; or

(2) That merger was entitled under law to be approved [*see Corp. Code § 1201*] and was approved by board of directors alone [*Corp. Code § 1103*; *see* § 11C.212].

NOTE:
As a practical matter, if the board alone is entitled to approve the merger agreement [*Corp. Code § 1201*; ***see*** *§ 11C.103[1]*], the officers' certificate should specify the circumstances that permitted the board to do so [***see*** *§ 11C.211*].

c. If shares of parent corporation will be issued in merger, either that:

(1) No vote of shareholders of the parent was required, or

(2) Required vote of shareholders was obtained.

2. Have officers' certificate signed and verified by [*Corp. Code §§ 173, 1103*]:

a. Chairman of board of directors, president, or any vice-president; and

b. Secretary, chief financial officer, treasurer, or any assistant secretary or assistant treasurer.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Directors & Officers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Statutory Mergers

5-11C California Legal Forms--Transaction Guide § 11C.124

[Reserved]

§ 11C.124[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Statutory Mergers

5-11C California Legal Forms--Transaction Guide § 11C.125

§ 11C.125 Perfecting Merger

NOTE:

The merger, and any amendment of the articles contained in the merger agreement, ordinarily will become effective on filing the agreement and the officers' certificate with the Secretary of State [*Corp. Code § 1103*]. The corporation, however, may request a later filing date [***see*** *Corp. Code § 110*]. For a discussion of the effect of perfecting a merger, see *§ 11C.22[9]*. If the merger involves both foreign and domestic corporations, each foreign disappearing corporation that is qualified for the transaction of intrastate business [***see*** *Corp. Code § 191*; ***see also*** Ch. 12B, ***Foreign Corporations and Associations***], by virtue of the filing, will automatically surrender its right to transact intrastate business [*Corp. Code § 1108(c)*].

The board of directors may abandon the merger at any time before filing, subject to any contractual rights of third parties. No approval of the outstanding shares is required for abandonment [*Corp. Code §§ 1105, 1201(g)*; ***see*** *§ 11C.209* (resolution abandoning merger)].

1. File each of following with Secretary of State [*Corp. Code § 1103*]:

NOTE:

The Secretary of State will compare and certify two copies for each merger transaction without charge, provided that the copies are submitted to the Secretary with the original to be filed [*Gov. Code § 12185*].

a. Merger agreement [*Corp. Code § 1101*; *see § 11C.120*].

b. Officers' certificate for each disappearing corporation [*Corp. Code § 1103*; *see §*

11C.123].

2. Pay filing fees.

NOTE:

The fee for filing a merger agreement for any or all of the filings for each merger transaction, regardless of the number of constituent corporations, is set forth in *Gov. Code § 12186(k)*, (***I***).

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Statutory Mergers

5-11C California Legal Forms--Transaction Guide §§ 11C.126-11C.129

[Reserved]

§§ 11C.126[Reserved]



41 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Short-Form Mergers

5-D California Legal Forms--Transaction Guide Scope

Scope

NOTE: This guide should be used only for a merger of a domestic corporation owning at least 90 percent of each class of outstanding shares of one or more domestic or foreign corporations with that subsidiary (or those subsidiaries) [*Corp. Code § 1110(a), (b)*; ***see*** *§ 11C.100[3]*]. However, a foreign subsidiary corporation may not be merged into a parent domestic corporation unless the laws of its place of incorporation permit such a merger [*Corp. Code § 1110(g)*; ***see*** *§ 11C.101[2]*]. A "domestic" corporation is a corporation formed under California law [*Corp. Code § 167*]. A "foreign" corporation is any corporation other than a domestic corporation [*Corp. Code § 171*].

A foreign parent corporation may use a short-form merger if the law of its place of incorporation permits such a merger [*Corp. Code § 1110(i)*], and if at least one subsidiary corporation is a domestic corporation [*Corp. Code § 1110(i)*]. However, no filings with the Secretary of State are made for the foreign parent [*Corp. Code § 1110(i)*; ***see*** *§ 11C.134[2]*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Short-Form Mergers

5-11C California Legal Forms--Transaction Guide § 11C.130

§ 11C.130 Resolution or Plan of Merger

1. Draft resolution or plan of merger [*see § 11C.300* (wholly owned subsidiary), § 11C.301 (90-percent-owned subsidiary)].

NOTE:
If a domestic corporation owns all the outstanding shares, or owns at least 90 percent of the outstanding shares of each class, of a corporation or corporations, whether foreign or domestic, subsidiaries may be merged into the parent corporation, or the parent (and other subsidiaries) may be merged into a subsidiary corporation [*Corp. Code § 1110(a)*].

a. If domestic corporation owns all outstanding shares of corporation(s), include following:
(1) Provision for merger of disappearing corporation(s) into surviving corporation [*Corp. Code § 1110(a)*].

(2) Provision that surviving corporation assumes all liabilities of each disappearing corporation [*Corp. Code § 1110(a)*].

b. If parent corporation owns less than all outstanding shares, but at least 90 percent of outstanding shares of each class, of each subsidiary corporation that is party to merger, add description of securities, cash, property, or rights to be issued, paid, delivered, or granted on surrender of each outstanding share of subsidiary corporation not owned by parent [*Corp. Code § 1110(b)*].

c. If parent corporation will be merged into subsidiary, add provision for pro rata conversion of outstanding shares of parent corporation intoshares of surviving subsidiary [*Corp. Code § 1110(c)*; *see § 11C.302*].

d. If appropriate, add provision for amendment of surviving corporation's articles of incorporation to change name [*Corp. Code § 1110(d)*; *see Corp. Code §§ 201* (name restrictions), 907(a)(2)(wording of amendment)].

NOTE:
The surviving corporation's new name may be the same as or similar to one of the disappearing corporations' names [*Corp. Code § 1110(d)*].

2. Secure appropriate corporate approvals:

a. If domestic corporation owns all of outstanding shares, have board of parent corporation adopt and approve resolution or plan of merger [*Corp. Code § 1110(a)*].

b. If parent owns less than all, but at least 90 percent, of outstanding shares of each class of disappearing subsidiary [*Corp. Code § 1110(a), (b)*], have:

(1) Board of parent corporation adopt and approve resolution or plan of merger.

(2) Board of each disappearing subsidiary approve entire resolution or plan of merger, including amount of consideration for shares not owned by parent.

c. If parent will be merged into subsidiary [*Corp. Code § 1110(a), (c)*], have:

(1) Board of parent corporation adopt and approve resolution or plan of merger.

(2) Board of surviving subsidiary approve the resolution or plan of merger, including pro rata conversion provision.

NOTE:
If the merger of a parent corporation into a subsidiary would otherwise constitute a merger reorganization [***see*** *Corp. Code § 181*], such that the principal terms of the merger must be approved by the outstanding shares of any class of the parent [***see*** *Corp. Code § 1201(d)*], the principal terms of the resolution or plan must be approved by the outstanding shares of the same class of the parent [*Corp. Code § 1110(c)*].

3. Have board(s) of directors adopt resolution.

NOTE:
When the parent owns less than 100 percent of the subsidiary, the parent's board must adopt the resolution of merger, and the subsidiary's board must adopt the resolution approving fairness [***see*** P 2, ***above***].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Short-Form Mergers

5-11C California Legal Forms--Transaction Guide § 11C.131

[Reserved]

§ 11C.131[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Short-Form Mergers

5-11C California Legal Forms--Transaction Guide § 11C.132

§ 11C.132 Notice to Shareholders

NOTE:
This section applies only to those short-form mergers in which the parent corporation owns less than 100 percent of the subsidiary corporation [*Corp. Code § 1110(h)*].

1. Prepare notice to shareholders of subsidiary corporation, including [*Corp. Code § 1110(h)*; *see § 11C.304*]:

a. Statement that short-form merger will become effective on specified date;

b. Copy of resolutions or plan of merger adopted by:
(1) Board of directors of parent corporation [*see § 11C.130[1]*]; and

(2) Board of directors of subsidiary corporation [*see § 11C.130[2]*].

c. Following information regarding share purchase rights [*Corp. Code § 1110(h)*; *see Corp. Code § 1301(a)*]:

NOTE:
Any shareholder of the subsidiary corporation has the right to demand payment of cash for his or her shares pursuant to *Corp. Code §§ 1300-1312* [*Corp. Code § 1110(h)*; ***see*** *§ 11C.140* et seq.].

(1) Copies of *Corp. Code §§ 1300-1304*;

(2) Price determined by corporation to represent fair market value of dissenting shares; and

(3) Brief description of procedure to be followed if shareholder desires to exercise right to have corporation purchase his or her shares.

2. Mail notice to address for shareholder appearing on records of corporation, at least 20 days before effective date of merger [*Corp. Code § 1110(h)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentMergersMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersMergers & Acquisitions LawMergersRights of Dissenting ShareholdersMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Short-Form Mergers

5-11C California Legal Forms--Transaction Guide § 11C.133

§ 11C.133 Securities Requirements

NOTE:

If the securities issued in the short-form merger must be qualified or exempted under the Corporate Securities Law [***see*** *§ 11C.204*], the qualification or exemption procedures *set forth in § 11C.121* for an "ordinary merger" should be followed.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Short-Form Mergers

5-11C California Legal Forms--Transaction Guide § 11C.134

§ 11C.134 Certificate of Ownership

1. Prepare certificate of ownership that [*Corp. Code § 1110(e)*; *see § 11C.303*]:

NOTE:
For a discussion of the certificate of ownership, see *§ 11C.29[3]*.

a. Sets forth all of following:
(1) Identity of parent and subsidiary corporation or corporations;

(2) Share ownership by parent of each subsidiary corporation as:
(a) 100 percent of outstanding shares; or

(b) At least 90 percent of outstanding shares of each class.

(3) Resolution or plan of merger.

(4) Approval of resolution or plan of merger by board of parent corporation.

(5) Other approvals of resolution or plan of merger, if applicable.

NOTE:
A subsidiary's approval is only required when the parent owns less than 100 percent of the subsidiary or the parent is being merged into a subsidiary [***see*** *Corp. Code § 1110(b), (c)*; ***see also*** *§ 11C.120[2]*].

b. Is signed by parent corporation's [*Corp. Code § 1110(e)*; *see Corp. Code § 172* (definition of "officers' certificate")]:

(1) Chairman of board of directors, president, or any vice-president; and

(2) Secretary, chief financial officer, treasurer, or any assistant secretary or assistant treasurer.

2. File following with Secretary of State:

NOTE:
On filing the certificate of ownership, the merger will become effective. Any amendment of the articles of the surviving corporation set forth in the certificate will also become effective [*Corp. Code § 1110(f)*].

a. Original certificate of ownership on behalf of parent [*Corp. Code § 1110(e)*];

NOTE:
If the parent is a foreign corporation, no filing must be made for the parent. However, filings must still be made for each domestic and qualified foreign subsidiary [*Corp. Code § 1110(g)*; ***see*** P b, ***below***].

The Secretary of State will compare and certify two copies of the certificate of ownership without charge, provided that the copies are submitted to the Secretary with the original to be filed [*Gov. Code § 12185*].

b. Executed copy of certificate of ownership for each domestic and disappearing qualified foreign subsidiary [*Corp. Code § 1110(e)*].

3. Pay filing fees.

NOTE:
The fee for filing a certificate of ownership for any or all of the filings for each merger transaction, regardless of the number of constituent corporations, is set forth in *Gov. Code § 12186* (***I***).

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
D. Procedural Guide to Short-Form Mergers

5-11C California Legal Forms--Transaction Guide §§ 11C.135-11C.139

[Reserved]

§§ 11C.135[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
E. Procedural Guide to Foreign Law Mergers

5-E California Legal Forms--Transaction Guide Scope

Scope

NOTE: This guide applies to only those mergers, conducted under foreign law, in which a foreign corporation is the surviving corporation [***see*** *§ 11C.101*]. Mergers in which a domestic corporation is the surviving corporation are conducted as if only domestic corporations were merging [***see*** *Corp. Code §§ 1108(b)*, 1110(g); ***see also*** *§ 11C.120* et seq.]. A "foreign" corporation is any corporation other than a domestic corporation [*Corp. Code § 171*]. A "domestic" corporation is a corporation formed under California law [*Corp. Code § 167*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
E. Procedural Guide to Foreign Law Mergers

5-11C California Legal Forms--Transaction Guide § 11C.140

§ 11C.140 Foreign Law Procedures

1. Confirm that foreign law authorizes merger of corporation incorporated under its laws with California corporation.

NOTE:
The merger of a domestic and foreign corporation may take place only if the foreign corporation is authorized by the laws under which it was formed to effect such a merger [***see*** *Corp. Code § 1108(a)*].

2. Comply with all procedures required to perfect merger in foreign jurisdiction, subject to following California requirements for domestic corporation only [*Corp. Code § 1108(b)*]:

NOTE:
The merger proceedings may be conducted under the law of the place in which the surviving foreign corporation was incorporated, subject to the following California rules applicable to each disappearing domestic corporation [*Corp. Code § 1108(b)*].

a. Shareholder and board approval [*see Corp. Code §§ 1200, 1201*; *see also § 11C.120[1], 11C.122*].

b. Dissenters' rights [*Corp. Code § 1108(b)*; *see Corp. Code §§ 1300-1312*; *see also § 11C.150* et seq.].

c. Comply with fractional share requirements, if applicable [*see Corp. Code § 407*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
E. Procedural Guide to Foreign Law Mergers

5-11C California Legal Forms--Transaction Guide § 11C.141

§ 11C.141 California Procedures

1. For each disappearing domestic corporation, file one of following documents [*Corp. Code § 1108(d)*; *see Corp. Code § 1110(g)* (short-form mergers); *see also § 11C.140*]:

NOTE:

The merger will become effective as to the foreign corporation in accordance with foreign law [*Corp. Code § 1108(d)*], and will become retroactively effective as to a domestic disappearing corporation to the effective date in the foreign jurisdiction, upon this filing [*Corp. Code § 1108(d)*]. However, if the date of the California filing is more than six months after the merger becomes effective in the foreign jurisdiction, or if thepowers of the domestic corporation are suspended when the merger becomes effective in the foreign jurisdiction, the merger is effective as to the disappearing domestic corporation as of the date of the California filing [*Corp. Code § 1108(e)*].

Any foreign disappearing corporation that is qualified to transact intrastate business in California [***see*** *Corp. Code § 191*] will automatically surrender that right on this filing [*Corp. Code § 1108(d), (e)*].

a. Copy of merger agreement, certificate, or other document that has been certified by the public official having official custody of original;

b. Executed counterpart of merger agreement, certificate, or other document;

c. Copy of merger agreement with officers' certificate of each constituent corporation attached [*see Corp. Code § 1103*; *see also §§ 11C.120, 11C.123*]; or

d. Certificate of ownership [*see Corp. Code § 1110(e)*].

2. Pay filing fees.

NOTE:
The fee for filing a document pursuant to *Corp. Code § 1108(d)* for any or all of the filings for each merger transaction, regardless of the number of constituent corporations, is set forth in *Gov. Code § 12186(k)*, (**I**).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
E. Procedural Guide to Foreign Law Mergers

5-11C California Legal Forms--Transaction Guide §§ 11C.142-11C.149

[Reserved]

§§ 11C.142[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
F. Procedural Guide for Dissenting Shareholders

5-F California Legal Forms--Transaction Guide Scope

Scope

NOTE: This guide applies only to those shareholders who wish to sell back their shares to the corporation before a merger takes place. A shareholder required to vote on the merger transaction, or a shareholder in a short-form merger, who is dissatisfied with the proposed merger may require the corporation in which he or she holds shares to purchase those shares for cash at their fair market value [*Corp. Code § 1300*]. This procedure is a dissenting shareholder's exclusive remedy to attack the validity of a merger [***see*** *Corp. Code § 1312*; ***see also*** Ballantine & Sterling, California Corporation Laws, Ch. 12, ***Corporate Acquisitions, Mergers, and Reorganizations*** , § 262.04 (Matthew Bender)].

This procedure applies to the shareholders of any domestic constituent corporation, whether it is merged with a surviving domestic or foreign corporation [***see*** *Corp. Code § 1108(b), (f)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
F. Procedural Guide for Dissenting Shareholders

5-11C California Legal Forms--Transaction Guide § 11C.150

§ 11C.150 Evaluating Dissenting Shareholder Status

NOTE:

"Dissenting shareholder" means the recordholder of dissenting shares, and includes a transferee of record [*Corp. Code § 1300(c)*].

1. Confirm that shareholder is one of following with right to require corporation to purchase shares [*Corp. Code § 1300(a)*]:

a. Shareholder of corporation in which approval of outstanding shares is required for merger [*see Corp. Code § 1201(a), (b), (e), (f)*; *see § 11C.103*]; or

b. Shareholder of subsidiary corporation in short-form merger [*Corp. Code § 1110*; *see § 11C.130* et seq.].

2. Verify that shares in question come within all of following descriptions for classification as "dissenting shares" [*Corp. Code § 1300(b)*].

a. Immediately prior to merger, shares were not listed on any national securities exchange certified by Commissioner, except listed shares may qualify as dissenting shares if [*Corp. Code § 1300(b)(1)*; *see Corp. Code § 25100(o)*]:

NOTE:

The purpose of the dissenting shareholder statutes is to allow shareholders whose investments have been changed without their approval to "cash out" those investments without being harmed by the change [*see* Leg. Comm. Comment to *Corp. Code § 1300*]. If a liquid market for those shares already exists, there is no need for purchase by the

corporation. For further discussion of listed securities as dissenting shares, see *§ 11C.400*.

(1) They are not readily marketable because of transfer restrictions;

(2) Corporation's notice of meeting of shareholders to act on merger fails to summarize Corporation Code provisions related to dissenting shares, including procedure for qualifying shares as such [*see Corp. Code §§ 1300-1304*]; or

(3) Demands for payment are filed with respect to five percent or more of outstanding shares of that class.

b. Shares were outstanding and held of record on date for determination of shareholders entitled to vote on reorganization and voted against it [*Corp. Code § 1300(b)(2)*].

NOTE:
When approval of the outstanding shares of a corporation is obtained by written consent of shareholders instead of by vote at a shareholders' meeting, listed shares otherwise qualified to be dissenting shares need only not have consented to the reorganization. There is no requirement that the holders of the listed shares were actually asked to sign the written consent and refused [*Corp. Code § 1300(b)(2)*].

c. Shares which dissenting shareholder has demanded that corporation purchase at fair market value [*Corp. Code § 1300(b)(3)*; *see Corp. Code § 1301*].

d. Shares which dissenting shareholder has submitted for endorsement [*Corp. Code § 1300(b)(4)*; *see Corp. Code § 1302*].

3. Advise shareholder that status as dissenting shareholder will terminate on occurrence of any of following [*Corp. Code § 1309*]:

NOTE:
On termination of this status, a shareholder ceases to be entitled to require the corporation to purchase his or her shares [*Corp. Code § 1309*].

a. Corporate abandonment of reorganization.

NOTE:
The board may abandon the proposed reorganization without further action by the shareholders, subject to any contractual rights of third parties [*Corp. Code § 1201(h)*].

b. Either:

(1) Transfer of shares for endorsement [*see § 11C.151[2]*]; or

(2) Surrender for conversion into shares of another class in accordance with articles.

c. Shareholder and corporation disagree over dissenting status of shares or purchase price of shares, without taking either of following actions within six months after notice of approval by outstanding shares [*see Corp. Code § 152*; *see also § 11C.122[2]*] or notice of short-form merger [*see Corp. Code §*

1110(h); *see also § 11C.132*] was mailed to shareholder:

(1) Filing complaint [*see § 11C.152[1]*]; or

(2) Filing intervention [*see § 11C.152[2]*].

d. Shareholder withdraws demand for purchase, with corporation's consent.

NOTE:

A shareholder of dissenting shares may not withdraw a demand for payment without the corporation's consent [***see*** *Corp. Code § 1308*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentMergersBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentProceduresBusiness & Corporate LawCorporationsShareholdersTransfers of SharesMergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersMergers & Acquisitions LawMergersRights of Dissenting ShareholdersMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
F. Procedural Guide for Dissenting Shareholders

5-11C California Legal Forms--Transaction Guide § 11C.151

§ 11C.151 Exercising Shareholder Rights

NOTE:

The corporation is required to inform the shareholders of their right to require the corporation to purchase back any dissenting shares [***see*** *§ 11C.150[2]*] pursuant to a notice of reorganization given within 10 days after the outstanding shares have approved the reorganization [***see*** *Corp. Code § 1301(a)*; ***see also*** *§ 11C.122[2]*], or, for a short-form merger, within 20 days before the effective date of merger [*Corp. Code § 1301(a)*; ***see*** Corp.Code § 1110(h); ***see also*** *§ 11C.132*].

1. Have shareholder make written demand on corporation that complies with all of following [*Corp. Code § 1301*; *see § 11C.401*]:

NOTE:

Once a dissenting shareholder has made a demand for payment, he or she may not withdraw the demand without the corporation's consent [*Corp. Code § 1308*].

a. Demands both [*Corp. Code § 1301(b)*]:

(1) Purchase of dissenting shares.

(2) Payment at fair market value in cash.

b. States [*Corp. Code § 1301(c)*]:

(1) Number and class of shares held of record by shareholder that he or she demands to be purchased; and

(2) Price that shareholder claims is fair market value for shares as of day before announcement of proposed merger.

NOTE:
The statement of fair market value constitutes an offer by the shareholder to sell the shares at that price [*Corp. Code § 1301(c)*].

c. Is received by corporation or its transfer agent [*Corp. Code § 1301(b)*]:

NOTE:
If the demand is not received by the corporation in accordance with the following time limitations, it will not be effective for any purpose [*Corp. Code § 1301(b)*].

(1) If dissenting shares are listed on national securities exchange certified by Commissioner [*see Corp. Code § 1300(b)(1)*], no later than date of shareholders' meeting to vote on proposed reorganization.

(2) For any shares other than those described in P (1), *above*, within 30 days after date on which either of following was mailed to shareholders:

(a) Notice of approval by outstanding shares [*Corp. Code § 1301(a)*; *see § 11C.122[2]*]; or

(b) Notice of effective date of short-form merger [*Corp. Code § 1110*; *see § 11C.132*].

2. Instruct shareholder to submit following to corporation's principal office (or office of any transfer agent) within 30 days after notice of approval by outstanding shares [*Corp. Code § 1301(a)*] or notice of effective date of short-form merger [*Corp. Code § 1110*] was mailed to shareholder [*Corp. Code § 1302*]:

NOTE:
On subsequent transfer of the dissenting shares on the corporation's books, the new certificates (or written statements for uncertificated securities) must bear a statement that the shares are dissenting shares, and the name of the original dissenting holder of the shares [*Corp. Code § 1302*].

a. For certificated securities, share certificates for all shares that shareholder demands that corporation purchase.

NOTE:
A "certificated security" is a share, participation, or other interest in property, an enterprise of the issuer, or an obligation of the issuer that is (1) represented by an instrument in bearer or registered form, (2) of a type commonly dealt in on securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment, and (3) one of a class or series, or by its terms divisible into a class or series, of shares, participations, interests, or obligations [*Corp. Code § 156.1*; *Com. Code § 8102(a)(4), (15)*]. The share certificates will be stamped or endorsed with a statement that the shares are dissenting shares, or exchanged for certificates of appropriate denomination that are stamped or endorsed with that statement [*Corp. Code § 1302*].

b. For uncertificated securities, notice of number of shares that shareholder demands that corporation

purchase.

NOTE:

An "uncertificated security" is a share, participation, or other interest in property or an enterprise of the issuer or an obligation of the issuer that is (1) not represented by an instrument and the transfer of which is registered on books maintained for that purpose by or on behalf of the issuer, (2) of a type commonly dealt in on securities exchanges or markets, and (3) either one of a class or series, or by its terms divisible into a class or series, of shares, participations, interests, or obligations [*Corp. Code § 191.1*; *Com. Code § 8102(a)(18)*].

3. If shareholder and corporation agree that shares are dissenting shares and agree on price of shares [*see § 11C.151[1]*], instruct shareholder to file any agreement fixing fair market value with corporate secretary [*Corp. Code § 1303(a)*].

NOTE:

The dissenting shareholder is entitled to the agreed price with interest thereon at the legal rate payable on judgments from the date of the agreement [*Corp. Code § 1303(a)*].

4. Regarding payment for shares, advise shareholder that [*Corp. Code § 1303(b)*; *see Corp. Code § 1306*]:

NOTE:

The following rules apply in the absence of any agreement to the contrary between the corporation and shareholder [*Corp. Code § 1303(b)*].

a. If corporation is able to make a "distribution to its shareholders" [*see Corp. Code § 166*], it must pay fair market value for shares:

NOTE:

The corporation must be able to pass the "retained earnings" or "remaining assets" and other balance sheet tests before making any distribution to its shareholders [*Corp. Code §§ 1303(b), 1306*; ***see*** Corp. Code§ 500(a)]. For further discussion of those tests, see the Legal Background to Ch. 9, ***Dividends, Reacquisitions of Shares, and Assessments.***

The distribution tests set forth in *Corp. Code § 500* do not apply to a corporation licensed as a broker-dealer [***see*** *Corp. Code § 25210 et seq.*] if the corporation, immediately after giving effect to any distribution, is in compliance with the net capital rules of the Commissioner of Corporations [***see*** *10 Cal. Code Reg. § 260.216.12*] and the Securities and Exchange Commission [*Corp. Code § 500(c)*; ***see*** *17 C.F.R. § 240.15c3-1*].

(1) Within later of following:

(a) 30 days after amount of fair market value has been agreed upon; or

(b) 30 days after any statutory or contractual conditions to reorganization are satisfied.

(2) After shareholder surrenders stock certificates, if securities are certificated.

b. If corporation cannot make "distribution to its shareholders" [*see Corp. Code § 166*], dissenting shareholder becomes creditor of corporation [*Corp. Code § 1306*]:

(1) For fair market value of shares with interest at legal rate on judgments until day of payment.

(2) Subordinate to all other creditors in any liquidation proceedings.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsFair Market ValueBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentMergersMergers & Acquisitions LawMergersRights of Dissenting ShareholdersMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
F. Procedural Guide for Dissenting Shareholders

5-11C California Legal Forms--Transaction Guide § 11C.152

§ 11C.152 Bringing Action to Enforce Payment

NOTE:
This section applies only when the corporation and shareholder cannot agree that shares are dissenting shares, or on the fair market value of the shares [*Corp. Code § 1304(b)*; ***see*** *§ 11C.151* (shareholder's demand for purchase)].

1. File complaint to enforce dissenting shareholder's rights [*Corp. Code § 1304*]:

NOTE:
Two or more dissenting shareholders may join as plaintiffs or be joined as defendants in the same action, and two or more actions by dissenting shareholders may be consolidated [*Corp. Code § 1304(b)*].

a. In superior court of [*Corp. Code §§ 177, 1304(a)*]:
(1) County where corporation's principal executive office is located; or

(2) Sacramento County if:
(a) Corporation's principal executive office is not located in California; or

(b) Corporation has no principal executive office.

b. Within six months after date that notice of approval of reorganization by outstanding shares [*see Corp. Code § 152*; *see also § 11C.122*] or notice of effective date of short-form merger [*see Corp. Code § 1110(h)*; *see also § 11C.132*] was mailed to shareholder.

c. Requesting court to determine [*Corp. Code § 1304(a)*]:

(1) Whether shares are dissenting shares;

(2) Fair market value of dissenting shares; or

(3) Both of above issues.

2. If action on complaint to enforce payment of dissenting shares is already pending, file intervention on behalf of shareholder [*Corp. Code § 1304(a)*].

NOTE:

For discussion and forms for intervention generally, see *California Forms of Pleading and Practice, Ch. 395, **Parties**, §§ 395.120-395.127* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentProceduresMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersRights of Dissenting Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
F. Procedural Guide for Dissenting Shareholders

5-11C California Legal Forms--Transaction Guide §§ 11C.153-11C.159

[Reserved]

§§ 11C.153[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
G. Related and Subsequent Procedures

5-11C California Legal Forms--Transaction Guide § 11C.160

§ 11C.160 Filing With County Recorder

NOTE:

The procedures in this section apply only to disappearing domestic or foreign corporations and disappearing domestic or foreign other business entities (limited partnerships, limited liability companies, or domestic reciprocal insurers organized after 1974 to provide medical malpractice insurance) [*Corp. Code §§ 165.5*, *167.3*, *167.7*, *167.8*, *171.03*, *171.05*, *171.07*, *171.5*, *174.5*] if (1) the corporation or entity owns real property located in California, and (2) the laws of the corporation's place of incorporation (or the laws of the other business entity's place of organization) provide substantially that the making and filing of an agreement of merger or consolidation or certificate of ownership or certificate of merger vests all of the real property of the disappearing corporation or other business entity in the survivor [*Corp. Code § 1109*; ***see*** *§ 11C.101* (determinations for foreign corporations)]. Domestic corporations are subject to such a provision [***see*** *Corp. Code § 1107(a)*].

1. File copy of either of following, certified by Secretary of State or an authorized public official of state or place pursuant to laws of which merger or consolidation is effected [*Corp. Code § 1109*], in county recorder's office in county where real property is located:

NOTE:

The filing evidences record ownership in the surviving or consolidated corporation or surviving other business entity of all interest of the disappearing corporation or other business entity in and to the real property located in that county [*Corp. Code § 1109*].

a. Merger or consolidation agreement;

b. Certificate of ownership or certificate of merger.

2. Pay recording fees [*see Gov. Code § 27361*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewReal Property LawPriorities & RecordingRecording Acts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
G. Related and Subsequent Procedures

5-11C California Legal Forms--Transaction Guide § 11C.161

§ 11C.161 Statutory Change in Ownership

NOTE:
This section applies only to the surviving corporation of a merger in which a statutory change in ownership has occurred [*Rev. & Tax. Code § 64(c)*; ***see*** *§ 11C.105*].

1. Prepare and file change in ownership statement [*Rev. & Tax. Code § 480.1*]:

a. Complete official form [*see Rev. & Tax. Code §§ 480.1, 480.2*].

NOTE:
The appropriate form may be obtained from the district office of the State Board of Equalization for the area in which the acquired corporation's real property is located. For discussion and an example of a change in ownership statement used for the transfer of real property [***see*** *Rev. & Tax. Code § 480*], ***see also*** *Ch. 23,* ***Real Property Sales Agreements****, § 23.204*.

b. Obtain signature of either [*Rev. & Tax. Code §§ 480.1(c), 480.2(c)*]:

(1) Officer of corporation; or

(2) Employee or agent designated in writing by board of directors to sign change in ownership statement on behalf of corporation.

c. File statement within 45 days from date of change in control with Sacramento office of State Board of Equalization [*Rev. & Tax. Code §§ 480.1(b), 480.2(b)*].

NOTE:

A change in ownership statement also must be filed whenever the State Board of Equalization makes a written request for that statement [*Rev. & Tax. Code §§ 480.1(b), 480.2(b)*].

2. Advise corporation that Board of Equalization will impose monetary penalty of 10 percent of taxes for [*Rev. & Tax. Code § 482(b)*]:

NOTE:

Rev. & Tax. Code § 64(e) establishes a procedure under which a corporation's tax return must indicate whether control was transferred or sold during the year. Changes are then reported to the State Board of Equalization. Apparently this is one source of information that is used as the basis for the issuance of a written request by the Board. By filing the statement within 45 days from the date of change in ownership, the corporation avoids incurring a penalty following a written request from the Board.

a. Failing to file statement within 45 days from earlier of:

(1) Date of change in control or change in ownership; or

(2) Date of written request by Board of Equalization.

b. Failing to file missing information after filing incomplete statement and receiving second request for information.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewReal Property LawPriorities & RecordingRecording ActsTax LawState & Local TaxesReal Property TaxAssessment & ValuationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
G. Related and Subsequent Procedures

5-11C California Legal Forms--Transaction Guide § 11C.162

§ 11C.162 Amending Merger Agreement

NOTE:

This section applies only to those mergers in which an agreement [***see*** *§ 11C.120*] has been filed with the Secretary of State [***see*** *Corp. Code § 1103*]. It does not apply to "short-form" mergers, which do not require merger agreements [***see*** *Corp. Code § 1110*; ***see also*** *§ 11C.130* et seq.]. An agreement that has been amended and approved will constitute the new agreement of merger [*Corp. Code § 1104*].

1. Obtain approval of board of directors [*Corp. Code § 1104*; *see § 11C.120*].

2. If amendment changes any principal terms of agreement and shareholder approval is required [*see Corp. Code §§ 1200, 1201*; *see also § 11C.120*], obtain approval of outstanding shares [*Corp. Code § 1104*; *see Corp. Code § 152* (approval of outstanding shares); *see also § 11C.122*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Directors & Officers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
G. Related and Subsequent Procedures

5-11C California Legal Forms--Transaction Guide § 11C.163

§ 11C.163 Referenced Agreements

1. If any terms of merger agreement [*see § 11C.120*] were made dependent on facts ascertainable outside agreement through reference to another document, instruct surviving corporation to [*Corp. Code § 109.5(b)*; *see Corp. Code § 1103*]:

a. Maintain copy of referenced document and all amendments at its principal executive office; and

b. Provide copy of referenced document and all amendments to shareholders of any constituent corporation upon written request, without charge.

2. If merger agreement [*see § 11C.120*] refers to contract to which corporation is party, instruct surviving corporation to obtain following approval for any amendment or revision of that contract [*Corp. Code § 109.5(c)*]:

NOTE:
The approval listed below must be obtained in addition to any approval that is otherwise required [*Corp. Code § 109.5(c)*].

a. Approval of outstanding shares of affected class or series, if amendment or revision would result in material change in rights, preferences, privileges, or restrictions of class or series of shares [*Corp. Code § 109.5(c)(1)*].

NOTE:
"Approval of the outstanding shares" means approval by the affirmative vote of a majority of the outstanding shares entitled to vote [*Corp. Code § 152*].

b. Approval of outstanding shares [*see Corp. Code § 152*] of affected class or series, if amendment or revision would result in material change in rights or liabilities of any class or series of shares with respect to following optional article provisions [*Corp. Code § 109.5(c)(2)*; *see* Ch. 3, *Articles of Incorporation*]:

(1) Provision regarding levy of assessments [*Corp. Code § 204(a)(1)*].

(2) Provision regarding preemptive rights to subscribe to any or all issues of shares or securities [*Corp. Code § 204(a)(2)*].

(3) Provision regarding special qualifications for shareholder status [*Corp. Code § 204(a)(3)*].

(4) Provision requiring larger vote for corporate action than required by law [*Corp. Code § 204(a)(5)*].

(5) Provision requiring approval of shareholders or outstanding shares for corporate actions, when approval is not required by law [*Corp. Code § 204(a)(9)*].

c. Approval of outstanding shares of affected class or series, if amendment or revision would result in material change in restrictions on transfer or hypothecation of any class or series of shares [*Corp. Code § 109.5(c)(3)*].

d. Approval required for change in principal terms of merger agreement [*see Corp. Code § 1104*; *see also § 11C.162*], if amendment or revision would result in change of any of principal terms of merger agreement [*Corp. Code § 109.5(c)(4)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeepingMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART III. TRANSACTION GUIDE
G. Related and Subsequent Procedures

5-11C California Legal Forms--Transaction Guide §§ 11C.164-11C.199

[Reserved]

§§ 11C.164[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
A. Merger Reorganizations Between Unrelated Corporations

5-11C California Legal Forms--Transaction Guide § 11C.200

§ 11C.200 Merger Agreement--General Form

[1] Comment

[a] Use of Form

This form is a general agreement for the merger of two corporations pursuant to the merger and reorganization requirements of California's General Corporation Law. The basic document to a merger of corporations is the agreement of merger [Cavitch, *Business Organizations with Tax Planning, Ch. 162, Mergers, § 162.02[1]* (Matthew Bender)]. The first step required by the General Corporation Law in California to effectuate a merger of two or more corporations is for the board of directors of each corporation to approve an agreement of merger [*Corp. Code § 1101*]. This form assumes that both the disappearing corporation and the surviving corporation have par value stock. In the event that one or both of the corporations does not have par value stock, the form should be modified accordingly. For a longer merger agreement containing a specific plan of reorganization for the merged corporations, see *§ 11C.201*.

[b] Parties to Agreement

The corporations constituent to the merger must be parties to the merger agreement; other parties, including a parent corporation [*see Corp. Code § 1200*], may be parties to the agreement [*Corp. Code § 1101*]. Each corporation must sign the agreement by its board chairman or president, or a vice-president and secretary or an assistant secretary acting on behalf of the corporation [*see Corp. Code § 1102*].

[c] Contents of Merger Agreement

A merger agreement under California law must state the following [*Corp. Code § 1101*]:

- The terms and conditions of the merger.

- The amendments, if any, to be made by the merger to the articles of incorporation of the surviving corporation.

- The name of each constituent corporation to the merger and which constituent corporation is to be the surviving corporation.

- The manner of converting shares of each corporation into shares of the surviving corporation.

For a more detailed discussion of these requirements, see *§ 11C.22[1], [3]*. For resolutions of the boards of directors of the surviving corporation and the disappearing corporation approving the merger agreement, see *§§ 11C.202*, *11C.203*. For a discussion of the manner in which the merger agreement must be approved by each corporation, see *§ 11C.22[4]*, *[5]*.

The merger agreement must also state the place of incorporation for each constituent corporation [*Corp. Code § 1101*].

Any of the terms of a merger agreement pursuant to *Corp. Code § 1101* may be made dependent on facts ascertainable outside that agreement, if the manner in which those facts will operate on the agreement terms is clearly and expressly set forth [*Corp. Code § 109.5*]. For further discussion, see *§ 11C.22[2]*.

[d] Amendment of Articles

Although amendment of the articles of the survivor may not be necessary in some cases, it is required whenever the merger results in a change that ordinarily would require an amendment to the articles [*see* Ch. 10, *Amendment of Articles*]. Thus, for example, substantial amendment would be required if a new class of stock or additional authorized stock for issuance in the exchange were necessary [*see § 6.01* of this form].

[2] FORM

Merger Agreement--General Form

AGREEMENT TO MERGE

_____ [*Name of disappearing corporation*] with and into _____ [*name of surviving corporation*] under the name of "_____"

_____[*Name*], hereinafter sometimes called _____, and
_____[*name*], hereinafter sometimes called _____, agree as follows:

ARTICLE 1 RECITALS OF CONSTITUENT CORPORATIONS

Disappearing Corporation

Section 1.01. _____[*Name of disappearing corporation*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of California [*or specify other state*].

Survivor

Section 1.02. _____[*Name of survivor*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of California [*or specify other state*].

Surviving Corporation

Section 1.03. _____[*full name of survivor corporation*] is to be the surviving corporation, as that term is defined in the General Corporation Law of California, to the merger described in this agreement.

ARTICLE 2 MERGER

Merger of Corporations

Section 2.01. _____[*Name of disappearing corporation*] shall be merged into _____[*full name of survivor corporation*] under the laws of the State of California [*or specify other state*].

ARTICLE 3 TERMS AND CONDITIONS

Negative Covenants

Section 3.01. Between the date of this agreement and the date on which the merger shall become effective, neither constituent corporation shall

(a) Declare or pay any dividends to its shareholders.

(b) Except in the normal course of business and for adequate value, dispose of any of its assets.

Further Assignments or Assurances

Section 3.02. If at any time the surviving corporation shall consider or be advised that any further assignments or assurances in law are necessary to vest or to perfect or to confirm of record in the surviving corporation the title to any property or rights of _____[*name of disappearing corporation*], or otherwise carry out the provisions hereof, the proper officers and directors of _____[*name of disappearing corporation*], as of the effective date of the merger, shall execute and deliver all proper deeds, assignments, confirmations, and assurances in law, and do all acts proper to vest, perfect, and confirm title to the property or rights in the surviving corporation, and otherwise carry out the provisions of this agreement.

ARTICLE 4 BASIS OF CONVERTING SHARES

Basis

Section 4.01. (a) At the effective date of the merger, each share of the common stock of the disappearing corporation of a par value of $_____ per share (other than shares held by disappearing corporation as treasury shares) shall be converted into _____[*number*] share(s) of common stock of the par value of $_____ per share of the surviving corporation. Each share of the _____[*e.g.*, 6 percent convertible preferred stock] of the disappearing corporation shall be converted into _____[*number*] share(s) of the _____[*e.g.*, 6 percent convertible preferred stock], $_____ par value, of the surviving corporation.

(b) No fractional shares of the common stock of the surviving corporation will be issued to the holders of the

common stock of the disappearing corporation, but holders who would otherwise be entitled to receive a fraction of a share of the common stock of the surviving corporation on the basis of the conversion provided for herein shall in lieu thereof receive a cash payment equal to the value of that fraction, based on the market value of the common stock of the disappearing corporation as of the effective date of the merger.

(c) Any shares of the disappearing corporation, common or preferred, held by the disappearing corporation in its treasury on the effective date of the merger shall be surrendered to the surviving corporation for cancellation.

Exchange

Section 4.02. Each holder of the shares of the disappearing corporation shall surrender his or her shares, properly endorsed, to the surviving corporation or its agent, and shall thereupon receive in exchange therefor a certificate or certificates representing the number of shares of the surviving corporation into which the shares of the disappearing corporation have been converted.

Shares of Survivor

Section 4.03. (a) The presently outstanding _____[*number*] shares of _____[*e.g.*, 6 percent convertible preferred stock] of _____[*survivor*], each of $_____ par value, shall remain outstanding as _____[*e.g.*, 6 percent convertible preferred stock], each of $_____ par value, of the surviving corporation.

(b) The presently outstanding _____[*number*] shares of common stock of _____[*name of survivor*], each of $_____ par value, shall remain outstanding as common stock, each of $_____ par value, of the surviving corporation.

ARTICLE 5 DIRECTORS

[*EITHER*]

Board of Survivor

Section 5.01. The present Board of Directors of _____[*name of survivor*] shall continue to serve as the Board of Directors of the surviving corporation until the next annual meeting or until such time as their successors have been elected and qualified.

[*OR*]

Revised Board

Section 5.01. The following named persons shall serve as the Board of Directors of the surviving corporation until the next annual meeting or until such time as their successors have been elected and have qualified: _____[*insert names of directors*].

[*Continue with the following:*]

ARTICLE 6 ARTICLES OF INCORPORATION

[*EITHER*]

Articles of Survivor

Section 6.01. The articles of _____[*name of survivor*], as existing on the effective date of the merger, shall continue in full force as the articles of the surviving corporation until altered, amended as provided therein, or as provided by law.

[*OR*]

Amended Articles

Section 6.01. (a) Article _____ of the articles of incorporation of _____[*name of survivor*] is amended to read as follows: _____[*set forth amended article in full*].

(b) Except as amended in subsection (a), the articles of incorporation of _____[*name of survivor*] shall continue in full force as the articles of the surviving corporation until further amended as provided therein or as provided by law.

[*OR*]

Full Statement

Section 6.01. The articles of incorporation of _____[*name of survivor*] shall read in their entirety as follows: _____[*set forth articles in full*].

[*Continue with the following:*]

ARTICLE 7 BYLAWS

Bylaws of Survivor

Section 7.01. The bylaws of _____[*name of survivor*], as existing on the effective date of the merger, shall continue in full force as the bylaws of the surviving corporation until altered, amended, or repealed as provided therein or as provided by law.

ARTICLE 8 INTERPRETATION AND ENFORCEMENT

Notices

Section 8.01. Any notice, request, demand, or other communication required or permitted hereunder shall be deemed to be properly given when deposited in the United States mail, postage prepaid, or when deposited with a public telegraph

company for transmittal, charges prepaid, addressed

(a) In the case of _____[*name of disappearing corporation*], to _____[*corporate name, name of officer concerned, street address, city, and state*] or to any other person or address as _____[*name of disappearing corporation*] may from time to time furnish to _____[*name of survivor*].

(b) In the case of _____[*name of survivor*], to _____[*corporate name, name of officer concerned, street address, city, and state*] or to any other person or address as _____[*name of survivor*] may from time to time furnish to _____[*name of disappearing corporation*].

Counterpart Executions

Section 8.02. This agreement may be executed in any number of counterparts, each of which shall be deemed an original.

Controlling Law

Section 8.03. The validity, interpretation, and performance of this agreement shall be controlled by and construed under the laws of the State of California [*or specify other state*], the state in which this agreement is being executed.

Executed on _____[*date*], at _____[*city and state*].

_____ [*name of disappearing corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]
_____ [*name of surviving corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
A. Merger Reorganizations Between Unrelated Corporations

5-11C California Legal Forms--Transaction Guide § 11C.201

§ 11C.201 Merger Agreement With Specific Detailed Plan of Reorganization

[1] Comment

[a] Use of Form

This form is a merger agreement, the basic document to a merger. It contains longer and more detailed provisions than the form in *§ 11C.200*. The purpose of the detailed provisions in this form is to focus on the specific plan of reorganization to be effected by the merger, and the merger date proposed by the parties. Setting forth the details contained in this form may be valuable in seeking compliance with the income tax provisions defining a statutory merger as a form of tax-free "reorganization" [*see § 11C.26*].

The constituent corporations must be parties to the merger agreement. Other persons, including a parent party corporation [*see Corp. Code § 1200*] may be parties to the agreement [*Corp. Code § 1101*]. For further discussion, see the comment to § 11C.200, which is also applicable to this form.

[b] Execution of Agreement

Each corporation must sign the agreement. The corporation's signature may be by its board chairman, president or a vice-president and secretary or an assistant secretary acting on behalf of the corporation [*see Corp. Code § 1102*].

[2] FORM

Merger Agreement With Specific Detailed Plan of Reorganization

AGREEMENT TO MERGE

_____ [*Name of disappearing corporation*] with and into _____ [*name of surviving corporation*] under the name of "_____"

_____[*Name*], hereinafter sometimes called _____, and _____[*name*], hereinafter sometimes called _____, agree as follows:

ARTICLE 1 PLAN OF REORGANIZATION

Plan Adopted

Section 1.01. A plan of reorganization of _____[*disappearing corporation*] and _____[*survivor*], pursuant to the provisions of Chapters 11 and 12 of the General Corporation Law of California[, Sections _____ of the _____ (*specific appropriate code of foreign state as relevant*),] and *Internal Revenue Code Section 368(a)(1)(A)*, is adopted as follows:

(a) _____[*name of disappearing corporation*] shall be merged with and into _____[*name of survivor*], to exist and be governed by the laws of the State of California [*or specify other state as appropriate*].

(b) The name of the surviving corporation shall be _____[*official name*].

(c) The separate existence of the constituent corporations shall cease and the surviving corporation shall succeed, without other transfer, to all the rights and property of each of the constituent corporations, and shall be subject to all the debts and liabilities of each, in the same manner as if the surviving corporation has itself incurred them. All rights of creditors and all liens upon the property of each constituent corporation shall be preserved unimpaired, limited in lien to the property affected by those liens immediately prior to the merger.

(d) The surviving corporation will carry on business with the assets of _____[*name of disappearing corporation*], as well as with the assets of _____[*name of survivor*].

(e) The shareholders of _____[*name of disappearing corporation*] will surrender all of their shares in the manner hereinafter set forth.

(f) In exchange for the shares of _____[*name of disappearing corporation*] surrendered by its shareholders, the surviving corporation will issue and transfer to those shareholders on the basis hereinafter set forth, shares of its convertible preferred [*or specify other class*] stock [*add if "boot" is included:* plus cash *or* warrants *or specify other*].

(g) The shareholders of _____[*name of disappearing corporation*], in the aggregate, will acquire stock of the surviving corporation equal in value to at least 50 [*or specify higher figure as appropriate*] percent of all of the outstanding stock of _____[*name of disappearing corporation*].

(h) [*Add as appropriate:* _____ (*name of survivor*) will amend its articles of incorporation as hereinafter set forth to provide for issuance of those shares of convertible preferred stock to be used in the exchange.]

(i) The shareholders of _____[*name of survivor*] will retain their shares as shares of the surviving corporation.

Effective Date

Section 1.02. The effective date of the merger shall be the date on which this agreement of merger with required

officers' certificates attached is filed with the California Secretary of State [*or specify other date when merger is pursuant to the laws of a foreign state*].

ARTICLE 2 RECITALS OF CONSTITUENT CORPORATIONS

Disappearing Corporation

Section 2.01. _____[*Name of disappearing corporation*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of California [*or specify other state*]. _____[*Name of disappearing corporation*] is qualified to transact business as a foreign corporation and is in good standing in all jurisdictions in which its principal properties are located [*or* is not required to be qualified as a foreign corporation to transact business in any other jurisdiction].

Survivor

Section 2.02. _____[*Name of survivor*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of California [*or specify other state*]. _____[*Name of survivor*] is qualified to transact business as a foreign corporation and is in good standing in all jurisdictions in which its principal properties are located [*or* is not required to be qualified as a foreign corporation to transact business in any other jurisdiction].

ARTICLE 3 TERMS AND CONDITIONS AND MODE OF CARRYING INTO EFFECT

Capital Structure

Section 3.01. The surviving corporation shall have two classes of shares, namely, _____[*number*] shares of _____[*e.g.*, 41/2 percent convertible preferred stock], and _____[*number*] shares of common stock.

Assets Contributed by Disappearing Corporation

Section 3.02 (a) _____[*Name of disappearing corporation*] shall contribute to the surviving corporation acceptable assets having a book value, over and above its liability to its creditors, of at least $_____, and having an estimated fair value, over and above its liability to its creditors, of at least $_____, or _____[*number*] percent of the estimated fair value of excess acceptable assets, over and above its liabilities to creditors of the surviving corporation, adjusted, however, for normal earnings and expenses between _____[*date*], and the effective date of the merger [and for allowance of cash payments, if any, permitted under this Agreement].

(b) The difference between the book value and the estimated fair value of the assets to be contributed shall be made up as follows: _____[*specify main items and dollar amounts that will make up the difference*].

Assets Held on Hand by Survivor

Section 3.03. (a) At the effective date of the merger, _____[*name of survivor*] shall have on hand assets having a book value of at least $_____, over and above its liability to creditors, and having a

fair value, over and above its liability to creditors, of at least $_____, or _____ percent of the estimated fair value of excess acceptable assets, over and above its liabilities to creditors of the surviving corporation, adjusted, however for normal earnings and expenses between _____[*date*], and the effective date of the merger [and for allowance of cash payments, if any, permitted under this agreement].

(b) The difference between the book value and fair value of excess acceptable assets, as set forth in subsection (a), is made up as follows: _____[*specify the main items and dollar amounts that make up the difference*].

Committee to Pass on Assets

Section 3.04. At the effective date of the merger, a committee of six Directors, three of whom shall be appointed by the Board of Directors of each constituent corporation, shall have satisfied themselves from the reports of accountants for each constituent corporation that the balance sheet of each constituent corporation, as of _____[*date*], fairly presents its financial condition and since that date there has been no material adverse change in the financial condition or business of either corporation.

Interim Conduct of Business; Limitations

Section 3.05. (a) Except as limited by subsection (b), pending consummation of the merger, each of the constituent corporations will carry on its business in substantially the same manner as heretofore and will use its best efforts to maintain its business organization intact, to retain its present employees, and to maintain its relationships with suppliers and others having business relationships with it.

(b) Except with the prior consent in writing of _____[*name of survivor*], pending consummation of the merger, _____[*name of disappearing corporation*] shall not do any of the following:

(1) Except for declaration and payment of a cash dividend on its common stock not exceeding $_____ per share, declare or pay any dividend or make any other distribution on its shares.

(2) Create or issue any indebtedness for borrowed money.

(3) Enter into any transaction other than those involved in carrying on its business in the usual manner.

Submission to Shareholders and Filing

Section 3.06. (a) This agreement shall be submitted separately to the shareholders of the constituent corporations in the manner provided by the laws of the State of California [and the state of _____] for approval.

(b) On approval of this agreement by the shareholders of the respective constituent corporations, provided (1) all required governmental approvals, permissions, and authorizations shall have been obtained; (2) no governmental action affecting the merger shall have been taken or shall be threatened; and (3) all conditions precedent to that filing shall have been satisfied, _____[*name of survivor*] shall promptly file this agreement in the office of the Secretary of State of California [and thereafter or concurrently in the office of the Secretary of State].

Expenses

Section 3.07. (a) If the merger is consummated, the surviving corporation shall pay all costs and expenses of the merger.

(b) If the merger is not consummated, each party to this agreement shall pay its own costs and expenses incident to the proposed merger.

Further Assignments or Assurances

Section 3.08. If at any time the surviving corporation shall consider or be advised that any further assignments or assurances in law are necessary to vest or to perfect or to confirm of record in the surviving corporation the title to any property or rights of _____[*name of disappearing corporation*], or otherwise carry out the provisions of this agreement, the proper officers and directors of _____[*name of disappearing corporation*], as of the effective date of the merger, shall execute and deliver all proper deeds, assignments, confirmations, and assurances in law, and do all acts proper to vest, perfect, and confirm title to that property or rights in the surviving corporation, and otherwise carry out the provisions of this agreement.

ARTICLE 4 MANNER AND BASIS OF CONVERTING SHARES

Manner

Section 4.01. The holders of shares of _____[*name of disappearing corporation*] shall surrender their shares to the Secretary of the surviving corporation [*or specify transfer agent as appropriate*] promptly after this agreement shall become effective, in exchange for shares of the surviving corporation to which they are entitled.

Basis

Section 4.02. (a) The shareholders of _____[*disappearing corporation*], in exchange for the excess acceptable assets contributed by their corporation to the surviving corporation, shall be entitled to receive _____[*number*] shares of _____[*e.g.*, 41/2 percent convertible preferred stock] of the surviving corporation, each of $_____ par value, being _____[*number*] percent of the total outstanding _____[*e.g.*, 41/2 percent convertible preferred stock] of the surviving corporation, to be distributed on the basis of _____[*e.g.*, one] share, each of $_____ par value, for each share of common stock of _____[*name of disappearing corporation*], each of $_____ par value, now held by them [and, in addition, shall be entitled to receive a cash payment *or* warrants *or specify other* of _____, to be distributed on the basis of _____ (*describe basis*)].

(b) [*Add as appropriate:* No fractional shares shall be issued, but each shareholder entitled to a fractional share shall receive a scrip certificate, expiring as of a fixed date, in any form as the directors may determine, evidencing the right to that fractional share, and full shares shall be issued as hereinafter provided in exchange for the surrender of that scrip certificates aggregating a full share or shares. The surviving corporation shall enter into an agreement with a named trustee and will issue to that trustee a stock certificate covering the aggregate of the fractional shares represented by the transferable scrip certificates issued and outstanding. That agreement shall provide

(1) During the life of the scrip certificates any individual acquiring a sufficient amount of fractions to equal one or more whole shares may exchange them through the trustee for stock certificates representing whole shares.

(2) After _____ (*date*), the expiration date of the scrip certificates, that portion of stock remaining in the hands of the trustee will be disposed of by him or her under sealed bids, following appropriate public notice or at a public auction, to the highest bidder or in any manner determined by the Board of Directors of the surviving corporation, but at not less than the market value on the date of sale, and the proceeds of sale shall then be distributed

pro rata to the holders of scrip certificates outstanding, not presented for exchange, upon surrender of them.]

Shares of Survivor

Section 4.03. (a) The presently outstanding _____[*number*] shares of _____[*e.g.*, 41/2 percent convertible preferred stock] of _____[*name of survivor*], each of $_____ par value, shall remain outstanding as _____[*e.g.*, 41/2 percent convertible preferred stock], each of $_____ par value, of the surviving corporation.

(b) The presently outstanding _____[*number*] shares of common stock of _____[*name of survivor*], each of $_____ par value, shall remain outstanding as common stock, each of $_____ par value, of the surviving corporation.

ARTICLE 5 DIRECTORS AND OFFICERS

[*EITHER*]

Directors and Officers of Survivor

Section 5.01. (a) The present Board of Directors of _____[*name of survivor*] shall continue to serve as the Board of Directors of the surviving corporation until the next annual meeting or until such time as their successors have been elected and qualified.

(b) If a vacancy shall exist on the Board of Directors of the surviving corporation on the effective date of the merger, that vacancy may be filled by the Board of Directors as provided in the bylaws of the surviving corporation.

(c) All persons who at the effective date of the merger shall be executive or administrative officers of _____[*name of survivor*], shall remain as officers of the surviving corporation until the Board of Directors of the surviving corporation shall otherwise determine. The Board of Directors of the surviving corporation may elect or appoint any additional officers as it may determine.

[*OR*]

Change in Directors and Officers

Section 5.01. The names of the directors and principal officers of the surviving corporation who shall hold office until the next annual meeting of the shareholders of the surviving corporation or until such time as their respective successors have been elected or appointed and qualified are

(a) Directors: _____[*names*].

(b) Officers: _____[*names and titles*].

[*Continue with the following:*]

ARTICLE 6 ARTICLES OF INCORPORATION

[*EITHER*]

Amended Articles

Section 6.01. (a) Article _____ of the articles of incorporation of _____[*name of survivor*] is amended to read as follows: _____[*set forth amended article in full*].

(b) Except as amended in subsection (a), the articles of incorporation of _____[*name of survivor*] shall continue in full force as the articles of the surviving corporation until further amended, altered, or repealed as provided therein or as provided by law.

[*OR*]

Full Statement

Section 6.01. The articles of incorporation of the surviving corporation shall read in their entirety as follows: _____[*set forth articles in full*].

[*OR*]

Articles of Survivor

Section 6.01. The articles of _____[*name of survivor*], as existing on the effective date of the merger, shall continue in full force as the articles of the surviving corporation until altered, amended, or repealed as provided therein or as provided by law.

[*Continue with the following:*]

ARTICLE 7 BYLAWS

Bylaws of Survivor

Section 7.01. The bylaws of _____[*name of survivor*], as existing on the effective date of the merger, shall continue in full force as the bylaws of the surviving corporation until altered, amended, or repealed as provided therein or as provided by law.

ARTICLE 8 TERMINATION

Circumstances

Section 8.01. This agreement may be terminated and the merger herein provided for may be abandoned at any time prior to the effective date of the merger, whether before or after shareholder approval, on occurrence of any of the following conditions:

(a) By mutual consent of the Boards of Directors of the constituent corporations.

(b) At the election of the Board of Directors of either constituent corporation if any of the following occur:

(1) The number of shareholders of either constituent corporation, or of both, dissenting from the merger shall be so large as to make the merger, in the opinion of either Board of Directors, inadvisable or undesirable.

(2) Any material litigation or proceeding shall be instituted or threatened against either of the constituent corporations, or any of its assets, which, in the opinion of either Board of Directors, renders the merger inadvisable or undesirable.

(3) Any legislation shall be enacted which, in the opinion of either Board of Directors, renders the merger inadvisable or undesirable.

(4) Between the date of this agreement and the effective date of the merger, there shall have been, in the opinion of either Board of Directors, any materially adverse change in the business or condition, financial or otherwise, of either constituent corporation.

(5) The Securities and Exchange Commission shall have disapproved the use of the "pooling of interests" basis in accounting for the merger.

(c) At the election of the Board of Directors of _____[*name of survivor*], if, without the prior consent in writing of _____[*name of survivor*], _____[*name of disappearing corporation*] does any of the following:

(1) Declared or paid a cash dividend on its common stock in excess of $_____ per share, or declared or paid any other dividend or made any other distribution on its shares.

(2) Created or issued any indebtedness for borrowed money.

(3) Entered into any transaction other than those involved in carrying on its business in the usual manner.

Notice of and Liability on Termination

Section 8.02. In the event an election is made to terminate this agreement and to abandon the merger provided for herein,

(a) The President or any Vice-President of the constituent corporation whose Board of Directors has made that election shall give written notice thereof to the other constituent corporation.

(b) On the giving of notice as provided in subsection (a), this agreement shall terminate and the proposed merger be abandoned and, except for payment of its own costs and expenses incident to this agreement, there shall be no liability on the part of either constituent corporation as a result of that termination and abandonment.

ARTICLE 9 INTERPRETATION AND ENFORCEMENT

Notices

Section 9.01. Any notice or other communication required or permitted hereunder shall be properly given when deposited in the United States mail for transmittal by certified or registered mail, postage prepaid, or when deposited

with a public telegraph company for transmittal, charges prepaid, addressed:

(a) In the case of _____[*name of disappearing corporation*], to _____[*corporate name, name of officer concerned, street address, city, and state*] or to any other person or address that _____[*name of disappearing corporation*] may from time to time furnish to _____[*name of survivor*].

(b) In the case of _____[*name of survivor*], to _____[*corporate name, name of officer concerned, street address, city, and state*] or to any other person or address that _____[*name of survivor*] may from time to time furnish to _____[*name of disappearing corporation*].

Entire Agreement; Counterparts

Section 9.02. This instrument and the attached exhibits contain the entire agreement between the parties with respect to the transaction contemplated. It may be executed in any number of counterparts, each of which shall be deemed an original, but those counterparts together constitute only one and the same instrument.

Controlling Law

Section 9.03. The validity, interpretation, and performance of this agreement shall be controlled by and construed under the laws of the State of California [*or specify other state*], the state in which this agreement is being executed.

Executed on _____[*date*], at _____[*city and state*].

_____ [*name of disappearing corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]
_____ [*name of surviving corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersDuties & Liabilities of Shareholders



California Legal Forms--Transaction Guide

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5-11C California Legal Forms--Transaction Guide § 11C.202

§ 11C.202 Resolution of Board of Directors of Surviving Corporation Approving Merger Agreement and Calling Special Shareholders' Meeting to Approve Merger

[1] Comment

[a] Use of Form

This form is a resolution that may be adopted by the board of directors of the surviving corporation to a proposed merger to approve the merger agreement. The resolution approves the merger agreement, calls a special meeting of the corporation's shareholders to approve the merger, and authorizes and directs the filing of an application for approval of the merger under the Corporate Securities Law of 1968. It may be used to approve the merger agreements set forth in *§§ 11C.200* and *11C.201*. The application to the California Corporations Commissioner for the permit approving the merger is set forth in *§ 11C.204*.

A resolution to be passed by the board of directors of the disappearing corporation approving the merger agreement and calling a special meeting of that corporation's shareholders to approve the merger is set forth in *§ 11C.203*.

For a discussion of the approval of a proposed merger required by the boards of directors and shareholders of the various corporations that are parties to the merger, see *§§ 11C.22[4]-[6]*. For a discussion of the method in which the merger agreement should be executed by corporate officers, see *§ 11C.22[8]*.

For general information relevant to the subject of corporate resolutions generally, see Ch. 5, *Directors Meetings, Actions, and Resolutions* .

[b] Purpose of Resolution

The first step specified by California's General Corporation Law for effectuating a merger is approval of a merger agreement by the boards of directors of the corporations wishing to merge [*Corp. Code § 1101*; *see* discussion in *§ 11C.22[4]*]. The approval of the merger agreement by the board of directors of a constituent corporation to a merger may be given either before or after the outstanding shares of each class of the corporation have approved the principal

terms of the proposed merger [*Corp. Code § 1201(g)*]. Traditionally and as a practical matter, however, the merger agreement is almost always approved by the board of directors of at least the surviving corporation to the proposed merger before it is submitted to the shareholders of that or any other constituent corporation to the merger for approval.

The Corporate Securities Law of 1968 requires that either a definitive permit or a negotiating permit for the shares that must be issued and transferred in the merger be obtained from the California Commissioner of Corporations before shareholder approval of the merger may be solicited [*Corp. Code §§ 25103(a), 25120-25122*]. An application for such a permit must be filed by the surviving corporation to the proposed merger [*Corp. Code §§ 25120, 25121*; *10 Cal. Code Reg. §§ 260.110, 260.121, 260.140.63*; *see § 11C.204*]. In turn, the filing of an application for such a permit normally must be authorized by the board of directors of the corporation for which it is filed.

This resolution authorizes the filing of an application for a permit from the California Corporations Commissioner approving the merger. It also calls a special meeting of the corporation's shareholders for the purpose of approving, as required by statute, the principal terms of the proposed merger [*Corp. Code § 1201(a)*]. The date of the proposed special shareholders' meeting should allow the Commissioner's staff time to examine the application for a permit and issue the permit.

[c] Call of Special Shareholders' Meeting--Notice and Call

With a few exceptions [*see § 11C.22[6]*], the principal terms of a proposed merger must be approved by the outstanding shares of each class of each corporation that is a party to the merger [*see § 11C.22[5]*]. Approval may be obtained either by vote of all outstanding shares at a meeting specially called for that purpose, or by obtaining the written consent to the merger of shareholders holding a majority of the shares of each class of the corporation [*Corp. Code § 603(a)*]. The resolution contained in this form proposes to obtain the required approval by the corporation's outstanding shares by a vote of the shares at a special shareholders' meeting called for that purpose. It therefore calls a special shareholders' meeting to approve the merger and sets a record date for that meeting.

Special meetings of the shareholders may be called by the board of directors, the chairman of the board of directors, or president of a corporation [*Corp. Code § 600(d)*]. They may also be called by holders of shares entitled to cast not less than 10 percent of the votes at the meeting and any additional persons specified in the corporation's bylaws or articles of incorporation [*Corp. Code § 600(d)*].

Notice of any meeting of shareholders at which the shareholders are required or permitted to take any action must be given to each shareholder entitled to vote at the meeting not more than 60 nor less than 10 days (or, if sent by third-class mail, 30 days) before the date of the meeting [*Corp. Code § 601(a)*]. The notice must be in writing and must state the place, date, and hour of the meeting. The notice must also state any means of electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication by which shareholders may participate in the meeting [*Corp. Code § 601(a)*]. In the case of a special meeting, the notice must state the general nature of the business to be transacted at the meeting. No other business than that described in the notice may be transacted at the meeting [*Corp. Code § 601(a)*]. Even when the notice is of the annual meeting of shareholders, approval by the outstanding shares of each class of the corporation of the principal terms of a merger at the meeting would be invalid unless the general nature of the proposal and the fact it would be presented for approval at the meeting were stated in the notice [*Corp. Code § 601(f)*].

The required notice of a shareholders' meeting must be given to each shareholder entitled to vote at the meeting either personally; by electronic transmission by the corporation [*see Corp. Code § 20*]; by first-class mail; in the case of a corporation with outstanding shares held of record by 500 or more persons [*see Corp. Code § 605*], on the record date for the shareholders' meeting, by third-class mail; or other means of written communication [*Corp. Code § 601(a), (b)*]. In the case of a proposed merger, this means the notice ordinarily must be given to every shareholder of the corporation because the merger must be approved by majority vote of the outstanding shares of each class regardless of limitation

on their voting rights [*see* discussion in *§ 11C.22[4], [5]*]. When the notice is given by mail or other means of written communication, it must be addressed to each shareholder at the address of the shareholder appearing on the books of the corporation or given by the shareholder to the corporation for purpose of notice [*Corp. Code § 601(b)*].

For further discussion of shareholder notices and meetings, see Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

[d] Fixing Record Date for Meeting

In order that a corporation may determine the shareholders entitled to notice of any meeting and the shareholders entitled to vote at the meeting, the board of directors of a corporation may fix a record date for the meeting [*Corp. Code § 701(a)*]. Except as otherwise provided by the corporation's articles of incorporation or by agreement, only those shareholders who are shareholders "at the close of business" on the record date are entitled to notice of and to vote at the meeting [*Corp. Code § 701(d)*]. A transferee of shares after the record date may have a right against his or her transferor to obtain the transferor's proxy to vote the transferred shares at the meeting but, without the proxy, he or she has no right, as against the corporation, to vote the transferred shares [*Corp. Code § 701(d)*].

The record date fixed by the corporation's board of directors must not be more than 60 nor less than 10 days prior to the date of the shareholders' meeting [*Corp. Code § 701(a)*]. When the corporation's board of directors fails to fix in advance a record date for a shareholders' meeting, the record date for the meeting is fixed automatically by statute in California. If no record date is fixed by the board of directors, the record date for determining shareholders entitled to notice of or to vote at a meeting of shareholders will be the close of business on the business day next preceding the day on which notice is given [*Corp. Code § 701(b)(1)*]. If notice of the meeting is waived, the record date is the close of business on the business day next preceding the day on which the meeting is held [*Corp. Code § 701(b)(1)*]. When given by mail, notice of a meeting of shareholders is deemed given when deposited in the mail [*Corp. Code § 601(b)*].

This resolution specifically fixes the close of business on a specified day as the record date for the shareholders meeting called by it. That date should be not more than 60 nor less than 10 days before the date set for the meeting [*Corp. Code § 701(a)*].

[2] FORM

Resolution of Board of Directors of Surviving Corporation Approving Merger Agreement and Calling Special Shareholders' Meeting to Approve Merger

RESOLUTIONS APPROVING MERGER AGREEMENT

Recital of Presentation of Merger Agreement

WHEREAS, a proposed Agreement of Merger providing for the statutory merger of _____[*name of disappearing corporation*] into this corporation has been presented to and discussed at this meeting; and

Recital That Merger Is in Best Interest of Corporation

WHEREAS, this Board of Directors deems it to be in the best interests of this corporation and its shareholders that the Agreement of Merger be approved and that _____[*name of disappearing corporation*] be merged into this corporation; be it

Approval of Merger Agreement

RESOLVED, that the terms and conditions of the proposed Agreement of Merger presented to this meeting and the mode of carrying them into effect as set forth in that agreement, as well as the manner and basis of converting the shares of the constituent corporations into shares of the surviving corporation as set forth in that agreement, are hereby approved.

Direction to Execute Merger Agreement

RESOLVED FURTHER, that the President [*or* a Vice-President] and the Secretary [*or* an Assistant Secretary] of this corporation are directed to execute and acknowledge the Agreement of Merger in the name and on behalf of this corporation and deliver a duly executed copy thereof to _____[*name of disappearing corporation*].

Call of Special Shareholders' Meeting

RESOLVED FURTHER, that a special meeting of the shareholders of this corporation is called for _____ M. on _____[*date*], at _____ Street, _____, California, for the purpose of considering and voting on the proposed Agreement of Merger.

Record Date for Shareholders' Meeting

RESOLVED FURTHER, that _____[*date*] is hereby fixed as the record date for determination of shareholders entitled to notice of and to vote at that meeting, and that only shareholders of record as of the close of business of this corporation on that day are entitled to notice of or to vote at that meeting.

Application for Securities Permit

RESOLVED FURTHER, that any officer of this corporation is authorized and directed to execute, verify, and file on behalf and in the name of this corporation applications with the Commissioner of Corporations of the State of California, including any amendments or supplements thereto that he or she may deem advisable, for any permits that may be required to authorize this corporation to submit the proposed Agreement of Merger to the shareholders of the constituent corporations for approval and, if approved by the shareholders in the manner required by the General Corporation Law of California to do any other acts that may be necessary or proper to carry out the terms and conditions of that agreement.

Authority to Perform Merger Agreement

RESOLVED FURTHER, that on receipt of the appropriate permits from the Commissioner of Corporations of the State of California and approval of the principal terms of the proposed Agreement of Merger by the shareholders of each constituent corporation in the manner required by the General Corporation Law of California, the officers of this corporation are directed to execute, acknowledge, file, and record those instruments and do any other acts in the name and on behalf of this corporation that may be necessary or proper to fully perform the terms and conditions of the Agreement of Merger.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingSpecial MeetingsMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
A. Merger Reorganizations Between Unrelated Corporations

5-11C California Legal Forms--Transaction Guide § 11C.203

§ 11C.203 Resolution of Board of Directors of Disappearing Corporation Approving Merger Agreement and Calling Special Shareholders' Meeting to Approve Merger

[1] Comment--Use of Form

This form is a resolution that may be adopted by the board of directors of a disappearing corporation to a proposed merger approving the merger agreement. For a resolution that may be adopted by the board of directors of the surviving corporation to a proposed merger approving the merger agreement, see *§ 11C.202*. Both resolutions approve the proposed merger agreement and call a special shareholders' meeting to approve the principal terms of the merger. They both fix a record date for the special shareholders' meeting. This resolution, however, does not direct and authorize the filing of an application with the Corporations Commissioner for a permit approving the merger. That action is normally taken by the surviving corporation and therefore is provided for in the resolution contained in § 11C.202 rather than this form.

For further discussion, see *§ 11C.202*. The discussion in that section is equally applicable to the resolution contained in this form.

[2] FORM

Resolution of Board of Directors of Disappearing Corporation Approving Merger Agreement and Calling Special Shareholders' Meeting to Approve Merger

RESOLUTIONS APPROVING MERGER AGREEMENT

Recital of Presentation of Merger Agreement

WHEREAS, a proposed Agreement of Merger providing for the statutory merger of this corporation into _____[*name of surviving corporation*] has been presented to and discussed at this meeting; and

Recital That Merger Is in Best Interests of Corporation

WHEREAS, this Board of Directors deems it to be in the best interests of this corporation and its shareholders that the Agreement of Merger be approved and this corporation merge with and into _____[*name of surviving corporation*]; be it

Approval of Merger Agreement

RESOLVED, that the terms and conditions of the proposed Agreement of Merger presented to this meeting and the mode of carrying them into effect as set forth in that agreement, as well as the manner and basis of converting the shares of the constituent corporations into shares of the surviving corporation as set forth in that agreement, are hereby approved.

Direction to Execute Merger Agreement

RESOLVED FURTHER, that the President [*or* a Vice-President] and the Secretary [*or* an Assistant Secretary] of this corporation are directed to execute and acknowledge the Agreement of Merger in the name and on behalf of this corporation and to deliver a duly executed copy to _____[*name of surviving corporation*].

Call of Special Shareholders' Meeting

RESOLVED FURTHER, that a special meeting of the shareholders of this corporation is called for _____ M. on _____[*date*], at _____ Street, _____, California for the purpose of considering and voting on the principal terms of the proposed merger.

Record Date for Shareholders' Meeting

RESOLVED FURTHER, that _____[*date*], is hereby fixed as the record date for determination of shareholders entitled to notice of and to vote at that meeting, and that only shareholders of record as of the close of business of this corporation on that day are entitled to notice of or to vote at the meeting.

Authority to Perform Merger Agreement

RESOLVED FURTHER, that if the shareholders of this corporation approve the principal terms of the proposed Agreement of Merger in the manner required by the General Corporation Law of California, the officers of this corporation are directed to execute, acknowledge, file, and record any instruments and do any other acts in the name and on behalf of the corporation that may be necessary or proper to fully perform the terms and conditions of the Agreement of Merger.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingSpecial MeetingsMergers & Acquisitions

LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
A. Merger Reorganizations Between Unrelated Corporations

5-11C California Legal Forms--Transaction Guide § 11C.204

§ 11C.204 Application to Commissioner of Corporations for Permit Qualifying Securities to Be Issued in Merger or Exchange of Shares for Assets of Another Corporation

[1] Comment

[a] Use of Form

This form sets forth the portion of the required application for a permit relevant to mergers and exchanges of shares for assets. The Corporate Securities Law of 1968 makes it unlawful to offer or sell in California any securities issued in connection with a merger or an exchange of shares for assets of another corporation unless the securities have been qualified by the California Commissioner of Corporations or are not subject to qualification [*Corp. Code § 25120*]. The securities are qualified by a permit issued by the Commissioner [*Corp. Code § 25121*]. The permit is issued only on application of the corporation that is to issue the securities, which in a merger is the surviving corporation [*Corp. Code § 25121*].

In addition to the material set forth in this form, a facing page is required for the application for a permit. An official printed form "facing page" is issued by the California Commissioner of Corporations and most often used on an application for a permit [*see Ch. 6H, Qualification of Securities, § 6H.200*].

[b] Transactions Covered by Form

Shares that are to be issued in exchange for shares held by shareholders of another corporation (an "exchange reorganization" under *Corp. Code § 181*) are treated differently under the Corporate Securities Law of 1968 than shares that are to be issued as part of a statutory merger or in exchange for the assets of another corporation.

Shares that are to be issued as part of a statutory merger or in exchange for the assets of another corporation are considered as being issued in a "recapitalization" or "reorganization" transaction [*Corp. Code § 25120*]. Thus, they are subject to special qualification requirements, and the exemptions therefrom, applicable only to "recapitalization" and "reorganization" transactions [*Corp. Code §§ 25103, 25120, 25121, 25133*]. Shares that are to be issued in an "exchange reorganization" [*see Corp. Code § 181*] are treated like an original issuance of shares and not a recapitalization or

reorganization transaction by the Corporate Securities Law of 1968 [Marsh & Volk, *Practice Under the California Securities Laws, § 7.06[5][c]* (Matthew Bender)]. Shares that are to be issued in exchange for shares of another corporation, in other words, must be qualified in the same manner as shares that are to be issued for cash [Marsh & Volk, *Practice Under the California Securities Laws, Ch. 7, Recapitalizations and Reorganizations, § 7.06[5][c]* (Matthew Bender)].

The material set forth in this form is that required on an application for qualification of securities to be issued in a recapitalization or reorganization transaction [10 Cal. Code Reg. § 260.121.1]. Thus, it is not applicable to and should not be included in an application for a permit qualifying shares that are to be issued in exchange for shares of another corporation. The material that must be included in an application for qualification of shares that are to be issued in exchange for shares of another corporation is the same as the material that must be included in an application for qualification of shares that are to be issued for cash. That material is set forth generally in Ch. 6H, *Qualification of Securities*.

Because the information required to qualify shares to be issued in a statutory merger and the information required to qualify shares to be issued in exchange for the assets of another corporation is the same, this form may be used for either type of transaction. It is set forth here and is not repeated in Ch. 11E, *Acquisition of Assets for Shares*.

[c] General Requirements

The management of each constituent corporation may negotiate and agree to the terms and conditions of a proposed merger, or a proposed acquisition of assets for securities prior to general solicitation of shareholder approval without obtaining a permit from the Commissioner of Corporations [*Corp. Code § 25103(a)*]. However, if the securities to be issued pursuant to the proposed merger or acquisition are to be received by persons having California addresses on the records of the corporation, and those persons hold 25 percent or more of the outstanding shares of any class, any of which are to be exchanged, it is unlawful for the issuing corporation to sell the securities, or even to offer them by soliciting shareholder approval of the merger or acquisition, without first qualifying the securities by obtaining a permit from the Commissioner of Corporations [*Corp. Code §§ 25103(c), 25120, 25121*]. Determination of whether 25 percent of the shares are held by persons having California addresses must be made as of the record date for determining shareholders entitled to vote on the merger or acquisition [*Corp. Code § 25103(d)*; *see § 11C.202*]. An additional exemption from the qualification by permit requirement exists for exchanges incident to mergers, consolidations, or sales of corporate assets in consideration of the issuance of stock that satisfy the requirements of the limited offering exemption, determined without regard to *Corp. Code § 25102(f)(3)*, which requires representation that purchaser is purchasing for own account, not for resale [*Corp. Code § 25103(h)*]. The requirements of this exemption are *set forth in § 11C.104*.

[d] Contents of Application

The application for qualification of a "recapitalization and reorganization" transaction by permit must contain both a facing page [*10 Cal. Code Reg. § 260.110*] and the information required by the Commissioner's regulations [*10 Cal. Code Reg. § 260.121*]. The facing page contains the first seven items of the application. The official printed application is reproduced in Ch. 6H, *Qualification of Securities*, § 6H.200.

This form sets forth all of a required application for qualification of a "reorganization" except the facing page. It begins with item 8 of the application and must be typed since the Commissioner's official form, Form 260.121 [*see Ch. 6H, Qualification of Securities, § 6H.250*], is merely a printed set of instructions for the information required in this part of the application. The item numbers and headings must be identical to those set forth in the instructions. If the information requested by any item is inapplicable, the item should be listed by number followed by the word "Inapplicable" [*10 Cal. Code Reg. § 260.121*]. The application must be signed and verified in the manner prescribed by the Code of Civil Procedure for the verification of pleadings [*Corp. Code § 25160*; *see Ch. 6H, Qualification of*

Securities, § 6H.245].

[e] Requirements for Issuance of Permit

The Commissioner requires that exchange of securities in the merger fairly reflect the relative values of the corporations that are parties to the plan of reorganization [*10 Cal. Code Reg. § 260.140.61*]. The Commissioner normally will not issue a negotiating permit in connection with a merger since any negotiations prior to solicitation of shareholder approval are exempt under *Corp. Code § 25103(a)* [*10 Cal. Code Reg. § 260.140.63*]. The definitive permit, however, may be conditioned upon obtaining an affirmative vote of a specified percentage of outstanding shares held by persons other than those who have a conflict of interest in connection with the adoption of the plan of merger [*10 Cal. Code Reg. §§ 260.140.63, 260.140.6*]. In an extraordinary case, the Commissioner may delay the issuance of a definitive permit until after the shareholders' vote, in which case, the Commissioner will issue a negotiating permit (with a separate application therefor and without payment of an additional fee) in order to qualify the solicitation of shareholder approval [*10 Cal. Code Reg. § 260.140.63*].

[f] Supplemental Filings and Incorporation by Reference

Any required information or exhibits not contained in the application when first filed may be submitted in a verified supplemental filing, at any time prior to final action on the application by the Commissioner [*Corp. Code § 25160*]. Any documents filed within four years prior to the filing of the application, or otherwise available in the files of the Commissioner, may be incorporated by reference in the application to the extent that the documents are currently accurate [*Corp. Code § 25161*].

[g] Public Hearings

The Commissioner is expressly authorized to hold a hearing to determine the fairness of the terms and conditions of any proposed transaction involving the issuance of securities in exchange for bona fide outstanding securities, claims, or property rights. When these hearings are held, all persons to whom it is proposed to issue securities have a right to appear [*Corp. Code § 25142*]. Based on current and past practices of the Commissioner, it may be anticipated that hearings will be held in connection with most mergers and acquisitions if stock in one or more of the corporations is publicly held [Ballantine & Sterling, California Corporation Laws, Ch. 21, *Corporate Securities* (Matthew Bender)].

[h] Collateral Jurisdiction

If a substantial number of the shareholders to whom the securities are to be issued reside in a jurisdiction other than California, it is possible that the proposed transaction comes within the scope of the securities law of that jurisdiction. In order to avoid future insurmountable complications, the possibility of collateral regulation should be determined by referring to the applicable law of any jurisdiction possibly involved in light of the particular facts of the proposed transaction.

[i] Fees

The fee for filing an application for this type of permit is $200, plus one-fifth of one percent of the value as alleged in the application, or the actual value as determined by the Commissioner, to be received in exchange for the securities up to a maximum aggregate fee of $2,500 [*Corp. Code § 25608(h)(2)*]. The fee should be paid at the time of the filing of the application since qualification cannot become effective until the fee has been paid [*Corp. Code § 25615*].

[2] FORM

Application to Commissioner of Corporations for Permit Qualifying Securities to Be Issued in Merger or Exchange of Shares for Assets of Another Corporation

ITEM 8. **DESCRIPTION OF PLAN**

_____[*Describe the material features of the plan of reorganization, the reasons for reorganization, the general effect upon the rights of existing security holders, the approximate number of shareholders of each corporation involved, the vote needed for its approval, the proposed date for the mailing of proxies, and the proposed date of the shareholders' meeting*].

ITEM 9. **EXECUTION OF PLAN**

_____[*Describe the method by which the plan described in Item 8 will be carried out, including the names of any broker-dealers or agents to be employed by each corporation in effecting purchases or sales of securities pursuant to the plan and the compensation to be paid those persons, or other consideration to be received by those persons or any other persons, in connection with the sale or purchase of securities*].

[*If agents (other than licensed broker-dealers) are to be employed by the applicant in connection with the distribution of securities in California pursuant to the plan, comply with 10 Cal. Code Reg. §§ 260.141.30, 260.141.31 by furnishing the following information:*]

a. _____[*Name and business address of each person who will represent the applicant as an agent in this state*].

b. _____[*Name and business address of the officer or other official who will supervise those agents on behalf of the applicant*].

c. _____[*Statement that all agents are employees of the applicant*].

d. _____[*Statement of the compensation to be paid to the agents, and a statement of the compensation to be paid to the supervisory personnel, other than their regular salaries if they are regular employees of the applicant*].

e. _____[*Description of any order, judgment, or decree of any governmental agency or administrator, or of any court of competent jurisdiction revoking or suspending for cause any license, permit, or other authority of an agent or supervisory person or of any corporation of which he or she is an officer or director, to engage in the securities business or in the sale of a particular security or temporarily or permanently restraining or enjoining that person or any corporation of which he or she is an officer or director from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting that person of any felony or misdemeanor involving a security or any aspect of the securities business, or of theft or of any felony*].

f. _____[*Statement that a surety bond complying with 10 Cal. Code Reg. § 260.216.15 is attached*].

ITEM 10. **DESCRIPTION OF BUSINESS**

_____[*Describe the business of the issuer and each other corporation involved in the transaction*].

ITEM 11. **DIVIDENDS IN ARREARS OR DEFAULTS**

_____[*Make a statement concerning any dividends in arrears or defaults in principal or interest in*

respect of any securities of the issuer and any other corporation involved in the transaction, and concerning the effect of the plan thereon].

ITEM 12. **HIGH AND LOW SALES PRICES WITHIN TWO YEARS**

_____[*As to each class of securities of the issuer and of each other corporation involved in the transaction that is admitted to trading on a securities exchange or with respect to which a market otherwise exists and that will be materially affected by the plan, state the high and low sale prices (or, in the absence of that information, the range of the bid prices) for each quarterly period within two years*].

ITEM 13. **DIRECTORS AND EXECUTIVE OFFICERS**

(a) _____[*List the names of all directors and officers of the issuer and of each other corporation involved in the transaction, indicating all positions and offices held by each person named*].

(b) _____[*Describe any order, judgment, or decree of any governmental agency or administrator, or of any court of competent jurisdiction revoking or suspending for cause any license, permit, or other authority of that person or of any corporation of which he or she is an officer or director, to engage in the securities business or in the sale of a particular security, or temporarily or permanently restraining or enjoining that person or any corporation of which he or she is an officer or director from engaging in or continuing any conduct, practice, or employment in connection with the purchase or sale of securities, or convicting that person of any felony or misdemeanor involving a security or any aspect of the securities business, or of theft or of any felony*].

ITEM 14. **PRINCIPAL HOLDERS OF SECURITIES**

_____[*State any material interest in the transaction of each person who, with respect to the issuer or any other corporation involved in the transaction, is a director or officer or person occupying a similar status or performing similar functions, or owns of record or beneficially (if known to the issuer) 10 percent or more of the outstanding shares of any class of equity securities, or is a promoter if the issuer of the other corporation was organized within the past three years. An interest of one of the specified persons which arises solely from the ownership of securities of only one of the corporations involved in the transaction is not a material interest if the specified person receives no extra or special benefit not shared on a pro rata basis by all holders of securities of that class*].

ITEM 15. **EXCHANGE RATIO**

_____[*State the basis of the ratio for the exchange of the securities of the issuer corporation for the securities of the constituent corporation(s)*].

ITEM 16. **EXHIBITS**

There are attached hereto as exhibits, if applicable, the following that are incorporated by reference:

[*For any exhibit that is inapplicable, list letter for exhibit followed by word "inapplicable":*]

A. With respect to the issuer and each other corporation involved in the transaction, the financial statements required by *Section 260.613 of Title 10 of the California Code of Regulations,* and pro forma financial statements giving

effect to the proposed transaction.

B. A copy of the plan of reorganization, including any request for delayed effectiveness of the filing of that document with the Secretary of State or similar authority.

C. Copies in restated or composite form of the current charter documents, as defined in *Section 260.001 of Title 10 of the California Code of Regulations*, of the issuer and of each constituent corporation involved in a merger or consolidation.

D. A copy of any contract made or to be made by the issuer affecting any of the rights, preferences, privileges, or transferability of the securities.

[*EITHER, if copy of shareholder's agreement affecting securities is available:*]

E. A copy of any agreement made or to be made by or among shareholders of the issuer which does or will materially affect any of the rights, preferences, privileges, or restrictions of or on securities of the issuer or the management of the issuer (including any voting agreement, irrevocable proxy, or shareholders' agreement).

[*OR, if no copy is available:*]

E. A statement of the fact that no copy of a shareholder's agreement that materially affects any of the rights, preferences, privileges, or restrictions of or on securities of the issuer or the management of the issuer (including any voting agreement, irrevocable proxy, or shareholders' agreement) is available, and a brief description of the agreement, including any information regarding the parties and terms as is known to the issuer.

[*Continue with the following:*]

F. A preliminary copy of the proxy material to be used to solicit the vote or consents of security holders [*add if applicable:* and the amended and final copies are submitted as supplemental information to the application], and the consent of any attorney, accountant, or other expert named in the proxy material in the form prescribed by *Section 260.504.2.2 of Title 10 of the California Code of Regulations* if the expert's consent is required pursuant to that section.

G. The Consent to Service of Process by *California Corporations Code Section 25165*.

H. A Customer Authorization of Disclosure of Financial Records Form.

ITEM 17. **REPORTS OF FINANCIAL CONDITION**

Pursuant to *Section 25146 of the California Corporations Code* and *Section 260.146 of Title 10 of the California Code of Regulations*, applicant hereby undertakes, as long as required under the above-named sections and subject to the exceptions therein contained, to file with the Commissioner (a) within 120 days after the end of each fiscal year a report of financial condition and a related statement of income and expenses covering that fiscal year; and (b) within 90 days after the first six months of each fiscal year, a like report and statement covering that six-month period.

The applicant has duly caused this application to be signed on its behalf by the undersigned, thereunto duly authorized.

_____ [*name of applicant*]
By _____ [*signature*]
[*typed name and title*]

I certify or declare under penalty of perjury under the laws of the state of California that I have read this application and the exhibits thereto and know the contents thereof, and that the statements therein are true and correct.

Executed at _____[*place*], on _____[*date*].

_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawMergersGeneral OverviewSecurities LawBlue Sky LawsSecurities Registration



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
A. Merger Reorganizations Between Unrelated Corporations

5-11C California Legal Forms--Transaction Guide § 11C.205

§ 11C.205 Notice to Shareholders of Special Meeting of Shareholders to Consider and Vote on Proposed Merger

[1] Comment

[a] Use of Form

This form is a notice to the shareholders of a special meeting regarding a proposed merger. The principal terms of a proposed merger must be approved by the outstanding shares of each class of each corporation a party to the proposed merger [*Corp. Code §§ 1200, 1201*; *see § 11C.22[4], [5]*]. The notice must state the place, date, and hour of the meeting, any means of electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication by which shareholders may participate in the meeting, and the general nature of the business to be transacted at the meeting [*Corp. Code § 601(a)*]. No business except that specified in the notice may be transacted at the special shareholders' meeting [*Corp. Code § 601(a)*]. If a proposed merger is approved at an annual meeting of shareholders, the approval will be invalid unless the notice given to shareholders of the meeting stated the general nature of the proposal and that it would be considered at the meeting [*Corp. Code § 601(a)*].

[b] Manner of Giving Notice of Special Meeting

Written notice of a shareholders' meeting must be given to each shareholder entitled to vote at the meeting [*Corp. Code § 601(a)*]. This means that when a proposed merger is to be voted on at a meeting, notice must be given to every corporate shareholder. The principal terms of a merger must be approved by the majority affirmative vote of the outstanding shares of each class of shares of the corporation, regardless of any limitations on their voting rights [*Corp. Code §§ 117, 1201(a)*; *see* discussion in *§ 11C.22[4], [5]*].

Notice of a shareholders' meeting must be given personally, or by electronic transmission by the corporation [*see Corp. Code § 20*], or by first-class mail, or by other means of written communication to each shareholder entitled to vote at the meeting [*Corp. Code § 601(a), (b)*]. The notice must be given no less than 10 or more than 60 days before the date of the meeting [*Corp. Code § 601(a)*]. If the corporation has 500 or more shareholders of record (as determined under *Corp. Code § 605*) as of the record date for the meeting, notice may be sent by third-class rather than first-class mail. However, in that case, notice must be sent not less than 30 days before the meeting [*Corp. Code § 601(a), (b)*]. If the

notice is given by mail or other means of written communication, it must be addressed to a shareholder at the address of the shareholder appearing on the books of the corporation or given to the corporation by the shareholder for the purpose of notice [*Corp. Code § 601(b)*]. The notice will be deemed to have been given when delivered personally, sent by electronic transmission by the corporation, deposited in the mail, or sent by other means of written communication [*Corp. Code § 601(b)*].

If no address for a shareholder appears on the books of the corporation or has been given by the shareholder to the corporation, the notice may be mailed to the shareholder at the place where the principal executive office of the corporation is located [*Corp. Code § 601(b)*]. As an alternative in that case, the notice may be given to the shareholder by publication at least once in a newspaper of general circulation in the county in which the principal executive office of the corporation is located [*Corp. Code § 601(b)*].

An affidavit of mailing or electronic transmission by the corporation of any notice executed by the secretary, assistant secretary, or transfer agent of a corporation is prima facie evidence of the giving of the notice [*Corp. Code § 601(b)*].

[c] Report by Independent Appraiser

If a tender offer (including a "share exchange tender offer" [*see Corp. Code § 183.5* (definition)] or a written proposal for approval of a "reorganization" [*see Corp. Code §§ 181(a), 1200*] or a sale of assets [*see Corp. Code § 1001(a)*] is made to some or all of a corporation's shareholders by a party to the transaction who has control of or a financial interest in that corporation (an "interested party proposal"), an affirmative opinion in writing regarding the fairness of the consideration to the shareholders of the corporation must be provided to the shareholders or the corporation. This requirement does not apply if the target corporation does not have shares held of record by 100 or more persons [*see Corp. Code § 605* (determination of shareholders of record)], or if the transaction has been qualified pursuant to *Corp. Code § 25113* or *Corp. Code § 25121* (qualification of issuer transaction by permit or qualification of recapitalization or reorganization by permit), and no stop order [*see Corp. Code §§ 25140, 25143(a)*] is in effect regarding that qualification [*Corp. Code § 1203(a)*]. If another person makes a subsequent tender offer or written proposal at least 10 days before the date for acceptance of the tendered shares or the vote or notice of shareholder approval on the interested party proposal, additional shareholder notification and withdrawal requirements apply [*see Corp. Code § 1203(b)*]. For further discussion of this requirement and related requirements when such a proposal is pending at the same time as another proposal for a reorganization [*see Corp. Code § 181* (definition)] or a short-form merger [*see Corp. Code § 1203(b)*], see Ch. 11, *Merger and Acquisition Issues* .

[2] FORM

Notice to Shareholders of Special Meeting of Shareholders to Consider and Vote on Proposed Merger

NOTICE OF SPECIAL MEETING OF SHAREHOLDERS

TO: Shareholders of _____[*name of corporation*]:

NOTICE IS HEREBY GIVEN that a special meeting of all shareholders of: _____[*name of corporation*] will be held at _____ Street, _____, California, on _____[*date*], at _____ M. for the purpose of

Considering and voting on the principal terms of a proposed merger between _____[*name*], a California corporation, and _____[*name*], a California corporation, which provides for

(1) The merger of _____[*name of disappearing corporation*] into _____[*name of surviving corporation*]; and

[*EITHER, if notice is to shareholders of disappearing corporation:*]

(2) The conversion of _____[*set forth conversion rate, e.g.,* each outstanding share of the common stock of this corporation into one-half share of the common stock of _____ (*name of surviving corporation*) and payment to the common shareholders of this corporation at the rate of $_____ per share of the value of any remaining fractional shares of _____ (*name of surviving corporation*) to which they are entitled].

[*OR, if notice is to shareholders of surviving corporation:*]

(2) The amendment of the articles of incorporation of this corporation to authorize it to issue _____[*number*] shares of its _____[common] stock in exchange for all outstanding shares of _____[*name of disappearing corporation*].

[*Continue with the following:*]

A statement of the general terms of the proposed merger is included in the accompanying proxy statement and the text thereof is set forth in full as Exhibit _____ attached to that proxy statement, reference to which should be made for further details.

Only shareholders of record at the close of business of this _____[*date*], are entitled to notice of and to vote at the meeting or at any adjournment thereof. Shareholders who do not expect to attend the meeting in person are requested to sign, date, and return the enclosed proxy in the enclosed envelope [which requires no postage to be affixed for mailing within the United States].

Date: _____.

_____ [*name of corporation*]
By Order of the Board of Directors
_____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingSpecial MeetingsMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
A. Merger Reorganizations Between Unrelated Corporations

5-11C California Legal Forms--Transaction Guide § 11C.206

§ 11C.206 Proxy Statement Soliciting Proxies for Shareholders' Meeting Called to Approve Merger

[1] Comment

[a] Use of Form

This form is a proxy statement soliciting proxies for a shareholders meeting called to approve a merger. The rules of the Commissioner of Corporations do not specify the contents of proxy statements soliciting proxies for shareholders' meetings called to approve mergers. However, Section 14(a) of the Federal Securities Exchange Act of 1934 [*15 U.S.C. § 78n(a)* makes it unlawful for any person to solicit any proxy in respect to any security, other than an exempted security, registered on any national securities exchange in contravention of SEC rules and regulations. Schedule 14A of the General Rules and Regulations, issued by the Securities and Exchange Commission under the Securities Exchange Act of 1934 [*17 C.F.R. § 240.14a-101*], specifies in detail what must be contained in a proxy statement soliciting holders of securities subject to the Act. Some of the required information is of general applicability, and provisions based on these general requirements are contained in this form with citations to the relevant Schedule 14A provisions. These general provisions may also be used in connection with securities not registered on any national exchange.

Schedule 14A also contains many detailed provisions that require extensive information tailored to the particular corporations involved in a specific merger. Because this information is so specific to each situation, no attempt has been made to draft provisions containing that information. Instead, references to these complex regulations are provided, and the attorney must consult the applicable regulations in order to complete this form. These matters should be set forth in simple narrative terms or, when required by the regulations, in appropriate tables.

In addition to the information provided in this form, Item 15 of Schedule 14A requires the following information: the financial statements required by Regulation S-X [*see 17 C.F.R. §§ 210.3-01-210.3A-08*], and the supplementary financial information requested by Item 12 of Regulation S-K [*17 C.F.R. §§ 229.302-229.304*].

The Commissioner requires that a preliminary copy of proxy material to be used to solicit the vote or consents of security holders accompany an application for a recapitalization or reorganization permit. These materials must be supplemented by amended and final copies of the proxies [*10 Cal. Code Reg. § 260.121*]. No materials designed to

solicit proxies or consents may be distributed without the prior filing of the proxy materials and the issuance of a permit [*10 Cal. Code Reg. § 260.140.60*]. Although the Commissioner's rules do not specify the contents of proxies, untrue statements of material facts or omissions of material facts necessary to avoid misleading the security holders are clearly prohibited [*Corp. Code § 25401*].

[b] Smaller Reporting Companies

Smaller reporting companies [*see 17 C.F.R. § 240.12b-2* (definition)] need not provide all of the information that other issuers must state in proxy statements under Schedule 14A. First, smaller reporting companies need not disclose all of the nonfinancial information that is required of other companies under Schedule 14A [*see 17 C.F.R. § 240.14a-101* (introductory note F); compare *17 C.F.R. § 228.10 et seq.* (Regulation S-B applicable to small business issuers) with *17 C.F.R. § 229.10 et seq.* (Regulation S-K applicable to other issuers)]. Second, smaller reporting companies are required to provide less financial information than is required of other companies [*see 17 C.F.R. § 240.14a-101* (introductory note F); compare *17 C.F.R. § 228.310* (Regulation S-B financial statement requirements applicable to smaller reporting companies) with *17 C.F.R. § 240.14a-101* (Schedule 14A)]. A smaller reporting company should modify the provisions of this form accordingly.

[2] FORM

Proxy Statement Soliciting Proxies for Shareholders' Meeting Called to Approve Merger

_____ [*Name of corporation in capital letters*]

PROXY STATEMENT FOR SPECIAL MEETING OF SHAREHOLDERS

_____ [*date of meeting*]

Purpose of Statement

[*17 C.F.R. § 240.14a-101, Item 1*]

This statement is furnished in connection with the solicitation of proxies by the management of _____[*name of corporation*], a California corporation, herein called "this corporation" or "_____" [*short title based on corporate name, e.g.,* "Western," "Columbia," *etc.*] for use at a special meeting of its shareholders to be held at the offices of this corporation in _____, California on _____[*date*], at _____[*time*], for the purposes set forth in the accompanying Notice of Special Meeting of Shareholders.

[*Unless otherwise disclosed in accompanying or preceding materials, add:* The principal executive offices of this corporation are located _____ (*complete mailing address*).]

[*If action will be taken by written consent, add:* Action at this special shareholders' meeting may be taken by written consent. Written consents must be submitted by _____ (*date*).]

Voting of Proxies

The shares represented by all properly executed proxies received by management in time for the meeting will be voted. When a shareholder has specified a choice by marking the ballot provided in the proxy, the shares represented by that proxy will be voted in accordance with the specification made. If no specification is made, those shares will be voted in favor of approval of the proposal.

No business can be considered at the meeting other than the proposal set forth in the accompanying notice of special meeting of shareholders.

Revocability of Proxies

[*17 C.F.R. § 240.14a-101, Item 2*]

The giving of a proxy does not preclude the right of the person giving the proxy to vote in person at the meeting should he or she so desire, because a proxy may be revoked at any time before its exercise either by delivery to this corporation of a written revocation of the proxy, or by a duly executed proxy bearing a later date, or by action of the shareholder taken at the meeting.

Voting Rights

[*17 C.F.R. § 240.14a-101, Item 6*]

At the close of business on _____[*record date fixed by board of directors, see §§ 11C.202, 11C.203*], there were outstanding _____[*number*] shares of common stock of this corporation [and _____ (*number*) shares of preferred stock of this corporation]. Each outstanding share of common stock [and each outstanding share of preferred stock] of this corporation is entitled to one vote on the matter to be considered at the meeting. Only shareholders of record at the close of business on _____[*record date*] will be entitled to vote at the meeting. [*Add if Schedule 14A is applicable, action is to be taken with respect to the election of directors, and the persons solicited have cumulative voting rights:* Shareholders of all classes have cumulative voting rights with respect to the election of directors and may exercise those rights either in person or by proxy. There are no conditions precedent to the exercise of the right to cumulate votes.]

Control Ownership

[*17 C.F.R. § 240.14a-101, Item 6*]

At the close of business on _____[*record date or most recent practicable date*], the persons or groups, so far as known to the persons on whose behalf this solicitation is made, who are the beneficial owners of more than 5 percent of any class of this corporation's voting securities are as follows:

Title of Class of Securities	Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class Owned
_____	_____	_____	_____
___	_____		_____%

_____	_____	_____	_____
___	_____		_____%
_____	_____	_____	_____
___	_____		_____%

[*If Schedule 14A is applicable, indicate (by footnote or otherwise) the amount of shares in the third column as to which there is a right to acquire beneficial ownership as specified in 17 C.F.R. § 240.13d-3(d)(1).*]

Shares Owned by Management

[*17 C.F.R. § 240.14a-101, Item 6*]

At the close of business on _____[*record date or most recent practicable date*], each class of voting securities of this corporation or any of its parents or subsidiaries, other than directors' qualifying shares, owned beneficially by all its directors and officers is as follows:

Title of Class of Securities	Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class Owned
_____	_____	_____	_____
___	_____		_____%
_____	_____	_____	_____
___	_____		_____%
_____	_____	_____	_____
___	_____		_____%

[*If Schedule 14A is applicable, indicate (by footnote or otherwise) the amount of shares in the third column as to which there is a right to acquire beneficial ownership as specified in 17 C.F.R. § 240.13d-3(d)(1).*]

Change of Control

[*17 C.F.R. § 240.14a-101, Item 6*]

There has not been a change in the control of this corporation to the knowledge of the persons on whose behalf this solicitation is made since the beginning of the last fiscal year of this corporation.

BUSINESS TO BE TRANSACTED AT THE MEETING

Consideration of Proposed Merger

The matter of business to be brought before the meeting will be a proposal to approve the principal terms of an Agreement of Merger already approved in separate meetings by the Boards of Directors of this corporation and _____[*name of other corporation*], a California corporation, herein called "_____" [*short title based on corporate name, e.g.,* "Eastern," "National," *etc.*]. By the terms of that agreement _____[*short title of disappearing corporation*] will be merged into _____[*short title of surviving corporation*]. The terms of that Agreement of Merger, information with respect to both corporations, and other matters related to the proposed merger are discussed elsewhere in this Proxy Statement. A copy of the Agreement of Merger is also attached and marked Exhibit _____, and any summary of its terms contained in this Proxy Statement is qualified by reference to the document itself. The approval of that Agreement of Merger by the directors of this corporation was _____[*set forth vote, e.g.,* by a vote of five to two of the directors present at the meeting; three directors being absent, *or* by unanimous vote of the directors present at the meeting; three directors being absent, all of whom had been polled prior to the meeting and had expressed their approval of the proposed merger and its terms]. There was no [dissent or] abstention from voting. The approval by the directors of _____[*short title of other corporation*] was _____[*set forth vote*].

Vote Required

[*17 C.F.R. § 240.14a-101, Item 21*]

[*EITHER*]

To perfect the proposed merger the principal terms of the merger must be approved by the affirmative vote of shareholders holding a majority of the outstanding shares of each class of shares issued by this corporation, regardless of the limitations or restrictions on the voting rights of any such class of shares.

In addition, to perfect the proposed merger, the principal terms of the merger must be approved by the affirmative vote of shareholders holding a majority of the outstanding shares of each class of shares issued by _____[*short title of other corporation*] regardless of any limitations or restrictions on the voting rights of any such class of shares.

[*OR, if other corporation is close corporation but surviving corporation is not a close corporation:*]

To perfect the proposed merger the principal terms of the merger must be approved by the affirmative vote of shareholders holding a majority of the outstanding shares of each class of shares issued by this corporation regardless of any limitations or restrictions on the voting rights of any class of shares.

In addition, to perfect the proposed merger, the principal terms of the merger must also be approved by the affirmative vote of shareholders holding at least two-thirds of each class of shares issued by _____[*name of disappearing corporation*], which is a close corporation, regardless of any limitations or restrictions on the voting rights of any such class of shares.

[*Continue with the following:*]

THE PROPOSED MERGER

[*17 C.F.R. § 240.14a-101, Item 14(a)*]

Reasons for Merger

Management favors adoption of the proposed Agreement of Merger for the following reasons: _____[*set forth reasons, e.g.:*]

The _____[*e.g.*, surviving] corporation is a major producer of_____[*specify type*] products in the growing western markets of the United States and the Pacific area and also produces and markets other products in twenty-three states, primarily in the western, southwestern, and southeastern areas of the United States. It is a growing organization with aggressive management operating on a profitable basis.

It is the opinion of management of this corporation that the proposed merger presents an excellent opportunity for this corporation's shareholders to obtain a desirable investment participation in new and growing markets for _____[*specify type*] products as well as additional products not produced or marketed by this corporation. Such a merger would result in the present shareholders of this corporation having an investment in a stronger financial structure available to meet changes brought on by increasing competitive conditions and technological advances in the industry.

Terms of Proposed Merger

The following is a statement of the general terms of the Agreement of Merger that will be submitted to the shareholders of this corporation at the special meeting. This statement does not purport to be complete and reference should be made to the Agreement of Merger attached as Exhibit _____ to this Proxy Statement for complete details of the merger.

On the filing of the Agreement of Merger in the office of the Secretary of State of California the merger will become effective and the corporate existence of _____[*name of disappearing corporation*] will terminate. _____[*name of surviving corporation*] will survive the merger and continue its corporate existence. The articles of incorporation of _____[*name of surviving corporation*] will remain unchanged except that Article _____ will be amended as set forth in Article _____ of the Agreement of Merger to _____[*set forth effect of amendment, e.g.*, increase the authorized number of shares of the corporation to _____ (*number*)].

[*EITHER*]

The directors and officers of _____[*name of surviving corporation*] on the effective date of the merger will continue in office.

[*OR*]

On the merger becoming effective, the Board of Directors of _____[*name of surviving corporation*] will be reconstituted to consist of the persons named in Article _____ of the Agreement of Merger, _____[*number*] of whom are now directors of _____[*name of disappearing corporation*], and _____[*name*], President of _____[*name of disappearing*

corporation] will become _____[*title, e.g.,* a Vice-President] of the surviving corporation.

[*Continue with the following:*]

Conversion of Shares

The merger will result in the conversion of _____[*set forth conversion rate, e.g.,* each outstanding share of _____ (*name of disappearing corporation*) into one share of _____ (*name of surviving corporation*)]. Certificates for shares of _____[*name of surviving corporation*] will be delivered by it on surrender of certificates for shares of _____[*name of disappearing corporation*]. Reference is made to Article _____ of the Agreement of Merger for a complete statement of the manner of converting shares of _____[*name of disappearing corporation*] into shares of _____[*name of surviving corporation*].

No officer or director of this corporation nor any associate thereof owns any shares of _____[*name of other corporation*], and no officer or director of _____[*name of other corporation*] nor any associate of that corporation owns any of the shares of this corporation.

Termination of Merger Agreement

The Agreement of Merger may be terminated and the merger abandoned at any time before the agreement is filed in the office of the California Secretary of State if any of the conditions specified in Articles _____ and _____ of the Agreement of Merger occur. Among the conditions which would allow the Agreement of Merger to be terminated and the merger abandoned are _____[*list more important conditions, see Article 8 of the form in § 11C.201*].

DESCRIPTION OF SURVIVING CORPORATION

[*Describe in detail the surviving corporation. If Schedule 14A is applicable, include the information required by Item 14(b) of Schedule 14A (17 C.F.R. § 240.14a-101).*]

DESCRIPTION OF DISAPPEARING CORPORATION

[*Describe in detail the disappearing corporation. If Schedule 14A is applicable, include the information required by Item 14(b) of Schedule 14A (17 C.F.R. § 240.14a-101).*]

[*Add, if Schedule 14A is applicable and action is to be taken with respect to the election of directors:*]

DIRECTORS OF SURVIVING CORPORATION

[*Set forth the information required by Items 7 and 8 of Schedule 14A (17 C.F.R. § 240.14a-101).*]

RIGHTS OF DISSENTING SHAREHOLDERS

Right to Fair Value of Shares

[*17 C.F.R. § 240.14a-101, Item 3*]

Any shareholder of this corporation who objects to the proposed merger, by following the procedures set forth in *Sections 1300 through 1312 of the California Corporations Code*, may demand that this corporation pay the shareholder the fair market value of those shares as of the day before the first day on which the terms of the proposed merger are announced, adjusted in accordance with the proposed merger, but adjusted for any stock split, reverse stock split, or share dividend that becomes effective thereafter.

[*If appraisal rights may only be exercised for a limited time after specified event, add:* This corporation _____ (will *or* will not) notify dissenting shareholders of the date on which _____ (*specify triggering event, e.g.*, the _____ (*identify*) proposal is adopted), from which date the time to exercise appraisal rights runs for _____ (*specify duration*)].

SOLICITATION OF PROXIES

[*17 C.F.R. § 240.14a-101, Item 4*]

The cost of soliciting proxies will be borne by this corporation. In addition to the use of the mails, proxies may be solicited personally, by telephone, or by telegram. This corporation has retained _____[*name of broker*], _____[*complete mailing address*], to aid in the solicitation of proxies and will pay that firm an amount estimated not to exceed $_____ for fees and expenses. Brokerage houses, custodians, nominees, and fiduciaries are requested to forward soliciting material to their principals and will be reimbursed by this corporation for their expenses.
Dated: _____.

_____ [*name of corporation*]
By Order of the Board of Directors
_____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
A. Merger Reorganizations Between Unrelated Corporations

5-11C California Legal Forms--Transaction Guide § 11C.207

§ 11C.207 Proxy From Shareholder Authorizing Vote for or Against Merger

[1] Comment

[a] Use of Form

This form is a proxy authorizing a vote for or against a proposed merger. It is drafted to conform with the requirements set forth in *17 C.F.R. § 240.14a-4* [*see* [b], *below*]. For a proxy statement that solicits proxies for a shareholders' meeting called to approve a merger, see *§ 11C.206*.

[b] Proxy Requirements

Rule 14A-4 of the General Rules and Regulations issued by the Securities and Exchange Commission [*17 C.F.R. § 240.14a-4*] under Section 14a of the Federal Securities Exchange Act of 1934 [*15 U.S.C. § 78n(a)*] specifies the requirements for a proxy that is to be used in respect to any security, other than an exempted security, registered on any national securities exchange. Among other things, such a proxy must [*17 C.F.R. § 240.14a-4(a)*]

- Indicate in boldface type whether or not the proxy is solicited on behalf of the corporation's board of directors, or, if provided other than by a majority of the board, must indicate in boldface type on whose behalf the solicitation is made (every individual member of the soliciting group need not be identified [*see 45 Fed. Reg. 76976]*);

- Provide a specifically designated blank space for its date; and

- Identify clearly and impartially each matter intended to be acted on with the proxy whether or not related to or conditioned on the approval of other matters, and whether proposed by the corporation or by security holders.

No reference need be made to proposals as to which discretionary authority is conferred [*17 C.F.R. § 240.14a-4(a)*]. Electronic filers must satisfy the requirements set forth in *17 C.F.R. § 240.14a-6* with respect to the form of proxy by

filing the form of proxy as an appendix at the end of the proxy statement. Forms of proxy should not be filed as exhibits or separate documents within an electronic submission [*17 C.F.R. § 240.14a-4(a)(3)*, Note].

The proxy must provide means whereby the person solicited is afforded an opportunity to specify by boxes a choice between approval or disapproval of, or abstention, with respect to each separate matter referred to in the proxy intended to be acted on, other than elections to office. A proxy may confer discretionary authority with respect to matters as to which a choice is not specified by the security holder, provided that the form of proxy states in boldface type how it is intended to vote the shares represented by the proxy in each such case [*17 C.F.R. § 240.14a-4(b)(1)*]. Such a proxy may confer discretionary voting power in the proxy holder to vote only on matters incident to the conduct of the meeting and certain other very limited matters specified in the regulations [*see 17 C.F.R. § 240.14a-4(c)*]. The proxy should also state that the shares represented by it will be voted in accordance with the choice specified in the ballot portion of the proxy by the shareholder and if no choice is indicated that the shares will be voted for the merger [*17 C.F.R. § 240.14a-4(e)*].

[2] FORM

Proxy From Shareholder Authorizing Vote for or Against Merger

PROXY

I, the undersigned, a shareholder of _____[*name of corporation*], herein called "the corporation," hereby appoint _____, and _____[*names*], and each of them, with full power of substitution and full power in each to act without the others, as my agents and proxies to vote at the special meeting of shareholders of the corporation to be held at _____ Street, _____, California on _____[*date*], at _____[*time*], or at any adjournment or adjournments of that meeting, all shares of the corporation which I would be entitled to vote if personally present at that meeting

For [ ] Against [ ] Abstain [ ]

approval of the Agreement of Merger between the corporation and _____[*name of other corporation*] dated _____, and any other actions that may be necessary or advisable to carry out the terms of that Agreement of Merger, and to vote in their discretion on any other matters that may legally come before that meeting or any adjournment or adjournments thereof.

I hereby acknowledge receipt of notice of that special meeting of shareholders together with a proxy statement containing a statement of the general terms of the proposed Agreement of Merger to be considered at that meeting.

THE SHARES REPRESENTED BY THIS PROXY SHALL BE VOTED IN ACCORDANCE WITH THE DIRECTIONS ABOVE SET FORTH, BUT IF NO DIRECTION IS INDICATED, THOSE SHARES WILL BE VOTED IN FAVOR OF THE AGREEMENT OF MERGER.
Dated: _____.

_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

This proxy is solicited by and on behalf of the board of directors [*or indicate in boldface type on*

Please sign your name exactly as it appears on your share certificates. If shares are owned by two or more persons, this proxy should be signed by each owner. Executors, administrators, trustees, guardians, and other fiduciaries should state their full title. If the shares are owned by a cor-

whose behalf the solicitation is made]. This proxy will not be used if you attend the meeting in person.	poration, the proxy should be signed by an authorized officer and the corporate seal affixed.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesProxy AgreementsMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
A. Merger Reorganizations Between Unrelated Corporations

5-11C California Legal Forms--Transaction Guide § 11C.208

§ 11C.208 Resolution of Shareholders Approving Principal Terms of Merger

[1] Comment--Use of Form

This form is a simple resolution that may be introduced at a shareholders' meeting called for the purpose of approving a merger. The principal terms of a merger must, with a few exceptions, be approved by the outstanding shares of each class of each corporation that is a party to the merger [*see § 11C.22[4], [5]*]. The resolution will be effective only when it is passed by the affirmative vote of a majority of the outstanding shares of each class of shares, regardless of voting rights, issued by the corporation.

For further discussion of the vote of shareholders, or written consent of shareholders, required for a merger, see *§ 11C.22[5]*. For the situations in which shareholder approval, or the approval of a particular class of shareholders, is not required for a merger, see *§ 11C.22[6]*.

[2] FORM

Resolution of Shareholders Approving Principal Terms of Merger

RESOLUTION

WHEREAS, an Agreement of Merger between _____[*name of other corporation*] and this corporation has been presented to this meeting[, dated _____, which has been approved by the Boards of Directors of this corporation and _____ (*name of other corporation*) and duly executed by the officers of both corporations in the manner required by *Section 1102 of the California Corporations Code*], and

WHEREAS, it is deemed in the best interests of the shareholders of this corporation that the terms and conditions of that agreement be approved and performed, be it

RESOLVED, that the principal terms of the proposed merger and the Agreement of Merger between this corporation and _____[*name of other corporation*] submitted to this meeting are approved in the form submitted.

RESOLVED FURTHER, that the Board of Directors and officers of this corporation are authorized on behalf of this corporation to take any actions and execute, acknowledge, verify, and file any documents that may be necessary or convenient to carry out and perform that Agreement of Merger.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Shareholders



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5-11C California Legal Forms--Transaction Guide § 11C.209

§ 11C.209 Resolution of Board of Directors of Constituent Corporation Abandoning Merger

[1] Comment

[a] Authority to Abandon

This form is a resolution of the board of directors of a constituent corporation abandoning a merger. The General Corporation Law provides that the directors of a corporation may, in their discretion, abandon a merger at any time before the merger has been completed, subject to the rights of third parties, without further action or approval by the shareholders of the corporation [*Corp. Code § 1105*]. The merger is not completed until the merger agreement, with attached officers' certificates of each constituent corporation, is accepted for filing by the Secretary of State [*see § 11C.22[9]*]. Consequently, until acceptance for filing, either party may abandon the merger [*see § 11C.22[8]*].

[b] Circumstances for Abandonment

Circumstances or grounds for abandonment are not required. The merger agreement is not recognized as effective until accepted for filing [*see Corp. Code §§ 1103, 1105*] and, therefore, neither party needs any legally prescribed ground or circumstance for its action. The directors of either corporation may act in their discretion [*Corp. Code § 1105*]. Obviously, a party reverses course and abandons a merger because there has been a material adverse change in the position, financial or otherwise, of the other party, or there has been a violation of an understanding the parties had or the like. It is usually not diplomatic or otherwise desirable to publicize that reason.

[2] FORM

Resolution of Board of Directors of Constituent Corporation Abandoning Merger

RESOLUTION

WHEREAS, at a special [*or* regular] meeting of the Board of Directors of this corporation duly held on _____[*date*], in the City of _____, State of _____, an Agreement of

Merger providing for the merger of this corporation with _____[*name of other corporation*], a California [*or specify other state*] corporation was presented, discussed, and approved; and

[WHEREAS, at a special (*or* regular) meeting of the shareholders of this corporation duly held on _____[*date*], in the City of _____, State of _____, the terms and conditions of the agreement were approved by the vote of the holders of not less than two-thirds of the issued and outstanding shares of each class, regardless of limitations or restrictions on the voting power thereof, entitled to vote at that meeting; and]

WHEREAS, the merger has not been completed; and

WHEREAS, the proposed merger has been discussed further at this meeting and the Board of Directors of this corporation deem it to be in the best interests of this corporation and its shareholders to abandon the merger; be it

RESOLVED, that subject to the rights of any third parties under any contracts relating thereto, the merger with _____[*name of other corporation*] is abandoned.

RESOLVED FURTHER, that the President or any Vice-President of this corporation is directed to give written notice to _____[*name of other corporation*] of abandonment of merger with that corporation.

RESOLVED FURTHER, that the Secretary of this corporation is directed to give notice in the manner that _____[he *or* she] deems advisable to the shareholders of this corporation of the adoption of these resolutions.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Directors & Officers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
A. Merger Reorganizations Between Unrelated Corporations

5-11C California Legal Forms--Transaction Guide § 11C.210

§ 11C.210 Officers' Certificate of Constituent Corporation Perfecting Merger--Certificate for Corporation Whose Shares Have Approved Merger

[1] Comment--Use of Form

This form is a basic officers' certificate to be executed by officers of a corporation whose shareholders have approved the merger agreement in the percentages required by the General Corporation Law of California. After a merger has been approved by the board of directors and outstanding shares of each class of each corporation that is a party to the merger, a copy of the merger agreement must be filed with the California Secretary of State to perfect the merger [*Corp. Code § 1103*]. An officers' certificate for each constituent corporation to the merger must be attached to the merger agreement filed with the Secretary of State. The certificate must state the matters required by statute showing the merger was approved by the outstanding shares of that corporation [*Corp. Code § 1103*; *see § 11C.22[9]*]. The officers' certificate must be signed and verified, either by affidavit or declaration under penalty of perjury by (1) the chairman of the board of directors, president, or a vice-president of the corporation, and (2) the secretary, chief financial officer, or an assistant secretary or assistant treasurer of the corporation [*Corp. Code §§ 173, 193*].

For an officers' certificate to be executed by officers of a corporation whose shareholders were not required to approve the merger agreement under provisions of the General Corporation Law, see § 11C.212. The certificate contained in either form, after being duly executed by the appropriate corporate officers, should be attached to an executed copy of the merger agreement for filing with the Secretary of State.

For further discussion of the shareholder approval of a merger required by the General Corporation Law in California, and when that shareholder approval is excused, see *§ 11C.22[5], [6]*. For a discussion of the required contents and use of the officers' certificate contained here and in § 11C.212, see *§ 11C.22[9]*.

[2] FORM

Officers' Certificate of Constituent Corporation Perfecting Merger--Certificate for Corporation Whose Shares Have Approved Merger

OFFICERS' CERTIFICATE OF MERGER FOR _____ [*name of corporation*]

We, the undersigned, do certify:

1. We are, and at all times herein mentioned, were the duly elected and qualified _____[Chairman of the Board of Directors *or* President *or* Vice-President] and _____[Secretary *or* Chief Financial Officer *or* Treasurer *or* Assistant Secretary *or* Assistant Treasurer of _____ [*name of corporation*], a corporation organized and existing under the laws of the State of California.

2. On _____[*date*], the principal terms of the merger agreement in the form attached were approved by that corporation by a vote of a number of shares of each class which equaled or exceeded the vote required, under the General Corporation Law of California, for approval of the principal terms of the merger described in the attached agreement by the outstanding shares of each class of that corporation.

3. The total number of outstanding shares of each class of that corporation entitled to vote on the merger was and is

_____ [*number*] Class A Preferred Shares
_____ [*number*] Class B Preferred Shares
_____ [*number*] Common Shares.

4. Each class of shares of that corporation entitled to vote on the merger agreement, the percentage vote required by each class, and the number and percentage of affirmative votes cast by each class is as follows:

Class	Percentage Votes Required	Affirmative Votes Cast	Percentage Vote Obtained
[*Fill out schedule, e.g.:*]			
Class A Preferred	50% plus 1	1,091	52%
Class B Preferred	50% plus 1	921	75%
Common	50% plus 1	8,599	99%

We declare under penalty of perjury that the foregoing matters stated in this certificate are true to our knowledge. Executed at _____, _____ County, California on _____[*date*].

_____ [*signature*]
[*typed name and title*]
_____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Directors & Officers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
A. Merger Reorganizations Between Unrelated Corporations

5-11C California Legal Forms--Transaction Guide § 11C.211

§ 11C.211 Officers' Certificate of Constituent Corporation Perfecting Merger--Certificate for Corporation Whose Shareholders Were Not Required to Approve Merger

[1] Comment--Use of Form

This form is an officers' certificate to be attached to the filed copy of the merger agreement for a corporation whose shareholders were not required to approve the merger. To perfect a merger, a copy of the merger agreement must be filed with the California Secretary of State. It must have attached an officers' certificate for each constituent corporation to the merger, showing that either (1) the merger was approved by the shareholders of that corporation, or (2) the merger was not required to be approved by the shareholders of the particular corporation [*Corp. Code § 1103*]. An officers' certificate for a corporation whose shareholders were required to and did approve the merger is set forth in *§ 11C.210*. The discussion in that section is also applicable to the officers' certificate contained in this form and should be read in connection with its use.

For a discussion of the shareholder approval of a merger required in California and under what conditions that approval is not needed, see *§ 11C.22[4]-[6]*. For a discussion of the required contents and use of the officers' certificate contained in this form, or the one contained in § 11C.210, see *§ 11C.22[9]*.

[2] FORM

Officers' Certificate of Constituent Corporation Perfecting Merger--Certificate for Corporation Whose Shareholders Were Not Required to Approve Merger

CERTIFICATE OF MERGER FOR _____ [*name of corporation*]

We, the undersigned, do certify:

1. We are, and at all times herein mentioned, were the duly elected or appointed and qualified _____[Chairman of the Board of Directors *or* President *or* Vice-President] and _____[Secretary *or* Chief Financial Officer *or* Treasurer *or* Assistant Secretary *or* Assistant Treasurer]

of _____[*name of corporation*], herein called "the corporation," a corporation duly organized and existing under the laws of the State of California;

2. On _____[*date*], the Board of Directors of the corporation approved the attached merger agreement.

3. The total number of outstanding shares of each class of the corporation entitled to vote on the merger described in the attached agreement of merger is _____[*number*] Common Shares

4. The merger agreement was entitled to be and was approved by the Board of Directors of the corporation alone under the provisions of *Section 1201 of the California Corporations Code* because shareholder of the corporation immediately prior to the merger shall own, immediately after the merger, equity securities other than warrant or right to subscribe or purchase equity securities of the surviving corporation possessing more than five-sixth of the voting power of the surviving corporation, to wit: _____[*specify, e.g.*, the shareholders of the corporation immediately before the merger will immediately after the merger own 3,969 of the 3,975 outstanding voting shares of the surviving corporation].

We declare under penalty of perjury that the foregoing is true and correct of our own knowledge. Executed at _____ County, California on _____[*date*].

_____ [*signature*]
[*typed name and title*]
_____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
A. Merger Reorganizations Between Unrelated Corporations

5-11C California Legal Forms--Transaction Guide §§ 11C.212-11C.299

[Reserved]

§§ 11C.212[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
B. Short-Form Mergers

5-11C California Legal Forms--Transaction Guide § 11C.300

§ 11C.300 Resolution by Board of Directors of Parent Corporation for Short-Form Merger of Subsidiary Into Parent--Wholly Owned Subsidiary

[1] Comment--Use of Form

This form is the resolution required for the short-form merger of a wholly owned subsidiary into a parent corporation. A "short-form merger" is a term used in California's General Corporation Law to describe the abbreviated procedure authorized by that law for the merger of wholly owned and 90%-owned subsidiary corporations into their parent corporation [*Corp. Code §§ 187, 1110*]. The California General Corporation Law authorizes two types of short-form mergers: the merger of wholly owned subsidiaries and the merger of 90 percent or more owned subsidiaries. The resolutions required to effect a short-form merger of a 90 percent or more owned subsidiary into its parent corporation are *set forth in §§ 11C.301, 11C.302*.

California's General Corporation Law additionally provides for the short-term merger of a parent corporation into its wholly owned subsidiary [*see Corp. Code § 1110(a)*]. Together with the provision *set forth in § 11C.302*, this form can be adapted to provide for a merger of a parent corporation into its wholly owned subsidiary.

The only resolution or approval required to merge a wholly owned subsidiary into a parent corporation is a resolution by the board of directors of the parent corporation providing for the merger and providing the parent corporation assumes all the liabilities of the subsidiary [*Corp. Code § 1110(a)*]. The resolution, in addition, may change the name of the parent corporation to a new name which may be the same as or similar to the name of the disappearing subsidiary corporation [*Corp. Code § 1110(d)*].

For further discussion of the resolution required for a short-form merger of a subsidiary into its parent corporation, see *§ 11C.29*.

[2] FORM

Resolution by Board of Directors of Parent Corporation for Short-Form Merger of Subsidiary Into Parent--Wholly Owned Subsidiary

RESOLUTION

WHEREAS, this corporation owns 100 percent of the outstanding shares of _____[*name of disappearing corporation*], a California corporation; and

WHEREAS, it is deemed in the best interest of this corporation to effect a merger of _____[*name of disappearing corporation*] into this corporation; now, therefore, it is

RESOLVED, that _____[*name of disappearing corporation*] be merged into this corporation pursuant to *Section 1110 of the California Corporations Code* and

RESOLVED FURTHER, that the officers of this corporation are hereby directed to do all acts and to execute, verify, and file all documents necessary to effectuate the merger into this corporation pursuant to *Section 1110 of the California Corporations Code* of _____[*name of disappearing corporation*]; and

RESOLVED FURTHER, that this corporation hereby assumes all the liabilities of _____[*name of disappearing corporation*]; and

RESOLVED FURTHER, that Article 1 of the Articles of Incorporation of this corporation are hereby amended to change the name of this corporation to the name of _____[*name of disappearing corporation*] and to read as amended:

"ARTICLE 1

The name of this corporation is _____[*name of disappearing corporation*]."

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
B. Short-Form Mergers

5-11C California Legal Forms--Transaction Guide § 11C.301

§ 11C.301 Resolution by Board of Directors for Short-Form Merger of Subsidiary Into Parent Corporation--90-Percent-Owned Subsidiary

[1] Comment

[a] Use of Form

This form is a resolution to be adopted by the board of directors of the parent corporation and of each disappearing subsidiary for the short-form merger of a subsidiary corporation into its parent, when the parent owns less than all but at least 90 percent of the outstanding shares of each class of the subsidiary [*see Corp. Code § 1110(a)*, *(b)*]. A "short-form merger" is a term used to describe the abbreviated procedure authorized by the General Corporation Law for the merger of wholly owned or at least 90-percent-owned subsidiary corporations into their parent corporation, or the merger of a parent corporation into its wholly owned or 90-percent-owned subsidiary [*Corp. Code §§ 187*, *1110*; *see Corp. Code § 1110(a)*]. These types of mergers are effected by the adoption and approval of a resolution or plan of merger by the board of the parent corporation, the approval of the resolution or plan by the board of the subsidiary, and the filing of a certificate of ownership [*Corp. Code § 1110(a)*; *see Corp. Code § 1110(e)*; *see also § 11C.303*]. The subsidiary corporation may be either domestic or foreign [*Corp. Code § 1110(a)*].

In this situation, the resolution must provide for the merger, provide that the surviving corporation assumes all the liabilities of each disappearing corporation, and set forth the securities, cash, property, or rights to be issued paid, delivered, or granted on surrender of each outstanding share of the subsidiary corporation that is not owned by the parent [*Corp. Code § 1110(b)*]. In this resolution, the consideration is specified as a fixed amount per share in cash.

For further discussion of the requirements of a short-form merger with a 90-percent-owned subsidiary, see *§ 11C.29*.

[b] Merger of 90-Percent-Owned Subsidiary Into Parent

California's General Corporation additionally provides for the short-form merger of a parent corporation into a wholly owned or 90-percent-owned subsidiary [*see Corp. Code § 1110(a)- (c)*]. Mergers of parent corporations into wholly owned or 90-percent-owned subsidiaries are discussed in *§ 11C.302*. Together with the provision set forth in that form,

this form can be adapted to provide for a merger of a parent corporation into a 90-percent-owned subsidiary. Similarly, the *form in § 11C.300*, which is a resolution for the merger of a wholly owned subsidiary into a parent corporation, can be adapted to provide for the merger of a parent corporation into its wholly owned subsidiary.

[2] FORM

Resolution by Board of Directors for Short-Form Merger of Subsidiary Into Parent Corporation--90-Percent-Owned Subsidiary

RESOLUTION OF MERGER

WHEREAS, _____[*name of parent corporation*], a California corporation, owns at least 90 percent of the outstanding shares of each class of _____[*name of subsidiary corporation*].

RESOLVED, that _____[*name of subsidiary corporation*] be merged into _____[*name of parent corporation*] pursuant to *Corporations Code Section 1110*; and

RESOLVED FURTHER, that the officers of _____[*name of subsidiary corporation*] and the officers of _____[*name of parent corporation*] are authorized and directed to do all acts and to execute, verify, and file all documents necessary to effectuate the merger pursuant to *Corporations Code Section 1110*; and

RESOLVED FURTHER, that _____[*name of parent corporation*] assumes all liabilities of _____[*name of subsidiary corporation*]; and

RESOLVED FURTHER, that on surrender of each share of _____[*name of subsidiary corporation*] not owned by _____[*name of parent corporation*] the holder of that share will be paid by _____[*name of parent corporation*] the sum of $_____ cash in lawful money of the United States; and

RESOLVED FURTHER, that the Board of Directors of _____[*name of parent corporation*] adopts and approves this resolution of merger; and

RESOLVED FURTHER, that the Board of Directors of _____[*name of subsidiary corporation*] approves this resolution of merger and the consideration stated above to be received for each share of _____[*name of subsidiary corporation*] not owned by _____[*name of parent corporation*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
B. Short-Form Mergers

5-11C California Legal Forms--Transaction Guide § 11C.302

§ 11C.302 Additional Provision for Short-Form Merger of Parent Into Subsidiary

[1] Comment--Use of Form

This form is a provision stating a ratio for converting shares of the disappearing parent into shares of the surviving subsidiary. California's General Corporation provides for the short-term merger of a parent corporation into a wholly owned or 90-percent-owned subsidiary [*see Corp. Code § 1110(a)- (c)*]. When a parent corporation is to be merged into one of its subsidiary corporations (and any other subsidiary corporation or corporations), the resolution or plan of merger must provide for the pro rata conversion of the outstanding shares of the parent corporation into shares of the surviving subsidiary [*Corp. Code § 1110(c)*].

This form can be added to § 11C.300 (wholly owned subsidiaries) or § 11C.301 (90-percent-owned subsidiaries) in order to effectuate an upside-down merger. Both §§ 11C.300 and 11C.301 are drafted to provide for the merger of a subsidiary into its parent, and the terminology will need to be adapted in order to provide for the merger of a parent corporation into a subsidiary corporation.

When a parent is being merged into a subsidiary, the entire resolution or plan of merger must be approved by the board of the surviving subsidiary [*Corp. Code § 1110(c)*]. If the merger would constitute a merger reorganization [*see Corp. Code § 181(a)*] but for the operation of the short-form merger statute [*see Corp. Code § 1110*], so that the principal terms of the merger would have to be approved by the outstanding shares of any class of the parent corporation [*see Corp. Code §§ 152, 1201(d)*; *see § 11C.22[5]*, then the principal terms of the resolution or plan of merger must be approved by the outstanding shares of that same class of the parent corporation [*Corp. Code § 1110(c)*].

For further discussion of short-form mergers, including short-form mergers of parent corporations into their subsidiaries, see *§ 11C.29*.

[2] FORM

Additional Provision for Short-Form Merger of Parent Into Subsidiary

[*EITHER, if the subsidiary is wholly owned by the parent corporation:*]

RESOLVED FURTHER, that the outstanding shares of _____[*name of parent corporation*] will be converted into shares of _____[*name of subsidiary corporation*] according to the ratio of _____[*specify pro rata conversion ratio*]; and

[*OR, if the subsidiary is at least 90 percent owned by the parent corporation:*]

RESOLVED FURTHER, that the outstanding shares of _____[*name of parent corporation*] will be converted into shares of _____[*name of subsidiary corporation*] according to the ratio of _____[*specify pro rata conversion ratio*].

[*Continue with the following:*]

RESOLVED FURTHER, that the Board of Directors of _____[*name of subsidiary corporation*] approves this resolution of merger.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
B. Short-Form Mergers

5-11C California Legal Forms--Transaction Guide § 11C.303

§ 11C.303 Certificate of Ownership Merging Wholly Owned Subsidiary Into Parent Corporation

[1] Comment

[a] Use of Form

This form is a certificate of ownership perfecting the short-form merger of a wholly owned subsidiary into its parent corporation. A short-form merger is perfected under California's General Corporation Law by the filing of a "certificate of ownership" with the California Secretary of State [*Corp. Code § 1110(e)*].

This form may be adapted when a subsidiary at least 90 percent owned is being merged into its parent. In that case, Paragraph 1 of this form should be modified to state that the parent owns a given percentage, not less than 90 percent, of all the outstanding shares of each class of the subsidiary, and a copy of the resolution approved by the board of directors of the subsidiary relating to the short-form merger should also be set forth in the certificate [*Corp. Code § 1110(e); see § 11C.301*]. For discussion of mergers of parent corporations into subsidiaries, see [c], *below*.

[b] Officers' Certificate

The certificate of ownership must be a certificate of officers of the parent corporation [*Corp. Code § 1110(e)*]. An "officers' certificate" is a certificate signed and verified by either the chairman of the board of directors, president, or vice-president, as well as either the secretary, assistant secretary, chief financial officer, treasurer, or assistant treasurer [*see Corp. Code § 173*]. It must identify the parent and subsidiary corporation or corporations, set forth the share ownership by the parent corporation of each subsidiary as 100 percent of the outstanding shares or at least 90 percent of the outstanding shares of each class, set forth the resolution or plan of merger, set forth the approval of the resolution or plan of merger by the board of the parent corporation, and set forth any other required approvals of the resolution or plan of merger [*Corp. Code § 1110(e)*].

For further discussion of the requirements of the certificate of ownership required to perfect a short-form merger, see *§ 11C.29[3]*. For the resolution needed for a short-form merger of a wholly owned subsidiary, see *§ 11C.300*. A resolution for a short-form merger of a 90-percent-owned subsidiary into a parent corporation is *set forth in § 11C.301*.

A provision regarding mergers of parent corporations into wholly owned or 90-percent-owned subsidiaries is *set forth in § 11C.302*.

[c] Merger of Wholly Owned or 90-Percent-Owned Subsidiary Into Parent

California's General Corporation Law additionally provides for the short-term merger of a parent corporation into a wholly owned or 90-percent-owned subsidiary [*see Corp. Code § 1110(a)- (c)*]. Mergers of parent corporations into wholly owned or 90-percent-owned subsidiaries are effected by the adoption and approval of a resolution or plan of merger and the filing of a certificate of ownership [*Corp. Code § 1110(a), (c)*]. This form can be adapted for use in a upside-down merger.

[2] FORM

Certificate of Ownership Merging Wholly Owned Subsidiary Into Parent Corporation

CERTIFICATE OF OWNERSHIP MERGING _____ [*name of subsidiary*] INTO _____ [*name of parent*]

_____[*Name of officer*], _____[*specify title, e.g.*, Chairman of the Board *or* President *or* Vice-President], and _____[*name of officer*], _____[*title, either:* Secretary *or* Assistant Secretary *or* Chief Financial Officer *or* Treasurer *or* Assistant Treasurer] of _____[*name of parent corporation*], a California Corporation, certify that:

1. _____[*Name of parent corporation*] owns all the outstanding stock of _____[*name of subsidiary*], a corporation duly incorporated on _____[*date*], under the laws of the State of _____.

2. The following resolutions were adopted by a majority of the Board of Directors of _____[*name of parent corporation*]:

WHEREAS, this corporation owns all the outstanding stock of _____[*name of subsidiary*]; and

WHEREAS, it is deemed in the best interests of this corporation and its shareholders that this corporation merge _____[*name of subsidiary*] into itself and assume all of its obligations; it is

RESOLVED, that this corporation merge _____[*name of subsidiary*] into itself [and change its name to _____ (*name of subsidiary*)] as of the effective date of the Certificate of Ownership to be filed pursuant to *Section 1110 of the California Corporations Code*, and assume all obligations of the merged corporation.

[RESOLVED FURTHER, that Article I of the Articles of Incorporation of this corporation be amended to read

I: The name of this corporation is _____ (*name of subsidiary*).]

RESOLVED FURTHER, that the _____[Chairman of the Board *or* President *or* Vice-President], and _____[Secretary *or* Assistant Secretary *or* Treasurer *or* Assistant Treasurer] of this corporation are directed to execute and file a Certificate of Ownership pursuant to *Section 1110 of the California Corporations Code* and to take any further action that may be necessary or proper to accomplish the merger.

3. These resolutions were adopted at a regular [*or* special] meeting of the Board of Directors of this corporation held at _____ M. on _____[*date*], at _____ Street, _____, California. This corporation has _____[*number*] directors, all of whom were

present at that meeting, and the resolutions were adopted by the vote of _____[*number*] directors [*or* by unanimous vote of the directors].

4. The following resolution was adopted by the board of directors of _____[*name of subsidiary*]: _____[*insert resolution, see, e.g., § 11C.302*].

_____ [*name of parent corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]

VERIFICATION

_____ and _____[*Names of officers who executed certificate*] say:

They are the _____[*title*] and _____[*title*], respectively, of _____[*name of parent corporation*], a California corporation.

They have read the foregoing Certificate of Ownership and know the contents thereof.

The same is true of their own knowledge.

Executed on _____[*date*], at _____, _____ County, California.

We declare under penalty of perjury that the foregoing is true and correct.

_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
B. Short-Form Mergers

5-11C California Legal Forms--Transaction Guide § 11C.304

§ 11C.304 Notice of Effective Date of Short-Form Merger of 90-Percent-Owned Subsidiary Into Parent Corporation

[1] Comment--Use of Form

This form is a notice of the effective date of a short-form merger of a subsidiary (90 percent or more of which is owned by its parent). When a subsidiary corporation not owned entirely by its parent is merged by means of a short-form merger into its parent corporation, the parent must give notice of the effective date of the short-form merger to each shareholder of the disappearing subsidiary corporation at least 20 days before the effective date of the merger [*Corp. Code § 1110(h)*]. This form sets forth a form of the notice that should be given by the parent corporation in such a short-form merger. The notice must set forth the resolutions of merger adopted by the boards of directors of the two corporations, a brief description of the procedure to be followed by dissenting shareholders of the disappearing corporation to force that corporation to purchase their shares, and a statement of the price the parent has determined to be the fair market value of those shares [*Corp. Code §§ 1110(h), 1301(a)*].

The rights of minority shareholders in a disappearing corporation to a short-form merger are the same as the rights of dissenting shareholders of a corporation that is a party to an ordinary merger. Those rights and the procedure for enforcing them are discussed further in § 11C.400. A procedural guide for their enforcement is *set forth in § 11C.150* et seq.

[2] FORM

Notice of Effective Date of Short-Form Merger of 90-Percent-Owned Subsidiary Into Parent Corporation

NOTICE OF SHORT-FORM MERGER

TO SHAREHOLDERS OF _____[*name of disappearing corporation*]:

NOTICE IS HEREBY GIVEN that a short-form merger as defined by the General Corporation Law of the State of California merging _____[*name of disappearing corporation*] into _____[*name of*

surviving corporation] will become effective on _____[*date*]. That merger was effected by resolutions of the Boards of Directors of the two corporations. The resolution of merger adopted by the Board of Directors of _____[*name of surviving corporation*] was adopted on _____[*date*], and is as follows: _____[*set forth exact wording of resolution; see § 11C.302*].

NOTICE IS FURTHER GIVEN that any shareholder of this corporation may require the corporation to purchase for cash at their fair market value on the day before the first announcement of the reorganization described in this notice any shares owned by the shareholder which come within the definition of "dissenting shares" contained in *Section 1301(b) of the California Corporations Code*. To be dissenting shares within the definition contained in *Section 1301(b) of the California Corporations Code*, the shares must have been held of record, that is, outstanding, on the date for determination of the shareholders who were entitled to vote on the reorganization described in this notice and not voted in favor of the reorganization.

NOTICE IS FURTHER GIVEN that for a shareholder to enforce his or her right to require this corporation to purchase any dissenting shares owned by him or her, the shareholder must do two things:

1. Within 30 days after the date of the mailing of this notice to the shareholder, the shareholder must serve a written demand for this corporation to purchase his or her dissenting shares and pay the shareholder in cash the fair market value of those shares on the corporation or on a transfer agent of the corporation. The demand must state the number and class of shares held by the shareholder which the shareholder demands the corporation purchase as dissenting shares and the price the shareholder claims to be the fair market value of those shares as of the day before announcement of the proposed reorganization described in this notice.

2. Within 30 days after the date of the mailing of this notice to a shareholder, the shareholder must, in addition to making the demand described above, submit the certificate for the shares he or she claims to be dissenting shares to the corporation or its transfer agent so that there may be stamped or endorsed on the share certificate a statement that the shares represented by it are dissenting shares. The certificate should be submitted to the corporation at its principal office at _____ Street in _____, California or to its transfer agent, _____[*name*] at its office at _____ Street, _____, California.

Thereafter, should the corporation fail to agree to purchase the shareholder's dissenting shares at an agreed price or deny they are dissenting shares, the shareholder may file a complaint against the corporation to force it to purchase the shares in the Superior Court of the State of California for the County of _____, the county where the principal executive office of this corporation is located. The complaint must be filed by the shareholder with that court within six months after the date on which this notice was mailed to the shareholder. A copy of *California Corporations Code Sections 1300-1304* governing the procedure a shareholder must follow to require this corporation to purchase dissenting shares owned by the shareholder is enclosed with this notice.

[*EITHER, if corporation has only one class of shares outstanding:*]

NOTICE IS FURTHER GIVEN that this corporation has determined that the price of $_____ per share represents the fair market value of dissenting shares of this corporation as of the day before the first announcement of the terms of the reorganization described in this notice.

[*OR, if corporation has more than one class of shares outstanding:*]

NOTICE IS FURTHER GIVEN that this corporation has determined that the following prices represent the fair market value of dissenting shares of this corporation as of the day before the first announcement of the terms of the reorganization described in this notice, to-wit: _____[*specify, e.g.:*]

$_____ per share for voting common shares;
$_____ per share for Class A Preferred shares; and
$_____ per share for Class B Preferred shares.

[*Continue with the following:*]

Dated: _____.

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentMergersMergers & Acquisitions LawMergersRights of Dissenting ShareholdersMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
B. Short-Form Mergers

5-11C California Legal Forms--Transaction Guide §§ 11C.305-11C.399

[Reserved]

§§ 11C.305[Reserved]



81 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
C. Rights of Dissenting Shareholders

5-11C California Legal Forms--Transaction Guide § 11C.400

§ 11C.400 Notice to Shareholders by Corporation of Approval of Merger by Outstanding Shares and Right of Dissenting Shareholders to Require Corporation to Purchase Their Dissenting Shares

[1] Comment

[a] Use of Form

This form is the notice that the corporation must send to each of its shareholders informing them the proposed merger or other reorganization has been approved by the outstanding shares of each class of the corporation. One of the supposed disadvantages of a statutory merger to a corporation is the right of each of its shareholders to force it to purchase for cash their dissenting shares. To initiate the process by which a shareholder may force it to purchase his or her dissenting shares, the General Corporation Law requires a corporation to mail notice to each of its shareholders that the proposed merger has been approved by the outstanding shares of each class of the corporation as required by the General Corporation Law [*Corp. Code § 1301(a)*]. The notice must be sent to each shareholder within 10 days after approval of the proposed merger by the outstanding shares of the corporation [*Corp. Code § 1301(a)*].

The notice of approval of the proposed merger or reorganization must be accompanied by the following [*Corp. Code § 1301(a)*]:

- A copy of *Corp. Code §§ 1300-1304*;
- A statement of the price the corporation determined to be the fair market value of dissenting shares; and
- A brief description of the procedure a shareholder must follow to require the corporation to purchase his or her dissenting shares.

The notice in this form incorporates in the body of the notice itself the last two of these requirements. It sets forth as part of the notice itself (1) a brief description of the procedure a shareholder must follow to require the corporation to purchase his or her dissenting shares and (2) a statement of the price the corporation has determined to be the fair

market value of its dissenting shares.

When this form is used it should be mailed by first-class mail to each shareholder by the corporation within 10 days after the proposed merger or other reorganization has been approved by the outstanding shares of the corporation [*Corp. Code § 1301(a)*].

[b] Rights of Dissenting Shareholders in General

When a corporate reorganization, such as a merger or exchange of assets for shares, changes the nature of the corporation's business or the nature of his or her investment beyond the manner contemplated by a shareholder, the shareholder should be permitted to "cash out" his or her investment in the corporation [Assembly Select Comm. Rep., at 96]. Thus, when the approval of the outstanding shares of a corporation is required for a merger or other "reorganization," each shareholder of the corporation may require the corporation to purchase for cash at their fair market value any "dissenting shares" owned by him or her [*Corp. Code § 1300(a)*]. The fair market value of the shares the corporation must pay the shareholder is their fair market value on the day before first announcement of the terms of the proposed reorganization requiring shareholder approval [*Corp. Code § 1300(a)*]. Any appreciation or depreciation of the fair market value of the shares caused by announcement of the proposed reorganizations is, of course, to be disregarded [*Corp. Code § 1300(a)*]. The fair market value of the shares on the day before the announcement of the proposed reorganization must be adjusted, however, for any stock split or reverse stock split or share dividend which became effective after that date [*Corp. Code § 1300(a)*].

If the approval of the outstanding shares of a corporation is required for a reorganization, only those shareholders who are entitled to vote on the transaction may require the corporation to purchase his or her "dissenting shares" [*Corp. Code § 1300(a)*]. Each shareholder of a disappearing corporation in a short-form merger is also entitled to require the purchase of his or her dissenting shares [*Corp. Code § 1300(a)*].

[c] Corporations That Must Purchase Dissenting Shares

Dissenting shares must be purchased by (1) a corporation that is required to have a proposed reorganization approved by its outstanding shares, and (2) a corporation that is a disappearing corporation in a short-form merger [*Corp. Code § 1300(a)*]. Obviously, however, the requirement to purchase its dissenting shares could not apply to a disappearing corporation to a short-form merger that was a wholly owned subsidiary of the surviving corporation to the short-form merger [*see § 11C.29*].

There are four types of corporations to a proposed "reorganization" as that term is defined in the General Corporation Law of California that must have the proposed reorganization approved by its outstanding shares. There are, therefore, four types of corporations to proposed reorganizations that, under the General Corporation Law, must on demand purchase dissenting shares owned by their shareholders [*see Corp. Code §§ 1200, 1201, 1300*]. The first is a surviving or disappearing corporation to a proposed statutory merger. The proposed merger must be approved both by the board of directors and the outstanding shares of each class of each corporation that is a party to the merger [*Corp. Code §§ 1200, 1201(a)*]. The second type of corporation is the acquiring corporation to a proposed share exchange. When one corporation seeks to acquire ownership of another corporation by exchanging its shares for those of the corporation it seeks to acquire, the proposed share exchange must be approved by the board of directors and outstanding shares of the acquiring corporation but not the corporation sought to be acquired [*Corp. Code §§ 1200, 1201(a)*; *see* Ch. 11D, *Acquisition of Shares for Shares*].

The third type of corporation that is required to have a proposed "reorganization" approved by its outstanding shares and therefore is required to purchase its dissenting shares is a corporation that is a party to a proposed exchange of assets for shares. When one corporation seeks to acquire another corporation by exchanging its shares for all or substantially all the assets of the other corporation, the proposed exchange must be approved by the boards of directors

and outstanding shares of both corporations [*Corp. Code §§ 1200, 1201(a)*; *see* Ch. 11E, *Acquisition of Assets for Shares*].

The fourth type of corporation that is required to have a proposed "reorganization" approved by its outstanding shares and is therefore under an obligation to purchase its dissenting shares is a "parent party" to a reorganization. A "parent party" is a corporation that (1) is in control of a constituent corporation to a merger or the acquiring corporation to a share exchange or assets-for-shares exchange and (2) is exchanging its shares for shares of the other corporation to a merger or share exchange or for the assets being acquired in an assets-for-shares exchange [*Corp. Code § 1200(e)*]. Both the board of directors and outstanding shares of a parent party must approve the proposed merger, share exchange, or assets-for-shares exchange [*Corp. Code §§ 1200, 1201(a)*].

[d] Dissenting Shares That Must Be Purchased

The purpose of the dissenting shareholder statutes requiring a corporation to purchase the shares of a dissenting shareholder is to allow a shareholder whose investment has been radically changed without his or her approval to "cash out" without being harmed by the change [Assembly Select Comm. Rep., at 96]. If there is a readily available established market for the shares, a shareholder can normally "cash out" his or her investment rather easily on that readily available established liquid market for the shares. In that case, there is no need for requiring the corporation to purchase the shares and "cash out" the shareholder [Assembly Select Comm. Rep., at 96].

In defining the rights of dissenting shareholders, therefore, the General Corporation Law distinguishes between shareholders holding shares for which there is a readily available established market and shareholders holding shares for which there is no readily available market. It provides special requirements for considering as "dissenting shares" shares of a corporation that, immediately prior to a proposed reorganization, were listed on any national securities exchange certified by the Commissioner of Corporations. Shares so listed cannot be considered "dissenting shares" unless either (1) there exists some restriction on their transfer imposed either by the corporation or a law or regulation or (2) demands for their purchase as dissenting shares are filed with respect to 5 percent or more of the particular class to which they belong [*Corp. Code § 1300(b)(1)*]. In addition, to be considered as dissenting shares, the shares must have been outstanding on the date for determination of shareholders entitled to vote on the proposed reorganization and those shares must have been voted against the reorganization [*Corp. Code § 1300(b)(2)*]. Shares not listed on a national exchange may be "dissenting shares" provided they were outstanding on the date for determining shareholders entitled to vote on the proposed reorganization and not voted in favor [*Corp. Code § 1300(b)(2)*].

When approval of the outstanding shares of a corporation is obtained by written consent of shareholders instead of by vote at a shareholders' meeting, listed shares otherwise qualified to be dissenting shares need only not have consented to the reorganization. There is no requirement that the holders of the shares were actually asked to sign the written consent and refused [*Corp. Code § 1300(b)(2)*].

When a national securities exchange has been certified under the Corporate Securities Law of 1968 by the California Corporations Commissioner, shares listed on that exchange need not be "qualified" with the California Corporations Commissioner before they can be sold or offered for sale in California [*Corp. Code § 25100(o)*]. Shares are also exempt from qualification if they are listed or approved for listing on notice of issuance on a national securities exchange if the exchange has been certified [*Corp. Code § 25100(o)*]. However, this exemption does not apply to securities listed or approved for listing on notice of issuance, in a rollup transaction unless it is an eligible rollup transaction [*Corp. Code § 25100(o)*; *see Corp. Code § 25014.7* ("eligible rollup transaction" defined)].

[e] Procedure for Enforcing Dissenting Shareholder Rights

The procedure for enforcing a shareholder's rights to require a corporation to purchase his or her dissenting shares begins with action by the corporation itself. Within 10 days after approval by its outstanding shares of a proposed

merger or other "reorganization" to which it is a party, the corporation must send each shareholder a written notice of the approval [*Corp. Code § 1301(a)*]. The notice must be accompanied by a statement of what the corporation has determined to be the fair market value of dissenting shares, a brief description a shareholder must follow to require the corporation to purchase his or her dissenting shares, and a copy of *Corp. Code §§ 1300-1304* [*Corp. Code § 1301(a)*].

The corporation's notice of approval of the reorganization is not fatally flawed if the notice omits the required statement of the fair-market price for dissenters' shares, as long as the corporation meets the statutory requirement to provide the full text of *Corp. Code §§ 1300-1304*. Shareholders who are thus notified that the corporation is obligated by statute to provide a statement of the price determined by the corporation to represent the fair market value of dissenters' shares and that the statement constitutes an offer by the corporation to purchase dissenters' shares at the price stated [*Corp. Code § 1301(a)*] can act to protect their interests as potential dissenters by promptly demanding a buyout price from the corporation. If unsuccessful, the shareholders can seek judicial relief by petitioning for a writ of mandate to compel the corporation immediately to provide a statement of the buyout price as required by statute [*Singhania v. Uttarwar (2006) 136 Cal. App. 4th 416, 432, 38 Cal. Rptr. 3d 861* ; *see Code Civ. Proc. § 1085* (right to petition for writ of mandate); *see also Code Civ. Proc. §§ 1027, 1032* (costs recoverable by prevailing party)].

A shareholder who wishes the corporation to purchase his or her dissenting shares must serve a written demand for purchase on the corporation within 30 days after the mailing of notice to the shareholder [*Corp. Code § 1301(b)*]. The demand must (1) state the number and class of the shares held of record by the shareholder that the shareholder wishes the corporation to purchase, and (2) contain a statement of what the shareholder claims to be the fair market value of those shares as of the day before the announcement of the proposed reorganization or short-form merger [*Corp. Code § 1301(c)*; *see § 11C.401*]. The demand should be served on the corporation at its principal office or at any transfer agent's office [*Corp. Code § 1301(b)*]. If the shares claimed to be dissenting shares are listed on a national securities exchange certified by the Corporations Commissioner, the demand must be received by the corporation or its transfer agent not later than the day of the shareholder's meeting called to vote on the reorganization, provided that the notice of that meeting summarized the provisions of *Corp. Code §§ 1300-1304* [*Corp. Code 1300(b)(1), 1301(b)*].

Within 30 days after the mailing of the notice of shareholder approval, ashareholder wishing the corporation to purchase his or her dissenting shares also must submit the certificate for those shares to the corporation or its transfer agent to be stamped or endorsed with a statement that the shares are dissenting shares [*Corp. Code § 1302*]. The certificate should be submitted to the corporation at its principal office or at the office of any of its transfer agents [*Corp. Code § 1302*]. If the corporation's securities are uncertificated [*Corp. Code § 191.1*; *Com. Code § 8102(a)(4)*], the shareholder must submit notice of the number of shares that he or she demands that the corporation purchase [*Corp. Code § 1302*].

A failure to timely perfect dissenters' rights is a de facto choice by a shareholder to accept a merger or other reorganization and forgo dissenters' rights [*Singhania v. Uttarwar (2006) 136 Cal. App. 4th 416, 434-435, 38 Cal. Rptr. 3d 861* (allegations or evidence of fraud might prevent application of this rule)].

[f] Payment for Dissenting Shares

When the corporation and shareholder agree that the shareholder's shares are dissenting shares and the price that must be paid for the shares, the shareholder is entitled to that price plus interest on it at the legal rate payable on judgments from the date of the agreement until it is paid [*Corp. Code § 1303(a)*]. Payment of the fair market value of dissenting shares may be made within 30 days after the amount has been agreed on, or within 30 days after any statutory or contractual conditions to the reorganization, such as the various balance sheet tests, have been satisfied, whichever is later [*Corp. Code §§ 166, 500-504, 1303(b), 1306*]. The distribution tests set forth in *Corp. Code § 500* do not apply to a corporation licensed as a broker-dealer [*see Corp. Code § 25210 et seq.*] if the corporation, immediately after giving effect to any distribution, is in compliance with the net capital rules of the Commissioner of Corporations [*see 10 Cal. Code Reg. § 260.216.12*] and the Securities and Exchange Commission [*Corp. Code § 500(c)*; *see 17 C.F.R. § 240.15c3-1*]. If the corporation is unable to pass these tests, it is unable to pay for and purchase the dissenting shares. In

that case, the dissenting shareholder becomes a creditor of the corporation for the amount due for the shares plus interest on that amount at the legal rate on judgments until the corporation does become able to pay [*Corp. Code § 1306*]. The rights of the dissenting shareholder as a creditor, however, are subordinate to all other corporate creditors in any liquidation proceedings of the corporation [*Corp. Code § 1306*].

[g] Suit to Enforce Dissenters' Rights

If a corporation denies that a shareholder's shares are dissenting shares, or fails to agree on the fair market value of the shares, the shareholder may file a complaint against the corporation to enforce his or her other rights in the superior court of the county where the principal executive office of the corporation is located [*Corp. Code § 1304(a)*]. If the corporation does not have principal executive offices, or does not maintain them in California, the complaint must be filed in the Superior Court of Sacramento County [*Corp. Code § 1304(a)*]. The shareholder must file the complaint within six months after the corporation mails to the shareholder the notice of approval by its outstanding shares of the merger or other reorganization giving rise to the shareholder's rights as a dissenting shareholder [*Corp. Code § 1304(a)*].

Two or more dissenting shareholders may join as plaintiffs in the same action or be joined as defendants in the same action [*Corp. Code § 1304(b)*]. Two or more dissenting shareholder actions against a corporation may be consolidated [*Corp. Code § 1304(b)*]. On trial of the action, the court determines all issues [*Corp. Code § 1304(c)*]. The court first determines, if it is in issue, whether the shareholder's shares are dissenting shares. The court then determines, either alone or by appointing one or more impartial appraisers, the fair market value of the dissenting shares [*Corp. Code § 1304(c)*].

[2] FORM

Notice to Shareholders by Corporation of Approval of Merger by Outstanding Shares and Right of Dissenting Shareholders to Require Corporation to Purchase Their Dissenting Shares

NOTICE OF SHAREHOLDERS' APPROVAL OF REORGANIZATION

TO SHAREHOLDERS OF _____[*name of corporation*]:

NOTICE IS HEREBY GIVEN that at a special meeting of shareholders of this corporation held on _____[*date*], at _____ Street, _____, California, there was approved by the outstanding shares of each class of this corporation, as those terms are defined in the General Corporation Law of California, the principal terms of reorganization, as defined in the General Corporation Law of California, pursuant to which _____[*specify, e.g.,* this corporation will be merged into _____ (*name of surviving corporation*) pursuant to the terms of a Merger Agreement between the two corporations dated _____ *or* this corporation will acquire 80 percent or more of the outstanding shares of _____ (*name of corporation to be acquired*) in exchange for its voting common shares by exchanging one of its voting common shares for every four outstanding shares of _____ (*name of corporation to be acquired*)].

NOTICE IS FURTHER GIVEN that any shareholder of this corporation may require the corporation to purchase for cash at their fair market value on the day before the first announcement of the reorganization described in this notice any shares owned by the shareholder which come within the definition of "dissenting shares" contained in *California Corporations Code Section 1301(b)*. To be dissenting shares within the definition contained in *California Corporations Code Section 1301(b)*, the shares must have been held of record, i.e., outstanding, on the date for determination of the shareholders who were entitled to vote on the reorganization described in this notice and not voted in favor of the reorganization.

NOTICE IS FURTHER GIVEN that for a shareholder to enforce his or her right to require this corporation to purchase any dissenting shares owned by him or her, the shareholder must do two things:

1. Within 30 days after the date of the mailing of this notice to the shareholder, the shareholder must serve a written demand for this corporation to purchase his or her dissenting shares and pay the shareholder in cash in fair market value of those shares on the corporation or on a transfer agent of the corporation. The demand must state the number and class of shares held by the shareholder which the shareholder demands the corporation purchase as dissenting shares and the price the shareholder claims to be the fair market value of those shares as of the day before announcement of the proposed reorganization described in this notice.

2. Within 30 days after the date of the mailing of this notice to shareholder, shareholder, in addition to making the demand described above, must submit the certificate for the shares he or she claims to be dissenting shares to the corporation or its transfer agent so that there may be stamped or endorsed on the share certificate a statement that the shares represented by it are dissenting shares. The certificate should be submitted to the corporation at its principal office at _____ Street in _____, California or to its transfer agent, _____[*name*], at its office at _____ Street, _____, California.

Thereafter, if the corporation fails to agree to purchase the shareholder's dissenting shares at an agreed price or denies they are dissenting shares, the shareholder may file a complaint against the corporation to force it to purchase the shares in the Superior Court of the State of California for the County of _____, the county where the principal executive office of this corporation is located. The complaint must be filed by the shareholder with that court within six months after the date on which this notice was mailed to the shareholder. A copy of *Sections 1300-1304 of the California Corporations Code* governing the procedure a shareholder must follow to require this corporation to purchase dissenting shares owned by the shareholder is enclosed with this notice.

[*EITHER, if corporation has only one class of shares outstanding:*]

NOTICE IS FURTHER GIVEN that this corporation has determined that the price of $_____ per share represents the fair market value of dissenting shares of this corporation as of the day before the first announcement of the terms of the reorganization described in this notice.

[*OR, if corporation has more than one class of shares outstanding:*]

NOTICE IS FURTHER GIVEN that this corporation has determined that the following prices represent the fair market value of dissenting shares of this corporation as of the day before the first announcement of the terms of the reorganization described in this notice: _____[*specify, e.g.:*]

$_____ per share for voting common shares;
$_____ per share for Class A Preferred shares; and
$_____ per share for Class B Preferred shares.

[*Continue with the following:*]

Dated: _____.

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsFair Market ValueBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRemediesMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersRights of Dissenting Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
C. Rights of Dissenting Shareholders

5-11C California Legal Forms--Transaction Guide § 11C.401

§ 11C.401 Demand by Shareholder in Merger or Short-Form Merger for Purchase of Dissenting Shares

[1] Comment--Use of Form

This form is the written demand that must be served on a corporation that is a party to a merger, or on the disappearing corporation in a short-form merger, by a shareholder desiring to have the corporation purchase his or her dissenting shares. The nature of a shareholder's right to require a corporation to purchase dissenting shares, corporations that must purchase dissenting shares, shares that are dissenting shares, and the procedure to be followed to enforce a dissenting shareholder's rights to require such a purchase are discussed in *§ 11C.400*. That discussion should be read in connection with the use of the demand contained in this form. For a procedural guide for enforcing the rights of a dissenting shareholder, up to filing an action to enforce those rights, see *§ 11C.150* et seq.

The demand contained in this form must be served on a corporation within 30 days after it has mailed a notice to the shareholder of approval of a proposed merger by its outstanding shares or the effective date of the short-term merger by its outstanding shares or the effective date of the short-form merger in which it is the disappearing corporation [*Corp. Code § 1301(b)*]. When the dissenting shares covered by this demand are listed on a national securities exchange or on the list of OTC margin stocks of the Federal Reserve System, however, it should be served on the corporation on the date set for the shareholders' meeting at which there will be a vote on the proposed merger [*Corp. Code § 1301(b)*].

[2] FORM

Demand by Shareholder in Merger or Short-Form Merger for Purchase of Dissenting Shares

DEMAND FOR PURCHASE OF SHARES

TO: _____[*name of corporation*], a California corporation:

I am the holder of record of _____[*number*] of _____[*class, e.g,* common *or* preferred *or* Class A preferred, *etc.*] shares issued by you as evidenced by Share Certificate No. _____ issued by you.

Pursuant to *California Corporations Code Section 1301(b)*, I make written demand on you that you purchase those shares and pay to me in cash their fair market value as of the day, _____[*date*], before the first announcement of the terms of the proposed reorganization [*or* short-form merger] by which _____[*specify, e.g.*, you will be merged into _____ (*name of surviving corporation*) or _____ (*name of disappearing corporation*) will be merged into you].

I hereby state, pursuant to *California Corporations Code Section 1301(c)*, that I claim $_____ per share to be the fair market value of those shares as of the day before the announcement of the proposed reorganization [*or* short-form merger] described above.

I submit to you the certificate representing the shares with respect to which this demand is made, in order that it may be stamped or endorsed with a statement that those shares are dissenting shares and returned to me at the address set forth below.
Dated: _____.

_____ [*signature*]
[*typed name*]
_____ [*street address*]
_____, CA

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsFair Market ValueBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentMergersMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersRights of Dissenting ShareholdersMergers & Acquisitions LawMergersShort-Form Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
C. Rights of Dissenting Shareholders

5-11C California Legal Forms--Transaction Guide §§ 11C.402-11C.499

[Reserved]

§§ 11C.402[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11C MERGERS
PART IV. FORMS
D. Miscellaneous Forms

5-11C California Legal Forms--Transaction Guide § 11C.500

§ 11C.500 Notice of Exchange Transaction Under Corp. Code § 25103(h)

[1] Comment

[a] Use of Form

This form is the official Department of Corporations notice of an exchange transaction under *Corp. Code § 25103*. To qualify under the exemption from securities qualification provided in *Corp. Code § 25103(h)*, an acquiring entity in an exchange transaction must file this form with the Commissioner of Corporations. The acquiring entity must file this notice no later than 15 calendar days after the first sale of the securities in the transaction in California [*10 Cal. Code Reg. § 260.103.6(a)*]. No notice is required to be filed if there is no sale in California [*10 Cal. Code Reg. § 260.103.6(a)*].

The notice referred to in *Corp. Code § 25103(h)* must be in the form illustrated here, and must be on 81/2 " by 11" paper [*10 Cal. Code Reg. § 260.103.6(b)*].

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained via the securities forms page of the official website of the California Department of Corporations, which is located at http://www.corp.ca.gov/forms/securities.asp#sl. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 11C.500. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Exemption From Qualification for Exchanges Incident to Merger, Consolidation, or Sale of Assets

Corp. Code § 25103(h) provides an exemption from the qualification provisions of the California securities laws for qualifying exchanges incident to a merger, consolidation, or sale of assets, in which the consideration for the transaction

is the issuance of the equity securities of another entity or any entity conversion transaction [*Corp. Code § 25103(h)*]. Rollup transactions, as defined in *Corp. Code § 25014.6*, are ineligible for this exemption [*Corp. Code § 25103(h)*].

To be eligible for this exemption, the exchange transaction, had it involved an issuer transaction [*see Corp. Code § 25110*], would have to have been exempted from qualification under the California limited offering exemption, determined without regard to *Corp. Code § 25102(f)(3)* (which requires representation that purchaser is purchasing for own account, not for resale) [*Corp. Code § 25102(h)(1)*]. In addition, either of the following sets of criteria must be applicable [*Corp. Code § 25102(h)(1)*]:

- All of the following must apply:
  - Not less than 75 percent of the outstanding equity securities of each constituent or converting entity entitled to vote on the proposed transaction voted in favor of the transaction;
  - Not more than 10 percent of the outstanding equity securities of each constituent or converting entity entitled to vote on the proposed transaction voted against the transaction; and
  - Each constituent or converting entity whose security holders are entitled to vote on the proposed transaction is subject to a state statute that has provisions for dissenters' rights for holders of equity securities entitled to vote on the proposed transaction that do not vote in favor of or voted against the transaction; or
- All of the following must apply:
  - The transaction is solely for the purposes of changing the issuer's state of incorporation or organization, or form of organization;
  - All the securities of the same class or series, unless all the security holders of the class or series consent, are treated equally; and
  - The holders of nonredeemable voting equity securities receive nonredeemable voting equity securities.

[c] Failure to File Notice

The failure to file the notice, or to file it within the specified time, will not affect the availability of this exemption. However, an acquiring entity that fails to file the notice as discussed in [a], *above*, within 15 business days after demand by the Commissioner, must file the notice and pay a fee equal to the fee that would have been payable had the transaction been qualified under *Corp. Code §§ 25110* or *25120* [*Corp. Code § 25103(h)(2)*; *see Corp. Code § 25608*; *see also Ch. 6H, Qualification of Securities, § 6H.200[1][d]*].

[2] FORM

Notice of Exchange Transaction Under Corp. Code § 25103(h)

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Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawMergersGeneral OverviewSecurities LawBlue Sky LawsExcluded Transactions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES

5-11D California Legal Forms--Transaction Guide 11D.syn

§ 11D.syn Synopsis to Chapter 11D: ACQUISITION OF SHARES FOR SHARES

§ 11D.01 California Sources

[1] Statutes

[2] Regulations

§ 11D.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 11D.03-11D.04 [Reserved]

§ 11D.05 Law Reviews and Periodicals

§ 11D.06 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 11D.07-11D.19 [Reserved]

§ 11D.20 Acquisition of Shares for Shares Generally

§ 11D.21 California Statutory Requirements

[1] Directors' and Shareholders' Approval

[2] Conditions Excusing Shareholder Approval

[3] Report by Independent Appraiser

§ 11D.22 Share Exchange Tender Offer

[1] In General

[2] Approval Requirements

[3] Appraisal Report

§ 11D.23 Income Tax Factors and Requirements

[1] Status as Tax-Free Reorganization

[2] Voting Stock Requirement

[3] Deferred Stock Payments

[4] Creeping Control Situations

[5] Business Purpose and Continuity of Business Interest

[6] Income Tax Basis for Acquired Assets and Shares

[7] Net Operating Loss Carryforward

§ 11D.24 Corporate Securities Law Requirements

[1] Qualification and Exemption

[2] Issuer Transactions

[a] In General

[b] Requirements for Two Types

§ 11D.25 Nonassumption of Acquired Corporation's Liabilities

§ 11D.26 Other Advantages and Disadvantages of Share Exchanges

[1] Advantages

[a] No Board Approval

[b] Purchase of Dissenting Shares

[c] No Sales and Use Tax

[d] Simplicity

[2] Disadvantages

§§ 11D.27-11D.99 [Reserved]

§ 11D.100 Facts

Scope

§ 11D.101 Documents

Scope

§§ 11D.102-11D.109 [Reserved]

§ 11D.110 Preliminary Determinations for Shares-for-Shares Exchange

Scope

§ 11D.111 Advantages of Shares-for-Shares Acquisition

Scope

§ 11D.112 Disadvantages of Shares-for-Shares Acquisition

Scope

§§ 11D.113-11D.119 [Reserved]

§ 11D.120 Procedures for Consummating Shares-for-Shares Exchange

Scope

§§ 11D.121-11D.129 [Reserved]

§ 11D.130 When Acquired Corporation Is to Be Operated as Subsidiary

Scope

§ 11D.131 Transferring Acquired Corporation's Net Operating Loss Carryover to Acquiring Corporation

Scope

§ 11D.132 Reporting Statutory Change in Ownership

Scope

§§ 11D.133-11D.199 [Reserved]

§ 11D.200 Agreement for Exchange of Shares--Voting Shares of Acquiring Corporation to Be Exchanged for Shares of Corporation Sought to Be Acquired in Tax-Free Reorganization

[1] Comment--Use of Form

[2] Form

Agreement for Exchange of Shares--Voting Shares of Acquiring Corporation to Be Exchanged for Shares of Corporation Sought to Be Acquired in Tax-Free Reorganization

§ 11D.201 Agreement for Exchange of Shares--Acquisition by Large Corporation of Shares of Smaller Corporation in Tax-Free Reorganization

[1] Comment--Use of Form

[2] Form

Agreement for Exchange of Shares--Acquisition by Large Corporation of Shares of Smaller Corporation in Tax-Free Reorganization

§ 11D.202 Agreement for Exchange of Shares--Alternative Contract Provision for Deferred Issuance of Acquiring Corporation's Shares

[1] Comment--Use of Form

[2] Form

Agreement for Exchange of Shares--Alternative Contract Provision for Deferred Issuance of Acquiring Corporation's Shares

§ 11D.203 Tender Offer--Offering Letter by Acquiring Corporation Offering to Exchange Its Shares for Shares of Corporation Sought to Be Acquired

[1] Comment

[a] Use of Form

[b] Methods of Making Tender Offer

[c] State Regulation of Exchange Tender Offers

[d] Federal Regulation of Exchange Tender Offers

[e] Number of Shares Sought to Be Acquired

[f] Report by Independent Appraiser

[2] Form

Tender Offer--Offering Letter by Acquiring Corporation Offering to Exchange Its Shares for Shares of Corporation Sought to Be Acquired

§ 11D.204 Tender Offer--Letter of Acceptance and Assignment by Shareholder of Corporation Sought to Be Acquired

[1] Comment--Use of Form

[2] Form

Tender Offer--Letter of Acceptance and Assignment by Shareholder of Corporation Sought to Be Acquired

§ 11D.205 Resolution by Board of Directors of Acquiring Corporation Approving Proposed Share Exchange--Sufficient Authorized but Unissued Voting Shares to Consummate Exchange

[1] Comment--Use of Form

[2] Form

Resolution by Board of Directors of Acquiring Corporation Approving Proposed Share Exchange--Sufficient Authorized but Unissued Voting Shares to Consummate Exchange

§ 11D.206 Resolution by Board of Directors of Acquiring Corporation Approving Proposed Share Exchange--Articles of Incorporation Require Amendment to Authorize Issuance of Shares Required by Exchange

[1] Comment--Use of Form

[2] Form

Resolution by Board of Directors of Acquiring Corporation Approving Proposed Share Exchange--Articles of Incorporation Require Amendment to Authorize Issuance of Shares Required by Exchange

§ 11D.207 Resolution of Shareholders of Acquiring Corporation Approving Proposed Share Exchange

[1] Comment--Use of Form

[2] Form

Resolution of Shareholders of Acquiring Corporation Approving Proposed Share Exchange

§ 11D.208 Tender Offer--Published by Dealer-Manager for Acquiring Corporation

[1] Comment--Use of Form

[2] Form

Tender Offer--Published by Dealer-Manager for Acquiring Corporation

§ 11D.209 Notice of Approval of Proposed Share Exchange by Outstanding Shares and Right of Dissenting Shareholders to Require Purchase of Dissenting Shares

[1] Comment--Use of Form

[2] Form

Notice of Approval of Proposed Share Exchange by Outstanding Shares and Right of Dissenting Shareholders to Require Purchase of Dissenting Shares

§ 11D.210 Shareholder Demand for Purchase of Dissenting Shares

[1] Comment--Use of Form

[2] Form

Shareholder Demand for Purchase of Dissenting Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES

5-11D California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter covers corporate reorganizations pursuant to an exchange of shares of one corporation for the shares of another. The Legal Background discusses the requirements, advantages, and disadvantages of a shares for shares exchange. In addition, it examines the differences between the Internal Revenue Code and General Corporation Law definitions of "reorganization" as those differences affect shares for shares exchanges. The Legal Background also contains a general discussion of the securities considerations applicable to reorganizations. The Transaction Guide contains procedures for a shares for shares exchange. This chapter also contains forms designed to effectuate a tax-free shares for shares exchange.

For a detailed discussion of corporate securities requirements, and appropriate forms, see Ch. 6, *Securities Regulation Issues* . For a discussion and comparison of the various methods of corporate acquisition, see Ch. 11, *Merger and Acquisition Issues* . These methods are covered individually in Ch. 11A, *Cash Purchase of Shares* , Ch. 11B, *Cash Purchase of Assets* ; Ch. 11C, *Mergers* ; and Ch. 11E, *Acquisition of Assets for Shares* .

For additional detailed discussion of the acquisition of shares for shares, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , § 252.04 (Matthew Bender). An agreement for an exchange reorganization is set forth in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Appendix A, Form 13.09 (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART I. RESEARCH GUIDE
A. Primary Sources

5-11D California Legal Forms--Transaction Guide § 11D.01

§ 11D.01 California Sources

[1] Statutes

Covenant not to compete by shareholder selling all shares. *Bus. & Prof. Code § 16601*.

Vote of each class of outstanding shares means vote of each class regardless of limitations on voting rights. *Corp. Code § 117*.

"Approval of outstanding shares" defined. *Corp. Code § 152*.

Acquisition of shares for shares as form of corporate "reorganization." *Corp. Code § 181(b)*.

Written consent of outstanding shares is same as vote of shares. *Corp. Code § 603*.

Short-form merger of wholly owned subsidiary into parent. *Corp. Code § 1110(a)*.

Short-form merger of 90 percent-owned subsidiary into parent. *Corp. Code § 1110(a), (b)*, (h).

Approval of share-for-share exchange by board of directors of acquiring corporation required. *Corp. Code § 1200(b)*.

Approval of share exchange tender offer by board of directors of acquiring corporation required. *Corp. Code § 1200(d)*.

Approval of share-for-share exchange by board of directors of "parent party" of acquiring corporation required. *Corp. Code § 1200(e)*.

Approval of outstanding shares of each class of acquiring corporation, and acquiring corporation's parent party, required. *Corp. Code § 1201(a)*.

Conditions excusing approval of share exchange by outstanding shares of acquiring corporation or its parent party. *Corp. Code § 1201(b).*

Shareholder approval by outstanding shares of acquiring corporation or its parent party may be given before or after approval by board of directors of acquiring corporation or its parent party. *Corp. Code § 1201(g).*

Approval of share exchange tender offer by shareholders. *Corp. Code § 1201.5*.

Law of state or place of incorporation governs shareholder approval requirements for parent party that is foreign corporation. *Corp. Code § 1202(c).*

Requirements applicable to reorganization proposal made by person controlling or involved in management of target corporation. *Corp. Code § 1203*.

Rights of dissenting shareholders.

Right to require purchase at value on day before announcement of proposed share exchange. *Corp. Code § 1300(a)*.

Dissenting shares to which right applies. *Corp. Code § 1300(b).*

Notice of shareholders' approval by corporation, statutory requirement. *Corp. Code § 1301(a).*

Demand for purchase of shares, statutory requirement and time for making. *Corp. Code § 1301(b).*

Demand for purchase of shares, contents required. *Corp. Code § 1301(c).*

Submission of shares for endorsement. *Corp. Code § 1302*.

Agreement for share purchase by corporation, amount and time of payment. *Corp. Code § 1303*.

Suit to enforce rights of dissenting shareholders, time and place for commencing. *Corp. Code § 1304(a), (b).*

Suit to enforce rights of dissenting shareholders, issues determined by court. *Corp. Code § 1304(c).*

Qualification of securities required by share exchange.

Exempt transactions. *Corp. Code § 25102*.

Qualification required for offer or sale of securities in issuer transaction. *Corp. Code § 25110*.

Qualification by coordination under Securities Act of 1933. *Corp. Code § 25111*.

Qualification by permit when coordination not possible.

Requirement. *Corp. Code § 25113(a).*

Application. *Corp. Code § 25113(b).*

Effective date. *Corp. Code § 25113(c).*

Execution of application for qualification. *Corp. Code § 25115*.

Share exchange not included as recapitalization for qualification purposes. *Corp. Code § 25120*.

Advertised tender offer must first be submitted to Corporations Commissioner. *Corp. Code §§ 25300(a), 25302*.

[2] Regulations

Share exchanges exempt from qualification. *10 Cal. Code Reg. § 260.105.15*.

Application for qualification, facing page. *10 Cal. Code Reg. § 260.110*

Application for qualification, form and contents. *10 Cal. Code Reg. §§ 260.110.1-260.110.4*.

Application for qualification by permit, required contents. *10 Cal. Code Reg. § 260.113*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART I. RESEARCH GUIDE
A. Primary Sources

5-11D California Legal Forms--Transaction Guide § 11D.02

§ 11D.02 Federal Sources

[1] Statutes

Restrictions on tender offers of Securities Act of 1933. *15 U.S.C. §§ 77b(a)(10), 77e(c), 77j*.

Williams Act regulating tender offers. *15 U.S.C. §§ 78l, 78m(d), (e), 78n(d)*-(f).

Net operating loss carryover income tax deduction allowed. *I.R.C. § 172(a)*.

Limitations on net operating loss carrybacks attributable to specified corporate equity reduction interest losses. *I.R.C. § 172(h)*.

No taxable gain to parent on liquidation of subsidiary. *I.R.C. § 332*.

Parent takes income tax basis of subsidiary for assets of dissolved subsidiary. *I.R.C. § 334(b)(1)*.

Determining gain or loss to subsidiary upon Section 332 liquidation. *I.R.C. § 337*.

Purchase of stock of subsidiary treated as purchase of assets with grossed-up basis. *I.R.C. § 338*.

No taxable gain on exchange of shares of one corporation to a reorganization for shares of another corporation to a reorganization. *I.R.C. § 354(a)*.

Basis for shares received in exchange between corporation to a reorganization, shareholders' basis. *I.R.C. § 358*.

Basis for property or shares received by acquiring corporation in exchange for its own shares. *I.R.C. § 362*.

Corporate acquisition by means of share exchange as form of tax-free reorganization. *I.R.C. § 368(a)(1)(B)*.

Use of subsidiary as part of tax-free share exchange. *I.R.C. § 368(a)(2)(C)*.

Party to tax-free reorganization defined. *I.R.C. § 368(b)*.

Control that acquiring corporation must have of acquired corporation after tax-free share exchange. *I.R.C. § 368(c)*.

Net operating loss carryover deduction, when available to acquiring corporation. *I.R.C. § 381*.

Limitation on net operating loss carryforwards for acquiring corporation. *I.R.C. § 382*.

[2] Regulations

Purpose of making reorganizations tax-free. *Treas. Reg. § 1.368-1(b)*.

Requirements for share exchange to be tax-free reorganization. *Treas. Reg. § 1.368-2(c)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART I. RESEARCH GUIDE
A. Primary Sources

5-11D California Legal Forms--Transaction Guide §§ 11D.03-11D.04

[Reserved]

§§ 11D.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11D California Legal Forms--Transaction Guide § 11D.05

§ 11D.05 Law Reviews and Periodicals

Kennedy, *Tender Moment, 23 Bus. Law. 1091 (1968).*

Cohen, *Tender Offers and Takeover Bids, 23 Bus. Law. 611 (1968).*

Kramer, *Loss Carryovers Following "A," " B" or "C" Reorganizations; Consolidated Returns*, 26 N.Y.U. Tax. Inst. 921 (1968).

Cohen, *A Note on Takeover Bids and Corporate Purchases of Stock, 22 Bus. Law. 149 (1966).*

Brew, *Uses and Effects of Different Kinds of Stock on Organization, Reorganization and Liquidation*, 24 N.Y.U. Tax. Inst. 1023 (1966).

Kerr & Letts, *Appraisal Procedures of Dissenting Delaware Stockholders, 20 Bus. Law. 1083 (1965).*

Riordan & Wragg, *Examination of Corporate Books in Connection With Stock Offerings and Acquisitions, 18 Bus. Law. 677 (1963).*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11D California Legal Forms--Transaction Guide § 11D.06

§ 11D.06 Text References

[1] Matthew Bender Sources

CALIFORNIA FORMS OF PLEADING AND PRACTICE, ch. 163, *Corporations: Transfers of Shares* (Matthew Bender).

Ballantine & Sterling, CALIFORNIA CORPORATIONS LAWS, ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations*, §§ 251.04, 252.05 (Matthew Bender).

Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING (Matthew Bender)

Ch. 160, *Review of Methods of Buying and Selling Corporate Businesses*.

Ch. 161, *Review of Factors to Be Considered in Selecting Form of Acquisition*.

Ch. 165, *Sales of Stock*.

Ch. 166A, *Tender Offers*.

Ch. 168, *Investigation Required to Be Made by Each Party to Mergers and Acquisitions.*

Ch. 171, *The Acquisition Agreement*.

Ch. 173, *Choosing the Method of Transferring the Ownership of a Corporate Business*.

Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS (Matthew Bender)

Ch. 1, *The Business Setting of Corporate Acquisitions and Mergers*.

Ch. 2, *The Legal Setting of Corporate Acquisitions and Mergers*.

Ch. 2A, *General Considerations in Corporate Acquisitions and Mergers*.

Ch. 3, *Tax Factors in Corporate Acquisitions and Mergers*.

Ch. 4, *Tax-Free Acquisitions*.

Ch. 5, *Taxable Transactions*.

Ch. 5A, *Summary of Acquisition Methods*.

Ch. 5D, *Acquisitions of Stock*.

Ch. 5E, *Tender Offers and Takeovers*.

Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, ch. 16, *Corporate Reorganizations and Liquidations* , Forms 16.08-16.12A. (Matthew Bender).

Rabkin & Johnson, FEDERAL INCOME, GIFT AND ESTATE TAXATION, ch. 31, *Exchanges of Securities* , ch. 32, *Reorganization Patterns* (Matthew Bender).

[2] Additional Text References

Witkin, *S* ummary of California Law, vol. 9, *Corporations*, §§ 196-213 (9th ed. 1989).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11D California Legal Forms--Transaction Guide §§ 11D.07-11D.19

[Reserved]

§§ 11D.07[Reserved]



93 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART II. LEGAL BACKGROUND

5-11D California Legal Forms--Transaction Guide § 11D.20

§ 11D.20 Acquisition of Shares for Shares Generally

The second method by which one corporation may acquire another corporation, defined as a "reorganization" in both the Internal Revenue Code and the California General Corporation Law, is a shares for shares exchange [*see I.R.C. § 368(a)(1)(B)*; *Corp. Code § 181(b)*]. Under the General Corporation Law, an "exchange reorganization" is defined as the acquisition by one corporation of shares of another corporation in exchange in whole or in part for equity securities of the acquiring corporation a corporation in control of the acquiring corporation if, immediately after the acquisition, the acquiring corporation has control of the other corporation [*Corp. Code § 181(b)*]. "Control" is defined as direct or indirect ownership of shares or equity securities possessing more than 50 percent of the voting power of the acquired corporation or other business entity [*Corp. Code § 160(b)*]. Voting power is the power to elect directors of the acquired corporation [*Corp. Code § 194.5*; *see § 11D.21*]. Under the Internal Revenue Code, the acquisition by one corporation of stock of another corporation in exchange solely for all or a part of the voting stock of the acquiring corporation or a corporation in control of the acquiring corporation is a tax-free reorganization if immediately after the acquisition the acquiring corporation has control of the other corporation [*I.R.C. § 368(a)(1)(B)*; *see § 11D.23*]. The two definitions, although similar, have differences which are due to the different purposes served by each of the "reorganization" definitions [*see* Ch. 11, *Merger and Acquisition Issues*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTax-Free AcquisitionsTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART II. LEGAL BACKGROUND

5-11D California Legal Forms--Transaction Guide § 11D.21

§ 11D.21 California Statutory Requirements

[1] Directors' and Shareholders' Approval

Because an exchange of the shares of one corporation for the shares of another corporation is defined by the General Corporation Law as a form of "reorganization," it requires the same type of director and shareholder approval as a statutory merger or an exchange of assets for shares [*Corp. Code §§ 181, 1200, 1201*; *see Ch. 11C, Mergers, § 11C.22*; Ch. 11E, *Acquisition of Assets for Shares*]. There is one major difference, however, between the director and shareholder approval required for a merger or an exchange of assets for shares and the director and shareholder approval required for a share exchange. The board of directors and shareholders of the corporation whose shares are sought to be acquired by the acquiring corporation are not required by statute to approve an exchange of shares of the acquiring corporation for shares of the acquired corporation [*compare Corp. Code § 1200(b)* (approval of acquiring corporation's board required in exchange reorganization) *with Corp. Code § 1200(c)* (board approval of both acquiring and acquired corporation's board required in sale-of-assets reorganization) *and Corp. Code § 1201(a)* (shareholder approval required when board approval is required, subject to various exceptions)].

The General Corporation Law requires a "reorganization" to be approved by the board of directors and by the outstanding shares of each class of the acquiring corporation [*Corp. Code §§ 1200, 1201(a)*]. If shares of a corporation in control of the acquiring corporation will be exchanged for shares of the corporation sought to be acquired, the corporation in control is a "parent party" [*Corp. Code § 1200(e)*]. In that case, the proposed share exchange must also be approved by the board of directors and by the outstanding shares of each class of the parent party [*Corp. Code §§ 1200(d), 1201(a)*]. However, if the parent party [*Corp. Code § 1200(e)*] is a foreign corporation (other than one subject to the General Corporation Law [*see Corp. Code § 2115(a)*; *see also* Ch. 12B, *Foreign Corporations and Associations*]), any requirement or lack of requirement for approval by the outstanding shares of the foreign corporation is not governed by *Corp. Code §§ 1200* and *1201*. Instead, the law of the state or place of incorporation of the foreign corporation will apply [*Corp. Code § 1202(c)*].

Because a proposed share exchange defined as a "reorganization" by the General Corporation Law must be approved by the outstanding shares as well as by the board of directors of the acquiring corporation, it must be approved by the board of directors of the acquiring corporation itself and not by a committee of the board [*Corp. Code §§ 151, 311*].

Ordinarily, a board of directors may delegate its authority to one or more committees consisting of two or more directors and those committees may approve matters otherwise requiring approval by the corporation's board of directors. The board of directors, however, may not delegate to any committee or committees power to approve on its behalf any matter, such as a proposed share exchange, which in addition to being approved by the board must also be approved by the shareholders or "approved by the outstanding shares" of the corporation [*Corp. Code § 311(a)*].

The term "approved by the outstanding shares" means that a matter must be approved by the affirmative vote of a majority of all outstanding shares of the corporation entitled to vote on it and not just a majority of the shares represented and voting at a shareholders' meeting at which a quorum of shares is present [*see Corp. Code §§ 152, 153*]. A proposed share exchange defined as a "reorganization" by the General Corporation Law, in addition to being approved by the board of directors of the acquiring corporation, must be "approved by the outstanding shares of each class" of the acquiring corporation [*Corp. Code §§ 1200(b), 1201(a)*]. This means the proposed share exchange must be approved by the affirmative vote of a majority of all outstanding shares of each class or series, regardless of limitations or restrictions on voting rights, of shares of the acquiring corporation [*Corp. Code §§ 117, 152*]. The proposed share exchange must also be approved by the affirmative vote of all or a greater than majority proportion of any class or series of shares if a unanimous or greater than majority vote is required by the acquiring corporation's articles of incorporation [*Corp. Code § 152*]. When the acquiring corporation has two classes of common shares that differ only as to voting rights, however, they may be considered as a single class of shares for purposes of approving the proposed share exchange [*Corp. Code § 1201(a)*].

[2] Conditions Excusing Shareholder Approval

The purpose of requiring a proposed share exchange "reorganization" to be approved by each class of the outstanding shares, regardless of voting rights, is to prevent undue dilution of the ownership interest and voting rights of the holders of the outstanding shares without their consent. Thus, approval by any class of shares of the acquiring corporation should not be required if the proposed share exchange will not result in any significant changes in the rights or interests represented by shares of that class [Assembly Select Committee on the Revision of the Corporation Code, dated December 1, 1975, at 93, 94 (hereafter cited in this chapter as "Assembly Select Comm. Rep.")]. The General Corporation Law expressly provides that in two situations, approval by one or more classes of shares of the acquiring corporation to a proposed share exchange of the share exchange is not needed [*Corp. Code § 1201(a), (b)*; *but see Corp. Code § 1201(g)*].

The first situation involves outstanding preferred shares of the acquiring corporation. No approval of any class of outstanding preferred shares of the acquiring corporation or its parent party is required when the rights, preferences, privileges, and restrictions granted to or imposed on that preferred class of shares remains unchanged by the proposed share exchange [*Corp. Code § 1201(a)*]. The second situation arises when the shareholders of the acquiring corporation immediately before the proposed share exchange will still own, immediately after the proposed share exchange, equity securities of the acquiring corporation possessing more than five sixths of its voting power [*Corp. Code § 1201(b)*]. In that case, no approval of the outstanding shares of any class of the acquiring corporation is required for consummation of the proposed share exchange [*Corp. Code § 1201(b)*], because the share exchange will make no significant change in the rights or interests of the shareholders of the acquiring corporation and their approval is not needed.

In determining whether the shareholders of the acquiring corporation immediately before the proposed share exchange will own, immediately after the proposed share exchange, equity securities possessing five sixths of the voting power of the acquiring corporation, shares owned by any shareholders of the acquiring corporation in the acquired corporation must be disregarded [*Corp. Code § 1201(b)*]. For purposes of determining what will constitute five sixths of the voting power of the acquiring corporation after the exchange, it must be assumed that all securities convertible, either immediately or at some future time, into its voting shares have been converted [*Corp. Code § 1201(b)*]. It will not be assumed, however, that any outstanding warrants or rights to subscribe to or purchase its voting shares have been exercised [*Corp. Code § 1201(b)*].

Notwithstanding the provisions of *Corp. Code § 1201(a)* and *(b)*, discussed *above*, the principal terms of a reorganization must be approved by all shareholders of any class or series if, as a result of the reorganization, the holders of that class or series become personally liable for any obligations of a party to the reorganization, unless all holders of that class or series have dissenters' rights [*Corp. Code § 1201(g)*; *see Corp. Code § 1300 et seq.*].

[3] Report by Independent Appraiser

When a tender offer (including a share exchange tender offer [*see Corp. Code § 183.5* (definition); *see also § 11D.22[1]*]), or a written proposal for approval of a "reorganization" [*see Corp. Code §§ 181, 1200*] or sale of assets [*see Corp. Code § 1001(a)*] is made to some or all of a corporation's shareholders by a party to the transaction who has control of or a financial interest in that corporation (an "interested party proposal"), an affirmative opinion in writing regarding the fairness of the consideration to the shareholders of the corporation must be provided to those shareholders. This requirement does not apply if the target corporation does not have shares held of record by 100 or more persons [*see Corp. Code § 605* (determination of shareholders of record)], or if the transaction has been qualified pursuant to *Corp. Code § 25113* (qualification of issuer transaction by permit) or 25121 (qualification of recapitalization or reorganization by permit) and no stop order [*see Corp. Code §§ 25140, 25143(a)*] is in effect regarding that qualification [*Corp. Code § 1203(a)*].

If a subsequent tender offer or written proposal is made by another person at least 10 days before the date for acceptance of the tendered shares or the vote or notice of shareholder approval on the interested party proposal, additional shareholder notification and withdrawal requirements apply [*see Corp. Code § 1203(b)*]. For further discussion, see Ch. 11, *Merger and Acquisition Issues* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART II. LEGAL BACKGROUND

5-11D California Legal Forms--Transaction Guide § 11D.22

§ 11D.22 Share Exchange Tender Offer

[1] In General

A "share exchange tender offer" is a type of acquisition method that is similar to an exchange reorganization [*see Corp. Code § 181(b)*] but is not included in the definition of "reorganization" [*see Corp. Code § 181*]. The term "share exchange tender offer" includes any acquisition (other than an "exchange reorganization") by one corporation, in exchange in whole or in part for the acquiring corporation's equity securities (or the equity securities of a corporation that is in control of the acquiring corporation), of shares of another corporation [*Corp. Code § 183.5*]. Unlike an exchange reorganization, a share exchange tender offer does not require that the acquiring corporation have control of the acquired corporation immediately after the acquisition [*see Corp. Code §§ 181(b), 183.5*].

The discussions in [2] and [3], *below*, give a general overview of the approval requirements applicable to share exchange tender offers. Because share exchange tender offers are not "reorganizations," and therefore are not subject to the Corporations Code provisions regarding dissenters' rights [*see Corp. Code §§ 1300-1312*], they are beyond the scope of this chapter. For coverage of tender offers generally, see Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 5E, *Tender Offers and Takeovers* (Matthew Bender).

[2] Approval Requirements

A share exchange tender offer [*see Corp. Code § 183.5* (definition); *see also § 11D.22[1]*] must be approved by the board of the acquiring corporation [*Corp. Code § 1200(d)*] in the same manner as an exchange reorganization [*see § 11D.21[1]*].

Similarly, the outstanding shares [*see Corp. Code § 152* (definition)] of each class of the corporation making the tender offer (or the corporation whose shares will be used in the tender offer) must approve the principal terms of a share exchange tender offer. For purposes of this requirement, two classes of common shares differing only as to voting rights will be considered as a single class of shares [*Corp. Code § 1201.5(a)*]. This type of approval requirement is intended to protect shareholders of the acquiring corporation from dilution of the value and voting power of their stock [*see § 11D.21[1] ; see also* Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , § 262.03 (Matthew Bender)].

As in an exchange reorganization, there are exceptions to the approval requirement when shareholders' voting power remains basically unchanged [*see Corp. Code § 1201*; *see also § 11D.21[2]*]:

- First, unless otherwise provided in the articles, no approval of any class of outstanding preferred shares of the acquiring corporation or its parent will be required if the rights, preferences, privileges, and restrictions granted to or imposed on that class of shares remains unchanged by the share exchange tender offer [*Corp. Code § 1201.5(a)*].

- Second, no approval of the outstanding shares is required if either [*Corp. Code § 1201.5(b)*] (1) the corporation; (2) the persons who are shareholders immediately before the tender offer; or (3) both the corporation and those shareholders will, immediately after completion of the share exchange proposed in the tender offer, still own equity securities (other than any warrant or right to subscribe to or purchase the equity securities) of the corporation making the tender offer or its parent possessing more than five sixths of the voting power of either corporation.

In determining share ownership by shareholders of the acquiring corporation, equity securities owned immediately before the tender offer as shareholders of another party to the transaction will be disregarded [*Corp. Code § 1201.5(b)*]. In calculating the voting power of a corporation, it will be assumed that all equity securities convertible (either immediately or at a future time) into voting shares have been converted. However, it will not be assumed that any warrants or rights to subscribe to or purchase shares have been exercised [*Corp. Code § 1201.5(b)*].

[3] Appraisal Report

When a share exchange tender offer [*see Corp. Code § 183.5* (definition); *see also § 11D.22[1]*] is made to some or all of a corporation's shareholders by an interested party, an affirmative written opinion as to the fairness of the consideration to the shareholders of that corporation must be delivered to the shareholders [*Corp. Code § 1203(a)*]. Exceptions to this requirement, and additional requirements applicable to subsequent tender offers [*see Corp. Code § 1203(b)*], are discussed in *§ 11D.21[3]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART II. LEGAL BACKGROUND

5-11D California Legal Forms--Transaction Guide § 11D.23

§ 11D.23 Income Tax Factors and Requirements

[1] Status as Tax-Free Reorganization

No taxable gain or loss will be recognized if shares or securities in a corporation that is a party to a "reorganization" are exchanged, pursuant to the plan of "reorganization," solely for shares or securities in another corporation that is a party to the "reorganization" [*I.R.C. § 354(a)(1)*]. *I.R.C. § 368(a)(1)(B)* defines a "reorganization" as the acquisition by one corporation of the stock of another corporation, in exchange solely for all or part of the voting stock of the acquiring corporation (or a corporation in control of the acquiring corporation), if immediately after the acquisition the acquiring corporation has control of the other corporation [*I.R.C. § 368(a)(1)(B)*]. Because of its placement in the income tax statute defining tax-free "reorganizations," a shares for shares exchange is sometimes called a "B reorganization" [*see* Ch. 11, *Merger and Acquisition Issues*].

In order to effectuate a tax-free shares for shares exchange, two important statutory requirements must be met. First, the acquiring corporation must acquire the shares of the acquired corporation solely in exchange for voting shares of itself or its parent corporation [*I.R.C. § 368(a)(1)(B)*]. Second, immediately after the exchange is completed, the acquiring corporation must have control of the acquired corporation [*I.R.C. § 368(a)(1)(B)*]. The fact that the acquiring corporation may have had control of the acquired corporation immediately before the exchange is immaterial [*I.R.C. § 368(a)(1)(B)*]. For purposes of the statutory definition of a share exchange that constitutes a tax-free reorganization, "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of voting stock of the acquired corporation and at least 80 percent of the total number of shares of all other classes of stock of the acquired corporation [*I.R.C. § 368(c)*].

The receipt of other property ("boot") in the transaction will result in the recognition of gain to the recipient equal to the sum of the money and fair market value of the property received [*I.R.C. § 356(a)*]. That gain will normally be treated as capital gain [*see I.R.C. §§ 1221, 1222*]. However, if the exchange has the effect of a distribution of a dividend [*see I.R.C. §§ 302, 316* (definition)], the gain will be taxed as dividend to the extent of the each shareholder's ratable share of the corporation's undistributed earnings and profits [*see I.R.C. § 356(a)(2)*; *see also* Ch. 9, *Dividends, Reacquisitions of Shares, and Assessments*]. For tax years beginning after December 31, 2002, and before January 1, 2009, the amount treated as a dividend will be taxed at capital gains rates [*I.R.C. §§ 1(h)(11), 356(a)(2)*; *see* Pub. Law No. 108-27, §§

302(f)(1), 303 (effective date and sunset provisions)]. For other years, the amounts treated as a dividend are taxed at ordinary income tax rates [*I.R.C. §§ 1(a)-(e), (h)(11), (i)(2), 356(a)(2)*; *see* Pub. Law No. 108-27, §§ 302(f)(1), 303 (effective date and sunset provisions)]. To determine whether an exchange has the effect of a dividend distribution or a stock redemption, a court must view the exchange as an integrated whole [*Commissioner v. Clark (1989) 489 U.S. 726, 109 S. Ct. 1455, 103 L. Ed. 2d 753]* . In a case in which there was no evidence that a payment of cash was a concealed dividend, the boot was characterized as a part of the proceeds of a sale of stock rather than as a proxy for a dividend, and qualified for capital gains treatment [*Commissioner v. Clark (1989) 489 U.S. 726, 109 S. Ct. 1455, 103 L. Ed. 2d 753]* .

[2] Voting Stock Requirement

For a share exchange to be a tax-free "reorganization" under the Internal Revenue Code, the acquiring corporation must acquire shares of the acquired corporation solely in exchange for its own voting shares or the voting shares of its parent corporation [*I.R.C. § 368(a)(1)(B)*]. The income tax statutes do not define what constitute "voting" shares of the acquiring corporation. The Supreme Court has held, however, that shares of an acquired corporation acquired in exchange for stock purchase warrants of the acquiring corporation were not acquired, as required by statute, solely in exchange for voting shares of the acquiring corporation or its parent [*Helvering v. Southwest Consol. Corp. (1942) 315 U.S. 194, 200-201, 62 S. Ct. 546, 86 L. Ed. 789]* . The Internal Revenue Service has also ruled that shares whose voting rights are suspended for five years do not constitute voting shares that may be exchanged for shares of an acquired corporation in a tax-free reorganization [Rev. Rul. § 72-72, *1972-1 C.B. 104*].

The "solely for stock" requirement means only stock may be exchanged. The requirement is not limited to just that stock needed to meet the control requirement. The exchange of stock for 80 percent of an acquired corporation's stock and the purchase of the remaining 20 percent of the acquired corporation's stock, therefore, disqualified the transaction under *I.R.C. § 368(a)(1)(B)* and gain or loss was recognized for all stock exchanged in the transaction [*Rev. Rul. 75-123, 1975-1 C.B. 115*].

A de minimis rule, however, allows for payment for fractional shares in the exchange when the cash is not a separately bargained-for consideration but only a method to round off fractional shares in an exchange. The payment of cash for fractional shares in an otherwise qualifying B reorganization, therefore, will not cause the loss of its tax-free status [*Mills v. Commissioner of Int. Rev. (5th Cir. 1964) 331 F.2d 321, 324* ; *Rev. Rul. 66-365, 1966-2 C.B. 116*].

Another exception to the solely-for-stock rule is that securities may be exchanged without disqualifying the transaction if done in pursuance of the reorganization. The IRS has ruled that a type B reorganization was not disqualified by a separate exchange of debentures of the corporations in pursuance of the reorganization when the stock of the acquired corporation was exchanged solely for the stock of the acquiring corporation [*Rev. Rul. 98-10, 1998-10 I.R.B. 11*].

[3] Deferred Stock Payments

The acquiring corporation in a share exchange acquisition may want to defer determination of the number of its voting shares it wishes to exchange for shares of the acquired corporation. The acquiring corporation may wish to observe performance of the acquired corporation as its subsidiary, it may question the ability of the acquired corporation to sustain its past pattern of growth, or it may wish to withhold computation of the shares to be exchanged for the acquired corporation until pending litigation against the acquired corporation has been determined [*see* Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, ch. 4, Tax-Free Acquisitions, § 4.03[4][c]* (Matthew Bender)]. A plan that defers this determination to some specified future time is known as a deferred stock payment plan.

Ordinarily, a deferred stock payment plan is based on future earnings of the acquired corporation. The more the acquired corporation earns as a subsidiary of the acquiring corporation, the more the acquiring corporation is willing to pay for it, and the more voting shares of the acquiring corporation or its parent the former shareholders of the acquired

corporation may receive [Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, ch. 4, Tax-Free Acquisitions, § 4.03[4][c]* (Matthew Bender)]. The Internal Revenue Service has ruled that such a deferred stock payment plan does not destroy a share exchange's status as a tax-free reorganization. When the shareholders of the acquired corporation receive in the exchange of nonassignable contingent contractual right to receive additional voting shares of the acquiring corporation based on the future earnings of the acquired corporation, the IRS has ruled the "solely for voting shares" requirement of the statute is not violated and the exchange is a tax-free reorganization [*Rev. Rul. 66-112, 1966-1 C.B. 68*].

The IRS has issued guidelines relating to deferred stock payment plans as they relate to both shares-for-shares tax-free reorganizations and assets-for-shares tax-free reorganizations. Although the guidelines are simply for the IRS' own use in issuing ruling letters on proposed transactions and do not purport to be substantive law [*Rev. Proc. 77-37, 1977-2 C.B. 568*], they are worth noting. According to the guidelines, all the shares that are to be issued by the acquiring corporation or its parent in exchange for the shares or assets of an acquired corporation need not be issued immediately on transfer of the acquired corporation's shares or assets to the acquiring corporation. The IRS will still issue a ruling letter saying the transaction is a tax-free reorganization, provided that all of the following conditions are satisfied [*Rev. Proc. 77-37*]:

- All of the shares of the acquiring corporation or its parent that are to be issued in the exchange are issued within five years from the date of the transfer of the acquired corporation's assets to the acquiring corporation or the initial shares are originally distributed for shares of the acquired corporation.

- There is a valid business reason for not issuing all of the acquiring corporation's shares immediately, such as the difficulty in determining the value of one or both of the corporations involved in the reorganization.

- The maximum number of shares which may be issued in the exchange is stated.

- At least 50 percent of the maximum number of shares of each class which may be issued are issued in the initial distribution.

- The agreement evidencing the right to receive shares in the future is either nonassignable or is not evidenced by negotiable certificates and is not readily marketable.

- The right to receive shares in the future can give rise only to the receipt of additional shares of the acquiring corporation or additional shares of the acquiring corporation's parent, as the case may be.

[4] Creeping Control Situations

A corporation may acquire control [*see I.R.C. § 368(c)*] in stages through a series of stock-for-stock exchanges, rather than all at once, and still qualify the entire series of exchanges as a type B reorganization. Under the Treasury Regulations, a series of stock-for-stock exchanges transacted over a relatively short period of time (such as 12 months) will qualify if the solely for stock requirement is met throughout and control requirements are met at the end [*Treas. Reg. § 1.368-2(c)*].

The control requirement also may be met in stages by an initial purchase of stock of the corporation to be acquired followed at a later time by a stock-for-stock exchange. For example, assume corporation A purchases a 25 percent interest in corporation B. At some later time, corporation A exchanges its stock for 60 percent of the stock in corporation B. The stock-for-stock exchange qualifies as a type B reorganization because Corporation A meets the control requirement after the exchange by owning 85 percent of corporation B stock [*Treas. Reg. § 1.368-2(c)*].

Once the control requirement is met, any subsequent stock- for-stock-exchange between the two corporation that meets the solely for stock requirement will qualify as a type B reorganization [*Treas. Reg. § 1.368-2(c)*].

[5] Business Purpose and Continuity of Business Interest

A stock-for-stock reorganization [*I.R.C. § 368(a)(1)(B)*] must meet the general business purpose and continuity of business enterprise and interest requirements applicable to all reorganizations [*see Treas. Reg. § 1.368-1(c)*-(e)]. To obtain the nonrecognition treatment of a qualified reorganization, therefore, the transaction must have a bona fide business purpose and may not be a device simply to avoid taxes [*Treas. Reg. § 1.368-1(c)*].

The continuity of business enterprise requirement means that the acquiring corporation must either continue the acquired corporation's historic business or use a significant portion of the acquired corporation's business assets in a business after the reorganization [*Treas. Reg. § 1.368-1(d)(1)*]. The continuity of interest requirement means that some proprietary interest of the acquired corporation must be preserved so that transactions that resemble sales do not qualify for nonrecognition treatment available to qualified reorganizations [*Treas. Reg. § 1.368-1(e)*]. For further discussion, see Ch. 11, *Merger and Reorganization Issues* .

[6] Income Tax Basis for Acquired Assets and Shares

In tax-free reorganizations generally, recognition of gain is deferred pursuant to substituted and carryover basis provisions. In a tax-free "B" reorganization, the shareholders receiving shares of the acquiring corporation have a "substituted" basis equal to their basis in the shares of the acquired corporation [*I.R.C. § 358*]. The acquiring corporation does not obtain a new income tax basis for either the shares or assets of the acquired corporation. It receives a "carryover" basis for the stock received equal to the transferors' former basis [*I.R.C. § 362(b)*; *see* Ch. 11, *Merger and Reorganization Issues*]. Because the acquired corporation continues as a separate legal and tax entity after the exchange, the income tax basis of its assets also remains unchanged [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 4, *Tax-Free Acquisitions* (Matthew Bender)]. In contrast to an acquisition by taxable purchase of shares, in which the acquiring corporation may step-up the basis of the acquired corporation's assets pursuant to *I.R.C. § 338* [*see § 11A.22[3]*], there is no method for the acquiring corporation in a tax-free "B" reorganization to step-up the basis of those assets. For a further discussion of the basis rules for the various acquisition methods, see Ch. 11, *Merger and Acquisition Issues* .

[7] Net Operating Loss Carryforward

An acquiring corporation succeeds to the net operating loss carryover of an acquired corporation only pursuant to *I.R.C. § 381* [*see* Ch. 11, *Merger and Acquisition Issues*]. A "B" reorganization is not one of the acquisition methods enumerated in that section that automatically result in a transfer of any net operating loss carryforward from the acquired corporation to the acquiring corporation [*see I.R.C. § 381(a)(1), (c)(1)*]. Because the acquired corporation continues as a separate legal entity, it can continue to use any net operating loss carryforward deduction to which it is entitled [*see I.R.C. § 172*; *see also* Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 174, *The Carryover and Use of Tax Attributes in a Corporate Acquisition* (Matthew Bender)]. The acquiring corporation may obtain the carryforward only by merging the acquired corporation into itself [*see I.R.C. § 381(a)(2)*; *see also* Ch. 11C, *Mergers*], or by liquidating the acquired corporation, which has become a subsidiary, pursuant to *I.R.C. § 332* [*see I.R.C. § 381(a)(1)*]. However, if a liquidation occurs shortly after the acquisition, and the assets are distributed directly to the purchaser, the entire transaction may be recharacterized as a sale of assets ("C" reorganization) [*see* Ch. 11E, *Acquisition of Assets for Shares*] rather than a sale of stock [*Rev. Rul. 67-274, 1967-2 C.B. 141*].

The amount of carryforward will be limited if, after the reorganization, the percentage of stock in the acquiring corporation owned by one or more five-percent shareholders has increased by more than 50 percentage points over the lowest percentage of stock of the acquired corporation owned by those shareholders at any time during the three-year

period ending on the reorganization date [*I.R.C. § 382(g)*]. The carryforward will be disallowed if the acquiring corporation does not continue the business enterprise of the acquired corporation at all times during the two-year period beginning on the reorganization date [*see I.R.C. § 382(c)*].

Even if the acquired corporation's shareholders meet the continuity of ownership standards, however, the carryforward still may be disallowed if the acquiring corporation's principal purpose in making the acquisition is the avoidance of federal income tax by obtaining a deduction that it would otherwise not obtain [*see I.R.C. § 269(a)*]. For a detailed discussion of the net operating loss carryforward and the restrictions on its use, see Ch. 11, *Merger and Acquisition Issues* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTax-Free AcquisitionsTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Tax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)CarryforwardsTax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)Stock & Other Securities



97 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART II. LEGAL BACKGROUND

5-11D California Legal Forms--Transaction Guide § 11D.24

§ 11D.24 Corporate Securities Law Requirements

[1] Qualification and Exemption

Under California's Corporate Securities Law of 1968, it is unlawful to offer or sell any security in California unless it has been "qualified" with the California Commissioner of Corporations, or unless the security is exempt from qualification or is not subject to qualification [*Corp. Code §§ 25110, 25120, 25130*]. Mergers are exempt from the qualification requirements set forth in *Corp. Code § 25120* under specified circumstances. Any change in the rights, preferences, privileges, or restrictions on or of outstanding securities, and any exchange of securities by the issuer with its existing security holders exclusively, will be exempt from qualification if the transaction, had it involved the issuance of a new security containing the changed rights, preferences, privileges, or restrictions, or a new issuance of the exchanged security, would have been exempt from qualification [*see Corp. Code § 25110*]. For discussion of qualification and exemption of securities, including the preemption of state qualification or registration of "covered securities," as defined by the National Securities Markets Improvement Act of 1996 [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005); *see 15 U.S.C. § 77r*], *see* Ch. 6, *Securities Regulation Issues* , and Marsh & Volk, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, ch. 3A, *Federal Preemption of State Securities Regulation* (Matthew Bender).

[2] Issuer Transactions

[a] In General

The Corporate Securities Law of 1968 divides the offers and sales of securities that must be qualified into two broad categories: those involving "issuer transactions" and those involving "nonissuer transactions" [*Corp. Code §§ 25010, 25011, 25110*]. Any type of corporate acquisition method involving the issuance of new shares by one corporation in exchange for the shares or assets of another corporation is an "issuer transaction" under the Corporate Securities Law of 1968 [*Corp. Code §§ 25010, 25120*]. The acquisition of one corporation by another corporation by means of a statutory merger, an exchange of shares, or an exchange of assets for shares is an "issuer transaction" subject to California's Corporate Securities Law of 1968.

[b] Requirements for Two Types

The Corporate Securities Law further divides issuer transactions subject to the Law into two types, which the statutes refer to as "issuer transactions" [*Corp. Code § 25110*] and "recapitalizations and reorganizations" [*Corp. Code § 25120*], respectively. Shares to be issued in a proposed merger or exchange of assets for shares must be qualified as a recapitalization or reorganization [*Corp. Code § 25120*]. Shares to be issued as part of a proposed share exchange, however, must be qualified as an ordinary issuer transaction in the same manner as the original issuance of shares by a corporation for cash [Marsh & Volk, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, ch. 7, *Recapitalizations and Reorganizations* (Matthew Bender)]. There are several differences between the requirements for qualifications of securities to be issued in a "recapitalization or reorganization" and the requirements for qualifications of securities to be issued in a simple "issuer transaction." The requirements for qualification of securities to be issued in a "recapitalization or reorganization," such as a merger, are *set forth in Ch. 11C, Mergers, § 11C.204*. The requirements for qualification of securities to be issued in an ordinary "issuer transaction" are covered in Ch. 6H, *Qualification of Securities* .

The main difference between the requirements for qualification of securities to be issued in the two types of transactions is that the requirements for securities to be issued in a recapitalization or reorganization are less strict than for an original issuer transaction. For example, shares to be issued in a proposed merger or de facto merger are exempt from qualification unless 25 percent of the persons who are to receive them reside in California [Marsh & Volk, *PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, ch. 7, Recapitalizations and Reorganizations, § 7.06[5][b]* (Matthew Bender)]. Shares to be issued as part of an ordinary issuer transaction, including a shares for shares exchange, must be qualified if even one shareholder of the acquired corporation resides in California [Marsh & Volk, *PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, ch. 7, Recapitalizations and Reorganizations, § 7.06[5][c]*(Matthew Bender)]. The permit for a share exchange should be obtained before approval of the shareholders of the acquiring corporation is sought and before any tender offer is made to the shareholders of the corporation sought to be acquired. Ordinarily it is applied for immediately after the board of directors of the acquiring corporation passes a resolution approving the proposed exchange of its shares for the shares of the corporation sought to be acquired.

The reason for imposing stricter controls on a proposed share exchange than on a statutory merger or exchange of assets for shares is because of the lack of group action required in a share exchange by shareholders of the corporation sought to be acquired. They accept the offer to exchange their shares for shares of the acquiring corporation individually. No meeting of shareholders of the acquired corporation to approve the proposed exchange is held and they are not provided with the disclosures usually required to be made to shareholders at such a meeting [Marsh & Volk, *PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, ch. 7, Recapitalizations and Reorganizations, § 7.06[5][c]* (Matthew Bender)]. Further, in a merger or assets-for-shares exchange all shares of the acquired corporation must be exchanged for shares of the acquiring corporation or "cashed out" as dissenting shares. In a share exchange, a dissenting shareholder of the acquired corporation simply keeps his or her shares. The fact that 80 percent of the acquired corporation's shareholders reside outside California and have accepted the exchange offer may seriously affect the investment of the lone dissenting acquired corporation shareholder who resides in California. Issuance of any shares pursuant to a proposed share exchange, therefore, must be qualified under the Corporate Securities Law even though only one shareholder of the corporation proposed to be acquired in the exchange resides in California [Marsh & Volk, *PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, ch. 7, Recapitalizations and Reorganizations, § 7.06[5][c]* (Matthew Bender)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsExempted Issuers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART II. LEGAL BACKGROUND

5-11D California Legal Forms--Transaction Guide § 11D.25

§ 11D.25 Nonassumption of Acquired Corporation's Liabilities

A corporation is a distinct separate legal entity from its shareholders, and the shareholders ordinarily are not liable for its obligations [*Hollywood Cleaning & Pressing Co. v. Hollywood Laundry Service, Inc. (1932) 217 Cal. 124, 129]* . The mere fact that one corporation owns all the shares of another corporation is not of itself sufficient to cause the courts to disregard the separate legal entity of the owned corporation and hold its corporate shareholder liable for its debts [*Hollywood Cleaning & Pressing Co. v. Hollywood Laundry Service, Inc. (1932) 217 Cal. 124, 129]* . Thus, when one corporation acquires all the shares of another corporation, whether by means of a cash purchase or a tax-free share exchange, it does not become directly liable for the debts and obligations of the acquired corporation [Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 165, Sales of Stock, § 165.02[2]* (Matthew Bender)].

Any purchaser of corporate shares, however, whether for cash or otherwise, runs the risk that his or her purchase may become worthless because of unknown or undisclosed liabilities of the corporation that issued the purchased shares [Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 161, Review of Factors to Be Considered in Selecting Form of Acquisition, § 161.02[1]* (Matthew Bender)]. All corporations have debts and liabilities that appear on their accounting books and financial statements. The acquiring corporation can and should discover these by careful investigation. The acquired corporation may also have debts and liabilities that are not listed on its accounting books and financial statements. This may be because the books and financial statements are improperly kept and prepared, or it may be because the unknown debts or liabilities are inchoate and have not as yet been asserted or arisen [Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 161, Review of Factors to Be Considered in Selecting Form of Acquisition, § 161.02* (Matthew Bender)]. A claim for injuries caused by a defective product placed on the market by an acquired corporation may not arise until many years after the defective product was placed on the market. When that claim arises, however, it may bankrupt the acquired corporation and cause its shares, for which the acquiring corporation exchanged valuable shares of its own, to become worthless.

For this reason, the agreement for a share exchange usually contains many warranties and representations by shareholders of the corporation whose shares are being acquired. Along with a complete investigation of the history and affairs of the acquired corporation, this may be the only protection the acquiring corporation can obtain against unknown or contingent liabilities of the acquired corporation making its shares worthless [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 2A, *General Considerations in Corporate Acquisitions and*

Mergers, § 2A.03 (Matthew Bender)]. The personal warranties the selling shareholders are willing to give, however, usually are limited to assuring that the relevant balance sheets and accounting books of the acquired corporation are true, complete, and disclose all known liabilities of the acquired corporation [Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 161, Review of Factors to Be Considered in Selecting Form of Acquisition, § 161.02* (Matthew Bewnder)]. Few shareholders of an acquired corporation would personally warrant to the acquiring corporation that no claims will arise due to defective products placed on the market by the acquired corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesPersonal LiabilityMergers & Acquisitions LawLiabilities & Rights of SuccessorsSuccessor Liability Doctrine



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART II. LEGAL BACKGROUND

5-11D California Legal Forms--Transaction Guide § 11D.26

§ 11D.26 Other Advantages and Disadvantages of Share Exchanges

[1] Advantages

[a] No Board Approval

The most noticeable feature of a share acquisition or share exchange is that it does not need the approval of the management or board of directors of the corporation sought to be acquired [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 5D, *Acquisitions of Stock*, § 5D.01 (Matthew Bender)]. In fact, many corporations have acquired other corporations through share exchange offers made directly through "tender offers" to the shareholders of the corporation sought to be acquired, despite vigorous opposition to the offer by that corporation's board of directors [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 5E, *Tender Offers and Takeovers* (Matthew Bender)]. In the usual case, however, the fact that approval by the management and directors of the acquired corporation is not required may not be too important to a proposed share acquisition.

A more important feature of a share exchange, especially one designed to be a tax-free reorganization, is the fact that it will dilute the ownership interests and voting rights of existing shareholders of the acquiring corporation. For this reason, the California General Corporation Law requires a proposed share exchange corporation acquisition to be approved by the outstanding shares of each class, regardless of voting rights, of the acquiring corporation or its parent party [*see § 11D.21[1]*]. The General Corporation Law also gives to minority shareholders of the acquiring corporation who do not approve the proposed share exchange the same rights as dissenting shareholders to a proposed merger to require their shares to be purchased for cash at their appraised fair market value on the date preceding first announcement of the terms of the share exchange [*Corp. Code §§ 1200, 1201(a), 1300*; *see* [b], *below*].

[b] Purchase of Dissenting Shares

An advantage of a proposed corporate acquisition by means of a share exchange is that the right to require the shares to be purchased for cash at their appraised fair market value extends only to dissenting shareholders of the *acquiring* corporation. Dissenting shareholders of the corporation sought to be acquired have no such right. They merely refuse to exchange their shares in the acquired corporation for shares of the acquiring corporation. This means, however, that after completion of the exchange, the acquiring corporation may be faced with a minority group of problem

shareholders of the acquired corporation who hamper its efforts to manage that corporation [Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 161, Review of Factors to Be Considered in Selecting Form of Acquisition, § 161.08* (Matthew Bender)]. The acquiring corporation can solve this problem by dissolving the acquired corporation or merging it into itself. Dissolution of the acquired corporation or merger of it into the acquiring corporation, however, ordinarily will have no tax advantages and may destroy one of the advantages of a share exchange--continued preservation of the identity and goodwill of the acquired corporation.

[c] No Sales and Use Tax

Another advantage of a share exchange is that it is not subject to California sales and use tax [*see Rev. & Tax. Code § 6001 et seq.*]. No requisite sale of tangible personal property occurs because the only property transferred--stock--is intangible personal property [*see Rev. & Tax. Code § 6016*] (definition of tangible personal property)]. For further discussion of the sales and use tax in the context of mergers and acquisitions, see Ch. 11, *Merger and Acquisition Issues* .

[d] Simplicity

A supposed advantage of acquiring a corporation by means of a share exchange instead of a purchase of its assets or an exchange of its assets for shares of the acquiring corporation is the simplicity of consummating the transaction. As a result of the share exchange, the acquired corporation continues in existence and remains liable for its obligations. Therefore, compliance with the provisions of the Uniform Commercial Code--Bulk Sales Division is not necessary [Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 161, Review of Factors to Be Considered in Selecting Form of Acquisition, § 161.06* (Matthew Bender)].

An asset transaction will require the drafting, execution, and recording of different instruments of conveyance for different types and in some cases different individual assets of the acquired corporation. In contrast, the only conveyances required in a share exchange are endorsement of the acquired corporation's share certificates for transfer to the acquiring corporation, and issuance of the acquiring corporation's shares to former shareholders of the acquired corporation. This supposed advantage may be illusory, however, when the shares of the acquired corporation are publicly owned, its shareholders are scattered over a wide part of the world, and the acquiring corporation must expend considerable funds and effort in obtaining surrender of their shares for shares of its own. Further, the advantages of a share exchange acquisition's simplicity may be lost when it is or becomes necessary to dissolve the acquired corporation after its shares have been acquired by the acquiring corporation [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 2A, *General Considerations in Corporate Acquisitions and Mergers* (Matthew Bender)].

[2] Disadvantages

A major disadvantage of a proposed corporation acquisition by means of a share exchange is the need to secure a permit for the exchange from the California Corporations Commissioner, regardless of the percentage of shareholders of the acquired corporation residing in California [*see Corp. Code § 25110*; *see also § 11D.24*]. The requirements for obtaining the permit are more burdensome than those for obtaining a permit for a merger or asset acquisition. Furthermore, a permit for a merger or asset acquisition is not necessary unless 25 percent of the affected shareholders reside in California [*see Ch. 11C, Mergers, § 11C.204*].

As discussed in *§ 11D.21[1]*, the proposed share exchange must be approved by the affirmative vote of a majority of all outstanding shares of each class of the acquiring corporation, regardless of any restrictions on their voting rights [*see Corp. Code §§ 117, 153*]. Finally, undisclosed and unknown liabilities of the acquired corporation may render the shares of the acquired corporation worthless [*see § 11D.25*]. For a list of the relative advantages and disadvantages of a shares for shares acquisition, including tax factors, see *§§ 11D.111, 11D.112*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersRights of Dissenting ShareholdersMergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawTax-Free AcquisitionsMergers & Acquisitions LawMergersDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART II. LEGAL BACKGROUND

5-11D California Legal Forms--Transaction Guide §§ 11D.27-11D.99

[Reserved]

§§ 11D.27[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11D California Legal Forms--Transaction Guide § 11D.100

§ 11D.100 Facts

1. Identity of acquiring corporation.

a. Exact name as it appears on corporation's articles of incorporation.

b. Address and telephone number of principal executive offices.

c. Names, addresses, and telephone numbers of principal corporate officers:
(1) Directors.

(2) President.

(3) Executive vice president.

(4) Corporate secretary.

(5) Corporate treasurer.

(6) Other executive officers.

d. Name, address, and telephone number of accountant or accounting officer for corporation.

e. Type of business corporation engages principally in conducting.

f. Brief business history of corporation.

NOTE:

This business history is needed on the application to the California Corporations Commissioner for a permit qualifying the shares to be issued in the proposed share exchange [***see*** *Ch. 6H,* ***Qualification of Securities****, § 6H.220*].

g. Number of shares of each class and series that corporation is authorized to issue.

NOTE:

This will determine whether corporation's articles of incorporation must be amended to authorize issuance of additional shares required by proposed share exchange.

h. Number of shares of each class and series outstanding.

i. Number of shareholders of each class or series.

j. Usual time and place for holding meetings of board of directors.

k. Usual time and place for holding meetings of shareholders.

l. Meeting of board of directors at which proposed share exchange may be considered and approved.

(1) Regular meeting.

(2) Special meeting.

2. Identity of corporation sought to be acquired.

a. Exact name as it appears on its articles of incorporation.

b. State or place of incorporation.

c. Address of principal executive offices.

d. Names and addresses of directors and principal officers.

e. Classes and series of shares outstanding.

f. Number of shares of each class outstanding.

g. Voting rights of different classes outstanding shares.

h. Names and addresses of shareholders.

NOTE:

A list of shareholders of the corporation sought to be acquired can usually be obtained from the management of that corporation if that management is friendly to the proposed share exchange. A list of shareholders of the corporation sought to be acquired can also be obtained through any shareholder of that corporation. The record of shareholders of a corporation must be open to inspection and copying by any shareholder of the corporation at any time during usual business hours on written demand to the corporation [*Corp. Code § 1600(c)*]. The inspection and copying may be done by the shareholder, or his or her

agent or attorney [*Corp. Code § 1600(d)*].

i. Type of business primarily conducted by corporation.

j. Financial reputation and credit rating of corporation.

k. Approximate net worth of corporation.

l. National and regional securities exchanges, if any, on which shares of corporation are traded or listed.

m. Present approximate market value of shares of corporation of each class and series.

3. Whether negotiations concerning proposed share exchange have been conducted with management or any shareholders of corporation sought to be acquired.

a. Results of negotiations.

b. Person who conducted negotiations on behalf of acquiring corporation.

c. Information about persons who conducted negotiations on behalf of corporation sought to be acquired or its shareholders:

(1) Position as principal shareholder, director, or officer of corporation sought to be acquired.

(2) Address and telephone number.

(3) Attitude toward proposed share exchange.

4. Purpose of proposed acquisition:

a. To acquire goodwill and identity of corporation sought to be acquired?

b. To acquire assets of corporation sought to be acquired?

c. To acquire tax advantage enjoyed by corporation sought to be acquired?

d. Other purpose.

5. Attitude of management and directors of corporation sought to be acquired toward proposed share exchange.

a. Friendly toward proposal.

b. Noncommittal.

c. Opposed to proposal.

d. Vigorously opposed to proposal.

6. Attitude of principal shareholders of corporation sought to be acquired toward proposed share exchange.

7. Approximate present market value of voting shares of acquiring corporation.

8. Whether fractional shares should be issued by acquiring corporation as part of proposed share exchange, or whether cash payment should be made for fractional shares due shareholders of corporation sought to be acquired.

9. Any litigation threatened or pending against corporation sought to be acquired.

a. Name of litigants.

b. Court when pending or threatened.

c. Case number when litigation is already pending.

d. Nature of litigation and liability alleged.

e. Names, addresses, and telephone numbers of attorneys involved in pending or threatened litigation for each side.

f. Whether liability alleged against corporation sought to be acquired in pending or threatened litigation is funded with insurance or other source.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11D California Legal Forms--Transaction Guide § 11D.101

§ 11D.101 Documents

1. Articles of incorporation of acquiring corporation, as last amended.

2. Articles of incorporation of corporation sought to be acquired, as last amended.

NOTE:
A copy of the articles can be obtained from Secretary of State if the corporation sought to be acquired is a California corporation.

3. Bylaws of acquiring corporation, as last amended.

4. Original permit to issue shares and any subsequent permits to issue shares or securities obtained by acquiring corporation.

5. Stock certificate book and stock record book of acquiring corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11D California Legal Forms--Transaction Guide §§ 11D.102-11D.109

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§§ 11D.102[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11D California Legal Forms--Transaction Guide § 11D.110

§ 11D.110 Preliminary Determinations for Shares-for-Shares Exchange

1. Determine whether proposed share exchange can be arranged as income tax-free reorganization.

a. Shares of acquired corporation must be acquired solely in exchange for voting shares of acquiring corporation or its parent.
(1) Cash may be paid for fractional shares due to shareholders of acquired corporation in exchange [*see § 11D.23[2]*].

(2) Issuance of shares of acquiring corporation for shares of acquired corporation can be deferred under guidelines issued by Internal Revenue Service to determine value of acquired corporation's shares [*see Rev. Proc. 77-37, 1977-2 C.B. 568* ; *see also § 11D.23[3]*]:
(a) Cannot be deferred for more than five years.

(b) At least 50 percent of maximum number of acquiring corporation's shares to be issued in exchange must be issued and given to acquired corporation's shareholders when shares of acquired corporation are tendered to acquiring corporation.

(c) Right of shareholders of acquired corporation to receive shares in future must be nonassignable and be right to receive only additional shares of acquiring corporation or its parent.

b. Immediately after share exchange qualifying as tax-free reorganization, acquiring corporation must be in control of acquired corporation [*I.R.C. § 368(a)(1)(B), (c)*]:

(1) Must own shares of acquired corporation possessing at least 80 percent of combined voting power

of acquired corporation.

(2) Must own at least 80 percent in number of all other outstanding shares of acquired corporation [*see § 11D.23[1]*].

(3) May acquire required control of acquired corporation in one or series of share exchanges over short period such as 12 months [*see § 11D.23[4]*].

2. Determine ratio in which shares of corporation sought to be acquired are to be exchanged for shares of acquiring corporation:

a. Depends on relative net worth and value of shares of each corporation.

b. Depends on extent to which shares of acquiring corporation may be diluted by straight shares for shares exchange.

c. Shares of acquired corporation must be exchanged solely for voting shares of acquiring corporation to make exchange tax-free reorganization.

3. Determine whether cash or scrip should be paid for fractional shares due shareholders of acquired corporation in exchange [*see § 11D.23[2]*].

4. Determine risk that acquired corporation has unknown and inchoate liabilities that may render its shares worthless:

a. Liability or injuries caused by defective products acquired corporation manufactured or placed on market.

b. Other unknown tort liabilities.

5. Determine extent to which shareholders, or principal shareholders, of corporation sought to be acquired will personally warrant and guarantee its liabilities:

a. Warrant financial statements and account books to be true, full, and complete.

b. Guarantee no liabilities existing at all including unknown and inchoate liabilities.

c. Assume liability for some pending litigation or claim, such as action involving patent infringement claim or breach of fiduciary duty.

6. Determine whether proposed corporate acquisition should be consummated by means of share exchange or by other acquisition method such as cash purchase of shares, cash purchase of assets, statutory merger, or exchange of shares for the assets of corporation sought to be acquired.

7. Determine classes of shares of acquiring corporation that must approve proposed share exchange:

a. Need not be approved by any class of outstanding preferred shares when rights, preferences, privileges, and restrictions granted to or imposed on them will remain unchanged [*Corp. Code § 1201(a)*].

b. Two classes of common shares differing only as to voting rights will be considered as only one class of shares for purposes of voting on proposed share exchange [*Corp. Code § 1201(a)*].

c. No approval is needed when shareholders of acquiring corporation will, immediately after exchange, still own shares of acquiring corporation possessing more than five-sixths of voting power of the acquiring corporation [*Corp. Code § 1201(b)*].

NOTE:

In determining whether shareholders of the acquiring corporation, after the exchange, will still own the required amount of shares in the acquiring corporation, any shares owned by any of them before the exchange in the corporation to be acquired must be disregarded [*Corp. Code § 1201(b)*].

8. Determine amount of votes required by each class of shares of acquiring corporation or its parent party to approve proposed share exchange.

9. Determine whether required approval by outstanding shares of each class of acquiring corporation of proposed share exchange should be obtained at special meeting of shareholders or by written consent of shareholders.

10. Determine whether proposed share exchange can be consummated as friendly transaction with cooperation of management of corporation sought to be acquired, or whether public tender offer directly to shareholders of the corporation sought to be acquired must be made.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewBusiness & Corporate LawGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Mergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of ShareholdersMergers & Acquisitions LawTax-Free Acquisitions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11D California Legal Forms--Transaction Guide § 11D.111

§ 11D.111 Advantages of Shares-for-Shares Acquisition

NOTE:
This section and § 1D.112 are designed to assist the attorney in assessing, and counseling a party to a corporate acquisition regarding, the relative advantages and disadvantages of a shares-for-shares acquisition. For additional discussion, see Ch. 11, ***Merger and Acquisition Issues*** .

1. Mechanical simplicity:

a. Compliance with escrow and notice requirements of Uniform Commercial Code--Bulk Sales Division is not required [*see Com. Code § 6101 et seq.*].

NOTE:
For a discussion of those requirements, see *Ch. 11B,* ***Cash Purchase of Assets****, § 11B.20[1][c]*; for more detailed discussion, see Ch. 17, ***Buying and Selling a Business*** .

b. Separate instruments of conveyance need not be drafted, executed, and recorded for various assets of acquired corporation [*see Ch. 11B, Cash Purchase of Assets, § 11B.112[7]*].

2. Approval of board of directors and management of corporation sought to be acquired is not needed.

3. Acquiring corporation is not liable after share exchange for debts, liabilities, and obligations of acquired corporation.

4. Separate identity and goodwill of acquired corporation are preserved after share exchange.

5. Dissenting shareholders of corporation sought to be acquired have no right to require their shares to be purchased for cash at their appraised fair market value.

6. Income tax advantages:

a. Share exchange can be arranged as income tax-free reorganization [*I.R.C. § 368(a)(1)(B)*; *see § 11D.23[1]*].

b. By dissolving or merging acquired corporation into itself, acquiring corporation, can obtain net operating loss carryover deduction belonging to acquired corporation [*see § 11D.23[7]*].

NOTE:

That carryforward, however, may be reduced or disallowed [***see*** *I.R.C. §§ 269(b), 382*].

7. Transaction is not subject to California sales and use tax.

NOTE:

The sales and use tax [*Rev. & Tax. Code §§ 6001-7176*] imposes a tax on property transferred in other types of reorganizations. For a discussion of the application of this tax to mergers and acquisitions, see Ch. 11, ***Merger and Acquisition Issues*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTax-Free AcquisitionsMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersGeneral Overview



106 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11D California Legal Forms--Transaction Guide § 11D.112

§ 11D.112 Disadvantages of Shares-for-Shares Acquisition

1. Permit must be obtained from California Commissioner of Corporations qualifying shares to be issued in exchange by acquiring corporation [*Corp. Code § 25110*; *see* Ballantine & Sterling, California Corporation Laws, ch. 21, *Corporate Securities Law* (Matthew Bender)].

NOTE:
The qualification requirements are stricter for a shares for shares exchange ("B" reorganization) [***see*** *I.R.C. § 368(a)(1)(B)*] than for shares to be issued in a statutory merger ("A" reorganization) [***see*** *I.R.C. § 368(a)(1)(A)*] or assets-for-shares exchange ("C" reorganization) [***see*** *I.R.C. § 368(a)(1)(C)*]. Although "A" and "C" reorganizations are exempt from qualification unless 25 percent of the persons who will receive shares reside in California [***see*** *Corp. Code § 25103(c)*], a permit is required in a "B" reorganization even if only one shareholder of the corporation sought to be acquired lives in California [***see*** *§ 11D.24*].

2. Acquiring corporation cannot acquire new income tax basis for assets of acquired corporation, even by dissolving or merging with acquired corporation after exchange [*see I.R.C. § 362(b)*].

NOTE:
See *§ 11D.26*. In a taxable acquisition of stock, however, the acquiring corporation may elect to step-up the basis of the acquired corporation's assets [***see*** *I.R.C. § 338*; ***see also*** *Ch. 11A,* ***Cash Purchase of Shares****, § 11A.22[3]*].

3. Proposed share exchange must be approved by affirmative vote of majority of all outstanding shares of each class of acquiring corporation, regardless of any restrictions on their voting rights [*see § 11D.21[1]*].

4. Undisclosed and unknown liabilities of acquired corporation may render shares of acquired corporation worthless [*see § 11D.25*].

5. When corporation sought to be acquired has large number of shareholders scattered over world, cost and effort required to obtain their acceptance of share exchange offer may be prohibitive.

6. Shareholders of acquiring corporation who do not approve of proposed exchange may require their shares to be purchased for cash at their appraised fair market value.

7. Shareholders of acquired corporation who refuse to exchange their shares may constitute group of minority shareholders hampering effective management of acquired corporation by acquiring corporation after exchange.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawTaxable AcquisitionsStock AcquisitionsMergers & Acquisitions LawTax-Free AcquisitionsTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11D California Legal Forms--Transaction Guide §§ 11D.113-11D.119

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§§ 11D.113[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-11D California Legal Forms--Transaction Guide § 11D.120

§ 11D.120 Procedures for Consummating Shares-for-Shares Exchange

1. Prepare either:

a. Agreement between acquiring corporation and shareholders of corporation sought to be acquired for proposed exchange of shares:
(1) Include warranties and personal representations binding on shareholders of corporation sought to be acquired [*see §§ 11D.200-11D.202*].

(2) Specify closing date for consummating transaction.

b. Tender offer to be made by acquiring corporation directly to shareholders of corporation sought to be acquired for proposed share exchange [*see §§ 11D.203. 11D.204, 11D.208*].

2. Prepare resolution of board of directors of acquiring corporation approving share exchange agreement or tender offer, which does the following:

a. Directs appropriate corporate officers to sign agreement or cause tender offer to be mailed to shareholders of corporation sought to be acquired and published.

b. Authorizes and directs appropriate corporate officers to complete, execute, and file with California Corporations Commissioner application for qualification under Corporate Securities Law of 1968 of shares that must be issued in exchange by acquiring corporation.

c. After receipt of qualifying permit from California Corporations Commissioner, calls special meeting of shareholders of acquiring corporation to approve proposed share exchange.

3. Have board of directors of acquiring corporation adopt resolution approving proposed share exchange agreement or tender offer and authorizing filing of application for qualification of shares to be issued in exchange by acquiring corporation.

a. Ensure that proposed share exchange is approved by board of directors itself and not committee of board [*see § 11D.21[1]*].

b. When shares of acquiring corporation's parent corporation are to be exchanged for shares of the corporation sought to be acquired, ensure that board of directors of parent corporation also approves proposed share exchange.

4. Have officers of acquiring corporation execute and file application to California Corporations Commissioner for permit qualifying shares to be issued in exchange by acquiring corporation [*see* Ch. 6H, *Qualification of Securities* ; *see also § 11D.24*].

NOTE:

A qualification permit is not required in all share exchanges, however. Any change in the rights, preferences, privileges, or restrictions of or on outstanding securities, and any exchange of securities by the issuer with its existing security holders exclusively, are exempt from qualification if the transaction, had it involved the issuance of a new security containing the changed rights, preferences, privileges, or restrictions, or a new issuance of the exchange security, would have been exempt from qualification [***see*** *Corp. Code § 25110*] as an issuer transaction [*10 Cal. Code Reg. § 260.103(a)*; ***see*** *Corp. Code § 25102*]. For discussion of the qualification and exemption of securities, see Ch. 6, ***Securities Regulation Issues*** .

5. On receipt of any required permit from California Corporations Commissioner qualifying shares to be issued in exchange, prepare resolution or written consent to be adopted by shareholders of each class of shares issued by acquiring corporation approving proposed share exchange [*Corp. Code § 1201*].

6. With respect to shareholders of acquiring corporation, either [*Corp. Code § 1201*]:

NOTE:

For related requirements when the reorganization proposal is made by a party involved in the management and control of the corporation, see P 9, ***below***.

a. Call special shareholders' meeting for shares of each class to approve share exchange [*Corp. Code § 600(d)*]; or

b. Obtain written consent of majority of shareholders of each class approving share exchange [*Corp. Code § 603*].

7. Within 10 days after proposed share exchange has been approved by outstanding shares of each class of acquiring corporation, have acquiring corporation send notice to its shareholders of shareholder approval of share exchange [*see Corp. Code § 1301*].

a. Notice must:

(1) Inform shareholders of approval by outstanding shares of each class of proposed share exchange;

(2) State price determined by acquiring corporation to represent fair market value of dissenting shares;

(3) Contain brief description of procedure dissenting shareholder must follow to require his or her shares to be purchased for cash by acquiring corporation; and

(4) Be accompanied by copy of *Corp. Code §§ 1300-1304*.

b. Notice must be mailed to each shareholder by first-class mail [*Corp. Code §§ 113, 1301(a)*].

8. Have officers of acquiring corporation and shareholders of corporation sought to be acquired execute share exchange agreement.

9. If share acquisition is to be made by tender offer directly to shareholders of corporation sought to be acquired:

a. Have officers of acquiring corporation make any filings required by federal Williams Act [*see 15 U.S.C. §§ 78m(d), (e), 78n(d)*-(f)] with federal Securities Exchange Commission.

NOTE:
The Williams Act requirements will be applicable only if shares of the corporation sought to be acquired are registered on a national securities exchange [***see** Ch. 11A, **Cash Purchase of Shares**, § 11A.21[3]*].

b. Have officers of acquiring corporation:

(1) Mail tender offer offering letter [*see § 11D.203*] to shareholders of corporation sought to be acquired; and

(2) If necessary, publish tender letter in appropriate newspapers or other periodicals.

c. Include affirmative written opinion by independent appraiser regarding fairness of consideration to shareholders if reorganization proposal is made by party who [*Corp. Code § 1203(a)*]:

NOTE:
For purposes of the written opinion requirement, the term "tender offer" includes a share exchange tender offer [*Corp. Code § 1203(a)*; ***see** Corp. Code § 183.5* (definition); ***see also** § 11D.22*]. However, this requirement does not apply if the target corporation does not have shares held of record by 100 or more persons [***see** Corp. Code § 605* (determination of shareholders of record)] or if the transaction has been qualified pursuant to *Corp. Code § 25113* (qualification of issuer transaction by permit) or 25121 (qualification of recapitalization or reorganization by permit), and no stop order [***see** Corp. Code §§ 25140, 25143(a)*] is in effect regarding that qualification [*Corp. Code § 1203(a)*]. For further discussion, see Ch. 11, ***Merger and Acquisition Issues*** .

(1) Directly or indirectly controls corporation;

(2) Is (or is directly or indirectly controlled by) officer or director of corporation; or

(3) Is entity in which a material financial interest [*see Corp. Code § 310(a)*] is held by

director or executive officer of target corporation.

10. On day set for consummation of exchange in exchange agreement or tender offer offering letter:

a. Have certificates for shares of corporation sought to be acquired that are being tendered for shares of acquiring corporation properly endorsed in manner required to transfer shares to acquiring corporation.

b. Determine, under terms of share exchange agreement or tender offer:

(1) Number of voting shares of acquiring corporation that are due to each shareholder of corporation being acquired who tendered his or her shares for transfer to acquiring corporation; and

(2) Amount due each shareholder for any fractional share of acquiring corporation due under terms of share exchange agreement or tender offer.

c. Have acquiring corporation:

(1) Issue predetermined number of voting shares to shareholders of corporation to be acquired who have tendered their shares for transfer; and

(2) Pay to each transferring shareholder predetermined amount due for any fractional share due under terms of share exchange agreement or tender offer.

d. Present all shares of acquired corporation that have been tendered for shares of acquiring corporation to transfer agent of acquired corporation and have agent issue new certificate for those shares showing them owned by acquiring corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of ShareholdersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Offerors



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-11D California Legal Forms--Transaction Guide §§ 11D.121-11D.129

[Reserved]

§§ 11D.121[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

5-11D California Legal Forms--Transaction Guide § 11D.130

§ 11D.130 When Acquired Corporation Is to Be Operated as Subsidiary

NOTE:
These procedures do not apply if the acquiring corporation wishes to acquire any net operating loss carryover of the acquired corporation [***see*** *§ 11D.131*].

1. Request resignations of acquired corporation's board of directors.

2. Hold special shareholder meeting of shareholders of acquired corporation and elect new board of directors.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Offerors



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

5-11D California Legal Forms--Transaction Guide § 11D.131

§ 11D.131 Transferring Acquired Corporation's Net Operating Loss Carryover to Acquiring Corporation

NOTE:

These procedures do not apply if the acquired corporation will continue to operate as a subsidiary [***see*** *§ 11D.130*]. An acquiring corporation will succeed to the net operating loss of an acquired corporation only pursuant to a tax-free liquidation or reorganization [***see*** *I.R.C. § 381*].

1. Liquidate corporation pursuant to *I.R.C. § 332* [*I.R.C. § 381(a)(1)*]; or

NOTE:

For a discussion of California dissolution procedures, see Ch. 12, ***Winding Up and Dissolution*** . For a tax discussion of the liquidation of subsidiaries, see Rabkin & Johnson, FEDERAL INCOME, GIFT, AND ESTATE TAXATION, ch. 23, ***Complete Liquidation*** (Matthew Bender).

2. Merge acquired corporation into acquiring corporation as follows [*see I.R.C. § 381(a)(2)*; *see also I.R.C. § 368(a)(1)(A)*]:

NOTE:

For a discussion of merger requirements, see Ch. 11C, ***Mergers*** .

a. Use ordinary "merger reorganization" if acquiring corporation owns less than 90 percent of all outstanding shares of acquired corporation.

b. Use short-form merger if acquiring corporation owns more than 90 percent of all outstanding shares of acquired corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTax-Free AcquisitionsMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersShort-Form MergersTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)Affiliated CorporationsTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)CarryforwardsTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)General OverviewTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

5-11D California Legal Forms--Transaction Guide § 11D.132

§ 11D.132 Reporting Statutory Change in Ownership

1. Prepare and file change in ownership statement.

NOTE:

Real property subject to local property taxation is reassessed when a change in ownership occurs [***see*** Cal. Const., arts. XIII, XIIIA; ***see also*** CALIFORNIA REAL ESTATE LAW AND PRACTICE, ch. 401, ***Real Property Valuation and Assessment*** (Matthew Bender)]. A "change in ownership" is a transfer of a present interest in real property, including the beneficial use of that property, the value of which is substantially equal to the value of the fee interest [*Rev. & Tax. Code § 60*]. One of the instances in which real property owned by a corporation undergoes a change in ownership is when one corporation obtains control, that is, direct or indirect ownership or control of more than 50 percent of voting stock, of another corporation through the purchase or transfer of that stock [*Rev. & Tax. Code § 64(c)(1)*]. For purposes of obtaining control, any purchase or transfer of 50 percent or less of the ownership interest through which control or a majority ownership interest is obtained is included [*Rev. & Tax. Code § 64(c)(1)*]. Such a change requires the acquiring corporation to prepare and file a change in ownership statement [*Rev. & Tax. Code § 480.1*]. For discussion and an example of a change in ownership statement used for the transfer of real property [***see*** *Rev. & Tax. Code § 480*], see *Ch. 23,* ***Real Property Sales Agreements****, § 23.204*.

a. Complete official form [*see Rev. & Tax. Code §§ 480.1, 480.2*].

NOTE:

A form may be obtained from the district office of the State Board of Equalization for the area in which the acquired corporation's real property is located.

b. Have statement signed either by [*Rev. & Tax. Code §§ 480.1(c), 480.2(c)*]:

(1) Officer of corporation; or

(2) Employee or agent designated in writing by board of directors to sign statements on behalf of corporation.

c. File statement as follows [*Rev. & Tax. Code §§ 480.1(b), 480.2(b)*]:

NOTE:
A change in ownership statement must also be filed whenever the State Board of Equalization makes a written request for that statement [*Rev. & Tax. Code § 480.1(b)*].

(1) Within 45 days from date of change in control.

(2) At Sacramento office of State Board of Equalization.

2. Advise corporation that Board of Equalization will impose monetary penalty of 10 percent of taxes for [*Rev. & Tax. Code § 482(b)*]:

NOTE:
Rev. & Tax. Code § 64(e) establishes a procedure under which a corporation's tax return must indicate whether control was transferred or sold during the year. Changes are then reported to the State Board of Equalization. Apparently this is one source of information that is used as the basis for the issuance of a written request by the Board. By filing the statement within 45 days from the date of change in ownership, the corporation avoids incurring a penalty following a written request from the Board.

a. Failing to file statement within 45 days from earlier of:

(1) Date of change in control or change in ownership; or

(2) Date of written request by Board of Equalization.

b. Failing to file missing information after filing incomplete statement and receiving second request for information.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewTax LawState & Local TaxesReal Property TaxAssessment & ValuationGeneral OverviewReal Property LawPriorities & RecordingRecording ActsReal Property LawOwnership & TransferBusiness & Corporate Entities



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

5-11D California Legal Forms--Transaction Guide §§ 11D.133-11D.199

[Reserved]

§§ 11D.133[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART IV. FORMS

5-11D California Legal Forms--Transaction Guide § 11D.200

§ 11D.200 Agreement for Exchange of Shares--Voting Shares of Acquiring Corporation to Be Exchanged for Shares of Corporation Sought to Be Acquired in Tax-Free Reorganization

[1] Comment--Use of Form

This form is an agreement for a share exchange between an acquiring corporation and the shareholders of the corporation whose shares the acquiring corporation seeks to acquire. When one corporation desires to acquire another corporation by means of a share exchange, the first formal document is usually an agreement embodying the agreed terms of the exchange [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 5D, *Acquisitions of Stock* (Matthew Bender)]. This form contemplates a tax-free share exchange coming within the definition of the Internal Revenue Code of a type "B" Reorganization [*see § 11D.23*]. Under this agreement, the acquiring corporation is attempting to acquire at least 80 percent of all outstanding shares of the corporation sought to be acquired solely in exchange for its own voting shares [*see § 11D.23[1], [2]*].

This type of agreement is most often used when both corporations are of moderate size and the corporation sought to be acquired is privately owned. If the corporation sought to be acquired is publicly owned, the acquiring corporation may have to attempt to acquire the shares of that corporation by means of a publicly advertised tender offer [*see § 11D.204*]. In this form the acquiring corporation and the shareholders of the corporation sought to be acquired make relatively the same covenants, representations, and warranties to each other. If the corporations are disparate in size and the acquiring corporation is larger, it will usually make relatively few covenants, representations, and warranties compared to those it demands from the shareholders of the corporation it seeks to acquire.

[2] Form

Agreement for Exchange of Shares--Voting Shares of Acquiring Corporation to Be Exchanged for Shares of Corporation Sought to Be Acquired in Tax-Free Reorganization

PLAN AND AGREEMENT OF REORGANIZATION
by exchange of voting stock of _____ [*name of acquiring corporation*] for _____ [all *or* 80 percent or more] of the shares of _____ [*name of acquired corporation*]

_____[*name of acquiring corporation*], referred to as "_____," and _____[*names of shareholders of acquired corporation or* the persons whose names and signatures appear at the end of this agreement], all of whom are shareholders of _____[*name of acquired corporation*], referred to collectively as "shareholders" and individually as "shareholder," agree as follows:

ARTICLE 1 PLAN OF REORGANIZATION

Plan Adopted

Section 1.01. A plan of reorganization of _____[*name of acquiring corporation*] and _____[*name of acquired corporation*], pursuant to the provisions of *Internal Revenue Code Section 368(a)(1)(B)*, is hereby adopted as follows:

(a) Each shareholder will transfer to _____[*name of acquiring corporation*] the number of shares of capital stock of _____[*name of acquired corporation*], listed after his or her name in column _____ of Exhibit _____, which together will constitute all [*or specify other percentage of 80 percent or more*] of the issued and outstanding shares of stock of _____[*name of acquired corporation*].

(b) In exchange for the number of shares transferred by each shareholder, _____[*name of acquiring corporation*] will issue and cause to be delivered to each shareholder the number of shares of common stock of _____[*name of acquiring corporation*] listed after the name of the shareholder in column _____ of Exhibit _____.

Closing Date

Section 1.02. Subject to the conditions precedent set forth in this agreement, this plan of reorganization shall be consummated at _____[*office, street address, city, and state*], on _____[*date*], at the hour of _____ M., or any other place and date that may be fixed by mutual consent of the parties. The date of the consummation is referred to in this agreement as the "closing date."

ARTICLE 2 COVENANTS, REPRESENTATIONS, AND WARRANTIES OF _____ [*name of acquiring corporation*]

Legal Status

Section 2.01. _____[*name of acquiring corporation*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of California [*or specify other state*], with corporate power to own property and carry on its business as it is now being conducted. Copies of the articles of incorporation of _____[*name of acquiring corporation*], certified by the Secretary of State of _____[*state of incorporation*] and delivered to the shareholders, are complete and accurate as of the date hereof. _____[*name of acquiring corporation*] is qualified to transact business as a foreign corporation and is in good standing in all jurisdictions in which its principal properties are located [*or* is not required to be qualified as a foreign corporation to transact business in any other jurisdiction].

Subsidiaries

[*EITHER, if acquiring corporation has no subsidiaries or interests in other business entities:*]

Section 2.02. _____[*Name of acquiring corporation*] has no subsidiaries nor any interest in any other corporation, firm, or partnership.

[*OR, if acquiring corporation owns other firms or businesses, modify the following as necessary to reflect those ownership interests:*]

Section 2.02. _____[*Name of acquiring corporation*] owns all of the issued and outstanding capital stock of _____, a corporation duly organized, validly existing, and in good standing under the laws of the State of _____, with corporate power to own property and to carry on its business as now conducted.

[*Continue with the following:*]

Capitalization

Section 2.03. _____[*Name of acquiring corporation*] has an authorized capitalization of _____[*number*] shares of common stock [with a the par value of $_____ per share]. On the date of this agreement, _____ of those shares are issued and outstanding, fully paid, and nonassessable. [Except for _____ (*number*) shares of the authorized but unissued stock which are reserved for stock options (*or specify additional or other purpose*),] there are no outstanding options, contracts, calls, commitments, or demands relating to the authorized but unissued stock of _____[*name of acquiring corporation*].

Financial Statements

Section 2.04. (a) _____[*Name of acquiring corporation*] has delivered to the shareholders the _____[consolidated] balance sheet of _____[*name of acquiring corporation*] [and its _____ (subsidiary *or* subsidiaries)] as of _____[*date*]; the related _____[consolidated] statements of income and retained earnings of _____[*name of acquiring corporation*] [and its _____ (subsidiary *or* subsidiaries)] for the five years then ended, all reported on by _____, certified public accountants; the unaudited _____[consolidated] balance sheet of _____[*name of acquiring corporation*] [and its _____ (subsidiary *or* subsidiaries)] as of _____[*date*]; and the related _____[consolidated] statements of income and retained earnings for the year [*or* six months] then ended, prepared by _____[*name of acquiring corporation*] and subject to usual changes resulting from year-end audit. All such financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and present fairly the financial position of _____[and its subsidiary] at _____[*date*], and _____[*date*], respectively, and the results of operations for the respective periods then ended, subject, however, to usual changes resulting from year-end audit of the financial statements as of _____[*date*].

(b) Other than changes in the usual and ordinary conduct of the business since _____[*date*], there have been, and at the closing date there will be, no changes in the financial statements as of _____[*date*].

Title to Properties

Section 2.05. All book assets of _____[*name of acquiring corporation*] are in existence, are in the possession of _____[*name of acquiring corporation*], are in good condition and repair, and conform to all applicable zoning and building laws and ordinances. _____[*Name of acquiring corporation*] has good and marketable title to all of its assets and, except for any liens or encumbrances that are shown on its financial statements as of _____[*date*], or which have arisen in the ordinary course of business since the date of the financial statements and which do not interfere with the conduct of its business in the ordinary course, holds the assets subject to no mortgage, lien, or encumbrance.

Indebtedness

Section 2.06. Except as set forth in the _____[consolidated] balance sheet of _____[*name of acquiring corporation*] [and its _____ (subsidiary *or* subsidiaries)] as of _____[*date*], there is no outstanding indebtedness other than liabilities incurred in the ordinary course of business or in connection with this transaction. _____[_____ (*name of acquiring corporation*) is not *or* Neither _____ (*acquiring corporation*) nor _____ (its subsidiary *or* any of its subsidiaries) is] in default with respect to any terms or conditions of any indebtedness.

No Litigation or Proceeding Pending or Threatened

Section 2.07. _____[*Name of acquiring corporation*] is not[, nor is _____ (its subsidiary *or* any of its subsidiaries),] a party to, nor has _____[it *or* _____ (either *or* any) of them] been threatened with, any litigation or governmental proceeding which, if decided adversely to it, would have a material adverse effect on the transaction contemplated hereby, or upon the financial condition, net worth, prospects, or business of _____[*name of acquiring corporation*] [or its subsidiary], or would create a material liability on the part of _____[*name of acquiring corporation*] [or its _____ (subsidiary *or* subsidiaries)].

No Restriction Preventing Transaction

Section 2.08. [_____ (*Name of acquiring corportion*) is not *or* Neither _____ (*name of acquiring corporation*) nor _____ (its subsidiary *or* any of its subsidiaries) is] subject to any charter, bylaw, mortgage, lien, lease, agreement, judgment, or other restriction of any kind that would prevent consummation of the transaction contemplated by this agreement.

Status of Receivables

Section 2.09. None of the accounts receivable or contracts receivable indicated in the financial statements that _____[*name of acquiring corporation*] has delivered to shareholders is subject to any counterclaim or setoff, and all such accounts receivable and contracts receivable are good and collectible at the aggregate recorded amount thereof.

No Broker or Finder

Section 2.10. _____[*name of acquiring corporation*] has not retained or otherwise utilized the services of any broker or finder in connection with the transaction contemplated by this agreement.

Taxes

Section 2.11. _____[*Name of acquiring corporation*] [and its _____ (subsidiary *or* subsidiaries)] _____[has *or* have] filed all federal income tax returns and, in each state where qualified or incorporated, all state income tax or franchise tax returns which are required to be filed, _____[has *or* have] paid all taxes as shown on those returns as have become due, and _____[has *or* have] paid all assessments received to the extent that the assessments have become due.

Status of Shares Being Transferred

Section 2.12. The shares of stock of _____[*name of acquiring corporation*] that are to be issued and delivered to shareholders pursuant to the terms of this agreement, when issued and delivered, will be validly authorized and issued, and will be fully paid and nonassessable. No shareholder of _____[*name of acquiring corporation*] will have any preemptive right of subscription or purchase with respect to any of those shares.

Authority to Execute Agreement

Section 2.13. _____[*Name of acquiring corporation*] has the legal power and right to enter this agreement but consummation of this agreement by it is subject to the following:

(a) Approval of the principal terms of this agreement by the outstanding shares of each class, as those terms are defined in the General Corporation Law of California, of _____[*name of acquiring corporation*]; and

(b) Issuance by the California Commissioner of Corporations to _____[*name of acquiring corporation*] of a permit authorizing _____[*name of acquiring corporation*] to issue and transfer _____[*number*] shares of its common stock to shareholders pursuant to the plan and agreement of reorganization contained in this agreement.

Best Efforts to Obtain Approval

Section 2.14. _____[*Name of acquiring corporation*] will use its best efforts to obtain any approval of the transaction set forth in this agreement by its outstanding shares required by the General Corporation Law of California and to obtain any necessary permit from the California Commissioner of Corporations required to allow it to issue shares and perform its obligations under this agreement.

Disclosure

Section 2.15. On the date of this agreement _____[*name of acquiring corporation*] has, and at the closing date it will have, disclosed all events, conditions, and facts materially affecting the business and prospects of _____[*name of acquiring corporation*]. _____[*name of acquiring corporation*] has not now and will not have, at the closing date, withheld knowledge of any such events, conditions, and facts which it knows, or has reasonable ground to know, may materially affect the business and prospects of _____[*name of acquiring corporation*]. None of the representations and warranties made by

_____[*name of acquiring corporation*] in this agreement and contained in any certificate or other instrument furnished or to be furnished to shareholders pursuant to this agreement, contains or will contain any untrue statement of a material fact, or omits or will omit to state a material fact necessary in order to make the statements contained in this agreement not misleading.

ARTICLE 3 COVENANTS, REPRESENTATIONS, AND WARRANTIES OF SHAREHOLDERS OF _____ [*name of acquired corporation*]

Legal Status of Corporation

Section 3.01. _____[*Name of acquired corporation*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of California [*or specify other state*], with corporate power to own property and carry on its business as it is now being conducted. Copies of the articles of incorporation of _____[*name of acquired corporation*], certified by the Secretary of State of _____ and delivered to _____[*name of acquiring corporation*], are complete and accurate as of the date of this agreement. _____[*Name of acquired corporation*] is qualified to transact business as a foreign corporation and is in good standing in all jurisdictions in which its principal properties are located [*or* is not required to be qualified as a foreign corporation to transact business in any other jurisdiction].

Subsidiaries

Section 3.02. _____[*Name of acquired corporation*] has no subsidiaries nor any interest in any other corporation, firm, or partnership [*or specify subsidiaries, legal status, and capitalization as appropriate*].

Capitalization

Section 3.03. _____[*Name of acquired corporation*] has an authorized capitalization of _____ shares of capital stock, all of one class [with a par value of $_____ per share]. On the date of this agreement, _____ of those shares are issued and outstanding, fully paid, and nonassessable. [Except for _____ shares of the authorized but unissued stock which are reserved for stock options *or specify other purpose*] there are no outstanding options, contracts, calls, commitments, or demands relating to the authorized but unissued stock of _____[*name of acquired corporation*].

Financial Statements

Section 3.04. (a) Shareholders have delivered to _____[*name of acquiring corporation*] the balance sheet of _____[*name of acquired corporation*] as of _____[*date*], the related statements of income and retained earnings for the _____[*e.g.*, five] years then ended, all reported on by _____, certified public accountants, the unaudited balance sheet of _____[*name of acquired corporation*] as of _____[*date*], and the related statements of income and retained earnings for the year [*or* six months] then ended, prepared by _____[*name of acquired corporation*] and subject to usual changes resulting from year-end audit. All such financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and present fairly the financial position of _____[*name of acquired corporation*] and subject to usual changes resulting from year-end audit. All such financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and present fairly the financial position of _____[*name of acquired corporation*] at _____[*date*], and _____[*date*], respectively, and the results of operations for the

respective periods then ended, subject, however, to usual changes resulting from year-end audit of the financial statements as of _____[*date*].

(b) Other than changes in the usual and ordinary conduct of the business since _____[*date*], there have been, and at the closing date there will be, no changes in the financial conditions of _____[*name of acquired corporation*]. None of these changes is, and at the closing date none will be, materially adverse.

(c) Subject to any changes that may have occurred in the ordinary and usual course of business, the assets of _____[*name of acquired corporation*] at the closing date will be substantially those owned by it and shown on its financial statements as of _____[*date*].

(d) Since the date of the financial statements _____[*name of acquired corporation*] has not increased, and prior to the closing date will not increase, its long-term debt.

Properties

Section 3.05. Shareholders have delivered to _____[*name of acquiring corporation*] a schedule of assets as of _____[*date*], listing the real property, leased equipment, and other property and equipment owned or leased by _____[*name of acquired corporation*]. _____[*Name of acquired corporation*] is not in default in any respect under the terms of any lease, deed of trust, contract, or agreement to which it is a party. Shareholders do not have knowledge of any information which would materially affect any of the assets listed in the schedule of assets.

Indebtedness

Section 3.06. Except as set forth in the balance sheet of _____[*name of acquired corporation*] as of _____[*date*], there is no outstanding indebtedness other than liabilities incurred in the ordinary course of business or in connection with this transaction. _____[*Name of acquired corporation*] is not in default in respect of any terms or conditions of any indebtedness.

No Litigation or Proceeding Pending or Threatened

Section 3.07. [Except for the contested income tax liability which is reflected on its balance sheet as of _____ (*date*)], _____[*name of acquired corporation*] is not a party to, nor has it been threatened with, any litigation or governmental proceeding which, if decided adversely to it, would have a material adverse effect upon the transaction contemplated by this agreement, or upon the financial condition, net worth, prospects, or business of _____[*name of acquired corporation*], or would create a material liability on its part.

No Restriction Preventing Transaction

Section 3.08. _____[*Name of acquired corporation*] is not subject to any charter, bylaw, deed of trust, lien, lease, agreement, judgment, or any other restriction of any kind which would prevent consummation of the transaction contemplated by this agreement.

Status of Receivables

Section 3.09. Except to the extent that an allowance for uncollectible accounts has been established on its books, all accounts receivable and notes receivable of _____[*name of acquired corporation*] are current and collectible.

Liability for Finder's Fee

Section 3.10. Shareholders have retained the services of _____[*name*] as finder in connection with the transaction contemplated by this agreement. Shareholders have not retained or otherwise utilized the services of any other broker or finder. Shareholders will pay any finder's fee due and will indemnify _____[*name of acquiring corporation*] for any loss or expense, including attorneys' fees, which it may incur as a result of any claim for a finder's fee or broker's commission asserted against it by anyone.

Taxes

Section 3.11. (a) _____[*Name of acquired corporation*] has filed all federal income tax returns and, in each state where qualified or incorporated all state income tax and franchise tax returns which are required to be filed, has paid all taxes as shown on those returns as have become due, and has paid all assessments received to the extent that the assessments have become due.

(b) Shareholders will indemnify _____[*name of acquiring corporation*] for any deficiencies in prior years' taxes determined against _____[*name of acquired corporation*].

Status of Shares Being Transferred

Section 3.12. Shareholders own _____[all *or* at least 80 percent *or specify other percentage greater than 80 percent*] of the issued and outstanding shares of the capital stock of _____[*name of acquired corporation*]. Subject to obtaining the consent to transfer of the California Commissioner of Corporations, shareholders have full power to convey good and marketable title to their shares, free of any liens, charges, or encumbrances of any nature.

Shares Being Acquired for Investment

Section 3.13. Each shareholder is acquiring the shares of common stock of _____[*name of acquiring corporation*] for investment and without any present intention to sell, distribute, transfer, or otherwise dispose of the shares. Each shareholder will execute and deliver to _____[*name of acquiring corporation*] on the closing date an investment letter substantially in the form of Exhibit _____ attached to this agreement.

Restrictions on Sale of Acquired Shares

Section 3.14. (a) Each shareholder will not sell or otherwise transfer any of the shares of common stock of _____[*name of acquiring corporation*] to which that shareholder is entitled under this agreement during the period ending _____[*e.g.*, two] years from the closing date and without first offering the shares to _____[*name of acquiring corporation*] for purchase.

(b) Each shareholder shall execute and deliver to _____[*name of acquiring corporation*] on the closing date an agreement implementing the undertakings made in this section. The agreement shall provide, among other things, for the endorsement of a restrictive legend on the share certificate stating the restriction on transfer set forth in this agreement and for the right of first refusal. The agreement shall be substantially in the form attached as Exhibit _____.

Activities Since Balance Sheet Due

Section 3.15. Since its balance sheet as of _____[*date*], _____[*name of acquired corporation*] has not, and prior to the closing date will not have

(a) Issued or sold any stock, bond, or other corporate securities.

(b) Except for current liabilities incurred and obligations under contracts entered into in the ordinary course of business, incurred any obligation or liability, absolute or contingent.

(c) Except for current liabilities shown on the balance sheet and current liabilities incurred since that date in the ordinary course of business, discharged or satisfied any lien or encumbrance, or paid any obligation or liability, absolute or contingent.

(d) Mortgaged, pledged, or subjected to lien or any other encumbrance, any of its assets, tangible or intangible.

(e) Except in the ordinary course of business, sold or transferred any of its tangible assets or canceled any debts or claims.

(f) Sold, assigned, or transferred any patents, formulas, trademarks, trade names, copyrights, licenses, or other intangible assets.

(g) Suffered any extraordinary losses, been subjected to any strikes or other labor disturbances, or waived any rights of any substantial value.

(h) Except for transactions contemplated by this agreement, entered into any transaction other than in the ordinary course of business.

Disclosure

Section 3.16. On the date of this agreement shareholders have, and at the closing date they will have, disclosed all events, conditions, and facts materially affecting the business and prospects of _____[*name of acquired corporation*]. Shareholders have not now and will not have, at the closing date, withheld knowledge of any such events, conditions, and facts which they know, or have reasonable ground to know, may materially affect the business and prospects of _____[*name of acquired corporation*]. None of the representations and warranties made by shareholders in this agreement and contained in any certificate or other instrument furnished or to be furnished to _____[*name of acquiring corporation*] pursuant to this agreement contains or will contain any untrue statement of a material fact, or omits or will omit to state a material fact necessary in order to make the statements contained in this agreement not misleading.

ARTICLE 4 CONDUCT OF BUSINESS OF _____ [*name of acquiring corporation*] PENDING CLOSING

Access to Information and Documents

Section 4.01. (a) _____[*Name of acquiring corporation*] will afford shareholders and accredited representatives, from the date of this agreement until consummation of the plan or reorganization, full access during normal business hours to all properties, books, accounts, contracts, commitments, and records of every kind of _____[*name of acquiring corporation*] in order that shareholders may have full opportunity to make any investigation as they shall desire to make of, and to keep themselves informed with respect to, the affairs of _____[*name of acquiring corporation*].

(b) In addition, _____[*name of acquiring corporation*] will permit shareholders to make extracts or copies of all such books, accounts, contracts, commitments, and records and will furnish to shareholders, within _____[*e.g.*, 10 days] after demand, any further financial and operating data and other information with respect to the business and assets of the corporation as shareholders shall reasonably request from time to time.

(c) Shareholders will use any information so secured only for their own purposes in connection with the consummation of the transaction contemplated and will not divulge the information to any persons not entitled to it.

Carry on Business as Usual

Section 4.02. _____[*Name of acquiring corporation*] will carry on its business in substantially the same manner as before.

Satisfy Conditions Precedent

Section 4.03. _____[*Name of acquiring corporation*] will use its best efforts to cause the satisfaction of all conditions precedent contained in this agreement.

Negative Covenants

Section 4.04. Except with the prior written consent of shareholders, _____[*name of acquiring corporation*] will not declare or pay any dividend, or declare or make any other distribution, to its shareholders.

ARTICLE 5 CONDUCT OF BUSINESS OF _____ [*name of acquired corporation*] PENDING CLOSING

Access to Information and Documents

Section 5.01. (a) Shareholders will cause _____[*name of acquired corporation*] to afford the officers and accredited representatives of _____[*name of acquiring corporation*], from the date of this agreement until consummation of the plan of reorganization, full access during usual business hours to all properties, books, accounts, contracts, commitments, and records of every kind of _____[*name of acquired corporation*] in order that _____[*name of acquiring corporation*] may have full opportunity to make any investigation that it may desire to make, and to keep itself fully informed with respect to, the affairs of _____[*name of acquired corporation*].

(b) In addition, shareholders will cause _____[*name of acquired corporation*] to permit _____[*name of acquiring corporation*] to make extracts or copies of all such books, accounts, contracts, commitments, and records, and to furnish to _____[*name of acquiring corporation*], within

_____[*e.g.*, 10 days] after demand, any further financial and operating data and other information with respect to the business and assets of the corporation that _____[*name of acquiring corporation*] may reasonably request from time to time.

(c) _____[*Name of acquiring corporation*] will use any information so secured only for its own purposes in connection with the consummation of the transaction contemplated hereby, and will not divulge the information to any person not entitled to it.

Business as Usual

Section 5.02. Shareholders will cause _____[*name of acquired corporation*] to carry on its business in substantially the same manner, and to continue in full force insurance coverage comparable in amount and scope of coverage to that maintained by it. Shareholders will use their best efforts to cause _____[*name of acquired corporation*] to maintain its business organization intact and to retain its present employees, and to maintain its relationship with suppliers and others having business relationships with it. Shareholders will exercise due diligence in safeguarding and maintaining confidential reports and data used in its business.

Satisfy Conditions Precedent

Section 5.03. Shareholders will use their best efforts to cause the satisfaction of all conditions precedent contained in this agreement.

ARTICLE 6 CONDITIONS PRECEDENT TO OBLIGATIONS OF _____ [*name of acquiring corporation*] TO CLOSE

Section 6.01. The obligations of _____[*name of acquiring corporation*] to consummate the plan of reorganization shall be subject to the following conditions precedent:

Truth of Representations and Warranties and Compliance With Covenants

(a) Representations and warranties of shareholders contained in this agreement shall be true as of the closing date with the same effect as though made on the closing date. Shareholders shall have performed all obligations and complied with all covenants required by this agreement to be performed or complied with by them prior to the closing date. Shareholders shall have delivered to _____[*name of acquiring corporation*] a certificate dated as of the closing date and signed by each of the shareholders, certifying as to the truth of the representations and warranties, as to the performance of the obligations, and as to the compliance with the covenants.

Commitment as to Investment Purpose

(b) Each shareholder shall have delivered to _____[*name of acquiring corporation*], prior to the closing date, a written commitment in form satisfactory to _____[*name of acquiring corporation*] that the shareholder is taking the shares of common stock of _____[*name of acquiring corporation*] for purposes of investment and will not dispose of the shares received by him or her hereunder in a manner which would result in a violation of the Securities Act of 1933.

Acceptability of Papers and Proceedings

(c) To the extent requested by _____[*name of acquiring corporation*], the form and substance of all papers and proceedings shall be acceptable to counsel for _____[*name of acquiring corporation*].

Permits Obtained

(d) All permits from the California Commissioner of Corporations required for the lawful consummation of the reorganization shall have been obtained.

Approval of Shareholders

(e) The principal terms of this agreement shall have been approved by the outstanding shares of all classes of _____[*name of acquiring corporation*] as required by the General Corporation Law of California.

Resignations of Officers and Directors

(f) There shall have been delivered to _____[*name of acquiring corporation*] the written resignations of the officers and directors of _____[*name of acquired corporation*][, with the exception of _____ (*list names and titles of any directors or officers to whom this requirement does not apply*)].

Appointment of New Directors

(g) Contemporaneously with the closing, shareholders shall elect three persons designated by _____[*name of acquiring corporation*] as directors of _____[*name of acquired corporation*].

Certified Financial Statements

(h) _____[*Names of certified public accountants*] shall deliver to _____[*name of acquiring corporation*] certified financial statements of _____[*name of second corporation*] for the _____[*e.g.*, five] fiscal years ended _____[*date*].

Title Insurance Policies and Confirmation

(i) Shareholders shall have delivered to _____[*name of acquiring corporation*] existing title insurance policies and supplemental confirmation from the issuing company that the land described in the policies and still owned by _____[*name of acquired corporation*] is covered by the policies.

ARTICLE 7 CONDITIONS PRECEDENT TO OBLIGATIONS OF SHAREHOLDERS TO CLOSE

Section 7.01 The obligations of the shareholders to consummate the plan of reorganization shall be subject to the following conditions precedent:

Truth of Representations and Warranties and Compliance With Covenants

(a) Representations and warranties of _____[*name of acquiring corporation*] contained in this agreement shall be true as of the closing date with the same effect as though made on the closing date. _____[*Name of acquiring corporation*] shall have performed all obligations and complied with all covenants that _____[*name of acquiring corporation*] is required by this agreement perform or comply with prior to the closing date. _____[*Name of acquiring corporation*] shall have delivered to shareholders a certificate dated as of the closing date and signed by the President or a Vice President and the Secretary or an Assistant Secretary of _____[*name of acquiring corporation*], certifying as to the truth of the representations and warranties, as to the performance of the obligations, and as to the compliance with the covenants.

[*Add, if applicable:*]

(b) The _____[Pacific Stock Exchange *or name of other stock exchange*] shall have approved for listing, upon official notice of issuance, the shares of _____[*name of acquiring corporation*] to be issued and delivered by it pursuant to this agreement.

[*Continue with the following:*]

Permits Obtained

(c) All permits from the California Commissioner of Corporations required for the lawful consummation of the reorganization shall have been obtained.

Opinion from Counsel for Acquiring Corporation

(d) On the closing date, there shall be furnished to shareholders an opinion from _____, counsel for _____[*name of acquiring corporation*], dated the closing date and in form satisfactory to counsel for shareholders, to the effect that _____[*name of acquiring corporation*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of _____, and that the shares of common stock of _____[*name of acquiring corporation*] delivered to shareholders on the closing date have been duly authorized, issued, and delivered and are validly issued and outstanding, fully paid and nonassessable shares of common stock of _____[*name of acquiring corporation*].

ARTICLE 8 CONSUMMATION OF TRANSACTION

Consideration of Shareholders

Section 8.01. Shareholders shall deliver to _____[*name of acquiring corporation*], on the closing date, certificates representing _____[all *or specify percentage*] of the issued and outstanding shares of stock of _____[*name of acquired corporation*].

Consideration of Acquiring Corporation

Section 8.02. _____[*Name of acquiring corporation*] shall deliver to shareholders, on the closing date, certificates representing _____ shares of common stock of _____[*name of acquiring corporation*] in any denominations that the respective shareholders may request.

Expenses

Section 8.03. _____[*Name of acquiring corporation*] shall pay its own, and shareholders shall pay their own, expenses and costs incident to the preparation of this agreement and to the consummation of the plan of reorganization. If the reorganization is not consummated, however, through no fault of _____[*name of acquiring corporation*], shareholders shall bear all the expenses and costs of both parties. If the reorganization is not consummated, through no fault of shareholders, _____[*name of acquiring corporation*] shall bear all the expenses and costs of both parties.

ARTICLE 9 INTERPRETATION AND ENFORCEMENT

Notices

Section 9.01. Any notice or other communication required or permitted under this agreement shall be deemed to be properly given when deposited in the United States mails for transmittal by certified or registered mail, postage prepaid, or when deposited with a public telegraph company for transmittal, charges prepaid, if that communication is addressed,

(a) In the case of _____[*name of acquiring corporation*], to _____[*corporate name, name of officer concerned, street address, city, and state*], or to any other person or address as _____[*name of acquiring corporation*] may from time to time furnish to the shareholders for this purpose.

(b) In the case of the shareholders, to the address of each of the shareholders as that address appears on the books of _____[*name of acquired corporation*], or to any other person or address that any shareholder may from time to time furnish to _____[*name of acquiring corporation*] for this purpose.

Assignment

Section 9.02. (a) Except as limited by the provisions of subsection (b), this agreement shall be binding upon and inure to the benefit of the respective successors and assigns of the parties, as well as the parties.

(b) Any assignment of this agreement or the rights of any of the parties under it, without the written consent of the other parties, shall be void.

Entire Agreement; Counterparts

Section 9.03. This instrument and the exhibits to it contain the entire agreement between the parties with respect to the transaction contemplated. It may be executed in any number of counterparts, each of which shall be deemed an original, but any counterparts together constitute only one and the same instrument.

Controlling Law

Section 9.04. The validity, interpretation, and performance of this agreement shall be controlled by and construed under the laws of the State of _____, the state in which this agreement is being executed.

Executed on _____[*date*], at _____[*city and state*].

_____ [*name of acquiring corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]
SHAREHOLDERS
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]
_____ [*signature*]

[*typed name*]
_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of ShareholdersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Offerors



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART IV. FORMS

5-11D California Legal Forms--Transaction Guide § 11D.201

§ 11D.201 Agreement for Exchange of Shares--Acquisition by Large Corporation of Shares of Smaller Corporation in Tax-Free Reorganization

[1] Comment--Use of Form

This form is an agreement for the exchange of shares between a corporation seeking to acquire another corporation and the shareholders of the corporation it seeks to acquire. This form is similar to the agreement set forth in *§ 11D.200*, but is particularly designed for use by a large corporation whose securities are publicly traded on a stock exchange. It requires fewer representations and warranties to be made by the acquiring corporation than by the contracting shareholders of the corporation sought to be acquired.

This form, like the form in *§ 11D.200*, is designed to make the stock exchange described in it a form of tax-free reorganization. For discussion of the income tax requirements that must be satisfied for a share exchange to qualify as a tax-free reorganization, see *§ 11D.23[1]*. For the California statutory requirements for a share exchange as a method by which one corporation may acquire another corporation, see *§ 11D.21*.

[2] Form

Agreement for Exchange of Shares--Acquisition by Large Corporation of Shares of Smaller Corporation in Tax-Free Reorganization

PLAN AND AGREEMENT OF REORGANIZATION
by exchange of voting stock of _____ [*name of acquiring corporation*] for _____ [all *or* 80 percent or more] of the shares of _____ [*name of acquired corporation*]

_____[*Name of acquiring coporation*], referred to as "_____," and _____[*names of shareholders of acquired corporation or* the persons whose names and signatures appear at the end of this agreement], all of whom are shareholders of _____[*name of acquired corporation*], referred to collectively as "shareholders" and individually as "shareholder," agree as follows:

ARTICLE 1 PLAN OF REORGANIZATION

Plan Adopted

Section 1.01. A plan of reorganization of _____[*name of acquiring corporation*] and _____[*name of acquired corporation*], pursuant to the provisions of *Internal Revenue Code Section 368(a)(1)(B)*, is adopted as follows:

(a) Each shareholder will transfer to _____[*name of acquiring corporation*] the number of shares of capital stock of _____[*name of acquired corporation*] set forth opposite his or her name in subsection (d) below, which together will constitute all [*or specify other percentage of 80 or more*] of the issued and outstanding shares of stock of _____[*name of acquired corporation*].

(b) Shareholders will place certificates, in form for transfer, representing the shares in escrow for delivery pursuant to an escrow agreement made with _____[*name of escrow holder*], as escrow holder. Shareholders agree that the shares to be transferred by them, represented by the certificates so held in escrow, are subject to the interests of _____[*name of acquiring corporation*], that the arrangements made by them for that escrow are to that extent irrevocable, that except as otherwise provided in this agreement their obligations under this agreement shall not be terminated by operation of law or the occurrence of any event, including death, and that if any such event shall occur before the delivery of the shares to be exchanged hereunder, certificates for those shares shall be delivered by the escrow holder in accordance with the terms and conditions of this agreement as if that event had not occurred, whether or not the escrow holder receives notice of that event.

(c) In exchange for the number of shares transferred by each shareholder, _____[*name of acquiring corporation*] will cause to be delivered to each shareholder the number of shares of common stock of _____[*name of acquiring corporation*] set forth opposite the name of the shareholder in subsection (d), below. The common stock may consist of issued and outstanding shares, treasury shares, or authorized but unissued shares, or any combination thereof.

(d) The shares of _____[*name of acquired corporation*], to be transferred by the respective shareholders to _____[*name of acquiring corporation*], and the shares of common stock of _____[*name of acquiring corporation*], to be delivered by _____[*name of acquiring corporation*] for the account of the respective shareholders, are as follows:

Shareholder	Shares of _____ [*name of acquired corporation*]	Shares of _____ [*name of acquiring corporation*]
_____	_____	_____
_____	_____	_____
_____	_____	_____

Closing Date

Section 1.02. Subject to the conditions precedent set forth in this agreement, the plan of reorganization shall be consummated at _____[*office, street address, city, and state*], on _____[*date*], at _____ M., or any other place and date that may be fixed by mutual consent of the parties. The date of the consummation is the "closing date" referred to in this agreement.

ARTICLE 2 COVENANTS, REPRESENTATIONS, AND WARRANTIES OF SHAREHOLDERS OF _____ [*name of acquired corporation*]

Legal Status of Corporation

Section 2.01. _____[*Name of acquired corporation*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of California [*or specify other state*], with corporate power to own property and carry on its business as it is now being conducted in the State of California [*or specify other state*], the only jurisdiction in which its business is presently conducted.

Subsidiaries

Section 2.02. _____[*Name of acquired corporation*] has no subsidiaries nor any interest in any other corporation, firm, or partnership [*or specify subsidiaries, legal status, and capitalization as appropriate*].

Capitalization

Section 2.03. _____[*Name of acquired corporation*] has an authorized capitalization consisting of _____[*number*] shares of capital stock, each of $_____ par value, of which _____[*number*] shares, and no more, are validly issued and outstanding, fully paid and nonassessable. _____[*Name of acquired corporation*] has no obligation of any kind to issue any additional capital stock or other securities, and has no other outstanding securities.

Financial Statements

Section 2.04. (a) The audited [*or* unaudited] balance sheet of _____[*name of acquired corporation*] as of _____[*date*], and the related statements of income and retained earnings for the _____[*e.g.*, five] years then ended _____[are attached to this agreement as Exhibits _____ through _____ *or* previously have been delivered to _____ (*name of acquiring corporation*)]. All such financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and present fairly the financial position of _____[*name of acquired corporation*] on _____[*date*], and the results of operations for the period then ended [*add if statements are unaudited:*, subject, however, to usual changes resulting from year-end audit of the financial statements].

(b) The book values of the assets shown on that balance sheet correspond substantially to the values of the assets for federal income tax purposes.

Collectibility of Accounts Receivable

Section 2.05. Except as specifically provided in that balance sheet, the accounts receivable shown in the balance sheet will be collected in the ordinary course of business or have been so collected.

Material Liabilities Disclosed

Section 2.06. Except as set forth in Exhibit _____, all material liabilities of _____[*name of acquired corporation*], fixed or contingent, as of _____[*date*], including but not limited to all liabilities for taxes based upon or measured by income, are disclosed and adequately provided for in that balance sheet.

Title to Assets

Section 2.07. Except for any assets disposed of in the ordinary course of its business subsequent to the date of that balance sheet, _____[*name of acquired corporation*] has good title, free and clear of defects in title, claims, liens or encumbrances, other than taxes not delinquent or liens and encumbrances disclosed in the balance sheet, to all assets represented as being owned by it in the balance sheet, and to all assets thereafter acquired.

Obligations Owed to Acquired Corporation

Section 2.08. All notes, contracts, guaranties, and other instruments evidencing or securing obligations owed to _____[*name of acquired corporation*], and all security interests in real or personal property, tangible or intangible, given to secure those obligations as shown in that balance sheet were, as of _____[*date*], valid and legally enforceable, and those held at the date hereof are valid and legally enforceable.

No Material Changes

Section 2.09. Except as set forth in Exhibit _____, and except for changes not materially adverse to the business of _____[*name of acquired corporation*] resulting from transactions in the normal and ordinary course of business since _____[*date*], there have been no substantial changes in the assets or liabilities or financial condition and results of operations of _____[*name of acquired corporation*].

Performance Not Violative of Any Instrument

Section 2.10. The performance by shareholders of their respective obligations under this agreement will not result in any breach of the terms or conditions of, or constitute a default under, any agreement or instrument to which _____[*name of acquired corporation*] or any shareholder is a party, or by the terms of which _____[*name of acquired corporation*] or any shareholder is bound.

Material Contracts

Section 2.11. Except as set forth in Exhibit _____, _____[*name of acquired corporation*] is not a party to or bound by any material, oral or written

(a) Contract not made in the ordinary course of business.

(b) Contract for the employment of any officer or employee or commitment for any special bonus, compensation, or severance pay.

(c) Pension, profit-sharing, retirement, or stock purchase plan with its employees or others.

(d) Contract with any labor union.

_____[*Name of acquired corporation*] is not materially in default under any material contract or other instrument to which it is a part or by the terms of which it is bound.

Litigation

Section 2.12. Except as set forth in Exhibit, there are no

(a) Claims made or pending or threatened against or affecting _____[*name of acquired corporation*].

(b) Actions, proceedings, or investigations pending or threatened against or affecting _____[*name of acquired corporation*] in any court or before or by any federal, state, municipal, or other governmental agency or instrumentality.

(c) Orders, writs, injunctions, or decrees of any court or any governmental agency or instrumentality against or affecting _____[*name of acquired corporation*] which might result in any material adverse change in its assets, business operations or conditions, financial or otherwise.

_____[*Name of acquired corporation*] is in compliance with all laws and regulations and all orders and decrees applicable to it or its business or assets.

Taxes

Section 2.13. (a) Except as set forth in Exhibit _____, _____[*name of acquired corporation*] has filed all income and other tax returns, federal, state, and local, which are required to be filed, and has paid all taxes due.

(b) Federal income tax returns of _____[*name of acquired corporation*] have been audited through _____[*date*], and, except as set forth in Exhibit _____, all deficiencies have been paid or provided for. Federal income tax deficiencies of _____[*name of acquired corporation*] for tax years ending _____[*date*], have been determined by negotiations between _____[*name of acquired corporation*] and the Internal Revenue Service and the amounts, together with interest on them, shall not exceed in the aggregate the amount set forth in Exhibit _____.

(c) California franchise tax deficiencies, together with interest thereon, of _____[*name of acquired corporation*] for tax years through _____[*date*], shall not exceed the amounts set forth in Exhibit _____.

(d) The federal income and California franchise tax liabilities of _____[*name of acquired corporation*] for the tax years ending in [*date*] shall not exceed in the aggregate $_____.

Activities Since Balance Sheet Date

Section 2.14. Except as set forth in the Exhibits _____, since _____[*date*], _____[*name of acquired corporation*] has not

(a) Incurred any material obligations or fixed or contingent liabilities not heretofore discharged, except in the ordinary course of business.

(b) Made any loans or advances to its officers or shareholders or declared or made any payment or distribution on its stock.

(c) Redeemed or purchased or otherwise acquired any of its stock, or agreed to take any such actions.

(d) Purchased or contracted to purchase any annuities for any of its officers or employees.

(e) Subjected any of its assets, tangible or intangible, to a lien or other encumbrance, except in the ordinary course of business.

(f) Except in the ordinary course of business, sold or transferred any of its assets or canceled any debts or claims.

(g) Except in the ordinary course of business, entered into any material transaction or made any capital expenditure.

(h) Made any increase in the compensation or benefits of any officer or employee in excess of $_____ per year.

(i) Made any material change in its accounting policies.

(j) Changed its capitalization.

Valid and Binding Agreement to Transfer Shares

Section 2.15. This agreement has been duly executed and delivered by shareholders and is, as to each of them, a valid agreement binding upon them in accordance with its terms. Shareholders have full right and power to exchange, transfer, and deliver the shares of _____[*name of acquired corporation*] to be exchanged by them for shares of common stock of _____[*name of acquiring corporation*] as provided in this agreement, and on such exchange, transfer, and delivery, _____[*name of acquiring corporation*] will acquire good and marketable title to the shares of _____[*name of acquired corporation*], free and clear of all voting or other trust arrangements, liens, encumbrances, equities, and claims whatsoever.

Acquisition for Investment

Section 2.16. The shares of common stock of _____[*name of acquiring corporation*] to be delivered pursuant to this agreement are being acquired by the shareholders for investment and not with a view to or for sale in connection with any distribution thereof. Shareholders do not presently have any reason to anticipate any change in circumstances or any other particular occasion or event that would cause them to distribute any of those shares.

Restriction on Sale of Shares

Section 2.17. Unless at the time a registration statement is in effect under the Securities Act of 1933 covering the shares of common stock of _____[*name of acquiring corporation*] delivered hereunder, shareholders will not offer for sale, sell, or otherwise dispose of these shares under circumstances that would require the registration of these shares under that act.

No Finder's Fee

Section 2.18. Neither _____[*name of acquired corporation*] nor any shareholder has made, or will

make, any commitment to pay any finder's or brokerage fee or commission on account of the execution of this agreement or the consummation of the transaction contemplated hereby.

ARTICLE 3 COVENANTS, REPRESENTATIONS, AND WARRANTIES OF _____ [*name of acquiring corporation*]

Legal Status

Section 2.01. _____[*Name of acquiring corporation*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of _____, with corporate power to own property and carry on its business as it is now being conducted, and is duly qualified to transact its business and is in good standing under the laws of the State of California [*or specify other state*], the only state in which it is presently conducting its business.

Capitalization

Section 3.02. _____[*Name of acquiring corporation*] has an authorized capitalization of $_____, divided into _____[*number*] shares of _____[*e.g.*, four-and-one-half percent] convertible preferred stock, par value of $_____ per share, and _____[*number*] shares of common stock, par value of $_____ per share. At the close of business on _____[*date*], there were outstanding _____[*number*] shares of the convertible preferred stock and _____[*number*] shares of the common stock. _____[*number*] shares of the common stock were reserved for conversion of outstanding shares of the convertible preferred stock, and _____[*number*] shares of the common stock were reserved for issuance under a stock option plan. By action of its Board of Directors on _____[*date*], _____[*name of acquiring corporation*] declared a _____[*e.g.*, two percent] stock dividend payable _____[*date*], to shareholders of record as of _____[*date*]. That stock dividend will require the issuance by _____[*name of acquiring corporation*] of an additional _____[*number*] shares of its common stock. _____[*Name of acquiring corporation*] has several acquisitions, either in process or under consideration, which will require delivery of shares of stock of _____[*name of acquiring corporation*] in exchange for assets or stock of the companies being acquired.

Financial Statements

Section 3.03. (a) The audited [*or* unaudited] balance sheet of _____[*name of acquiring corporation*] as of _____[*date*], and the related statements of income and retained earnings for the _____[*e.g.*, five] years then ended _____[are attached to this agreement as Exhibits _____ through _____ *or* previously have been delivered to the shareholders]. All such financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and present fairly the financial position of _____[*name of acquiring corporation*] at _____[*date*], and the results of operations for the period then ended [*add if statements are unaudited:*, subject, however, to usual changes resulting from year-end audit of the financial statements].

(b) The book values of the assets shown on that balance sheet correspond substantially to the values of the assets for federal income tax purposes.

Status of Shares Being Delivered

Section 3.04. The shares of common stock of _____[*name of acquiring corporation*] to be delivered pursuant to this plan and agreement of reorganization are, or at the time of issuance will be, validly issued, fully paid, and nonassessable voting shares and are, or on notice of the issuance thereof will be, fully listed on _____[*specify stock exchange(s), e.g.*, the New York and Pacific Stock Exchanges].

Public Offering of Shares

Section 3.05. On written request of shareholders within a period of _____[*e.g.*, two] years after the closing date, _____[*name of acquiring corporation*] will take the following steps for the purpose of enabling shareholders to sell, in a public offering, shares of common stock of _____[*name of acquiring corporation*] received under this agreement:

(a) Do whatever shall be necessary or appropriate, in the opinion of counsel, to obtain an exemption of the proposed offering from the registration requirements of the Securities Act of 1933.

(b) If an exemption from the Securities Act of 1933 is not available, and if _____[*number*] or more shares are to be offered, file with the Securities and Exchange Commission, and use its best efforts to cause to become effective, an appropriate registration statement covering the shares of common stock of _____[*name of acquiring corporation*] proposed to be offered. _____[*Name of acquiring corporation*] shall be required to file only one such registration statement pursuant to this clause.

(c) If _____[*name of acquiring corporation*] shall determine within _____[*e.g.*, two] years following the closing date to file a registration statement under the Securities Act of 1933 with respect to any offering of its common stock, give _____[*e.g.*, 20 days'] notice, in writing, of that intention to shareholders, and on written request of shareholders within that _____[*e.g.*, 20-day] period, to include not less than _____[*number*] shares of common stock of _____[*name of acquiring corporation*] owned by shareholders in the registration statement for the purpose of a public offering.

(d) If required, furnish shareholders a reasonable number of prospectuses for the purpose of a public offering.

(e) Pay all expenses in connection with the preparation, printing, and filing of any such registration statement and prospectus, but not any separate expenses of any shareholder in connection with the offering of their shares.

Public offering by any shareholder of shares of common stock of _____[*name of acquiring corporation*] so registered shall be effected in an organized manner through securities dealers or in any other manner as _____[*name of acquiring corporation*] shall have approved.

Acquisition for Investment

Section 3.06. _____[*Name of acquiring corporation*] is acquiring the shares of capital stock of _____[*name of acquired corporation*] for investment, and not with a view to or for sale in connection with any distribution of that stock.

No Finder's Fee

Section 3.07. _____[*Name of acquiring corporation*] has not made, and will not make, any commitment to pay any finder's or brokerage fee or commission on account of the execution of this agreement or the

consummation of the transaction contemplated hereby.

Approval of Agreement and Transaction

Section 3.08. The Board of Directors of _____[*name of acquiring corporation*] has duly approved, or will approve, this agreement and the transaction contemplated by this agreement, and has authorized, or will authorize, the execution, delivery, and performance of this agreement by _____[*name of acquiring corporation*]; provided however approval of the principal terms of this agreement by the outstanding shares of each class of _____[*name of acquiring corporation*], as those terms are defined in the General Corporation Law of California, is an express condition precedent to performance of this agreement by _____[*name of acquiring corporation*]. The Board of Directors of _____[*name of acquiring corporation*] warrants and agrees to use its best efforts to obtain as soon as is practical the approval of the principal terms of this agreement by the outstanding shares of each class of _____[*name of acquiring corporation*] as those terms are defined in the General Corporation Law of California.

ARTICLE 4 CONDUCT OF BUSINESS OF _____ [*name of acquired corporation*] PENDING CLOSING

Access to Information and Documents

Section 4.01. (a) Shareholders will cause _____[*name of acquired corporation*] to afford the officers and accredited representatives of _____[*name of acquiring corporation*], from the date of this agreement until consummation of the plan of reorganization, full access during usual business hours to all properties, books, accounts, contracts, commitments, and records of every kind of _____[*name of acquired corporation*] in order that _____[*name of acquiring corporation*] may have full opportunity to make any investigation it may desire to make, and keep itself informed with respect to, the affairs of _____[*name of acquired corporation*].

(b) In addition, shareholders will cause _____[*name of acquired corporation*] to permit _____[*name of acquiring corporation*] to make extracts or copies of all such books, accounts, commitments, and records and to furnish to _____[*name of acquiring corporation*], within _____[*e.g.*, 10 days] after demand, any further financial and operating data and other information with respect to the business and properties of the corporation as it may reasonably request from time to time.

(c) _____[*Name of acquiring corporation*] will use any information so secured only for its own purposes in connection with the transaction contemplated and will not divulge the information to any persons not entitled to it.

Business as Usual

Section 4.02. Except as required or permitted by this agreement, or consented to in writing by _____[*name of acquiring corporation*] pending consummation of the plan of reorganization, shareholders will cause _____[*name of acquired corporation*] to carry on its business in substantially the same manner in which that business has been conducted.

Negative Covenants

Section 4.03. Except with the written consent of _____[*name of acquiring corporation*] pending consummation of the plan of reorganization, shareholders will cause _____[*name of acquired corporation*] not to do any of the acts listed in Section 2.14, nor engage in any activities other than the customary and ordinary business activities now carried on by it.

ARTICLE 5 CONDUCT OF BUSINESS OF _____ [*name of acquiring corporation*] PENDING CLOSING

Business as Usual

Section 5.01. _____[*Name of acquiring corporation*] will carry on its business in substantially the same manner in which that business has been conducted.

Obtain Permit

Section 5.02. _____[*Name of acquiring corporation*] will exercise due diligence to obtain any necessary permit of the California Commissioner of Corporations with respect to the transaction contemplated by this agreement and to comply with all other legal requirements applicable to that transaction.

ARTICLE 6 CONDITIONS PRECEDENT TO OBLIGATIONS OF _____ [*name of acquiring corporation*] TO CLOSE

Section 6.01. The obligations of _____[*name of acquiring corporation*] to deliver its shares of common stock under this agreement shall be subject to the following conditions precedent, the nonoccurrence of which, unless waived by it, shall relieve it from all performance under this agreement:

Opinion From Counsel for Shareholders

(a) On the closing date, _____[*name of acquiring corporation*] shall have received an opinion from _____, counsel for shareholders, addressed to _____[*name of acquiring corporation*] and dated the closing date, and in form and substance satisfactory to _____[*name of acquiring corporation*] and its counsel, to the effect that

(1) _____ [*Name of acquired corporation*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of _____; is not subject to regulation by any federal or state regulatory authority; is duly authorized to conduct its business as presently and at the closing date being conducted.

(2) _____ [*Name of acquired corporation*] has an authorized capitalization consisting of _____ [*number*] shares of capital stock, par value $_____ per share, of which _____ [*number*] shares, and no more, are validly issued and outstanding, fully paid and nonassessable.

(3) This agreement has been duly executed and delivered by shareholders and is a valid and binding obligation of shareholders in accordance with its terms.

(4) On delivery to _____ [*name of acquiring corporation*], or its order of a certificate or certificates for the shares of _____ [*name of acquired corporation*] against the delivery of shares of common stock of _____ [*name of acquiring corporation*] in exchange therefor as provided in this agreement, the recipient will have good and marketable title to the shares of _____ [*name of acquired corporation*

], free and clear of any liens, charges, encumbrances, or claims.

Opinion From Counsel for Acquiring Corporation

(b) On the closing date, _____[*name of acquiring corporation*] shall have received a favorable opinion from _____, counsel for _____[*name of acquiring corporation*], addressed to _____[*name of acquiring corporation*] and dated the closing date, covering any legal matters incident to the transaction contemplated by this agreement, as _____[*name of acquiring corporation*] shall reasonably request.

Performance of Terms and Conditions

(c) All terms and conditions of this agreement to be performed by shareholders on or before the closing date shall have been performed.

Correctness of Representations and Warranties

(d) Except to the extent that any representations and warranties shall be incorrect as of the closing date because of events or changes not materially adversely affecting the business, property, or condition, financial or otherwise, of _____[*name of acquired corporation*], occurring or arising after the date of this agreement in the ordinary course of business, the representations and warranties made by shareholders shall be correct in all material respects, as of the closing date, with the same force as though the representations and warranties had been made on the closing date, and shareholders shall have delivered to _____[*name of acquiring corporation*] on the closing date a certificate executed by them, dated the closing date, making those representations and warranties as of the closing date.

If _____[*name of acquiring corporation*] discovers any material breach in the representations and warranties of shareholders herein prior to the closing date, it shall notify shareholders in order that they shall have an opportunity to correct the breach prior to the closing date to the satisfaction of _____[*name of acquiring corporation*]. Failure of _____[*name of acquiring corporation*] to give the notice, however, shall not constitute a waiver of the conditions in this subsection or a waiver of any of its rights or remedies on account of the breach.

Absence of Litigation

(e) On the closing date, no actions, proceedings, or investigations shall be pending or, to the knowledge of shareholders, threatened against or affecting shareholders in any court or before any federal, state, municipal, or other governmental agency or instrumentality to restrain or prohibit the transactions contemplated by this agreement.

Repayment of Loans

(f) On or prior to the closing date, all loans or advances previously or hereafter made by _____[*name of acquired corporation*] to directors, officers, employees, or others shall have been repaid or the loan repayment obligations shall have been sold by _____[*name of acquired corporation*] at the face amount, plus accrued interest.

Permit Obtained

(g) On or prior to the closing date, the California Commissioner of Corporations shall have issued any necessary permit, in form satisfactory to counsel for _____[*name of acquiring corporation*], authorizing _____[*name of acquiring corporation*] to deliver to shareholders the shares of common stock of

_____[*name of acquiring corporation*] to which they may become entitled under this agreement, and the permit by its terms shall be in full force on the closing date.

Stock Exchange Listing

(h) On or prior to the closing date, all shares of common stock of _____[*name of acquiring corporation*] to be delivered to shareholders on the closing date which are authorized but unissued shares, shall have been approved for listing on [*e.g.,* the New York and Pacific Stock Exchanges], effective upon notice of issue.

Sale of Obligation

(i) On or prior to the closing date, _____[*name of acquired corporation*] shall have sold the obligation of _____[*name of acquiring corporation*] at the face amount, plus accrued interest.

Certificate of Accountants

(j) _____[*Name of acquiring corporation*] shall have received from _____, certified public accountants, a certificate dated as of the closing date to the effect that, on the basis of the latest available interim financial statements prepared by or at the direction of _____[*name of acquired corporation*], consultations with responsible officers of _____[*name of acquired corporation*], and other pertinent inquiries, they have no reason to believe that during the period from _____[*date*], to a specified date not more than _____[*e.g.,* five] business days prior to the closing date, there have been any material adverse changes other than changes required or expressly permitted by this agreement or requested in writing by _____[*name of acquiring corporation*] in the financial condition or results of operations of _____[*name of acquired corporation*] from those reflected in the financial statements as of _____[*date*].

Resignations of Directors

(k) On the closing date, shareholders shall have delivered to _____[*name of acquiring corporation*] written resignations, effective on delivery, of any of the Directors of _____[*name of acquired corporation*] that _____[*name of acquiring corporation*] shall designate by written notice to shareholders at least _____[*e.g.,* five] days prior to the closing date.

ARTICLE 7 CONDITIONS PRECEDENT TO OBLIGATIONS OF SHAREHOLDERS TO CLOSE

Section 7.01. The obligations of shareholders to consummate the exchange of shares contemplated by this agreement shall be subject to the following conditions precedent:

Reaffirmation of Representations and Warranties

(a) Shareholders shall have received a certificate dated as of the closing date, signed by the President or a Vice President and the Secretary or an Assistant Secretary of _____[*name of acquiring corporation*], reaffirming as of the closing date the then applicable representations and warranties set forth in this agreement.

Shareholder Approval

(b) Prior to the closing date the principal terms of this agreement have been approved by the outstanding shares of each class of _____[*name of acquiring corporation*] as required by the General Corporation Law of California.

Permit Obtained

(c) Prior to the closing date, the California Commissioner of Corporations shall have issued any necessary permit, in form satisfactory to counsel for shareholders, authorizing _____[*name of acquiring corporation*] to deliver to shareholders the shares of common stock of _____[*name of acquiring corporation*] to which the shareholders may become entitled pursuant to this agreement, and the permit by its terms shall be in full force on the closing date.

Opinion of Counsel for Acquiring Corporation

(d) On the closing date, shareholders shall have received an opinion of _____, counsel for _____[*name of acquiring corporation*], dated the closing date and in form satisfactory to counsel for shareholders, to the effect that _____[*name of acquiring corporation*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of _____ and that the shares of common stock of _____[*name of acquiring corporation*] delivered to shareholders on the closing date have been duly authorized, issued, and delivered, and are validly issued and outstanding, fully paid and nonassessable voting shares of _____[*name of acquiring corporation*].

ARTICLE 8 TERMINATION

Nonfulfillment of Conditions Precedent

Section 8.01. If for any reason the closing shall not have taken place by _____[*date*], or if, on the closing date, any conditions to the consummation of the transaction contemplated by this agreement, other than any conditions that have been waived by the party for whose benefit the conditions were imposed, have not been fulfilled, this agreement shall terminate forthwith and be of no further force and, except for payment of their own expenses incident to this agreement, _____[*name of acquiring corporation*], and shareholders shall be relieved of all obligations hereunder.

Return to Stock and Documents

Section 8.02. In the event of termination of this agreement, the escrow holder shall return to shareholders the share certificates representing shares of stock of _____[*name of acquired corporation*], and any accompanying documents previously deposited in escrow pursuant to Section 1.01.

ARTICLE 9 CONSUMMATION OF TRANSACTION

Consideration of Acquiring Corporation

Section 9.01. On the closing date, _____[*name of acquiring corporation*] will deliver or cause to be delivered to the shareholders the shares of common stock of _____[*name of acquiring corporation*] to which the shareholders are entitled, registered in the respective names of the shareholders.

Consideration of Shareholders

Section 9.02. On the closing date the escrow holder, on behalf of the shareholders, shall deliver to _____[*name of acquiring corporation*], or its order, certificates for the shares of

_____[*name of acquired corporation*], duly endorsed in blank for transfer or accompanied by stock powers or other appropriate instruments of transfer duly executed in blank.

Expenses

Section 9.03. Each of the parties to this agreement shall pay that party's own expenses incident to the preparation of this agreement and the consummation of the transaction contemplated by it.

Employment Agreements

Section 9.04. On the consummation of the transaction contemplated by this agreement, _____[*name of acquiring corporation*] will cause _____[*name of acquired corporation*] to enter into agreements with its key employees for their employment for not more than _____ years and to consult with shareholders as to the persons with whom the agreements will be entered into and with respect to the terms of those agreements.

ARTICLE 10 INTERPRETATION AND ENFORCEMENT

Survival of Representations and Warranties

Section 10.01. All the representations and warranties of the respective parties set forth in this agreement shall survive the closing date. Except for representations and warranties contained in Section 2.13 and for any other representations and warranties claimed in a written notice given by one of the parties hereto prior to the last day of the _____[*e.g.*, 24th month] following the closing date to have been breached, all such representations and warranties shall terminate on the last day of the _____[*e.g.*, 24th month] following the closing date.

Indemnification

Section 10.02. Shareholders will hold _____[*name of acquired corporation*] and _____[*name of acquiring corporation*] harmless from any loss or liabilities resulting from the breach of any of the warranties or representations made by shareholders herein. In the event of the loss or liability, shareholders shall deliver to _____[*name of acquiring corporation*], or its order, that number of shares of common stock of _____[*name of acquiring corporation*], together with the number of additional shares, rounded to the next whole share, that represents the stock dividends thereon, the record dates of which are after the closing date, as shall be determined by dividing _____[*e.g.*, 47.303] into the amount of the loss or liability, rounded off to the next whole share. In the event that a stock dividend is declared on common stock of _____[*name of acquiring corporation*], or there is a stock split or reverse stock split in respect thereof, the record or effective date of which is after the closing date and prior to the date of contemplated redelivery of shares to _____[*name of acquiring corporation*], the figure of _____[*e.g.*, 47.303] shall be adjusted accordingly.

Control of Tax Litigation

Section 10.03. (a) In the event any tax deficiencies, federal or state, in respect of taxes based on or measured by income for any period prior to the closing date, are asserted against _____[*name of acquired corporation*], shareholders shall have the right, solely at their expense, to contest the deficiencies. The contest shall include all

proceedings permitted by law.

(b) Subject to the right of _____[*name of acquiring corporation*], at its option, to direct and control all matters with reference to any tax deficiencies asserted against _____[*name of acquired corporation*] if, in the reasonable opinion of _____[*name of acquiring corporation*], the action taken by shareholders would affect the tax liability of _____[*name of acquired corporation*] after the closing date in a manner unacceptable to _____[*name of acquiring corporation*], _____[*name of acquiring corporation*] and _____[*name of acquired corporation*] shall abide by and be bound by any reasonable action taken by shareholders or their tax counsel.

Notices

Section 10.04. Any notice or other communication required or permitted under this agreement shall be deemed to be properly given when deposited in the United States mail for transmittal by certified or registered mail, postage prepaid, and addressed as follows:

(a) In the case of _____[*name of acquiring corporation*], to: _____[*corporate name, name of officer concerned, street address, city, and state*] or to any other person or address that _____[*name of acquiring corporation*] may furnish to shareholders for that purpose from time to time.

(b) In the case of the shareholders, to the address of each of the shareholders as that address appears on the books of _____[*name of acquired corporation*], or to any other person or address that any shareholder may from time to time furnish to _____[*name of acquiring corporation*] for this purpose.

Entire Agreement; Counterparts

Section 10.05. This instrument and its exhibits contain the entire agreement between the parties with respect to the transaction contemplated by it. It may be executed in any number of counterparts, each of which shall be deemed an original, but any counterparts together constitute only one and the same instrument.

Controlling Law

Section 10.06. The validity, interpretation, and performance of this agreement shall be controlled by and construed under the laws of the State of _____, the state in which this agreement is being executed.

Executed on _____[*date*], at _____[*city and state*].

_____ [*name of acquiring corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]
SHAREHOLDERS
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTax-Free AcquisitionsMergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of ShareholdersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Offerors



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART IV. FORMS

5-11D California Legal Forms--Transaction Guide § 11D.202

§ 11D.202 Agreement for Exchange of Shares--Alternative Contract Provision for Deferred Issuance of Acquiring Corporation's Shares

[1] Comment--Use of Form

This form consists of contractual provisions for a deferred stock payment plan that may be inserted into a share exchange agreement and still allow the agreement to provide for a tax-free reorganization share exchange. When used, the provisions in this form should be substituted for Article 1 of the form in either § 11D.200 or § 11D.201.

An acquiring corporation may be reluctant to specify the exact number of shares it is willing to exchange for shares of the corporation it seeks to acquire. The value of the shares of the corporation sought to be acquired may be difficult to determine, the acquiring corporation may wish to discover how the acquired corporation functions as its subsidiary, or the acquiring corporation may be doubtful that the growth pattern established by the acquired corporation will continue. For any or all of these reasons, the acquiring corporation may wish to defer the shares it is to issue in exchange for shares of the corporation it seeks to acquire until a future time when the acquired corporation's potential and value can be better determined.

For discussion of plans providing for deferred issuance of the acquiring corporation's shares in exchange for shares of the acquired corporation and, the income tax requirements such a plan must meet, see *§ 11D.23[3]*.

[2] Form

Agreement for Exchange of Shares--Alternative Contract Provision for Deferred Issuance of Acquiring Corporation's Shares

ARTICLE 1 PLAN OF REORGANIZATION

Plan Adopted

Section 1.01. A plan of reorganization of _____[*name of acquiring corporation*] and _____[*name of acquired corporation*] pursuant to the provisions of *Internal Revenue Code Section 368(a)(1)(B)* is adopted as follows:

(a) Each shareholder will transfer to _____[*name of acquiring corporation*] the number of shares of capital stock of _____[*name of acquired corporation*] listed after his or her name in column _____, of Exhibit _____, which together will constitute all [*or specify other percentage of 80 or more*] of [each class of] the issued and outstanding shares of stock of _____[*name of acquired corporation*].

(b) In exchange for the number of shares transferred by each shareholder, _____[*name of acquiring corporation*] will issue and cause to be delivered to each shareholder the number of shares of common stock of _____[*name of acquiring corporation*] listed after the name of the shareholder in column _____ of Exhibit _____.

(c) In addition to the exchange of shares provided for in subsection (b), additional shares of common stock of _____[*name of acquiring corporation*] may become payable to each shareholder in accordance with a deferred payment plan to be operative in the _____[*e.g.*, four years] following the exchange of shares contemplated herein, based on the earnings of _____[*name of acquired corporation*]. The provisions for this deferred payment plan are set forth in Exhibit _____. The amount of shares to be awarded to each shareholder as a result of the operations of any applicable year shall be an amount of shares of common stock of _____[*name of acquiring corporation*] equal to the total number of shares of common stock of _____[*name of acquiring corporation*] payable in that year multiplied by the individual shareholder's "multiplier" figure as set forth after each shareholder's name in Exhibit _____.

(d) The maximum number of shares of common stock of _____[*name of acquiring corporation*] in the exchange under subsection (b) and the deferred payment plan provided for in subsection (c) will be _____ shares, of which at least 50 [*or specify higher figure as appropriate*] percent will be issued in the initial distribution provided for in subsection (b).

(e) The rights of shareholders to any such additional shares of common stock of _____[*name of acquiring corporation*] under the deferred payment plan provided for in subsection (c) will not be assignable.

Closing Date

Section 1.02. Subject to the conditions precedent set forth herein, the plan of reorganization shall be consummated at _____[*office, street address, city, and state*] on _____[*date*], at _____ M. or any other place and date that may be fixed by mutual consent of the parties. The date of the consummation is the "closing date" referred to in this agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTax-Free AcquisitionsMergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of ShareholdersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Offerors



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART IV. FORMS

5-11D California Legal Forms--Transaction Guide § 11D.203

§ 11D.203 Tender Offer--Offering Letter by Acquiring Corporation Offering to Exchange Its Shares for Shares of Corporation Sought to Be Acquired

[1] Comment

[a] Use of Form

This form is an offering letter that may be sent by the acquiring corporation directly to shareholders of the corporation sought to be acquired, offering to exchange shares of the acquiring corporation for "tendered" shares of the corporation sought to be acquired. A letter offer directly to shareholders of the corporation sought to be acquired is known as a "tender offer" because it offers to acquire all "tendered" shares [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5E, *Tender Offers and Takeovers* (Matthew Bender)]. A form of published "tender offer" is set forth in *§ 11D.208*.

A tender offer is employed when the corporation sought to be acquired is publicly owned with numerous shareholders, making direct contact with all shareholders difficult. It is also often used when the acquisition of the corporation sought to be acquired is opposed by the latter corporation's board of directors or management. In such a case, the tender offer is often called a "takeover bid." A tender offer may offer to acquire tendered shares either for cash, securities of the offering corporation, or some combination of cash and securities. When the tender offer is an offer to acquire shares for securities of the offering corporation it is called an "exchange offer" [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5E, *Tender Offers and Takeovers* (Matthew Bender)].

[b] Methods of Making Tender Offer

A tender offer typically is made by letter. It may also be published in a financial newspaper. The letter is sent by the offering corporation directly to the shareholders of the acquired corporation, with an accompanying letter of acceptance for use by the accepting shareholder. When the tender offer is in the form of an exchange offer of stock for stock, a prospectus is also enclosed.

The offering corporation typically enters into an agreement with two prominent securities dealers as dealer-managers to handle the acquisition and they, in turn, publish the offer in a financial newspaper. In addition, the dealer-managers

usually enter into an agreement with soliciting dealers [Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 5E, *Tender Offers and Takeovers* (Matthew Bender)].

[c] State Regulation of Exchange Tender Offers

The General Corporation Law defines "share exchange tender offer" as any acquisition by one corporation, in exchange in whole or in part for its equity securities (or the equity securities of a corporation that is in control of the acquiring corporation), of shares of another corporation, other than an "exchange reorganization" [*Corp. Code § 183.5*]. Directors' and shareholders' approval of the share exchange tender offer is required [*Corp. Code § 1201.5*; *see § 11D.22[2]*].

The Corporate Securities Law of 1968 does not contain any specific reference to tender offers of any kind. However, several provisions of that law affect a tender offer to exchange shares for securities. *Corp. Code § 25110* makes it unlawful for any issuer to offer or sell in California any security issued by it until the sale of that security has been qualified by the California Commissioner of Corporations. The definitions of "sell" and "offer" contained in the Corporate Securities Law [*see Corp. Code § 25017(a), (b)*] are broad enough to include a tender offer to exchange shares for securities.

The Corporate Securities Law also prohibits any person from publishing any advertisement in California concerning any security sold or offered for sale in California unless a true copy of the advertisement has been filed in the office of the Commissioner of Corporations at least three days before its publication [*Corp. Code § 25300(a)*]. Furthermore, no such advertisement may be published in California after the Commissioner of Corporations finds that it contains any statement that is false or misleading or omits to make any statement necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and so notifies the person publishing the advertisement in writing [*Corp. Code § 25302*]. Note, however, that an advertisement is not published in California, and therefore need not be filed with the Commissioner, if it is published in any bona fide newspaper, or other publication of general, regular, and paid circulation which has had more than two-thirds of its circulation outside of California during the preceding 12 months [*Corp. Code § 25008(c)*].

Finally, *Corp. Code § 25210(a)* provides that no broker-dealer may effect any transaction in, or induce or attempt to induce the purchase or sale of, any security in California unless he or she has secured from the Commissioner a certificate then in effect authorizing him or her to act as broker-dealer. Furthermore, no agent acting on behalf of a broker-dealer or issuer may effect any transaction in, or induce or attempt to induce the purchase or sale of, any security in California unless the broker-dealer and agent have complied with the rules adopted by the Commissioner [*Corp. Code § 25210(b)*; *see Corp. Code § 25213* (Commissioner's power to censure, suspend, deny, or bar agent from employment)]. The Commissioner will review the disciplinary histories of agents on the filing of notice of (1) the employment or transfer of an agent for a broker-dealer, (2) an amendment to the information filed by the agent at the time of employment or transfer, and (3) the termination of employment of the agent from the broker-dealer [*Corp. Code § 25210(c)*]. For a detailed discussion and forms relating to the qualifications of securities for sale in California under the Corporate Securities Law of 1968, see Ch. 6H, *Qualification of Securities* .

[d] Federal Regulation of Exchange Tender Offers

Section 5(c) of the Securities Act of 1933 [*15 U.S.C. § 77e(c)*] makes it unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce, or of the mails, to offer to sell or buy any security unless a registration statement has been filed as to the security with the United States Securities and Exchange Commission. Section 10 of the Act [*15 U.S.C. § 77j*] specifies what a prospectus relating to a security must contain, and Section 2 of the Act [*15 U.S.C. § 77b(a)(10)*] defines a "prospectus" to include any circular, advertisement, letter, or communication which offers any security for sale. The term "prospectus" under this section refers only to documents related to public offerings of securities by an issuer or its controlling shareholders, not private agreements to sell securities [*Gustafson v. Alloyd Co., Inc. (1995) 513 U.S. 561, 115 S. Ct. 1061, 1063, 131 L. Ed. 2d*

1] . A tender offer for the exchange of shares for securities of the offeror offers a security for sale. As the Chairman of the SEC stated in 1966: "The law recognizes that the shareholder whose stock is sought by means of the exchange offer is in the position both of a seller and a buyer: that is, he is selling the security he presently owns, and buying the security offered to him" [Cohen, *A Note on Takeover Bids and Corporate Purchases of Stock, 23 Bus. Law. 149 (1966)*].

Section 2 of the Securities Act of 1933, however, excepts from its definition of "prospectus" a notice, circular, advertisement, letter, or communication that states from whom a written prospectus meeting the requirements of Section 10 of the Act may be obtained and that does no more than identify the security, state the price, state by whom orders will be executed, and that contains any other information that the SEC deems necessary or appropriate in the public interest and for the protection of investors. Because a prospectus meeting the requirements of Section 10 of the Act and the SEC rules adopted pursuant to that section will be several pages in length and therefore inconvenient to publish in a newspaper, a published tender offer for exchange of shares is drafted to comply with this exception of Section 2. Consequently, such an offer merely identifies the securities to be exchanged for shares, states the rate of exchange, names the deposit agent by whom orders will be executed, and states how a written prospectus concerning the offer and complying with Section 10 of the Act may be obtained. The offer also contains a notation, usually in italics, that it is not an offer to sell or an offer to buy and that the exchange offer is made only by the prospectus.

[e] Number of Shares Sought to Be Acquired

A tender offer may be made for all the shares of the acquired corporation, or only a number sufficient to give the acquiring corporation the control that it seeks. In the latter case, the offer must contain provisions covering the situation in which fewer or more than the specified number of shares are tendered. The offer may provide that if fewer than the specified number of shares are tendered, the offeror has the choice of purchasing all shares tendered or of purchasing none. The offer may provide that if more than the specified number of shares are tendered, the offeror may purchase all the shares tendered or only the specified number of shares selected on a pro rata basis.

The express policy of the New York and American Stock Exchanges requires that listed issuers making tender offers must purchase the specified number of shares on a pro rata basis from those tendered in the first 10 days of the offer [New York Stock Exchange Company Manual, at A 179-180; American Stock Exchange Co. Guide § 904]. The New York Stock Exchange also requires tender offers by listed issuers to be held open long enough to enable all shareholders of the corporation sought to be acquired to participate, suggesting a minimum of 10 days and recommending 30 days for the offer to remain open [*see* Kennedy, *Tender Moment, 23 Bus. Law. 1091, 1101 (1968)*]. The offer always names an independent "deposit agent," usually the stock transfer or corporate trust department of a well-known bank, as escrow holder of the stock pending its purchase by the offeror, and requires share certificates to be transmitted to the deposit agent with a prescribed letter of acceptance and assignment prepared by the offeror [*see § 11D.204*]. For a detailed discussion of the terms of tender offers, see Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 5E, *Tender Offers and Takeovers* (Matthew Bender).

[f] Report by Independent Appraiser

Corp. Code § 1203 provides that if a tender offer (including a "share exchange tender offer" [*see Corp. Code § 183.5* (definition)] or a written proposal for approval of a "reorganization" [*see Corp. Code §§ 181(a), 1200*] or a sale of assets [*see Corp. Code § 1001(a)*] is made to some or all of a corporation's shareholders by a party to the transaction who has control of or a financial interest in that corporation (an "interested party proposal"), an affirmative opinion in writing regarding the fairness of the consideration to the shareholders of the corporation must be provided to the shareholders or the corporation. This requirement does not apply if the target corporation does not have shares held of record by 100 or more persons [*see Corp. Code § 605* (determination of shareholders of record)] or if the transaction has been qualified pursuant to *Corp. Code § 25113* or *25121* (qualification of issuer transaction by permit or qualification of recapitalization or reorganization by permit), and no stop order [*see Corp. Code §§ 25140, 25143(a)*] is in effect regarding that qualification [*Corp. Code § 1203(a)*]. If a subsequent tender offer or written proposal is made by another

person at least 10 days before the date for acceptance of the tendered shares or the vote or notice of shareholder approval on the interested party proposal, additional shareholder notification and withdrawal requirements apply [*see Corp. Code § 1203(b)*]. For further discussion of this requirement and related requirements when such a proposal is pending at the same time as another proposal for a reorganization [*see Corp. Code 181* (definition)] or short-form merger [*see Corp. Code § 1203(b)*; *see also Corp. Code §§ 187, 1110* (short-form merger defined)], see Ch. 11, *Merger and Acquisition Issues* .

[2] Form

Tender Offer--Offering Letter by Acquiring Corporation Offering to Exchange Its Shares for Shares of Corporation Sought to Be Acquired

To the Stockholders of _____[*name of acquired corporation*]:

The undersigned, _____[*name of acquiring corporation*] offers, on the terms and conditions set forth or referred to below, to exchange for each outstanding share of common stock of _____[*name of acquired corporation*], either _____[*e.g.*, one-half] shares of _____[*name of acquiring corporation*] common stock and _____[*e.g.*, one-eighth] shares of $_____ convertible preferred stock (the preferred stock) of _____[*name of acquiring corporation*], or, in the alternative and at the option of each _____[*name of acquired corporation*] stockholder, one full share of _____[*name of acquiring corporation*] common stock. Places are provided on the enclosed Letter of Acceptance and Assignment for indication of the alternative selected.

In this exchange, no fractional shares of _____[*name of acquiring corporation*] stock will be issued. If the exchange ratio results in a fraction, you may instruct the depositary named below, as your agent and in any manner it shall determine, either (1) to sell, or cause to be sold, your fractional share interest and pay you the proceeds of sales or (2) to buy, or cause to be bought, the additional fractional share interest required to increase your fractional share interest to one full share and send you a certificate, as explained later in this Exchange Offer, for a full share, or a certificate that will include a full share, on your payment for an additional fractional share interest. If you do not indicate your preference, you will be deemed to have instructed the depositary, as your agent and in any manner that it shall determine, to sell, or cause to be sold, your fractional share interest and pay you the proceeds of sale.

Further details of this Exchange Offer and pertinent information concerning _____[*name of acquiring corporation*] and _____[*name of acquired corporation*] are contained in the enclosed prospectus, dated _____[*date*].

_____[*Name of acquiring corporation*] has designated _____, at its office at _____, as depositary for the Exchange Offer.

This Exchange Offer may be validly accepted by depositing with the depositary

1. The enclosed Letter of Acceptance and Assignment, completed and executed, with signatures guaranteed by a bank or trust company or by a member firm of the New York or Pacific Stock Exchange, and accompanied by required supporting documents, all in accordance with the applicable instructions.

2. The share certificate or certificates evidencing the shares of common stock of _____[*name of acquired corporation*] that you desire to exchange for shares of _____[*name of acquiring corporation*].

For the convenience of stockholders of _____[*name of acquired corporation*] who may so desire, the above documents may be delivered or mailed to _____, which has been designated as the forwarding agent, for forwarding to the depositary.

The deposit must be received by the depositary or the forwarding agent on or before _____[*date*], _____[*name of acquiring corporation*] may from time to time extend the period for acceptance of this Exchange Offer to a date not later than _____[*date*], by giving notice to the depositary, and may further extend it from time to time by similar notice, provided it has been made effective on or before _____[*date*].

This Exchange Offer and your deposit are each subject to the conditions specified here, in the Letter of Acceptance and Assignment and in the enclosed prospectus.

Assuming the acceptances of this Exchange Offer have been made effective by _____[*name of acquiring corporation*] by appropriate notice to the depositary, the depositary, as soon as practicable, will deliver to _____[*name of acquiring corporation*] the shares of _____[*name of acquired corporation*] evidenced by deposited share certificates in proper form for transfer and will deliver, or mail by first-class mail insured, certificates evidencing the number of shares of _____[*name of acquiring corporation*] to which you are entitled pursuant to this Exchange Offer, to your address shown in the Letter of Acceptance and Assignment. In those cases in which a fractional share interest is purchased, the share certificate including that interest will not be forwarded until after payment is received.

As more fully described in the prospectus, _____[*name of acquiring corporation*] will pay securities dealers for soliciting acceptances of this Exchange Offer. A space is provided in the Letter of Acceptance and Assignment for the name of the soliciting dealer, if any, to whom a fee should be paid.

If the acceptances of this Exchange Offer are not made effective on or before the termination date of this Exchange Offer (which will be _____[*date*], unless extended as mentioned above) your deposited share certificates and related documents will be promptly returned, by first-class mail insured, without expense to you, to your address shown in the Letter of Acceptance and Assignment.

Additional copies of the Letter of Acceptance and Assignment are available at the offices of _____[*name of acquiring corporation*] and _____[*name of acquired corporation*], and at the offices indicated above of the depositary and the forwarding agent. For your convenience, a return envelope addressed to the depositary is enclosed.

You are urged to give this matter your immediate attention. This Exchange Offer expires _____[*date*], unless extended as mentioned above.

_____ [*name of acquiring corporation*]
By _____ [*signature*]
[*typed name*], President

Tax Information

A legal opinion by tax counsel on the tax consequences of the exchange has been received to the effect that if 80 percent or more of the issued and outstanding shares of _____[*name of acquired corporation*] are exchanged pursuant to the Exchange Offer, the exchanges will not, under existing federal law, result in the recognition of any

taxable income to or deductible loss by the stockholders of _____[*name of acquired corporation*], except that gain or loss will be recognized by those _____[*name of acquired corporation*] stockholders who sell their fractional interests in _____[*name of acquiring corporation*] stock, measured by the difference between the adjusted basis of the fractional interests and the consideration received for the fractional interests. The basis of the shares of _____[*name of acquiring corporation*] stock received by _____[*name of acquired corporation*] stockholders in the exchange will be the same as the cost or basis of their shares of common stock of _____[*name of acquired corporation*] exchanged therefor. _____[*Name of acquiring corporation*] will need to know the cost or basis of your shares of common stock of _____[*name of acquired corporation*] since _____[*name of acquiring corporation*] will acquire the same cost or basis. Please furnish this information in the place indicated on the Letter of Acceptance and Assignment.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of ShareholdersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Offerors



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART IV. FORMS

5-11D California Legal Forms--Transaction Guide § 11D.204

§ 11D.204 Tender Offer--Letter of Acceptance and Assignment by Shareholder of Corporation Sought to Be Acquired

[1] Comment--Use of Form

This form is a letter of acceptance and assignment to be used by shareholders to accept a tender offer. When one corporation proceeds by means of a tender offer made directly to shareholders of another corporation to attempt to acquire shares of the acquired corporation, it usually includes this type of form with its offering letter. This letter is designed to be sent with the offering letters contained in § 11D.203. The discussion in that section is equally applicable to the acceptance letter set forth in this form and should be read in connection with it.

[2] Form

Tender Offer--Letter of Acceptance and Assignment by Shareholder of Corporation Sought to Be Acquired

LETTER OF ACCEPTANCE AND ASSIGNMENT

IMPORTANT: First please read the instructions below and the Exchange Offer. Then complete, sign, and transmit this document to the depositary named below in accordance with the instructions.

_____, as depositary
Corporate Trust--Stock Transfer
_____[*street address*]
_____[*city*], _____[*state*]

Ownership of Shares

The undersigned is the owner and holder of the following outstanding shares of common stock of

_____[*name of acquired corporation*]:

Total number of shares owned: _____

Certificate numbers: _____

Assignment--Receipt of Offer [*see* Instruction 3]

The shares of common stock of _____[*name of acquired corporation*] are hereby assigned to _____[*name of acquiring corporation*], dated _____[*date*]. Receipt of The Exchange Offer and the prospectus relating to it is hereby acknowledged.

Exchange Ratio [*see* Instruction 4]

The undersigned hereby irrevocably deposits The certificate[s] for exchange for shares of _____[*name of acquiring corporation*] as follows:

Indicate Choice in One Box

A. ☐ [*e.g.,* One-eighth share of _____ (*name of acquiring corporation*) $_____ convertible preferred stock and one-half share of _____ (*name of acquiring corporation*) common stock]

B. ☐ [*e.g.,* One share of _____ (*name of acquiring corporation*) common stock]

If the selected exchange ratio results in a fraction, the depositary is appointed agent of the undersigned and instructed, in any manner it shall determine, to buy or sell, or cause to be bought or sold, as indicated below, and on the terms and conditions as set forth in the Exchange Offer and prospectus, the fractional interest in a share of _____[*name of acquiring corporation*] common stock or preferred stock necessary to eliminate the fraction.

Mark in One Box Only

	Preferred	Common
Buy fractional interest	☐	☐
Sell fractional interest	☐	☐

Transfer and Delivery of Shares

If the acceptances of the Exchange Offer are made effective, the depositary is directed, in accordance with the Exchange Offer, to transfer the shares of common stock of _____[*name of acquired corporation*] evidenced by the enclosed certificate[s] to _____[*name of acquiring corporation*] and to deliver, or mail by first-class mail insured, to the address of the undersigned on the records of _____[*name of acquired corporation*] unless otherwise indicated below, certificate[s] registered in the name of the undersigned evidencing the number of shares of stock of _____[*name of acquiring corporation*] to which the undersigned is entitled pursuant to the Exchange Offer.

Return of Certificates

If the acceptances of the Exchange Offer are not made effective, the enclosed share certificate[s] and related documents (including this document) shall be returned without expense to the undersigned and the assignment shall become void.

Dated: _____.

Signatures [*see* Instruction 1]

Signature[s] of Owner[s]
Owner's Signature: _____
Printed Name of Owner: _____
Social Security or Employer Identification Number: _____
Mailing Address to Which Certificates Should be Forwarded: _____
Signature(s) guaranteed:
_____
_____
_____

Tax Information

The Internal Revenue Code requires _____[*name of acquiring corporation*] to take your cost or basis of your shares of common stock of _____[*name of acquired corporation*] for federal income tax purposes. It would be helpful to _____[*name of acquiring corporation*], therefore, if you would furnish below your aggregate cost or basis of your shares of common stock of _____[*second corporation*] for federal income tax purposes:

No. of Shares _____ .....Aggregate Cost or Basis $_____

INSTRUCTIONS
(Please read and follow carefully)

Signatures Required

(Please do not endorse your certificates)

1. The accompanying Letter of Acceptance and Assignment must be completed and signed by or on behalf of the owner[s] of the deposited certificate[s] exactly as the name[s] of the owner[s] appears on the certificate[s], with all signatures guaranteed by a bank or trust company or by a member firm of the New York or Pacific Coast Stock Exchange. If signature is by an agent, attorney, executor, administrator, trustee, guardian, or other fiduciary, or by an officer of a corporation (with corporate seal affixed), the full title of the person must be given and satisfactory evidence of his or her authority to exchange and transfer the deposited shares of _____[*name of acquired corporation*] (including court order if necessary) must be included in the deposit.

Delivery to the Depositary

2. When properly completed and signed with signature[s] guaranteed, deliver or mail (by a method at your option and risk) the Letter of Acceptance and Assignment, together with the certificate[s] for shares of _____[*name of acquired corporation*] and supporting documents, if any, to _____, as depositary, Corporate Trust--Stock Transfer, _____[*address*]. For your convenience, a return envelope is enclosed. If you wish, the Letter of Acceptance and Assignment, and share certificate[s] may be mailed or delivered to _____, for forwarding to the depositary.

Validity of Acceptance and Assignment

3. _____[*Name of acquiring corporation*] reserves the right to determine whether any Letter of Acceptance and Assignment, certificate for shares of _____[*name of acquired corporation*], and supporting documents are valid and are in proper form for good delivery. It is suggested that you act immediately in order that any defect in your acceptance may be corrected before the Exchange Offer expires on _____[*date*], unless extended as stated.

If you have any questions regarding the procedure for acceptance, you are invited to consult the depositary, _____[*name of acquired corporation*], or _____[*name of acquiring corporation*].

Fractional Shares

The following instruction is applicable only to stockholders of _____[*name of acquired corporation*] entitled to a fractional interest in a share of stock of _____[*name of acquiring corporation*] as a result of electing Choice A above:

4. By marking in the appropriate box above, a stockholder of _____[*name of acquired corporation*] appointed the depositary his or her agent, and instructs the depositary, in any manner that it shall determine, to buy or sell, or cause to be bought or sold, as the case may be, any fractional interest in a share of stock of _____[*name of acquiring corporation*] necessary to round out his or her holdings to the unit of a full share and eliminate the fraction. If no such direction is given to the depositary, the stockholder will be deemed to have elected to sell the fractional share interest and the depositary will sell it, or cause it to be sold, in his or her behalf as his or her agent. The depositary will bill each stockholder for the cost and charges of fractional share interests purchased and will pay each stockholder the net proceeds of each fractional share interest sold. See the prospectus for further details.

SOLICITING DEALER TO WHOM FEE SHOULD BE PAID

Name of Dealer: _____

Address of Dealer: _____

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of ShareholdersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Offerors



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART IV. FORMS

5-11D California Legal Forms--Transaction Guide § 11D.205

§ 11D.205 Resolution by Board of Directors of Acquiring Corporation Approving Proposed Share Exchange--Sufficient Authorized but Unissued Voting Shares to Consummate Exchange

[1] Comment--Use of Form

This form is a resolution to be adopted by the board of directors of an acquiring corporation approving a proposed exchange of its voting shares for 80 percent or more of all outstanding shares of another corporation. The 80 percent requirement is designed to make the proposed share exchange a tax-free reorganization as defined in the Internal Revenue Code [*see I.R.C. § 368(c)*; *see also § 11D.23[1]*]. For a discussion of the approval required for a proposed share exchange in California, see *§ 11D.21[1], [2]*.

For an alternative resolution that may be adopted by the board of directors of the acquiring corporation if its articles of incorporation must be amended to authorize it to issue the shares required to be issued by it as part of the proposed share exchange, see *§ 11D.206*.

[2] Form

Resolution by Board of Directors of Acquiring Corporation Approving Proposed Share Exchange--Sufficient Authorized but Unissued Voting Shares to Consummate Exchange

RESOLUTION

WHEREAS, the President of this corporation has negotiated with the principal shareholders of _____[*name of corporation to be acquired*] for the acquisition by this corporation of 80 percent or more of all outstanding shares of that corporation in exchange for voting common shares of this corporation as described in a proposed written Agreement of Share Exchange, called "the agreement," submitted to this meeting; and

WHEREAS, this corporation is authorized to issue _____[*number*] shares of its voting common shares and has issued only _____[*number*] of the common shares;

NOW, THEREFORE, BE IT RESOLVED that this corporation acquire 80 percent or more of all outstanding shares of

_____[*name of corporation to be acquired*], a California corporation, in exchange for voting common shares of this corporation pursuant to the written Agreement for Share Exchange submitted to this meeting; and

RESOLVED FURTHER, that the written Agreement for Share Exchange submitted to this meeting and the proposed exchange of common shares of this corporation for 80 percent or more of all outstanding shares of _____[*name of corporation to be acquired*] described in the agreement are approved by this Board of Directors; and

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to prepare, execute, and file on behalf of this corporation with the Commissioner of Corporations of the State of California any and all applications required to secure any permits required to allow this corporation to issue the shares required to be issued by it as part of the share exchange approved in this resolution; and

RESOLVED FURTHER, that the officers of this corporation are directed, on receipt by this corporation of a permit from the California Commissioner of Corporations authorizing it to issue the shares required to be issued by it as part of the share exchange approved by this resolution, to solicit approval of the share exchange described in this resolution by the outstanding shares of each class of this corporation as required by the California General Corporation Law by either calling a special meeting of shareholders for that purpose or obtaining the written consent of the required number of shareholders of each class; and

RESOLVED FURTHER, that when the share exchange approved by this resolution is approved by the outstanding shares of each class of this corporation as required by the General Corporation Law of California, the officers of this corporation are directed to execute on behalf of this corporation the written Agreement for Share Exchange submitted to this meeting and to do all things reasonably required to consummate the share exchange described in that agreement; and

RESOLVED FURTHER, that this corporation determines for purposes of the share exchange approved by this resolution that the fair market value as defined by *California Corporations Code Section 1300* of dissenting shares of this corporation as also defined by Calfiornia *Corporations Code Section 1300* is _____ [*specify* $_____ per share *or*

$_____ per share for common voting shares;

$_____ per share for Class A preferred shares;

$_____ per share for Class B preferred shares; and

$_____ per share for Class C preferred shares].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART IV. FORMS

5-11D California Legal Forms--Transaction Guide § 11D.206

§ 11D.206 Resolution by Board of Directors of Acquiring Corporation Approving Proposed Share Exchange--Articles of Incorporation Require Amendment to Authorize Issuance of Shares Required by Exchange

[1] Comment--Use of Form

This form is a resolution to be adopted by the board of directors of an acquiring corporation approving a proposed exchange of its voting shares for 80 percent or more of all outstanding shares of another corporation. This form differs in one respect from the resolution approving a proposed share exchange contained in *§ 11D.205*, which specifies that the acquiring corporation is already authorized to issue sufficient voting shares to consummate the proposed share exchange that resolution approves. This form, in contrast, is designed to be used by the board of directors of an acquiring corporation when the acquiring corporation is not already authorized to issue sufficient additional shares to consummate the proposed share exchange approved by the resolution. In addition to approving the proposed share exchange, it also approves amendment of the corporation's articles of incorporation to authorize the corporation to issue the additional voting shares required by the approved share exchange.

For discussion of the approval required for a proposed share exchange in California, see *§ 11D.21[1], [2]*. For a discussion of the requirement that the acquiring corporation exchange voting shares for 80 percent or more of all outstanding shares of the corporation to be acquired, see *§ 11D.23[1], [2]*.

[2] Form

Resolution by Board of Directors of Acquiring Corporation Approving Proposed Share Exchange--Articles of Incorporation Require Amendment to Authorize Issuance of Shares Required by Exchange

WHEREAS, the President of this corporation has negotiated with the principal shareholders of _____[*name of corporation to be acquired*], a California corporation, for the acquisition by this corporation of 80 percent or more of all outstanding shares of that corporation in exchange for voting common shares of this corporation pursuant to the terms of a proposed written Agreement for Share Exchange submitted to this meeting; and

WHEREAS, this corporation is authorized to issue only _____[*number*] shares of its voting common shares, all of which have already been issued;

NOW, THEREFORE, BE IT RESOLVED that this corporation acquire 80 percent or more of all outstanding shares of _____[*name of corporation to be acquired*], a California corporation, in exchange for voting common shares of this corporation pursuant to the written Agreement for Share Exchange submitted to this meeting; and

RESOLVED FURTHER, that the written Agreement for Share Exchange submitted to this meeting and the proposed exchange of common shares of this corporation for 80 percent or more of all outstanding shares of _____[*name of corporation to be acquired*] described in the agreement are approved by this Board of Directors; and

RESOLVED FURTHER, that Article _____ of the Articles of Incorporation of this corporation be amended to increase the number of voting common shares this corporation is authorized to issue from _____[*number*] to _____[*number*] and to read:

"Section 3.01. This corporation is authorized to issue _____ [*number*] shares of the same class"; and

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to prepare, execute, and file on behalf of this corporation with the Commissioner of Corporations of the State of California any and all applications, and amendments to them, required to secure any permission required to allow this corporation to issue the shares required to be issued by it as part of the share exchange approved in this resolution; and

RESOLVED FURTHER, that the officers of this corporation are directed, on receipt by this corporation of a permit from the California Commissioner of Corporations authorizing it to issue the shares required to be issued by it as part of the share exchange approved by this resolution, to solicit approval of the share exchange approved in this resolution by the outstanding shares of each class of this corporation as required by the General Corporation Law of California by either calling a special meeting of shareholders for that purpose or obtaining the written consent of the required number of shareholders of each class; and

RESOLVED FURTHER, that the officers of this corporation are further directed, on receipt by this corporation of a permit from the California Commissioner of Corporations authorizing it to issue the shares required to be issued by it as part of the share exchange approved by this resolution, to solicit the approval of shareholders required by the General Corporation Law of California, either by calling a special meeting of shareholders for that purpose or obtaining the written consent of the required number of shareholders, for amending the articles of incorporation of this corporation to increase the number of voting common shares this corporation is authorized to issue from _____[*number*] to _____[*number*] in the manner specified in this resolution; and

RESOLVED FURTHER, that when the amendment to this corporation's articles of incorporation described in this resolution is approved by the outstanding shares of this corporation as required by the General Corporation Law of California, the officers of this corporation are directed to execute and file a certificate so amending the articles of incorporation of this corporation and take any other action as may be required to so amend the articles of incorporation of this corporation; and

RESOLVED FURTHER, that when the share exchange approved by this resolution is approved by the outstanding shares of each class of this corporation as required by the General Corporation Law of California, the officers of this corporation are directed to execute on behalf of this corporation the written Agreement for Share Exchange submitted to this meeting and to do all things reasonably required to consummate the share exchange described in that agreement; and

RESOLVED FURTHER, that this corporation determines for purposes of the share exchange approved by this resolution that the fair market value as defined by *California Corporations Code Section 1300* for dissenting shares of this corporation as also defined in *California Corporations Code Section 1300* is $_____ per share.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Directors & OfficersBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART IV. FORMS

5-11D California Legal Forms--Transaction Guide § 11D.207

§ 11D.207 Resolution of Shareholders of Acquiring Corporation Approving Proposed Share Exchange

[1] Comment--Use of Form

This form is a resolution of the shareholders of the acquiring corporation approving a proposed share exchange. The proposed acquisition of one corporation by another corporation by means of a share exchange must be approved by the board of directors of the acquiring corporation and by the outstanding shares of each class of the acquiring corporation [*Corp. Code §§ 1200, 1201*; *see § 11D.21[1]*]. Resolutions of the acquiring corporation's board of directors approving a proposed acquisition by means of a share exchange are *set forth in §§ 11D.205* and *11D.206*.

This resolution must be adopted by the affirmative vote of a majority of all outstanding shares of each class of shares issued by the acquiring corporation unless its articles of incorporation require a greater than majority vote by any particular class of shares [*Corp. Code § 1201(a)*].

This resolution also approves amendment of the acquiring corporation's articles of incorporation to increase the number of voting shares the corporation is authorized to issue so as to allow it to consummate the proposed share exchange. For other forms, and discussion of the requirements for amending a corporation's articles of incorporation, see Ch. 10, *Amendment of Articles* .

[2] Form

Resolution of Shareholders of Acquiring Corporation Approving Proposed Share Exchange

RESOLUTION

WHEREAS, the Board of Directors of this Corporation on _____[*date*], adopted a resolution approving a proposed exchange of voting shares of this corporation for 80 percent or more of all outstanding shares of _____[*name of corporation to be acquired*] pursuant to the terms of a proposed written Agreement for Share Exchange submitted to the Board of Directors on that date and submitted to this special meeting of shareholders; and

WHEREAS, the Board of Directors of this corporation in the resolution adopted by it on _____[*date*], also approved amending the articles of incorporation of this corporation to increase the number of voting shares this corporation is authorized to issue from _____[*number*] to _____[*number*] so that this corporation would be able to consummate the share exchange described in the proposed written Agreement for Share Exchange submitted to this meeting; and

WHEREAS, the Commissioner of Corporations of the State of California has issued a permit qualifying the issuance and transfer by this corporation of the shares required by the share exchange approved by the Board of Directors of this corporation on _____[*date*];

NOW, THEREFORE, IT IS RESOLVED that the proposed exchange of voting shares of this corporation for 80 percent or more of all outstanding shares of _____[*name of corporation to be acquired*], a California corporation, approved by the Board of Directors of this corporation on _____[*date*], is approved by the outstanding shares of each class of this corporation as required by the General Corporation Law of the State of California; and

RESOLVED FURTHER, as required by the General Corporation Law of the State of California, the outstanding shares of this corporation approve the amendment of the articles of incorporation of this corporation to increase the number of voting common shares this corporation is authorized to issue from _____[*number*] to _____[*number*] and to make Article _____ of the articles of incorporation of this corporation read:

"Article 3. This corporation is authorized to issue _____ [*increased number*] shares of the same class."

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of ShareholdersMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of OfferorsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of IncorporationBusiness & Corporate LawCorporationsFinanceInitial Capitalization & Stock SubscriptionsGeneral Overview



122 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART IV. FORMS

5-11D California Legal Forms--Transaction Guide § 11D.208

§ 11D.208 Tender Offer--Published by Dealer-Manager for Acquiring Corporation

[1] Comment--Use of Form

This form is a notice of an offer to exchange securities of the offering corporation for shares of the corporation sought to be acquired, in compliance with provisions of the Securities Act of 1933 [*15 U.S.C. § 77b(a)(10)*]. For other items that may be included in such a notice, see Rule 134 of the General Rules and Regulations Under the Securities Act of 1933 [*17 C.F.R. § 230.134*]. The notice is published by the dealer-manager for the offering corporation [*see § 11D.203*].

[2] Form

Tender Offer--Published by Dealer-Manager for Acquiring Corporation

IMPORTANT NOTICE OF EXCHANGE OFFER TO HOLDER OF COMMON STOCK OF _____ [*name of corporation*]

A registration statement has been filed with the Securities and Exchange Commission and has become effective covering the issuance of

_____[*dollar amount or number of shares*]

_____[*name of offeror*]

_____[*description of securities, e.g.*, Five percent convertible subordinated debentures due July 1, 2010, convertible into common stock at $60 per share].

Offer to Exchange

_____[*Name of offeror*] is offering to exchange its _____[*description of security, e.g.*, 5 percent convertible subordinated debentures due July 1, 2010,] for all of the outstanding shares of common stock

of _____[*name of corporation to be acquired*] tendered, subject to the terms and conditions contained in the prospectus in the ratio of _____[*set forth ratio, e.g.*, $45 principal amount of debentures of _____ (*offeror*) for one share of common stock of _____ (*corporation to be acquired*)].

Expiration Time

This exchange offer expires at _____ M. Pacific Standard Time on _____[*date*], unless extended.

Acceptance

Holders of common stock of _____[*corporation to be acquired*] who wish to accept the exchange offer, after reviewing the prospectus in which it is set forth, should send certificates for the common stock they wish to exchange, together with a letter of transmittal duly completed and executed in time to reach the exchange agent no later than _____ M., Pacific Standard Time, on _____[*date*]. Copies of the prospectus and the letter of transmittal may be obtained from the exchange agent listed below, as well as from _____[*name of security dealer*] or other qualified Broker-Dealers soliciting acceptances under the terms of the exchange offer.

Exchange Agent

_____[*Name of depository*]
Corporate Securities Division

_____[*street address*]

_____[*city*], _____[*state*]

_____[*offeror*] has authorized _____[*name of security dealer*], as Dealer-Manager, to use its best efforts to cause dealers, including itself, to solicit acceptances of the exchange offer. Members of the National Association of Security Dealers, Inc. who have lawfully obtained the tender of shares actually exchanged will be paid a commission of _____ cents per share provided the name of the dealer appears on the letter of transmittal.

This announcement is neither an offer to sell nor a solicitation of an offer to buy or exchange these securities. The exchange offer is made only by the prospectus, copies of which may be obtained in any state only from such of the several dealers, including the undersigned, as may lawfully solicit exchanges under the exchange offer in such state.
Dated: _____.

_____ [*name of dealer-manager*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawTakeovers &

Tender OffersGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersDuties & Liabilities of Offerors



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART IV. FORMS

5-11D California Legal Forms--Transaction Guide § 11D.209

§ 11D.209 Notice of Approval of Proposed Share Exchange by Outstanding Shares and Right of Dissenting Shareholders to Require Purchase of Dissenting Shares

[1] Comment--Use of Form

This form is a notice that the acquiring corporation to a proposed share exchange must send to its shareholders. The acquiring corporation to a proposed share exchange must purchase for cash, at their fair market value on the day preceding announcement of the proposed share exchange, any of its shares that are "dissenting shares." To protect the rights of its shareholders to force it to purchase any dissenting shares owned by them, the corporation is required to give notice to each of its shareholders within 10 days after the proposed exchange has been approved by its outstanding shares of that approval. The notice must include, or be accompanied by, a brief description of the procedure a shareholder must follow to force the corporation to purchase his or her shares. It must also be accompanied by a copy of *Corp. Code §§ 1300-1304* and a statement of the price the corporation determined to be the fair market value of dissenting shares [*Corp. Code § 1301(a)*].

The nature of a dissenting shareholder's right to require purchase of his or her shares, the definition of dissenting shares, and the procedure to be followed in enforcing a dissenting shareholder's rights, are discussed in *Ch. 11C, Mergers, § 11C.400*.

[2] Form

Notice of Approval of Proposed Share Exchange by Outstanding Shares and Right of Dissenting Shareholders to Require Purchase of Dissenting Shares

NOTICE OF SHAREHOLDERS' APPROVAL OF REORGANIZATION

TO SHAREHOLDERS OF _____[*name of corporation*]:

NOTICE IS HEREBY GIVEN that, at a special meeting of shareholders of this corporation held on _____[*date*], at _____[*street address*], _____[*city*], California, the outstanding shares of each class of this corporation approved, as those terms are defined in the General Corporation

Law of California, the principal terms of a reorganization, as defined in the General Corporation Law of California, by which this corporation will acquire 80 percent or more of the shares of the outstanding shares of _____[*name of corporation to be acquired*] in exchange for its voting common shares by exchanging one of its voting common shares for every _____[*number*] outstanding shares of _____[*name of corporation to be acquired*].

NOTICE IS FURTHER GIVEN that any shareholder of this corporation may require the corporation to purchase for cash at their fair market value on the day before the first announcement of the reorganization described in this notice any shares owned by the shareholder which come within the definition of "dissenting shares" contained in *California Corporations Code Section 1301(b)*. To be dissenting shares within the definition contained in *California Corporations Code Section 1301(b)* the shares must have been held of record, that is, outstanding, on the date for determination of the shareholders who were entitled to vote on the reorganization described in this notice and not voted in favor of the reorganization.

NOTICE IS FURTHER GIVEN that for a shareholder to enforce his or her right to require this corporation to purchase any dissenting shares owned by him or her, the shareholder must do two things:

1. Within 30 days after the date of the mailing of this notice to the shareholder, the shareholder must serve a written demand for this corporation to purchase his or her dissenting shares and pay the shareholder in cash the fair market value of those shares on the corporation or on a transfer agent of the corporation. The demand must state the number and class of shares held by the shareholder which the shareholder demands the corporation purchase as dissenting shares and the price the shareholder claims to be the fair market value of those shares as of the day before announcement of the proposed reorganization described in this notice.

2. Within 30 days after the date of the mailing of this notice to the shareholder, in addition to making the demand described above, the shareholder must submit the certificate for the shares he or she claims to be dissenting shares to the corporation or its transfer agent so that there may be stamped or endorsed on the share certificate a statement that the shares represented by it are dissenting shares. The certificate should be submitted to the corporation at its principal office at _____[*street address*], _____[*city*], California or to its transfer agent, _____[*name*] at its office at _____[*street address*], _____[*city*], California.

Thereafter, if the corporation fails to agree to purchase the shareholder's dissenting shares at an agreed price or denies they are dissenting shares, the shareholder may file a complaint against the corporation to force it to purchase the shares in the Superior Court of the State of California for the County of _____, the County where the principal executive office of this corporation is located. The complaint must be filed by the shareholder with the court within six months after the date on which this notice was mailed to the shareholder. A copy of *California Corporations Code Sections 1300-1304* governing the procedure a shareholder must follow to require this corporation to purchase dissenting shares owned by the shareholder is enclosed with this notice.

NOTICE IS FURTHER GIVEN that this corporation has determined that the price of $_____ per share represents the fair market value of dissenting shares of this corporation as of the day before the first announcement of the terms of the reorganization described in this notice.

[*OR, if corporation has more than one class of shares outstanding:*]

NOTICE IS FURTHER GIVEN that this corporation has determined that the following prices represent the fair market value of dissenting shares of this corporation as of the day before the first announcement of the terms of the reorganization described in this notice: _____[*specify, e.g.:*]

$_____ per share for voting common shares;

$_____ per share for Class A Preferred shares, and

$_____ per share for Class B Preferred shares.
Dated: _____.

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentMergersMergers & Acquisitions LawMergersRights of Dissenting ShareholdersBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsFair Market ValueBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11D ACQUISITION OF SHARES FOR SHARES
PART IV. FORMS

5-11D California Legal Forms--Transaction Guide § 11D.210

§ 11D.210 Shareholder Demand for Purchase of Dissenting Shares

[1] Comment--Use of Form

This form is the written demand that must be served on the acquiring corporation to a proposed share exchange reorganization covered by the General Corporation Law by a shareholder desiring to have the corporation purchase his or her dissenting shares. The nature of a shareholder's right to require a corporation to purchase his or her dissenting shares and the procedure he or she must follow to enforce that right are discussed in *Ch. 11C, Mergers, § 11C.400*.

[2] Form

Shareholder Demand for Purchase of Dissenting Shares

DEMAND FOR PURCHASE OF SHARES

TO: _____[*name of corporation*],
A California corporation

I am the holder of record of _____[*number*] of _____[*specify class, e.g.*, common *or* preferred *or* Class A preferred, *etc.*] shares issued by you as evidenced by Share Certificate No. _____ issued by you.

Pursuant to *California Corporations Code Section 1301(b)*, I now make written demand on you that you purchase the shares and pay to me in cash their fair market value as of the day, _____[*date*], before the first announcement of the terms of the proposed acquisition by you of 80 percent or more of the shares of _____[*name of corporation to be acquired*] in exchange for your voting common shares.

Pursuant to *California Corporations Code Section 1301(c)*, I state that I claim $_____ per share to be the fair market value of the shares as of the day before the announcement of the proposed share exchange described above.

I submit to you the certificate representing the shares in respect to which this demand is made in order that it may be stamped or endorsed with a statement that the shares are dissenting shares and returned to me at the address set forth below.

_____ Dated:

_____ [*signature*]
[*typed name*]
_____ [*address*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentMergersBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsFair Market ValueBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentProceduresMergers & Acquisitions LawMergersRights of Dissenting Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES

5-11E California Legal Forms--Transaction Guide 11E.syn

§ 11E.syn Synopsis to Chapter 11E: ACQUISITION OF ASSETS FOR SHARES

§ 11E.01 California Sources

[1] Statutes

[2] Regulations

§ 11E.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 11E.03-11E.04 [Reserved]

§ 11E.05 Law Reviews and Periodicals

§ 11E.06 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 11E.07-11E.19 [Reserved]

§ 11E.20 Acquisition of Assets for Shares

[1] Assets-for-Shares Acquisition as "De Facto Merger"

[2] Background and Evolution

[a] Comparison With Statutory Merger

[b] Rights of Minority Shareholders

[c] Shareholder Approval Not Required

[d] Nonliability for Debts of Disappearing Corporation

[e] Present Status

§ 11E.21 California Statutory Requirements

[1] Director and Shareholder Approval

[a] Basic Requirement

[b] Board of Directors of Both Corporations

[c] Shareholders of Both Corporations

[d] Shareholders of Close Corporation

[e] Preferred Shares

[f] Triangular Transactions

[2] Conditions Excusing Shareholder Approval

[a] Purpose of Approval Requirement

[b] Acquiring Shareholders Unaffected

[c] Control Not Diluted

[3] Report by Independent Appraiser

§ 11E.22 Income Tax Factors and Requirements

[1] Status as Tax-Free Reorganization

[a] Nonrecognition of Gain or Loss

[b] Advance Rulings

[c] "C" Reorganizations

[2] Substantially All Assets Requirement

[a] Question of Fact

[b] IRS Guidelines

[c] Pre-Exchange Planning

[3] Voting Stock Requirement

[a] Basic Requirement

[b] Exception When 80 Percent of Property Acquired

[c] Assumption of Liabilities

[4] Business Purpose, Continuity of Business Enterprise, and Continuity of Interest Requirements

[5] Income Tax Basis for Acquired Assets and Shares

[6] Net Operating Loss Carryforward Deduction

§ 11E.23 Corporate Securities Law Requirements

[1] Qualification Requirement and Exemptions

[2] Permits

§ 11E.24 Nonassumption of Selling Corporation's Liabilities

[1] General Rule and Exceptions

[2] Bulk Sales Requirements

[3] Successor Liability Statutes

[4] Liability for Defective Products

[a] Historical Development

[b] Ray v. Alad Corp.

[c] Subsequent Decisions

§ 11E.25 Other Advantages and Disadvantages of Assets-for-Shares Exchanges

[1] Advantages

[2] Disadvantages

§§ 11E.26-11E.99 [Reserved]

§ 11E.100 Facts

Scope

§ 11E.101 Documents

Scope

§§ 11E.102-11E.109 [Reserved]

§ 11E.110 Determinations for Assets-for-Shares Exchange

Scope

§ 11E.111 Advantages of Assets-for-Shares Exchange

Scope

§ 11E.112 Disadvantages of Assets-for-Shares Exchange

Scope

§§ 11E.113-11E.119 [Reserved]

§ 11E.120 Procedures for Consummating Assets-for-Shares Exchange

Scope

§§ 11E.121-11E.199 [Reserved]

§ 11E.200 Agreement for Exchange of Voting Shares of Acquiring Corporation for Substantially All Assets of Selling Corporation--General Form

[1] Comment

[a] Use of Form

[b] Shareholder Approval and Qualification of Shares

[c] Assumption of Products Liability Claims

[2] Form

Agreement for Exchange of Voting Shares of Acquiring Corporation for Substantially All Assets of Selling Corporation--General Form

§ 11E.201 Agreement for Exchange of Voting Shares of Acquiring Corporation's Parent Corporation for Substantially All Assets of Selling Corporation

[1] Comment

[a] Use of Form

[b] Approval Requirements

[c] Qualification of Shares

[d] Assumption of Liabilities

[2] Form

Agreement for Exchange of Voting Shares of Acquiring Corporation's Parent Corporation for Substantially All Assets of Selling Corporation

§ 11E.202 Resolution of Board of Directors of Acquiring Corporation Approving Proposed Acquisition of Assets of Another Corporation in Exchange for Voting Common Shares of Acquiring Corporation

[1] Comment--Use of Form

[2] Form

Resolution of Board of Directors of Acquiring Corporation Approving Proposed Acquisition of Assets of Another Corporation in Exchange for Voting Common Shares of Acquiring Corporation

§ 11E.203 Resolution of Board of Directors of Selling Corporation Approving Exchange of Substantially All Its Assets for Voting Shares of Acquiring Corporation

[1] Comment--Use of Form

[2] Form

Resolution of Board of Directors of Selling Corporation Approving Exchange of Substantially All Its Assets for Voting Shares of Acquiring Corporation

§ 11E.204 Request to Commissioner of Internal Revenue for Income Tax Ruling on Proposed Assets-for-Shares Exchange

[1] Comment--Use of Form

[2] Form

Request to Commissioner of Internal Revenue for Income Tax Ruling on Proposed Assets-for-Shares Exchange

§ 11E.205 Resolution of Shareholders of Acquiring Corporation Approving Proposed Acquisition of Assets for Shares

[1] Comment--Use of Form

[2] Form

Resolution of Shareholders of Acquiring Corporation Approving Proposed Acquisition of Assets for Shares

§ 11E.206 Resolution of Shareholders of Selling Corporation Approving Proposed Exchange of Its Assets for Shares of Acquiring Corporation

[1] Comment

[a] Use of Form

[b] Written Consent

[c] Report by Independent Appraiser

[2] Form

Resolution of Shareholders of Selling Corporation Approving Proposed Exchange of Its Assets for Shares of Acquiring Corporation

§ 11E.207 Notice to Shareholders of Approval by Outstanding Shares and Right of Dissenting Shareholders to Require Purchase of Dissenting Shares

[1] Comment--Use of Form

[2] Form

Notice to Shareholders of Approval by Outstanding Shares and Right of Dissenting Shareholders to Require Purchase of Dissenting Shares

§ 11E.208 Demand on Corporation by Shareholder for Purchase of Dissenting Shares

[1] Comment--Use of Form

[2] Form

Demand on Corporation by Shareholder for Purchase of Dissenting Shares



126 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES

5-11E California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter examines the nature, purpose, and requirements for the acquisition by one corporation of all, or substantially all, the assets of another corporation in exchange for its shares. The Legal Background discusses the advantages and disadvantages of a corporate acquisition by means of an assets-for-shares exchange and the manner in which such an acquisition is treated by California's General Corporation Law. It also discusses the income tax requirements for making an assets-for-shares exchange a form of tax-free corporate "reorganization" under the Internal Revenue Code. The Legal Background also covers the requirements for qualifying the securities or shares that must be issued as part of an assets-for-shares acquisition under the California securities laws. The Transaction Guide sets forth the procedures required for an acquisition of assets for shares. This chapter also contains forms for accomplishing an acquisition of assets in exchange for shares, either of the acquiring corporation or its parent or subsidiary corporation.

For a discussion and comparison of the various methods of corporate acquisition, see Ch. 11, *Merger and Acquisition Issues* . These methods are covered individually in Ch. 11A, *Cash Purchase of Shares* ; Ch. 11B, *Cash Purchase of Assets* ; Ch. 11C, *Mergers* ; and Ch. 11D, *Acquisition of Shares for Shares* .

Further detailed discussion of the acquisition of assets for shares is contained in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* (Matthew Bender). Applicable forms are set forth in Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Appendix A, Forms 13.01-13.06.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART I. RESEARCH GUIDE
A. Primary Sources

5-11E California Legal Forms--Transaction Guide § 11E.01

§ 11E.01 California Sources

[1] Statutes

Bulk sales, requirements for notice. *Com. Code §§ 6101-6111*.

Vote of each class of shares means each class regardless of limitations on voting rights. *Corp. Code § 117*.

"Approval of outstanding shares" defined. *Corp. Code § 152*.

Assets-for-shares exchange as form of corporate "reorganization." *Corp. Code § 181(c)*.

Corporation need not issue fractional shares. *Corp. Code § 407*.

Written consent of outstanding shares same as vote of shares. *Corp. Code § 603*.

Approval of boards of directors of both acquiring and selling corporations in assets-for-shares exchange required. *Corp. Code § 1200(c)*.

Approval of board of directors of "parent party" to assets-for-shares exchange required. *Corp. Code § 1200(e)*.

Approval of outstanding shares of each class of both acquiring and selling corporation required for assets-for-shares exchange. *Corp. Code § 1201(a)*.

Conditions excusing approval by shareholders of corporation to assets-for-shares exchange. *Corp. Code § 1201(b)*.

Exceptions to conditions excusing approval by shareholders of corporation to assets-for-shares exchange.

Shareholders to receive shares having different rights or shares of foreign corporation as result of exchange. *Corp.*

Code § 1201(d).

Shareholders of close corporation to receive shares in corporation not a close corporation as result of exchange. *Corp. Code § 1201(e)*.

Shareholder approval to assets-for-shares exchange may be obtained before or after approval by directors. *Corp. Code § 1201(g)*.

Shareholder approval requirements when preferred shares receive less consideration than required by articles, or when parent party is foreign corporation. *Corp. Code § 1202(b), (c)*.

Requirements applicable to reorganization proposal made by person controlling or involved in management of target corporation. *Corp. Code § 1203*.

Rights of dissenting shareholders.

Right to require purchase at value on day before announcement of proposed exchange. *Corp. Code § 1300(a)*.

Dissenting shares defined. *Corp. Code § 1300(b)*.

Notice to shareholders of exchange approval. *Corp. Code § 1301(a)*.

Demand for purchase of shares, statutory requirement and time required. *Corp. Code § 1301(b)*.

Demand for purchase of shares, contents. *Corp. Code § 1301(c)*.

Submission of shares for endorsement. *Corp. Code § 1302*.

Agreement for share purchase by corporation, amount and time of payment. *Corp. Code § 1303*.

Suit for enforcement of dissenting shareholders' rights, court and time for bringing. *Corp. Code § 1304*.

Qualification of securities required by exchange.

No permit required for negotiations prior to shareholders' solicitation. *Corp. Code § 25103(a)*.

No permit required unless 25 percent of shareholders of selling corporation are California residents. *Corp. Code § 25103(c)*.

No permit required if exchange would have been exempt under *Corp. Code § 25102(f)* had it involved issuance of security subject to *Corp. Code § 25110*, and certain additional requirements are met. *Corp. Code § 25103(h)*.

Determination of residence of shareholders. *Corp. Code § 25103(d)*.

Necessity for qualification of shares. *Corp. Code § 25120*.

Qualification to be by permit. *Corp. Code § 25121*.

Effective date of qualification. *Corp. Code § 25122*.

Sales and use tax, successor liability statutes. *Rev. & Tax. Code §§ 6811, 6812*.

Unemployment compensation insurance contributions.

Successor liability statutes. *Unemp. Ins. Code §§ 1731-1736*.

Transfer of employer's reserve account. *Unemp. Ins. Code §§ 1051-1060*.

[2] Regulations

Application for qualification of shares required by assets-for-shares exchange. 10 Cal. Code Reg. § 260.121.1.

Negotiation permits for assets-for-shares exchanges not generally issued. *10 Cal. Code Reg. § 260.140.63*.

Sales tax on sale of a business. *18 Cal. Code Reg. § 1595(b)*.

Sales tax on transfer of business asset on reorganization of business, no tax when no substantial change in ownership. *18 Cal. Code Reg. § 1535(b)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART I. RESEARCH GUIDE
A. Primary Sources

5-11E California Legal Forms--Transaction Guide § 11E.02

§ 11E.02 Federal Sources

[1] Statutes

Net operating loss carryforward income tax deduction allowed. *I.R.C. § 172(a)*.

No taxable gain on exchange of shares of one corporation to reorganization for shares of another corporation to reorganization. *I.R.C. § 354(a)*.

Basis for shares received in exchange between corporations to reorganization. *I.R.C. § 358*.

No taxable gain on exchange of assets by corporation to reorganization for shares of another corporation to reorganization. *I.R.C. § 361*.

Basis for property received by corporation in exchange for its shares in tax-free exchange. *I.R.C. § 362*.

Assets-for-shares exchange as tax-free reorganization. *I.R.C. § 368(a)(1)(C)*.

Exchange of shares for 80 percent in value of assets and cash for rest as tax-free reorganization. *I.R.C. § 368(a)(2)(B)*.

Use of subsidiaries as part of assets-for-shares exchange. *I.R.C. § 368(a)(2)(C)*.

Party to tax-free reorganization defined. *I.R.C. § 368(b)*.

Net operating loss carryforward deduction, when available to surviving or successor corporation *I.R.C. § 381*.

Limitation on net operating loss carryforwards for acquiring corporation. *I.R.C. § 382*.

[2] Regulations

Purpose of making tax-free reorganizations. *Treas. Reg. § 1.368-1(b)*.

Meaning of tax-free reorganization definition of assets-for-shares exchange. *Treas. Reg. § 1.368-2(d)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART I. RESEARCH GUIDE
A. Primary Sources

5-11E California Legal Forms--Transaction Guide §§ 11E.03-11E.04

[Reserved]

§§ 11E.03[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11E California Legal Forms--Transaction Guide § 11E.05

§ 11E.05 Law Reviews and Periodicals

Broadwin, *How to Draft Letters of Intent for Business Acquisitions (With Forms), 37 Prac. Law. 13 (Mar. 1991).*

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Note, *Corporations: Sale of Assets or De Facto Mergers? 47 Cal. L. Rev. 180 (1959).*

Note, *Corporations: Sale of Assets: Dissenting Shareholders' Appraisal Right in Absence of Statute, 46 Cal. L. Rev. 283 (1958).*

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11E California Legal Forms--Transaction Guide § 11E.06

§ 11E.06 Text References

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CALIFORNIA LEGAL FORMS (Matthew Bender)

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Ch. 17, *Buying and Selling a Business or Professional Practice* .

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Cavitch, BUSINESS ORGANIZATIONS WITH TAX PLANNING (Matthew Bender)

Ch. 160, *Review of Methods of Buying and Selling Corporate Businesses.*

Ch. 161, *Review of Factors to Be Considered in Selecting Form of Acquisition* .

Ch. 162, *Mergers.*

Ch. 163, *Sales of Assets Transactions* .

Ch. 171, *The Acquisition Agreement* .

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Ch. 176, *Tax-Free Reorganizations: General Rules*.

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Ch. 1, *The Business Setting of Corporate Acquisitions and Mergers* .

Ch. 2, *The Legal Setting of Corporate Acquisitions and Mergers*.

Ch. 2A, *General Considerations in Corporate Acquisitions and Mergers* .

Ch. 3, *Tax Factors in Corporate Acquisitions and Mergers* .

Ch. 4, *Tax-Free Acquisitions* .

Ch. 5, *Taxable Transactions* .

Ch. 5A, *Summary of Acquisition Methods* .

Ch. 5C, *Acquisitions of Assets*.

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Ch. 4, *Carryovers in Reorganization or Purchase*.

Ch. 31, *Exchanges for Securities*.

Ch. 32, *Reorganization Patterns*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11E California Legal Forms--Transaction Guide §§ 11E.07-11E.19

[Reserved]

§§ 11E.07[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART II. LEGAL BACKGROUND

5-11E California Legal Forms--Transaction Guide § 11E.20

§ 11E.20 Acquisition of Assets for Shares

[1] Assets-for-Shares Acquisition as "De Facto Merger"

Of the five principal methods by which one corporation may acquire another corporation [*see* Ch. 11, *Merger and Acquisition Issues*], none is more controversial than the exchange of shares of the acquiring corporation for all assets of the corporation sought to be acquired. This acquisition method not only gave rise to the "de facto merger doctrine," but was also the principal cause of the "reorganization" provisions contained in the present California General Corporation Law [*see* Ch. 11, *Merger and Acquisition Issues* ; *see also* Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares, 19 Cal. L. Rev. 349 (1931)*].

The de facto merger doctrine treats an exchange of assets of one corporation for shares of another corporation followed by dissolution of the asset-selling corporation, with respect to the shareholders of the two corporations, as a statutory merger of the corporations [*see Farris v. Glen Alden Corp. (1958) 393 Pa. 427, 143 A.2d 25, 31* ; *see also* [2], *below*]. That doctrine has been codified in California [*see* Assembly Select Comm. Rep., at 27, 93]. Both mergers, other than short-form mergers, and assets-for-shares exchanges are defined in California's General Corporation Law as "reorganizations" [*Corp. Code § 181(a), (c)*]. A merger is labeled a "merger reorganization" [*Corp. Code § 181(a)*], and an exchange of assets for shares is labeled by the Law a "sale-of-assets reorganization" [*Corp. Code § 181(c)*]. The same type of shareholder and director approval is required by the General Corporation Law for either type of "reorganization" [*see* Ch. 11, *Merger and Acquisition Issues* ; *see also § 11E.21[1]*].

[2] Background and Evolution

[a] Comparison With Statutory Merger

In a statutory merger of two corporations, shareholders of the disappearing corporation exchange their shares for shares of the surviving corporation and on perfection of the merger all assets of the disappearing corporation become property of the surviving corporation [*Corp. Code §§ 1101, 1107(a)*]. Almost the same result can be achieved by having one corporation exchange all its assets for shares of another corporation and then dissolve [Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares, 19 Cal. L. Rev. 349 (1931)*]. The result is the same upon conclusion of either a statutory merger or an exchange of assets for shares followed by dissolution of the selling

corporation. The assets of the selling or disappearing corporation are owned by the acquiring or surviving corporation, former shareholders of the selling or disappearing corporation own shares in the acquiring or surviving corporation, and the selling or disappearing corporation no longer exists [*see* Ch. 11, *Merger and Acquisition Issues*].

Historically, however, there were three differences between a statutory merger and an exchange of assets for shares followed by dissolution of the asset-selling corporation [*see* [b]-[d], *below*]. The differences appeared to encourage corporate management and attorneys to combine corporations by means of an assets-for-shares exchange followed by dissolution of the asset-selling corporation rather than by means of a statutory merger of the corporations [*see* Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares, 19 Cal. L. Rev. 349 (1931)*]. These differences made an exchange of assets for shares followed by dissolution of the selling corporation less protective of shareholder and creditor rights than a statutory merger.

[b] Rights of Minority Shareholders

First, in a statutory merger, minority shareholders of a corporation who objected to the merger had the right, as "dissenting shareholders," to require the corporations to the merger to purchase their shares for cash at the appraised fair market value of the shares prior to the merger. In contrast, minority shareholders of a corporation that was a party to an assets-for-shares exchange who objected to the exchange had no such right to require the corporations to the exchange to "cash out" their shares [*see* Note, *Corporations: Sale of Assets: Dissenting Shareholders' Appraisal Right in Absence of Appraisal Statute, 46 Cal. L. Rev. 283 (1958)*]. The absence of this right in an exchange of assets for shares followed by dissolution of the selling corporation led to development of the "de facto merger" doctrine by the Pennsylvania Supreme Court [*Farris v. Glen Alden Corp. (1958) 393 Pa. 427, 143 A.2d 25, 31]* . That court held that a proposed exchange of assets for shares followed by dissolution of the selling corporation was in effect a merger protected by that state's merger statutes giving dissenting shareholders of a disappearing corporation in a merger the right to require purchase of their shares for cash at their appraised fair market value [*Farris v. Glen Alden Corp. (1958) 393 Pa. 427, 143 A.2d 25, 31]* .

[c] Shareholder Approval Not Required

Second, shareholders of the acquiring corporation in a proposed exchange of assets for shares usually were not required to approve the exchange. A proposed statutory merger had to be approved by the shareholders of each corporation to the merger, including shareholders of the surviving corporation to the merger [*see* Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares, 19 Cal. L. Rev. 349, 351 (1931)*]. The reason for requiring approval of a proposed merger by shareholders of the surviving corporation to a merger was to prevent dilution of their ownership interests and voting rights in the surviving corporation without their consent [*see* Assembly Select Comm. Rep., at 94; *see also* Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, Ch. 161, Review of Factors to Be Considered in Selecting Form of Acquisition Summary, § 161.10* (Matthew Bender)]. Until 1977, shareholders of a California corporation that proposed to issue additional shares in exchange for the assets of another corporation were not required to approve the exchange [*see* Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares, 19 Cal. L. Rev. 349, 351 (1931)*].

[d] Nonliability for Debts of Disappearing Corporation

Third, the surviving corporation to a statutory merger automatically assumes all debts and liabilities of the disappearing corporations to the merger [*Corp. Code § 1107(a)*]. The general rule is when one corporation sells or transfers all its assets to another corporation, even in return for shares of the purchasing corporation, the acquiring corporation is not liable for the debts and liabilities of the selling corporation unless the purchasing corporation is merely a continuation of the selling corporation or the transaction is entered into fraudulently [*Ortiz v. South Bend Lathe (1975) 46 Cal. App. 3d 842, 846, 120 Cal. Rptr. 556* ; *see McClellan v. Northridge Park Townhome Owners Association, Inc. (2001) 89 Cal. App. 4th 746, 753-756, 107 Cal. Rptr. 2d 702* (successor corporation properly added as judgment debtor in addition

to bankrupt predecessor, when substantial evidence supported conclusion that successor was mere continuation of predecessor)].

[e] Present Status

The first two of the above-mentioned three differences between a statutory merger and an exchange of assets for shares were resolved by California's present General Corporation Law, which became effective in 1977. The rights of shareholders of corporations that are parties to a proposed statutory merger and the rights of shareholders of corporations that are parties to a proposed exchange of assets for shares are now the same in California [*see § 11E.21[1]*]. The third difference changed with the development of a doctrine permitting products liability plaintiffs in some circumstances to sue the purchaser of the assets of the firm that sold the defective product [*see § 11E.24[4]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentSales of Assets & PropertyMergers & Acquisitions LawLiabilities & Rights of SuccessorsDe Facto MergersMergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsRights of Dissenting ShareholdersBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentSales of Assets & Property



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART II. LEGAL BACKGROUND

5-11E California Legal Forms--Transaction Guide § 11E.21

§ 11E.21 California Statutory Requirements

[1] Director and Shareholder Approval

[a] Basic Requirement

A proposed exchange of assets of one corporation for shares of another corporation, like a statutory merger, must be approved by the board of directors and outstanding shares of each class of both the purchasing or acquiring corporation and the corporation whose assets are being acquired [*Corp. Code §§ 1200(c), 1201(a)*]. Dissenting shareholders of each corporation, like dissenting shareholders of each corporation to a statutory merger, are also given the right to require their corporation to purchase their dissenting shares for cash at their appraised fair market value before first announcement of the proposed exchange [*Corp. Code § 1300(a)*; *see § 11E.208*].

[b] Board of Directors of Both Corporations

Because a proposed exchange of assets for shares must be approved by both the board of directors and outstanding shares of each corporation involved, it cannot be approved merely by a committee of the board [*Corp. Code §§ 151, 311*]. Ordinarily, the board of directors of a corporation may act through a duly appointed and authorized committee of board members appointed by it [*Corp. Code § 311*]. A committee of the board, however, cannot approve on behalf of the corporation's board of directors any matter, such as a proposed merger or proposed exchange of assets for shares, that also must be approved by the shareholders or outstanding shares of the corporation [*Corp. Code § 311(a)*].

[c] Shareholders of Both Corporations

California's General Corporation Law requires, for either a proposed merger or a proposed assets-for-shares exchange, that the principal terms of the proposed transaction be approved by the outstanding shares of each class of each corporation to the proposed transaction [*Corp. Code § 1201(a)*]. The term "approved by the outstanding shares" means the proposed merger or assets-for-shares exchange must be approved by the affirmative vote of a majority of the outstanding shares of each class, regardless of any limitations or restrictions on their voting rights, of each corporation to the merger or exchange [*Corp. Code §§ 117, 152, 1201(a)*]. The mere approval by the affirmative vote of a majority of the outstanding shares of each class present at a shareholders' meeting at which a quorum of shares is represented is

insufficient. The proposed reorganization must be approved by the affirmative vote of a majority of all the outstanding shares of each class of each corporation, regardless of voting rights [*but see Corp. Code §§ 152, 153*]. When the articles of incorporation of either corporation to the proposed exchange require the exchange to be approved by a greater than majority vote of any class of outstanding shares, the exchange must be approved by that greater than majority vote of all outstanding shares of that class [*Corp. Code § 152*].

[d] Shareholders of Close Corporation

When the selling corporation in an assets-for-shares exchange is a close corporation [*see Corp. Code § 158(a)*], the proposed exchange ordinarily will have to be approved by the affirmative vote of at least two thirds of each class of its outstanding shares when the purchasing corporation in the exchange is not a close corporation [*Corp. Code § 1201(e)*]. Any proposed "reorganization" must be approved by at least two thirds of each class of the outstanding shares of any close corporation when the reorganization will result in that corporation's shareholders receiving shares of a corporation that is not a close corporation [*Corp. Code § 1201(e)*]. Ordinarily, an assets-for-shares exchange will be followed by dissolution of the selling corporation and distribution by it to its shareholders of the purchasing corporation's shares it received in the assets-for-shares exchange. The articles of incorporation of a close corporation may provide for a less than two-thirds vote by each class of its outstanding shares, but not for less than a majority vote by each class of its outstanding shares [*Corp. Code § 1201(e)*].

[e] Preferred Shares

If the terms of the assets-for-shares reorganization provide that a class or series of preferred shares will receive as a distribution a lesser amount than would be required by applicable article provisions, the principal terms of the reorganization must be approved by the same percentage of outstanding shares of that class or series that would be required to approve an amendment of the article provisions to provide for the distribution of that lesser amount [*Corp. Code § 1202(b)*; *see* Ch. 10, *Amendment of Articles*].

[f] Triangular Transactions

In some situations an assets-for-shares exchange may involve a "triangular transaction" [*see* Assembly Select Comm. Rep., at 93]. In that type of transaction the assets of the selling corporation are transferred to the acquiring corporation, not in exchange for shares of the acquiring corporation, but in exchange for shares of the acquiring corporation's parent corporation. Such a transaction tends to dilute the ownership interests and voting rights in the parent corporation itself of its outstanding shareholders. California's General Corporation Law therefore requires approval of the proposed assets-for-shares exchange by the boards of directors and outstanding shares of each class of both the selling and acquiring corporation, and also by the board of directors and outstanding shares of each class of the acquiring corporation's parent, which it labels a "parent party" to the proposed exchange [*Corp. Code §§ 1200(e), 1201(a)*]. However, if the parent party [*Corp. Code § 1200(e)*] is a foreign corporation (other than one subject to the General Corporation Law [*see Corp. Code § 2115(a)*; *see also* Ch. 12B, *Foreign Corporations and Associations*]), any requirement or lack of requirement for approval by the outstanding shares of the foreign corporation is not governed by *Corp. Code §§ 1200* and *1201*. Instead, the law of the state or place of incorporation of the foreign corporation will apply [*Corp. Code § 1202(c)*].

When a corporation has two classes of common shares differing only as to voting rights, they will be considered as a single class of shares for purposes of voting on a proposed merger or exchange of assets for shares [*Corp. Code § 1201(a)*].

[2] Conditions Excusing Shareholder Approval

[a] Purpose of Approval Requirement

The purpose of requiring shareholder approval of either a merger or a de facto merger (that is, an assets-for-shares exchange) is to prevent corporate action significantly changing the rights and interests of shareholders without their consent [*see* Assembly Select Comm. Rep., at 93, 94]. When a proposed merger or assets-for-shares exchange will not result in any significant change in the rights or interests of shareholders of a particular class or corporation, their approval of the proposed merger or exchange is not required and is excused by the General Corporation Law [*see* Assembly Select Comm. Rep., at 93, 94].

A proposed assets-for-shares exchange or a proposed merger need not be approved by shareholders of a particular class or a particular corporation in two situations described in *Corp. Code § 1201(a), (b)*, and discussed in [b] and [c], *below*. However, notwithstanding those provisions, the principal terms of a reorganization must be approved by all shareholders of any class or series if, as a result of the reorganization, the holders of that class or series become personally liable for any obligations of a party to the reorganization, unless all holders of that class or series have dissenters' rights [*Corp. Code § 1201(g)*; *see Corp. Code § 1300 et seq.*].

[b] Acquiring Shareholders Unaffected

An exception to the shareholder approval requirement exists with respect to preferred shareholders when preferred shareholders of the acquiring corporation or its parent party will be unaffected by the proposed assets-for-shares exchange. No approval of any class of outstanding preferred shares of the acquiring corporation or its parent party is required when the rights, preferences, privileges, and restrictions granted to or imposed on that class of shares remain unchanged by the proposed assets-for-shares exchange [*Corp. Code § 1201(a)*; *but see Corp. Code § 1201(g)*, discussed in [a], *above*].

[c] Control Not Diluted

Shareholder approval also is excused when the corporate control exercised by the shares of a particular corporation will not be unduly diluted by the proposed exchange. Approval of a proposed exchange by the outstanding shares of a particular corporation is not required when that corporation or its existing shareholders, immediately after the exchange, will own equity securities of the acquiring corporation or its parent party possessing more than five-sixths of the voting power of the acquiring corporation or its parent party [*Corp. Code § 1201(b)*; *but see Corp. Code § 1201(g)*, discussed in [a], *above*]. For purposes of the dilution test, equity securities of the acquiring corporation or its parent party means either shares or debt securities convertible into shares [*Corp. Code §§ 168, 1201(b)*]. It does not mean mere warrants or rights to subscribe to or purchase shares of the acquiring corporation or its parent party [*Corp. Code § 1201(b)*].

For purposes of the dilution test, the total voting power of the acquiring corporation or its parent party, which means the power to elect directors of the acquiring corporation or its parent party [*Corp. Code § 194.5*] immediately after the exchange, is determined by assuming that all of its securities that are convertible, either immediately or at some future time, into voting shares have been so converted [*Corp. Code § 1201(b)*]. It is not to be assumed, however, that any warrant or right to subscribe to or purchase shares of the acquiring corporation or its parent party has been exercised [*Corp. Code § 1201(b)*]. In determining whether the shareholders of a selling corporation, immediately after an exchange of assets for shares, will own equity securities of the acquiring corporation or its parent party possessing more than five sixths of the voting power of the acquiring corporation or its parent party, any shares owned by them in the acquiring corporation or its parent party before the exchange are to be disregarded [*Corp. Code § 1201(b)*].

In two situations, shareholders of the selling corporation in an assets-for-shares exchange must approve the exchange even if the shareholders of the corporation, after the exchange, will possess more than five sixths of the voting power of the acquiring corporation or its parent party:

- First, the principal terms of the proposed exchange must be approved by the outstanding shares of any class of the selling corporation if holders of those shares are to receive, as a result of the exchange,

shares of the acquiring corporation having different rights, preferences, privileges, or restrictions from their present shares [*Corp. Code § 1201(d)*]. Shares in a foreign corporation to be received in exchange for shares in a domestic California corporation have different rights, preferences, privileges, and restrictions from the receiving shareholders' present shares for this purpose [*Corp. Code § 1201(d)*].

- Second, the principal terms of the proposed exchange must be approved by the outstanding shares of each class of the selling corporation, regardless of its shareholders' voting interest after the exchange in the acquiring corporation or its parent party, if the selling corporation is a close corporation and the acquiring corporation is not [*Corp. Code § 1201(e)*]. In such a case, the principal terms of the proposed exchange must be approved by the affirmative vote of at least two thirds of each class of outstanding shares of the selling corporation unless its articles of incorporation provide for a lesser vote, but not less than majority vote of each class [*Corp. Code § 1201(e)*].

[3] Report by Independent Appraiser

When a tender offer (including a share exchange tender offer) or a written proposal for approval of an assets-for-shares exchange, other "reorganization" [*see Corp. Code § 181(b), 1200*], or sale of assets [*see Corp. Code § 1001(a)*] is made to some or all of a corporation's shareholders by a party to the transaction who has control of or a financial interest in that corporation, an affirmative opinion in writing regarding the fairness of the consideration to the shareholders must be provided to the shareholders or the corporation. This requirement does not apply, however, if the target corporation does not have shares held of record by 100 or more persons [*see Corp. Code § 605* (determination of shareholders of record)], or if the transaction has been qualified pursuant to *Corp. Code § 25113* (qualification of issuer transaction by permit) or *Corp. Code § 25121* (qualification of recapitalization or reorganization by permit), and no stop order [*see Corp. Code §§ 25140, 25143(a)*] is in effect regarding that qualification [*Corp. Code § 1203(a)*]. For further discussion, see Ch. 11, *Merger and Acquisition Issues* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawSales of AssetsRights of Dissenting ShareholdersMergers & Acquisitions LawMergersGeneral OverviewBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentSales of Assets & PropertyBusiness & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentMergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART II. LEGAL BACKGROUND

5-11E California Legal Forms--Transaction Guide § 11E.22

§ 11E.22 Income Tax Factors and Requirements

[1] Status as Tax-Free Reorganization

[a] Nonrecognition of Gain or Loss

Gain or loss is not recognized for federal income tax purposes when a corporation that is a party to a reorganization exchanges property, pursuant to the plan of reorganization, solely for stock or securities in another corporation that is a party to the reorganization [*I.R.C. § 361(a)*]. The receipt of other property ("boot"), however, that is not distributed pursuant to the reorganization will result in the recognition of gain up to the fair market value of the property (or the amount of money received) [*I.R.C. § 361(b)*]. No gain or loss is recognized for income tax purposes when stock or securities of a corporation that is a party to a "reorganization" are exchanged, pursuant to the plan of "reorganization," solely for stock or securities in another corporation that is a party to the "reorganization" [*I.R.C. § 354(a)*].

Both of these nonrecognition provisions are applicable to a typical de facto merger, that is, an assets-for-shares exchange followed by dissolution of the asset selling corporation, if such a transaction is a "reorganization" for income tax purposes [*see I.R.C. § 368(a)(1)(C), (D)*]. The selling corporation will not recognize any gain or loss upon distribution to its shareholders (pursuant to the plan of reorganization) of shares that were received from the acquiring corporation pursuant to the plan of reorganization [*I.R.C. § 361(e)*]. The shareholders will have no recognizable gain or loss when it exchanges its property pursuant to the plan of "reorganization" for shares of the acquiring corporation, which would also be a party to the "reorganization" [*I.R.C. § 361(a)*; Rabkin & Johnson, FEDERAL INCOME, GIFT AND ESTATE TAXATION, ch. 32, *Reorganization Patterns* (Matthew Bender)]. Similarly, when the selling corporation dissolves and distributes to its shareholders the shares of the acquiring corporation it received in the assets-for-shares exchange, its shareholders should have no recognizable gain or loss for income tax purposes if the assets-for-shares exchange was a "reorganization" for income tax purposes. On its dissolution, the shareholders of the selling corporation are merely exchanging their shares in it, a party to a "reorganization," for shares of the acquiring corporation, a party to the "reorganization," pursuant to the plan of "reorganization" [*I.R.C. § 354(a)*].

[b] Advance Rulings

An assets-for-shares exchange may receive a favorable advance ruling from the Internal Revenue Service even if the

acquired corporation is not dissolved in the reorganization to meet the distribution requirement under *I.R.C. § 368(a)(2)(G)(i)*. The IRS will rule favorably if the exchange plan calls for continuing the corporation shell with minimum required capitalization for the purpose of selling the corporate charter to an unrelated party within 12 months after the exchange [*see Rev. Proc. 89-50, 1989-2 C.B. 631*].

[c] "C" Reorganizations

The Internal Revenue Code defines three types of corporate acquisitions as "reorganizations" for income tax purposes [*I.R.C. § 368(a)(1)*]. The third type is often referred to as a "C Reorganization" [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, ch. 4, *Tax-Free Acquisitions*, § 4.04 (Matthew Bender)]. A C reorganization is the acquisition by one corporation in exchange solely for all or a part of its voting shares of substantially all of the property of another corporation [*I.R.C. § 368(a)(1)(C)*]. The exchange is still considered a "reorganization" for income tax purposes when one corporation acquires in exchange solely for all or part of the voting shares of its parent corporation, instead of for its own voting shares, substantially all the assets of another corporation [*I.R.C. § 368(a)(1)(C)*]. The assumption by the acquiring corporation or its parent of a liability of the corporation whose assets are so acquired is disregarded for purposes of determining whether the solely for stock requirement is met [*I.R.C. § 368(a)(1)(C)*].

To qualify under the statutory definition of an assets-for-shares exchange as a "reorganization" for income tax purposes, two requirements must be met [*I.R.C. § 368(a)(1)(C)*]:

- The acquiring corporation must acquire "substantially all of the property" of the selling corporation [*see* [2], *below*].

- The acquiring corporation must acquire it in exchange solely for its voting shares or the voting shares of its parent corporation [*see* [3], *below*].

[2] Substantially All Assets Requirement

[a] Question of Fact

For an assets-for-shares exchange to be a tax-free "reorganization" for federal income tax purposes, the acquiring corporation must exchange its voting shares for "substantially all of the property" of the selling corporation [*I.R.C. § 368(a)(1)(C)*]. Whether the acquiring corporation in a given assets-for-shares exchange has acquired "substantially all" of the assets of the selling corporation is a question of fact. The answer will depend on the facts and circumstances in each case rather than on any particular percentage [*Rev. Rul. 57-518, 1957-2 C.B. 253*].

Most writers agree that it is the value of the acquired assets, rather than the number of items or their income tax basis to the selling corporation, that determines whether they constitute "substantially all" the assets of the selling corporation [*see* Fox & Fox, *CORPORATE ACQUISITIONS AND MERGERS, ch. 4, Tax-Free Acquisitions, § 4.04[2][a]*; Rabkin & Johnson, *FEDERAL INCOME, GIFT AND ESTATE TAXATION, § 32.04*(1) (Matthew Bender)]. In one frequently cited case, the transfer of 68 percent of the selling corporation's assets was held to be insufficient although all of its operating assets had been transferred to the acquiring corporation [*Pillar Rock Packing Co. v. Commissioner of Int. Rev. (9th Cir. 1937) 90 F.2d 949, 950]* . In another frequently cited case, the transfer of 86 percent of the selling corporation's assets were held sufficient, the court stressing that they constituted all its "operating" assets [*Commissioner of Int. Rev. v. First Nat'l Bank (3rd Cir. 1939) 104 F.2d 865, 870]* . The only generalization that can be safely made concerning the "substantially all" requirement is that all the facts and circumstances of the particular case must be carefully considered [*see* Rabkin & Johnson, *FEDERAL INCOME, GIFT AND ESTATE TAXATION, § 32.04*(1) (Matthew Bender); Cavitch, *BUSINESS ORGANIZATIONS WITH TAX PLANNING, ch. 180, Tax-Free Asset Deals: C and D Reorganizations, § 180.01[2]*] (Matthew Bender).

[b] IRS Guidelines

The Internal Revenue Service has issued guidelines for issuing ruling letters on particular proposed assets-for-shares exchanges. It will consider the "substantially all" assets requirement of the definition of such an exchange as a tax-free reorganization met when at least 90 percent of the fair market value of the net assets of the selling corporation and at least 70 percent of the fair market value of the gross assets of the selling corporation are to be transferred to the acquiring corporation in the exchange. All payments paid to dissenting shareholders and all distributions made by the selling corporation immediately prior to the exchange will be considered under the guidelines set forth by the IRS as property owned by the selling corporation immediately before the exchange [*Rev. Proc. 86-42*]. However, the IRS has also ruled that a regular quarterly dividend paid to its shareholders by the selling corporation immediately before an assets-for-shares exchange will not be taken into consideration in determining whether substantially all of the assets of the selling corporation were transferred to the acquiring corporation in the exchange [*Rev. Rul. 74-457, 1974-2 C.B. 122*].

[c] Pre-Exchange Planning

The substantially all test applies to the time of the exchange and may permit pre-exchange planning in certain circumstances. For example, a corporation with two separate lines of business sold off one of the lines of business for cash. Shortly thereafter the corporation had its assets from the second line of business and cash from the sale of the first line acquired by another corporation in an assets for voting shares exchange that the IRS ruled was a qualified *I.R.C. § 368(a)(1)(C)* reorganization [*Rev. Rul. 88-48, 1988-1 C.B. 117*].

[3] Voting Stock Requirement

[a] Basic Requirement

The second major requirement of an assets-for-shares exchange to qualify as a "reorganization" is to acquire the assets in exchange solely for its voting stock or the voting stock of its parent corporation [*I.R.C. § 368(a)(1)(C)*]. This is the same requirement imposed by statute on the acquisition by one corporation of another corporation by means of a share exchange to make the share exchange a tax-free reorganization [*see Ch. 11D, Acquisition of Shares for Shares, § 11D.23[2]*].

Even when the acquiring corporation acquires the assets of the acquired corporation in exchange for its voting stock, the transaction will fail to qualify as a "C reorganization" unless the acquired corporation distributes the stock, securities, and other properties it receives, as well as its other properties, pursuant to the reorganization plan [*I.R.C. § 368(a)(2)(G)(i)*]. However, this requirement may be waived by Treasury regulation [*I.R.C. § 368(a)(2)(G)(ii)*].

[b] Exception When 80 Percent of Property Acquired

In a share exchange, the exchange will not qualify as a tax-free reorganization when the acquiring corporation gives voting shares plus some other consideration for the shares of the acquired corporation [*I.R.C. § 368(a)(1)(B); see Ch. 11D, Acquisition of Shares for Shares, § 11D.23[2]*]. In the case of an assets-for-shares exchange there is one exception to this rule. An assets-for-shares exchange will still qualify as a tax-free reorganization when the acquiring corporation acquires at least 80 percent of the fair market value of all the property of the selling corporation solely in exchange for its or its parent's voting shares and then gives money or other property for the remainder of the selling corporation's property [*I.R.C. § 368(a)(2)(B)*].

[c] Assumption of Liabilities

The acquiring corporation in an assets-for-shares exchange may assume liabilities of the selling corporation without disqualifying the exchange as a "reorganization" [*I.R.C. § 368(a)(1)(C)*]. The term "liability" used in the statute appears to mean an obligation to pay money rather than an obligation to perform some act [Fox & Fox, *CORPORATE*

ACQUISITIONS AND MERGERS, ch. 4, Tax-Free Acquisitions, § 4.04[3][c] (Matthew Bender)]. Further, it appears the obligation must have arisen prior to the proposed assets-for-shares exchange [*Helvering v. Southwest Consol. Corp. (1942) 315 U.S. 194, 199, 62 S. Ct. 546, 86 L. Ed. 789]* . An obligation that is incurred as part of the exchange by the selling corporation, although it is merely a liquidation of a prior existing liability of the selling corporation, cannot be safely assumed by the acquiring corporation. In such a case, the acquiring corporation would be exchanging something in addition to its voting shares for substantially all the assets of the selling corporation and the exchange would not be a tax-free reorganization [*Helvering v. Southwest Consol. Corp. (1942) 315 U.S. 194, 199, 62 S. Ct. 546, 86 L. Ed. 789]* .

The IRS has ruled that payment by the acquiring corporation of valid reorganization expenses incurred by the selling corporation in an assets-for-shares exchange does not preclude the assets-for-shares exchange from being a tax-free reorganization [*Rev. Rul. § 73-54*]. Treasury Regulations warn, however, that the assumption of liabilities by the acquiring corporation may in some cases so alter the character of an assets-for-shares exchange as to make it another form of transaction and disqualify it as a tax-free reorganization [*Treas. Reg. § 1.368-2(d)(1)*].

[4] Business Purpose, Continuity of Business Enterprise, and Continuity of Interest Requirements

An assets-for-shares reorganization must meet the general business purpose and continuity of business enterprise and interest requirements applicable to all reorganizations [*see Treas. Reg. § 1.368-1(c)*-(e)]. To obtain the nonrecognition treatment of a qualified reorganization, the transaction must have a bona fide business purpose and may not be a device simply to avoid taxes [*Treas. Reg. § 1.368-1(c)*].

The continuity of business enterprise requirement means that the acquiring corporation must either continue the acquired corporation's historic business or use a significant portion of the acquired corporation's business assets in a business after the reorganization [*Treas. Reg. § 1.368-1(d)(1)*]. The continuity of interest requirement means that some proprietary interest of the acquired corporation must be preserved so that transactions that resemble sales do not qualify for nonrecognition treatment available to qualified reorganizations [*Treas. Reg. § 1.368-1(e)*]. For further discussion, see Ch. 11, *Merger and Acquisition Issues*].

[5] Income Tax Basis for Acquired Assets and Shares

In tax-free reorganizations generally, recognition of gain is postponed pursuant to "carryover" and "substituted" basis provisions [*see* Fox & Fox, CORPORATE ACQUISITIONS AND MERGERS, Ch. 4, *Tax-Free Acquisitions*, § 4.01 (Matthew Bender)]. In a "C" reorganization, the selling corporation receives a "substituted" basis in shares received in the surviving corporation or its parent equal to its basis in the assets transferred [*see I.R.C. § 358(a)*]. When those shares are distributed in dissolution, the shareholders who receive them obtain a substituted basis equal to their basis in the shares of the dissolving corporation [*I.R.C. § 358(a)*]. The acquiring corporation receives a "carry-over" basis for the assets acquired equal to the selling corporation's basis in those assets [*I.R.C. § 362(b)*]. If the fair market value of the assets or shares received exceeds their substituted or carry-over basis, gain on the transaction is postponed until those assets or shares are disposed of or sold [*I.R.C. § 354*; *see* [1], *above*]. For further discussion, see Ch. 11, *Merger and Acquisition Issues* .

[6] Net Operating Loss Carryforward Deduction

In a "C" reorganization, the acquiring corporation automatically succeeds to any net operating loss carryforward of the acquired corporation, and may deduct it against income earned after the acquisition [*I.R.C. § 381(a)(2), (c)(1)*].

The carryforward will be disallowed if the acquiring corporation does not continue the business enterprise of the acquired corporation at all times during the two-year period beginning on the reorganization date [*see I.R.C. § 382(c)*]. Furthermore, the carryforward may be disallowed if the principal purpose of the acquisition is the avoidance of federal

income tax by obtaining a deduction that the acquiring corporation would otherwise not obtain [*see I.R.C. § 269(a)*]. For further discussion of the net operating loss carryforward and the restrictions on its use, see Ch. 11, *Merger and Acquisition Issues* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsMergers & Acquisitions LawTax-Free AcquisitionsTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Tax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)Changes in Corporate OwnershipTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)General OverviewTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)Carryforwards



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART II. LEGAL BACKGROUND

5-11E California Legal Forms--Transaction Guide § 11E.23

§ 11E.23 Corporate Securities Law Requirements

[1] Qualification Requirement and Exemptions

Under California's Corporate Securities Law of 1968, shares issued in connection with an assets-for-shares exchange are treated the same as shares issued in connection with a statutory merger of corporation. Generally, the issuance of the shares by the acquiring corporation must be "qualified" by permit issued by the California Corporations Commissioner [*Corp. Code §§ 25120, 25121*]. Application for qualification of the securities must be made under the provisions requiring qualification of securities to be issued in connection with a recapitalization or reorganization [*Corp. Code § 25120*]. However, a qualification permit is not required in all assets-for-shares exchanges. Any change in the rights, preferences, privileges, or restrictions of or on outstanding securities, and any exchange of securities by the issuer with its existing security holders exclusively, will be exempt from qualification if the transaction, had it involved the issuance of a new security containing the changed rights, preferences, privileges, or restrictions, or a new issuance of the exchange security, would have been exempt from qualification [*see Corp. Code § 25110*] as an issuer transaction [*10 Cal. Code Reg. § 260.103(a)*; *see Corp. Code § 25102*].

This exemption, however, is not available for a rollup transaction [*Corp. Code § 25103(c)*; *see Corp. Code § 25014.6* ("rollup transaction" defined)], or if the transaction is excluded from the definition of a rollup transaction by *Corp. Code § 25014.6(b)(5)* or *(6)* if the transaction is one of a series of transactions that directly or indirectly, through acquisition or otherwise, involves the combination or reorganization of one or more rollup participants [*Corp. Code § 25103(c)*]. In addition, no permit qualifying the shares to be issued in connection with a merger or an assets-for-shares exchange is required if, had the exchange transaction involved issuance of a security in a transaction subject to *Corp. Code § 25110*, it would have been exempt from qualification by *Corp. Code § 25102(f)* (limited offering exemption), without giving effect to *Corp. Code § 25102(f)(3)* (which requires representation that purchaser is purchasing for own account, not for resale) and the exchange satisfies certain additional criteria [*Corp. Code § 25103(h)*; *see Ch. 11C, Mergers, § 11C.104*].

For a more detailed discussion of the qualification and exemption of securities, including the preemption of state qualification or registration of "covered securities," as defined by the National Securities Markets Improvement Act of 1996 [Pub. L. No. 104-290, 110 Stat. 3416 (H.R. 3005); *see 15 U.S.C. § 77r*; *see also* Ch. 6, *Securities Regulation*

Issues , and subsequent chapters; Marsh & Volk, PRACTICE UNDER THE CALIFORNIA SECURITIES LAWS, Ch. 3A, *Federal Preemption of State Securities Regulation* (Matthew Bender)].

[2] Permits

A permit qualifying the shares to be issued in an assets-for-shares exchange is not required in order for the corporations to the exchange to conduct preliminary negotiations concerning it. However, either a negotiating permit or a definitive permit qualifying the shares for issuance must be obtained before shareholder approval of the proposed exchange is solicited [*Corp. Code §§ 25103(a), 25120*]. Negotiating permits for such a transaction ordinarily are not issued by the Corporations Commissioner. Instead, the Commissioner usually will issue a definitive permit qualifying the shares for issuance and exchange [*10 Cal. Code Reg. § 260.140.63*]. However, that permit may be conditional. The corporation may be required to obtain the affirmative vote of a specified percentage of the outstanding shares of the corporations involved in the exchange [*10 Cal. Code Reg. § 260.140.63*]. No permit qualifying the shares to be issued in connection with either a merger or an assets-for-shares exchange is required unless at least 25 percent of the outstanding shares of any class whose holders are to receive securities in the exchange are held by persons having addresses in California [*Corp. Code § 25103(c)*].

An application to the California Commissioner of Corporations for a permit qualifying securities to be issued in a merger or an exchange of shares for assets is set forth in *Ch. 11C, Mergers, § 11C.204*. That section discusses the requirements of the application and qualification of shares to be issued in a merger or assets-for-shares exchange, and should be consulted in connection with an assets-for-shares exchange involving a California corporation or residents of California as shareholders of the acquiring or selling corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART II. LEGAL BACKGROUND

5-11E California Legal Forms--Transaction Guide § 11E.24

§ 11E.24 Nonassumption of Selling Corporation's Liabilities

[1] General Rule and Exceptions

In California, the general rule is that if one corporation sells or otherwise transfers all of its assets to another corporation, the purchasing corporation is not liable for the debts and liabilities of the selling corporation [*Ortiz v. South Bend Lathe (1975) 46 Cal. App. 3d 842, 846, 120 Cal. Rptr. 556* ; *see Schwartz v. McGraw-Edison Co. (1971) 14 Cal. App. 3d 767, 780, 92 Cal. Rptr. 776* ; *Pierce v. Riverside Mtg. Securities Co. (1938) 25 Cal. App. 2d 248, 254, 77 P.2d 226]* .

The following are four well-recognized exceptions to this rule [*Ortiz v. South Bend Lathe (1975) 46 Cal. App. 3d 842, 846, 120 Cal. Rptr. 556* ; *Schwartz v. McGraw-Edison Co. (1971) 14 Cal. App. 3d 767, 781, 92 Cal. Rptr. 776* ; *Pierce v. Riverside Mtg. Securities Co. (1938) 25 Cal. App. 2d 248, 255, 77 P.2d 226* ; *but see Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 33-34, 136 Cal. Rptr. 574, 560 P.2d 3* (concluding that party which acquires a manufacturing business and continues the output of its line of products under circumstances presented assumes strict tort liability for defects in units of the same product line previously manufactured and distributed by the entity from which the business was acquired; and overruling anything to the contrary in *Ortiz* or *Schwartz*); *see also Franklin v. USX Corporation (2001) 87 Cal. App. 4th 615, 629-630, 105 Cal. Rptr. 2d 11* (successor corporation not liable for asbestos-related injuries under theories of express or implied assumption of tort liabilities of predecessor, de facto merger or mere continuation, or product line successor)]:

- When the purchasing corporation expressly or impliedly agrees to assume the liabilities of the selling corporation [*see, e.g., Fisher v. Allis-Chalmers Corp. (2002) 95 Cal. App. 4th 1182, 1188-1190, 116 Cal. Rptr. 2d 310* (manufacturer's successor in interest was not entitled to summary judgment because it failed to establish that its agreement to assume liabilities excluded plaintiff's product liability claim].

- When the transaction amounts to a merger or consolidation of the corporations.

- When the purchasing corporation is merely a continuation of the selling corporation [*see McClellan v. Northridge Park Townhome Owners Association, Inc. (2001) 89 Cal. App. 4th 746, 753-756, 107 Cal.*

Rptr. 2d 702 (successor corporation properly added as judgment debtor in addition to bankrupt predecessor, when substantial evidence supported conclusion that successor was "mere continuation" of predecessor); *but see Katzir's Floor and Home Design, Inc. v. M-MLS.com (9th Cir. 2004) 394 F.3d 1143, 1149-1151* (inadequate consideration is essential ingredient to "mere continuation" finding; amended judgment adding new corporation as additional judgment debtor on successor liability grounds reversed)].

- When the transaction is entered into fraudulently in order to escape liability for the debts of the selling corporation.

Although a corporate successor that is liable for the torts of its predecessor by operation of law may seek coverage for that liability under its predecessor's insurance policies, when a corporation assumes liability by contract its rights are defined and limited by that contract [*Henkel Corp. v. Hartford (2003) 29 Cal. 4th 934, 941-943, 945, 129 Cal. Rptr. 2d 828, 62 P.3d 69* (in case in which successor was sued for injuries arising from predecessor's chemical products, any assignment of predecessor's insurance benefits required consent of insurers; no coverage existed when policy had no-assignment clause and insurers did not consent to assignment)].

[2] Bulk Sales Requirements

For the acquiring corporation in an assets-for-shares exchange to escape liability for obligations of the selling corporation in the exchange, it may have to comply with the Uniform Commercial Code--Bulk Sales Division (Division 6 of the UCC) [*see Com. Code § 6101 et seq.*]. If the sale of assets is subject to the bulk sales requirements and the buyer fails to comply with the notice requirements, the buyer is liable for damages in the amount of any claims against the seller, less any amount that the claimant would not have realized if the buyer had complied with the notice requirements [*see Com. Code § 6107(a)*; *see also Com. Code § 6107(c)* (good faith effort at compliance), (d) (limitation of liability)]. Basically, the bulk sale provisions apply to any firm whose principal business is the sale of inventory from stock, including firms who manufacture what they sell, or is that of restaurant owner [*Com. Code § 6103(a)*; *see Com. Code § 6103(c)* (exceptions)]. Unless specifically exempted, a bulk sale is subject to the public notice requirement [*see Com. Code §§ 6104(b), 6105*] if the sale is not in the ordinary course of the firm's business and constitutes more than half of the firm's inventory and equipment [*Com. Code § 6102(a)(3)*]. The Bulk Sales Division is designed to give creditors of a business firm notice of the bulk sale of its business and give the creditors opportunity to levy attachment either on the assets being sold or the proceeds of their sale. For further coverage of the required notices, and the bulk sales requirements in general, see *Ch. 2A, Incorporating a Going Business, § 2A.11*, and Ch. 17, *Buying and Selling a Business or Professional Practice* .

[3] Successor Liability Statutes

The acquiring corporation in an assets-for-shares exchange should require the selling corporation to comply with the successor liability statutes contained in the California Sales and Use Tax Law [*see Rev. & Tax. Code §§ 6811, 6812*] and the California Unemployment Insurance Code [*Unemp. Ins. Code §§ 1731-1736*]. Those statutes make the acquiring corporation liable for any sales taxes or unemployment compensation insurance contributions owed by the selling corporation unless the acquiring corporation withholds the purchase price being paid for the assets of the selling corporation until certificates showing no such taxes or contributions are due from the selling corporation are issued by the California State Board of Equalization and Department of Benefit Payments, respectively [*Rev. & Tax. Code §§ 6811, 6812*; *Unemp. Ins. Code §§ 1731, 1732*]. For a more detailed discussion of the successor liability statutes, see *Ch. 17, Buying and Selling a Business or Professional Practice, § 17.14.*

[4] Liability for Defective Products

[a] Historical Development

The original reason for the development of the so-called "de facto merger" doctrine was to protect shareholders of corporations involved in an assets-for-shares exchange. Little attention was paid to the fact that the successor corporation in a statutory merger automatically assumes liabilities of the disappearing corporations to the merger, but the acquiring corporation in an assets-for-shares exchange generally is not liable for obligations of the selling corporation [*see* Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares, 19 Cal. L. Rev. 349 (1931)*]. It may have been thought that the bulk sales law provided adequate protection for the normal creditors of a selling business--its wholesale suppliers [*see § 11E.24*]. Furthermore, most businesses normally carried adequate liability insurance to protect them against any tort claims that might be made against them.

In 1963, the California Supreme Court held that a business was strictly liable for any injuries caused by a defective product it placed on the market [*Greenman v. Yuba Power Products, Inc. (1963) 59 Cal. 2d 57, 62, 27 Cal. Rptr. 697, 377 P.2d 897]* . Under the strict products liability doctrine, the cause of action for an injury caused by a defective product does not accrue until the injury is suffered [*Howe v. Pioneer Mfg. Co. (1968) 262 Cal. App. 2d 330, 340, 68 Cal. Rptr. 617]* . The injury, however, might occur years after the defective product was placed on the market by a business, and perhaps years after the business that placed it on the market had sold all its assets or exchanged them for shares of another corporation [*see Ortiz v. South Bend Lathe (1975) 46 Cal. App. 3d 842, 844-846, 120 Cal. Rptr. 556]* . This concept gave rise to a new controversy over whether the acquiring corporation in an assets-for-shares exchange should be held liable for injuries caused by a defective product placed on the market by the selling corporation in that exchange.

[b] *Ray v. Alad Corp.*

In California, a purchasing corporation was held liable for injuries caused by a defective product manufactured by the corporation whose assets it had purchased. In the first case to come before it raising the issue, the California Supreme Court based its decision on three grounds. Imposition of liability for the defective product on the successor corporation was justified, according to the Court, in the circumstances by the following [*Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 31, 136 Cal. Rptr. 574, 560 P.2d 3]* :

- The virtual destruction of the injured plaintiff's remedies against the original manufacturer caused by the sale of the manufacturing corporation's assets and business to the successor corporation.

- The successor corporation's ability to assume the original manufacturing corporation's risk-spreading role.

- The fairness of requiring the successor corporation in enjoying the goodwill it had purchased from the manufacturing corporation to assume a burden, the responsibility for defective products, necessarily attached to that goodwill in the hands of the manufacturing corporation.

In the particular case before the California Supreme Court, the successor corporation had purchased all the assets and goodwill of the manufacturing corporation for cash under an agreement that provided the manufacturing corporation would be dissolved as soon as practical so its name could be used by the successor corporation [*Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 26, 136 Cal. Rptr. 574, 560 P.2d 3]* . Plaintiff's injury, caused by the defective product, did not occur until more than six months after the manufacturing corporation had been dissolved and the successor corporation had changed its name to the name formerly belonging to the dissolved manufacturing corporation [*Ray. v. Alad Corp. (1977) 19 Cal. 3d 22, 26, 136 Cal. Rptr. 574, 560 P.2d 3]* . This, in practical effect, not only destroyed the plaintiff's remedies against the original manufacturing corporation but gave the successor corporation the same resources and ability as the manufacturing corporation for determining the risks of claims for injuries from defects in previously manufactured products and obtaining insurance or self-insurance coverage to spread those risks [*Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 31-33, 136 Cal. Rptr. 574, 560 P.2d 3]* . It also gave the successor corporation full benefit of the manufacturing corporation's goodwill [*Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 34, 136 Cal. Rptr. 574, 560 P.2d 3]* .

[c] Subsequent Decisions

In a subsequent California case, the Court of Appeal for the Fifth Appellate District held a successor corporation liable for injury caused by a defective product manufactured by the corporation whose assets it had purchased. The appellate court based its decision on a provision in the sales agreement, executed in 1956 before the development of the strict liability doctrine, pursuant to which the successor corporation agreed to assume all liabilities, obligations, contracts, orders for the purchase of material, and warranties of the selling corporation. The court noted that the agreement was to assume "all liabilities" of the selling corporation. "We conclude that although principles of contract law should apply and the intention of the parties should be determinative, it should not be necessary to look for unusually clear, express language in order to find a provision transferring tort liability in the sale of a business or line of business. The question is one of contract interpretation, and we should use a pragmatic approach" [*SCM Corp. v. Berkel, Inc. (1977) 73 Cal. App. 3d 49, 58, 140 Cal. Rptr. 559]* .

The "pragmatic approach" used by the Court of Appeal was based on its view as to how two objectives of tort damage law could best be served. It felt the law's objective of deterring the manufacture of future defective products could best be served by imposing liability for injuries caused by previously manufactured defective products on the successor corporation, which was still manufacturing similar products, rather than imposing it on the selling corporation which no longer manufactured those products. It also felt the law's objective of spreading the loss caused by defective products among the users of the products was best served by imposing liability on the successor corporation, which could pass the loss through to future buyers of the product, rather than imposing liability on the selling corporation that no longer sold those products [*SCM Corp. v. Berkel, Inc. (1977) 73 Cal. App. 3d 49, 57, 140 Cal. Rptr. 559]* .

The rule imposing liability on a successor corporation for its predecessors' defective products [*see Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 31, 136 Cal. Rptr. 574, 560 P.2d 3]* does not apply if the successor corporation purchases only part of the predecessor's business, and the asset sale did not contribute to the destruction of the plaintiff's remedies against the predecessor [*see Kline v. Johns-Manville (9th Cir. 1984) 745 F.2d 1217, 1218]* . In a 1999 case, after determining that a corporation that purchased the assets of an asbestos distributor had not expressly or impliedly assumed other than specifically identified obligations of the predecessor, the Court of Appeal reviewed the principles set forth in *Ray v. Alad Corp.*, held that the *Alad* court's rationale for imposing strict liability was not met, and declined to impose liability on the successor based on the three *Alad* principles [*Chaknova v. Wilbur-Ellis Co. (1999) 69 Cal. App. 4th 962, 967-969, 970-973, 81 Cal. Rptr. 2d 871* ; *see Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 31, 136 Cal. Rptr. 574, 560 P.2d 3* , discussed in [b], *above*; *see also Franklin v. USX Corporation (2001) 87 Cal. App. 4th 615, 629-630, 105 Cal. Rptr. 2d 11* (successor corporation not liable for asbestos-related injuries under theories of express or implied assumption of tort liabilities of predecessor, de facto merger or mere continuation, or product line successor)].

For further discussion of corporate successor liability for defective products, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS, Ch. 3, *Formation of Corporations* , § 54.08[4] (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Bulk Sales (Article 6)NoncomplianceMergers & Acquisitions LawLiabilities & Rights of SuccessorsDe Facto MergersMergers & Acquisitions LawLiabilities & Rights of SuccessorsMere ContinuationMergers & Acquisitions LawLiabilities & Rights of SuccessorsSuccessor Liability DoctrineMergers & Acquisitions LawLiabilities & Rights of SuccessorsDuty to Warn



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART II. LEGAL BACKGROUND

5-11E California Legal Forms--Transaction Guide § 11E.25

§ 11E.25 Other Advantages and Disadvantages of Assets-for-Shares Exchanges

[1] Advantages

The chief advantage of an assets-for-shares exchange over other methods by which one corporation may acquire another corporation is nonassumption by the acquiring corporation of the selling corporation's liabilities [*see § 11E.24*]. Most of the other advantages once enjoyed by assets-for-shares exchanges over other corporate acquisition methods have been eliminated by codification of the de facto merger doctrine in California's General Corporation Law. An assets-for-shares exchange in California is no longer preferable to a statutory merger because it does not require approval by the shareholders of the acquiring corporation or because dissenting shareholders have no appraisal rights. Under California's General Corporation Law, mergers and de facto mergers (assets-for-shares exchanges), are treated almost exactly alike. Both require approval by the outstanding shares of each class of each corporation involved in the transaction and both afford dissenting shareholders of any corporation to the transaction the right to require cash purchase of their shares at the appraised fair market value of those shares [*see § 11E.21[1]*]. Furthermore, statutory mergers and assets-for-shares exchanges are treated alike by the California Corporate Securities Law of 1968. Shares that are to be issued in a statutory merger or in an assets-for-shares exchange must be qualified by the California Corporations Commissioner in exactly the same way [*see § 11E.23*].

[2] Disadvantages

An assets-for-shares exchange differs from a statutory merger in that it is more cumbersome. A statutory merger is effected by filing of the merger agreement with attached officers' certificates for each constituent corporation with the Secretary of State and recording a certified copy in each county in which a disappearing corporation owned any interest in real property [*see Ch. 11C, Mergers, § 11C.22[9]*]. An assets-for-shares exchange may require compliance with the requirements of Uniform Commercial Code--Bulk Sales Division [*see Com. Code § 6101 et seq.*]. The notice required by that division may require publication in the judicial district where the largest portion of the property is located and, if different, the judicial district in which the seller is located [*Com. Code § 6105(b)*]. When an assets-for-shares exchange is part of a true de facto merger, the exchange is followed by dissolution of the selling corporation. In a statutory merger, the selling or disappearing corporations to the merger are automatically dissolved by perfection of the merger [*Corp. Code § 1107(a)*]. Furthermore, a number of instruments of conveyance must be prepared, executed, and delivered in an assets-for-shares exchange. A general bill of sale is usually required to transfer the intangible and

miscellaneous unregistered assets of the selling corporation to the purchasing corporation. In addition, however, each lease ordinarily must be separately assigned by the selling corporation to the purchasing corporation. Each lease also ordinarily must be separately assigned by the selling corporation to the purchasing corporation. Each piece of real property must be separately conveyed by the selling corporation to the purchasing corporation, and each motor vehicle must be separately transferred on the records of the Department of Motor Vehicles from the selling to the purchasing corporation.

Another disadvantage of an assets-for-shares transaction is that it will be subject to the state sales and use tax [*see Rev. & Tax. Code § 6001 et seq.*]. The transfer of assets for stock is treated as a sale that is taxable unless otherwise exempt [*see Simplicity Pattern Co. v. State Bd. of Equalization (1980) 27 Cal. 3d 900, 915, 167 Cal. Rptr. 366, 615 P.2d 555]* . For further discussion of the sales and use tax in the context of mergers and acquisitions, see Ch. 11, *Merger and Acquisition Issues* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawLiabilities & Rights of SuccessorsDe Facto Mergers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART II. LEGAL BACKGROUND

5-11E California Legal Forms--Transaction Guide §§ 11E.26-11E.99

[Reserved]

§§ 11E.26[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11E California Legal Forms--Transaction Guide § 11E.100

§ 11E.100 Facts

1. Identity of acquiring and selling corporations.

a. Exact names of acquiring and selling corporations as they appear on their articles, or certificate, of incorporation as last amended.

b. Date and state or place of incorporation of acquiring and selling corporations.

c. Address and telephone number of principal executive office of both acquiring and selling corporations.
(1) Principal executive office for each corporation.

(2) Principal executive office in California where principal executive office for entire corporation is outside California.

d. Name, address, and telephone number of each principal officer of both acquiring and selling corporations, including:

(1) Chairman of board of directors.

(2) President.

(3) Executive vice president or vice president.

(4) Secretary and assistant secretary.

(5) Treasurer and assistant treasurer or other chief fiscal officer.

e. Names and addresses of directors of both acquiring and selling corporations.

f. Any order, judgment, or decree of any government agency or administrator or court suspending or revoking or enjoining the sale or right to engage in securities business of:

(1) Either acquiring or selling corporation;

(2) Any officer or director of either acquiring or selling corporation;

(3) Any subsidiary of either acquiring or selling corporation; and

(4) Any corporation of which any officer or director of either acquiring or selling corporation was officer or director.

g. Names and addresses of all persons who own 10 percent or more of outstanding shares of any class of either acquiring or selling corporation [*see 10 Cal. Code Reg. § 260.121*].

(1) Whether shareholder is officer, director, or person occupying similar status with either acquiring or selling corporation.

(2) Whether shareholder has any connection with any other corporation to proposed assets-for-shares exchange.

h. Type of business in which each corporation is engaged.

i. Types, classes, and series of shares of each corporation.

(1) Rights, preferences, privileges, and restrictions applicable to each class or series of outstanding shares.

(2) Voting rights of each class or series of shares.

(3) Number of shares of each class or series outstanding.

(4) Number of shareholders owning each class or series of outstanding shares.

(5) Total number of shares of all classes each corporation has outstanding and total number of shareholders of each corporation.

NOTE:
It should be determined whether approval of the principal terms of the proposed exchange by the outstanding shares of each class of the acquiring or selling corporation can more easily be obtained by written consent of its shareholders or by calling a shareholders' meeting of its shareholders.

j. All other outstanding securities that have been issued by either acquiring or selling corporation.

k. Any national or regional securities exchange on which shares of either acquiring or selling corporation are listed.

l. Any dividends due on shares of either acquiring or selling corporation that are in default.

m. Any payments of interest or principal due on securities of either acquiring or selling corporation that are in default.

n. Fiscal and tax year of each corporation:

(1) Calendar year.

(2) July 1 to June 30.

(3) Other period.

o. Name, address, and telephone number of accountants or accounting officers of both corporations.

2. Shares to be issued in exchange for assets of selling corporation.

a. Amount of shares.

(1) Value of assets of selling corporation being acquired by acquiring corporation.

(2) Value of acquiring corporation's shares.

b. Type of shares.

(1) Must be voting shares when tax-free exchange is desired [*see § 11E.22[3]*].

(2) May be combination of any type of shares when taxable exchange contemplated.

3. Types of assets being transferred by selling corporation to acquiring corporation.

NOTE:
This fact will help determine the types of conveyances that must be drafted to consummate the exchange.

a. Inventory.

b. Fixtures and equipment.

(1) Fixtures and equipment used in business requiring retail sales tax permit.

(2) Fixtures and equipment not used in business requiring retail sales tax permit.

c. Depreciable assets.

d. Leases of real or personal property.

(1) Location of leased premises.

(2) Name and address of lessor.

(3) Whether consent to assignment of lease is required by lessor.

e. Real property.

(1) Title company acquiring corporation wishes to handle transfer.

(2) Whether title insurance policy is required.

f. Automobiles and other motor vehicles requiring transfer of registration with Department of Motor Vehicles.

g. Corporate stock or securities to be transferred on books of their issuer.

h. Other assets needing transfer of registration or recorded conveyance.

4. Any assets of selling corporation that will not be transferred to acquiring corporation:

a. Delinquent accounts receivable.

b. Securities carried as investments by selling corporation.

c. Operating assets.

5. Location of all assets of selling corporation that are being transferred to acquiring corporation.

a. Street, city, and county.

NOTE:

The notice to creditors required by the Uniform Commercial Code--Bulk Sales Division [***see*** *Com. Code §§ 6101-6111*] must be recorded in the California county or counties in which the tangible assets being transferred by the seller are located, and, if different, in the county in which the seller is located [*Com. Code § 6105(b)(1)*; ***see*** P 6a, ***below***]. In addition, the notice must be delivered or sent by registered or certified mail to the county tax collector in the California county or counties where the tangible assets being transferred by the seller are located [*Com. Code § 6105(b)(3)*].

If the notice is delivered or sent during the period from January 1 to May 7, inclusive, the notice must be accompanied by a completed business property statement with respect to the property involved in the bulk sale [*Com. Code § 6105(b)(3)*]; ***see*** *Rev. & Tax. Code § 414* (procedure for filing property statements)].

b. Judicial district.

NOTE:

The bulk sale notice to creditors must be published in a newspaper of general circulation published in the judicial district where the tangible assets being transferred by the seller are located, and, if different, in the district in which the seller is located [*Com. Code § 6105(b)(2)*; ***see*** P 6b, ***below***]. If the assets are located in more than one judicial district,

the notice must be published in the judicial district where a greater portion of the assets is located [*Com. Code § 6105(b)*].

If no newspaper of general circulation exists in the judicial district in which the assets or the seller is located, then the notice must be published in a newspaper of general circulation in the county in which the judicial district is located [*Com. Code § 6105(b)(2)*; ***see*** P a, ***above***].

6. Location of all places of business maintained by selling corporation in California, including seller's chief executive office.

a. Street, city, and county.

NOTE:
If the California county in which the seller is located [***see*** *Com. Code § 6103(a)(2), (b)*] is different from the counties where the assets being transferred are located, the bulk sale notice to creditors must also be recorded in the county where the seller is located [*Com. Code § 6105(b)(1)*].

b. Judicial district.

NOTE:
If the California judicial district in which the seller is located [***see*** *Com. Code § 6103(a)(2), (b)*] is different from the judicial district where the bulk sale notice will be published (based on the location of the tangible assets being transferred [***see*** P 5, ***above***]), the bulk sale notice must also be published in the judicial district where the seller is located [*Com. Code § 6105(b)*].

7. Whether retail sales tax permit has been issued to selling corporation by California State Board of Equalization and, if so, whether that permit is still outstanding.

8. All business names and addresses used by selling corporation within past three years.

NOTE:
These facts must be specified in the bulk sale notice [*Com. Code § 6105(a)(2)*]. For further discussion of the bulk sale requirements, see *Ch. 17,* ***Buying and Selling a Business or Professional Practice****, § 17.20*.

9. Any licenses, franchises, or other governmental authorizations issued to selling corporation that must be transferred to acquiring corporation.

a. Type of license or franchise, such as alcoholic beverage license or cable television franchise.

b. Governmental agency or authority issuing and regulating franchise or license.

c. License or franchise number.

10. Name, address, and telephone number of person or firm who is to serve as escrow holder for consummation of proposed exchange.

a. Attorney for acquiring corporation.

b. Attorney for selling corporation.

c. Escrow department of particular bank or trust company.

d. Commercial escrow corporation.

11. Approximate date for consummating exchange.

NOTE:
The exact date may depend on when a permit qualifying the shares that are to be issued in connection with the exchange is received from the California Corporations Commissioner and shareholder approval of the proposed exchange can be obtained from the outstanding shares of each class of both the acquiring and selling corporation.

12. Whether shares of acquiring corporation's parent corporation are to be issued in exchange and if so, all information regarding acquiring corporation's parent corporation [*see § 11E.100[1]*].

13. Liabilities, if any, of selling corporation that are to be assumed by acquiring corporation.

14. General solvency and financial condition of selling corporation and number of claims that may be expected to be filed in escrow against it.

15. Whether selling corporation, after assets-for-shares exchange, is to be dissolved.

16. Any noncompetition agreements or other special clauses desired in agreement of exchange.

17. Time, place, and date of meetings of board of directors of each corporation, selling corporation, and acquiring corporation, and any parent corporation of acquiring corporation, at which proposed exchange might be considered and approved.

18. Normal place for holding special shareholders' meetings, if any have been held, of selling corporation, acquiring corporation, and any parent corporation of acquiring corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Bulk Sales (Article 6)Notice to ClaimantsMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11E California Legal Forms--Transaction Guide § 11E.101

§ 11E.101 Documents

1. Articles or certificates of incorporation, as last amended, of acquiring and selling corporations and any parent corporation of acquiring corporation.

2. Bylaws, as last amended, of acquiring and selling corporations and any parent corporation of acquiring corporation.

3. Stock certificate book and stock record book of acquiring and selling corporations and any parent party involved.

4. Any orders, judgments, or decrees of any court or administrative agency suspending, revoking, or enjoining sale or right to engage in securities business of any of following:

a. Either acquiring or selling corporation.

b. Any officer or director of either acquiring or selling corporation.

c. Any subsidiary or parent of either acquiring or selling corporation.

d. Any corporation of which any officer or director of either acquiring or selling corporation was officer or director.

5. Leases to which selling corporation is party, either as lessor or lessee.

6. Deed for each piece of real property owned by selling corporation.

7. Any collective bargaining agreements between selling corporation and any labor unions.

8. All franchise or licensing agreements to which selling corporation is a party whether as franchisor, franchisee, licensor, or licensee.

9. All licenses issued to selling corporation for its business.

10. All executory contracts to which selling corporation is a party.

11. Any loan agreement or other instruments on which selling corporation is obligated to pay money.

12. Any deeds of trust or other instruments encumbering any of assets or property of selling corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawSales of AssetsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART III. TRANSACTION GUIDE
A. Client Interview--Fact and Documents

5-11E California Legal Forms--Transaction Guide §§ 11E.102-11E.109

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§§ 11E.102[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11E California Legal Forms--Transaction Guide § 11E.110

§ 11E.110 Determinations for Assets-for-Shares Exchange

1. Determine which, if any, assets of selling corporation should be omitted from exchange.

a. Must include at least 90 percent of assets in exchange to obtain ruling letter from Internal Revenue that exchange is tax-free reorganization [*see Rev. Proc. 86-42, 1986-2 C.B. 722* ; *see also § 11E.22[2]*].

b. Percentage required to be "substantially all assets" of selling corporation included in exchange measured by value of assets of selling corporation.

2. Determine type and amount of shares of acquiring corporation or its parent party that should be issued in exchange for assets of selling corporation.

a. Amount of shares to be exchanged will depend on relative values of shares and assets for which they are to be exchanged.

b. Voting shares must be exchanged for assets, or at least 80 percent in value of assets, of selling corporation to make exchange a tax-free reorganization [*see § 11E.22[2], [3]*].

3. Determine whether proposed transfer of assets of selling corporation to acquiring corporation in exchange for shares of acquiring corporation or its parent party is subject to requirements of Uniform Commercial Code--Bulk Sales Division [*see Com. Code § 6101*].

NOTE:

The requirements of the Uniform Commercial Code--Bulk Sales Division and the transactions to which it applies are discussed more fully in Ch. 17, ***Buying and Selling a Business or Professional Practice***, § 17.20.

4. Determine, when proposed transfer of assets is subject to Uniform Commercial Code--Bulk Sales Division:

a. Municipal court or judicial districts in which selling corporation maintains places of business.

b. Name and address of newspaper of general circulation in each municipal court of judicial district in which selling corporation maintains place of business, including:
(1) Publication dates of that newspaper.

(2) Newspaper's deadline for accepting legal notices for publication on each of its publication dates.

c. Name and address of county tax collector of each county in which selling corporation maintains place of business.

d. Address of county recorder for each county in which selling corporation maintains place of business.

5. Determine whether California sales tax will be imposed on value of any of shares of acquiring corporation or its parent party that are to be received by selling corporation in exchange for any of its fixtures and assets.

NOTE:
See *Ch. 17,* ***Buying and Selling a Business or Professional Practice****, § 17.12*.

6. Determine approval requirements:

a. Proposed exchange must be approved by board of directors of both acquiring corporation and corporation whose property and assets are being acquired [*Corp. Code § 1200(c)*].

b. Principal terms of proposed exchange must be approved by outstanding shares of each class of corporation that is "parent party" to the acquiring corporation [*Corp. Code §§ 1200(e), 1201(a)*].

NOTE:
A "parent party" is a corporation that is in control of the acquiring corporation and whose shares are being issued and exchanged, instead of shares of the acquiring corporation itself, for the assets of the selling corporation [*Corp. Code § 1200(e)*]. If a parent party [*Corp. Code § 1200(e)*] is a foreign corporation (other than one subject to the General Corporation Law [***see*** *Corp. Code § 2115(a)*; ***see also*** Ch. 12B, ***Foreign Corporations and Associations***]), any requirement or lack of requirement for approval by the outstanding shares of the foreign corporation is not governed by *Corp. Code §§ 1200* and *1201*. Instead, the law of the state or place of incorporation of the foreign corporation will apply [*Corp. Code § 1202(c)*].

7. Determine what classes of shares of each corporation must approve principal terms of proposed assets-for-shares exchange.

a. Need not be approved by any class of outstanding preferred shares of acquiring corporation or its parent party if rights, preferences, privileges, and restrictions granted to or imposed on that class of shares will remain unchanged as result of assets-for-shares exchange [*Corp. Code § 1201(a)*].

NOTE:
The principal terms of a reorganization must be approved by all shareholders of any class or series if, as a result of the reorganization, the holders of that class or series become

personally liable for any obligations of a party to the reorganization, unless all holders of that class or series have dissenters' rights [*Corp. Code § 1201(g)*; ***see*** *Corp. Code § 1300 et seq.*].

b. Two classes of common shares differing only as to voting rights will be considered only one class of shares for purposes of voting on proposed exchange [*Corp. Code § 1201(a)*].

c. Need not be approved by outstanding shares of either corporation if that corporation or its shareholders will immediately after exchange own shares of acquiring corporation or its parent party possessing more than five sixths of voting power of acquiring corporation or its parent party [*Corp. Code § 1201(b)*; *see § 11E.21[2]*].

NOTE:
See P7a, NOTE, ***above*** [*Corp. Code § 1201(g)*; ***see*** *Corp. Code § 1300 et seq.*].

(1) Shares owned by any shareholder of selling corporation in acquired corporation before exchange will be disregarded in determining whether shareholder approval by shareholders of selling corporation is required.

(2) Shares owned by any shareholder of acquiring corporation or its parent party in selling corporation before exchange will be disregarded in determining whether exchange must be approved by outstanding shares of acquiring corporation or its parent party.

(3) Shareholders' approval required for any class of shares of selling corporation whose holders will receive as final result of assets-for-shares exchange shares of acquiring corporation or parent party having different rights, preferences, privileges, or restrictions than their shares in selling corporation [*Corp. Code § 1201(d)*].

(4) Shareholders' approval required for any class of shares of domestic California selling corporation whose holders will receive as final result of assets-for-shares exchange shares of foreign corporation [*Corp. Code § 1201(d)*].

(5) Shareholders' approval required if selling corporation is "close corporation" and its shareholders will receive as final result of assets-for-shares exchange shares of corporation that is not "close corporation" as defined in California's General Corporation Law [*Corp. Code § 1201(e)*].

d. If class or series of preferred shares will receive lesser amount for shares than would be required by articles, must be approved by that class or series [*Corp. Code § 1202(b)*; *see* (8)(e), *below*].

8. Determine vote or written consent required to approve proposed assets-for-shares exchange by each class of shares of selling and acquiring corporations.

a. Must be approved by affirmative vote of majority of all outstanding shares of each class, regardless of voting rights, of shares of acquiring and selling corporations [*Corp. Code § 1201(a)*; *see § 11E.21[1]*].

b. Must be approved by affirmative vote of majority of all outstanding shares of each class of any "parent party" of acquiring corporation [*Corp. Code §§ 1200(e), 1201(a)*].

NOTE:

However, if a parent party [*Corp. Code § 1200(e)*] is a foreign corporation (other than one subject to the General Corporation Law [***see*** *Corp. Code § 2115(a)*]), any requirement or lack of requirement for approval by the outstanding shares of the foreign corporation is not governed by *Corp. Code §§ 1200* and *1201*. Instead, the law of the state or place of incorporation of the foreign corporation will apply [*Corp. Code § 1202(c)*].

c. Must also be approved by affirmative vote of at least two thirds of each class of outstanding shares of selling corporation if it is close corporation and acquiring corporation or its parent party is not close corporation [*Corp. Code § 1201(e)*; *see Corp. Code § 158*].

(1) Articles of incorporation of selling corporation that is close corporation may provide for lesser vote [*Corp. Code § 1201(e)*].

(2) However, articles of incorporation of selling close corporation cannot provide for less than majority vote of outstanding shares of each class of its shares [*Corp. Code § 1201(e)*].

d. Articles of incorporation of particular acquiring or selling corporation or parent party may require unanimous or greater than majority vote approving exchange by any or all classes of corporation's outstanding shares [*Corp. Code § 152*].

e. If class or series of preferred shares will receive lesser amount for shares than would be required by articles, proposed exchange must be approved by same percentage of outstanding shares of that class or series that would be required to approve amendment of article provisions to provide for distribution of that lesser amount [*Corp. Code § 1202(b)*].

9. Determine what licenses, if any, must be transferred from selling to acquiring corporation to consummate exchange and requirements for their transfer.

a. Alcoholic beverage license [*see* Ch. 18, *Buying and Selling a Retail Alcoholic Beverage License and Business*].

b. Federal Communications Commission license.

10. Determine what licenses, if any, must be acquired by acquiring corporation from state or federal government to operate selling corporation's business or assets.

NOTE:

For a list of some of the major types of businesses that require a license from either the state or federal government, see Ch. 1A, ***Role of Counsel in Starting a New Business*** .

11. Determine what instruments of conveyance will be required to transfer all assets of selling corporation to acquiring corporation on consummation of assets-for-shares exchange.

12. Determine consents or other instruments that must be obtained from third persons in order to consummate exchange.

13. Determine date, time, and place for calling and holding:

a. Meeting of board of directors of acquiring corporation to approve proposed exchange.

b. Meeting of board of directors of selling corporation to approve proposed exchange.

c. Meeting of shareholders of acquiring corporation to approve proposed exchange.

NOTE:
Shareholder approval may be obtained by means of written consent of shareholders instead of a shareholders' meeting and vote [*Corp. Code § 603*.].

d. Meeting of shareholders of selling corporation to approve proposed exchange.

NOTE:
Shareholder approval may be obtained by means of written consent of shareholders instead of shareholders' meeting and vote [*Corp. Code § 603*].

e. Meetings, when required, of board of directors and shareholders of acquiring corporation's parent party to approve proposed exchange [*see Corp. Code §§ 1200(e), 1201(a)*].

14. Determine whether proposed corporate acquisition should be consummated by means of exchange of shares for assets or by some other method such as cash purchase of assets, share-for-share exchange, or statutory merger.

15. Determine whether selling corporation should be dissolved after exchange.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Bulk Sales (Article 6)Notice to ClaimantsMergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Mergers & Acquisitions LawSales of AssetsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11E California Legal Forms--Transaction Guide § 11E.111

§ 11E.111 Advantages of Assets-for-Shares Exchange

NOTE:
This section and § 1E.112 are designed to assist the attorney in assessing, and counseling a party to a corporate acquisition regarding, the relative advantages and disadvantages of an assets-for-shares exchange. For additional discussion, see Ch. 11, ***Merger and Acquisition Issues*** .

1. Acquiring corporation does not automatically become liable for debts and liabilities of selling corporation, with possible exception of products liability claims [*see § 11E.24[1], [4]*].

2. There is no minority interest that might harass acquiring corporation in managing business and assets acquired from selling corporation.

3. Assets-for-shares exchange can be arranged to be income-tax-free.

a. No gain or loss is recognized for income tax purposes to selling corporation or shareholders of selling corporation as result of transaction [*see I.R.C. §§ 354, 361, 368(a)(1)(C); § 11E.22[1]*].

b. Acquiring corporation must acquire substantially all assets of selling corporation solely in exchange for its voting shares or voting shares of its parent corporation [*see I.R.C. § 368(a)(1)(C); see also § 11E.22[2], [3]*].

4. Acquiring corporation succeeds to any net operating loss carryforward of acquired corporation [*see I.R.C. § 381(a)(2), (c)(1)*].

NOTE:
That carryforward, however, may be reduced or disallowed [***see*** *I.R.C. §§ 269(b), 382*]. For a detailed

discussion of these restrictions, see Ch. 11, ***Merger and Acquisition Issues*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawLiabilities & Rights of SuccessorsGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral OverviewTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)Changes in Corporate OwnershipTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)CarryforwardsTax LawFederal Income Tax ComputationDeductions for LossesNet Operating Loss (IRC secs. 172, 382)General OverviewMergers & Acquisitions LawTax-Free AcquisitionsTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11E California Legal Forms--Transaction Guide § 11E.112

§ 11E.112 Disadvantages of Assets-for-Shares Exchange

1. Proposed exchange must be approved by boards of directors, and principal terms of proposed exchange must be approved by outstanding shares of each class of both acquiring and selling corporations.

a. Must be approved by affirmative vote of majority of outstanding shares of each class, regardless of voting rights, of both acquiring and selling corporations [*Corp. Code §§ 117, 152, 1200(c), 1201(a)*].

b. May, if articles of either corporation so provide, require approval by all or greater than majority vote of outstanding shares of all or some of classes of shares of that corporation [*Corp. Code §§ 152, 1200(c), 1201(a)*].

c. If shares of acquiring corporation's parent will be exchanged for assets of selling corporation, must also be approved by board of directors and outstanding shares of each class of parent corporation [*Corp. Code §§ 152, 1200(e), 1201(a)*].

NOTE:
However, if a parent party [*Corp. Code § 1200(d)*] is a foreign corporation (other than one subject to the General Corporation Law [***see*** *Corp. Code § 2115(a)*; ***see also*** Ch. 12B, ***Foreign Corporations and Associations***]), any requirement or lack of requirement for approval by the outstanding shares of the foreign corporation is not governed by *Corp. Code §§ 1200* and *1201*. Instead, the law of the state or place of incorporation of the foreign corporation will apply [*Corp. Code § 1202(c)*].

d. If selling corporation is close corporation, must be approved by two-thirds vote of outstanding shares of each class of selling corporation [*Corp. Code § 1201(e)*].

e. If class or series of preferred shares will receive lesser amount for shares than would be required by articles, must be approved by same percentage of outstanding shares of that class or series that would be required to approve amendment of article provisions to provide for distribution of that lesser amount [*Corp. Code § 1202(b)*].

2. Shares to be issued by corporation or its parent in exchange generally must be qualified with California Commissioner of Corporations [*Corp. Code § 25120*; *see* Ch. 6, *Securities Regulation Issues* , Ch. 6H, *Qualification of Securities*].

NOTE:

Qualification is not required if an exemption from qualification is available [***see*** *Ch. 6,* ***Securities Regulation Issues****, § 6.200,* for a list of the exemptions from qualification provided by California law]. Any change in the rights, preferences, privileges, or restrictions of or on outstanding securities, and any exchange of securities by the issuer with its existing security holders exclusively, will be exempt from qualification if the transaction, had it involved the issuance of a new security containing the changed rights, preferences, privileges, or restrictions, or a new issuance of the exchange security, would have been exempt from qualification [***see*** *Corp. Code § 25110*] as an issuer transaction [*10 Cal. Code Reg. § 260.103(a)*; ***see*** *Corp. Code § 25102*]. For further discussion of the qualification and exemption of securities, see Ch. 6H, ***Qualification of Securities*** .

a. Must be obtained before solicitation of required shareholder approval of exchange terms by shareholders of either selling or acquiring corporation or any parent party [*Corp. Code § 25120*].

b. Permit required when 25 percent of shares of any class of selling corporation are owned by California residents [*Corp. Code § 25103(c)*].

c. Permit not needed for preliminary negotiations of proposed exchange by corporate officers of acquiring and selling corporations or for approval of exchange by boards of directors of acquiring and selling corporations and any parent party involved.

3. Dissenting shareholders of either acquiring or selling corporation have right to require their shares to be purchased by their corporation for cash at appraised fair market value of shares on day preceding first announcement of terms of proposed assets-for-shares exchange [*Corp. Code § 1300*].

NOTE:

The same right is available to dissenting shareholders of the acquiring corporation's parent party. A parent party is a corporation in control of the acquiring corporation whose shares, rather than those of the acquiring corporation itself, are to be exchanged for the assets of the selling corporation [*Corp. Code § 1200(e)*].

4. Acquiring corporation does not obtain new income tax basis for assets it is acquiring from selling corporation in assets-for-shares exchange.

a. Must use income tax basis for assets of selling corporation [*see I.R.C. §§ 358, 362*; *see also § 11E.22[5]*].

b. When income tax basis of selling corporation for assets is less than value of shares of acquiring corporation or its parent exchanged for assets:

(1) Depreciation deduction allowed acquiring corporation less than would be allowed had assets been purchased by it for cash or acquired by it in taxable exchange.

(2) Gain on sale of assets by acquiring corporation increased for income tax purposes when it eventually sells assets.

5. Tangible personal property transferred for stock may be subject to California sales tax.

NOTE:

The transfer of assets for stock will be treated as a taxable sale under the Sales and Use Tax Law [*Rev. & Tax. Code §§ 6001-7176*] unless the transaction is otherwise exempt. For a discussion of the sales and use tax and the exemptions from that tax, see *Ch. 17,* ***Buying and Selling a Business or Professional Practice****, § 17.12*.

6. Transfer of assets from selling corporation to acquiring corporation may require compliance with Uniform Commercial Code--Bulk Sales Division under following circumstances:

NOTE:

If the Uniform Commercial Code--Bulk Sales Division applies [***see*** *Com. Code §§ 6101-6111*], the buyer must give public notice of the bulk sale, essentially to provide notice to the seller's creditors. The buyer may be required to record, publish, and deliver notice of the intended transfer in several jurisdictions [***see*** *Com. Code § 6105(b)*]. The requirements of the Bulk Sales Division are covered in more detail in Ch. 17, ***Buying and Selling a Business or Professional Practice***, § 17.20.

a. Selling firm's principal business is sale of inventory from stock, including those who manufacture what they sell, or is that of restaurant owner [*Com. Code § 6103(a)(1)*; *see Com. Code § 6103(c)* (exceptions)];

NOTE:

Many transactions are specifically exempted from the bulk sales law [***see*** *Com. Code § 6103(c)*], including a sale of assets with a value of less than $10,000, or a value of more than $5 million [*Com. Code § 6103(c)(12)*].

b. On date of bulk sale agreement, selling firm is located in California or is located in jurisdiction outside United States but has its major American executive office in California [*Com. Code § 6103(a)(2)*; *see Com. Code § 6103(b)*]; and

c. Sale of assets is not in ordinary course of selling firm's business and constitutes more than half of firm's inventory and equipment [*Com. Code § 6102(a)(3)*; *see Com. Code § 6102(a)(8), (15)*].

NOTE:

In determining the percentage of the seller's inventory and equipment being transferred, the assets are valued at their fair market value as of the date of the bulk sale agreement [*Com. Code § 6102(a)(3), (8), (15)*]. If the consideration for the sale of assets is $2 million or less and is substantially all in cash and/or an obligation of the buyer to pay cash in the future, the buyer or escrow agent may have to settle claims against the seller before paying the seller [***see*** *Com. Code §§ 6106.2, 6106.4*].

7. To protect acquiring corporation from liability under successor liability statutes for sales taxes and unemployment

compensation insurance contributions owed by selling corporation, exchange of shares for assets cannot be consummated until selling corporation obtains [*see Rev. & Tax. Code §§ 6811, 6812*; *Unemp. Ins. Code § 1731, 1732*]:

NOTE:
See *Ch. 17*, ***Buying and Selling a Business or Professional Practice****, § 17.14*.

a. Sales tax clearance from California State Board of Equalization.

b. Statement from California State Department of Benefit Payments that no amounts are due from selling corporation for unemployment compensation insurance contributions.

8. Acquiring corporation may become liable for products liability claims arising from sales of defective products by predecessor business [*see § 11E.24[4]*].

9. Separate documents of conveyance or transfer must be drafted, executed, and registered or recorded for every:

a. Automobile or motor vehicle being transferred.

b. Lease being assigned.

c. Piece of real property being conveyed.

d. Corporate shares or securities being transferred.

e. Other assets whose ownership is registered or recorded with some governmental, corporate, or other agency.

10. May require obtaining from some third person or corporation:

a. Consent to assignment of leases.

b. Consent to purchase of franchised business.

c. Title insurance policy for real property included in exchange.

d. Consent to assignment of collective bargaining, employment, or other contracts.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsCommercial Law (UCC)Bulk Sales (Article 6)Notice to ClaimantsMergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsRights of Dissenting Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11E California Legal Forms--Transaction Guide §§ 11E.113-11E.119

[Reserved]

§§ 11E.113[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-11E California Legal Forms--Transaction Guide § 11E.120

§ 11E.120 Procedures for Consummating Assets-for-Shares Exchange

1. Prepare agreement for assets-for-shares exchange [*see §§ 11E.200, 11E.201*].

2. Prepare resolutions to be adopted by board of directors and shareholders acquiring and selling corporation and by board of directors of acquiring corporation's parent party, if any, as applicable, approving agreement for exchange of assets for shares:

a. Resolution of board of directors of acquiring corporation approving proposed acquisition of assets in exchange for shares of acquiring corporation [*see § 11E.202[2]* (form)].

b. Resolution of board of directors of selling corporation approving exchange of substantially all its assets for voting shares of acquiring corporation [*see § 11E.203[2]* (form)].

c. Resolution of shareholders of acquiring corporation approving proposed acquisition of assets for shares [*see § 11E.205*(2) (form)].

d. Resolution of shareholders of selling corporation approving proposed exchange of its assets for shares of acquiring corporation [*see § 11E.206[2]* (form)].

e. Resolutions of approval by acquiring corporation or its parent party should do all of following:
(1) Approve agreement for exchange.

(2) Authorize and direct officers of acquiring corporation or its parent party to file

application to qualify shares that will be issued in assets-for-shares exchange.

(3) Name escrow holder to consummate transaction and authorize escrow holder to take all actions required by Uniform Commercial Code--Bulk Sales Division [*Com. Code §§ 6101-6111*], if applicable, and successor liability statutes of the California Sales and Use Tax Law and California Unemployment Insurance Code [*Rev. & Tax. Code §§ 6811, 6812*; *Unemp. Ins. Code §§ 1731-1736*; *see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.14*].

(4) Authorize and direct officers of corporation to secure approval, on receipt of permit from California Corporations Commissioner, of proposed exchange by its outstanding shares of each class [*Corp. Code § 1201(a)*].

(5) Authorize and direct officers of corporation to do all things reasonably necessary to carry out proposed assets-for-shares exchange after its approval by outstanding shares of corporations involved.

f. Resolutions of approval adopted by selling corporation should do all of following:

(1) Contain same matters as resolutions of approval passed by board of directors of acquiring corporation or its parent party except direction to apply for permit qualifying shares to be issued as part of exchange.

(2) Provide, if selling corporation is to be dissolved, for dissolution of selling corporation and distribution of its assets to its shareholders after exchange.

NOTE:
A transaction will fail to qualify as a "C reorganization" unless the acquired corporation distributes the stock, securities, and other properties that it receives, as well as its other properties, pursuant to the reorganization plan [*I.R.C. § 368(a)(2)(G)(i)*]. However, the Internal Revenue Service may waive the application of this requirement to any transaction, subject to any condition that the IRS may prescribe [*I.R.C. § 368(a)(2)(G)(ii)*].

3. Have board of directors of acquiring and selling corporation and board of directors of any parent party of acquiring corporation adopt resolutions approving proposed assets-for-shares exchange.

a. Must be approved by board of directors itself and not committee of board of directors [*see § 11E.21[1]*].

b. Parent party is corporation in control of acquiring corporation whose shares, instead of those of acquiring corporation, are to be exchanged for assets of selling corporation [*Corp. Code § 1200(e)*].

4. Have officers of acquiring corporation or its parent party (whichever is to issue shares in exchange) prepare, execute, and file with California Commissioner of Corporations application for permit qualifying issuance of shares that will be issued by acquiring corporation or its parent party in exchange for assets of selling corporation [*see Ch. 11C, Mergers, § 11C.204*; *see also* Ch. 6H, *Qualification of Securities*].

NOTE:

A qualification permit is not required in all share exchanges. For further discussion, see *Ch. 11C, **Mergers**, § 11C.25*; see also Ch. 6, ***Securities Regulation Issues*** .

a. Permit must be issued by Commissioner and received by acquiring corporation, or its parent party, before shareholder approval of proposed exchange by shareholders of any corporation, acquiring corporation or selling corporation or parent party, may be solicited [*Corp. Code §§ 25103(a), 25120*].

b. Check for Commissioner's fee should accompany filing of application [*Corp. Code § 25615*] and be in amount equal to [*Corp. Code § 25608(h)(2)*]:

(1) $200, plus

(2) One fifth of 1 percent of value as alleged in application, or actual value as determined by Commissioner, of consideration that is to be received for shares sought to be issued, with

(3) Total aggregate fee not to exceed $2,500.

5. On receipt by acquiring corporation or its parent party of a permit from Commissioner, secure approval of principal terms of proposed exchange by outstanding shares of each class of each corporation that are determined to be required to approve principal terms of exchange [*see § 11E.110[7]*], by either:

NOTE:

When a tender offer, including a share exchange tender offer [***see** Corp. Code § 183.5* (definition)], or a written proposal for approval of an assets-for-shares exchange, other "reorganization" [***see** Corp. Code § 181(b), 1200*], or sale of assets [***see** Corp. Code § 1001(a)*] is made to some or all of a corporation's shareholders by a party to the transaction who has control of or a financial interest in that corporation (an "interested party proposal"), an affirmative opinion in writing regarding the fairness of the consideration to the shareholders of the corporation must be provided to the shareholders or the corporation [*Corp. Code § 1203(a)*; ***see** Ch. 11D, **Acquisition of Shares for Shares**, § 11D.22*]. However, this requirement does not apply if the target corporation does not have shares held of record by 100 or more persons [***see** Corp. Code § 605* (determination of shareholders of record)], or if the transaction has been qualified pursuant to *Corp. Code § 25113* (qualification of issuer transaction by permit) or 25121 (qualification of recapitalization or reorganization by permit), and no stop order [***see** Corp. Code §§ 25140, 25143(a)*] is in effect regarding that qualification [*Corp. Code § 1203(a)*]. For further discussion, see Ch. 11, ***Merger and Acquisition Issues*** .

a. Obtaining both of following [*see Corp. Code § 1201*; *Corp. Code § 603* (requirements for written consent)]:

(1) Written consent of shareholders holding majority of outstanding shares of each required class of each corporation that is not close corporation; and

(2) Written consent of shareholders holding two thirds of outstanding shares of each class of any close corporation; or

b. Calling special meeting of shareholders of each corporation for vote of each class of shareholders that is required to approve proposed assets-for-shares exchange [*Corp. Code § 601(d)*; *see § 11E.120[5]*].

(1) Give written notice of meeting personally, or by electronic transmission by corporation, or by first-class mail to each shareholder not more than 60 or less than 10 days before date set for meeting and [*Corp. Code § 601(a), (b)*]:

NOTE:
If the corporation has 500 or more shareholders of record (as determined under *Corp. Code § 605*) as of the record date for the meeting, notice may be sent by third-class rather than first-class mail. However, in that case, notice must be sent not less than 30 days before the meeting [*Corp. Code § 601(a), (b)*; ***see*** *Corp. Code § 113* ("mail" normally means first-class mail)].

(a) State place, date, and hour of meeting [*Corp. Code § 601(a)*].

(b) State means of any transmission by and to corporation or electronic video screen communication by which shareholders may participate in meeting [*Corp. Code § 601(a)*; *see Corp. Code §§ 20, 21*].

(c) State general nature of business to be transacted at meeting [*Corp. Code § 601(a)*].

(d) Address, if given by mail, to each shareholder at address for shareholder appearing on books of corporation or given to corporation by shareholder for purpose of notice [*Corp. Code § 601(b)*].

(2) Obtain following approval of shareholders:

(a) Affirmative vote of all outstanding shares of each class of both acquiring and selling corporation and any parent party unless excused by statute [*see § 11E.21[2]*] or by greater than majority vote of any class if vote is required by corporation's articles of incorporation [*Corp. Code § 1201*].

NOTE:
However, if a parent party [*Corp. Code § 1200(e)*] is a foreign corporation (other than one subject to the General Corporation Law [***see*** *Corp. Code § 2115(a)*; ***see also*** Ch. 12B, ***Foreign Corporations and Associations***]), any requirement or lack of requirement for approval by the outstanding shares of the foreign corporation is not governed by *Corp. Code §§ 1200* and *1201*. Instead, the law of the state or place of incorporation of the foreign corporation will apply [*Corp. Code § 1202(c)*].

(b) Affirmative vote of two-thirds of all outstanding shares of each class of selling corporation if it is close corporation and acquiring corporation or its parent party is not close corporation [*Corp. Code § 1201*].

(c) If class or series of preferred shares will receive lesser amount for shares than would be required by articles, affirmative vote by same percentage of outstanding shares of that class or series that would be required to approve amendment of article provisions to provide for distribution of that lesser amount [*Corp. Code § 1202(b)*].

6. Select date on or after which proposed assets-for-shares exchange will be consummated and assets of selling corporation transferred to acquiring corporation.

a. If recordation of notice of intended transfer is required under Uniform Commercial Code--Bulk Sales Division [*see Com. Code § 6101 et seq.*], allow sufficient time so that notice can be recorded at least 12 business days before date selected [*Com. Code § 6105(b)(1)*].

NOTE:
For a detailed discussion of Uniform Commercial Code--Bulk Sales Division [***see** Com. Code §§ 6101-6111*] requirements, see *Ch. 17, **Buying and Selling a Business or Professional Practice**, § 17.20*.

b. If publication of notice of intended transfer is required under Uniform Commercial Code--Bulk Sales Division [*see Com. Code § 6101 et seq.*], allow sufficient time so that notice can be published at least 12 business days before date selected [*Com. Code § 6105(b)*].

NOTE:
If applicable, the Uniform Commercial Code--Bulk Sales Division [***see** Com. Code §§ 6101-6111*] also requires that the notice be delivered or sent by registered or certified mail to the county tax collector in the county where the property is located at least 12 business days before the date selected [*Com. Code § 6105(b)(3)*]. If the notice is delivered or sent during the period from January 1 to May 7, inclusive, the notice must be accompanied by a completed business property statement with respect to the property involved in the bulk sale [*Com. Code § 6105(b)(3); **see** Rev. & Tax. Code § 441* (procedure for filing property statements)].

7. Have officers of selling and acquiring corporation and any parent party of acquiring corporation formally execute:

a. At least five copies of agreement for assets-for-shares exchange.

b. At least three copies of escrow instructions for handling exchange of acquiring corporation or its parent party's shares for assets of selling corporation.

c. Notice of intended transfer required, when applicable, by Uniform Commercial Code--Bulk Sales Division [*Com. Code § 6105*].

8. Distribute two executed copies of agreement for exchange and one executed copy of escrow instructions to:

a. Secretary of each corporation.

b. Escrow holder appointed to handle transfer of assets for shares.

9. Prepare notice to shareholders for each corporation, including all of following [*Corp. Code § 1301(a); see § 11E.207*]:

NOTE:
Due to the nature of the material contained in the notice, a separate notice must be prepared for the selling corporation, the acquiring corporation, and any parent party of the acquiring corporation.

a. Statement that proposed exchange has been approved by outstanding shares of each class of corporation.

b. Price determined by corporation to represent fair market value of dissenting shares.

c. Brief description of procedure to be followed by shareholder who wants to exercise right to sell his or her dissenting shares [*see* § 11.208].

d. Copy of *Corp. Code §§ 1300-1304*.

10. Ensure that each corporation mails notice to shareholders within 10 days after date that outstanding shares have approved principal terms of reorganization [*Corp. Code § 1301(a)*].

11. Conduct both of following in same manner as cash sale of incorporated or unincorporated business [*see* Ch. 17, *Buying and Selling a Business or Professional Practice*]:

a. Exchange of assets for shares.

b. Transfer of assets from selling corporation to acquiring corporation.

NOTE:
The same notices must be given and the same tax clearances obtained from the California State Board of Equalization and Department of Benefit Payments that would be required in the sale of any business similar to the business conducted by the selling corporation [***see*** Rev. & Tax. Code §§ 6811, 6812; ***see also*** *Unemp. Ins. Code §§ 1731, 1732*]. Discussion of the requirements for, forms for, and a Transaction Guide for the sale of a business are set forth in Ch. 17, ***Buying and Selling a Business or Professional Practice*** . That material is not repeated here, but it should be used in connection with the exchange of all, or substantially all assets, of any business including a corporation for cash or for shares of the acquiring corporation. The only difference between the transactions is that shares of the acquiring corporation or its parent party will be issued in payment for the assets of the selling corporation instead of in payment for cash or promissory notes.

12. Distribute assets and shares received among shareholders.

13. Dissolve selling corporation [*see* Ch. 12, *Winding Up and Dissolution*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsAsset AcquisitionsMergers & Acquisitions LawTax-Free AcquisitionsMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Directors & OfficersCommercial Law (UCC)Bulk Sales (Article 6)General OverviewTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Commercial Law (UCC)Bulk Sales (Article 6)Notice to Claimants



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-11E California Legal Forms--Transaction Guide §§ 11E.121-11E.199

[Reserved]

§§ 11E.121[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART IV. FORMS

5-11E California Legal Forms--Transaction Guide § 11E.200

§ 11E.200 Agreement for Exchange of Voting Shares of Acquiring Corporation for Substantially All Assets of Selling Corporation--General Form

[1] Comment

[a] Use of Form

This form is an agreement for the acquisition by one corporation of all or substantially all of the assets of another corporation in exchange for the acquiring corporation's voting shares. In this agreement the acquiring corporation also agrees to assume certain liabilities of the selling corporation. The agreement is designed to effect an assets-for-shares exchange that will be a tax-free reorganization under applicable provisions of the Internal Revenue Code [*see § 11E.22[1]*]. In addition to this agreement, escrow instructions should be prepared and executed by the corporation for the handling of the transaction and proposed exchange. Forms for escrow instructions are *set forth in Ch. 17, Buying and Selling a Business or Professional Practice, § 17.250*.

[b] Shareholder Approval and Qualification of Shares

The principal terms of this agreement must be approved by the holders of outstanding shares of each class of both the acquiring and selling corporations [*see § 11E.21[1]*]. Before that approval can be obtained or even solicited, the shares that the acquiring corporation will issue to perfect the assets-for-shares exchange must be qualified with the California Corporations Commissioner under the Corporate Securities Law of 1968. An application for qualification, together with a discussion of the requirements of the application, is *set forth in Ch. 11C, Mergers, § 11C.204*; see also Ch. 6H, *Qualification of Securities* .

[c] Assumption of Products Liability Claims

Section 9.01 of the form contains an optional provision making the buyer responsible for products liability claims based on product sales that took place before the sale of the business. For an explanation of the legal rules that will influence the parties' consideration of who should bear this risk, see *Ch. 11B, Cash Purchase of Assets, § 11B.200*.

[2] Form

Agreement for Exchange of Voting Shares of Acquiring Corporation for Substantially All Assets of Selling Corporation--General Form

PLAN AND AGREEMENT OF REORGANIZATION
by exchange of voting stock of _____ [*name of acquiring corporation*] for substantially all the property and assets of _____ [*name of acquired corporation*]

_____[*Name of acquiring corporation*], Buyer, and _____[*name of acquired corporation*], Seller, agree as follows:

ARTICLE 1 PLAN OF REORGANIZATION

Plan Adopted

Section 1.01. A plan of reorganization of the parties in accordance with the provisions of *Internal Revenue Code Section 368(a)(1)(C)* is adopted as follows:

(a) Seller will transfer to Buyer, subject to certain of its liabilities, substantially all of the properties of Seller.

(b) In exchange for the properties transferred by Seller, Buyer will issue and deliver to Seller _____[*number*] shares of its common stock, and will assume certain liabilities of Seller as provided in this Agreement.

(c) Seller will wind up its affairs, liquidate and distribute its assets, including the shares of common stock of Buyer received pursuant to the exchange, and voluntarily dissolve.

Closing Date

Section 1.02. Subject to the conditions precedent set forth in this agreement, the plan of reorganization shall be consummated at _____[*office, street address, city, and state*], on _____[*date*], at _____ M. or any other place and date that may be fixed by mutual consent of the parties. The date of that consummation is referred to in this Agreement as the "closing date."

ARTICLE 2 COVENANTS, REPRESENTATIONS, AND WARRANTIES OF SELLER

Legal Status

Section 2.01. Seller is a corporation duly organized, validly existing, and in good standing under the laws of the State of California [*or specify other state*], with corporate power to own property and carry on its business as it is now being conducted. Seller is duly qualified to do business in each jurisdiction in which the character and location of its properties make that qualification necessary.

Subsidiaries

Section 2.02. Seller has no subsidiaries or any interest in any other corporation, firm, or partnership [*or specify subsidiaries, legal status, and capitalization as appropriate*].

Capitalization

Section 2.03. Seller has an authorized capitalization of $_____, divided into _____[*number*] shares of common stock. As of the date of this agreement, _____[*number*] shares of the common stock are validly issued and outstanding, fully paid and nonassessable.

Financial Statements

Section 2.04. Seller has delivered to Buyer the audited [*or* unaudited] balance sheet of Seller as of _____[*date*], and the related statements of income and retained earnings for the _____ years [*or* months] then ended. All such financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and present fairly the financial position of Seller at _____[*date*], and the results of operations for the period then ended [*add if statements are unaudited:*, subject, however, to normal changes resulting from year-end audit of the financial statements].

Properties

Section 2.05. (a) Seller has delivered to Buyer a list [*or* an appraisal] as of _____[*date*], of the assets and properties of Seller. The list [*or* appraisal] is substantially complete and the information reported in that list is correct in all material respects. Except as previously disclosed to Buyer in writing, Seller does not know of any circumstances, events, or other information, occurring prior to or subsequent to _____[*date*], which would adversely affect the values as of _____[*date*], or subsequent to that date, set forth in the list [*or* appraisal] of properties.

(b) Except for properties and interests in properties sold or otherwise disposed of in the ordinary course of business since _____[*date*], on the closing date Seller will have good and marketable title to all of the properties and interests in properties, real and personal, reflected in the list [*or* appraisal] as of _____[*date*], free and clear of all mortgages, liens, or encumbrances, other than the following:

(1) The lien of current taxes not yet due and payable.

(2) Minor exceptions, not in the aggregate material.

(3) Any imperfections of title or easements that do not materially detract from or interfere with the operations, value, or use of the properties subject to it or affected by it, or materially affect title.

(4) Any liens, charges, or encumbrances as are set forth in the list [*or* appraisal].

(c) All leases included among the properties, or to which any of the properties are subject, are in good standing, valid and effective and, to the best of Seller's knowledge, information, and belief after reasonable investigation by Seller, there is not under any of those leases any existing material default or event of default or event which with notice or lapse of time or both would constitute a material default.

(d) The plants, structures, and equipment, including automotive equipment of Seller, included among the properties are in good condition and repair, subject only to ordinary wear and tear.

(e) Except to the extent set forth in Schedule 5, no restriction exits on the right of Seller to convey, assign, and

transfer all of the properties, and convey good title to them to Buyer.

Activities Since Balance Sheet Date

Section 2.06. Except as previously disclosed to Buyer in writing, since _____[*date*], Seller has not

(a) Suffered any change in its financial condition or the operations of its business, materially and adversely affecting its properties, or earning power, nor suffered any damage, destruction or loss, whether covered by insurance or not, materially and adversely affecting the properties or earning power.

(b) Sold, exchanged, or otherwise disposed of any of its properties or any interest in it.

(c) Except in the ordinary course of business, entered into any agreement or arrangement selling, exchanging, or otherwise disposing of any of its assets or granting any preferential or other right to purchase any of its assets or rights, or requiring the consent of any party to the transfer and assignment of those assets or rights.

(d) Discharged or satisfied any lien or encumbrance or paid any obligation or liability, absolute or contingent, other than current liabilities shown on its balance sheet, including noncurrent liabilities so shown which have become current by the passage of time, and current liabilities incurred since that date in the ordinary course of business.

(e) Incurred or agreed to incur any contractual obligation or liability, absolute or contingent, except current liabilities incurred or obligations under contracts entered into in the ordinary course of business.

(f) Issued any stock, bonds, or other corporate securities, or any options with respect to them.

(g) Except to the extent consistent with past practice, granted any increase in the compensation of, or paid any bonus to, any employee.

(h) Except in the ordinary course of business, waived any right or claim having value.

(i) Declared or paid any dividends, or made, or agreed to make, any other distribution to any shareholder.

(j) Mortgaged or pledged or, except in the ordinary course of business, subject to lien, charge, or any other encumbrance any of its assets, tangible or intangible.

(k) Entered into any transaction or transactions the effect of which, considered as a whole, would be to cause its net ownership in any of its [*add reference or limitation to specific properties if desired, e.g.,* oil and gas producing] properties to be materially less than it was at that date.

(l) Except with respect to any property that may have been farmed out, abandoned, or quitclaimed in the exercise of good business judgment in good faith, performed or omitted to perform any act or acts the effect of which, considered as a whole, would be to cause its net ownership in any of its [*add reference or limitation to specific interests if desired, e.g.,* nonproducing leasehold, mineral, or royalty] interests to be materially less than it was at that date.

(m) Sold, assigned, or transferred any patents, copyrights, or other intangible assets.

(n) Had any labor troubles other than routine grievance matters, none of which is material.

(o) Entered into any transaction other than in the ordinary course of business.

(p) Made any expenditure for capital items, including construction and work in process, or investment in stock of or advances in any form to corporations or business firms in excess of $_____.

Schedules Furnished

Section 2.07. Seller has delivered to Buyer the schedules listed below. To the extent that any such schedule identifies any contract, agreement, or other instrument in general terms in lieu of specific descriptions, the schedule will be supplemented by setting forth any specific descriptions that Buyer may request. If, after the date of this agreement, any change occurs in the matters reflected in any such schedule, Seller will deliver to Buyer promptly, and in any case prior to the closing date, appropriate supplements to the schedule so affected, making any deletions, modifications, and additions that may be required to provide Buyer with complete and correct information as to the matters to be reflected in each schedule. Each of the schedules, and each supplement to any of the schedules, delivered by Seller to Buyer, is substantially complete and the information reported in it or in any documents provided is correct in all material respects as of the date of that schedule or supplement.

Off-Balance Sheet Liabilities and Obligations

(a) Schedule 1: This schedule lists all indebtedness or liabilities affecting Seller or any of its assets or rights which arise under sale and leaseback arrangements, through-put agreements, and any other agreements or arrangements which fall within the category or concept of off-balance sheet financing.

Guaranties

(b) Schedule 2: This schedule lists all indebtedness or liabilities of any person, firm, or corporation which Seller has guaranteed or otherwise become liable for, including both absolute and contingent liabilities and indebtedness

Certain Material Contracts

(c) Schedule 3: This schedule lists all agreements, contracts, and other instruments, to the extent not listed in any other schedule, not cancelable by Seller on _____[*e.g.*, 90 days'] notice without penalty which involve a payment or payments to be made by or to Seller, or a liability or liabilities of or to Seller, in excess of $_____ in any year.

Pending Litigation

(d) Schedule 4: This schedule lists all litigation and proceedings pending or threatened in courts and governmental commissions and bureaus affecting Seller or any of its properties or rights which are not fully covered by insurance.

Restrictions on Transfer of Properties

(e) Schedule 5: This schedule lists any of the properties, the transfer of which by Seller as herein contemplated is subject to any restriction, or that requires the consent of any third party, pursuant to a preferential or other right of purchase or otherwise, and describes in detail each such restriction, consent requirement, or purchase right.

Options, Warrants, or Other Stock Purchase Rights

(f) Schedule 6: This schedule lists all commitments by Seller to issue shares of capital stock pursuant to outstanding options, warrants, or rights of conversion.

Employment and Deferred Compensation Contracts

(g) Schedule 7: This schedule lists all employment, deferred compensation, and similar contracts by which Seller is

bound.

Insurance

(h) Schedule 8: This schedule lists all fire, liability, and other insurance now in effect with respect to any of the properties of Seller.

Compliance With Laws and Regulations

Section 2.08. Seller is in compliance with all laws, regulations, and orders applicable to its business.

Agreement Not Violative of Law or Instrument

Section 2.09. The execution and carrying out of this agreement and compliance with the provisions of this agreement by Seller will not violate, with or without the giving of notice or passage of time, any provisions of law applicable to the Seller, and will not conflict with, or result in the breach or termination of any provision of, or constitute a default under, or result in the creation of any lien, charge, or encumbrance upon any of the properties, pursuant to any corporate charter, bylaws, indenture, mortgage, deed of trust, or other agreements or instrument to which Seller is a party or by which Seller of any of its properties may be bound.

Taxes

Section 2.10. The respective amounts reserved as provisions for taxes on Seller's balance sheet of _____[*date*], are sufficient for the payment of all unpaid federal, state, county, and local taxes, other than current ad valorem taxes not exceeding $_____, of Seller accrued for or applicable to the fiscal period ended on that date and all fiscal periods prior to it. Seller has filed all federal, state, county, and other local tax returns that are required to be filed, and has paid, or made provision for the payment of all taxes which have or may become due pursuant to the returns or pursuant to any assessment received by Seller. The Internal Revenue Service has completed its audit and review of all federal income tax returns of Seller for its fiscal year ending _____[*date*], and all prior years, and all additional taxes, interest, and penalties resulting from all known differences between the Internal Revenue Service and Seller with respect to the income tax returns have been paid.

Not in Default

Section 2.11. Seller has not received any notice of default and, to the knowledge of any of its officers or directors, is not in default under

(a) Any order, writ, injunction, or decree of any court or any commission or other administrative agency.

(b) Any agreement or obligation to which it is a party or by which it is bound or to which it may be subject.

Not Obligated for Broker's Fee

Section 2.12. Seller has not incurred any obligation or liability, contingent or otherwise, for a broker's or finder's fee in respect of the matters provided for in this agreement.

Contract or Commitment Relating to Properties

Section 2.13. Except as set forth in the list [*or* appraisal] of properties as of _____[*date*], Seller does not have any lease, contract, or commitment, written or oral, which relates to any of the properties, and it has duly complied with all provisions of that lease, contract, or commitment set forth in the list [*or* appraisal] and is not in default with respect to any of them.

Litigation

Section 2.14. Except for matters disclosed in Schedule 4, there is no litigation, proceeding, or governmental investigation pending, or, to the knowledge of any of the officers or directors of Seller, threatened, affecting Seller or any of its properties, or its right to enter into this agreement or to perform its obligations hereunder, nor do any of those officers or directors know of any ground for any such litigation, proceeding, or investigation.

Insurance

Section 2.15. Seller now has in force fire, liability, and other insurance with respect to its properties as set forth in Schedule 8 and, except in accordance with the written approval of Buyer pending the closing date, will not change, increase, or decrease any such insurance.

Approval of Board

Section 2.16. The Board of Directors of Seller, acting at a special meeting thereof called for the purpose and duly held on _____[*date*], has duly approved the transactions contemplated hereby and has authorized the execution and delivery of this agreement by Seller, and the performance by Seller. True copies of the resolution giving that authorization and approval have been given to Buyer and that authorization and approval have not since been altered, amended, or revoked.

Character of Statements

Section 2.17. The information provided and to be provided by Seller and its officers and directors to Buyer pursuant to this agreement, for use in any proxy statement or listing application, does not and will not contain any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, and does not and will not omit to state any material fact in order to make the statements in it not false or misleading.

ARTICLE 3 COVENANTS, REPRESENTATIONS, AND WARRANTIES OF BUYER

Legal Status

Section 3.01. Buyer is a corporation duly organized, validly existing, and in good standing under the laws of the State of California [*or specify other state*], with corporate power to own property and carry on its business as it is now being conducted.

Subsidiaries

Section 3.02. Buyer has no subsidiaries nor any interest in any other corporation, firm, or partnership [*or specify subsidiaries, legal status, and capitalization as appropriate*].

Capitalization

Section 3.03. Buyer has an authorized capitalization of $_____, divided into _____[*number*] shares of common stock. As of the date of this agreement, _____[*number*] shares of the common stock are validly issued and outstanding, fully paid and nonassessable.

Financial Statements

Section 3.04. Buyer has delivered to Seller the audited [*or* unaudited] balance sheet of Buyer as of _____[*date*], and the related statements of income and retained earnings for the _____[*number*] years [*or* months] then ended. All such financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and present fairly the financial position of Buyer at _____[*date*], and the results of operations for the period then ended [*add if statements are unaudited:*, subject, however, to normal changes resulting from year-end audit of the financial statements].

Properties

Section 3.05. (a) Buyer has delivered to Seller a list [*or* an appraisal] as of _____[*date*], of the properties of Buyer. The list [*or* appraisal] is substantially complete and the information reported in it is correct in all material respects. Except as previously disclosed to Buyer in writing, Seller does not know of any circumstances, events, or other information, occurring prior to or subsequent to _____[*date*], which would adversely affect the values as of _____[*date*], or subsequent to it, set forth in the list [*or* appraisal] of the properties.

(b) Except for properties and interests in properties sold or otherwise disposed of in the ordinary course of business since _____[*date*], on the closing date Buyer will have good and marketable title to all of the properties and interests in properties, real and personal, reflected in the list [*or* appraisal] as of _____[*date*], free and clear of all mortgages, liens, or encumbrances, other than the following:

(1) The lien of current taxes not yet due and payable.

(2) Minor exceptions, not in the aggregate material.

(3) Any imperfections of title or easements that do not materially detract from or interfere with the operations, value, or use of the properties subject to them or affected by them, or materially affect title.

(c) All leases included among the properties, or to which any of the properties are subject, are in good standing, valid and effective and, to the best of Buyer's knowledge, information, and belief after reasonable investigation by buyer, there is not under any of those leases any existing material default or event of default or event which with notice or lapse of time or both would constitute a material default and in respect of which Buyer has not taken adequate steps

to prevent a default from occurring.

Activities Since Balance Sheet Date

Section 3.06. Except as previously disclosed to Seller in writing, since _____[*date*], Buyer has not

(a) Suffered any change in its financial condition or the operations of its business, materially and adversely affecting its properties, or earning power, nor suffered any damage, destruction, or loss, whether covered by insurance or not, materially and adversely affecting the properties or earning power.

(b) Except in the ordinary course of business, sold, exchanged, or otherwise disposed of, or entered into any agreement or arrangement to sell, exchange, or otherwise dispose of, any of its properties, rights, or any interest in it.

Litigation

Section 3.07. There are no actions or proceedings pending, or, to the knowledge of Buyer, threatened against, by, or affecting the Buyer in any court or before any governmental agency, domestic or foreign, which, if decided adversely to the Buyer, would materially and adversely affect the condition or operations, financial or otherwise, of Buyer. Buyer, to its knowledge, is not in default with respect to any order, writ, injunction, or decree of any such court or agency.

Employment of Seller Employees

Section 3.08. At the closing, Buyer will offer to employ those employees of Seller listed in Schedule 7, on terms and conditions satisfactory to Buyer.

Status of Shares Deliverable

Section 3.09. The shares of stock of Buyer deliverable pursuant to this agreement, when issued and delivered as providing in this agreement, will be validly issued and outstanding shares of common stock of Buyer, fully paid and nonassessable, and will be voting stock of the Buyer.

Approval of Board

Section 3.10. The Board of Directors of Buyer, acting at a special meeting thereof called for the purpose and duly held on _____[*date*], has duly approved the transactions contemplated hereby and has authorized the execution and delivery of this agreement by Buyer, and the performance by Buyer. True copies of the resolution giving such authorization and approval have been given to Seller and such authorization and approval have not since been altered, amended, or revoked.

ARTICLE 4 CONDUCT OF BUSINESS OF SELLER PENDING CLOSING

Preservation of and Access to Properties, Information, and Documents

Section 4.01. From the date of this agreement until the closing date, Seller will

(a) Except for [depletion due to normal production and] depreciation through ordinary wear and tear, maintain and

keep its properties in as good condition and working order as at present.

(b) Preserve in full force to the extent consistent with best industry practices all its _____[*e.g.*, producing oil and gas] leases and any agreement entitling it to produce _____[*e.g.*, oil, gas, or other hydrocarbons], and perform all covenants and conditions imposed on it.

(c) Operate or cause to be operated all of the properties in accordance with best industry practices.

(d) Use its best efforts to perform all its obligations under contracts relating to or affecting the properties.

(e) Exercise all due diligence in safeguarding and maintaining secure all _____[*e.g.*, geological and geophysical] maps, confidential reports and data, and all other confidential data in its possession relating to the properties.

(f) Confer with Buyer regarding all significant developments and transactions relating to the properties and give to Buyer full access at any time to all the properties, books, records, tax returns, contracts, and documents of Seller.

(g) Promptly after execution of this agreement, on request of Buyer, furnish to Buyer the detailed _____[*e.g.*, engineering and geological] information on which the _____[*e.g.*, oil and gas appraisal] was based to the extent not previously furnished to Buyer.

(h) Permit Buyer and its representatives to examine those agreements, leases, abstracts of title, title policies, title opinions, title files, ownership maps, records, and surveys as relate to the properties as Buyer may request.

(i) Use its best efforts to cure all title defects of any of the properties as requested by Buyer.

Submission to Shareholders

Section 4.02. On Buyer's receipt of a permit from the California Corporations Commissioner qualifying the shares to be issued by it pursuant to this agreement, Seller will submit this agreement and the plan of liquidation and distribution contemplated by Section 1.01 of this agreement to its outstanding shares for their approval pursuant to the California General Corporation Law [*and/or specify statutes of another state if appropriate*]. Seller shall use its best efforts to cause its shareholders to adopt this agreement and the plan of liquidation and distribution.

Furnish Proxy and Listing Information

Section 4.03. Seller, and its officers and directors, will furnish to Buyer any information that shall be needed for use in any proxy statement or listing application which may be required or deemed desirable by Buyer in order to consummate the transactions contemplated by this agreement.

Satisfaction of Conditions Precedent

Section 4.04. Seller will use its best efforts to cause the satisfaction of all conditions precedent contained in this agreement.

ARTICLE 5 CONDUCT OF BUSINESS OF BUYER PENDING CLOSING

Business as Usual

Section 5.01. Pending the consummation of the plan of reorganization, Buyer will carry on its business in substantially the same manner as previously.

Satisfaction of Conditions Precedent

Section 5.02. Buyer will use its best efforts to cause the satisfaction of all conditions precedent contained in this agreement.

Negative Covenants

Section 5.03. Except with the prior written consent of Seller, Buyer will not declare or pay any dividend, or declare or make any other distribution to its shareholders.

Submission to Shareholders

Section 5.04. On Buyer's receipt of a permit from the California Commissioner of Corporations qualifying the shares to be issued by it pursuant to this agreement, Buyer shall submit this agreement and the principal terms of the assets-for-shares exchange described in this agreement to its outstanding shares of each class for their approval, as required by the California General Corporation Law. Buyer shall use its best efforts to cause its outstanding shares of each class to approve this agreement in the manner required by California's General Corporation Law.

ARTICLE 6 CONDITIONS PRECEDENT TO OBLIGATIONS OF BUYER TO CLOSE

Section 6.01. The obligations of Buyer under this agreement are subject, at Buyer's option, to the conditions that, on or before the closing date,

Proceedings and Instruments Approved by Counsel for Buyer

(a) All actions, proceedings, instruments, and documents required to carry out this agreement, or incidental to it, and all other related legal matters shall have been approved by _____, counsel for Buyer.

Opinion of Counsel for Seller

(b) Buyer shall have received an opinion of _____, counsel for Seller, dated the closing date, in form and substance satisfactory to Buyer and its counsel, to the effect that

(1) Seller is duly incorporated, validly existing, and in good standing under the laws of its state of incorporation; and is duly qualified to do business in each jurisdiction in which the character and location of its properties make that qualification necessary.

(2) Seller has an authorized capitalization of $_____, divided into _____ [*number*] shares of common stock, of which _____ [*number*] shares are validly issued and outstanding, fully paid and nonassessable.

(3) Seller has complied with all laws, regulations, and orders applicable to its business.

(4) Seller is not in default under any order, writ, injunction, or decree of any court or of any commission or other

administrative agency, nor under any agreement or obligation to which it is a party or by which it is bound or may be subject.

(5) Except as set forth in the list [*or* appraisal] of properties as of _____ [*date*], Seller does not have any lease, contract, or commitment, written or oral, which relates to any of the properties, and it has duly complied with all provisions of that lease, contract, or commitment set forth in the list [*or* appraisal] and is not in default with respect to any of them.

(6) Except for matters disclosed in Schedule 4, counsel does not know or have reason to believe that there is any litigation, proceeding, or investigation pending or threatened which might result in any material adverse change in the properties, business, or prospects or in the condition, financial or otherwise, of Seller, or which questions the validity of this agreement or of any action taken or to be taken by Seller or its shareholders, including without limitation the liquidation and dissolution proceedings of Seller, or by Buyer pursuant to or in connection with the provisions of this agreement.

(7) All corporate acts and other proceedings required to be taken by or on the part of the Seller to authorize it to carry out this agreement and to sell and transfer its properties as provided herein, and to liquidate and dissolve, have been duly and properly taken, including the approval and consent of shareholders, and this agreement has been duly executed by the Seller and is the valid and binding obligation of the Seller enforceable in accordance with its terms.

(8) No provision of the articles of incorporation or the bylaws of Seller, or of any indenture, mortgage, or other agreement known to Seller's counsel, prevents Seller from transferring good title to the properties in the manner contemplated by this agreement or has or will result in a breach of the Seller's warranties contained in Section 2.09 of this agreement.

(9) Except as set forth in the list [*or* appraisal] of properties as of _____ [*date*], good and marketable title to all of the properties has been duly vested in the Buyer, free of all claims, liens, and encumbrances.

(10) The issuance of shares of its common stock hereunder by Buyer to Seller and the transfer by the latter to its shareholders of the shares upon its liquidation and dissolution do not require the registration of the shares under the Securities Act of 1933.

Compliance With Terms, Conditions, and Covenants

(c) All the terms, conditions, and covenants of this agreement to be complied with by the Seller on or before the closing date shall have been complied with, and Seller shall have delivered to Buyer a certificate signed by its Chair of the Board and Treasurer [*or specify other officers as appropriate*] to that effect.

Truth of Representations and Warranties

(d) The representations and warranties by Seller in this agreement shall be correct, as of the closing date, with the same force as though those representations and warranties had been made on the closing date, and Seller shall have delivered to Buyer a certificate signed by its chairman and treasurer [*or specify other officers as appropriate*] to any effect and as to any other matters that the Buyer may reasonably request.

Permit Granted

(e) The California Commissioner of Corporations [*or specify official of other state as appropriate*] shall have granted to Buyer an appropriate permit authorizing it to issue shares of its common stock in accordance with this agreement.

Approval by Outstanding Shares

(f) The principal terms of this agreement and the assets-for-shares exchange covered by it shall have been approved as required by the General Corporation Law of California by the outstanding shares of each class of both Buyer and Seller.

Stock Exchange Listing

(g) The shares of common stock of Buyer to be delivered to Seller pursuant to this agreement shall have been duly listed on the American Stock Exchange [*or specify other as appropriate*], subject to official notice of issuance or distribution or other formal condition.

Commitment as to Investment Purpose

(h) All holders or owners of shares of capital stock of Seller deemed by Buyer to be controlling or dominant shareholders of Seller shall have delivered to Buyer, in form satisfactory to Buyer, agreements to the effect that they are taking the shares of common stock of Buyer to be delivered hereunder for purposes of investment and that they will not sell or distribute any of the shares in a manner which would result in a violation of the Securities Act of 1933 or the regulations under that Act.

ARTICLE 7 CONDITIONS PRECEDENT TO OBLIGATIONS OF SELLER TO CLOSE

Section 7.01. The obligations of the Seller under this agreement are, at its option, subject to the conditions that, on or before the closing date,

Proceedings and Instruments Approved by Counsel for Seller

(a) All actions, proceedings, instruments, and documents required to carry out this agreement, or incidental to it, and all other related legal matters shall have been approved by _____, counsel for the Seller.

Opinion of Counsel for Buyer

(b) Seller shall have received an opinion of _____, counsel for Buyer, dated the closing date, in form and substance satisfactory to Seller and its counsel, to the effect that

(1) Buyer is duly incorporated, validly existing, and in good standing under the laws of its state of incorporation.

(2) Seller has an authorized capitalization of $_____, divided into _____ [*number*] shares of common stock of which _____ [*number*] shares are validly issued and outstanding, fully paid and nonassessable.

(3) Buyer is not in default under any order, writ, injunction, or decree of any court or of any commission or other administrative agency, nor under any agreement or obligation to which it is a party or by which it is bound or may be subject.

(4) Counsel does not know or have reason to believe that there is any litigation, proceeding, or investigation pending or threatened which might result in any material adverse change in the properties, business, or prospects or in the condition, financial or otherwise, of Buyer, or which questions the validity of this agreement or of any action taken or to be taken by Buyer, or by Seller pursuant to or in connection with the provisions of this agreement.

(5) All corporate acts and other proceedings required to be taken by or on the part of Buyer to authorize it to carry out this agreement and to deliver the shares of common stock of Buyer deliverable as provided in this agreement have been duly and properly taken and this agreement has been duly executed by Buyer and is the valid and binding obligation of Buyer enforceable in accordance with its terms.

(6) Buyer has received an appropriate permit from the California Commissioner of Corporations [*or specify official of other state as appropriate*] in connection with the issuance of its common stock under this agreement.

(7) No provision of the articles of incorporation or the bylaws of Buyer, or of any indenture, mortgage, or other agreement, known to counsel, prevents Buyer from issuing and delivering to Seller good title to all of the shares of common stock of Buyer being delivered pursuant to the terms of this agreement.

(8) The shares of common stock of Buyer, on delivery of the certificates representing the shares in accordance with the terms of this agreement, will be duly and validly issued, fully paid and nonassessable, and voting stock of Buyer and Seller will have good title to shares issued to it.

(9) The assumption by Buyer of the debts, liabilities, and obligations of Seller, as provided in this agreement, has been duly and validly authorized, and the agreement evidencing that assumption has been duly executed and delivered by Buyer and is valid and binding upon Buyer in accordance with its terms.

(10) The issuance of shares of its common stock under this agreement by Buyer to Seller and the transfer by the latter to its shareholders of the shares upon its liquidation and dissolution do not require the registration of the shares under the Securities Act of 1933.

(11) The shares of common stock of Buyer to be issued under this agreement have been duly authorized for listing on the American Stock Exchange [*or specify other as appropriate*] on official notice of issuance.

Compliance With Terms, Conditions, and Covenants

(c) All the terms, conditions, and covenants of this agreement to be complied with by Buyer on or before the closing date shall have been complied with, and Buyer shall have delivered to Seller a certificate signed by its chief executive officer [*or specify other officer or officers as appropriate*] to that effect.

Truth of Representations and Warranties

(d) The representations and warranties made by Buyer herein shall be correct, as of the closing date, with the same force as if the representations and warranties had been made on the closing date, and Buyer shall have delivered to Seller a certificate signed by its chief executive officer [*or specify other officer or officers as appropriate*] to that effect and as to any other matters that the Seller may reasonably request.

Favorable Tax Ruling

(e) Seller shall have received a written ruling or rulings of the Internal Revenue Service, satisfactory to its counsel, to the effect that the sale of the assets and business of Seller and the distribution to the shareholders of Seller of the shares of common stock of Buyer in connection with the liquidation and dissolution of Seller, all as contemplated in this agreement, will not result in the recognition of any taxable income or deductible loss by Seller or by its shareholders.

No Substantial Adverse Change

(f) There shall have been no substantial adverse change in the financial condition or operations of Buyer [and no suspension of trading in its stock on the American Stock Exchange *or specify other as appropriate*].

Approval of Shareholders

(g) All corporate proceedings requisite to the sale and transfer by Seller of its properties, and its liquidation and dissolution, shall have been approved and consented to by the shareholders of Seller in the manner required by applicable law or other applicable requirements.

Approval by Outstanding Shares

(h) The principal terms of this agreement have been approved, as required by the General Corporation Law of California, by the outstanding shares of each class of both Buyer and Seller.

ARTICLE 8 CONSUMMATION OF TRANSACTION

Consideration of Seller

Section 8.01. (a) Except for cash, not exceeding $_____, in any amount that Seller shall deem necessary to pay all fees, costs, and expenses incurred by it in carrying out this plan and agreement of reorganization, Seller will deliver to Buyer, on the closing date, in the form satisfactory to counsel for Buyer, instruments of transfer for all of the properties of Seller as those properties shall exist on the closing date, including, without limitation, the goodwill and corporate name of Seller, and all Seller's books and records. Except for minute books, stock books, and corporate records, which shall be delivered within a reasonable time after its dissolution, Seller shall deliver to Buyer, on the closing date, possession of the properties so transferred to it.

(b) Seller shall use the retained cash specified in Subsection (a), above, only to pay fees, costs, and expenses incurred by it in carrying out this plan and agreement of reorganization and shall pay to Buyer, at the expiration of _____[*e.g.*, 120 days] after the closing date, any balance remaining unpaid.

Consideration of Buyer

Section 8.02. (a) Except for liabilities and obligations specified in Subsection (b), below, upon receipt of the properties of Seller, Buyer will assume, and will deliver to Seller, the appropriate instruments evidencing assumption by Buyer of all of the liabilities and obligations of Seller reflected or referred to in its list [*or* appraisal] of properties as of _____[*date*], and thereafter incurred in the ordinary course of business to and including the closing date, including all obligations under agreements, contracts, and other arrangements to which it is a part.

(b) Buyer shall not assume nor be responsible for any of the following items:

(1) Fees, costs, and expenses incurred by Seller in carrying out the plan and agreement of reorganization.

(2) Any liability of Seller to its shareholders, whether or not arising from the plan and agreement of reorganization.

(3) Any taxes imposed upon Seller by reason of the plan and agreement of reorganization.

(4) Any liability or obligation of Seller with respect to taxes, assessments, or other governmental charges for periods prior to _____ [*date*], not described or in excess of the amounts provided therefor in the balance sheet of Seller as of _____ [*date*].

Dissolution of Seller

Section 8.03. (a) Promptly after the closing date, Seller shall proceed with due diligence to wind up its affairs, liquidate, and distribute its assets, including the shares of common stock of Buyer received pursuant to the exchange, and voluntarily dissolve.

(b) In connection with the winding up of its affairs, Seller shall proceed promptly after the closing date to prepare and file all income tax returns and reports required under applicable law, state or federal, covering all periods prior to the closing date for which tax returns and reports have not previously been filed and, if requested in writing by Buyer, shall file a request for prompt assessment under *Internal Revenue Code Section 6501(d)* for all open years. Prior to filing, Seller shall submit all tax returns and reports to Buyer for examination and approval.

Expenses

Section 8.04. Each party shall pay its own expenses incident to this agreement and the transactions contemplated by this agreement, including all fees of its counsel, accountants, and employees whether or not those transactions shall be consummated.

ARTICLE 9 INTERPRETATION AND ENFORCEMENT

Indemnification

Section 9.01. (a) Each party agrees to protect, defend, indemnify, and hold harmless the other party, its successors and assigns, against and in respect of all loss, damage, or expense occasioned by any breach by the indemnifying party of any of its representations, warranties, covenants, or agreements contained herein.

(b) Each party will indemnify and hold harmless the other party against and in respect of any claim for brokerage or other commission relative to this agreement or to the transactions contemplated by this agreement, based in any way on agreements, arrangements, or understandings claimed to have been made by that party with any third party.

(c) Seller agrees to indemnify and hold harmless the Buyer from any loss, damage, or expenses, including reasonable counsel fees, sustained or incurred by Buyer by reason of any claim asserted against Buyer to pay or discharge any liability or obligation of Seller not expressly assumed by Buyer under the terms of this agreement.

[*Add, if buyer will insure or self-insure against products liability arising out of past sales by seller:*]

(d) Buyer agrees to indemnify and hold Seller harmless from any loss, damage, or expenses, including reasonable counsel fees, sustained or incurred because of any liability when both of the following conditions are true:

(1) The liability is for injury or damage caused by a defect in the design or manufacture of a product sold by Seller on the course of Seller's operation of the business; and

(2) Seller has no actual knowledge of the liability or potential liability at the closing date.

For purposes of Subsection (c), above, this paragraph constitutes an assumption of liability.

Specific Performance

Section 9.02. Seller acknowledges that the properties to be transferred to Buyer pursuant to plan and agreement of

reorganization are unique and that Buyer will have no adequate remedy at law if Seller shall fail to perform any of its obligations under this agreement. In that event, Buyer shall have the right, in addition to all other rights, and remedies, to specific performance of this plan and agreement of reorganization.

Survival of Covenants, Representations, and Warranties

Section 9.03. All covenants, agreements, representations, and warranties made under this agreement and in any certificates delivered at the closing shall be deemed to be material and to have been relied on by Buyer and Seller, notwithstanding any investigation made by Buyer and Seller or on their respective behalfs, and shall survive the closing.

Assignment

Section 9.04. Except with the written consent of the other party, the rights and obligations under this agreement shall not be assignable by either party. Nothing herein expressed or implied is intended to confer upon any person, other than the parties or their respective successors, assigns, heirs, and legal representatives, any rights, remedies, or liabilities under or by reason of this agreement.

Notices

Section 9.05. Any notice or other communication required or permitted under this agreement shall be deemed to be properly given when deposited in the United States mails for transmittal by certified or registered mail, postage prepaid, or when deposited with a public telegraph company for transmittal, charges prepaid, if that communication is addressed

(a) In the case of Seller, to _____[*corporate name, name of officer concerned, street address, city, and state*] or to any other person or address that Seller may from time to time furnish to Buyer for the purpose of giving notice.

(b) In the case of Buyer, to _____[*corporate name, name of officer concerned, street address, city, and state*] or to any other person or address that Buyer may from time to time furnish to Seller for the purpose of giving notice.

Entire Agreement; Counterparts

Section 9.06. This instrument and the exhibits to it contain the entire agreement between the parties with respect to the transaction contemplated. It may be executed in any number of counterparts, each of which shall be deemed an original, but those counterparts together constitute only one and the same instrument.

Controlling Law

Section 9.07. The validity, interpretation, and performance of this agreement shall be controlled by and construed under the laws of the State of _____, the state in which this agreement is executed.

Executed on _____[*date*], at _____[*city and state*].

SELLER
By _____ [*signature*]

[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]
BUYER
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Directors & OfficersMergers & Acquisitions LawLiabilities & Rights of SuccessorsDuty to Warn



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART IV. FORMS

5-11E California Legal Forms--Transaction Guide § 11E.201

§ 11E.201 Agreement for Exchange of Voting Shares of Acquiring Corporation's Parent Corporation for Substantially All Assets of Selling Corporation

[1] Comment

[a] Use of Form

This form is an agreement under which shares of a parent corporation are to be issued in exchange for all, or substantially all, the assets of another corporation but the assets of that corporation are to be transferred, not to the parent corporation, but to its subsidiary. This type of transaction is sometimes referred to as a "triangular" transaction.

The transaction is designed as a tax-free assets-for-shares exchange [*I.R.C. § 368(a)(1)(C)*]. Under the Internal Revenue Code, for the transaction to be tax-free substantially all of the assets of the selling corporation must be acquired by the acquiring corporation solely in exchange for its voting shares or the voting shares of its parent corporation [*I.R.C. § 368(a)(1)(C)*]. In the agreement set forth in this form, the selling corporation's assets are being acquired by the acquiring corporation solely in exchange for voting shares of its parent corporation.

[b] Approval Requirements

The California General Corporation Law classifies the transaction contemplated by the agreement set forth in this form as a "sale-of-assets reorganization" and requires it to be approved by the boards of directors and outstanding shares of *all three corporations* [*Corp. Code §§ 181(c), 1200(c), (e), 1201(a)*].

The corporation whose shares are being exchanged for all assets of the selling corporation is labeled by the General Corporation Law a "parent party" [*Corp. Code § 1200(e)*]. A "parent party" is a corporation in control of the acquiring corporation whose shares, instead of those of the acquiring corporation, are being exchanged for the assets of the selling corporation [*Corp. Code § 1200(e)*]. The contemplated assets-for-shares exchange must be approved by its board of directors and outstanding shares as well as those of the acquiring corporation [*Corp. Code §§ 1200(e), 1201(a)*]. The management of the parent party, being in control of the acquiring corporation, can guarantee, of course, that the proposed transaction will be approved by the board of directors and outstanding shares of the acquiring corporation. It cannot, however, guarantee the proposed transaction will be approved by the outstanding shares of each class of the

parent party itself.

[c] Qualification of Shares

Before approval of this agreement by the outstanding shares of any corporation--in this case, the selling corporation, the acquiring corporation, or the acquiring corporation's parent party--the parent party must obtain a permit from the California Corporations Commissioner for the shares to be issued by it under this agreement. An application for such a permit is *set forth in Ch. 11C, Mergers, § 11C.204*; see also *§ 11E.21* and Ch. 6H, *Qualification of Securities* .

[d] Assumption of Liabilities

Since the agreement provides for dissolution of the selling corporation, the acquiring corporation may become liable for products liability claims based on previous product sales by the selling corporation [*see Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 136 Cal. Rptr. 574* ; *see also § 11E.24[4]*]. For a discussion of means by which the buyer can limit its exposure to those liabilities, see *Ch. 11B, Cash Purchase of Assets, § 11B.200*.

[2] Form

Agreement for Exchange of Voting Shares of Acquiring Corporation's Parent Corporation for Substantially All Assets of Selling Corporation

PLAN AND AGREEMENT OF REORGANIZATION
by transfer of stock of _____ [*name of parent corporation*] to _____ [*name of acquired corporation*] in exchange for transfer of substantially all the property and assets of _____ [*name of acquired corporation*] to _____ [*name of acquiring (subsidiary) corporation*]

Parties

_____[*Name of acquired corporation*], _____[*name of parent corporation*], and _____[*name of acquiring (subsidiary) corporation*], hereby agree as follows:

ARTICLE 1 PLAN OR REORGANIZATION

Plan Adopted

Section 1.01. A plan of reorganization among the parties, in accordance with *Internal Revenue Code Section 368(a)(1)(C)*, is hereby adopted as follows:

(a) _____[*Name of acquiring (subsidiary) corporation*], control (as the term is defined in the applicable provisions of the Internal Revenue Code) of which is in _____[*name of parent corporation*], will acquire from _____[*name of acquired corporation*] substantially all the properties of _____[*name of acquired corporation*].

(b) _____[*Name of acquiring (subsidiary) corporation*] will assume certain liabilities of _____[*name of acquired corporation*].

(c) _____[*Name of parent corporation*] will cause to be delivered to _____[*name of acquired corporation*] _____[*number*] shares of the common stock of _____[*name of parent corporation*].

(d) _____[*Name of acquired corporation*] will wind up its affairs, liquidate and distribute its assets, including the shares of common stock of _____[*name of parent corporation*] received pursuant to the exchange, and voluntarily dissolve.

Closing Date

[*EITHER*]

Section 1.02. Subject to the conditions precedent set forth in this agreement, this plan of reorganization shall be consummated at any time and place mutually agreed on by _____[*name of parent corporation*], _____[*name of acquiring (subsidiary) corporation*], and _____[*name of acquired corporation*], on or after _____[*date*]. The date of that consummation is the "closing date" referred to in this agreement.

[*OR*]

Section 1.02. Subject to the conditions precedent set forth in this agreement, the plan of reorganization shall be consummated at _____[*office, street address, city, and state*], on _____[*date*], at _____ M., or any other place and date that may be fixed by mutual consent of the parties. The date of that consummation is the "closing date" referred to in this agreement.

[*Continue with the following:*]

ARTICLE 2 COVENANTS, REPRESENTATIONS, AND WARRANTIES OF _____ [*name of acquired corporation*]

Legal Status

Section 2.01. _____[*Name of acquired corporation*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of California [*or specify other state*], with corporate power to own property and carry on its business as it is now being conducted. Copies of the articles of incorporation of _____[*name of acquired corporation*], certified by the Secretary of State of _____[*name of state*] and previously delivered to _____[*names of parent and acquiring (subsidiary) corporations*], are complete and accurate as of the date hereof. _____[*Name of acquired corporation*] is qualified to transact business as a foreign corporation and is in good standing in all jurisdictions in which its principal properties are located [*or* is not required to be qualified as a foreign corporation to transact business in any other jurisdiction].

Subsidiaries

Section 2.02. _____[*Name of acquired corporation*] has no subsidiaries or any interest in any other corporation, firm, or partnership [*or specify subsidiaries, legal status, and capitalization*].

Capitalization

Section 2.03. _____[*Name of acquired corporation*] has an authorized capitalization of _____[*number*] shares of capital stock, all of one class, of which on the date of this agreement _____[*number*] shares are validly issued and outstanding, fully paid and nonassessable. _____[*Name of acquired corporation*] does not have any other securities outstanding or any obligation of any kind to issue any additional stock or other securities.

Financial Statements

Section 2.04. (a) Attached as Exhibits _____ through _____ are the audited [*or* unaudited] balance sheet of _____[*name of acquired corporation*] as of _____[*date*], and the related statements of income and retained earnings for the _____[*number*] years [*or* months] then ended. All such financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and present fairly the financial position of _____[*name of acquired corporation*] at _____[*date*], and the results of operations for the period then ended [*add if statements are unaudited:*, subject, however, to normal changes resulting from year-end audit of the financial statements].

(b) Subject to any changes that may have occurred in the ordinary and usual course of business, the assets of _____[*name of acquired corporation*] at the closing date will be substantially those owned by it and shown on its balance sheet as of _____[*date*].

(c) The book value of the assets shown on the balance sheet as of _____[*date*], correspond substantially to the values of those assets for federal income tax purposes.

Location of and Title to Assets

Section 2.05. All book assets of _____[*name of acquired corporation*] are in existence, are in good condition and repair, are in its possession, and are located at _____[*street address, city, and state*]. Except for any liens or encumbrances which are shown on its financial statements as of _____[*date*], or which have arisen in the ordinary course of business since the date of those financial statements and which do not interfere with the conduct of its business in the ordinary course, _____[*name of acquired corporation*] has good and marketable title to all of its assets and holds those assets subject to no mortgage, lien, or encumbrance.

Material Liabilities Disclosed

Section 2.06. Except as set forth in Exhibit _____, _____[*name of acquired corporation*] does not have any unrealized or anticipated losses or any unfavorable commitment or contract, and all material liabilities of _____[*name of acquired corporation*], fixed or contingent, as of _____[*date*], including but not limited to all liabilities for taxes based upon or measured by income, are disclosed and adequately provided for in the balance sheet as of _____[*date*].

No Material Changes

Section 2.07. Except for changes, not materially adverse to the business of _____[*name of acquired corporation*], resulting from transactions in the ordinary course of business, changes contemplated by this agreement, and changes set forth in Exhibit _____, there has been no material change in the assets, liabilities, or financial condition of _____[*name of acquired corporation*] since _____[*date*].

Material Contracts Listed

Section 2.08. Exhibit _____ lists the only employment contracts with officers or employees, the only employee benefit plans or programs, and the only material contracts to which _____[*name of acquired corporation*] is a party or under which it is bound. For the purposes of this subsection, material contracts are limited to contracts which involve payments or liabilities of _____[*name of acquired corporation*] in excess of $_____ and shall not include policies of life insurance issued in the ordinary course of business.

Litigation

Section 2.09. Except as set forth in Exhibit _____, there is no order, writ, or judgment or any litigation or administrative proceeding pending or threatened against or affecting _____[*name of acquired corporation*] which might result in any material adverse change in the properties, business operations, or condition, financial or otherwise, of _____[*name of acquired corporation*].

Compliance With Tax and Other Laws and Regulations

Section 2.10. _____[*Name of acquired corporation*] is in compliance in all material respects with all laws, regulations, and orders applicable to its business, including the filing of all income and other tax returns that are required to be filed. Income tax returns of _____[*name of acquired corporation*] have been examined by federal tax authorities, or the period of limitations has expired, for all years through the dates set forth in Exhibit _____ and, except as otherwise set forth in Exhibit _____, all deficiencies or assessments determined as a result of those examinations have been paid or settled.

No Broker or Finder

Section 2.11. _____[*Name of acquired corporation*] has not retained or otherwise utilized the services of any broker or finder in connection with any of the transactions contemplated by this agreement.

Disclosure

Section 2.12. On the date of this agreement, _____[*name of acquired corporation*] has, and at the closing date it will have, disclosed all events, conditions, and facts materially affecting its current and future business and prospects. _____[*Name of acquired corporation*] has not now and will not, at the closing date, have withheld knowledge of any events, conditions, and facts which it knows, or has reasonable ground to know, may materially affect its current and future business and prospects. None of the representations and warranties made by _____[*name of acquired corporation*] in this agreement and contained in any certificate or other instrument furnished or to be furnished to _____[*names of parent and acquiring (subsidiary) corporations*] pursuant to this agreement contains or will contain any untrue statement of a material fact, or omits or will omit to state a material fact necessary in order to make the statements contained in this agreement not misleading.

ARTICLE 3 COVENANTS, REPRESENTATIONS, AND WARRANTIES OF _____ [*name of parent corporation*]

Legal Status

Section 3.01. _____[*Name of parent corporation*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of _____[*e.g.*, Delaware], and is duly qualified to transact its business and is in good standing under the laws of the State of California, the only state in which it is presently conducting its business.

Capitalization

Section 3.02. _____[*Name of parent corporation*] has an authorized capitalization consisting of _____[*number*] shares of _____[*e.g.*, 4.5 percent convertible preferred stock], and _____[*number*] shares of common stock. At the close of business on _____[*date*], there were outstanding _____[*number*] shares of the _____[*e.g.*, convertible preferred stock] and _____[*number*] shares of common stock; there were reserved _____[*number*] shares of the common stock for conversion of the [*e.g.*, convertible preferred stock]; and there were reserved _____[*number*] shares of the common stock for issuance under a stock option plan.

Control of Acquiring (Subsidiary) Corporation

Section 3.03. _____[*name of parent corporation*] owns _____[all *or specify percentage of 80 or more*] of the capital stock of _____[*name of acquiring (subsidiary) corporation*] and is in control of that corporation as that term is defined in applicable provisions of the Internal Revenue Code.

Status of Shares Being Transferred

Section 3.04. All outstanding shares of capital stock of _____[*name of parent corporation*], issued and to be issued or delivered pursuant to the exchange hereunder, are or will be validly issued, fully paid and nonassessable shares[, and are or will be listed on _____ (*e.g.*, the New York and the Pacific Stock Exchange)].

Authority to Execute Agreement

Section 3.05. The Board of Directors or the Executive Committee of the Board of Directors of _____[*name of parent corporation*] has duly approved, or will approve, this agreement and the transaction contemplated and has authorized, or will authorize, the execution, delivery, and performance by _____[*name of parent corporation*]. Approval of this agreement and of the principal terms of the contemplated transaction by the shareholders of _____[*name of parent corporation*] will be solicited on receipt of a permit from the California Commissioner of Corporations for the shares to be issued under this agreement by _____[*name of parent corporation*].

ARTICLE 4 COVENANTS, REPRESENTATIONS, AND WARRANTIES OF _____ [*name of acquiring (subsidiary) corporation*]

Legal Status

Section 4.01. _____[*Name of acquiring (subsidiary) corporation*] is a corporation duly organized, validly existing, and in good standing under the laws of the State of California [*or specify other state*], with corporate

power to own property and carry on its business as it is now being conducted. Copies of the articles of incorporation of _____[*name of acquiring (subsidiary) corporation*], certified by the Secretary of State of _____[*name of state*] and previously delivered to _____[*name of acquired corporation*], are complete and accurate as of the date of this agreement. _____[*name of acquiring (subsidiary) corporation*] is qualified to transact business as a foreign corporation and is in good standing in all jurisdictions in which its principal properties are located [*or* is not required to be qualified as a foreign corporation to transact business in any other jurisdiction].

Capitalization

Section 4.02. _____[*Name of acquiring (subsidiary) corporation*] has an authorized capitalization of _____[*number*] shares of capital stock, all of one class, of which on the date hereof _____[*number*] shares are issued and outstanding, fully paid and nonassessable. _____[All *or specify percentage of 80 or more*] of the issued and outstanding shares of _____[*name of acquiring (subsidiary) corporation*] are owned by _____[*name of parent corporation*], which is in control of _____[*name of acquiring (subsidiary) corporation*] as that term is defined in the applicable provisions of the Internal Revenue Code.

ARTICLE 5 CONDUCT OF BUSINESS OF _____ [*name of acquired corporation*] PENDING CLOSING

Access to Information and Documents

Section 5.01. (a) _____[*Name of acquired corporation*] will afford _____[*names of parent and acquiring (subsidiary) corporations*] and accredited representatives of each, from the date of this agreement until consummation of the plan of reorganization, full access during normal business hours to all properties, books, accounts, contracts, commitments, and records of every kind of _____[*name of acquired corporation*] in order that _____[*names of parent and acquiring (subsidiary) corporations*] may have full opportunity to make any investigation that they desire of, and keep themselves informed with respect to, the affairs of _____[*name of acquired corporation*].

(b) In addition, _____[*name of acquired corporation*] will permit _____[*names of parent and acquiring (subsidiary) corporations*] to make extracts or copies of all books, accounts, commitments, and records, and will furnish to _____[*names of parent and acquiring (subsidiary) corporations*], within _____[*e.g.*, 10 days] after demand, any further financial information and operating data and other information with respect to the business and properties of the corporation as they may reasonably request from time to time.

(c) _____[*names of parent and acquiring (subsidiary) corporations*] will use any information obtained under this section and this agreement only for their own purposes in connection with the transaction contemplated hereby and will not divulge the information to any persons not entitled to it.

Carry on Business as Usual

Section 5.02. Except as required or permitted by this agreement, or consented to in writing by _____[*name of parent corporation*] or _____[*name of acquiring (subsidiary) corporation*], pending consummation of the plan or reorganization, _____[*name of acquired corporation*] will carry on its business in substantially the same manner in which that business has been conducted

previously.

Submission to Shareholders

Section 5.03. (a) On receipt of a permit from the California Corporations Commissioner by _____[*name of parent corporation*] qualifying the shares to be issued by _____[*name of parent corporation*] under this agreement, _____[*name of acquired corporation*] will cause a meeting of its shareholders to be called and held for the purposes of

(1) Authorizing and approving, as required by California's General Corporation Law, the acquisition of substantially all of the properties of _____ [*name of acquired corporation*] by _____ [*name of acquiring (subsidiary) corporation*] on the terms and conditions set forth in this agreement.

(2) If requested by _____ [*name of acquiring (subsidiary) corporation*], changing the name of _____ [*name of acquired corporation*].

(3) Approving and consenting to a plan of complete liquidation and voluntary dissolution of _____ [*name of acquired corporation*].

(b) Any proxy material to be sent to shareholders of _____[*name of acquired corporation*] in connection with the meeting referred to in Subsection (a) shall first be approved by _____[*names of parent and acquiring (subsidiary) corporations*].

Consents to Transfer

Section 5.04. As soon as reasonably practicable after the execution of this agreement and in any event on or prior to the closing date, _____[*name of acquired corporation*] will obtain the consent of all necessary persons to the assignment and transfer to _____[*name of acquiring (subsidiary) corporation*] of all of the properties and agreements to be assigned and transferred to _____[*name of acquiring (subsidiary) corporation*] under the terms of this agreement. Specifically, without limiting the generality of the preceding sentence, _____[*name of acquired corporation*] shall obtain, on or before the closing date, appropriate agreements from the holders of its outstanding long-term debt obligations permitting the exchange, including the transfer to and assumption by _____[*name of acquiring (subsidiary) corporation*] of those debt obligations and the retirement by _____[*name of acquiring (subsidiary) corporation*], at any time on or before _____[*e.g.*, 30 days] after the closing date, of those debt obligations at an aggregate prepayment premium not to exceed $_____.

Satisfy Conditions Precedent

Section 5.05. _____[*Name of acquired corporation*] will use its best efforts to cause the satisfaction of all conditions precedent.

Negative Covenants

5.06. Except with the prior approval of _____[*name of acquiring (subsidiary) corporation*], pending consummation of the plan of reorganization, _____[*name of acquired corporation*] will not

(a) Except in accordance with established employment practices, enter into any contract of employment with any officers or employees.

(b) Make any material change in employee pension arrangements, formal or informal, or in any other employee benefits.

(c) Make any unusual purchase, sale, or commitment for the purchase or sale of any securities, investments, or other assets.

(d) Make any unusual capital expenditures or commitments.

(e) Incur or assume any liabilities, contingent or otherwise, or subject to lien or encumbrance any assets other than in the ordinary course of business.

(f) Make any loans or advances to shareholders or, except in accordance with established dividend policies, declare or pay any dividends or make any other distribution to shareholders.

(g) Except for the issuance of additional shares upon conversion of convertible securities or exercise of stock options outstanding on _____[*date*], and for the redemption for cash of the _____[*number*] outstanding shares of _____[*e.g.*, 6 percent junior cumulative preferred stock] at an aggregate redemption price of $_____, plus unpaid accumulated dividends, purchase, redeem, retire, acquire, or agree to do so, or issue, sell, or grant any option or right to purchase or otherwise dispose of, or agree to do so, any shares of its capital stock.

ARTICLE 6 CONDUCT OF BUSINESS OF _____ [*name of parent corporation*] PENDING CLOSING

Business as Usual

Section 6.01. _____[*Name of parent corporation*] will carry on its business in substantially the same manner in which that business has been conducted previously. [It is understood that _____ (*name of parent corporation*) has several acquisitions in process or under consideration which will require delivery of shares of stock of _____ (*name of parent corporation*) in exchange for assets or stock of the companies being acquired.]

Access to Information

Section 6.02. _____[*Name of parent corporation*] will furnish to _____[*name of acquired corporation*] any information relating to its business that is reasonably requested by _____[*name of acquired corporation*] for use in the proxy statement to be mailed to the shareholders of _____[*name of acquired corporation*] with respect to the plan of reorganization. That information will not include any untrue statement of a material fact, or omit any material fact if that omission would make the information involved false or misleading.

Obtain Permit

Section 6.03. _____[*Name of parent corporation*] will use due diligence to obtain any necessary permit from the California Commissioner of Corporations with respect to the transaction contemplated by this agreement, and to comply with all other legal requirements applicable to it with respect to the matters contemplated in

this agreement.

Shareholder Approval

Section 6.04. When _____[*name of parent corporation*] receives the permit described in Section 6.03 of this agreement, it will

(a) Solicit, either by means of their written consent or by calling a shareholders' meeting for that purpose, approval by its outstanding shares of each class, as required by the General Corporation Law of California, of the principal terms of the transaction contemplated by this agreement; and

(b) As controlling shareholder of _____[*name of acquiring (subsidiary) corporation*], cause the principal terms of the transaction contemplated by this agreement to be approved, as required by the General Corporation Law of California, by the outstanding shares of each class of _____[*name of acquiring (subsidiary) corporation*].

ARTICLE 7 CONDUCT OF BUSINESS OF _____ [*name of acquiring (subsidiary) corporation*] PENDING CLOSING

Carry on Business as Usual

Section 7.01. _____[*Name of acquiring (subsidiary) corporation*] will carry on its business in substantially the same manner in which that business has been conducted previously.

Satisfy Conditions Precedent

Section 7.02. _____[*Name of acquiring (subsidiary) corporation*] will use its best efforts to cause the satisfaction of all conditions precedent contained in this agreement.

ARTICLE 8 CONDITIONS PRECEDENT TO OBLIGATIONS OF _____ [*names of parent and acquiring (subsidiary) corporations*]

Section 8.01. All of the obligations of _____[*names of parent and acquiring (subsidiary) corporations*] under this agreement are subject to the following conditions having been fulfilled on or before the closing date:

Truth of Representations and Warranties and Performance of Obligations

(a) The representations and warranties made by _____[*name of acquired corporation*] in this agreement shall be true in all material respects as of the closing date, with the same force as if those representations and warranties had been made on the closing date, and _____[*name of acquired corporation*] shall have performed in all material respects its obligations under this agreement to be performed on or before the closing date. _____[*name of parent corporation*] shall have received a certificate, dated the closing date, executed by the President and the Treasurer or Controller of _____[*name of acquired corporation*] confirming and verifying to the best of their knowledge the truth of the representations and warranties and the performance of the obligations, and containing any other assurances as _____[*name of parent corporation*] may reasonably request.

Permit Granted

(b) The California Commissioner of Corporations shall have granted to _____[*name of parent corporation*] an appropriate permit authorizing it to issue shares of its common stock in accordance with this agreement.

[*Optional provision:*]

Stock Exchange Listing

(c) The _____[*e.g.,* New York Stock Exchange and the Pacific Stock Exchange] shall have approved for listing on notice of issuance the shares of common stock to be issued in accordance with this agreement.

[*Continue with the following:*]

Shareholder Approval

(d) The principal terms of the transaction contemplated by this agreement shall have been, as required by the General Corporation Law of California, approved by the outstanding shares of each class of _____[*name of parent corporation*], _____[*name of acquiring (subsidiary) corporation*], and _____[*name of acquired corporation*].

Commitment as to Investment Purpose

(e) All holders or owners of shares of capital stock of _____[*name of acquired corporation*] deemed by _____[*name of parent corporation*] to be controlling or dominant shareholders of _____[*name of acquired corporation*] shall have delivered to _____[*name of parent corporation*], in form satisfactory to _____[*name of parent corporation*], agreements to the effect that they are taking the shares of common stock of _____[*name of parent corporation*] to be delivered hereunder for purposes of investment and that they will not sell or distribute any of the shares in a manner that would result in a violation of the Securities Act of 1933 or the regulations under that Act, or the California Corporate Securities Law of 1968.

Opinion of Counsel for Acquired Corporation

(f) _____[*Name of acquired corporation*] shall have delivered to _____[*name of parent corporation*] an opinion or opinions of counsel for _____[*name of acquired corporation*], dated the closing date, in form and substance satisfactory to counsel for _____[*name of parent corporation*], to the effect that:

(1) _____ [*Name of acquired corporation*] is duly incorporated, validly existing, and in good standing under the laws of its state of incorporation, is duly qualified to transact its business, possesses all necessary permits and licenses, and is in good standing under the laws of each jurisdiction in which its business is conducted, and all such permits and licenses will continue in full force following the exchange and shall not be subject to cancellation or revocation as a consequence of the exchange.

(2) This agreement has been duly and validly authorized, executed, and delivered by _____ [*name of acquired corporation*] and is valid and binding on _____ [*name of acquired corporation*] in accordance with its terms, and the sale of properties and the consideration for it as provided in this agreement are valid and binding on the shareholders of _____ [*name of acquired corporation*].

(3) All corporate proceedings requisite to the sale and transfer by _____ [*name of acquired* corporation] of its properties, its change of name, and its liquidation and dissolution have been duly had and taken, including the approval and consent of shareholders in the manner required by applicable law, and any other applicable requirements.

(4) Except as set forth in Exhibit _____, counsel does not know or have reason to believe that there is any litigation, proceeding, or investigation, pending or threatened, that might result in any material adverse change in the properties, business, or prospects or in the condition, financial or otherwise, of _____ [*name of acquired corporation*], or which questions the validity of this agreement or of any action taken or to be taken by _____ [*name of acquired corporation*] or its shareholders, including without limitation the liquidation and dissolution proceedings of _____ [*name of acquired corporation*] or by _____ [*name of parent corporation*] or _____ [*name of acquiring (subsidiary) corporation*] pursuant to or in connection with the provisions of this agreement.

(5) Except for restrictions and limitations that have been satisfied by _____ [*name of acquired corporation*] by obtaining all appropriate and sufficient waivers or consents, counsel does not know or have any reason to believe that there are any restrictions or limitations on the power of _____ [*name of acquired corporation*] to sell, transfer, and deliver to _____ [*second corporation*] all of the properties and business to be sold by _____ [*name of acquired corporation*] under this agreement that would materially affect the use by _____ [*name of acquiring (subsidiary) corporation*] of those properties and business.

(6) Except for those defects that do not materially interfere with the use of the property for the business conducted by _____ [*name of acquired corporation*], or as disclosed in the financial statement of _____ [*name of acquired corporation*] as of _____ [*date*], or in Exhibit _____, counsel does not know of or have any reason to believe that there are any defects in the title of _____ [*name of acquired corporation*] to the personal property or the real property to be conveyed hereunder.

(7) The issuance of shares of its common stock under this agreement by _____ [*name of parent corporation*] to _____ [*name of acquired corporation*] and the transfer of those shares by _____ [*name of acquired corporation*] to its shareholders upon its liquidation and dissolution do not require the registration of the shares under the Securities Act of 1933.

Certificate of Accountants

(g) _____[*Name of parent corporation*] shall have received from _____[*name*], certified public accountants, a certificate or letter dated as of the closing date to the effect that on the basis of the latest available interim financial statements prepared by _____[*name of acquired corporation*], consultations with responsible officers of _____[*name of acquired corporation*], and other pertinent inquiries, they have no reason to believe that during the period from _____[*date*], to a specified date not more than _____[*e.g.*, five] business days prior to the closing date, there have been any changes, other than changes required or expressly permitted by this agreement or requested in writing by _____[*name of parent corporation*], which would have a material adverse effect on the financial condition or results of operations of _____[*name of acquired corporation*] from the condition reflected in the financial statements of _____[*name of acquired corporation*] at _____[*date*], as set forth in Exhibits _____ through _____.

Additional Data

(h) _____[*Name of parent corporation*] shall have received any additional certificates, opinions, and documents as it may reasonably request.

ARTICLE 9 CONDITIONS PRECEDENT TO OBLIGATIONS OF _____ [*name of acquired corporation*]

Section 9.01. All of the obligations of _____[*name of acquired corporation*] under this agreement are subject to the following conditions having been fulfilled on or before the closing date:

Truth of Representations and Warranties and Performance of Obligations

(a) The representations and warranties made by _____[*name of parent corporation*] and _____[*name of acquiring (subsidiary) corporation*] in this agreement shall be true in all material respects as of the closing date with the same force as if those representations and warranties had been made on the closing date, and _____[*name of parent corporation*] and _____[*name of acquiring (subsidiary) corporation*] shall have performed in all material respects their obligations under this agreement to be performed on or before the closing date. _____[*name of acquired corporation*] shall have received a certificate, dated the closing date, executed by the President or a Vice President and the Treasurer or an Assistant Treasurer of _____[*name of parent corporation*] and of _____[*name of acquiring (subsidiary) corporation*] confirming and verifying the truth of the representations and warranties and the performance of the obligations, and containing any other assurances that _____[*name of acquired corporation*] may reasonably request.

Approval of Shareholders

(b) All corporate proceedings requisite to the sale by _____[*name of acquired corporation*] of its properties and its liquidation and dissolution, shall have been approved and consented to by the shareholders of _____[*name of acquired corporation*] in the manner required by applicable law, and the principal terms of the exchange of assets for shares described in this agreement shall have been approved by the outstanding shares of each class, as required of each party by the General Corporation Law of California.

Opinion of Counsel for Parent and Acquiring (Subsidiary) Corporations

(c) _____[*Name of parent corporation*] shall have delivered to _____[*name of acquired corporation*] an opinion of _____, counsel for _____[*names of parent and acquiring (subsidiary) corporations*], dated the closing date, in form and substance satisfactory to counsel for _____[*name of acquired corporation*], to the effect that

(1) _____ [*Name of parent corporation*] and _____ [*name of acquiring (subsidiary) corporation*] are corporations duly organized, validly existing, and in good standing under the laws of their state of incorporation.

(2) This agreement has been duly and validly authorized, executed, and delivered by _____ [*name of parent corporation*] and _____ [*name of acquiring (subsidiary) corporation*] and is valid and binding upon _____ [*name of parent corporation*] and _____ [*name of acquiring (subsidiary) corporation*] in accordance with its terms.

(3) All corporate proceedings required by law or by the provisions of this agreement to be taken by _____ [*name of parent corporation*] and _____ [*name of acquiring (subsidiary) corporation*] on or prior to the closing date in connection with the consummation of the transactions contemplated by this agreement have been duly and validly taken, and an appropriate permit from the California Commissioner of

Corporations has been received by _____ [*name of parent corporation*] in connection with the issuance of its common stock as required by this agreement.

(4) The shares of common stock of _____ [*name of parent corporation*] to be issued and delivered pursuant to this agreement, when so issued and delivered and when paid for as provided in this agreement, will be validly issued, fully paid, and nonassessable, and _____ [*name of acquired corporation*] will have good title to those shares issued to it.

(5) [*Add if appropriate:* The shares of common stock of _____ (*name of parent corporation)* to be issued under this agreement have been duly authorized for listing on the _____ (*e.g.*, New York Stock Exchange and the Pacific Stock Exchange) on official notice of issuance.]

(6) The issuance by _____ [*name of parent corporation*] of shares of its common stock to _____ [*name of acquired corporation*], and the transfer of those shares by _____ [*name of acquired corporation*] to its shareholders upon liquidation and dissolution of _____ [*name of acquired corporation*] do not require the registration of the shares under the Securities Act of 1933.

Favorable Tax Ruling

(d) _____[*Name of acquired corporation*] shall have received a written ruling or rulings of the Internal Revenue Service, satisfactory to its counsel, to the effect that the sale of the assets and business of _____[*name of acquired corporation*] and the distribution of the shares of common stock of _____[*first corporation*] to the shareholders of _____[*name of acquired corporation*] in connection with the liquidation and dissolution of _____[*name of acquired corporation*], all as contemplated in this agreement, will not result in the recognition of any taxable income or deductible loss by _____[*name of acquired corporation*] or by its shareholders.

No Substantial Adverse Change

(e) There shall have been no substantial adverse change in the financial condition or operations of _____[*name of parent corporation*] [and no suspension of trading in its stock on the New York Stock Exchange].

Additional Data

(f) _____[*Name of acquired corporation*] shall have received any additional certificates, opinions, and documents that it may reasonably request.

ARTICLE 10 TERMINATION

Time of Essence

Section 10.01. Time is of the essence of this agreement. Each of the parties will diligently and faithfully carry out all of the terms and conditions of this agreement and will take all necessary action in order that the transactions contemplated by this agreement may be consummated as contemplated.

Nonfulfillment of Conditions Precedent

Section 10.02. If, on _____[*date*], any of the conditions precedent to the consummation of the

transactions contemplated by this agreement, other than conditions, if any, that have been waived by the party for whose benefit those conditions were imposed, shall not have been fulfilled, this agreement may be terminated by _____[*e.g.*, 10 days'] written notice by either party.

ARTICLE 11 CONSUMMATION OF TRANSACTION

Consideration of Acquired Corporation

Section 11.01. Except for cash, not exceeding $_____, in any amount that _____[*name of acquired corporation*] deems necessary to pay all fees, costs, and expenses incurred by it in carrying out this plan and agreement or reorganization, _____[*name of acquired corporation*] will deliver to _____[*name of acquiring (subsidiary) corporation*] on the closing date instruments of transfer, in the form satisfactory to counsel for _____[*names of parent and acquiring (subsidiary) corporations*], for all of the properties of _____[*name of acquired corporation*] as those properties shall exist on the closing date, including, without limitation, the goodwill and corporate name of _____[*name of acquired corporation*], and all books and records. Except for minute books, stock books, and corporate records which shall be delivered within a reasonable time after its dissolution, _____[*name of acquired corporation*] shall deliver to _____[*name of acquiring (subsidiary) corporation*] on the closing date possession of the properties so transferred to it. _____[*name of acquired corporation*] shall use the retained cash only to pay fees, costs, and expenses incurred by it in carrying out this plan and agreement of reorganization, and shall pay over to _____[*name of acquiring (subsidiary) corporation*], within _____[*e.g.*, 120 days] after the closing date, any remaining balance.

Consideration of Parent and Acquiring (Subsidiary) Corporations

Section 11.02. On receipt by _____[*name of acquiring (subsidiary) corporation*] of the properties of _____[*name of acquired corporation*], _____[*name of parent corporation*] will deliver to _____[*name of acquired corporation*], on the closing date, certificates for _____ shares of the common stock of _____[*name of parent corporation*].

Dissolution of Acquired Corporation

Section 11.03. (a) Promptly after the closing date, _____[*name of acquired corporation*] shall proceed with due diligence to wind up its affairs, liquidate, and distribute its assets, including the shares of common stock of _____[*name of parent corporation*] received pursuant to the exchange set forth in this agreement, and voluntarily dissolve.

(b) In connection with the winding up of its affairs, _____[*name of acquired corporation*] shall proceed promptly after the closing date to prepare and file all income tax returns and reports required under applicable state and federal law covering all periods prior to the closing date for which tax returns and reports have not previously been filed and, if requested in writing by _____[*name of parent corporation*] or _____[*name of acquiring (subsidiary) corporation*], _____[*name of acquired corporation*] shall also file a request for prompt assessment under *Internal Revenue Code Section 6501(d)* for all open years. Prior to filing any tax returns or reports, _____[*name of acquired corporation*] shall submit all tax returns and reports to _____[*name of acquiring (subsidiary) corporation*] for examination and approval.

Brokers

Section 11.04. It is understood that none of the parties has made any commitment for payment of any brokerage or finder's fee or any similar fee in connection with any of the transactions contemplated by this agreement, and that no such commitment will be made and no such fee will be payable.

Expenses

Section 11.05. Except as otherwise specified in this agreement, each of the parties will pay all costs and expenses of its performance of and compliance with all terms and conditions of the agreement to be performed or complied with by it.

Implementing Action by Acquired Corporation

Section 11.06. On request and at the expense of _____[*name of parent corporation*] or _____[*name of acquiring (subsidiary) corporation*] whether at or after the closing, and without further consideration, _____[*name of acquired corporation*] will execute and deliver any further instruments of transfer and will take any other action that _____[*name of parent corporation*] or _____[*name of acquiring (subsidiary) corporation*] reasonably may request in order more effectively to transfer any of the property to be sold hereunder, and will assist in the collection or reduction to possession of any such property.

ARTICLE 12 INTERPRETATION AND ENFORCEMENT

Survival of Representations and Warranties

Section 12.01. The representations and warranties made by _____[*name of parent corporation*], _____[*name of acquiring (subsidiary) corporation*], and _____[*name of acquired corporation*] in this agreement, and their respective obligations to be performed under the terms of this agreement at, prior to, or after closing, shall not expire with or be terminated by that closing on the closing date, or the liquidation or dissolution of _____[*name of acquired corporation*], notwithstanding any investigations of the facts constituting the basis of the representatives and warranties of any party by any other party.

Notices

Section 12.02. Any notice or other communication required or permitted under this agreement shall be deemed to be properly given when deposited in the United States mail for transmittal by certified or registered mail, postage prepaid, or when deposited with a public telegraph company for transmittal, charges prepaid, if that communication is addressed

(a) In the case of _____[*names of parent and acquiring (subsidiary) corporations*], to _____[*corporate name, name of officer concerned, street address, city, and state*] or to any other person or address that _____[*name of acquiring (subsidiary) corporation*] may furnish to _____[*name of acquired corporation*] from time to time.

(b) In the case of _____[*name of acquired corporation*], to _____[*corporate name, name of officer concerned, street address, city, and state*] or to any other person or address that _____[*name of acquired corporation*] may from furnish to _____[*name of acquiring*

(subsidiary) corporation] from time to time.

Counterpart Executions

Section 12.03. This agreement may be executed in one or more counterparts, each of which shall be deemed an original.

Controlling Law

Section 12.04. The validity, interpretation, and performance of this agreement shall be controlled by and construed under the laws of the State of California [*or specify other state*], the state in which this agreement is being executed.

Executed on _____[*date*], at _____[*city and state*].

_____ [*name of parent corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]
_____ [*name of acquiring (subsidiary) corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]
_____ [*name of acquired corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTax-Free AcquisitionsTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Mergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Directors & Officers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART IV. FORMS

5-11E California Legal Forms--Transaction Guide § 11E.202

§ 11E.202 Resolution of Board of Directors of Acquiring Corporation Approving Proposed Acquisition of Assets of Another Corporation in Exchange for Voting Common Shares of Acquiring Corporation

[1] Comment--Use of Form

This form is a simple resolution that may be adopted by the board of directors of the acquiring corporation approving a proposed assets-for-shares exchange with another corporation. The resolution must be adopted by the board of directors itself, and not a committee of the board of directors [*see § 11E.21[1]*]. This resolution also authorizes the officers of the acquiring corporation to file an application on its behalf with the California Corporations Commissioner for a permit qualifying the shares it must issue in the proposed assets-for-shares exchange. A form for that application is set forth *Ch. 11C, Mergers, § 11C.204*.

The resolution in this form presumes that the acquiring corporation has not issued all the voting common shares it is authorized by its articles of incorporation to issue and may issue the shares required for the assets-for-shares exchange without amending its articles of incorporation. When the acquiring corporation must amend its articles of incorporation to authorize the issuance of more common voting shares in order to issue the shares required by the assets-for-shares exchange, the provision relating to such an amendment set forth in Ch. 11D, *Acquisition of Shares for Shares*, § 11D.306, should be added to the resolution in this form.

[2] Form

Resolution of Board of Directors of Acquiring Corporation Approving Proposed Acquisition of Assets of Another Corporation in Exchange for Voting Common Shares of Acquiring Corporation

RESOLUTION

WHEREAS, there has been presented to this meeting a proposed "Plan and Agreement of Reorganization" pursuant to which this corporation shall acquire substantially all the assets of _____[*name of selling corporation*], a California corporation, in exchange for _____[*number*] of this corporation's common voting shares; and

WHEREAS, this corporation is authorized to issue _____[*number*] shares of its voting common shares, only _____[*number*] of which have been issued and are now outstanding;

NOW, THEREFORE, BE IT RESOLVED, that this corporation acquire substantially all the assets of _____[*name of selling corporation*], a California corporation, in exchange for voting common shares of this corporation in the manner specified in the written "Plan and Agreement of Reorganization" submitted to this meeting; and

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to prepare, execute, and file on behalf of this corporation with the Commissioner of Corporations of the State of California any and all applications required to secure any permits required to allow this corporation to issue the shares required to be issued by it as part of the asset acquisition approved in this resolution; and

RESOLVED FURTHER, that the officers of this corporation are directed, on receipt by this corporation of a permit from the California Commissioner of Corporations authorizing it to issue the shares required to be issued by it as part of the asset acquisition approved by this resolution, to solicit approval of the asset acquisition and share exchange described in this resolution by the outstanding shares of each class of this corporation as required by California General Corporation Law by either calling a special meeting of shareholders for that purpose or obtaining the written consent of the required number of shareholders of each class of this corporation; and

RESOLVED FURTHER, that on the asset acquisition approved by this resolution being approved by the outstanding shares of each class of this corporation as required by the General Corporation Law of California, the officers of this corporation are directed to execute on behalf of this corporation the "Plan and Agreement of Reorganization" submitted to this meeting and to do all things reasonably required to consummate the share exchange described in that agreement; and

RESOLVED FURTHER, that _____[*name of attorney*] is appointed escrow holder to conduct the asset acquisition and share exchange approved by this resolution; and

RESOLVED FURTHER, that this corporation determines for the purposes of the asset acquisition approved by this resolution that the fair market value as defined by *California Corporations Code Section 1300* of dissenting shares of this corporation as also defined by *California Corporations Code Section 1300* is _____
[$_____ per share *or*

$_____ per share for common voting shares;

$_____ per share for Class A preferred shares;

$_____ per share for Class B preferred shares; *etc.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Directors & Officers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART IV. FORMS

5-11E California Legal Forms--Transaction Guide § 11E.203

§ 11E.203 Resolution of Board of Directors of Selling Corporation Approving Exchange of Substantially All Its Assets for Voting Shares of Acquiring Corporation

[1] Comment--Use of Form

This form is a resolution for adoption by the board of directors of the selling corporation approving a proposed assets-for-shares exchange. The first act required by statute in California to perfect a proposed assets-for-shares exchange between corporations is to have the proposal approved by the board of directors of each corporation involved [*Corp. Code § 1200(c)*]. A resolution for adoption by the board of directors of the acquiring corporation approving the proposed assets-for-shares exchange is contained in § 11E.202. The two resolutions are similar except that this resolution does not direct corporate officers to file an application for a permit from the California Commissioner of Corporations. Although a permit must be obtained before either corporation may solicit shareholder approval of the transaction, the shares required by the exchange must be issued by the acquiring corporation and therefore the acquiring corporation should apply for the Corporation Commissioner's permit.

For a further discussion of the board of directors' approval required for an assets-for-shares exchange, see *§ 11E.21[1]*.

[2] Form

Resolution of Board of Directors of Selling Corporation Approving Exchange of Substantially All Its Assets for Voting Shares of Acquiring Corporation

RESOLUTION

WHEREAS, a proposed written "Plan and Agreement of Reorganization" has been presented to this meeting pursuant to which this corporation would transfer substantially all its assets to _____[*name of acquiring corporation*], a California corporation, in exchange for voting common shares of that corporation and dissolve; and

WHEREAS, it is deemed by this Board of Directors to be in the best interests of the shareholders of this corporation that the proposed written "Plan and Agreement of Reorganization" be accepted and this corporation be dissolved;

NOW, THEREFORE, BE IT RESOLVED, that this corporation transfer substantially all its assets to _____[*name of acquiring corporation*], a California corporation, in exchange for voting common shares of that corporation in the manner specified in the written "Plan and Agreement of Reorganization" submitted to this agreement and then dissolve; and

RESOLVED FURTHER, that the officers of this corporation are directed, on receipt by _____[*name of acquiring corporation*] of a permit from the California Commissioner of Corporations authorizing it to issue the shares required to be issued by it as part of the asset exchange approved by this resolution, to solicit approval of the principal terms of the transaction described in this resolution and the written "Plan and Agreement of Reorganization" submitted to this meeting by the outstanding shares of each class of this corporation, as required by the General Corporation Law of California, by either calling a special meeting of shareholders for that purpose or obtaining the written consent of the required number of shareholders of each class of this corporation; and

RESOLVED FURTHER, that on the approval by the outstanding shares of each class of this corporation of the principal terms of the transaction approved in this resolution, the officers of this corporation are directed to execute on behalf of this corporation the "Plan and Agreement of Reorganization" submitted to this meeting and to do all things reasonably required to consummate the transaction described in it; and

RESOLVED, FURTHER, that _____[*name of attorney*] is appointed escrow holder to conduct the transaction described in the "Plan and Agreement of Reorganization" submitted to this meeting; and

RESOLVED FURTHER, that this corporation determines for the purposes of the asset exchange for shares approved by this resolution that the fair market value, as defined by *California Corporations Code Section 1300*, of dissenting shares of this corporation, as also defined by *California Corporations Code Section 1300*, is _____ [$_____ per share *or* $_____ per share for common voting shares *or*

$_____ per share for Class A preferred shares;

$_____ per share for Class B preferred shares; *etc.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsSecurities LawsMergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Directors & Officers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART IV. FORMS

5-11E California Legal Forms--Transaction Guide § 11E.204

§ 11E.204 Request to Commissioner of Internal Revenue for Income Tax Ruling on Proposed Assets-for-Shares Exchange

[1] Comment--Use of Form

This form is a request for a tax ruling that may be submitted to the Commissioner of Internal Revenue to determine the income tax status of a proposed assets-for-shares exchange. A tax ruling is a written statement issued to a taxpayer by the National Office of the Internal Revenue Service interpreting and applying the law to a specific set of facts [*Treas. Reg. § 601.201(a)(2)*]. Tax rulings may be issued only by the National Office of the IRS [*Treas. Reg. § 601.201(a)(2)*]. The request in this form, therefore, is addressed to the National Office of the Commissioner of Internal Revenue in Washington, D.C.

A corporation's status as a tax-free reorganization under the Internal Revenue Code may be the most important factor connected with a proposed assets-for-shares exchange for purposes of gaining shareholder approval of the exchange. When one corporation has proposed to exchange all its assets for shares of another corporation, it is advisable to obtain as early as possible, before solicitation of shareholder approval by either corporation of the proposed exchange, a ruling on the income tax status of the proposed transaction.

For a description of the representations that the Internal Revenue Service requires for approval of a letter ruling, see *Rev. Proc. 86-42, 1986-2 C.B. 722* , and *Rev. Proc. 89-50, 1989-2 C.B. 631* .

[2] Form

Request to Commissioner of Internal Revenue for Income Tax Ruling on Proposed Assets-for-Shares Exchange

REQUEST FOR TAX RULING

Commissioner of Internal Revenue
Attention: T: PS: T Washington, DC 20224

To Whom It May Concern:

RE _____[*Name of transferor corporation*]
Taxpayer Identification Number: _____
District Having Audit Jurisdiction: _____

_____[*Name of acquirer corporation*]
Taxpayer Identification Number: _____
District Having Audit Jurisdiction _____

_____[*Name of transferor*] and _____[*name of acquirer*] respectfully request a ruling with respect to the federal income tax consequences of the proposed acquisition by _____[*name of acquirer*] of substantially all of the properties of _____[*name of transferor*] in exchange solely for shares of common stock of _____[*name of acquirer*] and the assumption of substantially all the liabilities of _____[*name of transferor*]. The detailed terms and conditions of the transaction are set forth in the Plan and Agreement of Reorganization, dated _____[*date*], called the agreement, and the Plan of Complete Liquidation and Voluntary Dissolution of _____[*name of transferor*], which are attached as Exhibits 1 and 2, respectively.

The facts on which this request for ruling is based are as follows:

Legal Status and Capitalization of Transferor

1. _____[*Name of transferor*] is a corporation organized and existing under the laws of the State of California [*or specify other state*], having been incorporated in _____[*date*]. Its authorized capitalization consists of _____[*number*] shares of capital stock, all of one class, of which _____[*number*] shares are issued and outstanding as of _____[*date*].

Business of Transferor

2. _____[*Name of transferor*] is engaged in the business of _____[*e.g.*, exploration for and development and production of petroleum in the United States].

Financial Position of Acquirer

3. As of _____[*date*], _____[*name of transferor*] had gross assets with a book value of $_____, and a net worth of $_____. The balance sheet of _____[*name of transferor*] showing its financial position as of _____[*date*], together with its combined statement of income and retained earnings showing its results of operations for the period then ended, is included in the proxy statement mailed _____[*date*], to its shareholders in connection with a shareholders' meeting to be held _____[*date*], to vote on the transaction. A copy of the proxy statement is attached as Exhibit 2. A detailed description of the business of _____[*name of transferor*] will be found on pages _____ through _____ of the proxy statement.

Legal Status and Capitalization of Acquirer

4. _____[*Name of acquirer*] is a corporation organized and existing under the laws of the State of California [*or specify other state*], having been incorporated in _____[*date*]. Its authorized capitalization consists of _____[*number*] shares of common stock of which _____[*number*] shares are issued and outstanding as of _____[*date*].

Business of Acquirer

5. _____[*Name of acquirer*] is engaged in the business of _____[*e.g.*, oil and gas exploration and production].

Financial Position of Acquirer

6. As of _____[*date*], _____[*name of acquirer*] had gross assets with a book value of $_____, and a net worth of $_____. The balance sheet of _____[*name of acquirer*] showing its financial position as of _____[*date*], together with its combined statement of income and retained earnings showing its results of operations for the period then ended, is included in the proxy statement of _____[*name of transferor*] mailed to its shareholders _____[*date*], a copy of which is attached as Exhibit 2. A detailed description of the business of _____[*name of acquirer*] will be found on pages _____ through _____ of the proxy statement.

Exchange Plan

7. Under the agreement, _____[*name of transferor*] will transfer substantially all of its properties to _____[*name of acquirer*] in exchange for the issuance to _____[*name of transferor*] of a certificate for _____[*number*] shares of the common stock of _____[*name of acquirer*], and the assumption of substantially all of the liabilities of _____[*name of transferor*] on the closing date. _____[*name of acquirer*] shall not assume (a) the costs and expenses, including taxes, if any, of _____[*name of transferor*] incident to or arising from the transaction, including the liquidation and dissolution of _____[*name of transferor*]; or (b) any other liabilities incurred after the closing date. _____[*name of transferor*] will retain any amount of cash, not in excess of $_____, as it may deem to be reasonably required to cover the costs and expenses incident to or arising from the transaction and not previously paid by _____[*name of transferor*], and any portion not required for that purpose shall be paid to _____[*name of acquirer*] at the expiration of _____[*e.g.*, 120 days] after the closing date. _____[*name of transferor*] will effect its complete liquidation by distributing to its shareholders, against surrender of all of the stock of _____[*name of transferor*], the common stock of _____[*name of acquirer*] received by _____[*name of transferor*] in the exchange.

Business Purpose of Acquisition

8. _____[*Describe business purpose, e.g.,* The business purpose of _____ (*name of acquirer*) in making the proposed acquisition of the properties of _____ (*name of transferor*) is to obtain new working properties, together with employment of certain operating personnel, which will make the corporation substantially larger and stronger in both resources and personnel, and more able to take advantage of acquisition and other similar situations which may arise. Combining the properties of both corporations under one ownership should also result in substantial economies of operation. The present shareholders of _____ (*name of transferor*), through the receipt of stock in _____ (*name of acquirer*), are expected to have a substantially improved investment position.] The advantages of the acquisition are outlined in detail in the proxy statement attached as Exhibit 2.

Requested Ruling

9. Request is made for a ruling that will establish the following results:

(a) The transfer under the agreement by _____[*name of transferor*] of its properties to _____[*name of acquirer*], in exchange for _____[*number*] shares of common stock of _____[*name of acquirer*] and the assumption by _____[*name of acquirer*] of the liabilities of _____[*name of transferor*], will constitute a reorganization within the meaning of *Internal Revenue Code Section 368(a)(1)(C)*, to which both _____[*name of transferor*] and _____[*name of acquirer*] will be parties.

(b) No gain or loss will be recognized by _____[*name of transferor*] or _____[*name of acquirer*] by reason of the exchange [*I.R.C. §§ 361(a), 1032*].

(c) The basis of the assets received by _____[*name of acquirer*] will be the same as the basis of the assets in the hands of _____[*name of transferor*] [*I.R.C. § 362(b)*].

(d) The holding period of the assets received by _____[*name of acquirer*] will include the period those assets were held by _____[*name of transferor*] [*I.R.C. § 1223(1)*].

(e) No gain or loss will be recognized to the shareholders of _____[*name of transferor*] on the distribution to them of shares of common stock of _____[*name of acquirer*] in exchange for the surrender by them of their shares of _____[*name of transferor*] [*I.R.C. § 354*].

(f) The respective bases of the stock of _____[*name of acquirer*] received by the shareholders of _____[*name of transferor*] will be the same as their respective bases in the stock of _____[*name of transferor*] surrendered by them in the exchange [*I.R.C. § 358(a)(1)*].

(g) The respective holding periods of the stock of _____[*name of acquirer*] received by the shareholders of _____[*name of transferor*] will include the respective holding periods of the stock of _____[*name of transferor*] surrendered in the exchange [*I.R.C. § 1223(1)*].

(h) The accumulated earnings and profits of _____[*name of transferor*] on the closing date of the transaction will retain their character as earnings and profits in the hands of _____[*name of acquirer*] [*I.R.C. § 381(c)(2)*].

Closing Date

10. The agreement provides for the consummation of the transaction on _____[*date*], and that consummation is conditioned on the receipt of a satisfactory ruling. Because delay in receiving such a ruling would prejudice consummation of the transaction, it is respectfully requested that this application be given prompt attention so that a ruling may be issued not later than _____[*date*], and permit the closing on the date set. Consummation of the transaction does not require submission of the agreement to shareholders of _____[*name of acquirer*], and that submission is not contemplated [*or specify otherwise if articles of incorporation or applicable stock exchange rules so require*].

Issues Presented Not Presently Under Consideration

11. To the best knowledge of the taxpayers and their respective attorneys, no issues identical to those on which this ruling is requested are being considered by any field office of the Internal Revenue Service in connection with an active examination or audit of a tax return of the taxpayers already filed.

Powers of Attorney

12. Separate powers of attorney executed by each of the corporate parties are enclosed.

Conference

We would appreciate your advising us if you should find that a conference would be helpful at any stage of your consideration of this request, or that a conference may be in the interest of the taxpayers. In the event you wish any further information after submission of this request, please telephone the undersigned collect at _____[*(area code) telephone number*].

Respectfully submitted, _____ [*signature of attorney*]
[*typed name*]
Attorney for _____ [*name of acquirer*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTax-Free AcquisitionsTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)Mergers & Acquisitions LawSales of AssetsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART IV. FORMS

5-11E California Legal Forms--Transaction Guide § 11E.205

§ 11E.205 Resolution of Shareholders of Acquiring Corporation Approving Proposed Acquisition of Assets for Shares

[1] Comment--Use of Form

This form is a resolution that may be adopted by the outstanding shares of each class of the acquiring corporation approving the proposed assets-for-shares exchange. Because the de facto merger doctrine was codified in California [*see § 11E.20*], a proposed exchange of all or substantially all of the assets of one corporation for shares of another corporation must be approved by the outstanding shares of each class of both corporations [*see § 11E.21[1]*]. A resolution that may be adopted by the outstanding shares of each class of the selling corporation approving the proposed assets-for-shares exchange is *set forth in § 11E.206*. This resolution must be adopted by the affirmative vote of a majority of outstanding shares of each class of shares issued by the acquiring corporation unless its articles require a greater than majority vote by all or any class of its outstanding shares [*Corp. Code §§ 152, 1201(a)*].

In addition to the shareholder approval requirements of *Corp. Code § 1201*, if the terms of the assets-for-shares reorganization provide that a class or series of preferred shares will receive as a distribution a lesser amount than would be required by applicable article provisions, the principal terms of the reorganization must be approved by the same percentage of outstanding shares of that class or series that would be required to approve an amendment of the article provisions to provide for the distribution of that lesser amount [*Corp. Code § 1202(b)*; *see* Ch. 10, *Amendment of Articles*]. For further discussion, see *§ 11E.21[1]*.

Any action that shareholders can take by vote at a shareholders' meeting can be taken instead by written consent without a meeting when the written consent is signed by the requisite number of shareholders [*Corp. Code § 603(a)*]. Approval by the outstanding shares of each class, therefore, may also be obtained to a proposed assets-for-shares exchange by written consent signed by holders of a majority of outstanding shares of each class of the acquiring corporation. The resolution in this form may be changed to a written consent resolution by simply inserting at its beginning "The undersigned hereby consent in writing to adoption of the following resolutions:" and adding signature lines at the bottom of the resolutions.

[2] Form

Resolution of Shareholders of Acquiring Corporation Approving Proposed Acquisition of Assets for Shares

RESOLUTION

WHEREAS, the Board of Directors of this corporation on _____[*date*] adopted a resolution approving the acquisition by this corporation of substantially all the assets of _____[*name of selling corporation*] in exchange for voting common shares of this corporation as proposed in a written "Plan and Agreement of Reorganization" submitted to the Board of Directors on that date and submitted to this special meeting of shareholders; and

WHEREAS, the Commissioner of Corporations of the State of California has issued a permit qualifying the issuance and transfer by this corporation of the shares required in the transaction for acquisition of the assets of _____[*name of selling corporation*] approved by the Board of Directors of this corporation on _____[*date*];

NOW, THEREFORE, IT IS RESOLVED, that the proposed acquisition by this corporation of substantially all the assets of _____[*name of selling corporation*], a California corporation, in exchange for voting common shares of this corporation pursuant to the written "Plan and Agreement of Reorganization" submitted to this meeting and approved by the Board of Directors of this corporation on _____[*date*] is approved by the outstanding shares of each class of this corporation as required by the General Corporation Law of California.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART IV. FORMS

5-11E California Legal Forms--Transaction Guide § 11E.206

§ 11E.206 Resolution of Shareholders of Selling Corporation Approving Proposed Exchange of Its Assets for Shares of Acquiring Corporation

[1] Comment

[a] Use of Form

This form is a resolution of the shareholders of a selling corporation approving an assets-for-shares reorganization. Because California has codified the so-called "de facto merger" doctrine [*see § 11E.20[1]*], a proposed exchange of assets of one corporation for shares of another corporation must be approved by the outstanding shares of each class of both corporations [*Corp. Code § 1201(a)*]. The resolution in this form approves the proposed exchange and resolves that after the exchange the selling corporation be dissolved. A resolution to be adopted by shareholders of the acquiring corporation approving the proposed exchange is *set forth in § 11E.205*.

For a discussion of additional shareholder approval requirements imposed by *Corp. Code § 1202(b)*, see *§ 11E.205*.

[b] Written Consent

Any action that may be taken at an annual or special shareholders' meeting may be taken without a meeting, pursuant to written consent of the shareholders [*see Corp. Code § 603*]. Approval of the outstanding shares of each class of a proposed assets-for-shares exchange, therefore, can be obtained by obtaining written consent of holders of a majority of the outstanding shares of each class of a corporation to such an exchange. To convert the resolution in this form to a written consent by the outstanding shares of each class of the selling corporation to a proposed assets-for-shares exchange, a statement such as "The undersigned hereby consent in writing to adoption of the following resolutions:" should be added to the beginning of the form, and signature lines should be added at the end of the form.

For further discussion of the required shareholder approval of a proposed assets-for-shares exchange, see *§ 11E.21[1],[2]*.

[c] Report by Independent Appraiser

If the assets-for-shares proposal is made to the corporation or to some or all of the corporation's shareholders by a party directly or indirectly controlling the corporation or involved in the management or direction of the management of the corporation, a report of an independent appraiser attesting that the value of the proposal is just and reasonable to the shareholders of the corporation sought to be acquired must accompany the proposal [*Corp. Code § 1203(a)*]. For further discussion of this requirement and related requirements when such a proposal is pending at the same time as another proposal for a reorganization [*see Corp. Code § 181* (definition)] or short-form merger [*see Corp. Code § 1203(b)*; *see also Corp. Code § 187, 1110* (definition of short-form merger)], see Ch. 11, *Merger and Acquisition Issues* .

[2] Form

Resolution of Shareholders of Selling Corporation Approving Proposed Exchange of Its Assets for Shares of Acquiring Corporation

RESOLUTION

WHEREAS, the Board of Directors of this corporation on _____[*date*], adopted a resolution approving a written "Plan and Agreement of Reorganization" submitted to the Board of Directors on that date and submitted to this special meeting of shareholders, that this corporation would exchange all its assets for voting common shares of _____[*name of acquiring corporation*], a California corporation, and then dissolve;

[*Add, if qualification permit is required:*]

WHEREAS, the Commissioner of Corporations of the State of California has issued a permit qualifying the issuance and transfer by _____[*name of acquiring corporation*] of the shares required to be issued and transferred by it to this corporation pursuant to the written "Plan and Agreement of Reorganization" submitted to this meeting;

[*Continue with the following:*]

NOW, THEREFORE, IT IS RESOLVED, that the proposed exchange by this corporation of all its assets for voting common shares of _____[*name of acquiring corporation*], a California corporation, pursuant to the "Plan and Agreement of Reorganization" submitted to this meeting and approved by the Board of Directors of this corporation on _____[*date*], is approved by the outstanding shares of this corporation as required by the General Corporation Law of California; and

RESOLVED FURTHER, that on completion of the transaction contemplated by the "Plan and Agreement of Reorganization" submitted to this meeting this corporation be dissolved, its affairs wound up, and its assets distributed to its shareholders in the following manner: _____[*specify manner of distribution to shareholders*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawMergersDuties & Liabilities of ShareholdersMergers & Acquisitions LawSales of AssetsDuties & Liabilities of Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART IV. FORMS

5-11E California Legal Forms--Transaction Guide § 11E.207

§ 11E.207 Notice to Shareholders of Approval by Outstanding Shares and Right of Dissenting Shareholders to Require Purchase of Dissenting Shares

[1] Comment--Use of Form

This form is a notice of shareholder approval of a proposed assets-for-shares exchange and of dissenting shareholder rights. Each corporation to a proposed exchange of assets for shares must purchase for cash at their fair market value on the day first preceding the proposed exchange any of its shares that are "dissenting shares" and are presented for purchase by it. To protect the rights of its shareholders to force it to purchase dissenting shares owned by them, each corporation is required to give notice to each of its shareholders within 10 days after the proposed exchange has been approved by its outstanding shares of that approval. The notice must include, or be accompanied by, a brief description of the procedure a shareholder must follow to force the corporation to purchase his or her shares. It must also be accompanied by a copy of *Corp. Code §§ 1300-1304* and a statement of the price the corporation has determined to be the fair market value of dissenting shares [*Corp. Code § 1301(a)*].

The nature of a dissenting shareholder's right to require purchase of his or her shares, the definition of what are dissenting shares, and the procedures to be followed in enforcing a dissenting shareholder's rights are discussed in *Ch. 11C, Mergers, § 11C.400*. A procedural guide to enforcing a dissenting shareholder's rights is *set forth in § 11C.150* et seq. in that chapter. That discussion and procedural guide should be used in conjunction with this form.

[2] Form

Notice to Shareholders of Approval by Outstanding Shares and Right of Dissenting Shareholders to Require Purchase of Dissenting Shares

NOTICE OF SHAREHOLDERS' APPROVAL OF REORGANIZATION

TO THE SHAREHOLDERS OF _____[*name of corporation*]

NOTICE IS HEREBY GIVEN that, at a special meeting of shareholders of this corporation held on _____[*date*] at _____ Street, _____, California, the outstanding

shares of this corporation approved, as those terms are defined in the General Corporation Law of California, the principal terms of a proposed acquisition by this corporation of all the assets of _____[*name of selling corporation*] in exchange for voting common shares of this corporation as described in the "Plan and Agreement of Reorganization" dated _____[*or* the principal terms of a proposed exchange of all assets of this corporation for common voting shares of _____, a California corporation, as outlined in the "Plan and Agreement of Reorganization" executed by the two corporations and dated _____].

NOTICE IS FURTHER GIVEN that any shareholder of this corporation may require the corporation to purchase for cash at their fair market value on the day before the first announcement of the reorganization described in this notice any shares owned by the shareholder which come within the definition of "dissenting shares" contained in *California Corporations Code Section 1301(b)*. To be dissenting shares within the definition contained in *California Corporations Code Section 1301(b)* the shares must have been held of record, that is outstanding, on the date for determination of the shareholders who were entitled to vote on the reorganization described in this notice and not voted in favor of the reorganization.

NOTICE IS FURTHER GIVEN that for a shareholder to enforce his or her right to require this corporation to purchase any dissenting shares owned by him or her, the shareholder must do two things:

1. Within 30 days after the date of the mailing of this notice to the shareholder, the shareholder must serve a written demand for this corporation to purchase his or her dissenting shares and pay the shareholder in cash the fair market value of those shares on the corporation or on a transfer agent of the corporation. The demand must state the number and class of shares held by the shareholder which the shareholder demands the corporation purchase as dissenting shares and the price the shareholder claims to be the fair market value of those shares as of the day before announcement of the proposed reorganization described in this notice.

2. Within 30 days after the date of the mailing of this notice to the shareholder, the shareholder must, in addition to making the demand described above, submit the certificate for the shares he or she claims to be dissenting shares to the corporation or its transfer agent so that there may be stamped or endorsed on the share certificate a statement that the shares represented by it are dissenting shares. The certificate should be submitted to the corporation at its principal office at _____ Street in _____, California or to its transfer agent, _____[*name*] at its office at _____ Street, _____, California.

Thereafter, should the corporation fail to agree to purchase the shareholder's dissenting shares at an agreed price or deny they are dissenting shares, the shareholder may file a complaint against the corporation to force it to purchase the shares in the Superior Court of the State of California for the County of _____, the county where the principal executive office of this corporation is located. The complaint must be filed by the shareholder with that court within six months after the date on which this notice was mailed to the shareholder. A copy of *California Corporations Code Sections 1300, 1301, 1302, 1303,* and *1304,* governing the procedure a shareholder must follow to require this corporation to purchase dissenting shares owned by the shareholder, is enclosed with this notice.

[*EITHER*]

NOTICE IS FURTHER GIVEN that this corporation has determined that the price of $_____ per share represents the fair market value of dissenting shares of this corporation as of the day before the first announcement of the terms of the reorganization described in this notice.

[*OR, if corporation has more than one class of shares outstanding:*]

NOTICE IS FURTHER GIVEN that this corporation has determined that the following prices represent the fair market value of dissenting shares of this corporation as of the day before the first announcement of the terms of the reorganization described in this notice: _____[*specify, e.g.:*]

$_____ per share for voting common shares;

$_____ per share for Class A Preferred shares; and

$_____ per share for Class B Preferred shares.

[*Continue with the following:*]

_____ Dated:

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawSales of AssetsRights of Dissenting ShareholdersMergers & Acquisitions LawMergersRights of Dissenting ShareholdersBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsFair Market ValueBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentSales of Assets & PropertyBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11E ACQUISITION OF ASSETS FOR SHARES
PART IV. FORMS

5-11E California Legal Forms--Transaction Guide § 11E.208

§ 11E.208 Demand on Corporation by Shareholder for Purchase of Dissenting Shares

[1] Comment--Use of Form

This form contains the written demand that must be served on a corporation to a proposed assets-for-shares exchange (a "sale-of-assets reorganization" under the General Corporation Law [*see Corp. Code § 181(c)*]) by a shareholder desiring to have the corporation purchase his or her dissenting shares [*see Corp. Code § 1301(c), (d)*]. The nature of a shareholder's right to require a corporation to purchase his or her dissenting shares and the procedure he or she must follow to enforce that right are discussed more fully in Ch. 11C, *Mergers*, § 11C.400. A procedural guide for enforcement of a dissenting shareholder's rights is set forth in § 11E.150 et seq. of that chapter. That guide should be used in connection with the demand contained in this form.

[2] Form

Demand on Corporation by Shareholder for Purchase of Dissenting Shares

DEMAND FOR PURCHASE OF SHARES

TO: _____[*name of corporation*], a California corporation

I am the holder of record of _____[*number*] of _____[*class, e.g.*, common *or*, preferred *or* Class A preferred, *etc.*] shares issued by you as evidence by Share Certificate No. _____ issued by you.

Pursuant to *California Corporations Code Section 1301(b)*, I hereby make written demand on you that you purchase those shares and pay to me in cash their fair market value as of the day, _____[*date*], before the first announcement of the terms of the proposed acquisition by you of substantially all the assets of _____[*name of selling corporation*] in exchange for your voting common shares [*or* the proposed exchange by you of substantially all your assets for voting common shares of _____ (*name of acquiring corporation*)].

I state, pursuant to *California Corporations Code Section 1301(c)*, that I claim $_____ per share to be the fair market value of those shares as of the day before the announcement of the proposed acquisition [*or exchange*] described above.

I am submitting to you the certificate representing the shares in respect to which this demand is made in order that it may be stamped or endorsed with a statement that those shares are dissenting shares and returned to me at the address set forth below.

_____ Dated:

_____ [*signature*]
[*typed name*]
_____ [*street address*]
_____ , California

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawSales of AssetsRights of Dissenting ShareholdersMergers & Acquisitions LawMergersRights of Dissenting ShareholdersBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsFair Market ValueBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentSales of Assets & PropertyBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentProcedures



158 of 197 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS

5-11F California Legal Forms--Transaction Guide 11F.syn

§ 11F.syn Synopsis to Chapter 11F: CORPORATE CONVERSIONS

§ 11F.01 California Statutes

§§ 11F.02-11F.04 [Reserved]

§ 11F.05 Law Reviews and Periodicals

§ 11F.06 Text References

[1] Matthew Bender Sources

§§ 11F.07-11F.49 [Reserved]

§ 11F.50 Conversions In General

§ 11F.51 Definitions

[1] Other Business Entity

[2] Converting Corporation; Converting Entity

[3] Converted Corporation; Converted Entity

§ 11F.52 Conversion of Corporation Into Domestic Other Business Entity

[1] Carryover of Interests Required

[2] Applicable Law Must Authorize Conversion

§ 11F.53 Plan of Conversion

[1] Contents

[2] Requisite Approvals

[a] All Corporations

[b] Close Corporations

[c] Conversion Into Partnership or LLC

[3] All Non-Dissenting Shareholders Deemed Parties to Plan

[4] Amending of Plan of Conversion

[5] Maintaining Plan of Conversion

[6] Abandoning Plan of Conversion

§ 11F.54 Effective Date of Conversion

§ 11F.55 Statement or Certificate of Conversion

[1] Applicable Form

[a] Domestic Limited Partnership

[b] Domestic Partnership

[c] Domestic Limited Liability Company

[2] Contents

[3] Execution and Acknowledgment of Form

[4] Certificate of Dissolution Not Required

[5] Tax Clearance Certificate Requirement

§ 11F.56 Dissenters' Rights

§ 11F.57 Conversion of Other Business Entity Into Corporation

[1] Law Must Authorize Conversion

[2] Approvals

[3] Filing Statement of Conversion

§ 11F.58 Effect of Conversion on Converting Entity

[1] Converting Entity Unchanged

[2] Shareholder Liability

[a] In General

[b] Converting General Partnership

[3] Notice to Creditors

§ 11F.59 Title to Real Property of Converting Entity

[1] Recording Requirements

[2] Presumption in Favor of Bona Fide Purchasers

§§ 11F.60-11F.99 [Reserved]

§ 11F.100 Facts

[1] General Information

Scope

[2] Information for Corporation Converting to Other Business Entity

Scope

§ 11F.101 Documents

Scope

§§ 11F.102-11F.109 [Reserved]

§ 11F.110 Approval of Conversion

Scope

§ 11F.111 Provisions Regarding Conversion

Scope

§§ 11F.112-11F.119 [Reserved]

Scope

§ 11F.120 Conversion of California Corporation Into Other Business Entity

Scope

§§ 11F.121-11F.149 [Reserved]

§ 11F.150 Plan of Conversion

Scope

§ 11F.151 Resolution Authorizing Conversion

Scope

§§ 11F.152-11F.169 [Reserved]

§ 11F.170 Filing With County Recorder

Scope

§ 11F.171 Giving Notice of Conversion

Scope

§§ 11F.172-11F.199 [Reserved]

§ 11F.200 Plan of Conversion

[1] Comment

[a] Use of Form

[b] Contents of Plan

[c] Approval by Board and Shareholders

[d] Amending or Abandoning Plan of Conversion

[e] All Non-Dissenting Shareholders Deemed Parties to Plan

[2] FORM

Plan of Conversion

§ 11F.201 Board Resolution Approving Conversion

[1] Comment--Use of Form

[2] FORM

Board Resolution Approving Conversion

§ 11F.202 Shareholders' Resolution Approving Conversion

[1] Comment--Use of Form

[2] FORM

Shareholders' Resolution Approving Conversion

§§ 11F.203-11F.209 [Reserved]

§ 11F.210 Certificate of Conversion [FORM CONV-1A]

[1] Comment

[a] Use of Form

[b] Certificate or Statement of Conversion

[c] Contents, Execution, and Acknowledgment

[d] Filing Fee

[e] Effect of Filing Certificate of Conversion

[2] FORM

Certificate of Conversion [FORM CONV-1A]

§§ 11F.211-11F.279 [Reserved]

§ 11F.280 Notice to Creditors

[1] Comment--Use of Form

[2] FORM

Notice to Creditors



159 of 197 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS

5-11F California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter covers the conversion of corporations into other business entities, under Chapter 11.5 of the General Corporation Law [*Corp. Code § 1150 et seq.*]. The Legal Background covers the requirements for effectuating a conversion, and discusses the effect of conversion on the converting entity. The Transaction Guide sets forth the procedures for converting a corporation to another form of entity pursuant to statutory requirements, and contains a guide for drafting the necessary documents. This chapter also includes forms used in a conversion, including a plan of conversion, a resolution authorizing conversion, and a certificate of conversion.

This chapter assumes that the legal and tax consequences of a conversion have been considered, and the decision made to proceed with the transaction. Its focus is on the procedures necessary to effectuate a conversion pursuant to California law. For an in-depth comparison of potential business forms available under California law, see Ch. 1B, *Selecting Form of Business Entity* .

This chapter does not attempt to enumerate the steps necessary to form the entities into which a corporation or other business entity can convert. If the converted entity is a limited partnership, general partnership, or limited liability company, Ch. 15A, *Formation of Limited Partnerships*, Ch. 15, Part A, *Formation of General Partnerships*, or Ch. 12C, *Limited Liability Companies*, should be consulted as appropriate.

This chapter contains a brief discussion of the general rules governing the conversion of other business entities (including limited liability companies, general partnerships, and limited partnerships) into corporations [*see § 11F.57*]. Because the conversion process depends to some extent on the type of entity involved, however, the conversion of those other types of entities into California corporations is discussed primarily in the chapters dealing specifically with those types of entities. The conversion of limited liability companies into other business entities, including corporations, is discussed in Ch. 12C, *Limited Liability Companies* . For discussion of the conversion of general partnerships into other business entities, see Ch. 15, Part C, *Conversions and Mergers of General Partnerships* . The conversion of limited partnerships into other business entities is discussed in Ch. 15C, *Conversions and Mergers of Limited Partnerships* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART I. RESEARCH GUIDE
A. Primary Sources

5-11F California Legal Forms--Transaction Guide § 11F.01

§ 11F.01 California Statutes

"Domestic other business entity" defined. *Corp. Code § 167.7*; *see Corp. Code § 1150(e).*

"Foreign other business entity" defined. *Corp. Code § 171.07*; *see Corp. Code § 1150(f).*

"Other business entity" defined. *Corp. Code § 174.5*; *see Corp. Code § 1150(g).*

Corporate conversions. *Corp. Code § 1150 et seq.*

Definitions. *Corp. Code § 1150.*
Conversion of corporation to domestic other business entity. *Corp. Code § 1151.*
Plan of conversion; approval. *Corp. Code § 1152.*
Filing of documents to effect conversion. *Corp. Code § 1153.*
Statement or certificate of conversion. *Corp. Code § 1155.*
Conversion of corporation or other business entity owning real property; filing with county recorder. *Corp. Code § 1156.*
Conversion of other business entity, foreign other business entity, or foreign corporation into domestic corporation. *Corp. Code § 1157.*
Effect of conversion; rights and obligations of converted entity. *Corp. Code § 1158.*
Rights of shareholders of converting corporation. *Corp. Code § 1159.*
Secretary of State's fee for conversion. *Corp. Code § 1160.*

Dissenters' rights. *Corp. Code § 1300 et. seq.*; *see Corp. Code § 1159.*

Conversion of limited partnership into corporation or other entity.
Authority for conversion. *Corp. Code § 15677.2* (CRLPA, repealed January 1, 2010); *Corp. Code § 15911.02* (ULPA '08).

Plan of conversion; approval requirements. *Corp. Code § 15677.3* (CRLPA, repealed January 1, 2010); *Corp. Code § 15911.03* (ULPA '08).
When conversion becomes effective. *Corp. Code § 15677.4* (CRLPA, repealed January 1, 2010); *Corp. Code § 15911.04* (ULPA '08).
Certificate or statement of conversion. *Corp. Code § 15677.6* (CRLPA, repealed January 1, 2010); *Corp. Code § 15911.07* (ULPA '08).

Conversion of corporations and other entities into California limited partnerships. *Corp. Code § 15677.8* (CRLPA, repealed January 1, 2010); *Corp. Code § 15911.08* (ULPA '08).

Conversion of general partnership into corporation or other entity.
Authority for conversion. *Corp. Code § 16902*.
Plan of conversion; approval requirements. *Corp. Code § 16903*.
When conversion becomes effective. *Corp. Code § 16904*.
Statement of conversion. *Corp. Code § 16905*.

Conversion of corporations and other entities into California general partnerships. *Corp. Code § 16908*.

Conversion of limited liability company into corporation or other entity.
Authority for conversion. *Corp. Code § 17540.2*.
Plan of conversion; approval requirements. *Corp. Code § 17540.3*.
Certificate or statement of conversion. *Corp. Code § 17540.6(a)(3)*.

Conversion of corporations and other entities into California limited liability companies. *Corp. Code § 17540.8*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART I. RESEARCH GUIDE
A. Primary Sources

5-11F California Legal Forms--Transaction Guide §§ 11F.02-11F.04

[Reserved]

§§ 11F.02[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11F California Legal Forms--Transaction Guide § 11F.05

§ 11F.05 Law Reviews and Periodicals

McBurney, *Conversion of Start-Up Corporations to LLCs Could Provide Tax Benefits to Investors*, 97(5) J. Taxation 298 (2002).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11F California Legal Forms--Transaction Guide § 11F.06

§ 11F.06 Text References

[1] Matthew Bender Sources

Ballantine & Sterling, California Corporation Laws (Matthew Bender), Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* , §§ 263 (dissenters' rights), 265 (conversions).

California Legal Forms (Matthew Bender).
Ch. 2, *Formation of Corporations* .
Ch. 3, *Articles of Incorporation* .
Ch. 5, *Directors' Meetings, Actions, and Resolutions*, § 5.240 et seq.
Ch. 11C, *Mergers*, §§ 11C.150-11C.152 (dissenting shareholders' rights).
Ch. 12C, Limited Liability Companies, § 12C.26.
Ch. 15, Part A, *Formation of General Partnerships*; *Ch. 15, Part C, Conversions and Mergers of General Partnerships, § 15.602.*
Ch. 15A, *Formation of Limited Partnerships.*
Ch. 15C, *Conversions and Mergers of Limited Partnerships*, § 15C.30 et seq.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-11F California Legal Forms--Transaction Guide §§ 11F.07-11F.49

[Reserved]

§§ 11F.07[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART II. LEGAL BACKGROUND

5-11F California Legal Forms--Transaction Guide § 11F.50

§ 11F.50 Conversions In General

Chapter 11.5 of the General Corporation Law, added in 2002 [*see Corp. Code §§ 161.9, 1150 et seq.*; Stats. 2002, ch. 480], permits both (1) the conversion of corporations into domestic "other business entities" [*see § 11F.52* et seq.], and (2) the conversion of domestic or foreign other business entities and foreign corporations into corporations [*see § 11F.57*]. California corporations, however, cannot convert into foreign corporations or foreign other business entities.

The conversion of corporations governed by the General Corporation Law into nonprofit public benefit corporations, nonprofit mutual benefit corporations, nonprofit religious corporations, or cooperative corporations (or of those corporations into corporations governed by the General Corporation Law) has been permitted since 1979 pursuant to a simple amendment of the articles of incorporation [*see Corp. Code § 911*; Ch. 10, *Amendment of Articles*, § 10.31].

Limited liability companies, general partnerships, and limited partnerships are authorized to convert into domestic or foreign "other business entities," including corporations [*see Corp. Code §§ 17540.2, 16902*, 15677.2 (CRLPA, repealed January 1, 2010); *Corp. Code § 15911.02(a)(3)* (ULPA '08); *see § 11F.57*]. These conversions are primarily discussed in the chapters dealing with these respective types of entities:

- For detailed discussion and forms for converting a limited liability company into a corporation or other entity, see *Ch. 12C, Limited Liability Companies, §§ 12C.26, 12C.126[2], 12C.213*].

- For detailed discussion and forms for converting a general partnership into a corporation or other entity, see Ch. 15, Part C, *Conversions and Mergers of General Partnerships* .

- For detailed discussion and forms for converting a limited partnership into a corporation or other entity, see Ch. 16B, *Conversions and Mergers of Limited Partnerships* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation &

BylawsAmendments to Articles of IncorporationBusiness & Corporate LawForeign BusinessesDomesticationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistence



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART II. LEGAL BACKGROUND

5-11F California Legal Forms--Transaction Guide § 11F.51

§ 11F.51 Definitions

[1] Other Business Entity

For purposes of the statutes governing corporate conversions, "other business entity" means a domestic or foreign limited liability company, limited partnership, general partnership, business trust, real estate investment trust, unincorporated association (other than a nonprofit association), or a domestic reciprocal insurer organized after 1974 to provide medical malpractice insurance [*Corp. Code § 1150(g)*; *see Corp. Code § 174.5*].

"Domestic other business entity" means an other business entity organized under California law [*Corp. Code § 1150(e)*; *see Corp. Code § 167.7*].

"Foreign other business entity" means an other business entity organized under the laws of any state other than California, or of the District of Columbia, or under the laws of a foreign country [*Corp. Code § 1150(f)*; *see Corp. Code § 171.07*].

[2] Converting Corporation; Converting Entity

"Converting corporation" means a corporation that converts into a domestic other business entity pursuant to Chapter 11.5 of the General Corporation Law [*Corp. Code § 1150(c)*]. "Converting entity" means an other business entity or a foreign other business entity or foreign corporation that converts into a corporation pursuant to *Corp. Code § 1157* [*Corp. Code § 1150(d)*; *see § 11F.57*].

[3] Converted Corporation; Converted Entity

"Converted corporation" means a corporation that results from a conversion of an other business entity or a foreign other business entity or a foreign corporation pursuant to *Corp. Code § 1157* [*Corp. Code § 1150(a)*; *see § 11F.55*]. "Converted entity" means a domestic other business entity that results from a conversion of a corporation under Chapter 11.5 of the General Corporation Law [*Corp. Code § 1150(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormationReal Property LawTrustsReal Estate Investment Trusts (REITs)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART II. LEGAL BACKGROUND

5-11F California Legal Forms--Transaction Guide § 11F.52

§ 11F.52 Conversion of Corporation Into Domestic Other Business Entity

[1] Carryover of Interests Required

A corporation may be converted into a "domestic other business entity" [*see § 11F.51[1]*] if, pursuant to the proposed conversion [*Corp. Code § 1151(a)*]:

- Each share of the same class or series of the converting corporation will be treated equally with respect to any cash, rights, securities, or other property to be received by, or any obligations or restrictions to be imposed on, the holder of that share, unless all the shareholders of the class or series consent to a different treatment; and

- Nonredeemable common shares of the converting corporation will be converted only into nonredeemable equity securities of the converted entity unless all of the shareholders of the class consent.

The first requirement, however, does not restrict the ability of the shareholders of a converting corporation to appoint one or more managers, if the converted entity is a limited liability company, or one or more general partners, if the converted entity is a limited partnership, in the plan of conversion or in the converted entity's governing documents [*Corp. Code § 1151(a)*].

[2] Applicable Law Must Authorize Conversion

The conversion of a corporation into a domestic other business entity may be effected only if both of the following conditions regarding applicable law are satisfied [*Corp. Code § 1151(b)*]:

- The law under which the converted entity will exist expressly permits the formation of that entity pursuant to a conversion [*see Corp. Code §§ 15677.8* (CRLPA, repealed January 1, 2010), 15911.08 (ULPA '08) (conversion into California limited partnership), 16908 (conversion into California general partnership), 17540.8 (conversion into California LLC)]; and

- The corporation complies with any and all other requirements of any other law that applies to conversion to the converted entity.

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART II. LEGAL BACKGROUND

5-11F California Legal Forms--Transaction Guide § 11F.53

§ 11F.53 Plan of Conversion

[1] Contents

A corporation that wants to convert to a domestic other business entity must approve a plan of conversion that states all of the following [*Corp. Code § 1152(a)*]:

- The terms and conditions of the conversion.
- The jurisdiction of the organization of the converted entity and of the converting corporation.
- The name of the converted entity after conversion.
- The manner of converting the shares of each of the shareholders of the converting corporation into securities of, or interests in, the converted entity.
- The provisions of the governing documents for the converted entity, including the partnership agreement or limited liability company articles of organization and operating agreement, to which the holders of interests in the converted entity are to be bound.
- Any other details or provisions that are required by the laws under which the converted entity is organized.
- Any other details or provisions that are desired by the converting corporation.

[2] Requisite Approvals

[a] All Corporations

The plan of conversion must be approved by the board of the converting corporation [*Corp. Code § 1152(b)*; *see Corp. Code § 151* ("approved by board" defined)]. Furthermore, the principal terms of the plan of the conversion must be

approved by the outstanding shares of each class of the converting corporation [*Corp. Code § 1152(b)*; *see Corp. Code § 152* ("approved by outstanding shares" defined)]. The approval of the outstanding shares may be given before or after approval by the board [*Corp. Code § 1152(b)*].

[b] Close Corporations

If a converting corporation is a close corporation, the conversion must be approved by the affirmative vote of at least two-thirds of each class of outstanding shares of that converting corporation. However, the articles may provide for a lesser vote, but not less than a majority of the outstanding shares of each class [*Corp. Code § 1152(b)*].

[c] Conversion Into Partnership or LLC

The statute also provides that if the corporation is converting into a general or limited partnership or into a limited liability company, then in addition to the approval of the shareholders, as stated in [a] and [b], *above*, the plan of conversion must be approved by each shareholder who will become a general partner or manager, as applicable, of the converted entity pursuant to the plan of conversion, unless the shareholders have dissenters' rights pursuant to *Corp. Code §§ 1159, 1300 et seq.* [*Corp. Code § 1152(c)*; *see § 11F.56*]. Since *Corp. Code § 1159* appears to grant dissenters' rights to shareholders of a converting corporation in all cases, however [*see § 11F.56*], it is unclear when this additional approval requirement would actually apply.

[3] All Non-Dissenting Shareholders Deemed Parties to Plan

When the conversion is effective [*see § 11F.54*], all shareholders of the converting corporation, except those that exercise dissenters' rights [*see Corp. Code §§ 1159, 1300 et seq.*; *§ 11F.56*], will be deemed parties to any agreement or agreements constituting the governing documents for the converted entity adopted as part of the plan of conversion, regardless of whether or not a shareholder has executed the plan of conversion or those governing documents for the converted entity. Any "deemed" adoption of governing documents will be effective at the effective time or date of the conversion [*Corp. Code § 1152(d)*].

[4] Amending of Plan of Conversion

Notwithstanding prior approval by the board, the outstanding shares, or either of them, a plan of conversion may be amended before the conversion takes effect if the amendment is approved by the board. If the amendment changes any of the principal terms of the plan of conversion, the shareholders of the converting corporation must also approve the amendment in the same manner and to the same extent as was required for approval of the original plan of conversion [*Corp. Code § 1152(e)*; *see* [2], *above*].

[5] Maintaining Plan of Conversion

The converted entity must keep the plan of conversion at one of the following locations [*Corp. Code § 1152(g)*]:

- The principal place of business of the converted entity, if the converted entity is a domestic general partnership.

- The office at which records are to be kept, if the converted entity is a domestic limited partnership [*see Corp. Code §§ 15614, 15901.11*].

- The office at which records are to be kept, if the converted entity is a domestic limited liability company [*see Corp. Code § 17057*].

On request of a shareholder of a converting corporation, the authorized person on behalf of the converted entity must

deliver to the shareholder promptly, at the expense of the converted entity, a copy of the plan of conversion. Any waiver by a shareholder of these rights is unenforceable [*Corp. Code § 1152(g)*].

[6] Abandoning Plan of Conversion

At any time before a conversion is effective, the plan of conversion may be abandoned by the board of the converting corporation, or by the shareholders of the converting corporation if the abandonment is approved by the outstanding shares. In each case, the abandonment must be approved in the same manner required for approval of the plan of conversion [*see* [2], *above*], subject to the contractual rights of third parties [*Corp. Code § 1152(f)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawLimited Liability CompaniesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART II. LEGAL BACKGROUND

5-11F California Legal Forms--Transaction Guide § 11F.54

§ 11F.54 Effective Date of Conversion

After the approval of a plan of conversion by the board and the outstanding shares of a corporation converting into a domestic other business entity [*see* § 11.53[2]], the converting corporation must file all documents required by law to effect the conversion and create the converted entity, including a certificate of conversion or a statement of conversion [*see § 11F.55*]. The conversion will be effective when this filing is made [*Corp. Code § 1153(a)*].

A copy of the statement of partnership authority, certificate of limited partnership, or articles of organization complying with *Corp. Code § 1155* [*see § 11F.55*], duly certified by the Secretary of State on or after the effective date, is conclusive evidence of the conversion of the corporation [*Corp. Code § 1153(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormationReal Property LawTrustsReal Estate Investment Trusts (REITs)Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistence



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART II. LEGAL BACKGROUND

5-11F California Legal Forms--Transaction Guide § 11F.55

§ 11F.55 Statement or Certificate of Conversion

[1] Applicable Form

[a] Domestic Limited Partnership

If a corporation is converting into a domestic limited partnership, a statement of conversion must be completed on the certificate of limited partnership for the converted entity [*Corp. Code § 1155(a)(1)*]. Secretary of State Form LP-1A [*see* Ch. 15C, *Conversions and Mergers of Limited Partnerships*, § 15C.205 (form and discussion)] is used for this purpose.

[b] Domestic Partnership

If a corporation is converting into a domestic partnership, a statement of conversion must be completed on the statement of partnership authority for the converted entity, if a statement of partnership authority has been filed. Secretary of State Form GP-1A [*see Ch. 15, Part C, Conversions and Mergers of General Partnerships, § 15.801* (form and discussion)] is used for this purpose.

If no statement of partnership authority has been filed, however (nonregistered general partnership), a certificate of conversion must be filed separately on a form prescribed by the Secretary of State [*Corp. Code § 1155(a)(2), (c)*]. Secretary of State Form CONV-1A is used for the that purpose [*see § 11F.210* (form and discussion)].

[c] Domestic Limited Liability Company

If a corporation is converting into a domestic limited liability company, a statement of conversion must be completed on the articles of organization for the converted entity [*Corp. Code § 1155(a)(3)*]. Secretary of State Form LLC-1A [*see* Ch. 12C, *Limited liability Companies*, § 12C.200A (form and discussion)] is used for this purpose.

[2] Contents

A statement or certificate of conversion of a converting corporation must set forth all of the following [*Corp. Code §*

1155(b)]:

- The name and the Secretary of State's file number of the converting corporation.

- A statement of the total number of outstanding shares of each class entitled to vote on the conversion.

- That the principal terms of the plan of conversion were approved by a vote of the number of shares of each class which equaled or exceeded the required vote [*see Corp. Code § 1152*], specifying each class entitled to vote and the percentage vote required of each class.

- The name, form, and jurisdiction of organization of the converted entity.

[3] Execution and Acknowledgment of Form

A statement or certificate of conversion of a converting corporation must be executed and acknowledged by those officers of the converting corporation who would be required to sign an officers' certificate [*Corp. Code § 1155(b)*; *see Corp. Code § 173* ("officers' certificate" defined)]: the chair of the board, the president or any vice president, *and* the secretary, chief financial officer, treasurer or any assistant secretary or assistant treasurer.

[4] Certificate of Dissolution Not Required

No converting corporation that has filed a statement of conversion or certificate of conversion with the Secretary or State is required to file a certificate of election [*see Corp. Code § 1901*] or a certificate of dissolution [*see Corp. Code § 1905*] as a result of the conversion [*Corp. Code § 1155(d)*]. Filing a statement of conversion or a certificate of conversion with the Secretary of State has the effect of the filing of a certificate of dissolution by the converting corporation [*Corp. Code § 1155(d)*].

[5] Tax Clearance Certificate Requirement

No statement or certificate of conversion may be filed with the Secretary of State until a certificate of satisfaction of the Franchise Tax Board that all taxes imposed have been paid or secured has been filed by or on behalf of the converting corporation [*Corp. Code § 1155(e)*].

If, however, the converted entity is a domestic general partnership, domestic limited partnership, or domestic limited liability company, the Secretary of State will file the statement or certificate of conversion without a certificate of satisfaction and will notify the Franchise Tax Board of the conversion. When the conversion is effective, a converted entity that is a domestic general partnership, domestic limited partnership, or domestic limited liability company will be deemed to have assumed the liability of the converting corporation to (1) to prepare and file or cause to be prepared and filed all tax and information returns otherwise required of the converting corporation, and (2) pay any tax liability determined to be due pursuant to that law [*Corp. Code § 1155(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormation



171 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART II. LEGAL BACKGROUND

5-11F California Legal Forms--Transaction Guide § 11F.56

§ 11F.56 Dissenters' Rights

Shareholders of a converting corporation may dissent from the proposed conversion. A conversion pursuant to Chapter 11.5 of the General Corporation Law [*see Corp. Code § 1150 et seq.*] is deemed to constitute a reorganization [*see Corp. Code § 181* ("reorganization" defined)] solely for purposes of applying the provisions of Chapter 13 (dissenters' rights in reorganizations) [*Corp. Code § 1313*; *see Corp. Code § 1300 et seq.*]. Therefore, the shareholders of a converting corporation have all of the rights under Chapter 13 of the shareholders of a corporation involved in a reorganization requiring the approval of its outstanding shares [*Corp. Code § 1159*; *see Corp. Code § 152*]. Correspondingly, the converting corporation has all of the obligations under Chapter 13 of a corporation involved in a reorganization [*Corp. Code § 1159*].

Solely for purposes of applying the dissenters' provisions of Chapter 13, and not for purposes of Chapter 12 governing reorganizations [*see Corp. Code § 1200 et seq.*], a corporate conversion [*see Corp. Code §§ 1151, 1157*] is deemed to constitute a reorganization [*Corp. Code § 1159*]. For discussion of reorganizations, see Ch. 11C, *Mergers* . Dissenters' rights are *covered in Ch. 11C, Mergers, § 11C.150* et seq.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentMergersBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART II. LEGAL BACKGROUND

5-11F California Legal Forms--Transaction Guide § 11F.57

§ 11F.57 Conversion of Other Business Entity Into Corporation

[1] Law Must Authorize Conversion

An other business entity, a foreign other business entity, or a foreign corporation may be converted into a corporation, provided the converting entity is authorized by the laws under which it is organized to effect the conversion [*Corp. Code § 1157(a)*]. California law specifically authorizes California general partnerships, limited partnerships, and limited liability companies to convert to California corporations [*see Corp. Code §§ 15677.2* (CRLPA, repealed January 1, 2010), 15911.02(a)(3) (ULPA '08) (limited partnerships), 16902 (general partnerships), 17540.2 (limited liability companies)]. For foreign business entities, the governing law of the state or country of organization must be reviewed to determine if that law authorizes conversion to a California corporation.

The California statutes governing general partnerships, limited partnerships,and limited liability companies set forth their own requirements and procedures for converting each of those types of entities into other business entities, including corporations. These requirements and procedures are specific to the type of entity involved, and are not discussed in detail in this chapter. For detailed discussion of the conversion requirements applicable to these entities, and the appropriate form for the specific type of entity involved, see Ch. 12C, *Limited Liability Companies* , Ch. 15, Part C, *Conversion and Mergers of General Partnerships* and Ch. 16B, *Conversions and Mergers of Limited Partnerships*, as appropriate.

The requirements of *Corp. Code § 1157* do not apply to a foreign corporation's conversion into another foreign corporation. Therefore, the capacity of a qualified foreign corporation to do business, and to appear in legal proceedings, in California cannot be affected by the corporation's noncompliance with that code section in the event that the corporation converts, for example, from a Nevada corporation into a Delaware corporation [*Capital Gold Group, Inc. v. Nortier (2009) 176 Cal. App. 4th 1119, 1130-1132, 98 Cal. Rptr. 3d 439]* .

[2] Approvals

An other business entity, a foreign other business entity, or a foreign corporation that desires to convert into a corporation must approve a plan of conversion or other instrument that is required to be approved to effect the conversion pursuant to the laws under which that entity is organized [*Corp. Code § 1157(b)*; *see Corp. Code §§*

15677.3(a) (CRLPA, repealed January 1, 2010), 15911.03(a) (ULPA '08) (California limited partnerships), 16903(a) (California general partnerships), 17540.3(a) (California limited liability companies)].

The conversion of an other business entity or a foreign other business entity or a foreign corporation must be approved by the number or percentage of the partners, members, shareholders, or other holders of interest of the converting entity that is required by the laws under which that entity is organized, or any greater or lesser percentage that set forth in the converting entity's organizational document in accordance with applicable laws [*Corp. Code § 1157(c)*; *see Corp. Code §§ 15677.3(b)* (CRLPA, repealed January 1, 2010), 15911.03(b) (ULPA '08) (California limited partnerships), *16903(b)* (California general partnerships), *17540.3(b)* (California limited liability companies)].

[3] Filing Statement of Conversion

The conversion by an other business entity, foreign other business entity, or foreign corporation will be effective as of the filing with the Secretary of State of the articles of incorporation of the converted corporation containing a statement of conversion [*Corp. Code § 1157(d)*]. This filing has the effect of the filing of a certificate of cancellation by a converting foreign limited liability company or foreign limited partnership. No converting foreign limited liability company or foreign limited partnership that has made the filing is required to file a certificate of cancellation as a result of that conversion [*Corp. Code § 1157(f)*; *see Corp. Code §§ 15696*, 15909.06, *17455*]. If a converting entity is a foreign corporation qualified to transact business in California, the foreign corporation, by virtue of the filing, automatically surrenders its right to transact intrastate business [*Corp. Code § 1157(f)*].

The Secretary of State has developed sample articles of incorporation, containing the required statement of conversion, for limited liability companies, general partnerships, and limited partnerships. These samples are reproduced in this publication in the chapters dealing with conversion of each respective type of entity. For articles of incorporation for a converting limited liability company, see *Ch. 12C, Limited Liability Companies, § 12C.213*. For articles of incorporation for a converting general partnership, see Ch. 15, Part C, *Conversion and Mergers of General Partnerships* , §§ 15.803, 15.804. For articles of incorporation for a converting limited partnership, see Ch. 15C, *Conversions and Mergers of Limited Partnerships*, § 15C.207.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawForeign BusinessesDomesticationBusiness & Corporate LawLimited Liability CompaniesDissolution & Winding UpBusiness & Corporate LawLimited PartnershipsDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART II. LEGAL BACKGROUND

5-11F California Legal Forms--Transaction Guide § 11F.58

§ 11F.58 Effect of Conversion on Converting Entity

[1] Converting Entity Unchanged

Any entity that converts into another entity is the same entity that existed before the conversion, for all purposes other than for purposes of Parts 10 (Personal Income Tax), 10.2 (administration of franchise and income tax laws), and 11 (Corporation Tax Law) of Division 2 of the Revenue and Taxation Code [*Corp. Code § 1158(a)*; *see Rev. & Tax. Code §§ 17001 et seq., 18401 et seq., 23001 et seq.*].

As of the effective date of conversion, all of the following apply [*Corp. Code § 1158(b)*]:

- All the rights and property, whether real, personal, or mixed, of the converting entity or converting corporation are vested in the converted entity or converted corporation.

- All debts, liabilities, and obligations of the converting entity or converting corporation continue as debts, liabilities, and obligations of the converted entity or converted corporation.

- All rights of creditors and liens upon the property of the converting entity or converting corporation are preserved unimpaired and remain enforceable against the converted entity or converted corporation to the same extent as against the converting entity or converting corporation as if the conversion had not occurred.

- Any action or proceeding pending by or against the converting entity or converting corporation may be continued against the converted entity or converted corporation as if the conversion had not occurred.

[2] Shareholder Liability

[a] In General

A shareholder of a converting corporation is liable for the following [*Corp. Code § 1158(c)*]:

- All obligations of the converting corporation for which the shareholder was personally liable before the conversion, but only to the extent that the shareholder was personally liable for the obligations of the converting corporation before the conversion.

- All obligations of the converted entity incurred after the conversion takes effect if:

  - The shareholder becomes a general partner of a converted entity that is a general or limited partnership and, as a general partner, has liability under the laws under which the converted entity is organized or under the converted entity's governing documents; or

  - The shareholder becomes a holder of other interests in the converted entity and, as a holder, has liability under the laws under which the converted entity is organized or under the converted entity's governing documents.

A shareholder of a converted corporation remains liable for any and all obligations of the converting entity for which the shareholder was personally liable before the conversion, but only to the extent that the shareholder was personally liable for the obligations of the converting entity before the conversion [*Corp. Code § 1158(d)*].

[b] Converting General Partnership

If a party to a transaction with a converted corporation that converted from a partnership reasonably believes when entering into the transaction that a shareholder of the converted corporation continues to be a general partner of the converting entity after the conversion is effective, and the shareholder was a general partner of the partnership that converted into the converted corporation, the shareholder is liable for any obligation incurred by the converted corporation within 90 days after the conversion takes effect [*Corp. Code § 1158(e)*]. The shareholder's liability for all other obligations of the converted corporation incurred after the conversion takes effect is that of a corporate shareholder [*Corp. Code § 1158(e)*].

[3] Notice to Creditors

The converted entity must cause written notice of the conversion to be given by mail within 90 days after the effective date of the conversion to all known creditors and claimants whose addresses appear on the records of the converting entity. Failure to comply with this requirement, however, does not affect the validity of the conversion, extend the 90-day period of shareholder liability [*see Corp. Code § 1158(e)*; *see also* [2], *above*], or otherwise affect the rights of a creditor or claimant under *Corp. Code § 1158* [*Corp. Code § 1158(f)*]. For a form for this notice to creditors, see *§ 11F.280*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesPersonal LiabilityBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionContinuation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART II. LEGAL BACKGROUND

5-11F California Legal Forms--Transaction Guide § 11F.59

§ 11F.59 Title to Real Property of Converting Entity

[1] Recording Requirements

Whenever an entity having any real property in California converts into a corporation or an other business entity pursuant to California law or the law of the state or place in which the corporation or other business entity was organized, and the laws of the state or place of organization (including California) of the converting corporation or other converting entity provide substantially that the conversion vests in the converted corporation or other converted entity all the real property of the converting corporation or other converting entity [*see Corp. Code §§ 15677.7* (real property of converting California limited partnership), 16907 (CRLPA, repealed January 1, 2010), 15911.07 (ULPA '08) (real property of converting California general partnership), 17540.7 (real property of converting California limited liability company)], either of the following may be filed for record in the office of the county recorder of any county in California in which any of the real property of the converting corporation or other converting entity is located [*Corp. Code § 1156(a)*]:

- A certificate of conversion or statement of partnership authority, certificate of limited partnership, or articles of organization containing a statement of conversion complying with *Corp. Code § 1155* [*see § 11F.55*] that is certified on or after the effective date of the conversion by the Secretary of State; or

- A copy of a certificate of conversion or a statement of partnership authority, certificate of limited partnership, articles of organization, articles of incorporation, or other comparable organizing document evidencing the creation of a foreign other business entity or foreign corporation, containing a statement of conversion, meeting the requirements of *Corp. Code § 1156(b)* [*see* discussion *below*] and certified on or after the effective date of the conversion by the Secretary of State or any other authorized public official of the state or place pursuant to the laws of which the converted entity is organized.

This filing provides evidence of record ownership in the converted corporation or other converted entity of all interest of the converting corporation or other converting entity in and to the real property located in that county [*Corp. Code § 1156(a)*].

Corp. Code § 1156(b) provides that a filed and (if appropriate) recorded certificate of conversion, or a statement of partnership authority, certificate of limited partnership, articles of organization, articles of incorporation, or other comparable organizing document evidencing the formation of a foreign other business entity or a foreign corporation that contains a statement of conversion, stating the name of the converting corporation or other converting entity in whose name property was held before the conversion and the name of the converted entity or converted corporation, but not containing all of the other information required by *Corp. Code § 1155* [*see § 11F.55*], operates with respect to the converted entity named to the same extent [*Corp. Code § 1156(b)*].

[2] Presumption in Favor of Bona Fide Purchasers

The recording of a certificate of conversion, or statement of partnership authority, certificate of limited partnership, articles of organization, articles of incorporation, or other comparable organizing document evidencing the creation of an other business entity or a corporation, containing a statement of conversion [*see Corp. Code § 1156(a)*; *see also* [1], *above*], creates a conclusive presumption in favor of bona fide purchasers or encumbrances for value that the conversion was validly completed [*Corp. Code § 1156(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawPriorities & RecordingRecording Acts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART II. LEGAL BACKGROUND

5-11F California Legal Forms--Transaction Guide §§ 11F.60-11F.99

[Reserved]

§§ 11F.60[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

5-11F California Legal Forms--Transaction Guide § 11F.100

§ 11F.100 Facts

[1] General Information

1. Form and business of existing entity.

2. Reasons why entity proposes to convert into another form of entity.

3. Following information about existing entity:

    a. Mailing address.

    b. Telephone and fax number.

    c. Tax identification number of business.

    d. Name and address of registered agent for service of process.

4. Desired effective date of proposed conversion.

5. Any provisions in governing documents regarding required approval for conversion.

6. All information concerning any pending litigation to which entity is party, including names of counsel.

7. Jurisdiction of converting entity.

8. Persons who will be general partners, managers, members, directors, or officers in converted entity.

9. Persons likely to dissent from conversion.

10. Whether converting entity is aware of potential costs of conversion:

a. Attorney, accountant, and appraiser fees.

b. Property taxation of changes in ownership.

c. Franchise taxes and fees.

d. Income tax consequences.

[2] Information for Corporation Converting to Other Business Entity

NOTE:
This specific information is required in the corporation's plan of conversion [***see*** *Corp. Code § 1152(a)*; ***see also*** *§ 11F.150*].

1. Terms and conditions of conversion.

2. Jurisdiction of organization of both:

a. Converting corporation.

b. Converted entity.

3. Name of converted entity after conversion.

4. Manner of converting shares of converting corporation into securities of, or interests in, converted entity.

5. Provisions of governing documents for converted entity (including partnership agreement or limited liability company articles of organization and operating agreement), to which interest holders of converted entity will be bound.

6. Other details or provisions required by laws under which converted entity is organized.

7. Other details or provisions of conversion desired by converting corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

5-11F California Legal Forms--Transaction Guide § 11F.101

§ 11F.101 Documents

1. Copy of governing documents for converting corporation, including all amendments.

2. If entity involved in conversion is foreign entity, copy of applicable law governing conversion.

3. Copies of any powers of attorney under which governing documents were executed.

4. Current financial statements and/or balance sheet.

5. Most recent tax returns of converting entity.

6. List of converting entity's assets.

7. All instruments evidencing title to property owned by converting entity, such as:

    a. Deeds.

    b. Leases.

    c. Documents of title to motor vehicles.

    d. Liens, deed of trust, or mortgages.

8. Licenses, permits, and patents, if any.

9. Franchise agreements, if any.

10. Fictitious business name statement, if any.

11. Insurance policies on all real and personal property.

12. List of all creditors of converting entity, and their addresses [*see § 11F.171*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

5-11F California Legal Forms--Transaction Guide §§ 11F.102-11F.109

[Reserved]

§§ 11F.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11F California Legal Forms--Transaction Guide § 11F.110

§ 11F.110 Approval of Conversion

1. Determine whether conversion can be approved by required vote of converting corporation:

a. By board of converting corporation [*Corp. Code § 1152(b)*; *see Corp. Code § 151*].

b. By outstanding shares of each class of converting corporation [*Corp. Code § 1152(b)*; *see Corp. Code § 152*].

NOTE:
The principal terms of the plan of the conversion must be approved by the outstanding shares of each class of the converting corporation [*Corp. Code § 1152(b)*; ***see*** *Corp. Code § 152*]. For discussion of these general approval requirements for a plan of conversion, see *§ 11F.53[2]* .

c. If converting corporation is close corporation, by affirmative vote of at least two thirds of each class of outstanding shares [*Corp. Code § 1152(b)*; *see § 11F.53[2]*]?

NOTE:
The statute also provides that if the corporation is converting into a general or limited partnership or into a limited liability company, then in addition to the approval of the shareholders, the plan of conversion must be approved by each shareholder who will become a general partner or manager, as applicable, of the converted entity pursuant to the plan of conversion ***unless the shareholders have dissenters' rights*** pursuant to *Corp. Code §§ 1159, 1300 et seq.* [*Corp. Code § 1152(c)*]. Since *Corp. Code § 1159* appears to grant dissenters' rights to shareholders of a converting corporation in all cases, however, it is unclear when this additional approval requirement would actually apply.

2. With respect to possible dissent:

NOTE:

Shareholders of a converting corporation may dissent from the proposed conversion. A conversion pursuant to Chapter 11.5 of the General Corporation Law [***see*** *Corp. Code § 1150 et seq.*] is deemed to constitute a reorganization [***see*** *Corp. Code § 181* (definition)] solely for purposes of applying the provisions of Chapter 13 of the Corporations Code, relating to dissenters' rights in reorganizations [*Corp. Code § 1313*; ***see*** *Corp. Code § 1300 et seq.*]. Therefore, the shareholders of a converting corporation have all of the rights under Chapter 13 of the shareholders of a corporation involved in a reorganization requiring the approval of its outstanding shares [*Corp. Code § 1159*; ***see*** *Corp. Code § 152*]. For discussion of dissenters' rights in reorganizations, see *Ch. 11C, **Mergers** § 11C.150* et seq.

a. Are any shareholders likely to dissent?

b. How will purchase of dissenting interests be funded?

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistenceBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11F California Legal Forms--Transaction Guide § 11F.111

§ 11F.111 Provisions Regarding Conversion

1. Determine what details or provisions are required by laws under which converted entity is to be organized.

NOTE:
These provisions must be included in the plan of conversion [***see*** *Corp. Code § 1152(a)*; *§ 11F.150*].

2. Determine what additional details or provisions are desired by converting corporation.

NOTE:
These provisions may be included in the plan of conversion [***see*** *Corp. Code § 1152(a)*; § 11F.150].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-11F California Legal Forms--Transaction Guide §§ 11F.112-11F.119

[Reserved]

§§ 11F.112[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-C California Legal Forms--Transaction Guide Scope

Scope

NOTE: The conversion of California limited partnerships, general partnerships, and limited liability companies into domestic or foreign "other business entities," including corporations [***see*** *Corp. Code §§ 15677.2*, *16902*, *17540.2*] is briefly discussed in *§ 11F.57*. These conversions are primarily discussed in their respective chapters: Ch. 12C, ***Limited Liability Companies*** [***see*** *§§ 12C.26*, *12C.213*]; Ch. 15, Part C, ***Conversion and Mergers of General Partnerships,*** *§ 15.602*; and Ch. 15C, ***Conversions and Mergers of Limited Partnerships*** [§ 15C.30.

This transaction guide does not attempt to enumerate the steps necessary to form the entities into which a corporation or other business entity can convert. If the converted entity is a corporation, limited partnership, general partnership, or a limited liability company, the chapters containing the appropriate procedures and forms should be consulted [***see*** Ch. 2, ***Formation of Corporations*** ; Ch. 15A, ***Formation of Limited Partnerships*** ; Ch. 15, Part A ***Formation of General Partnerships*** , ***Formation of General Partnerships***; Ch. 12C, ***Limited Liability Companies***].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-11F California Legal Forms--Transaction Guide § 11F.120

§ 11F.120 Conversion of California Corporation Into Other Business Entity

NOTE:

Chapter 11.5 of the General Corporation Law [***see*** *Corp. Code §§ 161.9, 1150 et seq.*] permits the conversion of corporations into domestic "other business entities." However, a California corporation cannot convert into a foreign corporation or foreign other business entity.

"Other business entity" means a domestic or foreign limited liability company, limited partnership, general partnership, business trust, real estate investment trust, unincorporated association (other than a nonprofit association), or a domestic reciprocal insurer organized after 1974 to provide medical malpractice insurance [*Corp. Code § 1150(g)*; *see* *Corp. Code § 174.5*].

"Domestic other business entity" means an other business entity organized under California law [*Corp. Code § 1150(e)*; *see* *Corp. Code § 167.7*]. "Foreign other business entity" means an other business entity organized under the laws of any state other than California, or of the District of Columbia, or under the laws of a foreign country [*Corp. Code § 1150(f)*; ***see*** *Corp. Code § 171.07*].

1. Draft plan of conversion [*see Corp. Code § 1152*; *see also §§ 11F.150* (drafting guide), 11F.200 (form)].

2. Submit plan of conversion to all of following for approval:

a. Board of directors of converting corporation.

NOTE:

The plan must be approved by the board of the converting corporation [*Corp. Code § 1152(b)*; ***see*** *Corp. Code § 151*].

b. Outstanding shares of each class of converting corporation.

NOTE:

The ***principal terms*** of the plan must be approved by the outstanding shares of each class of the converting corporation [*Corp. Code § 1152(b)*; ***see*** *Corp. Code § 152*]. The approval of the outstanding shares may be given before or after approval by the board [*Corp. Code § 1152(b)*].

If the converting corporation is a close corporation, the conversion must be approved by the affirmative vote of at least two-thirds of each class of outstanding shares of that converting corporation. However, the articles may provide for a lesser vote, but not less than a majority of the outstanding shares of each class [*Corp. Code § 1152(b)*].

c. Each shareholder who will become general partner or manager of converted entity, if corporation is converting into general partnership, limited partnership, or LLC [*but see* NOTE, *below*].

NOTE:

The statute provides that if the corporation is converting into a general or limited partnership or into a limited liability company, then in addition to the approval of the shareholders, the plan of conversion must be approved by each shareholder who will become a general partner or manager, as applicable, of the converted entity pursuant to the plan of conversion ***unless the shareholders have dissenters' rights*** pursuant to *Corp. Code §§ 1159, 1300 et seq.* [*Corp. Code § 1152(c)*; ***see*** [8], ***below***]. Since *Corp. Code § 1159* appears to grant dissenters' rights to shareholders of a converting corporation in all cases, however, it is unclear when this additional approval requirement would actually apply.

3. Advise corporation that converted entity must keep plan of conversion at one of following locations [*Corp. Code § 1152(g)*]:

NOTE:

Upon the request of a shareholder of the converting corporation, an authorized person of the converted entity must promptly deliver a copy of the plan of conversion to the shareholder. The copy must be made at the expense of the converted entity. Any waiver by a shareholder of these rights is unenforceable [*Corp. Code § 1152(g)*].

a. If converted entity is domestic general partnership, at principal place of business.

b. If converted entity is domestic limited partnership, at office where records are to be kept [*see Corp. Code §§ 15614, 15901.11*].

c. If converted entity is domestic limited liability company, at office where records are to be kept [*see Corp. Code § 17057*].

4. If amendment to plan of conversion is required before conversion takes effect [*Corp. Code § 1152(e)*]:

NOTE:

Notwithstanding prior approval of the plan by the board, the outstanding shares, or either of them, a plan may be amended before the conversion takes effect if approval requirements are met [*Corp. Code § 1152(e)*].

a. Have board of directors approve amendment.

b. If amendment changes any principal terms of plan, have shareholders approve amendment.

NOTE:
In these circumstances, the shareholders of the converting corporation must approve the amendment in the same manner and to the same extent as was required for approval of the original plan [*Corp. Code § 1152(e)*; ***see*** [2], ***above***].

5. If corporation decides to abandon conversion before conversion is effective, arrange for applicable vote.

NOTE:
A plan of conversion may be abandoned by the board of a converting corporation, or by the shareholders if the abandonment is approved by the outstanding shares, in each case in the same manner as required for approval of the plan of conversion, subject to the contractual rights of third parties [*Corp. Code § 1152(e)*; ***see*** [2], ***above***].

6. Draft resolution authorizing conversion of corporation into other business entity [*see §§ 11F.151* (drafting guide), 11F.201 (form)].

7. Have directors adopt resolution authorizing conversion.

NOTE:
For procedures applicable to meetings and resolutions of the board of directors, see Ch. 5, ***Directors' Meetings, Actions, and Resolutions*** .

8. Comply with dissenters' rights [*see* Ch. 12, *Mergers*, § 12C.150, for a procedural guide for dissenting shareholders)].

NOTE:
A conversion pursuant to Chapter 11.5 of the General Corporation Law [***see*** *Corp. Code § 1150 et seq.*] is deemed to constitute a reorganization [***see*** *Corp. Code § 181* ("reorganization" defined)] solely for purposes of applying the provisions of Chapter 13 (dissenters' rights in reorganizations) [*Corp. Code § 1313*; ***see*** *Corp. Code § 1300 et seq.*]. Therefore, the shareholders of a converting corporation have all of the rights under Chapter 13 of the shareholders of a corporation involved in a reorganization requiring the approval of its outstanding shares, and the converting corporation has all of the obligations under Chapter 13 of a corporation involved in a reorganization [*Corp. Code § 1159*; ***see*** *§ 11F.56*].

9. Complete and file statement or certificate of conversion, as appropriate, with Secretary of State [*Corp. Code § 1155(a)*]:

a. If corporation is converting into domestic limited partnership, file Secretary of State Form LP-1A, Certificate of Limited Partnership--Conversion [*Corp. Code § 1155(a)(1)*].

NOTE:
See Ch. 15C, ***Conversions and Mergers of Limited Partnerships***, § 15C.205 for an example and discussion of this form.

b. If corporation is converting into domestic general partnership [*Corp. Code § 1155(a)(2), (c)*], file:

(1) Secretary of State Form GP-1A, General Partnership Statement of Partnership--Conversion; or

NOTE:
See *Ch. 15, Part C,* ***Conversion and Mergers of General Partnerships****, § 15.801* for an example and discussion of this form.

(2) Secretary of State Form CONV-1A, Certificate of Conversion, if no statement of partnership authority is filed.

NOTE:
See *§ 11F.210* for an example and discussion of the official form. **That form contains the language prescribed by statute [*see* *Corp. Code § 1155(b)*]**.

c. If corporation is converting into domestic LLC, file Secretary of State Form LLC-1A, Limited Liability Company Articles of Organization--Conversion [*Corp. Code § 1155(a)(3)*].

NOTE:
See Ch. 12C, ***Limited liability Companies***, § 12C.200A for an example and discussion of this form.

10. Have statement or certificate of conversion executed and acknowledged by officers of converting corporation who would be required to sign officers' certificate [*Corp. Code § 1155(b)*; *see Corp. Code § 173*].

a. Chairman of the board, president, or any vice president; and

b. Secretary, chief financial officer, treasurer or any assistant secretary or assistant treasurer.

11. File statement or certificate, as appropriate, with Secretary of State.

NOTE:
After the approval of a plan of conversion by the board and the outstanding shares of a corporation converting into a domestic other business entity [***see*** [2], ***above***], the converting corporation must file all documents required by law to effect the conversion and create the converted entity, including a certificate of conversion or a statement of conversion. The conversion thereupon will be effective [*Corp. Code § 1153(a)*].

A copy of the statement of partnership authority, certificate of limited partnership, or articles of organization complying with *Corp. Code § 1155,* duly certified by the Secretary of State on or after the effective date, is conclusive evidence of the conversion of the corporation [*Corp. Code § 1153(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistenceBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-11F California Legal Forms--Transaction Guide §§ 11F.121-11F.149

[Reserved]

§§ 11F.121[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
D. Drafting Guide for Converting Corporations Into Other Business Entities

5-11F California Legal Forms--Transaction Guide § 11F.150

§ 11F.150 Plan of Conversion

1. Set forth all of following [*Corp. Code § 1152(a)*]:

NOTE:
These items are required in the plan of conversion [*Corp. Code § 1152(a)*]. For an example of a plan of conversion, see § 11F. 200.

a. Terms and conditions of conversion.

b. Jurisdiction of organization of both:
(1) Converting corporation.

(2) Converted entity.

c. Name of converted entity after conversion.

d. Manner of converting shares of converting corporation into securities of, or interests in, converted entity.

e. Provisions of governing documents for converted entity (including partnership agreement or limited liability company articles of organization and operating agreement), to which interest holders of converted entity will be bound.

2. Include any other details or provisions required by laws under which converted entity is organized [*Corp. Code § 1152(a)*].

3. Add any other details or provisions desired by converting corporation [*Corp. Code § 1152(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawForeign BusinessesDomesticationBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistence



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
D. Drafting Guide for Converting Corporations Into Other Business Entities

5-11F California Legal Forms--Transaction Guide § 11F.151

§ 11F.151 Resolution Authorizing Conversion

NOTE:
California law neither defines resolutions nor prescribes a form for them. However, certain standard formats are commonly used. For an example of a resolution authorizing conversion, see *§ 11F.201*. For discussion and examples of resolutions generally, see *Ch. 5,* ***Directors' Meetings, Actions, and Resolutions****, § 5.240* et seq.

1. Set forth board of directors' decision to convert into other business entity and any specific reasons for conversion.

2. State that corporation has adopted a plan of conversion, including date of instrument.

3. Specify type of entity into which corporation will convert.

4. Include fact that both of following have approved principal terms of the plan of conversion:

NOTE:
Corp. Code § 1152 contains the specific approval requirements [***see*** *§ 11F.53[2]*].

a. Board of directors.

b. Outstanding shares of each class.

5. Indicate compliance with conversion prerequisites regarding carryover of shareholder interests and applicable governing.

NOTE:

Those requirements are set forth in *Corp. Code § 1151* [***see § 11F.52***].

6. Include authorization for each officer of corporation to execute all documents and to take all actions necessary or advisable to carry out purpose of resolution.

7. If desired, include direction for corporate secretary to attach copy of plan of conversion to minutes of meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
D. Drafting Guide for Converting Corporations Into Other Business Entities

5-11F California Legal Forms--Transaction Guide §§ 11F.152-11F.169

[Reserved]

§§ 11F.152[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

5-11F California Legal Forms--Transaction Guide § 11F.170

§ 11F.170 Filing With County Recorder

1. Record certified original or copy of certificate or statement of conversion in each county where converted entity owns real property [*Corp. Code § 1156(a)*].

NOTE:

Recordation provides notice to third parties and also provides a title chain for the real property for title insurance purposes. Furthermore, recordation will create, in favor of bona fide purchasers or encumbrances for value, a conclusive presumption that the conversion was validly completed [*Corp. Code § 1156(a)*; ***see*** *§ 11F.59*].

2. Pay applicable recording fee [*see Gov. Code § 27361(a)*].

NOTE:

There also is a separate fee for certifying the copy [*see Gov. Code § 27364*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawPriorities & RecordingRecording Acts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

5-11F California Legal Forms--Transaction Guide § 11F.171

§ 11F.171 Giving Notice of Conversion

1. Compile list of all creditors and claimants of converting entity and their mailing addresses.

2. Give notice of fact and effective date of conversion to all creditors and claimants.

NOTE:

A converted entity must cause written notice of the conversion to be given by mail within 90 days after the effective date of the conversion to all known creditors and claimants whose addresses appear on the records of the converting entity. Failure to comply with this requirement, however, does not affect the validity of the conversion, extend the 90-day period of shareholder liability [***see*** *Corp. Code § 1158(e)*; ***see also*** *§ 11F.58[2]*], or otherwise affect the rights of a creditor or claimant under this section [*Corp. Code § 1158(f)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistenceContracts LawDebtor & Creditor Relations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

5-11F California Legal Forms--Transaction Guide §§ 11F.172-11F.199

[Reserved]

§§ 11F.172[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART IV. FORMS
A. Corporate Forms

5-11F California Legal Forms--Transaction Guide § 11F.200

§ 11F.200 Plan of Conversion

[1] Comment

[a] Use of Form

This form is a plan of conversion to convert a corporation to a "domestic other business entity" pursuant to Chapter 11.5 of the General Corporation Law [*Corp. Code § 1150 et seq.*]. The term "corporation" unless modified means a corporation organized under the General Corporation Law or subject to its provisions pursuant to *Corp. Code § 102(a)* [*see Corp. Code § 162*.] The term "domestic other business entity" means a domestic (California) limited liability company, limited partnership, general partnership, business trust, real estate investment trust, unincorporated association (other than a nonprofit association), or a domestic reciprocal insurer organized after 1974 to provide medical malpractice insurance [*Corp. Code § 1150(c)*; *see Corp. Code § 174.5*].

There are no statutory provisions in California allowing a corporation to convert into a foreign corporation or foreign other business entity. (The term "foreign other business entity" includes the same types of entities listed in the definition of "domestic other business entity" above, except that such an entity is organized in a jurisdiction other than California [*Corp. Code § 1150(f)*]). A domestic corporation, however, can become a foreign corporation or foreign other business entity through the process of merger [*see Corp. Code §§ 1108, 1113*]. This requires a second entity, but creating one for a merger is easy and relatively inexpensive. A domestic corporation can also "convert" into a California nonprofit or consumer cooperative corporation without using a second entity by amending its articles as permitted by *Corp. Code § 911*.

Under this form the shares of the converting entity will be exchanged for equal interests in the converted entity. Unequal treatment of shares of the same class or series is permitted only with the unanimous approval of all the shareholders of that class or series [*see Corp. Code § 1151(a)*; *see also § 11F.52*].

[b] Contents of Plan

A corporation converting to a domestic other business entity must approve a plan of conversion that states all of the

following [*Corp. Code § 1152(a)*; *see* [2], *below*]:

- The terms and conditions of the conversion.
- The jurisdiction of organization of the converted entity and of the converting corporation.
- The name of the converted entity after conversion.
- The manner of converting shares of each shareholder of the converting corporation into securities of, or interests in, the converted entity.
- The provisions of the governing documents for the converted entity, including the partnership agreement or limited liability company articles of organization and operating agreement, to which the holders of interests in the converted entity are to be bound. Specification of these documents in the text of the statute does not mean that provisions of corresponding documents for another kind of entity need not be included; provisions of the plan should include whatever documentation would be needed for the proper organization and governance of the converted entity.
- Any other details or provisions that are required by the laws under which the converted entity is organized.
- Any other details or provisions desired by the converting corporation.

[c] Approval by Board and Shareholders

The board of the converting corporation must approve the plan of conversion, and the outstanding shares of each class of the converting corporation must approve the principal terms of that plan [*Corp. Code § 1152(b)*; *see Corp. Code §§ 151, 152*]. The approval of the outstanding shares may be given before or after approval by the board [*Corp. Code § 1152(b)*].

If the converting corporation is a close corporation, the conversion must be approved by the affirmative vote of at least two thirds of each class of its outstanding shares. However, its articles may provide for a lesser vote, but not less than a majority of the outstanding shares of each class [*Corp. Code § 1152(b)*].

If the corporation is converting into a general or limited partnership or into a limited liability company, then, in addition to the approval of the shareholders described above, the statute states that plan of conversion must be approved by each shareholder who will become a general partner or manager, as applicable, of the converted entity pursuant to the plan of conversion *unless the shareholders have dissenters' rights* pursuant to *Corp. Code §§ 1159, 1300 et seq.* [*Corp. Code § 1152(c)*; *see § 11F.56*]. The statutory use of the word "unless" seems inapt since *Corp. Code § 1159* seems to provide shareholders of the converting corporation with dissenters' rights in all cases.

[d] Amending or Abandoning Plan of Conversion

Notwithstanding prior approval by either or both of the board or the outstanding shares, a plan of conversion may be amended before the conversion takes effect if the amendment is approved by the board. If, however, the amendment changes any of the principal terms of the plan, the shareholders of the converting corporation must also approve the amendment in the same manner and to the same extent as was required for approval of the original plan of conversion [*Corp. Code § 1152(e)*].

Furthermore, at any time before a conversion is effective, the plan of conversion may be abandoned by the board of the

converting corporation, or by the shareholders of the converting corporation if the abandonment is approved by the outstanding shares [*Corp. Code § 152*]. In each case, the abandonment must be approved in the same manner required for approval of the plan [*see* [c], *above*], subject to the contractual rights of third parties [*Corp. Code § 1152(f)*].

[e] All Non-Dissenting Shareholders Deemed Parties to Plan

When the conversion is effective, all shareholders of the converting corporation, except those that exercise dissenters' rights [*see Corp. Code §§ 1159, 1300 et seq.*], will be deemed parties to any agreement or agreements constituting the governing documents for the converted entity adopted as part of the plan of conversion, whether or not a shareholder has executed the plan of conversion or those governing documents for the converted entity. Any such "deemed" adoption of governing documents will be effective at the effective time or date of the conversion [*Corp. Code § 1152(d)*].

[2] FORM

Plan of Conversion

_____ [*name of converting corporation*]

PLAN OF CONVERSION ("Plan")

1. The board of directors of the above corporation, a California corporation (the "Company"), has approved its conversion to a _____ [*specify, e.g.*, limited liability company] (the "Converted Entity") and, as set forth below, the shareholders of the Company have approved that conversion.

2. The Company is validly existing and in good standing under the laws of the State of California. The Secretary of State's file number for the Company is _____ [*file number*].

3. The name of the Converted Entity will be _____[*name of converted entity*]. The Converted Entity will be organized under the laws of the State of California.

4. The address of the chief executive office of the Converted Entity will be _____[*address of chief executive office*].

[*Include the following provision if the converted entity is a limited partnership or a limited liability company--in those cases, appointment of an agent is required by statute; otherwise this provision can be omitted:*]

5. The agent for service of process on the Converted Entity will be _____ [*name; state only agent's name if agent is a corporate agent (Corp. Code §§ 15902.01(a)(3) (ULPA '08), 15621(a)(4), (CRLPA, repealed January 1, 2010) 17051(a)(4)); otherwise add:*, at _____ (*address*)].

[*Continue with the following:*]

6. The manner of converting the shares of the Company into interests in the Converted Entity is: _____ [*specify into what interest(s) in the converted entity each share of the Company will be converted*].

7. As a result of the conversion of shares into interests of the Converted entity as described above, _____ [*specify effect of conversion in terms of equality of treatment of shareholders of each class or*

series, e.g.: upon the effective date of the conversion, each share of the same class or series of the Company will be treated equally with respect to any cash, rights, securities, or other property to be received by, or any obligations or restrictions to be imposed on, the holder of that share, unless all shareholders of the class or series, shall have consented to a different treatment. Nonredeemable common shares of the Company will be converted only into nonredeemable equity securities of the Converted Entity unless all of the shareholders of the class shall have consented to a different treatment.]

8. All nondissenting holders of shares of the Company will be bound by the _____ [*specify, e.g., if the converted entity is an LLC,* articles of organization and operating agreement *or specify other organizational document, such as a partnership agreement*] of the Converted Entity, a copy of which is attached to and made a part of this Plan.

9. The principal terms of this Plan, including without limitation the manner of converting shares of the Company into interests in the Converted Entity, were approved by the percentage vote required by Corporations Code Section [*add, if appropriate:* § 1151(a) and] 1152.

[*Add if corporation is converting to a general or limited partnership or LLC:*]

10. Each nondissenting shareholder who will become a _____ [general partner *or* manager] of the Converted Entity has approved the terms of this Plan.

[*Continue with the following:*]

[*Add any other details or provisions required by laws under which converted entity is to be organized or are desired by converting corporation:*]

Executed on _____[*date*], at _____[*place*].

_____ [*name of company*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]

[*Attach copy of articles and operating agreement, partnership agreement, or other organic governing document of converted entity*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsBusiness & Corporate LawLimited PartnershipsFormationReal Property LawTrustsReal Estate Investment Trusts (REITs)Business & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistenceBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART IV. FORMS
A. Corporate Forms

5-11F California Legal Forms--Transaction Guide § 11F.201

§ 11F.201 Board Resolution Approving Conversion

[1] Comment--Use of Form

This form is a resolution of the board of directors of a California corporation approving its conversion into a domestic other business entity pursuant to Chapter 11.5 of the General Corporation Law [*Corp. Code § 1150 et seq.*].

For discussion and examples of resolutions generally, including resolution formats and the certificate of adoption of a resolution by the board of directors, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* , Part E. For additional examples of specific resolutions, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS (Matthew Bender), Appendix A.

[2] FORM

Board Resolution Approving Conversion

BOARD RESOLUTION APPROVING CONVERSION INTO OTHER BUSINESS ENTITY

WHEREAS, it is deemed to be in the best interests of this corporation and its shareholders that the corporation convert into a California [*specify type of other business entity, e.g.*, limited partnership] (the "Converted Entity") pursuant to Chapter 11.5 of the General Corporation Law; and

WHEREAS, to do so this corporation must adopt a Plan of Conversion (the "Plan") and a proposed Plan has been presented to this meeting; and

WHEREAS, the Board of Directors has considered and hereby approves the Plan in accordance with *Corporations Code Section 1152*; and

WHEREAS, the Plan meets the requirements regarding conversion of shares of this corporation into interests in the Converted Entity and applicable governing law set forth in *Corporations Code Section 1151*;

Therefore, it is

RESOLVED, that the form, terms, and provisions of the Plan of Conversion ("Plan") presented to and considered at this meeting be and each of them is hereby approved but with such changes therein (other than as to the type of entity into which this corporation is to be converted and the manner of conversion of the shares of this corporation into interests of the Converted Entity), if any, as the officer or officers acting in the premises shall approve, such approval to be conclusively evidenced by his, her, or their action in the premises.

RESOLVED FURTHER, that this corporation shall convert into the Converted Entity pursuant to the Plan.

RESOLVED FURTHER, that the officers of this corporation are each authorized and directed to seek approval by the shareholders of the principal terms of the Plan as required by *Corporations Code Section 1152(b)* [*add, if the converting corporation is a close corporation:* and the consent required by the last sentence of *Corporations Code Section 1152(b) and/or if some shares of the converting corporation are not to be treated equally with other shares of the same class or series:* the consent required by *Corporations Code Section 1151(a)*.]

RESOLVED FURTHER, that each of the officers of this corporation is authorized and directed to execute all documents and to take any other action necessary or advisable to carry out the purpose of this resolution.

RESOLVED FURTHER, that the Corporate Secretary is directed to attach a copy of the Plan to the minutes of this meeting.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistence



193 of 197 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART IV. FORMS
A. Corporate Forms

5-11F California Legal Forms--Transaction Guide § 11F.202

§ 11F.202 Shareholders' Resolution Approving Conversion

[1] Comment--Use of Form

This form is a resolution of the shareholders of a corporation approving principal terms of the plan for its conversion into a domestic other business entity pursuant to Chapter 11.5 of the General Corporation Law [*Corp. Code §§ 1150 et seq.*]. If the corporation is a close corporation [*Corp. Code § 158*] or if each share of a class or series is not to be treated equally with other shares of that class or series, this resolution should be modified to provide for the appropriate consents required by *Corp. Code §§ 1151(a)* and *1152(b).*

For discussion and examples of resolutions generally, including resolution formats, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* , Part E. Shareholder actions are covered in Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* . For additional examples of specific resolutions, see Ballantine & Sterling, CALIFORNIA CORPORATION LAWS (Matthew Bender), Appendix A.

[2] FORM

Shareholders' Resolution Approving Conversion

SHAREHOLDERS' RESOLUTION APPROVING CONVERSION

WHEREAS, the board of directors of this corporation has approved a proposed Plan of Conversion ("Plan") of this corporation into a [*specify type of other business entity and its jurisdiction of organization, e.g.,* a limited partnership organized under the laws of California], and the Plan has been submitted to the shareholders of this corporation for approval of its principal terms; and

WHEREAS, it is deemed to be in the best interests of this corporation and its shareholders that the conversion shall occur pursuant to the principal terms of the Plan,

THEREFORE, IT IS RESOLVED, that principal terms of the Plan be and they hereby are approved.

RESOLVED FURTHER, that the corporate secretary is directed to attach a copy of the Plan as submitted to the shareholders to the copy of this approval in the minute book or other appropriate records of the corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistenceBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART IV. FORMS
A. Corporate Forms

5-11F California Legal Forms--Transaction Guide §§ 11F.203-11F.209

[Reserved]

§§ 11F.203[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART IV. FORMS
B. Official Forms

5-11F California Legal Forms--Transaction Guide § 11F.210

§ 11F.210 Certificate of Conversion [FORM CONV-1A]

[1] Comment

[a] Use of Form

This form is the Secretary of State's official form for a certificate of conversion, together with the accompanying official instructions. This form is used when a domestic stock corporation is converting into a California general partnership *if no statement of partnership authority* [*see Ch. 15, Part C, Conversion and Mergers of General Partnerships, § 15.801*] *is filed* (a nonregistered general partnership) [*Corp. Code § 1155(a)(2)*; *see* Instructions for Completing Form CONV-1A, set forth in [2], *below*]. If the domestic general partnership wants to register as part of the conversion, then FORM GP-1A should be used [*see* [b], *below*].

This form is available from any office of the Secretary of State, or can be obtained on the Secretary of State's website as described below.

ELECTRONIC FORMS NOTE

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.sos.ca.gov/business/bpd_forms.htm#corp . You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800)424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 11F.230. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Certificate or Statement of Conversion

A corporation converting into an other business entity must file either a certificate or a statement of conversion to effect the conversion and create the converted entity [*Corp. Code § 1153(a)*]. In most cases, as discussed below, this form is

not appropriate for California corporations that are converting to other California business entities because a *statement* of conversion, rather than a *certificate* of conversion, is filed.

If the corporation is converting into a domestic limited partnership, the statement of conversion must be completed on the certificate of limited partnership for the converted entity [*Corp. Code § 1155(a)(1)*]. Secretary of State Form LP-1A [*see* Ch. 15C, *Conversions and Mergers of Limited Partnerships*, § 15C.205 (form and discussion)] is used for this purpose.

If a corporation is converting into a domestic limited liability company, a statement of conversion must be completed on the articles of organization for the converted entity [*Corp. Code § 1155(a)(3)*]. Secretary of State Form LLC-1A [*see* Ch. 12C, *Limited liability Companies*, § 12C.200A (form and discussion)] is used for this purpose.

If the corporation is converting into a domestic partnership, the statement of conversion must be completed on the statement of partnership authority for the converted entity if one has been filed. Secretary of State Form GP-1A [*see Ch. 15, Part C, Conversion and Mergers of General Partnerships, § 15.801* (form and discussion)] is used for this purpose. If no statement of partnership authority has been filed, however, then a certificate of conversion (this form) must be filed separately [*Corp. Code § 1155(a)(2), (c)*].

[c] Contents, Execution, and Acknowledgment

The required contents of the certificate of conversion are specified by statute [*see Corp. Code § 1155(b)*] and are reflected in this form. The certificate of conversion must be executed and acknowledged by those officers of the converting corporation that would be required to sign an officers' certificate; that is, the chairman of the board, the president or any vice president, *and* the secretary, the chief financial officer, the treasurer or any assistant secretary or assistant treasurer [*Corp. Code § 1155(b) ; see Corp. Code § 173*].

[d] Filing Fee

The filing fee for this Certificate of Conversion involving a domestic corporation is $250 [*see* Instructions for Completing Form CONV-1A, set forth in [2], *below*; *Corp. Code § 1160*]. The Secretary of State will certify two copies of the filed document without charge, provided that the copies are submitted to the Secretary of State with the original to be filed [*see* Instructions for Completing Form CONV-1A, set forth in [2], *below*].

[e] Effect of Filing Certificate of Conversion

The filing with of a certificate of conversion with the Secretary of State has the same effect as the filing of a certificate of dissolution by the converting corporation. No converting corporation that has made this filing is required to file a certificate of election [*see Corp. Code § 1901*] or a certificate of dissolution [*see Corp. Code § 1905*] as a result of the conversion [*Corp. Code § 1155(d)*].

Once the statement of conversion has been filed, certified copies of the statement may be recorded in the county recorder's office of counties where the corporation held real property [*Corp. Code § 1156(a)*]. Recordation provides notice to third parties and also provides a title chain for the real property for title insurance purposes. Furthermore, recordation will create, in favor of bona fide purchasers or encumbrances for value, a conclusive presumption that the conversion was validly completed [*Corp. Code § 1156(a)*].

[2] FORM

Certificate of Conversion [FORM CONV-1A]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeGeneral OverviewBusiness & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistence



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART IV. FORMS
B. Official Forms

5-11F California Legal Forms--Transaction Guide §§ 11F.211-11F.279

[Reserved]

§§ 11F.211[Reserved]



197 of 197 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 11F CORPORATE CONVERSIONS
PART IV. FORMS
C. All Converting Entities

5-11F California Legal Forms--Transaction Guide § 11F.280

§ 11F.280 Notice to Creditors

[1] Comment--Use of Form

This form is a notice to creditors of a converted entity informing them of the conversion. A converted entity must cause written notice of the conversion to be given by mail within 90 days after the effective date of the conversion to all known creditors and claimants whose addresses appear on the records of the converting entity. Failure to comply with this requirement, however, does not affect the validity of the conversion, extend the 90-day period of shareholder liability [*see Corp. Code § 1158(e)*; *see also § 11F.58[2]*], or otherwise affect the rights of a creditor or claimant under this section [*Corp. Code § 1158(f)*].

Any entity that converts into another entity is the same entity that existed before the conversion, for all purposes other than for purposes of Parts 10, 10.20, and 11 of Division 2 of the Revenue and Taxation Code [*Corp. Code § 1158(a)*; *see Rev. & Tax. Code §§ 17001 et seq., 18401 et seq., 23001 et seq.*]. As of the effective date of conversion, all of the following apply [*Corp. Code § 1158(b)*]:

- All the rights and property, whether real, personal, or mixed, of the converting entity or converting corporation are vested in the converted entity or converted corporation.

- All debts, liabilities, and obligations of the converting entity or converting corporation continue as debts, liabilities, and obligations of the converted entity or converted corporation.

- All rights of creditors and liens upon the property of the converting entity or converting corporation will be preserved unimpaired and remain enforceable against the converted entity or converted corporation to the same extent as against the converting entity or converting corporation as if the conversion had not occurred.

- Any action or proceeding pending by or against the converting entity or converting corporation may be continued against the converted entity or converted corporation as if the conversion had not occurred.

For further discussion, see *§ 11F.58*.

[2] FORM

Notice to Creditors

NOTICE OF CONVERSION OF _____ [*name of converting entity*]

To all creditors and claimants of _____[*name of converting entity*]:

You are hereby notified that on _____[*date*], _____[*name of converting entity*] converted into _____[*name of converted entity*], a [general partnership *or* limited partnership *or* limited liability company *or* corporation], pursuant to Chapter 11.5 of the General Corporation Law of California.

The mailing address for _____[*name of converted entity*] is as follows: _____.
_____ Dated:

_____ [*name of converted entity*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeExistenceContracts LawDebtor & Creditor Relations



1 of 146 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION

5-12 California Legal Forms--Transaction Guide 12.syn

§ 12.syn Synopsis to Chapter 12: WINDING UP AND DISSOLUTION

§ 12.01 California Sources

[1] Statutes

[2] Regulations

[3] Rules of Professional Conduct

§ 12.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 12.03-12.04 [Reserved]

§ 12.05 Law Reviews and Periodicals

§ 12.06 Annotations

§ 12.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 12.08-12.09 [Reserved]

§ 12.10 Terminology

§ 12.11 Types of Dissolution

§ 12.12 Role of Counsel; Conflicts of Interest

§§ 12.13-12.19 [Reserved]

§ 12.20 Voluntary Dissolution Without Court Supervision

[1] Who May Elect Dissolution

[a] Shareholders

[b] Board of Directors

[2] Commencement of Proceedings

[3] Certificate of Election

[4] Dissolution Procedure

[a] Power and Duties of Board

[b] Notification Requirements if Corporation Has Employees

[c] Payment of Outstanding Debts

[d] Plan of Distribution

[e] Distribution of Assets

[f] Duty to Minority Shareholder

[g] Sale of Assets When Shareholders Refuse to Approve Plan of Distribution

[5] Revocation of Election

[6] Certificate of Dissolution

[a] Filing Requirement

[b] Contents of Certificate

[c] Effect of Filing

[7] Petition for Court Order Declaring Corporation Wound Up and Dissolved

[8] Continued Existence of Dissolved Corporation

[a] Existence Limited to Winding Up Corporate Affairs

[b] Suits Against Dissolved Corporations

[c] Suits Against Shareholders of Dissolved Corporations

[d] Quiet Title Actions

[9] Avoiding Dissolution by Purchasing Shares of Moving Parties

§ 12.21 Voluntary Dissolution With Court Supervision

[1] Who May Institute Proceedings; Costs

[2] Specific Powers of Court

§ 12.22 Sale of Stock as Alternative to Dissolution

§§ 12.23-12.29 [Reserved]

§ 12.30 Procedure for Involuntary Dissolution

[1] Who May Institute Proceedings

[2] Grounds for Involuntary Dissolution

[3] Commencement of Proceedings Requires Cessation of Corporate Activities

[4] Powers and Jurisdiction of Court

[a] Powers Same as in Voluntary Dissolution With Court Supervision

[b] Creditors' Claims

[5] Court Order Declaring Corporation Wound Up and Dissolved

[6] Filing Court order With Secretary of State

§ 12.31 Action by Attorney General

[1] Grounds for Attorney General's Action

[2] When Prior Notice Required

[3] Court Powers

§§ 12.32-12.39 [Reserved]

§ 12.40 Voluntary Dissolution

[1] Governing Law

[2] Who May Elect Dissolution

[3] Certificate of Election

[a] Filing Requirement

[b] Contents of Certificate

[4] Revocation of Election

[5] Certificate of Dissolution

[a] Filing Requirement; Effect of Filing

[b] Contents of Certificate

[6] Petition for Court Order Declaring Corporation Wound Up and Dissolved

[7] Continued Existence of Dissolved Corporation

[a] Existence Limited to Winding Up Corporate Affairs

[b] Suits Against Dissolved Corporations

[c] Suits Against Dissolved Corporation and Distributees

[d] Quiet Title Actions

§ 12.41 Supervision of Attorney General

[1] Notification Requirement

[2] Public Benefit and Religious Corporations

[3] Mutual Benefit Corporations

§§ 12.42-12.49 [Reserved]

§ 12.50 Public Benefit and Mutual Benefit Corporations

[1] Who May Institute Proceedings

[2] Grounds for Involuntary Dissolution

[3] Winding Up Procedure; Corporate Powers Limited to Winding Up

[4] Specific Powers of Court

§ 12.51 Action by Attorney General on Behalf of State

§§ 12.52-12.59 [Reserved]

§ 12.60 Double Taxation Continues

§ 12.61 Corporate Recognition of Gain and Loss

§ 12.62 Shareholder Recognition of Gain or Loss

[1] In General

[2] Collapsible Corporations

[3] Dissolution Preceded or Followed by Asset Transfer to Another Corporation Owned by Same Shareholders

[4] Installment Obligations

[5] Liquidation of Solvent Subsidiary

§ 12.63 Treatment of S Corporation Gain or Loss

§§ 12.64-12.99 [Reserved]

§ 12.100 Facts

[1] Domestic Stock Corporation

Scope

[2] Domestic Nonprofit Corporation

Scope

§ 12.101 Documents

Scope

§§ 12.102-12.109 [Reserved]

§ 12.110 Voluntary Dissolution of Stock Corporation

Scope

§ 12.111 Involuntary Dissolution of Stock Corporation

Scope

§ 12.112 Voluntary Dissolution of Nonprofit Corporation

Scope

§ 12.113 Involuntary Dissolution of Public Benefit and Mutual Benefit Corporations

Scope

§§ 12.114-12.119 [Reserved]

§ 12.120 Voluntary Dissolution of Stock Corporation

Scope

§ 12.121 Voluntary Dissolution of Nonprofit Corporation

Scope

§§ 12.122-12.129 [Reserved]

§ 12.130 Certificate of Dissolution for Domestic Stock Corporation

Scope

§ 12.131 Revocation of Election to Dissolve

Scope

§§ 12.132-12.199 [Reserved]

§ 12.200 Directors' Resolutions to Obtain Shareholders' Election to Dissolve

[1] Comment

[a] Use of Form

[b] Dissolution by Board Approval Alone

[c] Plan of Distribution of Assets

[2] FORM

Directors' Resolutions to Obtain Shareholders' Election to Dissolve

§ 12.201 Waiver of Notice of Directors' Meeting

[1] Comment--Use of Form

[2] FORM

WAIVER OF NOTICE AND CONSENT TO HOLDING OF SPECIAL MEETING OF BOARD OF DIRECTORS

§ 12.202 Shareholders' Written Consent to Voluntary Dissolution

[1] Comment

[a] Use of Form

[b] Dissolution by Election of Shareholders

[2] FORM

Shareholders' Written Consent to Voluntary Dissolution

§ 12.203 Shareholders' Resolution to Elect to Dissolve

[1] Comment

[a] Use of Form

[b] Call and Notice of Meeting

[2] FORM

SHAREHOLDERS' RESOLUTION TO ELECT TO WIND UP AND DISSOLVE

§ 12.204 Directors' Resolution to Wind Up and Dissolve

[1] Comment

[a] Use of Form

[b] Voluntary Election by Directors to Dissolve

[c] Mandatory Election to Dissolve

[2] FORM

DIRECTORS' RESOLUTION TO WIND UP AND DISSOLVE

§ 4 Domestic Stock Corporation Certificate of Election to Wind Up and Dissolve (Form ELEC STK)

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[c] Filing Requirements and Fees

[2] FORM

Certificate of Election to Wind Up and Dissolve

§ 12.206 [Reserved]

§ 12.207 Transmittal Letter for Filing Certificate of Election to Dissolve

[1] Comment--Use of Form

[2] FORM

TRANSMITTAL LETTER FOR FILING CERTIFICATE OF ELECTION TO DISSOLVE

§ 12.208 Notice of Commencement of Voluntary Dissolution

[1] Comment--Use of Form

[2] FORM

NOTICE OF COMMENCEMENT OF VOLUNTARY DISSOLUTION

§ 12.209 Certificate of Mailing Notice of Voluntary Dissolution

[1] Comment--Use of Form

[2] FORM

CERTIFICATE OF MAILING NOTICE OF COMMENCEMENT OF VOLUNTARY DISSOLUTION

§ 12.210 [Reserved]

§ 12.211 Information Return of Dissolving Corporation [IRS Form 966]

[1] Comment

[a] Use of Form

[b] Contents of Form

[c] Time for Filing

[2] FORM

Information Return of Dissolving Corporation

§ 12.212 Transmittal Letter for IRS Filing Form 966

[1] Comment--Use of Form

[2] FORM

Transmittal Letter for IRS Filing Form 966

§§ 12.213-12.219 [Reserved]

§ 12.220 Minutes of Special Meeting of Directors to Formulate Plan of Distribution of Assets in Cash and Property

[1] Comment

[a] Use of Form

[b] Distribution of Assets

[c] Modifying the Form

[2] FORM

MINUTES OF A SPECIAL MEETING OF THE BOARD OF DIRECTORS OF CORPORATION

§ 12.221 Waiver of Notice to Directors' Meeting to Adopt Plan of Distribution

[1] Comment--Use of Form

[2] FORM

WAIVER OF NOTICE AND CONSENT TO HOLDING OF SPECIAL MEETING OF BOARD OF DIRECTORS

§ 12.222 Directors' Resolutions Authorizing Sale of All or Substantially All of the Corporate Assets

[1] Comment--Use of Form

[2] FORM

DIRECTORS' RESOLUTIONS AUTHORIZING SALE OF ALL OR SUBSTANTIALLY ALL OF THE CORPORATE ASSETS

§ 12.223 Shareholders' Written Consent Approving Sale of All or Substantially All of the Corporate Assets for Consideration Other Than Cash

[1] Comment--Use of Form

[2] FORM

WRITTEN CONSENT OF SHAREHOLDERS APPROVING SALE OF ALL OR SUBSTANTIALLY ALL OF THE CORPORATE ASSETS

§ 12.224 Shareholders' Resolution Authorizing Sale of All or Substantially All of the Corporate Assets for Consideration Other Than Cash

[1] Comment--Use of Form

[2] FORM

SHAREHOLDERS' RESOLUTIONS APPROVING SALE OF ALL OR SUBSTANTIALLY ALL OF THE CORPORATE ASSETS

§ 12.225 Certificate of Authorization of Dissolution and Sale of Assets, Attachment to Deed or Other Instrument of Transfer

[1] Comment--Use of Form

[2] FORM

CERTIFICATE OF AUTHORIZATION OF DISSOLUTION AND SALE OF CORPORATE ASSETS

§ 12.226 Resolution of Directors for Distribution of Specific Assets in Kind

[1] Comment--Use of Form

[2] FORM

RESOLUTION OF DIRECTORS FOR DISTRIBUTION OF ASSETS IN KIND

§ 12.227 Shareholders' Written Consent Approving Plan of Distribution Not in Accordance With Liquidation Rights of Preferred Shares

[1] Comment

[a] Use of Form

[b] Special Requirement When Shareholders Give Written Consent to Plan

[2] FORM

SHAREHOLDERS' WRITTEN CONSENT APPROVING PLAN OF DISTRIBUTION NOT IN ACCORDANCE WITH LIQUIDATION RIGHTS OF PREFERRED SHARES

§ 12.228 Notice to Nonconsenting Shareholders of Approval of Plan of Distribution by Shareholders' Written Consent

[1] Comment--Use of Form

[2] FORM

NOTICE OF APPROVAL OF PLAN OF DISTRIBUTION BY SHAREHOLDERS' WRITTEN CONSENT

§ 12.229 Declaration of Secretary of Mailing of Notice to Nonconsenting Shareholders of Adoption of Plan of Distribution by Written Consent of Shareholders

[1] Comment--Use of Form

[2] FORM

DECLARATION OF SECRETARY OF MAILING OF NOTICE TO NONCONSENTING SHAREHOLDERS OF ADOPTION OF PLAN OF DISTRIBUTION BY WRITTEN CONSENT OF SHAREHOLDERS

§ 12.230 Shareholders' Resolutions Approving Plan of Distribution of Assets in Kind

[1] Comment--Use of Form

[2] FORM

SHAREHOLDERS' RESOLUTIONS APPROVING PLAN OF DISTRIBUTION OF ASSETS IN KIND

§ 12.231 Notice of Plan of Distribution to Preferred Shareholders

[1] Comment--Use of Form

[2] FORM

NOTICE OF PLAN OF DISTRIBUTION

§ 12.232 Certificate of Secretary of Mailing of Notice of Plan of Distribution to Preferred Shareholders

[1] Comment--Use of Form

[2] FORM

CERTIFICATE OF MAILING OF NOTICE OF PLAN OF DISTRIBUTION TO PREFERRED SHAREHOLDERS

§ 12.233 Dissent to Plan of Distribution by Preferred Shareholders

[1] Comment--Use of Form

[2] FORM

Dissent to Plan of Distribution by Preferred Shareholders

§ 12.234 Assumption of Corporate Debts and Liabilities by Shareholders

[1] Comment

[a] Use of Form

[b] Alternative Methods of Providing for Debts

[2] FORM

ASSUMPTION OF CORPORATE DEBTS AND LIABILITIES BY SHAREHOLDERS

§ 12.235 Distribution of Assets to Shareholders in Kind--Assignment of All Assets to Shareholders

[1] Comment

[a] Use of Form

[b] Distribution of Assets in Kind

[2] FORM

ASSIGNMENT

§ 12.236 Distribution of Assets to Shareholders in Kind--Receipt of Distribution by Shareholders

[1] Comment--Use of Form

[2] FORM

RECEIPT OF DISTRIBUTION

§§ 12.237-12.239 [Reserved]

§ 12.240 Domestic Stock Corporation Certificate of Dissolution (Form DISS STK)

[1] Comment

[a] Use of Form

[b] Dissolution by Court Order as Alternative to Filing Certificate

[c] Filing Requirements and Fees

[d] Effect of Filing Certificate

[2] FORM

Certificate of Dissolution by All Shareholders or Entire Board

§ 12.241 [Reserved]

§ 12.242 Domestic Stock Corporation Short Form Certificate of Dissolution (Form DSF STK)

[1] Comment

[a] Use of Form

[2] FORM

Certificate of Dissolution When Corporation Has Not Issued Shares

§ 12.243 Transmittal Letter for Filing Certificate of Dissolution

[1] Comment--Use of Form

[2] FORM

Transmittal Letter for Filing Certificate of Dissolution

§§ 12.244-12.249 [Reserved]

§ 12.250 Shareholders' Written Consent to Revocation of Election to Dissolve

[1] Comment

[a] Use of Form

[b] Revocation of Voluntary Election to Dissolve

[c] More Than 100 Shareholders

[2] FORM

Written Consent of Shareholders to Revocation of Election to Dissolve

§ 12.251 Shareholders' Resolutions Revoking Election to Dissolve

[1] Comment--Use of Form

[2] FORM

SHAREHOLDERS' RESOLUTIONS REVOKING ELECTION TO DISSOLVE

§ 12.252 Certificate of Revocation

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[2] FORM

Certificate of Revocation of Election to Wind Up and Dissolve

§§ 12.253-12.259 [Reserved]

§ 12.260 Directors' Resolutions to Wind Up and Dissolve

[1] Comment

[a] Use of Form

[b] Contents of Form

[2] FORM

Directors' Resolutions to Wind Up and Dissolve

§ 12.261 Members' Written Ballot to Elect to Wind Up and Dissolve

[1] Comment

[a] Use of Form

[b] Ballot Requirements for Public Benefit and Mutual Benefit Corporations

[c] Ballot Requirements for Religious Corporations

[2] FORM

Members' Written Ballot to Elect to Wind Up and Dissolve

§ 12.262 Domestic Nonprofit Corporation Certificate of Election to Wind Up and Dissolve (Form ELEC NP)

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[c] Filing Requirements and Fees

[2] FORM

Certificate of Election to Wind Up and Dissolve

§ 12.263 Notice to Attorney General; Request for Waiver of Objections

[1] Comment--Use of Form

[2] FORM

Notice to Attorney General: Request for Waiver of Objections

§ 12.264 Notice to Creditors and Members of Voluntary Dissolution

[1] Comment--Use of Form

[2] FORM

Notice to Creditors and Members of Voluntary Dissolution

§ 12.265 [Reserved]

§ 12.266 Domestic Nonprofit Corporation Certificate of Dissolution (Form DISS NP)

[1] Comment

[a] Use of Form

[b] Dissolution by Court Order as Alternative to Filing Certificate

[c] Filing Requirements and Fees

[d] Effect of Filing Certificate

[2] FORM

Certificate of Dissolution by All Members or Entire Board

§§ 12.267-12.279 [Reserved]

§ 12.280 Liquidating Trust Agreement

[1] Comment

[a] Use of form

[b] Circumstances Warranting Use of Trust

[2] FORM

Liquidating Trust Agreement

§ 12.281 Final Quarterly Wage and Withholding Report [EDD Form DE-6]

[1] Comment

[a] Use of Form

[b] Filing and Payment Requirements

[2] FORM

Final Quarterly Wage and Withholding Report

§ 12.282 Final Annual Reconciliation Statement [EDD Form DE-7]

[1] Comment

[a] Use of Form

[b] Filing and Transmittal Requirements

[2] FORM

Final Annual Reconciliation Statement



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION

5-12 California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter discusses voluntary dissolution of corporations with court supervision, voluntary dissolution without court supervision, and involuntary dissolution by shareholders/directors. The chapter contains an overview of the fourth type of dissolution, which is involuntary dissolution by the state. The chapter also covers the dissolution of nonprofit corporations.

The Transaction Guide includes a client interview checklist and procedural guides for advising clients seeking to dissolve a corporation. The forms in the chapter include official state forms, a liquidating trust agreement, a conveyance form, a notice to creditors, and a petition for judicial supervision.

For coverage of the tax considerations and other aspects of the acquisition of a corporation in a merger or liquidation situation, see Ch. 11, *Mergers and Acquisition Issues* . For a discussion of the dissolution of noncorporate entities, see Ch. 12C, *Limited Liability Companies* ; Ch. 15, Part B, *Dissolution of General Partnerships* ; Ch. 15B, *Dissolution of Limited Partnerships* ; and Ch. 16C, *Limited Liability Partnerships* .



3 of 146 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART I. RESEARCH GUIDE
A. Primary Sources

5-12 California Legal Forms--Transaction Guide § 12.01

§ 12.01 California Sources

[1] Statutes

Dissolution by involuntary court proceedings. *Corp. Code §§ 1800-1809*.
Dissolution by court proceedings instituted by attorney general. *Corp. Code § 1801*.

Orders, certificates, and decrees of winding up and dissolution. *Corp. Code §§ 1808, 1809*.

Voluntary dissolution with court supervision. *Corp. Code §§ 1802-1809, 1904*.
Orders, certificates, and decrees of winding up and dissolution. *Corp. Code §§ 1901, 1905, 1907*.

Voluntary dissolution without court supervision. *Corp. Code §§ 1900-1903, 1905*.

General provisions relating to dissolution. *Corp. Code § 2000 et seq.*
Avoiding dissolution by purchasing shares of moving parties. *Corp. Code § 2000*.
Directors' powers, duties, vacancies, and appointments during winding up. *Corp. Code §§ 2001-2003*.
Distributions. *Corp. Code §§ 2004-2009*.
Continued corporate existence after dissolution. *Corp. Code §§ 2010-2011*.

Foreign corporation's surrender of right to transact intrastate business. *Corp. Code §§ 2112-2114*.

Nonprofit corporations.
Public benefit corporations. *Corp. Code §§ 6510-6519, 6610-6618, 6710-6721*.
Mutual benefit corporations. *Corp. Code §§ 8510-8519, 8610-8618, 8710-8724*.
Religious corporations. *Corp. Code § 9680*.
Corporations sole. *Corp. Code §§ 10012-10015*.

Banks and savings and loan associations--Special provisions relevant to liquidation and dissolution. *Fin. Code § 3100*

et seq.

Franchise tax on dissolution. *Rev. & Tax. Code §§ 23331-23335*.
Computation of final franchise tax. *Rev. & Tax. Code § 23332*.

Tax effects of corporate dissolution of *I.R.C. §§ 301*-385 apply in *California. Rev. & Tax. Code § 24451*.

Limitations on application of *I.R.C. §§ 301*-385 in *California. Rev. & Tax. Code §§ 24452-24481*.

Unemployment insurance procedures required on initiating dissolution proceedings. *Unemp. Ins. Code § 1116*.

[2] Regulations

Date of dissolution for franchise tax purposes. *18 Cal. Code Reg. § 23331*.

[3] Rules of Professional Conduct

Attorney obligations; organization as client. Cal. Rules *Prof. Cond., Rule 3-600*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART I. RESEARCH GUIDE
A. Primary Sources

5-12 California Legal Forms--Transaction Guide § 12.02

§ 12.02 Federal Sources

[1] Statutes

Tax effects of corporate dissolution. *I.R.C. §§ 301*-385.
Gain or loss to shareholders in corporate liquidations. *I.R.C. § 331*.
Complete liquidation of subsidiaries. *I.R.C. § 332*.
Basis of property received in liquidations. *I.R.C. § 334*.
Gain or loss to corporation on liquidation-general rule. *I.R.C. § 336*.
Nonrecognition of gain or loss to subsidiary upon Section 332 liquidation. *I.R.C. § 337*.
Collapsible corporations. *I.R.C. § 341*, repealed by Pub. Law No. 108-27.

Information return of dissolving corporation. *I.R.C. § 6043*.

[2] Regulations

Collapsible corporations. *Treas. Reg. §§ 1.341-1*-1.341-6.

Requirement that corporate income tax return be filed for fractional year of corporate existence. *Treas. Reg. § 1.6012-2(a)(2)*.

Return of information regarding corporate dissolution or liquidation. *Treas. Reg. § 1.6043-1*.

Return of information respecting distributions in liquidation. *Treas. Reg. § 1.6043-2*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART I. RESEARCH GUIDE
A. Primary Sources

5-12 California Legal Forms--Transaction Guide §§ 12.03-12.04

[Reserved]

§§ 12.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART I. RESEARCH GUIDE
B. Secondary Sources

5-12 California Legal Forms--Transaction Guide § 12.05

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART I. RESEARCH GUIDE
B. Secondary Sources

5-12 California Legal Forms--Transaction Guide § 12.06

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART I. RESEARCH GUIDE
B. Secondary Sources

5-12 California Legal Forms--Transaction Guide § 12.07

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Ch. 11A, *Cash Purchase of Shares* .
Ch. 11D, *Acquisition of Shares for Shares* .
Ch. 11E, *Acquisition of Assets for Shares* .
Ch. 12B, *Foreign Corporations and Associations* .
Ch. 13, *Nonprofit Corporations* .
Ch. 17, *Buying and Selling a Business or Professional Practice* .
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Ch. 76, *Assignments of Rights and Obligations*.
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART I. RESEARCH GUIDE
B. Secondary Sources

5-12 California Legal Forms--Transaction Guide §§ 12.08-12.09

[Reserved]

§§ 12.08[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
A. Overview of Dissolution of Corporate Entities

5-12 California Legal Forms--Transaction Guide § 12.10

§ 12.10 Terminology

The "dissolution" of a corporation is the termination of its existence. In the case of voluntary dissolution, this is achieved by the filing of a certificate of dissolution [*Corp. Code § 1905*], or, alternatively, by the issuance of a court order declaring the corporation duly wound up and dissolved, on petition by the board of directors in the name of the corporation [*Corp. Code § 1907(a)-(d)*]. In the case of an involuntary, or court-supervised voluntary dissolution, the corporation is dissolved by an order of the court [*Corp. Code § 1808(a)*]. For the distinction between these various methods of dissolution, see *§ 12.11*.

"Winding up" is the process of terminating the business of a corporation and begins as of the date the corporation elects to dissolve [*Corp. Code § 1903(a)*], or, in the case of an involuntary dissolution, when the order for winding up is entered by the court [*Corp. Code § 1805(a)*].

"Liquidation" technically means the collection of the assets of the corporation and the payment or settlement of its debts. However, the term is generally used to refer to the termination of the corporation's existence, as is the case in the Internal Revenue Code [*see I.R.C. §§ 331*-346].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipInvoluntary Dissolution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
A. Overview of Dissolution of Corporate Entities

5-12 California Legal Forms--Transaction Guide § 12.11

§ 12.11 Types of Dissolution

There are four types of corporate dissolution:

- Voluntary dissolution more or less without court supervision [*see Corp. Code §§ 1900-1907*].
- Voluntary dissolution with court supervision [*see Corp. Code §§ 1802-1809, 1904*].
- Involuntary dissolution (court proceedings) by a percentage of the shareholders and/or directors, any shareholder of a close corporation, any shareholder if the corporation's term of existence has expired, or any other person designated in the articles of incorporation [*Corp. Code §§ 1800, 1802-1809*].
- Involuntary dissolution when the state institutes court proceedings [*Corp. Code § 1801*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipInvoluntary Dissolution



12 of 146 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
A. Overview of Dissolution of Corporate Entities

5-12 California Legal Forms--Transaction Guide § 12.12

§ 12.12 Role of Counsel; Conflicts of Interest

The decision to dissolve a corporation and the dissolution procedure present potential conflicts of interest. A lawyer retained by the corporation owes his or her professional duties and obligations to the corporation as client [Cal. Rules *Prof. Cond., Rule 3-600(A)*; *see Meehan v. Hopps (1956) 144 Cal. App. 2d 284, 290, 301 P.2d 10* (corporate counsel represents corporation and its shareholders and officers in their representative capacity, but not corporation's officers personally)]. The interests of the board of directors, or the shareholders or members, may diverge. Whenever it becomes apparent that the entity's interests are or may become adverse to those of its directors, officers, employees, members, shareholders, or other constituents, the attorney must identify the client for whom the attorney is acting and act accordingly [Cal. Rules *Prof. Cond., Rule 3-600(D)*; *see* A.B.A. Model Rules Prof. Cond., Rule 1.13].

An attorney representing an entity may also represent its constituents, provided that the attorney makes a written disclosure to the client [Cal. Rules *Prof. Cond., Rule 3-310(B)*] and discloses his or her relationship to the entity [Cal. Rules *Prof. Cond., Rule 3-600(E)*]. Dual representation of clients whose interests conflict is permitted, under certain circumstances, if the attorney obtains the written consent of each client [Cal. Rules *Prof. Cond., Rule 3-600(E)*; *see Pringle v. La Chapelle (1999) 73 Cal. App. 4th 1000, 1005-1007, 87 Cal. Rptr. 2d 90* (although attorney failed to follow Rule 3-600(E), violation of rule does not automatically preclude attorney from obtaining fees)]. However, caution should be exercised in dual representation situations when an actual conflict of interest exists. Further, even in the absence of an actual conflict, an attorney should not undertake multiple representation under some circumstances.

For further discussion, see Ch. 1A, *Role of Counsel in Starting a New Business* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Legal EthicsClient RelationsConflicts of InterestBusiness & Corporate LawCorporationsDissolution & ReceivershipGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
A. Overview of Dissolution of Corporate Entities

5-12 California Legal Forms--Transaction Guide §§ 12.13-12.19

[Reserved]

§§ 12.13[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
B. Dissolution of Domestic Stock Corporations
1. Voluntary Dissolution

5-12 California Legal Forms--Transaction Guide § 12.20

§ 12.20 Voluntary Dissolution Without Court Supervision

[1] Who May Elect Dissolution

[a] Shareholders

Any corporation may elect voluntarily to wind up and dissolve by the vote of shareholders holding shares representing 50 percent or more of the voting power [*Corp. Code § 1900(a)*]. This election may be in the form of a resolution or by the written consent of the shareholders. However, if the voluntary dissolution motion carries by a vote of exactly 50 percent, dissolution may be avoided by having either the corporation or the remaining shareholder(s) purchase for cash the shares of the shareholders voting for dissolution [*Corp. Code § 2000(a)*; *see* [9], *below*].

The authority of the shareholders to voluntarily dissolve the corporation is qualified by the requirement that the power be exercised in good faith and without intent to injure other shareholders [*see In re Security Finance Co. (1957) 49 Cal. 2d 370, 317 P.2d 1]* .

Although the articles of incorporation may not impose a supermajority voting requirement on shareholders to elect voluntary dissolution [*see Corp. Code §§ 204(a)(5), 1900*], the articles may provide for classes or series of preferred shares and that voluntary dissolution requires the consent of a supermajority of preferred shares, not to exceed 662/3 percent [*Corp. Code § 402.5(b)*]. Therefore, the articles must be reviewed to determine if they require a supermajority of preferred shares to authorize voluntary dissolution.

[b] Board of Directors

In addition to dissolution of a corporation by the shareholders [*see* [a], *above*], any corporation that meets one of the following qualifying criteria may elect, by approval of the board of directors, to wind up and dissolve [*Corp. Code § 1900(b)*]:

- A corporation as to which an order for relief has been entered under Chapter 7 of the federal

bankruptcy law.

- A corporation that has disposed of all of its assets and has not conducted any business for a period of five years immediately preceding the adoption of the resolution electing to dissolve the corporation.

- A corporation that has issued no shares.

Except as otherwise provided by law, if the term of corporate existence expires without renewal or extension of its term, the board *must* terminate the corporation's business and wind up its affairs. When the business and affairs have been wound up, a majority of the directors must execute and file a certificate of dissolution [*Corp. Code § 1906*; *see Corp. Code § 1905*; *see also* [6], *below*].

In other situations, the board may not act on its own and need not take any action before voluntary dissolution proceedings commence [*see* [a], *above*]. However, it is common practice for the board to adopt a resolution stating that it is in the best interests of the corporation and its shareholders to dissolve the corporation before submitting the issue to the shareholders.

[2] Commencement of Proceedings

Voluntary proceedings for winding up a corporation begin on the adoption of the resolution of shareholders or directors of the corporation electing to wind up and dissolve, or on the filing with the corporation of a written consent of shareholders to dissolution [*Corp. Code § 1903(a)*]. The board continues to act as a board and has full powers to wind up and settle the corporation's affairs, both before and after the filing of the certificate of dissolution [*Corp. Code § 1903(b)*; *see* [4][a], *below*].

Once a voluntary winding up proceeding begins, the corporation must cease to carry on business except (1) to the extent necessary for the beneficial winding up of the corporation and (2) during the period that the board deems necessary to preserve the corporation's goodwill or going-concern value pending a sale of its business or assets, or both, in whole or in part. The board must cause written notice of the commencement of the voluntary winding up proceeding to be given by mail to all shareholders (except that no notice need be given to the shareholders who voted in favor of winding up and dissolving the corporation) and to all known creditors and claimants whose addresses appear in the records of the corporation [*Corp. Code § 1903(c)*].

[3] Certificate of Election

Whenever a corporation elects to wind up and dissolve, it must file a certificate evidencing that election [*Corp. Code § 1901(a)*]. The certificate must be an officers' certificate [*see Corp. Code § 173* (definition)], or must be signed and verified by at least a majority of the directors then in office or by one or more shareholders authorized to do so by shareholders holding shares representing 50 percent or more of the voting power [*Corp. Code § 1901(b)(3)*]. The certificate of election must set forth all of the following [*Corp. Code § 1901(b)*; *see* § 12.205]:

- That the corporation has elected to wind up and dissolve.

- If the election was made by the vote of shareholders, the number of shares voting for the election and that the election was made by shareholders representing at least 50 percent of the voting power.

- If the certificate is executed by one or more shareholders, that the subscribing shareholder or shareholders were authorized to execute the certificate by shareholders holding shares representing at least 50 percent of the voting power.

- If the election was made by the board, the certificate must also set forth the circumstances showing the corporation is within one of the categories permitting dissolution by the board [*see* Corp. Code § 1900(b)].

However, if an election to dissolve is made by the vote of all the outstanding shares and a statement to that effect is added to the certificate of dissolution [*see Corp. Code § 1905*], the separate filing of the certificate of election is not required [*Corp. Code § 1901(c)*]. Further, the separate filing of a certificate of election is not required if winding up and dissolution are mandatory because the term of existence of the corporation has expired without renewal [*see Corp. Code § 1906*].

[4] Dissolution Procedure

[a] Power and Duties of Board

In a voluntary dissolution without court supervision, the board of directors conducts the winding up of the affairs of the corporation. During dissolution, the directors are authorized to do all things proper and convenient for the purposes of winding up, settling, and liquidating the affairs of the corporation. More specifically, the directors are empowered to take the following actions [*Corp. Code §§ 2001, 2002*]:

- Elect officers and employ agents and attorneys to liquidate or wind up corporate affairs.
- Continue to conduct the business insofar as necessary for winding up.
- Carry out contracts and collect, pay, compromise, and settle debts and claims for or against the corporation.
- Defend suits brought against the corporation.
- Sue, in the name of the corporation, for all sums due or owing to the corporation or to recover any of its property.
- Collect any amounts remaining unpaid on subscriptions to shares, or to recover unlawful distributions.
- Sell at public or private sale, exchange, convey, or otherwise dispose of all or any part of the assets of the corporation [*see Corp. Code § 2001(g)*].
- Make contracts.
- Do any and all things in the name of the corporation that may be proper or convenient for the purposes of winding up, settling, and liquidating the corporation's affairs.
- Fill any vacancy on the board [*see Corp. Code § 305*].

[b] Notification Requirements if Corporation Has Employees

Within 10 days after the earlier of beginning dissolution proceedings or quitting business, the corporation must file a final quarterly wage and withholding report with the Employment Development Department ("EDD") if the corporation had employees [*Unemp. Ins. Code § 1116(a)(2)*; *see § 12.281* (EDD Form DE 6)]. At the same time, the corporation must pay contributions with respect to the final return [*Unemp. Ins. Code § 1116(b)*]. Further, the corporation must file

a final annual reconciliation return within this initial 10-day period [*see* EDD California Employer's Guide, Pub. No. DE 44; *see also § 12.282* (EDD Form DE 7)]. However, on a showing of good cause, the EDD may extend for 30 days the time in which the corporation must file a return or pay any amount due without penalty or interest [*Unemp. Ins. Code § 1116(c)*].

For further discussion of procedures applicable on termination of a business, see the Transaction Guide to Ch. 17, *Buying and Selling a Business or Professional Practice*.

[c] Payment of Outstanding Debts

The directors must collect, pay, compromise, and settle all of the debts and claims for or against the corporation [*Corp. Code § 2001(c)*]. The board cannot distribute the corporate assets to the shareholders until all debts and liabilities of the corporation have been paid or adequately provided for [*Corp. Code § 2004*]. The payment of a debt or liability, whether the location of a creditor is known or unknown, is "adequately provided for" if one or more financially responsible corporations or persons, or the United States government or any of its agencies, has assumed or guaranteed the debt in good faith, and the board has determined in good faith and with reasonable care that the payment provision was adequate at the time of distribution of the assets [*Corp. Code § 2005(a)*]. A debt or liability is also "adequately provided for" if the corporation has deposited the amount of the debt or liability with the Controller in trust for the benefit of those entitled to the payment [*Corp. Code § 2005(b)*; *see Corp. Code § 2008* (deposit provisions)]. A corporation may make adequate provision for debts and liabilities in other ways; these provisions are not the exclusive means of doing so [*Corp. Code § 2005*].

[d] Plan of Distribution

As a general rule, the board of directors typically adopts a plan of distribution, which outlines the dissolution proceedings. There is no statutory requirement that the board or the shareholders formally adopt a plan of distribution. However, if the directors intend to adopt a plan for the distribution of the noncash corporate assets and the plan is not in accordance with the liquidation preferences of the preferred shareholders as stated in the articles, the plan must be approved by (1) the board of directors and (2) the holders of a majority of the outstanding shares of each class entitled to vote [*Corp. Code § 2007(a)*; *see Corp. Code § 152*]. The plan may provide that the distribution is in complete or partial satisfaction of the rights of any preferred shareholders on distribution and liquidation of the assets [*Corp. Code § 2007(a)*]. The board must give notice of the adoption of the plan by mail within 20 days after its adoption to all holders of shares having a liquidation preference [*Corp. Code § 2007(b)*].

Once adopted by the shareholders, a plan of distribution is binding on all shareholders [*Corp. Code § 2007(b)*] except dissenting preferred shareholders. Dissenting shareholders must be paid their liquidation preferences in cash unless the plan is abandoned, provided that they file a written demand for payment with the corporation within 30 days after the mailing date of the notice of the adoption of the plan. The demand must state the number and class of shares held of record by the dissenting shareholder in respect of which the shareholder claims payment [*Corp. Code § 2007(c)*]. If a demand for cash payment is filed, the board has discretion to abandon the plan without further approval of the outstanding shares. In this situation, all shareholders will be entitled to distribution according to their rights and liquidation preferences in the winding up process [*Corp. Code § 2007(d)*].

These rules [*Corp. Code § 2007(a)-(d)*] do not apply to certain distributions made in accordance with merger reorganizations [*Corp. Code § 181(a)* (definition); *see* Ch. 11C, *Mergers*] and sale-of-assets reorganizations [*Corp. Code § 181(c)* (definition); *see* Ch. 11E, *Acquisition of Assets for Shares*]. Specifically, these rules do not apply to those distributions under the following circumstances [*Corp. Code § 2007(e)*; *see Corp. Code § 1202(b)*]:

- The terms of the reorganization provide that a class or series of preferred shares will receive as a distribution a lesser amount than would be required by applicable article provisions; and

- The principal terms of the reorganization have been approved by the same percentage of outstanding shares of that class or series that would be required to approve an amendment of the article provisions to provide for the distribution of that lesser amount.

It appears advisable to obtain shareholder approval of any plan involving distribution of the corporate assets in kind, even if the plan does not violate the liquidation preferences of preferred shareholders. Under former law, a plan of distribution approved by the directors and two thirds of the outstanding shares, regardless of limitations on voting power, was deemed fair and ratable [*see* former *Corp. Code §§ 5004, 5005*]. Current law contains no provision for the approval of a plan of liquidation by the shareholders, except in the case of a plan for distribution in kind that is not in accordance with the liquidation preferences as set forth in the articles [*see Corp. Code § 2007(a)*; *see also Corp. Code §§ 1001(a), (d), 2001(g)* (shareholder approval required for certain sales of assets)]. However, approval of any plan of liquidation by the shareholders would considerably lessen the chance of a subsequent challenge to the fairness of the distribution. In any event, a plan of distribution cannot be adopted under which the business assets are distributed to majority shareholders and the minority shareholders are compelled to take cash for their distributive share, if the minority shareholders object [*Zimmerman v. Tide Water Associated Oil Co. (1943) 61 Cal. App. 2d 585, 591-592, 143 P.2d 409* ; *In re San Joaquin L.&P. Corp. (1942) 52 Cal. App. 2d 814, 823-824, 127 P.2d 29]* .

[e] Distribution of Assets

After determining that all the known debts and liabilities have been paid or adequately provided for [*see Corp. Code § 2005*; *see also* [c], *above*], the board must distribute all the remaining corporate assets among the shareholders according to their respective rights and preferences or, if there are no shareholders, to the persons entitled to the assets [*Corp. Code § 2004*]. If the winding up is by court proceeding [*see § 12.30* et seq.] or subject to court supervision [*see § 12.21*], the board may not distribute the assets until after the expiration of any period for the presentation of claims that has been prescribed by order of the court [*Corp. Code § 2004*].

Distributions to the shareholders may be made in installments or in a lump sum, and may be in money, in property, or in securities, if done fairly and ratably and in conformity with the articles of incorporation and any liquidation preferences [*Corp. Code § 2006*]. Attorneys who practice together in a law corporation are bound by equitable principles in allocating fees received for cases pending at the time the corporation is dissolved, and are entitled to share in fees for that work in proportion to their interest in the former firm [*Fox v. Abrams (1985) 163 Cal. App. 3d 610, 616-617, 210 Cal. Rptr. 260]* .

[f] Duty to Minority Shareholder

Even when dissolution is properly effected, there is a possibility that minority shareholders may have a cause of action against majority shareholders for dissolving the corporation if the dissolution would violate the majority shareholders' duty of good faith and inherent fairness to the minority shareholders [*see Jones v. H.F. Ahmanson & Co. (1969) 1 Cal. 3d 93, 109, 81 Cal. Rptr. 592, 460 P.2d 464* (concerning merger that violated duty of majority to minority shareholders)]. Bad faith actions leading to dissolution may also give rise to a derivative cause of action [*see Thrasher v. Thrasher (1972) 27 Cal. App. 3d 23, 26-28, 103 Cal. Rptr. 618* (shareholder entitled to bring derivative action on behalf of corporation when bad faith action of majority shareholder in enforcing payment of demand notes held by him against corporation had effect of destroying corporation)]. Good faith on the part of shareholders acting to dissolve a corporation voluntarily is shown when they are acting to protect their investment, alternative methods of doing so are foreclosed, no advantage is secured over other shareholders, and no rights of third parties will be adversely affected [*In re Security Finance Co. (1957) 49 Cal. 2d 370, 378, 317 P.2d 1]* .

[g] Sale of Assets When Shareholders Refuse to Approve Plan of Distribution

If the board of directors fails to obtain shareholder approval of a plan of distribution in kind, the corporation may sell all of the assets at a public or private sale and distribute the proceeds of the sale to the shareholders [*see Corp. Code § 2001(g)*]. After commencement of a dissolution proceeding, the directors may sell all or any part of the corporation's assets for cash in an amount they deem reasonable, without the shareholder approval normally required for a cash sale of all or substantially all of the corporate assets pursuant to *Corp. Code § 1001(a)* [*Corp. Code § 2001(g)*]. However, if the acquiring party is in control of, or under common control with, the disposing or dissolving corporation, the principal terms of the sale must be approved by at least 90 percent of the voting power of the disposing corporation, unless the disposition is to a corporation or other business entity in consideration of the nonredeemable common shares or nonredeemable equity securities of the acquiring party or its parent [*Corp. Code §§ 1001(d), 2001(g)*]. Shareholder approval is not required if the Commissioner of Corporations, Commissioner of Financial Institutions, Insurance Commissioner, or Public Utilities Commissioner has approved the terms and conditions of the transaction and approved their fairness [*Corp. Code § 1001(e)*; *see Corp. Code § 25142*; *Fin. Code § 696.5*; *Ins. Code § 838.5*; *Pub. Util. Code § 822*].

Sales of all or substantially all of the assets for consideration other than cash requires the approval of the outstanding shares [*Corp. Code §§ 1001(a), 2001(g)*; *see Corp. Code § 152* ("approval of outstanding shares" defined)]. A sale of the assets in exchange for the shares of another corporation may constitute a reorganization [*see Corp. Code § 181*], in which case the transaction is subject to *Corp. Code § 1200 et seq.* rather than *Corp. Code § 1001*, except for *Corp. Code § 1001(d)*, discussed above [*Corp. Code § 1001(a)*]. For further discussion, see Ch. 11E, *Acquisition of Assets for Shares* . A transaction constituting a conversion [*see Corp. Code § 161.9*] is subject to the conversion provisions of *Corp. Code § 1150 et seq.* [*Corp. Code § 1001(a)*].

In most cases of dissolution, a sale of the corporation's assets for cash will be the best way to make a ratable distribution among the shareholders. A cash distribution is simpler to make and does not involve the problems inherent in distribution of noncash assets to shareholders as tenants in common. Ratable noncash distributions are likely to be economically undesirable and to pose serious problems of valuation and fairness.

[5] Revocation of Election

A voluntary election to wind up and dissolve may be revoked before the distribution of any assets by the vote of shareholders holding shares representing a majority of the voting power, or by approval by the board if the election to wind up was by the board [*Corp. Code § 1902(a)*; *see Corp. Code § 1900(b)*]. It is important to note that although only 50 percent of the corporation's voting power is required for voluntary dissolution, the revocation of that election requires a majority vote [*Corp. Code §§ 1900(a), 1902(a)*].

The revocation is effective when a signed and verified certificate evidencing the revocation is filed with the Secretary of State in the prescribed manner [*Corp. Code § 1902(a)*; *see Corp. Code § 1901*]. The certificate of revocation must set forth all of the following [*Corp. Code § 1902(b)*; *see § 12.252*]:

- That the corporation has revoked its election to wind up and dissolve.
- That no assets have been distributed pursuant to the election.
- If the revocation was made by the vote of shareholders, the number of shares voting for the revocation and the total number of outstanding shares whose holders were entitled to vote on the revocation.
- That the election and revocation was made by the board, if applicable.

[6] Certificate of Dissolution

[a] Filing Requirement

When a corporation has been completely wound up without court proceedings, a majority of the directors then in office must sign and verify a certificate of dissolution [*Corp. Code § 1905(a)*]. The certificate must be filed with the Secretary of State's office in Sacramento, and the corporate powers, rights, and privileges of the corporation cease as of the filing. Once the certificate is filed, the Secretary of State will notify the Franchise Tax Board of the dissolution [Corp. Code § 1905(b)]. In lieu of filing this certificate, the board may petition the superior court of the proper county for an order declaring the corporation duly wound up and dissolved [*Corp. Code § 1907(a)*; *see* [7], *below*].

If a corporation has not issued shares, a majority of the directors may sign and verify a certificate of dissolution. If no directors were named in the articles or have subsequently been elected, the incorporator or a majority of the incorporators may sign and verify a certificate of dissolution [*Corp. Code § 1900.5(a)*]. Among other items, the certificate must state that it is being filed within 12 months from the date that the articles were filed [*Corp. Code § 1900.5(a)(1)*; *see* [b], *below*]. This certificate must be filed with the Secretary of State and its filing similarly terminates corporate existence [*Corp. Code § 1900.5(b), (c)*].

[b] Contents of Certificate

A certificate of dissolution must contain the following information [*Corp. Code § 1905(a)*]:

- That the corporation has been completely wound up.

- That the corporation's known debts and liabilities have been actually paid, or adequately provided for, or paid or adequately provided for as far as its assets permitted, or that it has incurred no known debts or liabilities, as the case may be. If adequate provision has been made to pay known debts or liabilities, the certificate must state what provision has been made, setting forth the name and address of the corporation, person or governmental agency that has assumed or guaranteed the payment, or the name and address of the depositary with which deposit has been made or any other information that may be necessary to enable the creditor or other person to whom payment is to be made to appear and claim payment of the debt or liability.

- That the corporation's known assets have been distributed to the persons entitled to them, or that the corporation acquired no known assets, as applicable.

- That the corporation is dissolved.

- If no certificate of election is to be filed [*see Corp. Code § 1901(c)*], that the election to dissolve was made by the vote of all the outstanding shares.

- That a final franchise tax return has been or will be filed with the Franchise Tax Board [*see* Rev. & Tax Code § 23332].

For a drafting guide for certificates of dissolution and the Secretary of State's form, see *§§ 12.130* and *12.240*, respectively.

A certificate of dissolution filed by a corporation that has not issued shares must specifically state the following [Corp. Code § 1900.5(a)]:

- That the certificate of dissolution is being filed within 12 months from the date the corporation's articles were filed.

- That the corporation does not have any debts or other liabilities, except with respect to tax liability as provided immediately below.

- That the tax liability will be satisfied on a taxes paid basis, or that a person, corporation, or other business entity assumes any tax liability of the dissolving corporation and is responsible for any additional corporate taxes that are assessed and that become due after the due date of the tax liability assumption.

- That a final franchise tax return has been or will be filed with the Franchise Tax Board [*see* Rev. & Tax. Code § 23332].

- That the corporation has not conducted any business from the time the corporation's articles were filed.

- That the known assets of the corporation remaining after payment of, or adequately provided for, known debts and liabilities have been distributed to the persons entitled to them or that the corporation acquired no known assets, as the case may be.

- That either a majority of the directors, or, if no directors have been named in the articles or elected, the incorporator or a majority of the incorporators, authorized the dissolution and elected to dissolve the corporation.

- That the corporation has not issued any shares, and if the corporation has received payments for shares from investors, those payments have been returned to those investors.

- That the corporation is dissolved.

For the Secretary of State's form for a certificate of dissolution by a corporation that has not issued shares, see *§ 12.242*.

[c] Effect of Filing

The corporation's powers, rights, and privileges will cease when the certificate of dissolution is filed with the Secretary of State. When the certificate is filed, the Secretary of State will notify the Franchise Tax Board of the dissolution [Corp. Code § 1905(b); *see* Catalina Investments, Inc. v. Jones (2002) 98 Cal. App. 4th 1, 7-8, 119 Cal. Rptr. 2d 256 (as consequence of dissolved status, former corporation lacked capacity to submit purported certificate of revocation of dissolution more than four years later, in attempt to reinstate corporation existence)].

A dissolved corporation's existence continues for the purpose of further winding up its affairs, prosecuting and defending actions, collecting and discharging its obligations, and disposing and conveying property, and collecting and disposing of its assets [*see Corp. Code § 2010(a)*]. The corporation also continues to exist for the purpose of distributing any assets omitted from its winding up [*Corp. Code § 2010(c)*]. Further, any proceeding to which the corporation is a party is not abated [*Corp. Code § 2010(b)*]. For further discussion, see [8], *below*.

When a corporation that has not issued shares files a signed and verified certificate of dissolution with the Secretary of State, the corporation is dissolved and its powers, rights, and privileges cease [Corp. Code § 1900.5(b), (c)]. The Secretary of State who will then notify the Franchise Tax Board of the dissolution [Corp. Code § 1809]. The corporation is dissolved, and its powers, rights, and privileges cease, as of the filing of the certificate of dissolution [*Corp. Code § 1900.5(c)*].

[7] Petition for Court Order Declaring Corporation Wound Up and Dissolved

In lieu of filing a certificate of dissolution, the board may file a petition in the name of the corporation with the superior court of the proper county for an order declaring the corporation duly wound up and dissolved [*Corp. Code § 1907(a)*]. On the filing of the petition, the court will order all interested persons to show cause why an order should not be made declaring the corporation duly wound up and dissolved and will direct that the order be served by notice to all creditors, claimants, and shareholders in the same manner as the notice given in the case of involuntary dissolution [*Corp. Code § 1907(b)*; *see Corp. Code § 1807(b)*].

Any person claiming to be interested as shareholder, creditor, or otherwise may appear in the proceeding at any time before the expiration of 30 days from the completion of publication of the order to show cause and contest the petition. If the individual fails to appear, that person's claim will be barred [*Corp. Code § 1907(c)*]. Thereafter, an order declaring the corporation duly wound up and dissolved will be entered and filed and have the effect as in the case of involuntary dissolution [*Corp. Code § 1907(d)*; *see Corp. Code §§ 1808, 1809*].

In addition to limiting the time for creditors' claims, another advantage of this procedure is that the order effectively settles the accounts of the directors and discharges them from their duties and liabilities [*Corp. Code § 1808(a)(3), (b)*]. Therefore, securing a court order may afford valuable protection to the directors.

For a form for this petition, see California Forms of Pleading and Practice, Ch. 170, *Corporations: Dissolution and Winding Up* (Matthew Bender).

[8] Continued Existence of Dissolved Corporation

[a] Existence Limited to Winding Up Corporate Affairs

Corporate existence is not absolutely terminated by the filing of a certificate of dissolution or the entry of a court order declaring the corporation wound up and dissolved. The corporation continues to exist for the purpose of winding up its affairs, prosecuting and defending actions against it, collecting and discharging obligations, conveying corporate property, and collecting and dividing assets [*Corp. Code § 2010(a)*; *see Penasquitos, Inc. v. Superior Court (1991) 53 Cal. 3d 1180, 283 Cal. Rptr. 135, 812 P.2d 154]* . However, the corporation is no longer permitted to transact business, except as necessary for the winding up [*Corp. Code § 2010(a)*; *see, e.g., Catalina Investments, Inc. v. Jones (2002) 98 Cal. App. 4th 1, 7-8, 119 Cal. Rptr. 2d 256* (as consequence of dissolved status, former corporation lacked capacity to submit purported certificate of revocation of dissolution more than four years later, in attempt to reinstate corporate existence)]. Any assets that are inadvertently or otherwise omitted from the winding up continue in the dissolved corporation for the benefit of the persons entitled to them on dissolution, and on realization must be distributed accordingly [*Corp. Code § 2010(c)*].

[b] Suits Against Dissolved Corporations

Actions or proceedings to which a corporation is a party do not abate as a result of the dissolution of the corporation, or by reason of proceedings for winding up and dissolution [*Corp. Code § 2010(b)*]. Causes of action against a dissolved corporation, whether arising before or after dissolution, may be enforced against the dissolved corporation to the extent of its undistributed assets. These undistributed assets include, without limitation, any insurance assets held by the corporation that may be available to satisfy claims [*Corp. Code § 2011(a)(1)(A)*].

Summons or other process against a dissolved corporation may be served by delivering a copy to an officer, director, or other person having charge of the corporation's assets. If none of these persons can be found in the exercise of due diligence, and it is so shown by affidavit to the satisfaction of the court, then the court may make an order that process be served on the dissolved corporation by personally delivering a copy, together with a copy of the order, to the

Secretary of State (or an assistant or deputy secretary of state). Service in this manner is deemed complete on the 10th day after delivery of the process to the Secretary of State [*Corp. Code § 2011(b)*]. On receipt of the process, and the applicable fee, the Secretary of State will give notice to the corporation [*Corp. Code § 2011(d)*; *see Corp. Code § 1702*].

[c] Suits Against Shareholders of Dissolved Corporations

Actions or proceedings to which a corporation is a party do not abate as a result of the dissolution of the corporation, or by reason of proceedings for winding up and dissolution [*Corp. Code § 2010(b)*]. If any of the assets of the dissolved corporation have been distributed to shareholders, causes of action against the dissolved corporation may be enforced against the shareholders to the extent of the lesser of (1) their pro rata share of the claim or (2) the corporate assets distributed to them, regardless of whether the cause of action arose before or after dissolution [*Corp. Code § 2011(a)(1)(B)*]. Except with regard to quiet title actions [*see Corp. Code § 2011(c)*; *see also* [d], *below*], all causes of action against a shareholder of a dissolved corporation are extinguished unless the claimant commences a proceeding to enforce the cause of action against that shareholder before the earlier of the following [*Corp. Code § 2011(a)(2)*]:

- The expiration of the applicable statute of limitations; or
- Four years after the effective date of the dissolution.

As a procedural matter and not for purposes of determining liability, shareholders of the dissolved corporation may be sued in the corporate name on any cause of action against the corporation [*Corp. Code § 2011(a)(3)*]. This rule does not affect the rights of the corporation or its creditors to recover an improper distribution pursuant to dissolution [*see Corp. Code § 2009*], or any rights of creditors under the Uniform Fraudulent Transfer Act [*see Civ. Code §§ 3439-3439.12*], that may arise against the shareholders [*Corp. Code § 2011(a)(3)*].

[d] Quiet Title Actions

A corporation survives and continues to exist indefinitely for the purpose of being sued in any quiet title action. Any judgment rendered in a quiet title action binds all of the corporation's shareholders, and all other persons having any equity or other interest in the corporation to the extent of their interest [*Corp. Code § 2011(c)*]. Further, the judgment has the same force and effect as an action brought under *Code Civ. Proc. §§ 410.50* or *410.60*. Service of summons or other process may be made as provided in the Code of Civil Procedure [*see Code Civ. Proc. §§ 413.10-417.40*] or under the method provided for in *Corp. Code § 2011(b)* [*see § 12.20[8][b], above*].

[9] Avoiding Dissolution by Purchasing Shares of Moving Parties

Subject to any contrary provision in the articles, in any suit for voluntary dissolution initiated by shareholder vote, the corporation may avoid dissolution by purchasing the shares of the parties moving for dissolution. The election may be made by the affirmative vote of a majority of the outstanding shares entitled to vote, excluding the shares held by the parties moving for dissolution [*Corp. Code § 2000(a)*; *see Corp. Code § 152*]. If the corporation does not elect to purchase these shares, the holders of 50 percent or more of the voting power of the corporation may avoid dissolution by purchasing the shares of the plaintiffs [*Corp. Code § 2000(a)*].

The purchase must be in cash, for the fair value of the shares. "Fair value" is determined on the basis of the liquidation value as of the date that at least 50 percent of the shareholders initiated the proceedings (the "valuation date"), but taking into account any possibility of the sale of the entire business as a going concern in a liquidation [*Corp. Code § 2000(a), (f)*; *Mart v. Severson (2002) 95 Cal. App. 4th 521, 535-536, 115 Cal. Rptr. 2d 717* ; *Abrams v. Abrams-Rubaloff & Associates, Inc. (1980) 114 Cal. App. 3d 240, 249, 170 Cal. Rptr. 656]* . If the sale of the business as a going concern is unlikely, the assets must be valued piecemeal for liquidation purposes; this valuation is typically significantly lower than that applicable to the sale of the business [*see Brown v. Allied Corrugated Box Co. (1979) 91*

Cal. App. 3d 477, 490, 154 Cal. Rptr. 170 (court must determine likelihood of selling business as going concern if shareholders fail to agree)]. On motion by any party, the court for good cause shown may designate some date other than the date on which the proceeding was initiated as the valuation date [*Corp. Code § 2000(f)*; *see, e.g., Trahan v. Trahan (2002) 99 Cal. App. 4th 62, 76-78, 120 Cal. Rptr. 2d 814* (substantial evidence supported court's confirmation of appraiser's determination of fair value as piecemeal sale of assets, even though it did not take into account existing but uncompleted contracts; parties could have requested court to set later valuation date to allow completion of unperformed contracts)]. Further, if the initiation of the dissolution proceedings is a breach of any purchase agreement, the amount of any damages resulting from that breach may be deducted from the amount payable for the shares; however, no offset is permitted when the grounds for dissolution is that the parties controlling the corporation are guilty of (or knowingly countenanced) persistent and pervasive fraud, mismanagement, abuse of authority, or persistent unfairness towards shareholders or misapplication or waste of corporate property [*Corp. Code § 2000(a)*; *see Corp. Code § 1800(b)(4)*].

A determination of the fair value of the shares of the corporation must include an assessment of the value, if any, of a pending derivative action and the effect of the action on the fair value of the shares [*Cotton v. Expo Power Sys., Inc. (2009) 170 Cal. App. 4th 1371, 1374, 1380-1381, 89 Cal. Rptr. 3d 112* (derivative claim is property right that belongs to corporation and is properly viewed as asset of corporation)].

If an agreement cannot be reached as to the price of the shares to be purchased, the court will appoint three disinterested appraisers to determine the fair value of those shares and make an order referring the matter to them. The order will specify the time and manner of producing evidence, if evidence is required to support the valuation [*Corp. Code § 2000(b), (c)*; *see, e.g., Mart v. Severson (2002) 95 Cal. App. 4th 521, 535-536, 115 Cal. Rptr. 2d 717* (holding that trial court erred in finding that fair value was piecemeal liquidation value of $1.48 million, when appraisers unanimously had concluded that corporation could have been sold as ongoing concern for $5.6 million)]. The determination of a majority of the appraisers, once confirmed by the court, is final and conclusive on all parties [*Corp. Code § 2000(c)*]. The court may not postpone the appraisal, or the completion of the appraisal, until some related matter is concluded (for instance, until a pending derivative action comes to an end), because *Corp. Code § 2000* contemplates a summary procedure. The court is required either to obtain a complete appraisal of the fair value of the shares from the appraisers, without delay, or to conduct a hearing forthwith to resolve the matter [*Cotton v. Expo Power Sys., Inc. (2009) 170 Cal. App. 4th 1371, 1381-1382, 89 Cal. Rptr. 3d 112]* .

The court will enter a decree that provides in the alternative for the winding up and dissolution of the corporation, which is effective unless payment for the shares is made within the time specified in the decree. If the purchasing parties do not make payment for the shares within the specified time, judgment will be entered against them and the surety or sureties on the bond for the amount of the expenses (including attorneys' fees) of the moving parties. Any shareholder aggrieved by the action of the court may appeal [*Corp. Code § 2000(c), (d)*]. There is no automatic stay of the court's decree in the event of an appeal, but a reviewing court has discretion to issue a writ of supersedeas if a proper and sufficient showing is made [*Veyna v. Orange County Nursery, Inc. (2009) 170 Cal. App. 4th 146, 154-156, 87 Cal. Rptr. 3d 658]* . For the applicable procedure and determination of the share price, see California Forms of Pleading and Practice, Ch. 170, *Corporations: Dissolution and Winding Up* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpLimited SurvivalBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination &

Winding UpDistribution of AssetsCreditor RightsBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsGeneral OverviewBusiness & Corporate LawCorporationsShareholdersAppraisal & Dissent RightsRight to DissentSales of Assets & Property



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
B. Dissolution of Domestic Stock Corporations
1. Voluntary Dissolution

5-12 California Legal Forms--Transaction Guide § 12.21

§ 12.21 Voluntary Dissolution With Court Supervision

[1] Who May Institute Proceedings; Costs

When a corporation is in the process of voluntarily winding up, a corporation, the holders of five percent or more of the total number of shares of any class of its outstanding shares, any shareholder of a close corporation, or three or more creditors may petition the superior court of the proper county to supervise the dissolution. Following notice to the corporation and to other persons interested in the corporation as shareholders and creditors, as the court may order, the court may take jurisdiction over the voluntary winding up proceeding if supervision appears necessary for the protection of the parties in interest [*Corp. Code § 1904*].

If the court assumes jurisdiction, the court may make orders as to any and all matters concerning the winding up of the affairs of the corporation and for the protection of its shareholders and creditors as justice and equity may require [*Corp. Code § 1904*]. However, the corporation and its shareholders commonly avoid petitioning for court supervision, since court supervision is costly and time-consuming.

Nonpetitioning shareholders are not automatically parties to the voluntary dissolution proceeding. Those shareholders are not parties unless they are named as defendants or they intervene; and they cannot be effectively named as defendants unless the petition seeks relief against them [*In re Fair WageLaw (2009) 176 Cal. App. 4th 279, 286-288, 97 Cal. Rptr. 3d 652* (court's adjudication, in voluntary dissolution proceeding, of corporation's claim against nonpetitioning shareholder, who was not named as defendant in that proceeding, violated shareholder's right to due process, even though shareholder had intervened so as to pursue claim against corporation)].

Creditors ordinarily are protected without court supervision, because a certificate of dissolution may not be filed with the Secretary of State unless all of the debts have been adequately provided for or paid [*Corp. Code § 1905(a)(2)*]. If distributions are made to shareholders without adequate provision for or payment of the corporation's debts, the creditors may bring an action against the shareholders and/or the directors in the name of the corporation to recover those distributions [*Corp. Code §§ 316(a)(2), (c), 2009(b)*].

[2] Specific Powers of Court

When a court petitioned to supervise a voluntary dissolution determines that supervision is necessary for the protection of any parties in interest, its jurisdiction is basically the same as in an involuntary dissolution proceeding [*Corp. Code § 1904*; *see Corp. Code §§ 1802-1809*; *see also § 12.30* et seq.]. Specifically, the court's powers include all of the following:

- Appointing a provisional director in case of a deadlock [*Corp. Code §§ 1802, 1904*; *see Corp. Code § 1800(b)(2)*].

- Appointing a receiver, on application and after notice and hearing, to assume control and manage the business and affairs of the corporation and to preserve its property [*Corp. Code §§ 1803, 1904*; *see Code Civ. Proc. §§ 566, 567* (security); *see also Gold v. Gold Realty Co. (2003) 114 Cal. App. 4th 791, 803-805, 8 Cal. Rptr. 3d 118* (judge had authority to appoint receiver under *Code Civ. Proc. § 564(b)(3), (b)(4)* and *Corp. Code § 1803* and did not abuse discretion in doing so in order to implement judgment which called for involuntary dissolution of corporation and liquidation of its assets)].

- Requiring proof of all claims and demands against the corporation, whether due or not yet due, contingent, unliquidated, or sounding only in damages, and barring claims not filed with the court during the period prescribed by the court, which can be from three to six months [*Corp. Code §§ 1806(a), 1807(a), 1904*].

- Determining the amount of or compromising all claims against the corporation or any of its property, and determining the amount of money or assets required to be retained to pay or provide for the payment of claims [*Corp. Code §§ 1806(b), 1904*].

- Determining the rights of shareholders and all classes of shareholders in and to the assets of the corporation [*Corp. Code §§ 1806(c), 1904*].

- Requiring the presentation and filing of intermediate and final accounts of the directors (or other persons appointed to conduct the winding up), holding a hearing on those accounts, allowing, disallowing, or settling the accounts, and discharging the directors or other persons from their duties and liabilities [*Corp. Code §§ 1806(d), 1904*].

- Appointing a commissioner to hear and determine any or all matters, with power and authority as the court deems proper [*Corp. Code §§ 1806(e), 1904*].

- Filling any vacancies on the board of directors that the directors or shareholders have been unable to fill [*Corp. Code §§ 1806(f), 1904*].

- Removing any director who is unable to act, or who has been guilty of dishonesty, misconduct, neglect, or abuse of trust, and appointing a director to fill the vacancy or ordering an election for that purpose [*Corp. Code §§ 1806(g), 1904*].

- Staying the prosecution of any suit, proceeding, or action against the corporation and requiring the parties to present and prove their claims in the manner required of other creditors [*Corp. Code §§ 1806(h), 1904*].

- Determining whether adequate provision has been made for the payment or satisfaction of all debts and liabilities not actually paid [*Corp. Code §§ 1806(i), 1904*].

- Making orders for the withdrawal or termination of proceedings to wind up and dissolve, subject to conditions for the protection of shareholders and creditors [*Corp. Code §§ 1806(j), 1904*].

- Making orders for bringing in new parties as the court deems proper for the determination of all questions and matters [*Corp. Code §§ 1806(l), 1904*].

- Making an order, upon the allowance or settlement of the final accounts of the directors or other persons, that the corporation has been duly wound up and is dissolved [*Corp. Code §§ 1806(k), 1808, 1904*].

For further discussion and forms regarding court-supervised dissolutions, see California Forms of Pleading and Practice, Ch. 170, *Corporations: Dissolution and Winding Up*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipReceivershipsGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipReceivershipsAppointment of ReceiversBusiness & Corporate LawCorporationsDissolution & ReceivershipReceivershipsPresentation & Payment of ClaimsBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsGeneral Overview



16 of 146 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
B. Dissolution of Domestic Stock Corporations
1. Voluntary Dissolution

5-12 California Legal Forms--Transaction Guide § 12.22

§ 12.22 Sale of Stock as Alternative to Dissolution

If the purpose of the dissolution is to dispose of the business of the corporation to a third party, the shareholders have an alternative course of action. Instead of selling the business to the third party and dissolving the corporation, they may sell all of the stock to the third party. The tax consequences are identical to the shareholders under either method [*see I.R.C. § 331*; *see also § 12.62*], and the purchaser has the choice of either operating the business as a corporation or dissolving the corporation and operating outside the corporate form. Whether substantially all of a corporation's assets or all of its stock is sold, the purchaser will be able to bargain for the seller's covenant not to compete, since the law now recognizes that the sale of all stock will carry with it a transfer of the goodwill of the corporation [*Bus. & Prof. Code § 16601*; *Radiant Industries, Inc. v. Skirvin (1973) 33 Cal. App. 3d 401, 403, 109 Cal. Rptr. 96]* . Disposition of a corporate business by sale of all the shares is discussed in detail in Ch. 11A, *Cash Purchase of Shares* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawTakeovers & Tender OffersGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
B. Dissolution of Domestic Stock Corporations
1. Voluntary Dissolution

5-12 California Legal Forms--Transaction Guide §§ 12.23-12.29

[Reserved]

§§ 12.23[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
B. Dissolution of Domestic Stock Corporations
2. Involuntary Dissolution

5-12 California Legal Forms--Transaction Guide § 12.30

§ 12.30 Procedure for Involuntary Dissolution

[1] Who May Institute Proceedings

Any of the following persons may file a verified complaint for the involuntary dissolution of a corporation on specified grounds [*see* [2], *below*] in the superior court for the proper county [*Corp. Code §§ 1800(a), 1801*]:

- At least one-half of the corporation's directors in office.

- A shareholder or shareholders who hold shares representing at least 331/3 percent of (1) the total number of outstanding shares (assuming conversion of any preferred shares convertible into common shares); (2) the outstanding common shares; or (3) the equity of the corporation [*see Kline Hawkes California v. Superior Court (2004) 117 Cal. App. 4th 183, 196, 11 Cal. Rptr. 3d 581* (proper interpretation of *Corp. Code § 1800(a)(2)(iii)* gives preferred shareholders right to file for involuntary dissolution if their preferred shares represent 331/3 percent of corporation's equity)].

- Any shareholder if the ground for dissolution is that the period for which the corporation was formed has terminated without extension.

- Any shareholder or shareholders of a close corporation.

- Any person expressly authorized to do so in the articles of incorporation.

- The Attorney General [*see § 12.31*].

With regard to shareholders' right to seek involuntary dissolution, the shares owned by persons who have personally participated in persistent and pervasive fraud, mismanagement, or abuse of authority, or persistent unfairness toward any shareholders, or in the misapplication or waste or corporate property are excluded [*Corp. Code § 1800(a)(2), (b)(4)*

]. Thus, for example, if all but one of the shareholders participated in one or more of the prohibited actions that constitute grounds for dissolution, the sole nonparticipating shareholder would be entitled to file a complaint for involuntary dissolution of the corporation, regardless of percentage of share ownership. The directors may be joined as defendants following an interlocutory judgment of dissolution, even if they were not named as parties in the original complaint, for the purpose of charging them for the sums due the plaintiffs who originally sought the dissolution [*see Howard v. Data Storage Associates, Inc. (1981) 125 Cal. App. 3d 689, 695-698, 178 Cal. Rptr. 269* ; *see also Corp. Code § 1806(l)*].

For this purpose, the term "shareholder" includes a beneficial owner of share who has entered a shareholder' agreement relating to the affairs of a close corporation [*see Corp. Code § 300(b)*] or a voting agreement [*Corp. Code § 1800(e)*; *see Corp. Code § 706*].

At any time before the trial, any shareholder or creditor may intervene [*Corp. Code § 1800(c)*].

The above requirements do not apply to any corporation subject to the Banking Law [*see Fin. Code § 99 et seq.*], the Public Utilities Act [*see Pub. Util. Code § 201 et seq.*], the Savings and Loan Association Law [*see Fin. Code § 5000 et seq.*], or the Insurance Code [*see Ins. Code § 1010 et seq.*].

[2] Grounds for Involuntary Dissolution

The following constitute the statutory grounds for involuntary dissolution:

- The corporation has abandoned its business for more than one year [*Corp. Code § 1800(b)(1)*].

- The corporation has an even number of directors who are equally divided and cannot agree on the management of its affairs, so that business cannot be conducted to advantage or a danger exists that the corporation's property and business will be impaired or lost and the shareholders are so divided into factions that they cannot elect an uneven number of directors [*Corp. Code § 1800(b)(2)*].

- Internal dissension exists among the shareholders and (1) two or more factions are so deadlocked that the corporation's business can no longer be conducted with advantage to the shareholders; or (2) the shareholders have failed at two consecutive annual meetings at which all voting power was exercised to elect successors to directors whose terms have expired (or would have expired on the election of successors [*Corp. Code § 1800(b)(3)*; *see Belio v. Panorama Optics, Inc. (1995) 33 Cal. App. 4th 1096, 1104-1106, 39 Cal. Rptr. 2d 737* (both internal dissension and deadlock required; involuntary dissolution denied in two-shareholder corporation without showing of shareholder deadlock)].

- Those in control of the corporation have been guilty of, or have knowingly countenanced, persistent and pervasive fraud, mismanagement, abuse of authority, or persistent unfairness toward any shareholders, or the corporate property is being misapplied or wasted by its directors or officers [*Corp. Code § 1800(b)(4)*; *see Bauer v. Bauer (1996) 46 Cal. App. 4th 1106, 1113-1114, 54 Cal. Rptr. 2d 377* (*Corp. Code § 1800(b)(4)* "persistent unfairness" standard is not interpreted in terms of minority shareholders' "reasonable expectations")].

- The period for which the corporation was formed has terminated without extension [*Corp. Code § 1800(b)(6)*].

- In the case of a corporation with 35 or fewer shareholders [*see Corp. Code § 605*], liquidation is reasonably necessary for the protection of the rights or interests of the complaining shareholder or shareholders [*Corp. Code § 1800(b)(5)*; *see Stuparich v. Harbor Furniture Manufacturing, Inc. (2000)*

83 Cal. App. 4th 1268, 1279, 100 Cal. Rptr. 2d 313 (minority shareholders failed to raise triable issue of material fact as to right to involuntary dissolution under *Corp. Code § 1800(b)(5)*; dissolution of corporation was not reasonably necessary to protect their rights); *Bauer v. Bauer (1996) 46 Cal. App. 4th 1106, 1116, 54 Cal. Rptr. 2d 377* (*Corp. Code § 1800(b)(5)* requires trial court to determine whether minority shareholders require protection by considering relative misconduct of parties); *see also Stumpf v. C.E. Stumpf & Sons, Inc. (1975) 47 Cal. App. 3d 230, 233-234, 120 Cal. Rptr. 671* (decided under former statute, holding that reasonable necessity for dissolution to protect interests of complaining shareholder could be found in circumstances other than specifically enumerated statutory grounds for involuntary dissolution such as deadlock, dissension, and mismanagement)].

[3] Commencement of Proceedings Requires Cessation of Corporate Activities

Involuntary proceedings for winding up a corporation commence when an order for winding up is entered by the court [*Corp. Code § 1805(a)*; *see Corp. Code § 1804*]. Once an involuntary proceeding for winding up begins, the board must conduct the winding up of the affairs of the corporation, subject to the supervision of the court, unless the court, on good cause shown, appoints other persons to conduct the winding up. The directors or other persons conducting the winding up may, subject to any restrictions imposed by the court, exercise all their powers through the executive officers without any further order of court [*Corp. Code § 1805(b)*]. The corporation must cease to carry on business except to the extent necessary for the beneficial winding up of the corporation and except during any period that the board deems necessary to preserve the corporation's goodwill or going-concern value pending a sale of its business or assets, or both, in whole or in part. The directors must cause written notice of the commencement of the proceeding for involuntary winding up to be given by mail to all shareholders and to all known creditors and claimants whose addresses appear on the records of the corporation, unless the order for winding up has been stayed by appeal or otherwise, or the proceeding or the execution of the order has been enjoined [*Corp. Code § 1805(c)*].

[4] Powers and Jurisdiction of Court

[a] Powers Same as in Voluntary Dissolution With Court Supervision

The powers and jurisdiction of a court in an involuntary proceeding are the same powers that a court may exercise in the case of a voluntary dissolution in which judicial supervision has been sought [*see Corp. Code §§ 1802-1808*; *see also Gold v. Gold Realty Co. (2003) 114 Cal. App. 4th 791, 803-805, 8 Cal. Rptr. 3d 118* (judge had authority to appoint receiver under *Code Civ. Proc. § 564(b)(3), (b)(4)* and *Corp. Code § 1803* and did not abuse discretion in doing so in order to implement judgment which called for involuntary dissolution of corporation and liquidation of its assets)]. These matters are discussed in *§ 12.21[2]*.

[b] Creditors' Claims

In addition, the court may specify the time period in which all creditors and claimants must present their claims and proofs to the court. This period may not be less than four nor more than six months after the first publication of notice to creditors unless it appears by affidavit that there are no claims, in which case the time limit may be three months. The court may bar all creditors and claimants from participation in any distribution of the general assets if they fail to make and present claims and proofs within the designated time [*Corp. Code § 1807(a)*; *see Corp. Code § 1807(c)*]. However, if it is shown that a claimant did not receive notice because of absence from the state or other cause, the court may allow a claim to be filed or presented at any time before distribution is completed [*Corp. Code § 1807(a)*].

Notice to creditors must be published not less than once a week for three consecutive weeks in a newspaper of general circulation published in the county in which the proceeding is pending or, if there is no such newspaper published in that county, in a newspaper designated by the court. The notice must direct creditors and claimants to make and present claims and proofs to the person, at the place and within the time specified in the notice. A copy of the notice must be mailed to each person shown as a creditor or claimant on the books of the corporation, at that person's last known

address [*Corp. Code § 1807(b)*].

If the court rejects a claim, the claimant must file suit against the corporation within 30 days after written notice of the rejection is given to the claimant [*Corp. Code § 1807(e)*].

[5] Court Order Declaring Corporation Wound Up and Dissolved

On the final settlement of the accounts of the directors or other persons appointed to conduct the winding up [*see Corp. Code § 1805(b)*; *see also* [3], *above*] and the determination that the corporation's affairs are in condition for it to be dissolved, the court may make an order declaring the corporation duly wound up and dissolved [*Corp. Code § 1808(a)*]. The order must state the following [*Corp. Code § 1808(a)*]:

- That the corporation has been duly wound up, that a final franchise tax return has been filed with the Franchise Tax Board [*see* Rev. & Tax. Code § 23332], and that its other known debts and liabilities have been paid or adequately provided for, or that those debts and liabilities have been paid as far as its assets permitted, as applicable. If adequate provision has been made for known debts or liabilities, the order must specify what provision has been made, setting forth the name and address of the corporation, person, or governmental agency that has assumed or guaranteed the payment, the name and address of the depositary with which deposit has been made, or other information as may be necessary to enable the creditor or other person to whom payment is to be made to appear and claim payment of the debt or liability.

- That the corporation's known assets have been distributed to the persons entitled to them, or count o the corporation acquired no known assets.

- That the accounts of directors or other persons conducting the winding up have been settled and that they are discharged from their duties and liabilities to creditors and shareholders.

- That the corporation is dissolved.

Further, the court may make any additional orders and grant any further relief as deemed proper on the evidence submitted [*Corp. Code § 1808(a)*].

On the issuance of an order declaring the corporation dissolved, corporate existence terminates except for the purposes of any further needed winding up. The directors or other persons conducting the winding up are discharged from their duties and liabilities, except in respect to completion of the winding up [*Corp. Code § 1808(b)*].

For further discussion and forms regarding court-supervised dissolutions, see California Forms of Pleading and Practice, Ch. 170, *Corporations: Dissolution and Winding Up* (Matthew Bender).

[6] Filing Court order With Secretary of State

Whenever a corporation is dissolved or its existence forfeited by order, decree, or judgment of a court, the corporation immediately must file a copy of that order, decree or judgment, certified by the clerk of court, in the office of the Secretary of State [*Corp. Code § 1809*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersActions Against CorporationsStandingGeneral OverviewBusiness

& Corporate LawCorporationsDissolution & ReceivershipInvoluntary DissolutionBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
B. Dissolution of Domestic Stock Corporations
2. Involuntary Dissolution

5-12 California Legal Forms--Transaction Guide § 12.31

§ 12.31 Action by Attorney General

[1] Grounds for Attorney General's Action

The Attorney General may bring an action against any domestic corporation (or purported domestic corporation) in the name of the people of California, on the Attorney General's own information or on complaint of a private party, to procure a judgment dissolving the corporation and annulling, vacating, or forfeiting its corporate existence on any of the following grounds [*Corp. Code § 1801(a)*; *see Corp. Code § 1801(d)* (service of process)]:

- The corporation has seriously offended any provision of the statutes regulating corporations.
- The corporation has fraudulently abused or usurped corporate privileges or powers.
- The corporation has violated any provision of law by any act or default that under the law is a ground for forfeiture of corporate existence.
- The corporation has failed to pay any tax imposed by the Bank and Corporation Tax Law to the Franchise Tax Board for a period of five years.

[2] When Prior Notice Required

If the basis of the Attorney General's action is a matter or act that the corporation has done or omitted to do that can be corrected by amendment of its articles or by other corporate action, the suit may not be maintained unless (1) the Attorney General gives the corporation written notice of the matter or act done or omitted to be done at least 30 days before instituting the suit, and (2) the corporation fails to institute proceedings to correct it within the 30-day period or the corporation then fails to prosecute those corrective proceedings [*Corp. Code § 1801(b)*].

[3] Court Powers

In any action instituted by the Attorney General, the court may order dissolution or any other complete or partial relief that the court deems just and expedient. The court may also appoint a receiver for winding up the affairs of the corporation, or may order that the corporation be wound up by its board subject to the supervision of the court [*Corp. Code § 1801(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationCorporate Existence, Powers & PurposeGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipInvoluntary DissolutionBusiness & Corporate LawCorporationsFinanceFranchise TaxPenalties for Noncompliance



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
B. Dissolution of Domestic Stock Corporations
2. Involuntary Dissolution

5-12 California Legal Forms--Transaction Guide §§ 12.32-12.39

[Reserved]

§§ 12.32[Reserved]



21 of 146 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
C. Dissolution of Domestic Nonprofit Corporations
1. Voluntary Dissolution

5-12 California Legal Forms--Transaction Guide § 12.40

§ 12.40 Voluntary Dissolution

[1] Governing Law

With respect to nonprofit corporations formed after January 1, 1980 [*see Corp. Code § 9911*] or subject to the provisions of the law governing dissolution by virtue of a separate statute [*see Corp. Code §§ 9923, 9924*], the Nonprofit Corporation Law [*Corp. Code § 5000 et seq.*] governs the dissolution of California nonprofit corporations [*see Corp. Code §§ 6510-6519, 6610-6617, 6710-6721* (public benefit corporations), 8510-8519, 8610-8618, 8710-8724 (mutual benefit corporations), 9680 (religious corporations)]. As a general rule, the law follows the rules and manner of dissolution prescribed by the General Corporation Law for the dissolution of corporations organized for profit. However, the Attorney General has jurisdiction to protect assets held in charitable trust [*see Corp. Code §§ 6510(a)(5), 8510(a)(5), 9680(c)*].

Nonprofit public benefit corporations are prohibited from distributing assets to their members on dissolution [*Corp. Code §§ 5049, 5410*]. In contrast, the assets of nonprofit mutual benefit corporations may not be distributed to their members except on dissolution of the corporation [*Corp. Code § 7411(a)*].

If any lot, parcel, area, or apartment unit is being managed or controlled by an owners' association, the association cannot transfer all or substantially all of its assets, or file a certificate of dissolution, without the approval of 100 percent of its members, nor may a court declare the association duly wound up and dissolved absent that approval [*Corp. Code § 8724*; *see Committee to Save the Beverly Highlands Homes Assn. v. The Beverly Highlands Homes Assn. (2001) 92 Cal. App. 4th 1247, 1262-1263, 1271, 112 Cal. Rptr. 2d 732* (trial court erred in granting summary judgment to plaintiffs who sought to enjoin allegedly wrongful dissolution of nonprofit mutual benefit corporation; because corporation was not common interest development, Davis-Stirling Act and *Corp. Code § 8724* did not apply)].

[2] Who May Elect Dissolution

Public benefit, mutual benefit, and religious corporations may elect to voluntarily dissolve, typically by a vote of a majority of the members. The voluntary dissolution of a domestic nonprofit corporation is initiated by an election to

dissolve. The election to dissolve may be made by the vote or written consent of a majority of all the members of the corporation or, by the board of directors and the members [*Corp. Code §§ 6610(a), 8610(a), 9680(b)(1)*].

The board of directors, acting alone, may elect to wind up and dissolve the following corporations [*Corp. Code §§ 6610(b), 8610(b), 9680(b)(2)*]:

- A corporation that has been the subject of an order for relief in bankruptcy.

- A corporation that has disposed of all of its assets and has not conducted any activity for a period of five years immediately preceding the adoption of the resolution electing to dissolve the corporation.

- A corporation that has no members.

- A subordinate corporation that must dissolve under the provisions of its articles requiring dissolution whenever its charter is surrendered, taken away, or revoked by head organization [*see Corp. Code §§ 5132(a)(2)(A), 7132(a)(4)(A), 9132(a)(2)(A)*].

If a corporation fits any of these descriptions and the number of directors then in office is less than a quorum, the corporation may elect to voluntarily wind up and dissolve by any of the following [*Corp. Code § 6610(c); 8610(c); 9680(b)(3)*]:

- The unanimous consent of the directors then in office.

- The affirmative vote of a majority of the directors then in office at a meeting held pursuant to a waiver of notice by those directors [*see Corp. Code § 5211(a)* (waiver of notice)].

- The vote of a sole remaining director.

If a corporation elects to wind up and dissolve by any of these means, statutory references to the "board" will be deemed to be a board consisting of those directors then in office or that sole director and action by the board will require at least the same consent or vote as would be required to make the election to wind up and dissolve, as described above [*Corp. Code §§ 6610(d), 8610(d), 9680(b)(4)*].

For a procedural checklist covering the voluntary dissolution of a nonprofit corporation, see *§ 12.121*.

[3] Certificate of Election

[a] Filing Requirement

Whenever a domestic nonprofit corporation elects to wind up and dissolve, the corporation must prepare and file a certificate evidencing that election with the Secretary of State's Office and file a copy with the Attorney General [*Corp. Code §§ 6611(a), 8611(a)* (if assets held in charitable trust or under charitable dissolution clause), 9680(a)]. However, if the election to dissolve is made by the vote of all the members of a corporation with members, or by all members of the board of directors of a corporation without members, the certificate of election is not required to be filed if the certificate of dissolution includes a statement to that effect [*Corp. Code §§ 6611(c), 8611(c), 9680(a)*].

[b] Contents of Certificate

The certificate of election must be an officers' certificate, or be signed and verified by at least a majority of the directors then in office or by one or more members authorized to do so by the approval of all the members. The certificate must

set forth all of the following [*Corp. Code §§ 6611(b), 8611(b), 9680(a)*]:

- That the corporation has elected to wind up and dissolve.
- If the election was made by the vote of members alone, the number of votes for the election and that the election was made by a majority of all members.
- If the election was made by the board and members, that the election was made by the board and the members.
- If the certificate is executed by a member or members, that the subscribing person or persons were authorized to execute the certificate by a majority of all members.
- If the election was made by the board alone, the circumstances showing the corporation to be within one of the categories permitting dissolution solely by the board [*see* [2], *above*].

[4] Revocation of Election

A voluntary election to wind up and dissolve may be revoked before the distribution of any assets if: (1) the election was by the vote of a majority of all members; (2) the election was made by the approval of the board and the members; or (3) the election was by the approval of the board. The certificate of revocation must be signed, verified, and filed in the prescribed manner with the Secretary of State and a copy must be filed with the Attorney General [*Corp. Code §§ 6612(a), 8612(a), 9680(a)*].

The certificate of revocation must state the following information [*Corp. Code §§ 6612(b), 8612(b), 9680(a)*]:

- That the corporation has revoked its election to wind up and dissolve.
- That no assets have been distributed pursuant to that election.
- If the revocation was made by the vote of members alone, the number of votes for the revocation and that the revocation was made by a majority of all members.
- If the revocation was made by the board and members, the certificate must state that fact.
- If the revocation was made by the board alone, the certificate must state that fact.

[5] Certificate of Dissolution

[a] Filing Requirement; Effect of Filing

To complete the dissolution when the corporation has been completely wound up, a nonprofit corporation must prepare and file a certificate of dissolution with the Secretary of State's Office. The certificate must be signed and verified by a majority of the directors then in office [*Corp. Code §§ 6615(a), 8615(a), 9680(a)*].

Nonprofit public benefit and religious corporations must attach one of the following documents, issued by the Attorney General, to the certificate of dissolution [*Corp. Code §§ 6615(b)*, 9860(a)]:

- A written waiver of objections to the distribution of the corporation's assets [*see Corp. Code § 6716(c)*]; or

- A written confirmation that the corporation has no assets.

The Secretary of State will not accept a certificate of dissolution for filing unless one of these documents is attached to the certificate [*Corp. Code §§ 6615(c),* 9860(a)]. On the filing of the certificate, corporate existence ceases, except for the limited purpose of any further winding up. The Secretary of State will notify the Franchise Tax Board of the dissolution [Corp. Code §§ 6615(c), 8615(b), 9680(a)].

If the board of a public benefit, mutual benefit, or religious corporation petitions the superior court of the proper county for an order declaring the corporation wound up, the corporation must file the petition in lieu of a certificate [*Corp. Code §§ 6617, 8617, 9680(a)*].

[b] Contents of Certificate

The certificate of dissolution must state the following information [*Corp. Code §§ 6615(a), 8615(a), 9680(a)*]:

- That the corporation has been completely wound up.

- That the corporation's known debts and liabilities have been actually paid, or adequately provided for, or paid or adequately provided for as far as its assets permitted, or that it has incurred no known debts or liabilities, as the case may be. If there are known debts or liabilities for payment of which adequate provision has been made, the certificate must state what provision has been made, setting forth the name and address of the corporation, person or governmental agency that has assumed or guaranteed the payment, or the name and address of the depositary with which deposit has been made or other information as may be necessary to enable the creditor or other person to whom payment is to be made to appear and claim payment of the debt or liability.

- That the corporation is dissolved.

- That a final franchise tax return has been or will be filed with the Franchise Tax Board [*see* Rev. & Tax. Code § 23332].

Nonprofit mutual benefit corporations must also state in the certificate of dissolution that the corporation's known assets have been distributed to the persons entitled to them, or that the corporation acquired no known assets [*Corp. Code § 8615(a)*].

[6] Petition for Court Order Declaring Corporation Wound Up and Dissolved

If a public or mutual benefit corporation is in the process of voluntarily winding up, the superior court of the proper county may take jurisdiction over the voluntary winding up proceeding if it appears necessary for the protection of any parties in interest or if it appears necessary to protect the purpose or purposes served by the corporation. Any of the following may petition for judicial intervention [*Corp. Code §§ 6614, 8614*]:

- The corporation;

- The authorized number of the voting power, typically 5 percent [*see Corp. Code § 5036*];

- The Attorney General; or

- Three or more creditors.

The court may require notice to the corporation and to other persons interested in the corporation as members and creditors [*Corp. Code §§ 6614, 8614*].

If the court assumes jurisdiction, it may issue orders as to any and all matters concerning the winding up of the affairs of the corporation and the protection of its creditors, its assets, and its purpose or purposes as justice and equity may require. Statutory provisions relating to involuntary dissolution apply to the court proceedings except provisions specifying who may file a complaint for dissolution, the intervention rights of creditors, and the Attorney General's right to bring suit [*Corp. Code §§ 6614, 8614*; *see Corp. Code §§ 6510, 6511, 8510, 8511*].

For a petition that may be adapted for use by dissolving nonprofit corporations, see California Forms of Pleading and Practice, Ch. 170, *Corporations: Dissolution and Winding Up* (Matthew Bender).

[7] Continued Existence of Dissolved Corporation

[a] Existence Limited to Winding Up Corporate Affairs

Even after the filing of a certificate of dissolution, or the entry of a court order declaring the corporation wound up and dissolved, the corporation is not absolutely extinguished. The corporation continues to exist for the purpose of winding up its affairs, prosecuting and defending actions against it, collecting and discharging obligations, conveying corporate property, and collecting and dividing assets [*Corp. Code §§ 6720(a), 8722(a), 9680(a)*].

If any assets are inadvertently or otherwise omitted from the winding up, those assets continue in the dissolved corporation for the benefit of the persons entitled to them on dissolution and must be distributed to them [*Corp. Code §§ 6720(c), 8722(c), 9680(a)*].

[b] Suits Against Dissolved Corporations

Following the filing of a certificate of dissolution, the corporation continues to exist for the purpose of prosecuting and defending actions against it [*Corp. Code §§ 6720(a), 8722(a), 9680(a)*]. Actions or proceedings to which a corporation is a party do not abate as a result of the dissolution of the corporation, or by reason of proceedings for winding up and dissolution [*Corp. Code §§ 6720(b), 8722(b), 9680(a)*].

[c] Suits Against Dissolved Corporation and Distributees

Any person to whom assets of a public benefit or religious corporation were distributed on dissolution may be sued in the corporate name on any cause of action arising before dissolution. Notice must be given to the Attorney General, who may intervene [*Corp. Code §§ 6721(a), 9680(a)*].

Causes of action against a dissolved mutual benefit corporation, whether arising before or after the dissolution, may be enforced against the dissolved corporation to the extent of its undistributed assets [*Corp. Code § 8723(a)(1)(A)*]. If any assets have been distributed to other persons, causes of action against the dissolved corporation may be enforced against those persons to the extent of the lesser of (1) their pro rata share of the claim or (2) the corporate assets distributed to them, regardless of whether the cause of action arose before or after the dissolution. However, the total liability of a person may not exceed the total amount of assets distributed to them on dissolution [*Corp. Code § 8723(a)(1)(B)*]. With the exception of quiet title suits [*see* [d], *below*], all causes of action against distributees of corporate assets are extinguished unless the claimant commences an enforcement proceeding before the earlier of (1) the expiration of the applicable statute of limitations and (2) four years after the effective date of the dissolution [*Corp. Code § 8723(a)(2)*].

[d] Quiet Title Actions

A corporation survives and continues to exist indefinitely for the purpose of being sued in any quiet title action. Any judgment rendered in a quiet title action binds each and every person having any interest in the dissolved corporation, to the extent of that interest [*Corp. Code §§ 6721(c), 8723(c), 9680(a)*]. Further, the judgment has the same force and effect as an action brought under *Code Civ. Proc. §§ 410.50* or *410.60*. Service of summons or other process may be made as provided in the Code of Civil Procedure [*see Code Civ. Proc. §§ 413.10-417.40*] or under the method provided for in *Corp. Code §§ 6721(b), 8723(b),* and *9680(a)*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil ProcedurePartiesCapacity of PartiesGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding UpBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesCivil ProcedurePartiesSubstitutionsTransfers of Interests



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
C. Dissolution of Domestic Nonprofit Corporations
1. Voluntary Dissolution

5-12 California Legal Forms--Transaction Guide § 12.41

§ 12.41 Supervision of Attorney General

[1] Notification Requirement

The Attorney General has general supervisory and enforcement authority over nonprofit corporations [*see, e.g., Corp. Code §§ 5250, 6216, 7240*]. The Attorney General also has specific authority over the dissolution and distribution of the assets of public benefit, mutual benefit, and religious corporations [*see Corp. Code §§ 6716(c), 8716(c), 9680(a), (e)(3)*]. Therefore, when a public benefit corporation, mutual benefit corporation holding assets in charitable trust, or religious corporation elects voluntary dissolution, the corporation must notify the Attorney General of the commencement of the dissolution by sending a copy of the election certificate [*Corp. Code §§ 6611(a), 6613(c), 8611(a), 8613(c), 9680(a)*; *see § 12.40[3]*].

[2] Public Benefit and Religious Corporations

The Attorney General may bring suit in the name of a public benefit or religious corporation to enforce a liability that has not been adequately provided for before assets are distributed [*Corp. Code §§ 6719(a), (b), 9680(a)*]. Further, the Attorney General is entitled to notice of, and may intervene in, any suit brought against a distributee of the assets of a public benefit or religious corporation [*Corp. Code §§ 6721(a), 9680(a)*].

After a public benefit or religious corporation pays or provides for all known debts and liabilities [*see Corp. Code §§ 6713, 9680(a), (e)*] and returns, transfers, or conveys all property subject to a condition requiring the property's return [*see Corp. Code §§ 6715, 9680(a), (e)*], the corporation must dispose of any remaining assets in accordance with its articles or bylaws, subject to the provisions of any trust under which the assets are held [*Corp. Code §§ 6716(a), 9680(e)(1)*]. The disposition must be made (1) by court decree in proceedings in which the Attorney General is a party, or (2) without court decree if the Attorney General makes a written waiver of objections to the disposition [*Corp. Code §§ 6716(b), (c), 9680(e)(2), (3)*]. The decree must be made on petition by the Attorney General or, after 30 days notice to the Attorney General, by any person concerned in the dissolution [*Corp. Code §§ 6716(b), 9680(e)(2)*].

[3] Mutual Benefit Corporations

After a mutual benefit corporation holding assets in charitable trust pays or provides for all known debts and liabilities [*see Corp. Code § 8713*] and returns, transfers, or conveys all property subject to a condition requiring the property's return [*see Corp. Code § 8715*], the corporation must dispose of any remaining assets held in charitable trust in accordance with its articles or bylaws, subject to complying with the provisions of the trust under which the assets are held [*Corp. Code § 8716(a)*]. The disposition must be made (1) by court decree in proceedings in which the Attorney General is a party, or (2) without court decree if the Attorney General makes a written waiver of objections to the disposition [*Corp. Code § 8716(b), (c)*]. The decree must be made on petition by the Attorney General or, after 30 days notice to the Attorney General, by any person concerned in the dissolution [*Corp. Code § 8716(b)*]. Any remaining assets must be distributed in accordance with the articles or bylaws or, if the organizational documents do not specify the manner of disposition, to the members in accordance with their respective rights [*Corp. Code § 8717*]. The Attorney General does not have any statutory supervisory authority over this final distribution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
C. Dissolution of Domestic Nonprofit Corporations
1. Voluntary Dissolution

5-12 California Legal Forms--Transaction Guide §§ 12.42-12.49

[Reserved]

§§ 12.42[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
C. Dissolution of Domestic Nonprofit Corporations
2. Involuntary Dissolution

5-12 California Legal Forms--Transaction Guide § 12.50

§ 12.50 Public Benefit and Mutual Benefit Corporations

[1] Who May Institute Proceedings

Public benefit and mutual benefit corporations may be subject to involuntary dissolution proceedings [*see Corp. Code §§ 6510 et seq., 8510 et seq.*]. Any one of the following persons may file a complaint for involuntary dissolution in the superior court of the proper county [*Corp. Code §§ 6510(a), 8510(a)*]:

- At least one-half of the directors in office.
- A person or persons holding or authorized in writing by persons holding at least 331/3 percent of the voting power, exclusive of memberships held by persons who have personally participated in any of prohibited transactions [*see Corp. Code §§ 6510(b)(5), 8510(b)(5)*].
- Any member if the ground for dissolution is that the period for which the corporation was formed has terminated without extension.
- Any other person expressly authorized to do so in the articles of incorporation.
- The Attorney General.
- The head organization under whose authority the corporation was created, provided that the corporation's articles include a provision that the subordinate corporation will dissolve whenever its charter is surrendered to, taken away by, or revoked by the granting organization [*see Corp. Code §§ 5132(a)(2)(A), 7132(a)(4)(A)*].

At any time before the trial, any creditor or the authorized number of members may intervene [*Corp. Code §§ 6510(c), 8510(c)*; *see Corp. Code §§ 5036*].

If a public benefit corporation is being dissolved, the Attorney General is an indispensable party [*Corp. Code §§ 6510(d)*]. If a mutual benefit corporation holds assets in charitable trust at the time of dissolution, a copy of the complaint must be served on the Attorney General, who may intervene in the suit [*Corp. Code § 8510(e)*].

The above rules do not apply to a mutual benefit corporation subject to the following laws [*Corp. Code § 8510(d)*]:

- The Public Utilities Act unless an order is obtained from the PUC authorizing the corporation either (1) to dispose of its assets or (2) to dissolve [*see Pub. Util. Code § 210 et seq.*; *see also Pub. Util. Code § 851*].

- Specified provisions of the Insurance Code [*see Ins. Code § 1010 et seq.*] when an application authorized by *Ins. Code § 1011* has been filed by the Insurance Commissioner, unless the corporation obtains the consent of the Insurance Commissioner.

- The California Credit Union Law [*see Fin. Code § 14000 et seq.*].

[2] Grounds for Involuntary Dissolution

The statutory grounds for involuntary dissolution are as follows [*Corp. Code § 6510(b), 8510(b)*]:

- When the corporation has abandoned its business for more than one year.

- When the corporation has an even number of directors who are equally divided and cannot agree on the management of its affairs, so that business cannot be conducted to advantage or a danger exists that the corporation's property and business will be impaired or lost and the members are so divided into factions that they cannot elect an uneven number of directors.

- When internal dissension exists among the members and two or more factions are so deadlocked that the corporation's business can no longer be conducted with advantage.

- When the members have failed to elect successor directors whose terms have expired (or would have expired on the election of their successors) during the shorter of (1) any four-year period, or (2) when all voting power has been exercised at two consecutive meetings or in two written ballots for the election of directors.

- When those in control of the corporation have been guilty of, or have knowingly countenanced, persistent and pervasive fraud, mismanagement, abuse of authority, or persistent unfairness toward any shareholders, or the corporate property is being misapplied or wasted by its directors or officers.

- When liquidation is reasonably necessary as the corporation is failing and has continuously failed to carry out its purposes.

- The period for which the corporation was formed has terminated without extension.

- The corporation is required to dissolve under the terms of any article provision requiring that subordinate corporation will dissolve whenever its charter is surrendered to, taken away by, or revoked by the granting organization [*see Corp. Code §§ 5132(a)(2)(A)*], 7132(a)(4)(A)].

[3] Winding Up Procedure; Corporate Powers Limited to Winding Up

Involuntary proceedings for winding up a corporation commence when the order for winding up is entered [*Corp. Code §§ 6515(a), 8515(a)*; *see Corp. Code §§ 6514, 8514*; *see also* [4], *below*]. Once the proceeding begins, the board of directors will conduct the winding up of the corporation's affairs, subject to the supervision of the court, unless other persons are appointed by the court, on good cause shown, to conduct the winding up. The persons winding up the corporation may, subject to any restrictions imposed by the court, exercise all their powers through the executive officers without any order of court [*Corp. Code §§ 6515(b), 8515(b)*]. The corporation must cease to conduct its activities, except to the extent necessary for the beneficial winding up and except during any period that the board deems necessary to preserve the corporation's goodwill or going concern value, pending a sale or other disposition of its assets, or both, in whole or in part. The directors will cause written notice of the commencement of the involuntary winding up proceeding to be given by mail to all members and to all known creditors and claimants whose addresses appear on the records of the corporation, unless the order for winding up has been stayed (by appeal or otherwise) or the proceeding or the execution of the order has been enjoined [*Corp. Code §§ 6515(c), 8515(c)*].

[4] Specific Powers of Court

If the ground for the complaint for involuntary dissolution of the corporation is a deadlock in the board [*see Corp. Code §§ 6510(b)(2), 8510(b)(2)*], the court may appoint a provisional director [*Corp. Code §§ 6512, 8512*]. A provisional director must be an impartial person, who is neither a member nor a creditor of the corporation, nor related by consanguinity or affinity within the third degree according to the common law to any of the other directors of the corporation or to any judge of the court by which the provisional director is appointed. A provisional director has all the rights and powers of a director until the deadlock in the board or among members is broken, or until the provisional director is removed by order of the court or by approval of a majority of all members. The provisional director is entitled to compensation, as fixed by the court, unless otherwise agreed with the corporation [*Corp. Code §§ 5225(e), 6512, 7225(d), 8512*].

The court may appoint a receiver if, at the time of the filing of a complaint for involuntary dissolution or at any time thereafter, the court has reasonable grounds to believe that the interests of the corporation or its members will suffer pending the hearing and determination of the complaint unless a receiver of the corporation is appointed. Following application by the plaintiff and a hearing, on notice to the corporation as the court may direct, and on the provision of security [*see Code Civ. Proc. §§ 566, 567*], the court may appoint a receiver to take over and manage the affairs of the corporation and to preserve its property pending the hearing and determination of the complaint for dissolution [*Corp. Code §§ 6513, 8513*].

After the hearing, the court may decree a winding up and dissolution of the corporation if adequate cause is shown or, with or without winding up and dissolution, may make any orders and decrees and issue any injunctions in the case as justice and equity require [*Corp. Code §§ 6514, 8514*].

For forms that may be adapted for use by dissolving nonprofit corporations, see California Forms of Pleading and Practice, Ch. 170, *Corporations: Dissolution and Winding Up* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
C. Dissolution of Domestic Nonprofit Corporations
2. Involuntary Dissolution

5-12 California Legal Forms--Transaction Guide § 12.51

§ 12.51 Action by Attorney General on Behalf of State

The Attorney General may bring suit against a public benefit or mutual benefit corporation (or purported corporation) in the name of the people of California on the Attorney General's own information or on complaint of a private party to secure a judgment dissolving the corporation and annulling, vacating, or forfeiting its corporate existence [*Corp. Code §§ 6511(a), 8511(a)*; *see Corp. Code §§ 6511(d), 8511(d)* (service of process on corporation)]. Such an action may be based on any of the following grounds [*Corp. Code §§ 6511(a), 8511(a)*]:

- The corporation has seriously offended against any provision of the statutes regulating corporations or charitable organizations.

- The corporation has fraudulently abused or usurped corporate privileges or powers.

- The corporation has violated any provision of law by any act or default that is a legal ground for forfeiture of corporate existence.

- The corporation has failed to pay to the Franchise Tax Board for a period of five years any tax imposed by the Corporation Tax Law.

The Corporations Code contains no procedure for the involuntary dissolution of religious corporations.

If the ground of the action is a matter or act that the corporation has done or omitted to do that can be corrected by amendment of its articles or by other corporate action, the suit will not be maintained unless (1) the Attorney General gives the corporation written notice of the matter or act done or omitted to be done, at least 30 days before the institution of suit, and (2) the corporation fails to institute proceedings to correct it within that 30-day period or thereafter fails to duly and properly make the amendment or take the corrective corporate action [*Corp. Code §§ 6511(b), 8511(b)*].

In any suit brought by the Attorney General, the court may order dissolution or any other relief as the court deems just and expedient. The court may also appoint a receiver for winding up the affairs of the corporation, or may order that the corporation be wound up by its board subject to the supervision of the court [*Corp. Code §§ 6511(c), 8511(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
C. Dissolution of Domestic Nonprofit Corporations
2. Involuntary Dissolution

5-12 California Legal Forms--Transaction Guide §§ 12.52-12.59

[Reserved]

§§ 12.52[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
D. Tax Considerations

5-12 California Legal Forms--Transaction Guide § 12.60

§ 12.60 Double Taxation Continues

Corporate dissolution often results in significant income tax liabilities for both the corporation and its shareholders. Both levels of tax consequences should be evaluated to determine the potential effect of dissolution [*see I.R.C. §§ 331*-336]. For further discussion, see *§§ 12.61* and *12.62*. The special rules applicable to S corporations are discussed in *§ 12.63*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsLiquidations (IRC secs. 331-338)Tax LawFederal Income Tax ComputationTaxable Income (IRC sec. 63)Business & Corporate LawCorporationsDissolution & ReceivershipGeneral Overview



28 of 146 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
D. Tax Considerations

5-12 California Legal Forms--Transaction Guide § 12.61

§ 12.61 Corporate Recognition of Gain and Loss

A liquidating corporation ordinarily recognizes gain or loss on the distribution of property in complete liquidation, as if it had sold the property to the distributee at its fair market value [*I.R.C. § 336(a)*]. If any property distributed in the liquidation is subject to a liability, or if the distributee assumes a liability on the distribution, then the fair market value of the property is the greater of the property's fair market value or the amount of the liability for purposes of determining gain or loss [*I.R.C. § 336(b)*].

The recognition of loss by a liquidating corporation is subject to limitations. First, if the corporation distributes property to a "related person" [*see I.R.C. § 267*], the corporation cannot recognize loss on that distribution when (1) the distribution is not pro rata, or (2) the property is "disqualified property" [*I.R.C. § 336(d)(1)(A)*]. The term "disqualified property" means any property that was acquired by the liquidating corporation as a tax-free transfer to a controlled corporation [*see I.R.C. § 351*], or as a contribution to capital, during the five-year period ending on the date of distribution. The term also includes any property that has an adjusted basis determined in whole or in party by reference to the adjusted basis of disqualified property [*I.R.C. § 336(d)(1)(B)*].

Second, the corporation cannot recognize a loss on the sale, exchange, or distribution of built-in loss property contributed to the corporation in order to create a loss. Specifically, the adjusted basis of property that was acquired as a tax-free transfer to a controlled corporation [*see I.R.C. § 351*] or as a contribution to capital is reduced, for purposes of determining loss on distribution, if the acquisition was part of a plan that had as a principal purpose the recognition of loss with respect to the property in connection with the liquidation [*I.R.C. § 336(d)(2)(A), (B)(i)*]. Any such built-in loss property acquired by the liquidated corporation after the date two years before the day on which the plan of liquidation is adopted will be treated as part of the plan to recognize loss [*I.R.C. § 336(d)(2)(B)(ii)*].

Third, a liquidating subsidiary corporation does not recognize gain or loss with respect to distributions to a parent corporation holding at least 80 percent of the total value of the subsidiary's stock and voting power if the parent takes a carry-over basis in the property and the liquidation is accomplished with the specified time periods [*I.R.C. §§ 332, 337*; *see I.R.C. § 1504(a)(2)* (ownership tests)]. However, the liquidating corporation cannot rely on this parent-subsidiary exception with regard to minority shareholders [*I.R.C. §§ 332, 337*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsC CorporationsLiquidations (IRC secs. 331-338)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
D. Tax Considerations

5-12 California Legal Forms--Transaction Guide § 12.62

§ 12.62 Shareholder Recognition of Gain or Loss

[1] In General

The amount distributed to a shareholder in a complete liquidation is treated as full payment in exchange for the shareholder's stock [*I.R.C. § 331(a)*]. Gain is measured by the value of money or property received by the shareholders, less their adjusted basis in the stock; loss is recognized to the extent that their adjusted basis exceeds the amount received [*I.R.C. §§ 331(c), 1001(a)*; *Rev. & Tax. Code § 18031*]. Normally, the gain or loss to the shareholders on the dissolution of a corporation is a capital gain or loss, unless the stock is not deemed a capital asset [*see I.R.C. § 1221*] or (for years beginning before January 1, 2003, or after December 31, 2008 [*see I.R.C. § 341*, before repeal by Pub. Law No. 108-27; *see also* Pub. Law No. 108-27, §§ 302(f)(1), 303 (effective date and sunset provisions for repeal of collapsible corporation rules)]) the corporation is considered a collapsible corporation [*see I.R.C. § 341*, before repeal by Pub. Law No. 108-27]. Capital gain or loss treatment is dependent on how long the shareholder held the stock [*see I.R.C. § 1223*].

[2] Collapsible Corporations

For years in which the collapsible corporation rules apply, if the corporation is a "collapsible corporation," the gain will be treated as ordinary income [*I.R.C. § 341*, before repeal by Pub. Law No. 108-27]. In general, a collapsible corporation is a corporation that has appreciated property on which it has not been taxed. There are, however, many exceptions to the rule, and, in some cases, the timing of a dissolution can determine whether or not a corporation will be considered collapsible. The rules determining the collapsibility of a corporation are complex and if it appears that the shareholders will recognize a considerable gain upon dissolution, a thorough study should be made to determine the collapsibility of the corporation, and the methods, if any, of avoiding it.

[3] Dissolution Preceded or Followed by Asset Transfer to Another Corporation Owned by Same Shareholders

If dissolution is preceded or followed by the transfer of a substantial amount of corporate assets to another corporation owned by a majority of the same shareholders, it is possible that the transaction will be characterized as a

"liquidation-reincorporation." In this case, the liquidation may be deemed incomplete and all the assets retained by the shareholders personally will be taxed to them as a dividend [*see Treas. Reg. § 1.331-1(c)*]. Thus, the liquidation of a corporation will be disregarded when it substantially reincorporates and the business enterprise remains in substantially continuous operation [*see Boyter v. Commissioner (4th Cir. 1981) 668 F.2d 1382, 1387 ; see also Atlas Tool Co. (1978) 70 T.C. 86 , aff'd, 614 F.2d 860 (3d Cir. 1980) , cert. denied, 449 U.S. 836 (1980)]* .

[4] Installment Obligations

Ordinarily, all gain recognized in a corporate dissolution is reported for the year in which the distributions are received. However, shareholders may be able to use the installment method [*see I.R.C. § 453*] if (1) the shareholder receives an installment obligation acquired by the corporation within 12 months of the date that a complete liquidation plan is adopted and liquidation is completed within that period [*I.R.C. § 453(h)*]; and (2) the shareholder sells the stock before the liquidation, with payment in installments over a number of years, and the stock would not be attributed to the shareholder after the sale [*I.R.C. § 453(e)*; *see I.R.C. §§ 267(b), 318(a)*].

[5] Liquidation of Solvent Subsidiary

Further, shareholders may not recognize gain as a result of the liquidation of a solvent subsidiary corporation with respect to distributions to a parent corporation holding at least 80 percent of the subsidiary's stock if the parent takes a carry-over basis in the property [*I.R.C. §§ 332, 337*; *see Treas. Reg. § 1.332-6*]. However, this parent-subsidiary exception does not apply to the liquidating corporation's minority shareholders [*I.R.C. §§ 332, 337*; *see Treas. Reg. § 1.332-5*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationSales & ExchangesInstallment Sales (IRC secs. 1001, 1031, 1231)General OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsGeneral OverviewTax LawFederal Income Tax ComputationSales & ExchangesCapital Gains & Losses (IRC secs. 1201-1202, 1211-1212, 1221-1223, 1231-1260, 1271-1278, 1281-1288, 1291-1298)Treatment of LossesTax LawFederal Income Tax ComputationSales & ExchangesCapital Gains & Losses (IRC secs. 1201-1202, 1211-1212, 1221-1223, 1231-1260, 1271-1278, 1281-1288, 1291-1298)Treatment of GainsTax LawFederal Income Tax ComputationOrdinary Income (IRC sec. 64)Tax LawFederal Taxpayer GroupsC CorporationsCollapsible Corporations (IRC sec. 341)Tax LawFederal Income Tax ComputationSales & ExchangesBasis (IRC secs. 1011-1017, 1019, 1021, 1023)Stock & Other SecuritiesTax LawFederal Taxpayer GroupsC CorporationsLiquidations (IRC secs. 331-338)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
D. Tax Considerations

5-12 California Legal Forms--Transaction Guide § 12.63

§ 12.63 Treatment of S Corporation Gain or Loss

In general, the liquidation rules apply equally in the S corporation context. However, this tax treatment ordinarily results in less overall tax for S corporations and their shareholders than in the C corporation context because S corporate gain is passed through and taxed to the shareholders and increases their basis in their stock [*see I.R.C. § 1361* et seq.]. This increased basis reduces any gain that would otherwise be recognized at the shareholder level.

However, a special tax applies to the "recognized built-in gain" of an S corporation that liquidates or sells all its assets within 10 years after the effective date of the conversion from a C corporation [*I.R.C. § 1374*]. "Recognized built-in gain" means gain recognized during that ten-year period on the disposition of any asset owned by the corporation at the beginning of its first year as an S corporation that does not exceed the excess (if any) of the asset's fair market value over the asset's adjusted basis at the beginning of that first taxable year [*I.R.C. § 1374(d)(3)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsBasis (IRC secs. 1361, 1367)Tax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Determination of Tax Liability



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART II. LEGAL BACKGROUND
D. Tax Considerations

5-12 California Legal Forms--Transaction Guide §§ 12.64-12.99

[Reserved]

§§ 12.64[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

5-12 California Legal Forms--Transaction Guide § 12.100

§ 12.100 Facts

[1] Domestic Stock Corporation

1. Exact name of corporation as it appears in its articles of incorporation.

2. Address and telephone number of principal executive office.

3. Date of incorporation.

4. Nature of business.

5. Number of employees.

6. Authorized number of directors.

7. Names, addresses, titles, and telephone numbers of officers and directors.

8. Time and place of regular meetings of the board of directors.

9. Usual location for special directors' meetings.

10. Quorum requirements.

11. Shares outstanding:

    a. Classes and series of shares outstanding.

b. Voting rights of each class and series, particularly classes and series of shares outstanding that are entitled to vote for the election of directors.

c. Number of outstanding shares in each class and series.

d. Liquidation preferences of each class.

12. Names and addresses of shareholders and number of shares held in each class.

13. Quorum and notice requirements and location for special shareholders' meetings.

14. Description, value, and tax basis of each asset:

a. Inventory.

b. Accounts receivable.

c. Fixtures and equipment.

d. Leases, including any restrictions on assignment.

e. Real property, including any encumbrances.

f. Motor vehicles.

g. Corporate stock and securities.

h. Other.

15. Name, address, and telephone number of accountant for corporation.

16. Name and address of bank where corporation maintains its account.

17. Fiscal year of corporation.

18. Description and nature of each liability.

19. Nature and amount of contingent claims by or against the corporation.

20. Lawsuits by or against the corporation.

[2] Domestic Nonprofit Corporation

1. Facts Relating to corporation:

a. Exact name of corporation as it appears in its articles of incorporation.

b. Other name(s) (fictitious), if any, under which corporation will do business.

c. Date of incorporation.

d. Date of transfer of assets to corporation.

e. Type of nonprofit corporation:
(1) Public benefit corporation.

(2) Mutual benefit corporation.

(3) Religious corporation.

(4) Other types of nonprofit corporations.

f. Purpose(s) of corporation.

(1) Nature of nonprofit activities.

(2) Nature of any unrelated business activities.

g. Street and mailing address, and telephone and fax numbers of corporation's principal office.

h. Fiscal year of corporation.

i. Whether corporate existence is limited to specified date or purpose.

2. Facts relating to directors, if any.

a. Authorized number of directors.

b. Authority and duties of directors and any limitations on that authority.

c. Qualifications and manner of selection.

d. Terms of office.

e. Compensation.

f. Names, addresses, titles, and telephone and fax numbers.

g. Liabilities of directors.

h. Removal, resignation, and vacancy.

i. Manner of filling vacancies on board of directors.

j. Meetings.

(1) Time and place of regular meetings of the board of directors.

(2) Usual location for special directors' meetings.

(3) Quorum requirements.

(4) Conduct and adjournment of board meetings.

3. Facts relating to officers, if any.

a. Official designations or titles.

b. Authority and duties of officers and any limitations on that authority.

c. Qualifications and manner of selection.

d. Terms of office.

e. Compensation.

f. Names, addresses, titles, and telephone and fax numbers.

g. Removal, resignation, and vacancy.

h. Manner of filling vacancies.

4. Facts relating to members, if any.

a. Number.

b. Names, addresses, and telephone and fax numbers of members.

c. Qualifications and eligibility.

d. Manner of admission, such as applications, dues, assessments, and fees.

e. Classes and series of membership

f. Rights and obligations of members, including voting authority.

g. Transferability of memberships.

h. Termination of membership.

i. Quorum and notice requirements and location for regular and special meetings.

5. Actions that may be taken without meetings.

6. Number of employees.

7. Description, value, and tax basis of each asset:

a. Inventory.

b. Accounts receivable.

c. Fixtures and equipment.

d. Leases, including any restrictions on assignment.

e. Real property, including any encumbrances.

f. Motor vehicles.

g. Corporate stock and securities.

h. Other.

8. Nature and extent of any indemnification of directors, officers, and/or employees.

9. Business and financial advisers.

a. Name, address, and telephone number of accountant and accountancy firms.

b. Insurance agents.

c. Bankers and banks.

10. Name and address of bank where corporation maintains its account.

11. Agent for service of process.

a. If agent is natural person, name and complete business or residence address in California.

b. If agent is corporation, including domestic, foreign, or foreign business corporation, name and complete business address.

12. Description and nature of each liability.

13. Nature and amount of any contingent claims against corporation.

14. Lawsuits by or against corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding UpBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

5-12 California Legal Forms--Transaction Guide § 12.101

§ 12.101 Documents

1. Articles of incorporation.

2. Bylaws.

3. Permit to issue stock.

4. Minute book.

5. Stock certificate book and stock record book.

6. Stock subscription agreements.

7. Balance sheet and income statements.

8. Income tax returns.

9. Options, agreements, deeds, bills of sale, other documents of title, and other instruments pertaining to or affecting property rights.

10. Title reports.

11. Leases.

12. Executory contracts.

13. Loan agreements.

14. Notes and security agreements.

15. Insurance policies.

16. Employment contracts.

17. Labor union contracts.

18. Employee pension or profit-sharing agreements.

19. Proposed contracts for sale of any, or all, of assets of corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary Dissolution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

5-12 California Legal Forms--Transaction Guide §§ 12.102-12.109

[Reserved]

§§ 12.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-12 California Legal Forms--Transaction Guide § 12.110

§ 12.110 Voluntary Dissolution of Stock Corporation

NOTE:

The following guide is primarily concerned with the voluntary dissolution of a corporation by its shareholders. However, this guide, except as otherwise indicated, also applies to a dissolution at the election of the directors.

1. Determine whether dissolution is necessary.

NOTE:

Counsel and the parties should carefully evaluate the need for dissolution and consider all alternatives as the dissolution decision has potentially serious consequences: the liquidation value of the corporation may be significantly less than its value as an operating business; the corporation may need to retain assets to cover contingent liabilities, and the shareholders may face income tax consequences from the dissolution.

If dissolution is necessary, the shareholders or the board of directors should carefully plan the dissolution. Adopting a "wait and see" approach may result in the corporation becoming insolvent or wasting its assets, which may expose the directors to liability.

a. If corporation is being dissolved for financial reasons, investigate:

(1) Methods for cutting expenses, including reduction of work force and relocation;

(2) Methods for increasing income;

(3) Sources of additional capital, including merger;

(4) Possibility of obtaining new management; and

(5) Sale of all corporate stock.

b. If dissolution is resulting from dissension among shareholders, consider purchase of shares of dissenters by other shareholders or redemption by corporation.

c. Evaluate factors weighing against dissolution:

(1) Determine if corporation has long-term liabilities, such as long-term lease, which might preclude dissolution.

(2) Review all loan documents and financing agreements to determine if prepayment penalty exists, such as acceleration of loan on dissolution or on distributions to shareholders, or if documents restrict dissolution or liquidation.

(3) Review all leases and contracts and consider provisions for breach or early termination, and determine if contract is assignable.

(4) Determine if sufficient cash is available to pay current liabilities of corporation and shareholders' taxes on dissolution.

2. If dissolution is necessary, determine whether dissolution should be voluntary or involuntary:

NOTE:
If parties believe dissolution should be involuntary, see *§ 12.111*.

a. Ascertain whether grounds for involuntary dissolution exist [*Corp. Code § 1800(b)*; *see § 12.30[2]*].

b. Determine whether proper parties are willing to file complaint [*Corp. Code § 1800(a)*; *see § 12.30[1]*].

3. Evaluate potential federal and state income tax consequences of dissolution to corporation and shareholders.

a. Determine if dissolution will cause corporation to recognize significant gain from income previously deferred, such as deferred income on installment notes.

b. For years in which the collapsible corporation rules apply (tax years beginning before January 1, 2003, and after December 31, 2008 [Pub. Law No. 108-27, §§ 302(e)(4)(A), 302(f)(1), 303] if corporation is collapsible [*I.R.C. § 341*, before repeal by Pub. Law No. 108-27] and if methods exist for avoiding consequences of collapsibility, such as delaying dissolution [*see § 12.62*].

4. Evaluate applicable requirements of state and federal agencies other than Secretary of State, including taxing authorities, Employment Development Department, State Board of Equalization.

5. Evaluate corporation's current and potential assets, debts, and liabilities and prepare list of creditors.

6. Determine whether any pending or potential litigation affecting the corporation.

7. Examine articles of incorporation, bylaws, and shareholders' agreements to determine if liquidation preferences or conversion rights have been created.

8. Determine applicability of bulk sales law, especially notice requirements [*see Com. Code § 6101 et seq.*; *see also* Ch. 2A, *Incorporating a Going Business*].

9. Consider methods for satisfying claims against corporation.

a. Determine if all liabilities of the corporation will be paid.

b. Determine if liabilities can be secured by depositing an amount equal to liabilities with a bank or trust company.

c. Consider possibility of all or any portion of liabilities being assumed by shareholders.

d. Consider petitioning court to supervise dissolution [*Corp. Code § 1904*; *see* P 13, *below*] in order to bar creditors' claims after a fixed period [*Corp. Code § 1807(a)*].

10. Consider retaining reserve for payment of contingent or unknown liabilities, such as pollution and product liability claims.

11. Consider use of liquidating trust [*see § 12.280*].

12. Draft plan for liquidation and distribution of assets.

13. Consider whether court supervision is warranted [*see § 12.21*]:

a. Shareholders are in conflict.

b. Creditors' claims are in dispute.

c. Other unusual circumstances.

14. Consider necessity and means for preserving corporate rights under license and existing contracts.

15. Explore possibility of licensing or selling use of corporate name.

16. Determine procedure for handling dissenting shareholders, or any shareholders who refuse to surrender shares.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpLimited SurvivalBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsCreditor RightsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-12 California Legal Forms--Transaction Guide § 12.111

§ 12.111 Involuntary Dissolution of Stock Corporation

NOTE:
The following guide does not apply to any corporation subject to the Banking Law [***see*** *Fin. Code § 99 et seq.*], the Public Utilities Act [***see*** *Pub. Util. Code § 201 et seq.*], the Savings and Loan Association Law [***see*** *Fin. Code § 5000 et seq.*], or the Insurance Code [***see*** *Ins. Code § 1010 et seq.*].

1. Assuming dissolution is necessary [*see § 12.110*, P 1], determine whether proper parties are willing to file complaint:

a. At least one-half of corporation's directors in office.

b. Shareholders who hold shares representing at least 331/3 percent of:

NOTE:
The shares owned by persons who have personally participated in persistent and pervasive fraud, mismanagement, or abuse of authority, or persistent unfairness toward any shareholders, or in the misapplication or waste or corporate property are excluded from the computation [*Corp. Code § 1800(a)(2), (b)(4)*].

(1) Total number of outstanding shares (assuming conversion of any preferred shares convertible into common shares);

(2) Outstanding common shares; or

(3) Equity of corporation.

NOTE:

The court of appeals has held that a proper interpretation of *Corp. Code § 1800(a)(2)(iii)* gives preferred shareholders the right to file for involuntary dissolution if their preferred shares represent 331/3 percent of the corporation's equity [*Kline Hawkes California v. Superior Court (2004) 117 Cal. App. 4th 183, 196, 11 Cal. Rptr. 3d 581* (sustaining demurrer with leave to amend; although plaintiffs failed to describe equity of corporation correctly for purposes of *Corp. Code § 1800(a)(2)(ii)*, they might have been able to do so)].

c. Any shareholder if ground for dissolution is that period for which corporation was formed has terminated without extension.

d. Any shareholder or shareholders of close corporation.

e. Any person expressly authorized to do so in articles of incorporation.

f. Attorney General [*see § 12.31*].

2. Assuming proper parties are willing to file complaint [*see* P 1, *above*], determine whether proper grounds exist for involuntary dissolution:

a. If corporation has abandoned its business for more than one year [*Corp. Code § 1800(b)(1)*].

b. If corporation has even number of directors who are equally divided and cannot agree on management matters, so that:

(1) Business cannot be conducted to advantage or danger exists that corporation's property and business will be impaired or lost; and

(2) Shareholders are so divided into factions that they cannot elect uneven number of directors [*Corp. Code § 1800(b)(2)*].

c. If internal dissension exists among shareholders and:

NOTE:

Both internal dissension and deadlock are required. Involuntary dissolution has been denied in a two-shareholder corporation absent a showing of shareholder deadlock [*Belio v. Panorama Optics, Inc. (1995) 33 Cal. App. 4th 1096, 1104-1106, 39 Cal. Rptr. 2d 737]* .

(1) Two or more factions are so deadlocked that corporation's business can no longer be conducted with advantage to shareholders; or

(2) Shareholders have failed at two consecutive annual meetings at which all voting power was exercised to elect successors to directors whose terms have expired (or would have expired on election of successors [*Corp. Code § 1800(b)(3)*].

d. If parties in control of the corporation have been guilty of, or have knowingly countenanced, persistent and pervasive fraud, mismanagement, abuse of authority, or persistent unfairness toward any shareholders [*Corp. Code § 1800(b)(4)*].

e. If corporate property is being misapplied or wasted by its directors or officers [*Corp. Code § 1800(b)(4)*].

f. If corporation has 35 or fewer shareholders [*see Corp. Code § 605*], and liquidation is reasonably necessary to protect rights or interests of complaining shareholder or shareholders [*Corp. Code § 1800(b)(5)*].

g. If period for which corporation was formed has terminated without extension [*Corp. Code § 1800(b)(6)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipInvoluntary Dissolution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-12 California Legal Forms--Transaction Guide § 12.112

§ 12.112 Voluntary Dissolution of Nonprofit Corporation

1. Determine whether dissolution is necessary.

NOTE:

Counsel and the parties should carefully evaluate the need for dissolution and consider all alternatives as the dissolution decision has potentially serious consequences. The liquidation value of the corporation may be significantly less than its value as an operating business and the corporation may need to retain assets to cover contingent liabilities.

If dissolution is necessary, the members or the board of directors should carefully plan the dissolution. Adopting a wait and see approach may result in the corporation becoming insolvent or wasting its assets, which may result in exposing the directors to liability.

a. If corporation is being dissolved for financial reasons, investigate:
(1) Methods for cutting expenses, including reduction of work force and relocation;

(2) Methods for increasing income;

(3) Sources of additional capital; and

(4) Possibility of obtaining new management.

b. If dissolution is resulting from dissension among members, consider purchase of shares of dissenters by other members or redemption by corporation.

c. Evaluate factors weighing against dissolution:

(1) Determine if corporation has long-term liabilities, such as long-term lease, which might preclude dissolution.

(2) Review all loan documents to determine if prepayment penalty exists, such as acceleration of loan on dissolution or on distributions to member, or if documents restrict dissolution.

(3) Review all leases and contracts and consider provisions for breach or early termination, and determine if contract is assignable.

(4) Determine if sufficient cash is available to pay current liabilities of corporation and members' taxes on dissolution.

2. If dissolution is necessary, determine whether dissolution should be voluntary or involuntary:

NOTE:
If parties believe that dissolution should involuntary, see *§ 12.113*.

3. Evaluate potential federal and state income tax consequences of dissolution to corporation and members.

4. Evaluate applicable requirements of state and federal agencies other than Secretary of State, including taxing authorities, Employment Development Department, State Board of Equalization.

5. Evaluate corporation's current and potential assets, debts, and liabilities and prepare list of creditors.

6. Determine whether any pending or potential litigation affecting the corporation.

7. Examine articles of incorporation, bylaws, and members' agreements to determine if liquidation preferences or conversion rights have been created.

8. Determine applicability of bulk sales law, especially notice requirements [*see Com. Code § 6101 et seq.*; *see also* Ch. 2A, *Incorporating a Going Business*].

9. Consider methods for satisfying claims against corporation.

a. Determine if all liabilities of the corporation will be paid.

b. Determine if liabilities can be secured by depositing an amount equal to liabilities with a bank or trust company.

c. Consider possibility of all or any portion of liabilities being assumed by members.

d. Consider petitioning court to supervise dissolution [*Corp. Code §§ 6614, 8614*] in order to bar creditors' claims after a fixed period [*Corp. Code §§ 6517, 8517*].

10. Consider retaining reserve for payment of contingent or unknown liabilities, such as pollution and product liability claims.

11. Draft plan for liquidation and distribution of assets.

12. Consider whether court supervision is warranted [*see Corp. Code §§ 6614, 8614*]:

a. Members are in conflict.

b. Creditors' claims are in dispute.

c. Other unusual circumstances.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Bulk Sales (Article 6)Notice to ClaimantsBusiness & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding UpBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-12 California Legal Forms--Transaction Guide § 12.113

§ 12.113 Involuntary Dissolution of Public Benefit and Mutual Benefit Corporations

NOTE:

The following rules do not apply to mutual benefit corporation subject to (1) the Public Utilities Act unless an order is obtained from the PUC authorizing the corporation either (a) to dispose of its assets or (b) to dissolve [***see*** *Pub. Util. Code § 210 et seq.*; ***see also*** *Pub. Util. Code § 851*]; (2) specified provisions of the Insurance Code [***see*** *Ins. Code § 1010 et seq.*] when an application authorized by *Ins. Code § 1011* has been filed by the Insurance Commissioner, unless the corporation obtains the consent of the Insurance Commissioner; and (3) the California Credit Union Law [*Corp. Code § 8510(d)*; ***see*** *Fin. Code § 14000 et seq.*].

The Corporations Code contains no procedure for the involuntary dissolution of religious corporations.

1. Assuming dissolution is necessary [*see § 12.112*, P 1], determine whether proper parties are willing to file complaint:

NOTE:

If a public benefit corporation is being dissolved, the Attorney General is an indispensable party [*Corp. Code §§ 6510(d)*]. If a mutual benefit corporation holds assets in charitable trust at the time of dissolution, a copy of the complaint must be served on the Attorney General, who may intervene in the suit [*Corp. Code § 8510(e)*].

a. At least one-half of directors in office.

b. Persons holding or authorized in writing by persons holding at least 331/3 percent of voting power, exclusive of memberships held by persons who have personally

participated in any of prohibited transactions [*see Corp. Code §§ 6510(b)(5), 8510(b)(5)*].

c. Any member if ground for dissolution is that period for which corporation was formed has terminated without extension.

d. Any other person expressly authorized to do so in articles of incorporation.

e. California Attorney General.

f. Head organization under whose authority corporation was created, provided that corporation's articles provide that subordinate corporation will dissolve whenever its charter is surrendered to, taken away by, or revoked by granting organization [*see Corp. Code §§ 5132(a)(2)(A)*], 7132(a)(4)(A)].

2. Assuming proper parties are willing to file complaint [*see* P 1, *above*], determine whether proper grounds exist for involuntary dissolution [*Corp. Code § 6510(b), 8510(b)*]:

a. If corporation has abandoned its business for more than one year.

b. If corporation has an even number of directors who are equally divided and cannot agree on the management of its affairs, so that:
(1) Business cannot be conducted to advantage; or

(2) Danger exists that corporation's property and business will be impaired or lost; and

(3) Members are so divided into factions that they cannot elect uneven number of directors.

c. If internal dissension exists among members and two or more factions are so deadlocked that corporation's business can no longer be conducted with advantage.

d. If members have failed to elect successor directors whose terms have expired (or would have expired on the election of their successors) during shorter of:

(1) Any four-year period; or

(2) When all voting power has been exercised at two consecutive meetings or in two written ballots for election of directors.

e. If persons controlling corporation have been guilty of, or have knowingly countenanced, persistent and pervasive fraud, mismanagement, abuse of authority, or persistent unfairness toward any shareholders.

f. If corporate property is being misapplied or wasted by its directors or officers.

g. If liquidation is reasonably necessary as corporation is failing and has continuously failed to carry out its purposes.

h. If period for which corporation was formed has terminated without extension.

i. If corporation is required to dissolve under terms of any article provision requiring that subordinate corporation will dissolve whenever its charter is surrendered to, taken away by, or revoked by granting organization [*see Corp. Code §§ 5132(a)(2)(A), 7132(a)(4)(A)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding UpCivil ProcedurePartiesJoinderIndispensable Parties



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-12 California Legal Forms--Transaction Guide §§ 12.114-12.119

[Reserved]

§§ 12.114[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-12 California Legal Forms--Transaction Guide § 12.120

§ 12.120 Voluntary Dissolution of Stock Corporation

1. Hold directors' meeting to authorize dissolution.

NOTE:
The first step in corporate dissolution is ordinarily to conduct a directors' meeting to determine that the corporation should be dissolved and to authorize obtaining the vote or written consent of the shareholders to dissolve the corporation. However, unless the directors are electing dissolution themselves, board action is not necessary to commence voluntary dissolution proceedings [***see*** *Corp. Code § 1900(a)*]. Nevertheless, it is good practice for the board to adopt a resolution stating that it is in the best interests of the corporation and its shareholders to dissolve the corporation before submitting the issue to the shareholders.

a. If directors' meeting is held, it must be validly called [*Corp. Code § 307(a)(1)*] and proper notice must be given as provided in bylaws [*Corp. Code § 307(a)(2)*; *see* Ch. 5, *Directors' Meetings, Actions, and Resolutions*].

NOTE:
Notice of a meeting need not be given to any director who signs a waiver of notice [***see*** *§ 12.201*] either before or after the meeting or who attends the meeting without protesting the lack of notice [*Corp. Code § 307(a)(3)*].

b. At meeting, instruct directors to adopt resolution stating following [*see § 12.200*]:

NOTE:
If the directors may elect winding up and dissolution on their own [***see*** *§ 12.20[1][b]*],

they should instead adopt the resolution *set forth in § 12.204*.

(1) That it is in best interests of corporation to dissolve.

(2) That officers and directors are authorized to obtain vote or written consent of shareholders to wind up and dissolve corporation [*see Corp. Code § 1900(a)*; *see also §§ 12.202, 12.203*].

(3) That corporation will file certificate of election to wind up and dissolve with Secretary of State following shareholders' election [*see Corp. Code § 1901*; *see also* § 12.205].

(4) That notice of election to dissolve be mailed to all shareholders and known claimants and creditors of corporation [*Corp Code § 1903(c)*].

(5) That officers are authorized and directed to file Form 966, Return of Information, as required by Internal Revenue Code.

(6) That officers of corporation are authorized and directed to prepare and file any other documents and take any other action that is necessary or advisable in connection with winding up and dissolution of corporation.

2. Obtain vote or written consent of shareholders to elect to dissolve [*Corp. Code § 1900(a)*].

NOTE:
In order to elect to dissolve the corporation, it is necessary to obtain the vote or written consent of the shareholders holding at least 50 percent of the voting power of the corporation [*Corp. Code § 1900(a)*; ***see*** *§§ 12.202, 12.203*], except in certain cases in which the directors may dissolve the corporation without shareholder approval [***see*** *Corp. Code §§ 1900(b), 1906*; ***see*** *§§ 12.20[1][b], 12.204*].

a. If meeting will be held to obtain consent to election:

(1) Ensure that meeting is validly called [*Corp. Code § 600(d)*].

(2) Ensure that proper notice of meeting is given [*Corp. Code § 601(a), (b), (f)*] or waived [*Corp. Code § 601(e)*].

(3) Have shareholders holding at least 50 percent of voting power adopt resolution to dissolve corporation [*see § 12.203*].

NOTE:
A provision in the articles of incorporation purporting to require a supermajority of shareholders to elect voluntary dissolution is unenforceable [***see*** *Corp. Code §§ 204(a)(5), 1900*]. However, the articles may provide for classes or series of preferred shares and that dissolution requires the consent of a supermajority of preferred shares, not to exceed 662/3 percent [*Corp. Code § 402.5*].

b. If election will by written consent, have shareholders holding at least 50 percent of voting power execute consent [

Corp. Code § 1900(a); *see § 12.202*].

NOTE:

Shareholder action is permitted without meeting if holders of requisite percentage of shares consent in writing [***see** Corp. Code § 603(a)*]. A provision in the articles of incorporation purporting to require a supermajority of shareholders to elect voluntary dissolution is unenforceable [***see** Corp. Code §§ 204(a)(5), 1900*]. However, the articles may provide for classes or series of preferred shares and that dissolution requires the consent of a supermajority of preferred shares, not to exceed 662/3 percent [*Corp. Code § 402.5*].

If the motion to dissolve a corporation voluntarily carries by a vote of exactly 50 percent, dissolution may be avoided by having either the corporation or the remaining shareholder(s) purchase for cash the shares of the shareholders voting for dissolution [*Corp. Code § 2000(a)*; ***see** § 12.20[9]*]. For further discussion of the applicable procedure and determination of the share price, see Ballantine & Sterling, California Corporation Laws, Ch. 15, ***Dissolution and Winding Up*** (Matthew Bender).

3. Draft certificate of election to wind up and dissolve [*see* § 12.205] stating [*Corp. Code § 1901(b)*]:

NOTE:

The separate filing of a certificate of election is not required if (1) the election to dissolve is made by the vote of all the outstanding shares and (2) a statement to that effect is inserted in the certificate of dissolution [*Corp. Code § 1901(c)*; ***see*** § 12.205]. Further, the separate filing of a certificate of election is not required if winding up and dissolution are mandatory because the term of existence of the corporation has expired [***see** Corp. Code § 1906*]. For the Secretary of State's form for a Domestic Stock Corporation Certificate of Election to Wind Up and Dissolve (Form ELEC STK), see § 12.205.

a. Name of corporation exactly as it appears on records of office of Secretary of State [*see* Secretary of State's website].

b. That corporation has elected to wind up and dissolve.

c. If election was made by vote of shareholders:

(1) Number of shares voting for election.

(2) That election was made by shareholders representing at least 50 percent of voting power.

d. If certificate is executed by shareholder(s), that subscribing shareholder(s) were authorized to execute certificate by shareholders representing at least 50 percent of voting power.

e. If election was made by directors, grounds for election permitting directors to act on their own [*Corp. Code § 1901(b)*].

f. If certificate is executed by directors, that subscribing directors constitute majority in office.

g. Date document is actually signed [*see* Secretary of State's website].

4. Have certificate executed in one of following ways [*Corp. Code § 1901(b)*]:

a. By following officers [*see Corp. Code § 173*]:

(1) Chairman of the board, president, or any vice president.

(2) Secretary, chief financial officer, treasurer, any assistant secretary, or assistant treasurer.

b. By either:

(1) Majority of directors then in office; or

(2) One or more shareholders authorized to do so by shareholders representing 50 percent or more of voting power.

5. Have certificate verified in one of following ways [*Corp. Code § 1901(b)*; *see Corp. Code § 193*]:

a. By affidavit signed under oath before officer authorized to administer oaths, or

b. By declaration in writing executed under penalty of perjury, stating date and place of execution.

6. Send original and at least two copies of certificate to Secretary of State for filing [*Corp. Code §§ 169*, *1901(a)*; *see § 12.207* (transmittal letter)].

NOTE:

There is no fee for filing original certificate [Gov. Code § 121886(m)]. The Secretary of State's office will certify up to two copies of the certificate at no charge, provided that the copies are submitted with the original [*Gov. Code § 12185*]. Additional certified copies may be obtained for a nominal fee [***see*** *Gov. Code § 12183*; ***see*** § 12.205[1][c]].

Although it is permissible to file both the certificate of election to wind up and dissolve and the certificate of dissolution contemporaneously, the Secretary of State's office advises that they must be filed as separate documents.

7. Prepare list of shareholders, identifying liquidation preferences.

8. Prepare list of creditors, identifying specific nature of debt.

9. Mail notice of election to [*Corp. Code § 1903(c)*; *see* Form 12.208]:

a. Shareholders.

NOTE:

Notice is not required to be given to shareholders who voted in favor of winding up and dissolving the corporation [*Corp. Code § 1903(c)*].

b. All known creditors and claimants whose addresses appear on records of corporation.

10. Place both of following in corporation's minute book:

a. Certified copy of certificate of election to dissolve; and

b. Executed certificate of mailing of notice of election to dissolve [*see § 12.209*].

11. Ensure that within 10 days after commencing dissolution proceedings or quitting business, whichever occurs first, corporation takes following actions:

NOTE:

For good cause, the EDD may extend for 30 days the time in which the corporation may file a return or pay any amount due without penalty or interest [*Unemp. Ins. Code § 1116(c)*]. "Quitting business" does not include any change in the form or membership of the employer if before and after the change, 50 percent or more of the control of management is held by the same individual, or is held by an individual before death and after death by his or her estate or heirs [*Unemp. Ins. Code § 1116(a)(4)*].

For additional coverage of unemployment insurance procedures on termination of business, see Ch. 17, ***Buying and Selling a Business or Professional Practice*** .

a. Files final quarterly wage and withholding report (EDD Form DE-6) [*see § 12.281*] with EDD [*Unemp. Ins. Code § 1116(a)(2)*; *see* EDD California Employer's Guide, Pub. No. DE 44].

NOTE:

Box D in Form DE-6 should be checked off to indicate that the report is a final report.

b. Pays all required contributions with respect to return [*see Unemp. Ins. Code § 1116(b)*].

NOTE:

This payment should be made using the standard payroll tax deposit coupons supplied by the EDD. Form DE-6 and the payroll tax payment may be submitted together, but if they are mailed together they must be mailed to the payroll tax deposit coupon mailing address [EDD California Employer's Guide, Pub. No. DE 44]. A 10-percent penalty, plus interest, accrues for delinquent payments [*Unemp. Ins. Code §§ 1112*, *1113*; ***see*** *Rev. & Tax. Code § 19521* (computation of interest)]. The penalty also applies to payments that, although required to be submitted electronically, an employer submits by means other than an electronic funds transfer without good cause [*Unemp. Ins. Code § 1112(b)*].

12. Ensure that within 10 days after quitting business, corporation files final annual reconciliation return (EDD Form DE-7) [*see § 12.282*] for current year [EDD California Employer's Guide, Pub. No. DE 44].

NOTE:

Box B should be checked off to indicate that the return is a final return. The form should be sent separately from the DE-6 and payroll tax payment. Employee W-2 forms should not be sent to EDD [EDD California Employer's Guide, Pub. No. DE 44]. For the mailing address and additional discussion of the filing requirements, see *§ 12.282[1]*.

13. [Reserved]

14. Hold directors' meeting to determine following [*see § 12.220*]:

NOTE:

The meeting must be validly called [***see*** *Corp. Code § 307(a)(1)*]. Notice must be given [*Corp. Code § 307(a)(2)*] or a waiver of notice obtained [***see*** *Corp. Code § 307(a)(3)*; ***see also*** *§ 12.221*].

a. All of the corporation's assets and liabilities;

b. Method of collecting assets;

c. Method for payment or assumption of liabilities;

d. Whether any long-term obligations, such as a long-term lease, necessitates delaying or revoking the dissolution;

e. Plan for distribution of assets to shareholders; and

f. Tax planning that is available, including determination as to collapsibility of corporation [*see § 12.62*].

15. If directors intend to adopt a plan for distribution of corporate assets to shareholders that is not in accordance with liquidation preferences of preferred shareholders, have plan approved by both board of directors [*see § 12.226*] and outstanding shares of each class [*Corp. Code § 2007(a)*; *see §§ 12.227, 12.230*], as follows:

NOTE:

The plan may provide that the distribution be in complete or partial satisfaction of the rights of any of those shareholders on distribution and liquidation of the assets [*Corp. Code § 2007(a)*]. Once adopted by the shareholders, the plan of distribution is binding on all shareholders [*Corp. Code § 2007(b)*] except objecting preferred shareholders, who must be paid their liquidation preferences in cash unless the plan is abandoned [*Corp. Code § 2007(c), (d)*]. These rules [*Corp. Code § 2007(a)-(d)*] do not apply, however, to certain distributions made in accordance with merger reorganizations [*Corp. Code § 181(a)* (definition); ***see*** Ch. 11C, ***Mergers***] and sale-of-assets reorganizations [*Corp. Code § 181(c)* (definition); ***see*** Ch. 11E, ***Acquisition of Assets for Shares***].

a. If plan of distribution is not in accordance with liquidation preferences of preferred shareholders, give notice of adoption of plan to those shareholders within 20 days of adoption of plan [*Corp. Code § 2007(b)*; *see § 12.231*].

NOTE:

The officer giving notice should execute a certificate of mailing of notice and place it in the corporation's minute book [***see*** *§ 12.229*].

b. Give preferred shareholders 30 days from date of mailing to dissent from plan and demand that they be paid their liquidation preferences in cash [*Corp. Code § 2007(c)*; *see § 12.233*].

c. If preferred shareholders dissent, directors may abandon plan without approval of shareholders [*Corp. Code § 2007(d)*], and may either adopt new plan of distribution or distribute assets according to rights and liquidation preferences of shareholders [*Corp. Code § 2007(d)*].

16. Within 30 days of adopting plan of liquidation, file notice on Form 966 with Internal Revenue Service [*I.R.C. § 6043(a)(1)*].

NOTE:

Form 966 must be filed with the IRS within 30 days after the adoption of a plan of liquidation [*I.R.C. § 6043(a)(1)*]. If no formal plan of liquidation is adopted at the time of the election to dissolve, Form 966 should be filed within 30 days after the election. The corporate seal must be affixed to Form 966.

17. Collect corporation's assets; assets that cannot be collected can be either:

a. Assigned to shareholders for collection [*see § 12.235*];

b. Collected subsequently by corporation and distributed to shareholders at that time, even if subsequent to dissolution [*Corp. Code § 2010(a), (c)*]; or

c. Transferred to liquidating trust [*see § 12.280*].

18. Arrange for sale of any assets that are not to be distributed to shareholders and execute contract of sale.

19. Pay or provide for known debts and liabilities of corporation [*Corp. Code § 2004*].

NOTE:

Distributions may not be made to shareholders unless the corporation's known debts and liabilities are paid or provided for [*Corp. Code § 2004*]. Shareholders will be liable for those liabilities to the extent of distributions received in dissolution [***see*** *Corp. Code § 2009(a)*], and directors may also be liable for those distributions [*Corp. Code § 316(a)(2), (c)*]. The final certificate of dissolution of corporation may not be filed unless debts and liabilities have been provided for or paid [***see*** *Corp. Code § 1905(a)(2)*].

a. All current debts and liabilities should be paid, including those owed to city, county, state, and federal agencies.

b. Debt can be provided for by being assumed by financially responsible person [*Corp. Code § 2005(a)*], or by depositing amount of debt with Controller in trust for benefit of those entitled to the payment [*Corp. Code §§ 2005(b), 2008(a)*].

c. Usual method of providing for known debts and liabilities is to have shareholders assume them in same proportion as their interests in corporation (but only to extent of amount of distributions received by them in dissolution) and receive right of ratable contribution from other shareholders to extent that other shareholders do not pay their share of assumed debts or liabilities [*Corp. Code § 2009(c)*; *see § 12.234*].

d. If shareholders do not agree to assume debts and liabilities of corporation, directors must either [*Corp. Code §§ 1806(b), (i), 1904*]:

(1) Retain sufficient assets in corporation to pay debts and liabilities, or

(2) Petition court to supervise dissolution in order to pay or provide for debts and liabilities.

e. Directors cannot distribute assets to shareholders until known debts and liabilities are paid or provided for [*Corp. Code § 2004*].

NOTE:

If the directors make distributions to the shareholders without providing for debts and liabilities, they are subject to suit by creditors in the name of corporation [*Corp. Code § 316(a)(2), (c)*], as are shareholders themselves [*Corp. Code § 2009(b)*].

20. Distribute assets to shareholders [*see § 12.235*].

a. Pay any liquidation preferences first [*see Corp. Code § 2004*].

b. Distribute remaining assets to shareholders according to plan of distribution [*see §§ 12.220, 12.226*].

NOTE:

Distributions to the shareholders can be made in installments or in a lump sum, and can be in money or in kind, but must be fair and ratable to each of the shareholders [*Corp. Code § 2006*].

c. Assets may be retained to provide for contingent liabilities.

d. For tax purposes, have shareholders execute receipt for distributions [*see § 12.236*].

e. If location or identity of certain shareholders is unknown, if payments, dividends, or distributions are unclaimed, if existence or amount of shareholder's claim is contingent or contested, or if ownership of stock is in dispute, deposit unclaimed or disputed distributive share with Controller in trust for benefit of those entitled to payment [*Corp. Code § 2008(a)*].

NOTE:

These deposits with the Controller may be reclaimed in the manner provided in *Code Civ. Proc. §§ 1500-1582* [*Corp. Code § 2008(b)*].

f. If claims against corporation exceed its assets, instruct corporation to recover amounts previously distributed to shareholders pursuant to dissolution proceedings [*Corp. Code § 2009(a)*].

21. File appropriate tax forms.

a. Federal tax forms.

(1) On or before February 28 following every calendar year in which distributions are made to shareholders pursuant to dissolution proceedings, file Form 1099 DIV with IRS for each shareholder receiving distributions totaling $600 or more in preceding calendar year [*see I.R.C. § 6043(a)(2)*; *Treas. Reg. § 1.6043-2*].

(2) File final federal income tax return (IRS Form 1120) on or before 15th day of third full month following close of tax year (that is, date of dissolution), unless District Director permits later filing date [*see I.R.C. § 6072(b)*; *Rev. Rul. 71-129, 1971-1 C.B. 397*].

NOTE:

Corporate dissolution occurs (1) when a court enters an order declaring the corporation duly wound up and dissolved [*Corp. Code §§ 1808(b), 1907(d)*], or (2) on the date on which the certificate of dissolution is filed [Corp. Code § 1905(b)].

b. File final California franchise tax return [FTB Form 100], within 2 months and 15 days after close of income year (that is, date of dissolution) [*Rev. & Tax. Code § 18601(a)*].

NOTE:

For franchise tax purposes, dissolution occurs on the date when a certificate of dissolution is filed with the Secretary of State [*Corp. Code § 1905(b)*] or when an order declaring the corporation duly wound up and dissolved is filed with the Secretary of State [*Rev. & Tax. Code § 23331(a)*]. The Secretary of State must provide the taxpayer with an acknowledgment of the receipt of all winding up and dissolution documents on or before 21 days after their receipt [*Rev. & Tax. Code § 23331(c)*].

If the corporation filing the certificate of dissolution has not issued shares and is filing under *Corp. Code § 1900.5*, the certificate of dissolution must state that the final franchise tax return has been filed [*Corp. Code § 1900.5(a)(4)*].

22. Arrange procedure for submission, receipt, and cancellation of share certificates.

23. Prepare certificate of dissolution [*see §§ 12.240-12.242*].

a. Draft certificate [*see §§ 12.130, 12.242*].

b. Have certificate executed by majority of directors then in office [*Corp. Code § 1905(a)*].

c. Have certificate verified under penalty of perjury, dated and signed with person's name and title [*Corp. Code §§ 1900.5(a), 1905(a)*; *see Code Civ. Proc. § 2015.5*].

24. File original and at least two copies of certificate of dissolution with Secretary of State [*Corp. Code §§ 169*, 1905(b); *see § 12.243* (transmittal letter)].

NOTE:

No fee is required for filing a certificate of dissolution [*Gov. Code § 12186(o)*]. The Secretary of State will provide the taxpayer with an acknowledgment of the receipt of all winding up and dissolution documents on or before 21 days after receipt [*Rev. & Tax. Code § 23331(c)*]. The Secretary of State will certify up to two copies of the certificate of dissolution at no charge, provided that the copies are submitted with the original [*Gov. Code § 12185*]. Additional copies are available for a nominal fee [*Gov. Code §§ 12182, 12183*]. For further discussion, see *§ 12.240[1]*.

25. After Secretary of State certifies and returns copy, file certified copy of certificate in corporation's minute book.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpLimited SurvivalBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsCreditor RightsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-12 California Legal Forms--Transaction Guide § 12.121

§ 12.121 Voluntary Dissolution of Nonprofit Corporation

1. Instruct nonprofit board of directors, members, or both, to adopt resolution to elect to dissolve corporation [*see §§ 12.260, 12.261*]:

a. By vote or written consent of majority of all members of corporation; or

b. By board of directors, if corporation has no members.

2. Prepare and file certificate of election to wind up and dissolve [*see § 12.262*].

NOTE:
The certificate of election must be filed before, or simultaneously with, the certificate of dissolution. However, if the election to dissolve is made by the vote of all the members of a corporation with members, or by all members of the board of directors of a corporation without members, the certificate of election is not required to be filed if the certificate of dissolution states either (1) the corporation has no members and the election was made by all the directors of the corporation, or (2) the election to dissolve was made by the vote of all the members of the corporation [*Corp. Code §§ 6611(c), 8611(c)*].

The original and at least two copies of the certificate should be submitted. The Secretary of State will certify two copies of the filed certificate without charge, provided that the copies are submitted to the Secretary of State with the original to be filed. Any additional copies submitted with the original will be certified on request and payment of the $8.00 per copy certification fee.

3. If nonprofit is public benefit corporation, religious corporation, or mutual benefit corporation holding assets in charitable trust at time of dissolution, file copy of certificate of election to wind up and dissolve [*see § 12.262*] with Attorney General [*Corp. Code §§ 6611(a), 8611(a), 9680(a)*].

4. Prepare certificate of dissolution [*see § 12.266*].

5. [Reserved]

6. If nonprofit is public benefit corporation, religious corporation, or mutual benefit corporation holding assets in charitable trust at time of dissolution, have distribution of those assets approved by Attorney General or secure waiver of objections to proposed distribution [*see Corp. Code §§ 6716, 8716, 9680*].

NOTE:

Information regarding the Attorney General's approval can be obtained by calling the Registrar of Charitable Trusts at (916) 445-2021 or can be downloaded from the Registrar of Charitable Trusts website which is located at http://caag.state.ca.us/charities. The website contains a searchable database of charitable organizations registered with the California Attorney General's office.

7. Send notice of dissolution to members and creditors.

8. Wind up business operations:

a. Pay or adequately provide for all liabilities.

b. Distribute assets in accordance with approved plan.

9. File certificates, by mail or hand delivered for over-the-counter processing, with the Secretary of State's office in Sacramento.

NOTE:

Dissolution documents are not filed in branch offices. All dissolution documents must be filed with the Secretary of State's Office in Sacramento. Mailing or submitting dissolution documents to other state or federal agencies, including the Franchise Tax Board and the Internal Revenue Service, does not satisfy the statutory filing requirements for dissolution.

The Secretary of State advises that for proof of submittal of proposed dissolution documents, documents mailed to the Secretary of State's office should be sent by certified mail, return receipt requested. To facilitate processing of mailed documents, a self-addressed envelope and a letter referencing the corporate name and number as well as the name, return address and telephone number of the individual filing the documents should be submitted.

A $15.00 special handling fee applies to documents delivered in person at the public counter in the Sacramento office. This fee must be remitted by separate check, as it will be retained whether the documents are filed or rejected.

10. If corporation is required to file informational returns, file final return.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-12 California Legal Forms--Transaction Guide §§ 12.122-12.129

[Reserved]

§§ 12.122[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
D. Drafting Guide to Corporate Dissolution Documents

5-12 California Legal Forms--Transaction Guide § 12.130

§ 12.130 Certificate of Dissolution for Domestic Stock Corporation

NOTE:

Corporate dissolution is effected by the filing of a certificate of dissolution of the corporation with the Secretary of State in the Sacramento office [*Corp. Code § 1905(b)*; ***see*** *§ 12.20[6]*]. In lieu of filing the certificate of dissolution, the directors may petition the superior court for an order declaring the corporation duly wound up and dissolved [*Corp. Code § 1907(a)*; ***see*** *§ 12.20[7]*].

A corporation that has not issued shares and is filing for dissolution within 12 months of filing the articles of incorporation may file a somewhat different certificate of dissolution [*Corp. Code § 1900.5(a)*]. For further discussion, see *§ 12.242*.

1. Draft certificate of dissolution, stating all of the following [*Corp. Code § 1905(a)*; *see §§ 12.240* 12.242]:

a. Name of corporation, exactly as name appears on records at office of Secretary of State.

b. That person(s) executing certificate are majority of directors of corporation now in office.

c. That corporation has been completely wound up [*Corp. Code § 1905(a)(1)*].

NOTE:

The Corporations Code requires the inclusion of this exact statement: "The corporation has been completely wound up." [*Corp. Code § 1905(a)(1)*].

d. That one of following requirements has been met [*Corp. Code § 1905(a)(2)*]:

NOTE:

The certificate may ***only*** use one of the five alternatives set forth below [***see*** *Corp. Code § 1905(a)(2)*]. For example, stating that both (1) the dissolving corporation's known debts and liabilities have been actually paid and (2) the dissolving corporation's known debts and liabilities have been adequately provided for by their assumption by a specified person or corporation is inconsistent, and will result in the certificate being returned for correction.

(1) Corporation's known debts and liabilities have been actually paid;

(2) Corporation's known debts and liabilities have been paid as far as its assets permit;

(3) Corporation's known debts and liabilities have been adequately provided for as far as its assets permit; or

NOTE:

If adequate provision has been made for debts and liabilities, the pertinent facts regarding those provisions must also be stated [*Corp. Code § 1905(a)(2)*]. The paragraph must state (1) the name and address of the person, corporation, or governmental agency that has assumed or guaranteed payment; (2) the name and address of the depository with which deposit has been made; or (3) other information needed to enable the creditors and other persons to whom payment will be made to appear and claim payment [*see § 12.240* (form)].

(4) Corporation has not incurred any known debts or liabilities.

e. That one of following requirements has been met [*Corp. Code § 1905(a)(3)*]:

(1) Corporation's known assets have been distributed to persons entitled to them; or

(2) Corporation acquired no known assets.

f. That a final franchise tax return has been or will be filed with the Franchise Tax Board [see Rev. & Tax Code § 23332].

g. If election to dissolve was made by vote of all outstanding shares, statement to that effect [*see* Corp. Code § 1901(c)].

h. That corporation is dissolved [*Corp. Code § 1905(a)(4)*].

2. Have majority of directors then in office sign and verify certificate of dissolution [Corp. Code § 1905(a)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
D. Drafting Guide to Corporate Dissolution Documents

5-12 California Legal Forms--Transaction Guide § 12.131

§ 12.131 Revocation of Election to Dissolve

NOTE:
A domestic stock or nonprofit corporation may only revoke its election to wind up and dissolve before the distribution of any assets [***see*** *Corp. Code §§ 1902(a), 6612(a), 8612(a), 9680(a)*].

1. If revocation election is by shareholders or members, either:

NOTE:
The election to dissolve the corporation may be revoked by the vote of shareholders or members holding a majority of the voting power if the election to dissolve was made by the shareholders or members, or by approval of the board if the election to dissolve was made by the directors. The election may only be revoked if no assets have been distributed pursuant to the dissolution [*Corp. Code §§ 1902(a), 6612(a), 8612(a), 9680(a)*].

a. Call and notice meeting for that purpose [*see § 12.251*]; or

b. Prepare form for obtaining written consent of shareholders [*see § 12.250*].

2. If revocation election is by directors, secure written consent of board.

NOTE:
The election to dissolve the corporation may be revoked before the distribution of assets by the approval of the board if the election to dissolve was made by the directors. The election may only be revoked if no assets have been distributed pursuant to the dissolution

[*Corp. Code §§ 1902(a), 6612(a), 8612(a), 9680(a)*].

3. If revocation election is by approval of board and members, secure written consent of board and members.

NOTE:
Nonprofit public benefit and religious corporations may revoke an election to dissolve before the distribution of assets by the approval of the board and the members [*Corp. Code §§ 6612(a), 9680(a)*].

4. Draft certificate of revocation [*see § 12.252*], stating [*Corp. Code §§ 1902(b), 6612(b), 8612(b), 9680(a)*]:

a. That corporation has revoked its election to wind up and dissolve.

b. That no assets have been distributed pursuant to election.

c. If election and revocation are made by shareholders or members alone:
(1) Number of shares voting for revocation.

(2) Total number of outstanding shares entitled to vote on revocation or that election was made by majority of all members.

d. If election and revocation are made by board alone, statement of that fact.

e. If election and revocation are made by board and members, statement of that fact [*see Corp. Code §§ 6612(b)(4), 9680(a)*].

5. Have certificate executed in one of following ways [*Corp. Code §§ 1902(a), 6612(a), 8612(a), 9680(a)*; *see Corp. Code §§ 1901(b), 6611(a), 8611(a)*].

a. By the following officers [*see Corp. Code § 173*]:

(1) Chairman of the board, president, or any vice president.

(2) Secretary, chief financial officer, treasurer, any assistant secretary, or assistant treasurer.

b. By either:

(1) Majority of directors then in office; or

(2) One or more shareholders authorized to do so by shareholders representing 50 percent or more of voting power.

6. Have certificate verified in one of following ways [*Corp. Code §§ 1902(a), 6612(a), 8612(a), 9680(a)*; *see Corp. Code § 193*; *see also Corp. Code §§ 1901(b), 6611(a), 8611(a)*]:

a. By affidavit signed under oath before officer authorized to administer oaths, or

b. By declaration in writing executed under penalty of perjury, stating date and place of execution.

7. File original and at least two copies of certificate with Secretary of State [*Corp. Code §§ 1902(a), 6612(a), 8612(a), 9680(a)*; *see Corp. Code § 169*; *see also Corp. Code §§ 1901(b), 6611(a), 8611(a)*].

NOTE:

The above materials must be accompanied by the filing fee [***see** Gov. Code § 12186(p)*]. The Secretary of State will certify up to two copies of the certificate at no charge provided the copies are submitted with the original [*Gov. Code § 12185*].

8. File certified copy of certificate of revocation in corporation's minute book.

9. If nonprofit corporation, file copy of certificate of revocation with Attorney General [*Corp. Code §§, 6612(a), 8612(a), 9680(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART III. TRANSACTION GUIDE
D. Drafting Guide to Corporate Dissolution Documents

5-12 California Legal Forms--Transaction Guide §§ 12.132-12.199

[Reserved]

§§ 12.132[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 12.200

§ 12.200 Directors' Resolutions to Obtain Shareholders' Election to Dissolve

[1] Comment

[a] Use of Form

This form is a set of minutes of the meeting held by the board of directors of a domestic stock corporation to consider the advisability of dissolving the corporation. It records the resolution of the directors that dissolution is in the best interests of the corporation, and authorizes the officers and directors to obtain the vote or written consent of the shareholders in support of the dissolution.

A corporation may validly elect to wind up and dissolve by the vote or written consent of shareholders holding at least 50 percent of the voting power of the corporation [*Corp. Code § 1900(a)*; *see Corp. Code §§ 194* ("vote" includes authorization by written consent), 603(a) (shareholder action is permitted without meeting if holders of requisite percentage of outstanding shares consent in writing)] without a prior meeting of the board of directors. However, the usual procedure for dissolving a corporation is for the directors to hold a meeting to discuss the possibility of and need for dissolution. Once a decision to dissolve is reached, the directors then attempt to obtain the vote or written consent of shareholders holding at least 50 percent of the voting power [*Corp. Code § 1900(a)*]. The form may be adapted if the articles of incorporation provide for special voting rights or preferences in the event of corporate dissolution.

[b] Dissolution by Board Approval Alone

Any corporation may elect by approval of the board to wind up and dissolve without shareholder action if (1) an order for relief has been entered under Chapter 7 of the federal bankruptcy law; (2) the corporation that has disposed of all of its assets and has not conducted any business for a period of five years immediately preceding the adoption of the resolution electing to dissolve the corporation; and (3) the corporation that has issued no shares [*Corp. Code § 1900(b)*]. In addition, a majority of the directors must dissolve the corporation if its term of corporate existence expires without renewal or extension, unless otherwise provided by law [*Corp. Code § 1906*]. This form is designed for use when further action by the shareholders is required, but may be adapted for use when only board action is required.

[c] Plan of Distribution of Assets

If dissolution is a virtual certainty, the directors may also adopt a plan of liquidation and distribution of assets at this meeting. This form incorporates only the decision of the directors to obtain the vote or written consent of the shareholders to dissolve. However, if a plan of distribution of assets is also to be adopted, the resolutions in this form should be combined with those in § 12.222. By combining them, the directors can obtain in one document the written consents of the shareholders to dissolution and, if necessary, to the plan of distribution.

[2] FORM

Directors' Resolutions to Obtain Shareholders' Election to Dissolve

MINUTES OF A SPECIAL MEETING OF THE BOARD
OF DIRECTORS OF _____ [*name of corporation*]

A special meeting of the Board of Directors of _____ [*name of corporation*], a California corporation, was held at _____ [*street address, city, and state*], on _____ [*date*], at _____ [*time*].

The following directors were present at the meeting: _____.

The following directors were absent from the meeting: _____.

_____ [*Name of director*] acted as Chair of the meeting, and _____ [*name of director*] acted as Secretary. The Chair announced that the purpose of the meeting was to consider the winding up and dissolution of the corporation. After discussion, the following resolutions were _____ [unanimously adopted *or* adopted by majority vote]:

RESOLVED, that the directors have determined that it is in the best interests of this corporation and of its shareholders that this corporation be wound up and dissolved.

RESOLVED FURTHER, that the officers and directors of this corporation are authorized and directed to take appropriate measures to obtain the vote or written consent of shareholders representing at least 50 percent of the voting power to wind up and dissolve the corporation.

RESOLVED FURTHER, that as soon as the shareholders have _____ [voted for *or* given their written consent to] dissolution, the Chair of the Board, the _____ [President *or* Vice President] and the _____ [Secretary *or* Chief Financial Officer *or* Treasurer *or* Assistant Secretary *or* Assistant Treasurer] of this corporation are authorized and directed to execute a Certificate of Election to Wind Up and Dissolve this corporation in accordance with the provisions of *Corporations Code Section 1901*, and to cause the certificate to be filed in the office of the Secretary of State of California.

RESOLVED FURTHER, that, on the commencement of proceedings to wind up, the officers of this corporation will mail or cause to be mailed to all shareholders, and to all known creditors and claimants whose addresses appear on the records of the corporation, written notice of the commencement of proceedings to wind up and dissolve this corporation.

RESOLVED FURTHER, that, on the commencement of proceedings to wind up, the officers of this corporation are authorized and directed to file Form 966, Return of Information, as required by the applicable provisions of the Internal Revenue Code.

RESOLVED FURTHER, that, on the commencement of proceedings to wind up, the officers of this corporation are authorized and directed to prepare and file any other documents and to take all other actions as necessary or advisable in connection with the winding up and dissolution of this corporation.

There being no further business to come before the meeting, the meeting was adjourned on motion duly made, seconded, and unanimously carried.

_____ [*date*].

_____ [*signature*]
[*typed name*], President
_____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 12.201

§ 12.201 Waiver of Notice of Directors' Meeting

[1] Comment--Use of Form

This form may be used to obtain the written waiver of notice and consent to the holding of the meeting of the directors to discuss the dissolution of the corporation, in the event the meeting is held without the giving of proper notice [*see Corp. Code § 307(a)(2), (3)*]. Although attendance by a director, without protest of the lack of notice, operate as a waiver of notice of the meeting, it is customary to have all directors, absent or present, sign a waiver of notice, a consent to holding the meeting, or an approval of the minutes of the meeting [*see Corp. Code § 307(a)(3)*]. Such waivers, consents, or approvals may be signed before or after the meeting and must be filed with the corporate records or made a part of the minutes of the meeting [*Corp. Code § 307(a)(3)*]. For further discussion of, and forms for, the call and notice of a directors' meeting, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

A waiver of notice need not specify the purpose of any regular or special meeting of the board [*Corp. Code § 307(a)(2)*]. However, specifying the purpose of the meeting is advisable, particularly in the context of corporate dissolution. If the meeting is called to discuss both the election to dissolve and the adoption of a plan of distribution of the assets in dissolution, the purpose clauses contained in the waiver in § 12.220 should be added to this waiver.

[2] FORM

WAIVER OF NOTICE AND CONSENT TO HOLDING OF SPECIAL MEETING OF BOARD OF DIRECTORS

WAIVER OF NOTICE AND CONSENT TO HOLDING OF SPECIAL MEETING OF BOARD OF DIRECTORS OF _____ [*name of corporation*], A CALIFORNIA CORPORATION

The undersigned, constituting all of the Directors of _____[*name of corporation*], a California corporation, hereby waive notice and consent to the holding of a special meeting of the Board of Directors to be held at _____[*street address, city, and state*], on _____[*date*] at _____[

time], for the purpose of:

1. Considering and acting on an election to wind up and dissolve the corporation, and

2. Transacting any other business as may come before the meeting.

This waiver of notice and consent is made in compliance with the terms of *Corporations Code § 307(a)(3)*, and the undersigned consent to the same being made a part of the records of the meeting. Any business transacted at the meeting will be as valid as if conducted at a regularly called and noticed meeting.

Date: _____.

_____ [*signature*]
[*typed name*], director
_____ [*signature*]
[*typed name*], director
_____ [*signature*]
[*typed name*], director

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 12.202

§ 12.202 Shareholders' Written Consent to Voluntary Dissolution

[1] Comment

[a] Use of Form

This form may be used to obtain the written consent of shareholders holding 50 percent or more of the voting power of a corporation to the voluntary dissolution of the corporation [*Corp. Code § 1900(a)*]. Although the election to dissolve may be made by shareholders holding 50 percent or more of the voting power at a properly called and noticed meeting [*see Corp. Code §§ 600(d), 601(a), (b), (f)*; *see also § 12.203[1]*], the election to dissolve can also be made by the filing of written consents by the holders of at least 50 percent of the voting power without holding a meeting [*Corp. Code §§ 194* ("vote" includes written consent), 603(a) (shareholder action as permitted without meeting if holders of requisite percentage of outstanding shares consent in writing); *see In re Security Finance Co. (1957) 49 Cal. 2d 370, 376, 317 P.2d 1]* . Prompt notice must be given in writing to all shareholders who did not vote in favor of dissolution [*Corp. Code § 1903(c)*; *see Corp. Code § 603(b)*; *see also § 12.208*].

This form contains an optional provision under which the consenting shareholders waive their right to notice of the commencement of voluntary dissolution proceedings. For a form for that notice, see *§ 12.208*.

If 50 percent of the shareholders object to the dissolution of the corporation, the only method of dissolution might be by written consent, since the lack of a quorum might prevent valid action being taken at a meeting called to vote on dissolution [*see Corp. Code § 602(a)*].

Voluntary dissolution proceedings commence on the filing of the shareholders' written consents with the corporation [*Corp. Code § 1903(a)*].

[b] Dissolution by Election of Shareholders

Except in certain situations when the board may act alone to dissolve the corporation [*see Corp. Code §§ 1900(b), 1906*;

see also § 12.20[1][b]], it is necessary to obtain the vote or written consent of shareholders holding at least 50 percent of the voting power of the corporation to voluntarily dissolve the corporation [*Corp. Code § 1900(a)*]. *Corp. Code § 1900(a)* does not distinguish between classes of stock having voting power for purposes of the percentage requirement, whereas other sections of the Corporations Code sometimes have percentage requirements based on each class of shares [*see, e.g., Corp. Code § 2007(a)*]. As used in the Corporations Code, "voting power" means the power to vote for the election of directors at the time any determination of voting power is made; it does not include the right to vote on some condition that has not yet occurred [*Corp. Code § 194.5*]. In any case in which different classes of shares are entitled to vote as separate classes for different members of the board, the determination of percentage of voting power is made on the basis of the percentage of the total number of authorized directors that the shares in question have the power to elect in an election in which all shares then entitled to vote for the election of any directors are voted [*Corp. Code § 194.5*].

[2] FORM

Shareholders' Written Consent to Voluntary Dissolution

SHAREHOLDERS' WRITTEN CONSENT TO VOLUNTARILY DISSOLVE _____ [*name of corporation*], A CALIFORNIA CORPORATION

The undersigned shareholders of record of _____[*name of corporation*], a California corporation, holding of record the number of shares set forth below and representing at least 50 percent of the voting power of the corporation, hereby adopt and consent to the following actions:

RESOLVED, that the it is in the best interests of this corporation and of its shareholder to dissolve the corporation.

FURTHER RESOLVED, that the shareholders elect and consent to the winding up and voluntary dissolution of the corporation.

FURTHER RESOLVED, that the officers or directors are authorized and directed to take all actions necessary or proper to wind up and dissolve the corporation, including the filing of a certificate evidencing the election to wind up and dissolve as required by *Corp. Code § 1901*.

[*Optional:*]

FURTHER RESOLVED, that the undersigned waive their right to written notice of the commencement of voluntary dissolution proceedings.

[*Continue with the following:*]

IN WITNESS WHEREOF, each of the undersigned shareholders of record has executed this written consent, and has stated the number of shares entitled to vote for the election of directors held as of the record date.

Name	Date	Number of Shares	Certificate Number	Shareholder Signature

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsShareholdersShareholder Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness &

Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 12.203

§ 12.203 Shareholders' Resolution to Elect to Dissolve

[1] Comment

[a] Use of Form

If the election to dissolve the corporation [*Corp. Code § 1900(a)*] will be made at a meeting of the shareholders, the resolutions set forth in this form should be adopted and incorporated in the appropriate place in the minutes of the meeting. For a complete form for minutes of a shareholders' annual meeting, see *Ch. 8A, Shareholders' Meetings, Voting, and Agreements, § 8A.260*. The election to dissolve the corporation may be made at either the annual meeting [*Corp. Code § 600(b)*] or at a special meeting [*Corp. Code § 600(d)*] called to discuss dissolution.

Although the shareholders may elect to dissolve may be made by written consent without holding a meeting [*Corp. Code §§ 194, 603(a), 1900(a)*; *In re Security Finance Co. (1957) 49 Cal. 2d 370, 376, 317 P.2d 1* ; *see § 12.202*], if the corporation has many shareholders, or if the possibility of dissolution must be discussed by the shareholders before making the election, the election should be conducted at a shareholders' meeting.

[b] Call and Notice of Meeting

If a meeting is conducted to obtain the vote of the shareholders to dissolve, the meeting must be properly called [*Corp. Code § 600(d)*] and notice must be given to all of the shareholders [*Corp. Code § 601(a), (b), (f)*]. Unless the election to dissolve is made at a meeting by the unanimous vote of all shareholders entitled to vote, the election is not valid unless the notice of the meeting states that the purpose of the meeting is to consider dissolution of the corporation [*Corp. Code § 601(f)*]. For forms and discussions for calls and notices of shareholders' meetings, see Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* . Notice of the holding and general purpose of the meeting is also required if the resolution to dissolve is to be validly adopted at the annual shareholders' meeting [*Corp. Code § 601(a), (f)*].

[2] FORM

SHAREHOLDERS' RESOLUTION TO ELECT TO WIND UP AND DISSOLVE

SHAREHOLDERS' RESOLUTION TO ELECT TO WIND UP AND DISSOLVE

WHEREAS, it is deemed advisable that it would be in the best interests of this corporation to be wound up and dissolved;

RESOLVED, that the shareholders hereby elect to wind up and dissolve the corporation; and

RESOLVED FURTHER, that this corporation voluntarily elects to wind up and dissolve and that its business will be wound up in the manner provided by statute; and

RESOLVED FURTHER, that the officers or directors of this corporation are authorized and directed to file the certificate evidencing the election to wind up and dissolve as required by *Corp. Code § 1901*, and to take any and all further action as may be necessary or convenient to wind up and dissolve the corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 12.204

§ 12.204 Directors' Resolution to Wind Up and Dissolve

[1] Comment

[a] Use of Form

This form contains resolutions by the directors to elect to dissolve the corporation. It should be used when the election can be made by the board of directors acting alone [*see* [b], *below*]. The resolutions should be adopted at a meeting of the directors and incorporated in the appropriate place in the minutes of that meeting. For a complete set of minutes of a directors' meeting, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* . The directors' election to dissolve the corporation also can be made by unanimous written consent [*Corp. Code § 307(b)*].

[b] Voluntary Election by Directors to Dissolve

The board of directors may elect to voluntarily dissolve the corporation if it (1) has been adjudicated a bankrupt; (2) has disposed of all its assets and has not conducted any business for the preceding five-year period; or (3) has issued no shares [*Corp. Code § 1900(b)*]. The board must dissolve the corporation if its term of existence expires without renewal or extension [*Corp. Code § 1906*]. This form contains three alternative recital clauses to cover these situations in which the directors have the authority to dissolve the corporation without the approval of the shareholders.

The phrase "approval of the board," as used in *Corp. Code § 1900(b)*, means approval or ratification by the vote of the board of directors, or by the vote of a committee authorized to exercise the power of the board [*Corp. Code § 151*]. Under the general provisions of the Corporations Code governing voting by the board of directors, an election to dissolve can be made by a majority of directors present at a meeting at which a quorum is present [*Corp. Code § 307(a)(8)*]. A quorum consists of a majority of the authorized number of directors [*Corp. Code § 307(a)(7)*]. The certificate of election to wind up and dissolve, to be filed with the Secretary of State after an election by the directors [*see Corp. Code § 1901*], should be in the form set forth in § 12.205.

[c] Mandatory Election to Dissolve

The board must dissolve the corporation if its term of existence expires without renewal or extension [*Corp. Code § 1906*].

[2] FORM

DIRECTORS' RESOLUTION TO WIND UP AND DISSOLVE

DIRECTORS' RESOLUTION TO WIND UP AND DISSOLVE

WHEREAS, the board of directors has determined that it is in the best interests of the corporation to wind up and dissolve; and

[*If corporation is in bankruptcy:*]

WHEREAS, in the proceedings in the District Court of the United States for the _____ District of California, _____ Division, in case No. _____, entitled "In the Matter of _____, a Corporation, Bankrupt," this corporation was duly adjudicated a bankrupt on _____[*date*];

[*OR, if corporation has disposed of all assets and conducted business:*]

WHEREAS, this corporation has disposed of all of its assets and has not conducted any business for a period of five years immediately preceding the adoption of these resolutions electing to dissolve this corporation;

[*OR, if corporation has never issued shares:*]

WHEREAS, this corporation has issued no shares;

[*Continue with the following:*]

RESOLVED, that this corporation voluntarily elects to wind up and dissolve and that its business will be wound up in the manner provided by statute; and

RESOLVED FURTHER, that the officers or directors of this corporation are authorized and directed to file a certificate of election to wind up and dissolve with the Secretary of State as required by *Corp. Code § 1901*, and to take any and all further action as may be necessary or convenient to dissolve the corporation and wind up its affairs.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary Dissolution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 4

§ 4 Domestic Stock Corporation Certificate of Election to Wind Up and Dissolve (Form ELEC STK)

[1] Comment

[a] Use of Form

This form is a certificate of election to wind up and dissolve a domestic stock corporation. Any format that meets the statutory requirements may be used [*see* Corp. Code § 1901]. However, use of the standard form is recommended inasmuch as it is simple and easy and there is no advantage to using any other version.

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.sos.ca.gov/business/bpd_forms.htm#corp . You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12.205. Please be sure to include your email address along with your request, and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

A certificate of election to dissolve is required to be filed when the election is made by the vote of less than 100 percent of the outstanding shares, or no shares have been issued [*see* Corp. Code § 1901(c)]. A certificate of election to dissolve is not required when the election is made by the vote of all the outstanding shares and a statement to that effect is included in the Certificate of Dissolution [*see* Corp. Code § 1905; *see also § 12.240*], or the corporation meets the requirements for filing a Short Form Certificate of Dissolution [*see* Corp. Code § 1900.1; *see also § 12.242*]. It also is not required if winding up and dissolution are mandatory because the corporation's term of existence has expired [*see* Corp. Code § 1906].

The certificate must be filed before, or at the same time as, the Certificate of Dissolution [*see § 12.240[1]*].

[b] Contents of Certificate

The certificate must set forth [Corp. Code § 1901(b)(1), (2)]:

- That the corporation has elected to wind up and dissolve; and

- If the election was made by shareholder vote, the number of shares voting for the election and that the election was made by shareholders representing at least 50 percent of the voting power.

The certificate must either be an officers' certificate or be signed and verified by at least a majority of the directors then in office, or by one or more shareholders authorized to do so by shareholders holding 50 percent or more of the voting power [*Corp. Code § 1901(b)(3)*]. An officers' certificate is a certificate signed and verified by the chairman of the board, the president, or any vice president and the secretary, the chief financial officer, or the treasurer, or any assistant secretary or assistant treasurer [*Corp. Code § 173*].

[c] Filing Requirements and Fees

The Secretary of State's office requires that all dissolution documents must be filed with the Secretary of State in the Sacramento office. Mailing or submitting documents to branch offices, or other state or federal agencies, including the Franchise Tax Board and the Internal Revenue Service, will not satisfy the filing requirements for corporate dissolution.

The original and at least two copies of the certificate should be included in the submission. There is no fee required to file a certificate of election to wind up and dissolve by mail [*Gov. Code § 12186(n)*]. For proof of submission of proposed dissolution documents, the Secretary of State's office recommends that documents be sent by certified mail, return receipt requested. A self-addressed envelope and letter referencing the corporate name and file number, as well as the attorney's name, return address, and telephone number should also be submitted.

The Secretary of State will certify two copies of the certificate at no charge, provided that they are submitted with the original for filing [*see Gov. Code § 12185*]. Additional copies submitted with the originals will be certified on request and payment of a per copy fee. A certified copy should be placed in the corporation's minute book.

A special handling fee applies for processing documents delivered in person at the public counter in the Sacramento Office. This fee must be remitted by separate check as it will be retained regardless of whether the documents are filed or rejected.

Preclearance or expedited filing of eligible corporate documents can be requested in a specified time frame, for an additional fee (in lieu of the special handling fee) [*see Gov. Code § 12182(c)*]. This preclearance/expedited filing service is not available in the branch offices.

[2] FORM

Certificate of Election to Wind Up and Dissolve

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 12.206

[Reserved]

§ 12.206[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 12.207

§ 12.207 Transmittal Letter for Filing Certificate of Election to Dissolve

[1] Comment--Use of Form

This form is a transmittal letter used to accompany the certificate of election to wind up and dissolve [*see Corp. Code § 1901*; *see also* § 12.205]. The original and at least two copies of the certificate should be included in the submission. There is no fee required to file a certificate of election to wind up and dissolve by mail [*Gov. Code § 12186(o)*]. For proof of submission of proposed dissolution documents, the Secretary recommends that documents be sent by certified mail, return receipt requested. A self-addressed envelope and letter referencing the corporate name and file number, as well as the attorney's name, return address, and telephone number should also be submitted [*see* Secretary of State's website which is located at http://www.ss.ca.gov/business/bpd_forms.htm].

Counsel should also enclose a check for any filing, special handling, or preclearance fees [*see* § 12.205[1][c]].

For further discussion of the certificate of election to dissolve and filing and execution requirements, see § 12.205[1].

[2] FORM

TRANSMITTAL LETTER FOR FILING CERTIFICATE OF ELECTION TO DISSOLVE

TRANSMITTAL LETTER FOR FILING CERTIFICATE OF ELECTION TO DISSOLVE
[*Letterhead of attorney*]
_____[*date*]
Secretary of State's Office
Business Programs Division
1500 11th Street, Room 390
Sacramento, CA 95814

RE: Certificate of Election to Wind Up and Dissolve of _____ [*name of corporation*].
Dear _____ [*name*]:

Enclosed are an original and _____ [*number*] copies of the Certificate of Election to Wind Up and Dissolve of _____[*name of corporation*], file number _____. Please file the original in your office at your earliest convenience, and certify the remaining _____ [*number*] copies and return them to me.

[*If more than two certified copies of the certificate are desired:*]

Also enclosed is a check for $ _____ [*indicate amount*] in payment of your fees for the certification of _____ [*specify*] additional certified copies of the Certificate.

[*Continue with the following:*]

[*If special handling or preclearance is desired:*]

Also enclosed is a check for $ _____ [*indicate amount*] in payment of the _____ [special handling fee *or* preclearance fees].

[*Continue with the following:*]

If you have any question or comments concerning the certificate or if you need any further information, please feel free to call me collect at _____ [*phone number*].

Sincerely,
_____ [*signature of attorney*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary Dissolution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 12.208

§ 12.208 Notice of Commencement of Voluntary Dissolution

[1] Comment--Use of Form

This form notifies shareholders and creditors that a voluntary proceeding to wind up and dissolve the corporation has commenced. The notice must be mailed to all shareholders (except no notice is required to be given to shareholders who voted in favor of dissolution) and to all known creditors and claimants whose addresses appear on the records of the corporation promptly after the commencement of voluntary dissolution proceedings [*Corp. Code § 1903(c)*]. The date on which proceedings for voluntary dissolution are deemed to begin is the date that (1) the directors adopted the resolution, (2) the shareholders adopted the resolution, or (3) the written consent of the shareholders was filed with the corporation [*Corp. Code § 1903(a)*].

It would appear to be good practice to send notice to all shareholders, whether or not they voted in favor of dissolution. Therefore, this form states that notice is being sent to all shareholders. If the notice will only be sent to shareholders who did not vote for dissolution, the form should be amended accordingly. It is also advisable to have the officer (typically the secretary) who caused notice to be given to execute a certificate stating that notice of the dissolution was given to all shareholders, creditors, and claimants [*see § 12.209*].

[2] FORM

NOTICE OF COMMENCEMENT OF VOLUNTARY DISSOLUTION

NOTICE OF COMMENCEMENT OF VOLUNTARY DISSOLUTION
OF _____ [*name of corporation*], A CALIFORNIA CORPORATION

TO ALL SHAREHOLDERS, CREDITORS, AND CLAIMANTS OF _____[*name of corporation*]:

NOTICE IS HEREBY GIVEN, that _____[*name of corporation*], a California corporation whose principal office is located at _____[*street address and city*], California, has voluntarily elected to wind

up its affairs and dissolve.

Proceedings for the winding up of the corporation commenced on _____[*date*], in accordance with *Corp. Code § 1900*. _____[*Specify manner of election, e.g.*, On that date, shareholders representing at least 50 percent of the voting power of the corporation _____ (filed with the corporation written consents *or* adopted a resolution) in which they elected and consented to the winding up and dissolution of the corporation]. The corporation is now in the process of winding up its affairs in the manner provided by law.
Dated: _____.

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary Dissolution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 12.209

§ 12.209 Certificate of Mailing Notice of Voluntary Dissolution

[1] Comment--Use of Form

Because written notice of the dissolution proceedings must be given to all shareholders who did not vote in favor of dissolution and to all known creditors and claimants whose addresses appear on the corporate books [*Corp. Code § 1903(c)*], it is good practice to have the secretary, or other person giving notice, execute a certificate that the requisite notice was given. The certificate and a copy of the notice should be placed in the corporate minute book.

This form, like the notice in § 12.208, states that notice is being sent to all shareholders. If the notice will only be sent to shareholders who did not vote for dissolution, the form should be amended accordingly.

[2] FORM

CERTIFICATE OF MAILING NOTICE OF COMMENCEMENT OF VOLUNTARY DISSOLUTION

CERTIFICATE OF MAILING NOTICE OF COMMENCEMENT OF VOLUNTARY DISSOLUTION OF _____ [*name of corporation*], A CALIFORNIA CORPORATION

The undersigned hereby certifies that _____[he *or* she] is the duly elected, qualified, and acting _____ [*specify officer, e.g.,* Secretary *or other officer*] of _____[*name of corporation*]. On _____[*date of mailing of notice*], the Secretary caused to be mailed to all shareholders, and all known creditors and claimants whose addresses appear on the books of the corporation, a notice of the voluntary election to wind up and dissolve this corporation. A copy of the notice was mailed, postage prepaid, to each shareholder and all known creditors and claimants at the addresses appearing on the books of the corporation. A copy of this notice is attached to this certificate as Exhibit A.

Executed on _____[*date*], at _____ [*specify location*].

_____ [*signature*]
[*typed name, office*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary Dissolution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 12.210

[Reserved]

§ 12.210[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 12.211

§ 12.211 Information Return of Dissolving Corporation [IRS Form 966]

[1] Comment

[a] Use of Form

This is IRS Form 966, an information return to be used by dissolving corporations. Form 966 may be filled in online, downloaded, and printed out by going to the forms and publications page of the IRS website at http://www.irs.gov/formspubs/index.html?portlet=3 .

In general, every corporation must file Form 966 with the Internal Revenue Service if the corporation adopts a resolution or plan to dissolve the corporation or liquidate any of its stock [*I.R.C. § 6043(a)*; *Treas. Reg. § 1.6043-1(a)*]. However, exempt corporations and qualified subchapter S subsidiaries are not required to file this form [*see I.R.C. § 6043(b)*; Form 966, instructions; *see also* IRS Forms 990, 990-PF, 8869].

IRS Form 966 must be filed with the Internal Revenue Service center where the corporation is required to file its income tax return [IRS Form 966, instructions].

[b] Contents of Form

IRS Form 966 must contain the following information [*Treas. Reg. § 1.6043-1(b)(1)*; IRS Form 966, instructions]:

- The name and address of the corporation.
- The place and date of incorporation.
- Whether the liquidation is complete or partial.
- The date of the adoption of the resolution or plan of dissolution or complete or partial liquidation.

- The Internal Revenue Service center where the last income tax return was filed, and the taxable year covered by that return.

- The date of the final tax year.

- Whether the corporation's final tax return was filed as part of a consolidated income tax return and related matters.

- The total number of shares outstanding at the time of the adoption of the plan of liquidation.

- The section of the Internal Revenue Code under which the corporation is being dissolved or liquidated.

- Dates of any amendments to the plan of dissolution and the dates of any previously filed IRS Forms 966 [*see* [c], *below*].

A certified copy of the resolution or plan (and any amendments or supplements not previously filed) must be attached to the form [IRS Form 966, instructions].

[c] Time for Filing

IRS Form 966 must be filed within 30 days after the resolution or plan is adopted to dissolve the corporation or liquidate any of its capital stock [*I.R.C. § 6043(a)*]. Although it would appear that the first meeting of the directors (resolving to obtain the vote or written consent of the shareholders to dissolve) would not constitute a "plan of dissolution," it is better practice to file IRS Form 966 counting from that date, attaching a certified copy of the appropriate resolutions [*see § 12.200*] and a certified copy of the written consent or the resolutions adopted by the shareholders consenting to the election [*see §§ 12.202*, *12.203*].

An amended IRS Form 966 must be filed within 30 days after the directors' second meeting dealing with the disposition of the assets [*Treas. Reg. § 1.6043-1(a)(2)*]. The amended IRS Form 966 must state the date the original form was filed and contain a certified copy of the directors' resolutions [*see § 12.220*] and a certified copy of any consents or resolutions of the shareholders [*see §§ 12.227*, *12.230*] that are obtained with respect to the directors' second meeting. If any further resolutions are adopted by the directors at any subsequent meetings concerning the dissolution, additional amended IRS Forms 966 must be filed within 30 days of the adoption of those resolutions [IRS Form 966, instructions].

The attorney should delay filing the original IRS Form 966 if it appears that the second directors' meeting concerning the disposition of the assets and the shareholders' consent will be obtained within 30 days of the first directors' meeting. In this situation, the attorney will only have to file an original IRS Form 966 containing certified copies of the resolution of the directors at both their first and second meetings, and certified copies of all written consents or resolutions of the shareholders.

[2] FORM

Information Return of Dissolving Corporation

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionTax LawFederal Taxpayer GroupsC CorporationsLiquidations (IRC secs. 331-338)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide § 12.212

§ 12.212 Transmittal Letter for IRS Filing Form 966

[1] Comment--Use of Form

This form is a transmittal letter that may be used to accompany Internal Revenue Service Form 966 [*see § 12.211*].

The attorney should give his or her telephone number and instruct the Internal Revenue Service to call collect if any problems arise concerning the filing. The attorney should also instruct the Internal Revenue Service to stamp the duplicate transmittal letter and return it in the enclosed self-addressed, stamped letter as proof of filing.

[2] FORM

Transmittal Letter for IRS Filing Form 966

TRANSMITTAL LETTER FOR FILING IRS FORM 966
[*Letterhead of attorney*]
_____ [*date*]
Internal Revenue Service Center
_____ [*location where income tax returns are filed*]

RE: _____ [*name of corporation*], IRS Form 966

On behalf of _____[*name of corporation*], a California corporation, I am enclosing its IRS Form 966 and certified copies of the resolutions of the directors and _____ [the written consent *or* resolutions] of the shareholders to dissolve the corporation.

If you should have any questions or comments about this IRS Form 966 or the certified copies, please feel free to call me collect at _____ [*phone number*] in _____[*city*].

Please acknowledge your receipt of this IRS Form 966 by stamping the enclosed duplicate transmittal letter and returning it in the enclosed envelope.

Sincerely,
_____ [*signature of attorney*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsLiquidations (IRC secs. 331-338)Business & Corporate LawCorporationsDissolution & ReceivershipGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary Dissolution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
1. Forms for Election to Wind Up and Dissolve

5-12 California Legal Forms--Transaction Guide §§ 12.213-12.219

[Reserved]

§§ 12.213[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.220

§ 12.220 Minutes of Special Meeting of Directors to Formulate Plan of Distribution of Assets in Cash and Property

[1] Comment

[a] Use of Form

This form is a general form of minutes for a meeting of the board of directors of a dissolving corporation held to discuss the method for paying or providing for the known debts and liabilities of the corporation, for the collection of its assets, and for the distribution of the assets. The meeting should be held after the certificate of election to dissolve the corporation has been filed with the Secretary of State [*see* § 12.205]. This form contains resolutions authorizing the directors to sell any or all of the assets and to distribute, pro rata, the cash and undivided interests in the assets other than cash, and other necessary resolutions.

It may not always be necessary to hold two separate directors' meetings, one to authorize obtaining the shareholders' election to dissolve [*see § 12.200*] and another to adopt a plan for distribution of the assets. All of these matters could be resolved at one meeting, the determinations regarding the distribution of assets being conditional upon the election by the shareholders to dissolve. If the directors' meetings are combined, the resolutions contained in § 12.200 should be combined with the resolutions in this form.

There is no requirement that a notice or waiver of notice specify the purpose of any regular or special meeting of the board [*Corp. Code § 307(a)(2)*]. However, the specification of purpose is advisable. Therefore, if the meeting is called to discuss both the election to dissolve and the adoption of a plan of distribution of the assets in dissolution, the call and notice, or the waiver of notice, to this combined meeting should state that the meeting is being held for both purposes. In the case of the waiver of notice, this can be accomplished by combining the purpose clauses in § 12.203 and § 12.221.

If the directors' meetings are combined, it will be necessary to have only one meeting of shareholders to obtain shareholder approval of the dissolution and plan of distribution (to the extent that shareholder approval is required), or,

if written consents are obtained from shareholders in lieu of a meeting, a single document may be used.

The necessity for shareholder approval, and the percentage of shareholder votes required for approval, of a plan of distribution depends on the nature of the distribution intended by the directors, and, in some instances, on whether or not the assets are to be sold, the nature of the consideration to be paid, and the relationship of the purchaser to the selling corporation [*see* [c], *below*]. If the shareholder election to dissolve and shareholder approval of a plan of distribution or sale of the assets is obtained in the same document, care must be taken to comply with the differing voting requirements for both types of shareholder approval. Shareholder election to dissolve requires the vote of at least 50 percent of the voting power of the corporation [*Corp. Code § 1900(a)*; *see §§ 12.202, 12.203*]. Approval of a plan of distribution [*Corp. Code § 2007(a)*] or sale of the assets for noncash consideration [*Corp. Code §§ 1001(a), 2001(g)*] for example, have different voting requirements [*see §§ 12.223, 12.224, 12.227, 12.230*].

[b] Distribution of Assets

The assets may be distributed to the shareholders when all of the known debts and liabilities have been provided for or paid [*Corp. Code § 2004*], and as soon as reasonably consistent with the beneficial liquidation of the corporation [*Corp. Code § 2006*]. The distributions may be in installments or in one lump sum [*Corp. Code § 2006*], in money or in property or securities, if this can be done fairly and ratably, and in conformity with the provisions of the articles of incorporation and the rights of the shareholders [*Corp. Code § 2006*]. For forms for assumption of the corporate liabilities by shareholders, assignment of corporate assets to shareholders, and receipt of corporate assets by shareholders, see *§§ 12.234-12.236*.

If all of the assets are sold, and the funds from the sale distributed to all of the shareholders in accordance with their respective rights, the distribution will be fair and ratable. If the assets in kind are distributed in undivided interests to the shareholders as tenants in common with the same interests in the assets as they had in the corporation, the distribution would appear to be fair and ratable. However, if the assets are valued and distributed on the basis of that value, the distribution may not be fair and ratable.

Shareholders with liquidation preferences must receive their liquidation preferences before distributions to other shareholders, as provided in the articles of incorporation [*see Corp. Code § 2004*]. For a discussion of the adoption of a plan of distribution of the assets in kind that is not in accordance with the liquidation rights of the preferred shares, including provisions for shareholder approval and protest by the holders of preferred shares, see *§ 12.226[1]*.

[c] Modifying the Form

If it is desirable to specify certain assets and provide for their distribution, see *§ 12.226*. Other modifications of the form may be required depending on the nature of the plan of distribution adopted by the directors.

If the directors propose to distribute noncash corporate assets, such as securities in other corporations, according to a method of distribution that is not in accordance with the liquidation rights of the preferred shares as specified in the articles, approval of the outstanding shares of each class is required [*Corp. Code §§ 152, 2007(a)*; *see §§ 12.227, 12.230*] and a resolution should be added to authorize the obtaining of that shareholder approval. In addition, a resolution should be adopted authorizing and directing the giving of notice to shareholders with liquidation preferences within 20 days after the adoption of such a plan, in the event it is adopted [*Corp. Code § 2007(b)*; *see § 12.231*]. For further discussion of a plan of distribution in kind that is not in accordance with liquidation preferences, including a discussion of shareholder approval and notice requirements, see *§ 12.226*.

If the directors propose to sell the assets of the corporation for consideration other than cash, shareholder approval is required [*Corp. Code §§ 1001(a), 2001(g)*; *see §§ 12.223, 12.224*], and a resolution to obtain that consent should be adopted. If the directors propose to sell the assets to a buyer in control of, or under common control with, the selling

corporation, a resolution must be adopted to obtain the requisite 90 percent shareholder approval that is required by statute [*Corp. Code §§ 1001(d), 2001(g)*].

[2] FORM

MINUTES OF A SPECIAL MEETING OF THE BOARD OF DIRECTORS OF CORPORATION

MINUTES OF A SPECIAL MEETING OF THE BOARD OF DIRECTORS OF _____ [*name of corporation*]

A special meeting of the Board of Directors of _____[*name of corporation*], a California corporation, was held at [*location*], on _____[*date*], at _____[*time*].

The following directors were present:_____[*type the names of the directors present*].

The following directors were absent: _____[None *or type the names of the directors absent*].

_____[*Name of director*] acted as Chair of the meeting, and _____[*name of director*] acted as Secretary. The Chair then announced that the purpose of the meeting was to adopt a plan for the distribution of the assets in dissolution of the corporation. After discussion, the following resolutions were adopted:

WHEREAS, a Certificate of Election to Wind Up and Dissolve of _____[*name of corporation*] has been filed with the Secretary of State of California; and

WHEREAS, the corporation must wind up and dissolve; and

WHEREAS, the corporation presently has issued and outstanding [*number*] shares of common stock; and

WHEREAS, the corporation is financially able to pay or provide for all of its known debts and liabilities;

RESOLVED, that all of the known debts and liabilities of the corporation will be provided for or paid; and

RESOLVED FURTHER, that the officers of the corporation are authorized to sell any or all of those assets on the terms and conditions, and for the consideration, that the officers deem reasonable or expedient, and to execute any instruments that are necessary to transfer title to those assets; and

RESOLVED FURTHER, that after the provision for, or the payment of, the known debts and liabilities of the corporation, the officers of the corporation are authorized and directed to distribute the remaining assets of the corporation to the shareholders of record in the following manner: (1) with respect to any cash, by distributing to each shareholder of record a proportion of that cash equal to the proportion that the shares owned by that shareholder bears to the total issued and outstanding shares of this corporation; and (2) with respect to assets other than cash, by distributing to each shareholder of record an undivided interest in each of those assets equal to the proportion that the shares of this corporation owned by that shareholder bears to the total issued and outstanding shares of this corporation; and

RESOLVED FURTHER, that the distribution of the assets will be made to the shareholders of record of this corporation on the following conditions: (1) that on demand made by the Board of Directors, each shareholder surrender the certificate or certificates evidencing his or her ownership of capital stock of this corporation for cancellation; and (2) that distribution will be in complete satisfaction of the rights of each shareholder as a shareholder of this corporation; and

RESOLVED FURTHER, that the officers of this corporation are authorized to do those acts and to take those steps that are necessary or convenient to carry these resolutions into effect, including, but not limited to, the execution of any instruments that may be required to vest title to the assets of this corporation in the shareholders; and

RESOLVED FURTHER, that as soon as the assets of this corporation have been distributed in conformity with these resolutions, the officers or directors of this corporation are authorized and directed to execute a Certificate of Dissolution pursuant to, and in conformity with, the provisions of the Corporations Code of California, and to cause the Certificate of Dissolution to be filed in the office of the Secretary of State of California, and to do all other things necessary or convenient to the winding up and dissolution of this corporation.

There being no further business to come before the meeting, on motion duly made, seconded, and unanimously carried, the meeting was adjourned.

Date: _____.

_____ [*signature*]
[*typed name*], Secretary
_____ [*signature*]
[*typed name*], President

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsCreditor RightsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.221

§ 12.221 Waiver of Notice to Directors' Meeting to Adopt Plan of Distribution

[1] Comment--Use of Form

This form is a written waiver of notice and consent to the holding of a directors' meeting to discuss the adoption of a plan of dissolution for the corporation, in the event that the meeting is held without giving the notice required by statute [*see Corp. Code § 307(a)(2), (3)*]. Although the mere attendance by a director, without protest of the lack of notice, operates as a waiver of notice of the meeting, it is customary to have all directors, absent or present, sign a waiver of notice, a consent to holding the meeting, or an approval of the minutes of the meeting [*Corp. Code § 307(a)(3)*]. The waiver, consents, or approvals may be signed before or after the meeting and must be filed with the corporate records or made a part of the minutes of the meeting [*Corp. Code § 307(a)(3)*]. For a further discussion of, and forms for, the call and notice of a directors' meeting, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

There is no requirement that a waiver of notice specify the purpose of any regular or special meeting of the board [*Corp. Code § 307(a)(2)*]. However, the specification of purpose is advisable. If the meeting is called to discuss both the election to dissolve and the adoption of a plan of distribution of the assets in dissolution, the purpose clauses contained in § 12.202 should be added to this waiver.

[2] FORM

WAIVER OF NOTICE AND CONSENT TO HOLDING OF SPECIAL MEETING OF BOARD OF DIRECTORS

WAIVER OF NOTICE AND CONSENT TO HOLDING OF SPECIAL MEETING OF BOARD OF DIRECTORS OF _____ [*name of corporation*], A CALIFORNIA CORPORATION

The undersigned, constituting all of the directors of _____[*name of corporation*], a California corporation, waive notice and consent to the holding of a special meeting of the Board of Directors of the corporation, to be held at [*location*], on _____[*date*], at _____[*time*], for the purpose of:

(1) Considering and acting on a plan for the distribution of the assets in dissolution of the corporation; and

(2) Transacting other business as may come before the meeting.

This waiver of notice and consent is made in compliance with the terms of *Section 307(a)(3) of the Corporations Code* of California, and the undersigned hereby consent to the same being made a part of the records of the meeting, and any business transacted at the meeting will be as valid as if conducted at a meeting regularly called and noticed.

Date: _____.

_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.222

§ 12.222 Directors' Resolutions Authorizing Sale of All or Substantially All of the Corporate Assets

[1] Comment--Use of Form

This form is a directors' resolution authorizing the sale of all or substantially all of the assets of the corporation. Among the powers expressly listed by *Corp. Code § 2001* is the power to sell at public or private sale, exchange, convey, or otherwise dispose of all or any part of the assets of the corporation, on the terms and conditions and for the consideration that the board of directors deems reasonable or expedient and to execute bills of sale and deeds of conveyance in the name of the corporation [*Corp. Code § 2001(g)*]. No shareholder approval of such a sale is required if the sale is solely for cash [*Corp. Code § 2001(g)*; *see* Comment to Form 12.223].

This form may be used when the agreement for sale of the business has been negotiated and the sale agreement drafted by the time the directors adopt resolutions for distribution of assets to shareholders. A sale agreement may be negotiated and executed under a general plan of distribution of assets such as that contained in Form 12.220.

For other forms related to the sale of all or substantially all the assets of a corporation, see Ch. 11B, *Cash Purchase of Assets* , and Ch. 17, *Buying and Selling a Business or Professional Practice* .

[2] FORM

DIRECTORS' RESOLUTIONS AUTHORIZING SALE OF ALL OR SUBSTANTIALLY ALL OF THE CORPORATE ASSETS

DIRECTORS' RESOLUTIONS AUTHORIZING SALE OF ALL OR SUBSTANTIALLY ALL OF THE CORPORATE ASSETS

WHEREAS, voluntary proceedings to wind up the affairs of this corporation commenced on _____ the adoption of a resolution of _____ (shareholders *or* directors) of this corporation electing to wind up and dissolve *or* the filing with this corporation of the written consent of shareholders to wind up and dissolve this

corporation];

WHEREAS, the Board of Directors of this corporation deems it to be for the best interests of this corporation and its shareholders that all or substantially all of its property and assets be sold to_____[*name*], in consideration of the payment to this corporation of the sum of $_____ and the assumption by _____[*name*] of certain liabilities of this corporation, pursuant to the terms, conditions, and provisions of that certain agreement of purchase and sale that has been presented to this meeting and discussed, and the terms, conditions, and provisions and the considerations are deemed, by this Board of Directors, to be reasonable and expedient;

WHEREAS, after paying all remaining known debts and liabilities, or adequately providing for same, the directors will distribute the balance of the assets among the shareholders and owners of the shares according to their respective rights and preferences, fairly, ratably and in conformity with the provisions of the articles of incorporation.

RESOLVED, that [*if the sale is for consideration other than cash:* subject to obtaining shareholder approval as required by *Sections 1001(a)* and *2001(g) of the Corporations Code*]:

1. The President and Secretary of this corporation are authorized and directed to execute and deliver on behalf of this corporation and in its name the agreement of purchase and sale of all or substantially all of the property and assets of this corporation, a copy of which is attached as Exhibit A and incorporated by reference;

2. All or substantially all of the property and assets of this corporation be sold to _____[*name*] for the consideration provided in, and in accordance with, the terms and provisions of this agreement of purchase and sale;

[*If sale is for consideration other than cash, use:*]

RESOLVED FURTHER, that the officers of this corporation are authorized and directed to take such steps as they may deem necessary or proper to procure the approval of the principal terms of the transaction and the nature and amount of the consideration by the vote or written consent of the outstanding shares of this corporation to sell all or substantially all of the property and assets of this corporation as provided above; and

RESOLVED FURTHER, that [*if the sale is for consideration other than cash:* on procuring such approval by the shareholders] the President and Secretary of this corporation are authorized and directed to execute and deliver in the name of and on behalf of this corporation all deeds, bills of sale, assignments, and other instruments of transfer as may be deemed necessary or proper to effect the sale pursuant to the agreement of purchase and sale, and in general the directors and officers of this corporation are authorized and directed to do any and all acts and things necessary to carry out, perform, and consummate this agreement of purchase and sale.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.223

§ 12.223 Shareholders' Written Consent Approving Sale of All or Substantially All of the Corporate Assets for Consideration Other Than Cash

[1] Comment--Use of Form

This form is a written consent of corporate shareholders approving the sale of all or substantially all of the assets of a corporation for consideration other than cash. If a sale or exchange of all or substantially all of the assets of a corporation for profit is made in the course of dissolution for a consideration consisting in whole or in part of something other than money, it must be approved or ratified by the vote of the outstanding shares, either before or after the action of the directors [*Corp. Code §§ 1001(a), 2001(g)*]. Approval by the outstanding shares means approval by a majority of the outstanding shares entitled to vote (or, if required by the articles, by the vote of a majority of each class of shares entitled to vote, or by a higher percentage of the shares) [*Corp. Code § 152*]. Shareholder approval of a sale of the corporate assets for consideration other than cash may be given by written consent, as well as by vote at a meeting [*Corp. Code §§ 194, 603(a)*; *see § 12.224*].

This form must be modified if it will be used by a corporation with outstanding shares held of record by 100 or more persons, unless the form is to be distributed to fewer than 10 of the shareholders. Any written consent form distributed to 10 or more shareholders of a corporation with outstanding shares held of record by 100 or more persons must (1) allow the shareholder to specify a choice between approval and disapproval of each matter or group of related matters to be acted on; and (2) provide that when a choice is specified, the shares will be voted in accordance with that choice [*Corp. Code § 604(a)*]. For a general consent form that satisfies the requirements of *Corp. Code § 604*, see *Ch. 8A, Shareholders' Meetings, Voting, and Agreements, § 8A.223*.

If the consideration for the sale of the assets during dissolution is solely cash, shareholder approval is not required [*Corp. Code § 2001(g)*]. However, if the consideration consists in whole or in part of the equity securities of another corporation or its parent, or of the debt securities of another corporation or its parent, which are not adequately secured and have a maturity date in excess of five years after the consummation of the transaction, the sale of the assets is characterized as a "sale-of-assets reorganization" [*Corp. Code § 181(c)*]. The required shareholder approval for this type

of transaction is discussed in Ch. 11E, *Acquisition of Assets for Shares* .

[2] FORM

WRITTEN CONSENT OF SHAREHOLDERS APPROVING SALE OF ALL OR SUBSTANTIALLY ALL OF THE CORPORATE ASSETS

WRITTEN CONSENT OF SHAREHOLDERS APPROVING SALE OF ALL OR SUBSTANTIALLY ALL OF THE CORPORATE ASSETS

WHEREAS, at a [regular *or* special] meeting of the Board of Directors of the corporation duly held at its principal office at _____, California, on _____[*date*], the Board of Directors of this corporation duly adopted resolutions authorizing the sale, pursuant to an agreement of purchase and sale, of all or substantially all of its property and assets to _____[*name*]; a copy of the minutes of that directors' meeting setting forth those resolutions is attached as Exhibit A and incorporated by reference, together with a copy of the agreement of purchase, attached and marked Exhibit B and incorporated by reference;

NOW, THEREFORE, each of the undersigned shareholders of the corporation, each holding of record at the close of business on _____[*date*], the number of shares entitled to vote set opposite his or her signature below, consisting, in the aggregate, of [a majority *or any higher percentage that may be required in the articles*] of the outstanding shares of the corporation entitled to vote, does hereby approves and consents to the principal terms of the transaction and the nature and amount of the consideration, and the agreement of purchase and sale in its entirety;

The undersigned do further hereby authorize, and direct that:

1. The President and Secretary of this corporation execute and deliver on behalf of this corporation and in its name, this agreement of purchase and sale of all or substantially all of the property and assets of this corporation;

2. All or substantially all of the property and assets of this corporation be sold to _____ for the consideration provided in, and in accordance with, the terms and provisions of the agreement of purchase and sale.

The undersigned further authorize, and direct the President and Secretary to execute and deliver in the name and on behalf of this corporation all deeds, bills of sale, assignments, and other instruments of transfer that may be deemed necessary or proper to effect the sale pursuant to the agreement of purchase and sale, and in general the directors and officers of this corporation are authorized and directed to do any and all acts and things necessary to carry out, perform, and consummate the agreement of purchase and sale.

IN WITNESS WHEREOF, each of the undersigned has signed his or her name and set opposite thereto the date of signing and the number of shares entitled to vote held by that person of record at the close of business on _____[*date*].

Name	Date	Number of Shares	Certificate Number	Shareholder Signature

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder

RightsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.224

§ 12.224 Shareholders' Resolution Authorizing Sale of All or Substantially All of the Corporate Assets for Consideration Other Than Cash

[1] Comment--Use of Form

This form contains resolutions that should be adopted if shareholder consent to a sale of all or substantially all of the corporate assets in dissolution for a consideration other than cash is sought at a shareholders meeting. If a sale or exchange of all or substantially all of the assets of a corporation is made in the course of dissolution for a consideration, in whole or in part, other than money, it must be approved or ratified by the vote of the outstanding shares, either before or after the action of the directors [*Corp. Code §§ 1001(a), 2001(g)*]. For a further discussion of the shareholder consent required for a sale of the assets in dissolution for consideration other than cash, and for a form for written consent (which can be executed instead of adopting resolutions at a meeting) see *§ 12.223*.

[2] FORM

SHAREHOLDERS' RESOLUTIONS APPROVING SALE OF ALL OR SUBSTANTIALLY ALL OF THE CORPORATE ASSETS

SHAREHOLDERS' RESOLUTIONS APPROVING SALE OF ALL OR SUBSTANTIALLY ALL OF THE CORPORATE ASSETS

WHEREAS, at a [regular *or* special] meeting of the Board of Directors of this corporation duly held at its principal office at _____, California, on _____[*date*], the Board of Directors of this corporation duly adopted resolutions authorizing the sale, pursuant to an agreement of purchase and sale, of all or substantially all of its property and assets to _____[*name*]; a copy of the minutes of this directors' meeting, setting forth this resolution, together with a copy of this agreement, attached and marked Exhibit A, is attached and marked Exhibit B, and incorporated herein by reference;

RESOLVED, that the principal terms of this transaction, and the nature and amount of the consideration under this

agreement of purchase and sale are approved by the shareholders of this corporation;

RESOLVED FURTHER, that:

1. The President and Secretary of this corporation are authorized and directed to execute and deliver on behalf of this corporation and in its name this agreement of purchase and sale of all or substantially all of the property and assets of this corporation;

2. All or substantially all of the property and assets of this corporation be sold to _____[*name*] for the consideration provided in, and in accordance with the terms and provisions of this agreement of purchase and sale;

RESOLVED FURTHER, that the President and Secretary of this corporation are authorized and directed to execute and deliver in the name of and on behalf of this corporation all such deeds, bills of sale, assignments, and other instruments of transfer as may be deemed necessary or proper to effect the sale pursuant to this agreement of purchase and sale, and in general the directors and officers of this corporation are authorized and directed to do any and all acts and things necessary to carry out, perform, and consummate this agreement of purchase and sale.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.225

§ 12.225 Certificate of Authorization of Dissolution and Sale of Assets, Attachment to Deed or Other Instrument of Transfer

[1] Comment--Use of Form

When shareholder approval is required for a sale of all or substantially all corporate assets during dissolution because consideration other than cash is being received [*Corp. Code §§ 1001(a), 2001(g)*], the secretary or an assistant secretary of the corporation may execute a certificate setting forth the resolutions of the board of directors and stating the fact of approval by the outstanding shares, for the purpose of annexing the certificate to any deed or instrument conveying or otherwise transferring the assets of the corporation [*Corp. Code § 1002*]. Such a certificate is prima facie evidence of the existence of the facts authorizing such conveyance or other transfer of the assets and is conclusive evidence in favor of any innocent purchaser or encumbrancer for value [*Corp. Code § 1002*].

If the sale is for cash only and no shareholder approval is obtained, the purchaser may require a certificate stating that the corporation is in dissolution, because the directors may not sell all the assets without shareholder approval otherwise [*Corp. Code § 1001(a)*]. If such a certificate is desired, the following form should be modified by eliminating Paragraphs 3 and 4 [*see* [2], *below*].

[2] FORM

CERTIFICATE OF AUTHORIZATION OF DISSOLUTION AND SALE OF CORPORATE ASSETS

CERTIFICATE OF AUTHORIZATION OF DISSOLUTION AND SALE OF CORPORATE ASSETS

The undersigned, _____, certifies:

1. That _____[he *or* she] is, and has been at all times mentioned in this certificate, the duly elected and acting Secretary [*or* Assistant Secretary] of _____[*name of corporation*], a California corporation.

2. That at a [special *or* regular] meeting of the Board of Directors of the corporation held on _____[*date*], at the principal office of the corporation at _____[*city*], California, the following resolutions for winding up and dissolution and sale of all the assets of the corporation were duly adopted: [*set out resolutions; see § 12.223*].

[*EITHER*]

3. That these resolutions of the Board of Directors of the corporation were duly approved by the vote of the holders of [a majority *or* higher percentage required by the articles] of the outstanding shares of this corporation entitled to vote at a special shareholders' meeting duly held on _____[*date*], at the principal office of the corporation, at which meeting the following resolutions were duly adopted by the affirmative vote of _____ shares: [*set out resolutions*].

[*OR*]

3. That these resolutions of the Board of Directors of the corporation have been duly approved by the written consents of the holders of [a majority *or higher percentage required by the articles*] of the outstanding shares of this corporation entitled to vote; these consents have been evidenced by the filing with the Secretary of the corporation, of written consents in the form attached as Exhibit A and incorporated by reference, by shareholders holding of record [*number*] shares of the corporation.

[*Continue with the following:*]

4. That the total number of issued and outstanding shares of the corporation entitled to vote is _____.

Executed on _____[*date*], at _____[*city and state*].

_____ [*signature*]
[*typed name*], Secretary

ACKNOWLEDGMENT
[*Acknowledgments taken in California must be in the following form (Civ. Code § 1189(a)*):]

State of California)
County of _____)

On _____[*date*], before me, _____[*name and title of officer taking acknowledgment*], personally appeared [*name(s) of person(s) signing instrument*], [personally known to me *or* proved to me on the basis of satisfactory evidence] to be the person[s] whose name[s] [is *or* are] subscribed to the within instrument and acknowledged to me that _____[he *or* she *or* they] executed the same in _____[his *or* her *or* their] authorized _____[capacity *or* capacities], and that by _____[his *or* her *or* their] signature[s] on the instrument the person [s], or the entity upon behalf of which the person[s] acted, executed the instrument.

WITNESS my hand and official seal.

Signature _____ [*Seal*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.226

§ 12.226 Resolution of Directors for Distribution of Specific Assets in Kind

[1] Comment--Use of Form

This form is a resolution that should be adopted by the directors at a meeting to discuss a plan of distribution of corporate assets in dissolution when the corporate assets will be distributed in kind, rather than being sold and the proceeds of the sale distributed among the shareholders. The form contains optional paragraphs that can be used whenever appropriate to specify the distribution of particular types of assets to particular classes of shareholders.

If the directors propose to distribute noncash corporate assets, such as securities in other corporations, according to a method of distribution that is not in accordance with the liquidation rights of the preferred shares as specified in the articles, the plan of distribution must be approved by the board and by a majority (or any greater percentage specified in the articles) of the outstanding voting shares of each class [*Corp. Code §§ 151*, *152*, *2007(a)*; *see §§ 12.227*, *12.230*]. Notice of the adoption of the plan of distribution must be given to shareholders with liquidation preferences within 20 days after its adoption [*Corp. Code § 2007(b)*; *see § 12.231*]. Dissenting preferred shareholders are entitled to be paid the amount of their liquidation preference in cash if they file a written demand for payment within 30 days after the date of mailing of the notice of the plan [*Corp. Code § 2007(c)*; *see § 12.233*].

If a shareholder with liquidation preferences files a dissent from the plan of distribution, the directors may adopt a new plan of distribution, or abandon the plan without further approval of the shareholders and distribute the assets according to the rights and liquidation preferences of the shareholders [*Corp. Code § 2007(d)*].

These rules [*Corp. Code § 2007(a)-(d)*] do not apply, however, to certain distributions made in accordance with merger reorganizations [*Corp. Code § 181(a)* (definition); *see* Ch. 11C, *Mergers*] and sale-of-assets reorganizations [*Corp. Code § 181(c)* (definition); *see* Ch. 11E, *Acquisitions of Assets for Shares*]. The rules do not apply to those distributions when [*Corp. Code § 2007(e)*; *see Corp. Code § 1202(b)*]:

- The terms of the reorganization provide that a class or series of preferred shares will receive as a

distribution a lesser amount than would be required by applicable article provisions; and

- The principal terms of the reorganization have been approved by the same percentage of outstanding shares of that class or series that would be required to approve an amendment of the article provisions to provide for the distribution of that lesser amount [*Corp. Code § 2007(e)*; *see Corp. Code § 1202(b)*].

If, by adopting a plan for the distribution of assets in kind, the directors are departing from the liquidation preferences expressed in the articles, this form should be modified by the addition of a resolution authorizing the obtaining of the approval of the outstanding shares of each class. In addition, a resolution should be adopted authorizing and directing the giving of notice to shareholders with liquidation preferences within 20 days after the adoption of the plan, in the event it is adopted. For forms for written consent and resolutions of the shareholders approving such a distribution plan, see *§§ 12.227* and *12.230*. For a form for giving notice to preferred shareholders, see *§ 12.231*.

For further discussion of the adoption of a plan for the distribution of the assets in dissolution, see *§ 12.220*, which is a general form for minutes of the directors meeting held to adopt a plan of distribution.

[2] FORM

RESOLUTION OF DIRECTORS FOR DISTRIBUTION OF ASSETS IN KIND

RESOLUTION OF DIRECTORS FOR DISTRIBUTION
OF ASSETS IN KIND

WHEREAS, voluntary proceedings to wind up the affairs of this corporation commenced on _____[the filing with this corporation of the written consent of shareholders to wind up and dissolve this corporation *or* _____ (the adoption of resolutions by the shareholders *or* the adoption of resolutions by directors) electing to wind up or dissolve];

WHEREAS, after paying or adequately providing for all of its known debts and liabilities, and setting aside the amount of $_____ in cash as a reserve fund for the payment of estimated expenses, taxes, unascertained or contingent liabilities, and expenses and costs of winding up, distribution, and dissolution, this corporation will have remaining on hand the following corporate assets (opposite each of which is its equivalent fair market value as determined by _____[*name*]):

Assets	Fair Market Value
_____	$_____
_____	$_____
_____	$_____

WHEREAS, it is the opinion of the Board of Directors that it is in the best interests of the shareholders to avoid selling the unliquidated assets listed above and converting the same into cash and that distribution can be done fairly and ratably and in conformity with the provisions of the articles of incorporation and in accordance with the respective rights and preferences of the shareholders, as provided in the plan of distribution;

RESOLVED, that this corporation will set aside in reserve the amount of $_____ in cash for the payment of estimated expenses, taxes, unascertained or contingent liabilities, and expenses and costs of winding up, distribution, and dissolution;

RESOLVED FURTHER, that after paying or adequately providing for all of its known debts and liabilities and setting

aside the amount of the reserve fund, the corporate assets remaining on hand shall be distributed to those shareholders of record at the close of business on _____[*date*], as follows:

[*Use each of the following, as appropriate:*]

1. All of the cash in the amount of $_____ to the holders of the [*class*] stock of this corporation payable as follows: _____[$_____ per share *or* pro rata in accordance with their respective share holdings].

2. Royalty interests of this corporation in _____, to be distributed as provided in the attached Exhibit _____, incorporated by reference.

3. [*number*] shares of [*class*] stock of _____, a _____ corporation, which shall be distributed to the holders of the [*class*] stock of this corporation, in the following manner: at the rate of [*number*] share(s) of [*class*] stock of _____[*name of corporation*] for [*number*] share(s) of stock of this corporation.

4. To each of the holders of the [*class*] stock of this corporation as tenants in common [*or* as joint tenants] an undivided, equal interest, in all that certain real property located in the County of _____, State of _____ commonly known as _____ and more particularly described as follows: [*legal description*], together with all buildings, fixtures, appurtenances, and furniture, subject to the following liabilities: _____.

5. To the holders of the [*class*] stock of this corporation, in undivided, equal interest, as tenants-in-common [*or* as joint tenants], all of the merchandise, machinery, furniture and furnishings, supplies, leaseholds, and _____, a schedule of which is attached as Exhibit _____ and incorporated by reference.

RESOLVED FURTHER, that when the Board of Directors of this corporation may determine that all liabilities of the corporation have been paid or adequately provided for and that there be no further need for the reserve fund, any remaining balance in the reserve fund will be distributed as follows: _____.

RESOLVED FURTHER, that distribution of the assets pursuant to the plan provided in these resolutions is subject to the following conditions:

1. That each shareholder properly endorse and surrender the certificate or certificates evidencing that shareholder's ownership of shares of the capital stock of this corporation;

2. That the distribution will be in complete satisfaction of the rights of each shareholder of this corporation upon distribution and liquidation of assets;

3. That this plan of distribution be approved by the shareholders as specified in *Corp. Code § 2007(a)*;

RESOLVED FURTHER, that the officers of this corporation are authorized, empowered, and directed to take all steps as they deem necessary or proper to procure the approval of the shareholders of record at the close of business on _____[*date*], in accordance with *Corp. Code § 2007(a)*;

RESOLVED FURTHER, that on procuring the shareholders' approval, the President and Secretary of this corporation are authorized, empowered, and directed to execute and deliver in the name of and on behalf of the corporation, all deeds, bills of sale, assignments, and other instruments of transfer that may be deemed necessary or proper, and that in

general the officers and directors of this corporation are empowered, authorized, and directed to do any and all acts and things necessary to carry out, perform, implement, and consummate this plan of distribution and to wind up corporate affairs and dissolve this corporation, including, but not necessarily limited to, the filing of the certificate of dissolution in accordance with *Corp. Code § 1905*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.227

§ 12.227 Shareholders' Written Consent Approving Plan of Distribution Not in Accordance With Liquidation Rights of Preferred Shares

[1] Comment

[a] Use of Form

This form may be used to obtain the written consent of shareholders to a plan of distribution of the noncash assets of the corporation that is not in accordance with the liquidation rights of the preferred shares as specified in the articles [*see Corp. Code § 2007(a)*; *see also § 12.20[4][e]*]. After the plan has been approved by the board of directors, it must be approved by the affirmative vote of a majority of the outstanding shares of each class entitled to vote unless a higher percentage is required by the articles of incorporation [*Corp. Code § 2007(a)*; *see Corp. Code § 152*].

This form must be modified if it will be used by a corporation with outstanding shares held of record by 100 or more persons, unless the form is to be distributed to fewer than 10 of the shareholders. Any written consent form distributed to 10 or more shareholders of a corporation with outstanding shares held of record by 100 or more persons must (1) allow the shareholder to specify a choice between approval and disapproval of each matter or group of related matters to be acted on; and (2) provide that when a choice is specified, the shares will be voted in accordance with that choice [*Corp. Code § 604(a)*]. For a general consent form that satisfies the requirements of *Corp. Code § 604*, see *Ch. 8A, Shareholders' Meetings, Voting, and Agreements, § 8A.223*.

If the directors' decisions to seek shareholder consent to dissolution, and (if dissolution is elected) to distribute the assets under a plan not in accordance with liquidation preferences, are made at the same meeting, this consent can be combined with the consent to the election to dissolve provided in § 12.202. However, it is important to remember that although only 50 percent of the voting power of the corporation must consent to dissolution [*Corp. Code § 1900(a)*], the plan of distribution must be approved by a majority of the voting shares of each class, or a higher percentage if the articles so require [*Corp. Code §§ 152, 2007(a)*].

Because approval of the plan must be by each class of shares [*Corp. Code §§ 152, 2007(a)*], a separate consent form for

each class may be preferable. For further discussion of shareholders' written consents, see Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

[b] Special Requirement When Shareholders Give Written Consent to Plan

When written shareholder consent to a plan of distribution is sought pursuant to *Corp. Code § 2007(a)*, the consents of all shareholders entitled to vote should be solicited in writing. Otherwise, even if the minimum number of votes is obtained to authorize the plan of distribution, its adoption must be delayed for a 10-day period while notice of the adoption of the plan is given to those shareholders entitled to vote who did not consent in writing [*Corp. Code § 603(b)(1)*]. However, if the consent to dissolution and the consent to the plan of distribution were combined in one document, it appears that the election to dissolve would be effective as soon as the requisite number of consents were filed with the corporation, even though the 10-day notice requirement might delay valid adoption of the plan of distribution, provided prompt notice is given to the shareholders not consenting in writing to the dissolution [*Corp. Code § 603(b)(2)*].

[2] FORM

SHAREHOLDERS' WRITTEN CONSENT APPROVING PLAN OF DISTRIBUTION NOT IN ACCORDANCE WITH LIQUIDATION RIGHTS OF PREFERRED SHARES

SHAREHOLDERS' WRITTEN CONSENT APPROVING PLAN OF DISTRIBUTION NOT IN ACCORDANCE WITH LIQUIDATION RIGHTS OF PREFERRED SHARES

The undersigned, shareholders of record of the issued and outstanding shares of [*class*] stock of _____[*name of corporation*], a California corporation, in the amounts shown below, whose shares constitute at least a majority of shares of each class of the corporation's outstanding stock:

1. Certify that each of the undersigned received a copy of the minutes of the meeting of the Board of Directors held on _____[*date*], at which meeting the directors of the corporation adopted a plan of distribution in kind of the assets in dissolution of the corporation that is not in accordance with the liquidation preferences of the preferred shares of the corporation as specified in its articles of incorporation.

2. Certify that each of the undersigned received a copy of the proposed plan of distribution, which is attached and incorporated by reference into this consent as Exhibit A.

3. Certify that each of the undersigned approve and consent to the adoption of this plan of distribution and authorize and direct the officers and directors of the corporation to distribute the assets of the corporation in accordance with the terms and on the conditions set forth in this plan and take all further actions as may be necessary or proper to wind up and dissolve the corporation.

IN WITNESS WHEREOF, each of the undersigned shareholders of record has signed his or her name and the date of signing and the number of voting shares of [*class*] stock of the corporation held by him or her of record on that date.

_____

Shareholder Name Date Number of Shares Class of Shares

The total number of consenting shares is _____ per class.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder Rights



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.228

§ 12.228 Notice to Nonconsenting Shareholders of Approval of Plan of Distribution by Shareholders' Written Consent

[1] Comment--Use of Form

This form may be used to give notice to nonconsenting shareholders of the adoption by the board of directors and the written consent of shareholders of a plan of distribution of corporate assets in kind that is not in accordance with the liquidation preferences of preferred shares [*Corp. Code §§ 603(b), 2007(a)*]. Such a notice must be given if shareholder consents to the adoption of the plan were not solicited in writing from all of the shareholders entitled to vote on the plan [*Corp. Code § 603(b)*]. If that is the case, notice of the authorization of the plan by the directors and a majority of the outstanding voting shares of each class must be given to all nonconsenting shareholders who were entitled to vote on the plan including, apparently, those nonconsenting shareholders whose votes were solicited, and a waiting period of 10 days before the plan goes into effect is imposed after notice is given or mailed [*Corp. Code § 603(b)(1)*].

Notice may be given by first-class mail, in which case it is deemed to be given at the time of deposit in the mail [*Corp. Code §§ 601(b)* (third-class mailing permitted when at least 500 shareholders of record), 603(b)]. It may also be given personally or by means of written communication other than by mail [*Corp. Code §§ 601(b), 603(b)*]. Notice may also be given by electronic transmission by the corporation, in which case notice is deemed to be given when sent [*Corp. Code §§ 601(b), 603(b)*; *see Corp. Code § 20*].

[2] FORM

NOTICE OF APPROVAL OF PLAN OF DISTRIBUTION BY SHAREHOLDERS' WRITTEN CONSENT

NOTICE OF APPROVAL OF PLAN OF DISTRIBUTION BY SHAREHOLDERS' WRITTEN CONSENT

TO: ALL SHAREHOLDERS OF _____[*name of corporation*] WHO DID NOT CONSENT IN WRITING TO THE ADOPTION OF A PLAN OF DISTRIBUTION OF ASSETS IN DISSOLUTION PURSUANT TO CORPORATIONS CODE SECTION 2007(a)

NOTICE IS HEREBY GIVEN, pursuant to *Corporations Code § 601(b)*, that a plan for the distribution of the assets of the corporation pursuant to its dissolution, which is not in accordance with the liquidation rights of the preferred shares as specified in the articles, has been duly approved and adopted by a resolution of the directors at a special meeting held on _____[*date*], at _____[*time*], at [*location of meeting*], and by the written consent of a majority of the outstanding shares of each class filed with the corporation on _____[*date*].

Attached as Exhibit A is a copy of the resolutions of the directors at the above-described meeting, setting forth the plan of distribution of the assets. A copy of the written consent of the shareholders approving that plan is attached as Exhibit B and incorporated by reference.

Pursuant to *Corporations Code § 603(b)(1)*, the adoption of the plan of distribution of the assets by the board of directors and the written consent of the shareholders will not be consummated until ten days after the giving of this notice.

Executed and mailed on _____[*date*], at _____, County, California.

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder Rights



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.229

§ 12.229 Declaration of Secretary of Mailing of Notice to Nonconsenting Shareholders of Adoption of Plan of Distribution by Written Consent of Shareholders

[1] Comment--Use of Form

This form is a declaration, to be executed by the secretary or other officer who gave notice, that notice has been mailed to all nonconsenting shareholders that a plan of distribution of corporate assets that is not in accordance with the liquidation preferences of preferred shareholders [*Corp. Code § 2007(a)*] has been adopted by the written consent of a majority of the outstanding shares of each class, or a higher percentage if required by the articles [*Corp. Code §§ 152, 2007(a)*]. This notice must be given in the event that not all the shareholders entitled to vote were solicited for their written consent, even if the holders of the required percentage of the outstanding voting shares of each class gave their consent [*Corp. Code § 603(b)(1)*; *see § 12.227*]. An affidavit (or declaration under penalty of perjury [*Code Civ. Proc. § 2015.5*]) is prima facie evidence of the giving of the notice [*Corp. Code §§ 601(b), 603(b)*]. This declaration should be executed as proof of mailing of the required notice and placed in the corporate minute book for safekeeping.

[2] FORM

DECLARATION OF SECRETARY OF MAILING OF NOTICE TO NONCONSENTING SHAREHOLDERS OF ADOPTION OF PLAN OF DISTRIBUTION BY WRITTEN CONSENT OF SHAREHOLDERS

DECLARATION OF SECRETARY OF MAILING OF NOTICE TO NONCONSENTING SHAREHOLDERS OF ADOPTION OF PLAN OF DISTRIBUTION BY WRITTEN CONSENT OF SHAREHOLDERS

The undersigned certifies that _____[he *or* she] is the duly elected, qualified, and acting Secretary [*or state other title*] of _____[*name of corporation*], and that on _____[*date of mailing of notice*], _____[he *or* she] mailed to all shareholders of record who were entitled to vote and who did not consent in writing to the adoption of the plan of distribution of the assets that was not in accordance with the liquidation rights of the preferred shares as specified in the articles of incorporation, notice of the adoption of the plan

pursuant to *Corp. Code § 2007(a)* by written consent of the holders of a majority of the outstanding voting shares of each class of stock of the corporation, a copy of which notice is attached as Exhibit A. This notice was mailed at _____[*city*], California, in a sealed envelope with postage prepaid and addressed to each of the nonconsenting shareholders at the addresses appearing on the books and records of the corporation.

The undersigned declares under penalty of perjury that the foregoing is true and correct of his own knowledge.

Executed on _____[*date*], at _____, California.

_____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder Rights



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.230

§ 12.230 Shareholders' Resolutions Approving Plan of Distribution of Assets in Kind

[1] Comment--Use of Form

This form is a shareholders' resolution approving a plan of distribution of the corporations's assets in kind. If the consent of shareholders to a plan of distribution of the noncash assets of the corporation which is not in accordance with the liquidation rights of the preferred shares as specified in the articles [*see Corp. Code § 2007(a)*] is to be obtained at a meeting of the shareholders, the resolutions set forth in this form should be adopted.

It is not necessary to hold a shareholders' meeting to obtain shareholders' consent to the adoption of a plan of liquidation that is not in accordance with the liquidation rights of the preferred shares as specified in the articles, because that consent may be obtained in writing [*Corp. Code §§ 194, 603(a), 2007(a)*; *see § 12.227*]. However, if a meeting is held proper call [*Corp. Code § 600(d)*] and notice [*Corp. Code § 601(a), (b)*] must be given [*see* Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* (call and notice of shareholders' meetings)]. The vote may be taken at the shareholders' annual meeting or at a special meeting, but in either event, for a vote on a plan of distribution pursuant to *Corp. Code § 2007(a)* to be valid, the notice of the meeting must contain a statement of the general nature of the proposal to be voted on [*Corp. Code § 601(f)*].

After a plan of distribution of the noncash assets of the corporation which is not in accordance with the liquidation rights of the preferred shares as specified in the articles has been approved by the board of directors [*see § 12.226*], it must be approved by the affirmative vote of the holders of a majority of the outstanding voting shares of each class of stock, or a higher percentage if the articles require it [*Corp. Code §§ 152, 2007(a)*]. If the plan of distribution is approved at the meeting by the required percentage of the outstanding voting shares of each class, the minutes of the meeting should reflect that fact. For forms and discussion of the minutes of annual and special meetings of shareholders, see Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

[2] FORM

SHAREHOLDERS' RESOLUTIONS APPROVING PLAN OF DISTRIBUTION OF ASSETS IN KIND

SHAREHOLDERS' RESOLUTIONS APPROVING PLAN OF DISTRIBUTION OF ASSETS IN KIND

WHEREAS, at a meeting held on _____[*date of directors' meeting*], at [*location of meeting*], the Board of Directors of _____[*name of corporation*] adopted resolutions approving a plan of distribution in kind of the assets in dissolution of the corporation that is not in accordance with the liquidation preferences of the preferred shares of the corporation as specified in the articles of incorporation; a copy of the minutes of that meeting is attached as Exhibit A and incorporated by reference;

RESOLVED, that the plan of distribution set forth in that directors' resolutions is hereby approved by the shareholders of the corporation; and

RESOLVED FURTHER, that the officers and directors of the corporation are authorized and directed to distribute the assets of the corporation in accordance with the terms and on the conditions set forth in the plan, and to take any further action as may be necessary or proper to wind up and dissolve the corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsShareholdersMeetings & VotingAnnual MeetingsBusiness & Corporate LawCorporationsShareholdersMeetings & VotingSpecial Meetings



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.231

§ 12.231 Notice of Plan of Distribution to Preferred Shareholders

[1] Comment--Use of Form

This form is a notice to preferred shareholders of a plan of distribution. If a plan of distribution that is not in accordance with the liquidation preferences of preferred shareholders is adopted by approval of the board and the outstanding shares [*Corp. Code § 2007(a)*; *see §§ 12.226, 12.227*], notice of the plan must be given by mail to all shareholders with liquidation preferences [*Corp. Code § 2007(b)*].

The notice must be given within 20 days after the adoption of the plan [*Corp. Code § 2007(b)*]. The plan is adopted on the date that the shareholders vote. However, if the shareholders adopt the plan by written consent and fewer than all of the shareholders are solicited for their written consent, notice must be given to all nonconsenting shareholders [*see § 12.228*] and a 10-day waiting period after the giving of notice is imposed before the plan can be considered to be adopted [*Corp. Code § 603(b)*].

The notice should set forth the date and place of the directors' meeting and contain a copy of the resolutions setting forth the plan [*see § 12.226*]. It should also contain a copy of the written consent of shareholders to the plan, or, the date and place of the shareholders' meeting and a copy of the shareholders' resolutions adopted at the meeting approving the plan [*see §§ 12.227, 12.230*].

[2] FORM

NOTICE OF PLAN OF DISTRIBUTION

NOTICE OF PLAN OF DISTRIBUTION

TO: ALL SHAREHOLDERS OF _____[*name of corporation*] HAVING A LIQUIDATION PREFERENCE:

NOTICE IS HEREBY GIVEN, pursuant to *Corp. Code § 2007(b)*, that a plan for the distribution of the assets of the corporation pursuant to its dissolution, which is not in accordance with the liquidation rights of the preferred shares as specified in the articles of incorporation, has been duly approved and adopted by a resolution of the directors at a special meeting held on _____[*date*] at _____[*time*] at [*location of meeting*] and _____[by the vote of the outstanding shares of each class at a special shareholders' meeting held on _____ (*date*) at _____ (*time*) at _____ (*location of meeting*) *or* written consent of the outstanding shares of each class filed with the corporation on _____ (*date*)]. Attached to this notice as Exhibit A is a copy of the resolutions of the directors at such meeting, setting forth the plan of distribution of the assets. A copy of the [resolutions of the shareholders adopted at their meeting approving the plan is attached as Exhibit B *or* written consent of the shareholders approving the plan is attached as Exhibit B].

The plan for the distribution of the assets of the corporation pursuant to its dissolution is binding on all shareholders except those shareholders having a liquidation preference who dissent to the plan and, pursuant to *Corp. Code § 2007(c)*, file a written demand for cash payment with the corporation within 30 days after date of mailing of this notice. The written demand of the dissenting shareholders must state the number and class of the shares held of record by the shareholder in respect of which the shareholder claims payment.

Executed and mailed on _____[*date*], at _____ County, California.

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.232

§ 12.232 Certificate of Secretary of Mailing of Notice of Plan of Distribution to Preferred Shareholders

[1] Comment--Use of Form

This form is a certificate to be executed by the secretary or other officer who gave notice that notice has been mailed to all preferred shareholders of the adoption of a plan of distribution of noncash corporate assets that is not in accordance with the liquidation rights of the preferred shares as specified in the articles [*Corp. Code § 2007(b)*; *see § 12.231*]. This certificate should be executed as proof of mailing of the required notice and should be placed in the corporate minute book.

[2] FORM

CERTIFICATE OF MAILING OF NOTICE OF PLAN OF DISTRIBUTION TO PREFERRED SHAREHOLDERS

CERTIFICATE OF MAILING OF NOTICE OF PLAN OF DISTRIBUTION TO PREFERRED SHAREHOLDERS

The undersigned certifies that he is the duly elected, qualified, and acting [Secretary *or other title*] of _____[*name of corporation*], and that on _____[*date of mailing of notice*], _____[he *or* she] mailed to all shareholders of record having liquidation preference a notice of the adoption of a plan for the distribution of the assets pursuant to the winding up and dissolution of the corporation, by depositing a copy of this notice in the United States mail at _____[*city*], California, in a sealed envelope with postage prepaid and addressed to each of the preferred shareholders at the addresses appearing on the books and records of the corporation. A copy of this notice is attached as Exhibit A.

Executed on _____[*date*] at _____[*city*], _____ County, California.

_____ [*signature*]

[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial MeetingsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProcedures



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.233

§ 12.233 Dissent to Plan of Distribution by Preferred Shareholders

[1] Comment--Use of Form

This form may be used by a preferred shareholder who dissents from the adoption of a plan of distribution of corporate assets that is not in accordance with the liquidation rights of the preferred shares as specified in the articles [*Corp. Code § 2007(c)*]. Shareholders with liquidation preferences may demand to be paid in cash their liquidation preferences, including any preferred dividend arrearages to which they are entitled, rather than accept the distribution of assets as set forth in the plan of distribution [*Corp. Code § 2007(c)*]. The preferred shareholder's written dissent and demand for cash payment must be filed within 30 days after the date of mailing of the notice of the adoption of the plan required by *Corp. Code § 2007(b)* [*Corp. Code § 2007(c)*]. For further discussion, see *§ 12.220*.

The demand should be signed in the same manner that the shareholder's name appears on the certificate. If the stock is held jointly, both parties should execute the demand. If the shareholder holds several stock certificates, the shareholder should execute additional demands for each of the following, when applicable:

- If the names appear differently on the certificates.
- If some shares are held jointly and not others.
- If the shares constitute different classes of stock having different liquidation preferences.

[2] FORM

Dissent to Plan of Distribution by Preferred Shareholders

DISSENT TO PLAN OF DISTRIBUTION OF _____ [*name of corporation*], A CALIFORNIA CORPORATION

To the Secretary of _____[*name of corporation*]:

The undersigned states that _____[he *or* she] is the holder of record of [*number*] shares of preferred stock of _____[*name of corporation*], a California corporation, par value of $_____ per share [*or* no-par value], class [*class of stock*], having liquidation preferences of $_____ per share, evidenced by Certificate No. [*number(s) of certificate(s)*]; that _____[he *or* she] dissents from the plan adopted and approved by the directors at a meeting held on _____[*date*], at [*location of meeting*] and by the holders of the outstanding shares of each class by their _____[vote at a meeting held on _____ (*date*), at _____ (*location of meeting*) or written consent filed with the corporation on _____ (*date*)] for the distribution of the assets pursuant to the winding up and dissolution of the corporation; and that _____[he *or* she] demands payment in cash the liquidation preferences [*if applicable, including arrears of dividends*] of these shares.

Executed on _____[*date*], at [*location*],_____ County, California.

_____ [*signature as name appears on stock certificate*]
[*typed name as it appears on stock certificate*]

[*If stock is jointly owned, add signature(s) of other joint owner(s)*]:

_____ [*signature of other joint owner as name appears on stock certificate*]
[*typed name of other joint owner as it appears on stock certificate*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder Rights



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.234

§ 12.234 Assumption of Corporate Debts and Liabilities by Shareholders

[1] Comment

[a] Use of Form

This form is an assumption of corporate liabilities by the shareholders. All known corporate debts and liabilities must be paid or adequately provided for before the remaining assets of a corporation in the process of winding up can be distributed to its shareholders [*Corp. Code § 2004*]. This form may be used when the shareholders of the corporation choose to assume its liabilities and debts as the method of providing for their payment. Assumption of the debts and liabilities by the shareholders is only one of several ways that corporate debts and liabilities can be adequately provided for [*see* [b], *below*].

In most dissolutions of small corporations when the property is being distributed to the shareholders as tenants in common, all of the known liabilities and debts of the corporation that have not yet become due ordinarily are assumed by the shareholders in the same proportion as their share holdings. However, in some cases, the corporate assets will be valued and distributed to the shareholders on the basis of that value and on the basis of the amount of liabilities to be assumed by each shareholder. In this case, the liabilities of the corporation are not assumed proportionately by the shareholders, and this form should be modified to specify those liabilities being assumed by each shareholder.

To the extent that an unknown liability is not assumed by the shareholders, each shareholder will be liable, to the extent of the distributions received from the corporation, for that liability [*see Corp. Code § 2009(a), (b)*]. Suit against the shareholder(s) may be brought by the corporation [*Corp. Code § 2009(a)*], or by an unpaid creditor in the name of the corporation [*Corp. Code § 2009(b)*]. To the extent that a shareholder satisfies any unknown and unassumed liability in excess of the shareholder's proportionate share of that liability, the shareholder has the right of ratable contribution from the other shareholders [*Corp. Code § 2009(c)*].

[b] Alternative Methods of Providing for Debts

The assumption of corporate debts by shareholders is only one method of adequately providing for the known debts and liabilities of a corporation before distributing the corporation's assets to the shareholders. In general, a liability or debt is paid or adequately provided for if: (1) payment is assumed or guaranteed in good faith by one or more financially responsible persons, corporations, or by the United States government or one of its agencies and the provision was determined by the directors, acting with reasonable care and on good faith, to be adequate at the time of any distribution of assets; or (2) the maximum amount of the debt or liability is deposited with the Controller in trust for the benefit of those entitled to the payment, and accompanied by a statement of the name of the person entitled to the debt, the time the debt was created, and any information possessed as to the residence of the person entitled to the debt [*Corp. Code §§ 2005(a), (b), 2008*].

[2] FORM

ASSUMPTION OF CORPORATE DEBTS AND LIABILITIES BY SHAREHOLDERS

ASSUMPTION OF CORPORATE DEBTS AND LIABILITIES BY SHAREHOLDERS

This assumption of debts and liabilities is made as of _____[*date*], by the undersigned as shareholders of _____[*name of corporation*], a California corporation.

WHEREAS, _____[*name of corporation*] has elected to wind up and dissolve:

NOW, THEREFORE, in consideration of the distribution by the corporation to the undersigned shareholders of certain assets and properties of the corporation, and in order to complete the winding up and dissolution, each of the undersigned shareholders agrees that, to the extent of the property and assets received by him or her in distribution by the corporation pursuant to the winding up and dissolution, he or she hereby assumes and agrees to discharge the known liabilities and obligations of the corporation not in fact discharged or otherwise adequately provided for in the winding up and dissolution. However, each of the undersigned shareholders retains the right of contribution and recovery as provided in *Corporations Code Section 2001(c)* and as otherwise provided by law. This assumption of debts and liabilities is effective as of the date of distribution of the corporate assets to the undersigned shareholders.

IN WITNESS WHEREOF, each of the undersigned has signed his or her name and the date of signing and the number of shares of the corporation entitled to vote held by him or her of record on this date.

Name	Date	Number of Shares
_____ [*signature*] [*typed name*]		
_____ [*signature*] [*typed name*]		
_____ [*signature*] [*typed name*]		

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsCreditor Rights



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.235

§ 12.235 Distribution of Assets to Shareholders in Kind--Assignment of All Assets to Shareholders

[1] Comment

[a] Use of Form

If the assets of the corporation are to be distributed to the shareholders in kind, it is necessary to prepare documents transferring title. This form is a simple assignment of all of the assets to the shareholders in undivided interests in proportion to their interests in the corporation. If any property is to be transferred to fewer than all of the shareholders, this form must be modified accordingly. It is also necessary to prepare all deeds and other documents of transfer, such as assignments of leases, necessary to transfer the property to the shareholders. For forms and discussion of deeds, see Ch. 27, *Deeds and Recording* . For a form and discussion of assignment of lease, see Ch. 35A, *Assignment and Sublease of Leasehold Interests* .

[b] Distribution of Assets in Kind

In the case of a small corporation with few shareholders, the assets may be distributed to them as tenants in common with the same interests in the assets as they had in the corporation. This approach is common when the shareholders will continue to operate the business in a noncorporate form. In many cases they will immediately transfer the assets to a partnership. It is also desirable to transfer the assets to the shareholders as tenants in common when there is a disagreement as to the value of the assets and the disagreement cannot be settled prior to the time that they desire to make distributions. In many cases, this problem can be avoided by making a determination as to the distribution of the assets before the making of the election to dissolve. Alternatively, the assets may be transferred to a liquidating trust [*see § 12.280*].

[2] FORM

ASSIGNMENT

ASSIGNMENT

Under the plan of liquidation adopted on _____[*date*], and in complete satisfaction of the rights of each of its shareholders and in consideration for the assumption of its liabilities by the shareholders (to the extent of its property received by each of them pursuant to its dissolution), _____[*name of corporation*], the undersigned corporation, assigns, transfers, and conveys all of its right, title, and interest in and to all of its property, both real and personal, tangible and intangible, whether known or unknown, to its shareholders as follows: [*set forth the undivided interest to be received by each shareholder*].

[*Optional:*]

The title to all properties covered by this assignment are fully and completely conveyed and transferred to the shareholders as provided below by the execution of this instrument. On request, this corporation will to execute and deliver to the shareholders any deeds, bills of sale, conveyances, assignments or other instruments of title that may be desirable to provide further of this assignment.

[*Continue with the following:*]

Executed on _____[*date*], at _____[*city*], _____ County, California.

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder Rights



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide § 12.236

§ 12.236 Distribution of Assets to Shareholders in Kind--Receipt of Distribution by Shareholders

[1] Comment--Use of Form

It may be desirable from a tax standpoint for the shareholders to acknowledge receipt of all of the property of the corporation, especially when the distributions must have been made during a certain period, such as in the case of a Section 332 dissolution [*see I.R.C. § 332*] or a Section 337 dissolution [*see I.R.C. § 337*]. If a receipt document is executed, it is very difficult for the Internal Revenue Service to take the position that the property was not distributed within the required period.

[2] FORM

RECEIPT OF DISTRIBUTION

RECEIPT OF DISTRIBUTION

In complete satisfaction of the rights of each of the undersigned as shareholders in _____[*name of corporation*], a California corporation, and in consideration of their assumption of the corporation's liabilities (to the extent of the property received by each of them pursuant to the dissolution of the corporation), each of the undersigned, constituting all of the shareholders of the corporation, hereby acknowledges receipt of all of the right, title, and interest of the corporation in and to all of its property, both real and personal, tangible and intangible, whether known or unknown, in dissolution of the corporation.
Dated: _____.

_____ [*signature of shareholder*]
[*typed name*]
_____ [*signature of shareholder*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsTax LawFederal Taxpayer GroupsC CorporationsLiquidations (IRC secs. 331-338)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
2. Winding Up and Distribution of Assets

5-12 California Legal Forms--Transaction Guide §§ 12.237-12.239

[Reserved]

§§ 12.237[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
3. Certificate of Dissolution

5-12 California Legal Forms--Transaction Guide § 12.240

§ 12.240 Domestic Stock Corporation Certificate of Dissolution (Form DISS STK)

[1] Comment

[a] Use of Form

This form is the Secretary of State's form for a certificate of dissolution of a corporation to be used once the corporation has initiated a voluntary dissolution by an election to dissolve. If the election to dissolve is not made by the vote of all the outstanding shares, a Certificate of Election to Wind Up and Dissolve (Form ELEC STK) [*see* § 12.205] must be filed either before or together with this form. In lieu of this form, a corporation can file a Short Form Certificate of Dissolution (Form DSF STK) if specified requirements are met [*see § 12.242*].

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.sos.ca.gov/business/bpd_forms.htm#corp . You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12.240. Please be sure to include your email address along with your request, and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

The certificate must be dated, signed, and verified under penalty of perjury by a majority of the directors of the corporation in office at the time, or by the sole director, if there is only one [Corp. Code § 1905(a)]. If additional signature space is necessary, any additional dated and verified signatures may be made on 8-1/2" x 11" attachments.

For further discussion and a drafting guide to certificates of dissolution, see *§§ 12.20[6]* and *12.130*.

[b] Dissolution by Court Order as Alternative to Filing Certificate

In lieu of filing a certificate of dissolution with the Secretary of State, the directors may petition the superior court for

an order declaring the corporation duly wound up and dissolved [*Corp. Code § 1907*; *see § 12.20[7]*]. For a form for such a petition, see California Forms of Pleading and Practice, Ch. 170, *Corporations: Dissolution and Winding Up* (Matthew Bender).

[c] Filing Requirements and Fees

All dissolution documents must be filed with the Secretary of State in the Sacramento office. Mailing or submitting documents to branch offices, or other state or federal agencies, including the Franchise Tax Board and the Internal Revenue Service, will not satisfy the filing requirements for corporate dissolution.

The original and at least two copies of the certificate should be included in the submission. There is no fee required to file a certificate of dissolution by mail [*Gov. Code § 12186(o)*]. For proof of submission of proposed dissolution documents, the Secretary of State's office recommends that documents be sent by certified mail, return receipt requested. A self-addressed envelope and letter referencing the corporate name and file number, as well as the attorney's name, return address, and telephone number should also be submitted.

The Secretary of State will certify two copies of the certificate at no charge, provided that they are submitted with the original for filing [*see also Gov. Code § 12185*]. Additional copies submitted with the originals will be certified on request and payment of a per copy fee. A certified copy should be placed in the corporation's minute book.

A $15 special handling fee applies for processing documents delivered in person at the public counter in the Sacramento Office. This fee must be remitted by separate check as it will be retained regardless of whether the documents are filed or rejected.

Preclearance or expedited filing of eligible corporate documents can be requested in a specified time frame, for an additional fee (in lieu of the $15 special handling fee) [*see Gov. Code § 12182(c)*]. This preclearance/expedited filing service is not available in the branch offices.

[d] Effect of Filing Certificate

Once the certificate is filed, the corporation's powers, rights, and privileges will cease. The Secretary of State will notify the Franchise Tax Board of the dissolution [Corp. Code § 1905(b)]. The Secretary of State will provide the taxpayer with an acknowledgment of the receipt of all winding up and dissolution documents on or before 21 days after their receipt [*Rev. & Tax. Code § 23331(c)*].

However, even after the filing of a certificate of dissolution, or the entry of a court order declaring the corporation wound up and dissolved, the corporation is not absolutely extinguished. The corporation continues to exist for the purpose of winding up its affairs, prosecuting and defending actions against it, collecting and discharging obligations, conveying corporate property, and collecting and dividing assets [*Corp. Code § 2010(a)*; *see Penasquitos, Inc. v. Superior Court (1991) 53 Cal. 3d 1180, 283 Cal. Rptr. 135, 812 P.2d 154* ; *see, e.g., Catalina Investments, Inc. v. Jones (2002) 98 Cal. App. 4th 1, 7-8, 119 Cal. Rptr. 2d 256* (as consequence of dissolved status, former corporation lacked capacity to submit purported certificate of revocation of dissolution more than four years later, in attempt to reinstate corporate existence)]. Actions or proceedings to which a corporation is a party do not abate as a result of the dissolution of the corporation, or by reason of proceedings for winding up and dissolution [*Corp. Code § 2010(b)*]. Causes of action against a dissolved corporation, whether arising before or after the dissolution, may be enforced against the dissolved corporation to the extent of its undistributed assets [*Corp. Code § 2011(a)(1)(A)*]. Further, if any of the assets of the dissolved corporation have been distributed to shareholders, causes of action against the dissolved corporation may be enforced against the shareholders to the extent of the lesser of (1) their pro rata share of the claim or (2) the corporate assets distributed to them, regardless of whether the cause of action arose before or after the dissolution [*Corp. Code § 2011(a)(1)(B)*; *see § 12.20[8]*].

[2] FORM

Certificate of Dissolution by All Shareholders or Entire Board

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpLimited Survival



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
3. Certificate of Dissolution

5-12 California Legal Forms--Transaction Guide § 12.241

[Reserved]

§ 12.241[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
3. Certificate of Dissolution

5-12 California Legal Forms--Transaction Guide § 12.242

§ 12.242 Domestic Stock Corporation Short Form Certificate of Dissolution (Form DSF STK)

[1] Comment

[a] Use of Form

This form is the Secretary of State's short form certificate of dissolution (Form DSF STK). It is an alternative to Domestic Stock Corporation Certificate of Dissolution (Form DISS STK) [*see § 12.240*] when all of the following requirements are met [*see* Corp. Code § 1900.5(a)]:

- The certificate of dissolution is being filed within 12 months from the date the corporate articles were filed.
- The corporation has no debts and liabilities (other than tax liability).
- The tax liability will be either satisfied on a taxes paid basis, or assumed.
- The final tax return has been, or will be, filed with the Franchise Tax Board.
- The corporation has not conducted any business.
- The corporation has not issued shares.
- The majority of the directors (or incorporators, if directors were not named in the articles and none have been elected) authorize the dissolution and elect to dissolve the corporation.
- The assets have been distributed to the persons entitled to them, or no assets have been acquired.

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be

obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.sos.ca.gov/business/bpd_forms.htm#corp . You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12.242. Please be sure to include your email address along with your request, and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

For coverage of the applicable filing requirements and the effect of filing a certificate of dissolution, see *§ 12.240[1][c]* and *[d]*, respectively. For further discussion and a drafting guide to certificates of dissolution, see *§§ 12.20[6]* and *12.130*.

[2] FORM

Certificate of Dissolution When Corporation Has Not Issued Shares

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary Dissolution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
3. Certificate of Dissolution

5-12 California Legal Forms--Transaction Guide § 12.243

§ 12.243 Transmittal Letter for Filing Certificate of Dissolution

[1] Comment--Use of Form

This form is a transmittal letter to accompany the certificate of dissolution that must be filed with the Secretary of State at the completion of the winding up process [*Corp. Code § 1905*; *see § 12.240*]. The original and at least two copies of the certificate should be included in the submission. There is no fee required to file a certificate of dissolution by mail [*Gov. Code § 12186(o)*].

For proof of submission of proposed dissolution documents, the Secretary of State's office recommends that documents be sent by certified mail, return receipt requested. The Secretary of State's office advises that a self-addressed envelope and letter referencing the corporate name and file number, as well as the attorney's name, return address, and telephone number should also be submitted.

For further discussion of the certificate of dissolution, filing, and execution requirements, see *§ 12.240[1][c]*.

[2] FORM

Transmittal Letter for Filing Certificate of Dissolution

TRANSMITTAL LETTER FOR FILING CERTIFICATE OF ELECTION TO DISSOLVE
[*Attorney's letterhead*]
_____ [*date*]
Secretary of State's Office
Business Programs Division
1500 11th Street, Room 390
Sacramento, CA 95814

RE: Certificate of Dissolution of _____ [*name of corporation*].
Dear Sir/Madam:

Enclosed are an original and _____ [*number*] copies of the Certificate of Dissolution of _____[*name of corporation*], file number _____. Please file the original in your office at your earliest convenience, and certify the remaining _____ [*number*] copies and return them to me.

[*If more than two certified copies of the certificate are desired:*]

Also enclosed is a check for $ _____ [*indicate amount*] in payment of your fees for the certification of _____ [*specify*] additional certified copies of the Certificate.

[*If special handling is desired, add:*]

Also enclosed is a check for $ _____ [*indicate amount*] in payment of the special handling fee.

[*Continue with the following:*]

If you have any question or comments concerning the certificate or if you need any further information, please feel free to call me collect at _____ [*phone number*].

Sincerely,
_____ [*signature of attorney*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary Dissolution



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
3. Certificate of Dissolution

5-12 California Legal Forms--Transaction Guide §§ 12.244-12.249

[Reserved]

§§ 12.244[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
4. Revocation of Dissolution

5-12 California Legal Forms--Transaction Guide § 12.250

§ 12.250 Shareholders' Written Consent to Revocation of Election to Dissolve

[1] Comment

[a] Use of Form

This form may be used to obtain the written consent of shareholders representing a majority of the voting power of a corporation to revoke a voluntary election to dissolve the corporation [*Corp. Code §§ 194, 603(a), 1902(a)*]. A certificate evidencing the revocation [*see § 12.252*] must be signed, verified, and filed with the Secretary of State [*Corp. Code § 1902(a)*].

[b] Revocation of Voluntary Election to Dissolve

In general, a voluntary election to dissolve may be revoked in the same manner that it was made. A voluntary election to dissolve the corporation may be revoked by shareholders representing a majority of the voting power at any time before the distribution of assets to the shareholders [*Corp. Code § 1902(a)*]. The revocation may be made by the vote or the written consent of the shareholders [*Corp. Code §§ 194, 603(a), 1902(a)*]. Ordinarily, revocation of the election to dissolve is by written consent. If so, prompt notice of the revocation by written consent must be given to those shareholders who did not consent in writing, unless the consents of all shareholders entitled to vote were solicited in writing [*Corp. Code § 603(b)(2)*].

[c] More Than 100 Shareholders

This form must be modified if it will be used by a corporation with outstanding shares held of record by 100 or more persons, unless the form is to be distributed to fewer than 10 of the shareholders. Any written consent form distributed to 10 or more shareholders of a corporation with outstanding shares held of record by 100 or more persons must do both of the following [*Corp. Code § 604(a)*]:

- Allow the shareholder to specify a choice between approval and disapproval of each matter or group

of related matters to be acted on; and

- Provide that when a choice is specified, the shares will be voted in accordance with that choice.

If the revocation of the election to dissolve is by the vote of the shareholders at a meeting, the resolutions in § 12.251 should be adopted at the meeting.

[2] FORM

Written Consent of Shareholders to Revocation of Election to Dissolve

WRITTEN CONSENT OF SHAREHOLDERS TO REVOCATION OF ELECTION TO WIND UP AND DISSOLVE _____ [*name of corporation*], A CALIFORNIA CORPORATION

The undersigned shareholders of record of _____[*name of corporation*], a California corporation, whose shares represent more than 50 percent of the voting power of the corporation, hereby elect and consent to revoke the election to wind up and dissolve, a certificate of which was filed in the office of the Secretary of State on _____[*date*]. The undersigned do authorize and direct the officers or directors to execute a certificate evidencing the election to revoke the election to wind up and dissolve, pursuant to and in conformity with the *Corporations Code Section 1902*, to cause that certificate to be filed in the office of the Secretary of State, and to take any further action as may be necessary or convenient to revoke that election.

IN WITNESS WHEREOF, each of the undersigned shareholders of record has executed and dated this written consent, and has stated the number of shares entitled to vote for the election of directors held by him or her of record as of that date.

Name	Date	Number of Shares	Shareholder Signature

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral Overview



84 of 146 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
4. Revocation of Dissolution

5-12 California Legal Forms--Transaction Guide § 12.251

§ 12.251 Shareholders' Resolutions Revoking Election to Dissolve

[1] Comment--Use of Form

This form is a resolution by the shareholders of a corporation revoking an earlier election to dissolve. If the election to revoke the dissolution is to be obtained at a meeting of the shareholders, the resolutions set forth in this form should be adopted and inserted in the appropriate place in the minutes of the shareholders' meeting. If the revocation is to be adopted by the vote of the shareholders it is necessary that proper call [*Corp. Code § 600(d)*] and notice [*Corp. Code § 601(a), (b)*] of the meeting be given, even though the election could have been made by the written consent of the shareholders, without the necessity of holding a meeting [*see § 12.250*].

In general, a voluntary election to dissolve may be revoked in the same manner that it was made. A voluntary election to dissolve the corporation may be revoked by shareholders representing a majority of the voting power at any time before the distribution of assets to the shareholders [*Corp. Code § 1902(a)*]. The revocation may be by the vote or the written consent of the shareholders [*Corp. Code §§ 194, 603(a), 1902(a)*].

[2] FORM

SHAREHOLDERS' RESOLUTIONS REVOKING ELECTION TO DISSOLVE

SHAREHOLDERS' RESOLUTIONS REVOKING ELECTION TO DISSOLVE _____ [*name of corporation*], A CALIFORNIA CORPORATION

WHEREAS, shareholders representing 50 percent or more of the voting power had elected to wind up and dissolve the corporation, and a Certificate of Election to Wind Up and Dissolve the corporation was filed in the office of the Secretary of State of California on _____[*date*]; and

WHEREAS, no assets of the corporation have been distributed pursuant to that election; and

WHEREAS, it is deemed advisable that it would be in the best interests of the corporation to revoke that election and to terminate the dissolution proceedings.

RESOLVED, that the voluntary election to wind up and dissolve the corporation is hereby revoked;

RESOLVED FURTHER, that the officers or directors are authorized and directed to execute a certificate of revocation of election to wind up and dissolve, pursuant to and in conformity with the provisions of the Corporations Code of California, to cause that certificate to be filed in the office of the Secretary of State, and to do all other things necessary or convenient to effect that revocation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewBusiness & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental Changes



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
4. Revocation of Dissolution

5-12 California Legal Forms--Transaction Guide § 12.252

§ 12.252 Certificate of Revocation

[1] Comment

[a] Use of Form

This form is a certificate of revocation of election to dissolve. It must be filed with the Secretary of State to revoke a previously filed certificate of election to wind up and dissolve [*Corp. Code § 1902(a)*]. The certificate must be signed, verified, and filed with the Secretary of State [*Corp. Code § 1902(a)*].

This form contains two alternative versions of Paragraph 4. The first is for use in the usual case when the election to dissolve and the revocation of that election were by the vote or written consent of the shareholders. The second is for use when the election to dissolve and revocation were by the board of directors [*see Corp. Code §§ 1900(b), 1902(a)*]. Revocation by approval of the board alone is permitted if the original election was approved solely by the board [*see Corp. Code § 1900(b)*; *see also § 12.20[1][b]*].

This certificate is an officers' certificate. A certificate of revocation must be either an officers' certificate [*see Corp. Code § 173*] or executed by at least a majority of the directors then in office, or by one or more shareholders authorized to do so by shareholders holding 50 percent or more of the voting power [*Corp. Code §§ 1901(b), 1902(a)*]. An officers' certificate is a certificate signed and verified by the chairman of the board, the president, or any vice president and the secretary, the chief financial officer, or the treasurer, or any assistant secretary or assistant treasurer [*Corp. Code § 173*]. The certificate must be verified [*Corp. Code §§ 173, 1901(b), 1902(a)*] either by affidavit [*Code Civ. Proc. § 2009*] or by declaration under penalty of perjury [*Code Civ. Proc. § 2015.5*]. If the certificate will instead be executed by the directors or shareholders, such as when the shareholders have reason to believe that the officers would refuse to execute the certificate, the form should be modified.

An original and at least two copies of the certificate should be sent to the Secretary of State. The Secretary of State will certify up to two copies without charge, provided that they are submitted with the original. One certified copy should be placed in the corporation's minute book. The filing fee for the original is set forth in *Gov. Code § 12186(p)*. For further

discussion of fees, see *§ 12.240[1][c]*.

[b] Contents of Certificate

If the revocation of the election to dissolve the corporation was by the shareholders, the certificate must set forth the following [*Corp. Code § 1902(b)(1)-(3)*]:

- That the corporation has revoked its election to wind up and dissolve;
- That no assets have been distributed pursuant to the dissolution; and
- The number of shares voting for revocation and the total number of outstanding shares the holders of which were entitled to vote on the revocation.

If the revocation was made by the directors, that fact must be stated [*Corp. Code § 1902(b)(4)*].

[2] FORM

Certificate of Revocation of Election to Wind Up and Dissolve

CERTIFICATE OF REVOCATION OF ELECTION TO WIND UP AND DISSOLVE _____ [*name of corporation*], A CALIFORNIA CORPORATION

The undersigned certify:

1. They are the president and the secretary, respectively [*or specify other officers authorized by statute*], of _____[*name of corporation*], a California corporation, file number _____.

2. The corporation has revoked its election to wind up and dissolve.

3. No assets have been distributed pursuant to the election.

[*If revocation is being made by vote of shareholders:*]

4. The revocation was made by the vote of _____ [*number*] shares of the corporation, and representing at least a majority of the voting power of the corporation.

[*Or, if revocation is being made by directors in accordance with Corp. Code §§ 1900(b), 1902(a):*]

4. The revocation was made by the vote of a majority of the board of directors. The board elected to wind up and dissolve and may revoke that election on its own because _____ [*specify ground listed in Corp. Code § 1900(b), e.g.*, the corporation has not issued any shares].

[*Continue with the following:*]

We further declare under penalty of perjury under the laws of the State of California that the matters set forth in this certificate are true and correct of our own knowledge.

IN WITNESS WHEREOF, the undersigned have executed this certificate on _____[*date*] at _____ [*location*].

_____ [*signature*]
[*typed name*], _____ [Chair of the Board *or* President *or* Vice-President]
_____ [*signature*]
[*typed name*], _____ [Secretary *or* Chief Financial Officer *or* Treasurer *or* Assistant Secretary *or* Assistant Treasurer]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipVoluntary DissolutionBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityGeneral OverviewBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesFundamental ChangesBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
A. Domestic Stock Corporations
4. Revocation of Dissolution

5-12 California Legal Forms--Transaction Guide §§ 12.253-12.259

[Reserved]

§§ 12.253[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
B. Domestic Nonprofit Corporations

5-12 California Legal Forms--Transaction Guide § 12.260

§ 12.260 Directors' Resolutions to Wind Up and Dissolve

[1] Comment

[a] Use of Form

This form contains the resolutions of the board of directors of a domestic nonprofit corporation to wind up and dissolve adopted at a special meeting of the board convened to discuss dissolution. Voluntary dissolution proceedings commence on the filing of the adoption of a resolution electing dissolution by the members, the board and the members, or, in certain circumstances, the board acting alone [*see Corp. Code §§ 6613(a), 8613(a), 9680(a)*].

[b] Contents of Form

This form records the resolution of the directors that dissolution is in the best interests of the corporation. The form contains alternative provisions for use if the directors may initiate the dissolution on its own, or if the directors must obtain the vote or written consent of the members in support of dissolution of the corporation.

This form can be used when the directors may initiate dissolution proceedings on their own--i.e., when corporation has no members, has been the subject of an order for relief in bankruptcy, has disposed of all of its assets and has not conducted any activity for the immediately preceding five years, or is a subordinate corporation required to dissolve after the loss of its charter [*see Corp. Code §§ 6610(b), 8610(b), 9680(b)(2)*]. The form can also be used when the directors must secure the members' consent to dissolution [*see Corp. Code §§ 6610(a), 8610(a), 9680(b)(1)*; *see also § 12.40[2]*].

The form also contains optional resolutions stating that the corporation will pay all known debts and liabilities, set aside a reserve, and distribute any remaining assets appropriately [*see Corp. Code §§ 6716, 8717, 9680*; *see also § 12.20[4][d]*]. Finally, the form authorizes the directors and officers to take all other necessary actions.

[2] FORM

Directors' Resolutions to Wind Up and Dissolve

RESOLUTIONS OF THE BOARD OF DIRECTORS OF _____ [*name of corporation*], A CALIFORNIA NONPROFIT CORPORATION

WHEREAS the Board of Directors of _____[*name of corporation*], a California nonprofit corporation, held a special meeting at _____[*street address, city, and state*], on _____[*date*], at _____[*time*]. The following directors were present at the meeting: _____. The following directors were absent from the meeting: _____.

WHEREAS the purpose of the meeting was to consider the winding up and dissolution of the corporation. After discussion, the following resolutions were _____ [unanimously adopted *or* adopted by majority vote]: _____ [*specify*].

RESOLVED, that the directors have determined that it is in the best interests of _____[this corporation *or* this corporation and its members] that this corporation be wound up and dissolved.

RESOLVED FURTHER, that the directors and officers of the corporation are authorized and directed to take all appropriate actions to wind up and dissolve this corporation.

[*If directors may act alone, use the following two resolutions:*]

RESOLVED FURTHER, that a majority of the board of directors may authorize the voluntary dissolution of this corporation because _____ [*specify facts permitting directors to act alone, e.g.*, the corporation has no members].

RESOLVED FURTHER, that the board of directors and officers are authorized and directed to execute, verify, and file a certificate of election to wind up and dissolve with the Secretary of State in accordance with Corporations Code Section _____ [6611 *or* 8611 *or* 9680]. The board of directors and officers are further authorized to file a copy of the certificate with the California Attorney General.

[*Or, if members must consent to dissolution, use the following two resolutions:*]

RESOLVED FURTHER, that the officers and directors of this corporation are authorized and directed to take appropriate measures to obtain the vote or written consent of the members as is necessary for the election to wind up and dissolve the corporation.

RESOLVED FURTHER, that after obtaining the consent of the members, the board of directors and officers are authorized and directed to execute, verify, and file a certificate of election to wind up and dissolve with the Secretary of State in accordance with Corporations Code Section _____ [6611 *or* 8611 *or* 9680]. The board of directors and officers are further authorized to file a copy of the certificate with the California Attorney General.

[*Continue with the following:*]

RESOLVED FURTHER, that on the commencement of dissolution proceedings, the officers and directors of this corporation are authorized and directed to take all other actions as may be necessary or reasonable in connection with the winding up and dissolution of this corporation.

[*Optional:*]

RESOLVED FURTHER, that this corporation currently holds the assets set forth in Exhibit A and is able and will therefore pay all known debts and liabilities. The directors and officers will establish a reserve in the amount of $ _____ to cover the payment of the estimated expenses of dissolution and winding up and any unknown debts and liabilities.

RESOLVED FURTHER, that the directors and officers are authorized and directed to secure [a decree from the superior court in a proceeding to which the Attorney General is a party *or* the Attorney General's written waiver of objections to the proposed distribution] and to distribute the corporation's remaining assets in accordance with its articles of incorporation.

[*Continue with the following:*]

RESOLVED FURTHER, that the directors and officers are authorized and directed to execute any instrument as may be necessary or reasonable to complete the dissolution and wind up the corporation's affairs, including the filing of a certificate of dissolution in accordance with Corporations Code Section _____ _____ [6615 *or* 8615 *or* 9680].

There being no further business to come before the meeting, the meeting was adjourned on motion duly made, seconded, and unanimously carried.

_____[*date*].

_____ [*signature*]
[*typed name*], President
_____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding UpBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
B. Domestic Nonprofit Corporations

5-12 California Legal Forms--Transaction Guide § 12.261

§ 12.261 Members' Written Ballot to Elect to Wind Up and Dissolve

[1] Comment

[a] Use of Form

This form is a ballot that may be used to obtain the consent of a majority of the members to wind up and dissolve a nonprofit corporation [*see Corp. Code §§ 6610(a), 8610(a), 9680(b)(1)*; *Corp. Code §§ 5033, 5034*; *see also § 12.40[2]*]. Voluntary dissolution proceedings commence on the filing of the adoption of a resolution electing dissolution by the members, the board and the members, or, in certain circumstances, the board acting alone [*see Corp. Code §§ 6613(a), 8613(a), 9680(a)*]. In general, and unless prohibited in the articles or bylaws, any action that may be taken at any regular or special meeting of members may be taken without a meeting if the corporation distributes a written ballot to every member entitled to vote on the matter [*see Corp. Code §§ 5513(a), 7513(a), 9413(a)*]. If approved by the board and not prohibited by the articles or bylaws, the ballot and any accompanying materials may be sent by electronic transmission by the corporation [*Corp. Code §§ 5513(a), 7513(a), 9413(a)*; *see Corp. Code § 20*].

This form contains a ballot permitting the members to consent to the voluntary winding up and dissolution of the corporation. If the members will discuss the matter at a members' meeting and authorize dissolution by resolution, see *§ 12.203* (stock corporation) and Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*. If the members will authorize the action by written consent, see *§ 12.202* (stock corporation) and Ch. 13, *Nonprofit Corporations*.

[b] Ballot Requirements for Public Benefit and Mutual Benefit Corporations

Any action that may be taken at any regular or special meeting of members may be taken without a meeting if the corporation distributes a written ballot to every member entitled to vote on the matter unless prohibited in the articles or bylaws [*see Corp. Code §§ 5513(a), 7513(a)*]. Unless otherwise provided by the articles or bylaws, and if approved by the board of directors, the ballot and any related material may be sent by electronic transmission by the corporation and responses may be returned to the corporation by electronic transmission to the corporation [*Corp. Code §§ 5513(a), 7513(a)*; *see Corp. Code §§ 20, 21*]. The ballot must set forth the proposed action, provide an opportunity to specify approval or disapproval of any proposal, and provide a reasonable time within which to return the ballot to the

corporation [*Corp. Code §§ 5513(a), (c), 7513(a), (c)*]. If written ballots are distributed to 10 or more members of a corporation with at least 100 members, the ballot must specify that, when a member indicates a choice on any matter presented in the ballot, the vote will be cast as directed, subject to reasonable specified conditions [*Corp. Code §§ 5514(a), 7514(a)*]. Unless otherwise provided in the articles or bylaws, a written ballot may not be revoked [*Corp. Code §§ 5513(d), 7513(d)*].

The ballots must be properly solicited [*see Corp. Code §§ 5511(b), 5514, 7511(b), 7514*]. The solicitation must specify the number of responses needed to meet the quorum requirement, the percentage of approvals necessary to pass the matter at hand, and the time by which the ballot must be received in order to be counted [*Corp. Code §§ 5513(c), 7513(c)*]. The ballot solicitation must be delivered to each member, personally, by electronic transmission by the corporation, or by first class mail, postage prepaid, or by other means of written communication, addressed to the member at the address appearing on the corporation's books or given by that member for the purpose of notice [*Corp. Code §§ 5511(b), 5513(c), 7511(b), 7513(c)*].

Approval by written ballot is valid only when the number of votes cast by ballot within the designated time period equals or exceeds the quorum required to be present at a meeting authorizing the action, and the number of approvals equals or exceeds the number of votes that would be required to approve at a meeting at which the total number of votes cast was the same as the number of votes cast by ballot [*Corp. Code §§ 5513(b), 7513(b)*].

[c] Ballot Requirements for Religious Corporations

Any action that may be taken at any regular or special meeting of members may be taken without a meeting if the corporation solicits the written ballot of every member entitled to vote on the matter and the required number of signed approvals are received [*see Corp. Code § 9413(a)*]. The signed approvals must set forth the proposed action [*Corp. Code § 9413(a), (c)*]. A written ballot may not be revoked [*Corp. Code § 9413(d)*].

Unless otherwise provided by the articles or bylaws, and if approved by the board of directors, the ballot and any related material may be sent by electronic transmission by the corporation and responses may be returned to the corporation by electronic transmission to the corporation [*Corp. Code § 9413(a)*; *see Corp. Code §§ 20, 21*].

The ballots must be properly solicited [*see Corp. Code §§ 5511(b), 5514, 7511(b), 7514*]. The solicitation must specify the time by which the ballot must be received in order to be counted [*Corp. Code § 9413(b)*].

Approval by written ballot is valid only when the number of ballots cast within the designated time period equals or exceeds the quorum required to be present at a meeting authorizing the action, and the number of approvals equals or exceeds the number of votes that would be required to approve at a meeting at which the total number of votes cast was the same as the number of ballots cast [*Corp. Code § 9413(c)*].

[2] FORM

Members' Written Ballot to Elect to Wind Up and Dissolve

MEMBERS' WRITTEN BALLOT TO ELECT TO WIND UP AND DISSOLVE _____ [*name of corporation*], A CALIFORNIA NONPROFIT CORPORATION

Under Corporations Code Section _____ [5513 *or* 7513 *or* 9413], the undersigned member of _____[*name of corporation*], a California nonprofit _____ [public benefit *or* mutual benefit *or* religious] corporation takes action by written ballot as specified below:

_____[*name of corporation*] will be voluntarily wound up and dissolved.

For _____ .....Against _____

This written ballot must be returned to the corporation at _____[*address*] no later than _____[*date*], at _____[*time*]. The affirmative vote of _____ [*specify percentage*] of the members are required to approve and authorize dissolution. The quorum requirement will be satisfied when written ballots are received from _____ [*specify percentage*] of the members.

Date: _____.

_____ [*signature*]
[*typed name*], member

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding UpBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
B. Domestic Nonprofit Corporations

5-12 California Legal Forms--Transaction Guide § 12.262

§ 12.262 Domestic Nonprofit Corporation Certificate of Election to Wind Up and Dissolve (Form ELEC NP)

[1] Comment

[a] Use of Form

This form is a certificate of election to wind up and dissolve a domestic nonprofit corporation. As noted below, it is available on the Secretary of State's website, where it can be filled in online, downloaded, and printed out. Use of the Secretary's form is not required, and any format that meets the statutory requirements may be used. However, use of the standard form is recommended inasmuch as it is easy to complete and there is no advantage to using any other version.

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.sos.ca.gov/business/bpd_forms.htm#corp . You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12.262. Please be sure to include your email address along with your request, and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

This form is intended for use when the election is made by the members, the board and the members, or the board acting alone [*see Corp. Code §§ 6610(a), (b), 8610(a), (b), 9680(b)*; *see also* [2], P3, *below*; *Committee to Save the Beverly Highlands Homes Association v. The Beverly Highlands Homes Association (2001) 92 Cal. App. 4th 1247, 1262-1263, 1271, 112 Cal. Rptr. 2d 732* (trial court erred in granting summary judgment to plaintiffs who sought to enjoin allegedly wrongful dissolution of nonprofit mutual benefit corporation, based on finding that nonprofit corporation was common interest development within meaning of Davis-Stirling Act)].

The certificate must be filed with the Secretary of State immediately after the corporation elects to wind up and dissolve, either before or simultaneously with the certificate of dissolution [*Corp. Code §§ 6611(a), 8611(a), 9680(a)*; *see* Secretary of State's website; *see also* [c], *below*]. A copy of the election must be filed with the Attorney General [*Corp. Code §§ 6611(a), 8611(a), 9680(a)*].

The separate filing of this certificate is not required if (1) the election is made by the vote of all the members of a corporation with members or (2) the election was made by all members of the board of directors of a corporation without members and (3) a statement to that effect is included in the certificate of dissolution [*Corp. Code §§ 6611(c), 8611(c), 9680(a)*; *see also* 12.266].

For a transmittal letter, see *§ 12.207*.

[b] Contents of Certificate

The certificate of election to wind up and dissolve must state the following [*Corp. Code §§ 6611(b), 8611(b), 9680(a)*]:

- That the corporation has elected to wind up and dissolve; and
- If the election was made by the members alone, the number of votes for the election and that the number constitutes a majority of all members; or
- That the election was made by the board of directors and a majority of the members; or
- If the election was made by the board alone, the circumstance showing that the corporation is of type that the board may dissolve on its own [*see § 12.40[2]*].

If the certificate is executed by a member or members, the certificate must also show that the subscribing member(s) were authorized to execute the certificate by a majority of all members [*Corp. Code §§ 6611(b)(4), 8611(b)(4), 9680(a)*].

The certificate must either be an officers' certificate [*see Corp. Code § 173*] or be signed and verified by at least a majority of the directors then in office, or by one or more members authorized to do so by the approval of a majority of all members [*Corp. Code §§ 6611(b), 8611(b), 9680(a)*]. An officers' certificate is a certificate signed and verified by the chairman of the board, the president, or any vice president and the secretary, the chief financial officer, or the treasurer, or any assistant secretary or assistant treasurer [*Corp. Code § 173*]. The verification may be by affidavit [*Code Civ. Proc. § 2009*] or by declaration under penalty of perjury [*Code Civ. Proc. § 2015.5*]. If the declaration is made under penalty of perjury, the certificate must state the date and place of execution [*Code Civ. Proc. § 2015.5*].

[c] Filing Requirements and Fees

The Secretary of State's office requires that all dissolution documents must be filed with the Secretary of State in the Sacramento office. Mailing or submitting documents to branch offices, or other state or federal agencies, including the Franchise Tax Board and the Internal Revenue Service, will not satisfy the filing requirements for corporate dissolution.

The original and at least two copies of the certificate should be included in the submission. There is no fee required to file a certificate of election to wind up and dissolve by mail [*Gov. Code § 12186(o)*]. For proof of submission of proposed dissolution documents, the Secretary of State's office recommends that documents be sent by certified mail, return receipt requested. A self-addressed envelope and letter referencing the corporate name and file number, as well as the attorney's name, return address, and telephone number should also be submitted.

The Secretary of State will certify two copies of the certificate at no charge, provided that they are submitted with the original for filing [*see Gov. Code § 12185*]. Additional copies submitted with the originals will be certified on request and payment of a per copy fee. A certified copy should be placed in the corporation's minute book.

A special handling fee applies for processing documents delivered in person at the public counter in the Sacramento Office. This fee must be remitted by separate check as it will be retained regardless of whether the documents are filed or rejected.

Preclearance or expedited filing of eligible corporate documents can be requested in a specified time frame, for an additional fee (in lieu of the special handling fee) [*see Gov. Code § 12182(c)*]. This preclearance/expedited filing service is not available in the branch offices.

[2] FORM

Certificate of Election to Wind Up and Dissolve

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding UpBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
B. Domestic Nonprofit Corporations

5-12 California Legal Forms--Transaction Guide § 12.263

§ 12.263 Notice to Attorney General; Request for Waiver of Objections

[1] Comment--Use of Form

When a nonprofit corporation elects to dissolve, it must give notice to the Attorney General and submit a copy of the certificate of election to wind up and dissolve [*see § 12.262[2]*] if one is filed [*Corp. Code §§ 6611(a), 8611(a), 9680(a)*; *see § 12.262[1][a]*]. In order to distribute any assets remaining after the corporation's debts and liabilities are paid, and after the return of any corporate property subject to a condition requiring their return to the proper distributee, the corporation must secure a court decree or the Attorney General's waiver of objections [*see Corp. Code §§ 6716(c), 8716(c), 9680(e)*; *see § 12.41*]. This form provides the requisite notice and seeks such a waiver.

The form should be accompanied by copies of the corporation's organizational instruments, exemption letters, and documentation supporting the proposed distribution of assets.

The form should be signed by a corporate director, the officer managing the dissolution, or counsel.

[2] FORM

Notice to Attorney General: Request for Waiver of Objections

Department of Justice
Registry of Charitable trusts
P.O. Box 903447
Sacramento, CA 94203-4470

Re: Dissolution and Disposition of Assets of _____ [*name of corporation*]
Dear Registrar:

_____[*name of corporation*], a California nonprofit _____ [public benefit *or* mutual

benefit *or* religious] corporation, file number _____, has elected to wind up and dissolve. Pursuant to Corporations Code Section _____ [6716(c) *or* 8716(c) *or* 9680(e)], the corporation requests a written waiver of objections to the disposition of the remaining assets in connection with its dissolution.

Copies of the articles of incorporation, bylaws, and all amendments are attached as Exhibit A. Copies of the California and federal exemption letters are attached as Exhibit B. [*Add, if filed:* A copy of the corporation's certificate of election to wind up and dissolve is attached as Exhibit C.] A certified copy of the resolutions of _____ [the board of directors *or* the board of directors and the members *or* all the members] is attached as Exhibit _____.

The corporation's current assets are the _____ [*specify, e.g.,* cash, property and securities] described in the balance sheet attached as Exhibit _____. The corporation's _____[*specify, e.g.,* financial statements *or* federal tax returns] for the last three fiscal years are attached as Exhibit _____.

The _____ [*specify title, e.g.,* the chief financial officer *or* treasurer] of _____[*name of corporation*] warrants that none of the assets were purchased with the proceeds of restricted gifts in violation of that restriction. Further, none of these assets represent or consist of the proceeds of fundraising campaigns in which representations were made to the donors concerning the use of the donations.

_____[The resolutions contain *or* Attached as Exhibit _____ is] a complete plan of liquidation, including the proposed distribution of the remaining assets of _____[*name of corporation*]. The proposed distribution of these assets is as follows:

1. _____ [*describe specific assets*] to _____, a California nonprofit [public benefit *or* religious] corporation, file number _____.

2. _____ [*describe specific assets*] to _____, a California nonprofit [public benefit *or* religious] corporation, file number _____.

[*Repeat as necessary.*]

_____. The remaining assets to _____, a California nonprofit [public benefit *or* religious] corporation, file number _____.

The _____ [*specify title, e.g.,* the chief financial officer *or* secretary] of _____[*name of corporation*] warrants that all of the above-named corporations are organized and operated for religious, charitable, scientific, or educational purposes. A majority of the board of directors now in office selected these corporations as required by _____[*name of corporation*]'s articles of incorporation. Copies of the organizational documents and exemption letters of these corporations are attached as Exhibit _____.

If you need further information, clarification, or documentation, please contact the undersigned at _____ [*telephone number*].

Thank you,

_____ [*name of corporation*],
a California nonprofit corporation
By: _____ [*signature*]
[*typed name, title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesBusiness & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
B. Domestic Nonprofit Corporations

5-12 California Legal Forms--Transaction Guide § 12.264

§ 12.264 Notice to Creditors and Members of Voluntary Dissolution

[1] Comment--Use of Form

This form notifies members and creditors that a voluntary proceeding to wind up and dissolve the corporation has commenced. The notice must be mailed to all members (except that notice is not required to be given to the members who voted in favor of winding up and dissolving the corporation [*but see below*]), to all known creditors and claimants whose addresses appear on the records of the corporation, and to the Attorney General [*Corp. Code §§ 6613(c), 8613(c), 9680(a)*; *see § 12.263*]. The date on which proceedings for voluntary dissolution are deemed to begin is the date that the resolution to elect to wind up and dissolve was adopted by the members, the members and the board, or the board alone [*Corp. Code §§ 6613(a), 8613(a), 9680(a)*].

Although notice is not required to be given to members who voted in favor of winding up and dissolving the corporation [*Corp. Code §§ 6613(c), 8613(c), 9680(a)*], it would appear to be good practice to send notice to all members, whether or not they voted in favor of dissolution. Therefore, this form states that notice is being sent to all members. If the notice will only be sent to those members who did not vote for dissolution, the form should be amended accordingly.

It is also advisable to have the officer (typically the secretary) who caused notice to be given to execute a certificate stating that notice of the dissolution was given to all members, creditors and claimants, and the Attorney General. For a form that may be adapted for this use, see *§ 12.209*.

[2] FORM

Notice to Creditors and Members of Voluntary Dissolution

NOTICE OF COMMENCEMENT OF VOLUNTARY DISSOLUTION OF _____ [*name of corporation*], A CALIFORNIA NONPROFIT CORPORATION

TO ALL MEMBERS, CREDITORS, AND CLAIMANTS OF _____[*name of corporation*], A CALIFORNIA NONPROFIT _____ [PUBLIC BENEFIT *or* MUTUAL BENEFIT *or* RELIGIOUS]

CORPORATION, FILE NUMBER _____:

NOTICE IS HEREBY GIVEN, that _____[*name of corporation*], a California nonprofit corporation whose principal office is located at _____[*street address and city*], California, has voluntarily elected to wind up its affairs and dissolve.

Proceedings for the winding up of the corporation commenced on _____[*date*], in accordance with _____ [*Corp. Code § 6610 or Corp. Code § 8610 or Corp. Code § 9680(b)*].
_____[*Specify manner of election, e.g.,* On that date, members representing at least 50 percent of the voting power of the corporation _____ (filed with the corporation written consents *or* adopted a resolution) in which they elected and consented to the winding up and dissolution of the corporation]. The corporation is now in the process of winding up its affairs in the manner provided by law.
Dated: _____.

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
B. Domestic Nonprofit Corporations

5-12 California Legal Forms--Transaction Guide § 12.265

[Reserved]

§ 12.265[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
B. Domestic Nonprofit Corporations

5-12 California Legal Forms--Transaction Guide § 12.266

§ 12.266 Domestic Nonprofit Corporation Certificate of Dissolution (Form DISS NP)

[1] Comment

[a] Use of Form

This form is the Secretary of State's form for a certificate of dissolution of a domestic nonprofit corporation. If the election to dissolve is not made by the vote of all members, or if the corporation has no members, by the vote of all the directors, a Certificate of Election to Wind Up and Dissolve (Form ELEC STK) [*see* § 12.205] must be filed either before or together with this form. As noted below, it is available on the Secretary of State's website, where it can be filled in online, downloaded, and printed out.

A majority of the directors then in office must execute and verify the certificate of dissolution [*Corp. Code §§ 6615(a), 8615(a), 9680(a)*]. Verification may be by affidavit [*see Code Civ. Proc. § 2009*], or by declaration under penalty of perjury [*Corp. Code § 193*; *see Code Civ. Proc. § 2015.5*]. The sample forms that appear on the Secretary of State's website use a declaration under penalty of perjury.

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.sos.ca.gov/business/bpd_forms.htm#corp You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12.266. Please be sure to include your email address along with your request, and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

The certificate of dissolution must be filed with the Secretary of State when all the debts of the corporation have been paid or adequately provided for, the assets distributed to shareholders, and the corporation completely wound up without court proceedings [*Corp. Code §§ 6615(a), 8615(a), 9680*; *but see* [b], *below*].

Nonprofit public benefit and religious corporations must attach a document, issued by the Attorney General, waiving

objections to the corporation's distribution of assets or confirming that the corporation has no assets [*Corp. Code §§ 6615(b)*, 9860(a); *see* [c], *below*; *see also § 12.263* (request for waiver of objections)]. Nonprofit mutual benefit corporations must instead state in the certificate of dissolution that the corporation's known assets have been distributed to the persons entitled to them, or that the corporation acquired no known assets [*Corp. Code § 8615(a)*].

[b] Dissolution by Court Order as Alternative to Filing Certificate

If the board of a public benefit, mutual benefit, or religious corporation petitions the superior court of the proper county for an order declaring the corporation wound up, the corporation must file the petition is lieu of a certificate [*Corp. Code §§ 6617, 8617, 9680(a)*; *see § 12.40[5][a]*]. For a form for such a petition, see California Forms of Pleading and Practice, Ch. 170, *Corporations: Dissolution and Winding Up* (Matthew Bender).

[c] Filing Requirements and Fees

Nonprofit public benefit and religious corporations must attach one of the following documents, issued by the Attorney General, to the certificate of dissolution [*Corp. Code §§ 6615(b)*, 9860(a)]:

- A written waiver of objections to the distribution of the corporation's assets [*see Corp. Code § 6716(c)*; *see also § 12.263* (request for waiver of objections)]; or
- A written confirmation that the corporation has no assets.

The Secretary of State will not accept a certificate of dissolution for filing unless one of these documents is attached to the certificate [*Corp. Code §§ 6615(c)*, 9860(a)].

All dissolution documents must be filed with the Secretary of State in the Sacramento office. The Secretary of State's office advises that mailing or submitting documents to branch offices, or other state or federal agencies, including the Franchise Tax Board and the Internal Revenue Service, will not satisfy the filing requirements for corporate dissolution.

The original and at least two copies of the certificate should be included in the submission. There is no fee required to file a certificate of dissolution by mail [*Gov. Code § 12186(o)*]. For proof of submission of proposed dissolution documents, the Secretary of State's office recommends that documents be sent by certified mail, return receipt requested. The Secretary of State's office also advises that a self-addressed envelope and letter referencing the corporate name and file number, as well as the attorney's name, return address, and telephone number, should also be submitted.

The Secretary of State will certify two copies of the certificate at no charge, provided that they are submitted with the original for filing [*see Gov. Code § 12185*]. Additional copies submitted with the originals will be certified on request and payment of a per copy fee. A certified copy should be placed in the corporation's minute book.

A $15 special handling fee applies for processing documents delivered in person at the public counter in the Sacramento Office. This fee must be remitted by separate check as it will be retained regardless of whether the documents are filed or rejected.

Preclearance or expedited filing of eligible corporate documents can be requested in a specified time frame, for an additional fee (in lieu of the $15 special handling fee) [*see Gov. Code § 12182(c)*]. This preclearance/expedited filing service is not available in the branch offices.

[d] Effect of Filing Certificate

The corporate existence will cease when the Secretary of State has accepted and filed the certificate of dissolution and

attachment by the Secretary of State, except for the purpose of further winding up if needed. The Secretary of State will.notify the Franchise Tax Board of the dissolution [Corp. Code §§ 6615(c), 8615(b), 9680(a)]. The Secretary of State will provide the taxpayer with an acknowledgment of the receipt of all winding up and dissolution documents on or before 21 days after their receipt [*Rev. & Tax. Code § 23331(c)*].

However, even after the filing of a certificate of dissolution, or the entry of a court order declaring the corporation wound up and dissolved, the corporation is not absolutely extinguished. The corporation continues to exist for the purpose of winding up its affairs, prosecuting and defending actions against it, collecting and discharging obligations, conveying corporate property, and collecting and dividing assets [*Corp. Code §§ 6720(a), 8722(a), 9680(a)*]. Actions or proceedings to which a corporation is a party do not abate as a result of the dissolution of the corporation, or by reason of proceedings for winding up and dissolution [*Corp. Code §§ 6720(b), 8722(b), 9680(a)*]. Further, if any assets are inadvertently or otherwise omitted from the winding up, those assets continue in the dissolved corporation for the benefit of the persons entitled to them on dissolution and must be distributed to them [*Corp. Code §§ 6720(c), 8722(c), 9680(a)*]. For further discussion, see *§ 12.40[7]*.

[2] FORM

Certificate of Dissolution by All Members or Entire Board

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesBusiness & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
B. Domestic Nonprofit Corporations

5-12 California Legal Forms--Transaction Guide §§ 12.267-12.279

[Reserved]

§§ 12.267[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
B. Domestic Nonprofit Corporations

5-12 California Legal Forms--Transaction Guide § 12.280

§ 12.280 Liquidating Trust Agreement

[1] Comment

[a] Use of form

This form is a liquidating trust agreement to establish an irrevocable trust to complete the winding up and dissolution of a corporation. The form may be used by domestic stock corporations, as well as nonprofit mutual benefit corporations. The trust is drafted in terms of shareholders, but may be easily amended to cover members.

The trust agreement terms should be tailored to the purpose of the trust: the orderly disposition of a dissolving corporation's assets. The term of the trust is limited to a finite number of years; its duration should be based on a reasonable estimate of the time needed to properly dispose of the trust's assets.

The form provides that the trustee will hold the trust assets for disposition, but in the interim will manage the assets in the best interests of the beneficiaries. The trustee will collect payments on any promissory notes and accounts receivable, but may not conduct any business on behalf of the trust. The trustee has the ordinary powers and duties of a trustee, including maintaining books and records and filing necessary tax returns. On termination, the trustee will provide a complete accounting of all transactions made under the authority of the trust agreement.

The corporation must convey and assign the remaining assets to the trust. For a form that may be adapted to this purpose, see *§ 12.235*.

[b] Circumstances Warranting Use of Trust

In most cases of dissolution, a sale of the corporation's assets for cash will be the best way to make a ratable distribution among the shareholders. A cash distribution is simpler to make and does not involve the problems inherent in distribution of noncash assets to shareholders as tenants in common. Ratable noncash distributions are likely to be economically undesirable and to pose serious problems of valuation and fairness. However, in many circumstances, such as the following, a ratable cash distribution is not practical. In the following circumstances, the use of a liquidating

trust may be useful:

- When the distribution of the corporation's assets will be complicated, either because of the nature of the assets or their valuation.
- When the corporation has unliquidated debts.
- When some shareholders or members cannot be found.
- When the shareholders or members are so numerous that it is impractical for them to manage the property as tenants in common.
- When there is substantial conflict amongst the shareholders or members.

For example, if the corporation holds several promissory notes, and it is impractical to break the notes into smaller denominations so that they can be divided among the shareholders or members, a liquidating trust might be useful to collect the proceeds and ratably distribute them to the trust beneficiaries.

[2] FORM

Liquidating Trust Agreement

LIQUIDATING TRUST AGREEMENT

Article 1. Creation of Trust

1.01. **Agreement Creating Trust.** This Agreement is executed on _____[*date*] between _____[*name of dissolving corporation*] (Corporation), which is in the process of voluntarily winding up and dissolving, and _____[*name of trustee*] (Trustee). The Trustee will administer and distribute the property held in trust, according to the terms of this Agreement.

1.02. **Irrevocability of Trust.** This trust is irrevocable. It may not be amended, revoked, or terminated, in whole or in part, except as otherwise specified in this Agreement.

1.03. **Term of Trust.** This trust terminates on _____[*specify date not more than five years from date of execution*].

1.04. **Trust Estate.** All property subject to this Agreement constitutes the "trust estate. The trust estate includes all shares of outstanding stock owned by the persons in the amount and percentage voting power as set forth in Exhibit A, attached to this Agreement.

[*Optional:*]

The Corporation also has the following assets, which also form part of the trust estate. Corporation may transfer additional assets to the trust: _____ [*specify*].

[*Continue with the following:*]

Corporation will execute and deliver to Trustee all instruments necessary to transfer these assets and title to the trust. The Trustee will collect payments on any promissory notes and accounts receivable on behalf of the Corporation. These payments will become a part of the trust estate.

1.05. **Appointment of Trustee.** _____[*name*] is appointed Trustee, to serve in accordance with the provisions of this Trust Agreement.

1.06. **Beneficiaries.** Holder of shares listed on Exhibit A are the beneficiaries (Beneficiaries) of this Trust.

Article 2. Purpose of Trust

2.01. **Completion of winding up.** The purpose of this trust is to administer the remaining assets of the dissolving Corporation to complete its winding up. Thereafter, the Trustee will distribute the Trust corpus in accordance with the provisions of this Trust.

Article 3: Recitals

3.01. **Election to wind up and dissolve.** On _____[*date*], persons holding at least 50 percent of the Corporation's outstanding voting stock elected to wind up and dissolve the Corporation, authorized the Corporation's board to adopt a plan of liquidation, and authorized the board and officers to take all necessary and proper actions to wind up the affairs of and dissolve the Corporation.

3.02. **Liquidation Activity.** On _____[*date*], the Board adopted a plan of liquidation; a certified copy of this plan is attached to this Agreement as Exhibit B. Pursuant to this plan, the Corporation has _____[*specify actions to liquidate corporation, e.g.*, sold real property located at _____ to _____ (*name of buyer*) for _____ (*specify consideration, e.g.*, cash in the amount of _____ and a promissory note in the amount of _____, accruing annual installments beginning on _____ [*date*])]. The proceeds from these actions include cash, accounts receivable, and promissory notes.

Article 4: Powers and Duties of Trustee

4.01. **Administration in Beneficiaries' Best Interests.** The trustee will hold and administer the trust estate in the best interests of the Beneficiaries and distribute the property described in Exhibit A, any other property that may be subject to this trust, and all income and proceeds attributable to that property, in accordance with the provisions of this Agreement.

4.02. **Additions to Trust.** The trustee will collect payments on any promissory notes and accounts receivable that are part of the trust estate on behalf of the Corporation. These payments will become a part of the trust estate and be administered in the best interests of the Beneficiaries.

4.03. **Powers of Trustee.** To carry out the purposes of this trust, and subject to any limitations stated elsewhere in this Agreement, the trustee has the power to do all of the following:

(a) Collect installments on all promissory notes and accounts receivable that are part of the trust estate. The Trustee will retain a portion of these payments to cover reasonably estimated trust expenses and any obligations of the trust. All

other funds will be distributed pro rata to each Beneficiary in accordance with Exhibit A _____ [*specify time of distribution, e.g.,* quarterly *or* as soon as practical after receipt].

(b) Hold all assets other than cash, promissory notes, and accounts receivable for distribution to the Beneficiaries, on the terms and at the time that the Trustee determines is in the best interests of the Beneficiaries.

(c) Take any and all actions to collect on any defaults on any note or account receivable, including filing suit or accelerating the entire balance due under the instrument. The trustee will be entitled to reasonable expenses, including attorneys' fees, in connection with any enforcement action.

(d) Preparing and filing all state and federal tax returns required to be filed by the trust.

(e) Preparing, filing with appropriate authorities, and mailing to each Beneficiary listed on Exhibit A annual information returns, setting forth each Beneficiary's share of the trust's net income.

(f) Maintaining books and records of all transactions.

(g) Furnishing an annual accounting to each Beneficiary stating the trust's remaining assets, gross income, and gross disbursements other than distributions to Beneficiaries.

(h) Paying any and all obligations of the trust, including trustee compensation as set forth in Paragraph 4.05.

(i) Preparing a final account on termination of the trust. The Trustee has broad authority to carry out the purposes of this trust and need not secure the consent of the Beneficiaries to any acts authorized by this Agreement.

4.04. **Limitations on Trustee's Powers.** The Trustees' activities are limited to the collection, enforcement, and distribution of trust assets. The trustee may not conduct any business of any nature on behalf of the trust estate.

4.05. **Compensation of Trustee.** The trustee is entitled to reasonable compensation for services rendered in administering this trust, payable without court order.

4.06. **Trustee Expenses.** The trust estate will pay all expenses of Trustee incurred in carrying out the purpose of this trust. These expenses include, without limitation, the Trustee's compensation, taxes, attorney fees, fees for other professional advice, and costs of collecting, selling, and conveying any and all portions of the trust estate.

4.07. **Liability of Trustee.** The Trustee is not liable for any distribution made in accordance with the shareholders' percentage interests, as set forth in Exhibit A. Further, the Trustee is not liable for any act or omission specifically authorized by this Agreement. The Trustee will be liable for any acts of willful misconduct or gross negligence.

4.08. **Successor Trustee.** If the office of trustee becomes vacant by reason of death, incapacity, or any other reason, and no successor trustee or co-trustees have been designated under any other provisions of this trust instrument, then _____[*name*] will be successor trustee. If _____[he *or* she] is unwilling or unable to serve as successor trustee, a new trustee or co-trustees will be appointed by the court.

Article 5: Miscellaneous Provisions

5.01. **Severability Clause.** If any provision of this instrument is invalid, that provision shall be disregarded, and the remainder of this instrument shall be construed as if the invalid provision had not been included.

5.02. **California Law to Apply.** All questions concerning the validity, interpretation, and administration of this instrument, including any trusts created under this instrument, shall be governed by the laws of the State of California, regardless of the domicile of any trustee or beneficiary.

5.03. **Execution.** The trustee hereby approves this instrument and accepts the trusts provided for in it, certifying that it correctly states the terms and conditions under which the trust estate is to be held, administered, and distributed.

Executed on _____[*date*], at _____ [*location*].

In witness whereof, the parties have executed this Agreement on _____[*date*].

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name*], President
TRUSTEE
_____ [*signature of trustee*]
[*typed name*], Trustee

[*For acknowledgment, see § 12.225.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding UpBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsShareholder RightsBusiness & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpDistribution of AssetsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
B. Domestic Nonprofit Corporations

5-12 California Legal Forms--Transaction Guide § 12.281

§ 12.281 Final Quarterly Wage and Withholding Report [EDD Form DE-6]

[1] Comment

[a] Use of Form

This is EDD Form DE-6, the quarterly wage and withholding report that an employer must file on discontinuing business. It may be filled in online and printed out by going to the Payroll Taxes-Forms and Publications page of the Employment Development Department (EDD) website at http://www.edd.ca.gov/Payroll_Taxes/Forms_and_Publications.htm . The form is also available from any district office of the EDD. The official EDD instructions to Form DE-6 and the EDD checklist for completing Form DE 6 (EDD Form DE 6CL) are also reproduced here, along with the text of the form itself. Form DE-7 [*see § 12.282*], the reconciliation of income tax withheld, must be filed at the same time as this form.

[b] Filing and Payment Requirements

Within 10 days after the earlier of commencing dissolution proceedings or "quitting business," every domestic corporation must file a final contribution return and report of wages of its employees with the EDD [*Unemp. Ins. Code § 1116(a)(2)*]. "Quitting business" does not include any change in the form or membership of the employer if before and after the change, 50 percent or more of the control of management is held by the same individual, or is held by an individual before death and after death by his or her estate or heirs [*Unemp. Ins. Code § 1116(a)(4)*].

The EDD requires that form DE-6 be used to make the report mentioned above [*see* EDD California Employer's Guide, Pub. No. DE 44]. When completing the form, Box D must be checked to indicate that this is a final report. The form should be mailed to the EDD, addressed as follows:

State of California
Employment Development Department
P.O. Box 826288
Sacramento, CA 94230-2688

Note that Form DE-7, which is also required, should be sent to a different post office box address [*see § 12.282*]; thus, the two forms should not be sent under the same cover. Magnetic media filing requires prior approval, which may be obtained from the EDD Magnetic Media Coordinator, P.O. Box 942840, Sacramento, CA 94280-0001, (916) 654-6845 [*see* EDD California Employer's Guide, Pub. No. DE 44].

The corporation must also pay contributions with respect to the return within 10 days of quitting business [*Unemp. Ins. Code § 1116(b)*]. These payments should be made using the standard payroll tax deposit coupons supplied by the EDD [*see* EDD California Employer's Guide, Pub. No. DE 44]. Form DE-6 and the payroll tax payment may be submitted together, but if they are mailed together they must be mailed to the payroll tax deposit coupon mailing address instead of the address listed for Form DE-6 in the preceding paragraph. Address labels are located in the back of the payroll tax booklet [*see* EDD California Employer's Guide, Pub. No. DE 44]. A 10-percent penalty, plus interest, accrues for delinquent payments [*Unemp. Ins. Code §§ 1112, 1113*; *see Rev. & Tax. Code § 19521* (computation of interest)]. The 10 percent penalty also applies to payments that, although required to be submitted electronically, an employer submits by means other than an electronic funds transfer without good cause [*Unemp. Ins. Code § 1112(b)*]. For good cause, however, the EDD may extend for 30 days the time in which the corporation may file a return or pay any amount due without penalty or interest [*Unemp. Ins. Code § 1116(c)*].

For further coverage of unemployment contribution procedures on termination of a business, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

[2] FORM

Final Quarterly Wage and Withholding Report

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewLabor & Employment LawDisability & Unemployment InsuranceUnemployment CompensationCoverage & DefinitionsLabor & Employment LawWage & Hour LawsRecordkeeping RequirementsLabor & Employment LawWage & Hour LawsStatutory ApplicationGeneral OverviewTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12 WINDING UP AND DISSOLUTION
PART IV. FORMS
B. Domestic Nonprofit Corporations

5-12 California Legal Forms--Transaction Guide § 12.282

§ 12.282 Final Annual Reconciliation Statement [EDD Form DE-7]

[1] Comment

[a] Use of Form

This is EDD Form DE-7, the annual reconciliation statement that an employer must file on discontinuing business. It may be filled in online and printed out by going to the Payroll Taxes - Forms and Publications page of the Employment Development Department (EDD) website at http://www.edd.ca.gov/Payroll_Taxes/Forms_and_Publications.htm . It is also available from any district office of the EDD. Form DE-6 [*see § 12.281*], the final quarterly wage and withholding report, must be filed at the same time as this form.

The purpose of this form is to reconcile the payments submitted during the year for state disability insurance (SDI) and personal income tax (PIT) withheld as required by law, and employer payments of unemployment insurance tax and employment training tax [*see* EDD California Employer's Guide, Pub. No. DE 44].

[b] Filing and Transmittal Requirements

Employers quitting business must file Form DE-7 within 10 days of quitting business, regardless of the usual reporting period due date [*see* EDD California Employer's Guide, Pub. No. DE 44]. Box B in the form must be checked to indicate that it is a final return. The form should be mailed to the EDD, addressed as follows:

```
State of California
Employment Development Department
P.O. Box 826286
Sacramento, CA 94230-2688
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Payroll tax payments are required and should be sent separately [*see* EDD California Employer's Guide, Pub. No. DE 44]. Employee W-2 forms should not be sent to EDD [*see* EDD California Employer's Guide, Pub. No. DE 44]. Magnetic media filing requires prior approval, which may be obtained from the EDD Magnetic Media Coordinator,

P.O. Box 942840, Sacramento, CA 94280-0001, (916) 654-6845 [*see* EDD California Employer's Guide, Pub. No. DE 44].

For further coverage of unemployment contribution procedures on termination of a business, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

[2] FORM

Final Annual Reconciliation Statement

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipTermination & Winding UpGeneral OverviewLabor & Employment LawDisability & Unemployment InsuranceUnemployment CompensationCoverage & DefinitionsLabor & Employment LawWage & Hour LawsWage PaymentsLabor & Employment LawWage & Hour LawsRecordkeeping RequirementsTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS

5-12A California Legal Forms--Transaction Guide 12A.syn

§ 12A.syn Synopsis to Chapter 12A: PROFESSIONAL CORPORATIONS

§ 12A.01 California Sources

[1] Statutes

[2] Regulations

§ 12A.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 12A.03-12A.04 [Reserved]

§ 12A.05 Law Reviews and Periodicals

§ 12A.06 Annotations

§ 12A.07 Matthew Bender Sources

§§ 12A.08-12A.09 [Reserved]

§ 12A.10 Governing Law

[1] Multiple Statutes Govern Professional Corporations

[2] Moscone-Knox Professional Corporation Act

[a] Definitions

[b] Corporations Not Covered by Act

[c] Professional Law Corporation May Incorporate as Nonprofit Public Benefit Corporation

§ 12A.11 Professionals Eligible to Incorporate

§ 12A.12 Restrictions on Corporate Practice of Multiple Professions

§ 12A.13 Advantages and Disadvantages of Incorporation

[1] Limitation of Liability Issues

[2] Other Corporate Features

[3] Federal Taxation Issues

§ 12A.14 Corporate Formation

[1] Restrictions on Corporate Names

[a] Permissible Names Determined by Regulating Agency

[b] Affidavit of Compliance With Agency Requirements

[c] Qualified Foreign Professional Corporations

[2] Articles of Incorporation

[3] Bylaws

[4] Director, Officer, and Shareholder Requirements

[5] Registration With Licensing Board

[a] Certificate of Registration Required Unless Exempt

[b] Registration Procedure Determined by Regulating Agency

[c] Registration Procedure for Law Corporations

[d] Registration Procedure for Accountancy Corporations

[6] Allied Professionals

[7] Fictitious Name Permits

§ 12A.15 Restrictions on Issuance and Transfer of Shares

[1] Transfer Restricted to Licensed Persons, Shareholders, and Allied Professionals

[2] Repurchase of Shares

§ 12A.16 Operating Requirements

[1] Malpractice Insurance

[2] Covenants Not to Compete

[3] Reporting Requirements

[a] Law Corporations

[b] Accountancy Corporations

§ 12A.17 Observing Corporate Formalities

§ 12A.18 Suspension or Revocation of Certificate of Registration

§ 12A.19 Securities Issues

[1] Federal Law

[2] California Law

§ 12A.20 Dissolving Professional Corporations

§ 12A.21 Federal Taxation of Professional Corporations

[1] Tax Aspects of Incorporation

[a] Incorporation Is Ordinarily Tax-Free

[b] Corporate Assumption of Liabilities May Result in Taxable Gain

[c] Taxation as Corporation

[2] Incorporation Presents Limited Tax Advantages

[a] Corporate Employees Enjoy Some Tax Advantages

[b] Group Term Life Insurance

[c] Health and Accident Insurance Plans

[d] Medical Reimbursement Plans

[i] Basic Requirements

[ii] Excess Reimbursement

[e] Disability Insurance

[f] Loans to Participants in Corporate Plans

[g] Limitations on Plan Contributions

[h] Benefits are Equally Portable

[3] Income Taxation of Professional Corporations

[a] Professional Corporations Taxed at 35 Percent Flat Rate

[b] Taxable Year

[c] Method of Accounting

[d] Deferred Compensation

[e] Death Benefits

[4] Potential Tax Disadvantages to Incorporating Professional Practices

[a] Problems Involving Unreasonable Compensation

[b] Penalty Tax on Personal Holding Companies

[c] Accumulated Earnings Tax

[d] Reallocation Under I.R.C. § 269A

§ 12A.22 California Taxation

§§ 12A.23-12A.99 [Reserved]

§ 12A.100 Facts

Scope

§ 12A.101 Documents

Scope

§§ 12A.102-12A.109 [Reserved]

§ 12A.110 Non-Tax Considerations Affecting Incorporation

Scope

§ 12A.111 Tax Considerations Affecting Incorporation

Scope

§§ 12A.112-12A.119 [Reserved]

§ 12A.120 Forming a Professional Corporation

Scope

§ 12A.121 Issuing Securities

Scope

§§ 12A.122-12A.129 [Reserved]

§ 12A.130 Maintaining Corporate Status

Scope

§§ 12A.131-12A.199 [Reserved]

§ 12A.200 Articles of Incorporation for Professional Corporation

[1] Comment

[a] Use of Form

[b] Required Provisions

[c] Optional Provisions

[d] Corporate Name

[e] Signature and Acknowledgment

[f] Filing

[g] Commencement of Practice

[2] FORM

Articles of Incorporation for Professional Corporation

§ 12A.201 Affidavit of Compliance With Corporate Name Requirements--By Licensed Person

[1] Comment--Use of Form

[2] FORM

Affidavit of Compliance With Corporate Name Requirements-By Licensed Person

§ 12A.202 Affidavit of Compliance With Corporate Name Requirements--By Attorney

[1] Comment--Use of Form

[2] FORM

Affidavit of Compliance With Corporate Name Requirements--By Attorney

§ 12A.203 Bylaws for Professional Corporation

[1] Comment

[a] Use of Form

[b] Restrictions Regarding Officers

[c] Directors of Medical Corporations

[d] Indemnification of Officers and Directors

[e] Sole Shareholder Corporations

[2] FORM

Bylaws for Professional Corporation

§ 12A.204 Minutes of First Meeting--Action by Written Consent of Directors

[1] Comment--Use of Form

[2] FORM

Minutes of First Meeting--Action by Written Consent of Directors

§ 12A.205 Letter Offer Transferring Assets of Professional Practice to Professional Corporation

[1] Comment

[a] Use of Form

[b] Tax-Free Incorporation

[2] FORM

Letter Offer Transferring Assets of Professional Practice to Professional Corporation

§§ 12A.206-12A.219 [Reserved]

§ 12A.220 Buy-Sell Agreement

[1] Comment

[a] Use of Form

[b] Problems Involving Transfer of Stock in Professional Corporations

[2] FORM

Buy-Sell Agreement

§ 12A.221 Share Purchase Agreement

[1] Comment--Use of Form

[2] FORM

Share Purchase Agreement

§§ 12A.222-12A.229 [Reserved]

§ 12A.230 Employment Agreement

[1] Comment--Use of Form

[2] FORM

Employment Agreement

§ 12A.231 Medical Reimbursement and Wage Continuation Plan

[1] Comment

[a] Use of Form

[b] Tax Consequences of Medical Reimbursement Plan

[c] Tax Consequences of Wage Continuation Plans

[2] FORM

Medical Reimbursement and Wage Continuation Plan

§ 12A.232 Medical Diagnostic Plan

[1] Comment

[a] Use of Form

[b] Types of Covered Expenses

[2] FORM

Medical Diagnostic Plan

§ 12A.233 Deferred Compensation Agreement

[1] Comment

[a] Use of Form

[b] Tax Consequences

[c] Reasonable Compensation

[2] FORM

Deferred Compensation Agreement

§ 12A.234 Client Memorandum for Professional Corporation

[1] Comment--Use of Form

[2] FORM

Client Memorandum for Professional Corporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS

5-12A California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter covers the incorporation of professionals under the Moscone-Knox Professional Corporation Act [*see Corp. Code § 13400 et seq.*] and the General Corporation Law [*see Corp. Code § 100 et seq.*]. The chapter covers the formation and operation of professional corporations. The chapter also includes a general discussion of the basic tax-saving plans and techniques that may be used by a professional corporation.

The chapter contains checklists and the forms necessary to incorporate. It also includes shareholder agreements, employee agreements, and employee benefit compensation plans applicable to professional corporations. For other employment contracts, see Ch. 85, *Employment Agreements* . For coverage of shareholder agreements generally, see Ch. 8C, *Close Corporation Shareholder Agreements* .

The formation and dissolution of professional partnerships are covered in Ch. 15, Part A, *Formation of General Partnerships* and Ch. 15, Part B, *Dissolution of General Partnerships* . The formation and dissolution of limited liability partnerships are covered in Ch. 16C, *Limited Liability Partnerships* .

For a detailed discussion of corporate tax planning and corporate taxation, see Cavitch, Business Organizations With Tax Planning (Matthew Bender).



100 of 146 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

5-12A California Legal Forms--Transaction Guide § 12A.01

§ 12A.01 California Sources

[1] Statutes

Chiropractic Act. *Bus. & Prof. Code § 1000 et seq.*

State Board of Chiropractic Examiners, establishment and duties regulating chiropractors. Bus. & Prof. Code, App., § 1.

License to practice chiropractic medicine; authorized acts. Bus. & Prof. Code, App., § 5.

Chiropractic corporations. *Bus. & Prof. Code § 1050 et seq.*

Definitions. *Bus. & Prof. Code § 1050.*

Application for registration. *Bus. & Prof. Code § 1051.*

Corporate reports. *Bus. & Prof. Code § 1053.*

Name of corporation restricted to names of shareholders. *Bus. & Prof. Code § 1054.*

Officers, directors, and shareholders required to be licensed persons. *Bus. & Prof. Code § 1055.*

Dental Practice Act. *Bus. & Prof. Code § 1600 et seq.*

Dental Board of California administers Dental Practice Act. *Bus. & Prof. Code § 1601.1.*

Multiple offices, conditions for allowing. *Bus. & Prof. Code § 1658.1 et seq.*

Dental corporations. *Bus. & Prof. Code § 1800 et seq.*

Name must be name of one or more shareholders. *Bus. & Prof. Code § 1804*.

Officers, directors, and shareholders required to be licensed dentists. *Bus. & Prof. Code § 1805*.

Medical Practice Act. *Bus. & Prof. Code § 2000 et seq.*

Administrative provisions creating Medical Board of *California. Bus. & Prof. Code §§ 2000-2029*.

Osteopathic licensing requirements. *Bus. & Prof. Code § 2099.5*.

Suspension or revocation of license on finding of unprofessional conduct. *Bus. & Prof. Code § 2227*.

Action must be taken against licensee charged with unprofessional conduct. *Bus. & Prof. Code § 2234.*

Fictitious name use without fictitious name permit is unprofessional conduct. *Bus. & Prof. Code § 2285*.

Violation of professional corporation statutes or regulations is unprofessional conduct. *Bus. & Prof. Code § 2286*.

Medical corporations. *Bus. & Prof. Code § 2400 et seq.*

Medical corporation defined and governed by Division of Licensing. *Bus. & Prof. Code § 2406*.

Application of provisions of fictitious business names. *Bus. & Prof. Code § 2407*.

License requirements for shareholders, directors, and officers. *Bus. & Prof. Code § 2408*.

Income from professional services not to accrue to disqualified shareholder. *Bus. & Prof. Code § 2409*.

Unprofessional conduct. *Bus. & Prof. Code §§ 2410, 2411*.

Osteopathic corporations subject to provisions except when inconsistent with specific provisions regulating osteopathic corporations. *Bus. & Prof. Code § 2413*.

Fictitious name permits. *Bus. & Prof. Code § 2415*.

Fictitious name permit fees. *Bus. & Prof. Code § 2443*.

Podiatrists, licensing and supervision by California Board of Podiatric Medicine. *Bus. & Prof. Code §§ 2460-2499.8*.

Speech-Language Pathologists and Audiologists Licensure Act. *Bus. & Prof. Code § 2530 et seq.*

Speech-language pathology, definition of practice. *Bus. & Prof. Code § 2530.2(d)*.

Audiology, definition of practice. *Bus. & Prof. Code § 2530.2(k)*.

License required. *Bus. & Prof. Code § 2532*.

Suspension or revocation of license of speech-language pathologist or audiologist for unprofessional conduct. *Bus. &*

Prof. Code § 2533.

Speech-language pathology corporations and audiology corporations. *Bus. & Prof. Code § 2536 et seq.*

Speech-language pathology or audiology corporation defined and governed by Speech Pathology and Audiology Examining Committee. *Bus. & Prof. Code § 2536*.

Violation of professional corporation statutes or regulations is unprofessional conduct by licensed speech-language pathologist or audiologist. *Bus. & Prof. Code §§ 2537, 2537.1*.

License required. *Bus. & Prof. Code § 2537.2*.

Name of speech-language pathology corporation must include titles set forth in *Bus. & Prof. Code § 2530.3(a)* and term "corporation" or wording or abbreviations denoting corporate existence. *Bus. & Prof. Code § 2537.4(a)*.

Name of audiology corporation must include titles set forth in *Bus. & Prof. Code § 2530.3(b)* and term "corporation" or wording or abbreviations denoting corporate existence. *Bus. & Prof. Code § 2537.4(b)*.

Speech-language pathology assistant. *Bus. & Prof. Code § 2538 et seq.*

Physical Therapy Practice Act. *Bus. & Prof. Code § 2600 et seq.*
Physical therapy defined. *Bus. & Prof. Code § 2620*.
License required to practice physical therapy. *Bus. & Prof. Code § 2630*.
Licensee is registered physical therapist licensed by Physical Therapy Board of *California. Bus. & Prof. Code § 2632*.
Suspension or revocation of physical therapist's license for violation of Physical Therapy Practice Act or State Medical Practice Act. *Bus. & Prof. Code § 2660*(*i*).

Physical therapy corporations. *Bus. & Prof. Code § 2690 et seq.*
Violation of professional corporation statutes or regulations is violation of Physical Therapy Act. *Bus. & Prof. Code § 2691*.
Name of physical therapy corporation must contain words "physical therapy" or "physical therapist." *Bus. & Prof. Code § 2693*.

Nursing corporations. *Bus. & Prof. Code § 2775 et seq.*
Unprofessional conduct. *Bus. & Prof. Code §§ 2776, 2777*.
Name requirements. *Bus. & Prof. Code § 2778*.

Psychology Licensing Law. *Bus. & Prof. Code § 2900 et seq.*
Names and titles indicating practice of psychology. *Bus. & Prof. Code § 2902(c)*.
Practice of psychology defined. *Bus. & Prof. Code § 2903*.
Psychological professional corporation allowed to practice psychology. *Bus. & Prof. Code § 2907.5*.
Suspension or revocation of license for violation of Psychological Licensing law or applicable regulations. *Bus. & Prof. Code § 2960(k)*.

Psychological corporations. *Bus. & Prof. Code § 2995 et seq.*
Violation of Psychological Licensing Law and unprofessional conduct violate professional corporations statutes and regulations. *Bus. & Prof. Code §§ 2996, 2996.1*.
Officers and directors must be licensed persons capable of being shareholders. *Bus. & Prof. Code § 2997*.
Name of psychological corporation required to contain name or title listed by statute. *Bus. & Prof. Code § 2998*.

Optometry, licensing and regulation of practice. *Bus. & Prof. Code § 3000 et seq.*
State Board of Optometry, creation and administration. *Bus. & Prof. Code §§ 3010-3029.*
Certificate of registration required for practice of optometry by any person. *Bus. & Prof. Code § 3040.*
Optometry defined. *Bus. & Prof. Code § 3041.*
Fictitious name permit from State Board of Optometry required for practice under false or assumed name. *Bus. & Prof. Code § 3078.*

Optometric Corporations. *Bus. & Prof. Code § 3160 et seq.*
Optometric corporation defined. *Bus. & Prof. Code § 3160.*
Name of corporation required to contain name of one or more shareholders. *Bus. & Prof. Code § 3163.*
Directors, shareholders, and officers required to be licensed optometrists. *Bus. & Prof. Code § 3164.*

Pharmacy. Corp. Code § 4000 et seq.
Pharmacy corporations. *Bus. & Prof. Code § 4150.*
Name requirements. *Bus. & Prof. Code § 4152.*
Unprofessional conduct. *Bus. & Prof. Code § 4156.*

Veterinary Medicine. *Bus. & Prof. Code § 4800 et seq.*

License required. *Bus. & Prof. Code §§ 4825, 4828.*

Practice defined. *Bus. & Prof. Code § 4826.*

Veterinary corporations. *Bus. & Prof. Code § 4910 et seq.*

Name requirements. *Bus. & Prof. Code § 4911.*

License requirements. *Bus. & Prof. Code § 4912.*

Unprofessional conduct. *Bus. & Prof. Code §§ 4914, 4915.*

Acupuncture Licensure Act. *Bus. & Prof. Code § 4925 et seq.*

Acupuncture Certification Act. *Bus. & Prof. Code § 4935 et seq.*

Suspension or revocation of license for unprofessional conduct. *Bus. & Prof. Code § 4955.*

Acupuncture corporations. *Bus. & Prof. Code § 4975 et seq.*

Acupuncture corporation governed by Acupuncture Committee. *Bus. & Prof. Code § 4975.*

Violation of professional corporation statutes or regulations is unprofessional conduct. *Bus. & Prof. Code § 4976.*

Shareholders, officer, and directors required to be licensed acupuncturists. *Bus. & Prof. Code § 4977.2.*

Name of acupuncture corporation, requirements. *Bus. & Prof. Code § 4978.*

Marriage, family, and child counselors, licensing and regulation of practice. *Bus. & Prof. Code § 4980 et seq.*

Marriage, family, and child counseling corporations. *Bus. & Prof. Code § 4987.5 et seq.*

Social workers, licensing and regulation of practice. *Bus. & Prof. Code § 4990 et seq.*

Licensed clinical social workers corporations. *Bus. & Prof. Code § 4998 et seq.*

Accountancy Act regulating practice of public accounting in *California. Bus. & Prof. Code § 5000 et seq.*

Public accounting, acts constituting. *Bus. & Prof. Code § 5051*.

Certified public accountant, title and designation. *Bus. & Prof. Code § 5055*.

Public accountants, title and designations. *Bus. & Prof. Code § 5056*.

No person or firm may use title or designation in connection with "certified public accountant" or "public accountant" that is false and misleading. *Bus. & Prof. Code § 5058.1*.

No person or firm may practice public accountancy under name that is false or misleading or other than that on valid permit. *Bus. & Prof. Code § 5060*.

Public accountancy permits and certificates, issuance to certified public accountants and others. *Bus. & Prof. Code § 5070*.

Accountancy corporations. *Bus. & Prof. Code § 5150 et seq.*

Application for registration as an accountancy corporation, requirements. *Bus. & Prof. Code § 5151*.

Officers, directors, and shareholders required to be licensed persons. *Bus. & Prof. Code § 5154*.

Unprofessional conduct. *Bus. & Prof. Code § 5156*.

Architects Practice Act. *Bus. & Prof. Code § 5500 et seq.*

License required. *Bus. & Prof. Code § 5536*.

License renewal. *Bus. & Prof. Code § 5600.2*.

Architectural corporations. *Bus. & Prof. Code § 5610 et seq.*

Name requirements. *Bus. & Prof. Code § 5610.3*.

Unprofessional conduct. *Bus. & Prof. Code § 5610.6*.

Law corporations. *Bus. & Prof. Code §§ 6127.5, 6160 et seq.*

Application requirements. *Bus. & Prof. Code § 6161*.

Annual renewal of registration. *Bus. & Prof. Code § 6161.1*.

Shorthand reporters, regulation and licensing. *Bus. & Prof. Code § 8000 et seq.*

Certified Shorthand Reporters Board, creation and composition. *Bus. & Prof. Code §§ 8000-8010*.

Certificate as certified shorthand reporter required to engage in practice of shorthand reporting. *Bus. & Prof. Code § 8016*.

Practice of shorthand reporting defined. *Bus. & Prof. Code § 8017*.

Shorthand reporting corporations. *Bus. & Prof. Code § 8040 et seq.*

Definition and identification of governing agency. *Bus. & Prof. Code § 8040*.

Name of corporation restricted to names of shareholders or names in prior organization. *Bus. & Prof. Code § 8043*.

Officers, directors, and shareholders required to be licensed persons. *Bus. & Prof. Code § 8044*.

General invalidity of contract restraints on practice of lawful profession, trade, or business. *Bus. & Prof. Code § 16600*.

Permissible use of noncompetition agreements on sale of corporate shares. *Bus. & Prof. Code § 16601*.

General Corporation Law. *Corp. Code §§ 100-2319*.

Organization and bylaws. *Corp. Code §§ 200-213*.

Directors and management. *Corp. Code §§ 300-318*.

Moscone-Knox Professional Corporation Act. *Corp. Code § 13400 et seq.*

Definitions. *Corp. Code § 13401*.

Corporate practice of multiple professions. *Corp. Code § 13401.5*.

Applicability of General Corporation Law. *Corp. Code § 13403*.

Certificate of registration. *Corp. Code § 13404*.

Services authorized by the Yacht and Ship Brokers Act. *Harb. & Nav. Code § 700 et seq.*

[2] Regulations

Accountancy Act regulations governing practice of public accountancy in California. *16 Cal. Code Reg. § 1 et seq.*

State Board of Chiropractic Examiners' regulations. *16 Cal. Code Reg. § 301 et seq.*

Regulations of Board of Dental Examiners. *16 Cal. Code Reg. § 1000 et seq.*

Medical practice regulations governing medical doctors and podiatrists. *16 Cal. Code Reg. § 1300 et seq.*

Psychology and psychological corporation regulations. *16 Cal. Code Reg. § 1380 et seq.*

Physical therapy regulations. *16 Cal. Code Reg. § 1398 et seq.*

Speech pathology and audiology corporation regulations. *16 Cal. Code Reg. § 1399.190 et seq.*

Acupuncture regulations. *16 Cal. Code Reg. § 1399.400 et seq.*

State Board of Optometry regulations. *16 Cal. Code Reg. § 1501.1 et seq.*

Medical corporation rules governing osteopathic corporations. *16 Cal. Code Reg. § 1600 et seq.*

Board of Behavioral Science Examiners regulations. *16 Cal. Code Reg. § 1802 et seq.*

Certified shorthand reporters regulations. *16 Cal. Code Reg. § 2400 et seq.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

5-12A California Legal Forms--Transaction Guide § 12A.02

§ 12A.02 Federal Sources

[1] Statutes

Federal employee death benefits; contributions by employer to accident and health plans. *I.R.C. § 106*.

Qualified pension, profit-sharing, and stock bonus plans, generally. *I.R.C. § 401*.

Taxability of beneficiary of employees' trust. *I.R.C. § 402*.

Taxation of employees' annuities. *I.R.C. § 403*.

Deductions for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan. *I.R.C. § 404*.

Taxable year of personal service corporation. *I.R.C. §§ 441*(*i*), 444.

Exemption from income tax on earnings of pension and profit-sharing plan trusts. *I.R.C. § 501*.

Personal holding companies. *I.R.C. §§ 541-547*.

[2] Regulations

Taxability of proceeds from employee's life insurance. *Treas. Reg. § 1.101-1(a)(1)*.

Reasonable compensation. *Treas. Reg. § 1.162-7(b)(3)*.

Deductibility of payments to employee health plans. *Treas. Reg. § 1.162-10(a)*.

Contributions to retirement account. *Treas. Reg. § 1.404(a)-1*.

Employee withholding tax. *Treas. Reg. § 31.3402(g)-1(a)(2)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

5-12A California Legal Forms--Transaction Guide §§ 12A.03-12A.04

[Reserved]

§§ 12A.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-12A California Legal Forms--Transaction Guide § 12A.05

§ 12A.05 Law Reviews and Periodicals

Comment, Optional Cumulative Voting & Staggered Terms of Directors: Is the California Climate Warming to Corporations? *27 San Diego L. Rev. 467* (March-April 1990).

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-12A California Legal Forms--Transaction Guide § 12A.06

§ 12A.06 Annotations

Annot., Ownership Interest in Employer Business as Affecting Status as Employee for Workers' Compensation Purposes, 78 A.L.R.4th 973 (1990) .

Annot., Workers' Compensation: Third-Party Tort Liability of Corporate Officer to Injured Workers, 76 A.L.R.4th 365 (1990) .

Annot., Issues Pertaining to Ownership of Professional Corporation as Affected by Resignation from Corporate Practice by Active Shareholder, 32 A.L.R.4th 921 (1984) .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-12A California Legal Forms--Transaction Guide § 12A.07

§ 12A.07 Matthew Bender Sources

CALIFORNIA LEGAL FORMS (Matthew Bender).

Ch. 1A, *Role of Counsel in Starting a New Business* .

Ch. 1B, *Selecting Form of Business Entity* .

Ch. 1E, *Taxation of Businesses* .

Ch. 2, *Formation of Corporations* .

Ch. 2A, *Incorporating a Going Business* .

Ch. 3, *Articles of Incorporation* .

Ch. 4, *Bylaws* .

Ch. 5, *Director's Meetings, Actions, and Resolutions* .

Ch. 7, *Corporate Records and Reports* .

Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* .

Ch. 8D, *Buy-Sell Agreements* .

Ch. 10, *Amendment of Articles* .

Ch. 12, *Winding Up and Dissolution* .

Ch. 16C, *Limited Liability Partnerships* .

Ch. 17, *Buying or Selling a Business or Professional Practice* .

Ch. 85, *Employment Agreements* .

Cavitch, Business Organizations With Tax Planning (Matthew Bender), Ch. 3, *Tax Factors in Choosing a Form of Business Organization* (Matthew Bender).

Eaton, Business Organizations, Professional Corporations and Associations (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

5-12A California Legal Forms--Transaction Guide §§ 12A.08-12A.09

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§§ 12A.08[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.10

§ 12A.10 Governing Law

[1] Multiple Statutes Govern Professional Corporations

Professional corporations are governed by three sets of California statutes and by regulations promulgated by the state agencies that regulate the services rendered by the various types of professional corporations:

- The Moscone-Knox Professional Corporation Act (Professional Corporation Act) [*see Corp. Code § 13400 et seq.*] authorizes the formation of professional corporations and sets forth the general law applicable to professional corporations [*see* [2], *below*].

- The Business and Professions Code contains separate sets of provisions for every profession that may incorporate. These provisions state the requirements for the particular types of professional corporations and authorize the state agencies regulating the professions to adopt rules covering professional corporations under their respective jurisdictions. Title 16 of the California Code of Regulations contains all rules of this type, with the exception of the Law Corporation Rules of the State Bar. It is critical to consult these rules when forming a professional corporation because they regulate matters such as corporate names, annual reports, and the practice of multiple professions [*see § 12A.01[2]*].

- The General Corporation Law [*see Corp. Code § 100 et seq.*] governs professional corporations except in instances when its provisions are inconsistent with those of the Professional Corporation Act [*Corp. Code § 13403*]. The General Corporation Law governs most aspects of formation, operation, and dissolution of professional corporations.

Professional corporations formed under the General Corporation Law may take advantage of the close corporation provisions in that law [*see Corp. Code § 158*]. Articles of incorporation for close corporations must contain special provisions and share certificates must contain a special legend [*see Corp. Code § 186*; *see also* Ch. 8C, *Close Corporation Shareholder Agreements*]. The shareholders' agreement is probably the most important document regulating the affairs of a close corporation. The attorney drafting a shareholders' agreement for a closely held

professional corporation must ensure that it complies with the Professional Corporation Act.

Because the provisions of the Professional Corporation Act prevail over inconsistent or conflicting provisions of the General Corporation Law, the shareholders' agreement cannot waive those provisions. For example, the General Corporation Law provides that requirements applicable to officers of the corporation [*see Corp. Code § 312*] may be waived by a shareholder agreement [*see Corp. Code § 300(c)*]. However, the Professional Corporation Act specifies that certain officers must exist, and this requirement may not be waived with respect to a professional corporation.

[2] Moscone-Knox Professional Corporation Act

[a] Definitions

The Moscone-Knox Professional Corporation Act (Professional Corporation Act) [*see Corp. Code § 13400 et seq.*] contains several important definitions:

- "Professional services" are defined as any type of professional services that may be rendered only under a license, certification, and/or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act, or the Yacht and Ship Brokers Act [*Corp. Code §§ 13401(a), 13401.3*; *see* Bus. & Prof. Code, App., §§ 1-20].

- "Professional corporations" are defined as corporations organized under the General Corporation Law (or a professional law corporation organized as a nonprofit public benefit corporation) [*see Corp. Code § 13406(b)*] that is engaged in rendering professional services in a single profession under a certificate of registration issued by its governing agency and that designates itself as a professional corporation [*Corp. Code § 13401(b)*]. However, there are limited statutory exceptions to the single profession restriction [*see Corp. Code § 13401.5*; *see also § 12A.14[6]*]. Furthermore, there are no certification requirements for medical, osteopathic, dental, pharmacy, veterinary, architectural, court reporter, behavioral sciences, or nursing corporations [*see Corp. Code § 13401(b)*; *see also Bus. & Prof. Code § 2406*].

- A "licensed person" is any natural person licensed to render the same professional services as are rendered by the professional corporation of which he or she is an officer, director, shareholder, or employee [*Corp. Code § 13401(d)*].

- A "disqualified person" is a licensed person who becomes legally disqualified (temporarily or permanently) to render the professional services that the professional corporation renders [*see Corp. Code § 13401(e)*].

[b] Corporations Not Covered by Act

The Professional Corporation Act does not apply to corporations that are authorized to render professional services under other laws. In other words, such a corporation is not a professional corporation within the meaning of the Professional Corporation Act [*Corp. Code § 13402(a)*]. For example, realtors and engineers are separately authorized to render professional services in the corporate form [*see Bus. & Prof. Code § 6738* (engineers); *see also Bus. & Prof. Code §§ 10006, 10150-10159.2*] and are not governed by the Professional Corporation Act.

If a corporation that is not a professional corporation conducts a business pursuant to a license or registration issued under any state law (except a law relating to taxation), the business will not be deemed the business of a professional corporation, regardless of whether a professional corporation could conduct the same business, or parts of it [*Corp. Code § 13402(b)*].

[c] Professional Law Corporation May Incorporate as Nonprofit Public Benefit Corporation

A professional law corporation may be incorporated as a nonprofit public benefit corporation under the Nonprofit Public Benefit Corporation Law under either of the following circumstances [*Corp. Code § 13406(b)*]:

- The corporation is a qualified legal services project or a qualified support center [*see Bus. & Prof. Code § 6213(a), (b)*]; or

- The professional law corporation otherwise meets all of the requirements and complies with all of the provisions of the Nonprofit Public Benefit Corporation Law, as well as all of the following requirements:

    - All of the members of the corporation, if it is a membership organization as described in the Nonprofit Corporation Law, are persons licensed to practice law in California;

    - All of the members of the professional law corporation's board of directors are persons licensed to practice law in California;

    - Seventy percent of the clients to whom the corporation provides legal services are lower income persons [*see Health & Safety Code 50079.5*], and to other persons who would not otherwise have access to legal services; and

    - The corporation will not enter into contingency fee contracts with clients.

A professional law corporation incorporated as a nonprofit public benefit corporation that is a recipient in good standing of State Bar funds for indigent legal services [*see Bus. & Prof. Code § 6213(c)* ("recipient" defined)] will be deemed to have satisfied all professional law corporation filing requirements [*Corp. Code § 13406(c)*; *see Bus. & Prof. Code §§ 6161.1, 6162, 6163*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Administrative LawAgency RulemakingGeneral OverviewAdministrative LawSeparation of PowersJurisdictionBusiness & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.11

§ 12A.11 Professionals Eligible to Incorporate

Professional corporations [*see Corp. Code § 13401(b)*], may be formed under the Professional Corporation Act for the practice of any of the following services:

- Accounting [*see Bus. & Prof. Code §§ 5150-5158*].
- Acupuncture [*see Bus. & Prof. Code §§ 4975-4979*].
- Architecture [*see Bus. & Prof. Code §§ 5610-5610.7*].
- Audiology [*see Bus. & Prof. Code §§ 2536-2537.5*].
- Chiropractic [*see Bus. & Prof. Code §§ 1050-1058*].
- Dental [*see Bus. & Prof. Code §§ 1800-1808*].
- Law [*see Bus. & Prof. Code §§ 6160-6172*].
- Licensed Clinical Social Worker [*see Bus. & Prof. Code §§ 4998-4998.6*].
- Marriage, Family and Child Counselors [*see Bus. & Prof. Code §§ 4987.5-4988.2*].
- Medical [*see Bus. & Prof. Code §§ 2400-2417*].
- Naturopathic Doctors [*see Bus. & Prof. Code §§ 3670-3675*].
- Nursing [*see Bus. & Prof. Code §§ 2775-2781*].
- Optometry [*see Bus. & Prof. Code §§ 3160-3167*].

- Osteopathic [*see Bus. & Prof. Code §§ 2099.5, 2413, 2416*].
- Pharmacy [*Bus. & Prof. Code §§ 4150-4156*].
- Physical therapy [*see Bus. & Prof. Code §§ 2690-2696*].
- Physicians' assistants [*see Bus. & Prof. Code §§ 3540-3546*].
- Podiatry [*see* Corp. C. § 13401.5, *Bus. & Prof. Code §§ 2400-2417*].
- Psychology [*see Bus. & Prof. Code §§ 2995-2999*].
- Speech language pathology [*see Bus. & Prof. Code §§ 2536-2537.5*].
- Services authorized by the Yacht and Ship Brokers Act [*see Harb. & Nav. Code §§ 720-728*].
- Veterinary medicine [*see Bus. & Prof. Code §§ 4910-4917*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.12

§ 12A.12 Restrictions on Corporate Practice of Multiple Professions

Generally, a professional corporation may render services only in a single profession [*Corp. Code § 13401(b)*]. Shareholders and, under some circumstances, directors and certain officers, must be licensed to practice the professional services that the corporation will render [*Corp. Code §§ 13401(d)*, *13403*, *13406*]. However, in some cases, persons licensed in professions other than the one that the corporation was formed to practice (that is, "allied professionals") may be shareholders, officers, directors, or professional employees rendering allied services in their own professions. In these cases, the "allied professionals" can neither outnumber professionals licensed by the agency regulating the corporation nor own more than 49 percent of the stock [*Corp. Code § 13401.5*]. For a list of "allied professionals" and the corporations in which they may participate as shareholders, officers, directors, or professional employees, as well as the restrictions placed on that participation, see *§ 12A.14[6]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & Corporations



110 of 146 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.13

§ 12A.13 Advantages and Disadvantages of Incorporation

[1] Limitation of Liability Issues

When advising professionals about whether to incorporate, an attorney must decide whether incorporation will offer any business and tax advantages that otherwise would not be available. Shareholders of a professional corporation have the same insulation from liability for nonprofessional acts or omissions as the shareholders of other types of corporations [*see Corp. Code § 13404.5*; *see also* Ballantine & Sterling, California Corporation Laws, Ch. 2, *Choice of Form of Doing Business* (Matthew Bender)]. Furthermore, professionals forming a close corporation [*see Corp. Code § 158* (definition)] will obtain the flexibility of management and still receive the limited protection of *Corp. Code § 300(e)*, which insulates shareholders from personal liability based solely on the failure to observe corporate formalities [*see* Ch. 1B, *Selecting Form of Business Entity* ; Ballantine & Sterling, California Corporation Laws, Ch. 2, *Choice of Form* (Matthew Bender); *see also* Ch. 2, *Formation of Corporations*].

However, the major source of potential liability in a professional practice is personal liability for malpractice, professional negligence, and similar claims. Incorporation as a professional corporation ordinarily will *not* help the professional to avoid such liability. Professional corporation shareholders ordinarily remain personally liable for claims arising from acts or omissions of the corporate practice pursuant to applicable agency regulations, which generally take one of the following forms [*see* Ballantine & Sterling, California Corporation Laws, Ch. 2, *Choice of Form of Doing Business* (Matthew Bender)]:

- A provision that the applicable laws or regulations will not alter the duties or responsibilities of licensed professionals to their clients or others [*see, e.g., 16 Cal. Code Reg. § 2462* (shorthand reporting corporations)];

- A requirement that an application for a corporate certificate of registration be accompanied by a corporate guarantee of payment of all claims, signed by the shareholders [*see, e.g.*, Law Corp. Rule IV(B)(3); *16 Cal. Code Reg. § 75.8* (accountancy corporations)]; or

- A provision that establishes shareholder liability up to specified amounts, unless insurance is

purchased to cover at least those amounts [*see 16 Cal. Code Reg. §§ 367.8* (chiropractic corporations), 1059(b) (dental corporations), 1547 (optometric corporations), 1671 (osteopathic corporations)].

Thus, insulation from shareholder professional liability is not a primary reason for adopting the corporate form. On the other hand, limitation of liability for other, nonprofessional expenses, such as expenses relating to the business aspects of the professional practice, may be a consideration if the practice has a high operating expense or overhead.

[2] Other Corporate Features

Three other important reasons for incorporating a business--free transferability of interests, centralized management, and continuity of existence--ordinarily are secondary concerns in a small professional practice. To the extent they are actually significant concerns, these goals can be achieved by agreements among partners and rarely justify the expense and effort involved in incorporating.

[3] Federal Taxation Issues

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) [Pub. L. No. 97-248] was largely successful in achieving parity between corporate and noncorporate qualified pension plans. Consequently, TEFRA greatly lessened the previous principal appeal of professional corporations--the favorable treatment afforded to corporate retirement plans. Nevertheless, practice in the corporate form still offers a few tax advantages. For example, if a corporation is likely to have substantial income, it may benefit from the availability of loans to qualified pension plan participants [*see § 12A.21[2][f]*] and the potentially greater contribution allowances available under corporate plans [*see § 12A.21[2][g]*].

A professional practice that is likely to employ a significant number of persons will benefit from the deductibility of payments to fringe benefit plans, such as group term insurance [*see § 12A.21[2][b]*], medical, health, and accident plans [*see § 12A.21[2][c], [d]*], and disability income plans [*see § 12A.21[2][e]*]. Counsel advising a professional regarding the desirability of incorporating should review these discussions and determine whether they have any specific application to the client's own situation. If they do not, ordinarily there would be no tax reason to incorporate.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsPensions & Benefits LawEmployee Benefit PlansGeneral OverviewTortsMalpractice & Professional LiabilityAttorneysTortsMalpractice & Professional LiabilityHealthcare ProvidersTortsMalpractice & Professional LiabilityProfessional Services



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.14

§ 12A.14 Corporate Formation

[1] Restrictions on Corporate Names

[a] Permissible Names Determined by Regulating Agency

A professional corporation may adopt any name that is permitted by the law applicable to the profession in which it will be engaged, or that is permitted by a rule or regulation of the agency regulating that profession [*Corp. Code § 13409(a)*].

For example, under the Medical Practice Act [*Bus. & Prof. Code §§ 2000-2521*], the name of a medical or podiatry corporation must be the name or surname of one or more of the present, prospective, or former shareholders who are licensed physicians or podiatrists, unless a fictitious name permit is obtained and the appropriate fee paid [*Bus. & Prof. Code §§ 2285*, *2415*; *16 Cal. Code Reg. § 1344(a), (b)*; *see 16 Cal. Code Reg. §§ 1350-1350.3* (obtaining fictitious name permit); *but see Bus. & Prof. Code § 2285* (exceptions for contractors, employees, or staff members of licensed clinics, licensees employed by professional corporation holding fictitious name permit, accredited outpatient surgeries, approved medical schools, and faculty practice plans)].

Without a fictitious name permit, the use of any fictitious, false, or assumed name in any public communication, advertisement, sign, or announcement of a professional practice constitutes unprofessional conduct [*Bus. & Prof. Code § 2285*]. If the corporate name is a physician's name or surname, and the corporate name does not include the words "medical doctor," "M.D.," "podiatrist," "doctor of podiatric medicine," or the abbreviation "M.D." or "D.P.M.," the words or abbreviations denoting corporate existence must indicate that the corporation is a medical or podiatry corporation [*16 Cal. Code Reg. § 1344(e)*]. If a fictitious name is used, it must not be deceptive, misleading, or confusing [*see Bus. & Prof. Code § 2415(c)*]. Regardless of whether a licensee's name or a fictitious name is used, a medical corporation's name must contain one of the following terms: "Medical Corp.," "Medical Corporation," "Podiatry Corp.," "Podiatry Corporation," "Professional Corp.," "Professional Corporation," "Corporation," "Corp.," "Incorporated," or "Inc." [*16 Cal. Code Reg. § 1344(c)*]. However, a professional corporation with a majority of physicians and surgeons as shareholders, officers, and directors may not use the designations "Podiatry Corporation" and "Podiatry Corp." Similarly, a corporation with a majority of podiatrists as shareholders, officers, and directors may not use the designation "Medical Corporation" and "Medical Corp." [*16 Cal. Code Reg. § 1344(d)*].

Corp. Code § 201(b), prohibiting misleading names, does not apply to a professional corporation whose name contains and is restricted to the name or last name of one or more of the present, prospective, or former shareholders, or persons who were associated with a predecessor person, partnership, or other organization or whose name or names appeared in the name of the predecessor organization [*Corp. Code § 13409*]. Therefore, the Secretary of State may not refuse to file the articles of incorporation of a professional corporation with such a name solely on the basis of *Corp. Code § 201(b)*, provided that the name is not substantially the same as the name of a domestic corporation, the name of a foreign corporation that is authorized to transact business in California, or a name already reserved by another corporation [*Corp. Code § 13409(a)*].

[b] Affidavit of Compliance With Agency Requirements

The Secretary of State may require proof, by affidavit or otherwise, establishing that the name of the professional corporation complies with the requirements and the law governing the profession in which the corporation is engaged. The statement of fact in such an affidavit may be accepted by the Secretary of State as sufficient proof of the facts [*Corp. Code § 13409(a)*]. For forms for such an affidavit, see *§§ 12A.201* (affidavit by licensed person) and 12A.202 (affidavit by attorney).

[c] Qualified Foreign Professional Corporations

Foreign professional corporations qualified to render services in California may transact intrastate business by any name permitted by a law expressly applicable to the profession in which the corporation is engaged, or by a rule or regulation of the governmental agency regulating the corporation's rendering of professional services in California [*Corp. Code § 13409(b)*]. Foreign professional corporations are governed by corporate name rules similar to those applicable to domestic professional corporations [*see Corp. Code § 13409(b)*; *see also* [a], *above*].

[2] Articles of Incorporation

The formation of a professional corporation is governed by the General Corporation Law [*see Corp. Code § 100 et seq.*] unless that law conflicts with the Professional Corporation Act [*Corp. Code § 13403*]. Although the General Corporation Law requires that all initial directors named in the articles of incorporation sign the articles, the initial directors need not be named in the articles [*Corp. Code § 204(c)*]. If the initial directors are not named, the articles must be signed by the incorporators [*Corp. Code § 200(b)*]. For an explanation of corporate formation under the General Corporation Law [*see Corp. Code §§ 100 et seq.*], see Ch. 3, *Articles of Incorporation*].

The articles of incorporation must contain a statement that the corporation is a professional corporation within the meaning of the Professional Corporation Act [*Corp. Code § 13404*]. If the professional corporation will be a closely held corporation, the articles must provide [*Corp. Code § 158(a)*]:

- That all of the corporation's issued shares all classes will be held of record by no more than a specified number of persons, not exceeding 35; and

- The statement, "This corporation is a close corporation."

[3] Bylaws

In general, bylaws are the rules under which a corporation conducts its internal business and manages its affairs [*see Corp. Code §§ 202, 204, 206, 212(b)*]. The shareholders or the board may adopt, amend, and repeal bylaws [*see Corp. Code §§ 207(b), 211*]. A representative set of bylaws for a professional corporation is *set forth in § 12A.203*. For further discussion, see Ch. 4, *Bylaws* .

[4] Director, Officer, and Shareholder Requirements

A corporation must have at least three directors unless it has fewer than three shareholders [*Corp. Code § 212(a)*]. A sole shareholder corporation may have one director. That director must be the sole shareholder, who must also serve as corporate president and treasurer [*Corp. Code § 13403*; *see Corp. Code § 212(a)*]. In a sole shareholder professional corporation, the shareholder who holds the offices of president and treasurer must be licensed to practice the profession for which the corporation is formed, but the other corporate officers need not be licensed persons [*see Corp. Code § 13403*].

PRACTICE TIP:

The single shareholder requirements of *Corp. Code § 13403* highlight a discrepancy between the General Corporation Law and the Professional Corporation Act. Under the General Corporation Law, the office of "treasurer" has been replaced by the office of "chief financial officer" [*see Corp. Code § 312(a)*]. The treasurers of corporations in existence, on January 1, 1977, when the General Corporation Law took effect were deemed chief financial officers as of the effective date of that law [*see Corp. Code §§ 2300, 2305*]. However, the General Corporation Law applies to professional corporations only to the extent that it does not conflict with the Professional Corporation Act [*Corp. Code § 13403*]. Because the latter requires that a sole shareholder act as "treasurer," the attorney drafting the sole-shareholder corporation's articles of incorporation or bylaws may want to include for both a treasurer and a chief financial officer in order to ensure literal compliance with both statutory schemes.

A corporation in which there are only two shareholders need have only two directors [*Corp. Code § 13403*; *see Corp. Code § 212(a)*]. Those directors must be the two shareholders and, between them, they must serve as president, vice-president, secretary, and treasurer of the corporation [*Corp. Code § 13403*].

PRACTICE TIP:

The two-shareholder requirements of *Corp. Code § 13403* highlight another discrepancy between the General Corporation Law and the Professional Corporation Act. Under the General Corporation Law, any number of offices may be held by the same person unless the corporate articles or bylaws provide otherwise [*Corp. Code § 312(a)*]. Thus, to ensure literal compliance with both statutory schemes, the attorney drafting the articles or bylaws for a two-shareholder professional corporation may wish to provide that (1) all offices may not be held by a single shareholder, and (2) one of the shareholders will serve as president and treasurer and the other shareholder will serve as vice-president and secretary.

In general, shares of capital stock in a professional corporation may be issued only to persons licensed in California and persons who are licensed in another jurisdiction to render the same professional services [*Corp. Code § 13406(a)*]. However, specified "allied professionals" qualify as licensed persons, provided that specified membership requirements are met [*see Corp. Code § 13401.5*; *see also §§ 12A.12, 12A.14[6]*]. Shares issued to nonlicensed persons are void. Shareholders may not enter into voting trusts, execute proxies, or enter into any other arrangement to give voting power of the shares to any other persons unless those persons are both licensed and shareholders of the professional corporation. Purported voting trusts, proxies, and other arrangements violating this rule are void [*Corp. Code § 13406(a)*].

Particular professional corporations may be subject to additional requirements regarding directors, officers, and shareholders. For example, except in a sole shareholder corporation [*see Corp. Code § 13403*] or a corporation in which other licensed persons own less than half the corporate stock [*see Corp. Code § 13401.5*], each shareholder, director, and officer of a medical or podiatry corporation (other than an assistant secretary or assistant treasurer) must be a licensed person [*Bus. & Prof. Code § 2408*; *see Corp. Code § 13401(d)* ("licensed person" defined)]. Therefore, even a provisional director of such a corporation appointed by a court when the corporation's directors cannot agree regarding the corporation's management [*see Corp. Code § 208*] must be a licensed person [*see Marik v. Superior Court (1987)*

191 Cal. App. 3d 1136, 1141, 236 Cal. Rptr. 751] .

[5] Registration With Licensing Board

[a] Certificate of Registration Required Unless Exempt

All corporations subject to the Professional Corporations Act must have a certificate of registration before they can render professional services, except corporations regulated by the following [*Corp. Code §§ 13401(a), (b), 13404*; *Bus. & Prof. Code §§ 2400, 2402* (Moscone-Knox exceptions)]:

- Medical Board of California.
- Osteopathic Medical Board of California.
- Dental Board of California.
- Veterinary Medical Board.
- California State Board of Pharmacy.
- California Architects Board [*see Bus. & Prof. Code § 5502*].
- Court Reporters Board of California.
- Board of Behavioral Sciences.
- Board of Registered Nursing.

[b] Registration Procedure Determined by Regulating Agency

A certificate of registration is issued by the agency that regulates the profession in which the corporation proposes to practice [*see Corp. Code §§ 13401(b), 13404*]. Each agency prescribes its own registration procedures.

PRACTICE TIP:

The Department of Consumer Affairs permits online professional licensing for certain professionals, including dentists, nurses, physicians/surgeons, and psychologists [*see* www.dca.ca.gov/proflic/index.html (Department of Consumer Affairs website)].

[c] Registration Procedure for Law Corporations

An applicant for registration as a law corporation must supply to the State Bar all necessary and pertinent documents and information requested by the State Bar concerning the applicant's plan of operation, including, but not limited to the following [*Bus. & Prof. Code § 6161*]:

- A copy of the corporation's articles of incorporation, certified by the Secretary of State.
- A copy of its bylaws, certified by the secretary of the corporation.
- The names and addresses of the corporation, its officers, directors, shareholders, members, and employees who will render professional services, the address of each office, and any fictitious name or names which the corporation intends to use.

The State Bar will issue a certificate of registration on payment of the registration fee if the State Bar finds that all of the following requirements have been satisfied [*Bus. & Prof. Code § 6161*]:

- The corporation is duly organized and existing or duly qualified for the transaction of intrastate business pursuant to the General Corporation Law of [*see Corp. Code § 13406(b)*].

- Each officer (except as provided in *Corp. Code § 13403*), director, shareholder (except as provided in *Corp. Code § 13406(b)*), and employee who will render professional services is a licensed person.

- The application states that the affairs of the corporation will be conducted in compliance with law and the rules and regulations of the State Bar.

[d] Registration Procedure for Accountancy Corporations

An applicant for registration as an accountancy corporation must supply to the board all necessary and pertinent documents and information requested by the board concerning the applicant's plan of operation [*Bus. & Prof. Code § 5151*]. The board will issue a certificate of registration on payment of the registration fee If the board finds that all of the following requirements have been satisfied [*Bus. & Prof. Code § 5151*]:

- The corporation is duly organized and existing or duly qualified for the transaction of intrastate business.

- Each officer (except as provided in *Bus. & Prof. Code §§ 5053, 5079*), director, shareholder, and employee who will render professional services is a licensed person.

- The application indicates that the affairs of the corporation will be conducted in compliance with law and the rules and regulations of the board.

[6] Allied Professionals

Specified "allied professionals" may be shareholders, directors, officers, or professional employees of designated professional corporations if two conditions exist [*Corp. Code § 13401.5*]:

- First, the sum of all shares owned by allied professionals must not exceed 49 percent of all shares in the corporation.

- Second, the number of allied professionals owning shares must not exceed the number of share owners who are professionals licensed by the regulatory agency governing the professional corporation.

The professionals listed below qualify as "allied professionals" with respect to the types of professional corporations indicated [*Corp. Code § 13401.5*]:

For medical corporations:

- Licensed doctors of podiatric medicine.

- Registered nurses.

- Licensed optometrists.

- Licensed psychologists.
- Licensed marriage and family therapists.
- Licensed clinical social workers.
- Licensed physician assistants.
- Licensed chiropractors.
- Licensed acupuncturists.
- Naturopathic doctors.

For podiatric medical corporations:

- Licensed physicians and surgeons.
- Licensed psychologists.
- Registered nurses.
- Licensed optometrists.
- Licensed chiropractors.
- Licensed acupuncturists.
- Naturopathic doctors.

For psychological corporations:

- Licensed physicians and surgeons.
- Licensed doctors of podiatric medicine.
- Registered nurses.
- Licensed optometrists.
- Licensed marriage and family therapists.
- Licensed clinical social workers.
- Licensed chiropractors.
- Licensed acupuncturists.
- Naturopathic doctors.

For speech-language pathology corporations:

- Licensed audiologists.

For audiology corporations:

- Licensed speech-language pathologists.

For nursing corporations:

- Licensed physician and surgeons.
- Licensed doctors of podiatric medicine.
- Licensed psychologists.
- Licensed optometrists.
- Licensed marriage and family therapists.
- Licensed clinical social workers.
- Licensed physician assistants.
- Licensed chiropractors.
- Licensed acupuncturists.
- Naturopathic doctors.

For marriage and family therapy corporations:

- Licensed physicians and surgeons.
- Licensed psychologists.
- Licensed clinical social workers.
- Registered nurses.
- Licensed chiropractors.
- Licensed acupuncturists.
- Naturopathic doctors.

For licensed clinical social worker corporations:

- Licensed physicians and surgeons.

- Licensed psychologists.
- Licensed marriage and family therapists.
- Registered nurses.
- Licensed chiropractors.
- Licensed acupuncturists.
- Naturopathic doctors.

For physician assistants corporations:

- Licensed physicians and surgeons.
- Registered nurses.
- Licensed acupuncturists.
- Naturopathic doctors.

For optometric corporations:

- Licensed physicians and surgeons.
- Licensed doctors of podiatric medicine.
- Licensed psychologists.
- Registered nurses.
- Licensed chiropractors.
- Licensed acupuncturists.
- Naturopathic doctors.

For chiropractic corporations:

- Licensed physicians and surgeons.
- Licensed doctors of podiatric medicine.
- Licensed psychologists.
- Registered nurses.
- Licensed optometrists.

- Licensed marriage and family therapists.
- Licensed clinical social workers.
- Licensed acupuncturists.
- Naturopathic doctors.

For acupuncture corporations:

- Licensed physicians and surgeons.
- Licensed doctors of podiatric medicine.
- Licensed psychologists.
- Registered nurses.
- Licensed optometrists.
- Licensed marriage and family therapists.
- Licensed clinical social workers.
- Licensed physician assistants.
- Licensed chiropractors.
- Naturopathic doctors.

For naturopathic doctor corporations:

- Licensed physicians and surgeons.
- Licensed psychologists.
- Registered nurses.
- Licensed physician assistants.
- Licensed chiropractors.
- Licensed acupuncturists.
- Licensed physical therapists.
- Licensed doctors of podiatric medicine.
- Licensed marriage, family, and child counselors.

- Licensed clinical social workers.
- Licensed optometrists.

For dental corporations:

- Licensed physicians and surgeons.
- Dental assistants.
- Registered dental assistants.
- Registered dental assistants in extended functions.
- Registered dental hygienists.
- Registered dental hygienists in extended functions.
- Registered dental hygienists in alternative practice.

[7] Fictitious Name Permits

Every person who regularly transacts business in California for profit under a fictitious business name must file a fictitious business name statement [*Bus. & Prof. Code § 17910*]. A "fictitious business name" is either of the following [*Bus. & Prof. Code § 17900(b)*.(c)]:

- Any name other than the surname of an individual owner, the surnames of all general partners, or the full name of a business entity.
- A name that suggests the existence of additional owners.

In many instances, the rules governing the use of fictitious name permits are specific to the particular profession. For example, medical corporations are subject to specific statutory requirements for fictitious business names [*see Bus. & Prof. Code §§ 2407, 2415, 2443*]. Using a factitious name without first obtaining a permit constitutes unprofessional conduct [*see Bus. & Prof. Code § 2285*].

For further discussion of fictitious name permits, *see* Ch. 1A, *Role of Counsel in Starting a New Business* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesGeneral OverviewBusiness & Corporate LawCorporate NamesFictitious NamesGeneral OverviewBusiness & Corporate LawCorporate NamesFictitious NamesRegistration RequirementsBusiness & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.15

§ 12A.15 Restrictions on Issuance and Transfer of Shares

[1] Transfer Restricted to Licensed Persons, Shareholders, and Allied Professionals

Shares of a professional corporation (or a foreign professional corporation qualified to render professional services in California) may be transferred only to the following [*Corp. Code § 13407*]:

- Persons licensed in California or another jurisdiction to practice the profession for which the corporation was formed;
- A shareholder of the same professional corporation;
- A person licensed to practice the same profession in the jurisdiction or jurisdictions in which the person practices; or
- The professional corporation [*see* [2], *below*].

Any transfer in violation of these rules is void [*Corp. Code § 13407*]. However, specified licensed persons ("allied professionals") may be shareholders provided that [*Corp. Code § 13401.5*]:

- The sum of all shares owned by allied professionals does not exceed 49 percent of the total number of shares of the corporation; and
- The number of allied professionals owning shares in the corporation does not exceed the number of persons licensed by the agency regulating the corporation.

For a list of allied professionals who may own stock in professional corporations, see *§ 12A.14[6]*.

[2] Repurchase of Shares

A professional corporation may purchase its own shares, without regard to any restrictions on the corporate repurchase

of shares, as long as at least one share remains issued and outstanding [*Corp. Code § 13407*].

Within 90 days following the date of disqualification of a shareholder, or within six months following the date of death of the shareholder, the professional corporation's certificate of registration may be suspended or revoked by the governmental agency regulating the profession in which the corporation is engaged, under any of the following circumstances [*Corp. Code § 13407*]:

- If a professional corporation (or a foreign professional corporation qualified to render professional services in California) fails to acquire all the shares of a shareholder who is disqualified from rendering professional services in California; or

- If a professional corporation (or a foreign professional corporation qualified to render professional services in California) fails to acquire all the shares of a deceased shareholder who was, on his or her date of death, licensed to render professional services in California; or

- If the disqualified shareholder or the representative of the deceased shareholder fails to transfer the shares to the corporation, to another shareholder of the corporation, to a person licensed to practice the same profession in the jurisdiction or jurisdictions in which the person practices, or to a licensed person.

In the event of such a suspension or revocation, the corporation must immediately cease rendering professional services in California [*see § 12A.18*].

PRACTICE TIP:

These transfer and repurchase restrictions may cause problems. For example, on the shareholder's death, the shares owned by a professional become assets of his or her estate. On the death or disqualification of a shareholder, his or her shares must be transferred to a licensed person or persons or to the corporation [*Corp. Code § 13407*].

If the shareholder dies, the transfer must occur within six months following the death. If the shareholder becomes legally disqualified (either permanently or temporarily) from rendering the accustomed professional services [*see Corp. Code § 13401(e)*], the shares must be transferred within 90 days following the date of disqualification. Although not always practicable, if these transfers are not made within the specified period, the certificate of registration may be suspended or revoked by the governing board, in which case the corporation must immediately stop rendering professional services [*Corp. Code § 13407*].

One solution is for the corporation's articles of incorporation to provide that the corporation will redeem shares immediately on the death or the disqualification of any shareholder, or any attempted transfer of shares to someone other than a licensed person. However, such an inflexible solution is not ideal. Alternatively, all corporate shares may be subject to a buy-sell agreement among all the shareholders [*see § 12A.220*]. A buy-sell agreement can govern the disposition of a shareholder's shares in the event of death or disqualification. Similar problems may arise if shares in the corporation are attached by a creditor of the shareholder.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.16

§ 12A.16 Operating Requirements

[1] Malpractice Insurance

Professional corporations need to purchase malpractice insurance to protect the corporation's assets. The board governing the particular professional practice may specify required amounts of coverage. As a practical matter, the corporation should purchase and maintain the policy [*see § 12A.16[1]*].

For further discussion of insurance issues, *see* Ch. 1F, *Insurance Considerations in Business Formation* .

[2] Covenants Not to Compete

In general, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void [*Bus. & Prof. Code § 16600*]. However, the following sellers may agree with a buyer to refrain from carrying on a similar business within a specified geographic area in which the business so sold, or that of the business entity, division, or subsidiary has been carried on, so long as the buyer, or any person deriving title to the goodwill or ownership interest from the buyer, carries on a like business in that geographic area [*Bus. & Prof. Code § 16601*]:

- Any person who sells the goodwill of a business.

- Any owner of a business entity selling or otherwise disposing of all of his or her ownership interest in the business entity.

- Any owner of a business entity that sells (1) all or substantially all of its operating assets together with the goodwill of the business entity; (2) all or substantially all of the operating assets of a division or a subsidiary of the business entity together with the goodwill of that division or subsidiary; or (3) all of the ownership interest of any subsidiary [*but see Hill Med. Corp. v. Wycoff (2001) 86 Cal. App. 4th 895, 897, 906-908, 103 Cal. Rptr. 2d 779* (noncompetition provision in radiologist's stock redemption agreement was void and outside exception of *Bus. & Prof. Code § 16601* because business goodwill not a factor in purchase of shares); *see also* Ch. 17, *Buying and Selling a Business or Professional Practice*].

A covenant not to compete may raise an income tax problem to a selling shareholder and afford a benefit to the acquiring corporation. Ordinarily, the profit a shareholder receives on the sale of corporate shares is a capital gain. For shares held more than 12 months, only one-half of that capital gain is subject to income taxation [*see I.R.C. § 1222*]. The covenant not to compete may have an independent value if the seller's covenant not to compete with the buyer or the business is structured as part of the sale of the shares in the business. The buyer may be paying one amount for the selling shareholder's shares and an additional amount for the covenant not to compete. Upon a determination that the covenant not to compete has an independent value, the portion of the purchase price found to have been paid for the covenant not to compete, as opposed to the shares, is taxed to the selling shareholder as ordinary income [Fox & Fox, Corporate Acquisitions and Mergers, Ch. 5D, *Acquisitions of Stock* (Matthew Bender)]. The buyer, on the other hand, is allowed to depreciate the *covenant's* purchase price over the duration the covenant by means of depreciation deductions for a portion of that price each year during the term of the covenant [*see O'Dell & Co. v. Commissioner (1974) 61 T.C. 461, 468-469]* .

[3] Reporting Requirements

[a] Law Corporations

The Business and Professions Code requires that law corporations renew their certificate of registration annually at a time to be fixed by the State Bar and pay the applicable fee [*Bus. & Prof. Code § 6161.1*]. At least annually, law corporations must also file a report with the State Bar containing the requisite information pertaining to qualification and compliance with the statutes, rules, and regulations, together with the applicable fee [*Bus. & Prof. Code § 6163(a)*; *see Bus. & Prof. Code § 6127.5*]. The report must be signed and verified by an officer of the corporation [*Bus. & Prof. Code § 6163(a)*].

The certificate of registration of any law corporation failing to file the annual report, renew its certificate, and pay any applicable fee and penalty will be suspended for 60 days following written notice of delinquency [*Bus. & Prof. Code § 6163(b)*]. However, a client may not use this failure as justification for refusing to pay legal fees [*see Olson v. Cohen (2003) 106 Cal. App. 4th 1209, 1215, 131 Cal. Rptr. 2d 620]* .

In addition, law corporations must report in writing to the State Bar any change in directors, officers, employees performing professional services, share ownership, and amendments to its articles of incorporation and bylaws [*Bus. & Prof. Code § 6162*].

[b] Accountancy Corporations

The Business and Professions Code requires that accountancy corporations biennially renew their permit to practice and pay the applicable renewal fee [*Bus. & Prof. Code § 5152.1*; *see Bus. & Prof. Code § 5134*]. In addition, each accountancy corporation must file a report with the board containing information pertaining to qualification and compliance with the statutes, rules, and regulations. All reports must be signed and verified by an officer of the corporation [*Bus. & Prof. Code § 5152*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsContracts LawTypes of ContractsCovenantsInsurance LawMalpractice InsuranceGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.17

§ 12A.17 Observing Corporate Formalities

The corporation must observe the formalities of corporate organization to take advantage of corporate limited liability [*see § 12A.13[1]*] and the potential tax benefits afforded by incorporation [*see § 12A.21*]. Therefore, the corporation must hold shareholders' and directors' meetings, keep proper minutes, issue stock certificates, keep accurate stock records, pass resolutions, and use the corporate name in all of its business activities.

Accounting and legal fees may increase because of the necessity of keeping corporate minutes and drafting the various documents necessary to carry out the corporation's tax planning programs. Nevertheless, the increase in these fees may be outweighed by the benefits gained through incorporation.

Professionals forming a close corporation [*see Corp. Code § 158* (definition)] receive the limited protection of *Corp. Code § 300(e)*, which insulates shareholders from personal liability based solely on the failure to observe corporate formalities [*see* Ch. 1B, *Selecting Form of Business Entity* ; Ballantine & Sterling, California Corporation Laws, Ch. 2, *Choice of Form of Doing Business* (Matthew Bender)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsManagement Duties & LiabilitiesBusiness & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.18

§ 12A.18 Suspension or Revocation of Certificate of Registration

In addition to suspension or revocation for failure to make a timely transfer of shares after a shareholder dies or becomes disqualified [*see § 12A.15*], the certificate of registration of a professional corporation may be suspended or revoked under any of the following circumstances [*Corp. Code § 13408*]:

- At any one time, all of the shareholders are"disqualified persons" [*see Corp. Code § 13401(e)* (definition)].
- The sole shareholder is a "disqualified person."
- The corporation knowingly employs or retains in its employment a "disqualified person"
- The corporation violates any applicable rule or regulation of its governing board.
- The corporation violates any statute applicable to a professional corporation.
- Other grounds exist for suspension or revocation under provisions of the Business and Professions Code relating to the profession in which the corporation is engaged.

A corporation whose certificate of registration is suspended or revoked must immediately stop rendering professional services [*Corp. Code § 13408*].

For corporations no longer required to have a certificate [*see § 12A.10[2]*], the sanction for violation of the Professional Corporation Act or applicable regulations is disciplinary action against the practitioners involved [*see Bus. & Prof. Code §§ 2234, 2286*].

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawProfessional Associations & Corporations



116 of 146 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.19

§ 12A.19 Securities Issues

[1] Federal Law

The issuance of stock by a professional corporation or by a foreign professional corporation qualified to render professional services in California under the Professional Corporation Act is exempt from federal registration requirements under the intrastate or private offering exemption [*see 15 U.S.C. § 77c(a)(11), (b)*; *see also Corp. Code § 13401(c)* (foreign professional corporation defined)] or Regulation D [*see 17 C.F.R. §§ 230.501-230.508*]. For a general discussion of the securities laws, see Ch. 6, *Securities Regulation Issues* . For general coverage of the mechanics of issuing corporate stock, *see* Ch. 6I, *Issuance of Equity Securities* .

[2] California Law

The issuance of stock by a professional corporation or by a foreign professional corporation [*see Corp. Code § 13401(c)*] qualified to render professional services in California under the Professional Corporation Act is exempt from the qualification requirement of the Corporate Securities Law [*see 10 Cal. Code Reg. § 260.105.6*]. However, the anti-fraud provisions apply to the transaction [*see Corp. Code §§ 25401, 25501*].

This exemption does not apply to a subsequent transfer of stock issued by a professional corporation. However, any sale of stock by a shareholder for his or her own account is exempt from qualification if the sale is not accompanied by an advertisement and is not effected by or through a broker-dealer in a public offering [*Corp. Code § 25104(a)*]. Thus, most sales of shares by a shareholder of a professional corporation will be exempt from qualification requirements.

For a general discussion of the securities laws, *see* Ch. 6, *Securities Regulation Issues* . For general coverage of the mechanics of issuing corporate stock, *see* Ch. 6I, *Issuance of Equity Securities* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawExemptions From RegistrationExempt TransactionsRegulation D Exemptions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.20

§ 12A.20 Dissolving Professional Corporations

The Professional Corporation Act does not address the dissolution of professional corporations. Therefore the provisions of the General Corporation Law apply. When the sole shareholder of a professional corporation dies, the decedent's personal representative will be faced with the choice of either dissolving the corporation or continuing it in existence until dissolution and liquidation are desirable from a tax standpoint [*see § 12A.15[1]*]. For an explanation of the procedures involved in filing a certificate of election to wind up and dissolve a corporation, *see* Ch. 12, *Winding Up and Dissolution* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDissolution & ReceivershipGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsPersonal & Professional Service Corporations (IRC secs. 269A, 280H)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.21

§ 12A.21 Federal Taxation of Professional Corporations

[1] Tax Aspects of Incorporation

[a] Incorporation Is Ordinarily Tax-Free

In general, the transfer of property to a corporation controlled by the transferors will not cause the transferors to recognize gain or loss, provided they receive only stock and securities in the corporation, and, immediately after the exchange, those persons own at least (1) 80 percent of the total combined voting power of all classes of the corporation's voting stock, and (2) 80 percent of the total number of shares of all other classes of the corporation's stock [*I.R.C. §§ 351(a), 368(c)*]. If this rule would apply to an exchange but for the fact that the transferors receive other property or money in addition to stock and securities, then gain, if any, will be recognized, but not in excess of the amount of money received plus the fair market value of the other property received [*I.R.C. § 351(b)(1)*]. Loss may never be recognized by the transferors [*I.R.C. § 351(b)(2)*].

[b] Corporate Assumption of Liabilities May Result in Taxable Gain

The assumption of liabilities by the corporation may cause gain to be recognized by the liabilities' transferors. The excess of the amount of liabilities assumed by the corporation over the total of the adjusted tax bases of the property transferred to the corporation will be treated as gain taxable to the transferors as capital gain (capital asset) or ordinary income (non-capital asset) [*I.R.C. § 357(c)(1)*]. Thus, the relevant tax and financial records must be reviewed before incorporation to determine whether, in the aggregate, the liabilities to be assumed by the corporation will not exceed the aggregate tax bases of the assets transferred to the corporation. For purposes of this computation, however, certain liabilities (such as the following) will not be taken into account as long as the creation of the liabilities does not result in the creation of or an increase in the basis of any property [*I.R.C. § 357(c)(3)*]:

- Liabilities, the payment of which will give rise to a deduction (for example, accrued but unpaid business expenses)

- Liabilities described in *I.R.C. § 736(a)* (payments to a retiring partner or a deceased partner's successor in interest).

In calculating the amount of liability assumed, any portion of a recourse liability is treated as having been assumed if, determined on the basis of all facts and circumstances, the transferee has agreed to (and is expected to) satisfy that liability regardless of whether the transferor has been relieved of the liability [*I.R.C. § 357(d)(1)(A)*]. Nonrecourse liabilities are treated as assumed, except that the amount is reduced by the lesser of (1) the amount of the liability that an owner of other assets not transferred to the transferee and also subject to the liability has agreed with the transferee to, and is expected to, satisfy, or (2) the fair market value of those other assets (determined without regard to *I.R.C. § 7701(g)*) [*I.R.C. § 357(d)(1)(B), (2)*].

[c] Taxation as Corporation

In general, professional corporations organized under state law are treated as corporations for tax purposes [*Rev. Rul. 70-101, 1970-1 C.B. 278*]. However, if the manner in which the business is conducted indicates that the shareholders of the professional corporation continue to practice as individuals, the corporate entity will be disregarded and the members will be taxed as individuals [*see Roubik v. Commissioner (1969) 53 T.C. 365]* . Furthermore, when an employee-sole shareholder of a professional corporation provides services to another entity under an agreement between the employee and the other entity, the employee-sole shareholder, not the professional corporation, is taxed on the resulting income [*Keller v. Commissioner (1981) 77 T.C. 1014]* .

PRACTICE TIP:

A professional corporation will be treated as a corporation for tax purposes only to the extent it is operated as a corporation distinct from its shareholders. The mere organization of a corporation by professional persons will not suffice to bestow the desired tax status. To ensure corporate treatment, the corporation should hold title to assets used in the practice, bill and receive fees in the corporate name, handle employment matters, and observe corporate formalities.

The general tax consequences of incorporation are discussed in Ch. 1E, *Taxation of Businesses* .

[2] Incorporation Presents Limited Tax Advantages

[a] Corporate Employees Enjoy Some Tax Advantages

Prior to 1982, a principal reason for conducting an incorporated professional practice, rather than using the traditional proprietorship or partnership form, was to afford the practitioner the same income tax advantages available to employees of business corporations, such as group term life insurance [*see* [b], *below*], health and accident insurance plans [*see* [c], *below*], medical reimbursement plans [*see* [d], *below*], and disability income plans [*see* [e], *below*]. However, the favorable treatment of corporate retirement plans over those of other entities was largely eliminated by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) [Pub. L. No. 97-248]. Nevertheless, corporate employees enjoy some remaining tax advantages, such as group term life insurance benefits and medical reimbursement plans [*see* [b], [d], *below*].

[b] Group Term Life Insurance

A corporation may provide each of its employees with up to $50,000 in group term life insurance and may fully deduct the premiums paid for that insurance. If the group term life insurance coverage provided through the employer exceeds $50,000 per employee, the cost of the excess coverage must be included in the gross income of the employee [*I.R.C. § 79(a)*]. Although includable, the cost of the excess coverage is taxed at the rates provided in the regulations, rather than at actual cost of the excess coverage [*Treas. Reg. § 1.79-3(d)(2)*].

In contrast, if the corporation's group term life insurance plan discriminates in favor of key employees, either with respect to eligibility to participate or the type and amounts of available benefits, those key employees will not receive

favorable tax treatment in terms of the exclusion and the uniform rates [*see I.R.C. § 79(d)*]. A plan is discriminatory unless it has the following attributes [*I.R.C. § 79(d)(3)(A)*; *see I.R.C. § 79(d)(3)(B)* (excluded employees)]:

- At least 70 percent of all employees benefit;
- At least 85 percent of all participating employees are not key employees;
- The participating employees qualify under a classification that the IRS determines to be nondiscriminatory; or
- The plan is a cafeteria plan that satisfies *I.R.C. § 125* requirements.

An employee's status as a "key employee" is determined by reference only to an employee's status during the plan year, and not to prior plan years. An employee is considered a key employee if, during the plan year, the employee was any of the following [*I.R.C. §§ 79(d)(6), 416(i)(1)(A)*]:

- An officer with compensation in excess of $130,000 (adjusted for inflation for plan years beginning after 2002 in $5,000 increments).
- A 5-percent owner.
- A 1-percent owner with compensation in excess of $150,000.

No more than 50 employees (or if fewer, the greater of 3 employees or 10 percent of the total employees) may be treated as officers for the purpose of being considered a key employee [*I.R.C. § 416(i)(1)(A)*]. The term "key employee" also includes any former employee, if the employee was a key employee at the time of retirement or separation from service [*I.R.C. § 79(d)(6)*].

PRACTICE TIP:

The ability of the corporation to provide a group term life insurance plan allows the corporate employer a favorable business expense deduction and at the same time provides an attractive and nontaxable benefit to the employees.

[c] Health and Accident Insurance Plans

The corporate employer's contributions to health and accident insurance plans are not taxable to the employees [*I.R.C. § 106*], and the corporation may deduct its contributions to the plans [*see I.R.C. § 162(a)*]. Payments made under a plan to employees are not taxable as long as they are used to reimburse the employee for expenses incurred for medical care [*I.R.C. § 105(b)*] or are compensation for permanent injuries [*see I.R.C. § 105(c)*].

PRACTICE TIP:

The ability of the corporation to provide health and accident plans allows the corporate employer a favorable business expense deduction and at the same time provides an attractive and nontaxable fringe benefit to the employees.

Following the repeal of former *I.R.C. § 89* [repealed Nov. 8, 1989, by Pub. L. 101-140, § 202(a), 103 Stat. 830], no discrimination rules apply to insured health and accident plans with regard to the exclusion of employer contributions [*see I.R.C. § 106*] or the exclusion of amounts received on account of personal injury or sickness [*see I.R.C. § 105*]. For a plan to be treated as an insured plan for this purpose, however, it must involve the actual shifting of risk to an unrelated third party. A plan underwritten by a policy of insurance, or a prepaid health care plan that does not involve a

shifting of risk, will be treated as a self-insured plan for this purpose. Thus, a policy that, in effect, provides only administrative or bookkeeping services is considered self-insured [*Treas. Reg. § 1.105-11(b)(1)(ii)* (plan not deemed self-insured merely because insurer uses employer's prior claims experience as factor in determining premium)].

[d] Medical Reimbursement Plans

[i] Basic Requirements

Amounts paid to non-highly compensated employees for expenses incurred for medical care under a self-insured medical reimbursement plan [*see I.R.C. § 105(h)(6)* (definition)] are excludable, regardless of whether the plan is discriminatory [*see I.R.C. § 105(b), (h)(1)*]. However, in order for medical payments made to highly compensated employees under a self-insured medical reimbursement plan to be excludable under *I.R.C. § 105(b)*, the plan may not discriminate in terms of (1) eligibility to participate in the plan [*see I.R.C. § 105(h)(3)* ("nondiscriminatory eligibility" defined)]; or (2) actual availability of benefits under the plan [*I.R.C. § 105(h)(1)*; *see I.R.C. § 105(h)(4)* ("nondiscriminatory benefits" defined)].

A self-insured medical reimbursement plan satisfies the eligibility requirement if the plan benefits (1) 70 percent or more of all employees of the corporation; (2) 80 percent or more of all the corporation's employees who are eligible to benefit under the plan, if 70 percent or more of the employees of the corporation are eligible; or (3) all employees who qualify under a classification set up by the employer, and the Internal Revenue Service determines that the classification does not discriminate in favor of highly compensated employees [*I.R.C. § 105(h)(3)(A)*; *see Treas. Reg. § 1.105-11(c)(2)(ii)*]. For the purpose of determining whether the plan discriminates in terms of eligibility, the following employees may be excluded [*I.R.C. § 105(h)(3)(B)*]:

- Employees who have not completed three years of service [*see Treas. Reg. § 1.105-11(c)(2)(iii)(A)*].
- Employees under the age of 25.
- Part-time or seasonal employees [*see Treas. Reg. § 1.105-11(c)(2)(iii)(C)*].
- Employees not included in the plan who are covered by a collective bargaining agreement if accident and health benefits were the subject of good faith bargaining between the employee representatives and the employer.
- Nonresident alien employees who received no earned income [*see I.R.C. § 911(d)(2)*] from the employer that constitutes income from sources within the United States [*see I.R.C. § 861(a)(3)*].

A self-insured medical reimbursement plan satisfies the benefits requirement only if the plan benefits provided for highly compensated employees and their dependents are also provided for all other participants and their dependents [*I.R.C. § 105(h)(4)*; *Treas. Reg. § 1.105-11(c)(3)(i)*]. This test is applied to the benefits subject to reimbursement under the plan, rather than the actual benefit payments or claims under the plan [*Treas. Reg. § 1.105-11(c)(3)(i)*].

Furthermore, not only must a plan not discriminate on its face in providing benefits in favor of highly compensated employees, the plan also must not discriminate in actual operation [*Treas. Reg. § 1.105-11(c)(3)(ii)*]. The determination of whether plan benefits discriminate in actual operation in favor of highly compensated employees is made based on the facts and circumstances of each case [*Treas. Reg. § 1.105-11(c)(3)(ii)*]. Special rules apply to retired employees, multiple plans, and health maintenance organization participants [*see Treas. Reg. § 1.105-11(c)(3)(iii), (4)*].

[ii] Excess Reimbursement

If a corporation provides a self-insured medical reimbursement plan, and the plan discriminates in any plan year in favor of highly compensated employees, either in terms of eligibility to participate or actual benefits available, then amounts paid to a highly compensated employee during that year are includable to the extent that the payments constitute an excess reimbursement of that employee [*I.R.C. § 105(h)(1)*; *see I.R.C. § 105(h)(7)* ("excess reimbursement" defined)]. A "highly compensated employee" is any person [*see I.R.C. § 105(h)(5)*; *Treas. Reg. § 1.105-11(d)*]:

- Who is one of the five highest paid officers of the corporation;

- Who is a shareholder who owns more than 10 percent in value of the stock of the employing corporation; or

- Who is among the highest paid 25 percent of all employees.

The status of an employee as an officer or stockholder is determined with respect to a particular benefit on the basis of the employee's officer status or stock ownership at the time during the plan year when the benefit is provided [*Treas. Reg. § 1.105-11(d)*; *see* Young, Pensions and Profit Sharing Plans (Matthew Bender)].

The amount that is treated as an "excess reimbursement" from a self-insured medical reimbursement plan (and is includable in a highly compensated employee's income) depends on the extent of the discrimination. If the plan provides a benefit that is available to highly compensated employees but not to all other participants (i.e., provides discriminatory benefits), the entire amount of the reimbursement is an excess reimbursement [*I.R.C. § 105(h)(7)(A)*; *Treas. Reg. § 1.105-11(e)(2)*]. If the plan discriminates in eligibility to participate (discriminatory coverage), a portion of the benefit paid to a highly compensated employee in a plan year constitutes an excess reimbursement. The includable portion is the amount in the same proportion to the total reimbursed to the highly compensated employee as the ratio of the total amount reimbursed to all highly compensated employees during the plan year to the total amount reimbursed to all participants in that year. Discriminatory benefits are not included in this calculation [*I.R.C. § 105(h)(7)(B)*; *see Treas. Reg. § 1.105-11(c)(3), (e)(3), (4)*].

PRACTICE TIP:

Ordinarily, shareholder employees of professional corporations want to provide themselves with the maximum benefits under corporate medical reimbursement plans. Consequently, because of the antidiscrimination provisions of *I.R.C. § 105(h)*, self-insured plans may not be attractive to professional corporations.

[e] Disability Insurance

A corporation may purchase long term disability insurance on behalf of its employees. The premiums paid by the corporation for that insurance are deductible [*see I.R.C. § 162(a)*]. The insured employees need not include the value of the premiums in their gross income [*I.R.C. § 106(a)*]; however, amounts actually received under the policy are includible in the recipient's gross income [*see I.R.C. § 61(a)(1)*].

PRACTICE TIP:

The ability of the corporation to provide a group term life insurance plan allows the corporate employer a favorable business expense deduction and at the same time provides an attractive and generally nontaxable benefit to the employees.

[f] Loans to Participants in Corporate Plans

Access to plan funds is often an important consideration to high income professionals, who tend to view the plan as an investment fund rather than a retirement plan. One advantage to a corporate plan is that a loan from a corporate plan to a participant, secured only by the employee's vested accrued benefits within the plan, will cause neither the

disqualification of the plan [*see I.R.C. § 401(a)(13)*] nor the imposition of an excise tax on a prohibited transaction, provided that specified requirements are met [*I.R.C. § 4975(d)(1)*]. However, loans from noncorporate plans to owner-employees or, in the case of S corporation plans, loans to shareholder-employees, are treated as prohibited transactions [*see I.R.C. § 4975(c)*]. Such loans, if secured only by the participants' vested benefits, will result in the disqualification of the entire plan [*see I.R.C. § 401(a)(13)*]. If secured by property outside of the plan, the loans will still be prohibited transactions, and although the plan will not be disqualified, an excise tax of 15 percent on prohibited transactions will be imposed [*I.R.C. § 4975(a)*].

PRACTICE TIP:

The ability to borrow from the plan, free of excise tax and without outside security, can be an important advantage to incorporation. A loan secured only by vested benefits is the functional equivalent of an early withdrawal, and the interest paid on the loan provides an additional deduction to the professional participant.

[g] Limitations on Plan Contributions

Annual contributions to a defined benefit plan (a plan designed to produce a designated payout) cannot exceed an amount necessary to fund the lesser of an annual benefit of $160,000 or 100 percent of the employee's compensation for his or her three highest years [*I.R.C. § 415(b)*]. Annual contributions to a defined contribution plan (a plan in which contributions rather than benefits are fixed) cannot exceed the lesser of $40,000 or 100 percent of the participant's compensation [*I.R.C. § 415(c)(1)*]. The $160,000 limit for defined benefit plans and the $40,000 limit for defined contribution plans are both subject to cost-of-living adjustments [*I.R.C. § 415(d)(1)*].

Although the contribution limitations for the corporate and self-employed plans appear to be the same, the definition of earned income [*see I.R.C. §§ 401(c)(2)(A)(v), 415(b)(3), (c)(3)(B)*] serves to make the contribution limitation for the self-employed lower than for corporate plans. To determine a self-employed person's earned income, the definition requires that the deduction for contributions to qualified plans be subtracted from individual's compensation [*I.R.C. § 401(c)(2)(A)(v)*]. This deduction reduces the amount that is considered 100 percent of the participant's compensation for purposes of the defined benefit or defined contribution limitation [*see I.R.C. § 415(b)(1), (c)(1)*].

[h] Benefits are Equally Portable

The rules that apply to rollovers from one plan to another plan are the same for self-employed persons and corporate qualified plans [*see I.R.C. §§ 401(a)(31), 402(c), (f), 408(d)*]. Therefore, portability of benefits is not a factor bearing on the merit of incorporating.

[3] Income Taxation of Professional Corporations

[a] Professional Corporations Taxed at 35 Percent Flat Rate

All taxable income of a "qualified personal service corporation" is subject to a flat tax rate of 35 percent [*I.R.C. § 11(b)(2)*]. A "qualified personal service corporation" means any corporation that meets both of the following criteria [*I.R.C. § 448(d)(2)*]:

- Substantially all of the corporation's activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting [*see I.R.C. § 448(d)(2)(A)*].

- Substantially all of the corporate stock (by value) is held directly (or indirectly through one or more partnerships, S corporations, or qualified personal service corporations) by employees performing services in those fields, retired employees who performed those services for the corporation, the estates

of these persons, or anyone who acquired the stock due to the death of those persons (but only for the two-year period beginning on the date of the employee's death [*see I.R.C. § 448(d)(2)(B)*].

This flat rate of tax means that professional corporations are not eligible for the graduated tax rates generally applicable to individuals and other corporations [*see* I.R.C. §§ 1(a)-(d), (*i*)(2), 11(b)(1)].

The highest corporate tax rates (including the qualified personal service corporation's tax rate) are now slightly higher than the highest individual tax rates [*see I.R.C. §§ 1, 11*]. It is likely that the typical professional corporation will have a smaller tax base than any of its shareholders. In general, this result occurs because the overwhelming portion of the corporation's income is usually devoted to the payment of salaries and to tax-deductible contributions to qualified pension and profit-sharing plans for the shareholders' benefit [*see I.R.C. § 401* et seq.]. However, because of the similarity in corporate and individual tax brackets, and particularly between the brackets applicable to qualified personal service corporations and highly compensated individuals, there is only limited flexibility in income tax planning.

[b] Taxable Year

A professional corporation, like S corporations and partnerships, must use the calendar year for tax reporting purposes, unless the corporation can show a valid business purpose for adopting a different fiscal year and the IRS approves the change [*I.R.C. § 441*(*i*); *see I.R.C. §§ 441(a), (b), 706*]. However, a professional corporation may elect a different taxable year if the new taxable year does not result in more than a three-month deferral of income. Thus, a professional corporation may have taxable year ending in September, October, or November [*see I.R.C. § 444(a), (b)*; *see also I.R.C. § 444(d)* (manner of election)]. If such an election is in effect, the corporation may be subject to limitations on the deductibility of amounts paid to employee owners [*see I.R.C. §§ 280H, 444(c)(2)*].

[c] Method of Accounting

A professional corporation that is a qualified personal service corporation [*see I.R.C. § 448(d)(2)*; *see* [b], *above*] ordinarily may use either the accrual method of accounting or the cash method, provided that the method selected clearly reflects income [*I.R.C. §§ 446(a), (b), 448(a), (b)(2)*]. Most professional corporations use cash basis accounting.

A person using an accrual method of accounting is not required to accrue, but may use a non-accrual experience method of accounting, for amounts to be received for the performance of services by that person, but that based on that person's experience will not be collected. This rule does applies only if interest is required to be paid on that amount, or if there is any penalty for failure to timely pay that amount [*I.R.C. § 448(d)(5)*].

[d] Deferred Compensation

Gross income received by a sole practitioner or by a professional partnership is includable in the income tax return of the professional for the calendar year during which the gross income was received by the partnership. In other words, operating a professional practice as a sole proprietor or a professional partnership generally will not enable a professional to defer the taxable year for recognition of any item of gross income.

In contrast, the professional corporation offers flexibility with respect to the year during which the professional is deemed to have received income. An incorporated professional, as an employee who receives compensation in the form of a salary (and possible a bonus) can control the timing of the payment of the compensation. Because the Internal Revenue Code does not require that a salary or bonus be paid on a predetermined periodic basis, the incorporated professional may adjust the amount and frequency of payment to a schedule that will provide the maximum deferral of payment of tax on the compensation. However, the professional will also be trying to minimize the corporation's taxable income as of the last day of its taxable year. Otherwise, the corporation will be required to pay tax on income that would have been distributed in the form of compensation relatively soon *after* the end of the corporation's taxable year.

Generally, both these goals can be achieved if the corporation adopts a fiscal year as its taxable year [*see* [b], *above*]. The professional employees often will be paid monthly salaries whose aggregate sum is substantially less than the amounts the professional employees anticipate receiving as salaries and bonuses over the course of the corporation's fiscal year. Then, immediately before the end of the corporation's fiscal year, the corporation will pay bonuses to its professional employees in amounts that will enable the corporation to optimally reduce its taxable income as much as possible.

Although each professional employee will have income tax withheld at the rate of 20 percent of the year-end bonus [*see Treas. Reg. § 31.3402(g)-1(a)(2)(ii)*], this rate of withholding is substantially less than the withholding if the bonus had been paid as part of the professional's periodic salary. The remaining income tax liability based on payment of the bonus will not be due until April of the year following the year in which the bonus was paid.

As in any case of aggressive tax planning, the professional must be careful. If the professional attempts to supplement a low salary through a series of open-account advances during the course of the year, the advances may be challenged and construed as periodic salary, taxable when received. Furthermore, if the professional corporation is a personal service corporation within the meaning of *I.R.C. § 269A*, and the corporation is formed or operated primarily to avoid or evade federal income taxation, the IRS may reallocate items of income and deduction between the corporation and its employees [*see I.R.C. § 269A*; *see also* [4][d], *below*].

For a sample deferred compensation agreement, see *§ 12A.233*.

[e] Death Benefits

One advantage of incorporation is that the corporation may own insurance policies on the lives of its employees, and, in effect, pay the premiums with corporate earnings that have not been subject to tax at the high tax rates of the corporation's shareholders. However, the corporation cannot take a deduction for premiums paid on those policies or for interest paid or accrued on excessive indebtedness incurred with respect to those policies [*I.R.C. § 264(a)*; *see I.R.C. § 264(d)*].

A greater tax advantage can be achieved through the purchase of group term life insurance by the corporation. Premiums paid by the corporation are generally fully deductible for tax purposes [*I.R.C. § 162(a)(1)*]. In addition, the cost of that insurance [*I.R.C. § 79(c)*] is not included in the employee's gross income to the extent that its cost does not exceed the cost of $50,000 of insurance plus any amounts paid by the employee toward the purchase of the insurance [*I.R.C. § 79(a)*; *see I.R.C. § 79(b)* (exceptions), (d) (nondiscrimination rules)]. Furthermore, the proceeds of the policies are not subject to income tax when paid to the employee's estate or beneficiary [*I.R.C. § 101(a)(1)*; *Treas. Reg. § 1.101-1(a)(1)*].

An attorney arranging a group term life insurance program must take care to ensure that the program does not discriminate in favor of key employees [*see I.R.C. §§ 79(d)(6), 416*(*i*)(1) ("key employee" defined); *see also §§ 12A.21[2][b], [d]*]. It appears that a group term program under which each employee is given an amount of insurance protection based on the same proportion of his or her compensation as the insurance protection provided to the other employees will not be viewed as discriminatory.

[4] Potential Tax Disadvantages to Incorporating Professional Practices

[a] Problems Involving Unreasonable Compensation

A professional corporation may deduct compensation paid to its employees, including shareholder-employees, only if the amount of the compensation is reasonable [*I.R.C. § 162*]. For purposes of this test, "reasonable compensation" is the amount that would ordinarily be paid for like services by like enterprises under like circumstances [*Treas. Reg. §*

1.162-7(b)(3)]. For this purpose, all forms of compensation, including salary, bonus, and fringe benefits will be taken into account [*Keller v. Commissioner (1981) 77 T.C. 1014]* .

The absence of dividend payments by the corporation does not necessarily indicate that a portion of the compensation paid to a shareholder-employee should be treated as a dividend [*see Charles McCandless Tile Serv. v. United States (Ct. Cl. 1970) 422 F.2d 1336, 1338-1339]* . A corporation that has historically paid more than an insubstantial portion of its earnings as dividends on its stock will elicit close scrutiny, especially if the compensation paid to shareholder-employees is not found to be reasonable. But deductions for such compensation under *I.R.C. § 162(a)* will not be denied on the sole ground that the corporation has not paid more than an insubstantial portion of its earnings as dividends on its outstanding stock [*Rev. Rul. 79-8, 1979-1 C.B. 92*].

If the corporation is a viable, independent taxable entity, but the compensation paid to the shareholder-employees is treated as being unreasonable, a portion of the amounts paid to its shareholder-employees will be disallowed as a deduction; in effect, the corporation will be treated as having paid dividends. Such a characterization will cause the corporation's tax liability to increase. In contrast, if the existence of the corporation is ignored, all professional fees received by the corporation will be deemed to have been received by the professionals and all corporate expenses will be deemed to have been paid by them. Furthermore, the professionals will be treated as if they are self-employed and, as such, will not be able to take deductions for those expenditures paid by the corporation that are not deductible by self-employed individuals.

PRACTICE TIP:

Year bonuses are most likely to be challenged, especially if distributed to all shareholders in proportion to their salaries [*see Pediatric Surgical Assocs., P.C. v. Commissioner (2001) TC Memo 2001-81]* .

[b] Penalty Tax on Personal Holding Companies

If a professional corporation is classified as a personal holding company, it will also be taxed at 15 percent on its undistributed income [*I.R.C. § 541*]. A professional corporation will be treated as a "personal holding company" if it satisfies two tests [*I.R.C. § 542(a)*]:

- More than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals at any time during the last half of the taxable year.

- At least 60 percent of its adjusted ordinary gross income [*see I.R.C. § 543(b)(2)*] for the taxable year is personal holding company income [*see I.R.C. § 543(a)*].

"Personal holding company income" includes amounts received under an express or implied contract for a corporation to furnish personal services, if either (1) some person other than the corporation has the right to designate, by name or description, the individual who is to perform the services; or (2) the individual who is to perform the services is designated by name or description in the contract. This definition applies with respect to amounts received for services under a particular contract only if, at some time during the taxable year, 25 percent or more in value of the corporation's outstanding is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated by name or description as the one to perform the services [*I.R.C. § 543(a)(7)*].

Because a single-person professional corporation necessarily involves the client's or patient's selection of the performing individual, the personal holding company penalty tax may present particular problems for this type of professional corporation. The IRS has clarified this situation in a ruling relating to a medical corporation with one practitioner. The IRS ruled that while a patient customarily will solicit and expect to receive the services of a particular physician, as long as the physician-patient relationship is terminable at will by either party and the physician can provide a competent substitute physician if unable to provide a particular medical service, the corporation will not have personal holding

company income derived from a personal service contract. On the other hand, a personal service contract would obtain if the corporation contracted with the patient to provide the services of a designated physician, or if a physician performed services so unique as to preclude substitution of another physician. However, the IRS has not defined what constitutes "unique services" [*Rev. Rul. 75-67, 1975-1 C.B. 169* ; *see Rev. Rul. 75-250, 1975-1 C.B. 172*].

PRACTICE TIP:

A professional corporation should have a written agreement with clients reserving the right to designate the professional who will render the services.

[c] Accumulated Earnings Tax

A professional corporation also may be subject to the accumulated earnings tax imposed on current earnings if the corporation has unreasonable accumulations of income [I.R.C. §§ 531-537]. Although most corporations may accumulate up to $250,000 without concern for the existence of proper business justification for the accumulations, for purposes of this tax, corporations that provide services in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting may accumulate only $150,000 absent proper business justification [*I.R.C. § 535(c)(2)(B)*]. If the corporation exceeds the applicable limitation, a 15 percent penalty tax will be imposed on the accumulated taxable income of the corporation [*I.R.C. § 531*].

Income that has been accumulated for the reasonable needs of the business is not taken into account when computing a corporation's accumulated taxable income [*I.R.C. § 535(c)(1)*]. Nevertheless, unless the professional corporation can demonstrate a business need to purchase expensive equipment or a building in which its offices will be located, it may be difficult to justify business needs that require accumulations in excess of $150,000.

[d] Reallocation Under I.R.C. § 269A

I.R.C. § 269A provides that the Internal Revenue Service can reallocate income and deductions between a personal service corporation and its owner-employees if both of the following conditions exist [*I.R.C. § 269A*]:

- Substantially all of the services of the corporation are performed for or on behalf of another entity.

- The corporation was formed principally to avoid or evade federal income tax by reducing the income of, or securing the benefit of any expense, deduction, credit, exclusion, or other allowance for, any employee-owner that would not otherwise be available.

I.R.C. § 269A applies only to partnerships of professional corporations or to professional corporations serving an outside entity (such as an incorporated doctor employed solely by a hospital). It does not apply to professional corporations that serve a number of clients. For a more detailed discussion of *I.R.C. § 269A*, see Ballantine & Sterling, California Corporation Laws, Ch. 23, *Tax Planning for the Closely-Held Corporation* , § 483.02[3] (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsGeneral OverviewTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsCafeteria Plans (IRC sec. 125)Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)General OverviewTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsLife Insurance (IRC sec. 79)Tax LawFederal Income Tax ComputationCompensation & Welfare BenefitsTips, Wages & Other Compensation (IRC secs. 61, 3121, 3231)Bonuses & TipsTax LawFederal Income Tax ComputationOrdinary Income (IRC sec. 64)Tax LawFederal Income Tax ComputationRetirement PlansContributions (IRC secs. 401-404A, 406-408A, 410-420)Tax LawFederal Income Tax

ComputationRetirement PlansNondiscrimination Rules (IRC sec. 401)Tax LawFederal Taxpayer GroupsC CorporationsPersonal & Professional Service Corporations (IRC secs. 269A, 280H)



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide § 12A.22

§ 12A.22 California Taxation

Professional corporations incorporating in California must pay an annual franchise tax to the State of California for the privilege of doing business in California [*Rev. & Tax. Code § 23151; see Rev. & Tax. Code § 23101.5* (activities excluded from franchise tax)]. For taxable years beginning on or before December 31, 2010, "doing business in California" means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit [*Rev. & Tax. Code § 23101(a)*]. For taxable years beginning on or after January 1, 2011, a taxpayer is "doing business in California" if any of the following conditions has been satisfied [*Rev. & Tax. Code § 23101(b)*]:

1. The taxpayer is organized or commercially domiciled in California;

2. The taxpayer's sales in California for the taxable year exceed the lesser of $500,000 or 25 percent of the taxpayer's total sales [*see Rev. & Tax. Code §§ 25101(b)(2), 25120(e), (f)* (determination of "sales")];

3. The taxpayer's real property and tangible personal property in California exceed the lesser of $50,000 or 25 percent of the taxpayer's total real property and tangible personal property [*see Rev. & Tax. Code § 25101(b)(3)* (determination of property value)]; or

4. The amount the taxpayer paid in California for compensation exceeds the lesser of $50,000 or 25 percent of the total compensation paid by the taxpayer [see *Rev. & Tax. Code §§ 23101(b)(4), 25133, 25137* (rules for determining compensation)].

The amounts in 2.-4., above, are subject to annual revision [see *Rev. & Tax. Code § 23101(c)*]. The taxpayer's sales, property, and payroll include the taxpayer's pro rata or distributive share of a partnership or S corporation [*Rev. & Tax. Code § 23101(d)*].

The franchise tax is based on the corporation's net income for that taxable year and is imposed on general corporations at the rate of 8.84 percent [*Rev. & Tax. Code § 23151(a), (e), (f)*].

With limited exceptions, the minimum franchise tax is imposed on professional corporations until they formally

dissolve [*Rev. & Tax. Code §§ 23153(a), (d)(1), 23181*]. However, corporations that incorporate or qualify to do business in California after January 1, 2000, are not subject to the minimum franchise tax for the first taxable year, unless the corporation reorganized solely to avoid payment of the minimum franchise tax [*Rev. & Tax. Code § 23153(f)(1), (3)*].

For further discussion, *see* Ch. 1E, *Taxation of Businesses* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxGeneral OverviewBusiness & Corporate LawProfessional Associations & CorporationsTax LawState & Local TaxesFranchise TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART II. LEGAL BACKGROUND

5-12A California Legal Forms--Transaction Guide §§ 12A.23-12A.99

[Reserved]

§§ 12A.23[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

5-12A California Legal Forms--Transaction Guide § 12A.100

§ 12A.100 Facts

1. Identity of persons who will form corporation.

a. Name, address, and telephone and fax numbers of incorporators.

b. Professional status of each incorporator.
(1) Valid, current registration or certificate.

(2) Any suspensions or pending disciplinary proceedings.

c. Age of each incorporator.

d. Marital status of each incorporator.

2. Proposed name of corporation [*see Corp. Code § 13409*; *see also § 12A.14[1]*].

3. Address of principal office.

4. Name and address of statutory agent.

5. Purpose of corporation.

a. Professional service or services that corporation will render.

b. Names, addresses, telephone and fax numbers, and qualifications of persons who will practice on behalf of corporation.

6. Proposed share structure of corporation.

a. Authorized number of shares.

b. Any express terms of shares.

7. Amount of stated capital with which corporation will commence operation.

8. Property to be transferred to corporation:

a. Cash.

b. Assets of former unincorporated practice.

9. If existing partnership is being incorporated:

NOTE:

For a discussion of procedures and considerations involved in incorporating a going business, see Ch. 2A, ***Incorporating a Going Business*** .

a. Net worth or capital account of each partner.

b. Taxable year of partnership.

c. Taxable year of each partner.

10. Directors [*see Corp. Code § 13403*].

a. Number of initial directors.

b. Name, address, and telephone and fax numbers of initial directors.

c. Professional status of initial directors.

11. Shareholders [*see Corp. Code § 13406*].

a. Name, address, and telephone and fax numbers of each shareholder.

b. Professional status of each shareholder, including years of professional employment.

c. Proposed disposition of shares on death or disqualification of shareholder [*see § 12A.15[1]*].

12. Proposed fringe benefit plans to be adopted by professional corporation, if any:

a. Pension plan.

b. Profit-sharing plan.

c. Group term life insurance [*see § 12A.21[2][b]*].

d. Medical reimbursement plan [*see § 12A.21[2][d]*].

e. Medical diagnostic plan [*see § 12A.232*].

f. Deferred compensation agreements.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

5-12A California Legal Forms--Transaction Guide § 12A.101

§ 12A.101 Documents

1. If existing partnership is being incorporated, copy of partnership agreement.

NOTE:
For a discussion of procedures and considerations involved in incorporating a going business, see Ch. 2A, ***Incorporating a Going Business*** .

2. Any existing preincorporation agreements and proposed corporate agreements, such as:

a. Subscription contracts.

NOTE:
For a discussion of subscription agreements, see Ch. 2, ***Formation of Corporations*** .

b. Employment contracts [*see § 12A.230*].

c. Buy-sell agreement [*see § 12A.220*].

d. Share purchase agreement [*see § 12A.221*].

e. Medical reimbursement and/or diagnostic plans [*see §§ 12A.231* and *12A.232*].

f. Pension and profit-sharing plans [*see* Ch. 1D, *Overview of Employee Benefits* ; *see also* Young, Pensions and Profit Sharing Plans (Matthew Bender)].

g. Contracts, obligations, and debts to be assumed by corporation.

h. Financial statements or appraisals supportive of value of property, if any, to be received for issuance of shares.

3. Financial and tax records of organization to be incorporated, if any.

4. Copy of any lease or other agreement that is to be assigned to corporation.

5. Deed, bill of sale, or other instrument describing any real or personal property to be transferred to corporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawProfessional Associations & CorporationsContracts LawTypes of ContractsPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

5-12A California Legal Forms--Transaction Guide §§ 12A.102-12A.109

[Reserved]

§§ 12A.102[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-12A California Legal Forms--Transaction Guide § 12A.110

§ 12A.110 Non-Tax Considerations Affecting Incorporation

NOTE:

It is important to consider multiple representation issues when advising professionals whether or not to incorporate. Following corporate formation, will the client be the corporation or one of the professionals. For further discussion of this potential conflict of interest, see Ch. 1A, ***Role of Counsel in Starting a New Business*** .

Accountants, lawyers, and architects are permitted to operate as limited liability partnerships (LLPs) [***see*** *Corp. Code § 16951 et seq.*]. An LLP shields the professionals from vicarious liability for the debts and obligations of the partnership and permits flexible management. For further discussion, see Ch. 16C, ***Limited Liability Partnerships*** . The authority permitting architectural LLPs expires on January 1, 2007 [*Corp. Code § 16101(17)*].

1. Are prospective shareholders of a professional corporation seeking insulation from liability for nonprofessional acts or omissions or acts of professional partners [*see Corp. Code § 13403*; *T & R Foods, Inc. v. Rose, 47 Cal. App. 4th Supp. 1* ; *see also § 12A.13[2]*]?

NOTE:

If the professional corporation is organized as a close corporation [***see*** *Corp. Code § 158* (definition)], the corporation will obtain the flexibility of management and still receive the limited protection of *Corp. Code § 300(e)*, which insulates shareholders from personal liability based solely on the failure to observe corporate formalities [***see*** Ch. 1B, ***Selecting Form of Business Entity*** ; ***see also*** Ch. 2, ***Formation of Corporations***].

2. On what terms will corporation employ professionals?

NOTE:

Formal written employment agreements should be drafted for each professional employee of the corporation. For a representative employment agreement, see *§ 12A.230*.

3. What terms will be included in buy-sell agreement?

NOTE:
Among other matters, the buy-sell agreement must restrict the transfer of shares to licensed professionals [***see** § 12A.15[1]*]. For a representative buy-sell agreement, see *§ 12A.220*.

4. Will "allied professionals" own shares or hold office in corporation [*see § 12A.14[6]*]?

a. If any shares of prospective professional corporation will be held by person licensed only to practice a profession other than professional corporation's principal profession, do these persons qualify as "allied professionals" [*see Corp. Code § 13401.5*]?

NOTE:
For a list of the "allied professionals" permitted to hold stock in particular classes of corporations, see *§ 12A.14[6]*.

b. Do interests of proposed shareholders who are allied professionals total no more than 49 percent of all shares in corporation?

NOTE:
The sum of all shares owned by allied professionals cannot exceed 49 percent of the corporations total shares [*Corp. Code § 13401.5*].

c. Is total number of proposed shareholders who are allied professionals less than or equal to number of shareholders who are licensed by regulatory agency governing proposed professional corporation?

NOTE:
The number of allied professionals owning shares must not exceed the number of share owners who are professionals licensed by the regulatory agency governing the professional corporation [*Corp. Code § 13401.5*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-12A California Legal Forms--Transaction Guide § 12A.111

§ 12A.111 Tax Considerations Affecting Incorporation

1. Are prospective incorporators likely to want to borrow from pension plan fund?

NOTE:

The availability of pension plan funds as a source for loans is advantageous to most professionals. These funds are not available under noncorporate plans. For an explanation of the tax aspects of professionals securing loans from their corporate pension plans, see *§ 12A.21[2][f]*.

2. Is professional practice currently lucrative; is it likely to be so in the near future?

NOTE:

Professionals who will receive high incomes from their practice may benefit from incorporation in that the limits on their contributions to pension plans may be higher than the limits placed on noncorporate plans. For an explanation of the laws governing these contributions, see *§ 12A.21[2][g]*.

3. Will costs of incorporation be offset by additional corporate advantages, such as:

a. Deductibility of payments to medical, life, and disability insurance plans.

NOTE:

For an explanation of the allowable deductions and the anti-discriminatory provisions that apply to these plans, see *§ 12A.21*.

b. Possibly slightly lower flat tax rate, but without benefit of graduated rates.

c. Tax deferral through adoption of corporate fiscal year.

4. What are the current tax planning strategies of the potential incorporators?

NOTE:
If the professionals have been practicing as partners or as self-employed individuals, it is important to remember that, if they incorporate, they will not be able to offset the incorporated business's losses or gains against their personal losses or gains.

5. What compensation will be paid to professional employees, including:

a. Salaries.

b. Fringe benefits.

c. Bonuses.

NOTE:
For tax planning purposes, it is important to avoid paying compensation that the IRS may consider unreasonable. For an explanation of the law governing this matter, see *§ 12A.21[4][a]*.

6. What period will prospective corporation select as taxable year?

NOTE:
A professional corporation must use the calendar year for tax reporting purposes unless the corporation can show a valid business purpose for adopting a different fiscal year and the IRS approves the change [*I.R.C. § 441*(***i***)]. However, a professional corporation may elect a different taxable year if the new taxable year does not result in more than a three-month deferral of income; thus, a professional corporation may have taxable year ending in September, October, or November [***see*** *I.R.C. § 444(a), (b)*; ***see also*** *I.R.C. § 444(d)* (manner of election)]. If such an election is in effect, the corporation may be subject to limitations on the deductibility of amounts paid to employee owners [***see*** *I.R.C. §§ 280H, 444(c)(2)*].

a. Calendar year.

b. Fiscal year.

7. Should corporation elect to be taxed as S corporation [*see* I.R.C. §§ 1361-1379; *see also* Ch. 2B, *Electing Subchapter S Status*]?

NOTE:
Most professional corporations will derive no tax benefits from the election of Subchapter S status because there is only a slight chance that the corporation will accumulate. For a detailed explanation of the taxation of S corporations, see Ch. 2B, ***Electing Subchapter S Status*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsPensions & Benefits LawEmployee Benefit

PlansPension Benefit PlansTax LawFederal Income Tax ComputationRetirement PlansNondiscrimination Rules (IRC sec. 401)Tax LawFederal Taxpayer GroupsC CorporationsPersonal & Professional Service Corporations (IRC secs. 269A, 280H)Tax LawFederal Taxpayer GroupsS CorporationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

5-12A California Legal Forms--Transaction Guide §§ 12A.112-12A.119

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§§ 12A.112[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-12A California Legal Forms--Transaction Guide § 12A.120

§ 12A.120 Forming a Professional Corporation

1. Choose corporate name that [*see Corp. Code § 13409(a)*; *see also § 12A.14[1]*]:

a. Is permitted by law applicable to profession in which corporation will engage, and by any rules or regulations of governmental agency regulating profession.

NOTE:
Detailed regulatory requirements apply to the selection of corporate names for professional corporations. For a list of the regulations applicable to the selection of corporate names, see *§ 12A.200[1][d]*.

b. Is not deceptively similar to name of another corporation [*Corp. Code § 201(b)*; *see* Ch. 2, *Formation of Corporations*] or, if similar to name of another corporation, meets both of following criteria:

(1) Contains and is restricted to name or last name of one or more:
(a) Present, prospective, or former shareholders; or

(b) Persons who were associated with predecessor person, partnership, or other organization; or whose name or names appeared in name of predecessor organization.

(2) Is not substantially the same as name of:

(a) Domestic corporation;

(b) Foreign corporation authorized to transact business in California; or

(c) Name under reservation for another corporation.

2. Obtain, by letter or telephone, a name clearance from Sacramento office of Secretary of State, Name Availability Unit; email or online requests cannot be accepted.

3. Prepare initial filings to incorporate professional practice.

a. Draft articles of incorporation and make at least five copies [*see Corp. Code § 200*; *see also § 12A.200*]:

NOTE:
The articles of incorporation must be signed and acknowledged by the initial directors of the corporation if they are named in the articles. If no initial directors are named, the incorporators must sign the articles [*Corp. Code § 200(b)*].

(1) Original copy for filing with Secretary of State.

(2) Duplicate original for Secretary of State's files when articles are filed with Secretary of State.

(3) Two copies for certification by Secretary of State and filing with corporation's application for certificate of registration.

(4) Copy to be "endorsed filed" stamped by Secretary of State for counsel's office files.

b. Prepare affidavit certifying that name of professional corporation complies with corporate name requirements [*see Corp. Code § 13409(a)*]:

(1) If articles will be filed by licensed person, use *§ 12A.201*.

(2) If articles will be filed by attorney or someone else other than licensed person, use *§ 12A.202*.

c. Obtain check for filing fees [*see Gov. Code § 12186(c)*].

d. File articles of incorporation with Secretary of State [*see* Ch. 3, *Articles of Incorporation*], together with applicable filing fees.

4. Prepare bylaws [*see § 12A.203*].

NOTE:
Bylaws for a professional corporation ordinarily contain the same provisions found in bylaws of a business corporation [***see*** Ch. 4, ***Bylaws***].

5. Restrict ownership of shares by doing both of following:

a. Specifying required manner of disposition of shares belonging to deceased or disqualified shareholder.

b. Requiring corporate shares to contain appropriate restrictive legend [*see § 12A.203[1]*].

6. Prepare minutes of organizational meeting [*see § 12A.204*].

a. Either:

(1) Instruct incorporators to hold initial meeting of board of directors; or

(2) Have initial board of directors waive meeting and take initial actions by unanimous written consent.

b. Discuss and, if desired, draft resolutions approving:

(1) Profit-sharing plan and trust, pension plan and trust, and other qualified plans under *I.R.C. § 401(a)* [*see* Young, Pensions and Profit Sharing Plans (Matthew Bender)].

(2) Subscription for malpractice insurance covering corporation and its employees.

(3) Purchase of life, health, accident, and other medical disability insurance.

(4) Fringe benefit plans, such as medical reimbursement plan or medical diagnostic plan [*see §§ 12A.231*, *12A.232*].

7. Make at least three copies of each resolution.

a. Insert one copy into minutes of meeting.

b. Deliver one copy, certified by corporation secretary, to bank, regulatory agency, or any other third party affected by resolution.

c. File one copy in counsel's office file.

8. Draft all documents for fringe benefit plans.

NOTE:

For a detailed explanation of pension and profit sharing plans and representative forms, see Young, Pensions and Profit Sharing Plans (Matthew Bender).

9. Obtain advance Internal Revenue Service approval of pension and profit-sharing plans.

NOTE:

The IRS issues an annual Revenue Procedure containing the current procedures for requesting determination letters [***see, e.g.,*** Rev. Proc. 2004-1, 2004-1 I.R.B. 1]. As these procedures are updated every year, the attorney is advised to review the most recent Revenue Procedure for information on current procedures.

10. Prepare and file application for certificate of registration, if required.

NOTE:

Professional corporations rendering professional services by persons duly licensed by the Medical Board of California (or any examining committee under its jurisdiction), the Osteopathic Medical Board of

California, the Dental Board of California, the California State Board of Pharmacy, the Veterinary Medical Board, the California Architects Board, the Court Reporters Board of California, Board of Behavioral Sciences, the Board of Registered Nursing, or the State Board of Optometry need not obtain a certificate of registration [*Corp. Code § 13401(b)*; ***see*** *§ 12A.10[2][b]*].

11. Obtain federal employer identification number by filing IRS Form SS-4 with Internal Revenue Service.

12. Obtain California employer identification number.

NOTE:

Within 15 days after becoming subject to the personal income tax withholding requirements [***see*** *Unemp. Ins. Code § 675*], an employer must register with the Employment Development Division (EDD) and secure an account by filing the Registration Form for Commercial Employers (Form DE-1) at an Employment Tax district office [*Unemp. Ins. Code § 1086*]. Alternatively, if the employer will be seeking a sales tax permit, the employer may register at a State Board of Equalization office [***see*** *Rev. & Tax Code §§ 6014, 6066, 6226*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesGeneral OverviewBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-12A California Legal Forms--Transaction Guide § 12A.121

§ 12A.121 Issuing Securities

NOTE:

Issuance of stock by a professional corporation or by a foreign professional corporation qualified to render professional services in California under the Professional Corporation Act ordinarily is exempt from the qualification requirement of the Corporate Securities Law [***see*** *10 Cal. Code Reg. § 260.105.6*] and federal securities laws [***see*** *15 U.S.C. § 77c(a)(11), (b)*; ***see also*** *17 C.F.R. §§ 230.501-230.508*]. For further discussion, see *§ 12A.19*. For a general discussion of the securities laws, see Ch. 6, ***Securities Regulation Issues*** . For general coverage of the mechanics of issuing corporate stock, see Ch. 6I, ***Issuance of Equity Securities*** .

1. Obtain and prepare share certificates containing legend:

a. Restricting share ownership to licensed persons; and

b. Requiring deceased or disqualified shareholders' shares to be transferred to corporation or to another eligible person.

2. If shares will be issued in exchange for assets of prior unincorporated professional practice:

a. Prepare bill of sale that [*see* Ch. 17, *Buying and Selling a Business or Professional Practice*]:
(1) Transfers accounts to corporation; and

(2) Grants corporation power of attorney to collect accounts receivable of the practice.

b. Have owners of incorporating practice execute original of bill of sale and retain copy for counsel's files.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsSecurities LawBlue Sky LawsExempted IssuersSecurities LawExemptions From RegistrationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

5-12A California Legal Forms--Transaction Guide §§ 12A.122-12A.129

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§§ 12A.122[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

5-12A California Legal Forms--Transaction Guide § 12A.130

§ 12A.130 Maintaining Corporate Status

NOTE:

To protect itself from possible attacks by the Internal Revenue Service, it is essential that the corporation conduct itself at all times like a corporation [***see*** *Roubik v. Commissioner (1969) 53 T.C. 365, 379* (taxpayer seems to have existed as "mere set of bookkeeping entries and bank accounts")].

1. Advise client to use corporate name at all times on:

a. Stationery.

b. Business cards.

c. Announcements.

d. Office directory.

e. Office doors.

f. Professional listings.

g. All contracts, employment agreements, and insurance policies.

h. Checks.

i. Telephone listing.

j. All bank accounts.

k. All other documents.

2. Advise client to deposit all funds in corporate bank account, never in any individual's account.

3. Advise client to bill for and receive all fees for all services rendered in corporate name.

4. Advise client to incur and pay all expenses of the practice in corporate name.

5. Advise client to be employer and execute all employment agreements in corporation's name [*see § 12A.230*].

6. Advise client to observe all corporate formalities.

NOTE:
If the corporation is a close corporation, it may dispense with many of the corporate formalities otherwise required of corporations.

a. Issue stock and maintain records of stock transfers.

b. Obtain corporate record book and keep detailed minutes of all meetings of shareholders and directors.

c. Hold regular meetings of shareholders and directors, at least annually, and take following steps at meetings:
(1) Elect directors and officers.

(2) Record discussions of resolutions regarding:
(a) Salaries.

(b) Bonuses.

(c) All corporate plans (e.g., pension, profit-sharing, insurance, and medical plans).

7. Ensure that corporation executes employment contracts with all professional employees.

8. Have corporation pay all:

a. Federal income tax.

b. Social security withholding tax.

c. Unemployment compensation.

d. Workers' compensation.

e. State franchise tax.

f. City taxes.

g. Other applicable taxes.

9. Instruct corporation not to pay nonbusiness expenses of any shareholder.

10. Verify that corporation has filed statement of officers and directors within 90 days of filing articles [*see Corp. Code § 1502*].

NOTE:

This statement must be filed on a form provided by the Secretary of State, which is reproduced in Ch. 7, ***Corporate Records and Reports***.

11. Send annual report to shareholders within 120 days after close of fiscal year [*see Corp. Code § 1501(a)(1)*].

NOTE:

For instructions on how to prepare an annual report, see Ch. 7, ***Corporate Records and Reports*** .

12. If shareholders desire corporation to be taxed as S corporation [*I.R.C. §§ 1361*-1379], file appropriate form with Internal Revenue Service [*see* Ch. 2B, *Electing Subchapter S Status*].

13. Advise corporation to file annual report if required by regulating agency.

14. If client wishes to open additional offices, check to see whether applicable regulatory restrictions require that permit be obtained.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawClosely Held CorporationsGeneral OverviewBusiness & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawProfessional Associations & CorporationsTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

5-12A California Legal Forms--Transaction Guide §§ 12A.131-12A.199

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§§ 12A.131[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
A. Organizational Documents

5-12A California Legal Forms--Transaction Guide § 12A.200

§ 12A.200 Articles of Incorporation for Professional Corporation

[1] Comment

[a] Use of Form

This form is a set of articles of incorporation for a professional corporation modeled after the California Secretary of State's sample form. It is a general purpose form and does not purport to illustrate provisions related to any particular profession. The incorporation of some professions may be governed by statutes and regulations other than and in addition to the Moscone-Knox Professional Corporation Act [*see Corp. Code § 13400 et seq.*]. These provisions commonly regulate matters such as the name and purpose of the corporation [*see* [d], *below*; *see also § 12A.14[1]*] and the qualification of shareholders [*see § 12A.14[4]*]. The agency regulating the profession may require that a professional corporation's articles include provisions for the purpose of enforcing the profession's code of ethics. This form should be adapted in accordance with any rules and regulations for the particular profession to be practiced by the corporation.

For a detailed analysis of articles of incorporation generally, see Ch. 3, *Articles of Incorporation* .

[b] Required Provisions

Articles of incorporation for professional corporations differ from articles for business corporations in that they must state that the corporation is a professional corporation [*Corp. Code §§ 202(b)(4), 13404*; *see* art. I, *below*]. The articles must also identify the professional purpose of the corporation [*see Corp. Code § 202(b)(1)(ii)*; *see also* art. II, *below*]. The articles may not contain any additional statement regarding the powers or purposes of the corporation except for purposes of limitation or as required by other state or federal law [*Corp. Code § 202(b)(4)*].

The articles must specify the name of the corporation's initial agent for service of process. If the designated agent is an individual, the articles also must specify the agent's California street address [*Corp. Code § 202(c)*; *see Corp. Code § 1502(b)*; *see also* art. IV, *below*]. Article IV of this form contains two alternative provisions for the appointment of the initial corporate agent for service of process. The first alternative should be used if a natural person is appointed agent. The second alternative should be used if a corporation will be appointed agent. If a corporate agent is appointed, that

agent must comply with the requirements contained in *Corp. Code § 1505*. For a discussion of *Corp. Code § 1505* and a representative certificate of consent of a corporation to act as agent for service of process for another corporation, see Ch. 3, *Articles of Incorporation* .

If the corporation is authorized to issue only one class of stock, the articles must specify all of the following [*Corp. Code § 202(e)(1)*]:

- The total number of authorized shares [*Corp. Code § 202(d)*; *see* art. V, *below*]. If the corporation is authorized to issue more than one class of stock or if any single class of stock will have two or more series, the articles must specify the total number of authorized shares for each class or series or, alternatively, that the board of directors is authorized to fix the number of shares in each series.

- The designation of each class or series or, alternatively, that the board of directors is authorized to determine the designation of each series.

- The rights, preferences, privileges and restrictions granted to or imposed on the respective classes or series of shares or the holders of those shares or, alternatively, that the board of directors may alter those rights, preferences, privileges, and restrictions subject to any stated limitations on any wholly unissued class or series of shares.

[c] Optional Provisions

This form contains optional provisions setting forth the number of directors [*see* art. VI, *below*], the names of initial directors [*see* art. VI, *below*], the number of shareholders [*see* art. VII, *below*], and the fact that the corporation is a close corporation [*see* art. VII, *below*]. The clauses relating to the directors are optional in that their absence will not affect the acceptability of the articles for filing with the Secretary of State [*see Corp. Code §§ 204(c), 212(a)*]. However, the clause specifying the number of directors must appear in the articles if it is not contained in the bylaws [*Corp. Code § 212(a)*]. The clause specifying the number of shareholders in a close corporation is also optional, but it must appear in the articles for the corporation to effectively elect close corporation status on formation [*Corp. Code § 158*; *see* Ch. 3, *Articles of Incorporation*].

[d] Corporate Name

As a general rule, the names of professional corporations must reflect the nature of the professional practice in which the corporation will engage. Most professional corporation names must contain and be restricted to the last name of one or more of the present, prospective, or former shareholders or of persons who were associated with a predecessor person, partnership, or other organization and must include wording or abbreviations denoting the corporate existence such as "Professional Corporation," "Prof. Corp.," "Corporation," "Corp.," "Incorporated," or "Inc." [*see Bus. & Prof. Code §§ 1054* (chiropractic corporations), *1804* (dental corporations), 2530.3, 2537.4 (speech pathology and audiology corporations), *2693* (physical therapy corporations), *2902* (psychological corporations), *4978* (acupuncture corporations), *8043* (shorthand reporting corporations), *4987.7* (counseling corporations); *see also 16 Cal. Code Reg. §§ 367.7* (chiropractic corporations), 1344 (medical and podiatry corporations), 1399.476 (acupuncture corporations), 1546 (optometric corporations), 1850.6 (counseling corporations)].

The names of accountancy corporations are not restricted to the name of one or more of the shareholders. However, the name chosen for the corporation may not be false or misleading [*see Bus. & Prof. Code §§ 5058.1, 5060(a)*; *see Bus. & Prof. Code § 5060(b)* (no one may practice public accountancy under name other than that on valid permit)].

For an analysis of the prohibition against use of misleading names and how it relates to professional corporations, see *§ 12A.14[1]*.

[e] Signature and Acknowledgment

The articles of incorporation must be signed and acknowledged by each initial director named in the articles. If no initial directors are named, the articles must be signed by the incorporators [*Corp. Code § 200(b)*; *see Corp. Code § 149*]. Certificates of acknowledgment must be in the form prescribed by statute [*Civ. Code §§ 1188, 1189(a)*; *see* [2], *below*]. The officer taking the acknowledgment of an instrument must authenticate the certificate by endorsing it, and must then attach the certificate to the instrument [*Civ. Code §§ 1188, 1193*]. A certificate of acknowledgment of an instrument executed by a duly authorized person on behalf of an incorporated or unincorporated entity in the prescribed form [*see Civ. Code § 1189(a)*] is prima facie evidence that the instrument is the duly authorized act of the entity named in the instrument, and is conclusive evidence of that fact in favor of any good faith purchaser, lessee, or encumbrancer [*Civ. Code § 1190*].

For a more detailed discussion of the execution and acknowledgment of articles, see Ch. 3, *Articles of Incorporation* .

[f] Filing

An original and at least two copies should be included in the filing with the Secretary of State, together with the current filing fee [*see Gov. Code § 12186(c)*]. The Secretary of State will compare and certify two copies of the articles without charge if submitted with the original [*Gov. Code § 12185*]. For a detailed discussion of filing procedures, see Ch. 3, *Articles of Incorporation* .

[g] Commencement of Practice

Although the act of filing the articles of incorporation with the Secretary of State establishes the existence of the corporation, the corporation may not begin to render professional services until it has obtained a certificate of registration, when necessary [*Corp. Code §§ 13401(b), 13404*]. For an explanation of the registration certificate requirement for professional corporations, see *§ 12A.14[5]*.

[2] FORM

Articles of Incorporation for Professional Corporation

ARTICLES OF INCORPORATION
of
_____ [*name of corporation*],

A PROFESSIONAL CORPORATION

I. NAME

The name of this corporation is _____.

II. PURPOSE

The purpose of the corporation is to engage in the PROFESSION of _____[*specify, e.g.*, medicine] and any other lawful activities (other than the banking or trust company business) not prohibited to a corporation engaging in such profession by applicable laws and regulations.

III. PROFESSIONAL CORPORATION

This corporation is a professional corporation within the meaning of the Moscone-Knox Professional Corporation Act.

IV. AGENT FOR SERVICE OF PROCESS

The name and address in the State of California of this corporation's initial agent for service of process are:

[*EITHER, if agent is natural person:*]

Name: _____
Street Address: _____
City: _____, California _____ [*zip code*]

[*OR, if agent is corporation:*]

Name: _____

[*Continue with the following:*]

V. STOCK

The corporation is authorized to issue only one class of shares of stock. The total number of shares that the corporation is authorized to issue is _____.

[*If more than one class of shares is authorized, see Ch. 3, Articles of Incorporation, § 3.203[2], for alternative provisions. For other article provisions that may be appropriate for corporations with complex stock structures, see Ch. 3, Articles of Incorporation, §§ 3.240-3.257.*]

[*Optional*]

VI. NUMBER OF DIRECTORS

The names and addresses of the persons appointed to act as initial directors are:

Name	Address
_____	_____
_____	_____
_____	_____
_____	_____

[*Continue with the following:*]

[*If corporation is a close corporation, add:*]

VII. NUMBER OF SHAREHOLDERS

This corporation is a close corporation. The corporation's issued shares will be held of record by not more than _____[*number not exceeding 35*] persons.

[*Continue with the following:*]

Execution

IN WITNESS WHEREOF, the undersigned _____[has *or* have] executed these Articles of Incorporation on _____[*date*].

[*If initial directors are named in articles:*]

_____ [*signature of director*]
[*typed name*]
_____ [*signature of director*]
[*typed name*]
_____ [*signature of director*]
[*typed name*]

[*Or, if initial directors are not named in articles:*]

_____ [*signature of incorporator*]
[*typed name*]
_____ [*signature of incorporator*]
[*typed name*]
_____ [*signature of incorporator*]
[*typed name*]

[*If initial directors are named in articles, each director must acknowledge the articles. Otherwise, acknowledgment is not required (Corp. Code § 200(b)):*]

ACKNOWLEDGMENT

[*Acknowledgments taken in California must be in the following form (Civ. Code § 1189(a)):*]

State of California
County of _____

On _____[*date*], before me, _____[*name and title of officer taking acknowledgment*], personally appeared _____[*name(s) of person(s) signing instrument*], _____[personally known to me or proved to me on the basis of satisfactory evidence] to be the person[s] whose name[s] _____[is *or* are] subscribed to the within instrument and acknowledged to

me that _____[he *or* she *or* they] executed the same in _____[his *or* her *or* their] authorized _____[capacity *or* capacities], and that by _____[his *or* her *or* their] signature[s] on the instrument the person[s], or the entity upon behalf of which the person[s] acted, executed the instrument.

WITNESS my hand and official seal.
Signature _____ [*Seal*]

[*If initial directors are named in articles, each director should use the following declaration:*]

Declaration

We, and each of us, declare:

1. We are the persons whose names are subscribed below.

2. We collectively are all of the incorporators of _____[*name of corporation*] [and all of the initial directors named in these Articles of Incorporation], and we have executed these Articles of Incorporation.

3. These Articles of Incorporation are our act and deed, jointly and severally.

Executed on _____[*date*] at _____[*location*].

_____ [*signature of director*]
[*typed name*]
_____ [*signature of director*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawProfessional Associations & Corporations

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
A. Organizational Documents

5-12A California Legal Forms--Transaction Guide § 12A.201

§ 12A.201 Affidavit of Compliance With Corporate Name Requirements--By Licensed Person

[1] Comment--Use of Form

This form is an affidavit certifying under penalty of perjury that the name of a professional corporation complies with the corporate name requirements of *Corp. Code § 13409*. The Secretary of State is authorized by statute to require proof by affidavit or otherwise that the name of a professional corporation meets these requirements and complies with the requirements of the law governing the profession in which the professional corporation is engaged. The statute authorizes the Secretary of State to accept the statements in such an affidavit as sufficient proof of the facts [*Corp. Code § 13409*]. This affidavit is ordinarily filed as a separate document with the articles of incorporation.

This version of the affidavit is for use when the licensed person will file the articles of incorporation. If the attorney or another person will file the articles, § 12A.202 should be used in place of this form.

For discussion of the corporate name requirements imposed by *Corp. Code § 13409*, see *§ 12A.14[1]*.

[2] FORM

Affidavit of Compliance With Corporate Name Requirements-By Licensed Person

Affidavit of Compliance With Corporate Name Requirements

I, _____[*name of licensed person*], declare under penalty of perjury at _____, California, on _____[*date*] that:

1. The personal name included within the name of _____[*corporate name*] is my name.

2. I am the prospective shareholder of the corporation.

3. I am a "licensed person" within the meaning of *Section 13401(d) of the Corporations Code*.

_____ [*signature of licensed person*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
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5-12A California Legal Forms--Transaction Guide § 12A.202

§ 12A.202 Affidavit of Compliance With Corporate Name Requirements--By Attorney

[1] Comment--Use of Form

This form is an affidavit certifying under penalty of perjury that the name of a professional corporation complies with the corporate name requirements of *Corp. Code § 13409*. The Secretary of State is authorized by statute to require proof by affidavit or otherwise that the name of a professional corporation meets these requirements and complies with the requirements of the law governing the profession in which the professional corporation is engaged. The statute authorizes the Secretary of State to accept the statements in such an affidavit as sufficient proof of the facts [*Corp. Code § 13409*]. This affidavit is typically filed as a separate document with the articles of incorporation.

This version of the affidavit is for use when the attorney or some other person will file the articles of incorporation as incorporator. If a licensed person will file the articles, § 12A.201 should be used in place of this form.

For discussion of the corporate name requirements imposed by *Corp. Code § 13409*, see *§ 12A.14[1]*.

[2] FORM

Affidavit of Compliance With Corporate Name Requirements--By Attorney

Affidavit of Compliance With Corporate Name Requirements

I, _____[*name of attorney*], declare under penalty of perjury at _____, California, on _____[*date*] that:

1. I am the attorney representing _____[*corporate name*].

2. The personal name included within the name of the corporation is that of a prospective shareholder of the corporation. This person is a "licensed person" within the meaning of *Section 13401(d) of the Corporations Code*.

_____ [*signature of attorney*]

[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
A. Organizational Documents

5-12A California Legal Forms--Transaction Guide § 12A.203

§ 12A.203 Bylaws for Professional Corporation

[1] Comment

[a] Use of Form

This form is a representative set of bylaws for a professional corporation. Because it is not designed to be used for any particular type of professional corporation, it contains provisions of general application that in most cases will have to be modified and augmented to meet the needs of the particular type of professional practice involved.

Because many professional corporations are small entities with only a few shareholders, this form has been kept relatively simple and basic. If more detailed provisions regarding corporate structure and management are desired, the provisions of this form may be augmented by adding provisions from the long-form corporate bylaws *set forth in Ch. 4, Bylaws, § 4.200*. For a detailed discussion of corporate bylaws, and other alternative bylaw clauses, see Ch. 4, *Bylaws* .

For ease of reference, the headings of the individual provisions in these bylaws contain reference to the relevant Corporations Code sections. These statutory references should be omitted from actual bylaws drafted using this form as a model.

[b] Restrictions Regarding Officers

Specified persons licensed in other professions related to the profession in which a corporation is engaged may be officers, directors, shareholders, or employees of the corporation. However, the roles of allied professionals in professional corporations are subject to restrictions [*see Corp. Code § 13401.5*]. For an explanation of those restrictions, see *§ 12A.12*. For a complete list of allied professionals, see *§ 12A.14[6]*.

[c] Directors of Medical Corporations

The bylaws (or articles) of a medical professional corporation may set forth the powers, duties, compensation, and methods of selection and removal of directors. Each term of office for these directors may not exceed three years.

However, if the medical corporation has more than 200 shareholders, the bylaws or articles may provide that directors who are officers of the corporation or who are responsible for the management of all medical services at one or more medical centers may have directors' terms of up to six years. In no event, however, may more than 50 percent of the members of the board, plus one additional member of the board, have six-year terms of office [*Corp. Code § 13403*].

[d] Indemnification of Officers and Directors

Article Five of these bylaws provides that the corporation will indemnify any corporate director, officer, or employee for expenses and/or liabilities incurred as a result of good faith activities on behalf of the corporation. This provision will enable any professional employee who is found liable for malpractice to have a right of reimbursement against the corporation. The determination of whether or not the person is seeking indemnity reasonably and in good faith will be up to the directors and will not necessarily depend on the outcome of any proceeding in connection with which the director, officer, or employee seeks indemnity.

[e] Sole Shareholder Corporations

In a sole shareholder corporation, the shareholder must serve as both president and treasurer [*Corp. Code § 13403*; *see § 12A.14[4]*]. That shareholder must be licensed to practice the profession for which the corporation is formed, but the other corporate officers and directors need not be licensed persons [*Corp. Code § 13403*; *see* [2*], §§ 4.01, 4.02, below*].

[2] FORM

Bylaws for Professional Corporation

BYLAWS OF

_____ [*name of corporation*]

I. SHARE OWNERSHIP

Qualifications of Shareholders [*Corp. Code §§ 13401.5, 13406(a), 13407*]

1.01. The Corporation may not issue shares, nor may any shareholder transfer any of its capital stock, to anyone other than the Corporation or an individual who is duly licensed or otherwise legally authorized to render the specific professional services for which the Corporation was organized. [*If allied professionals may be officers of corporation (see Corp. Code § 13401.5), add:* Persons licensed to practice _____ (*specify allied profession(s), e.g.,* psychology) may at no time own more than 49 percent of the total number of shares of the corporation and may at no time outnumber those persons licensed to practice _____ (*specify profession in which corporation will render services, e.g.,* medicine)].

Required Transfer of Shares [*Corp. Code § 13407*]

1.02. (a) Shares owned by a person who dies or becomes a disqualified shareholder will be sold and transferred to the Corporation or its shareholders on the terms agreed on by the Corporation and its shareholders. The sale or transfer will occur not later than six months following the death of any shareholder, or within 90 days following the disqualification of any shareholder to practice the profession of _____[*specify profession for which corporation is organized*].

[*If shareholders executed a buy-sell agreement (see § 12A.220), add:*]

The terms for the purchase and sale are set forth in _____ (title of the buy-sell agreement), executed by the shareholders and the Corporation on _____[*date*].

[*If shareholders will not execute a buy-sell agreement, add:*]

(b) If the shareholders and a disqualified shareholder or the estate of a deceased shareholder are unable to agree on the value of shares in the Corporation, that value will be determined by arbitration conducted in accord with the terms of this section. One arbitrator will be selected by the Corporation, and one arbitrator will be selected by the disqualified shareholder or the estate of the deceased shareholder. The two arbitrators will confer and determine the value of the shares. If the two arbitrators cannot agree on the disputed matter, they will select a third arbitrator whose decision will be final and binding on all parties.

[*Continue with the following:*]

II. MEETINGS AND ACTIONS OF SHAREHOLDERS

Annual Meetings [*Corp. Code § 600(a), (b)*]

2.01. (a) The annual meeting of the Corporation's shareholders will be held at the principal office of the Corporation or at another place determined from time to time by the Board of Directors. The annual meeting will be held _____[*e.g.*, at 10:00 o'clock A.M., on the first Monday in April] each year it is if not a legal holiday (but if it is a legal holiday, then on the next day not a legal holiday), or at another time in each year, as determined from time to time by the Board of Directors.

(b) The annual meeting will be held for the purpose of electing directors and considering reports. On due notice, matters that can properly be considered and acted on at a special meeting may also be considered and acted on at an annual meeting, in which case the annual meeting will also be considered as, and will be, a special meeting. If the annual meeting is not held, or if directors are not elected at the annual meeting, a special meeting may be called and held for that purpose.

Special Meetings [*Corp. Code § 600(d)*]

2.02. Special shareholders' meetings may be called by the Chairman of the Board, the President or a Vice-President; by the Board of Directors pursuant to a meeting of the Board; by a majority of the directors acting without a meeting; or by any person or persons who hold not less than 25 percent of all shares outstanding and entitled to be voted on any proposal to be submitted at the meeting. On written request by any person or persons entitled to call a shareholders' meeting, made by registered or certified mail or delivered in person to the Secretary, the Secretary will provide the shareholders with notice of a meeting. If the Secretary fails to set the meeting and give notice within 20 days after the delivery of the request, the person or persons requesting the meeting may fix the time of the meeting and give notice in the manner provided in Section 2.03. No business other than that specified in the notice may be considered at any special meeting.

Notice of Meetings [*Corp. Code § 601(a), (b)*]

2.03. (a) A written notice of annual or special shareholders' meetings, stating the time, place, and in the case of special meetings, the object or objects of the meetings, must be given by or at the direction of the President, Vice-President, Secretary, or Assistant Secretary to each shareholder of record entitled to vote at the meeting. The record date for the determination of shareholders who are entitled to vote at any meeting is the close of business on the date preceding the date on which notice is given.

(b) Notice will be mailed not less than 10 nor more than 60 days before the date fixed for the meeting to the

shareholder's address on the books of the corporation. Notice will be deemed to have been given on the day mailed. No failure or irregularity of notice of meeting will invalidate the meeting or any proceeding or action taken at the meeting, and actual attendance at any meeting without protest prior to commencement of the meeting constitutes a waiver. Notice of meetings may be waived by any shareholder or by all the shareholders pursuant to law.

Quorum [*Corp. Code § 602(a)*]

2.04. Unless otherwise provided by statute, the Articles, or these Bylaws, shareholders of record entitled to vote not less than a majority in number of the shares authorized, issued, and outstanding, represented in person or by proxy, constitute a quorum sufficient for the taking of any action submitted to a vote at a meeting of the shareholders.

Voting [*Corp. Code §§ 700, 708*]

2.05. Unless otherwise provided by statute, the Articles, or these Bylaws, shareholders at the close of business on the record date are entitled to notice and to vote, notwithstanding the transfer of any shares on the books of the corporation after the record date. Each share has one vote. Unless otherwise provided by statute, the Articles, or these Bylaws, a majority of the shares entitled to vote, represented in person or by proxy, will determine any matter submitted to a vote at a meeting of the shareholders. Cumulative voting in the election of directors _____[is *or* is not] permitted.

Voting Trusts and Proxies [*Corp. Code §§ 705, 706*]

2.06. Shareholders may enter into voting trusts, proxies, or any other arrangement vesting authority to exercise the voting power of any or all of their shares in another person only if that other person is a shareholder of the Corporation. Any voting trust, proxy, or other arrangement with any other person is void.

Adjournment [*Corp. Code § 602(c)*]

2.07. At any meeting, the shareholders present in person or by proxy, whether or not a quorum, may adjourn the meeting from time to time.

Action Without Meeting [*Corp. Code §§ 603*]

2.08. Any action that may be authorized or taken at a shareholders' meeting may be authorized or taken without a meeting with the affirmative vote or approval of, and in writing signed by, all of the shareholders who would be entitled to notice of a meeting for that purpose. The writing will be filed with or entered on the records of the Corporation.

III. DIRECTORS

Number of Directors [*Corp. Code § 212(a)*]

3.01. The number of directors will be determined, from time to time, at a shareholders' meeting called for the purpose of electing directors, at which a quorum is present, by resolution of shareholders holding a majority of the shares, in person or by proxy, entitled to vote. The number of directors will not be less than three unless all the shares of the Corporation are owned of record by one or two shareholders, in which case the number of directors may be less than three but not less than the number of shareholders. In case the shareholders at any meeting for the election of directors fail to fix the number of directors to be elected, the number elected will be deemed to be the number of directors so fixed.

Licensing [*Corp. Code §§ 13401.5, 13403*]

3.02. All directors must hold a current valid license to practice _____[*specify profession*] or to practice the allied profession[s] of _____[*specify allied profession(s)*] in California. If any director is disqualified from the practice of _____[*restate profession, or, if more than one type of professional is authorized to be a director, state:* any of the aforementioned professions], that director will be removed from the board and an election to replace the vacancy thus created will be conducted in accordance with Section 3.04.

Election and Term of Office [*Corp. Code § 301*]

3.03. The directors will be elected at each annual shareholders' meeting, or if not so elected, at a special shareholders' meeting called for that purpose. Each director will hold office until the expiration of the term for which he or she was elected and will continue in office until a successor is elected, or until earlier resignation, removal from office, or death. Each director's term of office will be _____[*specify number not greater than three unless company is a large professional medical corporation (see Corp. Code § 13403), e.g.,* one year, from the annual meeting date to the next succeeding annual meeting date].

Vacancies [*Corp. Code § 305*]

3.04. Any vacancy occurring in the Board of Directors by reason of death, resignation, or other incapacity will be filled by a majority vote of the remaining members of the Board except as otherwise provided in the articles of incorporation. Interim directors appointed in this manner will hold office until the next annual shareholders' meeting, until a successor is elected. If the vote of the remaining members of the Board results in a tie, the vacancy may be filled by a vote of the shareholders at a special meeting called for that purpose.

Meetings of Directors [*Corp. Code §§ 212(b)(2), 307(a)(1)*]

3.05. (a) Regular meetings of the Board of Directors will be held on dates that the Board may designate. The Secretary will give at least _____[*e.g.,* five] days notice of the time and place of each meeting to each member of the Board.

(b) Special meetings of the Board of Directors may be held on call of the President, or the Chairman of the Board, and will be called by the President on request of not less than one-third of the members of the Board of Directors. A special meeting may be held at any place, within or without the State of California, on four days notice to each director by first-class mail, postage prepaid, or 48 hours notice delivered personally or by telephone, including a voice messaging system or other system or technology designed to record and communicate messages, telegraph, facsimile, electronic mail, or other electronic means. The notice must specify the time, place, and general purposes of the meeting and be served on each director either personally or by telephone, or by mail or telegram addressed to his or her last place of residence known to the Corporation.

(c) Notice of any meeting need not be given to any director who signs a waiver of notice, or a consent to holding the meeting or an approval of the minutes of the meeting, whether before or after the meeting, or who attends the meeting without protesting, prior to the meeting or at its commencement, the lack of notice to the director. Any waiver of notice need not specify the purpose of the meeting. All waivers, consents, and approvals of minutes shall be filed with the corporate records or made a part of the minutes of the meeting to which they pertain.

Quorum [*Corp. Code §§ 212(b)(4), 307(a)(7)*]

3.06. A majority of the number of directors then in office constitutes a quorum for the transaction of any business except the filling of vacancies. The act of the majority of the directors present at the meeting at which a quorum is present constitutes the act of the Board of Directors, unless the act of a greater number is required by the California General Corporation Law, the Articles of Incorporation, or these Bylaws. If at any meeting of the directors there is less than a quorum present, a majority of those present may adjourn the meeting from time to time without notice, other than

giving an announcement at the meeting, until a quorum will be present.

Action Without a Meeting [*Corp. Code § 307(b)*]

3.07. Any action that may be authorized or taken at a meeting of the directors may be authorized or taken without a meeting with the affirmative vote or approval of, and in a writing or writings signed by, all the directors, provided that the number of directors serving at the time the action is taken constitutes a quorum. The writing or writings must be filed with or entered on the records of the Corporation.

No Compensation for Director Services [*Corp. Code §§ 212(b)(4)*]

3.08. Directors will not receive any stated salary for their services as members of the Board of Directors. However, on resolution of the Board, a fixed sum for attendance may be allowed for regular and special meetings. Nothing contained in this provision will be construed to preclude any director from serving the Corporation in any other capacity and receiving compensation from the Corporation for those services.

IV. OFFICERS

Number and Types [*Corp. Code §§ 212(b)(6), 312(a)*]

4.01. The Corporation will have a President, a Secretary, and a Treasurer/Chief Financial Officer. The Corporation may also have one or more Vice-Presidents and any other officers and assistants that the Board of Directors may deem necessary and proper for the conduct of the business of the corporation. [*add if corporation will have only one shareholder:* The offices of President and Treasurer/Chief Financial Officer will be held by the same person].

[*If corporation will have more than one shareholder:*]

Qualifications of Officers [*Corp. Code §§ 13401(d), 13401.5, 13403*]

4.02. All officers of the corporation must be licensed to practice _____[*specify profession in which corporation will render services and, if desired, any allied professions specified in Corp. Code § 13401.5; if allied professionals may be officers, include additional language indicated in Section 1.01, above, e.g.,* medicine *or* psychology] in the State of California. The President of the corporation will serve as a director, but other corporate officers need not be directors.

[*Or, if corporation will have only one shareholder:*]

4.02. The President and Treasurer/Chief Financial Officer of the corporation must be licensed to practice _____[*specify profession in which corporation will render services and, if desired, any allied professions specified in Corp. Code § 13401.5; if allied professionals may be officers, include additional language indicated in Section 1.01, above, e.g.,* medicine *or* psychology] in the State of California. The other officers of the corporation need not be licensed. The President and Chief Financial Officer of the corporation will serve as a director, but other corporate officers need not be directors.

[*Continue with the following:*]

Election and Term [*Corp. Code §§ 212(b)(6), 312(b)*]

4.03. All officers and assistant officers will be elected by the Board of Directors at its annual meeting for a term of one year unless a shorter term is designated by the Board.

Removal and Resignation [*Corp. Code §§ 212(b)(6), 312(b)*]

4.04. Any officer may be removed, either with or without cause, subject to any rights of the officer under any employment contract with the corporation, by the vote of the Board of Directors at any regular or special meeting of the Board, or by the unanimous written consent of the directors then in office without a meeting. Any officer may resign at any time without prejudice to any rights of the corporation under any contract to which the officer is a party by giving written notice to the President or the Secretary of the corporation. Any resignation shall take effect on the date the notice is received unless a later effective date is specified, in which case the resignation is effective on the specified date. Unless otherwise specified in the notice, acceptance of the resignation by the Board of Directors is not necessary to make it effective.

Vacancies [*Corp. Code §§ 212(b)(6), 312(a)*]

4.05. If the office, President, Secretary, or Treasurer/Chief Financial Officer becomes vacant by reason of death, resignation, removal, or otherwise, the Board of Directors shall fill it by appointing a successor officer [who shall hold the office for the unexpired term]. If any other office becomes vacant, the Board of Directors, in its discretion, may leave it unfilled for any period that it may fix or it may appoint a successor officer to fill the vacancy.

V. INDEMNIFICATION

Right to Indemnification [*Corp. Code §§ 204(a)(10), (11), 317*]

5.01. The Corporation has the authority to indemnify any person who was or is a party to any threatened, pending, or completed civil lawsuit or proceeding, whether administrative, or investigative, including all appeals (other than an action brought by or on behalf of the Corporation) by reason of the fact that person is or was acting as a director, officer, or employee of the Corporation. Indemnification will include all expenses, including without limitation, attorneys' fees, court costs, expert witness fees, judgments, decrees, and fines actually paid by the person in settlement of any action, suit, or proceedings provided that the Board of Directors first determines, in its sole judgment, that the person acted in good faith and in a manner that he or she reasonably believed to be in the best interests of the Corporation. The termination of any action, suit, or proceeding by judgment, order, or settlement does not of itself create a presumption that the person did not act in good faith.

Gross Negligence or Misconduct [*Corp. Code §§ 204(a)(10), (11), 317(b)*]

5.02. No indemnification will be made for any claim, issue, or matter as to which the person is finally adjudged to be liable for gross negligence or intentional misconduct in the performance of his or her duties as director, officer, or employee.

Indemnity for Successful Defense [*Corp. Code § 317(d)*]

5.03. In spite of any limitations *set forth in Sections 5.01* and *5.02*, to the extent that any person is successful on the merits or otherwise in defense of any action, suit, or proceeding referred to in those sections, that person will be indemnified against all expenses actually and reasonably paid by him or her, including, without limitation, attorneys' fees, court costs, and expert witness fees.

Advancement of Expenses [*Corp. Code § 317(f)*]

5.04. Expenses incurred in defending a civil action, suit, or proceeding may be paid by the Corporation in advance of the final disposition of the action, suit, or proceeding as authorized by the Board of Directors, on receipt by the Board of Directors of an undertaking by or on behalf of the director, officer, or employee involved to repay the expenses if it is

ultimately determined that the person is not entitled to be indemnified by the Corporation as authorized in this section.

Indemnification Not Exclusive [*Corp. Code § 317(g)*]

5.05. The indemnification provided under this section is not exclusive of any other rights to which any person indemnified may be entitled under any regulation, agreement, vote of the stockholders or disinterested directors, or otherwise. The indemnification provided under this section will be deemed exclusive of any other power to indemnify or right to indemnification that the Corporation or any person referred to in this section may have or acquire. Indemnification will continue and inure to the benefit of the heirs, executors, and administrators of any person entitled to indemnification under this section.

Liability Insurance [*Corp. Code § 317(i)*]

5.06. The Corporation may purchase and maintain insurance on behalf of any person who is or was a director, officer, employee, or designated agent of the Corporation against any liability asserted against and incurred by that person whether or not the Corporation would have the power to indemnify that person under the provisions of these Bylaws.

VI. AMENDMENT OF BYLAWS

Vote Required to Amend [*Corp. Code §§ 211, 212*]

6.01. These Bylaws may be adopted, amended, or repealed by the affirmative vote of a majority of the shares empowered to vote at any meeting called and held for that purpose, or without a meeting, by the written assent of the owners of record of two-thirds of the shares of the Corporation entitled to vote.

Articles to Govern [*Corp. Code § 212(b)*]

6.02. In case any provision of these Bylaws is inconsistent with the Articles of Incorporation, the Articles govern.

CERTIFICATE OF SECRETARY

[*Corp. Code § 314*]

I certify that:

1. I am the Secretary of _____[*name of corporation*], a California professional corporation; and

2. The attached Bylaws, consisting of _____ articles and _____ pages, constitute the Bylaws of the corporation as duly approved by unanimous vote of the persons named in the Articles of Incorporation to act as the first directors of this corporation, at a meeting of the Board of Directors duly held on _____[*date*], at _____[*location of meeting, e.g.,* the principal executive office of the corporation located at _____ (*address*), California].
Dated: _____.

_____ [*signature of Secretary*]
[*typed name*]

[*For alternative certificates, see Ch. 4, Bylaws.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
A. Organizational Documents

5-12A California Legal Forms--Transaction Guide § 12A.204

§ 12A.204 Minutes of First Meeting--Action by Written Consent of Directors

[1] Comment--Use of Form

This form is a set of minutes of the first meeting of a newly established professional corporation. After the shareholders of the new professional corporation have met to elect directors and adopt a code of regulations, or after these actions have been taken by unanimous written consent of the shareholders, the directors must take various steps to initiate the corporation's operation. This form can be used if the action by the directors is by unanimous written consent in lieu of an actual first meeting. For forms to be used if an actual meeting is held, see Ch. 5, *Directors Meetings, Actions, and Resolutions* .

This form includes the usual resolutions made at the first meeting of the directors. In addition, it contains resolutions for an assignment of lease, purchase of assets, and assignment of accounts receivable from the person or persons who are forming the professional corporation. It also contains resolutions adopting pension and profit-sharing plans [*see* Ch. 1D, *Overview of Employee Benefits* ; *see also* Young, Pensions and Profit Sharing Plans (Matthew Bender)] and a medical reimbursement plan.

[2] FORM

Minutes of First Meeting--Action by Written Consent of Directors

ACTION BY WRITTEN CONSENT OF DIRECTORS
OF
_____ [*name of corporation*]

Pursuant to the authority contained in *California Corporations Code Section 307(b)*, the undersigned Directors of _____[*name of corporation*], a California professional corporation, take the following action in writing, without meeting:

Election of Officers

1. The following named persons are elected officers of the Corporation, to serve until their successors are duly elected:

_____[*name*], _____[*title*]

_____[*name*], _____[*title*]

_____[*name*], _____[*title*]

Employment Agreement

2. The officers of the Corporation are authorized, on behalf of the Corporation, to enter into employment agreements with _____[*name(s) of employees*], copies of which are attached to these Minutes as Exhibits.

Assignment of Lease

3. The officers of the Corporation are authorized to accept an assignment of lease on behalf of the Corporation from _____[*name of present lessee*], covering office space located at _____[*street address*], _____[*city*], California. The Corporation will indemnify and hold harmless _____[*name of present lessee*] from any loss, liability, cost, or expense, that may result from the tenancy and occupancy after _____[*date*]. This assignment of lease will be effective on _____[*date*].

Purchase of Assets

4. The Corporation will acquire from _____[*name of practitioner*] all of the _____[*e.g.*, furniture, equipment, medical supplies, records, and other property] used by _____[*name of practitioner*] in the practice of _____[*e.g.*, medicine]. The Corporation will pay to _____[*name of practitioner*] the sum of $_____ payable _____[*e.g.*, in three equal annual installments] commencing _____[*date*]. In addition, the Corporation shall pay to _____[*name of practitioner*] interest on the unpaid balance computed at the rate of _____ percent per annum, commencing _____[*date*]. The officers of the Corporation are authorized to execute a promissory note to _____[*name of practitioner*], containing the terms of the purchase and a reservation of right of prepayment without penalty at any time.

Assignment of Accounts Receivable

5. The Corporation is authorized to accept the transfer from _____[*name of practitioner*] of all existing accounts receivable, both billed and unbilled, as of _____[*date*]. The accounts receivable will be treated as additional contribution to capital of this Corporation by _____[*name of practitioner*].

Pension Plan

6. The proposed Pension Trust Agreement for all of the _____[*e.g.*, full-time employees] of the Corporation is adopted by the Corporation. The President and the Treasurer/Chief Financial Officer of the Corporation are authorized and directed to execute on behalf of this Corporation the Pension Trust Agreement, a copy of which is attached to these Minutes and marked Exhibit _____.

Profit-Sharing Plan

7. The proposed Profit-Sharing Plan for all of the _____[*e.g.,* full-time employees] of the Corporation is adopted by the Corporation. The President and the Treasurer/Chief Financial Officer are authorized and directed to execute on behalf of this Corporation the Profit-Sharing Plan, a copy of which is attached these Minutes and marked Exhibit _____.

Medical and Dental Reimbursement Plan

8. The Corporation adopts a Medical and Dental Reimbursement Plan for all of the _____[*e.g.,* full-time employees] of the Corporation, a copy of which is attached to these Minutes and marked Exhibit _____.

Automobile Expense

9. The Corporation will pay all expenses incurred by _____[*specify e.g.,* all full-time employees] with respect to the automobile used by _____[*e.g.,* them] in the discharge of _____[his *or* her *or* their] duties as _____[an employee *or* employees] of the Corporation.

Banking Resolutions

10. The Corporation adopts the following banking resolutions: _____[*specify and attach pertinent carbon or photocopy excerpts from the bank's printed form certificate to be filed by the corporation with the bank*]. Dated: _____.

_____ [*signature of director*]
[*typed name*]
_____ [*signature of director*]
[*typed name*]
_____ [*signature of director*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral OverviewBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsProceduresBusiness & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
A. Organizational Documents

5-12A California Legal Forms--Transaction Guide § 12A.205

§ 12A.205 Letter Offer Transferring Assets of Professional Practice to Professional Corporation

[1] Comment

[a] Use of Form

This form is a letter offer transferring the assets of an existing professional practice to a professional corporation. It can be used to transfer all of the assets of an existing professional practice to a newly formed professional corporation. The assets are exchanged solely for the stock of the corporation to accomplish a tax-free incorporation.

[b] Tax-Free Incorporation

As a general rule, the transfer of property to a corporation controlled by the transferors will not cause the transferors to recognize gain or loss as long as they receive only stock and securities in the corporation, and, immediately after the exchange, those persons own at least 80 percent of the total combined voting power of all classes of the corporation's voting stock and at least 80 percent of the total number of shares of all other classes of the corporation's stock [*I.R.C. §§ 351(a), 368(c)*]. If the transferor receives property or money in addition to stock and securities, then gain will be recognized, but not in excess of the amount of money received plus the fair market value of the other property received [*I.R.C. § 351(b)(1)*]. Furthermore, the assumption of liabilities by the corporation may cause gain to be recognized by the transferor. The excess of the amount of liabilities assumed by the corporation over the total of the adjusted tax bases of the property transferred to the corporation will be treated as gain taxable to the transferor as ordinary income [*I.R.C. § 357(c)(1)*].

For further discussion, see *§ 12A.21[1][b]*.

[2] FORM

Letter Offer Transferring Assets of Professional Practice to Professional Corporation

[*Letterhead*]

_____[*date*]
_____[*Name of offeror*]
_____[*address*]

Dear _____:

I am currently the sole proprietor of a professional _____[*type of practice, e.g.*, medical] practice conducted under the name of _____. I hereby make the following offers to your corporation:

I offer to transfer and assign to your corporation, on the day on which this offer is accepted by your corporation, all of the following assets: (1) equipment, supplies, office equipment, and furniture currently used by me in my practice and appraised by two independent appraisers on or about _____[*date*], as having a fair market value of $_____; (2) any prepaid tenant's and casualty insurance relating to the practice, at the valuation these prepayments have as of the date of the transfer to your corporation; (3) the _____[*describe year, make, model, etc.*] automobile currently owned by me and used in the business and having a book value of $_____ as of _____[*date*]; and (4) all accounts receivable as of the date of transfer.

This offer to your corporation is based on the condition that your corporation will assume and pay all liabilities of the practice existing as of the date of transfer (except for any liability for my personal income taxes), and will assume all of the tenancy conditions under my office lease as of the date of transfer.

The transfer by me to your corporation of the assets listed above, subject to the conditions listed above, will be in exchange for the issuance of _____ shares of the common stock of your corporation to me.

Sincerely,
_____ [*signature of offeror*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsTax LawFederal Taxpayer GroupsC CorporationsReorganizations (IRC secs. 351-368, 381-384)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
A. Organizational Documents

5-12A California Legal Forms--Transaction Guide §§ 12A.206-12A.219

[Reserved]

§§ 12A.206[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
B. Shareholder Agreements

5-12A California Legal Forms--Transaction Guide § 12A.220

§ 12A.220 Buy-Sell Agreement

[1] Comment

[a] Use of Form

This form is a basic buy-sell agreement that sets forth the terms and conditions of the purchase and sale of shares in a professional corporation. This form covers the purchase of a shareholder's shares by the corporation or the remaining shareholders. In general, buy-sell agreements are designed to create a ready market for shareholders' shares and to ensure that the corporation's shares are not transferred to outsiders. In the case of a professional corporation, the buy-sell agreement serves a third purpose. It ensures that the shares will not be transferred to a person who is not licensed to practice the profession for which the corporation was incorporated. The shares of a professional corporation can be transferred only to an individual who is licensed to practice the profession for which the corporation was organized [*Corp. Code § 13407*; *see § 12A.15[1]*].

Generally, the market for a shareholder's shares will be either the remaining shareholders, the corporation, or both. It is usually advantageous to allow the corporation to purchase the shares of a shareholder who desires to sell since the dollars used to pay the purchase price will be subject to tax only once, at the corporation's income tax bracket.

Although there are many different formulas to determine the price at which shares will be purchased, the buy-out approach and valuation method selected should reflect the nature of the professional corporation involved. Two features are common to most professional corporations: (1) most professional corporations lack substantial business assets; and (2) most professional corporations report income and expenses on the cash receipts and disbursements method of accounting [*see I.R.C. § 446*]. The combination of these characteristics ordinarily means that the corporate stock is properly valued by taking into account only its relatively modest book value (determined without regard to accounts receivable, which represent future income rather than after-tax profits). The accounts receivable, in turn, are relevant to determining the amount of deferred compensation to which the departing shareholder will be entitled [*see § 12A.21[3][d]*]. This form adopts this means of disregarding future corporate income as an element of value in determining the buy-sell price.

For further discussion of buy-sell agreements, and additional forms for such agreements, see Ch. 8D, *Buy-Sell Agreements* .

[b] Problems Involving Transfer of Stock in Professional Corporations

Several potential problems may arise in the transfer of shares of stock in a professional corporation and in a close corporation. Any transfer of shares in a professional corporation to a nonlicensed person is void [*Corp. Code § 13406(a)*]. A professional corporation may purchase its own shares without regard to any restrictions otherwise provided by law, provided that at least one share remains outstanding [*Corp. Code § 13407*]. For a more detailed explanation of these problems and possible solutions, see *§ 12A.15*.

A legend restricting transfer of the shares subject to the agreement must be printed on the shares themselves [*see Corp. Code § 418(a)(1)*] to ensure that any transferee has adequate notice that the shares are subject to a buy-sell agreement. If the required statement does not appear on the certificate, transfer restrictions imposed by the corporation are unenforceable against a transferee without actual knowledge of the restrictions [*Corp. Code § 418(b)*].

By accepting a stock certificate that contains a restrictive legend [*see Corp. Code § 418(c)*], a shareholder in a close corporation agrees not to make any inter vivos transfer of that stock if the transfer would cause the number of shareholders of record to exceed the number specified in the articles of incorporation. Acceptance also constitutes a waiver of any right that the shareholder might have to sell the stock to a greater number of purchasers or to demand registration of the stock under the Securities Act of 1933 [*Corp. Code § 421*]. If the certificate for stock in a close corporation contains a restrictive legend, any attempt to make an inter vivos transfer of the stock will be void if the transfer would result in the number of shareholders of record exceeding the number specified in the articles of incorporation [*Corp. Code § 418(d)*].

[2] FORM

Buy-Sell Agreement

BUY-SELL AGREEMENT

This Agreement is entered into on this _____ day of _____, _____[*year*] at _____[*location*], California, between _____[*name of corporation*], a California professional corporation ("Corporation"), and _____, _____, and _____[*names of all the shareholders*] (collectively "Shareholders" and individually "Shareholder").

Recitals

The Shareholders are or will be the principal executive officers and sole shareholders of the Corporation.

The parties in furtherance of the interests of the Corporation desire to establish consistent and harmonious policies and to ensure continuity of management by persons who have a proprietary interest in the Corporation and continuity of stock ownership by persons licensed to practice the profession of _____[*specify, e.g.*, medicine].

In consideration of the promises and mutual covenants contained below, the undersigned agree with each other as follows:

Sale of Shares

1. The Corporation will purchase and the Shareholder or the estate of the deceased Shareholder will sell to the Corporation at the price set forth in Paragraph 11, all of the shares in the Corporation legally or beneficially owned by the Shareholder or by the Shareholder's estate at the time of the occurrence of any of the events:

(a) The death of a Shareholder;

(b) The disqualification of a Shareholder from the practice of _____[*type of professional practice, e.g.*, medicine];

(c) The permanent disability or incapacity of a Shareholder rendering him or her unable to practice _____[*type of professional practice, e.g.*, medicine]; or

(d) The complete cessation of employment of a Shareholder by the Corporation for any other reason.

Restrictions on the Transferability of Shares

2. Neither the Shareholder nor the Shareholder's heirs, executors, or administrators will sell, exchange, give, transfer, pledge, hypothecate, or otherwise dispose of any shares in the Corporation or any interest in the shares, except as provided in this Agreement. The corporation will ensure that a legend restricting the transfer of shares subject to the agreement is printed on the shares themselves.

Method of Sale

3. After the occurrence of any of the events specified in Paragraph 1, and before the purchase date, the Shareholder or the Shareholder's estate whose shares are being sold under this Agreement must deliver to the Corporation the certificates for the shares accompanied by an assignment and power of attorney in blank or properly endorsed for transfer. The Corporation will pay the Shareholder or the Shareholder's estate the price set forth in Paragraph 11. [*Optional:* Thereafter, the Corporation will retire the purchased shares.]

Terms of Payment on Death of Shareholder

4. If the Shareholder has died, the terms of payment are as follows:

(a) If the proceeds of any life insurance policy on the life of the deceased Shareholder owned by the Corporation are equal to or exceed the purchase price for the shares of the deceased Shareholder, the purchase price will be paid in cash on the purchase date.

(b) If the proceeds of any life insurance are less than the purchase price, the total proceeds from the insurance on the deceased Shareholder's life will be paid on the Purchase Date to the deceased Shareholder's estate, plus any additional amount of cash as will be required to make the payment to the deceased Shareholder's estate equal to at least 20 percent of the purchase price, and the balance of the purchase price will be paid in 60 equal monthly installments beginning one year after the date of the first payment. The obligation to pay will be evidenced by the Corporation's promissory note providing for the payment of the balance in 60 equal monthly installments commencing one year from the Purchase Date bearing interest at the rate determined pursuant to Paragraph 15 on the unpaid balance. The obligation to pay will be personally guaranteed by the surviving Shareholder(s). The Corporation may prepay any promissory note, in whole or in part, at any time without penalty.

Terms of Payment on Occurrence Other Than Death

5. If an event specified in Paragraph 1 other than death of a Shareholder has occurred, the purchase price will be paid over a period of years, evidenced by Corporation's promissory note providing for the payment of the purchase price in 10 equal annual installments commencing one year from the date of delivery of the certificates to the Corporation and

bearing interest, from the date of delivery, at the rate determined pursuant to Paragraph 15 on the unpaid balance. Payment of the note will be personally guaranteed by the remaining Shareholder[s]. The Corporation may prepay any promissory note, in whole or in part, at any time, without penalty.

Consolidation of Debts

6. On the purchase by the Corporation of shares from a Shareholder or a Shareholder's estate in accordance with this Agreement, the Corporation will proceed according to this Paragraph with respect to any indebtedness of the Corporation to the Shareholder. As to all indebtedness to the Shareholder, whether or not evidenced by promissory notes or other evidence of indebtedness of the Corporation, the Corporation will deliver to the Shareholder or a deceased Shareholder's estate (and at that time any outstanding promissory notes or other evidences of indebtedness of the Corporation to the Shareholder will be canceled) its nonnegotiable promissory note in the principal amount equal to the indebtedness, including any accrued interest. The nonnegotiable promissory note will be payable to the order of the Shareholder or the administrator or executor of a deceased Shareholder's estate; dated as of the date 90 days after the occurrence of the event causing sale of the Shareholder's shares; be payable in five equal annual installments; and bear interest at the rate determined pursuant to Paragraph 15 on the unpaid balance from the date of the event causing sale of the Shareholder's shares. The first installment will be due and payable one year from the date of execution of the note. The Corporation may prepay the note, in whole or in part, at any time without penalty. Payment of the note must be personally guaranteed by the remaining Shareholder(s).

Subordination

7. Each promissory note issued and delivered by the Corporation under this Agreement at a time when there is an outstanding debt of the Corporation that requires subordination, must contain a subordination clause in the form required by the terms of any agreement with the Corporation's creditors.

Right of First Refusal

8. (a) If a Shareholder wishes to dispose of any of his or her shares in the Corporation and no event specified in Paragraph 1 of this Agreement has occurred, the Shareholder must first offer, in writing, to sell all of the stock to the Corporation at a price determined in accordance with the provisions of Paragraph 11.

(b) Any shares not purchased by the Corporation within 30 days after receipt of the offer in writing must be offered at the same price to the other Shareholder(s) who shall have the right to purchase all or any portion of the shares offered for sale. If more than one of the remaining Shareholders agree to purchase the shares, then unless those Shareholders who desire to purchase the shares agree otherwise, the shares will be purchased pro rata on the basis of the number of the Corporation's shares owned by each of those Shareholders who desire to purchase the shares.

Sale to Licensed Professional Only

9. If the shares offered pursuant to Paragraph 8 are not purchased by the Corporation or the remaining Shareholder(s) within 60 days of the receipt of the offer, the Shareholder desiring to sell shares may sell them to any other person licensed to practice the profession of _____[*specify profession for which corporation was formed*]. However, the Shareholder may not sell the shares without giving the Corporation and the remaining Shareholder(s) the right to purchase the remaining shares at the price and on the terms offered to the other person.

Terms of Payment

10. (a) Payment by the Corporation for any shares offered by the offering Shareholder pursuant to Paragraph 8 will be at the price set forth in Paragraph 11 on the terms set forth in this Paragraph. Twenty percent of the purchase price will be payable in cash on delivery of the share certificates to the Corporation, and the balance will be payable in 60

equal monthly installments commencing one year from the date of delivery of the share certificates to the Corporation and continuing from month to month until paid in full.

(b) If any Shareholder or Shareholders exercise an option to purchase, the purchase price of the shares will be determined by Paragraph 11 and be paid on the following terms: Twenty percent of the purchase price is payable in cash on delivery of the share certificates to the purchaser and the balance will be payable in 60 equal monthly installments commencing one year from the date of delivery of the share certificates to the purchaser and continuing from month to month until paid in full.

(c) The portion of any purchase price not paid in cash will be evidenced by the promissory note(s) of the purchasing Corporation or Shareholder(s), bearing interest at the rate determined pursuant to Paragraph 15 on the unpaid balance. Payment of the Corporation's promissory note will be personally guaranteed by the remaining Shareholder(s). The purchasing Corporation or Shareholder(s) may prepay the note(s), in whole or in part, at any time without penalty.

Purchase Price

11. The purchase price to be paid for the interest of a Shareholder will be an amount equal to the number of shares of stock in the Corporation owned by that Shareholder on the Purchase Date multiplied by the book value of a single share of the corporation's stock as determined under Paragraph 13 of this Agreement. In no event, however, will the purchase price for a deceased Shareholder's interest be less than the amount of insurance, if any, on the deceased Shareholder's life owned by the Corporation for the specific purpose of purchasing a deceased Shareholder's interest. For purposes of this Agreement, the valuation date will be the last day of the fiscal quarter preceding the month in which the offer to sell is submitted by the Shareholder, or the last day of the fiscal quarter preceding the month in which some event specified in Paragraph 1 occurs.

Life Insurance

12. Any insurance on the lives of the Shareholders carried by the Corporation for the specific purpose of purchasing a deceased Shareholder's interest must be carried in amounts proportionate to their share holdings in the Corporation. Any excess of the purchase price paid for the stock of a Shareholder who has died or who is permanently disabled or incapacitated over the book value of the stock is attributable to the goodwill of the Corporation.

Definition and Computation of Book Value

13. (a) "Book value," for purposes of this Agreement, means the value of the capital stock of the Corporation as of the valuation date, after deducting the sum of all the Corporation's liabilities from the sum of all of the Corporation's assets and property as shown on the Corporation's books, except that the Corporation's capital stock will not be deducted as a liability, nor will any surplus or undivided profits or any reserve fund representing the surplus or undivided profits be deducted. The book value of any single share of capital stock of the Corporation is its proportionate share of the book value of all the outstanding stock of the Corporation as of the valuation date.

(b) To determine book value for purposes of this Paragraph, an inventory will be taken of the property, assets (excluding accounts receivable), and liabilities of the Corporation as of the valuation date. Accounts receivable will not be taken into account. All other sums owed to the Corporation will be valued as they are carried gross on the books. Furniture, fixtures, equipment and other fixed assets on hand will be valued as they appear on the books of the Corporation, being original cost, less depreciation. Goodwill, trademarks, and trade names will be deemed of no value unless they have been acquired and paid for in cash, and in that event, the sum will be computed at the amount paid for them. Insurance policies on the life or lives of Shareholders owned by the Corporation and in which it is named as a beneficiary will be valued at their cash surrender value on the valuation date. Federal income taxes payable on operating profits for the year up to the date of valuation will be apportioned. All state and other taxes and assessments that are unpaid will be apportioned. Outstanding contracts with suppliers will be deemed of no value for the purpose of this

inventory. The usual accounting practices employed by the accountant auditing the books of the Corporation must be employed in determining the foregoing values.

(c) In the event of a disagreement between the parties with respect to valuation of any asset, or any other matter relating to the determination of the book value of the capital stock of the Corporation, one arbitrator will be selected by the selling Shareholder and one arbitrator will be selected by the purchaser or purchasers. If the two arbitrators cannot agree on the disputed matter, they will select a third arbitrator. The decision of the majority is final and binding on all the parties. The arbitration will be governed by the rules of the American Arbitration Association.

Purchase Date

14. The purchase date of a deceased Shareholder's shares will be _____[*specify number; must be within six-month period specified by Corp. Code § 13407, e.g.,* 120] days following the death of that Shareholder. The purchase date of a Shareholder's shares sold by reason of the occurrence of any event specified in Paragraph 1, other than the death of a Shareholder, will be _____[*specify number; must be within 90-day period specified by Corp. Code § 13407, e.g.,* 30] days after the date of the event precipitating the sale.

Interest Rate

15. The interest rate determined under this Paragraph will be equal to the lowest interest rate per annum by which no interest will be imputed to the recipient of this interest by reason of *I.R.C. § 483* and the Treasury Regulations under that section as amended from time to time. This determination will be made as of the date the payer of the interest first becomes obligated to pay interest on any obligation created pursuant to this Agreement.

Shareholder Actions

16. If any vote, consent, or other action on the part of the Corporation's Shareholders is necessary to remove a legal impediment that would otherwise prevent the performance by the Corporation of any one or more of its obligations under this Agreement, each of the Shareholders agrees to supply that vote, consent, or other action. By executing this agreement, each of the Shareholders hereby authorizes and directs his or her heirs, executors, administrators, and assigns to execute any and all instruments and to take any and all further action necessary or desirable for the purpose of carrying out the provisions of this Agreement. The Shareholders specifically agree for themselves and their heirs, administrators, successors, and assigns to take appropriate action as Shareholders of the Corporation to reduce the stated capital of the Corporation and/or to cause the Corporation to write up to fair market value any or all of its physical assets if either or both of these actions are necessary or desirable to make lawful the purchase by the Corporation of its own shares under the provisions of this Agreement.

Amendment

17. This Agreement may be altered, amended, or terminated by a writing signed by the Corporation and by all the Shareholders who are parties to this Agreement.

Termination

18. This Agreement terminates on the occurrence of any of the following events:

(a) The bankruptcy, insolvency, receivership, or dissolution of the Corporation;

(b) The deaths within a period of 90 days of all Shareholders who are parties to this Agreement;

(c) When only one Shareholder who is a party to this Agreement survives, but only after the purchase by the Corporation of the shares in the Corporation of any deceased Shareholder; or

(d) The written consent of all parties to this Agreement.

Necessary Acts

19. All parties to this Agreement will perform any acts, including executing any documents, that may be reasonably necessary to fully carry out the provisions and intent of this Agreement.

Notices

20. All notices, demands, requests, or other communications required or permitted by this Agreement must be in writing and will be deemed duly served when personally delivered to the party or to an officer or agent of the party, or when deposited in the United States mail, first-class postage prepaid, addressed to the Corporation at _____[*address of corporation's principal office*], or to a Shareholder at the address appearing for him or her on the books and records of the Corporation, or at any other address the party may designate by written notice to the others.

Attorneys' Fees

21. In the event of any litigation concerning this Agreement between the parties to this Agreement or the parties to this Agreement and the estate of any deceased Shareholder, the prevailing party will be entitled, in addition to any other relief as may be granted, to reasonable attorneys' fees.

Binding on Successors and Assigns

22. This Agreement is binding on the Shareholders, their heirs, legal representatives, successors, and assigns and on the Corporation, its successors, and assigns.

Severability

23. If any provision is unenforceable or invalid for any reason, the remaining provisions will be unaffected by that holding.

Governing Law

24. This Agreement will be construed according to and governed by the laws of the State of California.

Agreement Available for Inspection

25. An original copy of this Agreement duly executed by the Corporation and by each of the Shareholders will be delivered to the Secretary of the Corporation and maintained by the Secretary at the principal office of the Corporation available for inspection by any person requesting to see it.

Executed on _____[*date*] at _____[*location*], California.

THE CORPORATION
_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]

THE SHAREHOLDERS
_____ [*signature*]
[*typed name and title*]
_____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsTax LawFederal Income Tax ComputationTax AccountingCash Basis Method (IRC secs. 446, 448, 451, 461)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
B. Shareholder Agreements

5-12A California Legal Forms--Transaction Guide § 12A.221

§ 12A.221 Share Purchase Agreement

[1] Comment--Use of Form

This form is a basic share purchase agreement for use by professional corporations having more than one shareholder. When an existing professional corporation hires a new professional, it is often desirable to have the professional "buy into" the practice over a period of time. One way of structuring this transaction is to have the newly admitted professional purchase shares from the remaining shareholders. In general, the purchase price will be based on the value of the corporation's stock as of the date the professional commences employment.

One problem with the staged buy-in is what happens if for some reason the relationship does not work out. In that case, the newly employed professional's obligation to purchase additional shares immediately terminates. Furthermore, he or she should be required to resell to the remaining shareholders or the corporation the shares purchased to date. This latter goal can be accomplished by requiring the newly employed professional to enter into a buy-sell agreement [*see § 12A.220*] at the same time that the purchase agreement is executed.

[2] FORM

Share Purchase Agreement

SHARE PURCHASE AGREEMENT

This Agreement is made this _____, day of _____, _____[*year*], by _____[*name of selling shareholder*], _____[*name of selling shareholder*], and _____[*name of selling shareholder*], collectively referred to as "Sellers" in this Agreement _____[*name of buying shareholder*], "Buyer," and _____[*name of corporation*], "Corporation."

Recitals

Sellers are the owners of _____[*number*] shares of the outstanding common stock of the Corporation.

Sellers desire to sell a total of _____[*number of shares to be sold to Buyer*] shares ("the shares") of the common stock of the Corporation to Buyer.

Buyer desires to purchase an aggregate of _____[*number of shares to be purchased from Sellers*] shares of common stock of the Corporation from Sellers;

In consideration of the promises and mutual covenants made in this Agreement, it is agreed as follows:

Sale of Shares

1. Sellers will sell, transfer, and assign to Buyer a total of _____ shares of the Corporation's common stock standing in the Sellers' names, as follows:

(a) _____[*name of selling shareholder*] will sell _____ shares;

(b) _____[*name of selling shareholder*] will sell _____ shares; and

(c) _____[*name of selling shareholder*] will sell _____ shares.

Each of the sales described in this Paragraph will be made in _____[*number, e.g.,* five] annual installments beginning on _____[*date of first purchase*], and continuing on the next _____[*number of installments less one, e.g.*, four] anniversaries of that date, all in accordance with the Share Transfer and Purchase Price Schedule set forth in Exhibit A attached to this Agreement and incorporated by this reference.

Each of the Sellers will execute the necessary documents effecting the transfers at the time Buyer tenders to Sellers the purchase prices for each of the installments on or before _____[*month and day of each year on which purchase will take place*] of each year.

Purchase Price

2. Buyer will pay to Sellers the total sum of $_____, payable according to the annual installment schedule established in Paragraph 1, as payment for the shares in accordance with the Share Transfer and Purchase Price Schedule set forth in Exhibit A. Buyer will pay to each of the Sellers as follows:

(a) $_____ to _____[*name of first selling shareholder*];

(b) $_____ to _____[*name of second selling shareholder*]; and

(c) $_____ to _____[*name of third selling shareholder*].

Sellers' Obligations To Sell

3. Sellers' obligations to sell and Buyer's obligation to purchase shares of the Corporation's common stock as of the date of each installment payment are conditioned on Buyer's continued employment with the Corporation. If Buyer is not an employee of the Corporation on the due date for any installment payment, then Buyer's right to purchase shares on or after that date and Sellers' obligations to sell the shares on that date shall terminate.

Sellers' Representations and Warranties

4. Sellers expressly represent, warrant, and agree as follows:

(a) The _____[*number*] shares of the Corporation common stock constitute all of the issued and outstanding shares of the Corporation.

(b) Each of the Sellers have good and marketable title to the shares of common stock standing in each of their names, and, on full execution of this Agreement, that Sellers, collectively, own all issued and outstanding shares of the Corporation with the absolute right to sell, assign, and transfer the same free and clear of all liens, pledges, and encumbrances of any kind.

(c) All issued and outstanding shares of the Corporation are fully paid and nonassessable. There are no outstanding subscriptions, options, or other agreements obligating the Corporation to issue additional shares of its capital stock or any other securities of any kind or class.

No Right to Continued Employment

5. Buyer, Sellers, and the Corporation acknowledge to each other that this Agreement may not be deemed to give the Buyer any right to continued employment by the Corporation.

Shareholders' Agreement

6. As of the date of this Agreement, Buyer, Sellers, and the Corporation agree to all of the terms of the Shareholders' Agreement set forth in Exhibit B this Agreement and incorporated by this reference. From and after the date of this Agreement, the Shareholders' Agreement will be effective for all parties to this Agreement, the execution of this Agreement serving also as the execution and adoption of the Shareholders' Agreement. Notwithstanding any provision to the contrary, each of the undersigned agrees to the share transfers covered by this Agreement and waives any rights with respect to the share transfers that he, she, or it may have under the Shareholders' Agreement, but only to the extent necessary to permit the transfers covered by this Agreement.

IN WITNESS WHEREOF, the parties set their hands to this Agreement effective as of the date first written above.

SELLER
_____ [*signature of seller*]
[*typed name*]
BUYER
_____ [*signature of buyer*]
[*typed name*]
_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Exhibit A

[*Attach purchase price and share transfer schedule*]

Exhibit B

[*Attach shareholders' agreement (see Ch. 8C, Close Corporation Shareholder Agreements)*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
B. Shareholder Agreements

5-12A California Legal Forms--Transaction Guide §§ 12A.222-12A.229

[Reserved]

§§ 12A.222[Reserved]



142 of 146 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
C. Miscellaneous Forms

5-12A California Legal Forms--Transaction Guide § 12A.230

§ 12A.230 Employment Agreement

[1] Comment--Use of Form

This form is an employment agreement between the corporation and a professional employee. Each professional employee of the corporation should execute a formal employment agreement with the corporation. This form may be adapted to the requirements of the parties in particular corporation-employee relationships.

If an employee is moving from out of state to join the professional corporation, the employee should enter a California address in the introductory paragraph.

For a general discussion of employment contracts, see Ch. 85, *Employment Agreements* . For coverage of professional service contracts for attorneys, see Ch. 86A, *Agreements for Legal Services* ; professional service contracts for other professional fields are discussed in Ch. 86, *Agreements for Professional Services* .

[2] FORM

Employment Agreement

EMPLOYMENT AGREEMENT

This Agreement is made on _____[*date*], by _____[*name of corporation*], a California professional corporation (Corporation), and _____[*name of employee*], who resides at _____[*address*] (Employee). The Corporation by this Agreement employs Employee and Employee accepts employment on the terms and conditions set forth below.

Full Time Employment

1. During the period of employment, Employee agrees to devote Employee's full time, attention, skill, and efforts to the performance of duties on behalf of the Corporation, to maintain and promote the business of the Corporation, and, at

the Corporation's request, to serve as an officer and/or a director of the Corporation. The expenditure of reasonable amounts of time for teaching, personal or outside business, and charitable and professional activities will not be deemed a breach of this Agreement, provided the activities do not materially interfere with the services required to be rendered to the Corporation under this Agreement.

Assignment of All Business to Corporation

2. All _____[*type of services to be performed, e.g.*, legal] services performed by Employee, and any revenues derived from those services will be considered the business and the income of the Corporation. Employee irrevocably assign all those revenues to the Corporation immediately on receipt by Employee during the term of this Agreement.

Salary

3. As compensation for the services to be rendered by Employee, the Corporation will pay Employee a fixed salary at the rate per annum specified in Schedule A attached to this agreement and incorporated by this reference, payable in equal installments on the first and fifteenth days of every month. However, if the employment terminates for any reason on any date other than on the first or fifteenth day of any month, then the salary payable for the annual period during which the employment terminates will be prorated.

Other Compensation

4. As further compensation, the Corporation will pay Employee such a bonus or bonuses as may from time to time be awarded to Employee by the Board of Directors of the Corporation in its discretion, payable at the time and in the amounts as the Board of Directors may determine.

Term

5. The term of employment will be _____[*number*] years from the date specified in Schedule A attached to this Agreement, subject to the following conditions:

(a) This Agreement may be terminated at any time by mutual agreement in writing of the Corporation and Employee.

(b) Employee has the absolute right to terminate this Agreement unilaterally by providing the Board of Directors with written notice of termination and, in that case, termination will occur on the expiration of _____[*specify number, e.g.*, 60] days after the date of the notice.

(c) If, during the effective period of this Agreement, Employee violates the provisions of Paragraph 6, the Corporation may terminate this Agreement on _____[*specify number, e.g.*, 30] days notice to Employee.

(d) If, during the effective period of this Agreement, Employee is absent from employment by reason of illness or any other incapacity, physical or mental, for a period or periods aggregating more than _____[*specify number, e.g.*, 90] days in any fiscal year, the Corporation may on _____[*specify number, e.g.*, 30] days notice to Employee terminate this Agreement. In this event, the Corporation will pay Employee six months pay, as severance pay, for the six-month period beginning with the date on which the Corporation mails the notice to Employee. The Corporation will have no further obligations under this Agreement.

(e) For cause, including without limitation Employee's failure or refusal to perform obligations under this Agreement, or the disqualification of Employee to practice the profession of _____[*specify type of professional practice*], the Corporation may terminate this Agreement at any time on _____[*specify*

number, e.g., 30] days' notice to Employee.

(f) In the event of the death of Employee, the period of employment terminates on the date of death of Employee, and Employee's legal representatives will be entitled to receive Employee's compensation up to the date of death.

(g) The Corporation may terminate this Agreement on _____[*specify number, e.g.,* 30] days written notice to Employee on adoption by the Corporation of a bona fide plan to terminate its business and liquidate its assets, or if the Corporation is ordered to be liquidated pursuant to a judicial proceeding.

Restrictive Covenant

6. Employee agrees that during the term of this Agreement _____[he *or* she] will not engage in any other business duties or pursuits whatsoever, directly or indirectly, except for the following: _____ [*specify, e.g.,*

(a) Activities approved in writing by the Board of Directors;

(b) Directorships in companies not in competition with the Corporation; and

(c) Passive personal investments.]

Furthermore, Employee will not, directly or indirectly, acquire, hold, or retain any interest in any business competing with or similar in nature to the business of the Corporation, and will not own or hold to any substantial degree any securities in any company competing with the Corporation, for the duration of employment.

Corporation's Authority

7. Employee agrees to observe and comply with the rules and regulations of the Corporation, as adopted by the Corporation's Board of Directors, respecting performance of duties, and to carry out and perform orders, directions, and policies stated by the Corporation from time to time, either orally or in writing. Employee understands that the Corporation has final authority over acceptance or refusal of any client and over the amount of fee to be charged any client for professional services.

Disclosure of Information

8. Employee recognizes and acknowledges that the list of the Corporation's clients, as it may exist from time to time, is a unique asset of the Corporation's business. Employee will not disclose, either during or after the term of employment, all or any part of the list of the Corporation's clients to any person, firm, corporation, association, or other entity for any reason or purpose whatsoever. In the event of a breach or threatened breach by Employee of the provisions of this Paragraph, the Corporation will be entitled to an injunction restraining Employee from disclosing, in whole or in part, the list of the Corporation's clients, or from rendering any services to any person, firm, corporation, association, or other entity to whom the list, in whole or in part, has been disclosed or is threatened to be disclosed. Nothing in this Agreement will be construed as prohibiting the Corporation from pursuing any other remedies available to the Corporation for disclosure, including the recovery of damages from Employee.

Reimbursement of Disallowed Compensation and Expenses

9. In the event that any expenses paid for Employee or any reimbursement of expenses paid to Employee are determined not to be allowable deductions from the gross income of the Corporation, on audit or other examination of the Corporation's income tax returns, a final decision by the appropriate state or federal taxing authority, or a final judgment of a court of competent jurisdiction, Employee must repay to the Corporation the amount of the disallowed expenses. [*Optional:* The Corporation may not waive this right to repayment.]

Expenses

10. During the period of employment, Employee will be reimbursed for reasonable expenses incurred on behalf of the Corporation in accordance with the Corporation's general policy as adopted by the Corporation's Board of Directors. In addition to reimbursable expenses, the Employee may incur and pay in the course of employment by the Corporation other necessary expenses as a practicing _____[*type of professional*], that Employee will be required personally to pay and that the Corporation will be under no obligation to reimburse, including, but not limited to automobile and transportation expenses; professional, entertainment, and promotional expenses; home telephone bills; educational expenses incurred for the purpose of maintaining or improving the Employee's professional skills; club dues and expenses of membership in civic groups, professional societies, and fraternal organizations, and all other items of reasonable and necessary professional expense incurred by the Employee in the interest of the _____[*type of services to be performed; e.g.*, medical] practice of the Corporation. Nothing in this Paragraph prevents the Corporation from assuming an obligation to pay or reimbursing the Employee, in whole or in part, for any expenses in any of the above-enumerated categories.

Records

11. On the termination of this Agreement, Employee will not be entitled to keep or preserve records or charts of the Corporation as to any _____[clients *or* patients] unless a _____[client *or* patient] specifically requests a different disposition of those records. In no event will Employee be entitled to the records of clients not served by Employee.

Vacation

12. Employee is entitled to an annual vacation as specified in Schedule A, without loss of compensation. Employee is entitled to additional time without loss of compensation for attendance at meetings, conventions, and postgraduate courses as determined by the Board of Directors.

Notices

13. All notices required under this Agreement must be in writing and will be deemed to have been given at the time they are personally delivered to the party to whom given, or mailed in any general or branch United States Post Office enclosed in a registered or certified postage-paid envelope addressed to the address of the respective parties stated below, or to any changed address either party may have fixed by notice: _____[*name of corporation*], _____[*address of corporation*], _____[*name of employee*], _____[*address of employee*]. Any notice of change of address is effective only on receipt.

Waiver

14. Failure to insist on strict compliance with any of the terms, covenants, or conditions of this Agreement will not be deemed a waiver of that term, covenant, or condition. Furthermore, no waiver or relinquishment of any right or power at any one time or times will be deemed a waiver or relinquishment of the right or power for all or any other times.

Remedy for Breach

15. If Employee breaches any provision of this Agreement, the Corporation may institute and prosecute proceedings in any court of competent jurisdiction to obtain damages for breach of this Agreement or for any other legal or equitable relief to which the Corporation may be entitled at law. The prevailing party in any action to enforce or interpret the terms of this Agreement will be entitled to recover from the other party reasonable attorneys' fees, court

costs, and other necessary expenses incident to the action, in addition to any other relief to which that party is entitled.

Partial Invalidity

16. The invalidity or unenforceability of any term or provision or any clause of this Agreement in no way impairs or affects the validity or enforceability of any other provision of this Agreement, which will remain in full force and effect.

Assignment

17. This Agreement is personal in nature, and neither of the parties may assign or transfer this Agreement or any rights or obligations under this Agreement without the consent of the other party, except that the Corporation may assign or transfer this Agreement to a successor corporation in the event of merger, consolidation, or transfer or sale of all or substantially all of the assets of Corporation; provided, that in the case of any assignment or transfer under the terms of this Paragraph, this Agreement will be binding on and inure to the benefit of the successor corporation, and the successor corporation will discharge and perform all of the obligations of the Corporation under this Agreement.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year first written above.

CORPORATION
_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]
EMPLOYEE
_____ [*signature of employee*]
[*typed name*]

Schedule A

Effective Date: _____

Annual Salary: $_____[*amount of annual compensation*]

Annual Vacation _____[*amount of annual vacation*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsLabor & Employment LawEmployment RelationshipsEmployment ContractsConditions & TermsCompensationLabor & Employment LawEmployment RelationshipsEmployment ContractsConditions & TermsDuration of EmploymentGeneral OverviewLabor & Employment LawEmployment RelationshipsEmployment ContractsConditions & TermsTrade Secrets & Unfair CompetitionFormer Employer's CustomersLabor & Employment LawEmployment RelationshipsEmployment ContractsConditions & TermsTrade Secrets & Unfair CompetitionNoncompetition & Nondisclosure Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
C. Miscellaneous Forms

5-12A California Legal Forms--Transaction Guide § 12A.231

§ 12A.231 Medical Reimbursement and Wage Continuation Plan

[1] Comment

[a] Use of Form

This form is a medical reimbursement and wage continuation plan providing for the reimbursement of medical expenses for the employees of a professional corporation and their dependents. There are two general areas in which a medical reimbursement plan can be tailored to fit the needs of the corporation.

First, the scope of reimbursable medical expenses can be limited [*see* [2], P 3].

Second, and more importantly, serious consideration should be given to the maximum dollar amount of claims that may be submitted by any one employee. The reason for such a limitation is that the medical reimbursement plan must be available to all employees of the corporation who meet the eligibility requirements, not just the highly compensated or professional employees. If the plan discriminates in favor of the corporation's highly compensated or professional employees, then amounts paid to a highly compensated employee during that year are includable in that employee's gross income to the extent that the payments constitute an excess reimbursement of that employee [*I.R.C. § 105(h)(1), (7)*; *see § 12A.21[2][d]*]. Paragraph 12 of this form allows the corporation to limit the amount to be paid under the plan to or for the benefit of any employee and that employee's dependents during any plan year. Paragraph 13 provides for a continuation of wages during the disability of an employee.

[b] Tax Consequences of Medical Reimbursement Plan

A medical reimbursement plan is a significant fringe benefit to employees because the employer's contributions to the plan for the benefit of the employees will not be includable in the covered employees' gross incomes [*I.R.C. § 106*], nor will the benefits received by covered employees be includable in their gross incomes [*I.R.C. § 105(b)*]. Furthermore, the payments by the corporation for employee medical expenses may qualify as a deductible expense for the corporation [*I.R.C. § 162(a)*]. A qualifying plan may be one that covers one or more employees, and different plans may be provided for different employees or classes of employees.

Few requirements limit the types of plans that can qualify for favorable tax treatment. An accident or health plan may be insured or noninsured, it need not be in writing, and an employee's rights under a plan need not be legally enforceable. However, if the employee's rights are not enforceable, amounts will be deemed received under a plan only if, as of the date that the employee became ill or injured, the employee was covered by a plan providing for the payment of amounts to the employee in the event of illness or injury and notice or knowledge of the plan was reasonably available to the employee [*Treas. Reg. § 1.105-5(a)*]. Furthermore, favorable tax treatment does not depend on the identity of the payor of the benefits to the employee; the payor may be the employer, a welfare fund, a state sickness or disability benefits fund, an association of employers or employees, or an insurance company [*Treas. Reg. § 1.105-5(a)*].

For further discussion of the taxation of medical reimbursement plans, see *§ 12A.21[2][d]*. For a medical diagnostic plan, under which reimbursements are not treated as taxable income to the employee even if the plan fails the antidiscrimination rules [*Treas. Reg. § 1.105-11(g)*], see *§ 12A.232*.

[c] Tax Consequences of Wage Continuation Plans

Although premium payments for disability insurance are deductible by the corporation [*I.R.C. § 162(a)*; *Treas. Reg. § 1.162-10(a)*], and are not includible in the employee's gross income [*I.R.C. § 106(a)*; *see § 12A.21[2][e]*], amounts actually received under the policy are no longer excluded from taxation. Therefore, the corporate employee will be subject to income tax on any payments received under the policy [*see I.R.C. § 61(a)(1)*].

[2] FORM

Medical Reimbursement and Wage Continuation Plan

MEDICAL REIMBURSEMENT AND WAGE CONTINUATION PLAN FOR BENEFIT OF EMPLOYEES OF _____ [*name of corporation*]

Reimbursement for Medical Care Expenses

1. _____[*name of corporation*] (Corporation) will reimburse at least annually any eligible employee of the Corporation for all expenses incurred by the employee for the medical care (as defined in *Internal Revenue Code Section 213(d)(1)*) of the employee, the employee's spouse, and the employee's dependents (as defined in *Internal Revenue Code Section 152*).

Eligible Employees

2. The term "eligible employee" means an employee who has completed 3 years of employment with the Corporation and has attained the age of 25 years before the commencement of the Plan year, has a customary work week with the Corporation of 35 hours or more, has customary annual employment with the Corporation of nine months or more and is not included in a unit of employees covered by an agreement between employee representatives and one or more employers that the Secretary of the Treasury finds to be a collective bargaining agreement, in which accident and health benefits were the subject of good faith bargaining between the employee representatives and the employers. Eligibility will be determined as of the last day of the Plan year.

Included Expenses

3. Expenses for medical care as defined in *Internal Revenue Code Section 213(d)(1)* shall include _____[*specify, e.g.*, all amounts paid for hospital bills, doctor and dental bills, drugs, and premiums on accident or health insurance, including hospitalization, surgical, and medical insurance]. Dependents, as defined in *Internal Revenue Code Section 152*, include any member of the eligible employee's family over one half of whose

support is furnished by the eligible employee.

Direct Payment

4. The Corporation, in its discretion, may pay any or all of the above-defined expenses directly in lieu of making reimbursement for them. In that event, the Corporation will be relieved of all further responsibility with respect to that particular medical expense.

Submission of Records

5. Any eligible employee applying for reimbursement under this Plan must submit to the Corporation, at least annually, all hospitalization, doctor, dental, or other medical bills, including premium notices for accident or health insurance, for verification by the Corporation before the payment. Failure to comply may terminate the employee's right to reimbursement, at the discretion of the Corporation.

Other Insurance

6. Reimbursement under this Plan will be made by the Corporation only in the event and to the extent that reimbursement or payment is not provided for under any insurance policy or policies, whether owned by the Corporation or the eligible employees, under any other health and accident plan, or under any government reimbursement or payment plan or program. In the event that there is such a policy in whole or in part, the Corporation will be relieved of any liability under this Plan to the extent of the coverage under that policy, plan, or program.

Purpose

7. It is the intention of the Corporation that benefits payable under this Plan are eligible for exclusion from the gross income of the eligible employees covered by this Plan, as provided by *Internal Revenue Code Sections 105* and *106*, as now or hereafter amended.

Determination and Enforcement

8. All determinations under this Plan will be made by the Board of Directors of the Corporation and will be final. No person has any right to enforce payment under this Plan in any court of law or equity, or in any form of judicial or administrative proceeding.

Coverage

9. Any person becoming an employee of the Corporation after the execution of this Agreement will be eligible for the benefits provided under this Plan on becoming an eligible employee as defined in Paragraph 2, above. A copy of this Plan will be given to all present and future eligible employees of the Corporation.

Termination

10. This Plan is subject to termination at any time by the affirmative vote of the Board of Directors of the Corporation. However, termination of the Plan will not affect any right to claim reimbursement for medical expenses arising before termination.

Effective Date and Plan Year

11. The Plan will be effective as of _____. The Plan year will be the Corporation's fiscal year.

Limitation On Medical Benefits

12. Notwithstanding any other provision of this Plan, total reimbursement and/or direct payments under this Plan to or for the benefit of any eligible employee, spouse and dependents will not exceed $_____ during any one Plan year.

Continuation of Wages During Disability

13. The Corporation will pay, for a period of 12 months, the wages of any eligible employee who is absent from work as a result of personal injury or sickness. The 12-month period commences with the month following the month in which the disability occurs.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsLabor & Employment LawDisability & Unemployment InsuranceDisability BenefitsGeneral OverviewPensions & Benefits LawEmployee Benefit PlansGeneral OverviewTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsFringe Benefits (IRC secs. 61, 132)General OverviewTax LawFederal Income Tax ComputationDeductions for Nonbusiness ExpensesMedical Expenses (IRC sec. 213)Tax LawFederal Income Tax ComputationRetirement PlansNondiscrimination Rules (IRC sec. 401)Tax LawFederal Taxpayer GroupsIndividualsExclusions From Gross Income (IRC secs. 101-112, 115, 117-123, 125-139)General Overview



144 of 146 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
C. Miscellaneous Forms

5-12A California Legal Forms--Transaction Guide § 12A.232

§ 12A.232 Medical Diagnostic Plan

[1] Comment

[a] Use of Form

This form is a medical diagnostic plan. Many professional corporations do not adopt self-insured medical reimbursement plans because the tax advantages of these plans are limited if the plan discriminates in favor of highly compensated employees [*see I.R.C. § 105(h)*; *see also § 12A.231[1][b]*]. Nevertheless, these corporations may adopt a medical diagnostic plan, under which reimbursements for medical diagnostic procedures for employees (but not dependents) are not treated as taxable income to the employee even if the plan does not satisfy the antidiscrimination rules [*Treas. Reg. § 1.105-11(g)*].

[b] Types of Covered Expenses

The medical diagnostic procedures for which reimbursement may be made without regard to the antidiscrimination rules include routine medical examinations, blood tests, and X rays. On the other hand, reimbursement may not be made for expenses incurred for the treatment, cure, or testing of a known illness or disability, or for the treatment or testing for a physical injury, complaint, or specific symptom of a bodily malfunction. Furthermore, procedures do not include any activity undertaken for exercise, fitness, nutrition, recreation, or the general improvement of health unless they are for medical care [*Treas. Reg. § 1.105-11(g)(1)*; *see I.R.C. § 213(e)*]. Diagnostic procedures for which reimbursement is made must be performed at a facility that provides no services, directly or indirectly, other than medical and ancillary services. Physical proximity between a medical facility and nonlexical facilities does not alone cause the medical facility not to qualify. For example, an employee's annual physical examination conducted at the employee's personal physician's office is not considered a part of the medical reimbursement plan and therefore is not subject to the nondiscrimination requirements. Accordingly, the amount reimbursed may be excludable from the employee's income if the requirements of *I.R.C. § 105(b)* are satisfied [*Treas. Reg. § 1.105-11(g)(1)*].

Transportation expenses incurred primarily for an allowable diagnostic procedure may also be reimbursed under the plan without regard to anti-discrimination rules, but only to the extent they are ordinary and necessary. Neither

transportation undertaken merely for the general improvement of health, or in connection with a vacation, nor incidental expenses for food or lodging qualify for this treatment. Therefore, amounts reimbursed for such expenses may constitute excess reimbursements [*Treas. Reg. § 1.105-11(g)(2)*; *see § 12A.21[2][d]*].

[2] FORM

Medical Diagnostic Plan

MEDICAL DIAGNOSTIC PLAN

Reimbursement for Medical Diagnostic Expense

1. _____[*name of corporation*] (Corporation) will reimburse at least annually any eligible employee of the Corporation for all expenses incurred by the employee for medical diagnostic procedures (as defined in *Treasury Regulations Section 1.105-11(g)*).

Eligibility

2. The term "eligible employee" means an employee who is an officer of the Corporation. Eligibility will be determined as of the last day of the Corporation's fiscal year.

Covered Expenses

3. Expenses for medical diagnostic procedures, as defined in *Treasury Regulations Section 1.105-11(g)*, include all amounts paid for routine medical and dental examinations, X rays, and blood tests at a facility that does not provide any services, directly or indirectly, other than medical and ancillary services, and travel expenses incurred primarily to obtain an allowable medical diagnostic procedure. Expenses incurred for the treatment, care, or testing of a known illness or disability, or for the treatment of or testing for a physical injury, complaint, or specific symptom or bodily malfunction will not be reimbursed pursuant to this Plan. The reimbursement to or the payment on behalf of any one eligible employee will be without limitation.

Direct Payment

4. The Corporation, in its discretion, may pay any or all of the above-defined expenses directly in lieu of making reimbursement. In that event, the Corporation will be relieved of all further responsibility with respect to that particular medical diagnostic expense.

Submission of Records

5. An eligible employee applying for reimbursement under this Plan must submit to the Corporation, at least annually, all bills relating to medical diagnostic procedures or vouchers for reimbursement of travel expenses incurred primarily to obtain an allowable medical diagnostic procedure for verification by the Corporation before payment. A failure to comply may terminate the employee's right to reimbursement, at the discretion of the Corporation.

Other Insurance

6. Reimbursement under this Plan will be made by the Corporation only in the event and to the extent that reimbursement or payment is not provided for under any insurance policy or policies, whether owned by the Corporation or the eligible employee, under any other health plan, or under any government reimbursement or payment plan or program. In the event that there is such a policy, plan, or program providing for reimbursement or payment in whole or in part, then the Corporation will be relieved of any liability under this Plan to the extent of the coverage under that policy, plan, or program.

Purpose

7. The Corporation intends that benefits payable under this Plan are eligible for exclusion from the gross income of the eligible employees covered by this Plan, as provided by *Internal Revenue Code Sections 105* and *106*, as now or hereafter amended.

Determinations and Enforcement

8. All determinations under this Plan will be made by the Board of Directors of the Corporation and will be final. No person has any right to enforce payment under this Plan in any court of law or equity or in any form of judicial or administrative proceeding.

Termination

9. This Plan is subject to termination at any time by affirmative vote of the Corporation's Board of Directors. However, termination will not affect any right to claim reimbursement for expenses arising before termination.

Effective Date

10. This Plan is effective _____[*date*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsGeneral OverviewTax LawFederal Income Tax ComputationRetirement PlansNondiscrimination Rules (IRC sec. 401)Tax LawFederal Taxpayer GroupsC CorporationsPersonal & Professional Service Corporations (IRC secs. 269A, 280H)Tax LawFederal Taxpayer GroupsIndividualsExclusions From Gross Income (IRC secs. 101-112, 115, 117-123, 125-139)General Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
C. Miscellaneous Forms

5-12A California Legal Forms--Transaction Guide § 12A.233

§ 12A.233 Deferred Compensation Agreement

[1] Comment

[a] Use of Form

This form is a deferred compensation agreement. The primary purpose of a deferred compensation agreement is to delay the receipt of compensation until after retirement, when the shareholder may be in a lower tax bracket. Another important objective, in the context of a professional corporation, is to adequately reward a departing shareholder for his or her interest in the corporation. In most incorporated professional practices, business is conducted under the cash receipts and disbursements accounting method. Thus, the corporation's accounts receivable existing on the date of the shareholder's termination will not be a corporate after-tax asset, but will represent future corporate income [*see* [b], *below*].An allocation of a portion of the accounts receivable to the departing shareholder will compensate that shareholder for work done on the corporation's behalf.

[b] Tax Consequences

Because a deferred compensation arrangement does not constitute a qualified plan under the Internal Revenue Code, the corporation is not entitled to a deduction during the year in which the compensation is deferred. Rather, the corporation may deduct deferred compensation, as well as any vacation pay treated as deferred compensation, in the taxable year in which paid to the employee. Similarly, the employee is not taxed on deferred compensation in the year during which it is deferred, but the employee is taxed in the year the compensation is received [*I.R.C. § 404(a)(5)*].

Although the corporation will not be able to deduct currently the amount of compensation deferred, it will have the use of the money that would otherwise be paid as compensation. Deferred compensation agreements often provide that the amount of compensation deferred will grow at an assumed rate of interest to reflect the fact that the professional has in effect made loans to the corporation. However, care must be taken in structuring these arrangements. If the professional has more than a mere contractual right to receive payment, he or she may be treated as having constructively received that deferred compensation in the year during which it is deferred [*Rev. Rul. 60-31, 1960-1 C.B. 174*].

[c] Reasonable Compensation

In structuring a deferred compensation arrangement, the parties must consider the total compensation paid to the professional. It is important that the compensation be reasonable [*see Treas. Reg. § 1.162-7(b)(3); see also § 12A.21[3][d], [4]*]. In computing the compensation, the IRS considers not only the amount of salary and bonus paid to the professional, but also the amount of fringe benefits, pension plan benefits, medical benefits, and deferred compensation paid or accrued on his or her behalf [*Keller v. Commissioner (1981) 77 T.C. 1014]* . Thus, deferred compensation agreements, as in the case of any other compensation or fringe benefit arrangement, must provide a reasonable benefit in light of the other compensation paid to or accrued on behalf of the professional.

[2] FORM

Deferred Compensation Agreement

DEFERRED COMPENSATION AGREEMENT

This Agreement is made on _____[*date*], between _____[*name of corporation*] (Corporation), and _____[*name of employee*] (Employee).

Recitals

Employee has been employed in an executive capacity by the Corporation for many years, and has performed and is currently performing valuable services for and on behalf of the Corporation, resulting in substantial profits to the Corporation.

The Corporation desires further to compensate Employee for past services, to secure future services, to secure a commitment not to compete with the Corporation after termination of employment by the Corporation, and to compensate the Employee in return.

The Corporation and Employee mutually agree as follows:

Employment

1. The Corporation agrees to employ Employee, and Employee agrees to remain in the employ of the Corporation, at Employee's current rate of compensation or any other compensation mutually agreed to by Employee and the Corporation, to and including _____[*specify, e.g.*, the last day of the month in which falls Employee's birthday, or such other time as may be mutually agreed on by Employee and the Corporation, or until the Employee's death or disability].

Covenant Not to Compete

2. Employee agrees that on the termination of employment by the Corporation under Paragraph 1, and during the period of receipt of monthly payments from the Corporation under Paragraph 3, Employee will not directly or indirectly act in an executive or other capacity for any business enterprise that competes in a substantial degree with the Corporation, and will not engage in any activity involving substantial competition with the Corporation. Nothing in this Agreement prohibits Employee from owning stock or other securities of a competitor that are relatively insubstantial to the total stock of the competitor, as long as the Employee does not have the power to control or direct the management or policies of the competitor and does not serve as a director or officer of, and is not otherwise associated with, any competitor.

Deferred Compensation

3. On the termination of the Employee's employment for any reason, including death, disability, retirement, voluntary termination, or discharge with or without cause, the Employee will be paid as deferred compensation for past services rendered to the Corporation an amount determined in accord with this Paragraph. The Corporation's uncollected fees, both billed and unbilled (adjusted for estimated uncollectible accounts by the public accountant or certified public accountant then servicing the Corporation's account), as of the date of the Employee's termination of employment, must be determined. The Employee will be paid deferred compensation equal to _____ percent of the amount so determined, in [*specify, e.g.,* 60] equal consecutive monthly installments. The first installment will be paid within the period of _____[*specify, e.g.,* 60] days following the Employee's termination of employment. Payments made pursuant to this Paragraph 3 will be made to Employee, or after death, to any person or entity that the Employee designates in writing to the Corporation. In the absence of any designation, the payments will be made to the Employee's spouse; or, if the Employee has no spouse or the Employee's spouse does not survive the Employee, to the Employee's estate. If the Employee's spouse survives the Employee but is not living at the time a monthly payment is due and payable, the payment will be made to any person that the Employee's spouse has designated in writing, or, in the absence of any designation, to the Employee's estate.

Transfer of Rights to Receive Payments

4. Neither Employee, Employee's spouse, nor any other person has any right to commute, encumber, or dispose of the right to receive payments under this Agreement. The payments and the rights to the payments are expressly declared to be nonassignable and nontransferable, and in the event of any attempted assignment or transfer, the Corporation will have no further liability under this Agreement.

Default

5. In the event that Employee defaults at any time on any of the obligations under Paragraphs 1 or 2, or in the event that the Employee is discharged for willful disloyalty or other just cause during the period specified in Paragraph 1, all amounts then remaining unpaid under this Agreement will be forfeited, and the Corporation will have no further liability to any person under this Agreement.

Miscellaneous

6. This Agreement is binding on and inures to the benefit of any successor of the Corporation, and the successor will be deemed substituted for the Corporation under the terms of this Agreement. As used in this Agreement, the term "successor" includes any person, firm, corporation, or other business entity, that at any time, whether by merger, purchase, or otherwise, acquires all or substantially all of the assets or business of the Corporation.

IN WITNESS WHEREOF, the Corporation and Employee have executed this Agreement, each intending to be legally bound by it.

CORPORATION
_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]
EMPLOYEE
_____ [*signature of employee*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsPensions & Benefits LawEmployee Benefit PlansGeneral OverviewTax LawFederal Income Tax ComputationTax AccountingGeneral OverviewTax LawFederal Taxpayer GroupsC CorporationsPersonal & Professional Service Corporations (IRC secs. 269A, 280H)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12A PROFESSIONAL CORPORATIONS
PART IV. FORMS
C. Miscellaneous Forms

5-12A California Legal Forms--Transaction Guide § 12A.234

§ 12A.234 Client Memorandum for Professional Corporation

[1] Comment--Use of Form

This form is a client memorandum for a professional corporation. It is designed to be signed by the attorney representing the corporation and given to the officers, directors, and shareholders of the professional corporation. This memorandum explains the conduct by the professionals and the corporation necessary to sustain the validity of the corporate entity for federal tax purposes [*see § 12A.17*]. The form serves as a confirmation of the explanation to the parties of the legal consequences of the incorporation.

[2] FORM

Client Memorandum for Professional Corporation

[*Law firm letterhead*]

To: Directors and Officers of _____[*name of corporation*]

The Articles of Incorporation for _____[*name of corporation*] were filed on _____[*date*] with the Secretary of State of California pursuant to the provisions of the General Corporation Law and the Moscone-Knox Professional Corporations Act. In addition to the filing of the Articles of Incorporation, several other formal steps should be undertaken soon: (1) the adoption of bylaws for the corporation; (2) the organizational meetings of the shareholders and the Board of Directors; and (3) the issuance of shares of stock.

As soon as these steps have been taken, your professional corporation will be organized and in operation. However, even though the legal formalities for transition into a professional corporation will have been completed, many other organizational matters should be addressed.

To make the transition easier, we provide the following memorandum outlining the future activities of the corporation.

1. **Lawful Activity.** Under *Corporations Code Section 13401(b)*, a professional corporation ordinarily may not engage in more than one type of professional service. The term "professional service" is defined in *Corp. Code § 13401(a)* to mean any type of professional service that may lawfully be rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, or the Osteopathic Act.

2. **Ownership of Shares in the Corporation.** The shares of stock in the corporation are transferable only to persons who are duly licensed to render the same type of professional service that the Corporation was organized to render in accordance with the laws of the State of California.

3. **Transition to a Professional Corporation.** The following initial steps should be taken at the time you commence practice as a professional corporation:

(a) Your letterhead, bills, stationery, and other papers should be modified or changed to reflect the full name of the professional corporation.

(b) All of your professional cards should be changed to reflect the name of the professional corporation.

(c) A new bank account should be opened in the name of the professional corporation, as authorized at the organizational meeting of the Board of Directors of the corporation.

(d) Your telephone listing and your listing in all professional directories should be changed to reflect the corporation's name.

(e) All leases, contracts, and other arrangements previously entered into in connection with your professional practice should be modified, assigned, or rewritten to reflect the fact that the corporation has replaced you entirely as the contracting party to each lease, contract, or obligation.

(f) Any loans or indebtedness created in your professional practice should be transferred to or assumed by the corporation, but only after a determination that no adverse tax consequences will result from the assumption of liability. New loans and indebtedness created after the date of the creation of the professional corporation should be made in the name of the professional corporation.

(g) Any listing of your name on an office building directory or similar place should be changed to reflect the professional corporation.

(h) You should meet with your insurance agent to determine which insurance policies should be retained individually and which should be transferred to the professional corporation.

4. **Professional Corporation Activities.** The professional corporation must be maintained, operated, and regarded as a corporation rather than as a partnership or individual practice. The corporation is a tax-paying entity separate from its members, and this distinction must be maintained. The corporation should hold regular meetings of its Board of Directors and its shareholders, and any transaction of significance should be reflected in the minutes of the meetings. All contracts, plans, pension plans, trust agreements, loans, leases, purchase contracts, insurance contracts, and other agreements and transactions should be made in the name and on behalf of the professional corporation and should be reflected by appropriate minutes in the corporation minute book.

5. **Accounting and Finances.** You should meet with your accountant to discuss such matters as setting up a new set of books for the professional corporation, securing a Federal Employer's Identification Number for the corporation, and any other matters that the accountant may suggest. In addition, you should discuss a cash-flow analysis with your accountant or other advisor to determine the salaries that will be necessary to meet your living expenses and other

commitments.

6. **Directors and Officers.** There is an important distinction between Directors and Officers of the professional corporation. The Directors have the responsibility of controlling the policy, actions, and functions of the professional corporation. This duty may not be delegated. An Officer, however, serves at the pleasure of the Board of Directors and performs only those duties and obligations conferred by the Board of Directors. Therefore, it will be necessary for the Board of Directors to hold an annual meeting for the purpose of electing Officers of the corporation. Likewise, the shareholders of the corporation should hold a meeting at least annually for the purpose of electing the Director or Directors to serve the professional corporation.

7. **Individual Responsibilities to Professional Corporation.** As individuals, you may have certain fiduciary relationships and duties to the corporation. Before the forming of a professional corporation, an individual is free to deal with the affairs and interests of the practice. However, once the professional corporation is a separate entity, the Directors and shareholders must respect this separate identity in their dealings with the corporation. Such matters as leasing equipment to the corporation, use of the corporation's assets for personal activities, and other matters must be carefully monitored to maintain an arm's length relationship between the shareholder and the corporation. Although the corporation may offer many tax advantages to the shareholders, these advantages can be lost if the formalities are not followed. For example, the withdrawal of a sum from the corporation's bank account may be considered either a dividend from the corporation (taxable to the shareholder) or a loan from the corporation that will have to be repaid.

This memorandum has not attempted to answer all the questions that may arise in the operations of the corporation, but rather to provide some general guidelines and suggestions for operation that you may find beneficial. Although the formalities and procedures of corporate operation may seem different and unusual at first, they will become routine once a pattern of dealing with the corporation is established. As the transition to an incorporated form of practice progresses, please call on us with any questions that you may have.
Dated: _____.

Sincerely,
_____ [*name of law firm*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawProfessional Associations & CorporationsTax LawFederal Taxpayer GroupsC CorporationsPersonal & Professional Service Corporations (IRC secs. 269A, 280H)



1 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS

6-12B California Legal Forms--Transaction Guide 12B.syn

§ 12B.syn Synopsis to Chapter 12B: FOREIGN CORPORATIONS AND ASSOCIATIONS

§ 12B.01 California Sources

[1] Constitution

[2] Statutes

[3] Regulations

§ 12B.02 Federal Sources

[1] Constitution

[2] Statutes

§§ 12B.03-12B.04 [Reserved]

§ 12B.05 Law Reviews and Periodicals

§ 12B.06 Annotations

§ 12B.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 12B.08-12B.09 [Reserved]

§ 12B.10 Status of Foreign Corporations in California

[1] Nature of California Law Applicable to Foreign Corporations

[2] Types of Foreign Corporations Subject to Regulation

[a] Foreign Corporations in General

[b] Foreign Associations

[c] Foreign Nonprofit Corporations

[d] Nominally Foreign and Resident Foreign Corporations

[e] Foreign Professional Corporations

§ 12B.11 Qualifying to Transact Intrastate Business in California

[1] When Certificate of Qualification Is Required

[a] Transacting Intrastate Business

[b] Activities Not Requiring Certificate of Qualification

[i] In General

[ii] Activities by Foreign Lending Institution

[2] Requirements for Certificate of Qualification

[a] Statement and Designation

[b] Corporate Name Requirements

[i] In General

[ii] Alternatives to General Requirements

[iii] Requirements for Foreign Insurance Companies

[3] Annual Statement of Information; Corporate Disclosure Statement

[a] Annual Filing Required

[b] Penalty for Failure to File

§ 12B.12 Modification, Surrender, and Forfeiture of Certificate of Qualification

[1] Modification

[2] Surrender or Withdrawal

[a] Certificate of Surrender

[b] Merger

[c] Conversion

[d] Service of Process on Surrendered Corporation

[3] Forfeiture

§ 12B.13 Transacting Business Without Certificate of Qualification

[1] Protecting Corporate Name

[2] Penalties for Transacting Business Without Qualification

§ 12B.14 Regulation of Internal Affairs of Foreign Corporations

[1] Nominally Foreign Corporations

[a] In General

[b] Excluded Corporations and Associations

[c] Determination of Nominally Foreign Status

[i] Tax Factors

[ii] Residence of Holders of Voting Securities

[d] Duration of Nominally Foreign Status

[e] General Corporation Law Applicable to Nominally Foreign Corporations

[i] In General

[ii] Law Governing Directors

[iii] Law Governing Shareholders and Distributions

[iv] Records, Sales, and Reorganizations

[v] Duty to Advise of Nominally Foreign Status

[2] Resident Foreign Corporations

[3] Sales of Securities in California

[4] Violations of Directors' Duties

§ 12B.15 California Jurisdiction Over Foreign Corporations

[1] Jurisdiction

[a] Long-Arm Statute

[b] Minimum Contacts

[c] Over Foreign Corporations Transacting Intrastate Business in California

[d] On Grounds Other Than Transacting Intrastate Business

[2] Service of Process

[a] Direct Service

[b] Substituted Service

§§ 12B.16-12B.19 [Reserved]

§ 12B.20 Effect of Doing Business in States Other Than California

[1] In General

[2] State's Power Over Corporations Conducting Purely Interstate Commerce: Taxation and Jurisdiction

[a] In General

[b] Jurisdiction

[c] Taxation

[3] State's Power Over Foreign Corporations Doing Intrastate Business: Qualification Requirements

[a] In General

[b] When Qualification Is Required

[c] Penalties for Failure to Qualify

§§ 12B.21-12B.29 [Reserved]

§ 12B.30 Overview

§ 12B.31 California Franchise Tax

[1] In General

[a] Types of Corporations Subject to Franchise Tax

[b] Requirement That Corporation Be Doing Business in California

[c] Franchise Tax Rates

[2] Prepayment for Qualification

[3] Forfeiture Penalty for Failure to Pay Franchise Tax

[a] Bases for Forfeiture

[b] Notice and Effect of Forfeiture

[c] Reviving Corporate Powers

[i] Revivor With Payment of Amounts Due

[ii] Revivor Without Payment of Amounts Due

[iii] Issuance and Effect of Certificate of Revivor

[4] Contract Voidability Penalty for Failure to Pay Tax

[a] In General

[b] Effect of Voidability

[c] Relief From Voidability

[i] Application

[ii] Effect of Relief

[5] Liability for Year of Cessation

[a] General Corporations

[b] Banks and Financial Corporations

§ 12B.32 California Corporation Income Tax

§ 12B.33 Exclusion and Exemption From Franchise or Income Tax

[1] Application for Exclusion

[2] Exempt Corporations

§ 12B.34 Alternative Minimum Tax

§ 12B.35 Additional California Taxes

[1] Property Tax

[2] Sales and Use Taxes

§§ 12B.36-12B.99 [Reserved]

§ 12B.100 Foreign Corporation Transacting Business in California

[1] Facts

Scope

[2] Documents

Scope

§ 12B.101 California Corporation Transacting Business in Other State

[1] Facts

Scope

[2] Documents

Scope

§§ 12B.102-12B.109 [Reserved]

§ 12B.110 General Determinations for Foreign Corporations in California

Scope

§ 12B.111 Determinations Regarding California Filing Requirements

Scope

§ 12B.112 Determinations Regarding Filing Requirements in Other States

Scope

§ 12B.113 Determinations Regarding Regulation of Internal Corporate Affairs

Scope

§ 12B.114 Determinations Regarding State Taxation

Scope

§§ 12B.115-12B.119 [Reserved]

§ 12B.120 Qualification to Transact Intrastate Business in California

Scope

§ 12B.121 Name Registration for Corporations Not Transacting Intrastate Business in California

Scope

§ 12B.122 Filing Procedures for Foreign Lending Institutions Not Qualified to Transact Intrastate Business in California

Scope

§§ 12B.123-12B.129 [Reserved]

§ 12B.130 Payment of California State Tax

Scope

§ 12B.131 Obtaining Relief From Forfeiture and Contract Voidability Penalties

Scope

§ 12B.132 Filing Annual Statements of Information; Corporate Disclosure Statement

Scope

§ 12B.133 Amending Filed Statements

Scope

§ 12B.134 Surrendering Right to Transact Intrastate Business

Scope

§ 12B.135 Renewing Name Registration of Corporations Not Transacting Intrastate Business

Scope

§ 12B.136 Procedures for Nominally Foreign Corporations

Scope

§ 12B.137 Disclosure Procedures for Resident Foreign Corporations

Scope

§ 12B.138 Procedures for Requesting and Providing Information Regarding Results of Shareholder Voting

Scope

§§ 12B.139-12B.199 [Reserved]

§ 12B.200 Resolution Authorizing Qualification, Agent, and Name

[1] Comment

[a] Use of Form

[b] Qualification Requirements

[c] Selecting Agent for Service of Process

[d] Corporate Name

[2] FORM

Resolution Authorizing Qualification, Agent, and Name

§ 12B.201 Statement and Designation for Foreign Corporation [Corp. Code § 2105]

[1] Comment

[a] Use of Form

[b] Contents of Form

[c] Corporate Name

[i] Availability

[ii] Use of Assumed Name

[iii] Use as Trade Name

[d] Agent for Service of Process

[e] Accompanying Certificate of Good Standing

[f] Filing Requirements

[g] Amendments to Form

[2] FORM

Statement and Designation for Foreign Corporation [Corp. Code § 2105]

§ 12B.201A Statement and Designation for Foreign Professional Corporation

[1] Comment--Use of Form

[2] FORM

Statement and Designation for Foreign Professional Corporation

§ 12B.201B Statement and Designation for Foreign Insurer Corporation

[1] Comment--Use of Form

[2] FORM

Statement and Designation for Foreign Insurer Corporation

§ 12B.202 Request for Certificate of Good Standing From State of Incorporation

[1] Comment

[a] Use of Form

[b] Form and Contents of Certificate

[2] FORM

Request for Certificate of Good Standing From State of Incorporation

§ 12B.203 Statement and Designation and Officers' Certificate for Foreign Association [Corp. Code § 2105]

[1] Comment

[a] Use of Form

[b] Form and Contents of Certificate

[2] FORM

Statement and Designation and Officers' Certificate for Foreign Association [Corp. Code § 2105]

§ 12B.204 Foreign Corporation's Certificate of Consent to Act as Agent for Service of Process [Corp. Code § 1505]

[1] Comment

[a] Use of Form

[b] Contents

[c] Filing Requirements

[2] FORM

Foreign Corporation's Certificate of Consent to Act as Agent for Service of Process [Corp. Code § 1505]

§ 12B.205 Instructions to Agent for Transmittal of Process

[1] Comment

[a] Use of Form

[b] Resignation, Removal, or Death of Agent

[c] Change of Address of Natural Person

[2] FORM

Instructions to Agent for Transmittal of Process

§§ 12B.206-12B.209 [Reserved]

§ 12B.210 Annual Statement of Information by Foreign Corporation [Corp. Code § 2117]

[1] Comment

[a] Use of Form

[b] Contents and Effect of Form

[i] Initial Filing

[ii] Subsequent Filings

[c] Filing Statement

[d] Penalties for Failure to File

[i] Monetary Penalties

[ii] Suspension of Corporate Powers

[2] FORM

Annual Statement by Foreign Corporation [Corp. Code § 2117]

§ 12B.211 Corporate Disclosure Statement--Publicly Traded Companies

[1] Comment

[a] Use of Form

[b] Contents of Form

[c] Filing and Execution

[2] FORM

Corporate Disclosure Statement--Publicly Traded Companies

§§ 12B.212-12B.219 [Reserved]

§ 12B.220 Amended Statement and Designation by Foreign Corporation [Corp. Code § 2107]

[1] Comment

[a] Use of Form

[b] Requirements

[c] Changing Corporate Address or Agent

[d] No Amendment of Domicile

[2] FORM

Amended Statement and Designation by Foreign Corporation [Corp. Code § 2107]

§ 12B.221 Request for Certificate From State of Incorporation

[1] Comment--Use of Form

[2] FORM

Request for Certificate From State of Incorporation

§ 12B.222 Amended Statement and Designation by Foreign Association [Corp. Code § 2107]

[1] Comment

[a] Use of Form

[b] Contents of Form

[2] FORM

Amended Statement and Designation by Foreign Association [Corp. Code § 2107]

§ 12B.223 Officer's Certificate Regarding Foreign Association's Change of Name [Corp. Code § 2107]

[1] Comment--Use of Form

[2] FORM

Officer's Certificate Regarding Foreign Association's Change of Name [Corp. Code § 2107]

§§ 12B.224-12B.229 [Reserved]

§ 12B.230 Foreign Corporation's Certificate of Surrender of Right to Transact Intrastate Business [Corp. Code § 2112]

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[c] Tax Clearance Certificate

[d] Filing

[2] FORM

Foreign Corporation's Certificate of Surrender of Right to Transact Intrastate Business [Corp. Code § 2112]

§ 12B.231 Statement of Change of Name or Address of Surrendered Foreign Corporation [Corp. Code § 2112]

[1] Comment--Use of Form

[2] FORM

Statement of Change of Name or Address of Surrendered Foreign Corporation [Corp. Code § 2112]

§ 12B.232 Foreign Association's Certificate of Surrender of Right to Transact Intrastate Business [Corp. Code § 2112]

[1] Comment--Use of Form

[2] FORM

Foreign Association's Certificate of Surrender of Right to Transact Intrastate Business [Corp. Code § 2112]

§ 12B.233 Statement of Change of Name or Address of Surrendered Foreign Association [Corp. Code § 2112]

[1] Comment--Use of Form

[2] FORM

Statement of Change of Name or Address of Surrendered Foreign Association [Corp. Code § 2112]

§ 12B.234 Request for Certificate Confirming Merger [Corp. Code § 2113]

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[2] FORM

Request for Certificate Confirming Merger [Corp. Code § 2113]

§§ 12B.235-12B.239 [Reserved]

§ 12B.240 Application for Registration of Name by Foreign Corporation Not Transacting Intrastate Business [Corp. Code § 2101]

[1] Comment

[a] Use of Form

[b] Name Availability

[c] Registration Requirements

[d] Alternatives to Registration

[2] FORM

Application for Registration of Name by Foreign Corporation Not Transacting Intrastate Business [Corp. Code § 2101]

§§ 12B.241-12B.249 [Reserved]

§ 12B.250 Resolution Authorizing Filing of Annual Address Statements

[1] Comment

[a] Use of Form

[b] "Foreign Lending Institution" Defined

[c] Statement Requirement

[2] FORM

Resolution Authorizing Filing of Annual Address Statements

§ 12B.251 Statement by Foreign Lending Institution of Address for Notice or Process [Corp. Code § 2104]

[1] Comment

[a] Use of Form

[b] Filing Requirements

[c] Transmittal of Process

[2] FORM

Statement by Foreign Lending Institution of Address for Notice or Process [Corp. Code § 2104]

§ 12B.252 Supplement to Statement by Foreign Lending Institution

[1] Comment--Use of Form

[2] FORM

Supplement to Statement by Foreign Lending Institution

§§ 12B.253-12B.259 [Reserved]

§ 12B.260 Application of Foreign Corporation for Exclusion From State Taxation [Rev. & Tax. Code § 23101.5]

[1] Comment

[a] Use of Form

[b] Criteria for Exclusion

[i] Purchasing Activities

[ii] Educational Activities

[c] Contents of Application

[i] In General

[ii] Based on Purchasing Activities

[iii] Based on Educational Activities

[d] Determination of Exclusion

[e] Subsequent Filings

[2] FORM

Application of Foreign Corporation for Exclusion From State Taxation [Rev. & Tax. Code § 23101.5]

§ 12B.261 Application for Certificate of Revivor From Forfeiture for Failure to Pay Taxes or File Returns [Rev. & Tax. Code § 23305] or for Failure to File Annual Statement [Corp. Code § 2117]

[1] Comment

[a] Use of Form

[b] Bases for Forfeiture

[c] Notice and Effect of Forfeiture

[i] For Failure to Pay Taxes or File a Tax Return

[ii] For Failure to File Annual Statements

[d] Reviving Corporate Powers

[e] Issuance and Effect of Certificate of Revivor

[2] FORM

Application for Certificate of Revivor From Forfeiture for Failure to Pay Taxes or File Returns [Rev. & Tax. Code § 23305] or for Failure to File Biennial Statement [Corp. Code § 2117]

§ 12B.262 Application for Relief From Contract Voidability for Failure to Pay Taxes or File Returns [Rev. & Tax. Code § 23305.1]

[1] Comment

[a] Use of Form

[b] Bases for Contract Voidability

[c] Effect of Voidability

[d] Applying for Relief From Contract Voidability

[i] Application Procedure

[ii] Effect of Relief

[2] FORM

Application for Relief From Contract Voidability for Failure to Pay Taxes or File Returns [Rev. & Tax. Code § 23305.1]



2 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS

6-12B California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter covers the application of California law to foreign corporations and associations, and the effect of business activities by California corporations doing business in other states. The chapter focuses on California regulation of foreign corporations and associations doing business in California. It discusses the qualification procedures that foreign corporations and associations must follow in order to transact intrastate business in California, the procedures required to maintain qualified status, and the surrender and forfeiture of the right to transact intrastate business. It covers California regulation of the internal corporate affairs of resident and nominally foreign corporations. This chapter also examines the California taxation and securities regulations of a foreign corporation in California. It briefly considers the basis for California judicial jurisdiction over foreign corporations and service of process on foreign corporations in California. Finally, it addresses issues facing California corporations doing business in other states.

The Legal Background and form comments are intended as a basic orientation to of the governing law. The Transaction Guide provides checklists concerning procedures for qualifying and maintaining the qualification of corporations to transact intrastate business, and also provides checklists for corporations not planning to qualify in California. The forms in this chapter include those necessary for qualification and the maintenance of qualification, and also forms for registering the corporate name of an unqualified corporation, for amending forms filed by qualified corporations, for surrendering a foreign corporation's right to transact intrastate business, and forms related to forfeiture of a corporation's rights, duties, and powers, and taxation.

For a discussion of the formation of corporations under California law, see Ch. 2, *Formation of Corporations* . The rights and obligations of directors and shareholders of California covered in corporations are Ch. 5, *Directors' Meetings, Actions, and Resolutions* , and Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* . For a discussion of corporate mergers and acquisitions, see Ch. 11, *Merger and Acquisition Issues* . For a discussion of procedures on the cessation of business, see Ch. 12, *Winding Up and Dissolution* . For a general discussion of nonprofit corporations and associations in California, see Ch. 13, *Nonprofit Corporations* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

6-12B California Legal Forms--Transaction Guide § 12B.01

§ 12B.01 California Sources

[1] Constitution

Property tax liability. *Cal. Const. art. XIII, § 1*.

"Insurer" defined. *Cal. Const. art. XIII, § 28*.

[2] Statutes

Definitions.
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Approved by outstanding shares. *Corp. Code § 152*.
Approved by shareholders. *Corp. Code § 153*.
Board. *Corp. Code § 155*.
Constituent corporation. *Corp. Code § 161*.
Corporation. *Corp. Code § 162*.
Directors. *Corp. Code § 164*.
Disappearing corporation. *Corp. Code § 165*.
Distribution to shareholders. *Corp. Code § 166*.
Domestic corporation. *Corp. Code § 167*.
Equity security. *Corp. Code § 168*.
Filed. *Corp. Code § 169*.
Foreign association. *Corp. Code § 170*.
Foreign corporation. *Corp. Code § 171*.
Officers' certificate. *Corp. Code § 173*.
Parent. *Corp. Code § 175*.
Shareholder. *Corp. Code § 185*.

Subsidiary. *Corp. Code § 189*.
Surviving corporation. *Corp. Code § 190*.
Transaction of intrastate business. *Corp. Code § 191*.

Reservation of corporate name. *Corp. Code § 201*.

Regulation of foreign corporations.

Regulation of resident foreign corporations. *Corp. Code §§ 1501(g), 1600-1605*.

Name registration without qualification. *Corp. Code § 2101*.

Regulation of foreign insurance companies. *Corp. Code § 2103*.

Foreign lending institutions. *Corp. Code § 2104*.

Prerequisites to qualification. *Corp. Code § 2105*.

Certificate of qualification and corporate name requirements. *Corp. Code § 2106*.

Insurer's name requirements. *Corp. Code § 2106.5*.

Amended statement and designation. *Corp. Code § 2107*.

Service of process. *Corp. Code §§ 2110, 2110.1, 2111, 2114*.

Surrender of right to transact intrastate business. *Corp. Code §§ 2112, 2113*.

Regulation of nominally foreign corporations. *Corp. Code § 2115*.

Liability of directors. *Corp. Code § 2116*.

Annual statement and designation. *Corp. Code § 2117*.

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Securities regulation of issuer transactions. *Corp. Code §§ 25110, 25120*.

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Sales and use tax. *Rev. & Tax. Code § 6051*.

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Minimum franchise tax. *Rev. & Tax. Code § 23153*.

Tax on banks and financial corporations. *Rev. & Tax. Code §§ 23181-23188*.

Prepayment. *Rev. & Tax. Code § 23221*.

Computation. *Rev. & Tax. Code § 23224*.

Suspension and revivor. *Rev. & Tax. Code §§ 23301-23305.2*.

Withdrawal. *Rev. & Tax. Code §§ 23331-23334*.

Alternative minimum tax. *Rev. & Tax. Code § 23400 et seq.*

Corporate income tax. *Rev. & Tax. Code § 23501 et seq.*

[3] Regulations

Income from sources within state. *18 Cal. Code Reg. § 23040(a)*.

"Doing business" defined. *18 Cal. Code Reg. § 23101*.

Exclusion of certain activities from taxation. *18 Cal. Code Reg. § 23101.5*

Continuing tax liability of qualified corporations. *18 Cal. Code Reg. § 23151*.

Tax on banks and financial corporations. *18 Cal. Code Reg. § 23183*.

Tax on commencing corporations. *18 Cal. Code Reg. § 23222*.

Apportionment formula. *18 Cal. Code Reg. § 25128*.

Property factor. *18 Cal. Code Reg. § 25129*.

Sales factor. *18 Cal. Code Reg. § 25136*.

Allocation and apportionment of bank and financial corporation income. *18 Cal. Code Reg. § 25137-4*-1(c).



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

6-12B California Legal Forms--Transaction Guide § 12B.02

§ 12B.02 Federal Sources

[1] Constitution

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[2] Statutes

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

6-12B California Legal Forms--Transaction Guide §§ 12B.03-12B.04

[Reserved]

§§ 12B.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

6-12B California Legal Forms--Transaction Guide § 12B.05

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

6-12B California Legal Forms--Transaction Guide § 12B.06

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

6-12B California Legal Forms--Transaction Guide § 12B.07

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

6-12B California Legal Forms--Transaction Guide §§ 12B.08-12B.09

[Reserved]

§§ 12B.08[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Regulation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.10

§ 12B.10 Status of Foreign Corporations in California

[1] Nature of California Law Applicable to Foreign Corporations

States are limited by the United States Constitution in their power to regulate interstate commerce [*see* U.S. Const., art. I, § 8; *Pike v. Bruce Church (1970) 397 U.S. 137, 142-143, 90 S. Ct. 844, 25 L. Ed. 2d 174* ; *see also § 12B.20[2]*]. In spite of this limitation, when a corporation conducts activities outside of its place of incorporation, or conducts activities in its place of incorporation that have an impact in a different jurisdiction, it becomes subject to the laws of and taxation by the foreign jurisdiction in varying degrees [*see* Ballantine & Sterling, California Corporation Laws, Ch. 18, *Foreign Corporations* (Matthew Bender); *see also § 12B.20[2]*]. Therefore, California has the right to prescribe the terms on which any foreign corporation may do intrastate business within its limits [*see, e.g., Chattanooga National B. & L. Asso. v. Denson (1903) 189 U.S. 408, 416-417, 23 S. Ct. 630, 47 L. Ed. 870]* .

A foreign corporation that transacts intrastate business in California is governed by Ch. 21 of the Corporations Code [*Corp. Code § 2100*; *see Corp. Code §§ 2100-2117*], which requires the foreign corporation to obtain a certificate of qualification [*Corp. Code § 2105(a)*; *see § 12B.11*]. The general provisions of the General Corporation Law [*see Corp. Code §§ 100-195*; *see also Corp. Code §§ 200-14202*] apply to foreign corporations only when expressly provided by statute [*Corp. Code §§ 102(a), 162*]. The laws governing foreign corporations generally do not affect the conduct of a foreign corporation's internal affairs, with the exception of provisions governing nominally foreign and resident corporations [*see Corp. Code §§ 2100-2117*; *see also § 12B.14*].

However, even if a foreign corporation's activities in California do not fall under the definition of "transacting intrastate business" [*see § 12B.11[1]*], the corporation may be subject to certain provisions not related to the transaction of intrastate business. For example, many California laws governing such fields as the environment, health and safety, and regulation of special entities such as insurance apply to all corporations regardless of the place of incorporation.

[2] Types of Foreign Corporations Subject to Regulation

[a] Foreign Corporations in General

A "foreign corporation" is any corporation that is not formed under the laws of California [*Corp. Code § 171*; *see Corp. Code § 167* ("domestic corporation" is corporation formed under California laws)]. Therefore, with one exception, the term "foreign corporation" applies to corporations formed in the United States as well as abroad, as long as they are not formed in California. The exception is any corporation or association chartered under the laws of the United States; these organizations are not included in the definition of "foreign corporation" for the purposes of Corporations Code Ch. 21 [*see Corp. Code §§ 2100-2117*], and therefore are not subject to its provisions [*Corp. Code § 171*; *see Corp. Code § 2100*].

[b] Foreign Associations

Foreign associations, which are business associations organized as trusts under the laws of a foreign jurisdiction [*Corp. Code § 170*; *see Corp. Code § 200.5* (procedures for incorporating business trust as California corporation)], are considered foreign corporations (unless the applicable statute states otherwise) for purposes of the General Corporation Law regulating foreign corporations [*see Corp. Code §§ 191, 201, 2100-2117*] and for purposes of certain penalties relating to foreign corporations [*Corp. Code § 171*; *see Corp. Code §§ 2203, 2258, 2259*; *see also §§ 12B.11[3], 12B.12[3], 12B.31[3], [4]*]. In this chapter, the term "foreign corporation" will include foreign associations unless otherwise specified.

[c] Foreign Nonprofit Corporations

Under the Nonprofit Corporation Law [*see Corp. Code §§ 5000-10841*], a "foreign corporation" is, for most purposes, any corporation incorporated in a jurisdiction outside California pursuant to that jurisdiction's law for the incorporation of nonprofit corporations [*Corp. Code § 5053*]. Foreign nonprofit corporations fall within the general definition of "foreign corporations" [*see Corp. Code § 171*] and are governed by the same provisions [*see Corp. Code §§ 2100-2117*], except as to provisions expressly excluding nonprofit corporations and as to matters specifically otherwise provided for in the Nonprofit Corporation Law [*Corp. Code § 6910*].

For example, foreign nonprofit corporations are not subject to certain requirements applicable to foreign corporations generally, such as requirements concerning nominally foreign corporations [*Corp. Code § 6910*; *see Corp. Code § 2115*; *see also* [d], *below*]. Further, foreign nonprofit corporations are treated differently from foreign for-profit corporations under the Nonprofit Corporation Law for purposes of mergers [*see Corp. Code §§ 6010, 6018, 8010, 8018*].

In this chapter, the term "foreign corporations" applies to both foreign nonprofit corporations and foreign for-profit corporations, unless otherwise indicated.

[d] Nominally Foreign and Resident Foreign Corporations

Certain foreign corporations (other than foreign associations and foreign nonprofit corporations) transacting intrastate business are subject to California regulation of their internal affairs if, although organized as foreign corporations, they are actually more than half domestic [*see Corp. Code § 2115(a)*]. These corporations, generally referred to as "nominally foreign" or "pseudo-foreign" corporations, are made subject to various provisions of the General Corporation Law [*see § 12B.14[1][e]*] that are otherwise only applicable to domestic corporations [*Corp. Code § 2115(b)*; *see* Ballantine & Sterling, California Corporation Laws, Ch. 18, *Foreign Corporations* (Matthew Bender)]. For a discussion of regulation of these corporations, see *§ 12B.14[1]*.

Additionally, a foreign corporation may be subject to some California regulation of its internal corporate affairs if it is a "resident foreign" corporation because it "resides" in California [*see Corp. Code §§ 1501, 1600, 1601-1603*]. For further discussion, see *§ 12B.14[2]*.

[e] Foreign Professional Corporations

Foreign professional corporations may qualify as foreign professional corporations to transact intrastate business in California in accordance with Chapter 21 [*Corp. Code § 2100 et seq.*] of the Corporations Code, and are generally subject to the provisions of the Corporations Code applicable to foreign corporations [*Corp. Code § 13404.5(a)*]. In addition, foreign professional corporations must have a currently effective certificate of registration issued by the governmental agency regulating the profession, under the applicable provisions of the California Business and Professions Code expressly authorizing those professional services to be rendered by a foreign professional corporation [*Corp. Code § 13404.5(b)*]. Foreign professional corporations are subject to California rules governing shareholder liability [*Corp. Code § 13404.5(c)*], and every application by a foreign professional corporation to do business in California must contain a statement, in language prescribed by statute, agreeing to be subject to any applicable California liability rules and submitting to the jurisdiction of California courts to the same extent as a California professional corporation [*Corp. Code § 13404.5(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsConstitutional LawCongressional Duties & PowersCommerce ClauseIntrastate Commerce



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Regulation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.11

§ 12B.11 Qualifying to Transact Intrastate Business in California

[1] When Certificate of Qualification Is Required

[a] Transacting Intrastate Business

A foreign corporation must obtain a certificate of qualification from the Secretary of State before it may transact intrastate business in California [*Corp. Code § 2105(a)*; *see* [2], *below*]. A foreign corporation "transacts intrastate business" when it enters into repeated and successive transactions of its business in California, other than interstate or foreign commerce [*Corp. Code § 191(a)*].

The concept of "transacting intrastate business" for purposes of requiring qualification is narrower than the concept of "doing business" for purposes of service of summons [*Thorner v. Selective Cam Transmission Co. (1960) 180 Cal. App. 2d 89, 91, 4 Cal. Rptr. 409]* . One of the factors considered in determining whether a corporation is transacting intrastate business is the presence of agents and employees in California [*see Mediterranean Exports, Inc. v. Superior Court (1981) 119 Cal. App. 3d 605, 616-618, 174 Cal. Rptr. 169* ; *see also Eli Lilly & Co. v. Sav-On-Drugs (1961) 366 U.S. 276, 280-282, 81 S. Ct. 1316, 6 L. Ed. 2d 288]* . For further discussion of this determination, see Ballantine & Sterling, California Corporation Laws, Ch. 18, *Foreign Corporations* (Matthew Bender).

[b] Activities Not Requiring Certificate of Qualification

[i] In General

Foreign corporations are expressly permitted to conduct certain activities without having to obtain a certificate of qualification for transacting intrastate business. First, a foreign corporation is not considered to be transacting intrastate business merely because its subsidiary transacts intrastate business [*Corp. Code § 191(b)*]. For most purposes, such a foreign "parent" corporation would normally possess more than 50 percent of the voting power directly or indirectly through one or more of its subsidiaries [*Corp. Code § 189(a)*; *see Corp. Code §§ 189(b), 703*]. Further, a foreign corporation is not considered to be transacting intrastate business merely because of its status as any one or more of the following [Corp. Code § 191(b)]:

- A shareholder of a domestic corporation.
- A shareholder of a foreign corporation transacting intrastate business.
- A limited partner of a domestic limited partnership.
- A limited partner of a foreign limited partnership transacting intrastate business.
- A member or manager of a domestic limited liability company.
- A member or manager of a foreign limited liability company transacting intrastate business.

A foreign corporation also is not considered to be transacting intrastate business solely because it carries on in California any one or more of the following activities, which are generally attributable to interstate corporate activities [*Corp. Code § 191(c)*; *see* Ballantine & Sterling, California Corporation Laws, Ch. 18, *Foreign Corporations* (Matthew Bender)]:

- Maintaining, defending, or settling any action, suit, administrative or arbitration proceeding, or settling any other claim or dispute.
- Holding meetings of its board or shareholders or carrying on other activities concerning its internal affairs.
- Maintaining bank accounts.
- Maintaining offices or agencies for the transfer, exchange, and registration of its securities or depositaries with relation to its securities.
- Effecting sales through independent contractors.
- Soliciting or procuring orders by mail, through employees or agents, or otherwise, if those orders require acceptance outside of California before becoming binding contracts.
- Creating evidences of debt, mortgages, liens, or security interests on real or personal property.
- Conducting an isolated transaction that is completed within a period of 180 days and is not in a course of repeated transactions of a like nature.

Activities other than those enumerated above may also be activities that do not constitute "transacting intrastate business" [*see Corp. Code § 191(c)*; *see e.g., United Systems of Arkansas, Inc. v. Stamison (1998) 63 Cal. App. 4th 1001, 1007, 74 Cal. Rptr. 2d 407* (simply submitting bid in response to request for quotation by DMV was not "transacting intrastate business"; out-of-state bidder could maintain its suit challenging award of contract to another bidder without obtaining certificate of qualification from Secretary of State)].

[ii] Activities by Foreign Lending Institution

A foreign lending institution may engage in various other activities, listed below, without transacting intrastate business [*see Corp. Code § 191(d)*]. The term "foreign lending institution" includes the following [*Corp. Code § 191(d)*]:

- Any foreign banking corporation.

- Any foreign corporation whose capital stock is all owned by one or more foreign banking corporations.

- Any foreign savings and loan association.

- Any foreign insurance company.

- Any foreign corporation or association authorized by its charter to invest in loans secured by real and personal property, whether organized under the laws of the United States or of any other state, district, or territory of the United States.

A foreign lending institution is not required to qualify, nor does it become subject to any provisions of the Bank and Corporation Tax Law [*Rev. & Tax. Code § 23001 et seq.*] or the Corporations Code [*Corp. Code § 2100 et seq.*], Financial Code, or Insurance Code relating to the transaction of intrastate business, solely by engaging in one or more of the activities listed below [*Corp. Code § 2104*]. These activities do not include all possible activities that are not considered "transacting intrastate business" [*Corp. Code § 191(d)*]. However, an institution engaging in any of the activities listed below is deemed to have appointed the Secretary of State as its agent for service of process for actions arising out of those activities. It must file an annual statement with the Secretary showing the address to which any process should be sent [*Corp. Code § 2104*; *see Corp. Code § 2111*; *see also § 12B.251* (form)].

A foreign lending institution is not considered to be "transacting intrastate business" solely because it engages in any or all of the following activities, either (1) on its own behalf, (2) as a trustee of a pension plan, employee profit-sharing or retirement plan, testamentary or inter vivos trust, or (3) in any other fiduciary capacity [*Corp. Code § 191(d)*]:

- The acquisition by purchase, contract to purchase, advance commitment to purchase, or assignment of any loans (secured or unsecured) or any interest in loans through activities carried on by the institution from outside California.

- The making, by the institution's officer or employee, of physical inspections and appraisals of real or personal property securing or proposed to secure any loan, if the officer or employee is not a resident of and does not maintain a place of business for such purpose in California.

- The ownership of any loans and the enforcement of any loans by trustee's sale, judicial process, or deed in lieu of foreclosure or otherwise.

- The modification, renewal, extension, transfer, or sale of loans or the acceptance of additional or substitute security for loans or the full or partial release of the security for loans or the acceptance of substitute or additional obligors for loans if the activities are carried on by the lending institution from outside of California.

- The engaging by contract of a corporation, firm, or association, qualified to do business in California, that is not a subsidiary or parent of the lending institution and that is not under common management with the lending institution, to make collections and to service loans in any manner, including the payment of ground rents, taxes, assessments and the like and the making of, on behalf of the institution, physical inspections and appraisals of real or personal property securing any loans or proposed to secure any loans, and the performance of that engagement.

- The acquisition of title to the real or personal property covered by any mortgage, deed of trust, or

other security instrument by trustee's sale, judicial sale, foreclosure, or deed in lieu of foreclosure, or for the purpose of transferring title to any federal agency or instrumentality as the insurer or guarantor of any loan, and the retention of title to any real or personal property acquired in that manner pending the property's orderly sale or other disposition.

- The engaging in activities necessary or appropriate to carry out any of the activities listed in the first six categories above.

[2] Requirements for Certificate of Qualification

[a] Statement and Designation

To obtain a certificate of qualification to transact intrastate business in California (to "qualify"), a foreign corporation must file a statement and designation setting forth the required information [*see §§ 12B.120, 12B.201, 12B.203*], including the corporate name [*Corp. Code § 2105(a)*; *see* [b], *below*]. In addition, the foreign corporation must attach a certificate from the appropriate official stating that the foreign corporation is an existing corporation in good standing, or that the foreign association is a validly organized and existing business association under the laws of the specified foreign jurisdiction [*Corp. Code § 2105(b)*; *see § 12B.202*].

On submitting these materials and paying a filing fee (subject to corporate name requirements [*see* [b], *below*]), the Secretary of State will issue a certificate of qualification stating that the corporation is qualified to transact intrastate business, subject to any licensing requirements otherwise imposed by California law [*Corp. Code § 2106(a)*; *see Corp. Code § 2105*; *see also Gov. Code § 12186(f)(fee)*]. The Secretary may cancel the filing of the statement and designation if a check or other remittance in payment of the filing fee or franchise tax is not paid on presentation [*Corp. Code § 110.5*]. Foreign nonprofit corporations are entitled to a reduced fee requirement [*see Gov. Code § 12186(e)*].

For a detailed guide to procedures for qualifying, see *§ 12B.120*.

[b] Corporate Name Requirements

[i] In General

A foreign corporation cannot qualify to transact intrastate business in California [*see* [a], *above*] if its name is likely to mislead the public [*Corp. Code § 201(b)*]. In addition, except in certain circumstances [*see* [ii], *below*], a foreign corporation cannot qualify if its name is the same as, or resembles so closely as to tend to deceive, any of the following names [*Corp. Code § 2106(b)*; *see Corp. Code § 201(b)*]:

- The name of a domestic corporation;

- The name of a foreign corporation that is authorized to transact intrastate business or that has registered its name with the Secretary of State [*see Corp. Code § 2101*; *see also § 12B.13[1]*];

- A name that a foreign corporation has assumed [*see* [ii], *below*];

- A name that will become the record name of a domestic or foreign corporation on the effective date of a filed corporate instrument [*see Corp. Code §§ 110(c), 5008(c)*]; or

- A name under reservation for another corporation.

If the corporation's name conflicts with one of these names, the corporation has three alternative means of qualifying [*see* [ii], *below*].

Additional restrictions on names may be applicable as well. For example, the words "Olympic" or "Olympiad" may, under certain circumstances, violate federal law [*see 36 U.S.C. § 380*]. In addition, use of the word "cooperative" is restricted [*see Corp. Code § 12311(b)*; *Food & Agric. Code § 54036*].

[ii] Alternatives to General Requirements

A foreign corporation has several alternatives in attempting to qualify under a corporate name that might otherwise not be available. First, if the corporate name is substantially the same as the name of an existing domestic corporation or a foreign corporation that has either qualified or registered its name [*see Corp. Code § 2101*; *see also § 12B.13[1]*], the corporation may qualify under that name by providing proof of consent by the other corporation. The foreign corporation seeking to use the conflicting name must also provide a finding by the Secretary of State that, under the circumstances, the public is not likely to be misled [*Corp. Code § 2106(b)*; *see Corp. Code § 201(b)*].

Second, if the corporate name conflicts with any of the names listed in [i], *above*, the foreign corporation may nevertheless qualify if it obtains and files an order from a court of competent jurisdiction permanently enjoining the corporation with the conflicting name from doing business in California under that name [*Corp. Code § 2106(b)*].

Third, in the event of a conflict [*see* [i], *above*], the corporation may qualify under an assumed name. The assumed name may be the corporation's name with the addition of some distinguishing word or words acceptable to the Secretary of State, or a name available for the name of a new domestic corporation [*Corp. Code § 2106(b)*; *see Corp. Code § 201(b)*].

To qualify under an assumed name, the foreign corporation must obtain from the Secretary of State a finding, pursuant to an affidavit or other manner selected by the Secretary, that the business to be conducted in California by the foreign corporation is not the same as or similar to the business being conducted or to be conducted by the corporation with the conflicting name, and that the public is not likely to be deceived. The foreign corporation must then agree to transact business in California under the assumed name and to use that assumed name in all of its dealings with the Secretary of State and in the conduct of its affairs in California. During the period that the agreement remains in effect, the corporation may only do business in California under the assumed name [*Corp. Code § 2106(b)*].

[iii] Requirements for Foreign Insurance Companies

To qualify under one of the alternative methods [*see* [ii], *above*], foreign insurance companies must first obtain a certificate from the Insurance Commissioner approving the corporate name [*Corp. Code § 2106(b)*]. The Secretary of State will not file any statement and designation [*see* [a], *above*] or amended statement and designation [*see § 12B.12[1]*] of a foreign insurer unless the certificate is attached [*Corp. Code § 2106.5*; *see also Corp. Code §§ 2106, 2107*; Ballantine & Sterling, California Corporation Laws, Ch. 18, *Foreign Corporations* (Matthew Bender)].

[3] Annual Statement of Information; Corporate Disclosure Statement

[a] Annual Filing Required

Every foreign corporation (other than a foreign association) qualified to transact intrastate business must file a statement of information during the applicable filing period annually [*Corp. Code § 2117(a)*; *see §§ 12B.132, 12B.210*]. That period is the calendar month during which the original statement and designation [*see Corp. Code § 2105*] was filed and the five calendar months immediately preceding that month [*Corp. Code § 2117(d)*]. The statement of information must be on the form prescribed by the Secretary of State and must include the information required by statute [*Corp. Code § 2117(a)*; *see §§ 12B.132, 12B.210*]. If the information in the statement last filed in the Secretary of State's office has not changed, the corporation, in lieu of completing the entire statement, may merely check the box indicating that no changes have occurred during the applicable filing period [*Corp. Code § 2117(f)*; *see Corp. Code § 1502(c)*].

Every publicly traded foreign corporation must also file annually, within 150 days after the end of its fiscal year, a corporate disclosure statement on a form prescribed by the Secretary of State [*Corp. Code § 2117.1(a)*; *see §§ 12B.132, 12B.211*].

[b] Penalty for Failure to File

If a corporation does not comply with these filing requirements, the Secretary of State will mail a notice of delinquency to the corporation. If the corporation does not file an annual statement within 60 days after the notice is mailed, the Secretary of State will notify the Franchise Tax Board [*Corp. Code §§ 2204(a), 2206(a)*], which will assess a penalty against the corporation [*Corp. Code §§ 2204(b), 2206(a)*; *see Rev. & Tax. Code § 19141*]. The corporation may request relief from the Secretary of State because of reasonable cause or unusual circumstances justifying the failure to file. If the Secretary of State does not grant relief, the corporation may pay the penalty under protest and file a claim with the Board of Control requesting relief [*Corp. Code §§ 2204(a), 2206(a)*].

A corporation that (1) fails to file a statement [*see* Corp. code § 1502] for an applicable filing period, (2) has not filed a statement during the preceding 24 months, and (3) was certified for a penalty [*see Corp. Code §§ 2204(a), (b), 2206(a)*] for the same filing period will forfeit the exercise of the corporate powers, rights, and privileges of a foreign corporation, but will not be assessed a monetary penalty [*Corp. Code §§ 2205(a), 2206(a)*]. In this situation, the Secretary of State will mail a notice to the corporation informing it that its corporate powers, rights, and privileges will be suspended after 60 days if it fails to file a statement [*Corp. Code §§ 2205(b), 2206(a)*]. After the 60-day period has expired without the filing of a statement, the Secretary of State will notify the Franchise Tax Board of the forfeiture, and mail a notice of the forfeiture to the corporation. The corporate powers, rights, and privileges of the corporation are thereby forfeited, except for the purpose of amending the articles of incorporation to set forth a new name [*Corp. Code §§ 2205(c), 2206(a)*; *see Palm Valley Homeowners Assn., Inc. v. Design MTC (2000) 85 Cal. App. 4th 553, 560-561, 102 Cal. Rptr. 2d 350* (trial court did not abuse its discretion in imposing sanctions on law firm for continuing litigation activities on behalf of corporation that it knew to be suspended under *Corp. Code § 2205* for failure to file information statement required by *Corp. Code § 1502*)]. Additionally, a suspended corporation may file an application for exempt status, and amend its articles of incorporation as necessary to perfect that application [*Corp. Code § 1502(c)*], and a foreign nonprofit corporation that has suffered forfeiture may nevertheless file an application for exempt status [*Corp. Code § 2206(b)*; *see Rev. & Tax. Code § 23301*; *see also* Ch. 13, *Nonprofit Corporations*].

If a corporation that has suffered forfeiture thereafter files the statement, the Secretary of State will certify that fact to the Franchise Tax Board. The corporation may then be relieved from forfeiture in accordance with *Rev. & Tax. Code § 23305a*, unless the corporation's powers have been forfeited for failure to pay taxes [*Corp. Code §§ 2205(d), 2206(a); see Rev. & Tax. Code §§ 23301, 23301.5, 23775*]. According to the Office of the Secretary of State, the same application form is used for revivor from forfeiture for failure to file annual statements [*see Corp. Code § 2117(a)*] as is used for revivor from forfeiture for failure to pay taxes. For an illustration of this form, see *§ 12B.261*. For further information on the Revenue and Tax Code provisions concerning forfeiture and revivor, see *§ 12B.31[3]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsFinanceFranchise TaxPenalties for NoncomplianceBusiness & Corporate LawCorporationsFinanceFranchise TaxReinstatementBusiness & Corporate LawForeign BusinessesNoncomplianceBusiness & Corporate LawForeign BusinessesQualificationsTax LawState & Local TaxesFranchise TaxFailure to Pay TaxTax LawState & Local TaxesFranchise TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Regulation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.12

§ 12B.12 Modification, Surrender, and Forfeiture of Certificate of Qualification

[1] Modification

A qualified foreign corporation (other than a foreign association) qualified to transact intrastate business may change its name or make a change affecting an assumed name [*see Corp. Code § 2106*; *see also § 12B.11[2][b][ii]*] by filing an amended statement signed by a corporate officer setting forth the change made. The statement must set forth the name relinquished and the new name assumed. The corporation must annex to the amended statement a certificate of an authorized public official from the corporation's state or place of incorporation certifying that the name change was made in accordance with the laws of that state or place [*Corp. Code § 2107(a)*; *see §§ 12B.133, 12B.223*]. Name changes are subject to the general requirements for corporate names [*see Corp. Code § 2106(b)*; *see also § 12B.11[2][b]*]. On the filing of the amended statement, the Secretary of State will issue a new certificate of qualification [*Corp. Code § 2107(a)*].

A qualified corporation (other than a foreign association) may change (1) the address of its principal office in California, (2) the address of its principal executive office, (3) its agent for service of process, or (4) the stated address of any natural person designated as an agent by filing its annual statement [*see Corp. Code § 2117*; *see also § 12B.11[3]*]. The filing of an annual statement will supersede the statement and designation with respect to the changes made [*Corp. Code § 2107(d)*].

A qualified foreign association may change (1) its name, (2) the address of its principal office in California, (3) the address of its principal executive office, (4) its agent for the service of process, or (5) the stated address of any natural person designated as an agent by filing an amended statement and designation signed by an officer setting forth the changes made. If the association is changing its name, the amended statement and designation must set forth the name relinguished and the new name assumed, and must include an officers' certificate stating that the change of name was made in accordance with its declaration of trust. If the change includes a change of name or a change affecting an assumed name [*see Corp. Code § 2106*; *see also § 12B.11[2][b][ii]*], the Secretary of State will issue a new certificate of qualification once the amended statement has been filed [*Corp. Code § 2107(b)*].

If the modification includes a change of name of an insurer subject to the Insurance Code, the amended statement must state that the corporation is such an insurer, if that statement does not already appear [*Corp. Code § 2107(c)*].

To correct an error, such as a misstatement of fact, a defect in execution, or any other error or defect contained in the certificate, the corporation should file a certificate of correction [*see Corp. Code § 109*]. For further discussion and a form for a certificate of correction, see Ch. 10, *Amendment of Articles* .

For a procedural guide to amending filed certificates, see *§ 12B.133*. For forms, see *§§ 12B.220, 12B.222*.

A qualified foreign corporation that converts into another foreign corporation (for instance, a Nevada corporation that becomes a Delaware corporation) cannot lose its capacity to do business, or to appear in legal proceedings, in California because of a failure to follow the notification procedure in *Corp. Code § 2107* for a change in name or address of a qualified foreign corporation, since that code section does not require (nor does any other statute require) notification of a mere change in the state of incorporation [*Capital Gold Group, Inc. v. Nortier (2009) 176 Cal. App. 4th 1119, 1130-1133, 98 Cal. Rptr. 3d 439* (also holding that *Corp. Code § 1157*, governing conversion of certain entities to or from status as corporation, does not apply to foreign corporation's conversion into another foreign corporation, and noncompliance with that code section would not affect such foreign corporation's status as qualified foreign corporation)].

[2] Surrender or Withdrawal

[a] Certificate of Surrender

A foreign corporation that has qualified to transact intrastate business may surrender that status by filing a certificate of surrender, signed by a corporate officer, with the Secretary of State [*Corp. Code § 2112*; *see §§ 12B.230, 12B.232* (forms)]. If a qualified foreign corporation has ceased transacting intrastate business in California, filing this certificate may remove the corporation from the jurisdiction of California courts concerning events that occur after surrender [*see Corp. Code § 2114(b)*; *Northern Natural Gas Co. v. Superior Court (1976) 64 Cal. App. 3d 983, 987 n.1, 134 Cal. Rptr. 850]* . A corporation does not revoke its appointment of any agent for the service of process merely by ceasing to do business without filing a certificate of surrender [*Corp. Code § 2114(d)*; *see* [e], *below*].

The certificate of surrender must contain all of the following [*Corp. Code § 2112(a)*]:

- The name of the corporation and the state or place of incorporation or organization.
- A statement that the corporation revokes its designation of agent for service of process.
- A statement that the corporation surrenders its authority to transact intrastate business [*Corp. Code § 2112(a)(3)*].
- A statement that the corporation consents that process against it in any action on any liability or obligation incurred in California before the filing of the certificate of withdrawal may be served on the Secretary of State. Presumably, the term "certificate of withdrawal" [*see Corp. Code § 2112(a)(4)*] refers to the certificate of surrender [*see Corp. Code § 2114(b)*].
- A post office address to which the Secretary of State may mail a copy of any process against the corporation served on the Secretary of State. This address may be changed by a corporate officer filing a signed statement.

For a guide to surrending the right to transact business, see *§ 12B.135*. For certificates of surrender, see *§§ 12B.230* and

12B.232.

Surrender of a foreign insurance company's right to transact intrastate business will not prevent it from carrying out contracts made before surrender [*Corp. Code § 2103*].

[b] Merger

A qualified foreign corporation that is disappearing due to merger may, depending on the circumstances of the merger, surrender its right to transact intrastate business in California in one of the following ways [*Corp. Code § 2113(a)*]:

- It may surrender by filing a certificate of surrender [*see* [a], *above*]. If a qualified foreign corporation disappears in a merger not involving any domestic corporation, it must file a certificate of surrender [*see Corp. Code § 2113(b)*].

- If a qualified foreign corporation is the disappearing corporation [*see Corp. Code § 165*] in a merger with a domestic surviving corporation [*see Corp. Code §§ 167, 190*], it may surrender by filing the merger agreement and the officers' certificate [*Corp. Code § 2113(a)*; *see Corp. Code § 1103*] or a certificate of ownership [*see Corp. Code § 1108(c)*; *see also Corp. Code §§ 110(c), 1110*], and, in the case of a foreign nonprofit or mutual benefit corporation, the officers' certificate of each constituent corporation as provided by *Corp. Code § 6014* or *8014* [*Corp. Code §§ 6018(c), 8018(c)*].

- If the foreign corporation disappears in a merger with a disappearing domestic corporation and a surviving foreign corporation, it may surrender its right to transact intrastate business by filing a certified copy or executed counterpart of the merger agreement, certificate, or other merger document filed by the surviving corporation in the state or place of incorporation to effect the merger [*Corp. Code § 2113(a)*; *see Corp. Code § 1108(d)*].

- If a foreign subsidiary corporation is merged into a domestic parent corporation, it may surrender by filing a certificate of ownership [*Corp. Code § 2113(a)*; *see Corp. Code § 1110(e)*].

For a discussion of the impact of securities regulations on mergers involving foreign corporations, see *§ 12B.14[3]*. For a detailed discussion of mergers, including the effective dates of mergers involving foreign corporations and dissenting shareholders' rights, see Ch. 11C, *Mergers* .

[c] Conversion

A qualified foreign corporation that is disappearing as a result of conversion may surrender its right to transact intrastate business in California by filing an organizational document containing a statement of conversion [*Corp. Code § 2113(a)*; *see Corp. Code §§ 15677.8* (CRLPA, repealed January 1, 2010), 15911.08 (ULPA '08) (limited partnership), 16908 (general partnership), 17540.8 (limited liability company)]. This filing automatically terminates the corporation's right to transact intrastate business and precludes the need to file a certificate of surrender [*see Corp. Code § 2113(a)*].

[d] Service of Process on Surrendered Corporation

A corporation that has surrendered its right to transact intrastate business pursuant to a certificate of surrender or merger may be served with process in any action on a liability or obligation incurred in California before surrender, by delivery of process to the Secretary of State. The Secretary of State will send the process to the address set forth in the certificate of surrender or to the address of the surviving corporation in a merger [*Corp. Code § 2114(a), (b)*; *see § 12B.15[2]*].

Unless it files a certificate of surrender, a foreign corporation does not revoke the appointment of any agent for the

service of process when it ceases to transact intrastate business [*Corp. Code § 2114(d)*].

[3] Forfeiture

A qualified foreign corporation's right to transact intrastate business may be revoked by the Franchise Tax Board if the corporation fails to file its tax returns or to pay its franchise tax or corporation income tax [*see Rev. & Tax. Code §§ 23301-23303, 23775*; *see also § 12B.31[3]*]. However, forfeiture of the corporation's right to transact intrastate business does not extend to the filing of an application for exempt status or the amending of the articles of incorporation as necessary either to perfect the application or to set forth a new name [*Rev. & Tax. Code § 23301*]. In addition, every contract made in California during the time that the corporation's rights are forfeited for failure to pay taxes or file a tax return is voidable at the instance of any party to the contract other than the foreign corporation [*Rev. & Tax. Code § 23304.1*]. For further information, including a discussion of revivor from forfeiture, see *§ 12B.31[3], [4]*. For a form for application for relief from contract voidability, see *§ 12B.262*.

The Secretary of State must revoke qualification if a corporation fails to file an annual statement under certain circumstances [*see Corp. Code §§ 2205(a), 2206(a)*]. For further discussion, see *§ 12B.11[3]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesRegistration RequirementsBusiness & Corporate LawCorporate NamesName ChangesBusiness & Corporate LawForeign BusinessesQualificationsMergers & Acquisitions LawGeneral OverviewCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Regulation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.13

§ 12B.13 Transacting Business Without Certificate of Qualification

[1] Protecting Corporate Name

Any foreign corporation (other than a foreign association) that is not transacting intrastate business in California may register its corporate name with the Secretary of State, provided its corporate name would be available to a new corporation organized under the General Corporation Law at the time of registration [*Corp. Code § 2101*; *see Corp. Code § 201*; *see also § 12B.11[2][b]*].

A foreign corporation that plans to qualify in California at some future time may wish to reserve its name in advance to avoid name availability problems at the time of qualification. However, registration does not protect against use of the name; it merely prevents any other corporation from incorporating or qualifying under that name [*see Bus. & Prof. Code § 14415*].

If the name to be registered includes the words "bank," "trust," "trustee," or related words, the foreign corporation must, in addition to meeting the general requirements for a corporate name, obtain written approval from the Superintendent of Banks [*Corp. Code §§ 201(a), 2101(a)*].

The corporation must file an application for registration and a certificate of good standing from the place where the corporation is organized [*Corp. Code § 2101(b)*; *see §§ 12B.11[2][a], 12B.202*]. Registration is effective until the close of the calendar year in which the application is filed [*Corp. Code § 2101(b)*]. Registration may be renewed from year to year by filing an application for renewal and a certificate of good standing as required for the original registration [*Corp. Code § 2101(c)*; *see § 12B.136*]. For a detailed guide to registration and renewal procedures, see *§ 12B.121*. For an application form, see *§ 12B.240*.

As an alternative to registration, a foreign corporation may reserve its name by applying for a certificate of reservation pursuant to the procedures set forth in *Corp. Code § 201(c)* [*see* Ch. 2, *Formation of Corporations*]. However, that type of reservation is only valid for 60 days, and is non-renewable [*see Corp. Code § 201(c)*].

[2] Penalties for Transacting Business Without Qualification

Any foreign corporation that transacts intrastate business without first qualifying with the Secretary of State when it is required to do so is subject to all of the following:

- The corporation is guilty of a misdemeanor punishable by a fine, recoverable in any court of competent jurisdiction. The Attorney General or any district attorney may bring prosecution [*Corp. Code § 2258*].

- Any person who transacts intrastate business on behalf of a foreign corporation that is not qualified, knowing that it is not qualified, is guilty of a misdemeanor punishable by a fine [*Corp. Code § 2259*].

- The corporation may be subject to a penalty for each day that it willfully transacts unauthorized intrastate business [*Corp. Code § 2203(a), (b)*]. Prosecution may be brought by the Attorney General or any district attorney [*Corp. Code § 2203(b)*; *see Corp. Code § 2258*]. The amount of the penalty assessed will be determined by the court based on the circumstances, including the size of the corporation and the willfulness of the violation [*Corp. Code § 2203(b)*].

- The corporation cannot maintain any action or proceeding in any California court on any intrastate business transacted in California, until it has (a) complied with the qualification requirements [*see Corp. Code § 2105*; *see also § 12B.12[2]*], (b) paid to the Secretary of State a penalty in addition to the fees due for filing the statement and designation required to qualify [*see Corp. Code § 2105*], and (c) filed with the clerk of the court in which the action is pending receipts showing the payment of those fees and penalties, all franchise taxes, and any other taxes on business or property in California that should have been paid for the period during which it transacted intrastate business [*Corp. Code § 2203(c)*].

A foreign corporation transacting intrastate business that has failed to qualify may *commence* an action in state court. It may also *defend* an action brought against it in state court [*United Medical Management Ltd. v. Gatto (1996) 49 Cal. App. 4th 1732, 1739, 57 Cal. Rptr. 2d 600* ; *Ward Land etc. Co. v. Mapes (1905) 147 Cal. 747, 753, 82 P. 426]* . The act of *maintaining* an action commenced prior to qualification requires compliance with *Corp. Code § 2203(c)*. However, a foreign corporation that qualifies to transact intrastate business after transacting, but before commencing an action on, intrastate business, may maintain the action without complying with *Corp. Code § 2203(c)*, as long as the Franchise Tax Board has not suspended the corporation for failure to pay taxes before it commences the action [*United Medical Management Ltd. v. Gatto (1996) 49 Cal. App. 4th 1732, 1742, 57 Cal. Rptr. 2d 600* ; *see also United Systems of Arkansas, Inc. v. Stamison (1998) 63 Cal. App. 4th 1001, 1007, 74 Cal. Rptr. 2d 407* (out-of-state bidder's submission of bid was not "transacting intrastate business" and bidder could maintain suit challenging award of contract to another bidder without obtaining certificate of qualification from Secretary of State)].

In addition, a foreign corporation transacting unauthorized intrastate business is deemed to consent to the jurisdiction of California courts in any civil action arising in California in which the corporation is named a party defendant [*Corp. Code § 2203(a)*].

If an unqualified foreign corporation fails to file a tax return or to pay any taxes required by the Bank and Corporation Law [*see Rev. & Tax. Code § 23001 et seq.*], additional penalties may apply, including the voidability of contracts entered into during the applicable time period [*see § 12B.31[4]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawForeign BusinessesNoncomplianceBusiness & Corporate LawForeign BusinessesNoncomplianceBusiness & Corporate

LawForeign BusinessesQualificationsBusiness & Corporate LawForeign BusinessesQualificationsTax LawState & Local TaxesFranchise TaxFailure to Pay Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Regulation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.14

§ 12B.14 Regulation of Internal Affairs of Foreign Corporations

[1] Nominally Foreign Corporations

[a] In General

Certain foreign corporations transacting intrastate business are subject to California regulation of their internal affairs, although organized as foreign corporations, they are actually more than half domestic. These corporations are made subject to various provisions of the General Corporation Law [*see* [e], *below*] that are otherwise applicable only to domestic corporations [*Corp. Code § 2115(b)*; *see Corp. Code § 2115* Legislative Committee Comment (1975)--Assembly]. Corporations in this category are generally referred to as "nominally foreign" corporations, and are also sometimes called "pseudo-foreign" corporations [*see* Ballantine & Sterling, California Corporation Laws, Ch. 18, *Foreign Corporations* (Matthew Bender); *see also* Kruse, *California's Statutory Attempt to Regulate Foreign Corporations: Will It Survive the Commerce Clause? 16 San Diego L. Rev. 943 (1979)*].

CAUTION:
In May 2005, the Delaware Supreme Court declared *Corp. Code § 2115* unconstitutional and inapplicable to a Delaware corporation on federal constitutional grounds and also on the basis of the "internal affairs doctrine" [***see*** *VantagePoint Venture Partners 1996 v. Examen, Inc. (Del. 2005) 871 A.2d 1108]* . For a comprehensive discussion of this case, see Ballantine & Sterling, California Corporation Laws, Ch. 18, ***Foreign Corporations*** , § 393.07 (Matthew Bender).

[b] Excluded Corporations and Associations

The rules governing nominally foreign corporations do not apply to foreign associations or foreign nonprofit corporations [*Corp. Code § 2115(a)*]. In addition, the rules do not apply to any of the following corporations [*Corp. Code § 2115(c)*]:

- Corporations that have outstanding securities listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market.

- Corporations in which all of the voting shares, other than directors' qualifying shares, are owned directly or indirectly by a corporation or corporations that are not nominally foreign.

[c] Determination of Nominally Foreign Status

[i] Tax Factors

Two criteria are used to determine whether a corporation is nominally foreign: tax factors and shareholder residence factors [*see* [ii], *below*].

The tax factors determine whether the corporation does more than half of its business in California. That occurs when the average of the corporation's "property factor," "payroll factor," and "sales factor" are more than 50 percent during the corporation's latest full income year [*Corp. Code § 2115(a)(1)*; *see § 12B.113*, P 1]. Each of these factors is a fraction that has already been computed by the corporation to determine business income apportionable to California for franchise tax purposes [*see Corp. Code § 2115(a)*; *see also Rev. & Tax. Code § 25128*]. If the allocation of the corporation's income is governed by special formulas, or if the corporation is not required to file separate or any tax returns, the determination is based on the factors that would have been used if the corporation were governed by the three-factor formula [*Corp. Code § 2115(a)(2)*].

The "property factor" is the average value of the taxpayer's real and tangible personal property that is owned or rented and used in California during the income year, over the average value of all of the taxpayer's real and tangible personal property that is owned or rented and used during the taxable year [*Rev. & Tax. Code § 25129*; *see Corp. Code § 2115(a)(1)*]. The "payroll factor" is the total amount paid in California during the taxable year by the taxpayer for compensation, over the total compensation paid in all states during the taxable year [*Rev. & Tax. Code § 25132*; *see Corp. Code § 2115(a)(1)*]. The "sales factor" is the total sales of the taxpayer in California during the taxable year, over the total sales of the taxpayer everywhere during the taxable year [*Rev. & Tax. Code § 25134*; *see Corp. Code § 2115(a)(1)*].

If the corporation is a parent corporation, these factors are determined on a special consolidated basis. The computation must eliminate intercompany transactions and deduct a percentage of the property, payroll, and sales of any subsidiary equal to the percentage minority ownership, if any, in the subsidiary. The computation includes the property, payroll, and sales of the parent and all of its subsidiaries in which the parent owns directly or indirectly more than 50 percent of the outstanding shares entitled to vote for the election of directors [*Corp. Code § 2115(a)(2)*].

[ii] Residence of Holders of Voting Securities

The shareholder residence factor is determined from the corporation's books, which must show that more than half of the foreign corporation's outstanding voting securities are held of record by persons with California addresses, as appears on the corporation's books on the record date for the latest meeting of shareholders held during its latest full income year or, if no meeting was held during that year, on the last day of latest full income year [*see Corp. Code § 2115(a)(2)*]. Any securities that, to the knowledge of the issuer, are held in the names of broker-dealers, nominees for broker-dealers (including clearing corporations), or banks, associations, or other entities holding securities in a nominee name or otherwise on behalf of beneficial owners (collectively "nominee holders") are not considered outstanding [*Corp. Code § 2115(a)(2)*].

However, the foreign corporation may request all nominee holders to certify the number of shares held for beneficial owners both inside and outside California, according to the addresses shown on the nominee holder's records. All shares so certified will be considered outstanding and held of record by persons having addresses either in California or outside California, as indicated on the certification. The certification must be retained with the shareholder record and made

available for inspection and copying in the same manner as the shareholder record [*Corp. Code § 2115(a)(2)*; *see Corp. Code §§ 1600, 1601* (inspection provisions)]. A current list of beneficial owners of a foreign corporation's securities provided to the corporation by one or more nominee holders, or their agents, pursuant to the requirements of federal Rule 14b-1(b)(3) [*see 17 C.F.R. § 240.14b-1(c)*] or Rule 14b-2(b)(3) [*see 17 C.F.R. § 240.14b-2(b)(3)*] as adopted on January 6, 1992, will constitute an acceptable certification with respect to beneficial owners for these purposes [*Corp. Code § 2115(a)*]. For a detailed discussion of the Securities Exchange Act of 1934 and its regulations, see Federal Securities Exchange Act of 1934 (Matthew Bender).

[d] Duration of Nominally Foreign Status

The provisions concerning nominally foreign corporations become applicable on the first day of the first income year of the corporation beginning on or after (1) the 135th day of the income year immediately following the latest income year with respect to which the tests establishing nominally foreign status have been met [*see* [c], *above*] or (2) the entry of a final order by a court of competent jurisdiction declaring that those tests have been met [*Corp. Code § 2115(d)*].

A corporation's nominally foreign status ceases at the end of (1) the first income year of the corporation immediately following the latest income year with respect to which at least one of the tests establishing nominally foreign status is not met [*see* [c], *above*] or (2) the income year of the corporation during which a final order has been entered by a court of competent jurisdiction declaring that one of those tests is not met, provided that a contrary order is not entered before the end of the income year [*Corp. Code § 2115(e)*].

[e] General Corporation Law Applicable to Nominally Foreign Corporations

[i] In General

Nominally foreign corporations are subject to specific provisions of the General Corporation Law [*see* [ii]-[iv], *below*], that govern directors, corporate distributions, records and reports, shareholder meetings, and corporate sales and reorganizations, to the exclusion of the law in the corporation's state or place of incorporation [*Corp. Code § 2115(b)*]. In addition, all of the general provisions and definitions of the General Corporation Law [*see Corp. Code §§ 100-195*] apply to nominally foreign corporations to the extent that they apply to those specific provisions [*Corp. Code § 2115(b)*].

To avoid any conflicts with the law of the state or place of incorporation, the corporation may amend its articles and bylaws to reflect the applicable provisions of California law [*see* Halloran & Hammer, *Section 2115 of the New California General Corporation Law--The Application of California Corporation Law to Foreign Corporations, 23 UCLA L. Rev. 1282 (1976)*].

[ii] Law Governing Directors

A nominally foreign corporation must elect and remove directors in accordance with California law. Directors must be elected at an annual meeting of shareholders for a one-year term, although it is permissible to effectuate a voting shift [*see Corp. Code § 194.7* (definition)] by providing in the articles that directors hold office for a shorter term. Separate classes or series of shares may have the right to elect one or more directors [*Corp. Code § 2115(b)*; *see Corp. Code § 301(a)*].

The directors may be removed without cause when approved by the outstanding shares [*see Corp. Code § 152* (definition of "approval by outstanding shares")], subject to certain requirements limiting removal (1) of individual directors when the number of votes not voting for removal would be sufficient to elect the director under similar circumstances [*see Corp. Code § 303(a)(1), (3)*] and (2) to the holders of the class or series of shares with the right to elect the director [*see Corp. Code § 303(a)(2)*]. Any reduction of the authorized number of directors or amendment reducing the number of classes of directors does not remove any director before the expiration of the director's term of

office [*Corp. Code § 2115(b)*; *see Corp. Code § 303(b)*].

The appropriate California superior court may remove a director from office and may bar any director so removed from reelection on suit of a certain percentage of the shareholders in the case of fraudulent or dishonest acts or gross abuse of authority or discretion and [*Corp. Code § 2115(b)*; *see Corp. Code § 304*].

If, after the directors fill a vacancy, the elected directors constitute less than a majority of the directors, the holders of an aggregate of at least 5 percent of the total shares at the time outstanding may call a special meeting to elect a new board or apply to the court for an order for a special meeting [*Corp. Code § 2115(b)*; *see Corp. Code § 305(c)*; *see also* Ch. 5, *Directors' Meetings, Actions, and Resolutions*].

For further discussion of electing and removing directors, see Ch. 3, *Articles of Incorporation* , Ch. 5, *Directors' Meetings, Actions and Resolutions* , Ch. 10, *Amendment of Articles* , and Ch. 13, *Nonprofit Corporations* . For detailed discussion of these topics, see Ballantine & Sterling, California Corporation Laws, Ch. 5, *Management: Functions of Directors, Officers, and Committees* (Matthew Bender).

The directors of a nominally foreign corporation are held to the same standard of care as directors of domestic corporations [*Corp. Code § 2115(b)*; *see Corp. Code § 309*; *see also* Ch. 5, *Directors' Meetings, Actions, and Resolutions*]. They are also liable for unlawful distributions to the same extent as directors of domestic corporations, except for certain loans or guaranties [*Corp. Code § 2115(b)*; *see Corp. Code § 316(a)(1), (2), (b)- (f)*]. Finally, the rules governing indemnification of directors and officers apply to nominally foreign corporations [*Corp. Code § 2115(b)*; *see Corp. Code § 317*]. For further discussion, see Ballantine & Sterling, California Corporation Laws, Ch. 6, *Management: Duties and Liabilities of Directors and Controlling Shareholders* (Matthew Bender).

[iii] Law Governing Shareholders and Distributions

A foreign corporation must hold an annual shareholders' meeting and the required notice or report must be given [*Corp. Code § 2115(b)*; *see Corp. Code § 600(b)*]. The appropriate superior court may order a meeting on failure to hold the annual meeting [*Corp. Code § 2115(b)*; *see Corp. Code § 600(c)*]. The shareholders of a foreign corporation are entitled to cumulate votes for the election of directors [*Corp. Code § 2115(b)*; *see Corp. Code § 708*]. In addition, the articles or a certificate of determination may provide for a supermajority vote in accordance with California law [*Corp. Code § 2115(b)*; *see Corp. Code § 710*; *see also* Ch. 3, *Articles of Incorporation*]. For further information on shareholders meetings and voting, see Ch. 8A, *Shareholders' Meetings, Voting, and Agreements* . For further information on election of directors, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

The basic limitations on corporate distributions contained in the General Corporation Law [*see Corp. Code §§ 500-505*] apply to nominally foreign corporations [*Corp. Code § 2115(b)*]. In addition, shareholders are liable for receiving prohibited distributions [*Corp. Code § 2115(b)*; *see Corp. Code § 506*]. For further discussion, see Ch. 9, *Dividends, Reacquisitions of Shares, and Assessments* .

[iv] Records, Sales, and Reorganizations

Nominally foreign corporations are required to keep adequate and correct books and records of account, minutes of proceedings, and records of shareholders [*Corp. Code § 2115(b)*; *see Corp. Code § 1500*]. In addition, unless the corporation has less than 100 holders of record [*see Corp. Code § 605*], the board must send shareholders an annual report containing certain required information, including financial statements and current income statements [*Corp. Code § 2115(b)*; *see Corp. Code § 1501*]. The provisions of the General Corporation Code regarding shareholder and director rights of inspection [*see Corp. Code §§ 1600-1605*] also apply to nominally foreign corporations [*Corp. Code § 2115(b)*]. The Attorney General may enforce compliance with the laws regarding records and reports and rights of inspection [*Corp. Code § 2115(b)*; *see Corp. Code § 1508*]. For further information, see Ch. 7, *Corporate Records and*

Reports .

Nominally foreign corporations must comply with limitations on the sale of assets [*Corp. Code § 2115(b)*; *see Corp. Code § 1001(d)*]. They must comply with the General Corporation Law's requirements applicable to conversions [*see Corp. Code § 1152*] and the first sentence of *Corp. Code § 1151* relating to limitations on conversions [*Corp. Code § 2115(b)*]. Further, they must comply with the provisions of the General Corporation Law regarding reorganizations [*see Corp. Code §§ 1200, 1201*] and dissenters' rights [*Corp. Code § 2115(b)*; *see Corp. Code §§ 1300-1312*; *see also* Ch. 11C, *Mergers*]. For a detailed discussion of reorganization and dissenters' rights, see Ballantine & Sterling, California Corporation Laws, Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations* (Matthew Bender).

[v] Duty to Advise of Nominally Foreign Status

Nominally foreign corporations must advise any shareholder of record; any officer, director, employee, or other agent [*see Corp. Code § 317*]; and any creditor of the corporation in writing, within 30 days of receiving a written request for the information, whether or not the corporation is subject to *Corp. Code § 2115(b)* at the time the request is received [*Corp. Code § 2115(f)*; *see* [1], *above*]. If a party obtains a final determination from a court of competent jurisdiction that the corporation failed to provide the requisite information, or provided incorrect information, the court has discretion to award all court costs and reasonable attorneys' fees incurred in that legal proceeding to the extent that they relate to obtaining this final determination [*Corp. Code § 2115(f)*].

[2] Resident Foreign Corporations

A foreign corporation that does not meet the criteria of a "nominally foreign" corporation [*see* [1][c], *above*] may nevertheless be subject to some California regulation of its corporate affairs if it is a "resident foreign" corporation because it "resides" in the state by having its principal executive office in California or customarily holding meetings of its board in California. Such a corporation is subject to the California rules regarding the right of shareholders to inspect and copy the shareholder list [*see Corp. Code § 1600(d)*], the requirement of an annual report [*see Corp. Code § 1501(g)*], and the directors' right to inspect records and physical properties [*see Corp. Code § 1602*]. For these purposes, a foreign association is not considered a foreign corporation [*Corp. Code § 171*].

In addition, a foreign corporation that has its principal executive office in California or keeps its books and records in California must allow its shareholders to inspect its accounting books, records, and minutes [*Corp. Code § 1601(a)*]. Compliance may be enforced by court order [*see Corp. Code §§ 1508, 1603*].

For a detailed discussion of these inspection rights, see Ch. 7, *Corporate Records and Reports* .

[3] Sales of Securities in California

Foreign corporations that offer or sell securities in California [*see Corp. Code §§ 25008, 25017* (definitions)] are subject to California securities regulation to the same extent as domestic corporations [*see Corp. Code § 25110*]. They are also subject to regulation of changes in rights, preferences, privileges, and restrictions [*see Corp. Code § 25120*].

If a foreign corporation exchanges securities incident to a merger or reorganization, that exchange will be exempt from qualification if less than 25 percent of the outstanding shares of each class whose holders are to receive securities in the reorganization are held by persons who have California addresses [*Corp. Code § 25103(c)*]. For a detailed discussion of California securities regulation, see Chs. 6- 6H. For a detailed discussion of mergers and reorganizations, see Ch. 11C, *Mergers* .

Securities transactions that take place in California are subject to the Corporate Securities Law of 1968 even if the securities were issued by foreign corporations. In particular, officers and directors of a foreign corporation who engage

in prohibited insider trading in California [*see Corp. Code § 25402*] can be liable to the corporation under *Corp. Code § 25502.5*, and the internal-affairs doctrine of *Corp. Code § 2116* [*see* [4], *below*] will not shield them from liability [*Friese v. Superior Court (2005) 134 Cal. App. 4th 693, 709-710, 36 Cal. Rptr. 3d 558]* . For discussion of the prohibition against insider trading, see *California Forms of Pleading and Practice, Ch. 515, Securities and Franchise Regulation, § 515.22* (Matthew Bender).

[4] Violations of Directors' Duties

The directors of a foreign corporation that transacts intrastate business are liable to the corporation, its shareholders, creditors, receiver, liquidator, or trustee in bankruptcy, for the making of unauthorized dividends, purchase of shares or distribution of assets or false certificates, reports, or public notices, or for the violation any other official duty according to the applicable laws of the state or place of incorporation or organization. This liability is incurred whether the acts are committed in California or elsewhere. The liability may be enforced in California courts [*Corp. Code § 2116*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesDomesticationBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Regulation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.15

§ 12B.15 California Jurisdiction Over Foreign Corporations

[1] Jurisdiction

[a] Long-Arm Statute

California law does not distinguish between foreign and domestic corporations for the purpose of exercising jurisdiction. A California court may exercise jurisdiction on any basis not inconsistent with the state and federal constitutions [*Code Civ. Proc. § 410.10*]. By imposing no limitations except those imposed by constitutional considerations, this statute authorizes the broadest possible exercise of judicial jurisdiction [*Magnecomp Corp. v. Athene Co. (1989) 209 Cal. App. 3d 526, 534, 257 Cal. Rptr. 278]* . This allows California courts to obtain jurisdiction over a foreign corporation based on a sufficient amount of activity in or affecting California, regardless of whether the corporation has specifically designated an agent for service of process or consented to service of process on the Secretary of State [*see § 12B.15[1][b]-[d], [2], below*].

[b] Minimum Contacts

As a general constitutional principle, a court may exercise personal jurisdiction over a foreign corporate defendant only if that defendant has sufficient "minimum contacts" with the state so that the maintenance of the suit does not offend traditional notions of fair play and substantial justice [*International Shoe Co. v. Washington (1945) 326 U.S. 310, 316-319, 66 S. Ct. 154, 90 L. Ed. 95* ; *see McGee v. International Life Ins. Co., 355 U.S. 220, 222-224, 78 S. Ct. 199, 2 L. Ed. 2d 223 (1957)* ; *see also In re Marriage of Martin (1989) 207 Cal. App. 3d 1426, 1435-1438, 255 Cal. Rptr. 720]* .

It is essential that there be some act by the defendant to purposefully avail itself of the privilege of conducting activities in the forum state, thus invoking the benefits and protections of the state's laws [*Hanson v. Denckla (1958) 357 U.S. 235, 253, 78 S. Ct. 1228, 2 L. Ed. 2d 1283]* . In other words, the minimum contacts must be based on an act of the defendant. Foreseeability that the defendant's act might cause injury in the forum state is not, by itself, a sufficient basis for jurisdiction. Instead, it is necessary that the defendant's conduct and connection with the forum be such that the defendant should reasonably anticipate being taken to court there [*World-Wide Volkswagen Corp. v. Woodson (1980)*

444 U.S. 286, 295-298, 100 S. Ct. 559, 62 L. Ed. 2d 490 ; *see Asahi Metal Industry Co. v. Superior Court (1987) 480 U.S. 102, 108-113, 107 S. Ct. 1026, 94 L. Ed. 2d 92]* . The basis for jurisdiction generally depends on an assessment of the relationship among the corporation, the forum, and the litigants [*see Helicopteros Nacionales de Colombia v. Hall (1984) 466 U.S. 408, 414, 104 S. Ct. 1868, 80 L. Ed. 2d 404* ; *Rush v. Savchuk (1980) 444 U.S. 320, 327, 100 S. Ct. 571, 62 L. Ed. 2d 516* ; *see also Sammons Enterprises, Inc. v. Superior Court (1988) 205 Cal. App. 3d 1427, 1434-1435, 253 Cal. Rptr. 261]* .

The mere ownership of a subsidiary in California does not subject a foreign parent corporation to specific personal jurisdiction based on the subsidiary's contacts with California. Ownership of a subsidiary alone does not constitute purposeful availment. A foreign parent corporation purposefully avails itself of forum benefits through the activities of its subsidiary, as required to justify the exercise of specific personal jurisdiction, if and only if the parent deliberately directs the subsidiary's activities in, or having a substantial connection with, the forum state. Only in those circumstances should the parent corporation reasonably anticipate being haled into court in the forum state based on the activities of its subsidiary [*HealthMarkets, Inc. v. Superior Court (2009) 171 Cal. App. 4th 1160, 1169, 90 Cal. Rptr. 3d 527]* .

For a more detailed discussion of California jurisdiction over foreign corporations, see Ballantine & Sterling, California Corporation Laws, Ch. 18, *Foreign Corporations* (Matthew Bender). For a discussion of jurisdiction in general, see California Forms of Pleading and Practice, Ch. 323, *Jurisdiction, Inconvenient Forum, and Appearances* (Matthew Bender).

[c] Over Foreign Corporations Transacting Intrastate Business in California

Foreign corporations that qualify in California are required to designate an agent for service of process [*see Corp. Code §§ 2105(a)(4), 2117(b)*] and thereby subject themselves to jurisdiction of the state courts [*see Code Civ. Proc. § 410.10* Comment--Judicial Council; *Corp. Code § 2105(a)(5)* (qualifying corporation must irrevocably consent to service of process); *see also Pennsylvania. Fire Ins. Co. v. Gold Issue Mining Co. (1917) 243 U.S. 93, 95-96, 37 S. Ct. 344, 61 L. Ed. 610* ; *Oro Navigation Co. v. Superior Court (1947) 82 Cal. App. 2d 884, 889, 187 P. 2d 444]* . Additionally, a qualifying corporation must consent to service of process on the Secretary of State if the designated agent or his or her successor is no longer authorized to act or cannot be found at the address given in the corporation's statement and designation [*Corp. Code § 2105(a)(5)*; *see § 12B.15[2], below*; *see also § 12B.11[1][a]*].

Foreign corporations that transact intrastate business without qualifying are deemed to consent to the jurisdiction of California courts in any civil action arising in California in which that corporation is named a party defendant [*see Corp. Code § 2203(a)*].

Similarly, a corporation that has transacted intrastate business in California and then withdraws, surrenders, has its right to transact intrastate business revoked, or ceases to transact business without filing a certificate of surrender before being served may be served with process [*Corp. Code § 2114*]. Therefore, California courts impliedly have jurisdiction over such corporations, at least for actions arising out of the business conducted [*see, e.g., Corp. Code § 2114(a)*].

[d] On Grounds Other Than Transacting Intrastate Business

Other foreign corporations may also be subject to California jurisdiction based on their activities in the state. Under the minimum contacts test [*see* [a], *above*], there is a constitutionally sufficient relationship to warrant general jurisdiction over a foreign defendant if its activities in the state may be described as "extensive or wide-ranging" [*see Buckeye Boiler Co. v. Superior Court (1969) 71 Cal. 2d 893, 898-899, 80 Cal. Rptr. 113, 458 P.2d 57]* , or "substantial, continuous and systematic" [*see Perkins v. Benguet Mining Co. (1951) 342 U.S. 437, 447-448, 72 S. Ct. 413, 96 L. Ed. 485, 63 Ohio Law Abs. 146]* .

However, if the defendant's activities in the forum are not so pervasive as to justify the exercise of general jurisdiction, then the finding of jurisdiction depends on the character of the defendant's activity in the forum, whether the cause of action arises out of or has a substantial connection with that activity, and on the balancing of the convenience of the parties and the interests of the state in assuming jurisdiction [*Cornelison v. Chaney (1976) 16 Cal. 3d 143, 147-148, 127 Cal. Rptr. 352, 545 P.2d 264]* .

A dissolved corporation continues to exist for purposes of prosecuting and defending actions by or against it [*Corp. Code § 2010(a)*]. This provision applies to foreign corporations as well as domestic corporations [*North American Asbestos Corp. v. Superior Court (1986) 180 Cal. App. 3d 902, 911, 225 Cal. Rptr. 877]* .

[2] Service of Process

[a] Direct Service

Process may be served on foreign corporations transacting intrastate business in California by hand delivery of a copy of any process to any of the following agents [*Corp. Code § 2110*]:

- Any officer of the corporation, its general manager in California, or, if the corporation is a bank, to a cashier or an assistant cashier.

- Any natural person designated by it as agent for the service of process.

- If the corporation has designated a corporate agent, to any person named in the latest certificate of the corporate agent filed pursuant to *Corp. Code § 1505*.

A copy of the statement and designation, or a copy of the latest statement filed pursuant to *Corp. Code § 2117*, certified by the Secretary of State, is sufficient evidence of the appointment of an agent for the service of process [*Corp. Code § 2110*].

A foreign corporation may serve as an agent for service of process for another corporation only if it is qualified to transact business in California and is in good standing on the records of the Secretary of State [*Corp. Code § 1505(c)*]. If the foreign corporate agent has forfeited its certificate of qualification to transact intrastate business, designation of a new agent must be filed [*Corp. Code § 1504*].

In addition, service may be effected by any method provided for under the Code of Civil Procedure provisions on service [*Corp. Code § 2110.1*; *see Code Civ. Proc. §§ 413.10-417.40*].

[b] Substituted Service

Substituted service may be effected on the Secretary of State or to an assistant or deputy Secretary of State under any of the following circumstance:

- If the agent for the service of process is a natural person and cannot be found with due diligence at the address stated in the statement and designation [*Corp. Code § 2111(a)*; *see Corp. Code § 2117(b)*; *see also § 12B.11[1][a]*].

- If the agent is a corporation [*see Corp. Code § 1505*] and no person can be found with due diligence to whom the delivery authorized by *Corp. Code § 2110* [*see* [a], *above*] may be made for the purpose of delivery to the corporate agent [*Corp. Code § 2111(a)*].

- If the agent designated is no longer authorized to act, or if no agent has been designated, and if no one of the officers or agents of the corporation specified in *Corp. Code § 2110* [*see* [a], *above*] can be found after diligent search [*Corp. Code § 2111(a)*].

- If the foreign corporation has surrendered its qualification to transact intrastate business [*see Corp. Code §§ 2112, 2113*; *see also § 12B.12[2]*] and the action is on a liability or obligation incurred within California before the surrender [*Corp. Code § 2114(b)*]. If a corporation ceases to transact business without filing a certificate of surrender, the appointment of its agent for service of process remains effective [*Corp. Code § 2114(d)*].

It is unclear from the language of the statute whether an affidavit must be submitted to the court in any of the above circumstances showing that one or more of the conditions exist, or if the affidavit need only be submitted in the third circumstance [*see Corp. Code § 2111(a)*]. However, logic would require that the affidavit be submitted whenever a court order must be obtained to effect substituted service [*see Tri-State Mfg. Company v. Superior Court (1964) 224 Cal. App. 2d 442, 444, 36 Cal. Rptr. 750]* .

In addition, the qualification provisions in the Corporations Code requiring designation of an agent for service of process with the Secretary of State do not affect the Insurance Code provisions requiring foreign insurance companies to maintain such a designation in the Insurance Commissioner's office [*Corp. Code § 2103*; *see Ins. Code §§ 1600-1605*]. Those qualification provisions do not prevent a foreign insurance company from carrying out contracts made before the surrender of its right to engage in intrastate business or contracts made with citizens of other states who subsequently become California citizens or residents [*Corp. Code § 2103*]. Special provisions exist permitting service on the Insurance Commissioner for service of process on foreign insurers that are not qualified to transact intrastate business that do specified acts of business in California [*see Ins. Code §§ 1610, 1611*].

For further information on service of process and its procedures, see California Forms of Pleading and Practice, Ch. 518, *Service of Summons and Papers* (Matthew Bender), and Ballantine & Sterling, California Corporation Laws, Ch. 18, *Foreign Corporations* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesQualificationsCivil ProcedureJurisdictionPersonal Jurisdiction & In Rem ActionsIn Personam ActionsDoing BusinessCivil ProcedureJurisdictionPersonal Jurisdiction & In Rem ActionsIn Personam ActionsMinimum ContactsCivil ProcedurePleading & PracticeService of ProcessMethodsPersonal DeliveryCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



16 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Regulation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide §§ 12B.16-12B.19

[Reserved]

§§ 12B.16[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Advising California Corporations Doing Business in Other States

6-12B California Legal Forms--Transaction Guide § 12B.20

§ 12B.20 Effect of Doing Business in States Other Than California

[1] In General

A California corporation doing or planning to do business in other states must consider the impact of its activities in the following three areas: (1) whether the nature of its activities will subject the corporation to the jurisdiction of the other state, (2) whether the corporation will be subject to taxation by the other state, and (3) whether the corporation will be subject to the other state's requirements for qualification [*see* Ballantine & Sterling, California Corporation Laws, Ch. 18, *Foreign Corporations* (Matthew Bender)].

Each of these areas requires a different level of activity to subject the corporation to the other state's laws [*see §§ 12B.11[1], 12B.15, 12B.30, 12B.31[1][a]*]. The greater the amount of activity, the more likely the corporation will be required to obtain a certificate of authority [*see, e.g.,* Rev. Model Business Corp. Act § 15.03 (1984)], also called a certificate of qualification [*see, e.g., § 12B.11*], to do business in the foreign state. A corporation that has obtained, or is required to obtain, a certificate will virtually always be subject to service of process and taxation in the foreign state, but a corporation that is subject to service of process or state taxation is not necessarily required to qualify [*see* Rev. Model Business Corp. Act § 15.01 (1984--Official Comment)].

If the corporation will be conducting purely interstate commerce, the Commerce Clause prohibits most state regulation [U.S. Const., art. I, § 8; *see* [2], *below*; *but see, e.g.,* Md. Corps. & Ass'ns Code Ann. § 7-202 (unqualified foreign corporations must register before doing interstate business)]. However, If the corporation will also be conducting intrastate commerce, it becomes subject to state regulation [*see Ford Motor Co. v. Beauchamp (1939) 308 U.S. 331, 334-335, 60 S. Ct. 273, 84 L. Ed. 304 , reh'g denied, 308 U.S. 640* ; *Atlantic Refining Co. v. Virginia (1937) 302 U.S. 22, 26, 58 S. Ct. 75, 82 L. Ed. 24]* .

[2] State's Power Over Corporations Conducting Purely Interstate Commerce: Taxation and Jurisdiction

[a] In General

As a threshold consideration, all states are limited in the amount they can regulate foreign corporations by the

constitutional considerations of the Commerce Clause [*U.S.Const. art. I, § 8*; *see, e.g., Pike v. Bruce Church, Inc., 397 U.S. 137, 142, 90 S. Ct. 844 (1970)* ; *Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520, 529-530, 79 S. Ct. 962, 3 L. Ed. 2d 1003 (1959)* ; *S. Pac. Co. v. Arizona, 325 U.S. 761, 767-768, 65 S. Ct. 1515, 89 L. Ed. 1915 (1945)*] and by the requirements of due process [*see* [b], [c], *below*; *see also § 12B.15[1][a]*]. If a corporation is conducting purely interstate commerce, the Commerce Clause prohibits the other state from requiring qualification [*Atlantic Refining Co. v. Virginia (1937) 302 U.S. 22, 26, 58 S. Ct. 75, 82 L. Ed. 24* ; *see* U.S. Const. art. I, § 8].

"Interstate commerce" is not limited to transportation across state lines. The term includes all of the parts of commercial intercourse between different states to which the corporation is a party, including negotiations, contracts, trade, or dealings between the corporation and the other parties to the transaction that result in the movement of goods, persons, or information from one state to another [*Furst v. Brewster (1931) 282 U.S. 493, 497-498, 51 S. Ct. 295, 75 L. Ed. 478]* .

[b] Jurisdiction

In general, the power of a state's courts to subject a foreign corporation to jurisdiction depends on whether the corporation's activities supply the necessary "minimum contacts" and whether the exercise of jurisdiction offends traditional notions of fair play and substantial justice [*Internat. Shoe Co. v. Washington (1945) 326 U.S. 310, 316-319, 66 S. Ct. 154, 90 L. Ed. 95* ; *McGee v. International Life Ins. Co., 355 U.S. 220, 222-224, 78 S. Ct. 199, 2 L. Ed. 2d 223 (1957)* .] For additional information on jurisdiction, see *Section 12B.15[1]*. For a detailed discussion of the subject in the context of California law, see Ballantine & Sterling, California Corporation Laws, Ch. 18, *Foreign Corporations* (Matthew Bender), and California Forms of Pleading and Practice, Ch. 323, *Jurisdiction, Inconvenient Forum, and Appearances* (Matthew Bender).

[c] Taxation

A state's power to tax a foreign corporation engaged in interstate commerce generally depends on whether the corporation's activities create a sufficient "nexus" between the tax and the transactions within the state, and on whether the state's tax is non-discriminatory and properly apportioned to local activities within the state. A corporation's activities must forge a "definite link, some minimum connection" sufficient to satisfy due process requirements to permit a state to tax income from interstate commerce activities within its borders. The controlling question is whether the state has given the corporation anything, such as opportunities, protections, or benefits, for which the state can ask return [*Northwestern Cement Co. v. Minn. (1959) 358 U.S. 450, 452, 464-465, 79 S. Ct. 357, 3 L. Ed. 2d 421* ; *see Complete Auto Transit, Inc. v. Brady (1977) 430 U.S. 274, 287-289, 97 S. Ct. 1076, 51 L. Ed. 2d 326]* .

However, states are prohibited by federal law from taxing a foreign taxpayer's income that is derived in interstate commerce if the only business activities of the taxpayer within the state consist of solicitation, by or for the taxpayer, of orders for tangible personal property [*see 15 U.S.C. §§ 381-384*; *see also Brown Group Retail, Inc. v. Franchise Tax Board (1996) 44 Cal. App. 4th 823, 838, 52 Cal. Rptr. 2d 202* (immunity not available when employees of independent retail distributor division in California went beyond mere solicitation)].

[3] State's Power Over Foreign Corporations Doing Intrastate Business: Qualification Requirements

[a] In General

All states have enacted some form of qualification requirement for foreign corporations transacting intrastate business in their state, although some jurisdictions do not specifically provide for a certificate to be issued but instead require the foreign corporation to make certain filings [*see* Rev. Model Business Corp. Act § 15.01 (1984), annotation (list of each state's qualification statute)]. These statutes and the accompanying regulations imposed by the states generally govern only the foreign corporation's external affairs [*see Southern Sierras Power Co. v. Railroad Comm'n (1928) 205 Cal. 479, 482-483, 271 P. 747* ; *see also* Kruse, *California's Statutory Attempt to Regulate Foreign Corporations: Will It*

Survive the Commerce Clause? 16 San Diego L. Rev. 943, 947-948 (August 1979)].

[b] When Qualification Is Required

To determine whether a corporation will be required to qualify, the attorney must consult the individual state's qualification statute. Although most states do not define what constitutes the transaction of business sufficient to require qualification, most of the statutes list activities that do not require qualification.

For example, the Revised Model Business Corporation Act provides that the following activities, among others, do not constitute transacting business so as to require a certificate of qualification [Rev. Model Business Corp. Act § 15.01 (1984)]:

- Maintaining, defending, or settling any proceeding.
- Carrying on internal corporate affairs, including holding meetings of the board of directors or shareholders.
- Maintaining bank accounts.
- Maintaining offices or agencies for the transfer, exchange, and registration of the corporation's own securities or maintaining trustees or depositaries with respect to those securities.
- Selling through independent contractors.
- Soliciting or obtaining orders, whether by mail or through employees or agents or otherwise, if the orders require acceptance outside the state.
- Creating or acquiring indebtedness, mortgages, and security interests in real or personal property.
- Securing or collecting debts or enforcing mortgages and security interests in property securing the debts.
- Owning real or personal property.
- Conducting an isolated transaction that is completed within 30 days and that is not in the course of repeated transactions of a like nature.
- Transacting business in interstate commerce.

In addition, many states permit unqualified foreign corporations to engage in lending activities. Typically, these states allow corporations to lend money to residents, take security for mortgages, enforce the security, and service mortgages without obtaining a certificate of authority. It is necessary to consult the individual state's statute to determine precisely which lending activities are permitted without qualification.

The question of whether a particular activity other than those listed in the state's qualification statute would require the corporation to qualify can only be answered by consulting the case law of the jurisdiction [*see, e.g., Jay-Lor Textiles v. Pacific Compress Warehouse (Tex. Civ. App. 1977) 547 S.W.2d 738, 741* (rental of equipment past 30-day statutory period required corporation to qualify)]. However, any activity should be considered in the context of the purpose for which a corporation is organized, since the corporation's "ordinary business" may be a decisive element in the consideration of whether qualification is required [*see e.g., Royal Ins. Co. v. All States Theatres, Inc., 242 Ala. 417,*

419, 6 So. 2d 494 (1942);].

[c] Penalties for Failure to Qualify

Most states provide a combination of jurisdictional and monetary penalties for a corporation's failure to qualify. To determine which penalties apply in the state in which the California corporation intends to do business, it is necessary to consult that state's statutes. The Revised Model Business Corporation Act prescribes the following consequence for transacting business without authority [Rev. Model Business Corp. Act § 15.02(a)- (d)(1984)]:

- A prohibition against maintaining a proceeding in any court in the state until the foreign corporation obtains a certificate of authority.

- A prohibition against the foreign corporation's successor and the assignee of a cause of action arising out of the unauthorized business maintaining a proceeding based on that cause of action in any court in the state until the foreign corporation or its successor obtains a certificate of authority.

- A stay of a proceeding commenced by a foreign corporation, its successor, or its assignee to determine whether the foreign corporation or its successor requires a certificate of authority and, if applicable, until the foreign corporation or its successor obtains the certificate.

- Civil monetary penalties for the period during which the corporation transacted unauthorized business, to be collected by the attorney general.

On the other hand, under the Revised Model Business Corporation Act, unqualified foreign corporations doing intrastate business are permitted to defend themselves in suits brought against them [*see* Rev. Model Business Corp. Act § 15.02(e)(1984)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesNoncomplianceBusiness & Corporate LawForeign BusinessesQualificationsCivil ProcedureJurisdictionPersonal Jurisdiction & In Rem ActionsIn Personam ActionsDoing BusinessTransportation LawInterstate CommerceFederal PowersTransportation LawInterstate CommerceState Powers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Advising California Corporations Doing Business in Other States

6-12B California Legal Forms--Transaction Guide §§ 12B.21-12B.29

[Reserved]

§§ 12B.21[Reserved]



19 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
C. California Taxation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.30

§ 12B.30 Overview

Foreign corporations in California, except those that are exempt from taxation [*see § 12B.33[2]*], may be subject to any of the following three taxes:

- A franchise tax on the privilege of exercising the corporation franchise in California [*see Rev. & Tax. Code §§ 23101-23364a*]. This tax is imposed on all corporations, including financial corporations and certain noncorporate entities, that are "doing business" in California [*see § 12B.31[1][a][ii]*]. Franchise tax liability for commencing or withdrawing corporations, and for corporations ceasing or resuming business is determined under special rules [*see Rev. & Tax. Code §§ 23221-23226* (commencing corporations), 23281-23282 (resuming business), 23331-23334 (withdrawing corporations); *see also § 12B.31*].

- A corporation income tax, imposed on corporations that are not subject to the franchise tax but that derive income from California sources, based on the net income from California sources for the immediately preceding year [*see Rev. & Tax. Code §§ 23501-23561*; *see also § 12B.32*]. Banks are not subject to this tax [*Rev. & Tax. Code §§ 23181, 23501(a)*].

- An alternative minimum tax, adopted from the federal alternative minimum tax, which is imposed on all general corporations subject to the franchise tax or the corporation income tax, and on exempt organizations subject to tax on unrelated business income, and banks and financial corporations [*see Rev. & Tax. Code §§ 23400-23459*]. This tax, however, is not imposed on S corporations [*Rev. & Tax. Code § 23400(b)*; *see § 12B.34*].

In addition, other taxes are imposed such as property tax [*see § 12B.35[1]*] and sales and use taxes [*see § 12B.35[2]*].

Insurance companies are not taxed under the Bank and Corporation Tax Law. They are, instead, required to pay a tax on gross premiums [*see Rev. & Tax. Code § 12201(a)*; *see also Rev. & Tax. Code §§ 12001-13170*], which is in lieu of all other state taxes except real property taxes, retaliatory taxes, ocean marine insurance taxes, and vehicle registration fees

and taxes [*Rev. & Tax. Code §§ 12102*, 12204(a)]. However, each corporate or other attorney in fact of a reciprocal or interinsurance exchange is subject to taxes imposed on corporations or others doing business in California, except taxes on income derived from its principal business as attorney in fact [*Rev. & Tax. Code § 12204(a)(5)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsTax LawState & Local TaxesFranchise TaxImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
C. California Taxation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.31

§ 12B.31 California Franchise Tax

[1] In General

[a] Types of Corporations Subject to Franchise Tax

Every foreign or domestic corporation that is "doing business" in California [*see* [b], *below*] and that is not expressly exempt from taxation [*see § 12B.33*] must pay an annual franchise tax for the privilege of exercising its corporate franchise in the state [*Rev. & Tax. Code § 23151(a)*; *see Rev. & Tax. Code §§ 23181, 23183*; *see also Citicorp North America, Inc. v. Franchise Tax Board (2000) 83 Cal. App. 4th 1403, 1407-1409, 100 Cal. Rptr. 2d 509 , cert. denied, 121 S. Ct. 2623 (2001)* (holding that trial court properly included California sales of South Dakota affiliate in calculating amount of income apportionable to California operations under rule in effect at the time, despite fact that SBE subsequently returned to prior rule)]. See Ballantine & Sterling, California Corporation Laws, Ch. 22, *Corporate Franchise and Income Taxes in California* (Matthew Bender) for a discussion of the special tax problems of multijurisdictional taxpayers.

Banks, financial corporations [*see 18 Cal. Code Reg. § 23183(a)* (definition)], other than certain exempt entities, and other special entities, including insurance companies [*see § 12B.30*], are also subject to franchise taxes, but the tax liability for these entities is computed under special provisions [*see Rev. & Tax. Code §§ 12001-13170, 23151(a), 23181, 23183, 23183.1*]. The franchise tax rate is higher for these corporations than for other corporations, in lieu of certain other state and local taxes [*see Rev. & Tax. Code §§ 23182, 23186*].

Foreign banks and financial corporations that are not subject to the franchise tax include international banks maintained by banks in California [*see Rev. & Tax. Code § 25107(a)*; *see Rev. & Tax. Code § 25107(b)* (definition)], foreign lending institutions [*see Corp. Code §§ 191(d)* (definition), 2104 (foreign lending institutions are not considered to be doing business unless located in California)], and federal reserve banks [*see 12 U.S.C. § 531*; *see also* Ballantine & Sterling, California Corporation Laws, Ch. 22, *Corporate Franchise and Income Taxes in California* (Matthew Bender)].

Foreign corporations that obtain a certificate of qualification [*see § 12B.11*] are liable for the minimum franchise tax

even if they do not engage in any intrastate business in California. A foreign corporation that does not obtain a certificate of qualification but that nevertheless does business in California is subject to the minimum franchise tax for any year that it engages in such activities [*see 18 Cal. Code Reg. § 23151*].

[b] Requirement That Corporation Be Doing Business in California

The term "doing business" for franchise tax purposes [*see Rev. & Tax. Code § 23151*] is broader than the term "transacting intrastate business" used in the Corporations Code [*see Corp. Code § 191(a)*]. It does not require that the corporation maintain a regular course of business or transactions in California [*Hise v. McColgan (1944) 24 Cal. 2d 147, 151, 148 P.2d 616]* . "Doing business" for taxable years beginning before January 1, 2011, means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit [*Rev. & Tax. Code § 23101(a)*], and includes such minimal activities as (1) buying or selling stocks or bonds, (2) endorsing notes of a subsidiary corporation, (3) leasing real property to a subsidiary corporation or to other tenants, and (4) liquidating activities such as selling or renting property or collecting on notes [*18 Cal. Code Reg. § 23101*]. For taxable years beginning **on or after January 1, 2011**, a taxpayer is doing business in California for a taxable year if any of the following conditions has been satisfied [Corp. Code § 23101(b)]:

- The taxpayer is organized or commercially domiciled in California.

- Sales [*see Rev. & Tax. Code § 25120(e), (f)*] for the taxable year in California exceed the lesser of $500,000 or 25 percent of the taxpayer's total sales.

- The real property and tangible personal property of the taxpayer in California exceed the lesser of $50,000 or 25 percent of the taxpayer's total real property and tangible personal property.

- The amount paid in California by the taxpayer for compensation [*see Rev. & Tax. Code § 25120(c)*] exceeds the lesser of $50,000 or 25 percent of the total compensation paid by the taxpayer.

Thus, a foreign corporation that maintains a stock of goods in California and that makes deliveries in California pursuant to orders taken by employees in California is "doing business" and its entire income from sources within California is subject to the corporate franchise tax [*18 Cal. Code Reg. § 23101*]. On the other hand, a corporation holding or organized to hold stock or bonds of other corporations that does not trade in stocks, bonds, or other securities, and that engages in no activities other than the receipt and disbursement of dividends from stock or interest from bonds is not "doing business" for the purpose of imposing franchise taxes [*Rev. & Tax. Code § 23102*].

A foreign corporation engaging entirely in interstate commerce is not subject to a California franchise tax. It is, unless it is exempt, subject to a tax on income derived from California sources [*see Rev. & Tax. Code §§ 23501-23561*; *see also § 12B.32*]. However, if the foreign corporation engages in intrastate activities in California in addition to its interstate activities, it is subject to the franchise tax on its entire net income derived from California sources, including its income derived from interstate commerce [*18 Cal. Code Reg. §§ 23101, 23501*; *see Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 287-289, 97 S. Ct. 1076, 51 L. Ed. 2d 326 (1977)*].

A foreign corporation may petition the Franchise Tax Board for a determination that its activities in California do not constitute "doing business" and that it does not derive income from California sources [*Rev. & Tax. Code § 23101.5(b)*; *see 18 Cal. Code Reg. § 23101.5(d)*]. For further information, see *§ 12B.33*. For a form to apply for exclusion from state taxation, see *§ 12B.260*.

[c] Franchise Tax Rates

The franchise tax rate, applicable to every corporation subject to the franchise tax except banks and financial

corporations, is 8.84 percent of the corporation's net income for the preceding year [*Rev. & Tax. Code § 23151(e), (f)*] subject to an annual minimum tax [*Rev. & Tax. Code § 23153(d)(1), (e)*; *see* Ballantine & Sterling, California Corporation Laws, Ch. 22, *Corporate Franchise and Income Taxes in California* (Matthew Bender)]. For the first taxable year beginning on or after January 1, 2000, the annual franchise tax is the sum of the tax based on the net income for the next preceding year (but not less than the minimum tax) plus the tax based on the net income for the first taxable year beginning on or after January 1, 2000 (but not less than the minimum tax) [*Rev. & Tax. Code § 23151(f)(1)*].

The tax rate for banks and financial corporations is the rate specified for other corporations [*Rev. & Tax. Code § 23151*] plus 2 percent [*Rev. & Tax. Code § 23186*], subject to an annual minimum tax [*see Rev. & Tax. Code §§ 23153, 23181(e), 23183(a)*]. For the first taxable year beginning on or after January 1, 2000, the annual franchise tax is the sum of the tax based on the net income for the next preceding year (but not less than the minimum tax) plus the tax based on the net income for the first taxable year beginning on or after January 1, 2000 (but not less than the minimum tax) [*Rev. & Tax. Code §§ 23181(f)(1), 23183(c)(1)*].

A foreign corporation is generally subject to the minimum tax from the taxable year in which it is qualified or commences doing business in California, whichever is earlier, until the later of the effective date of dissolution or withdrawal [*see Rev. & Tax. Code § 23331*], or the date that the corporation ceases to do business in California [*Rev. & Tax. Code § 23153(a)*]. However, every corporation that qualifies to do business in California on or after January 1, 2000, is not subject to the minimum franchise tax for its first taxable year [*Rev. & Tax. Code § 23153(f)(1), (3)* (limitation)].

The "taxable year" for purposes of the franchise tax is the calendar year or the fiscal year for which the tax is payable [*see Rev. & Tax. Code § 23041(a), (e)* (calendar or fiscal years beginning before January 1, 2000)], that is, the year in which the corporation is exercising the corporate franchise and doing business [*see* Ballantine & Sterling, California Corporation Laws, Ch. 22, *Corporate Franchise and Income Taxes in California* (Matthew Bender)]. For taxable tears beginning before January 1, 2000, and the first taxable year beginning on or after that date, "income year" for franchise tax purposes is the calendar year or the fiscal year on the basis of which the net income is computed or, in the case of a return made for part of a year, the period for which the return is made [*Rev. & Tax. Code § 23042(a)(1)*]. For taxable years (other than the first taxable year) beginning on or after January 1, 2000, the term "income year" has the same meaning as the term "taxable year" [*Rev. & Tax. Code § 23042(b)*; *see Rev. & Tax. Code § 23041*].

If a foreign corporation is receiving income from business conducted in several states, the California tax is measured by the net income attributable to sources in California pursuant to allocation and apportionment rules [*see Rev. & Tax. Code §§ 25101-25141*]. Three of those rules are used for purposes of determining nominally foreign corporation status [*see Rev. & Tax. Code §§ 25128, 25129, 25132*; *see § 12B.14[1][c]*]. Banks and financial corporations are subject to special apportionment rules [*see 18 Cal. Code Reg. § 25137-4*-1(c)].

[2] Prepayment for Qualification

Before January 1, 2000, foreign corporations were required to prepay the minimum tax for their first year of business in California when filing the first annual statement [*see Rev. & Tax. Code § 23153*; *see* former *Rev. & Tax. Code § 23221(a)*]. Corporations that qualify to do business in California on or after January 1, 2000, and before January 1, 2001, are not subject to the prepayment requirement [*see* former *Rev. & Tax. Code § 23221(f)*]. Effective January 1, 2001, only credit unions are subject to the prepayment requirement [*see Rev. & Tax. Code § 23221* (effective on January 1, 2001)].

[3] Forfeiture Penalty for Failure to Pay Franchise Tax

[a] Bases for Forfeiture

A foreign corporation qualified to do business in California may forfeit its corporate powers, rights, and privileges, except for purposes of filing an application for exempt status, or the filing of an amended statement and designation to set forth a new or assumed name [*see Rev. & Tax. Code § 23305a*], if it either fails to pay any franchise tax, penalty, or interest when due [*Rev. & Tax. Code §§ 23301, 23301.6*] or fails to file a tax return [*Rev. & Tax. Code §§ 23301.5, 23301.6*; *see Rev. & Tax. Code §§ 21020, 23302(a)- (c)* (forfeiture procedure)]. Forfeiture will occur if the payment is not made within the following time limits [*Rev. & Tax. Code § 23301*]:

- For all or part of any tax, penalty, or interest that is due either at the time the return must be filed or on or before the 15th day of the ninth month following the close of the taxable year, by 6:00 P.M. on the last day of the 12th month after the close of the taxable year.

- For all or part of any tax, penalty, or interest that is due and payable on notice and demand from the Franchise Tax Board, by 6:00 P.M. on the last day of the 11th month following the due date of the tax.

- For taxes due and payable pursuant to the Revenue and Taxation Code provisions on interest and penalties [*see Rev. & Tax. Code § 19131 et seq.*], by 6:00 P.M. on the last day of the 11th month following the due date of the tax liability.

[b] Notice and Effect of Forfeiture

Before forfeiture can become effective, the corporation must receive notice from the Franchise Tax Board indicating that the corporation will be suspended on a particular date pursuant to the appropriate section of the Revenue and Taxation Code. The notice must be mailed to the corporation at least 60 days before the effective date [*Rev. & Tax. Code §§ 23302(a), (b), 21020*].

Once the Franchise Tax Board transmits the names of corporations whose legal rights have been forfeited to the Secretary of State, the forfeiture becomes effective. The certificate of the Secretary of State is prima facie evidence of the forfeiture [*Rev. & Tax. Code § 23302(c)*]. Additionally, a certificate of forfeiture from the Franchise Tax Board stating that the forfeited taxpayer has been notified of its tax liability or the requirement to file a return and that the taxpayer has not paid or filed is prima facie evidence of those facts [*Rev. & Tax. Code § 23305d*].

If a foreign corporation's powers, rights, and privileges are forfeited, the corporation may not sell, transfer, or exchange real property in California during the period of forfeiture [*Rev. & Tax. Code § 23302(d)*]. Any transaction of business after forfeiture is punishable by fine, imprisonment, or both [*see Rev. & Tax. Code § 19719(a)*; *see Rev. & Tax. Code § 19719(b)* (bar does not apply to insurer's duty to defend)]. If a corporation nevertheless transacts business during forfeiture, any income received or business transacted during the forfeiture period is subject to franchise taxes [*Rev. & Tax. Code § 23303*]. The Franchise Tax Board will also impose an annual penalty on a corporation doing business after forfeiture if the corporation fails to make and file a tax return, unless the failure to file is due to reasonable cause and not willful neglect [*Rev. & Tax. Code § 19135*].

Contracts made in California with foreign corporations after forfeiture [*see Rev. & Tax. Code §§ 23301, 23301.5, 23775*] are voidable at the option of any party to the contract other than the foreign corporation [*Rev. & Tax. Code § 23304.1(a)*; *see* [4], *below*].

[c] Reviving Corporate Powers

[i] Revivor With Payment of Amounts Due

The corporation's powers may be revived by (1) applying in writing to the Franchise Tax Board for a certificate of

revivor [*see § 12B.261* (form)], (2) filing all tax returns required under the Bank and Corporation Tax Law, and (3) paying all taxes, additions to tax, deficiencies, interest, and penalties due [*Rev. & Tax. Code § 23305*].

The application for revivor of a corporation that has suffered forfeiture may be made by (1) any stockholder or creditor, (2) a majority of the surviving trustees or directors of the corporation, (3) an officer, or (4) any other person who has interest in relief from forfeiture [*Rev. & Tax. Code § 23305*].

[ii] Revivor Without Payment of Amounts Due

The Franchise Tax Board may revive a corporation to good standing without full payment of franchise tax liability if it determines that revival will improve the prospects for collection of the full amount due [*Rev. & Tax. Code § 23305b*]. The revivor may be limited as to time, may limit the functions the revived corporation can perform, or both. The corporate powers, rights, and privileges may be forfeited again if the Franchise Tax Board determines that the prospects for collection of the full amount due have not been improved by the revivor of the corporation [*Rev. & Tax. Code § 23305b*].

In addition, the Franchise Tax Board will issue a certificate of revivor if the corporation provides the Board with an assumption of liability, a bond, deposit, or other acceptable security for the corporation's tax liability in lieu of actual payment of all outstanding tax liabilities [*Rev. & Tax. Code § 23305.2*]. Obtaining revivor by securing the debt does not constitute an admission of liability and does not relieve the corporation from liability for taxes, additions to tax, penalties, or interest [*Rev. & Tax. Code § 23305.2*]. After securing the debt, the corporation has a reasonable time after the issuance of the certificate of revivor in which to file any necessary returns, notwithstanding the otherwise applicable requirement that the corporation file all necessary returns before the Franchise Tax Board will grant revivor [*Rev. & Tax. Code § 23305.2*; *see Rev. & Tax. Code § 23305*].

[iii] Issuance and Effect of Certificate of Revivor

Before the certificate of revivor can be issued, the Franchise Tax Board must obtain from the Secretary of State an endorsement on the application for reinstatement of the fact that the name of the corporation continues to meet the corporate name requirements [*Rev. & Tax. Code § 23305a*; *see Corp. Code § 2106(b)*; *see also Boyer v. Jones (2001) 88 Cal. App. 4th 220, 221-222, 105 Cal. Rptr. 2d 824* (holding that under *Corp. Code § 201(b)* and *Rev. & Tax. Code § 23305a*, name of suspended corporation may be reserved and adopted by another corporation during period of suspension, and affirming trial court's denial of suspended corporation's petition for writ of mandate seeking restoration of its name); § 12B.11[2][b]]. Once this endorsement is received, the Franchise Tax Board will issue a certificate of revivor to the corporation [*Rev. & Tax. Code § 23305*] and inform the Secretary of State that the corporation's powers, rights, and privileges have been revived [*Rev. & Tax. Code § 23305c(a)*; *see Rev. & Tax. Code § 23305c(c)* (restoration for erroneous forfeitures)].

Before a certificate of revivor can be issued, the corporation, in addition to the taxes, penalties, and interest already owed [*see Rev. & Tax. Code § 23305*], must prepay the minimum franchise tax imposed to resume doing business after revivor [*Rev. & Tax. Code § 23282(a)*; *see Rev. & Tax. Code §§ 23153, 23221*]. The tax imposed on any taxpayer that has suffered suspension or forfeiture [*see Rev. & Tax. Code § 23301*] and revives in any taxable year other than the taxable year in which the suspension or forfeiture occurred is computed on the basis of the net income for the taxable year in which the corporation revives, but not less than the minimum tax [*Rev. & Tax. Code § 23282(c)*; *see Rev. & Tax. Code § 23153*].

On issuance of the certificate, the corporation is reinstated and its legal rights are revived [*Rev. & Tax. Code § 23305a*; *see Rochin v. Pat Johnson Mfg. Co. (1998) 67 Cal. App. 4th 1228, 1236-1237, 79 Cal. Rptr. 2d 719* (although manufacturer's corporate powers were suspended before personal injury action was brought against it and before subsequent action to vacate amended judgment, corporation was entitled to defend appeal from order sustaining its

demurrer in second action because corporation's certificate of revivor became effective during pendency of appeal); *Benton v. County of Napa (1991) 226 Cal. App. 3d 1485, 1490, 277 Cal. Rptr. 541* (revivor validates procedural steps taken during suspension)]. The reinstatement is without prejudice to any action, defense, or right that has accrued because of the original forfeiture except as to the voidability of some contracts [*Rev. & Tax. Code § 23305a*; *see Rev. & Tax. Code §§ 23304.5, 23305.1*; *see also* [4], *below*]. Further, the certificate of revivor operates as prima facie evidence of the reinstatement, and may be recorded in the office of any county recorder [*Rev. & Tax. Code § 23305a*].

If the forfeiture was erroneous, the corporation's status will be "restored" retroactive to the date of forfeiture as if there had been no forfeiture [*Rev. & Tax. Code § 23305c(c)*].

For an application for a certificate of revivor, see *§ 12B.261*. For further discussion of the suspension and revivor of corporate powers, see Ballantine & Sterling, California Corporation Laws, Ch. 14, *Litigation Involving Corporations and Shareholders* (Matthew Bender).

[4] Contract Voidability Penalty for Failure to Pay Tax

[a] In General

Contracts made in California by a qualified foreign corporation during the time that the corporation's powers, rights, and privileges are forfeited due to a failure to pay taxes or file a tax return [*see Rev. & Tax. Code §§ 23301, 23301.5, 23775*; *see also* [3], *above*] are voidable at the option of any party to the contract other than the foreign corporation [*Rev. & Tax. Code § 23304.1(a)*; *see Rev. & Tax. Code § 23304.5* (procedure)]. In addition, if a foreign corporation that neither is qualified to do business in California nor has a corporate account number from the Franchise Tax Board fails to file a tax return required by the Bank and Corporation Tax Law [*see Rev. & Tax. Code § 23001 et seq.*], any contract made in California during the applicable period may be voided by any party to the contract other than the corporation [*Rev. & Tax. Code § 23304.1(b)*].

The "applicable period" is the period beginning on the later of (1) January 1, 1991, or (2) the first day of the taxable year for which the taxpayer failed to file a return, and ending on the earlier of (1) the date that the taxpayer qualified to do business in California or (2) the date that the taxpayer obtained a corporate account number from the Franchise Tax Board [*Rev. & Tax. Code § 23304.1(c)*; *see Rev. & Tax. Code § 23304.1(d)* (voidability of contracts of nonqualified corporations with corporate accounts); *see also Rev. & Tax. Code § 23305c(d)*].

If a corporation is unqualified [*see § 12B.11*] but has a corporate account number from the Franchise Tax Board, failure to file a tax return or to pay any amount owing to the Franchise Tax Board required under the Bank and Corporation Tax Law [*see Rev. & Tax. Code § 23001 et seq.*], or an exempt organization's failure to file any informational statement or return [*see Rev. & Tax. Code §§ 23772, 23774*; *see § 12B.33[2]*], will render any contract made by the corporation in California during a certain time period voidable at the instance of any party to the contract other than the taxpayer [*Rev. & Tax. Code § 23304.1(d)*]. To be subject to this penalty, the corporation must have failed to file or pay within 60 days after the Franchise Tax Board mailed a written demand. The time period for voidability begins at the end of this 60-day period and ends on the earlier of (1) the date relief is granted [*see Rev. & Tax. Code § 23305.1*; *see* [c], *below*] or (2) the date the taxpayer qualifies to do business in California [*Rev. & Tax. Code § 23304.1(d)*; *see § 12B.11*].

[b] Effect of Voidability

A party with the right to declare a contract void under these provisions may exercise that right only in a lawsuit on the contract [*Rev. & Tax. Code § 23304.5*]. The rights of the parties to the contract are not affected by these provisions except to the extent expressly provided by a final judgment of the court, and that judgment must allow the corporation a reasonable time to cure the voidability [*see Rev. & Tax. Code § 23305.1*].

If the court finds the contract voidable, it must order the contract rescinded. However, the court cannot order rescission unless the unqualified foreign corporation receives full restitution of the benefits provided under the contract [*Rev. & Tax. Code § 23304.5*].

If the corporation applies for relief from voidability, the Franchise Tax Board may assess additional penalties [*Rev. & Tax. Code § 23305.1(b)*; *see* [c], *below*].

[c] Relief From Voidability

[i] Application

A corporation may apply to the Franchise Tax Board for relief from contract voidability [*see Rev. & Tax. Code § 23305.1(a)*]. Relief will be granted if the application is properly filed [*see § 12B.262*], the period for which relief is requested is indicated, any necessary tax returns are filed, and any taxes, penalties, interest, and other amounts due are paid to the Franchise Tax Board [*Rev. & Tax. Code § 23305.1(a)*] or liability for them is assumed [*see Rev. & Tax. Code § 23305.2*]. The Franchise Tax Board will assess a penalty for each day of the period for which relief from voidability is granted. The total penalty assessed, however, must not exceed the amount of the tax for the period for which relief is requested [*Rev. & Tax. Code § 23305.1(b)(1)*]. A daily penalty with a different maximum is specified if an application for relief from contract voidability is filed for a period in which an application for revivor has been filed and a certificate of revivor has been issued [*Rev. & Tax. Code § 23305.1(b)(2)*; *see § 12B.262[1]* (application for revivor)].

Notwithstanding the requirement that the corporation pay any liability due [*see Rev. & Tax. Code § 23305.1(a)*], the Franchise Tax Board will issue a certificate of relief from voidability if the corporation provides the Board with an assumption of liability or a bond, deposit, or other acceptable security for the corporation's tax liability in lieu of actual payment of all outstanding tax liabilities [*Rev. & Tax. Code § 23305.2*]. Obtaining relief by securing the debt does not constitute an admission of liability and does not relieve the corporation from liability for taxes, additions to tax, penalties, or interest [*Rev. & Tax. Code § 23305.2*]. After securing the debt, the corporation has a reasonable time after relief is granted in which to file any necessary returns, notwithstanding the otherwise applicable requirement that the corporation file all necessary returns before the Franchise Tax Board will grant revivor [*Rev. & Tax. Code § 23305.2*; *see Rev. & Tax. Code § 23305.1*].

For an application for certificate of revivor from contract voidability, see *§ 12B.262*.

[ii] Effect of Relief

If the taxpayer is granted relief from contract voidability, all contracts entered into during the period for which relief is granted that have not been rescinded by a final court order [*see Rev. & Tax. Code § 23304.5*] may be enforced in the same manner and to the same extent, with regard to both parties to the contract and any third parties, as if the contract had never been voidable [*Rev. & Tax. Code § 23305.1(c)(1)(A)*]. Sales, transfers, and exchanges of California real property during the period for which relief is granted (that is, when the taxpayer was not entitled to sell, transfer, or exchange real property [*see Rev. & Tax. Code § 23302(d)*; *see also* [3], *above*]) that have not been rescinded by a final court order [*see Rev. & Tax. Code § 23304.5*] are as valid as if the taxpayer had not been prohibited from conveying real property [*Rev. & Tax. Code § 23305.1(c)(1)(B)*].

Once relief is granted, the Franchise Tax Board will issue and mail a certificate to the taxpayer, or as directed by the taxpayer [*Rev. & Tax. Code § 23305.1(c)(2)*]. The certificate (1) indicates the period for which relief is granted [*Rev. & Tax. Code § 23305.1(c)(2)*], (2) constitutes prima facie evidence of the relief from voidability, and (3) may be recorded [*Rev. & Tax. Code § 23305.1(d)*].

[5] Liability for Year of Cessation

[a] General Corporations

In general, when a corporation (other than a financial or an exempt corporation [*see § 12B.33[2]*]) ceases doing business in California [*see* [1][a], *above*], its franchise tax for its final year is measured by its net income for the prior year plus its net income for the final year, with a stated minimum tax [*Rev. & Tax. Code § 23151.1(d), (e)*; *see* Rev. & Tax. Code § 23153]. If a corporation begins and ceases doing business in the same taxable year, its franchise tax ordinarily would be measured by its net income for that year, subject to the stated annual minimum [*Rev. & Tax. Code §§ 23151.1(b), 23153*]. However, corporations that qualify to do business in California on or after January 1, 2000, are not subject to the minimum franchise tax for the first taxable year [*Rev. & Tax. Code § 23153(f)(1), (3)* (exemption inapplicable if corporation reorganized solely to avoid payment of minimum franchise tax)].

If the corporation withdraws in the same year that it ceases to do business, it ordinarily has no further California tax liability if it has no other income from California sources [*see Rev. & Tax. Code §§ 23151.1, 23151.2, 23504*]. To withdraw, the corporation must file a certificate of surrender or document of merger [*see Corp. Code §§ 2112, 2113*; *see also § 12B.12[2]*].

On the other hand, if the corporation does not legally withdraw, it remains liable for the minimum franchise tax for years after the year of cessation, until it either resumes business activities or withdraws [*see Rev. & Tax. Code §§ 23281, 23151.2, 23153*]. A corporation that has qualified must continue to pay the annual minimum tax, even after ceasing to do business, until it files a certificate of surrender with the Secretary of State or dissolves in its state of incorporation [*18 Cal. Code Reg. § 23151*]. If the corporation withdraws in a year subsequent to the year of cessation of business, it is liable for franchise tax in its final income year based on its net income for the income for the taxable year in which it ceased doing business, unless that income has already been taxed, subject to the stated minimum tax [*Rev. & Tax. Code § 23151.2*].

If a foreign corporation ceases doing business, but continues to derive income from California sources, it will become liable for the corporation income tax [*see § 12B.32*] for the years subsequent to the year in which it ceased doing business [*Rev. & Tax. Code § 23504*]. A qualified corporation that ceases doing business but continues to receive income from California sources before it withdraws will be subject to both the minimum franchise tax and the corporation income tax. In that situation, however, the franchise tax is allowed as an offset against the income tax [*see Rev. & Tax. Code § 23503*].

[b] Banks and Financial Corporations

If a financial corporation ceases to do business in California, the tax for the taxable year during which the cessation occurred is based on the corporation's net income for the prior year plus its net income for the taxable year during which the corporation ceased doing business. If a financial corporation dissolves or withdraws from California, the tax for the taxable year during which the dissolution or withdrawal occurs is based on its net income for the income year in which the corporation ceased doing business, unless the income had previously been taxed [*Rev. & Tax. Code § 23332.5*; *see Rev. & Tax. Code §§ 23183(b), (d), 23183.1, 23183.2*; *see also Rev. & Tax. Code § 23186* (rate)].

If a bank ceases doing business in the same taxable year as it commences doing business, the tax ordinarily would be based on its net income for that year, subject to the annual minimum franchise tax [*Rev. & Tax. Code § 23181(b)*; *see Rev. & Tax. Code § 23186* (rate)]. However, corporations that qualify to do business in California on or after January 1, 2000, are not subject to the minimum franchise tax for the first taxable year [*Rev. & Tax. Code § 23153(f)(1), (3)* (exemption inapplicable if corporation reorganized solely to avoid payment of minimum franchise tax)]. If a bank ceases doing business in any other year, the tax for the taxable year of cessation is based on its net income for the prior year plus its net income for the taxable year during which the bank ceased doing business [*Rev. & Tax. Code § 23181(c)*; *see Rev. & Tax. Code § 23186*]. In any event, the bank is liable for the annual minimum franchise tax [*Rev. & Tax. Code § 23181(e)*; *see Rev. & Tax. Code § 23153*], except for in its first taxable year [*Rev. & Tax. Code §*

23153(f)(1)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxGeneral OverviewBusiness & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsFinanceFranchise TaxComputationBusiness & Corporate LawCorporationsFinanceFranchise TaxExemptionsBusiness & Corporate LawCorporationsFinanceFranchise TaxPenalties for NoncomplianceBusiness & Corporate LawCorporationsFinanceFranchise TaxReinstatement



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
C. California Taxation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.32

§ 12B.32 California Corporation Income Tax

The corporate income tax [*Rev. & Tax. Code §§ 23501-23571*] complements the franchise tax by taxing the income of those corporations (other than banks or financial institutions) whose activities within California are not sufficient to subject them to the franchise tax [*see § 12B.31[1]*], but who receive income from California sources [*see Rev. & Tax. Code § 23501*]. Banks are not subject to the corporate income tax [*see Rev. & Tax. Code §§ 23181-23183, 23501*]. The corporation income tax rate is 8.84 percent, but there is no minimum income tax [*see Rev. & Tax. Code §§ 23151(e), 23501(c)*].

All corporate net income, other than income subject to the franchise tax, that is derived from sources within California (whether in intrastate, interstate, or foreign commerce) is subject to income taxation [*Rev. & Tax. Code § 23501(a)*; *see Rev. & Tax. Code § 23040* ("income" defined)]. Sources of California income include the following [*see 18 Cal. Code Reg. § 23040(a)*]:

- Income, rents, and gains from the sale of real or tangible personal property located in California, regardless of where the sale or transfer is consummated.

- Income from the ownership, control, or management of real or personal property located in California.

- Income from business or activities carried on in California.

- Income from stocks, bonds, notes, bank deposits, and other intangible personal property with a business situs in California.

Federal law restricts California's ability to tax a corporation earning income in interstate commerce whose only business activities in California consist of soliciting orders for tangible personal property to be filled from inventories maintained outside the state [*see 15 U.S.C. § 381*; *see also The Reader's Digest Association, Inc. v. Franchise Tax Board (2001) 94 Cal. App. 4th 1240, 1248, 115 Cal. Rptr. 2d 53* (finding that wholly owned subsidiary was not "independent

contractor" pursuant to *15 U.S.C. § 381(d)(1)* and thus plaintiff was not exempt from tax under *15 U.S.C. § 381(c)*)].

A foreign corporation will forfeit the exercise of its corporate powers, rights, and privileges in the state if it fails to pay the corporate income tax or to file an income tax return when required [*see Rev. & Tax. Code §§ 23301, 23301.5*; *see § 12B.31[3]*].

If a corporation that has been subject to the corporate income tax begins doing business in California, or qualifies to transact intrastate business, the corporation continues to pay income tax for the year of the changeover [*Rev. & Tax. Code § 23224.5(a)*]. The following year is treated as the year in which the corporation commences doing business [*see Rev. & Tax. Code § 23224.5(b)*; *see also Rev. & Tax. Code §§ 23151.1(c)(2), 23153*].

If a corporation that has been subject to the franchise tax ceases doing business, withdraws, or dissolves, the corporation becomes subject to the corporation income tax on income thereafter received from California sources. For the year in which the change occurs, however, only the franchise tax will be assessed against the corporation. For subsequent years, the corporation will be subject to the income tax [*Rev. & Tax. Code § 23504*]. Corporation income tax liability is offset by any franchise taxes imposed for the same period. If any taxes, interest, or penalties that should have been paid as franchise tax are in fact paid as corporation income tax, they shall be considered as if they had been paid as franchise tax as of the date they were made [*Rev. & Tax. Code § 23503*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsLimitations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
C. California Taxation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.33

§ 12B.33 Exclusion and Exemption From Franchise or Income Tax

[1] Application for Exclusion

The Franchise Tax Board may determine that a corporation is not doing business in California for purposes of the franchise tax, or is not deriving income from sources within California for purposes of the income tax, if its only activities in California comprise either or both of the following [*Rev. & Tax. Code § 23101.5(a)*; *see also 18 Cal. Code Reg. § 23101.5(a)- (c), (e)*]:

- The presence of employees in California for the sole purpose of attending a public or private school, college, or university [*Rev. & Tax. Code § 23101.5(a)(2)*].

- The purchase of personal property or services solely for its own use or use by its affiliate outside California if the following three conditions are satisfied:

  (1) The corporation does not have more than 100 employees in California, and their duties are limited to solicitation, negotiation, liaison, monitoring, auditing, and inspecting the personal property or services acquired, or providing technical advice with respect to its requirements [*Rev. & Tax. Code § 23101.5(a)(1)(A)*].

  (2) The corporation does not have more than 200 employees in California, whose duties are limited to solicitation, negotiation, liaison, monitoring, auditing, and inspecting the personal property or services acquired, or providing technical advice with respect to its requirements, and the corporation or its affiliate uses the personal property or property for the construction or modification of a physical plant or facility located outside California [*Rev. & Tax. Code § 23101.5(a)(1)(B)*].

  (3) The combined number of employees in California described in paragraphs (a) and (b) does not exceed 200 [*Rev. & Tax. Code § 23101.5(a)(1)(C)*].

When the corporation is engaged in a unitary business, the limitation of 100 or 200 employees must be applied to the aggregation of all corporations in the unitary group [*Rev. & Tax. Code § 23101.5(e)*].

A corporation may petition the Franchise Tax Board, in accordance with procedures established by the Board [*Rev. & Tax. Code § 23101.5(b)*; *see 18 Cal. Code Reg. § 23101.5(d), (e), (g)*] for such a determination [*see § 12B.260* (form for petition)]. If a corporation submits a petition, it is deemed to have waived the confidentiality provisions as to the facts alleged in the petition and any additional evidence produced concerning those facts [*Rev. & Tax. Code § 23101.5(b)*; *see Rev. & Tax. Code § 19543*; *see also 18 Cal. Code Reg. § 23101.5(h)*]. The confidentiality provisions prohibit agents of the Franchise Tax Board from divulging income information set forth on a taxpayer's returns or other filed documents [*see Rev. & Tax. Code § 19542*].

Exclusions are granted for a period of five years, as long as the corporation continues to meet the requirements [*Rev. & Tax. Code § 23101.5(c)*]. A new petition may be filed when the exemption expires. During the period of an exclusion, the corporation's records are subject to audit to the same extent as are the records of any other corporation doing business or deriving income from sources in California [*18 Cal. Code Reg. § 23101.5(g)*].

There are related annual reporting requirements for the corporation after it has obtained an FTB determination [*see Rev. & Tax. Code § 23101.5(d)*] and for any taxpayer that sells property or services to a corporation that has obtained an FTB determination [*see Rev. & Tax. Code § 23101.5(f)*].

[2] Exempt Corporations

Certain nonprofit corporations are exempt from both the franchise and income tax on the filing and approval of an application for exemption [*see Rev. & Tax. Code § 23701*]. A corporation (other than a bank, financial corporation, association, or business trust) entitled to this exemption that has income that otherwise would be subject to the franchise tax must file a return reporting that income and must pay a tax on its unrelated business taxable income [*Rev. & Tax. Code § 23771*; *see Rev. & Tax. Code §§ 23731*, *23732* (definition)].

In addition, most exempt corporations must file an annual information return [*see Rev. & Tax. Code § 23772*] or an annual statement [*Rev. & Tax. Code § 23774*]. Failure to (1) file an information return or a statement, or (2) pay any amounts due as a result of the disallowance of an exemption [*see Rev. & Tax. Code § 23703*] or as a filing fee for or penalty for failure to file an information return [*see Rev. & Tax. Code § 23772(a)(3), (c)(1)*] will subject the corporation to forfeiture of its corporate powers, rights, and privileges [*Rev. & Tax. Code § 23775*; *see § 12B.31[3]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxGeneral OverviewBusiness & Corporate LawCorporationsFinanceFranchise TaxExemptionsBusiness & Corporate LawForeign BusinessesGeneral OverviewTax LawState & Local TaxesFranchise TaxImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsLimitations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
C. California Taxation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.34

§ 12B.34 Alternative Minimum Tax

In addition to any other taxes imposed by the Bank and Corporation Tax Law [*see Rev. & Tax. Code § 23001 et seq.*], California imposes an alternative minimum tax on most corporations [*see Rev. & Tax. Code § 23400 et seq.*]. This tax is determined, with a few exceptions, pursuant to the alternative minimum tax provisions of the Internal Revenue Code [*Rev. & Tax. Code § 23400(b)*; *see I.R.C. §§ 55-59*]. The purpose of the alternative minimum tax is to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credits [*see* S. Rep. No. 99-313 (Pub. L. No. 99-514), at 518]. It accomplishes this by imposing a tax on the excess of the tentative minimum tax [*see I.R.C. §§ 55-59*] over the regular state tax [*see Rev. & Tax. Code §§ 23400(a), 23455, 23456*], in addition to the regular tax.

Corporations subject to the alternative minimum tax include those subject to the franchise tax other than banks and financial corporations [*Rev. & Tax. Code § 23455(a)(1)*; *see § 12B.31*], those subject to the corporation income tax [*Rev. & Tax. Code § 23455(a)(2)*; *see § 12B.32*], exempt organizations subject to the tax on unrelated business income [*Rev. & Tax. Code § 23455(a)(3)*; *see* § 12B.3[2]], and banks and financial corporations [*Rev. & Tax. Code § 23455(a)(4), (5)*].

The alternative tax is calculated in the following manner [*Rev. & Tax. Code §§ 23400-23459*; *see I.R.C. §§ 53-59*]. The "alternative minimum taxable income" [*see Rev. & Tax. Code §§ 23051.5(a), 23455(b)*; *I.R.C. § 55*] is computed as the net income, minus various adjustments [*see Rev. & Tax. Code §§ 23051.5(a), 23456, 23456.5* (modifications to *I.R.C. § 56*); *I.R.C. § 56*], plus various items of tax preference [*see Rev. & Tax. Code §§ 23051.5(a), 23457* (modifications to *I.R.C. § 57*); *I.R.C. § 57*].

The "tentative minimum tax" [*see Rev. & Tax. Code §§ 23051.5(a), 23455(a)*; *I.R.C. § 55*] is computed by subtracting from the alternative minimum taxable income the exemption amount multiplied by the applicable tax rate. The "exemption amount" is $40,000 [*see Rev. & Tax. Code §§ 23051.5(a), 23400(a)*; *I.R.C. § 55(d)(2)*]. The applicable tax rate is generally 6.65 percent, although it is augmented for banks and financial corporations [*see Rev. & Tax. Code §§ 23051.5(a), 23400, 23455(a), (d)*; *I.R.C. § 55*].

The alternative minimum tax equals the excess of the tentative minimum tax over the regular tax [*Rev. & Tax. Code §§ 23400-23459*; *see I.R.C. §§ 53-59*]. The "regular tax" is the corporation's liability for, as applicable, the California franchise tax, the California corporation income tax, and the tax on unrelated business income, determined before reduction by any credits against the tax [*see Rev. & Tax. Code §§ 23051.5(a), 23455(c)*; *I.R.C. § 55(c)*].

The franchise tax rules for corporations that commence, reorganize, resume, have their rights forfeited, or withdraw from doing business in California [*see § 12B.31*] apply to the alternative minimum tax, except that the alternative minimum tax need not be prepaid [*Rev. & Tax. Code § 23455(b)(2)*].

For information on the alternative minimum tax in the context of equipment leasing, see Ch. 53, *Personal Property Leasing* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewTax LawFederal Income Tax ComputationAlternative Minimum Tax (IRC secs. 55-59)Tax LawState & Local TaxesMinimum Tax



24 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
C. California Taxation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.35

§ 12B.35 Additional California Taxes

[1] Property Tax

A foreign corporation that has an interest in real property located in California is liable for property taxes, unless the property is exempt [*see Cal. Const. art. XIII, § 1*; *Rev. & Tax. Code § 201*; *see also Rev. & Tax. Code §§ 201.1-236*].

[2] Sales and Use Taxes

Foreign corporations that engage in retail sales in California are liable for sales tax on the gross receipts from the sale of tangible personal property sold at retail in California [*see Rev. & Tax. Code § 6051*]. In addition, foreign corporations that purchase tangible personal property in California for storage, use, or consumption in California are liable for use tax on the sales price of the property [*see Rev. & Tax. Code § 6201*]. For a general discussion of the Sales and Use Tax Law [*see Rev. & Tax. Code §§ 6001-7176*], see Ch. 17, *Buying and Selling a Business or Professional Practice* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewTax LawState & Local TaxesPersonal Property TaxTangible PropertyImposition of TaxTax LawState & Local TaxesReal Property TaxAssessment & ValuationAssessment Methods & TimingTax LawState & Local TaxesSales TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART II. LEGAL BACKGROUND
C. California Taxation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide §§ 12B.36-12B.99

[Reserved]

§§ 12B.36[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-12B California Legal Forms--Transaction Guide § 12B.100

§ 12B.100 Foreign Corporation Transacting Business in California

[1] Facts

1. General information concerning corporation:

a. Name, mailing address, and phone number of corporation.

b. Place and date of incorporation.

c. Whether corporation is in good standing in state of incorporation.

d. Address of principal executive office.

e. Address of principal business office in California, if any.

f. Names, titles, and business and residential addresses of corporate officers.

g. Names and addresses of shareholders.

h. Information concerning subsidiary or affiliate:
(1) Name.

(2) Address of principal executive office.

(3) Extent of ownership or control.

(4) Nature and extent of business carried on through each subsidiary or affiliate.

i. Name and address of any parent corporation.

j. Whether corporation is:

(1) Bank, lending institution, or financial corporation.

(2) Insurance company.

(3) Nonprofit corporation.

(4) Nonstock corporation.

(5) Federal corporation.

(6) Business association organized as trust.

k. Name and address of corporate bank accounts.

l. Name, address, and telephone number of accountant.

m. Name, address, and telephone number of insurance carriers.

n. Taxable year of corporation.

o. National securities exchanges on which corporation has securities listed.

p. Percentage of outstanding voting securities held of record by persons with California addresses.

q. Percentage of voting shares owned directly or indirectly by other corporations.

r. Location of board and shareholder meetings.

s. Location of corporate accounting books, records, and minutes.

t. Assumed or fictitious names currently or previously used by corporation.

u. Proposed agent for service of process:

(1) If individual, residential or business address.

(2) If corporation, business address.

v. Whether corporation has previously qualified to transact intrastate business in California.

w. Previously registered or reserved name in California, if any.

x. Whether corporation has previously been subject to California taxation.

y. Whether corporation has previously been subject to California regulation of internal affairs.

2. Facts relating to corporation's current activities:

a. Nature of corporation's current principal business activity.

b. Nature and extent of corporation's activities in other states.

c. Whether corporation's activities require license or registration.

d. Fiscal year used by corporation.

e. Value of all property owned or rented and used during income year.

f. Value of property, if any, owned or rented and used in California during income year.

g. Total compensation paid in all states during income year.

h. Total amount, if any, paid in California during income year for payroll compensation.

i. Total sales everywhere during income year.

j. Total sales, if any, in California during income year.

3. Facts relating to corporation's anticipated California activities:

a. Nature of business activities transacted or to be transacted in California.

b. If corporation is not currently transacting business in California, when it intends to begin.

c. Address of California office, if any.

d. Number and duties of employees to be located in California, if any.

e. Location and description of any property in California to be leased, rented, or purchased.

f. Name and address of any California distributors.

g. Name and address of any non-employee salespersons in California.

h. Whether corporation's activities in California will consist entirely of any of following:

(1) Participating in litigation or settlement.

(2) Holding board or shareholder meetings concerning internal affairs.

(3) Maintaining corporate bank account.

(4) Maintaining offices for transfer, exchange, and registration of securities.

(5) Making sales through independent contractors.

(6) Soliciting or procuring orders requiring acceptance outside of California.

(7) Creating debt, mortgages, liens, or securities interests on property.

(8) Making isolated transaction completed within 180 days.

(9) Purchasing personal property or services solely for corporation or affiliates.

(10) Sending employees to California educational institutions.

(11) Offering or selling securities in California.

i. If corporation is lending institution, whether its activities in California will consist entirely of any of following:

(1) Acquiring loans through activities carried on outside California.

(2) Making inspections and appraisals of property that secures loans by nonresident officer or employee.

(3) Owning and enforcing loans.

(4) Altering or selling loan arrangements, or releasing security for loans, by activities outside California.

(5) Contracting with firm qualified to do business in California to service loans.

(6) Acquiring title to property covered by security instrument.

j. Whether corporation will receive income from any of following activities in California:

(1) Purchasing or selling stocks and bonds.

(2) Endorsing notes of subsidiary corporation.

(3) Leasing real property.

(4) Liquidation activities.

(5) Maintaining and delivering stock of goods and taking orders for goods by employees in California.

(6) Receiving and distributing dividends and interest.

k. Whether corporation will receive income from any of following California sources:

(1) Real or tangible personal property.

(2) Ownership, control, or management of personal property.

(3) Stocks, bonds, notes, bank deposits, and other intangible personal property.

[2] Documents

1. Corporate charter documents:

    a. Articles.

    b. Bylaws.

    c. Resolutions.

2. Tax returns for previous five years:

    a. Federal.

    b. State of incorporation.

    c. California.

    d. Other states, if any.

3. Federal and state securities filings.

4. Leases or deeds to California real property.

5. Previous California qualification documents, if any.

6. Previous California name registration documents, if any.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-12B California Legal Forms--Transaction Guide § 12B.101

§ 12B.101 California Corporation Transacting Business in Other State

[1] Facts

1. General information concerning corporation [*see § 12B.100[1]*, P 1].

2. Facts relating to corporation's current activities [*see § 12B.100[1]*, P 2].

3. Facts relating to corporation's anticipated activities in other state:

a. List of other states where corporation will be transacting business.

b. Nature of business activities to be transacted in other state.

c. Address of office in other state, if any.

d. Number and duties of employees to be located in other state, if any.

e. Location and description of any property in other state to be leased, rented, or purchased.

f. Name and address of any distributors located in other state.

g. Name and address of any non-employee salespersons in other state.

h. Whether corporation's activities in other state will consist entirely of any of following:
(1) Maintaining, defending, or settling any proceeding.

(2) Carrying on internal corporate affairs.

(3) Maintaining corporate bank account.

(4) Maintaining offices or agencies for transfer, exchange, and registration of securities, or maintaining trustees or depositaries with respect to those securities.

(5) Making sales through independent contractors.

(6) Soliciting or obtaining orders requiring acceptance outside of California.

(7) Creating or acquiring debt, mortgages, or security interests on property.

(8) Securing or collecting debts or enforcing mortgages and security interests in property securing debts.

(9) Owning real or personal property.

(10) Making isolated transaction completed within 30 days.

[2] Documents

1. Corporate charter documents [*see § 12B.100[2]*].

2. Tax returns for previous five years:

    a. Federal.

    b. California.

    c. State where corporation intends to do or does business, if any.

    d. Other states, if any.

3. Federal and state securities filings.

4. Leases or deeds to real property in other state.

5. Previous qualification documents, if any.

6. Previous name registration documents, if any.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-12B California Legal Forms--Transaction Guide §§ 12B.102-12B.109

[Reserved]

§§ 12B.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-12B California Legal Forms--Transaction Guide § 12B.110

§ 12B.110 General Determinations for Foreign Corporations in California

1. Ascertain whether corporation is foreign corporation under California law:

a. Determine whether corporation incorporated under laws of any jurisdiction other than California.

NOTE:
A corporation formed under the laws of California is a "domestic corporation" [*Corp. Code § 167*]. Any other corporation, except a federal corporation in certain situations [***see*** P b, ***below***], is a "foreign corporation" [*Corp. Code § 171*].

b. Determine whether corporation is federal corporation.

NOTE:
A corporation chartered under federal law is a "foreign corporation" in California except with respect to laws governing the transaction of intrastate business [*Corp. Code § 171*; ***see*** *Corp. Code §§ 2100-2117*].

c. Determine whether corporation is nonprofit corporation.

NOTE:
The provisions of the General Corporation Law governing foreign corporations apply to foreign nonprofit corporations, except for provisions that expressly exclude nonprofit corporations [***see, e.g.,*** *Corp. Code § 2115*], and except as to matters otherwise provided for in the Nonprofit Corporation Law [*Corp. Code § 6910*; ***see*** *Corp. Code §§ 5000-10841*]. For further information, see *§ 12B.10[2][c]*.

d. Determine whether corporation is business association organized as trust under laws of foreign jurisdiction.

NOTE:

These foreign associations are considered foreign corporations for purposes of the provisions governing foreign corporations, except when otherwise provided [*Corp. Code §§ 170, 171*; ***see*** *Corp. Code §§ 191, 201, 2100-2117, 2203, 2258, 2259*].

2. Determine whether corporation is one of following organizations deemed to be foreign lending institution under California law [*Corp. Code § 191(d)*]:

NOTE:

Foreign lending institutions [***see*** *Corp. Code § 191(d)*] in California are subject to some different requirements than other foreign corporations [***see*** *§§ 12B.111* P 1, 12B.122]. Additionally, foreign lending institutions are permitted to carry on certain transactions without obtaining a certificate of qualification [***see, e.g.,*** *Corp. Code § 191(d)*; ***see also*** *§§ 12B.11[1][b][ii], 12B.122*].

a. Foreign banking corporation.

b. Foreign corporation whose capital stock is all owned by one or more foreign banking corporations.

c. Foreign savings and loan association.

d. Foreign insurance company.

e. Foreign corporation or association authorized by charter to invest in loans secured by real and personal property.

3. Determine whether corporation is bank or financial corporation.

NOTE:

A financial corporation is a corporation that predominantly deals in money or moneyed capital in substantial competition with the business of national banks, except that the term "financial corporation" does not include any corporation whose principal business activity consists of leasing tangible personal property [*18 Cal. Code Reg. § 23183(a)*; ***see*** *18 Cal. Code Reg. § 23183(b)*; *Rev. & Tax. Code § 23183(b)*]. Banks and financial corporations are subject to special rules concerning taxation. For more information, see *§ 12B.31[1][a], [5][b]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral Overview



30 of 177 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-12B California Legal Forms--Transaction Guide § 12B.111

§ 12B.111 Determinations Regarding California Filing Requirements

1. Determine whether corporation is required to obtain certificate of qualification from Secretary of State before carrying on its activities in California:

NOTE:
To qualify, the corporation must file a statement and designation and certificate of good standing and pay a filing fee [***see*** *Corp. Code § 2105*; ***see also*** *§ 12B.120*].

a. Ascertain if foreign corporation or association is chartered under federal law.

NOTE:
Federal corporations are not required to qualify in California [***see*** *Corp. Code § 171*].

b. Ascertain if corporation will transact intrastate business in California.

NOTE:
Qualification is a prerequisite to the transaction of intrastate business in California [*Corp. Code § 2105*]. A foreign corporation "transacts intrastate business" in California if it enters into repeated and successive transactions of its business in California, other than interstate or foreign commerce [*Corp. Code § 191(a)*]. Failure to obtain qualification before transacting intrastate business will result in various penalties [***see*** *§ 12B.13[2]*].

A foreign corporation is not considered to be transacting intrastate business merely because its subsidiary does so [*Corp. Code § 191(b)*]. Further, a foreign corporation is not considered to be transacting intrastate business merely because of its status as a shareholder of a domestic corporation or foreign corporation transacting intrastate

business, as a limited partner of a domestic limited partnership or foreign limited partnership transacting intrastate business, or as a member or manager of a domestic limited liability company or a foreign limited liability company transacting intrastate business [Corp. Code § 191(b)]. The transaction of purely interstate business does not require qualification [***see*** *Corp. Code § 2105*; *Atlantic Refining Co. v. Virginia (1937) 302 U.S. 22, 26, 58 S. Ct. 75, 82 L. Ed. 24* ; ***see also*** *§ 12B.20[2]*].

c. Ascertain whether activities of corporation in California consist solely of one or more of the following:

NOTE:

A foreign corporation will not be considered to be transacting intrastate business solely because it carries on the following activities [*Corp. Code § 191(c)*; ***see*** *§ 12B.11[1][b]*]. However, this list does not include all possible activities that do not constitute the transaction of intrastate business [***see*** *Corp. Code § 191(c)*; ***see e.g.,*** *United Systems of Arkansas, Inc. v. Stamison (1998) 63 Cal. App. 4th 1001, 1007, 74 Cal. Rptr. 2d 407* (simply submitting bid in response to request for quotation by DMV held not to be "transacting intrastate business"; out-of-state bidder could maintain suit challenging award of contract to another bidder without obtaining certificate of qualification from Secretary of State)].

(1) Maintaining or defending any action, suit, or administrative or arbitration proceeding, or settling any such proceeding or other claim or dispute.

(2) Carrying on internal affairs, including holding meetings of its board or shareholders.

(3) Maintaining bank accounts.

(4) Maintaining offices or agencies for transfer, exchange, and registration of its securities or depositaries.

(5) Effecting sales through independent contractors.

(6) Soliciting or procuring orders that require acceptance outside of California.

(7) Creating evidences of debt, mortgages, liens, or security interests on real or personal property.

(8) Conducting isolated transaction that:

(a) Is completed within period of 180 days; and

(b) Is not in course of repeated transactions of like nature.

d. If corporation is foreign lending institution [*see § 12B.110,* P 2], ascertain whether its actions in California consist solely of one or more of following:

NOTE:

A foreign lending institution is not considered to be transacting intrastate business solely because it engages in any of the following activities, whether (1) on its own behalf, (2) as a trustee of a pension

plan, employee profit-sharing or retirement plan, testamentary or inter vivos trust, or (3) in any other fiduciary capacity [*Corp. Code § 191(d)*]. However, this list does not include all possible activities that do not constitute transacting intrastate business [***see** Corp. Code § 191(d)*].

A foreign lending institution will not be required to qualify, or be subject to any provisions of the Bank and Corporation Tax Law [***see** Rev. & Tax. Code § 23001 et seq.*] or the Corporations, Financial, or Insurance Codes relating to the transaction of intrastate business solely by engaging in one or more of the following activities [*Corp. Code § 2104*; ***see** Corp. Code § 191(d)*]. However, such an institution will be deemed to have appointed the Secretary of State as its agent for service of process [*Corp. Code § 2104*].

(1) Acquiring loans, or any interest in loans, through activities carried on outside California by:

(a) Purchase.

(b) Contract to purchase.

(c) Advance commitments to purchase.

(d) Assignment of loans.

(2) Making physical inspection and appraisals of real or personal property securing or proposed to secure any loan, by officer or employee who:

(a) Is not California resident; and

(b) Does not maintain place of business in California for purposes of inspections and appraisals.

(3) Owning and enforcing loans.

(4) Altering loan arrangements through following activities carried on by institution from outside California:

(a) Modification.

(b) Renewal.

(c) Extension.

(d) Transfer or sale.

(e) Acceptance of additional or substitute security.

(f) Full or partial release of security.

(g) Acceptance of substitute or additional obligors.

(5) Contractually engaging qualified corporation, firm, or association to:

NOTE:

The entity engaged cannot be a subsidiary or parent of the lending institution, or under common management with the lending institution [*Corp. Code § 191(d)(5)*].

(a) Make collections.

(b) Service loans in any manner.

(c) Pay ground rents, taxes, assessments, or insurance.

(d) Make physical inspections and appraisals of real or personal property securing or proposed to secure any loans on behalf of institution.

(6) Acquiring and retaining (pending disposition) title to real or personal property covered by mortgage, deed of trust, or other security instrument:

(a) By trustee's sale, judicial sale, foreclosure, or deed in lieu of foreclosure.

(b) For purpose of transferring title to any federal agency or instrumentality as insurer or guarantor of loan.

(7) Engaging in activities necessary or appropriate to carry out any of foregoing activities.

2. If corporation is other than foreign association [*see Corp. Code § 170*], determine whether corporation should register or reserve its name with Secretary of State [*see § 12B.121*]:

NOTE:

The name registration procedures do not apply to foreign associations [*Corp. Code § 2101(a)*].

Name reservation, as opposed to registration, will reserve a corporation's name for 60 days only on a non-renewable basis [***see** Corp. Code § 201(c)*]. Therefore, this procedure is used primarily in advance of registration or qualification [***see** §§ 12B.120, 12B.121*].

a. Ascertain whether corporation intends to transact intrastate business in California, but not in immediate future.

NOTE:

Registration of a foreign corporation's name prevents any other corporation from incorporating or qualifying under that name through the end of the calendar year, or subsequent years for which the registration is renewed [***see** Corp. Code §§ 201(b), 2101(b)*].

b. Ascertain that corporation is not transacting intrastate business in California [*see* P 1, *above*; *see also § 12B.11[1][b]*].

NOTE:

Name registration procedures apply only to corporations that do not transact intrastate business [*Corp. Code § 2101*]. The names of foreign corporations that qualify in

California are already protected to the same extent as those of domestic corporations [***see*** *Corp. Code § 201(b)*].

c. Ascertain whether corporation's name would be available to new corporation under General Corporation Law [*see §§ 12B.11[2][b], 12B.120*, PP 3, 4].

NOTE:

A foreign corporation can register a corporate name only if the name would be available to a new corporation [*Corp. Code § 2101(a)*; ***see*** *Corp. Code § 201*].

3. If corporation is foreign lending institution [*see § 12B.110*, P 2], determine whether it is required to file annual statement of address for service of process with Secretary of State [*Corp. Code § 2104*; *see § 12B.122*]:

a. Ascertain whether institution is qualified to transact intrastate business in California [*see §§ 12B.11[2], 12B.120*].

NOTE:

Qualified foreign lending institutions are not required to file this statement [*Corp. Code § 2104*]. Qualified foreign corporations must follow specific procedures regarding an agent for service of process [***see*** *§§ 12B.120* P 7, 12B.132].

b. Ascertain whether institution will engage in any of specified activities that do not require qualification in California [*see* P 1d, *above*].

NOTE:

A foreign lending institution that engages in certain activities [***see*** *Corp. Code § 191(d)*; ***see also*** P 1d, ***above***] is deemed to have appointed the Secretary of State as its agent for service of process, and must notify the Secretary of its address for receipt of process [*Corp. Code § 2104*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-12B California Legal Forms--Transaction Guide § 12B.112

§ 12B.112 Determinations Regarding Filing Requirements in Other States

NOTE:

To advise California corporations intending to transact business in other states, it is essential to consult the other state's business and corporations statutes. Although many statutes are based on the Model Business Corporation Act or the revised Act, state requirements can, and often do, vary widely.

1. Determine whether level of corporate activity proposed to be undertaken in other state would render corporation subject to jurisdiction by other state.

NOTE:

Whether a corporation's activities are sufficient to subject it to the other state's jurisdiction depends on whether the corporation's activities supply the necessary "minimum contacts" and whether the exercise of jurisdiction offends traditional notions of fair play and substantial justice [*International Shoe Co. v. Washington (1945) 326 U.S. 310, 316-319, 66 S. Ct. 154, 90 L. Ed. 95* ; ***see*** *McGee v. International Life Ins. Co., 355 U.S. 220, 222-224, 78 S. Ct. 199, 2 L. Ed. 2d 223 (1957)* .] For further information, see *§§ 12B.15* and *12B.20*.

2. Determine whether level of corporate activity proposed to be undertaken in other state would render corporation subject to taxation by other state.

NOTE:

A state's power to tax a foreign corporation engaged in interstate commerce generally depends on whether the corporation's activities create a sufficient "nexus" between the tax and the transactions within the state, and on whether the state's tax is non-discriminatory and properly apportioned to local activities within the state [*Northwestern States*

Portland Cement Co. v. Minnesota, 358 U.S. 450, 452, 464-465, 79 S. Ct. 357 (1959)] However, states are prohibited by from taxing a foreign taxpayer's income from interstate commerce if the only business activities of the taxpayer within the state consist of solicitation, by or for the taxpayer, of orders for tangible personal property [***see*** *15 U.S.C. §§ 381-384*; ***see also*** *§ 12B.20[2][c]*].

3. Determine whether level of corporate activity proposed to be undertaken in other state would render corporation subject to other state's qualification requirement:

NOTE:

States require different levels of activity to subject a corporation to their qualification requirement. The greater the level of corporate activity, the more likely that qualification will be required. Most statutes provide a list of activities that do not require qualification [***see*** *§ 12B.20*][3]]. To determine whether qualification would be required because of a particular activity, it is necessary to consult the case law of the jurisdiction.

If a corporation will be transacting purely interstate business, it need not qualify [***see*** *Atlantic Refining Co. v. Virginia (1937) 302 U.S. 22, 26, 58 S. Ct. 75, 82 L. Ed. 24* ; ***see also*** *§ 12B.20[2]*].

a. Ascertain whether corporation is considered foreign corporation under other state's statute.

NOTE:

A corporation that is not organized under the laws of the other state is not always considered a foreign corporation. For example, in California, corporations chartered under federal law, foreign associations, and foreign nonprofit corporations are not always subject to the same regulations as other foreign corporations [***see, e.g.,*** *Corp. Code §§ 171, 2115, 6910*].

b. Ascertain whether corporation's proposed activities in other state are permitted without qualification [*see* P 1, *above*].

c. If corporation is lending institution, ascertain whether other state's statutes permit foreign corporations to lend money without qualifying.

NOTE:

In addition to listing activities of general corporations that do not require qualification, many statutes permit unqualified foreign corporations to lend money to residents [***see, e.g.,*** Kan. Stat. Ann. § 17-7305; Wash. Rev. Code Ann. §§ 23B.18.010-23B.18.030; Wis. Stat. Ann. § 180.801(2); ***see*** *§ 12B.20[3]*].

4. Determine whether other state permits registration or other protection for corporate name in advance of qualifying [*see § 12B.121*].

5. If corporation does not need to qualify, determine whether other state requires any other kind of filing to transact business [*see, e.g., Corp. Code § 2104*; Md. Corps. & Ass'ns Code Ann. § 7-202 (unqualified foreign corporations must register before doing interstate business)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-12B California Legal Forms--Transaction Guide § 12B.113

§ 12B.113 Determinations Regarding Regulation of Internal Corporate Affairs

1. Determine whether corporation is required to comply with California laws applicable to nominally foreign corporations [*see §§ 12B.14[1][e], 12B.136*].

NOTE:

Nominally foreign corporations are corporations whose connections with California are sufficient to justify extensive regulation of their internal affairs, to the exclusion of the law of the jurisdiction in which they are incorporated [***see*** *Corp. Code § 2115*; ***see also*** cautionary note in § 12B.14[1][a] regarding ***VantagePoint Venture Partners 1996 v. Examen, Inc.*** *(Del. 2005) 871 A.2d 1108, 2005 Del. LEXIS 179* , a Delaware case in which *Corp. Code § 2115* was found to be unconstitutional and inapplicable to a Delaware corporation].

a. Ascertain whether corporation is exempt from nominally foreign status as:

(1) Foreign association [*see Corp. Code § 2115(a)*].

(2) Foreign nonprofit corporation [*see Corp. Code § 2115(a)*].

(3) Foreign corporation with outstanding securities meeting one of following criteria [*see Corp. Code § 2115(c)*; *see Corp. Code § 25100(o)*]:

(a) Listed on New York Stock Exchange;

(b) Listed on NYSE Amex;

(c) Listed on NASDAQ Global Market;

(d) Listed on NASDAQ Capital Market.

(4) Foreign corporation in which all voting shares (other than directors' qualifying shares) are owned directly or indirectly by any corporation or corporations not subject to provisions governing nominally foreign corporations [*see Corp. Code § 2115(c)*].

b. If corporation is parent, ascertain whether its subsidiary is transacting intrastate business in California.

NOTE:
Only corporations transacting intrastate business are subject to nominally foreign status [***see*** *Corp. Code § 2115(a)*; ***see also*** *Corp. Code § 2100*]. However, a foreign parent corporation may be nominally foreign, even though it does not itself transact intrastate business [*Corp. Code § 2115(a)*].

c. Determine whether average of following factors was more than 50 percent during corporation's latest full income year:

NOTE:
This test measures whether the foreign corporation does more than half of its business in California [***see*** *Corp. Code § 2115* (Legislative Committee Comment (1975)--Assembly)]. The following computation involves figures already generated for the corporation's franchise tax returns [***see*** *Corp. Code § 2115(a)*; ***see also*** *Rev. & Tax. Code § 25128*].

If allocation of the foreign corporation's income is governed by a special formula, or if the corporation is not required to file separate tax returns or any tax returns, the corporation must use the factors that would have been used if it were governed by the following formula [*Corp. Code § 2115(a)*]. For further information, see *§ 12B.14[1][c]*. For a complete discussion, see Ballantine & Sterling, California Corporation Laws, Ch. 22, ***Corporate Franchise and Income Taxes in California*** (Matthew Bender).

(1) Property factor, comprised of [*Rev. & Tax. Code § 25129*; *see Corp. Code § 2115(a)(1)*]:

(a) Average value of taxpayer's real and tangible personal property owned or rented and used in California during taxable year, over

(b) Average value of all of taxpayer's real and tangible personal property owned or rented and used during taxable year.

(2) Payroll factor, comprised of [*Rev. & Tax. Code § 25132*; *see Corp. Code § 2115(a)(1)*]:

(a) Total amount paid by taxpayer in California during taxable year for compensation, over

(b) Total compensation paid in all states during taxable year.

(3) Sales factor, comprised of [*Rev. & Tax. Code § 25134*; *see Corp. Code § 2115(a)(1)*]:

(a) Taxpayer's total sales in California during taxable year, over

(b) Taxpayer's total sales everywhere during taxable year.

NOTE:

If the corporation is a parent corporation, the determination of the factors described above will be made on a consolidated basis, including in a unitary computation (after elimination of intercompany transactions) the property, payroll, and sales of the parent and all of its subsidiaries in which it owns directly or indirectly more than 50 percent of the outstanding shares entitled to vote for the election of directors, but deducting a percentage of those factors of any subsidiary equal to the percentage minority ownership, if any, in that subsidiary [*Corp. Code § 2115(a)(2)*].

d. Ascertain whether more than 50 percent of corporation's outstanding voting securities are held of record by persons with California addresses, as appearing on corporation's books on record date for latest meeting of shareholders held during its latest full income year or, if no meeting was held during that year, on last day of latest full income year [*Corp. Code § 2115(a)(2)*].

NOTE:

Any securities held to the knowledge of the issuer in the names of broker-dealers, nominees for broker-dealers (including clearing corporations), banks, associations, or other entities holding securities on behalf of a beneficial owner will not be considered outstanding [*Corp. Code § 2115(a)*]. However, such shares may be considered outstanding if the nominee holder certifies the number of shares held for the beneficial owners both inside and outside California [*Corp. Code § 2115(a)(2)*; ***see*** *§ 12B.14[1][c][ii]*].

2. Determine whether corporation is required to comply with California laws applicable to resident foreign corporations [*see Corp. Code § 2115(b)*; *see also § 12B.137*].

NOTE:

Even if a foreign corporation's contacts with California are less extensive than those maintained by a nominally foreign corporation [***see*** P 1, ***above***], in certain circumstances it must also comply with the shareholder and director inspection rights [***see*** *Corp. Code §§ 1501*, *1600*, *1602*; ***see also*** *§ 12B.138*], requirements normally applicable only to domestic corporations [***see*** *§ 12B.14[2]*].

a. Determine whether corporation is exempt from resident foreign corporation status.

NOTE:

For purposes of these requirements, the term "foreign corporation" does not include foreign associations [*Corp. Code § 171*; ***see*** *Corp. Code §§ 1501(g)*, *1600(d)*, *1601(a)*, *1602*].

b. Ascertain whether corporation will do either of following:

NOTE:

A corporation maintaining the following contacts with California must comply with the provisions regarding the right of shareholders to inspect and copy the shareholder list [***see*** *Corp. Code § 1600(d)*], the requirement of an annual report [***see*** *Corp. Code § 1500(g)*], and the directors' right to inspect records and physical properties [***see*** *Corp. Code § 1602*; ***see also*** *§ 12B.138*].

(1) Have its principal executive office in California.

(2) Customarily hold board meetings in California.

c. Ascertain whether corporation will do either of following:

NOTE:
A corporation maintaining the following contacts with California must allow its shareholders to inspect its accounting books, records, and minutes [*Corp. Code § 1601(a)*; ***see*** *Corp. Code §§ 1508, 1603*; ***see also*** *§ 12B.138*].

(1) Have its principal executive office in California.

(2) Keep its corporate accounting books, records, or minutes in California.

3. If California corporation is transacting or planning to transact business in other state, determine whether other state has provisions governing nominally or resident foreign corporations [*see* PP 1, 2, *above*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-12B California Legal Forms--Transaction Guide § 12B.114

§ 12B.114 Determinations Regarding State Taxation

1. If corporation is California corporation transacting or intending to transact business in other state, consult other state's tax laws to determine which taxes, if any, corporation will be subject to, based on level of business activity in other state.

NOTE:

A state may tax a foreign corporation engaged in interstate commerce if the corporation's activities create a sufficient "nexus" between the tax and the transactions within the state, and if the state's tax is non-discriminatory and properly apportioned to local activities within the state [*Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 452, 464-465, 79 S. Ct. 357 (1959)* .] States are prohibited from taxing a foreign taxpayer's income that is derived from interstate commerce if the only business activities of the taxpayer within the state consist of solicitation, by or for the taxpayer, of orders for tangible personal property [***see*** *15 U.S.C. §§ 381-384*; ***see also*** *Brown Group Retail, Inc. v. Franchise Tax Board (1996) 44 Cal. App. 4th 823, 838, 52 Cal. Rptr. 2d 202* (immunity not available when employees of independent retail distributor division in California went beyond mere solicitation); § 12B.20[2][c]].

2. If foreign corporation is doing or will do business in California, determine whether corporation is subject to California franchise tax [*see Rev. & Tax. Code § 23101*]:

NOTE:

A foreign corporation subject to the state franchise tax must file an annual return and pay any amount due [***see*** *§ 12B.130*] unless it is eligible for exemption or exclusion from tax [*Rev. & Tax. Code § 23151*; ***see*** P 4, ***below***].

a. For taxable years beginning before January 1, 2011, ascertain whether corporation will "do business" in California by actively engaging in any transaction for the purpose of financial or pecuniary gain or profit, including [*see Rev. & Tax. Code § 23101(a)*; *18 Cal. Code Reg. § 23101*]:

NOTE:
The term "doing business" is much broader than the term "transacting intrastate business"; it does not require that the corporation maintain a regular course of business or transactions [*Hise v. McColgan (1944) 24 Cal. 2d 147, 151, 148 P.2d 616]* . A corporation holding or organized to hold stock or bonds of other corporations that will engage in no activities other than receipt and disbursement of dividends or interest is not "doing business" [*Rev. & Tax. Code § 23102*].

(1) Buying or selling stocks or bonds.

(2) Endorsing notes of subsidiary corporation.

(3) Leasing real property to subsidiary corporations or to other tenants.

(4) Liquidating activities such as selling or renting property or collecting on notes.

b. For taxable years beginning on or after January 1, 2011, ascertain whether corporation will "do business" in California because any of the following apply [Corp. Code § 23101(b)]:

(1) Taxpayer is organized or commercially domiciled in California.

(2) Sales [*see Rev. & Tax. Code § 25120(e),(f)*] for taxable year in California exceed lesser of $500,000 or 25 percent of taxpayer's total sales.

(3) Real property and tangible personal property of taxpayer in California exceed lesser of $50,000 or 25 percent of taxpayer's total real property and tangible personal property.

(4) Amount paid in California by taxpayer for compensation [*see Rev. & Tax. Code § 25120(c)*] exceeds lesser of $50,000 or 25 percent of total compensation paid by the taxpayer.

c. Ascertain whether corporation will obtain certificate of qualification to transact intrastate business [*see § 12B.111,* P 1].

NOTE:
A foreign corporation is deemed to be "doing business" and is therefore subject to the franchise tax if it obtains a certificate of qualification, even if it does not actually transact intrastate business [***see*** *18 Cal. Code Reg. § 23151*].

d. If corporation will not obtain certificate of qualification, ascertain if it will transact purely interstate business [*see § 12B.20[2][a]*].

NOTE:
A foreign corporation engaging entirely in interstate commerce is not subject to the

franchise tax [***see*** *18 Cal. Code Reg. § 23101*]. For further discussion, see *§ 12B.20[2]*.

3. If foreign corporation is receiving or will receive income from California sources, determine whether corporation is required to pay California corporate income tax.

NOTE:
A corporation subject to the state corporate income tax must file an annual return and pay any amount of tax due [*Rev. & Tax. Code § 23501*; ***see*** *§§ 12B.32, 12B.130*] unless it is eligible for exemption or exclusion from tax [***see*** P 4, ***below***].

a. Ascertain whether corporation is not subject to corporate income tax on either of following bases:

(1) Corporation is subject to franchise tax.

NOTE:
The corporate income tax applies to corporations other than banks on net income derived from sources in California other than income subject to the franchise taxation [*Rev. & Tax. Code § 23501(a)*; ***see*** *Rev. & Tax. Code § 23181 et seq.* (banks and financial corporations subject to franchise tax)].

(2) Corporation's income in interstate commerce derives from business activities in California consisting only of soliciting orders for tangible personal property to be filled from inventories maintained outside California [*see 15 U.S.C. §§ 381-384*; *see also § 12B.32*].

b. Ascertain whether corporation will derive income from sources in California, including following:

NOTE:
All corporate income, other than that subject to the franchise tax and that of banks, that is derived from sources within California, whether in intrastate, interstate, or foreign commerce, is subject to income taxation [*Rev. & Tax. Code § 23501(a)*; *18 Cal. Code Reg. 23040(a)*].

(1) Rents and gains from sale of real or tangible personal property located in California, regardless of where transaction is consummated.

(2) Ownership, control, or management of real or personal property located in California.

(3) Business or activities carried on in California.

(4) Stocks, bonds, notes, bank deposits, and other intangible personal property with business situs in California.

(5) Portion of income derived from business carried on between California and other states that is attributable to California sources.

4. Determine whether foreign corporation is eligible for exemption or exclusion from California franchise or income tax on one of following bases:

a. Corporation is nonprofit organization [*see Rev. & Tax. Code § 23701 et seq*].

NOTE:

Certain nonprofit organizations are exempt from both the franchise and income tax. However, the organization must apply for exempt status [*Rev. & Tax. Code § 23701(a)*]. For further information, see *§ 12B.33[2]*. For a detailed discussion of exemption, see Ch. 13B, ***Tax-Exempt Status for Nonprofit Entities*** .

b. Corporation's activities are limited to one or both of following [*Rev. & Tax. Code § 23101.5*]:

NOTE:

A corporation that does not engage in any other activities in California may petition the Franchise Tax Board for a determination that it is not doing business for franchise tax purposes [***see*** P 2, ***above***], or is not deriving income from sources within California for income tax purposes [***see*** P 3, ***above***], and is therefore exempt from the franchise tax [*Rev. & Tax. Code § 23101.5(a)*; ***see*** *18 Cal. Code Reg. 23101.5(a)- (c), (e)*; ***see also*** *§§ 12B.130*, P 3, 12B.260 (petition)].

(1) Presence of employees in California for sole purpose of attending public or private school, college, or university [*Rev. & Tax. Code § 23101.5(a)(2)*].

(2) Purchase of personal property or services solely for its own use or use by its affiliate outside California if following three conditions are satisfied:

(a) Corporation does not have more than 100 employees in California, and their duties are limited to solicitation, negotiation, liaison, monitoring, auditing, and inspecting the personal property or services acquired, or providing technical advice with respect to its requirements [*Rev. & Tax. Code § 23101.5(a)(1)(A)*].

(b) Corporation does not have more than 200 employees in California, whose duties are limited to solicitation, negotiation, liaison, monitoring, auditing, and inspecting the personal property or services acquired, or providing technical advice with respect to its requirements, and corporation or its affiliate uses the personal property or property for construction or modification of physical plant or facility located outside California [*Rev. & Tax. Code § 23101.5(a)(1)(B)*].

(c) Combined number of employees in California described in paragraphs (a) and (b) does not exceed 200 [*Rev. & Tax. Code § 23101.5(a)(1)(C)*].

NOTE:

When the corporation is engaged in a unitary business, the limitation of 100 or 200 employees must be applied to the aggregation of all corporations in the unitary group [*Rev. & Tax. Code § 23101.5(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxComputationBusiness & Corporate LawCorporationsFinanceFranchise TaxExemptionsBusiness & Corporate LawForeign BusinessesQualificationsTax LawState & Local TaxesFranchise TaxImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-12B California Legal Forms--Transaction Guide §§ 12B.115-12B.119

[Reserved]

§§ 12B.115[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12B California Legal Forms--Transaction Guide § 12B.120

§ 12B.120 Qualification to Transact Intrastate Business in California

NOTE:

The following procedures apply only to those foreign corporations that "transact intrastate business" in California [***see** Corp. Code § 191* (definition); ***see also** § 12B.111*, P 1]. When a corporation has met all of the applicable requirements, the Secretary of State will issue a certificate of qualification [***see** Corp. Code § 2106(a)*]. A corporation that transacts intrastate business without first obtaining qualification is subject to monetary and other penalties [***see** § 12B.13[2]*].

For procedures governing qualification in other states, consult the other state's statutes and the secretary of state's office.

1. Instruct corporation's board of directors to adopt resolution that does following [*see § 12B.200*]:

NOTE:

The form and manner of adoption of the resolution are governed by the laws of the jurisdiction in which the corporation was incorporated.

a. Authorizes qualification of corporation to transact intrastate business in California.

b. Selects agent for service of process who meets following requirements [*see Corp. Code §§ 1502(b), 1505, 2105(c)*]:

(1) Natural person residing in California; or

(2) Corporation that meets all of following criteria:

(a) Is currently authorized to engage in business in California;

(b) Is in good standing on records of Secretary of State; and

(c) Has filed certificate of consent [*see Corp. Code §§ 1502(b), 1505, 2105(c)*].

NOTE:
A corporation cannot be named as agent for service of process for itself.

On designation of the agent, the corporation should give the agent written instructions regarding the transmittal of any process received [***see** § 12B.205*].

c. Submits several assumed names under which corporation could do business in California if actual name is unavailable [*see* P 6, *below*].

2. If corporation is foreign insurer [*see Ins. Code §§ 23, 27*]:

a. File and maintain designation of agent for service of process in office of Insurance Commissioner [*Corp. Code § 2103*; *see Ins. Code §§ 1600-1605*].

b. Obtain certificate from Insurance Commissioner approving use of name under which it proposes to transact business in California [*Corp. Code § 2103*; *see Ins. Code § 881*].

NOTE:
The Secretary of State will not file any statement and designation [***see*** P 7, ***below***] of an insurer subject to the Insurance Code unless a certificate of the Insurance Commissioner approving the corporate name is attached [*Corp. Code § 2106.5*; ***see** Ins. Code §§ 800-886*]. The provisions regarding a foreign corporation's name [***see*** P 3, ***below***] do not apply to a foreign insurer unless it has first obtained that certificate [*Corp. Code § 2106(b)*].

3. Verify with Secretary of State that corporation's name is [*see Corp. Code § 2106(b)*; *see also Corp. Code § 201(b)*]:

NOTE:
Preliminary inquiries may be made in writing or by telephone. Written requests for the availability of up to three names, in order of preference, should be sent to Secretary of State, Business Filings, 1500 11th Street, Sacramento, CA 95814, Attention: Name Availability Unit [***see*** Secretary of State website at http://www.ss.ca.gov/business/corp/corp_naav2.htm]. A request will typically be processed in two to four working days after the date of receipt.

A telephone request, may be made to the Secretary of State's Name Availability Unit, provided that the client has established a prepaid priority account. Special fees apply [***see** 2 Cal. Code Reg. § 21903*].

a. Not likely to mislead public.

b. Not same as, or resembling so closely as to tend to deceive:

(1) Name of domestic corporation.

(2) Name of foreign corporation that:

(a) Is authorized to transact intrastate business; or

(b) Has registered its name with Secretary of State [*Corp. Code § 2101*].

(3) Name that foreign corporation has assumed [*see Corp. Code § 2106(b)*].

(4) Name that will become record name of domestic or foreign corporation on effective date of filed corporate instrument [*see Corp. Code §§ 110(c), 5008(c)*].

(5) Name under reservation for another corporation [*see Corp. Code §§ 201, 5122, 7122, 9122*].

NOTE:

If the proposed name is substantially the same as that of an existing domestic corporation, an authorized foreign corporation, or a foreign corporation that has registered its name [***see*** *Corp. Code § 2101*; ***see also*** *§ 12B.121*], the name may be available for use if the other corporation consents [***see*** P 5, ***below***].

4. If selected name does not conflict with any other corporate name on file with Secretary of State [*see* P 3, *above*]:

a. Reserve proposed name with Secretary of State [*see Corp. Code § 201(c)*]:

NOTE:

Because a name reservation is effective for only 60 days, it should be timed so that the statement and designation [***see*** P 7, ***below***] will be filed within 60 days after the reservation [***see*** *Corp. Code § 201(c)*]. For a detailed checklist of procedures for name reservation, see Ch. 2, ***Preincorporation Planning*** .

(1) By mail.

NOTE:

Reservations by mail should be sent to Secretary of State Business Filings, 1500 11th Street, Sacramento, CA 95814, Attention: Name Availability Unit [***see*** instructions for Name Reservation Request Form on Secretary of State website at http://www.ss.ca.gov/business/corp/pdf/naavreservform.pdf].

(2) In person, over counter at the Sacramento office of the Secretary of State.

(3) By telephone.

NOTE:

Approved corporate names may be reserved via telephone if a prepaid priority account has previously been established. Special fees apply [***see*** Secretary of State website at http://www.ss.ca.gov/business/corp/corp_naav2.htm].

b. Pay filing fee [*Gov. Code § 12186(a)*].

NOTE:

There is a fee for each name to be reserved by mail. There is an additional special handling fee for each name to be reserved over the counter [***see*** *2 Cal. Code Reg. § 21903(b)(3)*].

5. If name is substantially same as name of domestic corporation or foreign corporation that has qualified or registered its name, and consent to name's use has been obtained from other corporation [*see Corp. Code § 201(b)*; *see also Corp. Code § 2106(b)*]:

a. File proof of consent by other corporation.

b. Obtain finding by Secretary of State that under circumstances public is not likely to be misled.

6. If name conflicts with name of any other corporation on file with Secretary of State [*see* P 3, *above*], and other corporation does not consent to name's use, either [*see Corp. Code § 2106(b)*]:

a. Obtain and file order from court of competent jurisdiction permanently enjoining corporation with conflicting name from doing business in California under that name [*see* California Forms of Pleading and Practice, Ch. 303, *Injunctions* (Matthew Bender)]; or

b. Do all of following:

(1) Select assumed name under which corporation will do business by:
(a) Adding distinguishing word or words acceptable to Secretary of State to actual corporate name; or

(b) Selecting another name available to new domestic corporation [*see Corp. Code § 201(b)*; *see also* P 3, *above*] that does not conflict with any corporate name on file with Secretary of State.

(2) Obtain finding from Secretary of State, on proof by affidavit or otherwise as Secretary determines, that:

(a) Corporate business to be conducted in California is not same as or similar to business conducted by corporation with conflicting name; and

(b) Public is not likely to be deceived.

(3) Have corporation agree to:

NOTE:
This agreement is set forth in the statement and designation [***see § 12B.201[2]***].

(a) Transact business in California under assumed name disclosed to Secretary of State; and

(b) Use assumed name in all its dealings with Secretary of State and in conduct of its affairs in California.

NOTE:
A corporation that makes such an agreement with the Secretary of State may do business in California only under the agreed name as long as the agreement is in effect [*Corp. Code § 2106(b)(2)*].

If the foreign corporation uses a name that differs from the name stated in its filed articles, and regularly

transacts business for profit in California under that name, it must also file a fictitious name statement within 40 days from the time it begins transacting business [*Bus. & Prof. Code §§ 17900(b)(3), 17910* ***see*** Ch. 1A, ***Role of Counsel in Starting a New Business***].

7. File statement and designation with Secretary of State in following manner [*see Corp. Code § 2105*]:

NOTE:

Expedited filing services are also available [***see*** *2 Cal. Code Reg. § 21905*]. For procedures for expedited filing, see P f, ***below***.

a. If desired, submit statement and designation form for preclearance as follows [*2 Cal. Code Reg. § 21904(c)*]:

NOTE:

The statement and designation form may be precleared for filing with the Secretary of State [*2 Cal. Code Reg. § 21904(a)(3)*]. "Preclearance" is a written determination by the Secretary of State that an eligible document submitted for review prior to an intended filing date, conforms to law within the meaning of the applicable sections of the code under which it is intended to be filed, and will be filed when the eligible document is submitted for filing, if all the applicable requirements are satisfied [*2 Cal. Code Reg. § 21904(a)(5)*]. Preclearance is an optional procedure.

A precleared document may be submitted to the Secretary of State for filing through the usual filing process [***see*** PP b-e, ***below***], the special handling provisions [***see*** *2 Cal. Code Reg. § 21903*], or the expedited filing provisions [***see*** *2 Cal. Code Reg. § 21905*; ***see also*** P f, ***below***]. To submit a precleared document for filing with the Secretary of State, the person seeking filing must submit (1) the completed document, containing the required signatures; (2) two copies of the document; (3) a copy the preclearance response; (4) the requisite filing fee; and (5) the requisite special handling fee or expedited filing fee, if applicable. The review of a document that has received a preclearance generally will be limited to the following determinations: (1) whether any changes have been made to the document since the preclearance was issued; (2) whether all designated blank spaces, if any, in the preclearance version have been completed and, if not, whether the failure to complete that information causes the document not to conform to law; and (3) whether the eligible document has been signed and, to the extent required by law, verified or acknowledged, in accordance with the applicable provisions related to its execution [*2 Cal. Code Reg. § 21904(d)(1)- (3)*].

If the Secretary of State determines that a precleared document submitted for filing does not conform to law, the filing response must state the reason or reasons for the return of the document [*2 Cal. Code Reg. § 21904(d)(4)*].

(1) Personally deliver one copy of document in form for which preclearance is sought to Secretary of State's Sacramento office.

(2) Include applicable filing fee [*see 2 Cal. Code Reg. § 21904(c)(8)*].

(3) Include statement that does all of following [*2 Cal. Code Reg. § 21904(c)(1)*]:
(a) Identifies class of service requested [*see 2 Cal. Code Reg. § 21904(c)(7)* (classes I through IV of service)].

NOTE:
Filing fees are based on the class of service requested [***see** 2 Cal. Code Reg. § 21904(c)(8)*].

(b) States preferred means of delivery of preclearance response [*see 2 Cal. Code Reg. § 21904(c)(9)*].

(c) Gives name and telephone number of person to whom any questions regarding document or type of service requested may be addressed.

NOTE:
After receipt of an eligible document, the Secretary of State will issue a preclearance response within the time period for the requested class of service [*2 Cal. Code Reg. § 21904(c)(3)*; ***see** 2 Cal. Code Reg. § 21904(c)(7)* (time periods for classes of service)]. This time period ranges from 24 hours for Class I service to 10 business days for Class IV service [*2 Cal. Code Reg. § 21904(c)(7)*].

b. Complete form [*see §§ 12B.201* (foreign corporation), 12B.203 (foreign association)].

c. Attach appropriate certificate of good standing, as follows [*see Corp. Code § 2105(b)*]:

NOTE:
The certificate must be an original, dated no more than six months before the anticipated qualification date. The name of the corporation as it appears on the good standing certificate must agree exactly with the name of the corporation as set forth in the statement and designation, including punctuation and abbreviations see Secretary of State website at http://www.ss.ca.gov/business/corp/corp_filetips.htm. Charter documents certified by the public officer of the corporation's state of incorporation are not acceptable substitutes [***see** Secretary of State website at http://www.ss.ca.gov/business/corp/corp_sdcinfo.htm (general stock corporation) and http://www.ss.ca.gov/business/corp/corp_sdcnpinfo.htm (nonprofit corporation)].

(1) For foreign corporations other than foreign associations, certificate by authorized public official of state or place of incorporation stating that foreign corporation is existing corporation in good standing in that state or place [*see § 12B.202* (request for certificate)].

NOTE:
The certificate of a nonprofit corporation must also indicate that it is a nonstock, nonprofit corporation [***see** Gov. Code § 12204*; ***see also** Secretary of State's information packet].

(2) For foreign associations, officers' certificate stating that association is validly organized and existing business association under laws of specified foreign jurisdiction [*see § 12B.203*].

d. File statement and designation with attached certificate within 60 days of reserving name with Secretary of State, as follows:

NOTE:

The reservation of a corporate name [***see*** P 4, ***above***] is effective for 60 days [*Corp. Code § 201(c)*]. If the qualification documents are submitted after that period, the corporation's name may no longer be available.

(1) By mail; or

NOTE:
Filings by mail should be sent to Business Filings, 1500 11th Street, Sacramento, CA 95814, Attention: Document Filing Support Unit [***see*** instructions for Statement and Designation by Foreign Corporation on Secretary of State website at http://www.ss.ca.gov/business/corp/pdf/foreign/corp_s&dcgen.pdf (general stock corporation) and http://www.ss.ca.gov/business/corp/pdf/foreign/corp_s&dcnp.pdf (nonprofit corporation)].

(2) In person, over counter.

NOTE:
Over-the-counter filings may be made at the Sacramento, Los Angeles, San Diego, Fresno, or San Francisco branch office. If documents are submitted to one of those regional offices, duplicate originals are also required [***see*** instructions for Statement and Designation by Foreign Corporation on Secretary of State website at http://www.ss.ca.gov/business/corp/pdf/foreign/corp_s&dcgen.pdf (general stock corporation) and http://www.ss.ca.gov/business/corp/pdf/foreign/corp_s&dcnp.pdf (nonprofit corporation)].

e. Pay filing fee [*Gov. Code § 12186(e), (f)*; *see 2 Cal. Code Reg. § 21903(d)*].

NOTE:
Up to two copies of the statement and designation will be compared and certified without charge if duplicates are submitted with the original [*Gov. Code § 12185*]. Additional copies will be compared and certified for an additional charge [***see*** *Gov. Code §§ 12182, 12183*].

f. If expedited filing is desired, personally deliver all of following to Sacramento office of Secretary of State [*see 2 Cal. Code Reg. § 21905(c)(1)*]:

(1) Eligible document, including the required signatures;

(2) Two copies of document;

(3) Requisite filing fee;

(4) Written request for expedited filing;

(5) Statement as to class of service requested [*see 2 Cal. Code Reg. § 21905(e)*], either:

NOTE:
The time periods listed below exclude excluding weekends and state holidays in which the Secretary of State is closed for business [***see*** *2 Cal. Code Reg. § 21905(e)*].

(a) Class A service: eligible document will be filed or a filing response issued within four hours of receipt by the Secretary of State,

NOTE:
To be eligible for Class A service, the eligible document must have been precleared [***see*** P a, ***above***], and the Secretary of State's office must determine that the information completing the designated blank spaces in the preclearance version, if any, does not require additional time to review [***see*** *2 Cal. Code Reg. § 21905(e)(1)*].

(b) Class B service: eligible document will be filed or filing response issued by 4:00 p.m. on same business day, if Secretary of State received document by 9:30 a.m.; or

(c) Class C service: eligible document will be filed or filing response issued within 24 hours of receipt by the Secretary of State, excluding weekends and state holidays in which the Secretary of State is closed for business.

(6) Statement as to means of delivery of filing confirmation or filing response [*see 2 Cal. Code Reg. § 21905(i)*], either:

(a) In person at Sacramento office of Secretary of State;

(b) Fax, if fax number accompanies request;

(c) E-mail, if e-mail address accompanies request;

(d) Overnight courier delivery, if prepaid overnight courier envelope is provided; or

(e) U.S. Mail, first class mail.

(7) Name and telephone number of person to whom questions regarding document or service may be directed.

(8) Requisite expedited filing fee (varies depending on what class of service is selected [*see 2 Cal. Code Reg. § 21905(f)*].

NOTE:
The expedited filing fees are in addition to the regular filing fees for filing the document [*2 Cal. Code Reg. § 21905(g)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12B California Legal Forms--Transaction Guide § 12B.121

§ 12B.121 Name Registration for Corporations Not Transacting Intrastate Business in California

NOTE:

These procedures apply only to foreign corporations (other than foreign associations) that plan to reserve their names in California without complying with qualification procedures [*Corp. Code § 2101*; ***see*** *§ 12B.111*, P 2]. Registration does not protect against use of a corporate name; it merely prevents any other corporation from incorporating or qualifying under that name [***see*** *Bus. & Prof. Code § 14415*].

For procedures governing name registration in other states, consult the other state's statutes and the appropriate agency in the other state.

1. Check with Secretary of State's Name Availability Unity to ensure that corporation's name is available [*see Corp. Code §§ 201, 2101(a)*; *see also § 12B.120*, P 3].

NOTE:

In addition to the limitations on the corporate name *outlined in § 12B.120*, P 3, a corporation registering its name must obtain written approval from the Superintendent of Banks for any name that includes the words "bank," "trust," "trustee," or related words [*Corp. Code § 2101(a)*; ***see*** *Corp. Code § 201(a)*].

2. File application for registration [*see Corp. Code § 2101(b)(1)*; *see also § 12B.240*].

NOTE:

A foreign name registration may be precleared for filing with the Secretary of State [*2 Cal. Code Reg. § 21904(a)(3)*]. For discussion of preclearance procedures, see *§ 12B.120*, P 7a. Expedited filing services are also available [***see*** *2 Cal. Code Reg. § 21905*; ***see also*** *§ 12B.120*, P 7f].

3. Obtain and file original certificate of good standing [*see § 12B.202* (request for certificate)] from state or place of incorporation [*see Corp. Code § 2101(b)*; *see also § 12B.120*, P 7].

4. Pay filing fee [*see Gov. Code § 12186(b)*].

NOTE:

Registration is effective from the date of filing until the close of the calendar year in which the application is filed [*Corp. Code § 2101(b)*]. For the procedures required for renewal of registration, see *§ 12B.135*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawForeign BusinessesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12B California Legal Forms--Transaction Guide § 12B.122

§ 12B.122 Filing Procedures for Foreign Lending Institutions Not Qualified to Transact Intrastate Business in California

NOTE:

The following procedures apply only to foreign lending institutions [***see*** *Corp. Code § 191(d)*; ***see also*** *§ 12B.110*, P 2] that are not qualified to transact intrastate business in California and that engage in the activities listed in *Corp. Code § 191(d)* [*Corp. Code §§ 191(d), 2104*; ***see*** *§ 12B.111*, P 3]. To determine whether these activities subject the corporation to California taxation, see *§ 12B.114*.

For procedures for California lending institutions in other states, consult the other state's statutes and secretary of state's office.

1. Advise board to adopt resolution confirming appointment of California Secretary of State as agent for service of process for actions arising from activities in California [*see Corp. Code § 2104*; *see § 12B.250*].

2. File annual statement on or before June 30 of each year, showing address to which any notice or process may be sent [*see Corp. Code § 2104*; *see § 12B.251*].

3. Pay filing fee [*see Gov. Code § 12186(o)*].

4. If address changes before next annual filing, file supplemental statement [*see § 12B.252*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign

BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12B California Legal Forms--Transaction Guide §§ 12B.123-12B.129

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§§ 12B.123[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-12B California Legal Forms--Transaction Guide § 12B.130

§ 12B.130 Payment of California State Tax

NOTE:

This section discusses only the payment of California tax. Federal taxation of foreign corporations is beyond the scope of this chapter. For a summary of the federal income tax imposed on corporations, see Ch. 2, ***Formation of Corporations*** **.** For discussion of the federal income taxation of nonprofit corporations, see Ch. 13B, ***Tax-Exempt Status for Nonprofit Entities*** .

For state tax procedures for other states, consult the other state's tax statutes and tax boards.

1. If foreign corporation is subject to California franchise tax [*see § 12B.114*, P 2], advise corporation:

a. To file annual franchise tax return (Form FTB 100) [*see Rev. & Tax. Code § 23151(a)*; *see also Rev. & Tax. Code §§ 23181, 23183*].

NOTE:

The franchise tax is a percentage of the corporation's net income for the immediately preceding income year, subject to a stated annual minimum [*Rev. & Tax. Code §§ 23151(a), 23153(d)*; ***see*** *§ 12B.31[1][b]*].

In general, every corporation that qualifies to do business in California on or after January 1, 2000, is not subject to the minimum franchise tax for its first taxable year [*Rev. & Tax. Code § 23153(f)(1)*]. Further, corporations are no longer required to prepay the minimum tax [***see*** former *Rev. & Tax. Code § 23221(f), (g)*; ***see also*** *Rev. & Tax. Code § 23221* (effective January 1, 2001; credit unions subject to prepayment requirement)]. For coverage of tax procedures for the year in which a qualified corporation surrenders its right to transact business, see *§ 12B.135*, PP 4, 5, and 7.

b. That failure to pay franchise tax or penalty assessment when due or failure to file franchise tax return may result in forfeiture of corporation's powers, rights, and privileges [*see Rev. & Tax. Code §§ 23301, 23301.5, 23301.6*; *see also § 12B.31[3]*] and following additional penalties [*see § 12B.31[3], [4]*]:

NOTE:
During the period of forfeiture, a corporation may not sell, transfer, or exchange real property in California [*Rev. & Tax. Code § 23302(d)*].

(1) Contracts entered into in California during forfeiture may be voidable at option of other party [*see Rev. & Tax. Code § 23304.1(a)*; *see also § 12B.31[4]*].

(2) Transaction of business after forfeiture may lead to either or both of following [*see Rev. & Tax. Code § 19719(a)*]:

NOTE:
The rule barring the transaction of business during suspension or forfeiture does not apply to an insurer (or counsel retained by an insurer) on behalf of a suspended corporation who (1) provides a defense for the corporation in a civil action based on a claim for personal injury, property damage, or economic losses against the suspended corporation and (2) prosecutes subrogation, contribution, or indemnity rights in the corporate name in connection with that defense [*Rev. & Tax. Code § 19719(b)*].

(a) Fine.

(b) Imprisonment.

NOTE:
If a corporation nevertheless transacts business during forfeiture, any income received or business transacted is subject to franchise taxes [*Rev. & Tax. Code § 23303*].

(3) If corporation does business after forfeiture and fails to make and file tax return, Franchise Tax Board may impose annual penalty [*Rev. & Tax. Code § 19135*].

2. If corporation is subject to corporate income tax [*see § 12B.114*, P 3], advise corporation:

a. To file annual corporate income tax return (Form FTB 100) [*Rev. & Tax. Code § 23501(a)*].

NOTE:
The same form (Form FTB 100) is used for filing an income or franchise tax return. The corporate income tax is imposed on the corporation's net income from California sources for the preceding year [*Rev. & Tax. Code § 23501*].

b. That corporation may suffer forfeiture [*see Rev. & Tax. Code § 23301*] if it fails to pay any tax, penalty, or interest due or to file any tax returns required under Bank and Corporation Tax Law [*Rev. & Tax. Code §§ 23301, 23301.5*; *see Rev. & Tax. Code § 23305a*].

NOTE:
For further discussion, see P 1b, ***above***, and § 12B.31[3], [4].

3. If corporation is nonprofit organization eligible for exempt status [*see § 12B.114*, P 4], file, or advise corporation to file, application for exemption from tax (Form FTB 3500) [*see Rev. & Tax. Code § 23701*].

NOTE:

The same form is used to file a petition for exemption from corporate income tax or franchise tax [***see*** *Rev. & Tax. Code § 23701*]. For an example and discussion of the application for exemption, see Ch. 13B, ***Tax-Exempt Status for Nonprofit Entities*** .

If the nonprofit corporation transacts intrastate business in California, it may file an application for exemption on filing its statement and designation [***see*** *§ 12B.120*, P 7e(2)] to avoid the prepayment requirement for franchise taxes.

If the corporation thereafter has unrelated business income, it must file an annual return (Form FTB 109) [*Rev. & Tax. Code § 23771*; ***see*** Ch. 13B, ***Tax-Exempt Status for Nonprofit Entities***].

4. If corporation is eligible to apply for exemption from taxation [*see § 12B.114*, P 4], petition, or advise corporation to petition, Franchise Tax Board for determination of exemption [*Rev. & Tax. Code § 23101.5(b)*; *18 Cal. Code Reg. § 23101.5(d)*; *see § 12B.260*].

NOTE:

The same form is used to apply for exemption from either franchise or corporate income tax [***see*** *Rev. & Tax. Code § 23101.5(a)*; ***see also*** *18 Cal. Code Reg. § 23101.5(d), (f)*]. Exemption from tax is granted for a period of five years, if the corporation continues to meet the requirements [*Rev. & Tax. Code § 23101.5(c)*]. A new application may be filed when the exclusion expires [*18 Cal. Code Reg. § 23101.5(f)*].

a. Submit, or have corporation submit, application to Franchise Tax Board, P.O. Box 1468, Sacramento, California 95807.

NOTE:

The application should be submitted as soon as the corporation contemplates having employees within California [*18 Cal. Code Reg. § 23101.5(f)*]. The act of filing the petition is deemed to be a waiver of the confidentiality provisions as to facts alleged in the petition and any additional evidence produced with respect to those facts [*Rev. & Tax. Code § 23101.5(b)*; ***see*** *Rev. & Tax. Code § 26451*; ***see also*** *§ 12B.33[1]*].

The granting of an exclusion is discretionary with the Franchise Tax Board, and no standards are provided regarding the exercise of that discretion. Favorable rulings are uncommon when the application is based on purchasing activities in California, and are unlikely when the corporation maintains a permanent office in California.

b. If exclusion is granted, file statement, or have corporation file statement, two months and 15 days after close of fiscal year that [*see 18 Cal. Code Reg. § 23101.5(f)*]:

NOTE:

During the period of exclusion the corporation's records are subject to audit to the same extent as the records of any other corporation subject to the franchise or corporate income tax [*18 Cal. Code Reg. § 23101.5(f)*].

(1) Affirms that facts relevant to granting of exclusion then in effect remain unchanged; or

(2) Explains changes that have occurred since preceding report was filed.

5. Advise corporation to pay alternative minimum tax, if any [*see Rev. & Tax. Code §§ 23400, 23453-23459*].

NOTE:

The alternative minimum tax is the excess of the tentative minimum tax [***see** I.R.C. §§ 55-59*] over the regular state tax [*Rev. & Tax. Code § 23400(a)*; *I.R.C. § 55(a)*; ***see** § 12B.34*].

6. If corporation owns property in California, advise corporation to pay state property taxes [*see Rev. & Tax. Code § 201*].

7. If corporation engages in retail sales in California, advise corporation to pay sales tax on gross receipts from sale of tangible personal property sold at retail within state [*see Rev. & Tax. Code § 6051*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxComputationBusiness & Corporate LawCorporationsFinanceFranchise TaxExemptionsBusiness & Corporate LawForeign BusinessesQualificationsTax LawState & Local TaxesFranchise TaxFailure to Pay TaxTax LawState & Local TaxesFranchise TaxImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-12B California Legal Forms--Transaction Guide § 12B.131

§ 12B.131 Obtaining Relief From Forfeiture and Contract Voidability Penalties

1. If corporate powers have been forfeited for failure to pay franchise or corporation income tax, apply to Franchise Tax Board for certificate of revivor using one of following procedures:

NOTE:

The application may be made by any stockholder or creditor, a majority of the surviving trustees or directors of the corporation, an officer, or any other person with an interest in the relief from forfeiture [*Rev. & Tax. Code § 23305*]. The same application may be used by a corporation seeking relief from forfeiture for failure to file an annual statement [*Corp. Code §§ 2205(d), 2206(a)*; ***see*** *Corp. Code § 2117*; ***see also*** *§ 12B.132*].

Before a certificate of revivor can be issued, the Franchise Tax Board must obtain from the Secretary of State an endorsement on the application for reinstatement that the corporate name continues to meet the corporate name requirements [*Rev. & Tax. Code §§ 23305a, 23305c(c)*; ***see*** *Corp. Code § 2106(b)*; ***see also*** *Boyer v. Jones (2001) 88 Cal. App. 4th 220, 221-222, 105 Cal. Rptr. 2d 824* (holding that under *Corp. Code § 201(b)* and *Rev. & Tax. Code § 23305a*, name of suspended corporation may be reserved and adopted by another corporation during period of suspension, and affirming trial court's denial of suspended corporation's petition for writ of mandate seeking restoration of its name); § 12B.120, P 3].

Before the corporation can resume business, it must prepay the higher of the minimum franchise tax or the appropriate tax on the income from business done in the year preceding the year of revivor [*Rev. & Tax. Code § 23282(b)(1)*; ***see*** *§ 12B.31[3][c]*].

On issuance of the certificate, the corporation is reinstated and its legal rights are revived [*Rev. & Tax. Code § 23305a*; ***see, e.g.,*** *Rochin v. Pat Johnson Mfg. Co. (1998) 67 Cal.*

App. 4th 1228, 1236-1237, 79 Cal. Rptr. 2d 719 (although manufacturer's corporate powers were suspended before personal injury action was brought against it and before subsequent action to vacate amended judgment, corporation was entitled to defend appeal from order sustaining its demurrer in second action because corporation's certificate of revivor became effective during pendency of appeal)].

a. Apply in writing to Franchise Tax Board for certificate of revivor (Form FTB 3557) [*see § 12B.261* (application form)] and make, or have corporation make, following filings and payments [*see Rev. & Tax. Code § 23305*]:

(1) File all tax returns required to be filed.

(2) Pay all taxes due, including:

(a) Tax.

(b) Additions to tax.

(c) Deficiencies.

(d) Interest.

(e) Penalties.

b. Apply in writing for determination from Franchise Tax Board that revivor will improve prospects for collection of full amount due [*see Rev. & Tax. Code § 23305b*].

NOTE:

A revivor on this basis may be limited as to time, may limit the functions the revived corporation can perform, or both. Forfeiture may occur again if the Franchise Tax Board determines that the prospects for collection of the full amount due have not been improved by the revivor [*Rev. & Tax. Code § 23305b*].

c. Apply in writing to Franchise Tax Board and have corporation secure debt by any of following [*see Rev. & Tax. Code § 23305.2*]:

(1) Assumption of liability [*see* § 12B.263].

(2) Bond.

(3) Deposit.

(4) Any other acceptable security for tax liability.

NOTE:

Obtaining revivor by securing the debt does not constitute an admission of liability and does not relieve the corporation from liability for taxes, additions to tax, penalties, or interest [*Rev. & Tax. Code § 23305.2*]. After securing the debt, the corporation has a reasonable time after the issuance of the certificate of revivor in which to file any necessary returns, notwithstanding the otherwise applicable requirement that the corporation file all necessary returns before the Franchise Tax Board will grant revivor [*Rev. & Tax. Code § 23305.2*; ***see*** *Rev. & Tax. Code § 23305*].

2. If corporation has entered into contracts that may be voidable [*see § 12B.31[4]*], apply in writing to Franchise Tax Board for relief from voidability (Form FTB 2518) [*see § 12B.262* (application form)] and ensure that corporation does all of following [*see Rev. & Tax. Code § 23305.1(a)*]:

a. State in application period for which relief is requested in accordance with *Rev. & Tax. Code § 23305.1(b)*.

NOTE:

Ordinarily, the period for which relief is requested begins on the date that one of the taxpayer's income years begin and ends on the date that relief is granted [*Rev. & Tax. Code § 23305.1(b)(1)(A)*]. However, if an application for relief for voidability is filed for a period in which an application for revivor has been filed and a certificate of revivor has been issued, the period for which relief is requested begins on the date the taxpayer's powers, rights, and privileges had been suspended or forfeited and ends on the date relief is granted [*Rev. & Tax. Code § 23305.1(b)(2)(A)*].

b. File any tax returns required.

c. Pay any tax, additions to tax, penalties, interest, and any other amounts owing to Franchise Tax Board.

d. Pay penalty imposed by Franchise Tax Board.

NOTE:

The Franchise Tax Board will assess a penalty for each day of the period for which relief from voidability is granted, not to exceed the total amount of the tax owed for the period for which relief was requested [*Rev. & Tax. Code § 23305.1(b)(1)(B)*]. A daily penalty with a different maximum is specified if an application for relief is filed for a period in which an application for revivor has been filed and a certificate of revivor has been issued [*Rev. & Tax. Code § 23305.1(b)(2)(B)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxPenalties for NoncomplianceBusiness & Corporate LawCorporationsFinanceFranchise TaxReinstatementTax LawState & Local TaxesFranchise TaxFailure to Pay TaxTax LawState & Local TaxesFranchise TaxImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsFailure to Pay TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-12B California Legal Forms--Transaction Guide § 12B.132

§ 12B.132 Filing Annual Statements of Information; Corporate Disclosure Statement

1. Prepare annual statement of information by foreign corporation in following manner [*see Corp. Code § 2117(a), (f)*; *see § 12B.210*]:

a. Complete entire form if:
(1) Corporation is filing statement for first time [*see §§ 12B.210, 12B.211*].

(2) Changes from last filed statement exist [*see Corp. Code § 2117(e)*; *see also § 12B.133*]; or

(3) Changes, other than those affecting corporate name, from original filed statement and designation exist [*see Corp. Code § 2107(d)*].

b. Merely check appropriate box if there have been no changes in information contained in last filed statement [*see Corp. Code §§ 1502(c), 2117(f)*].

2. File annual statement with Secretary of State during either of following periods [*see Corp. Code § 2117(f)*; *see Corp. Code § 1502(d)*]:

NOTE:
The Secretary of State will mail a notice for compliance to each corporation approximately three months before the close of the applicable filing period. The notice will state the due date for compliance and will be mailed to the last address of the corporation according to the for compliance Secretary of State's records. The failure of the corporation to receive the notice is not an excuse for failing to file the annual statement [*Corp. Code §§ 1502(f), 2117(f)*]. Copies of the form may be obtained from office of the Secretary of State.

(1) In calendar month in which original statement and designation [*see Corp. Code § 2105*; *see also § 12B.201*] was filed; or

(2) During five calendar months immediately preceding month in which original statement and designation was filed.

3. Pay filing fee [*see Gov. Code § 12186(h)*; *see also Corp. Code § 2117(d)*].

NOTE:

Foreign corporations must also pay a small "disclosure fee" when filing the statement and designation. One-half of this fee is used to further the development and maintenance of the online database permitting on-line inspection of annual statements and one-half is deposited into the Victims of Corporate Fraud Compensation Fund [*Corp. Code § 2117(d)*; ***see*** *Corp. Code § 1502.5*]. There is a fee for furnishing a copy of the statement [***see*** *Gov. Code § 12182*].

4. If foreign corporation is publicly traded, complete and file corporate disclosure statement annually within 150 days after end of fiscal year on prescribed form [*Corp. Code § 2117.1(a)*; *see § 12B.211*].

NOTE:

The foreign corporation must certify that the information provided in this form is true and correct. No claim may be made against the state for inaccurate information contained in corporate disclosure statements [*Corp. Code § 2117.1(d)*]. There is no fee for filing this form [*Gov. Code § 12186(j)*].

5. Advise corporation that failure to file may result in monetary penalties or, under some circumstances, forfeiture of corporate powers, rights, and privileges in California [*see Corp. Code §§ 2204, 2205(a), 2206(a)*; *see § 12B.11[3][a][ii]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawForeign BusinessesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-12B California Legal Forms--Transaction Guide § 12B.133

§ 12B.133 Amending Filed Statements

NOTE:
To correct a mere error in the names or addresses of the initial agent for service of process or of the first directors, the corporation should file a certificate of correction [***see*** *Corp. Code § 109*]. For further discussion and a certificate of correction, see Ch. 10, ***Amendment of Articles*** **.**

1. If qualified foreign corporation (other than foreign association) changes name or assumed name set forth in statement and designation [*see § 12B.120*, P 7], file amended statement and designation by foreign corporation [*see Corp. Code § 2107(a)*; *see also § 12B.220*]:

NOTE:
The Secretary of State will issue a new certificate of qualification when a foreign corporation files an amended statement and designation [*Corp. Code § 2107(a)*]. For procedures for foreign associations seeking to amend their statements, see Paragraph 4, below.

a. Complete form prescribed by Secretary of State [*see § 12B.220*], including:
(1) Name relinquished.

(2) New name assumed.

NOTE:
A corporation cannot file an amended statement containing a name that would not be available to a new domestic corporation organized under the General Corporation Law [*Corp. Code § 2106(b)*; ***see*** *§ 12B.120*, P 3].

(3) If change includes change of name of insurer subject to Insurance Code, statement that corporation is insurer [*see Corp. Code § 2107(c)*].

b. Attach certificate of authorized public official of corporation's state or place of incorporation that change of name was made in accordance with laws of that state or place [*see § 12B.221* (request for certificate)].

c. Pay filing fee [*Gov. Code § 12186(p)*].

NOTE:

The Secretary of State will compare and certify up to two copies without charge when the copies are submitted along with the original [*Gov. Code § 12185*].

2. If qualified foreign corporation (other than foreign association) changes any of following information set forth in statement and designation [*see § 12B.120*, P 3], file statement of information by foreign corporation [*see Corp. Code §§ 2107(d), 2117*; *see also §§ 12B.132, 12B.210*]:

NOTE:

The annual statement of information may be used to change information contained in the original statement and designation [***see*** *Corp. Code § 2107(d)*]. There is a fee for filing and a fee for furnishing a copy of the statement [***see*** *Gov. Code § 12186(h)* ***see also*** *Corp. Code § 2117(d)* (additional "disclosure fee")].

a. Address of principal office in California.

b. Address of principal executive office.

c. Agent for service of process.

d. Stated address of any natural person designated as agent for service of process.

3. If foreign corporation (other than foreign association) changes any information set forth in annual statement of information by foreign corporation [*see § 12B.210*]:

a. File new statement of information by foreign corporation [*see Corp. Code § 2117(c)*; *see also § 12B.210*].

NOTE:

If the changed information concerns the names and addresses of the corporation's officers, the address of its principal executive office or principal business office, or the general type of corporate business, filing a current statement is optional. However, to change its agent for service of process or the agent's address, the corporation must file a current statement containing all of the information required in the annual statement of information. Filing an annual statement of information supersedes any previously filed statement and the original statement and designation [*Corp. Code §§ 1502(e), 2117(f)*; ***see*** *Corp. Code §§ 2105, 2117*; ***see also*** *§ 12B.210*].

b. Pay filing fee [*see Gov. Code § 12186(e), (f)*; *see also Corp. Code § 2117(d)* (additional "disclosure fee")].

4. If qualified foreign association changes any information set forth in statement and designation [*see Corp. Code § 2105(a)*; *see § 12B.203*]:

a. File amended statement and designation on form prescribed by Secretary of State [*see Corp. Code § 2107(b)*; *see also § 12B.222*].

b. If name is changed, include both of following [*see Corp. Code § 2107(b)*]:

(1) Both name relinquished and new name assumed.

(2) Officers' certificate, annexed to amended statement and designation, stating that change of name was made in accordance with association's declaration of trust.

NOTE:
Unlike the procedure required for foreign corporations [***see*** PP 1, 2, ***above***], the same form is used to indicate changes in a foreign association's name as well as changes in the address of its principal office in California, the address of its principal executive office, its agent for service of process, and the stated address of any natural person designated as its agent for service of process [*Corp. Code § 2107(b)*].

If the change includes a change of name or a change affecting an assumed name, the Secretary of State will issue a new certificate of qualification on the filing of the amended statement [*Corp. Code § 2107(b)*].

c. Pay filing fee [*Gov. Code § 12191(a)(2)*].

NOTE:
The Secretary of State will compare and certify up to two copies without charge when the copies are submitted along with the original [*Gov. Code § 12185*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-12B California Legal Forms--Transaction Guide § 12B.134

§ 12B.134 Surrendering Right to Transact Intrastate Business

NOTE:

These procedures apply only to qualified foreign corporations that wish to terminate their right to transact intrastate business in California. A qualified foreign corporation that merely ceases to transact intrastate business will remain liable for state taxes until it either dissolves in its state of incorporation or follows California surrender procedures [*18 Cal. Code Reg. § 23151*; ***see*** *§ 12B.31[5]*].

1. If corporation is not surrendering pursuant to merger [*see* PP 2, 3, *below*], file certificate of surrender [*see Corp. Code § 2112*; *see also §§ 12B.12[2][a], 12B.230, 12B.232*].

NOTE:

There is no fee for filing the certificate of surrender [***see*** *Gov. Code §§ 12186(n)* (corporation), 12191(a)(3)(association)].

The term "certificate of withdrawal" used in the statute [***see*** *Corp. Code § 2112(a)(4)*] presumably refers to the certificate of surrender [***see*** *Corp. Code § 2114(b)*].

2. If foreign corporation "disappears" in merger [*see Corp. Code § 165*] with another foreign corporation, file certificate of surrender signed by either of following [*see Corp. Code § 2113(b)*; *see also* P 1, *above*]:

a. Officer of disappearing corporation [*see Corp. Code §§ 2112(a), 2113(b)*].

b. Officer of surviving corporation in name of surviving corporation [*see Corp. Code § 2113(c)*].

NOTE:
If the certificate is signed in the name of the surviving corporation by one of its officers, it must be accompanied by a certificate of an authorized public official of the state or place of incorporation of the merged foreign corporation stating that it has been merged into another foreign corporation and setting forth the name and state or place of incorporation of the surviving foreign corporation [*Corp. Code § 2113(c)*; ***see*** *§ 12B.234* (request for certificate)].

3. If foreign corporation disappears in merger involving domestic corporation [*see Corp. Code § 2113*; *see also Corp. Code § 165*]:

NOTE:
A foreign corporation will automatically surrender its right to transact intrastate business by filing the following merger documents, and need not file a certificate of surrender [*Corp. Code § 2113(a)*; ***see*** Ballantine & Sterling, California Corporation Laws, Ch. 18, ***Foreign Corporations*** (Matthew Bender)]. Alternatively, the corporation may file a certificate of surrender [***see*** P 1, ***above***]. For a detailed discussion of mergers, see Ch. 11C, ***Mergers*** .

a. When merger involves surviving domestic corporation [*see Corp. Code §§ 190, 1103*], file either of following documents with Secretary of State [*see Corp. Code § 1108(c)*]:

(1) Merger agreement and officers' certificate [*see Corp. Code § 1103*].

(2) Certificate of ownership.

NOTE:
In the case of a foreign nonprofit or mutual benefit corporation, the officers' certificate of each constituent corporation also must be filed [*Corp. Code §§ 6018(c), 8018(c)*; ***see*** *Corp. Code §§ 6014, 8014*].

b. When merger involves disappearing domestic corporation and other surviving foreign corporation, file with Secretary of State copy or executed counterpart of any of following filed by surviving corporation in state or place of incorporation to effect merger [*see Corp. Code § 2113(a)*; *see also Corp. Code § 1108(d)*]:

(1) Merger agreement.

(2) Certificate.

(3) Other merger document.

NOTE:
If a copy is filed, it must be certified by the public officer having custody of the original [*Corp. Code § 1108(d)*].

By filing the documents listed above, a foreign disappearing corporation automatically surrenders its right to transact business as of the date of filing in California regardless of the time of effectiveness as to a domestic disappearing corporation [***see*** *Corp. Code §§ 1103(d), 1108(e), 2113(a)*].

c. When foreign subsidiary corporation is merged into domestic parent corporation, file certificate of ownership [*see Corp. Code § 2113(a)*; *see also Corp. Code § 1110(e)*].

4. If qualified foreign corporation disappears as result of conversion and files organizational document containing statement of conversion, that filing constitutes surrender of foreign corporation's right to transact intrastate business in California [*Corp. Code § 2113(a)*; *see Corp. Code §§ 15677.8* (CRLPA, repealed January 1, 2010), 15911.08 (ULPA '08) (limited partnership), 16908 (general partnership), 17540.8 (limited liability company)].

5. If corporation has employees in California, within 10 days after surrendering right to transact intrastate business or "quitting business" [*see Unemp. Ins. Code § 1116(a)(3), (b)*; *see also Unemp. Ins. Code § 1116(a)(4)* (definition of "quitting business")]:

a. File final return and report of employee wages with Employment Development Department [*see* Ch. 12, *Winding Up and Dissolution*].

b. Pay any amount due.

6. File final franchise tax return (Form FTB 100) [*see Rev. & Tax. Code § 18601(c)*].

NOTE:

Taxpayers required to file a short period return [***see*** *Rev. & Tax. Code § 24634*] must file the state return (1) by the same due date for the federal return that includes the net income of the taxpayer for that short period, or (2) within two months and 15 days after end of month in which the corporation files a certificate of surrender if no federal return need be filed that would include the net income for the short period [*Rev. & Tax. Code § 18601(a), (c)*].

The corporation is liable for franchise tax for its last taxable year based on its net income for the year in which it ceased doing business, unless that income has already been subject to tax. However, it will be liable for at least the $800 minimum tax [*Rev. & Tax. Code § 23151.2*; ***see*** *Rev. & Tax. Code §§ 23151(a), 23153(d)*].

For a list of federal and state tax procedures upon dissolution or withdrawal, see Ch. 12, ***Winding Up and Dissolution*** .

7. Advise surrendering corporation that it is still subject to service of process for actions on liability or obligation incurred in California before surrender [*see Corp. Code § 2114*].

NOTE:

Process may be served on the corporation by delivery to the Secretary of State, or to the Secretary's assistant or deputy, without court order. The Secretary will mail a copy of process to the corporation's address as set forth in the certificate of surrender [***see*** *Corp. Code § 2114(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesDomesticationBusiness & Corporate LawForeign BusinessesQualificationsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-12B California Legal Forms--Transaction Guide § 12B.135

§ 12B.135 Renewing Name Registration of Corporations Not Transacting Intrastate Business

NOTE:
The name registration of a foreign corporation not qualified to transact intrastate business in California [***see** § 12B.121*] is only effective until the end of the calendar year of filing, but may be renewed annually [*Corp. Code § 2101(c)*].

1. Prepare application for renewal setting forth facts required in original application for registration [*see Corp. Code § 2101(c)*; *see also § 12B.240*].

NOTE:
The same form is used for both the original registration and for renewal of that registration [***see** § 12B.240*].

2. Attach certificate of good standing [*see Corp. Code § 2101(c)*; *see also §§ 12B.120*, P 7b, 12B.202 (request for certificate)].

3. File application and certificate with Secretary of State between October 1 and December 31 [*Corp. Code § 2101(c)*].

4. Pay filing fee [*Gov. Code § 12186(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawForeign BusinessesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-12B California Legal Forms--Transaction Guide § 12B.136

§ 12B.136 Procedures for Nominally Foreign Corporations

NOTE:

A corporation is "nominally foreign" if more than on half of its outstanding voting securities are held by California residents and more than one half of its business is conducted in California [***see*** *Corp. Code § 2115(a)*; ***see also*** *§§ 12B.14[1][c], 12B.113*]. A nominally foreign corporation is required to comply with extensive California regulation of its internal affairs, to the exclusion of the law of the jurisdiction in which it is incorporated [*Corp. Code § 2115*; ***see*** *§ 12B.14[1][e]*].

1. Advise corporation to begin compliance with California requirements for internal affairs [*see* P 2, *below*] within following time limits [*see Corp. Code § 2115(d)*]:

a. On first day of first income year of corporation beginning on or after 135th day of the income year immediately following the latest income year with respect to which the tests establishing nominally foreign status are met.

b. If nominal status is subject of litigation, on or after entry of final order by court of competent jurisdiction declaring that tests of nominally foreign status have been met.

2. Ensure that corporation complies with following California requirements [*see Corp. Code § 2115(b)*]:

a. Holds election of directors at annual shareholders' meeting [*see Corp. Code § 301*; *see also* P i, *below*].

NOTE:

For a discussion of the election of directors, see Ch. 5, ***Directors' Meetings, Actions, and Resolutions*** **.**

b. Permits removal without cause of any or all directors by vote of outstanding shares [*see Corp. Code § 303*].

NOTE:

There are several restrictions on the removal of directors without cause [***see*** *Corp. Code § 303*; ***see also*** *Corp. Code § 301.5* (directors in different classes serving different terms)]. Additionally, 10 percent of the shareholders of a nominally foreign corporation may petition the proper court for removal of directors for misconduct [*Corp. Code § 304*]. For further information, see *§ 12B.14[1][e][iii]*. For a detailed discussion of both types of removal, see Ballantine & Sterling, California Corporation Laws, Ch. 5, ***Management: Functions of Directors, Officers, and Committees*** (Matthew Bender).

c. Permits special election of entire board when, after directors have filled vacancy on board, elected directors constitute less than majority of board [*see Corp. Code § 305(c)*].

NOTE:

For a detailed discussion of this procedure, see Ch. 5, ***Directors' Meetings, Actions, and Resolutions .***

d. Requires directors to perform duties in good faith, in best interests of corporation and its shareholders, with care that ordinarily prudent person in like position would use under similar circumstances [*see Corp. Code § 309*; *see also* Ballantine & Sterling, California Corporation Laws, Ch. 6, *Management: Duties and Liabilities of Directors and Controlling Shareholders* (Matthew Bender)].

NOTE:

Subject to the director's standard of care, directors are liable for improper distributions, not including improper loans or guaranties [***see*** *Corp. Code § 316(a)(1), (2), (b)- (f)*]. A foreign corporation may indemnify directors and other personnel and agents under appropriate circumstances [***see*** *Corp. Code § 317*].

e. Does not make, or allow subsidiary to make, any distribution to shareholders unless both of the following conditions exist [*see Corp. Code § 500*]:

NOTE:

A distribution consists of cash or property transferred to the shareholders without consideration, whether by dividend or otherwise, except for share dividends and reacquisitions [***see*** *Corp. Code § 166*]. For a discussion of the restriction on distributions, see Ch. 9, ***Dividends, Reacquisitions of Shares, and Assessments .***

The distribution restrictions do not apply to a corporation licensed as a broker-dealer [***see*** *Corp. Code §§ 25210-25220*] if the corporation, immediately after giving effect to any distribution, is in compliance with the net capital rules of the Commissioner of Corporations [***see*** *10 Cal. Code Reg. § 260.216.12*] and the Securities and Exchange Commission [*Corp. Code § 500(c)*; ***see*** *17 C.F.R. § 240.15c3-1*].

(1) Immediately before distribution, retained earnings equal or exceed amount of proposed distribution; and

(2) Assets remain to effect that:

(a) Sum of assets is at least 11/4 times liabilities.

(b) Current assets are at least equal to current liabilities (or, in certain instances, at least 11/4 times

current liabilities).

f. Does not make, or permit subsidiary to make, any distribution to shareholders if corporation or subsidiary making distribution would be unable to meet liabilities [*see Corp. Code § 501*].

NOTE:
For further discussion, see Ch. 9, ***Dividends, Reacquisitions of Shares, and Assessments*** .

g. Does not make, or permit subsidiary to make, distribution of assets to junior shareholders if remaining assets would be less than liquidation preference of senior shares [*see Corp. Code § 502*].

NOTE:
For further discussion, see Ch. 9, ***Dividends, Reacquisitions of Shares, and Assessments*** .

h. Does not make, or permit subsidiary to make, distribution to junior shareholders unless retained earnings equal or exceed amount of proposed distribution plus aggregate of cumulative dividends in arrears on preferred shares [*Corp. Code § 503*].

NOTE:
Certain exceptions exist for regulated investment companies [***see*** *Corp. Code § 504(a)(1), (b)*; ***see also*** *I.R.C. § 851* (definition)] and for real estate investment trusts [***see*** *Corp. Code § 504(a)(2)*; ***see also*** *I.R.C. § 856* (definition)]. For discussion, see Ch. 9, ***Dividends, Reacquisitions of Shares, and Assessments*** .

The corporation may place additional restrictions on declaring dividends or purchasing or redeeming shares [*Corp. Code § 505*]. Shareholders are liable for receiving distributions that they should be aware are improper [*Corp. Code § 506*].

i. Holds annual shareholders' meeting for election of directors and other proper business [*Corp. Code § 600(b), (c)*].

NOTE:
If the meeting is not held for 60 days after the designated date, or for 15 months after organization or the last annual meeting, any shareholder may seek proper court action for a meeting, at which the actual number of votes represented automatically will constitute a quorum [*Corp. Code § 600(c)*]. The Attorney General may enforce compliance with these requirements [*Corp. Code § 1508*].

j. Recognizes cumulative voting in election for directors if [*see Corp. Code § 708(a)- (c)*]:

NOTE:
Corporations with shares listed on the New York Stock Exchange, the NYSE Amex, the NASDAQ Global Market, or the NASDAQ Capital Market ("listed corporations") may amend their articles or bylaws to eliminate cumulative voting [*Corp. Code § 301.5*; ***see*** *Corp. Code §§ 708, 708.5*; ***see also*** Ch. 4, ***Bylaws ;*** Ch. 10, ***Amendment of Articles***].

(1) Name of candidate to be voted on has been placed in nomination before voting.

(2) At least one shareholder has given notice:

(a) At meeting before voting.

(b) Of shareholder's intention to cumulate votes.

k. Recognizes right of corporation with outstanding shares held of record by 100 or more persons [*see Corp. Code § 605*] to amend articles or certificate of determination to permit supermajority voting [*see Corp. Code § 710*].

NOTE:

A "supermajority vote" is a requirement that specified corporate actions be approved by a larger proportion of the outstanding shares than a majority, subject to certain limitations [***see*** *Corp. Code § 710(b)*]. For further discussion, see Ch. 3, ***Articles of Incorporation*** .

l. Observes following special protective provisions applicable to reorganizations, conversions, or outright major property dispositions:

(1) Requirement of special voting approval when assets are transferred to buyer in control relationship with selling corporation [*see Corp. Code § 1001(d)*].

NOTE:

For discussion of this requirement, see Ch. 11B, ***Cash Purchase of Assets*** .

(2) Fairness limitations on transformation of common shares and fair allocation provisions on distributions within classes or series of shares [*see Corp. Code § 1101(e)*].

NOTE:

For further discussion, see Ch. 11C, ***Mergers*** .

(3) Requirements applicable to conversions.

NOTE:

Nominally foreign corporations are subject to the General Corporation Law's requirements applicable to conversions [*Corp. Code § 2115(b)*; ***see*** *Corp. Code § 1152*]. They are also subject to the first sentence of *Corp. Code § 1151*, which requires that under the proposed conversion, (1) each share of the same class or series of the converting corporation must be treated equally with respect to any cash, rights, securities, or other property to be received by, or any obligations or restrictions to be imposed on, the holder of that share, unless all the shareholders of the class or series consent to a different treatment; and (2) nonredeemable common shares of the converting corporation must be converted only into nonredeemable equity securities of the converted entity unless all of the shareholders of the class consent [*Corp. Code § 2115(b)*; ***see*** *Corp. Code § 1151(a)*]. For further discussion of these conversion rules and limitations, see Ch. 11C, ***Mergers*** **.**

(4) Approval requirements for merger, exchange, and sale-of- asset reorganizations [*Corp. Code §§ 1200, 1201*].

NOTE:

For further discussion, see Ch. 11C, ***Mergers*** .

(5) Dissenting shareholders' rights and procedures in reorganizations [*Corp. Code §§ 1300-1312*].

NOTE:

For further discussion, see Ch. 11C, ***Mergers*** .

m. Keeps following records [*Corp. Code § 1500*]:

NOTE:
For further discussion, see Ch. 7, ***Corporate Records and Reports*** **.**

(1) Adequate and correct books and records of account.

(2) Minutes of proceedings of shareholders, board, and committees of board.

(3) Record of shareholders, including:

(a) Names and addresses.

(b) Number and class of shares held by each.

n. Sends annual report and provides financial information on request [*Corp. Code § 1501*].

NOTE:
This requirement also applies to corporations that are not nominally foreign, but that have their principal executive office in California or customarily hold board meetings in California [***see*** *§§ 12B.14[2], 12B.138*]. For further discussion, see Ch. 7, ***Corporate Records and Reports*** **.**

o. Allows shareholders and directors to inspect records, minutes, books, or properties, to extent required by law [*Corp. Code §§ 1600-1603*].

NOTE:
Shareholders may be awarded expenses, including attorneys' fees, if the corporation fails without justification to comply with a demand for inspection [*Corp. Code § 1604*]. A request for inspection is not deemed complied with until the corporation, at its own expense, makes the records available in written form [*Corp. Code § 1605*]. For further discussion, see Ch. 7, ***Corporate Records and Reports*** **.**

3. Advise corporation that its nominally foreign status will terminate [*Corp. Code § 2115(e)*] if either of the following occurs [*see Corp. Code § 2115(e)*]:

NOTE:
Neither of the following circumstances will terminate the corporation's nominally foreign status if a contrary order is entered before the end of that income year [*Corp. Code § 2115(e)*].

a. When at least one of tests of nominal status [*see Corp. Code § 2115(a)*; *see also § 12B.113*, P 1c] is not met.

NOTE:
In this circumstance, the nominally foreign status terminates at the end of the first income year of the corporation immediately following the latest income year with respect to which at least one of the tests establishing nominally foreign status is not met [*Corp. Code § 2115(e)*].

b. Final order is entered by court of competent jurisdiction declaring that one of tests of nominal status [

see Corp. Code § 2115(a); *see also § 12B.113*, P 1c] has not been met.

NOTE:

In this circumstance, the nominally foreign status terminates at the end of the income year of the corporation during which the final order is entered [*Corp. Code § 2115(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-12B California Legal Forms--Transaction Guide § 12B.137

§ 12B.137 Disclosure Procedures for Resident Foreign Corporations

NOTE:
A corporation that is a "resident" foreign corporation [***see*** *§ 12B.113*, P 2] must comply with certain disclosure requirements normally applicable only to domestic corporations [***see*** *Corp. Code §§ 1501*, *1600-1602*]. Compliance may be enforced by court order [***see*** *Corp. Code §§ 1508*, *1603*].

1. If corporation has its principal executive office, or customarily has meetings of its board, in California, ensure that it:

a. Furnishes following financial information to shareholders [*see Corp. Code § 1501*]:

NOTE:
Unless otherwise provided by the articles or bylaws, and if approved by the board of directors, an annual report and any accompanying material sent pursuant to Section 1501 may be sent by electronic transmission by the corporation [*Corp. Code § 1501(a)(1)*; ***see*** *Corp. Code § 20*]. Furthermore, the annual report requirements [*see Corp. Code § 1501(a)(1),(2)*] will be satisfied if a corporation with an outstanding class of securities registered under Section 12 of the Securities Exchange Act of 1934 complies with *17 C.F.R. § 240.14a-16*, with respect to the obligation of a corporation to furnish an annual report to shareholders pursuant to *17 C.F.R. § 240.14a-3(b)* [*Corp. Code § 1501(a)(4)*].

(1) Annual report with required exhibits [*see Corp. Code § 1501(a)(1)*].

NOTE:
The bylaws of a corporation with fewer than 100 shareholders of record may waive the

requirement of an annual report [*Corp. Code § 1501(a)(1)*; ***see*** *Corp. Code § 605*]. Additional information is required from a corporation with 100 or more shareholders that is not required to report to the federal Securities and Exchange Commission [***see*** *Corp. Code § 1501(b)*]. For a detailed discussion of annual reports, see Ch. 7, ***Corporate Records and Reports*** .

(2) Statements required in annual report, on written demand of shareholder who has not received annual report [*see Corp. Code § 1501(c)*].

NOTE:
For further discussion, see Ch. 7, ***Corporate Records and Reports*** .

(3) Following information on written request of shareholder with at least 5 percent of outstanding shares [*see Corp. Code § 1501(c)*]:

NOTE:
For a detailed discussion, see Ch. 7, ***Corporate Records and Reports*** .

(a) Income statements for quarters of current fiscal year.

(b) Balance sheet for same period.

(c) Annual report statements if not sent to shareholder.

NOTE:
In addition, the corporation must keep copies of report statements on file in the principal office of the corporation for 12 months and must exhibit them at all reasonable times or mail copies to any shareholder demanding an examination or copy [*Corp. Code § 1501(c)*].

b. Permits shareholders holding at least 5 percent of outstanding shares, or holding 1 percent of shares and filing Schedule 14B with federal Securities and Exchange Commission, or certain banks with insured deposits [*see Corp. Code § 1600(a)*]:

NOTE:
For a detailed guide to shareholder inspection rights, see Ch. 7, ***Corporate Records and Reports*** .

(1) To inspect and copy record of shareholders' names, addresses, and holdings during business hours upon prior written demand; or

(2) To obtain from corporate transfer agent, on written demand and payment of fees, list of shareholders entitled to vote for directors, their addresses, and holdings.

c. Permits directors to inspect all corporate documents and properties at any reasonable time [*see Corp. Code § 1602*].

NOTE:
For a guide to these inspection rights, see Ch. 7, ***Corporate Records and Reports*** .

2. If corporation has principal executive office in California or keeps corporate accounting books, records, or minutes in California, ensure that it permits shareholders or holders of voting trust certificates to inspect those documents on written demand during business hours [*see Corp. Code § 1601*].

NOTE:

For a detailed guide to the shareholder inspection rights, see Ch. 7, ***Corporate Records and Reports*** **.**

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawForeign BusinessesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-12B California Legal Forms--Transaction Guide § 12B.138

§ 12B.138 Procedures for Requesting and Providing Information Regarding Results of Shareholder Voting

NOTE:
The procedures described below apply to any foreign corporation that is qualified to transact intrastate business in California [***see*** *Corp. Code § 1510(a)*; ***see also*** *§ 12B.11*]. They also apply to any foreign corporation that is not qualified, but that has one or more subsidiaries that are domestic corporations or qualified foreign corporations [***see*** *Corp. Code § 1511*].

1. Advise corporation to provide written results [*see* P 2, *below*] of any vote taken at annual, regular, or special shareholder meeting to resident shareholder [*see Corp. Code §§ 1510(b), 1512(a)* (definition)] who, within 60 days after meeting, takes following actions [*see Corp. Code § 1509*]:

a. Makes written request to foreign corporation within 60 days following conclusion of meeting [*Corp. Code § 1509*].

NOTE:
For an example of this written request, see Ch. 8A, ***Shareholders' Meetings, Voting, and Agreements*** .

b. Shareholder named on records of central depository, bank, or broker-dealer with respect to shares that are subject to control of that depository, bank, or broker-dealer, attaches photocopy of statement from depository, bank, or broker-dealer showing shareholder status [*Corp. Code § 1512(c)*].

NOTE:
The corporation must accept the photocopy as sufficient evidence of the person's status as a shareholder [*Corp. Code § 1512(c)*].

2. If corporation receives written request from shareholder for voting results within applicable time period [*Corp. Code § 1509*; *see* P 1, *above*], advise corporation to prepare written report as follows [*Corp. Code § 1509*]:

NOTE:
For an example of this written report, see Ch. 8A, ***Shareholders' Meetings, Voting, and Agreements*** .

a. Include all of following:

NOTE:
If more than one class or series of shares voted, the report must state the appropriate numbers by class and series of shares [*Corp. Code § 1509*].

(1) If matter voted on was not an election of directors:
(a) Number of shares voting for matter.

(b) Number of shares voting against matter.

(c) Number of shares abstaining or withheld from voting.

(2) If matter voted on was an election of directors, number of shares (or votes, if voted cumulatively) cast for each nominee for director.

b. Mail to shareholder.

NOTE:
There is no specific statutory time limit on how long the corporation may take to provide the shareholder with the information after receipt of the initial request. The only requirement is that the shareholder be informed "forthwith" [***see*** *Corp. Code § 1509*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsGeneral OverviewBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsInspection RightsShareholdersBusiness & Corporate LawCorporationsShareholdersMeetings & VotingVoting SharesDirector Elections & RemovalsBusiness & Corporate LawForeign BusinessesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-12B California Legal Forms--Transaction Guide §§ 12B.139-12B.199

[Reserved]

§§ 12B.139[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
1. Documents for Obtaining Certificate of Qualification

6-12B California Legal Forms--Transaction Guide § 12B.200

§ 12B.200 Resolution Authorizing Qualification, Agent, and Name

[1] Comment

[a] Use of Form

This form is a resolution of a foreign corporation's board of directors that (1) authorizes qualification of the corporation to transact intrastate business in California, (2) selects the agent for service of process, and (3) states the name that the corporation will use to transact business in California. While this form suggests the content of the resolution, the method of adoption and specific form of the resolution are governed by laws of the foreign corporation's state of incorporation. For examples of resolutions made pursuant to California law, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* .

[b] Qualification Requirements

A corporation that wishes to transact intrastate business in California [*see Corp. Code § 191(a)* (definition); *see also § 12B.11[1]*] must obtain a certificate of qualification from the Secretary of State [*Corp. Code § 2105(a)*]. To qualify, a foreign corporation must file a statement and designation [*see § 12B.201*] and a certificate of good standing [*see § 12B.202*] with the Secretary of State [*Corp. Code § 2105*]. A foreign association must file a statement and designation, together with an officers' certificate [*see § 12B.203* (foreign association)] stating that the association is validly organized and existing under the laws of its home jurisdiction [*Corp. Code § 2105*]. The organization must also pay the filing fee [*see Gov. Code § 12186(e), (f), (p), 12191(a)*].

For a guide to procedures for qualification in California, see *§ 12B.120*. For further discussion, see *§ 12B.11*.

[c] Selecting Agent for Service of Process

The corporation's agent for service of process must be either a natural person residing in California or a domestic or foreign corporation whose capacity to act as an agent has not terminated [*Corp. Code § 2105(a)(4)*; *see Corp. Code §§*

1502(b), 1505]. If a corporate agent is selected, it must (1) be currently authorized to engage in business in California, (2) be in good standing on the Secretary of State's records, and (3) have filed a cert ificate of consent [*see Corp. Code §§ 1502(b), 1505, 2105(c)*]. For further discussion, see *§ 12B.20*][1][d].

[d] Corporate Name

It is possible that a foreign corporation's name, as set forth in its articles of incorporation, may not be available for use in California. The Secretary of State may determine that the name would be likely to mislead the public, or it may be unavailable if it is the same as, or deceptively similar to, a name that has been officially recognized by the Secretary of State as used or reserved for use in California by another corporation [*see Corp. Code § 2106(b)*; *see also Corp. Code § 201(b)*; §§ 12B.11[2][b], 12B.201[1][c]].

If the corporation's name is unavailable due to conflict, the corporation may use an assumed name if the Secretary of State finds that (1) its business is not the same as or similar to the corporation with the conflicting name, and (2) the public is not likely to be deceived [*Corp. Code § 2106(b)(2)*; *see § 12B.20[1][c][ii]*]. The directors should therefore agree on several alternative assumed names that the corporation can use in its business dealings in California, if necessary. The name may be the corporation's name, with the addition of some distinguishing word or words, or another name available in California [*see Corp. Code § 2106(b)(2)*; *see also Corp. Code § 201(b)*].

For additional discussion of corporate name issues, see *§ 12B.11[2][b]*; see also *Ch. 2, Formation of Corporations, § 2.13*.

[2] FORM

Resolution Authorizing Qualification, Agent, and Name

RESOLUTION

Qualification in California

1. RESOLVED, that this corporation will qualify itself to transact business in the State of California and thereby subject itself to the laws of the State of California applicable to foreign corporations. It is further resolved that the President and the Secretary, or other proper officers, of this corporation are authorized and directed to prepare, execute, and file with the California Secretary of State any applications, documents, or statements necessary to accomplish qualification; to pay the required filing fees; and to _____[prepay the California franchise tax *or* submit an application for exemption from franchise taxes].

Agent and Address for Service of Process

2. RESOLVED FURTHER, that this corporation's agent for service of process in California is _____[*name of agent*], and whose is address for service of process is _____[*address of agent*].

Name

3. RESOLVED FURTHER, that _____[*name of corporation*] will be the name under which the corporation will do business in California. If this name is not available, the following alternative names may be submitted to the Secretary of State: _____[*list alternative names*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
1. Documents for Obtaining Certificate of Qualification

6-12B California Legal Forms--Transaction Guide § 12B.201

§ 12B.201 Statement and Designation for Foreign Corporation [Corp. Code § 2105]

[1] Comment

[a] Use of Form

This form is the statement and designation that a foreign corporation, other than a foreign association [*see Corp. Code § 170* (definition); *see also § 12B.203* (form for foreign association)], must file to obtain a certificate of qualification to transact intrastate business in California [*see Corp. Code § 2105*]. To "transact intrastate business" means to enter into repeated and successive transactions of the corporation's business in California, other than interstate or foreign commerce [*Corp. Code § 191(a)*; *see § 12B.11[1]*].

The statement and designation must be on a form prescribed by the Secretary of State's office [*see Corp. Code § 2105(a)*]; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. The version reproduced here is the Secretary of State's official form. Forms prepared by the Secretary of State may be obtained from its Sacramento office or from any of its satellite offices in Los Angeles, San Diego, Fresno, or San Francisco, or on the Secretary of State's website as indicated below.

ELECTRONIC FORMS NOTE

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12B.201. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

This form is the general form for use by most foreign corporations. For a form for use by foreign professional

corporations, see *§ 12B.201A*. For a form for use by a foreign insurer corporation, see *§ 12B.201B*.

This form may be filed in the Sacramento office or any of the satellite offices of the Secretary of State [*see* Instructions to Form, reproduced in [2], *below*]. On filing the statement and designation with an attached certificate of good standing [*see Corp. Code § 2105(b)*; *see also § 12B.202* (request for certificate)], and payment of the required fees and taxes, the Secretary of State will issue a certificate of qualification [*Corp. Code § 2106(a)*; *see* [f], *below*]. For a guide to the procedures for qualification, see *§ 12B.120*.

[b] Contents of Form

The form must be signed by a corporate officer, and must state the following information [*Corp. Code § 2105(a)*]:

- The corporation's name and state or place of incorporation or organization. This information must agree with the certificate of good standing that accompanies the statement [*see* [e], *below*]. If the corporation must use an assumed name, the assumed name must be set forth in the first line of the statement, following the correct corporate name [*see* [c][ii], [2], *below*]. The assumed name should not be set forth anywhere else in the form [*see* Instructions to Form, reproduced in [2], *below*].

- The addresses of its principal executive office and its principal office in California, if any. Formerly the Secretary of State's office would accept only a full street address, not a post office box. However, the office has advised that it has changed this policy and is now accepting post office box addresses.

- The name of an agent for service of process in California and, if the agent is a natural person, the agent's complete residence or business address [*see* [d], *below*].

- The corporation's irrevocable consent to service of process on its designated agent, or on the Secretary of State if the agent or the agent's successor is not authorized or cannot be found at the address given.

- If applicable, the fact that the corporation is an insurance company.

A foreign corporation's irrevocable consent to service of process extends to service of process directed to the corporation's agent in California for a search warrant issued pursuant to *Penal Code § 1524.2* and for any other validly issued and properly served search warrant for records or documents that are in the corporation's possession [*Corp. Code § 2105(a)(5)(B)* (rule applies regardless of whether corporation is party or nonparty to matter for which warrant is sought)].

[c] Corporate Name

[i] Availability

A corporate name may not be available if it is likely to mislead the public or if it resembles any of the following names so closely as to tend to deceive [*see Corp. Code § 2106(b)*; *see also Corp. Code § 201(b)*]:

- The name of a domestic corporation.

- The name of a foreign corporation that is authorized to transact intrastate business or that has registered its name with the Secretary of State [*see Corp. Code § 2101*].

- A name that a foreign corporation has assumed [*see Corp. Code § 2106(b)*].

- A name that will become the record name of a domestic or foreign corporation on the effective date of a filed corporate instrument [*see Corp. Code §§ 110(c), 5008(c)*].

- A name under reservation for another corporation [*Corp. Code § 2106(b)*; *see Corp. Code § 201(b)*].

A foreign corporation that has a name that would not be available to a new corporation organized in California [*see Corp. Code §§ 201(b), 2106(b)*; *see also § 12B.120*, P 3 (checking name availability)] must comply with one of the following procedures concerning its name to obtain qualification to transact intrastate business in California [*see Corp. Code § 2106*; *see also Corp. Code § 210(b)*]: (1) obtain an injunction against the corporation with the conflicting name; (2) obtain permission from the other corporation to use that name; or (3) use an assumed name in California [*Corp. Code § 2106(b)*; *see Corp. Code § 201(b)*].

For additional discussion of corporate name issues, see *§ 12B.11[2][b]*; see also *Ch. 2, Formation of Corporations, § 2.13*.

[ii] Use of Assumed Name

For a foreign corporation to use an assumed name, the Secretary of State must find, based on affidavit or other proof, that the business to be conducted in California by the foreign corporation is not the same as or similar to the business being or to be conducted by the corporation with the conflicting name, and that the public is not likely to be deceived [*Corp. Code § 2106(b)*]. The corporation may choose an assumed name that is either the corporation's name with the addition of some distinguishing word or words acceptable to the Secretary of State, or a name that would be available to a new domestic corporation [*Corp. Code § 2106(b)*; *see Corp. Code § 201(b)*].

In addition, the foreign corporation must agree that it will transact business in California under the assumed name disclosed to the Secretary of State and that it will use that assumed name in all of its dealings with the Secretary of State and in the conduct of its affairs in California [*Corp. Code § 2106(b)*]. This agreement is set forth in the first line of the statement and designation [*see* [2], *below*]. The corporation may do business in California only under the agreed name, as long as the agreement with the Secretary of State is in effect [*Corp. Code § 2106(b)(2)*].

In completing the form, the corporation must set forth its correct corporate name, followed by the statement "which will do business in California as (assumed name)." The assumed name should not be used anywhere else in the document Instructions to Form, reproduced in [2], *below*].

[iii] Use as Trade Name

Qualification under a corporate name establishes a rebuttable presumption that the corporation has the exclusive right to use that name, or any confusingly similar name, as a trade name if the corporation (1) is the first to have obtained qualification or filed articles under that name, and (2) is actually engaged in a trade or business utilizing that corporate name or a confusingly similar name [*Bus. & Prof. Code § 14415*]. For a discussion of trade names, see Ch. 103B, *Trademarks* .

[d] Agent for Service of Process

The corporation's agent for service of process must be either a natural person residing in California, or a domestic or foreign corporation (1) that is currently authorized to engage in business in California (that is, qualified to transact intrastate business if a foreign corporation), (2) that is in good standing on the Secretary of State's records, (3) that has filed a certificate of consent providing the information required by statute [*see Corp. Code § 1505(a)*; *see also § 12B.204* (certificate of consent for foreign corporation)], and (4) whose capacity to act as an agent has not terminated [

Corp. Code § 2105(a)(4); *see Corp. Code §§ 1502(b), 1505, 2105(c)*]. A corporation cannot be named as agent for service of process for itself [*see* Instructions to Form, reproduced in [2], *below*].

If a natural person is designated, the statement and designation must set forth the agent's complete business or residence street address. Formerly the Secretary of State's office would accept only a full street address, not a post office box. However, the office has orally advised that it has changed this policy and is now accepting post office box addresses. No address should be set forth for a corporate agent [*see Corp. Code §§ 1502(b), 2105(a)(4)*]; this information will appear in the corporation's certificate of consent [*see Corp. Code § 1505(a)*].

A foreign corporation's irrevocable consent to service of process extends to service of process directed to the corporation's agent in California for a search warrant issued pursuant to *Penal Code § 1524.2* and for any other validly issued and properly served search warrant for records or documents that are in the corporation's possession [*Corp. Code § 2105(a)(5)(B)* (rule applies regardless of whether corporation is party or nonparty to matter for which warrant is sought)].

The designation requirements of the Corporations Code do not affect the provisions contained in the Insurance Code [*see Ins. Code §§ 1600-1605*] that require a foreign insurer to maintain a designation of an agent for service of process in the Insurance Commissioner's office [*Corp. Code § 2103*].

On designation of an agent for service of process, the corporation should give the agent written instructions regarding transmittal of any process received [*see § 12B.205*].

[e] Accompanying Certificate of Good Standing

A foreign corporation (other than a foreign association) must attach a certificate of good standing from a public official of its state or place of incorporation to the statement and designation [*see Corp. Code § 2105(b)*; *see § 12B.202* (request for certificate)]. The Secretary of State's office advises that although the use of the words "good standing" is not per se essential, provided that the certificate conveys the meaning that the corporation exists and is authorized to function as a corporation as of the certificate date, it is very important that the name of the corporation as it appears in the certificate of good standing agree with the name of the corporation as it appears in the statement and designation, including punctuation and abbreviations.

If a nonprofit corporation is to be qualified, the Secretary of State requires that the certificate of good standing also indicate that the corporation is a nonstock, nonprofit corporation; *see* Requirements for Qualification of Foreign Nonprofit Corporations, Secretary of State's website http://www.ss.ca.gov/business/corp/corp_sdcnpinfo.htm]. The latter information is required as proof that the corporation is eligible for the reduced filing fees that apply to nonprofit corporations. Although the information on the Secretary of State's website states that a certified copy of the articles of incorporation will not be accepted in lieu of the required certificate [*see* Requirements for Qualification of Foreign Nonprofit Corporations, Secretary of State's website http://www.ss.ca.gov/business/corp/corp_sdcnpinfo.htm], the Secretary of State's office has orally advised that the certificates typically provided by some states or places of incorporation do not specify that the corporation is nonprofit, and that in such a case the Secretary of State's office will accept an endorsed copy of the corporation's articles as proof of its nonprofit status.

The certificate of good standing for a foreign association must be in the form of an officers' certificate [*Corp. Code § 2105(b)*; *see § 12B.203*].

[f] Filing Requirements

The statement and designation, together with the certificate of good standing, should be filed within 60 days of reserving a corporate name with the Secretary of State, because a name reservation is valid for 60 days only [*see Corp.*

Code § 201(c)]. The corporation may file at any of the Secretary of State's offices, including the satellite offices located in Los Angeles, San Diego, Fresno, and San Francisco, together with the applicable filing fee [*see Gov. Code § 12186(e), (f)* (filing fees)].

The Secretary of State may cancel the filing of the statement and designation if the check or other remittance accepted in payment of the filing fee is not honored on presentation. After receiving written notification that the remittance has not been honored, the Secretary of State, 70 days or less after the original filing, will give written notice of cancellation and the cancellation date, which will be not less than 20 days from the date of mailing, to the person submitting the remittance or to the agent for service of process. If the amount is not then paid by cashier's check or the equivalent before the cancellation date, the cancellation will become effective [*Corp. Code § 110.5*].

[g] Amendments to Form

The corporation must notify the Secretary of State if any of the information set forth in the filed statement and designation changes. A foreign association uses one form to change any of the information set forth in the statement and designation [*Corp. Code § 2107(b)*; *see § 12B.222*]. A foreign corporation uses one type of form to notify the Secretary of a change in its name [*Corp. Code § 2107(a)*; *see § 12B.220*], and another type of form [*see §§ 12B.210*, *12B.211*] to change any other information set forth in the statement and designation [*Corp. Code § 2107(d)*; *see Corp. Code § 2117*].

[2] FORM

Statement and Designation for Foreign Corporation [Corp. Code § 2105]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
1. Documents for Obtaining Certificate of Qualification

6-12B California Legal Forms--Transaction Guide § 12B.201A

§ 12B.201A Statement and Designation for Foreign Professional Corporation

[1] Comment--Use of Form

This form is a statement and designation that a foreign professional corporation must file to obtain a certificate of qualification to transact intrastate business in California [*see Corp. Code § 2105*; *see also Corp. Code § 13401* ("foreign professional corporation" defined)]. Foreign corporations other than professional corporations file a different form [*see § 12B.201* (general form)], as do insurers [*see § 12B.201B* (form for insurers)].

The statement and designation must be on a form prescribed by the Secretary of State's office [*see Corp. Code § 2105(a)*]; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. The version reproduced here is the Secretary of State's official form. Forms prepared by the Secretary of State may be obtained from its Sacramento office or from any of its satellite offices in Los Angeles, San Diego, Fresno, or San Francisco, or on the Secretary of State's website as indicated below.

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For further discussion of applicable requirements, see *§ 12B.201[1]*.

[2] FORM

Statement and Designation for Foreign Professional Corporation

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Legal Topics:

For related research and practice materials, see the following legal topics:
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52 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
1. Documents for Obtaining Certificate of Qualification

6-12B California Legal Forms--Transaction Guide § 12B.201B

§ 12B.201B Statement and Designation for Foreign Insurer Corporation

[1] Comment--Use of Form

This form is a statement and designation that a foreign insurer corporation must file to obtain a certificate of qualification to transact intrastate business in California [*see Corp. Code § 2105*]. Foreign corporations other than insurer corporations file a different form [*see § 12B.201*], as do foreign professional corporations [*see § 12B.201A*]. For more detailed discussion on use and filing of statement of designation forms for foreign corporations, see *§ 12B.201[1]*.

The statement and designation must be on a form prescribed by the Secretary of State's office [*see Corp. Code § 2105(a)*]; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. The version reproduced here is the Secretary of State's official form. Forms prepared by the Secretary of State may be obtained from its Sacramento office or from any of its satellite offices in Los Angeles, San Diego, Fresno, or San Francisco, or on the Secretary of State's website as indicated below.

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A foreign insurer corporation must attach a certificate from the California Insurance Commissioner approving the corporate name [*Corp. Code § 2106.5*; *see* instructions to form]. For further discussion of applicable requirements, see *§ 12B.201[1]*.

[2] FORM

Statement and Designation for Foreign Insurer Corporation

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesQualificationsInsurance LawIndustry RegulationInsurance Company OperationsConducting BusinessForeign Insurers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
1. Documents for Obtaining Certificate of Qualification

6-12B California Legal Forms--Transaction Guide § 12B.202

§ 12B.202 Request for Certificate of Good Standing From State of Incorporation

[1] Comment

[a] Use of Form

This form is a letter, for use by a foreign corporation other than a foreign association, requesting an authorized public official in the foreign corporation's place of incorporation to issue a certificate stating that the corporation is in good standing. The certificate requirements are different for foreign associations [*see Corp. Code § 2105(b)*]. This form contains only the requirements for a foreign corporation, not a foreign association. For the certificate of good standing required for a foreign association, see *§ 12B.203*.

A foreign corporation must attach a certificate of good standing to its statement and designation [*see § 12B.201*] to obtain a certificate of qualification to transact intrastate business in California [*Corp. Code § 2105(b)*]. A certificate of good standing is also required when a foreign corporation that is neither currently qualified nor applying for qualification to transact intrastate business in California files an application to register its name in the state [*Corp. Code § 2101(c)*; *see Corp. Code § 2101*; *see also § 12B.240*].

[b] Form and Contents of Certificate

A corporation should not prepare a certificate of good standing in advance, because states generally have standard printed forms of certificates that each state will issue, and the Secretary of State will not accept a certificate unless it is on the official form. The certificate must set forth that the corporation is an existing corporation in good standing in that state or place [*Corp. Code § 2105(b)*]. Use of the words "good standing" is not essential, as long as the certificate conveys the meaning that the corporation exists and is authorized to function as a corporation on the date of the certificate. It is very important that the name of the corporation as it appears in the certificate of good standing agree with the name of the corporation as it appears in the statement and designation [*see § 12B.201*], including punctuation and abbreviations [*see* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_filetips.htm].

If the corporation is nonprofit, the certificate must also indicate that it is a nonstock, nonprofit corporation or a corporation organized for educational, religious, scientific, or charitable purposes that is not issuing shares.

The certificate submitted for filing must be an original executed by, or in the name of, the Secretary of State or other public official from the jurisdiction of incorporation who has custody of the corporation's charter documents, or by a public official of that jurisdiction who is authorized by the laws of that jurisdiction to provide the certificate. Charter documents, such as articles of incorporation, that are certified by the public officer of the state are not acceptable substitutes for the required certificate [*see* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_sdcinfo.htm (general stock corporation) and http://www.ss.ca.gov/business/corp/corp_sdcnpinfo.htm (nonprofit corporation)].

The Corporations Code does not specify how recently dated the certificate must be. The Secretary of State's office requires that the certificate be dated within six months of the anticipated qualification date [*see* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_filetips.htm].

[2] FORM

Request for Certificate of Good Standing From State of Incorporation

_____ [*date*]
_____ [Secretary of State *or other authorized public official*]
State of _____ [*state of incorporation*]
_____ [*address*]
RE: Request for Issuance of Certificate of Good Standing
Dear Sir or Madam:

_____[*Name of foreign corporation*] was incorporated in [*year*] under the laws of your state and is currently existing and in good standing under those laws.

You are hereby requested, as an officer of your state, to issue [*number*] certificates to the effect that the above corporation is an existing corporation and in good standing in your state.

[*If corporation is nonprofit, add:*]

It is further requested that the certificate(s) state that the corporation is nonstock and nonprofit.

[*If corporation is organized for educational, religious, scientific, or charitable purposes, add:*]

It is further requested that the certificate(s) state that this corporation is organized for [educational *or* religious *or* scientific *or* charitable] purposes and is not issuing shares.

[*Continue with the following:*]

Enclosed please find a check in the amount of $_____ for your fee in issuing the requested certificate(s). [*Add, as appropriate:* Also enclosed please find a stamped, self-addressed envelope for your use in mailing the certificate(s) *or* Please send the certificate(s) to _____ (*specify address*).]

Sincerely, _____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
1. Documents for Obtaining Certificate of Qualification

6-12B California Legal Forms--Transaction Guide § 12B.203

§ 12B.203 Statement and Designation and Officers' Certificate for Foreign Association [Corp. Code § 2105]

[1] Comment

[a] Use of Form

This form is the Secretary of State's official form for a statement and designation and attached officers' certificate of good standing, which a foreign association must file to obtain a certificate of qualification to transact intrastate business in California [*see Corp. Code § 2105(a), (b)*]. A "foreign association" is a business association organized as a trust under the laws of a foreign jurisdiction [*see Corp. Code § 170*]. For a statement and designation for use by foreign corporations other than business associations, see *§ 12B.201*.

The association's statement and designation must be on a form prescribed by the Secretary of State's office [*see Corp. Code § 2105(a)*]; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. Copies of the Secretary of State's form can be obtained only from the Sacramento office of the Secretary of State. Unlike most other official forms of the Secretary of State, this form was not available online at the time this form comment was last revised.

Although foreign associations are generally treated as foreign corporations under the General Corporation Law [*see Corp. Code § 171*], and are subject to the same requirements as general corporations for the statement and designation [*see Corp. Code § 2105(a)*], they are governed by different requirements for the certificate of good standing [*see Corp. Code § 2105(b)*]. For a discussion of the requirements of the statement and designation, see *§ 12B.201[1]*. For a discussion of the certificate of good standing used for foreign corporations other than foreign associations, see *§ 12B.202*.

If the association changes its name or if there are any changes in the information contained in its statement and designation, the association must file an amended statement and designation [*Corp. Code § 2106(b)*]. For an amended statement and designation for use by an association, see *§ 12B.222*.

[b] Form and Contents of Certificate

The certificate of a foreign association is an officers' certificate issued by the association itself [*see Corp. Code § 2105(b)*; *see also Corp. Code § 173*]. The form for the certificate appears on the back of the form of statement and designation prepared by the Secretary of State for use by a foreign association [*see Corp. Code § 2105(a)*].

The certificate must state that the foreign association is a validly organized and existing business association under the laws of a specified foreign jurisdiction [*Corp. Code § 2105(b)*]. The certificate must be signed and verified by (1) the chairman of the board, the president, or any vice president, and (2) the secretary, chief financial officer, treasurer, assistant secretary, or assistant treasurer [*see Corp. Code §§ 173, 2105(b)*]. However, according to the form provided by the Office of the Secretary of State, it may instead be signed and verified by two of the trustees of the association [*see* [2], *below*]. "Verified" means that the statements contained in the certificate are declared to be true to the knowledge of the persons executing it, either in an affidavit signed by them under oath before an officer authorized to administer oaths or in a written declaration executed by them under penalty of perjury and stating the date and place of execution [*Corp. Code § 193*]. An affidavit sworn to outside California before a notary public, judge, or clerk of a court of record with an official seal need not be further authenticated [*Corp. Code § 193*].

[2] FORM

Statement and Designation and Officers' Certificate for Foreign Association [Corp. Code § 2105]

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For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
1. Documents for Obtaining Certificate of Qualification

6-12B California Legal Forms--Transaction Guide § 12B.204

§ 12B.204 Foreign Corporation's Certificate of Consent to Act as Agent for Service of Process [Corp. Code § 1505]

[1] Comment

[a] Use of Form

This form is a certificate of consent to be filed by a foreign corporation for the corporation to act as the agent for service of process for another corporation in California [*Corp. Code § 2105(a)(4)*; *see Corp. Code §§ 1502(b), 1505(a)*]. The agency may be made by either a foreign or a domestic corporation on behalf of any domestic corporation or any foreign corporation that has qualified to transact intrastate business [*see Corp. Code §§ 202(c), 1502, 2105*]. For a comparable form used by a domestic corporation to consent to act as agent for service of process, see Ch. 3, *Articles of Incorporation* .

For a discussion of a foreign corporation's designation of an agent for service of process in its statement and designation, see *§ 12B.201 [1][d]*. For a discussion of a domestic corporation's designation of an agent for service of process in its articles of incorporation, see Ch. 3, *Articles of Incorporation* .

The version reproduced here is the Secretary of State's official form.

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[b] Contents

A corporation's certificate of consent must set forth all of the following [*Corp. Code § 1505(a)*]:

- The complete address of its office or offices in California where any corporation that has designated it as agent may be served with process.
- The name of each employee at each specified office to whom it authorizes delivery of process.
- Its consent that delivery to any specified employee at a specified office will constitute delivery of process to it as agent for service of process.

The certificate must be executed in the name of the corporation by an officer of the corporation [*Corp. Code § 1505(a)*].

[c] Filing Requirements

A corporation may not file the certificate of consent unless it is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State [*Corp. Code § 1505(c)*]. For a foreign corporation, the term "authorized to engage in business" means that it has obtained qualification to transact intrastate business [*see* Ballantine & Sterling, California Corporation Laws, ch. 18, *Foreign Corporations*].

The corporation designated as agent must file the certificate and pay the filing fee [*see Gov. Code § 12186(p)*] before any domestic or foreign corporation may designate it as agent for service of process [*Corp. Code §§ 1505(a), 2105(c)*]. It may thereafter file any number of supplemental certificates containing all of the information required in the original certificate. On filing, a supplemental certificate will supersede the original certificate or any previously-filed supplemental certificate [*Corp. Code § 1505(b)*].

A new agent must be designated when a foreign corporation that is the agent for service of process withdraws from California, dissolves or surrenders its qualification, or forfeits its qualification in California [*Corp. Code § 1504*; *see § 12B.12*].

[2] FORM

Foreign Corporation's Certificate of Consent to Act as Agent for Service of Process [Corp. Code § 1505]

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Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
1. Documents for Obtaining Certificate of Qualification

6-12B California Legal Forms--Transaction Guide § 12B.205

§ 12B.205 Instructions to Agent for Transmittal of Process

[1] Comment

[a] Use of Form

This form is a letter of instruction from a foreign corporation to an individual authorized to accept service of process on behalf of that corporation. Every foreign corporation qualified to transact intrastate business must designate in its statement and designation either a natural person or another corporation as its agent in California on whom service of process directed to it may be served [*see Corp. Code §§ 1502(b), 2105(a)*; *see also § 12B.201[1][d]*]. If a corporate agent is selected, that agent must file a certificate of consent naming employees who are authorized to receive process [*see Corp. Code §§ 1502(b), 1505(a), 2105(c)*; *see also § 12B.204*]. In either case, a particular individual will receive a copy of process or other notice. The foreign corporation should give every individual authorized to receive process specific instructions regarding his or her responsibilities if process is served.

[b] Resignation, Removal, or Death of Agent

The authority of an agent for service of process ceases on the filing of a signed and acknowledged statement of resignation with the Secretary of State [*Corp. Code § 1503*]. Although the Secretary of State must promptly notify the corporation of the resignation [*Corp. Code § 1503*], the agent should be instructed to notify the corporation in advance of resignation so that it may select another agent before the authority of the original agent ceases [*see* [2], *below*].

The foreign corporation must designate a new agent in an amended statement if either of the following occurs [*Corp. Code § 1504*; *see Corp. Code §§ 2107(b), (d), 2117*; *see also §§ 12B.220* (foreign corporation), 12B.222 (foreign association)]:

- A natural person designated as agent for service of process resigns, dies, or moves from California.
- A corporate agent resigns, dissolves, withdraws from California, forfeits its right to transact

intrastate business, has its corporate rights, powers, and privileges suspended, or ceases to exist.

The foreign corporation should then provide the new agent with this set of instructions.

[c] Change of Address of Natural Person

If the stated address of a natural person designated for service of process changes, the foreign corporation must file an amended statement with the Secretary of State [*Corp. Code §§ 2107(b), (d), 2117*; *see §§ 12B.220* (foreign corporation), 12B.222 (foreign association)]. Therefore, the agent should be instructed to immediately notify the corporation of any such change [*see* [2], *below*].

[2] FORM

Instructions to Agent for Transmittal of Process

_____ [*date*]
_____ [*Name of agent*]
_____ [*street address*]
_____ [*city*] , CA [*zip code*]
RE: Instructions for Transmittal of Process
Dear _____ [*name of agent*] :

You have been designated by this corporation as one of the persons who may be served with a copy of process or other notices directed to this corporation. Process is generally a summons and complaint in a lawsuit against this corporation, but may consist of any other document handed to you that is directed to this corporation and requires it to take some action, usually within a stated period.

If you receive such a document or any document that you suspect may constitute process, you are requested to make, and attach to the document, a memorandum of the date, time, and place you received the document. In addition, you are requested to follow these instructions:

Notice to Corporation

1. Immediately contact _____[*name of corporate officer*] at _____[his *or* her] office at _____[*address and telephone number*], or at _____[his *or* her] home, at _____[*address and telephone number*], and advise [him *or* her] of the contents of the document you received.

Notice to Local Attorney

2. Immediately contact the corporation's attorney, _____[*name*], at _____[*address and telephone number*], advise [him *or* her] of the contents of the document, and request that _____[he *or* she] take whatever action is appropriate to protect the interests of this corporation.

Mailing Copies

3. Whether or not you reach the above persons by telephone, immediately mail one copy of the document and the

memorandum of the date, time, and place that you received the document to both _____[*name of corporate officer*] at _____[*address*], and to the corporation's attorney, _____[*name*] at _____[*address*].

Further Instructions

4. You are authorized to follow any further or different instructions that you may receive from time to time from this office in writing, or any instructions after service on you from _____[*name of corporate officer*] or _____[*name of corporation's attorney*].

Change of Address or Resignation

5. If you change your address or desire to terminate this agency, notify _____[*name and title*] at _____[*address*]. If your address changes, please give notification as soon as the new address is known so that the Secretary of State may be informed. Send notification of resignation at least 30 days before you wish the resignation to become effective. Your resignation will take effect at the time you file a signed and acknowledged written statement with the Secretary of State.

Acceptance by Agent

6. If you have any questions regarding these instructions, please contact this office. Otherwise, if the instructions meet with your understanding and approval, please sign the enclosed copy of this letter and return it to this office in the enclosed stamped, self-addressed envelope [*optional:* as soon as possible *or* by _____ (*date*)].

Sincerely, _____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

I have received the above instructions and will comply with them.
Dated: _____.

_____ [*signature of agent*]
[*typed name*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesQualificationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
1. Documents for Obtaining Certificate of Qualification

6-12B California Legal Forms--Transaction Guide §§ 12B.206-12B.209

[Reserved]

§§ 12B.206[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
2. Annual Statements of Information

6-12B California Legal Forms--Transaction Guide § 12B.210

§ 12B.210 Annual Statement of Information by Foreign Corporation [Corp. Code § 2117]

[1] Comment

[a] Use of Form

This form is Secretary of State Form SI 350, Statement of Information by Foreign Corporation, also sometimes referred to as the Statement of Officers, or simply "annual statement" or "Statement of Information." The Secretary of State's official printed form is reproduced here, along with the text of the official instructions. Every foreign corporation (other than a foreign association) qualified to transact intrastate business must file this form during the applicable filing period each year [*Corp. Code § 2117(a)*; *see* [c], *below*]. For the comparable forms used by domestic corporations, see *Ch. 7, Corporate Records and Reports, §§ 7.207*, 2.207A. This form may be used by both foreign stock corporations and foreign nonprofit corporations. If the corporation is a publicly traded company, the corporation must also file a corporate disclosure statement [*see Corp. Code § 2117.1(a)*; *see also § 12B.211*].

This form is also used to indicate a change in the information set forth in a previously filed statement of information [*see Corp. Code § 2117(e)*] or in the foreign corporation's original statement and designation [*see § 12B.201*] regarding the address of its principal office in California, the address of its principal executive office, its agent for service of process, or the address of any natural person designated as agent for service of process [*Corp. Code § 2107(d)*; *see* [b][ii], *below*]. However, it is not necessary to file this form to correct a mere error in the names or addresses of the initial agent for service of process or of the first directors. These errors can be corrected by a certificate of correction [*see Corp. Code § 109*]. For further discussion and a form for a certificate of correction, see Ch. 10, *Amendment of Articles* .

The Secretary of State's office requires that the officially prepared form be used; copies and other reproductions are not sufficient. After the initial filing, the Secretary will mail a notice for compliance to each corporation approximately three months before the close of the applicable annual filing period [*see* [c], *below*]. The notice will state the due date for compliance and will be mailed to the last address of the corporation according to the Secretary of State's records. However, failure of the corporation to receive the notice is not an excuse for failing to file the statement [*Corp. Code §§*

1502(d), 2117(f)].

ELECTRONIC FORMS NOTE

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12B.210. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Contents and Effect of Form

[i] Initial Filing

The first time that a corporation files this statement, it must complete the entire form [*see* [2], *below* (Instructions to Form)], which must contain all of the following information [*Corp. Code § 2117(a), (b)*]:

- The names and complete business or residence addresses (a post office box is not acceptable) of the corporation's chief executive officer, secretary, and chief financial officer. If the executive officers use other titles, such as president or treasurer, the statement must include the executive officers performing comparable duties under other titles. If the corporation has no officers, or has no executive officers who are natural persons, the statement must include the names of natural persons performing comparable duties for the corporation pursuant to a management contract or other arrangement.

- The street address of its principal executive office.

- The mailing address of the corporation, if different from the street address of its principal executive office.

- The street address of its principal business office in California, if any.

- A statement of the general type of business that constitutes the principal business activity of the corporation (for example, manufacturer of aircraft, wholesale liquor distributor, or retail department store). If the corporation has not yet commenced doing business, it should include a statement of the type of business in which it intends to engage.

- The agent for service of process. The agent for service of process must be either a natural person residing in California or a corporation that has filed a certificate of consent and whose capacity to act as an agent has not terminated [*Corp. Code § 2117(b)*; *see Corp. Code § 1505*]. If a natural person is designated, the statement must also set forth that person's complete business or residence street address. If a corporate agent is designated, no address need be given [*Corp. Code § 2117(b)*]. For further discussion, see *§§ 12B.201[1][d]* and *12B.205[1]*.

In addition, every publicly traded company (that is, foreign corporation that is an issuer [*see 15 U.S.C. Sec. 78c*], and has at least one class of securities listed or admitted for trading on a national securities exchange, the OTC-Bulletin Board, or the electronic service operated by Pink OTC Markets Inc. [*Corp. Code § 2117.1(b)(1)*; *see Corp. Code § 171*]) must file a separate disclosure statement [*see Corp. Code § 2117.1*; *see also Corp. Code § 2117.1(b)(1)*], which is *set forth in § 12B.211*.

A foreign corporation's irrevocable consent to service of process extends to service of process directed to the corporation's agent in California for a search warrant issued pursuant to *Penal Code § 1524.2* and for any other validly issued and properly served search warrant for records or documents that are in the corporation's possession [*Corp. Code § 2105(a)(5)(B)* (rule applies regardless of whether corporation is party or nonparty to matter for which warrant is sought)].

[ii] Subsequent Filings

After complying with the initial filing requirement, the corporation need not complete the entire form if the information contained in the last filed statement remains unchanged. In that circumstance, the corporation should complete only Items 1 and 13 of the form [*Corp. Code §§ 1502(c), 2117(f)*; *see* [2], *below*]. The filing fee must be paid regardless of whether the entire form has been submitted [*see Gov. Code § 12186(e), (f)*; *see also Corp. Code § 2117(d)* (additional "disclosure fee")].

If a qualified corporation wishes to indicate changes in any of the information contained in its annual statement other than the corporate name, the corporation may file a current annual statement containing all of the information required in the initial statement [*Corp. Code §§ 2107(d), 2117(e)*; *see Corp. Code § 2107(a)*; *see also* [i], *above*]. Such an optional filing can be made at any time (other than during the applicable annual filing period).

If the changes concern the agent for service of process or the address of the agent, the corporation *must* file a current statement containing all the information required in the initial statement [*Corp. Code § 2117(e)*]. The corporation must designate a new agent when the agent's authority ceases [*Corp. Code § 2117(b)*], if a natural person designated as agent dies or no longer resides in California, or if a corporate agent dissolves, withdraws from the state, forfeits its right to transact intrastate business, has its corporate rights, powers, and privileges suspended, or ceases to exist [*Corp. Code § 1504*]. For further information on changes concerning agents for service of process, see *§ 12B.205[1]*. Changes affecting the corporate name or assumed name require a separate form [*Corp. Code § 2107(a)*; *see § 12B.220*].

A current annual statement will supersede the original statement and designation [*see Corp. Code § 2105*; *see also § 12B.201*] and any previously filed statement [*Corp. Code §§ 2107(d), 2117(e)*]. The Secretary of State may destroy or otherwise dispose of any original, annual, or current statement and designation after it has been superseded by the filing of a new statement [*Corp. Code §§ 1502(f), 2117(f)*].

The provisions governing the annual statement do not place any person dealing with the corporation on notice of, or under any duty to inquire about, the existence or content of a statement filed pursuant to that provision [*Corp. Code §§ 1502(g), 2117(f)*].

[c] Filing Statement

The annual statement is to be filed by the last day of the anniversary month of incorporation or qualification, or within the five month period preceding the anniversary month, and whenever the agent for service of process or the agent's address is changed [*see Corp. Code § 2105*; *see also* [b], *above* (change in status of agent for service of process)]. A preprinted form and self addressed envelope are automatically sent to each active foreign and domestic corporation, to the last mailing address of record, for completion and return to the Secretary of State prior to the applicable due date [*see* [1][a], *above*].

There are two fees that apply to the filing of the statement [*see Gov. Code § 12186(e), (f)*; *see also Corp. Code § 2117(d)* (additional "disclosure fee")] and an additonal fee for furnishing a copy of the statement [*see Gov. Code § 12*]. If a copy of the statement is submitted with the original document, the copy will be endorsed and returned to the corporation. If no copy is included, the cancelled check will be the corporation's only proof of filing.

[d] Penalties for Failure to File

[i] Monetary Penalties

If a corporation fails to file an annual statement, the Secretary of State will mail a notice of delinquency to the corporation. The notice must advise the corporation of its right to request relief due to reasonable cause or unusual circumstances, and, if the Secretary does not grant relief, to pay any penalty under protest and to file a claim with the Board of Control requesting relief [*Corp. Code §§ 2204(a), 2206(a)*; *see 2 Cal. Code Reg. §§ 630-632* (claim form)]. If the corporation does not file a statement within 60 days after the notice is mailed, the Secretary of State will certify the name of the corporation to the Franchise Tax Board [*Corp. Code §§ 2204(a), 2206(a)*], which will assess a penalty against the corporation [*Corp. Code §§ 2204(b), 2206(a)*; *see Rev. & Tax. Code § 19141*].

If, after certification, the Secretary of State finds that the required statement was filed before expiration of the 60-day period after the notice of delinquency was filed, or the failure to provide notice of delinquency was due to an error of the Secretary of State, the Secretary must decertify the name of the corporation to the Franchise Tax Board, which will abate any penalty assessed [*Corp. Code §§ 2204(e), 2206(a)*]. If the Secretary of State determines that the corporation's failure to file the statement is excusable due to reasonable cause or unusual circumstances that justify the failure, the Secretary may waive the penalty and not certify the corporation's name to the Franchise Tax Board [*Corp. Code §§ 2204(f), 2206(a)*].

The penalty does not apply to a corporation that on or before the date of certification has dissolved or been merged into another corporation [*Corp. Code §§ 2204(c), 2206(a)*]. The statute does not state whether or not the penalty applies to a foreign corporation that has surrendered without merger [*see Corp. Code §§ 2204(c), 2206(a)*]. However, the penalty does not apply to, and no notice of delinquency need be mailed to, a corporation that has suffered forfeiture of its corporate powers, rights, and privileges by the Franchise Tax Board [*see Rev. & Tax. Code §§ 23301, 23301.5, 23775*] on or before, and remain suspended on, the last day of the filing period [*Corp. Code §§ 2204(d), 2206(a)*].

[ii] Suspension of Corporate Powers

A corporation that (1) fails to file an annual statement for an applicable filing period [*see* [c], *above*], (2) has not filed a statement during the preceding 24 months, and (3) was certified for a penalty [*see Corp. Code §§ 2204(a), (b), 2206(a)*] for the same filing period will be subject to forfeiture of the exercise of the corporate powers, rights, and privileges of a foreign corporation in California, rather than to the monetary penalty [*Corp. Code §§ 2205(a), 2206(a)*]. In this situation, the Secretary of State will mail a notice to the corporation informing it that its corporate powers, rights, and privileges will be forfeited after 60 days if it fails to file a statement [*Corp. Code §§ 2205(b), 2206(a)*]. After the 60-day period has expired without the filing of a statement, the Secretary of State will notify the Franchise Tax Board of the forfeiture, and mail a notice of the forfeiture to the corporation. The corporate powers, rights, and privileges of the corporation are thereby forfeited, except for the purpose of amending the articles of incorporation to set forth a new name [*Corp. Code §§ 2205(c), 2206(a)*; *see Palm Valley Homeowners Assn., Inc. v. Design MTC (2000) 85 Cal. App. 4th 553, 560-561, 102 Cal. Rptr. 2d 350* (trial court did not abuse its discretion in imposing sanctions on law firm for continuing litigation activities on behalf of corporation that it knew to be suspended under *Corp. Code § 2205* for failure to file information statement required by *Corp. Code § 1502*)]. In addition, a suspended corporation may file an application for exempt status, and amend its articles of incorporation as necessary to perfect that application [*Corp. Code § 1502(c)*; *see* Ch. 13, *Nonprofit Corporations*].

Forfeiture of the exercise of the corporate powers, rights, and privileges of a foreign corporation in California does not prohibit the transaction of business by the foreign corporation if the business carried on subsequent to the forfeiture would not, considered as an entirety, require the foreign corporation to obtain a certificate of qualification [*Corp. Code § 2206(c)*; *see Corp. Code § 2105*]. In addition, a foreign nonprofit corporation that has forfeited the exercise of its corporate powers, rights, and privileges in California may nonetheless file an application for exempt status [*Corp. Code*

§ 2206(b); *see Rev. & Tax. Code § 23301*].

[2] FORM

Annual Statement by Foreign Corporation [Corp. Code § 2117]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
2. Annual Statements of Information

6-12B California Legal Forms--Transaction Guide § 12B.211

§ 12B.211 Corporate Disclosure Statement--Publicly Traded Companies

[1] Comment

[a] Use of Form

This form is Secretary of State Form SI-PT, Corporate Disclosure Statement and Form SI-PTA. Every domestic stock and foreign corporation that is a publicly traded company must complete this form and include it when filing either a complete statement of information or changing information to a previously filed statement [*see Corp. Code § 2117.1(a)*; *see also § 12B.210*]. A "publicly traded company" is any foreign corporation that is an issuer [*see 15 U.S.C. § 78c*], and has at least one class of securities listed or admitted for trading on a national securities exchange, the OTC Bulletin Board, or on the electronic service operated by Pink OTC Markets Inc. [*Corp. Code § 2117.1(b)(1)*; *see Corp. Code § 171*]. This form may be used by both foreign stock corporations and foreign nonprofit corporations. The text of the Secretary of State's official instructions are also reproduced with the form below.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 3405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12B.211. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Contents of Form

The Corporate Disclosure Statement must set forth the following information [*Corp. Code § 2117.1(a)*]:

- The name of the independent auditor that prepared the most recent auditor's report on the publicly traded foreign corporation's annual financial statements.

- A description of other services, if any, performed for the publicly traded foreign corporation during its two most recent fiscal years and the period between the end of its most recent fiscal year and the date of the statement by the foregoing independent auditor, by its parent corporation, or by a subsidiary or corporate affiliate of the independent auditor or its parent corporation.

- The name of the independent auditor employed by the foreign corporation on the date of the statement, if different from the independent auditor listed above.

- The compensation for the most recent fiscal year paid to each member of the board of directors and to each of the five most highly compensated executive officers of the foreign corporation who are not members of the board, including the number of any shares issued, options for shares granted, and similar equity-based compensation granted to each of those persons. If the chief executive officer is not among the five most highly compensated executive officers of the corporation, the compensation paid to the chief executive officer must also be included.

- A description of any loan, including the amount and terms of the loans, made to any member of the board by the publicly traded foreign corporation during the foreign corporation's two most recent fiscal years at an interest rate lower than the interest rate available from unaffiliated commercial lenders generally to a similarly situated borrower.

- A statement indicating whether an order for relief has been entered in a bankruptcy case with respect to the foreign corporation, its executive officers, or members of the board of directors of the foreign corporation during the 10 years preceding the date of the statement.

- A statement indicating whether any member of the board of directors or executive officer of the corporation was convicted of fraud during the 10 years preceding the date of the statement and the conviction has not been overturned or expunged.

- A description of any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the corporation or any of its subsidiaries is a party or of which any of their property is the subject, as specified by Item 103 of Regulation S-K of the Securities Exchange Commission [*see* 12 C.F.R. § 229.103].

- A description of any material legal proceeding during which the corporation was found legally liable by entry of a final judgment or final order that was not overturned on appeal during the five years preceding the date of the statement.

The term "executive officer" means means the chief executive officer, president, any vice president in charge of a principal business unit, division, or function, any other officer of the corporation who performs a policymaking function, or any other person who performs similar policymaking functions for the corporation [*Corp. Code § 2117.1(b)(2)*]. The term "compensation" means all plan and nonplan compensation awarded to, earned by, or paid to the person for all services rendered in all capacities to the corporation and to its subsidiaries, as the compensation is specified by Item 402 of Regulation S-K of the Securities and Exchange Commission [*Corp. Code § 2117.1(b)(3)*; *see 17 C.F.R. § 229.402*]. The term "loan" excludes an advance for expenses, the corporation's payment of life insurance premiums, and any advance of litigation expenses, in each instance as permitted according to the applicable law of the state or place of incorporation or organization of the foreign corporation [*Corp. Code § 2117.1(b)(4)*].

Form SI-PTA, an optional attachment to the corporate disclosure statement, is for use when additional directors, loans to members of the board, and any other supplemental information must be stated that exceeds the space allowed by Form SI-PT (or Form SI-PTA itself).

CAUTION:

This statement will be available and open to the public for inspection. The Secretary of State must provide access to all information contained in this statement by means of an online database no later than December 31, 2004 [*Corp. Code § 2117.1(c)*].

[c] Filing and Execution

A publicly traded domestic stock corporation must file this form annually within 150 days after the end of its fiscal year on a form prescribed by the Secretary of State [*Corp. Code § 2117.1(a)*; *see* Secretary of State's website, http://www.ss.ca.gov/business/corp/corp_soinfo.htm].

The corporation must certify that the information provided is true and correct [*Corp. Code § 2117.1(d)*]. There is no fee for filing this form [*Gov. Code § 12186(j)*].

[2] FORM

Corporate Disclosure Statement--Publicly Traded Companies

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsSecurities LawBlue Sky LawsSecurities Registration



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
2. Annual Statements of Information

6-12B California Legal Forms--Transaction Guide §§ 12B.212-12B.219

[Reserved]

§§ 12B.212[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
3. Amendments to Documents Filed With Secretary of State

6-12B California Legal Forms--Transaction Guide § 12B.220

§ 12B.220 Amended Statement and Designation by Foreign Corporation [Corp. Code § 2107]

[1] Comment

[a] Use of Form

This form is an amended statement that a qualified foreign corporation (other than a foreign association) must file if it changes its name or makes a change affecting an assumed name set forth in the statement and designation [*see Corp. Code § 2107(a)*; *see also Corp. Code § 2105*; *see also* Secretary of State's information packet]. The new name chosen by a foreign corporation must be a name available to a new domestic corporation in California [*Corp. Code § 2106(b)*; *see Corp. Code § 201(b)*; *see also §§ 12B.11[2][b], 12B.201[1][c][i]*].

The amended statement and designation must be on a form prescribed by the Secretary of State's office [*see Corp. Code § 2107(a)*]; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. The version reproduced here is the Secretary of State's official form and can be obtained from the Secretary of State's office in Sacramento or from any of its satellite offices in Los Angeles, San Diego, or Fresno, or on the Secretary of State's website as indicated below.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12B.220. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

The form must be filed in the office of the Secretary of State. On filing and payment of the filing fee [*see Gov. Code §*

12186(p)], the Secretary of State will issue a new certificate of qualification [*Corp. Code § 2107(a)*]. The Secretary will compare and certify up to two copies of the amended statement without charge when the copies are submitted along with the original [*Gov. Code § 12185*].

For the original statement and designation of a foreign corporation, see *§ 12B.201*. For the form used to indicate any change in information set forth in a foreign association's statement and designation, see *§ 12B.222*.

[b] Requirements

The statement must set forth the name relinquished as well as the new name assumed. It must also include the signature of a corporate officer [*Corp. Code § 2107(a)*].

To enable filing, an original certificate of an authorized public official of the state or place of incorporation must be attached to this form unless the corporation is merely deleting or changing a "doing business as" name and not changing the legal corporate name. The certificate must state that the name change was made in accordance with the laws of the state or place of incorporation [*see* Secretary of State's information packet]. A certified copy of the certificate of amendment or other document by which the name change was effected is not a sufficient substitute for this certificate [*see* Secretary of State's information packet; *see also § 12B.221* (request for certificate)].

If the change includes a change of name of an insurer subject to the Insurance Code, the form must include a statement that the corporation is an insurer if it does not already appear on previously filed documents [*Corp. Code § 2107(c)*].

[c] Changing Corporate Address or Agent

To change a foreign corporation's corporate address or the identity or address of the agent for service of process, the corporation *must* request a Statement by Foreign Corporation form from the Secretary of State, Statement of Officers Unit [*see Corp. Code § 2117*; Secretary of State's information packet; *see also § 12B.210*]. The information on each newly filed statement supersedes previous information of record [*see* Secretary of State's information packet].

[d] No Amendment of Domicile

A foreign corporation's state of domicile cannot be changed by amendment. This change can only be accomplished in California by filing (1) an agreement of merger or (2) a certificate of surrender on behalf of the qualified corporation of record from the original place of domicile and the qualification of the corporation under its new place of domicile. Using the second option, the documents may be filed simultaneously to permit continued use of the corporate name in California [*see* Secretary of State's information packet].

[2] FORM

Amended Statement and Designation by Foreign Corporation [Corp. Code § 2107]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ChangesBusiness & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualifications



62 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
3. Amendments to Documents Filed With Secretary of State

6-12B California Legal Forms--Transaction Guide § 12B.221

§ 12B.221 Request for Certificate From State of Incorporation

[1] Comment--Use of Form

This form is a letter to the Secretary of State of a foreign corporation's state of incorporation requesting a certificate stating that the corporation's change of name was made in accordance with the laws of that state. This type of certificate from an authorized public official of the state of incorporation is required for filing an amended statement and designation in California [*Corp. Code § 2107(a)*; *see § 12B.220*].

For a discussion of the procedures required to indicate a change in a foreign corporation's name, see *§ 12B.220[1]*.

[2] FORM

Request for Certificate From State of Incorporation

_____ [*date*]
Office of the Secretary of State
State of _____ [*state of incorporation*]
_____ [*address*]
Dear Sir or Madam:

_____[*Original name of foreign corporation*] was incorporated in [*year*] under the laws of your state. On _____[*date*], this corporation changed its name to _____[*new name*].

You are hereby requested, as an officer of your state, to issue [*number*] certificates to the effect that the above change in name was made in accordance with the laws of the state of _____[*state of incorporation*].

Enclosed please find a check in the amount of $_____ for your fee in issuing the requested

certificate(s). [*Add, as appropriate:* Also enclosed please find a stamped, self-addressed envelope for your use in mailing the certificate(s) *or* Please send the certificate(s) to _____ (*specify address*).]

Sincerely, _____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ChangesBusiness & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualifications



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
3. Amendments to Documents Filed With Secretary of State

6-12B California Legal Forms--Transaction Guide § 12B.222

§ 12B.222 Amended Statement and Designation by Foreign Association [Corp. Code § 2107]

[1] Comment

[a] Use of Form

This form is an amended statement and designation that a qualified foreign association--that is, a business association organized as a trust under the laws of a foreign jurisdiction [*Corp. Code § 170* (definition)]--must file with the Secretary of State when any of the information set forth in its original statement and designation has changed. A foreign association is treated as a species of foreign corporation for purposes of the Corporations Code provisions regulating foreign corporations [*Corp. Code § 171* (definition)]. Note that this discussion applies only to "foreign associations" as defined by *Corp. Code § 170*. Nonprofit unincorporated associations [*see Corp. Code § 18020(a)*] are governed by different requirements [*see* Ch. 13A, *Nonprofit Unincorporated Associations* .]

Foreign associations, unlike other foreign corporations, use the same form for name changes as for changes in the address of its principal office in California, the address of its principal executive office, its agent for service of process, or the stated address of any natural person designated as agent for service of process [*Corp. Code § 2107(b)*; *see Corp. Code § 2107(a), (d)*].

The amended statement and designation must be on the form prescribed by the Secretary of State's office [*see Corp. Code § 2107(b)*]; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. This form may be ordered from the Secretary of State's Sacramento Office. Unlike most other official forms of the Secretary of State, this form was not available online at the time this form comment was last revised.

The form must be filed in the office of the Secretary of State [*Corp. Code § 2107(b)*]. There is a fee for filing the statement [*Gov. Code § 12191(a)(2)*]. The Secretary of State will compare and certify up to two copies of the statement without charge when the copies are submitted along with the original [*Gov. Code § 12185*].

If the change includes a change of name or a change affecting an assumed name [*see Corp. Code § 2106*], the Secretary

of State will issue a new certificate of qualification on the filing of the form [*Corp. Code § 2107(b)*].

For an original statement and designation, see *§ 12B.201*. For the form used to indicate a change in the name of a foreign corporation, see *§ 12B.220*. For the form used to indicate a change in other information set forth in a foreign corporation's original statement and designation, see *§ 12B.210*.

[b] Contents of Form

The form must set forth the change or changes made, and must be signed by an officer of the association [*Corp. Code § 2107(b)*].

If the change is in the association's name, the form must (1) set forth the name relinquished, (2) set forth the new name assumed, and (3) have attached an officers' certificate stating that the change of name was made in accordance with its declaration of trust [*Corp. Code § 2107(b)*; *see § 12B.223*]. The new name chosen by the foreign association must be a name available to a new domestic corporation in California [*Corp. Code § 2106(b)*; *see Corp. Code § 201(b)*; *see also § 12B.201[1][c]*].

If the change includes a change of name of an insurer subject to the Insurance Code, the form must include a statement that the corporation is such an insurer [*Corp. Code § 2107(c)*].

[2] FORM

Amended Statement and Designation by Foreign Association [Corp. Code § 2107]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ChangesBusiness & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
3. Amendments to Documents Filed With Secretary of State

6-12B California Legal Forms--Transaction Guide § 12B.223

§ 12B.223 Officer's Certificate Regarding Foreign Association's Change of Name [Corp. Code § 2107]

[1] Comment--Use of Form

This form is the officers' certificate that must be attached to a foreign association's amended statement and designation indicating a change in its name [*see § 12B.222*]. The certificate must state that the change of name was made in accordance with the foreign association's declaration of trust [*Corp. Code § 2107(b)*]. For a discussion of the requirements of an officers' certificate, see *§ 12B.203[1][b]*. For a discussion of a foreign association's amended statement and designation, see *§ 12B.222[1]*.

[2] FORM

Officer's Certificate Regarding Foreign Association's Change of Name [Corp. Code § 2107]
(DO NOT WRITE IN THIS SPACE)

_____

OFFICER'S CERTIFICATE
CHANGE OF NAME

_____

_____ and _____[*Names*] certify:

1. They are the [Chairman of the Board *or* the President *or* a Vice President] and the [Secretary *or* the Chief Financial Officer *or* the Treasurer *or* an Assistant Secretary *or* an Assistant Treasurer], respectively, of _____[*new name of association*], a foreign association qualified to transact intrastate business in California.

2. The name of this association as set forth in its Statement and Designation filed with the California Secretary of State on _____[*date*], was _____[*former name*].

3. This association has changed its name from _____[*former name*] to _____[*association's new name*] in accordance with its declaration of trust.

_____ [*new name of association*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]

[*EITHER*]

Declaration

Each of the undersigned declares under penalty of perjury that the matters set forth in the foregoing certificate are true and correct of _____[his *or* her *or* his or her] own knowledge and that this declaration was executed on _____[*date*], at _____[*city and state*].

_____ [*signature*]
[*typed name and title*]
_____ [*signature*]
[*typed name and title*]

[*OR*]

Affidavit

State of _____
County of _____

_____ and _____[*Names*], being duly sworn, each states that _____[he *or* she *or* he or she] has read the foregoing certificate and knows its contents, and that the matters set forth therein are true of _____[his *or* her *or* his or her] own knowledge.

_____ [*signature*]
[*typed name and title*]
_____ [*signature*]
[*typed name and title*]

Subscribed and sworn to before me on _____[*date*].

[*Notarial seal*]

_____ [*signature*]
NOTARY PUBLIC

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ChangesBusiness & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualifications



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CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
A. Qualification to Transact Intrastate Business in California
3. Amendments to Documents Filed With Secretary of State

6-12B California Legal Forms--Transaction Guide §§ 12B.224-12B.229

[Reserved]

§§ 12B.224[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
B. Surrender and Forfeiture of Right to Transact Intrastate Business in California

6-12B California Legal Forms--Transaction Guide § 12B.230

§ 12B.230 Foreign Corporation's Certificate of Surrender of Right to Transact Intrastate Business [Corp. Code § 2112]

[1] Comment

[a] Use of Form

This form is the certificate that a qualified foreign corporation must file to surrender its right to transact intrastate business in California. This form is used (1) when the corporation is disappearing in a merger into another foreign corporation in a transaction not involving a domestic corporation or (2) when the corporation is surrendering its right to transact intrastate business, but not disappearing due to a merger involving a domestic corporation [*see Corp. Code §§ 2112, 2113*]. Alternatively, a foreign corporation disappearing in a merger or conversion involving a domestic corporation may surrender that right by filing the appropriate documents [*Corp. Code § 2113(a)*]. For further discussion of the requirements to surrender, see *§ 12B.12[2]*. For a guide to surrender procedures for foreign corporations disappearing due to merger or conversion, see *§ 12B.135*, PP 2, 3, and 4.

The certificate of surrender must be on a form prescribed by the Secretary of State's office; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. The version reproduced here is the Secretary of State's official form. Forms prepared by the Secretary of State may be obtained from its Sacramento office or from any of its satellite offices in Los Angeles, San Diego, or San Francisco, or on the Secretary of State's website as indicated below.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12B.230. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or

higher.

Filing a certificate of surrender will remove a foreign corporation from the jurisdiction of California courts concerning events that occur after surrender; however, the corporation remains subject to jurisdiction for events that occurred before surrender [*see Corp. Code § 2114(a), (b)*; *see also Northern Natural Gas Co. v. Superior Court (1976) 64 Cal. App. 3d 983, 987 n.1, 134 Cal. Rptr. 850*]. A foreign corporation that ceases to do business without filing a certificate of surrender does not revoke the appointment of any agent for the service of process [*Corp. Code § 2114(d)*]. For information on service of process on corporations that have surrendered, see *§ 12B.12[2][d]*.

[b] Contents of Certificate

The certificate of surrender must state all of the following [*Corp. Code § 2112(a)*]:

- The corporation's name as shown on the records of the Secretary of State, and the state or place of incorporation or organization.
- That the corporation revokes its designation of agent for service of process.
- That the corporation surrenders its authority to transact intrastate business.
- That the corporation consents that process against it in any action on any liability or obligation incurred within California before filing of the certificate may be served on the Secretary of State.
- A post office address to which the Secretary of State may mail a copy of any process against the corporation that is served on the Secretary. The corporation may change the address or the name to which the process should be sent by filing a statement signed by a corporate officer [*see § 12B.231*].
- That a final franchise tax return [*see* Rev. & Tax. Code § 23332] has been or will be filed with the Franchise Tax Board.

The certificate of surrender must be signed by a corporate officer [*Corp. Code § 2112(a)*], unless it is filed by a foreign corporation disappearing due to merger with another foreign corporation in a transaction not involving a domestic corporation. In that case, the certificate may be signed in the name of the surviving corporation by an officer of the surviving corporation, and must be accompanied by a certificate of an authorized public official of the jurisdiction of incorporation stating that the corporation has been merged into another foreign corporation and setting forth the name and state or place of incorporation of the surviving corporation [*Corp. Code § 2113(c)*].

[c] Tax Clearance Certificate

A tax clearance certificate from the Franchise Tax Board is no longer required in order to obtain a certificate of surrender [*see* former Rev. & Tax Code § 23334; 2006 Stats., ch. 773]. The Secretary of State will notify the Franchise Tax Board of the surrender [*see* Corp. Code § 2112(b)].

[d] Filing

There is no fee for filing a certificate of surrender [*see* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_formsfees.htm; *see Gov. Code §§ 12186(o)* (corporation), 12191(a)(3)(association)].

The certificate of surrender may be filed in person at the Sacramento office or by mail. There is a special handling fee

for filing the certificate in person [*see 2 Cal. Code Reg. § 21903*]. If the certificate is mailed for filing, the Secretary of State recommends that it be sent by certified mail, with return receipt requested, for proof of submittal.

[2] FORM

Foreign Corporation's Certificate of Surrender of Right to Transact Intrastate Business [Corp. Code § 2112]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesDomesticationBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
B. Surrender and Forfeiture of Right to Transact Intrastate Business in California

6-12B California Legal Forms--Transaction Guide § 12B.231

§ 12B.231 Statement of Change of Name or Address of Surrendered Foreign Corporation [Corp. Code § 2112]

[1] Comment--Use of Form

This form is a statement that a foreign corporation must file to change the name or address stated in the certificate of surrender filed with the Secretary of State [*see Corp. Code § 2112(a)(5)*]. The certificate of surrender [*see § 12B.230*] must set forth a post office address to which the Secretary of State may send any process that has been served on the Secretary as the corporation's agent for service of process [*see Corp. Code § 2112(a)(5)*]. This form is used to change that address, or to indicate a change in the corporation's name made after the certificate of surrender was filed. The statement must be signed by a corporate officer [*Corp. Code § 2112(a)(5)*].

The statement of change of name or address must be on a form prescribed by the Secretary of State's office; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. This form is based on a form prepared by the Secretary of State's office and meets the applicable requirements. Unlike most other Secretary of State forms, this form was not available online at the time this form comment was last revised.

[2] FORM

Statement of Change of Name or Address of Surrendered Foreign Corporation [Corp. Code § 2112]

(DO NOT WRITE IN THIS SPACE)

CERTIFICATE OF CHANGE OF ADDRESS SURRENDERED FOREIGN CORPORATION

On behalf and by the authority of _____[*current name of surrendered corporation*], a corporation organized and existing under the laws of _____[*state or place of incorporation*], the undersigned certifies and declares:

1. That the post office address to which any process against this corporation that may be served on the Secretary of State of the State of California shall hereafter be sent is _____[*address*].

2. That the name of this corporation has been changed since the filing of its Certificate of Surrender of Right to Transact Intrastate Business and that the name of the corporation at the time of that filing and as shown in that Certificate of Surrender of Right to Transact Business was _____[*former name of corporation*].

Dated: _____

_____ [*name of corporation*]
By _____ [*signature of corporate officer*]
[*typed name and title of corporate officer*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ChangesBusiness & Corporate LawForeign BusinessesQualificationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
B. Surrender and Forfeiture of Right to Transact Intrastate Business in California

6-12B California Legal Forms--Transaction Guide § 12B.232

§ 12B.232 Foreign Association's Certificate of Surrender of Right to Transact Intrastate Business [Corp. Code § 2112]

[1] Comment--Use of Form

This form is a certificate of surrender for use by a qualified foreign business association to surrender its right to transact intrastate business in California. The certificate must contain specified information [*see § 12B.230[1][b]*], and must be signed by an officer of the association [*Corp. Code § 2112(a)*]. Under some circumstances, documents of merger may be filed instead of the certificate of surrender [*see Corp. Code § 2113*]. There is no fee for filing a certificate of surrender [*see Gov. Code § 12191(a)(3)*]. For further discussion of surrender, see *§§ 12B.12[2]* and *12B.230[1]*. For a procedural guide to surrender, see *§ 12B.135*.

The certificate of surrender must be on a form prescribed by the Secretary of State's office; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. This form may be ordered from the Secretary of State's Sacramento Office. Unlike most other official forms of the Secretary of State, this form was not available online at the time this form comment was last revised.

[2] FORM

Foreign Association's Certificate of Surrender of Right to Transact Intrastate Business [Corp. Code § 2112]

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Legal Topics:

For related research and practice materials, see the following legal topics:
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CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
B. Surrender and Forfeiture of Right to Transact Intrastate Business in California

6-12B California Legal Forms--Transaction Guide § 12B.233

§ 12B.233 Statement of Change of Name or Address of Surrendered Foreign Association [Corp. Code § 2112]

[1] Comment--Use of Form

This form is a statement that a foreign association must file to change the name or address stated in the certificate of surrender filed with the Secretary of State [*see Corp. Code § 2112(a)(5)*]. The certificate of surrender [*see § 12B.232*] must set forth a post office address to which the Secretary of State may send any process that has been served on the Secretary as the association's agent for service of process. This form is used to change that address, or to indicate a change in the association's name made after the certificate of surrender was filed. The statement must be signed by an officer of the association [*Corp. Code § 2112(a)(5)*].

The statement of change of name or address must be on a form prescribed by the Secretary of State's office; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. This form may be ordered from the Secretary of State's Sacramento Office. Unlike most other official forms of the Secretary of State, this form was not available online at the time this form comment was last revised.

[2] FORM

Statement of Change of Name or Address of Surrendered Foreign Association [Corp. Code § 2112]

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Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
B. Surrender and Forfeiture of Right to Transact Intrastate Business in California

6-12B California Legal Forms--Transaction Guide § 12B.234

§ 12B.234 Request for Certificate Confirming Merger [Corp. Code § 2113]

[1] Comment

[a] Use of Form

This form is a letter requesting an authorized public official in a foreign corporation's place of incorporation to issue a certificate stating that the corporation has been merged into another foreign corporation. A foreign corporation must attach this certificate to its certificate of surrender [*see §§ 12B.230* (corporation), 12B.232 (association)] when the certificate of surrender is signed in the name of the surviving corporation in a merger [*Corp. Code § 2113(c)*]. For a discussion of the certificate of surrender, see *§ 12B.230[1]*.

[b] Contents of Certificate

The certificate confirming merger must be made by an authorized public official of the foreign corporation's state or place of incorporation. It must state that the foreign corporation has been merged into another foreign corporation. It must also include the name and state or place of incorporation of the surviving foreign corporation [*Corp. Code § 2113(c)*].

[2] FORM

Request for Certificate Confirming Merger [Corp. Code § 2113]

_____ [*date*]
State of _____ [*state of incorporation*]
_____ [*address*]
RE: Request for Issuance of Certificate Confirming Merger
Dear Sir or Madam:

_____[*Name of foreign corporation*] was incorporated in [*year*] under the laws of your state. It has

since been merged into _____[*name of surviving foreign corporation*], a [*state or place, e.g.,* Delaware] corporation.

You are hereby requested, as an officer of your state, to issue [*number*] certificate(s) to the effect that _____[*name of merged foreign corporation*] has been merged into another corporation. Please set forth the name and state or place of incorporation of the surviving foreign corporation. Please send the certificate(s) to _____[_____ (*name of surviving corporation*) *or* the Secretary of State] in the enclosed stamped, addressed envelope.

Enclosed please find a check in the amount of $_____ for your fee in issuing the requested certificate(s).

Sincerely, _____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsMergers & Acquisitions LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
B. Surrender and Forfeiture of Right to Transact Intrastate Business in California

6-12B California Legal Forms--Transaction Guide §§ 12B.235-12B.239

[Reserved]

§§ 12B.235[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
C. Related California Procedures
1. Registration of Corporate Name in California

6-12B California Legal Forms--Transaction Guide § 12B.240

§ 12B.240 Application for Registration of Name by Foreign Corporation Not Transacting Intrastate Business [Corp. Code § 2101]

[1] Comment

[a] Use of Form

This form is an application by a foreign corporation (other than a foreign association) that is not transacting intrastate business in California to register its name with the Secretary of State. The registration process is not available to foreign associations [*Corp. Code § 2101(a)*]. The names of qualified corporations are already protected [*see Corp. Code § 201*; *see also Corp Code § 2101(a)*].

A foreign corporation that is not qualified to do business in California may reserve its name in the state to avoid name availability complications that could arise if it later decides to qualify under that name [*see Corp. Code § 2106(b)*; *see also § 12B.120*, P 3]. Registration is effective until the close of the calendar year in which the application is filed, and may be renewed [*Corp. Code § 2101(b), (c)*]. Registration prevents any other corporation from incorporating or qualifying under the same name for the duration of the registration.

This form may also be used to renew a registration. Renewal may be accomplished by filing an application for renewal between October 1 and December 31 of each year. A registration form, with a certificate of good standing attached, may be used as the request for renewal. Filing a renewal application will extend the name registration through the following calendar year [*Corp. Code § 2101(c)*; *see Gov. Code § 12186(b)* (filing fee)].

The application for name registration must be on a form prescribed by the Secretary of State's office; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. The version reproduced here is the Secretary of State's official form. Forms prepared by the Secretary of State may be obtained from its Sacramento office, or on the Secretary of State's website as indicated below.

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12B.240. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Name Availability

The applicant's name must be a name that would be available to a new corporation organized at the time of registration [*Corp. Code § 2101(a)*; *see Corp. Code § 201*; *see also § 12B.201[1][c][i]*]. In addition, it must not be a name in which the words "bank," "trust," "trustee," or related words appear, unless a certificate of approval is attached [*Corp. Code § 2101(a)*; *see Corp. Code § 201(a)*].

[c] Registration Requirements

A foreign corporation may register its name by filing an application for registration with the Secretary of State and paying a filing fee [*Corp. Code § 2101(a)*; *see Gov. Code § 12186(b)*]. The application must be signed by a corporate officer and must state (1) the name of the corporation; (2) the state or place of incorporation; (3) the date of incorporation; and (4) the corporation's desire to register its name under *Corp. Code § 2101* [*Corp. Code § 2101(b)*]. The application must be accompanied by an original certificate of an authorized public official of the state or place of incorporation, stating that the corporation is in good standing under those laws [*Corp. Code § 2101(b)*; *see* Secretary of State's information packet; *see also § 12B.202* (request for certificate)].

Foreign name registration documents must be mailed, or hand delivered for over the counter processing to the Sacramento headquarters office [Secretary of State's information packet]:

Business Filings
1500 11th Street
Sacramento, CA 95814
Attention: Document Filing Support Unit

Foreign name registration documents may not be filed in satellite offices [Secretary of State's information packet].

[d] Alternatives to Registration

A foreign corporation may reserve its name by applying for a certificate of reservation pursuant to the procedures set forth in *Corp. Code § 201(c)* [*see § 12B.120*, P 4]. However, since that type of reservation is valid for only 60 days and is non-renewable [*see Corp. Code § 201(c)*], it is best used in conjunction with an application for qualification. A corporation may also qualify to transact intrastate business in California [*see Corp. Code § 2105*] or incorporate in California in order to obtain the same name protection.

[2] FORM

Application for Registration of Name by Foreign Corporation Not Transacting Intrastate Business [Corp. Code § 2101]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawForeign BusinessesQualifications



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
C. Related California Procedures
1. Registration of Corporate Name in California

6-12B California Legal Forms--Transaction Guide §§ 12B.241-12B.249

[Reserved]

§§ 12B.241[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
C. Related California Procedures
2. Foreign Lending Institutions

6-12B California Legal Forms--Transaction Guide § 12B.250

§ 12B.250 Resolution Authorizing Filing of Annual Address Statements

[1] Comment

[a] Use of Form

This form is a resolution by the board of directors of a foreign lending institution that has not qualified to transact intrastate business in California confirming the appointment of the California Secretary of State as the foreign corporation's agent for service of process and authorizing the filing of annual address statements [*see Corp. Code § 2104*]. While this form suggests the content of the resolution, the method of adoption and specific form of the resolution are governed by laws of the foreign corporation's state of incorporation. For the form for the annual address statement, see *§ 12B.251*.

[b] "Foreign Lending Institution" Defined

The term "foreign lending institution" includes any (1) foreign banking corporation, (2) foreign corporation whose capital stock is owned exclusively by one or more foreign banking corporations, (3) foreign savings and loan association, (4) foreign insurance company, or (5) foreign corporation or association authorized by its charter to invest in loans secured by real and personal property. Other types of organizations may also be included within the definition. The lending institution may have been organized under the laws of the United States or any state, district, or territory of the United States [*Corp. Code § 191(d)*].

[c] Statement Requirement

Any foreign lending institution that has not qualified to do business in California, but engages in certain activities within the state that do not constitute the transaction of intrastate business [*see Corp. Code § 191(d)*; *see also § 12B.11[1][b][ii]*] is considered to have appointed the Secretary of State as its agent for service of process for any action arising out of those activities. It must file a statement showing its address for receipt of process, and pay the appropriate filing fee [*see Gov. Code § 12186(o)*], on or before June 30 of each year [*Corp. Code § 2104*; *see Corp. Code § 2111*;

see also § 12B.251].

A lending institution is not required to qualify, and does not become subject to certain statutes regarding qualification for doing or transacting business solely because it engages in one or more of the activities giving rise to the statement requirement [*Corp. Code § 2104*; *see Corp. Code § 191(d)*].

[2] FORM

Resolution Authorizing Filing of Annual Address Statements

RESOLUTION

Recitals

WHEREAS, this corporation maintains no office in the State of California, and is and will be conducting activities in the State of California that are enumerated in *California Corporations Code Section 191(d)*, and has thereby appointed the Secretary of State of California as its agent on whom process and notices directed to this corporation may be served in California; therefore it is:

Resolution

RESOLVED, that the [*title of officer*], or other proper officer, of this corporation is hereby authorized and directed to file with the California Secretary of State, on or before June 30 of each year, a statement showing _____[*address*] as the principal place of business of this corporation to which any notice or process may be sent, and to pay the applicable filing fee.

Legal Topics:

For related research and practice materials, see the following legal topics:
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CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
C. Related California Procedures
2. Foreign Lending Institutions

6-12B California Legal Forms--Transaction Guide § 12B.251

§ 12B.251 Statement by Foreign Lending Institution of Address for Notice or Process [Corp. Code § 2104]

[1] Comment

[a] Use of Form

This form is Secretary of State Form LL-25, Statement by Foreign Lending Institution of Address of Principal Place of Business to Which Notice or Process May Be Sent [*see Corp. Code § 2104*]. The Secretary of State's official printed form is reproduced here, along with the text of the official instructions. For a discussion of the organizations required to file this statement, see *§ 12B.250[1][b]*.

The statement must be on a form prescribed by the Secretary of State's office; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. Forms prepared by the Secretary of State may be obtained from its Sacramento office, or on the Secretary of State's website as indicated below.

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12B.251. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Filing Requirements

A foreign lending institution that is required to file the address statement must do so on or before June 30 of each year. A new statement must be filed every year even if the address remains unchanged [*see Corp. Code § 2104*; *see Gov.*

Code § 12186(o) (filing fee)]. The lending institution should file a supplemental statement if, before the following June 30, it changes the address to which process should be sent [*see § 12B.252*].

There is no procedure for filing a withdrawal statement when the institution ceases the activities requiring the statement. If the lending institution expands its activities in California [*see Corp. Code § 191(d)*], it must qualify to transact intrastate business by filing a statement and designation that specifies an agent for service of process [*see Corp. Code § 2105(a)(4)*; *see also § 12B.201*].

[c] Transmittal of Process

Service of process is deemed complete on the tenth day after delivery to the Secretary of State [*Corp. Code §§ 2104, 2111(a)*]. After receiving process for the lending institution, the Secretary will forward a copy, by registered or certified mail with a request for return receipt, to the address set forth in the annual statement [*Corp. Code §§ 2104, 2111(b)*; *see* [2], *below*]. The Secretary of State will keep a record of all process served on that office for the lending institution and the time of service. The Secretary's certificate and seal certifying the (1) receipt of process, (2) giving of notice, and (3) forwarding of process to the institution will be competent and prima facie evidence of the facts stated in the certificate [*Corp. Code §§ 2104, 2111(c)*].

[2] FORM

Statement by Foreign Lending Institution of Address for Notice or Process [Corp. Code § 2104]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
C. Related California Procedures
2. Foreign Lending Institutions

6-12B California Legal Forms--Transaction Guide § 12B.252

§ 12B.252 Supplement to Statement by Foreign Lending Institution

[1] Comment--Use of Form

This form is Secretary of State Form LL-25A, Supplement to Statement by Foreign Lending Institution [*see Corp. Code § 2104*]. It is for use by foreign lending institutions that do not transact intrastate business in California [*see Corp. Code § 191(d)*]. It should be filed at any time when a foreign lending institution changes either the name or address for service of process set forth in its previous annual address statement [*see § 12B.251*]. There is no filing fee. The Secretary of State's official printed form is reproduced here, along with the text of the official instructions.

A supplementary statement does not take the place of a new statement for the next filing period, which must be filed each year [*see Corp. Code § 2104*; *see also § 12B.251[1][b]*].

The supplement to statement must be on a form prescribed by the Secretary of State's office; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. Forms prepared by the Secretary of State may be obtained from its Sacramento office, or on the Secretary of State's website as indicated below.

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12B.252. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[2] FORM

Supplement to Statement by Foreign Lending Institution

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ChangesBusiness & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
C. Related California Procedures
2. Foreign Lending Institutions

6-12B California Legal Forms--Transaction Guide §§ 12B.253-12B.259

[Reserved]

§§ 12B.253[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
C. Related California Procedures
3. State Taxation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.260

§ 12B.260 Application of Foreign Corporation for Exclusion From State Taxation [Rev. & Tax. Code § 23101.5]

[1] Comment

[a] Use of Form

This form is an application by a foreign corporation to the California Franchise Tax Board for a determination that the corporation is excluded from state franchise or corporate income taxation. The same form is used to apply for exclusion from either franchise or corporate income tax [*see Rev. & Tax. Code § 23101.5(a)*; *see also 18 Cal. Code Reg. § 23101.5(d), (f)*].

A corporation is subject to the franchise tax if it is doing business in California [*Rev. & Tax. Code § 23151*; *see § 12B.31*]. For taxable years beginning before January 1, 2011, a corporation is "doing business" if it actively engages in any transaction for the purpose of financial or pecuniary gain or profit [*Rev. & Tax. Code § 23101(a)*; *see 18 Cal. Code Reg. § 23101*], or if it has qualified in California [*see 18 Cal. Code Reg. § 23151*]. For taxable years beginning on or after January 1, 2011, a taxpayer is doing business in California for a taxable year if any of specified conditions has been satisfied [Corp. Code § 23101(b); *see § 12B.31, above*]. A corporation is subject to the corporate income tax if it is not subject to the franchise tax, but is deriving income from sources within California [*Rev. & Tax. Code § 23501*]. For further discussion of franchise and income taxation, see *§§ 12B.30-12B.32, 12B.114*.

However, a corporation may be excluded from the requirement to pay these taxes if its only activities within California are related to the purchase of personal property or services and/or the education of its employees [*Rev. & Tax. Code § 23101.5(a)*; *see* [b], *below*; *see also § 12B.33*].

The Franchise Tax Board has not prepared an official form of application for exclusion. This form includes all the information required by statute for the application [*see Rev. & Tax. Code § 23101.5(b)*; *18 Cal. Code Reg. § 23101.5(d)*]. The corporation should submit the application for exclusion to the Franchise Tax Board, P.O. Box 1468, Sacramento, California 95807, as soon as it contemplates having employees in California [*18 Cal. Code Reg. § 23101.5(f)*].

By filing an application, the corporation waives the confidentiality provisions governing taxpayer documents [*see Rev. & Tax. Code § 19542*] as to facts alleged in the application and any additional evidence produced with respect to those facts [*Rev. & Tax. Code § 23101.5(b)*].

[b] Criteria for Exclusion

[i] Purchasing Activities

The Franchise Tax Board may determine that a corporation is not doing business in California for purposes of the franchise tax, or is not deriving income from sources within California for purposes of the income tax, if its only activities in California comprise the purchase of personal property or services solely for its own use or use by its affiliate outside California, and the following three conditions are satisfied.

- The corporation does not have more than 100 employees in California, and their duties are limited to solicitation, negotiation, liaison, monitoring, auditing, and inspecting the personal property or services acquired, or providing technical advice with respect to its requirements [*Rev. & Tax. Code § 23101.5(a)(1)(A)*].

- The corporation does not have more than 200 employees in California, whose duties are limited to solicitation, negotiation, liaison, monitoring, auditing, and inspecting the personal property or services acquired, or providing technical advice with respect to its requirements, and the corporation or its affiliate uses the personal property or property for the construction or modification of a physical plant or facility located outside California [*Rev. & Tax. Code § 23101.5(a)(1)(B)*].

- The combined number of employees in California described in paragraphs (a) and (b) does not exceed 200 [*Rev. & Tax. Code § 23101.5(a)(1)(C)*].

When the corporation is engaged in a unitary business, the limitation of 100 or 200 employees must be applied to the aggregation of all corporations in the unitary group [*Rev. & Tax. Code § 23101.5(e)*].

The term "purchase of personal property" includes storage of property purchased, manufactured, or assembled in California pending shipment to destinations outside the state [*18 Cal. Code Reg. § 23101.5(b)*]. Employees are "temporarily present" when their contact with California, disregarding *Rev. & Tax. Code § 23101.5*, would not subject the foreign corporation to California franchise or corporate income tax [*18 Cal. Code Reg. § 23101.5(b)*].

The Franchise Tax Board will not grant an exclusion to a corporation whose purchasing activities constitute its principal business activity, unless the corporation is engaged in a unitary business (that is, a business earning income within and without the state) with one or more other corporations outside California and the purchasing activities in California do not constitute the principal business activity of that unitary business [*18 Cal. Code Reg. § 23101.5(e)*].

[ii] Educational Activities

The Franchise Tax Board may determine that a corporation is not doing business in California for purposes of the franchise tax, or is not deriving income from sources within California for purposes of the income tax, if its only activities in California comprise the presence of employees in California for the sole purpose of attending a public or private school, college, or university [*Rev. & Tax. Code § 23101.5(a)(2)*; *18 Cal. Code Reg. § 23101.5(c)*].

[c] Contents of Application

[i] In General

An application for exclusion from taxation based on purchasing activities and/or employee presence in California must contain the following information [*18 Cal. Code Reg. § 23101.5(d)*]:

- The corporation's name.
- The corporation's federal employer identification number, if any.
- The corporation's mailing address.
- The date of incorporation.
- The corporation's accounting period for tax purposes.
- The years, of the four income years preceding the year for which the exclusion is sought, in which a California franchise or corporate income tax return was filed.
- Any corporations in which the applicant owns 50 percent or more of the voting stock.
- Any corporations that own 50 percent or more of the applicant's voting stock.

[ii] Based on Purchasing Activities

In addition to the general information specified in [i], *above*, an application based on corporate purchasing activities in California must also contain the following information [*18 Cal. Code Reg. § 23101.5(d)(8)- (12)*]:

- The names and addresses of businesses or individuals with which the applicant expects to purchase or has purchased personal property or services and which are covered by the exclusion.
- The names of employees the applicant expects to be present within California during the income year, and the expected duration of each employee's presence in state, to the extent determinable.
- The destination and use of personal property and services contracted for that are to be covered by exclusion, to the extent determinable.
- The period for which the exclusion is requested.
- The estimated number of California jobs created and the economic effect on California resulting from the act for which exclusion is sought.

[iii] Based on Educational Activities

In addition to the general information specified in [i], *above*, an application based on the educational activities of corporate employees in California must also include (1) the names of the employees and the schools, colleges, and universities in California at which they are or will be enrolled, and (2) the period for which exclusion is requested [*18 Cal. Code Reg. § 23101.5(d)*].

[d] Determination of Exclusion

The granting of an exclusion is discretionary with the Franchise Tax Board, and no standards are provided regarding the

exercise of that discretion. However, in the past the Board has seldom granted favorable rulings on applications of corporations that maintain a permanent office in California. A determination of exemption will remain in force for a period of five years, if the corporation continues to meet the required criteria [*Rev. & Tax. Code § 23101.5(c)*].

If the corporation receives an exclusion from taxation, its records are subject to audit during the period of exclusion to the same extent as the records of any other corporation subject to the franchise or corporate income tax [*18 Cal. Code Reg. § 23101.5(f)*].

[e] Subsequent Filings

A corporation receiving an exclusion must annually confirm within two months and 15 days after the close of the fiscal year that facts relevant to the granting of the exclusion then in effect remain unchanged, or state and explain the changes that have occurred since the preceding report was filed [*18 Cal. Code Reg. § 23101.5(f)*].

If an exclusion has expired, or if the Board or the corporation determines that due to changed circumstances the original exclusion is invalidated but another exclusion should be granted, the corporation should submit a new application setting forth all of the information required for an initial application [*18 Cal. Code Reg. § 23101.5(f)*].

[2] FORM

Application of Foreign Corporation for Exclusion From State Taxation [Rev. & Tax. Code § 23101.5]

Chief Counsel
Franchise Tax Board
P. O. Box 1720
Rancho Cordova, CA 95741-1720

APPLICANT FOR DETERMINATION THAT _____ [*name of foreign corporation*] IS EXCLUDED FROM CALIFORNIA CORPORATE _____ [FRANCHISE *or* INCOME] TAX

_____[*Name of corporation*] (hereafter "Applicant") applies to the Franchise Tax Board for a determination that it is not [doing business *or* deriving income from sources] in California, and is thus excluded from the California _____[franchise *or* corporate income] tax.

1. Applicant's federal employer identification number is _____[*state number, if any*].

2. Applicant's mailing address is _____[*address*].

3. Applicant's date of incorporation is _____[*date*].

4. Applicant's accounting period for tax purposes is _____[*state period*].

5. Within the four income years preceding [*income year for which exclusion is sought*], Applicant filed a California corporate _____[franchise *or* income] tax return for [*state years, e.g.*, 2002-2003].

[*If the foreign corporation owns 50 percent or more of the voting stock in any other corporation, add:*]

6. Applicant owns 50 percent or more of the voting stock in the following corporations: _____[*list names of corporations*].

[*If any other corporations own 50 percent or more of the foreign corporation's voting stock, add:*]

7. The following corporations own 50 percent or more of Applicant's voting stock: _____[*list names of corporations*].

[*If application is based on corporation's purchasing activities in California, include:*]

8. To the extent determinable by Applicant, the names and addresses of businesses or individuals with whom Applicant expects to purchase or has purchased personal property or services that are to be covered by the exclusion are: _____[*list names and addresses of businesses and individuals*].

9. To the extent determinable by Applicant, the names of employees Applicant expects to be present within California during [*income year*], and the expected duration of each employee's presence in California are: _____.

10. To the extent determinable by Applicant, the destination and use of personal property and services contracted for that are to be covered by the exclusion are _____.

11. _____[The period for which the exclusion is requested is _____ (*specify*) *or* The Applicant requests an exclusion of indefinite duration because _____ (*give facts supporting indefinite exclusion*)].

12. The estimated number of California jobs created and the economic effect on California resulting from the activities for which Applicant seeks an exclusion are: _____.

[*If application is based on corporation's employee presence in California, include:*]

13. To the extent known by Applicant, the following employees are or will be enrolled at the following schools, colleges, and universities in California: [*list names of employees and schools, e.g.*, (1) Jane Doe, University of California at Santa Barbara; (2) John Roe, Stanford University].

14. _____[The period for which the exclusion is requested is _____ (*specify*) *or* The Applicant requests an exclusion of indefinite duration because _____ (*give facts supporting indefinite exclusion*)].

Accordingly, on the basis of the above-stated facts, Applicant hereby requests that an exclusion from California corporate _____[franchise *or* income] tax be granted pursuant to *Section 23101.5 of the California Revenue and Taxation Code*.
_____ Dated:

_____ [*name of corporation*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxExemptionsBusiness & Corporate LawForeign

BusinessesGeneral OverviewTax LawState & Local TaxesFranchise TaxImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
C. Related California Procedures
3. State Taxation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.261

§ 12B.261 Application for Certificate of Revivor From Forfeiture for Failure to Pay Taxes or File Returns [Rev. & Tax. Code § 23305] or for Failure to File Annual Statement [Corp. Code § 2117]

[1] Comment

[a] Use of Form

This form is an application for certificate of revivor for use by a foreign corporation that has had its powers, rights, and privileges forfeited, and that seeks revivor from that forfeit. Forfeiture can be due to failure to pay taxes or file tax returns [*see Rev. & Tax. Code §§ 23301*, *23301.5*, *23301.6*; *see also §§ 12B.31[3][c]*, *12B.131*], or failure to file required statements [*see Corp. Code § 2205(d)*, *2206(a)*; *see also Corp. Code §§ 2117*, *2205(a)*, *(c)*, §§ 12B.1][3], 12B.210]. For an application for relief from forfeiture for failure to file an annual officer's certificate, see § 12B.235. For an application for relief from contract voidability, see *§ 12B.262*.

The form illustrated here is the official Franchise Tax Board form (Form FTB 3557BC). The Franchise Tax Board will accept applications only on the official form; photocopies and other reproductions are not sufficient. Forms may be ordered by telephoning 1-800-852-5711, or by mail from the Franchise Tax Board.

ELECTRONIC FORMS NOTE

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Franchise Tax Board, which is located at http://www.ftb.ca.gov. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12B.261. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

The application on behalf of a taxpayer that has suffered forfeiture may be made by (1) any stockholder or creditor, (2) a majority of the surviving trustees or directors of the corporation, (3) an officer, or (4) any other person who has

interest in the relief from forfeiture [*Rev. & Tax. Code § 23305*].

[b] Bases for Forfeiture

A foreign corporation qualified to do business in California may forfeit its corporate powers, rights, and privileges, except for purposes of filing an application for exempt status, or the filing of an amended statement and designation to set forth a new or assumed name [*see Rev. & Tax. Code § 23305a*], if it either fails to pay any franchise tax, penalty, or interest when due [*Rev. & Tax. Code §§ 23301, 23301.6*] or fails to file a tax return [*Rev. & Tax. Code §§ 23301.5, 23301.6*; *see Rev. & Tax. Code §§ 21020, 23302(a)- (c)* (forfeiture procedure)]. Forfeiture will occur if the payment is not made within the required following time limits [*Rev. & Tax. Code § 23301*; *see § 12B.31[3][a]*]. For further discussion of forfeiture for failure to pay taxes, see *§ 12B.31[3]*.

In addition, a foreign corporation may suffer forfeiture for failure to file an annual statement if it (1) fails to file a statement for an applicable filing period, (2) has not filed a statement during the preceding 24 months, and (3) was certified for a penalty [*see Corp. Code §§ 2204(a), (b), 2206(a)*] for the same filing period [*Corp. Code §§ 2205(a), 2206(a)*; *see Corp. Code §§ 2117, 2204*]. If the corporation later files the required statement, it may be relieved from forfeiture pursuant to the provisions of *Rev. & Tax. Code § 23305(a)* [*Corp. Code § 2205(d)*]. For further discussion of forfeiture for failure to file an annual statement, see *§ 12B.11[3][a]*.

[c] Notice and Effect of Forfeiture

[i] For Failure to Pay Taxes or File a Tax Return

Before forfeiture for failure to pay taxes or file a tax return can become effective, the corporation must receive notice from the Franchise Tax Board indicating that the corporation will be suspended on a particular date pursuant to the appropriate section of the Revenue and Taxation Code. The notice must be mailed to the corporation at least 60 days before the effective date [*Rev. & Tax. Code §§ 21020, 23302(a), (b)*].

If a foreign corporation's powers, rights, and privileges are forfeited, the corporation may not sell, transfer, or exchange real property in California during the period of forfeiture [*Rev. & Tax. Code § 23302(d)*]. Any transaction of business after forfeiture is punishable by a fine, imprisonment, or both [*Rev. & Tax. Code § 19719(a)*; *see Rev. & Tax. Code § 19719(b)* (bar does not apply to insurer's duty to defend); *see also § 12B.130*, P 1b]. If a corporation nevertheless transacts business during forfeiture, any such income received or business transacted during the forfeiture period is subject to franchise taxes [*Rev. & Tax. Code § 23303*]. Additionally, the Franchise Tax Board will impose an annual penalty on a corporation doing business after forfeiture if the corporation fails to make and file a tax return, unless the failure to file is due to reasonable cause and not willful neglect [*Rev. & Tax. Code § 19135*].

In addition, contracts made in California after forfeiture [*see Rev. & Tax. Code §§ 23301, 23301.5, 23775*] are voidable at the option of any party to the contract other than the foreign corporation [*Rev. & Tax. Code § 23304.1(a)*; *see §§ 12B.31[4], 12B.262* (form)].

[ii] For Failure to File Annual Statements

When a corporation has suffered forfeiture for failure to file an annual statement, the Secretary of State will mail a notice to the corporation, informing it that its corporate powers, rights, and privileges will be suspended after 60 days if it fails to file a statement [*Corp. Code §§ 2205(b), 2206(a)*]. After the 60-day period has expired without the filing of a statement, the Secretary of State will notify the Franchise Tax Board of the forfeiture, and mail a notice of the forfeiture to the corporation.

In this circumstance, when the corporate powers, rights, and privileges of the corporation are forfeited, the corporation may nevertheless amend the articles of incorporation to set forth a new name [*Corp. Code §§ 2205(c), 2206(a)*].

Additionally, a suspended corporation may file an application for exempt status, and amend its articles of incorporation as necessary to perfect that application [*Corp. Code § 1502(c)*], and a foreign nonprofit corporation that has suffered forfeiture may nevertheless file an application for exempt status [*Corp. Code § 2206(b)*; *see Rev. & Tax. Code § 23301*].

[d] Reviving Corporate Powers

When forfeiture was suffered for failure to pay taxes or file tax returns, the corporation's powers may be revived by (1) applying in writing to the Franchise Tax Board for a certificate of revivor [*see* [2], *below*], (2) filing all tax returns required under the Bank and Corporation Tax Law, and (3) paying all taxes, additions to tax, deficiencies, interest, and penalties due [*Rev. & Tax. Code § 23305*; *see Rev. & Tax. Code § 23305.1(e)* (simultaneous filing for relief from voidability)].

Alternatively, the Franchise Tax Board may revive a corporation to good standing without full payment of franchise tax liability if the Board determines that doing so will improve the prospects for collection of the full amount due [*Rev. & Tax. Code § 23305b*]. In addition, the Franchise Tax Board will issue a certificate of revivor if the corporation provides the board with an assumption of liability, a bond, deposit, or other acceptable security for the corporation's tax liability in lieu of actual payment of all outstanding tax liabilities [*Rev. & Tax. Code § 23305.2*]. After securing the debt, the corporation has a reasonable time after the issuance of the certificate of revivor in which to file any necessary returns, notwithstanding the otherwise applicable requirement that the corporation file all necessary returns before the Franchise Tax Board will grant revivor [*Rev. & Tax. Code § 23305.2*; *see Rev. & Tax. Code § 23305*]. For further discussion of reviving corporate powers, see *§ 12B.31[3][c]*.

A foreign corporation that has suffered forfeiture for failure to file annual statements must file all required statements before applying for revivor [*see Corp. Code §§ 2205(d), 2206(a)*].

[e] Issuance and Effect of Certificate of Revivor

Before the certificate of revivor can be issued, the Franchise Tax Board must obtain from the Secretary of State an endorsement on the application for reinstatement of the fact that the name of the corporation continues to meet the corporate name requirements [*Rev. & Tax. Code § 23305a*; *see Corp. Code § 2106(b)*; *see also Boyer v. Jones (2001) 88 Cal. App. 4th 220, 221-222, 105 Cal. Rptr. 2d 824* (holding that under *Corp. Code § 201(b)* and *Rev. & Tax. Code § 23305a*, name of suspended corporation may be reserved and adopted by another corporation during period of suspension, and affirming trial court's denial of suspended corporation's petition for writ of mandate seeking restoration of its name); § 12B.11[2][b]]. Once this endorsement is received, the Franchise Tax Board will issue a certificate of revivor to the corporation [*Rev. & Tax. Code § 23305*] and inform the Secretary of State that the corporation's powers, rights, and privileges have been revived [*Rev. & Tax. Code § 23305c(a)*; *see Rev. & Tax. Code § 23305c(c)* (restoration for erroneous forfeitures)].

Before a certificate of revivor can be issued for a corporation that has suffered forfeiture for failure to pay taxes or file a tax return, the corporation must, in addition to paying the taxes, penalties, and interest already owed [*see Rev. & Tax. Code § 23305*], prepay the minimum franchise tax imposed to resume doing business after revivor [*Rev. & Tax. Code § 23282(c)*; *see Rev. & Tax. Code § 23153*]. Additional taxes may be due depending on whether the corporation was "doing business" in the year preceding or during the year of revivor [*Rev. & Tax. Code § 23282(a), (c)*]. For further discussion, see *§ 12B.31[3][c][iii]*.

On issuance of the certificate, the corporation is reinstated and its legal rights are revived [*Rev. & Tax. Code § 23305a*; *see Rochin v. Pat Johnson Mfg. Co. (1998) 67 Cal. App. 4th 1228, 1236-1237, 79 Cal. Rptr. 2d 719* (although manufacturer's corporate powers were suspended before personal injury action was brought against it and before subsequent action to vacate amended judgment, corporation was entitled to defend appeal from order sustaining its

demurrer in second action because corporation's certificate of revivor became effective during pendency of appeal); *Benton v. County of Napa (1991) 226 Cal. App. 3d 1485, 1490, 277 Cal. Rptr. 541* (revivor validates procedural steps taken during suspension)]. However, the reinstatement is without prejudice to any action, defense, or right that has accrued by reason of the original forfeiture except as to the voidability of some contracts [*Rev. & Tax. Code § 23305a*; *see Rev. & Tax. Code §§ 23304.5, 23305.1*; *see also §§ 12B.31[4], 12B.262* (form)]. Further, the certificate of revivor operates as prima facie evidence of the reinstatement, and may be recorded in the office of any county recorder [*Rev. & Tax. Code § 23305a*].

[2] FORM

Application for Certificate of Revivor From Forfeiture for Failure to Pay Taxes or File Returns [Rev. & Tax. Code § 23305] or for Failure to File Biennial Statement [Corp. Code § 2117]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsFinanceFranchise TaxPenalties for NoncomplianceBusiness & Corporate LawCorporationsFinanceFranchise TaxReinstatementTax LawState & Local TaxesFranchise TaxFailure to Pay Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12B FOREIGN CORPORATIONS AND ASSOCIATIONS
PART IV. FORMS
C. Related California Procedures
3. State Taxation of Foreign Corporations

6-12B California Legal Forms--Transaction Guide § 12B.262

§ 12B.262 Application for Relief From Contract Voidability for Failure to Pay Taxes or File Returns [Rev. & Tax. Code § 23305.1]

[1] Comment

[a] Use of Form

This form is an application for relief from contract voidability [*see Rev. & Tax. Code § 23305.1*]. It is used by a foreign corporation to apply to have voided (but unrescinded) contracts enforced [*see* [d], *below*] after the corporation has been deprived of its corporate power to make contracts due to a failure to pay taxes or file tax returns [*see* [b], *below*].

The form illustrated here is the official Franchise Tax Board form (Form FTB 2518BC). The Franchise Tax Board will accept applications only on the official form; photocopies and other reproductions are not sufficient. Forms may be ordered by telephoning 1-800-852-5711, or by mail, from the Franchise Tax Board.

ELECTRONIC FORMS NOTE

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Franchise Tax Board, which is located at http://www.ftb.ca.gov. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12B.261. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Bases for Contract Voidability

Contracts made in California by a qualified foreign corporation during the time that the corporation's powers, rights, and privileges are forfeited due to a failure to pay taxes or file a tax return [*see Rev. & Tax. Code §§ 23301, 23301.5, 23775*; *see also § 12B.31[3]*] are voidable at the option of any party to the contract other than the foreign corporation [*Rev. &*

Tax. Code § 23304.1(a); *see Rev. & Tax. Code § 23304.5* (procedure)]. In addition, if a foreign corporation that neither is qualified to do business in California nor has a corporate account number from the Franchise Tax Board fails to file a tax return required by the Bank and Corporation Tax Law [*see Rev. & Tax. Code § 23001 et seq.*], any contract made in California during the applicable period may be voided by any party to the contract other than the corporation [*Rev. & Tax. Code § 23304.1(b)*; *see Rev. & Tax. Code § 23304.1(c)* ("applicable period")].

If a corporation is unqualified [*see § 12B.11*] but has a corporate account number from the Franchise Tax Board, failure to file a tax return or to pay any amount owing to the Franchise Tax Board required under the Bank and Corporation Tax Law [*see Rev. & Tax. Code § 23001 et seq.*], or an exempt organization's failure to file any informational statement or return [*see Rev. & Tax. Code §§ 23772, 23774*; *see § 12B.31[2]*], will render any contract made by the corporation in California during a certain time period voidable at the instance of any party to the contract other than the taxpayer [*Rev. & Tax. Code § 23304.1(d)*]. To be subject to this penalty, the corporation must have failed to file or pay within 60 days after the Franchise Tax Board mailed a written demand. The time period for voidability begins at the end of this 60-day period and ends on the earlier of (1) the date relief is granted [*see Rev. & Tax. Code § 23305.1*; *see* [d], *below*] or (2) the date the taxpayer qualifies to do business in California [*Rev. & Tax. Code § 23304.1(d)*; *see § 12B.11*].

[c] Effect of Voidability

A party with the right to declare a contract void under these provisions may exercise that right only in a lawsuit on the contract [*Rev. & Tax. Code § 23304.5*]. The rights of the parties to the contract are not affected by these provisions except to the extent expressly provided by a final judgment of the court, and that judgment must allow the corporation a reasonable time to cure the voidability [*see Rev. & Tax. Code § 23305.1*].

If the court finds the contract voidable, it must order the contract rescinded. However, the court cannot order rescission unless the unqualified foreign corporation receives full restitution of the benefits provided under the contract [*Rev. & Tax. Code § 23304.5*].

If the corporation applies for relief from voidability, the Franchise Tax Board may assess additional penalties [*Rev. & Tax. Code § 23305.1(b)*; *see* [d], *below*].

[d] Applying for Relief From Contract Voidability

[i] Application Procedure

A corporation may apply to the Franchise Tax Board for relief from contract voidability [*see Rev. & Tax. Code § 23305.1(a)*], which will be granted if the application is properly filed, the period for which relief is granted is specified, any necessary tax returns are filed, and any taxes, penalties, interest, and other amounts due are paid to the Franchise Tax Board [*Rev. & Tax. Code § 23305.1(a)*] or liability for them is assumed [*see Rev. & Tax. Code § 23305.2*]. The Franchise Tax Board will assess a penalty for each day of the period for which relief from voidability is granted. The total penalty assessed, however, must not exceed the amount of the tax for the period for which relief is requested [*Rev. & Tax. Code § 23305.1(b)(1)(B)*]. A daily penalty with a different maximum is specified if an application for relief is filed for a period in which an application for revivor has been filed and a certificate of revivor has been issued [*Rev. & Tax. Code § 23305.1(b)(2)(B)*].

Ordinarily, the period for which relief is requested begins on the date that one of the taxpayer's income years begin and ends on the date that relief is granted [*Rev. & Tax. Code § 23305.1(b)(1)(A)*]. However, if an application for relief for voidability is filed for a period in which an application for revivor has been filed and a certificate of revivor has been issued, the period for which relief is requested begins on the date the taxpayer's powers, rights, and privileges had been suspended or forfeited and ends on the date relief is granted [*Rev. & Tax. Code § 23305.1(b)(2)(A)*].

Notwithstanding the requirement that the corporation pay any liability due [*see Rev. & Tax. Code § 23305.1(a)*], the Franchise Tax Board will issue a certificate of relief from voidability if the corporation provides the Board with an assumption of liability or a bond, deposit, or other acceptable security for the corporation's tax liability in lieu of actual payment of all outstanding tax liabilities [*Rev. & Tax. Code § 23305.2*]. Obtaining relief by securing the debt does not constitute an admission of liability and does not relieve the corporation from liability for taxes, additions to tax, penalties, or interest [*Rev. & Tax. Code § 23305.2*]. After securing the debt, the corporation has a reasonable time after relief is granted in which to file any necessary returns, notwithstanding the otherwise applicable requirement that the corporation file all necessary returns before the Franchise Tax Board will grant revivor [*Rev. & Tax. Code § 23305.2*; *see Rev. & Tax. Code § 23305.1*].

[ii] Effect of Relief

If the taxpayer is granted relief from contract voidability, all contracts entered into during the period for which relief is granted that have not been rescinded by a final court order [*see Rev. & Tax. Code § 23304.5*] may be enforced in the same manner and to the same extent, with regard to both parties to the contract and any third parties, as if the contract had never been voidable [*Rev. & Tax. Code § 23305.1(c)(1)(A)*]. Sales, transfers, and exchanges of California real property during the period for which relief is granted (that is, when the taxpayer was not entitled to sell, transfer, or exchange real property [*see Rev. & Tax. Code § 23302(d)*; *see also § 12B.31[3]*]) that have not been rescinded by a final court order [*see Rev. & Tax. Code § 23304.5*] are as valid as if the taxpayer had not been prohibited from conveying real property [*Rev. & Tax. Code § 23305.1(c)(1)(B)*].

Once relief is granted, the Franchise Tax Board will issue and mail a certificate to the taxpayer, or as directed by the taxpayer [*Rev. & Tax. Code § 23305.1(c)(2)*]. The certificate (1) indicates the period for which relief is granted [*Rev. & Tax. Code § 23305.1(c)(2)*], (2) constitutes prima facie evidence of the relief from voidability, and (3) may be recorded [*Rev. & Tax. Code § 23305.1(d)*].

[2] FORM

Application for Relief From Contract Voidability for Failure to Pay Taxes or File Returns [Rev. & Tax. Code § 23305.1]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxPenalties for NoncomplianceBusiness & Corporate LawForeign BusinessesQualificationsContracts LawPerformanceGeneral OverviewTax LawState & Local TaxesFranchise TaxFailure to Pay Tax



81 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES

6-12C California Legal Forms--Transaction Guide 12C.syn

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.syn Synopsis to Chapter 12C: LIMITED LIABILITY COMPANIES

§ 12C.01 California Statutes

§ 12C.02 Federal Sources

[1] Statutes

[2] Regulations

§ 12C.03 Revenue Procedures

§ 12C.04 Revenue Rulings

§ 12C.05 Law Reviews

§ 12C.06 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 12C.07-12C.09 [Reserved]

§ 12C.10 Overview

[1] Effective Date

[2] General Characteristics of Limited Liability Companies

[3] Overriding the Act Through Articles or Operating Agreement

[4] Role of Limited Liability Companies

[5] Prohibited Activities

[a] Professional Limited Liability Companies

[b] Banking, Insurance, or Trust Company Business

[c] Health Care Service Plan

§ 12C.11 Foreign Limited Liability Companies

[1] Recognition and Governing Law

[2] Registration; Transacting Intrastate Business

[3] Effect of Recognition and Registration

§§ 12C.12-12C.19 [Reserved]

§ 12C.20 General Description and Characteristics

[1] Definition and Powers Under the Act

[2] Characteristics of a Limited Liability Company

[a] Limited Liability

[b] Treatment Similar to Partnership for Income Tax Purposes

[c] Limited Duration

[d] Members

[3] Taxation of Limited Liability Companies

§ 12C.21 Formation

[1] General Requirements

[2] Name

[a] Requirements

[b] Reservation

[3] Articles of Organization

[a] Filing Requirements

[b] Contents

[c] Articles of Organization Govern Operating Agreement

[d] Amendment of Articles

[e] Restatement of Articles

[f] Recording of Articles

[4] Operating Agreement

[5] Biennial Statement

§ 12C.22 Agent, Office, and Recordkeeping Requirements

[1] Agent for Service of Process

[2] Office in California

[3] Records Required to Be Kept at Office

§ 12C.23 Members

[1] "Member" Defined

[2] "Membership Interest" Defined

[3] Classes of Members

[4] Becoming a Member

[5] Rights and Duties of Members

[a] Rights Contained in Articles of Organization or Operating Agreement

[b] Transfer of Interests

[c] Class and Derivative Actions

[6] Authority of Members

[7] Capital Contributions and Accounts of Members

[a] In General

[b] Additional Contributions of Members

[c] Tax Consequences of Contributions

[8] Profits, Losses, and Distributions

[9] Voting

[10] Members' Meetings

[11] Information and Inspection Rights

[a] Right to Information

[b] Inspection of Records

[c] LLCs With More than 35 Members

[d] Persons Entitled to Make Request

[e] Enforcement

[12] Withdrawal of Members

[13] Termination of Membership Interests

[14] Liability of Members

[a] General Non-Liability

[b] Situations Giving Rise to Personal Liability

[i] Agreement to Be Personally Obligated

[ii] Liability Comparable to That of a Shareholder

[iii] Improper Distributions

[iv] Failure to Pay Taxes

[v] Tortious Conduct

[15] Indemnification and Insurance

[16] Standard of Conduct of Members

§ 12C.24 Management

[1] "Manager" Defined

[2] Tax Implications of Management Structure

[3] Management by Members, Managers, or Officers

[4] Appointment and Removal of Managers

[5] Managers and Officers As Agents

[6] Managers' Fiduciary Duties

[a] Application of Partnership Standards

[b] Modification of Managers' Fiduciary Duties

[7] Managers' Other Duties

[8] Liability of Managers and Officers

[a] General Non-Liability

[b] Situations Giving Rise to Personal Liability

[i] Agreement To Be Obligated

[ii] Breach of Fiduciary Duties

[iii] Criminal or Tortious Conduct

[iv] Misstatement in Articles of Organization

[v] Voting for Improper Distributions

[vi] Failure to Pay Sales Taxes

[9] Indemnification and Insurance

[10] Remuneration of Managers

§ 12C.25 Merger and Reorganization Procedure

§ 12C.26 Conversions

[1] Entities Into Which LLC May Convert; Carryover of Interests

[2] Applicable Law Must Authorize Conversion

[3] Plan of Conversion

[a] Contents

[b] Requisite Approvals

[c] All Non-Dissenting Members Deemed Parties to Plan

[d] Amendment of Plan

[e] Maintaining Plan of Conversion

[4] Abandoning Conversion

[5] Conversion Into Domestic Other Business Entity

[a] Effective Date of Conversion

[b] Evidence of Conversion

[c] Statement or Certificate of Conversion

[6] Conversion Into Foreign Other Business Entity or LLC

[a] Effective Date of Conversion

[b] Certificate of Conversion

[c] Secretary of State as Agent for Service of Process

[7] Title to Real Property of Converting LLC

[a] Recording Requirements

[b] Presumption in Favor of Bona Fide Purchasers

[8] Conversion of Other Business Entity or Foreign LLC Into Domestic LLC

[9] Effect of Conversion on Rights and Liabilities of Converting Entities and Members

[a] Converting Entity Unchanged

[b] Liabilities of Members

§ 12C.27 Dissenter's Rights on Merger, Conversion, or Reorganization

[1] In General

[2] "Dissenting Interest" Defined

[3] Procedure to Require Company to Purchase Dissenting Interest

[4] Loss of Status as Dissenting Interest

§ 12C.28 Dissolution and Winding Up

[1] Causes of Dissolution

[2] Judicial Dissolution

[3] Noncompetition Agreements

[4] Continuation of Existence After Dissolution

[5] Winding Up

[6] Certificate of Dissolution and Certificate of Cancellation

§ 12C.29 Securities Issues

[1] LLC Interests Classified As Securities

[2] California Securities Exemptions Applicable to LLCs

§§ 12C.30-12C.39 [Reserved]

§ 12C.40 Overview

§ 12C.41 Corporations

[1] Formation and Operation

[2] Limited Liability

[3] Tax Treatment

§ 12C.42 S Corporations

[1] Definition

[2] Structural Restrictions Applicable to S Corporations

[3] Tax Treatment

§ 12C.43 Limited Partnerships

[1] Formation and Operation

[2] Limited Liability

[3] Tax Treatment

§ 12C.44 General Partnerships

[1] Formation and Operation

[2] Liability

[3] Tax Treatment

§ 12C.45 Conversion Costs

[1] Introduction

[2] Dissolution of Existing Entity

[3] Property Taxation of Changes in Ownership

[4] Conversion of Partnership Interest Into Limited Liability Company Interest

§§ 12C.46-12C.49 [Reserved]

§ 12C.50 Taxation of Income of Limited Liability Company

[1] Freedom to Choose Type of Tax Treatment

[2] Treatment as Partnership for Income Tax Purposes

[a] Advantage of Partnership Tax Treatment

[b] Obtaining Partnership Tax Treatment

[c] California Tax Classification

[d] Tax Matters Member

§ 12C.51 Limited Liability Company as Accounting Entity for Income Taxation of Members

§ 12C.52 Income Taxation of Members of Limited Liability Company

[1] Overview

[2] Separately Stated Items

[3] Distributive Shares of Income, Loss, and Other Items to Members

[4] LLC Taxable Income

[5] Loss Allowance

[6] Basis in LLC Assets and Interests

[7] Built-in Gain or Loss

[8] Current Distributions

§ 12C.53 Taxes and Fees Applicable to Limited Liability Company

[1] Minimum California Franchise Tax

[2] California Fee Based on Income

[3] Property Taxes

[a] In General

[b] Power to Own Real Property

[c] Limited Liability Company Treated as Partnership

§ 12C.54 Filing Requirements Applicable to Limited Liability Company

[1] Requirement to File California Tax Return

[2] Requirement to File Federal Tax Return

[3] Requirement to Provide Tax Information to Members

§§ 12C.55-12C.99 [Reserved]

§ 12C.100 Facts

Scope

§ 12C.101 Documents

Scope

§§ 12C.102-12C.109 [Reserved]

§ 12C.110 Determining Whether to Form Limited Liability Company

Scope

§ 12C.111 Determining Structure of Limited Liability Company

Scope

§§ 12C.112-12C.119 [Reserved]

§ 12C.120 Forming Domestic Limited Liability Company

Scope

§ 12C.121 Registering Foreign Limited Liability Company

Scope

§ 12C.122 Operating Domestic Limited Liability Company

Scope

§ 12C.123 Amending Articles of Organization

Scope

§ 12C.124 Filing Certificate of Correction

Scope

§ 12C.125 Filing Statement of Information

Scope

§ 12C.126 Merging, Converting, and Reorganizing

[1] Merger

Scope

[2] Conversion

Scope

[3] Dissenters' Rights on Merger or Reorganization

Scope

§ 12C.127 Dissolving and Winding Up Limited Liability Company

Scope

§ 12C.128 Cancelling Registration of Foreign Limited Liability Company

Scope

§ 12C.129 Filing Tax Returns

[1] California Forms

Scope

[2] Federal Forms

Scope

§§ 12C.130-12C.139 [Reserved]

§ 12C.140 Drafting Operating Agreement

Scope

§§ 12C.141-12C.198 [Reserved]

§ 12C.199 Request for Reservation of Limited Liability Company Name--Official Form

[1] Comment

[a] Use of Form

[b] Name Reservation

[c] Name Requirements

[d] Special Name Requirements for Foreign Limited Liability Companies

[2] FORM

Request for Reservation of Limited Liability Company Name--Official Form

§ 12C.200 Articles of Organization [Form LLC-1]

[1] Comment

[a] Use of Form

[b] Contents of Articles of Organization

[c] Steps Required to Form Limited Liability Company

[2] FORM

Articles of Organization [Form LLC-1]

§ 12C.200A Limited Liability Company Articles of Organization--Conversion [Form LLC-1A]

[1] Comment

[a] Use of Form

[b] Requirement for Statement of Conversion

[2] FORM

Limited Liability Company Articles of Organization--Conversion [Form LLC-1A]

§ 12C.201 Certificate of Amendment [Form LLC-2]

[1] Comment

[a] Use of Form

[b] When to File Certificate of Amendment

[c] Contents of Certificate of Amendment

[2] FORM

Certificate of Amendment [Form LLC-2]

§ 12C.202 Certificate of Dissolution [Form LLC-3]

[1] Comment

[a] Use of Form

[b] Causes of Dissolution

[c] Judicial Dissolution

[d] Winding Up and Filing Certificate of Cancellation

[2] FORM

Certificate of Dissolution [Form LLC-3]

§ 12C.203 Certificate of Cancellation [Form LLC-4/7]

[1] Comment

[a] Use of Form

[b] Filing Certificate of Cancellation

[c] Contents of Certificate

[2] FORM

Certificate of Cancellation [Form LLC-4/7]

§ 12C.203A Certificate of Cancellation--Short Form [Form LLC-4/8]

[1] Comment

[a] Use of Form

[b] Contents of Form

[2] FORM

Certificate of Cancellation--Short Form [Form LLC-4/8]

§ 12C.204 Application for Registration [Form LLC-5]

[1] Comment

[a] Use of Form

[b] Completing Form

[c] Certificate of Good Standing

[d] Filing Fees

[2] FORM

Application for Registration [Form LLC-5]

§ 12C.205 Certificate of Amendment [Form LLC-6]

[1] Comment

[a] Use of Form

[b] When to File Certificate of Amendment

[2] FORM

Certificate of Amendment [Form LLC-6]

§ 12C.206 Certificate of Continuation [Form LLC-8]

[1] Comment

[a] Use of Form

[b] Effect of Filing Certificate of Continuation

[c] Contents of Certificate of Continuation

[2] FORM

Certificate of Continuation [Form LLC-8]

§ 12C.207 Certificate of Merger [Form OBE MERGER-1]

[1] Comment

[a] Use of Form

[b] Merger of Limited Liability Companies

[c] Contents of Certificate of Merger

[2] FORM

Certificate of Merger [Form OBE MERGER-1]

§ 12C.208 Restated Articles of Organization [Form LLC-10]

[1] Comment

[a] Use of Form

[b] Filing Restated Articles of Organization

[2] FORM

Restated Articles of Organization [Form LLC-10]

§ 12C.209 Certificate of Correction [Form LLC-11]

[1] Comment

[a] Use of Form

[b] Completing Certificate of Correction

[2] FORM

Certificate of Correction [Form LLC-11]

§ 12C.210 Statement of Information [Form LLC-12]

[1] Comment

[a] Use of Form

[b] Contents of Statement of Information

[c] Filing Initial Statement

[d] Failure to File

[2] FORM

Statement of Information [Form LLC-12]

§ 12C.210A Statement of Information Renewal [Form LLC-12R]

[1] Comment

[a] Use of Form

[b] Applicable Filing Period

[c] "No Change" Filings

[d] Change of LLC's Agent, Agent's Address, or Other Information

[e] Failure to File

[2] FORM

Statement of Information Renewal [Form LLC-12R]

§ 12C.211 Resignation of Agent for Service of Process [Form RA-100]

[1] Comment

[a] Use of Form

[b] Resignation of Agent for Service of Process

[2] FORM

Resignation of Agent for Service of Process [Form LLC-100]

§ 12C.212 Certificate of Conversion [Form CONV-1A]

[1] Comment

[a] Use of Form

[b] Statutory Requirements for Certificate of Conversion--Conversion to Foreign Limited Liability Company or Other Business Entity

[c] Statutory Requirements for Statement of Conversion--Conversion to Domestic Entities

[d] Effect of Filing Certificate of Conversion

[2] FORM

Certificate of Conversion to Foreign Other Business Entity [Form All Entity-1A]

§ 12C.213 Articles of Incorporation With Statement of Conversion

[1] Comment

[a] Use of Form

[b] Mandatory Provisions

[c] Execution, Filing, and Fees

[2] FORM

Articles of Incorporation With Statement of Conversion

§§ 12C.214-12C.218 [Reserved]

§ 12C.219 Attachment to LLC Articles of Organization

[1] Comment

[a] Use of Form

[b] Contents of Form

[2] FORM

Attachment to LLC Articles of Organization

§ 12C.220 Manager-Managed LLC Operating Agreement--Short Form

[1] Comment

[a] Use of Form

[b] Contents of Agreement

[c] Allocation Provisions

[d] Conversion to Single Member-Managed Agreement

[2] FORM

Basic Operating Agreement

§ 12C.221 Member-Managed Operating Agreement--Long Form

[1] Comment

[a] Use of Form

[b] Contents of Agreement

[c] Allocation Provisions

[2] FORM

Member-Managed Operating Agreement--Long Form

§ 12C.226 Short-Form Provisions for Member-Managed LLC

[1] Comment--Use of Form

[2] FORM

Short-Form Provisions for Member-Managed LLC

§ 12C.227 Provisions for Officers

[1] Comment--Use of Form

[2] FORM

Provisions for Officers

§ 12C.228 Provisions for Marital Dissolution

[1] Comment--Use of Form

[2] FORM

Provisions for Marital Dissolution

§ 12C.229 [Reserved]

§ 12C.230 Agreement of Merger

[1] Comment

[a] Use of Form

[b] Types of Entities That May Merge

[c] Procedure for Merger

[d] Contents of Agreement of Merger

[2] FORM

Agreement of Merger

§ 12C.231 Notice of Approval of Reorganization

[1] Comment

[a] Use of Form

[b] Definitions

[c] Procedure to Require Company to Purchase Dissenting Interest

[2] FORM

Notice of Approval of Reorganization

§ 12C.232 Demand for Purchase of Dissenting Interest

[1] Comment

[a] Use of Form

[b] Requiring Limited Liability Company to Purchase Dissenting Interest

[c] "Dissenting Interest" Defined

[d] Loss of Status as Dissenting Interest

[2] FORM

Demand for Purchase of Dissenting Interest

§§ 12C.233-12C.239 [Reserved]

§ 12C.240 [Reserved]

Scope

§ 12C.241 Transmittal Letter for Domestic Limited Liability Company's Articles of Organization

[1] Comment

[a] Use of Form

[b] Prohibition on Professional Limited Liability Companies

[2] FORM

Transmittal Letter for Domestic Limited Liability Company's Articles of Organization

§ 12C.242 Transmittal Letter for Foreign Limited Liability Company's Application for Registration

[1] Comment

[a] Use of Form

[b] Certificate of Good Standing

[c] Prohibition on Professional Limited Liability Companies

[2] FORM

Transmittal Letter for Foreign Limited Liability Company's Application for Registration

§§ 12C.243-12C.249 [Reserved]

§ 12C.250 Limited Liability Company Return of Income [Form 568]

[1] Comment

[a] Use of Form

[b] Who Must File Form 568

[c] Filing Form 568

[d] Filing Amended Form 568

[e] Determination of Income

[f] Taxation of Limited Liability Companies

[i] Net Income Tax

[ii] Minimum Franchise Tax

[iii] California Fee Based on Income

[g] Filing Group Return

[h] Information Returns

[2] FORM

Limited Liability Company Return of Income [Form 568]

§ 12C.251 Member's Share of Income, Deductions, Credits, etc. [Schedule K-1 (568)]

[1] Comment

[a] Use of Form

[b] Amended Return Requires Amended Schedule

[2] FORM

Member's Share of Income, Deductions, Credits, etc. [Schedule K-1 (568)]

§ 12C.252 Depreciation and Amortization [Form FTB 3885L]

[1] Comment

[a] Use of Form

[b] Depreciation and Amortization of Assets

[2] FORM

Depreciation and Amortization [Form FTB 3885L]

§ 12C.253 Capital Gain or Loss [Schedule D (568)]

[1] Comment--Use of Form

[2] FORM

Capital Gain or Loss [Schedule D (568)]

§ 12C.254 Limited Liability Company's List of Members and Consents [Form FTB 3832]

[1] Comment

[a] Use of Form

[b] Consents of Nonresident Members

[c] Filing a Group Return

[2] FORM

Limited Liability Company's List of Members and Consents [Form FTB 3832]

§ 12C.255 Payment Voucher for Automatic Extension for Limited Liability Companies [Form FTB 3537]

[1] Comment

[a] Use of Form

[b] Automatic Extension of Time to File Tax Return

[c] When Tax Return Must be Filed

[d] Liability for Taxes and Fees

[i] Minimum Franchise Tax

[ii] California Fee Based on Income

[iii] Member's Fee

[e] Penalties and Interest

[2] FORM

Payment Voucher for Automatic Extension for Limited Liability Companies [Form FTB 3537]

§ 12C.256 Limited Liability Company Tax Voucher [Form FTB 3522]

[1] Comment

[a] Use of Form

[b] Who Must Pay Minimum Franchise Tax

[2] FORM

Limited Liability Company Tax Voucher [Form FTB 3522]

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FOOTNOTES:

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Mr. Johal was extremely active in the development of California's LLC legislation. He co-authored the lead article on limited liability companies in the October and December 1994 issues of the *California Business Law Reporter*. In addition, he co-authored a National Business Institute publication entitled *Limited Liability Companies--The Entity of Choice in California*, and was a featured speaker on this subject at National Business Institute presentations to attorneys and accountants. Mr. Johal and Trainor Robertson attorney Colby Campbell co-authored the tax chapter in *Forming and Operating California Limited Liability Companies* (C.E.B. 1995). Mr. Johal was an assistant editor and drafter for the *Guide to Organizing and Operating a Limited Liability Company in California*, Report of the Partnerships and Unincorporated Business Organizations Committee of the Business Law Section of the State Bar (April 1995). He also co-authored the Limited Liability chapter for the CEB *Business Start-Up Manual*, and "Practicing Under California's Version of the Revised Uniform Partnership Act" for *California Business Law News*, published by the Business Law Section of the State Bar of California. Mr. Johal has taught continuing education courses on limited liability companies, and has been an instructor for property tax courses at Golden Gate University-Sacramento.

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Ms. Campbell and Jack S. Johal are coauthors of the tax chapter of *Forming and Operating California Limited Liability Companies* (C.E.B. 1995). She is also coauthor of the article "Income and Real Property Tax Consequences Associated with the Damage of Real Property," published by the California Real Property Journal in 1995. In addition, she is the author of the limited partnership chapter of the CEB *Business Start-Up Manual*. Ms. Campbell has also instructed the course, "Ownership Vehicles for Real Property" for Business Owners and Managers Institute International.

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Ms. Marsh participated in the November 2002 revision of the forms in the chapter and developed the *forms in §§ 12C.221* and 12C.225-*12C.228* of this chapter.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES

6-12C California Legal Forms--Transaction Guide Scope

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

Scope

Jack S. Johaln*
Colby A. Campbelln**
Practice ConsultantsMelissa C. Marshn***
Practice Consultant for November 2002 Forms Revision Scope

This chapter discusses the nature and formation of limited liability companies ("LLCs") under California's Beverly-Killea Limited Liability Company Act [*Corp. Code § 17000 et seq.*]. The Legal Background covers the applicability of the Act, including domestic and foreign LLCs. Formation and operation of LLCs are covered, including structuring formalities, member and management concerns, registration and recordkeeping requirements, and merger and dissolution procedures. The Legal Background also examines taxation and liability issues that will arise in the formation and operation of an LLC. Finally, the Legal Background provides preformation planning assistance, by comparing LLCs with other types of business entities.

The Transaction Guide provides checklists of information and documents to be covered in client interviews, as well as guides to help in deciding whether to form an LLC and if so, how to structure the LLC. Procedural guides are provided for forming and operating a domestic LLC, amending the articles, correcting other filed forms, filing annual statements, filing tax forms, merging and reorganizing, and dissolving. Procedural guide are also provided for registering and canceling a foreign LLC. Finally, the Transaction Guide includes a guide to drafting an operating agreement.

The forms in this chapter contain all of the Secretary of State's mandatory LLC forms, complete operating agreements and optional or alternative provisions, an agreement of merger, a notice and demand related to dissenters' rights on reorganization, transmittal letters to the LLC Unit in the Sacramento office of the Secretary of State, and various Franchise Tax Board tax forms for use by LLCs.

For coverage of S corporations, see Ch. 2B, *Electing Subchapter S Status* . General and limited partnerships are covered in Chs. 15 through 15C. For a discussion of the conversion of business entities, including limited liability companies, into corporations, and the conversion of corporations into other business entities, see Ch. 11F, *Corporate Conversions* .

FOOTNOTES:

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Mr. Johal was extremely active in the development of California's LLC legislation. He co-authored the lead article on limited liability companies in the October and December 1994 issues of the *California Business Law Reporter*. In addition, he co-authored a National Business Institute publication entitled *Limited Liability Companies--The Entity of Choice in California*, and was a featured speaker on this subject at National Business Institute presentations to attorneys and accountants. Mr. Johal and Trainor Robertson attorney Colby Campbell co-authored the tax chapter in *Forming and Operating California Limited Liability Companies* (C.E.B. 1995). Mr. Johal was an assistant editor and drafter for the *Guide to Organizing and Operating a Limited Liability Company in California*, Report of the Partnerships and Unincorporated Business Organizations Committee of the Business Law Section of the State Bar (April 1995). He also co-authored the Limited Liability chapter for the CEB *Business Start-Up Manual*, and "Practicing Under California's Version of the Revised Uniform Partnership Act" for *California Business Law News*, published by the Business Law Section of the State Bar of California. Mr. Johal has taught continuing education courses on limited liability companies, and has been an instructor for property tax courses at Golden Gate University-Sacramento.

(n34)Footnote **. A.B. University of California, Berkeley 1980; J.D. University of Santa Clara, 1985; L.L.M., Taxation, Golden Gate University 1992. Colby A. Campbell is an associate attorney with the Sacramento commercial real estate law firm of Trainor Robertson. Her practice emphasizes real estate, taxation, business planning, and estate planning. She is a member of the California State Bar, the Sacramento County Bar Association, and the Planned Giving Forum of Sacramento. She is a member of several committees of the State Bar of California, including its Tax Committee and its Estate Planning Committee. She is also a consultant for the Business Law Subcommittee of the Continuing Education of the Bar Joint Advisory Committee.

Ms. Campbell and Jack S. Johal are coauthors of the tax chapter of *Forming and Operating California Limited Liability Companies* (C.E.B. 1995). She is also coauthor of the article "Income and Real Property Tax Consequences Associated with the Damage of Real Property," published by the California Real Property Journal in 1995. In addition, she is the author of the limited partnership chapter of the CEB *Business Start-Up Manual*. Ms. Campbell has also instructed the course, "Ownership Vehicles for Real Property" for Business Owners and Managers Institute International.

(n35)Footnote ***. Melissa C. Marsh is an attorney in private practice in Los Angeles, California. Formerly of counsel at Rosenfeld, Myers & Susman, Ms. Marsh received her J.D. degree from Loyola Law School (Order of the Coif) and was admitted to the California Bar in 1996. Ms. Marsh's practice focuses on corporate, business, and intellectual property law.

Ms. Marsh participated in the November 2002 revision of the forms in the chapter and developed the *forms in §§ 12C.221* and 12C.225-*12C.228* of this chapter.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART I. RESEARCH GUIDE
A. Primary Sources

6-12C California Legal Forms--Transaction Guide § 12C.01

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.01 California Statutes

Beverly-Killea Limited Liability Company Act. *Corp. Code § 17000 et seq.*
General provisions. *Corp. Code § 17000 et seq.*
Formation. *Corp. Code § 17050 et seq.*
Members. *Corp. Code § 17100 et seq.*
Management. *Corp. Code § 17150 et seq.*
Finance. *Corp. Code § 17200 et seq.*
Distributions and withdrawals. *Corp. Code § 17250 et seq.*
Interests and assignment of interests. *Corp. Code § 17300 et seq.*
Dissolution. *Corp. Code § 17350 et seq.*
Foreign limited liability companies. *Corp. Code § 17450 et seq.*
Class actions and derivative actions. *Corp. Code § 17500 et seq.*
Merger. *Corp. Code § 17550 et seq.*
Dissenting members' rights. *Corp. Code § 17600 et seq.*
Miscellaneous provisions. *Corp. Code § 17650 et seq.*
LLCs registered under federal securities laws liable for civil penalty of up to $1,000,000 for failure to notify Attorney General or regulatory agency of misstatement or misconduct by LLC members, officers, managers, or agents intended to give membership shares a greater or lesser market value. [*Corp. Code § 17656(a)*].

Conversion of corporation into "other business entity" (including limited liability company) *Corp. Code § 1151*; *see Corp. Code § 1150 et seq.*

Conversion of "other business entity" (including limited liability company) into domestic corporation. *Corp. Code § 1157*.

Fee provisions. *Gov. Code § 12190*.

Applicability of Labor Code compensation provisions to wage-earning members of LLC. *Lab. Code § 3351(f), (g)*.

Requirement to file California tax return. *Rev. & Tax. Code § 18633.5*.

Minimum franchise tax and fees on limited liability companies. *Rev. & Tax. Code §§ 17941*, *17942*, 17947, *23153*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART I. RESEARCH GUIDE
A. Primary Sources

6-12C California Legal Forms--Transaction Guide § 12C.02

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.02 Federal Sources

[1] Statutes

Method of accounting. *I.R.C. § 448*.

Losses and credits from passive activities. *I.R.C. § 469*.

Income taxation of partners and partnership. *I.R.C. §§ 701*-761.

Partnership information income tax return. *I.R.C. §§ 6031, 6072*.

Taxation of partnership as corporation. *I.R.C. § 7701*.

Taxation of publicly traded partnerships as corporations. *I.R.C. § 7704*.

[2] Regulations

Income taxation of partners and partnerships. Treas. Reg. §§ 1.701-1.771.

Self-employment tax applicable to member managers. Prop. *Treas. Reg. § 1.1402(a)-2*.

Filing partnership information tax returns. Treas. Reg. § 1.6031-1.

Valuation of business interests subject to buy-sell agreements. *Treas. Reg. §§ 20.2031-2(h),* 20.2031-3(c).

Valuation of partnership interests for federal estate tax purposes. *Treas. Reg. § 20.2031-3*.

Valuation of gift of partnership interest to family member for estate tax purposes; treatment of unpaid qualified payments at death of transferor or applicable family member. *Treas. Reg. §§ 25.2701-1*-25.2701-8.

Valuation of partnership interest subject to option, contract to purchase, or other agreement for estate tax purposes. *Treas. Reg. §§ 25.2703-1*, 25.2703-2.

Estate tax effect of (1) transfer of interest in family partnership through lapse of voting and liquidation rights, and (2) restrictions on liquidation of interest in family partnership. *Treas. Reg. §§ 25.2704-1*-25.2704-3.

Entity classification rules for federal tax purposes (effective January 1, 1997) *Treas. Reg. §§ 301.7701-1*-301.7701-3.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART I. RESEARCH GUIDE
A. Primary Sources

6-12C California Legal Forms--Transaction Guide § 12C.03

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§ 12C.03 Revenue Procedures

Conditions for requesting ruling on classification of LLC as partnership for federal tax purposes (obsolete as of January 1, 1997). *Rev. Proc. 95-10, 1995-1 C.B. 501* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART I. RESEARCH GUIDE
A. Primary Sources

6-12C California Legal Forms--Transaction Guide § 12C.04

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§ 12C.04 Revenue Rulings

Conversion of interest in partnership into interest in LLC classified as partnership for federal tax purposes is considered partnership-to-partnership conversion. *Rev. Rul. 95-37, 1995-1 C.B. 130* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART I. RESEARCH GUIDE
B. Secondary Sources

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AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.05 Law Reviews

Cohen-Whelan, *Individual Responsibility in the Wake of Limited Liability, 32 U.S.F. L. Rev. 335 (1998).*

Rosenstein, *Ten Obstacles to a Negotiated Agreement and How to Overcome Them*, 44(7) Prac. Law. 47 (1998).

Stein, *How to Use Defined Terms to Make Transactional Documents Work Better*, 43(7) Prac. Law. 15 (1997).

Cohen, *Bankrutpcy and Limited Liability Entities (Part 1)*, 42(3) Prac. Law. 61 (1996).

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART I. RESEARCH GUIDE
B. Secondary Sources

6-12C California Legal Forms--Transaction Guide § 12C.06

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.06 Text References

[1] Matthew Bender Sources

Ballantine & Sterling, California Corporation Laws (Matthew Bender).

Ch. 25, *Limited Partnerships*.

Ch. 26, *Income Taxation of Partnerships*.

Ch. 27, *Limited Liability Companies*.

California Forms of Pleading and Practice, Ch. 346 *Limited Liability Companies* (Matthew Bender).

California Legal Forms (Matthew Bender).

Ch. 2B, *Electing Subchapter S Status*.

Ch. 15, Part A, *Formation of General Partnerships* .

Ch. 15, Part B, *Dissolution of General Partnerships* .

Ch. 15, Part C, *Conversions and Mergers of General Partnerships* .

Ch. 15B, *Dissolution of Limited Partnerships*.

Ch. 15C, *Mergers of Limited Partnerships*.

Ch. 16, *Starting a New Business*.

Ch. 29A, *Joint Ventures*.

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Warren' S Forms of Agreements, Ch. 2, *Organization of Firm* (Matthew Bender).

[2] Additional Text References

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Sargent, Limited Liability Company Handbook (Clark Boardman Callaghan 1993-1994).

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89 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART I. RESEARCH GUIDE
B. Secondary Sources

6-12C California Legal Forms--Transaction Guide §§ 12C.07-12C.09

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§§ 12C.07[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
A. The Beverly-Killea Limited Liability Company Act

6-12C California Legal Forms--Transaction Guide § 12C.10

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.10 Overview

[1] Effective Date

On September 30, 1994, Governor Pete Wilson signed legislation enacting the Beverly-Killea Limited Liability Company Act (the "Act") [Stats. 1994, ch. 1200, § 27; S.B. 469; *see Corp. Code § 17000 et seq.*]. As urgency legislation, the Act became effective on that date [Stats. 1994, ch. 1200, § 100]. Conforming legislation to various California codes was also enacted [Stats. 1994, ch. 1010; S.B. 2053].

[2] General Characteristics of Limited Liability Companies

The Limited Liability Company or "LLC" is a relatively new type of business entity that is essentially a hybrid of a corporation and a partnership. If structured properly, a California LLC can be taxed as a partnership on both the federal and California level, without some of the restrictions imposed on corporations and limited partnerships. Properly structured LLCs can also provide their members, managers, and officers limited liability similar to that enjoyed by corporate shareholders; that is, liability limited to their investments and commitments to invest in the LLC.

LLCs offer great flexibility of form and structure, which can range from the extremely simple to the very complex and, if desired, can closely resemble the management and ownership structures of either corporations or general or limited partnerships.

LLCs have two basic organizational documents. The first is the articles of organization, a one-page statutory form, which must be filed with the Secretary of State [*see § 12C.200*]. The second is the operating agreement, a vehicle for prescribing the structural details of the LLC [*see § 12C.220*]. It is permissible to have an oral operating agreement, though prudent practice would indicate having a written agreement. Various other registration forms are also prescribed by the Secretary of State [*see §§ 12C.201-12C.211*].

[3] Overriding the Act Through Articles or Operating Agreement

The Act expressly allows an LLC's articles of organization and operating agreement to govern the relations among members and between members and the LLC. To the extent that the articles of organization or operating agreement do not provide otherwise, the Act will govern those relations [*Corp. Code § 17005(a)*]. Thus, with the exceptions noted below, the Act's provisions are default provisions that will apply when the articles or operating agreement are silent. The Act further provides that the presence in any of its provisions of the words "unless otherwise provided in the articles of organization or operating agreement" (or similar words) does not imply that other provisions of the Act may not be varied as among members by those documents [*Corp. Code § 17005(e)*].

Some provisions of the Act may *only* be varied by the articles or a written operating agreement. These include the provision that the power to adopt, alter, amend, or repeal an operating agreement is vested in the members [*Corp. Code § 17059*]; certain matters as to members' voting rights [*Corp. Code § 17103*]; certain matters as to meetings of members [*Corp. Code § 17104*]; certain matters as to election, removal, resignation, or expiration of terms of managers [*Corp. Code § 17152*]; appointment, resignation, and removal of officers and their authority [*Corp. Code § 17154*]; and indemnification of managers and others and securing insurance for them [*Corp. Code § 17155*].

The provision as to the fiduciary duties of a manager [*see § 12C.24[6]*] can be modified only by a written operating agreement "with the informed consent of the members" [*Corp. Code § 17005(d)*].

Corp. Code § 17005(b) lists several provisions of the Act respecting relations of members that *cannot* be overridden by articles or an operating agreement. These include the definitions in the Act and a number of voting and other rights of members [*Corp. Code § 17005(b)*]. Certain other matters relating to formation of LLCs, class and derivative actions, mergers, and dissenting rights of members in reorganizations and dissolution of an LLC may be varied only to the extent expressly provided by the pertinent provisions of the Act [*Corp. Code § 17005(c)*].

This chapter includes reminders in several key places that a particular provision of the Act may or may not be overridden. Other provisions of the Act described in this chapter, however, may also be overridden. Therefore, the reader should refer back to this section or to *Corp. Code § 17005* for guidance as to whether a particular provision of the Act may be overridden and in what way.

[4] Role of Limited Liability Companies

The role of LLCs in California is becoming clearer with the passage of time. Though the Act is designed especially to assist the formation and operation of small, closely-held or closely-controlled business arrangements, unlike some other states' statutes the California Act permits structures sufficiently flexible to be attractive to larger, more complex business ventures. Business areas in which the LLC seems particularly useful include real estate, joint ventures (particularly ventures with foreign partners), high technology and venture capital, oil and gas, and theatrical investments. LLCs often may be used in situations in which a general or limited partnership or S corporation previously might have been used.

[5] Prohibited Activities

[a] Professional Limited Liability Companies

The California LLC Act, unlike similar legislation in other states, prohibits domestic and foreign LLCs from rendering professional services in California [*Corp. Code § 17375*]. "Professional services" means any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Osteopathic Act, the Yacht and Ship Brokers Act, or the Chiropractic Act [*Corp. Code §§ 13401(a), 13401.3*].

The Limited Liability Company Unit (LLC Unit) in the Sacramento office of the Secretary of State (where LLC documents must be filed) has indicated that it is the applicant's responsibility to determine whether the LLC is prohibited from filing; the LLC Unit will not make that determination. The current policy of the LLC Unit is to return any filing or name reservation that is indicative of a "professional service" LLC [*see Corp. Code § 13401(a)* (definition)]. If the documents are returned in error, the applicant may resubmit the documents accompanied by a letter stating that the applicant is aware of the prohibition. If the document originally submitted for filing was otherwise acceptable, the filing date will be the date indicated in the Secretary of State stamp on the reverse of the document [Secretary of State's LLC form packet].

To prevent delays, the Secretary of State recommends that the applicant submit a cover letter with the documents stating that the applicant is aware of the prohibition on LLCs rendering professional services, and that the LLC is not prohibited from filing [Secretary of State's LLC form packet; *see §§ 12C.241*, *12C.242* (transmittal letters)].

Chapter 9of the LLC Act has been reserved for possible future use if changes in law permit LLCs to render professional services. For the present, however, professional LLCs may not be formed.

[b] Banking, Insurance, or Trust Company Business

Limited liability companies may not engage in the banking business, the business of issuing insurance policies and assuming insurance risks, or trust company business [*Corp. Code § 17002(a)*]. This relatively narrow restriction should not detract from the overall business usefulness of LLCs.

[c] Health Care Service Plan

No LLC may operate as a licensed health care service plan unless it is a subsidiary of a licensed health care service plan and is established to serve an existing line of business of the parent [*Corp. Code § 17002(b)*]. Further, the tort and contractual liability of an LLC created to operate as a health care service plan and its members is not limited or restricted in any manner because of the LLC status of the health care service plan [*Corp. Code § 17002(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
A. The Beverly-Killea Limited Liability Company Act

6-12C California Legal Forms--Transaction Guide § 12C.11

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.11 Foreign Limited Liability Companies

[1] Recognition and Governing Law

A foreign limited liability company ("foreign LLC") may register as an LLC in California. A foreign LLC will be recognized as such and its organization and internal affairs, and the authority and liability of its managers and members, will be governed by the laws of the state or foreign country under which it is organized [*Corp. Code § 17450(a)*].

[2] Registration; Transacting Intrastate Business

A foreign LLC is allowed to register with the Secretary of State and must do so to transact intrastate business in California lawfully [*Corp. Code §§ 17450-17457*]. To register as a foreign LLC, it must register with the Secretary of State on Form LLC-5 [*see § 12C.204*], comply with name requirements, and pay applicable fees [*Corp. Code §§ 17451, 17452*].

A foreign LLC may not be denied registration because of a difference between the laws under which it is organized and the laws of California [*Corp. Code § 17450(b)*]. This can be of considerable importance because the definition of a "foreign LLC" [*see Corp. Code § 17001(q)*] allows considerable latitude of form and structure with respect to the foreign LLC. However, this provision does not override the restriction described in § 12C.10[5], prohibiting the rendition of professional services. Accordingly, foreign LLCs may not render professional services as LLCs in California [*Corp. Code § 17375*].

Failure to register before transacting intrastate business subjects a foreign LLC to penalties essentially the same as those applicable to unregistered foreign corporations or limited partnerships. The definition of "transacting intrastate business" [*see Corp. Code § 17001(ap)*] is also essentially the same for foreign LLCs as for other foreign business entities. Penalties include the inability to maintain proceedings in California courts until the LLC registers and monetary penalties [*Corp. Code § 17456(a), (b)*]. In addition, a foreign LLC transacting business in California without having

registered appoints the Secretary of State as its agent for service of process for causes of action arising out of the transaction of business in California [*Corp. Code § 17456(d)*]. A member of a foreign LLC does not become liable for obligations of the foreign LLC solely because of its failure to register [*see Corp. Code § 17456(c)*]. A registered foreign LLC is required to file the same biennial report as an LLC within specified periods [*see Corp. Code § 17060(a)*] and is subject to monetary penalties and possible loss of its right to transact intrastate business in California if it does not do so [*Corp. Code § 17655*].

[3] Effect of Recognition and Registration

Recognition of foreign LLCs is very significant for them under California law. Before enactment of the California LLC Act, a foreign LLC might have been treated as a general partnership, an unincorporated association, or a corporation. Treatment might have differed depending on the purpose; for example, liability of members, taxation, entity status, or right to hold property. The Act seems to lay most of these uncertainties to rest, subject to future judicial interpretations.

As with other types of foreign entities doing intrastate business in California, registration of a foreign LLC means that it may transact intrastate business, may maintain legal actions, is required to pay state taxes and fees [*see § 12C.53*], and can avoid pecuniary penalties for failure to register [*Corp. Code §§ 17456, 17457*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawLimited Liability CompaniesGeneral Overview



92 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
A. The Beverly-Killea Limited Liability Company Act

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§§ 12C.12[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
B. California Limited Liability Companies

6-12C California Legal Forms--Transaction Guide § 12C.20

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§ 12C.20 General Description and Characteristics

[1] Definition and Powers Under the Act

A "limited liability company" or "domestic limited liability company" is an entity with one or more members organized under the Beverly-Killea Limited Liability Company Act [*Corp. Code §§ 17001(t), 17050(b)*].

An LLC may engage in any lawful business activity (subject to any limitations contained in its articles of organization and to compliance with any other applicable laws) except the banking business, the business of issuing insurance policies and assuming insurance risks, or trust company business [*Corp. Code § 17002(a)*], and except for rendering professional services as described in § 12C.10[5]. An LLC may operate as a licensed health care service plan if it is a subsidiary of a licensed health care service plan and is established to serve an existing line of business of the parent [*Corp. Code § 17002(b)*]. In carrying out its business activities, an LLC has all of the powers of a natural person, subject to any limitations contained in its articles of organization and subject to compliance with the Act and other applicable laws. These powers include the power to transact business, sue or be sued, make contracts, own and transfer real and personal property, issue stock, and many others [*see Corp. Code § 17003*].

[2] Characteristics of a Limited Liability Company

[a] Limited Liability

In general, LLCs afford their members and managers (including officers) limited liability essentially like that enjoyed by a corporate shareholder. They are not personally liable for any debt, liability, or obligation of the LLC arising in "contract, tort, or otherwise" solely by being a member, manager or officer of the LLC [*Corp. Code §§ 17101(a), (b), 17158*; *but see Corp. Code § 17101(a)* (LLC members subject to liability under common law alter ego doctrine)]. However, neither the tort and contractual liability of an LLC created to operate as a health care service plan, nor that of its members, is limited or restricted in any manner because of the LLC status of the health care service plan [*Corp.*

Code § 17002(b)]. Additional exceptions to limited liability of members, managers, and officers are discussed in *§§ 12C.23[14][b]* and *12C.24[8][b]*.

[b] Treatment Similar to Partnership for Income Tax Purposes

A properly structured LLC will be taxed as a partnership for income tax purposes. That treatment avoids the double taxation attributable to corporations that are not S corporations; that is, taxation once on the corporate earnings and again on shareholders' dividends. It also allows other tax benefits as contrasted not only with corporations but also, in a few respects, with partnerships. For detailed coverage of partnership tax treatment of an LLC, see *§ 12C.50[2]*.

[c] Limited Duration

The articles of organization may specify the time when the limited liability company is dissolved [*Corp. Code § 17051(c)(3)*], but are no longer required to do so. When the Act was first enacted in California, a date of dissolution was required to be set forth in the articles [*see* former *Corp. Code § 17051(a)(2)*]. This requirement was included in the Act to help achieve partnership tax treatment for LLCs under the Internal Revenue Service's entity classification rules in effect prior to January 1, 1997. Under the pre-1997 rules, continuity of life was one corporate characteristic that combined with others could result in the classification of an entity as a corporation rather than a partnership for income tax purposes. Under the liberalized treasury regulations, commonly called "check-the-box regs," that took effect on January 1, 1997, the requirement that a date of dissolution be specified to avoid continuity of life is no longer relevant because partnership tax status is a matter of election rather than counting up corporate characteristics [*see Treas. Reg. § 301.7701-2(a)(1)*; *see also § 12C.50*]. Accordingly, the Act's former requirement that a date of dissolution be included in the articles of organization was eliminated in 1998, and inclusion of a date of dissolution is now optional instead [*Corp. Code § 17051(c)(3)*].

Similarly, under former law an LLC was required to dissolve on the death, bankruptcy, retirement, resignation, expulsion, or dissolution of any member who is a manager (in an LLC managed by one or more member-managers) or any member (in an LLC managed by its members or by one or more nonmember-managers) unless the agreement provided to the contrary or permitted a majority in interest of the remaining members to vote to continue the business [*see* former *Corp. Code § 17350(d)*]. This requirement is no longer imposed by statute, or necessary to ensure proper tax status [*Treas. Reg. § 301.7701-2(a)(1)*].

[d] Members

An LLC must have at least one member [*see Corp. Code §§ 17001(t), 17050(b)*; *see also § 12C.23[1]*]. A membership interest includes the member's economic interest in the LLC, any right to vote or participate in management, and any right to information about the affairs of the LLC [*Corp. Code § 17001(z)*]. The interest may, but need not, be issued in the form of certificates of interest.

Except for membership interests in LLCs that are actively managed by all members, an interest in an LLC is a "security" as that term is defined by the Corporate Securities Law of 1968, and is subject to qualification under that law unless an exemption from qualification is available. The person claiming that an LLC interest is not a "security" because all members actively manage the LLC has the burden of proof. Evidence that members vote, or have the right to vote, or the right to information concerning the LLC's business and affairs, or the right to participate in management does not establish, without more, that all members are actively managing the LLC [*Corp. Code § 25019*].

[3] Taxation of Limited Liability Companies

A domestic or foreign LLC classified as a partnership for California tax purposes that is doing business in California, organized in California, or registered with the Secretary of State must file a California tax return [*Rev. & Tax. Code § 18633.5*; *see § 12C.250* (tax return)]. It must pay an annual minimum franchise tax of $800 for the privilege of doing

business in California [*Rev. & Tax. Code §§ 17941(a), (b), 23151, 23153(d)(1)*]. In addition, an LLC subject to the minimum franchise tax must also pay a graduated annual fee based on its total income of $250,000 or more from all sources derived from or attributable to California [*Rev. & Tax. Code § 17942(a), (b)*]. For more detailed coverage of the taxation of LLCs, see *§ 12C.53*.

An LLC is a pass-through tax entity for California and federal income tax purposes, much like a partnership, and so its members, not the LLC, pay tax on its net income, much as partners would [*I.R.C. § 701*]. For further discussion, see *§§ 12C.51* and *12C.52*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesDissolution & Winding UpBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral OverviewTax LawState & Local TaxesFranchise TaxImposition of Tax



94 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
B. California Limited Liability Companies

6-12C California Legal Forms--Transaction Guide § 12C.21

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§ 12C.21 Formation

[1] General Requirements

An LLC must have at least one member [*Corp. Code §§ 17001(t), 17050(b)*]. Members may be natural persons, partnerships, limited partnerships, trusts, estates, associations, corporations, other LLCs, or other types of entities, whether domestic or foreign [*Corp. Code § 17001(x), (ae)*; *see* Secretary of State's LLC form packet].

PRACTICE TIP:

For federal tax purposes, a LLC with only one member is disregarded as an entity separate from its owner for federal tax purposes, unless it elects to be taxed as an "association" (corporation) [*Treas. Reg. § 301.7701-3(a)*].

Forming an LLC is simple: the LLC comes into existence when its articles of organization are filed with the Secretary of State [*Corp. Code § 17050(c)*; *see* [3], *below*; *see also § 12C.200*]. Before or after (presumably *promptly* after) that filing, the members must enter into a written or oral operating agreement [*Corp. Code § 17050(a)*; *see* [4], *below*; *see also § 12C.220*].

[2] Name

[a] Requirements

The Act sets forth specific requirements regarding an LLC's name. The name of the LLC must be set forth in the articles of organization [*Corp. Code § 17052*; *see* [3][b], *below*]. Chiefly, the name must not be one that the Secretary of State determines is likely to mislead the public, and must not be the same as, or resemble so closely as to tend to deceive, the name of an existing domestic or registered foreign LLC or a name already reserved by an LLC or foreign LLC. An existing domestic or foreign LLC may, however, consent to the use of the proposed name, and if the Secretary of State

finds that under the circumstances the public is not likely to be misled, the name may be used [*Corp. Code § 17052(c)*; *see* [b], *below*].

The last words of the name must be "limited liability company" or the abbreviation "LLC" or "L.L.C." The words "limited" and "company" may be abbreviated to "Ltd." and "Co." respectively [*Corp. Code § 17052(a)*]. The words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," "corp.," "insurer," "insurance company," or any other words suggesting that the LLC is in the business of issuing policies of insurance and assuming insurance risks, may not be used in the name of an LLC [*Corp. Code § 17052(d)*].

An LLC's name may contain the name of one or more of its members [*Corp. Code § 17052(b)*].

[b] Reservation

On payment of the required fee [*see Gov. Code § 12190(a)*], an applicant may reserve an approved LLC name with the Secretary of State for 60 days. The same person may not reserve the same name for consecutive 60-day periods [*Corp. Code § 17053*], but may do so with breaks between 60-day periods. If the name is approved by the LLC Unit, the applicant will receive a certificate of reservation for the name. However, obtaining a certificate of reservation for an LLC name is not a prerequisite to filing articles of organization [Secretary of State's LLC form packet]. For the official form reserving an LLC name, see *§ 12C.199*.

PRACTICE TIP:

It is the policy of the LLC Unit to return any filing or name reservation that is indicative of a "professional service" LLC [Secretary of State's LLC form packet; *see Corp. Code §§ 13401(a)*, *13401.3* (definition), 17375]. For this reason, the applicant should include a statement in his or her filing instructions that the LLC will not be rendering professional services.

[3] Articles of Organization

[a] Filing Requirements

Articles of organization must be filed on Form LLC-1 [*see § 12C.200* (form)]. This form may be obtained from any office of the Secretary of State. However, the articles, like all mandatory LLC forms, must be filed with the LLC Unit in the Sacramento office of the Secretary of State [*see* Secretary of State's LLC form packet]. The articles must be executed by one or more persons, who need not be members of the LLC, and submitted for filing with the applicable filing fee [*Corp. Code § 17050(a)*; *see Gov. Code § 12190(b)(fee)*].

[b] Contents

The articles of organization of an LLC must set forth all of the following [*Corp. Code § 17051(a)*]:

- The name of the LLC.
- A statement regarding the purpose of the LLC in the form specified by the Act.
- The name and address of the LLC's initial agent for service of process.
- If it is to be managed by managers and not by all of its members, a statement to that effect. If it is to be managed by only one manager, a statement to that effect [*Corp. Code § 17151(b)*; *see* Form LLC-1, item 6; *see also § 12C.200[2]*].

PRACTICE TIP:

The Act contains a default provision stating that if the articles of organization are silent on the issue of management, the LLC will be deemed to be managed by its members [*Corp. Code §§ 17150, 17151(b)*]. An LLC may elect management by managers after the initial filing of the articles by amending them, or by executing restated articles [*see* [d], [e], *below*].

The articles may include other provisions not inconsistent with law, including provisions limiting or restricting the business or powers of the LLC; governing admission of members; the time when the limited liability company is dissolved; any events that will cause dissolution of the LLC [*see § 12C.26[1]*]; a statement of whether there are limitations on the authority of managers or members to bind the LLC and if so what they are; and the names of the managers of the LLC [*Corp. Code § 17051(c)*].

PRACTICE TIP:

Because the articles of organization are a public document and can be changed only by amendment filed with the Secretary of State and, unless otherwise provided in the articles or a written operating agreement, require the unanimous vote of all members for their amendment, it may be desirable not to include optional matters in the articles.

[c] Articles of Organization Govern Operating Agreement

If any provision of the articles of an LLC conflicts with the LLC's written operating agreement, the articles control [*Corp. Code § 17005(f)*; *see* [4], *below*].

[d] Amendment of Articles

Subject to the requirement that at least a majority in interest of the members vote to amend [*Corp. Code § 17103(b)*], the members of an LLC may amend its articles at any time [*Corp. Code § 17054(a)*]. An amendment may make any change in the articles determined by the members and that would be lawful to insert in original articles filed at the time the amendment is filed [*Corp. Code 17054(a)*].

To amend the articles, at least one manager of the LLC (or a greater number, if provided in articles) must execute and file a certificate of amendment (Form LLC-2) with the Secretary of State [*Corp. Code § 17054(b)*; *see § 12C.201*]. Although the Act expressly requires the manager(s) to execute the certificate [*see also Corp. Code § 17056(a)* (generally requiring managers to execute documents filed with the Secretary of State)], and has no provision for members in a member-managed LLC to execute a certificate of amendment, such members would have to have that authority if the LLC has no manager(s) [*see Corp. Code § 17157*]. Thus, presumably, the LLC's operating agreement would designate which member or members in an LLC without managers would have the authority to execute certificates of amendment.

The certificate must contain the LLC's name, its Secretary of State's file number, and the text of the amendment [*Corp. Code § 17054(b)*]. It must be filed to effect the following [*Corp. Code § 17054(c)*]:

- A change in the name of the LLC.
- A change in the statement regarding the existence of managers [*see Corp. Code § 17151(b)*].
- A change in the time for dissolution of the LLC.
- A change in the events that will cause dissolution of the LLC.

In addition, a certificate of amendment must be filed within 30 days of discovery by a manager (or, presumably, a

member if the LLC has no managers) of any false or erroneous material statement in the articles [*Corp. Code § 17054(d)*].

A manager may be liable for misstatements in a certificate of amendment [*Corp. Code § 17054(e)*; *see § 12C.24[8][b][iii]*].

[e] Restatement of Articles

An LLC's articles of organization may be restated at any time by filing Form LLC-10 [*see § 12C.208*] with the Secretary of State. In general, the restated articles must contain all the information required to be included in the original articles [*Corp. Code § 17054(f)*; *see Corp. Code § 17051* (requirements for original articles); *see also* [b], *above*].

[f] Recording of Articles

An LLC may record with any county recorder a certified copy of its articles of organization and any exhibits, attachments, or amendments filed with the Secretary of State. A foreign LLC may record a certified copy of its application for registration, certificate of registration, or any amendment filed in the office of the Secretary of State. The recording will create a conclusive presumption in favor of any bona fide purchaser or encumbrancer for value of the LLC's real property located in the county in which the certified copy has been recorded of the statements contained in the document [*Corp. Code § 17052(f)*].

[4] Operating Agreement

The members of an LLC must enter into an operating agreement either before or after the filing of its articles [*Corp. Code § 17050(a)*]. The Act defines an "operating agreement" as any agreement, written or oral, among all the members as to the affairs of the LLC and the conduct of its business in a manner not inconsistent with law or its articles, including amendments [*Corp. Code § 17001(ab)*].

The operating agreement may be written or oral and may be as simple as an agreement to organize an LLC pursuant to the provisions of the Act [*Corp. Code § 17001(ab)* ("operating agreement" defined)].

PRACTICE TIP:

Except in unusual circumstances or when its terms are relatively simple and readily provable, an operating agreement should be written. A written agreement may help to avoid (1) future disagreements among members and between members, managers, and officers, and (2) arguments against limited liability protection based on a lack of operating agreement or the inadequacy of the agreement (for example, insufficient structuring of capital accounts). A written agreement that provides for the active management of all members will also assist in establishing that membership interests are not "securities" for the purposes of the California Corporate Securities Law [*see Corp. Code § 25019*].

Depending, among other things, on the complexity of the desired business structure and on whether the LLC will be managed by its members or by managers other than all of the members, the operating agreement may need to contain provisions somewhat akin to those in corporate bylaws and certainly many of the provisions that would be contained in a well thought out partnership agreement. One of the advantages of the LLC format is the flexibility to structure the operating agreement with some or all of the elements of bylaws, partnership agreements, or combinations of both in order to customize and conform the agreement to the parties' economic arrangements.

The operating agreement may include, without changes, the matters already provided for by the Act simply as a readily available administrative guide. This practice, common in drafting corporate bylaws, will require that the agreement be reviewed when the governing law is amended. The operating agreement should also specify any respects in which the

"default provisions" of the initial Act [*see § 12C.10[3]*] are to be changed or rendered inapplicable to the LLC. Some changes to default provisions must be in a written operating agreement to be effective [*Corp. Code § 17005(b)- (d)*].

The power to adopt and change the operating agreement of an LLC is vested in its members but its articles of organization or a written operating agreement may prescribe the manner in which the operating agreement may be changed [*Corp. Code § 17059*].

For a checklist of provisions to be included in the operating agreement, refer to the drafting guide in § 12C.140. For an operating agreement form, see *§ 12C.220*.

[5] Biennial Statement

Every LLC, whether domestic or foreign, must file a biennial statement of information on a form prescribed by the Secretary of State [*see §§ 12C.210* (Form LLC-12--initial statement), 12C.210A (Form LLC-12R--biennial renewal statement)]. The form must be filed with the Secretary of State within 90 days after an LLC's original articles of organization are filed, and biennially thereafter during the calendar month when the original articles of organization were filed, or in the case of a foreign LLC, the month during which its application for registration was filed, and the immediately preceding five months [*Corp. Code § 17060(a), (c)*]. Approximately three months prior to the close of the applicable filing period, the Secretary of State will mail a form for compliance with this filing requirement to the LLC's last known address according to the records of the Secretary of State. Failure of an LLC to receive the form will not exempt it from complying with the filing requirement [*Corp. Code § 17060(c)*]. If no required information has changed since the previous statement was filed, an LLC, in lieu of filing this statement, may advise the Secretary of State that no changes in the required information have occurred on a form prescribed by the Secretary of State [*Corp. Code § 17060(b)*; *see § 12C.210A[1][c]*].

If the biennial statement is not filed as required, an LLC is subject to monetary penalties and possible suspension of its powers and rights [*Corp. Code §§ 17651(b)*, *17653*, *17654*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
B. California Limited Liability Companies

6-12C California Legal Forms--Transaction Guide § 12C.22

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.22 Agent, Office, and Recordkeeping Requirements

[1] Agent for Service of Process

An LLC must continuously maintain an agent in California for service of process [*Corp. Code § 17057(b)*].

If there is a change in the identity or address of the agent, the LLC must file a new Statement of Information (Form LLC-12 or LLC-12R) containing the updated information [*Corp. Code § 17060(d)*; *see § 12C.210A[1][d]*].

[2] Office in California

An LLC must continuously maintain an office located in California at which it keeps required records [*Corp. Code § 17057(a)*; *see* [3], *below*]. Within California the office may be located where the managers, if any, or the members of the LLC choose.

[3] Records Required to Be Kept at Office

An LLC must maintain the following records at its office in California, in writing or in any other form capable of being converted into clearly legible tangible form [*Corp. Code § 17058(a)*]:

- A current list of the full name and last known business or residence address of each member and each holder of an economic interest in the LLC, set forth in alphabetical order, and the contribution and share in profits and losses of each member and holder of an economic interest.

- A current list of the full name and business or residence address of each manager [*see Corp. Code § 17151(b)*].

- A copy of its articles of organization, any amendments to the articles, and executed copies of any powers of attorney relating to the execution of the articles.

- Copies of the LLC's federal, state, and local income tax or information returns and reports, if any, for the six most recent taxable years.

- A copy of any written operating agreement, any amendments to the agreement, and executed copies of any powers of attorney relating to the execution of the agreement.

- Copies of the LLC's financial statements for the six most recent fiscal years.

- The LLC's books and records as they relate to its internal affairs for at least the current and past four fiscal years.

On an assessor's request, an LLC owning, claiming, possessing, or controlling property in California that is subject to local assessment must make available at the LLC's principal office in California, or at a place mutually acceptable to the assessor and the LLC, a true copy of business records relevant to the amount, cost, and value of all property that it owns, claims, possesses, or controls within the county [*Corp. Code § 17058(b)*].

An LLC failing to comply with these recordkeeping requirements after a written request to do so by a member is subject to daily monetary penalties up to a stated maximum [*Corp. Code § 17651*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



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CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
B. California Limited Liability Companies

6-12C California Legal Forms--Transaction Guide § 12C.23

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.23 Members

[1] "Member" Defined

A "member" of an LLC is a person who has been admitted as a member in accordance with its articles of organization or operating agreement, or is an assignee of an interest in the LLC who has become a member, and who has not resigned, withdrawn, or been expelled or dissolved [*Corp. Code § 17001(x)*]. The term "person" includes natural persons and most other types of entities, domestic and foreign [*Corp. Code § 17001(ae)*; *see § 12C.21[1]*]. Thus, potentially any person can be a member of an LLC, which is one of the primary advantages LLCs have over, for example, S corporations [*see § 12C.42*].

[2] "Membership Interest" Defined

A "membership interest" in an LLC is a member's rights in it, collectively, including the member's economic interest, any right to vote or participate in its management, and any rights to information concerning its business and affairs provided by the Act [*Corp. Code § 17001(z)*]. "Economic interest" means a person's right to share in income, gains, losses, deductions, credit, or similar items of, and receive distributions from, an LLC, but does not include any other rights of a member including, without limitation, rights to vote or to participate in management or, with some exceptions set forth in *Corp. Code § 17106*, rights to information concerning the business and affairs of the LLC [*Corp. Code § 17001(n)*]. A membership interest or an economic interest is the personal property of the member or an assignee, and neither a member nor an assignee has any interest in specific LLC property [*Corp. Code § 17300*; *see Paclink Communications International, Inc. v. Superior Court (2001) 90 Cal. App. 4th 958, 964-965, 109 Cal. Rptr. 2d 436]* . Thus, for example, an action by LLC members for fraudulent transfer of company's assets could only be brought as derivative action. Because members hold no direct ownership interest under *Corp. Code § 17300*, they cannot be directly injured when company is improperly deprived of those assets [*see Paclink Communications International, Inc. v. Superior Court (2001) 90 Cal. App. 4th 958, 964-965, 109 Cal. Rptr. 2d 436]* .

A member's interest in an LLC is not subject to execution if the LLC is not a judgment debtor [*Code Civ. Proc. § 699.720(a)(2)*]. A judgment creditor, however, may charge the membership interest of a member, and to the extent charged, become an assignee of that interest and entitled to the economic interest of the member [Corp. Code § 17032]. Whether a judgment creditor may foreclose on an LLC interest in the same manner that a judgment creditor may foreclose on a partnership interest is unclear because the Act, unlike the Uniform Partnership Acts, does not mention foreclosure of an LLC member's interest in connection with charging the member's interest [*cf. Corp. Code § 16504* (creditors' rights respecting partnership interest subject to charging order); *see Hellman v. Anderson (1991) 233 Cal. App. 3d 840, 848-850, 284 Cal. Rptr. 830* (right of creditor to foreclose implied from statute)].

An employee's interest in an LLC issued pursuant to a membership interest purchase or option plan, or an officer's or manager's membership interest issued in any transaction in connection with securing employment, is not subject to Labor Code provisions governing employee investments in an employer's business [*Corp. Code § 17100(d)*; *see Lab. Code §§ 406, 407*].

[3] Classes of Members

The articles or a written operating agreement may provide for different classes of members. A class may have such relative rights, powers, and duties, which may be senior or subordinate to other classes, as provided by those documents [*Corp. Code § 17103(a)*].

[4] Becoming a Member

On formation of an LLC, its members are the persons who enter into its operating agreement before or after filing of its articles of organization [*Corp. Code § 17050(a)*]. After an LLC is formed, a person may become a member by acquiring a membership interest from it in conformity with its articles of organization or operating agreement or, if those documents do not otherwise provide, by vote of a majority in interest of the members, excluding the vote of the person acquiring the membership interest, and only on becoming a party to the operating agreement [*Corp. Code § 17100(a)(1)*].

A person who is an assignee of a membership interest may become a member on the unanimous vote (or if so provided in the articles or operating agreement, a lesser vote) of the other members and by complying with the articles or operating agreement or, if those documents do not so provide, when the person becomes a party to the operating agreement [*Corp. Code § 17100(a)(2)*]. Thus, even if membership interests are freely assignable, an assignee can become a member only as set forth in the preceding sentence.

The operating agreement may provide that interests of members or assignees may be evidenced by certificates and provide for their transfer [*Corp. Code § 17105*].

[5] Rights and Duties of Members

[a] Rights Contained in Articles of Organization or Operating Agreement

Membership rights and responsibilities are generally determined by the operating agreement or articles of organization. If those documents are silent, the Act provides default provisions [*see § 12C.10[3]*; *see also Corp. Code §§ 17100-17104*]. Particularly important issues to consider include members' rights concerning classes of members, capital contributions, allocations of profits and losses, distributions, voting, management rights (and rights as to managers), transfer of interests, and dissolution or merger.

[b] Transfer of Interests

Except as provided in the articles or the operating agreement, members may freely assign or encumber their economic

interests [*Corp. Code § 17301(a)(1)*; *see* [2], *above*]. They also may transfer their membership interests at any time with the consent of a majority in interest of the members not transferring their interests [*Corp. Code §§ 17301(a), 17303(a)(1)*]. Assignment of an economic interest does not of itself dissolve an LLC or, except as set forth in articles of organization or the operating agreement, entitle the assignee to vote and participate in the management and affairs of the LLC or to become or exercise any rights of a member [*Corp. Code § 17301(a)(2)*]. The assignment merely entitles the assignee to receive, to the extent assigned, economic benefits to which the assignor would have been entitled [*Corp. Code § 17301(a)(3)*]. In contrast, the assignment or transfer of a membership interest in accordance with the articles or operating agreement entitles the assignee to all of the rights and powers, and certain of the obligations, of a member [*Corp. Code § 17303(a), (b)*]. The assignee is not obligated for liabilities that are unknown to the assignee at the time the assignee became a member and that could not be determined from the articles or the operating agreement [*Corp. Code § 17303(b)*].

[c] Class and Derivative Actions

Any member of a domestic or foreign LLC may bring a class action on behalf of all or a class of members to enforce a claim common to those members, and may bring derivative actions in the name or right of the LLC. Any such class action is governed by the general law applicable to class actions [*Corp. Code § 17500*; *see Code Civ. Proc. § 382*; *see also* California Forms of Pleading & Practice, Ch. 120, *Class Actions* (Matthew Bender)]. In order to maintain a class action with regard to an LLC, there is no requirement that the class be so numerous that joinder of all members of the class is impractical [*Corp. Code §§ 17500, 17501*].

[6] Authority of Members

Unless the articles provide that an LLC will be managed by one or more managers, who may, but need not be members [*Corp. Code § 17151(b)*], every member is an agent of the LLC for the purpose of its business and affairs [*Corp. Code § 17157(a)*]. The act of any member for the apparent purpose of carrying on in the usual way the LLC's business and affairs binds the LLC, unless the member has no authority to act for the LLC in the particular matter and the person with whom the member is dealing actually knows that the member has no such authority [*Corp. Code § 17157(a)*]. A member acting in contravention of a restriction on authority cannot bind the LLC to persons actually knowing of the restriction [*Corp. Code § 17157(c)*].

If the LLC is managed by one or more managers, then no member, acting solely as such, is an agent of the LLC or can bind or act for the LLC [*Corp. Code § 17157(b)(1)*].

[7] Capital Contributions and Accounts of Members

[a] In General

The articles or operating agreement of an LLC may provide for capital contributions of members, which may be in money, property, or services, or an obligation to contribute money, property or services to the LLC [*Corp. Code § 17200(a)*]. The Act does not require that members make capital contributions, but some member capital is generally required by the business and adequate capitalization may be necessary for members to avoid personal liability [*see § 12C.23[14][b][i]*]. Subject to the articles or operating agreement, a member is not excused from an agreement to make a contribution to the LLC because of death, disability, dissolution, or other reason [*Corp. Code § 17201(a)(1)*].

A member who does not make an agreed contribution of property or services may be required, at the LLC's option, to contribute an amount of cash equal to the fair market value (or written agreed value, if any) of the contribution not made [*Corp. Code § 17201(a)(2)*]. This option is in addition to other rights under the articles, the operating agreement or applicable law.

An operating agreement may provide that the interest of a member who fails to make any agreed contribution or other

payment shall be subject to specified remedies or consequences. Such a provision is enforceable in accordance with its terms unless the member seeking to invalidate it establishes that it was unreasonable under the circumstances at the time the agreement was made. The Act lists a number of specific remedies which may be provided, including, without limitation, loss of voting rights and rights to participate in management of the LLC; liquidated damages; a dilution of the member's interest in the LLC; subordinating the defaulting member's interest to that of the nondefaulting members; and permitting a forced sale of the defaulting member's interest [*Corp. Code § 17201(a)(3)*].

The capital contribution of a member to an LLC is to be credited to a capital account established for the member. Unless otherwise provided in the operating agreement, that account will consist of the original contribution, increased by any additional contribution and the member's share of profits and decreased by any distribution to the member and by that member's share of losses [*see Corp. Code § 17001(d)*]. For the tax consequences of capital accounts and allocations, see *§ 12C.51* and Ballantine & Sterling, California Corporation Laws, Ch. 26, *Partnership Taxation* .

Except as otherwise provided in the articles or operating agreement, the obligation of a member to make a contribution may be compromised only by the unanimous vote of the other members. Notwithstanding any such compromise, a person whose claim against an LLC arose before receipt of notice of the compromise may enforce the original obligation of the member to make the contribution but any other person with a claim may enforce only the existing obligation to make a contribution after giving effect to the compromise [*Corp. Code § 17201(b)*].

If an obligation of a member to make a contribution is conditional, a person with a claim against the LLC may not enforce the obligation unless the conditions have been satisfied or waived. "Conditional obligations" include, among other things, a capital contribution payable on a discretionary call of the LLC before the call occurs [*Corp. Code § 17201(c)*].

[b] Additional Contributions of Members

Absent a provision to the contrary in the articles or operating agreement, no member is required to make a capital contribution other than any agreed initial contribution [*Corp. Code § 17200(b)*]. If additional contribution is required, the obligation to make it and the remedies for failure to do so are the same as those described above as to an initial contribution [*Corp. Code § 17201*].

[c] Tax Consequences of Contributions

Various tax consequences arise for both the member and the LLC from a member's contribution to an LLC. For example, a contribution of services by a member to an LLC in exchange for an interest in the LLC capital is a taxable event for the member. Providing services to an LLC in exchange for a profit interest, however, would not be a taxable event for either the member or the LLC [*Rev. Proc. 93-27, 1993-2 C.B. 343*]. There are likely to be other tax consequences from the receipt of services by the LLC. An in-depth discussion of tax issues is beyond the scope of this chapter, but they are important, and an LLC should not be formed and capitalized without careful consultation with a tax professional. Allocations of LLC tax items among the members may depend on conformity to IRS rules, among other things, as to capital accounts [*see Treas. Reg. § 1.704-1(b)(2)(iv)*].

[8] Profits, Losses, and Distributions

Profits and losses of an LLC and distributions to members are allocated among them, and among the classes of members, as provided in the operating agreement. If the operating agreement does not provide otherwise, profits and losses are allocated in proportion to the contributions of each member [*Corp. Code § 17202*]. If the operating agreement does not provide otherwise, distributions that are a return of capital are allocated in proportion to the contributions of each member, and distributions that are not a return of capital are made in proportion to the allocation of profits [*Corp. Code § 17250*].

The operating agreement may provide for allocation of profits and losses or distributions independent of the capital contributions or accounts of LLC members. If those allocations are to be upheld for federal income tax purposes, however, they must meet the requirements of *I.R.C. § 704(b)* and the regulations thereunder. See *§ 12C.50* et seq. and Ch. 26, *Partnership Taxation* , in Ballantine & Sterling, California Corporation Laws (Matthew Bender) for further discussion.

At the time a member becomes entitled to receive a distribution, the member has the status of a creditor of the LLC with respect to the distribution, and is entitled to all remedies available to creditors, subject to limitations on distributions that would result in insolvency [*Corp. Code § 17250*; *see Corp. Code §§ 17254, 17353*; *but see Paclink Communications International, Inc. v. Superior Court (2001) 90 Cal. App. 4th 958, 965-966, 109 Cal. Rptr. 2d 436* (members of LLC who brought direct action alleging fraudulent transfer of LLC assets incorrectly relied on *Corp. Code § 17250*; derivative action is appropriate when gravamen of complaint is injury to LLC)]. The operating agreement may provide for establishing a record date with respect to the sharing of profits and distributions [*Corp. Code § 17250*].

A member is entitled to receive distributions from an LLC while a member and before dissolution and winding up of the LLC, as specified in the operating agreement, subject to certain limitations on distributions that would result in insolvency [*Corp. Code §§ 17251, 17254*].

Regardless of the nature of a member's contribution, a member does not have the right to demand other than cash distributions. In addition, a member cannot be forced to accept a distribution of any in-kind asset offered in lieu of a proportionate distribution of money being made to other members. Except on dissolution and winding up of an LLC, a member cannot be compelled to accept a distribution of any asset in kind [*Corp. Code § 17253*].

[9] Voting

Members' voting rights may be tailored on almost any basis in an LLC. The articles or a written operating agreement may provide all or certain identified members or a specified class or group of members the right to vote separately or with all or any class or group of members on any matter. Voting may be on a per capita, number, financial interest, class, group or other basis [*Corp. Code § 17103(a)*; *see* [3], *above* (classes of members)]. If no voting provision is contained in the articles or a written operating agreement, members vote in proportion to their interests in current profits (or in the case of a member whose entire economic interest in the LLC has been assigned to a person who is not a member, the interest in current profits the assigning member would have had if the assignment had not been made) [*Corp. Code § 17103(a)(1)*]. Any amendment of the articles of organization or operating agreement will require the unanimous vote of all members [*Corp. Code § 17103(a)(2)*]. In no event may the articles be amended by a vote of less than a majority in interest of the members and members must be afforded the right to vote on a merger of the LLC or on its dissolution [*Corp. Code § 17103(b), (c)*]. These amendment provisions may not be overridden [*Corp. Code § 17005(b)(3)*].

[10] Members' Meetings

Members' meetings may be held at any place in or out of California specified by the caller of the meeting or by articles of organization or a written operating agreement. If no location is so specified, meetings are to be held at the principal executive office of the LLC [*Corp. Code § 17104(a)*]. A members' meeting may be called by a manager or by one or more members representing more than 10 percent of the interests of members [*Corp. Code § 17104(b)*].

Meetings may also be held by electronic video screen communication or by electronic transmission by and to the limited liability company [*Corp. Code § 17104(a)*; *see Corp. Code § 17001(o)* (definition)]. Members may participate in an LLC meeting through the use of a conference telephone call or electronic video screen communication, as long as all members participating in the meeting can hear one another, or by electronic transmission by and to the limited

liability company. Participation in a meeting in this manner constitutes presence in person at that meeting [*Corp. Code § 17104(f)*].

Meetings must be noticed, conducted, and adjourned and special meetings may be called and adjourned as specified in the Act [*Corp. Code § 17104(c)- (e), (g), (h)*]. A majority in interest of the members represented at a meeting in person or by proxy constitutes a quorum [*Corp. Code § 17104(h)*]. Record dates may be set much as in the case of business corporations [*Corp. Code § 17104(k)*]. Proxies may be used as they are in corporations formed under the General Corporation Law [*Corp. Code § 17104(j)*]. Note that many of these rules may be varied by a written operating agreement [*see §§ 12C.10[3], 12C.21[4]*].

PRACTICE TIP:

The members' failure to strictly comply with meeting requirements set forth in the Act provides the LLC's creditors with additional grounds for holding members personally liable. For this reason, it is generally not advisable to incorporate meeting requirements into the operating agreement.

Actions that may be taken at a meeting may be taken without a meeting if written consent is received within a specified time from a sufficient number of members [*Corp. Code § 17104(i)*]. Unless prohibited by the articles of organization and if authorized by the operating agreement, members not physically present in person or by proxy at a meeting of members may, by electronic transmission by and to the limited liability company or by electronic video screen communication, participate in the meeting, be deemed present in person or by proxy, and vote at the meeting, whether that meeting is to be held at a designated place or in whole or in part by means of electronic transmission by and to the limited liability company or by electronic video screen communication [*Corp. Code § 17104(a)*; *see Corp. Code §§ 17001(o), 17104* (*l*)(definition; conducting meeting by electronic communication)].

[11] Information and Inspection Rights

[a] Right to Information

The Act provides certain rights to members and holders of economic interests in LLCs to obtain information and to inspect records, to receive annual reports, financial statements, and federal and state income tax information [*Corp Code § 17106*]. These rights cannot be varied by the articles of organization or an operating agreement, nor can they be waived by the members [*Corp. Code § 17005(b)(4), 17106(h)*].

Upon the request of a member or a holder of an economic interest, for purposes reasonably related to the interest of that person as a member or a holder of an economic interest, a manager must, at the LLC's expense, promptly deliver to the requesting person a copy of [*Corp. Code § 17106(a)*]:

- A current alphabetical list of the full name and last known business or residence address of each member and of each holder of an economic interest, together with the contribution and the share in profits and losses of each member and holder of an economic interest.

- If the articles of organization state that the LLC will have a manager or mangers, a current list of the full name and business or residence address of each manager.

- The LLC's federal, state, and local income tax or information returns and reports, if any, for the six most recent taxable years.

- Any written operating agreement.

In addition, an LLC is obliged to [*Corp. Code § 17106(d), (e)*]:

- Promptly furnish to a member a copy of any amendment to the articles of organization or operating agreement executed by a manager pursuant to a power of attorney from the member, which the LLC may send by electronic transmission [*see Corp. Code § 17001(o)(1)*].

- Send or cause to be sent to each member or holder of an economic interest within 90 days after the end of each taxable year such information as is necessary to complete federal and state income tax or information returns, and, in the case of an LLC with 35 or fewer members, a copy of its federal, state, and local income tax or information returns for the year.

[b] Inspection of Records

Each member, manager, and holder of an economic interest has the right upon reasonable request, for purposes reasonably related to the interest of that person as a member, manager, or holder of an economic interest, to each of the following [*Corp. Code § 17106(b)*]:

- To inspect and copy during normal business hours any of the records required to be maintained by *Corp. Code § 17058*.

- To obtain in writing from the LLC promptly after becoming available, a copy of the LLC's federal, state, and local income tax or information returns for each year.

[c] LLCs With More than 35 Members

In the case of any LLC with more than 35 members [*Corp. Code § 17106(c)*]:

- A manager must cause an annual report to be sent to each of the members not later than 120 days after the close of the fiscal year. That report, which may be sent by electronic transmission [*see Corp. Code § 17001(o)(1)*], must contain a balance sheet as of the end of the fiscal year and an income statement and statement of cash flows for the fiscal year.

- Members representing at least 5 percent of the voting interests of members, or three or more members, may make a written request to a manager for an income statement of the LLC for the initial three-month, six-month, or nine-month period of the current fiscal year ended more than 30 days prior to the date of the request, and a balance sheet of the LLC as of the end of that period. The statement must be delivered or mailed to the members within 30 days thereafter.

- The financial statements referred to above must be accompanied by the report thereon, if any, of the independent accountants engaged by the LLC or, if there is no report, the certificate of a manager of the LLC that the financial statements were prepared without audit from the books and records of the LLC.

[d] Persons Entitled to Make Request

Any request, inspection, or copying by a member or holder of an economic interest may be made by that person or by that person's agent or attorney [*Corp. Code § 17106(i)*].

[e] Enforcement

The Act provides that a court of competent jurisdiction may enforce the duty of making and mailing or delivering the information and financial statements as required by the Act [*Corp. Code § 17106(f)*], and, if it finds the failure to comply with those requirements is without justification, the court may award the person bringing the action the

reasonable expenses incurred by that person, including attorney's fees. The Attorney General is also given the power to enforce the information and inspection rights of members [*see Corp. Code § 17107*].

[12] Withdrawal of Members

The articles or operating agreement may provide that a member may withdraw, resign, or retire from an LLC at the time or on the happening of events specified in the operating agreement, or that a member does not have the right to withdraw, resign, or retire [*Corp. Code § 17252(a)*; *see Corp. Code § 17001(as)* ("withdrawal" defined to include the resignation or retirement of a member)]. Notwithstanding any restriction on the right to withdraw, resign, or retire, a member may withdraw at any time by giving notice to the other members. Unless the articles or operating agreement provide otherwise, a withdrawn member is no longer a member of the LLC and is not entitled to payment for the member's interest in the LLC. Beginning on the date of the withdrawal, the withdrawn member will have only the right of a holder of an economic interest [*see Corp. Code § 17001(n)* (definition); *see also* § 346.14[2]] with respect to that member's interest, and then only with respect to distributions, if any, to which a holder of an economic interest is entitled under the operating agreement [*Corp. Code § 17252(a)*].

If the withdrawal, resignation, or retirement is in violation of the operating agreement, the LLC has the right, in addition to any other remedies set forth in the operating agreement, to offset any damages for breach of the operating agreement from any amounts otherwise distributable to the withdrawn member with respect to that member's economic interest in the LLC [*Corp. Code § 17252(a)*]. When a member withdraws, the list of members must be amended accordingly [*Corp. Code § 17252(b)*; *see Corp. Code § 17058(a)(1)*].

[13] Termination of Membership Interests

An LLC's operating agreement may provide for termination in whole or part of membership interests and economic interests. If an member's economic interest is terminated pursuant to the operating agreement, the member is entitled to demand and receive a return of that member's contribution. Any provision in an operating agreement governing the termination of a member's interest and the return of a member's contribution is enforceable in accordance with its terms unless the member seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the agreement was made. On any termination of a membership interest, the membership list must be amended accordingly [*Corp. Code § 17100(c)*].

[14] Liability of Members

[a] General Non-Liability

In general, a member of an LLC is not personally liable for any debt, obligation, or liability of the LLC arising in contract, tort, or otherwise solely by reason of being a member [*Corp. Code § 17101(a)*]. However, neither the tort and contractual liability of an LLC created to operate as a health care service plan, nor that of its members, is limited or restricted in any manner because of the plan's LLC status [*Corp. Code § 17002(b)*]. In addition, there are a number of situations in which members may be personally liable for the LLC's obligations and liabilities for their actions taken as members. The most important of these are covered in [b], *below*.

[b] Situations Giving Rise to Personal Liability

[i] Agreement to Be Personally Obligated

Notwithstanding the personal liability protection afforded by the Act, a member of an LLC may agree to be obligated personally for any or all of the LLC's debts, obligations, and liabilities, as long as the agreement to be obligated is set forth in the articles of organization or in a written operating agreement that specifically refers to the code section (*Corp. Code § 17101(e)*) authorizing liability [*Corp. Code § 17101(e)*]. In addition, pursuant to the terms of a written guarantee

or other contractual obligation (other than an operating agreement), a member may be personally obligated for any debt, obligation or liability of the LLC [*Corp. Code § 17101(c)*].

[ii] Liability Comparable to That of a Shareholder

A member of an LLC is subject to liability under the common law governing alter ego liability and is personally liable under a judgment of a court or for an obligation of the LLC arising in contract, tort, or otherwise under the same or similar circumstances and to the same extent as a shareholder of a corporation may be personally liable for such an obligation of the corporation, except that failure to hold meetings or to observe formalities pertaining to calling or conducting meetings may not be considered a factor tending to establish personal liability when the articles of organization or operating agreement do not expressly require the holding of meetings of members or managers [*Corp. Code § 17101(b)*].

PRACTICE TIP:

As a general rule, therefore, it is not advisable for the operating agreement to require meetings.

[iii] Improper Distributions

Personal liability will attach for receiving improper distributions (that is, distributions that, if made, would render the LLC insolvent) made before or during the winding up of an LLC [*Corp. Code §§ 17101(a), (c), 17254*]. A member or assignee of a member is personally obligated to return an improper distribution from an LLC to the extent that the member or assignee had actual knowledge of facts indicating the impropriety of the distribution [*Corp. Code § 17254(e)*].

Moreover, a member or manager who votes for a distribution in violation of the operating agreement or that is improper under the Act is personally liable to the LLC for the amount of the distribution that exceeds what could have properly been distributed if the member or manager had acted in compliance with the relevant sections of the Act governing distributions [*Corp. Code § 17255(a)*].

[iv] Failure to Pay Taxes

Personal liability may also attach to a member who is responsible for an LLC that collects sales tax and fails to remit this tax to the State Board of Equalization [*Rev. & Tax. Code § 6829(c)*]. Notwithstanding any provision in the Corporations Code to the contrary, personal liability will result if the SBE can establish that (1) the member had a duty to comply with *Rev. & Tax. Code 6829*; (2) the member willfully failed to pay or failed to cause the LLC to pay the taxes [*Rev. & Tax. Code § 6829(a)*; *see Rev. & Tax. Code § 6829(d)* (definition)]; and (3) that the LLC included tax reimbursement in the selling price of, or added tax reimbursement to the selling price of, tangible personal property sold in the conduct of LLC business or that the LLC consumed tangible personal property and failed to pay the tax to the seller, or has included use tax on the billing and collected the use tax or has issued a receipt for the use tax and failed to report and pay use tax [*Rev. & Tax. Code § 6829(c)*; *see Rev. & Tax. Code § 6829(f)* (notice of deficiency determination)].

[v] Tortious Conduct

Nothing in the provisions limiting liability of members of an LLC is intended to affect a member's liability to third parties for the member's participation in tortious conduct [*Corp. Code § 17101(c)*; *see Corp. Code § 17101(a)* (general liability rule)].

[15] Indemnification and Insurance

If provided in its articles or written operating agreement, an LLC may indemnify a member for any act in that capacity

except a breach of fiduciary duty [*Corp. Code § 17155(a)*; *see* [16], *below* (fiduciary duties)]. Similarly, an LLC may purchase insurance on behalf of any member against liabilities asserted against the member in that capacity [*Corp. Code § 17155(b)*].

[16] Standard of Conduct of Members

The fiduciary duties of members, solely in their capacity as members, are not set forth in the Act. *Corp. Code § 17153* does provide that the fiduciary duties of *managers* are the same as those of partners in a partnership [*see Corp. Code § 16404* (partners' fiduciary duties); *see also* Ch. 15A, *Formation of General Partnerships*]. It is likely, therefore, that the fiduciary duties owed by members to each other and the LLC are also the same as the duties partners owe to the partnership and the other partners. As for members in an LLC without managers, since they are deemed to be managers [*Corp. Code § 17001(w)*], they clearly would be covered by the language of *Corp. Code § 17153*, and as managers would owe partnership fiduciary duties to the LLC and to other members. Furthermore, as mangers in a member-managed LLC, members would come under the provision of the Act that states that the fiduciary duties of a manager to the LLC and its members may be modified in a written operating agreement with the informed consent of the members [*Corp. Code § 17005(d)*; *see § 12C.24[6][b]*]. Whether any such modification of members' duties could be accomplished in the same manner if the LLC is one that is *not* member-managed (i.e., its articles provide for managers), is not clear. By analogy, however, partnership law does permit the modification of the partners' fiduciary duties under certain circumstances [*see Corp. Code § 16103(b)(3), (4)* (partnership agreement may specify standards of care, loyalty, and obligation of good faith and fair dealing)]. There is no reason to suppose that members' duties could not be similarly modified or a provision included in the operating agreement permitting member ratification of acts that might ordinarily violate such duties.

A member of an LLC is expressly permitted to lend money to and transact other business with the LLC and, "subject to other applicable law," has the same rights and liabilities as a person who is not a member [*Corp. Code § 17004*]. The interplay of these two concepts remains to be determined.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesMembers & Other Constituents



97 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
B. California Limited Liability Companies

6-12C California Legal Forms--Transaction Guide § 12C.24

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§ 12C.24 Management

[1] "Manager" Defined

A "manager" of an LLC is a person elected by the members to manage the LLC if its articles contain the required statement regarding managers [*see Corp. Code § 17151(b)*; *see also § 12C.21[3][b]*]. If the articles do not contain that statement, "manager" refers to each member of the LLC [*Corp. Code § 17001(w)*]. Therefore, for an LLC without elected managers, the management provisions outlined in this section and references to management elsewhere in this summary and the Act apply to all members of the LLC.

[2] Tax Implications of Management Structure

Prior to January 1, 1997, a manager-managed LLC would be deemed under IRS rules to have the corporate characteristic of centralized management. If that LLC had one other corporate characteristic, it would be taxed as a corporation. Thus, prior to January 1, 1997, how an LLC was managed could have a bearing on whether it was taxed as a partnership or as a corporation.

New entity classification regulations that went into effect on January 1, 1997, eliminated IRS reliance on "corporate characteristics" as a basis for entity classification. Instead, LLCs are now simply permitted to elect whether or not they want to be taxed as partnerships or as corporations [*see Treas. Reg. § 301.7701-3*], and the presence or absence of centralized management is no longer a factor in determining the tax classification of an LLC.

[3] Management by Members, Managers, or Officers

An LLC may be managed either by all of its members or by one or more managers [*Corp. Code §§ 17150, 17151*]. A manager need not be a member [*Corp. Code § 17151(a)*] or a natural person [*Corp. Code § 17151(c)*].

If management is vested in the members, they have the rights, duties, and obligations of managers [*Corp. Code § 17150*] and the description contained in this chapter as to "rights, duties, and obligations" of managers in general apply to the members in their management role. Care should be taken in applying this rule since not all of the provisions of the Act concerning managers involve the creation of rights of, or imposition of duties or obligations on, managers. For example, *Corp. Code § 17152*, dealing with election, removal, resignation, and expiration of the term of office of a manager, would seem by its terms to apply only to a situation when managers manage; the references in it ought not to apply to members as managers.

If an LLC is to be managed by managers, its articles of organization must contain a statement to that effect [*Corp. Code § 17151(b)*]. The articles need not state the number or names of managers, but if there is to be only one manager, the articles must so state [*Corp. Code § 17151(b)*]. The articles or operating agreement may, and one of them (preferably the operating agreement) should, contain provisions in detail regarding the names [see *Corp. Code § 17051(c)(6)*], number, qualifications, and duties of managers [*Corp. Code § 17151(c)*] and about the authority of managers to bind the LLC [*Corp. Code § 17051(c)(5)*]. One of those documents (again, preferably, the operating agreement) should also contain provisions and regulations appropriate to the particular LLC for its management [*see § 12C.21[4]* (operating agreement and its contents)]. If an LLC has manager(s), a member acting solely in the capacity of a member is not an agent of the LLC and cannot bind it or execute any instrument on its behalf [*Corp. Code § 17157(b)(1)*].

A written operating agreement may provide for the appointment of officers for the LLC, including, without limitation, a chairperson or a president, or both, a secretary, a chief financial officer, and any other officers with powers and duties as specified in the articles or operating agreement, or determined by the manages or members. Officers may, but need not, be members or managers. Any number of offices may be held by the same person [*Corp. Code § 17154(a)*]. If the operating agreement does not provide for the appointment of officers, the managers may appoint officers [*Corp. Code § 17154(b)*]. An officer serves at the pleasure of the managers, and may be removed or resign at any time, subject in each case to rights and liabilities of the officer or LLC, as the case may be, under any contract to which the officer is a party [*Corp. Code § 17154(b)*].

[4] Appointment and Removal of Managers

The Act's provisions regarding the appointment and removal of managers cannot be varied except by the articles of organization or a written operating agreement [*Corp. Code § 17005(b)*]. Management positions must be filled by the affirmative vote of a majority in interest of the members [*Corp. Code § 17152(a)*]. Unless otherwise provided in the operating agreement, a "majority in interest of the members" is more than 50 percent of the interests of members in current profits [*Corp. Code § 17001(v)*]. Unless they resign or are removed, managers hold office until expiration of their terms or until their successors have been elected and qualified [*Corp. Code § 17152(d)*].

Removal of managers may be with or without cause, but must be by a vote of a majority in interest of the members at a meeting called expressly for that purpose [*Corp. Code § 17152(b)*]. Managers may resign as such at any time on written notice to the LLC [*Corp. Code § 17152(c)*]. Neither removal nor resignation of a manager prejudices the rights, if any, of the manager or the LLC under any contract of employment [*Corp. Code § 17152(b), (c)*].

[5] Managers and Officers As Agents

If the articles of organization provide that an LLC is to be managed by one or more managers, every manager is an agent of the LLC for the purpose of its business and affairs [*Corp. Code § 17157(b)(2)*]. Except as otherwise provided in the articles of organization or the operating agreement, if the members have appointed more than one manager, decisions of the managers must be made by majority vote of the managers if at a meeting, or by unanimous written consent [*Corp. Code § 17156*]. The act of any manager for the apparent purpose of carrying on in the usual way the business and affairs of the LLC binds the LLC, unless the manager has no actual authority to act for the LLC in the particular matter and the person with whom the member is dealing actually knows that the manager has no such

authority [*Corp. Code § 17157(b)(2)*]. A manager acting in contravention of a restriction on authority cannot bind the LLC to persons actually knowing of the restriction [*Corp. Code § 17157(c)*].

The general rule is that no act of a manager or member in contravention of a restriction on authority can bind an LLC to persons having actual knowledge of the restriction [*Corp. Code § 17157(c)*]. The Act also provides that in the absence of another person's actual knowledge of the signer's lack of authority to execute or enter any note, mortgage, evidence of indebtedness, contract, certificate, statement, conveyance, or other instrument in writing, and any assignment or endorsement thereof, between an LLC and that person, none of those instruments is invalidated as to the LLC when signed by any of the following [*Corp. Code §§ 17154(c), 17157(d)*]:

- Two managers;
- One manager if the articles of organization state that there is only one manager;
- The chairperson of the board;
- The president or any vice-president;
- Any secretary or assistant secretary;
- The chief financial officer; or
- Any assistant treasurer.

[6] Managers' Fiduciary Duties

[a] Application of Partnership Standards

A manager owes the same fiduciary duties to an LLC and to its members that a partner owes to a partnership and to the other partners [*Corp. Code § 17153*; *see Corp. Code § 16404* (describing partners' fiduciary duties)]. For a detailed discussion of partnership fiduciary duties, refer to Ch. 15A, *Formation of General Partnerships.*

[b] Modification of Managers' Fiduciary Duties

In the case of partnerships, the Uniform Partnership Act of 1994 permits the partners to agree to specific standards regarding the obligation of good faith and fair dealing in order to measure a partner's performance of that obligation [*Corp. Code § 16103(b)(5)*]. Similarly, while the partners' duty of loyalty may not be eliminated by the partnership agreement, it may provide, if not manifestly unreasonable, for specific type or categories of activities that do not violate the duty of loyalty, or for ratification by all or some lesser number of partners, after full disclosure of all material facts, of acts or transactions that would violate the duty of loyalty. [*Corp. Code § 16103(b)(3)(A), (B)*]. Finally, a partner's duty of care may not be unreasonably reduced by the partnership agreement [*Corp. Code § 16103(b)(4)*].

Since these fairly specific limitations on the ability of partners to fine-tune fiduciary duties also apply to managers of LLCs, it is not clear why the Act separately provides an apparently much broader authority for LLCs by permitting fiduciary duties of managers to be "modified in a written operating agreement with the informed consent of the members" [*Corp. Code § 17005(d)*]. It would seem that any court reviewing an LLC's "modification" of fiduciary duties would be inclined to apply the narrowly drafted limitations on customizing those duties that are set out in the Uniform Partnership Act of 1994.

From a practical standpoint, some tailoring of managers' duty of care and loyalty may be beneficial. For example, the

duty of care could be graduated, ranging from breach that stems from negligence to breach stemming from willful misconduct, depending on the proscribed activity and the skills expected from the manager.

From the view of the manager, the modification could serve to narrow the scope of the duty of loyalty to allow the manager to enter into business that is competitive with the company or to take opportunities for the manager's personal advantage. Such an arrangement may be necessary to induce the manager to serve the LLC as such.

With respect to the duty of care, in certain circumstances a reasonable reduction of that duty might be to exclude negligence as a breach. An LLC manager's duty of care might also be modified to reflect the requisite conduct and skill expected in the performance of the particular managerial role.

Presumably the standard of fiduciary duty and the power of an operating agreement to change that standard apply to members in their role as managers in an LLC that they manage [*see Corp. Code § 17001(w)* (members deemed managers in member-managed LLC); *see also § 12C.23[16]*]. It is probable that members are even more likely than managers to have outside interests that impinge on or even compete with their LLC and that need to be limited or permitted by careful drafting as to their duty of loyalty. Similarly, members entitled to participate in management of an LLC may bring entirely different skills to it so that their duty of care needs to be carefully addressed in light of the particular facts.

[7] Managers' Other Duties

The Act does not provide that managers must hold meetings or observe any formalities. Because the Act is silent in this regard, the operating agreement has the flexibility and should be used to establish whatever rules and procedures for management suit the parties' purposes. However, as with members' liability issues, if particular formalities are required in the operating agreement, failure to observe those formalities may impose personal liability on the members for obligations of the LLC [*Corp. Code § 17101(b)*]. Therefore, inclusion of such formalities in the operating agreement should be considered with particular attention. If such formalities are included in an operating agreement, they should be meticulously followed.

Managers must file a certificate of amendment [*see § 12C.205*] to the articles of organization within 30 days after discovering any false or erroneous material statement in the articles or in any amendment to the articles [*Corp. Code § 17054(d)*; *see § 12C.21[3][d]* (amendment of articles)].

[8] Liability of Managers and Officers

[a] General Non-Liability

In general, managers and officers of an LLC are not personally liable for any debt, obligation, or liability of the LLC arising in contract, tort or otherwise, solely by reason of being a manager or officer [*Corp. Code § 17158(a)*]. However, neither the tort and contractual liability of an LLC created to operate as a health care service plan, nor that of its members, is limited or restricted in any manner because of the plan's LLC status [*Corp. Code § 17002(b)*]. In addition, there are a number of instances in which a manager will be personally liable for actions taken as a manager or officer [*see* [b], *below*].

[b] Situations Giving Rise to Personal Liability

[i] Agreement To Be Obligated

A manager may agree to be obligated personally for any or all of the LLC's debts, obligations, and liabilities if the agreement to be liable is set forth in the articles or a written operating agreement that specifically refers to the code section (*Corp. Code § 17158(b)*) authorizing liability [*Corp. Code § 17158(b)(1)*]. Furthermore, a manager may agree to

be obligated pursuant to the terms of a written guarantee or other contractual obligation entered into by the manager, other than an operating agreement [*Corp. Code § 17158(b)(2)*].

[ii] Breach of Fiduciary Duties

A manager may be liable for breach of fiduciary duties [*Corp. Code § 17153*; *see* [6], *above*].

[iii] Criminal or Tortious Conduct

Although the Act does not specifically deal with the liability of a manager for participation in tortious conduct (as it does in *Corp. Code § 17101(c)* with respect to members), there seems no doubt that a manager as well as a member would be so liable. In addition, under well established criminal principles applied in a business context, a manager could have personal criminal responsibility for participation in criminal acts in the same manner as corporate officers. For example, the Corporate Criminal Liability Act of 1989 [*Pen. Code § 387*], which imposes criminal liability for certain workplace safety violations, applies to corporations, LLCs, and to any person who is a manager, including managers of an LLCs, provided that person's activities bring him or her under the definition of "manager" in the Criminal Liability Act [*see Pen. Code § 387(b)(1)*]

[iv] Misstatement in Articles of Organization

A manager who executes a certificate of amendment to the articles of organization is personally liable for any statement materially inconsistent with the operating agreement or any material misstatement of fact in the certificate of amendment if the manager knew or should have known that the statement was false when made or that the statement became false and a required amendment was not filed, and a person suffered from reliance on those statements [*Corp. Code § 17054(e)*; *see Corp. Code § 17054(d)* (manager's duty to file certificate of amendment within 30 days of discovering false or erroneous statement); *see also § 12C.21[4][d]*].

[v] Voting for Improper Distributions

A manager who votes for a distribution in violation of the operating agreement or *Corp. Code §§ 17254* or *17353* is personally liable to the LLC for the amount of the distribution that exceeds what could have been distributed without violating those sections or the operating agreement. For this liability to apply, it must be established that the manager did not act in compliance with *Corp. Code §§ 17254* or *17353* [*Corp. Code § 17255(a)*]. A manager held liable under this provision may compel contribution from other liable parties [*Corp. Code § 17255(b)*]. Improper distributions are discussed in *§ 12C.23[14][b]*.

[vi] Failure to Pay Sales Taxes

A manager may become personally liable for unpaid sales taxes and interest and penalties on those taxes under certain circumstances if the manager willfully fails to pay or cause to be paid sales taxes due from the LLC [*Rev. & Tax. Code § 6829(a)*; *see State Board of Equalization v. Wirick (2001) 93 Cal. App. 4th 411, 413, 419, 112 Cal. Rptr. 2d 919* (*Rev. & Tax. Code § 6829* applied to former chief financial officer of corporation, despite fact that he had resigned position over one year before corporation ceased business; because present tense in statute includes past tense, section covers former officers as well as those in charge when corporation ceases)]. Notwithstanding any provision in the Corporations Code to the contrary, personal liability will result if the SBE can establish that the manager (1) had a duty to comply with *Rev. & Tax. Code § 6829*; (2) willfully failed to pay or failed to cause the LLC to pay the taxes [*Rev. & Tax. Code § 6829(a)*; *see Rev. & Tax. Code § 6829(d)* (definition)]; and (3) that the LLC included tax reimbursement in the selling price of, or added tax reimbursement to the selling price of, tangible personal property sold in the conduct of LLC business or that the LLC consumed tangible personal property and failed to pay the tax to the seller, or has included use tax on the billing and collected the use tax or has issued a receipt for the use tax and failed to report and pay use tax [*Rev. & Tax. Code § 6829(c)*; *see Rev. & Tax. Code § 6829(f)* (notice of deficiency determination)].

[9] Indemnification and Insurance

If so provided in its articles of organization or written operating agreement, an LLC may indemnify its managers, officers, employees, or agents for any act done in such a capacity, except a breach of the fiduciary duty set forth in *Corp. Code § 17153* [*Corp. Code § 17155(a)*]. The standard of fiduciary duty set forth in *Corp. Code § 17153* can be varied with "the informed consent of the members" [*Corp. Code § 17005(d)*]. *Corp. Code § 17153* (fiduciary duty) refers only to managers, not officers or others [*see* [6], *above*]. The document providing for indemnification should set forth clearly the standards for entitlement to it and the procedures for receiving it.

In addition to the indemnification described above, an employee of an LLC would be entitled to the indemnity provided by *Lab. Code § 2802*.

An LLC also may purchase insurance on behalf of its managers, officers, employees, or agents who have liability asserted against them in that capacity or arising out of their status as such [*Corp. Code § 17155(b)*].

[10] Remuneration of Managers

Managers and members of an LLC are not entitled to remuneration for acting in the LLC business, except as follows:

- The LLC operating agreement or other agreement among all LLC members may provide for remuneration to members for acting in the LLC business [*Corp. Code § 17004(b)*].

- Managers or members winding up the affairs of the LLC are entitled by statute to reasonable compensation, except as otherwise provided in the articles of organization or a written operating agreement [*Corp. Code §§ 17004(b), 17352(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesManagement Duties & Liabilities



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
B. California Limited Liability Companies

6-12C California Legal Forms--Transaction Guide § 12C.25

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§ 12C.25 Merger and Reorganization Procedure

One or more LLCs may merge with or be acquired by any other business entity or entities [*Corp. Code § 17550(a), (b)*] if the other entity or entities are authorized to do so by their governing law. This applies to domestic as well as foreign LLCs and other business entities [*Corp. Code § 17555*].

The Act specifies the procedures for merger. First, each LLC must approve an agreement of merger [*see § 12C.230*] by a majority vote, and each other merging entity must approve that agreement by those persons required to do so by the laws under which it is organized [*Corp. Code § 17551(a)*]. The agreement of merger must contain information specified by the Act, which is similar to that required in mergers of business corporations and limited partnerships [*Corp. Code § 17551(a)(1)- (6)*; *see § 12C.230[1][d]*]. Specific rules must be followed concerning treatment of interests in LLCs in mergers involving their parents or other entities owning more than 50 percent of the voting interests in the LLC [*Corp. Code § 17551(b)*]. An agreement of merger may be amended or abandoned [*Corp. Code § 17551(c), (d)*]. The Act provides for filings of one or more certificates of merger, the content and filing of which differ depending on the identity of the surviving entity [*Corp. Code § 17552*]. If the members of any constituent LLC would become personally liable for any obligations of a party to the merger, the principal terms of the agreement of merger must be approved by all members of the constituent LLCs unless all members would have dissenters' rights [*Corp. Code § 17551(a)*].

For a basic merger agreement, see *§ 12C.230*. For additional merger agreements that may be modified for use with LLCs, see *Ch. 11C, Mergers, §§ 11C.200, 11C.201* (corporations), and Ch. 15C, *Mergers of Limited Partnerships*. Dissenters' rights forms, including a notice of approval of reorganization and demand for purchase of dissenting interests, are provided in §§ 12C.231 and 12C.232 [*see § 12C.126*].

Mergers are effective on filing of the certificate of merger (Form OBE MERGER-1) [*see § 12C.207*] with the Secretary of State, unless it provides for delayed effective date [*Corp. Code § 17553*]. On the effective date of merger, existence of the disappearing business entities ceases, and the surviving entity succeeds automatically to the rights, property,

debts, and liabilities of the disappearing entities [*Corp. Code § 17554*].

An agreement of merger may amend the operating agreement of a constituent LLC, or adopt a new operating agreement for a constituent LLC, if it is the surviving LLC in the merger. The amendment or adoption is effective at the effective time or date of the merger. However, if a greater number of members is required to approve an amendment to the operating agreement of the constituent LLC than is required to approve the agreement of merger, any amendment or adoption takes effect if the vote of the constituent LLC in favor of the merger is at least as great as the vote required to amend the operating agreement of that LLC [*Corp. Code § 17551(e)*].

Both the merger procedures and the rules governing dissenting interests are similar to the rules applicable to mergers and reorganizations of business corporations and limited partnerships [*Corp. Code §§ 1200-1312, 15678.1-15678.9, 15679.1-15679.14*].

The tax treatment of a merger of an LLC with another entity should be carefully reviewed, since such a merger may or may not qualify as a tax-free reorganization.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
B. California Limited Liability Companies

6-12C California Legal Forms--Transaction Guide § 12C.26

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§ 12C.26 Conversions

[1] Entities Into Which LLC May Convert; Carryover of Interests

An LLC may be converted into a domestic or a foreign other business entity [*see Corp. Code § 17001(k), (s), (ac)* (definitions)] or a foreign LLC [*see Corp. Code § 17001(q)* (definition)] if, pursuant to a conversion into a domestic or foreign general partnership or limited partnership or into a foreign LLC, each of the members of the converting LLC will receive a percentage interest in profits and capital of the converted entity equal to that member's percentage interest in profits and capital of the converting limited liability company as of the effective time of the conversion [*Corp. Code § 17540.2(a)(1)*].

An LLC may be converted into a domestic or a foreign other business entity other than a general or limited partnership or foreign LLC if both of the following occur [*Corp. Code § 17540.2(a)(2)*]:

- Each of the membership interests of the same class is treated equally with respect to any distribution of cash, property, rights, interests, or securities of the converted entity, unless all members of the class consent; and

- The nonredeemable membership interests of the converting limited liability company are converted only into nonredeemable interests or securities of the converted entity, unless all holders of the nonredeemable interests consent.

[2] Applicable Law Must Authorize Conversion

LLC conversion to a domestic or foreign other business entity or a foreign LLC may be effected only if both of the following apply [*Corp. Code § 17540.2(b)*]:

- The law under which the converted entity will exist expressly permits the formation of that entity pursuant to a conversion; and

- The LLC complies with any and all other requirements of any other law that applies to conversion to the converted entity.

Chapter 11.5 of the General Corporation Law [*see Corp. Code §§ 161.9, 1150 et seq.*; Stats. 2002, ch. 480], permits both (1) the conversion of corporations into domestic "other business entities" (including limited liability companies) and (2) the conversion of domestic or foreign other business entities and foreign corporations into corporations [*Corp. Code § 1157(a)*; *see Corp. Code §§ 174.5, 1150(g)*]. For further discussion of the conversion of corporations into LLCs and other types of business entities, see Ch. 11F, *Corporate Conversions* .

[3] Plan of Conversion

[a] Contents

An LLC that wants to convert to a domestic or foreign other business entity or a foreign LLC must approve a plan of conversion that states all of the following [*Corp. Code § 17540.3(a)*]:

- The terms and conditions of the conversion.

- The place of the organization of the converted entity and of the converting LLC and the name of the converted entity after conversion.

- The manner of converting the membership interests of each of the members into securities of, shares of, or interests in, the converted entity.

- The provisions of the governing documents for the converted entity, including the articles or certificate of incorporation if the converted entity is a domestic or foreign corporation, the partnership agreement, or the LLC articles of organization and operating agreement, to which the holders of interests in the converted entity are to be bound.

- Any other details or provisions required by the laws under which the converted entity is organized.

- Any other provisions desired by the parties.

[b] Requisite Approvals

Unless the articles of organization or written operating agreement of the converting LLC specifies a greater percentage of the voting interests of members for conversion, a plan of conversion must be approved by a vote of a majority in interest of the members of the converting LLC [*Corp. Code § 17540.3(b)*]. However, if the LLC members would become personally liable for any obligations of the converted entity as a result of the conversion, the plan of conversion must be approved by all of the members of the converting LLC, unless the plan of conversion provides that all members will have dissenters' rights [*Corp. Code § 17540.3(b)*; *see Corp. Code § 17600 et seq.*; *see also § 12C.27*].

In addition to the above approvals, if the LLC is converting into a limited partnership, the plan of conversion must be approved by those members who will become general partners of the converted limited partnership pursuant to the plan of conversion [*Corp. Code § 17540.3(c)*].

[c] All Non-Dissenting Members Deemed Parties to Plan

All members of the converting LLC, except those that exercise dissenters' rights, are deemed parties to any governing documents for the converted entity adopted as part of the plan of conversion, regardless of whether the member has executed the plan of conversion or similar governing documents for the converted entity. Adoption of the new governing documents made pursuant to the conversion are effective at the effective time or date of the conversion [*Corp. Code § 17540.3(d)*; *see* [5], *below*].

[d] Amendment of Plan

Notwithstanding its prior approval, a plan of conversion may be amended before the conversion takes effect if the amendment is approved by the members of the converting LLC in the same manner that was required for approval of the original plan of conversion [*Corp. Code § 17540.3(e)*].

[e] Maintaining Plan of Conversion

The converted entity must keep the plan of conversion at one of the following locations [*Corp. Code § 17540.3(g)*]:

- The principal place of business of the converted entity if the converted entity is a domestic partnership or foreign other business entity.

- The principal executive office of or registrar or transfer agent of the converted entity if the converted entity is a domestic corporation.

- The office at which records are to be kept under *Corp. Code § 15614* or 15901.14 if the converted entity is a domestic limited partnership.

A member of a converting LLC has an unwaivable right to request that the person authorized to act on behalf of the converted entity, at the entity's expense, promptly deliver to the member or the holder of interests, shares, or other securities a copy of the plan of conversion [*Corp. Code § 17540.3(g)*].

[4] Abandoning Conversion

The members of the converting LLC may abandon a plan of conversion at any time before the conversion is effective, provided that the abandonment is effected in the same manner as required for approval of the plan of conversion, subject to the contractual rights of third parties [*Corp. Code § 17540.3(f)*].

[5] Conversion Into Domestic Other Business Entity

[a] Effective Date of Conversion

If an LLC converts into a domestic "other business entity," the conversion is effective on the earliest date that all of the following occur [*Corp. Code § 17540.4(a)*]:

- The approval of the plan of conversion by the members of the converting LLC [*see* [3][b], *above*].

- The filing of all documents required by law to effect the conversion and create the converted entity, including, if required, a statement of conversion [*see Corp. Code § 17540.6*; *see also* [c], *below*].

- The occurrence of the effective date, if set forth in the plan of conversion.

[b] Evidence of Conversion

A copy of the statement of partnership authority or certificate of limited partnership (including any required statement of conversion), duly certified by the Secretary of State, constitutes conclusive evidence of the conversion of the LLC [*Corp. Code § 17540.4(b)*; *see Corp. Code § 17540.6*; *see also* [c], *below*].

[c] Statement or Certificate of Conversion

If an LLC is converting into a domestic limited partnership, the converting entity must complete a statement of conversion on the certificate of limited partnership for the converted entity [*Corp. Code § 17540.6(a)(1)*]. Secretary of State Form LP-1A, Certificate of Limited Partnership--Conversion [*see* § 15C.205] is used for that purpose. Form LP-1A includes the appropriate Statement of Conversion.

If the LLC is converting into a domestic partnership, the converting entity must complete a statement of conversion on the statement of partnership authority for the converted entity [*Corp. Code § 17540.6(a)(2)*]. Secretary of State Form GP-1A, General Partnership Statement of Partnership--Conversion [*see § 15.801*] is used for that purpose. Form GP-1A includes the appropriate Statement of Conversion. Alternatively, if no statement of partnership authority is filed, then the converting entity must file a separate certificate of conversion [*Corp. Code § 17540.6(a)(2)*]. Secretary of State Form CONV-1A, Certificate of Conversion [*see § 12C.212*], is used for this purpose.

If the LLC is converting to a domestic corporation, a statement of conversion must be completed on the articles of incorporation for the converted entity [*Corp. Code § 17540.6(a)(3)*]. The conversion by an other business entity, including a limited liability company [*see Corp. Code §§ 174.5*, *1150(g)*], will be effective as of the filing with the Secretary of State of the articles of incorporation of the converted corporation containing a statement of conversion [*Corp. Code § 1157(d)*]. The Secretary of State has provided sample articles of incorporation containing the required statement of conversion [*see § 12C.213*].

If an LLC is converting into a foreign LLC or foreign other business entity, the converting entity must file a certificate of conversion (Form CONV-1A) [*see § 12C.212*] with the Secretary of State [*Corp. Code § 17540.6(a)(3)*].

The filing with the Secretary of State of a certificate of conversion or an organizational document containing a statement of conversion has the effect of the filing of a certificate of cancellation by the converting LLC. No converting LLC that has made this filing need also file a certificate of dissolution or a certificate of cancellation [*see Corp. Code § 17356*] as a result of that conversion [*Corp. Code § 17540.6(c)*].

A certificate or statement of conversion must set forth all of the following [*Corp. Code § 17540.6(b)*]:

- The name and the Secretary of State's file number of the converting limited liability company.

- A statement that the principal terms of the plan of conversion were approved by a vote of the members that equaled or exceeded the requisite vote [*see Corp. Code § 17540.3*; *see also* [3][b], *above*], specifying each class entitled to vote and the percentage vote required of each class.

- The form of organization of the converted entity.

Any certificate or statement of conversion must be executed and acknowledged by all of the managers, unless a lesser number is provided in the articles of organization or the operating agreement of the converting LLC [*Corp. Code § 17540.6(b)*].

[6] Conversion Into Foreign Other Business Entity or LLC

[a] Effective Date of Conversion

The conversion of an LLC into a foreign other business entity or a foreign LLC is generally governed by the laws of the state or place of organization of the foreign other business entity or foreign LLC. The conversion becomes effective in accordance with that law [*Corp. Code § 17540.5(b)*; *but see Corp. Code § 17540.4(a)* (effective date of conversion to foreign LLC); *see also* [5][a], *above*].

[b] Certificate of Conversion

When an LLC is converting into a foreign LLC or foreign other business entity, a certificate of conversion must be filed with the Secretary of State [*Corp. Code § 17540.6(a)(4)*]. Secretary of State Form CONV-1A, Certificate of Conversion [*see § 12C.212*] is used for this purpose. The contents of the certificate and execution requirements are discussed in [5][c], *above.*

[c] Secretary of State as Agent for Service of Process

To enforce an obligation of an LLC that has converted to a foreign LLC or foreign other business entity, the Secretary of State is the agent for service of process in an action or proceeding against that converted foreign entity if (1) the agent designated for the service of process is a natural person and cannot be located with due diligence; (2) if the agent is a corporation and no person to whom delivery may be made can be located with due diligence; or (3) if no agent has been designated and if none of the officers, partners, managers, members, or agents of that entity may be located after diligent search, and it is so shown by affidavit to the satisfaction of the court [*Corp. Code § 17540.5(c)(1)*]. The court may then order that service be made by personal delivery to the Secretary of State (or to an assistant or deputy Secretary of State) of two copies of the process together with two copies of the order; the order must set forth an address to which the process will be sent by the Secretary of State. Service in this manner is deemed complete on the 10th day after delivery of the process to the Secretary of State [*Corp. Code § 17540.5(c)(1)*]. On receiving process and the applicable fee, the Secretary of State will give notice to the foreign entity of the service of the process by forwarding by certified mail, return receipt requested, a copy of the process and order to the specified address [*Corp. Code § 17540.5(c)(2)*; *see Gov. Code § 12206 (fee)*]. The certificate of the Secretary of State, under official seal, certifying to the receipt of process, the giving of notice to that entity, and the forwarding of the process, constitutes competent and prima facie evidence of the contents [*Corp. Code § 17540.5(c)(3)*].

[7] Title to Real Property of Converting LLC

[a] Recording Requirements

The recording of (1) a certificate of conversion, statement of partnership authority, certificate of limited partnership, or articles of organization complying with *Corp. Code § 17540.6* in the prescribed form, or (2) a copy of a certificate of conversion, or a statement of partnership authority, certificate of limited partnership, articles of organization, articles or certificate of incorporation, or other certificate or document evidencing the creation of a foreign other business entity or foreign LLC by conversion, containing a statement of conversion, certified by the Secretary of State or an authorized public official of the state or place pursuant to the laws of which the conversion is effected, in the county where the converting LLC or other converting entity owns California real property, is evidence of record ownership in the converted LLC or other converted entity of all interest of the converting LLC or other converting entity in and to the real property located in that county. This rule operates only when the law of the jurisdiction of the place of organization provides, as does California law, that conversion vests in the converted LLC or other converted entity all the real property of the converting LLC or other converting entity [*Corp. Code § 17540.7(a)*; *see Corp. Code § 17540.9(b)*].

A filed and recorded (if appropriate) certificate of conversion, or a statement of partnership authority, certificate of limited partnership, articles of organization, articles or certificate of incorporation, or other certificate evidencing the formation of a foreign other business entity or a foreign LLC containing a statement of conversion, stating the name of the converting LLC or other converting entity in whose name property was held before the conversion and the name of

the converted entity or converted LLC, is sufficient to effect a change in record title [*Corp. Code § 17540.7(b)*].

[b] Presumption in Favor of Bona Fide Purchasers

The recording of a certificate of conversion or a statement of partnership authority, certificate of limited partnership, articles of organization, articles or certificate of incorporation, or other certificate evidencing the creation of an other business entity or a LLC by conversion, containing a statement of conversion [*see* [a], *above*], creates a conclusive presumption in favor of bona fide purchasers or encumbrances for value that the conversion was validly completed [*Corp. Code § 17540.7(c)*].

[8] Conversion of Other Business Entity or Foreign LLC Into Domestic LLC

An other business entity or a foreign other business entity or foreign LLC may be converted to a domestic LLC, provided that the converting entity is authorized by the laws under which it is organized to effect the conversion [*Corp. Code § 17540.8(a)*]. The domestic or foreign other business entity or foreign LLC that desires to convert into a domestic LLC must approve the plan of conversion or other instrument that is required to be approved to effect the conversion pursuant to the laws under which that entity is organized [*Corp. Code § 17540.8(b)*]. The conversion of a domestic or foreign other business entity or a foreign LLC must be approved by that number or percentage of the partners, members, or holders of interest of the converting entity that is required by the law under which that entity is organized, or a greater or lesser percentage, subject to applicable laws, as set forth in the converting entity's partnership agreement, articles of organization, operating agreement, articles or certificate of incorporation, or other governing document [*Corp. Code § 17540.8(c)*].

A limited partnership or corporation that is converting into a California limited liability company must complete a statement of conversion on the articles of organization for the converted entity [*Corp. Code §§ 1155(a)(3)* (corporation), 15677.6(a)(1) (limited partnership)]. A California general partnership that is converting into a California limited liability company must complete a statement of conversion on the articles of organization for the converted entity if the converting partnership had filed a statement of partnership authority under *Corp. Code § 16303* and that statement is effective at the time of conversion [*Corp. Code § 16906(a)*]. Secretary of State Form LLC-1A, which is reproduced in § 12C.200A, is a form for articles of organization containing the statement of conversion language. If a converting partnership has not filed a statement of partnership authority under *Corp. Code § 16303* that is effective at the time of conversion, then the filing of a statement of conversion on its articles of organization is optional [*Corp. Code § 16906(a)*].

The conversion by an other business entity or foreign LLC is effective when the conversion is effective under the law under which the converting entity is organized, as long as the articles of organization have been filed with the Secretary of State. If the converting entity's governing law is silent as to the effectiveness of the conversion, the conversion is effective on the completion of all acts required under California law to form an LLC [*Corp. Code § 17540.8(d)*].

The filing with the Secretary of State of a certificate of conversion or articles of organization containing a statement of conversion [*see Corp. Code § 17540.8(a)*] has the effect of the filing of a certificate of cancellation by a converting foreign limited liability company or foreign limited partnership. Therefore, a converting foreign limited liability company or foreign limited partnership that has made this filing is not required to file a certificate of cancellation as a result of the conversion [*Corp. Code § 17540.8(e)*; *see Corp. Code §§ 15696*, 15909.07, *17455*]. If a converting other business entity is a foreign corporation qualified to transact business in California, the foreign corporation automatically surrenders its right to transact intrastate business in California by virtue of this filing [*Corp. Code § 17540.8(e)*].

[9] Effect of Conversion on Rights and Liabilities of Converting Entities and Members

[a] Converting Entity Unchanged

An entity that converts into another entity pursuant to the LLC conversion provisions is for all purposes the same entity that existed before the conversion [*Corp. Code § 17540.9(a)*]. When conversion takes effect, the following rules apply [*Corp. Code § 17540.9(b)*]:

- All the rights and property, whether real, personal, or mixed, of the converting entity or converting LLC are vested in the converted entity or converted LLC.

- All debts, liabilities, and obligations of the converting entity or converting LLC continue as debts, liabilities, and obligations of the converted entity or converted LLC.

- All rights of creditors and liens on the property of the converting entity or converting LLC are preserved unimpaired and remain enforceable against the converted entity or converted LLC to the same extent as against the converting entity or converting LLC as if the conversion had not occurred.

- Any action or proceeding pending by or against the converting entity or converting LLC may be continued against the converted entity or converted LLC as if the conversion had not occurred.

[b] Liabilities of Members

A member of a converting LLC is liable for the following [*Corp. Code § 17540.9(c)*]:

- All obligations of the converting LLC for which the member was personally liable before the conversion.

- All obligations of the converted entity incurred after the conversion takes effect, but those obligations may be satisfied only out of property of the entity if the member is a limited partner, a shareholder in a corporation, or, unless expressly provided otherwise in the articles of organization or other governing documents, a member of a converted LLC or a holder of equity securities in an other converted entity if the holders of equity securities in the entity are not personally liable for the obligations of the entity under the law under which that entity is organized or its governing documents.

A member of a converted LLC remains liable for any and all obligations of the converting entity for which the member was personally liable before the conversion, but only to the extent that the member was personally liable for the obligations of the converting entity before the conversion [*Corp. Code § 17540.9(d)*].

If the other party to a transaction with an LLC reasonably believes when entering the transaction that the LLC member is a general partner, that LLC member is liable for an obligation incurred by the LLC within 90 days after the conversion takes effect. The LLC member's liability for all other obligations of the LLC incurred after the conversion takes effect is that of a LLC member [*Corp. Code § 17540.9(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited PartnershipsDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
B. California Limited Liability Companies

6-12C California Legal Forms--Transaction Guide § 12C.27

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§ 12C.27 Dissenter's Rights on Merger, Conversion, or Reorganization

[1] In General

The Act provides for dissenters' rights in mergers or other reorganizations [*see Corp. Code §§ 17600-17613*]. "Reorganization" is defined to include mergers, conversions, certain acquisitions of controlling interests in other business entities, and certain acquisitions of substantially all of the assets of other business entities [*Corp. Code § 17600(a)*]. In general, in a merger or reorganization, a member who is entitled to vote on a reorganization and has taken necessary steps to have a dissenting interest [*see Corp. Code § 17601(b)* (definition)] may require the LLC to purchase that interest for cash at fair market value [*Corp. Code § 17601(a)*; *see* [3], *below; see also § 12C.126* (procedures for enforcing dissenters' rights)].

These dissenters' rights provisions apply to domestic LLCs, and to foreign LLCs if members holding more than 50 percent of voting interests reside in California [*Corp. Code § 17612(a)*]. These provisions do not apply to an LLC with 35 or fewer members if all the members have waived the application of dissenters' rights provisions in writing [*Corp. Code § 17612(c)*].

With certain listed exceptions, a dissenting member of an LLC that is reorganizing does not have the right to attack the validity of the reorganization or to have the reorganization set aside or rescinded [*see Corp. Code § 17613(a)*].

[2] "Dissenting Interest" Defined

A "dissenting interest" is a membership interest in an LLC that satisfies all of the following [*Corp. Code § 17601(b)*]:

- The membership interest was outstanding on the date for the determination of members entitled to vote on the reorganization.

- The membership interest was not voted in favor of the reorganization, or the membership interest was voted against the reorganization [*see Corp. Code § 17601(b)(2)*].

- The member has demanded that the LLC purchase its interest at its fair market value [*see Corp. Code § 17602* (method of demand)].

- The member has submitted the certificate of interest for endorsement, if applicable [*see Corp. Code § 17603*].

[3] Procedure to Require Company to Purchase Dissenting Interest

If LLC members have the right to require the LLC to purchase their dissenting interests [*see Corp. Code § 17601(b)* (definition); *see also* [b], *above*], the LLC must mail to each member a notice of approval of the proposed reorganization [*see § 12C.231* (form for notice)]. The notice must contain specified information, including the price determined to be the fair market value of outstanding interests, the method of valuation, the latest available balance sheet, the latest income statement, and a description of the procedure to exercise dissenters' rights. The statement of price constitutes an offer by the LLC to purchase dissenting interests at that price [*Corp. Code § 17602(a)*].

A member with a dissenting interest who wishes the LLC to purchase his or her interest must make a written demand on the LLC for the purchase of the interest and the payment to the member in cash of its fair market value [*see § 12C.232* (form for demand)]. To be effective, the demand must be received by the LLC within 30 days after the notice of reorganization was mailed to members [*Corp. Code § 17602(b)*]. The demand must state the number or amount of interest, and must contain a statement of the member's claim of the fair market value of the interest on the day before the announcement of the proposed reorganization. The statement of value constitutes an offer by the member to sell the dissenting interest at that price [*Corp. Code § 17602(c)*].

If the LLC and the dissenting member agree that the interest is a dissenting interest, and agree on the price to be paid for the interest, the dissenting member is entitled to the agreed price, with interest from the date of consummation of the reorganization. Agreements as to value of dissenting interests must be in writing and must be kept with the records of the LLC [*Corp. Code § 17604(a)*]. The LLC must pay for a dissenting interest within 30 days after the amount of the interest has been agreed on, or within 30 days after conditions to the reorganization are satisfied, whichever is later [*Corp. Code § 17604(b)*]. The dissenting member must submit certificates of interest (or, if none, written notice of the number or amount of interests) on payment [*Corp. Code § 17604(b)*; *see Corp. Code § 17603*].

If the LLC denies that an interest is a dissenting interest, or the LLC and the dissenting member cannot agree on the value of a dissenting interest, either the LLC or the member may bring an action in superior court within six months after the date of the notice of approval of the reorganization to settle the issue [*Corp. Code § 17605*]. The court may appoint an appraiser to determine the fair market value of dissenting interests [*see Corp. Code § 17606*].

For detailed coverage of the procedure for enforcing dissenters' rights, see *§ 12C.126[2]*.

[4] Loss of Status as Dissenting Interest

A dissenting interest loses its status as such, and the holder of that interest ceases to be a dissenting member, on the occurrence of any of the following [*Corp. Code § 17610*]:

- The LLC abandons the reorganization.

- The interest is transferred before its submission for endorsement [*see Corp. Code § 17603*].

- The dissenting member and the LLC do not agree that the interest is a dissenting interest or disagree on the purchase price of the interest, and neither files a complaint within six months after the notice of approval of the reorganization [*see Corp. Code § 17605*].

- The dissenting member, with the LLC's consent, withdraws the demand for purchase of the dissenting interest.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawMergersRights of Dissenting Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
B. California Limited Liability Companies

6-12C California Legal Forms--Transaction Guide § 12C.28

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.28 Dissolution and Winding Up

[1] Causes of Dissolution

An LLC must be dissolved, and its affairs wound up, when the first of the following occurs [*Corp. Code § 17350*]:

- When specified in the articles of organization.
- On the happening of events specified in the articles or written operating agreement.
- By the vote of a majority in interest of the members [*see Corp. Code § 17001(v)* (definition)], or greater percentage of the voting interests of members specified in the articles or written operating agreement.
- Entry of a decree of judicial dissolution pursuant to *Corp. Code § 17351* [*see* [2], *below*].

Provisions respecting dissolution and winding up may not be varied in the articles of organization or operating agreement except as indicated by statute.

[2] Judicial Dissolution

An LLC may be judicially dissolved pursuant to an action filed by a manager or member when any of the following occurs [*Corp. Code § 17351(a)*]:

- It is not reasonably practicable to carry on the LLC's business in conformity with its articles or operating agreement.

- Dissolution is reasonably necessary for the protection of the rights or interests of the complaining members.

- The LLC's business has been abandoned.

- The LLC's management is deadlocked or subject to internal dissention.

- Those in control of the LLC have been guilty of, or have knowingly countenanced persistent and pervasive fraud, mismanagement, or abuse of authority.

Noninitiating members may avoid dissolution by purchasing the membership interests of the initiating members at their fair market value [*Corp. Code § 17351(b)(1)*]. The Act specifies procedures for such a purchase [*see Corp. Code § 17351(a)(1)- (4)*].

[3] Noncompetition Agreements

Any member, on or in anticipation of dissolution of an LLC, may agree not to carry on a business similar to that carried on by the LLC within a specified geographic area where LLC business has been transacted so long as any other member of the LLC (or any person deriving title to the business or its goodwill from any other member of the LLC) carries on a similar business in that area [*Bus. & Prof Code § 16602.5*]. For additional discussion and examples, see Ch. 17, *Buying and Selling a Business or Professional Practice* , and Ch. 85, *Employment Agreements* .

[4] Continuation of Existence After Dissolution

A dissolved LLC continues to exist for the purpose of winding up its affairs, dealing with actions by or against it, collecting or discharging its obligations, disposing of or conveying its property, and collecting and dividing its assets [*Corp. Code § 17354(a)*]. A dissolved LLC may not continue business, however, except so far as necessary for its winding up. In that connection, actions to which the LLC is a party do not abate by reason of its dissolution or its winding up proceedings and assets inadvertently omitted from its winding up continue to be owned by it for the benefit of the persons entitled to it [*Corp. Code § 17354(b)*].

Causes of action against a dissolved LLC may be enforced against it to the extent of its undistributed assets and, if its assets have been distributed to its members, against them to the extent of the assets distributed to them [*Corp. Code § 17355*]. The Act provides for contribution in the event a member is compelled to return distributed assets in an amount in excess of the member's pro rata share of the claim and for a statute of limitations for such claims against members [*Corp. Code § 17355(a)*]. In addition, as with business corporations, LLCs survive and continue to exist indefinitely for the purpose of being sued in quiet title actions; and judgments rendered in any such actions bind all members or other persons to the extent of their interest in the LLC [*Corp. Code § 17355(c)*].

Even if a certificate of dissolution has been filed [*see* [5], *below*], a majority in interest of the members of an LLC may file a certificate of continuation (Form LLC-8) [*see § 12C.206*] with the Secretary of State [*Corp. Code § 17357(a)*] and on that filing, the certificate of dissolution is of no effect [*Corp. Code § 17357(c)*].

A certificate of continuation may be filed in any of the following circumstances [*Corp. Code § 17357(a)*]:

- The business of the LLC is to be continued pursuant to a unanimous vote of the remaining members.

- The dissolution of the LLC was by vote of the members pursuant to *Corp. Code § 17350(b)* and each member who consented to the dissolution has agreed in writing to revoke that member's vote in favor of or consent to the dissolution.

- The LLC was not, in fact, dissolved.

[5] Winding Up

When a limited liability company is dissolved, the managers or members must wind up its affairs. In a judicial dissolution [*see* [2], *above*], winding up is conducted in accordance with the decree of dissolution [*Corp. Code § 17352(a)*]. In a nonjudicial dissolution, the managers who have not wrongfully dissolved the LLC or, if none, the members may wind it up. The winding up process requires notification to known creditors and claimants, payment or adequate provision for debts and liabilities and distributions of remaining assets among members according to their respective rights and preferences as specified in the Act [*Corp. Code § 17353(a)*; *see Corp. Code § 17353(c)* (method of adequately providing for payment of debts and liabilities)] or as otherwise specified in articles of organization or the operating agreement.

On the petition of a manager, a member, or three or more creditors, a court may order the winding up of the LLC if it appears necessary for the protection of those parties [*Corp. Code § 17352(b)*].

For detailed coverage of the dissolution and winding-up procedure, see *§ 12C.127*.

[6] Certificate of Dissolution and Certificate of Cancellation

When a limited liability company dissolves, its managers must file a certificate of dissolution (Form LLC-3) [*see § 12C.202*] with the Secretary of State [*Corp. Code § 17356(a)*]. If, however, the LLC is dissolved by the vote of all of the members [*see Corp. Code § 17350(b)*] and a statement to that effect is added to the certificate of cancellation of articles, a separate filing of a certificate of dissolution is not required [*Corp. Code § 17356(a)(3)*].

When the affairs of the LLC have been wound up, a certificate of cancellation (Form LLC-4/7) [*see § 12C.203*] must be filed with the Secretary of State, canceling the LLC's articles of organization [*Corp. Code § 17356(b)*]. The Secretary of State will notify the Franchise Tax Board of the filing [Corp. Code § 17356(b)(3)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesDissolution & Winding Up



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
B. California Limited Liability Companies

6-12C California Legal Forms--Transaction Guide § 12C.29

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.29 Securities Issues

[1] LLC Interests Classified As Securities

Under California law, an LLC interest is included in the statutory definition of a security. The term "security" includes every interest in an LLC and any class or series of those interests (including any fractional or other interest in that LLC interest) [*Corp. Code § 25019*].

A limited exception to this definition excludes a membership interest in an LLC in which the person claiming this exception can prove that all of the members are actively engaged in the management of the LLC. However, the statute provides that evidence that members vote or have the right to vote, the right to information concerning the business and affairs of the LLC, or the right to participate in management, does not establish, without more, that all members are actively engaged in the management of the LLC [*Corp. Code § 25019*]. As a practical matter, virtually all LLC interests are securities under California law and must be qualified unless exempt.

Under federal law, the determination of whether or not an interest is a security similarly involves an analysis of whether or not the interest holder actively participates in the business affairs of the issuing entity [*see 15 U.S.C. §§ 77b(a)(1), 78c(a)(10)* (investment contracts as securities); *see also SEC v. Howey Co. (1946) 328 U.S. 293, 298, 66 S. Ct. 1100, 90 L. Ed. 1244* (analysis determines whether investment opportunity is financial arrangement or investment contract)]. Stated differently, courts must determine whether the sale of an LLC interest was essentially an investment transaction (securities law applies) or a commercial transaction (securities law inapplicable) [*Great Lakes Chem. Corp. v. Monsanto Co. (D. Del. 2000) 96 F. Supp. 2d 376, 389]* . It is possible that a different result will be reached under state and federal law, such that an LLC interest may be a security for California purposes, but not for federal securities laws purposes.

For a detailed discussion of securities registration, qualification, and exemptions, see Ch. 6, *Securities Regulation Issues*

, and subsequent chapters.

[2] California Securities Exemptions Applicable to LLCs

The most common California exemption applicable to LLC membership interests is the limited offering exemption, which is similar to federal Regulation D [*see* Ch. 6B, *California Limited Offering Exemptions* ; for discussion of Regulation D, *see* Ch. 6A, *Federal Securities Exemptions for California Nonpublic Corporations*]. Key to this exemption is the prohibition on advertising [*Corp. Code § 25102(f)*; *see Corp. Code § 25102(f)*; *see also 17 C.F.R. §§ 230.501-230.508*].

The California small offering exemption applies only to the issuance of shares and is therefore inapplicable [*see Corp. Code § 25102(h)*; for discussion of the small offering exemption, *see* Ch. 6C, *California Small Offering Exemption*]. An LLC can rely on the qualified purchaser exemption if sales are made only to qualified purchasers or other persons that the LLC reasonable believes, after reasonable inquiry, to be qualified purchasers [*Corp. Code § 25102(n)*; for discussion of the qualified purchaser exemption, *see* Ch. 6D, *California Qualified Purchaser Exemptions*].

In addition, an offer or sale of a security issued by an LLC pursuant to a purchase plan or agreement, or issued pursuant to an option plan or agreement, is exempt from qualification if, at the time of issuance or grant, the security is exempt from registration under federal law [*see 17 C.F.R. § 230.701*] and (1) the terms of the plan or agreement comply with California requirements [*see 10 Cal. Code Reg. §§ 260.140.41* (option plan), 260.140.42 (purchase plan), 260.140.45, 260.140.46]; (2) the issuer files a notice of transaction within 30 days after the initial issuance of any security under the plan; and (3) the issuer pays the prescribed filing fee [*Corp. Code § 25102(o)*; *see Corp. Code § 25608(y)(fee)*]. However, the failure to file the notice, or to file the notice within the specified time, does not affect the availability of the exemption. An issuer that fails to file the notice as required by statute must, within 15 business days after the earlier of the discovery of the failure to file the notice or demand by the Commissioner, file the notice and pay a fee equal to the maximum aggregate fee that would have been payable had the transaction been qualified [*Corp. Code § 25102(o)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsSecurities LawBlue Sky LawsGeneral OverviewSecurities LawBlue Sky LawsSecurities Exempt From Registration



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
B. California Limited Liability Companies

6-12C California Legal Forms--Transaction Guide §§ 12C.30-12C.39

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[Reserved]

§§ 12C.30[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
C. Comparison of Limited Liability Companies With Other Business Entities

6-12C California Legal Forms--Transaction Guide § 12C.40

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.40 Overview

This part of the Legal Background briefly compares LLCs with corporations (generally including S corporations except as noted) in § 12C.41; with S corporations in § 12C.42; with limited partnerships in § 12C.43; and with general partnerships in § 12C.44. Section 12C.45 discusses some cost and other considerations not otherwise mentioned in this summary that are involved in converting an existing business entity to an LLC.

Proponents of the LLC entity believe that it has very favorable attributes compared to other business entities, principally because it offers the personal liability protection associated with corporations and the pass-through tax treatment and flexibility of a partnership.

Several types of businesses may not operate through the LLC form. Certain providers of professional services are not currently authorized to render those services through an LLC [*Corp. Code § 17375*; *see Corp. Code §§ 13401(a), 13401.3* (definition); *see also § 12C.10[5]*]. In addition, LLCs may not be formed to engage in the banking business, the business of issuing policies of insurance and assuming insurance risks, or trust company business [*Corp. Code § 17002(a)*]. No LLC may operate as a licensed health care service plan unless it is a subsidiary of a licensed health care service plan and is established to serve an existing line of business of the parent [*Corp. Code § 17002(b)*]. However, entities engaged in these otherwise prohibited businesses may be members of an LLC [*Corp. Code § 17001(x)*].

Since January 1, 2000, California has permitted the formation and operation of LLCs with one member [*Corp. Code §§ 17001(t), 17050(b)*]. However, a single-member LLC will be disregarded as an entity separate from its owner for tax purposes unless it elected to be taxed as a corporation [*Treas. Reg. § 301.7701-3(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
C. Comparison of Limited Liability Companies With Other Business Entities

6-12C California Legal Forms--Transaction Guide § 12C.41

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.41 Corporations

[1] Formation and Operation

The formation requirements applicable to an LLC are somewhat similar to those applicable to a corporation formed under the California General Corporation Law, so there is no particular advantage to either type of entity at the formation stage. With respect to day-to-day operations, the members of an LLC are required to enter into an operating agreement governing the LLC's internal affairs [*Corp. Code §§ 17001(ab), 17050(a)*], while corporations must adopt written bylaws [*Corp. Code §§ 211-213*]. Although, unlike corporate bylaws, an LLC's operating agreement need not include any particular provisions, and need not be in writing, as a practical matter those agreements are fairly detailed and as a rule should be in writing [*see §§ 12C.21[4], 12C.220*].

As noted in § 12C.40, LLCs are not permitted to engage in certain businesses or render certain professional services [*Corp. Code §§ 17002, 17375*; *see § 12C.10[5]*]. In contrast, corporations, other than corporations subject to the Banking Law or professional corporations, may pursue any lawful business activity; corporations subject to the Banking Law and professional corporations may form and engage in business activities that are permitted under the respective governing statutes [*Corp. Code § 206*; *see Corp. Code §§ 163, 13400-13410*].

An LLC may operate under a traditional management structure, with a nonmember board of directors and officers, it may be managed by one or more managers (who may, but need not, be members), or it may be managed by all of its members [*Corp. Code §§ 17150-17157*; *see* 12C.24]. In contrast to a corporation's usual board of directors structure in which each director has a single vote, an LLC operating agreement may create nearly any management structure and may allocate management voting rights based on ownership or other factors [*Corp. Code § 17103*]. A corporation, however, may be formed as a close corporation under the General Corporation Law and as such may operate without a board of directors and pursuant to a shareholders agreement, which may be structured much like a partnership agreement or an operating agreement of an LLC. Although statutory close corporations may only have 35 or fewer

shareholders, this limitation may not be germane to selection of form of entity in a great many cases when an LLC is being considered.

Finally, as a general rule, an LLC's record keeping and reporting burdens are less onerous than those of corporations [*compare Corp. Code § 1500 et seq.* (corporations) *with Corp. Code §§ 17058, 17106* (LLCs); *see § 12C.23[11]*].

[2] Limited Liability

LLC members and corporate shareholders generally are shielded from personal liability for company obligations [*Corp. Code §§ 17101(a), 17158*]. Nevertheless, both members of LLCs and corporate shareholders may be personally liable under some circumstances [*Corp. Code § 17101(b)*; *see People v. Clauson (1964) 231 Cal. App. 2d 374, 41 Cal. Rptr. 691* ; *Cooperman v. Unemployment Ins. Appeals Bd. (1975) 49 Cal. App. 3d 1, 122 Cal. Rptr. 127]* . For example, the tort and contractual liability of an LLC created to operate as a health care service plan, and that of its members, is not limited or restricted in any manner because of the plan's LLC status [*Corp. Code § 17002(b)*]. In addition, LLC members are subject to liability under the common law governing alter ego liability, and may be personally liable under a court judgment for any debt, obligation, or liability of the LLC under the same circumstances and to the same extent as a corporate shareholder [*Corp. Code § 17101(b)*]. Further, LLC members may agree to be obligated personally for any or all of the LLC's debts, obligations, and liabilities under certain circumstances [*Corp. Code § 17101(c), (e)*; *see* § 12.23[14][b]]. Finally, LLC members are subject to certain statutory liabilities for participation in tortious conduct [*Corp. Code § 17101(c)*] or in criminal acts, situations unlikely to arise as to shareholders except in close corporations managed by shareholders. These liabilities, however, should arise as to LLC members only when they manage the LLC or there is actual malfeasance on their part [*Corp. Code § 17101(c)*]. Liability of LLC members and managers is discussed further in §§ 12C.23[14] and 12C.24[8].

[3] Tax Treatment

The principal advantage of an LLC over a business corporation that is not an S corporation (a "C corporation") is the different tax treatment afforded the LLC. An LLC is treated as a partnership unless it elects to be taxed as a corporation [*Treas. Reg. § 301.7701-3(a)*; *see § 12C.50[2]*].

Usually, the most immediate advantage of partnership income tax status for an LLC is the pass-through aspect of profit and loss to its members. This treatment avoids the double taxation applicable to C corporations, once on earnings at the corporate level [*I.R.C. § 11*; *Rev. & Tax. Code §§ 23038, 23151*] and again on dividend and appreciated property distributions at the shareholder level [*I.R.C. § 61(a)(7)*]. Further, LLCs are not subject to accumulated earnings taxes [*I.R.C. § 531* et seq.] and personal holding company taxes [*I.R.C. § 541* et seq.] that may be imposed on C corporations. LLCs have an advantage over S corporations in that LLCs can specially allocate items of income, gain, loss, deduction, and distributions pursuant to the operating agreement, within the restrictions of *I.R.C. § 704(b)*.

Whether the pass-through of income from an LLC to members is beneficial depends on the applicable tax rates and the amount of income involved. Pass-through (and therefore, selection of LLC status over a C corporation) will be beneficial if an individual member's tax rate is less than the federal corporate tax rate. The maximum individual tax rate after 2002 is 35 percent, although taxpayers with taxable income of less than $250,000 are subject to lower tax rates [*I.R.C. § 1(a)- (d), (i)(2)*]. In contrast, the maximum federal corporate tax rate for taxable income between $75,000 and $10 million is 34 percent. For taxable income over $10 million, the maximum corporate tax rate is 35 percent [*I.R.C. § 11(b)*]. An additional 5 percent tax is imposed on corporate taxable income exceeding $100,000, with an $11,750 cap on additional tax liability. This causes an effective tax rate of 39 percent on taxable income between $100,000 and $335,000. A 3 percent additional tax is imposed on corporate taxable income exceeding $15 million, with a $100,000 cap on additional tax liability. This causes an effective tax rate of 38 percent on corporate taxable income between $15 million and $18,333,333. Corporate taxable income over $18,333,333 is subject to a tax rate of 35 percent [*I.R.C. § 11(b)(1)*]. Thus, the pass-through of income may not be beneficial, especially if the business needs to retain its earnings

and does not plan significant cash distributions to its owners. Nonetheless, for businesses that traditionally have higher deductions and write-offs, LLC members may be able to use their pass-through losses to offset other income. In addition, because LLC income taxation is at the member level, natural person members (but not C corporations) may benefit from the lower capital gain income tax rates [*I.R.C. §§ 1(h), 11* 1201(a)].

One advantage of a corporation available to holders of "small business stock" is that 50 percent of the gain from sale of the stock may be excluded under certain circumstances [*I.R.C. § 1202(a)(1)*; *see I.R.C. § 1202(a)(2)* (60 percent in empowerment zone business); *see I.R.C. § 1202(a)(3)* (75 percent for certain stock acquired in 2009 or 2010)]. In addition, shareholders of a "small business corporation" in some circumstances may deduct, as an ordinary loss, losses from the sale, exchange, or worthlessness of their stock in the business, which ordinarily would be capital losses [*I.R.C. § 1244*]. These provisions are not available to members of LLCs.

An important tax difference between corporations and LLCs may arise if an appreciated asset is to be contributed to the entity's capital in exchange for an ownership interest. Unless the transferors are in "control" of the corporation immediately after the exchange, they will recognize gain in the amount of the fair market value of the acquired interest in the corporation over the tax basis of the property transferred [*I.R.C. § 351(a)*], but no such rule applies to contributions to an LLC by its members.

There is also an important difference between the basis of a shareholder in a C corporation in the corporation's stock and of an LLC member in the LLC membership. The stock basis of the C corporation shareholder is not affected by the gains or losses realized by the C corporation, while the bases of LLC members (and S corporation shareholders) in their ownership interests are increased by allocations to them of gains and profits earned by their company and decreased by allocations to them of losses incurred by the company [*I.R.C. §§ 705(a), 1367(a)*]. Losses of C corporations therefore are retained at the corporate level; losses of LLCs and S corporations that flow through to the members and S corporation shareholders may be used by them to offset other income, subject to rules too complex to delineate here involving primarily the owner's basis and the application of passive loss limitations.

Typically, an LLC suffers no adverse tax consequences on liquidation [*I.R.C. § 731(b)*]. An LLC member generally will not recognize gain unless the distribution of cash exceeds the member's adjusted basis in the LLC immediately before the distribution [*I.R.C. § 731(a)*]. However, C corporations are subject to potential double taxation on liquidation [*I.R.C. §§ 331*, 336], which may be a consideration for C corporations that are considering reorganization as LLCs.

In addition to federal taxes, both LLCs and C corporations must pay state taxes and fees to do business in California. For example, LLCs must pay a minimum franchise tax and a graduated fee on income [*see § 12C.53*]. Like LLCs, corporations must pay a minimum franchise tax and pay income tax on their net earnings [*see* Rev. & Tax. Code §§ 23010 et seq., *23501 et seq.*], and may be subject to other fees.

There are a number of other tax rules that differ as between C corporations and the other entities considered here, such as differences in accounting methods that may be used and taxable years that may be elected.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral Overview



106 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
C. Comparison of Limited Liability Companies With Other Business Entities

6-12C California Legal Forms--Transaction Guide § 12C.42

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.42 S Corporations

PRACTICE TIP:

Federal law limits the number of shareholders of an S corporation to 100 [*I.R.C. § 1361(b)(1)(A)*]. California has generally conformed to the federal rules except that California S corporations are subject to the minimum franchise tax and tax at the rate of 11/2 percent of taxable income [*Rev. & Tax. Code §§ 17024.5, 23800, 23802*]. For further discussion of the federal changes, see Ch. 2B, *Electing Subchapter S Status* .

[1] Definition

S corporation status is primarily a creature of federal and state tax law [*see I.R.C. § 1361* et seq.; *Rev. & Tax. Code § 23800 et seq.*]. While retaining the corporate characteristic of limited liability, a corporation can generally secure pass-through tax status by filing an S election on Form 2553 with the Internal Revenue Service and Form 3560 with the Franchise Tax Board [*see I.R.C. § 1362; Rev. & Tax. Code § 23801*]. However, S corporations are subject to structural restrictions [*see* [2], *below*], and are subject to tax restrictions [*see* [3], *below*] not applicable to LLCs.

[2] Structural Restrictions Applicable to S Corporations

Unlike LLC membership, which is virtually unrestricted [*see Corp. Code §§ 17001(x), 17102*], S corporation shareholder status is subject to several restrictions. An S corporation may not have (1) more than 100 shareholders; (2) shareholders who are not individuals other than estates and qualified trusts [*see I.R.C. § 1361(c)(2)*]; or (3) shareholders who are nonresident aliens [*I.R.C. § 1361(b)(1)*].

In addition, LLCs may have a variety of classes of members and classes of interests [*Corp. Code §§ 17001(z), 17102*], but S corporations may not have more than one class of stock [*I.R.C. § 1361(b)(1)(D), (c)*].

LLCs may be subsidiaries of other corporations or entities and may themselves have subsidiaries. S corporations are limited as to the identity of their shareholders and may not own 80 percent or more of the voting stock of another corporation or otherwise be a member of an affiliated group [*I.R.C. § 1361(b)(2)*], but these restrictions do not apply to LLCs.

LLCs also have the other advantages over S corporations, such as more flexible management structure and less burdensome record and report keeping obligations, that were discussed in connection with corporations generally [*see § 12C.41*].

[3] Tax Treatment

Properly constituted LLCs and S corporations are not subject to federal income taxation at the LLC/corporate level. Most items of S corporation income and loss (and their tax attributes) pass through to the shareholders [*I.R.C. §§ 1361*-1379]. The profits and losses of an LLC can be allocated among members and classes of members within IRS restrictions by its operating agreement; if the agreement does not provide to the contrary, profits and losses are allocated in proportion to the contributions of the members [*Corp. Code § 17202*]. Each S corporation shareholder, however, recognizes and reports a pro rata share, based on shareholdings, of the corporation's income, loss, deductions, and credits; S corporations are not permitted to specially allocate these items [*I.R.C. §§ 1366*, *1377(a)*]. An S corporation shareholder does not have a basis in the corporation's debts (except debt to that shareholder) to use to support loss deductions [*I.R.C. § 1366(d)*]. LLC members are entitled to basis for the LLC's debts [*I.R.C. §§ 701*-704, 752], even though the debts are nonrecourse as to the members.

S corporations may be subject to penalty taxes for certain built-in gains [*I.R.C. § 1374*] and on excessive passive income [*I.R.C. § 1375*; *see also Rev. & Tax. Code § 23811*]. LLCs are not subject to these penalties.

The death of an S corporation shareholder and changes in the number and identity of shareholders may result in the termination of the S election [*I.R.C. § 1362(d)(2)*], but does not affect the basis of the assets of the corporation [*I.R.C. § 1014(a)*]. In contrast, an LLC faced with the death or withdrawal of a member or admission of new members must allocate taxable income or loss among the continuing members and the deceased or withdrawing member [*I.R.C. §§ 706*, *708*; *see Treas. Reg. § 1.706-1(c)*] and, if the LLC is not continued by the remaining members, could face dissolution and winding up.

LLCs taxed as partnerships are not subject to California income taxation at the LLC level, but are subject to the annual minimum franchise tax and a statutory fee on gross income [*see Rev. & Tax. Code §§ 17941*, *17942*; *see also § 12C.53*]. S corporations are subject to the greater of the annual minimum franchise tax [*Rev. & Tax. Code §§ 23151*, *23153(d)(1)*, *23802(c)*] or 1.5 percent income tax at the corporate level [*Rev. & Tax. Code § 23802(b)(1)*; *see Rev. & Tax. Code § 23802(b)(2)* (higher rate for S financial corporations)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationTax LawFederal Taxpayer GroupsS CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsElections (IRC secs. 1362-1363)Requirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
C. Comparison of Limited Liability Companies With Other Business Entities

6-12C California Legal Forms--Transaction Guide § 12C.43

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.43 Limited Partnerships

[1] Formation and Operation

Most LLCs and all limited partnerships involve the association of two or more persons to form and carry on a business: a limited partnership requires one or more general partners and one or more limited partners [*Corp. Code 15901.02(q)* (ULPA '08)]; however, LLCs are permitted to form and operate with one member [*Corp. Code §§ 17001(t), 17050(b)*]. Formal formation requirements are minimal: LLCs must file a simple articles of organization form (Form LLC-1) with the Secretary of State and must have an oral or written operating agreement [*Corp. Code § 17050(a)*]; similarly, limited partnerships must file a simple certificate of limited partnership (Form LP-1) with the Secretary of State and must have an oral or written partnership agreement [*Corp. Code 15901.02(x), 15902.01(a), (b)* (ULPA '08)]. The articles of organization and operating agreement of the LLC and the certificate of limited partnership and partnership agreement respectively govern the business operations of the entity [*Corp. Code §§ 15901.02(x), 15902.01(a), (b)*(ULPA '08), *17001(ab)*].

[2] Limited Liability

LLC members and limited partners of properly structured entities are ordinarily shielded from personal liability for company obligations [*Corp. Code §§ 15903.03* (ULPA '08), *17101(a), 17158*]. Nevertheless, both members of LLCs and limited partners may be liable beyond the amount of their capital contributions under certain circumstances [*see §§ 12C.23[14], 12C.24[8]*; *see also Corp. Code §§ 17101(b), (c),* 15903.03 (ULPA '08)]. As with misstatements contained in LLC articles of organization, personal liability attaches to a partner executing a Form LP-1 knowing it to be false. Because the person executing this statement is usually the general partner, and general partners have unlimited liability for the limited partnership's obligations [*Corp. Code § 15904.04* (ULPA '08)], this limitation rarely affects the status of the limited partners. However, a limited partner who participates in the control of the limited partnership's business is treated as a general partner and loses the protection of limited liability [*Corp. Code § 15903.03* (ULPA '08)]. LLCs are not required to have a member who is personally liable for the debts of the LLC and members have limited liability

even if they participate in management of the business.

The liability of LLC members and managers is discussed in *further detail in §§ 12C.23[14]* and *12C.24[8]*.

[3] Tax Treatment

LLCs and limited partnerships, if they elect to be taxed as partnerships [*see Treas. Reg. § 301.7701-3*], provide pass-through income tax treatment to their members and limited and general partners: members and partners are subject to tax [*I.R.C. § 701*]. This treatment avoids for both the double-level taxation imposed on C corporations. Despite their overall similarity as to tax treatment, there are some potentially significant differences between LLCs and limited partnerships, details of which are beyond the scope of this summary and some of which are still evolving with the tax treatment of LLCs. One important advantage for LLCs, however, is that limited partners are automatically subject to the passive loss limitation rules for federal income tax purposes, while LLC members are not automatically subject to those limitations [*see I.R.C. § 469(h)(2)*].

Both LLCs and limited partnerships must pay the minimum franchise tax annually if they do business in California, and remain liable for this tax until a tax clearance certificate is issued by the Franchise Tax Board in conjunction with entity's termination [*Rev. & Tax. Code §§ 17935, 17941, 23151, 23153(d)(1)*]. LLCs must also pay a graduated fee on gross income [*see § 12C.53[2]*; *see also Rev. & Tax. Code § 17942*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partner Distributive SharesTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partner Income & CreditsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partners Subject to Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
C. Comparison of Limited Liability Companies With Other Business Entities

6-12C California Legal Forms--Transaction Guide § 12C.44

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.44 General Partnerships

[1] Formation and Operation

Most LLCs and all general partnerships essentially involve the association of two or more persons to form and carry on a business [*Corp. Code §§ 16101(9), 17050(b)*]; however, LLCs are permitted to form and operate with one member [*Corp. Code §§ 17001(t), 17050(b)*]. Formal formation requirements are minimal: LLCs must file simple articles of organization (Form LLC-1) with the Secretary of State and must have an oral or written operating agreement [*Corp. Code § 17050(a)*]; general partnerships have no formal filing requirements, and need not have a formal oral, written, or express partnership agreement [*see Cochran v. Board of Supervisors (1978) 85 Cal. App. 3d 75, 81, 149 Cal. Rptr. 304* ; *see also Leff v. Gunter (1983) 33 Cal. 3d 508, 514-518, 189 Cal. Rptr. 377, 658 P.2d 740]* . However, as a general partnership is "an association of two or more persons to carry on as co-owners a business for profit" [*Corp. Code §§ 16101(7)*], there are inherently some formal or informal business arrangements that, subject to proof as to what these arrangements are and subject to the rules of the Uniform Partnership Act of 1994, define partners' relationships with each other and are best reflected in a written agreement.

Both general partnerships and LLCs allow for the participation of any number of principals in the conduct of the business, distributing work, and sharing risks and rewards [*Corp. Code §§ 16301, 16401, 17157*]. Each partner is an agent of the partnership for the purpose of its business and the act of a partner for apparently carrying on in the usual way the partnership business binds the partnership [*Corp. Code §§ 16301*]. Each member of an LLC may be a similar agent of the LLC with similar powers or, if the LLC is managed by managers will not have those agency or management powers [*Corp. Code § 17157*; *see § 12C.24[3]*].

Unlike LLCs, which currently are not permitted to render certain types of professional services [*see § 12C.10[5]*], general partnerships can and do render those services, subject, of course, to satisfying licensing and other requirements as to the particular profession. With that exception, LLCs and general partnerships, generally speaking, can engage in

much the same businesses and have the same capital and operating structure as the other.

[2] Liability

A major difference between LLCs and general partnerships is that the liability of LLC members is generally limited to their paid-in or committed capital contributions to the LLC, subject to certain exceptions [*see §§ 12C.23[14]* (members), 12C.24[8] (members who are managers)]. With these exceptions, LLC members, whether they or managers manage it, are not personally liable for the LLC's obligations [*Corp. Code §§ 17101, 17158*].

In contrast, general partners have unlimited personal liability for the obligations of the general partnership [*Corp. Code §§ 16305-16308* (applicable to all partnerships after 1998)]. General partners are jointly and severally liable for the wrongful acts and omissions of any partner acting in the ordinary course of partnership business [*Corp. Code §§ 16305(a), 16306(a)*] and for the misapplication of funds or property by other partners [*Corp. Code §§ 16305(b), 16306(a)*]. In addition, partners in general partnerships are jointly and severally liable for partnership obligations [*Corp. Code § 16306(a)*]. It is this broad liability of general partners and the recourse to each partner's personal assets that is the fundamental disadvantage of a general partnership compared to an LLC. This difference between LLCs and general partnerships should be considered, however, in light of the fact that within limits, those wishing to operate through a general partnership can do so through a corporation (including an S corporation) as general partner and limit their personal exposure to their investment in the corporate partner. On the other hand, because such an arrangement would require two separate entities, it would entail additional legal, accounting, and administrative costs and burdens.

[3] Tax Treatment

LLCs [*see Treas. Reg. § 301.7701-3*] and general partnerships can provide pass-through income tax treatment to their members and general partners: members and partners are subject to tax [*I.R.C. § 701*]. Both LLC members and general partners are treated very similarly for income tax purposes.

LLCs, but not general partnerships, must pay the minimum franchise tax annually if they do business in California, and remain liable for this tax until dissolution documents are filed [*see Rev. & Tax. Code §§ 17941, 23151, 23153(d)(1)*; *see also § 12C.53[1]*]. LLCs must also pay a graduated fee on gross income [*see Rev. & Tax. Code § 17942*; *see also § 12C.53[2]*]; general partnerships are not subject to such a fee.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionPartnership LiabilitiesBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsPartnership Tax Returns (IRC sec. 6031)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
C. Comparison of Limited Liability Companies With Other Business Entities

6-12C California Legal Forms--Transaction Guide § 12C.45

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.45 Conversion Costs

[1] Introduction

Sections 12C.40 through 12C.44 compare and contrast the LLC entity with other business entities (C corporations, S corporations, limited partnerships, and general partnerships) from the perspective of two or more persons deciding to form a new business and determining which type of entity best suits their needs. This section focuses on three key factors that should be evaluated when an existing business entity is considering reorganizing as an LLC. Many of the costs involved in creating a business entity as an LLC and converting an existing business entity into an LLC are much the same: professional fees (such as attorneys, accountants, and appraisers), which tend to fluctuate with the complexity of the proposed business structure; filing fees; and other formation costs. However, the additional costs of dissolving an existing entity [*see* [2], *below*] or converting it into an LLC and the effect of a change in ownership of business real property [*see* [3], *below*] should also always be considered. In addition, the tax consequences of converting a partnership interest to an LLC interest are covered [*see* [4], *below*].

For discussion, procedures, and forms related to the conversion of general partnerships into LLCs, *see* Ch. 15, Part C, *Conversions and Mergers of General Partnerships* .

[2] Dissolution of Existing Entity

Often, the process of dissolving an existing business entity to redeploy some or all of its assets in an LLC can be costly, involving one or more of the following expenses:

- Obtaining the consent of the shareholders or partners [*see, e.g., Corp. Code §§ 1900, 15637, 15681,* 15901.15, 15908.01].

- Preparing and mailing notices and document filings and recordings [*see, e.g., Corp. Code §§ 1901,*

1903, 1905, 15621, 15623, 15902.03, 15908.07, *16805*].

- Paying or assuming outstanding debts and liabilities [*see, e.g., Corp. Code §§ 2001-2009, 15683*, 15908.09, *16807*].

- Paying or assuming tax liabilities [*see, e.g., Corp. Code §§ 2001, 15038, 16802, 16803*].

- Valuing, liquidating, and distributing business assets [*see, e.g., Corp. Code §§ 2004-2007, 15684*, 15908.09, *16401, 16801 et seq.*; *see also Com. Code §§ 6101-6111* (bulk sales)].

Some of these procedures and expenses can be eliminated if the existing business entity can be merged into a newly formed LLC, a procedure possible if the existing business is a corporation [*see Corp. Code §§ 174.5, 1109, 17550*], a limited partnerships [*see Corp. Code §§ 15611(v)*, 15677.2, 15911.01(k), 15911.03] or a general partnership [*see Corp. Code § 16901 et seq*; *see also* Ch. 15, Part C, *Conversions and Mergers of General Partnerships*].

Such business reorganizations or combinations may not be tax free reorganizations (the reorganization of a corporation into an LLC would not be), so the income tax cost of such a reorganization should be carefully reviewed with tax counsel [*see § 12C.45[4]*].

[3] Property Taxation of Changes in Ownership

Ordinarily, transfers of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person, and between entities, constitute changes in ownership [*see Rev. & Tax. Code §§ 61(j), 62*] that may result in the reassessment of the value of the real property and a resulting change in property taxes [*see* Cal. Const. art. XIIIA, § 2]. However, no change in ownership occurs in certain tax free or other specified reorganizations or if the transfer between entities (or by individuals to an entity) preserves the previous owners' proportionate interests in the property and the transfer is only a change in the method of holding title to the property [*Rev. & Tax. Code § 62(a)*; *see Rev. & Tax. Code § 64(b)* (exemption for affiliated group transfers)]. Further, existing business entities such as partnerships and corporations will be permitted to convert into, or transfer real property to, LLCs without incurring a documentary transfer tax, provided the direct or indirect proportional interests in the property remain the same [Stats. 1996, ch. 57, § 29]. The purchase or transfer of ownership interests in legal entities, such as the purchase or sale of LLC interests, does not constitute a transfer of the real property of the entity unless the purchase or transfer involves a change of control or is of a majority interest of the LLC [*Rev. & Tax. Code § 64(a), (c), (d)*]. From the foregoing, it is clear that in converting an entity to an LLC, the practitioner should take care to structure the conversion in a manner that does not trigger a change of ownership of the entity's real property for property tax purposes.

When a member of a limited liability company satisfies a company-funding obligation by conveying real property to the LLC, that change in ownership is, for property tax purposes, a 100-percent change in ownership because the entire "beneficial use" of the property [*see Rev. & Tax. Code § 60*] has been transferred from the member to the LLC. The member does not retain any measure of the beneficial use of the property because, except in a fiduciary context (which this situation is not), for property tax purposes, it is not possible for the beneficial use of property to be separated from the holder of the legal title. Therefore, the conveyance is not a partial change in ownership even though the member retains an inchoate ownership interest in the property, proportional to the member's interest in the LLC, and even though the member likewise retains partial power respecting the use and subsequent disposition of the property. Consequently, a reassessment of the entire property will ensue along with, usually, a resulting increase in the assessed value of the property [*Fashion Valley Mall, LLC v. County of San Diego (2009) 176 Cal. App. 4th 871, 885-887, 98 Cal. Rptr. 3d 327* (trial court properly disregarded parties' purported reformation of transactional documents, which parties explicitly undertook to avoid adverse property tax consequence of original transaction)].

[4] Conversion of Partnership Interest Into Limited Liability Company Interest

Under *Rev. Rul. 95-37* [*see Rev. Rul. 95-37, 1995-1 C.B. 130*], the conversion of an interest in a domestic partnership into an interest in a domestic LLC that is classified as a partnership for federal tax purposes is treated as a conversion of a general partnership to a limited partnership that is subject to the principles of *Rev. Rul. 84-52* [*Rev. Rul. 95-37* ; *see Rev. Rul. 84-52, 1984-1 C.B. 157*]. *Rev. Rul. 84-52* provides that if specified conditions are met, the conversion of a general partnership to a limited partnership has the following effects [*Rev. Rul. 84-52, 1984-1 C.B. 157* ; *see Rev. Rul. 95-37, 1995-1 C.B. 130*]:

- It generally does not cause the partners to recognize gain or loss [*but see I.R.C. §§ 704(b), 752*];
- It does not terminate the partnership for tax purposes under *I.R.C. § 708*;
- If partners' shares of liabilities remain unchanged, there is no change in basis of any partners' interests (and other basis provisions); and
- Under *I.R.C. § 1223(1)*, there is no change in the holding period of any partner's total interest in the partnership.

In summary, *Rev. Rul. 95-37* [*Rev. Rul. 95-37, 1995-1 C.B. 130*] holds that the federal income tax consequences described in *Rev. Rul. 84-52* [*see Rev. Rul. 84-52, 1984-1 C.B. 157*] apply to the conversion of an interest in a domestic partnership into an interest in a domestic LLC that is classified as a partnership for federal tax purposes. Therefore, if structured properly, the LLC will simply be treated as a continuation of the partnership for federal tax purposes, with no federal income tax consequences. Accordingly, the taxable year of the converting partnership does not close with respect to any of the partners, and the resulting LLC does not need to obtain a new taxpayer identification number [*Rev. Rul. 95-37, 1995-1 C.B. 130*].

The holdings of *Rev. Rul. 95-37* apply to the similar conversion of an interest in a domestic LLC classified as a partnership for tax purposes to an interest in a domestic partnership. *Rev. Rul. 95-37* does not address the federal tax consequences of a conversion of an organization classified as a corporation into an organization classified as a partnership for federal tax purposes [*Rev. Rul. 95-37, 1995-1 C.B. 130*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationTax LawState & Local TaxesPersonal Property TaxGeneral OverviewTax LawState & Local TaxesReal Property TaxAssessment & ValuationGeneral Overview



110 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
C. Comparison of Limited Liability Companies With Other Business Entities

6-12C California Legal Forms--Transaction Guide §§ 12C.46-12C.49

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[Reserved]

§§ 12C.46[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
D. Taxation of Limited Liability Companies and Members

6-12C California Legal Forms--Transaction Guide § 12C.50

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.50 Taxation of Income of Limited Liability Company

[1] Freedom to Choose Type of Tax Treatment

For income tax purposes, an LLC may be taxed as a corporation or as a partnership. It seems likely that most LLCs will choose partnership tax treatment, in which the LLC is merely a pass-through tax entity, and the members report their respective shares of LLC tax items on their own tax returns. LLCs will automatically be taxed as partnerships for federal income tax purposes unless they affirmatively elect to be taxed as an "association" (corporation) [*Treas. Reg. § 301.7701-3(a)* (election), (b)(1)(i)(classification as partnership in default of election)].

California entity classification issues are discussed in [2][c], below.

[2] Treatment as Partnership for Income Tax Purposes

[a] Advantage of Partnership Tax Treatment

If desired, an LLC will receive pass-through income tax treatment essentially like that of a partnership. One of the primary benefits of an LLC is its ability to be classified as a partnership for tax purposes. For income tax purposes, the LLC is not a separate taxpaying entity and is not subject to tax at the entity level [*I.R.C. § 701*]. Instead, the LLC's members report their respective shares of LLC income, gain, loss, deduction, and credit on their own federal tax returns.

[b] Obtaining Partnership Tax Treatment

Prior to January 1, 1997, whether an LLC was taxed as a corporation or as a partnership was determined based on the presence or absence of four corporate characteristics. If an entity lacked two or more of those characteristics, it was treated as a partnership, not a corporation, for federal income tax purposes. These corporate characteristics were (1) continuity of life, (2) centralized management, (3) limited liability for obligations of the enterprise, and (4) free

transferability of interests [*see Rev. Proc. 95-10, 1995-1 C.B. 501* (obsolete as of January 1, 1997)]. Complex guidelines applied to determine the presence or absence of these characteristics, and avoiding at least two of them was an important consideration in planning an LLC.

Effective January 1, 1997, the entity classification rules were substantially revised. The complex classification rules were replaced by a much simpler system under which entities (including LLCs) other than corporations are permitted simply to elect whether to be classified as corporations or partnerships for federal income tax purposes [*see Treas. Reg. §§ 301.7701-1*-301.7701-3]. Under these rules, a LLC with at least two members can elect to be classified as either an association (i.e., corporation) or a partnership, and a LLC with only one member can elect to be classified as an association or to be disregarded as an entity separate from its owner [*Treas. Reg. § 301.7701-3(a)*]. Entities that fail to make an election will automatically be classified as partnerships if they have more than one member, or will be disregarded as entities separate from their owners if they have only one member [*Treas. Reg. § 301.7701-3(b)*]. Entities that prefer *not* to be classified as partnerships may elect to be classified as corporations by filing IRS Form 8832. The election will be effective on the date specified by the entity on Form 8832 [*Treas. Reg. § 301.7701-3(c)* (procedures for making election)].

[c] California Tax Classification

California specifically provides that the classification of an eligible business entity as a partnership or association taxable as a corporation for Personal Income Tax and Bank and Corporation Tax purposes must be the same as the classification for federal tax purposes effective for income or taxable years beginning on or after January 1, 1997. However, any business entity that was classified as an association taxable as a corporation for California tax purposes at any time during a 60-month period preceding January 1, 1997, will continue to be classified as an association taxable as a corporation until it elects to be classified as a partnership or disregarded as an entity separate from its owners, the same as the entity is classified for federal purposes [*Rev. & Tax. Code § 23038(b)(2)(A), (B)*].

[d] Tax Matters Member

LLCs must select a tax matters partner (TMP) in the same fashion as a TMP is selected for a partnership [*see I.R.C. § 6231(a)(7)*; *see also Treas. Reg. §§ 301.6231(a)(7)-1*, 301.6231(a)(7)-2]. Designation and termination of a TMP must be made under *Treas. Reg. § 301.6231(a)(7)-1*. Among other responsibilities, the TMP gives notice to the other partners of tax proceedings, makes tax decisions that bind the other partners, and petitions the IRS for readjustments [*see I.R.C. §§ 6223(g), 6224(c)(3), 6226(a)*].

A TMP is either (1) the general partner designated as the TMP, or (2) if no such partner is designated, the general partner having the largest profits interest in the partnership at the close of the taxable year. If there is more than one such partner, the first such partner alphabetically is the TMP [*I.R.C. § 6231(a)(7)*]. If the partnership has not designated a tax matters partner and it is impracticable [*see Treas. Reg. § 301.6231(a)(7)-1(o)* (determination of impracticability)] to apply the largest-profits-interest rule, the Commissioner will select a tax matters partner [*I.R.C. § 6231(a)(7)*; *Treas. Reg. § 301.6231(a)(7)-1(n), (p)*]. Within 30 days of that selection, the Secretary must notify all partners entitled to notice [*see I.R.C. § 6223(a)*] of the name and address of the selected TMP [*I.R.C. § 6231(a)(7)*; *see Treas. Reg. § 301.6231(a)(7)-1(r)*]. The person designated as TMP must be, or have been, a general partner during the taxable period in question [*Treas. Reg. § 301.6231(a)(7)-1(b)(1)*].

For purposes of selecting a TMP for an LLC, only a member-manager of an LLC is treated as a general partner. A member who is not a member-manager is treated as a partner other than a general partner [*Treas. Reg. § 301.6231(a)(7)-2(a)*]. A member-manager for the purpose of selecting a TMP is a member of an LLC who, alone or together with others, is vested with the continuing exclusive authority to make the management decisions necessary to conduct the business for which the organization was formed. If there are no elected or designated member-managers, each member will be treated as a member-manager for purposes of selecting a TMP [*Treas. Reg. §*

301.6231(a)(7)-2(b)(3)].

An LLC should designate a TMP in its operating agreement rather than risk having the IRS choose its TMP based on profits interests or other criteria [*I.R.C. § 6231(a)(7)(B)*; *see § 12C.220*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partner Distributive SharesTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partner Income & CreditsTax LawState & Local TaxesIncome TaxPartnerships



112 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
D. Taxation of Limited Liability Companies and Members

6-12C California Legal Forms--Transaction Guide § 12C.51

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.51 Limited Liability Company as Accounting Entity for Income Taxation of Members

If an LLC is taxed as a partnership for federal and California income tax purposes [*see § 12C.50*], it will be taxed under the partnership taxation statutes and regulations. The basic premise of Subchapter K (partnership provisions) of the Internal Revenue Code (applicable to qualifying LLCs) [*see I.R.C. § 701* et seq.] is that the LLC is merely an accounting entity for determining items of income, gain, loss, deduction, and credit that are to be allocated to individual taxpayers (the members of the LLC).

Though an LLC is not treated as a tax-paying entity, it does make its own elections related to accounting, including choosing a taxable year, which generally must be the same as that of its principal members [*see I.R.C. §§ 703(b), 706*]. The Internal Revenue Code provides methods for determining the taxable year of an LLC [*see I.R.C. §§ 444, 706(b)*]. Detailed discussion of these issues is beyond the scope of this legal background. Text references from the Research Guide [§ 12C.06] should be consulted for more detailed explanations.

For California purposes, taxation of LLCs treated as partnerships is generally determined in accordance with Subchapter K of the Internal Revenue Code [*Rev. & Tax. Code § 17851*; *see I.R.C. § 701* et seq.]. However, there are certain California modifications [*see Rev. & Tax. Code § 17853 et seq.*; *see also Rev. & Tax. Code § 17941 et seq.*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partner Income & CreditsTax LawState & Local TaxesIncome TaxPartnerships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
D. Taxation of Limited Liability Companies and Members

6-12C California Legal Forms--Transaction Guide § 12C.52

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.52 Income Taxation of Members of Limited Liability Company

[1] Overview

If taxed as a partnership, an LLC is not a federal income taxpayer. Instead, the members, not the LLC, report their respective shares of LLC income, gain, loss, deduction, and credit on their own tax returns [*I.R.C. § 701*]. The main purpose of partnership income tax law [*see I.R.C. § 701* et seq.] is to allocate income and loss (and certain other items) to the members for use in preparing their individual tax returns. Another chief purpose is to determine the tax consequences of members' contribution of assets to the LLC.

For detailed coverage of the taxation of partnerships and partners, see Ballantine & Sterling, California Corporation Laws, Ch. 26, *Income Taxation of Partnerships* (Matthew Bender).

[2] Separately Stated Items

Because the LLC is essentially an accounting entity, items of taxable income or loss realized by the LLC are allocated to the members; amounts allocated are known as "distributive shares." Each member must take into account and separately report on his or her income tax return the member's distributive share of the following LLC items [*I.R.C. § 702(a)*]:

- Gains and losses from sales or exchanges of capital assets held for not more than one year.
- Gains and losses from sales or exchanges of capital assets held for more than one year.
- Gains and losses from sales or exchanges of property described in *I.R.C. § 1231* (relating to certain property used in a trade or business and involuntary conversions).

- Charitable contributions [*see I.R.C. § 170(c)*].

- Dividends that are subject to capital gains treatment [*see I.R.C. § 1(h)(11)*] or for which a corporate dividends-received deduction applies [*see I.R.C. § 241* et seq.].

- Taxes paid or accrued to foreign countries and United States possessions [*see I.R.C. § 901*].

- Other items of income, gain, loss, deduction, or credit to the extent provided by the regulations [*see Treas. Reg. § 1.702-1(a)(8)*].

- Taxable income or loss, exclusive of items requiring separate computation under the preceding paragraphs.

The purpose of these separate computations is to preserve the character of the items, such as charitable contributions, whose ultimate treatment depends on facts particular to each member. Further, the tax character of any item of income, gain, loss, deduction, or credit included in a member's distributive share is determined at the LLC level as if the items were realized directly from the same source as that realized by the LLC, or incurred in the same manner as incurred by the LLC [*I.R.C. § 702(b)*].

[3] Distributive Shares of Income, Loss, and Other Items to Members

As stated in [1], *above*, an LLC merely passes tax items on to its members. After computation of income and loss at the LLC level, each member is allocated a "distributive share" of these items as provided in the LLC's operating agreement [*I.R.C. §§ 704(a), 706(a)*]. The IRS will not recognize special allocations of income, gain, loss, deduction, or credit unless they are in accordance with the member's interest in the LLC and have a substantial economic effect [*see I.R.C. § 704(b)*]. A special allocation has a "substantial economic effect" if it affects the dollar amount of the members' share in total LLC income independent of tax consequences [*Treas. Reg. § 1.704-1(b)(2)*].

Members are responsible in their individual capacities for payment of taxes on LLC income. Liability for tax due on the distributive share attaches regardless of whether or not the share is actually distributed [*see I.R.C. §§ 701, 702*].

[4] LLC Taxable Income

For federal tax purposes, LLC taxable income is computed in the same manner as individual taxable income except that items of gain and loss must be stated separately [*I.R.C. § 703(a)(1)*; *see I.R.C. § 702(a)*; *see also* [3], *above*]. In addition, the following deductions are not available [*I.R.C. § 703(a)(2)*; *Treas. Reg. § 1.703-1(a)(2)*]:

- Personal exemptions [*see I.R.C. § 151*].

- Net operating losses [*see I.R.C. § 172*].

- Standard deductions [*see I.R.C. § 63(c)*].

- Items that must be separately stated [*see* [2], *above*].

[5] Loss Allowance

A member's distributive share of LLC losses is allowed only to the extent of the member's adjusted basis in the LLC at the end of the LLC taxable year in which the loss occurs. Any excess may be deducted at the end of the LLC year in which that excess is repaid to the LLC [*I.R.C. § 704(d)*].

Loss allowances are further limited for a member of an LLC who is (1) an individual, (2) a Subchapter S corporation, or (3) a closely held corporation in which five or fewer individuals own more than 50 percent of the stock [*see I.R.C. §§ 465(a)(1), 542(a)(2)*]. These members may deduct losses from certain activities to the extent of the amounts they have at risk in the activity giving rise to the loss [*I.R.C. § 465(a)*; *see I.R.C. § 465(b)* ("at risk" defined)].

The at-risk rule acts as a ceiling on the amount of loss that may be deducted for any activity. The passive activity rule then acts as a potential further limitation on the deductibility of losses that are otherwise allowable under the at-risk rule.

In addition, a member may be limited by the passive loss rules. An activity involving the conduct of a trade or business in which the taxpayer does not materially participate is a "passive activity" for federal income tax purposes [*I.R.C. § 469(c)*]. Deductions and credit arising from passive activities may only be taken against income and tax liability attributable to all passive activities [*I.R.C. § 469(a)(1), (d)*]. Deductions and credits that are disallowed under the rule in any taxable year may be carried forward to the next taxable year, but not back to any previous taxable year [*I.R.C. § 469(b)*].

[6] Basis in LLC Assets and Interests

An LLC has a tax basis in its assets. For assets purchased by the LLC, the basis is usually the cost of the asset [*I.R.C. § 1012*]. For assets contributed by a member to the LLC, the basis is the contributing member's adjusted tax basis in the asset, increased by any gain [*I.R.C. §§ 722, 723*].

Each member has a tax basis in his or her interest in an LLC. The basis is first established by the member's basis in the property contributed to the LLC, which is equal to the member's tax basis in the property [*I.R.C. § 722*]. The member's basis is increased by the member's distributive share of items of income, and decreased by the member's distributive share of loss and distributions [*I.R.C. § 705*]. A member's basis may also be affected any increase or decrease in a member's share of LLC liabilities [*see I.R.C. § 752*].

[7] Built-in Gain or Loss

Income, gain, loss, and deductions with respect to property contributed to the LLC by a member must be shared among the members pursuant to Treasury Regulations so as to take account of the variation between the basis of the property and its fair market value at the time of contribution. Similar rules apply to contributions by a member of accounts payable and other accrued but unpaid items [*I.R.C. § 704(c)(1)(A)*]. Special rules apply to distributions of contributed property that occur within seven years of contribution [*see I.R.C. § 704(c)(1)(B)*], contributed property that has a built-in loss [*see I.R.C. § 704(c)(1)(C)*], and distributions of contributed property that would not result in gain or loss outside the LLC context [*see I.R.C. § 704(c)(2)*].

[8] Current Distributions

When an LLC transfers money or property to a member in a transaction other than a loan, sale, or guaranteed payment, a distribution occurs [*Treas. Reg. § 1.731-1(c)(2), (3)*]. Any decrease in a member's share of LLC liabilities and any assumption by the LLC of a member's personal liabilities are treated as money distributions to the member [*I.R.C. § 752(b)*]. Distributions are considered current for tax purposes if they do not result in a termination of the recipient member's LLC interest [*Treas. Reg. §§ 1.731-1(a),* 1.761-1(d)].

When money is distributed by an LLC to a member, no gain is recognized to the member except to the extent that the amount of money distributed exceeds the adjusted basis of the member's interest in the LLC immediately before the distribution [*I.R.C. § 731(a)(1)*; *Treas. Reg. § 1.731-1(a)*]. No loss is recognized by a member on a current distribution [

see I.R.C. § 731(a)(2)].

There is an exception to the general rule of nonrecognition of gain or loss on current distributions in certain situations involving unrealized receivables and substantially appreciated property [*see I.R.C. § 751(b)(1)*].

An LLC has no gain or loss on distributions of property or money to a member [*I.R.C. § 731(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partner Distributive SharesTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partner Income & CreditsTax LawState & Local TaxesIncome TaxPartnerships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
D. Taxation of Limited Liability Companies and Members

6-12C California Legal Forms--Transaction Guide § 12C.53

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.53 Taxes and Fees Applicable to Limited Liability Company

[1] Minimum California Franchise Tax

In general, every LLC that is doing business in California and that is required to file a California tax return [*see Rev. & Tax. Code § 18633.5*; *see § 12C.250* (tax return)] must pay an annual minimum franchise tax of $800 for the privilege of doing business in California [*Rev. & Tax. Code §§ 17941(a), (b), 23153(d)(1)*; *see § 12C.256* (tax voucher)]. This tax must be paid annually until a certificate of cancellation of articles of organization (LLC) or certificate of cancellation of registration (foreign LLC) is filed with the Secretary of State [*Rev. & Tax. Code § 17941(b)(1)*]. An LLC, however, is not subject to the franchise tax for a taxable year if it (1) files a timely final annual return [*see* Rev. & Tax. Code § 17947(b) (definition)] for the preceding taxable year, (2) does not do business in California after the end of the taxable year for which it filed the final return, and (3) files a certificate of cancellation [*see* Corp. Code §§ 17356, 17455] with the Secretary of State before the end of the 12-month period beginning with the date the final return was filed [Rev. & Tax. Code § 17947(a)]. An LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax [*see Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; *see also I.R.C. § 501(c)(2), (25)* (title holding companies)].

PRACTICE TIP:

The Secretary of State includes a notice, in its instructional materials provided in conjunction with the form for filing articles of organization, that filing the LLC registration obligates the LLC to pay the annual minimum tax for that taxable year [*Corp. Code §§ 17050(d), 17451(d)*; *see Rev. & Tax. Code § 17941(a), (b)*]. The notice will be updated annually to specify the dollar amount of that tax [*Corp. Code §§ 17050(d), 17451(d)*]. If an LLC files a return that is designated as its final return, the Franchise Tax Board will notify the LLC that the annual tax is due annually until a certificate of cancellation is filed [*Rev. & Tax. Code § 17941(b)(2)*; *see Corp. Code §§ 17356, 17455*].

[2] California Fee Based on Income

In addition to the minimum franchise tax [*see* [1], *above*], every LLC or foreign LLC subject to the minimum franchise tax [*see Rev. & Tax. Code § 17941*] must also pay a graduated annual fee based on its total income of $250,000 or more from all sources derived from or attributable to California [*see Rev. & Tax. Code §§ 17942(a), (b)(1),* 24172 ("total income" defined); *see also Rev. & Tax. Code § 17942(b)(1)* (limitation on total income)]. However, an LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax, and thus not subject to this annual fee [*see Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; *see also I.R.C. § 501(c)(2), (25)* (title holding companies)].

The base range for this annual fee is $900 to $11,790 [*Rev. & Tax. Code § 17942(a)*]. Special income determination provisions apply to commonly controlled LLCs [*see Rev. & Tax. Code § 17942(b)(2)*]. This fee is due and payable on the date the LLC is required to file its tax return [*Rev. & Tax. Code §§ 17942(c), 18633.5*; *see* [1], *above*]. The fee must be estimated and paid on or before the 15th day of the sixth month of the current taxable year [*Rev. & Tax. Code § 17942(d)*].

[3] Property Taxes

[a] In General

While an in-depth discussion of property taxation issues regarding LLCs is beyond the scope of this chapter, a few items warrant mentioning. For coverage of property taxation issues brought about by Proposition 13 on a change of ownership, see *§ 12C.45[3]*.

[b] Power to Own Real Property

An LLC is an entity separate from its members [*see Corp. Code § 17001(t)*], and has all of the powers of a natural person in carrying out its business activities, including the power to purchase, lease, use, and dispose of real property [*Corp. Code § 17003(f)*]. This means that an LLC can own property in its own name, rather than in the name of one of its members, and will, accordingly, pay tax on that property.

[c] Limited Liability Company Treated as Partnership

For purposes of California property taxation, limited liability companies are considered partnerships, except when context or specific provisions otherwise require [*Rev. & Tax. Code § 28.5*]. Thus, most partnership property tax law will also apply to LLCs.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewTax LawState & Local TaxesFranchise TaxGeneral OverviewTax LawState & Local TaxesFranchise TaxImposition of TaxTax LawState & Local TaxesReal Property TaxGeneral Overview



115 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
D. Taxation of Limited Liability Companies and Members

6-12C California Legal Forms--Transaction Guide § 12C.54

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.54 Filing Requirements Applicable to Limited Liability Company

[1] Requirement to File California Tax Return

Every LLC or foreign LLC classified as a partnership for California tax purposes that is doing business in California, organized in California, or registered with the Secretary of State is required to file a California tax return [*Rev. & Tax. Code § 18633.5*; *see § 12C.250* (tax return)]. The return is used (1) to report income, deductions, gains, losses, and the like from the operation of an LLC, (2) to show payment of the $800 minimum franchise tax, and (3) to determine and pay the amount of the LLC's annual fee, if any, based on total income [*see Rev. & Tax. Code §§ 17941*, *17942*, *18633.5*]. For coverage of filing deadlines and other information, see *§ 12C.250[1]*. For a procedural guide to completing and filing California LLC tax forms, see *§ 12C.129[1]*.

With its return, every LLC must file the agreement, in the prescribed form, of each nonresident member to file a return [*Rev. & Tax. Code § 18501*], to make timely payment of all California taxes imposed on the member with respect to the LLC's income, and to be subject to personal jurisdiction in California for purposes of collecting income taxes imposed on the member with respect to the LLC's income [Rev. & Tax. Code § 186335.5(e)(1); *see* Rev. & Tax. Code § 186335.5(f); *see also § 12C.254*].

Various related schedules and forms must be filed along with the LLC tax return. For coverage of these forms, see *§§ 12C.251-12C.256*.

An LLC classified as a corporation must file a corporate tax return [*see Rev. & Tax. Code § 18633.5(h)*; *see also* Instructions for Form 568, p. 3].

[2] Requirement to File Federal Tax Return

An LLC classified as a partnership for federal tax purposes must file a partnership return [*see* Treas. Reg. §

1.6031-1(a)], as well as related schedules and other forms. For a procedural guide to completing and filing federal LLC tax forms, see *§ 12C.129[2]*.

[3] Requirement to Provide Tax Information to Members

Every LLC required to file a California tax return [*see Rev. & Tax. Code § 18633.5(a)*] for any taxable or income year must furnish to each person who holds an interest in the LLC a copy of the information required to be shown on the tax return [*Rev. & Tax. Code § 18633.5(b)*]. This may include copies of California Form 568, federal Form 1065, and related schedules and attachments [*see § 12C.129*; *see also §§ 12C.250-12C.256* (forms)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral OverviewTax LawState & Local TaxesIncome TaxPartnerships



116 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART II. LEGAL BACKGROUND
D. Taxation of Limited Liability Companies and Members

6-12C California Legal Forms--Transaction Guide §§ 12C.55-12C.99

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§§ 12C.55[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-12C California Legal Forms--Transaction Guide § 12C.100

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.100 Facts

1. Proposed name for LLC [*see Corp. Code § 17052*; *see also § 12C.120*, P 1].

2. LLC's duration, as defined by any of following [*see Corp. Code § 17051(c)(3), (4)*]:

    a. Period of time.

    b. Latest date on which LLC is to dissolve.

    c. Events of termination before latest date on which LLC is to dissolve.

3. Specific business or businesses in which LLC will engage.

4. Limitations or restrictions, if any, on business or powers.

5. Location and mailing address of place of business.

6. Location and mailing address of initial registered office.

7. Name and address of initial registered agent in state.

8. Facts related to organizers, if different from members [*see* P 9, *below*]:

a. Names, addresses, and marital status.

b. Compensation.

9. Facts related to members:

a. Number of initial and ongoing members.

b. Names, addresses and marital status.

c. Membership capital contribution requirements, including:
(1) Total amount of cash and description and agreed value of property other than cash contributed initially.

(2) Value of services to be contributed to LLC.

(3) Amount and nature of any additional contributions agreed to be made by members and when such contributions are to be made.

(4) Consequences of member's failure to make contribution to LLC.

(5) Terms and conditions under which members's contribution may be compromised or released.

(6) Any liabilities to which contributed property is subject at time of contribution.

(7) Any liability that LLC is assuming in connection with contribution of property.

(8) Pre-formation costs for which a member expects capital account credit.

(9) Description and value of any contractual rights being contributed.

d. Whether new members may be admitted, and if so, terms and conditions of admissions.

e. Terms and conditions under which members' interests may be transferred or assigned.

f. Terms and conditions under which assignee of interest may become member.

g. Withdrawal of member.

10. Whether management of company will be vested in members or managers.

11. If management is vested in managers:

a. Names, addresses and terms of managers who will serve until successor managers are elected and qualified.

b. Qualification requirements for managers.

c. Extent to which company will indemnify managers.

d. Insurance provisions for managers.

e. Extent of managers' powers and duties.

f. Manner for electing managers.

g. Any desired limitations on authority of managers.

h. Acts that will require members' consent.

i. Members' rights, if any, to remove managers.

12. Whether LLC will have officers.

13. Manner of distributing company property to members.

14. Whether remaining members will have right to continue business on death, retirement, resignation, expulsion, bankruptcy, or dissolution of member.

15. Financing of LLC's business.

16. Whether any member expects to earn interest or a return of capital contribution, together with rate of return.

17. Manner in which profits and losses will be allocated among members for tax purposes.

18. Compensation to managers, members, and/or their affiliates.

19. Right to reimbursement of expenses.

20. Tax year of LLC.

21. Method of accounting.

22. Whether one or more members can provide annual audit or examination of books.

23. Terms and conditions of buyout rights, including events that will trigger members' rights to buy out a member.

24. Events of dissolution.

25. In an LLC that is not actively managed only by members, facts concerning preexisting relations, sophistication, and location of potential members, number of membership interests to be offered, duration and total dollar amount of offering, and any other facts relevant to determining whether the interests are exempt from qualification as securities under Corporate Securities Law [*see Ch. 6, Securities Regulation Issues, §§ 6.40, 6.110-6.118, 6.200*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness

& Corporate LawLimited Liability CompaniesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-12C California Legal Forms--Transaction Guide § 12C.101

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.101 Documents

1. Any business plan.

2. Any preorganization agreements, including agreements to make contributions.

3. Any other existing agreements between members of LLC.

4. Any drafts of operating agreement.

5. Contracts, franchises, leases, service agreements, or employment agreements that will be assigned to or assumed by company.

6. If going concern will be formally organized as LLC, financial and tax records of business.

7. Any financial statements or appraisals establishing value of property contributions to company.

8. Documents of transfer, including deeds or other instruments.

9. If member is other than natural person, document of formation of partnership, limited partnership, LLC, trust, estate, or corporation.

10. Fictitious business or trade name certificates, if already obtained.

11. Reservation of name certificate, if already obtained.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-12C California Legal Forms--Transaction Guide §§ 12C.102-12C.109

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

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§§ 12C.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-12C California Legal Forms--Transaction Guide § 12C.110

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.110 Determining Whether to Form Limited Liability Company

NOTE:
For discussion of the qualities of an LLC as compared to C corporations, S corporations, limited partnerships, and general partnerships, see *§§ 12C.40-12C.44*.

1. Is income tax treatment as partnership desired?

NOTE:
An LLC may elect to be taxed either as a corporation or as a partnership [*Treas. Reg. § 301.7701-3(a)*].

2. Will business entity engage in one of following areas?

a. Real estate.

b. Joint ventures (especially with foreign partners).

c. High technology and venture capital.

d. Oil and gas.

e. Theatrical investments.

NOTE:

The LLC Act is designed to assist formation and operation of small, closely-held or closely-controlled businesses. However, the Act seems flexible enough to accommodate more complex ventures. Most likely, an LLC will be used in situations in which a partnership or S corporation might be used.

3. Will business entity engage in one of following areas?

a. Professional practice, such as:

(1) Law.

(2) Healing arts.

(3) Accounting.

(4) Contracting.

b. Banking business.

c. Business of issuing policies of insurance and assuming insurance risks.

d. Trust company business.

e. Any professional services business requiring license under the California Business and Professions Code.

NOTE:

The California LLC Act, unlike similar legislation in other states, prohibits domestic and foreign LLCs from rendering professional services in California [*Corp. Code § 17375*; ***see*** *Corp. Code §§ 13401(a), 13401.3* (definition)]. However, a law, accounting, or architecture practice may do business as a limited liability partnership [*Corp. Code § 16101(6), (8)*; ***see*** Ch. 16C, ***Limited Liability Partnerships***]. An LLC may not engage in the banking business, the business of issuing policies of insurance and assuming insurance risks, or trust company business [*Corp. Code § 17002*].

4. Can business afford to pay following taxes and fees?

a. Annual minimum franchise tax of $800 [*Rev. & Tax. Code § 17941(a)*].

NOTE:

An LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax [***see*** *Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; ***see also*** *I.R.C. § 501(c)(2), (25)* (title holding companies)].

b. Additional fee based on gross income over $250,000 [*Rev. & Tax. Code § 17942(a)*; *see Rev. & Tax. Code § 17942(b)*].

NOTE:

An LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is

not subject to the annual minimum franchise tax, and thus not subject to this annual fee [***see*** *Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; ***see also*** *I.R.C. § 501(c)(2), (25)* (title holding companies)].

c. Filing fees for filing articles and statement of information [*see Gov. Code § 12190(b)*; *see also § 12C.210[2]* (form)].

NOTE:

If the business cannot afford these costs of doing business, another form of doing business, such as sole proprietorship or general partnership, may be more appropriate.

5. Are organizers seeking flexibility in allocating profits and losses?

6. Would existing business entity have elected S corporation status absent some unavoidable restriction against that status [*see § 12C.42*]?

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawState & Local TaxesFranchise TaxImposition of Tax



121 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-12C California Legal Forms--Transaction Guide § 12C.111

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.111 Determining Structure of Limited Liability Company

1. Determine number of initial members of LLC.

NOTE:
LLCs are permitted to form and operate with one member [*Corp. Code §§ 17001(t), 17050(b)*].

2. Determine classes of LLC membership, with corresponding rights [*see Corp. Code § 17102*].

3. Determine whether members want right to continue business on death, retirement, resignation, expulsion, bankruptcy, or dissolution of member or occurrence of any other event that terminates continued membership of member.

4. Determine whether to vest management in:

a. Members.

NOTE:
If members participate in the active management of an LLC, these members will most likely be subject to the federal self-employment tax on LLC distributions [***see*** Treas. Reg. § 1.1402].

b. One or more managers.

c. Officers.

5. Determine whether to establish limited duration for LLC.

NOTE:

An LLC is no longer required to have limited duration [***see*** *§ 12C.20[2][c]*]. However, a specified date of dissolution of an LLC may be stated in its articles of organization if desired [*Corp. Code § 17051(a)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-12C California Legal Forms--Transaction Guide §§ 12C.112-12C.119

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

[Reserved]

§§ 12C.112[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12C California Legal Forms--Transaction Guide § 12C.120

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.120 Forming Domestic Limited Liability Company

NOTE:

The Limited Liability Company Unit will not file documents for professional LLCs [*Corp. Code § 17375*]. The policy of the LLC Unit is to return any filing or name reservation that is indicative of a "professional service" LLC [***see*** *Corp. Code §§ 13401(a), 13401.3* (definition)]. If the documents are returned in error, the applicant may resubmit the documents accompanied by a letter stating that the applicant is aware of the prohibition. If the document originally submitted for filing was otherwise acceptable, the filing date will be the date indicated in the Secretary of State stamp on the reverse of the document. An applicant can prevent delays by submitting a cover letter with the articles of organization stating that the applicant is aware of the prohibition on professional LLCs, and that the LLC is not prohibited from filing [Secretary of State's LLC form packet; ***see*** *§ 12C.10[5][a]*; ***see also*** P 6, ***below***].

1. Select appropriate name for LLC [*see Corp. Code § 17052*]:

NOTE:

The LLC's name must not be one that the Secretary of State determines is likely to mislead the public, and it must not be the same as, or resemble so closely as to tend to deceive, the name of an existing domestic or registered foreign LLC (absent consent) or a name reserved by an LLC or foreign LLC [***see*** *Corp. Code § 17052(c)*].

a. Last words of name must be "limited liability company" or abbreviation "LLC" or

"L.L.C."; words "limited" and "company" may be abbreviated to "Ltd." and "Co.", respectively.

b. Words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," "corp.," "insurer," "insurance company," or any other words suggesting that the LLC is in the business of issuing policies of insurance and assuming insurance risks, may not be used [*Corp. Code § 17052(d)*].

c. LLC's name may contain name of one or more of its members [*Corp. Code § 17052(b)*].

2. If desired, reserve approved LLC name with Secretary of State for period of 60 days by sending official name reservation form [*see § 12C.199*] and paying applicable fee [*Corp. Code § 17053*; *see Gov. Code § 12190(a)(fee)*].

NOTE:

On payment of the required fee, an applicant may reserve an approved LLC name with the Secretary of State for 60 days. The same person may not reserve the same name for consecutive 60-day periods [*Corp. Code § 17053*] but may do so with breaks between 60-day periods.

If the name is acceptable, the Secretary of State will issue a certificate of reservation. However, obtaining a certificate of reservation for an LLC is not a prerequisite to filing articles of organization [Secretary of State's LLC form packet].

3. Prepare articles of organization on official form designated by Secretary of State (Form LLC-1) [*see § 12C.200*], setting forth [*Corp. Code § 17051(a)*]:

NOTE:

If the LLC is converting to the LLC form from another form of business entity, Form LLC-1A [§ 12.200A] should be used.

a. Required information:

(1) Name of LLC.

(2) Statement regarding LLC's purpose in form specified by LLC Act.

(3) Name and address of LLC's initial agent for service of process.

(4) Statement as to whether LLC will be managed by [*see Corp. Code § 17151(b)*]:

(a) One manager;

(b) One or more managers but not by all its members.

b. Other provisions not inconsistent with law, including provisions [*Corp. Code § 17051(c)*]:

NOTE:

Since the articles are a public document and can be changed only by formal amendment filed with the Secretary of State and, unless otherwise provided in the articles or a written operating agreement, require

the unanimous vote of all members for their amendment, it may be desirable to include optional matters in operating agreement rather than the articles.

(1) Limiting or restricting business or powers of LLC.

(2) Governing admission of members.

(3) Specifying time when LLC will dissolve.

(4) Stating events that will cause dissolution of the LLC.

(5) Statement of whether there are limitations on authority of managers or members to bind LLC and if so what they are

(6) Stating names of managers of the LLC.

4. Have articles executed by one or more persons [*Corp. Code § 17050(a)*].

5. Verify that all formation requirements have been satisfied:

a. Establish and maintain office in California [*Corp. Code § 17057(a)*].

b. Appoint initial agent for service of process in California, ensuring that agent satisfies statutory requirements [*Corp. Code §§ 17051(a)(4), 17057(b)*; *see Corp. Code § 17061(d)(1)*]:

(1) Individual residing in California.

(2) Corporation that has filed an agency certificate [*see Corp. Code § 1505*] and whose capacity to act as agent has not terminated.

6. Prepare cover letter stating [Secretary of State's LLC form packet; *see § 12C.241* (cover letter)]:

a. Applicant is aware of prohibition on professional LLCs [*see* Stats. 1994, ch. 1200, § 93; *see also Corp. Code § 17375*].

b. LLC is not prohibited from filing.

7. File original together with at least one copy of properly executed articles of organization with Secretary of State and pay applicable filing fee [*Corp. Code § 17050(a)*; *see Gov. Code § 12190(b)(fee)*].

NOTE:

The articles of organization and other forms required to be filed with the Secretary of State may be obtained from any office of the Secretary of State. However, LLC forms must be filed with the LLC Unit in the Sacramento office of the Secretary of State. If the original is filed with two copies, the Limited Liability Unit will certify two copies for no extra fee [*Gov. Code § 12185*]. Only one original, executed copy of each form (no copies) should be filed. Contact the Limited Liability Company Unit more information [***see*** Secretary of State's LLC form packet].

8. If desired, record certified copy of articles, together with any exhibits, attachments, amendments, or corrections, with county recorder.

NOTE:

An LLC may record with any county recorder a certified copy of its articles of organization and any exhibits, attachments, or amendments filed with the Secretary of State. The recording will create a conclusive presumption in favor of any bona fide purchaser or encumbrancer for value of the LLC's real property located in the county in which the certified copy has been recorded of the statements contained in the document [*Corp. Code § 17052(f)*].

9. Prepare operating agreement either before or after filing articles of organization [*see § 12C.140*].

10. Within 90 days after filing articles of organization, file initial statement of information (Form LLC-12) [*see § 12C.210*] and pay applicable filing fee [*Corp. Code § 17060(a)*; *see Gov. Code § 12190(k)(fee)*; *see also § 12C.125*].

11. Pay franchise taxes and fees:

NOTE:

An LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax or the fee based on income [***see** Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; ***see also** I.R.C. § 501(c)(2), (25)* (title holding companies)].

a. On or before 15th day of fourth month of organization, pay annual minimum franchise tax [*see Rev. & Tax. Code §§ 17941(a), 23153(d)(1)*].

b. Additional fee based on income [***see** Rev. & Tax. Code § 17942(a), (b)*].

12. File annual tax return [***see** Rev. & Tax. Code § 18633.5*; *see § 12C.129*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12C California Legal Forms--Transaction Guide § 12C.121

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.121 Registering Foreign Limited Liability Company

NOTE:
A foreign LLC must register with the Secretary of State to transact intrastate business in California lawfully [*Corp. Code § 17451*; ***see*** *Corp. Code §§ 17450-17457*].

1. Verify that foreign LLC is organized and currently registered with state of organization [*Corp. Code § 17451(a)(2)*].

NOTE:
The foreign LLC's organization and internal affairs, and the authority and liability of its managers and members, is be governed by the law of the state or foreign country under which it is organized [*Corp. Code § 17450(a)*]. A foreign LLC may not be denied registration because of a difference between the laws of its home state and the laws of California [*Corp. Code § 17450(b)*].

2. Verify that foreign LLC has name acceptable to Secretary of State [*Corp. Code §§ 17451(a)(1), 17452(b)*; *see § 12C.120*, P 1].

3. Verify that foreign LLC has appointed agent for service of process in California [*Corp. Code § 17451(a)(3)*; *see Corp. Code § 17061(d)(1)*; *see also § 12C.120*, P 5b].

4. Complete application for registration (Form LLC-5) [*see § 12C.204*], available from Secretary of State [*Corp. Code §§ 17451(a), 17452(a)*], which must include all of following [*Corp. Code § 17451(a)*]:

a. Name under which foreign LLC proposes to do business in California.

b. Name of foreign LLC, if different from above.

c. State or other jurisdiction and date of formation.

d. Name of agent for service of process meeting qualification requirements [*see Corp. Code § 17061(d)*].

e. If agent is individual, complete business or residential street address [*see Corp. Code § 17061(d)*].

f. Statement that Secretary of State is appointed agent of foreign LLC for service of process if no other agent is available.

g. Address of principal executive office of foreign LLC.

h. Address of principal office in California, if any.

5. Prepare cover letter to accompany application for registration, including [Secretary of State's LLC form packet; *see § 12C.242* (cover letter)]:

a. One of following [*Corp. Code § 17451(b)*]:
(1) Certificate from authorized public official of foreign LLC's jurisdiction that foreign LLC is in good standing in that jurisdiction, or, if not available;

(2) Statement by foreign LLC that laws of its jurisdiction do not permit issuance of such certificates.

b. Statement that applicant is aware of prohibition on professional LLCs and that applicant is not prohibited from filing [*see Corp. Code § 17375*; *see also* Stats. 1994, ch. 1200, § 93].

c. Request for delayed effective date, if desired [*Corp. Code § 17056(c)*].

NOTE:
If the foreign LLC wishes to delay the effective date of the registration, for up to 90 days [*Corp. Code § 17056(c)*], the LLC should indicate the month, day, and year on which the registration is to be effective [***see*** Form LLC-5, Instructions].

6. File application for registration with Secretary of State and pay applicable filing fee [*Corp. Code §§ 17451, 17452*; *see Gov. Code § 12190(c)(fee)*].

7. If any statement in application for registration was false when made or has become erroneous:

a. Promptly file with Secretary of State certificate of amendment to the application for registration (Form LLC-6) [*see § 12C.205*], signed by person with authority to do so [*Corp. Code § 17454*].

b. Include applicable filing fee [*Gov. Code § 12190(f)*].

8. Within 90 days after registering, file initial statement of information (Form LLC-12) [*see § 12C.210*] and pay

applicable filing fee [*Corp. Code § 17060(a)*; *see Gov. Code § 12190(k)(fee)*; *see also § 12C.125*].

9. If desired, record certified copy of application for registration, certificate of registration, or any amendment filed in office of Secretary of State with county recorder.

NOTE:

A foreign LLC may record in the office of the county recorder of any county a certified copy of its application for registration, certificate of registration, or any amendment that was filed in the office of the Secretary of State. The recording will create a conclusive presumption in favor of any bona fide purchaser or encumbrancer for value of the LLC's real property located in the county in which the certified copy has been recorded of the statements contained in the document [*Corp. Code § 17052(f)*].

10. Pay franchise tax and fees:

a. Annual minimum franchise tax [*see Rev. & Tax. Code §§ 17941(a), 23153(d)(1)*].

b. Additional statutory fee based on total income [*see Rev. & Tax. Code § 17942(a), (b)*].

11. File annual tax return [*see Rev. & Tax. Code § 18633.5*; *see § 12C.129*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawLimited Liability CompaniesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12C California Legal Forms--Transaction Guide § 12C.122

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.122 Operating Domestic Limited Liability Company

NOTE:
After executing and filing the articles of organization, and preparing an operating agreement [***see*** *§ 12C.120*], the managers and/or counsel should review the documents again for errors.

1. If required, file certificate of amendment (Form LLC-2) to amend articles of organization [*see § 12C.123*].

2. If required, file certificate of correction (Form LLC-11) to correct any document filed with Secretary of State [*see § 12C.124*].

3. Within 90 days after filing articles of organization, file initial statement of information (Form LLC-12) [*Corp. Code § 17060(a)*; *see § 12C.125*, P 2].

4. Pay minimum franchise tax and income-based fee [*see § 12C.120*, P 9].

5. Maintain agent for service of process in California [*see § 12C.120*, P 5b].

6. If agent resigns, dissolves, withdraws, or dies [*Corp. Code § 17061(d)(2), (3)*]:

a. Appoint new agent.

b. File amended statement (Form LLC-12 [*see § 12C.210*] or LLC-12R [*see § 12C.210A*

]) with Secretary of State [*see § 12C.125*].

NOTE:
An agent may resign by completing and filing Form RA-100 [***see** § 12C.211*] or by sending the Secretary of State a letter of resignation [***see*** Secretary of State's LLC form packet].

7. In unlikely event that LLC wishes to be taxed as a corporation rather than a partnership, file Form 8832, Change of Entity Classification, with IRS, and attach copy of Form 8832 to federal tax or information return for year in which election is made [*Treas. Reg. § 301.7701-3(c)*].

NOTE:
If no election is made, the LLC will be classified as a partnership if it has more than one member, or will be disregarded as an entity separate from its owner if it has only one member [*Treas. Reg. § 301.7701-3(b)*]. Thus, as a practical matter, it is necessary to make a formal election only if the LLC wants to be taxed as a corporation.

8. File annual tax or information return [*see § 12C.120*, P 10].

9. File biennial statement of information during applicable period [*Corp. Code § 17060(a)*; *see § 12C.125*, P 3].

10. Establish and maintain office in California [*see § 12C.120*, P 5a].

11. Keep following records at office [*Corp. Code § 17058(a)*]:

NOTE:
The LLC may maintain these records in writing or in any other form capable of being converted into clearly legible tangible form [*Corp. Code § 17058(a)*].

a. Current list of name and address of each member with contribution and share in profits and losses.

b. Current list of name and address of each holder of economic interest with contribution and share in profits and losses.

c. Current list of name and address of each manager, if any.

d. Copy of articles of organization, any related powers of attorney, and any amendments.

e. Copies of LLC's federal, state, and local tax returns for six most recent taxable years.

f. Copy of written operating agreement, if any, any related powers of attorney, and any amendments.

g. Copies of LLC's financial statements for six most recent fiscal years.

h. Books and records of LLC for current and past four fiscal years.

12. On assessor's request, make business records available [*Corp. Code § 17058(b)*].

13. On proper request of member or holder of economic interest, deliver following records [*Corp. Code § 17106(a)*]:

a. Current list of name and address of each member with contribution and share in profits and losses.

b. Current list of name and address of each holder of economic interest with contribution and share in profits and losses.

c. Current list of name and address of each manager, if any.

d. Copies of LLC's federal, state, and local tax returns for six most recent taxable years.

e. Written operating agreement, if any.

14. On proper request of member, manager, or holder of economic interest [*Corp. Code § 17106(b)*]:

a. Allow inspection and copying of records listed in P 12, *above*.

b. Provide copies of LLC's federal, state, and local tax returns in writing promptly after becoming available.

15. For LLC with over 35 members [*Corp. Code § 17106(c)*]:

a. Send annual report to each member within 120 days after close of fiscal year.

NOTE:
The LLC may send the annual report by electronic transmission [*Corp. Code §§ 17001(o)(1), 17106(c)(1)*].

b. On written request of members representing at least 5 percent of voting interests (or three or more members), provide within 30 days:

(1) Income statement for current period of fiscal year.

(2) Balance sheet as of end of current period.

16. Within 90 days after end of each taxable year, provide each member and holder of economic interest with information necessary to complete federal and state tax returns [*Corp. Code § 17106(e)*].

17. For LLC with 35 or fewer members, provide copy of federal, state, and local tax return each year [*Corp. Code § 17106(e)*].

18. On stated time or dissolution event, dissolve LLC and wind up its affairs [*see § 12C.127*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral OverviewTax LawState & Local TaxesFranchise TaxImposition of Tax



126 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12C California Legal Forms--Transaction Guide § 12C.123

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.123 Amending Articles of Organization

1. File amendment to articles for one of following purposes:

a. To revise articles to contain any lawful provision members desire [*Corp. Code § 17054(a)*].

b. To effect one of following [*Corp. Code § 17054(c)*]:
(1) Change in name of LLC.

(2) Change in statement regarding management of LLC [*see Corp. Code § 17151(b)*].

(3) Change in time for dissolution of LLC.

(4) Change in events causing dissolution of LLC.

c. To correct false or erroneous material statement in articles.

2. Complete certificate of amendment (Form LLC-2) [*see § 12C.201*], including [*Corp. Code § 17054(b)*]:

a. Name of LLC.

b. Secretary of State's file number of LLC.

c. Text of amendment.

3. Have amendment executed by person authorized by articles to do so [*Corp. Code § 17054(b)*].

4. File certificate of amendment with Secretary of State and pay applicable filing fee [*Corp. Code § 17054(a)*; *see Gov. Code § 12190(d)(fee)*].

NOTE:

The articles of organization of an LLC may also be restated at any time. The procedure for restating articles is similar to the procedure for amendment, involving filing a required form (Form LLC-10) and paying a fee [*Corp. Code § 17054(f)*; ***see*** *Gov. Code § 12190(e)(fee)*; ***see also*** *§ 12C.208* (form)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12C California Legal Forms--Transaction Guide § 12C.124

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.124 Filing Certificate of Correction

1. File certificate of correction if any document filed with Secretary of State contains any of following [*Corp. Code § 17055(a)*]:

a. Typographical error.

b. Error of transcription.

c. Other technical error.

d. Defective execution.

2. Complete certificate of correction (Form LLC-11) [*see § 12C.209*], including [*Corp. Code § 17055(b)*]:

a. Name of LLC.

b. Secretary of State's file number of LLC.

c. Name of each party to document being corrected.

d. Date document being corrected was filed.

e. Provision in document as previously filed and as corrected.

f. If document was defectively executed, manner in which defective.

3. Have certificate of correction executed in same manner document being corrected was required to be executed [*Corp. Code § 17055(d)*].

4. File certificate of correction with Secretary of State and pay applicable filing fee [*Corp. Code § 17055(b)*; *see Gov. Code § 12190(g)(fee)*].

NOTE:

A certificate of correction may not make any change or amendment that would not have complied with the requirements of the Act at the time the document was filed [*Corp. Code § 17055(c)*]. In addition, a certificate of correction may not change the effective date of the document being corrected or affect any right or liability accrued or incurred before its filing, with limited exceptions [*Corp. Code § 17055(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12C California Legal Forms--Transaction Guide § 12C.125

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.125 Filing Statement of Information

1. Prepare statement of information, including [*Corp. Code § 17060(a)*]:

a. Name of LLC.

b. Secretary of State's file number of LLC.

c. For foreign LLC, state in which organized.

d. Name and address of agent for service of process [*see Corp. Code § 17057(b)*].

e. Street address of principal executive office.

f. For domestic LLC, street address of office containing records [*see Corp. Code § 17057(a)*].

g. Name and complete business or residence address of managers, if any, and chief executive officer, if any.

h. If there are no managers, name and business or residence address of each member.

i. General type of business that constitutes principal business activity of LLC.

2. File initial statement of information (Form LLC-12) [*see § 12C.210*] within 90 days after [*Corp. Code § 17060(a)*]:

a. For domestic LLC, filing original articles of organization.

b. For foreign LLC, filing application for registration.

3. File biennial statement of information (Form LLC-12R) [*see § 12C.210A*] biennially thereafter, during applicable filing period [*Corp. Code § 17060(a), (c)*]:

NOTE:

The Secretary of State's Official Instruction to Form LLC-12R state that LLCs organized during the months of January, March, May, July, September, and November will be due to file in odd years, and those organized during the months of February, April, June, August, October, and December will be due in even years. Approximately three months before the close of the applicable filing period, the Secretary of State's office will mail the statement of information to the last known address of the LLC on record. However, the failure to receive a statement of information from the Secretary of State does not exempt an LLC from complying with the law [***see*** *Corp. Code § 17060(c)*].

On certification by the Secretary of State that an LLC has failed to file its initial or subsequent biennial statement, the Franchise Tax Board will assess a penalty [*Rev. & Tax. Code § 19141*; ***see*** *Corp. Code § 17060, 17653(a)*].

a. For domestic LLC, calendar month in which original articles were filed and preceding five months.

b. For foreign LLC, calendar month in which application for registration was filed and preceding five months.

NOTE:

If there has been no change in the information in the last filed statement of information, the LLC, by checking the appropriate box on Form LLC-12R, may advise the Secretary of State of that fact [*Corp. Code § 17060(b)*]. However, if there have been ***any*** changes to the information in the form, the statement must be completed ***in its entirety***.

4. If name or address of agent for service of process changes, file current statement of information containing all information listed in P 1, *above* [*Corp. Code § 17060(d)*; *see* § 12.210A[1][d]; *see also Corp. Code § 17061(d)(3)*].

NOTE:

When the name or street address of an LLC's agent for service of process changes, a current statement of information ***must*** be filed. When any other information required by *Corp. Code § 17060(a)* changes, a current statement of information ***may*** be filed [*Corp. Code § 17060(d)*]. For additional discussion, see *§ 12C.210A[1][d]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormation



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12C California Legal Forms--Transaction Guide § 12C.126

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.126 Merging, Converting, and Reorganizing

[1] Merger

NOTE:
One or more LLCs may merge with or be acquired by any other business entity or entities [*Corp. Code § 17550(a), (b)*] if the other entity or entities are authorized to do so by their governing law. This applies to domestic as well as foreign LLCs and other business entities [*Corp. Code § 17555*]. Certain special provisions apply if the surviving entity of a merger is a foreign LLC [***see*** *Corp. Code § 17555(b)- (f)*]. The procedures in this section are for use if a domestic LLC is the surviving business entity in a merger.

1. Each merging LLC must approve agreement of merger [*see § 12C.230*] by vote of majority of interest of members (or other greater specified percentage) [*Corp. Code § 17551(a)*].

NOTE:
For an agreement of merger for two domestic LLCs, see *§ 12C.230*. For additional agreements of merger, which may be modified as needed, see Ch. 11C, ***Mergers*** (corporations), and Ch. 15C, ***Mergers of Limited Partnerships***.

2. Each other merging entity must approve agreement of merger by persons required to approve merger by governing law [*Corp. Code § 17551(a)*].

3. Agreement of merger must contain all of following [*Corp. Code § 17551(a)(1)- (6)*; *see § 12C.230[1]*]:

a. Terms and conditions of merger.

b. Name and place of organization of surviving LLC or other entity.

c. Name and place of organization of each disappearing LLC or other entity.

d. Manner of converting interests of each constituent LLC into interests in surviving business entity.

e. Amendments to articles of organization of surviving LLC, if applicable, to be effected by merger.

f. Any other provisions required by law.

g. Any other provisions desired.

NOTE:
Specific rules must be followed concerning treatment of interests in LLCs in mergers involving their parents or other entities owning more than 50 percent of the voting interests in the LLC [*Corp. Code § 17551(b)*].

4. If necessary, amend agreement of merger before filing certificate of merger [*Corp. Code § 17551(c)*].

5. If necessary, abandon merger before filing certificate of merger [*Corp. Code § 17551(d)*].

6. Amend articles of organization as required by merger [*Corp. Code § 17551(a)(4)*; *see § 12C.123*].

7. If desired, amend operating agreement [*Corp. Code § 17551(e)*].

8. Retain copy of agreement of merger at office in California [*Corp. Code § 17551(f)*].

9. On request, provide copy of agreement of merger to member or holder of shares [*Corp. Code § 17551(f)*].

10. Complete certificate of merger (Form OBE MERGER-1) [*see § 12C.207*], which must contain all of following [*Corp. Code § 17552(a)*]:

a. Name of each constituent business entity.

b. Secretary of State's file number, if any, of each constituent business entity.

c. Separate identification of disappearing and surviving business entities.

d. If vote of members was required [*see Corp. Code § 17551*], statement about vote.

e. If surviving entity is LLC, any changes required to articles of organization.

f. If merger is not to be effective on filing of certificate, future effective date of merger.

g. If surviving entity is not domestic LLC, description of that entity.

h. Any other information required to be stated in certificate of merger.

11. Have each constituent business entity execute and acknowledge certificate of merger [*Corp. Code § 17552(a)*].

12. An FTB certificate of satisfaction for each constituent business entity [*see* former *Corp. Code § 17552(e)*] is no longer required [*see* Stats. 2006, ch. 773].

13. File certificate of merger with Secretary of State and pay applicable filing fee [*Corp. Code § 17552*; *see Gov. Code § 12190(i), (j)* (fees)].

NOTE:

Mergers are effective on filing the certificate of merger, unless it provides for a delayed effective date [*Corp. Code § 17553(a)*]. On the effective date of merger, the disappearing business entities cease to exist, and the surviving entity succeeds automatically to the rights, property, debts, and liabilities of the disappearing entities [*Corp. Code § 17554*].

14. If required by local law, record ownership of real property in name of surviving entity [*Corp. Code § 17556*].

[2] Conversion

1. Draft plan of conversion containing [*Corp. Code § 17540.3*]:

a. Terms and conditions of conversion.

b. Place of organization of converted entity and of converting LLC.

c. Name of converted entity after conversion.

d. Manner of converting membership interests of each member into securities of, shares of, or interests in converted entity.

NOTE:

Conversion is permitted only if each member of the converting LLC will receive a percentage interest in the profits and capital of the converted entity equal to the partner's percentage interest in the converting LLC as of the effective time of conversion [*Corp. Code § 17540.2(a)*].

e. Provisions of governing documents for converted entity, including the articles or certificate of incorporation if the converted entity is a domestic or foreign corporation, the partnership agreement, or the LLC articles of organization and operating agreement, to which that will bind holders of interests in converted entity are to be bound.

NOTE:

Including provisions of the converted entity's governing document is ordinarily accomplished by attaching it and incorporating it by reference.

f. Any other details or provisions required by laws under which converted entity is organized.

g. Any other details or provisions that are desired.

h. Effective date of conversion.

NOTE:

Conversion into an other business entity or a foreign LLC is effective on the earliest date that all of the following occur: (1) the approval of the conversion plan [***see*** *Corp. Code § 17540.3*]; (2) the filing of all documents required by law to create the converted entity, including, if required, a statement of conversion [***see*** *Corp. Code § 17540.6*]; and (3) the effective date set forth in the plan of conversion [***see*** *Corp. Code § 17540.4*]. If an LLC is converting to a foreign entity, conversion is effective according to the law of the foreign jurisdiction [*Corp. Code § 17540.2(b)(1)*].

2. Submit plan of conversion for approval of members.

NOTE:

A plan must be approved by a majority in interest of the members of the converting LLC, unless the articles or operating agreement specify a higher percentage. However, if the members of the LLC would become personally liable for any obligations of the converted entity as a result of the conversion, the plan of conversion must be approved by all of the members of the converting LLC, unless the plan of conversion provides that all members will have dissenters' rights [*Corp. Code § 17540.3(b)*; ***see*** *§ 12C.25[3]*; ***see also*** [3], ***below***]. In addition to the foregoing approvals, if the LLC is converting into a limited partnership, then the plan of conversion must be approved by all members who will become general partners of the converted limited partnership pursuant to the plan of conversion [*Corp. Code § 17540.3(c)*].

3. Submit any amendments of plan of conversion to members for approval by same vote as required for adoption of original plan [*Corp. Code § 17540.3(e)*].

4. If members decide to abandon conversion, arrange for vote to abandon by same vote required to approve original plan [*Corp. Code § 17540.3(f)*].

NOTE:

The plan can be abandoned at any time before the conversion is effective, but abandonment cannot prejudice the rights of third parties [*Corp. Code § 17540.3(f)*].

5. Complete and file statement or certificate of conversion.

a. Use Form LP-1A, Certificate of Limited Partnership--Conversion [*see* § 15C.205] for limited liability company that is converting into a California limited partnership [Corp. Code § 17450.6(a)(1)].

NOTE:

The form referred to above contains the statement of conversion language prescribed by statute [***see*** *Corp. Code § 17540.6(b)*].

b. For limited liability company that is converting into a California general partnership [Corp. Code § 17450.6(a)(2)], use:

(1) Form GP-1A, General Partnership Statement of Partnership--Conversion [*see § 15.801*]; or

NOTE:

The form referred to above contains the statement of conversion language prescribed by statute [***see*** *Corp. Code § 17540.6(b)*].

(2) Certificate of conversion (Form CONV-1A) [*see § 12C.212*], if no statement of partnership authority is filed.

c. For LLC that is converting into domestic corporation, prepare and file articles of incorporation as follows:

NOTE:

For an illustration of the Secretary of State's sample set of articles of incorporation for a California limited partnership that is converting into a California stock corporation, see *§ 12C.213*. The sample is to be used as a guide and satisfies minimum statutory requirements. The sample form includes suggested language for the required statement of conversion, containing the information specified below.

(1) Include in articles of incorporation for converted entity a statement of conversion containing following information [*Corp. Code § 1157(e)*, 17540.b(a)(3), (b)]:

(a) Name, form, and jurisdiction of organization of converting entity [*Corp. Code § 1157(e)*].

(b) Secretary of State's file number of converting limited partnership [*Corp. Code §§ 1157(e), 17540.6(b)(1)*].

(c) Statement that principal terms of plan of conversion were approved by vote of partners that equaled or exceeded vote required under *Corp. Code § 17540.3*, specifying [*Corp. Code § 17540.6(b)(2)*]:

(i) Each class entitled to vote; and

(ii) Percentage vote required of each class.

(d) Form of organization of converted entity (*i.e.*, a California stock corporation) [*Corp. Code § 17540.6(b)(3)*].

(e) Name of corporation's initial agent for process and address, if agent is individual [*see § 12C.213*].

(f) If converting entity is a foreign limited partnership, all of following [*Corp. Code § 1157(e)*]:

(i) Statement that converting entity is authorized to effect the conversion by laws under which it is organized.

(ii) Statement that converting entity has approved plan of conversion or other instrument as is required to be approved to effect conversion under laws under which converting entity is organized.

(iii) Statement that conversion has been approved by number or percentage of partners, members, shareholders, or other holders of interest of converting entity that is required by laws under which that entity is organized, or a greater or lesser percentage as may be set forth in converting entity's partnership agreement, articles of organization, operating agreement, articles of incorporation, or other governing document in accordance with

applicable laws.

(2) File articles of incorporation with Secretary of State as follows [*see § 12C.213*]:

NOTE:

The conversion to a corporation by an other business entity, including a limited liability company [*see Corp. Code §§ 174.5, 1150(g)*], will be effective as of the filing with the Secretary of State of the articles of incorporation of the converted corporation containing a statement of conversion [*Corp. Code § 1157(d)*].

(a) Include original and at least two copies with submission.

NOTE:

The Secretary of State will certify two copies of the filed document without charge, provided that the copies are submitted to the Secretary of State with the document to be filed. Any additional copies submitted will be certified on request and payment of an additional per-copy certification fee.

(b) Include appropriate filing fee.

(c) Include both of following submission to facilitate return of documents:

(i) Self-addressed envelope.

(ii) Letter referencing corporate name and sender's name, return address, and telephone number.

(d) Mail or hand deliver filing packet to Sacramento office of Secretary of State.

NOTE:

These documents must be mailed or hand delivered for over-the-counter processing to the Sacramento office. They cannot be processed using the preclearance, expedited, wait for, or rush letter service, and cannot be filed in the regional offices].

d. Use certificate of conversion (Form CONV-1A) [*see § 12C.212*] for limited liability company that is converting to foreign other business entity [*Corp. Code § 17540.6(a)(4)*].

NOTE:

Although the statute does not mandate that the official form be used for filing a certificate of conversion [***see** Corp. Code § 17540.6*], there is no reason to draft a non-standard form, nor is there any guarantee that such a form would be readily accepted by the Secretary of State's office in lieu of the official form.

6. Record certified copy of certificate of conversion or statement of conversion in each county in which converted entity owns real property [*Corp. Code § 17540.7(a)*; *see* P 5, NOTE, *above*; *see also § 12C.26[7]*].

NOTE:

Recording a certificate of conversion or a statement of partnership authority, certificate of limited partnership, or articles of organization, articles or certificate of incorporation, or other certificate

showing the formation of an other business entity or LLC by conversion containing a statement of conversion creates a conclusive presumption in favor of bona fide purchasers or encumbrancers that the conversion was validly completed [*Corp. Code § 17540.7(c)*]. The fee for recording documents is $10 for the first page and $3 for each additional page [*Gov. Code § 27361*]. A separate fee for certifying the copy applies as well [***see** Gov. Code § 27364*].

7. Comply with rules regarding dissenter's rights [*see Corp. Code § 17600 et seq.*; *see also* [3], *below*].

8. Notify all creditors of LLC of effective date of conversion and of dissociation of any member.

[3] Dissenters' Rights on Merger or Reorganization

NOTE:

The LLC Act provides for dissenters' rights in mergers, conversions, and other reorganizations [***see** Corp. Code § 17600 et seq.*]. "Reorganization" includes mergers, certain acquisitions of controlling interests in other business entities, and certain acquisitions of substantially all of the assets of other business entities [*Corp. Code § 17600(a)*]. In general, in a merger or reorganization, a member who is entitled to vote on a reorganization and has taken the necessary steps to have a dissenting interest [***see** Corp. Code § 17601(b)*] may require the LLC to purchase that interest for cash at fair market value [*Corp. Code § 17601(a)*]. With certain listed exceptions, a dissenting member of a reorganizing LLC does not have the right to attack the validity of the reorganization or to have the reorganization set aside or rescinded [***see** Corp. Code § 17613(a)*].

These dissenters' rights provisions apply to domestic LLCs, and to foreign LLCs if members holding more than 50 percent of voting interests reside in California [*Corp. Code § 17612(a)*]. These provisions do not apply to LLCs with 35 or fewer members if all the members have waived the application of dissenters' rights provisions in writing [*Corp. Code § 17612(c)*].

1. Ensure that dissenting member has "dissenting interest" [*Corp. Code § 17601(b)*]:

a. Membership interest was outstanding on date for determination of members entitled to vote on reorganization.

b. Membership interest was not voted in favor of reorganization, or membership interest was voted against reorganization [*see Corp. Code § 17601(b)(2)*].

c. Member has demanded that LLC purchase its interest at its fair market value [*see Corp. Code § 17602* (method of demand)].

d. Member has submitted certificate of interest for endorsement, if applicable [*see Corp. Code § 17603*].

2. Dissenting interest loses status as such, and holder of interest ceases to be dissenting member, on occurrence of any of following [*Corp. Code § 17610*]:

a. LLC abandons reorganization.

b. Interest is transferred before submission for endorsement [*see Corp. Code § 17603*].

c. Dissenting member and LLC do not agree that interest is dissenting interest, or disagree on purchase price of interest, and neither files complaint within six months after notice of approval of reorganization [*see Corp. Code § 17605*].

d. Dissenting member, with LLC's consent, withdraws demand for purchase of dissenting interest.

3. If LLC members have right to require LLC to purchase dissenting interests [*see* P 1, *above*], LLC must mail each member notice of approval of proposed reorganization within 10 days after date of approval [*Corp. Code § 17602(a)*; *see § 12C.231* (notice)].

4. Notice of approval of reorganization must contain all of following [*Corp. Code § 17602(a)*]:

a. Copies of *Corp. Code §§ 17601 through 17605*.

b. Statement of price determined by LLC to be the fair market value of outstanding interests.

c. Statement of method of valuation used.

d. Latest available balance sheet of LLC.

e. Latest available income statement of LLC.

f. Description of procedure to exercise dissenters' rights.

NOTE:
The statement of price constitutes an offer by the LLC to purchase dissenting interests at that price [*Corp. Code § 17602(a)*].

5. Member with dissenting interest who wishes LLC to purchase interest must make written demand on LLC for purchase of interest and payment to member in cash of its fair market value [*Corp. Code § 17602(b)*; *see § 12C.232* (form for demand)].

6. Demand must be received by LLC within 30 days after notice of reorganization was mailed to members [*Corp. Code § 17602(b)*].

7. Demand must include all of following [*Corp. Code § 17602(c)*]:

a. Number or amount of member's interest.

b. Statement of member's claim of fair market value of interest on day before announcement of proposed reorganization.

NOTE:
The statement of value constitutes an offer by the member to sell the dissenting interest at that price [*Corp. Code § 17602(c)*].

8. If LLC and dissenting member agree that interest is dissenting interest and agree on price to be paid, dissenting member is entitled to agreed price, with interest from date of consummation of reorganization [*Corp. Code § 17604(a)*].

NOTE:

Agreements as to the value of dissenting interests must be in writing and must be kept with the records of the LLC [*Corp. Code § 17604(a)*].

9. LLC must pay for dissenting interest within 30 days after price of interest has been agreed on, or within 30 days after conditions to reorganization are satisfied, whichever is later [*Corp. Code § 17604(b)*].

10. Dissenting member must submit certificates of interest (or, if none, written notice of number or amount of interests) on payment [*Corp. Code § 17604(b)*; *see Corp. Code § 17603*].

11. If LLC denies that interest is dissenting interest, or LLC and dissenting member cannot agree on value of dissenting interest, LLC or member may bring action in superior court within six months after date of notice of approval of reorganization [*Corp. Code § 17605*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsMergers & Acquisitions LawMergersGeneral Overview



130 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12C California Legal Forms--Transaction Guide § 12C.127

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.127 Dissolving and Winding Up Limited Liability Company

NOTE:
An LLC may be dissolved by the arrival of a stated time, by the occurrence of an event, or by judicial action [***see*** *Corp. Code §§ 17350, 17351*]. For discussion of the causes of dissolution, see *§ 12C.26*.

1. On dissolution, managers who have not wrongfully dissolved LLC (or if none, members) must wind up affairs of LLC [*Corp. Code § 17352(a)*]:

NOTE:
If the LLC is being judicially dissolved [***see*** *Corp. Code §§ 17350(c), 17351*], winding up must be conducted in accordance with the decree of dissolution [*Corp. Code § 17352(a)*].

a. Give written notice of winding up to all known creditors and claimants whose addresses appear in LLC's records [*Corp. Code § 17352(a)*].

b. Determine that all known debts and liabilities of creditors of LLC (including debts and liabilities to creditor members) have been paid or adequately provided for [*Corp. Code § 17353(a)*; *see Corp. Code § 17353(c)* (adequate provision for payment)].

c. Distribute remaining assets among members according to respective rights and preferences set forth in operating agreement, but if agreement does not specify, then as follows [*Corp. Code § 17353(a)*]:

(1) To members in satisfaction of liabilities for distributions under *Corp. Code §§ 17201, 17202,* or *17255*.

(2) To members for return of their contributions.

(3) To members in proportion in which members share in distributions.

d. Prosecute and defend actions by or against LLC [*Corp. Code § 17354(a)*].

NOTE:
A dissolved LLC continues to exist indefinitely for the purpose of being sued in quiet title actions, and judgments rendered in such actions bind the members of the LLC [***see*** *Corp. Code § 17355(c)*].

e. Dispose of and convey property [*Corp. Code § 17354(a)*].

f. Collect and divide assets [*Corp. Code § 17354(a)*].

2. If required, file certificate of dissolution (Form LLC-3) [*see § 12C.202*] with Secretary of State [*Corp. Code § 17356(a)(1)*], which must contain all of following [*Corp. Code § 17356(a)(2)*]:

NOTE:
If the LLC is dissolved by the vote of all of the members [***see*** *Corp. Code § 17350(b)*], and a statement to that effect is added to the certificate of cancellation of articles, a separate filing of a certificate of dissolution is not required [*Corp. Code § 17356(a)(3)*].

a. Name of LLC.

b. Secretary of State's file number of LLC.

c. Any other information managers or members decide to include.

3. On completion of winding up, file certificate of cancellation (Form LLC-4/7) [*see § 12C.203*] with Secretary of State [*Corp. Code § 17356(b)(1)*], which must contain all of following [*Corp. Code § 17356(b)(2)*]:

a. Name of LLC.

b. Secretary of State's file number of LLC.

c. Statement that final tax return or final annual tax return has been or will be filed with FTB. tax liability will be satisfied on taxes paid basis or that person or entity assumes tax liability of dissolving LLC as security for tax clearance certificate from FTB and is responsible for any additional taxes or fees.

d. Any other information managers or members decide to include.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesDissolution & Winding UpBusiness & Corporate LawLimited

Liability CompaniesMembers & Other ConstituentsContracts LawDebtor & Creditor Relations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
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6-12C California Legal Forms--Transaction Guide § 12C.128

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.128 Cancelling Registration of Foreign Limited Liability Company

1. File certificate of cancellation (Form LLC-4/7) [*see § 12C.203*; *see also § 12C.127*, P 4], signed by person with authority to do so, with Secretary of State [*Corp. Code § 17455*].

2. Cancellation does not terminate authority of Secretary of State to accept service of process on foreign LLC for causes of action arising out of transaction of business in California [*Corp. Code § 17455*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesDissolution & Winding Up



132 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
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6-12C California Legal Forms--Transaction Guide § 12C.129

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.129 Filing Tax Returns

NOTE: This section is for use by an LLC that is classified as a partnership for state and federal tax purposes. LLCs that are exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that are not taxed as corporations for California tax purposes are not subject to the annual minimum franchise tax or the fee based on income [***see*** *Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; ***see also*** *I.R.C. § 501(c)(2), (25)* (title holding companies)].

If the LLC will be taxed as a corporation, see Ballantine & Sterling, California Corporation Laws (Matthew Bender), for coverage of corporate tax issues and procedures. Chiefly, an LLC classified as a corporation for tax purposes must pay the $800 minimum franchise tax when filing its articles of organization or application for registration [Secretary of State's LLC form packet] and must file California Form 100, Corporation Income or Franchise Tax Return, rather than Form 568 [***see*** Instructions for Form 568, p. 4; ***see also*** *Rev. & Tax. Code § 18633.5(h)*].

[1] California Forms

1. File Form 568 [Instructions for Form 568, p. 4; *see Rev. & Tax. Code § 18633.5(a)*; *see also § 12C.250*]:

a. If LLC is any of following:
(1) Doing business in California.

(2) Organized in California.

(3) Organized in another state but registered with California Secretary of State.

b. Within following time periods:

(1) For calendar year filer, by April 15.

(2) For fiscal year filer, by 15th day of fourth month following close of taxable year.

c. Include all necessary attachments to Form 568, as applicable, for example:

(1) Form FTB 3885L, concerning depreciation and amortization [*see § 12C.252*].

(2) Schedule D (568), concerning capital gain and loss [*see § 12C.253*].

(3) Form FTB 3832, containing consents of nonresident members to California jurisdiction for taxation of pro rata share of LLC income [*see* Rev. & Tax. Code § 186335.5(e)(1), (f); *see also § 12C.254*].

2. If LLC later discovers changes to return are required, file following within six months [Instructions for Form 568, p. 6; *see § 12C.250*]:

a. Amended Form 568.

b. Amended Schedule K-1 for each member [*see § 12C.251*].

NOTE:
If an LLC discovers that it needs to amend its federal partnership return (Form 1065), or if the return is changed in response to an IRS audit, it is likely the LLC will need to file an amended California Form 568. This must be done within six months of final federal adjustments. If an IRS audit was done, the LLC must attach a copy of the IRS Federal Agent's Report. Members of the LLC may also need to file amended returns [Instructions for Form 568, p. 6].

3. If LLC wishes to obtain automatic six-month extension of time to file Form 568:

a. File Form FTB 3537 [*see § 12C.255*] within following time periods [Instructions for Form 568, p. 45]:

(1) For fiscal year filer, by 15th day of 10th month following close of taxable year.

(2) For calendar year filer, by October 15 of following year.

NOTE:
Filing the LLC's tax return within the six-month extension period verifies that the LLC qualified for the extension. No separate written request is required [***see*** Instructions for Form 568, p. 4].

b. Pay the following [Instructions for Form 568, p. 45; *see Rev. & Tax. Code §§ 17941*, *17942*]:

NOTE:
An LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax, and thus not subject to the annual statutory fee [***see*** *Rev. & Tax. Code §§*

17941(d), 23701h(b), 23701x(b); ***see also*** *I.R.C. § 501(c)(2), (25)* (title holding companies)].

(1) $800 minimum franchise tax [*see Rev. & Tax. Code § 23153(d)(1)*; *see § 12C.256[1][d], [e]*].

(2) LLC statutory fee, if any, based on income [*see § 12C.255*].

(3) Any nonconsenting nonresident member's tax [*see § 12C.255*].

4. Within LLC's filing deadline, provide copies of filed tax forms to LLC's members and other holders of LLC interests [*see Rev. & Tax. Code § 18633.5(b)*].

5. Use Form FTB 3522 to pay $800 minimum franchise tax by 15th day of fourth month after close of LLC's tax year [*Rev. & Tax. Code § 17941*; *see § 12C.256*].

NOTE:

An LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax [***see*** *Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; ***see also*** *I.R.C. § 501(c)(2), (25)* (title holding companies)].

[2] Federal Forms

NOTE:

Under IRS entity classification rules effective January 1, 1997, LLCs can elect to be classified either as associations (i.e., corporations) or as partnerships [*Treas. Reg. § 301.7701-3(a)*]. If an LLC elects to be classified as a corporation rather than a partnership, it must file Form 8832, and attach a copy of Form 8832 to its federal tax or informational return for that tax year. Such an election will be effective on the date specified in Form 8832, or on the date filed if no date is specified in the election form [*Treas. Reg. § 301.7701-3(c)*]. The steps below assume that the LLC elects to be classified as a partnership rather than a corporation for tax purposes. When that is the case, no formal election is required, inasmuch as the default rules provide for such a classification in the absence of an election [***see*** *Treas. Reg. § 301.7701-3(b)*].

1. File Form 1065 [Treas. Reg. § 1.6031-1(a)]:

a. With District Director of Internal Revenue for district in which LLC's principal place of business is located [*see* Treas. Reg. § 1.6031-1(e)(1)].

b. Within following time periods [*I.R.C. § 6072(a)*]:

(1) For calendar year filer, by April 15.

(2) For fiscal year filer, by 15th day of fourth month following close of taxable year.

2. File Form 1099 with both IRS and FTB [*see I.R.C. § 6041* et seq.; *see also* Instructions for Form 568, p. 6]:

a. If in course of trade or business, LLC has done any of following:

(1) Made payments to one person of rents, salaries, wages, annuities, or other fixed or determinable income of $600 or more.

(2) Paid to one employee interest and dividends of $10 or more.

(3) Received cash payments of over $10,000.

b. By February 28 of year following close of reporting year.

3. If LLC is reporting its income for first time, include one of following with both federal and state returns [*see Treas. Reg. §§ 1.441-1(c)*, 1.706-1(b)(7); *Rev. & Tax. Code § 17851*]:

a. Copy of letter from Commissioner of IRS approving adoption of LLC taxable year other than that of all principal members;

b. Statement that LLC taxable year is same as that of all principal members;

c. Statement that all principal members are concurrently changing to taxable year adopted by LLC; or

d. Statement that all principal members are on different taxable years and LLC has adopted calendar year without prior approval.

4. If LLC changes taxable year, file separate return for period beginning on day after former taxable year closed and ending day before new taxable year [*see Treas. Reg. §§ 1.443-1(a)*, 1.706-1(b)(8)(i)(B)]:

a. Include copy of letter from IRS Commissioner approving adoption of new year.

NOTE:
An existing LLC may only change its tax year by securing the Commissioner's approval [***see*** *I.R.C. § 442*] or by making an *I.R.C. § 444* election. However, approval is automatic for certain changes, such as a change to the required tax year pursuant to administrative procedures [*Treas. Reg. 1.706-1(b)(8)*].

b. File by 15th day of fourth month after close of short period.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewTax LawState & Local TaxesFranchise TaxImposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of TaxTax LawState & Local TaxesIncome TaxPartnerships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-12C California Legal Forms--Transaction Guide §§ 12C.130-12C.139

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

[Reserved]

§§ 12C.130[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
D. Drafting Guide

6-12C California Legal Forms--Transaction Guide § 12C.140

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.140 Drafting Operating Agreement

NOTE:

This section provides a guide to the provisions that should be considered, and included, in a written operating agreement. For sample operating agreement forms, see *§§ 12C.220* and *12C.221*.

The members of an LLC must enter into an operating agreement, either written or oral, before or after filing of its articles or organization [*Corp. Code § 17050(a)*]. An operating agreement is any agreement among all the members as to the affairs of the LLC and the conduct of its business in a manner not inconsistent with law or its articles, including amendments [*Corp. Code § 17001(ab)*]. It is advisable to have a written operating agreement, because it is likely to be the key document of an LLC. The degree of complexity in the agreement is largely up to the drafter and the parties themselves. The operating agreement may not be filed with the Secretary of State [***see*** Secretary of State's LLC form packet].

Provisions typically found in corporate bylaws or partnership agreements generally can be adapted to LLC operating agreements in appropriate instances. For a variety of corporate bylaw provisions, see Ch. 4, ***Bylaws*** . For partnership provisions, see Ch. 15, Part A, ***Formation of General Partnerships*** . For other provisions that may be appropriate to this type of agreement, see Ch. 8C, ***Close Corporation Shareholder Agreements*** .

1. Define terms used in operating agreement [*see §§ 12C.220[2]*, art. 1, 12C.221[2], art. 1].

2. State name, purpose, and operative date of LLC [*see §§ 12C.220[2]*, art. 2, 12C.221[2], PP 1.2, 1.3, 1.5, and 1.6].

3. Set forth names and addresses of members.

4. Detail initial and additional (if any) capital contributions of members [*see §§ 12C.220[2]*, art. 3, 12C.221[2], art. 3].

5. Enumerate LLC's remedies in the event of member's failure to make initial and subsequent capital contributions.

6. Specify capital accounts and capital structure [*see §§ 12C.220[2]*, art. 3, 12C.221[2], art. 4].

7. Include provisions governing transfers and assignment of membership interests, and disposition of a member's interest on that member's death [*see §§ 12C.220[2]*, PP 3.09-3.17, 12C.221[2], art. 8].

NOTE:

If LLC is an association of closely acquainted individuals, in the nature of a small general partnership, the members may wish to place significant limitations on the transfer of membership interests, to ensure that they are not forced to accept as a member someone whom they do not want. Similarly, the disposition of a membership interest on the death of a member may be limited in appropriate cases. If desired, provisions similar to those frequently included in corporate or partnership buy-sell agreements should be included. The operating agreements in this chapter contains significant transfer restrictions on membership interests [***see*** *§§ 12C.220[2]*, PP 3.09-3.12, 12C.221[2], art. 8], as well as simple buy-sell provisions for optional or mandatory purchase of a membership interest [***see*** *§§ 12C.220[2]*, PP 3.13-3.17, 12C.221[2], art. 10]. For other buy-sell provisions, see Ch. 8D, ***Buy-Sell Agreements*** (close corporations), Ch. 15, Part A, ***Formation of General Partnerships***, §§ 15.240-15.262 (partnerships).

8. Specify rights and duties of members, including limiting authority and liability [*see, e.g., § 12C.221[2]*, art. 2].

9. Specify rights and duties of classes of members, if any.

10. Specify procedures for amending articles of organization and operating agreement [*see, e.g., §§ 12C.220[2]*, P 22.10, 12C.221[2], P 12.2].

NOTE:

The power to adopt and change the operating agreement of an LLC is vested in its members, but its articles of organization or a written operating agreement may prescribe the manner in which the operating agreement may be changed [*Corp. Code § 17059*].

11. State whether LLC is to be managed by the members, managers, or officers [*see §§ 12C.220[2]*, art. 5, 12C.221, Section 5.01].

12. If LLC is to be managed by members, include provisions as to management and as to a management group of members, if any [*see §§ 12C.221[2], 12C.226*].

13. If LLC is to be managed by managers or officers, set forth necessary details of that management [*see § 12C.220[2]*, arts. 5-10; *see also § 12C.227*].

14. Detail members' meeting requirements and voting rights [*see §§ 12C.220[2]*, arts. 15-17, 12C.221[2], Sections 5.07-5.09].

15. Set forth method of allocating profits and losses and any special allocations [*see §§ 12C.220[2]*, art. 18, 12C.221, art. 6].

16. Provide for indemnification of members and managers, and specify members' and managers' fiduciary duties [*see §§ 12C.220[2]*, art. 19, 12C.221[2], art. 11].

NOTE:

The drafter should also consider (1) whether the individual members will be permitted to do business with the LLC in their individual capacities [***see*** *§ 12C.220[2]*, P 19.02], and (2) whether and to what extent they will be allowed to engage in activities that might be deemed competitive with the business of the LLC [***see*** *§§ 12C.220[2]*, P 19.03, 12C.221[2], Section 5.02].

Trade secret protection may be essential in LLCs that involve processes or information not generally available to the public [***see*** *§ 12C.220[2]*, P 19.04].

17. Set forth provisions as to accounting, records, financial statements, and reports [*see §§ 12C.220[2]*, art. 20, 12C.221[2], art. 7].

18. Set forth method of making distributions.

19. Include provisions covering various tax matters such as tax elections and identification of equivalent of tax matters partner [*see §§ 12C.220[2]*, P 16.03, 12C.221[2], Section 7.06].

20. Include provisions governing dissolution and winding up [*see § 12C.220[2]*, art. 21].

21. Include provisions governing procedures common to detailed contracts, including [*see § 12C.220[2]*, art. 22]:

a. Statements of consideration.

b. Provisions for notice, severability, integration, governing law, and confidentiality (if appropriate).

22. Include provisions covering any matters as to which LLC Act's default rules are changed.

NOTE:

The LLC Act allows the members of an LLC to alter the "default" provisions of the Act in the articles of organization or operating agreement [*Corp. Code § 17005(b)*]. For discussion of the statutory provisions that may and may not be altered, see *§ 12C.10[3]*.

23. Provide for consents of spouses of married members [*see §§ 12C.220[2]*, *12C.221[2]*].

24. Attach schedule showing:

a. Each member's initial contributions of:
(1) Cash;

(2) Property; and/or

(3) Services.

b. Percentage interest of each member in LLC.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART III. TRANSACTION GUIDE
D. Drafting Guide

6-12C California Legal Forms--Transaction Guide §§ 12C.141-12C.198

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

[Reserved]

§§ 12C.141[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.199

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.199 Request for Reservation of Limited Liability Company Name--Official Form

[1] Comment

[a] Use of Form

This form is the official name reservation form used by the California Secretary of State's office. The form may be used to request the reservation of a corporate, limited partnership, or limited liability company name.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12C.199. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Up to three names may be listed, in order of preference, and the first available name will be reserved for a period of 60 days [*see Corp. Code § 17053*]. Only one reservation will be made per request form. The name reservation request must be accompanied by a check, payable to the Secretary of State, covering the applicable fee of $10. The applicable fee does not depend on the number of names included in the request [*see* "Limited Liability Company Name Availability," Secretary of State's website located at http://www.ss.ca.gov/business/llc/llc_naav2.htm#resv].

The request may be submitted by mail, along with a self-addressed envelope, to the Sacramento office at [*see* "Limited Liability Company Name Availability," Secretary of State's website located at

http://www.ss.ca.gov/business/llc/llc_naav2.htm#resv]:

Secretary of State
Name Availability Unit
1500 11th Street, 3d Floor
Sacramento, CA 95814

The request may be submitted in person at the Secretary of State's Sacramento office. A special handling fee applies to each name reserved in person. This fee must be remitted by separate check, payable to the Secretary of State; the fee will be retained regardless of whether the reservation of the proposed name is accepted or denied. Currently, email and/or online requests for name reservations are not accepted [*see* "Limited Liability Company Name Availability," Secretary of State's website located at http://www.ss.ca.gov/business/llc/llc_naav2.htm#resv].

For a procedural guide to assist in choosing a name, see *§ 12C.120*.

[b] Name Reservation

On payment of the required fee [*see Gov. Code § 12190(a)*], an applicant may reserve an approved LLC name [*see* [c], *below*] with the Secretary of State for 60 days. The same person may not reserve the same name for consecutive 60-day periods [*Corp. Code § 17053*], but may do so with breaks between 60-day periods. If the name is approved by the LLC Unit, the applicant will receive a certificate of reservation for the name. However, obtaining a certificate of reservation for an LLC name is not a prerequisite to filing articles of organization [Secretary of State's LLC form packet].

PRACTICE TIP:

It is the policy of the LLC Unit to return any filing or name reservation that is indicative of a "professional service" LLC [Secretary of State's LLC form packet; *see Corp. Code §§ 13401(a), 13401.3* (definition), 17375]. For this reason, the applicant should ensure that the desired LLC name is not indicative of a professional service and state in the transmittal letter that the LLC is not being formed to conduct any business that requires a license under the Business and Professions Code [*see § 12C.241[2]* (transmittal letter)].

[c] Name Requirements

The name of a domestic LLC must be set forth in the articles of organization [*Corp. Code § 17052*]. Chiefly, the name must not be one that the Secretary of State determines is likely to mislead the public, and must not be the same as, or resemble so closely as to tend to deceive, the name of an existing domestic or registered foreign LLC (absent consent) or a name already reserved by an LLC or foreign LLC [*Corp. Code § 17052(c)*]. The last words of the name must be "limited liability company" or the abbreviation "LLC" or "L.L.C." The words "limited" and "company" may be abbreviated to "Ltd." and "Co." respectively [*Corp. Code § 17052(a)*]. The words "bank," "trust," "trustee," "incorporated," "inc.," "corporation," "corp.," "insurer," "insurance company," or any other words suggesting that the LLC is in the business of issuing policies of insurance and assuming insurance risks, may not be used in the name of an LLC [*Corp. Code § 17052(d)*]. An LLC's name may contain the name of one or more of its members [*Corp. Code § 17052(b)*].

[d] Special Name Requirements for Foreign Limited Liability Companies

An application for registration of a foreign LLC must contain its name and any different name under which it proposes to transact business in California [*Corp. Code § 17451(a)(1)*]. If the name of the foreign LLC does not satisfy *Corp. Code § 17052* [*see* [c], *above*], to obtain a certificate of registration, the foreign LLC must either (1) add the words "limited liability company" or the abbreviation "LLC" or "L.L.C." to its name for use in California, or (2) use an assumed name that is available and that satisfies *Corp. Code § 17052* [*see* [c], *above*]. If a foreign LLC uses an assumed

name, it must agree to use only that name in its dealings with the Secretary of State and in the conduct of its affairs in California [*Corp. Code § 17452(b)*].

[2] FORM

Request for Reservation of Limited Liability Company Name--Official Form

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.200

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.200 Articles of Organization [Form LLC-1]

[1] Comment

[a] Use of Form

This form is official Form LLC-1, "Articles of Organization," used to file an LLC's articles with the Secretary of State. Articles of organization must be filed by every domestic LLC [*see Corp. Code §§ 17050*, *17051*]. Use of this form is mandatory. This form may be obtained from any office of the Secretary of State. However, the form must be filed with the Limited Liability Company Unit in the Sacramento office of the Secretary of State [*see* Secretary of State's LLC form packet].

The articles of organization must be executed by one or more persons, and only one original submitted for filing with the applicable filing fee of $70 [*Corp. Code § 17050(a)*; *see Corp. Code § 17701(b)(fee)*]. For a cover letter to submit with the articles, see *§ 12C.241*.

The articles are a public document and can be changed only by a formal amendment filed with the Secretary of State. Such an amendment requires the unanimous vote of all members unless otherwise stated in the LLC's articles of organization or operating agreement [*Corp. Code § 17054(a)*]. In addition, notwithstanding any provision to the contrary in the articles or operating agreement, in no event may the articles be amended by a vote of less than a majority in interest of the members [*Corp. Code § 17103(b)*]. Therefore, it may be desirable to cover optional matters in the operating agreement rather than the articles.

[b] Contents of Articles of Organization

An LLC's articles of organization must set forth all of the following [*Corp. Code § 17051(a)*]:

- The LLC's name [*see § 12C.21[2]* (name requirements and reservation of name)].

- A statement regarding the LLC's purpose in the form specified by the Act.

- The name of the LLC's initial agent for service of process [*see § 12C.22[1]*]. If an individual is named as agent for service of process, include a business or residence address; if a corporation is designated as agent for service of process and the corporation has filed a certificate pursuant to *Corp. Code § 1505*, do not include an address [*Corp. Code § 17051(a)(4)*; *see* [2], *below* (Instructions for Form LLC-1, item 4)].

- If the LLC is to be managed by managers and not by all of its members, a statement to that effect. If it is to be managed by only one manager, a statement to that effect. If the LLC is to be managed by members, as statement to that effect [*see Corp. Code § 17151(b)*; *see* [2], *below* (Form LLC-1, item 5)].

The articles may include other provisions not inconsistent with law, including provisions limiting or restricting the business or powers of the LLC; governing admission of members; the time when the limited liability company is dissolved; any events that will cause dissolution of the LLC [*see § 12C.25[1]*]; a statement of whether there are limitations on the authority of managers or members to bind the LLC and if so, what they are; and the names of the managers of the LLC [*Corp. Code § 17051(c)*]. Any additional provisions should be added to the articles on separate attached pages. If any provision of the articles of an LLC conflicts with its written operating agreement, the articles control [*Corp. Code § 17005(f)*].

For an illustration of sample attorney-drafted provisions that may be included as an attachment to the operating agreement, see *§ 12C.219*.

[c] Steps Required to Form Limited Liability Company

To form an LLC, several steps are required. The articles of organization must be drafted, executed, and filed along with payment of the applicable fee. The existence of the LLC begins on the date of filing of the articles. Before or after filing the articles, the members of an LLC must enter into a written or oral operating agreement [*Corp. Code § 17050(a)*]. For further discussion of formation issues, see *§ 12C.21*. For a procedural guide to forming a domestic LLC, see *§ 12C.120*. For an operating agreement, see *§ 12C.220*.

[2] FORM

Articles of Organization [Form LLC-1]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.200A

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.200A Limited Liability Company Articles of Organization--Conversion [Form LLC-1A]

[1] Comment

[a] Use of Form

This form is the Secretary of State's official form for limited liability company articles of organization that must be filed by an entity that is converting *to* a California limited liability company *from* some other form of entity. It includes the mandatory statement of conversion required by statute [*see Corp. Code §§ 1155(a)(3)* (conversion from corporation), 15677.6 (conversion from limited partnership), 16906(a) (conversion from general partnership)]. The form is available from any office of the Secretary of State, or can be obtained on the Secretary of State's website as described below.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12C.200A. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

This form is, in effect, a specialized form of limited liability company articles of organization that is to be used when the limited liability company being formed is a preexisting business that is being converted from some other form of business entity, rather than a brand new entity. Newly formed limited liability companies file their articles of organization using Form LLC-1, which is illustrated as § 12C.200. For general discussion of the effect of filing a certificate of limited partnership, see § 15A.200[1].

Entities that are converting *from* California limited liability companies *to* other business entities do not file this form. Rather, they file a statement or certificate of conversion that is appropriate for the type of business entity into which they are converting. For discussion, see *§ 12C.212[1]*.

[b] Requirement for Statement of Conversion

A corporation that is converting into a California limited liability company must complete a statement of conversion of the articles of organization for the converted entity [*Corp. Code § 1155(a)(3)*]. A limited partnership that is converting into a California limited liability company must complete a statement of conversion on the articles of organization for the converted entity [*Corp. Code §§ 15677.6(a)(1)*, 15911.06]. A California general partnership that is converting into a California limited liability company must complete a statement of conversion on the articles of organization for the converted entity if the converting partnership had filed a statement of partnership authority under *Corp. Code § 16303* and that statement is effective at the time of conversion. If a converting partnership has not filed a statement of partnership authority under *Corp. Code § 16303* that is effective at the time of conversion, then the filing of a statement of conversion on its articles of organization is optional [*Corp. Code § 16906(a)*].

This form contains the statement of conversion information.

[2] FORM

Limited Liability Company Articles of Organization--Conversion [Form LLC-1A]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.201

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.201 Certificate of Amendment [Form LLC-2]

[1] Comment

[a] Use of Form

This form is official Form LLC-2, "Certificate of Amendment." To amend an LLC's articles of organization, at least one manager (or one member if the LLC is member-managed) of the LLC (or greater number, if provided in the articles) must file this certificate of amendment with the Secretary of State and pay the applicable fee [*Corp. Code § 17054(b)*; *see Corp. Code § 17701(d)(fee)*]. Subject to the requirement that at least a majority in interest of the members vote to amend [*Corp. Code § 17103(b)*], the members of an LLC may amend its articles at any time [*Corp. Code § 17054(a)*].

Use of this form is mandatory. This form may be obtained from any office of the Secretary of State. However, the form must be filed with the Limited Liability Company Unit in the Sacramento office of the Secretary of State [*see* Secretary of State's LLC form packet].

[b] When to File Certificate of Amendment

The articles of organization of an LLC may be amended at any time. An amendment may make any change in the articles determined by the members and that would be lawful to insert in original articles filed at the time the amendment is filed [*Corp. Code § 17054(a)*]. A certificate of amendment to articles must be filed to effect the following [*Corp. Code § 17054(c)*]:

- A change in the name of the LLC.
- A change in the statement regarding the existence of managers [*Corp. Code § 17151(b)*].

- A change in the time for dissolution of the LLC.
- A change in the events that will cause dissolution of the LLC.

In addition, a certificate of amendment must be filed within 30 days of discovery by a manager (or member in a member-managed LLC) of any false or erroneous material statement in the articles [*Corp. Code § 17054(d)*]. A manager, and presumably a member of a member-managed LLC who filed the original certificate, may be liable for misstatements in a certificate of amendment [*Corp. Code § 17054(e)*; *see § 12C.24[8][b][iii]*].

[c] Contents of Certificate of Amendment

The certificate of amendment must contain the LLC's name, its Secretary of State's file number, and the text of the amendment [*Corp. Code § 17054(b)*].

[2] FORM

Certificate of Amendment [Form LLC-2]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.202

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.202 Certificate of Dissolution [Form LLC-3]

[1] Comment

[a] Use of Form

This form is official Form LLC-3, "Certificate of Dissolution." The managers (or member(s) if the LLC is member-managed) of an LLC must file this certificate with the Secretary of State when the LLC dissolves [*Corp. Code § 17356(a)*; *see* [b], [c], *below*]. A separate filing of a certificate of dissolution is not required, however, if the LLC is dissolved by the vote of all of the members [*see Corp. Code § 17350(b)*] and a statement to that effect is added to the certificate of cancellation of articles [*Corp. Code § 17356(a)(3)*]. After filing this form, the managers of the LLC must wind up the business of the LLC [*Corp. Code §§ 17352, 17353*; *see* [d], *below*].

Use of this form is mandatory. This form may be obtained from any office of the Secretary of State. However, the form must be filed with the Limited Liability Company Unit in the Sacramento office of the Secretary of State [*see* Secretary of State's LLC form packet].

[b] Causes of Dissolution

An LLC must be dissolved, and its affairs wound up, when the first of the following occurs [*Corp. Code § 17350*]:

- When specified in the articles of organization.
- On the happening of events specified in the articles or written operating agreement.
- By the vote of a majority in interest of the members [*see Corp. Code § 17001(v)* (definition)], or greater percentage of the voting interests of members specified in the articles or written operating

agreement.

- Entry of a decree of judicial dissolution pursuant to *Corp. Code § 17351*.

[c] Judicial Dissolution

An LLC may be judicially dissolved pursuant to an action filed by a manager or member when any of the following occurs [*Corp. Code § 17351(a)*]:

- It is not reasonably practicable to carry on the LLC's business in conformity with its articles or operating agreement.

- Dissolution is reasonably necessary for the protection of the rights or interests of the complaining members.

- The LLC's business has been abandoned.

- The LLC's management is deadlocked or subject to internal dissention.

- Those in control of the LLC have been guilty of, or have knowingly countenanced, persistent and pervasive fraud, mismanagement, or abuse of authority.

[d] Winding Up and Filing Certificate of Cancellation

When a limited liability company is dissolved, the managers or members must wind up its affairs. In a judicial dissolution, winding up is conducted in accordance with the decree of dissolution [*Corp. Code § 17352(a)*]. In a nonjudicial dissolution, the managers who have not wrongfully dissolved the LLC or, if none, the members may wind it up. The winding up process requires notification to known creditors and claimants, payment or adequate provision for debts and liabilities and distributions of remaining assets among members according to their respective rights and preferences as specified in the operating agreement, or if the operating agreement does not specify, then pursuant to the Act [*Corp. Code § 17353(a)*; *see Corp. Code § 17353(c)*] or as otherwise specified in articles of organization or the operating agreement.

After the affairs of the LLC have been wound up, a certificate of cancellation (Form LLC-4/7) must be filed with the Secretary of State, canceling the LLC's articles of organization [*Corp. Code § 17356(b)*; *see § 12C.203* (form for certificate of cancellation); *see also Gov. Code § 12190(m)* (no fee)].

[2] FORM

Certificate of Dissolution [Form LLC-3]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesDissolution & Winding UpBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.203

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.203 Certificate of Cancellation [Form LLC-4/7]

[1] Comment

[a] Use of Form

This form is official Form LLC-4/7, "Certificate of Cancellation." This form is used to cancel the existence of a dissolved LLC after its affairs have been wound up and its taxes paid [*see* [b], *below*].

Use of this form is mandatory. This form may be obtained from any office of the Secretary of State. However, the form must be filed with the Limited Liability Company Unit in the Sacramento office of the Secretary of State [*see* Secretary of State's LLC form packet]. For a general discussion of dissolution and winding up, see *§ 12C.26*. For a procedural guide to dissolution and winding up, see *§ 12C.127*.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12C.203. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Filing Certificate of Cancellation

After filing a certificate of dissolution [*see § 12C.202* (form)] and winding up the affairs of an LLC, the members or

managers of the LLC must file a certificate of cancellation with the Secretary of State, canceling the LLC's articles of organization [*Corp. Code § 17356(b)*; *see also Gov. Code § 12190(m)* (no fee)]. If the LLC is dissolved by the vote of all of the members [*see Corp. Code § 17350(b)*] and a statement to that effect is added to the certificate of cancellation, however, a separate filing of a certificate of dissolution is not required [*Corp. Code § 17356(a)(3)*].

The certificate of cancellation may also be used by a foreign LLC to cancel its registration. The form must be signed by a person with the authority to do so under the laws of the jurisdiction of the organization [*Corp. Code § 17455*].

[c] Contents of Certificate

The certificate of cancellation must state the name of the LLC, the Secretary of State's file number, and that a final tax return or final annual tax return has been or will be filed with the Franchise Tax Board [*Corp. Code § 17356(b)(2)(A), (B)*]. The certificate may also set forth any other information that the managers or members filing the certificate of cancellation determine to include [*Corp. Code § 17356(b)(2)(C)*].

[2] FORM

Certificate of Cancellation [Form LLC-4/7]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesDissolution & Winding Up



142 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.203A

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.203A Certificate of Cancellation--Short Form [Form LLC-4/8]

[1] Comment

[a] Use of Form

This form is official Form LLC-4/8, "Short Form Certificate of Cancellation." If a domestic LLC has not conducted any business, then a majority of the members (or if there are no members, a majority of the managers or, if none, the person or majority of the persons signing the articles of organization) may execute and acknowledge a certificate of cancellation of the articles of organization [*see Corp. Code § 17350.5(a)*].

This form, properly executed and acknowledged, must be filed with the Secretary of State within 12 months from the date the articles of organization were filed. The Secretary will notify the Franchise Tax Board of the cancellation [*Corp. Code § 17350.5(b), (d)*].

On the filing of this certificate of cancellation, the LLC is canceled and its powers, rights, and privileges cease [*Corp. Code § 17350.5(c)*].

For further discussion of cancellation, see *§§ 12C.28* and *12C.203*.

[b] Contents of Form

The short-form cancellation certificate must state the name of the LLC, the Secretary of State's file number, and all of the following [*see Corp. Code § 17350.5(a)*]:

- The certificate of cancellation is being filed within 12 months from the date the articles of organization were filed.

- The LLC does not have any debts or other liabilities, other than tax liabilities.

- The final tax return has been or will be filed with the Franchise Tax Board [*see Rev. & Tax. Code § 18401 et seq.*].

- The LLC's known assets remaining after payment of (or adequate provision for) known debts and liabilities have been distributed to the persons entitled to receive them; or that the LLC acquired no known assets.

- The LLC has not conducted any business from the time of the filing of the articles of organization.

- A majority of the managers or members (or, if no managers or members, the person or a majority of the persons signing the articles of organization) voted to dissolve the LLC.

- If the LLC has received payments for interests from investors, those payments have been returned to those investors.

[2] FORM

Certificate of Cancellation--Short Form [Form LLC-4/8]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.204

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.204 Application for Registration [Form LLC-5]

[1] Comment

[a] Use of Form

This form is official Form LLC-5, "Application for Registration." Before transacting business in California, a foreign LLC must register with the Secretary of State [*Corp. Code §§ 17450-17457*] by filing this application, complying with name requirements for the LLC [*see Corp. Code § 17452(b)*], attaching a certificate of good standing [*see Corp. Code § 17451(b)*; *see also* [c], *below*], and paying applicable fees [*Corp. Code §§ 17451*, *17452*; *see* [d], *below*]. This form must be signed by a person with the authority to do so under the laws of the state of the LLC's organization [*Corp. Code § 17451(a)*], and must be executed with an original signature [*see* Instructions to Form LLC-5, item 9]. For a cover letter to submit with the application, see *§ 12C.242*.

This form may be obtained from any office of the Secretary of State. However, the form must be filed with the Limited Liability Company Unit in the Sacramento office of the Secretary of State [*see* Secretary of State's LLC form packet].

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12C.204. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Completing Form

This application must set forth all of the following [*Corp. Code § 17451(a)*; *see* Instructions to Form LLC-5]:

- The name under which the foreign LLC is to be registered and transact business in California and, if different, the name of the foreign LLC as it appears on its articles of organization [*compare Corp. Code § 17451(a)(2) with* Instructions to Form LLC-5, items 1, 2].

- The state or other jurisdiction of formation and the date of its organization [*compare Corp. Code § 17451(a)(2) with* Instructions to Form LLC-5, item 3].

- The name and business or residential address of an agent for service of process on the foreign LLC company meeting the qualifications specified in *Corp. Code § 17061(d)(1)*, unless a corporate agent is designated, in which case only the name of the agent need be set forth [*see* Instructions to Form LLC-5, items 4, 5].

- A statement that the Secretary of State is appointed the agent of the foreign LLC for service of process if the agent has resigned and has not been replaced, or if the agent cannot be found or served with the exercise of reasonable diligence.

- The address of the principal executive office of the foreign LLC.

- The address of the foreign LLC's principal office in California, if any.

If the Secretary of State determines that the application for registration conforms to law and that all requisite fees have been paid, the Secretary will issue a certificate of registration to transact business in California, subject to any licensing requirements [*see Corp. Code § 17452(a)*].

For a general discussion of foreign limited liability companies, including their registration, recognition, governing law, and transaction of business in California, see *§ 12C.11*.

[c] Certificate of Good Standing

A certificate of good standing must be attached to the application for registration. The certificate must be from an authorized public official of the foreign LLC's jurisdiction of organization, stating that the foreign LLC is in good standing in that jurisdiction. If the laws of that jurisdiction do not permit the issuance of a certificate of good standing, a statement by the foreign LLC that the laws of its jurisdiction of organization do not permit the issuance of this certificate must be attached to the application [*Corp. Code § 17451(b)*].

[d] Filing Fees

An application for registration must be accompanied by the applicable filing fee [*Corp. Code §§ 17451*, *17452*; *see Gov. Code § 12190(c)(fee)*]. If the accompanying remittance is not paid on presentation, the Secretary of State may cancel the application and certificate of registration of the foreign LLC [*Corp. Code § 17451(c)*]. After receiving written notification that the remittance was not honored, the Secretary must give written notice to the agent for service of process or the person submitting the application. If the fee is not then paid by cashier's check or its equivalent, the Secretary will give a second written notice of cancellation, within 90 days after the original filing and at least 20 days after the first notice, and the cancellation automatically takes effect [*Corp. Code § 17451(c)*].

Foreign LLCs registered with the Secretary of State are subject to the annual minimum franchise tax and should pay it

on or before the 15th day of the fourth month after the close of their tax year [*Rev. & Tax. Code § 17941*].

[2] FORM

Application for Registration [Form LLC-5]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.205

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.205 Certificate of Amendment [Form LLC-6]

[1] Comment

[a] Use of Form

This form is official Form LLC-6, "Certificate of Amendment," for use by a foreign LLC in amending its application for registration (Form LLC-5) [*see § 12C.204*; *see also* [b], *below*].

Use of this form is mandatory. This form may be obtained from any office of the Secretary of State. However, the form must be filed with the Limited Liability Company Unit in the Sacramento office of the Secretary of State [*see* Secretary of State's LLC form packet].

ELECTRONIC FORMS NOTE:

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[b] When to File Certificate of Amendment

If any statement in the foreign LLC's application for registration was false when made, or any statements made then have become erroneous, the foreign LLC must promptly file an amendment to the application for registration in the

office of the Secretary of State. The certificate of amendment must be signed by a person with authority to do so under the laws of the state of its organization [*Corp. Code § 17454*]. In addition, the foreign LLC must pay the applicable fee [*see Gov. Code § 12190(f)*].

For a general discussion of foreign LLCs, including their registration and recognition under California's law, the governing law of the foreign LLC's state of organization, and their transaction of business in California, see *§ 12C.11*.

[2] FORM

Certificate of Amendment [Form LLC-6]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.206

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.206 Certificate of Continuation [Form LLC-8]

[1] Comment

[a] Use of Form

This form is official Form LLC-8, "Certificate of Continuation." It is used after a certificate of dissolution has been filed to continue the existence of an LLC and cancel the effect of the certificate of dissolution [*Corp. Code § 17357(a)*; *see* [b], *below*].

Use of this form is mandatory. This form may be obtained from any office of the Secretary of State. However, the form must be filed with the Limited Liability Company Unit in the Sacramento office of the Secretary of State [*see* Secretary of State's LLC form packet].

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12C.206. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Effect of Filing Certificate of Continuation

Even if a certificate of dissolution has been filed [*see § 12C.202*], a majority in interest of the members of an LLC may

file a certificate of continuation with the Secretary of State [*Corp. Code § 17357(a)*]. On that filing and payment of the applicable fee [*see Gov. Code § 12190(h)*], the certificate of dissolution is of no effect [*Corp. Code § 17357(c)*].

A certificate of continuation may be filed in the following situations [*Corp. Code § 17357(a)*]:

- The business of the LLC is to be continued pursuant to a unanimous vote of the remaining members.
- The dissolution of the LLC was by vote of the members pursuant to *Corp. Code § 17350(b)* and each member who consented to the dissolution has agreed in writing to revoke that member's vote in favor of or consent to the dissolution.
- The LLC was not, in fact, dissolved.

For a general discussion of continuation of existence after dissolution, see *§ 12C.26[3]*.

[c] Contents of Certificate of Continuation

The certificate of continuation must contain all of the following [*Corp. Code § 17357(b)*]:

- The name of the LLC.
- The Secretary of State's file number of the LLC.
- The grounds provided by *Corp. Code § 17357(a)* that are the basis for filing the certificate of continuation.

[2] FORM

Certificate of Continuation [Form LLC-8]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesDissolution & Winding Up



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.207

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.207 Certificate of Merger [Form OBE MERGER-1]

[1] Comment

[a] Use of Form

This form is official Form OBE MERGER-1, "Certificate of Merger." This form is used by a foreign or domestic LLC to report a merger with other LLCs or other entities to the Secretary of State [*see Corp. Code § 17552*; *see also* [b], *below*]. This form must be accompanied by the applicable fee [*Gov. Code § 12190(i), (j)*]. If the LLC is merging with one or more LLCs, the fee is $70 [*Gov. Code § 12190(i)*]. If one or more LLCs are merging with one or more other business entities, the applicable fee is $150 [*Gov. Code § 12190(j)*].

Use of this form is mandatory. This form may be obtained from any office of the Secretary of State.

The certificate of merger must be mailed or hand delivered for over-the-counter processing to the Sacramento office. They cannot be filed in the regional offices. The address for filing is:

Secretary of State
Attention: Document Filing Support Unit
1500 11th St., 3d Floor
Sacramento, CA 95814

The form is reproduced here along with the Secretary of State's official information and instructions pertaining to the filing and use of the form.

ELECTRONIC FORMS NOTE:
Electronic copies of this form that may be printed out and filled in for filing can be obtained at the

official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12C.207. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Merger of Limited Liability Companies

One or more LLCs may merge with any other business entity or entities [*Corp. Code § 17550(a), (b)*] if the other entity or entities are authorized to do so by its governing law. This applies to domestic as well as foreign LLCs and other business entities [*Corp. Code § 17555*]. Every constituent business entity in the merger must approve an agreement of merger before the filing of the certificate of merger. Ordinarily, the agreement of merger must be approved by the vote of a majority of interest of the members [*Corp. Code § 17551(a)*]. For an agreement of merger, see *§ 12C.230*.

Mergers are effective on filing of the certificate of merger unless that document provides for a delayed effective date [*Corp. Code § 17553*]. At the effective date, existence of the disappearing business entities ceases, and the surviving entity succeeds automatically to the rights, property, debts, and liabilities of the disappearing entities [*Corp. Code § 17554*].

For a more detailed discussion of mergers and reorganizations, including dissenters rights, see *§ 12C.25*. For a procedural guide to mergers and dissenters' rights, see *§ 12C.126*. For forms related to dissenters' rights, see *§§ 12C.231* and *12C.232*.

[c] Contents of Certificate of Merger

The certificate of merger must contain all of the following [*Corp. Code § 17552(a)*]:

- The name of each constituent business entity.
- The Secretary of State's file number, if any, of each constituent business entity.
- A separate listing of the disappearing and surviving business entities.
- If a vote of the members of each entity was required [*see Corp. Code § 17551*], a statement about those votes.
- If the surviving entity is an LLC, any changes required to its articles of organization.
- If the merger is not to be effective on filing of the certificate, the future effective date of merger.
- If the surviving entity is not a domestic LLC, a description of that entity.
- Any other information required to be stated in the certificate of merger.

The certificate of merger must be executed and acknowledged by each constituent business entity [*Corp. Code § 17552(a)*].

[2] FORM

Certificate of Merger [Form OBE MERGER-1]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesFormationMergers & Acquisitions LawGeneral Overview



147 of 177 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.208

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.208 Restated Articles of Organization [Form LLC-10]

[1] Comment

[a] Use of Form

This form is official Form LLC-10, "Restated Articles of Organization." An LLC's articles of organization may be restated at any time by filing this form with the Secretary of State [*Corp. Code § 17054(f)*] and paying the applicable fee [*see Gov. Code § 12190(e)*].

Use of this form is mandatory. This form may be obtained from any office of the Secretary of State. However, the form must be filed with the Limited Liability Company Unit in the Sacramento office of the Secretary of State [*see* Secretary of State's LLC form packet].

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[b] Filing Restated Articles of Organization

The articles of organization of an LLC may be restated at any time to change any of the information required to be

included in the articles. If the name of the LLC is to be changed by filing the restated articles of organization, the old and new name must be set forth, indicating the intent to change the name. Either this form or a Form LLC-12 may be used to change the LLC's agent for service of process or the address of an individual designated as agent for service of process [Secretary of State's LLC form packet]. The restated articles may set forth the name of the agent for service of process (and address if the agent is an individual). If the restated articles include the agent for service of process, any previous statements of information [*see § 12C.210* (Form LLC-12)] are superseded as to the agent for service or process until another statement of information is subsequently filed [*Corp. Code § 17054(f)*].

The restated articles must include the name of the LLC, the Secretary of State's file number of the LLC, and any other information required to be included in the original articles of organization [*Corp. Code § 17054(f)*; *see Corp. Code § 17051*; *see also § 12C.200[1][b]* (contents of articles of organization)].

[2] FORM

Restated Articles of Organization [Form LLC-10]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.209

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.209 Certificate of Correction [Form LLC-11]

[1] Comment

[a] Use of Form

This form is official Form LLC-11, "Certificate of Correction." This form is used to correct any document required to be filed with the Secretary of State [*Corp. Code § 17055*; *see* [b], *below*].

Use of this form is mandatory. This form may be obtained from any office of the Secretary of State. However, the form must be filed with the Limited Liability Company Unit in the Sacramento office of the Secretary of State [*see* Secretary of State's LLC form packet].

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12C.209. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Completing Certificate of Correction

If any LLC document filed with the Secretary of State contains any typographical error, error of transcription, or other technical error, or has been defectively executed, the document may be corrected by filing a certificate of correction

with the Secretary of State [*Corp. Code § 17055(a)*] and paying the applicable fee [*see Gov. Code § 12190(g)*].

The certificate of correction must set forth all of the following [*Corp. Code § 17055(b)*]:

- The name and Secretary of State's file number of the LLC.
- The title of the document being corrected.
- The name of each part to the document being corrected.
- The date that the document being corrected was filed.
- The provision in the document as previously filed and as corrected and, if execution of the document was defective, the manner in which it was defective.

The certificate of correction must be executed in the same manner the document being corrected was required to be executed [*Corp. Code § 17055(d)*].

A certificate of correction may not make any other change or amendment that would not have complied in all respects with the requirements of the LLC Act at the time the document being corrected was filed [*Corp. Code § 17055(c)*]. In any case, a certificate of correction may not change the effective date of the document being corrected. Similarly, it may not affect any right or liability accrued or incurred before its filing, except that any right or liability accrued or incurred by reason of the error or defect being corrected will be extinguished by the filing if the person having the right or to whom the liability is owed has not detrimentally relied on the original document [*Corp. Code § 17055(e)*].

[2] FORM

Certificate of Correction [Form LLC-11]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.210

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.210 Statement of Information [Form LLC-12]

[1] Comment

[a] Use of Form

This form is official Form LLC-12, "Statement of Information." Every domestic and foreign LLC must file a statement of information with the Secretary of State within 90 days after filing its original articles of organization (or application for registration) and biennially thereafter [*Corp. Code § 17060(a)*; *see* [c], [d], *below*]. An LLC is required to file this statement even if it is not actively engaged in business when the statement is due [*see* Instructions to Form LLC-12]. A fee of $20 must accompany each statement [*see Gov. Code § 12190(k)*]. The contents requirements are the same for the initial statement and biennial statements [*see* [b], *below*].

This form (Form LLC-12) should be used for making the initial filing of the statement of information. For subsequent biennial renewal filings, Form LLC-12R should be used instead of this form. Form LLC-12R is reproduced in this publication in § 12C.210A. The *comment in § 12C.210A[1]* discusses the biennial filing requirements that apply after the initial filing has been made. Apparently, either this form or Form LLC-12R may be used to change the name or street address of an LLC's agent for service of process or to make the optional change-of-information filings authorized by *Corp. Code § 17060(d)* [*see § 12C.210A[1][d]*].

Use of this form is mandatory. This form may be obtained from any office of the Secretary of State. However, the form must be filed with the Limited Liability Company Unit in the Sacramento office of the Secretary of State [*see* Secretary of State's LLC form packet].

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at

http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12C.210. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Contents of Statement of Information

The initial statement of information must include all of the following [*Corp. Code § 17060(a)*]:

- The name of the LLC.
- The Secretary of State's file number of the LLC.
- For a foreign LLC, the state or country of formation.
- The name of its agent for service of process [*see Corp. Code § 17057(b)*]. If an individual is named as agent for service of process, include a business or residence address; if a corporation is designated as agent for service of process and the corporation has filed a certificate under *Corp. Code § 1505*, do not include an address [*see* [2], *below* (Instructions for Form LLC-12, item 4)].
- The street address of its principal executive office.
- For a domestic LLC, the street address of the office containing its records [*see Corp. Code § 17057(a)*].
- The name and complete business or residence address of the managers, if any, and the chief executive officer, if any.
- If there are no managers, the name and business or residence address of each member.
- The general type of business that constitutes the principal business activity of the LLC.

[c] Filing Initial Statement

The initial statement of information must be filed within 90 days after one of the following [*Corp. Code § 17060(a)*]:

- For a domestic LLC, filing the original articles of organization.
- For a foreign LLC, filing the application for registration.

The Secretary of State will endorse one copy of the filed statement at no additional cost, provided that the copy is submitted along with the original being filed [*see* Instructions to Form LLC-12].

[d] Failure to File

Failure to file the completed statement by the due date may result in assessment of a $250 penalty [*see Corp Code § 17651(b)*]. An LLC that does not file also is subject to possible suspension of its powers and rights [*Corp. Code §§ 17653, 17654*].

[2] FORM

Statement of Information [Form LLC-12]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormation



150 of 177 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.210A

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.210A Statement of Information Renewal [Form LLC-12R]

[1] Comment

[a] Use of Form

This form is official Form LLC-12R, "Statement of Information." Domestic and foreign LLCs registered to transact interstate business in California must file this statement biennially [*see* [b], *below*, for discussion of the applicable filing period].

This form (Form LLC-12R) should be used only for renewal filings. It should *not* be used for making the initial filing of the Statement of Information, which must be filed within 90 days after the LLC files its original Articles of Organization (or application for registration) [*Corp. Code § 17060(a)*]. Form LLC-12 should be used for making initial filings, instead of this form. Form LLC-12 is reproduced in this publication in § 12C.210. The *comment in § 12C.210[1]* discusses the initial filing requirements, as well as the content of the statement, and other matters that are applicable to this form and are not repeated here.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12C.210A. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

A LLC is required to file the statement even if it is not actively engaged in business at the time the statement is due [*see Corp. Code § 17060(a)* (filing requirement extends to "every" LLC registered to transact intrastate business in California); *see also* Instructions to Form LLC-12R].

[b] Applicable Filing Period

After the initial statement is filed, the statement of information must be filed biennially thereafter, during the applicable filing period [*Corp. Code § 17060(a), (c)*]:

- For a domestic LLC, the calendar month in which the original articles were filed and the preceding five months.

- For a foreign LLC, the calendar month in which the application for registration was filed and the preceding five months.

Approximately three months before the close of the applicable filing period, the Secretary will mail the statement of information to the last known address of the LLC on record. However, he failure to receive a statement of information from the Secretary of State does not exempt an LLC from complying with the law [*see Corp. Code § 17060(c)*].

The Secretary of State will endorse one copy of the filed statement at no additional cost, provided that the copy is submitted along with the original being filed [*see* Instructions to Form LLC-12R].

[c] "No Change" Filings

If there has been no change in the information contained in the last Statement of Information on file with the Secretary of State, the person filling out the form for the LLC may simply check the "no change" box and execute the form. However, if there have been *any* changes to the information in the form, the statement must be completed *in its entirety*.

[d] Change of LLC's Agent, Agent's Address, or Other Information

When the name or street address of an LLC's agent for service of process changes, a new complete current statement of information *must* be filed. When any other information required by *Corp. Code § 17060(a)* changes, a current statement of information *may* be filed [*Corp. Code § 17060(d)*].

It appears that the mandatory and optional filings noted in the preceding paragraph may be made using either Form LLC-12R (this form) or Form LLC-12 (the *form in § 12C.210*). Although the instructions to the forms do not expressly state that either form may be used, both sets of instructions do note that there is no fee for filing changes of information to initial or biennial statements.

A statement changing the name and address of the agent for service of process supersedes any previously filed statement and any statement in the original or restated articles of organization, or application for registration in the case of a foreign LLC. However, any subsequent filing of restated articles of organization containing a statement of the name and address of the LLCs agent for service of process supersedes any previously filed statement of information [*Corp. Code § 17060(d)*].

[e] Failure to File

Failure to file the completed statement by the due date may result in assessment of a $250 penalty [*see Corp Code § 17651(b)*]. An LLC that does not file also is subject to possible suspension of its powers and rights [*Corp. Code §§ 17653*, *17654*].

[2] FORM

Statement of Information Renewal [Form LLC-12R]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.211

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.211 Resignation of Agent for Service of Process [Form RA-100]

[1] Comment

[a] Use of Form

This form is official Form RA-100, "Resignation of Agent for Service of Process." This form is for use by a resigning agent for service of process to notify the Secretary of State of the resignation [*see Corp. Code § 17061(d)(2)*; *see also* [b], *below*]. Unlike the Secretary of State's other LLC forms illustrated in this chapter, use of this form is *not* mandatory. It is provided for the convenience of the resigning agent. The resigning agent may alternatively notify the Secretary of State of his or her resignation with a letter of resignation. When notified of the resignation, the Secretary of State will provide written notice of the resignation to the LLC [*see* Secretary of State's LLC form packet].

This form may be obtained from any office of the Secretary of State. However, if used, the form must be filed with the Limited Liability Company Unit in the Sacramento office of the Secretary of State [*see* Secretary of State's LLC form packet].

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12C.211. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Resignation of Agent for Service of Process

A domestic LLC's articles of organization (and a foreign LLC's application for registration) must provide the name and address of the LLC's agent for service of process in California [*Corp. Code §§ 17051(a)(4), 17061(d)(1)*]. The agent may resign at any time by filing with the Secretary of State a signed and acknowledged written statement of resignation as agent. On filing of the statement, the authority of the agent ceases, and the Secretary of State will give written notice to the LLC at its principal executive office of the agent's resignation [*Corp. Code § 17061(d)(2)*].

On resignation of its agent for service of process, an LLC must appoint a new agent and inform the Secretary of State of the name and address of the new agent [*see Corp. Code § 17061(d)(1)*]. Information about the new agent can be filed on the statement of information (Form LLC-12) [*see § 12C.210* (form)].

[2] FORM

Resignation of Agent for Service of Process [Form LLC-100]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.212

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.212 Certificate of Conversion [Form CONV-1A]

[1] Comment

[a] Use of Form

This form is the Secretary of State's official form for a certificate of conversion, together with the accompanying official instructions. This form is filed with the Secretary of State in the following situations involving LLC conversions:

- By a California limited liability company that is converting into a foreign limited liability company or a foreign other business entity [*see Corp. Code § 17540.6(a)(4)*; *see also* [b], *below*]. Except as noted below, California limited liability companies that are converting into other California business entities should file a statement of conversion using the form that is appropriate for the type of business entity into which they are converting [*Corp. Code § 17540.6(a)(1), (2)*; *see* [c], *below*].

- By a California limited liability company that is converting into a California general partnership *if no statement of partnership authority is filed* [Corp. Code §§ 15677(a)(2) (limited partnership), 17540.6(a)(2) (limited liability company); *see* Ch. 15, Part C, *Conversions and Mergers of General Partnerships* , § 15.801 (statement of partnership authority)].

- By a California general partnership or limited partnership that is converting to a foreign limited liability company [*see* Corp. Code §§ 15677(a)(3) (limited partnership), 16906(b)(general partnership)]. For discussion, see Ch. 15, Part C, *Conversions and Mergers of General Partnerships* , and Ch. 15C, *Conversions and Mergers of Limited Partnerships*, respectively.

This form is available from any office of the Secretary of State, or can be obtained on the Secretary of State's website as described below.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12C.212. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Statutory Requirements for Certificate of Conversion--Conversion to Foreign Limited Liability Company or Other Business Entity

Corp. Code § 17540.6(a)(4) provides that a California limited liability company that is converting into a foreign limited liability company or a foreign other business entity--that is, any other business entity formed under the laws of any state other than California or under the laws of a foreign country [*see Corp. Code § 17001(s)*]--must file a certificate of conversion with the Secretary of State [Corp. Code § 15740.6(a)(4)].

The required contents of a certificate of conversion are specified by statute [*see* Corp. Code § 15740.6(b)] and incorporated into this form. While the statute does not mandate that the official form be used for filing a certificate of conversion [*see Corp. Code § 17540.6*], there is no reason to draft a non-standard form, nor is there any guarantee that such a form would be readily accepted by the Secretary of State's office in lieu of the official form.

[c] Statutory Requirements for Statement of Conversion--Conversion to Domestic Entities

In most cases, this form is not appropriate for California limited liability companies that are converting to other California business entities. In most cases, a *statement* of conversion, rather than a *certificate* of conversion, is filed as discussed below [Corp. Code § 17640.6(a)(1), (2)].

If the limited liability company is converting to a California limited partnership, a statement of conversion must be completed on the certificate of limited partnership of the converted entity [*Corp. Code § 17540.6(a)(1)*].

If the limited liability company is converting into a California general partnership, a statement of conversion must be completed on the statement of partnership authority for the converted entity. If the limited liability company is converting into a California general partnership and no statement of partnership authority is filed, however, a certificate of conversion (this form) must be filed separately [*Corp. Code § 17540.6(a)(2)*].

If the limited liability company is converting into a California domestic corporation, a statement of conversion must be completed on the articles of incorporation for the converted entity [*Corp. Code §§ 1157(d), (e), 17540.6(a)(3)*; *see § 12C.126[2]*, P 5(c)(1); *see also § 12C.213*].

The contents of the statement of conversion are specified by statute [*see Corp. Code § 17540.6(b)*] and are reflected in the forms promulgated by the Secretary of State. These forms are to be filed as follows:

- A limited liability company that is converting into a California limited partnership will file Form LP-1A, Certificate of Limited Partnership--Conversion [*see* Ch. 15C, *Conversions and Mergers of Limited Partnerships*, § 15C.205]. That form includes the appropriate Statement of Conversion.

- A limited liability company that is converting into a California general partnership will file Form GP-1A, General Partnership Statement of Partnership--Conversion [*see* Ch. 15, Part C, *Conversions and*

Mergers of General Partnerships , § 15.801]. That form includes the appropriate Statement of Conversion. (If no partnership statement is filed, then this form, Form CONV-1A, must be filed separately.)

- A limited liability company that is converting into a California corporation will include a statement of conversion in the new entity's articles of incorporation. For an illustration of the Secretary of State's sample articles of incorporation containing statement of conversion language, see *§ 12C.213[2]*.

[d] Effect of Filing Certificate of Conversion

The filing of a certificate of conversion with the Secretary of State has the same effect as the filing of a certificate of cancellation by the converting limited liability company. No limited liability company that has made the filing is required to file a certificate of dissolution or a certificate of cancellation as a result of the conversion [Corp. Code § 15740.6(c)].

Once the statement of conversion has been filed, certified copies of the statement may be recorded in the county recorder's office of counties where the limited liability company held real property. Recordation provides notice to third parties and also provides a title chain for the real property for title insurance purposes [*Corp. Code § 17540.7*]. Furthermore, recordation will create, in favor of bona fide purchasers or encumbrancers for value, a conclusive presumption that the conversion was validly completed [Corp. Code § 15740.7(c)].

[2] FORM

Certificate of Conversion to Foreign Other Business Entity [Form All Entity-1A]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesDissolution & Winding UpBusiness & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesMergers & Acquisitions LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide § 12C.213

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.213 Articles of Incorporation With Statement of Conversion

[1] Comment

[a] Use of Form

This form is a sample set of articles of incorporation containing a statement of conversion for use by limited liability companies converting into California general stock corporations. It is modeled after the sample provided by the Secretary of State, and satisfies the minimum statutory requirements [*see Corp. Code §§ 200, 1150, 1157, 17540.1*]. A sample also is available on official website of the California Secretary of State, Business Programs Division, which is located at www.ss.ca.gov/business/business.htm. However, the sample is illustrative only, and cannot be filled in and submitted in the form reproduced on the website. The Secretary of State's office advises that this sample may be used as a guide in preparing articles. The Secretary of State's office further advises that modifications can be made to add permissive provisions and/or to meet the specific statutory requirements for a professional or close corporation. The Secretary of State's office does not provide a standardized form due to the many possible drafting variations. For general discussion of articles of incorporation, including the statutory requirements for articles of incorporation as well as mandatory and optional provisions for corporate articles, see Ch. 3, *Articles of Incorporation* .

[b] Mandatory Provisions

Article I must be completed with the name of the corporation exactly as the name is to appear on the records of the Secretary of State.

Article II contains language required by the Secretary of State and cannot be modified.

Article III must be completed with the name of the initial agent for service of process, as well as the address if an individual is designated as agent.

Article IV must include the total number of shares that the corporation will be authorized to issue.

Article V contains the statement of conversion [*see Corp. Code §§ 1157, 17540.6*]. If the class of interests entitled to vote or the percentage vote required differs from the sample, the articles must be modified accordingly.

[c] Execution, Filing, and Fees

The statement of conversion must be signed and acknowledged by all of the managers of the limited liability company, unless a lesser number is provided in the articles of organization or operating agreement. If initial directors are named in the in the articles, additional signatures and acknowledgments will be required as the articles must also be signed by any named initial directors. If initial directors are not named in the articles, the individuals executing the articles are the incorporators [*see Corp. Code § 200(b)*; *see* [2], *below* (instructions)].

The original and at least two copies of the completed documents are mailed or hand delivered to the Secretary of State, together with the applicable fee [*see* Office of Secretary of State, State of California, Conversion of a California Limited Liability Company Into a California Stock Corporation, Information Sheet]. These articles of incorporation must be mailed or hand-delivered for over-the-counter processing at the Sacramento office. The articles cannot be filed in the regional offices, and cannot be processed using the preclearance, expedite, wait for or rush letter service. To facilitate processing, articles of incorporation submitted by mail should be accompanied by a self-addressed envelope and a letter referencing the proposed corporate name as well as the name, telephone number, and return address of the person filing the articles [*see* Office of Secretary of State, State of California, Conversion of a California Limited Liability Company Into a California Stock Corporation, Information Sheet]. The articles of incorporation must be accompanied by the applicable filing fee [*see Gov. Code § 12186(c), (d)*].

The original and at least two copies should be included with the submission. The Secretary of State will compare and certify up to two copies of the articles at no charge provided that the copies are submitted with the original to be filed [*Gov. Code § 12185*]. If additional certified copies are required, an additional minimal fee is charged, provided that the copies are furnished to the Secretary of State and the fee is prepaid [*Gov. Code §§ 12182, 12183*]. A separate and nonrefundable handling fee is charged for processing documents delivered in person at the Sacramento office. The handling fee must be remitted by separate check for each submittal. Check(s) should be made payable to the Secretary of State [*see* Office of Secretary of State, State of California, Conversion of a California Limited Liability Company Into a California Stock Corporation, Information Sheet].

[2] FORM

Articles of Incorporation With Statement of Conversion

ARTICLES OF INCORPORATION WITH STATEMENT OF CONVERSION

I.

The name of the corporation is _____[*name of corporation*].

II.

The purpose of this corporation is to engage in any lawful act or activity for which a corporation may be organized under the GENERAL CORPORATION LAW of California other than the banking business, the trust company business or the practice of a profession permitted to be incorporated by the California Corporations Code.

III.

The name and address in the State of California of this Corporation's initial agent for service of process is

Name _____

[*Include only if designated agent is an individual:*]

Street address _____

City _____, California Zip _____

[*Continue with the following*:]

IV.

The corporation is authorized to issue only one class of shares of stock; and the total number of shares which this corporation is authorized to issue is _____.

V.

The name of the converting California limited liability company is _____[*name*]. The limited liability company's California Secretary of State file number is _____. The principal terms of the plan of conversion were approved by a vote of the members, which equaled or exceeded the vote required under *Corp. Code § 17540.3*. There is one class of members entitled to vote and the percentage vote required is a majority in interest of the members. The limited liability company is converting into a California stock corporation.

It is hereby declared that I am the person who executed this instrument, which execution is my act and deed.

_____ [*signature of manager*]
[*typed name*], Manager of _____ [*LLC name*] and Incorporator
_____ [*signature of manager*]
[*typed name*], Manager of _____ [*LLC name*] and Incorporator

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesDissolution & Winding UpBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



154 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
A. Official Forms of the Secretary of State

6-12C California Legal Forms--Transaction Guide §§ 12C.214-12C.218

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

[Reserved]

§§ 12C.214[Reserved]

155 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
B. Operating Agreement and Related Forms

6-12C California Legal Forms--Transaction Guide § 12C.219

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.219 Attachment to LLC Articles of Organization

[1] Comment

[a] Use of Form

This form is an attachment to the articles of organization of a California LLC. The articles of organization are filed on a one-page statutory form, which must be filed with the Secretary of State. The applicable statutory form includes a check box to note the number of pages of additional attachments [*see §§ 12C.200[2]*, P 7 (formation), 12C.200A[2], P 8 (conversion)]. The additional provisions should be added to the articles on separate attached pages and keyed to the paragraph number of the statutory form.

The articles of organization may include other provisions not inconsistent with law, including provisions limiting or restricting the business or powers of the LLC; governing admission of members; the time when the limited liability company is dissolved; any events that will cause dissolution of the LLC [*see § 12C.25[1]*]; a statement of whether there are limitations on the authority of managers or members to bind the LLC and if so, what they are; and the names of the managers of the LLC [*Corp. Code § 17051(c)*]. If any provision of the articles of an LLC conflicts with its written operating agreement, the articles control [*Corp. Code § 17005(f)*].

Because the articles of organization are a public document and can be changed only by amendment filed with the Secretary of State and, unless otherwise provided in the articles or a written operating agreement, require the unanimous vote of all members for their amendment, caution should be exercised when determining whether to include optional matters in the articles.

[b] Contents of Form

The provisions in this form are important to the structure, continuity, and dissolution of the LLC. In general, they

provide notice of their existence and refer to the operating agreement. Specifically, these provisions include:

- Restrictions on the admission of new members [*see § 12C.219[2]*, P A].
- Provisions as to the nature and transferability of membership interests [*see § 12C.219[2]*, P B, C].
- Provisions as to dissolution and continuity [*see § 12C.219[2]*, P D, E].
- Statement that the LLC will be regulated by the articles and a written operating agreement [*see § 12C.219[2]*, P F].
- Provisions as to indemnification [*see § 12C.219[2]*, P G].
- Provisions governing the amendment of the articles of organization [*see § 12C.219[2]*, P H].

[2] FORM

Attachment to LLC Articles of Organization

ATTACHMENT TO LIMITED LIABILITY COMPANY
ARTICLES OF ORGANIZATION OF
_____ [*name*]

_____ **A. Restrictions on Admission of a New Member.**

The members may admit to the LLC one or more additional members who shall participate in the profits, losses, available cash flow, and ownership of the assets of the LLC only on the terms and conditions set forth in the Operating Agreement, as amended from time to time.

_____ **B. Restrictions on Transfer of Membership Interests.**

The transfer of a member's membership interest may be effectuated only on the terms and conditions as are set forth in the Operating Agreement, as amended from time to time.

_____ **C. Nature and Transferability of Membership Interest.**

The interest of each member of the LLC constitutes the personal estate of that member and may be transferred or assigned as provided in these Articles of Organization, as amended from time to time, and the Operating Agreement, as amended from time to time. However, if the members of this LLC, other than the member proposing to dispose of his, her or its interest, do not unanimously approve of the proposed transfer or assignment by written consent, the transferee of the membership interest will have no right to participate in the management of the business and affairs of this LLC or to become a member. Without the requisite unanimous written consent, the transferee of the membership interest holds only an economic interest and is entitled only to an allocation of the share of net profits, net losses, distributions and returns of capital to which the transferring member would otherwise be entitled.

_____ **D. Dissolution and Continuity.**

The LLC will be dissolved and wound up on the occurrence of any of the following events:

a. When the period fixed for the duration of the LLC in these Articles of Organization expires, if limited; or

b. A determination by the unanimous written agreement of all members; or

c. By entry of a decree of judicial dissolution of the LLC pursuant to *California Corporations Code 17352*; or

d. The sale of all, or substantially all, of the assets of the LLC unless all members consent in writing to the continuation of business by the LLC; or

e. Any other event or circumstances provided in the Operating Agreement as a condition for or as an event of dissolution.

_____ **E. Continuation of Business.**

The LLC will not be dissolved or wound up solely as a result of the death, retirement, withdrawal, resignation, expulsion, bankruptcy or dissolution of a member, or the occurrence of any other disassociation event that terminates the continued membership of a member in the LLC except as otherwise provided by the Beverly-Killea Limited Liability Company Act, as amended from time to time. On the occurrence of any disassociation event described in the preceding sentence and as otherwise permitted by the Beverly-Killea Limited Liability Company Act, the remaining members or member will continue the business of the LLC unless [the remaining member *or* all the remaining members] by action or resolution duly made under the Operating Agreement approve and authorize the dissolution and winding up of the LLC.

_____ **F. Regulation of Business and Affairs.**

The business and affairs of the LLC will be regulated by a written Operating Agreement between the LLC and its members consistent with the legal requirements and provisions of the Beverly-Killea Limited Liability Company Act as amended from time to time and these Articles of Organization as amended from time to time.

_____ **G. Indemnifications.**

The LLC may indemnify any manager, member, officer, employee or agent of the LLC incurred as result of action in that capacity and made a party to a proceeding as a result of action against judgments, settlements, penalties, or expenses of any kind, only on the terms and conditions as are set forth in the Operating Agreement as may amended from time to time,

The indemnification of expenses may only be authorized by the Operating Agreement and the unanimous written consent or agreement approved by all of the members. The Articles of Organization will not be interpreted to limit in any manner the power of the LLC to provide indemnification, to purchase any insurance, or to advance expenses of a person who would otherwise be entitled thereto.

In addition to the foregoing, the LLC will indemnify and hold the organizer harmless for all acts taken as organizer of the LLC, and will pay all costs and expenses incurred by or imposed on the organizer as a result of the same, including compensation based on the usual charges for any time expenditures required of the organizer in pursuit of the defense against any liability arising on the account of acting as organizer, or arising on the account of enforcing the indemnification right under these Articles, and the LLC releases the organizer from all liability for any act as organizer not involving willful or grossly negligent misconduct.

_____ **H. Amendments.**

Amendments to the Articles of Organization of the LLC will be adopted by vote of the members as set forth in the

Operating Agreement or with the unanimous written consent of the members, but in no event will the Articles of Organization be amended by a vote or written consent representing less than a majority-in-interest of the members. For purposes of amending the Articles of Organization, a majority-in-interest means members holding more than _____ percent of the interest of members in net profits for the current annual period and the capital account balances of the LLC determined under the Operating Agreement as amended as of the date of the proposed action to amend.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



156 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
B. Operating Agreement and Related Forms

6-12C California Legal Forms--Transaction Guide § 12C.220

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.220 Manager-Managed LLC Operating Agreement--Short Form

[1] Comment

[a] Use of Form

This form is a skeletal manager-managed operating agreement for a California LLC. It is intended to provide a basic outline of what an operating agreement should cover. It should be modified to meet the particular operating needs of the LLC being formed.

The members of an LLC must enter into an operating agreement either before or after the filing of the LLC's articles of organization [*Corp. Code § 17050(a)*]. An "operating agreement" is any agreement among all the members as to the affairs of the LLC and the conduct of its business in a manner not inconsistent with law or the LLC's articles, including amendments to those articles. For a foreign LLC, all documents that serve a like function under the laws of the jurisdiction in which the foreign LLC is organized is defined as an operating agreement under the California Act [*Corp. Code § 17001(ab)*]. An operating agreement may be written or oral, and it may be as simple as an agreement to organize an LLC [*Corp. Code § 17001(ab)*]. In most cases, it is best to have a written operating agreement, since it is likely to be the key document of an LLC. The operating agreement is not filed with the office of the Secretary of State [Secretary of State's LLC form packet].

Many of the same types of provisions typically found in corporate bylaws or partnership agreements may be appropriate in a LLC operating agreement if the members so desire. For a variety of corporate bylaw provisions, see Ch. 4, *Bylaws* . For partnership provisions, see Ch. 15, Part A, *Formation of General Partnerships* . For other provisions that may be appropriate to this type of agreement, see Ch. 8C, *Close Corporation Shareholder Agreements* . The complexity of the agreement depends on the drafter and the wishes of the members.

This form is drafted for manager-managed LLC that will have more than one member, and it contains provisions

appropriate in that situation. However, effective January 1, 2000, California LLCs are permitted to have only a single member [*Corp. Code §§ 17001(t), 17050(b)*]. This form may be converted to a single member LLC. For further discussion, see [d], *below*.

[b] Contents of Agreement

This form contains many provisions covering a great variety of topics; it must be revised as needed for each particular limited liability company. In general, a well-drafted, relatively detailed operating agreement should contain provisions addressing some or all of the following topics:

- Definitions of terms used in the agreement [*see* [2], art. 1, *below*]. Note that an operating agreement may not vary the definitions set forth in *Corp. Code § 17001*, except as specifically provided in that section [*Corp. Code § 17005(b)(1)*].

- Extent and nature of the LLC's business.

- The operative date of the agreement. Paragraph 2.04 allows this date to be either the date of execution of the agreement, or a specified future time.

- Specification of rights and duties of members [*see* [2], art. 3, *below*].

- Information on initial and additional capital contributions [*see* [2], PP 1.01(d), 3.01, 3.02, *below*]. In this regard, Paragraph 3.03 gives the drafter the option of either prohibiting future contributions except on unanimous consent of the members, or permitting such contributions on specified terms. Paragraph 3.02(b) and (c) specifies the remedies of the LLC against any member who fails to make any required initial or future contribution. The specified remedies are stated broadly to include all those specified by statute [*see Corp. Code § 17201(a)(2), (3)*].

- Names and addresses of members [*see* [2], P 3.01, *below*].

- If the LLC is to be managed by the members, provisions as to management and as to a management group of members, if any [*see §§ 12C.221* (member-managed operating agreement), 12C.226 (member management provisions)].

- Information on capital accounts and capital structure [*see* [2], P 3.04, *below*].

- Amendment of operating agreement [*see* [2], art. 4, *below*].

- If the LLC is to be managed by managers, the necessary details of that management, including duties, time required to be devoted to management, and potential conflicts of interest [*see* [2], arts. 5-10, *below*].

- Members' right, if any, to withdraw, including buyout rights enforceable by withdrawing member and exercisable by remaining members. In this regard, the provisions in this form contemplate that the interests of the members will not be freely transferrable and that prior consent of the other members is required [*see* [2], PP 3.09-3.12, *below*]. Paragraphs 3.13 through 3.17 contain simple buyout provisions giving the remaining members either the option or the duty (depending on the alternative version of Paragraph 3.13 included by the drafter) to purchase the interest of any member who dies or who is expelled under the terms of the operating agreement. Many other arrangements for the transfer of membership interests are possible, depending on what the members want to do. If the LLC members

wish to have a different type of buy-sell arrangement, appropriate provisions from the corporate or partnership materials in this publication may be adapted to a LLC agreement [*see* Ch. 8D, *Buy-Sell Agreements* (close corporations); Ch. 15, Part A, *General Partnerships*, §§ 15.240-15.262 (partnerships)].

- Termination of memberships and rights of members holding terminated memberships.

- Assignment of membership interests [*see* [2], P 3.10, *below*] and admission of additional members [*see* [2], P 3.06, *below*].

- Rights of the members with respect to meeting, voting, proxies, and similar matters [*see* [2], arts. 12-14, *below*].

- Allocations of items of LLC profits, losses, gain, deduction and credit [*see* [c]; *see also* art. 15, *below*].

- Time, manner, and priority of distributions [*see* [2], PP 15.02, 15.03, *below*].

- Provisions governing indemnification, fiduciary duties, competition, and trade secrets [*see* [2], art. 16, *below*].

- Accounting, records, financial statements and reports [*see* [2], art. 17, *below*].

- Various tax matters, such as tax elections and identification of the equivalent of a tax matters partner [*see* [2], P 17.03, *below*].

- Dissolution and winding up [*see* [2], art. 18, *below*]. Among other circumstances, this agreement permits dissolution on the agreement of a majority of the members or on the occurrence of specific events (to be specified by the drafter) that are deemed to constitute a failure of the LLC achieve its intended purpose. The latter provision is intended to provide a "safety valve" if the LLC is formed for a specific purpose and there is uncertainty over whether all the necessary conditions for fulfillment of that purpose will exist in the future [*see* [2], P 18.01, *below*].

- Other provisions common to detailed contracts, including statements of consideration, provisions for notice, severability, integration, governing law, and confidentiality (if appropriate) [*see* [2], art. 19, *below*].

- A spousal consent under which the spouses of the members consent to the terms of the Agreement with respect to any portion of the membership interests that are community property. This consent should be executed by all the spouses of the LLC members. For additional discussion of the law relating to this type of spousal consent, see *Ch. 8C, Corporation Shareholder Agreements, § 8C.203*.

- A schedule showing the respective contributions of cash, property, or services to be made by each member, and the percentage interest in the LLC allocated to each member. This schedule may be amended from time to time to reflect subsequent adjustments in the interests of the members due to additional contributions, purchase of the interest of a deceased or departing member, or other sources [*see* [2], Schedule A, *below*].

The operating agreement should also specify any respects in which the default provisions of the LLC Act are to be changed or rendered inapplicable to the LLC [*see Corp. Code § 17005(e)*; *see also § 12C.10[3]*]. With regard to

changes in some default provisions, only a written operating agreement is effective [*see Corp. Code § 17005(b), (c)*]. If any provision of the articles of an LLC conflicts with its written operating agreement, the articles control [*Corp. Code § 17005(f)*].

[c] Allocation Provisions

The operating agreement provides for allocation of net income, net loss and capital gain according to each member's percentage interest in the LLC. This generally meets the requirements of *I.R.C. § 704* and *Treas. Reg. § 1.704-1* that allocations have substantial economic effect. The agreement also provides for special allocation of built-in gain or loss if property is contributed to the LLC that has a tax basis different from its value for purposes of the contribution [*see Treas. Reg. § 1.704-3*; *see also* [2], art. 15, *below*].

Other issues arise in the context of allocating gains or losses and whether the operating agreement allocation provisions have substantial economic effect including the maintenance of capital accounts, distributions on the liquidation of the LLC, and the obligation of members to make up any deficits in their capital accounts on the liquidation of the member's interest [*Treas. Reg. § 1.704-1(b)(2)*]. Practitioners should review the safe harbor provisions in *Treas. Reg. § 1.704-1(b)* to determine if any of those provisions are necessary for the LLC's for which for the operating agreement is being drafted.

[d] Conversion to Single Member-Managed Agreement

This basic manager-managed LLC operating agreement may be converted to a single member LLC. For federal tax purposes, a LLC with only one member is disregarded as an entity separate from its owner for federal tax purposes unless it elects to be taxed as an "association" (corporation) [*Treas. Reg. § 301.7701-3(a)*].

Counsel should consider whether, the retention, deletion, or modification of the relevant provisions of this agreement is appropriate in a one-member situation. For example, provisions governing allocations and profit-sharing should be reviewed and ordinarily deleted from the agreement. However, although provisions governing contributions, voting rights, and so on may seem superfluous in a single-member LLC, it may be desirable to retain many of these provisions even when the LLC will be formed with a single member. Even if not anticipated at the time of formation, the admission of additional members may become desirable at a future time due to changing or unanticipated circumstances, and those provisions may obviate the need for revising the operating agreement of a single-member LLC that subsequently admits additional members.

[2] FORM

Basic Operating Agreement

OPERATING AGREEMENT OF
_____ [*full name of limited liability company*],
A CALIFORNIA LIMITED LIABILITY COMPANY

In accordance with the Beverly-Killea Limited Liability Company Act and subject to the Articles of Organization, which were filed on _____[*date*], with the Secretary of State of California, the members of _____[*name of limited liability company*], listed on the signature page, make the following agreement on _____[*date*], regarding the conduct of the business and affairs of _____[*name of limited liability company*], a California limited liability company ("Company")]:

ARTICLE 1 DEFINITION OF TERMS

1.01. When used in this agreement, the following terms have the meanings set forth here:

(a) "Act" means California's Beverly-Killea Limited Liability Company Act, as set forth in Corporations Code Title 2.5.

(b) "Agreement" means this operating agreement, as originally executed and as amended from time to time.

(c) "Articles" means the Articles of Organization for the Company filed under *Corp. Code § 17050*, including all amendments thereto or restatements thereof.

(d) "Available cash" of the Company means all cash funds of the Company on hand from time to time (other than cash funds obtained as contributions to the capital of the Company by the members and cash funds obtained from loans to the Company), after (1) payment of all operating expenses of the Company as of such time, (2) provision for payment of all outstanding and unpaid current obligations of the Company as of such time, and (3) provision for a working capital reserve, as defined below.

(e) "Bankrupt" or "bankruptcy" means, with respect to any person, being the subject of any order for relief under Title 11 of the United States Code, or any successor statute.

(f) "Capital account" means the individual accounts established and maintained pursuant to Paragraph 3.04.

(g) "Capital contribution" means the total value of cash and agreed fair market value of property contributed and agreed to be contributed to the Company by each member, as shown in Exhibit A, as the same may be amended from time to time.

(h) "Code" means the Internal Revenue Code of 1986, as amended. All references in this Agreement to sections of the Code include any corresponding provision or provisions of succeeding law.

(i) "Company" means _____[*name of limited liability company*], a California limited liability company.

(j) "Entity" means any association, corporation, general partnership, limited partnership, limited liability company, joint stock association, joint venture, firm, trust, business trust, cooperative, and foreign association of like structure.

(k) "Interest" in the Company means the entire ownership interest of a Member in the Company at any particular time, including the right of the member to any and all benefits to which a Member may be entitled as provided in this Agreement and under the Act, together with the obligations of the member to comply with all of the terms and provisions of this Agreement.

(l) "Manager" means [a person elected by the Members of the Company to manage it *or* each of the Members of the Company].

(m) "Member" means a person who

(1) Has been admitted to the Company as a Member in accordance with the Articles of Organization or Operating Agreement, or an assignee of an interest in the Company who has become a Member pursuant to *Corp. Code § 17303*.

(2) Has not resigned, withdrawn, or been expelled as a Member or, if other than an individual, been dissolved.

(n) "Percentage interest" of a Member means the percentage of the member set forth opposite the name of the Member in Exhibit A attached to this Agreement, as the percentage may be adjusted from time to time pursuant to the terms of

this Agreement.

(o) "Principal office" means the office of the agent of this Company as shown in its Articles.

(p) "Pro Rata Part" means the proportion that a percentage interest of a Member bears to the aggregate interest in the Company of all Members.

(q) "Share" refers to an interest in the Company representing a contribution to capital. Whenever reference is made to "percentage interest," a share may be converted into the same by dividing a Member's number of shares by the total of all shares outstanding.

(r) "Substitute Member" means any individual or entity that is admitted into membership on the written consent of all Members in accordance with Paragraph 3.11.

(s) "Tax Matters Member" means the member chosen pursuant to *Internal Revenue Code § 6231(a)(7)* to deal with the Internal Revenue Service on tax matters.

ARTICLE 2 ORGANIZATION OF COMPANY

Formation of Company

2.01. The Members have formed a limited liability company under the Act by properly executing and filing the Articles and executing this Agreement. The rights, duties, and liabilities of the Members and the Managers are determined pursuant to the Act, the Articles, and this Agreement.

Company Name

2.02. The name of the Company is _____. The Company will transact business under that name. However, the Company may conduct business under another name if the [Members *or* Managers] think it advisable, provided that the [Members *or* Managers] comply with the Act and any other applicable laws, file fictitious name certificates and the like, and file any necessary amendments.

Company Purpose

2.03. The purpose of the Company is to engage in [*specify business for which LLC is to formed*]. [*Optional:* The Company will not engage in the business of _____ (*specify*) without the prior consent of _____ (all *or* a majority in interest) of the Members.]

Operative Date of Agreement

2.04. The provisions of this Agreement shall take effect on [the date of execution of this agreement as specified above *or specify delayed operative date for agreement*].

ARTICLE 3 MEMBERS AND MEMBERSHIP INTERESTS

Names, Addresses, and Initial Capital Contributions of Members

3.01. Members, their respective addresses, their initial capital contributions to the Company, and their respective percentage interests in the Company are set forth on Schedule A, attached to this Agreement and made a part of it. Each Member agrees to make the initial contribution set out in Schedule A within _____ days from the date [of execution of this Agreement *or* specified in Paragraph 2.04 of this Agreement]. Schedule A shall be amended from time to time to reflect any changes or adjustments in the respective contributions or percentage interests of the Members as required or permitted under this Agreement.

Failure to Make Contribution

3.02. (a) If a Member is required to contribute property or services in accordance with Paragraph 3.01 and Schedule A of this Agreement and fails to make that contribution within _____ days from the date [of execution of this agreement *or* specified in Paragraph 2.04 of this Agreement], that Member shall be obligated, at the option of the Company, to contribute cash equal to that portion of the agreed value, as stated in Schedule A, of the contribution that has not been made. The foregoing option shall be in addition to, and not in lieu of, any other rights, including the right to specific performance, that the Company may have against the Member.

(b) The interest of a Member who fails to make the initial contribution provided for in Paragraph 3.01 shall be subject, at the option of the Company, to any or all of the following remedies:

(1) Loss of voting and approval rights until contribution has been made.

(2) Payment of damages in the amount of the agreed contribution.

(c) In addition to the remedies provided for in Subparagraph (b) of this Paragraph, the defaulting Member's interest in the Company is subject, at the option of the Company, to the following:

(1) Reduction, dilution or elimination of the defaulting Member's proportionate interest in the limited liability company;

(2) Subordination the defaulting Member's interest in the Company to that of nondefaulting Members;

(3) Forced sale of the Membership interest on the terms specified in Paragraphs 3.13 through 3.17 of this Agreement;

(4) The lending or contribution by other Members of the amount necessary to meet the defaulting Member's commitment;

(5) Adjustment of the interest rates or other rates of return, preferred, priority, or otherwise, with respect to contributions by or capital accounts of the other Members; or

(6) Fixing the value of the defaulting Member's interest in the limited liability company by appraisal, formula and redemption, or sale of the defaulting Member's interest in the limited liability company at a percentage of that value.

(d) The obligation of a Member to make the initial contribution required by Paragraph 3.01 may be compromised only by [*specify, e.g.,* two-thirds *or* unanimous] vote of the Members.

Future Contributions

[*To prohibit additional contributions except upon unanimous approval of the company members:*]

3.03. (a) No Member may required to make any capital contribution to the Company other than that required under Paragraph 3.01, except upon unanimous agreement of the Members.

[*OR, to permit additional capital contributions:*]

3.03. (a) Members may be required to make additional capital contributions in the amount or amounts authorized from time to time by _____[a majority in interest of the Members *or, for a LLC that will have managers:* _____ (all *or* a majority) of the Managers]. No Member may be required to make additional contributions of property, services, or anything other than cash without that Member's express written consent.

[*CONTINUE*]

(b) All additional contributions made in accordance with Subparagraph (a), above, shall be made on a pro rata basis in accordance with the respective percentage interests of the Members of the Company, unless the Members unanimously agree to a different method of determining contributions. If additional contributions are made other than on a pro rata basis, the respective percentage interests of the Members in the Company shall be adjusted to reflect the total respective contributions of the Members, and Schedule A of this Agreement shall be amended accordingly.

(c) Any Member who fails to make an additional capital contribution after that contribution has been validly authorized in accordance with Subparagraph (a), above, shall be subject to the remedies specified in Paragraph 3.02(a) and (c).

Member Loans or Services

3.04. [Except as specified in Schedule A,] [s]ervices by any Member to the Company may not be considered to be contributions to the capital of the Company, and loans by any member to the Company shall not be treated as capital contributions to the Company. Any compensation that the Company pays to a Member for services, and any payment made by the Company to a Member on that Member's loan to the Company, shall not be treated as payment made to that Member acting in his, her, or its capacity as a Member under *Internal Revenue Code Section 707*.

Capital and Capital Accounts

3.05. (a) The initial Capital Contribution of each Member is as set forth in Exhibit A. No interest may be paid on any Capital Contribution.

(b) The Company will establish and maintain an individual Capital Accounts for each Member pursuant to *Treasury Regulations Section 1.704-1(b)(2)(iv)*

(c) No Member has the right to withdraw his or her capital contribution or to demand and receive property of the Company or any distribution in return for his or her Capital Contribution, except as may be specifically provided in this Agreement or required by law. No Member may receive out of Company property any part of that Member's capital contribution until (1) all liabilities of the Company, except liabilities to Members on account of their loans, have been paid or sufficient Company property remains to pay them, and (2) all Members consent, unless the return of the contribution to capital is rightfully demanded as provided in the Act.

(d) Subject to the provisions of Subparagraph 3.05(c), a Member may rightfully demand the return of that Member's Capital Contribution (1) after the Company has been dissolved and wound up pursuant to Article 18 of this Agreement,

or (2) as may otherwise be provided in the Act. A member may demand and receive only cash in return for the Member's Capital Contribution.

Admission of Additional Members

3.05. The Members may admit to the Company additional members to participate in the profits, losses, available cash flow, and ownership of the assets of the Company on such terms as are determined by all of the Members. Admission of any additional Member requires the written consent of all members then having any interest in the Company. Any additional Members are allocated gain, loss, income, or expense by the method provided in this Agreement.

Limitation on Liability

3.06. No Member is liable under a judgment, decree, or order of the court, or in any other manner, for a debt, obligation, or liability of the Company, except as provided by law. No Member is required to loan any funds to the Company.

No Individual Authority

3.07. Unless expressly provided in this Agreement, no Member, acting alone, has any authority to act for, or to undertake or assume, any obligation, debt, or responsibility on behalf of, any other Member of the Company.

No Member Responsible for Other Member's Commitment

3.08. In the event that a Member (or a Member's shareholders, partners, members, owners, or affiliates) has incurred any indebtedness or obligation before the date of this Agreement that relates to or otherwise affects the Company, neither the Company nor any other Member has any liability or responsibility with respect to the indebtedness or obligation unless the indebtedness or obligation is assumed by the Company pursuant to a written instrument signed by all Members. Furthermore, neither the Company nor any Member is responsible or liable for any indebtedness or obligation that is subsequently incurred by any other Member (or a Member's shareholder, partners, members, owners, or affiliates). In the event that a Member (or a Members' shareholders, partners, members, owners, or affiliates; collectively called the "liable Member"), whether before or after the date of this Agreement, incurs (or has incurred) any debt or obligation that neither the Company nor any of the other Members is to have any responsibility or liability for, the liable Member must indemnify and hold harmless the Company and the other Members from any liability or obligation they may incur in respect of the debt or obligation.

Transfer and Assignment of Membership Interests

3.09. No Member may assign, convey, sell, encumber, or in any way alienate all or any part of his or her interest in the Company as a Member without the prior written consent of all the other Members, which consent may be given or withheld, conditioned or delayed (as allowed by this Agreement or the Act), as the remaining Members may determine in their sole discretion. The remaining members in their sole discretion may require that any Member proposing to sell, assign, or in any way alienate all or any part of his or her interest in the Company offer the remaining members a right of first refusal to purchase that interest on the terms specified in Paragraphs 3.13 through 3.17 of this Agreement. Within _____ days after notice by a Member that the Member proposes to sell, assign, or in any way alienate all or any part of his or her interest in the Company, the remaining members shall advise the Member in writing of their consent or refusal to consent to the proposed transfer, and of any terms or conditions imposed with respect to the sale. If the remaining Members do not advise the Member of their consent or refusal to consent, or of any applicable

conditions, within that _____-day period, they shall be deemed to have consented to the proposed sale, assignment, or other transaction. Transfers in violation of this Paragraph are effective only to the extent set forth in Paragraph 3.12(b), below.

Further Restrictions on Membership Transfers

3.10. No Member may assign, convey, sell, encumber, or in any way alienate all or any part of his or her interest in the Company (1) without registration under applicable federal and state securities laws, or unless the Member delivers an opinion of counsel satisfactory to the Company that registration under those laws is not required; or (2) if the interest to be sold or exchanged, when added to the total of all other sold or exchanged in the preceding [*specify number*] consecutive months prior to that time, would result in the tax termination of the Company under *Internal Revenue Code Section 708*.

Substitute Members

3.11. A transferee may become a Substitute Member if (1) the requirements of Subparagraphs 3.09 and 3.10, above, are met; (2) the person executes an instrument satisfactory to the remaining Members accepting and adopting the terms and provisions of this Agreement; and (3) the person pays all reasonable expenses in connection with his or her admission as a remaining Member.

Effect of Transfer

3.12. (a) Any permitted transfer of all or any portion of a Member's interest in the company takes effect on the first day of the month following receipt by the Members of written notice of transfer. Any transferee of an interest in the company takes subject to the restrictions on transfer imposed by this Agreement.

(b) On a transfer of a Member's interest in the Company in violation of this Agreement, the transferee has no right to participate in the management of the business and affairs of the Company or to become a Member, but the transferee is entitled only to receive the share of profits or other compensation by way of income and the return of contributions to which the transferor of the interest in the Company would otherwise be entitled.

[*EITHER*]

Option to Purchase Member's Interest

3.13. In the event of the death of any Member, or the forced sale of any Member's interest as otherwise provided in this Agreement, the remaining Members shall have an option to purchase that Member's interest in the Company by paying to that Member or the person legally entitled thereto the value of that Member's interest, determined as provided in Paragraph 3.14. The remaining Members shall give written notice of their exercise of this option to the Member, or the personal representative of a deceased Member. In the case of a deceased Member, this notice shall be given within [*number*] days after the death of the deceased Member. The portion of the interest that an individual remaining Member may purchase under this Agreement shall be that proportion which the remaining Member's net worth in the Company bears to the total net worth in the Company of all remaining Members. The amount of the purchase prices shall be determined under Paragraph 3.14 of this Agreement. If any remaining Member is unable or unwilling to purchase his or her proportionate share of the interest of a Member as provided in this Paragraph, that right may be exercised and the interest purchased by the other remaining Members. No remaining Member shall be denied a right to participate in any

such purchase if that Member delivers to all other Members a written declaration of intent to participate. This written declaration shall be delivered to each other Member within [*number*] days after the death, retirement, resignation, or expulsion of the departing Member.

[*OR*]

Mandatory Purchase of Membership Interest

3.13. In the event of the death of any Member, or the forced sale of any Member's interest as otherwise provided in this Agreement, that Member or that Member's personal representative shall sell, and each remaining Member shall buy, a portion of the departing or deceased Member's interest in the Company. The portion of the interest that an individual remaining Member shall be obligated to buy under this Agreement shall be that proportion which the individual remaining Member's net worth in the Company bears to the total net worth in the Company of all remaining Members. The amount of the purchase prices shall be determined under Paragraph 3.14 of this Agreement.

[*CONTINUE*]

Purchase Price of Member's Interest

3.14. On any purchase or sale of a Member's interest under Paragraph 3.02(c)(3), 3.09, or 3.13 of this Agreement, the purchase price of that interest shall be determined as follows:

(a) The departing or deceased Member, or that Member's legal representative, and the remaining Members shall appoint a single appraiser. If the parties are unable to agree on the identity of the appraiser within _____ days after [the death, retirement, resignation, or expulsion of the departing Member *or* the giving of the notice required in Paragraph 3.09 or 3.13], each party thereafter shall appoint his or her own appraiser. If the two appraisers so appointed are unable to agree on the value of the interest within [*number*] days after being so appointed, they shall appoint a third appraiser. The decision in writing of any two of the three appraisers so appointed shall be binding and conclusive on the parties to this Agreement and on any person legally entitled to receive the value of the departing or deceased Member's interest. All fees and expenses of each appraiser shall be paid by the [Company *or* remaining Members *or* purchasing and selling parties in equal proportions *or* party on whose behalf that appraiser was appointed, and the fees and expenses of the third appraiser to be paid equally by the purchasing and selling parties].

(b) In determining the value of the membership interest to be purchased, the appraisers shall value:

(1) All items of inventory at their actual cost to the Company.

(2) All tangible assets of the Company, including lands, buildings, fixtures, machinery, automobiles, and equipment, at their fair cash market value.

(3) All accounts receivable due the Company that are not more than 90 calendar days old and not barred by the statute of limitations at one-half their face value.

(4) All accounts receivable due the Company that are less than 90 calendar days old at their full face value.

(5) Goodwill and other intangible assets of the Company at their fair cash market value.

Payment of Purchase Price

3.15. On any purchase and sale of a Member's interest under to this Agreement, the remaining Members shall pay to the person legally entitled thereto the value of the interest, determined as provided in Paragraph 3.14 of this Agreement, in the following manner: _____[*describe payment terms, e.g.,* One half in cash on receipt of the appraisers' report, and the balance in 12 equal monthly installments commencing not later than 30 days after receipt of that report. Each monthly installment shall be applied first to interest at the rate of _____ percent per annum on the then remaining unpaid principal balance of the purchase price from the date the appraisers' report was received by the remaining Members and then to the reduction of principal].

Assumption of Departing Member's Obligations

3.16. On any purchase and sale of a Membership interest under this Agreement, the remaining Members shall assume all Membership obligations and shall protect, defend, and indemnify the departing Member, the personal representative and estate of a deceased Member, and the property of any departing Member, from liability for any Membership obligations of the departing Member.

Publication of Notice

3.17. On any purchase and sale of a Membership interest under this Agreement, the remaining Members shall, at their own cost and expense, as soon as reasonably practicable, prepare, publish, file, and serve all notices that may be required by law to protect the departing Member and the personal representative and estate of a deceased Member from liability for future obligations of the Membership business.

ARTICLE 4 POWER TO AMEND AGREEMENT

4.01. The power to adopt, alter, amend, or repeal this Agreement is vested entirely in the Members of the Company.

[*OR, if articles of organization vest this power in managers:*]

4.01. The power to adopt, alter, amend, or repeal this Agreement is vested entirely in the Managers named in the articles of organization.

ARTICLE 5 MANAGEMENT RIGHTS IN MANAGERS

5.01. The right to exercise the powers of the Company and to manage the business and affairs of the Company is vested entirely in the Managers.

ARTICLE 6 ELECTION OF MANAGERS

6.01. (a) The initial Managers specified in the articles of organization serve as Managers for the period specified in the articles of organization, until _____[*date*], which is the date of the first meeting of the Members. Managers are elected at that first members meeting. The number of Managers of the Company shall be _____[*state specific number of managers, or manner of determining number, e.g.,* determined by allocating one Manager for each $1 million in gross revenues for the preceding calendar year as stated in the official annual report of the Company].

(b) Managers serve until they resign or are removed under Article 7.

ARTICLE 7 REMOVAL OF MANAGERS

7.01. (a) The Members may remove a Manager if [*specify events and circumstances that trigger members' rights to remove manager, e.g.,* the Manager acts outside the scope of the Manager's authority].

(b) At any meeting of Members called expressly for the purpose, a Manager may be removed for any reason, with or without cause, on a resolution adopted by the Members.

ARTICLE 8 QUORUM OF MANAGERS

8.01. At all meetings of the Managers, [*number*] of the Managers must be present to constitute a quorum for the transaction of business.

ARTICLE 9 ACTION BY MANAGERS

9.01. An act of the Managers is effective if [*specify number, e.g.,* more than a majority] of the Managers vote approval of the act at a meeting at which a quorum of Managers is present.

ARTICLE 10 COMPENSATION OF MANAGERS

10.01. Members may, by [*specify, e.g.,* a vote of a majority in interest *or* unanimous consent] establish reasonable compensation of all Managers for services to the Company. The compensation may include pensions, disability benefits, and death benefits.

ARTICLE 11 EXECUTION OF DOCUMENTS

11.01. The [Managers *or* Members *or* Managers and Members] have the authority to execute documents and instruments for the acquisition, mortgage, or disposal of property on behalf of the Company.

ARTICLE 12 MEETINGS OF MEMBERS

[No] Annual Meeting

12.01. The Company [shall *or* is not required to] hold a regular annual meeting of Members. [*If annual meeting is required, add:* The annual meeting shall be held on the _____ (*number, e.g.,* first) _____ (*day of week, e.g.,* Tuesday) of [*month*] of each year, at _____ (*time*); provided, however, that if that day falls on a legal holiday, the meeting shall be held at the same time on the next day that is not a legal holiday. At the annual meeting reports on the affairs of the Company shall be considered, and any other proper matter may be presented and business transacted that is within the power of the Members.]

Special Meetings

12.02. Special meetings of the Members will be held on request of [*specify who may call meetings, e.g.,* any Member *or* any Manager *or* Members holding _____ (*e.g.,* 10) percent or more interest in the Company]. The [Managers *or* Members calling the meeting] shall cause written notice of the location, date, and time of the meeting, and the general nature of the business to be transacted, to be sent by first class mail to the Members entitled to vote at that meeting at least [*specify notice period, e.g.,* 10 days] before the scheduled date of the meeting.

Record Date

12.03. Only persons whose names are listed as members in the official records of the Company [*number*] days before any meeting of the Members are entitled to notice of or to vote at that meeting.

Waiver of Notice

12.04. (a) The transactions of any meeting of Members, however called and noticed and wherever held, are as valid as if made at a meeting duly held after regular call and notice, if a quorum is present either in person or by proxy and if, either before or after the meeting, each of the Members entitled to vote, not present in person or by proxy, signs a written waiver of notice, or a consent to the holding of the meeting, or an approval of the minutes of the meeting. All waivers, consents, and approvals must be filed with the records of the Company or made a part of the minutes of the meeting. Except as otherwise provided, neither the business to be transacted nor the purpose of any meeting of Members need be specified in any written waiver of notice, consent to the holding of the meeting, or approval of the minutes of the meeting.

(b) Attendance by a Member at any meeting also constitutes a waiver of notice to that person if he or she fails to object at the beginning of the meeting to the transaction of business because the meeting was not lawfully called or convened, but attendance does not constitute a waiver of the right to object to the consideration of matters required to be included in the notice but not so included if the objection is expressly made at the meeting.

Quorum

12.05. At all meetings of the Members, [*number*] Members must be present to constitute a quorum for transaction of business.

ARTICLE 13 ACTIONS BY MEMBERS AND VOTING RIGHTS

Votes Required to Act

13.01. Except as otherwise provided in this Agreement, an act of the Members of record is effective if [the majority *or specify percent*] of Members' votes adopt the act at a meeting at which a quorum of Members is present. The voting rights of the Members are to be distributed in proportion to each Member's contribution to capital in the following manner: [*specify general voting rights*].

Vote by Proxy

13.02. Members may vote either in person or by proxy. Proxies must be executed in writing by the Members. A telegram, cablegram, or similar transmission by the member or a photographic, photostatic, facsimile, or similar reproduction of a writing executed by a Member is deemed an execution in writing for purposes of this Agreement.

Actions of Tax Matters Member

13.03. The Tax Matters Member of the Company, chosen pursuant to *Internal Revenue Code Section 6231(a)(7)*, is

_____[*name*], who has the same authority as granted by the Internal Revenue Code to a tax matters partner.

ARTICLE 14 ACTION BY CONSENT WITHOUT MEETING

14.01. Any action permitted to be taken by the Members may be taken without a meeting if all Members individually or collectively consent by signing a written approval of the action. Any action by written consent shall have the same force and effect as a unanimous vote of the Members.

ARTICLE 15 ALLOCATIONS: DISTRIBUTIONS AND INTERESTS

Allocation of Net Income, Net Loss, or Capital Gains

15.01. (a) Except as may be expressly provided otherwise in this Article 17, and subject to the provisions of *Internal Revenue Code Section 704(c)*, the net income, net loss, or capital gains of the Company for each fiscal year of the Company is allocated to the Members, pro rata in accordance with their percentage interests in the Company.

(b) If a Member, on formation of the Company or at any time thereafter, contributes property with an adjusted income tax basis different from the fair market value at which the property is accepted and credited to that Member's capital account, then solely for income tax purposes and the determination of each Member's distributive share of the net Company profits and losses, any depreciation, depletion, gain, or loss with respect to that property shall, pursuant to *Internal Revenue Code Section 704(c)* of 1986 and *Treasury Regulations Section 1.704-3*, be allocated according to the [*select one* traditional method, traditional method with curative allocations, *or* traditional method with remedial allocations].

Distribution of Available Cash

15.02. Periodically, but not less frequently than at the end of each calendar quarter, the available cash of the Company, if any, must be distributed to the Members, pro rata in accordance with their percentage interests. For any calendar quarter, available cash need not be distributed to the extent that the cash is required for a reasonable working capital reserve for the Company; the amount of the reasonable working capital reserve is to be determined by the Members.

Allocation of Income and Loss and Distributions in Respect of Interests Transferred

15.03. (a) If any interest in the company is transferred, or is increased or decreased by reason of the admission of a new Member or otherwise, during any fiscal year of the Company, each item of income, gain, loss, deduction, or credit of the Company for the fiscal year must be assigned pro rata to each day in the particular period of the fiscal year to which the item is attributable (that is, the day on or during which it is accrued or otherwise incurred) and the amount of each item so assigned to any day shall be allocated to the Member based on his or her respective interest in the Company at the close of the day. For the purpose of accounting convenience and simplicity, the Company may treat a transfer of, or an increase or decrease in, an interest in the Company that occurs at any time during a semimonthly period (commencing with the semimonthly period including the date of this Agreement) as having been consummated on the first day of the semimonthly period, regardless of when during the semimonthly period the transfer, increase, or decrease actually occurs (that is, sales and dispositions made during the first 15 days of any month are deemed to have been made on the 16th day of the month).

(b) Distributions of the Company assets in respect of any interest in the Company shall be made only to the Members who, according to the books and records of the Company, are holders of record of the interests in respect of which the

distributions are made on the actual date of distribution. Neither the Company nor any Member incurs any liability for making distributions in accordance with the provisions of the preceding sentence, whether or not the Company or Member has knowledge or notice of any transfer or purported transfer of ownership of interest in the Company that has not been approved by unanimous vote of the Members. Notwithstanding any provision above to the contrary, gain or loss of the Company realized in connection with a sale or other disposition of any of the assets of the Company must be allocated solely to the parties owning interests in the Company as of the date the sale or other disposition occurs.

ARTICLE 16 INDEMNIFICATION, FIDUCIARY DUTIES, COMPETITION, AND TRADE SECRETS

Indemnification and Fiduciary Duties

16.01. The Company will indemnify Members [and Managers] for any act taken in the capacity of a Member [or Manager], other than acts that involve a breach of fiduciary duty. The standard of the fiduciary duty each Member [and Manager] owes to the Company and to its members are those of a partner to a partnership and to the partners of the partnership. A Member's [or Manager's] standard of conduct owed to the Company and other Members [and Managers] is to act in the highest good faith to the Members [and Managers], and a Member [or Manager] may not seek to obtain an advantage in the Company affairs by the slightest misconduct, misrepresentation, concealment, threat, or adverse pressure of any kind.

Power of Member to Do Business With LLC

[*EITHER*]

16.02. Any Member [or Manager], acting in that Member's [or Manager's] individual capacity, shall have the power to do business with the Company at any time, provided that the transaction is fair and equitable to the Company, in the Company's best business interest, and in accordance with the basic fiduciary principles specified in Paragraph 16.01. This power includes, but is not limited to, the power to purchase property from or sell property to the Company at fair market value; exchange property for the Company's property of equal value; lease property from or to the Company at fair rental value; borrow funds from or lend or advance funds to the Company, with interest at then-prevailing rates, and give or receive security for any such loans in any commercially reasonable form. [*Optional:* The fair market value of any asset to be purchased, sold, or exchanged, or the fair rental value of any asset to be leased, under this provision, when the amount of the transaction exceeds $_____ (*e.g.*, $5,000) must first be determined by an independent appraisal.]

[*OR*]

16.02. No Member [or Manager], acting in that Member's [or Manager's] individual capacity, shall have the power to do business with the Company at any time, unless the transaction is approved in writing in advance by [all *or* a majority in interest *or* a majority] of the [Members *or* Managers] and is fair and equitable to the Company, in the Company's best business interest, and in accordance with the basic fiduciary principles specified in Paragraph 16.01. [*Optional:* The fair market value of any asset to be purchased, sold, or exchanged, or the fair rental value of any asset to be leased, under this provision, when the amount of the transaction exceeds $_____ (*e.g.*, $5,000) must first be determined by an independent appraisal.]

[*CONTINUE*]

Noncompetition

16.03. Each Member [and Manager] agrees that as long as he or she is a Member [or Manager] of the Company, he or she will not be employed, concerned, or financially interested, either directly or indirectly, in any other corporation, partnership, limited liability company, sole proprietorship, or other business entity that is engaged in the same or a similar business as that conducted by the Company (as specified in Paragraph 2.03 of this Agreement), or otherwise compete with the Company. However, it is not a breach of this Agreement for any Member [or Manager] to own, as a passive investment, not more than five percent of the outstanding stock of any publicly held company engaged in the business of the Company, as specified in Paragraph 2.03 of this Agreement. [*Optional:* For purposes of this Paragraph, _____ (*specify limitations, e.g.*, the development, marketing, or sale of computer software programs not related to inventory control, tracking, or billing) shall not be deemed to constitute the same or similar business as that of the Company or competition with the Company.]

Protection of Trade Secrets

16.04. Each Member and Manager acknowledges that the customer lists, trade secrets, processes, methods, and technical information of the Company and any other matters designated by [all *or* a majority in interest *or* a majority] of the [Members *or* Managers] are valuable assets. Unless he or she obtains the written consent of each Member of the Company, each Member and Manager agrees never to disclose to any individual or organization, except in authorized connection with the business of the Company, any customer list, or any name on that list, or any trade secret, process, or other matter referred to in this Paragraph while a Member or Manager of the Company, or at any later time.

ARTICLE 17 COMPANY RECORDS AND REPORTS

Required Books and Records

17.01. The Company shall keep the following books and records in compliance with *Corporations Code Section 17058*:

(a) A current list setting forth, in alphabetical order, the full name and last known business or residence address of each Member and of each holder of an economic interest in the Company, together with the contribution and the share in profits and losses of each Member and holder of an economic interest.

(b) A copy of the Company's articles of organization and all amendments thereto, together with any powers of attorney pursuant to which the articles of organization or any amendments thereto were executed.

(c) Copies of the Company's federal, state, and local income tax or information returns and reports, if any, for the six most recent taxable years.

(d) A copy of this Agreement, and any amendments thereto, together with any powers of attorney pursuant to which any written operating agreement or any amendments thereto were executed.

(e) Copies of the Company's financial statements, if any, for the six most recent fiscal years.

(f) Accurate books and records of the Company's internal affairs for at least the current and past four fiscal years.

(g) A current list of the full name and business or residence address of each manager.

Records and Accounting; Fiscal Year

17.02. The books and records of the Company must be kept, and the financial position and the results of its operations recorded, in accordance with the accounting methods elected to be followed by the Company for federal and state income tax purposes. The books and records of the Company must reflect all Company transactions and must be appropriate and adequate for the Company's business. The fiscal year of the Company for financial reporting and for federal income tax purposes is the calendar year.

Access to Accounting Records

17.03. All books and records of the Company must be maintained at any office of the Company or at the Company's principal place of business, and each Member, and his or her duly authorized representative, must have access to them at the office of the Company and the right to inspect and copy them at reasonable times.

Annual and Tax Information

17.04. The Members must use their best efforts to cause the Company to deliver to each Member, within _____ days after the end of each fiscal year, all information necessary for the preparation of each Member's federal income tax return. The Members must also use their best efforts to cause the Company to prepare, within _____ days after the end of each fiscal year, a financial report of the Company for the fiscal year, which must contain a balance sheet as of the last day of the year then ended, an income statement for the year then ended, a statement of sources and applications of funds, and a statement of reconciliation of the capital accounts of the Members.

ARTICLE 18 DISSOLUTION AND WINDING UP OF COMPANY

Events Causing Dissolution

18.01. The Company shall be dissolved, its assets shall be disposed of, and its affairs shall be wound up on the first to occur of the following events:

(a) On determination by members owning more than 50 percent of the interests in the Company that the Company should be dissolved.

(b) On the death, insanity, bankruptcy, retirement, resignation, or expulsion of any Member, unless at least 50 percent of the remaining Members consent to continue the Company within 90 days of the dissolution event.

[*Optional; add if appropriate:*]

(c) On the failure of the Company to achieve its intended purpose as stated in Paragraph 2.02 of this Agreement, unless the Members unanimously agree to continue the existence of the Company at that time. For purposes of this Subparagraph, the Company shall be deemed to have failed to achieve its intended purpose if and only if any of the following occur: _____[*state specific conditions that will trigger winding up and dissolution, as agreed on by the members, e.g.,* the Company fails to obtain a valid patent for Process XYX by _____ (*date*); the Company fails to obtain distribution rights for Product Y from the manufacturer prior to _____ (*date*); the Company fails to obtain advance orders for Product X totaling $_____ by _____ (*date*); the Company fails to obtain all necessary governmental approvals for the manufacture of Product X by _____ (*date*); the Company fails to secure

manufacturing and distribution facilities for its products by _____ (*date*); the Company fails to commence manufacturing Brand X prior to _____ (*date*); any government law, order, or regulation is enacted prohibiting the manufacture or use of Product X; the Company fails to develop marketable and substantially error-free software for inventory control and billing by _____ (*date*)].

[*Optional; if articles of organization specify a date for expiration of the company term:*]

(d) On the expiration of the term of the Company, as stated in the Articles.

[*CONTINUE*]

(e) At any earlier time at which dissolution may be required under any applicable law.

Persons Who May Conduct Winding Up

18.02. (a) The [Managers *or* Members] who have not wrongfully dissolved the Company may wind up the Company's affairs. The persons winding up the affairs of the Company shall give written notice of the commencement of winding up by mail to all known creditors and claimants whose addresses appear on the records of the Company.

(b) The [Managers *or* Members] winding up the Company's affairs [shall *or* shall not] be entitled to reasonable compensation.

Distribution of Assets After Provision for Payment of Creditors.

18.03. (a) After determining that all the known debts and liabilities of the Company including, without limitation, debts and liabilities to Members who are creditors of the Company, have been paid or adequately provided for, the remaining assets shall be distributed among the Members according to their respective rights and preferences as follows:

(1) To members in satisfaction of liabilities for distributions pursuant to *Corporations Code Sections 17201, 17202,* or *17255*.

(2) To Members for the return of their contributions.

(3) To Members in the proportions in which those Members share in distributions.

(b) The payment of a debt or liability, whether the whereabouts of the creditor is known or unknown, has been adequately provided for if the payment has been provided for by either of the following means:

(1) Payment has been assumed or guaranteed in good faith by one or more financially responsible persons or by the United States government or any agency thereof, and the provision, including the financial responsibility of the person, was determined in good faith and with reasonable care by the _____ [Members *or* Managers] to be adequate at the time of any distribution of the Company's assets pursuant to this Paragraph 18.03.

(2) The amount of the debt or liability has been deposited with the Controller of the State of California pursuant to *Corporations Code Section 2008*.

ARTICLE 19 MISCELLANEOUS PROVISIONS

Complete Agreement

19.01. This Agreement and the Articles of this Company constitute the complete and exclusive statement of agreement among the members with respect to the subject matter described. This Agreement and the Articles replace and supersede all prior agreements by and among any of the Members. This Agreement and the Articles supersede all prior written and oral statements; no representation, statement, or condition or warranty not contained in this Agreement or the Articles is binding on the members or has any force or effect.

Governing Law

19.02. This Agreement and the rights of the parties under this Agreement will be governed by, interpreted, and enforced in accordance with the laws of the State of California.

Binding Effect

19.03. Subject to the provisions of this Agreement relating to transferability, this Agreement is binding on and inures to the benefit of the Members, and their respective distributees, successors, and assigns.

Severability

19.04. If any provision of this Agreement is held to be illegal, invalid, or unenforceable under the present or future laws effective during the term of this Agreement, the provision is fully severable; this Agreement is construed and enforced as if the illegal, invalid, or unenforceable provision had never comprised a part of this agreement; and the remaining provisions of this Agreement will remain in full force and effect and will not be affected by the illegal, invalid, or unenforceable provision; and there will be added automatically as a part of this Agreement a provision as similar in terms to the illegal, invalid, or unenforceable provision as may be possible and be legal, valid, and enforceable.

Multiple Counterparts

19.05. This Agreement may be executed in several counterparts, each of which is deemed an original but all of which constitute one and the same instrument. However, in making proof only one copy signed by the party to be charged is required.

Additional Documents and Acts

19.06. Each Member agrees to execute and deliver additional documents and instruments and to perform all additional acts necessary or appropriate to effectuate, carry out, and perform all of the terms, provisions, and conditions of this Agreement and the transactions contemplated by it.

No Third Party Beneficiary

19.07. This Agreement is made solely and specifically among and for the benefit of the parties to it, and their respective successors and assigns, subject to the express provisions of the agreement relating to successors and assigns, and no

other person has or will have any rights, interest, or claims under this Agreement as a third-party beneficiary or otherwise.

Tax Consequences

19.08. Members acknowledge that the tax consequence of each Member's investment in the Company is dependent on each Member's particular financial circumstances. Each Member will rely solely on the Member's financial advisors and not the Company. The Company makes no warranties as to the tax benefits that the Members receive or will receive as a result of the Member's investment in the Company.

Notices

19.09. Any notice to be given or to be served on the Company or any party to this Agreement in connection with this Agreement must be in writing and is deemed to have been given and received when delivered to the address specified by the party to receive the notice. Notices must be given to each Member at the address specified in Exhibit A. Any Member or the Company, at any time, may designate any other address in substitution of the foregoing address to which notice will be given by giving written notice to the other Members and the Company _____ days before the date of delivery of the notice.

Amendments

19.10. Any provision of this Agreement may be amended only with affirmative vote of the number of Members that would be required to approve the action authorized by the provision prior to its amendment. All amendments to this Agreement must be in writing and signed by all of the Members.

Title to Company Property

19.11. Legal title to all property of the Company must be held and conveyed in the name of the Company.

Reliance on Authority of Person Signing Agreement

19.12. In the event that a Member is not a natural person, neither the Company nor any Member will (1) be required to determine the authority of the individual signing this agreement to make any commitment or undertaking on behalf of the entity or to determine any fact or circumstance bearing on the existence of the authority of the individual, or (2) be required to see to the application or distribution of proceeds paid or credited to individuals signing this Agreement on behalf of the entity.

Execution of Spousal Consent

19.13. Each Member who is a married person agrees that at the time that Member executes this Agreement, he or she shall supply a signed consent by that Member's spouse, in the form attached to this Agreement, by which that Member's spouse agrees to be bound by the provisions of this Agreement.

Warranty of Each Member

19.14. Each Member agrees, represents, and warrants that at the time he or she executes this agreement, either

(a) He or she is under no legal obligation, by way of judgment, agreement, contract, or otherwise, specifically including but not limited to any employment agreement, marital settlement agreement, prenuptial or postnuptial agreement, nonmarital property agreement, or creditor's agreement, that conflicts with the terms of this Agreement or might impede that Member's ability to comply with the terms of this Agreement, including but not limited to those provisions of this Agreement respecting the operation and management of the Company or dealing with the transfer or interests in the Company; or

(b) That if he or she is under any legal obligation referred to in Subparagraph (a), above, he or she shall supply, at the time he or she executes this Agreement, a signed consent by each person legally to entitled to enforce that obligation, in substantially the form of the spousal consent form attached to this Agreement, modified as appropriate to the circumstances and approved by all the other members of the Company, by which that person legally entitled to enforce the obligation agrees to be bound by all provisions of this Agreement.

IN WITNESS WHEREOF, the undersigned [has *or* have] executed this Agreement, to be effective as of the date the Articles of Organization of the Company are accepted for filing by the Secretary of State.

_____[*date*]

_____ [*name of limited liability company*]
By _____ [*signature*]
[*typed name and title*]
_____ [*address*]
_____ [*telephone number*]
By _____ [*signature*]
[*typed name and title*]
_____ [*address*]
_____ [*telephone number*]
By _____ [*signature*]
[*typed name and title*]
_____ [*address*]
_____ [*telephone number*]

Consent of Spouses

The undersigned are the spouses (referred to individually as "spouse" or collectively as "spouses") of the Members of _____[*name of limited liability company*] ("Company"). Each spouse acknowledges that he or she has read and understands th e Operating Agreement of the Company ("Agreement"). Each spouse understands that by signing the Agreement, each Member has agreed that the Member's interest in the Company, including any portion of that interest that is the community property of the Member and that Member's spouse, shall be subject to all the provisions of the Agreement. Each spouse agrees to be bound by the provisions of the Agreement in their entirety, including, but not limited to, those provisions of the Agreement governing the sale or transfer of interests in the Company. Each spouse further agrees that in the event his or her Member spouse predeceases him or her, the non-Member spouse will not devise all or any part of any community property interest that he or she may have in the Member's interest in the Company in violation of this Agreement. The spouse of each Member understands and acknowledges that the Member is operating or managing the business of the Company to the extent provided in the

Agreement and that the Member has and will continue to have the primary management and control of the Company's business, as provided in the Agreement, to the maximum extent that the member may lawfully do so.

Executed on _____[*date*], at _____[*city*], [*county*], California.

SPOUSES
[*Repeat, as required:*]
_____ [*name of spouse*], spouse of _____ [*name of member*]
_____ [*name of spouse*], spouse of _____ [*name of member*]
_____ [*name of spouse*], spouse of _____ [*name of member*]

Schedule A

Contributions and Percentage Interests of Members of _____ [*name of limited liability company*]

As of _____[*date*]

Name	Cash	Property--Description and Agreed Value	Services--Description and Agreed Value	Total Agreed Value of Member's Contributions	Percentage Interest

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
B. Operating Agreement and Related Forms

6-12C California Legal Forms--Transaction Guide § 12C.221

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.221 Member-Managed Operating Agreement--Long Form

[1] Comment

[a] Use of Form

This form is a detailed, member-managed operating agreement for a California limited liability company. It should be modified to meet the particular operating needs of the LLC being formed.

The members of an LLC must enter into an operating agreement either before or after the filing of the LLC's articles of organization [*Corp. Code § 17050(a)*]. An "operating agreement" is any agreement among all the members as to the affairs of the LLC and the conduct of its business in a manner not inconsistent with law or the LLC's articles, including amendments to those articles. For a foreign LLC, all documents that serve a like function under the laws of the jurisdiction in which the foreign LLC is organized is defined as an operating agreement under the California Act [*Corp. Code § 17001(ab)*]. An operating agreement may be written or oral, and it may be as simple as an agreement to organize an LLC [*Corp. Code § 17001(ab)*]. In most cases, it is best to have a written operating agreement, since it is likely to be the key document of an LLC. The operating agreement is not filed with the office of the Secretary of State [Secretary of State's LLC form packet].

Many of the same types of provisions typically found in corporate bylaws or partnership agreements may be appropriate in a LLC operating agreement if the members so desire. For a variety of corporate bylaw provisions, see Ch. 4, *Bylaws* . For partnership provisions, see Ch. 15, Part A, *Formation of General Partnerships* . For other provisions that may be appropriate to this type of agreement, see Ch. 8C, *Close Corporation Shareholder Agreements* . The complexity of the agreement depends on the drafter and the wishes of the members.

This form is drafted for an LLC that will have more than one member, and it contains provisions appropriate for that situation. However, since January 1, 2000, California LLCs have been permitted to have only a single member [*Corp.*

Code §§ 17001(t), 17050(b)]. The form may be adapted for use in a single-member LLC, and counsel should consider whether the retention, deletion, or modification of the relevant provisions of this agreement is appropriate [*see § 12C.220[1][d]*; *see also* [2], Section 9.01(g), *below*].

[b] Contents of Agreement

This form contains many provisions covering a great variety of topics; it must be revised as needed for each particular limited liability company. In general, a well-drafted, relatively detailed operating agreement should contain provisions addressing some or all of the following topics:

- Definitions of terms used in the agreement [*see* [2], art. 1, *below*]. Note that an operating agreement may not vary the definitions set forth in *Corp. Code § 17001*, except as specifically provided in that section [*Corp. Code § 17005(b)(1)*].

- Extent and nature of the LLC's business.

- The operative date of the agreement [see [2], Section 1.05, *below*].

- Specification of rights and duties of members [*see* [2], art. 2, *below*].

- Information on initial and additional capital contributions [*see* [2], art. 3, *below*]. In this regard, Paragraph 3.02 permits additional capital contributions on specified terms.

- Names and addresses of members [*see* [2], Section 2.01, Exhibit A, *below*].

- If the LLC is to be managed by the members, provisions as to management [*see* [2], art. 5, *below*].

- Information on capital accounts and capital structure [*see* [2], art. 4, *below*].

- Amendment of operating agreement [*see* [2], Section 12.02, *below*].

- Members' right, if any, to withdraw, including buyout rights enforceable by withdrawing member and exercisable by remaining members. In this regard, the provisions in this form contemplate that members may not voluntarily withdraw [*see* [2], Section 2.03, *below*], that membership interests are not freely transferrable and that prior consent of the other members is required. The form contains buyout provisions giving the remaining members either the option or the duty to purchase the interest of any member who dies or who is expelled under the terms of the operating agreement [*see* [2], art. 8, *below*]. Many other arrangements for the transfer of membership interests are possible, depending on what the members want to do. If the LLC members wish to have a different type of buy-sell arrangement, appropriate provisions from the corporate or partnership materials in this publication may be adapted to a LLC agreement [*see* Ch. 8D, *Buy-Sell Agreements* (close corporations); Ch. 15, Part A, *General Partnerships*, §§ 15.240-15.262 (partnerships)].

- Rights of the members with respect to meeting, voting, proxies, and similar matters [*see* [2], art. 5, *below*].

- Allocations of items of LLC profits, losses, gain, deduction and credit [*see* [c]; *see also* art. 6, *below*].

- Accounting, records, financial statements and reports [*see* [2], art. 7, *below*].

- Time, manner, and priority of distributions [*see* [2], Exhibit D, *below*].

- Dissolution and winding up [*see* [2], art. 9, below]. Among other circumstances, this agreement permits dissolution on the agreement of all of the members or on the occurrence of specific events that are deemed to constitute a failure of the LLC achieve its intended purpose. The latter provision is intended to provide a "safety valve" if the LLC is formed for a specific purpose and there is uncertainty over whether all the necessary conditions for fulfillment of that purpose will exist in the future [*see* [2], Section 9.01(e), *below*].

- Provisions governing indemnification [*see* [2], art. 11, *below*].

- A spousal consent under which the spouses of the members consent to the terms of the Agreement with respect to any portion of the membership interests that are community property [*see* [2], Exhibit E, *below*]. This consent should be executed by all the spouses of the LLC members. For additional discussion of the law relating to this type of spousal consent, see *Ch. 8C, Close Corporation Shareholder Agreements, § 8C.203*.

- A schedule showing the respective contributions of cash, property, or services to be made by each member, and the percentage interest in the LLC allocated to each member. This schedule may be amended from time to time to reflect subsequent adjustments in the interests of the members due to additional contributions, purchase of the interest of a deceased or departing member, or other sources [*see* [2], Exhibit A, *below*].

The operating agreement should also specify any respects in which the default provisions of the LLC Act are to be changed or rendered inapplicable to the LLC [*see Corp. Code § 17005(e)*; *see also § 12C.10[3]*]. With regard to changes in some default provisions, only a written operating agreement is effective [*see Corp. Code § 17005(b), (c)*]. If any provision of the articles of an LLC conflicts with its written operating agreement, the articles control [*Corp. Code § 17005(f)*].

[c] Allocation Provisions

This operating agreement provides for allocation of net income, net loss and capital gain according to each member's percentage interest in the LLC [*see* [2], Section 6.01(b), (c), *below*]. This allocation generally meets the requirements of *I.R.C. § 704* and *Treas. Reg. § 1.704-1* that allocations have substantial economic effect. The agreement also provides for special allocation of built-in gain or loss if property is contributed to the LLC that has a tax basis different from its value for purposes of the contribution [*see Treas. Reg. § 1.704-3*; *see also* [2], Section 6.02, *below*]. The agreement also provides rules for allocations solely for tax purposes [*see* [2], Section 6.03, *below*], and for distributions in respect of transferred interests [*see* [2], Section 6.04, *below*].

Other issues arise in the context of allocating gains or losses and whether the operating agreement allocation provisions have substantial economic effect including the maintenance of capital accounts, distributions on the liquidation of the LLC, and the obligation of members to make up any deficits in their capital accounts on the liquidation of the member's interest [*Treas. Reg. § 1.704-1(b)(2)*]. Practitioners should review the safe harbor provisions in *Treas. Reg. § 1.704-1(b)* to determine if any of those provisions are necessary for the LLC for which for the operating agreement is being drafted. Consultation with the LLC's accountant is strongly recommended.

[2] FORM

Member-Managed Operating Agreement--Long Form

OPERATING AGREEMENT OF
_____ [*name of limited liability company*]

This Agreement is effective as of _____[*date*]

TABLE OF CONTENTS

ARTICLE 1 INTRODUCTORY MATTERS

1. 01 Definition of Terms

1. 02 Formation

1. 03 Name

1. 04 Required Number of Members

1. 05 Term

1. 06 Purpose

1. 07 Regulation of Internal Affairs by Operating Agreement.

1. 08 Limited Liability

1. 09 Tax Classification

1. 10 Laws Governing Operating Agreement

1. 11 Title to All Properties in Name of Company

1. 12 Required Maintenance of Registered Agent in California

1. 13 Required Maintenance of Records in California Office

1. 14 Places of Business Outside State of California

1. 15 Other Formation Matters

ARTICLE 2 MEMBERS

2. 01 Members

2. 02 Additional Members

2. 03 No Withdrawal

2. 04 Limitations on Liability of Members For Debts of Company

2. 05 Liability of Members to Company

2. 06 Rights of Judgment Creditor of Member

2. 07 Member Compensation

2. 08 Legal Representative or Successor of a Member

2. 09 Authority of Members

2. 10 Limitation on Power to Contract Debts

ARTICLE 3 CAPITAL CONTRIBUTIONS

3. 01 Initial Capital Contributions

3. 02 Additional Capital

3. 03 Percentage Interest of Member and Certificates

3. 04 Cancellation and Replacement of Certificates

3. 05 Limitation on Withdrawals of Capital Contributions

3. 06 Interest

ARTICLE 4 CAPITAL ACCOUNTS

4. 01 Capital Account for Each Member

4. 02 Simplified Description of Capital Account Determination

4. 03 Capital Account Adjustments for Special Events

4. 04 Power to Modify Capital Accounts to Comply with Tax Regulations

4. 05 Maintenance of Income (Drawing) Accounts

4. 06 Succession to Capital Accounts by Transferee of Interest

ARTICLE 5 MANAGEMENT AND CONTROL OF BUSINESS INCLUDING MEETINGS

5. 01 Management of Company

5. 02 Other Activities of Members Permitted

5. 03 Specific Powers and Limitations of Members as Managers

5. 04 Warranted Reliance by Members on Others

5. 05 Limitations on Liability of Members Acting as Managers

5. 06 Deadlock

5. 07 Annual Meeting of Members Not Required

5. 08 Special Meetings of Members

5. 09 Notices, Voting And Procedures at Meetings of Members

ARTICLE 6 ALLOCATIONS OF NET PROFITS AND NET LOSSES AND DISTRIBUTIONS

6. 01 Allocation of Net Profits and Net Losses

6. 02 Special Allocations

6. 03 *I.R.C. § 704(c)* Allocations

6. 04 Allocations of Net Profits and Losses and Distributions in Respect of Transferred Interests

6. 05 Distributions

ARTICLE 7 ACCOUNTING, RECORDS, AND REPORTING

7. 01 Accounting Decisions And Reliance on Others

7. 02 Maintenance of Books And Records And Accounting

7. 03 Fiscal Year End

7. 04 Bank Accounts

7. 05 Tax Returns

7. 06 Tax Matters for Company

7. 07 Annual Filing of List Of Managers and Designation of Agent for Service of Process

ARTICLE 8 TRANSFER AND ASSIGNMENT OF INTERESTS

8. 01 General Restriction on Transfers and Assignments of Membership Interests

8. 02 Substitution of Members After Transfer of a Membership Interest

8. 03 Effective Date of Permitted Transfers of a Membership Interest

8. 04 Effect of Transfers of Interest in Violation of Agreement

8. 05 Pledge or Grant of Security Interest Not a Transfer

ARTICLE 9 DISSOLUTION, WINDING UP, AND DISASSOCIATION EVENTS

9. 01 Company Dissolution

9. 02 Filing of Statement of Intent to Dissolve Company

9. 03 Winding up Affairs of Company

9. 04 Responsibility For Winding up Affairs of Company

9. 05 Order of Payment of Liabilities on Dissolution

9. 06 Limitations on Payments Made in Dissolution

9. 07 Consequences of Disassociation Event; Consent to Continue Business of Company

ARTICLE 10 OPTIONAL PURCHASE EVENTS

10. 01 "Optional Purchase Event" Defined

10. 02 Purchase Option

10. 03 Purchase Price

10. 04 Notice of Intent to Purchase

10. 05 Election to Purchase Less Than All of the Selling Member's Interest

10. 06 Payment of Purchase Price

10. 07 Closing of Purchase of Selling Member's Interest

10. 08 Purchase Terms Varied By Agreement

ARTICLE 11 INDEMNIFICATION

11. 01 Indemnification of Members And Managers

11. 02 Advance Undertakings For Indemnification

11. 03 Advancement of Expenses

11. 04 Indemnification of Others

11. 05 Standards of Conduct Required For Indemnification

11. 06 Procedures to Approve Indemnification

11. 07 Court Order of Indemnification

11. 08 Described Indemnification Rights as Non-exhaustive

11. 09 Construction of Indemnification Rights

11. 10 Definitions For Indemnification Provisions

11. 11 Insurance Funding of Indemnification

ARTICLE 12 MISCELLANEOUS

12. 01 Additional Documents And Acts

12. 02 Amendments

12. 03 Attorneys' Fees

12. 04 Binding Effect

12. 05 Complete Agreement

12. 06 Exhibits

12. 07 Governing law; Venue; Jurisdiction

12. 08 Arbitration

12. 09 Headings

12. 10 Counterparts

12. 11 Parties In Interest

12. 12 Not For Benefit of Creditors

12. 13 Notices

12. 14 Reliance on Authority of Person Signing Agreement

12. 15 Severability

12. 16 Specific Performance

12. 17 Interpretation

12. 18 Consent of Spouse

OPERATING AGREEMENT OF
_____ [*name*], LLC
a California Limited Liability Company

This operating agreement ("Agreement") of _____[*name*] ("Company") is entered into and effective as of _____[*date*] ("Effective Date") by and among _____[*member name*], _____[*member name*], _____[*investor name*], and _____[*investor name*] (each a "Member" and collectively, the "Members"), the signatories to this Agreement. This Agreement governs the relationship among the Company's Members and between the Company and its Members, pursuant to the Beverly-Killea Limited Liability Company Act ("Act") and the Articles, as either may be amended from time to time. Unless otherwise specified, capitalized words used in this Agreement have the meanings specified in Section 1.01 of this Agreement. In consideration of their mutual promises, covenants, and agreements, the parties as signatories to this Agreement hereby promise, covenant, and agree as follows:

RECITALS

The Members desire to enter into this Agreement to set forth their rights and liabilities as members, to provide for the Company's management, and to provide for certain other matters, all as permitted under the Act.

AGREEMENT

NOW THEREFORE, in consideration of the mutual promises, covenants, and undertakings specified herein with the intent to be obligated both legally and equitably, the parties agree as follows:

ARTICLE 1 INTRODUCTORY MATTERS

1.01. **Definition of Terms.** Capitalized terms used in this Agreement, unless the context otherwise requires, have the meanings specified in this Section 1.01 or, if not defined in this Section 1.01, elsewhere in this Agreement. Any term not defined below or in this Agreement is defined as provided in the Act or *Treas. Reg. §§ 1.704-1(b)*, 1.704-1(b)-2, 1.704-1(b)-3, and 1.704-1(b)-4, as appropriate to the context. When used in this Agreement and subject to the foregoing, the following terms have the meanings set forth below:

(a) "Act" means the Beverly-Killea Limited Liability Act, as amended from time to time.

(b) "Affiliate" means any individual, association, partnership, corporation, trust, or other entity, directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with the Member. The term "control," as used in the immediately preceding sentence, means, with respect to a corporation, the right to exercise, directly or indirectly, more than 50 percent of the voting rights attributable to the controlled corporation, and, with respect to any individual, association, partnership, trust, or other entity, directly or indirectly, possesses the power to direct or cause the direction of the management or policies of the controlled entity.

(c) "Agreement" means this Operating Agreement between all Members of Company regulating the affairs of Company and the conduct of its business, as originally executed and as amended or restated from time to time, and refers to this Agreement as a whole unless the context otherwise requires.

(d) "Articles" means the Articles of Organization for Company originally filed with the Secretary of State of California, including all amendments and restatements and refers to the Articles as a whole unless the context otherwise requires.

(e) "Assignee" means the owner of an Economic Interest who has not been admitted as a substitute Member in accordance with Article VIII.

(f) "Bankruptcy" means any of the following:

(1) The entry of a decree or order for relief by a court of competent jurisdiction in any involuntary case brought against a person under any bankruptcy, insolvency, or other similar law (collectively, "Debtor Relief Laws") generally affecting the rights of creditors and the relief of debtors now or hereafter in effect;

(2) The appointment of a receiver, liquidator, assignee, custodian, trustee, sequestrator, or other similar agent under applicable Debtor Relief Laws for a person or for any substantial part of the person's assets or property;

(3) The ordering of the winding up or liquidation of a person's affairs;

(4) The filing of a petition in any involuntary bankruptcy case, which petition remains not dismissed for a period of 180 days or that is not dismissed or suspended pursuant to *Section 305 of the Federal Bankruptcy Code* (or any corresponding provision of any future United States bankruptcy law);

(5) The commencement of a voluntary case under any applicable Debtor Relief Law;

(6) The consent to the entry of an order for relief in an involuntary case under any Debtor Relief Law or to the appointment of or the taking of possession by a receiver, liquidator, assignee, trustee, custodian, sequestrator, or other similar agent under any applicable Debtor Relief Laws for a person or for any substantial part of the person's assets or property; or

(7) The making by a person of any general assignment for the benefit of the person's creditors.

(g) "Capital Account" means the amount of the capital interest of a Member determined in accordance with Article IV of this Agreement.

(h) "Capital Contribution" means the value of any money, property (including promissory notes or other binding obligation to contribute money or property), obligation to render services to Company as capital in that Member's capacity as a Member, as shown in Exhibit A (attached to this Agreement and incorporated by reference), as may be amended from time to time.

(i) "Code" means the Internal Revenue Code of 1986, as amended. All references in this Agreement to sections of the Code include any corresponding provision or provisions of succeeding law.

(j) "Company" means _____[*name*].

(k) "Distribution" means a transfer of money or property by Company to its Members without consideration.

(l) "Disassociation Event" means, with respect to any Member, the death, retirement, withdrawal, resignation, expulsion, bankruptcy, or dissolution of the Member or the occurrence of any other event that terminates the continued membership in the Company.

(m) "Economic Interest" means the right to share in the Net Profits, Net Losses, deductions, credit, or similar items and to receive distributions from Company. The term does not include any other rights of a Member, including, without limitation, the right to vote or right to participate in the management of the Company or, except as provided in *Corp. Code § 17106*, any right to information concerning the business and affairs of Company.

(n) "Information Rights" means the right to inspect, copy, or obtain information and documents concerning the affairs of Company as provided in *Corp. Code § 17106* and in Sections 1.13 and 7.02 of this Agreement.

(o) "Interest" means, singly or collectively as the context indicates, any or all of the rights of ownership of a Membership Interest in Company including Economic Interests, Voting Interests, and Information Interests.

(p) "Majority-In-Interest" means, unless otherwise defined for a particular purpose in this Agreement, more than [*specify, e.g.*, 50 percent] of the interest of the Members in current Net Profits.

(q) "Manager" means any Member of Company.

(r) "Member" means each person (other than any person who has withdrawn, been expelled, died, retired, or dissolved) who has been admitted to Company as a Member in accordance with the Articles and this Agreement.

(s) "Membership Interest" in Company means a member's entire interest in the Company at any particular time, including the Member's Economic Interest, Voting Interest, and Information Interest as provided in this Agreement and under the Act, together with the obligations of the Member to comply with all terms and provisions of this Agreement. A Membership Interest constitutes personal property. A Member or assignee of any Economic Interest of a Member has no interest in specific property of Company.

[*OPTIONAL*]

(t) "Officer" means any person elected or appointed pursuant to Article V**.**

[*CONTINUE*]

(u) "Percentage Interest" means:

(1) For purposes of determining Voting Interests of a member, the Member's percentage set forth opposite the name of that Member under the column "Member's Percentage Voting Interest" in Exhibit A; and

(2) For purposes of allocations of Net Profits and Net Losses to a Member, the Member's percentage set forth opposite the name of that Member, respectively, in the columns headed "Member's Net Profits Percentage" or "Member's Net Losses Percentage" in Exhibit B as those percentage interests may be applied under this Agreement and adjusted from time to time pursuant to the terms of this Agreement.

For these above purposes, a Percentage Interest will be determined, unless otherwise provided in this Agreement, in accordance with the relative proportions of the Capital Accounts of Members, effective as of the first day of Company's fiscal year but with all distributions under Article VI to be deemed to have occurred on the day immediately before determination of the Percentage Interest of a Member.

(v) "Person" means individuals, general partnerships, limited partnerships, other limited liability companies, corporations, trusts, estates, real estate investment trusts, and any other association.

(w) "Prime Rate" as of a particular date means the prime rate of interest as published on that date in the Wall Street Journal, and generally defined therein as "the base rate on corporate loans posted by at least 75% of the nation's 30 largest banks." If the Wall Street Journal is not published on a date for which the Prime Rate must be determined, the Prime Rate is the prime rate published in the Wall Street Journal on the nearest-preceding date on which the Wall Street Journal was published.

(x) "Registered Office" means the office maintained at the street address of the agent for service of process of Company in California.

(y) "Regulations" means, unless the context clearly indicates otherwise, the regulations currently in force as final or temporary regulations that have been issued by the U.S. Department of Treasury pursuant to its authority under the Internal Revenue Code of 1986, as amended.

(z) "Return of Capital" means any distribution to a Member to the extent of the positive balance in the Capital Account of the Member immediately before the distribution.

(aa) "Secretary of State" means the Secretary of State of California or his or her duly appointed delegate unless another state is mentioned in the same context.

(bb) "Terminated Member" means a Member who, whether voluntarily or involuntarily, fails to devote at least [*specify, e.g.,* 1000 hours] per year of services to Company; provided, however, that this definition does not apply in the case of disability.

(cc) "Transfer" or "Transferred" means any sale, assignment, transfer, conveyance, pledge, hypothecation, or other disposition voluntarily or involuntarily, by operation of law, with or without consideration, or otherwise (including, without limitation, by way of intestacy, will, gift, bankruptcy, receivership, levy, execution, charging order, or other similar sale or seizure by legal process) of all or any portion of any Membership Interest.

(dd) "Voting Interests" means those rights of a Member described in Article V of this Agreement as they may be limited in this Agreement, the Articles, and the Act.

[*Select one of the following alternatives:*]

1.02. **Formation.** The Members acknowledge and confirm that they have formed a California limited liability company pursuant to the Act and that they are the initial Members of the limited liability company known as _____[*name*] organized under the laws of the State of California, whose Articles were filed, effective _____[*date*]. A copy of the Articles is attached to this Agreement. In connection with the execution of this Operating Agreement, the Members [have caused *or* promptly will cause] a Statement of Information that complies with the Act to be properly filed with the California Secretary of State, and will execute any further documents and take further actions as are appropriate to comply with the requirements of law for the formation and operation of a limited liability company in all places where Company may conduct its business.

[*OR*]

1.02. **Formation.** In connection with the execution of this Operating Agreement, the Members [have caused *or* promptly will cause] a Statement of Information that complies with the Act to be properly filed with the California Secretary of State, and will execute any further documents and take further actions as are appropriate to comply with the requirements of law for the formation and operation of a limited liability company in all places where Company may conduct its business.

[*CONTINUE*]

1.03. **Name.** The Company's name is _____[*name*]. All business of Company will be conducted under

the name _____[*name*] until the Members designate otherwise and file amendments to the Articles in accordance with the Articles and the Act. The term "LLC" will always appear as part of the name of Company on all correspondence, stationery, checks, invoices, and any and all documents and papers executed by Company and as otherwise required by the Act.

1.04. **Required Number of Members.** Company will at all times have at least [*specify required number of members, e.g.,* two] members.

1.05. **Term.** The Company's existence commenced on _____[*date*] and continues for the term stated in the Articles unless sooner terminated pursuant to Article 9.

[*Select one of the following alternatives; either:*]

1.06. **Purpose.** The general purposes for the organization of Company are those set forth in its Articles. Company may, as provided in its Articles and this Agreement, exercise all of the powers described in Title 2.5 of Corporations Code of the State of California, also known as the Act, as the Act may be amended from time to time.

[*OR*]

1.06. **Purpose.** The business of Company will be [specify particular business in which company will engage], to engage in all activities reasonably necessary or incidental to that business, and to engage in any or all businesses and related activities approved by the Members in which limited liability companies may engage under California law.

[*CONTINUE*]

1.07. **Regulation of Internal Affairs by Operating Agreement.** Consistent with the Articles and the Act, the internal affairs of Company and the conduct of its business will be governed and regulated by this Agreement as it may be amended by the Members. The term of this Agreement begins on the date that the Articles are filed and accepted by the Secretary of State and is coterminus with the period of duration of Company provided in the Articles, unless Company is earlier terminated on its voluntary or involuntary dissolution in accordance with this Agreement.

1.08. **Limited Liability.** Except as otherwise provided in this Agreement, or required by law, no Member is personally liable for any debt, obligation, or liability of the Company, whether that debt, obligation, or liability arises in contract, tort, or otherwise.

[*If partnership tax treatment is desired, use:*]

1.09. **Tax Classification.** The Members intend the Company to be classified as a partnership for federal and, to the maximum extent possible, state income taxes. This classification for tax purposes does not create or imply a general partnership, limited partnership, or joint venture between the Members for state law or any other purpose. Instead, the Members acknowledge the Company's status as a limited liability company formed under the Act and no Member will take any action inconsistent with the express intent of the parties to this Agreement.

[*Or, if corporate tax treatment is desired, use:*]

1.09. **Tax Classification.** The Members intend the Company to be classified as a corporation for federal and, to the

maximum extent possible, state income taxes.

[*CONTINUE*]

1.10. **Laws Governing Operating Agreement.** This Agreement is subject to, and governed by, the mandatory provisions of the Act and the Articles filed with the Secretary of State, as both may be amended from time to time. In the event of a direct conflict between the provisions of this Agreement and the mandatory provisions of the Act or the provisions of the Articles, the provisions of the Act or the Articles, as the case may be, control.

1.11. **Title to All Properties in Name of Company.** Real and personal property owned or purchased by Company will be held and owned, and conveyance made, in the name of Company. Written documents providing for the acquisition, mortgage, or disposition of property of Company are valid and binding on Company, except as otherwise limited in this Agreement, including Subsection 5.03(b), if executed by [*number of members required to approve acquisition and disposition of Company property*] or more Members of Company.

1.12. **Required Maintenance of Registered Agent in California.** Company will have an agent for service of process in California who may be either a natural person or a corporation meeting the qualifications of *Corp. Code § 17061*. Every agent for service of process must have a street address for the receipt of service of process. The agent's street address for receipt of service of process is the registered office of the limited liability company in California. If the agent changes the location of the agent's office, the agent for service of process must within 30 days file a certificate with the Secretary of State setting forth the names of the limited liability companies represented by the agent, the address at which the agent maintained the office for each of the limited liability companies, and the new address to which the office is transferred.

1.13. **Required Maintenance of Records in California Office.** Company will continuously maintain an office in the State of California, which may but need not be a place of its business in this state or its registered office, and at which the Company will maintain the following:

(a) A current list of the full name and last known business and residence address of each Member and of each holder of an Economic Interest, together with the Capital Contribution and Percentage Share in net profits and net losses.

(b) A copy of the filed Articles and all amendments thereto, together with any powers of attorney pursuant to which the Articles or any amendments were executed.

(c) A copy of this Agreement and any amendments thereto, together with any powers of attorney pursuant to which this Agreement or amendments were executed.

(d) Copies of Company's federal, state, and local income tax returns or information returns and reports, if any, for the six most recent taxable years.

(e) Copies of financial statements of Company for the six most recent taxable years.

These records are subject to the Inspection Rights, at the reasonable request and at the expense, of any Member during ordinary business hours.

1.14. **Places of Business Outside State of California.** The Members may identify other places of business of Company outside the State of California, appoint agents for service of process, and make filings as may be required or desired under the laws of those other places.

1.15. **Other Formation Matters.**

[*OPTIONAL*]

(a) **Adoption of Company Seal.** The Members will adopt a company seal circular in a form containing the words _____[*name*] together with the date of organization of Company**,** and any other information deemed appropriate.

[*CONTINUE*]

(b) **Maintenance of Company Record Book.** The Members will authorize the maintenance of a Company Record Book to include the Articles and this Operating Agreement, and any amendments, and the minutes of meetings (or written consents in lieu of meetings) of Members and Managers and other important Company documents.

(c) **Establishment of Bank Accounts.** The Members will authorize the establishment of one or more bank accounts for the funds of Company and designate persons authorized to draw against those accounts on behalf of Company (more specifically described elsewhere in this Agreement).

(d) **Obligation to Qualify to Do Business.** If required by law, the Members as Managers will qualify Company to do business in all states as required by obtaining a certificate of authority to do so from the Secretary of State or similar office.

(e) **Certificate of Manager of Limited Liability Company.** The Members may authorize the preparation of a certificate of Manager of Limited Liability Company setting forth the full legal name of Company, date of organization, the laws of organization, term of existence, good standing status as of the date of the certificate, name of manager, general description of authority of manager, taxpayer identification number with attachment of Article V as it may have been amended to date of this Agreement setting forth the management and control of the operations of Company.

[*OPTIONAL*]

(f) **Reimbursement of Expenses of Organization.** The Members authorize the Company to pay the expenses of organization and to reimburse any person advancing funds for this purpose.

[*CONTINUE*]

ARTICLE 2 MEMBERS

2.01. **Members.** The initial Members are each of the persons executing this Agreement and making the initial Capital Contributions set forth opposite their respective names in Exhibit A. Each initial Member is admitted as a Member effective as of the beginning of the Term of this Agreement. The Members, their respective addresses, their respective aggregate Capital Contributions to Company, and their respective Voting Interests and Percentage Interests in Net Profits and Net Losses (Economic Interests) of Company are set forth in Exhibits A and B, as the exhibits may be amended from time to time.

2.02. **Additional Members.** No additional Members, other than Permitted Transferees, may be admitted to Company without the unanimous written consent of the Members, which consent may be withheld for any reason or for no reason. On the admission of an additional Member pursuant to this Section 2.02, each Member (including the additional Member) will execute an amendment to this Agreement: (1) reflecting the Members' new Percentage Interests and (2)

evidencing the additional Member's consent to be bound by the provisions of this Agreement. The admission of any additional Member may result in a dilution of the Percentage Interests of the then Members in their Voting Interests and Economic Interests (Net Profits and Net Losses).

[*OPTIONAL*]

2.03. **No Withdrawal.** No Member may withdraw, retire, or resign from Company.

[*Continue*]

2.04. **Limitations on Liability of Members for Debts of Company.** Except as provided in this Agreement and *Corp. Code § 17254*, relating to distributions by Company, and *Corp. Code § 17101(b)*, relating to responsibility of Members for certain unsatisfied debts or obligations of Company, no Member will be liable under a judgment, decree, or order of a court, or in any other manner, for a debt, obligation, or liability of Company whether that liability or obligation arises in contract or tort. No Member will be required to loan any funds to Company. No Member will be required to make any contribution to Company by reason of any negative balance in the Member's capital account, nor will any negative balance in a Member's capital account create any liability on the part of the Member to any third party.

2.05. **Liability of Members to Company.**

(a) **Liability of Members to Company.** A Member is liable to Company: (1) for the difference between the Member's contribution to capital as actually made and that stated in the Articles, this Agreement, subscription for contribution, or other document executed by the Member as having been made by the Member; and (2) for any unpaid contribution to capital which the Member agreed in the Articles, this Agreement, or other document executed by the Member to make in the future at the time and on the conditions stated in the Articles of Organization, this Agreement, or other document evidencing that agreement. No Member will be excused from an obligation to Company to perform any promise to contribute money or property or to perform services because of death, disability, dissolution, or any other reason.

(b) **Member as Trustee for Company.** A Member holds as trustee for Company (1) specific property stated in the Articles of Organization, this Agreement, or other document executed by the Member as contributed by that Member, but that was not contributed or that has been wrongfully or erroneously returned; and (2) money or other property wrongfully paid or conveyed to the Member on account of the Member's contribution.

(c) **Waiver of Liability of Member.** The liabilities of a Member as set out in this Section 2.05 can be waived only by the unanimous written consent of the Members. However, a waiver does not affect the right of a creditor of Company who extended credit or whose claim arose after the filing and before a cancellation or amendment of the Articles of Organization to enforce the liabilities.

(d) **Liability of Member Receiving a Return of Capital.** When a Member has rightfully received the return in whole or in part of the capital of the Member's contribution, the Member is nevertheless liable to Company for a period of six years after the return of the capital contribution for any sum, not in excess of the return without interest, necessary to discharge Company's liability to all creditors of Company who extended credit during the period the capital contribution was held by Company or whose claims arose before the return.

(e) **No Responsibility for Pre-Formation Commitments.** In the event any Member (or any of the Member's shareholders or affiliates), (collectively "liable Member") incurs any indebtedness or obligation before the date of this Agreement that relates to or otherwise affects Company, neither Company nor any other Member will have any liability or responsibility for that indebtedness or obligation unless that indebtedness or obligation is assumed by Company

pursuant to a written instrument signed by all Members. Furthermore, neither Company nor any Member will be responsible or liable for any indebtedness or obligation that is hereafter incurred by any other liable Member. In the event that a liable Member, whether before or after the date of this Agreement, incurs (or has incurred) any debt or obligation that neither Company nor the other Members has any responsibility or liability for, the liable Member will indemnify and hold harmless Company and the other Members from any liability or obligation they may incur in respect thereof.

2.06. **Rights of Judgment Creditor of Member.** On application to a court of competent jurisdiction by a judgment creditor of a Member, the court may charge the Membership Interest with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an Assignee of the Membership Interest. This Section 2.06 does not deprive any Member of the benefit of any exemption from legal process applicable to that Member's interest.

[*Select one of the following alternatives:*]

2.07. **Member Compensation.** Unless approved by all of the Members, no Member or an Affiliate of a Member is entitled to any payment or compensation for services rendered or goods provided to, or on behalf of, Company, except for reasonable compensation under *Corp. Code § 17352(z)* for winding up of Company's affairs. Any compensation paid by Company to a Member or an Affiliate of a Member, pursuant to this Section 2.07, will be treated as a payment to a person who is not a Member under *I.R.C. § 707(a)* or *707(c)*.

[*OR*]

2.07. **Member Compensation.** Unless approved by all of the Members, no Member or an Affiliate of a Member is entitled to any payment or compensation for services rendered to, or on behalf of, Company, except for reasonable compensation under *Corp. Code § 17352(z)* for winding up of Company affairs. The Members may authorize reimbursement of all expenses of Company reasonably incurred and paid by the Member on behalf of Company.

[*CONTINUE*]

2.08. **Legal Representative or Successor of a Member**. If an individual Member dies or is adjudged by a court of competent jurisdiction to be incompetent to manage his or her person or property, the executor, administrator, guardian, conservator, or other legal representative may exercise all rights of that Member for the sole purpose of settling the estate or administering that Member's property.

2.09. **Authority of Members.** The Members will manage the Company. Except as otherwise provided in this Agreement, each Member as Manager has the full and complete authority, power, and discretion to act for and bind Company in the ordinary course of Company's business, except as provided below, and specifically Article 5.

2.10. **Limitation on Power to Contract Debts.** Except as otherwise provided in this Agreement, no debt will be contracted or liability incurred by or on behalf of Company, except by any Member as provided in the Articles and with particular reference to Article 5 of this Agreement.

ARTICLE 3 CAPITAL CONTRIBUTIONS

3.01. **Initial Capital Contributions.** As provided in the Articles, the Members will concurrently with a Member's execution of this Agreement make the initial Capital Contributions in the form of money (including promissory notes), property, or services rendered or to be rendered or other obligation to contribute money or property or to render

services, as set forth opposite that Member's name in Exhibit A to this Agreement.

3.02. **Additional Capital.** The Members may make any subsequent Capital Contributions in any type of money (including promissory notes), property, and services rendered or to be rendered as may be agreed on by all of the Members. No Member may be required to make any additional Capital Contributions to Company other than the capital contributions set opposite to the name of the Member in Exhibit A, as it may be amended from time to time. However, if Company's revenues are insufficient to pay Company's expenses, the Members have the opportunity, but not the obligation, to contribute additional capital in cash to Company on a pro-rata basis in accordance with their respective Percentage Interests. Each Member will receive a credit to that Member's Capital Account in the amount of any additional capital that the Member contributes to Company. Immediately following such Capital Contributions, the Percentage Interests will be adjusted, and Exhibit A will be revised, to reflect the new relative proportions of the Members' Capital Accounts. To obtain additional funds or for other business purposes, a Member may contribute additional capital to Company, but only upon the written consent of all other Members. As a condition to the acceptance of property other than money in Company, the value of the property will be determined by agreement of the contributing member and Company as evidenced by a signed writing.

3.03. **Percentage Interest of Member And Certificates**. The Membership Interest of Company held by each Member may be divided into a Percentage Interest to represent, respectively, voting power, allocation of Net Profits, and allocation of Net Losses as reflected, respectively, in Exhibit A and Exhibit B, as each exhibit may be amended from time to time. The Membership Interest in Company may be represented by a certificate of membership. The exact contents of a certificate of membership may be determined by action of the Members but will be issued substantially in conformity with the following requirements:

(a) Each certificate of membership will be consecutively numbered beginning with Number 1, and as each certificate is issued, it will be signed by the authorized representatives of Company and will be impressed with Company seal, if Company obtains one.

(b) Each certificate of membership will state the name of Company, the laws of the state under which Company is organized, the name of the person to whom the certificate is issued, the date the certificate is issued, and the Percentage Interest represented by the certificate.

(c) Each certificate will contain a statement of the designations, preferences, qualifications, limitations, restrictions, and special or relative rights of the Interests represented thereby, set forth in full or summarized on the face or back of the certificates that Company shall issue. Or, in lieu thereof, the certificate may set forth that the Company will furnish the statement or summary to any holder of the Interests on request and without charge.

3.04. **Cancellation and Replacement of Certificates.** All certificates of membership surrendered to Company for transfer will be canceled and no new certificates of membership will be issued in lieu thereof until the former certificates for a like number of Membership Interests have been surrendered and canceled, except as provided in this Agreement with respect to lost, stolen, or destroyed certificates. Any Member claiming that the Member's certificate of membership is lost, stolen, or destroyed may make an affidavit or affirmation of that fact and submit the same to the other Members of Company, accompanied by a signed application for a new certificate. Thereupon, and on the giving of a satisfactory bond of indemnity to Company not exceeding an amount double the value of the Membership Interests as represented by that certificate (the necessity for such a bond and the amount required to be determined by the Members of Company), a new certificate may be issued of the same tenor and representing the same Percentage Membership Interests as were represented by the certificate alleged to be lost, stolen, or destroyed.

3.05. **Limitations on Withdrawals of Capital Contribution**. Except as otherwise specifically provided in this Agreement, no Member has the right to demand the return of, or withdraw, any or all of that Member's Capital Contribution before the dissolution and winding up of Company. No Member guarantees the return of another

Member's Capital Contribution. No Member is required to contribute or to lend any cash or property to Company to enable Company to return any Member's Capital Contributions. No Member will receive property or any part of that Member's Capital Contribution until (1) all liabilities of Company, except liabilities to Members on account of their Capital Contributions, have been paid or there remains property of Company sufficient to pay them; (2) the consent of the Members holding a Majority-In-Interest or more is had, unless the return of the Capital Contributions may be rightfully demanded as provided in the Act; (3) the Articles are canceled or so amended as to allow the withdrawal or reduction. In the absence of a statement in the Articles to the contrary or the consent of Members holding at least a Majority-In-Interest, a Member, irrespective of the nature of the Member's contribution, has no right to demand and receive cash in return for the Member's Capital Contribution until the dissolution of Company. The withdrawn Member has only the rights of a holder of an Economic Interest with respect to the withdrawing Member's interest in the Company to which a holder of an Economic Interest in company is entitled, and then only with respect to distributions, if made pursuant to Article 6.

3.06. **Interest.** Members have no right to receive interest on any Capital Contributions or Capital Account balance, absent the unanimous written consent of the Members.

ARTICLE 4 CAPITAL ACCOUNTS

4.01. **Capital Accounts For Each Member.** The Company will establish and the Members will maintain a separate Capital Account (as defined in simplified *form in Section 4.02*) for each Member strictly in accordance with the requirements of *I.R.C. § 704(b)* and applicable regulations. The Members intend that the Capital Accounts of the Members be maintained strictly in accordance with the rules of *Treas. Reg. § 1.704-1(b)(2)(iv)*, as amended from time to time. In this connection, to the extent the results determined under a literal application of this Paragraph 4.1 vary from the results that would be obtainable under the rules described in *Treas. Reg. § 1.704-1(b)(2)(iv)*, the rules set forth in *Treas. Reg. § 1.704-1(b)(2)(iv)* will be used and govern the maintenance of capital accounts under this Agreement.

4.02. **Simplified Description of Capital Account Determination**. Subject to the other paragraphs in this Agreement, "Capital Account" generally means the amount of money contributed by the Member to Company,

(a) Increased (credited) by:

(1) The fair market value of property other than money contributed by the Member to Company as determined by the contributing Member and Company; and

(2) The Net Profits allocated to the Member; and

(3) The amount of any liabilities of Company assumed by Member or that are secured by property distributed to Member by Company; and

(b) Decreased (debited) by:

(1) The amount of money distributed to the Member;

(2) The fair market value of property distributed to the Member by Company as determined by recipient Member and Company;

(3) The Member's share of expenditures of Company described in *I.R.C. § 705(a)(2)(B)* (including, for this purpose, losses which are nondeductible under *I.R.C. § 267(a)(1)* or *I.R.C. § 707(b)*;

(4) The Member's share of amounts paid or incurred by Company to organize Company or to promote the sale of (or to

sell) an interest in Company (except to the extent properly amortizable for income tax purposes);

(5) The Net Losses allocated to the Member; and

(6) The amount of any liabilities the Member assumed by Company or secured by property contributed by Member of Company.

4.03. **Capital Account Adjustments For Special Events.**

(a) **Succession to Capital Account.** If a Member transfers all or part of a Membership Interest in accordance with this Agreement, that member's Capital Account attributable to the transferred Membership Interest shall carry over to the new owner of the Membership Interest pursuant to *Treas. Reg. § 1.704-1(b)(2)(iv)* and the transferee will succeed to the Capital Account of the transferor to the extent that it relates to the transferred interest.

(b) **Assumption of Liability.** An assumption of unsecured liability by Company will be treated as a distribution of money to the Member. An assumption of the unsecured liability of Company by a Member will be treated as a cash contribution to Company. In determining the amount of any liability for this purpose, there shall be taken into account *Internal Revenue Code Section 752(c)* and any other applicable provisions of the Code and Regulations.

(c) **Adjustment for Noncash Distribution.** In the event that assets of Company other than cash are distributed in kind to a Member, Capital Accounts will be adjusted for the hypothetical "book" gain or loss that would have been realized by Company if the distributed assets had been sold for their fair market values in a cash sale (in order to reflect unrealized gain or loss).

(d) **Adjustment to Fair Market on Transfer of Interest.** Capital Accounts will be adjusted to reflect fair market value of all properties in the event of acquisition of Membership Interest by an existing or new Member.

(e) **Adjustment for Constructive Termination of Company.** Capital Accounts will also be adjusted on the constructive termination of Company as provided under *I.R.C. § 708* in accordance with the method set forth in the immediately preceding subsection (as required by *Treas. Reg. § 1.704-1(b)(2)(iv)(b)*.

(f) **Adjustment for Recapture of Certain Credits.** Capital Accounts will be adjusted appropriately on account of investment tax credit and investment tax credit recapture in accordance with the principles of *I.R.C. § 48*.

4.04. **Power to Modify Capital Accounts to Company With Tax Regulations.** The foregoing provisions and the other provisions of this Agreement relating to the maintenance of Capital Accounts are intended to comply with *Treas. Reg. § 1.704-1(b)(2)(iv)*, and will be interpreted and applied in a manner consistent with the Regulations. In the event that the Members determine that it is necessary to modify the manner in which the Capital Accounts are computed to comply with the Regulations and to reflect the agreed on allocation of the distribution of cash, the Members may make a modification, provided that it is not likely to have a material effect on the amounts distributable to any member on the dissolution of Company. The Members will also make any appropriate modifications in the event unanticipated events occur that might otherwise cause this Agreement not to comply with *Treas. Reg. § 1.704-1(b)(2)(iv)*.

4.05. **Maintenance of Income (Drawing) Accounts.** A separate individual income account will be maintained for each Member. At the end of each fiscal year, each Member's share of the Net Profits and Net Losses of Company will be credited or debited to, and any withdrawals during the fiscal year deducted from, that Member's income account. After these amounts have been credited or debited to and deducted from the income account of a Member, any balance or deficit remaining in the account will be transferred to or charged against the individual capital account of that Member.

ARTICLE 5 MANAGEMENT AND CONTROL OF BUSINESS INCLUDING MEETINGS

5.01. **Management of Company.**

(a) **Management by Members.** The Members as managers will manage Company. Except as otherwise provided in this Agreement, each Member has the full and complete authority, power, and discretion to act for and bind Company in the ordinary course of Company's business.

(b) **General Duties and Obligations.** Except as otherwise provided in this Agreement, no Member will have any authority to hold itself out as a general or special agent of Company in any business or other activity. The Members will take all actions that may be necessary or appropriate (1) for the continuation of the Company's valid existence as a limited liability company under the Act, and (2) for the acquisition, development, maintenance, preservation, and operation of Company property in accordance with the provisions of this Agreement and applicable laws and regulations.

[*OPTIONAL*]

(c) **Insurance.** The Members will cause Company to procure and maintain in force a reasonable amount of insurance covering the Company and Company property for all types of liability and loss.

[*CONTINUE*]

(d) **Competition.** During the term of Company, each Member may engage in any business activity for his or her own profit or advantage without the other Members' consent; provided, however, no Member may engage in any activity that is in direct competition with Company's business.

[*Select one of the following alternatives:*]

5.02. **Other Activities of Members Permitted.** The Members may engage in other business activities and are obliged to devote only as much of their time to the business of Company as shall be reasonably required in light of the purposes of Company. A Member will perform the duties as a Manager in good faith, in a manner that the Member reasonably believes to be in the best interests of Company, and with such care as a reasonable person under similar circumstances. A Member who so performs the Member's duties as Manager will not have any liability by reason of being or having been a Manager of Company.

[*OR*]

5.02. **Other Activities of Members Permitted.** The Members must, unless otherwise agreed by the Members, devote full business time to the business and affairs of Company except that a Member (1) may engage in incidental other business activities that do not compete with Company or interfere with the Member's services to Company, and (2) may engage in personal investment activities in enterprises that do not directly compete with Company.

[*CONTINUE*]

5.03. **Specific Powers and Limitations of Members as Managers.**

(a) **Powers of Members as Managers.** Each Member as Manager has the power and authority to act on Company's

behalf, subject to the limitations of the Act and the following limitations:

(1) To acquire property from any person as the Members may determine. The fact that a Member is directly or indirectly affiliated or connected with any such person does not prohibit a Manager from dealing with that person or entity.

(2) To borrow money for Company from banks, other lending institutions, the Members, or Affiliates of the Members on the terms that the Member deems appropriate, and in that connection, to hypothecate, encumber, and grant security interests in the assets of Company to secure repayment of the borrowed sums. Except as otherwise provided in the Act, no debt will be contracted or liability incurred by or on behalf of Company, except by the Members.

(3) To purchase liability and other insurance to protect the property and business of Company.

(4) To hold and own any Company real and personal properties in the name of Company.

(5) To execute on behalf of Company all instruments and documents, including, without limitation, checks; drafts; notes and other negotiable instruments; mortgages or deeds of trust; security agreements; financing statements; documents providing for the acquisition, mortgage, or disposition of property of Company; assignments; bills of sale; leases; partnership agreements; and any other instruments or documents reasonably believed to be necessary in the opinion of the Members, to the business of Company.

(6) To employ accountants, legal counsel, managing agents, and other experts to perform services for Company and to compensate them from Company funds.

(7) To retain and compensate employees and agents generally, and to define their duties.

(8) To enter into any and all other agreements on behalf of Company, with any other person or entity for any purpose necessary or appropriate to the conduct of the business of Company.

(9) To reimburse all expenses of Company reasonably incurred and paid by the Members on behalf of Company.

(10) To do and perform all other acts as may be necessary or appropriate to the conduct of the business of Company.

[*Add the following, if desired:*]

Except that items 1 through 4 must be approved [in writing by _____ (*specify, e.g.,* 51 percent) of the Members at a meeting, via written consent signed by _____ (*specify, e.g.,* 51 percent) of the Members *or* by _____ (*specify, e.g.,* 51 percent) of the Voting Interest of all the Members].

[*CONTINUE*]

(b) **Limitations on Power of Members as Managers.** Notwithstanding the provisions of Section 5.03(a), *above*, no act shall be taken, sum expended, decision made, or obligation incurred by any member regarding a matter within the scope of any of the major decisions enumerated below ("Major Decisions") unless and until the same has been approved [in writing by all Members at a meeting *or* via unanimous written consent by the Members *or* by _____ (*specify, e.g.,* 75 percent) of the Voting Interest of all the Members]. "Major Decisions" are the following:

(1) The transfer, exchange, or other disposition of all Company's assets, any significant portion thereof, or any significant interest in Company assets occurring as part of a single transaction or plan.

(2) The merger of Company with any other limited liability company, limited partnership, or corporation.

(3) Contracting on behalf of Company of any debt, obligation, or liability on behalf of Company of more than _____ [*specify, e.g.,* $1,000], except for trade debt incurred in the ordinary course of Company's business and due within 12 months.

(4) Making any single expenditure in excess of _____ [*specify, e.g.,* $10,000], or expenditures in any one year that in the aggregate are in excess of _____ [*specify, e.g.,* $25,000].

(5) Approving the transfer of a Membership Interest and the admission of an Assignee as a Member.

(6) Amending the Articles or this Agreement.

(7) Performing any act that would make it impossible to carry on the ordinary business of Company.

(8) Making, executing, or delivering on behalf of Company any assignment for the benefit of creditors or any guarantee, indemnity bond, or surety bond, or any equivalent thereof.

(9) Lending funds belonging to Company to any third party or extending to any person, firm, or corporation, credit on behalf of Company, except in the ordinary course of business or as set forth in this Agreement.

(10) Changing the amount or character of Capital Contributions, or changing the character of the business of Company.

(11) Investing any funds of Company temporarily (by way of example and not imitation) in time deposits, short-term governmental obligations, commercial paper, or other investments.

(c) **Members as Agent of Company.** Every Member is an agent of Company for the purpose of its business, and for every other Member, for purposes of the execution in name of Company of any instrument for apparently carrying on in the usual way the business of Company and binds Company, unless that act is in contravention of the Articles or this Agreement, or unless the Member so acting otherwise lacks the authority to act for Company and the person with whom the Member is dealing knows or should have known that the Member has no such authority.

(d) **Acts of Member as Conclusive Evidence of Authority.** Every contract, deed, mortgage, lease and other instrument executed by at least [*specify, e.g.,* two] Members is conclusive evidence in favor of every person relying on or claiming under the instrument that at the time of its delivery (1) Company was in existence, (2) neither this Agreement nor the Articles had been amended in any manner so as to restrict the delegation of authority among Members, and (3) the execution and delivery of the instrument was duly authorized by Members. Any person may always rely on a certificate addressed to him or her and signed by any two Members:

(1) As to who are the Members under this Agreement.

(2) As to the existence or non-existence of any fact that constitutes a condition precedent to acts by the Members or in any other manner germane to the affairs of Company.

(3) As to who is authorized to execute and deliver any instrument or document of Company.

(4) As to the authenticity of any copy of the Articles or this Agreement, including amendments, and any other document relating to the conduct of the affairs of Company.

(5) As to any act or failure to act by Company or as to any other matter whatsoever involving Company or any Member in Member's capacity as a Member or Manager.

5.04. **Warranted Reliance by Members on Others.** In performing their duties, the Members as Managers are entitled to rely on information, opinions, reports, or statements of the following persons or groups unless they have knowledge concerning the matter in question that would cause that reliance to be unwarranted:

(a) One or more employees or other agents of Company whom the Managers reasonably believe to be reliable and competent in the matters presented.

(b) Any attorney, public accountant, or other person as to matters which the Managers reasonably believe to be within that person's professional or expert competence.

(c) A committee on which the Member does not serve, duly designated in accordance with a provision of the Articles or this Agreement, as to matters within its designated authority, provided that the Members reasonably believe the committee merits competence.

5.05. **Limitations on Liability of Members Acting as Managers.** A Member acting as a Manager is not liable to Company or the other Members for any loss or damage resulting from any mistake of fact or judgment or any act or failure to act unless the mistake, act, or failure to act is the result of fraud, bad faith, gross negligence, or willful misconduct.

5.06. **Deadlock.** If the Members are deadlocked on any matter or any decision, the Members must promptly select a mutually acceptable unrelated and independent individual who will, after good faith discussions with the Members, resolve the deadlocked matter (including, if necessary, by causing his or her vote in favor of a proposed resolution). If the Members cannot agree on the selection of such an individual, any Member is entitled to request that an official of the local office of the American Arbitration Association ("AAA") appoint such an individual. That Member will promptly give written notice to the other Members that such request has been made (whereupon no other Member will be entitled to make a duplicative request to the AAA). In this event, the official of the AAA will be instructed to use his or her best efforts to appoint an individual who (1) is of good reputation and possesses [*specify requisite experience, e.g.*, a minimum of five years experience as a senior executive of a retail company], and (2) has no prior relationship with either the requesting Member or Company. The appointed individual will, after good faith discussions with the Members, resolve the deadlocked matter (including, if necessary, by causing his or her vote in favor of a proposed resolution in the event that no consensus can be reached on the conclusion of these discussions). Company will indemnify and hold harmless any individual selected or appointed in accordance with the foregoing to the same extent that the person would be indemnified if he or she were a Member of Company. However, in no event will any such individual be designated or construed to be a Member of Company.

5.07. **Annual Meeting of Members Not Required.** The Members may but need not hold an annual meeting and may hold additional regular meetings. When held, the meetings must be noticed, held and conducted pursuant to the Act. Any action required or permitted to be taken by the Members at a meeting may be taken by the written consent of Members having not less than the minimum number of votes that would be necessary to authorize or take that action at a meeting at which all Members entitled to vote on that action at a meeting were present and voted.

5.08. **Special Meetings of Members**

(a) **Power to Call Special Meeting.** Special meetings of Members for any purpose or purposes of addressing any matters on which Members may vote, unless otherwise proscribed by the Act or by the Articles, may be called on written demand of any Member or Members representing at least [*specify, e.g.,* 10 percent] of the Voting Interests on any issue proposed to be considered.

(a) **Date, Time, and Place of Special Meeting.** Special meetings of Members for any purpose may be held at the date, time, and place within or without the State of California as stated in the notice of the meeting or in a duly executed and delivered waiver of notice, provided that notice of the meeting is given in accordance with Section 5.09, *below* .

5.09. **Notices, Voting and Procedures at Meetings of Members**.

(a) **Required Notification of Meetings of Members.** The Member or Members calling a meeting of Members will deliver or mail written notice to all Members stating the date, time, and place of any meeting of Members to each Member of record entitled to vote at the meeting, at the address as appears in the records of Company. In the case of a special meeting of Members or when otherwise required by law, the notice must contain a description of the purposes for which the meeting is called. Notice must be mailed _____[*specify, e.g.,* at least 10 days but not more than 60 days before the date of the meeting]. A Member may waive notice of any meeting, before or after the date of the meeting, by delivering a signed waiver to Company for inclusion in the minutes of Company. A Member's attendance at any meeting of members, in person or by proxy (1) waives objection to lack of notice or defective notice of the meeting, unless the Member at the beginning of the meeting objects to holding the meeting or transacting business at the meeting, and (2) waives objection to consideration of a particular matter at the meeting that is not within the purposes described in the meeting notice, unless the Member objects to considering the matter when it is presented.

(b) **Record Date for Eligibility of Members to Vote at Meetings of Members.** The record date for the purpose of determining the Members entitled to notice of a meeting of Members, for demanding a special meeting of Members, for voting, or for taking any other action shall be the tenth day before the date of the meeting or other action.

(c) **Quorum.** At any meeting of the Members, the presence of Members entitled to cast at least [*specify, e.g.,* 51 percent] of the total votes of all Members entitled to vote at the meeting constitutes a quorum.

(d) **Voting by Members at Meetings of Members.** A Member may appoint a proxy to vote or otherwise act for the Member pursuant to a written appointment form executed by the Member or the Member's duly authorized attorney-in-fact. An appointment of a proxy is effective when received by the Managers of Company. The general proxy of a fiduciary is given the same effect as the general proxy of any other Member. A proxy appointment is valid for eleven months unless otherwise expressly stated in the appointment form.

(e) **Relative Weight of Votes of Members at Meetings of Members.** At any meeting of Members, each Member entitled to vote will have a number of votes equal to the product of (1) the Member's percentage of Voting Interest as set forth in Exhibit A, as amended from time to time, multiplied by (2) one hundred. At any meeting of members, presence of Members entitled to cast at least 51 percent of the total votes of all Members entitled to vote at the meeting constitutes a quorum. Except for matters relating to the continuation of the business of Company on the occurrence of a condition of dissolution, action on a matter is approved if it receives approval by at least 51 percent of the total number of votes entitled to be cast by all Members in Company entitled to vote at the meeting or any greater number as may be required by law, the Articles, or this Agreement for the particular matter under consideration. On the occurrence of a Disassociation Event (as defined in Article 1), a Selling Member is not entitled to any vote in determining whether Company will purchase the interest of that Selling Member as permitted in Article 10 of this Agreement. Any Assignee of a Member's Interest is not entitled to vote or participate on any matters at any meeting unless that Assignee become a substitute Member as provided in Article 8 of this Agreement.

(f) **Appointment of Chair and Secretary for Meetings of Members.** At any annual or special meeting of Members, the Members will appoint a person to preside as chair at the meeting and a person to act as secretary of the meeting. The secretary of the meeting will prepare minutes of the meeting, which shall be placed in the minute books of Company.

(g) **Consent by Members in Lieu of Meetings of Members.** Subject to the applicable laws of the State of California,

any action required or permitted to be taken at a Members' meeting may be taken without a meeting if the action is approved by the written consent of the Members entitled to vote on the action. The written consent must describe the action to be taken, be signed by all the Members entitled to vote on the action, and delivered to Company for inclusion in the Company minutes. The record date for determining Members entitled to take action without a meeting is the first date a Member signs the consent to that action.

[*OPTIONAL*]

(h) **Telephonic Participation by Members at Meetings of Members.** Any or all Members may participate in any annual or special Members' meeting by, or through the use of, any means of communication by which all Members participating may simultaneously hear each other during the meeting. A Member so participating is deemed to be present in person at the meeting of Members.

[*If company will have officers, provide for their election, term, compensation, and powers and duties, see § 12C.227.*]

[*CONTINUE*]

ARTICLE 6 ALLOCATIONS OF NET PROFITS AND NET LOSSES AND DISTRIBUTIONS

PRACTICE TIP

These provisions should be drafted in consultation with the LLC's accountant.

6.01. **Allocations of Net Profits and Net Losses.**

(a) **Definitions.** As used in this Agreement, the following terms have the meanings set forth below:

(1) "Net Profit" and "Net Loss" means the income, gain, loss, deductions, and credits of Company in the aggregate or separately stated, as appropriate, determined in accordance with the method of accounting at the close of each fiscal year employed on Company's information tax return filed for federal income tax purposes; provided, that Net Profit and Net Loss do not include any items that are specially allocated pursuant to Section 6.02, below.

(2) "Fiscal Year" for Company means _____ [the calendar year *or as specified elsewhere in agreement*], unless and until changed to a different fiscal year with the consent of a Majority Interest of the Members.

(3) "Minimum Gain" means the excess of the fair market value of a Property over the tax basis of that Property, provided that Minimum Gain is never less than the excess of the amount by which the Nonrecourse Liability secured by a Property exceeds the tax basis of such Property.

(4) "Nonrecourse Liability" means any liability secured by a Property or Company assets with respect to which no Member (or a party closely related to or affiliated with the Member) is personally liable.

(b) **Allocation of Net Loss.** Net Loss will be allocated to the Members in proportion to their percentage interests. Notwithstanding the previous sentence, loss allocations to a Member will, to the extent possible, be made only to the extent that the loss allocations will not create a deficit Capital Account balance for that Member in excess of an amount, equal to that Member's share of Minimum Gain of Company (as defined above). Any loss not allocated to a Member because of the foregoing provision will be allocated to the other Members (to the extent the other Members are not limited pursuant to the allocation of losses stated above). Any loss reallocated under this Section 6.01(b) will be taken into account in computing subsequent allocations of income and losses pursuant to this Paragraph, so that the net

amount of any item so allocated and the income and losses allocated to each Member pursuant to this Section 6.01, will be to the extent possible equal to the net amount that would have been allocated to each Member pursuant to this Section 6.01 if no reallocation of losses had occurred.

(c) **Net Profit.** Net Profit will be allocated to the Members in proportion to their percentage interests.

6.02. **Special Allocations.** Although allocations different than those set forth in Section 6.01, above, are not anticipated, for federal tax purposes Company must follow certain special allocation rules in the event of unanticipated economic circumstances. Accordingly, notwithstanding Section 6.01:

(a) **Minimum Gain Chargeback.** If there is a net decrease in Company Minimum Gain occurs during any fiscal year, each Member must be specially allocated items of Company income and gain for that fiscal year (and, if necessary, in subsequent fiscal years) in an amount equal to the portion of that Member's share of the net decrease in Company Minimum Gain that is allocable to the disposition of Company property subject to a Nonrecourse Liability, which share of net decrease will be determined in accordance with *Treas. Reg. § 1.704-2(g)(2)*. Allocations pursuant to this Paragraph will be made in proportion to the amounts required to be allocated to each Member under this Paragraph). The items to be so allocated will be determined in accordance with *Treas. Reg. § 1.704-2(f)*. This Paragraph is intended to comply with the minimum gain chargeback requirement contained in *Treas. Reg. § 1.704-2(f)* and will be interpreted consistently with that Regulation.

(b) **Chargeback of Minimum Gain Attributable to Member Nonrecourse Debt.** If a net decrease in Company Minimum Gain attributable to a Member Nonrecourse Debt occurs during any fiscal year, each Member who has a share of the Company Minimum Gain attributable to that Member Nonrecourse Debt (which share will be determined in accordance with *Treas. Reg § 1.704-2(i)(5)*) will be specially allocated items of Company income and gain for that fiscal year (and, if necessary, in subsequent fiscal years) in an amount equal to that portion of that Member's share of the net decrease in Company Minimum Gain attributable to that Member Nonrecourse Debt that is allocable to the disposition of Company property subject to that Member Nonrecourse Debt (which share of the net decrease will be determined in accordance with *Treas. Reg § 1.704-2(i)(5)*). Allocations pursuant to this Section will be made in proportion to the amounts required to be allocated to each Member under this Article. The items to be so allocated will be determined in accordance with *Treas. Reg § 1.704-2(i)(4)*. This Subsection (b) is intended to comply with the minimum gain chargeback requirement contained in *Treas. Reg § 1.704-2(i)(4)* will be interpreted consistently with that Regulation.

(c) **Nonrecourse Deductions.** Any nonrecourse deductions (as defined in *Treas. Reg § 1.704-2(b)(1)*) for any fiscal year or other period will be specially allocated to the Members in proportion to their respective percentage interests.

(d) **Member Nonrecourse Deductions.** Those items of Company loss, deduction, or *I.R.C. § 705(a)(2)(B)* expenditures that are attributable to Member Nonrecourse Debt for any Fiscal Year or other period will be specially allocated to the Member who bears the economic risk of loss with respect to the Member Nonrecourse Debt to which the items are attributable in accordance with *Treas. Reg § 1.704-2(i)*.

(e) **Qualified Income Offset.** If a Member unexpectedly receives any adjustments, allocations, or distributions described in *Treas. Reg § 1.704-1(b)(2)(ii)(d)(4), (5)* or *(6)*, or any other event creates a deficit balance in the Member's Capital Account in excess of that Member's share of Company Minimum Gain, items of Company income and gain will be specially allocated to that Member in an amount and manner sufficient to eliminate the excess deficit balance as quickly as possible. Any special allocations of items of income and gain pursuant to this Section will be taken into account in computing subsequent allocations of income and gain so that the net amount of any item so allocated and the income, gain, and losses allocated to each Member pursuant to this Section to the extent possible, will be equal to the net amount that would have been allocated to each Member pursuant to the provisions of this Section 6.02(e) if the unexpected adjustments, allocations, or distributions had not occurred.

6.03. ***I.R.C. § 704(c)*** **Allocations.** Notwithstanding any other provision in this Article 6, in accordance with *I.R.C. § 704(c)* and the regulations promulgated under that section, income, gain, loss, and deduction with respect to any property contributed to the capital of the Company, solely for tax purposes, will be allocated among the Members so as to take account of any variation between the adjusted basis of the property to Company for federal income tax purposes and its fair market value on the date of contribution. Allocations pursuant to this Section 6.03 are solely for purposes of federal, state, and local taxes. As such, they do not affect or should in any way be taken into account in computing a Member's Capital Account or share of profits, losses, or other items or distributions pursuant to any provision of this Agreement.

6.04. **Allocation of Net Profits and Losses and Distributions in Respect of Transferred Interests.** If any Membership Interest is transferred, or is increased or decreased by reason of the admission of a new Member or otherwise, during any fiscal year of Company, Net Profits or Net Losses for that fiscal year will be assigned to the Members and other holders of Membership Interests according to any method permitted under *I.R.C. § 706*. Notwithstanding any provision above to the contrary, gain or loss of Company realized in connection with a sale or other disposition of any of the assets of Company will be allocated solely to the parties owning Membership Interests as of the date that the sale or other disposition occurs.

6.05. **Distributions.** Subject to applicable law and any limitations contained elsewhere in this Agreement, the Tax Matters Partner may, from time to time, cause Company to make distributions out of funds not needed for operations by Company. These distributions may be made in amounts and at such times as determined by the Tax Matters Partner. Distributions will be made to the Members in proportion to their Percentage Interests.

ARTICLE 7 ACCOUNTING, TAXES, AND BANKING

7.01. **Accounting Decisions and Reliance on Others.** The Members will make all decisions as to accounting matters, except as otherwise specifically set forth in this Agreement. The Members may rely on the advice of the independent accountants of Company as to whether those decisions are in accordance with accounting methods followed for federal income tax purposes.

7.02. **Maintenance of Books and Records and Accounting.** The Members will cause Company to keep proper and complete books of account of Company's business records**,** including all of Company's transactions**.** The records will be kept at Company's principal place of business and remain open to inspection by any of the Members or their authorized representatives at any reasonable time during business hours. The accounting records will be maintained in accordance with generally accepted bookkeeping practices for Company's type of business and those methods followed for federal and state income tax purposes.

7.03. **Fiscal Year End.** The fiscal year end of Company for financial reporting and for federal income tax purposes will be [*e.g.*, December 31].

7.04. **Bank Accounts.** The Members as Managers have the fiduciary responsibility for the safekeeping and use of all funds and assets of Company, whether or not in their immediate possession or control. The Members will cause Company's funds to be maintained in one or more separate bank accounts in the name of Company, and will not permit Company funds to be commingled in any fashion with the funds of any other person or the Members. Checks or drafts drawn on Company's accounts require the following signatures:

(a) Checks of [*e.g.*, $5000] or less require the signature of any one Member, acting alone.

(b) Checks in amounts greater than [*e.g.*, $5000] require the signature of at least two Members, acting together.

7.05. **Tax Returns.** The Members will cause to be prepared at least annually, at Company's expense, information necessary for the preparation of the Members' federal and state income tax returns. The Company will send or cause to be sent to each Member within 90 days after the end of each taxable year (1) the information necessary to complete federal and state income tax or information returns, and (2) a copy of the Company's federal, state, and local income tax or information returns for that year.

7.06. **Tax Matters for Company.** _____[*Member name*] is designated as the Tax Matters Partner ("TMP") for purposes of *I.R.C. § 6231(a)(7)* to represent Company, at Company's expense, in connection with all examinations of Company affairs by tax authorities and to expend Company funds for professional services and associated costs. The TMP has all authority granted by the Code. [*Optional, to limit TMP's authority:* However, _____ (*name*) may not take the following steps without first securing the unanimous consent of the members: _____ (*specify, e.g.,* entering into a settlement with the Internal revenue Service that purports to bind Company)].

7.07. **Annual Filing of List of Managers and Designation of Agent for Service of Process.** The Members on behalf of Company will, within 90 days after filing the original Articles and annually thereafter on or before the last day of the month in which the anniversary date of the filing of the original Articles occurs in each year, file with the Secretary of State an annual statement on a form prescribed by the Secretary of State and enclose any required filing fee. The statement required to be filed must contain all of the information required by *Corp. Code § 17060*.

ARTICLE 8 TRANSFER OF MEMBERSHIP INTERESTS

8.01. **General Prohibition on Transfers and Assignments of Membership Interests.** Except for those Permitted Transfers (as defined below) no Member may transfer, assign, convey, sell, encumber, or in any way alienate all or any part of the Member's Interest in Company, except with the prior written approval of all Members, which approval may be given or withheld in the sole discretion of the Members. Transfers in violation of this Section 8.01 are effective only to the extent set forth in Section 8.04. After the consummation of any transfer, conveyance, assignment, sale, or encumbrance of any part of a Member's Interest in the Company, the Interest in the Company so transferred must comply with all of the provisions of this Agreement. Each Member acknowledges the reasonableness of this prohibition in view of the purposes of Company and the relationship of the Members.

8.02. **Substitution of Members after Transfer of a Membership Interest**. A transferee of an Interest has the right to become a substitute Member with full management, participation, and voting rights under this Agreement ONLY IF:

(a) The transferee is a Permitted Transferee as described in Exhibit C; or

(b) The existing Members unanimously consent to the transfer and the transferee executes an instrument satisfactory to the other Remaining Members accepting and adopting the terms and provisions of this Agreement, and that transferee pays any reasonable expenses in connection with the transferee's admission as a new Member.

An Assignee who becomes a substituted Member has, to the extent assigned, the rights and powers of a Member under the Articles, this Agreement, and the Act. An Assignee who becomes a substituted Member is also liable for obligations to contribute to capital and to return any unlawful distributions made to Assignee.

8.03. **Effective Date of Permitted Transfers of a Membership Interest.** Any permitted Transfer of all or any portion of an Interest in Company will take effect on the first day of the month following receipt by the other Remaining Members of written notice of transfer. Any Permitted Transferee of a Permitted transfer of an Interest in Company shall take subject to the restrictions on Transfer imposed by this Agreement.

8.04. **Effect of Transfers of Interest in Violation of Agreement.** On any transfer of an Interest in Company in

violation of this Agreement, the transferee will have no right to participate in the management of the business and affairs of Company or to become a Member of Company. The transferee will hold only an Economic Interest and be entitled to an allocation of the share of Net Profits, Net Losses, distributions, and returns of capital to which the transferor of the Interest in Company would otherwise be entitled. In the event of an assignment that violates the terms of this Agreement, the assignor continues to be a Member and to have the power to exercise any rights and powers of a Member, including the right to vote until the assignee of an Interest in Company becomes a Member.

8.05. **Pledge or Grant of Security Interest Not a Transfer.** The pledge or granting of a security interest, lien, or other encumbrance in or against any or all of the Interest of a Member does not cause the Member to cease to be a Member or to grant anyone else the power to exercise any rights or powers of a Member.

ARTICLE 9 DISSOLUTION AND WINDING UP

9.01. **Company Dissolution.** The Company will be dissolved, its assets disposed of, and its affairs wound up on the first of the following "Dissolution Event" to occur:

(a) The expiration of the period fixed for the duration of Company term as stated in its Articles, if so fixed;

(b) A determination by the unanimous written agreement of all Members that the Company be dissolved and wound up;

(c) The sale of all, or substantially all, of the assets of Company unless Members holding a Majority-In-Interest consent to the continuation of business by Company;

(d) The entry of a decree of judicial dissolution by a court of competent jurisdiction pursuant to *Corp. Code § 17351*;

(e) The happening of any event that makes it unlawful or impossible to carry on the business of the Company; or

(f) The occurrence of a Disassociation Event and the failure of either (1) Company or the Remaining Members to purchase the Interest of the Selling Member as provided in Article 10**,** or (2) the other Members to provide written consent for the transfer resulting in the occurrence of the Disassociation Event or (3) Members holding a Majority-In-Interest to provide written consent to the continuation of business of Company as provided in Section 9.07, below, provided in all cases that Company will have at least two remaining Members.

PRACTICE TIP

Although single member LLCs are now permitted in California, tax treatment will differ. Nevertheless, the above provision may be amended to permit a single member LLC with amended articles.

9.02. **Filing of Statement of Intent to Dissolve Company.** As soon as possible following the occurrence of any of the Dissolution Events specified in Section 9.01, above, the Members on behalf of Company will execute a Certificate of Dissolution in the form prescribed by the Secretary of State and file the certificate as required by the Act. On the filing of the Certificate of Dissolution, Company will cease to carry on its business, except insofar as may be necessary for the winding up of its business. Company's separate existence will continue until the Certificate of Cancellation of Articles is filed with the Secretary of State or until a decree dissolving Company is entered by a court of competent jurisdiction. The Members who filed the Certificate of Dissolution will cause to be filed in the office of, and on a form prescribed by, the Secretary of State, a Certificate of Cancellation of Articles on the winding up of the affairs of Company.

9.03. **Winding Up the Affairs of Company.** On the occurrence of any of the events specified in Section 9.01, above, Company will continue solely for the purpose of winding up its affairs in an orderly manner, liquidating its assets,

disposing of and conveying its property, collecting and dividing its assets, satisfying the claims of its creditors, and prescribing and defending actions by or against company in order to collect and discharge obligations. No Member may take any action that is inconsistent with, or not necessary to or appropriate for, winding up the business and affairs of Company. To the extent not inconsistent with the foregoing, all covenants and obligations in this Agreement will continue in full force and effect until the assets have been distributed and Company has been dissolved.

[*OPTIONAL*]

9.04. **Responsibility for Winding up Affairs of Company.** The Members will be responsible for overseeing the winding up and liquidation of Company, will take full account of the liabilities of Company and its assets, will cause written notice of the commencement of the dissolution be given to all of the Company's known creditors, will cause its assets to be liquidated as promptly as is consistent with obtaining their fair market value, and will cause the proceeds, to the extent sufficient, to be applied and distributed as next provided. The persons responsible for winding up the affairs of Company will give written notice of the commencement of winding up by mail for all known creditors and claimants whose addresses appear on the records of Company.

[*OPTIONAL*]

9.05. **Order of Payment of Liabilities on Dissolution.** In settling accounts of Company after dissolution, the Members will settle the liabilities of Company with payments in the following order, as required by the Act:

(a) To creditors other than Members, in the order of priority as provided by law, except those to Members of Company on account of their contributions;

(b) To creditors who are Members in order of priority except amounts owed to Members on account of their contributions;

(c) To Members in respect of their share of the Net Profits and other compensation by way of income on their contributions;

(d) To Members for return of their contributions; and

(e) To Members in accordance with the respective positive account capital balances after giving effect to all Capital Contributions, distributions, revaluations, and allocations required under this Agreement.

[*OPTIONAL*]

9.06. **Limitations on Payments Made in Dissolution.** Except as otherwise specifically provided in this Agreement, each Member is only entitled to look solely at the assets of Company for the return of that Member's positive Capital Account balance and has no recourse for that Member's Capital Contribution and / or share of Net Profits (on dissolution or otherwise) against any other Member. Managers or Members winding up the affairs of Company are entitled to reasonable compensation. All payments to the Members on the winding up and dissolution of Company will be strictly in accordance with the positive capital account balance limitation and other requirements of *Treas. Reg. § 1.704-1(b)(2)(ii)(d)*.

[*CONTINUE*]

9.07. **Consequences of Disassociation Event; Consent to Continue Business of Company.** On the occurrence of any Dissolution Event, as described in Section 9.01 above, Company will dissolve unless the remaining Members holding a Majority-In-Interest consent in writing to the continuation of the business of Company. If the Member whose actions or conduct constitute one or more of the Dissolution Events described in this Article ("Selling Member") or that Selling Member's trustees or heirs, rightfully demands the return of the Capital Account of a Member by a written notice to the remaining Members, Company (with consent in writing of the remaining Members holding a Majority-In-Interest) may, within six months following that written notice, purchase the Selling Member's Interest as provided in Article 10 to avoid dissolution of Company.

ARTICLE 10 OPTIONAL PURCHASE EVENTS

10.01. **"Optional Purchase Event" Defined.** An "Optional Purchase Event" means, with respect to any Member, any one or more of the following:

(a) The death, disability, or bankruptcy of a Member;

(b) The withdrawal, retirement, or resignation of a Member in violation of Article II of this Agreement;

(c) A Member becoming a Terminated Member;

(d) The occurrence of any event that is, or would cause, a transfer in contravention of this Agreement; or

(e) A Member filing an action seeking a decree of judicial dissolution pursuant to *Corp. Code § 17351*.

10.02. **Purchase Option.** On the occurrence of an Optional Purchase Event with respect to any Member ("Selling Member"), Company first and then the other Members ("Purchasing Members") have the option to purchase the Selling Member's Membership Interest ("Selling Member's Interest"). If the option is exercised, the Selling Member, or the Selling Member's legal representative will sell the Selling Member's Interest as provided in this Article 10. Each Member who causes an Optional Purchase Event or to whom an Optional Purchase Event occurs, must provide prompt notice of the Optional Purchase Event to the other Members.

10.03. **Purchase Price.** The purchase price for the Selling Member's Interest is the fair market value of the Selling Member's Membership Interest on the date of the Optional Purchase Event, as determined by an independent appraiser jointly selected by the Selling Member (or the Selling Member's legal representative) and the Purchasing Member.

If the Selling Member (or the Selling Member's legal representative) and Company or Purchasing Member are unable to agree on the selection of an appraiser within 30 days after the Optional Purchase Event, each will select an independent appraiser within 20 days after the expiration of the 30-day period. The two appraisers will each independently appraise the Selling Member's Interest. Provided that the difference in the two appraisals does not exceed [*specify, e.g.*, 10 percent of the lower of the two appraisals], the fair market value is the average of the two appraisals and is binding on the parties. If either party fails to select an independent appraiser within the time required by this Section 10.03, the fair market value will be conclusively deemed to equal the appraisal of the independent appraiser timely selected by the other.

If the difference between the two appraisals referred to above exceeds [*specify above percentage, e.g.*, 10 percent of the lower of the two appraisals], the two selected appraisers will select a third appraiser who will also independently appraise the Selling Member's Membership Interest. In this case, the fair market value of the Selling Member's Membership Interest will be the average of the two closest appraisals. The determination of these appraisals is binding on the parties and not subject to judicial review by arbitration. Company and the Selling Member will each pay one-half of the cost of the third appraisal.

In determining the fair market value, the appraisers selected under this Agreement will consider all opinions and relevant evidence submitted to them by the parties, or otherwise obtained by them. [*Optional:* The appraisers must also consider appropriate discounts for illiquidity and the minority status of the Selling Member's Interest.] The appraisers will set forth their determination in writing together with their opinions and the considerations on which the opinions are based, with a signed counterpart to be delivered to each party within 60 days after commencing the appraisal.

Notwithstanding the foregoing, if the Optional Purchase Event results from a breach of this Agreement by the Selling Member, the purchase price will be reduced by 50 percent.

10.04. **Notice of Intent to Purchase.** Within five business days after the Selling Member receives the appraisals from which the purchase price of the Selling Member's Interest can be determined, the Selling Member will notify the Purchasing Member of that price in writing. Within 30 days after the Selling Member has notified the Purchasing Member of the purchase price of the Selling Member's Interest, the Purchasing Member will notify the Selling Member in writing of the Purchasing Member's desire to purchase the Selling Member's Interest. The failure of the Purchasing Member to submit a notice within the applicable period constitutes an election on the part of the Member not to purchase any of the Selling Member's Interest. The Purchasing Member may assign to Company or any other person that Purchasing Member's right to purchase the Selling Member's Interest. For convenience, the party or parties purchasing the Selling Member's Interest under this Agreement will be referred to collectively as the "Purchasers" and individually as a "Purchaser."

10.05. **Election to Purchase Less Than All of the Selling Member's Interest.** If the Purchasers do not elect to purchase all of the Selling Member's Interest, the portion of the interest not purchased will be an Economic Interest only.

10.06. **Payment of Purchase Price.** The purchase price will be paid by the Purchasers by either of the following methods, each of which may be selected separately by each Purchaser:

(a) At the Closing (as defined below), each Purchaser will pay in cash the total purchase price for the Selling Member's Interest; or

(b) Except as otherwise provided in this Section 10.06, at the Closing (as defined below), each purchaser will pay one-fifth of the purchase price in cash ("Down Payment") and the balance of the purchase price (the "Loan") must be paid in arrears in equal monthly installments over a four-year period, based on a 48-month schedule, plus accrued interest at the Prime Rate. The Loan will be evidenced by separate promissory notes (each, a "Note") executed by each Purchaser, as applicable. Each Note will be in an original principal amount equal to the portion owed by the Purchaser. The Purchaser may prepay the Note in full or in part at any time without penalty. The Note will contain customary terms, including a provision for the payment of attorneys' fees if litigation is commenced to enforce the Note. Any Note made by a Purchaser will be secured by a pledge of that portion of the Selling Member's Interest Purchased by the Purchaser, and if the Purchaser is not a natural person, then the beneficial owners of the Purchaser will personally guarantee the Purchaser's payment obligations under the Note.

(c) Notwithstanding anything to the contrary in this Section 10.06, if the event giving rise to the purchase of a Selling Member's Interest is the death of the Selling Member, the Down Payment will be increased to the amount of insurance proceeds, if any, actually received by Company from life insurance policies owned by Company insuring that Selling Member's life. However, at no time will the Down Payment exceed the purchase price determined pursuant to Section 10.03, above.

10.07. **Closing of Purchase of Selling Member's Interest.** Unless court approval is required, the closing ("Closing") for the sale of a Selling Member's Interest pursuant to this Article 10 will be held at 10:00 a.m. at the principal office of

the Company no later than 60 days after the determination of the purchase price, except that if the Closing date falls on a Saturday, Sunday, or legal holiday, then the closing will be held on the next succeeding business day. If Court approval is required, (1) the Closing of the sale of a Selling Member's Interest will occur not later than five business days after entry of the order approving that sale; (2) the Company will file the application seeking Court approval within 30 days after the determination of the purchase price; and (3) the parties to the Court proceeding will make every effort to obtain the Court's approval in an expeditious manner. At the Closing, the Selling Member will deliver to each Purchaser an instrument of transfer (containing warranties of title and no encumbrances) conveying the Selling Member's Interest. The Selling Member and each Purchaser will do all things and execute and deliver all papers as may be reasonably necessary fully to consummate the sale and purchase in accordance with the terms and provisions of this Agreement.

10.08. **Purchase Terms Varied by Agreement.** Nothing contained in this Article 10 is intended to prohibit Members from agreeing on terms and conditions for the purchase by Company or any Member of the Interest of any Member in Company desiring to retire, withdraw or resign, in whole or in part, as a Member (on the terms and conditions as may be agreed on by the Selling Member and Company or the remaining Members as the case may be). Nothing contained in this Agreement is intended to limit or otherwise affect the ability of a Member to demand a return of the Member's contribution to Company as provided in the Act.

ARTICLE 11 INDEMNIFICATION

PRACTICE TIP

Indemnifying members and managers is optional. If the operating agreement will provide for indemnification, that fact must also be stated in the articles of organization filed with the Secretary of State [*see § 12C.219*].

11.01. **Indemnification of Members And Managers.** To the greatest extent not inconsistent with the Act and the other laws and public policies of the State of California, Company will indemnify against expenses and liabilities any Member or Manager made a party or who was threatened to be made a party to any proceeding by Company or another because that party is or was a Member or Manager against all liability incurred by that person in connection with any action, suit, or proceeding, or any threatened, pending, or complete action of suit or proceeding; whether civil, criminal, administrative, or investigative pursuant to the procedures set forth in Section 11.06, below, it is determined that indemnification of that person is permissible under the circumstances because the person has met the standards of conduct for indemnification set forth in Section 11.05, below.

11.02. **Advance Undertakings for Indemnification.** To the greatest extent not inconsistent with the Act and other laws and public policies of the State of California, Company will pay for or reimburse the reasonable expenses incurred by a Member or Manager in connection with any proceeding as incurred in advance of final disposition of the action, suit, or proceeding if (1) the person furnishes Company a written affirmation of the person's good faith belief that the Member or Manager has met the standards of conduct for indemnification described in Section 11.05, below; (2) the Member or Manager furnishes Company a written undertaking to repay the advance if it is ultimately determined by a court of competent jurisdiction that the Member or Manager did not meet the applicable standard of conduct and that the Member or Manager is not entitled to be indemnified; and (3) a determination is made in accordance with the procedures set forth in Section 11.06, below , that, based on facts then known to those making the determination, indemnification would not be precluded under this Article 11.

The undertaking described above must be a general obligation of the Member or Manager, subject to any reasonable limitations as Company may permit, but need not be secured and may be accepted without reference to financial ability to make repayment. Company will indemnify a Member or Manager who is wholly successful, on the merits or

otherwise, in the defense of any such proceeding, as a matter of right, against reasonable expenses incurred by the Member or Manager in connection with the proceeding without the requirement of a determination described in Section 11.06, below.

11.03. **Advancement of Expenses.** On demand by a Member or Manager for indemnification or advancement of expenses incurred in defending a civil or criminal lawsuit or proceeding, Company will expeditiously determine whether the Member or Manager is entitled to indemnification or advancement of expenses in accordance with this Article 11. The indemnification and advancement of expenses provided for under this Article 11 will be applicable to any proceeding arising from acts or omissions occurring before or after the adoption of this Agreement.

11.04. **Indemnification of Others.** Company may, but is not required, to indemnify any person who is or was an employee or agent of Company to the same extent as if that person was a Member or Manager.

11.05. **Standards of Conduct Required for Indemnification.** Indemnification of a Manager or Member is permissible under this Article only if (1) the person acted in good faith, and (2) the person reasonably believed that the conduct was in Company's best interest; and (3) in the case of any criminal proceeding, the person had no reasonable cause to believe that the person's conduct was unlawful. The termination of a proceeding by judgment, order, settlement, conviction, or on a plea of nolo contendere or its equivalent is not, in itself, determinative that the person did not meet the standard of conduct described in this Section 11.05.

11.06. **Procedures to Approve Indemnification.** A determination as to whether indemnification of or advancement of expenses is permissible will be made by any one of the following procedures:

(a) By the Members not at the time parties to the proceedings holding a Majority-In-Interest; or

(b) By the Members or Managers not parties to the proceedings in the manner prescribed in Section 11.07, below.

11.07. **Court Order of Indemnification.** A Member or Manager who is a party to a proceeding may apply for indemnification from Company to the court, if any, conducting the proceeding or to another court of competent jurisdiction. On receipt of an application, the court, after giving notice the court considers necessary, may order indemnification if the court determines either of the following:

(a) In a proceeding in which the Member or Manager is wholly successful, on the merits or otherwise, that the Member or Manager is entitled to indemnification under this Section 11.07, in which case the court will order Company to pay the Member or Manager the reasonable expenses incurred to obtain that court ordered indemnification; or

(b) The Member or Manager is fairly and reasonably entitled to indemnification in view of all the relevant circumstances, regardless of whether the Member or Manager met the standards of conduct set forth in Section 11.05, above.

11.08. **Described Indemnification Rights Are Non-Exhaustive.** Nothing contained in this Article 11 limits or precludes the exercise, or may be deemed exclusive, of any right under the law, by contract or otherwise, relating to indemnification of or advancement of expenses to any person who is or was a Member or Manager, or is or was serving at Company's request as a director, officer, partner, manager, trustee, employee, or agent of another foreign or domestic company, partnership, association, limited liability company, corporation, joint venture, trust, employee benefit plan, or other enterprise, whether for profit or not.

11.09. **Construction of Indemnification Rights.** Nothing contained in this Article 11 limits the ability of Company to otherwise indemnify or advance expenses to any person. It is the intent of this Article 11 to provide indemnification to Members and Managers to the fullest extent now or hereafter permitted by the law consistent with the terms and

conditions of this Article 11. Indemnification will be provided in accordance with this Article 11 irrespective of the nature of the legal or equitable theory on which a claim is made including, without limitation, negligence, breach of duty, mismanagement, waste, breach of contract, breach of warranty, strict liability, violation of federal or state securities law, violation of the Employee Retirement Income Security Act of 1974, as amended, or violation of any other state or federal law.

11.10. **Definitions for Indemnification Provisions.**

(a) "**Expenses"** mean all direct and indirect costs (including, without limitation, attorney fees, retainers, court costs, transcripts, expert fees, witness fees, travel expenses, duplicating costs, printing and binding costs, facsimile charges, telephone charges, postage, messenger and delivery fees, and all other out-of-pocket expenses) actually incurred in connection with the investigation, defense, settlement, or appeal of a proceeding or establishing or enforcing a right to indemnification under this Section 11.10, applicable law, or otherwise.

(b) "**Liabilities"** mean obligations (including those incurred by way of settlement) to pay a judgment, settlement, penalty, fine, excise tax (including an excise tax assessed with respect to an employee benefit plan), or reasonable expenses incurred with respect to a proceeding.

(c) "**Party"** means a person who was or is threatened to be made a named defendant in a proceeding.

(d) "**Proceeding"** means any threatened, pending, or completed action, suit, or proceeding, whether civil, criminal, administrative, or investigative and whether formal or informal.

11.11. **Insurance Funding of Indemnification.** To the greatest extent not inconsistent with the Act and other laws and public policies of the State of California, Company may purchase and maintain insurance or other financial arrangement for the benefit of any person who is or was a Member, Manager, employee, or agent, against any liability asserted against or expenses incurred by that person arising out of that person's service with Company, whether or not Company would have the power to indemnify that person against liability. These other financial arrangements made by Company may include:

(a) Insurance.

(b) The creation of a trust fund.

(c) The establishment of a program of self-insurance.

(d) The granting of a security interest or other lien on any assets of the Company.

(e) The establishment of a letter of credit, guaranty or surety.

None of the above may, however, provide protection for a person adjudged by a court of competent jurisdiction, after exhaustion of all appeals, to be liable for intentional misconduct, fraud, or a knowing violation of law, except with respect to the advancement of expenses or indemnification ordered by a court. Any insurance or other financial arrangement made on behalf of a person pursuant to this Section 11.11 may be provided by Company or other person approved by the Members.

ARTICLE 12 MISCELLANEOUS

12.01. **Additional Documents and Acts**. Each Member agrees to execute and deliver additional documents and instruments and to perform additional acts as may be necessary or appropriate to effectuate, carry out, and perform the

terms, provisions, and conditions of this Agreement and the transactions contemplated by this Agreement.

12.02. **Amendments.** All amendments to this Agreement must be in writing and approved by the vote of the Members holding a Majority-In-Interest.

12.03. **Attorneys' Fees.** If any dispute between Company and the Members or among the Members results in litigation or arbitration, the prevailing party in the dispute will be entitled to recover from the other party all reasonable attorneys' fees, costs, and expenses of enforcing any right of the prevailing party.

12.04. **Binding Effect**. Subject to the provisions of this Agreement relating to transferability, this Agreement is binding on and inures to the benefit of the Members, and their respective transferees, successors, and assigns, but only to the extent that assignment and approval by all Members is in accordance with the Act, the Articles, and this Agreement.

12.05. **Complete Agreement.** This Agreement and the Articles constitute the complete and exclusive agreement among the Members. This Agreement and the Articles supersede all prior written or oral agreements.

12.06. **Exhibits.** All Exhibits attached to this Agreement are incorporated herein by reference.

12.07. **Governing Law; Venue; Jurisdiction.** The construction, validity, and performance of this Agreement will be governed by, and construed in accordance with, the laws of the State of California, and the parties expressly waive its choice of law rules. The parties agree that venue and jurisdiction for any litigation or arbitration arising out of, relating to, or regarding the validity of, this Agreement will lie in _____[*specify, e.g.*, the County of Los Angeles, State of California].

[*OPTIONAL*]

12.08. **Arbitration.** The parties further agree to submit any claim arising out of, relating to, or regarding the validity of, this Agreement in excess of the then current limitation for a small claims matter (presently $5,000.00), to binding arbitration administered by the American Arbitration Association ("AAA") pursuant to the Commercial Rules of the AAA and California law in the County of _____, State of California, with all expenses being shared equally by the parties. This arbitration clause, however, will not deprive the parties of any right they may otherwise have to seek provisional injunctive relief from a court of competent jurisdiction. Notice of demand for arbitration shall be filed in writing with the other parties to this Agreement and with the AAA, and that notice must set forth the demanding party's position as to the matter or matters in dispute, the amount of damages being sought, and any other relief sought. The arbitration will commence at a time noticed by the AAA, even if a party fails or refuses to participate. The arbitration will be conducted by a single arbitrator who shall be [*specify requisite experience, e.g.*, an attorney with a minimum of seven years experience in business law and no prior relationships with either the requesting Member or Company]. The arbitrator will be chosen by mutual agreement of the parties, but if the parties fail to agree within [*specify, e.g.*, 10] days of service of the demand for arbitration, the arbitrator will be chosen by [*e.g.*, the AAA]. The parties will ask the arbitrator to limit discovery to the greatest extent possible consistent with basic fairness. The parties will demand that the arbitrator conclude the hearing and render an award within [*specify, e.g.*, 90] days of its commencement. The arbitrator will have no power to assess punitive or special damages. Legal costs, attorneys' fees, the fees of expert witnesses, unless the arbitrator finds a party to have acted in bad faith. The arbitrator will not make any award that extends, modifies, or suspends any lawful term of this Agreement. The arbitrator must provide a written arbitration award setting forth the arbitrator's findings of fact and conclusions of law. Judgment on any AAA award may be entered in any court having competent jurisdiction. Any costs incurred in the enforcement of the arbitration award will be paid by the party against whom enforcement is sought.

[*CONTINUE*]

12.09. **Headings.** All captions are inserted for convenience and ease of reference only and are not to be considered in the construction or interpretation of any provision of this Agreement.

12.10. **Counterparts.** This Agreement may be executed in several counterparts, each of which will be deemed an original, but all of which will constitute one and the same instrument.

12.11. **Parties In Interest.** This Agreement is made solely and specifically among and for the benefit of the parties, and their respective successors and assigns subject to the express provisions relating to successors and assigns, and no other person will have any rights, interest, or claims under this Agreement or be entitled to any benefits on account of this Agreement as a third party beneficiary or otherwise.

12.12. **Agreement Not For Benefit of Creditors.** The provisions of this Agreement are intended only for the regulation of relations among the Members and Company. This Agreement is not intended for the benefit of a creditor who is not a Member and does not grant any rights to or confer any benefits on any creditor who is not a Member or any other person who is not a Member, a Manager, or an officer.

12.13. **Notices.** Any notice to be given or to be served on Company or any party to this Agreement in connection with this Agreement must be in writing and is deemed to have been given and received when delivered to the address specified by the party to receive the notice. Notices must be given to each Member at the address specified in Exhibit A. Any Member or the Company may, at any time, designate any other address in substitution of the foregoing address to which notice will be given by giving written notice to the other Members and Company [*specify, e.g.,* at least five days] before the date of delivery of the notice. A writing includes a facsimile transmission followed by deposit of the original communication in the United States Mail for First Class Delivery.

[*OPTIONAL*]

12.14. **Reliance on Authority of Person Signing Agreement.** If a Member is not a natural person, neither Company nor any Member will (1) be required to determine the authority of the individual signing this Agreement to make any commitment or undertaking on behalf of that entity, or to determine any fact or circumstance bearing on the existence of the authority of that individual or (2) be required to see to the application or distribution of proceeds paid or credited to individuals signing this Agreement on behalf of that entity.

[*CONTINUE*]

12.15. **Severability.** If any provision of this Agreement is held to be illegal, invalid, or unenforceable under the present or future laws effective during the term of this Agreement, that provision will be fully severable. This Agreement will be construed and enforced as if the illegal, invalid, or unenforceable provision had never comprised a part of this Agreement; the remaining provisions of this Agreement will remain in full force and effect and will not be affected by the illegal, invalid, or unenforceable provision or by its severance from this Agreement. Furthermore, the parties agree to replace any illegal, invalid, or unenforceable provision of this Agreement with a similar valid and enforceable provision that will achieve, to the fullest extent possible, the economic, business, and other purposes of the void or unenforceable provision.

12.16. **Specific Performance.** The Members agree that they will not have an adequate remedy at law if this Agreement is not performed in accordance with its terms, and that any damages available at law for breach of this Agreement would not be an adequate remedy. Therefore, the provisions and the obligations of the Members under this Agreement are enforceable by a decree of specific performance, and appropriate injunctive relief may be applied for and granted in

connection therewith. These remedies and all other remedies provided for in this Agreement are cumulative and not exclusive and are in addition to any other remedies that a Member may have under this Agreement.

12.18. **Interpretation.** Each party to this Agreement acknowledges that it has participated in the drafting of this Agreement, and any applicable rule of construction to the effect that ambiguities are to be resolved against the drafting party shall not be applied in connection with the construction or interpretation of this Agreement.

12.19 **Consent of Spouse.** Within 10 days after any individual becomes a Member, or within 10 days after a Member marries, that Member will have his or her spouse execute either (1) a consent of spouse substantially in the form of Exhibit E, attached to this Agreement or (2) a separate property waiver and acknowledgment substantially in the form of Exhibit F, attached to this Agreement.

Executed at _____[*place*] by all of the Members of _____[*name*], a California Limited Liability Company, effective _____[*date*].

MEMBER: _____ [*signature*]
[*typed name*]
[*date*]
MEMBER: _____ [*signature*]
[*typed name*]
[*date*]

EXHIBIT A
CAPITAL CONTRIBUTION AND VOTING PERCENTAGE OF MEMBERS AS OF _____ [*date*]

MEMBER'S NAME	MEMBER'S ADDRESS	MEMBER'S INITIAL CONTRIBUTION	MEMBER'S PERCENTAGE VOTING INTEREST	
		$	%	_____ _____ _____ ____
		$	%	_____ _____ _____ ____
		$	%	_____ _____ _____ ____
		$	%	_____ _____

TOTALS	$	%	_____

EXHIBIT B
PERCENTAGE INTERESTS IN NET PROFITS AND NET LOSSES AS OF _____ [*date*]

NAME OF MEMBER	MEMBER'S NET PROFIT PERCENTAGE	MEMBER'S NET LOSSES PERCENTAGE
TOTALS:	**100%**	**100%**

EXHIBIT C
PERMITTED TRANSFEREES TO A MEMBER'S INTERESTS AS OF _____ [*date*]

_____ is a Permitted Transferee of the Member named _____.
_____ is a Permitted Transferee of the Member named _____.
_____ is a Permitted Transferee of the Member named _____.

EXHIBIT D
ALLOCATION OF NET PROFITS, NET LOSS, MINIMUM GAIN, AND OTHER COMPANY ITEMS

A. Allocation of Net Profits. Except as otherwise provided elsewhere under this Agreement and after first giving effect to the special allocations in Paragraphs C through L, below, Net Profits for any fiscal year will be allocated to each Member in accordance with the Member's Percentage Interest in Net Profits as set forth in Exhibit B. Subject to any limitations described elsewhere in this Agreement, including but not limited to Paragraphs M and N, below, the above allocation of Net Profits may be modified by subsequent agreement to conform to adjustments made to the Percentage Interest in Net Profits because of loans converted to Capital Contributions, any distributions of cash, and any liquidating distribution. If a Member's Percentage Interest in Net Profits is not the same throughout a given fiscal year, the Members will determine the allocation of Net Profits by taking into account this varying Percentage Interest during the year but this determination will be in conformity with the requirements of *I.R.C. § 706(d)* and the regulations thereunder.

"Net Profits" refers to all items of income (including all items of gain and including income exempt from tax) as properly determined for book purposes. Net Profits will be determined based on the book value of the assets of Company as set forth on the books of Company in accordance with the principles of *Treas. Reg. § 1.704-1(b)(2)(iv)(g)*. Otherwise Net Income and loss will be determined strictly in accordance with Federal income tax principles (including

rules governing depreciation and amortization), applied hypothetically based on values of Company assets as set forth on the books of Company.

B. Allocation of Net Losses. Except as otherwise provided under this Agreement and after giving effect to the special allocations in Paragraphs C through L, below, Net Losses for any fiscal year will be allocated to each Member accordance with his, her or its Percentage Interest in Net Losses set forth in Exhibit B. Subject to any limitations described elsewhere in this Agreement, including but not limited to Paragraphs M and N, below, the above allocation of Net Losses may be modified by subsequent agreement to conform to adjustments made to the Percentage Interest in Net Losses because of loans converted to Capital Contributions, any distributions of cash and any liquidation distributions. If a Member's Percentage Interest in Net Losses is not the same throughout a given fiscal year, the Members will determine the allocation of Net Losses to the Member by taking into account his varying Percentage Interest in Net Losses during the year but this determination will be in conformity with the requirements of *I.R.C. § 706(d)* and the regulations thereunder.

"Net Losses" refers to all items of loss (including deductions) as properly determined for book purposes. Net Losses will be determined based on the value of the assets of Company as set forth on the books of Company in accordance with the principles of *Treas. Reg. § 1.704-1(b)(2)(iv)(g)*. Otherwise, Net Losses will be determined strictly in accordance with federal income tax principles (including rules governing depreciation and amortization) applied hypothetically based on values of Company assets as set forth on the books of Company.

C. Allocation of Company Minimum Gain. Notwithstanding any other provision of this Agreement, if there is a net decrease in Company Minimum Gain for a Company taxable year, then each Member will be allocated items of income and gain for that year (and, if necessary, for subsequent years) in proportion to, and to the extent of, an amount equal to the greater of (1) the portion of that Member's share of the net decrease in Company Minimum Gain during the year that is allocable to the disposition of Company property subject to one nor more Nonrecourse Liabilities of Company and (2) the deficit balance in such Member's capital account at the end of that year. These allocations must be made before any other allocation of Company items for the year. For the purpose of this Paragraph**,** the balance in a Members's capital account at the end of the year will be determined with the adjustments prescribed by Treas. Reg. § 1.704-1T(b)(4)(iv)(e)(2). These allocations must be made in accordance with the provisions of Treas. Reg. § 1.704-1T(b)(4)(iv)(e). Company Minimum Gain will be defined and determined in accordance with *Treas. Reg. § 1.704-2(d)*.

D. Allocation of Member's Share of Minimum Gain. Notwithstanding any other provision of this Agreement or this Exhibit D, if there is a net decrease during a Company taxable year in the Member's Share of Minimum Gain, then any Member with a share of the Minimum Gain at the beginning of that year will be allocated items of Company income and gain for that year (and, if necessary, subsequent years) in proportion to, and to the extent of, an amount equal to the greater of (1) the portion of that Member's share of the net decrease in the Minimum Gain that is allocable to the disposition of Company property subject to the Member's Nonrecourse Debt, and (2) the deficit balance in such Member's capital account at the end of that year. The items of Company income and gain allocated by this Exhibit D shall not include any items of income or gain allocated pursuant to the Paragraph above. The allocations under this Paragraph D must be made before any other allocation of Company items for the year. For the purpose of this Paragraph, the balance in a Member's capital account at the end of the year will be determined with the adjustments prescribed by, and the allocations under this Exhibit D will be made in accordance with, the provisions of Treas. Reg. § 1.704-1T(b)(4)(iv)(h)(4). Member's share of Minimum Gain shall be defined and determined in accordance with *Treas. Reg. § 1.704-2(d)*.

E. Allocation of Net Profits and Gains Under Qualified Income Offset. Items of Net Profits and gain will be specially allocated to each Member in an amount and manner sufficient to eliminate, to the extent required by the Regulations, the Adjusted Capital Account Deficit of the Member determined under *Treas. Reg. § 1.704-1(b)(2)(ii)(d)* as quickly as possible in the event any Member unexpectedly receives any (1) distributions that, as of the end of that

year, reasonably are expected to be made to a Member to the extent they exceed offsetting increases to that Member's capital account that reasonably are expected to occur during (or before) Company taxable years in which such distributions reasonably are expected to be made (other than increases pursuant to a minimum gain chargeback of this Agreement); or (2) adjustments, allocations, or distributions described in *Treas. Reg. § 1.704-1(b)(2)(ii)(d)(4), (5)* or *(6)*. This subparagraph is intended to comply with *Treas. Reg. § 1.704-1(b)(2)(ii)(d)* and should be so interpreted.

F. Allocation of Nonrecourse Deductions. Company Nonrecourse Deductions will be allocated to the Member, if any, that bears the economic risk of loss for the Member Nonrecourse Debt to which the Member Nonrecourse Deductions are attributable. If more than one Member bears the economic risk of loss for a Member Nonrecourse Debt, the Nonrecourse Deduction attributable to such Member Nonrecourse Debt shall be allocated among those Members in accordance with the ratios in which the Members share the economic risk of loss for that Nonrecourse Debt. Otherwise, Nonrecourse Deductions shall be allocated in the same manner as, and be subject to the same restrictions imposed upon Net Losses. Member Nonrecourse Debt is defined and determined in accordance with *Treas. Reg. § 1.704-2(b)(4)*. Company Nonrecourse Deductions shall be defined and determined in accordance with *Treas. Reg. § 1.704-2(b)* and *(c)*.

G. Allocation of Income, Gains and Losses Related to Contributed Property. In accordance with *I.R.C. § 704(c)* and the regulations thereunder, income, gain, loss, and deduction with respect to any property contributed to the capital of Company will, solely for tax purposes, be allocated among the Members so as to take account of any variation between the adjusted basis of that property to Company for federal income tax purposes and its initial gross fair market value. In the event that the initial gross fair market value of any Company asset is adjusted, subsequent allocations of income, gain, loss, and deduction with respect to that asset must take account of any variation between the adjusted basis of such asset for federal income tax purposes and its initial gross fair market value under one of the methods allowed under *I.R.C. § 704(c)* and the Regulations thereunder. Any elections or other decisions relating to these allocations must be made by the Managers in any manner that reasonably reflects the purpose and intention of this Agreement. Allocations pursuant to this Paragraph G are solely for purposes of federal, state, and local taxes and do not affect, or should in any way be taken into account in computing, any member's Capital Account or share of Net Profits, Net Losses, or other items or distributions pursuant to any other provision of this Agreement.

H. Allocation of Gain and Loss from Sale or Other Disposition of Property Not Revalued. If, in connection with the admission of an additional Member to Company or the liquidation of a Member's Interest in Company, Company property is not revalued pursuant to *Treas. Reg. § 1.704-1(b)(2)(iv)(f)* and the Members' capital accounts are not adjusted accordingly, then, on any subsequent sale or other disposition of Company property, gain or loss recognized on the sale or other disposition must be allocated among the Members so as to take into account the variation between the adjusted basis of the property and its fair market value as of the date the additional Member was admitted or the date the Member's Interest was liquidated, as the case may be, in the same manner as under *I.R.C. § 704(c)*.

I. Allocation of Gains and Losses Related to Adjustments in Tax Basis. To the extent an adjustment to the adjusted tax basis of any Company asset pursuant to *I.R.C. § 734(b)* or *I.R.C. § 743(b)* is required, pursuant to *Treas. Reg. § 1.704-1(b)(2)(iv)(m)*, to be taken into account determining Capital Accounts, the amount of the adjustment to the Capital Accounts will be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases such basis), and the gain or loss will be specially allocated to the Members in a manner consistent with the manner in which their Capital Accounts are required to be adjusted pursuant to *Treas. Reg. § 1.704-1(b)(2)(iv)(m)*.

J. Allocation to Avoid Adjusted Capital Account Deficit. Notwithstanding any other provision of this Article, no Member will receive an allocation of Net Losses, net capital losses, Nonrecourse Deductions as defined in *Treas. Reg. § 1.704-2(b)* and *(c)*, or any other item of loss or deduction that would create or increase an Adjusted Capital Account Deficit of the Member. Any loss, or item thereof, that cannot be allocated to a Member as a result of the foregoing limitation will be allocated to all Members. Any loss, or item thereof, allocated to all Members pursuant to the

preceding sentence must be taken into account in computing subsequent allocations of Net Profits or Losses or Net Capital Gain or Loss so that the net amount of any items so allocated and the profits, losses and all other items allocated to each Member will, to the extent possible, be equal to the net amount that would have been allocated to each Member if the allocations required by the preceding sentence had not been made.

K. Allocation of Gross Income to Restore Capital Account Deficit. In the event any Member has a distribution in the Member's Capital Account at the end of any fiscal year that exceeds of the sum of (1) the amount that the Member is obligated to restore pursuant to any provision of this Agreement, and (2) the amount the Member is deemed to be obligated to restore pursuant to the penultimate sentences of *Treas. Reg. § 1.704-2(g)(1)* and *Treas. Reg. § 1.704-2(i)(5)*, that Member will be specially allocated items of income and gain in the amount of that excess as quickly as possible, provided that an allocation pursuant to this subparagraph will be made only if and to the extent that the Member would have a Capital Account with a deficit balance in excess of that sum after all other allocations provided for in this Exhibit D have been made as if Paragraph E, above, relating to allocations under a qualified income offset and this subparagraph were not in this Agreement.

L. Allocation of Capital Event Adjustments and Subsequent Effects. To the extent the gross fair market value of any asset of Company is increased or decreased for a "capital event" as described in Section 4.03 of this Agreement relating to Capital Account adjustments for special events, any resulting book gain or loss will be allocated as required for capital account purposes and subsequent allocations of income, gain, loss, or deduction with respect to that asset will take into account any difference between the adjusted basis of that asset for federal income tax purposes and its gross fair market value.

M. Allocation of Net Profits and Net Losses Consistent with Distributions. Notwithstanding any other provision of this Agreement, the Net Profits and Net Losses will be allocated in a manner that is consistent with the requirements for distributions of cash described elsewhere in this Agreement, the requirements for distribution of assets of Company on its dissolution and winding up strictly in accordance with capital account balances determined in accordance with these procedures described below, and the requirements for the allocations to comply with applicable regulations under *I.R.C. § 704(b)*.

N. Allocation of Income, Gain, Losses, and Deductions to Comply with Regulations and Intentions of Members. If the allocations described above are not consistent with the manner in which Members intend to divide Company distributions, the Members are hereby authorized to divide and allocate Net Profits, Net Losses, and other items among Members so as to prevent the allocations from distorting the manner in which the Members intend the Company distributions to be divided among Members, but in a manner consistent with the requirements of *Treas. Reg. § 1.704-1(b)(2)(v)*. In general, Members anticipate that this division will be accomplished by specially allocating other Net Profits, Net Losses, and items of income, gain, loss, and deduction among the Members so that the net amount of the allocations and special allocations to each Member is zero. If, for whatever reason, the Members determine that the allocation provisions of this Agreement are unlikely to be respected for federal income tax purposes, the Managers are granted the authority to amend the allocation provisions of this Agreement, to the minimum extent necessary to effect the plan of allocations and distributions provided in this Agreement. Further, Managers have the discretion to adopt and revise rules, conventions, and procedures as they believe appropriate in any reasonable manner with respect to the admission of Members to reflect the Members' Interests in Net Profits, Net Losses and other items in Company at the close of the year.

O. Order for Applying Allocation Provisions. The allocation provisions shall be applied in the following order from first to last:

(1) Allocation of company minimum gain as required by Paragraph C;

(2) Allocation of member's share of Minimum Gain as required by Paragraph D;

(3) Allocation of Net Profits and gains under qualified income offset as required by Paragraph E;

(4) Allocation of Nonrecourse Deductions as required by Paragraph F;

(5) Allocation of income, gains, or losses related to contributed property as required by Paragraph G;

(6) Allocation of gain and loss from sale or other disposition of property not revalued as required by Paragraph H;

(7) Allocation of Net Profits as required by Paragraph A;

(8) Allocation of Net Losses as required by Paragraph B;

(9) Allocation of gains and losses related to adjustment in tax basis as required by Paragraph I;

(10) Allocations to avoid Adjusted Capital Account Deficit as required by Paragraph J;

(11) Allocation of gross income to restore capital account deficit as required by Paragraph K;

(12) Allocation of capital account adjustments and subsequent effects as required by Paragraph L;

(13) Allocation of Net Profits and Net Losses consistent with distributions as required by Paragraph M;

(14) Allocation of Net Profits, income gains, Net Losses, and deductions to comply with regulations and intentions of Members as required by Paragraph N.

EXHIBIT E
CONSENT OF SPOUSE

The undersigned are the spouses (referred to individually as "spouse" or collectively as "spouses") of the Members of _____[*name of limited liability company*] ("Company"). Each spouse acknowledges that he or s he has read and understands this [*number of pages of agreement*] page Operating Agreement of the Company ("Agreement"). Each spouse understands that, by signing this Spousal Consent, each Member has agreed that the Member's interest in the Company, including any portion of that interest that is the community property of the Member and that Member's spouse, will be subject to all the provisions of this Agreement. Each spouse understands and agrees that the Member is managing the business of Company and that the Member has and will continue to have the primary management and control of the Company's business, as provided in this Agreement, to the maximum extent that the member may lawfully do so. Each spouse agrees to be bound by the provisions of this Agreement, including, but not limited to, those provisions governing the sale or transfer of interests in the Company. Each spouse further agrees that in the event his or her Member spouse predeceases him or her, the non-Member spouse will not devise all or any part of any community property interest that he or she may have in the Member's interest in the Company in violation of this Agreement.

[*OPTIONAL*]

THE UNDERSIGNED HAS BEEN INFORMED OF THE RIGHT TO CONSULT WITH INDEPENDENT COUNSEL BEFORE SIGNING THIS SPOUSAL CONSENT, AND HE OR SHE HAS HAD AMPLE OPPORTUNITY TO DO SO. IF THE UNDERSIGNED HAS NOT CONSULTED WITH COUNSEL, THE UNDERSIGNED HAS KNOWINGLY AND WILLINGLY ELECTED NOT TO DO SO.

[*CONTINUE*]

Executed on _____[*date*], in _____[*city*], [*county*], California.

SPOUSES
[*Repeat, as required:*]
_____ [*name of spouse*], spouse of _____ [*name of member*]
_____ [*name of spouse*], spouse of _____ [*name of member*]
_____ [*name of spouse*], spouse of _____ [*name of member*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral Overview



158 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
B. Operating Agreement and Related Forms

6-12C California Legal Forms--Transaction Guide § 12C.226

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.226 Short-Form Provisions for Member-Managed LLC

[1] Comment--Use of Form

This form contains basic provisions for an LLC operating agreement to allow the members to manage the LLC. The article numbers are keyed to the basic short-form manager-managed LLC operating agreement *set forth in § 12C.220*, and should be substituted for articles 5 through 10 of that form as appropriate. For a more detailed member-managed agreement, see *§ 12C.221*.

[2] FORM

Short-Form Provisions for Member-Managed LLC

ARTICLE 5 MANAGEMENT RIGHTS IN MEMBERS

5.01. Except as otherwise provided in this Agreement or as otherwise agreed, management of the Company is vested in the Members in proportion to their initial capital contributions.

ARTICLE 6 EXERCISE OF COMPANY POWERS

6.01. Except as otherwise provided in this Agreement, all powers of the Company are exercised by or under the authority of the Members and the business and affairs of the Company are managed under the direction of the Members.

ARTICLE 7 MEMBERS TO MAKE JOINT DECISIONS

7.01. No act may be taken, money expended, decision made, or obligation incurred by the Company except by the unanimous consent of all Members with respect to a matter within the scope of any of the major decisions enumerated

below. Those decisions include the following:

(a) The sale of all or substantially all assets of the Company;

(b) A mortgage or encumbrance on all or substantially all assets of the Company;

(c) Any matter that could result in a change in the amount or character of the Company's contributions to capital;

(d) A change in the character of the business of the Company;

(e) Borrowing of money;

(f) Commission of an act that would make it impossible for the Company to carry on its ordinary business; or

(g) Commission of an act that would contravene this Agreement.

ARTICLE 8 ALTERATION OF MANAGEMENT RESPONSIBILITIES

8.01. Management responsibilities may not be altered except by the action of a majority in interest of all Members at a meeting called on written notice expressly describing alteration of management responsibilities as one of the purposes of the meeting.

ARTICLE 9 MANAGING MEMBER COMPENSATION

9.01. Members may receive compensation as determined by all Members for services provided in the management of the Company.

ARTICLE 10 REIMBURSEMENT OF EXPENSES

10.01. Each Member is entitled to reimbursement from the Company of all expenses of the Company reasonably incurred and paid by the Member on behalf of the Company.

ARTICLE 11 POWERS OF MEMBERS AS MANAGERS

11.01. Except as otherwise expressly provided, each of the Members has all necessary powers to carry out the purposes, business, and objectives of the Company, including the right to enter into and carry out contracts of all kinds; to employ employees, agents, consultants, and advisors on behalf of the Company; to lend or borrow money and to issue evidences of indebtedness; to bring and defend actions in law or at equity; and to buy, own, manage, sell, lease, mortgage, pledge, or otherwise acquire or dispose of Company property.

ARTICLE 12 COMPANY BOOKS AND RECORDS

12.01. The Members may employ a competent person to be responsible for authenticating the records of the Company, including keeping correct and complete books of account that show accurately at all times the financial condition of the Company; safeguarding all funds, notes, securities, and other valuables that may from time to time come into possession of the Company; and depositing all funds of the Company with such depositories as the Members designate. The employee may have other duties that the Members from time to time jointly prescribe, but under no circumstances does the employee have any of the rights, powers, responsibilities, or duties of a Member of the Company. Any person responsible for the above-described duties may be terminated at any time by a Member, and any Member may restrict the duties and/or authority of the person responsible for these duties at any time.

ARTICLE 13 EFFECT OF MEMBER'S EXECUTION OF DOCUMENT

13.01. Every contract, deed, mortgage, lease, and other instrument executed by a Member is conclusive evidence in favor of every person relying on, or claiming under, the fact that, at the time of the delivery, (1) the Company was in existence, (2) neither this Agreement nor the Articles had been amended in any manner to restrict the delegation of authority among the Members, and (3) the execution and delivery of that instrument was duly authorized by the Members.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
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B. Operating Agreement and Related Forms

6-12C California Legal Forms--Transaction Guide § 12C.227

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.227 Provisions for Officers

[1] Comment--Use of Form

This form contains provisions for the election, duties, termination, and replacement of LLC officers. These provisions are designed for inclusion in a member-managed LLC operating agreement when the managing members will be company officers. Depending on the size of the LLC and the number of members, the officer structure is recommended but not required by statute. These provisions may be included in § 12C.221[2] as Section 5.10.

[2] FORM

Provisions for Officers

_____ Officers of Company.

(a) **Election of Officers at Meetings of Members.** The Members may elect officers at an annual or special meeting of members. The officers of Company, if deemed necessary by the Members, will be president, vice president, secretary, and treasurer. Only a Member may be elected president or vice-president. Each officer holds office of the term for which he or she is elected until his or her successor has been elected. Any individual may hold any number of offices. No officer need be a resident of the State of California or citizen of the United States. If a Member is a corporation, that corporation's officers may serve as officers of Company if elected by the Members. The officers will exercise the powers and perform the duties as specified in this Agreement and as will be determined from time to time by the Members. At its first meeting after each annual meeting of Members, the Members by resolution will choose a president, one or more vice-presidents, a secretary and a treasurer.

(b) **Term, Removal, and Filling of Vacancy of Officers.** The then officers of Company will hold office until their successors are chosen and qualified by the Members. Any officer may be removed at any time by the affirmative vote of

the Members holding a majority of the Voting Interests. Any vacancy occurring in any office of Company will be filled by a resolution of the Members holding a majority of the Voting Interests, provided only a person who is a Member may be elected as president or vice president.

(c) **Determination of Salaries of Officers.** The salaries of all officers and agents of Company will be fixed by a resolution of the Members at a meeting of Members.

(d) **Duties and Powers of President.** The president will be the chief executive officer of Company, will preside at all meetings of the Members, will have general and active management of the business of Company, and will ensure that all orders and resolutions of the Members are carried into effect. The president will execute bonds, mortgages, and other contracts requiring a seal, under the seal of Company, except when required or permitted by law to be otherwise signed and executed, and except when the signing and execution requirements are expressly delegated by the Members to some other officer or agent of Company.

(e) **Duties and Powers of Vice-President.** The vice-president, or, if more than one, the vice-presidents in the order determined by a resolution of the Members, will, in the absence or disability of the president, perform the duties and exercise the powers of the president and perform any other duties and have any other powers as the Members by resolution may from time to time prescribe.

(f) **Duties and Powers of Secretary.** The secretary will attend all meetings of the Members and record all the proceedings of the meetings in a book to be kept for that purpose, and perform like duties for the standing committees when required. The secretary will give, or cause to be given, notice of all meetings of the Members and special meetings of the Members, and perform any other duties as may be prescribed by the Managers or president, under whose supervision the secretary will be. The secretary will have custody of the seal, and the authority to affix the same to any instrument requiring it; when so affixed, the seal may be attested to by the secretary's signature. The Members may give general authority to any other officer to affix the seal of Company and to attest the affixing of the seal by his, her or its signature.

(g) **Duties and Powers of Treasurer.** The treasurer will have the custody of the funds and securities of Company, and keep full and accurate accounts of receipts and disbursements in books belonging to Company, and will deposit all moneys and other valuable effects in the name and to the credit of Company in the depositories as may be designated by the Members. The treasurer will disburse the funds of Company as may be ordered by the Members, taking proper vouchers for those disbursements, and render to the president and the Members, at their regular meetings, or when Members so require, at a meeting of the members an account of all the treasurer's transactions as treasurer and of the financial condition of Company. If required by a resolution of the Members, the treasurer will give Company a bond in the amount and with surety or sureties that will be satisfactory to the Members for the faithful performance of the duties of the treasurer's office and for the restoration to Company, in case of the treasurer's death, resignation, retirement, or removal from office, of all books, papers, vouchers, money, and other property of whatever kind in the treasurer's possession or under the treasurer's control that belong to Company.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other Constituents



160 of 177 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
B. Operating Agreement and Related Forms

6-12C California Legal Forms--Transaction Guide § 12C.228

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.228 Provisions for Marital Dissolution

[1] Comment--Use of Form

This form is a provision governing the effects of marital dissolution, as defined, on the ownership of membership interests. First, the form requires that membership interests be allocated in any property division resulting form a marital dissolution to the extent possible to the member and not the member's spouse [*see* [2], P A, *below*]. Next, the member has a 90-day purchase option to purchase any portion of the spouse's interest remaining with the non-member spouse [*see* [2], P B, *below*]. If the member spouse does not purchase all of the membership interest, the member must notify the company, which then has an assignable option to purchase and redeem the remaining interest [*see* [2], P C, *below*]. The form also specifies a purchase procedure [*see* [2], P D, *below*] and a method to determine the applicable purchase price [*see* [2], P E, *below*]. Lastly, if the company and members do not exercise their option as to all of the former spouse's membership interest, the form provides that the former spouse continued to hold the membership interest, subject to the provisions of the agreement.

[2] FORM

Provisions for Marital Dissolution

_____ Dissolution of Marriage.

(a) **Marital Dissolution.** Any Membership Interest subject to transfer, disposition, or allocation in connection with a marital settlement agreement, legal separation, dissolution of marriage, or annulment of marriage ("Marital Dissolution"), as to the entire interest, community or separate, of any Member and any Member's spouse, will be allocated in the property division to the extent possible to the Member and not the Member's spouse ("Former Spouse"). If, however, a Former Spouse receives, retains, or is awarded any Membership Interest, the Former Spouse will promptly give notice of that fact to Company, and Company and/or the Members other than the Former Spouse will

have the right to purchase, and the Former Spouse will be obligated to sell, that Former Spouse's Membership Interest as provided in this Section _____.

(b) **Spouse's Option to Buy Former Spouse's Interest.** In the event of a Marital Dissolution (and notwithstanding Section _____ [*specify section of agreement covering notice of intent to purchase*]), the Member spouse in the Marital Dissolution will have the option, exercisable for a period of 90 days following Marital Dissolution (or the transfer of the Membership Interest pursuant to the Marital Dissolution, if later), to purchase any or all of the Former Spouse's Membership Interest at the price and terms provided in this Section _____.

(c) **Company's Option to Purchase.** If, for any reason, the Member spouse does not exercise the option to purchase all of the Former Spouse's Membership Interest within 90 days after the Marital Dissolution (or the transfer of the Membership Interest pursuant to the Marital Dissolution, if later), the Member spouse will promptly give notice of that fact to Company and the remaining Members. Company will have the assignable option, exercisable at any time thereafter, to purchase and redeem any or all of the Former Spouse's Membership Interest at the price and on the terms provided in this Section _____.

(d) **Purchase Procedure.** A purchase of the Membership Interest of a Former Spouse pursuant to this Section _____ will be initiated by Company or the Member exercising the Company's right as assignee by providing a notice of intent to purchase to the Manager and the Former Spouse. Within 30 days following the determination of the purchase price pursuant to Subparagraph E, *below*, Company or Member who filed the notice of intent to purchase will, by written notice to the Former Spouse, either confirm or withdraw that notice. If the notice of intent to purchase is confirmed, the closing for the sale of the Former Spouse's Membership Interest will be held pursuant to the procedure for closing of sale of a Former Member's Interest under Section _____ of this Agreement.

(e) **Determination of Purchase Price.** The purchase price of a Former Spouse's Membership Interest will be determined pursuant to the method set forth in Section _____ of this Agreement; provided that the determination of the purchase price will be initiated by a notice of intent to purchase and all deadlines will be measured from the date of that notice rather than from the notice of a Triggering Event; and, further provided that the purchase price will be determined as of the Marital Dissolution, unless the notice of intent to purchase is given more than 180 days after the Marital Dissolution, in which event, the determination will be made as of the date notice of intent to purchase is given.

(f) **Effect of Failure to Exercise Purchase Option.** If Company and the Members collectively do not exercise their option as to all of the Former Spouse's Membership Interest, then the Former Spouse will continue to hold the Membership Interest subject to the provisions of this Agreement, including the terms of Section _____, which sets forth conditions on the right of the Former Spouse to become a substitute Member.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
B. Operating Agreement and Related Forms

6-12C California Legal Forms--Transaction Guide § 12C.229

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

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§ 12C.229[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
C. Merger and Dissenters' Rights

6-12C California Legal Forms--Transaction Guide § 12C.230

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.230 Agreement of Merger

[1] Comment

[a] Use of Form

This form is an agreement of merger between two California LLCs, resulting in a surviving LLC. This form may be modified to provide for the merger of any other number of LLCs, or to provide for the merger of other types of entities into a successor LLC. For more detailed agreements of merger, which may be modified for use with LLCs, see Ch. 11C, *Mergers* , and Ch. 15C, *Mergers of Limited Partnerships* .

For further discussion of merger, see *§ 12C.25*. For a procedural guide to merger of LLCs, see *§ 12C.126[1]*. Dissenters' rights forms relating to merger, including a notice of approval of reorganization and demand for purchase of a dissenting interest, are provided in §§ 12C.231 and 12C.232.

[b] Types of Entities That May Merge

One or more LLCs may merge with or be acquired by an LLC or any other business entity or entities if the other entity or entities are authorized to do so by their governing law [*Corp. Code § 17550(a), (b)*]. This applies to domestic as well as foreign LLCs and other business entities [*Corp. Code § 17555*].

[c] Procedure for Merger

For an effective merger, each constituent LLC must first approve an agreement of merger [*see* [d], *below* (contents of agreement)] by a majority vote (or greater percentage specified in the articles or operating agreement), and each other merging entity must approve that agreement by the persons required to do so by the laws under which it is organized. If the members of a constituent LLC become personally liable for obligations of the constituent LLC because of the

merger, the principal terms of the agreement of merger must be approved by all the members of the LLC unless the agreement provides that all members will have dissenters' rights [*Corp. Code § 17551(a)*; *see §§ 12C.231, 12C.232*]. An agreement of merger may be amended or abandoned [*Corp. Code § 17551(c), (d)*]. The agreement of merger must be kept at the office of the surviving LLC or other business entity [*Corp. Code § 17551(f)*].

Specific rules must be followed concerning treatment of interests in LLCs in mergers involving their parents or other entities owning more than 50 percent of the voting interests in the LLC [*Corp. Code § 17551(b)*].

After approval of a merger, the constituent LLCs or other business entities must file a certificate of merger (Form LLC-9) with the office of the Secretary of State. The certificate of merger must be executed and acknowledge by specified persons of each constituent LLC or other business entity [*Corp. Code § 17552(a)*; *see § 12C.207* (form for certificate of merger)]. Unless a future effective date is provided by the certificate of merger, the merger is effective on the filing of the certificate of merger (or agreement of merger) in the office of the Secretary of State [*Corp. Code § 17553(a)*]. On the effective date of merger, existence of the disappearing business entities ceases, and the surviving entity succeeds automatically to the rights, property, debts, and liabilities of the disappearing entities [*Corp. Code § 17554*]. Filing the certificate of merger has the effect of filing a certificate of cancellation or articles of organization for each disappearing LLC; no separate certificate of cancellation need be filed [*Corp. Code § 17552(c)*].

An agreement of merger may amend the operating agreement of a constituent LLC, or adopt a new operating agreement for a constituent LLC, if it is the surviving LLC in the merger. The amendment or adoption takes effect at the effective time or date of the merger. However, if a greater number of members is required to approve an amendment to the operating agreement of the constituent LLC than is required to approve the agreement of merger, any amendment or adoption takes effect if the vote of the constituent LLC in favor of the merger is at least as great as the vote required to amend the operating agreement of that LLC [*Corp. Code § 17551(e)*].

Both the merger procedures and the rules governing dissenting interests are similar to the rules applicable to mergers and reorganizations of business corporations and limited partnerships [*see Corp. Code §§ 1200 et seq., 15678.1 et seq., 15679.1 et seq.*, 15911.11 et seq., 15911.20 et seq.].

[d] Contents of Agreement of Merger

The agreement of merger must contain all of the following information [*Corp. Code § 17551(a)(1)- (6)*]:

- The terms and conditions of the merger.
- The name and place of organization of the surviving LLC or other business entity, including any change in the name of the surviving LLC.
- The name and place of organization of each disappearing LLC or other business entity.
- The manner of converting interests of each constituent LLC into interests, shares, or other securities of the surviving LLC or other business entity.
- Any amendments to the articles of organization of the surviving LLC.
- Any other details or provisions required by the laws under which any constituent business entity is organized.
- Any other details or provisions desired, including a provision for the treatment of fractional shares.

[2] FORM

Agreement of Merger

AGREEMENT TO MERGE

_____[*Name of first LLC*], a California limited liability company, and _____[*name of second LLC*], a California limited liability company (the "LLCs"), agree as follows:

1. The LLCs agree to merge.

2. Each of the LLCs is organized, validly existing, and in good standing under the laws of the State of California. The Secretary of State's file number of _____[*name of first LLC*] is [*file number of first LLC*]. The Secretary of State's file number of _____[*name of second LLC*] is [*file number of second LLC*].

3. The name of the surviving LLC will be _____[*name of surviving LLC*], which will be organized under the laws of the State of California. [*Add if a constituent LLCs will be the surviving LLC:* The articles of organization of _____ (*name of surviving LLC*) will be amended in the following manner because of the merger: _____ (*list amendments*).]

4. The office of _____[*name of surviving LLC*] in California will be at _____[*address*].

5. The agent for service of process on _____[*name of surviving LLC*] will be _____[*name*], at _____[*address*].

6. This merger will be effective on the filing of the surviving LLC's articles of organization with the Secretary of State on _____[*date*].

7. The terms of this agreement of merger were approved by the [majority *or specify greater percentage*] vote of the members of each of the constituent LLCs.

8. Before merger, the percentage of interests of each class of interest in each LLC were:

a. _____[*name of first LLC*]:

(1) _____ [*first class of first LLC*]: _____ [*percent*].

(2) _____ [*second class of first LLC*]: _____ [*percent*].

b. _____ [*name of second LLC*]:

(1) _____ [*first class of second LLC*]: _____ [*percent*].

(2) _____ [*second class of second LLC*]: _____ [*percent*].

9. On merger, each interest of each [*specify first class of each LLC*] will become a [*specify percent*] interest of the surviving LLC, and each interest of each [*specify second class of each LLC*] will become a [*specify number of percent*] interest of the surviving LLC.

10. [*Specify other terms and conditions of merger not covered elsewhere in agreement*].

Executed on _____[*date*] at _____[*place*].

_____ [*name of first LLC*]
By _____ [*signature*]
[*typed name and title*]
_____ [*name of second LLC*]
By _____ [*signature*]
[*typed name and title*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesDissolution & Winding UpBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
C. Merger and Dissenters' Rights

6-12C California Legal Forms--Transaction Guide § 12C.231

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.231 Notice of Approval of Reorganization

[1] Comment

[a] Use of Form

This form is a notice of approval of reorganization of a limited liability company. It must be sent by an LLC that proposes to reorganize to all members who have the right to require the LLC to purchase their dissenting interests [*Corp. Code § 17602(a)*; *see* [b], *below* ("reorganization" and "dissenting interest" defined)]. In general, in a merger or reorganization, a member who is entitled to vote on a reorganization and has taken necessary steps to have a dissenting interest [*see Corp. Code § 17601(b)* (definition)] has the right to require the LLC to purchase that interest for cash at fair market value [*Corp. Code § 17601(a)*].

These dissenters' rights provisions apply to domestic LLCs, and to foreign LLCs if members holding more than 50 percent of voting interests reside in California [*Corp. Code § 17612(a)*]. These provisions do not apply to LLCs with 35 or fewer members if all the members have waived the application of dissenters' rights provisions in writing [*Corp. Code § 17612(c)*].

For further coverage of dissenters' rights, see *§ 12C.25*. For a procedural guide to merger, see *§ 12C.126[1]*. For a procedural guide to the steps involved in establishing dissenters' rights, see *§ 12C.126[2]*. For an agreement of merger, see *§ 12C.230*.

[b] Definitions

The term "reorganization" includes mergers, conversions, certain acquisitions of controlling interests in other business entities, and certain acquisitions of substantially all of the assets of other business entities [*Corp. Code § 17600(a)*].

A "dissenting interest" is a membership interest in an LLC that satisfies all of the following [*Corp. Code § 17601(b)*]:

- The membership interest was outstanding on the date for the determination of members entitled to vote on the reorganization.
- The membership interest was not voted in favor of the reorganization, or the membership interest was voted against the reorganization [*see Corp. Code § 17601(b)(2)*].
- The member has demanded that the LLC purchase its interest at its fair market value [*see Corp. Code § 17602* (method of demand)].
- The member has submitted the certificate of interest for endorsement, if applicable [*see Corp. Code § 17603*].

[c] Procedure to Require Company to Purchase Dissenting Interest

If LLC members have the right to require the LLC to purchase their dissenting interests [*see Corp. Code § 17601(b)* (definition); *see also* [b], *above*], the LLC must mail to each member a notice of approval of the proposed reorganization. The notice must contain all of the following information [*Corp. Code § 17602(a)*]:

- Copies of *Corp. Code §§ 17601-17605*.
- A statement of the price determined by the LLC to be the fair market value of outstanding interests.
- A statement of the method of valuation used.
- The latest available balance sheet of the LLC.
- The latest available income statement of the LLC.
- A description of the procedure to exercise dissenters' rights.

This form contains or provides for all of this required information.

A member with a dissenting interest who wishes the LLC to purchase his or her interest must make a written demand on the LLC for the purchase of the interest and the payment to the member in cash of its fair market value [*Corp. Code § 17602(b), (c)*; *see § 12C.232* (form for demand)].

If the LLC and the dissenting member agree that the interest is a dissenting interest, and agree on the price to be paid for the interest, the dissenting member is entitled to the agreed price, with interest from the date of consummation of the reorganization. Agreements as to value of dissenting interests must be in writing and must be kept with the records of the LLC [*Corp. Code § 17604(a)*]. The LLC must pay for a dissenting interest within 30 days after the amount of the interest has been agreed on, or within 30 days after conditions to the reorganization are satisfied, whichever is later [*Corp. Code § 17604(b)*]. The dissenting member must submit certificates of interest (or, if none, written notice of the number or amount of interests) on payment [*Corp. Code § 17604(b)*; *see Corp. Code § 17603*].

If the LLC denies that an interest is a dissenting interest, or the LLC and the dissenting member cannot agree on the value of a dissenting interest, either the LLC or the member may bring an action in superior court within six months after the date of the notice of approval of the reorganization to settle the issue [*Corp. Code § 17605*].

[2] FORM

Notice of Approval of Reorganization

NOTICE TO MEMBERS OF _____ [*name*],
A CALIFORNIA LIMITED LIABILITY COMPANY, OF APPROVAL OF REORGANIZATION

To: _____[*name of member*]
_____[*address of member*]

This is to give notice that the outstanding interests of [*add if applicable:* each class of interests of] _____[*name*], a California limited liability company, have approved by the requisite vote or consent the principal terms of a reorganization, as defined in the Beverly-Killea Limited Liability Company Act. In this reorganization, _____[*specify, e.g.*, this limited liability company will be merged into _____ (*name of surviving entity*), a _____ (*type of entity*)].

Any member of this limited liability company may require the limited liability company to purchase at its fair market value on the day before the announcement of the reorganization described in this notice the interest owned by the member that comes within the definition of "dissenting interest" set forth in *Corporations Code Section 17601(b)*. To meet the definition set forth in Section 17601(b), the interest (1) must have been outstanding on the date for determination of members entitled to vote on the reorganization, and (2) must not have been voted in favor of the reorganization or must have been voted against the reorganization.

For a member to enforce his or her right to require the limited liability company to purchase a dissenting interest owned by him or her, the member must take two actions:

1. Within 30 days after the date of the mailing of this notice to the member, the member must serve on the limited liability company a written demand for the limited liability company to purchase his or her dissenting interest and to pay the member the fair market value, in cash, of that interest. The demand must state the number or amount of the member's interest that the member demands the limited liability company purchase, and the price the member claims to be the fair market value of that interest on the day before the announcement of the proposed reorganization described in this notice.

2. Within 30 days after the date of the mailing of this notice to the member, the member must, in addition to making the demand described in Paragraph 1, above, submit to the limited liability company _____[*if interest is evidenced by certificate:* the member's certificate representing the interest the member demands the limited liability company purchase, to be stamped or endorsed with a statement that the interest is a dissenting interest, or to be exchanged for certificates of appropriate denominations so stamped or endorsed *or, if interest is not evidenced by certificate:* written notice of the number or amount of interest that the member demands the limited liability company purchase]. The [certificate *or* written notice] must be submitted to the limited liability company at its principal office at _____[*address*] or at the office of its transfer agent at _____[*address*].

If the limited liability company and the member agree that the member's interest is a dissenting interest, and agree on the price to be paid for the dissenting interest, the dissenting member is entitled to the agreed price, plus interest at the legal rate for judgments from the date of consummation of the reorganization. Payment will be made within 30 days after the price of the dissenting interest has been agreed on, or within 30 days after any statutory or contractual conditions to the reorganization are satisfied, whichever is later.

If the limited liability company denies that the member's interest is a dissenting interest, or if the limited liability company and the member fail to agree on the fair market value of the dissenting interest, the member may file a

complaint to determine whether the interest is a dissenting interest, or to determine the fair market value of the dissenting interest. The complaint must be filed in the Superior Court of the State of California for the County of _____, the county in which the principal office of the limited liability company is located. The complaint must be filed within six months after the date on which this notice was mailed to the member. A copy of *Corporations Code Sections 17601 through 17605*, which govern the procedure a member must follow to require the limited liability company to purchase a dissenting interest, is enclosed with this notice. In addition, copies of the latest available balance sheet and income statement of the limited liability company are enclosed with this notice.

The limited liability company has determined that the price of $ _____ per interest is the fair market value of outstanding interests on the day before the announcement of the terms of the reorganization described in this notice [*if there is more than one class of interest, specify each class and list price for each*]. The method of valuation used to determine this price was [*specify*].

Dated: _____

_____[*name of limited liability company*]
By [*signature*]
[*typed name and title*]

[*Attach copies of Corp. Code §§ 17601 through 17605.*]

[*Attach latest available balance sheet of limited liability company.*]

[*Attach latest available income statement of limited liability company.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsMergers & Acquisitions LawMergersRights of Dissenting Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
C. Merger and Dissenters' Rights

6-12C California Legal Forms--Transaction Guide § 12C.232

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.232 Demand for Purchase of Dissenting Interest

[1] Comment

[a] Use of Form

This form is a written demand that a dissenting member of an LLC must send to the LLC as a prerequisite to forcing the LLC to purchase the dissenting interest [*see* [b], *below*]. This form is sent by the dissenting member to the LLC after receiving a notice of proposed reorganization from the LLC [*see § 12C.231*].

For further coverage of dissenters' rights, see *§ 12C.25*. For a procedural guide to the steps involved in establishing dissenters' rights, see *§ 12C.126[2]*.

[b] Requiring Limited Liability Company to Purchase Dissenting Interest

A member of an LLC with a dissenting interest [*see* [c], *below* (definition)] who wishes the LLC to purchase his or her interest must make a written demand on the LLC for the purchase of the interest and for the payment to the member in cash of its fair market value. To be effective, the demand must be received by the LLC within 30 days after the notice of reorganization was mailed to member [*Corp. Code § 17602(b)*]. The demand must state the number or amount of the interest, and must contain a statement of the member's claim of the fair market value of the interest on the day before the announcement of the proposed reorganization. The statement of value constitutes an offer by the member to sell the dissenting interest at that price [*Corp. Code § 17602(c)*]. This form contains these required statements.

[c] "Dissenting Interest" Defined

A "dissenting interest" is a membership interest in an LLC that satisfies all of the following [*Corp. Code § 17601(b)*]:

- The membership interest was outstanding on the date for the determination of members entitled to vote on the reorganization.

- The membership interest was not voted in favor of the reorganization, or the membership interest was voted against the reorganization [*see Corp. Code § 17601(b)(2)*].

- The member has demanded that the LLC purchase its interest at its fair market value [*see Corp. Code § 17602* (method of demand)].

- The member has submitted the certificate of interest for endorsement, if applicable [*see Corp. Code § 17603*].

[d] Loss of Status as Dissenting Interest

A dissenting interest loses its status as such, and the holder of that interest ceases to be a dissenting member, on the occurrence of any of the following [*Corp. Code § 17610*]:

- The LLC abandons the reorganization.

- The interest is transferred before its submission for endorsement [*see Corp. Code § 17603*].

- The dissenting member and the LLC do not agree that the interest is a dissenting interest or disagree on the purchase price of the interest, and neither files a complaint within six months after the notice of approval of the reorganization [*see Corp. Code § 17605*].

- The dissenting member, with the LLC's consent, withdraws the demand for purchase of the dissenting interest.

[2] FORM

Demand for Purchase of Dissenting Interest

DEMAND FOR PURCHASE OF INTEREST

To: _____[*name of limited liability company*], a California limited liability company
_____[*address of limited liability company*]

I am a member of _____[*name of limited liability company*], a California limited liability company, and hold [*number or amount*] interest in that limited liability company.

Pursuant to *Corporations Code Section 17602(b)*, I demand that the limited liability company purchase this interest and pay to me in cash its fair market value as of _____[*date*], the day before the announcement of the proposed reorganization of this limited liability company, in which _____[*specify, e.g.*, this limited liability company will be merged into _____ (*name of surviving entity*), a _____ (*type of entity*)].

Pursuant to *Corporations Code Section 17602(b)*, I state that I claim $ _____ per interest is the fair market value of my interest on the day before the announcement of the terms of the reorganization described above.

Pursuant to *Corporations Code Section 17603*, I submit _____[*if interest is evidenced by certificate:* the certificate representing the interest I demand the limited liability company purchase, to be stamped or endorsed with

a statement that the interest is a dissenting interest, or to be exchanged for certificates of appropriate denominations so stamped or endorsed *or, if interest is not evidenced by certificate:* written notice of the number or amount of interest that I demand the limited liability company purchase]. I submit the [certificate *or* written notice] to the limited liability company at _____[its principal office at _____ (*address*) *or* the office of its transfer agent at _____ (*address*)].

_____ Dated:

_____ [*signature*]
[*typed name*]
[*address*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsMergers & Acquisitions LawMergersRights of Dissenting Shareholders



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
C. Merger and Dissenters' Rights

6-12C California Legal Forms--Transaction Guide §§ 12C.233-12C.239

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§§ 12C.233[Reserved]



166 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
D. Letters to Limited Liability Company Unit

6-12C California Legal Forms--Transaction Guide § 12C.240

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
D. Letters to Limited Liability Company Unit

6-12C California Legal Forms--Transaction Guide

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

NOTE:

For a form reserving a limited liability company name, see now the Secretary of State's official form reproduced in § 12C.199.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
D. Letters to Limited Liability Company Unit

6-12C California Legal Forms--Transaction Guide § 12C.241

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.241 Transmittal Letter for Domestic Limited Liability Company's Articles of Organization

[1] Comment

[a] Use of Form

This form is a transmittal letter to accompany a domestic LLC's articles of organization, when filed by mail. LLC forms must be filed with the LLC Unit in the Sacramento office of the Secretary of State [Secretary of State's LLC form packet]. The Secretary of State has indicated that it is desirable to include a transmittal letter for articles to be filed that includes, among other things, a statement that the applicant is aware of the prohibition on professional LLCs [*see* [b], *below*; *see also* Secretary of State's LLC form packet].

This letter should be used as a cover letter to the articles of organization, explaining that the articles are submitted for filing, stating that the required fee is enclosed [*see Gov. Code § 12190(b)*], and including the required statement about professional LLCs [*see* [b], *below*].

For an illustration of the official form for articles of organization (Form LLC-1) that must be filed with the LLC Unit, see *§ 12C.200*. For a transmittal letter to use when filing a foreign LLC's application for registration, see *§ 12C.242*.

[b] Prohibition on Professional Limited Liability Companies

The LLC Act currently does not permit a domestic or foreign LLC to render professional services, as defined in *Corp. Code §§ 13401(a)* and *13401.3*, that may be lawfully rendered only under a license, certification, or registration authorized by the Business and Professions Code, the Osteopathic Act, the Yacht and Ship Brokers Act, or the Chiropractic Act unless authorized under those laws [*Corp. Code § 17375*]. For further discussion of the prohibition on professional LLCs, see *§ 12C.10[5]*.

The LLC Unit in the Sacramento office of the Secretary of State (where LLC documents must be filed) has indicated that it is the applicant's responsibility to determine whether the LLC is prohibited from filing; the LLC Unit will not make that determination. The current policy of the LLC Unit is to return any filing or name reservation that is indicative of a "professional service" LLC [*see Corp. Code §§ 13401(a), 13401.3* (definition)]. If the documents are returned in error, the applicant may resubmit the documents accompanied by a letter stating that the applicant is aware of the prohibition. If the document originally submitted for filing was otherwise acceptable, the filing date will be the date indicated in the Secretary of State stamp on the reverse of the document [Secretary of State's LLC form packet].

To prevent delays in filing articles of organization, the Secretary of State recommends that the applicant submit a cover letter with the documents stating that the applicant is aware of the prohibition on LLCs rendering professional services, and that the LLC for which articles are being filed is not prohibited from filing [Secretary of State's LLC form packet]. This form includes language intended to satisfy this requirement.

[2] FORM

Transmittal Letter for Domestic Limited Liability Company's Articles of Organization

_____[*date*]
Office of the Secretary of State
Limited Liability Company Unit
1500 11th Street
P.O. Box 944228
Sacramento, CA 94244-2280

Re: Articles of Organization
Dear Sir or Madam:

Enclosed for filing is the executed original of the articles of organization of _____[*name of LLC*]. Please immediately file the articles, certify and endorse the file date, and return a certified copy to the undersigned. A self-addressed, stamped envelope is enclosed for your convenience. Also enclosed is a check for $[*specify fee*] to cover the filing fee for the articles.

The applicant is aware of the prohibition imposed by *Corporations Code Section 17375* on limited liability companies rendering professional services. _____[*Name of LLC*] is not prohibited from filing articles of organization by this prohibition.

Thank you for your attention to this matter.

Sincerely,
_____ [*signature*]
[*typed name*]

Encls.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
D. Letters to Limited Liability Company Unit

6-12C California Legal Forms--Transaction Guide § 12C.242

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.242 Transmittal Letter for Foreign Limited Liability Company's Application for Registration

[1] Comment

[a] Use of Form

This form is a transmittal letter to accompany a foreign LLC's application for registration, when filed by mail. LLC forms must be filed with the LLC Unit in the Sacramento office of the Secretary of State [Secretary of State's LLC form packet]. The Secretary of State has indicated that it is desirable to include a transmittal letter for an application to be filed that includes, among other things, a statement that the applicant is aware of the prohibition on professional LLCs [*see* [c], *below*; *see also* Secretary of State's LLC form packet].

This letter should be used as a cover letter to the application for registration, explaining that the application is submitted for filing, requesting a delayed effective date, if desired [*see Corp. Code § 17056(c)*], stating that the required fee is enclosed [*see Gov. Code § 12190(c)*], stating whether a certificate of good standing is included [*see Corp. Code § 17451(b)*; *see also* [b], *below*], and including the required statement about professional LLCs [*see* [c], *below*].

For an illustration of the official application for registration (Form LLC-5) that must be filed with the LLC Unit, see *§ 12C.204*. For a transmittal letter to use when filing a domestic LLC's articles of organization, see *§ 12C.241*.

[b] Certificate of Good Standing

An application for registration of a foreign LLC must be accompanied by a certificate of good standing from an authorized public official of the foreign LLC's jurisdiction. If the laws of the jurisdiction do not permit issuance of such a certificate, a statement by the LLC to that effect must be included [*Corp. Code § 17451(c)*]. This form provides text for either situation.

[c] Prohibition on Professional Limited Liability Companies

The LLC Act does not permit a domestic or foreign LLC to render professional services, as defined in *Corp. Code §§ 13401(a)* and *13401.3*, that may be lawfully rendered only under a license, certification, or registration authorized by the Business and Professions Code, the Osteopathic Act, the Yacht and Ship Brokers Act, or the Chiropractic Act unless authorized under those laws [*Corp. Code § 17375*]. For further discussion of the prohibition on professional LLCs, see *§ 12C.10[5]*.

The prohibition on LLCs rendering professional services is especially relevant to foreign LLCs, because various other states provide for professional LLCs. A professional LLC from one of these jurisdiction may register in California, but it may not register as a professional LLC, may not indicate in its name that it is a professional LLC, and may not render professional services in California [*Corp. Code § 17375*; *see* Secretary of State's LLC form packet].

The LLC Unit in the Sacramento office of the Secretary of State (where LLC documents must be filed) has indicated that it is the applicant's responsibility to determine whether the LLC is prohibited from filing; the LLC Unit will not make that determination. The current policy of the LLC Unit is to return any filing or name reservation that is indicative of a "professional service" LLC [*see Corp. Code §§ 13401(a), 13401.3* (definition)]. If the documents are returned in error, the applicant may resubmit the documents accompanied by a letter stating that the applicant is aware of the prohibition. If the document originally submitted for filing was otherwise acceptable, the filing date will be the date indicated in the Secretary of State stamp on the reverse of the document [Secretary of State's LLC form packet].

To prevent delays in filing applications for registration, the Secretary of State recommends that the applicant submit a cover letter with the documents stating that the applicant is aware of the prohibition on LLCs rendering professional services and that the LLC for which the application is being filed is not prohibited from filing [Secretary of State's LLC form packet]. This form includes language intended to satisfy this requirement.

[2] FORM

Transmittal Letter for Foreign Limited Liability Company's Application for Registration

_____[*date*]
Office of the Secretary of State
Limited Liability Company Unit
1500 11th Street
P.O. Box 944228
Sacramento, CA 94244-2280

Re: Application for Registration
Dear Sir or Madam:

Enclosed for filing is the executed original of the application for registration of _____[*name of LLC*]. Please _____[immediately file the application *or* file the application on _____ (*delayed effective date*)], certify and endorse the file date, and return a certified copy to the undersigned. A self-addressed, stamped envelope is enclosed for your convenience. Also enclosed is a check for $[*specify fee*] to cover the filing fee for the application.

The applicant is aware of the prohibition imposed by *Corporations Code Section 17375* on limited liability companies rendering professional services. _____[*Name of LLC*] is not prohibited from filing articles of organization by this prohibition.

_____[*Select one:* Enclosed please find a certificate of good standing for _____ (*name of LLC*) from _____ (*name of public official and jurisdiction*) *or* The laws of _____ (*name of jurisdiction*) do not permit the issuance of a certificate of good standing for a limited liability company].

Thank you for your attention to this matter.

Sincerely,
_____ [*signature*]
[*typed name*]

Encls.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawLimited Liability CompaniesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
D. Letters to Limited Liability Company Unit

6-12C California Legal Forms--Transaction Guide §§ 12C.243-12C.249

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

[Reserved]

§§ 12C.243[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
E. Official Forms of the Franchise Tax Board

6-12C California Legal Forms--Transaction Guide § 12C.250

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.250 Limited Liability Company Return of Income [Form 568]

[1] Comment

[a] Use of Form

This form (Form 568) is the official Franchise Tax Board (FTB) form used (1) to report income, deductions, gains, losses, and the like from the operation of an LLC, (2) to show payment of the $800 minimum franchise tax, and (3) to determine and pay the amount of the LLC's annual fee, if any, based on total income [*see Rev. & Tax. Code §§ 17941, 17942, 18633.5*]. California's reporting requirements for LLCs are generally the same as the federal reporting requirements for partnerships [Instructions for Form 568, p. 3; *see* Instructions for federal Form 1065].

This form can be obtained at any FTB office or by contacting the FTB at (800) 852-5711.

[b] Who Must File Form 568

Form 568 must be filed by every LLC classified as a partnership for tax purposes that is [Instructions for Form 568, p. 4; *see Rev. & Tax. Code § 18633.5*; *see also § 12C.54*]:

- Doing business in California;
- Organized in California; or
- Organized in another state but registered with the California Secretary of State.

Regardless of where the trade or business of an LLC is conducted, an LLC taxable as a partnership is considered to be "doing business" in California if any of its members, managers, or other agents are conducting business in California on

behalf of the LLC [Instructions for Form 568, p. 4].

An LLC classified as corporation for tax purposes must file Form 100, Corporation Income or Franchise Tax Return [*see Rev. & Tax. Code § 18633.5(h)*].

[c] Filing Form 568

Form 568 must be filed by the 15th day of the fourth month following the close of an LLC's taxable year [*see Rev. & Tax. Code § 18633.5(a)*]. If an LLC cannot file Form 568 by this date, the LLC is granted an automatic six-month extension without having to file a request for extension. However, this automatic extension does not extend the time to pay the LLC tax or the fee based on income [Instructions for Form 568, pp. 4, 5; *see* [f], *below*]. To pay the LLC tax and fee, the LLC should file Form FTB 3537 [*see § 12C.255*].

Form 568, accompanied by payment, is filed by mailing it to Franchise Tax Board, P.O. Box 942857, Sacramento, CA 94257-0501. Form 568, *not* accompanied by payment, is filed by mailing it to Franchise Tax Board, P.O. Box 942857, Sacramento, CA 94257-0500. Note that these two addresses are identical except for the last digit of the ZIP code. The included check should be made payable to the "Franchise Tax Board." The check must include the Secretary of State's LLC number and the LLC's federal employer ID number [Instructions for Form 568, pp. 4, 5].

Form 568 must be signed by an authorized member or manager of the LLC, or, if appropriate, a receiver, trustee in bankruptcy, or assignee controlling the LLC's property or business. If a paid preparer completes the return, that person should not sign the return, but must sign the Paid Preparer's Use Only area, provide the required preparer information, and give a copy of the return to the LLC, in addition to filing a copy with the FTB [Instructions for Form 568, p. 7].

[d] Filing Amended Form 568

If, after filing Form 568, the LLC discovers that it needs to make changes to the form, it must file an amended Form 568, as well as an amended Schedule K-1 for each member [Instructions for Form 568, p. 6].

In addition, if the LLC discovers that it needs to amend its federal partnership return, or if the return is changed in response to an IRS audit, it is likely the LLC will need to file an amended California Form 568. This must be done within six months of final federal adjustments. If an IRS audit was done, the LLC must attach a copy of the IRS Federal Agent's Report. Members of the LLC may also need to file amended returns [Instructions for Form 568, p. 6].

[e] Determination of Income

An LLC classified as a partnership determines its California income under the Personal Income Tax Law [Instructions for Form 568, p. 3; *see Rev. & Tax. Code § 17001 et seq.*].

Income of nonresident members, including banks and corporations, derived from "qualified investment securities" of an LLC that qualifies as an "investment partnership" is considered to be from a source other than California. Therefore, nonresident members are not taxed in California on this income [Instructions for Form 568, p. 7].

[f] Taxation of Limited Liability Companies

[i] Net Income Tax

If an LLC elects to be taxed as a partnership, its members, not the LLC, pay tax on its net income, much as partners would [*see I.R.C. § 701*; *Treas. Reg. § 301.7701-3* (election)]. As with a partnership, for tax purposes the LLC is merely an accounting entity for determining items of income and loss that are to be allocated to the members. An LLC, like a partnership, does not pay income tax, but must nonetheless file an information return (this form) [*see I.R.C. §§ 701,*

6031; *Rev. & Tax. Code § 17851*; *see also § 12C.50[2][c]*].

For further discussion of taxation of partnerships, also applicable to limited liability companies, see Ch. 15, *General Partnerships* .

[ii] Minimum Franchise Tax

In general, every LLC or foreign LLC classified as a partnership for California tax purposes must pay an annual minimum franchise tax of $800 for the privilege of doing business in California [*Rev. & Tax. Code § 17941(a)*]. However, an LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax [*see Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; *see also I.R.C. § 501(c)(2), (25)* (title holding companies)].

This tax applies to (1) an LLC that is doing business in California, (2) an LLC that has filed articles of organization in California, and (3) a foreign LLC that has registered with the California Secretary of State [*Rev. & Tax. Code §§ 17941(a), (b), 23153(d)(1)*; *see* Instructions for Form 568, p. 5]. This tax must be paid annually until a certificate of cancellation of articles of organization (LLC) or a certificate of cancellation of registration (foreign LLC) is filed with the Secretary of State [*Rev. & Tax. Code § 17941(b), (c)*].

The minimum franchise tax is due and payable on or before the 15th day of the fourth month after the close of the LLC's taxable year [*see Rev. & Tax. Code §§ 17941(c), 18633.5(a)*].

For LLCs that must pay the minimum franchise tax, the failure to pay the tax on time is subject to a late payment penalty plus interest. Penalties may also be charged for NSF checks and costs of collection [Instructions for Form 568, p. 5].

[iii] California Fee Based on Income

In addition to the minimum franchise tax [*see* [ii], *above*], an annual fee is also based on total for income from all sources derived from or attributable to California [Instructions for Form 568, p. 4; *see Rev. & Tax. Code § 17942(a)*; *see also Rev. & Tax. Code §§ 17942(b)(1),* 24172 ("total income" defined); *see Rev. & Tax. Code § 17942(b)(1)* (limitation on total income)]. However, an LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax, and thus not subject to this annual fee [*see Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; *see also I.R.C. § 501(c)(2), (25)* (title holding companies)].

The base range for this annual fee is $900 to $11,790 [*Rev. & Tax. Code § 17942(a)*]. Special income determination provisions apply to commonly controlled LLCs [*see Rev. & Tax. Code § 17942(b)(2)*]. The fee is due and payable on or before the 15th day of the fourth month following the close of the LLC's taxable year [*Rev. & Tax. Code §§ 17942(c), 18633.5*]. The fee must be estimated and paid on or before the 15th day of the sixth month of the current taxable year, and a penalty of 10 percent of the amount of any underpayment will be added to the fee [*Rev. & Tax. Code § 17942(d)*]. An LLC that fails to pay its total fee (or that fails to pay its total nonresident members' tax), by the due date, will be assessed for late payment as follows [Instructions for Form 568, p. 6]:

- Five percent of the unpaid fee; plus
- One half of one percent for each month or partial month (not to exceed 40 months) that the fee remains unpaid; but
- Subject to a 25-percent limit of the unpaid fee.

Penalties may also be charged for NSF checks and the costs of collection [Instructions for Form 568, p. 6].

[g] Filing Group Return

Individual nonresident members of a foreign or domestic LLC may elect [*see Rev. & Tax. Code § 18535*; *see also* Form FTB 3864, Group Nonresident Return Election] to file a group return on Form 540NR rather than an individual Form 540NR, but only if each nonresident member has no California source income other than that reported on the LLC group return [Instructions for Form 568, p. 7; *see* FTB Pub. 1067].

On group returns, income is taxed at the highest marginal rate. No deductions are allowed except those necessary to determine each member's distributive share of LLC income, and certain other deductions relating to earned income [*Rev. & Tax. Code § 18535(a), (b), (d)*; *see Rev. & Tax. Code § 17501 et seq.*]. No credits are allowed except those directly attributable to the LLC [*Rev. & Tax. Code § 18633.5(a)*].

[h] Information Returns

Every LLC must file an information return on federal Form 1099 if, in the course of its trade or business, it meets the following criteria [Instructions for Form 568, p. 6; *see I.R.C. § 6031* et seq.]:

- Makes payments to one person of rents, salaries, wages, annuities, or other fixed or determinable income of $600 or more;
- Pays to one payee interest and dividends of $10 or more; or
- Receives cash payments of over $10,000.

The return is for the calendar year, and must be filed by February 28 of the following year [Instructions for Form 568, p. 6].

[2] FORM

Limited Liability Company Return of Income [Form 568]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawState & Local TaxesFranchise TaxGeneral OverviewTax LawState & Local TaxesFranchise TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
E. Official Forms of the Franchise Tax Board

6-12C California Legal Forms--Transaction Guide § 12C.251

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.251 Member's Share of Income, Deductions, Credits, etc. [Schedule K-1 (568)]

[1] Comment

[a] Use of Form

This form (Schedule K-1 (568)) is the official Franchise Tax Board (FTB) form used by an LLC to report a member's share of an LLC's income, deductions, credits, and the like. This form is to be completed by the LLC. The LLC then sends one copy to the FTB, and one copy to the member. The member does not file Schedule K-1 with the FTB, but uses it to prepare his or her own tax return [Instructions for Form 568, pp. 12-14].

This form can be obtained at any FTB office or by contacting the FTB at (800) 852-5711.

[b] Amended Return Requires Amended Schedule

If an LLC files an amended Form 568 [*see § 12C.250[1][d]*], it must also file an amended Schedule K-1 for each resident member and provide the amended schedule to each member. This will usually require the member to file an amended tax return as well [Instructions for Form 568, p. 6].

[2] FORM

Member's Share of Income, Deductions, Credits, etc. [Schedule K-1 (568)]

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Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsGeneral OverviewTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
E. Official Forms of the Franchise Tax Board

6-12C California Legal Forms--Transaction Guide § 12C.252

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.252 Depreciation and Amortization [Form FTB 3885L]

[1] Comment

[a] Use of Form

This form (Form FTB 3885L) is the official Franchise Tax Board (FTB) form used by an LLC to show depreciation and amortization of its assets [Instructions for Form 568, p. 31; *see* [b], *below*].

This form can be obtained at any FTB office or by contacting the FTB at (800) 852-5711.

[b] Depreciation and Amortization of Assets

The California Personal Income Tax law incorporates by reference the federal depreciation and MACRS provisions, subject to several modifications and internal cross references to California statutes [*Rev. & Tax. Code §§ 17201, 17250*; *I.R.C. §§ 167, 168*]. Therefore, taxpayers subject to the California Personal Income Tax Law generally may compute depreciation or cost recovery deductions for California purposes in the same manner as under federal law.

The California provisions do not incorporate federal provisions relating to property on Indian reservations, however [*Rev. & Tax. Code § 17250(a)(3)*; *I.R.C. § 168(j)*], and the deduction for amortization of pollution control facilities is allowed only for facilities located in California [*Rev. & Tax. Code § 17250(b)*; *I.R.C. § 169*]. The California Personal Income Tax Law prohibits depreciation and other deductions relating to substandard housing [*Rev. & Tax. Code § 17274*] and also has specific provisions relating to depreciation of diseased grapevines [*Rev. & Tax. Code § 17250(a)(2)*]. California law also declines to incorporate certain federal provisions relating to straight line depreciation [*Rev. & Tax. Code § 17250(a)(5)*; *see I.R.C. § 168(b)(3)(G), (H)*], provisions relating to 15-year property [*Rev. & Tax. Code § 17250(a)(6)*; *see I.R.C. § 168(e)(3)(E)(iv), (v)*], and provisions relating to leasehold improvement property and qualified restaurant property [*Rev. & Tax. Code § 17250(a)(7)*; *see I.R.C. § 168(e)(6), (7)*].

It should be noted, however, that for tax years beginning on or after January 1, 2002 and on or before December 31, 2004 the incorporated federal law that applies for California purposes under the general conformity rule is the law in effect on January 1, 2001. For taxable years beginning on or after January 1, 2005, the applicable incorporated federal law is the federal law in effect on January 1, 2005 [*Rev. & Tax. Code § 17024.5(a)(1), 17201, 17250*; *I.R.C. §§ 167, 168*]. Thus, the California Personal Income Tax Law did not incorporate the federal provision allowing additional 30-percent first-year depreciation for certain property acquired after September 10, 2001 and before January 1, 2005, or the bonus 50-percent first-year depreciation deduction allowed for certain property acquired after May 5, 2003 and before January 1, 2005 [*see I.R.C. § 168(k)(4)*; *Rev. & Tax. Code §§ 17024.5(a)(1)(3), 17201, 17250(a)*]. However, California fully incorporates these federal provisions for tax years beginning on or after January 1, 2005 [*Rev. & Tax. Code § 17024.5(a)(N)*].

The California Personal Income Tax Law also allows taxpayers to expense certain costs of depreciable property, generally in accordance with federal law [*Rev. & Tax. Code § 17255*; *I.R.C. § 179*]. The California Personal Income Tax Law, however, has not incorporated the federal increase in the expensing amount to $125,000 beginning after 2006 and before 2011 [*I.R.C. § 179(b)(1)*; *Rev. & Tax. Code §§ 17024.5(a)(1), 17255(a), (b)*], or the federal eligibility of off-the-shelf computer software for current expensing for tax years beginning after 2002 and before 2011, [*I.R.C. § 179(d)(1)*; *Rev. & Tax. Code §§ 17024.5(a)(1), 17255(a), (f)*].

The California Corporation Tax Law does not incorporate *I.R.C. § 168* by reference or otherwise adopt those provisions. Accordingly, corporations (including LLCs that are treated for tax purposes as corporations) and other taxpayers subject to the Corporation Tax Law may not use MACRS to compute deprecation or cost recovery deductions for California tax purposes. Instead, depreciation deductions must generally be computed using one of several methods (straight-line, double declining balance, sum-of-years digits), taking into account useful life and salvage value [*Rev. & Tax. Code §§ 24349(a), (b), 24350, 24351, 24352, 24352.5, 24353, 24354, 24354.1, 24355*, 24355.1, *24355.4*]. These rules generally follow pre-1981 federal law, and result in depreciation deductions that are likely to be less favorable than under federal law [*see Rev. & Tax. Code §§ 24349(a), (b), 24350, 24351, 24352, 24352.5, 24353, 24354, 24354.1, 24355*, 24355.1, *24355.4*; *I.R.C. §§ 167, 168*].

The California Corporation Tax Law prohibits depreciation and other deductions related to substandard housing [*Rev. & Tax. Code § 24436.5*], and contains special depreciation provisions relating to diseased grapevines [*Rev. & Tax. Code § 24349(c)*]. The California Corporation Tax Law also restricts amortization deductions to pollution control facilities to facilities located in California [*Rev. & Tax. Code § 24372.3*; *see I.R.C. § 169*]. The Corporation Tax Law also allows an expensing election similar to that allowed under *I.R.C. § 179*, equal to 20 percent of the cost of qualifying property. The amount that can be expensed, however, is limited to $10,000 per year [*Rev. & Tax. Code § 24356(a), (c)*].

For further discussion of depreciation and amortization of personal property, see the Legal Background to Ch. 53, *Personal Property Leasing*.

[2] FORM

Depreciation and Amortization [Form FTB 3885L]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsDeductionsTax LawState & Local TaxesPersonal Property TaxTangible PropertyGeneral OverviewTax LawState & Local TaxesPersonal Property TaxTangible PropertyImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
E. Official Forms of the Franchise Tax Board

6-12C California Legal Forms--Transaction Guide § 12C.253

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.253 Capital Gain or Loss [Schedule D (568)]

[1] Comment--Use of Form

This form (Schedule D (568)) is the official Franchise Tax Board (FTB) form used by an LLC to report the sale or exchange of capital assets. However, this form is not used to report capital gains or losses that are specially allocated to any members. Those capital gains or losses are reported on other forms [Instructions for Form 568, p. 32; *see I.R.C. § 1201* et seq.].

This form can be obtained at any FTB office or by contacting the FTB at (800) 852-5711.

[2] FORM

Capital Gain or Loss [Schedule D (568)]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
E. Official Forms of the Franchise Tax Board

6-12C California Legal Forms--Transaction Guide § 12C.254

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.254 Limited Liability Company's List of Members and Consents [Form FTB 3832]

[1] Comment

[a] Use of Form

This form (Form FTB 3832) is the official Franchise Tax Board (FTB) form used by an LLC (1) to list the names and social security numbers or federal employer identification numbers of its members, and (2) to obtain the signature of its nonresident members evidencing their consent to California jurisdiction to tax their pro rata share of income attributable to California sources [Instructions for Form 568, p. 43; *see Rev. & Tax. Code § 18633.5(e)*].

This form should be completed only when an LLC has nonresident members. When completed, the form is filed with the FTB as an attachment to Form 568, and a copy is given to each nonresident member [Instructions for Form 568, p. 43; *see* [b], *below*].

This form can be obtained at any FTB office or by contacting the FTB at (800) 852-5711.

[b] Consents of Nonresident Members

When completed, this form provides that each nonresident member consents to California jurisdiction to tax the member's pro rata share of LLC income attributable to California sources [Instructions for Form 568, p. 43; *see Rev. & Tax. Code § 18633.5(e)(1)*].

If the LLC fails to timely file these consents, the LLC is required to pay the tax at the highest marginal rate on that member's distributive share of income [*Rev. & Tax. Code § 18633.5(e)(1)*]. Any amount paid by the LLC is considered a payment made by the member [Rev. & Tax. Code § 186335.5(g)]. The LLC may recover from the member any tax paid on his or her behalf [Instructions for Form 568, pp. 7, 43; *see Rev. & Tax. Code § 18633.5(e)(1)*].

If the LLC fails to attach this form, or to make a timely payment when required, the payment will be considered the LLC's tax for purposes of the penalty prescribed by *Rev. & Tax. Code § 19132* and the interest prescribed by *Rev. & Tax. Code § 19101* for failure to timely pay tax [*Rev. & Tax. Code § 18633.5(e)(2)*]. No penalty or interest will be imposed on the LLC if the nonresident member timely files and pays all taxes imposed on the member with respect to the LLC's income [*Rev. & Tax. Code § 18633.5(e)(3)*].

In addition to signing this form, nonresident members of an LLC may also need to file Form 540NR. Form 540NR must be filed if a member had income over specified amounts from California sources or tax liability of $1 or more [Instructions for Form 568, p. 43].

[c] Filing a Group Return

Individual nonresident members of a foreign or domestic LLC may elect [*see Rev. & Tax. Code § 18535*; *see also* Form FTB 3864, Group Nonresident Return Election] to file a group return on Form 540NR rather than an individual Form 540NR, but only if each nonresident member has no California source income other than that reported on the LLC group return [Instructions for Form 568, p. 7].

On group returns, income is taxed at the highest marginal rate. No deductions are allowed except those necessary to determine each member's distributive share of LLC income, and certain others deductions relating to earned income [*Rev. & Tax. Code § 18535(a), (b)*; *see Rev. & Tax. Code § 17501 et seq.*]. No credits are allowed except those directly attributable to the LLC [*Rev. & Tax. Code § 18535(a)*; *see* Instructions for Form 568, p. 7].

For more information on group returns, obtain FTB Pub. 1073, Guidelines for Filing a Group Nonresident Return for Nonresident Partners/Members of a Partnership/Limited Liability Company.

[2] FORM

Limited Liability Company's List of Members and Consents [Form FTB 3832]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsImposition of Tax



176 of 177 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
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6-12C California Legal Forms--Transaction Guide § 12C.255

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.255 Payment Voucher for Automatic Extension for Limited Liability Companies [Form FTB 3537]

[1] Comment

[a] Use of Form

This form (Form FTB 3537) is the official Franchise Tax Board (FTB) form used by an LLC to obtain an automatic six-month extension of the time [*see* [b], *below*] to file its tax return by paying its LLC tax (minimum franchise tax), LLC fee, and any member's tax due [Instructions for Form 568, p. 45; *see* [d], [e], *below*].

This form can be obtained at any FTB office or by contacting the FTB at (800) 852-5711.

[b] Automatic Extension of Time to File Tax Return

If an LLC cannot file its California tax return (Form 568) [*see § 12C.250*] on time [*see* [c], *below*], it may obtain an automatic six-month extension of the time to file by using Form FTB 3537 to pay its $800 minimum franchise tax, its fee (if any) based on income, and any tax due from nonresident members who did not sign Form FTB 3832 [Instructions for Form 568, p. 45; *see § 12C.255* (Form FTB 3832)]. The extension is granted automatically on submission of the voucher and payment, and no separate request need be filed to obtain the extension [Instructions for Form 568, p. 4]. Filing of the LLC's tax return within the six-month extension period will verify that the LLC qualified for the extension [Instructions for Form 568, p. 45].

Failure to file the LLC tax return on time or failure to file Form FTB 3537 along with the required payment will result in late penalties and interest [Instructions for Form 568, p. 45; *see* [e], *below*].

[c] When Tax Return Must be Filed

For fiscal year filers, the LLC tax return is usually due by the 15th day of the fourth month following the close of its taxable year. The six-month extension moves the filing deadline to the 15th day of the 10th month following the close of the taxable year [Instructions for Form 568, p. 45; *see Rev. & Tax. Code § 18633.5(a)*].

For calendar year filers, the LLC tax return is normally due on April 15 of each year.

[d] Liability for Taxes and Fees

[i] Minimum Franchise Tax

In general, every LLC or foreign LLC classified as a partnership for California tax purposes must pay an annual minimum franchise tax of $800 for the privilege of doing business in California. This tax applies to (1) an LLC that is doing business in California, (2) an LLC that as filed articles of organization in California, and (3) a foreign LLC that has registered with the California Secretary of State [*Rev. & Tax. Code §§ 17941(a), (b)(1), 23153(d)(1)*; *see* Instructions for Form 568, p. 5]. This tax must be paid annually until a certificate of cancellation of articles of organization (LLC) or certificate of cancellation of registration (foreign LLC) is filed with the Secretary of State [*Rev. & Tax. Code § 17941(b)(1)*]. The tax is due and payable on or before the 15th day of the fourth month following the close of the LLC's taxable year [*Rev. & Tax. Code § 17941(c)*].

However, an LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax [*see Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; *see also I.R.C. § 501(c)(2), (25)* (title holding companies)].

[ii] California Fee Based on Income

In addition to the minimum franchise tax [*see* [ii], *above*], an annual fee is due based on total income from all sources derived from or attributable to California [Instructions for Form 568, p. 5; *see Rev. & Tax. Code § 17942(a)*; *see also Rev. & Tax. Code §§ 17942(b)(1)*, 24172 ("total income" defined); *see also Rev. & Tax. Code § 17942(b)(1)* (limitation on total income)]. The fee is due and payable on or before the 15th day of the fourth month following the close of the LLC's taxable year [*Rev. & Tax. Code §§ 17942(c), 18633.5*]. The fee must be estimated and paid on or before the 15th day of the sixth month of the current taxable year, and a penalty of 10 percent of the amount of any underpayment will be added to the fee [*Rev. & Tax. Code § 17942(d)*]. An LLC that is exempt from taxes and fees under *Rev. & Tax. Code § 23701h* or *Rev. & Tax. Code § 23701x* and that is not taxed as a corporation for California tax purposes is not subject to the annual minimum franchise tax, and thus not subject to this annual fee [*see Rev. & Tax. Code §§ 17941(d), 23701h(b), 23701x(b)*; *see also I.R.C. § 501(c)(2), (25)* (title holding companies)].

[iii] Member's Fee

In certain situations, such as when a nonresident member fails to sign Form FTB 3832 [*see § 12C.254*], an LLC is required to pay tax on a member's distributive share of LLC income. Any amount paid by the LLC is considered a payment made by the member [Rev. & Tax. Code § 186335.5(g)]. The LLC may recover from the member any tax paid on his or her behalf [Instructions for Form 568, pp. 5, 36; *see Rev. & Tax. Code § 18633.5(e)(1)*]. This form provides for payment of those members' taxes by the LLC.

[e] Penalties and Interest

For LLCs that must pay the $800 minimum franchise tax [*see Rev. & Tax. Code§ 17941*], the failure to pay the tax on time is subject to a late payment penalty plus interest [Instructions for Form 568, p. 4]. If an LLC fails to pay its total fee (or that fails to pay its total nonresident members' tax (*see § 12C.254[1][b]*)), by the due date, the following penalties will be assessed [Instructions for Form 568, pp. 5, 6]:

- Five percent of the unpaid fee; plus

- One half of one percent for each month or partial month (not to exceed 40 months) that the fee remains unpaid; but

- Subject to a 25 percent limit of the unpaid fee.

Penalties may also be charged for NSF checks and the costs of collection [Instructions for Form 568, p. 6].

Filing this form and paying required taxes and fees will prevent imposition of these penalties and interest.

[2] FORM

Payment Voucher for Automatic Extension for Limited Liability Companies [Form FTB 3537]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability CompaniesMembers & Other ConstituentsTax LawState & Local TaxesAdministration & ProceedingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 12C LIMITED LIABILITY COMPANIES
PART IV. FORMS
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6-12C California Legal Forms--Transaction Guide § 12C.256

AUTHOR: Jack S. Johal Colby A. Campbell Practice ConsultantsMelissa C. Marsh Practice Consultant for November 2002 Forms Revision

§ 12C.256 Limited Liability Company Tax Voucher [Form FTB 3522]

[1] Comment

[a] Use of Form

This form (Form FTB 3522) is the official Franchise Tax Board (FTB) form used by an LLC [*see* [b], *below*] to pay the annual LLC minimum franchise tax [Instructions for Form 568, p. 47; *see Rev. & Tax. Code §§ 17941(a), (b)(1), 23153(d)(1)*].

This form can be obtained at any FTB office or by contacting the FTB at (800) 852-5711.

[b] Who Must Pay Minimum Franchise Tax

Every LLC or foreign LLC classified as a partnership for California tax purposes must pay an annual minimum franchise tax of $800 for the privilege of doing business in California. This tax applies to (1) an LLC that is doing business in California, (2) an LLC that has filed articles of organization in California, or (3) a foreign LLC that has registered with the California Secretary of State [*Rev. & Tax. Code §§ 17941(a), (b)(1), 23153(d)(1)*; *see* Instructions for Form 568, p. 5]. This tax must be paid annually until a certificate of cancellation of articles of organization (LLC) or certificate of cancellation of registration (foreign LLC) is filed with the Secretary of State [*Rev. & Tax. Code § 17941(b)(1)*; *see Corp. Code §§ 17356, 17455*].

For discussion of when the tax is due, see *§ 12C.255[1][b], [c]*.

[2] FORM

Limited Liability Company Tax Voucher [Form FTB 3522]

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Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesTax LawState & Local TaxesFranchise TaxImposition of Tax



1 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS

6-13 California Legal Forms--Transaction Guide 13.syn

§ 13.syn Synopsis to Chapter 13: NONPROFIT CORPORATIONS

§ 13.01 California Sources

[1] Constitution

[2] Statutes

[3] Regulations

[4] California Attorney General Opinions

[5] Pamphlets

§ 13.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 13.03-13.04 [Reserved]

§ 13.05 Law Reviews and Periodicals

§ 13.06 Annotations

§ 13.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 13.08-13.09 [Reserved]

§ 13.10 Nonprofit Corporation Law

§ 13.11 Types of Nonprofit Corporations

[1] Public Benefit Corporations

[2] Mutual Benefit Corporations

[3] Religious Corporations

[4] Common Interest Development Corporations

[5] Corporations Sole

§ 13.12 Selecting Appropriate Type of Nonprofit Corporation

§§ 13.13-13.19 [Reserved]

§ 13.20 Articles of Incorporation

[1] Filing Articles Begins Corporate Existence

[2] Contents

§ 13.21 Bylaws

[1] Purpose of Bylaws

[2] Contents

§ 13.22 Changing Unincorporated Association to Corporation

§ 13.23 Initial Meeting

§§ 13.24-13.29 [Reserved]

§ 13.30 Corporate Powers

§ 13.31 Directors

[1] Authority of Board

[a] Public Benefit and Mutual Benefit Corporations

[b] Religious Corporations

[2] Selection, Nomination, and Election of Directors

[a] Election of Directors of Public Benefit and Mutual Benefit Corporations

[b] Nomination Requirements for Directors of Public Benefit and Mutual Benefit Corporations

[c] Special Rule for Public Benefit Corporations and Interested Persons

[d] Religious Corporations

[e] Appointment by Superior Court

[3] Number and Qualifications of Directors

[4] Term of Office

[a] Public Benefit and Mutual Benefit Corporations

[b] Religious Corporations

[5] Meeting Requirements

[a] Call and Location

[b] Quorum Requirements

[c] Notice Requirements

[d] Participation Through Electronic Means

[e] Action Without Meeting

[f] Adjournment

[g] Brown Act Requirements

[6] Duties and Liabilities

[a] Good Faith Standard for Public and Mutual Benefit Corporations

[b] Good Faith Standard for Religious Corporations

[c] Liability for Distributions, Loans, and Guarantees

[7] Removal of Directors for Cause

[8] Removal of Directors Without Cause

[a] Public Benefit and Mutual Benefit Corporations

[b] Religious Corporations

[9] Removal of Directors by Suit

[a] Public Benefit Corporations

[b] Mutual Benefit Corporations

[c] Religious Corporations

[10] Resignation; Filling Vacancies

[a] Public Benefit and Mutual Benefit Corporations

[b] Religious Corporations

[11] Executive Committees

[12] Appointment of Provisional Directors

§ 13.32 Officers

§ 13.33 Members

[1] Admission of Members

[2] Meeting Requirements for Public Benefit and Mutual Benefit Corporations

[a] Meetings in Accordance With Bylaws

[b] Meetings by Electronic Transmission

[c] Regular Meetings

[d] Special Meetings

[e] Quorum Requirements

[f] Requirement and Timing of Notice

[g] Contents of Notice

[h] Manner of Giving Notice

[i] Notice of Adjourned Meeting

[j] Affidavit of Notice

[k] Waiver of Notice

[l] Appointment of Inspectors of Election

[m] Duties of Inspectors of Election

[3] Meeting Requirements for Religious Corporations

[a] Meetings in Accordance With Bylaws

[b] Meetings by Electronic Transmission

[c] Special Meetings

[d] Quorum Requirements

[e] Waiver of Notice

[4] Action Without Meeting

[a] Public Benefit and Mutual Benefit Corporations

[b] Religious Corporations

[5] Voting Requirements for Public Benefit and Mutual Benefit Corporations

[a] One-Vote Rule

[b] Record Date for Entitlement to Vote

[c] Record Date for Entitlement to Cast Ballots

[d] Record Date for Other Lawful Actions

[e] Use of Proxies

[f] Cumulative Voting

[6] Voting Requirements for Religious Corporations

[a] Written Consent

[b] Use of Proxies

[c] Cumulative Voting

[7] Good Faith Acceptance or Rejection of Ballots, Consents, Waivers, and Proxies

[8] Termination of Membership in Public Benefit and Mutual Benefit Corporations

[a] Operation of Bylaws

[b] Resignation

[c] Death or Dissolution

[d] Procedures for Expulsion, Suspension, or Termination

[e] Amending Articles or Bylaws to Terminate Membership

[9] Termination of Membership in Religious Corporations

[10] Membership Certificates for Mutual Benefit Corporations

[a] Issuance

[b] Contents

§ 13.34 Recordkeeping Requirements

[1] Articles of Incorporation and Bylaws

[2] Other Records

§ 13.35 Compliance With Rights of Inspection

[1] Public Benefit and Mutual Benefit Corporations

[a] In General

[b] Directors' Inspection Rights

[c] Members' Inspection Rights

[2] Religious Corporations

[a] Directors' Inspection Rights

[b] Members' Inspection Rights

§ 13.36 Reporting Requirements

[1] Annual Reports to Members and Directors

[a] Public Benefit Corporations

[b] Mutual Benefit Corporations

[c] Religious Corporations

[2] Biennial Statement of Information With Secretary of State

[3] Reports With Registrar of Charitable Trusts in Office of Attorney General

[a] Charitable Corporations Subject to Filing Requirements

[b] Entities Exempt From Filing Requirements

[c] Filing Requirements

[d] Effect of Failure to File

[e] Public Inspection

[4] Additional Attorney General Filing Requirements for Public Benefit Corporations

§ 13.37 Insurance Considerations and Liability Issues

[1] Need for Insurance

[2] Types of Insurance

[a] Commercial General Liability Policy

[b] Unemployment and Disability Insurance

[c] Workers' Compensation Insurance

[d] Directors and Officers Liability Policy

[3] Tort Liability of Volunteer Directors and Officers

[a] Limitation on Volunteer Directors' and Officers' Liability for Unintentional Torts

[b] Exceptions to Limited Liability

[c] Nonprofit Corporation's Liability Not Limited

[d] Additional Protection for Nonprofit Public Benefit and Religious Corporations

[e] Additional Protection for Nonprofit Mutual Benefit Corporations

[f] Volunteer Protection Act of 1997

§ 13.38 Restrictions on Transactions Between Corporations and Directors

[1] Public Benefit and Religious Corporations

[a] Self-Dealing Transactions Subject to Sanctions

[b] Exception for Approved Transactions

[c] Remedies

[2] Mutual Benefit Corporations

[a] Material Financial Interest

[b] Loans, Guarantees, and Advances

[3] Public Benefit Corporations--Loans, Guarantees, and Advances

§ 13.39 Actions for Breach of Charitable Trust

§ 13.40 Securities Law

[1] California Requirements

[a] Equity Securities

[b] Debt Securities

[c] Antifraud Requirements

[2] Federal Requirements

§ 13.41 Tax Considerations

[1] Nonprofit Corporations Subject to Income Tax Unless Exempt

[2] Charitable Gifts

[a] Gifts Generally Deductible From Income

[b] Documentation Requirements

[c] No Deduction for Gifts to Lobbying Entities; Use of Affiliate

[d] Estate and Gift Tax Deduction

[e] Property Tax Exemption

§ 13.42 Corporate Changes

[1] Conversions

[2] Mergers

[3] Dissolution

[a] Voluntary Dissolution

[b] Involuntary Dissolution

§§ 13.43-13.49 [Reserved]

§ 13.50 Application of General Corporation Law

§ 13.51 Qualification Requirements

§ 13.52 Factors in Determining Whether to Qualify or Incorporate in California

§§ 13.53-13.99 [Reserved]

§ 13.100 Facts

Scope

§ 13.101 Documents

Scope

§§ 13.102-13.109 [Reserved]

§ 13.110 Selection of Appropriate Entity

Scope

§ 13.111 Selection of Appropriate Corporate Name

Scope

§ 13.112 Fictitious Business Statement

Scope

§ 13.113 Securities Requirements

Scope

§§ 13.114-13.119 [Reserved]

§ 13.120 Forming Corporation

Scope

§ 13.121 Holding Initial Meeting of Directors

Scope

§§ 13.122-13.129 [Reserved]

§ 13.130 Articles of Incorporation

Scope

§ 13.131 Bylaws

Scope

§§ 13.132-13.139 [Reserved]

§ 13.140 Transferring Property From Unincorporated Association

Scope

§ 13.141 Filing Certificates of Correction and Amendment

Scope

§ 13.142 Recordkeeping and Reporting Requirements

Scope

§ 13.143 Securing Insurance Coverage

Scope

§ 13.144 Document Review

Scope

§§ 13.145-13.199 [Reserved]

§ 13.200 Articles of Incorporation

[1] Comment

[a] Use of Form

[b] Mandatory Provisions

[c] Optional Provisions

[d] Special Requirements for Unincorporated Associations

[e] Location and Inspection of Articles

[f] Execution, Filing, and Fees

[g] Acknowledgment of Articles Required

[2] FORM

Articles of Incorporation

§ 13.201 Bylaws--With Members in One Class

[1] Comment

[a] Use of Form

[b] "Member" Defined

[c] Mandatory Provisions

[d] Optional Provisions in General

[e] Directors and Executive Committees

[f] Officers

[g] Compensation

[h] Members

[i] Delegates

[j] Voting Requirements Affecting Corporate Actions

[k] Record Date

[l] Inspection Rights

[m] Proof of Corporate Bylaws

[n] Adoption, Amendment, and Repeal of Bylaws

[2] FORM

Bylaws--With Members in One Class

§§ 13.202-13.209 [Reserved]

§ 13.210 Articles of Incorporation

[1] Comment

[a] Use of Form

[b] Mandatory Provisions

[c] Optional Provisions

[d] Special Requirements for Unincorporated Associations

[e] Location and Inspection of Articles

[f] Execution, Filing, and Fees

[g] Acknowledgment of Articles Required

[2] FORM

Articles of Incorporation

§ 13.211 Articles of Incorporation--Common Interest Development Association

[1] Comment

[a] Use of Form

[b] Regulation of Common Interest Developments

[c] Mandatory Provisions

[d] Optional Provisions

[e] Special Requirements for Unincorporated Associations

[2] FORM

Articles of Incorporation--Common Interest Development Association

§ 13.212 Bylaws--With Members in Multiple Classes

[1] Comment

[a] Use of Form

[b] "Member" Defined

[c] Mandatory Provisions

[d] Optional Provisions in General

[e] Directors and Executive Committees

[f] Officers

[g] Compensation

[h] Members

[i] Delegates

[j] Voting Requirements Affecting Corporate Actions

[k] Record Date

[l] Inspection Rights

[m] Proof of Corporate Bylaws

[n] Adoption, Amendment, and Repeal of Bylaws

[2] FORM

Bylaws--With Members in Multiple Classes

§§ 13.213-13.219 [Reserved]

§ 13.220 Articles of Incorporation

[1] Comment

[a] Use of Form

[b] Mandatory Provisions

[c] Optional Provisions

[d] Special Requirements for Unincorporated Associations

[e] Location and Inspection of Articles

[f] Execution, Filing, and Fees

[g] Acknowledgment of Articles Required

[2] FORM

Articles of Incorporation

§ 13.221 Bylaws--Without Members [Corp. Code §§ 9150-9152]

[1] Comment

[a] Use of Form

[b] "Bylaws" Defined

[c] Mandatory Provisions

[d] Optional Provisions

[2] FORM

Bylaws--Without Members [Corp. Code §§ 9150-9152]

§§ 13.222-13.229 [Reserved]

§ 13.230 Authority to Establish Common Trust Fund

[1] Comment--Use of Form

[2] FORM

Authority to Establish Common Trust Fund

§ 13.231 Statement of Irrevocable Dedication

[1] Comment

[a] Use of Form

[b] Distribution of Corporate Assets on Dissolution--In Accordance With Articles or Bylaws

[c] Assets Subject to Condition

[d] Assets Held in Charitable Trust

[e] Tax Matters

[2] FORM

Statement of Irrevocable Dedication

§§ 13.232-13.239 [Reserved]

§ 13.240 Document Filing Transmittal Letter

[1] Comment--Use of Form

[2] FORM

Document Filing Transmittal Letter

§ 13.241 Declaration

[1] Comment

[a] Use of Form

[b] Penalty of Perjury

[c] Requirement of Separate Execution

[2] FORM

Declaration

§ 13.242 Verified Statement of Authorization to Incorporate Unincorporated Association

[1] Comment

[a] Use of Form

[b] Verification

[2] FORM

Verified Statement of Authorization to Incorporate Unincorporated Association

§ 13.243 Certificate of Correction

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[c] Restrictions on Use of Form

[d] Execution, Filing, and Fees

[2] FORM

Certificate of Correction

§ 13.244 Appointment of Initial Directors and Adoption of Bylaws

[1] Comment--Use of Form

[2] FORM

Appointment of Initial Directors and Adoption of Bylaws

§ 13.245 Waiver of Notice and Consent to Holding of First Meeting of Directors

[1] Comment

[a] Use of Form

[b] Recordkeeping Requirements

[2] FORM

Waiver of Notice and Consent to Holding of First Meeting of Directors

§ 13.246 Action by Unanimous Written Consent of Board

[1] Comment--Use of Form

[2] FORM

Action by Unanimous Written Consent of Board

§ 13.247 Minutes of Organizational Meeting

[1] Comment--Use of Form

[2] FORM

Minutes of Organizational Meeting

§ 13.248 Statement of Information by Domestic Nonprofit Corporation [Form SI-100]

[1] Comment

[a] Use of Form

[b] Amending Statement

[c] Effect of Failure to File

[2] FORM

Statement of Information by Domestic Nonprofit Corporation [Form SI-100]

§ 13.248A Statement and Designation by Foreign Nonprofit Corporation

[1] Comment--Use of Form

[2] FORM

Statement and Designation by Foreign Nonprofit Corporation

§ 13.249 Statement of Information by Foreign Nonprofit Corporation [Form SI-350]

[1] Comment--Use of Form

[2] FORM

Statement of Information by Foreign Nonprofit Corporation [Form SI-350]

§ 13.250 Statement of Resignation of Agent for Service of Process [Form RA-100]

[1] Comment--Use of Form

[2] FORM

Statement of Resignation of Agent for Service of Process

§ 13.251 Letter Seeking Attorney General's Approval of Self-Dealing Transaction

[1] Comment

[a] Use of Form

[b] Accompanying Documentation

[2] FORM

Letter Seeking Attorney General's Approval of Self-Dealing Transaction

§§ 13.252-13.259 [Reserved]

§ 13.260 Certificate of Amendment of Articles of Incorporation by Incorporators

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[c] Permissible Amendments In General

[d] Extension of Corporate Existence

[e] Amendment of Articles to Change Status

[f] Use of Alternative Forms

[g] Execution, Filing, and Fees

[2] FORM

Certificate of Amendment of Articles of Incorporation by Incorporators

§ 13.261 Certificate of Amendment of Articles of Incorporation--Officers' Certificate

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[c] Permissible Amendments In General

[d] Extension of Corporate Existence

[e] Amendment of Articles to Change Status of Public Benefit Corporation

[f] Amendment of Articles to Change Status of Mutual Benefit Corporation

[g] Amendment of Articles to Change Status of Religious Corporation

[h] Approval by Board Alone

[i] Approval by Board and Members

[j] Class Vote or Vote of Greater Proportion

[k] Amendments Affecting Voting or Merger Rights of Class

[l] Use of Alternative Forms

[m] Execution, Filing, and Fees

[2] FORM

Certificate of Amendment of Articles of Incorporation--Officers' Certificate

§ 13.262 Restated Articles of Incorporation

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[c] Use of Alternative Forms

[d] Execution, Filing, and Fees

[2] FORM

Restated Articles of Incorporation



2 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS

6-13 California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter covers the formation and operation of nonprofit public benefit corporations, nonprofit mutual benefit corporations, and nonprofit religious corporations formed under and subject to the California Nonprofit Corporation Law. The Transaction Guide discusses the procedural approach to the formation of nonprofit corporations and includes coverage of the preparation and filing of articles of incorporation and biennial statements, the preparation of bylaws, and the initial meetings of directors. The forms include articles, bylaws, and other forms related to the formation of nonprofit corporations, such as a certificate of correction of articles, a certificate appointing an agent for service of process, and forms related to the amendment of the articles.

Other types of nonprofit corporations that are subject to the Nonprofit Corporation Law but that are not specifically covered in this chapter include corporations sole [*Corp. Code § 10000 et seq.*], corporations for charitable or eleemosynary purposes [*Corp. Code § 10200*], societies for prevention of cruelty to children and animals [*Corp. Code § 10400 et seq.*], port and terminal protection and development corporations [*Corp. Code § 10700 et seq.*], and nonprofit medical, hospital, or legal services corporations [*Corp. Code § 10810 et seq.*].

Unincorporated nonprofit associations are covered in Ch. 13A, *Nonprofit Unincorporated Associations* . Discussion of the procedures for dissolution of domestic nonprofit corporations, with forms, is included in Ch. 12, *Winding Up and Dissolution* . Federal and state tax matters, including applications for exemption, are discussed in covered in Ch. 13B, *Tax-Exempt Status for Nonprofit Entities* . The role of counsel in starting a new business is Ch. 1A, *Role of Counsel in Starting a New Business* . The regulation of employers and employees benefits are discussed in Ch. 1C, *Regulation of Employers* and Ch. 1D, *Overview of Employee Benefits* , respectively. Insurance considerations applicable to general corporations are covered in Ch. 1F, *Insurance Considerations in Business Formation* . The formation of corporations subject to the General Corporation Law is covered in Chs. 2 through 5. The issuance of securities, including qualification and exemption, is discussed in Chapter 6I, *Issuance of Equity Securities* . Consumer cooperative corporations [*see Corp. Code § 12200 et seq.*] are covered in Ch. 14, *Consumer Cooperative Corporations* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

6-13 California Legal Forms--Transaction Guide § 13.01

§ 13.01 California Sources

[1] Constitution

Taxes and exemptions. *Cal. Const., art. XIII, §§ 3-5*.

Prohibition against state owning stock in or lending credit to corporations; exceptions. *Cal. Const., art. XVI, §§ 3, 5, 6*.

Legislature's power to insure or guarantee loans to nonprofit corporations and public agencies. *Cal. Const., art. XVI, § 4*.

Power of Legislature to amend or repeal laws concerning corporations. *Cal. Const., art. XX, § 24*.

[2] Statutes

Provisions and exemptions for owners' associations. *Bus. & Prof. Code § 11000 et seq.*; *Corp. Code §§ 25012, 25015, 25100(f)*.

Exemption from fictitious business name statement. *Bus. & Prof. Code § 17911*.

Davis-Stirling Common Interest Development Act. *Civ. Code § 1350 et seq.*

Nonprofit Corporation Law. *Corp. Code § 5000 et seq.*

Nonprofit corporation's right to self-insure. Corp. Code § 5001.1.

Generally applicable provisions and definitions. *Corp. Code §§ 5002-5080*.

Limitation on volunteers' liability. *Corp. Code § 5047.5*.

Nonprofit public benefit corporations. *Corp. Code § 5110 et seq.*

Self-dealing restrictions. *Corp. Code § 5233*.

Limitation on volunteers' liability. *Corp. Code § 5239*.

Nonprofit mutual benefit corporations. *Corp. Code § 7110 et seq.*

Limitation on volunteers' liability. *Corp. Code § 7231*.

Transaction involving directors with material financial interest. *Corp. Code § 7233*.

Corporations formed to operate single seven-person ridesharing vanpool vehicle exempt from filing fees under Government Code. *Corp. Code § 8217*.

Nonprofit religious corporations. *Corp. Code § 9110 et seq.*

Self-dealing restrictions. *Corp. Code § 9243*.

Limitation on volunteers' liability. *Corp. Code § 9247*.

Private foundations subject to compliance with Internal Revenue Code provisions as set forth in *Corp. Code § 5260*. *Corp. Code § 9260*.

Transition provisions. *Corp. Code § 9910 et seq.*

Corporations sole. *Corp. Code § 10000 et seq.*

Corporations for charitable or eleemosynary purposes. *Corp. Code § 10200*.

Trust funds. *Corp. Code §§ 10250, 10251*.

Societies for prevention of cruelty to children and animals. *Corp. Code § 10400 et seq.*

Port and terminal protection and development corporations. *Corp. Code § 10700 et seq.*

Nonprofit medical, hospital, or legal services corporations. *Corp. Code § 10810 et seq.*

Consumer and other cooperatives. *Corp. Code §§ 12200 et seq.*

Corporate Securities Law of 1968.

"Membership" in nonstock corporation or association within meaning of "security." *Corp. Code § 25019*.

Equity securities of nonprofit organizations exempt from permit requirements. *Corp. Code § 25100(j)*.

Debt securities not exempt from permit requirements and exceptions. *Corp. Code § 25100(j), (l), (p), 25102(a)-(c), (e)*.

Exemption of membership in owners' associations. *Corp. Code §§ 25012, 25015, 25100(f)*.

Exemption from qualification for cooperative corporations securities. *Corp. Code § 25100(r)*.

Uniform Supervision of Trustees for Charitable Purposes Act. *Gov. Code § 12580 et seq.*

Attorney general's duty to ensure compliance of charitable trusts with articles of incorporation and to protect assets. *Gov. Code § 12598*.

Nonprofit corporations formed to provide housing to low-income households. *Health & Safety Code § 52535 et seq.*

Nonprofit cooperative corporations formed by gas producers. *Pub. Util. Code § 3001 et seq.*

Property taxation.

"Property" defined. *Rev. & Tax. Code § 103*.

Interests included within meaning of terms "real estate" and "real property." *Rev. & Tax. Code § 104*.

"Improvements" defined. *Rev. & Tax. Code § 105*.

"Personal property" defined. *Rev. & Tax. Code § 106*.

"Possessory interests" defined. *Rev. & Tax. Code §§ 107, 107.1*.

Property subject to tax. *Rev. & Tax. Code § 201*.

Property used for free public libraries, free museums, or exclusively for public schools as exempt from tax. *Rev. & Tax. Code § 202*.

Colleges, buildings, equipment, grounds, and securities and income used exclusively for purposes of education. *Rev. & Tax. Code §§ 203, 254, 255, 258, 260, 270-273*.

Church property, including parking area. *Rev. & Tax. Code §§ 206, 206.1, 255, 255.5, 256, 260, 270-273*.

Property used exclusively used exclusively for religious purposes. *Rev. & Tax. Code §§ 207, 257, 257.1*.

Personal property brought into California for exhibition purposes. *Rev. & Tax. Code §§ 213, 254, 255, 255.5, 259, 260*.

Requirement that exempt property be available as election polling place. *Rev. & Tax. Code § 213.5*.

Welfare exemption. *Rev. & Tax. Code §§ 214-214.9, 215, 215.5, 221, 225.5, 251, 254, 254.5, 254.6, 260, 261, 270-273*.

Types of exempt property. *Rev. & Tax. Code §§ 214-214.14, 221-222.5*.

Affidavit requirements. *Rev. & Tax. Code §§ 254, 254.5, 255*.

Recordation requirements. *Rev. & Tax. Code §§ 260, 261*.

Late exemption applications. *Rev. & Tax. Code §§ 270-272*.

Veteran's organization exemption. *Rev. & Tax. Code § 215.1*.

Basis of evaluation for assessment purposes. *Rev. & Tax. Code § 401*.

Taxpayer's annual property statement. *Rev. & Tax. Code § 441*.

Sales tax exemption. *Rev. & Tax. Code § 6375*.

State franchise tax exemptions. *Rev. & Tax. Code § 23701 et seq.*

[3] Regulations

Owners' associations. *10 Cal. Code Reg. § 2790 et seq.*

Attorney General's regulations adopted under Uniform Supervision of Trustees for Charitable Purposes Act. *11 Cal. Code Reg. § 300 et seq.*

Nonprofit hospitals. 17 Cal. Code Reg. § 850.

Basis of evaluation for assessment purposes. *18 Cal. Code Reg. §§ 1-10*.

Taxpayer's annual property statement. *18 Cal. Code Reg. §§ 171, 172*.

[4] California Attorney General Opinions

Nonprofit mutual benefit corporation may not give notice of its annual regular meetings by publication in a newspaper of general circulation in the county in which its principal office is located and by posting notice of the meeting at its principal office even if authorized by the bylaws or if members have requested not to be notified personally or by mail. *82 Ops. Cal. Atty. Gen. 229 (1999)* .

Nonprofit association issuance of registration certificate as family to two or more individuals sharing common residence. *75 Ops. Cal. Atty. Gen. 1 (1992)* .

Charitable organization may not sponsor "casino night" when tickets sold to general public to gamble, and winnings used to buy raffle tickets or bid at auction for valuable merchandise. *71 Ops. Cal. Atty. Gen. 130 (1988)* .

School districts may permit sale of school supplies to private individuals and nonprofit and other organizations when property is not required for public school purposes or activities. *60 Ops. Cal. Atty. Gen. 184 (1977)* .

General grant of power to conclude that California law allows nonprofit corporations such as OEO-funded programs to provide for use of alternates within structure of boards of directors. *58 Ops. Cal. Atty. Gen. 442 (1975)* .

Physician-surgeon may be employed by duly licensed clinic which operates as a nonprofit corporation. *58 Ops. Cal. Atty. Gen. 291 (1975)* .

Nonprofit corporation's articles or bylaws permitted by General Nonprofit Corporation Law to provide for a director's term of office without limitation as to length of term. *56 Ops. Cal. Atty. Gen. 317 (1973)* .

Nonprofit accountancy corporation subject to licensing requirements of California Accountancy Act. 55 Ops. Cal. Atty. Gen. 338 (1972) .

[5] Pamphlets

Exempt Organizations: Nonprofit Doesn't Mean Tax Exempt (California Franchise Tax Board).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

6-13 California Legal Forms--Transaction Guide § 13.02

§ 13.02 Federal Sources

[1] Statutes

Volunteer Protection Act of 1997. *42 U.S.C. § 14501 et seq.*

Federal income tax. *I.R.C. §§ 501, 508(e), 509.*

[2] Regulations

Irrevocable dedication of property. *Treas. Reg. § 1.501(c)(3)-1(b)(4).*

Annual information returns. *Treas. Reg. § 1.6033-2.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

6-13 California Legal Forms--Transaction Guide §§ 13.03-13.04

[Reserved]

§§ 13.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

6-13 California Legal Forms--Transaction Guide § 13.05

§ 13.05 Law Reviews and Periodicals

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

6-13 California Legal Forms--Transaction Guide § 13.06

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

6-13 California Legal Forms--Transaction Guide § 13.07

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Ch. 1D, *Overview of Employee Benefits*.

Ch. 1F, *Insurance Considerations in Business Formation*.

Ch. 2, *Formation of Corporations*.

Ch. 3, *Articles of Incorporation*.

Ch. 4, *Bylaws*.

Ch. 5, *Directors' Meetings, Actions, and Resolutions*.

Ch. 6, *Securities Regulation Issues*.

Ch. 7, *Corporate Records and Reports*.

Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*.

Ch. 10, *Amendment of Articles*.

Ch. 11, *Merger and Acquisition Issues*.

Ch. 12, *Winding Up and Dissolution*.

Ch. 12B, *Foreign Corporations and Associations*.

Ch. 13A, *Nonprofit Associations*.

Ch. 13B, *Securing Exemption and Tax Compliance*.

Ch. 14A, *Agricultural Nonprofit Cooperative Associations*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

6-13 California Legal Forms--Transaction Guide §§ 13.08-13.09

[Reserved]

§§ 13.08[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
A. Governing Law and Types of Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.10

§ 13.10 Nonprofit Corporation Law

The California Nonprofit Corporation Law [*Corp. Code § 5000 et seq.*] provides for the formation and organization of nonprofit corporations to the exclusion of the General Corporation Law [*see Corp. Code § 100 et seq.*]. The Nonprofit Corporation law divides all nonprofit corporations into three primary groups:

- Nonprofit public benefit corporations [*see Corp. Code § 5110 et seq.*; *see also § 13.11[1]*].
- Nonprofit mutual benefit corporations [*see Corp. Code § 7110 et seq.*; *see also § 13.11[2]*].
- Religious corporations [*see Corp. Code § 9110 et seq.*; *see also § 13.11[3]*].

The Nonprofit Corporation law also governs other specialized types of nonprofit corporations:

- Corporations sole [*see Corp. Code § 10000 et seq.*].
- Corporations for charitable or eleemosynary purposes [*see Corp. Code § 10200*].
- Trust funds [*see Corp. Code §§ 10250, 10251*].
- Societies for prevention of cruelty to children and animals [*see Corp. Code § 10400 et seq.*].
- Port and terminal protection and development corporations [*see Corp. Code § 10700 et seq.*].
- Nonprofit medical, hospital, or legal services corporations [*Corp. Code § 10810 et seq.*].

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
A. Governing Law and Types of Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.11

§ 13.11 Types of Nonprofit Corporations

[1] Public Benefit Corporations

Public benefit corporations fall into two categories:

- Corporations organized primarily for charitable purposes that plan to obtain state tax exempt status under *Rev. & Tax. Code § 23701d* and/or federal tax exempt status under *I.R.C. § 501(c)(3)*.

- Corporations organized to act as civic leagues or social welfare organizations that plan to obtain state tax exempt status under *Rev. & Tax. Code § 23701f* and/or federal tax exempt status under *I.R.C. § 501(c)(4)*.

However, a public benefit corporation's status does not depend on state and federal tax-exempt status.

Public benefit corporations are organized under or subject to the Nonprofit Public Benefit Corporation Law [*Corp. Code § 5060*]. In general, public benefit corporations are prohibited from making distributions [*Corp. Code § 5410*] of any gains, profits, or dividends to members [*Corp. Code § 5049*]; however, this prohibition does not apply to the purchase of a membership in any limited-equity housing corporation organized as a public benefit corporation [*Corp. Code § 5410*; *see Health & Safety Code § 33007.5, repealed 2009* ("limited-equity housing corporation" defined); *now see Civ. Code § 817*].

For articles of incorporation and bylaws designed for public benefit corporations, see *§§ 13.200, 13.201*.

[2] Mutual Benefit Corporations

A corporation formed for purposes other than religious, charitable, civic league, or social welfare purposes that plans to obtain tax exempt status under provisions other than *Rev. & Tax. Code § 23701d* or *23701f*, or *Rev. & Tax. Code § 23701d*, *23701f*, or *I.R.C. § 501(c)(4)*, or that is not planning to be tax exempt at all, is a nonprofit mutual benefit corporation.

This type of nonprofit corporation is organized under or subject to the Nonprofit Mutual Benefit Corporation Law [*Corp. Code § 5059*]. These corporations may be operated for any lawful purpose (other than religious, charitable, civic league, or social welfare purposes) that does not contemplate any distribution prohibited by the Nonprofit Mutual Benefit Corporation Law [*see Corp. Code §§ 7410-7413* (corporation may distribute assets to members on dissolution)]. In general, these corporations are operated for the specific benefit of its members or persons engaging in a particular type of business or activity. However, a corporation, all of the assets of which are irrevocably dedicated to charitable, religious, or public purposes and that as a matter of law or according to its articles or bylaws must, on dissolution, distribute its assets to a person or persons carrying on a charitable, religious, or public purpose, may not be formed under the Nonprofit Mutual Benefit Corporation Law [*Corp. Code § 7111*]. Common mutual benefit corporations include social and neighborhood clubs, theater groups, business and trade associations, automobile and sports clubs, home owner associations, organizations formed for fraternal purposes, and cemeteries.

For articles of incorporation and bylaws for mutual benefit corporations, see *§§ 13.210-13.212*.

[3] Religious Corporations

A corporation organized to operate a church or to be otherwise structured for primarily religious purposes is a nonprofit religious corporation. Religious corporations are specifically governed by the Nonprofit Religious Corporation Law [*Corp. Code § 5061*] and are formed primarily or exclusively for religious purposes [*Corp. Code § 9111*].

For articles of incorporation and bylaws for religious corporations, see *§§ 13.220, 13.221*.

[4] Common Interest Development Corporations

Under the Davis-Stirling Common Interest Development Act [*Civ. Code § 1350 et seq.*], the term "association" means a nonprofit corporation or unincorporated association created for the purpose of managing a common interest development [*Civ. Code § 1350(a)*]. A "common interest development" includes any of the following [*Civ. Code § 1350(c)*; *see Committee to Save the Beverly Highlands Homes Association v. The Beverly Highlands Homes Association (2001) 92 Cal. App. 4th 1247, 1262-1263, 1271, 112 Cal. Rptr. 2d 732* (nonprofit mutual benefit corporation was not common interest development within meaning of Davis-Stirling Act; corporation had no common area within meaning of Corp. Code § 1351(b))]:

- A community apartment project; that is, a development in which an undivided interest in land is coupled with the right of exclusive occupancy of any apartment located in the development [*Civ. Code § 1350(d)*].

- A condominium project, which is a development consisting of condominiums, which in turn consists of an undivided interest in common in a portion of real property coupled with a separate interest in space called a unit [*see Civ. Code § 1350(e), (f)*].

- A planned development; that is a development (other than a community apartment project, a condominium project, or a stock cooperative) having either or both (1) a common area owned either by an the association or in common by the owners of the separate interests who possess appurtenant rights to the beneficial use and enjoyment of the common area or (2) a power existing in the association to enforce an obligation of an owner of a separate interest with respect to the beneficial use and enjoyment of the common area by means of an assessment that may become a lien on the separate interests [*Civ. Code § 1350(k)*; *see Civ. Code § 1367*].

- A stock cooperative; that is, a development in which a corporation is formed or availed of primarily

> for the purpose of holding title to, either in fee simple or for a term of years, improved real property, and all or substantially all of the shareholders of the corporation receive a right of exclusive occupancy in a portion of the real property, title to which is held by the corporation. The owners' interest in the corporation, whether evidenced by a share of stock, a certificate of membership, or otherwise, is deemed to be an interest in a common interest development and a real estate development [*see Corp. Code § 25100(f)*].

A common interest development is created whenever a separate interest coupled with an interest in the common area or membership in the association is, or has been, conveyed, provided, all of the following are recorded [*Civ. Code § 1352*]:

- A declaration [*see Civ. Code § 1353*];
- A condominium plan, if any exists; and
- A final map or parcel map, if required [*see Gov. Code § 66410 et seq.*].

A common interest development may form a nonprofit mutual benefit corporation by filing articles of incorporation with the Secretary of State [*see Corp. Code § 7210*; *see also Civ. Code § 1363.5*; § 13.211].

[5] Corporations Sole

A corporation sole is formed to administer and manage the affairs, property, and temporalities of any religious denomination, society, or church [*see Corp. Code § 10000 et seq.*]. The form is only available to church leaders, including bishops, chief priests, presiding elders, or other presiding officer [*Corp. Code § 10002*].

One principal purpose of a corporation sole is to ensure continuation of ownership of property dedicated to the benefit of a religious organization and held in the name of its titular head. There is a clear distinction between the corporation sole and the individual who happens to be the current office holder [*County of San Luis Obispo (1983) 146 Cal. App. 3d 380, 383-384, 194 Cal. Rptr. 5]* . Thus, in a case involving a pastor who was allegedly appointed by a predecessor under an amendment to the corporate articles without the approval of parishioners, the court rejected the plaintiff's argument that the requirement set forth in *Corp. Code § 10010* that an amendment to the articles be "duly authorized by the religious organization governed by the corporation" was met because there was no evidence of any religious organization other than the predecessor. The statutory scheme makes clear that the chief officer of the corporation sole is not also "the religious organization governed by the corporation" [*Berry v. Society of Saint Pius X (1999) 69 Cal. App. 4th 354, 368-372, 81 Cal. Rptr. 2d 574* (because putative pastor's appointment was ineffective, pastor had no right to possession of disputed church property)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
A. Governing Law and Types of Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.12

§ 13.12 Selecting Appropriate Type of Nonprofit Corporation

Public benefit corporations are formed for charitable or public purposes, rather than for the more limited purposes of either the mutual benefit of the members or the furtherance of religion [*Corp. Code § 5111*]. The Nonprofit Corporation Law does not define either "public" or "charitable" purposes. These entities are subject to greater oversight by the Attorney General than the other two primary types of nonprofit corporations.

Mutual benefit corporations are those formed primarily for the benefit of the members of the corporations or persons engaging in a particular type of business or activity. Because the business or activity of mutual benefit corporations tends to be of a limited nature, mutual benefit corporations serve a smaller group of recipients than public benefit corporations formed for public or charitable purposes. For example, most common interest development associations are formed as nonprofit mutual benefit corporations. However, a corporation whose assets will be irrevocably dedicated to charitable, religious, or public purposes and that, as a matter of law or according to its articles or bylaws, must distribute its assets to person or persons carrying on a charitable, religious, or public purpose on dissolution, may not be formed under the Nonprofit Mutual Benefit Corporation Law [*Corp. Code § 7111*].

Religious corporations are the least regulated of the three primary types of nonprofit corporations. On this basis, if the corporation will be formed primarily or exclusively for religious purposes [*see Corp. Code § 9111*], the corporation should organize under the Nonprofit Religious Corporation Law [*Corp. Code § 9110 et seq.*].

For further comparison of these entities and selection criteria, see *§ 13.110*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
A. Governing Law and Types of Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide §§ 13.13-13.19

[Reserved]

§§ 13.13[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
B. Organization of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.20

§ 13.20 Articles of Incorporation

[1] Filing Articles Begins Corporate Existence

One or more persons may form a nonprofit corporation by executing and filing articles of incorporation with the Secretary of State [*Corp. Code §§ 5120(a), 7120(a), 9120(a)*; *see Corp. Code § 5035* ("articles" defined)]. Societies for the prevention of cruelty to children and animals require 20 or more persons who are citizens and residents of California [*Corp. Code § 10400*]. A nonprofit corporation is formed and corporate existence begins on the filing of the articles of incorporation and continues perpetually unless otherwise expressly provided by law or in the articles [*Corp. Code §§ 5120(a), (c), 7120(a), (c), 9120(a), (c)*; *see Corp. Code §§ 5132(a)(1), 7132(a)(1), 9132(a)(1)* (limiting corporation's existence)].

For all purposes, other than an action in the nature of quo warranto, a copy of the articles of a corporation duly certified by the Secretary of State is conclusive evidence of the formation of the corporation and prima facie evidence of its corporate existence [*Corp. Code §§ 5133, 7133, 9133*]. Thus, the act of the Secretary of State in filing the articles, even though done under an erroneous view of the legal requirements for incorporation, the availability of the name chosen, or as to the sufficiency of the articles or their execution, is effective to create a valid corporation, except against direct attack by the state [*see Vallejo & N. R. Co. v. Reed Orchard Co. (1915) 169 Cal. 545, 559-560, 147 P. 238*].

For discussion of execution requirements, see *§§ 13.200[1][e]* (public benefit), *13.210[1][e]* (mutual benefit), and 13.220[1][e] (religious), respectively.

[2] Contents

The articles of incorporation must set forth provisions prescribed by the Nonprofit Corporation Law, including the name of the corporation, a prescribed statement concerning the purpose and governing law of the corporation, and information identifying the corporation's agent for service of process [*see Corp. Code §§ 5130, 7130, 9130*]. In addition to these mandatory provisions, the articles effecting incorporation of an unincorporated association [*see Corp. Code §§ 5121(a), 7121(a), 9121(a)*] must set forth the name of the unincorporated association and a statement that an existing unincorporated association is being incorporated by the filing of the articles [*Corp. Code §§ 5121(b), 7121(b), 9121(b)*].

The Nonprofit Corporation Law also specifically mentions numerous optional provisions that may be included in the articles [*see Corp. Code §§ 5131, 5132, 7131, 7132, 9131, 9132*; *see also § 13.130*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
B. Organization of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.21

§ 13.21 Bylaws

[1] Purpose of Bylaws

"Bylaws" are rules and procedures adopted by the corporation for its internal government that regulate its conduct and operations and prescribe the rights and duties of its members towards itself and among themselves in reference to the management of its affairs [*see Corp. Code §§ 5150(a), 7150(a), 9150(a)*; *see also Olincy v. Merle Norman Cosmetics, Inc. (1962) 200 Cal. App. 2d 260, 267, 19 Cal. Rptr. 387]* . The term "bylaws" includes amendments to the bylaws and amended bylaws [*Corp. Code § 5037*]. The bylaws provide rules for procedures not covered by statute, and may be used to alter default rules that apply in the absence of a bylaw to the contrary. Under the Nonprofit Religious Corporation Law, the term "bylaws" means the code or codes of rules used, adopted, or recognized for the regulation or management of the affairs of the corporation irrespective of the name or names by which those rules are designated [*Corp. Code § 9150(a)*; *see Metropolitan Philip v. Basil Steiger (2000) 82 Cal. App. 4th 923, 932, 98 Cal. Rptr. 2d 605* (bylaws of religious corporation can include more than just document bearing that title); Ballantine & Sterling, California Corporation Laws, Ch. 19, *Nonprofit Corporations and Organizations* , § 418.04 (Matthew Bender); *see also § 13.221*].

Subject to the provisions of the articles, the bylaws, and applicable statutes, nonprofit corporations generally may tailor the bylaws to suit their needs. However, the bylaws must operate reasonably and equally to all members [*see Haynes v. Annandale Golf Club (1935) 4 Cal. 2d 28, 30, 47 P.2d 470* ; *see also Braude v. Automobile Club of Southern Cal. (1978) 78 Cal. App. 3d 178, 182-185, 144 Cal. Rptr. 169]* . The adoption, amendment, and repeal of bylaws are discussed in *§§ 13.201[1][n]* (public benefit) and *13.212[1][n]* (mutual benefit), respectively.

[2] Contents

Unless stated in the articles, the bylaws must state (1) the number of directors of the corporation; (2) the method of determining the number of directors of the corporation; or (3) that the number of directors may not be less than a stated minimum (one or more) nor more than a stated maximum with the exact number of directors to be fixed, within the limits specified, by approval of the board or the members [*Corp. Code § 5034*], in the manner provided in the bylaws [*Corp. Code §§ 5151(a), 7151(a), 9151(a)*; *see Corp. Code §§ 5151(e), 7151(e), 9151(e)* (supermajority voting requirements)]. Except as otherwise provided in the articles or bylaws, once members have been admitted, a bylaw

specifying or changing a fixed number of directors or the maximum or minimum number or changing from a fixed to a variable board or vice versa may only be adopted by approval of the members [*Corp. Code §§ 5151(b), 7151(b), 9151(b)*].

The Nonprofit Corporation Law also specifically mentions numerous optional provisions that may be included in the bylaws [*see Corp. Code §§ 5151(c)-(f), 7151(c)-(f), 9151(c)-(f)*; *see also § 13.131*]. Further, the bylaws may delegate some or all of the members' authority. If delegates are provided for, the bylaws must state the delegates' terms of office, a reasonable method for delegates' selection and removal, and a reasonable method for calling, noticing, and holding meetings of delegates; the bylaws may set forth the manner in which delegates may act by written ballot [*Corp. Code §§ 5152, 7152, 9152*; *see Corp. Code §§ 5513, 7513, 9413*]. Delegates may only act personally at a meeting or by written ballot and may not act by proxy [*Corp. Code §§ 5152, 7152, 9152*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
B. Organization of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.22

§ 13.22 Changing Unincorporated Association to Corporation

An existing unincorporated association may change its status to that of a public benefit corporation if the change is properly authorized by the association in accordance with its rules and procedures [*Corp. Code §§ 5121(a), 7121(a), 9121(a)*]. In this situation, in addition to the matters required to be set forth in the articles [*see Corp. Code §§ 5130, 7130, 9130*], the articles must also state that an existing unincorporated association, stating its name, is being incorporated by the filing of the articles [*Corp. Code §§ 5121(b), 7121(b), 9121(b)*].

The articles of incorporation being filed must be accompanied by a verified statement of any two officers or governing board members of the association, stating that the incorporation of the association by means of the articles to which the verified statement is attached has been approved by the association in accordance with its rules and procedures [*Corp. Code §§ 5121(c), 7121(c), 9121(c)*; *see § 13.242*].

Effective on the change of status of an unincorporated association to a corporation, the property of the association becomes the property of the corporation and association members with voting rights [*see Corp. Code § 5056*] become members of the corporation [*Corp. Code §§ 5121(d), 7121(d), 9121(d)*]. The filing for record in the office of the county recorder of any California county in which any of the association's real property is located of a copy of the articles of incorporation, certified by the Secretary of State, constitutes evidence of record ownership in the corporation of all interests of the association in and to the real property located in that county [*Corp. Code §§ 5121(e), 7121(e), 9121(e)*]. All rights of creditors and all liens on association property are preserved unimpaired. Further, any action or proceeding pending by or against the unincorporated association may be prosecuted to judgment (and the judgment will bind the corporation) or the corporation may be proceeded against or substituted in its place [*Corp. Code §§ 5121(f), 7121(f), 9121(f)*].

If a corporation is organized by a person who is or was an officer, director, or member of an unincorporated association and the corporation is not organized pursuant to *Corp. Code §§ 5121(a), 7121(a),* or *9121(a),* then the unincorporated association may continue to use its name and the corporation may not use a name that is the same as or similar to the name of the unincorporated association [*Corp. Code §§ 5121(g), 7121(g), 9121(g)*].

PRACTICE TIP:

If the unincorporated association's voting members will not all be included as members of the corporation being formed, or if additional persons will become members of the corporation, the association's governing instrument(s) should be modified before incorporation, or the corporation's articles or bylaws should be drafted to achieve the desired result immediately on incorporation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawUnincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
B. Organization of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.23

§ 13.23 Initial Meeting

Following the filing of the articles of incorporation, nonprofit corporations must hold their initial meeting to complete corporate formation. At the meeting, corporations typically choose directors if not already selected, adopt bylaws [*see § 13.21*], elect officers, and make financial and operational decisions.

For the procedure for holding an organizational meeting, see *§ 13.121*. For a form for minutes of the meeting, see *§ 13.247*. To determine whether the meeting is subject to the Brown Act, see *§ 13.31[5][g]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
B. Organization of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide §§ 13.24-13.29

[Reserved]

§§ 13.24[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.30

§ 13.30 Corporate Powers

Subject to any limitations contained in the articles or bylaws and to compliance with other provisions of the Nonprofit Law and any other applicable laws, a nonprofit corporation, has all the powers of a natural person in carrying out its activities, including, without limitation, the power to take the following actions [*Corp. Code §§ 5140, 7140, 9140*]:

- Adopt, use, and at will alter a corporate seal, but failure to affix a seal does not affect the validity of any instrument.

- Adopt, amend, and repeal bylaws.

- Qualify to conduct its activities in any other state, territory, dependency, or foreign country.

- Issue, purchase, redeem, receive, take, or otherwise acquire, own, sell, lend, exchange, transfer, or otherwise dispose of, pledge, use and otherwise deal in and with its own bonds, debentures, notes and debt securities.

- Issue memberships.

- Pay pensions, and establish and carry out pension, deferred compensation, saving, thrift and other retirement, incentive and benefit plans [*see Corp. Code § 5054*], trusts, and provisions for any or all of its directors, officers, employees, and persons providing services to it or any of its subsidiary or related or associated corporations, and indemnify and purchase and maintain insurance on behalf of any fiduciary of those plans, trusts, or provisions.

- Levy dues, assessments, and fees.

- Make donations for the public welfare or for community funds, hospital, charitable, educational, scientific, civic, religious, or similar purposes.

- Assume obligations, enter into contracts [*see, e.g., ECC Construction Inc. v. Ganson (2000) 82 Cal. App. 4th 572, 576, 98 Cal. Rptr. 2d 292* (individual homeowner members of condominium complex homeowners association who were not parties to corporation's contract to repair common areas after earthquake had no personal liability for its debts)], including contracts of guarantee or suretyship, incur liabilities, borrow or lend money or otherwise use its credit, and secure any of its obligations, contracts, or liabilities by mortgage, pledge, or other encumbrance of all or any part of its property and income.

- Participate with others in any partnership, joint venture, or other association, transaction, or arrangement of any kind whether or not that participation involves sharing or delegation of control with or to others.

- Act as trustee under any trust incidental to the principal objects of the corporation, and receive, hold, administer, exchange, and expend funds and property subject to that trust.

- Carry on a business at a profit and apply any profit that results from the business activity to any activity in which it may lawfully engage.

- Pay the reasonable value of services rendered in California to the corporation before January 1, 1975, and not previously paid, by any person who performed those services on a full-time basis under the direction of a religious organization in connection with the religious tenets of the organization under specified circumstances.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.31

§ 13.31 Directors

[1] Authority of Board

[a] Public Benefit and Mutual Benefit Corporations

Each corporation must have a board of directors. Subject to the Nonprofit Corporation Law and any limitation in articles or bylaws requiring member approval or approval by a majority of the members [*see Corp. Code §§ 5033, 5034*], the board conducts the activities and affairs of the corporation, and all corporate powers [*see § 13.30*] are exercisable by or under the direction of the board subject to any limitations in the [*Corp. Code § 5210, 7210*]. The board may delegate corporate management authority to any person or persons, management company, or committee, however composed, provided that the activities and affairs of the corporation are managed and all powers exercised under the ultimate direction of the board [*Corp. Code § 5210, 7210*].

Subject to qualifications concerning the transaction of business [*see Corp. Code §§ 5212, 5233-5235, 5238(e), 7212, 7233, 7234, 7237(e), 7238*; *see also § 13.38*], every act or decision done or made by a majority of the directors present at a meeting duly held at which a quorum is present is the act of the board. The articles or bylaws may not provide that a lesser vote than a majority of the directors present at a meeting is the act of the board. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for that meeting, or such greater number as is required by the law, the articles, or the bylaws [*Corp. Code §§ 5211(a)(8), 7211(a)(8)*].

[b] Religious Corporations

Unless otherwise provided in the articles or bylaws, and subject to the Nonprofit Corporation Law, each corporation must have a board of directors. The board conducts the activities and affairs of the corporation, and all corporate powers [*see § 13.30*] are exercisable by or under the direction of the board subject to any limitations in the [*Corp. Code § 9210(a)*]. The board may delegate corporate management authority to any person or persons, provided that the activities of the corporation are managed and all powers exercised under the ultimate direction of the board [*Corp. Code § 9210(b)*].

Any act or decision by a majority of the directors present at a duly held meeting at which a quorum is present is the act of the board. The articles or bylaws may not provide that a lesser vote than a majority of the directors present at a meeting is the act of the board. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for that meeting, or a greater number if required by the applicable Corporations Code provisions, the articles, or the bylaws [*Corp. Code § 9211(a)(8)*].

[2] Selection, Nomination, and Election of Directors

[a] Election of Directors of Public Benefit and Mutual Benefit Corporations

In general, directors of public benefit or mutual benefit corporations must be elected unless the articles or bylaws permit the designation or selection by a specified designator of directors [*see Corp. Code §§ 5220(a), (d), 7220(a), (d)*]. Directors may be elected by written ballot [*see Corp. Code §§ 5513, 7513*]. When the corporation has members, the members must have reasonable nomination and election procedures given the nature, size, and operations of the corporation [*Corp. Code §§ 5520(a), 7520(a)*]. If the corporation complies with all of the following statutory provisions applicable to corporations with the same number of members, the nomination and election procedures of the corporation will be deemed reasonable [*Corp. Code §§ 5520(b), 7520(b)*]:

- *Corp. Code §§ 5521, 5523,* and *5524* or *7521, 7523,* and *7524*, applicable to corporations with 500 or more members.

- *Corp. Code §§ 5522* or *7522*, applicable to corporations with 5,000 or more members.

However, these statutes do not prescribe the exclusive means of making reasonable nomination and election procedures available to the members. A corporation may make other reasonable procedures available to the members, in view of the nature, size, and operations of the corporation [*Corp. Code §§ 5520(b), 7520(b)*].

[b] Nomination Requirements for Directors of Public Benefit and Mutual Benefit Corporations

A public benefit or mutual benefit corporation with 500 or more members may provide that, except for directors elected as authorized by the Corporations Code provision regarding the appointment of delegates [*see Corp. Code §§ 5152, 7152*] or on the basis of chapter or other organizational unit [*see Corp. Code §§ 5153, 7153*], and except as provided in the Corporations Code section relating to corporations with 5,000 or more members [*see Corp. Code §§ 5522, 7522*], any person qualified to be elected as a director of the corporation may be nominated [*Corp. Code §§ 5521, 7521*]

- By any method authorized by the bylaws, or if no method is set forth by the bylaws, by any method authorized by the board.

- By petition delivered to an officer of the corporation, signed within 11 months preceding the next time directors will be elected, by an appropriate number of voting members [*see Corp. Code §§ 5521(b), (c), 7521(b), (c)*].

- If a meeting will be held to elect directors, by any member present at the meeting in person or by proxy if proxies are permitted.

If the corporation has 5,000 or more members, several restrictions are applicable to the nomination and election of directors and inapplicable to an election of delegates [*see Corp. Code §§ 5152, 7152*] or an election on the basis of organizational or geographic grouping [*Corp. Code §§ 5522, 7522*; *see Corp. Code §§ 5153, 7153*]. For example, the

corporation's articles or bylaws must set a date for the close of nominations for the board, after which nominations may not be made. The date must not be less than 50 nor more than 120 days before the day the directors are to be elected. If more people are nominated for the board than can be elected, the election must take place by means of a procedure that allows all nominees a reasonable opportunity to solicit votes and all members a reasonable opportunity to choose among the nominees. A nominee must have a reasonable opportunity to communicate to the members the nominee's qualifications and the reasons for the nominee's candidacy. If after close of nominations the number of people nominated for the board is not more than the number of directors to be elected, the corporation may declare, without further action, that those nominated have been elected [*Corp. Code §§ 5522*, *7522*].

[c] Special Rule for Public Benefit Corporations and Interested Persons

No more than 49 percent of the board of directors of a public benefit corporation may be interested persons [*Corp. Code § 5227(a)*]. "Interested persons" include (1) persons currently compensated by the corporation for services rendered in the preceding year, whether as a full-time or part-time employee, independent contractor, or otherwise, excluding any reasonable compensation paid to a director as director and (2) any brother, sister, ancestor, descendant, spouse, brother-in-law, sister-in-law, son-in-law, daughter-in-law, mother-in-law, or father-in-law of any compensated person described in (1) [*Corp. Code § 5227(b)*; *see Corp. Code §§ 5227(c)*, *5142* (standing)]. Violations of these rules do not affect the validity or enforceability of any transaction entered into by the corporation [*Corp. Code § 5227(d)*].

The term "interested person," unlike the term "interested director" [*see § 13.38*] does not require a material financial interest [*compare Corp. Code § 5227(b) with Corp. Code § 5233(a)*].

[d] Religious Corporations

The articles or bylaws of religious corporations may provide for the tenure, election, selection, designation, removal, and resignation of directors [*Corp. Code § 9220(a)*]. Directors must perform their duties in good faith and in a manner believed to be in the corporation's best interests as to any acts or omissions in connection with the election, selection, and nomination of directors [*Corp. Code § 9242(a)*].

Absent specific provision in the articles or bylaws, the terms of directors is one year [*Corp. Code § 9220(b)*]. Each director, including a director elected to fill a vacancy, holds office until the expiration of the term for which elected and until a successor has been elected and qualified unless the articles or bylaws provide otherwise, or unless the director has been removed from office [*Corp. Code § 9220(c)*].

[e] Appointment by Superior Court

The superior court of any county may appoint directors of nonprofit corporations in two situations. First, if a nonprofit corporation has not issued memberships and all the directors resign, die, or become incompetent, the superior court may appoint directors on the application of any party in interest. Second, if the corporation's initial directors have not been named in the articles and all the incorporators resign, die, or become incompetent before the election of the initial directors, the superior court may appoint the directors on the application of any party in interest [*Corp. Code §§ 5220(e)*, 7220(e), *9220(d)*].

[3] Number and Qualifications of Directors

The bylaws must specify the exact number of directors of the corporation or the method of determining the number of directors of the corporation; unless the articles state that requirement. Alternatively, the bylaws or the articles may state that the number of directors must not be less than a stated minimum nor more than a stated maximum with the exact number of directors to be fixed by the approval of the board or the members. In either event, the number or minimum number of directors may be one or more [*Corp. Code §§ 5151(a)*, *7151(a)*, *9151(a)*]. Once members have been admitted, any adoption of a bylaw specifying or changing the fixed number of directors or the maximum or minimum

number or changing from a fixed to a variable board or vice versa must be approved by the members [*Corp. Code §§ 5151(b), 7151(b), 9151(b)*].

The bylaws may specify the required qualifications of the directors, provided that they do not conflict with the law or with the articles of incorporation [*Corp. Code §§ 5151(c)(3), 7153(c), 9153(c)*]. Typical qualifications include corporate membership, California residency, and specific educational or employment background.

[4] Term of Office

[a] Public Benefit and Mutual Benefit Corporations

With the exception of directors who may be designated or selected [*see Corp. Code §§ 5220(d), 7220(d)*], directors of public benefit and mutual benefit corporations must be elected for terms not longer than four years, as fixed in the articles or bylaws. Corporations without members may provide for terms up to six years. Absent provision in the articles or bylaws, a director's term of office is one year [*Corp. Code §§ 5220(a), 7220(a)*]. The articles or bylaws may provide for staggering the terms of directors by dividing the total number of directors into groups. The terms of office of the several groups, as well as the number of directors in each group, need not be uniform. However, no amendment of the articles or bylaws may extend the term of a director beyond that for which the director was elected, and a bylaw provision increasing the terms of directors may not be adopted without the approval of the members [*Corp. Code §§ 5220(a), 7220(a)*].

Unless the articles or bylaws provide to the contrary, each director, including a director elected to fill a vacancy, must hold office until the expiration of the term for which elected and until a successor has been elected and qualified, unless the director has been removed from office [*Corp. Code §§ 5220(b), 7220(b)*].

Notwithstanding these rules, all or any portion of the directors authorized in the articles or bylaws of a corporation may hold office by virtue of designation or selection by a specified designator as provided by the articles or bylaws rather than by election. These directors continue in office for the term prescribed by the governing article or bylaw provision; if no term is prescribed, directors continue until the governing article or bylaw provision is duly amended or repealed, or the director is removed without cause [*Corp. Code §§ 5220(d), 7220(d)*; *see Corp. Code §§ 5222(e), 7222(e)*]. A bylaw provision authorized by this subdivision may be adopted, amended, or repealed only by approval of the members [*see Corp. Code § 5034*] except as provided in *Corp. Code § 5150(d)* or *7150(d)* (written approval requirement) [*Corp. Code §§ 5220(d), 7220(d)*].

Unless otherwise provided in the articles or bylaws, the entitlement to designate or select a director or directors will cease if either of the following circumstances exist [*Corp. Code §§ 5220(d), 7220(d)*]:

- The specified designator of that director or directors has died or ceased to exist.

- The entitlement of the specified designator of that director or directors to designate is in the capacity of an officer, trustee, or other status and the office, trust, or status has ceased to exist.

[b] Religious Corporations

The articles or bylaws of a religious corporation may provide for the tenure of the directors [*Corp. Code § 9220(a)*]. Absent provision in the articles or bylaws, the terms of directors is one year [*Corp. Code § 9220(b)*]. Unless the articles or bylaws otherwise provide, each director, including a director elected to fill a vacancy, holds office until the expiration of the term for which elected and until a successor has been elected and qualified, unless the director has been removed from office [*Corp. Code § 9220(c)*].

[5] Meeting Requirements

PRACTICE TIP:

Counsel should advise nonprofits of the importance of complying with meeting, notice, and quorum requirements. Nonprofits may consider the technicalities of corporate formalities and governance of less import than the charitable purposes of the corporation.

[a] Call and Location

Meetings of the board may be called by the chair of the board or the president or any vice president or the secretary or any two directors unless otherwise provided in the articles or bylaws [*Corp. Code §§ 5211(a)(1), 7211(a)(1), 9211(a)(1)*]. Meetings of the board may be held at any place within or outside California that has been designated in the notice of meeting or, if not stated in the notice or if there is no notice, designated in the bylaws or by resolution of the board [*Corp. Code §§ 5211(a)(5), 7211(a)(5), 9211(a)(5)*]. Each director present and voting at a meeting has one vote on each matter presented to the board of directors for action at that meeting. No director may vote at any meeting by proxy [*Corp. Code §§ 5211(c), 7211(c), 9211(c)*].

[b] Quorum Requirements

A majority of the number of directors authorized in or pursuant to the articles or bylaws constitutes a quorum of the board for the transaction of business [*Corp. Code §§ 5211(a)(7), 7211(a)(7), 9211(a)(7)*]. The articles or bylaws may require the presence of one or more specified directors in order to constitute a quorum of the board to transact business, as long as the death of a director or the death or nonexistence of the person or persons otherwise authorized to appoint or designate that director does not prevent the corporation from transacting business in the normal course of events [*Corp. Code §§ 5211(a)(7), 7211(a)(7), 9211(a)(7)*]. The articles or bylaws of public or mutual benefit corporations may not provide that a quorum will be less than one fifth the number of directors authorized in or pursuant to the articles or bylaws, or less than two, whichever is larger, unless the number of directors authorized in or pursuant to the articles or bylaws is one, in which case the single directors constitutes a quorum [*Corp. Code §§ 5211(a)(7), 7211(a)(7)*].

[c] Notice Requirements

Regular meetings of the board may be held without notice if the time and place of the meetings are fixed by the bylaws or the board. Special meetings of the board must be held on four days notice by first class mail or 48 hours notice delivered personally or by telephone, including a voice messaging system or by electronic transmission by the corporation [*Corp. Code §§ 5211(a)(2), 7211(a)(2); see Corp. Code § 20*]. The articles or bylaws may not dispense with notice of a special meeting. A notice, or waiver of notice, need not specify the purpose of any regular or special meeting of the board [*Corp. Code §§ 5211(a)(2), 7211(a)(2), 9211(a)(2)*].

Notice of a meeting need not be given to a director who provided a waiver of notice, or a consent to holding the meeting, or an approval of the minutes of the meeting in writing, whether before or after the meeting, or who attends the meeting without protesting, before the meeting or at its commencement, the lack of notice to that director. All waivers, consents and approvals must be filed with the corporate records or made a part of the minutes of the meetings [*Corp. Code §§ 5211(a)(3), 7211(a)(3), 9211(a)(3)*].

[d] Participation Through Electronic Means

Board members may participate in a meeting through use of conference telephone, electronic video screen communication, or electronic transmission by and to the corporation. Participation in a meeting through use of conference telephone or electronic video screen communication constitutes presence in person at the meeting as long as all members participating in the meeting are able to hear one another. Participation in a meeting through use of electronic transmission by and to the corporation (other than conference telephone and electronic video) screen communication constitutes presence in person at the meeting if all the following apply [*Corp. Code §§ 5211(a)(6),*

7211(a)(6), 9211(a)(6)]:

- Each participating member can communicate with all other members concurrently.

- Each member has the means to participate in all matters before the board, including, without limitation, the capacity to propose, or to interpose an objection to, a specific action to be taken by the corporation.

[e] Action Without Meeting

Any action required or permitted to be taken by the board may be taken without a meeting, if all members of the board individually or collectively consent in writing to that action. All written consents must be filed with the minutes of the proceedings of the board. Such an action by written consent has the same force and effect as the unanimous vote of the directors [*Corp. Code §§ 5211(b), 7211(b), 9211(b)*].

[f] Adjournment

A majority of the directors present, whether or not a quorum is present, may adjourn any meeting to another time and place [*Corp. Code §§ 5211(a)(4), 7211(a)(4), 9211(a)(4)*]. If the meeting is adjourned for more than 24 hours, notice of any adjournment to another time or place must be given before the time of the adjourned meeting to the directors who were not present at the time of the adjournment [*Corp. Code §§ 5211(a)(4), 7211(a)(4)*].

[g] Brown Act Requirements

Under specified circumstances, meetings of boards of directors, commissions, committees, and other multimember bodies governing a private corporation, limited liability company, or other entity may be subject to the Brown Act. The Brown Act balances the need for public access to meetings of public entities and the need for confidentiality [*see Gov. Code § 54950 et seq.*].

Nonprofits may be subject to the Brown Act in one of two ways. First, the Brown Act expressly applies to corporations, limited liability companies, and other entities that are created by an elected legislative body to exercise authority that may lawfully be delegated by the elected governing body to a private corporation, limited liability company, or other entity [*Gov. Code § 54952(c)(1)(A)*]. Second, if the corporation, limited liability company, or other other entity (1) receives funds from a local agency and (2) has an appointed member of the legislative body of the local agency as a member of its own governing body includes a member of the appointed to that governing body as a full voting member by the legislative body of the local agency [*Gov. Code § 54952(c)(1)(B)*; *see Gov. Code § 54952(c)(2)*]. Thus, the Brown Act does not apply based solely on the receipt of public funds, or if the legislative body appoints someone other than one of its own members.

The Brown Act can apply to informal and formal meetings, including any congregation of a majority of the members of a legislative body (corporation) at the same time and location, including teleconference location as permitted by *Gov. Code § 54953*, to hear, discuss, deliberate, or take action on any item that is within the subject matter jurisdiction of the legislative body [*Gov. Code § 54952.2(a)*]. Further, the Act applies to purely social or ceremonial gatherings at which a majority of the legislative body is present unless a majority of the members do not discuss among themselves business of a specific nature that is within the subject matter jurisdiction of the legislative body of the local agency [*Gov. Code § 54952.2(c)(5)*].

The Brown Act imposes notice and agenda requirements [*Gov. Code §§ 54954.2, 54956*], and public access requirements [*see Gov. Code § 54954.3*]. The failure to comply with the Brown Act is subject to injunctive and declaratory relief [*see Gov. Code §§ 54960, 54960.1, 54960.5*], and the imposition of criminal penalties [*see Gov. Code*

§ 54959].

[6] Duties and Liabilities

[a] Good Faith Standard for Public and Mutual Benefit Corporations

A director of a public benefit or mutual benefit corporation must perform the duties of that office, including duties as a member of any board committee on which the director may serve, in good faith, in a manner that the director believes to be in the best interests of the corporation and with the care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances [*Corp. Code §§ 5231(a), 7231(a)*; *see Corp. Code §§ 5232*, *7232*]. In performing these duties, a director is entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, in each case prepared or presented by any of the following [*Corp. Code §§ 5231(b), 7231(b)*]:

- One or more officers or employees of the corporation whom the director believes to be reliable and competent in the matters presented.

- Counsel, independent accountants, or other persons as to matters that the director believes to be within that person's professional or expert competence.

- A committee on which the director does not serve that is composed exclusively of any or any combination of directors, persons described in item (1), *above*, or persons described in item (2), *above*, as to matters within its designated authority, if the director believes that the committee merits confidence, so long as the director acts in good faith, after reasonable inquiry when the need is indicated by the circumstances, and without knowledge that would cause reliance to be unwarranted.

A person who performs the duties of a director in accordance with these requirements will not be liable based on any alleged failure to discharge the person's obligations as a director, including, without limitation, any actions or omissions that exceed or defeat a public or charitable purpose to which a corporation, or the assets held by it, are dedicated [*Corp. Code §§ 5231(c), 7231(c)*; *but see Corp. Code § 5233* (self-dealing); *see also § 13.38*].

These rules apply regardless of whether or not the director is compensated [*Corp. Code §§ 5230(a)*, *7230(a)*].

[b] Good Faith Standard for Religious Corporations

A director of a religious corporation must perform the duties of that office, including duties as a member of any board committee on which the director may serve, in good faith, in a manner that the director believes to be in the best interests of the corporation and with the care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances [*Corp. Code § 9241(a)*]. In performing these duties, a director is entitled to rely on the same sources on which directors of other nonprofits may rely [*see* [a], *above*], plus information, opinions, reports or statements, including financial statements and other financial data, in each case prepared or presented by religious authorities and ministers, rabbis, priests, or other persons whose position or duties in the religious organization the director believes justifies reliance and confidence and who the director believes to be reliable and competent in the matters presented. In any event, the director must act in good faith, after reasonable inquiry when the need is indicated by the circumstances, and without knowledge that would cause reliance to be unwarranted [*Corp. Code § 9241(b)*]. Further, in making a good faith determination, the director may consider what he or she believes to be the religious purposes of the corporation and applicable religious tenets, canons, laws, policies, and authorities [*Corp. Code § 9240(c)*].

A person who performs the duties of a director in accordance with these requirements will not be liable based on any

alleged failure to discharge the person's obligations as a director, including, without limitation, any actions or omissions that exceed or defeat a public or charitable purpose to which a corporation, or the assets held by it, are dedicated [*Corp. Code § 9241(d)*; *but see Corp. Code § 9243* (self-dealing); *see also § 13.38*].

The good faith requirement rather than the rules on self-dealing govern any action or omissions of a director regarding the compensation of directors, as directors or officers, or any loan to or guaranty of the obligation of any director or officer. No otherwise valid obligation is voidable merely because directors who benefited by a board resolution to pay compensation or to make the loan or guaranty participated in making the resolution [*Corp. Code § 9241(c)*].

These rules apply regardless of whether or not the director is compensated [*Corp. Code § 9240(a)*].

[c] Liability for Distributions, Loans, and Guarantees

Subject to *Corp. Code §§ 5231*, *7231*, and *9241*, discussed in [a] and [b], *above*, directors of a corporation who approve any of the following corporate actions are jointly and severally liable to the corporation for the following [*Corp. Code §§ 5237(a), 7236(a), 9245(a)*]:

- The making of any distribution, or for a mutual benefit corporation, any distribution contrary to *Corp. Code § 7410 et seq.*

- The distribution of assets after institution of dissolution proceedings, without paying or adequately providing for all known liabilities of the corporation, excluding any claims not filed by creditors within the time limit set by the court in a notice given to creditors [*see Corp. Code §§ 6510-6721, 8510-8721, 9680*].

- The making of any loan or guaranty contrary to *Corp. Code §§ 5236*, *7235*, *9241* [*see § 13.38*].

Directors of public benefit or mutual benefit corporations who are present at a meeting of the board or any board committee, at which one of the above specified actions is taken and who abstains from voting is considered to have approved the action [*Corp. Code §§ 5237(b), 7236(b)*].

Recoverable damages include the amount of the illegal distribution, or if the illegal distribution consists of property, the fair market value of that property at the time of the illegal distribution, plus interest from the date of the distribution at the legal rate on judgments until paid, together with all reasonably incurred costs of appraisal or any other valuation of that property, or the loss suffered by the corporation as a result of the illegal loan or guaranty [*Corp. Code §§ 5237(d), 7236(d), 9245(c)*].

The directors sued may implead all other directors liable and may compel contribution, either in that action or in an independent action against directors not joined in that action [*Corp. Code §§ 5237(e), 7236(e), 9245(d)*]. Directors are also entitled to be subrogated to the rights of the corporation against the persons who received the distribution or the loan or guaranty. Directors may also file a cross-complaint against the person or persons who are liable to the director as a result of this subrogation or may proceed against them in an independent action [*Corp. Code §§ 5237(f), 7236(f), 9245(e)*].

[7] Removal of Directors for Cause

The board may declare vacant the office of a director who has been declared of unsound mind by a final order of court or convicted of a felony, If the bylaws provide that a director may be removed for missing a specified number of board meetings, as of the time of the director's election, the director may be removed for failing to attend the requisite number of meetings [*Corp. Code §§ 5221(a), 7221(a), 9221(a)*]. A public benefit or mutual benefit corporation director may be

removed if found by final court order or judgment to have breached specified duties [*Corp. Code §§ 5221(a), 7221(a)*; *see Corp. Code §§ 5230 et seq., 7238*].

If the articles or bylaws prescribe qualifications for the directors [*see Corp. Code §§ 5151(c)(3), 7151(c)(3), 9151(c)(3)*], the board, by a majority vote of the directors who meet all of the required qualifications to be a director, may declare vacant the office of any director who fails or ceases to meet any required qualification that was in effect at the beginning of that director's current term of office [*Corp. Code §§ 5221(b), 7221(b), 9221(b)*].

[8] Removal of Directors Without Cause

[a] Public Benefit and Mutual Benefit Corporations

If the corporation has no members, removal without cause requires the approval of a majority of the directors then in office except as provided in the articles or bylaws [*Corp. Code §§ 5222(a)(3), 5310, 7222(a)(3), 7310*].

In general, a directors may not be removed before the expiration of the director's term of office [*Corp. Code §§ 5222(d), 7222(d)*; *but see* [*Corp. Code §§ 5221, 5223, 7221, 7223* (removal for cause; members' suit)]. Unless designated, directors may be removed without cause as follows:

- For corporations with fewer than 50 members, the removal is approved by a majority of all members [*Corp. Code §§ 5222(a)(1), 7222(a)(1)*; *see Corp. Code § 5033*].

- For corporations with 50 or more members, the removal is approved by the members [*Corp. Code §§ 5222(a)(2), 7222(a)(2)*; *see Corp. Code § 5034*].

When a corporation's articles or bylaws authorize members to cumulate their votes [*see § 13.33[5]*], no director may be removed (unless the entire board is removed) when the votes cast against removal, or not consenting in writing to the removal, would be sufficient to elect the director if voted cumulatively at an election at which the same total number of votes were cast (or, if action is taken by written ballot, all memberships entitled to vote were voted) and the entire number of directors authorized at the time of the director's most recent election were then being elected [*Corp. Code §§ 5222(b)(1), 7222(b)(1)*].

If the articles or bylaws provide that the members of any class, voting as a class, are entitled to elect one or more directors, any directors so elected cannot be removed except by the applicable vote of the members of that class [*Corp. Code §§ 5222(b)(2), 7222(b)(2)*].

If the articles or bylaws provide that the members within a chapter or other organizational unit, or region or other geographic grouping, voting as such, are entitled to elect one or more directors, any director so elected may be removed only by the applicable vote of the members within that organizational unit or geographic grouping [*Corp. Code §§ 5222(b)(3), 7222(b)(3)*].

Any reduction of the authorized number of directors, or any amendment reducing the number of classes of directors, does not remove any director before the expiration of that director's term of office unless the reduction or any amendment also provides for the removal of one or more specified directors [*Corp. Code §§ 5222(c), 7222(c)*].

When a director removed without cause, for cause, or by members' suit was chosen by designation [*see Corp. Code §§ 5220(d), 7220(d)*; *see also* [4][a], *above*], the following rules apply [*Corp. Code §§ 5222(d), 7222(d)*]:

- If a different person may be designated pursuant to the governing article or bylaw provision, the new designation must be made.

- If the governing article or bylaw provision contains no provision under which a different person may be designated, the governing article or bylaw provision is deemed repealed.

When the articles or bylaws permit a designator to designate one or more directors, then any director so designated may be removed without cause by the designator unless otherwise provided in the articles or bylaws at the time of designation [*Corp. Code §§ 5222(f)(1), 7222(f)(1)*]. The designator must consent in writing to the removal [*Corp. Code §§ 5222(f)(2), 7222(f)(2)*]. Unless provided otherwise in the articles or bylaws, the right to remove will not apply if (1) the designator entitled to that right has died or ceased to exist, or (2) the right is in the capacity of an officer, trustee, or other status and that office, trust, or status has ceased to exist [*Corp. Code § 5222(f)(3)*].

[b] Religious Corporations

If a religious corporation has no members, removal without cause requires the approval of the board except as provided in the articles or bylaws [*Corp. Code §§ 9222(a), (b), 9310*].

For religious corporations with members, any or all directors may be removed without cause if the removal is approved by the members unless otherwise provided in the articles or bylaws [*Corp. Code § 9222(a)*]. When the members of any class, voting as a class, are entitled to elect one or more directors, by the provisions of the articles or bylaws, any director so elected may be removed only by the applicable vote of the members of that class [*Corp. Code § 9222(b)(1)*]. If the articles or bylaws provide that the members within a chapter or other organizational unit, or region or other geographic grouping, voting as such, are entitled to elect one or more directors, any director so elected may be removed only by the applicable vote of the members within that organizational unit or geographic grouping [*Corp. Code § 9222(b)(2)*].

Any reduction of the authorized number of directors, or any amendment reducing the number of classes of directors, does not remove any director before the expiration of that director's term of office, unless the reduction or the amendment also provides for the removal of one or more specified directors [*Corp. Code § 9222(c)*].

[9] Removal of Directors by Suit

[a] Public Benefit Corporations

The superior court of the proper county, on suit by a director, or the lesser of (1) twice the authorized number [*see Corp. Code § 5036*] of members or (2) 20 members, may remove from office any director in case of fraudulent or dishonest acts, gross abuse of authority or discretion with reference to the corporation, or breach of any duty arising the standards of conduct requirements [*Corp. Code § 5223(a)*; *see Corp. Code § 5230 et seq.*]. The court may bar from reelection any director so removed for a period prescribed by the court. The corporation must be made a party to the action [*Corp. Code § 5223(a)*]. The Attorney General may bring also an action, may intervene in such an action brought by any other party, and must be given notice of any such action brought by any other party [*Corp. Code § 5223(b)*].

[b] Mutual Benefit Corporations

The superior court of the proper county may, on suit by one of the following parties, remove from office any director in case of fraudulent or dishonest acts, gross abuse of authority or discretion with reference to the corporation, or breach of any duty arising from the corporation's holding assets in charitable trust [*Corp. Code § 7223(a), (b)*; *see Corp. Code § 7238*; *see also Committee to Save the Beverly Highlands Homes Association v. The Beverly Highlands Homes Association (2001) 92 Cal. App. 4th 1247, 1272, 1271, 112 Cal. Rptr. 2d 732* (suit by committee was insufficient to enable plaintiffs to obtain removal of board pursuant to *Corp. Code § 7223*)]:

- A director.

- In the case of a corporation in which the total number of votes entitled to be cast for a director is less than 5,000, the lesser of twice the authorized number [*see Corp. Code § 5036*] of members or 20 members.

- In the case of a corporation in which the total number of votes entitled to be cast for a director is 5,000 or more, the lesser of twice the authorized number [*see Corp. Code § 5036*] of members or 100 members.

Further, the court may bar from reelection any director so removed for a period prescribed by the court. The corporation must be made a party to the action [*Corp. Code § 7223(a)*].

In the case of a corporation holding assets in charitable trust, the Attorney General may bring such an action, may intervene in such an action brought by any other party, and must be given notice of any such action brought by any other party [*Corp. Code § 7223(c)*].

[c] Religious Corporations

The superior court of the proper county may, on suit by a director, or twice the authorized number [*see Corp. Code § 5036* (definition of "authorized number") of members, remove from office any director in case of fraudulent acts and may bar from reelection any director so removed for a period prescribed by the court. The corporation must be made a party to the action [*Corp. Code § 9223(a)*]. The Attorney General may also bring or intervene in such an action and must be given notice of any such action brought by any other party [*Corp. Code § 9223(b)*].

[10] Resignation; Filling Vacancies

[a] Public Benefit and Mutual Benefit Corporations

Any director may resign effective on giving written notice to the chairman of the board, the president, the secretary or the board of directors of the corporation, unless the notice specifies a later time for the effectiveness of the resignation. If the resignation is effective at a future time, a successor may be elected to take office when the resignation becomes effective [*Corp. Code §§ 5224(c), 7224(c)*]. However, a public benefit corporate director may not resign if the corporation would then be left without a duly elected director or directors in charge of its affairs except on notice to the Attorney General [*Corp. Code § 5226*].

Unless otherwise provided in the articles or bylaws and except for a vacancy created by removal, vacancies on the board may be filled by approval of the board [*see Corp. Code § 5032*] or, if the number of directors then in office is less than a quorum, by (1) the unanimous written consent of the directors then in office; (2) the affirmative vote of a majority of the directors then in office at a meeting held pursuant to notice or waivers of notice [*see Corp. Code §§ 5211, 7211*]; or (3) the sole remaining director [*Corp. Code §§ 5224(a), 7224(a)*]. Unless the articles or a bylaw approved by the members provides that the board may fill vacancies occurring in the board by reason of the removal of directors, or unless the corporation has no members [*see Corp. Code §§ 5310, 7310*], vacancies occurring because of removal may be filled only by approval of the members [*Corp. Code §§ 5224(a), 7224(a)*]. The members may elect a director at any time to fill any vacancy not filled by the directors [*Corp. Code §§ 5224(b), 7224(b)*].

[b] Religious Corporations

Any director may resign effective on giving written notice to the chairman of the board, the president, the secretary or the board of directors of the corporation, unless the notice specifies a later time for the effectiveness of the resignation. If the resignation is effective at a future time, a successor may be elected to take office when the resignation becomes effective [*Corp. Code § 9224(c)*]. However, a director may not resign if the corporation would then be left without a

duly elected director or directors in charge of its affairs [*Corp. Code § 9226*].

Unless otherwise provided in the articles or bylaws and except for a vacancy created by the removal of a director by the members, vacancies on the board may be filled by approval of the board [*see Corp. Code § 5032*] or, if the number of directors then in office is less than a quorum, by (1) the unanimous written consent of the directors then in office; (2) the affirmative vote of a majority of the directors then in office at a meeting held pursuant to notice or waivers of notice [*see Corp. Code § 9211*]; or (3) the sole remaining director [*Corp. Code § 9224(a)*]. Subject to any provision in the articles or a bylaws, the members may elect a director at any time to fill any vacancy not filled by the directors [*Corp. Code § 9224(b)*].

[11] Executive Committees

The board, by resolution adopted by a majority of the number of directors then in office, provided that a quorum is present, may create one or more committees. Each committee consists of two or more directors and must serve at the pleasure of the board. Committee appointments must be by a majority vote of the directors then in office, unless the articles or bylaws require a majority vote of the number of directors authorized in or pursuant to the articles or bylaws. The bylaws may authorize one or more committees, each consisting of two or more directors, and may provide that a specified officer or officers who are also directors of the corporation must be a member or members of the committee or committees. The board may appoint one or more directors as alternate members of any committee, who may replace any absent member at any meeting of the committee [*Corp. Code §§ 5212(a), 7212(a), 9212(a)*].

Any executive committee, to the extent provided in the resolution of the board or the bylaws, has all the authority of the board, except with respect to the following areas [*Corp. Code §§ 5212(a), 7212(a), 9212(a)*]:

- The approval of any action for which the approval of the members or approval of a majority of all members is required by law, regardless of whether the corporation has members.
- The filling of vacancies on the board or in any committee that has the authority of the board.
- The fixing of compensation of the directors serving on the board or on any committee.
- The amendment or repeal of bylaws or the adoption of new bylaws.
- The amendment or repeal of any resolution of the board which by its express terms is not so amendable or repealable.
- The appointment of committees of the board or the members of those committees.

Further, executive committees of public and mutual benefit corporations lack board authority over the following [*Corp. Code §§ 5212(a), 7212(a)*]:

- The expenditure of corporate funds to support a nominee for director after there are more people nominated for director than can be elected.
- The approval of any self-dealing transaction, except as provided in *Corp. Code § 5233(d)(3)*].

A committee exercising the authority of the board may not include as members persons who are not directors. The board may create other committees that do not exercise the authority of the board, and these other committees may include persons who are not directors [*Corp. Code §§ 5212(b), 7212(b), 9212(b)*].

Unless the bylaws provide to the contrary, a board of directors may delegate its powers to any committee, except as to the matters listed above over which the committees lack board authority [*Corp. Code §§ 5212(c), 7212(c), 9212(c)*].

[12] Appointment of Provisional Directors

If a public or mutual benefit corporation has an even number of directors who are equally divided and cannot agree as to the management of its affairs, so that its activities can no longer be conducted to advantage or so that there is danger that its property, activities, or business will be impaired or lost, the superior court of the proper county, notwithstanding any provisions of the articles or bylaws, and whether or not an action is pending for an involuntary winding up or dissolution of the corporation, may appoint a provisional director. An action seeking the appointment may be brought by any director or by members holding not less than 331/3 percent of the voting power [*Corp. Code §§ 5225(a), 7225(a)*].

If the members of a public or mutual benefit corporation are deadlocked so that they cannot elect the directors at the prescribed time, the superior court of the proper county may, notwithstanding any provisions of the articles or bylaws, on petition of members holding 50 percent of the voting power, appoint a provisional director or directors or order any other equitable relief as the court deems appropriate [*Corp. Code §§ 5225(b), 7225(b)*].

In the case of a public benefit corporation or a mutual benefit corporation holding assets in charitable trust, the person bringing the action must give notice to the Attorney General [*Corp. Code §§ 5225(c), 7225(c)(1)*]. The Attorney General may intervene, and the Attorney General may also bring suit independently [*Corp. Code §§ 5225(c), (d), 7225(c)*].

A provisional director must be an impartial person who is neither a member nor a creditor of the corporation, nor related by consanguinity or affinity within the third degree according to the common law to any of the other directors of the corporation or to any judge of the court by which the provisional director is appointed. A provisional director has all the rights and powers of a director until the deadlock in the board or among members is broken, or until that provisional director is removed by order of the court or by approval of a majority of all members [*Corp. Code §§ 5225(e), 7225(d)*; *see Corp. Code § 5033*]. Provisional directors are entitled to compensation as fixed by the court unless otherwise agreed with the corporation [*Corp. Code §§ 5225(e), 7225(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.32

§ 13.32 Officers

A nonprofit corporation must have a chair of the board (who may be given the title chair of the board, chairperson of the board, chairman of the board, or chairwoman of the board) [*see Corp. Code § 5039* ("chair" defined)] or a president or both, a secretary, a treasurer, a chief financial officer (or both), and other officers with titles and duties as are stated in the bylaws or determined by the board and as may be necessary to enable it to sign instruments [Corp. Code §§ 5213(a), 7213(a), 9213(a)]. The president or, if none, the chair of the board, is the general manager and chief executive officer of the corporation, unless otherwise provided in the articles or the bylaws. Unless otherwise specified in the articles or bylaws, if there is no chief financial officer, the treasurer is the chief financial officer of the corporation. Any number of offices may be held by the same person unless the articles or bylaws provide otherwise [*Corp. Code §§ 5213(a), 7213(a), 9213(a)*], except that neither the secretary, the treasurer, or the chief financial officer may serve concurrently as the president or chair of the board [*Corp. Code §§ 5213(a), 9213(a)*].

Except as otherwise provided in the articles or bylaws, officers are chosen by the board and serve at the pleasure of the board, subject to the rights, if any, of an officer under any contract of employment [*Corp. Code §§ 5213(b), 7213(b), 9213(b)*]. Any officer may resign at any time on written notice to the corporation without prejudice to the rights, if any, of the corporation under any contract to which the officer is a party [*Corp. Code §§ 5213(b), 7213(b), 9213(b)*]. However, if the articles or bylaws of a public benefit corporation provide for the election of any officers by the members, the term of office of that officer must be one year unless the articles or bylaws provide for a different term. If the articles or bylaws provide for a different term, that term may not exceed three years [*Corp. Code § 5213(c)*].

The scope of authority of corporate officers is determined by reference to any applicable statutes, the articles, the bylaws, and board resolutions. The articles, bylaws, or a board resolution may limit the activities, powers, and discretion of the officers. These restrictions should be clearly stated in the applicable instrument.

PRACTICE TIP:

Nonprofit corporations often use other designations for their officers. In this situation, the bylaws should correlate the "official" designation with the operation title in the bylaws.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



22 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.33

§ 13.33 Members

[1] Admission of Members

A nonprofit corporation may admit persons to one class of members or provide for multiple classes of membership, as provided in the articles or bylaws, or the articles or bylaws may provide that the corporation will not have members. Absent provision for members, a corporation has no members [*see Corp. Code §§ 5310(a), 7310(a), 9310(a)*; *see also Corp. Code §§ 5313, 7313, 9313*]. A corporation without members includes a corporation in which the directors are the only members *Corp. Code §§ 5310(c), 7310(c), 9310(c)*].

Memberships may be issued with or without consideration, subject to the articles and the bylaws, as determined by the board [*Corp. Code §§ 5311, 7311, 9311*].

[2] Meeting Requirements for Public Benefit and Mutual Benefit Corporations

PRACTICE TIP:
Counsel should advise nonprofits of the importance of complying with meeting, notice, and quorum requirements. Nonprofits may consider the technicalities of corporate formalities and governance of less import than the charitable purposes of the corporation.

[a] Meetings in Accordance With Bylaws

Meetings of members of a public benefit or mutual benefit corporation may be held at any place stated in or fixed in accordance with the bylaws. If the bylaws fail to provide for a place of meeting, the meetings of members must be held at the principal office of the corporation [*Corp. Code §§ 5510(a), 7510(a)*].

[b] Meetings by Electronic Transmission

A meeting of the members may be conducted, in whole or in part, by electronic transmission by and to the corporation or by electronic video screen communication if [*Corp. Code § 5510(f)*]:

- The corporation implements reasonable measures to provide members a reasonable opportunity to participate in person (or, if proxies are allowed, by proxy) in the meeting and to vote on matters submitted to the members, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with those proceedings; and

- The corporation maintains a record of any member's vote or other action made or taken by means of electronic transmission to the corporation or electronic video screen communication.

Members not physically present in person (or, if proxies are allowed, by proxy) at a meeting of the members may participate and vote at the meeting by electronic transmission by and to the corporation or by electronic video screen communication unless prohibited by the bylaws of the corporation provided that the board of directors has authorized electronic participation. The board has sole discretion to authorize electronic participation and adopt guidelines and procedures, subject to the requirement of obtaining the members' consent. A member will be deemed present in person or by proxy whether the meeting is held at a designated place or in whole or in part by means of electronic transmission by and to the corporation or by electronic video screen communication [*Corp. Code § 5510(a)*; *see Corp. Code §§ 20, 21*].

Any request by a corporation to a member for consent to conduct a meeting of the members by electronic transmission by and to the corporation must include a notice that absent consent of the member, the meeting will be held at a physical location in accordance with statute [*Corp. Code § 5510(f)*; *see Corp. Code § 20(b)*].

[c] Regular Meetings

A regular meeting of members must be held on a date and at a time, and with the frequency, stated in or fixed in accordance with the bylaws. In any event, a regular meeting must ordinarily be held in each year in which directors are to be elected at that meeting, for the purpose of conducting that election and transacting other proper business [*Corp. Code §§ 5510(b), 7510(b)*].

If a corporation with members is required to hold a regular meeting and fails to hold that meeting for a period of 60 days after the designated date, or if a meeting has not been held for a period of 15 months after formation or its last regular meeting if no date is designated in the bylaws, then the superior court of the proper county may summarily order the meeting to be held on the application of a member or the Attorney General [*Corp. Code §§ 5510(c), 7510(c)*; *see Corp. Code §§ 5510(d), 7510(d)* (order may specify time, place, and form of notice of, and record date for, meeting); *see also Corp. Code §§ 5515, 7515*]. Similarly, if the corporation fails to hold a written ballot for a period of 60 days after the designated date, the superior court may summarily order the ballot to be conducted [*Corp. Code §§ 5510(c), 7510(c)*]. In either case, the corporation is entitled to a notice giving it an opportunity to be heard [*Corp. Code §§ 5510(c), 7510(c)*].

[d] Special Meetings

Special meetings of members for any lawful purpose may be called by the board, the chairman of the board, the president, or any other persons specified in the bylaws. In addition, special meetings for any lawful purpose may be called by 5 percent or more of the members [*Corp. Code §§ 5510(e), 7510(e)*].

[e] Quorum Requirements

One third of the voting power represented in person or by proxy constitutes a quorum at a meeting of the members. If a quorum is present, the affirmative vote of the majority of the voting power represented at the meeting, entitled to vote, and voting on any matter is the act of the members, unless the vote of a greater number or voting by classes is required

by law or the articles or bylaws [*Corp. Code §§ 5512(a), 7512(a)*]. The term "voting power" means the power to vote for the election of directors at the time any determination of voting power is made. It does not include the right to vote on the happening of some condition or event that has not yet occurred. In any case in which different classes of memberships are entitled to vote as separate classes for different members of the board, the determination of percentage of voting power is made on the basis of the percentage of the total number of authorized directors that the memberships in question (whether of one or more classes) have the power to elect in an election at which all memberships then entitled to vote for the election of any directors are voted [*Corp. Code § 5078*].

However, subject to statutory limitations [*see Corp. Code §§ 5512(b), (c), 7512(b), (c)*], a bylaw may set a different quorum. Any bylaw amendment to increase the quorum may be adopted only by approval of the members [*Corp. Code §§ 5512(a), 7512(a)*]. If a bylaw authorizes a corporation to conduct a meeting with a lower quorum requirement than that set by statute, then the only matters that may be voted on at a regular meeting actually attended, in person or by proxy, by less than one-third of the voting power are those for which notice of a general nature was given [*Corp. Code §§ 5512(b), 7512(b)*].

If a meeting is called or written ballot ordered by the superior court pursuant to *Corp. Code § 5510(c)* or *7510(c)*, the votes represented, either in person or by proxy, at that meeting and entitled to be cast on the business to be transacted constitute a quorum for the purpose of the meeting, notwithstanding any provision of the articles or bylaws to the contrary [*Corp. Code § 5510(d)*].

The members present at a duly called or held meeting at which a quorum is present may continue to transact business until adjournment, notwithstanding the withdrawal of enough members to leave less than a quorum, if any action taken (other than adjournment) is approved by at least a majority of the members required to constitute a quorum or by the vote of any greater number or voting by classes required by law, the articles, or the bylaws [*Corp. Code §§ 5512(c), 7512(c)*]. Absent a quorum, any meeting may be adjourned from time to time by the vote of a majority of the votes represented either in person or by proxy and no other business may be transacted subject to the above requirement [*Corp. Code §§ 5512(d), 7512(d)*].

[f] Requirement and Timing of Notice

Whenever members are required or permitted to take any action at a meeting, a written notice of the meeting must be given not less than 10 nor more than 90 days before the date of the meeting to each member who is entitled to vote at the meeting as of the record date for notice of the meeting. If the notice is given by mail, and the notice is not mailed by first class, registered, or certified mail, that notice must be given not less than 20 days before the meeting [*Corp. Code §§ 5511(a), 7511(a)*].

In the case of a special call, on written request to the corporation addressed to the attention of chairman of the board, president, vice-president, or secretary by any person (other than the board of directors) entitled to call a special meeting of members, that officer must forthwith cause notice to be given to the members entitled to vote. The notice must state that a meeting will be held at a time fixed by the board, not less than 35 nor more than 90 days after receipt of the request [*Corp. Code §§ 5511(c), 7511(c)*; *see* [f], *below*]. If the notice is not given within 20 days after receipt of the request, the persons entitled to call the meeting may give the notice or the superior court of the proper county [*see Corp. Code § 5068* (definition of "proper county")] will summarily order the giving of the notice, after notice to the corporation giving it an opportunity to be heard. The court may issue any orders that may be appropriate, including, without limitation, orders designating the time and place of the meeting, the record date for determination of members entitled to vote, and the form of notice [*Corp. Code §§ 5511(c), 7511(c)*].

[g] Contents of Notice

The notice must state the place, date, and time of the meeting of members and any means of electronic transmission by

and to the corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication, if any, by which shareholders may participate in meeting [*Corp. Code § 5511(a)*]. In the case of a special meeting, it must also identify the general nature of the business to be transacted, and no other business may be transacted [*Corp. Code §§ 5511(a), 7511(a)*]. In the case of a regular meeting, the notice must also state those matters that the board, at the time of the mailing of the notice, intends to present for action by the members, but, subject to *Corp. Code § 5512(b)* or *7512(b)*, any proper matter may be presented at the meeting. If directors are to be elected, the notice must also state the names of the nominees as of the time the notice is sent to the members [*Corp. Code §§ 5511(a), 7511(a)*].

[h] Manner of Giving Notice

Notice of a members' meeting (or any report) must be given personally, by electronic transmission by the corporation, or by mail or other means of written communication addressed to the member at the address of the member appearing on the books of the corporation or given by the member to the corporation for purpose of notice. If no address appears or has been given, notice must be given at the place where the principal office of the corporation is located or by publication at least once in a newspaper of general circulation in the county in which the principal office is located [*Corp. Code §§ 5511(b), 7511(b)*].

Notice given by electronic transmission by the corporation is valid only if it complies with *Corp. Code § 20* [*Corp. Code §§ 5511(b), 7511(b)*]. "Electronic transmission by the corporation" means a communication (1) delivered by facsimile telecommunication or electronic mail when directed to the facsimile number or electronic mail address on record with the corporation, (2) posting on an electronic message board or network designated by the corporation for those communications, together with a separate notice to the recipient of the posting, or (3) other electronic means to a recipient who has provided an unrevoked consent to the use of those means of communication transmission. The electronic transmission must create a record capable of retention, retrieval, and review and that may be rendered into clearly legible tangible form [*Corp. Code § 20*]. In the case of an electronic posting, the posting will be validly delivered on the later of the posting or delivery of the separate notice [*Corp. Code § 20*].

Notice may not be given by electronic transmission by the corporation if (1) the corporation is unable to deliver two consecutive notices to the shareholder by that means, or (2) the inability to deliver notices via electronic transmission becomes known to the secretary, any assistant secretary, the transfer agent, or other person responsible for giving notice [*Corp. Code §§ 5511(b), 7511(b)*].

If any notice addressed to a member at the address appearing on the books of the corporation is returned to the corporation by the United States Postal Service marked to indicate that it is unable to deliver the notice to the member at that address, all future notices will be deemed to have been duly given without further mailing if they are available to the member on written demand of the member at the principal office of the corporation for a period of one year from the date on which the notice was given to all other members [*Corp. Code §§ 5511(b), 7511(b)*].

[i] Notice of Adjourned Meeting

In general, if a members' meeting is adjourned to another time or place, unless the bylaws otherwise require, notice need not be given of the adjourned meeting if the time and place of the meeting (or any means of electronic transmission by and to the corporation or electronic video screen communication by which members may participate) are announced at the meeting at which the adjournment is taken. However, if a new record date is fixed for notice or voting after the adjournment, notice of the adjourned meeting must be given to each member who, as of the record date for notice of the meeting, is entitled to vote at the meeting. No meeting may be adjourned for more than 45 days. At the adjourned meeting the corporation may transact any business which might have been transacted at the original meeting [*Corp. Code §§ 5511(d), 7511(d)*].

[j] Affidavit of Notice

The secretary, assistant secretary, or any transfer agent may execute an affidavit of giving of notice in accordance with the provisions of the Nonprofit Public Benefit or Mutual Benefit Corporation Law governing notices to members [*see Corp. Code §§ 5511(b), 7511(b)*]. The affidavit is prima facie evidence of the giving of notice [*Corp. Code §§ 5511(b), 7511(b)*].

[k] Waiver of Notice

The transactions of any meeting of the members, however called or noticed, and wherever held, are as valid as if effected at a meeting duly held after regular call and notice, if a quorum is present either in person or by proxy, and if, either before or after the meeting, each of the persons entitled to vote, not present in person or by proxy, provides waiver of notice, a consent to the holding of the meeting, or an approval of the minutes of the meeting in writing. All waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meeting [*Corp. Code §§ 5511(e), 7511(e)*]. In general, neither the business to be transacted at nor the purpose of any regular or special meeting of members need be specified in any written waiver of notice, consent to the holding of the meeting, or approval of the minutes, unless otherwise provided in the articles or bylaws [*see Corp. Code §§ 5511(e), 7511(e)*]. However, specified statutory approvals, other than unanimous approval, are valid only if the general nature of the approved proposal was stated in the notice of meeting or in any written waiver of notice [*Corp. Code §§ 5511(f), 7511(f)*; *see Corp. Code §§ 5222, 5224, 5812, 6610* (public benefit corporations); *see also Corp. Code §§ 7222, 7224, 7233, 7812, 8610, 8719* (mutual benefit corporations)].

Attendance of a person at a meeting constitutes a waiver of notice of and presence at the meeting, except when the person objects, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called. However, attendance at a meeting is not a waiver of any right to object to consideration of the matters required to be included in the notice but not so included, if that objection is expressly made at the meeting [*Corp. Code §§ 5511(e), 7511(e)*].

[l] Appointment of Inspectors of Election

In advance of any meeting of members, the board may appoint inspectors of election to act at the meeting and any adjournment of the meeting. If inspectors are not appointed, or if the appointed persons fail to appear or refuse to act, the chair of any meeting of members may, and on the request of any member or member's proxy must, appoint inspectors of election (or replacements) at the meeting [*Corp. Code §§ 5615(a), 7614(a)*].

The number of inspectors must be either one or three. If appointed at a meeting on the request of one or more members or proxies, the majority of members represented in person or by proxy must determine whether one or three inspectors are to be appointed [*Corp. Code §§ 5615(a), 7614(a)*]. If there are three inspectors, the decision, act, or certificate of a majority of inspectors is the decision, act, or certificate of all [*Corp. Code §§ 5615(c), 7614(c)*].

In any action by written ballot [*see* [4][a], *below*], the board may similarly appoint inspectors of election [*Corp. Code §§ 5615(a), 7614(a)*].

[m] Duties of Inspectors of Election

The inspectors of election must determine the number of memberships outstanding and the voting power of each; the number represented at the meeting; the existence of a quorum; and the authenticity, validity, and effect of proxies. They must receive votes, ballots, or consents; hear and determine all challenges and questions in any way arising in connection with the right to vote; and count and tabulate all votes and consents. Finally, the inspectors must properly conduct the election or vote with fairness to all members, and determine when the polls close and the election result [*Corp. Code §§ 5615(b), 7614(b)*]. The inspectors must perform their duties impartially, in good faith, to the best of

their ability and as expeditiously as is practical. Any report or certificate made by the inspectors constitutes prima facie evidence of the facts stated [*Corp. Code §§ 5615(c), 7614(c)*].

[3] Meeting Requirements for Religious Corporations

[a] Meetings in Accordance With Bylaws

The bylaws or articles may provide any reasonable method of calling, noticing, and holding regular or special meetings or obtaining approvals [*Corp. Code § 9410(a)*]. However, the articles or bylaws may not vary the provisions of *Corp. Code § 9411(e)* (notice contents), *Corp. Code § 9417(e)* (proxy notice contents), or *Corp. Code § 9418* (suit to determine validity of directorship).

[b] Meetings by Electronic Transmission

A meeting of the members may be conducted, in whole or in part, by electronic transmission by and to the corporation or by electronic video screen communication if [*Corp. Code § 9411(f)*]:

- The corporation implements reasonable measures to provide members a reasonable opportunity to participate in person (or, if proxies are allowed, by proxy) in the meeting and to vote on matters submitted to the members, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with those proceedings; and

- The corporation maintains a record of any member's vote or other action made or taken by means of electronic transmission to the corporation or electronic video screen communication.

Members not physically present in person (or, if proxies are allowed, by proxy) at a meeting of the members may participate and vote at the meeting by electronic transmission by and to the corporation or by electronic video screen communication unless prohibited by the bylaws of the corporation provided that the board of directors has authorized electronic participation. The board has sole discretion to authorize electronic participation and adopt guidelines and procedures, subject to the requirement of obtaining the members' consent. A member will be deemed present in person or by proxy whether the meeting is held at a designated place or in whole or in part by means of electronic transmission by and to the corporation or by electronic video screen communication [*Corp. Code § 9411(a)*; *see Corp. Code §§ 20, 21*].

Any request by a corporation to a member for consent to conduct a meeting of the members by electronic transmission by and to the corporation must include a notice that absent consent of the member, the meeting will be held at a physical location in accordance with statute [*Corp. Code § 9411(f)*; *see Corp. Code § 20(b)*].

[c] Special Meetings

Special meetings of members for any lawful purpose may be called by the board, the board chair, or the president. In addition, special meetings of members for any lawful purpose may be called by 5 percent or more of the members [*Corp. Code § 9411(b)*].

On written request to the board chair, president, vice-president, or secretary by any person (other than the board) entitled to call a special meeting of members, the board must expeditiously set a reasonable time and place for the meeting and the officer must cause notice to be given to the members entitled to vote of the time and place of the meeting. If the notice is not given within 20 days after receipt of the request, the persons entitled to call the meeting may give the notice or the superior court of the proper county must summarily order the giving of the notice, after notice to the corporation giving it an opportunity to be heard. The court may issue any appropriate orders, including, without limitation, orders designating the time and place of the meeting, the record date for determination of members

entitled to vote and the form of notice [*Corp. Code § 9411(c)*].

[d] Quorum Requirements

One third of the voting power represented in person or by proxy constitutes a quorum at a meeting of the members. If a quorum is present, the affirmative vote of the majority of the voting power represented at the meeting, entitled to vote, and voting on any matter is the act of the members, unless the vote of a greater number or voting by classes is required by law or the articles or bylaws [*Corp. Code § 9412(a)*]. The term "voting power" means the power to vote for the election of directors at the time any determination of voting power is made. It does not include the right to vote on the happening of some condition or event that has not yet occurred. In any case in which different classes of memberships are entitled to vote as separate classes for different members of the board, the determination of percentage of voting power is made on the basis of the percentage of the total number of authorized directors that the memberships in question (whether of one or more classes) have the power to elect in an election at which all memberships then entitled to vote for the election of any directors are voted [*Corp. Code § 5078*].

The members present at a duly called or held meeting at which a quorum is present may continue to transact business until adjournment, notwithstanding the withdrawal of enough members to leave less than a quorum, if any action taken (other than adjournment) is approved by at least a majority of the members required to constitute a quorum or by the vote of any greater number or voting by classes required by law, the articles, or the bylaws [*Corp. Code § 9412(b)*]. Absent a quorum, any meeting may be adjourned from time to time by the vote of a majority of the votes represented either in person or by proxy and no other business may be transacted subject to the above-mentioned requirement [*Corp. Code § 9412(c)*].

[e] Waiver of Notice

The transactions of any meeting of the members, however called or noticed, and wherever held, are as valid as if effected at a meeting duly held after regular call and notice, if a quorum is present either in person or by proxy, and if, either before or after the meeting, each of the persons entitled to vote, not present in person or by proxy, signs a written waiver of notice, a consent to the holding of the meeting, or an approval of the minutes of the meeting. All waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meeting [*Corp. Code § 9411(d)*].

In general, neither the business to be transacted at nor the purpose of any regular or special meeting of members need be specified in any written waiver of notice, consent to the holding of the meeting, or approval of the minutes [*see Corp. Code § 9411(d)*]. However, specified statutory approvals, other than unanimous approval, are valid only if the general nature of the approved proposal was stated in the notice of meeting or in any written waiver of notice [*Corp. Code § 9411(e)*; *see Corp. Code §§ 9150(b), 9222, 9631(a), 9640(c), 9680(b)*; *see also Corp. Code §§ 5812, 6015(a)* (made applicable by *Corp. Code §§ 9620, 9640*)].

A person's attendance at a meeting constitutes a waiver of notice of and presence at the meeting, except when the person objects, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called. However, attendance at a meeting is not a waiver of any right to object to consideration of the matters required to be included in the notice but not so included, if that objection is expressly made at the meeting [*Corp. Code § 9411(d)*].

[4] Action Without Meeting

[a] Public Benefit and Mutual Benefit Corporations

For the most part, any action that may be taken at any regular or special meeting of members may be taken without a meeting if the corporation distributes a written ballot to every member entitled to vote on the matter unless prohibited in the articles or bylaws. Further, unless otherwise provided by the articles or bylaws, and if approved by the board of

directors, the annual report and any accompanying materials may be sent by electronic transmission by the corporation and responses may be returned by electronic transmission to the corporation [*Corp. Code §§ 5513(a), 7513(a)*; *see Corp. Code §§ 20, 21*]. The ballot must set forth the proposed action, provide an opportunity to specify approval or disapproval of any proposal, and provide a reasonable time within which to return the ballot to the corporation [*Corp. Code §§ 5513(a), 7513(a)*]. However, the election of directors by written ballot may not be authorized if the directors are elected by cumulative voting [*Corp. Code §§ 5513(e), 7513(e)*; *see Corp. Code §§ 5616, 7615* (cumulative voting)]. Unless otherwise provided in the articles or bylaws, a written ballot may not be revoked [*Corp. Code §§ 5513(d), 7513(d)*].

Ballots must be solicited in a manner consistent with the requirements applicable to notice of members' meetings and proxy requirements [*Corp. Code §§ 5513(c), 7513(c)*; *see Corp. Code §§ 5511(b), 5514, 7511(b), 7514*; *see also* [2], *above*]. All ballot solicitations must indicate the number of responses needed to meet the quorum requirement and, with respect to ballots other than for the election of directors, must state the percentage of approvals necessary to pass the measure submitted. The solicitation must also specify the time by which the ballot must be received in order to be counted [*Corp. Code §§ 5513(c), 7513(c)*].

Directors may be elected by written ballot, if authorized by the articles or bylaws, unless the directors are elected by cumulative voting [*Corp. Code §§ 5513(e), 7513(e)*]. When directors are to be elected by written ballot and the articles or bylaws prescribe a nomination procedure, the procedure may provide for a date for the close of nominations before the printing and distributing of the written ballots [*Corp. Code §§ 5513(f), 7513(f)*].

Approval by written ballot pursuant is valid only when the number of votes cast by ballot within the specified time period equals or exceeds the quorum required to be present at a meeting authorizing the action, and the number of approvals equals or exceeds the number of votes that would be required to approve at a meeting at which the total number of votes cast was the same as the number of votes cast by ballot [*Corp. Code §§ 5513(b), 7513(b)*].

[b] Religious Corporations

In general, any action that may be taken at any regular or special meeting of members may be taken without a meeting if (1) the written ballot of every member is solicited, (2) the requisite number of signed approvals, setting forth the actions taken, is received; and (3) the approval requirements are met [*Corp. Code § 9413(a), (c)*]. Unless otherwise provided by the articles or bylaws, and if approved by the board of directors, that ballot and any related material may be sent by electronic transmission by the corporation [*see Corp. Code § 20*] and responses may be returned to the corporation by electronic transmission to the corporation [*Corp. Code § 9413(a)*; *see Corp. Code § 21*]. All solicitations of ballots must indicate the time by which the ballot must be returned to the corporation to be counted [*Corp. Code § 9413(b)*]. A written ballot may not be revoked [*Corp. Code § 9413(d)*].

Approval by written ballot pursuant is valid only when the number of ballots cast on or before the specified date on which the ballot must be returned for counting equals or exceeds the quorum required to be present at a meeting authorizing the action, and the number of approvals equals or exceeds the number of votes that would be required to approve at a meeting at which the total number of votes cast was the same as the number of votes cast by ballot [*Corp. Code § 9413(b)*].

Directors may be elected by written ballot, if authorized by the articles or bylaws, unless the directors are elected by cumulative voting [*Corp. Code § 9413(e)*; *see Corp. Code § 9415*; *see also* [6][c], *below*].

[5] Voting Requirements for Public Benefit and Mutual Benefit Corporations

[a] One-Vote Rule

In general, each member of a public benefit or mutual benefit corporation is entitled to only one vote on each matter submitted to a vote of the members. This rule is subject to the exceptions of cumulative voting and contrary provisions in the articles or the bylaws of the corporation [*Corp. Code §§ 5610, 7610*; *see Corp. Code §§ 5615, 7615*].

Single memberships in which two or more persons have an indivisible interest, including memberships standing in the names of two or more persons, are bound by the vote of one member, if only one member votes, or the act of the majority of members, if more than one member votes [*Corp. Code §§ 5610, 5612, 7610, 7612*]. This rule applies unless the secretary of the corporation is given written notice to the contrary and is furnished with a copy of the instrument or order appointing the members or creating the relationship wherein it is so provided [*Corp. Code §§ 5610, 5612, 7610, 7612*].

[b] Record Date for Entitlement to Vote

The bylaws may provide or, if there is no provision in the bylaws, the board may fix, in advance, a date as the record date for the purpose of determining the members entitled to vote at a meeting of members. This record date may not be more than 60 days before the date of the meeting. The record date also applies in the case of an adjournment of the meeting unless the board fixes a new record date for the adjourned meeting. If no record date is fixed, members on the day of the meeting who are otherwise eligible to vote are entitled to vote at the meeting of members or, in the case of an adjourned meeting, members on the day of the adjourned meeting who are otherwise eligible to vote are entitled to vote at the adjourned meeting of members [*Corp. Code §§ 5611(b), 7611(b)*].

[c] Record Date for Entitlement to Cast Ballots

The bylaws may provide or, if there is no provision in the bylaws, the board may fix, in advance, a date as the record date for the purpose of determining the members entitled to cast written ballots. This record date may not be more than 60 days before the day on which the first written ballot is mailed or solicited. If no record date is fixed, members on the day the first written ballot is mailed or solicited who are otherwise eligible to vote are entitled to case written ballots [*Corp. Code §§ 5611(c), 7611(c)*].

[d] Record Date for Other Lawful Actions

The bylaws may provide or, if there is no provision in the bylaws, the board may fix, in advance, a date as the record date for the purpose of determining the members entitled to exercise any rights in respect to any other lawful action. This record date may not be more than 60 days before the action. If no record date is fixed, members at the close of business on the day on which the board adopts the resolution relating to the action, or the sixtieth day before the date of that other action, whichever is later, are entitled to exercise their rights [*Corp. Code §§ 5611(d), 7611(d)*].

[e] Use of Proxies

Members may authorize another person or persons to act by proxy with respect to their membership, except that this right may be limited or withdrawn by the articles or bylaws [*Corp. Code §§ 5613(a), 7613(a)*; *see Corp. Code §§ 5613(e), 7613(f)*]. Any proxy purported to be executed in accordance with the provisions of the Nonprofit Corporation Law is presumptively valid [*Corp. Code §§ 5613(a), 7613(a)*].

A proxy is invalid after the expiration of 11 months from its issuance date unless otherwise provided in the proxy, except that the maximum term of any proxy is three years from the date of execution. Every proxy continues in full force and effect until revoked by the person executing it before the relevant vote. Revocation may be effected by a writing delivered to the corporation stating that the proxy is revoked, or by a subsequent proxy executed by the person executing the prior proxy and presented to the meeting, or as to any meeting by attendance at that meeting and voting in person by the person executing the proxy. The dates contained on the proxy forms presumptively determine the order of execution, regardless of the postmark dates on the envelopes in which they are mailed [*Corp. Code §§ 5613(b), 7613(b)*

].

A proxy is not revoked by the death or incapacity of the maker, or the termination of a membership as a result of death or incapacity, unless written notice of death or incapacity is received by the corporation before the vote is counted [*Corp. Code §§ 5613(c), 7613(c)*].

The proxy of a public benefit corporation member may not be irrevocable [*Corp. Code § 5613(d)*]. In contrast, a mutual benefit corporation member's proxy that states that is irrevocable for a specified period is irrevocable for that period (notwithstanding the three-year and death or incapacity rules), unless otherwise provided in the articles or bylaws, provided that the proxy is held by a statutorily specified person or nominee [*see Corp. Code § 7613(d)* (limits on irrevocability)]. Nevertheless, the proxy may be revoked by a transferee of a membership without knowledge of the existence of irrevocability provision, unless the existence of the proxy and its irrevocability appears on the membership certificate [*Corp. Code § 7613(e)*].

No amendment of the articles or bylaws repealing, restricting, creating or expanding proxy rights may be adopted without approval by the members [*Corp. Code §§ 5613(e), 7613(f)(1)*]. Furthermore, an amendment of the articles or bylaws of a mutual benefit corporation that restricts or limits the use of proxies does not affect the validity of a previously issued irrevocable proxy during the term of its irrevocability as long as the proxy complied with any applicable provisions of the articles or bylaws at the time of issuance and the proxy is otherwise valid under *Corp. Code § 7613* [*Corp. Code § 7613(f)(2)*].

Anything to the contrary notwithstanding, any proxy covering matters requiring a vote of the members pursuant to specified statutes is not valid as to those matters unless the proxy sets forth the general nature of the matter to be voted on [*Corp. Code §§ 5613(f), 7613(g)*]. Further, any public benefit corporation proxy relating to the election of directors [*see Corp. Code § 5220*] is not valid unless the proxy lists the nominees as of the time that the notice of the vote is given to members [*Corp. Code § 5613(f)*].

[f] Cumulative Voting

Every member entitled to vote an election of directors may cumulate the member's votes provided that the articles or bylaws authorize cumulative voting. Cumulative voting allows a member to give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which the member is entitled, or to distribute the member's votes on the same principle among as many candidates as the member thinks fit [*Corp. Code § 5616(a), 7615(a)*]. If applicable, a public benefit or mutual benefit corporation can only amend or repeal the article or bylaw provision authorizing cumulative voting only by approval of the members [*Corp. Code § 5034*]. The governing article or bylaw provision may require the vote of a greater proportion of the members, or of the members of any class, for its repeal [*Corp. Code § 5616(a), 7615(a)*].

No member may cumulate votes for a candidate or candidates unless the candidate's name or candidates' names were placed in nomination before the voting *and* at least one member gave notice at the meeting before the voting of the member's intention to cumulate votes [*Corp. Code § 5616(b), 7615(b)*].

Any form of proxy or written ballot distributed to 10 or more members of a corporation with 100 or more members must afford an opportunity on the proxy or form of written ballot to specify a choice between approval and disapproval of each matter or group of related matters intended, at the time the written ballot or proxy is distributed, to be acted on at the meeting for which the proxy is solicited or by written ballot. The proxy or ballot must also provide, subject to reasonable specified conditions, that when the person solicited specifies a choice, the vote must be cast in accordance with the choice [*Corp. Code §§ 5514(a), 7514(a)*]. Further, in any election of directors, any form of proxy or written ballot in which the directors to be voted on are named as candidates and that is marked by a member "withhold" or otherwise marked in a manner indicating that the authority to vote for the election of directors is withheld must not be

voted either for or against the election of the director [*Corp. Code §§ 5514(b), 7514(a)*]. The failure to comply with either of these two rules may be the basis for an action to challenge a proxy at a meeting or a written ballot, but does not invalidate any corporate action taken [*Corp. Code §§ 5514(c), 7514(c)*].

[6] Voting Requirements for Religious Corporations

[a] Written Consent

Any action required or permitted to be taken by the members of a religious corporation may be taken without a meeting, if all members individually or collectively consent in writing to the action [*Corp. Code § 9420*]. The written consent or consents must be filed with the minutes of the proceedings of the members. Action by written consent has the same force and effect as the unanimous vote of the members [*Corp. Code § 9420*].

[b] Use of Proxies

Members may authorize another person or persons to act by proxy with respect to their membership, except that this right may be limited or withdrawn by the articles or bylaws. Any proxy purported to be executed in accordance with the provisions of the Nonprofit Religious Corporation Law is presumptively valid [*Corp. Code § 9417*].

A proxy is invalid after the expiration of 11 months from its issuance date unless otherwise provided in the proxy. The maximum term of any proxy is three years from the date of execution. Every proxy continues in full force and effect until revoked by the person executing it before the relevant vote. Revocation may be effected by a writing delivered to the corporation stating that the proxy is revoked, or by a subsequent proxy executed by the person executing the prior proxy and presented to the meeting, or as to any meeting by attendance at that meeting and voting in person by the person executing the proxy [*Corp. Code § 9417(b)*].

The proxy of a religious corporation member may not be irrevocable [*Corp. Code § 9417(d)*]. A proxy is not revoked by the death or incapacity of the maker, or the termination of a membership as a result of death or incapacity, unless written notice of death or incapacity is received by the corporation before the vote is counted [*Corp. Code § 9417(c)*].

Anything to the contrary notwithstanding, any proxy covering matters requiring a vote of the members pursuant to specified statutes is not valid as to those matters unless the proxy sets forth the general nature of the matter to be voted on [*Corp. Code § 9417(e)*; *see Corp. Code §§ 9631(a), 9640(c), 9680(b)*; *see also Corp. Code §§ 5812, 6015(a)* (made applicable by *Corp. Code §§ 9620, 9640*)].

[c] Cumulative Voting

Every member of a religious corporation entitled to vote an election of directors may cumulate the member's votes provided that the articles or bylaws authorize cumulative voting. Cumulative voting allows a member to give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which the member is entitled, or to distribute the member's votes on the same principle among as many candidates as the member thinks fit [*Corp. Code § 9415(a)*]. No member may cumulate votes for a candidate or candidates unless the candidate's name or candidates' names were placed in nomination before the voting *and* at least one member gave notice at the meeting before the voting of the member's intention to cumulate votes [*Corp. Code § 9415(b)*].

[7] Good Faith Acceptance or Rejection of Ballots, Consents, Waivers, and Proxies

If the name signed on a ballot, consent, waiver, or proxy appointment, corresponds to the name of a member, the corporation may, if acting in good faith, accept the ballot, consent, waiver, or proxy appointment and give it effect as the act of the member [*Corp. Code §§ 5517(a), 7517(a), 9421(a)*].

When the name signed on a ballot, consent, waiver, or proxy appointment does not correspond to the record name of a member, the corporation, acting in good faith, is nevertheless entitled to accept the ballot, consent, waiver, or proxy appointment and give it effect as the act of the member if any of the following occur [*Corp. Code §§ 5517(b), 7517(b), 9421(b)*]:

- The member is an entity and the name signed purports to be that of an officer or agent of the entity.

- The name signed purports to be that of an attorney-in-fact of the member and, if the corporation requests, evidence acceptable to the corporation of the signatory's authority to sign for the member has been presented with respect to the ballot, consent, waiver, or proxy appointment.

- Two or more persons hold the membership as cotenants or fiduciaries and the name signed purports to be the name of at least one of the coholders and the person signing appears to be acting on behalf of all the coholders. A mutual benefit corporation, acting in good faith, may accept and effectuate a ballot, consent, waiver, or proxy appointment if the signed name purports to be that of an administrator, executor, guardian, conservator, receiver, or trustee representing the members and, on the corporation's request, if acceptable evidence of that status is presented to the corporation [*Corp. Code § 7517(b)(4), (5)*].

The corporation may reject a ballot, consent, waiver, or proxy appointment if the secretary or other officer or agent authorized to tabulate votes, acting in good faith, has a reasonable basis for doubt concerning the validity of the signature or the signatory's authority to sign for the member [*Corp. Code §§ 5517(c), 7517(c), 9421(c)*]. The corporation and the officer or agent accepting or rejecting a ballot, consent, waiver, or proxy appointment in good faith and in accordance with these standards are not liable in damages to the member for the consequences of the acceptance or rejection [*Corp. Code §§ 5517(d), 7517(d), 9421(d)*].

Corporate action based on the acceptance or rejection of a ballot, consent, waiver, or proxy appointment is valid unless a court of competent jurisdiction determines to the contrary [*Corp. Code §§ 5517(e), 7517(e), 9421(e)*].

[8] Termination of Membership in Public Benefit and Mutual Benefit Corporations

[a] Operation of Bylaws

A membership in a public benefit or mutual benefit corporation that is issued for a period of time expires when that period of time has elapsed unless the membership is renewed [*Corp. Code §§ 5340(c), 7340(c)*].

In addition, the bylaws may specifically provide for the termination of memberships. For example, the bylaws may provide that any membership terminates when the subject member fails to pay dues, assessments, or fees. Another example is a provision for membership termination on the attempted transfer of a membership for value. The drafting attorney may include other substantive grounds for termination; however, it should be kept in mind that the grounds must not violate contractual or other rights of the members.

Specific procedures, including notice and member approval, apply if a public benefit corporation wishes to amend its articles or bylaws to terminate all memberships [*Corp. Code § 5342*; *see* [e], *below*].

[b] Resignation

Resignation of a member as another cause of termination [see *Corp. Code §§ 5340(a), 7340(a)*]. A member may resign at any time [*Corp. Code §§ 5340(a), 7340(a)*]; however, a mutual benefit corporation may provide in its articles or bylaws that reasonable notice is required before the resignation is effective [*Corp. Code § 7340(a)*].

Although a corporation may levy dues, assessments, and fees on its members, a member may on learning of them avoid liability for them by promptly resigning from membership [*see Corp. Code §§ 5351, 7351*]. However, resignation does not relieve the resigning member from any obligation for charges incurred; services or benefits actually rendered; dues, assessments, or fees; or arising from contract or otherwise [*Corp. Code §§ 5340(b), 5351, 7340(b), 7351*]. The Nonprofit Mutual Benefit Corporation Law also expressly states that a resigning member will not be relieved of any condition to ownership of land or any obligation arising out of the ownership of land [*Corp. Code § 7340(b)*]. Furthermore, resignation does not diminish any right of the corporation to enforce any such obligation or to obtain damages for its breach [*Corp. Code §§ 5340(b), 7340(b)*].

[c] Death or Dissolution

Membership terminates and all rights of membership cease on the death or dissolution of the subject member [*Corp. Code §§ 5320(a)(2), 7320(a)(2)*]. However, the articles or bylaws of a mutual benefit corporation may provide for, or may authorize the board to provide for, the transfer of any memberships (or of memberships within any class or classes), with or without restriction or limitation, including transfer on the death, dissolution, merger, or reorganization of a member [*Corp. Code § 7320(b)*]. When transfer rights are provided, no applicable restriction is binding with respect to memberships issued before the adoption of the restriction unless of the holders of the memberships voted in favor of the restriction [*Corp. Code § 7320(c)*].

[d] Procedures for Expulsion, Suspension, or Termination

A member may not be suspended or expelled, and a membership or membership rights may not be terminated or suspended, unless the expulsion, suspension, or termination is consistent with and satisfies several procedures prescribed by statute [*see Corp. Code §§ 5341(a), (f), 7341(a), (f)*]. If the procedures are not satisfied, the expulsion, suspension, or termination is void and without effect [*Corp. Code §§ 5341(a), 7341(a)*].

Any expulsion, suspension, or termination must be done in good faith and in a fair and reasonable manner [*Corp. Code §§ 5341(b), 7341(b)*; *see Corp. Code §§ 5341(c), 7341(c)* ("fair and reasonable manner" defined)], and all notices to members must be given by any method reasonably calculated to provide actual notice [*Corp. Code §§ 5341(d), 7341(d)*; *see Corp. Code §§ 5341(e), 7341(e)* (action alleging defective notice)]. A procedure is fair and reasonable when it does all of the following [*Corp. Code §§ 5341(c), 7341(c)*]:

- The provisions of the procedure are set forth in the articles or bylaws, or copies of those provisions are sent annually to all members as required by the articles or bylaws.

- The procedure provides the giving of 15 days prior notice and the reasons for the proposed action proposed.

- The procedure provides an opportunity for the member to be heard, orally or in writing, at least five days before the effective date of the expulsion, suspension, or termination, by a person or body authorized to decide that the proposed expulsion, suspension, or termination not take place.

A member who is expelled or suspended, or whose membership is terminated, remains liable for charges incurred; services or benefits actually rendered; dues, assessments, or fees incurred before the expulsion, suspension, or termination; or arising out of contract or otherwise [*Corp. Code §§ 5341(g), 7341(g)*].

Case law recognizes that membership is a valuable right that may not be terminated or otherwise interfered with contrary to the fundamental requirements of the law. Thus, a member is entitled to a full and fair hearing in accordance with the rules of the organization and the law. Moreover, each member is entitled to adequate notice, an adequate

opportunity to defend him or herself a properly constituted tribunal, and a decision based on the evidence presented [*see Cunningham v. Burbank Bd. of Realtors (1968) 262 Cal. App. 2d 211, 214, 68 Cal. Rptr. 653]* . The procedural requirements discussed above codify the safeguards expressed by the courts.

[e] Amending Articles or Bylaws to Terminate Membership

Specific rules apply to public benefit corporations when a corporation with members or classes of members seeks to amend its articles or bylaws to terminate either all memberships or classes of memberships [*see Corp. Code § 5342*]. The corporation must give written notice describing the effect of the amendment on the corporation and the members to members not less than 45 nor more than 90 days before the members vote. However, the corporation need not send this notice at least 45 days in advance if all members entitled to vote (1) receive a written notice before the vote, describing the effect of the amendment on the corporation and the members, and (2) sign a written waiver of the 45 days notice [*Corp. Code § 5342(b)*]. The amendment must be approved by the members [*Corp. Code §§ 5034, 5342(c)*].

The articles or bylaws may impose additional requirements governing the termination of memberships or any class of memberships [*Corp. Code § 5342(d)*]. On request of a member, the corporation must allow the member to inspect the corporation's membership records or obtain an alphabetical list of the names, addresses, and voting rights [*see Corp. Code § 6330(a)*], at the corporation's option, as soon as reasonably possible to permit the member to contact other members regarding the proposed change [*Corp. Code § 5342(e)*]. Any membership termination effectively terminates the members' rights as members [*Corp. Code § 5342(f)*; *see Corp. Code § 5056*].

The rules governing expulsion, suspension, and termination discussed in [d], *above*, do not apply to the termination of all memberships (or any class) pursuant to an amendment to the articles or bylaws [*Corp. Code § 5342(g)*].

[9] Termination of Membership in Religious Corporations

A member of a religious corporation may resign from membership at any time [*Corp. Code § 9340(a)*]. However, resignation does not relieve the resigning member from any obligation for charges incurred or services or benefits actually rendered; dues, assessments, or fees; or obligations arising from contract or otherwise. The corporation may enforce such an obligation or obtain damage for its breach [*Corp. Code § 9340(b)*].

All rights of membership cease on the member's death or dissolution unless the articles or bylaws provide to the contrary [*Corp. Code § 9320(b)*]. Further, a membership issued for a period of time expires when that period of time elapses unless the membership is renewed (or unless the member resigns, dies, or dissolves before that date) [*Corp. Code § 9340(c)*].

A membership may be terminated as provided in the articles or bylaws of the corporation [*Corp. Code § 9340(d)*].

[10] Membership Certificates for Mutual Benefit Corporations

[a] Issuance

A mutual benefit corporation may issue membership certificates, but is not required to do so [*Corp. Code § 7313(a)*]. A corporation may issue a new membership certificate or a new certificate for security in the place of any certificate previously issued by it, alleged to have been lost, stolen, or destroyed. The corporation may require the owner of the lost, stolen, or destroyed certificate, or the owner's legal representative, to give the corporation a bond (or other adequate security) sufficient to indemnify the corporation against any claim that may be made against it on account of the alleged loss, theft, or destruction of any certificate or the issuance of a new certificate [*Corp. Code § 7314(a)*].

If the articles or bylaws are amended so that any statement required by *Corp. Code § 7313(b)* [*see* [b], *below*] on outstanding membership certificates is no longer accurate, the board may cancel the outstanding certificates and issue in

their place new certificates conforming to the articles or bylaw amendments. The board may order holders of outstanding certificates to surrender and exchange them for new certificates within a reasonable time fixed by the board [*Corp. Code § 7313(d), (e)*].

[b] Contents

Each membership certificate must state on the certificate that the corporation is a nonprofit mutual benefit corporation that may not make distributions to its members except on dissolution, or, if the articles so provide, that it may not make distributions to its members during its life or on dissolution. When appropriate, the certificate must also include a statement that the corporation issued the whole or any part of its memberships as partly paid and subject to call for the remainder of the consideration to be paid [*Corp. Code § 7313(b)(1), (3)*].

If transfer of memberships is restricted, the certificate must also state that a copy of the restrictions are on file with the secretary of the corporation and that the copy is open for inspection by a member on the same basis as the records of the corporation [*Corp. Code § 7313(b)(2)*]. If the membership certificates are transferable only with the consent of the corporation, then instead of placing a statement of transferability restrictions on the certificate, the corporation must give notice to the transferee, within a reasonable time after the corporation is first notified of the proposed transfer, and before the membership is transferred on the books and records of the corporation, of the information concerning the transfer restrictions [*Corp. Code § 7313(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.34

§ 13.34 Recordkeeping Requirements

[1] Articles of Incorporation and Bylaws

Every nonprofit corporation must keep at its principal office in California the original or a copy of its articles of incorporation and bylaws as amended to date. These documents must be open to inspection by the members at all reasonable times during office hours. If the corporation does not have a principal office in California, on the written request of any member it must furnish to that member a copy of the articles or bylaws as amended to date [*Corp. Code §§ 5160, 7160, 9160*].

[2] Other Records

Every nonprofit corporation must keep [*Corp. Code §§ 6320(a), 8320(a), 9510(a)*]:

- Adequate and correct books and records of account;
- Minutes of the proceedings of its members, board, and board committees; and
- A record of its members with their names, addresses, and the class of membership held by each.

These minutes and other books and records must be kept in written form, in any other form capable of being converted into clearly legible tangible form, or in any combination of the two. When minutes and other books and records are kept in a form capable of being converted into clearly legible paper form, the clearly legible paper form into which those minutes and other books and records are converted will be admissible in evidence, and accepted for all other purposes, to the same extent as an original paper record of the same information would have been, provided that the paper form accurately portrays the record [*Corp. Code §§ 6320(a), 8320(a), 9510(a)*].

PRACTICE TIP:

Counsel should advise nonprofits of the importance of complying with corporate record requirements. Nonprofits may consider the technicalities of corporate formalities and governance of less import than

the charitable purposes of the corporation.

Legal Topics:

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.35

§ 13.35 Compliance With Rights of Inspection

[1] Public Benefit and Mutual Benefit Corporations

[a] In General

Inspection rights can be exercised in person or by an agent or attorney, and include the right to copy and make extracts [*Corp. Code §§ 6311, 8311*]. Any right of inspection extends to the subsidiary of a corporation [*Corp. Code §§ 6312, 8312*]. The inspection rights of members may not be limited by contract, the articles of incorporation, or the bylaws [*Corp. Code §§ 6313, 8312*].

If a public benefit or mutual benefit corporation does not maintain any records subject to inspection, including membership lists, in written form, the corporation must make those records available in written form, at its own expense, before complying with a request for inspection [*Corp. Code §§ 6310, 8310*]. The terms "written" or "in writing" includes electronic means of communication [*Corp. Code §§ 6310, 8310*].

[b] Directors' Inspection Rights

Every director of a public benefit or mutual benefit corporation has the absolute right exercisable at any reasonable time to inspect and copy all books, records, and documents of every kind and to inspect the physical properties of the corporation of which that person is a director [*Corp. Code §§ 6334, 8334*].

[c] Members' Inspection Rights

The members of every public benefit or mutual benefit corporation have statutory rights of inspection with respect to the articles and bylaws of the corporation [*Corp. Code §§ 5160, 7160*]. Further, the accounting books and records and minutes of proceedings of members and the board and committees of the board must be open to inspection on the written demand on the corporation of any member at any reasonable time, for any purpose reasonably related to that person's interest as a member [*Corp. Code §§ 6333, 8333*].

Subject to the corporation's right to set aside the demand [*see Corp. Code §§ 6331, 8331*] and the power of the court to limit inspection rights of members [*see Corp. Code §§ 6332, 8332*], and unless the corporation offers a reasonable alternative [*see Corp. Code §§ 6330, 8330*; *see below*], a member may do either one or both of the following as permitted by *Corp. Code §§ 6330(b)* and *8330(b)* [*Corp. Code §§ 6330(a), 8330(a)*]:

- Inspect and copy the record of all members' names, addresses, and voting rights, at reasonable times, on five business days prior written demand on the corporation; the demand must state the purpose for which the inspection rights are requested.

- Obtain from the secretary of the corporation, on written demand and tender of a reasonable charge, a list of the names, addresses, and voting rights of those members entitled to vote for the election of directors, as of the most recent record date for which it has been compiled or as of a date specified by the member subsequent to the date of demand. The demand must state the purpose for which the list is requested. The list of members must be alphabetical and be made available on or before the later of 10 business days after the demand is received or after the date specified therein as the date as of which the list is to be compiled.

These rights may be exercised by any member, for a purpose reasonably related to that person's interest as a member, or the authorized number of members for a purpose reasonably related to the members' interest as members. In the case of a demand by a member, the corporation may deny the member access to the list if the corporation reasonably believes that the information will be used for another purpose, or the corporation provides a reasonable alternative [*Corp. Code §§ 6330(b), 8330(b)*; *see below*]. In any enforcement action, a court will enforce these rights unless the corporation proves that (1) the member will allow the use of the information for purposes unrelated to that person's interest as a member, or (2) the proposed alternative method reasonable achieves the proper purpose set forth in the demand [*Corp. Code §§ 6330(b)(1), 8330(b)(1)*].

Although the inspection rights of members cannot be limited by contract or the articles or bylaws [*Corp. Code §§ 6313, 8313*], the Nonprofit Corporation Law sets forth two limitations based on judicial action [*see Corp. Code §§ 6331, 6332, 8331, 8332*]. First, if the corporation, in good faith and with substantial basis, believes that the membership list demanded by the authorized number of members will be used for a purpose not reasonably related to the interests of members, or provides a reasonable alternative, the corporation may petition the superior court for an order setting aside the demand. The petition must be filed within 10 business days after the later of the date that the demand was made, or that a written rejection of the proposed alternative was received [*Corp. Code §§ 6331(a), (b), 8331(a), (b)*; *see Corp. Code §§ 6331(c), 8331(c)* (extension)]. Second, on petition of the corporation or any member, the superior court may limit or restrict the statutory inspection rights if, and only if, that limitation or restriction is necessary to protect the rights of any member under the Constitution of the United States or the Constitution of the State of California [*Corp. Code §§ 6332, 8332*].

Within 10 business days after receiving a member's inspection demand, the corporation may deliver to the person(s) making the demand a written offer of an alternative method of achieving the purpose identified in the demand without providing access to or a copy of the membership list. An alternative method that reasonably and in a timely manner accomplishes the proper purpose set forth in a demand will be deemed a reasonable alternative, unless the corporation fails to effect that alternative method within a reasonable time after acceptance of the offer. Any rejection of the offer must be in writing and must indicate the reasons the alternative proposed by the corporation does not meet the proper purpose of the demand [*Corp. Code §§ 6330(c), 8330(c)*].

[2] Religious Corporations

[a] Directors' Inspection Rights

Every director of a religious corporation is entitled, at any reasonable time, to inspect and copy all books, records, and documents of every kind and to inspect the physical properties of the corporation of which that person is a director. However, this right is limited to purposes reasonably related to that person's interests as a director [*Corp. Code § 9513*].

[b] Members' Inspection Rights

The members of every religious corporation have statutory rights of inspection with respect to the articles and bylaws of the corporation [*Corp. Code § 9160*]. Except as otherwise provided in the articles or bylaws, a member may inspect and copy the record of all the members' names, addresses, and voting rights, at reasonable times, on five business days prior written demand on the corporation for a purpose reasonably related to the member's interest as a member [*Corp. Code § 9511*]. Unless otherwise specified in the articles or bylaws, the accounting books and records and the minutes of proceedings of the members, the board, and board committees must be open to inspection on the written demand on the corporation of any member at any reasonable time, for a purpose reasonably related to the member's interests as a member [*Corp. Code § 9512*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.36

§ 13.36 Reporting Requirements

PRACTICE TIP:
Counsel should advise nonprofits of the importance of complying with corporate reporting requirements. Nonprofits may consider the technicalities of corporate formalities and governance of less import than the charitable purposes of the corporation.

[1] Annual Reports to Members and Directors

[a] Public Benefit Corporations

In general, public benefit corporations must prepare and deliver annual reports to members and directors within 120 days after close of corporation's fiscal year [*see Corp. Code § 6321(a)*; *see also § 13.142*, P 9]. However, no annual report is required if the corporation receives less than $25,000 in gross revenues or receipts during the fiscal year [*Corp. Code § 6321(c)*]. Further, if the corporation provides for regular meetings of members less often than annually, then the report need be made to members only with the frequency of the regular membership meetings unless the articles or bylaws require a report more often [*Corp. Code § 6321(d)*]. Nevertheless, a report containing the required information must be furnished annually to all directors and any member who so request in writing [*Corp. Code § 6321(e)*].

A corporation that solicits contributions in writing from 500 or more persons is also exempt from the annual reporting requirement under specified circumstances [*see Corp. Code § 6321(f)*]. If the corporation reports to the Attorney General [*see* [3][a], *below*], and the report contains the information required by the annual report, the corporation may furnish a copy of that report in lieu of the annual report [*Corp. Code § 6324*].

The annual report must be accompanied by any report of independent accountants, or, absent a report, the certificate of an authorized officer of the corporation to the effect that the statements in the report were prepared without audit from the books and records of the corporation [*Corp. Code § 6321(b)*].

Unless otherwise provided by the articles or bylaws, and if approved by the board of directors, the annual report and any accompanying material may be sent by electronic transmission by the corporation [*Corp. Code § 6321(a)*; *see Corp.*

Code § 20].

[b] Mutual Benefit Corporations

In general, mutual benefit corporations must prepare and deliver annual reports to members and directors within 120 days after close of corporation's fiscal year [*see Corp. Code § 8321(a)*; *see also § 13.142*, P 10]. However, no annual report need be sent if the corporation receives less than $10,000 in gross revenues or receipts during the fiscal year [*Corp. Code § 8321(c)*]. The annual report must be accompanied by any report of independent accountants, or, absent a report, the certificate of an authorized officer of the corporation to the effect that the statements in the report were prepared without audit from the books and records of the corporation [*Corp. Code § 8321(b)*].

Unless otherwise provided by the articles or bylaws, and if approved by the board of directors, the annual report and any accompanying material may be sent by electronic transmission by the corporation [*Corp. Code § 8321(a)*; *see Corp. Code § 20*].

[c] Religious Corporations

Religious corporations need not prepare and deliver annual reports to members and directors unless the articles or bylaws impose such a requirement. The Nonprofit Religious Corporation Law does not independently require annual reports. However, unless otherwise provided in the articles or bylaws, a member may inspect and copy the record of all the members' names, addresses, and voting rights, at reasonable times, on five business days prior written demand for a purpose reasonably related to the member's interest as a member [*Corp. Code § 9511*]. Similarly, unless otherwise provided in the articles or bylaws, the accounting books and records and the minutes of proceedings of the members, board, and board committees must be open to inspection on the written demand of any member at any reasonable time, for a purpose reasonably related to such person's interests as a member [*Corp. Code § 9512*]. Further, directors may, at any reasonable time, inspect and copy all books, records, and documents of every kind and to inspect the physical properties of the corporation for a purpose reasonably related to that person's interests as a director [*Corp. Code § 9513*].

[2] Biennial Statement of Information With Secretary of State

Every public benefit, mutual benefit, and religious corporation must file a biennial statement of information with the Secretary of State on Form SI 100 [*Corp. Code §§ 6210, 8210, 9660(a)*; *see § 13.248*]. If the corporation does not file the statement, the Secretary of State will mail a notice of delinquency. If the corporation fails to file within 60 days after that mailing date, the corporation will be assessed a nominal penalty [*Corp. Code §§ 6810, 8810, 9690*]. If the corporation fails to file for 24 months and been assessed a penalty in the preceding year, the corporation may be suspended [*Corp. Code § 5008.6*; *see Rev. & Tax. Code §§ 23301, 23305a, 23775*].

[3] Reports With Registrar of Charitable Trusts in Office of Attorney General

[a] Charitable Corporations Subject to Filing Requirements

In general, every charitable corporation and trustee subject to the Supervision of Trustees and Fundraisers for Charitable Purposes Act [*see Gov. Code § 12580 et seq.*] must file with the Registrar of Charitable Trusts in the office of the Attorney General periodic written reports, under oath, setting forth information as to the nature of the assets held for charitable purposes and the administration of those assets by the corporation or trustee [*Gov. Code § 12586(a)*; *11 Cal. Code Reg. § 301*]. Specifically, the following corporations must file Form RRF-1 [*see 11 Cal. Code Reg. § 303*]:

- Domestic nonprofit corporation formed for charitable or eleemosynary purposes [*Gov. Code § 12582.1*].

- Foreign nonprofit corporation doing business or holding property in California for charitable or eleemosynary purposes [*Gov. Code § 12582.1*].

- Corporations holding property for charitable purpose [*Gov. Code § 12581*].

- Commercial fundraisers for charitable purposes [*Gov. Code § 12581, 12599*].

[b] Entities Exempt From Filing Requirements

The following are exempt from these filing, registration, and reporting provisions [*Gov. Code § 12583*]:

- The United States, any state, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any agency or governmental subdivisions.

- Any religious corporation sole or other religious corporation or organization that holds property for religious purposes.

- Regulated cemetery corporations [*see Bus. & Prof. Code § 9600 et seq.*].

- Specified political action committees [*see Gov. Code §§ 82013, 84200 et seq.*].

- Charitable corporations or unincorporated associations organized and operated primarily as a religious organization, educational institution, hospital, or a health care service plan licensed pursuant to *Health & Safety Code § 1349*.

[c] Filing Requirements

Every charitable corporation, unincorporated association, and trustee that has received property for charitable purposes must file with the Attorney General an initial registration form, under oath [*see* Gov. Code § 12585(b) (Attorney General will adopt rules and regulations regarding contents, execution, and filing requirements for form)], within 30 days of receiving property. A trustee is not required to register as long as the charitable interest is a future interest, but must do so within 30 days after any charitable interest in a trust becomes a present interest [*Gov. Code § 12585(a)*; *see Gov. Code § 12593*]. Form RRF-1 must be filed with the Registry of Charitable Trusts annually on or before January 15 [*see* Form RRF-1; *see Gov. Code § 12586(d)*; *see also 11 Cal. Code Reg. § 305* (extension for good cause)]. The organization must also file annually within four and one half months after the end of the corporation's fiscal year a copy of the organization's IRS Form 990, 990-EZ, or 990-PF.

Form RRF-1 seeks information about the financial transactions between the corporation and its directors or officers, whether any financial malfeasance occurred, whether funds were paid as penalties or fines, and information about fundraising activities [*see* IRS Form 4720].

The Attorney General, on written request, may suspend a corporation's reporting duties as to a particular charitable trust or relationship for a reasonable, specifically designated time. However, the Attorney General must first file in the register of charitable trusts a written statement that (1) the interests of the beneficiaries will not be prejudiced by the suspension and (2) periodic reports are not required for proper supervision by his or her office [*Gov. Code § 12586(b)*].

[d] Effect of Failure to File

If a corporation fails to comply with the filing requirement discussed in [c], *abov* e, the Attorney General typically advises the corporation of the default and provides an opportunity to file. The failure to file can result in the

disallowance of franchise tax exemption, after the Attorney General sends the Franchise Tax Board written notice [*Rev. & Tax. Code § 23703(a), (b)*]. The exemption may be reinstated, but the corporation will be liable for the minimum franchise tax for any year of disallowance [*Rev. & Tax. Code § 23703(c)*]. However, the individual responsible for the default is personally liable for the tax [*Rev. & Tax. Code § 23703(d)*].

The Attorney General may also institute proceedings to secure compliance with these rules and to invoke the jurisdiction of the court [*Gov. Code § 12591*; *see Gov. Code § 12596* (10-year statute of limitations)]. If the judgment is in favor of the state, the judgment must require the payment of the state's reasonable investigation and prosecution costs by the person who had the duty to report [*Gov. Code § 12597*].

[e] Public Inspection

Subject to reasonable rules and regulations adopted by the Attorney General, the register, copies of instruments, and the reports filed with the Attorney General will be held open to public inspection. However, the Attorney General must withhold from public inspection any instrument whose content is not exclusively for charitable purposes [*Gov. Code § 12590*].

[4] Additional Attorney General Filing Requirements for Public Benefit Corporations

Public benefit corporations must provide certain documents to the office of the California Attorney General. First, public benefit corporations must provide a copy of its articles of incorporation or certificate of amendment to the Attorney General. This filing is accomplished by providing an extra copy to the Secretary of State when the original document is filed [*Corp. Code §§ 5120, 5817*; *see Corp. Code § 5120(e)* (extra copy for Controller in certain circumstances)]. Second, the corporation must file a copy of any proposed merger agreement at least 20 days before the merger is consummated [*Corp. Code § 6010(b)*]. Third, unless the sale, lease, transfer, or other disposition of all or substantially all of the corporation's assets is in the usual or regular course of the corporation's activities, the corporation must furnish at least 20 days written notice unless the Attorney General waives notice [*see Corp. Code § 5913*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesTax LawState & Local TaxesFranchise TaxImposition of TaxTax LawState & Local TaxesFranchise TaxLimitations



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.37

§ 13.37 Insurance Considerations and Liability Issues

[1] Need for Insurance

Nonprofit corporations ordinarily need some level of insurance to protect against business risks in the marketplace. Nonprofit corporations are not exempted from these risks by their nonprofit status. The types and amounts of coverage needed will vary depending on the nature of the corporation's activities, size and nature of workforce, risk experience, and revenues. Most nonprofits need at least a commercial general liability policy [*see* [2][a], *below*] and insurance coverages for employees if the corporation will have employees [*see* [2][b], *below*]. Further, nonprofits should consider securing a directors' and officers' liability policy [*see* [2][d], *below*]. Finally, if warranted, nonprofits should consider obtaining professional liability insurance. Typically, claims related to the provision of professional services are excluded from the coverage of standard commercial general liability policies.

For further discussion, see Ch. 1F, *Insurance Considerations in Business Formation* , and California Insurance Law and Practice(Matthew Bender).

[2] Types of Insurance

[a] Commercial General Liability Policy

A commercial general liability (CGL) policy typically covers premises and operations liability: injuries such as libel, slander, trade libel, and false imprisonment, and medical payments incurred by third parties. CGL coverage is probably the most important insurance for nonprofits.

[b] Unemployment and Disability Insurance

Nonprofit corporations that are employers, and their employees, may be required to contribute to the state Unemployment Fund for wages paid for employment [*Unemp. Ins. Code §§ 976, 984*]. "Employment" includes service that is excluded from the Federal Unemployment Tax Act [*see I.R.C. § 3306(c)(8)*] solely because it is service performed in the employ of a religious, charitable, educational or other nonprofit organization described in *I.R.C. §*

501(c)(3) that is exempt from federal income tax under *I.R.C. § 501(a)* [*Unemp. Ins. Code § 608*]. However, "employment" does not include service performed in the employ of any of the following [*Unemp. Ins. Code § 634.5*; *see Unemp. Ins. Code §§ 605, 608, 629, 631, 635, 639-648*]:

- A church, convention, or association of churches, or an organization operated primarily for religious purposes that is operated, supervised, controlled, or principally supported by a church, convention, or association of churches.

- A duly ordained, commissioned, or licensed minister of a church in the exercise of his or her ministry or by a member of a religious order in the exercise of required duties.

Similarly, employees of nonprofit corporations must contribute to the state Disability Fund for wages paid for employment [*see Unemp. Ins. Code § 2901*]. For purposes of disability insurance, "employment" does not include service performed in the employ of a corporation, community chest, fund, or foundation in connection with the operation of a health facility [*see Health & Safety Code § 1250* (defined)] that meets the following requirements [*Unemp. Ins. Code § 2606(b)*]:

- Its earnings do not inure to the benefit of any private shareholder or individual.

- Its activities are not substantially composed of carrying on propaganda or otherwise attempting to influence legislation.

- It does not participate or intervene in (including publishing or distributing statements) any political campaign on behalf of any candidate for public office.

- It is exempt from federal income tax under *I.R.C. § 501(a)*, except service performed by certain members of the clergy.

[c] Workers' Compensation Insurance

A workers' compensation policy covers workplace injuries to employees, and most California employers are subject to state workers' compensation laws. Nonprofit corporations are subject to workers' compensation laws, even if the corporation has only a single part-time employee [*see Lab. Code §§ 3300, 3351*]. Under workers' compensation laws, a corporation will be held strictly liable for injuries occurring on the job [*see Lab. Code §§ 3300 et seq.*]. For more detailed coverage of workers compensation insurance generally, see California Insurance Law and Practice, ch. 42, *Workers Compensation Insurance* (Matthew Bender), and California Law of Employee Injuries and Workers' Compensation(Matthew Bender).

Although nonprofits are not required by statute to secure workers' compensation insurance coverage for volunteers, nonprofits should still consider securing coverage limiting exposure to volunteer injuries. The need for this coverage is dependent on the nature of the nonprofit's business operations. Volunteer coverage is available if the volunteer receives no remuneration other than reimbursements for meals, transportation, lodging, and incidentals [*Lab. Code § 3352*]. The corporation's board of directors, in its sole discretion, may declare in writing that a volunteer is an employee solely for workers' compensation purposes, provided that the declaration is made before any injury [*see Lab. Code § 3363.6*]. Volunteer coverage is usually secured by an endorsement to the policy; cost is typically based on job classification, number of hours worked, and the assumption that the volunteer earns minimum wage. The corporation can ordinarily secure this protection at a low cost.

[d] Directors and Officers Liability Policy

A directors' and officers' liability (D&O) policy ordinarily covers directors and officers from claims arising from the performance of their corporate duties. Most D&O policies only cover injuries resulting arising from the business decisions and activities of directors and officers, and do not shield the corporation or its other employees. However, entity coverage, covering the company, employees, volunteers, and agents is increasingly available. Most D&O policies exclude coverage for the types of personal injury and property damage typically covered by a CGL policy, as well as many claims against directors and officers for self-dealing, intentional or willful violations, and environmental claims. For more detailed coverage of this type of insurance, see California Insurance Law and Practice, ch. 43, *Directors and Officers Insurance* (Matthew Bender).

[3] Tort Liability of Volunteer Directors and Officers

[a] Limitation on Volunteer Directors' and Officers' Liability for Unintentional Torts

For nonprofit corporations to conduct and manage public and charitable services efficiently in California, the services of directors and officers are often provided on a volunteer basis. However, many potential volunteers are deterred from contributing these valuable services because of the unavailability and cost of liability insurance to protect their personal assets [*see Corp. Code § 5047.5(a)*]. In response to this problem, *Corp. Code § 5047.5* provides that no cause of action for monetary damages will arise against any person serving without compensation [*see Corp. Code § 5047.5(f), (i)* (determination of compensation)] as a director or officer of a nonprofit corporation that is (1) subject to laws governing nonprofit public benefit corporations, nonprofit mutual benefit corporations, or nonprofit religious corporations [*see Corp. Code §§ 5110 et seq., 7110 et seq., 9110 et seq.*]; (2) organized to provide religious, charitable, literary, educational, scientific, social, or other forms of public service; and (3) exempt from federal income tax under *I.R.C. § 501(c)(3)* or *(6)*, on account of any negligent act or omission that occurs [*Corp. Code § 5047.5(b), (d)*]

- Within the scope of that person's duties as a director acting as a board member, or as an officer acting in an official capacity;
- In good faith;
- In a manner that the person believes to be in the best interest of the corporation; and
- In the exercise of his or her policymaking judgment.

This protection against damages only applies under the following circumstances [*see Corp. Code § 5047.5(e), (f), (h), (i)*]:

- The nonprofit corporation does not unlawfully restrict membership, services, or benefits conferred on the basis of political affiliation, age, or any characteristic listed or defined in *Civ. Code § 51(b)* or *(e)* (Unruh Civil Rights Act) [*Corp. Code § 5047.5(h)*].
- The volunteer director or officer does not receive compensation from the corporation in any other capacity, including but not limited to, as an employee [*Corp. Code § 5047.5(i)*]. The payment of actual expenses incurred in attending meetings or otherwise in the execution of the duties of a director or officer do not constitute compensation [*Corp. Code § 5047.5(f)*].
- The claim against the volunteer director or officer can be maintained directly against the corporation, and a liability insurance policy is applicable to the claim [*Corp. Code § 5047.5(e)*].
- The corporation maintains a liability insurance policy, so that a policy is applicable to the claim. If the corporation's annual budget is less than $50,000, the policy must provide at least $500,000 coverage;

if the corporation's annual budget equals or exceeds $50,000, the policy must provide at least $1 million coverage. If the policy is found to cover the damages caused by the director or officer, no cause of action based on the negligent acts or omissions (as discussed above) may be maintained against the director or the officer [*Corp. Code § 5047.5(e)*].

To effect the provisions of Corp. Code § 5047.5, the Code of Civil Procedure provides that without an order of the court, no cause of action against a *person* serving without compensation as a director or officer of a nonprofit public benefit, mutual benefit, or religious corporation may be included in a complaint or other pleading on account of his or her negligent act or omission occurring within the scope of his or her duties as a director or officer. The court will enter such an order only after it determines that the party seeking to file the pleading has established evidence that substantiates the claim [*Code Civ. Proc. § 425.15(a)*]. For this purpose, compensation is defined as remuneration, whether by way of salary, fee, or other consideration for services rendered; however, the payment of per diem, mileage, or other reimbursement expenses to a director or officer does not constitute compensation [*Code Civ. Proc. § 425.15(d)*].

[b] Exceptions to Limited Liability

Corp. Code § 5047.5 does not protect against the intentional torts of directors and officers. Further, the limitations on the liability of volunteer directors and officers (*see* [a], *above*) do not affect the liability of a volunteer director or officer for any of the following [*Corp. Code § 5047.5(c)*]:

- Self-dealing transactions [*see Corp. Code §§ 5233, 9243*; *see also § 13.38*].
- Conflicts of interest [*see Corp. Code § 7233*; *see also § 13.38*].
- Improper distributions, loans, or guarantees [*see Corp. Code §§ 5237, 7236, 9245*].
- With respect to a charitable trust, an action or proceeding against a trustee brought by a beneficiary of the trust.
- An action or proceeding brought by the Attorney General.
- Intentional, wanton, or reckless acts, gross negligence, or an action based on fraud, oppression, or malice.
- An action brought for a prohibited combination in restraint of trade [*see Bus. & Prof. Code § 16700 et seq.*].

[c] Nonprofit Corporation's Liability Not Limited

Corp. Code § 5047.5 does not limit the liability of a nonprofit *corporation* for any negligent act or omission of a director, officer, employee, agent, or servant occurring within the scope of his or her duties [*Corp. Code § 5047.5(g)*]. Similarly, *Corp. Code § 5239* and *Corp. Code § 9247*, which provide additional liability protection for volunteer directors and executive officers (*see* [3], *below*), do not affect the liability of a nonprofit public benefit or religious *corporation* for acts or omissions of volunteer directors and executive officers [*Corp. Code §§ 5239(d), 9247(d)*].

[d] Additional Protection for Nonprofit Public Benefit and Religious Corporations

In addition to *Corp. Code § 5047.5*, other provisions protect volunteer directors and volunteer executive officers of nonprofit public benefit corporations [*Corp. Code § 5239*] and nonprofit religious corporations [*Corp. Code § 9247*]

from liability. Volunteer directors and executive officers of these nonprofit corporations are shielded from personal liability to third parties for monetary damages caused by the directors' or officers' negligent acts or omissions in the performance of their duties, if all of the following criteria are met [*Corp. Code §§ 5239(a), 9247(a)*; *see Corp. Code §§ 5239(b), 9247(b)* (definitions)]:

- The act or omission was within the scope of the director's or executive officer's duties.
- The act or omission was performed in good faith.
- The act or omission was not reckless, wanton, intentional, or grossly negligent.
- Damages caused by the act or omission are covered by a liability insurance policy issued to the corporation (either in the form of a general liability policy or a director's and officers' liability policy, or personally to the director or executive officer), or the board of directors and the director or officer made all reasonable good faith attempts to obtain liability insurance.

For nonprofit public benefit corporations that have an annual budget of less than $25,000 and that are exempt from federal income taxation under *I.R.C. § 501(c)(3)*, the condition of making "all reasonable efforts in good faith to obtain available liability insurance" is satisfied if the corporation makes at least one inquiry per year to purchase a general liability insurance policy with coverage of at least $500,000, and that insurance was not available for less than 5 percent of the corporation's budget for the previous year. If the corporation is in its first year of operation, this subsection applies for as long as the budget of the corporation does not exceed $25,000 in its first year of operation [*Corp. Code § 5239(h)*].

Neither *Corp. Code § 5239* nor *Corp. Code § 9247* limits the liability of the corporation for acts or omissions of a volunteer director or executive officer [*Corp. Code §§ 5239(d), 9247(d)*], or the liability of a director or officer for self dealing [*Corp. Code §§ 5239(e)(1), 9247(e)(1)*; *see Corp. Code §§ 5233, 9243*], for making improper distributions, loans, or guaranties [*Corp. Code §§ 5239(e)(1), 9247(e)(1)*; *see Corp. Code §§ 5237, 9245*], or in any action or proceeding brought by the attorney general [*Corp. Code §§ 5239(e)(2), 9247(e)(2)*].

PRACTICE TIP:

The requirements of the two manners of limiting volunteer director and officer liability, securing qualifying insurance and attempting to purchase qualifying insurance, substantially overlap. However, the "purchase" requirements are more liberal: (1) the qualifying policy may be a director's and officer's liability policy (and either may purchase the policy directly); and (2) directors and officers may be protected if the board and affected person show good faith reasonable efforts to secure insurance [*compare Corp. Code §§ 5239(a), 9247(a) with Corp. Code § 5047.5*].

[e] Additional Protection for Nonprofit Mutual Benefit Corporations

In addition to *Corp. Code § 5047.5*, volunteer directors and volunteer executive officers of nonprofit mutual benefit corporations are shielded from monetary liability for failure to discharge their duties, if the duties were performed in a manner that meets all of the following criteria [*Corp. Code § 7231.5(a)*; *but see Corp. Code §§ 7233* (transactions involving directors), 7236 (directors' liability for distributions, loans, and guaranties)]:

- The duties were performed in good faith.
- The duties were performed in a manner that the director or officer believed to be in the best interests of the corporation.

- The duties were performed with the degree of care, including reasonable inquiry, that an ordinarily prudent person in a like position would use under similar circumstances.

This protection against liability applies only to trade, professional, and labor organizations incorporated pursuant to the Nonprofit Mutual Benefit Corporations Law [*see Corp. Code § 7110 et seq.*] that operate exclusively for fraternal, educational, and other nonprofit purposes, and under *I.R.C. § 501(c)* [*Corp. Code § 7231.5(d)*].

A director or executive officer is a "volunteer" if he or she does not receive remuneration by way of salary, fee, or other consideration for services rendered. However, the payment of per diem, mileage, or other reimbursement expenses does not affect the director's or executive officer's status as a volunteer [*Corp. Code § 7231.5(b)*]. "Executive officer" means the president, vice-president, secretary, or treasurer of a corporation, or other person serving in a similar capacity, who assists in establishing the policy of the corporation [*Corp. Code § 7231.5(c)*].

[f] Volunteer Protection Act of 1997

The Volunteer Protection Act of 1997 [*42 U.S.C. § 14501 et seq.*] limits lawsuits against volunteers performing services for nonprofit organizations that are exempt under *I.R.C. § 501(c)(3)* or any nonprofit organization organized and conducted for public benefit and operated primarily for charitable, civic, educational, religious, welfare or health purposes. The Act covers all volunteers who receive no compensation in excess of $500 a year (not including reimbursed expenses) [*42 U.S.C. § 14505(b)*]. No volunteer may be held liable for harm caused by his or her act or mission on behalf of the corporation if any of the following are true [*42 U.S.C. § 14503(a)*]:

- The volunteer was acting within the scope of his or her responsibilities.

- The volunteer held any requisite license or certification.

- The damage did not result from willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious flagrant indifference to the rights and safety of the individual harmed.

- The harm was not the result of the volunteer's operation of a motor vehicle, vessel, aircraft, or other vehicle that must be insured or operated pursuant to a license under state law.

However, the Act's limitation on liability does not apply to misconduct stemming from violent crimes, hate crimes, and damage resulting from being under the influence of alcohol and drugs [*42 U.S.C. § 14503(f)*; *18 U.S.C. § 16*; *28 U.S.C. § 534* note]; acts of terrorism or state law sex crimes for which the defendant is convicted [*42 U.S.C. § 14503(f)*; *18 U.S.C. § 2331*]; and acts involving misconduct for which the defendant is found to have violated state or federal civil rights laws [*42 U.S.C. § 14503(f)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesInsurance LawBusiness InsuranceDirectors & Officers Liability InsuranceCoveragePersons InsuredInsurance LawGeneral Liability InsuranceCoverageGeneral OverviewLabor & Employment LawDisability & Unemployment InsuranceUnemployment CompensationCoverage & DefinitionsWorkers' Compensation & SSDICoverageGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.38

§ 13.38 Restrictions on Transactions Between Corporations and Directors

[1] Public Benefit and Religious Corporations

[a] Self-Dealing Transactions Subject to Sanctions

Directors of public benefit and religious corporations are subject to sanctions for engaging in self-dealing transactions [*Corp. Code §§ 5233, 9243*]. A "self-dealing transaction" is any transaction to which the corporation is a party and in which one or more of its directors has a material financial interest, unless the transaction is expressly excluded from the application of the statute [*see Corp. Code §§ 5233(b), 9243(b)*] or the transaction is approved [*Corp. Code §§ 5233(a), 9243(a)*; *see Corp. Code §§ 5233(d), 9243(d)*; *see also* [b], *below*]. A director engaging in a self-dealing transaction is an "interested director" [*Corp. Code §§ 5233(a), 9243(a)*].

The following transactions are expressly excluded from the definition of self-dealing transactions [*Corp. Code §§ 5233(b), 9243(b)*]:

- Actions of the board fixing the compensation of a director as a director or officer of the corporation.

- Actions of the board of a religious corporation making any loan of money or property to, or guaranteeing the obligation of, any director or officer.

- Transactions that are part of the corporation's public, charitable (or for religious corporations, religious) programs if approved or authorized by the corporation in good faith and without unjustified favoritism, even though one or more directors or their families benefit because they are in the class of persons intended to be benefited by the program.

- Transactions of which the interested director or directors have no actual knowledge that do not exceed the lesser of 1 percent of the gross receipts of the corporation for the preceding fiscal year or $100,000.

[b] Exception for Approved Transactions

Participation in a self-dealing transaction is not subject to sanction if the transaction is validated in any of the following manners [*Corp. Code §§ 5233(d), 9243(d)*]:

- The Attorney General (or the court in a suit in which the Attorney General is an indispensable party) may approve the transaction before or after consummation [*Corp. Code §§ 5233(d)(1), 9243(d)(1)*; *see § 13.251* (letter seeking Attorney General's approval)].

- The board authorized or approved the transaction in good faith by a vote of a majority of disinterested directors then in office [*Corp. Code §§ 5234(d)(2), 9243(d)(3)*].

- A committee or person authorized by the board approved the transaction [*Corp. Code §§ 5234(d)(3), 9243(d)(4)*].

For board approval, the following facts must be established [*Corp. Code §§ 5233(d)(2), 9243(d)(3)*]:

- The corporation entered into the transaction for its own benefit or for the benefit of the religious organization.

- The transaction was fair and reasonable as to the corporation (or, for religious corporations, the transaction was in furtherance of its religious purposes) at the time the corporation entered into the transaction.

- The board, before consummating any part of the transaction, authorized or approved the transaction in good faith by a vote of a majority of the directors then in office without counting the vote of the interested director or directors, and with knowledge of the material facts concerning the transaction and the director's interest in the transaction.

- Before authorizing or approving the transaction, the board considered and in good faith determined after reasonable investigation under the circumstances that either the corporation could not have obtained a more advantageous arrangement with reasonable effort under the circumstances (or, for religious corporations, the transaction was in furtherance of the corporation's religious purposes) or, in fact, either the corporation could not have obtained a more advantageous arrangement with reasonable effort under the circumstances (or the transaction was in furtherance of the corporation's religious purposes) [*Corp. Code §§ 5233(d)(2), 9243(d)(3)*].

For approval by committee or authorized person, the following facts must be established [*Corp. Code §§ 5233(d)(3), 9243(d)(4)*]:

- The committee or person approved the transaction in a manner consistent with board approval.

- It was not reasonably practicable to obtain board approval before entering into the transaction.

- The board, after determining in good faith that these conditions were satisfied, ratified the transaction at its next meeting by a vote of the majority of the directors then in office without counting the vote of the interested director or directors.

Members of a religious corporation can ratify a transaction if the transaction is approved or ratified in good faith by the members, other than the directors, after notice and disclosure to the members of the material facts concerning the

transaction and the director's interest in the transaction [Corp. Code § 9234(d)(2)].

Although the vote of interested directors will not be counted [*Corp. Code §§ 5233(d)(2), (3), 9243(d)(3), (4)*], interested directors may be counted in determining the presence of a quorum at a board meeting that authorizes, approves, or ratifies a contract or transaction [*Corp. Code §§ 5233(g), 9243(g)*].

[c] Remedies

Any of the following may bring an action in the superior court of the proper county for the remedies provided by statute for violation of the self-dealing transaction rules [*Corp. Code §§ 5233(c), 9243(c)*]:

- The corporation, or a member asserting the right in the name of the corporation [*see Corp. Code § 5710*].
- A director or officer of the corporation.
- Any person authorized by the bylaws to bring an action.

When a self-dealing transaction has occurred, the interested director or directors must disgorge profits [*see Corp. Code §§ 5233(h), 9243(h)*]. The director must take those actions and pay damages as the court in its discretion determines will provide an equitable and fair remedy to the corporation, taking into account any benefit received by the corporation and whether the interested director or directors acted in good faith and with intent to further the best interest of the corporation. Specifically, the court may order the director to do any or all of the following [*Corp. Code §§ 5233(h), 9243(h)*]:

- Account for any profits made from the transaction, and pay them to the corporation.
- Pay the corporation the value of the use of any of its property used in the transaction.
- Return or replace any property lost to the corporation as a result of the transaction, together with any income or appreciation lost to the corporation by reason of the transaction, or account for any proceeds of sale of such property, and pay the proceeds to the corporation together with interest at the legal rate.

The court may also award prejudgment interest [*see Civ. Code §§ 3287, 3288*] and, in its discretion, grant exemplary damages for a fraudulent or malicious violation of the self-dealing rules [*Corp. Code §§ 5233(h), 9243(h)*].

[2] Mutual Benefit Corporations

[a] Material Financial Interest

Mutual benefit corporations are subject to significantly fewer restrictions regarding transactions involving the corporation and one or more directors than public benefit or religious corporations [*compare Corp. Code § 7233 with Corp. Code §§ 5233, 9243*; *see Corp. Code § 310*; *see also Raven's Cove Townhomes, Inc. v. Knuppe Development Co. (1981) 114 Cal. App. 3d 783, 171 Cal. Rptr. 334* (director may not benefit his or her own interests at corporation's expense)]. However, if a mutual benefit corporation holds assets in charitable trust, the conduct of its directors (or any person performing similar functions) is governed by the rules applicable to public benefit corporations with regard to the assets held in trust [*Corp. Code § 7238*; *see* [1], *above*].

No contract or other transaction between a corporation and one or more of its directors, or between a corporation and any domestic or foreign corporation, firm, or association in which one or more of its directors has a material financial

interest, is either void or voidable because that (1) director or directors or that other corporation, business corporation, firm, or association are parties or (2) director or directors are present at the meeting of the board or a committee that authorizes, approves, or ratifies the contract or transaction, if any of the following are true [*Corp. Code § 7233(a)*]:

- The material facts as to the transaction and as to the director's interest are fully disclosed or known to the members and the contract or transaction is approved by the members in good faith, with any membership owned by any interested director not being entitled to vote on the matter.

- The material facts as to the transaction and as to the director's interest are fully disclosed or known to the board or committee, and the board or committee authorizes, approves, or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the interested director or directors and the contract or transaction is just and reasonable as to the corporation at the time it is authorized, approved, or ratified.

- As to contracts or transactions not approved, the person asserting the validity of the contract or transaction sustains the burden of proving that the contract or transaction was just and reasonable as to the corporation at the time it was authorized, approved, or ratified.

A mere common directorship does not constitute a material financial interest. A director is not interested in a resolution fixing the compensation of another director as a director, officer, or employee of the corporation, notwithstanding the fact that the first director is also receiving compensation from the corporation [*Corp. Code § 7233(a)*].

No contract or other transaction between a corporation and any corporation, business corporation, or association of which one or more of its directors are directors is either void or voidable because that director or directors are present at the meeting of the board or a committee that authorizes, approves, or ratifies the contract or transaction, if any of the following are true [*Corp. Code § 7233(b)* (*Corp. Code § 7233(b)* does not apply when *Corp. Code § 7233(a)* applies)]:

- The material facts as to the transaction and as to the director's other directorship are fully disclosed or known to the board or committee, and the board or committee authorizes, approves, or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the common director or directors, or the contract or transaction is approved by the members in good faith.

- As to contracts or transactions not approved, the contract or transaction is just and reasonable as to the corporation at the time it is authorized, approved, or ratified.

Interested or common directors may be counted in determining the presence of a quorum at a board or committee meeting that authorizes, approves, or ratifies a contract or transaction [*Corp. Code § 7234*].

[b] Loans, Guarantees, and Advances

Unless prohibited by the articles or bylaws, a mutual benefit corporation may loan money or property to, or guarantee the obligation of, any director or officer of the corporation or of its parent, affiliate, or subsidiary, under the following circumstances [*Corp. Code § 7235(a)*]:

- The board determines the loan or guaranty may reasonably be expected to benefit the corporation.

- Before consummating any part of the transaction, the loan or guaranty is either (1) approved by the members, without counting the vote of the director or officer, if a member, or (2) approved by the vote of a majority of the directors then in office, without counting the vote of the director who is to receive the loan or the benefit of the guaranty.

Notwithstanding the above limitation, a corporation may advance money to a director or officer of the corporation (or of its parent, affiliate, or subsidiary) for any expenses reasonably anticipated to be incurred in the performance of the duties of the director or officer of the corporation (or of its parent, affiliate, or subsidiary), provided that the director or officer would otherwise be entitled to reimbursement in the absence of an advance [*Corp. Code § 7235(b)*].

These rules do not apply to any of the following [*Corp. Code § 7235(c)*]:

- Credit unions.

- The payment of premiums in whole or in part by a corporation on a life insurance policy on the life of a director or officer so long as repayment to the corporation of the premiums paid is secured by the proceeds of the policy and its cash surrender value.

- Loans permitted under any statute regulating any special class of corporations.

[3] Public Benefit Corporations--Loans, Guarantees, and Advances

A public benefit corporation may not make any loan of money or property to or guarantee the obligation of any director or officer, unless approved by the Attorney General. However, a corporation may advance money to a director or officer of the corporation (or of its parent or any subsidiary) for expenses reasonably anticipated to be incurred in the performance of official duties, provided that the director or officer would otherwise be entitled to reimbursement [*Corp. Code § 5236(a)*].

This restriction does not apply to the payment of premiums in whole or in part by a corporation on a life insurance policy on the life of a director or officer, as long as repayment to the corporation of the premiums paid is secured by the policy proceeds and its cash surrender value [*Corp. Code § 5236(b)*]. Further, this restriction does not apply to a loan of money to or for the benefit of an officer if, in the judgment of the board, the loan is necessary to provide financing for the purchase of the principal residence of the officer to secure the services or continued services of the officer and the loan is secured by real property located in the state [*Corp. Code § 5236(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



28 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.39

§ 13.39 Actions for Breach of Charitable Trust

An action to enjoin, correct, obtain damages for, or to otherwise remedy, a breach of a charitable trust under which any or all of the assets of a corporation are held, may be brought by any of the following [*Corp. Code §§ 5142(a), 7142(a), 9142(a)*]:

- The corporation or a member asserting the right in the name of the corporation [*see Corp. Code §§ 5710, 7710*], or a former member of a religious corporation asserting the right in the corporation's name.
- An officer of the corporation.
- A director of the corporation.
- A person with a reversionary, contractual, or property interest in the assets subject to the trust.
- The Attorney General or anyone granted relator status by the Attorney General if the corporation is a public or mutual benefit corporation.

For public and mutual benefit corporations, if someone other than the Attorney General brings suit, the Attorney General is entitled to notice and may intervene [*Corp. Code §§ 5142(a), 7142(a)*].

The court may not rescind or enjoin the performance of a contract pursuant to a suit for breach of charitable trust unless all of the following conditions are met [*Corp. Code §§ 5142(b), 7142(b), 9142(b)*]:

- All of the parties to the contract are parties to the action.
- No party to the contract has, in good faith and without actual notice of the restriction, parted with value under or in reliance on the contract.

- It is equitable to rescind or enjoin contractual performance.

No assets of a religious corporation are or will be deemed to be impressed with any express or implied trust, statutory or at common law, unless one of the following applies [*Corp. Code §§ 9142(c)*]:

- Unless, and only to the extent that, the assets were received by the corporation with an express commitment by resolution of its board of directors to so hold those assets in trust.

- Unless, and only to the extent that, the articles or bylaws of the corporation, or the governing instruments of a superior religious body or general church of which the corporation is a member, so expressly provide [*see Corp. Code §§ 9142(d)*].

- Unless, and only to the extent that, the donor expressly imposed a trust, in writing, at the time of the gift or donation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesEstate, Gift & Trust LawTrustsCharitable TrustsEstate, Gift & Trust LawTrustsTrusteesDuties & PowersClaims By & Against



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.40

§ 13.40 Securities Law

[1] California Requirements

[a] Equity Securities

Under the Corporate Securities Law [*see Corp. Code § 25000 et seq.*], the sale of, or offer to sell, securities must be qualified by the California Commissioner of Corporations. The word "security" includes membership in an incorporated or unincorporated association, as well as "debt securities" [*Corp. Code § 25019*; *see* [b], *below*]. Therefore, the offer or sale of memberships must be qualified unless exempt.

Corp. Code § 25100 lists certain securities that are exempt from the provisions of *Corp. Code §§ 25110* (issuer transactions), 25120 (recapitalizations and reorganizations), and 25130 (nonissuer transactions). *Corp. Code § 25100(j)* exempts any security (except evidences of indebtedness, whether interest bearing or not) of an issuer (1) organized exclusively for educational, benevolent, fraternal, religious, charitable, social, or reformatory purposes and not for pecuniary profit, if no part of the net earnings of the issuer inures to the benefit of any private shareholder or individual, or (2) organized as a chamber of commerce or trade or professional association. The fact that amounts received from memberships or dues or both will or may be used to construct or otherwise acquire facilities for use by members of the nonprofit organization does not disqualify the organization for this exemption. This exemption does not apply to the securities of any nonprofit organization if any promoter expects or intends to make a profit directly or indirectly from any business or activity associated with the organization or operation of that nonprofit organization or from remuneration received from that nonprofit organization. However, this exemption does not apply to the securities of any nonprofit organization if any promoter of that organization expects or intends to make a profit directly or indirectly from any business or activity associated with the organization or operation of the nonprofit organization or from remuneration received from the nonprofit organization [*Corp. Code § 25100(j)*; *but see 10 Cal. Code Reg. § 260.105.20* (limited exceptions to bar)]. An "issuer" is a person who issues or proposes to issue any security [*Corp. Code § 25010*].

If no exemption is available, the organization must comply with detailed qualification requirements before it offers or sells its memberships. For discussion of the qualification and exemption of securities, see Ch. 6, *Securities Regulation Issues* , and Ch. 6I, *Issuance of Equity Securities* .

PRACTICE TIP:

Not every membership in a nonprofit corporation is a membership within the meaning of *Corp. Code § 25019*. As used in that statute, "membership" refers to a security that confers rights on the holder similar to those conferred by the ownership of a share of stock [*see Corp. Code § 115*]. However, the term "membership" is often applied to license arrangements under which a person who is merely a licensee is entitled to use certain facilities or services. It is necessary to distinguish the two types of memberships carefully in order to avoid confusion and to properly determine whether a particular "membership" is subject to the qualification provisions or exempt [*see* Dept. of Corps. Releases No. 15-C (Revised Oct. 7, 1970)].

Despite the statutory exception for trade associations, the Commissioner has taken the position that the exemption does not apply to trade organizations formed to enhance the economic position of the members [*see* Corporations Commissioner's Policy Letter No. 10 (July 10, 1969)].

[b] Debt Securities

Although debt securities are specifically excluded from the exemption for nonprofit corporation securities [*Corp. Code § 25100(j)*; *see* [a], *above*], they may nonetheless be exempt from qualification under *Corp. Code § 25100(l)* (short-term commercial paper) or *Corp. Code § 25100(p)* (secured notes), or the transaction in which they are offered or sold may be exempt if it does not involve a public offering [*Corp. Code § 25102(e)*]. For a detailed discussion of debt securities, see Ch. 6J, *Issuance of Debt Securities* .

[c] Antifraud Requirements

Regardless of whether membership interests in a nonprofit corporation are exempt from qualification, the corporation is not exempt from the antifraud provisions. These statutes prohibit false and misleading business practices, misrepresentation of material fact, insider trading, and the inducement of illegal acts [*see Corp. Code §§ 25400-25403*].

[2] Federal Requirements

Memberships in nonprofit corporations ordinarily do not constitute securities under federal securities law [*see 15 U.S.C. § 77b(a)(1)*]. Thus, federal securities law will not apply, provided that the corporation and its members do not expect any profit or return and the corporation does not issue stock or other instruments deemed to be a security. However, if the corporation issues stock, sells notes or bonds, or sells memberships from which members anticipate a pecuniary return, the stock, bonds, or memberships are deemed to be securities. Therefore, the issuance must be registered with the Securities and Exchange Commission unless exempt.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesSecurities LawBlue Sky LawsCivil LiabilityGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawBlue Sky LawsSecurities Exempt From RegistrationSecurities LawExemptions From RegistrationGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.41

§ 13.41 Tax Considerations

[1] Nonprofit Corporations Subject to Income Tax Unless Exempt

Corporations formed under the California Nonprofit Corporation Law are subject to the federal income tax [*I.R.C. § 11*] unless they are entitled to an exemption [*see I.R.C. §§ 501*-528 (rules governing exempt organizations)]. Qualifying nonprofit organizations are also exempt from federal withholding tax [*see I.R.C. §§ 3121(b)(8)(B), 3401(a)(9)* (religious organizations)].

Nonprofit corporations are also subject to the California franchise and income taxes unless they are specifically exempted from that tax [*see Rev. & Tax. Code § 23701 et seq.* (exemptions)].

For a more detailed discussion of the federal income taxation of nonprofit corporations, see Ch. 13B, *Tax-Exempt Status for Nonprofit Entities* .

[2] Charitable Gifts

[a] Gifts Generally Deductible From Income

Contributions to qualified nonprofit corporations may entitle the donor to claim the federal income tax deduction for charitable contributions [*see I.R.C. § 170*]. For example, taxpayers ordinarily may deduct gifts made to *I.R.C. § 501(c)(3)* corporations (corporations organized and operated exclusively for religious, charitable, and specified public purposes) from income [*I.R.C. § 170(c)*]. However, the deduction is lost if the corporation attempts to intervene in any political campaign on behalf of or in opposition to any candidate for public office [*I.R.C. § 170(c)(2)(B), (D)*; *see* [c], *below*].

Charitable gifts by check are ordinarily deemed made (and deductible) when the check is delivered or mailed to the charitable organization, regardless of when the charity actually receives the check [*Treas. Reg. § 1.170A-1(b)*]. Similarly, gifts made by credit card are deemed made (and deductible) when the donor charges the contribution, regardless of when the donor pays the credit card bill [*Rev. Rul. 78-38, 1978-1 C.B. 67*].

Purchases at auctions are only deductible if and to the extent that the taxpayer intends a gift and the fair market value of the purchased item is less than the amount bid and paid [*I.R.C. § 170(c)*; *see Hardesty v. Commissioner (1993) 65 T.C.M. 2743, T.C. Memo. 1993-225]* . Under federal law, the cost of a raffle ticket generally is not deductible, unless the value of participating in the raffle is worth less than the ticket price [*see Rev. Rul. 83-130, 1983-2 C.B. 148* ; *but see Penal Code § 320*] (generally barring *sale* of raffle tickets).

For further discussion of state and federal income tax charitable deductions available for contributions to qualifying nonprofit organizations, see Ch. 69, *Charitable Dispositions* .

[b] Documentation Requirements

Federal law imposes disclosure and documentation requirements on charitable organizations described in *I.R.C. § 501(c)(3)* that solicit deductible and/or nondeductible contributions [*see I.R.C. §§ 170(f), 6113, 6115*]. Special substantiation rules apply to specific types of contributions [*see Treas. Reg. § 1.170A-13(f)(9), (11)*-(17)].

An *I.R.C. § 501(c)(3)* charitable organization must provide a contemporaneous written acknowledgment or receipt to each donor contributing $250 or more in cash or property [*I.R.C. § 170(f)(8)*]. The required contents of the receipt are specified by statute, but the charity is *not* required to state the value of the gift property [*I.R.C. § 170(f)(8)*; *see Treas. Reg. § 1.170A-13(a)(1), (b)(1), (f)(2)*]. Multiple gifts under the $250 threshold will not be aggregated [*Treas. Reg. § 1.170A-13(f)(1)*]. Although it is the donor's responsibility to obtain any necessary documentation, the charity nevertheless should provide a receipt, either at the time of the gift or by mail early in the succeeding year. Donors who incur deductible out-of-pocket expenses of $250 or more when rendering services to the nonprofit must obtain a written acknowledgment from the corporation describing the services provided by the donor and either goods or service received in return or that no goods or services were provided [*Treas. Reg. § 1.170A-13(f)(10)*; *see Treas. Reg. § 1.170A-13(f)(8)* (exception for membership benefits)].

When a gift of property other than cash or publicly traded securities valued in excess of $5,000 is made to a nonprofit, the donor must obtain a qualified appraisal and attach an appraisal summary to the donor's income tax return [*Treas. Reg. § 1.170A-13(c)(2)*]. For this purpose, all similar items contributed in a single year are aggregated, even when the gifts are made to different donees [*Treas. Reg. § 1.170A-13(c)(1), (7)* (similar items)].

[c] No Deduction for Gifts to Lobbying Entities; Use of Affiliate

Gifts to exempt organizations that attempt to intervene (including the publication and distribution of statements) in any political campaign on behalf of or in opposition to any candidate for public office are not deductible [*I.R.C. § 170(c)(2)(B), (D)*]. The prohibition against lobbying has been upheld by the United States Supreme Court, provided that an alternate means of communication is available [*Regan v. Taxation With Representation (1983) 461 U.S. 540, 552-553, 103 S. Ct. 1997, 76 L. Ed. 2d 129* (entity may use its *I.R.C. § 501(c)(3)* organization for nonlobbying activities and create *I.R.C. § 501(c)(4)* affiliate to pursue its charitable goals through lobbying); *see FCC v. League of Women Voters (1984) 468 U.S. 364, 400, 104 S. Ct. 3106, 82 L. Ed. 2d 278* (affirming *Regan* holding)].

When an *I.R.C. § 501(c)(3)* corporation wishes to engage in lobbying, the corporation typically creates an *I.R.C. § 501(c)(4)* affiliate to pursue its charitable goals through lobbying. An *I.R.C. § 501(c)(4)* entity, a nonprofit organization operated exclusively for the promotion of social welfare whose net earnings are devoted exclusively for charitable, educational, or recreational purposes, is also exempt from taxation [*I.R.C. § 501(c)(4)*]. Although an *I.R.C. § 501(c)(4)* entity is similarly banned from intervening in political campaigns [*see Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii)*], the entity may form a political action committee (PAC) that is free to participate in political campaigns [*see Treas. Reg. §§ 1.501(c)(4)-1(a)(2)(ii)*, 1.527-6(f), (g)]. However, the relatedI.R.C. § 501(c)(4) entity must be separately incorporated, and it must maintain records that show that tax-deductible contributions to the *I.R.C. § 501(c)(3)* entity have not been

used to support the political activities [*see I.R.C. § 527(f)(3)*; *Treas. Reg. § 1.527-6(e), (f)*; *see also Branch Ministries v. Rossotti (D.C. Cir. 2000) 211 F.3d 137, 141-144]* .

[d] Estate and Gift Tax Deduction

Five basic categories of organizations to which the transfer of property will give rise to a federal estate tax deduction are specified by statute [*I.R.C. § 2055(a)*]:

- The United States, any state, any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

- Any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), and the prevention of cruelty to children or animals, if no part of its net earning inures to the benefit of any private stockholder or individual; if it is not disqualified for tax exemption under *I.R.C. § 501(c)(3)* for attempting to influence legislation; and if it does not participate or intervene in any political campaign on behalf of any candidate for public office;

- A trustee or trustees, or a fraternal society, order, or association operating under the lodge system, but only if those contributions or gifts are to be used by that trustee or trustees, or by the fraternal society, order, or association, exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals; if the trust, fraternal society, order, or association would not be disqualified for tax exemption under *I.R.C. § 501(c)(3)* for attempting to influence legislation; and if the trustee, fraternal society, order, or association does not participate in or intervene in (including publishing or distributing statements) any political campaign on behalf of or in opposition to any candidate for public office;

- Any veterans' organization incorporated by act of Congress, or its departments, local chapters, or posts, if no part of its earnings inures to the benefit of any private shareholder or individual; and

- An ESOP if the transfer is a qualified gratuitous transfer of qualified employer securities [*see I.R.C. § 664(g)*].

The categories of organizations qualifying for the federal gift tax charitable deduction generally are coextensive with the categories listed above, although they are not identical [*see I.R.C. § 2522(a)*]. There are significant differences, however, between the categories of organizations qualifying for the federal income tax deduction [*see* [a], *above*] and those qualifying for the federal estate and gift tax deductions. For more detailed discussion of the federal estate and gift tax charitable deductions, and comparison with the federal income tax charitable deduction, see Ch. 69, *Charitable Dispositions* .

[e] Property Tax Exemption

Nonprofit corporations that are exempt from income taxation [*see Rev. & Tax. Code § 23701d*; *I.R.C. § 501(c)(3)*; *see also* [a], *above*] may also be exempted from property taxation pursuant to the "welfare exemption" [*Cal. Const., art. XIII, §§ 4(b), 5*; *Rev. & Tax. Code § 214*]. Under the welfare exemption, property used exclusively for religious, hospital, scientific, or charitable purposes that is owned and operated by community chests, funds, foundations, limited liability companies, or corporations organized and operated for religious, hospital, scientific, or charitable purposes ordinarily is exempt from taxation [*Rev. & Tax. Code § 214(a)*]. However, the welfare exemption will not be granted to any organization unless it is qualified as an exempt organization under either *Rev. & Tax. Code § 23701d* or *I.R.C. §*

501(c)(3) [*Rev. & Tax. Code § 214.8(a)*; *see Rev. & Tax. Code §§ 213.7, 214(g), 214.8(a), 215.1, 231* (additional exemptions)]. An organization will not be deemed "qualified" as an exempt organization unless it has filed a valid organizational clearance certificate with the assessor [*Rev. & Tax. Code §§ 214(a)(3)(C),* 214.18(b); *see Rev. & Tax. Code § 254.6* (claim for certificate must be filed with Board of Equalization)].

Property used exclusively for religious purposes is also subject to a "religious exemption" from property tax, which remains in effect until the property no longer qualifies [*see Rev. & Tax. Code § 207*]. The exemption provides a simplified claims process for churches and church schools to file for property tax exempt status [*see Rev. & Tax. Code § 257*], with minimal annual filing requirements [*see Rev. & Tax. Code § 257.1*].

For further discussion of exemptions from property tax, see Ch. 13B, *Tax-Exempt Status for Nonprofit Entities* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Estate & Gift TaxesDeductionsCharitable Deductions (IRC secs. 2055, 2522, 2524)General OverviewTax LawFederal Income Tax ComputationDeductions for Nonbusiness ExpensesCharitable Contributions (IRC sec. 170)Religious OrganizationsTax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific OrganizationsTax LawState & Local TaxesPersonal Property TaxExempt PropertyRequirements for Exempt StatusTax LawState & Local TaxesReal Property TaxGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.42

§ 13.42 Corporate Changes

[1] Conversions

Any business, public benefit, mutual benefit, religious, or cooperative corporation may convert into another type of corporation. This type of corporate change generally is effected by amending the articles of incorporation and making related filings as required [*see Corp. Code §§ 911, 5813.5, 7813.5, 9621(a), 12504*]. Because the Attorney General considers that all assets of public benefit corporations are held in charitable trust, the Attorney General must give advance written approval to a conversion of a public benefit corporation to a mutual benefit, business, or cooperative corporation unless the public corporation has no assets. In the latter situation, the Attorney General is entitled to 20 days advance notice by the corporation's submission of a copy of the amendment [*see Corp. Code § 5813.5(b)*].

[2] Mergers

In general, public benefit corporations, mutual benefit corporations, and religious corporations may merge with any other domestic or foreign nonprofit or stock corporation. However, these mergers require the prior written consent of the California Attorney General [*Corp. Code §§ 6010, 8010, 9640*]. To effect the merger, a copy of the agreement of merger, an officer's certificate for the surviving corporation and for each disappearing corporation, and a tax clearance certificate for each disappearing California corporation and each disappearing foreign corporation that has qualified in California must be filed with the Secretary of State [*see* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_mrgcorp.htm].

Without the prior written consent of the Attorney General, a public benefit corporation may only merge with another public benefit corporation, religious corporation, or foreign nonprofit corporation the articles of which provide that its assets are irrevocably dedicated to charitable, religious, or public purposes [*Corp. Code § 6010(a)*]. At least 20 days before the consummation of a merger, a public benefit corporation must provide a copy of the proposed merger agreement to the Attorney General [*Corp. Code § 6010(b)*]. Without the Attorney General's prior written consent, when a merger occurs, each member of a constituent corporation may only receive or keep a membership in the surviving corporation for or as a result of that member's membership in the constituent corporation [*Corp. Code § 6010(c)*]. Procedures governing mergers involving public benefit corporations are set forth in *Corp. Code § 6011 et seq.*

A mutual benefit corporation may merge with any domestic or foreign corporation, provided that a merger with a public benefit or religious corporation must have the prior written consent of the Attorney General [*Corp. Code § 8010*]. Procedures governing mergers involving public benefit corporations are set forth in *Corp. Code § 8011 et seq.*

A religious corporation may merge with any domestic or foreign corporation. However, without the prior written consent of the Attorney General, a religious corporation may only merge with another religious corporation, public benefit corporation, or foreign nonprofit corporation the articles of which provide that its assets are irrevocably dedicated to charitable, religious, or public purposes [*Corp. Code § 9640(b)*]. Merger procedure generally is governed by the rules applicable to public benefit corporations, other than *Corp. Code § 6010(a), 6011, 6012* [*Corp. Code § 9640(a)*; *see Corp. Code § 9640(c), (d)* (approval requirements)].

[3] Dissolution

[a] Voluntary Dissolution

Public benefit, mutual benefit, and religious corporations may elect to voluntarily dissolve, generally by a vote of a majority of the members [*see Corp. Code §§ 6610, 8610, 9680*; *Committee to Save the Beverly Highlands Homes Association v. The Beverly Highlands Homes Association (2001) 92 Cal. App. 4th 1247, 1262, 1271, 112 Cal. Rptr. 2d 732* (trial court erred in finding that nonprofit mutual benefit corporation was common interest development and thus approval of 100 percent of members was required for dissolution under *Corp. Code § 8724*)]. The corporation must file a certificate of election to wind up and dissolve with the Secretary of State, and with the Attorney General if the corporation holds assets in charitable trust or has a charitable dissolution clause [*Corp. Code §§ 6611(a), 8611(a), 9680(a)*]. The distribution of assets is regulated and subject to review by the courts and/or the Attorney General [*see Corp. Code §§ 6716(c), 8716(c), 9680(e)(3)*]. To finalize dissolution, the corporation must file a certificate of dissolution, executed by a majority of the directors, with the Secretary of State when the corporation is completely wound up [*see Corp. Code §§ 6615(a), 8615(a), 9680*]. However, if the corporation is wound up under court supervision, the final decree of dissolution must be filed in lieu of the certificate [*see Corp. Code §§ 6614, 8614, 9680*].

Detailed discussion of the procedures for dissolution of domestic nonprofit corporations, with forms, is included in Ch. 12, *Winding Up and Dissolution*.

[b] Involuntary Dissolution

Public benefit and mutual benefit corporations also may be subject to involuntary dissolution proceedings [*see Corp. Code §§ 6510 et seq., 8510 et seq.*; *but see Corp. Code § 8510(d)* (exceptions)]. The persons who may file the dissolution action and the permissible grounds are specified by statute [*see Corp. Code §§ 6510(a), (b), 8510(a), (b)*]. In addition, the Attorney General may bring suit to dissolve the corporation on any of the following grounds [*Corp. Code §§ 6511(a), 8511(a)*]:

- The corporation has seriously offended against any provision of the statutes regulating corporations or charitable organizations.

- The corporation has fraudulently abused or usurped corporate privileges or powers.

- The corporation has violated any provision of law by any act or default that is a legal ground for forfeiture of corporate existence.

- The corporation has failed to pay to the Franchise Tax Board for a period of five years any tax imposed by the Bank and Corporation Tax Law.

The Corporations Code contains no procedure for the involuntary dissolution of religious corporations.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFormationGeneral OverviewMergers & Acquisitions LawMergersGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding Up



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
C. Operations of Domestic Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide §§ 13.43-13.49

[Reserved]

§§ 13.43[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
D. California Requirements for Foreign Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.50

§ 13.50 Application of General Corporation Law

In general, foreign nonprofit public benefit and mutual benefit corporations transacting intrastate business in California must comply with the provisions of the General Corporation law applicable to foreign corporations [*see Corp. Code § 2100 et seq.*] except as to matters specifically covered under the Nonprofit Corporation Law [*Corp. Code §§ 6910, 8910*].

The Nonprofit Religious Corporation Law does not contain a statute expressly requiring *foreign* religious corporations to comply with the California General Corporation Law. However, *Corp. Code § 9660* subjects *all* religious corporations to the requirements noted in the preceding paragraph.

Corp. Code § 2115, which specifies various requirements applicable to for-profit foreign corporations, is inapplicable to foreign nonprofits [*Corp. Code §§ 6910, 8910*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
D. California Requirements for Foreign Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.51

§ 13.51 Qualification Requirements

A foreign nonstock, nonprofit corporation or a foreign corporation organized for educational, religious, scientific, or charitable purposes that does not issue shares, may qualify as a nonprofit corporation in California. Foreign public benefit, mutual benefit, and religious corporations must file a signed statement and designation consistent with the requirements of *Corp. Code § 2105* to qualify to transact intrastate business in California [*see § 13.249*]. The corporation must attach an original certificate by an authorized public official of the state or place of its incorporation, to the effect that the corporation making the statement is an existing corporation in good standing in that state or place. The certificate must also indicate that the corporation is a nonstock, nonprofit corporation [*see* Requirements for Qualification of Foreign Nonprofit Corporations, Secretary of State's website at http://www.ss.ca.gov/business/corp/corp_sdcnpinfo.htm]. The latter information is required as proof that the corporation is eligible for the reduced filing fees that apply to nonprofit corporations. Although the information on the Secretary of State's website states that a certified copy of the articles of incorporation will not be accepted in lieu of the required certificate [*see* Requirements for Qualification of Foreign Nonprofit Corporations, Secretary of State's website at http://www.ss.ca.gov/business/corp/corp_sdcnpinfo.htm], the Secretary of State's office has orally advised that the certificates typically provided by some states or places of incorporation do not specify that the corporation is nonprofit, and that in such a case the Secretary of State's office will accept an endorsed copy of the corporation's articles as proof of its nonprofit status.

For further discussion of California requirements applicable to foreign corporations, see Ch. 12B, *Foreign Corporations and Associations* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral Overview



35 of 192 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
D. California Requirements for Foreign Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide § 13.52

§ 13.52 Factors in Determining Whether to Qualify or Incorporate in California

In general, foreign nonprofit corporations are less common than their business counterparts. Nonprofit activities rarely warrant the expense of foreign incorporation and state qualification. However, foreign charitable corporations cannot secure some of the benefits of domestic incorporation. For example, foreign corporations are ineligible for the nonprofit public benefit corporations procedure for independent director approval of specified types of self-dealing transactions [*see Corp. Code §§ 5233, 7233*; *see also § 13.38*]. Further, the California Attorney General's office subjects foreign nonprofit corporations to the more stringent law applicable to trusts because they hold assets in charitable trust [*see Holt v. College of Osteopathic Physicians & Surgeons (1964) 61 Cal. 2d 750, 756, 40 Cal. Rptr. 244]* .

The term "charitable corporation" includes any nonprofit foreign corporations doing business or holding property in California for charitable or eleemosynary purposes. Therefore, such a corporation must file with the Registrar of Charitable Trusts [*Gov. Code § 12582.1*; *see § 13.36[3]*]. In addition, a foreign corporation with no principal office in California, on written request of any member, must furnish a copy of the bylaws as amended to date [*see Corp. Code §§ 5160, 7160, 9160*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewEstate, Gift & Trust LawTrustsCharitable Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART II. LEGAL BACKGROUND
D. California Requirements for Foreign Nonprofit Corporations

6-13 California Legal Forms--Transaction Guide §§ 13.53-13.99

[Reserved]

§§ 13.53[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-13 California Legal Forms--Transaction Guide § 13.100

§ 13.100 Facts

NOTE:
The following facts are necessary to draft the articles of incorporation and bylaws of a corporation formed under and subject to the California Nonprofit Corporation Law [***see*** *Corp. Code § 5000 et seq.*].

1. Names, addresses, and telephone and fax numbers of incorporators.

2. If unincorporated association is being incorporated, the following facts relating to unincorporated associations:

NOTE:
An unincorporated association may change its status to that of a corporation on the proper authorization for the change by the association in accordance with its rules and regulations [*Corp. Code §§ 5121(a), 7121(a), 9121(a)*]. For a discussion of the legal requirements involved in changing the status of an unincorporated association to a nonprofit corporation, see *§ 13.22*.

a. Name of unincorporated association.

b. Names, addresses, and telephone and fax numbers of members.

c. Names, addresses, and telephone and fax numbers of creditors.

d. Description of rights and liens.

e. California counties in which any real property of association is located.

3. Nonprofit corporation.

a. Name(s) of corporation [*see §§ 13.111, 13.120*, P 1].

b. Other name(s) (fictitious), if any, under which corporation will do business.

c. Type of nonprofit corporation.
(1) Public benefit corporations [*Corp. Code § 5110 et seq.*].

(2) Mutual benefit corporations [*Corp. Code § 7110 et seq.*].

(3) Religious corporations [*Corp. Code § 9110 et seq.*].

(4) Other types of nonprofit corporations.

d. Principal business and activities of corporation.

e. Purpose(s) of corporation.

f. Street and mailing address, and telephone and fax numbers of corporation's principal office.

g. Business and financial advisers.

(1) Insurance agents.

(2) Bankers and banks.

(3) Accountant and accountancy firms.

h. Fiscal year of corporation.

i. Date of formation of corporation.

j. Date of transfer of assets to corporation.

k. Whether corporate existence is limited to a specified date.

NOTE:
Corporate existence continues perpetually unless otherwise expressly provided in the articles of incorporation [*Corp. Code §§ 5120(c), 5132(a)(1), 7120(c), 7132(a)(1), 9120(c), 9132(a)(1)*].

l. Agent for service of process.

(1) If agent is natural person, name and complete business or residence address in California.

(2) If agent is corporation, including domestic, foreign, or foreign business corporation,

name and complete business address.

m. Directors.

NOTE:
The corporation may have one or more directors [*Corp. Code §§ 5151(a), 7151(a), 9151(a)*].

(1) Names, addresses, and telephone and fax numbers of directors.

(2) Qualifications and manner of selection.

(3) Terms of office.

(4) Powers and duties, and any limitations on authority.

(5) Compensation.

(6) Liabilities of directors.

(6) Removal, resignation, and vacancy.

(7) Manner of filling vacancies on board of directors.

(8) Location of board meetings.

(9) Quorum requirements for meetings.

(10) Conduct and adjournment of board meetings.

n. Officers.

(1) Official designations or titles.

NOTE:
Corporations must have a chair of the board (who may be given the title chair of the board, chairperson of the board, chairman of the board, or chairwoman of the board) [*see Corp. Code § 5039* ("chair" defined)] or a president or both, a secretary, a treasurer or a chief financial officer (or both), and other officers with those titles and duties as are stated in the bylaws or determined by the board of directors and as may be necessary to enable it to sign instruments [*Corp. Code §§ 5213(a), 7213(a), 9213(a)*].

(2) Names, addresses, and telephone and fax numbers of officers.

(3) Qualifications and manner of selection.

(4) Terms of office.

(5) Powers and duties.

(6) Compensation.

(7) Removal, resignation, and vacancy.

(8) Manner of filling vacancies.

o. Board committees.

(1) Manner of designation.

(2) Number and authority.

(3) Place and location of meetings.

(4) Quorum requirements for meetings.

(5) Conduct and adjournment of meetings.

p. Members.

(1) Number.

(2) Names, addresses, and telephone and fax numbers of members.

(3) Qualifications and eligibility.

(4) Manner of admission, such as applications, dues, assessments, and fees.

NOTE:
Subject to the articles or bylaws, memberships may be issued by a corporation for no consideration or for such consideration as is determined by the board [*Corp. Code §§ 5311, 7311, 9311*].

(5) Classes of membership.

NOTE:
Corporations may issue memberships having different rights, privileges, preferences, restrictions, or conditions as authorized by its articles or bylaws [*Corp. Code §§ 5330, 7330, 9330*].

(6) Rights and obligations of members.

(7) Transferability of memberships.

(8) Termination of membership.

4. Actions that may be taken without meetings.

5. Transactions between corporation and directors.

6. Indemnification.

NOTE:
Nonprofit corporations may indemnify agents, including directors, officers, employees, and other agents of the corporation to the extent specified by statute [***see*** *Corp. Code §§ 5238*, *7237*, *9246*].

a. Whether corporation will indemnify directors, officers, and/or employees.

b. Extent of indemnification.

7. Insurance.

a. General liability policy.

b. Director's and officer's liability policy.

c. Workers' compensation.

d. Unemployment insurance.

e. Property insurance.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-13 California Legal Forms--Transaction Guide § 13.101

§ 13.101 Documents

1. Options, agreements, deeds, and other documents and instruments pertaining to or affecting property rights to be transferred to corporation.

NOTE:

The transfer of real property to the corporation may have adverse tax consequences. If the transfer constitutes a change in ownership, the value of the property will be reassessed, resulting in tax changes [***see*** Cal. Const., art. XIIIA, § 2; ***see also*** *Rev. & Tax. Code §§ 62(a), 64*].

2. In case of incorporation of unincorporated association, constitution, rules or regulations, charter documents, bylaws, and documents relating to tax exemptions of association.

3. In case of incorporation of subordinate organization, parent organization's articles of incorporation or association, constitution, or other charter documents, bylaws, and rules.

4. In case of corporation formed for religious, charitable, scientific, and related purposes [*see I.R.C. § 501(c)(3)*; *Rev. & Tax. Code § 23701d*], copies of all literature distributed by it or its predecessor in carrying on propaganda or otherwise attempting to influence legislation or evidencing its participation or intervention in political campaigns in opposition to or on behalf of candidates for public office.

5. In case of sole corporation, rules, regulations, or constitution of religious denomination, society, or church authorizing incorporation and governing filling vacancy of office.

6. Insurance policies.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsTreatment of Unincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-13 California Legal Forms--Transaction Guide §§ 13.102-13.109

[Reserved]

§§ 13.102[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-13 California Legal Forms--Transaction Guide § 13.110

§ 13.110 Selection of Appropriate Entity

1. Determine whether entity should be nonprofit.

NOTE:

For-profit entities may conduct nonprofit activities without changing status. However, significant advantages may result from nonprofit status, including tax exemptions, minimum wage [***see*** *29 U.S.C. § 203(r)*], and special copyright treatment [***see*** *17 U.S.C. § 110 et seq.*].

a. Whether entity has clear nonprofit purpose, e.g., charitable, public benefit, mutual benefit, or religious purposes.

b. Whether nonprofit and/or tax-exempt status is important for operational reasons.

(1) Dependent on tax deductibility of contributions to entity [*see § 13.41[2]*].

(2) Dependent on grant or endowment funding.

(3) Securities exemptions [*see § 13.40*].

(4) Reduced rate mailing privileges.

(5) Property tax advantages [*see Rev. & Tax. Code §§ 202-207, 213.7-217, 221-231*; *see also* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*].

(6) Sales tax advantages [*see Rev. & Tax. Code § 6361 et. seq.*]

NOTE:
The gross receipts from the sale, storage, use, and other consumption in California of tangible personal property that is made, prepared, assembled, or manufactured by organizations that (1) are formed and operated for charitable purposes qualifying for the "welfare exemption" [*Rev. & Tax. Code § 214*], (2) are engaged in the relief of poverty and distress, and (3) make the sales and donations as a matter of assistance to the purchasers and donees are exempt [*Rev. & Tax. Code § 6375*].

c. Whether it will be easier or harder to attract qualified directors and officers.

(1) Public or charitable motive.

(2) Lack of incentive stock options and generally lower compensation.

d. Whether entity would comply with heightened corporate formalities.

NOTE:
Nonprofit entities must comply with reporting requirements of the Internal Revenue Service and Franchise Tax Board and may face stricter investment standards. Public benefit corporations are subject to the supervision of the California Attorney General.

e. Determine whether bar against distributions and personal benefit will defeat organizational purpose.

f. Determine whether organizers have private profit motivation.

(1) Plans to convert to profit corporation in future.

(2) Plans for future transactions with related parties.

2. Determine whether entity should be corporation or association [*see* Ch. 13A, *Nonprofit Unincorporated Associations*].

NOTE:
Disadvantages of incorporation include the costs of incorporation, transfer of assets, increased paperwork, and corporate formality requirements.

a. Whether entity will own real property.

NOTE:
If the entity will own real property, the corporation form is the easiest to establish ownership and title [***see*** *Corp. Code § 18115*].

b. Whether tort or other liability concerns are of significant concern.

NOTE:
Nonprofit corporations are eligible for tort liability protection for volunteer directors and officers [***see*** *Corp. Code § 24001.5*]. Although ordinarily money judgments against unincorporated associations may be enforced only against association property [*Corp. Code § 18260*], causes of action may be enforced against persons who received assets

distributed during dissolution [*Corp. Code § 18135(a)*]. Further, judgments against the association may be levied against assets of members, directors, officers, and agents of the association [*Corp. Code § 18270*]. For further discussion of insurance matters, see ***§ 13.37*** and Ch. 13A, ***Nonprofit Unincorporated Associations*** .

c. Whether entity will engage in active business operations.

NOTE:

If the client does not envision active business operations, a charitable trust, as a passive management or investment vehicle, may serve the client's goals without the expense and obligations involved in organizing a nonprofit corporation [***see*** *Estate of Graham (1923) 63 Cal. App. 41, 218 P. 84* (trust purpose must be exclusively and clearly charitable and beneficiaries must be public or institutions devoted to public welfare)]. Charitable trusts can be established relatively quickly and inexpensively and are not subject to many statutory formalities. However, trusts generally are not suited to members.

d. Whether entity will have members.

e. Whether entity will engage in some unrelated business activities.

f. Whether perpetual existence is desirable.

3. If incorporation is desirable, determine whether incorporation should occur in California or elsewhere.

NOTE:

This chapter assumes that incorporation will be in California. Foreign incorporation and qualification in California is discussed briefly in § 13.50 et seq. If the client emphasizes finding the state with the least regulation of nonprofit corporations, the client's long-range commitment to charitable purposes may be questionable.

4. Determine type of domestic nonprofit corporation.

NOTE:

A particular type of nonprofit corporation, such as a homeowners association or health care service plan, may be subject to additional statutory requirements beyond those required for public benefit, mutual benefit, and religious corporations [***see, e.g.,*** *Corp. Code §§ 10820, 10821*; Bus. & Prof. Code § 11005.5].

a. Determine whether corporation will be organized primarily or exclusively for religious purposes.

NOTE:

If the corporation will be organized primarily or exclusively for religious purposes, the corporation should consider forming as a nonprofit religious corporation as these entities are subject to the least amount of government oversight and requirements and have the most flexibility in managing their internal affairs. However, corporations with religious purposes may incorporate under the other two laws. Unlike public and mutual benefit corporations, the Nonprofit Law does not provide for the involuntary dissolution of religious corporations [***see*** *Corp. Code § 6510 et seq., 8510 et seq.*; ***see also*** *Corp. Code § 9680*].

b. If public benefit corporation status is being considered, advise client of following:

(1) Public benefit corporations are subject to most oversight by both Secretary of State and Attorney General.

NOTE:
Public benefit corporation members and other persons entitled to vote can file a court action to determine the validity of any election or appointment of any director, and the Attorney General may intervene [*Corp. Code § 5617*].

(2) Corporation may not distribute assets or profits to members during life of corporation and must distribute remaining assets on dissolution to charitable entity and not members.

(3) Stricter conflict of interest rules apply to public benefit corporations.

(a) No more than 49 percent of persons serving on board may be interested persons [*Corp. Code § 5227(a)*; *see § 13.31[2][c]*].

NOTE:
"Interested persons" means either any person currently being compensated by the corporation for services rendered to it within the previous 12 months, whether as a full-time or part-time employee, independent contractor, or otherwise, excluding any reasonable compensation paid to a director as director; or any brother, sister, ancestor, descendant, spouse, brother-in-law, sister-in-law, son-in-law, daughter-in-law, mother-in-law, or father-in-law of any such person [*Corp. Code § 5227(b)*]. There is no statutory counterpart applicable to mutual benefit or religious corporations.

Any person entitled to bring an action for breach of charitable trust may bring an action to correct violations of this rule [*Corp. Code § 5227(c)*; ***see*** *Corp. Code § 5142*]. However, these rules do not affect the validity or enforceability of any transaction entered into by the corporation [*Corp. Code § 5227(d)*].

(b) Restrictions against self-dealing transactions is significantly stricter and more detailed procedures [*compare Corp. Code § 5233 with Corp. Code § 7233*; *compare Corp. Code § 5233 with Corp. Code § 9243(d)(2)* (members may approve self-dealing transaction)].

(4) Members have no proprietary interest.

c. If mutual benefit corporation status is being considered, advise client of following:

(1) Corporation may qualify for federal tax exemption under *I.R.C. § 501(c)(3)* or *(6)*.

(2) Corporation may not distribute gain, profits, or dividends to members during lifetime of corporation.

(3) Corporation may provide services and facilities to members.

(4) Corporation may distribute remaining assets to members on dissolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesInsurance LawBusiness InsuranceDirectors & Officers Liability InsuranceCoverageGeneral OverviewInsurance LawGeneral Liability InsuranceCoverageGeneral OverviewTax LawState & Local TaxesFranchise TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-13 California Legal Forms--Transaction Guide § 13.111

§ 13.111 Selection of Appropriate Corporate Name

NOTE:

The incorporators may select the name they desire for the corporation on the basis of its proposed activities and personal factors before consulting counsel. Counsel should suggest two or three alternative names, and should be prepared to check the choices made against the statutory restrictions on the corporate names. The Secretary of State will not file articles of incorporation setting forth a corporate name that is proscribed by statute. The following list indicates the types of names and specific names that should be avoided.

Foreign corporations are subject to the same name restrictions and limitations as domestic corporations. If the true name of a foreign corruption is not available for use in California, the corporation may use an assumed name.

1. Ensure that name must not include any of the following terms [*Corp. Code §§ 5122(a), 7122(a), 9122(a)*]:

NOTE:

This prohibition does not apply if the incorporators obtain a certificate of approval from the Commissioner of Financial Institutions. The certificate must be attached to the articles of incorporation for filing [*Corp. Code §§ 5122(a), 7122(a), 9122(a)*].

a. "Bank";

b. "Trust";

c. "Trustee"; or

d. Any related terms.

2. Ensure that name is not likely to mislead public [*Corp. Code §§ 5122(b), 7122(b), 9122(b)*].

3. Ensure that name is not same as, or resemble so closely as to tend to deceive, any of the following [*Corp. Code §§ 5122(b), 7122(c), 9122(b)*]:

NOTE:
A corporation may adopt a name that is substantially the same as an existing domestic or foreign corporation that is authorized to transact intrastate business or has registered its name pursuant to *Corp. Code § 2101* on proof of consent by that corporation and a finding by the Secretary of State that under the circumstances the public is not likely to be misled [*Corp. Code §§ 5122(b), 7122(b), 9122(b)*]. The consent must be on the letterhead of the consenting corporation, and must be signed by an officer. The Secretary of State will determine the acceptability of a consent based on corporations of record at the time of presentation [***see*** Secretary of State website at http://www.ss.ca.gov/business/corp/corp_naav2.htm].

a. Name of another domestic corporation.

b. Name of a foreign corporation that is qualified or registered in California [*see Corp. Code § 2101*].

c. Name that a foreign corporation has assumed [*see Corp. Code § 2106(b)*].

d. Name that will become record name of a domestic or foreign corporation on effective date of filed corporate instrument that specifies delayed date [*see Corp. Code §§ 110(c), 5008(c)*].

e. Name that is under reservation [*see Corp. Code §§ 201, 5122, 7122, 9122*].

4. In case of mutual benefit corporation, ensure that name does not create impression that purpose of corporation is any of following [*Corp. Code § 7122(b)*]:

a. Public;

b. Charitable;

c. Religious; or

d. That corporation is charitable foundation.

5. Ensure that name does not contain "cooperative" or any abbreviation or derivation of that word or any similar word unless proposed corporation is incorporated as:

NOTE:
This prohibition has several exceptions [***see*** *Corp. Code § 12311(b)*].

a. Consumer cooperative corporation under *Corp. Code § 12311(b)* [*see* Ch. 14, *Consumer Cooperative Corporations*];

b. Nonprofit cooperative association under *Food & Agric. Code § 54001 et seq.* [*see* Ch. 14A, *Agricultual Nonprofit Cooperative Associations*].

c. Stock cooperative [*see Bus. & Prof. Code § 11003.2*];

d. Limited-equity housing cooperative [*see Civ. Code § 817*; *former Health & Safety Code § 33007.5* (repealed 2009)];

e. Credit union or organization owned for mutual benefit of credit unions; or

f. Corporation organized under some other enabling California law [*Corp. Code § 12311(b)*].

6. Ensure that name does not contain words "Olympic," "Olympiad," or "Citius Altius Fortius," or any combination or simulation tending to suggest connection with United States Olympic Committee or any Olympic activity, without consent of Committee [*36 U.S.C. § 380(a)(4)*].

7. Ensure that name does not include words indicating that corporation is involved in business of savings association unless authorized under Savings Association Law [*see Fin. Code § 5000 et seq.*], such as the following [*Fin. Code § 5652*; *see Fin. Code § 5652(a)*]:

NOTE:
The corporate name of every savings and loan association must include the words "savings association," "savings and loan association," "savings bank," or other designation approved by the Commissioner of Financial Institutions [*Fin. Code § 5650*].

a. "Savings association," "savings bank," "savings and loan association," "building and loan association," "building association."

b. Any combination of "building," "loan," "bank," "institution," "society," "company," "fund," or "corporation" with one or more of "saving," "savings," or similar words.

8. Ensure that name is not similar to federal government or certain federal agencies except as permitted by federal law [*see 18 U.S.C. § 709*].

9. Ensure that name conforms to any limitation imposed by state or federal licensing agencies covering particular business [*see, e.g., Bus. & Prof. Code §§ 6738, 8729* (limitations relating to professional engineers and land surveyors)].

10. Clear and reserve corporate name [*see § 13.120,* P 1].

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporate NamesGeneral OverviewBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawNonprofit Corporations & OrganizationsFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-13 California Legal Forms--Transaction Guide § 13.112

§ 13.112 Fictitious Business Statement

NOTE:
California nonprofit corporations are expressly exempt from filing a fictitious business name statement [*Bus. & Prof. Code § 17911*]. Nevertheless, corporations may wish to file the statement with county recorders in counties in which the corporation will hold property.

1. Determine whether corporation will do business.

2. If corporation will do business, determine whether it will do so under name other than its corporate name.

3. If corporation will do business under name other than corporate name, prepare, file, and publish fictitious name certificate in accordance with requirements of *Bus. & Prof. Code § 17900 et seq.*

NOTE:
For an example and discussion of a fictitious business name statement, see Ch. 1A, ***Role of Counsel in Starting a New Business*** . For a form for a board resolution adopting a fictitious business name and directing that the statement be filed and published, see Ch. 5, ***Directors Meetings, Actions, and Resolutions*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesConducting Business Under Fictitious NamesBusiness & Corporate LawCorporate NamesFictitious NamesRegistration RequirementsBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawNonprofit Corporations & OrganizationsFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-13 California Legal Forms--Transaction Guide § 13.113

§ 13.113 Securities Requirements

NOTE:

Requirements applicable to securities are discussed in *§ 13.40*. For further discussion of the issuance of equity securities, see Ch. 6I, ***Issuance of Equity Securities*** . For further discussion of the issuance of debt securities, see Ch. 6J, ***Issuance of Debt Securities*** .

1. If sale of corporate memberships is not exempt from permit requirements of Corporate Securities Law [*see Corp. Code § 25000 et seq.*], or if corporation will sell nonexempt debt securities, prepare application for securities permit from Commissioner of Corporations [*see Corp. Code §§ 25110, 25120, 25130* (qualification requirements)].

2. File application with Commissioner of Corporations [*see Corp. Code §§ 25110, 25120, 25130*].

3. If exemption from California securities laws is applicable, comply with all terms and requirements of exemption.

NOTE:

For a complete list of exemptions from the qualification requirements of the California securities laws, and the criteria applicable to each exemption, see *Ch. 6, **Securities Regulation Issues**, § 6.200*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesSecurities LawBlue Sky LawsExcluded

TransactionsSecurities LawBlue Sky LawsSecurities Exempt From Registration



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-13 California Legal Forms--Transaction Guide §§ 13.114-13.119

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-13 California Legal Forms--Transaction Guide § 13.120

§ 13.120 Forming Corporation

1. Reserve proposed corporate name.

a. Check name availability with Secretary of State's Name Availability Unit by written request:

NOTE:
If an unincorporated association is being incorporated, counsel should not automatically assume that the association's name is available for use [***see*** *§ 13.22*], and should check name availability in the same manner as in the ordinary incorporation process. However, dissident members of the association may be barred from using the same or similar name when attempting to form a rival organization [***see*** *Law v. Crist (1941) 41 Cal. App. 2d 862, 865, 107 P.2d 953]* .

Persons who have established prepaid priority accounts may check name availability by telephone. The account will be debited for the per-name fees. For further information on these accounts, contact Secretary of State's Prepaid Account Client Services, 1500 Eleventh Street, Sacramento, CA 95814 [***see*** Secretary of State website at http://www.ss.ca.gov/business/corp/corp_naav2.htm].

(1) Request up to three names, in order of preference.

(2) Address request to:

Secretary of State
1500 Eleventh Street

Sacramento, CA 95814
Attention: Name Availability Unit

NOTE:

Written requests for the preliminary checking of corporate names are accepted only in the Sacramento main office. These requests are ordinarily processed within two to four working days after receipt of the request [***see*** Secretary of State website at http://www.ss.ca.gov/business/corp/corp_naav2.htm and instructions for Name Availability Inquiry Letter on Secretary of State website at http://www.ss.ca.gov/business/corp/pdf/naavinquiryform.pdf].

b. Draft request for reservation of proposed corporate name [*see Corp. Code § 201(c)*; *see also Corp. Code §§ 5122(c), 7122(d), 9122(c)*]:

NOTE:

A written request for reservation of a corporate name may include up to three names, listed in preferred order, with the request that the first available name, or any number of the listed names, be reserved. If a proposed name is reserved using a consent (by a corporation's whose name is similar), a currently dates consent must accompany each renewal request [***see*** Secretary of State website at http://www.ss.ca.gov/business/corp/corp_naav2.htm and instructions for Name Reservation Request Form on Secretary of State website at http://www.ss.ca.gov/business/corp/pdf/naavreservform.pdf].

(1) List up to three names (in order of preference if only one name is to be reserved).

(2) State whether or not name(s) for which reservation is sought was previously checked and cleared by Name Availability Unit.

(3) State client's name and address and specify contact person.

(4) State principal business in which client will engage.

(5) State county in which proposed corporation's principal office will be located.

c. Mail written request to reserve corporate name to Secretary of State, or obtain reservation over the counter at Sacramento main office or any satellite offices, and pay applicable fee.

NOTE:

Written requests for reservations of corporate names must be accompanied by the applicable fee for each name to be reserved [***see*** *Gov. Code § 12186(a)*], plus the additional handling fee if the request is made over the counter [***see*** Secretary of State website at http://www.ss.ca.gov/business/corp/corp_formsfees.htm and instructions for Name Reservation Request Form on Secretary of State website at http://www.ss.ca.gov/business/corp/pdf/naavreservform.pdf]. Name reservation is effective for 60 days. The Secretary of State may not issue certificates reserving the same name for two or more consecutive 60-day periods [*Corp. Code §§ 5122(c), 7122(d), 9122(c)*].

2. Select agent for service of process [*see § 13.130*, P 1d].

NOTE:

The agent may be a natural person residing in California or any domestic or foreign or foreign business corporation that has complied with *Corp. Code § 1505* and whose capacity to act as an agent has not

been terminated. If a natural person is designated, the articles of incorporation [***see*** *§§ 13.200, 13.210, 13.220*] and the initial and biennial statements [***see*** *§ 13.248*] must set forth the person's complete business or residence [*Corp. Code §§ 6210(b), 8210(b), 9660(a)*].

a. Natural person.

b. Corporate agent.

NOTE:

If a corporate agent is selected, counsel should ensure that a certificate of consent by the corporation designated as agent is on file with the Secretary of State [*Corp. Code § 1505(a)*; ***see*** Ch. 2, ***Formation of Corporations***]. If a certificate of consent is not on file with Secretary of State, counsel should arrange to have it filed before designation. A domestic or foreign corporation may not file a certificate of consent unless it is currently authorized to engage in business in California and is in good standing on the records of the Secretary of State [*Corp. Code § 1505(c)*].

3. Draft articles of incorporation [*see § 13.130*].

NOTE:

If the purpose of the corporation is the prevention of cruelty to children or animals, or both, it must be incorporated by 20 or more persons who are citizens and residents of California [*Corp. Code § 10400*].

4. Secure approval of articles by any or all of following persons or entities:

a. By incorporators, for accuracy of names and addresses stated in articles and of other provisions.

b. By Secretary of State if an unusual sequence or phrasing of provisions is used or if unusual provisions are included.

NOTE:

Prior approval by the Secretary will avoid a possible rejection of the articles when presented for filing and the delay incidental to that rejection.

c. By Deputy Commissioner of Corporations if sale of memberships in the corporation is not exempt from the permit requirements of the Corporate Securities Law [*Corp. Code § 25000 et seq.*] or if the corporation is to issue nonexempt debt securities [*see § 13.40*].

d. By State Franchise Tax Board if there is any doubt as to effect of provisions set forth on franchise tax-exempt status of corporation.

e. By Internal Revenue Service if there is any doubt as to effect of provisions set forth on federal income tax-exempt status of corporation.

5. Execute articles of incorporation [*Corp. Code §§ 5120(b), 7120(b), 9120(b)*].

a. By one or more persons forming corporation who are thus incorporators of corporation, if initial directors are not named in articles; or

NOTE:

One or more persons may form a nonprofit corporation by executing and filing articles of incorporation [*Corp. Code §§ 5120(a), 7120(a), 9120(a)*]. Once the initial directors are elected, the role of the incorporators terminates. Up until that point, the incorporators may take any action necessary and proper to perfect the organization of the corporation [*Corp. Code §§ 5134, 7134, 9134*].

b. Each initial director named in articles.

6. Have articles acknowledged by [*see Corp. Code §§ 5120(b), 7120(b), 9120(b)*]:

a. Each initial director named in articles; or

b. Each incorporator if initial directors are not named in articles.

NOTE:

The acknowledgment of articles of incorporation may take either of two forms [*Corp. Code § 5030*]. It may be by notarial acknowledgment [***see Civ. Code § 1180 et seq.; see also*** *§ 13.200*] or by written declaration [***see*** *§ 13.241*].

7. If unincorporated association is changing to corporate status, attach verified statement of any two officers or governing board members of association stating that incorporation is approved by association in accordance with its rules and procedures [*see Corp. Code §§ 5121(c), 7121(c), 9121(c)*; *see also § 13.242*].

8. Obtain check(s) payable to Secretary of State for payment of filing and certification fees.

NOTE:

The fee for filing the articles of a nonprofit corporation is set forth in *Gov. Code § 12186(d)*. Additional fees apply if more than two certified copies are requested. A special handling fee applies for expedited processing of documents delivered in person at the public counter in the Sacramento and branch offices. This fee must be remitted by separate check for each submittal and will be retained whether the documents are filed or rejected [***see*** Secretary of State website at http://www.ss.ca.gov/business/corp/corp_artsnpinf.htm].

The Secretary of State may cancel the filing of the articles if the check or other remittance accepted in payment of the filing fee or franchise tax is not paid on presentation. Within 70 days after the articles were filed, the Secretary of State must give written notice to the agent for service of process or the person submitting the instrument that the item presented for payment was not honored. The notice must specify a date, not less than 20 days after the mailing date of the notice, on which the cancellation is to be effective if the fee is not paid by cashier's check or the equivalent [*Corp. Code § 5008.5*]. The receipt for these fees includes the number assigned to the corporation for use in its tax returns and ordinarily is given or mailed to counsel.

9. File original and at least four copies of articles of incorporation, together with applicable filing fee, within 60 days after name is reserved [*see* Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Information Sheet; *see also* P 1, *above*, for name registration procedures].

NOTE:

The Secretary of State information sheet, "Organization of California Nonprofit, Nonstock Corporations" states that the original and at least four copies must be included with the submittal. However, the form instructions require the filing of an original and at least two copies, and duplicate

originals when filing in a branch office [***see*** Secretary of State Instructions]. In any event, an extra copy must be included by all public benefit corporations for transmittal to the Attorney General [*Corp. Code § 5120(d)*]. If the corporation was created by the elected legislative body in order to exercise authority that may lawfully be delegated by the elected governing body to a private corporation or other entity, the corporation must furnish an additional copy of its articles to the Secretary of State for transmittal to the Controller [*Corp. Code § 5120(e)*].

The Secretary of State will compare and certify up to two copies of the articles at no charge provided that the copies are submitted with the original at the time of filing [***see*** Secretary of State information sheet; ***see also*** *Gov. Code § 12185*]. Additional copies submitted with the original will be certified on request and payment of a copy certification fee [***see*** Secretary of State information sheet; ***see also*** *Gov. Code §§ 12182, 12183*].

The articles should be accompanied by a self-addressed envelope and a letter stating the corporate name as well as the name of the person filing the articles, a return address, and telephone number. Corporate existence begins on the filing of the articles and continues perpetually unless otherwise expressly provided by law or in the articles [*Corp. Code §§ 5120(c), 7120(c), 9120(c)*].

10. File additional copies of articles for certification, as may be needed for any of following purposes:

NOTE:
The Secretary of State will compare and certify up to two copies of the articles at no charge when submitted with the original at the time of filing [***see*** Secretary of State information sheet; ***see also*** *Gov. Code § 12185*]. Additional copies submitted with the original will be certified on request and payment of a reduced copy certification fee [***see*** Secretary of State information sheet; ***see also*** *Gov. Code §§ 12182, 12183*].

a. Applying for nonprofit mailing permit [*see* P 24, *below*].

b. Applying for any necessary license or permits [*see* P 21, *below*].

c. Applying for local tax exemptions [*see* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*].

NOTE:
The corporation must submit two copies of the articles of incorporation to obtain exemption from local personal property and real property taxes.

d. If unincorporated association is changing to corporate status, one copy for each county recorder where association owns property [*see* P 20, *below*].

e. Additional copies if corporation will seek loans, grants, or endowments.

11. Secure minute book, corporate seal, and membership certificates as necessary.

NOTE:
Although corporations are not required to have a seal, it is customary to obtain one, particularly when transactions with third parties, such as banks, are contemplated.

Mutual benefit corporations may but need not issue membership certificates. If membership certificates

are desired, the certificate must contain the information prescribed by *Corp. Code § 7313(b)*, including any transfer restrictions [*Corp. Code § 7313*]. If membership certificates will be issued (after the application is accepted and any required fee paid), the president and secretary should sign the certificate. The member's name and certificate number should be entered in the membership list and the corporate records book.

12. Draft bylaws [*see § 13.131*].

a. Have bylaws approved by board.

NOTE:

The incorporators may adopt and amend bylaws if the initial directors have not been appointed [*Corp. Code §§ 5134, 7134*. 9134]. Incorporators typically appoint the directors (if known) and often adopt bylaws at that time. The directors then approve the bylaws at the initial meeting [***see*** *§ 13.121* (initial meeting)].

b. Have secretary certify bylaws.

NOTE:

The original or a copy in writing or in any other form capable of being converted into clearly legible tangible form of the bylaws, certified to be a true copy by a person purporting to be the secretary or an assistant secretary of the corporation, is prima facie evidence of the adoption of the bylaws and of the matters stated therein [*Corp. Code §§ 5215, 7215, 9215*].

c. Prepare copies:

NOTE:

The number of copies of the bylaws needed will vary with the needs of the corporation. For example, some corporations will distribute copies of the bylaws to all members of the corporation.

(1) One copy for corporate records book [*Corp. Code §§ 5160, 7160, 9160*].

(2) One copy to be attached to application for franchise tax exemption, if sought [*see Rev. & Tax. Code § 23701*; FTB Form 3500; *see also* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*].

(3) One copy for filing with Registrar of Charitable Trusts, Office of Attorney General, when corporation is charitable corporation or holds assets in charitable trust [*see 11 Cal. Code Reg. §§ 300, 302*].

NOTE:

Every charitable corporation, unincorporated association, trustee, or other person required by the Supervision of Trustees and Fundraisers for Charitable Purposes Act [***see*** *Gov. Code § 12580 et seq.*] must file with the Attorney General a copy of the articles of incorporation and bylaws, trust agreement, decree of distribution, or other instrument governing its operation [*11 Cal. Code Reg. § 300(a)*]. For further discussion, see *§ 13.142*, P 12.

(4) One copy for attorney's file.

13. Select tax year and method of accounting.

14. Secure employer identification number [*see* IRS Form SS-4].

15. Apply for federal tax exemption [*see* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*].

16. Apply for state tax exemption [*see* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*].

17. File biennial statement by domestic nonprofit corporation with Secretary of State, together with applicable filing fee [*Corp. Code §§ 6210(a), 8210(a), 9660(a)*; *see § 13.248*].

NOTE:

Every nonprofit corporation must file, within 90 days after the filing of its original articles and biennially thereafter during the applicable filing period, a statement, on a form prescribed by the Secretary of State, containing the names and complete business or residence addresses of its chief executive officer, secretary, and chief financial officer, the street address of its principal office in California, if any; the mailing address of the corporation (if different from the street address of its principal executive office or if it has no principal executive office in California); and the agent for service of process [*Corp. Code §§ 6210(a)*, (b), *8210(a)*, (b), *9660(a)*]. If the statement is being filed as the initial statement or the biennial statement, a filing fee must be attached; if the filing is simply to change information on a filed initial or biennial statement, there is no applicable fee [***see** § 13.248* (instructions to form)].

18. If issuance of memberships is not exempt under state and federal securities laws [*see § 13.40*], apply for qualification and registration.

19. If corporation will issue membership certificates, distribute certificates to members after they have applied and qualified for membership and paid any applicable fee.

NOTE:

Membership certificates should be signed by the president and secretary of the corporation before distribution. The corporate records book should contain the member's name, address, and certificate number.

20. If unincorporated association converts to corporate status and owned real property before conversion, file copy of articles with county recorder's office in each county where association owned real property.

NOTE:

Filing the articles demonstrates that the newly formed nonprofit corporation owns the property. Two copies of the articles should be submitted, requesting that one be returned file-stamped. The copy should then be placed in the corporate records book.

21. Secure all necessary license and permits.

NOTE:

The Secretary of State does not license corporations. For licensing requirements, counsel should contact the city and/or county where the principal place of business is located and/or the state agency with jurisdiction over the activities of the organization. If the corporation will obtain an on-sale liquor license,

consult *Bus. & Prof. Code §§ 23425-23455*.

a. Prepare and file with appropriate state or federal department, agency, board, or person, application for state or federal license, permit, or certificate of registration.

b. Prepare and file with appropriate local department or agency application for license or permit when license or permit is required to enable corporation to carry on given activity.

22. Comply with charitable solicitation requirements and register with Secretary of State if corporation will lobby for political purposes [*see Gov. Code § 82013*].

NOTE:

State and local laws may impose registration, permit, and disclosure requirements on charitable solicitations [***see*** *Bus. & Prof. Code § 17510 et seq.*]. However, some of these laws may be subject to constitutional challenge [***see*** *Riley v. National Fed'n of the Blind (1988) 487 U.S. 781, 108 S. Ct. 2667, 101 L. Ed. 2d 669]* .

California tracks federal tax law on lobbying and electioneering [***compare*** *Rev. & Tax. Code §§ 23701d, 23704.5, 23740* ***with*** *I.R.C. §§ 501(c)(3), (h), 4911*], but the federal tax imposed on excess lobbying expenditures does not apply [*Rev. & Tax. Code § 23740*; ***see*** *I.R.C. § 4911(a)(1)*; ***see also*** *Rev. & Tax. Code § 23740(b)*].

23. If corporation is public benefit corporation and exempt from tax [*Rev. & Tax. Code § 23701(d)*; *I.R.C. § 501(c)(3)*], register with California Attorney General.

NOTE:

The Registry monitors, audits, and registers charitable (public benefit) organizations to determine whether the assets they hold for the public benefit are properly administered [***see*** *Gov. Code §§ 12586(b), 12588*]. The files and annual financial reports of registered charitable organizations are available for public inspection.

Public benefit corporations will receive a notice to register, Registration Form RRF-1, and a copy of the Uniform Supervision of Trustees for Charitable Purposes Act from the Registry of Charitable Trust in the Office of the California Attorney General. However, schools and hospitals are generally exempt from these registration requirements. For further discussion, see *§ 13.36[3]*. A copy should be filed in the corporation's records book.

24. Obtain nonprofit mailing permit, if desired.

NOTE:

Nonprofit corporations may apply for a mailing permit at the local or main post office to take advantage of significantly lower postage rates [***see*** *39 U.S.C. § 3626*]. The corporation must submit a file-stamped or certified copy of the articles, a copy of the bylaws, copies of tax exemption letters, and promotional literature and pay an annual fee.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesName ReservationsBusiness & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationCivil

ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-13 California Legal Forms--Transaction Guide § 13.121

§ 13.121 Holding Initial Meeting of Directors

NOTE:

If the articles of incorporation do not specify the names of the initial directors, the incorporators will have to meet to name the directors. The rules regarding the holding of meetings of directors apply to the holding of meetings of incorporators [*Corp. Code §§ 5211(d), 7211(d), 9211(d)*]. Alternatively, the incorporators may unanimously elect the directors in writing without a meeting [***see*** *Corp. Code §§ 5211(b), 7211(b), 9211(b)*; ***see also*** *§ 13.244*]. Once the directors have been appointed by the incorporators, the process of corporate organization may continue.

1. Directors should determine whether various acts completing organization of corporation are to be taken at meeting of board with notice, or on written consent to holding meeting, or on waiver of notice or on approval of minutes of meeting.

2. Directors should fix time and place of meeting.

3. If meeting is to be held, directors should call meeting.

NOTE:

Any two directors may call a meeting of the board [*Corp. Code §§ 5211(a)(1), 7211(a)(1), 9211(a)(1)*]. Each director present and voting at a meeting has one vote on each matter presented to the board of directors for action at that meeting. No director may vote at any meeting by proxy [*Corp. Code §§ 5211(c), 7211(c), 9211(c)*].

4. Unless incorporators have adopted bylaws that prohibit holding of meeting on waiver of notice [*see Corp. Code §§ 5211(a)(3), 7211(a)(3), 9211(a)(3)*], hold first meeting on waiver of notice of meeting signed by all incumbent directors.

NOTE:

Notice is not required, absent a contrary article or bylaw provision, if each director provides waiver of notice, a written consent to holding the meeting, or an approval of the minutes of the meeting in writing, whether before or after the meeting. Attendance at the meeting without protest effectively waives notice. Waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meeting [*Corp. Code §§ 5211(a)(3), 7211(a)(3), 9211(a)(3)*].

5. At meeting, appoint temporary chairman and temporary secretary.

NOTE:

Board members may participate in a meeting through use of conference telephone, electronic video screen communication or other communications equipment. Participation in a meeting through use of conference telephone or electronic video screen communication constitutes presence in person at the meeting as long as all members participating in the meeting are able to hear one another. Participation in a meeting through use of electronic transmission by and to the corporation (other than conference telephone or electronic video screen communication) constitutes presence in person at the meeting if each participating member can communicate with all other members concurrently and each member has the means to participate in all matters before the board [*Corp. Code §§ 5211(a)(6), 7211(a)(6), 9211(a)(6)*].

6. State following recitations, as applicable, for purpose of corporate minutes:

a. That corporation is duly formed.

b. That meeting is being duly held pursuant to:
(1) Valid notice.

(2) Waiver of notice.

(3) Consent.

(4) Approval of minutes.

(5) Presence at meeting.

7. Directors should direct:

a. Filing of articles, certified by Secretary of State, in minute book or corporate records.

b. Filing of waivers of notice, consents, or approvals of minutes which were obtained before meeting.

8. Directors may adopt:

a. Bylaws.

NOTE:

For bylaws for public benefit corporations, mutual benefit corporations, and religious corporations, see *§§ 13.201*, *13.212*, *13.221*, respectively. If the incorporators adopted the

bylaws, the directors must approve them and, if any bylaws require change, adopt appropriate amendments.

b. Corporate seal.

c. Form of membership certificate, in case of mutual benefit corporation.

NOTE:

A mutual benefit corporation may issue membership certificates, but is not required to do so. If membership certificates are desired, the certificate must contain the information prescribed by *Corp. Code § 7313(b)*, including any transfer restrictions [*Corp. Code § 7313*]. If membership certificates will be issued (after the application is accepted and any required fee paid), the president and secretary should sign the certificate. The member's name and certificate number should be entered in the membership list and the corporate records book. Alternatively, the corporation may issue identity cards to identify members eligible to use facilities or services of corporation [*Corp. Code § 7313(a)*].

Although the Nonprofit Public Benefit Corporation Law does not expressly provide for membership certificates, they are not prohibited.

d. Operational resolutions.

(1) Opening bank accounts.

(2) Selecting accountants.

(3) Establishing accounting year.

(4) Securing taxpayer identification number.

(5) Securing employer identification number.

NOTE:

The directors should authorize application for federal employee identification number [***see*** Internal Revenue Service Form SS-4] if corporation will have employees whose wages are subject to withholding of income taxes or F.I.C.A.

(6) Maintaining corporate books and records.

(7) Authorizing payment of organizational and other expenses of corporate formation.

(8) Registering with California Employment Development Department for purposes of unemployment insurance.

(9) Securing nonprofit mailing permit.

9. Directors must determine:

a. Address of corporation's principal office unless already specified in bylaws [*see Corp. Code §§ 5160,*

7160, 9160].

b. Manner in which memberships, if any, will be issued and nature of consideration for issuance.

10. If bylaws establish larger number of directors than those in office, elect additional directors to fill vacancies.

11. Directors should elect following officers and establish their duties, responsibilities, and salary [*Corp. Code §§ 5213(a), 7213(a), 9213(a)*]:

a. Chair of board of directors, or president, or both.

NOTE:
The chair may be given the title chair of the board, chairperson of the board, chairman of the board, or chairwoman of the board [*see Corp. Code §§ 5213(a), 7213(a), 9213(a)*; *see also Corp. Code § 5039* ("chair" defined)].

b. Secretary.

c. Treasurer or chief financial officer (or both).

NOTE:
Unless otherwise specified in the articles or bylaws, if there is no chief financial officer, the treasurer is the chief financial officer of the corporation [*Corp. Code §§ 5213(a), 7213(a), 9213(a)*].

d. Other officers with titles and duties as:

(1) Are stated in bylaws or determined by board of directors; and

(2) May be necessary to enable it to sign instruments.

12. Authorize and direct following filings:

a. Necessary filings with California Commissioner of Corporations if corporation will issue securities not exempt under Corporate Securities Law [*see* Ch. 6, *Securities Regulation Issues* ; Ch. 6H, *Qualification of Securities*].

b. Necessary filings or other actions under federal securities law if nonexempt securities will be offered or issued [*see* Ch. 6, *Securities Regulation Issues*].

c. Filing of initial information statement with Secretary of State [*Corp. Code §§ 6210, 8210, 9660(a)*; *see § 13.248*].

d. Filing of necessary forms and documents to obtain tax-exempt status under *I.R.C. § 501* [*see* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*].

e. Filing of necessary forms and documents if corporation will qualify for tax-exempt status under California's Franchise Tax Law [*see* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*].

f. Application for federal employer identification number (Form SS-4).

g. Registration with California Employment Development Department for unemployment insurance purposes [*see Unemp. Ins. Code §§ 1086, 1087*].

h. If corporation will conduct activities in other jurisdictions, authorize qualification as foreign corporation in other jurisdiction.

13. If public benefit corporation will qualify for "welfare exemption" from property taxes, directors should direct that application for exemption be made as soon as federal income tax and state franchise tax exemptions are obtained.

14. Authorize application for any licenses or permits necessary to conduct incidental business or activity associated with purposes of corporation.

15. If corporation will engage in sale of tangible personality of kind that, if subject of a retail sale, would make gross receipts of sale taxable, authorize securing of state sales tax permit from California Board of Equalization [*see Rev. & Tax. Code §§ 6014, 6066*].

16. If executive committees are established, specify their duties to extent that duties are not covered in bylaws, and appoint members.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-13 California Legal Forms--Transaction Guide §§ 13.122-13.129

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§§ 13.122[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
D. Drafting Guide

6-13 California Legal Forms--Transaction Guide § 13.130

§ 13.130 Articles of Incorporation

1. Include following mandatory statements in articles of incorporation:

a. Name of corporation [*Corp. Code §§ 5130(a), 7130(a), 9130(a)*].

NOTE:
For an outline discussing names prohibited under the Nonprofit Corporation Law and other laws, see *§ 13.111*. The articles must state the name exactly as the corporation wants it to appear in the Secretary's records [***see*** *§§ 13.200, 13.210, 13.220* (instructions to form)]. For discussion concerning name clearance and reservation of the corporate name, see *§§ 13.111, 13.120*, P 1.

b. General statement of purpose.

NOTE:
The statement of purpose, as applicable to the type of nonprofit corporation, must be stated exactly as prescribed by statute and cannot be modified [***see*** *Corp. Code §§ 5130(b), 7130(b), 9130(a)*; ***see also*** Organization of Domestic Nonprofit, Nonstock Corporations, Secretary of State's website http://www.ss.ca.gov/business/corp/corp_artsnpinf.htm].

(1) For public benefit corporation, use [*Corp. Code § 5130(b)*]:

"This corporation is a nonprofit public benefit corporation and is not organized for the private gain of any person. It is organized under the Nonprofit Public Benefit Corporation Law for public or charitable or public or charitable (select either or both) purposes."

NOTE:

If the purposes include "public" purposes, the articles must, and in all other cases the articles may, include a further description of the corporation's purposes [*Corp. Code § 5130(b)*; ***see*** P c, ***below***].

(2) For mutual benefit corporation, use [*Corp. Code § 7130(b)*]:

"This corporation is a nonprofit, mutual-benefit corporation organized under the Nonprofit Mutual Benefit Corporation Law. The purpose of this corporation is to engage in any lawful act or activity, other than credit union business, for which a corporation may be organized under such law."

NOTE:

If the corporation is subject to the California Credit Union Law, the purpose statement must instead be as prescribed by that law [*Corp. Code § 7130(b)(2)*; ***see*** *Fin. Code § 14101(b)*; ***see also*** *§ 13.210[2]*]. The articles may include a further description of the corporation's purposes [*Corp. Code § 7130(b)*; ***see*** P c, ***below***].

(3) For religious corporation, use [*Corp. Code § 9130(b)*]:

"This corporation is a religious corporation and is not organized for the private gain of any person. It is organized under the Nonprofit Religious Corporation Law primarily or exclusively (select one or both) for religious purposes."

NOTE:

The articles may include a further description of the corporation's purposes [*Corp. Code § 9130(b)*; ***see*** P c, ***below***].

c. Identify specific purpose of corporation.

NOTE:

The articles should include a statement describing the corporation's specific purpose, and must be included if the corporation is organized for public purposes or if the corporation intends to apply for state franchise tax exemption [***see*** Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Instructions (available on Secretary of State's website)].

d. Designate initial agent for service of process.

NOTE:

The designated agent, individual or corporation, must agree to accept process on behalf of the corporation before designation. A proposed corporation cannot designate itself as agent for service of process. When designating another corporation as agent, the agent corporation must have on file, with the Secretary of State, a statement pursuant to *Corp. Code § 1505*. When a corporate agent is used, the address of the designated corporation is not included in the articles [***see*** Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Instructions (available on Secretary of State's website)].

(1) In case of natural person designated as initial agent for purpose of service of process, following items [*Corp. Code §§ 5130(c), 7130(c), 9130(c)*]:

(a) Name of natural person.

(b) Complete business or residence address of natural person in California.

(2) In case of corporation designated as initial agent for purpose of service of process, name of agent [*Corp. Code §§ 5130(c), 7130(c), 9130(c)*; *see Corp. Code §§ 6210(b), 8210(b), 9660* (biennial statement)].

e. If public benefit or religious corporation will seek state tax exemption, add:

(1) Statement that corporation is organized and operated exclusively for charitable purposes [*see I.R.C. § 501(c)(3)*].

(2) Statement that no substantial part of corporate activities will consist of attempting to influence legislation or participating in political campaigns.

(3) Irrevocable dedication of corporate property to charitable or religious purposes, as applicable.

f. If mutual benefit corporation will seek state tax exemption, add statement that corporation will not substantially engage in activities or exercise powers not in furtherance of its specific purposes [*see § 13.210[2]*, instructions to form].

g. If unincorporated association is being incorporated pursuant to *Corp. Code § 5121(a), 7121(a),* or *9121(a),* state following matters [*Corp. Code §§ 5121(b), 7121(b), 9121(b)*]:

(1) Name of unincorporated association.

(2) Statement that existing unincorporated association is being incorporated by filing of articles of incorporation.

h. To obtain welfare exemption from property taxes, include following in articles of incorporation [*Rev. & Tax. Code §§ 214(a)(6), (e), 214.01(a)*]:

NOTE:
For discussion of the welfare exemption [*Rev. & Tax. Code § 214*], see Ch. 13B, ***Tax-Exempt Status for Nonprofit Entities*** .

(1) For religious, hospital, scientific, or charitable fund, foundation, or association:

(a) Statement of irrevocable dedication to religious, charitable, scientific, or hospital purposes.

NOTE:
Property is deemed irrevocably dedicated to religious, charitable, scientific, or hospital purposes only if a statement of irrevocable dedication to these purposes is included in the articles of incorporation [*Rev. & Tax. Code § 214.01(a)*].

If the Board of Equalization determines that the applicant is ineligible for exemption because the articles do not contain a statement of irrevocable dedication, the Board will notify the applicant in writing. The applicant has until the next succeeding lien date to amend its articles and file a certified copy of the conforming amendments to be eligible for the organizational clearance certificate [*Rev. & Tax. Code § 214.01(b)*].

(b) Provision that on liquidation, dissolution, or abandonment, property will not inure to benefit of private person except fund, foundation, or corporation organized and operated for religious, hospital, scientific, or charitable purposes.

(2) For educational institution of collegiate grade:

NOTE:
For educational institutions of collegiate grade [***see*** *Rev. & Tax. Code § 203* (definition)], the following provisions must be in the articles of incorporation [*Rev. & Tax. Code § 214(e)*].

(a) Statement of irrevocable dedication to charitable and educational purposes, to religious and educational purposes, or to educational purposes [*see Rev. & Tax. Code § 214(j)* ("educational purposes" defined)].

(b) Provision that on liquidation, dissolution, or abandonment, property will be distributed to fund, foundation, or corporation organized and operated for religious, scientific, charitable, or educational purposes, complying with *Rev. & Tax. Code §§ 203* or *214*.

2. If desired or if appropriate, include permissive statement further limiting purposes or powers of corporation [*Corp. Code §§ 5131, 7131, 9131*].

3. Include any mandatory provision required by law other than Nonprofit Corporation Law.

NOTE:
For example, the Nonprofit Public Benefit Corporation Law applies to corporations formed under the Small Business Development Corporation Law, which requires a statement to that effect in the articles [***see*** *Corp. Code §§ 14045, 14051*].

4. If desired or if appropriate, include following permissible optional provisions, which are not effective unless expressly provided in articles [*Corp. Code §§ 5132(a), 7132(a), 9132(a)*]:

NOTE:
Neither the following provisions nor the authorizing statutory sections will affect the enforceability, as between the parties, of any lawful agreement not otherwise contrary to public policy [*Corp. Code §§ 5132(b), 7132(b), 9132(b)*].

a. Provision limiting duration of existence of corporation to specified date.

b. In case of subordinate corporation instituted or created under authority of head organization, provision setting forth either or both of the following:

NOTE:
The Department of Corporations has informally indicated that when the articles contain either or both of the following provisions, they should also contain an introductory statement that the corporation is a subordinate organization created under the authority of the head organization.

(1) That subordinate corporation will dissolve whenever its charter is surrendered to, taken away by, or revoked by head organization granting it; and/or

(2) That in event of its dissolution pursuant to article provision allowed by *Corp. Code §§ 5132(a)(2)(A), 7132(a)(4)(A),* or *9132(a)(2)(A),* or, in event of its dissolution for any reason, any assets of corporation remaining after compliance with applicable provisions governing distribution of assets will be distributed to head organization.

c. In case of mutual benefit corporations [*Corp. Code § 7132(a)(2), (3)*]:

(1) Provision conferring on holders of any evidences of indebtedness, issued or to be issued by corporation, right to vote in election of directors and on any other matters on which members may vote under Nonprofit Mutual Benefit Corporation Law even if corporation does not have members.

(2) Provision conferring on members right to determine consideration for which memberships shall be issued.

5. If desirable or appropriate, include following optional provisions (among many other optional provisions) [*Corp. Code §§ 5132(c), 7132(c), 9132(c)*]:

NOTE:

Counsel should weigh various factors in determining whether provisions relating to the members of the corporation should be set forth in the articles or in the bylaws. One consideration is that articles of incorporation are public documents. Further, amending articles is more complex than amending bylaws. For example, although the bylaws may generally be amended or repealed by the approval of the members or the board of directors [*Corp. Code §§ 5150, 7150, 9150*], articles, with certain exceptions, can be amended only if approved by the board, members, and any other persons, as required by the articles [*Corp. Code § 5812(a), 7812(a)*]. Moreover, an amendment of the articles is not effective until a certificate of amendment [***see** §§ 13.260, 13.261*] or restated articles [***see** § 13.262*] is filed with the Secretary of State [*Corp. Code §§ 5817, 7817*].

a. Names and addresses of persons appointed to act as initial directors of corporation.

b. Classes of members, if any.

NOTE:

The Nonprofit Corporation Law defines "member" as any person who, pursuant to a specific provision of a corporation's articles or bylaws, has the right to vote for the election of a director or directors or on a disposition of all or substantially all of the assets of a corporation or on a merger or on a dissolution, with the exception of holders of indebtedness having similar rights in the case of mutual benefit corporations [*Corp. Code § 5056(a)*; ***see** Corp. Code § 7132(a)*]. "Member" also means any person who is designated in the articles or bylaws as a member and, pursuant to a specific provision of a corporation's articles or bylaws, has the right to vote on changes to the articles or bylaws [*Corp. Code § 5056(a)*]. The term "person" includes natural persons as well as business entities [***see** Corp. Code § 5065*].

c. If there are two or more classes of membership, identify rights, privileges, preferences, restrictions, and conditions attaching to each class.

d. Provision allowing any member to have more or less than one vote in any election or other matter presented to members for vote.

e. Provision requiring that amendments to articles [*see Corp. Code §§ 5812(a), 7812(a)*] or bylaws, and any amendment or repeal of that amendment, be approved in writing by specified persons other than board or board members.

NOTE:

This approval requirement will not apply in the following circumstances unless the articles specify otherwise: (1) the specified person has died or ceased to exist, (2) the specified office, trust, or status has ceased to exist, or (3) the corporation has provided written notice of a specific proposal for amendment or repeal to the specified person and the corporation has not received approval or nonapproval within a specified time [*Corp. Code §§ 5132(c)(4), 7132(c)(4), 9132(c)(4)*].

f. Any other provision, not in conflict with law, for management of activities and for conduct of affairs of corporation, including any provision required or permitted by Nonprofit Public Benefit Corporation Law, Nonprofit Mutual Benefit Corporation Law, or Nonprofit Religious Corporation Law to be stated in bylaws.

g. In case of mutual benefit corporation, provisions concerning transfer of memberships, in accordance with *Corp. Code § 7320* [*Corp. Code § 7132(c)(2)*].

NOTE:

The rules governing the transferability of memberships vary depending on the type of nonprofit corporation. Members of public benefit corporations are prohibited from transferring memberships, or any rights arising out of membership, for value; however, members may transfer memberships, or any rights arising out of membership, if the transfer is authorized by the articles of incorporation or bylaws, but only if the transfer is not for value [*Corp. Code § 5320(a), (b)*; ***but see*** *Corp. Code § 5320(c)* (restrictions inapplicable to purchase of memberships in limited-equity housing public benefit corporations)]. Members of mutual benefit corporations may transfer memberships, or any rights arising out of membership, but only if the articles of incorporation or bylaws provide for, or authorize the board to provide for, membership transfer [*Corp. Code § 7320(a), (b)*]. Members of religious corporations are prohibited from transferring memberships, or any rights arising out of membership, for value [*Corp. Code § 9320(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
D. Drafting Guide

6-13 California Legal Forms--Transaction Guide § 13.131

§ 13.131 Bylaws

NOTE:
For bylaws for public benefit corporations, mutual benefit corporations, and religious corporations, see *§§ 13.201*, *13.212*, *13.221*, respectively.

1. Evaluate purpose and importance of bylaws to corporation.

NOTE:
General requirements for bylaws are specified by statute [*Corp. Code §§ 5151-5153*, *7151-7153*, *9151-9153*]. Bylaws contain the governing rule of the corporation. They can provide rules for matters not covered by statute, and can alter specific default provisions that apply in the absence of an applicable bylaw. The level of detail contained in the bylaws varies by the size of the corporation, its intended purposes, and complexity of corporate operations.

2. State number of directors of corporation.

NOTE:
The bylaws must specify the exact number of directors of the corporation, or the method of determining the number of directors of the corporation, unless the articles of incorporation contain that information. Alternatively, the articles or bylaws may state that the number of directors must not be less than a stated minimum nor more than a stated maximum with the exact number of directors to be fixed by the approval of the board or the members. In either event, the number of minimum number of directors may be one or more [*Corp. Code §§ 5151(a), 7151(a), 9151(a)*].

3. Include any of following optional provisions [*Corp. Code §§ 5151(c), 7151(c), 9151(c)*]:

NOTE:
The bylaws may contain any provision, not in conflict with the law or the articles, for the management of the activities of the corporation and for the conduct of the affairs of the corporation.

a. Principal office of corporation in California.

b. Names and addresses of persons appointed as initial directors [*Corp. Code §§ 5151(c)(1), 7151(c)(1), 9151(c)(1)*].

c. Corporations with members:
(1) Classes of members, if any.

(2) Qualifications for admission, such as approval and payment of membership fees and/or dues.

(3) Provisions setting, imposing, and collecting dues, assessments, and admission and transfer fees [*see Corp. Code §§ 5151(c)(8), 7151(c)(8), 9151(c)(8)*].

(4) If there are two or more classes of members, following items with respect to each class of members:
(a) Rights.

(b) Privileges.

(c) Restrictions.

(d) Conditions.

(5) Number of members.

NOTE:
The bylaws may limit the number of members, in total or of any class, that the corporation is authorized to admit [***see*** *Corp. Code §§ 5151(f), 7151(f), 9151(f)*].

(6) Time, place, manner of calling members' meetings, notice requirements and/or mail balloting procedure [*Corp. Code §§ 5151(c)(2), 7151(c)(2), 9151(c)(2)*].

(7) Quorum provisions.

(8) Record date.

(9) Inspectors of election provisions, including appointment, duties, and voting requirements.

(10) Voting rights, such as bylaw allowing cumulative or proxy voting.

(11) Waiver of notice and consent to action without meeting.

(12) Transfer of memberships:

(a) Transfer prohibited.

(b) For mutual benefit corporations, transfer provisions in accordance with *Corp. Code § 7320*.

(13) Admission, withdrawal, suspension, and expulsion of members [*see Corp. Code §§ 5151(d), 7151(d), 9151(d)*].

d. Director provisions [*see Corp. Code §§ 5151(c)(3), 7151(c)(3), 9151(c)(3)*; *see also* P 2, *above*].

(1) Qualifications.

(2) Time of election, nomination and election procedure, and tenure.

(3) Rights and duties.

(4) Compensation and reimbursement.

(5) Time, place, and manner of calling directors' meetings and/or mail balloting procedure [*Corp. Code §§ 5151(c)(2), 7151(c)(2), 9151(c)(2)*].

(6) Quorum provisions.

(a) Directors' meeting.

(b) Committee meetings.

(7) Conduct of board meetings.

(8) Adjournment.

(9) Actions without meeting.

(10) Vacancy, resignation, and removal provisions.

e. Committee provisions [*see Corp. Code §§ 5151(c)(4), 7151(c)(4), 9151(c)(4)*].

(1) Appointment.

(2) Types of committees.

(3) Composition.

(4) Authority.

(5) Time, place, and manner of calling committee meetings and/or mail balloting procedure [*Corp. Code §§ 5151(c)(2), 7151(c)(2), 9151(c)(2)*].

f. Officers [*Corp. Code §§ 5151(c)(5), 7151(c)(5), 9151(c)(5)*]:

(1) Appointment.

(2) Duties.

(3) Compensation.

NOTE:
The bylaws may fix the compensation of officers, or compensation may be settled by board resolution [*Corp. Code §§ 5151(c)(5), 7151(c)(5), 9151(c)(5)*; ***see*** *Corp. Code § 5235*]. Sanctions may be imposed on officers receiving excessive compensation and the manager who approves the payment [***see*** *I.R.C. § 4958*]. If an officer is also a director and compensation will be set by board resolution, the statutes governing self-dealing and financial interest transactions should be consulted [***see*** *Corp. Code §§ 5233, 7233, 9243*; ***see also*** *§ 13.38*].

(4) Tenure.

g. Mode of determination of members of record [*Corp. Code §§ 5151(c)(6), 7151(c)(6), 9151(c)(6)*].

h. Reporting requirements and financial statements [*Corp. Code §§ 5151(c)(7), 7151(c)(7), 9151(c)(7)*].

4. Include secretary's certificate form.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
D. Drafting Guide

6-13 California Legal Forms--Transaction Guide §§ 13.132-13.139

[Reserved]

§§ 13.132[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

6-13 California Legal Forms--Transaction Guide § 13.140

§ 13.140 Transferring Property From Unincorporated Association

1. In case of incorporation of unincorporated association, prepare following documents and instruments:

NOTE:

When an unincorporated association changes status to a corporation, the property of the association becomes the property of the corporation [*Corp. Code §§ 5121(d), 7121(d), 9121(d)*]. All rights of creditors and all liens on the property of the association are preserved unimpaired [*Corp. Code §§ 5121(f), 7121(f), 9121(f)*].

a. Deeds.

b. Assignments.

c. Other documents or instruments respecting transfer of property and other rights of unincorporated association.

2. Have appropriate officers of association execute conveyances and verified statement confirming proper reformation as corporation.

NOTE:

Two officers or two governing board members of the association must prepare a verified statement to accompany the articles stating that the incorporation of the association by means of the articles to which the verified statement is attached has been approved by the association in accordance with its rules and procedures [*Corp. Code §§ 5121(c), 7121(c), 9121(c)*; ***see*** *§ 13.242*].

3. Record certified copy of articles of incorporation in every California county in which association owned real property.

NOTE:

The filing for record in the office of the county recorder of a certified copy of the articles of incorporation evidences record ownership in the corporation of all interests of the association in and to real property located in that county [*Corp. Code §§ 5121(c), 7121(c), 9121(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawUnincorporated AssociationsReal Property LawOwnership & TransferGeneral OverviewReal Property LawOwnership & TransferBusiness & Corporate EntitiesReal Property LawPriorities & RecordingRecording Acts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

6-13 California Legal Forms--Transaction Guide § 13.141

§ 13.141 Filing Certificates of Correction and Amendment

1. Certificate of correction.

a. Draft certificate of correction to correct any of the following in any agreement, certificate, or other instruments [*Corp. Code § 5007*]:

NOTE:
The certificate must state the name of the corporation, the filing date of the instrument being corrected, and the provision as corrected or how the execution was defective. The filing of the certificate does not alter the original effective time of the instrument being corrected; the filing does not affect any right or liability accrued or incurred before the filing date of the certificate of correction, except that any right or liability accrued or incurred by reason of the error or defect being corrected is extinguished by the filing if the person having that right has not detrimentally relied on the original instrument [*Corp. Code § 5007*].

For a certificate of correction, and discussion of the required contents, see *§ 13.243*.

(1) Misstatement of fact contained in articles of incorporation.

(2) Defect in execution of articles.

(3) Any other error or defect contained in articles.

b. Do not prepare certificate of correction to alter wording of adopted resolution [*Corp. Code § 5007*].

c. Do not prepare certificate of correction to effect corrected amendment of articles of incorporation if corrected amendment would be in noncompliance with requirements applicable to nonprofits generally and specifically to public benefit, mutual benefit, and religious corporations [*Corp. Code § 5007*].

d. Have certificate of correction signed and verified or acknowledged by persons executing same [*Corp. Code § 5007*].

e. Pay filing fee [*see Gov. Code § 12186(p)*; *Corp. Code § 5006*].

NOTE:

The Secretary of State will compare and certify up to two copies of the certificate without charge provided that the copies are submitted with the original to be filed [***see*** *Gov. Code § 12185*].

2. Certificate of amendment of articles of incorporation.

NOTE:

The articles of incorporation may be amended by a majority of incorporators or, more commonly, by the officers of the corporation [***see*** *Corp. Code §§ 5815-5817*, *7815-7817*, *9620(a)*]. For forms, see *§§ 13.260, 13.261*. Alternatively, the articles may be restated in their entirety [***see*** *§ 13.262*].

a. Draft certificate of amendment to effect all necessary changes to articles of incorporation, stating following:

(1) At least majority of incorporators have signed certificate.

(2) No directors were named in articles and no directors have been elected.

(3) Corporation has no members.

(4) Incorporators have adopted amendment(s) stated in certificate.

(5) Wording of amendment [*see §§ 13.260, 13.261*]:

NOTE:

A corporation may not amend its articles to alter any statement that may appear in the original articles of the names and addresses of the first directors, the name and address of the initial agent, except to correct an error in the statement or to delete either after the corporation has filed a biennial statement pursuant to *Corp. Code §§ 6210, 8210,* or *9660(a)* [*Corp. Code §§ 5810(b), 7810(b), 9620(a)*].

(a) State that articles will be amended as set forth in certificate in full.

(b) State that specific provision, identified by numerical or other designation given in articles or by stating wording, is stricken and amended to read as set forth in certificate.

(c) State that provisions in certificate are added to articles.

b. Have certificate approved by:

(1) Majority of incorporators.

NOTE:

A majority of the incorporators may adopt any amendment of the articles of a nonprofit corporation, provided that the initial directors were not named in the articles, no directors have been elected, and the corporation does not have members [*Corp. Code §§ 5811, 5815, 7811, 7815, 9620(a)*; ***see*** *Corp. Code §§ 5819, 7819*; Amendment of California Nonprofit Corporations, Secretary of State's website, http://www.ss.ca.gov/business/corp/pdf/amendments/corp_amdtnp.pdf; ***see also*** *§ 13.260*].

(2) Approval of board of directors.

NOTE:

An amendment to the articles may be adopted by the approval of the board of directors if the corporation has no voting members [*Corp. Code §§ 5812(b)(3), 7812(b)(3), 9620(a)*; ***see*** *§ 13.261*].

(3) Approval of board of directors and requisite vote of members, if required.

NOTE:

The board may adopt the following amendments on its own, regardless of the existence of members: (1) amendment deleting names and addresses of initial directors or name and address of initial agent [*Corp. Code §§ 5812(b)(2), 7812(b)(2), 9620(a)*]; (2) amendment electing to be governed by new Nonprofit Corporation Law if corporation was organized before January 1, 1980 [*Corp. Code §§ 5812(b)(4), 7812(b)(4), 9620(a), 9913* (transition provisions)]; and (3) amendment extending corporate existence or making it perpetual if corporation was organized before August 14, 1929 [*Corp. Code §§ 5812(b)(1), 7812(b)(1), 9620(a)*].

c. Have certificate signed and verified by:

(1) Majority of incorporators [*Corp. Code §§ 5811, 5815, 7811, 7815, 9620(a)*].

(2) Two corporate officers, if board is approving amendment [*see* Amendment of California Nonprofit Corporations, Secretary of State's website, http://www.ss.ca.gov/business/corp/pdf/amendments/corp_amdtnp.pdf].

d. File original and at least two copies of certificate, together with filing applicable filing fees, in Sacramento office of Secretary of State.

NOTE:

The incorporators should file the original certificate and at least two copies of the certificate, and file a certified copy in the corporate records book. Amendment documents may only be filed in the Sacramento headquarters office, either by mail or hand delivery [***see*** Amendment of California Nonprofit Corporations, Secretary of State's website, http://www.ss.ca.gov/business/corp/pdf/amendments/corp_amdtnp.pdf]. The certificate must be accompanied by the applicable filing fee [***see*** *Gov. Code § 12186(o)*]. The Secretary of State will compare and certify up to two copies of the certificate at no charge provided that the copies are submitted with the original to be filed [*Gov. Code § 12185*]. If additional certified copies are required, an

additional minimal fee is charged, provided that the copies are furnished to the Secretary of State [*Gov. Code §§ 12182, 12183*; ***see also*** *Gov. Code §§ 12186, 12200, 12207, 12209*]. A separate and nonrefundable handling fee is charged for expedited processing of documents delivered in person, over the counter, to the Sacramento headquarters office [***see*** *2 Cal. Code Reg. § 21903*; ***see also*** Office of Secretary of State, State of California, Amendment of California Nonprofit Corporation, Instructions (available on Secretary of State's website)].

e. If corporation is public benefit corporation, file additional copy for transmittal to Attorney General [*Corp. Code § 5817*; Amendment of California Nonprofit Corporations, Secretary of State's website, http://www.ss.ca.gov/business/corp/pdf/ amendments/corp_amdtnp.pdf].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

6-13 California Legal Forms--Transaction Guide § 13.142

§ 13.142 Recordkeeping and Reporting Requirements

NOTE:
The failure to make or direct an entry into the corporate records as required by law is a crime punishable by fine and/or imprisonment [***see*** *Corp. Code §§ 6812, 6813, 8812, 8813, 9690*].

1. Maintain original or copy of following for inspection at corporation's principal office in California [*Corp. Code §§ 5160, 7160, 9160*]:

NOTE:
Every corporation must keep at its principal office in California the original or a copy of its articles and bylaws as amended to date. These documents must be open to inspection by the members at all reasonable times during office hours. A corporation with no office in California must, on the written request of any member, furnish a copy of the articles or bylaws as amended to date to that member [*Corp. Code §§ 5160, 7160, 9160*]. Every director has an right to inspect and copy all books, records, and documents of the corporation. For public benefit and mutual benefit corporations, this right is absolute. However, directors of religious corporation must have a purpose reasonably related to that person's interests as a director [*Corp. Code §§ 6334, 8334, 9513*].

a. Articles of incorporation.

b. Bylaws.

2. File all written consents, waivers, and approvals in corporate records books.

NOTE:

As an alternative to filing the following consents, waivers, and approvals in the corporate records books, the corporation may make them a part of the minutes of the meeting [*Corp. Code §§ 5211(a)(3), 5511(e), 5516, 7211(a)(3), 7511(e), 7516, 9211(a)(3), 9410(d), 9420*].

a. Director consents, waivers, and approvals [*Corp. Code §§ 5211(a)(3), (b), 7211(a)(3), (b), 9211(a)(3), (b)*].

b. Member consents, waivers, and approvals in corporate records or as part of minutes of proceedings of members [*Corp. Code §§ 5511(e), 5516, 7511(e), 7516, 9410(d), 9420*].

3. Keep adequate and correct books and records of account [*Corp. Code §§ 6320(a)(1), 8320(a)(1), 9510(a)(1)*].

NOTE:

These books and records must be kept in written form, in any other form capable of being converted into clearly legible tangible form, or any combination of the two. When records are kept in a form capable of being converted into clearly legible paper form, the form into which the record is converted is admissible in evidence, and accepted for all other purposes, to the same extent as an original paper record of the same information would have been, provided that the paper form accurately portrays the record [*Corp. Code §§ 6320(b), 8320(b), 9510(b)*].

4. Keep minutes of the proceedings of corporation's members, board, and board committees [*Corp. Code §§ 6320(a)(2), 8320(a)(2), 9510(a)(2)*].

NOTE:

The minutes must be kept in written form, in any other form capable of being converted into clearly legible tangible form, or any combination of the two. When records are kept in a form capable of being converted into clearly legible paper form, the form into which the record is converted is admissible in evidence, and accepted for all other purposes, to the same extent as an original paper record of the same information would have been, provided that the paper form accurately portrays the record [*Corp. Code §§ 6320(b), 8320(b), 9510(b)*].

5. Maintain record of members, stating their names, addresses and the class of membership held by each [*Corp. Code §§ 6320(a)(3), 8320(a)(3), 9510(a)(3)*].

NOTE:

These books and records must be kept in written form, in any other form capable of being converted into clearly legible tangible form, or any combination of the two. When records are kept in a form capable of being converted into clearly legible paper form, the form into which the record is converted is admissible in evidence, and accepted for all other purposes, to the same extent as an original paper record of the same information would have been, provided that the paper form accurately portrays the record [*Corp. Code §§ 6320(b), 8320(b), 9510(b)*].

6. Maintain accounting books, records, and minutes of board, committee, and member meetings for

inspection.

NOTE:

The accounting books and records and minutes of proceedings of members and the board and committees of the board must be open to inspection on the written demand on the corporation by any member at any reasonable time for a purpose reasonably related to that person's interest as a member [*Corp. Code §§ 6333, 8333, 9512*]. Every director has a right to inspect and copy all books, records, and documents of the corporation. For public benefit and mutual benefit corporations, this right is absolute; however, directors of religious corporations must have a purpose reasonably related to that person's interests as a director [*Corp. Code §§ 6334, 8334, 9513*].

7. File periodic statement of information as required by applicable California statute.

NOTE:

The fee for filing the statement is set forth in *Gov. Code § 12186(e)*. The Secretary of State may cancel the filing of the statement if the check or other remittance accepted in payment of the filing fee or franchise tax is not paid on presentation. Within 70 days after the articles were filed, the Secretary of State must give written notice to the agent for service of process or the person submitting the instrument that the item presented for payment was not honored. The notice must specify a date, not less than 20 days after the mailing date of the notice, on which the cancellation is to be effective if the fee is not paid by cashier's check or the equivalent [*Corp. Code § 5008.5*]. The receipt for these fees includes the number assigned to the corporation for use in its tax returns and ordinarily is given or mailed to counsel.

a. For domestic nonprofit corporations [*Corp. Code §§ 6210(a), 8210(a), (b), 9660(a)*; *see § 13.248* (form)]:

(1) Within 90 days after filing of original articles [*see § 13.120* P 17]; and

(2) Biennially thereafter during applicable filing period.

b. For foreign nonprofit corporations, annually during applicable filing period [*Corp. Code §§ 2117, 2117.1, 6910, 8910*; *see § 13.249* (form)].

8. If corporation is exempt, file annual information returns on Form 990 [*see Treas. Reg. § 1.6033-2(a)(1)*; *see also* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*].

NOTE:

Private foundations file their annual information return on Form 990-PF [***see** Treas. Reg. § 1.6033-2(a)(2)*]. A parent organization may file a single Form 990 on behalf of all group members [***see** Treas. Reg. § 1.6033-2(d)*]. Annual returns must be maintained by the organization and made available for inspection for three years.

9. For a public benefit corporation:

a. Prepare annual report to members and directors, stating following in "appropriate detail" [*see Corp. Code § 6321(a)*]:

NOTE:

The annual report must be accompanied by any report of independent accountants, or, absent a report, the certificate of an authorized officer of the corporation to the effect that the statements in the report were prepared without audit from the books and records of the corporation [*Corp. Code § 6321(b)*]. Unless otherwise provided by the articles or bylaws, and if approved by the board of directors, the annual report and any accompanying material may be sent by electronic transmission by the corporation [*Corp. Code § 6321(a)*; ***see*** *Corp. Code § 20*].

No annual report need be sent if the corporation receives less than $25,000 in gross revenues or receipts during the fiscal year [*Corp. Code § 6321(c)*]. If the corporation provides for regular meetings of members less often than annually, then the report need be made to members only with the frequency of the regular membership meetings unless the articles or bylaws require a report more often [*Corp. Code § 6321(d)*]. However, in any event, a report with the required information must be furnished annually to all directors and any member who requests it in writing [*Corp. Code § 6321(e)*]. A corporation that solicits contributions in writing from 500 or more persons is also exempt from the annual reporting requirement under specified circumstances [***see*** *Corp. Code § 6321(f)*].

If the corporation reports to the Attorney General [***see*** P 12, ***below***], and the report contains the information required by the annual report, the corporation may furnish a copy of that report in lieu of the annual report [*Corp. Code § 6324*].

(1) Assets and liabilities, including trust funds, of corporation as of end of fiscal year.

(2) Principal changes in assets and liabilities, including trust funds, during fiscal year.

(3) Revenue or receipts of corporation, both unrestricted and restricted to particular purposes, for fiscal year.

(4) Expenses or disbursements of corporation, for both general and restricted purposes, during fiscal year.

(5) Statement of transactions involving self-dealing, indemnification, and advances between corporation and 10 percent holder [*see Corp. Code § 6322*].

NOTE:
Most of the above information is required for preparing the annual state and federal tax returns [***see*** Ch. 13B, ***Tax-Exempt Status for Nonprofit Entities***], but the annual report must be distributed approximately 15 days earlier.

b. Deliver annual report to members and directors within 120 days after close of corporation's fiscal year in one of following ways [*Corp. Code § 6321(a)*; *see Corp. Code §§ 5016, 5511*]:

(1) Personal delivery.

(2) Mail or other written communication sent to member at address listed in corporate record books or address given for purpose of notice.

(3) Electronic transmission by the corporation [*see Corp. Code § 20*].

NOTE:
The board of directors must approve the use of electronic transmission [*Corp. Code § 6321(a)*].

(4) Including report in corporation's newsletter, magazine, or other organ regularly sent to members, addressed, and mailed or delivered to member.

NOTE:
In the case of members who are residents of the same household and have the same address in the corporate record books, notice to one is deemed notice to the others [*Corp. Code § 5016*].

(5) If no address is recorded or given, give notice by mail or other written communication addressed to corporation's principal office or by publication in newspaper of general circulation in county where corporation has principal office.

NOTE:
As a general matter and to avoid this option, the membership list should be reviewed annually before the earlier of the board or member meeting.

10. For a mutual benefit corporation:

a. Prepare annual report to members and directors, stating in "appropriate detail" [*see Corp. Code § 8321(a)*]:

NOTE:
The annual report must be accompanied by any report of independent accountants, or, absent a report, the certificate of an authorized officer of the corporation to the effect that the statements in the report were prepared without audit from the books and records of the corporation [*Corp. Code § 8321(b)*]. No annual report need be sent if the corporation receives less than $10,000 in gross revenues or receipts during the fiscal year [*Corp. Code § 8321(c)*]. Unless otherwise provided by the articles or bylaws, and if approved by the board of directors, the annual report and any accompanying material may be sent by electronic transmission by the corporation [*Corp. Code § 8321(a)*; ***see*** *Corp. Code § 20*].

(1) Balance sheet as of end of fiscal year and income statement and statement of cash flows for fiscal year.

(2) Statement of location of names and addresses of current members.

(3) Statement of transactions involving self-dealing, indemnification, and transactions in which director, officer, or 10 percent holder had material financial interest [*see Corp. Code § 8322*].

b. Deliver annual report to members and directors within 120 days after close of corporation's fiscal year in one of following ways [*Corp. Code § 8321(a)*; *see Corp. Code §§ 5016, 7511*]:

(1) By personal delivery.

(2) By mail or other written communication sent to member at address listed in corporate record books or address given for purpose of notice.

(3) Electronic transmission by the corporation [*see Corp. Code § 20*].

NOTE:
The board of directors must approve the use of electronic transmission [*Corp. Code § 8321(a)*].

(4) By including report in corporation's newsletter, magazine, or other organ regularly sent to members, addressed, and mailed or delivered to member.

NOTE:
In the case of members who are residents of the same household and have the same address in the corporate record books, notice to one is deemed notice to the others [*Corp. Code § 5016*].

(5) If no address is recorded or given, by mail or other written communication addressed to corporation's principal office or by publication in newspaper of general circulation in county where corporation has principal office.

NOTE:
As a general matter and to avoid this option, the membership list should be reviewed at least annually before any board or members meetings.

11. For a religious corporation, prepare and deliver annual report to members and directors if required by bylaws.

NOTE:
The Nonprofit Religious Corporation Law does not independently require annual reports. However, unless otherwise provided in the articles or bylaws, a member may inspect and copy the record of all the members' names, addresses, and voting rights, at reasonable times, on five business days prior written demand for a purpose reasonably related to the member's interest as a member [*Corp. Code § 9511*]. Similarly, unless otherwise provided in the articles or bylaws, the accounting books and records and the minutes of proceedings of the members, board, and board committees must be open to inspection on the written demand of any member at any reasonable time, for a purpose reasonably related to such person's interests as a member [*Corp. Code § 9512*]. Further, directors, at any reasonable time, may inspect and copy all books, records, and documents of every kind and to inspect the physical properties of the corporation for a purpose reasonably related to that person's interests as a director [*Corp. Code § 9513*].

12. If corporation is one of following, prepare and file annual report with California Attorney General (Registrar of Charitable Trusts) unless exempt [*see Gov. Code § 12580 et seq.*; *see also § 13.36[3][a]*; Form RRF-1].

NOTE:
The corporation must file Form RRF-1 with the Registry of Charitable Trusts on or before January 15 of each year or risk loss of exempt status, the assessment of minimum tax, and the imposition of late fees [***see*** Form RRF-1]. Form RRF-1 seeks information about the corporation's revenues, expenditures, assets, liabilities, financial situation, and fundraising activities.

Corporations with assets in excess of $25,000 must file a copy of their informational tax return (IRS Form 990, 990-EZ, or 990-PF) with the registry within four and one half months after the end of the

corporation's fiscal year [***see*** *Gov. Code § 12586(d)*; ***see also*** *11 Cal. Code Reg. § 305* (extension for good cause)].

Form RRF-1 is available from the registry and may be downloaded from http://caag.state.ca.us/charities [***see*** Form RRF-1].

a. Charitable corporations [*Gov. Code § 12582.1*].

(1) Domestic nonprofit corporation formed for charitable or eleemosynary purposes.

(2) Foreign nonprofit corporation doing business or holding property in California for charitable or eleemosynary purposes.

b. Corporations, unincorporated associations, trustees, and other legal entities holding property for charitable purposes [*Gov. Code § 12581*].

NOTE:

Every charitable corporation, unincorporated association, and trustee must file with the Attorney General a copy of the articles of incorporation or other instrument that governs the operation of the entity within 30 days of receiving property. A trustee is not required to register as long as the charitable interest is a future interest, but must do so within 30 days after any charitable interest in a trust becomes a present interest [Corp. Code § 12585].

c. Corporations that accepted property for particular charitable purpose as distinguished from general corporate purposes [*Gov. Code § 12581*].

d. Corporations formed to administer charitable trust, pursuant to directions of settlor or at instance of trustee [*Gov. Code § 12582*].

e. Commercial fundraisers for charitable purposes [*Gov. Code § 12581, 12599*].

13. For a public benefit corporation:

a. File copy of any proposed merger agreement with Attorney General at least 20 days before consummating merger [*Corp. Code § 6010(b)*].

b. Furnish at least 20 days written notice to Attorney General (unless waived) of sale, lease, transfer, or other disposition of all or substantially all of corporation's assets unless disposition is in usual or regular course of corporation's activities [*see Corp. Code § 5913*].

14. If person or entity designated as agent for service of process is no longer eligible, immediately file new designation with Secretary of State [*see Corp. Code §§ 6212, 8212, 9660*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesTax LawState & Local TaxesFranchise TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

6-13 California Legal Forms--Transaction Guide § 13.143

§ 13.143 Securing Insurance Coverage

1. Evaluate nonprofit corporation's existing and potential activities and determine areas of potential exposure to liability.

2. Recommend that nonprofit corporation secure insurance protection, for example, covering following potential exposures:

a. Discriminatory or improper employment practices;

b. Civil rights violations;

c. Improper board or executive actions;

NOTE:
Several statutes provide protection against liability for the good faith actions of unpaid or volunteer directors and executive officers [***see, e.g.,*** *Corp. Code §§ 5047.5, 5239, 7231.5, 9247*]. For further discussion, see *§ 13.37*.

d. Workers' compensation claims;

e. Personal injury liability; and

f. Financial or fiscal improprieties.

3. Examine corporate insurance policy to ensure that policy provides necessary coverage.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsFormationInsurance LawGeneral Liability InsuranceGeneral OverviewLabor & Employment LawDisability & Unemployment InsuranceUnemployment CompensationCoverage & DefinitionsWorkers' Compensation & SSDICoverageGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

6-13 California Legal Forms--Transaction Guide § 13.144

§ 13.144 Document Review

1. Advise board of directors of need to review following with counsel every three years:

NOTE:

The following documents should be reviewed for accuracy and consistency. As the corporation matures, one or more of these documents may need periodic amendment. The review should also ensure that corporate and tax exemption formalities have been followed.

a. Articles of incorporation.

b. Bylaws.

c. Corporate purpose or mission statement.

d. Public statements, brochures, and advertising copy.

e. Insurance policies.

f. Any indemnity provision.

NOTE:

Nonprofit corporations may indemnify agents, including directors, officers, employees, and other agents of the corporation to the extent specified by statute [***see*** *Corp. Code §§ 5238, 7237, 9246*].

2. Advise board of directors or executive committee to review bylaws with counsel before sending notice of meeting to elect directors:

a. Ensure that number of directors stated in bylaws is same as number actually serving.

b. Ensure that existing officers' titles, job description, and authority are as described.

c. Ensure that any statement of corporate purpose is consistent with articles and current operations.

3. Advise board of directors of need to review member list before sending notice of meeting.

a. Ensure accurate list of members and record of some address for each member.

b. Ensure that number of members does not exceed any numerical limit set forth in bylaws.

c. Ensure that existing members satisfy any eligibility requirements, including payment of membership fees or dues.

4. If corporation has conflict of interest policy, review policy annually:

a. For clear, substantive content.

b. Signed by directors in office.

c. Ensure that disclosures are recorded in minutes.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

6-13 California Legal Forms--Transaction Guide §§ 13.145-13.199

[Reserved]

§§ 13.145[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
1. Nonprofit Public Benefit Corporations

6-13 California Legal Forms--Transaction Guide § 13.200

§ 13.200 Articles of Incorporation

[1] Comment

[a] Use of Form

This form is a sample set of articles of incorporation for use by nonprofit public benefit corporations. It is modeled after the sample provided by the Secretary of State, and contains all provisions required by law. Samples are also available on official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. However, the latter samples are illustrative only, and cannot be filled in and submitted in the form reproduced on the website.

A nonprofit public benefit corporation is formed and corporate existence begins on the filing of the articles of incorporation and continues perpetually unless otherwise expressly provided by law or in the articles [*Corp. Code § 5120(a), (c)*; *see Corp. Code § 5132(a)(1)* (limiting corporation's existence); *see also §§ 13.20, 13.130*].

[b] Mandatory Provisions

Article I must be completed with the name of the corporation exactly as the name is to appear on the records of the Secretary of State.

Article IIA has been taken directly from the California Corporations Code as is required by law and should only be modified to include the applicable purpose description (preceding the word "purposes" in the second sentence, the word "charitable" or the words "public and charitable" may be substituted for the word "public").

Article IIB should be completed with a statement as to the specific purpose of the corporation. This statement is required if the corporation is organized for public purposes or if the corporation intends to apply for a state franchise tax exemption [*see* Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Instructions].

Article III must be completed with the name and California address, or physical location, of the agent for service of process.

Article IV and Article V, when applicable, contain language required by the Franchise Tax Board and Internal Revenue Service to be included in the articles of incorporation before tax exempt status may be granted. The Internal Revenue Service has refused to grant an exemption under *I.R.C. § 501(c)(3)* to a nonprofit corporation unless the articles of incorporation contain additional language that the Internal Revenue Service claims is required, although this requirement does not appear in the Code itself. This language essentially provides that notwithstanding any other provision of the articles of incorporation, the corporation may not perform any activities not permitted to be carried on by (1) a corporation that is exempt from federal income tax under *I.R.C. § 501(c)(3)*, or *(2)* a corporation to which contributions are deductible under *I.R.C. § 170(c)(2)*.

Article VI should be included if the nonprofit corporation is an existing unincorporated association that is changing its status to that of a corporation. Article VI, which is not included in the current version of the sample articles drafted by the Secretary of State, has been included by the publisher to satisfy the statutory requirement of *Corp. Code § 5121(b)*, which specifies that the articles must contain such a statement when an existing unincorporated association is changing its status to that of a corporation [*see Corp. Code § 5121(a)*; *see also* [d], *below*].

PRACTICE TIP:

Keeping the articles brief and tailored to the minimum statutory requirements ensures more privacy to the corporation. Further, counsel should consider the fact that it is more difficult to amend the articles than the bylaws. The bylaws generally may be amended or repealed by the approval of the members or the board of directors [*Corp. Code § 5150*], whereas the articles, with certain exceptions, can be amended only with the approval of the members, the board of directors, and such other persons, if any, required by the articles [*Corp. Code § 5812(a)*]. Moreover, amendment of the articles is not effective until a certificate of amendment is filed with the Secretary of State [*Corp. Code § 5817*].

[c] Optional Provisions

The articles of a nonprofit public benefit corporation may include additional provisions as warranted. Two provisions will not be effective unless expressly provided in the articles:

- First, if the corporation will be of limited duration, the articles must include a provision limiting the corporation's existence to a specified date [*Corp. Code § 5132(a)(1)*].

- Second, if a subordinate corporation is instituted or created under the authority of a head organization, the articles must include a provision setting forth either or both of the following: (1) that the subordinate corporation will dissolve whenever its charter is surrendered to, taken away by, or revoked by head organization granting it; and/or (2) that in event of its dissolution pursuant to article provision allowed by *Corp. Code § 5132(a)(2)(A)*, or, in event of its dissolution for any reason, any assets of corporation remaining after compliance with applicable provisions governing distribution of assets will be distributed to head organization [*Corp. Code § 5132(a)(2)*; *see Corp. Code § 5132(b)*; *see also § 13.130*, P 3]. If one or both of the these statements is included, the Department of Corporations has informally indicated that the articles should also contain an introductory statement that the corporation is a subordinate corporation created under the authority of the head organization.

The corporation may also include other optional provisions, such as the names and addresses of the initial directors [*Corp. Code § 5132(c)*; *see* [2], art. VII, *below*], and a further statement limiting the purposes or powers of the corporation [*Corp. Code § 5131*]. For further discussion, see *§ 13.130*, P 4.

[d] Special Requirements for Unincorporated Associations

An existing unincorporated association may change its status to that of a public benefit corporation if the change is properly authorized by the association in accordance with its rules and procedures [*Corp. Code § 5121(a)*]. In this situation, in addition to the matters required to be set forth in the articles by *Corp. Code § 5130*, as discussed in this comment, the articles must also state that an existing unincorporated association, stating its name, is being incorporated by the filing of the articles [*Corp. Code § 5121(b)*]. Optional Article VI of this form, added by the publisher includes the required statements.

When an existing unincorporated association changes its status to that of a public benefit corporation, the articles must be accompanied by a verified statement of any two officers or governing board members of the association, stating that the incorporation of the association by means of the articles to which the verified statement is attached has been approved by the association in accordance with its rules and procedures [*Corp. Code § 5121(c)*; *see § 13.242*].

For further discussion, see *§ 13.22*.

[e] Location and Inspection of Articles

The corporation must keep the original or a copy of its articles as amended to date at its principal office in California. These articles must be open to inspection by the members at all reasonable times during office hours. If the corporation does not have an office in California, it must furnish a copy of the articles as amended to date on the written request of any member [*Corp. Code § 5160*]. These requirements that apply to articles also apply to bylaws of public benefit corporations [*Corp. Code § 5160*; *see § 13.201*].

[f] Execution, Filing, and Fees

The articles of incorporation must be originally signed by an incorporator unless directors are named in the articles. If directors are named in the articles, each person named must sign and acknowledge the document. The name(s) of the person(s) signing must be typed directly below the signature(s) [*Corp. Code § 5120(b)*, *(c)*; *see* Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Instructions]. The statute does not require that the signatures be dated and the Secretary of State's sample forms do not provide for a date, but this form does contain one since most attorneys prefer to have a date associated with signatures on a document.

The original and at least four copies of the completed documents are then mailed or hand delivered to the Secretary of State, together with the applicable fee [*see* Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Information Sheet]. When documents are being hand delivered for filing in the San Francisco, Fresno, Los Angeles or San Diego office, a duplicate original is also required. To expedite processing, articles of incorporation submitted by mail should be accompanied by a self-addressed envelope and a letter referencing the proposed corporate name as well as the name, telephone number, and return address of the person filing the articles [*see* Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Instructions].

The articles of incorporation must be accompanied by the applicable filing fee [*see Gov. Code § 12186(d)*; *Corp. Code § 5006*]. The Secretary of State will compare and certify up to two copies of the amendment at no charge provided that the copies are submitted with the original to be filed [*Gov. Code § 12185*]. If additional certified copies are required, an additional minimal fee is charged, provided that the copies are furnished to the Secretary of State and the fee is prepaid [*Gov. Code §§ 12182, 12183*]. A separate and nonrefundable handling fee is charged for expedited processing of documents delivered in person, over the counter, to the Sacramento headquarters office [*see* Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Information Sheet].

The Secretary of State may cancel the filing of the articles if the check or other remittance accepted in payment of the filing fee is not paid on presentation [*Corp. Code § 5008.5*]. Within 70 days after the articles were filed, the Secretary of State must give written notice to the agent for service of process or the person submitting the instrument that the item presented for payment was not honored. The notice must specify a cancellation date that is not less than 20 days after the date the notice is mailed, on which the cancellation is to be effective if the fee is not paid by cashier's check or the equivalent [*Corp. Code § 5008.5*].

[g] Acknowledgment of Articles Required

If initial directors are named in the articles, each director named in the articles must sign *and acknowledge* the articles [*Corp. Code § 5120(b)*]. When the articles are signed by incorporators rather than by the initial directors [*see* [f], *above*], the statutory language states only that the articles "shall be signed" by the incorporators; it does not expressly require an acknowledgment, nor does it prohibit one being used, so an acknowledgment in the latter case should be regarded as optional [*see Corp. Code § 5120(b)*].

The Nonprofit Corporation Law defines "acknowledgment" as either the form of notarial acknowledgment prescribed in the Civil Code [*see Civ. Code § 1180 et seq.*] or the accompaniment of a declaration in writing signed by the persons executing the same that they are those persons and that the instrument is the act and deed of the person or persons executing it [*Corp. Code § 5030*].

This form contains a notarial acknowledgment prescribed by *Civ. Code § 1189(a)(1)*. For an acknowledgment by declaration, which may be used as an alternative to notarial acknowledgment [*see Corp. Code § 5030(b)*], see *§ 13.241*.

[2] FORM

Articles of Incorporation

ARTICLES OF INCORPORATION OF _____ [*name of corporation*]

I

The name of the corporation is _____[*name of corporation*].

II

A. This corporation is a nonprofit PUBLIC BENEFIT CORPORATION and is not organized for the private gain of any person. It is organized under the Nonprofit Public Benefit Corporation Law for

☐ public purposes.

or ☐ charitable purposes.

or ☐ public and charitable purposes.

B. The specific purpose of this corporation is to _____.

III

The name and address in the State of California of the Corporation's initial agent for service of process is

Name _____

[*Include only if designated agent is an individual:*]

Street address _____ [*do not use post office box*]
City _____, California Zip _____

[*Continue with the following:*]

IV

A. This corporation is organized and operated exclusively for charitable purposes within the meaning of *Internal Revenue Code § 501(c)(3)*.

B. No substantial part of the activities of this corporation shall consist of carrying on propaganda, or otherwise attempting to influence legislation, and the corporation shall not participate or intervene in any political campaign (including the publishing or distribution of statements) on behalf of any candidate for public office.

V

The property of this corporation is irrevocably dedicated to charitable purposes and no part of the net income or assets of this corporation shall ever inure to the benefit of any director, officer or member thereof or to the benefit of any private person. Upon the dissolution or winding up of the corporation, its assets remaining after payment, or provision for payment, of all debts and liabilities of this corporation shall be distributed to a nonprofit fund, foundation or corporation which is organized and operated exclusively for charitable purposes and which has established its tax exempt status under *Section 501(c)(3), Internal Revenue Code*.

[*Add, if existing unincorporated association is being incorporated:*]

VI

The name of the existing unincorporated association, now being incorporated by the filing of these articles, is _____

[*CONTINUE*]

[*Optional; may be added, if initial directors are named:*]

VII

The corporation will have [*number, e.g.*, three] Director(s). The names and addresses of the initial directors of the corporation are [*specify*].

[*Add other optional articles, if any; see comment to this form and Ch. 3, Articles of Incorporation:*]

[*CONTINUE*]

Date: _____.

[*If initial directors are named in articles (see optional Article VII of this form), then all initial directors must sign; otherwise only the incorporators must sign.*]

_____ [*signature of incorporator, or initial director if initial directors are named in articles*]
_____ [Incorporator *or* Initial Director]
_____ [*typed name*]
_____ [*signature of incorporator, or initial director if initial directors are named in articles*]
_____ [Incorporator *or* Initial Director]
_____ [*typed name*]

[Acknowledgments taken in California must be in the following form (*Civ. Code § 1189(a)(1)*):]

ACKNOWLEDGMENT

State of California
County of _____

On _____[*date*], before me, _____[*name and title of officer taking acknowledgment*], personally appeared [*name(s) of person(s) signing instrument*], who proved to me on the basis of satisfactory evidence to be the person[s] whose name[s] [is *or* are] subscribed to the within instrument and acknowledged to me that _____[he *or* she *or* they] executed the same in _____[his *or* her *or* their] authorized _____[capacity *or* capacities], and that by _____[his *or* her *or* their] signature[s] on the instrument the person[s], or the entity upon behalf of which the person[s] acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.
Signature _____ .....[*Seal*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness

& Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesBusiness & Corporate LawUnincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
1. Nonprofit Public Benefit Corporations

6-13 California Legal Forms--Transaction Guide § 13.201

§ 13.201 Bylaws--With Members in One Class

[1] Comment

[a] Use of Form

This form is an illustrative set of bylaws designed for use by a nonprofit public benefit corporation that has or will have only one class of members. The form contains numerous optional and permissive provisions that are discussed below.

A nonprofit public benefit corporation may admit persons to one class of membership, or may provide for multiple classes of membership [*Corp. Code §§ 5132(c)(2), 5151(c)(1), 5310(a)*]. The membership provisions in this form may be used if the corporation will admit one class of members. If the corporation will admit multiple classes of members, the provisions concerning the admission of members set forth in *§ 13.212[2]* (bylaws for nonprofit mutual benefit corporation with multiple classes of members) may be inserted in this form, with appropriate modification of provisions in this form that are inconsistent with the substituted provisions.

Alternatively, nonprofit public benefit corporations need not have members, and the Nonprofit Public Benefit Corporation Law provides that if the articles or bylaws prohibit members or fail to provide for members, the corporation may not have members [*Corp. Code § 5310(a)*]. For an example of bylaws for a nonprofit corporation without members, see *§ 13.221* (bylaws for religious corporation without members).

[b] "Member" Defined

A "member" is any person who, pursuant to a specific provision of the corporation's articles or bylaws, has the right to vote for the election of a director or directors, on a disposition of all or substantially all of the assets of the corporation, or on a merger or on a dissolution. The term also includes any person who is designated in the articles or bylaws as a member and, pursuant to a specific provision of a corporation's articles or bylaws, has the right to vote on changes to the articles or bylaws [*Corp. Code § 5056(a)*].

[c] Mandatory Provisions

Unless stated in the articles, the bylaws must state either the number of directors of the corporation, the method of determining the number of directors of the corporation, or that the number of directors may not be less than a stated minimum (one or more) nor more than a stated maximum with the exact number of directors to be fixed, within the limits specified, by approval of the board or the members [*Corp. Code § 5034*], in the manner provided in the bylaws [*Corp. Code § 5151(a), (e)*]. If the articles provide for the number of directors, that provision may only by changed by a formal amendment of the articles [*Corp. Code § 5151(a)*; *see § 13.261*]. Except as otherwise provided in the articles or bylaws, once members have been admitted, a bylaw specifying or changing a fixed number of directors or the maximum or minimum number or changing from a fixed to a variable board or vice versa may only be adopted by approval of the members [*Corp. Code § 5151(b)*].

[d] Optional Provisions in General

As a general rule, the bylaws may contain any provision, not in conflict with law or the articles, for the management of the activities and for the conduct of the affairs of the corporation. This authority includes any provision that is required or permitted by the Nonprofit Public Benefit Corporation Law to be stated in the bylaws [*Corp. Code §§ 5151(c), 5132(c)(5)*].

PRACTICE TIP:

Provisions of the Nonprofit Corporation Law establish many of the rules governing the management of corporate affairs, at least in the absence of a contrary bylaw. Although these rules are not required to be restated in the bylaws, corporations often do to provide a complete manual of corporate procedure for the management and members.

[e] Directors and Executive Committees

The Nonprofit Corporation Law permits the following optional bylaws provisions relating to directors and executive committees of public benefit corporations:

- The names and addresses of the persons appointed to act as initial directors [*Corp. Code §§ 5151(c)(1), 5132(c)(1)*];
- The time, place, and manner of calling, conducting, and giving notice of directors' and committee meetings, or of conducting mail ballots [*Corp. Code § 5151(c)(2)*];
- The qualifications, duties, and compensation of directors [*Corp. Code § 5151(c)(3)*];
- The time of the election of directors [*Corp. Code § 5151(c)(3)*];
- The requirements of a quorum for directors' and committee meetings [*Corp. Code § 5151(c)(3)*];
- The appointment and authority of committees [*Corp. Code § 5151(c)(4)*]; and
- A provision restricting the indemnification of directors [*Corp. Code § 5238(h)(1)*].

The bylaws, with some limitations, may restrict or eliminate the power of the board to adopt, amend, or repeal any or all of the bylaws [*Corp. Code § 5150(c)*]. The bylaws may also provide that the repeal or amendment of the bylaws, or the repeal or amendment of specified portions of the bylaws, may occur only with the written approval of specified persons other than the board or members [*Corp. Code § 5150(d)*]. For further discussion, see [n], *below*.

Unless otherwise provided in the bylaws or articles, and except for a vacancy created by the removal of a director, board vacancies may be filled by approval of the board [*see Corp. Code § 5032*] or, if the number of directors then in office is less than a quorum, by either (1) the unanimous written consent of the directors then in office, (2) the affirmative vote of a majority of the directors then in office at a meeting held pursuant to notice or waivers of notice complying with *Corp. Code § 5211,* or *(3)* a sole remaining director [*Corp. Code § 5224(a)*].

The directors of a corporation with fewer than 50 members may be removed without cause by a majority vote of the members; the directors of a larger corporation may be removed without cause with the approval of the members [*see Corp. Code §§ 5033, 5222(a)(1), (2); see also Corp. Code § 5034* ("approved by members" defined); *Corp. Code § 5222(b), (f)*]. These requirements may not be altered by the bylaws [*see Corp. Code § 5151(e)*]. If the corporation has no members, directors may be removed by a vote of the majority of the directors [*Corp. Code § 5222(a)(3)*]. If the articles or bylaws authorize cumulative voting, special rules apply to the removal of directors [*see Corp. Code § 5222(b)(1)*]. If the articles or bylaws authorize members of any class, voting as a class, to elect directors, a director elected by that class may be removed by the prescribed vote of the members of that class [*Corp. Code § 5222(b)(2)*]. If the articles or bylaws authorize the designation of directors, any designated director may be removed without cause by the designator unless otherwise provided in the articles or bylaws at the time the designation is made [*Corp. Code § 5222(i)* designator]. Any director so designated may only be removed with the written consent of the designator of that designator [*Corp. Code § 5222(f)(2)*]. Unless provided otherwise in the articles or bylaws, the right to remove will not apply if (1) the designator entitled to that right has died or ceased to exist, or (2) the right is in the capacity of an officer, trustee, or other status and that office, trust, or status has ceased to exist [*Corp. Code § 5222(f)(3)*].

[f] Officers

The bylaws may contain provisions concerning the appointment, duties, compensation, and tenure of officers [*Corp. Code § 5151(c)(5)*]. Absent a provision in the articles or bylaws, the president, or if there is no president the chair [*see Corp. Code § 5039.5* ("chair" includes "chairperson," "chairman," and "chairwoman")] of the board, is the general manager and chief executive officer of the corporation. Unless otherwise specified in the articles or bylaws, if there is no chief financial officer, the treasurer is the chief financial officer of the corporation [*Corp. Code § 5213(a)*]. Except as otherwise provided in the articles or the bylaws, officers must be chosen by the board and serve at the pleasure of the board, subject to the rights, if any, of an officer under any contract of employment [*Corp. Code § 5213(b)*]. If the articles or bylaws provide for the election of any officer by the members, the term of office of that officer must be one year unless the articles or bylaws provide for a different term, which may not exceed three years [*Corp. Code § 5213(c)*].

[g] Compensation

The bylaws may fix the compensation of directors [*Corp. Code § 5151(c)(3)*], or the bylaws may leave the determination of compensation to the board of directors. The following form contains two alternative provisions in Section 4.06 relating to the compensation of the directors. When drafting a provision specifying the compensation to be paid to directors, counsel should review *I.R.C. § 4941(d)(2)(E)* because it prohibits the payment of unreasonable compensation to directors of corporations qualifying as private foundations within the meaning of the Internal Revenue Code.

[h] Members

In general, the bylaws may confer some or all of the rights of a member, set forth in the Nonprofit Public Benefit Corporation Law, on any person or persons who do not have any of the voting rights referred to in *Corporations Code Section 5056(a)* [*Corp. Code § 5056(b)*]. More specifically, the bylaws may contain provisions concerning the following matters:

- The classes of members, if any, and if there are two or more classes, the rights, privileges, preferences, restrictions, and conditions attaching to each class [*Corp. Code §§ 5151(c)(1), 5132(c)(2)*].

- A provision that would allow any member to have more or less than one vote in any election or other matter presented to the members for a vote [*Corp. Code §§ 5151(c)(1), 5132(c)(3)*].

- The mode of determination of members of record [*Corp. Code § 5151(c)(6)*].

- The making of reports and financial statements to members [*Corp. Code § 5151(c)(7)*].

- Setting, imposing, and collecting dues, assessments, and admission fees [*Corp. Code § 5151(c)(8)*].

- A provision for the admission, withdrawal, suspension, and expulsion of members [*Corp. Code § 5151(d)*].

- A provision limiting the number of members, in total or of any class, which the corporation is authorized to admit [*Corp. Code § 5151(f)*].

- A provision that specified rights in the membership will not terminate on the death or dissolution of a member [*Corp. Code § 5320(a)(2)*].

- The time, place, and manner of calling, conducting, and giving notice of members' meetings [*Corp. Code § 5151(c)(2)*; *see § 13.33[2]*].

A corporation may provide in its bylaws that it does not have members. In the absence of a provision in its articles or bylaws, the corporation may not have members [*Corp. Code § 5310(a)*]. The bylaws may also provide that memberships may be issued without consideration, or for such consideration as is specified in the articles or bylaws. If no consideration is specified, memberships may be issued for consideration determined by the board of directors [*Corp. Code § 5311(a)*].

Meetings of members may be held at any place stated in or fixed in accordance with the bylaws. If the bylaws fail to provide for a place of meeting, the meetings of members must be held at the principal office of the corporation [*Corp. Code § 5510(a)*]. The drafting attorney should keep in mind the possibility that the directors may use a loosely drawn provision governing the place of members' meetings to discourage membership participation. For example, a provision permitting the directors to select a meeting place outside California provides the directors with an opportunity to abuse their discretion by selecting a purposeless and distant location. The better approach would be to provide the directors with reasonable geographical restrictions that will prevent the imposition of unnecessary hardships on the members. Thus, if the bylaws permit the directors to select the members' meeting place, the bylaws might, for example, specify that the selection of sites is limited to northern or southern California, or to one of several major cities in either region.

[i] Delegates

A corporation may provide in its bylaws for delegates having some or all of the authority of members. Delegates may be given a name other than "delegates." If delegates are provided for, the bylaws must set forth their terms of office, any reasonable method for delegate selection and removal, and any reasonable method for calling, noticing, and holding meetings of delegates [*Corp. Code § 5152*]. The bylaws may set forth the manner in which delegates may act by written ballot consistent with *Corp. Code § 5513*. However, delegates may only act personally at a meeting or by written ballot, and may not act by proxy [*Corp. Code § 5152*].

[j] Voting Requirements Affecting Corporate Actions

The bylaws may require, for any or all corporate actions with specified exceptions [*see Corp. Code §§ 5222, 5616(c), 6610*], the vote of a larger proportion of, or all of, the members or the members of any class, unit, or grouping of members, or the vote of a larger proportion of, or all of, the directors, than is otherwise required by the Nonprofit Public Benefit Corporation Law. A provision in the bylaws requiring a greater vote may not be altered, amended, or repealed except by a that greater vote, unless otherwise provided in the bylaws [*Corp. Code § 5151(e)*].

The bylaws may, within statutory limitations, establish and authorize cumulative voting [*Corp. Code § 5616(a)*]. A provision authorizing cumulative voting may be repealed or amended only by the approval of the members [*see Corp. Code § 5034*], except that the governing provision may require the vote of a greater proportion of the members, or of any class, to repeal the cumulative voting provision [*Corp. Code § 5616(a)*].

Section 3.10(e) bars cumulative voting. An alternative provision permitting cumulative voting is set forth in *§ 13.212[2]*, Section 3.10(e). This latter provision may be adapted for use in the following form provided related amendments are made with respect to inconsistent matters set forth in the form. For example, Section 3.10(a) provides for only one vote per member. If cumulative voting is authorized, this section must be amended to except cumulative voting from the one vote requirement. Section 3.10(a) contains an optional provision designed for this latter purpose.

Section 3.10(f) withdraws the right of members to vote or act by proxies. An alternative provision providing for proxy voting by members is set forth in *§ 13.212[2]*, Section 3.10(f). Because any amendment of the bylaws repealing, restricting, creating, or expanding proxy rights must be adopted with approval by the members of the corporation [*see Corp. Code § 5613(3)*; *see also Corp. Code § 5034*], only those proxy rights intended to be final should be stated in the bylaws.

[k] Record Date

The bylaws may provide a date as the record date for the purpose of determining the members entitled to notice of any meeting of members. Absent that bylaw, the board may fix the record date in advance. In either event, the record date must not be for more than 90 nor less than 10 days before the date of the meeting. If a record date is not fixed, members at the close of business on the business day preceding the day on which notice is given or, if notice is waived, at the close of business on the business day preceding the day on which the meeting is held are entitled to notice of a meeting of members. A determination of members entitled to notice of a meeting of members applies to any adjournment of the meeting unless the board fixes a new record date for the adjourned meeting [*Corp. Code § 5611(a)*].

[l] Inspection Rights

The members of every public benefit corporation have statutory rights of inspection with respect to the articles and bylaws of the corporation [*Corp. Code § 5160*; *see § 13.35[1][c]*]. Further, the accounting books and records and minutes of proceedings of members and the board and committees of the board must be open to inspection on the written demand on the corporation of any member at any reasonable time, for any purpose reasonably related to that person's interest as a member [*Corp. Code § 6333*].

In general, members may also inspect, and obtain copies of, membership lists [*see Corp. Code § 6330*; *see also Corp. Code §§ 6331, 6332* (court limitations and reasonable alternative); *see § 13.35[1][c]*]. However, although members' inspection rights cannot be limited by contract or the articles or bylaws [*Corp. Code § 6313*], the corporation may petition the superior court for an order setting aside a member's demand to inspect the membership list based on a good faith and substantial belief that the membership list will be used for an improper purpose [*Corp. Code § 6331*; *see § 13.35[1][c]*].

A nonprofit public benefit corporation does not have the right under *Corp. Code § 6331(g)* to review the proposed uses to which a membership list will be put by a member who has requested an opportunity to inspect the corporation's membership list [*KQED, Inc. v. Hall (1982) 135 Cal. App. 3d 951, 956-957, 185 Cal. Rptr. 630]* .

[m] Proof of Corporate Bylaws

The original or a copy of the bylaws, certified to be a true copy by a person purporting to be the secretary or an assistant secretary of the corporation, is prima facie evidence of the adoption of those bylaws and of the matters stated therein [*Corp. Code § 5215*].

[n] Adoption, Amendment, and Repeal of Bylaws

Bylaws of public benefit corporations may be adopted, amended, or repealed by the approval of the board, with various exceptions and limitations [*Corp. Code § 5150(a)*; *see Corp. Code §§ 5150(c), 5151, 5220, 5224, 5512, 5613*]. The board may adopt, amend, or repeal the bylaws unless the action would materially and adversely affect the rights of members as to voting, or transfer [*Corp. Code § 5150(a)*]."Approval of the board" means approval or ratification by the board or by the vote of an authorized committee of the board [*Corp. Code § 5032*]. For resolutions of the board of directors adopting the bylaws of for-profit corporations, see Ch. 4, *Bylaws* . Those forms may be adapted for the purpose of adopting bylaws of a public benefit corporation.

Bylaws may be adopted, amended, or repealed by approval of the members [*Corp. Code § 5150(b)*]. "Approval of the members" means that the bylaws were approved or ratified by the affirmative vote of a majority of votes represented and voting at a duly held meeting at which a quorum was present (which affirmative votes also constituted a majority of the required quorum) or written ballot in conformity with *Corp. Code § 5513*. The term also includes the affirmative vote or written ballot of any greater proportion, including all of the votes of the memberships of any class, unit, or grouping of members that may be provided in the bylaws or by law, for all or any specified member action [*Corp. Code § 5034*]. However, such an action requires the approval by the members of a class if the action would materially and adversely affect the rights of that class as to voting or transfer in any manner different from than the action affects another class [*Corp. Code § 5150(b)*].

The bylaws, subject to limitations, may restrict or eliminate the power of the board to adopt, amend, or repeal any or all of the bylaws [*Corp. Code § 5150(c)*]. The bylaws may also provide that the repeal or amendment of the bylaws, or the repeal or amendment of specified portions of the bylaws, may occur only with the written approval of specified persons other than the board or members. However, this approval requirement will not apply if any of the following circumstances exist, unless the bylaws specify otherwise [*Corp. Code § 5150(d)*]:

- The specified person or persons have died or ceased to exist;

- The right of the specified person or persons to approve is in the capacity of an officer, trustee, or other status and the office, trust, or status has ceased to exist; or

- The corporation has a specific proposal for amendment or repeal; the corporation has provided written notice of that proposal, including a copy of the proposal, to the specified person or persons at the most recent address for each, based on the corporation's records; and the corporation has not received written approval or nonapproval within the period specified in the notice, which must not be less than 10 nor more than 30 days beginning at least 20 days after the notice has been provided.

[2] FORM

Bylaws--With Members in One Class

BYLAWS OF _____ [*name of corporation*]

ARTICLE I
OFFICES

Principal Office

1.01. The principal office of the Corporation for its transaction of business is located in the City of _____ and County of _____, California [*or* is located at _____ (*street address*), _____ (*city*), _____ (*county*), California].

Change of Address

1.02. The Board of Directors is granted full power and authority to change the principal office of the Corporation from one location to another in _____[, the County of _____], California. Any change of address will be noted by the Secretary in these Bylaws, but will not be considered an amendment of these Bylaws.

ARTICLE II
MEMBERS

Classification of Members

2.01. The Corporation will have one class of members only, and each member has equal voting and other rights. No person may hold more than one membership in the Corporation.

Eligibility for Membership

2.02. Any person, as defined *Corporations Code Section 5065*, is eligible to be a member of the Corporation[, except that, in the case of a natural person, the person will not be eligible for membership unless over the age of _____ (*number, e.g.,* 18 years)].

Qualification of Members

2.03. Any person, eligible for membership under Section 2.02 of these Bylaws, is qualified for membership only after that person has satisfied the following qualifications: [*specify qualifications*].

Admission to Membership

2.04. Any person, eligible for membership under Section 2.02 of these Bylaws and qualified for membership under Section 2.03 of these Bylaws, will be admitted to membership only on the approval of [the Board of Directors *or* Membership Committee duly authorized, by resolution, to admit members] of an application submitted by that person in the form and manner prescribed by the Board of Directors [and on the payment of (the application fee specified in

Section 2.05 of these Bylaws and) the first annual dues as specified in Section 2.06 of these Bylaws].

Application Fee

[*EITHER*]

2.05. There is no fee for applying for membership in the Corporation.

[*OR*]

2.05. A fee _____[in the amount _____ (of $_____ *or* determined from time to time by resolution of the Board of Directors)] shall be charged for, and payable with, the application for membership. This application fee is nonrefundable.

[*Continue with the following:*]

Annual Dues

2.06. The annual dues payable to the Corporation by members will be in the amounts determined by resolution of the Board of Directors, but in no event may the annual dues exceed the amount of $_____. Dues are payable for the first year on admission to membership and annually thereafter at the time or times as may be fixed by the Board of Directors. A member, on learning of the amount of dues determined by the Board of Directors and the time or times of payment fixed by the Board of Directors, may avoid liability for the dues by promptly resigning from membership, except if the member is, by contract or otherwise, liable for the dues.

Assessments

[*EITHER*]

2.07. Memberships are nonassessable.

[*OR*]

2.07. Memberships are subject to assessments that may be levied and collected as follows: [*describe assessment*]. [*Optional:* Any member, on learning of an assessment, may avoid liability for it by promptly resigning from membership, providing that the member is not otherwise liable for the assessment by contract or otherwise.]

[*Continue with the following:*]

Number of Members

[*EITHER*]

2.08. There is no limit on the number of members the Corporation may admit.

[*OR*]

2.08. The Corporation may not have more than [*number*] members.

[*Continue with the following:*]

Transferability of Membership

2.09. Neither membership in the Corporation nor any rights in the membership may be transferred or assigned for value or otherwise.

Membership Book

2.10. The Corporation will keep a membership book containing the name, address, and class of each member [in written form *or* in any form capable of being converted into written form]. The book must also note if a membership has terminated and the date on which that membership ceased. The book will be kept at the principal office of the Corporation and is subject to the rights of inspection required by law and as set forth in Section 2.11 of these Bylaws.

Inspection Rights of Members--Demand

2.11. (a) Subject to the Corporation's right to set aside a demand for inspection pursuant to *Corporations Code Section 6331* and the authority of the court to limit inspection rights pursuant to *Corporations Code Section 6332*, and unless the Corporation provides a reasonable alternative as permitted by Section 2.11(c) of these Bylaws, a member satisfying the qualifications set forth may do either or both of the following:

(1) Inspect and copy the record of all the members' names, addresses, and voting rights, at reasonable times, on five business days prior written demand on the Corporation, which must state the purpose for which the inspection rights are requested; or

(2) Obtain from the Secretary of the Corporation, on written demand and tender of a reasonable charge, a list of the names, addresses, and voting rights of those members entitled to vote for the election of Directors, as of the most recent record date for which it has been compiled or as of the date of demand. The demand must state the purpose for which the list is requested. The membership list will be available on or before the later of 10 business days after the demand is received, or after the date specified in the demand as the date as of which the list is to be compiled.

Members Permitted to Exercise Rights of Inspection

(b) The rights of inspection *set forth in Section 2.11*(a) of these Bylaws may be exercised by the following:

(1) Any member, for a purpose reasonably related to that person's interest as a member;

(2) The authorized number of members for a purpose reasonably related to the members' interest as members; and

(3) _____ [*Other description of members who may exercise rights of inspection*].

Alternative Method of Achieving Purpose

(c) The Corporation, within 10 business days after receiving a demand pursuant to Section 2.11(a) of these Bylaws, may deliver to the person or persons making the demand a written offer of an alternative method of achieving the purpose identified in the demand without providing access to or a copy of the membership list. An alternative method that reasonably and in a timely manner accomplishes the proper purpose set forth in a demand made pursuant to Section 2.11(a) of these Bylaws will be deemed reasonable, unless within a reasonable time after acceptance of the offer, the Corporation fails to effect the alternative method. Any rejection of the offer must be in writing and indicate the reasons the alternative proposed by the Corporation does not meet the proper purpose of the demand made pursuant to Section 2.11(a) of these Bylaws.

Nonliability of Members

2.12. A member of the Corporation is not personally liable, solely because of membership, for the debts, obligations, or liabilities of the Corporation.

Termination of Membership--Causes

2.13. (a) The membership and all rights of membership automatically terminate on the occurrence of any of the following causes:

(1) The voluntary resignation of a member;

(2) When a membership is issued for a period of time, the expiration of that period;

(3) The death of a member;

(4) The dissolution of corporate members;

(5) The nonpayment of dues or assessments, subject to the limitations *set forth in Section 2.13*(b) of these Bylaws; and

(6) The termination of all memberships or any class of members on the amendment of these bylaws permitting the termination, pursuant to *Corporations Code Section 5342*.

Nonpayment of Dues or Assessments

(b) The membership of any member who fails to pay his or her dues or assessments within [*number of days, e.g.,* 30 days] of the due date automatically terminates at the end of that [*e.g.,* 30-day] period, provided that the member was given (1) 15 days prior written notice of the termination stating the reasons for termination, and (2) a timely opportunity to be heard on the matter of the termination. The notice will be given personally to the member or sent by [first class *or* registered] mail to the last address of the member as shown on the records of the Corporation. The opportunity to be heard, at the election of the member, may be oral or in writing and must occur not less than 5 days before the effective

date of the termination. The hearing shall be conducted at _____[*address*] by a committee composed of [*names of persons or other designations of committee members, e.g.,* the President, Secretary, and Assistant Secretary of the Corporation]. The hearing will be presided over by [*name of person, e.g.,* the President of the Corporation] who will perform the following duties:

(1) Read the charges against the subject member.

(2) Require that the charges be verified by the testimony of the person or persons making them.

(3) Hear any other witnesses against the subject member.

(4) Allow the subject member to cross-examine each witness following the testimony of that witness.

(5) Allow the subject member to make a statement in his or her own behalf;

(6) Allow the subject member to call witnesses in his or her own behalf.

(7) Allow the members of the committee conducting the hearing to question the witnesses after they have been questioned by the subject member.

The committee conducting the hearing will conduct the hearing in good faith and in a fair and reasonable manner. The committee has the exclusive power and authority to decide that the proposed termination not take place.

Effect of Termination

(c) Any and all rights of a member in the Corporation and in its property cease on the termination of membership. However, termination does not relieve the member from any obligation for charges incurred, services or benefits actually rendered, dues, assessments, or fees, or arising from contract or otherwise. The Corporation retains the right to enforce any obligation or obtain damages for its breach.

[*Optional provision if terminating all or classes of memberships:*]

Amendment Terminating Memberships

2.14. Effective _____[*date*], these Bylaws are amended to terminate [all *or specify classes of memberships*] memberships, pursuant to Corporations Code Section 4342. [_____ (*Add any desired requirements governing termination in addition to those required by statute*).]

ARTICLE III
MEETINGS OF MEMBERS

Place

3.01. Meetings of members will be held at _____[the principal office of the corporation *or* the location within the State of California as may be designated from time to time by resolution of the Board of Directors].

Regular Meetings

[*EITHER*]

3.02. Regular meetings of members will not be held.

[*OR*]

3.02. The members will meet [annually *or specify other time period; if directors are to be elected at regular meetings, time period must correspond to the directors' terms of office, and not exceed three year maximum term, e.g.,* every third year on the _____ (*day and month, e.g.,* first Monday in March) in each year (*or other time period as appropriate*), beginning with the year _____, at _____ (*time, e.g.,* 8:00 P.M.)] for the purpose of transacting proper business as may come before the meeting, including the election of Directors for the terms as are fixed in Section 4.03 of these Bylaws. If the election of Directors does not occur at any meeting of the members or without a meeting by written ballot pursuant to Section 3.11 of these Bylaws, the Board will (or 5 percent of the members may) cause the election of Directors to be held at a special meeting of members called and held as soon as it is reasonably possible after the adjournment of the regular meeting of the members. If the day fixed for the regular meeting of members falls on a legal holiday, the meeting will be held at the same hour and place on the next succeeding day.

[*Continue with the following:*]

Special Meetings

3.03. Special meetings of members will be called by _____[the Board of Directors *or* the Chair of the Board *or* the President of the Corporation *or names and titles of other persons*] and held _____[at the place (within the State of California) fixed in Section 3.01 of these Bylaws *or* at the times and places within the State of California that may be ordered by resolution of the Board of Directors)]. Five percent or more of the members of the Corporation may call special meetings for any lawful purpose.

Notice of Meetings

3.04. Written notice of every meeting of members must be either personally delivered or mailed by [first class *or* registered *or* certified] United States mail, postage prepaid, [*number not less than 10 or more than 90, e.g.,* 15] days before the date of the meeting to each member who is entitled to vote at the meeting as of the record date for notice of the meeting.

If notice is given by mail or other means of written communication, the notice must be addressed to the member at the address appearing on the books of the Corporation or at the address given by the member to the Corporation for the purpose of notice. If no address appears or was given by the member, notice will be given [at the principal office of the Corporation *or* by publication in any newspaper of general circulation in the county in which the principal office of the Corporation is located]. The [Secretary *or* Assistant Secretary] of the Corporation, or any transfer agent specially designated by the [Secretary *or* Assistant Secretary] for this purpose, will execute an affidavit of the giving of the notice of the meeting of members. In the case of a specially called meeting of members, notice that a special meeting will be

held at a time requested by the person or persons calling the meeting not less than 35 days nor more than 90 days after receipt of the written request from that person or persons by the [Chair of the Board *or* President *or* Vice-President *or* Secretary] of the Corporation will be sent to the members forthwith and in any event within 20 days after the request was received.

[*Optional; use only if permitted by articles or bylaws:*]

Notice of meetings may also be given by electronic transmission in accordance with *Corp. Code §§ 20* and *5511(b)*.

[*Continue with the following:*]

No meeting of members may be adjourned more than 45 days. If a meeting is adjourned to another time or place, and thereafter a new record date is fixed for notice or voting, a notice of the adjourned meeting will be given to each member of record who, on the record date for notice of the meeting, is entitled to vote at the meeting.

Contents of Notice

3.05. The notice will state the place, date, and time of the meeting. [*For regular meetings, add:* In the case of regular meetings, the notice will state those matters that the Board of Directors, at the time the notice is given, intends to present for action by the members.] The notice of any meeting at which Directors are to be elected must include the names of all those who are nominees at the time the notice is given to the members.

Waivers, Consents, and Approvals

3.06. The transactions of any meeting of members, however called and noticed, and wherever held, are as valid as though had at a meeting duly held after regular call and notice, if a quorum is present either in person or by proxy, and if, either before or after the meeting, each of the persons entitled to vote but not present in person or by proxy, signs a written waiver of notice, a consent to the holding of the meeting, or an approval of the minutes of the meeting. All waivers, consents, and approvals will be [filed with the corporate records *or* included in the minutes of the meeting].

Quorum

3.07. A quorum at any meeting of members consists of [*proportion or percentage, e.g.*, a majority *or* 35 percent] of the voting power, represented in person or by proxy. For purposes of this Bylaw, "voting power" means the power to vote for the election of directors at the time any determination of voting power is made and does not include the right to vote on the happening of some condition or event which has not yet occurred.

Loss of Quorum

3.08. The members present at a duly called or held meeting at which a quorum is present may continue to transact business until adjournment notwithstanding the withdrawal of enough members to leave less than a quorum, if any action taken, other than adjournment, is approved by at least a majority of members required to constitute a quorum.

Adjournment for Lack of Quorum

3.09. In the absence of a quorum, any meeting of members may be adjourned from time to time by the vote of a majority of the votes represented either in person or by proxy. However, no other business may be transacted except as provided in Section 3.08 of these Bylaws.

Voting of Membership--One Vote Per Member

[*EITHER*]

3.10. (a) Each member is entitled to one vote on each matter submitted to a vote of the members.

[*OR*]

3.10. (a) Except as provided in Section _____ of these Bylaws authorizing cumulative voting at the election of the Directors, each member is entitled to one vote on each matter submitted to a vote of the members.

[*Continue with the following:*]

Indivisible Interest in Single Memberships

(b) Single memberships in which two or more persons have an indivisible interest will be voted as *set forth in Section 3.10*(c) of these Bylaws relating to the voting of memberships in two or more names.

Memberships in Two or More Names

(c) When a membership stands of record in the names of two or more persons, whether fiduciaries, members of a partnership, joint tenants, tenants in common, husband and wife as community property, tenants by the entirety, or otherwise, or if two or more persons (including proxyholders) have the same fiduciary relationship respecting the same membership, unless the Secretary of the Corporation is given written notice to the contrary and is furnished with a copy of the instrument or order appointing them or creating the relationship wherein it is so provided, their acts with respect to voting have the following effect: if only one member votes, that act binds all members; if more than one member vote, the act of the majority so voting binds all members.

Record Date of Membership

(d) The record date for the purpose of determining the members entitled to notice of any meeting of members is [*number not greater than 90 or less than 10, e.g.*, 40] days before the date of the meeting of members. The record date for the purpose of determining the members entitled to vote at any meeting of members is [*number not greater than 60, e.g.*, 30] days before the date of the meeting of members. [The record date for the purpose of determining the members entitled to exercise any rights in respect to any other lawful action is _____ (*number not greater than 60, e.g.*, 20) days before that other action.]

Cumulative Voting

(e) Cumulative voting is not authorized for the election of directors or for any other purpose.

Proxy Voting

(f) Members entitled to vote are not permitted to vote or act by proxy. [*Optional:* Any amendment of this provision creating or expanding proxy rights must be adopted with approval by the members. For purposes of this provision of these Bylaws, "approval by the members" has the same definition set forth in *Corporations Code Section 5034*.]

Action Without Meeting by Written Ballot--Ballot Requirements

3.11. (a) Subject to the limitations specified in Section 3.11(b) of these Bylaws and any contained in the Articles, any action that may be taken at any regular or special meeting of members may be taken without a meeting. If an action is taken without a meeting, the Corporation must distribute a written ballot to every member entitled to vote on the matter. The ballot must state the proposed action, provide an opportunity to specify approval or disapproval of any proposal, and provide a reasonable time within which to return the ballot to the Corporation. Approval by written ballot is valid only when the number of votes cast by ballot within the time period specified equals or exceeds the quorum required to be present at a meeting authorizing the action, and the number of approvals equals or exceeds the number of votes that would be required to approve at a meeting at which the total number of votes cast was the same as the number of votes cast by ballot.

Limitations Pertaining to Election of Directors

(b) Directors [may *or* will] be elected by written ballot, as authorized in the Articles of the Corporation, except that election of Directors by written ballot is not permitted when the Directors are elected by cumulative voting pursuant to *Corporations Code Section 5616*.

Solicitation of Ballots

(c) Ballots will be solicited in a manner consistent with the requirements of giving notice of members' meetings *set forth in Section 3.04* of these Bylaws and of voting by written ballot *set forth in Section 3.11*(d) of these Bylaws. All solicitations must indicate the number of responses needed to meet the quorum requirement and, with respect to ballots other than for the election of Directors, state the percentage of approvals necessary to pass the measure submitted. The solicitation must specify the time by which the ballot must be received in order to be counted.

[*Add, if corporation has or will have 100 or more members:*]

Voting by Written Ballot

(d) The form of written ballots distributed to 10 or more members must afford an opportunity on the form of written ballot to specify a choice between approval and disapproval of each matter or group of related matters intended, at the time the written ballot is distributed, to be acted on by that written ballot. The form must also provide, subject to reasonable specified conditions, that if the person solicited specifies a choice with respect to any matter the vote must be

cast in accordance with that choice. In any election of Directors, any form of written ballot in which the Directors to be voted on are named as candidates and that is marked by a member "withhold" or otherwise marked in a manner indicating that the authority to vote for the election of Directors is withheld may not be voted either for or against the election of a Director.

[*Continue with the following:*]

Revocation of Ballot

[*EITHER*]

(e) Unless otherwise provided in the Articles of Incorporation of the Corporation or these Bylaws, a written ballot may not be revoked.

[*OR*]

(e) Any member casting a ballot may revoke the ballot, or substitute another, by a writing received by the Corporation before the time specified on the ballot for its receipt by the Corporation, but may not do so thereafter. The revocation is effective on its receipt by the Secretary of the Corporation].

[*Continue with the following:*]

Conduct of Meetings--Chair

3.12. (a) The President of the Corporation or, in his or her absence, any other person chosen by a majority of the voting members present in person or by proxy will be Chair of and preside over the meetings of the members.

Secretary of Meetings

(b) The Secretary of the Corporation will act as the secretary of all meetings of members. However, in the Secretary's absence, the Chair of the meetings of members will appoint another person to act as secretary of the meetings.

Rules of Order

(c) The Robert's Rules of Order, as amended from time to time, governs the meetings of members insofar as those rules are not inconsistent with or in conflict with these Bylaws, the Articles of Incorporation of this Corporation, or the rules governing agenda, motions, and related matters.

Inspectors of Election--Appointment

3.13. (a) Before any meeting of the members [or any action by written ballot], the Board may appoint any persons other than candidates for office as inspectors of election to act at the meeting. If inspectors of election are not so appointed for

any meeting, or if any person so appointed fails to appear or refuses to act, the Chair of the meeting may, and on request of any member or member's proxy must, appoint inspectors of election at the meeting. [If inspectors of election are not so appointed for any action by written ballot, or if any person so appointed refuses to act, the President of the Corporation must appoint inspectors of election for that written ballot on request of any member or member's proxy.] The number of inspectors will be either one or three. If appointed at a meeting on the request of one or more members or proxies, the majority of members represented in person or by proxy must determine whether one or three inspectors are to be appointed.

Duties

(b) The inspectors of election must perform the following duties:

(1) Determine the number of outstanding voting memberships, the voting power of each, and, when applicable, the number represented at the meeting, the existence of a quorum, and the authenticity, validity, and effect of proxies.

(2) Receive votes, ballots, or consents.

(3) Hear and determine all challenges and questions in any way arising in connection with the right to vote.

(4) Count and tabulate all votes and consents;

(5) Determine when the polls shall close.

(6) Determine the result.

(7) Do any other acts that may be proper to conduct the election or vote with fairness to all members.

The Inspectors must perform their duties impartially, in good faith, to the best of their ability and as expeditiously as is practical.

Vote of Inspectors

(c) If there are three inspectors of election, the decision, act, or certificate of a majority is effective in all respects as the decision, act or certificate of all.

Report and Certificate

(d) On request of the Chair or any member or member's proxy, the inspectors of election must make a written report concerning the performance of their duties and execute a certificate of any fact found by them. Any report or certificate made by the inspectors is prima facie evidence of the facts stated.

ARTICLE IV
DIRECTORS

Number

[*EITHER*]

4.01. The corporation will have _____[*number specified in the articles and, if not stated in the articles, number equal to or greater than one*] Director[s]. [Collectively,] the Director[s] will be known as the Board of Directors.

[*OR*]

4.01. The method of determining the number of directors of the corporation, will be _____[*specify, with number equal to or greater than one*].

[*OR*]

4.01. [As provided in Article _____ of the Articles of Incorporation of the Corporation,] the Corporation may not have less than [*minimum number specified in the articles*] or more than [*maximum number specified in the articles*] Directors. The exact number of Directors is [*number within specified limits*] and this number will be fixed from time to time, within the limits specified in this Bylaw [and Article _____ of the Articles of Incorporation of the Corporation], by an amendment to this Bylaw duly adopted by approval of the members, as that term is defined in *Corporations Code Section 5034*.

[*Continue with the following:*]

Qualifications

4.02. The Directors of the Corporation must be residents of the State of California. [*If membership is stated as a qualification, add:* With the exception of the initial Directors, the Directors must also be members of the Corporation.]

Terms of Office

4.03. Each Director holds office _____[*specify term of at least one year but not more than three years, e.g.,* until the next (annual) meeting of members as prescribed by Section 3.02 of these Bylaws *or* for a term of one year from the date of the Director's election], and until the Director's successor is elected and qualifies under Section 4.02 of these Bylaws. If a Director is removed at a special meeting of the members called and held as prescribed by Section 3.03 of these Bylaws, that Director will hold office until his or her removal and his or her successor is elected and qualifies.

Nomination

4.04. Any person qualified to be a Director under Section 4.02 of these Bylaws may be nominated by the method of nomination authorized by the Board or by any other method authorized by law. [*If corporation has 5,000 or more members, add:* The date for close of nominations for the board is _____ (*number not less than 50 or more than 120*) days before _____ (the day the Directors are to be elected *or, if directors are to be elected at regular meetings, use following language if desired:* before the regular meeting of members as provided in

Section 3.02 of these Bylaws *or, if directors are to be elected by written ballot, use following language if desired:* before printing and distributing written ballots for the election of Directors). A nomination for the board may not be made after the date set for close of nomination.]

Election

[*EITHER, if corporation will hold regular meetings:*]

4.05. (a) The Directors will be elected [at each annual meeting as prescribed by Section 3.02 of these Bylaws [*if authorized by the articles or bylaws (as in Section 3.11 of these bylaws), add:* or by written ballot as authorized by Section _____ (*e.g.,* 3.11) of these Bylaws].

[*OR, if corporation will not hold regular meetings:*]

4.05. (a) The Directors will be elected _____ by written ballot as authorized by Section 3.11 of these Bylaws.

[*Continue with the following:*]

(b) The candidates receiving the highest number of votes up to the number of Directors to be elected are elected. Directors are eligible for reelection, provided they continue to meet the qualifications required by Section 4.02 of these Bylaws, _____[without limitation on the number of terms they may serve *or* but may not be elected to more than _____ (*specify*) consecutive terms *or state other limitations*].

Compensation

[*EITHER*]

4.06. The Directors serve without compensation, [except that they shall be allowed and paid their actual and necessary expenses incurred in attending the meetings of the Board *or add other provisions allowing partial compensation*].

[*OR*]

4.06. The compensation of the Directors _____[is $_____ per month *or* shall be fixed from time to time by resolution of the Board and approved by the vote or written consent of a majority of the voting members of the corporation].

[*Continue with the following:*]

Meetings--Call of Meetings

4.07. (a) Meetings of the Board may be called by the Chair of the Board or the President or any Vice-President or the

Secretary or any two Directors.

Place of Meetings

(b) All meetings of the Board will be held at the principal office of the Corporation as specified in Section 1.01 of these Bylaws or as changed from time to time as provided in Section 1.02 of these Bylaws.

Regular Meetings

(c) Regular meetings of the Board will be held, without call or notice, [*specify time and place e.g.*, at the principal office of the Corporation immediately following each annual meeting of the members of the Corporation], as set forth in Section 3.02 of these Bylaws.

Special Meetings

(d) Special meetings of the Board may be called by the Chair of the Board or the President or any Vice-President or the Secretary or any two Directors. Special meetings may be held on four days notice by first class mail, postage prepaid, or on 48 hours' notice delivered personally or by telephone, including a voice messaging system or other system or technology designed to record and communicate messages, telegraph, facsimile, electronic mail, or other electronic means.

Notice of the special meeting need not be given to any Director who signs a waiver of notice or written consent to holding the meeting, or an approval of the minutes of the meeting, whether before or after the meeting, or who attends the meeting without protesting the lack of notice to that Director either before or at the commencement of the meeting. All waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meetings.

Quorum

(e) A majority of the authorized number of Directors constitutes a quorum of the Board for the transaction of business, except as otherwise provided in these Bylaws.

Transactions of Board

(f) Except as otherwise provided in the Articles, in these Bylaws, or by law, every act or decision done or made by a majority of the Directors present at a meeting duly held at which a quorum is present is the act of the Board provided, however, that any meeting at which a quorum was initially present may continue to transact business notwithstanding the withdrawal of Directors if any action taken is approved by at least a majority of the required quorum for that meeting, or such greater number as is required by the law, the Articles, or these Bylaws.

Conduct of Meetings

(g) The Chair of the Board or, in his or her absence, any Director selected by the Directors then present will preside at meetings of the Board of Directors. The Secretary of the Corporation or, in the Secretary's absence, any person

appointed by the presiding officer will act as Secretary of the Board. Members of the Board may participate in a meeting through use of conference telephone or similar communications equipment, so long as all members participating in the meeting can hear one another. This participation constitutes personal presence at the meeting.

Adjournment

(h) A majority of the Directors present at the meeting, whether or not a quorum is present, may adjourn any meeting to another time and place. If the meeting is adjourned for more than 24 hours, notice of the adjournment to another time or place must be given before the time of the adjourned meeting to the Directors who were not present at the time of the adjournment

Action Without Meeting

4.08. Any action required or permitted to be taken by the Board may be taken without a meeting, if all members of the Board individually or collectively consent in writing to that action. Written consents must be filed with the minutes of the proceedings of the Board. Action by written consent has the same force and effect as the unanimous vote of the Directors.

Removal of Directors--Removal for Cause

4.09. (a) The Board may declare vacant the office of a Director on the occurrence of any of the following events:

(1) The Director has been declared of unsound mind by a final order of court.

(2) The Director has been convicted of a felony.

(3) The Director has been found by a final order or judgment of any court to have breached duties imposed by *Corporations Code Section 5230 et seq.* on directors who perform functions with respect to assets held in charitable trust.

[*Add, if minimum attendance will be required:*]

(4) The Director has failed to attend _____ [*number*] meetings of the Board.

PRACTICE TIP

The Bylaws must be adopted *before* the appointment of the initial directors if the minimum attendance requirement is to applicable to those directors [*see Corp. Code § 5221(b)* (director's failure to meet qualification *that was in effect at beginning of director's current term* is grounds for removal of director)].

Removal Without Cause

(b) Any or all of the Directors may be removed without cause if, where the Corporation has fewer than 50 members, removal is approved by a majority of all members pursuant to *Corporations Code Section 5033*; or where the

Corporation has more than 50 members, removal is approved by the members within the meaning of *Section 5034 of the Corporations Code*. [*If articles or bylaws authorize cumulative voting, add:* However, a Director may not be removed, unless the entire Board is removed, when the votes cast against removal, or not consenting in writing to removal, would be sufficient to elect that Director if voted cumulatively at an election at which the same total number of votes were cast (or if the action is taken by written ballot, all memberships entitled to vote were voted) and the entire number of directors authorized at the time of the Director's most recent election were then being elected.] [*If articles or bylaws provide that members of any class, voting as a class, are entitled to elect one or more directors, add:* Any Director elected by the members of any class, voting as a class, may be removed only by the applicable vote of the members of that class.]

Resignation of Director

4.10. Any Director may resign effective on giving written notice to the Chair of the Board of Directors, the President, the Secretary, or the Board of Directors of the Corporation. The notice may specify a later time for the effectiveness of the resignation. If the resignation is effective at a future time, a successor may be elected to take office when the resignation becomes effective.

Vacancies in the Board--Causes

4.11. (a) Vacancies on the Board of Directors occur (1) on the death, resignation, or removal of any Director; (2) whenever the number of authorized Directors is increased; and (3) on the failure of the members in any election to elect the full number of authorized Directors.

Filling Vacancies by Directors

(b) Except as otherwise provided in the Articles or these Bylaws and except for a vacancy created by the removal of a Director pursuant to Section 4.09 of these Bylaws, vacancies on the Board of Directors may be filled by approval of the Board of Directors, or, if the number of Directors then in office is less than a quorum, by (1) the unanimous written consent of the Directors then in office; (2) the affirmative vote of a majority of the Directors then in office at a meeting held pursuant to notice or waivers of notice as provided in Section 4.07(d) of these Bylaws; or (3) a sole remaining Director.

Filling Vacancies by Members

(c) Vacancies created by removal of Directors may only be filled by the approval of the members within the meaning of *Corporations Code Section 5034*. The members may elect a Director at any time to fill any vacancy not filled by the Directors.

ARTICLE V
OFFICERS

Number and Titles

5.01. The officers of the Corporation shall be [*either or both* a Chair of the Board *or* a President], [a Vice-President,] a

Secretary, a _____[*either or both* Treasurer or Chief Financial Officer, and those other officers with such titles and duties as _____[stated in these Bylaws *or* determined by the Board] and as may be necessary to enable it to sign instruments. [The President *or* The Chair of the Board] is the general manager and chief executive officer of the Corporation. Any number of offices may be held by the same person, except that neither the Secretary, the Treasurer, or the Chief Financial Officer may serve concurrently as [the President *or* the Chair of the Board].

Appointment and Resignation

5.02. The officers will be chosen by the Board and serve at the pleasure of the Board, subject to the rights, if any, of an office under any contract of employment. Any officer may resign at any time on written notice to the Corporation without prejudice to the rights, if any, of the Corporation under any contract to which the officer is a party.

ARTICLE VI
CORPORATE RECORDS, REPORTS, AND SEAL

Keeping Records

6.01. The Corporation must keep adequate and correct records of account and minutes of the proceedings of its members, Board, and committees of the Board. The Corporation must also keep a record of its members giving their names and addresses and the class of membership held by each. The minutes will be kept in written form. Other books and records will be kept in either written form or in any other form capable of being converted into written form.

Annual Report

6.02. The Board will cause an annual report to be sent to the members not later than 120 days after the close of the Corporation's fiscal year. The report must contain all the information required by *Corporations Code Section 6321(a)* and be accompanied by any report of independent accountants. If there is no report of independent accountants, the certificate of an authorized officer of the Corporation that the statements were prepared without audit from the books and records of the Corporation. The annual report must be furnished to all Directors.

Annual Statement of Certain Transactions and Indemnifications

6.03. The Corporation must furnish annually to its members a statement of any transaction or indemnification described in *Corporations Code Section 6322(d)* and *(e)*, if that transaction or indemnification took place. The annual statement must be affixed to and sent with the annual report described in Section 6.02 of these Bylaws.

Corporate Seal

6.04. The Board of Directors will adopt a corporate seal in the following form and design: [*describe*]. The [Secretary *or specify other officer*] of the Corporation will maintain custody of the seal and affix it in all appropriate cases to all corporate documents. However, the failure to affix the seal does not affect the validity of any instrument.

CERTIFICATE OF SECRETARY OF

_____ [*name of corporation*], a California Nonprofit Corporation

I hereby certify that I am the duly elected and acting Secretary of this corporation and that the foregoing Bylaws, comprising [*number*] pages, constitute the Bylaws of this corporation as duly adopted at a meeting of the Board of Directors held on _____[*date*].
Dated: _____.

_____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
1. Nonprofit Public Benefit Corporations

6-13 California Legal Forms--Transaction Guide §§ 13.202-13.209

[Reserved]

§§ 13.202[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
2. Nonprofit Mutual Benefit Corporations

6-13 California Legal Forms--Transaction Guide § 13.210

§ 13.210 Articles of Incorporation

[1] Comment

[a] Use of Form

This form is a sample set of articles of incorporation for use by nonprofit mutual benefit corporations. It is modeled after the sample provided by the Secretary of State, and contains all provisions required by law. Samples are available on official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm.

A nonprofit mutual benefit corporation is formed and corporate existence begins on the filing of the articles of incorporation and continues perpetually unless otherwise expressly provided by law or in the articles [*Corp. Code § 7120(a), (c)*; *see §§ 13.20, 13.130*]. However, the articles may set forth a provision limiting the duration of the corporation's existence to a specified date [*Corp. Code § 7132(a)(1)*].

[b] Mandatory Provisions

Article I must be completed with the name of the corporation exactly as the name is to appear on the records of the Secretary of State.

Article IIA has been taken directly from the California Corporations Code as is required by law and should not be modified when drafting documents.

Article IIB should be completed with a statement as to the specific business of the corporation. A specific purpose statement must be included if the corporation (1) is organized for public purposes or (2) intends to apply for a state franchise tax exemption [*see* Organization of Domestic Noprofit, Nonstock Corporations, Secretary of State's website http://www.ss.ca.gov/business/corp/corp_artsnpinf.htm; *see also Corp. Code § 7130(b)(3)*].

Article III must be completed with the name and California address, or physical location, of the agent for service of process.

Article IV limits the activities of the corporation to those in furtherance of the specific purposes of the corporation

Article V states the name of the existing unincorporated association, if any, being incorporated by filing these articles. Article V should be included if the nonprofit corporation is an existing unincorporated association that is changing its status to that of a corporation. Article V, which is not included in the current version of the sample articles drafted by the Secretary of State, has been included by the publisher to satisfy the statutory requirement of *Corp. Code § 7121(b)*, which specifies that the articles must contain such a statement when an existing unincorporated association is changing its status to that of a corporation [*see Corp. Code § 7121(a)*; *see also* [d], *below*].

PRACTICE TIP

Keeping the articles brief and tailored to the minimum statutory requirements ensures more privacy to the corporation. Further, it is more difficult to amend the articles than the bylaws. The bylaws generally may be amended or repealed by the approval of the members or the board of directors [*Corp. Code § 7150*; *see Lake Arrowhead Chalets Timeshare Owners Assoc. v. Lake Arrowhead Chalets Owners Assoc. (1996) 51 Cal. App. 4th 1403, 1407-1409, 59 Cal. Rptr. 2d 875* (construing *Corp. Code § 7150(b)*, which imposes restrictions on powers of members to amend bylaws)]. In contrast, the articles, with certain exceptions, can be amended only with the approval of the members, the board of directors, and such other persons, if any, as the articles may require [*Corp. Code § 7812(a)*]. Moreover, amendment of the articles is not effective until a certificate of amendment is filed with the Secretary of State [*Corp. Code § 7817*].

[c] Optional Provisions

A nonprofit mutual benefit corporation may include additional provisions as warranted. Several provisions will not be effective unless expressly provided in the articles:

- If the corporation will be of limited duration, the articles must include a provision limiting the corporation's existence to a specified date [*Corp. Code § 7132(a)(1)*].

- The articles may contain a provision conferring on the holders of any evidences of indebtedness, issued or to be issued by a corporation, the right to vote in the election of directors, and on any other matters on which members may vote, even if the corporation does not have members [*Corp. Code § 7132(a)(2)*].

- The articles may confer on members the right to determine the consideration for which memberships will be issued [*Corp. Code § 7132(a)(3)*].

- If a subordinate corporation is instituted or created under the authority of a head organization, the articles must include a provision setting forth either or both of the following: (1) that the subordinate corporation will dissolve whenever its charter is surrendered to, taken away by, or revoked by head organization granting it; and/or (2) that in event of its dissolution pursuant to article provision allowed by *Corp. Code § 7132(a)(2)(A)*, or, in event of its dissolution for any reason, any assets of corporation remaining after compliance with applicable provisions governing distribution of assets will be distributed to head organization [*Corp. Code § 7132(a)(4)*; *see Corp. Code § 7132(b)*; *see also § 13.130*, P 4]. If one or both of the these statements is included, the Department of Corporations has informally indicated that the articles should also contain an introductory statement that the corporation is a subordinate corporation created under the authority of the head organization.

The corporation may also include other optional provisions, such as the names and addresses of the initial directors [*see § 13.200[2]*, art. VII], membership transfer, and classes of members [*Corp. Code § 7132(c)*], and a further statement limiting the purposes or powers of the corporation [*Corp. Code § 7131*]. For further discussion, see *§ 13.130*, P 4.

[d] Special Requirements for Unincorporated Associations

An existing unincorporated association may change its status to that of a mutual benefit corporation if the change is properly authorized by the association in accordance with its rules and procedures [*Corp. Code § 7121(a)*]. In this situation, in addition to the matters required to be set forth in the articles by *Corp. Code § 7130*, as discussed in this comment, the articles must also state that an existing unincorporated association, stating its name, is being incorporated by the filing of the articles [*Corp. Code § 7121(b)*]. Optional Article V of this form, included by the publisher, includes the required statements.

When an existing unincorporated association changes its status to that of a mutual benefit corporation, the articles must be accompanied by a verified statement of any two officers or governing board members of the association, stating that the incorporation of the association by means of the articles to which the verified statement is attached has been approved by the association in accordance with its rules and procedures [*Corp. Code § 7121(c)*; *see § 13.242*].

For further discussion, see *§ 13.22*.

[e] Location and Inspection of Articles

The corporation must keep the original or a copy of its articles as amended to date at its principal office in California. These articles must be open to inspection by the members at all reasonable times during office hours. If the corporation does not have an office in California, it must furnish a copy of the articles as amended to date on the written request of any member [*Corp. Code § 7160*]. These requirements that apply to articles also apply to bylaws of mutual benefit corporations [*Corp. Code § 7160*; *see § 13.212*].

[f] Execution, Filing, and Fees

The articles of incorporation must be originally signed by an incorporator unless directors are named in the articles. If directors are named in the articles, each director must sign and acknowledge the document. The name(s) of the person(s) signing must be typed directly below the signature(s) [*Corp. Code § 7120(b), (c)*; *see* Organziation of California Nonprofit, Nonstock Corporations, Secretary of State's website http://www.ss.ca.gov/business/corp/pdf/articles/corp_artsnp.pdf]. The statute does not require that the signatures be dated and the Secretary of State's sample forms do not provide for a date, but this form does contain one since most attorneys prefer to have a date associated with signatures on a document.

The original and at least four copies of the completed documents are then mailed or hand delivered to the Secretary of State, together with the applicable fee [*see* Organziation of California Nonprofit, Nonstock Corporations, Secretary of State's website http://www.ss.ca.gov/business/corp/pdf/articles/corp_artsnp.pdf]. When documents are being hand delivered for filing in the San Francisco, Fresno, Los Angeles or San Diego branch office, a duplicate original is also required. To expedite processing, articles of incorporation submitted by mail should be accompanied by a self-addressed envelope and a letter referencing the proposed corporate name as well as the name, telephone number, and return address of the person filing the articles [*see* Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Instructions (available on Secretary of State's website)].

The articles of incorporation must be accompanied by the applicable filing fee [*see Gov. Code § 12186(d)*; *Corp. Code § 5006*]. The Secretary of State will compare and certify up to two copies of articles without charge, provided that the

copies are submitted with the original to be filed [*Gov. Code § 12185*]. If additional certified copies are required, an additional minimal fee is charged, provided that the copies are furnished to the Secretary of State and the fee is prepaid [*Gov. Code §§ 12182, 12183*]. A separate and nonrefundable handling fee is charged for expedited processing of documents delivered in person, over the counter, to the Sacramento headquarters office, or to any branch office. Preclearance or expedited filing of eligible corporate documents in the Sacramento office can be requested in a specified time frame for an additional fee in lieu of the special handling fee [*see* Organization of Nonprofit, Nonstock Corporations, Secretary of State's website http://www.ss.ca.gov/business/corp/corp_artsnpinf.htm].

The Secretary of State may cancel the filing of the articles if the check or other remittance accepted in payment of the filing fee is not paid on presentation [*Corp. Code § 5008.5*]. Within 70 days after the articles were filed, the Secretary of State must give written notice to the agent for service of process or the person submitting the instrument that the item presented for payment was not honored. The notice must specify a cancellation date that is not less than 20 days after the date the notice is mailed, on which the cancellation is to be effective if the fee is not paid by cashier's check or the equivalent [*Corp. Code § 5008.5*].

A mutual benefit corporation formed for the sole purpose of operating a ridesharing vanpool designed to transport at least seven persons, including the driver, under an arrangement in which ridesharing is incidental to another purpose of the driver is exempt from any filing fee required by the Nonprofit Mutual Benefit Corporation Law [*Corp. Code § 8217*].

[g] Acknowledgment of Articles Required

If initial directors are named in the articles, each director named in the articles must sign *and acknowledge* the articles [*Corp. Code § 7120(b)*]. When the articles are signed by incorporators rather than by the initial directors [*see* [f], *above*], the statutory language states only that the articles "shall be signed" by the incorporators; it does not expressly require an acknowledgment, nor does it prohibit one being used, so an acknowledgment in the latter case should be regarded as optional [*see Corp. Code § 7120(b)*; *see also* Organization of California Nonprofit, Nonstock Corporations, Secretary of State's website http://www.ss.ca.gov/business/corp/pdf/articles/corp_artsnp.pdf]. (Note that the sample articles prepared by the Secretary of State's office do not include a form of acknowledgment).

For further discussion of acknowledgment, see *§ 13.200[1][f]*. For a notarial acknowledgment, see *§ 13.200[2]*. For an acknowledgment by declaration, which may be used as an alternative to notarial acknowledgment [*see Corp. Code § 5030(b)*], see *§ 13.241*.

[2] FORM

Articles of Incorporation

ARTICLES OF INCORPORATION OF _____ [*name of corporation*]

I

The name of the corporation is _____[*name of corporation*].

[*If corporation is not a credit union, use:*]

II

A. This corporation is a nonprofit MUTUAL BENEFIT CORPORATION organized under the Nonprofit Mutual Benefit Corporation Law. The purpose of this corporation is to engage in any lawful act or activity, other than credit union business, for which a corporation may be organized under such law.

[*If corporation is subject to the California Credit Union Law, use (Corp. Code § 7130(b)(2); Fin. Code § 14101(b)):*]

A. The purpose of the corporation is to engage in the business of a credit union and any other lawful activities not prohibited to a credit union by applicable laws and regulations.

[*Continue with the following*:]

B. The specific purpose of this corporation is to _____.

III

The name and address in the State of California of the Corporation's initial agent for service of process is

Name _____

[*Include only if designated agent is an individual:*]

Street address _____ [*do not use post office box*]
City _____, State California Zip _____

[*Add optional articles, if any; see comment to this form and Ch. 3, Articles of Incorporation, and continue with the following:*]

IV

Notwithstanding any of the above statements of purposes and powers, this corporation shall not, except to an insubstantial degree, engage in any activities or exercise any powers that are not in furtherance of the specific purposes of this corporation.

[*Add, if an existing unincorporated association is being incorporated:*]

V

The name of the existing unincorporated association, now being incorporated by the filing of these articles, is _____

[*CONTINUE*]

[*Optional; add if initial directors are named:*]

VI

The corporation will have [*number, e.g.,* three] Director(s). The names and addresses of the initial directors of the corporation are [specify].

[*Add other optional articles, if any.*]

[*CONTINUE*]

Date: _____.

[*If initial directors are named in articles (see optional Article VI of this form), then all initial directors must sign; otherwise only the incorporators must sign.*]

_____ [*signature of incorporator, or initial director if initial directors are named in articles*]
_____ [Incorporator *or* Initial Director]
_____ [*typed name*]
_____ [*signature of incorporator, or initial director if initial directors are named in articles*]
_____ [Incorporator *or* Initial Director]
_____ [*typed name*]

[*If an existing unincorporated association is being incorporated, include verified declaration (see § 13.242).*]

ACKNOWLEDGMENT

[*For acknowledgment, see § 13.200[2].*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
2. Nonprofit Mutual Benefit Corporations

6-13 California Legal Forms--Transaction Guide § 13.211

§ 13.211 Articles of Incorporation--Common Interest Development Association

[1] Comment

[a] Use of Form

This form is a sample set of articles of incorporation for use by a nonprofit mutual benefit corporation that is a common interest development association. It is modeled after the sample provided by the Secretary of State, and contains all provisions required by law [*see* Organization of Common Interest Development Associations, Secretary of State's website at http://www.ss.ca.gov/business/corp/corp_artscidinf.htm]. Samples are also available on official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm.

A nonprofit mutual benefit corporation is formed and corporate existence begins on the filing of the articles of incorporation and continues perpetually unless otherwise expressly provided by law or in the articles [*Corp. Code § 7120(a), (c)*; *see §§ 13.20, 13.130*]. However, the articles may set forth a provision limiting the duration of the corporation's existence to a specified date [*Corp. Code § 7132(a)(1)*].

Inspection requirements are discussed in *§ 13.210[1][e]*. The execution and filing requirements and applicable fees are discussed in *§ 13.210[1][f]*. Acknowledgment requirements are covered in *§ 13.210[1][g]*.

Bylaws for homeowners' associations organized as nonprofit corporations are set forth in Ch. 34, *Condominiums* .

The original and at least three copies of the articles of incorporation, together with the applicable fee, must be mailed or hand-delivered to the Secretary of State's office in Sacramento, or hand-delivered to one of the regional offices in Fresno, Los Angeles, San Diego, or San Francisco. Regional offices do not process mailed documents. When documents are submitted to a regional office, a duplicate original is also required. To facilitate the processing of documents mailed to the Sacramento office, the submission should include a self-addressed envelope and a letter referencing the corporate name, the of name of the person filing the documents, a return address, and a telephone

number [*see* Instructions to Secretary of State's sample articles].

[b] Regulation of Common Interest Developments

A common interest development [*see § 13.11[4]*] is managed by an association that may be incorporated or unincorporated [*Civ. Code § 1363(a)*]. The association, whether incorporated or unincorporated, must prepare a budget [*see Civ. Code § 1365*] and disclose information, on request [*Civil Code § 1363(b)*; *see Civ. Code § 1368*]. Unless the governing documents provide otherwise, the association may exercise the powers granted to a nonprofit mutual benefit corporation [*see Corp. Code § 7140*; *see also § 13.30*], except that an unincorporated association may not adopt or use a corporate seal or issue membership certificates [*Civ. Code § 1363(c)*; *see Corp. Code § 7313*].

The association, whether incorporated or unincorporated, may exercise the powers granted to the association by the Act [*Civ. Code § 1363(c)*]. Membership meetings must be conducted in accordance with a recognized system of parliamentary procedure, or any parliamentary procedures adopted by the association [*Civ. Code § 1363(d)*; *see Civ. Code § 1363(e)* (notice requirements)].

Common interest development associations are subject to open meeting requirements [*see Civ. Code § 1363.05*]. Members may attend board meetings, except when the board adjourns to executive session to consider litigation, matters relating to the formation of contracts with third parties, member discipline, personnel matters, or to meet with a member, on the member's request, regarding the member's payments of assessments [*Civ. Code § 1363.05(b)*; *see Civ. Code §§ 1367, 1367.1*]. The board must meet in executive session, if requested by a member who may be subject to a fine, penalty, or other form of discipline, and the member is entitled to attend the executive session [*Civ. Code § 1363.05(b)*; *see* Corp. Code § 1363.05(c), (d) (minutes requirements)]. The term "meeting" includes any congregation of a majority of the members of the board at the same time and place to hear, discuss, or deliberate on any item of business scheduled to be heard by the board, except those matters that may be discussed in executive session [*Civ. Code § 1363.05(j)*].

[c] Mandatory Provisions

Article I must be completed with the name of the corporation exactly as the name is to appear on the records of the Secretary of State.

Article IIA has been taken directly from the California Corporations Code as is required by law and may not be modified when drafting documents [*see Corp. Code § 7130(b)(1)*].

Article IIB should be completed with a statement as to the specific business of the corporation. A specific purpose statement must be included if the corporation (1) is organized for public purposes or (2) intends to apply for a state franchise tax exemption [*see* Organziation of California Nonprofit, Nonstock Corporations, Secretary of State's website at http://www.ss.ca.gov/business/corp/pdf/articles/corp_artsnp.pdf]; *see also Corp. Code § 7130(b)(3)*].

Article III must be completed with the name and California address, or physical location, of the agent for service of process. However, no address should be stated if the a corporate agent is designated.

Article IV is a statement required by the Franchise Tax Board before an exemption will be granted.

Article V must be included when forming a common interest development corporation [*see Civ. Code § 1363.5*].

Article VI must be completed by selecting one of the three options. If the association has a business or corporate office and that office is located on the site of the common interest development, that address must be stated, and a statement that the office is on site should be included. If the office is off site, the office address must be stated, including the

nine-digit zip code and the front street and nearest cross street to the development. If the association has no business or corporate office address, no statement is required.

Article VII must be completed by selecting the appropriate option. If the first option applies the name and address of the association's managing agent must be stated [*Civ. Code §§ 1363.1, 1363.5(a)*; *see Bus. & Prof. Code § 11502*]. No statement is required if the association has no managing agent.

[d] Optional Provisions

A nonprofit mutual benefit corporation may include additional provisions as warranted. Several provisions will not be effective unless expressly provided in the articles:

- If the corporation will be of limited duration, the articles must include a provision limiting the corporation's existence to a specified date [*Corp. Code § 7132(a)(1)*].

- The articles may contain a provision conferring on the holders of any evidences of indebtedness, issued or to be issued by a corporation, the right to vote in the election of directors and on any other matters on which members may vote even if the corporation does not have members [*Corp. Code § 7132(a)(2)*].

- The articles may confer on members the right to determine the consideration for which memberships will be issued [*Corp. Code § 7132(a)(3)*].

- If a subordinate corporation is instituted or created under the authority of a head organization, the articles must include a provision setting forth either or both of the following: (1) that the subordinate corporation will dissolve whenever its charter is surrendered to, taken away by, or revoked by head organization granting it; and/or (2) that in event of its dissolution pursuant to article provision allowed by *Corp. Code § 7132(a)(2)(A)*, or, in event of its dissolution for any reason, any assets of corporation remaining after compliance with applicable provisions governing distribution of assets will be distributed to head organization [*Corp. Code § 7132(a)(4)*; *see Corp. Code § 7132(b)*; *see also § 13.130*, P 4b]. If one or both of the these statements is included, the Department of Corporations has informally indicated that the articles should also contain an introductory statement that the corporation is a subordinate corporation created under the authority of the head organization.

The corporation may also include other optional provisions, such as the names and addresses of the initial directors [*see § 13.200[2]*, art. VII], membership transfer, and classes of members [*Corp. Code § 7132(c)*], and a further statement limiting the purposes or powers of the corporation [*Corp. Code § 7131*]. For further discussion, see *§ 13.130*, P 4.

[e] Special Requirements for Unincorporated Associations

An existing unincorporated association may change its status to that of a mutual benefit corporation if the change is properly authorized by the association in accordance with its rules and procedures [*Corp. Code § 7121(a)*]. In this situation, in addition to the matters required to be set forth in the articles by *Corp. Code § 7130*, the articles must also state that an existing unincorporated association, stating its name, is being incorporated by the filing of the articles [*Corp. Code § 7121(b)*; *see* Organization of California Nonprofit, Nonstock Corporations, Secretary of State's website at http://www.ss.ca.gov/business/corp/pdf/articles/corp_artsnp.pdf]. Optional Article VIII of this form satisfies this requirement.

[2] FORM

Articles of Incorporation--Common Interest Development Association

ARTICLES OF INCORPORATION OF _____ [*name of corporation*]

I

The name of the corporation is _____[*name of corporation*].

II

A. This corporation is a nonprofit MUTUAL BENEFIT CORPORATION organized under the Nonprofit Mutual Benefit Corporation Law. The purpose of this corporation is to engage in any lawful act or activity, other than credit union business, for which a corporation may be organized under such law.

B. The specific purpose of this corporation is to _____.

III

The name and address in the State of California of the Corporation's initial agent for service of process is

Name _____

[*Include only if designated agent is an individual:*]

Street address _____ [*do not use post office box*]
City _____, California Zip _____

[*Add optional articles, if any; see comment to this form and Ch. 3, Articles of Incorporation, and continue with the following:*]

IV

Notwithstanding any of the above statements of purposes and powers, this corporation shall not, except to an insubstantial degree, engage in any activities or exercise any powers that are not in furtherance of the specific purposes of the corporation.

V

This corporation is an association formed to manage a common interest development under the Davis-Stirling Common Interest Development Act.

VI

[*EITHER*]

The address of the business or corporate office of the association is _____. This office is on site.

[*OR*]

The address of the business or corporate office of the association is _____. This office is not on site. The nine-digit zip code of the common interest development is _____. The nearest front street and the nearest cross street to the common interest development are _____.

[*OR*]

The association has no business or corporate office. The nine-digit zip code of the common interest development is _____. The front street and the nearest cross street to the common interest development are _____.

[*Continue with following:*]

VII

The name and address of the association's managing agent is _____.

[*Add, if an existing unincorporated association is being incorporated:*]

VIII

The name of the existing unincorporated association, now being incorporated by the filing of these articles, is _____.

[*CONTINUE*]

[*Optional; add if initial directors are named:*]

IX

The corporation will have [*number, e.g.,* three] Director(s). The names and addresses of the initial directors of the corporation are [*specify*].

[*Add other optional articles, if any.*]

[*CONTINUE*]

Date: _____.

[*If initial directors are named in articles (see optional Article VIII of this form), then all initial directors must sign; otherwise only the incorporators must sign.*]

_____ [*signature of incorporator, or initial director if initial directors are named in articles*]
_____ [Incorporator *or* Initial Director] _____ [*typed name*]
_____[*signature of incorporator, or initial director if initial directors are named in articles*]
_____ [Incorporator *or* Initial Director] _____ [*typed name*]

[*If an existing unincorporated association is being incorporated, include verified declaration (see § 13.242).*]

ACKNOWLEDGMENT

[*For acknowledgment, see § 13.200[2].*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
2. Nonprofit Mutual Benefit Corporations

6-13 California Legal Forms--Transaction Guide § 13.212

§ 13.212 Bylaws--With Members in Multiple Classes

[1] Comment

[a] Use of Form

This form is an illustrative set of bylaws designed for use by a nonprofit mutual benefit corporation that has or will have more than one class of members. The form contains numerous optional and permissive provisions that are discussed below.

A nonprofit mutual benefit corporation may admit persons to one class of membership, or may provide for multiple classes of membership, and may provide for the transfer of memberships [*Corp. Code §§ 7132(c)(2)(3), 7310(a), 7320*]. The provisions of this form may be used to when the corporation will admit multiple classes of members. If the corporation will admit only one classes of membership, the provisions concerning the admission of membership set forth in *§ 13.201[2]* (bylaws for nonprofit public benefit corporation with single class of members) may be inserted in this form, with appropriate modification to provisions of this form that are inconsistent with the substituted provisions.

Alternatively, mutual benefit corporations need not have members, and the Nonprofit Mutual Benefit Corporation Law provides that if the articles or bylaws prohibit members or fail to provide for members, the corporation may not have members [*Corp. Code § 7310(a)*]. For an example of bylaws for a nonprofit corporation without members, see *§ 13.221* (bylaws for religious corporation without members).

[b] "Member" Defined

A "member" is any person who, pursuant to a specific provision of the corporation's articles or bylaws, has the right to vote for the election of a director or directors, on a disposition of all or substantially all of the assets of the corporation, or on a merger or on a dissolution. The term also includes any person who is designated in the articles or bylaws as a member and, pursuant to a specific provision of a corporation's articles or bylaws, has the right to vote on changes to the articles or bylaws [*Corp. Code § 5056(a)*].

[c] Mandatory Provisions

Unless stated in the articles, the bylaws must state (1) the number of directors of the corporation; (2) the method of determining the number of directors of the corporation; or (3) that the number of directors may not be less than a stated minimum (one or more) nor more than a stated maximum with the exact number of directors to be fixed, within the limits specified, by approval of the board or the members [*Corp. Code § 5034*], in the manner provided in the bylaws [*Corp. Code § 7151(a), (e)*]. Note that if the articles provide for the number of directors, that provision may only by changed by a formal amendment of the articles [*Corp. Code § 7151(a)*; *see § 13.261*]. Except as otherwise provided in the articles or bylaws, once members have been admitted, a bylaw specifying or changing a fixed number of directors or the maximum or minimum number or changing from a fixed to a variable board or vice versa may only be adopted by approval of the members [*Corp. Code § 7151(b)*].

[d] Optional Provisions in General

As a general rule, the bylaws may contain any provision, not in conflict with law or the articles, for the management of the activities and for the conduct of the affairs of the corporation [*Corp. Code § 7151(c)*]. This authority includes any provision that is required or permitted by the Nonprofit Mutual Benefit Corporation Law to be stated in the bylaws [*Corp. Code §§ 7132(c), 7151(c)*].

PRACTICE TIP

Provisions of the Nonprofit Corporation Law establish many of the rules governing the management of corporate affairs, at least in the absence of a contrary bylaw. Although these rules are not required to be restated in the bylaws, corporations often do to provide a complete manual of corporate procedure for the management and members.

[e] Directors and Executive Committees

The Nonprofit Corporation Law permits the following optional bylaws provisions relating to directors and executive committees of mutual benefit corporations:

- The names and addresses of the persons appointed to act as initial directors [*Corp. Code §§ 7151(c)(1), 7132(c)(1)*].
- The time, place, and manner of calling, conducting, and giving notice of directors' and committee meetings, or of conducting mail ballots [*Corp. Code § 7151(c)(2)*].
- The qualifications, duties, and compensation of directors [*Corp. Code § 7151(c)(3)*].
- The time of the election of directors [*Corp. Code § 7151(c)(3)*];
- The requirements of a quorum for directors' and committee meetings [*Corp. Code § 7151(c)(3)*].
- The appointment and authority of committees [*Corp. Code § 7151(c)(4)*].
- A provision restricting the indemnification of directors [*Corp. Code § 7237(h)(1)*].

The bylaws, subject to limitations, may restrict or eliminate the power of the board to adopt, amend, or repeal any or all of the bylaws [*Corp. Code § 7150(c)*]. The bylaws also may provide that the repeal or amendment of the bylaws, or the repeal or amendment of specified portions of the bylaws, may occur only with the written approval of specified persons other than the board or members [*Corp. Code § 7150(d)*]. However, unless the bylaws specify otherwise, this approval

requirement will not apply if any of the following circumstances exist [*Corp. Code § 7150(d)*]:

- The specified person has died or ceased to exist.

- If the right of the specified person to approve is in the capacity of an officer, trustee, or other status, the specified office, trust, or status has ceased to exist.

- If the corporation has a specific proposal for amendment or repeal and it has provided written notice of that proposal (including a copy) to the specified person at the most recent address in the corporation's records, and the corporation has not received written approval or nonapproval within the period specified in the notice (*i.e.*, not less than 10 nor more than 30 days commencing at least 20 days after the notice has been provided).

Unless otherwise provided in the bylaws or articles, and except for a vacancy created by the removal of a director, board vacancies may be filled by approval of the board [*see Corp. Code § 5032*] or, if the number of directors then in office is less than a quorum, by either (1) the unanimous written consent of the directors then in office, (2) the affirmative vote of a majority of the directors then in office at a meeting held pursuant to notice or waivers of notice complying with *Corp. Code § 7211*, or *(3)* a sole remaining director [*Corp. Code § 7224(a)*].

The directors of a corporation with fewer than 50 members may be removed without cause by a majority vote of the members. The directors of a larger corporation may be removed without cause with the approval of the members [*see Corp. Code §§ 5033, 7222(a)(1), (2); see also Corp. Code § 5034* ("approved by members" defined); *Corp. Code § 7222(b), (f)*]. These requirements may not be altered by the bylaws [*see Corp. Code § 5151(e)*]. If the corporation has no members, directors may be removed by a vote of the majority of the directors [*Corp. Code § 7222(a)(3)*]. If the articles or bylaws authorize cumulative voting, special rules apply to the removal of directors [*see Corp. Code § 7222(b)(1)*]. If the articles or bylaws authorize members of any class, voting as a class, to elect directors, a director elected by that class may be removed by the prescribed vote of the members of that class [*Corp. Code § 7222(b)(2)*]. If the articles or bylaws authorize the designation of directors, any designated director may be removed without cause by the designator unless otherwise provided in the articles or bylaws at the time the designation is made [*Corp. Code § 7222(f)(1)*]. Any director so designated may only be removed with the written consent of the designator of that designator [*Corp. Code § 7222(f)(2)*]. Unless provided otherwise in the articles or bylaws, the right to remove will not apply if (1) the designator entitled to that right has died or ceased to exist, or (2) the right is in the capacity of an officer, trustee, or other status and that office, trust, or status has ceased to exist [*Corp. Code § 7222(f)(3)*].

[f] Officers

The bylaws may contain provisions concerning the appointment, duties, compensation, and tenure of officers [*Corp. Code § 7151(c)(5)*]. Absent a provision in the articles or bylaws, the president, or, if there is no president, the chair of the board, [*see Corp. Code § 5039.5* ("chair" includes "chairperson," "chairman," and "chairwoman")] is the general manager and chief executive officer of the corporation; and if there is no chief financial officer, the treasurer is the chief financial officer of the corporation [*Corp. Code § 7213(a)*]. Except as otherwise provided in the articles or the bylaws, officers must be chosen by the board and serve at the pleasure of the board, subject to the rights, if any, of an officer under any contract of employment [*Corp. Code § 7213(b)*]. Any officer may resign at any time on written notice to the corporation without prejudice to any rights of the corporation under any contract to which the officer is a party [*Corp. Code § 7213(b)*].

[g] Compensation

The bylaws may fix the compensation of directors [*Corp. Code § 7151(c)(3)*], or may leave the determination of compensation to the board of directors. This form contains two alternative versions of Section 4.06 relating to the

compensation of the directors. When drafting a provision specifying the compensation to be paid to directors, counsel should review *I.R.C. § 4941(d)(2)(E)*, which prohibits the payment of unreasonable compensation to directors of corporations qualifying as private foundations within the meaning of the Internal Revenue Code.

[h] Members

In general, the bylaws may confer some or all of the rights of a member, set forth in the Nonprofit Mutual Benefit Corporation Law, on any person or persons who do not have any of the voting rights referred to in *Corp. Code § 5056(a)* [*Corp. Code § 5056(b)*]. Specifically, the bylaws may contain provisions concerning the following matters:

- The classes of members, if any, and if there are two or more classes, the rights, privileges, preferences, restrictions, and conditions attaching to each class [*Corp. Code §§ 7151(c)(1), 7132(c)(3)*].

- The transfer of memberships [*Corp. Code §§ 7151(c)(1), 7132(c)(2)*; *see Corp. Code § 7230*].

- A provision that would allow any member to have more or less than one vote in any election or other matter presented to the members for a vote [*Corp. Code §§ 7151(c)(1), 7132(c)(4)*].

- The mode of determination of members of record [*Corp. Code § 7151(c)(6)*].

- The making of reports and financial statements to members [*Corp. Code § 7151(c)(7)*].

- Setting, imposing, and collecting dues, assessments, and admission fees [*Corp. Code § 7151(c)(8)*].

- A provision for the admission, withdrawal, suspension, and expulsion of members [*Corp. Code § 7151(d)*].

- A provision limiting the number of members, in total or of any class, which the corporation is authorized to admit [*Corp. Code § 7151(f)*].

- A provision that specified rights in the membership will not terminate on the death or dissolution of a member [*Corp. Code § 7320(a)(2)*].

- The time, place, and manner of calling, conducting, and giving notice of members' meetings [*Corp. Code § 7151(c)(2)*; *see § 13.33[2]*].

A corporation may provide in its bylaws that it does not have members. In the absence of a provision in its articles or bylaws, the corporation may not have members [*Corp. Code § 7310(a)*]. The bylaws also may provide that memberships may be issued without consideration, or for such consideration as is specified in the articles or bylaws. If no consideration is specified, memberships may be issued for consideration determined by the board of directors [*Corp. Code § 7311(a)*].

Meetings of members may be held at any place stated in or fixed in accordance with the bylaws. If the bylaws fail to provide for a place of meeting, the meetings of members must be held at the principal office of the corporation [*Corp. Code § 7510(a)*]. The drafting attorney should keep in mind the possibility that the directors may use a loosely drawn provision governing the place of members' meetings to discourage membership participation. For example, a provision permitting the directors to select a meeting place outside California provides the directors with an opportunity to abuse their discretion by selecting a purposeless and distant location. The better approach would be to provide the directors with reasonable geographical restrictions that will prevent the imposition of unnecessary hardships on the members. Thus, if the bylaws permit the directors to select the members' meeting place, the bylaws might, for example, specify

that the selection of sites is limited to northern or southern California, or to one of several major cities in either region.

[i] Delegates

A corporation may provide in its bylaws for delegates having some or all of the authority of members. Delegates may be given a name other than "delegates." If delegates are provided for, the bylaws must set forth their terms of office, any reasonable method for delegate selection and removal, and any reasonable method for calling, noticing, and holding meetings of delegates [*Corp. Code § 7152*]. The bylaws may set forth the manner in which delegates may act by written ballot consistent with *Corp. Code § 5513*. However, delegates may only act personally at a meeting or by written ballot, and may not act by proxy [*Corp. Code § 7152*].

[j] Voting Requirements Affecting Corporate Actions

The bylaws may require, for any or all corporate actions with specified exceptions [*see Corp. Code §§ 7222(a)(1), (2), 7615(c), 8610*], the vote of a larger proportion of, or all of, the members or the members of any class, unit, or grouping of members, or the vote of a larger proportion of, or all of, the directors, than is otherwise required by the Nonprofit Public Benefit Corporation Law. A provision in the bylaws requiring a greater vote may not be altered, amended, or repealed except by a that greater vote, unless otherwise provided in the bylaws [*Corp. Code § 7151(e)*].

The bylaws, within statutory limitations, may establish and authorize cumulative voting [*Corp. Code § 7615(a)*]. A provision authorizing cumulative voting may be repealed or amended only by the approval of the members [*see Corp. Code § 5034*], except that the governing provision may require the vote of a greater proportion of the members, or of any class, to repeal the cumulative voting provision [*Corp. Code § 7615(a)*].

Section 3.10(e) of this form permits cumulative voting. An alternative provision barring cumulative voting is set forth in *§ 13.201[2],* Section 3.10(e). This latter provision may be adapted for use in the following form provided related amendments are made with respect to inconsistent matters set forth in the form. Section 3.10(f) of this form permits members to vote or act by proxies. An alternative provision withdrawing the right of members to vote by proxy is set forth in *§ 13.201[2],* Section 3.10(f).

[k] Record Date

The bylaws may provide a date as the record date for the purpose of determining the members entitled to notice of any meeting of members. Absent such a bylaw, the board may fix the record date in advance. In either event, the record date must not be more than 90 nor less than 10 days before the date of the meeting. If a record date is not fixed, members at the close of business on the business day preceding the day on which notice is given or, if notice is waived, at the close of business on the business day preceding the day on which the meeting is held are entitled to notice of a meeting of members. A determination of members entitled to notice of a meeting of members applies to any adjournment of the meeting unless the board fixes a new record date for the adjourned meeting [*Corp. Code § 7611(a)*].

[l] Inspection Rights

The members of every mutual benefit corporation have statutory rights of inspection with respect to the articles and bylaws of the corporation [*Corp. Code § 7160*; *see § 13.35[1][c]*]. Further, the accounting books and records and minutes of proceedings of members and the board and committees of the board must be open to inspection on the written demand on the corporation of any member at any reasonable time, for any purpose reasonably related to that person's interest as a member [*Corp. Code § 8333*].

In general, members may also inspect, and obtain copies of, membership lists [*see Corp. Code § 8330*; *see also Corp. Code §§ 8331, 8332* (court limitations and reasonable alternative); *see § 13.35[1][c]*]. However, although members' inspection rights cannot be limited by contract or the articles or bylaws [*Corp. Code § 8313*], the corporation may

petition the superior court for an order setting aside a member's demand to inspect the membership list based on a good faith and substantial belief that the membership list will be used for an improper purpose [*Corp. Code § 8331*; *see § 13.35[1][c]*].

[m] Proof of Corporate Bylaws

The original or a copy of the bylaws in writing or in any other form capable of being converted into clearly legible tangible form, certified to be a true copy by a person purporting to be the secretary or an assistant secretary of the corporation, is prima facie evidence of the adoption of those bylaws and of the matters stated therein [*Corp. Code § 7215*].

[n] Adoption, Amendment, and Repeal of Bylaws

Bylaws of mutual benefit corporations may be adopted, amended, or repealed by the approval of the members or the board, with specified exceptions and limitations [*Corp. Code § 7150(a), (b)*; *see Corp. Code §§ 7150(c), 7151, 7220, 7224, 7512, 7613, 7615*]. "Approval of the members" means that the bylaws were approved or ratified by the affirmative vote of a majority of votes represented and voting at a duly held meeting at which a quorum was present (which affirmative votes also constituted a majority of the required quorum) or written ballot in conformity with *Corp. Code § 7513*. The term also includes the affirmative vote or written ballot of any greater proportion, including all of the votes of the memberships of any class, unit, or grouping of members that may be provided in the bylaws or by law, for all or any specified member action [*Corp. Code § 5034*]. "Approval of the board" means approval or ratification by the board or by the vote of an authorized committee of the board [*Corp. Code § 5032*].

In general, the board may adopt, amend, or repeal the bylaws, unless the action would do any of the following [*Corp. Code § 7150(a)*]:

- Materially and adversely affect the rights of members as to voting, dissolution, redemption, or transfer.
- Increase or decrease the number of members authorized in total or for any class.
- Effect an exchange, reclassification or cancellation of all or part of the memberships.
- Authorize a new class of membership.

For resolutions of the board of directors adopting the bylaws of for-profit corporations, see Ch. 4, *Bylaws* . Those resolutions may be adapted for the purpose of adopting bylaws of a mutual benefit corporation.

The members also may adopt, amend, or repeal the bylaws. However, such an action requires the approval by the members of a class if the action would do any of the following [*Corp. Code § 7150(b)*]:

- Materially and adversely affect the rights, privileges, preferences, restrictions or conditions of this class as to voting, dissolution, redemption, or transfer in a manner different than the action affects another class.
- Materially and adversely affect this class as to voting, dissolution, redemption, or transfer by changing the rights, privileges, preferences, restrictions or conditions of another class.
- Increase or decrease the number of memberships authorized for this class.

- Increase the number of memberships authorized for another class.
- Effect an exchange, reclassification or cancellation of all or part of the memberships of this class.
- Authorize a new class of memberships.

The bylaws, subject to limitations, may restrict or eliminate the power of the board to adopt, amend, or repeal any or all of the bylaws [*Corp. Code § 7150(c)*]. The bylaws may also provide that the repeal or amendment of the bylaws, or the repeal or amendment of specified portions of the bylaws, may occur only with the written approval of specified persons other than the board or members [*Corp. Code § 7150(d)*]. This approval requirement will not apply in circumstances in which the specified person has ceased to exist [*see Corp. Code § 7150(d)*; *see also* [e], *above*].

[2] FORM

Bylaws--With Members in Multiple Classes

BYLAWS OF _____ [*name of corporation*]

ARTICLE I
OFFICES

Principal Office

1.01. The principal office of the Corporation for its transaction of business is located in the City of _____ and County of _____, California [*or* is located at _____ (*street address*), _____ (*city*), _____ (*county*), California].

Change of Address

1.02. The Board of Directors is granted full power and authority to change the principal office of the Corporation from one location to another in _____[, the County of _____], California. Any change of address will be noted by the Secretary in these Bylaws, but will not be considered an amendment of these Bylaws.

ARTICLE II
MEMBERS

Classification and Qualification of Members

2.01. The Corporation will have [*number, e.g.*, two] classes of members, [*describe, e.g.*, regular Members and Honorary Members. Regular Members of the Corporation are those persons as defined in *Corporations Code Section 5065* owning a retail business that serves the men's clothing and apparel market. Each qualifying person is entitled to one Regular Membership. Honorary Members of the Corporation are those persons as defined in *Corporations Code Section 5065* who are not otherwise eligible to be members of the Corporation but who, in the opinion of the Board of Directors, have performed services for the Corporation warranting their appointment as Honorary Members]. Any subsidiary of the Corporation may not be admitted to membership of the Corporation. A person, as defined in

Corporations Code Section 5065 may not hold more than one membership in each class.

Eligibility for Membership

2.02. Any person, as defined *Corporations Code Section 5065*, is eligible to be a member of the Corporation[, except that, in the case of a natural person, the person will not be eligible for membership unless over the age of _____ (*number, e.g.*, 18 years)].

Admission to Membership

2.03. Any person, eligible for membership under Section 2.02 of these Bylaws and qualified for membership under Section 2.02 of these Bylaws, will be admitted to membership only on the approval of the [Board of Directors *or* Membership Committee duly authorized, by resolution, to admit members] of an application submitted by that person in the form and manner as prescribed by the Board of Directors [and on the payment of (the application fee as specified in Section 2.04 of these Bylaws and) the first annual dues as specified in Section 2.05 of these Bylaws].

Application Fee

[*EITHER*]

2.04. There is no fee for applying for membership in the Corporation.

[*OR*]

2.04. There shall be a fee _____[in the amount _____ (of $_____ *or* determined from time to time by resolution of the Board of Directors)] charged for, and payable with, the application for membership. This application fee is nonrefundable.

[*Continue with the following:*]

Annual Dues

2.05. The annual dues payable to the Corporation by members will be in the amounts determined by resolution of the Board of Directors, but in no event may the annual dues exceed the amount of $_____. Dues are payable for the first year on admission to membership and annually thereafter at the time or times as may be fixed by the Board of Directors. A member, on learning of the amount of dues determined by the Board of Directors and the time or times of payment fixed by the Board of Directors, may avoid liability for the dues by promptly resigning from membership, except if the member is, by contract or otherwise, liable for the dues.

Assessments

[*EITHER*]

2.06. Memberships are nonassessable.

[*OR*]

2.06. Memberships are subject to assessment [specify, e.g., for capital contributions to enable the Corporation to acquire assets, provided, however, that assessments may not exceed the total aggregate sum $_____ (*e.g.*, $2,500) per membership]. The amount of each levy and the method of collection will be fixed from time to time by resolution of the Board of Directors of the Corporation. Assessments will be made payable at the times or intervals, and on notice, as prescribed by the Board. [*Optional:* Any member, on learning of an assessment, may avoid liability for it by promptly resigning from membership, providing that the member is not otherwise liable for the assessment by contract or otherwise.]

[*OR*]

2.06. Memberships are subject to assessments that may be levied and collected as follows: [*describe assessment*]. [*Optional:* Any member, on learning of an assessment, may avoid liability for it by promptly resigning from membership, providing that the member is not otherwise liable for the assessment by contract or otherwise.]

[*Continue with the following:*]

Number of Members

2.07. There is no limit on the number of members that the Corporation may admit. [*Optional:* However, the Corporation may not have more than _____ (*number*) Honorary Members at any one time.]

Membership Book

2.10. The Corporation shall keep a membership book containing the name, address, and class of each member [in written form *or* in any form capable of being converted into written form]. The book must also note if a membership has terminated and the date on which that membership ceased. The book will be kept at the principal office of the Corporation and is subject to the rights of inspection required by law and as set forth in Section 2.09 of these Bylaws.

Inspection Rights of Members--Demand

2.09. (a) Subject to the Corporation's right to set aside a demand for inspection pursuant to *Corporations Code Section 8331* and the authority of the court to limit inspection rights pursuant to *Corporations Code Section 8332*, and unless the Corporation provides a reasonable alternative as permitted by Section 2.09(c) of these Bylaws, a member satisfying the qualifications set forth may do either or both of the following:

(1) Inspect and copy the record of all the members' names, addresses, and voting rights, at reasonable times, on five business days prior written demand on the Corporation, which must state the purpose for which the inspection rights are requested; or

(2) Obtain from the Secretary of the Corporation, on written demand and tender of a reasonable charge, a list of the names, addresses, and voting rights of those members entitled to vote for the election of Directors, as of the most recent record date for which it has been compiled or as of the date of demand. The demand must state the purpose for which the list is requested. The membership list will be available on or before the later of 10 business days after the demand is received, or after the date specified in the demand as the date as of which the list is to be compiled.

Members Permitted to Exercise Rights of Inspection

(b) The rights of inspection set forth in Section 2.09(a) of these Bylaws may be exercised by the following:

(1) Any member, for a purpose reasonably related to that person's interest as a member;

(2) The authorized number of members for a purpose reasonably related to the members' interest as members; and

(3) _____ [*Other description of members who may exercise rights of inspection*].

Alternative Method of Achieving Purpose

(c) The Corporation, within 10 business days after receiving a demand pursuant to Section 2.09(a) of these Bylaws, may deliver to the person or persons making the demand a written offer of an alternative method of achieving the purpose identified in the demand without providing access to or a copy of the membership list. An alternative method that reasonably and in a timely manner accomplishes the proper purpose set forth in a demand made pursuant to Section 2.09(a) of these Bylaws will be deemed reasonable, unless within a reasonable time after acceptance of the offer, the Corporation fails to effect the alternative method. Any rejection of the offer must be in writing and indicate the reasons the alternative proposed by the Corporation does not meet the proper purpose of the demand made pursuant to Section 2.09(a) of these Bylaws.

Certificates of Membership

[*EITHER*]

2.10. The Corporation will not issue membership certificates. [*Optional:* However, the Corporation reserves the right to issue identity cards or similar devices to members to serve to identify members qualifying to use the facilities or services of the Corporation].

[*OR*]

2.10. The Board of Directors of the Corporation [may *or* shall] provide for the issuance of certificates evidencing membership in the Corporation. These certificates must state on the certificate that the Corporation is a nonprofit mutual benefit corporation that [may not make distributions to its members except on dissolution *or, if articles so provide,* may not make distributions to its members during its life or on dissolution]. [*If there are restrictions on transferability of certificates, add:* The certificates must also state on the certificate that a copy of the transfer restrictions are on file with the Secretary of the Corporation and are open for inspection by a member on the same basis as the records of the Corporation.]

[*Continue with the following:*]

Nonliability of Members

2.11. A member of the Corporation is not personally liable, solely because of membership, for the debts, obligations, or liabilities of the Corporation.

Transferability of Membership

[*EITHER*]

2.12. Neither membership in the Corporation nor any rights in the membership may be transferred or assigned for value or otherwise.

[*OR*]

2.12. The Board of Directors may provide by resolution for the transfer of memberships within any class or classes, with or without restriction or limitation, including transfer on the death, dissolution, merger, or reorganization of a member.

[*Continue with the following:*]

Termination of Membership--Causes

2.13. (a) The membership and all rights of membership automatically terminate on the occurrence of any of the following causes:

(1) The voluntary resignation of a member, with notice as prescribed by Section 2.13(b) of these Bylaws;

(2) When a membership is issued for a period of time, the expiration of that period;

(3) The death of a member;

(4) The dissolution of corporate members; and

(5) The nonpayment of dues or assessments, subject to the limitations *set forth in Section 2.13*(c) of these Bylaws.

Resignation by Giving Notice

(b) The membership of any member of the Corporation shall automatically terminate on such member's written request for such termination delivered to the President or Secretary of the Corporation personally or deposited in United States first class mail, postage prepaid.

Nonpayment of Dues or Assessments

(c) The membership of any member who fails to pay his or her dues or assessments within [*number of days, e.g.,* 30 days] of the due date automatically terminates at the end of that [*e.g.,* 30-day] period, provided that the member was given (1) 15 days prior written notice of the termination stating the reasons for termination, and (2) a timely opportunity to be heard on the matter of the termination. The notice will be given personally to the member or sent by [first class *or* registered] mail to the last address of the member as shown on the records of the Corporation. The opportunity to be heard, at the election of the member, may be oral or in writing, and must occur not less than 5 days before the effective date of the termination. The hearing shall be conducted at _____[*address*] by a committee composed of [*names of persons or other designations of committee members, e.g.,* the President, Secretary, and Assistant Secretary of the Corporation]. The hearing will be presided over by [*name of person, e.g.,* the President of the Corporation] who will perform the following duties:

(1) Read the charges against the subject member.

(2) Require that the charges be verified by the testimony of the person or persons making them.

(3) Hear any other witnesses against the subject member.

(4) Allow the subject member to cross-examine each witness following the testimony of that witness.

(5) Allow the subject member to make a statement in his or her own behalf.

(6) Allow the subject member to call witnesses in his or her own behalf.

(7) Allow the members of the committee conducting the hearing to question the witnesses after they have been questioned by the subject member.

The committee conducting the hearing will conduct the hearing in good faith and in a fair and reasonable manner. The committee has the exclusive power and authority to decide that the proposed termination not take place.

Effect of Termination

(d) Any and all rights of a member in the Corporation and in its property cease on the termination of membership. However, termination does not relieve the member from any obligation for charges incurred, services or benefits actually rendered, dues, assessments, or fees, or arising from contract or otherwise. The Corporation retains the right to enforce any obligation or obtain damages for its breach.

ARTICLE III
MEETINGS OF MEMBERS

Place

3.01. Meetings of members will be held at _____[the principal office of the corporation *or* any location within the State of California that may be designated from time to time by resolution of the Board of Directors].

Regular Meetings

[*EITHER*]

3.02. Regular meetings of members will not be held.

[*OR*]

3.02. The members will meet _____[annually *or specify other time period; if directors are to be elected at regular meetings, time period must correspond to the directors' terms of office, and not exceed three-year maximum term, e.g.,* every third year on the _____ (*day and month, e.g.,* first Monday in March) in each year [*or other time period as appropriate*], beginning with the year _____, at [*time, e.g.,* 8:00 P.M.)] for the purpose of transacting proper business as may come before the meeting, including the election of Directors for the terms as are fixed in Section 4.03 of these Bylaws. If the election of Directors does not occur at any meeting of the members or without a meeting by written ballot pursuant to Section 3.11 of these Bylaws, the Board will (or 5 percent of the members may) cause the election of Directors to be held at a special meeting of members called and held as soon as it is reasonably possible after the adjournment of the regular meeting of the members. If the day fixed for the regular meeting of members falls on a legal holiday, the meeting will be held at the same hour and place on the next succeeding day.

[*Continue with the following:*]

Special Meetings

3.03. Special meetings of members will be called by _____[the Board of Directors *or* the Chair of the Board *or* the President of the Corporation *or names and titles of other persons*] and held _____[at the place (within the State of California) as is fixed in Section 3.01 of these Bylaws *or* at the times and places within the State of California as may be ordered by resolution of the Board of Directors)]. Five percent or more of the members of the Corporation may call special meetings for any lawful purpose.

Notice of Meetings

3.04. Written notice of every meeting of members must be either personally delivered or mailed by [first class *or* registered *or* certified] United States mail, postage prepaid, [*number not less than 10 or more than 90, e.g.,* 15 days] before the date of the meeting to each member who is entitled to vote at the meeting as of the record date for notice of the meeting.

If notice is given by mail or other means of written communication, the notice must be addressed to the member at the address appearing on the books of the Corporation or at the address given by the member to the Corporation for the purpose of notice. If no address appears or was given by the member, notice will be given [at the principal office of the Corporation *or* by publication in any newspaper of general circulation in the county in which the principal office of the Corporation is located]. The [Secretary *or* Assistant Secretary] of the Corporation, or any transfer agent specially designated by the [Secretary *or* Assistant Secretary] for this purpose, will execute an affidavit of the giving of the notice of the meeting of members. In the case of a specially called meeting of members, notice that a special meeting will be

held at a time requested by the person or persons calling the meeting not less than 35 days or more than 90 days after receipt of the written request from that person or persons by the [Chairman of the Board *or* President *or* Vice-President *or* Secretary] of the Corporation will be sent to the members forthwith and in any event within 20 days after the request was received.

No meeting of members may be adjourned more than 45 days. If a meeting is adjourned to another time or place, and thereafter a new record date is fixed for notice or voting, a notice of the adjourned meeting will be given to each member of record who, on the record date for notice of the meeting, is entitled to vote at the meeting.

Contents of Notice

3.05. The notice will state the place, date, and time of the meeting. [*For regular meetings, add:* In the case of regular meetings, the notice will state those matters that the Board of Directors, at the time the notice is given, intends to present for action by the members.] The notice of any meeting at which Directors are to be elected must include the names of all those who are nominees at the time the notice is given to the members.

Waivers, Consents, and Approvals

3.06. The transactions of any meeting of members, however called and noticed, and wherever held, are as valid as though had at a meeting duly held after regular call and notice, if a quorum is present either in person or by proxy, and if, either before or after the meeting, each of the persons entitled to vote but not present in person or by proxy, signs a written waiver of notice, a consent to the holding of the meeting, or an approval of the minutes of the meeting. All waivers, consents, and approvals [will be filed with the corporate records *or* will be included in the minutes of the meeting].

Quorum

3.07. A quorum at any meeting of members consists of [*proportion or percentage, e.g.*, a majority *or* 35 percent] of the voting power, represented in person or by proxy. For purposes of this Bylaw, "voting power" means the power to vote for the election of directors at the time any determination of voting power is made and does not include the right to vote on the happening of some condition or event which has not yet occurred.

Loss of Quorum

3.08. The members present at a duly called or held meeting at which a quorum is present may continue to transact business until adjournment notwithstanding the withdrawal of enough members to leave less than a quorum, if any action taken, other than adjournment, is approved by at least a majority of members required to constitute a quorum.

Adjournment for Lack of Quorum

3.09. In the absence of a quorum, any meeting of members may be adjourned from time to time by the vote of a majority of the votes represented either in person or by proxy. However, no other business may be transacted except as provided in Section 3.08 of these Bylaws.

Voting of Membership--Entitlement

3.10. (a) Except as provided in Section 3.10(e) of these Bylaws authorizing cumulative voting at the election of Directors, each [*description of members entitled to vote, e.g.,* Regular Member] is entitled to one vote on each matter submitted to a vote of the members. [*Description of members not entitled to vote, e.g.,* Honorary members] are not be entitled to vote on any matter submitted to a vote of the members.

Indivisible Interest in Single Memberships

(b) Single memberships in which two or more persons have an indivisible interest will be voted as *set forth in Section 3.10*(c) of these Bylaws relating to the voting of memberships in two or more names.

Memberships in Two or More Names

(c) When a membership stands of record in the names of two or more persons, whether fiduciaries, members of a partnership, joint tenants, tenants in common, husband and wife as community property, tenants by the entirety, or otherwise, or if two or more persons (including proxyholders) have the same fiduciary relationship respecting the same membership, unless the Secretary of the Corporation is given written notice to the contrary and is furnished with a copy of the instrument or order appointing them or creating the relationship wherein it is so provided, their acts with respect to voting have the following effect: if only one member votes, that act binds all members; if more than one member vote, the act of the majority so voting binds all members.

Record Date of Membership

(d) The Board of Directors shall fix, in advance, a date as the record date for the purposes of determining the members entitled to notice of and to vote at any meeting of members. The record date for the purpose of determining the members entitled to notice of any meeting of members is [*number not greater than 90 or less than 10, e.g.,* 40 days] before the date of the meeting of members. The record date for the purpose of determining the members entitled to vote at any meeting of members is [*number not greater than 60, e.g.,* 30 days] before the date of the meeting of members. The Board will also fix, in advance, the record date for the purpose of determining the members entitled to exercise any rights in respect to any other lawful action. This date may not be more than 60 days before that other action.

Cumulative Voting

[*EITHER, if directors are elected at regular meetings:*]

(e) Every member entitled to vote at any election of the Directors may cumulate their votes and give one candidate a number of votes equal to the number of Directors to be elected multiplied by the number of votes to which the member is entitled, or distribute the member's votes on the same principle among as many candidates as the member thinks fit. No member is entitled to cumulate votes for a candidate or candidates unless that candidate's name or candidates' names have been placed in nomination before voting and a member has given notice at the meeting before the voting of the member's intention to cumulate votes. If any one member gives this notice, all members may cumulate their votes for candidates in nomination. In any election of Directors, the candidates receiving the highest number of votes are elected.

[*OR, if corporation elects directors by written ballot rather than at regular meetings of members:*]

(e) Cumulative voting is not authorized for the election of directors or for any other purpose.

[*Continue with the following:*]

Proxy Voting

(f) Members entitled to vote, as *set forth in Section 3.10*(a) of these Bylaws, have the right to vote either in person or by a written proxy executed by that member or his or her duly authorized agent and filed with the Secretary of the Corporation, except as otherwise expressly provided in the Articles of Incorporation or these Bylaws. However, a proxy is not valid after the expiration of 11 months from the date of its issuance unless otherwise stated in the proxy. The maximum term of any proxy is 3 years from the date of its execution. Every proxy continues in full force and effect until revoked by the person executing it before the vote.

Action without Meeting by Written Ballot--Ballot Requirements

3.11. (a) Subject to the limitations specified in Section 3.11(b) of these Bylaws and any contained in the Articles, any action that may be taken at any regular or special meeting of members may be taken without a meeting, provided that the following ballot requirements are satisfied:

(1) The Corporation distributes a written ballot to every member entitled to vote on the matter.

(2) The ballot states the proposed action, provides an opportunity to specify approval or disapproval of any proposal, and provides a reasonable time within which to return the ballot to the corporation.

(3) The number of votes cast by ballot with the time period specified equals or exceeds the quorum required to be present at a meeting authorizing the action.

(4) The number of approvals equals or exceeds the number of votes that would be required to approve at a meeting at which the total number of votes cast was the same as the number of votes cast by ballot.

Limitations Pertaining to Election of Directors

[*EITHER, if directors may be elected by written ballot:*]

(b) Directors [may *or* will] be elected by written ballot, as authorized in the Articles of the Corporation, except that election of Directors by written ballot is not permitted when the Directors are elected by cumulative voting pursuant to *Corporations Code Section 7615*.

[*OR, if directors may not be elected by written ballot:*]

(b) Directors may be elected by cumulative voting as provided for in Section 3.10(e) of these Bylaws, and not by written ballot.

[*Continue with the following:*]

Solicitation of Ballots

(c) Ballots will be solicited in a manner consistent with the requirements of giving notice of members' meetings *set forth in Section 3.04* of these Bylaws and of voting by written ballot *set forth in Section 3.11*(d) of these Bylaws. All solicitations must indicate the number of responses needed to meet the quorum requirement and, with respect to ballots other than for the election of Directors, state the percentage of approvals necessary to pass the measure submitted. The solicitation must specify the time by which the ballot must be received in order to be counted.

[*Add, if corporation has or will have 100 or more members:*]

Voting by Written Ballot

(d) The form of written ballots distributed to 10 or more members must afford an opportunity on the form of written ballot to specify a choice between approval and disapproval of each matter or group of related matters intended, at the time the written ballot is distributed, to be acted on by that written ballot. The form must also provide, subject to reasonable specified conditions, that if the person solicited specifies a choice with respect to any matter the vote must be cast in accordance with that choice. In any election of Directors, any form of written ballot in which the Directors to be voted on are named as candidates and that is marked by a member "withhold" or otherwise marked in a manner indicating that the authority to vote for the election of Directors is withheld may not be voted either for or against the election of a Director.

[*Continue with the following:*]

Revocation of Ballot

(e) Unless otherwise provided in the Articles of Incorporation of the Corporation or these Bylaws, a written ballot may not be revoked.

Conduct of Meetings--Chairman

3.12. (a) The President of the Corporation or, in his or her absence, any other person chosen by a majority of the voting members present in person or by proxy, will be Chair of and preside over the meetings of the members.

Secretary of Meetings

(b) The Secretary of the Corporation will act as the secretary of all meetings of members. However, in his or her absence, the Chair of the meetings of members will appoint another person to act as secretary of the meetings.

Rules of Order

(c) The Robert's Rules of Order, as amended from time to time, governs the meetings of members insofar as those rules

are not inconsistent with or in conflict with these Bylaws, the Articles of Incorporation of this Corporation, or the rules governing agenda, motions, and related matters.

Inspectors of Election--Appointment

3.13. (a) Before any meeting of the members [or any action by written ballot], the Board may appoint any persons other than candidates for office as inspectors of election to act at the meeting. If inspectors of election are not so appointed for any meeting, or if any person so appointed fails to appear or refuses to act, the Chair of the meeting may, and on request of any member or member's proxy must, appoint inspectors of election at the meeting. [If inspectors of election are not so appointed for any action by written ballot, or if any person so appointed refuses to act, the President of the Corporation must appoint inspectors of election for that written ballot on request of any member or member's proxy.] The number of inspectors will be either one or three. If appointed at a meeting on the request of one or more members or proxies, the majority of members represented in person or by proxy must determine whether one or three inspectors are to be appointed.

Duties

(b) The inspectors of election must perform the following duties:

(1) Determine the number of outstanding voting memberships, the voting power of each, and, when applicable, the number represented at the meeting, the existence of a quorum, and the authenticity, validity, and effect of proxies.

(2) Receive votes, ballots, or consents.

(3) Hear and determine all challenges and questions in any way arising in connection with the right to vote.

(4) Count and tabulate all votes and consents.

(5) Determine when the polls shall close.

(6) Determine the result.

(7) Do any other acts that may be proper to conduct the election or vote with fairness to all members.

The Inspectors must perform their duties impartially, in good faith, to the best of their ability and as expeditiously as is practical.

Vote of Inspectors

(c) If there are three inspectors of election, the decision, act, or certificate of a majority is effective in all respects as the decision, act or certificate of all.

Report and Certificate

(d) On request of the Chair or any member or member's proxy, the inspectors of election must make a written report concerning the performance of their duties and execute a certificate of any fact found by them. Any report or certificate

made by the inspectors is prima facie evidence of the facts stated.

ARTICLE IV
DIRECTORS

Number

[*EITHER*]

4.01. The corporation will have _____[*number specified in the articles and, if not stated in the articles, number equal to or greater than one*] Director[s]. [Collectively,] the Director[s] will be known as the Board of Directors.

[*OR*]

4.01. The method of determining the number of directors of the corporation will be _____[*specify, with number equal to or greater than one*].

[*OR*]

4.01. [As provided in Article _____ of the Articles of Incorporation of the Corporation,] the Corporation may not have less than [*minimum number specified in the articles*] nor more than [*maximum number specified in the articles*] Directors. The exact number of Directors is [*number within specified limits*] and this number will be fixed from time to time, within the limits specified in this Bylaw [and Article _____ of the Articles of Incorporation of the Corporation], by an amendment to this Bylaw duly adopted by approval of the members, as that term is defined in *Corporations Code Section 5034*.

[*Continue with the following:*]

Qualifications

4.02. The Directors of the Corporation must be residents of the State of California. [*If membership is stated as a qualification, add:* With the exception of the initial Directors, the Directors must also be members of the Corporation.]

Terms of Office

4.03. Each Director holds office _____[*specify term of at least one year but not more than four years, e.g.*, until the next (annual) meeting of members as prescribed by Section 3.02 of these Bylaws *or* for a term of one year from the date of the Director's election], and until the Director's successor is elected and qualifies under Section 4.02 of these Bylaws. If a Director is removed at a special meeting of the members called and held as prescribed by Section 3.03 of these Bylaws, that Director will hold office until his or her removal and his or her successor is elected and qualifies.

Nomination

4.04. Any person qualified to be a Director under Section 4.02 of these Bylaws may be nominated by the method of nomination authorized by the Board or by any other method authorized by law. [*If corporation has 5,000 or more members, add:* The date for close of nominations for the board is _____ (*number not less than 50 or more than 120*) days before _____ (the day the Directors are to be elected *or, if directors are to be elected at regular meetings, use following language if desired:* before the regular meeting of members as provided in Section 3.02 of these Bylaws *or, if directors are to be elected by written ballot, use following language if desired:* before printing and distributing written ballots for the election of Directors). A nomination for the board may not be made after the date set for close of nomination.]

Election

[*EITHER, if corporation will hold regular meetings:*]

4.05. (a) The Directors will be elected [at each annual meeting as prescribed by Section 3.02 of these Bylaws [*if authorized by the articles or bylaws as in Section 3.11 of these bylaws, add:* or by written ballot as authorized by Section 3.11 of these Bylaws].

[*OR, if corporation will not hold regular meetings:*]

4.05. (a) The Directors will be elected _____ by written ballot as authorized by Section 3.11 of these Bylaws.

[*Continue with the following:*]

(b) The candidates receiving the highest number of votes up to the number of Directors to be elected are elected. Directors are eligible for reelection, provided they continue to meet the qualifications required by Section 4.02 of these Bylaws, _____[without limitation on the number of terms they may serve *or* but may not be elected to more than _____ (*specify*) consecutive terms *or state other limitations*].

Compensation

[*EITHER*]

4.06. The Directors serve without compensation [, except that they shall be allowed and paid their actual and necessary expenses incurred in attending the meetings of the Board *or add other provisions allowing partial compensation*].

[*OR*]

4.06. The compensation of the Directors _____[is $_____ per month *or* shall be fixed from time to time by resolution of the Board and approved by the vote or written consent of a majority of the voting members of the corporation].

[*Continue with the following:*]

Meetings--Call of Meetings

4.07. (a) Meetings of the Board may be called by the Chair of the Board or the President or any Vice-President or the Secretary or any two Directors.

Place of Meetings

(b) All meetings of the Board will be held at the principal office of the Corporation as specified in Section 1.01 of these Bylaws or as changed from time to time as provided in Section 1.02 of these Bylaws.

Regular Meetings

(c) Regular meetings of the Board will be held, without call or notice, [*specify time and place e.g.,* at the principal office of the Corporation immediately following each annual meeting of the members of the Corporation as set forth in Section 3.02 of these Bylaws].

Special Meetings

(d) Special meetings of the Board may be called by the Chair of the Board or the President or any Vice-President or the Secretary or any two Directors. Special meetings may be held on four days notice by first class mail, postage prepaid, or on 48 hours' notice delivered personally or by telephone, including a voice messaging system or other system or technology designed to record and communicate messages, telegraph, facsimile, electronic mail, or other electronic means.

Notice of the special meeting need not be given to any Director who signs a waiver of notice or written consent to holding the meeting, or an approval of the minutes of the meeting, whether before or after the meeting, or who attends the meeting without protesting the lack of notice to that Director either before or at the commencement of the meeting. All waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meetings.

Quorum

(e) A majority of the authorized number of Directors constitutes a quorum of the Board for the transaction of business, except as otherwise provided in these Bylaws.

Transactions of Board

(f) Except as otherwise provided in the Articles, in these Bylaws, or by law, every act or decision done or made by a majority of the Directors present at a meeting duly held at which a quorum is present is the act of the Board provided, however, that any meeting at which a quorum was initially present may continue to transact business notwithstanding

the withdrawal of Directors if any action taken is approved by at least a majority of the required quorum for that meeting, or such greater number as is required by the law, the Articles, or these Bylaws.

Conduct of Meetings

(g) The Chair of the Board or, in his or her absence, any Director selected by the Directors then present will preside at meetings of the Board of Directors. The Secretary of the Corporation or, in the Secretary's absence, any person appointed by the presiding officer will act as Secretary of the Board. Members of the Board may participate in a meeting through use of conference telephone or similar communications equipment, as long as all members participating in the meeting can hear one another. This participation constitutes personal presence at the meeting.

Adjournment

(h) A majority of the Directors present at the meeting, whether or not a quorum is present, may adjourn any meeting to another time and place. If the meeting is adjourned for more than 24 hours, notice of the adjournment to another time or place must be given before the time of the adjourned meeting to the Directors who were not present at the time of the adjournment.

Action Without Meeting

4.08. Any action required or permitted to be taken by the Board may be taken without a meeting, if all members of the Board individually or collectively consent in writing to that action. Written consents must be filed with the minutes of the proceedings of the Board. Action by written consent has the same force and effect as the unanimous vote of the Directors.

Removal of Directors--Removal for Cause

4.09. (a) The Board may declare vacant the office of a Director on the occurrence of any of the following events:

(1) The Director has been declared of unsound mind by a final order of court.

(2) The Director has been convicted of a felony.

(3) The Director has been found by a final order or judgment of any court to have breached duties imposed by *Corporations Code Section 7230 et seq.* on directors who perform functions with respect to assets held in charitable trust.

[*Add, if minimum attendance will be required:*]

(4) The Director has failed to attend _____ [*number*] meetings of the Board.

PRACTICE TIP

The bylaws must be adopted before the appointment of the initial directors if the minimum attendance requirement is to applicable to those directors [*see Corp. Code § 7221(b)* (director's failure to meet

qualification *that was in effect at beginning of director's current term* is grounds for removal of director)].

Removal Without Cause

(b) Any or all of the Directors may be removed without cause if, while the Corporation has fewer than 50 members, removal is approved by a majority of all members pursuant to *Corporations Code Section 5033*; or while the Corporation has more than 50 members, removal is approved by the members within the meaning of *Corporations Code Section 5034*. [*If articles or bylaws authorize cumulative voting, add:* However, a Director may not be removed, unless the entire Board is removed, when the votes cast against removal, or not consenting in writing to removal, would be sufficient to elect that Director if voted cumulatively at an election at which the same total number of votes were cast (or if the action is taken by written ballot, all memberships entitled to vote were voted) and the entire number of directors authorized at the time of the Director's most recent election were then being elected.] [*If articles or bylaws provide that members of any class, voting as a class, are entitled to elect one or more directors, add:* Any Director elected by the members of any class, voting as a class, may be removed only by the applicable vote of the members of that class.]

Resignation of Director

4.10. Any Director may resign effective on written notice to the Chair of the Board of Directors, the President, the Secretary, or the Board of Directors of the Corporation. The notice may specify a later time for the effectiveness of the resignation. If the resignation is effective at a future time, a successor may be elected to take office when the resignation becomes effective.

Vacancies in the Board--Causes

4.11. (a) Vacancies on the Board of Directors occur (1) on the death, resignation, or removal of any Director; (2) whenever the number of authorized Directors is increased; and (3) on the failure of the members in any election to elect the full number of authorized Directors.

Filling Vacancies by Directors

(b) Except as otherwise provided in the Articles or these Bylaws and except for a vacancy created by the removal of a Director pursuant to Section 4.09 of these Bylaws, vacancies on the Board of Directors may be filled by approval of the Board of Directors, or, if the number of Directors then in office is less than a quorum, by (1) the unanimous written consent of the Directors then in office; (2) the affirmative vote of a majority of the Directors then in office at a meeting held pursuant to notice or waivers of notice as provided in Section 4.07(d) of these Bylaws; or (3) a sole remaining Director.

Filling Vacancies by Members

(c) Vacancies created by removal of Directors may only be filled by the approval of the members within the meaning of *Corporations Code Section 5034*. The members may elect a Director at any time to fill any vacancy not filled by the Directors.

ARTICLE V
OFFICERS

Number and Titles

5.01. The officers of the Corporation shall be [*either or both* a Chair of the Board *or* a President], [a Vice-President,] a Secretary, a _____[*either or both* Treasurer or Chief Financial Officer], and those other officers with such titles and duties as _____[stated in these Bylaws *or* determined by the Board] and as may be necessary to enable it to sign instruments. [The President *or* The Chair of the Board] is the general manager and chief executive officer of the Corporation. Any number of offices may be held by the same person, except that neither the Secretary, the Treasurer, or the Chief Financial Officer may serve concurrently as [the President *or* the Chair of the Board].

Appointment and Resignation

5.02. The officers will be chosen by the Board and serve at the pleasure of the Board, subject to the rights, if any, of an office under any contract of employment. Any officer may resign at any time on written notice to the Corporation without prejudice to the rights, if any, of the Corporation under any contract to which the officer is a party.

ARTICLE VI
CORPORATE RECORDS, REPORTS, AND SEAL

Keeping Records

6.01. The Corporation must keep adequate and correct records of account and minutes of the proceedings of its members, Board, and committees of the Board. The Corporation must also keep a record of its members giving their names and addresses and the class of membership held by each. The minutes will be kept in written form. Other books and records will be kept in either written form or in any other form capable of being converted into written form.

Annual Report

6.02. The Corporation will notify each member yearly of the member's right to receive a financial report pursuant to *Corporations Code Section 8321(a)*. Except when the Corporation does not have more than 100 members or more than $10,000 in assets at any time during the fiscal year, on the written request of a member, the board must promptly cause the most recent annual report to be sent to the requesting member. The annual report will be prepared not later than 120 days after the close of the Corporation's fiscal year. The annual report must contain in appropriate detail all the information required by *Corporations Code Section 8321(a)*, specifically,

(1) A balance sheet as of the end of the fiscal year and an income statement and statement of changes in financial position for the fiscal year;

(2) A statement of the place where the names and addresses of the current members are located; and

(3) Any information concerning certain transactions and indemnifications required by *Corporations Code Section 8322*.

The annual report must be accompanied by any report of independent accountants. However, if there is no report by independent accountants, the certificate of any authorized officer of the Corporation that the statements were prepared without audit from the books and records of the Corporation.

Annual Statement of Certain Transactions and Indemnifications

6.03. The Corporation must furnish annually to its members a statement of any transaction or indemnification described in *Corporations Code Section 8322(d)* and *(e)*, if that transaction or indemnification took place. The annual statement must be affixed to and sent with the annual report described in Section 6.02 of these Bylaws.

Corporate Seal

6.04. The Board of Directors will adopt a corporate seal in the following form and design: [*describe*]. The [Secretary *or specify other officer*] of the Corporation will maintain custody of the seal and affix it in all appropriate cases to all corporate documents. However, the failure to affix the seal does not affect the validity of any instrument.

CERTIFICATE OF SECRETARY OF
_____ [*name of corporation*], a California Nonprofit Corporation

I hereby certify that I am the duly elected and acting Secretary of this corporation and that the foregoing Bylaws, comprising [*number*] pages, constitute the Bylaws of this corporation as duly adopted at a meeting of the Board of Directors held on _____[*date*].
Dated: _____.

_____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
2. Nonprofit Mutual Benefit Corporations

6-13 California Legal Forms--Transaction Guide §§ 13.213-13.219

[Reserved]

§§ 13.213[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
3. Religious Corporations

6-13 California Legal Forms--Transaction Guide § 13.220

§ 13.220 Articles of Incorporation

[1] Comment

[a] Use of Form

This form is a sample set of articles of incorporation for use by nonprofit religious corporations. It is modeled after the sample provided by the Secretary of State, and contains all provisions required by law. Samples are also available on official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. However, the latter samples are illustrative only and cannot be filled in and submitted in the form reproduced on the website.

A nonprofit religious corporation is formed and corporate existence begins on the filing of the articles of incorporation and continues perpetually unless otherwise expressly provided by law or in the articles [*Corp. Code § 9120(a), (c)*; *see Corp. Code § 9132(a)(1)* (limiting corporation's existence); *see also §§ 13.20, 13.130*].

[b] Mandatory Provisions

Article I must be completed with the name of the corporation exactly as the name is to appear on the records of the Secretary of State.

Article IIA has been taken directly from the California Corporations Code as is required by law and should not be modified when drafting documents.

Article IIB should be completed with a statement as to the specific business of the corporation.

Article III must be completed with the name and California address, or physical location, of the agent for service of process.

Article IV states that the corporation is organized and operated exclusively for religious purposes and limits activities that might influence legislation.

Article V is an irrevocable dedication of corporate property for religious purposes.

Article VI states the name of the existing unincorporated association, if any, being incorporated by filing these articles [*see* [c], *below*].

PRACTICE TIP

Keeping the articles brief and tailored to the minimum statutory requirements ensures more privacy to the corporation. Further, counsel should consider the fact that it is more difficult to amend the articles than the bylaws. The bylaws may generally be amended or repealed by the approval of the members or the board of directors [*Corp. Code § 9150*]; whereas the articles, with certain exceptions, can be amended only with the approval of the members, the board of directors, and any other persons whose approval is required by the articles [*Corp. Code § 9620(a)*]. Moreover, amendment of the articles is not effective until a certificate of amendment is filed with the Secretary of State [*Corp. Code § 9620(a)*].

[c] Optional Provisions

A nonprofit religious corporation may include additional provisions as warranted. Two provisions will not be effective unless expressly provided in the articles. First, if the corporation will be of limited duration, the articles must include a provision limiting the corporation's existence to a specified date [*Corp. Code § 9132(a)(1)*]. Second, if a subordinate corporation is instituted or created under the authority of a head organization, the articles must include a provision setting forth either or both of the following: (1) that the subordinate corporation will dissolve whenever its charter is surrendered to, taken away by, or revoked by head organization granting it; and/or (2) that in event of its dissolution pursuant to article provision allowed by *Corp. Code § 9132(a)(2)(A)*, or, in event of its dissolution for any reason, any assets of corporation remaining after compliance with applicable provisions governing distribution of assets will be distributed to head organization [*Corp. Code § 9132(a)(2)*; *see Corp. Code § 9132(b)*; *see also § 13.130*, P 4b]. If one or both of the these statements is included, the Department of Corporations has informally indicated that the articles should also contain an introductory statement that the corporation is a subordinate corporation created under the authority of the head organization.

The corporation may also include other optional provisions, such as the names and addresses of the initial directors [*see § 13.200[2]*, art. VII], classes of members, and cumulative voting [*Corp. Code § 9132(c)*], and a further statement limiting the purposes or powers of the corporation [*Corp. Code § 9131*]. For further discussion, see *§ 13.130*, P 4.

[d] Special Requirements for Unincorporated Associations

An existing unincorporated association may change its status to that of a religious corporation if the change is properly authorized by the association in accordance with its rules and procedures [*Corp. Code § 9121(a)*]. In this situation, in addition to the matters required to be set forth in the articles by *Corp. Code § 9130*, the articles must also state that an existing unincorporated association, stating its name, is being incorporated by the filing of the articles [*Corp. Code § 9121(b)*]. Optional Article VI of this form includes the required provisions.

When an existing unincorporated association changes its status to that of a religious corporation, the articles must be accompanied by a verified statement of any two officers or governing board members of the association, stating that the incorporation of the association by means of the articles to which the verified statement is attached has been approved by the association in accordance with its rules and procedures [*Corp. Code § 9121(c)*; *see § 13.242*].

[e] Location and Inspection of Articles

The corporation must keep the original or a copy of its articles as amended to date at its principal office in California. These articles must be open to inspection by the members at all reasonable times during office hours. If the corporation does not have an office in California, it must furnish a copy of the articles as amended to date on the written request of any member [*Corp. Code § 9160*]. These requirements that apply to articles also apply to bylaws of religious corporations [*Corp. Code § 9160*; *see § 13.221*].

[f] Execution, Filing, and Fees

The articles of incorporation must be originally signed by an incorporator unless directors are named in the articles. If directors are named in the articles, each person named must sign and acknowledge the document. The name(s) of the person(s) signing must be typed directly below the signature(s). [*Corp. Code § 9120(b), (c)*; *see* Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Instructions]. The statute does not require that the signatures be dated and the Secretary of State's sample forms do not provide for a date, but this form does contain one since most attorneys prefer to have a date associated with signatures on a document.

The original and at least four copies of the completed documents are then mailed or hand delivered to the Secretary of State, together with the applicable fee [*see* Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Information Sheet]. When documents are being hand delivered for filing in the San Francisco, Fresno, Los Angeles or San Diego office, a duplicate original is also required. To expedite processing, articles of incorporation submitted by mail should be accompanied by a self-addressed envelope and a letter referencing the proposed corporate name as well as the name, telephone number, and return address of the person filing the articles [*see* Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Instructions].

The articles of incorporation must be accompanied by the applicable filing fee [*see Gov. Code § 12186(d)*; *Corp. Code § 5006*]. The Secretary of State will compare and certify up to two copies of the amendment at no charge provided that the copies are submitted with the original to be filed [*Gov. Code § 12185*]. If additional certified copies are required, an additional minimal fee is charged, provided that the copies are furnished to the Secretary of State and the fee is prepaid [*Gov. Code §§ 12182, 12183*]. A separate and nonrefundable handling fee is charged for expedited processing of documents delivered in person, over the counter, to the Sacramento headquarters office [*see* Office of Secretary of State, State of California, Organization of California Nonprofit, Nonstock Corporations, Information Sheet].

The Secretary of State may cancel the filing of the articles if the check or other remittance accepted in payment of the filing fee is not paid on presentation [*Corp. Code § 5008.5*]. Within 70 days after the articles were filed, the Secretary of State must give written notice to the agent for service of process or the person submitting the instrument that the item presented for payment was not honored. The notice must specify a cancellation date that is not less than 20 days after the date the notice is mailed, on which the cancellation is to be effective if the fee is not paid by cashier's check or the equivalent [*Corp. Code § 5008.5*].

[g] Acknowledgment of Articles Required

If initial directors are named in the articles, each director named in the articles must sign *and acknowledge* the articles [*Corp. Code § 9120(b)*]. When the articles are signed by incorporators rather than by the initial directors [*see* [f], *above*], the statutory language states only that the articles "shall be signed" by the incorporators; it does not expressly require an acknowledgment, nor does it prohibit one being used, so an acknowledgment in the latter case should be regarded as optional [*see Corp. Code § 9120(b)*].

For further discussion of acknowledgment, see *§ 13.200[1][g]*. For a notarial acknowledgment, see *§ 13.200[2]*. For an acknowledgment by declaration, which may be used as an alternative to notarial acknowledgment [*see Corp. Code § 5030(b)*], see *§ 13.241*.

[2] FORM

Articles of Incorporation

ARTICLES OF INCORPORATION OF _____ [*name of corporation*]

I

The name of the corporation is _____[*name of corporation*].

II

A. This corporation is a RELIGIOUS CORPORATION and is not organized for the private gain of any person. It is organized under the Nonprofit Religious Corporation Law exclusively for religious purposes.

B. The specific purpose of this corporation is to _____.

III

The name and address in the State of California of the Corporation's initial agent for service of process is

Name _____

[*Include only if designated agent is an individual:*]

Street address _____ [*do not use post office box*]
City _____, State California Zip _____

IV

A. This corporation is organized and operated exclusively for religious purposes within the meaning of *Internal Revenue Code Section 501(c)(3).*

B. No substantial part of the activities of this corporation shall consist of carrying on propaganda, or otherwise attempting to influence legislation, and the corporation shall not participate or intervene in any political campaign (including the publishing or distribution of statements) on behalf of any candidate for public office.

V

The property of this corporation is irrevocably dedicated to religious purposes and no part of the net income or assets of this corporation shall ever inure to the benefit of any director, officer or member thereof or to the benefit of any private person. Upon the dissolution or winding up of the corporation, its assets remaining after payment, or provision for payment, of all debts and liabilities of this corporation shall be distributed to a nonprofit fund, foundation or corporation which is organized and operated exclusively for religious purposes and which has established its tax exempt status

under *Internal Revenue Code Section 501(c)(3)*.

[*Add, if an existing unincorporated association is being incorporated:*]

VI

The name of the existing unincorporated association, now being incorporated by the filing of these articles, is _____.

[*CONTINUE*]

[*Optional; add if initial directors are named:*]

VII

The corporation will have [*number, e.g.,* three] Director(s). The names and addresses of the initial directors of the corporation are [specify].

[*Add other optional articles, if any.*]

[*CONTINUE*]

Date: _____.

[*If initial directors are named in articles (see optional Article VII of this form), then all initial directors must sign; otherwise only the incorporators must sign.*]

_____ [*signature of incorporator, or initial director if initial directors are named in articles*]
_____ [Incorporator *or* Initial Director]
_____ [*typed name*]
_____ [*signature of incorporator, or initial director if initial directors are named in articles*]
_____ [Incorporator *or* Initial Director]
_____ [*typed name*]

[*If an existing unincorporated association is being incorporated, include verified declaration (see § 13.242).*]

ACKNOWLEDGMENT

[*For acknowledgment, see § 13.200.*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesBusiness & Corporate LawUnincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
3. Religious Corporations

6-13 California Legal Forms--Transaction Guide § 13.221

§ 13.221 Bylaws--Without Members [Corp. Code §§ 9150-9152]

[1] Comment

[a] Use of Form

This form is a set of bylaws for a nonprofit religious corporation without members. The form expressly prohibits membership. For bylaws designed for other types of nonprofit corporations, including corporations with members of one or several classes of membership, see *§§ 13.201* and *13.212*. If the corporation wishes to admit a single class of members, the provisions contained in *§ 13.201* (bylaws for public benefit corporation with a single class of members) may be substituted for the provisions in Article II of this form, which expressly prohibits membership. Similarly, if the corporation will admit persons to multiple classes of membership, the provisions concerning multiple classes of membership set forth in *§ 13.212* (bylaws for nonprofit mutual benefit corporation with multiple classes of members) may be substituted for the provisions in Article II of this form. In either case, appropriate modifications may be made in the bylaws set forth below to reflect the change in membership status.

For resolutions of the board of directors adopting the bylaws of for-profit corporations, see Ch. 4, *Bylaws* . These resolutions may be adapted for the purpose of adopting bylaws of a nonprofit corporation.

[b] "Bylaws" Defined

Under the Nonprofit Religious Corporation Law, the term "bylaws" means the code or codes of rules used, adopted, or recognized for the regulation or management of the affairs of the corporation irrespective of the name or names by which those rules are designated [*Corp. Code § 9150(a)*; *see Metropolitan Philip v. Basil Steiger (2000) 82 Cal. App. 4th 923, 932, 98 Cal. Rptr. 2d 605* (bylaws of religious corporation can include more than just document bearing that title); Ballantine & Sterling, California Corporation Laws, Ch. 19, *Nonprofit Corporations and Organizations* , § 418.04 (Matthew Bender); *see also § 13.21[1]*]. This definition reflects the fact that many religions are governed by canons or other documents not contained in the bylaws of the corporation.

[c] Mandatory Provisions

The bylaws must specify the exact number of directors of the corporation, or the method of determining the number of directors of the corporation, unless the articles of incorporation contain that information. Alternatively, the articles or bylaws may state that the number of directors must not be less than a stated minimum nor more than a stated maximum with the exact number of directors to be fixed by the approval of the board or the members [*Corp. Code § 9151(a), (e)*]. In either event, the number of minimum number of directors may be one or more [*Corp. Code § 9151(a)*].

Note that, if the articles provide for the number of directors, this provision may only by changed by a formal amendment of the articles [*Corp. Code § 9151(a)*; *see § 13.261*]. Except as otherwise provided in the articles or bylaws, once members have been admitted, a bylaw specifying or changing a fixed number of directors or the maximum or minimum number or changing from a fixed to a variable board or vice versa may only be adopted by approval of the members [*Corp. Code § 9151(b)*].

[d] Optional Provisions

In general, the bylaws may contain any provision, not in conflict with law or the articles, for the management of the activities and for the conduct of the affairs of the corporation [*Corp. Code § 9151(c)*]. The following is a nonexclusive list of optional bylaw provisions for a nonprofit religious corporation [*Corp. Code § 9151(c)*]:

- Any optional provision that may be included in the articles [*see Corp. Code § 9132(c)*].
- The time, place, and manner of calling, conducting, and giving notice of members', directors', and committee meetings, or of conducting mail ballots.
- The qualifications, duties, and compensation of directors; the time of their election; and the requirements of a quorum for directors' and committee meetings.
- The appointment of committees, composed of directors or nondirectors or both, by the board or any officer, and the authority of each designated committee.
- The appointment, duties, compensation, and tenure of officers.
- The mode of determination of members of record.
- The making of reports and financial statements to members.
- Setting, imposing, and collecting dues, assessments, and admissions and transfer fees.

The bylaws may provide for the manner of admission, withdrawal, suspension, and expulsion of members [*Corp. Code § 9151(d)*]. Moreover, the bylaws may set forth a provision limiting the number of members, in total or of any class, that the corporation is authorized to admit [*Corp. Code § 9151(f)*].

The bylaws may also require, for any or all corporate actions, except as provided in *Corp. Code §§ 9222* and *9680(b)*, the vote of a larger proportion of, or of all of, the members or the members of any class, unit, or grouping of members, or the vote or quorum for taking action of a larger proportion of, or of all of, the directors than is otherwise required by the Nonprofit Religious Corporation Law. A bylaw requiring a supermajority vote may not be altered, amended, or repealed except by that supermajority vote unless the bylaws provide to the contrary may not [*Corp. Code § 9151(e)*].

PRACTICE TIP

Provisions of the Nonprofit Corporation Law establish many of the rules governing the management of corporate affairs, at least in the absence of a contrary bylaw. Although these rules are not required to be restated in the bylaws, corporations often do so, in order to provide a complete manual of corporate procedure for the management and members.

[2] FORM

Bylaws--Without Members [Corp. Code §§ 9150-9152]

BYLAWS OF _____ [*name of corporation*]

ARTICLE I
OFFICES

Principal Office

1.01. The principal office of the Corporation for its transaction of business is located in the City of _____ and County of _____, California [*or* is located at _____ (*street address*), _____ (*city*), _____ (*county*), California].

Change of Address

1.02. The Board of Directors is granted full power and authority to change the principal office of the Corporation from one location to another in _____[, the County of _____], California. Any change of address will be noted by the Secretary in these Bylaws, but will not be considered an amendment of these Bylaws.

ARTICLE II
MEMBERS

Members Prohibited

2.01. The Corporation will not have any members.

Effect of Prohibition

2.02. Any action that would otherwise require approval by a majority of all members or approval by the members requires only approval of the Board of Directors. All rights that would otherwise vest under the Nonprofit Religious Law in the members will vest in the Directors.

ARTICLE III
DIRECTORS

Number

[*EITHER*]

3.01. The corporation will have _____[*number specified in the articles and, if not stated in the articles, number equal to or greater than one*] Director[s]. [Collectively,] [T]he Director[s] will be known as the Board of Directors.

[*OR*]

3.01. The method of determining the number of directors of the corporation will be _____[*specify, with number equal to or greater than one*].

[*OR*]

3.01. [As provided in Article _____ of the Articles of Incorporation of the Corporation,] [T]he Corporation may not have less than [*minimum number specified in the articles*] nor more than [*maximum number specified in the articles*] Directors. The exact number of Directors is [*number within specified limits*] and this number will be fixed from time to time, within the limits specified in this Bylaw [and Article _____ of the Articles of Incorporation of the Corporation], by an amendment to this Bylaw duly adopted by approval of the members, as that term is defined in *Corporations Code Section 5034*.

[*Continue with the following:*]

Qualifications

3.02. The Directors of the Corporation must be residents of the State of California.

Term of Office

[*EITHER*]

3.03. Each Director will hold office for the term of [*specified term, e.g.,* one year] and until a successor Director has been elected and qualified.

[*OR*]

3.03. Each Director will hold office for life until the earlier of the death, resignation, or removal of that Director.

[*Continue with the following:*]

Nomination

3.04. Any person qualified to be a Director under Section 3.02 of these Bylaws may be nominated by the method of nomination authorized by the Board or by any other method authorized by law.

Election

3.05. The Directors will be elected at each regular meeting of the Board of Directors as prescribed by Section 3.07 of these Bylaws. The candidates receiving the highest number of votes up to the number of Directors to be elected are elected. Directors are eligible for reelection [without limitation on the number of terms they may serve, provided they continue to meet the qualifications required by Section 3.02 by these Bylaws *or* but not be elected to more than two consecutive terms *or specify other limitations*].

Compensation

[*EITHER*]

3.06. The Directors serve without compensation, [except that they shall be allowed and paid their actual and necessary expenses incurred in attending the meetings of the Board *or other provisions allowing partial compensation*].

[*OR*]

3.06. The compensation of the Directors _____[is $_____ per month *or* shall be fixed from time to time by resolution of the Board and approved by the vote or written consent of a majority of the voting members of the corporation].

[*Continue with the following:*]

Meetings--Call of Meetings

3.07. (a) Meetings of the Board may be called by [the Chair of the Board or the President or any Vice-President or the Secretary or any two Directors *or revise to reflect organization of the corporation in terms of number of directors and number and types of officers*].

Place of Meetings

(b) All meetings of the Board will be held at the principal office of the Corporation as specified in Section 1.01 of these Bylaws or as changed from time to time as provided in Section 1.02 of these Bylaws.

Regular Meetings

(c) Regular meetings of the Board of Directors will be held, without notice, [*date and time, e.g.,* on the first Wednesday in the months of June and December at 1:30 P.M.]. [*Add any provisions desired specifying the times of meetings of board committees.*] If any day fixed for the regular meetings of the Board of Directors falls on a legal holiday, the

meeting scheduled for that day will be held at the same hour on the next succeeding day that is not a legal holiday.

Special Meetings

(d) Special meetings of the Board may be called by the Chair of the Board or the President or any Vice-President or the Secretary or any two Directors. Special meetings may be held on four days notice by first class mail, postage prepaid, or on 48 hours' notice delivered personally or by telephone, including a voice messaging system or other system or technology designed to record and communicate messages, telegraph, facsimile, electronic mail, or other electronic means.

Notice of the special meeting need not be given to any Director who signs a waiver of notice or written consent to holding the meeting, or an approval of the minutes of the meeting, whether before or after the meeting, or who attends the meeting without protesting the lack of notice to that Director either before or at the commencement of the meeting. All waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meetings.

Quorum

(e) A majority of the authorized number of Directors constitutes a quorum of the Board for the transaction of business, except as otherwise provided in these Bylaws.

Transactions of Board

(f) Except as otherwise provided in the Articles, in these Bylaws, or by law, every act or decision done or made by a majority of the Directors present at a meeting duly held at which a quorum is present is the act of the Board; provided, however, that any meeting at which a quorum was initially present may continue to transact business notwithstanding the withdrawal of Directors if any action taken is approved by at least a majority of the required quorum for that meeting, or such greater number as is required by the law, the Articles, or these Bylaws.

Conduct of Meetings

(g) The Chair of the Board or, in his or her absence, any Director selected by the Directors then present will preside at meetings of the Board of Directors. The Secretary of the Corporation or, in the Secretary's absence, any person appointed by the presiding officer will act as Secretary of the Board. Members of the Board may participate in a meeting through use of conference telephone or similar communications equipment, so long as all members participating in the meeting can hear one another. This participation constitutes personal presence at the meeting.

Adjournment

(h) A majority of the Directors present at the meeting, whether or not a quorum is present, may adjourn any meeting to another time and place. If the meeting is adjourned for more than 24 hours, notice of the adjournment to another time or place must be given before the time of the adjourned meeting to the Directors who were not present at the time of the adjournment.

Action Without Meeting

3.08. Any action required or permitted to be taken by the Board may be taken without a meeting, if all members of the Board individually or collectively consent in writing to that action. Written consents must be filed with the minutes of the proceedings of the Board. Action by written consent has the same force and effect as the unanimous vote of the Directors.

Removal of Directors--Removal for Cause

3.09. (a) The Board may declare vacant the office of a Director on the occurrence of any of the following events:

(1) The Director has been declared of unsound mind by a final order of court.

(2) The Director has been convicted of a felony.

[*Add, if minimum attendance will be required:*]

(3) The Director has failed to attend _____ [*number*] meetings of the Board.

PRACTICE TIP

The bylaws must be adopted before the appointment of the initial directors if the minimum attendance requirement is to applicable to those directors [*see Corp. Code § 9221(b)* (director's failure to meet qualification *that was in effect at beginning of director's current term* is grounds for removal of director)].

Removal Without Cause

(b) [Except as provided in the Articles,] [A]ny Director may be removed without cause if removal is approved by the Board of Directors within the meaning of *Corporations Code Section 5032*.

Resignation of Director

3.10. Any Director may resign effective on giving written notice to the Chair of the Board of Directors, the President, the Secretary, or the Board of Directors of the Corporation. The notice may specify a later time for the effectiveness of the resignation. If the resignation is effective at a future time, a successor may be elected to take office when the resignation becomes effective. A Director may not resign if the Corporation would then be left without a duly elected Director in charge of its affairs.

Vacancies in the Board--Causes

3.11. (a) Vacancies on the Board of Directors occur (1) on the death, resignation, or removal of any Director; (2) whenever the number of authorized Directors is increased; and (3) on the failure of the members in any election to elect the full number of authorized Directors.

Filling Vacancies by Directors

(b) Except as otherwise provided in the Articles or these Bylaws and except for a vacancy created by the removal of a Director pursuant to Section 3.09 of these Bylaws, vacancies on the Board of Directors may be filled by approval of the Board of Directors, or, if the number of Directors then in office is less than a quorum, by (1) the unanimous written consent of the Directors then in office; (2) the affirmative vote of a majority of the Directors then in office at a meeting held pursuant to notice or waivers of notice as provided in Section 3.07(d) of these Bylaws; or (3) a sole remaining Director.

ARTICLE V
OFFICERS

Number and Titles

4.01. The officers of the Corporation shall be [*either or both* a Chair of the Board *or* a President], [a Vice-President,] a Secretary, _____ *either or both* Treasurer or Chief Financial Officer, and those other officers with such titles and duties as _____[stated in these Bylaws *or* determined by the Board] and as may be necessary to enable it to sign instruments. [The President *or* The Chair of the Board] is the general manager and chief executive officer of the Corporation. Any number of offices may be held by the same person, except that neither the Secretary, the Treasurer, or the Chief Financial Officer may serve concurrently as [the President *or* the Chairman of the Board].

Appointment and Resignation

4.02. The officers will be chosen by the Board and serve at the pleasure of the Board, subject to the rights, if any, of an office under any contract of employment. Any officer may resign at any time on written notice to the Corporation without prejudice to the rights, if any, of the Corporation under any contract to which the officer is a party.

Duties of Officers--President or Chair of the Board

4.03. (a) The [President *or* Chair of the Board] will be the general manager and chief executive of the Corporation and will, subject to the control of the Board of Directors, have supervision, direction, and control of the business and affairs of the Corporation. The [President *or* Chair of the Board] will preside at all meetings of the Board of Directors. The [President *or* Chair of the Board] will perform all duties incident to the office of [President *or* Chair of the Board] and any other duties as may be required by law, by the Articles of Incorporation of the Corporation, or by these Bylaws, or that may be prescribed from time to time by the Board of Directors. The [President *or* Chair of the Board] is hereby authorized to exercise any right to vote of execute a proxy to vote shares of stock of, any bonds, debentures, or other evidences of indebtedness of, any other corporation or corporations owned or possessed by the Corporation.

Vice-President

(b) In the absence of the [President *or* Chair of the Board], or in the event of his or her inability or refusal to act, the Vice-President will perform all the duties of the [President *or* Chairman of the Board], and when so acting will have all the powers of, and be subject to all the restrictions on, the [President *or* Chairman of the Board]. The Vice-President

will have those other powers and perform any other duties as may be prescribed by law, by the Articles of Incorporation, or by these Bylaws, or as may be prescribed by the Board of Directors.

Secretary

(c) The Secretary will keep or cause to be kept at the principal office of the Corporation, or other place as the Board of Directors may order, a book of minutes of all meetings of the Board of Directors. The Secretary will perform any other and further duties as may be required by law or as may be prescribed or required from time to time by the Board of Directors.

PRACTICE TIP

A corporation with members must keep a record of its members, giving their names and addresses and the class of membership held by each [*Corp. Code § 9510(a)(3)*]. If this form is adapted to provide for members, counsel should consider inserting a provision in the bylaws requiring the secretary of the corporation to keep the membership record.

Chief Financial Officer

(d) The Chief Financial Officer of the Corporation will keep and maintain in [written form *or* any other form capable of being converted into written form] adequate and correct books and records of account of the properties and business transactions of the Corporation, including accounts of its assets, liabilities, receipts, disbursements, gains, and losses. The books and records of account will at all times be open to inspection by any Director of the Corporation. The Chief Financial Officer will deposit all moneys and other valuables in the name of and to the credit of the Corporation with depositaries as may be designated by the Board of Directors. The Chief Financial Officer will disburse the funds of the Corporation as ordered by the Board of Directors, and will render to the [President *or* Chair of the Board] and the Directors, on request, an account of all that officer's transaction as Chief Financial Officer, and of the financial condition of the Corporation. The Chief Financial Officer will perform any other and further duties as may be required by law or as may be prescribed or required from time to time by the Board of Directors or these Bylaws.

Resignation and Removal of Officers

4.04. Any officer may resign at any time on written notice to the Corporation without prejudice to the rights, if any, of the Corporation under any contract to which the officer is a party. Officers may be removed with or without cause at any meeting of the Board of Directors by the affirmative vote of a majority of all of the Directors.

ARTICLE V
CORPORATE RECORDS, REPORTS, AND SEAL

Keeping Records

5.01. The Corporation must keep adequate and correct records of account and minutes of the proceedings of its Board and committees of the Board. The Corporation must also minutes in written form. Other books and records will be kept in either written form or in any other form capable of being converted into written form.

PRACTICE TIP

A corporation with members must keep a record of its members, giving their names and addresses and the class of membership held by each [*Corp. Code § 9510(a)(3)*]. If this form is adapted to provide for members, counsel should consider inserting a provision in the bylaws requiring the maintenance of this list [*see* § 13.202[2], Section 6.02].

Corporate Seal

5.02. The Board of Directors will adopt a corporate seal in the following form and design: [*describe*]. The [Secretary *or specify other officer*] of the Corporation will maintain custody of the seal and affix it in all appropriate cases to all corporate documents. However, the failure to affix the seal does not affect the validity of any instrument.

CERTIFICATE OF SECRETARY OF
_____ [*name of corporation*], a California Nonprofit Corporation

I hereby certify that I am the duly elected and acting Secretary of this corporation and that the foregoing Bylaws, comprising [*number*] pages, constitute the Bylaws of this corporation as duly adopted at a meeting of the Board of Directors held on _____[*date*].
Dated: _____.

_____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
3. Religious Corporations

6-13 California Legal Forms--Transaction Guide §§ 13.222-13.229

[Reserved]

§§ 13.222[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
4. Miscellaneous Article or Bylaw Provisions

6-13 California Legal Forms--Transaction Guide § 13.230

§ 13.230 Authority to Establish Common Trust Fund

[1] Comment--Use of Form

This form is provision for inclusion in the articles of incorporation of a public benefit or religious corporation authorizing the corporation to establish one or more common trust funds.

Any public benefit or religious corporation may, if so authorized by the articles of incorporation, establish one or more common trust funds for the purpose of furnishing investments to that corporation or to any church, parish, congregation, society, chapel, mission, religious, beneficial, charitable, or educational institution affiliated with it, or to any organization, society, or corporation holding funds or property for the benefit of any of those entities, or holding funds for the purpose of supporting a bishop, priest, religious pastor, or teacher or any buildings used by or owned by any of those entities. The fund may hold the funds or property as a fiduciary or otherwise [*Corp. Code § 10250(a)*].

In general, funds may be lawfully invested in shares or interests of these trust funds, notwithstanding any other legal limitations on the rights of any of the persons or entities listed above, or their officers or directors, to invest funds held by them. However, if the funds or property are held in a fiduciary capacity, the investment may not be prohibited by wording of the will, deed, or other instrument creating the fiduciary relationship [*Corp. Code § 10250(a)*].

The directors or trustees of these common trust funds may employ officers or agents, define the duties of those officers or agents, and fix their compensation. The directors or trustees may also appoint a trust company or bank as custodian of the trust estate, and may employ investment advisers, define their duties, and fix their compensation [*Corp. Code § 10250(b)*].

The directors or trustees must pay semiannual dividends, apportioned ratably among the holders of shares or beneficial certificates then outstanding. These semiannual dividends must approximately equal, in each fiscal year, the net income of the trust [*Corp. Code § 10250(c)*].

The Corporate Securities Law does not apply to the creation, administration, or termination of common trust funds, or to participation in a common trust fund [*Corp. Code § 10250(d)*].

[2] FORM

Authority to Establish Common Trust Fund

_____. TRUST FUNDS

The Corporation may establish one or more common trust funds for the purpose of furnishing investments to it or to _____[*name of church, parish, congregation, society, chapel, mission, or religious, beneficial, charitable, or educational institution affiliated with corporation*], or to any organization, society, or corporation holding funds or property for the benefit of _____[*name as set forth above*], or holding funds for the purpose of supporting a bishop, priest, religious pastor, or teacher or any building or buildings used by or owned by any of the foregoing, whether holding such funds or property as fiduciary or otherwise. Notwithstanding the provisions of any general or special law in any way limiting the right of any of the foregoing or the officers of directors, as fiduciary or otherwise, to invest funds held by them, the Corporation may lawfully invest any or all of its funds or property in shares or interests of the common trust fund or trust funds. However, in the case of funds or property held as fiduciary, the investment may not be prohibited by the wording of the will, deed, or other instrument creating that fiduciary relationship.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesEstate, Gift & Trust LawTrustsAdministrationEstate, Gift & Trust LawTrustsCreation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
4. Miscellaneous Article or Bylaw Provisions

6-13 California Legal Forms--Transaction Guide § 13.231

§ 13.231 Statement of Irrevocable Dedication

[1] Comment

[a] Use of Form

This form contains optional provisions that may be inserted in the articles of incorporation (or the bylaws) to secure tax exemption [*see* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*]. For example, the form contains an article providing that all property held by the nonprofit corporation is irrevocably dedicated to charitable purposes and that no corporate income or assets will inure to the benefit of any private persons. Further, the form provides that no substantial part of the corporation's activities will involve attempts to influence legislation. In addition, the form contains provisions requiring corporate distributions to avoid tax on undistributed income [*see I.R.C. § 4942*], and limitations on corporate activities including a ban on self-dealing [*see I.R.C. § 4941*].

The statement of dedication in this form contains a provision satisfying the requirement that the dedicated property must inure only to the benefit of another exempt fund, foundation, or corporation as a result of any liquidation, dissolution, or abandonment of the owner [*see Rev. & Tax. Code § 214(a)(6)*; *see also* [c], *below*]. This requirement is subject to an exception: if the dedicated property is used solely for charitable or hospital purposes for at least 30 years, the existence of any reversionary provisions in the conveyance, respecting liquidation, dissolution, or abandonment, will not defeat the welfare exemption, if the ownership, operation, use, and dedication of the property otherwise satisfy the requirements for the welfare exemption [*Rev. & Tax. Code § 214.3*]. The form can be adapted to accommodate this exception. For further discussion of property dedications, see Ch. 27A, *Dedication* .

[b] Distribution of Corporate Assets on Dissolution--In Accordance With Articles or Bylaws

After paying or providing for all known debts and liabilities of the corporation in the process of winding up [*see Corp. Code § 6714, 8714*], the board must distribute all the remaining corporate assets in accordance with the articles or bylaws, unless the transfer of the asset is subject to a condition [*see Corp. Code §§ 6715, 8715, 9680(e)*; *see also* [c], *below*] or the corporation holds the assets in trust [*Corp. Code §§ 6713(a), 8713(a), 8717(a), 9680(e)*; *see Corp. Code*

§§ 6716(a), 8716, 9680(e); *see also* [d], *below*]. For public benefit and religious corporations, the disposition of corporate assets must be made by decree of the superior court of the proper county in proceedings to which the California Attorney General is a party, except that the disposition may be made without a decree if the Attorney General makes a written waiver of objections to the disposition [*Corp. Code § 6716(b), (c), 9680(e)(2), (3)*].

If the articles or bylaws of a mutual benefit corporation do not provide the manner of disposition, the assets must be distributed among the members in accordance with their respective rights [*Corp. Code § 8717(b)*].

[c] Assets Subject to Condition

After complying with the provisions of *Corp. Code §§ 6713* or *8713* [*see* [b], *above*], assets held by the corporation subject to valid condition requiring return, transfer, or conveyance, which condition has occurred or will occur, must be returned, transferred, or conveyed in accordance with the condition [*Corp. Code §§ 6715, 8715, 9680(e)*].

[d] Assets Held in Charitable Trust

After complying with *Corp. Code § 8713* and except for assets subject to a valid condition [*see* [b], [c], *above*], assets held by a nonprofit corporation in a charitable trust must be disposed of on dissolution in conformity with its articles or bylaws, subject to complying with the provisions of any trust under which the assets are held [*Corp. Code §§ 6713(a), 8716(a), 9680(e)*]. For mutual benefit corporations, the distribution must be made by decree of the superior court of the proper county in proceedings to which the Attorney General is a party [*Corp. Code § 8716(b)*]. However, the disposition may be made without court decree, subject to the rights of persons concerned in the dissolution, if the Attorney General makes a written waiver of objections to the disposition [*Corp. Code § 8716(b)*].

[e] Tax Matters

Adverse tax ramifications result from the distribution of corporate assets to nontax-exempt organizations. For example, organizations claiming exemption from federal and California taxes under *I.R.C. § 501(c)(3)* and *Rev. & Tax. Code § 23701d* must show that their income and assets are irrevocably dedicated to exempt purposes. Although the assets of public benefit corporations are dedicated to tax-exempt purposes by operation of California law [*see Corp. Code §§ 5049, 5060, 5410*] and that dedication by operation of law is sufficient to meet the dedication requirements of exempt organizations for federal and California tax purposes [*Treas. Reg. § 1.501(c)(3)-1(b)(4)*; *18 Cal. Code Reg. § 23701*d], the better practice is to make an express provision in the articles for the distribution of corporate assets to tax-exempt distributees on dissolution of the corporation, as is set forth in this form.

If the corporation is to be exempt from local property taxes [*Rev. & Tax. Code § 214*], the articles should provide that on dissolution the property will not inure to the benefit of any private person but to a fund, foundation, or corporation organized and operated for religious, hospital, scientific, or charitable purposes [*Rev. & Tax. Code §§ 214(a)(6), (j), 214.01*; *see Stockton Civic Theatre v. Board of Supervisors (1967) 66 Cal. 2d 13, 22-23, 56 Cal. Rptr. 658, 423 P.2d 810* ; *Pacific Home v. Los Angeles County (1953) 41 Cal. 2d 844, 852, 264 P.2d 539]* . Property operated by an educational institution of collegiate grade [*see Rev. & Tax. Code § 203*] will also qualify for exemption from local property taxes [*see Rev. & Tax. Code § 214*] if the institution's articles provide that, on dissolution, liquidation, or abandonment, the property is distributed to a fund, foundation, or corporation that (1) is organized and operated for educational purposes, and (2) meets the requirements of *Rev. & Tax. Code § 203* or *214* [*see Rev. & Tax. Code § 214(e)(2)*].

For further discussion of tax exemptions, see Ch. 13B, *Tax-Exempt Status for Nonprofit Entities* .

[2] FORM

Statement of Irrevocable Dedication

_____. DEDICATION AND DISSOLUTION

_____. (a) The property of this corporation is irrevocably dedicated to [*e.g.*, charitable] purposes and no part of the net income or assets of this organization may ever inure to the benefit of any director, officer, or member, or to the benefit of any private persons.

(b) On the dissolution or winding up of the corporation, its assets remaining after payment of, or provision for payment of, all debts and liabilities of this corporation will be distributed to a nonprofit fund, foundation, or corporation organized and operated exclusively for [*e.g.*, charitable] purposes that has established its tax-exempt status under *Internal Revenue Code Section 501(c)(3)*.

(c) If this corporation holds any assets on trust, or the corporation is formed for charitable purposes, these assets must be disposed of in the manner as may be directed by decree of the superior court of the county in which the corporation has its principal office, on petition by the Attorney General or by any person concerned in the liquidation, in a proceeding to which the Attorney General is a party.

[*Optional*]

_____. LIMITATION ON CORPORATE ACTIVITIES

No substantial part of the activities of this corporation will consist of the carrying on of propaganda, or otherwise attempting to influence legislation, nor shall this corporation participate or intervene in any political campaign (including publishing or distribution of statements) on behalf of or in opposition to any candidate for public office.

_____. DISTRIBUTION OF INCOME AND PROHIBITED ACTIVITIES

Notwithstanding any other provision in these Articles of Incorporation, the Corporation is subject to the following limitations and restrictions:

(a) The Corporation will distribute its income for each taxable year at a time and in a manner that will not subject the corporation to the tax on undistributed income imposed by *Internal Revenue Code Section 4942*.

(b) The Corporation will not engage in any act of self-dealing as defined in *Internal Revenue Code Section 4941(d)*.

(c) The Corporation will not retain any excess business holdings as defined in *Internal Revenue Code Section 4943(c)*.

(d) The Corporation will not make any investments that will subject it to tax under *Internal Revenue Code Section 4944*.

(e) The Corporation will not make any taxable expenditures as defined in *Internal Revenue Code Section 4945(d)*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding UpEstate, Gift & Trust LawTrustsCharitable TrustsTax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific Organizations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation and Bylaws
4. Miscellaneous Article or Bylaw Provisions

6-13 California Legal Forms--Transaction Guide §§ 13.232-13.239

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§§ 13.232[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.240

§ 13.240 Document Filing Transmittal Letter

[1] Comment--Use of Form

This form is a transmittal letter requesting that the Secretary of State file the enclosed documents. The form identifies the form(s) being filed, the number of copies filed, the filing date, the numbers of copies to be certified or endorsed, the number of certificates of filing and status, and the amount of the enclosed fees. It is modeled after the sample form provided by the Secretary of State.

[2] FORM

Document Filing Transmittal Letter

[*Corporate letterhead*]

Document Filing Transmittal Letter

Date: _____

From: _____[*specify name, address, and telephone number of person or entity filing documents*]

To: Secretary of State
Corporate Division
1500 11th Street
Sacramento, CA 95814
Attention: Document Filing Support Unit

Re: [*specify*]

Enclosed is the originally signed

☐ Articles of Incorporation

☐ Certificate of Amendment

☐ Agreement of Merger

☐ Certificate of Election to Wind Up and Dissolve

☐ Certificate of Dissolution

☐ Other

together with _____ copies.

The original document is to be filed: ☐ date of receipt

☐ on future date of _____

_____ copies are to be CERTIFIED

_____ copies are to be ENDORSED

Additionally, please provide _____ Certificates of Filing
_____ Certificates of Status

[*EITHER*]

Enclosed is a check for $_____.

[*OR*]

Enclosed are checks in the aggregate amount of $_____.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.241

§ 13.241 Declaration

[1] Comment

[a] Use of Form

This form is a written declaration that is designed to be executed separately from the articles by the persons signing the articles, annexed to the articles, and thus, used in lieu of the more formal notarial acknowledgment set forth in *§ 13.200*. It has the advantage over notarial acknowledgment of not requiring the use of a notary public. The form may also be adapted to acknowledge other instruments.

The Nonprofit Corporation Law requires that if initial directors are named in the articles, each director named in the articles must sign *and acknowledge* the articles [*Corp. Code § 5120(b)*]. When the articles are signed by incorporators rather than by the initial directors, the statutory language states only that the articles "shall be signed" by the incorporators; it does not expressly require an acknowledgment, nor does it prohibit one being used, so an acknowledgment in the latter case should be regarded as optional [*see Corp. Code § 5120(b)*].

One method of acknowledgment permitted by the law is notarial acknowledgment [*Corp. Code § 5030*]. For an example of this method, see *§ 13.200[2]*.

A second method of acknowledgment is a written declaration signed by the persons who have executed the articles. Under the declaration, the subscribing parties declare that they are the persons who have executed the articles and that the articles are the act and deed of those persons [*Corp. Code § 5030*]. An example of this latter method of acknowledgment is set forth in this form.

[b] Penalty of Perjury

The section in the Nonprofit Corporation Law permitting the use of a declaration does not specifically require that the declaration be made under penalty of perjury [*see Corp. Code § 5030*; *see also Code Civ. Proc. § 2015.5* (governing declarations made under penalty of perjury)]. Moreover, the term "declaration" is not otherwise defined in the Nonprofit

Corporation Law. It therefore would appear that the declaration need not be made under penalty of perjury and that a simple statement setting forth the substance of the declaration [*see Corp. Code § 5030*] would be sufficient.

[c] Requirement of Separate Execution

If acknowledged articles of incorporation are to be filed with the Secretary of State and the acknowledgment is by declaration in writing rather than by formal notarial acknowledgment, the Secretary of State's office requires that the declaration of acknowledgment be separately executed from the articles. Therefore, the declaration should not be embodied in the articles of incorporation but should be executed as a separate instrument and annexed to the articles.

[2] FORM

Declaration

Declaration

We are the persons whose names are subscribed below. We collectively are all of the _____[incorporators *or, if initial directors are named in articles*, initial directors of _____ [*name of corporation*], and we have executed these Articles of Incorporation. The foregoing Articles of Incorporation are our act and deed, joint and severally.

Executed on _____[*date*] at _____, California.

We, and each of us, declare that the foregoing is true and correct.

_____ [*signature of incorporator, or initial director if initial directors are named in articles*]
_____ [Incorporator *or* Initial Director]
_____ [*signature of incorporator, or initial director if initial directors are named in articles*]
_____ [Incorporator *or* Initial Director]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.242

§ 13.242 Verified Statement of Authorization to Incorporate Unincorporated Association

[1] Comment

[a] Use of Form

This form is a verified statement of authorization to incorporate by the required officers or governing board members of an unincorporated association incorporating under the Nonprofit Corporation Law. It is designed to accompany the articles of incorporation of a nonprofit corporation [*see Corp. Code §§ 5121(c), 7121(c), 9121(c)*].

An existing unincorporated association may change its status to that of a nonprofit corporation on proper authorization by the association in accordance with its rules and procedures. When submitting the articles to the Secretary of State for filing, the articles must be accompanied by a verified statement of any two officers or two governing board members of the association stating that the incorporation of the association by means of the articles to which the affidavit is attached has been approved by the association in accordance with its rules and procedures [*Corp. Code §§ 5121(a), (c), 7121(a), (c), 9121(a), (c)*]. This form may be used to satisfy this requirement.

For further discussion of the incorporation of unincorporated associations, see *§ 13.22*.

[b] Verification

Under the Nonprofit Corporation Law, "verified" means that the statements contained in a document are declared to be true of the knowledge of the persons executing the document in either (1) an affidavit signed by them under oath before an officer authorized by the laws of California or of the place where it is executed to administer oaths; or (2) a declaration in writing executed by them under penalty of perjury and stating the date and place of execution [*Corp. Code § 5076*]. For a notarial acknowledgment, see *§ 13.200[2]*. This form contains a declaration under penalty of perjury. For a declaration not executed under penalty of perjury, see *§ 13.241*.

[2] FORM

Verified Statement of Authorization to Incorporate Unincorporated Association

STATEMENT BY _____ [DIRECTORS *or* GOVERNING BOARD MEMBERS] OF APPROVAL OF INCORPORATION OF _____ [*name of association*]

BY THE ASSOCIATION

The undersigned being [directors *or* governing board members] of _____[*name of unincorporated association*], the unincorporated association specified in the accompanying Articles of Incorporation, state that the incorporation of the association by means of the these Articles of Incorporation to which this Statement is attached has been approved by the association in accordance with its rules and procedures.
_____ Dated:

_____ [*signature of officer of association*]
_____ [*title, e.g.,* President]
_____ [*signature of second officer of association*]
_____ [*title, e.g.,* Secretary]

[*EITHER*]

ACKNOWLEDGMENT

[*For acknowledgment, see § 13.200[2].*]

[*OR*]

DECLARATION

Each of the undersigned declares under penalty of perjury under the laws of the State of California that they are [*specify titles, e.g.,* President and Secretary, respectively,] of the unincorporated association referred to in the Articles of Incorporation to which this declaration is attached, that the statements contained in the foregoing statement are true of his or her own knowledge, and that this declaration was executed on _____[*date*], at _____[*city and state where declaration is executed*].

_____ [*signature of officer of association*]
_____ [*title, e.g.,* President]
_____ [*signature of second officer of association*]
_____ [*title, e.g.,* Secretary]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawUnincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.243

§ 13.243 Certificate of Correction

[1] Comment

[a] Use of Form

This form is a certificate of correction designed to correct misstatements of fact contained in articles previously filed with the office of the Secretary of State. With appropriate modifications, the certificate may be used to correct any defect in execution of the articles or to correct any other error contained in the articles, or to correct any misstatement of fact, defect in execution, or other error contained in any agreement, certificate, or other instrument relating to a nonprofit corporation and filed with the Secretary of State pursuant to the Nonprofit Corporation Law [*Corp. Code § 5007*].

[b] Contents of Certificate

The certificate must set forth the following items [*Corp. Code § 5007*]:

- The name of the corporation.
- The date the instrument being corrected was filed with the Secretary of State.
- The provision in the agreement, certificate, or other instrument as corrected and, if the execution was defective, a statement wherein it was defective.

[c] Restrictions on Use of Form

A certificate of correction may not alter the wording of any resolution that was in fact adopted by the board or the members or delegates. Further, the certificate may not effect a corrected amendment of articles if the amendment as so corrected would not in all respects have complied with the Nonprofit Corporation Law at the time of filing of the corrected instrument [*Corp. Code § 5007*]. Hence, the certificate of correction must effect a correction that would have

rendered the corrected instrument in compliance with the law at the time the agreement, certificate, or other instrument being corrected was originally filed. If the correction would have rendered the instrument in noncompliance with that law, the Secretary of State may refuse to file the certificate.

The filing of the certificate does not alter the effective time of the agreement, certificate, or other instrument being corrected, which remains as its original effective time. Furthermore, the filing does not affect any right or liability accrued or incurred before the filing, except that any right or liability accrued or incurred by reason of the error or defect being corrected is extinguished by the filing if the person having that right has not detrimentally relied on the original instrument [*Corp. Code § 5007*].

[d] Execution, Filing, and Fees

A certificate of correction must be signed and verified [*see Corp. Code § 5076*] or acknowledged [*see Corp. Code § 5030*] as provided in the Nonprofit Corporation Law [*Corp. Code § 5007*]. "Verified" means that the statements contained in the certificate are declared to be true of the knowledge of the persons executing the certificate in either (1) an affidavit signed by them under oath before an officer authorized by the laws of California or of the place where it is executed to administer oaths; or (2) a declaration in writing executed by them under penalty of perjury and stating the date and place of execution [*Corp. Code § 5076*]. Examples of these two types of verification are set forth in this form. Alternatively, the certificate may be acknowledged [*see Corp. Code § 5007*] by formal acknowledgment [*see Civ. Code § 1180 et seq.*], or by written declaration stating that the signatories are the persons executing the agreement and that the instrument is the act and deed of the persons executing the agreement [*see Corp. Code § 5030*].

The filing fee for a certificate of correction is set by statute [*Corp. Code § 5006*; *Gov. Code § 12186(p)*]. The office of the Secretary of State will compare and certify up to two copies of the certificate without charge if the copies are submitted with the original to be filed [*Corp. Code § 5006*; *Gov. Code § 12185*].

[2] FORM

Certificate of Correction

CERTIFICATE OF CORRECTION OF ARTICLES OF INCORPORATION OF _____ [*name of corporation*]
_____ [*corporate number*]

We certify:

1. We are [the incorporators *or* the incorporators and the directors] named in the Articles of Incorporation of _____[*name of corporation*].

2. The name of the corporation filing this Certificate is _____[*name of corporation*], and the corporation is a California corporation.

3. The instrument being corrected is entitled Articles of Incorporation of _____[*name of corporation*], and it was filed with the office of the Secretary of State of the State of California on _____[*date*].

4. Article _____ of these Articles of Incorporation, as corrected, should read as follows: [*full text of provision as corrected*].

[*If execution of articles of incorporation was defective, add:*]

5. The execution of these Articles of Incorporation was defective in the following respects: [*describe defects*].

[*Continue with the following:*]

IN WITNESS WHEREOF, the undersigned have executed this Certificate of Correction on _____[*date*].

_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

[*EITHER*]
Affidavit

State of California) ss
County of _____)

[*names of persons signing certificate*], being duly sworn, each for himself [*or* herself *or* himself or herself], depose and say:

That they have read the foregoing certificate and know its contents.

That the matters set forth in the certificate are true of their own knowledge.

_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

Subscribed and sworn to before me this _____ day of [*month and year*].

[*Notarial seal*]

_____ [*signature*]
Notary Public

[*OR*]

Declaration

Each of the undersigned declares under penalty of perjury that the statements contained in the foregoing certificate are true of _____[his *or* her *or* his or her] own knowledge and that this declaration was executed on _____[*date*], at _____[*city and state where declaration is executed*].

_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

[*OR*]

ACKNOWLEDGMENT

[*For acknowledgment, see § 13.200[2]*.]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormation



74 of 192 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.244

§ 13.244 Appointment of Initial Directors and Adoption of Bylaws

[1] Comment--Use of Form

This form effects the appointment of the initial board of directors by the incorporators and adopts the bylaws of the corporation. If the initial directors are not named in the articles, the incorporators may do "whatever is necessary and proper" to perfect the organization of the corporation, including the adoption and amendment of bylaws and the election of directors and officers [*Corp. Code §§ 5134, 7134, 9134*].

If the incorporators know the identity of the initial directors, they usually appoint them, avoiding the necessity of holding a meeting to elect the initial directors. The directors will then complete the corporate organization by holding their first meeting [*see § 13.23, 13.121*].

[2] FORM

Appointment of Initial Directors and Adoption of Bylaws

APPOINTMENT OF INITIAL DIRECTORS AND ADOPTION OF BYLAWS OF _____ [*name of corporation*]

The undersigned Incorporators of _____[*name of corporation*], a California [public benefit *or* mutual benefit *or* religious] corporation, adopt the following resolutions on behalf of the Corporation.

WHEREAS, no Directors have been appointed or elected to the board of directors;

WHEREAS, no bylaws have been adopted;

WHEREAS, the Incorporators deem it in the corporation's best interest to appoint Directors and adopt bylaws;

WHEREAS, the Incorporators are authorized to adopt bylaws under Corporations Code Section _____

[5134 *or* 7134 *or* 9134]; and

WHEREAS, the Incorporators are authorized to elect Directors under *Corporations Code Section [5134 or 7134 or 9134*].

RESOLVED THAT The attached bylaws are adopted as the Corporation's bylaws and the Secretary is authorized to execute a certificate acknowledging the adoption of the bylaws and to insert a certified copy into the corporate records book.

RESOLVED THAT The individuals listed below are elected as the initial directors of the Corporation. In accordance with the corporate bylaws, the number of directors is _____, and they serve until their successors are duly elected and qualified.

_____ [*name*]
_____ [*address*]

_____ [*name*]
_____ [*address*]

_____ [*name*]
_____ [*address*]
_____ Dated:

_____ [*signature*]
[*typed name*], Incorporator
_____ [*signature*]
[*typed name*], Incorporator

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.245

§ 13.245 Waiver of Notice and Consent to Holding of First Meeting of Directors

[1] Comment

[a] Use of Form

This form is a waiver of notice of the first meeting of the board of directors. The first step in completing the organization of a corporation is the holding of a directors' meeting. Unless the articles expressly prohibit the holding of a meeting without notice [*see Corp. Code §§ 5211(a)(3), 7211(a)(3), 9211(a)(3)*], the first meeting of the directors should be held on waiver of notice signed by all incumbent directors. A waiver of notice need not specify the purpose of any regular or special meeting of the board [*Corp. Code §§ 5211(a)(2), 7211(a)(2), 9211(a)(2)*].

No notice of meeting need be given to any director who provided a waiver of notice, a consent to holding the meeting, or an approval of the minutes of the meeting, whether before or after the meeting. Attendance at the meeting in writing without protesting the lack of notice either before or at the commencement of the meeting also effects waiver of notice [*Corp. Code §§ 5211(a)(3), 7211(a)(3), 9211(a)(3)*].

For a checklist of the items ordinarily covered at the first meeting of directors, see *§ 13.121*. For a form for the minutes to be adopted at the first meeting of the board of directors, see *§ 13.247*.

[b] Recordkeeping Requirements

Waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meetings [*Corp. Code §§ 5211(a)(3), 7211(a)(3), 9211(a)(3)*].

[2] FORM

Waiver of Notice and Consent to Holding of First Meeting of Directors

WAIVER OF NOTICE AND CONSENT TO HOLDING OF FIRST MEETING OF DIRECTORS OF

_____ [*name of corporation*], A CALIFORNIA NONPROFIT CORPORATION

The undersigned, _____[*names*], being all of the Directors of _____[*name of corporation*], a California nonprofit [public benefit *or* mutual benefit *or* religious] corporation, hereby waive notice and consent to the holding of the first meeting of the Board of Directors of the Corporation to be held at _____[*street address, city, state, zip*], on _____[*date*], at [A.M. *or* P.M.]. The undersigned also consent to the transaction of any and all business that may be brought before the meeting. [*Optional, if corporation wishes to identify matters to be determined at meeting, e.g.,* This first meeting will be used to adopt the bylaws of the Corporation, to adopt a corporate seal, to elect the officers of the Corporation, to provide for a depositary for the funds of the Corporation and to authorize certain officers to deal with corporate funds, to adopt a fiscal year for the Corporation, to determine the principal office of the Corporation, to provide for the payment of the expenses of incorporation and organization of the Corporation, and to transact any other business as may be brought before the meeting.]

The undersigned further requests that this waiver and consent [be filed with the corporate records *or* be made a part of the minutes of the meeting] for the purpose of showing that the business transacted at the meeting is valid and of the same force and effect as though the business had been transacted at a meeting duly held after regular call and notice.
_____ Dated:

_____ [*signature*]
[*typed name*], Director
_____ [*signature*]
[*typed name*], Director
_____ [*signature*]
[*typed name*], Director

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesBusiness & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.246

§ 13.246 Action by Unanimous Written Consent of Board

[1] Comment--Use of Form

This form acknowledges the unanimous written consent of the board of directors to specific actions. Any action required or permitted to be taken by the board may be taken without a meeting, if all members of the board individually or collectively consent in writing to that action. Action by written consent of the board has the same force and effect as the unanimous vote of the directors [*Corp. Code §§ 5211(b), 7211(b), 9211(b)*].

All written consents must be filed with the minutes of the proceedings of the board [*Corp. Code §§ 5211(b), 7211(b), 9211(b)*].

[2] FORM

Action by Unanimous Written Consent of Board

ACTION BY UNANIMOUS WRITTEN CONSENT OF BOARD OF DIRECTORS OF _____ [*name of corporation*], A CALIFORNIA NONPROFIT _____ [PUBLIC BENEFIT *or* MUTUAL BENEFIT *or* RELIGIOUS] CORPORATION

The undersigned, constituting all the directors of _____[*name of corporation*], consent to adopt the following resolutions by unanimous written consent under *Corporations Code Section [5211(b) or 7211(b) or 9211(b)*]: [*specify*].

_____ Dated:

_____ [*signature*]
[*typed name*], Director
_____ [*signature*]
[*typed name*], Director
_____ [*signature*]

[*typed name*], Director

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.247

§ 13.247 Minutes of Organizational Meeting

[1] Comment--Use of Form

This form is a form for the minutes for the organizational meeting of a nonprofit corporation [*see § 13.23*]. This form assumes that the directors were named in the articles of incorporation or by the incorporators, and that the incorporators are not participating at the meeting in that capacity. If the incorporators are actively participating, the form should be adapted to reflect their presence and participation. The form covers most matters typically covered at the organizational meeting. However, additional resolutions may be required if the corporation will have members, such as authorization for membership certificates and qualification for registration of offer and sale of membership interests. Additional resolutions include appointing financial and legal advisers, securing insurance for the corporation and employees, and executing deeds, leases, loans, and grants.

Nonprofit corporations must keep minutes of the proceedings of its members, board of directors, and committees of the board. The minutes must be kept in written form, in any other form capable of being converted into clearly legible tangible form, or any combination of the two [*Corp. Code §§ 6320(a)(2), (b), 8320(a)(2), (b), 9510(a)(2), (b)*].

For the procedure for holding an organizational meeting, see *§ 13.121*.

[2] FORM

Minutes of Organizational Meeting

MINUTES OF FIRST MEETING OF INCORPORATORS AND FIRST BOARD OF DIRECTORS OF _____ [*name of corporation*], A CALIFORNIA NONPROFIT _____ [PUBLIC BENEFIT *or* MUTUAL BENEFIT *or* RELIGIOUS] CORPORATION

The initial directors named [in the articles of incorporation *or* by the incorporators], constituting the first Board of Directors of _____[*name of corporation*], held their first meeting at _____[*address*], at _____[*time*] [A.M. *or* P.M.], on _____[*date*], pursuant to the waiver of notice and

consent signed by all of the Directors.

The following Directors, constituting [all members *or* a quorum] of the Board were present: _____[*names*].

The following Director(s) [was *or* were] absent: _____[*name(s)*].

The meeting was called to order by _____[*name of chair*]. _____[*name of chair*] suggested the appointment of a temporary chair and temporary secretary. On motion made, seconded, and [unanimously] carried, _____[*name*] was appointed Temporary Chair and _____[*name*] was appointed Temporary Secretary.

The Temporary Chair stated that the meeting was held pursuant to a written waiver of notice and consent to the holding of the meeting signed by all the directors. The waiver and consent was presented and ordered filed with the minutes of the meeting.

The Temporary Chair reported that the original Articles of Incorporation of the Corporation were filed in the office of the Secretary of State of California on _____[*date*]. The articles of incorporation designate _____[*name*] as the initial agent for service of process. The Temporary Chair presented to the meeting a certified copy of the Articles of Incorporation and the Temporary Secretary was directed to insert that copy in the minute book of the Corporation and to keep a copy at the principal office of the corporation.

The Temporary Secretary presented a draft of bylaws to the meeting, which were read section by section, and discussed. On motion made, seconded, and unanimously carried, the following preambles and resolutions were duly adopted:

WHEREAS, there has been presented to this meeting a set of Bylaws for the regulation of the affairs of this Corporation; and

WHEREAS, it is deemed to be to the best interest of this Corporation that these Bylaws be adopted by this Board of Directors as the bylaws of this Corporation;

RESOLVED, that the Bylaws presented and discussed at this meeting are adopted as the Bylaws of this Corporation; and

FURTHER RESOLVED, that the Secretary of this Corporation is authorized and directed to execute a certificate of the adoption of these Bylaws and to insert the Bylaws as so certified in the minute book of this Corporation, and to see that a copy of the Bylaws, similarly certified, is kept at the principal office of the Corporation for the transaction of the business of the Corporation, in accordance with *Corporations Code Section [5160 or 7160 or 9160*].

The Temporary Secretary then presented for approval by the Board a proposed seal of the Corporation, consisting of two concentric circles with the words "_____" [*name*] and the words and figures "Incorporated _____[*date*], California," in the form and figures as follows: [*describe or print copy of seal*].

On motion duly made, seconded, and unanimously carried, the following resolution was adopted:

RESOLVED, that the corporate seal in the form, words, and figures presented to this Board by and the same is adopted as the seal of this Corporation.

The Temporary Chair stated that nominations were in order for the election of officers of the Corporation, which should be a president, a vice-president, a secretary, and a chief financial officer. The following slate of officers was nominated:

_____ [*name*], President
_____ [*name*], Vice-President
_____ [*name*], Secretary
_____ [*name*], Chief Financial Officer

There being no other nominations, on motion duly made, seconded, and unanimously carried, the slate of nominated officers was duly elected to hold office until the later of the first annual meeting of Directors or until their respective successors are duly elected. Each officer so elected, being present, accepted the office. The elected President and Secretary acted throughout the balance of the meeting as President and Secretary, respectively.

To provide for a depository for the funds of this Corporation, and to authorize certain officers to deal with corporate funds, the following resolutions were adopted:

RESOLVED, that this Corporation establish in its name one or more deposit accounts with the _____[*name*] bank, of _____[*city*], California, on the terms and conditions as may be agreed on with the bank, and that the following named officers of this Corporation are authorized to establish those account or accounts; and

FURTHER RESOLVED, that _____[*name*], President, _____[*name*], Vice-President, _____[*name*], Chief Financial Officer, and _____[*name*], Secretary, of this Corporation, or any one of them are authorized to withdraw funds of this Corporation from those account or accounts on checks of this Corporation with signatures duly certified to the bank by the secretary of this Corporation, and that the bank is authorized to honor and pay any and all checks so signed, including those drawn to the individual order of any officer or other person authorized to sign the same.

The matter of the adoption of a fiscal year was then considered. After discussion, on motion duly made, seconded, and unanimously carried, the following resolution was adopted:

RESOLVED, that the fiscal year end of this Corporation is fixed as _____[December 31 *or other date*] of each year.

After discussion and on motion duly made, seconded, and unanimously carried, the following resolution was adopted:

RESOLVED, that the principal office of this Corporation is designated and fixed as _____[*street address, city, state, zip*]. This office will remain the principal office location unless changed by resolution of the board of directors.

To provide for the payment of the expenses of incorporation and organization of this Corporation, on motion duly made, seconded, and unanimously carried, the following resolution was adopted:

RESOLVED, that [the Chief Financial Officer *or* each officer] of this Corporation is authorized and directed to pay the expenses of incorporation and organization of this Corporation.

On motion duly made, seconded, and unanimously carried, the following resolution was adopted:

RESOLVED, that the President is authorized and directed to execute and file the biennial statement with the Secretary of State's office as required by law.

[*Optional:*]

On motion duly made, seconded, and unanimously carried, the following resolution was adopted:

RESOLVED, that the President is authorized to consult with legal counsel and tax advisers to determine the availability of state and federal tax exemptions. If determined to be available, the President is authorized and directed to execute and file all necessary applications and documentation for the exemptions and to pay the applicable filing fees.

On motion duly made, seconded, and unanimously carried, the following resolution was adopted:

RESOLVED, that the President is authorized and directed to determine the legal requirements imposed on the public solicitation of funds for charitable purposes in the following cities and counties: [*specify*]. The President is authorized and directed to make all filings and pay all fees necessary to obtain a permit.

On motion duly made, seconded, and unanimously carried, the following resolution was adopted:

RESOLVED, that it is the corporation's best interest to, and the President is authorized and directed to, obtain a nonprofit mailing permit in the name of the corporation.

The Temporary Chair stated that the corporation needs a federal employer identification number for filing purposes. On motion duly made, seconded, and unanimously carried, the following resolution was adopted:

RESOLVED, that the officers of the corporation are authorized and directed to secure a federal employer identification number.

There being no further business to come before the meeting, on motion duly made, seconded, and unanimously carried, the meeting was adjourned.

_____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



78 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.248

§ 13.248 Statement of Information by Domestic Nonprofit Corporation [Form SI-100]

[1] Comment

[a] Use of Form

This form is Secretary of State Form SI-100, Statement of Information by Domestic Nonprofit Corporation. The Secretary of State's official printed form is reproduced here, along with the text of the official instructions. Form SI-100 is for use by domestic nonprofit corporations [*Corp. Code §§ 6210(a), 8210(a), 9660(a)*]. The statement contains the names and complete business or residence addresses of its chief executive officer, secretary, and chief financial officer; the street address of its principal office in California, if any; the mailing address of the corporation (if different from the street address of its principal executive office or if it has no principal executive office in California); and the agent for service of process [*Corp. Code §§ 6210(a), (b), 8210(a), (b), 9660(a)*].

Every domestic nonprofit corporation must file this statement within 90 days after the filing of its original articles of incorporation, and biennially thereafter during the applicable filing period [*Corp. Code §§ 6210(a), 8210(a), 9660(a)*]. The applicable filing period is the end of the calendar month during which its original articles were filed and the immediately preceding five calendar months [*Corp. Code §§ 6210(c), 8210(c), 9660(a)*]. The Secretary of State will mail a form for compliance with this requirement approximately three months before the close of the applicable filing period. The form will be mailed to the last address of the corporation according to the records of the Secretary of State, and states the required due date [*Corp. Code §§ 6210(c), 8210(c), 9660(a)*].

A domestic nonprofit corporation must file this statement even though the corporation is not actively engaged in business at the time that the statement is due [*see* [2], *below* (instructions to form)].

Note that although for-profit corporations and foreign nonprofits are now required to file a similar statement annually [*Corp. Code §§ 1502, 2117*; *see § 13.249* and *Ch. 7, Corporate Records and Reports, § 7.207A*], domestic nonprofits still file it only biennially.

An initial or biennial statement must be accompanied by the applicable filing fee, payable to the Secretary of State [*Corp. Code § 5006*; *Gov. Code § 12186(g)*].

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 13.248. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Foreign nonprofit corporations do not use this form, but instead use Form SI-350, which is reproduced in § 13.249.

[b] Amending Statement

Whenever any of the information contained in the statement is changed, the corporation may file a current statement containing all the required information. To change its agent for service of process (or the address of the agent), the corporation must file a current statement containing all the required information. Whenever any corrective statement is filed, it supersedes any previously filed statement, as well as the statement in the articles as to the agent for service of process and the agent's address [*Corp. Code §§ 6210(d), 8210(d), 9660(a)*]. There is no filing fee for a corrective filing [*see* [2], *below* (instructions to form)].

[c] Effect of Failure to File

The failure to file an initial or biennial statement is subject to penalty [*see Corp. Code §§ 6810, 8810, 9690*; *see also Rev. & Tax. Code §§ 19141, 25936*], unless the corporation has dissolved, been merged into another corporation, or has been suspended [*see Corp. Code §§ 6810(c), (d), 8810(c), (d), 9690*]. However, the Secretary may waive the penalty on a finding that the failure to file the statement is excusable because of reasonable cause or unusual circumstances that justify the failure [*Corp. Code §§ 6810(f), 8810(f), 9690*]. Repeated failures may result in suspension [*Corp. Code § 5008.6*]. Neither the failure of the Secretary of State to mail the form nor the failure of the corporation to receive it excuses the failure to comply with this filing requirement [*Corp. Code §§ 6210(c), 8210(c), 9660(a)*].

[2] FORM

Statement of Information by Domestic Nonprofit Corporation [Form SI-100]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesTax LawState & Local TaxesFranchise TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.248A

§ 13.248A Statement and Designation by Foreign Nonprofit Corporation

[1] Comment--Use of Form

This form is a statement and designation that a foreign nonprofit corporation must file to obtain a certificate of qualification to transact intrastate business in California [*see Corp. Code § 2105*]. Foreign corporations organized for profit file a different form [*see* Ch. 12B, *Foreign Corporations and Associations*].

The statement and designation must be on a form prescribed by the Secretary of State's office [*see Corp. Code § 2105(a)*]; however, unofficial forms that comply with the requirements of the Secretary of State will suffice. The version reproduced here is the Secretary of State's official form. Forms prepared by the Secretary of State may be obtained from its Sacramento office or from any of its satellite offices in Los Angeles, San Diego, Fresno, or San Francisco, or on the Secretary of State's website as indicated below.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 12B.248A. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

The original statement and designation form must be accompanied by the applicable filing fee, in cash or by check made payable to the Secretary of State. The form may be mailed or hand-delivered to the Sacramento Secretary of State office. To facilitate the processing of documents mailed to the Sacramento office, a self-addressed envelope and letter referencing the corporate name as well as the name, return address, and telephone number of the person filing the documents should be submitted. The form may also be hand-delivered to any branch office; however, a duplicate original must be submitted if documents are filed in any branch office. The Los Angeles and San Diego branch offices

do not accept cash [*see* Secretary of State's website at http://www.ss.ca.gov/business/corp/pdf/articles/corp_artsnp.pdf].

An original certificate of good standing by an authorized public official of the state or place of incorporation must be attached to this form. The certificate should indicate that the corporation is a nonstock, nonprofit corporation. This is required as proof that the corporation is eligible for the reduced filing fees applicable to nonprofit corporations; however, although a certified copy of the articles of incorporation will not be accepted in lieu of the required certificate [*see* "Requirements for Qualification of Foreign Nonprofit Corporations" appended to form in [2], *below*], the Secretary of State's office will accept an endorsed copy of the corporation's articles along with the certificate, as proof of its nonprofit status if, as will happen in some cases, the certificate of good standing provided by the state or place of incorporation does not specify that the corporation is nonprofit.

[2] FORM

Statement and Designation by Foreign Nonprofit Corporation

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.249

§ 13.249 Statement of Information by Foreign Nonprofit Corporation [Form SI-350]

[1] Comment--Use of Form

This form is Secretary of State Form SI-350, Statement of Information by Foreign Corporation, also sometimes referred to as the Statement of Officers, or simply "annual statement" or "statement of information." The Secretary of State's official printed form is reproduced here, along with the text of the official instructions. Every foreign corporation (other than a foreign association) qualified to transact intrastate business must file this form during the applicable filing period each year [*Corp. Code §§ 6910, 8910*; *see Corp. Code § 2117(a)*]. For a form for the initial statement and designation, see *§ 13.248A*. For Form SI-100, the comparable form used by domestic nonprofit corporations, see *§ 13.248*. Note, however, that while domestic nonprofits file biannially [*see Corp. Code §§ 6210, 8210, 9660*], foreign nonprofits must file annually, like all other foreign corporations [*see Corp. Code §§ 2117, 2117.1, 6910, 8910*].

Form SI-350 may be used by both foreign stock corporations and foreign nonprofit corporations. Note that while the Nonprofit Religious Corporation Law does not contain a statute expressly requiring *foreign* religious corporations to file, *Corp. Code § 9660* subjects *all* religious corporations to this filing requirement.

If the corporation must qualify under an assumed name [*see Corp. Code § 2106(b)*], the first line of the statement must state the correct corporate name, followed by "which will do business in California as ... ," setting forth the assumed name in the space indicated. The assumed name should not be set out in connection with the corporate name anywhere else in the statement [*see* Secretary of State's instructions].

This statement must be accompanied by the applicable filing fee, payable to the Secretary of State [*Gov. Code § 12186(e)*].

For further discussion, see *§ 13.248* and *Ch. 12B, Foreign Corporations and Associations, § 12B.210*.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at

http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 13.249. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[2] FORM

Statement of Information by Foreign Nonprofit Corporation [Form SI-350]

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesConducting Business Under Fictitious NamesBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.250

§ 13.250 Statement of Resignation of Agent for Service of Process [Form RA-100]

[1] Comment--Use of Form

This form is a statement of resignation of a corporation's agent for service of process. The form reproduced here is official Form RA-100 promulgated by the Secretary of State that appears on the Secretary of State's website, together with the accompanying instructions. The form may be used by both for-profit and nonprofit corporations.

Under the Nonprofit Corporation Law, an agent designated by a nonprofit corporation for service of process may file a signed and acknowledged written statement of resignation as agent [*Corp. Code §§ 6211, 8211, 9660(a)*]. For the purpose of the statement, the term "file" means filing the statement with the California Secretary of State [*Corp. Code § 5051*]. On the filing of a statement of resignation, the authority of the agent to act in that capacity ceases and the Secretary of State will give written notice of the filing of the statement of resignation by mail to the corporation addressed to its principal office [*Corp. Code §§ 6211(a), 8211(a), 9660(a)*].

Nonprofit corporations must file a designation of a new agent whenever a natural person designated as agent for service of process resigns, dies, or longer resides in California. Similarly, a new designation is required if a corporate agent for service of process resigns, dissolves, withdraws from California, forfeits its right to transact intrastate business, ceases to exist, or has its corporate rights, powers, and privileges suspended [*Corp. Code §§ 6212, 8212, 9660(a)*].

[2] FORM

Statement of Resignation of Agent for Service of Process

Click here to view image.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewCivil ProcedurePleading &

PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide § 13.251

§ 13.251 Letter Seeking Attorney General's Approval of Self-Dealing Transaction

[1] Comment

[a] Use of Form

This form is a letter seeking the approval of the Attorney General of a self-dealing transaction for use by public benefit or religious corporations [*see Corp. Code §§ 5233(d)(1), 9243(d)(1)*; *see also 11 Cal. Code Reg. § 999.1(c)*]. Ordinarily, participation in a self-dealing transaction is subject to strict sanctions unless validated pursuant to statute [*see Corp. Code §§ 5233(a), (d), 9243(a), (d)*; *see § 13.38*]. However, participation in a self-dealing transaction is not subject to sanction if the Attorney General (or the court in a suit in which the Attorney General is an indispensable party) approves the transaction before or after consummation [*Corp. Code §§ 5233(d)(1), 9243(d)(1)*; *see § 13.38[1][b]*].

Requests for approval must be submitted in writing to the office of Charitable Trusts Section of the Attorney General's office nearest to the corporation's principal office [*11 Cal. Code Reg. § 999.1(a)*]. The letter must state all material facts about the transaction and the extent to which any director has a material financial interest [*11 Cal. Code Reg. §§ 999.1(c), 999.2(b)(1)*]. This form is drafted under the assumption that only one director has a material interest in the transaction, but the form may be amended if more than one director is interested. Material facts include a description of the goods and services to be provided by or to the corporation; the price and estimated fair market value of those goods and services; the benefit of the transaction to the corporation; and a statement whether the board approved the transaction. If the board approved the transaction, the letter must also state the factual basis for that approval, the interested director's disclosures, alternatives considered, and the reason the alternatives were rejected [*11 Cal. Code Reg. § 999.1(c)*].

Once a director discloses the potential for a material financial interest in a proposed corporate transaction, the board should determine whether the transaction falls within an exception to the self-dealing bar [*see Corp. Code §§ 5233(b), 9243(b)*; *see also § 13.38[1][a]*]. If not, the board should prepare for full disclosure at the meeting and a disinterested person or committee should be assigned to investigate reasonable alternatives to the proposed transaction. At the meeting, all material facts about the transaction, including the nature and extent of the director's interest, must be disclosed. Proposed alternatives should be discussed. If the board will approve the transaction, the board should make

resolutions stating that the proposed transaction is fair and reasonable, that the corporation entered into the transaction for its own benefit, that the board considered and in good faith determined after reasonable investigation that the corporation could not have obtained a more advantageous arrangement.

[b] Accompanying Documentation

The corporation's letter seeking approval must be accompanied by the following documentation [*11 Cal. Code Reg. § 999.2(b)*]:

- Copies of the corporation's current financial statements, articles of incorporation, and bylaws unless these documents are already on file with the Registrar of Charitable Trusts.

- Copies of the minutes of board meetings at which the transaction was discussed. The minutes should reflect full disclosure of the material financial interest, the investigation of reasonable alternatives, board findings and resolutions approving the transaction, and the vote.

- A letter by the interested director disclosing his or her interest unless the letter would simply reiterate information in the corporation's letter.

- Any additional information required by the Attorney General [*see 11 Cal. Code Reg. §§ 999.2(b)(7)* (public benefit), 999.3(b)(7) (mutual benefit)].

[2] FORM

Letter Seeking Attorney General's Approval of Self-Dealing Transaction

[*Corporate letterhead*]

Date: _____

Charitable Trusts Section
Attorney General's Office

_____[*Name of corporation*], a nonprofit [public benefit *or* religious] corporation seeks the approval of the California Attorney General for a transaction in which one or more directors has a material financial interest.

On _____[*date*], _____[*name of corporation*] proposed entering into a contract with [*name of contracting party*] to [*identify goods or services to be provided by or to corporation*]. [*State other material facts concerning transaction, e.g., price and estimated fair market value of the goods and services and the transaction's benefit to corporation*].

_____[*Name of director*] has disclosed a material financial interest in this transaction as follows: [*describe extent of material financial interest*].

[*EITHER*]

The board of directors did not authorize or approve this transaction.

[*OR*]

The board of directors [authorized *or* approved] this transaction [before *or* after] its consummation by a majority of disinterested directors. At the meeting of the board on _____[*date*], at which a quorum was present, the board discussed the material facts surrounding the transaction and the director's interest in the transaction. Specifically, the board considered the following facts: [*describe material facts forming basis for approval, including interested director's disclosures*]. The board considered the following alternatives, after reasonable investigation: [*describe*]. On motion duly made, seconded, and carried by the required vote, the board rejected these alternatives because [*describe*].

The board then found and resolved that the proposed transaction is [fair and reasonable *or, for religious corporations,* in furtherance of its religious purposes], that the corporation entered into the transaction for its own benefit, and that the board considered and in good faith determined after reasonable investigation that the corporation could not have obtained a more advantageous arrangement.

[*Continue with the following:*]

On this basis, _____[*name of corporation*] seeks the approval of the California Attorney General for the above-described transaction. If your office needs additional information, please do not hesitate to contact us.

Sincerely, _____ [*signature*]
[*typed name*], President
_____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & LiabilitiesEstate, Gift & Trust LawTrustsCharitable Trusts



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
B. Forms Related to Corporate Formation and Operation

6-13 California Legal Forms--Transaction Guide §§ 13.252-13.259

[Reserved]

§§ 13.252[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
C. Amendment of Articles of Incorporation

6-13 California Legal Forms--Transaction Guide § 13.260

§ 13.260 Certificate of Amendment of Articles of Incorporation by Incorporators

[1] Comment

[a] Use of Form

This form is a certificate of amendment that must be filed with the Secretary of State by a majority of the incorporators to amend (change, add, or delete) the articles of incorporation of a nonprofit corporation without directors and members. It is similar to the sample provided by the Secretary of State. For a certificate of amendment designed for use when the corporation has directors or members, see *§ 13.261*.

The incorporators may adopt any amendment of the articles of a nonprofit corporation, provided that the initial directors were not named in the articles, no directors have been elected, and the corporation does not have members. In this case, the corporation must file a written certificate of amendment signed and verified by a majority of the incorporators [*Corp. Code §§ 5811, 5815, 7811, 7815, 9620(a)*; *see Corp. Code §§ 5819, 7819*].

On the filing of the certificate of amendment and the payment of applicable fees, the articles will be amended in accordance with the certificate and any change, reclassification, or cancellation of memberships will be effected. Furthermore, a copy of the certificate, certified by the Secretary of State, is prima facie evidence of the performance of the conditions necessary to the adoption of the amendment [*Corp. Code §§ 5817, 7817, 9620(a)*].

[b] Contents of Certificate

A certificate of amendment may establish the wording of an amendment or amended articles by one or more of three means [*Corp. Code §§ 5816, 7816, 9620(a)*]:

- First, the certificate may state that the articles will be amended to read as set forth in full in the certificate.

- Second, the certificate may state that any provision of the articles, which must be identified by the

numerical or other designation given it in the articles or by restating the article, will be stricken from the articles or will be amended to read as set forth in the certificate.

- Third, the certificate may state that the provisions stated in the certificate will be added to the articles.

If the purpose of the amendment is to reclassify, cancel, exchange, or otherwise change the outstanding memberships, the amended articles must state the effect of the change on outstanding memberships [*Corp. Code §§ 5816, 7816, 9620(a)*].

When the incorporators adopt the amendment [*see Corp. Code §§ 5811, 7811, 9620(a)*], the certificate must state, in addition to the general statements described above, that the signers constitute at least a majority of the incorporators, that directors were not named in the original articles and have not been elected, that the corporation has no members, and that the incorporators adopt the amendment or amendments stated in the certificate [*Corp. Code §§ 5815, 7815, 9620(a)*].

[c] Permissible Amendments In General

A nonprofit corporation may amend its articles from time to time, in any and as many respects as may be desired, as long as its articles as amended contain only those provisions as it would be lawful to insert in original articles filed at the time of the filing of the amendment or as authorized by statutes governing change of corporate status [*Corp. Code §§ 5810(a), 7810(a), 9620(a)*; *see Corp. Code §§ 5813.5, 7813.5, 9621*]. Furthermore, if a change in the rights of members or an exchange, reclassification, or cancellation of memberships is to be made, the articles as amended may contain only those provisions as may be necessary to effect that change, exchange, reclassification, or cancellation [*Corp. Code §§ 5810(a), 7810(a), 9620(a)*]. However, a corporation may not amend its articles to alter any statement that may appear in the original articles of the names and addresses of the first directors or the name and address of the initial agent, except to correct an error in the statement or to delete either after the corporation has filed a biennial statement pursuant to *Corp. Code §§ 6210, 8210,* or *9660(a)* [*Corp. Code §§ 5810(b), 7810(b), 9620(a)*].

[d] Extension of Corporate Existence

A nonprofit corporation formed for a limited period, at any time following the expiration of the term of its corporate existence, may extend the term of its existence by an amendment to its articles removing any provision limiting the term of its existence and providing for perpetual existence [*Corp. Code §§ 5818, 7818, 9620(b)*]. If the filing of the certificate of amendment providing for perpetual existence would be prohibited if it were original articles by the provisions of *Corp. Code § 5122, 7122,* or 9122, the Secretary of State will not accept the certificate of amendment for filing unless, by the same or a concurrently filed certificate of amendment, the articles of the corporation are amended to adopt a new available name. For the purpose of the adoption of any such amendment, persons who have been functioning as directors of the corporation are considered to have been validly elected even though their election may have occurred after the expiration of the original term of the corporate existence [*Corp. Code §§ 5818, 7818, 9620(b)*].

[e] Amendment of Articles to Change Status

A public benefit corporation may amend its articles to change its status to that of a mutual benefit, religious, business, or cooperative corporation [*Corp. Code § 5813.5(a)*]. A mutual benefit corporation may amend its articles to change its status to a public benefit, religious, business, or cooperative corporation [*Corp. Code § 7813.5(a)*]. A religious corporation may amend its articles to change its status to that of a public benefit corporation, mutual benefit corporation, business corporation, or cooperative corporation, by complying with the provisions concerning amendment of articles [*Corp. Code § 9621(a)*; *see Corp. Code §§ 5810-5820*]. For further discussion of the requirements for changing the status of a nonprofit corporation, see *§ 13.261[1][e]*.

[f] Use of Alternative Forms

Under some circumstances, it may be proper to file with the Secretary of State a certificate of correction rather than a certificate of amendment. For example, a certificate of correction can be filed with the Secretary of State to correct any misstatement of facts contained in the articles, any defects in the execution of the articles, or any other errors contained in the articles [*see Corp. Code § 5007*]. For a form and discussion of a certificate of correction of the articles of a nonprofit corporation, see *§ 13.243*.

Incorporators seeking to amend a corporation's articles of incorporation [*see Corp. Code §§ 5811, 5815, 7811, 7815, 9620(a)*] may alternatively restate in a single certificate the entire text of the articles (as amended) by filing a certificate, signed and verified by a majority of incorporators, entitled "Restated Articles of Incorporation of _____ [*name of corporation*]." For further discussion, see *§ 13.262*.

[g] Execution, Filing, and Fees

A certificate of amendment by the incorporators must be signed by a majority of the incorporators, and verified before the Secretary of State accepts it for filing [*Corp. Code §§ 5811, 5815, 7811, 7815, 9620(a)*]. For purposes of this requirement, "verified" means that the statements contained in the certificate are declared to be true of the own knowledge of the incorporators executing the certificate in either: (1) an affidavit signed by the incorporators under oath before an officer authorized by the laws of the State of California or of the place where it is executed to administer oaths; or (2) a written declaration executed by the incorporators under penalty of perjury and stating the date and place of execution [*Corp. Code § 5076*].

The incorporators should file the original certificate and at least two copies of the certificate, and file a certified copy in the corporate records book. Amendment documents may only be filed in the Sacramento office, either by mail or hand delivery [*see* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_amdtnpinfo.htm]. If the corporation is a public benefit corporation, an additional copy must be filed for transmittal to Attorney General [*Corp. Code § 5817*].

The certificate of amendment must be accompanied by the applicable filing fee [*see Gov. Code § 12186(p)*]. The Secretary of State will compare and certify up to two copies of the amendment at no charge provided that the copies are submitted with the original to be filed [*Gov. Code § 12185*]. If additional certified copies are required, an additional minimal fee is charged, provided that the copies are furnished to the Secretary of State and the fee is prepaid [*Gov. Code §§ 12182, 12183*]. A separate and nonrefundable handling fee is charged for expedited processing of documents delivered in person, over the counter, to the Sacramento headquarters office.

[2] FORM

Certificate of Amendment of Articles of Incorporation by Incorporators

CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF _____ [*name of corporation*]
_____ [*corporate number*]

_____[*Names of incorporators executing certificate*] certify:

1. That we constitute at least a majority of the Incorporators of _____[*name of corporation*], and constitute [*percentage constituting a majority of the incorporators, e.g.,* 75 percent] of the Incorporators of the Corporation.

2. That directors were not named in the Articles of Incorporation and have not been elected.

3. That the Corporation has not admitted any members.

4. That we hereby adopt the amendment of the Articles of Incorporation of the Corporation as set forth in Paragraph 4 of this Certificate.

[*EITHER*]

5. The Articles of Incorporation of the Corporation are amended to read as follows: [*articles as amended set forth in full*].

[*OR*]

5. Article [*number of other designation*] of the Articles of Incorporation of the Corporation is [*either* stricken from the Articles of Incorporation of the Corporation *or* amended to read as follows: _____ (*wording of amendment*)].

[*OR*]

5. The following provision(s) [is *or* are] added to the Articles of Incorporation of the Corporation: [*wording of amendment*].

[*Continue with the following:*]

_____ [*signature*]
[*typed name*], Incorporator
_____ [*signature*]
[*typed name*], Incorporator
_____ [*signature*]
[*typed name*], Incorporator

[*EITHER*]
Affidavit

State of California) ss
County of _____)

[*Names of incorporators signing certificate*], being duly sworn, each for [himself *or* herself *or* himself or herself], depose and say:

That they have read the foregoing Certificate of Amendment of Articles of Incorporation and know its contents.

That the matters set forth in the Certificate are true of their own knowledge.

_____ [*signature*]
[*typed name*], Incorporator

_____ [*signature*]
[*typed name*], Incorporator
_____ [*signature*]
[*typed name*], Incorporator

Subscribed and sworn to before me this _____ day of _____ [*date*]

[*Notarial seal*]

_____ [*signature*]
Notary Public

[*OR*]

Declaration

Each of the undersigned declares under penalty of perjury that the statements contained in the foregoing Certificate of Amendment of Articles of Incorporation are true of [his *or* her *or* his or her] own knowledge and that this declaration was executed on _____[*date*], at _____[*city and state where declaration is executed*].

_____ [*signature*]
[*typed name*], Incorporator
_____ [*signature*]
[*typed name*], Incorporator
_____ [*signature*]
[*typed name*], Incorporator

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
C. Amendment of Articles of Incorporation

6-13 California Legal Forms--Transaction Guide § 13.261

§ 13.261 Certificate of Amendment of Articles of Incorporation--Officers' Certificate

[1] Comment

[a] Use of Form

This form is a certificate of amendment designed for use by a corporation with directors and/or members desiring to amend (change, add or delete) the articles of incorporation of a nonprofit corporation [*see Corp. Code §§ 5814, 5816, 5817, 7814, 7816, 7817, 9620(a)*]. It is similar to the sample provided by the Secretary of State [*see* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_amdtnpinfo.htm].

On the filing of the certificate of amendment, the articles will be amended in accordance with the certificate and any change, reclassification, or cancellation of memberships will be effected. Furthermore, a copy of the certificate, certified by the Secretary of State, is prima facie evidence of the performance of the conditions necessary to the adoption of the amendment [*Corp. Code §§ 5817, 7817, 9620(a)*].

In lieu of this form, the corporation may use a certificate of correction or restate the articles of incorporation. For discussion of these alternatives, see *§ 13.243[1][d]*.

[b] Contents of Certificate

The certificate of amendment must state the following matters [*Corp. Code §§ 5814, 7814, 9620(a)*]:

- The wording of the amendment or amended articles [*see Corp. Code §§ 5816, 7816, 9620(a)*].
- That the amendment has been duly approved by the board.
- If the corporation has no members, the certificate must state that fact.
- If the amendment requires the approval of the members [*see Corp. Code § 5034*], that the

amendment was approved by the required vote of the members.

- If the amendment may be adopted with approval by the board alone, a statement of the facts entitling the board alone to adopt the amendment.

- If the amendment requires the approval of someone other than the incorporators, directors, or members, that the approval of that person or persons has been obtained.

To establish the wording of the amendment or the amended articles, the certificate must identify the particular provision to be amended using the numerical or other designation given that provision in the existing articles, or by quoting the wording of the provision as it currently appears, followed by the wording of the provision in full as amended. If the amendment is an addition to the articles, the certificate must state that the specified provisions are added to the articles [*see Corp. Code §§ 5816, 7816, 9620(a)*; *see also see* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_amdtnpinfo.htm].

[c] Permissible Amendments In General

A nonprofit corporation may amend its articles from time to time, in any and as many respects as may be desired, as long as its articles as amended contain only those provisions that it would be lawful to insert in original articles filed at the time of the filing of the amendment or as authorized by statutes governing change of corporate status [*Corp. Code §§ 5810(a), 7810(a), 9620(a)*; *see Corp. Code §§ 5813.5, 7813.5, 9621*]. Furthermore, if a change in the rights of members or an exchange, reclassification, or cancellation of memberships is to be made, the articles as amended may contain only those provisions as may be necessary to effect that change, exchange, reclassification, or cancellation [*Corp. Code §§ 5810(a), 7810(a), 9620(a)*]. However, a corporation may not amend its articles to alter any statement that may appear in the original articles of the names and addresses of the first directors, or the name and address of the initial agent, except to correct an error in the statement or to delete either after the corporation has filed a biennial statement pursuant to *Corp. Code §§ 6210, 8210,* or *9660(a)* [*Corp. Code §§ 5810(b), 7810(b), 9620(a)*].

[d] Extension of Corporate Existence

A nonprofit corporation formed for a limited period, at any time following the expiration of the term of its corporate existence, may extend the term of its existence by an amendment to its articles removing any provision limiting the term of its existence and providing for perpetual existence [*Corp. Code §§ 5818, 7818, 9620(b)*]. If the filing of the certificate of amendment providing for perpetual existence would be prohibited if it were original articles by the provisions of *Corp. Code §§ 5122, 7122,* or *9122,* the Secretary of State will not accept the certificate of amendment for filing unless, by the same or a concurrently filed certificate of amendment, the articles of the corporation are amended to adopt a new available name. For the purpose of the adoption of any such amendment, persons who have been functioning as directors of the corporation are considered to have been validly elected even though their election may have occurred after the expiration of the original term of the corporate existence [*Corp. Code §§ 5818, 7818, 9620(b)*].

[e] Amendment of Articles to Change Status of Public Benefit Corporation

A public benefit corporation may amend its articles to change its status to that of a mutual benefit, religious, business, or cooperative corporation [*Corp. Code § 5813.5(a)*]. The Secretary of State must notify the Franchise Tax Board of any amendments to a public benefit corporation's articles [*Corp. Code § 5813.5(a)*]. If the public benefit corporation has any assets, an amendment to change its status to a non-religious corporation must be approved in advance in writing by the Attorney General. If the corporation has no assets, it must give a copy of the amendment to the Attorney General at least 20 days before filing the amendment [*Corp. Code § 5813.5(b)*]. The amended articles must include the provisions that would have been required (other than the name of the initial agent for service of process if a biennial statement has been filed [*see Corp. Code § 6210*]), and may include only those provisions that would have been permitted, in original

articles filed by the type of corporation into which the public benefit corporation is changing its status [*see Corp. Code § 5813.5(c)*]. If the corporation changes to a business or cooperative corporation and the corporation was exempt from tax [*see Rev. & Tax. Code § 23701*], the corporation will become subject to tax on the filing of the certificate of amendment [*Corp. Code § 5813.5(d)*; *see Rev. & Tax. Code § 23221*].

[f] Amendment of Articles to Change Status of Mutual Benefit Corporation

A mutual benefit corporation may amend its articles to change its status to a public benefit, religious, business, or cooperative corporation [*Corp. Code § 7813.5(a)*]. When the corporation has members or directors, an amendment to change status to a public benefit or religious corporation must be approved in one of the following ways [*Corp. Code § 7813.5(b)*]:

- By the members, and the fairness of the amendment to the members must be approved by the Commissioner of Corporations [*see Corp. Code §§ 5034*, *25142*];

- By the members, in an election conducted by written ballot in which no negative votes are cast [*see Corp. Code § 7513*]; or

- By 100 percent of the voting power.

The amended articles must include the provisions that would have been required (other than the name of the initial agent for service of process if a biennial statement has been filed [*see Corp. Code § 8210*]), and may include only those provisions that would have been permitted, in original articles filed by the type of corporation into which the public benefit corporation is changing its status [*see Corp. Code § 7813.5(c)*].

If the corporation changes to a public benefit corporation, the corporation must furnish an additional copy of the certificate for forwarding to the Attorney General [*Corp. Code § 7813.5(d)*]. If the corporation changes to a business or cooperative corporation and the corporation was exempt from tax [*see Rev. & Tax. Code § 23701*], the corporation will become subject to tax on the filing of the certificate of amendment [*Corp. Code § 7813.5(e)*; *see Rev. & Tax. Code § 23221*].

[g] Amendment of Articles to Change Status of Religious Corporation

A religious corporation may amend its articles to change its status to that of a public benefit corporation, mutual benefit corporation, business corporation, or cooperative corporation, by complying with the provisions concerning amendment of articles [*Corp. Code § 9621(a)*; *see Corp. Code §§ 5810-5820*]. The amended articles must include the provisions that would have been required (other than the name of the initial agent for service of process, if a biennial statement has been filed pursuant to *Corp. Code §§ 6210* and *9660*) and, in addition, may only include those provisions that would have been permitted in the original articles filed by the type of corporation (public benefit, mutual benefit, business, or cooperative) to which the religious corporation is changing its status [*Corp. Code § 9621(b)*].

[h] Approval by Board Alone

If a corporation has no members, amendments may be adopted by the board of directors. However, if the articles require approval by any person for an amendment, that amendment may not be adopted without the required approval [*Corp. Code §§ 5812(b)(3), 7812(b)(3), 9620(a)*]. Further, the following amendments may be adopted by the approval of the board alone, even if the corporation has members [*Corp. Code §§ 5812(b), 7812(b), 9620(a)*]:

- An amendment extending the corporate existence or making the corporate existence perpetual, if the corporation was organized before August 14, 1929.

- An amendment deleting the names and addresses of the first directors or the name and address of the initial agent.

- An amendment adopted pursuant to *Corp. Code § 9913* (electing to be governed by new law not otherwise applicable).

[i] Approval by Board and Members

Except as otherwise required in *Corp. Code §§ 5813.5* and *7813*, and matters that may be approved by the board alone [*see* [h], *above*], amendments may be adopted if approved by the board and approved by the members [*Corp. Code §§ 5812(a)*, *7812(a)*, *9620(a)*]. Approval by the members generally means the approval or ratification by the affirmative vote of a majority of the votes represented and voting at a meeting at which a quorum is present (which affirmative vote also constitutes a majority of the required quorum); or similar action by written ballot [*see Corp. Code §§ 5513*, *7513*, *9413*]; or by the affirmative vote or written ballot of a specified supermajority [*Corp. Code § 5034*]. The amendments must also be approved by any other person or persons whose approval is required by the articles. The approval by the members or other person or persons may be before or after the approval by the board [*Corp. Code §§ 5812(a)*, *7812(a)*, *9620(a)*].

[j] Class Vote or Vote of Greater Proportion

Whenever the articles or bylaws require for corporate action the approval of a particular class of members or of a larger proportion of, or of all of, the votes of any class, or of a larger proportion of, or of all of, the directors, than is otherwise required by the law, the provision in the articles requiring that greater vote must not be altered, amended, or repealed except by that class or that greater vote, unless otherwise provided in the articles or bylaws [*Corp. Code §§ 5812(c)*, *7812(c)*, *9620(a)*].

[k] Amendments Affecting Voting or Merger Rights of Class

A proposed amendment to the articles of a public benefit or religious corporation must be approved by the members [*see Corp. Code § 5034*] of a class, whether or not the articles or bylaws entitle that class to vote on the amendment, if the amendment would materially and adversely affect the rights of that class as to voting or transfer in a manner different than the action affects another class [*Corp. Code §§ 5813*, *9620(a)*].

A proposed amendment to the articles of a mutual benefit corporation must be approved by the members of a class, whether or not the articles or bylaws entitle that class to vote on the amendment, if the amendment would do any of the following [*Corp. Code § 7813*]:

- Materially and adversely affect the rights, privileges, preferences, restrictions, or conditions of that class as to voting, dissolution, redemption, or transfer in a manner different than the amendment affects another class.

- Materially and adversely affect that class as to voting, dissolution, redemption, or transfer by changing the rights, privileges, preferences, restrictions, or conditions of another class.

- Increase or decrease the number of memberships authorized for that class.

- Increase the number of memberships authorized for another class.

- Effect an exchange, reclassification, or cancellation of all or part of the memberships of that class.

- Authorize a new class of memberships.

[l] Use of Alternative Forms

Under some circumstances, it may be proper to file with the Secretary of State a certificate of correction rather than a certificate of amendment. For example, a certificate of correction can be filed with the Secretary of State to correct any misstatement of facts contained in the articles, any defects in the execution of the articles, or any other errors contained in the articles [*see Corp. Code § 5007*]. For a form and a discussion of a certificate of correction of the articles of a nonprofit corporation, see *§ 13.243*.

Alternatively, directors seeking to amend a corporation's articles of incorporation [*see Corp. Code §§ 5811, 5815, 7811, 7815, 9620(a)*] may restate in a single certificate the entire text of the articles (as amended) by filing a certificate entitled "Restated Articles of Incorporation of _____ [*name of corporation*]." For further discussion, see *§ 13.262*.

[m] Execution, Filing, and Fees

The certificate of amendment, which consists of an officer's certificate, must be signed and verified by two specified officers of the corporation: the president, chair of the board [*see Corp. Code § 5039.5* ("chair" includes "chairperson," "chairman," and "chairwoman") or vice-president *and* the secretary, assistant secretary, chief financial officer, treasurer, or assistant treasurer [*see Corp. Code §§ 5062, 5814(a)*]. For purposes of this requirement, "verified" means that the statements contained in the certificate are declared to be true of the own knowledge of the officers executing the certificate in either of the following [*Corp. Code § 5076*]:

- An affidavit signed by the officers under oath before an officer authorized by the laws of the State of California or of the place where it is executed to administer oaths; or

- A written declaration executed by the officers under penalty of perjury and stating the date and place of execution.

The officers should file the original certificate and at least two copies of the certificate, and file a certified copy in the corporate records book. Amendment documents may only be filed in the Sacramento office, either by mail or hand delivery [*see* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_amdtnpinfo.htm]. If the corporation is a public benefit corporation, an additional copy must be filed for transmittal to Attorney General [*Corp. Code § 5817*].

The certificate of amendment must be accompanied by the applicable filing fee [*see Gov. Code § 12186(p)*]. The Secretary of State will compare and certify up to two copies of the amendment at no charge provided that the copies are submitted with the original to be filed [*Gov. Code § 12185*]. If additional certified copies are required, an additional minimal fee is charged, provided that the copies are furnished to the Secretary of State and the fee is prepaid [*Gov. Code §§ 12182, 12183*]. A separate and nonrefundable handling fee is charged for expedited processing of documents delivered in person, over the counter, to the Sacramento headquarters office.

[2] FORM

Certificate of Amendment of Articles of Incorporation--Officers' Certificate

CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF _____ [*name of corporation*]
_____ [*corporate number*]

The undersigned certify:

1. They are the [Chair of the Board *or* President *or* Vice-President] and the [Secretary *or* Chief financial Officer *or* Treasurer *or* Assistant Secretary *or* Assistant Treasurer], respectively, of _____[*name of corporation*], a California corporation.

2. Article [state correct designation] of the Articles of Incorporation of this corporation is amended to read as follows: [*article of incorporation as amended*].

3. The foregoing amendment has been duly approved by the Board of Directors.

[*EITHER, if amendment is one that requires approval of members:*]

4. That the amendment was approved by the required vote of the members.

[*OR, if corporation has no members:*]

4. The corporation has no members.

[*OR, if board may approve amendment without member approval, use:*]

4. The Board of Directors alone was entitled to adopt the foregoing amendment for the reason(s) that _____[*statement of facts entitling the board alone to adopt the amendment, e.g.,* the amendment is the deletion of the names and addresses of the first directors of the Corporation and Corporations Code Section _____ (5812(b)(2) *or* 7812(b)(2) *or* 9620(a)) permits that amendment to be adopted by the approval of the Board of Directors].

PRACTICE TIP

If the articles are amended pursuant to a merger, the filing of the officers' certificate and agreement of merger pursuant to either *Corp. Code § 6014* or *8014* are in lieu of any filing required under the law governing the particular nonprofit corporation involved [*Corp. Code §§ 5814(b), 7814(b), 9620(a)*].

[*If amendment requires approval of someone other than incorporators, directors, or members is required, add:*]

[5. The approval of _____ (*name(s) of person or persons*) has been obtained.]

[*Continue with the following:*]

We further declare under penalty of perjury under the laws of the State of California that the matters set forth in this certificate are true and correct of our own knowledge.

Date: _____.

_____ [*signature*]
[*typed name*], President
_____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13 NONPROFIT CORPORATIONS
PART IV. FORMS
C. Amendment of Articles of Incorporation

6-13 California Legal Forms--Transaction Guide § 13.262

§ 13.262 Restated Articles of Incorporation

[1] Comment

[a] Use of Form

This form is a certificate restating the articles of incorporation. A corporation may restate in a single certificate the entire text of its articles as amended by filing a certificate entitled "Restated Articles of Incorporation" [*see Corp. Code §§ 5819(a), 7819(a), 9620(a)*]. It is modeled after the sample form provided by the Secretary of State. Samples are also available on official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. However, the latter samples are illustrative only and cannot be filled in and submitted in the form reproduced on the website.

When existing or proposed amendments are numerous, restating the articles in their entirety may be the simplest method of correcting errors and making changes to the articles. Further, a certificate of restated articles need not itself effect a change in the articles.

Restated articles of incorporation supersede for all purposes the original articles and all previously filed amendments [*Corp. Code §§ 5819(c), 7819(c), 9620(a)*]. For a more detailed discussion of restated articles of incorporation, see Ch. 10, *Amendment of Articles* .

[b] Contents of Certificate

The certificate must set forth the articles as amended to the date of filing the certificate, except that the signatures and acknowledgments of the articles by the incorporators, any statements regarding the effect of any prior amendment on memberships, any provisions of agreements of merger (other than amendments to the articles of the surviving corporation), and the names and addresses of the first directors and the initial agent for service of process may be omitted [*Corp. Code §§ 5819(a), 7819(a), 9620(a)*]. These omissions are not alterations or amendments of the articles. However, if the corporation has not filed a biennial statement [*see § 13.248*], the names and addresses of the initial agent for service of process and, if previously set forth in the articles, the initial directors may not be omitted. The

certificate may also itself alter or amend the articles in any respect, provided that the certificate complies with the general requirements applicable to an officer's certificate [*Corp. Code §§ 5819(a), 7819(a), 9620(a)*; *see Corp. Code §§ 5814-5816, 7814-7816, 9620(a)*].

[c] Use of Alternative Forms

Under some circumstances, it may be proper to file a certificate of correction with the Secretary of State. A certificate of correction can be filed with the Secretary of State to correct any misstatement of facts contained in the articles, any defects in the execution of the articles, or any other errors contained in the articles [*see Corp. Code § 5007*]. For a form and discussion of a certificate of correction of the articles of a nonprofit corporation, see *§ 13.243*. Alternatively, the incorporators or the corporation may file a certificate of amendment to amend one or more provisions in the articles of incorporation [*see §§ 13.260, 13.261*]. When numerous amendments are being made, it may be simpler to file restated articles.

[d] Execution, Filing, and Fees

If the certificate does not itself alter or amend the articles of incorporation in any respect, and no memberships have been issued and no directors have been named or elected, the certificate must be approved by the board (or a majority of the incorporators if before the issuance of memberships and the naming of directors). The certificate is subject to the provisions of the Nonprofit Public Benefit, Mutual Benefit, or Religious Corporation Law relating to the amendment of articles not requiring approval of members [*Corp. Code §§ 5819(b), 7819(b), 9620(a)*; *see Corp. Code § 5034*]. If the certificate does itself alter or amend the articles, it is subject to the specific provisions of these laws relating to the type of amendment or amendments made [*Corp. Code §§ 5819(b), 7819(b), 9620(a)*].

If the certificate is filed by the incorporators [*see Corp. Code §§ 5811, 5815, 7811, 7815, 9620(a)*], the certificate must be signed and verified by a majority of the incorporators [*see § 13.260[1][g]*]. If the certificate is filed by corporate officers, the certificate must be signed and verified by two specified officers of the corporation: the president, chair of the board [*see Corp. Code § 5039.5* ("chair" includes "chairperson," "chairman," and "chairwoman"), or vice-president *and* the secretary, assistant secretary, chief financial officer, treasurer, or assistant treasurer [*see Corp. Code § 5062*; *see also* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_amdtnpinfo.htm]. For purposes of this requirement, "verified" means that the statements contained in the certificate are declared to be true of the own knowledge of the officers executing the certificate in either of the following [*Corp. Code § 5076*]:

- An affidavit signed by the officers under oath before an officer authorized by the laws of the State of California or of the place where it is executed to administer oaths; or

- A written declaration executed by the officers under penalty of perjury and stating the date and place of execution.

The officers should file the original certificate and at least two copies of the certificate, and file a certified copy in the corporate records book. Amendment documents may only be filed in the Sacramento office, either by mail or hand delivery [*see* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_amdtnpinfo.htm]. If the corporation is a public benefit corporation, an additional copy must be filed for transmittal to Attorney General [*Corp. Code § 5817*; *see* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_amdtnpinfo.htm].

The certificate of amendment must be accompanied by the applicable filing fee [*see Gov. Code § 12186(p)*]. The Secretary of State will compare and certify up to two copies of the amendment at no charge provided that the copies are submitted with the original to be filed [*Gov. Code § 12185*]. If additional certified copies are required, an additional minimal fee is charged, provided that the copies are furnished to the Secretary of State and the fee is prepaid [*Gov. Code §§ 12182, 12183*]. A separate and nonrefundable handling fee is charged for expedited processing of documents

delivered in person, over the counter, to the Sacramento headquarters office [*see 2 Cal. Code Reg. § 21903*; *see also* Secretary of State website at http://www.ss.ca.gov/business/corp/corp_amdtnpinfo.htm].

[2] FORM

Restated Articles of Incorporation

RESTATED ARTICLES OF INCORPORATION OF _____ [*name of corporation*]

The undersigned certify:

1. They are the president and the secretary, respectively, of _____[*name of corporation*], a California corporation.

2. The Articles of Incorporation of this corporation are amended and restated to read as follows: _____[*type the articles as amended and restated*].

3. The foregoing amendment and restatement of Articles of Incorporation has been duly approved by the board of directors.

[*EITHER*]

4. The foregoing amendment and restatement of Articles of Incorporation has been duly approved by the required vote of the members.

[*OR*]

4. The corporation has no members.

[*Continue with the following*]

We further declare under penalty of perjury under the laws of the State of California that the matters set forth in this certificate are true and correct of our own knowledge.

Date: _____.

_____ [*signature*]
[*typed name*], President
_____ [*signature*]
[*typed name*], Secretary

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawNonprofit Corporations & OrganizationsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS

6-13A California Legal Forms--Transaction Guide 13A.syn

§ 13A.syn Synopsis to Chapter 13A: NONPROFIT UNINCORPORATED ASSOCIATIONS

§ 13A.01 California Sources

[1] Constitution

[2] Statutes

[3] Regulations

[4] Attorney General Opinions

[5] Pamphlets

§ 13A.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 13A.03-13A.04 [Reserved]

§ 13A.05 Law Reviews and Periodicals

§ 13A.06 Annotations

§ 13A.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 13A.08-13A.09 [Reserved]

§ 13A.10 Governing Law

§ 13A.11 Definitions

[1] Association

[2] Nonprofit Association

[3] Labor Organization

§ 13A.12 Legal Status of Nonprofit Associations

[1] No Separate Status Apart From Members

[2] Associations Possess Attributes of Legal Entity

§ 13A.13 Formation of Association

[1] Governing Documents

[2] Contractual Effect of Governing Documents

[3] Judicial Reluctance to Exercise Jurisdiction

§ 13A.14 Trademarks and Trade Names

§ 13A.15 Names and Insignia

[1] Registration

[2] Penalties for Improper Use

§§ 13A.16-13A.29 [Reserved]

§ 13A.30 Powers of Association Regarding Property

§ 13A.31 Recordkeeping and Reporting Requirements

[1] Maintaining Copies of Organizational Documents

[2] Optional Filing of Statement Designating Principal Office and Agent for Service of Process

[a] Contents of Statement

[b] Effect of Filing Statement

[c] Amending Statement

[d] Expiration of Statement

[e] Resignation or Revocation of Designated Agent

[f] Certificate of Registration

§ 13A.32 Execution Requirements

[1] Real Property Conveyances

[2] Recordation

§ 13A.33 Rights and Duties of Members

[1] Admission

[2] Rights and Obligations

[a] Judicial Policy to Abstain From Oversight

[b] Membership

[c] Property of Association

[d] Voting Rights

[3] Termination of Membership

[a] Termination by Operation of Law or According to Contract Terms

[b] Withdrawal or Resignation

[c] Expulsion and Suspension

[d] Judicial Relief; Exhaustion of Remedies

[e] Effect of Termination

§ 13A.34 Amending Governing Documents

§ 13A.35 Insurance Considerations and Liability Issues

[1] Need for Insurance

[2] Liability of Association

[3] Liability of Members

[a] Member's Liability for Debts

[b] General Rule for Tort and Non-Real-Estate Contractual Liability

[4] Liability of Directors, Officers, and Agents

[5] Volunteer Directors and Officers of Nonprofit Medical Associations

[a] Requirements for Nonliability for Money Damages

[b] Exceptions to Limitations on Liability

[6] Members of Medical Societies

[7] Volunteer Protection Act of 1997

§ 13A.36 Regulation by Attorney General

§ 13A.37 Securities Law

§ 13A.38 Tax Considerations

[1] Nonprofit Associations Subject to Income Tax Unless Exempt

[2] Charitable Gifts

[a] Gifts Generally Deductible from Income

[b] Documentation Requirements

§ 13A.39 Entity Changes

[1] Conversions

[2] Merger

[a] Merger Procedure

[b] Effect of Merger

[c] Recordation of Real Property

[3] Dissolution

[a] Voluntary Dissolution

[b] Dissolution by Superior Organization

[c] Dissolution by Court Decree

§§ 13A.40-13A.99 [Reserved]

§ 13A.100 Facts

Scope

§ 13A.101 Documents

Scope

§§ 13A.102-13A.109 [Reserved]

§ 13A.110 Fictitious Business Statement

Scope

§ 13A.111 Securities Compliance

Scope

§§ 13A.112-13A.119 [Reserved]

§ 13A.120 Forming Association

Scope

§§ 13A.121-13A.129 [Reserved]

§ 13A.130 Articles of Association

Scope

§ 13A.131 Bylaws

Scope

§§ 13A.132-13A.199 [Reserved]

§ 13A.200 Articles of Organization

[1] Comment

[a] Use of Form

[b] Purposes of Association

[c] Internal Organization

[d] Amendment

[e] Construction

[f] Dedication and Distribution Provisions

[g] Statutory Governance Provisions

[2] FORM

Articles of Organization

§ 13A.201 Bylaws of Unincorporated Nonprofit Association

[1] Comment

[a] Use of Form

[b] Contents

[c] Arbitration of Member Disputes

[d] Rights of Members to Inspect Association Records

[e] Construction

[2] FORM

Bylaws of Unincorporated Nonprofit Association

§ 13A.202 Registration of Nonprofit Unincorporated Association [LP/UNA 128]

[1] Comment

[a] Use of Form

[b] Filing Requirements

[c] No Discretion to Deny Registration if Filing Proper

[d] Issuance of Certificate

[e] Amendment and Cancellation

[2] FORM

Registration of Nonprofit Unincorporated Association [LP/UNA 128]

§ 13A.203 Statement by Unincorporated Association of Address of Principal Office and Designation of Agent for Service or Process [UA-100]

[1] Comment--Use of Form

[2] FORM

Statement by Unincorporated Association of Address of Principal Office and Designation of Agent for Service or Process [UNA-100]

§ 13A.204 Contract for Assumption of Liability by Member

[1] Comment--Use of Form

[2] FORM

Contract for Assumption of Liability by Member



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS

6-13A California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter covers the formation and operation of nonprofit unincorporated associations formed under and subject to the California law. The Transaction Guide discusses the procedural approach to the formation of nonprofit associations and includes coverage regarding the preparation articles of association and bylaws. The chapter includes forms for these instruments, as well as a form for registering the name and/or insignia of the association.

Nonprofit corporations are covered in Ch. 13, *Nonprofit Corporations* . Federal and state tax matters, including applications for exemption, are discussed in Ch. 13B, *Tax-Exempt Status for Nonprofit Entities* . The role of counsel in starting a new business is covered in Ch. 1A, *Role of Counsel in Starting a New Business* . The regulation of employers and employees benefits are discussed in Ch. 1C, *Regulation of Employers* , and Ch. 1D, *Overview of Employee Benefits* , respectively. Insurance considerations applicable to general corporations are covered in Ch. 1F, *Insurance Considerations in Business Formation* . Foreign associations are discussed in Ch. 12B, *Foreign Corporations and Associations* . The issuance of securities, including qualification and exemption, is discussed in Chs. 6-6J.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

6-13A California Legal Forms--Transaction Guide § 13A.01

§ 13A.01 California Sources

[1] Constitution

Taxes and exemptions. *Cal. Const., art. XIII, §§ 3-5*.

[2] Statutes

Trademarks and trade names.

Registration.*Bus. & Prof. Code §§ 14200-14272*.

Labor unions. *Bus. & Prof. Code §§ 14003, 14004; Labor Code § 1014*.

Registration of organizational name. *Bus. & Prof. Code § 14492*.

Power to sue and be sued in own name. *Code Civ. Proc. § 369.5(a)*.

Service of process. *Code Civ. Proc. §§ 412.30, 416.40*.

"Governing documents" of unincorporated association defined. *Corp. Code § 18008*.

"Governing principles" of unincorporated association defined. *Corp. Code § 18010*.

"Nonprofit association" defined. *Corp. Code § 18020*.

"Unincorporated association" defined. *Corp. Code § 18035*.

"Labor organization" defined. *Corp. Code § 18055(e)*.

Member's interest is personal property. *Corp. Code § 18100*.

Power to own, encumber, and transfer property. *Corp. Code § 18105*.

Execution of conveyances. *Corp. Code § 18115*.

Governance of unincorporated associations. *Corp. Code § 18300 et seq.*

Membership termination and suspension. *Corp. Code §§ 18310, 18320*.

Membership voting. *Corp. Code § 18330*.

Amending governing documents. *Corp. Code § 18340*.

Merger. *Corp. Code §§ 18350-18400*.

Dissolution. *Corp. Code §§ 18410, 18420*.

Liability of members for association's debts. *Corp. Code §§ 18605, 18610, 18630*.

Tort liability of members, directors, officers, and agents. *Corp. Code § 18620*.

Medical society. *Corp. Code § 21200*.

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"Insignia" defined. *Corp. Code § 21300(b)*.

Registration of name or insignia; penalties for improper use. *Corp. Code §§ 21301-21310*.

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Joint stock associations. *Corp. Code §§ 22000-22003*.

Limited liability of volunteer directors and officers of nonprofit medical associations. *Corp. Code § 24001.5*.

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Membership in unincorporated association is within meaning of "security." *Corp. Code § 25019*.

When membership in unincorporated association is exempt from permit requirements. *Corp. Code § 25100(j)*.

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"Property" defined. *Rev. & Tax. Code § 103*.

Interests included within meaning of terms "real estate" and "real property." *Rev. & Tax. Code § 104*.

"Improvements" defined. *Rev. & Tax. Code § 105*.

"Personal property" defined. *Rev. & Tax. Code § 106*.

"Possessory interests" defined. *Rev. & Tax. Code §§ 107, 107.1*.

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[3] Regulations

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[4] Attorney General Opinions

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Reorganization of statewide nonprofit association as nonprofit corporation. *69 Ops. Cal. Atty. Gen. 130 (1986)* .

School districts may permit sale of school supplies to private individuals and nonprofit and other organizations when property is not required for public school purposes or activities. *60 Ops. Cal. Atty. Gen. 184 (1977)* .

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

6-13A California Legal Forms--Transaction Guide § 13A.02

§ 13A.02 Federal Sources

[1] Statutes

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[2] Regulations

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

6-13A California Legal Forms--Transaction Guide §§ 13A.03-13A.04

[Reserved]

§§ 13A.03[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

6-13A California Legal Forms--Transaction Guide § 13A.05

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

6-13A California Legal Forms--Transaction Guide § 13A.06

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

6-13A California Legal Forms--Transaction Guide § 13A.07

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Ch. 2, *Formation of Corporations*.

Ch. 3, *Articles of Incorporation*.

Ch. 4, *Bylaws*.

Ch. 6, *Securities Regulation Issues*.

Ch. 12B, *Foreign Corporations and Associations*.

Ch. 13, *Nonprofit Corporations*.

Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

6-13A California Legal Forms--Transaction Guide §§ 13A.08-13A.09

[Reserved]

§§ 13A.08[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Formation of Association

6-13A California Legal Forms--Transaction Guide § 13A.10

§ 13A.10 Governing Law

Prior to 2006, unincorporated associations were subject to few statutory requirements as to formation and operations. However, in 2005 the legislature enacted detailed legislation relating to the governance of unincorporated associations. This legislation is designed to establish general rules regarding member voting, membership termination and suspension, amending governing documents, merger, and dissolution [*see Corp. Code § 18300 et seq.*]. Because unincorporated associations are defined to include nonprofit organizations [*Corp. Code §§ 18020(a), 18035(a); see § 13A.11[1]*], these statutes apply to nonprofit associations.

The Corporations Code also contains a few statutes expressly applicable to nonprofit associations [*see Corp. Code § 18605 et seq.*]. These statutes deal primarily with liability issues [*see Corp. Code §§ 18605-18630*] and the registration and use of names and insignia [*see Corp. Code §§ 21300 et seq.*].

Under *Corp. Code § 18060*, if a statute specific to a particular type of unincorporated association is inconsistent with a general provision of Title 3 on unincorporated associations, the specific statute prevails to the extent of the inconsistency. For example, the statutes providing specific rules for amendment of the governing documents of a homeowners' association [*see Civ. Code §§ 1355, 1356*] will prevail over the general rules in *Corp. Code § 18340* applicable to the amendment of the governing documents of unincorporated associations [Unincorporated Association Governance, 34 Cal. L. Revision Com'n Reports 231, 236 (2004)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Formation of Association

6-13A California Legal Forms--Transaction Guide § 13A.11

§ 13A.11 Definitions

[1] Association

The word "association," as applied to organizations in everyday parlance, means an organization of persons having a common interest; a society [*see* Webster's New Collegiate Dictionary (8th ed.); *see also* Black's Law Dictionary]. The word has the same general meaning in law and has been applied to state institutions [*see Food & Agric. Code § 3802* (district agricultural associations)] and instrumentalities [*see Food & Agric. Code §§ 4602, 4701* (citrus fruit fair association)], to nonprofit corporations [*see Food & Agric. Code §§ 4602* (citrus fruit fair association), 54002], to for-profit corporations [*see Fin. Code § 5057* (savings and loan association)], and to unincorporated associations [*see Corp. Code § 21300(a)*]. For the purposes of the federal income tax, the word "association" means an organization that is taxed as a corporation, even if it is not incorporated as such [*see Treas. Reg. §§ 301.7701-2(b)(2),* 301.7701-3]. The Internal Revenue Code defines the word "corporation" to include an association [*I.R.C. § 7701(a)(3)*]. Use of the word "association" in an organization's name, without more, will not disclose the incorporated or unincorporated status of the organization.

As used in this chapter, the term "association" is used to refer to unincorporated associations, unless the context requires otherwise.

[2] Nonprofit Association

A "nonprofit association" is defined as an unincorporated association with a primary common purpose other than to operate a business for profit [*Corp. Code § 18020(a)*]. An "unincorporated association" is an unincorporated group of two or more persons joined by mutual consent for a common lawful purpose, whether organized for profit or not [*Corp. Code § 18035(a)*; *see Barr v. United Methodist Church (1979) 90 Cal. App. 3d 259, 264-267, 153 Cal. Rptr. 322]* . Typical examples of unincorporated associations include labor unions, social clubs, religious organizations, environmental societies, athletic organizations, condominium owners, lodges, and veterans' groups.

The term "association" includes, for the purpose of registering insignia, any lodge, order, beneficial association, fraternal or beneficial society or association, any historical, military, or veterans' organization, labor union, foundation

or federation, or any other society, organization, or association, or any degree, branch, subordinate lodge, or auxiliary [*Corp. Code § 21300*]. Illustrations of other nonprofit purposes can be found by examining the various statutes relating to tax exemptions [*see, e.g., I.R.C. § 501*; *Rev. & Tax. Code §§ 202-227*, *23701a-23701x*; see Ch. 13B, Tax-Exempt *Status for Nonprofit Entities*] and from statutes relating to nonprofit corporations [*see Corp. Code § 5000 et seq.*; *see also* Ch. 13, *Nonprofit Corporations*].

[3] Labor Organization

A "labor organization" is defined to mean any organization of any kind, or any agency or employee representation committee or plan, in which employees participate and that exists for the purpose, in whole or in part, of dealing with employers concerning grievances, labor disputes, wages, compensation rates, hours of employment, or work conditions [*Corp. Code § 18055(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Formation of Association

6-13A California Legal Forms--Transaction Guide § 13A.12

§ 13A.12 Legal Status of Nonprofit Associations

[1] No Separate Status Apart From Members

A nonprofit association has no legal existence apart from its members. In legal effect, each member becomes both a principal and an agent as to all other members for the actions of the group itself [*Marshall v. International Longshoremen's & Warehousemen's Union (1962) 57 Cal. 2d 781, 783-784, 22 Cal. Rptr. 211, 371 P.2d 987* (each member is both principal and agent as to all other members for actions of association)].

[2] Associations Possess Attributes of Legal Entity

Although California associations and nonprofit associations are not accorded the same separate legal status as a corporation, associations nevertheless possess some attributes of a legal entity [*see White v. Cox (1971) 17 Cal. App. 3d 824, 828, 95 Cal. Rptr. 259* (general recognition of separate legal status)]. For example, associations possess the following attributes:

- An association may sue and be sued in its own name [*Code Civ. Proc. § 369.5(a)*; *see Clean Air Transp. Sys. v. San Mateo County Transit Dist. (1988) 198 Cal. App. 3d 576, 578-579 . 243 Cal. Rptr. 799 , cert. denied, 488 U.S. 862]* .

- Only the association's property may be levied on under a writ of execution issued to enforce a money judgment [*Corp. Code § 18260*; *see Corp. Code § 18135(a)* (execution against distributed assets)].

- An association may register its trademark, trade name, and insignia with the Secretary of State [*Bus. & Prof. Code §§ 14003, 14004, 14200 et seq.*; *Lab. Code § 1014* (trademarks and trade names); *Corp. Code § 21300 et seq.*; *Bus. & Prof. Code § 14492, 14492.5* (names and insignia); *see Gov. Code §§ 12191(b)(2)* (insignia), 12193(a) (trademark), (f) (organizational name); *see also §§ 13A.14, 13A.15*].

- An association may be the object of unfair competition [*see Bus. & Prof. Code § 17200 et seq.*; *see also Most Worshipful Hiram of Tyre Grand Lodge v. The Most Worshipful Sons of Light Grand Lodge*

(1949) 94 Cal. App. 2d 25, 32, 210 P.2d 34 .

- An association may be taxed as a corporation [*see I.R.C. § 7701(a)(3)*; *Treas. Reg. §§ 301.7701-1(b)(2)*, 301.7701-3; *Rev. & Tax. Code § 23038*; *see § 13A.38*; *see also* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*].

- The members of an association are not individually or personally liable for its contractual debts or liabilities relating to real property [*Corp. Code §§ 18605, 18610, 18630*; *see § 13A.35*].

- Associations are expressly authorized to purchase, hold, lease, encumber, and sell property in their own names [*Corp. Code § 18105*].

- Associations may receive transfers of property for their own use or in trust [*Corp. Code §§ 18105* (medical associations); *see Rev. & Tax. Code § 15442* (property received by charitable associations)].

- Associations may receive property by testamentary disposition for their own use or in trust [*Corp. Code § 18105*; *Prob. Code § 27*; *see Rev. & Tax. Code § 13842* (bequests and devises to charitable associations)].

- Associations may enter into any of the commercial transactions governed by the Commercial Code [*see* Com. Code § 1201(b)(25)-(27) ("organization" is person other than individual, "person" includes association, and "party" includes "person")

- Unincorporated labor unions may enter into collective bargaining agreements [*see Labor Code § 1126*].

- Certain associations may be the object of, and may sue for, defamation [*see Daniels v. Sanitarium Ass'n, Inc. (1963) 59 Cal. 2d 602, 604-609, 30 Cal. Rptr. 828, 381 P.2d 652* (labor union); *Washburn v. Wright (1968) 261 Cal. App. 2d 789, 68 Cal. Rptr. 224* (nonprofit trust formed under law of sister state, but defamation not established); *see also Marshall v. International Longshoremen's & Warehousemen's Union (1962) 57 Cal. 2d 781, 784-787, 22 Cal. Rptr. 211, 371 P.2d 987* (reviewing cases and holding that member of labor union may sue union for negligent acts that member neither participated in nor authorized, and that judgment, if any, can be satisfied from funds and property of union alone); *DeMille v. American Fed'n of Radio Artists (1947) 31 Cal. 2d 139, 149, 187 P.2d 769* ; *Berkeley Teachers Ass'n v. Board of Educ. of Berkeley Unified School Dist. (1967) 254 Cal. App. 2d 660, 669, 62 Cal. Rptr. 515]* .

- The interest of a member of an unincorporated association, like that of a shareholder in a corporation, is personal property [*Corp. Code § 18100*].

- Under specified circumstances, an association may be taxed as a corporation [*see I.R.C. § 7701(a)(3)*; *Treas. Reg. §§ 301.7701-1*, 301.7701-2; *Rev. & Tax. Code § 23038*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawAgency RelationshipsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsCivil ProcedureRemediesWritsAncillary WritsWrits of ExecutionTrademark LawProtection of RightsRegistrationGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Formation of Association

6-13A California Legal Forms--Transaction Guide § 13A.13

§ 13A.13 Formation of Association

[1] Governing Documents

The formalities of quasi-corporate organization are not required for nonprofit unincorporated associations [*Law v. Crist (1940) 41 Cal. App. 2d 862, 865, 107 P.2d 953]* . Nonprofit associations typically exist by virtue of an agreement among the members that is generally embodied in a constitution or articles of association and bylaws. However, although clearly advisable, nonprofit associations are not required to execute these documents [*see People v. Cohen (1925) 71 Cal. App. 367, 372, 235 P. 658* (no presumption that unincorporated association has written articles of association, partnership, or otherwise); *see also Orser v. George (1967) 252 Cal. App. 2d 660, 670, 60 Cal. Rptr. 708* (loosely organized duck club treated as association despite lack of written agreement, constitution, bylaws, or officers, and only one meeting)]. Organizational documents may be simple or complex, depending on the size and nature of the association. Associations vary in size from loosely organized local bridge clubs or bird-watchers' associations to very large associations, such as labor unions, vying in size and power with corporations.

Nonprofit associations may adopt governing documents, defined to include a constitution, articles of association, bylaws, or other writing that governs the purpose or operation of an unincorporated association or the rights or obligations of its members [*Corp. Code § 18008*]. The governing principles of a nonprofit association are those principles stated in the unincorporated association's governing documents. If an association has no governing documents, or the governing documents do not contain a provision governing an issue, the association's governing principles regarding that issue may be inferred from its established practices. The term "established practices" means the practices used by an unincorporated association without material change or exception during the most recent five years of its existence, or if it has existed for less than five years, during its entire existence [*Corp. Code § 18010*].

The Corporations Code provides mandatory and default statutes covering the governance of nonprofit associations [*Corp. Code § 18300 et seq.*]. These statutes should be consulted when drafting the governing document. For example, *Corp. Code § 18310*, which addresses the termination and suspension of membership, only applies when the unincorporated association's governing documents are silent [*see § 13A.33[3][a], [e]*]. Other statutes, however, provide mandatory rules, either to guarantee minimal fairness [*see Corp. Code § 18320* (expulsion of members); *see also §*

13A.33[3][c], [e]] or to standardize relations with other organizations [*see Corp. Code § 18360 et seq.* (merger); *see also § 13A.39[2]*].

The governing documents will vary in content depending on the purposes of the association, its powers, and its property. The governing documents should spell out these matters. The governing documents should identify those persons (usually the governing board, if any, directors, and officers) who are authorized to act on behalf of the association. In the case of large associations, these documents should address the qualifications, admission, election, or appointment, withdrawal, suspension, and expulsion of members, their liabilities to dues and assessments, any different classes of membership, and the property, voting, and other rights, interests, or privileges, of the members or classes of members, the manner of transfer, forfeiture, and termination of membership, as well as other matters concerning the internal affairs of the association, and the manner of amending the governing documents.

[2] Contractual Effect of Governing Documents

The articles of association or constitution, the bylaws, and any rules adopted pursuant to these documents constitute a contract between the nonprofit unincorporated association and its members [*California Dental Assn. v. American Dental Assn. (1979) 23 Cal. 3d 346, 353, 152 Cal. Rptr. 546, 590 P.2d 401* ; *see Weber v. Marine Cooks' & Stewards' Ass'n (1949) 93 Cal. App. 2d 327, 334-335, 208 P.2d 1009* ; *Lawson v. Hewell (1897) 118 Cal. 613, 618-619, 50 P. 763* ; *Berke v. Tri Realtors (1989) 208 Cal. App. 3d 463, 469, 257 Cal. Rptr. 738*); *but see Gonzales v. International Ass'n of Machinists (1956) 142 Cal. App. 2d 207, 211, 298 P.2d 92 , aff'd, 356 U.S. 617, 78 S. Ct. 923, 2 L. Ed. 2d 1018]* . This contract determines the rights and duties of the members, as between the association and the members and between the members. However, these documents do not bind the association in its relations to others [*see Most Worshipful Sons v. Sons (1958) 160 Cal. App. 2d 560, 325 P.2d 606* ; *Most Worshipful Hiram of Tyre Grand Lodge v. The Most Worshipful Sons of Light Grand Lodge (1949) 94 Cal. App. 2d 25, 30, 210 P.2d 34* .]

[3] Judicial Reluctance to Exercise Jurisdiction

Courts traditionally are reluctant to intervene and exercise jurisdiction over disputes in which a member's rights and obligations under the charter documents in relation to the association are at issue [*California Dental Assn. v. American Dental Assn. (1979) 23 Cal. 3d 346, 353, 152 Cal. Rptr. 546, 590 P.2d 401]* . This hesitancy reflects the view that the resulting judicial burdens outweigh the interests of aggrieved parties and that courts should not unduly interfere with an association's autonomy by substituting judicial judgment for that of the association, particularly when the court's competence is not equal to that of the association [*California Dental Assn. v. American Dental Assn. (1979) 23 Cal. 3d 346, 353-354, 152 Cal. Rptr. 546, 590 P.2d 401* ; *Berke v. Tri Realtors (1989) 208 Cal. App. 3d 463, 466-468, 257 Cal. Rptr. 738*)].

Courts will overcome their reluctance when the aggrieved party can demonstrate an abuse of discretion and a clear, unreasonable, and arbitrary invasion of that party's private rights [*California Dental Assn. v. American Dental Assn. (1979) 23 Cal. 3d 346, 354, 152 Cal. Rptr. 546, 590 P.2d 401* ; *Berke v. Tri Realtors (1989) 208 Cal. App. 3d 463, 466-468, 257 Cal. Rptr. 738*); *see* Mandracio v. Bartenders Union, Local 41 *(1953) 41 Cal. 2d 81, 85, 256 P.2d 927* (court not bound by unreasonable construction of unambiguous article)]. When the challenged action clearly contravenes the charter documents, courts will balance the interest in protecting the party's rights against infringing on the association's autonomy against the judicial burden of interference in settling the dispute [*Berke v. Tri Realtors (1989) 208 Cal. App. 3d 463, 467-470, 257 Cal. Rptr. 738*); *California Trial Lawyers Assn. v. Superior Court (1986) 187 Cal. App. 3d 575, 580, 231 Cal. Rptr. 725* ; *see California Dental Assn. v. American Dental Assn. (1979) 23 Cal. 3d 346, 350, 152 Cal. Rptr. 546, 590 P.2d 401*] Thus, when the issue presented is whether the parent association's decision overruling the local chapter's decision to expel a member plainly violated the parent's own bylaws and the judicial burden and the national association's interest did not outweigh that of the local, the court could properly exercise jurisdiction [*California Dental Assn. v. American Dental Assn. (1979) 23 Cal. 3d 346, 354-355, 152 Cal. Rptr. 546, 590 P.2d 401*]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawUnincorporated AssociationsCivil ProcedureJurisdictionJurisdictional SourcesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Formation of Association

6-13A California Legal Forms--Transaction Guide § 13A.14

§ 13A.14 Trademarks and Trade Names

A nonprofit unincorporated association or union may register trademarks or trade names meeting the statutory requirements with the Secretary of State under the Model State Trademark Law [*Bus. & Prof. Code § 14200 et seq.*; *see Bus. & Prof. Code §§ 14003, 14004* (labor unions); *Labor Code § 1014* (labor unions)]. An application for registration must be accompanied by a filing fee payable to the Secretary of State [*Bus. & Prof. Code § 14207*; *see Gov. Code § 12193(a) (fee)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawUnincorporated AssociationsTrademark LawProtection of RightsRegistrationGeneral OverviewTrademark LawProtection of RightsRegistrationConstructive NoticeTrademark LawSubject MatterNamesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Formation of Association

6-13A California Legal Forms--Transaction Guide § 13A.15

§ 13A.15 Names and Insignia

[1] Registration

In addition to the registration of trademarks and trade names [*see § 13A.13*], any association, the principles and activities of which are not repugnant to the Constitution or laws of the United States or California, may register with the Secretary of State a facsimile or description of its name or insignia, and may by reregistration alter or cancel it [*Corp. Code § 21301*; *see Bus. & Prof. Code §§ 14492*, *14492.5*; *see Gov. Code § 12193(f)* (registration fee for organizational name)]. "Insignia" includes a badge, motto, button, decoration, charm, emblem, or rosette [*Corp. Code § 21300(b)*]. However, an association may not register any name or insignia similar to or so nearly resembling another name already registered as may be likely to deceive [*Corp. Code § 21302*; *see Bus. & Prof. Code § 14492(b)*].

The application for registration, alteration, or cancellation is made by the chief officer or officers of the association on a form provided by the Secretary of State [*Corp. Code § 21303*; *see § 13A.202*]. The application for registration must be accompanied by the applicable fee [*Corp. Code § 21304*; *see Gov. Code § 12191(b)(2) (fee)*].

On registration, the Secretary of State will issue a certificate setting forth the fact of registration [*Corp. Code § 21305*]. The Secretary must keep a properly indexed record of the registration, which must show any altered or canceled registration [*Corp. Code § 21306*]. The registration is for the use and benefit and on behalf of the association, the individual members, and those who become members [*Corp. Code § 21303*].

[2] Penalties for Improper Use

The unauthorized and willful wearing, exhibiting, or using of a registered name or insignia is a misdemeanor punishable by fine or imprisonment [*Corp. Code § 21307*]. The unauthorized use may be enjoined by any court of competent jurisdiction [*Corp. Code § 21308*; *see Bus. & Prof. Code § 14493*]. In any action seeking an injunction, it is not necessary to allege or prove actual damages, actual injury, or the threat of actual damages or injury. However, a plaintiff may recover the amount of any actual damages sustained by the plaintiff in addition to injunctive relief [*Corp. Code § 21309*; *see Corp. Code § 21310* (evidence); *see also Bus. & Prof. Code § 14494*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTrademark LawProtection of RightsRegistrationGeneral OverviewTrademark LawSpecial MarksTrade NamesRegistrationTrademark LawSubject MatterNamesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
A. Formation of Association

6-13A California Legal Forms--Transaction Guide §§ 13A.16-13A.29

[Reserved]

§§ 13A.16[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Operations

6-13A California Legal Forms--Transaction Guide § 13A.30

§ 13A.30 Powers of Association Regarding Property

Associations are expressly authorized to purchase, hold, lease, encumber, and sell property in their own names [*Corp. Code §§ 18115, 21200*]. The association owns its property and its governing board may make use or dispose of the property as authorized in its constitution and bylaws. This authority follows from the rule that the interest of a member of an unincorporated association is personal property [*Corp. Code § 18100*] and that members have no interest in the property held by the association.

An unincorporated association that is an organized medical society limiting its membership to licensed physicians and surgeons and having as members at least 25 percent of the eligible physicians and surgeons residing in the area in which it functions (which must be at least one county) may also, without incorporation, purchase, receive, own, hold, lease, mortgage, pledge, encumber by deed of trust or otherwise, manage, and sell all the real estate and other property that may be convenient for the purposes and objectives of the association. However, if the association has less than 100 members, it must have as members at least a majority of the eligible physicians and surgeons in the geographic area served by the association [*Corp. Code § 21200*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsContracts LawTypes of ContractsLease AgreementsGeneral OverviewReal Property LawPurchase & SaleGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Operations

6-13A California Legal Forms--Transaction Guide § 13A.31

§ 13A.31 Recordkeeping and Reporting Requirements

[1] Maintaining Copies of Organizational Documents

Nonprofit associations need to maintain a copy of their organizational documents, such as the articles of organization or constitution and bylaws, available for inspection at reasonable times. Nonprofit associations need to maintain membership lists and minutes of meetings of the board and members.

When actions are taken based on the written consent of the board or the members, those consents must be filed with the minutes or the association's records book. Similarly, all waivers must be filed.

[2] Optional Filing of Statement Designating Principal Office and Agent for Service of Process

[a] Contents of Statement

An unincorporated nonprofit association may file with the Secretary of State a statement containing either of the following [*Corp. Code § 18200(a), (b)*]:

- A statement designating the location and complete address of the association's principal office in California.

- A statement (1) designating the location and complete address of the association's principal office in California or, if the association does not have an office in California, designating the complete address of the association to which the Secretary of State will send any notices required to be sent to the association [*see Corp. Code §§ 18210* (resignation of agent), 18215 (expiration of statement)], and (2) designating as agent of the association for service of process any natural person residing in California or any corporation that has complied with *Corp. Code § 1505* and whose capacity to act as an agent has not terminated. If a natural person is designated as agent for service of process, the statement must include the person's complete business or residence address; if a corporate agent is designated, no address may be stated [*Corp. Code § 18200(b)*].

[b] Effect of Filing Statement

The presentation for filing of this statement, and one copy, together with the applicable filing fee [*see Gov. Code § 12191(b)(1)*], and acceptance of the statement by the office of the Secretary of State constitutes filing. The Secretary of State will note on the copy of the statement the file number and the date of filing of the original and deliver or send the copy to the unincorporated association filing the statement [*Corp. Code § 18200(c), 18205(b)*].

Secretary of State Form 100 is used for filing this statement. For an illustration of this form, see *§ 13A.203*.

Delivery by hand of a copy of any process against the association to the designated agent constitutes valid service on the association [Corp. Code § 24200(e)].

[c] Amending Statement

An unincorporated association that has filed this statement may file a new statement at any time that supersedes the last previously filed statement. If the new statement does not designate an agent for service of process, the filing of the new statement will be deemed to revoke the designation of any previously designated agent [*Corp. Code § 18200(d)*].

[d] Expiration of Statement

The statement expires five years from December 31 following the date that it was filed in the office of the Secretary of State, unless previously superseded by the filing of a new statement [*Corp. Code § 18200(d)*]. Between the first day of October and the first day of December immediately preceding the expiration date of the statement, the Secretary of State will send by first class mail a notice to the unincorporated association at the address stated in the filed statement. The notice will indicate the date on which the statement will expire and the file number assigned to the statement. Neither the failure of the Secretary of State to mail this notice, nor the failure of the notice to reach the unincorporated association, extends the effectiveness of the statement after the date of its expiration. Neither California nor any of its officers or employees will be held liable for damages for failure to mail this notice [*Corp. Code § 18215*].

[e] Resignation or Revocation of Designated Agent

An agent designated by an unincorporated nonprofit association for the service of process may file with the Secretary of State a written statement of resignation. The statement must be signed and its execution duly acknowledged by the agent. After filing the statement, the authority of the agent to act as agent for the association ceases. The Secretary of State will give written notice of the filing by mail to the association at the address set forth in the statement filed by the association [*Corp. Code § 18210(a)*].

An unincorporated nonprofit association may at any time file with the Secretary of State a revocation of a designation of an agent for service of process. The revocation is effective on filing [*Corp. Code § 18210(b)*].

Notwithstanding any preceding resignation or revocation, service made on an agent designated by an association for service of process in the prescribed manner [*see* [a], *above*] is effective if made within 30 days after the statement of resignation or the revocation is filed in the office of the Secretary of State [*Corp. Code § 18210(c)*].

[f] Certificate of Registration

On the request of any person and payment of the applicable filing fee [*see Corp. Code § 18205(c)*; *Gov. Code § 12183*], the Secretary of State will issue a certificate showing whether any presently effective statement designating the principal office or agent for service of process is on file for a nonprofit association using the specific name designated by the person making the request. If a presently effective statement is on file, the certificate will include the name of the association, the file number, the address of the association designated in the statement, and the name of any corporation

designated as agent or the named and address of any individual designated as agent [*Corp. Code § 18205(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Operations

6-13A California Legal Forms--Transaction Guide § 13A.32

§ 13A.32 Execution Requirements

[1] Real Property Conveyances

The acquisition, transfer, or encumbrance of an interest in real property by an unincorporated association must be executed by the president and the secretary, or other comparable officers, or by a person specifically designated by a resolution adopted by the association, committee, or other person authorized to act by the association's governing principles [*Corp. Code § 18115*; *see* Ch. 27, *Deeds and Recording* (unincorporated association deed)].

[2] Recordation

An unincorporated association may record a verified and acknowledged statement of authority in any county in which it has an interest in real property, stating the association's name and the name, title, or capacity of each officer (or other person) authorized to act on the association's behalf to acquire, transfer, or encumber real property [*Corp. Code § 18120(a)*; *see Corp. Code § 18120(b)* (revocation)]. This statement, duly recorded, creates a conclusive presumption in favor of a bona fide transferor, purchaser, or encumbrancer for value that the persons designated in the statement are authorized to execute conveyances on the association's behalf [*Corp. Code § 18120(c)*]. However, this presumption does not apply if, before the transfer, aqcuisition, or encumbrance, either of the following occurred [*Corp. Code § 18120(d)*]:

- The unincorporated association revoked the statement of authority [*see Corp. Code § 18120(b)*].

- A person claiming to be a member, director, or officer recorded a verified and acknowledged document, in the proper county, stating that the statement of authority is erroneous or unauthorized [*Corp. Code § 18120(d)(2)*; *see* Ch. 27, *Deeds and Recording* (unincorporated association deed)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawUnincorporated AssociationsReal Property LawDeedsGeneral OverviewReal Property

LawPriorities & RecordingGeneral OverviewReal Property LawPurchase & SaleGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Operations

6-13A California Legal Forms--Transaction Guide § 13A.33

§ 13A.33 Rights and Duties of Members

[1] Admission

Membership in a voluntary nonprofit unincorporated association is a privilege rather than an enforceable right. In general, admission may be granted or denied at the association's pleasure. Courts will not interfere to compel admission regardless of the arbitrariness or injustice of the rejection [*Kronen v. Pacific Coast Soc'y of Orthodontists (1965) 237 Cal. App. 2d 289, 300-302, 46 Cal. Rptr. 808 , cert. denied, 384 U.S. 905 (1965)]* . For example, an associate member does not acquire a contractual right to active membership based simply on associate membership status. Under a bylaw provision requiring five years of associate membership to qualify for active membership and activation within one year of being eligible for active status, the associate membership terminated automatically when the member failed to apply for active membership [*Kronen v. Pacific Coast Soc'y of Orthodontists (1965) 237 Cal. App. 2d 289, 302, 46 Cal. Rptr. 808 , cert. denied, 384 U.S. 905* (distinguishing between exclusion and expulsion)].

However, this general rule does not apply to labor unions and professional societies, as distinguished from clubs and fraternal associations, if membership is essential to the right to earn a living [*Kronen v. Pacific Coast Soc'y of Orthodontists (1965) 237 Cal. App. 2d 289, 300-302, 46 Cal. Rptr. 808 , cert. denied, 384 U.S. 905* (professional association of orthodontists); *James v. Marinship Corp. (1944) 25 Cal. 2d 721, 731, 155 P.2d 329* (labor union)]. Further the rule does not apply if association membership, while not strictly economically essential, is a practical necessity for anyone desiring to make a good living or reach maximum potential in a given field [*Pinsker v. Pacific Coast Soc'y of Orthodontists (1969) 1 Cal. 3d 160, 164-166, 81 Cal. Rptr. 623, 460 P.2d 495]* . In these cases, an applicant for membership has the right to have the application considered in a manner that satisfies the fundamental requirements of due process [*Pinsker v. Pacific Coast Soc'y of Orthodontists (1974) 12 Cal. 3d 541, 549-555, 116 Cal. Rptr. 245, 526 P.2d 253]* . Thus, a court may review and inquire into the facts and circumstances pertinent to the alleged exclusion of the plaintiff from the defendant organization to determine whether the power of the association was exercised arbitrarily or unlawfully in order to prevent the plaintiff from successfully practicing his or her profession [*Kronen v. Pacific Coast Soc'y of Orthodontists (1965) 237 Cal. App. 2d 289, 305, 46 Cal. Rptr. 808 , cert. denied, 384 U.S. 905]* . To establish a right to judicial intervention with respect to the denial of a membership application, the applicant need show only that exclusion from membership deprives him or her of substantial economic advantages [

Pinsker v. Pacific Coast Soc'y of Orthodontists (1969) 1 Cal. 3d 160, 164-166, 81 Cal. Rptr. 623, 460 P.2d 495 ("economic necessity" not required]. However, courts will not intervene to compel admission merely because membership may enhance or affect the applicant's professional or economic interests [*see Blatt v. University of S. California (1970) 5 Cal. App. 3d 935, 941-942, 85 Cal. Rptr. 601* (refusal to compel admission to order of coif)].

[2] Rights and Obligations

[a] Judicial Policy to Abstain From Oversight

The California Supreme Court has established a general policy of abstention from interfering in disputes between members of an association respecting their rights and obligations as members and in disputes between one member and officials or a governing unit of the association [*California Dental Assn. v. American Dental Assn. (1979) 23 Cal. 3d 346, 353-354, 152 Cal. Rptr. 546, 590 P.2d 401*] While there can be cases in which a court may appropriately afford relief on a member's complaint, such cases must present exceptional circumstances, such as acts clearly contrary to the association's bylaws [*California Dental Assn. v. American Dental Assn. (1979) 23 Cal. 3d 346, 354-355, 152 Cal. Rptr. 546, 590 P.2d 401* ; *see § 13A.13[3]*], or divestiture of membership rights without due process [*Pinsker v. Pac. Coast Soc'y of Orthodontists (1974) 12 Cal. 3d 541, 549-555, 116 Cal. Rptr. 245, 526 P.2d 253* ; *see* [1], *above*, [b], *below*], or expulsion that is arbitrary [*Ezekial v. Winkley (1977) 20 Cal. 3d 267, 273, 142 Cal. Rptr. 418, 572 P.2d 32* ; *see* [3][c], *below*].

The policy of abstention is to be applied broadly [*see California Dental Assn. v. American Dental Assn. (1979) 23 Cal. 3d 346, 353, 152 Cal. Rptr. 546, 590 P.2d 401* (acknowledging that court's determination of whether association member's complaint is judicially cognizable must be based on "general common law principles that govern disputes within private organizations"); *Oakland Raiders v. National Football League (2005) 131 Cal. App. 4th 621, 645, 32 Cal. Rptr. 3d 266* (courts may abstain from resolving dispute even if it does not involve issue of compliance with association's bylaws)].

[b] Membership

A membership interest in voluntary nonprofit unincorporated associations is personal property. Once established, membership constitutes a personal right based on a contract that can only be divested by the association in the manner provided by the contract [*Corp. Code § 18100*; *Berkeley Teachers Asso. v. Board of Education (1967) 254 Cal. App. 2d 660, 669, 62 Cal. Rptr. 515* ; *see Ezekial v. Winkley (1977) 20 Cal. 3d 267, 273, 142 Cal. Rptr. 418, 572 P.2d 32]* . Although courts are reluctant to interfere with the internal operations of unincorporated associations, courts will determine whether the divestiture satisfies the fundamental requirements of due process [*see Pinsker v. Pacific Coast Soc'y of Orthodontists (1974) 12 Cal. 3d 541, 549-555, 116 Cal. Rptr. 245, 526 P.2d 253]* .

[c] Property of Association

The members of a nonprofit unincorporated association have no individual interest in property owned by the association [*DeMille v. American Fed'n of Radio Artists (1947) 31 Cal. 2d 139, 146, 187 P.2d 769*] Property ownership rights are vested in the association's members as a whole, subject to the right of the association to dispose of the property in an authorized manner [*see* Grand Grove of United Ancient Order of Druids v. Garibaldi Grove No. 71 *(1900) 130 Cal. 116, 119-121, 62 P. 486]* .

[d] Voting Rights

The Corporations Code provides rules to govern member voting in nonprofit unincorporated associations, except as otherwise provided by statute, or by the association's governing principles. A vote may be conducted either at a member meeting at which a quorum is present, or by a written ballot in which the number of votes cast equals or exceeds the number required for a quorum. Approval of a matter voted on requires an affirmative majority of the votes cast [*Corp.*

Code § 18330(a)]. A quorum is defined as one-third the voting power of the association [*Corp. Code § 18330(d)*]. The voting power of the association is the total number of votes that can be cast by members on a particular issue at the time the member vote is held [*Corp. Code § 18330(e)*].

Written notice of the vote must be delivered to all members entitled to vote on the date of delivery. The notice must be delivered or mailed or sent electronically to the member addresses shown in the association's records as of a reasonable time before the vote is to be conducted. The notice may not be delivered electronically unless the recipient has consented to electronic delivery of the notice. The notice must state the matters to be decided and describe how and when the vote is to be conducted [*Corp. Code § 18330(b)*].

If the vote is to be conducted by written ballot, the notice of the vote will serve as the ballot. The ballot must set forth the proposed action, provide an opportunity to specify approval or disapproval of any proposal, and provide a reasonable time within which to return the ballot to the unincorporated association [*Corp. Code § 18330(c)*].

[3] Termination of Membership

[a] Termination by Operation of Law or According to Contract Terms

In general, memberships in nonprofit unincorporated associations terminate in accordance with the provisions of the charter or governing documents [*see, e.g., Kronen v. Pacific Coast Soc'y of Orthodontists (1965) 237 Cal. App. 2d 289, 302, 46 Cal. Rptr. 808 , cert. denied, 384 U.S. 905]* . Unless otherwise provided by a nonprofit unincorporated association's governing documents, membership is terminated by any of the following events [*Corp. Code § 18310(a)*]:

- Resignation of the member [*see* [b], *below*].
- Expiration of the fixed term of the membership, unless the membership is renewed before its expiration.
- Expulsion of the member [*see* [c], *below*].
- Death of the member.
- Termination of the legal existence of a member that is not a natural person.

[b] Withdrawal or Resignation

Memberships in nonprofit unincorporated associations may be terminated by the withdrawal or resignation of the members.

[c] Expulsion and Suspension

A distinction exists between situations involving the refusal to admit a person to membership [*see* [1], *above*] and those involving the expulsion of members. With regard to expulsion, the courts are inclined to grant at least a limited review and, if the expulsion is wrongful or arbitrary, to compel the reinstatement of the member [*Smith v. Kern County Medical Ass'n (1942) 19 Cal. 2d 263, 265, 268-269, 120 P.2d 874* (courts will determine if association acted in good faith in accordance with charter documents and law); *Kronen v. Pacific Coast Soc'y of Orthodontists (1965) 237 Cal. App. 2d 289, 301-302, 46 Cal. Rptr. 808 , cert. denied, 384 U.S. 905* (distinguishing between exclusion and expulsion)]. This rule follows from the fact that a membership in voluntary unincorporated associations is a personal right based on contract that cannot be arbitrarily withdrawn [*see Ezekial v. Winkley (1977) 20 Cal. 3d 267, 273, 142 Cal. Rptr. 418, 572 P.2d 32*] and can only be divested only in the manner provided by the contract [*Berkeley Teachers Asso. v. Board of Education (1967) 254 Cal. App. 2d 660, 669, 62 Cal. Rptr. 515*]. Individuals who associate

themselves in a voluntary fraternal organization may prescribe the conditions on which membership may be acquired or on which it may continue, and may also prescribe rules of conduct for themselves during their membership, with penalties for their violation, and the tribunal and mode in which the offenses will be determined and the penalty enforced. These rules constitute their agreement, and unless they contravene some law of the land, are regarded in the same light as the terms of any other contract [*Lawson v. Hewell (1897) 118 Cal. 613, 618-619, 50 P. 763* ; *Gear v. Webster (1968) 258 Cal. App. 2d 57, 60, 65 Cal. Rptr. 255]* .

In general, members may be expelled from the association provided that the expulsion proceedings are in accordance with the laws of the association and the member is given notice of the proceedings against him and an opportunity to be heard. The only function performed by courts is to determine whether the association has acted within its powers in good faith, in accordance with its laws and the law of the land. The law of the land (due process) and procedural fairness require that the member be afforded notice and an opportunity to be heard, whether or not the member takes advantage of this opportunity [*Smith v. Kern County Medical Ass'n (1942) 19 Cal. 2d 263, 265, 268-269, 120 P.2d 874* ; *see DeMille v. American Fed'n of Radio Artists (1947) 31 Cal. 2d 139, 187 P.2d 769* ; *see also Youngblood v. Wilcox (1989) 207 Cal. App. 3d 1368, 1374-1375, 255 Cal. Rptr. 527]* . In this respect, there is no fundamental distinction between a medical association, a labor union, or a fraternal or beneficial association. The member is entitled to adequate notice, an adequate opportunity to defend his or her interests, a properly constituted tribunal, and a decision based on the evidence presented [*see Cunningham v. Burbank Bd. of Realtors (1968) 262 Cal. App. 2d 211, 214, 68 Cal. Rptr. 653* (members of nonprofit corporation, real estate board, improperly censured and fined as result of defective proceedings)].

A member may not be suspended or expelled without charges, notice, and a fair hearing before the expulsion even when the association's governing documents make no provision for these requirements. These requirements are deemed so fundamental that they are imposed on the association regardless of its charter documents [*Youngblood v. Wilcox (1989) 207 Cal. App. 3d 1368, 1374-1375, 255 Cal. Rptr. 527]* . The common law doctrine of fair procedure protects against arbitrary decisions by private organizations affecting the public interest; under the doctrine the decision-making process must be "substantively rational and procedurally fair" [*see Youngblood v. Wilcox (1989) 207 Cal. App. 3d 1368, 1374-1375, 255 Cal. Rptr. 527* ; *see also Potvin v. Metropolitan Life Ins. Co. (2000) 22 Cal. 4th 1060, 1067, 95 Cal. Rptr. 2d 496, 997 P.2d 1153]* . Thus, for example, a country club could not expel lifetime members without notice and an opportunity to respond based on a bylaw provision that permitted the association to terminate memberships at will [*Youngblood v. Wilcox (1989) 207 Cal. App. 3d 1368, 1374-1375, 255 Cal. Rptr. 527]* . The common law right to fair procedure, however, has been held not to apply to the decision of whether a member of the Boy Scouts should be promoted to the rank of Eagle Scout [*Kim v. Southern Sierra Council Boy Scouts of America (2004) 117 Cal. App. 4th 743, 746-748, 11 Cal. Rptr. 3d 911]* .

When the membership in a nonprofit unincorporated association includes a property right, or if expulsion or suspension of a member would affect an important, substantial economic interest, the expulsion or suspension must be done in good faith and in a fair and reasonable manner [*Corp. Code § 18320(a), (b)*]. This rule does not apply to an unincorporated association that has a religious purpose [*Corp. Code § 18320(a)*]. A procedure for expulsion or suspension that satisfies the following requirements is fair and reasonable [*Corp. Code § 18320(c)*]:

- The procedure is included in the unincorporated association's governing documents.

- The member to be expelled or suspended is given notice [*see Corp. Code § 18320(d)*], including a statement of the reasons for the expulsion or suspension, delivered at least 15 days before the effective date of the expulsion or suspension.

- The member to be expelled or suspended is given an opportunity to be heard by the person or body deciding the matter, orally or in writing, not less than five days before the effective date of the expulsion or suspension.

The fact that a procedure satisfying these requirements is deemed fair and reasonable does not preclude a court from determining that another procedure is fair and reasonable under the circumstances [*Corp. Code § 18320(b)*]. In addition, an expulsion or suspension based on substantive grounds that violate a member's contractual or other rights or are otherwise unlawful is not made valid by compliance with a fair and reasonable procedure [*Corp. Code § 18320(f)*].

A member may challenge the expulsion or suspension [*Corp. Code § 18320(e)*; *see* [d], *below*].

[d] Judicial Relief; Exhaustion of Remedies

A member may institute a proceeding to challenge expulsion or suspension [*see* [c], *above*], including a claim alleging defective notice, within one year after the effective date of the expulsion or suspension [*Corp. Code § 18320(e)*]. A court may order any relief, including reinstatement, determined to be equitable under the circumstances. However, a vote of the members or of the board may not be set aside solely because a person was wrongfully excluded from voting by virtue of the challenged expulsion or suspension, unless the court determines that the wrongful expulsion or suspension was in bad faith and for the purpose, and with the effect, of wrongfully excluding the member from the vote, or from the meeting at which the vote took place, so as to affect the outcome of the vote [*Corp. Code § 18320(e)*].

Judicial relief may also be afforded when the association's rules or prescribed procedures are contrary to natural justice, the association failed to follow its own procedures, or when the expulsion is motivated by malice [*Youngblood v. Wilcox (1989) 207 Cal. App. 3d 1368, 1374-1375, 255 Cal. Rptr. 527* ; *Curran v. Mt. Diablo Council of the Boy Scouts (1983) 147 Cal. App. 3d 712, 720, 195 Cal. Rptr. 325]* . However, a plaintiff seeking judicial relief against an unincorporated association ordinarily must first invoke and exhaust the internal remedies provided by the governing documents applicable to the grievance. This rule is analogous to the rule requiring exhaustion of administrative remedies as a condition precedent to resorting to the courts and to the rule requiring the parties to a contract for arbitration of disputes to exhaust those remedies before seeking judicial relief [*Holderby v. International Union of Operating Eng'r (1955) 45 Cal. 2d 843, 846, 291 P.2d 463* ; *see Mooney v. Bartenders Union Local No. 284 (1957) 48 Cal. 2d 841, 843, 313 P.2d 857* ; *American Soc'y of Composers, Authors & Publishers v. Superior Court (1962) 207 Cal. App. 2d 676* (exhaustion of internal remedies is jurisdictional prerequisite to resort to courts)]. An exhaustion of internal remedies provision generally binds the members, provided that the procedure affords the "accused" member substantial justice [*Mooney v. Bartenders Union Local No. 284 (1957) 48 Cal. 2d 841*].

The exhaustion of remedies requirement is excused if the association violates its own rules providing for review or if it is shown that it would be futile to invoke them [*Mooney v. Bartenders Union Local No. 284 (1957) 48 Cal. 2d 841, 843-844, 313 P.2d 857* ; *Holderby v. International Union of Operating Eng'r (1955) 45 Cal. 2d 843, 847, 291 P.2d 463* ; *Weber v. Marine Cooks' & Stewards' Ass'n (1949) 93 Cal. App. 2d 327, 338, 208 P.2d 1009]* . However, the violation of the association's own rules that inflicts the initial wrong furnishes no right for direct resort to the courts [*Holderby v. International Union of Operating Eng'r (1955) 45 Cal. 2d 843, 847, 291 P.2d 463]* . Moreover, an association waives the requirement that members must exhaust internal remedies if the association invokes the jurisdiction of the court by an action against the member, including by way of cross-complaint for settlement of the very issues for which the association invoked the court's jurisdiction [*Hodcarriers, Bldg. & Common Laborers Local Union v. Miller (1966) 243 Cal. App. 2d 391, 394-395, 52 Cal. Rptr. 251]* .

When the expulsion determination is the result of internal quasi-judicial proceedings, a member alleging damages from the expulsion must first have the decision overturned by mandamus action before filing suit on the claim [*see Holder v. California Paralyzed Veterans Assn. (1980) 114 Cal. App. 3d 155, 165, 170 Cal. Rptr. 455.*]

PRACTICE TIP:

Given their shared common law origins, courts may look to statutory interpretations governing the suspension or expulsion of members of nonprofit corporations [*see Mooney v. Bartenders Union Local*

No. 284 (1957) 48 Cal. 2d 841, 843, 313 P.2d 857] . For further discussion, see Ch. 13, *Nonprofit Corporations* .

[e] Effect of Termination

The termination of membership in a nonprofit unincorporated association does not relieve the ex-member from an obligation incurred as a member before termination [*Corp. Code § 18310(b)*]. Further, termination does not affect the right of an unincorporated association to enforce an obligation against a person incurred as a member before termination, or to obtain damages for its breach [*Corp. Code § 18310(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Administrative LawJudicial ReviewReviewabilityExhaustion of RemediesBusiness & Corporate LawGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsCivil ProcedureJusticiabilityExhaustion of RemediesGeneral OverviewCivil ProcedureJusticiabilityExhaustion of RemediesAdministrative Remedies



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Operations

6-13A California Legal Forms--Transaction Guide § 13A.34

§ 13A.34 Amending Governing Documents

If a nonprofit unincorporated association's governing principles do not provide a procedure to amend the association's governing documents, the governing documents may be amended by a vote of the members [*Corp. Code § 18340*]. In general, an amendment may not impair an existing contract right without the consent of the person affected [*see Hogan v. Pacific Endowment League (1893) 99 Cal. 248, 250, 33 P. 924]* . However, if the governing documents reserve the power to make future changes to membership benefits, the association may amend its governing documents so as to impair those benefits, provided that the change is substantively reasonable. Nonetheless, an association may not use its amendment authority to repudiate its fair and just obligations [*see Power v. Sheriff's Relief Ass'n of Los Angeles County (1943) 57 Cal. App. 2d 350, 134 P.2d 827]* .

When the governing documents provide a procedure for amendment, that procedure should be carefully followed, particularly when members' rights are affected by the amendment [*Weber v. Marine Cooks' & Stewards' Ass'n (1949) 93 Cal. App. 2d 327, 337-338, 208 P.2d 1009]* . An association does not have the fundamental right to adopt new governing documents without regard to the existing documents based solely on the ground that the existing documents do not provide for their repeal when existing provisions direct the method of amendment [*Weber v. Marine Cooks' & Stewards' Ass'n (1949) 93 Cal. App. 2d 327, 334-335, 208 P.2d 1009]* .

Unless the governing documents, as they existed when an individual became a member of the association, limit the authority of the association to amend them, any amendment adopted in accordance with the prescribed procedure is binding on the member [*Lawson v. Hewell (1897) 118 Cal. 613, 621, 50 P. 763* ; *Gear v. Webster (1968) 258 Cal. App. 2d 57, 60-62, 65 Cal. Rptr. 255]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawUnincorporated Associations



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Operations

6-13A California Legal Forms--Transaction Guide § 13A.35

§ 13A.35 Insurance Considerations and Liability Issues

[1] Need for Insurance

Nonprofit associations ordinarily need some level of insurance to protect against business risks in the marketplace; nonprofit associations are not immune from these risks by their nonprofit status. The types and amounts of coverage needed will vary depending on the nature of the association's activities, size and nature of workforce, risk experience, and revenues. Most nonprofits need at least a commercial general liability policy, and insurance coverages for employees if the corporation will have employees. Further, nonprofits should consider securing a directors' and officers' liability policy. Finally, if warranted, nonprofits should consider obtaining professional liability insurance. Typically, claims related to the provision of professional services are excluded from the coverage of standard commercial general liability policies. These different types of insurance are discussed in Ch. 13, *Nonprofit Corporations* . For additional discussion, see Ch. 1F, *Insurance Considerations in Business Formation* , and California Insurance Law and Practice(Matthew Bender).

[2] Liability of Association

Except as otherwise provided by statute, an unincorporated association is liable to a person who is not a member of the association for an act or omission of the association and for the act or omission of its officer, agent, or employee acting within the scope of the office, agency, or employment to the same extent as if the association were a natural person [*Corp. Code § 18250*]. Nonprofit unincorporated associations are expressly authorized to contract with respect to real and personal property [*see Corp. Code § 18105*; *see also Labor Code § 1126*] and may incur liability based on those contracts. However, only the property of an unincorporated association may be levied on under a money judgment against the association [*Corp. Code § 18260*; *but see Corp. Code § 18135(a)* (execution against distributed assets)]. A judgment against the association does not bind the members [*Barr v. United Methodist Church (1979) 90 Cal. App. 3d 259, 264-267, 153 Cal. Rptr. 322]* .

Traditionally, members of nonprofit unincorporated associations were each charged with the negligence of each member acting in the prosecution of the enterprise of the association. Thus, each member's negligence is imputable to each and every other member. The reason for the rule is that the association, like an ordinary partnership, had no legal

existence apart from its members and that in legal effect each member becomes both a principal and an agent as to all other members for the actions of the group itself [*Marshall v. International Longshoremen's & Warehousemen's Union (1962) 57 Cal. 2d 781, 782-784, 22 Cal. Rptr. 211, 371 P.2d 987* (no cause of action against co-principal for wrongs of common agent); *see* Inglis v. Operating Engineers Local Union No. 12 *(1962) 58 Cal. 2d 269, 270, 23 Cal. Rptr. 403, 373 P.2d 467* (rule covers the intentional torts of the officers and members of a union to another member)]. The general rule of non-liability of the association typically involved fraternal organizations or beneficial associations [*Marshall v. International Longshoremen's & Warehousemen's Union (1962) 57 Cal. 2d 781, 783, 22 Cal. Rptr. 211, 371 P.2d 987]* . However, unincorporated labor unions became increasingly seen as separate entities because the members were not in any true sense the principals of officers and agents of the union [*see* *Marshall v. International Longshoremen's & Warehousemen's Union (1962) 57 Cal. 2d 781, 784, 787 n. 1, 22 Cal. Rptr. 211, 371 P.2d 987* (association's negligence would not be imputed to plaintiff member but limiting holding to labor unions); Inglis v. Operating Engineers Local Union No. 12 *(1962) 58 Cal. 2d 269, 270, 23 Cal. Rptr. 403, 373 P.2d 467* (union member may sue union for intentional torts of members and officers)].

The modern trend recognizes that the twin underpinnings of the traditional rule (no separate existence and members as agents), are no longer so true. Thus, courts have moved toward recognizing the association as a separate legal entity apart from its members; the members and association are distinct because the association represents the common or group interests of the members [*DeMille v. American Fed'n of Radio Artists (1947) 31 Cal. 2d 139, 149, 187 P.2d 769]* . Thus, for example, a member was permitted to sue an unincorporated condominium association for negligently maintaining the premises because the plaintiff had no "effective control" over the common areas, much like a shareholder in a corporation [*White v. Cox (1971) 17 Cal. App. 3d 824, 827-828, 95 Cal. Rptr. 259]* .

[3] Liability of Members

[a] Member's Liability for Debts

Members of a nonprofit association are not liable for a debt, obligation, or liability of the association solely by reason of being a member [*Corp. Code § 18605*]. A member is not liable for a contractual obligation of the association except under one of the following conditions [*Corp. Code § 18610*]:

- The member expressly assumed personal responsibility for the obligation in a signed writing that specifically identifies the obligation being assumed.
- The member expressly authorized or ratified the specific contract, as evidenced by a writing, and was not acting solely in the member's capacity as a director, officer, or agent of the association.
- With notice of the contract, the member received a benefit under the contract (but then the member's liability is limited to the value of the benefit received).
- The member executed the contract without disclosing that the member was acting on behalf of the association.
- The member executed the contract without authority to execute the contract.

Members of unincorporated organized medical societies that limit membership to licensed physicians and surgeons and having as members at least 25 percent of the eligible physicians and surgeons residing in the area in which it functions (which must be at least one county) are also not individually or personally liable for debts or liabilities contracted or incurred by the association in the acquisition of lands or leases. These members are not liable for debts or liabilities contracted or incurred in the purchase, leasing, construction, repairing, or furnishing of buildings or other structures to be used for the association's purposes [*Corp. Code § 21200*].

[b] General Rule for Tort and Non-Real-Estate Contractual Liability

In general, a member of a nonprofit unincorporated association is not liable to third parties for acts of the association or other members unless the member authorized or performed the act [*Orser v. George (1967) 252 Cal. App. 2d 660, 669-671, 60 Cal. Rptr. 708]* . However, a member is liable for injury, damage, or harm caused by an act or omission of the association or a director, officer, or agent of the association, if any of the following conditions is satisfied [*Corp. Code § 18620(a)*]:

- The member expressly assumes liability for injury, damage, or harm caused by particular conduct and that conduct causes the injury, damage, or harm.
- The member engages in tortious conduct that causes the injury, damage, or harm.
- The member is otherwise liable under any other statute.

This list of grounds for liability is nonexclusive, and does not foreclose any common law grounds for liability [*Corp. Code § 18620(b)*]. Thus, for example, an individual member is liable when the member (as opposed to management personnel) directly participates in authorizing acts that result in tort liability to third parties [*Steuer v. Phelps (1974) 41 Cal. App. 3d 468, 472-473, 116 Cal. Rptr. 61* (respondeat superior applies and all members are liable for injuries from car accident because all agreed that one would drive car)].

Under the common law, a member must actively or constructively assent to or ratify the contract on which liability is predicated in order to be held liable [*Security-First Nat. Bank v. Cooper (1944) 62 Cal. App. 2d 653, 667-669, 145 P.2d 722]* . If a member directly incurs a debt or expressly or impliedly authorizes or ratifies the transaction in which liability is incurred, the member is liable as a principal. Therefore, a members may be held liable for any debt that is necessarily contracted to in order to further organizational objectives in an appropriate manner [*Security-First Nat. Bank v. Cooper (1944) 62 Cal. App. 2d 653, 667-669, 145 P.2d 722* ; *see Barr v. United Methodist Church (1979) 90 Cal. App. 3d 259, 267, 153 Cal. Rptr. 322]* . The member's common law liability for contractual obligations has been modified by statute [*see Corp. Code §§ 18605, 18610, 18620, 18630*; *see also* [2], [3][a], *above*, [4]-[7], *below*].

[4] Liability of Directors, Officers, and Agents

Directors, officers, and agents of nonprofit associations are liable for injury, damage, or harm caused by an act or omission of the association or an act or omission of a director, officer, or agent of the association, if any of the following conditions is satisfied [*Corp. Code § 18620(a)*]:

- The director, officer, or agent expressly assumes liability for injury, damage, or harm caused by particular conduct and that conduct causes the injury, damage, or harm.
- The director, officer, or agent engages in tortious conduct that causes the injury, damage, or harm.
- The director, officer, or agent is otherwise liable under any other statute.

This list of grounds for liability is nonexclusive, and does not foreclose any common law grounds for liability [*Corp. Code § 18620(b)*].

[5] Volunteer Directors and Officers of Nonprofit Medical Associations

[a] Requirements for Nonliability for Money Damages

The Legislature has expressly found that the services of directors and officers of nonprofit medical associations [*see Corp. Code § 21200*] who serve without compensation are critical to the efficient conduct and management of public and charitable services in California. However, many potential volunteers are deterred from contributing these valuable services because of the perception that their personal assets are at risk for these activities and because of the unavailability and cost of liability insurance to protect these assets The unavailability or unaffordability of appropriate liability insurance makes it difficult for these associations to protect the personal assets of their volunteer decision-makers with adequate insurance. Therefore, it is California's policy to provide incentive and protection to the individuals performing these important functions [*Corp. Code § 24001.5(a)*].

In response to this problem, *Corp. Code § 24001.5* provides that no cause of action for monetary damages will arise against any person serving without compensation [*see Corp. Code § 24001.5(f)* (reimbursement of expenses), (i) (determination of compensation)] as a director or officer of a nonprofit medical association [*see Corp. Code § 21200*] that is organized to provide charitable, educational, scientific, social, or other forms of public service that are exempt from federal income tax under *I.R.C. § 501(c)(3)* or *(6)* [*see* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*] on account of any negligent act or omission that occurs [*Corp. Code § 24001.5(b), (d)*]

- Within the scope of that person's duties as a director acting as a board member, or as an officer acting in an official capacity;

- In good faith;

- In a manner that the person believes to be in the best interest of the association; and

- In the exercise of his or her policymaking judgment.

However, *Corp. Code § 24001.5* does not limit the liability of the nonprofit association itself for any negligent act or omission of a director, officer, employee, agent, or servant occurring within the scope of his or her duties [*Corp. Code § 24001.5(g)*].

This protection against damages only applies if three conditions are met [*see Corp. Code § 5047.5(e), (f), (h), (i)*]:

- The nonprofit association may not unlawfully restrict membership, services, or benefits conferred on the basis of political affiliation, age, or any characteristic listed or defined in *Civ. Code § 51(b)* or *(e)* (Unruh Civil Rights Act) [*Corp. Code § 24001.5(h)*].

- The volunteer director or officer may not receive compensation from the association in any other capacity, including but not limited to, as an employee [*Corp. Code § 24001.5(i)*]; the payment of actual expenses incurred in attending meetings or otherwise in the execution of the duties of a director or officer does not constitute compensation [*Corp. Code § 24001.5(f)*].

- The association must maintain a liability insurance policy, with coverage in the following amounts [*Corp. Code § 24001.5(e)*]:

    - If the association's annual budget is less than $50,000, the minimum required amount of coverage is $500,000.

    - If the association's annual budget equals or exceeds $50,000, the minimum required amount of coverage is $1 million.

        Corp. Code § 24001.5 applies only if the policy is applicable to the claim [*Corp.*

Code § 24001.5(e)].

[b] Exceptions to Limitations on Liability

Corp. Code § 24001.5 does not limit the liability of a director or officer for any of the following [*Corp. Code § 24001.5(c)*]:

- Self-dealing transactions [*see Corp. Code §§ 5233, 9243*].
- Conflicts of interest [*see Corp. Code § 7233*].
- Improper distributions, loans, or guarantees [see *Corp. Code §§ 5237, 7236, 9245*].
- With respect to a charitable trust, any action or proceeding against a trustee brought by a beneficiary of that trust.
- Any action or proceeding brought by the Attorney General.
- Intentional, wanton, or reckless acts, gross negligence, or an action based on fraud, oppression, or malice.
- Any action brought for a prohibited combination in restraint of trade [*see Bus. & Prof. Code § 16700 et seq.*].

[6] Members of Medical Societies

Members of unincorporated organized medical societies that limit membership to licensed physicians and surgeons and having as members at least 25 percent of the eligible physicians and surgeons residing in the area in which it functions (which must be at least one county) are not individually or personally liable for debts or liabilities contracted or incurred by the association in carrying out or performing any of the association's purposes [*Corp. Code § 21200*]. The purpose must be religious, scientific, social, literary, educational, recreational, benevolent, or other nonprofit purpose [*Corp. Code § 21200*].

[7] Volunteer Protection Act of 1997

The Volunteer Protection Act of 1997 [*42 U.S.C. § 14501 et seq.*] limits lawsuits against volunteers performing services for nonprofit organizations that are exempt under *I.R.C. § 501(c)(3)* or any nonprofit organization organized and conducted for public benefit and operated primarily for charitable, civic, educational, religious, welfare or health purposes. The Act covers all volunteers who receive no compensation in excess of $500 a year (not including reimbursed expenses) [*42 U.S.C. § 14505(b)*]. No volunteer may be held liable for harm caused by his or her act or omission on behalf of the corporation if any of the following are true [*42 U.S.C. § 14503(a)*]:

- The volunteer was acting within the scope of his or her responsibilities.
- The volunteer held any requisite license or certification.
- The damage did not result from willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious flagrant indifference to the rights and safety of the individual harmed.
- The harm was not the result of the volunteer's operation of a motor vehicle, vessel, aircraft, or other

vehicle that must be insured or operated pursuant to a license under state law.

However, the Act's limitation on liability does not apply to misconduct stemming from violent crimes, hate crimes, and damage resulting from being under the influence of alcohol and drugs [*42 U.S.C. § 14503(f)*; *18 U.S.C. § 16*; *28 U.S.C. § 534* note]; acts of terrorism or state law sex crimes for which the defendant is convicted [*42 U.S.C. § 14503(f)*; *18 U.S.C. § 2331*]; and acts involving misconduct for which the defendant is found to have violated state or federal civil rights laws [*42 U.S.C. § 14503(f)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawAgency RelationshipsDuties & LiabilitiesUnlawful Acts of AgentsIntentional & Willful InjuriesBusiness & Corporate LawAgency RelationshipsRatificationIllegal ActsBusiness & Corporate LawUnincorporated AssociationsInsurance LawBusiness InsuranceGeneral OverviewInsurance LawGeneral Liability InsuranceGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Operations

6-13A California Legal Forms--Transaction Guide § 13A.36

§ 13A.36 Regulation by Attorney General

Nonprofit unincorporated associations that hold property in trust for charitable purposes are subject to regulation under the Supervision of Trustees and Fundraisers for Charitable Purposes Act [*see Gov. Code § 12580 et seq.*]. Associations must file with the Registrar of Charitable Trusts in the office of the Attorney General periodic written reports, under oath, setting forth information as to the nature of the assets held for charitable purposes and the administration of those assets [*see Gov. Code § 12586(a)*; *11 Cal. Code Reg. § 301*]. For additions discussion, see Ch. 13, *Nonprofit Corporations* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawUnincorporated Associations



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Operations

6-13A California Legal Forms--Transaction Guide § 13A.37

§ 13A.37 Securities Law

Under the Corporate Securities Law of 1968 [*see Corp. Code § 25000 et seq.*], the sale of, or offer to sell, securities requires qualification from the California Commissioner of Corporations. The word "security" is defined to include membership in an incorporated or unincorporated association as well as notes and other evidences of indebtedness [*Corp. Code § 25019*]. However, *Corp. Code § 25100(j)* exempts securities (except evidences of indebtedness) of an issuer organized

- Exclusively for educational, benevolent, fraternal, religious, charitable, social, or reformatory purposes and not for pecuniary profit if no part of the net earnings of the issuer inures to the benefit of any private shareholder or individual; or

- As a chamber of commerce or trade or professional association.

The fact that amounts received from memberships or dues or both will or may be used to construct or otherwise acquire facilities for use by members of the nonprofit organization does not disqualify the organization from this exemption. Unless a nonprofit membership organization meets specific requirements enumerated in the Commissioner's regulations [*see 10 Cal. Code Reg. § 260.105.20*], this exemption does not apply to the securities of any nonprofit organization if any promoter expects or intends to make a profit directly or indirectly from any business activity associated with the organization or operation of the nonprofit organization, or from remuneration received from that nonprofit organization [*Corp. Code § 25100(j)*]. An issuer is defined as a person who issues or proposes to issue any security [*Corp. Code § 25010*]. Thus, memberships in unincorporated associations meeting the requirements of the foregoing sections are exempt from the permit requirements.

Debt securities, such as notes and other evidences of indebtedness, are excepted from this exemption and require qualification [*Corp. Code § 25100(j)*; see Ch. 6J, *Issuance of Debt Securities*]. *Corp. Code § 25100(l), (p)* exempts certain debt securities from the qualification requirement, and *Corp. Code § 25102(e)* exempts from issuer transactions [*Corp. Code § 25110*] the offer or sale of any evidence of indebtedness (including promissory notes), whether secured or unsecured, and any guarantee of the indebtedness in a transaction not involving a public offering.

For a discussion of qualification of corporate securities, see Ch. 6H, *Qualification of Securities* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsSecurities LawGeneral OverviewSecurities LawExemptions From RegistrationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Operations

6-13A California Legal Forms--Transaction Guide § 13A.38

§ 13A.38 Tax Considerations

[1] Nonprofit Associations Subject to Income Tax Unless Exempt

Nonprofit unincorporated associations are subject to the federal income tax [*I.R.C. § 11*; *see I.R.C. § 7701(a)(3)*] unless they are entitled to an exemption [*see I.R.C. §§ 501-528* (rules governing exempt organizations)]. Qualifying nonprofit organizations are also exempt from federal withholding tax [*see I.R.C. §§ 3121(b)(8)(B), 3401(a)(9)* (religious organizations)]. Nonprofit unincorporated associations are also subject to the California franchise and income taxes unless they are specifically exempted from that tax [*see Rev. & Tax. Code § 23701 et seq.* (exemptions)]. For a more detailed discussion of the income taxation of nonprofit corporations, see Ch. 13B, *Tax-Exempt Status for Nonprofit Entities* .

[2] Charitable Gifts

[a] Gifts Generally Deductible from Income

Contributions to qualified tax-exempt associations may entitle the donor to claim the federal income tax deduction for charitable contributions [*see I.R.C. § 170*]. For example, taxpayers may ordinarily deduct gifts made to *I.R.C. § 501(c)* associations organized and operated exclusively for religious, charitable, and specified public purposes from income [*I.R.C. § 170(c)*]. However, the deduction is lost if the corporation attempts to intervene in any political campaign on behalf of or in opposition to any candidate for public office [*see I.R.C. § 170(c)(2)(D)*; *see* Ch. 13, *Nonprofit Corporations*].

Charitable gifts by check ordinarily are deemed made (and deductible) when the check is delivered or mailed to the charitable organization, regardless of when the charity actually receives the check [*Treas. Reg. § 1.170A-1(b)*]. Similarly, gifts made by credit card are deemed made (and deductible) when the donor charges the contribution, regardless of when the donor pays the credit card bill [*Rev. Rul. 78-38, 1978-1 C.B. 67*].

Purchases at auctions are only deductible if and to the extent that the taxpayer intends a gift and the fair market value of the purchased item is less than the amount bid and paid [*I.R.C. § 170(c)*; *see Hardesty v. Commissioner (1993) 65*

T.C.M. 2743, T.C. Memo. 1993-225] . Under federal law, the cost of a raffle ticket is not generally deductible unless the value of participating in the raffle is worth less than the ticket price [*see Rev. Rul. 83-130, 1983-2 C.B. 148* ; *but see Penal Code § 320*] (generally barring sale of raffle tickets).

For further discussion of state and federal income tax charitable deductions available for contributions to qualifying nonprofit organizations, see Ch. 69, *Charitable Dispositions* .

[b] Documentation Requirements

Federal law imposes disclosure and documentation requirements on charitable organizations that solicit deductible and/or nondeductible contributions [*see I.R.C. §§ 170(f), 6113, 6115*]. Special substantiation rules apply to specific types of contributions [*see Treas. Reg. § 1.170A-13(f)(9), (11)*-(17)]. For further discussion of these rules, see Ch. 13, *Nonprofit Corporations* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawUnincorporated AssociationsEstate, Gift & Trust LawPersonal GiftsElements of Valid GiftsGeneral OverviewTax LawFederal Estate & Gift TaxesGifts (IRC secs. 2035, 2501-2524)Completed GiftsDeliveryTax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific OrganizationsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsTreatment of Unincorporated Associations



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Operations

6-13A California Legal Forms--Transaction Guide § 13A.39

§ 13A.39 Entity Changes

[1] Conversions

In general, a nonprofit unincorporated association may change its status to a nonprofit corporation, provided that the charter documents authorize the conversion. Most persons associating themselves for a nonprofit purpose choose the corporate form. In fact, the laws applicable to the principal types of nonprofit corporations each contain express provisions for converting a nonprofit unincorporated association into a public benefit, mutual benefit, or religious corporation [*see Corp. Code §§ 5121(a), 7121(a), 9121(a)*]. For further discussion, see Ch. 13, *Nonprofit Corporations* .

[2] Merger

[a] Merger Procedure

In general, a nonprofit unincorporated association may merge with a domestic or foreign corporation, domestic or foreign limited partnership, domestic or foreign general partnership, or domestic or foreign limited liability company. However, a merger may be effected only if each constituent entity is authorized to effect the merger by the laws under which it was organized [*Corp. Code § 18360*].

Each party to the merger must approve an agreement of merger. The agreement must include the following provisions [*Corp. Code § 18370(a)*]:

- The terms of the merger.
- Any amendments the merger would make to the articles, bylaws, or other governing documents of the surviving entity.
- The name, place of organization, and type of entity of each constituent entity.

- The name of the constituent entity that will be the surviving entity.

- If the name of the surviving entity will be changed in the merger, the new name of the surviving entity.

- The disposition of the memberships or ownership interests of each constituent entity.

- Any other desired details or provisions, including any details or provisions required by the law under which a constituent entity is organized.

The principal terms of the merger agreement must be approved by the board, the members, and any person whose approval is required by the association's governing documents [*Corp. Code § 18370(b)*]. Unless otherwise provided in the governing documents, the members must approve the agreement in the manner provided for amendment of the association's governing documents [*Corp. Code § 18370(b); see § 13A.34*]. The members may approve the agreement before or after the board approves the agreement [*Corp. Code § 18370(b)*].

Ordinarily, if a merger agreement would cause the members of the association to become individually liable for an obligation of a constituent or surviving entity, the agreement must be approved by all of the members of the unincorporated association. However, approval by all members is not required if the merger agreement provides for that the surviving entity will purchase the membership interest of a member who votes against approval [*Corp. Code § 18370(c)*].

The board may amend a merger agreement unless the amendment would change a principal term of the agreement, in which case the agreement is subject to the prescribed approval procedure [*Corp. Code § 18370(d)*]. Further, the board may abandon a merger without the approval of the members, subject to the contractual rights of third parties [*Corp. Code § 18370(e)*].

For discussion relating to mergers involving corporations, and forms for corporate mergers that may be used or adapted for mergers involving nonprofit entities, see Ch. 11C, *Mergers* .

[b] Effect of Merger

A merger under these provisions has the following effect [*Corp. Code § 18380(a)*]:

- The separate existence of the disappearing entity ceases.

- The surviving entity succeeds, without other transfer, to the rights and property of the disappearing entity.

- The surviving entity is subject to all the debts and liabilities of the disappearing entity. A trust or other obligation governing property of the disappearing entity applies as if it were incurred by the surviving entity.

All rights of creditors and all liens on or arising from the property of each of the constituent entities are preserved unimpaired, provided that a lien on property of a disappearing entity is limited to the property subject to the lien immediately before the merger is effective [Corp. Code § 18380(b)]. Further, an action or proceeding pending by or against a disappearing entity or other party to the merger may be prosecuted to judgment, which binds the surviving entity, or the surviving entity may be proceeded against or substituted in its place [*Corp. Code § 18380(c)*].

A merger does not affect an existing liability of a member, director, officer, or agent of a constituent unincorporated

association for an obligation of the unincorporated association [*Corp. Code § 18380(d)*].

Any bequest, devise, gift, grant, or promise contained in a will or other instrument of donation, subscription, or conveyance that is made to a disappearing entity and that takes effect or remains payable after the merger inures to the benefit of the surviving entity. A trust obligation that would govern property if transferred to the disappearing entity applies to property that is instead transferred to the surviving entity [*Corp. Code § 18400*].

[c] Recordation of Real Property

If a surviving entity succeeds to ownership of real property located in California as a consequence of merger, the surviving entity's record ownership of that property may be evidenced by recording a copy of the merger agreement in the county in which the property is located. The agreement must be signed by the president and secretary or other comparable officers of the constituent entities and be verified and acknowledged [*Corp. Code § 18390*; *see Corp. Code §§ 149, 193*].

[3] Dissolution

[a] Voluntary Dissolution

If a nonprofit unincorporated association's governing documents provide a method for dissolution, dissolution may be accomplished by that method [*Corp. Code § 18410(a)*]. This rule stems from the principle that the charter documents have the force and effect of a contract between the association and its members, as to which members are bound and charged with full knowledge [*Holt v. Santa Clara County Sheriff's Benefits Assn. (1967) 250 Cal. App. 2d 925, 929, 59 Cal. Rptr. 180* ; *Weber v. Marine Cooks' & Stewards' Ass'n (1949) 93 Cal. App. 2d 327, 334-335, 208 P.2d 1009]* .

If the association's governing documents do not provide a method for dissolution, the association may be dissolved by the affirmative vote of a majority of the voting power of the association [*Corp. Code § 18410(b)*]. Dissolution may also result from the decision of a superior organization [*see* [b], *below*] or court decree [*see* [c], *below*; *see also Holt v. Santa Clara County Sheriff's Benefits Assn. (1967) 250 Cal. App. 2d 925, 929-930, 59 Cal. Rptr. 180*] The association may also amend the governing documents to provide a method for dissolution [*see Holt v. Santa Clara County Sheriff's Benefits Assn. (1967) 250 Cal. App. 2d 925, 929-930* , & n.2, *59 Cal. Rptr. 180* ; *see also § 13A.34*].

If the association's operations have been discontinued for at least three years, the association may be dissolved by the board or, if the association has no incumbent board, by the members of its last preceding incumbent board [*Corp. Code § 18410(d)*]. If the association's operations have been discontinued, the association may be dissolved by court order [*Corp. Code § 18410(e)*].

Promptly after commencing dissolution proceedings, the board or, if the members if there is no board, must promptly wind up the affairs of the association, pay or provide for its known debts or liabilities, collect any amounts due to it, take any other action as is necessary or appropriate for winding up, settling, and liquidating its affairs, and properly dispose of its assets [*Corp. Code § 18420*; *see Corp. Code § 18130*].

[b] Dissolution by Superior Organization

Many nonprofit unincorporated associations are organized as local chapters or lodges of statewide or national organizations under a charter from the superior organization. The relationship between the local association and the superior organization is thus a matter of contract [*see* Grand Grove of United Ancient Order of Druids v. Garibaldi Grove No. 71 *(1900) 130 Cal. 116, 119-121, 62 P. 486]* . The charter documents of the superior organization (and typically the charter documents of the local chapter) ordinarily impose penalties for violations of their provisions. If the charter documents so provide, the superior organization may revoke the local chapter's charter and dissolve the local chapter without judicial interference [*see Grand Grove of United Ancient Order of Druids v. Duchein (1894) 105 Cal.*

219, 224, 38 P. 947] . However, the superior court may need judicial assistance in requiring the local chapter to cede its assets to the superior organization [*see Grand Grove of United Ancient Order of Druids v. Duchein (1894) 105 Cal. 219, 224-225, 38 P. 947* ; *see also* Supreme Lodge v. L.A. Lodge No. 386 *(1917) 177 Cal. 132, 136-137, 169 P. 1040]* .

[c] Dissolution by Court Decree

A court may decree the dissolution of a nonprofit unincorporated association and order the distribution of assets among the members when the association's operations have been discontinued and its objectives abandoned by common consent of the members. However, a nonprofit association will not be dissolved for slight causes, and a court will only act when the association has apparently ceased to answer the purpose of its existence and no other relief is available [*Holt v. Santa Clara County Sheriff's Benefits Assn. (1967) 250 Cal. App. 2d 925, 930, 59 Cal. Rptr. 180* .] Thus, in view of the attitude of courts against dissolution, even when a majority of members support it, courts will generally not interfere if "the government of the association is fairly administered and its purposes can be carried out by a minority consisting of a sufficient number to constitute the association." [*Holt v. Santa Clara County Sheriff's Benefits Assn. (1967) 250 Cal. App. 2d 925, 930, 59 Cal. Rptr. 180* .]

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsDissolution & Winding UpBusiness & Corporate LawUnincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART II. LEGAL BACKGROUND
B. Operations

6-13A California Legal Forms--Transaction Guide §§ 13A.40-13A.99

[Reserved]

§§ 13A.40[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-13A California Legal Forms--Transaction Guide § 13A.100

§ 13A.100 Facts

NOTE:
The following facts are necessary to draft the articles of organization and the bylaws of a nonprofit association.

1. Names, addresses, and telephone and fax numbers of all organizers of association.

2. Proposed name of association.

3. Location and complete address of association's principal office in California and addresses of any other offices in California or elsewhere.

4. Purposes for which association is being formed:

a. Specific and primary purpose.

NOTE:
If the association will seek a tax exemption under *I.R.C. § 501(c)(3)* or *Rev. & Tax. Code § 23701a et seq.*, the primary purpose should be stated as nearly as possible in the language of the applicable exemption provision.

b. General purposes.

NOTE:
Various statutory powers are typically stated under the heading of general purposes, but additional purposes may be included. However, if the association will be exempt from tax, the association should not include purposes that conflict with the specific and primary purpose of the association.

5. If existing business or nonprofit entity is being reorganized as nonprofit association, following information:

a. Name, nature, and designated purposes of entity.

b. Date of formal organization.

c. Street and mailing address, and telephone and fax numbers of entity's principal office.

d. Names, addresses, and telephone and fax numbers of members.

e. Names, addresses, and telephone and fax numbers of creditors.

f. Fiscal year of corporation.

g. Description of rights and liens.

h. California counties in which any real property of entity is located.

5. Agent for service of process.

a. If agent is natural person, name and complete business or residence address in California.

b. If agent is corporation, including domestic, foreign, or foreign business corporation, name and complete business address.

6. Manner in which association will be governed.

NOTE:
Nonprofit associations may be governed by a governing board, such as a board of directors or trustees or governors, or by officers alone or by both a governing board and officers.

a. Governing board.

(1) Title and number of members of governing body or board.

(2) Names and addresses of first members of governing board.

(3) Qualifications and manner of selection.

(4) Terms of office.

(5) Powers and duties, and any limitations on authority.

(6) Compensation.

(7) Liabilities.

(8) Removal, resignation, and vacancy.

(9) Manner of filling vacancies on board of directors.

(10) Location of board meetings.

(11) Quorum requirements for meetings.

(12) Conduct and adjournment of board meetings.

b. Officers.

(1) Official designations or titles.

NOTE:
Nonprofit associations must have officers with the titles and duties as are stated in the bylaws (or articles) or determined by the board as may be necessary to enable the association to sign instruments and manage the association. Typically, an association will have a chairman of the board or a president or both, a secretary, a chief financial officer, and other officers as needed to further the association's purposes.

(2) Names, addresses, and telephone and fax numbers of officers.

(3) Qualifications and manner of selection.

(4) Terms of office.

(5) Powers and duties, including any limitations on authority.

(6) Compensation.

(7) Removal, resignation, and vacancy.

(8) Manner of filling vacancies.

7. Committees, including standing and ad hoc or temporary committees.

a. Manner of designation.

b. Number and authority.

c. Place and location of meetings.

d. Quorum requirements for meetings.

e. Conduct and adjournment of meetings.

8. Members.

a. Number.

b. Names, addresses, and telephone and fax numbers of members.

c. Qualifications and eligibility.

d. Manner of admission, election, or appointment of members, such as applications, dues, assessments, and fees.

e. Classes of membership

f. Rights and obligations of members.

(1) Voting rights; if unequal, rule or rules by which respective voting rights are fixed and determined.

(2) Property, or other rights or interests of members in association; if unequal, rule or rules by which property or other rights or interests are fixed and determined.

g. Liability of members for dues and manner of payment and collection.

h. Manner of withdrawal, suspension, and expulsion of members, and manner of reinstatement.

i. Time, place, and manner of calling and giving notice of and conducting members' meetings, including quorum requirements.

j. Whether disputes among members will be made subject to arbitration.

NOTE:

Arbitration provisions are frequently included in the bylaws of professional societies, such as boards of trade, real estate boards, and labor unions.

k. Transferability of memberships, including any required fee.

l. Termination of membership.

9. Requirements with respect to annual reports, including financial statements, to members.

10. Manner of authorizing and executing contracts, checks, and notes on behalf of association.

11. Limitations, if any, on deposit of association funds.

12. Manner in which association may be dissolved or terminated.

13. Manner in which association's assets are to be distributed on dissolution or termination of association.

14. Restrictions on, and requirements for, amendment of articles of organization or constitution and bylaws.

15. Description of any insignia or seal of association.

16. Whether association plans to attempt to influence local, state, or national legislation.

17. Whether association plans to participate or intervene in political campaigns on behalf of any candidate.

18. Whether association plans to conduct any commercial businesses and, if so, whether it will do so under its own or another name.

19. Indemnification.

a. Whether corporation will indemnify directors, officers, and/or employees.

b. Extent of indemnification.

20. Insurance.

a. General liability policy.

b. Directors and Officers liability policy.

c. Workers' compensation.

d. Unemployment insurance.

e. Property insurance.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon AgentsInsurance LawBusiness InsuranceDirectors & Officers Liability InsuranceGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-13A California Legal Forms--Transaction Guide § 13A.101

§ 13A.101 Documents

1. Options, agreements, deeds, and other documents and instruments pertaining to or affecting property rights to be transferred to association.

NOTE:
The transfer of real property to the association may have adverse tax consequences. If the transfer constitutes a change in ownership, the value of the property will be reassessed, resulting in tax changes [***see*** Cal. Const., art. XIIIA, § 2; ***see also*** *Rev. & Tax. Code §§ 62(a), 64*].

2. In case of existing entity being reformulated as nonprofit association, constitution, rules or regulations, charter documents, bylaws, and documents relating to tax exemptions of entity.

3. If subordinate body having parent organization is being formed, copy of articles of incorporation, constitution, or other charter document, bylaws, and rules of parent organization.

4. Insurance policies.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsReal Property LawDeedsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-13A California Legal Forms--Transaction Guide §§ 13A.102-13A.109

[Reserved]

§§ 13A.102[Reserved]



117 of 192 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-13A California Legal Forms--Transaction Guide § 13A.110

§ 13A.110 Fictitious Business Statement

NOTE:
California nonprofit unincorporated associations are expressly exempt from filing a fictitious business name statement [*Bus. & Prof. Code § 17911*]. Nevertheless, they may wish to file such a statement with county recorders in counties in which the association will hold property.

1. Determine whether association will do business.

2. If association will do business, determine whether it will do so under name other than its name.

3. If association will do business under name other than its own name, prepare, file, and publish fictitious name certificate in accordance with requirements of *Bus. & Prof. Code § 17900 et seq.*

NOTE:
For an example of a fictitious business statement, and detailed discussion of the applicable requirements and procedures, see Ch. 1A, ***Role of Counsel in Starting a New Business*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawCorporate NamesFictitious NamesGeneral OverviewBusiness & Corporate LawCorporate NamesFictitious NamesRegistration RequirementsBusiness & Corporate LawUnincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-13A California Legal Forms--Transaction Guide § 13A.111

§ 13A.111 Securities Compliance

1. Determine whether association memberships are subject to Corporate Securities Law of 1968 [*see Corp. Code § 25000 et seq.*] and, if so:

a. Whether any exemptions from qualification are available; or

NOTE:
For a complete list of the California securities exemptions, and discussion of the Corporate Securities Law of 1968, see *Ch. 6,* ***Securities Regulation Issues****, § 6.200*.

b. Whether memberships must obtain securities qualification [for general discussion, *see* Ch. 6, *Securities Regulation Issues*].

NOTE:
Requirements applicable to securities are discussed in *§ 13A.37*. For further discussion of the issuance of equity securities, see Ch. 6I, ***Issuance of Equity Securities*** . For further discussion of the issuance of debt securities, see Ch. 6J, ***Issuance of Debt Securities*** .

2. If sale of association memberships is not exempt from permit requirements of Corporate Securities Law [*see Corp. Code § 25000 et seq.*], or if association will sell nonexempt debt securities, prepare application for qualification from Commissioner of Corporations [*see Corp. Code §§ 25110, 25120, 25130* (qualification requirements)].

3. File application with Commissioner of Corporations [*see Corp. Code §§ 25110, 25120, 25130*].

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsSecurities LawGeneral OverviewSecurities LawBlue Sky LawsExcluded TransactionsSecurities LawExemptions From RegistrationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-13A California Legal Forms--Transaction Guide §§ 13A.112-13A.119

[Reserved]

§§ 13A.112[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-13A California Legal Forms--Transaction Guide § 13A.120

§ 13A.120 Forming Association

1. Select agent for service of process.

NOTE:

The agent may be a natural person residing in California, or any domestic or foreign business corporation that has complied with *Corp. Code § 1505* and whose capacity to act as an agent has not been terminated. If a natural person is designated, the optional statement that may be filed with the Secretary of State [***see*** P 13, ***below***] must set forth the person's complete business or residence [*Corp. Code § 18200(b)*].

a. Natural person.

b. Corporate agent.

NOTE:

If a corporate agent is selected, counsel should ensure that a certificate of consent by the corporation designated as agent is on file with the Secretary of State [*Corp. Code § 1505(a)*; ***see*** Ch. 2, ***Formation of Corporations***]. If a certificate of consent is not on file with Secretary of State, counsel should arrange to have it filed before designation.

2. Draft charter documents [*see §§ 13A.130, 13A.131*].

3. Secure approval of charter documents by any or all of following persons or entities:

a. Organizers of association for accuracy of names and addresses stated in charter documents and of other provisions.

b. Commissioner of Corporations with respect to issuance of memberships, if memberships are not exempt from qualification [*Corp. Code § 25000 et seq.*] or if association intends to issue debt securities [*see § 13A.37*].

NOTE:
For discussion, see Ch. 6, ***Securities Regulation Issues*** ; Ch. 6H, ***Qualification of Securities*** ; Ch. 6I, ***Issuance of Equity Securities*** ; and Ch. 6J, ***Issuance of Debt Securities*** .

c. Franchise Tax Board if association will be exempt from tax and doubt exists as to effect of provisions on association's franchise tax-exempt status.

NOTE:
For discussion, see Ch. 13B, ***Tax-Exempt Status for Nonprofit Entities*** .

d. Internal Revenue Service if association will be exempt from tax and doubt exists as to effect of provisions on association's income tax-exempt status.

NOTE:
For discussion, see Ch. 13B, ***Tax-Exempt Status for Nonprofit Entities*** .

4. Have articles of association or constitution properly executed.

5. Have bylaws adopted and signed by organizers and certified by association secretary.

6. Prepare copies of executed charter documents for following:

a. One copy of each for books of association.

b. One copy of each for application for exemption from franchise tax.

c. Two copies of each for application for exemption from local personal property and real property taxes.

d. Two copies of each for application for exemption from federal income tax.

e. One copy of each for application securities permit [*see § 13A.37*].

f. Copy of articles or constitution for nonprofit mailing permit [*see* P 19, *below*].

g. Copy of articles or constitution for applying for any necessary license or permits.

h. One copy of each for attorney's file.

i. Additional copies if association will seek loans, grants, or endowments.

7. Obtain minute book and membership certificates as necessary [*see* P 17, *below*].

8. Obtain insignia or register trademarks [*see §§ 13A.14, 13A.15*; *see also* P 14, *below*].

9. Select tax year and method of accounting.

10. Secure employer identification number if association will have employees [*see* IRS Form SS-4].

11. Apply for federal tax exemption [*see* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*].

12. Apply for state tax exemptions [*see* Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*].

13. File original and copy of statement designating principal office in California and/or an agent for service of process, together with applicable filing fee [*see Corp. Code § 18200(f)*; *Gov. Code § 12191(b)(1)*], with Secretary of State [*see Corp. Code § 18200(a)*].

NOTE:

This is an optional filing [***see*** *Corp. Code § 18200(a)*]. If the association designates a corporate agent for service of process, the association or counsel should ensure that a certificate of consent to act as agent is on file with the Secretary of State. If not, this filing should be arranged before filing the designation of agent. For further discussion, see *§ 13A.31*.

14. Register name or insignia if desired [*see Corp. Code §§ 21301, 21304*; *Gov. Code § 12191(b)(2)*; *see also §§ 13A.15, 13A.202*].

NOTE:

A nonprofit association whose principles and activities are not repugnant to the Constitution or the laws of the United States or California, may register in the office of the Secretary of State a facsimile or description of its name or insignia, and may by reregistration alter or cancel it [*Corp. Code § 21301*; ***see*** *Gov. Code § 12191(b)(2) (fee)*]. Application for registration, alteration, or cancellation must be made by the chief officer or officers of the association on the prescribed form. The registration is for the use and benefit and on behalf of the association and the individual members [*Corp. Code § 21303*]. However, an association may not register any name of insignia that is similar to, or so nearly resembling, another registered name or insignia as may be likely to deceive [*Corp. Code § 21302*].

15. If issuance of memberships is not exempt under state and federal securities laws [*see § 13A.37*], apply for qualification and registration.

16. Secure all necessary license and permits.

a. Prepare and file with appropriate state or federal department, agency, board, or person, application for state or federal license, permit, or certificate of registration.

NOTE:

For example, if a nonprofit unincorporated association holds any property in trust for charitable purposes, the association must register with the Registrar of Charitable Trusts within six months after the income or principal of that property is authorized or required to be applied to charitable purposes [***see*** *Gov. Code § 12580 et seq.*]. For further discussion, see Ch. 13, ***Nonprofit Corporations*** .

b. Prepare and file with appropriate local department or agency application for license or permit when license or permit is required to enable corporation to carry on given activity.

17. Obtain check(s) payable to Secretary of State for payment of filing and registration fees [*see, e.g., Gov. Code § 12191*].

18. If association will issue membership certificates, distribute certificates to members after they have applied and qualified for membership and paid any applicable fee.

NOTE:

Membership certificates should be signed by the president and secretary of the association before distribution. The association's membership list should contain the member's name, address, and certificate number.

19. Obtain nonprofit mailing permit, if desired.

NOTE:

Nonprofit associations may apply for a mailing permit at the local or main post office to take advantage of significantly lower postage rates [***see*** *39 U.S.C. § 3626*]. The association must submit a file-stamped or certified copy of the articles or constitution, a copy of the bylaws, copies of tax exemption letters, and promotional literature and pay an annual fee.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawAgency RelationshipsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-13A California Legal Forms--Transaction Guide §§ 13A.121-13A.129

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§§ 13A.121[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Drafting Guide

6-13A California Legal Forms--Transaction Guide § 13A.130

§ 13A.130 Articles of Association

NOTE:

No statutory provisions govern the articles of association or constitution of a nonprofit unincorporated association. Thus, the articles or constitution may contain any provision not in conflict with existing law or public policy. Because the charter documents constitute a contract between the association and its members and because of the lack of statutory provisions to fill in any gaps, the charter documents should define as fully as possible the rights and obligations of board members, officers, and members. In general, drafters may look to parallel documents of nonprofit corporation for guidance [***see*** Ch. 13, ***Nonprofit Corporations***].

1. State name of association.

2. State purposes and powers of association [*see § 13A.200[2]*, art. II].

3. Designate association's principal office in California [*see § 13A.200[2]*, art. III].

4. Specify management of association [*see § 13A.200[2]*, art. IV].

5. Identify agent for service of process [*see § 13A.200[2]*, art. V].

6. Include membership provisions [*see § 13A.200[2]*, art. VI].

NOTE:

Typically, membership provisions in the articles of association or constitution refer to the bylaws for more detailed provisions. Absent a provision in the association's governing documents, membership is terminated by the member's resignation, expulsion, or death, the expiration of the fixed term of the membership unless renewed before its expiration,

or the termination of the legal existence of a member that is not a natural person [*Corp. Code § 18310(a)*].

7. Include provisions for dissolution [*see § 13A.200[2],* art. VII; *see also § 13A.39[3]*].

NOTE:

If the association's governing documents do not provide a method for dissolution, the association may be dissolved by the affirmative vote of a majority of the voting power of the association [*Corp. Code § 18410(b)*]. Dissolution also may result from the decision of a superior organization or court decree [*Corp Code § 18420(c)*; ***see*** *Holt v. Santa Clara County Sheriff's Benefits Assn. (1967) 250 Cal. App. 2d 925, 929-930, 59 Cal. Rptr. 180* .]

8. Include provisions for dedicating assets and distribution on dissolution [*see § 13A.200[2],* art. VIII].

9. Any limitations on association's authority [*see § 13A.200[2],* arts. IX, XIII].

10. Include provision authorizing merger [*see § 13A.200[2]*, art. XI; *see also § 13A.39[2]*].

11. Include provision authorizing amendment of governing documents [*see § 13A.200[2],* art. XI; *see also § 13A.34*].

12. Any other provisions to be included in articles or constitution.

NOTE:

In general, drafters may look to parallel documents of nonprofit corporation for guidance [***see*** *Mooney v. Bartenders Union Local No. 284 (1957) 48 Cal. 2d 841, 843, 313 P.2d 857* ; ***see also*** Ch. 13, ***Nonprofit Corporations***]. However, the notion that provisions should be included in the bylaws because the articles of incorporation are publicly filed documents [***see*** Ch. 13, ***Nonprofit Corporations***] does not apply in the context of nonprofit unincorporated associations.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Drafting Guide

6-13A California Legal Forms--Transaction Guide § 13A.131

§ 13A.131 Bylaws

NOTE:

No statutory provisions govern the bylaws of a nonprofit unincorporated association. Thus, the bylaws may contain any provision not in conflict with existing law or public policy. Because the charter documents constitute a contract between the association and its members and because of the lack of statutory provisions to fill in any gaps, the charter documents should define as fully as possible the rights and obligations of board members, officers, and members. In general, drafters may look to parallel documents of nonprofit corporation for guidance [***see*** Ch. 13, ***Nonprofit Corporations***]. If the association is a subordinate body organized under the charter documents and rules of a parent or superior organization, drafters must consult these documents when preparing the bylaws.

1. Evaluate purpose and importance of bylaws to association.

NOTE:

Bylaws contain the governing rule of the association. They can provide rules for matters not covered by statute, and can alter specific default provisions that apply in the absence of an applicable bylaw. Because few statutes apply to the bylaws of nonprofit unincorporated associations, the bylaws should be as complete as possible. However, the level of detail contained in the bylaws varies by the size of the association, its intended purposes, and the complexity of its operations.

2. Include membership provisions [*see § 13A.201[2]*, art. II].

a. Qualifications for membership.

b. Admission to membership.

c. Classes of membership.

NOTE:
A voluntary nonprofit unincorporated association may have different classes of membership with differing voting privileges and other rights [***see*** *Gear v. Webster (1968) 258 Cal. App. 2d 57, 65 Cal. Rptr. 255]* . The fact that a person may qualify for and become an associate member gives the member no contractual right to become an active member unless he or she qualifies; the provision for termination of associate membership on the lapse of qualification for active membership effectively terminates membership in the organization [***see*** *Kronen v. Pacific Coast Soc'y of Orthodontists (1965) 237 Cal. App. 2d 289, 302, 46 Cal. Rptr. 808* , ***cert. denied****, 384 U.S. 905 (1966)]* .

d. Membership fees, dues, and assessments.

e. Arbitration of disputes.

f. Termination of membership.

g. Transferability of memberships.

h. Inspection rights.

3. State requirements for members' meetings [*see § 13A.201[2],* art. III].

4. Provisions for board of directors or other management structure [*see § 13A.201[2],* art. IV].

a. Qualifications for office.

b. Election requirements.

c. Terms of office.

d. Duties.

e. Compensation.

f. Removal and vacancies.

g. Board Meetings.

5. Provisions for officers [*see § 13A.201[2],* art. V].

a. Numbers and titles.

b. Qualifications for office.

c. Appointment or election requirements.

d. Terms of office.

e. Duties.

f. Compensation.

g. Removal and vacancies.

6. Provisions for committees [*see § 13A.201[2]*, art. VI].

7. Miscellaneous matters [*see § 13A.201[2]*, art. VII].

a. Recordkeeping requirements.

b. Seal and insignia.

c. Fiscal year.

8. Execution of instruments [*see § 13A.201[2]*, art. VIII].

9. Provisions for adoption, amendment, and repeal of bylaws [*see § 13A.201[2]*, art. IX].

NOTE:
Any amendment or change to the charter documents adopted in accordance with the applicable amendment procedure is binding on existing members [*Lawson v. Hewell (1897) 118 Cal. 613, 621, 50 P. 763]* .

10. Any other provisions to be included in bylaws.

NOTE:
In general, drafters may look to parallel documents of nonprofit corporation for guidance [***see*** *Mooney v. Bartenders Union Local No. 284 (1957) 48 Cal. 2d 841, 843, 313 P.2d 857* ; ***see also*** Ch. 13, ***Nonprofit Corporations***].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawNonprofit Corporations & OrganizationsFormationBusiness & Corporate LawUnincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Drafting Guide

6-13A California Legal Forms--Transaction Guide §§ 13A.132-13A.199

[Reserved]

§§ 13A.132[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART IV. FORMS

6-13A California Legal Forms--Transaction Guide § 13A.200

§ 13A.200 Articles of Organization

[1] Comment

[a] Use of Form

This form is a sample complete set of articles of association (or constitution) of an unincorporated nonprofit association. The provisions are general in nature so that they are applicable to and may be used by a wide variety of nonprofit associations.

In drafting the organizational instrument, it is important to keep in mind that the provisions may not violate public policy or law. It is therefore helpful, in determining which provisions are permissible, to consult the statutory provisions relating to nonprofit corporations that the courts have occasionally applied to associations [*see Mooney v. Bartenders Union Local No. 284 (1957) 48 Cal. 2d 841, 843, 313 P.2d 857]* . Counsel may wish to consult the articles of incorporation of the various nonprofit corporations covered in Ch. 13, *Nonprofit Corporations* , for adaptation and inclusion in these articles.

Legislation relating to the governance of unincorporated associations is designed to establish mandatory rules, as well as default rules that apply when the association's governing documents are silent [*see Corp. Code § 18300 et seq.*]. For further discussion, see [g], *below*.

If a subordinate body is being organized, the contents of its constitution and bylaws will be governed by the articles of incorporation, articles of association, constitution, or other charter documents, bylaws, and rules of the parent organization, which will have to be consulted.

[b] Purposes of Association

A "nonprofit association" is an unincorporated association with a primary common purpose other than to operate a business for profit [*Corp. Code § 18020(a)*]. An "unincorporated association" is an unincorporated group of two or more persons joined by mutual consent for a common lawful purpose, whether organized for profit or not [*Corp. Code § 18035(a)*].

A nonprofit association may carry on a business for profit and apply any profit resulting from the business activity to any activity in which it may lawfully engage [*Corp. Code § 18020(b)*].

[c] Internal Organization

The internal organization of nonprofit associations varies from extremely informal arrangements to highly complex organizations similar to that of corporations. Although an unincorporated association is not required to have either a constitution or bylaws [*see People v. Cohen (1925) 71 Cal. App. 367, 372, 235 P. 658* (no presumption that unincorporated association has written articles of association, partnership, or otherwise); *see also Orser v. George (1967) 252 Cal. App. 2d 660, 670, 60 Cal. Rptr. 708* (loosely organized duck club treated for purposes of opinion as existing association although it had no written agreement, constitution, bylaws, or officers, and had held only one meeting)], these documents are usually executed since they constitute the agreement among the members and determine the nature of the association.

In general, articles of association have the same relationship to an unincorporated association that articles of incorporation have to a corporation. The articles and bylaws, as well as the rules adopted pursuant to those documents, constitute a contract between the association and its members [*Berke v. Tri Realtors (1989) 208 Cal. App. 3d 463, 469, 257 Cal. Rptr. 738*); *California Dental Assn. v. American Dental Assn. (1979) 23 Cal. 3d 346, 353, 152 Cal. Rptr. 546, 590 P.2d 401* ; *see § 13A.13[2]*]. The rights and duties of the members as between themselves and in relation to the association in all matters affecting the internal government of the association and the management of its affairs are measured by the terms of this contract [*Weber v. Marine Cooks' & Stewards' Ass'n (1949) 93 Cal. App. 2d 327, 334-335, 208 P.2d 1009* ; *see Corrigan v. Cox (1967) 254 Cal. App. 2d 919, 922-923, 62 Cal. Rptr. 733* ; *see also Mooney v. Bartenders Union Local No. 284 (1957) 48 Cal. 2d 841, 843, 313 P.2d 857]* . These charter documents, however, do not bind the association in its relations to others [*see Most Worshipful Sons v. Sons (1958) 160 Cal. App. 2d 560, 325 P.2d 606* ; *Most Worshipful Hiram of Tyre Grand Lodge v. The Most Worshipful Sons of Light Grand Lodge (1949) 94 Cal. App. 2d 25, 30, 210 P.2d 34]* .

[d] Amendment

The governing documents may contain provisions for their amendment. If a nonprofit unincorporated association's governing principles do not provide a procedure to amend the association's governing documents, the governing documents may be amended by a vote of the members [*Corp. Code § 18340*; *see § 13A.34*].

[e] Construction

The practical and reasonable construction of the association's articles or constitution and bylaws by the governing board is binding on the membership and will be recognized by the courts [*DeMille v. American Fed. of Radio Artists (1947) 31 Cal. 2d 139, 147, 187 P.2d 769 , cert. denied, 333 U.S. 876 (1948)* ; *Berke v. Tri Realtors (1989) 208 Cal. App. 3d 463, 469, 257 Cal. Rptr. 738*)]. Further, statutes relating to unincorporated associations in existence at the time of formation are deemed incorporated into the association agreement by implication [*see Security-First Nat. Bank v. Cooper (1944) 62 Cal. App. 2d 653, 669, 145 P.2d 722]* .

[f] Dedication and Distribution Provisions

If the association intends to apply for the welfare exemption from local property tax [*see Rev. & Tax. Code § 214*], the articles of association must contain an irrevocable dedication to religious, charitable, scientific, or hospital purposes [*Rev. & Tax. Code § 214.01*]. The articles must also provide that on liquidation, dissolution, or abandonment, the property will inure to a tax-exempt fund, foundation, or corporation organized and operated for one of those purposes [*Rev. & Tax. Code § 214(a)(6)*; *see* [2], art. VIII, *below*]. The requirement that the property inure to the benefit of another exempt entity is subject to an exception. If the dedicated property is being used solely for charitable or hospital

purposes for at least 30 years, the existence of any reversionary provisions in the property title respecting liquidation, dissolution, or abandonment will not defeat the welfare exemption if the ownership, operation, use, and dedication of the property otherwise satisfy the requirements of the welfare exemption. [*Rev. & Tax. Code § 214.3*]. This form can be adapted to suit this exception.

For a detailed discussion of the welfare exemption, see Ch. 13B, *Tax-Exempt Status for Nonprofit Entities* .

[g] Statutory Governance Provisions

The legislature has enacted legislation relating to the governance of unincorporated associations. These statutes are designed to establish both mandatory and default provisions regarding the following matters [*see Corp. Code § 18300 et seq.*]:

- Member voting [*see Corp. Code § 18330*; *for discussion, see § 13A.33[2][d]*].
- Membership termination and suspension [*see Corp. Code §§ 18310, 18320*; *for discussion, see § 13A.33[3][a]*].
- Amending governing documents [*see Corp. Code §§ 18310, 18320*; *for discussion, see § 13A.34*].
- Merger [*see Corp. Code §§ 18350-18400*; *for discussion, see § 13A.39[2]*].
- Dissolution [*see Corp. Code §§ 18410*, 18411; *for discussion, see § 13A.39[3]*].

These statutes should be consulted while drafting the articles of organization. Because the term "governing documents" is defined to include articles of organization and bylaws, as well as other organizational documents [*Corp. Code § 18008*], these matters may be addressed in either document or both. Counsel should ensure that no inconsistencies exist between the articles of organization and bylaws.

This form provides that the association may merge with any other nonprofit entity. The board and the members must approve the principal terms of the merger agreement [*see § 13A.200[2]*, art. XI; *see also § 13A.39[2]*]. The form also provides that the governing documents may be amended by a majority vote of the members [*see § 13A.200[2]*, art. XI; *see also § 13A.34*].

[2] FORM

Articles of Organization

ARTICLES OF ASSOCIATION OF _____ [*name of nonprofit association*], AN UNINCORPORATED ASSOCIATION

I. NAME

1.01. The name of the association is _____[*name of association*].

II. PURPOSES AND POWERS

2.01. The purposes for which this Association is formed are:

(1) The specific and primary purpose is to [*specify purpose (see Rev. & Tax. Code § 23701a et seq.; I.R.C. § 501(c))*].

(2) The general purposes and powers are:

(a) To sue and be sued in its own name.

[*EITHER, for a medical association (see Corp. Code § 21200):*]

(b) To enter into and perform contracts in its own name, provided, however, that no member of this Association will be individually or personally liable for the debts or liabilities contracted or incurred by this Association in the acquisition of lands or lease or the purchase, leasing, construction, repairing, or furnishing of buildings or other structures to be used for the purposes of the Association, or for the debts or liabilities contracted or incurred by the Association in the carrying out or performance of its purposes as *set forth in Section 2.01*(1) of this Article II.

[*OR, for other entities:*]

(b) In accordance with *Corporations Code § 18100 et seq.* to enter into and perform contracts in its own name [*if labor union, add:* including collective bargaining agreements]. No member of this Association will be individually or personally liable for the debts or liabilities contracted or incurred by the Association in the acquisition of lands or leases or the purchase, leasing, designing, planning, architectural supervision, erection, construction, repair, or furnishing of buildings or other structures, to be used for the purposes of the Association. However, a member may assume a specific debt or other liability by executing a writing, signed by the member or his or her agent, assuming that debt or liability. Furthermore, there is no presumption or inference that any member of this Association has consented or agreed to the incurring of any obligation by the Association from the mere fact of joining or being a member, or signing its Bylaws.

[*Continue with the following:*]

(c) To enter into any of the commercial transactions authorized by the California Commercial Code, including, without limitation, the right to be a party to negotiable paper, to the issuance or transfer of warehouse receipts, bills of lading, and other documents of title, and to the issuance or transfer of investment securities, subject to any conditions, restrictions, or requirements imposed by law.

[*EITHER, for a medical association (see Corp. Code § 21200):*]

(d) To purchase, receive, own, hold, lease, mortgage, pledge, or encumber by deed of trust or otherwise, manage, and sell all real estate and other property as is convenient for the purposes and objects of the Association.

[*OR, for other entities:*]

(d) In accordance with *Corporations Code Section 18105*, to purchase, receive, own, hold, lease, mortgage, pledge, or encumber by deed of trust or otherwise, manage, and sell all real estate and other property as necessary for the business purposes and objects of the Association, and to design, plan, erect, construct, repair, and furnish buildings or other structures to be used for the purposes of the Association, subject to any limitations stated in _____ [these Articles *or* this Constitution].

[*Continue with the following:*]

(e) To receive gifts of real or personal property, in trust or otherwise, and to take and receive by will real or personal property necessary for its business purposes and objects, subject to the laws regulating the transfer of property by will, and to take and receive by will or deed all other real or personal property, and hold it until disposed of.

(f) To adopt, alter, or cancel an insignia and to register that insignia, alteration, or cancellation in the office of the Secretary of State.

(g) To adopt, use, and at will alter an Association seal. However, the failure to affix the seal does not affect the validity of any instrument.

(h) To adopt, amend, or repeal Bylaws in any manner provided in the Bylaws. However, that the initial Bylaws of this Association may be adopted by the unanimous written consent of the Directors named in _____ [these Articles *or* this Constitution] or by the vote or written consent of a majority of the [voting] members of this Association.

(i) Generally to have and exercise all other rights and powers now conferred, or that may be conferred, on nonprofit associations by law, or that do not contravene the law or public policy of the State of California or of the United States.

(j) _____ [*Set forth any other purposes and powers*].

2.02. The foregoing statement of purposes is to be construed as a statement of both purposes and powers, and the purposes and powers in each paragraph are, except where otherwise expressed, not to be limited or restricted by reference to or inference from the terms or provisions of any other paragraph, but are to be regarded as independent purposes and powers.

[*Add, if association will seek tax exemption:*]

2.03. Notwithstanding any of the foregoing provisions, this Association shall not, except to an insubstantial degree, engage in any activities or exercise any powers that are not in furtherance of the primary nonprofit purposes of this Association as *set forth in Section 2.01*(1) of this Article II.

III. PRINCIPAL OFFICE

3.01. The principal office of the Association for the transaction of its business is located in _____ County, California at _____[*specify address*].

IV. GOVERNING BODY

4.01. The powers of the Association shall be exercised, its property controlled, and its affairs conducted by [a Board of _____ (*number*) _____ (Directors *or* Trustees *or* Governors) *or* an Executive Board that consists of the elected officers of the Association and _____ (*number*) additional members of the Association].

[*Add, to restrict board authority:*]

The Board of [Directors *or* Trustees *or* Governors] may not _____[*specify restrictions, e.g.,* incur any liability on behalf of the Association in excess of the sum of $_____ without the prior approval of a majority of the (voting) members of the Association].

[*Continue with the following:*]

4.02. The names and addresses of the initial [Directors *or other title*] of this Association are

Name	Address
_____	_____
_____	_____
_____	_____

4.03. The qualifications, the time and manner of election, the terms of office, the duties and compensation, and the manner of removing Directors and filling vacancies are set forth in the Bylaws of this Association.

V. AGENT FOR SERVICE OF PROCESS

The name (and address) in the State of California of the Association's initial agent for service of process is:

Name _____

[*Include only if designated agent is an individual:*]

Street address _____ [*do not use post office box*]
City _____, California Zip _____

VI. MEMBERS

6.01. The qualifications of members of the Association, the different classes of membership, if any, the voting and other rights and privileges of members, and their liability for dues and assessments and the method of collection, and the termination and transfer of membership are stated in the Bylaws.

6.02. If the voting or other rights or interests, or any of them, are unequal, the Bylaws will set forth the rule or rules by which the voting or other rights or interests of each member or class of members are fixed and determined.

6.03. The interest of any member of this Association is the personal property of that member, and no member has any interest in property held by the Association, regardless of the time or manner in which that property is acquired [*add, if property not irrevocably dedicated to charitable purposes or to be forfeited to parent organization:*, except as provided in Article VIII of these Articles or in any provision of the Bylaws respecting the termination of a member's interest].

6.04. The membership of any member of this Association is terminated by the member's resignation, expulsion, or death; the expiration of the fixed term of the membership unless renewed before its expiration, or the termination of the legal existence of a member that is not a natural person.

PRACTICE TIP

This paragraph is based on the default provision of *Corp. Code § 18310(a)*, and will be implied if the association's governing documents do not address membership termination.

VII. DISSOLUTION

7.01. This Association will be dissolved and its affairs wound up when the objects for which it is organized have been fully accomplished. [*Add, if appropriate:* Further, this Association will be dissolved and its affairs wound up _____ (on _____ (*date*) *or* by the vote or written consent of at least _____ percent of the (voting) members and not otherwise)].

PRACTICE TIP

If the association's governing documents do not provide a method for dissolution, the association may be dissolved by the affirmative vote of a majority of the voting power of the association [*Corp. Code § 18410(b)*]. Dissolution may also result from the decision of a superior organization or court decree [*see Holt v. Santa Clara County Sheriff's Benefits Assn. (1967) 250 Cal. App. 2d 925, 929-930, 59 Cal. Rptr. 180* .]

[*Optional, if association is subject to tax and will apply for exemption:*]

On dissolution, the assets of the funds will be distributed pro rata to [the members of the Association *or* all current members of the Association who have been members for at least _____ (*specify, e.g.,* five years)].

[*If association is subject to tax and will apply for exemption (see Rev. & Tax. Code §§ 214, 23701d; see also I.R.C. § 501(c)(3)), add one of the following alternatives.*]

[*If assets will be distributed to nonprofit entity or fund, add Sections 8.01-8.04 as set forth below:*]

VIII. DEDICATION OF ASSETS AND DISTRIBUTION ON DISSOLUTION

8.01. This Association is not organized, nor will it be operated, for pecuniary gain or profit. This Association is organized solely for nonprofit purposes and does not contemplate the distribution of gains, profits, or dividends to its members.

8.02. The property, assets, profits, and net income of this Association are irrevocably dedicated to [*specify, e.g.,* religious] purposes and no part of the profits or net income of this Association shall ever inure to the benefit of any Director, officer, or member of this Association.

8.03. On the dissolution or winding up of this Association, any assets remaining after payment of, or provision for payment of, all debts and liabilities of this Association must be distributed to a nonprofit fund, foundation, or corporation that is organized and operated exclusively for [*specify, e.g.,* religious] purposes and that has established its tax-exempt status under *Internal Revenue Code Section 501(c)(3)* and *Revenue and Taxation Code Section 23701d*.

8.04. If the Association holds any assets in trust, those assets will, on dissolution, be disposed of in a manner as may be directed by decree of the superior court of the county in which this Association's principal office is located, on petition by the Attorney General, or by any person concerned in the liquidation.

PRACTICE TIP

The above article provision may also be used in the constitution of a social welfare association by

substituting *I.R.C. § 501(c)(4)* for *I.R.C. § 501(c)(3)*. Social welfare organizations that develop parks and common recreational areas or build buildings or facilities that will eventually become the property of a city or the state require an irrevocable dissolution clause with a public body as the distributee [*see* FTB Form 1065 (4-67)].

[*OR, if assets will be surrendered to parent organization, add Section 8.01, below:*]

VIII. DISTRIBUTION OF ASSETS ON DISSOLUTION

8.01. On the dissolution or winding up of this Association, any assets remaining after payment of, or provision for payment of, all of its debts and liabilities will be forfeited and surrendered to _____[*name of superior or parent organization*].

[*OR, if assets will be distributed to members, add Section 8.01, below:*]

VIII. DISTRIBUTION OF ASSETS ON DISSOLUTION

8.01. On the dissolution or winding up of this Association, any assets remaining after payment of, or provision for payment of, all of its debts and liabilities will be distributed as follows: [*specify, e.g.*, all assets will be sold at public auction and the proceeds distributed among all members, share and share alike *or* property donated to the Association by its members within the 12-month period immediately preceding dissolution will be returned to those members and any remaining property will be sold at public auction and the proceeds distributed to all members, share and share alike *or specify any other distribution provisions*].

[*Continue with the following:*]

PRACTICE TIP

The following provision is required by *I.R.C. § 508(e)* for private foundations to be exempt from income tax under *I.R.C. § 501(a)*. This provision is substantially similar to the approved provision in *Rev. Rul. 70-270, 1970-1 C.B. 135* .

IX. DISTRIBUTION OF INCOME AND PROHIBITED ACTIVITIES

9.01 Notwithstanding any other provision in _____[these Articles *or* this Constitution], this Association is subject to the following limitations and restrictions:

(1) The Association must distribute its income for each taxable year at such time and in such manner as not to become subject to the tax on undistributed income imposed by Internal Revenue Code *Section 4942 of the Internal Revenue Code of 1986*, or corresponding provisions of any subsequent federal tax laws.

(2) The Association may not engage in any act of self-dealing as defined in Internal Revenue Code *Section 4941(d) of the Internal Revenue Code of 1986*, or corresponding provisions of any subsequent federal tax laws.

(3) The Association may not retain any excess business holdings as defined in Internal Revenue Code *Section 4943(c) of the Internal Revenue Code of 1986*, or in corresponding provisions of any subsequent federal tax laws.

(4) The Association may not make any investment in a manner as to subject it to tax under Internal Revenue Code *Section 4944 of the Internal Revenue Code of 1986*, or corresponding provisions of any subsequent federal tax laws.

(5) The Association shall not make any taxable expenditures as defined in Internal Revenue Code *Section 4945(d) of the Internal Revenue Code of 1986*, or corresponding provisions of any subsequent federal tax laws.

X. MEMBERS' RIGHT OF INSPECTION

The original or a copy of _____[these Articles *or* this Constitution], as amended, will be kept at the principal office of the Association, and will remain open to inspection by all members or their agents at any reasonable time.

XI. MERGERS

This Association may merge with any other nonprofit entity if the Board and the members of the association approve the principal terms of the merger agreement in the manner provided in Article XII of _____[these Articles *or* this Constitution] for amending the governing documents of this Association.

XII. AMENDMENT OF GOVERNING DOCUMENTS

_____[These Articles *or* This Constitution] may only be amended by a resolution duly adopted by a majority of the [board of directors *or* board of trustees *or* executive board *or other title of governing board*] and by the vote or written consent of at least [*specify, e.g.,* 80] percent of the [voting] members of the Association and not otherwise. [*Add, if appropriate:* However, notwithstanding the foregoing, _____ (*identify provisions requiring greater vote for amendment*) may be amended only by a duly adopted resolution, as specified above, and _____ (*specify, e.g.,* 100) percent of the (voting) members of the Association.]

[*Add, if association is charitable association that will seek tax exemption (see Rev. & Tax. Code §§ 214, 23701d, or I.R.C. § 501(c)(3)):*]

XIII. LIMITATION ON POLITICAL ACTIVITIES

[None *or* No substantial part] of the activities of this Association consist of the carrying on of propaganda, or otherwise attempting to influence legislation. This Association will not participate in or intervene in (including the publication or distributing of statements) any political campaign on behalf of or in opposition to any candidate for public office.

[*Add, if association is social and recreational organization seeking exemption under Rev. & Tax. Code § 23701d:*]

XIV. NET PROCEEDS FROM PUBLIC EVENTS

If this Association holds any events that members of the general public are invited to observe or participate in for a fee, the income from the general public, less a proportional share of the expenses, may not benefit members and will be paid over to an organization that is exempt from income tax under *Internal Revenue Code Section 501(c)(3)* on an annual basis.

[*Continue with the following:*]

Date: _____.

_____ [*signature*]
[*typed name*], Organizer
_____ [*signature*]

[*typed name*], Organizer
_____ [*signature*]
[*typed name*], Organizer



126 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART IV. FORMS

6-13A California Legal Forms--Transaction Guide § 13A.201

§ 13A.201 Bylaws of Unincorporated Nonprofit Association

[1] Comment

[a] Use of Form

This form is an illustrative complete set of bylaws for an unincorporated nonprofit association. The form is designed for use with the articles of organization set forth in *§ 13A.200*. The provisions are of a general nature, for the most part are illustrative only, and are intended to be varied by counsel according to the specific requirements and nature of the association being formed. The form is a guide to the various categories of matters that should be addressed in the bylaws [*see* [b], *below*], and provides a framework for organizing and grouping those provisions.

In drafting the bylaws, it is important to keep in mind that the provisions may not violate public policy or law. It is therefore helpful, in determining which provisions are permissible, to consult the statutory provisions relating to nonprofit corporations that the courts have occasionally applied to associations [*see Mooney v. Bartenders Union Local No. 284 (1957) 48 Cal. 2d 841, 843, 313 P.2d 857]* . Counsel may wish to consult the bylaws of the various nonprofit corporations covered in Ch. 13, *Nonprofit Corporations* , for adaptation and inclusion in these bylaws.

If a subordinate body is being organized, the contents of its constitution and bylaws will be governed by the articles of incorporation, articles of association, constitution, or other charter documents, bylaws, and rules of the parent organization. These documents must be consulted before drafting the bylaws.

[b] Contents

There are no statutory provisions generally governing the bylaws of nonprofit unincorporated associations. Therefore, the bylaws may contain any provision appropriate to the nature and organization of the association, and not in conflict with law or public policy. Since the bylaws form part of the contract between the association and its members [*see § 13A.13[2]*], they should spell out as fully as possible the rights and duties of the members and officers. Essential matters include the following:

- Qualifications for membership, manner of admission, classifications of membership, ongoing

membership requirements, and termination of membership.

- Rules for governing the association, including the composition of the board, manner of selection of board members and officers, rights and obligations, termination, and succession.

- Notice requirements.

- Provisions for the amendment of the bylaws.

- Provisions for the termination of the association, including dissolution and winding up.

With respect to the suspension and expulsion of members, it is essential that provision be made for the member to be given notice of the proceedings and a reasonable opportunity to be heard. Of course, the association then must comply with these provisions. For further discussion, see *§ 13A.33[3][c]*.

[c] Arbitration of Member Disputes

The bylaws may provide for binding arbitration of disputes between members. By accepting membership in a voluntary association whose bylaws required members to submit all disputes with other members to arbitration on request of either party, the member was bound to arbitrate the dispute [*Gear v. Webster (1968) 258 Cal. App. 2d 57, 61-62, 65 Cal. Rptr. 255]* . An appellate court has held that a member-plaintiff was bound by an amended bylaw requiring arbitration, even though the bylaws only recommended arbitration when that individual became a member [*Gear v. Webster (1968) 258 Cal. App. 2d 57, 61-62, 65 Cal. Rptr. 255* (noting that bylaws at time of entry provided for amendment)].

If the arbitration agreement provides a method of appointing one or more arbitrators, that method must be followed [*Code Civ. Proc. § 1281.6*]. Thus, the fact that the method of selecting arbitrators differs from the classic procedure in which each side selects one arbitrator and the two selected arbitrators appoint a third arbitrator does not render the agreement inequitable or excuse a member from being bound by the arbitration clause [*Gear v. Webster (1968) 258 Cal. App. 2d 57, 63, 65 Cal. Rptr. 255]* .

[d] Rights of Members to Inspect Association Records

Courts will apply the rules governing corporations by analogy to nonprofit unincorporated associations when necessary to protect the property rights of a member in the association. By statute, all corporate records in California must be open to inspection on the written demand of any shareholder at any reasonable time for a purpose reasonably related to his or her interests as a shareholder [*see* Corp. Code § 3003; *see also* Ch. 13, *Nonprofit Corporations*]. Thus, it appears clear that a member of an unincorporated labor union is entitled to inspect its financial records [*Mooney v. Bartenders Union Local No. 284 (1957) 48 Cal. 2d 841, 843, 313 P.2d 857]* .

Under the Labor-Management Reporting and Disclosure Act of 1959, every labor organization required to submit a report under the Act must make available the information required to be contained in that report to all of its members. The organization must permit members to examine any books, records, and accounts necessary to verify that report for just cause [*29 U.S.C. § 431(c)*].

The member must make a proper showing to justify the inspection before the court will issue a writ of mandate to compel it [*Deacon v. International Union of Operating Eng'r (1965) 236 Cal. App. 2d 302, 307, 46 Cal. Rptr. 11]* . However, the question of a member's right to inspect association documents can be obviated by the inclusion of a bylaw delineating that right. Such a bylaw should not provide for lesser inspections rights than those stated in *Mooney v. Bartenders Union Local No. 284*, discussed above [*see Mooney v. Bartenders Union Local No. 284 (1957) 48 Cal. 2d*

841, 843, 313 P.2d 857] .

[e] Construction

The practical and reasonable construction of the association's articles or constitution and bylaws by the governing board is binding on the membership and will be recognized by the courts [*DeMille v. American Fed. of Radio Artists (1947) 31 Cal. 2d 139, 147, 187 P.2d 769 , cert. denied, 333 U.S. 876 (1948)* ; *Berke v. Tri Realtors (1989) 208 Cal. App. 3d 463, 469, 257 Cal. Rptr. 738*); *Williams v. Inglewood Bd. of Realtors (1963) 219 Cal. App. 2d 479, 486, 33 Cal. Rptr. 289]* . Further, statutes relating to unincorporated associations in existence at the time of formation are deemed incorporated into the association agreement by implication [*see Security-First Nat. Bank v. Cooper (1944) 62 Cal. App. 2d 653, 669, 145 P.2d 722]* .

[2] FORM

Bylaws of Unincorporated Nonprofit Association

BYLAWS OF _____ [*name of nonprofit association*], AN UNINCORPORATED ASSOCIATION

ARTICLE I OFFICES

Principal Office

1.01. The principal office of the Association for the transaction of its business is located at _____[*street address*], _____[*city*], _____ County *or* City and County] of _____, California.

Other Offices

1.02. The Association may also have offices at other places within or without the state of California where it is qualified to do business, as its business may require and as [the Board of Directors *or* the Board of Trustees *or* the Board of Governors *or* the Executive Board *or other title*] may from time to time by resolution designate. [*Add, if appropriate:* _____ (The Board *or other title*) will incur no financial liability on behalf of the Association in obtaining other offices without the prior approval of a majority of the voting members of the Association or any other limitation.]

Change of Address

1.03. The [Board of Directors *or* Board of Trustees *or* Board of Governors *or* Executive Board *or other title*] has full power and authority to change the principal office of the Corporation from one location to another in _____[the County of _____, California *or* California]. Any change of address will be noted by the Secretary in these Bylaws, but will not be considered an amendment of these Bylaws.

ARTICLE II MEMBERS

Classes of Membership and Rights

[*EITHER, if association will have only one class of membership:*]

2.01. The Association will have one class of members only. The membership, voting, and other rights, interests and privileges of each member shall be equal.

[*OR, if association will have more than one class of membership:*]

2.01. The Association will have two classes of membership as follows: Active Members and Associate Members. Only Active Members have voting rights in the Association, and the voting rights of each member of that class are equal. Associate Members do not have voting rights. In all other respects, the membership and other rights, interests, and privileges of all members, regardless of class, shall be equal.

Qualifications

[*EITHER, if association will have only one class of membership:*]

2.02. Qualifications for membership are as follows: [*specify*].

[*OR, if association will have more than one class of membership:*]

2.02. (a) An applicant for Active Membership must first qualify for and become an Associate Member, be an Associate Member (not under suspension) at the time application for Active Membership is made, and have the following qualifications: [*specify*].

(b) To be eligible for Associate Membership, an applicant shall have the following qualifications: [*specify*].

Admission

[*EITHER, if association will have only one class of membership:*]

2.03. Qualified persons will be admitted to membership on submitting an application [*add, if appropriate:* endorsed by at least one _____ (member *or* active member) of the Association] and on approval of the application by [the Board of Directors *or* the Board of Trustees *or* the Board of Governors *or* the Executive Board *or other title*]. The application must be made on an application form as prescribed from time to time by the Association. The application form must contain the statement that the applicant has read the [Articles *or* Constitution], the Bylaws, and the Rules of this Association, that the applicant is familiar with and understands them, and that if admitted to membership, the applicant agrees to be bound by these instruments.

[*OR, if association will have more than one class of membership:*]

2.03. (a) Application for Active Membership must be made on the form prescribed by [the Board of Directors *or* the Board of Trustees *or* the Board of Governors *or* the Executive Board *or other title*]. If the applicant possesses the qualifications for Active Membership, as provided in these Bylaws, the application will be accepted.

(b) Active membership continues until the earlier of the death or resignation of the member or until the membership is terminated as provided in these Bylaws.

(c) Application for Associate Membership must be made on the form prescribed by [the Board of Directors *or* the Board of Trustees *or* the Board of Governors *or* the Executive Board *or other title*]. If the applicant possesses the qualifications for Associate Membership, as provided in these Bylaws, the application will be accepted.

(d) Associate membership _____[continues until the earlier of the death or resignation of the member or until the membership is terminated as provided in these Bylaws *or, to make associate member status essentially a trial membership, use the following:* terminates at the expiration of one year from the date it commences and under no circumstances may associate membership be extended or renewed. If any Associate Member fails within one year after admission to make application for and qualify as an Active Member, the associate membership in this Association automatically terminates and the former Associate Member is not eligible to reapply for membership in the Association until the expiration of one year from the date of that termination. In determining the one-year period for termination of membership, any time during which the member is suspended as provided in these Bylaws will be excluded].

(e) The application must be made on an application form as prescribed from time to time by the Association. The application form must contain the statement that the applicant has read the [Articles *or* Constitution], the Bylaws, and the Rules of this Association, that the applicant is familiar with and understands them, and that if admitted to membership, the applicant agrees to be bound by these instruments.

Fees, Dues, and Assessments--Application Fee

[*EITHER*]

2.04. (a) No fee will be charged for making application for membership in the Association.

[*OR*]

2.04. (a) An application fee in the amount _____[of $_____ *or* determined by resolution of _____ (the Board of Directors *or* the Board of Trustees *or* the Board of Governors *or* the Executive Board *or other title*) from time to time] must be submitted with the application for membership. The application fee is nonrefundable, regardless of whether the application is accepted or denied.

[*Continue with the following:*]

Annual Dues

(b) All members must pay annual dues _____[in the amount of $_____ *or* in the amount determined by resolution of _____ (the Board of Directors *or* the Board of Trustees *or* the Board of Governors *or* the Executive Board *or other title*) from time to time]. The first annual dues of each member is payable and must be submitted in full with the application for membership. Future annual dues are due and payable on the anniversary date of the member's admission to the Association. [*Optional:* Any member, on learning of the amount of dues and the time fixed for payment, may avoid liability for the dues by promptly resigning from membership, except if the member is, by contract or otherwise, liable for the dues.]

Assessments

[*EITHER*]

(c) Memberships in the Association are nonassessable.

[*OR*]

(c) Memberships in the Association are subject to assessments, which may be levied and collected as follows: [*describe assessment*]. [*Optional:* Any member, on learning of an assessment, may avoid liability for it by promptly resigning from membership, providing that the member is not otherwise liable for the assessment by contract or otherwise.]

[*OR*]

(c) Memberships are subject to assessment [*specify, e.g.,* for capital contributions to enable the Association to acquire assets, provided, however, that assessments may not exceed the total aggregate sum _____ (*e.g.,* $2,500) per membership]. The amount of each levy and the method of collection will be fixed from time to time by resolution of [the Board of Directors *or* the Board of Trustees *or* the Board of Governors *or* the Executive Board *or other title*)]. Assessments will be made payable at the times or intervals, and on notice, as prescribed by the Board. [*Optional:* Any member, on learning of an assessment, may avoid liability for it by promptly resigning from membership, providing that the member is not otherwise liable for the assessment by contract or otherwise.]

[*Continue with the following:*]

Property of Association

(d) Dues [*if assessments are authorized, add:* and assessments] paid to the Association become the property of the Association and any severable or individual interest of any member in the funds terminates on payment.

Number of Members

[*EITHER*]

2.05. There is no limit on the number of members that the Association may admit.

[*OR*]

2.05. The Association may not have more than [*number*] members.

Transferability of Membership

[*EITHER*]

2.06. Neither membership in the Association nor any rights in the membership may be transferred or assigned for value or otherwise.

[*OR*]

2.06. Any member may transfer his or her membership in the Association to any nonmember who is qualified for membership on the terms fixed by the transferring member and on giving written notice of the transfer to [*specify, e.g.*, the Secretary of the Association].

[*OR*]

2.06. The [Board of Directors *or* Board of Trustees *or* Board of Governors *or* Executive Board *or other title*] may provide by resolution for the transfer of memberships within any class or classes, with or without restriction or limitation, including transfer on the death, dissolution, merger, or reorganization of a member.

[*Continue with the following:*]

Membership Book

2.07. The Association will keep a membership book containing the _____[name and address *or* name, address, and class] of each member [in written form *or* in any form capable of being converted into written form]. The membership book must note if a membership has terminated, the manner of termination, and the date on which that membership ceased. The membership book will be kept at the principal office of the Association and is subject to the rights of inspection required by law and as set forth in Section 2.08 of these Bylaws.

Inspection Rights of Members

[*EITHER*]

2.08. All records of this Association [except the membership book] will be open to inspection on the written demand of any member at any reasonable time for a purpose reasonably related to his or her interests as a member.

[*OR*]

2.08. Membership in the Association is confidential. Notwithstanding any other provision of these Bylaws, the membership book is not available for inspection by any person, whether or not a member, officer, or Board Member of this Association, except as required by law and except as follows: [*list persons authorized to have access to the book, for what purposes, and measures, if any, for securing its secrecy*].

[*Continue with the following:*]

Termination of Membership--By Resignation or Death

2.09. (a) The membership of any member of the Association automatically terminates on the death of the member or on receipt of the member's written request for termination delivered to the President or Secretary of the Association personally or by United States mail. Termination of membership does not relieve the member, or the member's estate in the event of termination by death, of the obligation to pay any dues, assessments, or other charges that accrue and remain unpaid at termination.

By Nonpayment of Dues or Assessments

(b) The membership of any member who fails to pay membership dues or assessments within 30 days after they become due automatically terminates at the end of that 30-day period, provided that the member was given written notice, within 10 days before the due date, that the dues or assessments were due and payable as of that date. Written notice shall be delivered to the recipient personally or by United States mail, postage prepaid, addressed to the address of the member as it appears in the membership book of the Association. In the event that timely written notice is not given as provided in the preceding sentence, membership will not terminate for nonpayment of dues or assessments until that notice is given and the dues and assessments have not been fully paid within 30 days following that notice.

Rights on Termination

(c) All rights and interests of a member in the Association cease on the termination of membership.

Reinstatement

[*EITHER*]

(d) Any member whose membership is terminated, other than by death, may have his or her membership reinstated on the terms as [the Board of Directors *or* the Board of Trustees *or* the Board of Governors *or* the Executive Board *or other title*] deems appropriate by filing a written request for reinstatement with [the President or Secretary of the Association *or* any Board Member]. On approval of the request by a majority of the Board present at the meeting at which the request is considered, provided that a quorum is present at the meeting, the membership will be reinstated.

[*OR*]

(d) Any member whose membership is terminated, other than by death, may be readmitted to membership by satisfying the then applicable membership requirements and complying with the provisions applicable to the admission of new members.

[*OR*]

(d) Any member whose membership is terminated as provided in this section is not be eligible for readmission or reinstatement.

[*Continue with the following*]

Suspension and Expulsion

[*EITHER*]

2.10. No member of this Association may be suspended, fined, censured, or expelled for any reason whatsoever. Membership in the Association terminates only as provided in Section 2.09 of these Bylaws and not otherwise.

[*OR*]

2.10. (a) The [Board of Directors *or* Board of Trustees *or* Board of Governors *or* Executive Board *or other title*] is authorized to reprove either privately or publicly, impose a fine not to exceed $_____, suspend from membership for a period of not more than one year, or to censure, suspend, and fine, or expel from membership any member of this Association for good cause.

(b) "Good cause," as used in this section, means any of the following:

(1) Any conduct that brings the Association into public disrepute or violates the purposes for which this Association is formed.

(2) Any willful failure or refusal to abide by the _____ [Articles of Association or Constitution], Bylaws, or Rules of this Association.

(3) Any willful failure or refusal to abide by the terms of an award in any arbitration proceeding under the terms of this Article after having agreed in writing to do so and after having received notice of the award.

(4) Any willful failure or refusal to pay any assessment levied pursuant to the provisions of this Article.

(5) _____ [*Specify any other or additional definitions of "good cause", e.g.,* Any willful failure or refusal to abide by the Code of Ethics of the National Association].

(c) For purposes of this section, the following definitions shall apply:

(1) A "private reproval" is a reproval in letter form, signed by the President of the Association, and sent to the subject member by certified or registered mail, return receipt requested. A copy of the letter and the return receipt must be filed with the minutes of the Board meeting imposing discipline.

(2) A "public reproval" is the same as a private reproval except that in addition to sending a letter to the subject member and filing a copy of the letter, together with the return receipt, with the minutes of the Board meeting imposing discipline, a copy of the letter is read to the membership at the next regular meeting at which a quorum is present.

(3) A "suspension" requires compliance with the public reproval requirements of Subsection (2). In addition, all voting and other rights of the member during the term of the suspension are terminated, provided, however, that the member may not be relieved of any liability for payment of dues or assessments falling due or levied during the period of suspension.

(4) An "expulsion" requires compliance with the public reproval requirements of Subsection (2). In addition, the

membership of the member in this Association is immediately and conclusively terminated, provided, however, that the member may not be relieved of any liability for the payment of dues and assessments accruing before the hearing on the charges against the member as provided in Subsection (d), below.

(5) A "fine" may be imposed separately, in which case compliance with Subsection (1) is required, or a fine may be imposed in addition to a public reproval or suspension.

(d) Procedure:

(1) Proceedings against a subject member may be initiated by resolution of the _____ [Board of Directors *or* Board of Trustees *or* Board of Governors *or* Executive Board *or other title*)] adopted at any meeting at which a quorum is present, or by petition signed by at least _____ [*specify, e.g.,* 10 percent] of the voting members of the Association, filed with the Secretary or President of the Association.

(2) On adoption of the resolution or receipt of the petition, the President, or the Vice-President if the President is unable or refuses to act, will schedule the matter to be heard at the next regular or special meeting held not less than 20 days nor more than 40 days after the date the resolution is adopted or the petition received, as the case may be. The Secretary, or other person appointed by the President for the purpose, will deliver at least 10 days before the date of the hearing a copy of the resolution or petition, together with a notice of the time and place of the hearing, to the subject member either in person or by United States mail addressed to the member at the address as it appears on the books of the Association. If the person whose duty it is to serve the notice fail or refuse to do so, the copy and notice may be delivered by any Board Member of the Association; in this event the matter will heard at the next regular or special meeting of the Board at which a quorum is present held not less than 10 days after the copy and notice are personally delivered or deposited in the United States mail. If a quorum fails to attend that meeting, the matter will be heard at the next succeeding regular or special meeting. However, if a quorum fails to attend the next succeeding regular or special meeting, the matter against the subject member shall be dismissed. This dismissal is automatic and final, except that the alleged conduct of the subject member giving rise to the proceeding may be considered in any subsequent proceeding under this section based on future alleged misconduct.

(3) Notwithstanding any other provision in these Bylaws, notice of the meeting at which the hearing is first scheduled or subsequently scheduled must be given to all Board Members as required by these Bylaws for special meetings of the Board.

(4) The hearing will be informal and the rules of evidence and rules of judicial procedure need not be observed. The President of the Association will preside over the hearing. The President will (i) read the charges against the subject member; (ii) require that the charges be verified by the testimony of the person or persons making them; (iii) hear any other witnesses against the subject member; (iv) allow the subject member to cross-examine each witness; (v) allow the subject member to make a statement in his or her own behalf; (vi) allow the subject member to call witnesses in his or her own behalf; (vii) allow the Board Members present, when and as recognized by the chair, and subject to the control of the chair, to question witnesses; and (viii) rule on the admission and exclusion of evidence and on questions of hearing procedure.

(5) After the hearing has closed, the Board Members will vote on whether to impose discipline or dismiss the matter. If they vote to impose discipline but cannot agree on the nature and extent of discipline, the discipline will be a private reproval provided. Any vote imposing discipline or dismissing the matter is final.

(6) _____ [*Set forth any other procedure, including appellate procedure, if desired, for disciplining members*].

(e) An expelled member is not eligible for readmission to the Association _____[before the expiration

of _____ (*number*) year(s) from the date of expulsion *or specify any other provisions*].

(f) All rights of the subject member in the Association or in its property _____[cease on expulsion *or* will be determined as follows: _____ (*specify*)].

[*Optional provision:*]

Arbitration

2.11. (a) Any controversy between members involving their membership [*if appropriate, add:* and professional rights] will, on the written request of any member involved in the controversy filed with the President or Secretary of the Association, be submitted to arbitration. The arbitration must, except as otherwise provided in these Bylaws, comply with *Code Civ. Proc. §§ 1281-1288.8*.

(b) Each party to the controversy will nominate one Active Member of the Association as an arbitrator. The two arbitrators selected by the members will select a third arbitrator from the [Board of Directors *or* Board of Trustees *or* Board of Governors *or* Executive Board *or other title or* Associate Members]. The third arbitrator is the neutral arbitrator.

(c) The neutral arbitrator will appoint a time and place for the arbitration hearing and cause notice to be served personally or by registered or certified mail on the parties to the arbitration and on the other arbitrators not less than seven days before the hearing. Presence at the hearing waives the right to notice.

(d) The neutral arbitrator may adjourn the hearing from time to time as necessary. On request of a party to the arbitration for good cause, or on the neutral arbitrator's own determination, the neutral arbitrator may postpone the hearing to a time not later than the date fixed by the agreement for making the award, or to a later date if the parties to the arbitration consent to the postponement.

(e) The neutral arbitrator will preside at the hearing, rule on the admission and exclusion of evidence and on questions of hearing procedure, and exercise all powers relating to the conduct of the hearing.

(f) The parties to the arbitration are entitled to be heard, to present evidence, and to cross-examine witnesses appearing at the hearing. However, rules of evidence and rules of judicial procedure need not be observed.

(g) Any award must be in writing and signed by the concurring arbitrators. The written award must include a determination of all questions submitted to the arbitrators that are necessary to determine the controversy. The neutral arbitrator will serve a signed copy of the award on each party to the arbitration, [personally *or* by registered or certified mail *or specify any other provisions for service*].

(h) The award must be made within [*number*] days after the conclusion of the hearing. The objection that the award was not timely made is waived unless the objecting party gives the arbitrators written notice of the objection before receiving service of a signed copy of the award.

(i) An award may be corrected and enforced as prescribed in *Code Civ. Proc. §§ 1284, 1285 et seq.*

[*EITHER*]

(j) Each party to the arbitration will pay the expenses and fees of the arbitrator selected by them. Each party to the arbitration will pay their pro rata share of the expenses and fees of the neutral arbitrator, plus any other expenses incurred or approved by the neutral arbitrator, not including counsel fees, witness fees, or other expense incurred by a party for his or her own benefit.

[*OR*]

(j) Unless the parties otherwise agree, each party to the arbitration will pay their pro rata share of the costs of arbitration, including the expenses and fees of the arbitrators.

[*Continue with the following:*]

ARTICLE III MEETINGS OF MEMBERS

Place

3.01. Meetings of members will be held at the principal office of the Association or at any other place as may be designated from time to time by the [Board of Directors *or* Board of Trustees *or* Board of Governors *or* Executive Board *or other title*].

Regular Meetings

[*EITHER*]

3.02. Regular meetings of members will not be held.

[*OR*]

3.02. Members meet regularly [*specify, e.g.,* on the first Friday of each month at 8:00 P.M.]. Elections for board members and officers will be held at the regular meeting held in [*specify, e.g.,* March] of each year.

[*Continue with the following:*]

Special Meetings

3.03. Special meetings of members may be called by [*specify, e.g.,* the President or Secretary or any two Board members of the Association *or other persons*]. Special meetings will be held at the times and places within or without the State of California as stated in the resolution.

Notice of Meetings

3.04. Written notice of every meeting of members must be either personally delivered or mailed by [first-class *or* registered *or* certified] United States mail, postage prepaid, [*number not less than 10 or more than 90, e.g.,* 15 days] before the date of the meeting to each member who is entitled to vote at the meeting as of the record date for notice of

the meeting. However, notice of regular member meetings at the Association's principal office is not required.

If notice is given by mail or other means of written communication, the notice must be addressed to the member at the address appearing on the membership book of the Association or at the address given by the member to the Association for the purpose of notice. If no address appears or was given by the member, notice will be given [at the principal office of the Association *or* by publication in any newspaper of general circulation in the county in which the principal office of the Association is located]. The [Secretary *or* Assistant Secretary], or any transfer agent specially designated by the [Secretary *or* Assistant Secretary] for this purpose, will execute an affidavit of the giving of the notice of the meeting of members. In the case of a specially called meeting of members, notice that a special meeting will be held at a time requested by the person or persons calling the meeting not less than 35 days nor more than 90 days after receipt of the written request from that person or persons by the [Chairman of the Board *or* President *or* Vice-President *or* Secretary] of the Association will be sent to the members forthwith and in any event within 20 days after the receipt of the request for a special meeting.

Notwithstanding the provision dispensing with notice of regular meetings, no action may be taken on any of the following proposals at any regular meeting unless written notice of the general nature of the business or proposal has been given as in the case of a special meeting: (1) a proposal to sell, lease, convey, exchange, transfer, or otherwise dispose of all or substantially all of the property or assets of the Association; (2) any proposal relating to the real property of the Association; (3) any proposal of the Association to incur any indebtedness in excess of the sum of $_____; (4) any proposal to incorporate; (5) any proposal to amend the [Articles of Organization *or* Constitution] of this Association; or (6) any proposal to wind up and dissolve the Association.

Contents of Notice

3.05. The notice must state the place, date, and time of the meeting. In the case of special meetings, the notice must specify the general nature of the business to be transacted. Notice of regular meetings, when required, must identify those matters that the Board, at the time the notice is given, intends to present for action by the members. The notice of any meeting at which Board Members are to be elected must include the names of all those who are nominees at the time the notice is given to the members.

Waivers, Consents, and Approvals

3.06. The transactions of any meeting of members, however called and noticed, and wherever held, are as valid as though had at a meeting duly held after regular call and notice, if a quorum is present either in person or by proxy, and if, either before or after the meeting, each of the persons entitled to vote but not present in person or by proxy, signs a written waiver of notice, a consent to the holding of the meeting, or an approval of the minutes of the meeting. All waivers, consents, and approvals will be [filed with the Association's records *or* included in the minutes of the meeting].

Quorum

3.07. A quorum at any meeting of members consists of [*specify number, proportion, or percentage, e.g., number or* a majority *or* 35 percent] of the voting power, represented in person or by proxy. For purposes of this Bylaw, "voting power" means the power to vote for the election of Board Members at the time any determination of voting power is made and does not include the right to vote on the happening of some condition or event that has not yet occurred.

Adjournment for Lack of Quorum

3.08. In the absence of a quorum, no business may be transacted at any meeting of members, except as provided in Section 3.09 of these Bylaws. The only motion that the chair may entertain is a motion to adjourn. The meeting may be adjourned from time to time by the vote of a majority of the votes represented either in person or by proxy. If adjourned for less than 30 days, no notice of the adjourned meeting need be given. However, if a meeting is adjourned to another time or place, and thereafter a new record date is fixed for notice or voting, notice of the adjourned meeting must be given to each member of record who, on the record date for notice of the meeting, is entitled to vote at the meeting. No meeting of members may be adjourned more than 45 days.

Loss of Quorum

3.09. The members present at a duly called or held meeting at which a quorum is present may continue to transact business until adjournment notwithstanding the withdrawal of enough members to leave less than a quorum, if any action taken, other than adjournment, is approved by at least a majority of members required to constitute a quorum.

Voting of Membership

[*EITHER*]

3.10. (a) Each member is entitled to one vote on each matter submitted to a vote of the members.

[*OR*]

3.10. (a) Except as provided in Section _____ of these Bylaws authorizing cumulative voting at the election of the Board members, each member is entitled to one vote on each matter submitted to a vote of the members.

[*Continue with the following:*]

(b) Single memberships in which two or more persons have an indivisible interest will be voted as *set forth in Section 3.10*(c) of these Bylaws relating to the voting of memberships in two or more names.

(c) When a membership stands of record in the names of two or more persons, whether fiduciaries, members of a partnership, joint tenants, tenants in common, husband and wife as community property, tenants by the entirety, or otherwise, or if two or more persons (including proxyholders) have the same fiduciary relationship respecting the same membership, unless the Secretary of the Association is given written notice to the contrary and is furnished with a copy of the instrument or order appointing them or creating the relationship wherein it is so provided, their acts with respect to voting have the following effect: if only one member votes, that act binds all members; if more than one member vote, the act of the majority so voting binds all members.

(d) Cumulative voting is authorized for the election of Board members, but not for any other purpose.

PRACTICE TIP

For a provision authorizing cumulative voting, see *Ch. 13, Nonprofit Corporations, § 13.212[2]*.

(e) Members entitled to vote are not permitted to vote or act by proxy. [*Optional:* Any amendment of this provision

creating or expanding proxy rights must be adopted with approval by the members.]

PRACTICE TIP

For a provision authorizing proxy voting, see *Ch. 13, Nonprofit Corporations, § 13.212[2]*.]

(f) Voting will be by voice vote for all matters other than the election of [Board members *or* Board members and officers]. The election of [Board members *or* Board members and officers] will be by secret ballot.

Conduct of Meetings

3.11. (a) The President of the Association or, in his or her absence, any other person chosen by a majority of the voting members present in person or by proxy will be Chairman of and preside over the meetings of the members. The Secretary of the Association will act as the secretary of all meetings of members. However, in his or her absence, the Chairman of the meeting of members will appoint another person to act as secretary of the meeting.

(b) The Robert's Rules of Order, as amended from time to time, will govern the meetings of members insofar as those rules are not inconsistent with or in conflict with these Bylaws, the [Articles of Association *or* Constitution], or the rules governing agenda, motions, and related matters.

Record Date of Membership

3.12. The record date for the purpose of determining the members entitled to notice of any meeting of members is [*number not greater than 90 or less than 10, e.g.,* 40 days] before the date of the meeting of members. The record date for the purpose of determining the members entitled to vote at any meeting of members is [*number not greater than 60, e.g.,* 30 days] before the date of the meeting of members. [The record date for the purpose of determining the members entitled to exercise any rights in respect to any other lawful action is _____ (*number not greater than 60, e.g.,* 20 days) before that other action.]

Action Without Meeting by Written Ballot

3.13. (a) Any action that may be taken at any regular or special meeting of members may be taken without a meeting. If an action is taken without a meeting, the Association must distribute a written ballot to every member entitled to vote on the matter. The ballot must state the proposed action, provide an opportunity to specify approval or disapproval of any proposal, and provide a reasonable time within which to return the ballot to the Association. Approval by written ballot is valid only when the number of votes cast by ballot within the time period specified equals or exceeds the quorum required to be present at a meeting authorizing the action, and the number of approvals equals or exceeds the number of votes that would be required to approve at a meeting at which the total number of votes cast was the same as the number of votes cast by ballot.

(b) Ballots will be solicited in a manner consistent with the requirements of giving notice of members' meetings *set forth in Section 3.04* of these Bylaws. All solicitations must indicate the number of responses needed to meet the quorum requirement and, with respect to ballots other than for the election of Board members, state the percentage of approvals necessary to pass the measure submitted. The solicitation must specify the time by which the ballot must be received in order to be counted.

[*EITHER*]

(c) Unless otherwise provided in the Articles of Association or these Bylaws, a written ballot may not be revoked.

[*OR*]

(c) Any member casting a ballot may revoke the ballot, or substitute another, by a writing received by the Association before the time specified on the ballot for its receipt, but may not do so thereafter. The revocation is effective on its receipt by the Secretary of the Association.

[*Continue with the following:*]

ARTICLE IV BOARD MEMBERS

Number

4.01. The Association will have _____[*number specified in the articles and, if not stated in the articles, number equal to or greater than one*] Board Member(s).

Qualifications

[*EITHER*]

4.02. Any Active Member of this Association is qualified to be a Board Member. With the exception of the initial Board Members, all Board Members must also be Active Members of the Association.

[*OR*]

4.02. The Board Members of the Association must be residents of the State of California. [*Optional:* In addition, Board Members must also have the following qualifications: _____ (*specify, e.g., professional qualifications*)].

[*Continue with the following:*]

Terms of Office

4.03. (a) Each Board Member holds office _____[*specify term of at least one year but not more than three years, e.g.,* until the next (annual) meeting of members as prescribed by Section 3.02 of these Bylaws *or* for a term of one year from the date of the Board Member's election], and until the Board Member's successor qualifies under Section 4.02 of these Bylaws and is elected under Section 4.05. The initial Board Members serve until the qualification and election of their successors. If a Board Member is removed at a special meeting of the members called and held as prescribed by Section 3.03 of these Bylaws, that Board Member will hold office until his or her removal and his or her successor is elected and qualifies.

[*EITHER*]

(b) Board Members, including the initial Board Members, are eligible for reelection without limitation on the number of terms they may serve, provided they continue to meet the qualifications for office.

[*OR*]

(b) Board Members, including the initial Board Members, are eligible for reelection, provided they continue to meet the qualifications for office, but may not be elected to more than _____ consecutive terms.

[*Continue with the following:*]

Nomination

4.04. Any person qualified to be a Board Member under Section 4.02 of these Bylaws may be nominated by the method of nomination authorized by the Board or by any other method authorized by law. [*Optional:* The date for close of nominations for the board is _____ (*number not less than 50 or more than 120*) days before the day the Board Members are to be elected *or if board members are to be elected at regular meetings, add:* before the regular meeting of members as provided in Section 3.02 of these Bylaws *or when board members are to be elected by written ballot, add, if desired:* before printing and distributing written ballots for the election of Board Member. A nomination for the board may not be made after the date set for close of nomination.]

Election

[*EITHER, if association will hold regular meetings:*]

4.05. The Board Members will be elected [at each annual meeting as prescribed by Section 3.02 of these Bylaws [*if authorized by the articles or bylaws as in Section 3.13 of these bylaws, add:* or by written ballot as authorized by Section 3.13 of these Bylaws].

[*OR, if association will not hold regular meetings:*]

4.05. The Board Members will be elected _____ by written ballot as authorized by Section 3.13 of these Bylaws.

Compensation

[*EITHER*]

4.06. The Board Members serve without compensation, [except that they shall be allowed and paid their actual and necessary expenses incurred in attending the meetings of the Board *or other provisions allowing partial compensation*].

[*OR*]

4.06. The compensation of the Board Members _____[is $_____ per month *or* shall be fixed from time to time by resolution of the Board and approved by the vote or written consent of a majority of the voting members of the association].

PRACTICE TIP

Bear in mind that *I.R.C. § 4941(d)(2)(E)* prohibits unreasonable compensation.

[*Continue with the following:*]

Duties

4.07. The duties of the Board Members include the following:

(a) To perform any and all duties imposed on them collectively or individually by law, by the [Articles *or* Constitution] of this Association, or by these Bylaws.

(b) To employ officers, agents, and employees as may be authorized from time to time by the vote or written consent of a majority of the voting members of the Association.

(c) To supervise all officers, agents, and employees of this Association to ensure that their duties are properly performed.

(d) To register their addresses with the Secretary of the Association, and notices of meetings mailed or telegraphed to them at those addresses constitute valid notice of the meeting.

(e) [*Specify any other or additional provisions*].

Meetings

4.08. (a) Meetings of the Board may be called by the Chairman of the Board or the President or any Vice-President or the Secretary or any two Board Members.

(b) All meetings of the Board will be held at the principal office of the Association as specified in Section 1.01 of these Bylaws, or as changed from time to time as provided in Section 1.03 of these Bylaws.

(c) Regular meetings of the Board will be held, without call or notice, _____ [*specify time and place e.g.,* at the principal office of the Association immediately following each annual meeting of the members of the Association as *set forth in Section 3.02* of these Bylaws.

(d) Special meetings of the Board may be called by the Chairman of the Board or the President or any Vice-President or the Secretary or any two Board Members. Special meetings may be held on 4 days' notice by first-class mail, postage prepaid, or on 48 hours' notice delivered personally or by telephone, including a voice messaging system or other system or technology designed to record and communicate messages, telegraph, facsimile, electronic mail, or other electronic means. Notice of the special meeting need not be given to any Board Member who signs a waiver of notice or written consent to holding the meeting, or an approval of the minutes of the meeting, whether before or after the meeting, or who attends the meeting without protesting the lack of notice to that Board Member either before or at the

commencement of the meeting. All waivers, consents, and approvals must be filed with the association's records or made a part of the minutes of the meetings.

(e) A majority of the authorized number of Board Members constitutes a quorum of the Board for the transaction of business, except as otherwise provided in these Bylaws.

(f) Except as otherwise provided in the Articles, in these Bylaws, or by law, every act or decision done or made by a majority of the Board Members present at a meeting duly held at which a quorum is present is the act of the Board. At any meeting at which a quorum was initially present, the Board Members may continue to transact business notwithstanding the withdrawal of Members if any action taken is approved by at least a majority of the required quorum for that meeting, or any greater number as is required by the law, the Articles, or these Bylaws.

(g) The Chairman of the Board or, in his or her absence, any Board Member selected by the Board then present, will preside at meetings of the Board. The Secretary of the Association or, in the Secretary's absence, any person appointed by the presiding officer will act as Secretary of the Board. Members of the Board may participate in a meeting through use of conference telephone or similar communications equipment, so long as all members participating in the meeting can hear one another. This participation constitutes personal presence at the meeting.

(h) A majority of the Board Members present at the meeting, whether or not a quorum is present, may adjourn any meeting to another time and place. If the meeting is adjourned for more than 24 hours, notice of the adjournment to another time or place must be given before the time of the adjourned meeting to the Board Members who were not present at the time of the adjournment.

(i) The Robert's Rules of Order, as amended from time to time, will govern the meetings of the board insofar as those rules are not inconsistent with or in conflict with these Bylaws, the [Articles of Association *or* Constitution], or the rules governing agenda, motions, and related matters.

Action Without Meeting

4.09. Any action required or permitted to be taken by the Board may be taken without a meeting, if all members of the Board individually or collectively consent in writing to that action. Written consents must be filed with the minutes of the proceedings of the Board. Action by written consent has the same force and effect as the unanimous vote of the Board Members.

Removal

4.10. The entire Board, or any individual Board Member, may be removed from office at any time by the vote of a majority of the voting members of the Association. If any or all Members are so removed, new Members may be elected at the same meeting and the new Members hold office for the remainder of the terms of the removed Board Members. If new Board Members are not elected at the meeting, the vacancy or vacancies created by the removal will be filled as provided in Section 4.11 of these Bylaws.

Vacancies

4.11. (a) Vacancies in the Board exist (1) on the death, resignation, or removal of any Board Member; (2) whenever the number of Board Members authorized by the [Articles *or* Constitution] is increased by amendment; and (3) on failure of the members in any election to elect the full number of Board Members authorized.

(b) The Board may declare vacant the office of a Board Member (1) if the Member is declared of unsound mind by an order of court, or finally convicted of a felony; or (2) the Member does not accept the office either in writing or by attending a meeting of the Board within 60 days after notice of election as a Board Member.

(c) Vacancies caused by the death, resignation, or disability of a Member or Members, or by removal as provided in these Bylaws, or by an amendment to the [Articles *or* Constitution] increasing the authorized number of Board Members must be filled by a majority of the remaining Board Members, though less than a quorum, or by a sole remaining Board Member.

(d) A majority of the voting members of the Association may elect a Board Member at any time to fill any vacancy not filled by the Board as provided in Subparagraph (c). If all Board Memberships become vacant and no Board Member is left to fill the vacancies, the vacancies must be filled by a majority of the voting members present at a regular or special meeting of members called for that purpose, [provided a quorum is present *or* whether or not a quorum is present].

(e) Persons elected to fill vacancies hold office for the unexpired terms of their predecessors and until their successors are qualified and elected.

ARTICLE V OFFICERS

Number and Titles

5.01. The officers of the Association will be [*either or both* a Chairman of the Board *or* a President], [a Vice-President,] a Secretary, a Chief Financial Officer, and those other officers with such titles and duties as _____[stated in these Bylaws *or* determined by the Board] and as may be necessary to enable it to sign instruments. [The President *or* The Chairman of the Board] is the general manager and chief executive officer of the Association. Any number of offices may be held by the same person, except that neither the Secretary nor the Chief Financial Officer may serve concurrently as [the President *or* the Chairman of the Board].

Qualifications

[*EITHER*]

5.02. Any Active Member of this Association is qualified to be an officer.

[*OR*]

5.02. The officers of the Association must be residents of the State of California. [*Optional:* In addition, officers must also have the following qualifications: _____ (*specify, e.g., professional qualifications*)].

Appointment or Election

[*EITHER*]

5.03. The officers will be chosen by the Board and serve at the pleasure of the Board, subject to the rights, if any, of an

office under any contract of employment.

[*OR*]

5.03. The officers will be elected by the vote of a majority of the voting members of the Association at the regular meeting of the Members held in March.

[*Continue with the following:*]

Terms of Office

5.04. The first officers will serve until the qualification and [appointment *or* election] of their successors as provided in Section 5.03. Subsequent officers serve from the time of [appointment *or* election] until the next annual [appointment *or* election] of officers and until their successors are qualified and [appointed *or* elected]. [*If officers are not board members, add if appropriate*: The President, Vice-President, Secretary, and Treasurer are ex officio members, without voting rights, of the Board, attend Board and members' meeting, and are entitled to notice of all meetings as provided in these Bylaws.

Duties of Officers

5.05. (a) The President is the chief executive officer of the Association and, in general but subject to the control of the Board, supervises and controls the affairs of the Association. The President must perform all duties incident to the office and any other duties as may be required by law, by the organizational instruments, or that may be assigned to him from time to time by the Board or by the members.

(b) In the absence of the President, or in the event of the President's inability or refusal to act, the Vice-President will perform the duties of President. When acting as President, the Vice-President has all the powers of, and is subject to all the restrictions on, the President. The Vice President holds such other powers and performs other duties as may be prescribed by law, by the Constitution of this Association, or by these Bylaws, or which may be assigned to him from time to time by the Board of Directors or by the members.

(c) The Secretary shall have the following duties and responsibilities:

(1) Certify and keep at the principal office of the Association the original or a copy of its Bylaws as amended or otherwise altered to date, and keep at that office the original or a copy of the _____ [Articles *or* Constitution], as amended to date.

(2) Keep at the principal office of the Association a book of minutes of all meetings of the Board and members, recording the time and place of holding, whether regular or special, and, if special, how authorized, notice given, the names of those present at Board meetings, the number of members present at members' meetings, and the proceedings thereof.

(3) See that all notices are duly given in accordance with the provisions of these Bylaws or as may be required by law.

(4) Be custodian of the records [and of the seal] of the Association [*optional:* and see that the seal is affixed to all duly executed documents of the Association].

(5) Keep at the principal office of the Association a membership book containing the name and address of each member. If a membership terminates, that fact must be recorded in the book, together with the manner of termination and the date on which the membership ceased. [*If membership is secret, add limitations, if any, on manner of keeping book.*]

(6) Exhibit at all reasonable times to any Board Member or elected officer of the Association, or to his or her agent or attorney, on request, the _____ [Articles *or* Constitution], the Bylaws, the membership book [unless secret], and the minutes of the proceedings of Board and members' meetings.

(7) Exhibit at all reasonable times to any voting member, or to his or her agent or attorney, on written demand, for a purpose reasonably related to the interests of that member, the _____ [Articles *or* Constitution], the Bylaws, and the minutes of Directors' or members' meetings. The Secretary must exhibit these records at any time when required by the demand of 10 percent or more of the voting members.

(8) In general, perform all duties incident to the office of Secretary and such other duties as may be required by law, by the _____ [Articles *or* Constitution] of this Association, or by these Bylaws, or that may be assigned to the Secretary from time to time by the Board or by the members.

(d) The Treasurer of the Association shall have the following duties and responsibilities:

(1) Have charge and custody of, and be responsible for, all funds and securities of the Association, and deposit all funds in the name of the Association in the banks, trust companies, or other depositaries selected by the Board.

(2) Receive, and give receipt for, moneys due and payable to the Association from any source whatever.

(3) Disburse or cause to be disbursed the funds of the Association as may be directed by the Board of Directors, taking proper vouchers for the disbursements.

(4) Keep and maintain adequate and correct accounts of the Association's properties and business transactions, including accounts of its assets, liabilities, receipts, disbursements, gains, and losses.

(5) Exhibit at all reasonable times the books of account and financial records to any Board Member or elected officer of the Association, or to his or her agent or attorney, on request.

(6) Exhibit at all reasonable times to any voting member, his or her agent or attorney, on written demand for a purpose reasonably related to the interests of the member, the books of account and financial records of the Association, and exhibit these records at any time when required by the demand of 10 percent of more of the voting members.

Compensation

[*EITHER, if officers will serve without compensation:*]

5.06. Officers serve without compensation. The President, Vice-President, Secretary, and Treasurer will be allowed and paid their actual and necessary expenses in attending Board and members' meetings.

[*OR, if officers will be compensated:*]

5.06. The annual salary of officers shall be as follows: President, $_____; Vice-President, $_____; Secretary, $_____; and Treasurer, $_____. The salaries of all other officers will be in an amount that may be fixed from time to time by vote or written consent of a majority of the voting members of the Association.

[*Continue with the following:*]

Resignation

5.07. Any officer may resign at any time on written notice to the Association without prejudice to the rights, if any, of the Association under any contract to which the officer is a party.

Removal

5.08. Any or all officers may be removed from office at any time by the vote of a majority of the Board of the Association. In the case of the removal of any officer, a new officer will be [appointed *or* elected] to serve the unexpired portion of the term of the removed officer at the meeting at which the officer is removed.

Vacancies

5.09. (a) Vacancies in the office of [*specify, e.g.,* President, Vice-President, Secretary, or Treasurer] occur on the death, resignation, or removal of the officer or on the failure of the [Board *or* members] to fill the office.

(b) The Board may declare vacant the office of [*specify, e.g.,* President, Vice-President, Secretary, or Treasurer] if the officer is declared of unsound mind by order of court, is finally convicted of a felony, or if, within 60 days after notice of his or her election, the officer does not accept the office in writing or by attending a meeting of the Board.

(c) Vacancies caused by the death, resignation, or disability of an officer will be filled by the [Board *or* members] at the next regular or special meeting at which a quorum is present following the vacancy.

(d) Vacancies resulting from the removal of an officer will be filled as prescribed in Section 5.08.

(e) Officers [appointed *or* elected] to fill vacancies hold office [for the unexpired terms of their predecessors and until a successor is _____ (appointed *or* elected) *or* until their removal or resignation as provided in these Bylaws].

ARTICLE VI COMMITTEES

Executive Committee

6.01. (a) The [Board of Directors *or* Board of Trustees *or* Board of Governors *or* Executive Board *or other title*], by a majority vote of its members, may designate two or more of members of the Board to constitute an Executive Committee. The Board may delegate to that Committee any of the powers and authority of the Board in the management of the business and affairs of the association, except the power to adopt, amend, or repeal the Bylaws.

(b) The constitution of an Executive Committee and the delegation of management authority does not relieve the Board

or any individual Board Member of any responsibility imposed on by law, the [Articles *or* Constitution], or these Bylaws. By a majority vote of its members, the Board may at any time modify or revoke any or all of the authority delegated to the Executive Committee, increase or decrease but not below two the number of its members, and fill vacancies from the members of the Board.

(c) The Executive Committee shall establish rules and regulations for its meetings and meet when the Committee deems necessary, provided that reasonable notice of all meetings of the Executive Committee must be given to its members. No act of the Executive Committee is valid unless approved by the vote or written consent of a majority of its members. The Committee will keep regular minutes of its proceedings and report the same to the Board from time to time as the Board may require.

Standing Committees

6.02. The Association will have the following Standing Committees, each of which will be chaired by a Board Member or a designated officer of the association: [*identify each standing committee, the chair, the number of members, and duties, e.g.:*]

(a) The Membership Committee will be chaired by a Board Member and consist of [*number, e.g.,* four] additional members of the association selected by the Board Member. The Membership Committee will plan and execute programs for obtaining new members, giving notice to each member whose membership requires renewal, ensuring that Membership and Renewal Certificates, if applicable, are executed and delivered personally or by mail to the appropriate members, collect dues, account to the Treasurer of the corporation for all moneys received by the Committee, and perform all other duties as may be directed from time to time by the Board. Any expenditure of Association funds by the Committee requires the prior approval of the Board. The Committee will meet at the times and places as directed by its Chair or by the Board.

(b) The Publicity Committee will be chaired by a Board Members and consist of [*number, e.g.,* four] additional members of the association selected by the Board Member. The Publicity Committee will plan and execute publicity campaigns, and perform all other duties, as may be directed from time to time by the Board. Any expenditure of Association funds by the Committee requires the prior approval of the Board. The Committee will meet at the times and places as directed by its Chair or by the Board.

(c) The Public Relations Committee will be chaired by a Board Members and consist of [*number, e.g.,* four] additional members of the association selected by the Board Member. The Public Relations Committee will answer complaints against the Association made by nonmembers, and plan and execute public relations programs, and perform all other duties, as may be directed from time to time by the Board. Any expenditure of Association funds by the Committee requires the prior approval of the Board. The Committee will meet at the times and places as directed by its Chair or by the Board.

(d) A Policymaking Committee may be created at any regular or special meeting of the members, on the vote or written consent of [*specify, e.g.,* a majority of the members] for the purpose of taking any member action required for the adoption of amendments to the [Articles *or* Constitution]. The Policymaking Committee [is *or* is not] authorize to represent the members in any other matter requiring member action. The Policymaking Committee will be composed of [*number*] members of the corporation elected in the manner provided in these Bylaws for the election of Board Members. Each member of the Policymaking Committee serves until the earlier of (1) the termination of membership in the association, (2) the member is removed, or (3) the Committee is terminated. The Committee may be terminated, or a member of the Committee removed, by the vote or written consent of [*e.g.,* a majority] of the members of the association. The members of the Policymaking Committee may adopt rules for its government and procedure that are not in conflict with the law, the delegation of authority to the Committee, or its purpose.

Ad Hoc Committees

6.03. Ad hoc committees for specific purposes or activities may be designated from time to time by resolution of the Board. Committee Chairs will be appointed by the Board. Members of ad hoc committees will be appointed by their respective Chairs in the number deemed advisable, unless otherwise provided by the Board in its resolution designating an ad hoc committee. Except as otherwise provided by resolution, Committee Chairs and members must be members of the association. The Chair or any member may be removed from an ad hoc committee by the person or persons authorized to appoint the committee member whenever that person determines that the best interests of the association will be served by removal.

Terms of Office

6.04. The Chair and each member of the Executive Committee and each Chair of a Standing Committee serve until the earlier of (1) the next annual election of the Board and until a successor is appointed, (2) the Committee is dissolved, (3) the individual is removed as a Board Member or officer, (4) the termination of the individual's membership in the association, or (5) the individual otherwise ceases to qualify for the Committee. Each member of a Standing Committee serves until the earlier of (1) a new Chair is appointed, (2) the individual is removed from the Committee by its Chair, (3) the individual resigns or ceases to be a member of the association, or (4) otherwise ceases to qualify as a member of the Committee. Chairs and members of Ad Hoc Committees serve as such for the life of the Committee unless they are sooner removed, resign, or cease to qualify as the Chair or a member of the Committee.

Vacancies

6.05. Vacancies on any Committee may be filled for the unexpired portion of the term in the same manner as provided in the case of original appointments.

Quorum

6.06. A majority of the Executive Committee or of a Standing Committee constitutes a quorum. The act of a majority of the members present at a meeting at which a quorum is present constitutes the act of the Committee. Unless otherwise provided in the resolution of the Board designating the Committee, Ad Hoc Committees act under the direction of their respective Chairs without any requirement as to a quorum.

Rules

6.07. Each Committee may adopt rules for its own government and procedure not inconsistent with law, with these Bylaws, or with the rules, regulations, and resolutions adopted by the Board.

ARTICLE VII RECORDS, REPORTS, FISCAL YEAR, INSIGNIA, AND SEAL

Keeping Records

7.01. The Association must keep adequate and correct records of account and minutes of the proceedings of its members, Board, and committees of the Board. The Association must also keep a record of its members giving their

names and addresses and the class of membership held by each. The minutes will be kept in written form. Other books and records will be kept in either written form or in any other form capable of being converted into written form.

Annual Report

7.02. The Board will cause an annual report, including a financial statement, to be sent to the members not later than 120 days after the close of the Association's fiscal year. The annual report must [*specify, e.g.,* summarize the Association's activities for the preceding year and activities projected for the forthcoming year]. The financial statement consists of a balance sheet as of the close of business of the association's fiscal year and a summary of receipts and disbursements, prepared in manner and form as is sanctioned by sound accounting practices. The financial statement must be certified by the Treasurer or a public accountant.

Fiscal Year

7.02. The fiscal year of the Association is [*specify, e.g.,* the calendar year].

Insignia and Seal

7.03. The Board may adopt, use, alter, or cancel an Association insignia, seal, or both. The Board will adopt rules prescribing the time, manner, and place in which the insignia may be worn or used.

ARTICLE VIII EXECUTION OF INSTRUMENTS DEPOSITS, AND FUNDS

Execution of Instruments

8.01. The Board, except as otherwise expressly provided in the [Articles *or* Constitution] of this Association or in these Bylaws, may by resolution authorize any officer or agent of the Association to enter into any contract and deliver any instrument in the name of and on behalf of the Association. This authority may be general or confined to specific instances, provided, however, that the contract or delivery is expressly authorized by the [Articles *or* Constitution] or Bylaws [*add, if appropriate:* and approved by the vote or written consent of a majority of the voting members of the Association].

Checks and Notes

8.02. Except as otherwise specifically determined by resolution of the Board, as provided in Section 8.01, or as otherwise required by law, by the [Articles *or* Constitution] of this Association, or by these Bylaws, checks, drafts, promissory notes, orders for the payment of money, and other evidences of indebtedness of this Association must be signed by the Treasurer or Assistant Treasurer and countersigned by the President of the Association.

Deposits

8.03. All funds of the Association must be deposited from time to time to the credit of the Association in banks, trust companies, or other depositaries as the Board may select.

ARTICLE IX BYLAWS

Adoption, Amendment, and Repeal

9.01. These Bylaws become effective on their being signed by the original Members of the Board as named in the [Articles *or* Constitution], or on their adoption by the vote or written consent of a majority of the voting members of this Association. Bylaws may be amended or repealed, in whole or in part, and new Bylaws adopted by the vote or written consent of a majority of the [Board *or* voting members] of the Association, provided, however, that [*set forth any exceptions requiring a greater percentage for the amendment of specific bylaws*].

Certification and Inspection

9.02. The original or a copy of the Bylaws, as amended or otherwise altered to date, certified by the Secretary of the Association, will be recorded and kept in a book that will be kept in the principal office of the Association in California. The book will be open to inspection by the members at all reasonable times during regular office hours.

We, the undersigned, are all of the persons named as the initial Members of the Board in the [Articles *or* Constitution] of this Association. We hereby consent to and adopt these Bylaws as the Bylaws of this Association.
_____ Dated:

_____ [*signature*]
[*typed name*], Board Member
_____ [*signature*]
[*typed name*], Board Member
_____ [*signature*]
[*typed name*], Board Member

CERTIFICATE OF SECRETARY OF _____ [*name of association*], A CALIFORNIA NONPROFIT ASSOCIATION

I hereby certify that I am the duly elected and acting Secretary of this association and that the foregoing Bylaws, comprising [*number*] pages, constitute the Bylaws of this association as duly adopted at a meeting of the Board held on _____[*date*].
_____ Dated:

_____ [*signature*]
[*typed name*], Secretary



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART IV. FORMS

6-13A California Legal Forms--Transaction Guide § 13A.202

§ 13A.202 Registration of Nonprofit Unincorporated Association [LP/UNA 128]

[1] Comment

[a] Use of Form

This form is the California Secretary of State's official form for registration of nonprofit unincorporated associations [Form LP/UNA 128]. The form may be used to register the Association's name, insignia, or both.

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 3405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 13A.202. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Any collection of persons wishing to form a nonprofit unincorporated association and register its name with the Secretary may do so by filing this form. Any association, the principles and activities of which are not repugnant to the Constitution or laws of the United States or California, may register with the Secretary of State a facsimile or description of its name or insignia [*Corp. Code § 21301*; *see Bus. & Prof. Code §§ 14492, 14492.5*; *see Gov. Code § 12193(f)* (registration fee)]. However, an association may not register any name or insignia similar to or so nearly resembling another name already registered as may be likely to deceive [*Corp. Code § 21302*; *see Bus. & Prof. Code § 14492(b)*]. "Insignia" includes a badge, motto, button, decoration, charm, emblem, or rosette [*Corp. Code § 21300(b)*].

The registration is for the use and benefit and on behalf of the association, the individual members, and those who become members [*Corp. Code § 21303*]. Penalties for improper use are discussed in *§ 13A.15[2]*.

[b] Filing Requirements

The application for registration is made by the chief officer or officers of the association on a form provided by the Secretary of State [*Corp. Code § 21303*]. The form must be executed under penalty of perjury [*see* [2], *below*]. The application for registration must be accompanied by the applicable filing fee [*Corp. Code § 21304*; *see Gov. Code § 12191(b)(2) (fee)*]; an additional fee is required if the association requests certified copies [*see* [2], *below*].

The form must be filed at the following address:

Secretary of State
Limited Partnerships Section
P.O. Box 944225
Sacramento, CA 94244-2250

[c] No Discretion to Deny Registration if Filing Proper

If the form is properly completed and the applicable filing fee is paid, the Secretary of State has no discretion with respect to the filing of the registration and the issuance of the certificate. The Secretary of State has no authority or reason to investigate the relationships between or determine the motivations of the members of an association desiring to register its name. Further, the Secretary has no authority to alter the name sought to be registered, although a name that is deceptively similar to a registered name cannot be registered. For these reasons, the Secretary of State has accepted for filing associations registering with names such as "Family of Debra Deem and James Riley." Although the Secretary does not register families as such, the name of an association including the word "family" as part of the name will be registered [*see* Secretary of State, Unincorporated Nonprofit Association Filings General Information Sheet].

[d] Issuance of Certificate

On registration, the Secretary of State will issue a certificate setting forth the fact of registration [*Corp. Code § 21305*]. Provided that the form is properly completed and the applicable filing fee paid, the Secretary of State has no discretion with respect to the filing of the registration and the issuance of the certificate [*see* Secretary of State, Unincorporated Nonprofit Association Filings General Information Sheet]. The Secretary will keep a properly indexed record of the registration [*Corp. Code § 21306*].

[e] Amendment and Cancellation

A nonprofit unincorporated association may by reregistration alter or cancel the registration [*Corp. Code § 21301*; *see Bus. & Prof. Code §§ 14492, 14492.5*; *see Gov. Code § 12193(f)* (registration fee for organizational name)]. The application for alteration or cancellation of an existing registration, is made by the chief officer or officers of the association on a form provided by the Secretary of State [*Corp. Code § 21303*]. The Secretary will keep a properly indexed record of the registration, including any altered or canceled registration [*Corp. Code § 21306*].

[2] FORM

Registration of Nonprofit Unincorporated Association [LP/UNA 128]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART IV. FORMS

6-13A California Legal Forms--Transaction Guide § 13A.203

§ 13A.203 Statement by Unincorporated Association of Address of Principal Office and Designation of Agent for Service or Process [UA-100]

[1] Comment--Use of Form

This form is the California Secretary of State's official form for a statement by an unincorporated association of its principal office and designation of an agent for service of process. Unincorporated associations may use this form to designate the location and complete address of the association's principal office in California (or, if the association does not have an office in California, the address where the Secretary of State can send notices to the association [*see Corp. Code § 18200*]), or to designate and agent for service of process, or both.

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 3405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 13A.203. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Filing of this form is optional for unincorporated associations [*Corp. Code § 18200*]. The Secretary of State's office is required to index these statements and, on request of any person, to provide a certificate showing whether it has such a statement on file [*Corp. Code § 18205(b), (c)*]. Statements expire five years from December 31 following the date of filing [*Corp. Code § 18200(d)*]. The Secretary of State's office is required to mail a notice indicating when the statement will expire [*see Corp. Code § 18215*].

Hand delivery of service on the agent designated on the form constitutes valid service on the association [*Corp. Code § 18200(e)*].

For more detailed discussion of the use of this statement, see *§ 13A.31[2]*.

[2] FORM

Statement by Unincorporated Association of Address of Principal Office and Designation of Agent for Service or Process [UNA-100]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13A NONPROFIT UNINCORPORATED ASSOCIATIONS
PART IV. FORMS

6-13A California Legal Forms--Transaction Guide § 13A.204

§ 13A.204 Contract for Assumption of Liability by Member

[1] Comment--Use of Form

This form is a contract by which a member of a nonprofit unincorporated association may assume a specific contractual debt or liability of the association. The form may be adapted for use when two or more members agree to assume the debt or liability.

Any contract by which a member of a nonprofit association assumes any debt or liability of the association must be in writing. The assumption of liability is invalid unless the contract (or note or memorandum) specifically identifies the contract being assumed, is in writing, and is signed by the party to be charged or his or her agent [*Corp. Code § 18610(a)*]. A member does not consent or otherwise agree to the incurring of any obligation by the association, and nor presumption or inference to that effect arises, from the fact of joining or being a member of the association [*Corp. Code § 18605*].

[2] FORM

Contract for Assumption of Liability by Member

Assumption of Liability by Member

_____ [*Member's Letterhead*]

To Whom It May Concern:

I, the undersigned, _____[*name of assuming member*], a member of _____[*name of association*], a nonprofit association, agree unconditionally to assume financial responsibility for the [debt *or* liability] of the Association incurred under [*specifically identify contract being assumed, e.g.*, the contract between _____ (*name of association or director, officer, or member who executed contract being assumed*) and _____ (*identify other contracting party*), dated _____, for _____ (

identify subject matter of contract)].

I agree to pay in full all accrued or accruing liabilities under the above-described contract. My net worth is not less than $_____, including cash and non-cash assets.

Date: _____.

[*EITHER*]
_____ [*signature of assuming member*]
[*typed name*]
[*OR, if agreement will be signed by agent:*]
_____ [*signature of assuming member's agent*]
[*typed name*]
Agent for _____ [*name of assuming member*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES

6-13B California Legal Forms--Transaction Guide 13B.syn

§ 13B.syn Synopsis to Chapter 13B: TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES

§ 13B.01 California Sources

[1] Constitution

[2] Statutes

[3] Regulations

[4] California Attorney General Opinions

[5] Pamphlets

§ 13B.02 Federal Sources

[1] Statutes

[2] Regulations

[3] Pamphlets

§§ 13B.03-13B.04 [Reserved]

§ 13B.05 Law Reviews and Periodicals

§ 13B.06 Annotations

§ 13B.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 13B.08-13B.09 [Reserved]

§ 13B.10 Comparison of State and Federal Income Tax Exemptions

[1] Exemptions Similar but Not Identical

[2] Correlation Table

§ 13B.11 Nonprofit Status Does Not Automatically Ensure Exemption

§ 13B.12 Advantages of Tax-Exempt Status

§ 13B.13 Disadvantages of Tax-Exempt Status

§§ 13B.14-13B.19 [Reserved]

§ 13B.20 Establishing Exemption Under I.R.C. § 501(c)(3)

[1] Filing Requirement

[a] Filing Form 1023 as Condition Precedent to Exempt Status

[b] Exceptions From Filing Requirement

[c] Time of Filing

[2] Exempt Purpose

[3] Organizational Test

[a] Exclusively Exempt Purposes

[b] Dedication of Assets

[c] No Private Benefit or Inurement

[4] Operational Test

[a] Exclusively Operated for Exempt Purposes

[b] Limitation on Influencing Legislation and Lobbying

[c] Limitation on Unrelated Trade or Business

[d] Limitation on Providing Commercial-Type Insurance

[5] Private Foundation Status; Notice Requirement

[a] Presumption of Private Foundation Status

[b] Public Charity Distinguished

[c] Tax Ramifications

[d] Notice Requirement

[e] Governing Instruments of Private Foundations

[f] Imposition of Excise Taxes

[g] Private Operating Foundations

[h] Termination of Private Foundation Status

[6] Use of Affiliate to Engage in Lobbying

[7] Lobbying Election for Public Charities

§ 13B.21 Establishing Exemption Under I.R.C. § 501(c) Rather Than I.R.C. § 501(c)(3)

§ 13B.22 Remedies for Denial of Exemption

[1] Appeal of Adverse Determination

[2] Declaratory Judgment Relief

§ 13B.23 Exemption From Excise Taxes

§ 13B.24 Application of Unrelated Business Income Tax

[1] Scope of Tax

[2] Organizations Subject to Tax

[3] "Unrelated Trade or Business" Defined

[4] Filing Requirements

[5] Effect of Unrelated Business Income on Tax-Exempt Status

§ 13B.25 Maintaining Tax-Exempt Status

[1] Continuing to Meet Exemption Requirements

[2] No Material Changes

[3] Revocation or Modification

§ 13B.26 Compliance With Reporting Requirements

[1] Annual Information Return Filing Requirements

[2] Penalties for Noncompliance

§ 13B.27 Loss of Exempt Status

§§ 13B.28-13B.39 [Reserved]

§ 13B.40 Procedure for Obtaining Tax-Exempt Status

[1] California Filing as Condition Precedent to Exempt Status

[2] Qualification for Exemption

[3] Scope of Exemption

§ 13B.41 Application of Unrelated Business Income Tax

§ 13B.42 Loss of Exempt Status

§§ 13B.43-13B.49 [Reserved]

§ 13B.50 Property Taxable Unless Exempt

§ 13B.51 Welfare Exemption

[1] Overview

[2] Property Used for Religious, Hospital, Scientific or Charitable Purposes

[3] Additional Types of Property Eligible for Exemption

[4] Occasional and Incidental Uses

[5] Record Ownership

[6] Filing Requirements and Procedure

[7] Waiver of Exemption

§ 13B.52 Partial Welfare Exemption

§ 13B.53 Religious Exemption

[1] Covered Property

[2] Simplified Claim Process

§§ 13B.54-13B.59 [Reserved]

§ 13B.60 Sales and Uses Taxes

§ 13B.61 Business License Taxes

§§ 13B.62-13B.69 [Reserved]

§ 13B.70 Fines

§ 13B.71 Suspension and Relief

§ 13B.72 Revocation of Exemption; Restoration

§ 13B.73 Other Sanctions

§§ 13B.74-13B.79 [Reserved]

§ 13B.80 Continuing to Satisfy Exemption Requirements

§ 13B.81 Compliance With Reporting Requirements

§§ 13B.82-13B.99 [Reserved]

§ 13B.100 Exemption From Federal Income Taxation

[1] Facts

Scope

[2] Documents

Scope

§ 13B.101 Exemption From State Income and Franchise Taxation

[1] Facts

Scope

[2] Documents

Scope

§§ 13B.102-13B.109 [Reserved]

§ 13B.110 Tax-Exempt Classification of Organizations for Federal Income Tax Purposes

Scope

§ 13B.111 Tax-Exempt Classification of Organizations for State Franchise and Corporate Income Tax Purposes

Scope

§§ 13B.112-13B.119 [Reserved]

§ 13B.120 Obtaining Federal Income Tax Exemption

Scope

§ 13B.121 Obtaining Exemption From California Franchise or Income Tax

Scope

§ 13B.122 Obtaining Exemption From Property Tax

Scope

§§ 13B.123-13B.129 [Reserved]

§ 13B.130 Appealing Denial of Application for Federal Income Tax Exemption

Scope

§ 13B.131 Filing Federal Returns

[1] Annual Information Returns

Scope

[2] Donee Information Returns

Scope

§ 13B.132 Filing State Returns, Statements, and Reports

Scope

§§ 13B.133-13B.199 [Reserved]

§ 13B.200 Application for Recognition of Exemption Under I.R.C. § 501(c)(3) [IRS Form 1023]

[1] Comment

[a] Use of Form

[b] Filing Exceptions; Optional Filing

[c] Qualification for Exemption

[d] Charitable Purposes

[e] Educational Purposes

[f] Testing for Public Safety

[g] Scientific Purposes

[h] Rulings Relating to Nonprivate Foundation Status

[i] Conformed Copy of Organizing Documents

[j] Public Inspection of IRS Form 1023

[k] Signature and Filing Requirements

[2] FORM

Application for Recognition of Exemption Under I.R.C. § 501(c)(3) [IRS Form 1023]

§ 13B.201 Application for Recognition of Exemption Under I.R.C. § 501(a) [IRS Form 1024]

[1] Comment

[a] Use of Form

[b] Filing Exceptions; Optional Filing

[c] Title-Holding Corporations

[d] Civic Leagues and Social Welfare Organizations

[e] Labor, Agricultural, and Horticultural Organizations

[f] Business Leagues

[g] Social Clubs

[h] Fraternal Beneficiary Societies

[i] Voluntary Employees' Beneficiary Associations

[j] Local Benevolent Life Insurance Associations, Mutual Irrigation and Telephone Companies, and Like Organizations

[k] Cemetery Companies

[l] Supplemental Unemployment Benefit Trusts

[m] Veterans' Organizations

[n] Public Inspection of IRS Form 1024

[o] Signature and Filing Requirements

[2] FORM

Application for Recognition of Exemption Under I.R.C. § 501(a) [IRS Form 1024]

§ 13B.202 User Fee [IRS Form 8718]

[1] Comment--Use of Form

[2] FORM

User Fee [IRS Form 8718]

§ 13B.203 Election and Revocation of Election by Eligible Organization to Make Expenditures to Influence Legislation [IRS Form 5768]

[1] Comment

[a] Use of Form

[b] Eligible Organizations

[c] Expenditures to Influence Legislation; Limits

[d] Time and Manner of Election and Revocation

[e] Excise Tax on Excess Expenditures

[f] Loss of Exempt Status

[2] FORM

Election and Revocation of Election by Eligible Organization to Make Expenditures to Influence Legislation [IRS Form 5768]

§§ 13B.204-13B.209 [Reserved]

§ 13B.210 Application for Recognition of Exemption [FTB Form 3500]

[1] Comment

[a] Use of Form

[b] Application and Attachments

[c] Exceptions From Filing FTB Form 3500

[d] Signature and Filing Requirements

[e] Group Exemption Application

[f] Retroactivity of Exemption

[g] Public Inspection

[2] FORM

Application for Recognition of Exemption [FTB Form 3500]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES

6-13B California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter discusses the tax issues that nonprofit corporations and unincorporated associations must face. The chapter covers the preparation of applications to obtain federal and state tax-exempt status and other state tax exemptions, and provides checklists for maintaining for tax-exempt status.

The major portion of this chapter concerns tax-exempt organizations described in *I.R.C. § 501(c)(3)* and *Rev. & Tax. Code § 23701d*, that is, religious, charitable, educational, and scientific organizations. These types of organizations are the most significant of the categories of tax-exempt organizations, and the rules governing them are complex. Other exempt organizations described in *I.R.C. § 501* and in comparable provisions of the California tax law [*see Rev. & Tax. Code §§ 23701-23701x, 23704*] are also discussed but in less detail.

The formation and operation of nonprofit corporations is covered in Ch. 13, *Nonprofit Corporations* . The formation and operation of nonprofit unincorporated associations are discussed in Ch. 13A, *Nonprofit Unincorporated Associations* . The taxation of businesses is covered in Ch. 1E, *Taxation of Businesses* . Further discussion of state and federal income tax charitable deductions for contributions to qualifying nonprofit organizations may be found in Ch. 69, *Charitable Dispositions* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART I. RESEARCH GUIDE
A. Primary Sources

6-13B California Legal Forms--Transaction Guide § 13B.01

§ 13B.01 California Sources

[1] Constitution

Taxes and exemptions. *Cal. Const., art. XIII, §§ 3-5*.

[2] Statutes

Governing instruments of private foundations. *Corp. Code §§ 5260, 9260*.

Governing instruments of nonexempt charitable trusts. *Prob. Code §§ 16101-16104*.

Property taxation.

"Property" defined. *Rev. & Tax. Code § 103*.

Interests included within meaning of terms "real estate" and "real property." *Rev. & Tax. Code § 104*.

"Improvements" defined. *Rev. & Tax. Code § 105*.

"Personal property" defined. *Rev. & Tax. Code § 106*.

"Possessory interests" defined. *Rev. & Tax. Code §§ 107, 107.1*.

Property subject to tax. *Rev. & Tax. Code § 201*.

Property used for free public libraries, free museums, or exclusively for public schools are exempt from tax. *Rev. & Tax. Code § 202*.

Colleges, buildings, equipment, grounds, and securities and income used exclusively for purposes of education. *Rev. & Tax. Code §§ 203, 254, 255, 258, 260, 270-273*.

Church property, including parking area. *Rev. & Tax. Code §§ 206, 206.1, 255, 255.5, 256, 260, 270-273*.

Property used exclusively used exclusively for religious purposes. *Rev. & Tax. Code §§ 207, 257, 257.1*.

Personal property brought into California for exhibition purposes. *Rev. & Tax. Code §§ 213, 254, 255, 255.5, 259, 260*.

Requirement that exempt property be available as election polling place. *Rev. & Tax. Code § 213.5*.

Welfare exemption. *Rev. & Tax. Code §§ 214-214.9, 215, 215.5, 221, 225.5, 251, 254, 254.5, 254.6, 260, 261, 270-273*.

Types of exempt property. *Rev. & Tax. Code §§ 214-214.14, 221-222.5*.

Affidavit requirements. *Rev. & Tax. Code §§ 254, 254.5, 255*.

Recordation requirements. *Rev. & Tax. Code §§ 260, 261*.

Late exemption applications. *Rev. & Tax. Code §§ 270-272*.

Veteran's organization exemption. *Rev. & Tax. Code § 215.1*.

Basis of evaluation for assessment purposes. *Rev. & Tax. Code § 401*.

Taxpayer's annual property statement. *Rev. & Tax. Code § 441*.

Sales tax exemption. *Rev. & Tax. Code § 6375*.

Corporation defined to include tax-exempt charitable trusts. *Rev. & Tax. Code § 17009*.

Deductibility of individual charitable contributions determined in accordance with federal law unless provided otherwise. *Rev. & Tax. Code § 17201*.

Deductibility of individual charitable contributions. *Rev. & Tax. Code § 17214 et seq.*

California franchise tax exemptions. *Rev. & Tax. Code § 23701 et seq.*; *but see Rev. & Tax. Code § 23701d(c)(1)*; *see also § 13B.210[1][c]* for discussion

Denial of exempt status on failure to make required filings. *Rev. & Tax. Code § 23703*.

Exemption of cooperative hospital service organizations. *Rev. & Tax. Code § 23704*.

Status after organization ceases to qualify for exemption, due to substantial lobbying or participation in political campaigns. *Rev. & Tax. Code § 23704.6*.

Termination of private foundation status. *Rev. & Tax. Code § 23707*.

Presumption of foundation status and required provisions in governing instruments. *Rev. & Tax. Code § 23708*.

Private foundation defined. *Rev. & Tax. Code § 23709*.

Exempt organizations conducting bingo games. *Rev. & Tax Code § 23710*.

Taxation of unrelated business income. *Rev. & Tax. Code § 23731 et seq.*

Denial of exemption to certain organizations engaged in prohibited transactions. *Rev. & Tax. Code § 23736 et seq.*

Improper use of accumulated income. *Rev. & Tax. Code § 23737*.

Exemption of rental income received by one exempt church from another. *Rev. & Tax. Code § 23741*.

Return of unrelated business income filing requirements. *Rev. & Tax. Code § 23771*.

Information returns and statements of exempt organizations. *Rev. & Tax. Code §§ 23772, 23774*.

Suspension of corporate powers of exempt organization for failure to file annual information return or statement. *Rev. & Tax. Code § 23775*.

Relief from suspension of corporate powers. *Rev. & Tax. Code § 23776*.

Deductibility of corporate charitable contributions. *Rev. & Tax. Code §§ 24357-24359*.

Public inspection of applications of exempt organizations. *Rev. & Tax. Code § 26451.3*.

[3] Regulations

Taxpayer's annual property statement. *18 Cal. Code Reg. §§ 171, 172*.

Feeder organizations. *18 Cal. Code Reg. § 23702*.

Loss of exempt status for failure to register or file periodic reports with Attorney General. *18 Cal. Code Reg. § 23703*.

Termination of private foundation status. *18 Cal. Code Reg. § 23707*.

Classification as private foundation. *18 Cal. Code Reg. § 23708*.

Private foundation defined. *18 Cal. Code Reg. § 23708*.

Rules governing taxation of unrelated business income. *18 Cal. Code Reg. § 23731 et seq.*

Loss of exempt status for improper use of accumulations of income. *18 Cal. Code Reg. § 23737*.

Unrelated business income tax returns of exempt organizations. *18 Cal. Code Reg. § 23771*.

Annual information returns and statements of exempt organizations. *18 Cal. Code Reg. § 23772*.

Revocation of exempt status for failure to file returns and statements, and reestablishment of exemption. *18 Cal. Code Reg. §§ 23777, 23778.*

Deductions for corporate charitable contributions. 18 Cal. Code Reg. §§ 24357-24359.

[4] California Attorney General Opinions

Charitable organization may not sponsor "casino night" when tickets were sold to general public to gamble, and winnings used to buy raffle tickets or bid at auction for valuable merchandise. *71 Ops. Cal. Atty. Gen. 130 (1988)* .

School districts may permit sale of school supplies to private individuals and nonprofit and other organizations when property is not required for public school purposes or activities. *60 Ops. Cal. Atty. Gen. 184 (1977)* .

[5] Pamphlets

Exempt Organizations: Nonprofit Doesn't Mean Tax Exempt (California Franchise Tax Board).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART I. RESEARCH GUIDE
A. Primary Sources

6-13B California Legal Forms--Transaction Guide § 13B.02

§ 13B.02 Federal Sources

[1] Statutes

Deductions for charitable contributions. *I.R.C. §§ 170, 642(c), 2055(a), 2522(a)*.

Employees' trust exemption. *I.R.C. § 401(a)*.

Federal income tax. *I.R.C. §§ 501, 508(e), 509*.

Exemption from federal income taxation. *I.R.C. § 501(a)*.

Types of organizations exempt from income tax. *I.R.C. § 501(c)-(f)*.

Election by public charities to make expenditures to influence legislation and loss of exempt status for exceeding allowable amount. *I.R.C. § 501(h)*.

Nonexempt feeder organizations. *I.R.C. § 502*.

Denial of exemption to certain exempt employment trusts for engaging in prohibited transactions. *I.R.C. § 503*.

Status after organization ceases to qualify for exemption because of substantial lobbying. *I.R.C. § 504*.

Termination of private foundation status. *I.R.C. § 507*.

Notice to avoid presumption of private foundation status; required provisions. *I.R.C. § 508*.

Definition of private foundation. *I.R.C. § 509*.

Taxation of unrelated business income. *I.R.C. §§ 511*-515.

Exemption of farmers' cooperatives. *I.R.C. § 521*.

Exempt status of political organizations. *I.R.C. § 527*.

Exemption of homeowners' associations. *I.R.C. § 528*.

Excise tax imposed on electing public charity for exceeding allowable amount of expenditures to influence legislation. *I.R.C. § 4911*.

Prohibitions and excise taxes imposed on private foundations and certain nonexempt charitable trusts. I.R.C. §§ 4940-4948.

Annual information returns of exempt organizations, nonexempt charitable trusts, and nonexempt private foundations. *I.R.C. § 6033*.

Annual returns of certain split-interest trusts. *I.R.C. § 6034*.

Information required on return regarding dissolution, liquidation, termination, or substantial contraction of exempt organization. *I.R.C. § 6043(b)*.

Due date of unrelated business income returns. *I.R.C. § 6072(e)*.

Special penalties imposed for failure of certain exempt and nonexempt organizations to file required returns. *I.R.C. § 6652(c)*.

Additional penalty for violations giving rise to excise tax on private foundations. *I.R.C. § 6684*.

Penalty tax for failure to file annual report of private foundation and permit public inspection. *I.R.C. § 6685*.

[2] Regulations

Deductions for charitable contributions. *Treas. Reg. §§ 1.170A-1*-1.170A-12.

Exemption from federal income taxation and general application requirements. *Treas. Reg. § 1.501(a)-1*.

Qualification requirements for specific types of exempt organizations. *Treas. Reg. §§ 1.501(c)(2)-1*-1.501(e)-1.

Irrevocable dedication of property. *Treas. Reg. § 1.501(c)(3)-1(b)(4)*.

Termination of foundation status. *Treas. Reg. §§ 1.507-1*-1.507-9.

Notice to avoid presumption of foundation status and provisions in governing instruments. *Treas. Reg. §§ 1.508-1*-1.508-4.

Organizations excluded from definition of private foundation. *Treas. Reg. §§ 1.509(a)-1*-1.509(e)-1.

Taxation of unrelated business income. *Treas. Reg. §§ 1.511-1*-1.514(g)-1.

Unrelated business income tax returns. *Treas. Reg. §§ 1.6012-2(e), (i)(2),* 1.6012-3(a)(5).

Annual information returns. *Treas. Reg. § 1.6033-2.*

Return regarding dissolution of exempt organization. *Treas. Reg. § 1.6043-3.*

Public inspection of applications and annual reports. Treas. Reg. §§ 301.6104-1-301.6104-4.

Penalty for failure to file annual returns or reports. *Treas. Reg. § 301.6652-2.*

Procedures for obtaining ruling or determination letter concerning exempt status. *Treas. Reg. § 601.201(n), (r).*

[3] Pamphlets

IRS Publication No. 557, Tax-Exempt Status for Your Organization.

IRS Publication No. 578, Tax Information for Private Foundations and Foundation Managers.

IRS Publication No. 598, Tax on Unrelated Business Income of Exempt Organizations.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART I. RESEARCH GUIDE
A. Primary Sources

6-13B California Legal Forms--Transaction Guide §§ 13B.03-13B.04

[Reserved]

§§ 13B.03[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

6-13B California Legal Forms--Transaction Guide § 13B.05

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

6-13B California Legal Forms--Transaction Guide § 13B.06

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

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Ch. 1D, *Overview of Employee Benefits*.

Ch. 1F, *Insurance Considerations in Business Formation*.

Ch. 2, *Formation of Corporations*.

Ch. 3, *Articles of Incorporation*.

Ch. 4, *Bylaws*.

Ch. 6, *Securities Regulation Issues*.

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Ch. 13, *Nonprofit Corporations*.

Ch. 13B, *Securing Exemption and Tax Compliance*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART I. RESEARCH GUIDE
B. Secondary Sources

6-13B California Legal Forms--Transaction Guide §§ 13B.08-13B.09

[Reserved]

§§ 13B.08[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
A. Overview

6-13B California Legal Forms--Transaction Guide § 13B.10

§ 13B.10 Comparison of State and Federal Income Tax Exemptions

[1] Exemptions Similar but Not Identical

Organizations that are exempt from federal and California income taxes are enumerated in *I.R.C. §§ 501, 521, 527,* and *528* and in *Rev. & Tax. Code §§ 23701 et seq.*, and *23704.* Although the classification of organizations exempted from California franchise and income taxes is, for the most part, the same as the classification of organizations exempted from federal income tax, some organizations are exempt from federal taxation but not from California taxation, while other organizations are exempt from state taxes but not from federal taxes. The table in [2], *below*, illustrates the nature of those organizations eligible for exemption from tax and demonstrates, when applicable, the correlation between the California exemption and its federal counterpart.

It should never be assumed that an organization exempt from taxation for federal purposes is also exempt from California taxation. Neither should it be assumed that the California and federal requirements of a particular exempt category are identical merely because there is a comparable state and federal exemption; both California and federal tax law must be consulted. Furthermore, recognition of exempt status for federal income tax purposes does not automatically entitle an organization to tax-exempt status for California purposes. Although procedures for filing applications for exempt status with the Internal Revenue Service (IRS) and the Franchise Tax Board (FTB) are similar, separate exemption determinations are made by these agencies [*see §§ 13B.20, 13B.40*]. However, the California tax law is generally patterned after the federal law and is therefore substantially similar. The major differences are discussed in this Legal Background, and parallel citations between the Internal Revenue Code and the Revenue and Taxation Code are provided whenever the differences are minor or nonexistent.

[2] Correlation Table

Internal Revenue Code	Revenue and Taxation Code	Type of Organization
501(c)(1)	None	Corporations organized under act of Congress (including Federal Credit Unions)
501(c)(2)	23701h	Corporations holding title to property for exempt organ-

		izations
501(c)(3)	23701d	Religious, educational, charitable, scientific, literary, testing for public safety, foster certain national or international amateur sports competition, or prevention of cruelty to children or animals organizations
501(c)(4)	23701f	Civic leagues, social welfare organizations, and local associations of employees
501(c)(5)	23701a	Labor, agricultural, and horticultural organizations (California: cooperatives excluded unless determined by the IRS to be within I.R.C. § 501(c)(5))
501(c)(6)	23701e	Business leagues, chambers of commerce, real estate boards, etc.
501(c)(7)	23701g	Social, recreational, and pleasure clubs for members
501(c)(8)	23701b	Fraternal beneficiary societies and associations
501(c)(9)	23701i	Voluntary employees' beneficiary associations
501(c)(10)	23701l	Domestic fraternal societies and associations
501(c)(11)	23701j	Teachers' retirement fund associations
501(c)(12)	None	Benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies, etc.
501(c)(13)	23701c	Nonprofit cemetery companies
501(c)(14)	None	State chartered credit unions and mutual reserve funds
501(c)(15)	None	Insurance companies and associations
501(c)(16)	None	Cooperative organizations to finance crop operations
501(c)(17)	23701n	Supplemental unemployment compensation benefit trusts
501(c)(18)	23701s	Employee funded pension trust (created before June 25, 1959)
501(c)(19)	23701w	Post or organization of Armed Forces members
501(c)(20)	23701q	Organization forming group legal services plan (for years on or before 1991)
501(c)(21)	None	Black lung benefit trusts
501(c)(22)	None	Trusts established by plan sponsors of multiemployer plans for purpose of making withdrawal liability payments
501(c)(23)	None	Veterans' organizations organized before 1880 to provide insurance benefits
501(c)(24)	None	Trust established to receive and distribute liability payments from contributing sponsors of terminated pension plan [*see* 29 U.S.C. § 1349]
501(c)(25)	23701x	Title-holding companies
501(d)	23701k	Religious and apostolic associations
501(e)	23704	Cooperative hospital service organizations

501(f)	None	Cooperative service organizations of operating educational organizations
None	23701p	Trust or plan for self-employed Individuals (not otherwise exempt)
None	23701v	Organization of mobilehome owners formed to purchase mobilehome park
521	None	Farmers' cooperative organizations
527	23701r	Political organizations
528	23701t	Homeowners' associations

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific OrganizationsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsTreatment of Unincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
A. Overview

6-13B California Legal Forms--Transaction Guide § 13B.11

§ 13B.11 Nonprofit Status Does Not Automatically Ensure Exemption

The fact that an organization is formed as a nonprofit corporation [*see Corp. Code § 5000 et seq.*] or a nonprofit unincorporated association [*see Corp. Code § 18605 et seq.*] does not automatically entitle the organization to tax-exempt status under either California or federal law. Tax-exempt status is a statutory privilege rather than a right and is not automatically recognized or granted. Nonprofit corporations and unincorporated associations are therefore generally subjected to tax under *I.R.C. § 11* and *Rev. & Tax. Code §§ 23151, 23501* unless they establish a specific exemption.

To be tax-exempt, a nonprofit entity must come within one of the statutes declaring the exemption, and the entity's purposes and activities can be no broader than those described in the statute. For example, an organization organized and operated exclusively for charitable purposes is exempt from federal income tax [*I.R.C. § 501(c)(3)*] and from state franchise and income tax [*Rev. & Tax. Code § 23701d*], and a pleasure club organized and operated exclusively for pleasure, recreation, and other nonprofit purposes is also exempt from federal income tax [*I.R.C. § 501(c)(7)*] and from state franchise and income tax [*Rev. & Tax. Code § 23701g*]. However, an organization organized and operated both for charitable purposes and for pleasure, recreation, and other nonprofit purposes would not be exempt from either tax because its activities are not exclusively limited to those set forth in the governing statutes. A nonprofit organization that does not fit into one of the various categories of exempt organizations is not tax-exempt [*see Rev. Rul. 63-190, 1963-2 C.B. 212* ; *see also* FTB Form 1069].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific OrganizationsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsTreatment of Unincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
A. Overview

6-13B California Legal Forms--Transaction Guide § 13B.12

§ 13B.12 Advantages of Tax-Exempt Status

For-profit entities may conduct nonprofit activities without changing status. However, significant advantages may result from nonprofit status, including the following:

- Tax exemptions from federal income tax and state franchise and income tax [*see, e.g., I.R.C. § 501(a)*; *Rev. & Tax. Code § 23701*].

- Income tax deductibility of gifts to the entity [*see I.R.C. § 170*; *Rev. & Tax. Code § 17201* (deductions determined in accordance with federal law unless otherwise provided)].

- Securities exemptions [*see* Chs. 13, *Nonprofit Corporations* ; Ch. 13A, *Nonprofit Unincorporated Associations* ; *see also* Ch. 6, *Securities Regulation Issues*, for a list of the available California securities exemptions]

- Special copyright treatment [*see 17 U.S.C. § 110 et seq.*].

- Gifts to entity may be eligible for federal estate and gift tax deductions [*I.R.C. §§ 2055*, *2522*] and California gift tax exemptions [*Rev. & Tax. Code §§ 15441*, *15442*].

Assuming that an entity has clear nonprofit or exempt purpose, tax-exempt status may be important for operational reasons. If the entity will be dependent on the tax deductibility of contributions, or on grant or endowment funding, tax exempt status may be critical. In general, *I.R.C. § 501(c)(3)* and *Rev. & Tax. Code § 23701d* organizations rely on charitable contributions to generate sufficient support for their activities. Further, nonprofits are eligible for reduced rate mailing privileges, and may be able to secure property tax advantages [*see Rev. & Tax. Code §§ 202-207, 213.7-217, 221-231*] and sales tax advantages [*see Rev. & Tax. Code § 6361 et seq.* (exemptions)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Estate & Gift TaxesDeductionsCharitable Deductions (IRC secs. 2055, 2522, 2524)General OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific OrganizationsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsTreatment of Unincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
A. Overview

6-13B California Legal Forms--Transaction Guide § 13B.13

§ 13B.13 Disadvantages of Tax-Exempt Status

Despite the many attractions of nonprofit, tax-exempt status [*see § 13B.12*], that status may have significant disadvantages as well. For example, it may be more difficult to attract directors and officers, given the lack of profit motive, the lack of incentive stock options, and generally lower compensation. In addition, tax-exempt status is not particularly useful if the entity is operating at a loss, and tax exemptions do not cover unrelated business income [*see I.R.C. §§ 511*-514; *Rev. & Tax. Code §§ 23731-23735*; *see also § 13B.131[1]*].

Exempt organizations are prohibited from engaging in certain activities and can engage in other activities only to a limited extent to retain tax-exempt status [*see, e.g., I.R.C. § 503* (prohibited transactions)]. If an organization's ability to engage in these activities without restrictions is preferable to obtaining tax-exempt status, applying for tax-exempt status will not be worthwhile.

Finally, nonprofits are often subject to more governmental oversight. Because the penalty for failing to comply may be loss of exempt status [*see §§ 13B.25, 13B.26, 13B.42*], the consequence of noncompliance can be extremely severe.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Income Tax ComputationCompensation & Welfare BenefitsStock Options (IRC secs. 421-424)Tax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific OrganizationsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsTreatment of Unincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
A. Overview

6-13B California Legal Forms--Transaction Guide §§ 13B.14-13B.19

[Reserved]

§§ 13B.14[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
B. Obtaining and Maintaining Federal Income Tax Exemption

6-13B California Legal Forms--Transaction Guide § 13B.20

§ 13B.20 Establishing Exemption Under I.R.C. § 501(c)(3)

[1] Filing Requirement

[a] Filing Form 1023 as Condition Precedent to Exempt Status

The fact that an organization may qualify as an exempt organization does not automatically exempt it. Most organizations described in *I.R.C. § 501(c)(3)* must apply for, and be granted, exempt status as a condition precedent to recognition as tax-exempt organizations [*I.R.C. § 508(a)*; *Treas. Reg. § 1.508-1(a)(2)*]. The IRS interprets this notice requirement as requiring the filing of IRS Form 1023, the federal application form for recognition of exempt status under *I.R.C. § 501(c)(3)*. Thus, organizations qualifying for exempt status under *I.R.C. § 501(c)(3)* will not be treated as tax-exempt unless they file Form 1023 with the proper IRS District Director [*Treas. Reg. § 1.508-1(a)(2)(i)*].

[b] Exceptions From Filing Requirement

Exceptions to this filing requirement exist for the following [*I.R.C. § 508(c)*; *Treas. Reg. § 1.508-1(a)(3)(i)*-(ii)]:

- Churches, their integrated auxiliaries, and conventions or associations of churches.

- Any organization (other than a private foundation) satisfying the exemption requirements whose annual gross receipts do not normally exceed $5,000.

- Subordinate organizations (other than private foundations) covered by a group exemption letter.

Although these excepted entities are automatically excepted from this filing requirement, they may file the form voluntarily. If the entity wants to establish its exemption with the IRS and receive a ruling or determination letter recognizing its exempt status, it should file Form 1023 [*Treas. Reg. § 1.508-1(a)(4)*]. The organization may file to obtain certain incidental benefits, such as public recognition of tax-exempt status, exemption from certain state taxes, exemption from certain federal excise taxes, advance assurance to donors of deductibility of contributions, and nonprofit mailing privileges [*see* IRS Form 1023, Instructions; *see also § 13B.200*]. It is usually advantageous for an

excepted entity to make the filing to obtain a formal recognition of its status from the IRS, particularly if the entity plans to solicit contributions.

[c] Time of Filing

New entities must file Form 1023 within 15 months after the end of the month of formation [*Treas. Reg. § 1.508-1(a)*]. With the application of an automatic extension, organizations seeking exempt status have 27 months from the date of formation to make this filing [*see Rev. Proc. 92-85, 1992-2 C.B. 490*]. Entities may also request an additional extension, showing that they acted reasonably and in good faith and that the government's interests have not been prejudiced by the delayed filing [*see Rev. Proc. 92-85, 1992-2 C.B. 490 , as modified, Rev. Proc. 93-28, 1993-2 C.B. 344*].

Exemption applications must be accompanied by the applicable fee. The amount of the fee is based on the actual or expected annual gross receipts of the entity claiming exemption [*see* IRS Form 8718].

If the exemption is granted, the exemption will be made retroactive to the date of formation [*Treas. Reg. § 1.508-1(a)(2)*]. However, recognition will not be retroactive if the applicant must alter its activities or substantively amend the charter documents to qualify for exempt status [*see Rev. Proc. 84-47, 1984-1 C.B. 545*].

[2] Exempt Purpose

The stated purpose of an *I.R.C. § 501(c)(3)* organization must be one or more of the following: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or the prevention of cruelty to children or animals [*I.R.C. § 501(c)(3)*; *Treas. Reg. § 1.501(c)(3)-1(d)(1)(i)*]. Provided that they satisfy the requirements of their respective sections, certain cooperative hospital service organizations, cooperative service organizations, operating educational organizations, and child care organizations qualify as organizations organized and operated exclusively for charitable or educational purposes [*see I.R.C. § 501(e), (f), (k)*].

The exempt purpose requirement, in the context of the organizational and operational tests, is discussed in [3] and [4], *below*, respectively. The general nature of specific exempt purposes is discussed in *§ 13B.200[1][d]*.

[3] Organizational Test

[a] Exclusively Exempt Purposes

The *I.R.C. § 501(c)(3)* exemption requires that the entity's articles of organization [*see Treas. Reg. § 1.501(c)(3)-1(b)(2)*] limit the organizational purpose of the organization to one or more of the designated exempt purposes [*Treas. Reg. § 1.501(c)(3)-1(a), (b)(1)(i)(a)*; *see* [2], *above*]. Under this "organizational test," an entity's purposes, as stated in its articles, may be as broad as, or more specific than, the exempt purposes stated in *I.R.C. § 501(c)(3)*. An organization is not considered to be organized exclusively for one or more exempt purposes if, under the terms of its articles, its purposes are broader than those statutory purposes. The fact that the actual operation of the organization has been exclusively in furtherance of one or more exempt purposes is not sufficient to permit the organization to meet the organizational test. Similarly, the fact that members' statements or other evidence establishes that the members intend solely to operate in furtherance of one or more exempt purposes is not sufficient to permit the organization to meet the organizational test [*Treas. Reg. § 1.501(c)(3)-1(b)(1)(iv)*].

An organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it (1) to devote more than an insubstantial part of its activities to attempting to influence legislation by propaganda or otherwise [*Treas. Reg. § 1.501(c)(3)-1(b)(3)(i)*; *but see* [7], *below*]; (2) directly or indirectly to participate or intervene in any political campaign on behalf of or in opposition to any candidate for public office [*Treas. Reg. § 1.501(c)(3)-1(b)(3)(ii)*

]; or (3) to have objectives and to engage in activities that characterize it as an "action organization" [*Treas. Reg. § 1.501(c)(3)-1(b)(3)(iii)*; *see Treas. Reg. § 1.501(c)(3)-1(c)(3)* ("action organization" defined); *see also* [4], *below*]. However, notwithstanding the restriction on lobbying activity, it is possible for an organization to elect to be allowed to spend a considerable amount of its funds each year on lobbying, provided that the organization is classed as a public charity [*see I.R.C. §§ 501(h), 4911*; *Treas. Reg. §§ 1.501(h)-1*-1.501(h)-3; *see also* [7], *below*]. Further, an organization's articles do not violate the "insubstantial part" prong of this test even if the articles expressly empower it to (1) make the lobbying election [*see I.R.C. § 501(h)*; *see also* [7], *below*] with respect to influencing legislation; and (2) make lobbying or grass roots expenditures, on election, that do not exceed the prescribed ceiling amounts [*Treas. Reg. § 1.501(c)(3)-1(b)(3)*; *see I.R.C. § 501(h)(2)(B), (D)*]. The articles may *not* expressly empower the organization to engage, other than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes [*Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(b)*].

[b] Dedication of Assets

In addition to being organized exclusively for one or more exempt purposes [*see* [a], *above*], the assets of a nonprofit organization must be dedicated to an exempt purpose. An organization's assets are deemed dedicated to an exempt purpose, for example, if, on dissolution, those assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose, or would be distributed by a court to another organization to be used in such a manner as in the judgment of the court would best accomplish the general purposes for which the dissolved organization was organized. An organization does not satisfy the organizational test if its articles or the law of the state in which it was created provide that the assets would be distributed to an organization's members or shareholders on dissolution [*Treas. Reg. § 1.501(c)(3)-1(b)(4)*]. As a matter of course, an organization's articles should include a provision ensuring permanent dedication of assets for exempt purposes, rather than relying on state law to establish permanent dedication.

[c] No Private Benefit or Inurement

No part of a nonprofit entity's net earnings may inure to the benefit of private shareholders or members [*I.R.C. § 501(c)(3)*; *Treas. Reg. § 1.501(c)(3)-1(c)(2)*]. The organizational document should contain a provision to this effect.

A nonprofit must also establish that the entity will not be organized or operated for the benefit of private interests. An organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Accordingly, an organization must establish that it is not organized or operated for the benefit of private interests, such as designated individuals, its creator or his or her family, shareholders or members of the organization, or persons controlled directly or indirectly by these private interests [*Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii)*; *see Housing Pioneers, Inc. v. Commissioner (9th Cir. 1995) 58 F.3d 401* (general partner in limited partnerships formed to secure property tax exemption for limited partners not exempt because of substantial nonexempt purpose)]. The organizational document should contain a provision to this effect.

These two requirements are not precisely identical [*see American Campaign Academy v. Commissioner (1989) 92 T.C. 1053* (distinction between private inurement and private benefit)].

[4] Operational Test

[a] Exclusively Operated for Exempt Purposes

The "operational test" is an extension of the organizational test, that is, an organization must not only be organized in such a manner as to engage in or refrain from engaging in certain activities, it must also in its actual operation engage in or refrain from engaging in these activities as a continuing requirement for qualification under *I.R.C. § 501(c)(3)*. An organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages *primarily* in activities that accomplish one or more of the exempt statutory purposes.

An organization does not meet this test if more than an insubstantial part of its activities is not in furtherance of an exempt purpose [*Treas. Reg. § 1.501(c)(3)-1(c)(1)*]. Nor is an organization operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals [*Treas. Reg. § 1.501(c)(3)-1(c)(2)*; *see Treas. Reg. § 1.501(a)-1(c)*]. For example, a church that mailed out sermons to solicit contributions, was operated primarily for the purpose of providing a market for an affiliated advertising agency, and paid its ministers excessive salaries did not satisfy the operational test [*see Church by Mail, Inc. v. C.I.R. (9th Cir. 1985) 765 F.2d 1387, 1392-1393]* .

PRACTICE TIP:

An organization seeking a tax exemption need not have been in operation for any specified length of time to obtain tax-exempt status. A ruling or determination letter may be issued in advance of operations if the application and supporting documents provide sufficient detail to establish that the organization and its proposed activities meet the requirements of the particular exemption being asserted. However, the IRS may require a record of actual operations before a ruling or determination letter will be issued [*Treas. Reg. § 601.201(n)(1)(ii)*; *Rev. Proc. 80-25, 1980-1 C.B. 667*], and actual operations are required to maintain exempt status [*see § 13B.25[1]*].

[b] Limitation on Influencing Legislation and Lobbying

An organization does not meet the operational test if it is an "action organization." An organization is an action organization if a substantial part of its activities is attempting to influence legislation by propaganda or otherwise [*see Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii)*]. An organization for which the lobbying expenditure test election [*see I.R.C. § 501(h)*; *see also* [e], *below*] is in effect for a taxable year will not be considered an action organization under this rule for that year if the organization is not denied tax exempt status because of *I.R.C. § 501(h)* [*Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii)*].

Further, an organization is an action organization if it participates or intervenes in any political campaign on behalf of or in opposition to any candidate for public office [*Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii)*]. An action organization also has the following characteristics [*Treas. Reg. § 1.501(c)(3)-1(c)(3)(iv)*]:

- The entity's primary objective may be attained only by legislation, or a defeat of proposed legislation; and

- The entity advocates, or campaigns for, the attainment of that primary objective, as distinguished from engaging in nonpartisan analysis, study, or research, and making the results available to the public.

However, certain organizations may elect an alternative provision allowing them to engage in activities to influence legislation to a considerable extent [*see* [7], *below*].

Further, an *I.R.C. § 501(c)(3)* organization may not support or oppose any candidate for political office [*I.R.C. § 501(c)(3)*]. This bar is absolute and its violation results in denial or revocation of tax-exempt status [*see Christian Echoes Nat'l Ministry v. United States (10th Cir. 1972) 470 F.2d 849, 853-854]* . For further discussion, see *§ 13B.20[3][a], [4][b]*.

[c] Limitation on Unrelated Trade or Business

An organization organized and operated for the primary purpose of carrying on a trade or business that is unrelated to an exempt purpose does not qualify for exemption. However, an organization may meet the exemption requirements even though it operates a trade or business as a substantial part of its activities, if the operation of the trade or business is in

furtherance of the organization's exempt purpose and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business [*see I.R.C. § 513*]. In determining the existence of such a primary purpose, all the circumstances must be considered, including the size and extent of the trade or business, and the size and extent of the activities, which are in furtherance of one or more exempt purposes [*Treas. Reg. § 1.501(c)(3)-1(e)*]. An unrelated trade or business is generally any trade or business the conduct of which is not substantially related to the exercise or performance of the purpose constituting the basis of the organization's exemption [*see I.R.C. § 513(a)*].

[d] Limitation on Providing Commercial-Type Insurance

An organization will not qualify for exemption (under either *I.R.C. § 501(c)(3)* or *(4)*) if a substantial part of its activities consists of providing commercial-type insurance [*I.R.C. § 501(m)(1)*]. The issuance of annuity contracts will be treated as providing commercial-type insurance [*I.R.C. § 501(m)(4)*]. However, all of the following are excluded from the definition of "commercial-type insurance" [*I.R.C. § 501(m)(3)*]:

- Insurance provided at substantially below cost to a class of charitable recipients.
- Incidental health insurance provided by a health maintenance organization of a kind customarily provided by those organizations.
- Property or casualty insurance provided by a church, convention, or association of churches for that church, convention, or association.
- Retirement or welfare benefits (or both) provided by a church, convention, or association for its employees or their beneficiaries.
- Annuities for which a portion of the amount paid is allowable as a charitable deduction ("charitable gift annuities") [*see I.R.C. §§ 501(m)(5), 514(c)(5)* (description of annuity features); *see also I.R.C. §§ 170, 2055* (deduction requirements)].

If only an insubstantial part of the organization's activity consists of providing commercial-type insurance, that activity will be treated as an unrelated trade or business [*I.R.C. § 501(m)(2)(A)*; *see I.R.C. § 513*]. In these circumstances, the organization will be taxed under the provisions applicable to insurance companies [*I.R.C. § 501(m)(2)*; *see I.R.C. §§ 801*-845] rather than under *I.R.C. § 511* [*I.R.C. § 501(m)(2)(B)*].

PRACTICE TIP:
California does not contain a similar exception and will impose a tax on gross premiums [*see Cal. Const. art. XIII, § 28*.

[5] Private Foundation Status; Notice Requirement

[a] Presumption of Private Foundation Status

Every *I.R.C. § 501(c)(3)* organization that qualifies for tax exemption is a private foundation unless it falls into one of the categories specifically excluded from the definition of that term. *I.R.C. § 509(a)* defines the term "private foundation" in the negative, by actually defining the organizations that are *excluded* from the meaning of the term. In effect, the definition divides *I.R.C. § 501(c)(3)* organizations into two classes: private foundations and organizations other than private foundations. The latter organizations are commonly referred to as "public charities" or "publicly supported charities" [*see* [b], *below*].

Even if an organization falls into a category excluded from the definition of a private foundation, the entity will be presumed to be a private foundation, with some exceptions, unless it gives timely notice to the IRS that it is not a

private foundation [*see I.R.C. § 508(b)*]. Thus, it is not sufficient merely to be defined as a public charity [*see* [b], *below*]. The IRS must also be notified of this fact in the prescribed manner. Without notification, the organization will be treated as a private foundation [*Treas. Reg. § 1.508-1(b)(1)*; *see* [d], *below*].

PRACTICE TIP:

An organization may notify the IRS of its nonprivate foundation status by filing Form 1023 and providing the required information in support of that claim [*I.R.C. § 508(b)*; *Treas. Reg. § 1.508-1(b)(2)(iv)*; *see* IRS Form 1023, pt. III; *see also* [b], *below*]. For California tax purposes, the federal presumption of private foundation status is inapplicable to organizations that are not actually private foundations [*Rev. & Tax. Code § 23708(c)(2)*; *see 18 Cal. Code Reg. 23708*].

[b] Public Charity Distinguished

The following *I.R.C. § 501(c)(3)* organizations are considered to be public charities and are not private foundations [*I.R.C. § 509(a)*]:

- Organizations eligible for the 50 percent deduction limitation on charitable contributions [*see I.R.C. § 170(b)(1)(A)* (other than clauses (vii), (viii))], including the following:
  - A church or a convention or association of churches.
  - An educational organization such as a school or college.
  - Organizations operated for the benefit of certain state and municipal colleges and universities.
  - A hospital and medical research organization (operated in conjunction with a hospital).
  - A governmental unit [*see I.R.C. § 170(c)(1)*].
  - An *I.R.C. § 501(c)(3)* organization [*see I.R.C. § 170(c)(2)*] that ordinarily receives a substantial part of its support (exclusive of income received in the exercise or performance by that organization of its exempt purpose or function) from a governmental unit [*see I.R.C. § 170(c)(1)*] or from direct or indirect contributions from the general public.
- Organizations that receive broad public support in the amounts required by *I.R.C. § 509(a)(2)*.
- Organizations that actively function in a supporting relationship to, and are operated, supervised, or controlled by or in connection with one or more of the organizations described in the two preceding paragraphs.
- Organizations that are organized and operated exclusively for testing for public safety.

[c] Tax Ramifications

The federal income tax ramifications resulting the classification of an organization as a public charity or a private foundation are vastly different. Preferential tax treatment is accorded public charities, while private foundations are subject to complex and restrictive rules. For example, individual donors are entitled to deduct an amount not exceeding

50 percent of their adjusted gross income for contributions made to public charities in a taxable year [*I.R.C. § 170(b)(1)(A)*]. With minor exceptions [*see I.R.C. § 170(b)(1)(A)(vii)*], individual donors to private foundations are generally limited to a deduction of up to 30 percent of their adjusted gross income for contributions made during a taxable year [*I.R.C. § 170(b)(1)(B)*]. In addition, private foundations are subject to more burdensome annual return and reporting requirements [*see I.R.C. § 6033*] and to various excise taxes [*see I.R.C. § 4940* et seq.; *see also* [f], *below*].

[d] Notice Requirement

The notice requirement applicable to nonprivate foundation status is satisfied by the filing of IRS Form 1023, which provides the proper space for notification by *I.R.C. § 501(c)(3)* organizations that they are claiming nonprivate foundation status [*I.R.C. § 508(b)*; *Treas. Reg. § 1.508-1(b)(2)(iv)*; *see* IRS Form 1023, pt. III]. These organizations must also provide certain facts forming the basis for their claim [*see Treas. Reg. § 1.508-1(b)(2)(iv)*].

If a nonprofit must file notice that it is not a private foundation, the notice must be filed within 15 months from the end of the month in which it was organized [*Treas. Reg. § 1.508-1(b)(2)(i)*]. However, an extension of time for filing may be granted [*see Treas. Reg. § 1.508-1(b)(2)(v)*].

Some *I.R.C. § 501(c)(3)* organizations are exempt from this notice requirement [*see I.R.C. § 508(c)*]. The excepted organizations include the same organizations that are excepted from the requirement of filing a Form 1023 [*see* [1], *above; see also* IRS Pub. No. 557]. Certain nonexempt charitable trusts are also excepted [*see I.R.C. § 4947(a)(1)*]. However, any organization excepted from this requirement may voluntarily file [*Treas. Reg. § 1.508-1(b)(8)*].

[e] Governing Instruments of Private Foundations

A private foundation is not exempt from taxation unless its governing instrument [*see Treas. Reg. §§ 1.501(c)(3)-1(b)(2)*, 1.508-3(c)] contains provisions that do the following [*I.R.C. § 508(e)(1)*; *Treas. Reg. § 1.508-3(b)*; *but see I.R.C. § 508(e)(2)*]:

- Require income to be distributed in a manner and at a time that will not subject the foundation to the excise tax on undistributed income [*see I.R.C. § 4942*].
- Prohibit self-dealing [*see I.R.C. § 4941(d)*].
- Prohibit the foundation from retaining excess business holdings [*see I.R.C. § 4943(c)*].
- Prohibit the foundation from making investments that jeopardize its exempt purposes in such a manner as to subject [*see I.R.C. § 4944*].
- Prohibit the foundation from making taxable expenditures [*see I.R.C. § 4945(d)*].

The governing instruments of private foundations will be deemed to satisfy these requirements if valid provisions of state law have been enacted that contain the required prohibitions or treat the required prohibitions as contained in the governing instruments [*Treas. Reg. § 1.508-3(d)*]. California statutes make these required provisions part of every governing instrument creating a corporation that is either a private foundation [*see I.R.C. § 509*] or a nonexempt charitable trust that is treated as a private foundation under *I.R.C. § 4947(a)* [*Prob. Code §§ 16101-16104*; *see Corp. Code §§ 5260, 9260*; *see also Rev. Rul. 75-38, 1975-1 C.B. 161*]. Therefore, it is not required that the governing instruments of private foundations expressly contain these provisions.

PRACTICE TIP:

California requires that similar provisions be in the governing instruments of private foundations [*see*

Rev. & Tax. Code § 23708(e); *18 Cal. Code Reg. § 23708(b)*].

[f] Imposition of Excise Taxes

Private foundations are subject to many complex restrictions and requirements not applicable to publicly supported charities. The most important of these rules include the following:

- Restrictions on self-dealing between private foundations and their substantial contributors [*see I.R.C. §§ 507(d)(2), 4946(a)(1)(A)*] and other disqualified persons [*I.R.C. § 4941*; *see I.R.C. § 4946(a)*].
- Requirements that the foundation annually distribute income for charitable purposes [*I.R.C. § 4942*].
- Limitations on private foundation holdings in private businesses [*I.R.C. § 4943*].
- Provisions that investments may not jeopardize the carrying out of exempt purposes [*I.R.C. § 4944*].
- Provisions to ensure that expenditures further exempt purposes [*I.R.C. § 4945*].

If any of these provisions are violated, one or more specific excise taxes are imposed on the private foundation and, in some cases, its managers, its substantial contributors, and certain related persons [*see I.R.C. § 4946*].

I.R.C. § 4940 imposes an excise tax of 2 percent on the annual net investment income of private foundations that are exempt from taxation under *I.R.C. § 501(a)* [*I.R.C. § 4940(a)*]. Income items included in the calculation are income from interest, dividends, rents, payments with respect to securities [*see I.R.C. § 512(a)(5)*], and royalties [*see I.R.C. § 4940(c)*]. Private foundations may be eligible for a lower, 1 percent rate under certain conditions [*see I.R.C. § 4940(e)*], but only if the foundation was not liable for taxes for failure to distribute income for any year in the base period [*I.R.C. § 4940(e)(2)(B)*; *see I.R.C. § 4942*].

An "exempt operating foundation" is not required to pay any excise tax on investment income [*see I.R.C. § 4940(d)(1)*]. A private foundation qualifies as an exempt operating foundation if [*I.R.C. § 4940(d)(2)*]

- It is an operating foundation [*see I.R.C. § 4942(j)(3)*; *see also* [g], *below*].
- It has been publicly supported for at least 10 taxable years.
- Its governing body at all times during the taxable year is broadly representative of the general public and consists of individuals, at least 75 percent of whom are not disqualified individuals.
- No officer of the foundation, at any time during the taxable year, is a disqualified individual.

An additional penalty tax equal to the amount of the initial excise tax will be imposed on any person who becomes liable for any of the above excise taxes by reason of any act (or failure to act) that is not due to reasonable cause if that person has been liable for a prior excise tax, or that act (or failure to act) is both willful and flagrant [*I.R.C. § 6684*]. A termination tax may also be due if the private foundation's status is terminated because of willful, repeated acts, or a willful and flagrant act, giving rise to liability for one of the above excise taxes [*see I.R.C. § 507(a)(2)*]. Conversely, the IRS has discretion to abate or refund any excise taxes if it is established that the violation was due to a reasonable cause and not to willful neglect, and that the violation was corrected within the appropriate correction period [*I.R.C. § 4962(a)*].

PRACTICE TIP:

California imposes no special excise taxes on private foundations. Rather, California will revoke the exempt status of private foundations for certain violations of the foregoing prohibitions, resulting in liability for franchise taxes [*see Rev. & Tax. Code §§ 23707, 23708(e)*; *18 Cal. Code Reg. 23708(b)*].

[g] Private Operating Foundations

Private foundations may qualify as "private operating foundations" [*I.R.C. § 4942(j)(3)*]. The advantages of operating foundation status are twofold:

- First, charitable contributions to a private operating foundation qualify for the higher 50 percent charitable deduction limitation on a donor's tax return [*I.R.C. § 170(b)(1)(A)(vii)*, (F)(i)], while contributions to most other private foundations qualify for the lower 30 percent deduction limitation [*see I.R.C. § 170(b)(1)(B)*; *but see I.R.C. § 170(b)(1)(F)(ii), (iii)*].

- Second, an operating foundation is not subject to the rules requiring private foundations to distribute their income annually for charitable purposes and imposing an excise tax for their failure to do so [*I.R.C. § 4942(a)(1)*].

An operating foundation is subject to all of the other private foundation rules.

To qualify as a private operating foundation, an organization must make qualifying distributions [*see I.R.C. § 4942(g)(1), (2)*] directly for the active conduct of its exempt purposes or functions equal to substantially all of the lesser of its adjusted net income [*see I.R.C. § 4942(f)*] or its minimum investment return [*I.R.C. § 4942(j)(3)(A)*]. The foundation must also meet the assets test, the endowment test, or the support test [*see I.R.C. § 4942(j)(3)(B)*]. If distributions exceed the minimum investment returns for the taxable year, they must equal the foundation's adjusted net income unless substantially all of the distributions are made directly for the active conduct of its charitable activities [*I.R.C. § 4942(j)(3)(A)*].

PRACTICE TIP:

The primary distinction between a private foundation and an operating foundation is that a typical private foundation almost exclusively makes grants to other charities, whereas an operating foundation is itself directly involved in the performance of charitable activities.

[h] Termination of Private Foundation Status

An organization's status as a private foundation may be terminated voluntarily or involuntarily [*see I.R.C. § 507*; *see also Rev. & Tax. Code § 23707*]. An organization's status as a private foundation is voluntarily terminated if the organization notifies the IRS of its intent to terminate in the manner prescribed and the organization pays any applicable termination tax [*I.R.C. § 507(a)(1), (c), (g)*; *see I.R.C. § 507(b)*; *see also Treas. Reg. § 1.507-1(b)*]. Private foundation status is terminated involuntarily if there have been willful, repeated acts (or failures to act) or a willful and flagrant act (or failure to act) resulting in the imposition of an excise taxes [*see* [e], *above*], the IRS notifies the foundation that it is imposing a termination tax, and the organization pays any applicable termination tax [*I.R.C. § 507(a)(2), (c), (g)*; *see Treas. Reg. § 1.507-1(c)*]. The termination tax is equal to the lesser of the aggregate tax benefit of *I.R.C. § 501(c)(3)* status or the value of the foundation's net assets [*I.R.C. § 507(c)*; *see I.R.C. § 507(d), (e)*]. The unpaid portion of any termination tax may be abated by the IRS under certain circumstances [*see I.R.C. § 507(g)*].

A private foundation voluntarily terminating its status may avoid the termination tax if the foundation (1) has not committed willful, repeated acts (or failures to act) or a willful and flagrant act (or failure to act) giving rise to liability for excise tax (and involuntary termination) and (2) the foundation distributes all its assets to a qualified public charity or transforms itself into a public charity [*I.R.C. § 507(b)(1)*; *see Treas. Reg. § 1.507-2(a)(1)*]. The termination tax is not

imposed if the assets are transferred to another private foundation pursuant to liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization [*see I.R.C. § 507(b)(2)*; *see also Treas. Reg. § 1.507-3*].

[6] Use of Affiliate to Engage in Lobbying

In general, organizations exempt from taxation under *I.R.C. § 501(c)(3)* will lose tax-exempt status (and the ability to receive deductible charitable contributions [*see I.R.C. § 170(c)(2)(D)*]) if a substantial part of the entity's activities is carried on to influence legislation [*see I.R.C. § 501(c)(3)*; *see also* [4][b], *above*]. However, the organization may maintain its exempt status for its nonlobbying activities and establish an affiliate to engage in lobbying activities [*see I.R.C. § 501(c)(4)*]. For example, the organization might establish a political action committee (PAC) that is free to participate in political campaigns [*see Treas. Reg. §§ 1.501(c)(4)-1(a)(2)(ii)*, 1.527-6(f), (g)]. The related *I.R.C. § 501(c)(4)* entity must be separately incorporated, and it must maintain records that show that tax-deductible contributions to the *I.R.C. § 501(c)(3)* entity have not been used to support the political activities [*see I.R.C. §§ 170(c), 501(c)(3), (4), 527(f)(3)*; *Treas. Reg. §§ 1.501(c)(4)-1*, 1.527-6(e)-(g); *see also Branch Ministries v. Rossotti (D.C. 2000) 211 F.3d 137, 141-144* (church lost exempt status for political activities); *Regan v. Taxation With Representation (1983) 461 U.S. 540, 544, 103 S. Ct. 1997, 76 L. Ed. 2d 129* (separate incorporation and separate records not unduly burdensome)].

PRACTICE TIP:

In general, political organizations must notify the IRS electronically that they are to be treated as an exempt political organization in order to secure exempt status [*I.R.C. § 527(i)(1)*; *see I.R.C. § 527(i)(2), (3)* (time; contents); *but see I.R.C. § 527(i)(5), (6)* (exceptions, including if entity reasonably anticipates no gross receipts in excess of $25,000)]. If the organization fails to notify the IRS within 24 hours after the organization is established [*I.R.C. § 527(i)(2)*], the organization's taxable income must be computed by taking into account any exempt function income and any deductions directly connected with that income for any period that the organization is not in compliance with this requirement [*I.R.C. § 527(i)(4)*; *see § 13B.27*]. If the organization fails to notify the IRS within 30 days after any material change in the information required to be filed with the IRS, the organization's taxable income must be computed by taking into account the income and deductions only during the period beginning on the date when the material change occurred and ending on the date when the notice was given [*I.R.C. § 527(i)(2), (4)*].

[7] Lobbying Election for Public Charities

Organizations exempt from taxation under *I.R.C. § 501(c)(3)* will lose tax-exempt status (and the ability to receive deductible charitable contributions [*see I.R.C. § 170(c)(2)(D)*]) if a substantial part of the entity's activities is carried on to influence legislation [*see I.R.C. § 501(c)(3)*; *see also* [4][b], *above*]. However, certain public charities [*see* [5][b], *above*] may elect to replace the "substantial part of activities" test with a sliding-scale limitation defined in terms of expenditures for influencing legislation, which allows proportionately less expenditures for larger organizations. This elective provision enables these public charities to make limited expenditures to influence legislation without jeopardizing their tax-exempt status [*I.R.C. § 501(h)*; *see Rev. & Tax. Code § 23704.5*]. Most public charities (other than churches or conventions or associations of churches) are permitted to make this election. Private foundations are not eligible [*I.R.C. § 501(h)(3), (4), (5)*].

An organization making this election will be subject to an excise tax if its expenditures exceed the permissible amounts specified by statute [*see I.R.C. § 4911(c)*] to influence legislation [*see I.R.C. § 4911(d)*]. Furthermore, an organization will lose its tax-exempt status if its expenditures to influence legislation ordinarily (that is, on the average over a four-year period) exceed the permitted amounts by more than 50 percent [*I.R.C. § 501(h)(1), (2)*]. California does not impose an excise tax on an electing public charity that exceeds the lobbying expenditure limitation [*see Rev. & Tax.*

Code § 23740].

An election to be governed by the lobbying expenditures limitation is effective for all taxable years ending after the date the election is made and beginning before the date the election is revoked [*I.R.C. § 501(h)(6)*]. Thus, the election is revocable and can be made on a year-to-year basis. Eligible organizations that choose not to make this election are governed by the "substantial part of activities" test [*see I.R.C. § 501(h)(7)*].

The IRS has provided extensive regulations regarding (1) the application of the expenditure test to expenditures to influence legislation [*see Treas. Reg. § 1.501(h)-1*]; (2) the manner of electing the expenditure test [*see Treas. Reg. § 1.501(h)-2*]; and (3) the rules for determining whether an electing organization that is not a member of an affiliated group [*see Treas. Reg. § 56.4911-7(e)*] ordinarily makes lobbying or grass roots expenditures in excess of the applicable amounts such that the organization would lose its tax-exempt status [*see Treas. Reg. § 1.501(h)-3*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific OrganizationsTax LawFederal Taxpayer GroupsExempt OrganizationsConditions & Restrictions (IRC secs. 501-505, 521, 526-530)Tax LawFederal Taxpayer GroupsExempt OrganizationsPrivate Foundations (IRC secs. 507-509)General OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsPrivate Foundations (IRC secs. 507-509)Imposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
B. Obtaining and Maintaining Federal Income Tax Exemption

6-13B California Legal Forms--Transaction Guide § 13B.21

§ 13B.21 Establishing Exemption Under I.R.C. § 501(c) Rather Than I.R.C. § 501(c)(3)

In general, organizations attempting to establish tax-exempt status under a provision of *I.R.C. § 501(c)* other than *I.R.C. § 501(c)(3)* must file IRS Form 1024 [*see § 13B.10[2]*]. Similarly, organizations seeking exemption under *I.R.C. § 501(a)* also use this form. The filing requirements applicable to IRS Form 1023 generally apply to this form [*see § 13B.20*]. However, IRS Form 1024 contains no filing deadline. For further discussion, see *§ 13B.201[1]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific OrganizationsTax LawFederal Taxpayer GroupsExempt OrganizationsConditions & Restrictions (IRC secs. 501-505, 521, 526-530)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
B. Obtaining and Maintaining Federal Income Tax Exemption

6-13B California Legal Forms--Transaction Guide § 13B.22

§ 13B.22 Remedies for Denial of Exemption

[1] Appeal of Adverse Determination

If the IRS denies the application for exemption, it will send a proposed adverse determination notice to the organization. The organization has 30 days from the mailing date of the adverse determination letter in which to appeal. Appeal is by means of a protest letter, which must contain a statement of facts and applicable law and the arguments supporting the case for exemption [*see Rev. Proc. 90-27, 1990-1 C.B. 514*]. For additional discussion, see *§ 13B.130*.

PRACTICE TIP:
If the organization is notified of a potential adverse determination during the application period, the organization may be able to request technical advice from the IRS's national office [*see Rev. Proc. 2000-5, 2000-1 I.R.B. 158* (procedures)].

[2] Declaratory Judgment Relief

In general, organizations may obtain judicial review of an adverse determination of *I.R.C. § 501(c)(3)* tax-exempt status (or classification as a private foundation or private operating foundation) by filing suit for declaratory judgment in the Tax Court, Court of Federal Claims, or the Washington, D.C., District Court [*see I.R.C. § 7428(a)*]. The organization must first exhaust all administrative remedies [*see I.R.C. § 7428(b)(2)*], establish an active controversy [*see Tax. Ct. R. 210(c)(2)*], and file within the applicable filing period [*see I.R.C. § 7428(b)(3)*]. For additional discussion, see *§ 13B.130*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Administrative LawJudicial ReviewRemediesDeclaratory JudgmentsBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsCivil ProcedureAppealsReviewabilityGeneral OverviewCivil ProcedureAppealsReviewabilityAdverse DeterminationsTax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific OrganizationsTax LawFederal

Taxpayer GroupsExempt OrganizationsPrivate Foundations (IRC secs. 507-509)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
B. Obtaining and Maintaining Federal Income Tax Exemption

6-13B California Legal Forms--Transaction Guide § 13B.23

§ 13B.23 Exemption From Excise Taxes

The Internal Revenue Code specifically exempts certain organizations from specific federal excise taxes. For example, qualifying nonprofit educational organizations [*see I.R.C. § 170(b)(1)(A)(ii)*] are exempt from (1) retail excise taxes imposed on specified fuels with respect to the organization's purchase or use of the fuel [*see I.R.C. § 4041(g)*]; (2) taxes on communications services [*see I.R.C. §§ 4251, 4253(j)*]; and (3) manufacturers' excise taxes on purchases of items for exclusive use by the association [*see I.R.C. § 4221(a)(5)*; *but see I.R.C. §§ 4081, 4121* (no exemption)].

Certain aircraft museums [*see I.R.C. § 4041(h)(1)*] and nonprofit educational organizations are exempt from retail excise taxes imposed on specified fuels with respect to their purchase or use of the fuel [*see I.R.C. § 4041(h)(2)*; *see Treas. Reg. §§ 48.4041-14*, 48.4041-17]. Nonprofit hospitals [*see I.R.C. § 170(b)(1)(A)(iii)*] are exempt from taxes imposed on communications services [*see I.R.C. §§ 4251, 4253(h)*].

PRACTICE TIP:

Nonprofits seeking one or more of these exemptions must file the appropriate exemption certificate. For example, nonprofit educational organizations and nonprofit hospitals seeking exemption from the communications tax must provide a statement certifying entitlement to the exemption to the service provider (in the form and manner prescribed by regulations) [*see I.R.C. § 4253(l)(1)*].

Otherwise exempt private foundations are subject to an excise tax on net investment income [*see I.R.C. § 4940(a)*]. However, a private foundation that qualifies as an "exempt operating foundation" is not required to pay this tax [*I.R.C. § 4940(d)(1)*]. A private foundation qualifies for this exemption if it meets all of the following criteria [*I.R.C. § 4940(d)(2)*]:

- It is an operating foundation [*see I.R.C. § 4942(j)(3)*].
- It has been publicly supported for at least 10 taxable years.
- Its governing body at all times during the taxable year is broadly representative of the general public

and consists of individuals, at least 75 percent of whom are not disqualified individuals.

- No officer of the foundation, at any time during the taxable year, is a disqualified individual [*see I.R.C. § 4940(d)(3)* ("publicly supported" defined)].

A "disqualified individual" is an individual who is one of the following:

- A substantial contributor [*see I.R.C. § 507(d)(2)*] to the foundation.

- An owner of more than 20 percent of (1) the total combined voting power of a corporation; (2) the profit interest of a partnership; or (3) the beneficial interest of a trust or unincorporated enterprise; provided that the entity is a substantial contributor to the foundation.

- A member of the family [*see I.R.C. § 4946(d)*] of any individual described in the two preceding categories].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawExcise TaxesGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
B. Obtaining and Maintaining Federal Income Tax Exemption

6-13B California Legal Forms--Transaction Guide § 13B.24

§ 13B.24 Application of Unrelated Business Income Tax

[1] Scope of Tax

Even if a nonprofit organization qualifies for tax-exempt status, the exemption from taxation is not absolute. Although the effect of operating as an exempt organization varies depending on the particular provision under which exemption is granted, contributions, assessments or dues received, income derived from any activities related to an organization's exempt purpose, and certain types of investment income, are generally exempt from taxation. However, the tax exemption does not extend to income derived from activities unrelated to an organization's exempt purposes [*see I.R.C. § 511* et seq.], nor does it extend to all investment income [*see I.R.C. § 4940*; *see also § 13B.20[5][e]*]. The unrelated business income tax applies to net income realized from a regularly conducted trade or business that is unrelated to the purpose or functions that form the basis for tax exemption [*see I.R.C. § 512(a)*; *see* [3], *below*]. This tax applies regardless of the fact that the income is actually used for the organization's exempt purposes.

PRACTICE TIP:
The IRS has evinced particular interest in the following areas: travel tours, corporate sponsorships, licensing and royalty arrangements, advertising, and sales.

[2] Organizations Subject to Tax

The following exempt organizations are subject to tax on unrelated business taxable income [*I.R.C. §§ 501(b), 511(a)*]:

- Organizations exempt from tax under *I.R.C. § 501(a)*.
- Public colleges and universities.
- Corporations wholly owned by public colleges or universities.

Two exceptions apply: exempt organizations organized under an act of Congress [*see I.R.C. § 501(c)(1), 511(a)(2)(A)*] and specified federally licensed business of religious orders [*see I.R.C. § 512(b)(15)*]. Organizations whose unrelated

business income is derived from providing commercial-type insurance [*see I.R.C. § 501(m)(3)*] are taxed under the provisions applicable to insurance companies [*see I.R.C. § 801* et seq.], rather than pursuant to the unrelated business income tax provisions [*I.R.C. §§ 501(m)(2), 511* et seq.; *see § 13B.20[4][d]*].

[3] "Unrelated Trade or Business" Defined

The term "unrelated trade or business" means any trade or business the conduct of which is not substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by the organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under *I.R.C. § 501* [*I.R.C. § 513(a)*; *see Treas. Reg. §§ 1.512(a)-1*, 1.512(a)-4, 1.512(b)-1]. In the case of a college or university [*see I.R.C. § 511(a)(2)(B)*], "unrelated trade or business" means any trade or business the conduct of which is not substantially related to the exercise or performance of any purpose or function [*I.R.C. § 501(c)(3)*]. Unrelated trade or business does not include any trade or business [*I.R.C. § 513(a)*]

- In which substantially all the work in carrying on that trade or business is performed for the organization without compensation;

- That is carried on, in the case of a 501(c)(3) organization or college or university [*I.R.C. § 511(a)(2)(B)*], by the organization primarily for the convenience of its members, students, patients, officers, or employees; or

- That the is the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions.

Special rules apply to foreign organizations [*I.R.C. § 512(a)(2)*]. Further, social clubs, voluntary employee's beneficiary associations, supplemental unemployment benefits trusts, and legal services plans [*see I.R.C. § 501(c)(7), (9), (17), (20)*] are taxed on all income less (1) membership income; (2) capital gains from the sale of real property used to further an exempt purpose and reinvested in real property; and (3) certain income paid or set aside for the exempt purpose [*see I.R.C. § 512(a)(3)*].

[4] Filing Requirements

Every exempt organization subject to the tax on unrelated business income [*see* [2], *above*] must file IRS Form 990-T if the organization has gross income from an unrelated trade or business of $1,000 or more for a taxable year [*I.R.C. § 511(a)*; *Treas. Reg. §§ 1.6012-2(e)*, 1.6012-3(a)(5); *see Treas. Reg. § 1.6033-2(i)*]. For further discussion, see *§ 13B.131*.

[5] Effect of Unrelated Business Income on Tax-Exempt Status

If an organization's unrelated trade or business is substantial, the organization may be ineligible for or lose tax-exempt status [*see Treas. Reg. § 1.501(c)(3)-1(e)*]. An organization will be denied exemption if it is "organized and operated for the primary purpose of carrying on an unrelated trade or business" [*see Treas. Reg. § 1.501(c)(3)-1(e)*; *see also New Faith, Inc. v. Commissioner (1992) 64 T.C.M. 1050, T.C. Memo. 1992-601]* or if that income is excessive [*see Orange County Agric. Soc'y v. Commissioner (2d Cir. 1990) 893 F.2d 529]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsUnrelated Business Income (IRC secs. 511-513)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
B. Obtaining and Maintaining Federal Income Tax Exemption

6-13B California Legal Forms--Transaction Guide § 13B.25

§ 13B.25 Maintaining Tax-Exempt Status

[1] Continuing to Meet Exemption Requirements

To maintain tax-exempt status, the organization must continue to meet the original exemption requirements: exempt purpose, no private inurement, and no or insubstantial involvement in influencing legislation or political campaigns. The entity's activities must continue to be reasonably related to the exempt purpose [*see § 13B.20[2]-[4]*]. The existence of a substantial nonexempt purpose will defeat the exemption [*see Better Business Bureau v. United States (1945) 326 U.S. 279, 283, 66 S. Ct. 112, 90 L. Ed. 67* .]

In evaluating whether the organization continues to meet the operational test, the organization must have actual operations from which it can be determined that this test is met [*see Pius XII Academy, Inc. v. Commissioner (1982) 43 T.C.M. 634, T.C. Memo. 1982-97 , aff'd, 711 F.2d 1058 (6th Cir. 1983)* (plan for charitable operations insufficient)]. The manner in which the organization actually conducts its activities will be examined. The scope and commercial hue of its activities and the existence, amount, and use of profits generated by its activities are critical to this determination [*see Rev. Rul. 75-384, 1975-2 C.B. 204* ; *see also Church by Mail, Inc. v. Comm'r (9th Cir. 1985) 765 F.2d 1387* (exemption denied when operated for substantial nonexempt purpose)]. An organization may conduct a commercial business, even if it is a substantial part of its activities, if the business furthers the stated exempt purpose and the business is related to that purpose [*see Treas. Reg. § 1.501(c)(3)-1(e)(1)*; *see also Rev. Rul. 97-21, 1997-1 C.B. 121*]. In contrast, an exemption will be denied if the entity engages in a substantial activity that does not further its exempt purpose [*see Nationalist Movement v. Commissioner (1994) 102 T.C. 558* (newsletters advocating social and political change unrelated to educational purpose); *see also Treas. Reg. § 1.501(c)(3)-1(d)(1)*]. Each substantial activity will be evaluated separately; each substantial activity must further one or more of the organization's exempt purposes [*see Dumaine Farms v. Commissioner (1980) 73 T.C. 650, 663]* .

No more than an insubstantial part of the organization's activities may be other than to further an exempt purpose. The IRS looks to whether the activity in question is incidental in nature, examining expenditures, receipts, and time connected to that activity, as well as the activity's significance in overall operations [*see Rev. Rul. 77-430, 1977-2 C.B. 194*].

[2] No Material Changes

If an exempt organization makes a material change in its character, purpose, or method of operation that is inconsistent with the exemption, the organization may not rely on a previous ruling or determination letter recognizing the exempt status under state or federal law [*Treas. Reg. § 601.201(n)(3)(ii)*; *see Rev. Proc. 90-27* , § 13.02, *1990-1 C.B. 514*]. For example, the Tax Court has upheld the IRS's retroactive revocation of exempt status because no risk contingent fee fundraising contracts that were entered into after the entity obtained a determination letter constituted a substantial change in the entity's operations [*see United Cancer Council Inc. v. Commissioner (1997) 109 T.C. 326]* . Further, an exempt organization that changes its structure so that it becomes a new legal entity (for example, a change from a trust or an unincorporated association to a corporation) must reestablish its exemption by filing an appropriate application [*Rev. Rul. 67-390, 1967-2 C.B. 179*].

[3] Revocation or Modification

The IRS may revoke or modify the terms of the exemption by sending notice to the taxpayer to whom the original ruling letter was sent. Grounds for revocation or modification, other than a material change in operations [*see* [2], *above*], include the enactment of legislation, the ratification of a tax treaty, a Supreme Court decision, the issuance of a temporary or final regulations, and the issuance of a revenue procedure, revenue ruling, or other statement published in the Internal Revenue Bulletin, that is inconsistent with the exempt nature of the entity [Rev. Proc. 90-27]. Revocation or modification will be retroactive if [Rev. Proc. 90-27, § 14.01, 1990-1 C.B. 514 ; *see I.R.C. § 503*]

- The organization omitted or misstated a material fact;
- The organization operated in a manner materially different from original representations; or
- A prohibited transaction occurred with the aim of diverting a substantial portion of corpus or income from the exempt purpose.

If the IRS action is based on a material change, the decision will be retroactive to the date of the change. If the ruling or determination letter was erroneous or no longer valid, the decision will be retroactive, but no earlier than the date of the original ruling [*Rev. Proc. 90-27* , § 14.01, *1990-1 C.B. 514*].

The appeal procedures are the same for modification or revocation as they are for a denial of exemption [*Rev. Proc. 90-27* , § 14.02, *1990-1 C.B. 514*]. For further discussion, see *§ 13B.130*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsUnrelated Debt-Financed Income & Deductions (IRC sec. 514)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
B. Obtaining and Maintaining Federal Income Tax Exemption

6-13B California Legal Forms--Transaction Guide § 13B.26

§ 13B.26 Compliance With Reporting Requirements

[1] Annual Information Return Filing Requirements

Exempt organizations ordinarily must file annual information returns, unless specifically exempted from the filing requirement [*see I.R.C. § 6033(a)(1)*; *see also I.R.C. § 6033(a)(3)*; *Treas. Reg. § 1.6033-1* et seq.]. Most exempt organizations file IRS Form 990 to satisfy this requirement. Private foundations file their annual information return on IRS Form 990-PF [*Treas. Reg. § 1.6033-2(a)(2)(i)*]. The appropriate return must be filed on or before the 15th day of the fifth calendar month following the close of its annual accounting period [*Treas. Reg. § 1.6033-2(e)*]. Specific filing requirements, such as requirements applicable when the organization has unrelated taxable business income, are *covered in § 13B.131[1]*. Penalties for noncompliance, are addressed in [2], *below*.

[2] Penalties for Noncompliance

If an organization required to file IRS Form 990 fails to file an annual return in a timely manner, include any required information, or state correct information, the IRS may impose penalties [*see I.R.C. § 6652(c)(1)(A), (3)*]. A responsible person who fails to comply with an IRS demand that Form 990 be filed (or to furnish the information that should have been included in the Form) may also be penalized [*see I.R.C. § 6652(c)(1)(B)*]. Additional penalties may be imposed for failing to pay any tax due, willful failures to file, and fraudulent filings, including monetary penalties and imprisonment [*see I.R.C. §§ 6651, 6652, 7203* et seq.]. However, no penalties will be imposed if the failure to file a timely, complete, and accurate return is due to reasonable cause [*see I.R.C. § 6652(c)(4)*].

Underpayments of tax due on IRS Form 990-T are subject to penalty if the underpayment results from negligence or disregard or the discrepancy is substantial [*see I.R.C. § 6662(a)*; *see I.R.C. §§ 6662(d)-(h), 6664*]. A significantly more substantial penalty is imposed if the underpayment results from fraud [*see I.R.C. § 6663(a)*]. Once a portion of an understatement is attributable to fraud, the entire underpayment will be treated as attributable to fraud except with respect to any portion that the taxpayer establishes, by the preponderance of the evidence, that is not attributable to fraud [*I.R.C. § 6663(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesCivil Penalties (IRC secs. 6651-6751)General OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesCivil Penalties (IRC secs. 6651-6751)Failure to Collect & Pay Over TaxTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
B. Obtaining and Maintaining Federal Income Tax Exemption

6-13B California Legal Forms--Transaction Guide § 13B.27

§ 13B.27 Loss of Exempt Status

In general, if a nonprofit fails to operate in a manner consistent with the rules and regulations governing the provision under which the entity claims its exemption, that failure will result in loss of exempt status. In addition, a private foundation may lose its exempt status for willful, repeated violations (or a willful and flagrant violation) of the prohibitions contained in *I.R.C. §§ 4940*-4945 [*see § 13B.20[5][e]*]. A public charity may lose its exempt status if it normally exceeds the elective lobbying expenditure limitation [*see § 13B.20[7]*].

A church entity can forfeit its exempt status by intervening in political campaigns [*see Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii)*]. However, the entity may form a political action committee (PAC) that is free to participate in political campaigns [*see Treas. Reg. §§ 1.501(c)(4)-1(a)(2)(ii)*, 1.527-6(f), (g)]. The related *I.R.C. § 501(c)(4)* entity must be separately incorporated and it must maintain records that show that tax-deductible contributions to the *I.R.C. § 501(c)(3)* entity have not been used to support the political activities [*see I.R.C. §§ 170(c), 501(c)(3), (4), 527(f)(3)*; *Treas. Reg. §§ 1.501(c)(4)-1*, 1.527-6(e)-(g); *see also Branch Ministries v. Rossotti (D.C. Cir. 2000) 211 F.3d 137, 141-144* .].

Termination or revocation of exempt status by the IRS is generally made on a prospective basis. However, the IRS may revoke exempt status retroactively under some circumstances [*see Rev. Proc. 90-27* , § 14, *1990-1 C.B. 514* ; *Rev. Proc. 80-25, 1980-1 C.B. 667*]. For further discussion, see *§ 13B.25[3]*.

In addition, political organizations may lose the benefit of tax-exempt status by failing to comply with reporting requirements. For example, if a political organization that fails to properly notify the IRS electronically that they are to be treated as an exempt *I.R.C. § 527* political organization within 24 hours after the organization is established [*I.R.C. § 527(i)(1), (2)*; *see I.R.C. § 527(i)(3)* (contents); *but see I.R.C. § 527(i)(5), (6)* (exceptions, including if entity reasonably anticipates no gross receipts in excess of $25,000)], the organization's taxable income must be computed by taking into account any exempt function income and any deductions directly connected with that income for any period that the organization is not in compliance with this notification requirement [*I.R.C. § 527(i)(4)*]. Similar penalties apply if the organization fails to report any material change in information reported to the IRS within 30 days [*see I.R.C. § 527(i)(2), (4)*; *see also § 13B.20[6]*]. Further, penalties may be imposed on political organizations that accept a

contribution or make an expenditure for an exempt function and fail to make the required disclosures [*see I.R.C. § 527(j)*; *see also I.R.C. § 527(l)* (authority to waive penalty assessment)].

As an alternative to revoking tax-exempt status based on violations of the restrictions against private inurement and private benefit, the IRS may impose intermediate sanctions on disqualified persons and managers [*see I.R.C. § 4958*]. A "disqualified person" is one who during the preceding five years was in a position to exercise substantial influence over the entity's operations [*I.R.C. § 4958(f)(1)*; *see § 13B.20[5][e]*]. The IRS is able to penalize the individuals responsible for the private inurement without revoking the organization's exempt status; however, these intermediate sanctions can not be used against private foundations, which are subject to separate excise tax penalties [*see, e.g., I.R.C. §§ 4941, 4945*]. Proposed regulations provide safe harbors for compensation and related party transactions [*see* Prop. Treas. Reg. § 53.4958 et seq.].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific OrganizationsTax LawFederal Taxpayer GroupsExempt OrganizationsConditions & Restrictions (IRC secs. 501-505, 521, 526-530)Tax LawFederal Taxpayer GroupsExempt OrganizationsPrivate Foundations (IRC secs. 507-509)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
B. Obtaining and Maintaining Federal Income Tax Exemption

6-13B California Legal Forms--Transaction Guide §§ 13B.28-13B.39

[Reserved]

§§ 13B.28[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
C. California Franchise and Income Tax Exemption

6-13B California Legal Forms--Transaction Guide § 13B.40

§ 13B.40 Procedure for Obtaining Tax-Exempt Status

[1] California Filing as Condition Precedent to Exempt Status

California requires that all organizations claiming exemption from franchise or income tax file an exemption application, FTB Form 3500, pay the applicable filing fee, and receive a favorable determination letter from the Franchise Tax Board in order to be exempt from tax [*Rev. & Tax. Code § 23701 et seq.*; *but see Rev. & Tax. Code § 23701d(c)(1)*; *see also § 13B.210[1][c]* for discussion]. Absent exemption, all corporations and unincorporated associations that perform services, own land, or borrow money are subject to taxation, even though organized on a nonprofit basis, and must file an application for exemption in order to be exempt from tax. Trusts organized and operated for charitable purposes [*see Rev. & Tax. Code § 23701d* (the California counterpart of *I.R.C. § 501(c)(3)*)] are classified as corporations for exemption purposes [*Rev. & Tax. Code § 17009*].

The fact that an organization is tax-exempt for federal purposes does not mean that the organization is necessarily exempt from California franchise or corporate income tax. The application procedures are completely separate: a federally exempt organization must file separately for California tax-exempt status; an entity that is exempt from California income or franchise taxes must separately apply for exemption from federal income tax unless covered by a group ruling [*see Treas. Reg. § 601.201(n)(8)*].

[2] Qualification for Exemption

An organization is not entitled to exemption from California franchise or income tax unless the organization is both organized (that is, chartered or incorporated) and operated (conducting activities) primarily (and in some cases exclusively) for one or more of the purposes specified in the particular section describing the exempt organization [*Rev. & Tax. Code § 23701*; *18 Cal. Code Reg. § 23701(b)*]. These two requirements are referred to as the "organizational test," which requires that the charter document describe the exempt purpose and limit other purposes [*see 18 Cal. Code Reg. § 23701(c)*], and the "operational test," which permits only an insubstantial part of organizational activities to be in furtherance of nonexempt purpose [*see 18 Cal. Code Reg. § 23701(b), (d)*]. An organization will not satisfy these tests if its net earnings inure, directly or indirectly, in whole or in part, to the personal or private benefit of a member, officer, director, employee, or individual. With respect to an individual, "inurement" means receiving some special benefit that

is unreasonable under the circumstances because of his or her membership or relationship to the organization [*see 18 Cal. Code Reg. § 23701(b)(1)(A)*]. The term "exempt purpose or purposes" means any purpose or purposes specified in the section under which exemption is desired and as further elaborated in the regulations [*18 Cal. Code Reg. § 23701(b)*].

These requirements apply to all organizations claiming tax exemption under California law. In addition, an organization must meet the specific requirements of the particular provision under which exemption is sought to be exempt from taxation under California law [*see Rev. & Tax. Code §§ 23701a-23701z*].

These requirements are similar to those imposed by federal law [*see I.R.C. § 501(c)(3)*; *Treas. Reg. § 1.501(c)(3)-1*; *see also § 13B.20[3], [4]*]. *I.R.C. § 501*, enumerating the organizations exempt from federal income tax, is similar to *Rev. & Tax. Code § 23701 et seq.*, and the regulations, rulings, and interpretations relating to *I.R.C. § 501* may be used in interpreting the requirements of *Rev. & Tax. Code § 23701 et seq.* However, some differences between federal and California law relating to exempt organizations exist [*see, e.g., § 13B.10[2]*]. Therefore both the federal and California requirements of the particular provision under which exemption is claimed must be consulted.

Nonprofit public benefit corporations must comply with the limitation on interested persons serving on the board of directors [*see Corp. Code § 5227(a)*]. No more than 49 percent of the persons serving on the board may be interested persons, which generally include compensated employees, independent contractors, and family members [*Corp. Code § 5227(a), (b)*]. For further discussion, see Ch. 13, *Nonprofit Corporations* .

New corporations are no longer subject to the minimum franchise tax for the first two years of corporate existence [*Rev. & Tax. Code § 23153(f)(2)* (effective January 1, 2000)]. Therefore, corporations need not prepay the tax while awaiting the results of the exemption request. New corporations that paid the tax will receive an automatic refund.

[3] Scope of Exemption

The exemption from franchise or income taxation is not absolute. It does not extend to the unrelated business taxable income of an exempt organization [*see Rev. & Tax. Code § 23731 et seq.*; *see also § 13B.41*]. Further, the exemption is not applicable to organizations operated for the primary purpose of carrying on a trade or business for profit that pay all of their profits to one or more exempt organizations. These organizations are known as feeder organizations [*see Rev. & Tax. Code § 23702*; *see also I.R.C. § 502*].

An exemption determination may have a retroactive effect [*see Rev. & Tax. Code § 23701*; *18 Cal. Code Reg. § 23701(b)(4)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxAnnual Report FilingsBusiness & Corporate LawCorporationsFinanceFranchise TaxExemptionsBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
C. California Franchise and Income Tax Exemption

6-13B California Legal Forms--Transaction Guide § 13B.41

§ 13B.41 Application of Unrelated Business Income Tax

California imposes a tax on the unrelated business income of corporations and charitable trusts that are exempt from California franchise and income tax [*Rev. & Tax. Code § 23701 et seq.*; *see Rev. & Tax. Code §§ 23731, 23038(b)*]. Although California generally conforms to federal law on unrelated business income, both the Revenue and Taxation Code and the Internal Revenue Code should be consulted for more detailed information concerning taxation of unrelated business income [*see § 13B.24*]. Unrelated business taxable income is reported annually on FTB Form 109.

If an organization's unrelated trade or business is substantial, the organization may be ineligible for or lose tax-exempt status. Further, this income can jeopardize the welfare exemption from property tax [*see § 13B.50*].

Unrelated business taxable income is reported annually on FTB Form 109. This tax is also subject to the rules for making estimated tax payments [*see* FTB Form 109, Instructions]. For further coverage, see *§ 13B.132*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsUnrelated Business Income (IRC secs. 511-513)General OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
C. California Franchise and Income Tax Exemption

6-13B California Legal Forms--Transaction Guide § 13B.42

§ 13B.42 Loss of Exempt Status

The Franchise Tax Board can revoke the exemption of any organization that fails to make the required filings on or before the last day of the 12th month following the close of the income year [*Rev. & Tax. Code § 23777(a)*; *see § 13B.132*]. The exemption may also be revoked by the Franchise Tax Board if the organization fails to confine its activities to those permitted by the section under which the exemption was granted [*Rev. & Tax. Code § 23777(c)*; *see § 13B.70* et seq.].

A *Rev. & Tax. Code § 23701d* organization may lose its exempt status by improperly using accumulations of income [*see Rev. & Tax. Code § 23737*], or by engaging in certain prohibited transactions [*see Rev. & Tax. Code §§ 23736-23736.4*; *see also I.R.C. § 503*]. California also denies exemption to charitable corporations that fail to file certain required reports, returns, or statements [*see Rev. & Tax. Code §§ 23703, 23775* (authorizing suspension or forfeiture of corporate powers and rights), 23777; *see also § 13B.70* et seq.].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
C. California Franchise and Income Tax Exemption

6-13B California Legal Forms--Transaction Guide §§ 13B.43-13B.49

[Reserved]

§§ 13B.43[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
D. California Property Tax Exemptions

6-13B California Legal Forms--Transaction Guide § 13B.50

§ 13B.50 Property Taxable Unless Exempt

Property in California is taxed according to its value unless the property is exempt [*see Cal. Const., art. XIII, § 1*; *see also Rev. & Tax. Code § 201*]. Whether property is exempt from taxation is determined by the specific use of the property or the character of the owner or operator. The California Constitution contains numerous property tax exemptions [*see Cal. Const., art. XIII, §§ 3, 4*]. The most important exemption relied on by nonprofits is the welfare exemption [*see § 13B.51*].

Real property may only be exempted by the California Constitution (or federal law), whereas personal property can be exempted by a two-thirds vote of both houses of the legislature [*compare Cal. Const., art. XIII, § 1 with Cal. Const., art. XIII, § 2*]. Property tax exemptions apply to general taxes only. The exemptions do not apply to special assessments for local improvements [*Cedars of Lebanon Hosp. v. County of Los Angeles (1950) 35 Cal. 2d 729, 747, 221 P.2d 31]* .

If an entity fails to claim a property tax exemption, that failure is deemed a waiver of the exemption for that year [*Cal. Const., art. XIII, § 6*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
D. California Property Tax Exemptions

6-13B California Legal Forms--Transaction Guide § 13B.51

§ 13B.51 Welfare Exemption

[1] Overview

All or any portion of property used exclusively for religious, hospital, or charitable purposes and owned or held in trust by entities organized and operate for those purposes and not for profit and whose earnings or assets do not inure to the benefit of any private individual may be exempt from tax [*Cal. Const., art. XIII, § 4(b), 5*; *see Rev. & Tax. Code § 214-215*]. In general, the welfare exemption may not be granted unless the organization qualifies as exempt under *I.R.C. § 501(c)(3)* or *Rev. & Tax. Code § 23701d* [*Rev. & Tax. Code § 214.8(a)*].

Additional statutory provisions permit the granting of the welfare exemption under specified circumstances for the following:

- Property owned by volunteer fire departments that qualify for exemption under *Rev. & Tax. Code §§ 23701d* or *23701f* or *I.R.C. § 501(c)(3)* or *501(c)(4)* [*Rev. & Tax. Code §§ 213.7, 214.8(a)*].

- Property owned by nonprofit corporations and leased to and used exclusively by the government, provided that the nonprofit corporation qualifies for exemption under *Rev. & Tax. Code §§ 23701f* or *23701u* or *I.R.C. § 501(c)(4)* [*Rev. & Tax. Code §§ 214.8(a), 231*].

- Property owned and operated by veterans' organizations that qualify for exemption under *Rev. & Tax. Code § 23701f* or *I.R.C. § 501(c)(4)* or *501(c)(19)* [*Rev. & Tax. Code §§ 214(g), 214.8(a)*, 215.1(a)].

An organization will not be deemed "qualified" as an exempt organization unless it has filed a valid organizational clearance certificate with the assessor [*Rev. & Tax. Code §§ 213.7(c), 214(a)(3)(C), 214.8(b)*; *see Rev. & Tax. Code § 254.6* (claim for certificate must be filed with Board of Equalization)].

The welfare exemption extends to buildings under construction and the land underneath [*Rev. & Tax. Code §§ 214.1, 214.2*]. However, in general, no exemption will be allowed on unimproved real property, even when it is intended that

buildings will be constructed on the property for charitable goals. However, if the unimproved property is used for charitable purposes, such as a park, the property may qualify for exemption [*see Rev. & Tax. Code § 214.02*].

PRACTICE TIP:

Qualification under another property tax exemption does not bar an organization from qualifying for the welfare exemption [*see J. Paul Getty Museum v. County of Los Angeles (1983) 148 Cal. App. 3d 600, 195 Cal. Rptr. 916]* . The welfare exemption is in addition to any other exemption provided by law; the existence of the exemption provision in *Rev. & Tax. Code § 202(a)(2)* does not preclude the exemption for museum or library property [*see* [3], *below*]. However, in general, the welfare exemption will not be construed to enlarge the college exemption [*Rev. & Tax. Code § 214(a), (e)*].

[2] Property Used for Religious, Hospital, Scientific or Charitable Purposes

Under the welfare exemption, property used exclusively for religious, hospital, scientific, or charitable purposes *and* that is owned and operated by community chests, funds, foundations, or corporations organized and operated for religious, hospital, scientific, or charitable purposes is exempt from taxation in the following situations [*Rev. & Tax. Code § 214(a)(1)-(7)*]:

- The owner is not organized or operated for profit. For hospitals, the organization will not be deemed to be organized or operated for profit if, during the immediately preceding fiscal year, operating revenues, exclusive of gifts, endowments and grants-in-aid, did not exceed operating expenses by an amount equivalent to 10 percent of those operating expenses.

- No part of the net earnings of the owner inures to the benefit of any private shareholder or individual [*see Cal. Const., art. XIII, § 4(b)*; *see also* La Soci'et'e *Francaise v. California Employment Comm'n (1943) 56 Cal. App. 2d 534, 133 P.2d 47 , cert. denied, 320 U.S. 736 (California rules similar to federal)]* .

- The property is used for the actual operation of the exempt activity and does not exceed the amount of property reasonably necessary to accomplish the exempt purpose. When determining whether the property is used for the "actual operation" of the exempt activity, occasional use [*see Rev. & Tax. Code § 214(a)(3)(B)(i)* (definition)] of the property for either of the following purposes will not be considered [*Rev. & Tax. Code § 214(a)(3)(A)*]:

  - The owner conducts fundraising activities [*see Rev. & Tax. Code § 214(a)(3)(B)(ii)* (definition)] on the property; the proceeds are not unrelated business taxable income [*see I.R.C. § 512*]; and the owner uses the proceeds to further the exempt activity;

  - The owner permits another exempt organization to conduct fundraising activities on the property; the proceeds are not unrelated business taxable income subject to taxation [*see I.R.C. §§ 511, 512*]; and the proceeds are used to further the exempt activity of the organization.

However, to preclude consideration of this occasional use of the property, the owner and any other organization using the property must file a valid organizational clearance certificate with the assessor [*Rev. & Tax. Code § 214(a)(3)(C)*; *see Rev. & Tax. Code § 254.6* (claim for certificate must be filed with Board of Equalization)]. A similar provision states that, when determining whether the property is used for the actual operation of the exempt activity, the use of the property for meetings conducted by another exempt organization will not be considered if [*Rev. & Tax. Code § 214(a)(3)(D)*]:

- The meetings are incidental to the other organization's primary activities;

- The meetings do not involve fund raising activities [*see Rev. & Tax. Code § 214(a)(3)(B)*];

- The meetings are not held more frequently than weekly;

- The other organization and its use of the property satisfy all the other requirements of *Rev. & Tax. Code § 214(a)(1)-(5)*; and

- The owner of the other organization complies with specified filing requirements (by filing with the assessor a valid, unrevoked letter from the IRS or the FTB stating that the other organization, or the national organization of which it is a local chapter or affiliate, qualifies as an exempt organization).

- The property is not used or operated by the owner or by any other person so as to benefit any officer, trustee, director, shareholder, member employee, contributor, or bondholder of the owner or operator, or any other person, through the distribution of profits, payments of excessive charges, or compensations or the more advantageous pursuit of their business or profession.

- The property is not used by its owner or members for fraternal or lodge purposes, or for social club purposes except when that use is clearly incidental to a primary religious, hospital, scientific, or charitable purpose.

- The property is irrevocably dedicated to religious, charitable, scientific, or hospital purposes [*see Rev. & Tax. Code § 214.01* (dedication must be stated in articles of incorporation)], and on the liquidation, dissolution, or abandonment of the owner will not inure to the benefit of any private person except a fund, foundation, or corporation organized and operated for religious, hospital, scientific, or charitable purposes [*see Rev. & Tax. Code § 214.3* (exception for property used for charitable or hospital purposes for 30 years)].

- If used exclusively for scientific purposes, the property is used by a foundation or institution that has been chartered by the United States Congress (except when the scientific purposes are medical research), and whose objectives are the encouragement or conduct of scientific investigation, research, and discovery for the benefit of the community at large.

With respect to the welfare exemption, hospitals include nonprofit multispecialty clinics, but not any portion of an outpatient clinic rented to private physicians for general medical practice [*see Cedars of Lebanon Hosp. v. County of Los Angeles (1950) 35 Cal. 2d 729, 745-746, 221 P.2d 31]* .

"Charitable purposes" include educational purposes. "Educational purposes" include purposes and activities for the benefit of the community as a whole or an unascertainable and indefinite portion of the community, but do not include any educational purposes and activities primarily for the benefit of an organization's shareholders. Educational activities include the study of relevant information, the dissemination of that information to interested members of the general public, and the participation of interested members of the general public [*Rev. & Tax. Code § 214(j)*].

To qualify for exemption, the owner of the property and the user need not be the same. However, both must be charitable organizations [*see Christ the Good Shepherd Lutheran Church v. Mathiesen (1978) 81 Cal. App. 3d 355, 146 Cal. Rptr. 321]* .

[3] Additional Types of Property Eligible for Exemption

In addition to property used exclusively for religious, hospital, scientific, or charitable purposes [*see* [2], *above*], the welfare exemption also applies to the following types of property:

- Property used exclusively for purposes of a school of less than collegiate grade that is owned and operated by religious, hospital, or charitable funds, foundations, limited liability companies, or corporations, if both the property and its owners meet the requirements listed above [*Rev. & Tax. Code § 214(b)*; *see Sarah Dix Hamlin Sch. v. City & County of San Francisco (1963) 221 Cal. App. 2d 336, 34 Cal. Rptr. 376]* .

- Property used exclusively for nursery school purposes that is owned and operated by religious, hospital, or charitable funds, foundations, limited liability companies, or corporations, if both the property and its owners meet the requirements listed above [*Rev. & Tax. Code § 214(c)*; *see Rev. & Tax. Code § 221*].

- Property used exclusively for a noncommercial educational FM broadcast station or an educational television station that is owned and operated by religious, hospital, scientific, or charitable funds, foundations, limited liability companies, or corporations that meets the requirements listed above [*Rev. & Tax. Code § 214(d)*; *see Rev. & Tax. Code §§ 215.5, 225.5*].

- Property used exclusively for religious, hospital, scientific, or charitable purposes [*see Rev. & Tax. Code § 214(j)*] that is owned and operated by religious, hospital, scientific, or charitable funds, foundations, limited liability companies, corporations, and educational institutions of collegiate grade, if both the property and its owners meet the requirements listed above [*Rev. & Tax. Code § 214(e)*; *see Rev. & Tax. Code § 203(b), (c)*]. The "irrevocable dedication" requirement [*see Rev. & Tax. Code § 214(a)(6)*; discussed in [2], *above*] will be met only if (1) the institution's articles of incorporation irrevocably dedicate the property either to charitable and educational purposes, to religious and educational purposes, or solely to educational purposes, and (2) the institution's articles provide for distribution of its property on liquidation, dissolution, or abandonment to a fund, foundation, or corporation organized and operated for religious, hospital, scientific, charitable [*see Rev. & Tax. Code § 214(j)* (definition)], or educational purposes meeting the requirements for exemption set forth in *Rev. & Tax. Code § 203* [*Rev. & Tax. Code § 214(e)*]. A property tax is imposed, however, on the portion of bookstore property owned by an educational institution of collegiate grade that produces income that is taxable as unrelated business taxable income [*Rev. & Tax. Code § 203(d)*; *see I.R.C. § 512*]. At the end of the fiscal year when unrelated business income has been generated, the nonprofit must file with the assessor copies of the organization's most recent tax return filed with the Internal Revenue Service [*Rev. & Tax. Code § 203(d)*].

- Property used exclusively for housing and related facilities for elderly or handicapped families that is financed by the federal government and owned and operated by religious, hospital, scientific, or charitable funds, foundations, limited liability companies, or corporations that meets the requirements listed above [*Rev. & Tax. Code § 214(f)*; *see Fifield Manor v. County of Los Angeles (1961) 188 Cal. App. 2d 1, 10 Cal. Rptr. 242* (occupants need not be needy); *see also Martin Luther Homes v. County of Los Angeles (1970) 12 Cal. App. 3d 205, 90 Cal. Rptr. 524* (no exemption when rents adjusted per need, only limited facilities provided, and units not designed for elderly)]. Property used exclusively for housing and related facilities for elderly or handicapped families at which supplemental care or services designed to meet the special needs of elderly or handicapped residents are not provided, or not financed by the federal government, is not entitled to the exemption unless the property is used for housing and related facilities for low-and moderate-income elderly or handicapped families [*Rev. & Tax. Code §*

214(f); *see Health & Safety Code § 50093*]. A partial exemption is available for property that would be exempt except for the fact that it includes some housing for other than low-income and moderate-income elderly or handicapped families [*Rev. & Tax. Code § 214(f)*; *see* [4], *below*].

- Property used exclusively for rental housing and related facilities that is owned and operated by religious, hospital, scientific, or charitable funds, foundations, limited liability companies, or corporations (including limited partnerships in which the managing general partner is an eligible nonprofit corporation or eligible limited liability company) meeting all the requirements of *Rev. & Tax. Code § 214*, or by veterans' organizations [*see Rev. & Tax. Code § 215.1*] meeting all the requirements of *Rev. & Tax. Code § 214(a)(1)-(7)* [*Rev. & Tax. Code § 214(g)(1)*]. The property will be entitled to a partial exemption based on the occupancy of lower income households [*see Rev. & Tax. Code § 214(g)(3)*; *see also Health & Safety Code § 50079.5*] in any year in which any of the following criteria applies: (1) the acquisition, rehabilitation, development, and/or operation of the property is financed with tax-exempt mortgage revenue bonds or general obligation bonds, or is financed by local, state, or federal loans or grants and the lower income occupants' rents do not exceed those prescribed by deed restrictions or regulatory agreements pursuant to the terms of the financing or financial assistance [*Rev. & Tax. Code § 214(g)(1)(A)*]; (2) the property owner is eligible for and receives low-income housing tax credits [*Rev. & Tax. Code § 214(g)(1)(B)*; *see I.R.C. § 42*]; (3) in the case of a claim (other than a claim with respect to property owned by a limited partnership in which the managing general partner is an eligible nonprofit corporation) filed after January 1, 2000, at least 90 percent of the occupants of the property are lower income households whose rent does not exceed the prescribed amount [*Rev. & Tax. Code § 214(g)(1)(C)*; *see Health & Safety Code § 50053*; or (4) the property was previously purchased and owned by the Department of Transportation pursuant to a consent decree requiring housing mitigation measures relating to the construction of a freeway and is now solely owned by an organization qualifying as an exempt organization under *I.R.C. § 501(c)(3)* [*Rev. & Tax. Code § 214(g)(1)(D)*]. To be eligible for the exemption, the owner must certify and ensure that an enforceable and verifiable agreement with a public agency, or a recorded deed restriction or other legal document exists that restricts the project's usage and provides that units designated for use by lower income households are continuously available to or occupied by lower income households [*Rev. & Tax. Code § 214(g)(2)(A)* (restriction and provision must be contained in enforceable and verifiable agreement with public agency or in certified recorded deed restriction if limited partnership and managing general partner is eligible nonprofit corporation); *see Health & Safety Code § 50053*]; and certify that the funds that would otherwise be paid in property taxes are used to maintain the affordability of, or reduce rents otherwise necessary for, the units occupied by lower income households [*Rev. & Tax. Code § 214(g)(2)(B)*].

- Property used exclusively for an emergency or temporary shelter [*see Health & Safety Code § 50800 et seq.* (eligibility for funding)] and related facilities for homeless persons and families that is owned and operated by religious, hospital, scientific, or charitable funds, foundations, limited liability companies, or corporations meeting the requirements listed above. A partial exemption is available for property that would otherwise be exempt except that it includes housing for other than an emergency or temporary shelter [*Rev. & Tax. Code § 214(h)*].

- Property used exclusively for housing and related facilities for employees of religious, charitable, scientific, or hospital organizations that meets all the above requirements, that is owned and operated by funds, foundations, limited liability companies, or corporations that meet all of the above requirements, to the extent that the residential use of the property is institutionally necessary for the operation of the organization [*Rev. & Tax. Code § 214(i)*].

Property used exclusively for the charitable purposes of museums owned and operated by organizations meeting the welfare exemption requirements [*see* [2], *above*], is exempt. Property used for activities related to the primary charitable

purposes is exempt, as are food service facilities and gift shops selling primarily educational materials [*see Rev. & Tax. Code § 214.14*].

[4] Occasional and Incidental Uses

The welfare exemption is not defeated by the fact that the otherwise exempt property is subject to the occasional use of another organization whose purpose and use of the property also satisfy the welfare exemption. Specifically, in determining whether property is actually used in an exempt activity, the other organization's use of the property will be disregarded if [*Rev. & Tax. Code § 214(a)(3)*]:

- The meetings are incidental to the other organization's primary activities;
- The meetings or activities do not involve fund-raising; and
- The meetings are not held more frequently than weekly.

The welfare exemption is not defeated by nonqualifying incidental uses that are "reasonably necessary" to achieve the organization's exempt purpose. For example, a hospital's training facilities, employee housing, and employee recreational facilities are exempt as reasonably necessary for the exempt purpose; a thrift shop maintained to benefit a children's clinic is not exempt [*Cedars of Lebanon Hosp. v. County of Los Angeles (1950) 35 Cal. 2d 729, 745-746, 221 P.2d 31]* . The activities of a YMCA have been determined to have a charitable purpose [*Clubs of California for Fair Competition v. Kroger (1992) 7 Cal. App. 4th 709, 9 Cal. Rptr. 2d 247* (exemption not defeated by competition with private clubs)]. A community center building used daily by church groups was eligible for exemption despite the occasional use by non-church groups, but the exemption did not apply to recreational facilities operated like a private club for a nonexempt organization [*Peninsula Covenant Church v. County of San Mateo (1979) 94 Cal. App. 3d 382, 156 Cal. Rptr. 431]* .

[5] Record Ownership

For application of the welfare exemption, the interest of the organization claiming the exemption must be of record in the office of the county recorder where the property is situated as of January 1 (the lien date) of the year for which the exemption is claimed [*Rev. & Tax. Code § 261(a)*; *see also Rev. & Tax. Code §§ 261(b), 442* (options)]. If the claimant, as of January 1, holds a possessory interest in publicly owned lands, or owns water rights or improvements on another's land, the claimant may file a document establishing that possessory interest or a statement stating the separate ownership of the improvements with the assessor in lieu of recording [*Rev. & Tax. Code § 261(c)*].

If the claimant fails to make the required recording or filing, the exemption is deemed waived [*Rev. & Tax. Code § 261(a)*].

[6] Filing Requirements and Procedure

The welfare exemption must be claimed annually by February 15 by filing a form prescribed by the Board of Equalization with the county tax assessor [*see Rev. & Tax. Code § 254.5*; *see* BOE Form 267]. However, the assessor may not approve a property tax exemption claim until the claimant has been issued a valid organizational clearance certificate [*Rev. & Tax. Code § 254.5(a)*; *see Rev. & Tax. Code § 254.6*]. Financial statements must be submitted only if requested in writing by the assessor [*Rev. & Tax. Code § 254.5(a)*].

The assessor will review all claims for the welfare exemption to determine whether the property for which the exemption is claimed meets the statutory requirements. Among other matters, the assessor will consider whether (1) any capital investment of the owner or operator for expansion of a physical plant is justified by the return on the investment

and required to serve the interests of the community, and (2) the property is used for the actual operation of an exempt activity and does not exceed an amount of property reasonably necessary for the accomplishment of the exempt purpose [*Rev. & Tax. Code § 254.5(b)(1)*]. The assessor may institute an audit or other verification of the operations of the owner and operator to determine whether bot satisfy the welfare exemption requirements [*Rev. & Tax. Code § 254.5(b)(2)*]. The assessor may deny a claim for exemption even if the claimant has been granted an organizational clearance certificate by the Board of Equalization, but may not approve an exemption claim denied by the Board [*Rev. & Tax. Code § 254.5(a), (c)(1)*]. If the assessor finds that the claimant's property is ineligible for the welfare exemption, the assessor will notify the claimant in writing that (1) the property is ineligible; (2) the claimant may seek a refund of property taxes paid; and (3) the claimant may file a refund action in superior court if the refund claim is denied [*Rev. & Tax. Code § 254.5(c)(2)*]. If it is later determined that the property, or any portion of the property, is no longer eligible for exemption, the assessor will cancel the exemption on so much of the property as is no longer eligible [*Rev. & Tax. Code § 254.5(e)*]. If the exemption on the property was incorrectly allowed, an escape assessment in the amount of the exemption plus interest will be made. A penalty will be assessed for failing to notify the assessor as required in an amount equaling 10 percent of the escape assessment, not to exceed $250 [*Rev. & Tax. Code § 254.5(f)*].

To maintain the welfare exemption, the organization must file BOE Form 267-A with the county tax assessor annually by February 15 [*see* BOE Form 267-A; *see also Rev. & Tax. Code §§ 270, 271* (partial exemption for late filing)]. However, an entity granted a welfare exemption and owning any property exempted under *Rev. & Tax. Code § 214.15* or *231* need not reapply in any subsequent year in which there has been no transfer of, or other change in title to, the exempted property and the property is used exclusively by a governmental entity or by a nonprofit corporation for its interest and benefit [*Rev. & Tax. Code § 254.5(d)*]. The applicant must notify the assessor on or before February 15, if, on or before the preceding lien date, the applicant became ineligible for the welfare exemption, or if, on or before that lien date, the property was no longer owned by the applicant or otherwise failed to meet all requirements for the welfare exemption [*Rev. & Tax. Code § 254.5(d)*].

PRACTICE TIP:

Before the lien date, the assessor will annually mail a notice to every applicant relieved of the annual filing requirement. The notice must state the circumstances under which the property may no longer be eligible for exemption and advise the applicant of the obligation to inform the assessor if the property is no longer eligible for exemption. The notice will include a card to be returned to the assessor by all applicants desiring to maintain eligibility for exemption; the failure to return this card does not itself constitute waiver, but may result in the onsite inspection to verify the exempt activity [*Rev. & Tax. Code § 254.5(d)*]. The claim for exemption and the annual form are public records subject to public inspection [*see* BOE Forms 267, 267-A].

The welfare exemption covers personal property in addition to real property. Nonprofits may need to be reminded that filing requirements must be met to exempt both types of property.

If the property is subject to occasional use by another exempt entity [*see* [4], *above*], the property owner and any other organization must file a valid organizational clearance certificate with the assessor [*Rev. & Tax. Code § 214(a)(3)(D)*; *see Rev. & Tax. Code § 254.5(d)*].

[7] Waiver of Exemption

If an organization fails to claim a property tax exemption, that failure is deemed a waiver of the exemption for that year [*Cal. Const., art. XIII, § 6*]. Similarly, if an organization claiming the welfare exemption fails to make the required recording or filing establishing record ownership [*see* [5], *above*], the exemption is deemed waived [*Rev. & Tax. Code § 261(a)*].

PRACTICE TIP:

The failure to return the card sent by the assessor to all applicants relieved of the annual filing requirement, advising the applicant of the obligation to inform the assessor if the property is no longer eligible for exemption [*see* [6], *above*], by any applicant desiring to maintain eligibility for the exemption does not itself constitute waiver. However, the failure may result in an on-site inspection to verify the exempt activity [*Rev. & Tax. Code § 254.5(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsHealthcare LawBusiness Administration & OrganizationTax ExemptionsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific OrganizationsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
D. California Property Tax Exemptions

6-13B California Legal Forms--Transaction Guide § 13B.52

§ 13B.52 Partial Welfare Exemption

If an organization's property is granted the welfare exemption [*Rev. & Tax. Code § 214*; *see § 13B.51*], that property is deemed used exclusively for the organization's exempt purposes. However, to the extent that income derived from the organization's use of the property is unrelated trade or business taxable income [*see I.R.C. §§ 511, 512*], the property will be exempt from taxation only to a limited extent [*Rev. & Tax. Code § 214.05(a)*]. The partial welfare exemption is based on the amount of exempt income produced by the organization's activities on the property or the amounts of time devoted to exempt activities that produce no income [*see Rev. & Tax. Code § 214.05(b), (c)*].

If an organization claims the welfare exemption but the organization's activities on the property have produced unrelated business taxable income, the organization must file information related to its income-producing activities as part of its claim for exemption [*Rev. & Tax. Code § 214.05(d)*]. For a list of those requirements, see *§ 13B.122*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsUnrelated Business Income (IRC secs. 511-513)Taxable IncomeTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
D. California Property Tax Exemptions

6-13B California Legal Forms--Transaction Guide § 13B.53

§ 13B.53 Religious Exemption

[1] Covered Property

The "religious exemption" or "church property exemption" exempts from tax property used solely and exclusively for religious purposes [*see Rev. & Tax. Code § 207*]. If a church owns property that is used for purposes not covered by this exemption, church property is ordinarily divided and the exemption only covers the property used for religious purposes.

The religious exemption covers church buildings, the land underneath, and equipment used exclusively for religious worship [*Cal. Const. art. XIII, § 3(f)*]. The religious worship requirement is broadly defined [*see Fellowship of Humanity v. County of Alameda (1957) 153 Cal. App. 2d 673, 693, 315 P.2d 394]* . Churches under construction, related land, and equipment intended for religious use are also exempt [*Cal. Const. art. XIII, § 5*; *see Rev. & Tax. Code § 206*].

Church parking lots are also exempted if used by persons involved in religious activities [*Rev. & Tax. Code § 206.1*]. Parking fees may be charged without affecting the exemption if the charges do not exceed the "ordinary and necessary costs of maintaining the real property" [*Rev. & Tax. Code § 206.1(b)(3)*]. Further, the lot may be used by the public without endangering the exemption [*Peninsula Covenant Church v. County of San Mateo (1979) 94 Cal. App. 3d 382, 401, 156 Cal. Rptr. 431]* .

The religious exemption is in addition to the welfare exemption [*see § 13B.51*].

[2] Simplified Claim Process

The religious exemption provides a simplified claims process for churches and church schools to file for property tax exempt status [*see Rev. & Tax. Code § 257*], with minimal subsequent annual filing requirements [*see Rev. & Tax. Code § 257.1*], and remains in effect until the property is no longer eligible. This exemption allows a church that operates a church school to file one exemption for the whole property, instead of filing a church exemption [*see Rev. & Tax. Code § 206*] for the church property and a welfare exemption for the school portion of the property. However, the welfare

exemption alone remains applicable to certain property used for religious purposes, such as hospitals and certain church-owned housing [*see* Stats. 1981, ch. 542, § 1].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsCharitable, Religious & Scientific OrganizationsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
D. California Property Tax Exemptions

6-13B California Legal Forms--Transaction Guide §§ 13B.54-13B.59

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
E. Other California Tax Exemptions

6-13B California Legal Forms--Transaction Guide § 13B.60

§ 13B.60 Sales and Uses Taxes

Sales by or to nonprofits ordinarily are subject to state and local sales and use taxes. However, narrow and detail-specific exemptions may apply to exempt certain types of property from sales and use taxes in certain situations [*see, e.g., Rev. & Tax. Code § 6361 et seq.*]. In general, the gross receipts from the sale, storage, use, and other consumption in California of tangible personal property that is made, prepared, assembled, or manufactured by organizations that (1) are formed and operated for charitable purposes qualifying for the welfare exemption [*Rev. & Tax. Code § 214*], (2) are engaged in the relief of poverty and distress, and (3) make the sales and donations as a matter of assistance to the purchasers and donees are exempt from tax [*Rev. & Tax. Code § 6375*]. The following are some examples of these exemptions:

- Hand-crafted or artistic items made by disabled individuals who are members of the selling organization sold intermittently for $20 or less [*Rev. & Tax. Code § 6361.1*].

- Meals served to students; low-income seniors; homebound seniors or disabled persons; patients of hospitals, certain residential facilities, and recovery facilities; and meals served by religious organizations [*Rev. & Tax. Code §§ 6363, 6363.5-6363.7, 6374*,].

- Goods made, assembled, or manufactured by entity qualifying for welfare exemption [*Rev. & Tax. Code § 6375*; *see § 13B.51*].

- Property donated by a seller to a *I.R.C. § 170(b)(1)(A)* organization located in California that is used, stored, or consumed in California [*Rev. & Tax. Code §§ 6366.4, 6403*].

- Medical health literature and health and safety materials purchased by charities [*Rev. & Tax. Code §§ 6408, 6409*].

- Sales of property at an auction conducted by an exempt organization if the revenue is used to fund a homeless shelter and the auction is not conducted more than once in any 12-month period [*Rev. & Tax.*

Code § 6363.2].

- Sales of food products, non-alcoholic drinks, and other personal property made or produced by members of youth organizations made intermittently when the profits are used exclusively to further the purposes of the organization [*Rev. & Tax. Code § 6361*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral OverviewTax LawState & Local TaxesSales TaxGeneral OverviewTax LawState & Local TaxesUse TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
E. Other California Tax Exemptions

6-13B California Legal Forms--Transaction Guide § 13B.61

§ 13B.61 Business License Taxes

Many cities impose a business license tax on the gross receipts of businesses conducted within city limits. However, no city or county may impose a business license tax measured by income or gross receipts on any organization exempt from tax under *Rev. & Tax. Code §§ 23701-23778* or *I.R.C. §§ 501*-509. Similarly, no city or county may impose a flat business license tax on a *I.R.C. § 501(c)(3)* or *Rev. & Tax. Code § 23701d* organization or on the clergy of one of these organizations [*see Cal. Const. art. XIII, § 26*; *Bus. & Prof. Code §§ 16000(b), 16100*; *Gov. Code § 37101*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawState & Local TaxesGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
E. Other California Tax Exemptions

6-13B California Legal Forms--Transaction Guide §§ 13B.62-13B.69

[Reserved]

§§ 13B.62[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
F. California Penalties for Noncompliance

6-13B California Legal Forms--Transaction Guide § 13B.70

§ 13B.70 Fines

An exempt organization that fails to file any required return on the date and in the manner prescribed (determined with regard to any extension of time for filing) [*see § 13B.132*] may be fined, unless it is shown that the failure is due to reasonable cause. On notice and demand by the Franchise Tax Board, the fine must be paid, in the same manner as tax, by the exempt organization or trust [*Rev. & Tax. Code § 23772(c)(1)*]. The Franchise Tax Board may make written demand on a private foundation failing to file. The demand must specify a reasonable future date by for compliance and state that if the filing is not made on or before that date, and unless it is shown that failure is due to reasonable cause, an additional penalty will be assessed. If more than one person is liable for the failure to file, all are jointly and severally liable with respect to that failure [*Rev. & Tax. Code § 23772(c)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsCivil ProcedurePleading & PracticePleadingsTime LimitationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsPrivate Foundations (IRC secs. 507-509)Imposition of TaxTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



166 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
F. California Penalties for Noncompliance

6-13B California Legal Forms--Transaction Guide § 13B.71

§ 13B.71 Suspension and Relief

The corporate powers, rights, and privileges of an exempt domestic corporation may be suspended (and the exercise of the corporate powers, rights, and privileges of a foreign exempt corporation in California may be forfeited) if the organization fails to (1) file the required annual information return or annual statement [*see Rev. & Tax. Code §§ 23772, 23774*], or (2) pay any amount due [*see Rev. & Tax. Code §§ 23703, 23772*] on or before the last day of the 12th month following the close of the income year [*Rev. & Tax. Code § 23775*]. However, the organization may still amend its articles of incorporation to set forth a new name and file annual returns or statements [*Rev. & Tax. Code § 23775*; *see Rev. & Tax. Code §§ 23772, 23774*].

An organization that has suffered suspension or forfeiture may be relieved on the filing of all of the following [*Rev. & Tax. Code § 23776(a)*; *see Rev. & Tax. Code § 23305a*]:

- An application for revivor [*see Rev. & Tax. Code § 23776(b)*].
- A new application for exemption if required by the Franchise Tax Board.
- Any returns, statements, notifications, or amounts due under *Rev. & Tax. Code §§ 23772, 23774*, or *23775* that were not previously submitted or paid and that resulted in the suspension or forfeiture.
- An information return or statement and any amount of tax [*see Rev. & Tax. Code § 23772*] for each year, or any part of the year, during the period of suspension or forfeiture in which the organization conducted any activities or received income, grants, gifts or any other asset.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxPenalties for NoncomplianceBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated

AssociationsTax LawState & Local TaxesAdministration & ProceedingsFailure to File ReturnTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
F. California Penalties for Noncompliance

6-13B California Legal Forms--Transaction Guide § 13B.72

§ 13B.72 Revocation of Exemption; Restoration

The Franchise Tax Board can revoke the exemption of any organization that fails to make the required filings on or before the last day of the 12th month following the close of the income year [*Rev. & Tax. Code § 23777(a)*; *see § 13B.132*]. An organization whose exemption was revoked under *Rev. & Tax. Code § 23777*; may be reestablished as an exempt organization on the filing and payment of the following [*Rev. & Tax. Code § 23778(a)*]:

- A new application for exemption and payment of the applicable filing fee [*see Rev. & Tax. Code § 23701*].

- Any returns, statements, or payment of any amounts due that were not previously submitted or paid and that resulted in the revocation.

If the exemption was revoked because the organization failed to confine its activities to those permitted by the section under which the exemption was granted [*Rev. & Tax. Code § 23777(c)*], must also provide satisfactory proof of all of the following [*Rev. & Tax. Code § 23778(b)*]:

- The organization has corrected its nonexempt activities.

- The organization will operate in an exempt manner in the future.

- Any taxes for periods that the organization was not qualified for exemption have been paid.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
F. California Penalties for Noncompliance

6-13B California Legal Forms--Transaction Guide § 13B.73

§ 13B.73 Other Sanctions

The Attorney General may sue for injunctive relief, dissolution, or other appropriate remedy to enforce compliance with the reporting requirements applicable to public benefit, mutual benefit, and religious corporations [*see Corp. Code §§ 6216, 8216, 9660(b)*; *see also* Ch. 13, *Nonprofit Corporations*]. The Attorney General may also act to compel compliance with the Supervision of Trustees and Fundraisers for Charitable Purposes Act [*see Gov. Code § 12580 et seq.*; *see also* Ch. 13, *Nonprofit Corporations*].

Directors, officers, employees, and agents may be held liable for making or delivering certain corporate documents knowing the document to be false in some material respect [*see Corp. Code §§ 6215, 8215, 9660(a)*; *see also* Ch. 13, *Nonprofit Corporations*]. Further, directors and officers may be subject to criminal sanctions if they knowingly concurred in making or publishing materially false, or willfully or fraudulently exaggerated, financial reports or statements of the corporation's financial condition if those statements would tend to induce contributions or donations [*see Corp. Code §§ 6812, 8813, 9690*; *see also* Ch. 13, *Nonprofit Corporations*]. Incorporators, directors, officers, and agents who knowingly exhibit false, forged, or altered documents to public officers with the intent to deceive may also be subject to criminal penalties [*see Corp. Code §§ 6814, 8814, 9690*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsFailure to Pay Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
F. California Penalties for Noncompliance

6-13B California Legal Forms--Transaction Guide §§ 13B.74-13B.79

[Reserved]

§§ 13B.74[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
G. Maintaining California Tax-Exempt Status

6-13B California Legal Forms--Transaction Guide § 13B.80

§ 13B.80 Continuing to Satisfy Exemption Requirements

To maintain its California tax-exempt status, an organization must continue to meet the original exemption requirements: exempt purpose, no private inurement, and no or insubstantial involvement in influencing legislation or political campaigns [*see Rev. & Tax. Code § 23701d*]. If an exempt organization makes a material change in its character, purpose, or method of operation that is inconsistent with the exemption, the organization may not rely on a previous ruling or determination letter recognizing the exempt status under state or federal law [*Treas. Reg. § 601.201(n)(3)(ii)*; *see Rev. Proc. 90-27* , § 13.02, *1990-1 C.B. 514*]. Further, an exempt organization that changes its structure so that it becomes a new legal entity (for example, a change from a trust or an unincorporated association to a corporation) must reestablish its exemption by filing an appropriate application [*Rev. Rul. 67-390, 1967-2 C.B. 179* ; *see* FTB Form 3500]. For further discussion, see *§ 13B.25*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
G. Maintaining California Tax-Exempt Status

6-13B California Legal Forms--Transaction Guide § 13B.81

§ 13B.81 Compliance With Reporting Requirements

California generally requires the filing of an annual information return [*Rev. & Tax. Code § 23772*; *see § 13B.132*]. Unlike federal law, California requires that organizations excepted from this requirement [*see Rev. & Tax. Code § 23772(a)(2)*; *18 Cal. Code Reg. 23772(a)(1)*] must file an annual information statement with the Franchise Tax Board [*Rev. & Tax. Code § 23774*]. Both the annual information return and the annual information statement are set forth in FTB Form 199.

The failure to comply with these requirements may be subject to the organization to penalties, including fines, suspension, or revocation of exemption [*see* Rev. & Tax. Code §§ 23722-23778]. These sanctions are discussed in *§ 13B.70* et seq.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART II. LEGAL BACKGROUND
G. Maintaining California Tax-Exempt Status

6-13B California Legal Forms--Transaction Guide §§ 13B.82-13B.99

[Reserved]

§§ 13B.82[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-13B California Legal Forms--Transaction Guide § 13B.100

§ 13B.100 Exemption From Federal Income Taxation

[1] Facts

1. Full and exact name of organization as it appears in any filed organizational document.

2. Complete address, telephone number, fax number, and any file number of organization.

3. Type of organization, such as corporation, association, or trust.

4. Following information about organization and nature of its activities:

a. Organizational background, including whether entity has relationship with another entity [*see* P 13, *below*].

b. General purposes.

c. Specific purposes for which organization is or will be organized.

d. Specific activities in which organization will engage, e.g.:

NOTE:
Supplementary information may be required to complete special schedules relating to the specific activities of the organization.

(1) Nature and extent of proposed political activities.

(2) Promotion of athletics.

(3) Operating school, child care center, or senior home.

(4) Operating hospital or medical research or teaching facility.

e. Benefits and services provided by organization related to exempt purpose and fees charged.

5. Organization's federal employer identification number, if any.

NOTE:
Every exempt organization must have a federal employer identification number, whether or not it has any employees. If the organization does not have an employer identification number, the application for recognition of exemption (usually Form 1023) should be accompanied by a completed federal Form SS-4, the federal application for an employer identification number.

6. Membership structure.

a. Classification of memberships.

b. Qualifications.

c. Number.

d. Manner of limiting membership.

e. Manner of termination.

7. Month in which annual accounting period ends.

8. Place and date of incorporation or formation.

9. Form numbers, years filed, and IRS office where past federal income tax returns or exempt organization information returns were filed.

10. Names, addresses, telephone and fax numbers, background, qualifications, and proposed compensation of following persons:

a. Incorporators or founders of organization;

b. Directors or managers of organization;

c. Officers; and

d. Substantial contributors of money or property exceeding $5,000 in value.

11. Other business and financial interests or associations of persons listed in Paragraph 10, *above*.

12. Anticipated number of employees and proposed compensation.

13. Name and address of any entity with which the organization is legally associated and nature of that association.

NOTE:
A nonprofit may be a subsidiary of a parent nonprofit. Particular caution must be used when the nonprofit is the successor of a for-profit entity.

14. Method by which organization is funded.

a. Existing and proposed sources of funding.

b. Assets to be used in organizational activities.

c. Details about fund raising program.

15. If organization has not yet begun operations, date that operations will commence.

NOTE:
A ruling or determination letter recognizing exempt status may be issued in advance of operations by the IRS if the organization can describe its proposed operations in sufficient detail to permit a conclusion that it will clearly meet the particular requirements of the section under which the exemption is claimed [*Treas. Reg. § 601.201(n)(3)(ii)*; *Rev. Proc. 80-25, 1980-1 C.B. 667*].

16. If entity will be organized as exempt organization under *I.R.C. § 501(c)(3)*, any other facts required by IRS Form 1023.

17. If organization is to be organized for any exempt purpose other than those described in *I.R.C. § 501(c)(1), (3), (11), (14), (16), (18), (21), (d), (e),* or *(f),* any other facts required by IRS Form 1024.

18. Name, address, and telephone and fax numbers of person authorized to sign application for exemption and information returns.

19. Name, business address, and telephone and fax numbers of attorney and financial advisors.

20. Name, business address, and telephone and fax numbers of representative to whom correspondence concerning revision or amendment of charter documents or requests for additional information should be addressed.

[2] Documents

1. Organizational documents.

a. If incorporated, copies of original articles of incorporation, as amended, and of bylaws, as amended.

b. If unincorporated, copies of original constitution, articles of association, declaration of trust, bylaws, or other document setting forth provisions that may be binding on organization or members.

2. Copies of any leases, options, contracts, deeds, or other agreements entered into by organization.

3. Classified statement of receipts and expenditures and a balance sheet for current year and three immediate prior years (or years organization was in existence, if less).

NOTE:

Financial data for more than four years may be requested if the facts and circumstances warrant it. If the current year is less than a full year, the organization must submit financial data for the period ending 60 days before the date of the application. In all cases, the data must be in sufficient detail to show how the activities will be financed. Neither bank statements nor ledger sheets will be acceptable for this purpose since they are not classified. Profit and loss or other similar operating statements are not acceptable since they do not show all receipts and expenditures.

4. If organization is new organization, proposed budgets for next two years.

5. Copies of any corporate or organization resolutions authorizing reorganization as tax-exempt organization and filing of application for exemption.

6. If organization issues capital stock, document providing following information:

a. Class or classes of stock;

b. Number and par value of shares;

c. Consideration for which issued;

d. Whether organizing instrument authorizes dividends on any class of stock; and

e. Whether any dividends have been paid.

7. If organization has issued stock, copy of organization's stock certificate.

8. Current shareholder or membership list.

9. Documents containing any additional information necessary to clarify nature of organization, such as promotional materials, including copies of advertisements, publications such as magazines, and distributed written material used to further organizational purpose or for expressing views on proposed legislation.

10. Copies of any grant applications.

11. Past federal income tax returns or exempt organization information returns filed, if any

12. Additional documents required of specific types of organizations when applying for exemption on IRS Form 1023 or 1024.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Tax Administration & ProcedureAdministrationIdentification Numbers & Information Returns (IRC secs. 6031-6065)Exempt Organization ReturnsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsConditions &

Restrictions (IRC secs. 501-505, 521, 526-530)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-13B California Legal Forms--Transaction Guide § 13B.101

§ 13B.101 Exemption From State Income and Franchise Taxation

[1] Facts

1. Full and exact name of organization as it appears in any filed organizational document.

2. Complete address, telephone number, fax number, and any file number of organization.

3. Type of organization, such as corporation, association, or trust.

4. Organization's federal employer identification number, if any.

NOTE:
If the organization does not have a federal employer identification number, federal Form SS-4 should be filed with the IRS to obtain a number. The number should be furnished to the Franchise Tax Board with the first annual return of the organization.

5. Month in which annual accounting period ends.

6. Place and date of incorporation or formation.

7. If organization or its predecessor previously applied for exemption under federal law, California law, or law of any other state.

a. Whether exemption was granted or denied for each application filed.

b. If any exemption was granted, date of determination letter.

8. Past federal income tax returns filed, if any, including type of returns and years filed.

9. Nature of organization's activities.

a. Primary activity of organization.

b. Specific activities in which it will engage.

10. If organization is not new organization, name of its predecessor, period during which it was in existence, and reasons for termination.

11. If organization plans to distribute property or surplus to officers or members, full details of proposed transactions.

12. If any promoter, incorporator, founder, or member will be employed by organization, complete details, including duties, responsibilities, qualifications, and compensation.

13. If organization is a membership organization, details concerning qualifications for members, different classes of membership, number of members of each class, and voting rights and privileges accorded each class.

14. Information pertaining to any incorporators who will share any facilities with organization.

15. Details concerning any rental, purchase, or transfer of property from any of incorporators.

16. Depending on classification under which exemption is sought, other facts required by Franchise Tax Board Form 3500.

17. Name, business address, and telephone and fax numbers of attorney and financial advisors.

18. Name, business address, and telephone and fax numbers of representative to whom correspondence concerning revision or amendment of charter documents or requests for additional information should be addressed.

[2] Documents

1. Organizational documents.

a. If incorporated, copies of articles of incorporation and bylaws.

b. If preparing to incorporate, copies of proposed articles of incorporation and bylaws.

c. If unincorporated, copies of articles of association, constitution, declaration of trust, bylaws, or other document setting forth provisions that may be binding on the members.

2. Copies of any leases, options, contracts, deeds, or other agreements entered into by organization.

3. Classified statement of receipts and expenditures, assets and liabilities, and a balance sheet for current

year and three immediate prior years (or years organization was in existence, if less).

4. For organizations that have not commenced operations or have been operating less than one year, proposed budget, based on reasonable expectations, showing expected income by source and areas of expenditures for first year of operation.

5. Statement (not merely repetitive of articles or bylaws) setting forth specific purposes for which organization was formed.

6. Statement describing in detail programs and activities that are currently carried on or will be carried on by organization and how those programs and activities will accomplish specific purposes of organization.

7. Statement explaining in detail each fund-raising activity and each business enterprise organization has engaged in or plans to engage in, accompanied by copies of all agreements, if any, with other parties for the conduct of each fund-raising activity or business enterprise.

8. Statement that explains fully any specific activities that organization has engaged in or sponsored and that have been discontinued, including dates of commencement and termination and reasons for discontinuance.

9. Samples of any literature that organization sells or distributes and samples of any organizational advertising.

10. Past federal income tax returns or exempt organization information returns filed, if any

11. Copies of previously filed state income tax, franchise tax, or information returns.

12. Copy of any determination letter granting exemption.

13. Additional documents required of specific types of organizations when applying for exemption on Franchise Tax Board Form 3500.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral OverviewTax LawState & Local TaxesPublic Utilities TaxExemptions



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

6-13B California Legal Forms--Transaction Guide §§ 13B.102-13B.109

[Reserved]

§§ 13B.102[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-13B California Legal Forms--Transaction Guide § 13B.110

§ 13B.110 Tax-Exempt Classification of Organizations for Federal Income Tax Purposes

1. Determine type of organization and Internal Revenue Code provision under which it can claim exemption.

a. Corporations organized under act of Congress [*I.R.C. § 501(c)(1)*].

b. Corporations organized to hold title to property, collect income, and turn that income over to an exempt organization [*I.R.C. § 501(c)(2)*; *see I.R.C. § 501(c)(25)(G)*].

c. Corporations and any community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster international or national amateur athletics, or for prevention of cruelty to children or animals [*I.R.C. § 501(c)(3)*].

d. Civic leagues, social welfare organizations, or local associations of employees [*I.R.C. § 501(c)(4)*].

NOTE:
Social welfare organizations often have the option to choose between exemption under *I.R.C. § 501(c)(3)* or *I.R.C. § 501(c)(4)*, as the requirements are similar. The IRS is generally more reluctant to grant *I.R.C. § 501(c)(3)* status as gifts to *I.R.C. § 501(c)(3)* organizations are deductible, in contrast to gifts to *I.R.C. § 501(c)(4)* organizations.

e. Labor, agricultural, or horticultural organizations [*I.R.C. § 501(c)(5)*].

f. Business leagues, chambers of commerce, real estate boards, boards of trade, or professional football leagues, not organized for profit [*I.R.C. § 501(c)(6)*].

g. Social and recreational clubs [*I.R.C. § 501(c)(7)*; *see § 13B.201[1][c][v]*].

h. Fraternal beneficiary societies, orders, or associations [*I.R.C. § 501(c)(8)*].

i. Voluntary employees' beneficiary associations [*I.R.C. § 501(c)(9)*].

j. Domestic fraternal orders that do not provide any type of insurance or other benefits [*I.R.C. § 501(c)(10)*].

k. Local teacher retirement fund associations [*I.R.C. § 501(c)(11)*].

l. Local benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or similar organizations [*I.R.C. § 501(c)(12)*].

m. Nonprofit cemetery companies or cemetery companies owned and operated exclusively for benefit of their members [*I.R.C. § 501(c)(13)*].

n. State-chartered credit unions and mutual reserve funds [*I.R.C. § 501(c)(14)*].

o. Mutual insurance companies or associations (other than life) with written premiums of $350,000 or less [*I.R.C. § 501(c)(15)*].

NOTE:

These companies or associations (including interinsurers and reciprocal underwriters) are exempt if the greater of net written premiums or direct written premiums for the taxable year do not exceed $350,000 [*I.R.C. § 501(c)(15)(A)*]. For computation purposes, the company or association will be treated as receiving during the taxable year written premiums received by all other companies or associations that are members of the same controlled group [***see*** *I.R.C. §§ 831(b)(2)(B)(ii), 1563(a)*] as the insurance company or association for which the determination is being made [*I.R.C. § 501(c)(15)(C)*].

p. Corporations formed by farm cooperatives to finance ordinary crop operations of members [*I.R.C. § 501(c)(16)*].

q. Trusts that are part of plan providing supplemental unemployment compensation benefits [*I.R.C. § 501(c)(17)*].

r. Post or organization of past or present members of United States Armed Forces [*I.R.C. § 501(c)(19)*].

s. Organization or trust formed to provide qualified group legal services [*I.R.C. § 501(c)(20)*; *I.R.C. § 120(e)*].

NOTE:

Although the *I.R.C. § 501(c)(20)* exemption is still listed in the Internal Revenue Code, it is applicable only to taxable years ending on or before June 30, 1992 [*I.R.C. § 120(e)*].

t. Black lung benefit trusts [*I.R.C. § 501(c)(21)*].

u. Trusts established by plan sponsors of multi-employer plans for purpose of making withdrawal liability payments [*I.R.C. § 501(c)(22)*].

v. Veterans' organizations over 100 years old, organized to provide insurance and other benefits [*I.R.C. § 501(c)(23)*].

w. Trusts established to receive and distribute liability payments from contributing sponsors of terminated pension plan [*I.R.C. § 501(c)(24)*; *see 29 U.S.C. § 1349*].

x. Corporation or trust with 35 or fewer shareholders or beneficiaries formed solely to hold title to real property [*I.R.C. § 501(c)(25)*].

y. Membership organization established by a state exclusively to provide nonprofit medical coverage [*I.R.C. § 501(c)(26)*].

z. Membership organization established by a state before June 1, 1996, exclusively to reimburse its members for losses arising under worker's compensation acts [*I.R.C. § 501(c)(27)*].

aa. National Railroad Retirement Investment Trust established under Section 15(j) of Railroad Retirement Act [*I.R.C. § 501(c)(28)*].

ab. Religious or apostolic organizations [*I.R.C. § 501(d)*].

ac. Cooperative hospital service organizations [*I.R.C. § 501(e)*].

ad. Cooperative service organizations composed of operating educational organizations [*I.R.C. § 501(f)*].

ae. Child care organizations [*I.R.C. § 501(k)*].

af. Farmers' cooperative associations [*I.R.C. § 521(a)*].

NOTE:

The specific qualifications for the above organizations are defined by statute and regulation. Despite the fact that a client's organization may seem to fit within one of the above categories, the relevant statute and regulations must be consulted [***see*** *I.R.C. § 501*; *Treas. Reg. §§ 1.501(a)-1*-1.501(e)-1]. The specific qualification requirements for most of the foregoing classifications are in IRS Pub. No. 557, Tax-Exempt Status for Your Organization, which may be obtained from any local IRS office.

2. If *I.R.C. § 501(c)(3)* status is desired, determine whether organization meets following requirements:

NOTE:

For a detailed discussion of the requirements that a corporation must satisfy to qualify for exempt status, see *§ 13B.20* et seq.

a. Organization will be organized and operated exclusively for one or more of exempt purposes specified in *I.R.C. § 501(c)(3)*.

b. No part of organization's net earnings inure to benefit of any private shareholder or individual.

c. No substantial part of organization's activities include propaganda or other attempts to influence legislation, except as otherwise provided by *I.R.C. § 501(h)* [*see § 13B.20[4][b]*].

NOTE:

Certain public charities may elect to replace the "substantial part of activities" test with a sliding-scale limitation defined in terms of monetary expenditures to influence legislation

[***see*** *§ 13B.20[7]*].

d. No substantial part of organization's activities consists of providing commercial-type insurance [*see I.R.C. § 501(m)*; *see § 13B.20[4][d]*].

e. Organization does not participate in or intervene in (including the publication or distribution of statements) any political campaign on behalf of or in opposition to any candidate for public office.

NOTE:

This bar is absolute and strictly applied. Even indirect involvement in a candidate election may cause the denial or revocation of tax-exempt status [*I.R.C. § 501(c)(3)*; ***see*** *Christian Echoes Nat'l Ministry v. United States (10th Cir. 1972) 470 F.2d 849, 853-854]* . For further discussion, see § 13B. 20[3][a], [4][b].

f. Assets of organization are irrevocably dedicated to exempt purpose [*see Treas. Reg. § 1.501(c)(3)-1(b)(4)*].

3. If exempt status is desired under any provision of *I.R.C. § 501*, other than *I.R.C. § 501(c)(3)*, determine that organization meets qualification requirements of specific section under which exemption is sought [*see I.R.C. § 501*; *Treas. Reg. §§ 1.501(a)-1*-1.501(e)-1; *see also § 13B.201*].

4. Determine necessity of application for exemption and appropriate application form.

a. Organizations claiming exemption under *I.R.C. § 501(c)(3)* apply for exemption on IRS Form 1023, with following exceptions [*I.R.C. § 508(c)(1)*; *Treas. Reg. § 1.508-1(a)(3)*.]:

(1) Churches, their integrated auxiliaries, and conventions and associations of churches;

(2) Any organization that is not a private foundation and that normally does not have more than $5,000 of annual gross receipts; and

(3) Subordinate organizations, other than private foundations, belonging to exempt group of organizations.

NOTE:

The organizations excepted from the application requirement are automatically exempt from taxation. These organizations may nevertheless desire to establish their exemption formally and may do so by filing Form 1023 [***see*** *Treas. Reg. §§ 1.501(a)-1*, 1.508-1(a)(4); ***see also*** *§ 13B.20[1][b], 13B.200*].

I.R.C. § 508(a) provides that with the exception of the organizations described above, an organization will not be treated as exempt under *I.R.C. § 501(c)(3)* unless it has given notice to the IRS that it is applying for recognition of exempt status. The filing of a properly completed IRS Form 1023 satisfies this notice requirement [*Treas. Reg. § 1.508-1(a)(2)(i)*]. If the organization fails to give this notice within 15 months from the end of the month in which it was organized [***see*** *Treas. Reg. § 1.508-1(a)(2)(iii)*], it will not qualify for exempt status during the period before the date of actual notice. However, retroactive recognition of exempt status to the date of organization may be granted if the application is filed within the 15-month period.

b. Organizations claiming exemption under *I.R.C. § 501(c)(2), (4)*-(10), (12), (13), (15), (17), or (19) must apply by submitting IRS Form 1024.

c. Organizations claiming exemption under *I.R.C. § 501(e)* (cooperative hospital), (f) (educational service organizations) or (k) (child care organizations) may apply for exemption on IRS Form 1023.

d. Other organizations claiming exemption must make application to IRS, but no specific form has been prescribed [*Treas. Reg. § 1.501(a)-1(a)(2)*; *see* IRS Pub. No. 557].

NOTE:

When no form has been prescribed, the organization must apply by letter addressed to the District Director of the IRS. The letter must contain information necessary to establish that the organization meets the requirements for qualification under the classification for which exemption is claimed and be signed by an officer. A copy of the organizational document must be attached.

e. Central organization seeking group exemption letter to cover subordinates apply by letter [*see* IRS Pub. No. 557].

5. If entity will apply for *I.R.C. § 501(c)(3)* status, determine whether organization qualifies for nonprivate foundation status.

a. Following organizations are not private foundations [*I.R.C. § 509(a)*]:

(1) Churches or associations of churches, educational institutions that maintain full-time faculty, hospitals, and other exempt organizations that qualify for 50 percent contribution deduction under *I.R.C. § 170(b)(1)(A)* other than private foundations.

(2) Organizations that normally receive more than one-third of their support [*see I.R.C. § 509(d)*] in each taxable year from public contributions, membership fees, and gross receipts, but do not normally receive more than one-third of their support from gross investment income or from after-tax unrelated business income.

(3) Organizations set up to support one or more of organizations described in P (1) or (2), *above*, and operated, supervised, or controlled by such organizations and not by disqualified persons.

(4) Organizations organized and operated exclusively for testing for public safety.

NOTE:

Even though an organization falls within one of the above categories, the organization will be presumed to be a private foundation, with some exceptions, unless it gives timely notice to the IRS that it is not a private foundation [*I.R.C. § 508(b)*]. This notification requirement is satisfied by the filing of IRS Form 1023, which provides a proper space for notification of nonprivate foundation status by organizations claiming exemption under *I.R.C. § 501(c)(3)* [***see** Treas. Reg. § 1.508-1(b)(2)(iv)*].

b. If private foundation status cannot be avoided, following restrictions will be imposed:

(1) Organization will be subject to strict control over its operation and finances [*see I.R.C. §§ 4940*-4948]; and

(2) To qualify for tax exemption, organization must ordinarily provide in its governing instrument that it will operate within constraints of *I.R.C. §§ 4941*-4945 [*I.R.C. § 508(e)*].

NOTE:

The governing instruments of California organizations are not required to contain such a provision, since California law automatically incorporates them into the governing instruments of all private foundations [***see*** *Corp. Code §§ 5260, 9260*; ***see also*** *Treas. Reg. § 1.508-3(d)*; *Rev. Rul. 75-38, 1975-1 C.B. 161*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsConditions & Restrictions (IRC secs. 501-505, 521, 526-530)Tax LawFederal Taxpayer GroupsExempt OrganizationsPrivate Foundations (IRC secs. 507-509)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-13B California Legal Forms--Transaction Guide § 13B.111

§ 13B.111 Tax-Exempt Classification of Organizations for State Franchise and Corporate Income Tax Purposes

1. Determine type of organization and Revenue and Taxation Code provision under which exemption will be sought:

a. Labor, agricultural, or horticultural organizations other than [*Rev. & Tax. Code § 23701a*]:

NOTE:
The types of cooperative organizations set forth below are included in the exemption if the IRS determines that they are described in *I.R.C. § 501(c)(5)* [*Rev. & Tax. Code § 23701a(a)*].

(1) Growers' cooperatives or mutual associations [*Rev. & Tax. Code § 24404*]; or

(2) Cooperative or mutual associations for sale of property other than water, agricultural products, or food at wholesale [*Rev. & Tax Code § 24405*].

b. Fraternal beneficiary societies, orders, or organizations [*Rev. & Tax. Code § 23701b*; *see I.R.C. § 501(c)(8)*].

c. Nonprofit cemetery companies, cemetery companies owned and operated exclusively for the benefit of their members, and any corporations chartered solely for purpose of disposing bodies by burial or cremation that are not permitted by their charter to engage in any business not necessarily incident to that purpose and no part of net earnings inures to benefit of private shareholder or individual [*Rev. & Tax. Code § 23701c*; *see I.R.C. § 501(c)(13)*].

d. Corporations, community chests or trusts, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for prevention of cruelty to children or animals [*Rev. & Tax. Code § 23701d*].

e. Business leagues, chambers of commerce, real estate boards, or boards of trade, not organized for profit and no part of net earnings of which inures to benefit of any private shareholder or individual [*Rev. & Tax. Code § 23701e* (phrase "or professional football leagues (whether or not administering a pension fund for football players)" does not apply); *see I.R.C. § 501(c)(6)*].

f. Civic leagues, nonprofit organizations operated exclusively for promotion of social welfare, or local associations of employees [*Rev. & Tax. Code § 23701f(a)*; *see I.R.C. § 501(c)(4)*].

NOTE:

An organization is not organized exclusively for exempt purposes unless its assets are irrevocable dedicated to one or more exempt purposes listed in *I.R.C. § 501(c)(4)* [*Rev. & Tax. Code § 23701f(b)*].

g. Social clubs [*Rev. & Tax. Code § 23701g*; *see I.R.C. § 501(c)(7)*].

NOTE:

Social clubs may not discriminate against any person on the basis of race, color, or religion [***see** I.R.C. § 501(c)(7)*; ***see also** § 13B.201[1][c][v]*]. California similarly bars discrimination on the basis of ancestry, or any characteristic listed or defined in *Gov. Code § 11135*. Social clubs violating this prohibition cannot deduct business expenses [***see** Rev. & Tax. Code §§ 17269, 24343.2*]. A discriminatory club holding an alcoholic beverage license must incorporate a printed statement regarding nondeductibility on expense receipts [***see** Bus. & Prof. Code § 23438*; ***but see** Bus. & Prof. Code § 23425* (exception)].

h. Corporations organized for exclusive purpose of holding title to property, collecting income, and remitting that income to exempt organizations [*Rev. & Tax. Code § 23701h(a)*].

NOTE:

For this purpose, the term "corporation" includes a limited liability company that is classified as a partnership or disregarded entity [*Rev. & Tax. Code § 23701h(b)(1)*].

i. Voluntary employees' beneficiary associations [*Rev. & Tax. Code § 23701i*; *see I.R.C. § 501(c)(9)*].

j. Local teachers' retirement fund associations [*Rev. & Tax. Code § 23701j*; *see I.R.C. § 501(c)(11)*].

k. Religious or apostolic corporations [*Rev. & Tax. Code § 23701k*].

NOTE:

These corporations are extremely rare, and most religious groups ordinarily prefer to obtain exemption under *Rev. & Tax. Code § 23701d*.

l. Domestic fraternal societies, orders, or associations, operating under the lodge system, which do not provide any type of insurance or other benefits [*Rev. & Tax. Code § 23701l(a)*; *see I.R.C. § 501(c)(10)*].

NOTE:

The term "domestic" means created or organized in the United States or under the law of the United States or any state or territory [*Rev. & Tax. Code § 23701l(b)*].

m. Trusts forming part of plan providing for payment of supplemental unemployment compensation benefits [*Rev. & Tax. Code § 23701n(a)*; *see I.R.C. § 501(c)(17)*; *see also Rev. & Tax. Code § 23701n(b)* (modifications)].

n. Trusts or plans for self-employed individuals (not otherwise exempt as qualified plan [*see I.R.C. § 401(a)*] under *Rev. & Tax. Code § 17631*) [*Rev. & Tax. Code § 23701p*].

o. Certain political organizations [*Rev. & Tax. Code § 23701r*].

p. Employee-funded pension trusts [*Rev. & Tax. Code § 23701s(a)*; *see I.R.C. § 501(c)(18)*].

NOTE:

The last sentence of *I.R.C. § 501(c)(18)*, as amended by Title VI of Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. No. 107-16), relating to excess contributions under *I.R.C. § 4979*, does not apply for California purposes [*Rev. & Tax. Code § 23701s(b)*].

q. Homeowners' associations [*Rev. & Tax. Code § 23701t*].

NOTE:

The term "homeowners' association" includes a condominium management association, a residential real estate management association, a time-share association, and a cooperative housing corporation [*Rev. & Tax. Code § 23701t(d)*; ***see*** *Rev. & Tax. Code § 23701t(e)* ("cooperative housing corporation" defined), (f) ("time-share association" defined)].

r. Organization of owners of manufactured homes or mobilehomes, who are tenants in mobilehome park, formed to purchase mobilehome park to convert to condominium, stock cooperative, or other resident ownership interests [*Rev. & Tax. Code § 23701v*].

s. Veteran's organization [*Rev. & Tax. Code § 23701w*; *see I.R.C. § 501(c)(19)*].

t. Title-holding companies [*Rev. & Tax. Code § 23701x(a)*; *see I.R.C. § 501(c)(25)*].

NOTE:

For this purpose, the term "corporation" includes a limited liability company that is classified as a partnership or disregarded entity [*Rev. & Tax. Code § 23701x(b)(1)*].

u. Cooperative hospital service organizations [*Rev. & Tax. Code § 23704*; *see I.R.C. § 501(e)*].

2. If *Rev. & Tax. Code § 23701d* status [*see* P 1d, *above*] is desired, determine that [*Rev. & Tax. Code § 23701d*]:

a. Organization will be organized and operated exclusively for one or more of exempt purposes specified by statute.

b. No part of organization's net earnings inure to benefit of any private shareholder or individual.

c. No substantial part of organization's activities include propaganda or other attempts to influence legislation, except as otherwise provided by *Rev. & Tax. Code § 23704.5* [*see I.R.C. § 501(h)*].

NOTE:

Certain public charities may elect to replace the "substantial part of activities" test with a sliding-scale limitation defined in terms of monetary expenditures to influence legislation [*Rev. & Tax. Code §§ 23704.5, 23740*].

d. Organization has not and does not plan to intervene or participate in any political campaign on behalf of, or in opposition to, any candidate for public office.

e. Assets of organization are irrevocably dedicated to exempt purpose.

NOTE:

This requirement mandates the inclusion of a clause in the organization's articles of incorporation or other organizing instrument ensuring the irrevocable dedication of assets to an exempt purpose [*Rev. & Tax. Code § 23701d*; ***see*** *§ 13B.20[3]*; ***see also*** Ch. 13, ***Nonprofit Corporations***].

3. If exempt status is desired under any provision of *Rev. & Tax. Code § 23701* other than *Rev. & Tax. Code § 23701d*, determine that organization meets qualification requirements of specific statute under which exemption is claimed [*see Rev. & Tax. Code §§ 23701a-23701x*; *18 Cal. Code Reg. § 23701*; *see also* IRS Pub. No. 557].

4. Determine conditions precedent to operation as exempt organization in California:

a. Submission of application for exemption on FTB Form 3500 [*Rev. & Tax. Code § 23701(a)*].

b. Payment of filing fee [*see Rev. & Tax. Code § 23701(b)*].

c. Issuance of determination letter by Franchise Tax Board, granting exemption from California franchise and corporate income tax to applicant organization.

NOTE:

Exemption may be granted on a retroactive basis for years before the approval of the exemption application, but only to the extent that the organization can establish that it satisfied the requirements during each of the prior years. No claim for refund will be allowed unless timely filed under *Rev. & Tax Code § 19306* [*18 Cal. Code Reg. § 23701(b)(4)*].

5. If *Rev. & Tax. Code § 23701d* status will be sought, determine whether organization qualifies for nonprivate foundation status.

a. If organization is treated as private foundation for federal income tax purposes, it will be treated as private foundation for California tax purposes [*Rev. & Tax. Code § 23709*; *see §§ 13B.20[5], 13B.110*, P 5].

NOTE:

Any organization that has been classified as a private foundation or informed that it will be treated as a private foundation under federal law must inform the Franchise Tax Board of this classification on its annual information return (FTB Form 199) [*Rev. & Tax. Code § 23708*; *18 Cal. Code Reg. § 23708(a)*].

b. If private foundation status cannot be avoided, following restrictions will be imposed:

(1) Organization will be subject to strict federal controls over its operation and finances [*Rev. & Tax. Code § 23708*; *see I.R.C. §§ 4940*-4948]; and

NOTE:

California tax law has the effect of imposing and enforcing the federal restrictions on private foundations. The enforcement of these restrictions is considered the responsibility of the state Attorney General working in conjunction with the IRS. Therefore, if violators of the above restrictions are discovered by the Franchise Tax Board, they will be called to the attention of the Attorney General rather than immediately subjected to revocation of their exemption as might otherwise be proper. Unlike federal law, California imposes no special excise taxes for violation of the private foundation restrictions referred to above. Rather, if the exempt status of a private foundation is terminated under federal law for violation of these restrictions [***see*** *I.R.C. § 507*], California would also revoke the exempt status, resulting in liability for state franchise taxes [*Rev. & Tax. Code § 23708*; *18 Cal. Code Reg. § 23708(b)*].

California imposes several restrictions and rules on private foundations and other organizations exempt under *Rev. & Tax. Code § 23701d*. These organizations may lose their exempt status for improperly using accumulations of income [*Rev. & Tax. Code § 23737*], or by engaging in certain prohibited transactions [*Rev. & Tax. Code §§ 23736-23736.4*]. California also revokes the exemption of charitable corporations that fail to file certain required registrations and periodic reports with the Attorney General [*Rev. & Tax. Code § 23703*].

(2) To qualify for tax exemption, private foundation must ordinarily include provisions in its governing instrument that require it to operate within constraints of *I.R.C. § 4941*-4945 [*Rev. & Tax. Code § 23708(e)*].

NOTE:

The governing instruments of California organizations are not required to contain these provisions, since California law automatically incorporates them into the governing instruments of all private foundations [*Prob. Code §§ 16101-16104*; *Corp. Code §§ 5260, 9260*; ***see*** *18 Cal. Code Reg. § 23708(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawState & Local TaxesFranchise TaxGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

6-13B California Legal Forms--Transaction Guide §§ 13B.112-13B.119

[Reserved]

§§ 13B.112[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-13B California Legal Forms--Transaction Guide § 13B.120

§ 13B.120 Obtaining Federal Income Tax Exemption

1. Prepare application for submission to IRS.

a. Organizations seeking exemption under *I.R.C. § 501(c)(3), (e), (f),* or *(k)* apply on IRS Form 1023 [*see § 13B.200*].

NOTE:
Even those organizations that are not required to apply, such as churches, should consider submitting a formal application [***see*** *I.R.C. § 508(c)*]. A formal determination of tax-exempt status will avoid possible inquiry into whether the organization actually is of the type that does not have to apply, and may make fund raising easier, since many contributors wish evidence of exemption as assurance that their contributions will yield the maximum possible tax deduction [***see*** *Treas. Reg. §§ 1.501(a)-1,* 1.508-1(a)(4)]. For further discussion, see *§§ 13B.20[1][b], 13B.200.*

I.R.C. § 508(a) provides that an organization will not be treated as exempt under *I.R.C. § 501(c)(3)* unless it has given notice to the IRS that it is applying for recognition of exempt status. The filing of a properly completed IRS Form 1023 satisfies this notice requirement [*Treas. Reg. § 1.508-1(a)(2)(i)*]. If the organization fails to give notice within 15 months from the end of the month in which it was organized [***see*** *Treas. Reg. § 1.508-1(a)(2)(iii)*], it will not qualify for exempt status during the period prior to the date of actual notice (filing). However, retroactive recognition of exempt status to the date of organization may be granted if the application is filed within the 15-month period.

b. Organizations seeking exemption under *I.R.C. § 501(c)(2), (4)*-(10), (12), (13), (15), (17), or (19) apply for exemption on IRS Form 1024 [*see § 13B.201*].

c. All other organizations should apply by letter.

2. Have application signed under penalty of perjury by one of the following [*see* IRS Form 1023, Instructions]:

a. Principal officer of entity.

b. Trustee authorized to sign to application.

NOTE:
If signing authority is based on a board resolution, a conformed copy of the resolution should be submitted with the application.

c. Attorney or agent specifically appointed to execute application by power of attorney.

NOTE:
If signing authority is based on a power of attorney, the original power of attorney, signed by the persons authorized to sign Form 1023, must be submitted with the application. IRS Form 2848 may be used [***see*** IRS Form 1023, Instructions].

3. Assemble documents that must be submitted along with application, including:

a. Conformed copy of organization's articles of incorporation, constitution, articles of association, trust instrument, or other enabling instrument to be attached as Exhibit A.

NOTE:
Ordinarily, the exemption application will not be accepted until the articles of incorporation have been certified by the Secretary of State. The articles or other organizing instruments must contain certain mandatory provisions, depending on which exemption is sought [***see*** IRS Pub. No. 557; ***see also*** Ch. 13, ***Nonprofit Corporations*** ; Ch. 13A, ***Nonprofit Unincorporated Associations***].

b. Copy of organization's bylaws or similar code of regulations to be attached as Exhibit B.

NOTE:
The copy of the bylaws must be signed by a principal officer, or the bylaws may be accompanied by a written declaration, signed by an authorized officer of the entity, certifying that the document is a complete and accurate copy.

c. If capital stock is or will be issued, details as to classes, number, par value or consideration for which they were issued, and whether dividends are authorized or have been paid on any class.

d. Classified statement of receipts and expenditures and balance sheet for current year and three previous years or for period for which organization has operated if less.

e. If organization has not yet begun operation, detailed budget covering next two taxable years specifying proposed expenditures and receipts.

NOTE:
Lack of an operating history does not preclude a determination of exempt status, but the organization must describe its proposed operations in sufficient detail to permit a conclusion that it will in fact meet the requirements of the section of law under which

exemption is claimed [*Rev. Proc. 80-25, 1980-1 C.B. 667*]. To meet the operational test, a newly formed entity must submit a detailed statement of its proposed activities as part of the application for exemption [*Treas. Reg. § 1.501(c)(3)-1(b)(1)(v)*].

f. Other documents required from organizations applying for exemption under particular sections of law.

NOTE:
IRS Forms 1023 and 1024 contain specific instructions as to documents required to establish qualification under particular classifications of *I.R.C. § 501(c)*.

4. If organization claims exemption under *I.R.C. § 501(c)(3)*, request ruling as to its status as private or nonprivate foundation.

a. Definitive rulings will be given only if organization's first taxable year is more than eight months.

b. Advance rulings will be given to newly created organizations.

(1) Organization will be treated as nonprivate foundation for duration of ruling period.

(2) Ruling period will last two years, or three if first taxable year is less than eight months.

c. Extended advance rulings may be applied for.

(1) Organization must waive statute of limitations for assessment of excise tax under *I.R.C. § 4940* by submitting IRS Form 872-C.

(2) Organization will be treated as nonprivate foundation for duration of extended ruling period.

(3) Extended ruling period will be five years, or six if first taxable year is less than eight months.

NOTE:
Ruling requests are made in Part IV of IRS Form 1023 if the organization is required to submit that form, otherwise a separate letter request must be made. If an advance or extended advance ruling is granted, at the expiration of the ruling period the IRS will review the organization's operating history, determine if in fact the organization was a private foundation during that period, and if so, assess the excise taxes due on investment income earned during the period.

5. Prepare notice of claim of private or nonprivate foundation status.

NOTE:
I.R.C. § 501(c)(3) organizations are presumed to be private foundations unless notice is given to the contrary [*I.R.C. § 508(b)*]. Churches and related groups, nonprivate foundations with less than $5,000 of gross receipts yearly, and any subordinate organization covered by a group exemption need not file this notice [*I.R.C. § 508(c)*; *Treas. Reg. § 1.508-1(a)(3)*]. The filing of IRS Form 1023 constitutes the required notice; therefore, those organizations that are required to apply for tax-exempt status on that form do not have to draft a separate notice.

6. Prepare application for federal employer's identification number on IRS Form SS-4 if organization does not already have such a number.

NOTE:

If a number has not already been obtained, IRS Form SS-4 must accompany the application for exemption.

7. Obtain cashier's check for applicable filing (user) fee.

NOTE:

IRS Form 8718 prescribes the applicable fee. A check or money order must be attached to IRS Form 8718, which must in turn be attached to the exemption application [***see*** IRS Form 8718; ***see also*** *§ 13B.202*].

Because the IRS typically waits for checks to clear before processing the application, use of a cashier's check may expedite the application process. The applicant also may request expedited processing.

8. File application for exemption, along with all other necessary applications, requests, fee, and supporting documents, with the Internal Revenue Service, P.O. Box 192, Covington, KY 41012-0192 [*see* IRS Form 8718; *see also § 13B.202*].

NOTE:

New entities must file within 15 months after the end of the month of formation. An automatic one-year extension applies to applications for exempt status. In addition, the entity may request an additional extension [***see*** *Rev. Proc. 92-85, 1992-2 C.B. 490* ; *Rev. Proc. 93-28, 1993-2 C.B. 344* ; ***see also*** *§ 13B.20[1][c]*]. In determining the date of formation, the IRS looks to the date that the entity came into existence under the law of the state of formation; subsequent, nonsubstantive amendments to the formation instrument do not affect the date of formation for purposes of the notice requirement [IRS Form 1023, Instructions].

If the application is submitted using express mail or a delivery service, the application must be sent to the Internal Revenue Service, 201 West Rivercenter Blvd., Attn: Extracting Stop 312, Covington, KY 41011.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsConditions & Restrictions (IRC secs. 501-505, 521, 526-530)Tax LawFederal Taxpayer GroupsExempt OrganizationsPrivate Foundations (IRC secs. 507-509)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-13B California Legal Forms--Transaction Guide § 13B.121

§ 13B.121 Obtaining Exemption From California Franchise or Income Tax

NOTE:

Just as the fact that an entity's nonprofit status does not ensure a federal or state tax exemption, the fact that an organization is exempt from federal income tax does not make it exempt from California franchise or corporate income tax. The application procedures are completely separate, and the entity must separately apply for exemption from state tax. However, an organization organized and operated for nonprofit purposes in accordance *Rev. & Tax. Code § 23701d* [*see § 13B.11*] is exempted from state taxation upon submitting to the FTB a copy of a determination letter recognizing the organization's exemption from federal income tax, or group exemption letter, issued by the I.R.S. [*Rev. & Tax. Code § 23701d(c)(1)*; *see* paragraph 9, *below*]. The following summarizes the procedures for applying for an exemption from California taxes.

1. Prepare application for submission to Franchise Tax Board.

a. All organizations, other than those subject to *Rev. & Tax. Code § 23701d(c)(1)* [*see* paragraph 9, *below*], seeking exemption from state franchise and corporate income taxation apply on FTB Form 3500 [*see § 13B.210*].

NOTE:

When possible, FTB Form 3500 has been revised to conform with the federal exemption application. Therefore, it is advisable to obtain federal application forms and instructions for the appropriate category of organization and develop the materials for both applications at the same time. It is also recommended that the applicant secure a copy of IRS Pub. No. 557, which is available at any local IRS office.

In some cases, organizations are required to obtain a federal determination of tax-exempt

status before California will issue an exemption determination letter. For example, trusts must furnish a copy of the federal determination letter before the state exemption will be granted. If the trust has not yet received a federal exemption, a statement that the federal application was submitted should be attached to FTB Form 3500 [***see*** FTB Form 3500, Instructions; ***see also*** *§ 13B.210*].

b. Advise client that organization may not operate as exempt organization under California law until it has taken following steps [*Rev. & Tax. Code § 23701*]:

(1) Application for exemption has been submitted;

(2) Filing fee is submitted with application [*see Rev. & Tax. Code § 23701(b)*; *see also* FTB Form 3500]; and

(3) Franchise Tax Board has issued determination letter granting exemption from taxation to applicant organization.

NOTE:
An organization that has been determined to be exempt by the Franchise Tax Board can rely on the determination as long as there are no substantial changes in the law or the organization's charter, purposes, or method of operation [*18 Cal. Code Reg. § 23701(a)(2)*].

2. Have application executed and signed under penalty of perjury by authorized individual who is elected officer, director, authorized representative, or trustee.

NOTE:
FTB Form 3500 must be executed with an original signature of the authorized person [***see*** *§ 13B.210*].

3. Assemble documents that must be attached to application.

NOTE:
The exemption application and the accompanying attachments must show the character of the organization, the purpose for which it was organized, its actual and proposed activities, the sources of its income and receipts and disposition of that income, whether or not any of its income or receipts are credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations that may affect its right to exemption [*18 Cal. Code Reg. § 23701(b)(1)*].

a. If organization is already incorporated, copy of articles of incorporation endorsed by Secretary of State and all subsequent amendments.

NOTE:
Ordinarily, a federal exemption application will not be accepted until the articles have been certified by the Secretary of State. The articles or other organizing instruments are required to contain certain mandatory provisions depending on the provision under which exemption is sought [***see*** FTB Form 3500, Instructions; ***see also*** *§ 13B.210*].

b. If organization is in process of being incorporated, copy of proposed articles submitted with application.

c. If organization is unincorporated, copy of constitution, articles of association, declaration of trust, or other documents setting forth aims and purposes of entity, signed by principal officers or trustees.

d. Copy of bylaws, proposed bylaws, or other similar code of regulations.

e. If organization is operating, current, classified, and complete statements of receipts and expenditures and assets and liabilities for each accounting period that organization was in existence and for which exemption is sought.

NOTE:

Bank statements or monthly reports are insufficient [***see*** FTB Form 3500, Instructions; ***see also*** *§ 13B.210*].

f. For organizations that have not commenced operations or have been operating less than one year, proposed budget, based on reasonable expectations, showing sources of income and areas of expenditures for first year of operation.

NOTE:

The FTB will not process the application until it receives the budget [***see*** FTB Form 3500, Instructions; ***see also*** *§ 13B.210*].

Exempt status may be recognized in advance of operations (or incorporation) if proposed operations are planned to begin within one year and can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere restatement of purposes or a statement that proposed activities will be in furtherance of these purposes does not satisfy these requirements. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned for carrying out the activities; the anticipated source of receipts; and the nature of contemplated expenditures. If warranted, a record of actual operations may be required before a determination letter will be issued [*18 Cal. Code Reg. § 23701(d)(2)*].

g. A statement describing the specific purposes for which organization was formed.

NOTE:

Recitation of the articles or bylaws is insufficient for this purpose [***see*** FTB Form 3500, Instructions; ***see also*** *§ 13B.210*].

h. Statement providing detailed description of organization's programs or activities that organization currently conducts or will conduct and how organization will accomplish its specific purposes.

i. If exemption has already been recognized for federal income tax purposes, copy of federal determination letter or ruling.

NOTE:

The Franchise Tax Board advises that an unincorporated association or trust should secure a federal determination letter granting exempt status first, and furnish a copy of that determination letter with the state application for exemption.

j. Statement describing in detail each fund-raising activity and each business enterprise that organization

has engaged in or plans to engage in, either alone or with other parties, accompanied by copies of any agreements for conduct of each fund-raising activity or business enterprise.

k. Statement fully explaining any discontinued specific activities that organization has engaged in or sponsored.

NOTE:

The statement must provide dates of commencement and termination and explain the reasons for discontinuance [***see*** FTB Form 3500, Instructions; ***see also*** *§ 13B.210*].

l. Copy of any lease in which organization is lessor or lessee, or in which organization owns interest under lease, and copies of all agreements with other parties for development of leased property.

m. Samples of any literature that organization sells or distributes and samples of any organizational advertising.

n. Any other documents required generally and for specific classifications of organizations by FTB Form 3500 [*see* FTB Form 3500, Instructions].

4. Obtain filing fee for submission with exemption application.

NOTE:

To avoid any delay caused by waiting for the check to clear, organization may wish to submit a cashier's check to expedite the application process.

5. If organization is incorporated, submit completed and signed original of exemption application, required documentation [*see* P 3, *above*], and application fee to:

Exempt Organizations Section
Franchise Tax Board
P.O. Box 942857
Sacramento, CA 94527-4041

NOTE:

If the Franchise Tax Board determines that the articles need amendment, or if the FTB requires additional information, the FTB will contact the officer or representative designated on FTB Form 3500. If the organization qualifies for exemption, the FTB will mail a state exemption determination letter to the organization [***see*** FTB Form 3500, Instructions; ***see also*** *§ 13B.210*].

6. If organization is in process of being incorporated, or is filing for delayed incorporation, mail following to Office of Secretary of State:

NOTE:

If the Secretary of State determines that the proposed articles satisfy California requirements, the Secretary will notify the organization by letter and forward the exemption application materials to the Franchise Tax Board. If the Franchise Tax Board determines that the articles need amendment, or if the FTB requires additional information, the FTB will contact the officer or representative designated on FTB Form 3500. If the organization qualifies for exemption, the FTB will mail a state exemption determination letter to the organization and the Secretary of State, who will then endorse the articles [***see*** FTB Form 3500, Instructions; ***see also*** *§ 13B.210*].

a. Original and at least four copies of proposed articles of incorporation.

b. Check for Secretary of State's filing fees [*see Gov. Code § 12186(d)*].

c. Signed original of exemption application, together with all supporting documents [*see* P 3, *above*].

d. Separate check or money order payable to Franchise Tax Board for exemption application fee.

7. If organization is incorporated in another state and seeking immediate qualification as foreign corporation:

NOTE:
Similar rules apply to organizations that are seeking delayed qualification in California [***see*** FTB Form 3500, Instructions; ***see also*** *§ 13B.210*]. For further discussion of qualification requirements for foreign corporations and associations, see Ch. 12B, ***Foreign Corporations and Associations*** .

a. Mail following to Office of Secretary of State:

(1) Certificate of good standing from state or country having custody over original articles.

(2) Completed Statement and Designation by Foreign Corporation.

(3) Check for Secretary of State's filing fees [*see Gov. Code § 12186(e), (f)*].

NOTE:
If the Secretary of State determines that the organization satisfies California requirements, the Secretary will file the original Statement, endorse any extra copies submitted, and issue a Certificate of Qualification.

b. Mail following to Franchise Tax Board:

(1) Signed original of exemption application, together with all supporting documents [*see* P 3, *above*].

(2) Endorsed copy of Statement and Designation by Foreign Corporation.

(3) Separate check or money order payable to Franchise Tax Board for exemption application fee.

(4) Copy of federal exemption determination letter.

(5) Copies of federal information returns for last three years of operation.

NOTE:
Filing the federal information returns for the last three years of operation satisfies the financial data requirements. If the organization qualifies for exemption, the FTB will mail a state exemption determination letter to the organization [***see*** FTB Form 3500, Instructions; ***see also*** *§ 13B.210*].

8. Submit application at least 60 working days before exemption is needed to ensure adequate processing time.

9. For an organization organized and operated for nonprofit purposes in accordance with *Rev. & Tax. Code § 23701d*, submit copy of one of following to Franchise Tax Board [*Rev. & Tax. Code § 23701d(c)(1)*]:

NOTE:

Notwithstanding *Rev. & Tax. Code § 23701* (exemption application requirement), an organization organized and operated in accordance with *Rev. & Tax. Code § 23701d* [*see § 13B.11*] is exempted from California income taxation (except as provided in *Rev. & Tax Code §§ 23701 et seq.* or *23731 et seq.*) upon submitting to the FTB a copy of one of following documents [*Rev. & Tax. Code § 23701d(c)(1)*]. Upon receipt, the F.T.B. will issue an acknowledgment that the organization is exempt from California income tax. The acknowledgment may refer to the organization's recognition by the I.R.S. of exemption from federal income tax as an organization under *I.R.C. § 501(c)(3)*, and if applicable, the organization's subordinate organization status under a federal group exemption letter [*Rev. & Tax. Code § 23701d(c)(2)*].

The effective date of an organization's exemption from state income tax for state purposes is no later than the effective date of the organization's recognition of exemption from federal income tax under *I.R.C. § 501(c)(3)*, or its status as a subordinate organization under a federal group exemption letter, as applicable [*Rev. & Tax. Code § 23701d(c)(2)*].

If for federal income tax purposes, an organization's exemption under *I.R.C. § 501(c)(3)* is suspended or revoked, the organization must notify the FTB of that suspension or revocation in the form and manner prescribed by the FTB. Upon notification, the FTB will suspend or revoke for state income tax purposes the organization's exemption granted under *Rev. & Tax. Code § 23701d(c)(1)* [*Rev. & Tax. Code § 23701d(c)(3)*].

These provisions will not be construed to prevent the F.T.B. from revoking the exemption of an organization that is not organized or operated in accordance with the Revenue and Taxation Code or *I.R.C. § 501(c)(3)* [*Rev. & Tax. Code § 23701d(c)(4)*]. If the F.T.B. suspends or revokes the exemption of an organization pursuant to *Rev. & Tax. Code § 23701d(c)(3)* or *(4)*, the exemption will be reinstated only upon compliance with *Rev. & Tax. Code § 23701*, regardless of whether the organization can establish exemption under *Rev. & Tax. Code § 23701d(c)(1)* [*Rev. & Tax. Code § 23701d(c)(5)*].

a. Copy of determination letter or ruling issued by I.R.S. recognizing organization's exemption from federal income tax under *I.R.C. § 501(a)* as organization described in *I.R.C. § 501(c)(3)*.

b. Copy of group exemption letter issued by I.R.S. that states that both central organization and all subordinates are tax-exempt under *I.R.C. § 501(c)(3)*, and substantiation that organization is included in federal group exemption letter as subordinate organization.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsFinanceFranchise TaxExemptionsBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawState & Local TaxesFranchise TaxGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-13B California Legal Forms--Transaction Guide § 13B.122

§ 13B.122 Obtaining Exemption From Property Tax

NOTE:

The "welfare exemption" [***see** Rev. & Tax. Code § 214*] is discussed in *§ 13B.51*. The welfare exemption from property tax must be renewed annually [***see, e.g.,** Rev. & Tax. Code §§ 254, 254.5(a)*]. In addition, owners of tax-exempt property must report the creation, renewal, sublease, or assignment of any lease, sublease, license, use permit, or other document conveying the right to use the property to the local assessor within 60 days of the transaction [***see** Rev. & Tax. Code § 480.5(a)*] if the board of supervisors of the county in which the property is located has adopted this requirement [*Rev. & Tax. Code § 480.5(b)*].

1. Ensure that entity's interest in property is of record on lien date in office of recorder for county in which property is located [*see Rev. & Tax. Code § 261*].

2. File claim for organizational clearance certificate with Board of Equalization [*see Rev. & Tax. Code § 254.6*].

3. File claim for welfare exemption with assessor on or before February 15 of each year [*Rev. & Tax. Code §§ 254, 254.5, 254.6*].

NOTE:

The assessor may not approve a property tax exemption until the claimant has been issued a valid organizational clearance certificate. Financial statements are to be submitted only if the assessor so requests in writing [*Rev. & Tax. Code § 254.5(a)*; ***see** Rev. & Tax. Code § 254.6*].

A limited exemption from this annual filing requirement applies to applicants that have

been granted a welfare exemption under *Rev. & Tax. Code §§ 214.15, 231* (property owned by a nonprofit corporation and leased to and used exclusively by the government or by a nonprofit corporation described in *Rev. & Tax. Code § 214.15*) and continue to own exempt property. These applicants need not reapply in any subsequent year in which no transfer of, or other change in title to, the exempted property occurs and the property is used exclusively by a governmental agency for its interest and benefit. Instead, applicants seeking to maintain exemption eligibility must return a card, included in the notice sent by the assessor, to the assessor indicating continued eligibility [*Rev. & Tax. Code § 254.5(d)*].

Similar filing requirements apply to exempt property owned by volunteer fire departments [***see*** *Rev. & Tax. Code § 213.7(c)*] and property owned by nonprofit corporations and leased to and exclusively used by the government for its interest and benefit [***see*** *Rev. & Tax. Code § 231(k)*].

4. If organization permits another exempt organization to use its property for meetings, and those meetings do not destroy welfare exemption [*see Rev. & Tax. Code § 214(a)(3)(D)*], ensure that owner of other organization files valid, unrevoked letter from IRS or FTB stating that other organization, or national organization of which it is local chapter or affiliate, qualifies as exempt organization [*Rev. & Tax. Code § 214(a)(3)(D)*].

5. If organization's activities on property produce unrelated business taxable income [*see I.R.C. § 512*], file following with assessor [*Rev. & Tax. Code § 214.05(d)*]:

NOTE:

If some income derived from the organization's use of the property is unrelated business taxable income, the property is subject only to a partial exemption [*Rev. & Tax. Code § 214.05(a)*]. For further discussion, see *§ 13B.52*.

a. Organization's information and tax returns filed with Internal Revenue Service for immediately preceding fiscal year.

b. Information indicating amount of time devoted to income-producing and non-income-producing activities and, if applicable, description of portion of property on which activities are conducted.

c. Statement listing specific activities that produce unrelated business taxable income.

d. If more than 75 percent of organization's income is attributable to qualified property but is not specifically related to use of property [*see Rev. & Tax. Code § 214.05(c)*]:

(1) Amount of organization's income that is both attributable to activities in California and exempt from income or franchise tax; and

(2) Amount of organization's total income that is attributable to activities in California.

e. Any other information required by Franchise Tax Board.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsConditions & Restrictions (IRC secs. 501-505, 521, 526-530)Tax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral OverviewTax LawState & Local TaxesPersonal Property TaxExempt PropertyRequirements for Exempt StatusTax LawState & Local TaxesReal Property TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
C. Procedural Guide

6-13B California Legal Forms--Transaction Guide §§ 13B.123-13B.129

[Reserved]

§§ 13B.123[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-13B California Legal Forms--Transaction Guide § 13B.130

§ 13B.130 Appealing Denial of Application for Federal Income Tax Exemption

NOTE:
If an organization seeking exemption is notified of a potential adverse determination during the application period, the organization may be able to request technical advice from the IRS's national office [***see*** *Rev. Proc. 2000-5, 2000-1 I.R.B. 158* (procedures)] before the final determination.

1. If organization wishes to protest denial of exemption application [*see Rev. Proc. 90-27* , §§ 9-12, *1990-1 C.B. 514* ; *see also Rev. Proc. 80-25, 1980-1 C.B. 667* (group exemption)]:

NOTE:
When the IRS denies an exemption application without the use of formal technical advice, the IRS send a proposed adverse determination that may be protested. If the national office provided technical advice for the initial adverse decision, no further administrative appeal will be permitted as to those issues for which technical advice was provided [***see*** *Rev. Proc. 90-27* , § 10.02, *1990-1 C.B. 514*].

a. Draft formal protest, including following:
(1) Statement of facts.

(2) Statement of law.

(3) Arguments in support of organization's position.

NOTE:
The organization should make as complete an argument as possible for exemption when

filing its administrative appeal. The organization will then be able to make a showing of exhaustion of administrative remedies, a prerequisite to declaratory relief [***see*** P 2, ***below***].

(4) Whether appeals office conference is desired.

(5) If formal technical advice was provided on some issues, clarify that issues being appealed were not part of or covered by technical advice.

b. File protest within 30 days from date of adverse determination letter.

(1) With district appeals office; or

(2) With IRS's national office (Conference and Review Staff of the Exempt Organizations Technical Branch) in Washington D.C. if denial was made by national office.

2. If organization wishes to appeal final adverse determination of exempt status, or failure by IRS to act on its application, by seeking declaratory judgment [*I.R.C. § 7428*]:

NOTE:

The declaratory judgment procedure may be used to challenge (1) a final determination with regard to the initial qualification or continuing qualification of an *I.R.C. § 501(c)(3)* organization that is exempt from tax under *I.R.C. § 501(a)* or as an organization under *I.R.C. § 170(c)(2)*; *(2)* a final determination with regard to the initial classification or continuing classification of an organization as a private foundation or private operating foundation [***see*** *I.R.C. §§ 509(a), 4942(j)(3)*]; and (3) the failure of the IRS to make one of these determinations. A determination as to continuing qualification or classification includes any revocation of or other change in qualification or classification [*I.R.C. § 7428(a)*]. However, no action may be brought under I.R.C. § 7428 with respect to any revocation of status described in I.R.C. § 6033(j)(1) (loss of exempt status for failure to file any notice or return) [I.R.C. § 7428(4)].

a. Ensure either of following:

(1) That 270 days have elapsed since organization requested determination and it has taken all reasonable steps to secure determination.

NOTE:

The IRS has 270 days in which to make an exemption determination after a substantially complete Form 1023 is filed. If the organization cooperates with the IRS by supplying all available information relevant to the determination, the organization will be deemed to have exhausted all available remedies when the 270-day period elapses [*I.R.C. § 7428(b)(2)*].

(2) That all administrative remedies have been exhausted [*I.R.C. § 7428(a)*; *Rev. Proc. 90-27* , § 12, *1990-1 C.B. 514* ; *see also Rev. Proc. 80-25* , § 11, 1980-1 C.B. 667]:

(a) Organization has filed substantially completed IRS Form 1023.

(b) All additional information required to perfect exemption application has been submitted.

(c) Administrative appeals [*see* P 1, *above*] have been exhausted.

(d) Final adverse ruling or letter of determination has been issued (or 270 days have elapsed from date of application [*see* P (1), *above*]).

b. Draft petition for declaratory judgment:

(1) Establish that all administrative remedies have been exhausted [*see* P a(2), *above*].

NOTE:
An actual controversy must exist over the IRS denial of the exemption application or failure to act in order for the organization to have standing to seek declaratory judgment. The organization must be in existence before bringing suit and the adverse determination must be final [***see** Tax. Ct. R. 210(c)(2)*].

(2) State facts and law relevant to determination.

(3) Include arguments in support of organization's position.

(4) Establish entitlement to declaratory relief.

NOTE:
Requirements to challenge an adverse determination and establish right to declaratory relief in the Tax Court are discussed in *World Family Corp. v. Commissioner (1983) 81 T.C. 958* [***see** Nonprofits' Ins. Alliance v. United States (1994) 32 Fed. Cl. 277* (Court of Federal Claims follows Tax Court's procedures); ***see also** 1984-1 C.B. 1*].

c. File petition for declaratory judgment with Tax Court, Court of Federal Claims, or Washington D.C. District Court [*see I.R.C. § 7428(a)*]:

NOTE:
Only the organization itself may file the petition [*I.R.C. § 7428(b)(1)*].

(1) If final letter of adverse determination was sent to organization by certified or registered mail, within 90 days after mailing date [*I.R.C. § 7428(b)(3)*].

(2) If 270-day period has expired, within 360 days after request for determination was mailed.

Legal Topics:

For related research and practice materials, see the following legal topics:
Administrative LawJudicial ReviewReviewabilityStandingBusiness & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsCivil ProcedureDeclaratory Judgment ActionsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-13B California Legal Forms--Transaction Guide § 13B.131

§ 13B.131 Filing Federal Returns

[1] Annual Information Returns

NOTE:

Tax-exempt organizations must file various returns and reports. The appropriate forms for the returns and reports, as well as many relevant IRS publications, can be obtained from any local IRS office, by telephone, or from the IRS website located at http://www.irs.gov.

1. Determine whether organization is exempt from annual information filing requirement, such as following:

NOTE:

Many exemptions are set forth by statute [*I.R.C. § 6033(a)(3)(A), (C)*]. In addition, the IRS Secretary has discretion to relieve any organization from filing an otherwise required return if that filing is determined not necessary to the efficient administration of the internal revenue laws [*I.R.C. § 6033(a)(3)(B)*]. Additional exemptions are provided by revenue procedures [***see, e.g.,*** *Rev. Proc. 96-10, 1996-1 C.B. 577* ; *Rev. Proc. 95-48, 1995-2 C.B. 418* ; *Rev. Proc. 94-17, 1994-1 C.B. 579*].

a. Churches, integrated auxiliaries, and conventions or associations of churches [*I.R.C. § 6033(a)(3)(A)(i)*; *see Treas. Reg. § 1.6033-2(h)*].

b. Exclusively religious activities of any religious order [*I.R.C. § 6033(a)(3)(A)(iii)*; *Treas. Reg. § 1.6033-2(g)*].

c. Certain organizations (other than private foundations) that normally have gross receipts in each tax year of not more than $5,000 [*I.R.C. § 6033(a)(3)(A)(ii), (C)*]:

(1) Religious organizations and organizations operated, supervised, or controlled by religious organizations [*see I.R.C. § 501(c)(3)*; *Treas. Reg. § 1.6033-2(g)(1)*].

(2) Educational organizations [*see I.R.C. § 170(b)(1)(A)(ii)*].

(3) Charitable organizations or organizations for the prevention of cruelty to animals and children if supported by governmental or public funds [*see I.R.C. § 501(c)(3)*].

(4) Fraternal beneficiary societies, orders, or associations [*see I.R.C. § 501(c)(8)*].

(5) Corporations created by congressional act if wholly owned by the federal government or instrumentality (or a wholly owned subsidiary) [*see I.R.C. § 501(c)(1)*].

d. Organizations (other than private foundations) with gross receipts that are normally less than $25,000.

e. Foreign organizations (other than private foundations) with gross receipts from United States sources that are normally less than $25,000 and with no significant activity within the United States.

2. If required, prepare appropriate annual information return [*see I.R.C. § 6033*; *Treas. Reg. § 1.6033-2*].

a. Most tax-exempt organizations file IRS Form 990 [*but see* PP b, c, *below*].

NOTE:

Most organizations exempt under *I.R.C. § 501(a)* file IRS Form 990. Most organizations exempt under *I.R.C. § 501(c)(3)* (other than private foundations) and nonexempt wholly charitable trusts [***see** I.R.C. § 4947(a)(1)*] file IRS Form 990 and Schedule A. Tax-exempt organizations that have gross income between under $100,000 and total assets under $250,000 may file IRS Form 990-EZ (with or without Schedule A).

b. Tax-exempt private foundations and nonexempt private foundations file IRS Form 990-PF [*see Treas. Reg. §§ 1.6033-2*, 1.6033-3].

NOTE:

The excise tax on the net investment income of most domestic private foundations on Form 990-PF. The tax must be paid annually at the time of filing. However, if the total tax for the year is at least $500, the tax must be paid in quarterly tax payments [IRS Pub. No. 557].

c. Exempt religious or apostolic organizations [*see I.R.C. § 501(d)*] file IRS Form 1065 (partnership return).

d. Tax-exempt entity defined in I.R.C. § 4965(c), including any I.R.C. § 501(c) or (d) organization, must disclose entity's participation in any prohibited tax shelter transaction [I.R.C. § 6033(a)(2); *see* I.R.C. § 4965(e) (definition); *see also* I.R.C. § 6052(c)(3) (penalties for failure to file required disclosure); *IRS 2006-31 I.R.B. 102, Notice 2006-65* (excise taxes with respect to prohibited tax shelter transactions to which tax exempt entities are parties and related disclosure requirements)], in form and manner and at time as determined by Treasury Department.

3. If organization has gross income of more than $1,000 included in computing unrelated trade or business taxable income for year, file unrelated business income tax return on IRS Form 990-T [*see Treas. Reg. §§ 1.6012-2(e),* 1.6012-3(a)(5)].

NOTE:

The obligation to file IRS Form 990-T is in addition to the obligation to file any other required returns [*Treas. Reg. § 1.6033-2(i)*]. IRS Form 990-W is used to compute whether and in what amounts private foundations and tax-exempt organizations must make quarterly estimated payments of tax on unrelated business taxable income, but is not filed [***see** I.R.C. § 6655(g)(3)*]. If a *I.R.C. § 501(c)(4), (5),* or *(6)* organization pays a proxy tax in lieu of reporting lobbying expenses to members, that tax is reported on and paid with IRS Form 990-T.

4. File return no later than 15th day of fifth month after close of organization's taxable year.

NOTE:

For calendar year organizations, the filing deadline for IRS Form 990 is May 15 [***see** I.R.C. § 6072(a), (e)* (exception for employees' trust); ***see also** Treas. Reg. § 1.6033-2(e)*].

5. File annual return of excise taxes if [*see* IRS Form 4720]:

a. Private foundation has violated any restrictions imposed by *I.R.C. §§ 4941*-4945; *see § 13B.20[5][e]*].

b. Eligible public charity that has elected to be subject to monetary limitations on lobbying expenditures [*see § 13B.20[7]*] and has exceeded those limitations.

[2] Donee Information Returns

1. If donee of charitable deduction property disposes of property within three years after receipt [*see I.R.C. § 6050L(a)*]:

NOTE:

"Charitable deduction property" is any property (other than publicly traded securities [***see** I.R.C. § 6050L(a)(2)(B)*]) contributed in a contribution for which a deduction was claimed under *I.R.C. § 170* if the claimed value of the property (and the claimed value of all similar items donated by the donor to one or more donees) exceeds $5,000 [I.R.C. § 6050L(a)(2)(A)]. In other words, "charitable deduction property" is property for which the donee organization was required to file an IRS Form 8283 appraisal.

a. Prepare IRS Form 8282, including:

(1) Donee's name, address, and taxpayer identification number.

(2) Property description.

(3) Date of contribution.

(4) Donor's name, address, and taxpayer identification number.

(5) Date of disposition and amount received.

(6) Description of donee's use of property.

(7) Statement indicating whether use of property was related to purpose or function constituting basis for donee's exemption under I.R.C. § 501.

NOTE:
In any case in which the donee indicates that the use of applicable property [*see* I.R.C. § 170(e)(7)(c)] was related to the purpose or function constituting the basis for the exemption of the donee under I.R.C. § 501 [I.R.C. § 6050L(g)], the donee must include with the return the certification described in I.R.C. § 170(e)(7)(D) [I.R.C. § 6050L(a)(1)].

b. Provide donor with copy of return [*see I.R.C. § 6050L(c)*].

2. File IRS Form 8282 within 125 days after disposition [*see Treas. Reg. § 1.6050L-1*].

NOTE:
IRS Form 8282 need not be filed if the donee organizations sells the item and the appraisal summary signed by the donee contains the donor's statement that the value of the item was $500 or less.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawFederal Tax Administration & ProcedureAdministrationTax Payment & Tax Return Requirements (IRC secs. 6071-6091, 6151-6167)General OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-13B California Legal Forms--Transaction Guide § 13B.132

§ 13B.132 Filing State Returns, Statements, and Reports

1. Determine whether organization is exempt from FTB Form 199 (California Exempt Organization Annual Information Return) filing requirement, such as following [*see Rev. & Tax. Code § 23772(a)(2)*; *see also* FTB Form 199, Instructions]:

NOTE:

The organizations exempt from filing FTB Form 199 may be required to file an annual statement showing the following: (1) name and address of organization; (2) the applicable IRC exemption; and (3) the major activities and sources of income of the organization. If the entity is not required to file FTB Form 199 because annual gross receipts are less than $25,000, the statement must include information about assets and gross receipts [***see*** *Rev. & Tax. Code § 23774(a)*].

A religious organization exempt from filing Form 199 and declining to file this statement because of sincerely held religious convictions may instead file a notarized statement on organizational letterhead stating (1) organization's name and address, (2) the organization's major activities and sources of income; and (3) Internal Revenue Code section under which organization is exempt. This information is for the sole purpose of verifying the absence of unrelated business income of the organization [*Rev. & Tax. Code § 23774(b)*].

Either statement must be filed on or before the 15th day of the fifth calendar month following the close of the income year [*Rev. & Tax. Code § 23774*].

a. Churches, integrated auxiliaries, and conventions or associations of churches.

b. Exclusively religious activities of any religious order.

c. Certain organizations (other than private foundations) that ordinarily have gross receipts in each tax year of not more than $25,000.

d. Organizations formed to carry out state or public body functions that are controlled by the state or public body.

e. Political organizations exempt under Rev. & Tax. Code § Code 23701r.

NOTE:
The annual return and statement requirements [***see*** *Rev. & Tax. Code §§ 23772, 23774*] do not apply to a political organization or newsletter fund [*Rev. & Tax. Code § 23701r(i)*].

Exempt political organization must report and pay tax on political organization taxable income [***see*** *Rev. & Tax. Code § 23701r*].

f. Stock bonus, pension or profit sharing trusts exempt under *Rev. & Tax. Code § 17631*.

g. Education IRAs exempt under *Rev. & Tax. Code § 23712*.

2. If FTB Form 199 is required:

NOTE:
The FTB has discretion to permit the filing of a simplified return, based on gross receipts, total assets, or both, or may permit the filing of an information statement (without fee), or may permit the filing of a group return for incorporated or unincorporated branches of a state or national organization [***see*** *Rev. & Tax. Code § 23772(a)(2)(B)*].

a. Prepare FTB Form 199, which requires the following information [*see Rev. & Tax. Code §§ 23771, 23772(a)(1)*].

NOTE:
The FTB will accept copies of IRS Form 990 or 990-F [***see*** *§ 13B.131[1]*], attached to a completed first page of FTB Form 199. The attached federal form should be marked "filed in lieu of Form 1999."

(1) Annual gross income.

(2) Expenses attributable to that income and incurred within year.

(3) Disbursements for purposes giving rise to exemption.

(4) Balance sheet showing assets, liabilities, and net worth as of start of year.

(5) Total of contributions and gifts received during year, and names and addresses of all substantial contributors.

(6) Names and addresses of foundation manager [*see I.R.C. § 4946*] and highly compensated employees,

(7) C compensation and other payments made during to each foundation manager and highly compensated employees.

(8) If election under *Rev. & Tax. Code § 23704.5* is effective for taxable year, following amounts [*see Rev. & Tax. Code §§ 23704.5, 23772(b)(8)*]:

NOTE:
California has incorporated the federal restriction against nonprofit status if the nonprofit entity dedicates a substantial part of its activities to carrying on propaganda or otherwise attempting to influence legislation [*Rev. & Tax. Code § 23704.5*; ***see*** *I.R.C. § 501(h)*]. Although *I.R.C. § 4911*, relating to the imposition of tax on excess expenditures to influence legislation, generally applies in California, the tax imposed on excess lobbying expenditures does not apply [*Rev. & Tax. Code § 23740*; ***see*** *I.R.C. § 4911(a)(1)*; ***see also*** *Rev. & Tax. Code § 23740(b)*].

(a) Lobbying expenditures [*see Rev. & Tax. Code § 23772(b)(8)(A); see also I.R.C. § 4911(c)(1)*].

(b) Lobbying nontaxable or ceiling amount [*see Rev. & Tax. Code § 23772(b)(8)(B)*; *see also I.R.C. § 4911(c)(2)*].

(c) Grassroots expenditures [*see Rev. & Tax. Code § 23772(b)(8)(C)*; *see also I.R.C. § 4911(c)(3)*].

(d) Grassroots nontaxable or ceiling amount [*see Rev. & Tax. Code § 23772(b)(8)(D)*; *see also I.R.C. § 4911(c)(4)*].

(9) Other information with respect to direct or indirect transfers to, and other direct or indirect transactions and relationships with, other exempt organizations (other than exempt entities under *Rev. & Tax. Code §§ 23701d, 23701k,* and *23701t*), as FTB requires to prevent diversion of funds from organization's exempt purpose or misallocation of revenue or expense.

(10) Any other relevant information prescribed by FTB.

b. File FTB Form 199 on or before the 15th day of the fifth full calendar month following the close of the income year (May 15, for calendar year filers), together with applicable filing fee [*see Rev. & Tax. Code §§ 23771*, 23722(a)(1); *see also Rev. & Tax. Code § 23772(a)(3) (fee)*].

NOTE:
Filings fees are waived for exclusively religious organizations, designated educational organizations, organizations receiving broad governmental or public support, and organizations operated, supervised, or controlled by or in connection with exclusively religious organization *Rev. & Tax. Code § 23772(a)(4)*].

3. If exempt organization's gross taxable income derived from an unrelated business exceeds $1,000, file FTB Form 109 (paying applicable tax), California Exempt Organization Business Income Tax Return, in addition to FTB Form 199 [

see I.R.C. § 512(b)(12); *Rev. & Tax. Code § 23771*; *18 Cal. Code Reg. § 23771(a)*]:

NOTE:

Every exempt organization with income unrelated trade or business income must file a return, verified by an executive officer under penalty of perjury in the form prescribed by the Franchise Tax Board, reporting the organization's income from those activities and pay the required tax on its unrelated business taxable income [***see*** *Rev. & Tax. Code § 23771(a)*; ***see also*** *Rev. & Tax. Code §§ 23731, 23732*].

a. If exempt education IRA [*see Rev. & Tax. Code § 23712*], on or before the 15th day of the fourth month following the close of the income year.

b. For all other organization, on or before the 15th day of the fifth month following the close of the income year.

4. If exempt homeowners' association receives more than $100 in taxable income, file FTB Form 100 [*Rev. & Tax. Code § 23701t(c)*; *see Rev. & Tax. Code § 23732*].

5. If nonprofit corporation owns. processes, or controls property in California subject to local assessment, corporation may have to file copy of business records relevant to amount, cost, and value of that property with county assessor [*see Corp. Code §§ 6214, 8214, 9660(a)*].

NOTE:

This report is not required unless first requested by the county assessor.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawNonprofit Corporations & OrganizationsGeneral OverviewBusiness & Corporate LawUnincorporated AssociationsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral OverviewTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsFailure to Pay Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

6-13B California Legal Forms--Transaction Guide §§ 13B.133-13B.199

[Reserved]

§§ 13B.133[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART IV. FORMS
A. Federal Forms

6-13B California Legal Forms--Transaction Guide § 13B.200

§ 13B.200 Application for Recognition of Exemption Under I.R.C. § 501(c)(3) [IRS Form 1023]

[1] Comment

[a] Use of Form

This form is IRS Form 1023, and the accompanying official instructions. Unless excepted [*see* [b], *below*], all *I.R.C. § 501(c)(3)* organizations applying for recognition of tax-exempt status use this form to obtain IRS recognition of exemption for federal income tax [*see I.R.C. § 508(a)*; *Treas. Reg. § 1.508-1(a)(2)(i)*; *see also* IRS Form 1023, Instructions]. Cooperative service organizations [*see I.R.C. § 501(e), (f)*], child care organizations [*see I.R.C. § 501(k)*], and charitable risk pools [*see I.R.C. § 501(n)*] also apply for exemption using this form [*see* IRS Form 1023, Instructions]. Organizations seeking exemption under *I.R.C. § 501(a), (c)(2), (4)*-(10), (12), (13), (15), (17), (19), (25) file IRS Form 1024 [*see § 13B.201*] in lieu of this form.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the Internal Revenue Service, located at http://www.irs.gov. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 3405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 13B.200. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat version Reader 3.0 or higher.

I.R.C. § 508(a) provides that an organization is not treated as an organization described in *I.R.C. § 501(c)(3)* unless the organization has given notice to the IRS that it is applying for recognition of exempt status. *I.R.C. § 508(a)* also provides that an *I.R.C. § 501(c)(3)* organization is presumed to be a private foundation, whether or not it actually is a private foundation, if the organization fails to notify the IRS that it is not a private foundation. The filing of a properly completed IRS Form 1023 is deemed to constitute the requisite notice for the organization to be treated as described in *I.R.C. § 501(c)(3)*, and the requisite notice that the organization is claiming that nonprivate foundation status [*Treas. Reg. §§ 1.508-1(a)(2)(i)*, 1.508-1(b)(2)(iv)]. If the organization fails to give these notices within 15 months from the end

of the month in which it was formed [*Treas. Reg. § 1.508-1(a)(2)(iii)*], the organization will not qualify for exempt status during the period before the date of actual notice. The IRS looks to the law of the state of formation to determined the date of formation [IRS Pub. No. 557]. Retroactive recognition of exempt status to the date of organization may be granted if the application is filed within the 15-month period.

In general, IRS Form 1023 is not used to apply for a group exemption letter [*see* IRS Form 1023, Instructions; *see also* IRS Pub. No. 557].

[b] Filing Exceptions; Optional Filing

The following organizations may be considered exempt under *I.R.C. § 501(c)(3)* even if they do not file this form [*I.R.C. § 508(c)*; *Treas. Reg. § 1.508-1(a)(3)(i)*-(ii), (b)]:

- Churches, integrated auxiliaries of churches, and conventions or associations of churches.

- Organizations that are not private foundations [*see I.R.C. § 509(a)*] and has gross receipts in each taxable year of normally not more than $5,000.

- Subordinate organizations (other than private foundations) covered by a group exemption letter.

Even if organizations who would otherwise use IRS Form 1023 form to seek an exemption determination are not required to file in order to be tax-exempt, the organization may nevertheless wish to file to obtain certain incidental benefits. These benefits include public recognition of tax-exempt status, exemption from certain state taxes, exemption from certain federal excise taxes, advance assurance to donors of deductibility of contributions, and nonprofit mailing privileges [*see Treas. Reg. §§ 1.501(a)-1*, 1.508-1(a)(4), (b)(8); *see also* IRS Form 1023, Instructions].

In addition, an application for a group exemption letter to establish the tax-exempt status of a central organization's subordinate organizations is by letter instead of filing IRS Form 1023 [*see* IRS Pub. No. 557].

[c] Qualification for Exemption

To qualify for the exemption, the organization must be both organized and operated exclusively for one or more of the exempt purposes specified in *I.R.C. § 501(c)(3)* [*Treas. Reg. § 1.501(c)(3)-1(a)(1)*]. An organization may be exempt if it is organized and operated exclusively for one or more of the following purposes: religious; charitable; scientific; testing for public safety; literary; educational; to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment); or prevention of cruelty to children or animals [*see I.R.C. § 501(c)(3)*; *Treas. Reg. § 1.501(c)(3)-1(d)(1)(i)*]. No part of the net earnings of the organization may inure to the benefit of any private shareholder or individual and no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation (except with respect to public charities who elect to be governed by the special lobbying expenditures limitation [*see I.R.C. § 501(h)*; *see § 13B.20[4][b], [7]*]). The organization may not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office [*I.R.C. § 501(c)(3)*]. In addition, to qualify under that section, no substantial part of the corporation's activities may consist of providing commercial-type insurance [*see I.R.C. § 501(m)*; *see also § 13B.20[4][d]*]. The word "corporation" generally includes certain unincorporated associations [*see I.R.C. § 7701(a)(3)*; *Treas. Reg. § 301.7701-2*].If the organization is in fact organized for any of these purposes, the organization may obtain the exemption, notwithstanding the fact that the entity misclassifies itself in the application. For example, if an organization claims exemption on the ground that it is "educational," the exemption will not be denied if, in fact, the organization is "charitable" [*Treas. Reg. § 1.501(c)(3)-1(d)(1)(iii)*].

An organization that is a private foundation [*see I.R.C. § 509(a)* may only qualify for exemption under *I.R.C. §*

501(c)(3) if its governing instrument [*see Treas. Reg. § 1.508-3(c)*] contains certain provisions prohibiting it from acting in a manner that would give rise to liability for any of the excise taxes imposed by *I.R.C. §§ 4941*-4945 [*I.R.C. § 508(e)*; *Treas. Reg. § 1.508-3*]. However, the governing instruments of private foundations are deemed to satisfy this requirement if valid provisions of state law contain the required prohibitions, or treat the required prohibitions as contained in these governing instruments [*Treas. Reg. § 1.508-3(d)*]. California has enacted these provisions [*see Prob. Code §§ 16101-16104*; *Corp. Code §§ 5260, 9260*].

The requirements for exemption are discussed in *further detail in § 13B.20*.

[d] Charitable Purposes

The word "charitable" is used in *I.R.C. § 501(c)(3)* in its generally accepted legal sense and is not to be construed as limited by the separate enumeration of other tax-exempt purposes that may fall within the broad outlines of "charity." The term includes relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of government; and promotion of social welfare by organizations designed to accomplish any of the foregoing purposes, or to lessen neighborhood tensions, or to eliminate prejudice and discrimination, or to defend human and civil rights secured by law; or to combat community deterioration and juvenile delinquency [*see* IRS Pub. No. 557]. The fact that an organization organized and operated for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily prevent the organization from being exempt as an organization organized and operated exclusively for charitable purposes. The fact that an organization, in carrying out its primary purpose, advocates social or civic changes or presents opinions on controversial issues with the intention of molding public opinion or creating public sentiment to an acceptance of its views does not preclude the organization from qualifying for an exemption so long as it is not classified as an "action" organization [*Treas. Reg. § 1.501(c)(3)-1(d)(2)*]. For further discussion of action organization, see *§ 13B.20[4][b]*.

[e] Educational Purposes

The term "educational" relates to the instruction or training of individuals for the purpose of improving or developing their capabilities, or the instruction of the public on subjects useful to individuals and beneficial to the community. An organization may be educational even though it advocates a particular position or viewpoint, provided that it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion. On the other hand, an organization is not educational if its principal function is the mere presentation of unsupported opinion [*Treas. Reg. § 1.501(c)(3)-1(d)(3)(i)*; *see* IRS Pub. No. 557]. The term "educational purposes," for determining tax exempt status under *I.R.C. § 501(c)(3)* and eligibility for tax-deductible contributions under *I.R.C. §§ 170*, *2055*, and *2522*, includes the providing of care of children away from their homes if (1) substantially all of the care provided by the organization is for purposes of enabling individuals to be gainfully employed, and (2) the services provided by the organization are available to the general public [*I.R.C. § 501(k)*].

Examples of educational organizations include the following [*Treas. Reg. § 1.501(c)(3)-1(d)(3)(ii)*]:

- An organization, such as a primary or secondary school, a college, or a professional or trade school, that has a regularly scheduled curriculum, a regular faculty, and a regularly enrolled body of students in attendance at a place where the educational activities are regularly carried on.

- An organization whose activities consist of presenting public discussion groups, forums, panels, lectures, or other similar programs, which may be on radio or television.

- An organization that presents a course of instruction by means of correspondence or through the utilization of television or radio.

- Museums, zoos, planetariums, symphony orchestras, and other similar organizations.

Schools must file Schedule B, and organizations providing scholarships or student aid must file Schedule H, with their exemption application [IRS Form 1023, Instructions].

[f] Testing for Public Safety

The term "testing for public safety" includes the testing of consumer products, such as electrical products, to determine whether they are safe for use by the general public [*Treas. Reg. § 1.501(c)(3)-1(d)(4)*].

[g] Scientific Purposes

A scientific organization must be organized and operated in the public interest to qualify for exempt status. Thus, the term "scientific" includes the conduct of scientific research in the public interest. The determination of whether research is "scientific" does not depend on whether it is classified as "fundamental" or "basic" as contrasted with "applied" or "practical." However, for purposes of the exclusion from unrelated business taxable income [*see I.R.C. § 512(b)(9)*], a determination must be made whether the organization is operated primarily for the purposes of carrying on "fundamental," as contrasted with "applied," research [*Treas. Reg. § 1.501(c)(3)-1(d)(5)(i)*].

Scientific research will be regarded as carried on in the public interest in the following instances [*Treas. Reg. § 1.501(c)(3)-1(d)(5)(iii)*; *see* IRS Pub. No. 557]:

- The results of the research (including any resulting patents, copyrights, processes, or formulae) are made available to the public on a nondiscriminatory basis.

- The research is performed for the United States, or any of its agencies or instrumentalities, or for a state, county, or municipal government.

- The research is conducted for one of the following purposes:

    - Aiding in the scientific education of college or university students;

    - Obtaining scientific information that is published in a treatise, thesis, trade publication, or in any other form that is available to the interested public;

    - Discovering a cure for a disease; or

    - Aiding a community or geographical area by attracting new industry to the community or area, or by encouraging the development of, or retention of, an industry in the community or area.

Scientific research does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations. For example, the ordinary testing or inspection of materials or products or the designing or construction of equipment, buildings, and so forth does not qualify for exemption [*Treas. Reg. § 1.501(c)(3)-1(d)(5)(ii)*; IRS Pub. No. 557]. Further, an organization is not regarded as organized and operated for the purpose of carrying on scientific research in the public interest and therefore is not exempt as a scientific organization under the following circumstances [*Treas. Reg. § 1.501(c)(3)-1(d)(5)(iv)*]:

- The organization performs research only for persons who are directly or indirectly its creators and

that are not described in *I.R.C. § 501(c)(3)*; or

- The organization retains, directly or indirectly, the ownership or control of more than an insubstantial portion of the patents, copyrights, processes, or formulae resulting from its research and does not make those patents, copyrights, processes, or formulae available to the public.

A patent, copyright process, or formula is considered as made available to the public if (1) made available on a nondiscriminatory basis, or (2) although one person is granted the exclusive right to its use, the granting of the exclusive right is the only practicable manner in which it can be utilized to benefit the public. In the latter case, research will be regarded as carried on in the public interest only if carried on for the United States, or its agencies or instrumentalities, or for a state, county, or municipality, or if the scientific research is directed toward benefiting the public.

The fact that any organization, including a college, university, or hospital, carries on research that is not in furtherance of an exempt purpose will not bar the exemption, provided that the organization meets the organizational test [*see § 13B.20[3]*] and is not operated for the primary purpose of carrying on the nonqualifying research [*Treas. Reg. § 1.501(c)(3)-1(d)(5)(v)*].

[h] Rulings Relating to Nonprivate Foundation Status

Part III of IRS Form 1023 may be used by publicly supported organizations [*see I.R.C. § 509(a)(1), (2)*] to seek a definitive or advance ruling as to foundation status. Part III of IRS Form 1023 requires a statement as to private foundation status, and an indication of the basis for claiming nonprivate foundation status. If that basis relates to the organization's sources of support [*see I.R.C. §§ 170(b)(1)(A)(vi), 509(a)(1), (2)*], and the organization is a new one whose first taxable year is less than eight months, a definitive ruling as to its private foundation status cannot be made. New organizations may only request an advance ruling [*see* IRS Form 1023 and Instructions].

If the organization has completed a tax year of at least eight months and requests an advance ruling, or if the organization has not completed a tax year of at least eight months, the organization must complete, sign, and attach two IRS Forms 872-C to IRS Form 1023.

An advance ruling allows an organization claiming nonprivate foundation status based on its public sources of support to be treated as a public charity for certain purposes during the five-year advance ruling period, including the deductibility of contributions by the general public year. If an organization has not received significant public support during its first and second tax years, but reasonably expects to receive that support by the end of its fifth tax year, the organization should consider the advance ruling option [IRS Form 1023, Instructions]. At the end of the advance ruling period, the IRS will review the organization's operating history. If it is determined that the organization failed to qualify for nonprivate foundation status based on its sources of support, any taxes due as a result of violation of the private foundation operating requirements of *I.R.C. § 4940* will be assessed for the advance ruling period [*Treas. Reg. § 1.170A-9(e)(5)*].

In effect, IRS Form 872-C is an agreement to extend the applicable statute of limitations for assessing tax under *I.R.C. § 4940* if the IRS determines that the organization failed to meet the support requirements by the end of the advance ruling period [*see I.R.C. § 6501(c)(4)*]. Copies of IRS Form 872-C are included in the IRS Form 1023 application package.

[i] Conformed Copy of Organizing Documents

IRS Form 1023 requires that additional documents be submitted with the form. A conformed copy of the relevant organizational documents must be attached to IRS Form 1023 before mailing [*see* IRS Form 1023, Instructions; *see also Treas. Reg. § 1.501(c)(3)-1(b)(2)*]. For example, a corporation must attach a copy of the articles of incorporation

(including amendments and restatements) showing approval by the appropriate state official and include a copy of its bylaws. A trust must attach a copy of the trust indenture or agreement, including all appropriate signatures and dates. An association must attach a copy of its articles of organization, constitution, or other creating document, with a declaration or other evidence that the organization was formed by adoption of the document by two or more persons, and include a copy of the bylaws [*see* IRS Form 1023, pt. I, line 10, and Instructions; *see also* IRS Pub. No. 557]. The bylaws alone are not an organizing instrument. If the organization does not have an organizing instrument, it will not qualify for exempt status [*see* IRS Form 1023, Instructions].

A "conformed copy" is one that agrees with the original document and all amendments in every detail. A conformed copy may be a photocopy of the original signed and dated organizing document or a copy of that document that is unsigned but accompanied by a written declaration, signed by an authorized person, stating that the copy is a complete and accurate copy of the original signed and dated document. Copies of articles of incorporation must be accompanied by a declaration stating that the original copy was filed with and approved by the state and the filing date.

[j] Public Inspection of IRS Form 1023

If an organization's application for *I.R.C. § 501(c)(3)* exempt status is approved, the following documents will be open to public inspection in any district office and the national office of the IRS [*see I.R.C. § 6104*; *see also* IRS Form 1023, Instructions]:

- The organization's application Form 1023 and any supporting documents.
- Any letter or other document issued by the IRS with regard to the application.

However, information relating to a trade secret, patent, style or work, or apparatus, that, if released, would adversely affect the organization or the national defense, will not be made available for public inspection. Applicants must identify this information by clearly marking it "NOT SUBJECT TO PUBLIC INSPECTION" and attach a statement explaining why the organization requests that the information be withheld [*I.R.C. § 6104(a)(1)(D)*; Treas. Reg. § 301.6104-1(c)].

The exempt organization must make a copy of its approved application and supporting documents, as well as any letter or document issued by the IRS available for public inspection. The documents must be available during reasonable business hours at the organization's principal office and at each regional or district offices having at least three paid employees [*see* IRS Form 1023, Instructions; *see also 1988-2 C.B. 454, Notice 88-120*]. Monetary penalties may be assessed on a daily basis for failure to comply with these inspection requirements [IRS Form 1023, Instructions].

[k] Signature and Filing Requirements

An officer, a trustee authorized to sign, or another person authorized by a power of attorney must sign IRS Form 1023. If relied on, the power of attorney must be attached to the form [IRS Form 1023, Instructions; *see* IRS Form 2848 (power of attorney and declaration of representative)].

This form, together with the applicable fee and all other necessary applications, requests, schedules, and supporting documents, must be filed at the following address [*see* IRS Form 8718, Instructions; *see also § 13B.202*]:

Internal Revenue Service
P.O. Box 192
Covington, KY 41012-0192

If the application is submitted using express mail or a delivery service, the application must be sent to

Internal Revenue Service
201 West Rivercenter Blvd.
Attn: Extracting Stop 312
Covington, KY 41011

Each attachment or enclosure to IRS Form 1023 should show the name and address of the organization, the date, an identifiable heading showing the question number or subject matter to which it relates, and that it is an attachment to IRS Form 1023 [*see* IRS Form 1023, Instructions].

[2] FORM

Application for Recognition of Exemption Under I.R.C. § 501(c)(3) [IRS Form 1023]

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART IV. FORMS
A. Federal Forms

6-13B California Legal Forms--Transaction Guide § 13B.201

§ 13B.201 Application for Recognition of Exemption Under I.R.C. § 501(a) [IRS Form 1024]

[1] Comment

[a] Use of Form

This form is IRS Form 1024 and the accompanying official instructions. It is used by most types of organizations applying for recognition of tax-exempt status under *I.R.C. § 501(a), (c)(2), (4)*-(10), (12), (13), (15), (17), (19), (25). *I.R.C. § 501(c)(3)* organizations file IRS Form 1023 in lieu of this form [*see § 13B.200*].

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the Internal Revenue Service, which is located at http://www.irs.gov. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 3405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 13B.201. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Most organizations are required to complete Parts I through III of the form. Voluntary employees' beneficiary associations and supplemental unemployment benefit trusts [*see I.R.C. § 501(c)(9), (17)*] should also complete Part IV. In addition, the following organizations must complete the applicable schedule, indicated below, that corresponds to the relevant paragraph of *I.R.C. § 501(c)* under which the exemption is sought; an organization should not submit any blank schedules that do not apply to the applicant [*see* IRS Form 1024 and Instructions]:

- Title-holding corporations and trusts [*see I.R.C. § 501(c)(2), 501(c)(25)*] file Schedule A.

- Civic leagues, social welfare organizations (including certain veterans' organizations, such as posts and councils of veterans' organizations not qualifying for exemption under *I.R.C. § 501(c)(19)*), or local associations of employees [*see I.R.C. § 501(c)(4)*] file Schedule B.

- Labor, agricultural (including fishermen's organizations or horticultural organizations) [*see I.R.C. § 501(c)(5)*] and business leagues, chambers of commerce, and the like [*see I.R.C. § 501(c)(6)*] file Schedule C.

- Social clubs [*see I.R.C. § 501(c)(7)*] file Schedule D.

- Fraternal societies, orders, and associations [*see I.R.C. § 501(c)(8), (10)*] file Schedule E.

- Voluntary employees' beneficiary associations [*see I.R.C. § 501(c)(9)*] file Schedule F.

- Benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies, and like organizations [*see I.R.C. § 501(c)(12)*] file Schedule G.

- Cemeteries, crematoriums, and like corporations [*see I.R.C. § 501(c)(13)*] file Schedule H.

- Small insurance companies or associations (other than life) with written premiums of $350,000 or less [*see I.R.C. § 501(c)(15)*] file Schedule I.

- Trusts providing for the payment of supplemental unemployment compensation benefits [*see I.R.C. § 501(c)(17)*] file Schedule J.

- Posts or organizations composed of past or present armed services members and auxiliary units or societies [*see I.R.C. § 501(c)(19)*] file Schedule K.

In general, IRS Form 1024 is not used to apply for a group exemption letter [*see* IRS Form 1024, Instructions; *see also* IRS Pub. No. 557]. Homeowners associations seeking tax benefits and exemption under *I.R.C. § 528* file IRS Form 1120-H to elect beneficial tax treatment rather than this form [*see* IRS Form 1024, Instructions].

[b] Filing Exceptions; Optional Filing

The following organizations may be considered exempt under *I.R.C. § 501(c)(3)* even if they do not file this form [*I.R.C. § 508(c)*; *Treas. Reg. § 1.508-1(a)(3)(i)*-(ii), (b)]:

- Churches, integrated auxiliaries of churches, and conventions or associations of churches.

- Organizations that are not private foundations [*see I.R.C. § 509(a)*] and has gross receipts in each taxable year of normally not more than $5,000.

- Subordinate organizations (other than private foundations) covered by a group exemption letter.

Even when organizations who would otherwise use this form to seek an exemption determination are not required to file in order to be tax-exempt, the organization may nevertheless wish to file to obtain certain incidental benefits. These benefits include public recognition of tax-exempt status, exemption from certain state taxes, advance assurance to donors of deductibility of contributions, and nonprofit mailing privileges [*see Treas. Reg. §§ 1.501(a)-1*, 1.508-1(a)(4), (b)(8); *see also* IRS Form 1024, Instructions].

Other *I.R.C. § 501(c)* organizations are tax exempt without filing this application for recognition of their exemption:

- Trusts established to make payments under the Black Lung Acts [*I.R.C. § 501(c)(21)*].

- Certain trusts established by the sponsors of multi-employer plans to make retirement benefit payments under ERISA [*I.R.C. § 501(c)(22)*].

- Certain veterans' organizations organized over 100 years ago and whose principal purpose is to provide insurance and other benefits to veterans or their dependents [*I.R.C.501(c)(23)*].

- Trusts established in connection with terminated single-employer plans to receive liability payments and make distributions to participants and beneficiaries [*I.R.C. § 501(c)(24)*; *see 29 U.S.C. § 1349* (applicable ERISA provision)].

- Any small corporation or trust organized for the exclusive purpose of acquiring and holding real property [*I.R.C. § 501(c)(25)*].

The above-listed entities should apply for exemption by submitting a letter stating the information necessary to qualify for the particular exemption.

In addition, an application for a group exemption letter to establish the tax-exempt status of a central organization's subordinate organizations is by letter instead of filing IRS Form 1024 [*see* IRS Pub. No. 557].

[c] Title-Holding Corporations

To qualify for exemption from federal income taxation as a title-holding corporation, a corporation must be organized for the exclusive purpose of holding title to property, collecting income from that property, and turning over the entire amount, less expenses, to an organization that itself is exempt under *I.R.C. § 501(a)* [*I.R.C. § 501(c)(2)*]. A corporation cannot qualify as a holding company unless the corporate charter confines its purposes and powers to these activities. If the corporate charter authorizes the corporation to engage in activities that go beyond these limitations, the exemption may not be recognized even though its actual operations are so limited [IRS Pub. No. 557; *see Rev. Rul. 58-566, 1958-2 C.B. 261*]. Actual payment is required; a mere obligation to use the income for the exempt organization's benefit, or the fact that the distributee has control over the income is insufficient [IRS Pub. No. 557]. Thus, an exempt title-holding corporation cannot accumulate income and retain the exemption [*Treas. Reg. § 1.501(c)(2)-1(b)*]. In addition, an exempt title-holding corporation will not continue to qualify for exemption when any of the organizations to which it makes distributions of income ceases to qualify for exemption [*see Rev. Rul. 68-371, 1968-2 C.B. 204*]. An organization operated for the primary purpose of carrying on a trade or business for profit is not exempt from taxation on the ground that all of its profits are payable to one or more exempt organizations. These organizations are known as feeder organizations [*I.R.C. § 502*].

A title-holding corporation will only qualify for exemption if the recipient (distributee) exempt organization has effective ownership and control over the title-holding corporation. For example, the distributee may control the title-holding corporation by owning its voting stock or holding the power to select nominees to hold the voting stock [IRS Pub. No. 557; *see Rev. Rul. 71-544, 1971-2 C.B. 227*].

A title-holding corporation must furnish evidence that the organization for which title is held has obtained recognition of exempt status. If that organization has not been specifically notified in writing by the IRS that it is exempt, the title-holding corporation must submit the necessary application and supporting documents to enable the IRS to determine whether the organization for which title is held qualifies for exemption. A copy of a ruling or determination letter issued to the organization for which title is held constitutes proof of exemption. However, until the organization for which title is held obtains recognition of exempt status, or proof is submitted to show that it qualifies, the title-holding corporation cannot obtain recognition of exemption [IRS Pub. No. 557; *see Treas. Reg. § 1.501(a)-1(b)(1)(ii)*].

An otherwise exempt title-holding corporation is taxable on its unrelated business taxable income [*I.R.C. §§ 511*-514] if that income is payable either to an organization that is itself subject to that tax or to a church or to a convention or association of churches [*I.R.C. § 511(a)(2)(A)*; *see Rev. Rul. 68-490, 1968-2 C.B. 241*]. Because a title-holding corporation cannot be exempt if it engages in any business other than holding title to property and collecting income, its unrelated business taxable income, if any, will be unrelated business rental income, that is, rents from business leases [*Treas. Reg. § 1.501(c)(2)-1(a)*; *see I.R.C. § 514*]. All other rents from real property are excluded from unrelated business taxable income [*I.R.C. § 512(b)(3)*; *see Rev. Rul. 69-381, 1969-2 C.B. 113* ; *Rev. Rul. 69-278, 1969-1 C.B. 148*].

Donations to a tax-exempt title-holding company are generally not deductible as charitable contributions on the donor's federal income tax return [IRS Pub. No. 557].

[d] Civic Leagues and Social Welfare Organizations

A civic league or social welfare organization may be exempt if it is not organized or operated for profit and it is operated exclusively for the promotion of social welfare [*I.R.C. § 501(c)(4)*; *Treas. Reg. § 1.501(c)(4)-1(a)(1)*]. The organization's net earnings must be devoted only to charitable, educational, or recreational purposes and no part of net earnings may benefit any private shareholder or individual. If the organization provides an excess benefit to certain persons, an excise tax may be imposed. The organization will not be exempt if a substantial part of its activities consists of providing commercial-type insurance [*I.R.C. § 501(m)(1)*; *see I.R.C. § 501(m)(3), (4)*]. If only a nonsubstantial part of its activities consists of providing insurance, those activities will be treated as an unrelated trade or business and taxed under the provisions relating to insurance companies [*I.R.C. § 501(m)(2)*; *see I.R.C. § 801* et seq.; *see also § 13B.20[4][d]*].

The organization seeking exemption must submit evidence that it is organized and will be operated on a nonprofit basis. However, this evidence, including the fact that it is operated under the state law relating to nonprofit corporations, does not in itself establish a social welfare purpose. An organization is operated exclusively to promote social welfare if the organization will operate primarily to further in some way the common good and general welfare of the people of the community and includes an organization operated primarily for the purpose of bringing about civic betterment and social improvements [IRS Pub. No. 557; *Treas. Reg. § 1.501(c)(4)-1(a)(2)(i)*]. "Community" generally refers to a geographic unit recognizable as a governmental subdivision, unit, or district [*see* IRS Pub. No. 557]. The principal test for a social welfare organization's operations is whether benefits are provided to a whole community or a private group of citizens [*see Rev. Rul. 78-132, 1978-1 C.B. 157*]. The organization must not conduct activities directed to the exterior maintenance of private residences, and the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public [*Rev. Rul. 74-99, 1974-1 C.B. 131*]. However, a homeowners' association may be exempt if it serves a community bearing a reasonable and recognizable relationship to an area ordinarily identified as governmental; does not conduct activities directed to exterior maintenance of private residences; and maintains common areas or facilities for the use and enjoyment of the general public [*Rev. Rul. 80-63, 1980-1 C.B. 116*]. A homeowners' association that is not exempt under *I.R.C. § 501(c)(4)* may qualify under *I.R.C. § 528*, which generally permits the exclusion of its exempt function income from taxation [*see* Ch. 34, *Condominiums*].

Civic associations and volunteer fire companies are examples of types of organizations that are considered to be social welfare organizations [*see* IRS Pub. No. 557]. Volunteer fire companies actively engaged in fire fighting and similar disaster relief, organizations trying to encourage industrial development by making business loans to encourage relocation, and community associations working to improve public services or devoted to preserving a community's traditions and architecture are other examples of social welfare organizations [IRS Pub. No. 557].

A local employees' association may apply for exemption under *I.R.C. § 501(c)(4)*]. The organization must submit evidence that the organization is of a purely local character; its membership is limited to employees of a designated

person or persons in a particular locality; and net earnings will be devoted exclusively to charitable, educational, or recreational purposes. If the organization has a system of paying retirement and/or death benefits to members, or is primarily operated as a cooperative buying service to obtain discount prices for members, the organization will not be exempt [IRS Pub. No. 557].

An organization that restricts the use of its facilities to employees of selected corporations and their guests benefits a private group rather than the community and is not exempt. An organization formed to represent member-tenants of an apartment complex does not qualify for exemption as it benefits only the member-tenants and not all tenants in the community [IRS Pub. No. 557]. Further, when the benefit being accorded to members is in the nature of relieving them from their obligations to pay the general expenses of the organization, exemption will be denied [*see Rev. Rul. 73-349, 1973-2 C.B. 179* ; *Commissioner of Int. Rev. v. Lake Forest, Inc. (4th Cir. 1962) 305 F.2d 814, 818]* . Promoting social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of, or in opposition to, any candidate for public office; however, if the entity is organized exclusively to promote social welfare, it may still obtain the exemption despite legal participation in some political activity on behalf of or in opposition to public office candidates [IRS Pub. No. 557; *see Treas. Reg. § 1.501(c)(3)-1(c)(3)*]. However, an organization that loses its exempt status by reason of (1) carrying on propaganda or otherwise attempting to influence legislation or (2) participating or intervening in any political campaign on behalf of or in opposition to any candidate for public office, cannot at any time thereafter qualify as a social welfare organization [*I.R.C. § 504(a)(2)*].

An organization is not operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations that are operated for profit. However, these organizations may qualify for exemption under other provisions of the *I.R.C. § 501(c)* [*see I.R.C. § 501(c)(6), (7)*].

Contributions to exempt civic leagues or social welfare organizations generally are not deductible as charitable contributions on the donor's federal income tax return. The contributions may be deductible as trade or business expenses, if ordinary and necessary to the conduct of the taxpayer's business. Donations to volunteer fire companies are deductible if made for exclusively public purposes [IRS Pub. No. 557; *see Rev. Rul. 74-361, 1974-2 C.B. 159* ; *see also I.R.C. § 170(c)*; *Rev. Rul. 57-493, 1957-2 C.B. 314*].

[e] Labor, Agricultural, and Horticultural Organizations

Although the statutory classification exempting labor, agricultural and horticultural organizations is absolute in its terms [*see I.R.C. § 501(c)(5)*], this classification presupposes that no net earnings of the organization inure to the benefit of any member [IRS Pub. No. 557], and that the organization is primarily devoted to the betterment of the conditions of those engaged in these pursuits, the improvement of the grade of the products, and the development of a higher degree of efficiency in the respective occupations [IRS Pub. No. 557; *Treas. Reg. § 1.501(c)(5)-1(a)*]. Such organizations are nevertheless subject to tax on their unrelated business income [*I.R.C. § 511(a)(2)*; *Treas. Reg. § 1.501(c)(5)-1(b)*].

An exempt labor organization is generally an association of workers, usually in the form of a labor union, council, or committee, that is organized to protect and promote the interests of the members by bargaining collectively with employers to secure better working conditions. To show that an organization has the purpose of a labor union, the articles of organization or accompanying statements should include information establishing that the organization is organized to carry out the purposes described above [IRS Pub. No. 557]. Despite the requirement that no net earnings inure to the benefit of organization members, the payment of death, sickness, accident, and similar benefits to its members out of funds contributed by the members is a legitimate function and does not adversely affect its exempt status if made under a plan to better the conditions of the members [IRS Pub. No. 557; *Rev. Rul. 62-17, 1962-1 C.B. 87* ; *see Rev. Rul. 67-7, 1967-1 C.B. 137*]. However, an organization does not qualify for this exemption if it has no authority to represent members in job-related matters, even if it provides weekly income to its members in the event of a lawful strike by the members' union in return for an annual payment by the member [IRS Pub. No. 557; *Rev. Rul.*

76-420, 1976-2 C.B. 153].

Agricultural and horticultural organizations are connected with raising livestock, forestry, raising or harvesting crops or aquatic resources, cultivating useful or ornamental plants, and similar pursuits [IRS Pub. No. 557; *see I.R.C. § 501(g)*]. The primary purpose of exempt agricultural and horticultural organizations must be shown in their applications for exemption to relate to techniques of production, betterment of conditions of those engaged in agriculture or horticulture, development of efficiency, or improvement of the grade of products [IRS Pub. No. 557]. If the activities are directed toward the improvement of marketing or other business conditions in one or more lines of business rather than improvements of production techniques or the like, the organization must qualify as a business league or board of trade under *I.R.C. § 501(c)(6)*; *see* [f], *below*].

Contributions to labor, agricultural, and horticultural organizations are not deductible as charitable contributions on the donor's federal income tax return. However, the contributions may be deductible as trade or business expenses, if ordinary and necessary to the conduct of the taxpayer's business [IRS Pub. No. 557].

[f] Business Leagues

Business leagues, chambers of commerce, real estate boards, boards of trade, and professional football leagues, not organized for profit and no part of the net earnings of which inure to the benefit of any private shareholder or individual, are exempt from federal income taxation. The organization must be primarily engaged in the activities or functions that are the basis of the exemption, and must be primarily supported by memberships dues and other income from activities substantially related to the exempt purpose [*I.R.C. § 501(c)(6)*; IRS Pub. No. 557]. The organization must be devoted to the improvement of business conditions of one or more lines of business as opposed to the performance of particular services for individuals. The application and accompanying materials must show that the conditions of a particular trade or the interests of the community will be advanced [IRS Pub. No. 557]. An *I.R.C. § 501(c)(6)* organization may engage in legislative activities that relate to the common business interest supported by the organization [*Rev. Rul. 61-177, 1961-2 C.B. 117*].

A business league is an association of persons having some common business interest, the purpose of which is to promote that common interest and not to engage in a regular business of a kind ordinarily carried on for profit [*Treas. Reg. § 1.501(c)(6)-1*]. Trade associations and professional associations are considered business leagues. A common business interest of all members of the organization must be established by the application documents. Examples of activities that tend to illustrate a common business interest include the following [IRS Pub. No. 557]:

- Promotion of higher business standards and better business methods, and encouragement of uniformity and cooperation by a retail merchants' association.
- Education of the public in the use of credit.
- Establishment of uniform casualty rates and compilation of statistical information by an insurance rating bureau operated by casualty insurance companies.
- Establishing and maintaining the integrity of a local commercial market.
- Operation of trade publication primarily intended to benefit an entire industry.
- Encouragement of the use of goods and services of an entire industry.

Improvement of business conditions must be shown to be the general purpose of the organization. This requirement is not established by evidence of particular services that provide a convenience or economy to individual members in their

businesses, such as advertising using members' names, interest-free loans, assigning exclusive franchise areas, operating a real estate multiple listing system, or operating a credit reporting agency. A stock or commodity exchange and investment advisory organizations are expressly not a business league, a chamber of commerce, or a board of trade and are not exempt from tax [*Treas. Reg. § 1.501(c)(6)-1*; IRS Pub. No. 557]. If an organization engages in research to provide information relating to one particular industry, it must make the results available to all members of the industry (not just its own members) to qualify for exemption [*Rev. Rul. 69-106, 1969-1 C.B. 153*].

A nonprofit organization with a majority of its members located in a particular shopping center qualifies for exemption if it is operated to promote the common business interests of its members, has a voluntary membership open to all businesses in the neighboring community, and is not concerned with landlord-tenant matters relating to the shopping center [*Rev. Rul. 78-225, 1978-1 C.B. 159* (distinguishing *Rev. Rul. 73-411, 1973-2 C.B. 180*)]. However, a shopping center merchants' association whose membership is restricted to and required of the tenants of a one-owner shopping center and their common lessor, and whose activities are directed to promoting the general business interests of its members, does not qualify as a business league or chamber of commerce because the common business interests being served are not the business interests of the kind of public business community contemplated by the statute [*Rev. Rul. 73-411, 1973-2 C.B. 180*].

Dues paid to *I.R.C. § 501(c)(6)* entities are generally deductible, except to the extent that the funds support influencing legislation, intervening in political campaigns, and grassroots lobbying, even though the entity may work for the enactment of laws to advance common business interests without jeopardizing the election. However, dues remain deductible if the organization tries to affect local legislation of direct interest to the organization or its members, and the this limitation is subject to a $2,000 a year de minimis exception [*see* IRS Pub. No. 557].

Contributions to *I.R.C. § 501(c)(6)* organizations are not deductible as charitable contributions on the donor's federal income tax return [IRS Pub. No. 557]. However, they may be deductible as trade or business expenses if ordinary and necessary in the context of the taxpayer's business [*see I.R.C. §§ 170, 162*].

[g] Social Clubs

Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of whose activities are for these purposes and no part of the net earnings inures to the benefit of any private shareholder, qualify for exemption under *I.R.C. § 501(c)(7)*. Typical examples include certain college alumni associations; college fraternities or sororities operating chapter houses for students; country clubs; amateur hunting, fishing, tennis, swimming, and other sports clubs; dinner clubs that provide a meeting place, library, and dining room for members; hobby clubs; garden clubs; and variety clubs [IRS Pub. No. 557].

To show that an organization possesses the characteristics of a social club, it must be established that personal contact, commingling, and fellowship exist among members. Members must be bound together by a common objective of pleasure, recreation and other nonprofitable purposes [IRS Pub. No. 557; *see Keystone Auto. Club v. Commissioner (3d Cir. 1950) 181 F.2d 402, 405* ; *Rev. Rul. 69-527, 1969-2 C.B. 125*]. These elements should be indicated by provisions in the club's articles of organization or bylaws. Fellowship need not be present between each member and every other member of a club if fellowship constitutes a material part in the life of the organization. A statewide or nationwide organization that comprises individual members, but is divided into local groups, satisfies this requirement if fellowship constitutes a material part of the life of each group [*see Rev. Rul. 58-589, 1958-2 C.B. 266*]. An automobile club whose principal activity is rendering automobile services to its members does not qualify for exemption as a social club since there is no significant commingling of its members [*Rev. Rul. 69-635, 1969-2 C.B. 126*]. A luncheon club whose members study and discuss business issues but engage in only incidental social activities is not exempt [*Rev. Rul. 69-527, 1969-2 C.B. 125*].

Membership in a social club must be limited. Therefore, evidence should be submitted with the application for

exemption that there are limitations on admission to membership consistent with the character of the club. However, a social club will not be recognized as tax exempt if its charter, bylaws, or other governing instrument, or any written policy statement contains a provision that provides for discrimination against any person on the basis of race, color, or religion [*I.R.C. § 501(i)*; IRS Pub. No. 557]. However, the prohibition against discrimination on religious grounds does not apply to an auxiliary of an exempt *I.R.C. § 501(c)(8)* fraternal benefit society or to a club that in good faith limits its membership to members of a particular religion in order to further the teachings and principles of that religion, and not to exclude people on the grounds of race or color [*I.R.C. § 501(i)(1), (2)*; IRS Pub. No. 557].

In general, the exemption applies to social and recreation clubs that are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to the exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities [*Treas. Reg. § 1.501(c)(7)-1(a)*]. If a club engages in business, such as providing services, or selling real estate, timber, or other products or services, or if the organization makes its facilities available to the general public, the club will not qualify for exemption [*see Treas. Reg. § 1.501(c)(7)-1(b)*]. However, providing meals, refreshments, or services related to the exempt purposes to members, their dependents, or their guests will not cause denial of exemption [IRS Pub. No. 557].

An exempt social club may receive up to 35 percent of its gross receipts, including investment income, from sources outside of its membership without losing its tax-exempt status. Gross receipts are receipts from the normal and usual (traditionally conducted) activities of the club; unusual amounts of income, such as proceeds from the sale of a clubhouse, are not included in gross receipts or in applying the percentage limits. Of the 35 percent, not more than 15 percent of the gross receipts may be derived from the use of the club's facilities, services by the general public, or from other activities not furthering social or recreational purposes for members. If an organization has outside income that exceeds these limits, all the facts and circumstances will be taken into account in determining whether the organization will continue to qualify for exempt status [IRS Pub. No. 557; *see Rev. Proc. 71-17, 1971-1 C.B. 683*].

Donations to exempt social and recreational clubs are not deductible as charitable contributions on the donor's federal income tax return [IRS Pub. No. 557].

[h] Fraternal Beneficiary Societies

There are two types of fraternal societies:

- Fraternal societies exempt under *I.R.C. § 501(c)(8)*.
- Domestic fraternal societies exempt under *I.R.C. § 501(c)(10)*.

The primary distinction between the two is that *I.R.C. § 501(c)(8)* organizations provide for the payment of life, sick, accident, or other benefits to their members or their dependents, whereas *I.R.C. § 501(c)(10)* organizations do not provide these benefits but rather devote their earnings to fraternal, religious, or charitable purposes.

A fraternal beneficiary society, order, or association is exempt from taxation if its application and accompanying documents establish that the organization [*I.R.C. § 501(c)(8)*; IRS Pub. No. 557]

- Is a fraternal organization;
- Operates under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system; and
- Provides for the payment of life, sick, accident, or other benefits to the members of the society, order, or association or their dependents.

There is no requirement that either the fraternal features or the insurance features predominate so long as both features are present [*see Rev. Rul. 73-165, 1973-1 C.B. 224*]. The benefits must be limited to members and their dependents. If members are able to confer benefits to persons other than themselves and their dependents, the exemption will not be recognized. However, the organization can qualify for exemption if most but not all members are eligible for benefits if the benefits are paid from contributions or dues paid by those members [IRS Pub. No. 557].

A domestic fraternal beneficiary society, order, or association is exempt from taxation if its application and accompanying documents establish that the organization [IRS Pub. No. 557]

- Is a fraternal organization;
- Operates under the lodge system;
- Devotes its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes; and
- Does not provide for the payment of life, sick, accident, or other benefits to the members. The organization may arrange with insurance companies to provide optional insurance to its members without jeopardizing the exemption.

Operating under the lodge system means carrying on activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like [*Treas. Reg. § 1.501(c)(8)-1(a)*]. Fraternal orders that practice racial discrimination by excluding nonwhites are not entitled to exempt status under *I.R.C. § 501(c)(8)* [*see McGlotten v. Connally (D.D.C. 1972) 338 F. Supp. 448, 454-459]* .

Donations by individuals to domestic fraternal societies are deductible as charitable contributions only if used exclusively for religious, charitable, scientific, literary, educational, or preventing cruelty to children or animals purposes [IRS Pub. No. 557].

[i] Voluntary Employees' Beneficiary Associations

Voluntary employees' beneficiary associations, providing for the payment of life, sick, accident, or other benefits to their members, dependents or designated beneficiaries, qualify for exemption from federal income taxation if no part of the net earnings inures (other than through those payments) to the benefit of any private shareholder or individual [*I.R.C. § 501(c)(9)*]. The benefits may be provided directly by the association, or indirectly through paying premiums to the service provider. Benefits may be in the form of medical, clinical, or hospital services, transportation furnished for that care, or money payments [IRS Pub. No. 557; *see Treas. Reg. § 1.501(c)(9)-1(b)(3)*; *Rev. Rul. 82-148, 1982-2 C.B. 401*].

The voluntary nature of the association is demonstrated by evidence showing that an affirmative act is required on the part of the employee to become a member. Conversely, membership is involuntary if the designation as a member is due to employee status. An association is voluntary even if employees are required to be members as a condition of employment, but the member incurs no detriment as a result of that membership. However, an association is not a voluntary association if the employer unilaterally imposes membership in the association on the employees as a condition of their employment, and the employees incur a detriment (for example, in the form of payroll deductions) because of their membership [IRS Pub. No. 557]. An employer will not be deemed to have unilaterally imposed membership on the employee if the employer requires membership as the result of a collective bargaining agreement that validly requires membership in the association [*see Treas. Reg. § 1.501(c)(9)-1(b)(2)*].

The membership must consist of individuals who are employees and share an employment-related common bond. The common bond may be a common employer (or affiliated employers), coverage under one or more collective bargaining agreements, membership in a labor union, or membership in one or more locals of a national or international labor union. Exemption will not be barred merely because the membership of the association includes some individuals who are not employees, provided that they have an employment-related bond with the employee-members and 90 percent of total membership on one day of each quarter of the association's tax year consists of employees [IRS Pub. No. 557; *Treas. Reg. § 1.501(c)(9)-1(b)(1)(i)*; *see Rev. Proc. 82-46, 1982-2 C.B. 788*]. "Employees" include individuals who became entitled to membership because they are or were employees. An individual continues to qualify as an employee even though on a leave of absence or terminated because of retirement, disability, or layoff [IRS Pub. No. 557; *Treas. Reg. § 1.501(c)(9)-1(b)(1)(ii)*].

In general, an organization that is part of a plan is not exempt unless the plan meets certain nondiscrimination requirements. However, if the organization is part of a plan that is a collective bargaining agreement resulting from good faith bargaining, the plan need not meet these nondiscrimination requirements [IRS Pub. No. 557]. A plan meets the nondiscrimination requirements if both of the following are true:

- Each class of benefits under the plan is provided under a classification of employees that is set forth in the plan and does not discriminate in favor of highly compensated individuals.

- The benefits provided under each class of benefits do not discriminate in favor of highly compensated individuals.

It has been the position of the IRS that supplemental unemployment benefits to be paid by a trust, in accordance with the terms of a Supplemental Unemployment Benefit (SUB) Plan, may be considered as "other benefits" within the meaning of *I.R.C. § 501(c)(9)* [*see Rev. Rul. 82-148, 1982-2 C.B. 401*]. However, a special statutory classification has been established for SUB trusts [*see I.R.C. § 501(c)(17)*]. For discussion, see [l], *below*.

Donations by individuals to voluntary employees' benefits associations are not deductible as charitable contributions on the donor's federal income tax return [IRS Pub. No. 557].

[j] Local Benevolent Life Insurance Associations, Mutual Irrigation and Telephone Companies, and Like Organizations

Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, and like organizations must meet the requirements of *I.R.C. § 501(c)(12)* to be exempt from taxation. The organization (other than a benevolent life insurance association) must be organized and operated on a mutual or cooperative basis. The organization's income must be used solely to cover losses and expenses, with any excess being returned to members or retained for future losses and expenses. The organization must collect at least 85 percent of its income from members for the sole purpose of meeting losses and expenses, subject to certain exclusions and calculated on the basis of an annual accounting period [*I.R.C. § 501(c)(12)(A)*; IRS Pub. No. 557]. A "like organization" is an organization that performs services comparable to those performed by any of these associations [IRS Pub. No. 557; *Rev. Rul. 65-201, 1965-2 C.B. 170*].

A benevolent life insurance association's "purely local character" is established if the association shows that its activities are confined to a particular community, place, or district, without regard to political subdivisions. If the activities of an organization are limited only by the borders of a state, however, it cannot be considered to be purely local in character [*Treas. Reg. § 1.501(c)(12)-1(b)*]. A life insurance association that solicited business in four states and followed a policy of not refusing business from outside its authorized area was disqualified from exemption as lacking purely local character, even though less than 3 percent of its business resulted from nonlocal sources [*Huff-Cook. Mut. Burial Ass'n v. United States (W.D. Va. 1971) 327 F. Supp. 1209, 1213* ; *see Rev. Rul. 64-193, 1964-2 C.B. 151*]. A copy of each

type of policy issued by the organization should be included with the application for exemption. *I.R.C. § 501(c)(12)* organizations, other than benevolent life insurance associations, are associations of persons banded together to provide themselves a mutually desirable service approximately at cost and on a mutual basis. To maintain the mutual characteristic of democratic ownership and control, they must be so organized and operated that their members have the right to choose the management, to receive services substantially at cost, to receive a return of any excess of payments over losses and expenses, and to share in any assets on dissolution [*see New Jersey Auto. Club v. United States (Ct. Cl. 1960) 181 F. Supp. 259, 261 , cert. denied, 366 U.S. 964 (1961)* ; *see also* IRS Pub. No. 557]. The rights and interests of members in the savings of the organization must be determined in proportion to their business with the organization. On dissolution, gains from the sale of appreciated assets must be distributed to all persons who were members during the period the assets were owned by the organization, in proportion to the amount of business done during that period. The bylaws must not provide for forfeiture of a member's rights and interests on withdrawal or termination [*see Rev. Rul. 72-36, 1972-1 C.B. 151*].

Donations by individuals to these organizations are not deductible as charitable contributions on the donor's federal income tax return [IRS Pub. No. 557; *see I.R.C. § 170(c)*].

[k] Cemetery Companies

A cemetery company may be entitled to exemption if it is a nonprofit mutual cemetery company owned by and operated exclusively for the benefit of its lot owners who hold their lots for bona fide burial purposes and not for the purpose of resale [*I.R.C. § 501(c)(13)*; *Treas. Reg. § 1.501(c)(13)-1(a)*]. The fact that a mutual cemetery company limits its membership to a particular class of individuals, such as family members, does not affect its tax-exempt status as long as the other requirements are met [IRS Pub. No. 557; *see John D. Rockefeller Family Cemetery Corp. v. Commissioner (1974) 63 T.C. 355 , acq., 1977-2 C.B. 2*].

Any nonprofit cemetery corporation chartered solely for the purpose of the disposal of bodies by burial or cremation and not permitted by its charter (articles of incorporation) to engage in any business not necessarily incident to that purpose is exempt from income tax, provided that no part of its net earnings inures to the benefit of any private shareholder or individual [*I.R.C. § 501(c)(13)*; *see Rev. Rul. 71-300, 1971-2 C.B. 238*]. For example, operating a mortuary is not permitted [IRS Pub. No. 557]. However, the status of an exempt cemetery company is not adversely affected by the sale of monuments and markets, provided the sales proceeds are used for cemetery maintenance [*Rev. Rul. 72-17, 1972-1 C.B. 151*].

The organization's earning must be used only in one or more of the following ways [IRS Pub. No. 557]:

- To pay the ordinary and necessary expenses of operating, maintaining, and improving the cemetery or crematorium.

- To buy cemetery property.

- To create a fund that will provide a source of income for the perpetual care of the cemetery or a reasonable reserve for any ordinary or necessary purpose.

A cemetery company may issue common stock without jeopardizing its exemption if no dividends will be paid. Payment of dividends must be legally barred by the charter or by applicable state law. A cemetery company or crematorium will not be exempt if its issues preferred stock [IRS Pub. No. 557].

A perpetual care organization, including, for example, a trust organized to receive, maintain, and administer funds that it receives from a nonprofit tax-exempt cemetery pursuant to state law and contracts, may apply for recognition of exemption even though it does not own the land used for burial. However, the income from these funds must be devoted

exclusively to the perpetual care and maintenance of the nonprofit cemetery as a whole, and no part of the net earnings may inure to the benefit of any private shareholder or individual [IRS Pub. No. 557]. A perpetual care fund operated in connection with a profit-making cemetery is not entitled to exemption [*see Rev. Rul. 64-217, 1964-2 C.B. 153* ; *Rev. Rul. 58-190, 1958-1 C.B. 15*].

Donations to exempt cemetery companies, corporations chartered solely for burial purposes, and perpetual care funds (operated in connection with these exempt organizations) are deductible as charitable contributions on the donor's federal income tax return [*I.R.C. § 170(c)(5)*]. However, a donor may not deduct a contribution made for the perpetual care of a particular lot or crypt. Payments made to a cemetery company or a corporation as part of the purchase price of a burial lot or crypt, whether irrevocably dedicated to the perpetual care of the cemetery as a whole or earmarked for the care of a particular lot, are also not deductible. Neither an estate nor a gift tax deduction is available for a testamentary or inter vivos transfer for perpetual care to a nonprofit cemetery exempt unless the cemetery is owned by a religious organization [*see Rev. Rul. 67-170, 1967-1 C.B. 272* ; *see also I.R.C. §§ 2055(a), 2522(a)*].

[l] Supplemental Unemployment Benefit Trusts

A trust or trusts forming part of a plan providing solely for the payment of supplemental unemployment compensation benefits will be exempt from federal income taxation under the following circumstances [*I.R.C. § 501(c)(17)*; IRS Pub. No. 557]:

- The trust is a valid, existing trust under local law and is evidenced by an executed document. It must be part of a written plan established and maintained by an employer, the employees, or both the employer and the employees, providing solely for the payment of supplemental unemployment compensation benefits [*Treas. Reg. § 1.501(c)(17)-1(a)*].

- The benefits will be paid because of the employee's involuntary separation from employment resulting directly from a reduction-in-force, discontinuance of a plant or operation, or other similar condition [*I.R.C. § 501(c)(17)(D)*; *Treas. Reg. § 1.501(c)(17)-1(b)(1)(i)*].

- It is impossible under the plan (at any time before the satisfaction of all liabilities with respect to employees under the plan) for any part of the corpus or income to be used for, or diverted to, any purpose other than the providing of supplemental unemployment compensation benefits [*see Rev. Rul. 73-307, 1973-2 C.B. 186*].

- Neither the terms of the plan nor the actual payment of the discriminate in favor of the company's officers, stockholders, supervisors, or highly paid employees. A plan is not discriminatory merely because the benefits bear a uniform relationship to compensation or the rate of compensation.

Sickness and accident benefits (but not vacation, retirement, or death benefits) may be included if subordinate to the unemployment compensation benefits [*Treas. Reg. § 1.501(c)(17)-1(b)(1)(ii)*]. Whether sickness and accident benefits are subordinate to separation benefits is determined from all of the facts and circumstances [*Treas. Reg. § 1.501(c)(17)-1(b)(5)*]. Relocation benefits paid by a SUB trust to employees about to be separated involuntarily because of a plant force reduction are qualified benefits, as are payments to compensate employees partially for wages lost from a work-week reduction [*see Rev. Rul. 70-188, 1970-1 C.B. 133* ; *Rev. Rul. 70-189, 1970-1 C.B. 134*].

A conformed copy of the plan of which the trust is a part should be attached to the application.

Donations by individuals to supplemental unemployment compensation benefit trusts are not deductible as charitable contributions on the donor's federal income tax return [IRS Pub. No. 557].

[m] Veterans' Organizations

An organization or post of past or present members of the armed forces of the United States is exempt from income tax if it meets the following requirements [*I.R.C. § 501(c)(19)*; *Treas. Reg. § 1.501(c)(19)-1(a)(1), (b), (c)*]:

- The organization or post was organized in the United States or any of its possessions.

- At least 75 percent of the members are past or present members of the armed forces of the United States and at least 97.5 percent of the other members are cadets (only students in college or university ROTC programs or military academies) or spouses, widows, widowers, ancestors, or lineal descendants of past or present armed forces members or cadets.

- No part of the net earnings inure to the benefit of any private shareholder or individual.

- The post or organization is operated exclusively for one or more of the specified exempt purposes [*see Treas. Reg. § 1.501(c)(19)-1(c)*; *see also* IRS Pub. No. 557].

Examples of groups qualifying for this exemption are posts or auxiliaries of the American Legion, Veterans of Foreign Wars, and similar organizations.

An auxiliary unit or society of a veterans' organization and a trust or foundation for a veterans' organization may also be exempt, provided that the parent veterans' organization satisfies the requirements set forth above and either the auxiliary unit or society or the trust or foundation meets additional requirements imposed by regulation [*see Treas. Reg. § 1.501(c)(19)-1(a)(2), (d), (e)*; *see also* IRS Pub. No. 557].

Donations to veterans' organizations are deductible as charitable contributions on the donor's federal income tax return [*see I.R.C. § 170(c)(3)*], provided that at least 90 percent of the organization's membership must consist of war veterans [IRS Pub. No. 557].

[n] Public Inspection of IRS Form 1024

If an organization's application for *I.R.C. § 501(c)* exempt status is approved, the following documents will be open to public inspection in any district office and the national office of the IRS [*see I.R.C. § 6104*; *see also* IRS Form 1024, Instructions]:

- The organization's application Form 1024 and any supporting documents.

- Any letter or other document issued by the IRS with regard to the application.

However, information relating to a trade secret, patent, style or work, or apparatus, that, if released, would adversely affect the organization or the national defense, will not be made available for public inspection. Applicants must identify this information by clearly marking it "NOT SUBJECT TO PUBLIC INSPECTION" and attach a statement explaining why the organization requests that the information be withheld [*I.R.C. § 6104(a)(1)(D)*; Treas. Reg. § 301.6104-1(c)].

The exempt organization must make a copy of its approved application and supporting documents, as well as any letter or document issued by the IRS available for public inspection. The documents must be available during reasonable business hours at the organization's principal office and at each regional or district offices having at least three paid employees [*see* IRS Form 1024, Instructions; *see also 1988-2 C.B. 454, Notice 88-120*]. Monetary penalties may be assessed on a daily basis for failure to comply with these inspection requirements [IRS Form 1024, Instructions].

[o] Signature and Filing Requirements

An officer, a trustee authorized to sign, or another person authorized by a power of attorney must sign IRS Form 1024. If relied on, the power of attorney must be attached to the form [IRS Form 1024, Instructions; *see* IRS Form 2848 (power of attorney and declaration of representative)].

This form, together with the applicable fee and all other necessary applications, requests, and supporting documents, must be filed at the following address [*see* IRS Form 8718, Instructions; *see also § 13B.202*]:

Internal Revenue Service
P.O. Box 192
Covington, KY 41012-0192

If the application is submitted using express mail or a delivery service, the application must be sent to

Internal Revenue Service
201 West Rivercenter Blvd.
Attn: Extracting Stop 312
Covington, KY 41011

[2] FORM

Application for Recognition of Exemption Under I.R.C. § 501(a) [IRS Form 1024]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART IV. FORMS
A. Federal Forms

6-13B California Legal Forms--Transaction Guide § 13B.202

§ 13B.202 User Fee [IRS Form 8718]

[1] Comment--Use of Form

This form is the official IRS user fee form that must be attached to each application for a determination of exempt organization status [*see* [2], *below*; *see also §§ 13B.200, 13B.201*]. The form is available from local IRS offices, by telephone, or on the IRS website.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the Internal Revenue Service, which is located at http://www.irs.gov. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 3405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 13B.202. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

The form contains blanks for the organization's name and employer identification number. The form also sets forth the applicable filing fees, which vary depending on the actual or anticipated gross receipts of the organization. A check or money order payable to the IRS in the prescribed amount of the user fee must be attached to this form. If the full amount is not submitted, the application will be returned [*see* [2], *below*].

This form, together with the exemption determination letter request, along with all other necessary applications, requests, fee, and supporting documents, must be filed at the following address [*see* IRS Form 8718, Instructions; *see also* [2], *below*]:

Internal Revenue Service
P.O. Box 192
Covington, KY 41012-0192

New entities must file within 15 months after the end of the month of formation. An automatic one-year extension applies to applications for exempt status. In addition, the entity may request an additional extension [*see Rev. Proc. 92-85, 1992-2 C.B. 490* ; *Rev. Proc. 93-28, 1993-2 C.B. 344*].

[2] FORM

User Fee [IRS Form 8718]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART IV. FORMS
A. Federal Forms

6-13B California Legal Forms--Transaction Guide § 13B.203

§ 13B.203 Election and Revocation of Election by Eligible Organization to Make Expenditures to Influence Legislation [IRS Form 5768]

[1] Comment

[a] Use of Form

This form is IRS Form 5768, which is used to elect or revoke the election to make expenditures to influence legislation without losing tax-exempt status [*see I.R.C. § 501(h)*]. In general, if a substantial part of an otherwise exempt organization's activities consists of carrying on propaganda or otherwise attempting to influence legislation, the organization's tax exemption will be denied [*see I.R.C. § 501(c)(3)*; *Treas. Reg. § 1.501(c)(3)-1(b)(3), (c)(3)*]. However, certain public charities [*see* [b], *below*] may elect to replace the "substantial part of activities" test with a sliding-scale limitation defined in terms of monetary expenditures for influencing legislation [*see I.R.C. §§ 501(h), 4911*; *see also* IRS Pub. No. 557].

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the Internal Revenue Service, which is located at http://www.irs.gov. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 3405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 13B.203. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Recognizing the limitations of the "substantial part of activities" test on charities' involvement in public policy and legislative matters, Congress enacted *I.R.C. § 501(h)* and *I.R.C. § 4911* to permit charities to elect to have lobbying activities limited solely on the basis of lobbying expenditures [*see* [c], *below*]. Charities making this election can spend a considerable amount to influence legislation [*see* [d], *below*].

A new charity may file this form with its exemption application. However, the organization should attach a copy

because this form is filed at a different IRS address. The charity should keep a copy of Form 5768 with its tax records.

[b] Eligible Organizations

Most public charities [*see I.R.C. § 509(a)*; *see also I.R.C. § 170(b)(1)(A)(ii)-(vi)*; § 13B.20[7]] described in *I.R.C. § 501(c)(3)* are permitted to make this election [*I.R.C. § 501(c)(3), (h)(4)*]. However, the following organizations are not permitted to make the election [*I.R.C. § 501(h)(4), (5)*]:

- Churches, or conventions or associations of churches [*see I.R.C. § 170(b)(1)(A)(i)*].
- An integrated auxiliary of a church or of a convention or association of churches.
- A member of an affiliated group of organizations [*see I.R.C. § 4911(f)(2)*] if one or more members of such group is described in either of the preceding paragraphs.
- Organizations formed to do public safety testing [*see I.R.C. § 509(a)(4)*].
- Governmental units described in *I.R.C. § 170(b)(1)(a)(v)*.
- Private foundations [*see I.R.C. § 509*].

[c] Expenditures to Influence Legislation; Limits

A public charitable tax-exempt organization may replace the "substantial part of activities" test with a limit defined in terms of the entity's expenditures for influencing legislation [*see I.R.C. § 4911(d)* (definition of "influencing legislation")]. First, an electing entity determines its exempt purpose expenditures [*see I.R.C. § 4911(e)*] to determine what the entity may spend on lobbying. The lobbying limit for a year is 20 percent of the first $500,000 of the organization's exempt purpose expenditures for the year, plus 15 percent of the second $500,000, plus 10 percent of the third $500,000, plus 5 percent of any additional exempt purpose expenditures. However, in no event may the permitted level of expenditures exceed $1,000,000 [*I.R.C. § 4911(c)(2)*].

The term "exempt purpose expenditures" means the total of the amounts paid or incurred by an electing organization for a taxable year to accomplish its exempt purposes [*see I.R.C. § 170(c)(2)(B)*]. The term includes administrative expenses paid or incurred for the organization's exempt purposes, and amounts paid or incurred for the purpose of influencing legislation. The term excludes amounts paid or incurred to or for a separate fund-raising unit of the organization, or one or more other organizations, if those amounts are paid or incurred primarily for fund raising [*I.R.C. § 4911(e)(1)*].

Within the above-mentioned limits, a separate limitation is placed on grass roots lobbying expenditures [*see I.R.C. § 4911(c)(3)*]. The permitted level of grass roots expenditures (the "grass roots nontaxable amount") for a taxable year is 25 percent of the lobbying nontaxable amount [*I.R.C. § 4911(c)(4)*].

[d] Time and Manner of Election and Revocation

This form must be signed and postmarked within the first tax year for which it is to apply. The election is effective for all taxable years of the organization that end after the date of the election and begin before the date the election is revoked [*see* IRS Pub. No. 557]. Thus, an organization can, at any time before the end of the taxable year, elect the expenditures test for that taxable year. Once the election is made, it can be revoked only prospectively, that is, it cannot be revoked for a taxable year after that year has begun [*I.R.C. § 501(h)(6)*]. For any taxable year in which the election is not in effect, an organization is governed by the "substantial part of activities" test [*see I.R.C. § 501(h)(7)*].

If the form is used to revoke the election, it must be signed and postmarked before the first day of the tax year to which the revocation is to apply. A revocation is effective for the first tax year after the year in which the revocation was filed.

[e] Excise Tax on Excess Expenditures

If an electing public charity exceeds either the lobbying expenditures limitation or the grass roots expenditures limitation [*see I.R.C. § 4911(c)*; *see also* [c], *above*] for a taxable year, an excise tax of 25 percent of the excess lobbying expenditures will be imposed [*I.R.C. § 4911(a)(1)*; IRS Pub. No. 557]. Furthermore, if, for a taxable year, the organization's expenditures exceed both the lobbying and grass roots expenditures limitations, the 25 percent tax is imposed on whichever one of these excesses is the greater [*I.R.C. § 4911(b)*].

Eligible organizations that have made the election to be subject to the limitations on lobbying expenditures and that have an excise tax liability for excessive lobbying (or grass roots) expenditures (as computed in Part VII of Schedule A to IRS Form 990) for a taxable year are required to file an excise tax return on IRS Form 4720.

[f] Loss of Exempt Status

An electing public charity automatically loses its tax-exempt status if it normally (that is, on the average over a four-year period) makes "lobbying expenditures" in excess of 150 percent of the lobbying nontaxable amount (that is, the basic permitted level of lobbying expenditures) for the organization for each taxable year, or if it normally makes "grass roots expenditures" in excess of 150 percent of the grass roots nontaxable amount (that is, the basic permitted level of grass roots expenditures) [*see* [c], *above*] for the organization for each taxable year [*I.R.C. § 501(h)(1), (2)*]. "Lobbying expenditures" are any expenditures that are made for the purpose of influencing legislation [*see I.R.C. § 4911(d)*; *see also* IRS Pub. No. 557] and include expenditures for grass roots lobbying [*I.R.C. § 501(h)(2)(A)*]. The term "grass roots expenditures" refers only to expenditures that are made in attempting to affect the opinions of the general public or any segment thereof [*I.R.C. § 501(h)(2)(C)*]. If the charity loses its tax-exempt status, the charity cannot at any time thereafter become a social welfare organization under *I.R.C. § 501(c)(4)* [*see I.R.C. § 504(a)(2)*].

[2] FORM

Election and Revocation of Election by Eligible Organization to Make Expenditures to Influence Legislation [IRS Form 5768]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART IV. FORMS
A. Federal Forms

6-13B California Legal Forms--Transaction Guide §§ 13B.204-13B.209

[Reserved]

§§ 13B.204[Reserved]



192 of 192 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 13B TAX-EXEMPT STATUS FOR NONPROFIT ENTITIES
PART IV. FORMS
B. California Forms

6-13B California Legal Forms--Transaction Guide § 13B.210

§ 13B.210 Application for Recognition of Exemption [FTB Form 3500]

[1] Comment

[a] Use of Form

This form is the Franchise Tax Board's exemption application booklet. It consists of FTB Form 3500, accompanied by the Franchise Tax Board's official instructions. The booklet contains two copies of Form 3500, but for space considerations only one copy is reproduced here.

All organizations claiming exemption from California franchise and corporate income tax [*see Rev. & Tax. Code § 23701 et seq.*] must file their application for exemption using this form [*but see* [c], *below*]. The fact that an organization is exempt from federal income tax does not make it exempt from California franchise or income tax. An organization that is granted an exemption from California tax must apply separately for an exemption from federal tax unless the organization is covered under a federal group ruling [*see Treas. Reg. § 601.201(n)(8)*].

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Franchise Tax Board, "Tax Forms, Instructions and Publications" page, which is located at http://www.ftb.ca.gov/forms/index.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 3405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 13B.210. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Because California and federal laws are substantially similar, the Franchise Tax Board recommends that organizations obtain exemption forms and draft articles for both the state and federal applications at the same time. In some cases, California requires that the organization obtain a federal determination of tax-exempt status before California will issue a state exemption determination letter [FTB Form 3500, Instructions; *see* [b], *below*].

An organization that has been determined to be exempt by the Franchise Tax Board may rely on that determination as long as there are no substantial changes in the law or the organization's charter, purposes, or method of operation [*18 Cal. Code Reg. § 23701(a)(z)*]. However, an organization's exempt status may be revoked for improperly using accumulations of income [*see Rev. & Tax. Code § 23737*]; engaging in certain prohibited transactions [see *Rev. & Tax. Code §§ 23736-23736.4*]; or failing to file required reports, returns, or statements [*see Rev. & Tax. Code §§ 23703, 23775* (authorizing suspension or forfeiture of corporate powers and rights), 23777; *see also §§ 13B.42, 13B.70* et seq.].

[b] Application and Attachments

Organizations that are organized and operated for nonprofit purposes within the provisions of a specific exempt category [*see Rev. & Tax. Code § 23701a et seq.*], or that are subject to *Rev. & Tax. Code § 23701h* or *23701x* (relating to certain title-holding companies), are exempt from state franchise and corporate income taxes if all of the following criteria are satisfied [*Rev. & Tax. Code § 23701*]:

- FTB Form 3500, properly completed and executed, is submitted to the Franchise Tax Board.
- The applicable filing fee is paid with each application for exemption.
- The Franchise Tax Board issues a determination exempting the organization from tax.

If the IRS has already recognized an organization's exempt status for federal income tax purposes, a copy of the favorable determination letter issued by the IRS should be attached to FTB Form 3500 [*18 Cal. Code Reg. § 23701(b)(3)*; *see* FTB Form 3500, Instructions]. A trust must furnish a copy of the federal determination letter with the California application before state exemption will be granted. If the trust has not applied for a federal exemption, it should do so; the trust should then attach a statement to FTB Form 3500 stating when the federal application was submitted [FTB Form 3500, Instructions].

The following documents, as applicable, must be submitted with FTB Form 3500 [*see* FTB Form 3500 and Instructions]:

- A copy of the charter document. Corporations file an endorsed copy of the articles of incorporation and all subsequent endorsed amendments. Unincorporated associations file a copy of the constitution, articles of association, bylaws, or other document containing the appropriate language for exemption, signed by the governing body. Trusts file a copy of the trust document and any subsequent modifications.
- A copy of the bylaws, proposed bylaws, or other code of regulations.
- Financial statements. If the organization is operating, furnish complete statements showing receipts, expenditures, assets, and liabilities for each accounting period for which the organization has been in existence and for which exemption is sought. If the organization has not begun operations, furnish a proposed budget showing the sources of income and areas of expenditures for the first year of operation. The budget should be based on reasonable expectations.
- A statement describing the specific purposes for which the organization was formed. A general nonprofit purpose is not acceptable.
- A statement describing in detail the programs and activities that the organization presently conducts or will conduct and how the organization will accomplish its specific purposes.

- A statement describing in detail each type or source of funding, each fund-raising activity, and each business enterprise in which the organization has engaged or plans to engage. Copies of any agreements for the conduct of each fund-raising activity and business enterprise must be submitted.

- A statement that fully explains any discontinued specific activities that the organization engaged in or sponsored, including dates of commencement and termination and the reason for discontinuance.

- A copy of any lease in which the organization is the lessee or lessor, or in which an interest is owned under the lease, together with copies of any agreements with other parties for development of the property.

- Samples of any literature that the organization sells or distributes and samples of organizational advertising.

In addition, specific requirements apply to the individual types of organizations claiming exemption [*see* FTB Form 3500, items 8-25]. The failure to provide all required documentation may delay the determination of exempt status or result in the denial of exemption [FTB Form 3500, Instructions]. If the application and supporting documents are complete and the organization qualifies for exemption, the FTB will mail a state determination exemption letter to the organization.

Overall, the exemption package must show the character of the organization, the purpose for which it was organized, its actual and proposed activities, the sources and disposition of its income and receipts, whether or not any of its income or receipts is credited to surplus or may inure to the benefit of any private shareholder or individual, and, in general, all facts relating to its operations that may affect its right to exemption.

[c] Exceptions From Filing FTB Form 3500

Notwithstanding *Rev. & Tax. Code § 23701(a)-(c)* (exemption application requirements), an organization organized and operated in accordance with *Rev. & Tax. Code § 23701d* is exempted from California income taxation (except as provided in *Rev. & Tax Code §§ 23701 et seq.* or *23731 et seq.*) upon submitting to the FTB one of the following [*Rev. & Tax. Code § 23701d(c)(1)*]:

- A copy of a determination letter or ruling issued by the I.R.S. recognizing the organization's exemption from federal income tax under *I.R.C. § 501(a)* as organization described in *I.R.C. § 501(c)(3)*.

- A copy of a group exemption letter issued by the I.R.S. that states that both the central organization and all subordinates are tax-exempt under *I.R.C. § 501(c)(3)*, and substantiation that the organization is included in the federal group exemption letter as a subordinate organization.

Upon receipt, the F.T.B. will issue an acknowledgment that the organization is exempt from California income tax. The acknowledgment may refer to the organization's recognition by the I.R.S. of exemption from federal income tax as an organization under *I.R.C. § 501(c)(3)*, and if applicable, the organization's subordinate organization status under a federal group exemption letter [*Rev. & Tax. Code § 23701d(c)(2)*].

The effective date of an organization's exemption from state income tax for state purposes is no later than the effective date of the organization's recognition of exemption from federal income tax under *I.R.C. § 501(c)(3)*, or its status as a subordinate organization under a federal group exemption letter, as applicable [*Rev. & Tax. Code § 23701d(c)(2)*].

This exception from the FTB application requirement is intended to streamline the process of obtaining tax-exempt status for California income tax purposes [*see* stats. 2008, ch. 238, § 3]. If for federal income tax purposes, an

organization's exemption under *I.R.C. § 501(c)(3)* is suspended or revoked, the organization must notify the FTB of that suspension or revocation in the form and manner prescribed by the FTB. Upon notification, the FTB will suspend or revoke the organization's exemption granted under *Rev. & Tax. Code § 23701d(c)(1)* for state income tax purposes [*Rev. & Tax. Code § 23701d(c)(3)*].

These provisions will not be construed to prevent the F.T.B. from revoking the exemption of an organization that is not organized or operated in accordance with the Revenue and Taxation Code or *I.R.C. § 501(c)(3)* [*Rev. & Tax. Code § 23701d(c)(4)*]. If the F.T.B. suspends or revokes the exemption of an organization pursuant to *Rev. & Tax. Code § 23701d(c)(3)* or *(4)*, the exemption will be reinstated only upon compliance with *Rev. & Tax. Code § 23701*, regardless of whether the organization can establish exemption under *Rev. & Tax. Code § 23701d(c)(1)* [*Rev. & Tax. Code § 23701d(c)(5)*].

A political organization meeting the requirements of *Rev. & Tax. Code § 23701r* is not required to file FTB Form 3500. However, the organization must obtain a letter from the Board certifying tax-exempt status if the organization wants to incorporate. To obtain a letter certifying exemption, the organization must submit a written request to the FTB's Exempt Organizations Section describing the organization's activities [FTB Form 3500, Instructions].

Individual Retirement Accounts established in accordance with the requirements of *Rev. & Tax. Code § 23712*, educational IRAs that fund higher education costs, are exempt from taxation. People establishing education IRAs are not required to file FTB Form 3500. However, if unrelated business income in excess of $1,000 is received, FTB Form 109, California Exempt Organization Business Income Tax Return must be filed [*see* FTB Form 3500, Instructions; *see also § 13B.132*].

[d] Signature and Filing Requirements

Form FTB 3500 must have an original signature of an authorized individual, such as an elected officer, director, trustee, or other authorized representative [FTB Form 3500, Instructions]. The signature is made under penalty of perjury.

If the organization seeking exemption is already incorporated, the exemption package, including a check for the fee payable to the Franchise Tax Board, must be mailed to the following address [FTB Form 3500, Instructions]:

Exempt Organizations Section
Franchise Tax Board
P.O. Box 942857
Sacramento CA 94257-4041

To allow adequate time for processing, the application for exemption should be submitted at least 90 calendar days before the exemption is needed [FTB Form 3500, Instructions].

If the organization plans to incorporate but is not incorporated, the organization must first incorporate and then follow the regular application procedures [FTB Form 3500, Instructions; *see* Ch. 13, *Nonprofit Corporations*].

If the organization is a foreign corporation that has already qualified to do business in California with the Secretary of State, the regular application procedures apply. If the foreign corporation has not yet qualified in California, the organization must first qualify to do business and then follow the regular application procedures [FTB Form 3500, Instructions; *see* Chs. 12B, *Foreign Corporations* ; Ch 13, *Nonprofit Corporations*].

[e] Group Exemption Application

A parent organization desiring group exemption for its California unincorporated subordinates must first establish its

own exempt status. The parent may then file a separate FTB Form 3500 for a group exemption by completing side 1 of FTB Form 3500 and writing "Group Exemption" in red in the top margin of the form. The exemption package must include the following [FTB Form 3500, Instructions]:

- A cover letter stating that the subordinates are affiliated and are subject to the parent's general supervision and control.
- A sample copy of a uniform charter.
- An affirmation that the subordinates are operating in accordance with their stated purposes.
- A statement that the subordinates have furnished written authorization to be included with the group exemption application.
- A list of California subordinates, any organization numbers, and current addresses.

[f] Retroactivity of Exemption

Exempt status may be granted for years before approval of the exemption application. However, retroactive exempt status only applies to the extent that the organization establishes that it was organized and operated for exempt purposes during each of those prior years [FTB Form 3500, Instructions]. No claim for refund will be allowed unless made in a timely manner [*18 Cal. Code Reg. § 23701(b)(4)*; *see Rev. & Tax. Code § 19306* (claim for refund)].

[g] Public Inspection

If an organization is exempt from California taxation for any taxable year, the application filed with respect to that exemption, together with any papers submitted in support of the application and any letter or other document issued by the Franchise Tax Board with respect to the application, will be open to public inspection. After the application of any organization has been opened to public inspection, the Franchise Tax Board must, on the request of any person, furnish a statement indicating the section under which exemption has been granted [*Rev. & Tax. Code § 26451.3(a)*]. Application for inspection of materials relating to an organization's exemption application may be made on FTB Form 3510.

On the request of the applicant, the Franchise Tax Board will withhold from public inspection any information relating to any trade secret, patent, process, style of work, or apparatus of the organization if the Board determines that public disclosure of that information would adversely affect the organization. The Franchise Tax Board may also withhold any information contained in supporting papers submitted with an application from public inspection if it determines that public disclosure would adversely affect the national defense [*Rev. & Tax. Code § 26451.3(b)*].

[2] FORM

Application for Recognition of Exemption [FTB Form 3500]

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1 of 103 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS

7-14 California Legal Forms--Transaction Guide 14.syn

§ 14.syn Synopsis to Chapter 14: CONSUMER COOPERATIVE CORPORATIONS

§ 14.01 California Statutes

§ 14.02 Federal Statutes

§ 14.03 California Regulations

§ 14.04 Federal Regulations

§§ 14.05-14.19 [Reserved]

§ 14.20 Law Reviews

§ 14.21 Text References

[1] Related Forms With Tax Analysis

[2] Related California Forms

[3] Additional Text References

§§ 14.22-14.29 [Reserved]

§ 14.30 Nature of Consumer Co-ops

§ 14.31 Formation

[1] Filing Articles of Incorporation

[2] Changing Status of Unincorporated Association

§ 14.32 Corporate Name

[1] Requirements

[2] Prohibitions

§ 14.33 Members of Corporation

[1] In General

[2] Issuance of Memberships

[3] Right to Disclosure Document

[4] Transfer of Memberships

[5] Dues, Assessments, and Fees

[6] Memberships Exempt From Securities Qualification

[7] Liability of Members

[8] Termination of Membership

§ 14.34 Meetings of Members

[1] Regular and Special

[2] Notice of Meetings

[3] Quorum

[4] Adjournment

[5] Use of Written Ballots at Meetings

§ 14.35 Action by Written Ballot Without Meeting

[1] In General

[2] Ballot Requirements

§ 14.36 Voting of Memberships

[1] One Vote Rule

[2] Record Date

[3] Cumulative Voting and Voting by Proxy

§ 14.37 Inspectors of Election

[1] Appointment

[2] Duties

§ 14.38 Directors

[1] Term of Office

[2] Election of Directors

[3] Election by Written Ballot

[4] Designation or Selection

[5] Appointment by Court

[6] Resignation of Directors

§ 14.39 Removal of Directors

[1] In General

[2] Removal of Director Elected by Class

[3] Removal of Designated Director

[4] Removal by the Superior Court

§ 14.40 Vacancies on the Board

§ 14.41 Meetings of the Board

[1] Call, Place, and Presence

[2] Notice

[3] Quorum

[4] Adjournment

[5] Action Without Meeting

§ 14.42 Executive Committees

[1] Creation and Appointment

[2] Authority of Committees

§ 14.43 Officers

§ 14.44 Corporate Records and Reports

[1] Required Records

[2] Annual Report

[3] Annual Statement of Transactions and Indemnifications

§ 14.45 Inspection Rights

[1] Articles and Bylaws

[2] Books and Records

§ 14.46 Demand for Membership List

[1] Procedure

[2] Entitlement

[3] Alternative Method

§ 14.47 Distributions

§ 14.48 Federal Income Taxation

[1] In General

[2] Deduction of Patronage Dividends

[3] Netting of Patronage Gains and Losses

§ 14.49 State Income Taxation

§ 14.50 Dissolution

[1] Voluntary

[2] Involuntary

§§ 14.51-14.99 [Reserved]

§ 14.100 Facts

Scope

§ 14.101 Documents

Scope

§§ 14.102-14.119 [Reserved]

§ 14.120 Rights of Members

Scope

§ 14.121 Management

Scope

§§ 14.122-14.139 [Reserved]

§ 14.140 Selecting and Reserving Corporate Name

Scope

§ 14.141 Drafting and Filing Articles of Incorporation

Scope

§ 14.142 Holding First Meeting of Directors

Scope

§ 14.143 Drafting Bylaws

Scope

§§ 14.144-14.159 [Reserved]

§ 14.160 Issuing Memberships

Scope

§ 14.161 Filing Annual Statement

Scope

§ 14.162 Preparing Annual Report

Scope

§ 14.163 Correcting Errors or Defects in Filed Instruments

Scope

§ 14.164 Amending Articles of Incorporation

Scope

§ 14.165 Federal Income Tax Procedures

Scope

§ 14.166 State Income Tax Procedures

Scope

§§ 14.167-14.199 [Reserved]

§ 14.200 Articles of Incorporation for Consumer Cooperative Corporation

[1] Comment

[a] Use of Form

[b] Required Provisions--Corporate Name

[i] Corporate Purpose

[ii] Initial Agent for Service of Process

[iii] Voting Power and Proprietary Interests

[iv] Members' Interest in Corporation

[c] Optional Provisions

[i] Duration of Existence and Distribution of Assets

[ii] Management

[iii] Transfer of Memberships

[iv] Memberships Issued for Consideration

[v] Classes of Members

[vi] Statement of Purpose

[d] Execution and Filing of Articles

[e] Incorporating an Unincorporated Association

[f] Inspection Rights of Members

[g] Amendment of Articles

[2] FORM

Articles of Incorporation for Consumer Cooperative Corporation

§§ 14.201-14.219 [Reserved]

§ 14.220 Verified Statement of Approval to Incorporate Unincorporated Association

[1] Comment

[a] Use of Form

[b] Verification Requirements

[2] FORM

Verified Statement of Approval to Incorporate Unincorporated Association

§ 14.221 Certificate of Amendment of Articles of Incorporation

[1] Comment

[a] Use of Form

[b] Permissible Amendments--In General

[i] Extending Term of Existence

[ii] Changing Status of Co-Op

[c] Approval Requirements

[i] Incorporators

[ii] Board and Members

[iii] Class Members

[iv] Approval Requirements in Articles

[d] Certificate of Amendment

[i] Contents

[ii] Wording of Amendment

[e] Restated Articles of Incorporation

[f] Verification

[g] Filing Fees

[2] FORM

Certificate of Amendment of Articles of Incorporation

§§ 14.222-14.239 [Reserved]

§ 14.240 Bylaws for Consumer Cooperative Cooperation

[1] Comment

[a] Use of Form

[b] Adoption of Bylaws--By the Board

[i] By Approval of the Members

[c] Required Bylaw Provisions

[i] In General

[ii] Member's Share of Capital

[iii] Valuation of Member's Interest

[d] Optional Bylaw Provisions

[i] In General

[ii] Members and Memberships

[iii] Education

[iv] Delegates

[v] Voting

[vi] Transfer Provision

[e] Patronage Distributions

[f] Inspection of Bylaws

[2] FORM

Bylaws for Consumer Cooperative Cooperation

§§ 14.241-14.259 [Reserved]

§ 14.260 Disclosure Statement

[1] Comment

[a] Use of Form

[b] Issuance of Disclosure Document--In General

[i] Required Provisions

[ii] Alternative Statement

[c] Disclosure in Membership Certificates

[i] Requirements

[ii] Issuance of New Certificates

[2] FORM

Disclosure Statement



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS

7-14 California Legal Forms--Transaction Guide Scope

Scope

Scope

This Part covers the formation of consumer cooperative corporations ("consumer co-ops") pursuant to the Consumer Cooperative Corporation Law [*Corp. Code §§ 12200-12704*]. The Legal Background discusses the nature and formation of a consumer cooperative corporation, and includes a discussion of its tax status. The Transaction Guide presents a procedural approach to formation of a consumer co-op. The forms include articles, bylaws, and other forms related to the formation of consumer cooperatives.

Nonprofit agricultural cooperatives are covered in Ch. 14A, *Agricultural Nonprofit Cooperative Associations* . For a detailed discussion of other nonprofit organizations, see Ch. 13, *Nonprofit Corporations* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

7-14 California Legal Forms--Transaction Guide § 14.01

§ 14.01 California Statutes

Nonprofit Mutual Benefit Corporation Law. *Corp. Code §§ 7110-8910*.

Consumer Cooperative Corporation Law. *Corp. Code §§ 12200-12704*.
Provisions and definitions. *Corp. Code §§ 12200-12256*.
Corporate formation. *Corp. Code §§ 12300-12302*.
Articles of incorporation. *Corp. Code §§ 12310-12316*.
Corporate powers. *Corp. Code §§ 12320, 12321*.
Bylaws. *Corp. Code §§ 12330-12340*.
Directors and management. *Corp. Code §§ 12350-12377*.
Members. *Corp. Code §§ 12400-12445*.
Corporate distributions. *Corp. Code §§ 12450-12454*.
Meetings and voting. *Corp. Code §§ 12460-12490*.
Derivative actions by members. *Corp. Code § 12490*.
Amendment of articles of incorporation. *Corp. Code §§ 12500-12510*.
Sales of assets. *Corp. Code §§ 12520-12522*.
Mergers and effect on corporate rights, liabilities, and property. *Corp. Code §§ 12530-12540*.
Bankruptcy of cooperative corporations governed by General Corporation Law. *Corp. Code § 12560*.
Required filings by corporation. *Corp. Code §§ 12570-12576*.
Records, reports, and inspection rights. *Corp. Code §§ 12580-12608*.
Service of process on corporation. *Corp. Code § 12610*.
Dissolution of corporation. *Corp. Code §§ 12620-12663*.
Crimes and penalties involving corporation or management. *Corp. Code §§ 12670-12679*.

Memberships exempt from securities qualification when aggregate investment of member less than $300. *Corp. Code § 25100(r)*.

Deduction for income from business, other than sale of personal property, with members. *Rev. & Tax. Code § 24405*.

Deduction for patronage refunds paid by corporation selling personal property. *Rev. & Tax. Code § 24406*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

7-14 California Legal Forms--Transaction Guide § 14.02

§ 14.02 Federal Statutes

Application of cooperative tax laws to consumer corporations. *I.R.C. § 1381(a)(2)*.

Deduction for patronage dividends. *I.R.C. § 1382(b)*.

Tax treatment of cooperatives' patrons. *I.R.C. § 1385*.

Patronage dividends and per-unit retain allocations defined. *I.R.C. § 1388*.

Required filing of annual return disclosing patronage dividends. *I.R.C. § 6044*.

Annual federal income tax return filing requirements. *I.R.C. § 6072(b), (d)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

7-14 California Legal Forms--Transaction Guide § 14.03

§ 14.03 California Regulations

Tax deduction for income arising from business done with members or nonprofit income from nonmembers. *18 Cal. Code Reg. §§ 24404, 24405*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

7-14 California Legal Forms--Transaction Guide § 14.04

§ 14.04 Federal Regulations

Federal income tax forms.
Annual tax return. *Treas. Reg. § 1.6012-2(a)(3)*.
Annual information return disclosing patronage dividends. *Treas. Reg. § 1.6044-2(a)*.
Application for exemption from filing information return. *Treas. Reg. § 1.6044-4(b)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

7-14 California Legal Forms--Transaction Guide §§ 14.05-14.19

[Reserved]

§§ 14.05[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

7-14 California Legal Forms--Transaction Guide § 14.20

§ 14.20 Law Reviews

Englebrecht, "Review and Analysis of the Tax Effects of Distributions Affecting Cooperatives and Their Patrons," *60 Taxes 558 (1982)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

7-14 California Legal Forms--Transaction Guide § 14.21

§ 14.21 Text References

[1] Related Forms With Tax Analysis

Rabkin & Johnson, Current Legal Forms, Ch. 2A, *Joint Ventures, Business Trusts and Associations*, Form 2A.39 (bylaws of cooperative).

[2] Related California Forms

California Legal Forms (Matthew Bender)
Ch. 2, *Preincorporation Planning*.
Ch. 3, *Articles of Incorporation*.
Ch. 4, *Bylaws*.
Ch. 5, *Directors' Meetings, Actions, and Resolutions*.
Ch. 8A, *Shareholders' Meetings, Voting, and Agreements*.
Ch. 10, *Amendment of Articles*.
Ch. 12, *Winding Up and Dissolution*.
Ch. 13, *Nonprofit Corporations*, §§ 13.210, 13.212 (mutual benefit corporation articles and bylaws).

[3] Additional Text References

Ballantine & Sterling, California Corporations Laws, Vol. 1B, §§ 432-441.02.

Rabkin & Johnson, Federal Income Gift and Estate Taxation, Vol. 3, § 21.07.

Mertens, *Law of Federal Income Taxation* (Callaghan & Co. 1975), Vol. 6, Ch. 34A, *Cooperatives and Their Patrons*.

7 Cal. Jur 3d, *Associations and Clubs*, §§ 57, 58.

18 Am. Jur. 2d, "Cooperative Associations."



10 of 103 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

7-14 California Legal Forms--Transaction Guide §§ 14.22-14.29

[Reserved]

§§ 14.22[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.30

§ 14.30 Nature of Consumer Co-ops

A consumer co-op may be formed for any lawful purpose, provided that it is organized and conducts its business primarily for the mutual benefit of its members as patrons of the corporation [*Corp. Code § 12201*]. If the co-op is organized to provide goods or services to its members, its "patrons" are those who purchase those types of goods from, or use those types of service of, the corporation. If it is organized to market, process, or otherwise handle its members' products or services, its "patrons" are those persons whose products or services are marketed, processed, or handled by the co-op [*Corp. Code § 12243*]. Although these organizations are termed "consumer cooperatives" [*see Corp. Code § 12200*], there is no requirement that their members must actually be "consumers."

Consumer co-ops are democratically controlled and are not organized to make a profit for themselves or for their members. Rather, they are operated primarily for the mutual benefit of their members as patrons [*Corp. Code § 12201*]. The earnings, savings, or benefits of the co-op must be used for the general welfare of the members, or must be proportionately and equitably distributed to some or all of its members or patrons, based upon patronage in the form of cash, property, evidences of indebtedness, capital credits, memberships, or services [*Corp. Code § 12201*; *see § 14.47*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.31

§ 14.31 Formation

[1] Filing Articles of Incorporation

One or more persons may form a consumer co-op by executing and filing articles of incorporation with the Secretary of State [*Corp. Code § 12300(a)*]. Corporate existence begins upon the filing of the articles and continues perpetually unless otherwise provided in the articles or by law [*Corp. Code § 12300(c)*]. A certified copy of the articles is conclusive evidence of the formation of the co-op and prima facie evidence of its corporate existence [*Corp. Code § 12315*].

The articles must state the name of the co-op, the fact that it is a cooperative corporation organized under the Consumer Cooperative Corporation law [*Corp. Code §§ 12200-12704*], the co-op's purposes, the name and address of the initial agent for service of process, and whether or not the voting power or proprietary interests of the members are equal or unequal [*Corp. Code § 12310*]. When initial directors are named in the articles, each named director must sign and acknowledge the articles. When no initial directors are named, the person or persons who will file the articles must sign them, thereby becoming the incorporators of the co-op [*Corp. Code § 12300(b)*].

The incorporators may do whatever is necessary and proper to perfect the organization of the co-op, including the adoption and amendment of bylaws and the election of directors and officers, until the directors are elected [*Corp. Code § 12316*].

[2] Changing Status of Unincorporated Association

An unincorporated association may change its status to a consumer co-op on a proper authorization by the association in accordance with its rules and procedures [*Corp. Code § 12301(a)*]. The articles of incorporation must indicate, in addition to other required provisions [*see Corp. Code § 12310*], that an existing unincorporated association is being incorporated by the filing of the articles [*Corp. Code § 12301(b)*]. The articles must be accompanied by a verified statement of any two officers or governing board members of the association stating that the incorporation of the association by means of the articles has been approved by the association in accordance with its rules and procedures [*Corp. Code § 12301(c)*].

When an unincorporated association changes its status by filing articles of incorporation, the property of the association becomes the property of the corporation. The members of the association who have the right to vote in elections of directors [*see Corp. Code § 12238*] become members of the corporation [*Corp. Code § 12301(d)*]. All rights of creditors and all liens upon the property of the association will be preserved unimpaired. Any action or proceeding pending by or against the unincorporated association may be prosecuted to judgment, which will bind the corporation, or the corporation may be proceeded against or substituted in its place [*Corp. Code § 12301(f)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.32

§ 14.32 Corporate Name

[1] Requirements

A consumer co-op must include the word "cooperative" in its name [*Corp. Code § 12311(a)*]. In addition, it must affix or prefix some word or abbreviation to its name to indicate that it is a corporation, as distinguished from a natural person, a firm, or an unincorporated association [*Corp. Code § 12311(a)*].

[2] Prohibitions

The Secretary of State will not file articles if the words "bank," "trust," "trustee," or related words appear in the name of the co-op, unless a certificate of approval of the Commissioner of Financial Institutions is attached to the articles [*Corp. Code § 12302(a)*]. In addition, the Secretary of State will not file articles which set forth a name that is likely to mislead the public, or that is the same as or resembles so closely so as to tend to deceive the name of another corporation which has its name on file in California. However, the new consumer co-op may adopt a name substantially similar to that of an existing corporation upon proof of consent by the existing corporation and a finding by the Secretary of State that under the circumstances the public is not likely to be misled [*Corp. Code § 12302(b)*]. A corporation may be enjoined from using these prohibited names, even after the filing of the articles with the Secretary of State [*Corp. Code § 12302(c)*].

If a corporation is organized by a person who was or is an officer, director, or member of an unincorporated association that remains unincorporated, the new corporation may not use a name that is the same as or similar to the unincorporated association. The unincorporated association may continue to use its name [*Corp. Code § 12301(g)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporate NamesRequirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.33

§ 14.33 Members of Corporation

[1] In General

Consumer co-ops are structured on a membership rather than a stock system. A "member" is any person who, pursuant to a specific provision of the articles or bylaws, has the right to vote for the election of directors or possesses proprietary interests in the co-op [*Corp. Code § 12238(a)*]. A "membership" refers to the rights a member has pursuant to the articles and bylaws and by law [*Corp. Code § 12239*]. Except as provided in the articles or bylaws, a corporation may admit any person other than its subsidiary to membership [*Corp. Code § 12403(a)*; *see Corp. Code § 12403(b)* (prohibition against admission of subsidiary)]. A "person" includes any association, company, domestic or foreign corporation, corporation sole, estate, individual, joint stock company, joint venture, partnership, domestic or foreign limited liability company, government or political subdivision, agency or instrumentality of a government [*Corp. Code § 12245*].

The articles or bylaws may confer some or all of the rights of a member upon persons who do not have voting rights [*Corp. Code § 12238(b)*]. If a member is not a natural person, that member may give written authorization to one or more natural persons to vote on its behalf [*Corp. Code § 12238(c)*]. A person is not a member by virtue of any rights held as a delegate or director, or by virtue of any rights to designate or select directors [*Corp. Code § 12238(d)*].

[2] Issuance of Memberships

A co-op may issue memberships for consideration or without consideration, as provided in the articles or bylaws [*Corp. Code § 12400*]. If a membership is purchased for consideration, the co-op must provide the purchaser with a disclosure document [*Corp. Code § 12401(b)*; *see* discussion in *§ 14.33[3]*] and must issue a membership certificate, receipt, or written advice of purchase to anyone purchasing a membership upon the member's first purchase of a membership of any class [*Corp. Code § 12401(e)*]. Otherwise, the co-op may issue membership certificates, but is not required to do so. If issued, a membership certificate must contain the same mandatory information regarding membership rights and restrictions that must be contained in a disclosure document [*see Corp. Code § 12401(a)*].

The corporate articles or bylaws may provide for issuance of memberships having different rights, privileges, preferences, restrictions, or conditions [*Corp. Code § 12420*]. Otherwise, all memberships will have the same rights and

restrictions [*Corp. Code § 12421*].

[3] Right to Disclosure Document

Prior to issuing a membership, the co-op must provide the purchaser of a membership with a disclosure document. Since the statutory requirement applies only to "purchasers," no disclosure document need be provided to persons who do not purchase a membership for consideration. The document may be a prospectus, offering circular, brochure or similar document, a specimen copy of the membership certificate, or a receipt that the co-op proposes to issue [*Corp. Code § 12401(b)*].

The disclosure document must contain a statement that the co-op is a cooperative corporation, and a statement that a copy of the articles and bylaws will be furnished free of charge to a member or prospective member upon written request. The statement must include the address of the office of the co-op and the address to which a written request should be directed [*see Corp. Code § 12401(b)(1), (2)*].

The statement must include information regarding any transfer restrictions, any rights of the co-op to levy dues, any services that members are required to contribute, whether the membership is redeemable, and whether the voting power or proprietary interests of the members is equal or unequal [*Corp. Code § 12401(b)(3)-(7)*]. The document may either set forth this information verbatim or state that it will be provided free of charge to a member or prospective member upon written request, and include the address of the office of the co-op and the address to which the request should be directed [*Corp. Code § 12401(b)(8)*]. For an example of a disclosure document, see *§ 14.260*.

[4] Transfer of Memberships

The co-op's bylaws may provide for or authorize the board to provide for the transfer of memberships, or of memberships within a class or classes. Transfer provisions may be made with or without restrictions or limitations, including transfer upon the death, dissolution, merger, or reorganization of a member [*Corp. Code § 12410(b)*]. When transfer rights are provided, no restriction of those rights will be binding on memberships issued prior to the adoption of the restriction, unless the membership holders voted in favor of the restriction [*Corp. Code § 12410(c)*].

Unless the articles or bylaws provide otherwise, no member may transfer a membership or any right arising from it, and all membership rights will terminate upon the death of the member or dissolution of the co-op or a member that is a business entity [*Corp. Code § 12410(a)*].

[5] Dues, Assessments, and Fees

The co-op may levy dues, assessments, or fees on its members pursuant to bylaw or article provisions. A member, on learning of them, may avoid liability by promptly resigning from membership, unless the member is liable for them by contract, as a condition to ownership of an interest in real property, as an obligation arising out of an interest in real property, or otherwise. Unless they are called to the attention of the member and the member agrees to them in writing, article or bylaw provisions authorizing dues, assessments, or fees do not of themselves create such a liability [*Corp. Code § 12441*].

[6] Memberships Exempt From Securities Qualification

The memberships sold by a consumer co-op are exempt from the securities qualification requirements of *Corporations Code Section 25110*, provided the aggregate investment of any member in memberships sold does not exceed $300. The exemption does not apply to memberships of the co-op if any promoter expects or intends to make a profit directly or indirectly from any business or activity associated with the co-op or the operation of the co-op, or from remuneration other than reasonable salary from the co-op. The exemption does not apply to nonvoting memberships issued to any person who does not possess and will not acquire voting power in connection with the issuance of nonvoting

memberships [*Corp. Code § 25100(r)*].

[7] Liability of Members

Members of a consumer co-op are not, as such, personally liable for the debts, liabilities, or obligations of the corporation [*Corp. Code § 12440(a)*]. No person is liable for any obligation arising from membership unless that person was admitted to membership upon the person's application or with that person's consent [*Corp. Code § 12440(b)*]. "Consent" includes the ownership of an interest in real property, when membership in the co-op is a condition of ownership [*Corp. Code § 12440(c)*].

[8] Termination of Membership

A membership issued for a period of time will expire when the period has elapsed, unless the membership is renewed [*Corp. Code § 12430(c)*]. A member may resign from membership at any time, although the articles or bylaws may require reasonable notice before the resignation becomes effective [*Corp. Code § 12430(a)*]. A member's resignation will not relieve that member from obliga tions for charges incurred, services or benefits actually rendered, dues, assessments or fees, or for any obligation arising from contract, a condition to ownership of land, an obligation arising out of the ownership of land, or otherwise [*Corp. Code § 12430(b)*].

A member may also be expelled or suspended, provided that the applicable procedures satisfy statutory requirements [*see Corp. Code § 12431(a)*]. Any expulsion, suspension, or termination must be done in good faith and in a fair and reasonable manner [*see Corp. Code § 12431(b), (c)*], or it will be void and without effect [*see Corp. Code § 12431(a)*; *see also Corp. Code § 12431(d)* (notice requirements)]. A member may bring an action challenging an expulsion, suspension, or termination within one year after the event occurred, and may be entitled to reinstatement as a member [*Corp. Code § 12431(e)*].

A member who is expelled or suspended, or whose membership is terminated, is liable for any charges incurred, services or benefits actually rendered, dues, assessments, or fees incurred before the expulsion, suspension, or termination or arising from contract or otherwise [*Corp. Code § 12431(g)*].

These termination, expulsion, and suspension provisions govern procedures, not the substantive basis for the action. Therefore, even if the termination, expulsion, or suspension satisfies these procedural requirements, the action is not valid if it violates contractual or other rights of the member or is otherwise unlawful [*Corp. Code § 12431(f)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.34

§ 14.34 Meetings of Members

[1] Regular and Special

Regular meetings of members must be held annually. The election of directors must be held at the regular meeting unless the directors are chosen in some other manner [*Corp. Code § 12460(b)*]. Special meetings of the members may be called for any lawful purpose by the board, the chairman of the board, the president, any other person authorized in the bylaws, or by 5 percent of the members [*Corp. Code § 12460(e)*].

Meetings of members must be held at a place stated or fixed in accordance with the bylaws. If no other place is stated or fixed, meetings will be held at the principal executive office of the co-op [*Corp. Code § 12460(a)*]. Unless prohibited by the bylaws, and if authorized by the board of directors in its sole discretion, and subject to the requirement of consent [*see Corp. Code § 20(b)*] and any guidelines and procedures adopted by the board, members not physically present in person at a meeting of members may participate in and vote at a meeting of members, by electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*] or by electronic video screen communication, whether the meeting is to be held at a designated place or in whole or in part by means of electronic transmission by and to the corporation or by electronic video screen communication [*Corp. Code § 12460(a)*; *see Corp. Code § 12460(f)*]. Member meetings may be conducted, in whole or in part, by electronic transmission by and to the corporation or by electronic video screen communication if [*Corp. Code § 12460(f)*]:

- The corporation implements reasonable measures to provide members a reasonable opportunity to participate in the meeting and to vote on matters submitted to the members, including an opportunity to read or hear the proceedings of the meeting concurrently with those proceedings; and

- The corporation maintains a record of the vote or action if any member votes or takes other action at the meeting by means of electronic transmission to the corporation or electronic video screen communication.

Any request by a corporation to a member for consent to conduct a member meeting by electronic transmission by and to the corporation must include a notice that the meeting will be held at a physical location absent the member's consent

[*Corp. Code § 12460(f)*; *see Corp. Code § 20(b)*]. Members who participate via electronic transmission by and to the corporation will be deemed present in person at the meeting [*Corp. Code § 12460(a)*].

[2] Notice of Meetings

Whenever members are required or permitted to take action at a meeting, a written notice of the meeting must be given to each member who is entitled to vote on the record date [*see Corp. Code § 12461* (notice requirements)]. If no record date is fixed by the board or the bylaws, all those who are members at the close of business on the day preceding the day on which notice is given are entitled to notice [*Corp. Code § 12481(a)*]. A member may waive notice by providing a waiver of notice, consent to the holding of the meeting, or an approval of the minutes in writing, or by attending a meeting without objecting to lack of notice [*see Corp. Code § 12461(e)*].

Notice must be given personally, by electronic transmission by the corporation, or by mail or other means of written communication, addressed to a member at the address appearing on the books of the corporation or given by the member to the corporation for purpose of notice. If no address appears or has been provided, notice must be sent to the principal office of the corporation or by publication at least once in a newspaper of general circulation in the county in which the principal office is located [*Corp. Code § 12461(b)*].

PRACTICE TIP:

Notice may not be given by electronic transmission by the corporation if (1) the corporation is unable to deliver two consecutive notices to the shareholder by that means or (2) the inability to deliver notices via electronic transmission becomes known to the secretary, any assistant secretary, the transfer agent, or other person responsible for giving notice [*Corp. Code § 12461(b)*]. Further, an electronic transmission by the corporation to an individual shareholder or member is not authorized unless the transmission additionally satisfies the requirements applicable to consumer consent to electronic records under the Electronic Signatures in Global and National Commerce Act [*Corp. Code § 20* ; *see 15 U.S.C. § 7001(c)*].

[3] Quorum

The lesser of 250 members or members representing 5 percent of the voting power constitutes a quorum at a meeting of members. Any bylaw amendment to increase the quorum may be adopted only by approval of the members [*see Corp. Code § 12224* (approval defined)]. When a quorum is present, the affirmative vote of the majority of the voting power represented at the meeting and entitled to vote will be the act of the members, unless provided otherwise by the bylaws or the law [*Corp. Code § 12462(a)*].

If the corporation is authorized to conduct a meeting with a quorum of less than one third of the voting power, then the only matters that may be voted on at a regular meeting actually attended by less than one third of the voting power are those for which notice of their general nature was given [*Corp. Code § 12462(b)*; *see Corp. Code § 12461*].

The members present at a duly called or held meeting at which a quorum is present may continue to transact business until adjournment, notwithstanding the withdrawal of enough members to leave less than a quorum, if any action taken (other than adjournment) is approved by at least a majority of the members required to constitute a quorum, or the vote of a greater number or voting by classes if required by the articles, bylaws, or applicable law [*Corp. Code § 12462(c)*; *see Corp. Code § 12462(b)*].

In the absence of a quorum, any meeting of members may be adjourned by the vote of a majority of the votes represented in person, but no other business may be transacted unless certain conditions are met [*Corp. Code § 12462(d)*].

[4] Adjournment

The co-op may transact any business at an adjourned meeting that could have been transacted at the original meeting. When a meeting is adjourned to another time or place, no notice is required if the time and place (or any means of electronic transmission by or to the corporation or electronic video screen communication by which members may participate) are announced at the original meeting unless the bylaws otherwise require. If the adjournment is for more than 45 days or if a new record date is fixed, a notice of the adjourned meeting must be given to each member of record entitled to vote at the meeting [*Corp. Code § 12461(d)*].

[5] Use of Written Ballots at Meetings

Unless prohibited by the articles or bylaws, a combination of written ballot and personal voting may be used at any regular or special meeting of members. Prior to the meeting, the board may authorize distribution of a written ballot to every member entitled to vote. The ballot must set forth the proposed action to be taken, provide an opportunity to specify approval or disapproval of the proposed action, and state that unless revoked by the member voting in person, the ballot will be counted if received by the co-op on or before the time of the meeting [*Corp. Code § 12461(h)*].

When ballots are distributed, the number of members voting at the meeting by written ballot will be deemed present at the meeting for purposes of determining a quorum [*see Corp. Code § 12462*] but only with respect to the proposed actions referred to in the ballots [*Corp. Code § 12461(h)*]. The ballots must be distributed in a manner consistent with notice of meetings of members [*see Corp. Code § 12461(b)*] and consistent with the requirements for voting by written ballot without a meeting [*Corp. Code § 12461(h)*; *see Corp. Code § 12464*; *see also § 14.35[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsSpecial Meetings



16 of 103 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.35

§ 14.35 Action by Written Ballot Without Meeting

[1] In General

Unless otherwise provided in the articles or bylaws, any action that may be taken at any regular or special meeting may be taken without a meeting if the co-op distributes a written ballot to every member entitled to vote on the matter [*Corp. Code § 12463(a)*]. Unless otherwise provided by the articles or bylaws, and if approved by the board of directors, the ballot and any related material may be sent by electronic transmission by the corporation and responses may be returned to the corporation by electronic transmission to the corporation [*Corp. Code § 12463(a)*; *see Corp. Code §§ 20, 21*]. The secretary must cause a vote to be taken by written ballot on any action or recommendation proposed in writing by 20 percent of the members [*Corp. Code § 12463(f)*].

The number of votes cast by ballot within the time period specified in the ballot must equal or exceed the quorum required to be present at a meeting authorizing the action. The number of approvals must equal or exceed the number of votes that would be required to approve at a meeting at which the total number of votes cast was the same as the number of votes cast by ballot [*Corp. Code § 12463(b)*].

[2] Ballot Requirements

Ballots must be solicited in the same manner as that prescribed for giving notice of meetings [*see Corp. Code § 12461(b)*; *see also § 14.34[2]*]. The solicitations must indicate the number of responses needed to meet the quorum requirement and specify the time by which the ballot must be received to be counted. Ballots (other than for the election of directors) must state the percentage of approvals necessary to pass the measure [*Corp. Code § 12463(c)*].

A written ballot must set forth the proposed action, provide an opportunity to specify approval or disapproval of any proposal, and provide a reasonable time within which to return the ballot to the co-op [*Corp. Code § 12463(a)*]. Unless provided otherwise in the articles or bylaws, a written ballot cannot be revoked [*Corp. Code § 12463(d)*].

If a co-op has 100 or more members, any form of written ballot distributed to 10 or more members must afford an opportunity to specify a choice between approval and disapproval of each matter or group of related matters intended to be acted upon by the ballot at the time of distribution. The form must also provide that whenever the person solicited

specifies a choice with respect to any matter, the vote will be cast in accordance with that choice [*Corp. Code § 12464(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesBusiness & Corporate LawCooperativesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.36

§ 14.36 Voting of Memberships

[1] One Vote Rule

Each member of a consumer co-op is entitled to one vote on each matter submitted to a vote of the members, except for central organizations which have provided otherwise. Single memberships in which two or more persons have an indivisible interest, including memberships standing of record in the names of two or more persons, are bound by the vote of one member, when there is only one vote, and by the act of the majority when there is more than one vote [*Corp. Code § 12480*; *see Corp. Code § 12482*].

[2] Record Date

The bylaws may provide, or the board may fix in advance, a date as the record date for determining the members entitled to vote at a meeting or cast written ballots. That date must not be more than 60 days before the date of the meeting or the day on which the first ballot is mailed or solicited. If no record date is fixed, those who are members on the day of the meeting or the day the first ballot is mailed or solicited who are eligible to vote will be entitled to vote [*Corp. Code § 12481(b), (c)*]. Similar provisions govern the fixing of a record date to determine the members entitled to exercise any rights with respect to any other lawful action [*see Corp. Code § 12481(d)*].

[3] Cumulative Voting and Voting by Proxy

Cumulative voting is not permitted in consumer co-ops, except when authorized by the articles or bylaws of a central organization [*Corp. Code § 12484*; *see Corp. Code § 12256*]. Voting by proxy is not permitted at any time [*Corp. Code § 12405*].



18 of 103 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.37

§ 14.37 Inspectors of Election

[1] Appointment

In advance of any meeting of members, the board may appoint inspectors of election to act at the meeting and any adjournment. If inspectors are not appointed or if any appointed persons fail to appear or refuse to act, the chairman of the meeting may (and, on the request of any member, must) appoint inspectors at the meeting [*Corp. Code § 12483(a)*].

The number of inspectors must be either one or three. If they are appointed at a meeting on the request of one or more members, the majority of members represented in person will determine the number to be appointed [*Corp. Code § 12483(a)*]. If there are three inspectors, the decision, act, or certificate of a majority is effective in all respects as that of all three [*Corp. Code § 12483(c)*].

[2] Duties

The inspectors determine the number of memberships outstanding and the voting power of each, the number represented at the meeting, and the existence of a quorum. They receive votes, ballots, and consents, hear and determine all challenges and questions regarding the right to vote, count and tabulate all votes and consents, determine when the polls will close, and determine the result. They may do those acts which are proper to conduct the election or vote with fairness to all members [*Corp. Code § 12483(b)*]. The inspectors must perform these duties impartially, in good faith, to the best of their ability, and as expeditiously as is practical [*Corp. Code § 12483(c)*].



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.38

§ 14.38 Directors

[1] Term of Office

Each corporation must have a board of directors [*Corp. Code § 12350*]. Directors are elected for terms, not longer than four years, that are fixed in the articles or bylaws. In the absence of any provision, terms will be for one year. No amendment of the articles or bylaws may extend the term of a director beyond that for which the director was elected, nor may any bylaw provision increasing the terms of directors be adopted without approval of the members [*Corp. Code § 12360(a)*; *see Corp. Code § 12224* (approval defined)]. A director holds office until the expiration of the term for which elected and until a successor has been elected and qualified, unless the director has been removed from office [*Corp. Code § 12360(b)*].

[2] Election of Directors

The members must have reasonable nomination and election procedures given the nature, size, and operations of the co-op [*Corp. Code § 12470*].

When the co-op distributes any material soliciting a vote for any nominee for director in any publication owned or controlled by the co-op, it must make available to each other nominee, in the same material, an equal amount of space with equal prominence to be used by the nominee for a purpose reasonably related to the election [*Corp. Code § 12473*].

The co-op must mail to all members any material related to the election which a nominee for director has furnished, upon written request and payment of mailing costs by the nominee. Alternatively, within five business days of the request the co-op may allow the nominee to obtain the names, addresses and voting rights of members [*Corp. Code § 12474*; *see Corp. Code § 12600(a)*].

[3] Election by Written Ballot

Directors may be elected by written ballot without a meeting when authorized by the articles or bylaws, except that a central organization [*see Corp. Code § 12256*] may not authorize election by written ballot if its directors are elected by cumulative voting [*Corp. Code § 12463(e)*; *see Corp. Code § 12484*]. A combination of written ballot and personal

voting also may be used, except in the case of cumulative voting for directors of a central organization [*Corp. Code § 12461(i)*; *see Corp. Code § 12484*].

If a ballot naming directors is marked "withhold" (or in any other manner indicating that authority to vote for the election of directors is withheld) by a member, it cannot be voted for the election of a director [*Corp. Code § 12464(b)*].

[4] Designation or Selection

All or any portion of the directors authorized in the articles or bylaws may hold office by designation or selection by a specified designator, as provided in the articles or bylaws, rather than by election. Directors who hold office by designation or selection continue in office for the term prescribed by the governing article or bylaw. If no term is prescribed, these directors serve until the governing article or bylaw is amended or repealed [*Corp. Code § 12360(d)*; *see Corp. Code § 12362(f)*].

This type of bylaw provision may be adopted, amended, or repealed only by approval of the members [*Corp. Code § 12360(d)*; *see Corp. Code § 12224*], except as provided in *Corp. Code § 12330(d)* (approval of specified person). Unless otherwise provided in the articles or bylaws, the entitlement to designate or select a director or directors will cease if (1) the specified designator of that director or directors has died or ceased to exist, or (2) if the entitlement of the specified designator of that director or directors to designate is in the capacity of an officer, trustee, or other status and the office, trust, or status has ceased to exist [*Corp. Code § 12360(d)*]. When the articles or bylaws provide that a designator is entitled to designate one or more directors, (1) unless provided otherwise in the articles or bylaws at the time of designation, any director so designated may be removed without cause by the designator of that director; (2) any director so designated may only be removed with the written consent of the designator of that director; and (3) unless otherwise provided in the articles or bylaws, the right to remove will not apply if the designator entitled to that right has died or ceased to exist; and if that right is in the capacity of an officer, trustee, or other status, the office, trust, or status has ceased to exist [*Corp. Code § 12362(g)*]. For further discussion of removal, see *§ 14.39[3]*.

[5] Appointment by Court

If a corporation has not issued memberships and either (1) all the directors resign, die, or become incompetent, or (2) the corporation's initial directors have not been named in the articles and all the incorporators resign, a superior court of any county may appoint directors on the application of any party in interest [*Corp. Code § 12360(e)*]. For an application for appointment of directors under these circumstances, see California Forms of Pleading and Practice, Ch. 388, *Nonprofit Corporations* , § 388.168 (Matthew Bender).

[6] Resignation of Directors

Any director may resign effective upon written notice to the chairman of the board, the president, the secretary, or the board of directors, unless the notice specifies a later time for the effectiveness of the resignation. If a resignation is effective at a future time, a successor may be elected to take office when the resignation becomes effective [*Corp. Code § 12364(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.39

§ 14.39 Removal of Directors

[1] In General

Any or all directors may be removed without cause. In a co-op with fewer than 50 members, the removal must be approved by a majority of all members [*Corp. Code § 12362(a)(1)*; *see Corp. Code § 12223* (approval defined)]. In a co-op with 50 or more members, the removal must be approved by the members [*Corp. Code § 12362(a)(2)*; *see Corp. Code § 12224* (approval defined)].

A reduction in the number of directors authorized in the articles or bylaws does not remove any director prior to the expiration of that director's term of office, unless the reduction or amendment also provides for removal of one or more specified directors [*Corp. Code § 12362(d)*]. A director may not be removed prior to the expiration of the term of office, unless removed by the superior court [*see Corp. Code § 12363*] or unless the board is entitled to declare that director's office vacant [*Corp. Code § 12362(e)*; *see Corp. Code § 12361*].

[2] Removal of Director Elected by Class

When the provisions of the articles or bylaws permit the members of any class, voting as a class, to elect one or more directors, any director so elected can only be removed by the applicable vote of the members of that class [*Corp. Code § 12362(c)*]. Special limitations apply to the removal of directors in a central organization whose articles or bylaws authorize cumulative voting [*see Corp. Code § 12362(b)*].

[3] Removal of Designated Director

If the articles or bylaws permit designation of directors, any directors so elected may only be removed as provided [*Corp. Code § 12362(g)*; *see § 14.38[4], above*]. When a different person may be designated pursuant to the governing article or bylaw provision, the new designation must be made. If the governing article or bylaw contains no provision under which a different person may be designated, the governing article or bylaw provision will be deemed repealed [*Corp. Code § 12362(f)*].

[4] Removal by the Superior Court

When a director or members possessing 5 percent of the voting power bring suit in superior court to remove any director, the court may remove that director from office for fraudulent or dishonest acts, or gross abuse of authority or discretion with reference to the co-op. The court may also bar the removed director from reelection for a prescribed period [*Corp. Code § 12363*].



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.40

§ 14.40 Vacancies on the Board

The board may declare vacant the office of any director: (1) whose eligibility for election has ceased, (2) who has been declared of unsound mind by a final order of court, (3) who is convicted of a felony, or (4) who has failed to attend a specified number of board meetings, if at the time of election the bylaws provide that a director may be removed for missing a specified number of meetings [*Corp. Code § 12361*].

Vacancies may be filled by a majority of the directors then in office, whether or not less than a quorum, or by a sole remaining director, unless otherwise provided in the articles or bylaws and except for a vacancy created by removal. Vacancies may be approved only by approval of the members [*see Corp. Code § 12224*] unless the articles or a bylaw approved by the members provide that the board may fill vacancies occurring by reason of removal [*Corp. Code § 12364(a)*]. The members may elect a director at any time to fill any vacancy not filled by the directors [*Corp. Code § 12364(b)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

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§ 14.41 Meetings of the Board

[1] Call, Place, and Presence

Meetings of the Board may be called by the chair of the board, the president, any vice president, the secretary, or any two directors [*Corp. Code § 12351(a)(1)*]. Meetings may be held at any place designated in the notice, or, if not stated in a notice, designated in the bylaws or by resolution of the board [*Corp. Code § 12351(a)(5)*]. Directors may participate through the use of conference telephone, electronic video screen communication, or electronic transmission by and to the corporation [*Corp. Code § 12351(a)(6)*; *see Corp. Code §§ 20, 21*]. Participation in a meeting through use of conference telephone or electronic video screen communication constitutes presence in person at the meeting, as long as all directors participating in the meeting can hear one another. Participation in a meeting through use of electronic transmission by and to the corporation (other than conference telephone or electronic video screen communication) constitutes presence in person at the meeting if (1) each participating director can communicate with all the other directors concurrently and (2) each participating director is provided the means of participating in all matters before the board, including but not limited to the capacity to propose, or to interpose an objection to, a specific action to be taken by the corporation [*Corp. Code § 12351(a)(6)*].

[2] Notice

Regular meetings may be held without notice if the time and place are fixed by the bylaws or the board. Special meetings must be held on four days notice by first class mail or 48 hours notice delivered personally or by telephone, including a voice messaging system, or by electronic transmission by the corporation [*Corp. Code § 12351(a)(2)*; *see Corp. Code § 20*]. The articles or bylaws may not dispense with notice of a special meeting. A notice or waiver of notice need not specify the purpose of any meeting [*Corp. Code § 12351(a)(2)*].

Notice need not be given to any director who provides a waiver of notice, a consent to holding the meeting, or an approval of the minutes in writing (either before or after the meeting), or who attends the meeting without protesting prior to or at commencement the lack of notice. All waiver, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meeting [*Corp. Code § 12351(a)(3)*].

[3] Quorum

A majority of the number of directors authorized in or pursuant to the articles or bylaws constitutes a quorum for the transaction of business. The articles or bylaws may require the presence of one or more specified directors to constitute a quorum of the board to transact business, as long as the death of a director or the death or nonexistence of the person or persons otherwise authorized to appoint or designate a director does not prevent the corporation from transating business in the normal course of events [*Corp. Code § 12351(a)(7)*]. The articles or bylaws may not provide that a quorum is less than one-fifth the number of directors authorized in or pursuant to the articles or bylaws, or less than two, whichever is larger [*Corp. Code § 12351(a)(7)*].

Every act or decision done or made by a majority of the directors, with certain qualifications, present at a duly held meeting at which a quorum is present is the act of the board. The articles or bylaws may not provide that a lesser vote is the act of the board. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for the meeting or a greater number required by the articles, bylaws, or by law [*Corp. Code § 12351(a)(8)*].

Each director present and voting at a meeting has one vote on each matter presented to the board of directors for action at that meeting. No director may vote at any meeting by proxy [*Corp. Code § 12351(c)*].

[4] Adjournment

Whether or not a quorum is present, a majority of the directors present may adjourn to another time and place. If the meeting is adjourned for more than 24 hours, notice of the adjournment must be given prior to the time of the adjourned meeting to the directors who were not present at the time of adjournment [*Corp. Code § 12351(a)(4)*].

[5] Action Without Meeting

Any action required or permitted to be taken by the board may be taken without a meeting, if all directors individually or collectively consent in writing to the action. The consents must be filed with the minutes of the proceedings of the board. Action by written consent has the same force and effect as a unanimous vote of the directors [*Corp. Code § 12351(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporationsDirectors & OfficersScope of AuthorityMeetingsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.42

§ 14.42 Executive Committees

[1] Creation and Appointment

The board, by resolution of a majority of the directors then in office adopted when a quorum is present, may create committees to serve at its pleasure. Each committee must consist of two or more directors, appointed by a majority vote of the directors then in office, unless the articles or bylaws require a majority vote of the number of directors authorized in the articles or bylaws. The bylaws may authorize one or more such committees, each consisting of two or more directors, and may provide that specified officers who are also directors will be members of the committees. The board may appoint one or more directors as alternate members of any committee, who may replace any absent member at any meeting of the committee [*Corp. Code § 12352(a)*].

[2] Authority of Committees

Any executive committee, to the extent provided in the resolution of the board or in the bylaws, will have all the authority of the board, except with respect to the following actions [*Corp. Code § 12352(a)*]:

- The approval of any action for which the approval of the members [*Corp. Code § 12224*] or a majority of all members [*Corp. Code § 12223*] is required by law regardless of whether the corporation has members.
- The filing of vacancies on the board or in any committee which has the authority of the board.
- The fixing of compensation of the directors for serving on the board or on any committee.
- The amendment or repeal of bylaws or the adoption of new bylaws.
- The amendment or repeal of any resolution of the board which by its express terms is not amendable or repealable.
- The appointment of committees of the board or their members.

- The expenditure of corporate funds to support a nominee for director after there are more people nominated for director than can be elected.

A committee exercising the authority of the board may not include as members persons who are not directors. The board may create other committees that do not exercise the authority of the board, and these other committees may include persons who are not directors [*Corp. Code § 12352(b)*].

Unless the bylaws otherwise provide, the board may delegate to any committee, appointed pursuant to *Corp. Code § 12331(c)(4)* or otherwise, powers as authorized by *Corp. Code § 12350*, but may not delegate the powers listed in *Corp. Code § 12352(a)(1)-(7)*, listed *above* [*Corp. Code § 12352(c)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.43

§ 14.43 Officers

A consumer co-op must have a chair of the board (who may be given the title "chair of the board," "chairperson of the board," "chairman of the board," or "chairwoman of the board" [*see Corp. Code § 12228.5* for definition of "chair"]) or a president or both, a secretary, a treasurer, or a chief financial officer or both, and any other officer with the titles and duties as required in the bylaws or determined by the board, and as may be necessary to enable it to sign instruments. The president, or if none, the chair of the board, is the chief executive officer of the co-op, unless provided otherwise in the articles or bylaws. If there is no chief financial officer, the treasurer is the chief financial officer of the corporation, unless otherwise provided for in the articles or bylaws. The same person may hold any number of offices unless the articles or bylaws provide otherwise. Either the chair of the board or the president must be elected from among the board members elected by the membership of the co-op [*Corp. Code § 12353(a)*].

Unless otherwise provided by the articles or bylaws, officers must be chosen by the board and serve at the pleasure of the board, subject to the rights, if any, of an officer under any contract of employment. Any officer may resign at any time upon written notice to the co-op without prejudice to the rights, if any, of the co-op under any contract to which the officer is a party [*Corp. Code § 12353(b)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.44

§ 14.44 Corporate Records and Reports

[1] Required Records

The co-op must keep adequate and correct books and records of account and minutes of the proceedings of its members, board, and committees of the board. It must also keep a record of the members, giving the names, addresses, class of membership, and number of membership units held by each [*Corp. Code § 12590(a)*]. Minutes and other books and records must be kept either in written form, any other form capable of being converted into clearly legible tangible form, or any combination of the two [*Corp. Code § 12590(b)*]. When minutes and other books and records are kept in a form capable of being converted into clearly legible paper form, that clearly legible paper form is admissible in evidence, and accepted for all other purposes, to the same extent as an original paper record of the same information would have been, provided that the paper form accurately portrays the record [*Corp. Code § 12590(b)*].

[2] Annual Report

The co-op must notify each member yearly of the member's right to receive an annual financial report. Unless the co-op has less than 25 members at any time during the fiscal year [*see Corp. Code § 12591(a)*], the board must promptly cause the most recent annual report to be sent to a member upon written request. The annual report must be prepared no later than 120 days after the close of the co-op's fiscal year, and contain in appropriate detail all of the following [*Corp. Code § 12591(b)*; *see Corp. Code § 12592*]:

- A balance sheet as of the end of the fiscal year, an income statement, and statement of cash flows for the fiscal year.
- A statement of the place where the names and addresses of the current members are located.
- A statement of the transactions and indemnifications of interested persons [*see Corp. Code § 12592*].

The annual report must be accompanied by any pertinent report by independent accountants, or, if there is no such report, by the certificate of an authorized officer of the co-op that the statements were prepared without audit from the books and records of the co-op [*Corp. Code § 12591(b)*].

Unless otherwise specified in the articles or bylaws, this report and any acompanying material may be sent by electronic transmission by the corporation [*see Corp. Code § 20*] if approved by the board of directors [*Corp. Code § 12591(a)*].

[3] Annual Statement of Transactions and Indemnifications

The co-op must furnish annually to its members and directors a statement of the transactions and indemnifications of interested persons. The statement may be included in the annual report. If the co-op does not issue an annual report, the statement must be mailed or delivered to members within 120 days after the close of the fiscal year. Unless otherwise specified in the articles or bylaws, this statement may be sent by electronic transmission by the corporation [*see Corp. Code § 20*] if approved by the board of directors [*Corp. Code § 12592(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresRecords & Inspection RightsRecordkeeping



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.45

§ 14.45 Inspection Rights

[1] Articles and Bylaws

The co-op must keep at its principal office in California the original or a copy of the articles and bylaws as amended to date, which must be open to inspection by the members at all reasonable times during office hours. If the co-op has no office in California, it must furnish to any member upon written request a copy of the articles or bylaws as amended to date [*Corp. Code § 12340*].

[2] Books and Records

The accounting books and records and minutes of proceedings of the members, the board, and committees of the board must be open to inspection on the written demand of any member at any reasonable time, for a purpose reasonably related to that person's interests as a member [*Corp. Code § 12603*].

Every director has the absolute right at any reasonable time to inspect and copy all books, records, and documents of every kind, and to inspect the physical properties of the co-op [*Corp. Code § 12604*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.46

§ 14.46 Demand for Membership List

[1] Procedure

Subject to the co-op's right to set aside a member's demand for inspection [*see Corp. Code § 12601*] and the power of the court to limit inspection rights [*see Corp. Code § 12602*], and unless the co-op provides a reasonable alternative [*see Corp. Code § 12600(c)*], a member may do either or both of the following [*Corp. Code § 12600(a)*]:

- Inspect and copy the record of all the members' names, addresses, and voting rights, at reasonable times, on written demand five business days in advance stating the purpose of the inspection;

- Obtain from the secretary of the co-op, on written demand and tender of a reasonable charge, a list of the names, addresses, and voting rights of those members entitled to vote for the election of directors, as of the most recent record date for which it has been compiled, or as of a date specified by the member subsequent to the date of demand.

The demand must state the purpose for which the list is requested. The membership list must be made available on or before the later of 10 business days after the demand is received or after the date specified as the date as of which the list is to be compiled [*Corp. Code § 12600(a)*].

[2] Entitlement

Any member or members possessing 5 percent or more of the voting power may demand the list for a purpose reasonably related to the members' interests as members. The co-op may deny access if it reason-ably believes that the information will be used for another purpose or it provides a reasonable alternative pursuant to *Corp. Code § 12600(c)* [*Corp. Code § 12600(b)*].

[3] Alternative Method

The co-op, within 10 days after receiving a demand, may deliver a written offer of an alternative method of achieving the purpose identified in the demand without providing access to or a copy of the membership list. An alternative

method which reasonably and in a timely manner accomplishes the proper purpose set forth in a demand will be a reasonable alternative, unless the co-op fails to do the things it offered within a reasonable time after acceptance of the offer. Any rejection of the offer must be in writing and indicate the reasons the proposed alternative does not meet the proper purpose of the demand [*Corp. Code § 12600(c)*].



28 of 103 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.47

§ 14.47 Distributions

A consumer co-op may make several types of distributions to its members. A "patronage distribution" is any transfer made to a patron of the co-op the amount of which is computed with reference to the patron's patronage of the co-op [*Corp. Code § 12224*]. "Patronage" is measured by the volume and/or value of a patron's purchase of products from, and use of services furnished by, the co-op, and by the products and services provided by the patron to the co-op for marketing [*Corp. Code § 12243*]. Patronage distributions serve to provide members with goods or services at cost, or to return to members the net proceeds of their products.

A co-op may also make distributions to its members of gains, profits, or dividends that are not computed with reference to patronage [*see Corp. Code § 12235*]. However, in any fiscal year those distributions cannot exceed 15 percent, multiplied by contributions, whether the contributions are by membership fees, capital credits, or otherwise, to capital [*Corp. Code § 12451*]. A co-op may also purchase or redeem memberships [*Corp. Code § 12452*].

The Consumer Cooperative Corporation Law prohibits a co-op from purchasing or redeeming memberships, making a patronage distribution to members out of earnings of the co-op on nonmember patronage, or making a distribution, if it is or would be likely to be unable to meets its liabilities as they mature. The same restriction applies to any subsidiary of the co-op [*Corp. Code § 12453*]. Additional restrictions on the purchase or redemption of memberships, distributions, or patronage distributions may be provided for in the articles, bylaws, or by agreement [*Corp. Code § 12454*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesBusiness & Corporate LawCooperativesMembers & Other Constituents



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.48

§ 14.48 Federal Income Taxation

[1] In General

Consumer cooperative corporations are subject to the same general federal income tax treatment as other corporations. They must pay federal income tax according to the schedule imposed by *I.R.C. § 11*. However, they are also entitled to certain additional deductions [*see* discussion in *§ 14.48[2]*]. For a discussion of corporate income tax rates, see Ch. 2, *Formation of Corporations* .

[2] Deduction of Patronage Dividends

Most corporations operating on a cooperative basis are entitled to deduct patronage dividends (as that term is defined in the Internal Revenue Code in computing taxable income [*see I.R.C. §§ 1382(b)(1), 1381(a)*]. The Internal Revenue Code does not allow the deduction to mutual ditch, irrigation, or rural electrification cooperatives; mutual savings banks, building and loan associations, or mutual insurance companies; or cooperatives furnishing electric energy or telephone service to persons in rural areas [*see I.R.C. § 1381(a)(2)*].

The Internal Revenue Code definition of "patronage dividend" is different than the California definition of "patronage distribution" [*see I.R.C. § 1388(a)*; *Corp. Code § 12244*]. For federal income tax purposes, a "patronage dividend" is an amount paid to a patron under the following circumstances [*I.R.C. § 1388(a)*]:

- On the basis of quantity or value of business done with or for that patron;
- Under a preexisting obligation of the corporation to pay that amount; and
- Which is determined by reference to the net earnings of the co-op from business done with or for its patrons.

To be treated as earnings from business done with or for patrons that are deductible as patronage dividends, income must be produced in a transaction that actually facilitates the accomplishment of the cooperative's activities for its patrons, rather than merely enhancing the overall productivity of the cooperative. Under this test, interest income earned

on certificates of deposit and short-term commercial paper was deductible as patronage dividends by a cooperative whose seasonal business required the maintenance of temporary surpluses, since placing those surpluses in interest-bearing activities was integrally intertwined with the cooperative's function [*Cotter and Co. v. United States (Fed. Cir. 1985) 765 F.2d 1102, 1110]* .

Bylaws, articles of incorporation, or other written contracts constitute a preexisting obligation [*Treas. Reg. § 1.1388-1(a)*; *see Rev. Rul. 83-135, 1983-2 C.B. 149*]. A patronage dividend does not include amounts paid out of earnings from any business other than that done with or for patrons, or amounts paid out of earnings from business done with or for other patrons who are paid smaller or no amounts for substantially identical transactions [*I.R.C. § 1388(a)*]. A "patron" is defined as any person with whom or for whom the cooperative corporation does business on a cooperative basis, whether a member, nonmember, individual, trust, estate, partnership, company, corporation, or cooperative association [*Treas. Reg. § 1.1388-1(e)*].

Patronage dividends are deductible to the extent paid in money, qualified written notices of allocation, or other property with respect to patronage occurring during that taxable year [*I.R.C. § 1382(b)(1)*]. A notice of allocation is any form of written notice showing the amount allocated to that patron and any portion that constitutes a patronage dividend [*I.R.C. § 1388(b)*]. The notice is "qualified" if it is redeemable at face value within 90 days, or if the patron has consented to include the allocated amount in gross income for the year [*I.R.C. § 1388(c)*; *see I.R.C. § 1385(a)*]. "Consent" occurs when the patron either consents in writing, cashes a qualified check, or obtains or retains membership in the co-op after it has adopted a bylaw providing that membership constitutes consent [*I.R.C. § 1388(c)(2)*; *see I.R.C. § 1385(a)*]. Whichever way qualification occurs, it must be accompanied by payment of at least 20 percent of the amount of the patronage dividend [*I.R.C. §§ 1382(b)(1), 1388(b)*]. A nonqualified allocation becomes deductible only when redeemed in money or other property [*I.R.C. § 1382(b)(2)*].

In addition to patronage dividends, a cooperative corporation is entitled to deduct "per-unit retain allocations" paid in money, other property, or qualified certificates [*I.R.C. § 1382(b)(3)*]. A co-op may make allocations to a patron with respect to products marketed for that patron, and determine those allocations without reference to the net earnings of the co-op from business done with or for that patron [*see I.R.C. § 1388(f)*]. A "per-unit retain allocation certificate" is a written notice showing the amount allocated to that patron by the co-op [*I.R.C. § 1388(g)*]. The certificate is "qualified" if the recipient either consents in writing to include the allocated amount in gross income for the year, or if the recipient obtains or retains membership in the co-op after it has adopted a bylaw providing that membership constitutes consent [*I.R.C. § 1388(h)*; *see I.R.C. § 1385(a)*]. A nonqualified certificate becomes deductible only when redeemed in money or other property [*I.R.C. § 1382(b)(4)*].

[3] Netting of Patronage Gains and Losses

A co-op may determine its net earnings by offsetting patronage losses (including any patronage loss carried to that year) that are attributable to one or more allocation units against patronage earnings of one or more other allocation units [*see I.R.C. § 1388(j)(1)*]. The terms "patronage earnings" and "patronage losses" refer to earnings and losses derived from business done with or for patrons of the organization [*I.R.C. § 1388(j)(4)*]. A co-op that opts to net gains and losses for a taxable year must provide its patrons, on or before the 15th day of the ninth month following the close of the taxable year, with a written notice that states all of the following [*I.R.C. § 1388(j)(3)(A)*]:

- That the organization has offset earnings and losses from one or more allocation units, and that the offset may affect the amount distributed to its patrons;

- A general identification of the allocation units; and

- Any rights that its patrons have to additional financial information of the co-op under the terms of its charter, articles, bylaws, or any provision of law.

The corporation may omit any detailed data regarding earnings and losses that could result in a competitive disadvantage to the co-op, or could provide a competitive advantage to a competitor of the co-op [*I.R.C. § 1388(j)(3)(B)*]. Failure to provide sufficient notice will not affect the tax treatment of the co-op [*I.R.C. § 1388(j)(3)(C)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesTax LawFederal Income Tax ComputationGeneral Overview



30 of 103 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.49

§ 14.49 State Income Taxation

Consumer co-ops are subject to state income tax but are permitted certain special deductions. A co-op whose income is not principally derived from the sale in the regular course of business of tangible personal property (other than water, agricultural products, or food sold at wholesale) may deduct all income from or arising out of business activities carried on by the co-op or its agents for or with members, or when done on a nonprofit basis for or with nonmembers [*Rev. & Tax. Code § 24405*].

A co-op whose income is principally derived from the sale in the regular course of business of tangible personal property (other than water, agricultural products, or food sold at wholesale) may deduct all patronage refunds paid or accrued to patrons if the refunds are made and allocated as provided by statute [*Rev. & Tax. Code § 24406*]. The refunds must be made pursuant to a preexisting obligation which is created by the association's bylaws or other written instrument [*Rev. & Tax. Code § 24406(a)*]. They must be made from earnings that are attributable to business done by the association with the patrons to whom the patronage refunds are made, and allocated ratably according to patronage [*Rev. & Tax. Code § 24406(b)*]. The refunds must be allocated, and the patrons receiving the refunds must be notified of the allocation, on or before the due date for the filing of the association's franchise tax return, including any extension of time for the year in which the patronage occurred [*Rev. & Tax. Code § 24406(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide § 14.50

§ 14.50 Dissolution

[1] Voluntary

When a consumer co-op's term of existence expires without extension or renewal, the board must terminate its activities and wind up its affairs [*Corp. Code § 12636*]. A co-op may also voluntarily choose to wind up and dissolve, either by approval of a majority of all of the members [*see Corp. Code § 12223* (definition)], or by approval of the board and approval of the members [*Corp. Code § 12630(a)*; *see Corp. Code § 12224* (definition)]. Approval of the board alone may initiate dissolution for a co-op that [*Corp. Code § 12630(b)*]:

- Has been the subject of an order for relief in bankruptcy;
- Has disposed of all its assets and has not conducted any activity for five years; or
- Has no members.

If a corporation comes within one of the descriptions in § 12630(b), *above*, and if the number of directors then in office is less than a quorum, it may elect to voluntarily wind up and dissolve by any of the following [*Corp. Code § 12630(c)*]:

- The unanimous consent of the directors then in office.
- The affirmative vote of a majority of the directors then in office at a meeting held pursuant to waiver of notice by those directors complying with *Corp. Code § 12351(a)*.
- The vote of a sole remaining director.

If a corporation elects to voluntarily wind up and dissolve pursuant to § 12630(c), *above*, references to the board are deemed to be to a board consisting solely of those directors or that sole director, and action by the board will require at least the same consent or vote as would be required under § 12630(c) for an election to wind up and dissolve [*Corp. Code § 12630(d)*].

[2] Involuntary

A complaint for involuntary dissolution may be filed by one-half of the directors in office, any person holding or authorized by persons holding 33 1/3 percent of the voting power, any member when the co-op's term has expired, or any person authorized to do so in the articles [*Corp. Code § 12620(a)*]. One of the following grounds for involuntary dissolution must exist [*see Corp. Code § 12620(b)*]:

- Abandonment of corporate activity for more than one year.
- An even number of directors who are equally divided on the management of corporate affairs.
- A deadlock of member factions that inhibits corporate activities.
- Failure to elect successors to directors.
- Fraud or mismanagement of those in control of the corporation.
- Expiration (without extension) of the period for which the corporation was formed.

In addition, the Attorney General may bring an action to dissolve a co-op when the co-op has abused corporate powers or violated the law [*see Corp. Code § 12621*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART II. LEGAL BACKGROUND

7-14 California Legal Forms--Transaction Guide §§ 14.51-14.99

[Reserved]

§§ 14.51[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

7-14 California Legal Forms--Transaction Guide § 14.100

§ 14.100 Facts

1. Identity of incorporators.

NOTE:
One or more persons may form a consumer co-op [*Corp. Code § 12300(a)*].

a. Names.

b. Addresses.

c. Telephone numbers.

2. Proposed name of co-op.

NOTE:
For an outline of requirements and prohibitions relating to proposed corporate names, see *§ 14.140*.

3. Address of principal office.

4. Purpose of co-op.

NOTE:
A co-op may be formed for any lawful purpose as long as it is organized and conducts its business primarily for the mutual benefit of its members as patrons of the co-op [*Corp. Code § 12201*].

5. Whether any limitations on co-op's purposes or powers are desired.

6. Whether co-op's existence will be limited to a specified date.

7. Identity of initial agent for service of process.

a. If agent is natural person, name and complete business or residential address.

b. If agent is corporation, name.

8. Identity of initial directors, if any.

a. Names.

b. Addresses.

9. If unincorporated association is being incorporated:

NOTE:
An unincorporated association may change its status to a consumer co-op upon a proper authorization by the association in accordance with its rules and procedures [*Corp. Code § 12301(a)*]. For a discussion of the legal requirements involved in changing status, see discussion in *§ 14.200[1][e]*.

a. Name of unincorporated association.

b. Creditors.

c. Counties in which real property of association is located.

10. Business and financial advisors.

a. Banks

b. Insurance agents.

c. Accountants.

11. Directors.

a. Number.

NOTE:
The number of directors cannot be less than three [*Corp. Code § 12331(a)*].

1. Fixed.

2. Variable.

b. Whether alternative directors are desired.

12. Members.

a. Whether number will be limited.

b. Whether different classes are desired.

c. Whether voting power and proprietary interests of all members will be equal or unequal.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesDissolution & Winding UpBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

7-14 California Legal Forms--Transaction Guide § 14.101

§ 14.101 Documents

1. Any existing preincorporation documents:

    a. Membership applications.

    b. Loan or other financial documents.

2. If unincorporated association is changing status to consumer co-op, copy of:

    a. Rules and regulations.

    b. Charter documents.

    c. Financial and tax records.

    d. Real property deeds.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsTreatment of Unincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

7-14 California Legal Forms--Transaction Guide §§ 14.102-14.119

[Reserved]

§§ 14.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

7-14 California Legal Forms--Transaction Guide § 14.120

§ 14.120 Rights of Members

1. Will voting power or proprietary interests of members be equal or unequal [*see Corp. Code § 12310(d)*]?

2. What general rule will be used to determine voting power and proprietary interests of members, if unequal [*see Corp. Code § 12310(d)*]?

3. Will co-op will have more than one class of members [*see Corp. Code § 12313(c)(3)*]?

4. What rights, privileges, preferences, restrictions, and conditions will attach to each class, if any [*see Corp. Code § 12313(c)(3)*]?

5. Will members have right to membership certificate [*see Corp. Code § 12401(a)*]?

6. Will co-op authorize "delegates" to have some or all of authority of members [*Corp. Code § 12332*]?

7. What terms of office, reasonable method for selection and removal, and reasonable method for calling, noticing, and holding meetings of delegates, if authorized, will be used [*Corp. Code § 12332*]?

8. Will memberships have different rights, privileges, preferences, restrictions, or conditions [*see Corp. Code § 12420*]?

9. Will memberships be transferable [*see Corp. Code § 12410*]?

10. Will memberships be issued for consideration [*see Corp. Code § 12400*]?



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

7-14 California Legal Forms--Transaction Guide § 14.121

§ 14.121 Management

1. Will number of directors be [*Corp. Code § 12331(a)*]:

a. Fixed; or

b. Variable?

2. What method, if any, will be used to determine number of directors [*Corp. Code § 12331(a)*]?

3. Will alternate directors be allowed [*Corp. Code § 12331(a)*]?

4. What manner and times of election and conditions to service will apply to alternate directors, if any [*see Corp. Code § 12331(a)*]?



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

7-14 California Legal Forms--Transaction Guide §§ 14.122-14.139

[Reserved]

§§ 14.122[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Formation of Consumer Cooperative Corporations

7-14 California Legal Forms--Transaction Guide § 14.140

§ 14.140 Selecting and Reserving Corporate Name

NOTE:
For an extensive checklist of procedures for name selection and reservation, see *Ch. 2, Formations of Corporations, § 2.130* et seq.

1. Select name and several alternatives.

a. Name must include word or abbreviation indicating corporate status.

NOTE:
No consumer co-op can be formed unless some word or abbreviation indicating that the entity is a corporation rather than a natural person, firm, or unincorporated association is affixed or prefixed to the name [*Corp. Code § 12311(a)*].

b. Name must not include any of following words or related words [*Corp. Code § 12302(a)*]:

(1) "Bank."

(2) "Trust."

(3) "Trustee."

NOTE:
The prohibition does not apply if a certificate of approval from the Commissioner of Financial Institutions is attached to the articles of incorporation [*Corp. Code § 12302(a)*].

c. Name must not be likely to mislead public [*Corp. Code § 12302(b)*].

d. Name must not be same as, or resemble so closely as to tend to deceive [*Corp. Code § 12302(b)*]:

NOTE:
The co-op may adopt a name substantially similar to that of an existing corporation upon proof of consent by the existing corporation and a finding by the Secretary of State that under the circumstances the public is not likely to be misled [*Corp. Code § 12302(b)*].

(1) Name of domestic corporation.

(2) Name of foreign corporation that:

(a) Is authorized to transact intrastate business; or

(b) Has registered its name with Secretary of State [*see Corp. Code § 2101*].

(3) Name that foreign corporation has assumed [*see Corp. Code § 2106(b)*].

(4) Name that will become record name of domestic or foreign corporation upon effective date of filed corporate instrument.

(5) Name of corporation under reservation.

e. If co-op is organized by current or former officer, director, or member of unincorporated association that remains unincorporated, name must not be same as or similar to that of unincorporated association [*Corp. Code § 12301(g)*].

2. Check availability of name from Corporate Name Index Division of Secretary of State's Office.

3. Reserve corporate name by request to Secretary of State [*see Corp. Code § 201(c)*].

NOTE:
The fee for name reservation is specified in *Gov. Code § 12186(a)*. For a checklist of procedures for name reservation, see Ch. 2, ***Formation of Corporations*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporate NamesRequirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Formation of Consumer Cooperative Corporations

7-14 California Legal Forms--Transaction Guide § 14.141

§ 14.141 Drafting and Filing Articles of Incorporation

1. Draft articles [*see § 14.200*].

a. Include following mandatory information [*Corp. Code § 12310*]:
(1) Name of co-op.

(2) Following statement: "This corporation is a cooperative corporation organized under the Consumer Cooperative Corporation Law. The purpose of this corporation is to engage in any lawful act or activity for which a corporation may be organized under such law."

(3) Initial agent for service of process.

NOTE:
The agent may be a natural person residing in California, or any domestic or foreign corporation that has filed a required certificate and whose capacity to act as an agent has not terminated [*Corp. Code § 12310(c)*; ***see*** *Corp. Code § 12570(b)*].

(a) If agent is natural person, name and complete business or residential address.

(b) If agent is corporation, name only [*see Corp. Code § 12570(b)*].

(4) Statement whether voting power or proprietary interests of members are equal or unequal.

NOTE:
If co-op is a "central organization," whose membership is composed in whole or in part of other consumer co-ops [***see*** *Corp. Code § 12256*], its articles may provide for unequal voting power based on

number of its members' members, patronage of members, or both [*Corp. Code § 12314*]. Otherwise, the voting power of members having voting rights must be equal [*Corp. Code § 12404*].

(5) If voting power and proprietary interests will be unequal, either:

(a) Statement of general rule or rules by which they are determined; or

(b) Statement that general rule or rules will be prescribed in bylaws.

b. If appropriate, include either or both of following provisions [*Corp. Code § 12313(a)*]:

NOTE:
If the co-op will have the following features, they must be authorized in the articles in order to be effective [*Corp. Code § 12313(a)*].

(1) Limitation on duration of co-op's existence to specified date.

(2) Provision for distributing co-op's remaining assets to charitable trust after payment or adequate provision for all debts and liabilities.

c. If desired, include any or all of following optional information [*Corp. Code § 12313(c)*]:

(1) Names and addresses of persons appointed to act as initial directors.

(2) Provisions or authorization for board to provide for transfer of all memberships, or those within classes, with or without restriction or limitation.

NOTE:
Unless the articles or bylaws provide otherwise, no member may transfer a membership or any right arising from it, and all membership rights will terminate upon the death of the member or dissolution of the co-op or a member that is a business entity [*Corp. Code § 12410(a)*].

(3) Provision creating classes of members.

(4) If two or more classes created, any rights, privileges, preferences, restrictions, and conditions attaching to each class.

(5) Provision conferring on members right to determine consideration for which memberships will be issued.

(6) Any other provisions for management of activities and conduct of co-op's affairs that are required or permitted to be stated in bylaws and are not in conflict with law [*see § 14.143*, PP 1-3].

d. If desired, include further statement limiting purposes or powers of co-op [*Corp. Code § 12312*].

e. If desired, include provision stating that ownership of proprietary interests that would otherwise escheat to the state will be transferred to co-op [*see Corp. Code § 12446*; *see also Code Civ. Proc. §§ 1500-1582* (Unclaimed Property Law)].

NOTE:

This type of provision may be included in the articles or the bylaws [*Corp. Code § 12446*]. For an example and discussion of the transfer provision, see *§ 14.240*.

2. Have articles signed and acknowledged by [*Corp. Code § 12300(b)*]:

NOTE:

Acknowledgment may take either of two forms: notarial acknowledgment [***see*** *Civ. Code §§ 1180-1207*] or written declaration [*Corp. Code § 12221*; ***see*** *§ 14.200*].

a. Each named director, if initial directors are named in articles; or

b. Incorporators, if initial directors are not named in articles.

3. If incorporating an unincorporated association, draft verified statement of approval to accompany articles on filing [*Corp. Code § 12301(c)*; *see § 14.220*].

4. Obtain check for filing fee [*see Gov. Code § 12186(d)*].

NOTE:

The Secretary of State may cancel the filing of the articles if the check or other remittance accepted in payment of the filing fee or franchise tax is not paid on presentation [*Corp. Code § 12214.5*]. Within 70 days after the articles are filed, the Secretary of State must give written notice to the agent for service of process (or the person submitting the instrument for filing) that the item presented for payment was not honored. The notice must specify a date, not less than 20 days after the date that the notice is mailed, on which the cancellation becomes effective if the fee has not been paid by cashier's check or its equivalent [*Corp. Code § 12214.5*].

Corporations that incorporate or qualify to do business in California are generally exempt from the minimum franchise tax for the first taxable year [*Rev. & Tax. Code § 23153(f)(1), (3)* (limitation)].

5. Make copies for filing and tax purposes.

NOTE:

For a detailed discussion of the number of copies needed, see Ch. 3, ***Articles of Incorporation*** **.**

6. File articles with Secretary of State [*see Corp. Code § 12214*].

NOTE:

For a detailed checklist of procedures for filing articles of incorporation, see Ch. 3, ***Articles of Incorporation*** **.**

7. If incorporating an unincorporated association, file certified copy of articles in county recorder's office of county where real property of association is located.

NOTE:

Filing a copy of the articles will evidence record ownership in the corporation of all interests of the association in and to the real property located in that county [*Corp. Code § 12301(e)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Formation of Consumer Cooperative Corporations

7-14 California Legal Forms--Transaction Guide § 14.142

§ 14.142 Holding First Meeting of Directors

NOTE:
If the articles of incorporation do not specify the initial directors, the incorporators may meet to name the directors and adopt bylaws [***see*** *Corp. Code § 12316*].

1. Instruct initial board of directors to hold first meeting.

NOTE:
For a detailed checklist of procedures to be followed at the first meeting, see Ch. 5, ***Directors' Meetings, Actions, and Resolutions*** .

a. Fix time and place of meeting.

b. Have any two directors call meeting [*Corp. Code § 12351(a)(1)*].

c. Prepare notice of meeting [*Corp. Code § 12351(a)(2)*] or waiver of notice to be signed by each director [*Corp. Code § 12351(a)(3)*].

2. Distribute membership applications, if used.

3. Have directors adopt bylaws.

NOTE:
For an outline of considerations involved in drafting bylaws, see *§ 14.143*.

4. Have directors choose following officers [*Corp. Code § 12353(a)*]:

NOTE:
The same person may hold any number of offices unless the articles or bylaws provide otherwise [*Corp. Code § 12353(a)*].

a. Either:
(1) Chair of the board;

NOTE:
The chair may be given the title "chair of the board," "chairperson of the board," "chairman of the board," or "chairwoman of the board" [*Corp. Code § 12353(a)*; *see Corp. Code § 12228.5* (definition of "chair")].

(2) President; or

(3) Both chair and president.

NOTE:
Either the chair of the board or the president must be elected from among the board members elected by the membership of the co-op [*Corp. Code § 12353(a)*].

b. Secretary.

c. Treasurer or chief financial officer or both.

d. Any other officers with titles and duties that:

(1) Are stated in bylaws or determined by board; and

(2) May be necessary to enable it to sign instruments.

5. Have directors determine:

a. Address of co-op's principal office.

b. Manner in which memberships will be issued.

c. Whether consideration for memberships will be required.

d. Whether membership certificates will be issued.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Formation of Consumer Cooperative Corporations

7-14 California Legal Forms--Transaction Guide § 14.143

§ 14.143 Drafting Bylaws

1. Include the following required provisions [*Corp. Code § 12331(a)*]:

a. One of following regarding number of directors [*see § 14.240[2], Section 3.01*]:

NOTE:
The number of directors cannot be less than three [*Corp. Code § 12331(a)*].

(1) Statement of fixed number.

(2) Method of determining number of directors.

(3) Statement that number must not be less than stated minimum or more than stated maximum, with exact number to be fixed by approval of board or members subject to bylaw voting requirements [*see Corp. Code § 12331(e)*].

b. If alternate directors are provided for:

(1) Manner and times of election; and

(2) Conditions to their service.

2. Unless provided for in articles of incorporation, include [*Corp. Code § 12445*]:

a. Manner of determining each member's share of co-op's capital, and if repayable, time and manner for repayment [*see § 14.240[2]*, Section 1.08].

b. Manner of determining value, if any, of member's interest in co-op apart from contributed capital, and time and manner of co-op's purchase, if required, of interest from terminated member [*see § 14.240[2]*, Section 1.08].

3. If desired, include any of following optional provisions [*Corp. Code §§ 12331(c)-(g), 12332, 12333*]:

a. Any provisions that are permitted to be included in articles of incorporation [*see Corp. Code § 12313(c)*; *see also § 14.141*, P 1(c)].

b. Time, place, and manner of calling, conducting, and giving notice of members', directors', and committee meetings, or of conducting mail ballots [*see § 14.240[2], Sections 2.01-2.12*, 3.07-*3.15*].

c. Following matters regarding directors [*see § 14.240[2], Sections 3.02, 3.04, 3.06, 3.12*]:

(1) Qualifications.

(2) Duties.

(3) Compensation.

(4) Time of election.

(5) Quorum requirements for:
(a) Directors' meetings.

(b) Committee meetings.

d. Following matters regarding committees [*see § 14.240[2], Section 3.16*]:

(1) Appointment.

(2) Authority.

e. Following matters regarding officers [*see § 14.240[2], Sections 4.01, 4.02*]:

(1) Appointment.

(2) Duties.

(3) Compensation.

(4) Tenure.

f. Mode of determining members of record [*see § 14.240[2], Section 2.06*].

g. Making of reports and financial statements to members [*see § 14.240[2], Sections 5.02*, 5.03].

h. Setting, imposing, and collecting dues, assessments, and membership and transfer fees [*see § 14.240[2],* Sections 1.04, 1.05].

i. Following matters regarding patronage distributions [*see § 14.240[2], Sections 7.01, 7.02*]:

(1) Time.

(2) Manner.

j. Following matters regarding members [*see § 14.240[2],* Sections 1.02-1.04, 1.10-1.12]:

(1) Eligibility.

(2) Manner of admission.

(3) Withdrawal.

(4) Suspension.

(5) Expulsion.

(6) Suspension or termination of memberships.

k. Provisions limiting number of members, in total or of any class, that co-op is authorized to admit.

l. Provisions for establishing program for education of members, officers, employees, and general public in principles and techniques of cooperation.

m. Provisions requiring, for any or all corporate actions, greater vote of members, members of any class, unit, or grouping of members, or directors, than required by law.

n. Provisions for "delegates" of members.

NOTE:

A delegate is a person who is empowered with some or all of the authority of a member [*Corp. Code § 12332*]. However, that person is not a member by virtue of any rights held as a delegate [Corp. Code § 12338(d)(1)]. When delegates are authorized, the bylaws must set forth the delegates' terms of office, any reasonable method for selection and removal, and any reasonable method for calling, noticing, and holding meetings of delegates [*Corp. Code § 12332*].

o. Provisions for voting by members or delegates on basis of chapter or other organizational unit, or by region or other geographic grouping.

p. Provision stating that ownership of proprietary interests that would otherwise escheat to state will be transferred to co-op [*see Corp. Code § 12446*].

NOTE:

If this provision is included in the articles or bylaws, a "proprietary interest" in the co-op (including a membership, share, or certificate [***see*** *Corp. Code § 12446(c)*]) that would otherwise escheat to the state pursuant to the Unclaimed Property Law [*Code Civ. Proc. §§ 1500-1582*] will instead become the property of the co-op [*Corp. Code § 12446(a)*]. For discussion and an example of this optional provision, see *§ 14.240*.

q. Any other provision, not in conflict with law or articles, for management of activities and for conduct of affairs of co-op.

4. Include certificate of secretary.

NOTE:

The original or a copy of the bylaws, in writing or in any other form capable of being converted into clearly legible tangible form, certified to be a true copy by a person purporting to be the secretary or an assistant secretary of the co-op is prima facie evidence of the adoption of those bylaws and the matters stated therein [*Corp. Code § 12355*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Formation of Consumer Cooperative Corporations

7-14 California Legal Forms--Transaction Guide §§ 14.144-14.159

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§§ 14.144[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14 California Legal Forms--Transaction Guide § 14.160

§ 14.160 Issuing Memberships

1. Draft applications for membership, if used.

2. If memberships will be issued for consideration, draft disclosure document [*see § 14.260*].

NOTE:
The disclosure document may be in the form of a prospectus, offering circular, brochure or similar document, specimen copy of a membership certificate, or receipt that the co-op proposes to issue [*Corp. Code § 12401(b)*].

a. Include following required information [*Corp. Code § 12401(b)(1), (2)*]:
(1) Statement that co-op is cooperative corporation.

(2) Statement that copy of articles and bylaws will be furnished free of charge to member or prospective member upon written request, including:
(a) Address of office of co-op.

(b) Address to which written request should be directed.

b. Document must either:

(1) Contain following required information [*Corp. Code § 12401(b)(3)-(7)*]:

(a) Statement of whether membership is redeemable and conditions under which it may be redeemed at option of co-op or member.

(b) If co-op has imposed restrictions on transfer of memberships, statement to that effect and restrictions imposed.

(c) If co-op may levy dues, assessment, or membership or transfer fees, statement to that effect and conditions under which co-op can make levy.

(d) If members are required to contribute services to co-op, statement to that effect and amount and nature of services to be contributed.

(e) If voting power or proprietary interest of members is unequal, statement to that effect and rules by which voting power and interests will be determined.

(2) Include all of following [*Corp. Code § 12401(b)(8)*]:

(a) Reference to required information [*see § 14.160*, P 2(c)(i)].

(b) Statement that required information will be provided free of charge to member or prospective member who makes written request.

(c) Address of office of co-op.

(d) Address to which request should be directed.

3. If membership certificates will be issued, draft certificates to contain information required in disclosure documents [*Corp. Code § 12401(a)*; *see* § 14.144, P 1(b), (c)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesBusiness & Corporate LawCooperativesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14 California Legal Forms--Transaction Guide § 14.161

§ 14.161 Filing Annual Statement

1. File required annual statement on form prescribed by Secretary of State:

NOTE:
The statement contains the names and complete business or residence addresses of the co-op's chief executive officer or general manager, secretary and chief financial officer, the street address of the co-op's principal office in California, and its agent for service of process [*Corp. Code § 12570(a), (b)*].

a. Within 90 days after filing original articles.

b. Annually thereafter during applicable filing period.

NOTE:
The applicable filing period is the calendar month during which the original articles were filed and the preceding five calendar months. The Secretary of State will mail a form for compliance to the co-op three months prior to the close of the applicable filing period. The form will state its due date and will be mailed to the last address of the co-op according to the records of the Secretary of State [*Corp. Code § 12570(c)*].

2. Pay filing fee [Gov. Code § 121868(g), (p)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness

& Corporate LawCooperativesManagement Duties & LiabilitiesCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14 California Legal Forms--Transaction Guide § 14.162

§ 14.162 Preparing Annual Report

NOTE:

If the co-op has more than 25 members at any time during the fiscal year, an annual report must be prepared no later than 120 days after the close of the fiscal year [*Corp. Code § 12591(a), (c)*]. Unless otherwise specified in the articles or bylaws, this report and any accompanying material may be sent by electronic transmission by the corporation [***see*** *Corp. Code § 20*] if approved by the board of directors [*Corp. Code § 12591(a)*]. If the co-op has less than 25 members, it must only issue a statement of transactions and indemnifications of interested persons within 120 days after the close of the fiscal year [*Corp. Code § 12592*; ***see*** P 1e, ***below***]. Unless otherwise specified in the articles or bylaws, this statement may be sent by electronic transmission by the corporation [***see*** *Corp. Code § 20*] if approved by the board of directors [*Corp. Code § 12591(a)*].

1. Draft annual report, including in appropriate detail all of following [*Corp. Code § 12591(a)*]:

a. Balance sheet as of end of fiscal year.

b. Income statement.

c. Statement of cash flows for fiscal year.

d. Statement of place where names and addresses of current members are located.

e. Statement of transactions and indemnifications of interested persons involving more than $1,000 [*see Corp. Code § 12592(a)*; *see also Corp. Code § 12592(d), (e)*].

2. Attach either [*Corp. Code § 12591(b)*]:

a. Report by independent accountants; or

b. Certificate of authorized officer of co-op that statements were prepared without audit from books and records of co-op.

3. Notify each member of right to receive report.

4. Send most recent report to any member upon written request.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14 California Legal Forms--Transaction Guide § 14.163

§ 14.163 Correcting Errors or Defects in Filed Instruments

1. Draft certificate of correction to correct any of the following in any filed instrument [*Corp. Code § 12213*]:

NOTE:
For examples of certificates of correction, see Ch. 10, ***Amendment of Articles*** **.**

a. Misstatement of fact.

b. Defect in execution.

c. Any other error or defect.

2. Include all of the following [*Corp. Code § 12213*]:

a. Following title: "Certificate of Correction of _____ [*title of instrument and name of co-op*]."

b. Name of co-op.

c. Date that instrument being corrected was filed.

d. Provision in instrument as corrected.

e. If execution was defective, reason for defect.

3. Have certificate signed and verified or acknowledged according to requirements for instrument being corrected.

4. Pay filing fee when filing certificate with Secretary of State [*Gov. Code § 12186(p)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14 California Legal Forms--Transaction Guide § 14.164

§ 14.164 Amending Articles of Incorporation

NOTE:
For a detailed discussion and a form for the certificate of amendment of articles of incorporation, see *§ 14.221*.

1. Advise co-op that amendment generally requires approval of both board and members [*Corp. Code § 12502*; *see Corp. Code §§ 12222, 12224* (definitions of approval)].

a. Amendment by incorporators is permitted when [*Corp. Code § 12501*]:
(1) No directors were named in articles;

(2) No directors have been elected; and

(3) Corporation has no members.

b. Approval by members of class is also required if amendment affects any rights of that class [*see Corp. Code § 12503*].

2. Draft certificate of amendment, including [*Corp. Code § 12505(a)*]:

a. Statement that wording of amendment [*see* P 3, *below*] is in accordance with law.

b. Statement that amendment has been approved by board.

c. If amendment requires approval of members or 100 percent of voting power, statement that amendment was approved by required vote of members.

d. If amendment may be adopted by approval of board alone, statement of facts entitling board alone to adopt amendment.

3. Establish wording of amendment in certificate by one or more of following [*Corp. Code § 12507*]:

a. Statement that articles will be amended to read as set forth in full.

b. Statement that any specified provision will be stricken from articles or amended to read as set forth in certificate.

c. Statement that provisions set forth will be added to articles.

d. If purpose of amendment is to reclassify, cancel, exchange, or otherwise change outstanding memberships, statement of effect on outstanding memberships.

4. Have certificate signed and verified by both [*Corp. Code § 12241*; *see Corp. Code § 12505*]:

a. Chair of board, president, or any vice president; and

b. Secretary, chief financial officer, treasurer, assistant secretary, or assistant treasurer.

5. If amendment is adopted by incorporators, include [*Corp. Code § 12506*]:

a. Statements that:

(1) Signers constitute majority of incorporators.

(2) Directors were not named in articles or elected.

(3) Corporation has no members.

(4) Incorporators adopt amendments as set forth.

b. Signatures and verification of majority of incorporators.

6. Pay filing fee when filing certificate with Secretary of State [*Gov. Code § 12186(p)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14 California Legal Forms--Transaction Guide § 14.165

§ 14.165 Federal Income Tax Procedures

1. File annual income tax return on IRS Form 1120 [*Treas. Reg. § 1.6012-2(a)(3)*] on or before:

a. If return is made on basis of fiscal year, 15th day of third month following close of taxable year [*I.R.C. § 6072(b)*].

b. If return is made on basis of calendar year, fifteenth day of March following close of calendar year [*I.R.C. § 6072(b)*].

c. If 50 percent or more of net earnings from business done for or with patrons was paid out in patronage dividends [*see § 14.48[2]*, and *I.R.C. § 6072(d)(2)*]:
(1) If return is made on basis of fiscal year, 15th day of ninth month following close of fiscal year.

(2) If return is made on basis of calendar year, 15th day of September following close of taxable year.

2. File one of following forms if patronage dividends aggregating $10 or more were paid to any patron within calendar year [*I.R.C. § 6044*]:

a. Information return on IRS 1096 and 1099 showing [*Treas. Reg. § 1.6044-2(a)*]:

(1) Aggregate amount of dividend payments.

(2) Name and address of person to whom paid.

b. Application for exemption from reporting requirements on IRS Form 3491, if co-op is primarily engaged in selling at retail goods or services for personal, living, or family use [*I.R.C. § 6044(c)*; *Treas. Reg. § 1.6044-4(b)*].

3. If information return was filed, mail one of following to each person for whom co-op filed return [*I.R.C. § 6044(e)*]:

a. Statement that includes:

(1) Name and address of co-op [*see I.R.C. § 6044(e)*].

(2) Aggregate amount of payments reported for that person [*see I.R.C. § 6044(e)*].

(3) Legend stating that amount shown was reported to I.R.S. [*Treas. Reg. § 1.6044-5(b)*].

b. Copy of filed IRS Form 1099 [*Treas. Reg. § 1.6044-5(b)*].

4. If co-op opts to net patronage gains and losses for any taxable year [*I.R.C. § 1388(j)(3)(A)*; *see § 14.48[3]*]:

a. Prepare written notice stating all of following:

NOTE:
Any detailed data regarding earnings and losses that could result in a competitive disadvantage to the co-op, may be omitted [*I.R.C. § 1388(j)(3)(B)*].

(1) That organization has offset earnings and losses from one or more allocation units, and that offset may affect amount distributed to patrons.

(2) General identification of allocation units.

(3) Any rights that patrons have to additional financial information of co-op under terms of its charter, articles, bylaws, or any provision of law.

b. Send copy of notice to all patrons on or before 15th day of ninth month following close of taxable year.

NOTE:
Failure to provide sufficient notice will not affect the tax treatment of the co-op [*I.R.C. § 1388(j)(3)(C)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesTax LawFederal Taxpayer GroupsGeneral OverviewTax LawState & Local TaxesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14 California Legal Forms--Transaction Guide § 14.166

§ 14.166 State Income Tax Procedures

1. File annual state income tax return on or before 15th day of third month following close of income year [*see Rev. & Tax. Code § 18601(a)*].

2. File information return if patronage dividends [*see § 14.48[2]*] totaling $100 or more were paid to any patron within calendar year, stating [*Rev. & Tax. Code § 18640(a)*]:

a. Name and address of each patron receiving allocations of $100 or more.

b. Amount of allocations to each patron.

3. If information return is required to be filed [*see* P 2, *above*], provide written statement to each person whose name is required to be set forth in information return [*Rev. & Tax. Code § 18640(b)*].

NOTE:
The Franchise Tax Board may prescribe the form of the statement [*Rev. & Tax. Code § 18640(b)*].

a. Include both of following in statement [*Rev. & Tax. Code § 18640(b)*]:
(1) Name and address of co-op.

(2) Amount of allocations.

b. Provide statement [*Rev. & Tax. Code § 18640(c)*]:

(1) On or before January 31 of year following calendar year for which information return was made.

(2) In person or by first-class mail.

NOTE:
If the statement is provided in a separate mailing by first-class mail, it must contain adequate notice that the statement is enclosed [*Rev. & Tax. Code § 18640(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesTax LawState & Local TaxesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14 California Legal Forms--Transaction Guide §§ 14.167-14.199

[Reserved]

§§ 14.167[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation

7-14 California Legal Forms--Transaction Guide § 14.200

§ 14.200 Articles of Incorporation for Consumer Cooperative Corporation

[1] Comment

[a] Use of Form

This form is a set of articles of incorporation for a consumer cooperative corporation formed pursuant to the Consumer Cooperative Corporation Law [*Corp. Code §§ 12200-12704*]. It may also be used to incorporate an existing unincorporated association that intends to change its status to a consumer co-op.

For articles of incorporation for an agricultural cooperative association, see *§ 14A.32*. For a detailed analysis of articles of incorporation generally, see Ch. 3, *Articles of Incorporation* .

[b] Required Provisions--Corporate Name

The articles of incorporation for a consumer co-op must state the name of the corporation [*Corp. Code § 12310(a)*]. The co-op must include the word "cooperative" in its name [*Corp. Code § 12311(a)*]. In addition, it must affix or prefix some word or abbreviation to its name to indicate that it is a corporation, as distinguished from a natural person, a firm, or an unincorporated association [*Corp. Code § 12311(a)*].

The Secretary of State will not file the articles of incorporation if the words "bank," "trust," "trustee," or related words appear in the co-op's name, unless a certificate of approval of the Commissioner of Financial Institutions is attached to the articles [*Corp. Code § 12302(a)*]. In addition, the Secretary of State will not file articles that set forth a name that is likely to mislead the public, or that is the same as or resembles so closely so as to tend to deceive the name of another corporation that has its name on file in California. However, the new consumer co-op may adopt a name substantially similar to that of an existing corporation upon proof of consent by the existing corporation and a finding by the Secretary of State that under the circumstances the public is not likely to be misled [*Corp. Code § 12302(b)*]. A corporation may be enjoined from using these prohibited names, even after the filing of the articles with the Secretary of State [*Corp. Code § 12302(c)*].

If a co-op is organized by a person who was or is an officer, director, or member of an unincorporated association which remains unincorporated, the new co-op may not use a name that is the same as or similar to the unincorporated association. The unincorporated association may continue to use its name [*Corp. Code § 12301(g)*].

A co-op may obtain a certificate of reservation of corporate name from the Secretary of State by paying a reservation fee [*see Gov. Code § 12186(a)*]. For a discussion of the procedural steps involved in name reservation, see *Ch. 2, Formation of Corporations, § 2.100* et seq.

[i] Corporate Purpose

The articles must set forth verbatim the following statement: "This corporation is a cooperative corporation organized under the Consumer Cooperative Corporation Law. The purpose of this corporation is to engage in any lawful act or activity for which a corporation may be organized under such law." The articles may contain a further description or limitation of the co-op's purposes [*Corp. Code §§ 12310(b), 12312*].

[ii] Initial Agent for Service of Process

The name of the co-op's initial agent for service of process must be stated [*Corp. Code § 12310(c)*]. The agent may be a natural person residing in California, or any domestic or foreign corporation that has filed a required certificate [*see Corp. Code §§ 1505, 6213, 8213, 12573*] and whose capacity to act as an agent has not terminated. If a natural person is designated, the person's complete business or residence address must be stated. If a corporate agent is designated, no address must be stated [*Corp. Code § 12570(b)*; *see Corp. Code § 12310(c)*].

[iii] Voting Power and Proprietary Interests

The articles must also state whether the voting power or the proprietary interests of the members are equal or unequal. Equal voting power means voting power apportioned on the basis of one vote for each member. Equal proprietary rights means property rights apportioned on the basis of one proprietary unit for each member [*Corp. Code § 12310(d)*]. Each member entitled to vote is limited to one vote on each matter submitted to a vote of the members [*see Corp. Code § 12480*], and the voting power of members having voting rights must be equal, except in a "central organization" [*Corp. Code § 12404*; *see Corp. Code § 12314*], which is a co-op whose membership consists wholly or partially of other consumer co-ops [*Corp. Code § 12256*]. Voting power in a central organization may be based on the number of its members' members, the patronage of its members, or both. No member may have less than one vote [*Corp. Code § 12314*]. If rights and interests in a central organization are unequal, the articles must state either: (1) the general rule or rules by which the voting power and proprietary interests of the members are determined, or (2) that the general rule or rules will be prescribed in the bylaws [*Corp. Code § 12310(d)*]. This form provides for equal voting rights and proprietary interests.

[iv] Members' Interest in Corporation

Either the bylaws or the articles must prescribe the manner of determining each member's share of the capital of the co-op contributed by the members, and, if repayable, the time and manner for its repayment [*Corp. Code § 12445(a)*]. In addition, the bylaws or articles must prescribe the manner of determining the value, if any, of the member's interest in the co-op apart from contributed capital, and the time and manner of the co-op's purchase, if required, of that interest from a terminated member [*Corp. Code § 12445(b)*]. These articles do not include this provision. For such a provision, see *§ 14.240[2]*, Section 1.07(b), (c).

[c] Optional Provisions

[i] Duration of Existence and Distribution of Assets

To limit a co-op's duration effectively to a specified date or to require distribution of the remaining assets of the co-op (after payment or adequate provision for all of its debts and liabilities) to a charitable trust, the co-op must include specific provisions in its articles [*Corp. Code § 12313(a)*]. Such provisions, if included in the articles, will not affect the enforceability of any lawful agreement as between the parties [*Corp. Code § 12313(b)*].

[ii] Management

The articles may set forth the names and addresses of the persons appointed to act as initial directors [*Corp. Code § 12313(c)(1)*]. They may also include any other provision for the management of the activities, and for the conduct of the affairs of the co-op, that are required or permitted to be stated in the bylaws and are not in conflict with law [*Corp. Code § 12313(c)(4)*].

[iii] Transfer of Memberships

The articles may include provisions concerning transfer of memberships [*Corp. Code § 12313(c)(2)*]. Article provisions may provide for, or authorize the board to provide for, the transfer of all memberships, or of memberships within any class or classes. Transfer provisions may be made with or without restrictions or limitations, including transfer upon the death, dissolution, merger, or reorganization of a member [*Corp. Code § 12410(b)*]. If transfer rights are provided in the articles or bylaws, no restriction of those rights will be binding on memberships issued prior to the adoption of the restriction, unless the membership holders voted in favor of the restriction [*Corp. Code § 12410(c)*]. Unless the articles or bylaws provide otherwise, no member may transfer a membership or any right arising from it, and all membership rights will terminate upon the death of the member or dissolution of the co-op or a member that is a business entity [*Corp. Code § 12410(a)*].

The articles or bylaws may include a provision for the transfer of ownership of proprietary interests that would otherwise escheat to the state to the co-op [*see Corp. Code § 12446*; *see also Code Civ. Proc. §§ 1500-1582* (Unclaimed Property Law)]. For an example and discussion of the transfer provision, see *§ 14.240*.

[iv] Memberships Issued for Consideration

A co-op may issue memberships for consideration or without consideration, as provided in the articles or bylaws [*Corp. Code § 12400*]. The articles may also contain a provision conferring on members the right to determine the consideration for which memberships will be issued [*Corp. Code § 12313(c)(5)*].

[v] Classes of Members

The articles may include a provision creating classes of members. If there are two or more classes, the articles may state the rights, privileges, preferences, restrictions, and conditions attaching to each class [*Corp. Code § 12313(c)(3)*].

[vi] Statement of Purpose

The articles may set forth, in addition to the required statement of purpose [*see Corp. Code § 12310(b)*], a further statement limiting the purposes or powers of the co-op [*Corp. Code § 12312*].

[d] Execution and Filing of Articles

When initial directors are named in the articles [*see Corp. Code § 12313(c)(1)*], each named director must sign and acknowledge the articles. If no initial directors are named, the incorporators must sign the articles [*Corp. Code § 12300(b)*]. Acknowledgment means that the instrument is either formally acknowledged by a notary [*see Civ. Code §§ 1180-1207*] or accompanied by a declaration in writing signed by the persons executing it that they are those persons and that the instrument is the act and deed of the persons executing it [*Corp. Code § 12221*].

The articles must be filed with the Secretary of State, together with the applicable filing fee [*Gov. Code § 12186(c)*]. The Secretary of State may cancel the filing of the articles if the check or other remittance accepted in payment of the filing fee or franchise tax is not paid on presentation [*Corp. Code § 12214.5*; *see § 14.141*, P 4; *see also* Ch. 3, *Articles of Incorporation*].

[e] Incorporating an Unincorporated Association

An unincorporated association may change its status to a consumer co-op by filing articles of incorporation pursuant to the Consumer Cooperative Corporation Law [*Corp. Code § 12300(a)*; *see Corp. Code §§ 12200-12704*]. The articles of incorporation must state, in addition to other required provisions [*see Corp. Code § 12310*; *see also § 14.200[1][b]*], that an existing unincorporated association, stating its name, is being incorporated by the filing of the articles [*Corp. Code § 12301(b)*]. The articles must be accompanied by a verified statement of any two officers or governing board members of the association stating that the incorporation of the association by means of the articles has been approved by the association in accordance with its rules and procedures [*Corp. Code § 12301(c)*; *see § 14.220*]. For a discussion of the consequences of incorporation on an unincorporated association, see *§ 14.31[2]*.

[f] Inspection Rights of Members

The co-op must keep the original or a copy of the articles of incorporation as amended to date at its principal office in California. The articles must be open to inspection by the members at all reasonable times during office hours. If the co-op has no office in California, it must furnish to any member upon written request a copy of the articles as amended to date [*Corp. Code § 12340*].

[g] Amendment of Articles

The Corporations Code sets forth various requirements for amending the articles of incorporation [*see Corp. Code §§ 12500-12510*]. For a complete discussion of these requirements, see *§ 14.221[1]*.

[2] FORM

Articles of Incorporation for Consumer Cooperative Corporation

ARTICLES OF INCORPORATION
OF _____ [*name of co-op*]

I. NAME

The name of the Corporation is _____[*state name*]. [*If incorporating an existing association, add:*] An existing unincorporated association, _____[*state name*], is being incorporated pursuant to the filing of these articles.

II. PURPOSE

This Corporation is a cooperative corporation organized under the Consumer Cooperative Corporation Law. The purpose of this Corporation is to engage in any lawful act or activity for which a corporation may be organized under such law. [*If corporate purposes or powers are further limited, add:*] The _____ [purposes *or* powers] of the Corporation are further limited to: _____[*describe limitations*].

III. INITIAL AGENT FOR SERVICE OF PROCESS

The name of the Corporation's initial agent for service of process is _____[*name*]. [*If agent is a natural person, add:*] The agent's complete _____[business *or* residential] address is _____[*street, city, state, and zip code*].

IV. VOTING RIGHTS AND PROPRIETARY INTERESTS

The voting rights and proprietary interests of each member of the Corporation are equal, and each member is entitled to one vote.

[*Optional*]

V. DIRECTORS

The names and addresses of the persons appointed to act as the initial Directors are as follows:

Name	Address
_____	_____
_____	_____

[*Optional*]

VI. DURATION OF EXISTENCE

This Corporation's existence is of limited duration and will cease on _____[*date*].

[*Optional*]

VII. DISTRIBUTION OF ASSETS TO CHARITABLE TRUST

The remaining assets of the Corporation, after payment or adequate provision for all of its debts and liabilities, shall be distributed to the following charitable trust: _____[*describe trust*].

[*Optional*]

VIII. TRANSFER OF MEMBERSHIPS

The Board of Directors may provide for the transfer of all memberships, or of memberships within any class or classes, with or without restrictions or limitations, including transfer upon the death, dissolution, merger, or reorganization of a member.

[*Optional*]

IX. CLASSES OF MEMBERS

The Corporation shall have _____[*number greater than one*] classes of members. The rights, privileges, preferences, restrictions, and conditions attaching to each class shall be as follows: _____[*describe for each class*].

[*Optional*]

X. MEMBERSHIP CONSIDERATION

The members of the Corporation shall have the right to determine the amount of consideration for which memberships will be issued.

[*Continue with the following:*]

IN WITNESS WHEREOF, the undersigned have executed these Articles of Incorporation on _____[*date*].

[*If initial directors are not named in articles:*]

_____ [*signature of incorporator*]
[*typed name*]

_____ [*signature of incorporator*]
[*typed name*]

_____ [*signature of incorporator*]
[*typed name*]

[*Or, if initial directors are named in articles:*]

_____ [*signature of director*]
[*typed name*]

_____ [*signature of director*]
[*typed name*]

_____ [*signature of director*]
[*typed name*]

ACKNOWLEDGMENT

[*Acknowledgments taken in California must be in the following form (Civ. Code § 1189(a)(1)):*]

State of California)
County of _____)
)

On _____[*date*], before me, _____[*name and title of officer taking acknowledgment*], personally appeared _____[*name(s) of person(s) signing instrument*], who proved to me on the basis of satisfactory evidence] to be the person[s] whose name[s] _____[is *or* are] subscribed to the within instrument and acknowledged to me that _____[he *or* she *or* they] executed the same in _____[his *or* her *or* their] authorized _____[capacity *or* capacities], and that by _____[his *or* her *or* their] signature[s] on the instrument the person[s], or the entity upon behalf of which the person[s] acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct. WITNESS my hand and official seal.

Signature _____ _____[*Seal*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART IV. FORMS
A. Articles of Incorporation

7-14 California Legal Forms--Transaction Guide §§ 14.201-14.219

[Reserved]

§§ 14.201[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART IV. FORMS
B. Other Documents Related to Articles

7-14 California Legal Forms--Transaction Guide § 14.220

§ 14.220 Verified Statement of Approval to Incorporate Unincorporated Association

[1] Comment

[a] Use of Form

This form is intended to accompany the articles of incorporation of an existing unincorporated association that is incorporating pursuant to the Consumer Cooperative Corporation Law. An association may change its status to that of a co-op upon a proper authorization for incorporation by the association in accordance with its rules and procedures [*Corp. Code § 12301(a)*]. The articles filed with the Secretary of State must be accompanied by a verified statement of any two officers or governing board members of the association stating that the incorporation of the association by means of the articles has been approved by the association in accordance with its rules and procedures [*Corp. Code § 12301(c)*]. For a discussion of the consequences of incorporation on an unincorporated association, see *§ 14.31[2]*.

[b] Verification Requirements

The statement of approval must be signed and verified [*Corp. Code § 12301(c)*]. "Verified" means that the statements contained in the statement are declared to be true of the own knowledge of the persons executing it either in an affidavit signed by them under oath before an officer authorized to administer oaths, or in a declaration in writing executed by them under penalty of perjury and stating the date and place of execution [*Corp. Code § 12251*]. This form contains both types of verification.

[2] FORM

Verified Statement of Approval to Incorporate Unincorporated Association

STATEMENT OF _____ [DIRECTORS *or* GOVERNING BOARD MEMBERS] APPROVING INCORPORATION OF _____ [*name of association*]

The undersigned, as _____[Directors *or* governing Board members] of _____[*name of unincorporated association*], state that the incorporation of this Association by means of the Articles of Incorporation to which this Statement is attached has been approved by the Association in accordance with its rules and procedures.

_____ [*signature*]
[*typed name and title*]

_____ [*signature*]
[*typed name and title*]

[*EITHER*]

Declaration

Each of the undersigned declares under penalty of perjury that the matters set forth in the foregoing statement are true and correct of _____[his *or* her] own knowledge and that this declaration was executed on _____[*date*] at _____[*city and state*].

_____ [*signature*]
[*typed name and title*]

_____ [*signature*]
[*typed name and title*]

[*OR*]
Affidavit

State of California)
County of _____)
)

_____[*names*], being duly sworn,each states that _____[he *or* she] has read the foregoing statement and knows its contents, and that the matters set forth therein are true of _____[his *or* her] own knowledge.

_____ [*signature*]
[*typed name and title*]

_____ [*signature*]
[*typed name and title*]

Subscribed and sworn to before me this _____ day of _____, 20 _____.

[*notarial seal*]

_____ [*signature*]
Notary Public



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART IV. FORMS
B. Other Documents Related to Articles

7-14 California Legal Forms--Transaction Guide § 14.221

§ 14.221 Certificate of Amendment of Articles of Incorporation

[1] Comment

[a] Use of Form

This form is the certificate that a consumer co-op must file with the Secretary of State after it has adopted an amendment to its articles. Upon filing the certificate, the articles will be amended in accordance with the certificate and any change, reclassification, or cancellation of memberships will be effected. A copy of this certificate, certified by the Secretary of State, is prima facie evidence that the conditions necessary to adopt the amendment have been performed [*Corp. Code § 12508*].

For a discussion of the amendment of articles generally, see Ch. 10, *Amendment of Articles* .

[b] Permissible Amendments--In General

A consumer co-op may amend its articles at any time and in any respect, as long as the provisions of the amended articles would be lawful if contained in original articles filed at the time of the amendment. In addition, the amended articles may contain any provisions authorized to change its status [*see* discussion in *§ 14.221[1][b][iii]*]. The articles may also contain any provisions necessary to effect a change in the rights of members or an exchange, reclassification, or cancellation of memberships [*Corp. Code § 12500(a)*].

A corporation may not amend its articles to alter any statement contained in the original articles of the names and addresses of the first directors or the initial agent, except to correct an error or to delete the names and addresses after filing an annual statement [*Corp. Code § 12500(b)*; see *Corp. Code § 12570*].

[i] Extending Term of Existence

A consumer co-op formed for a limited period may extend the term of its corporate existence by amending its articles to remove any provision limiting the term of its existence and provide for perpetual existence. The amendment may be

made at any time prior to expiration of the term of corporate existence [*Corp. Code § 12509*].

[ii] Changing Status of Co-Op

A consumer co-op may amend its articles to change its status to that of a public benefit corporation, a mutual benefit corporation, a religious corporation, or a business corporation. Unless the corporation has no members, the amendment must be either (1) approved by the members [*see Corp. Code § 12224(b)*] and the fairness of the amendment to members approved by the Commissioner of Corporations [*see Corp. Code § 25142*], or (2) approved by 100 percent of the voting power [*Corp. Code § 12504(b)*].

The amended articles must include the provisions that would have been required in original articles filed by the type of corporation to which the co-op is being converted, and may include any provisions that such a corporation could include in its original articles of incorporation [*Corp. Code § 12504(c)*]. If the corporation is changing its status to a public benefit corporation, it must provide an additional copy of the certificate of amendment to the Secretary of State to be forwarded to the Attorney General [*Corp. Code § 12504(d)*].

[c] Approval Requirements

[i] Incorporators

An amendment may be adopted by a writing signed by a majority of the incorporators when no directors were named in the original articles, no directors have been elected, and the corporation has no members [*Corp. Code § 12501*]. When the incorporators adopt amendments, the certificate must be signed and verified by a majority of the incorporators. It must state that the signers constitute a majority of the incorporators, that directors were not named in the original articles and have not been elected, that the corporation has no members, and that the signers adopt the amendments set forth [*Corp. Code § 12506*].

For a general form for a certificate of amendment by incorporators, see *Ch. 10, Articles of Incorporation, § 10.200[1]*.

[ii] Board and Members

An amendment may be adopted by the board alone if it (1) extends the corporate existence or makes existence perpetual for a corporation organized before August 14, 1929; (2) deletes the names and addresses of the first directors or the name and address of the initial agent; or (3) is made at a time when the corporation has no members [*Corp. Code § 12502*]. All other amendments, except those requiring class approval [*see § 14.221[1][c][iii]*], may be adopted if approved by the board and the members [*Corp. Code § 12502(a)*; *see Corp. Code §§ 12222*, *12224* ("approval" defined)].

[iii] Class Members

An amendment must also be approved by the members [*see Corp. Code § 12224* (definition)] of a class, whether or not the articles entitle the class to vote, if the amendment would do any of the following [*Corp. Code § 12503*]:

(1) Materially and adversely affect the rights, privileges, preferences, restrictions, or conditions of that class as to voting, dissolution, redemption, or transfer, or the obligations of that class, in a different manner than the action affects another class;

(2) Materially and adversely affect the class as to voting, dissolution, redemption, or transfer by changing the rights, privileges, preferences, restrictions, or conditions of another class;

(3) Increase the number of memberships authorized for that class;

(4) Increase the number of memberships authorized for another class;

(5) Effect an exchange, reclassification, or cancellation of all or part of the memberships of that class; or

(6) Authorize a new class of memberships.

[iv] Approval Requirements in Articles

If, for corporate action, the articles require the approval of a particular class of members, all the votes of any class or a larger proportion than required by law, or approval of all of the directors or a larger proportion than is required by law, the article provision regarding votes may not be altered, amended, or repealed except as provided in the articles [*Corp. Code § 12502*].

[d] Certificate of Amendment

[i] Contents

After adopting an amendment, the corporation must file an "officers' certificate" with the Secretary of State [*Corp. Code § 12505(a)*]. An officers' certificate is a certificate that is signed and verified by the chair of the board, president, or any vice president; and by the secretary, chief financial officer, treasurer, any assistant secretary, or assistant treasurer [*Corp. Code § 12241*].

The certificate must state that the wording of the amendment or amended articles is in accordance with law [*see Corp. Code § 12507*], and that the amendment has been approved by the board [*Corp. Code § 12505(a)(1), (2)*; *see Corp. Code § 12222* (approval defined)]. If the amendment requires approval of the members or 100 percent of the voting power, the certificate must state that the amendment was approved by the required vote of members [*Corp. Code § 12505(a)(3)*]. If the amendment may be adopted by approval of the board alone, the certificate must give a statement of the facts entitling the board alone to adopt the amendment [*Corp. Code § 12505(a)(4)*]. If the articles are amended pursuant to a merger, an officers' certificate and merger agreement of the surviving corporation [*see Corp. Code § 12535*] must be filed in lieu of the certificate of amendment [*Corp. Code § 12505(b)*].

[ii] Wording of Amendment

The certificate of amendment must establish the wording of the amendment or amended articles by one or more of the following means: (1) by stating that the articles will be amended to read as set forth in full, (2) by stating that any provision of the articles (identified by the designation given in the articles or stating the wording) will be stricken from the articles or amended to read as set forth in the certificate, or (3) by stating that the provisions set forth will be added to the articles. If the purpose of the amendment is to reclassify, cancel, exchange, or otherwise change outstanding memberships, the amended articles must state their effect on outstanding memberships [*Corp. Code § 12507*].

[e] Restated Articles of Incorporation

A corporation may restate in a single certificate the entire text of its articles as amended by filing an officers' certificate [*see Corp. Code § 12241*] entitled "Restated Articles of Incorporation of _____ [name of corporation]." The certificate must set forth the articles as amended to the date of filing. The signatures and acknowledgments of the incorporators, any statements regarding the effect of prior amendments on membership, any provisions of agreements of merger, and the names, addresses, signatures, and acknowledgments of the first directors and of the initial agent for service of process must be omitted. These omissions are not alterations or amendments of the articles. The certificate itself may also alter or amend the articles in any respect, as long as the contents and form comply with the general requirements for an officers' certificate [*Corp. Code § 12510(a)*; *see Corp. Code §§*

12505-12507].

If the certificate itself does not alter or amend the articles in any respect, it must be approved by the board [*see Corp. Code § 12222*] and is subject to the law regarding amendments not requiring approval of the members. If it does alter or amend the articles, it is subject to the law relating to type the amendments made [*Corp. Code § 12510(b)*]. Restated articles supersede the original articles and any amendments to them for all purposes [*Corp. Code § 12510(c)*]. For a discussion of restated articles generally, see Ch. 10, *Articles of Incorporation* , § 10.220 et seq.

[f] Verification

The certificate of amendment must be signed and verified [*Corp. Code § 12241*]. "Verified" means that the statements contained in the certificate are declared to be true of the own knowledge of the persons executing it, either in an affidavit signed by them under oath before an officer authorized to administer oaths or in a written declaration executed by them under penalty of perjury and stating the date and place of execution [*Corp. Code § 12251*]. An affidavit sworn to outside California before a notary public, judge, or clerk of a court of record with an official seal need not be further authenticated [*Corp. Code § 12251*].

[g] Filing Fees

The fee for filing a certificate of amendment is stated in *Gov. Code § 12186(p)*. The Secretary of State will certify up to two copies without charge if the copies are submitted with the original for filing [Corp. Code § 12185].

[2] FORM

Certificate of Amendment of Articles of Incorporation

CERTIFICATE OF AMENDMENT OF ARTICLES OF INCORPORATION OF _____ [*name of corporation*]

_____[*Names*] certify:

1. They are the Chair of the Board [*or* the President *or* a Vice President] and the Secretary [*or* the Chief Financial Officer *or* the Treasurer *or* an Assistant Secretary *or* an Assistant Treasurer], respectively, of _____[*name*], a California corporation.

[*If setting forth amended articles:*]

2. The articles of incorporation are hereby amended to read as set forth here in full: _____[*set forth full text of amended articles*].

[*Or, if striking a provision:*]

2. Article _____ [*specify provision, e.g.,* VI. *or state wording of provision*] is hereby stricken from the articles.

[*Or, if amending a provision:*]

2. Article _____ [*specify provision, e.g.*, XI. *or state wording of provision*] is hereby amended to read as follows: _____ [*set forth full text of article as amended, e.g.*, "The period of duration of this Corporation is perpetual"].

[*Or, if adding a provision:*]

2. The following provision(s) are hereby added to the articles: _____[*set forth full text of article as added, e.g.*, "XV. The members of the Corporation shall have the right to determine the amount of consideration for which memberships will be issued"].

[*Continue with the following:*]

3. The wording of the above-stated _____[amendment *or* amended articles] is in accordance with *Section 12507 of the California Corporations Code*.

4. [*Add if the purpose of the amendment is to reclassify, cancel, exchange, or otherwise change outstanding memberships:*] The effect of the amended articles on outstanding memberships is as follows: _____[*describe effect*].

5. This amendment has been approved by the Board of Directors of _____[*name of corporation*].

[*If approval of members is required, add:*]

6. This amendment has been approved by the required vote of members, _____ [*specify number of required votes, e.g.*, one hundred percent of the voting power], in accordance with *Section 12505(a)(3) of the California Corporations Code*.

[*Or, if approval of Board alone is sufficient, add:*]

6. Approval of the Board alone is sufficient to adopt the amendment, based on the following facts: _____ [*state facts authorizing adoption of amendment by board approval alone, e.g.*, The amendment deletes the names and addresses of the first Directors and may be adopted by approval of the Board alone pursuant to *Section 12502(b)(2) of the California Corporations Code*].

[*Continue with the following:*]

_____ [*signature*]
[*typed name and title*]
_____ [*signature*]
[*typed name and title*]

[*EITHER*]

Declaration

Each of the undersigned declares under penalty of perjury that the matters set forth in the foregoing certificate are true and correct of _____[his *or* her] own knowledge and that this declaration was executed on _____[*date*] at _____[*city and state*].

_____ [*signature*]
[*typed name and title*]
_____ [*signature*]
[*typed name and title*]

[*OR*]

Affidavit

State of California)
County of _____)
)

_____[*names*], being duly sworn, each states that _____[he *or* she] has read the foregoing certificate and knows its contents, and that the matters set forth therein are true of _____[his *or* her] own knowledge.

_____ [*signature*]
[*typed name and title*]
_____ [*signature*]
[*typed name and title*]

Subscribed and sworn to before me this _____ day of _____[*date*].

[*notarial seal*]

_____ [*signature*]
Notary Public



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART IV. FORMS
B. Other Documents Related to Articles

7-14 California Legal Forms--Transaction Guide §§ 14.222-14.239

[Reserved]

§§ 14.222[Reserved]



57 of 103 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART IV. FORMS
C. Bylaws

7-14 California Legal Forms--Transaction Guide § 14.240

§ 14.240 Bylaws for Consumer Cooperative Cooperation

[1] Comment

[a] Use of Form

This form is a set of bylaws for a consumer co-op. Many of the bylaw provisions of a consumer co-op are substantially similar to those of a corporation formed under the Mutual Benefit Corporations Law [*see Corp. Code §§ 7110-8910*]. For bylaws of a mutual benefit corporation, see *§ 13.212*. For a detailed discussion of bylaws generally, see Ch. 4, *Bylaws* .

[b] Adoption of Bylaws--By the Board

Except as otherwise provided by law [*see Corp. Code § 12330(a)*], the board of directors may adopt, amend, or repeal bylaws unless that action would (1) materially and adversely affect the rights or obligations of members as to voting, dissolution, redemption, transfer, distributions, patronage distributions, patronage, property rights, or rights to repayment of contributed capital; (2) increase or decrease the number or members authorized in total or for any class; (3) effect an exchange, reclassification, or cancellation of all or part of the memberships; or (4) authorize a new class of membership [*Corp. Code § 12330(a)*].

The articles or bylaws may restrict or eliminate the power of the board to adopt, amend, or repeal any or all bylaws, subject to bylaw voting requirements [*Corp. Code § 12230(c)*; *see Corp. Code § 12231(e)*]. The bylaws may also provide that repeal or amendment of the bylaws (or of specified portions of the bylaws) may occur only with the approval in writing of specified person or persons other than the board or members [*see Corp. Code § 12330(d)*].

[i] By Approval of the Members

Bylaws may be adopted, amended, or repealed by approval of the members [*see Corp. Code § 12224* (definition of "approval of members")]. However, approval of the members of a class is also required if the action would do any of the following [*Corp. Code § 12330(b)*]:

(1) Materially and adversely affect the rights or obligations of that class as to voting, dissolution, redemption, transfer, distributions, patronage distributions, patronage, property rights, or rights to repayment of contributed capital, in a manner different than that action affects another class;

(2) Materially and adversely affect that class as to voting, dissolution, redemption, transfer, distributions, patronage distributions, patronage, property rights, or rights to repayment of contributed capital, by changing the rights, privileges, preferences, restrictions, or conditions of another class;

(3) Increase or decrease the number of memberships authorized for that class;

(4) Increase the number of memberships authorized for another class;

(5) Effect an exchange, reclassification, or cancellation of all or part of the memberships of that class; or

(6) Authorize a new class of memberships.

After members have been admitted, a bylaw provision that changes a fixed number of directors, changes the maximum or minimum number, or changes a fixed board to a variable one or vice versa can only be adopted by approval of the members [*Corp. Code § 12331(b)*].

[c] Required Bylaw Provisions

[i] In General

The bylaws must state the number of directors of the co-op, the method of determining the number of directors, or that the number of directors must not be less than a stated minimum or more than a stated maximum, with the exact number to be fixed by approval of the board or members [*see Corp. Code §§ 12222, 12224* (approval defined); *see also* Section 3.01 of Form] subject to bylaw voting requirements [*Corp. Code § 12331(a)*; *see Corp. Code § 12331(e)*]. The number of directors cannot be less than three. If alternate directors are provided for, the bylaws must specify the manner and times of their election and the conditions to their service in place of a director [*Corp. Code § 12331(a)*].

[ii] Member's Share of Capital

Either the bylaws or the articles must prescribe the manner of determining each member's share of the capital of the co-op contributed by the members, and if repayable, the time and manner for its repayment [*Corp. Code § 12445(a)*; *see* Section 1.09of Form]. This form provides that the only capital contributions will be made by members through membership fees [*see* Sections 1.04, 1.09 of Form]. Some co-ops, depending on the nature of their business, may require additional start-up capital to be provided through bank financing or additional member contributions.

This form provides that a member's share of capital will be determined simply by dividing the total capital by the total number of memberships, less outstanding obligations owed to the co-op by that member [*see* Section 1.09 of Form]. However, co-ops formed with a more complex capital structure may wish to provide a method for determining each member's share of capital based on that member's actual capital contributions.

[iii] Valuation of Member's Interest

The bylaws or articles must also prescribe the manner of determining the value, if any, of the member's interest in the co-op apart from contributed capital, and the time and manner of the co-op's purchase, if required, of that interest from a terminated member [*Corp. Code § 12445(b)*]. This form contains alternative provisions, allowing a co-op to grant members some or no additional interest in the co-op. It provides that upon dissolution, the co-op will distribute any

corporate assets remaining after payment of all known debts and liabilities among all members equally [*see Corp. Code § 12656*; *see also* Section 1.10 of Form]. Co-ops formed with unequal member contributions may provide for unequal distribution of assets upon dissolution.

[d] Optional Bylaw Provisions

[i] In General

The bylaws may contain any provision, not in conflict with law or the articles, for the management of the activities and for the conduct of the affairs of the co-op. They may include, but are not limited to, the following [*Corp. Code § 12331(c)*]:

(1) Any of the permissible provisions that could be included in the articles of incorporation [*see Corp. Code § 12313(c)*].

(2) The time, place, and manner of calling, conducting, and giving notice of members', directors', and committee meetings, or of conducting mail ballots [*see* Sections 2.01 -2.12, 3.07 -3.15 of Form]. This form requires notice to be given within the period prescribed by *Corporations Code Sections 12461* (members' meetings) and 12351 (directors' meetings).

(3) The qualifications, duties, and compensation of directors [*see* Sections 3.02, 3.06 of Form].

(4) The time of the election of directors [*see* Section 3.04 of Form].

(5) The requirements of a quorum for directors' and committee meetings [*see* Section 3.12 of Form].

(6) The appointment of committees (composed of directors, nondirectors, or both) by the board or any officer, and the authority of those committees [*see* Section 3.16 of Form].

(7) The appointment, duties, compensation, and tenure of officers [*see* Sections 4.01, 4.02 of Form].

(8) The mode for determining members of record [*see* Sections 2.06, 2.13 of Form]. This form requires the record date to be fixed in accordance with *Corporations Code Section 12481*.

(9) The making of reports and financial statements to members [*see* Sections 5.02, 5.03 of Form].

(10) Setting, imposing, and collecting dues, assessments, and membership and transfer fees [*see* Sections 1.04, 1.05 of Form].

(11) The time and manner of patronage distributions [*see* Sections 7.01, 7.02 of Form].

[ii] Members and Memberships

The bylaws may provide for eligibility, manner of admission, withdrawal, suspension, and expulsion of members, and the suspension or termination of memberships [*Corp. Code § 12331(d)*; *see* Sections 1.02 -1.04, 1.10 -1.12 of Form]. They may limit the number of members, in total or of any class, that the co-op is authorized to admit [*Corp. Code § 12331(f)*].

[iii] Education

The bylaws may provide for the establishment of a program for the education of its members, officers, employees, and

the general public in the principles and techniques of cooperation [*Corp. Code § 12331(g)*].

[iv] Delegates

The bylaws may provide for delegates to have some or all of the authority of members. When delegates are authorized, the bylaws must set forth the delegates' terms of office, any reasonable method for selection and removal, and any reasonable method for calling, noticing, and holding meetings of delegates. Unless directly elected by the membership, they must be elected by a body or bodies directly elected by the membership. Delegates may act personally at a meeting or by written ballot, but not by proxy. They may be given a name other than "delegates" [*Corp. Code § 12332*].

[v] Voting

The bylaws may require that any or all corporate actions be approved by all or a larger proportion of the members (or any class, unit, or grouping of members) than that required by law. They may also require the vote of all or a larger proportion of the directors than is required by law. A bylaw provision of this type cannot be altered, amended, or repealed except by that larger vote, unless otherwise provided in the bylaws [*Corp. Code § 12331(e)*].

The bylaws may also provide for voting by the members or delegates on the basis of chapter or other organizational unit, or by region or other geographic grouping [*Corp. Code § 12333*].

[vi] Transfer Provision

The articles or bylaws may specifically provide that proprietary interests in the cooperative corporation that would otherwise escheat to the state pursuant to the Unclaimed Property Law [*see Code Civ. Proc. §§ 1500-1582*; *see also* Ch. 102C, *Lost and Unclaimed Property*] will become the property of the co-op instead [*Corp. Code § 12446*]. For this purpose, a "proprietary interest" includes any membership, membership certificate, membership share, or share certificate of any class that represents a proprietary interest in, and is issued by, the corporation, together with all accrued and unpaid dividends and patronage distributions relating to that interest [*Corp. Code § 12446(c)*]. However, no proprietary interest will become the property of the co-op unless the co-op gives at least 60 days prior notice of a proposed transfer to the affected member (1) by first-class or second-class mail sent to the last address of the member shown on the corporation's records, and (2) by publication in a newspaper of general circulation in the county in which the co-op has its principal office. Notice given in this manner will be deemed to be actual notice [*Corp. Code § 12446(b)(2)*]. Furthermore, no proprietary interest will become the property of the co-op if written notice objecting to transfer is received by the corporation from the affected member prior to the date of the proposed transfer [*Corp. Code § 12446(b)(3)*]. An optional provision containing these requirements is set forth in Section 1.13 of this Form.

[e] Patronage Distributions

In order for a consumer co-op to deduct amounts paid to patrons as patronage dividends or per-unit retain allocations [*see* discussion in *§ 14.48[2]*], payment must be made in money, property, or a "qualified" written notice of allocation or per-unit retain certificate by the fifteenth day of the ninth month following the close of the taxable year [*see I.R.C. § 1382(b)-(d)*]. Qualification will occur if the patron obtains or retains membership in the co-op after it has adopted a bylaw providing that membership constitutes consent to be taxed on the distribution [*I.R.C. § 1388(c)(2)(B), (h)(2)(B)*; *see I.R.C. § 1385(a)*].

The income tax consent form in Section 7.02 of this Form ensures that any payments in the form of allocations will be qualified and thus deductible to the co-op. When consent is obtained through a bylaw provision, the member must receive written notification and copy of that bylaw [*see I.R.C. § 1388(c)(2)(B), (h)(2)(B)*].

[f] Inspection of Bylaws

The co-op must keep at its principal office in California the original or a copy of the bylaws as amended to date, which must be open to inspection by the members at all reasonable times during office hours. If the co-op has no office in California, it must furnish to any member upon written request a copy of the bylaws as amended to date [*Corp. Code § 12340*].

[2] FORM

Bylaws for Consumer Cooperative Cooperation

BYLAWS OF _____ [*name of corporation*]

ARTICLE I. MEMBERS

Number and Classification

Section 1.01. There shall be no limit on the number of members the Corporation may admit. The Corporation shall have only one class of members [*or, if co-op will be structured to have more than one class of members, state that fact and add provisions defining and distinguishing the rights and privileges of each class*].

Eligibility for Membership

Section 1.02. Any person, including any association, company, domestic or foreign corporation, corporation sole, estate, individual, joint stock company, joint venture, partnership, government or political subdivision, or agency or instumentality of a government, is eligible for membership in the Corporation [*or, if membership is to be limited to persons meeting specific requirements, state limitation and list applicable membership requirements in full*].

Admission to Membership

Section 1.03. Any person who has qualified for membership under Section 1.02 of these Bylaws shall be admitted to membership upon submission of an application for membership on a form prescribed by the Board of Directors, approval of that application by the Board, and payment of the amount required to purchase a membership.

Purchase of Memberships

Section 1.04. The amount of $ _____ [*specify amount, e.g.,* 100] shall be charged for the purchase of a membership in the Corporation.

Dues

Section 1.05. The annual dues payable to the Corporation by members shall be in an amount determined by resolution of the Board of Directors, but in no event shall they exceed the amount of $ _____[*specify amount*]. Dues shall be payable for the first year on admission, and annually thereafter at a time fixed by the Board of Directors. A member may avoid liability for dues by resigning from membership promptly after being notified of the dues, unless

the member is liable for them by contract, as a condition to ownership of an interest in real property, as an obligation arising out of the ownership of an interest in real property, or otherwise.

Membership Certificates

[*EITHER*]

Section 1.06(a). The Corporation shall not issue membership certificates, but shall issue a receipt or written advice of purchase to members upon their first purchase of a membership of any class. The Corporation _____[shall *or* may] also issue to members identity cards or similar devices that serve to identify members qualifying to use facilities or services of the Corporation.

(b) Prior to issuing a membership, the Corporation shall provide the purchaser with a disclosure document containing all statements and disclosures required by any applicable law. No disclosure document shall be provided to an existing member who purchases additional memberships if that member has previously been provided with a disclosure document that is accurate and correct as of the date of the purchase of the additional memberships.

[*OR*]

Section 1.06(a). The Corporation shall issue membership certificates to all members evidencing membership in the Corporation. The certificates shall contain the statements required by *Section 12401(a) of the Corporations Code*.

(b) If the articles and bylaws are amended so that any required statement becomes inaccurate, the Board may cancel the outstanding certificates and issue in their place new certificates conforming to the amendments. The Board may order holders of outstanding certificates to surrender and exchange them for new certificates within a reasonable time fixed by the Board, and provide that, upon notice of the order, the membership rights of a certificate holder will be suspended until the certificate is surrendered.

(c) The Corporation may issue a new membership certificate in the place of a certificate which has been lost, stolen, or destroyed. [*Optional:* The Corporation may require the member to give the Corporation a bond or other adequate security sufficient to indemnify it against any claim that may be made against it, including any expense or liability, on account of the alleged loss, theft, or destruction of the certificate or the issuance of the new certificate.]

Transferability of Membership

[*EITHER*]

Section 1.07. Neither membership in the Corporation nor any right arising from membership may be transferred.

[*OR*]

Section 1.07. The Board of Directors may provide for the transfer of memberships [or of memberships within any class or classes], with or without restriction or limitation, including transfer upon the death, dissolution, merger, or reorganization of a member.

Members' Share of Capital and Interest In Corporation

Section 1.08. A member's share of the capital of the Corporation contributed by the members through membership fees shall be a proportionate share based on the total amount of capital divided by the number of memberships, less any outstanding obligations owed by that member to the Corporation. A member's share of capital is repayable only on dissolution or upon a vote of the shareholders or directors. [*Or, if repayable:* A member's share of capital shall be repayable _____ (*specify time and manner, e.g.,* by certified check within 60 days after the close of the fiscal year in which membership is terminated)].

Members shall have no interest in the Corporation apart from contributed capital. [*Or, if members will have an interest, specify manner of determining value of interest, and time and manner of corporation's purchase, if required, of interest from terminated member*]. Upon dissolution, any corporate assets remaining after payment of all known debts and liabilities shall be distributed equally among all members.

Nonliability of Members

Section 1.09. The members of the Corporation shall not be personally liable for the debts, liabilities, or obligations of the Corporation.

Causes for Termination of Membership

Section 1.10. A membership and all membership rights shall automatically terminate upon any of the following events:

(1) The voluntary resignation of a member at any time, by written notice delivered to _____ [*specify officer or other person, e.g.,* the Secretary of the Corporation].

(2) The death of a member or the dissolution of a corporate member.

(3) The expulsion of a member pursuant to Section 1.11 of these Bylaws.

[*Optional*]

Expulsion of Members

Section 1.11(a). A member who _____ [*specify grounds for expulsion, e.g.,* fails to pay his or her dues within 30 days after the date for payment] shall be expelled from membership in the Corporation only after notice and an opportunity to be heard is given pursuant to this section.

(b) The Corporation shall provide written notice of the expulsion and the reasons for expulsion at least 15 days prior to the effective date of the expulsion. The notice shall be given personally or sent by first-class or registered mail to the last address of the member shown on the Corporation's records.

(c) The opportunity to be heard may, at the election of the member, be oral or in writing, and shall occur not less than five days before the effective date of the expulsion. The hearing shall be conducted at _____ [*specify place, e.g.,* the Corporation's principal office] by a committee composed of _____ [*specify persons, e.g.,* the President, Secretary, and Treasurer]. That committee shall have the exclusive authority to decide that the proposed

expulsion shall not take place.

The committee shall conduct the hearing in good faith and in a fair and reasonable manner, and perform the following duties:

(1) Read the charges against the member;

(2) Require the person making the charges to verify them by testimony;

(3) Hear witnesses against the member;

(4) Allow the member to question any witnesses;

(5) Allow the member to make a statement in his or her own behalf;

(6) Allow the member to call witnesses in his or her own behalf;

(7) Allow the committee to question the member's witnesses.

Effect of Termination of Membership

Section 1.12. All rights as a member of the Corporation shall cease on the termination of membership. Termination shall not relieve that member from obligations for charges incurred, services or benefits actually rendered, dues, assessments or fees, or for any obligation arising from contract, a condition to ownership of land, an obligation arising out of the ownership of land, or otherwise.

[*Optional*]

Escheat of Membership to State

Section 1.13. Any membership of a member, together with any accrued and unpaid dividends and patronage distributions relating to that membership, that would otherwise escheat to the State of California as unclaimed personal property shall instead become the property of the Corporation if the Corporation gives at least 60 days prior notice of the proposed transfer to the affected member by (1) first-class or second-class mail to the last address of the member shown on the Corporation's records, and (2) by publication in a newspaper of general circulation in the county in which the Corporation has its principal office. No membership shall become the property of the Corporation under this section if written notice objecting to the transfer is received by the Corporation from the affected member prior to the date of the proposed transfer.

ARTICLE II. MEETINGS OF MEMBERS

Location

Section 2.01. Meetings of members shall be held at the principal office of the Corporation.

Regular Meetings

Section 2.02. A regular meeting of members shall be held annually on the _____ [*specify day and month, e.g.,* first Monday in July] at _____ [*specify time, e.g.,* 4:00 p.m.] for the purpose of transacting any proper business, including the election of Directors, that may come before the meeting. If the day fixed for the regular meeting falls on a legal holiday, the meeting shall be held at the same time and place on the next day.

Special Meetings

Section 2.03. Special meetings of members for any lawful purpose may be called by the Board of Directors [*or* the President *or* the Chair of the Board *or specify other person*] or by five percent or more of the members.

Time for Notice of Meetings

Section 2.04. Whenever members are required or permitted to take action at a meeting, a written notice of the meeting shall be given _____ [*number not less than 10 nor more than 90, e.g.,* 20] days before the date of the meeting to each member who is entitled to vote on the record date for notice of the meeting. In the case of a specially called meeting of members, within 20 days after receipt of a written request, the Chair of the Board [*or* the President *or* the Vice President *or* the Secretary] shall cause notice to be given to the members entitled to vote that a meeting will be held at a time fixed by the Board not less than 35 nor more than 90 days after receipt of the request.

Method of Giving Notice

Section 2.05. Notice shall be given either personally, or by mail or other written communication to the address of a member appearing on the books of the corporation or provided by the member. If no address appears or is given, notice shall be given at the principal office of the Corporation [or by publication in a newspaper in the county where the principal office is located].

Record Date for Notice

Section 2.06. The record date for determining the members entitled to notice of any meeting of members is _____ [*number not greater than 60 nor less than 10, e.g.,* 30] days before the date of the meeting.

Contents of Notice

Section 2.07. The notice shall state the place, date, and time of the meeting. The notice of a regular meeting shall state any matters that the board, at the time of giving notice, intends to present for action by the members. The notice of a special meeting shall state the general nature of the business to be transacted. The notice of any meeting at which Directors are to be elected shall include the names of all nominees at the time of giving notice.

Waivers, Consents, and Approvals

Section 2.08. The transactions of a meeting, whether or not validly called and noticed, are valid if a quorum is present and each of the absent members who is entitled to vote, either before or after the meeting, signs a written waiver of notice, a consent to the holding of the meeting, or an approval of the minutes of the meeting. All waivers, consents, and approvals shall be filed with the corporate records or made a part of the minutes of the meeting.

A member's attendance at a meeting shall constitute a waiver of notice of and presence at the meeting, unless the member objects at the beginning of the meeting. However, attendance at a meeting is not a waiver of any right to object to the consideration of matters required to be included in the notice but not included, if an objection is made at the meeting.

Quorum at Meeting

Section 2.09. The lesser of 250 members or members representing 5 percent of the voting power shall constitute a quorum at a meeting of members. Any bylaw amendment to increase the quorum may be adopted only by approval of the members. When a quorum is present, the affirmative vote of the majority of the voting power represented at the meeting and entitled to vote shall be the act of the members, unless provided otherwise by these bylaws or the law.

Loss of Quorum at Meeting

Section 2.10. The members present at a duly called or held meeting at which a quorum is present may continue to transact business until adjournment, notwithstanding the withdrawal of enough members to leave less than a quorum, if the action taken, other than adjournment, is approved by at least a majority of the members required to constitute a quorum.

Adjournment for Lack of Quorum

Section 2.11. In the absence of a quorum, any meeting of members may be adjourned by the vote of a majority of the votes represented in person, but no other business may be transacted except as provided in Section 2.10 of these bylaws.

Adjourned Meetings

Section 2.12. The Corporation may transact any business at an adjourned meeting that could have been transacted at the original meeting. When a meeting is adjourned to another time or place, no notice is required if the time and place are announced at the original meeting. If the adjournment is for more than 45 days or if a new record date is fixed, a notice of the adjourned meeting shall be given to each member of record entitled to vote at the meeting.

Voting of Memberships

Section 2.13(a). Each member of the Corporation is entitled to one vote on each matter submitted to a vote of the members.

(b) If a membership stands of record in the names of two or more persons, whether fiduciaries, members of a partnership, joint tenants, tenants in common, husband and wife as community property, tenants by the entirety, persons entitled to vote under a voting agreement, or otherwise, or if two or more persons have the same fiduciary relationship respecting the same membership, unless the Secretary is given written notice to the contrary and furnished with a copy of the instrument or order appointing them or creating the relationship, the vote of one joint holder will bind all, when

only one votes, and the vote of the majority will bind all, when more than one joint holder votes.

(c) The record date for determining the members entitled to vote at a meeting or cast written ballots is _____ [*number not greater than 60, e.g.,* 20] days before the date of the meeting or the day on which the first ballot is mailed or solicited.

(d) Cumulative voting shall not be permitted for any purpose.

(e) Voting by proxy shall not be permitted for any purpose.

Use of Written Ballots at Meetings

Section 2.14. A combination of written ballot and personal voting may be used at any regular or special meeting of members, and may be used for the election of Directors. Prior to the meeting, the Board may authorize distribution of a written ballot to every member entitled to vote. The ballots shall be distributed in a manner consistent with the provisions of Sections 2.05 and 2.19 [*add if corporation will have 100 or more members:* and 2.17(b)] of these Bylaws. When ballots are distributed, the number of members voting at the meeting by written ballot shall be deemed present at the meeting for purposes of determining a quorum but only with respect to the proposed actions referred to in the ballots.

Contents of Written Ballot Used At Meeting

Section 2.15. Any written ballot used at a meeting shall set forth the proposed action to be taken, provide an opportunity to specify approval or disapproval of the proposed action, and state that unless revoked by the member voting in person, the ballot will be counted if received by the corporation on or before the time of the meeting.

Action by Ballot Without Meeting

Section 2.16. Any action that may be taken at any regular or special meeting, including election of Directors, may be taken without a meeting through distribution of a written ballot to every member entitled to vote on the matter. The Secretary shall cause a vote to be taken by written ballot on any action or recommendation proposed in writing by 20 percent of the members.

Contents of Written Ballot Used Without Meeting

Section 2.17(a). Any ballot used without a meeting shall set forth the proposed action, provide an opportunity to specify approval or disapproval of any proposal, and provide a reasonable time within which to return the ballot to the Corporation.

[*Add if co-op will have 100 or members:* (b) The form of written ballot distributed to 10 or more members shall afford an opportunity to specify a choice between approval and disapproval of each matter or group of related matters intended, at the time of distribution, to be acted on by the ballot. The form must also provide that whenever the person solicited specifies a choice with respect to any matter, the vote will be cast in accordance with that choice.]

(c) A written ballot cannot be revoked. Approval by written ballot shall be valid only when the number of votes cast by ballot within the time period specified equals or exceeds the quorum required to be present at a meeting authorizing the action, and the number of approvals equals or exceeds the number of votes that would be required to approve at a

meeting at which the total number of votes cast was the same as the number of votes cast by ballot.

Solicitation of Written Ballots

Section 2.18. Ballots shall be solicited in a manner consistent with Sections 2.05 and 2.19 [*add if corporation will have 100 or more members:* and 2.17(b)] of these Bylaws. The solicitations shall indicate the number of responses needed to meet the quorum requirement and specify the time by which the ballot must be received to be counted. Ballots other than for the election of Directors shall state the percentage of approvals necessary to pass the measure.

Withholding Vote

Section 2.19. In an election of Directors, any form of written ballot which names the candidates for director and which the member has marked "withhold" (or otherwise indicated that the authority to vote in the election of directors is withheld) shall not be used for voting in that election

Appointment of Inspectors of Election

Section 2.20. In advance of any meeting of members the Board may appoint inspectors of election to act at the meeting and any adjournment. If inspectors are not appointed or if any appointed persons fail to appear or refuse to act, the chairman of the meeting may, and, on the request of any member, shall, appoint inspectors at the meeting.

The number of inspectors shall be either one or three. If they are appointed at a meeting on the request of one or more members, the majority of members represented in person shall determine the number to be appointed. If there are three inspectors, the decision, act, or certificate of a majority is effective in all respects as that of all three.

Duties of Inspectors of Election

Section 2.21. The inspectors shall determine the number of memberships outstanding and the voting power of each, the number represented at the meeting, and the existence of a quorum. They shall receive votes, ballots, and consents, hear and determine all challenges and questions regarding the right to vote, count and tabulate all votes and consents, determine when the polls will close, and determine the result. They may do those acts which are proper to conduct the election or vote with fairness to all members. The inspectors shall perform these duties impartially, in good faith, to the best of their ability, and as expeditiously as is practical.

ARTICLE III. DIRECTORS

Number

[*EITHER*]

Section 3.01. The Corporation shall have _____ [*number not less than three*] Directors, collectively known as the Board of Directors.

[*OR*]

Section 3.01. The method of determining the number of directors of the corporation shall be as follows _____[*describe*].

[*OR*]

Section 3.01. The Corporation shall not have less than _____ [*number not less than three*] nor more than _____[*number*] of Directors. The exact number of Directors shall be fixed by approval of the _____[board *or* members]. The Directors shall be known collectively as the Board of Directors.

Qualifications

Section 3.02. The Directors of the Corporation shall be members of the Corporation [*add if desired:* and residents of California].

Nomination

Section 3.03(a). The Board of Directors shall prescribe reasonable nomina tion and election procedures for the election of Directors given the nature, size, and operations of the corporation. The procedures shall include: (1) a reasonable means of nominating persons for election as directors, (2) a reasonable opportunity for a nominee to communicate the nominee's qualifications and the reasons for the nominee's candidacy to the members, (3) a reasonable opportunity for all nominees to solicit votes, (4) a reasonable opportunity for all the members to choose among the nominees.

(b) When the Corporation distributes any material soliciting a vote for any nominee for director in any publication owned or controlled by the Corporation, it shall make available to each other nominee, in the same material, an equal amount of space with equal prominence to be used by the nominee for a purpose reasonably related to the election. The Corporation shall mail to all members any material related to the election which a nominee for Director has furnished, upon written request and payment of mailing costs by the nominee or allow the nominee to obtain the names, addresses and voting rights of members within five business days after the request.

Election

Section 3.04. The Directors shall be elected at the annual meetings [*add if election by written ballot is authorized:* or by written ballot in accordance with Sections 2.16-2.19 of these Bylaws]. The candidates receiving the highest number of votes up to the number of Directors to be elected shall be elected.

Terms of Office

Section 3.05. The terms of office for Directors shall be _____[*number not greater than four*] year(s). Each Director shall hold office until the expiration of the term for which elected and until the election and qualification of a successor.

Compensation

Section 3.06. The Directors shall serve without compensation except that they shall be paid their actual and necessary expenses incurred in serving the corporation.

Meetings

Call of Meetings

Section 3.07. Meetings of the Board may be called by the Chair of the Board, the President, any Vice President, the Secretary, or any two Directors.

Place of Meetings

Section 3.08. Meetings of the Board may be held at any place designated in the notice of the meeting, or, if not stated in a notice, by resolution of the Board.

Presence at Meetings

Section 3.09. Directors may participate at meetings of the Board through the use of conference telephone or other communications equipment, as long as all participating Directors can hear one another. Participation by communications equipment constitutes presence at the meeting.

Regular Meetings

Section 3.10. Regular meetings shall be held, without call or notice, _____ [*specify time and place, e.g.,* at the principal office of the Corporation immediately following the annual meeting of members as *set forth in Section 2.02* of these Bylaws].

Special Meetings

Section 3.11. Special meetings shall be held on four days notice by first class mail or 48 hours notice delivered personally or by telephone or telegraph. Notice of special meetings need not be given to any director who signs a waiver of notice, a written consent to holding the meeting, or an approval of the minutes (either before or after the meeting), or who attends the meeting without protesting, prior thereto or at its commencement, the lack of notice to that Director. All waiver, consents, and approvals shall be filed with the corporate records or made a part of the minutes of the meeting.

Quorum at Meetings

Section 3.12. A majority of the authorized number of Directors constitutes a quorum for the transaction of business.

Acts of Board at Meetings

Section 3.13. Unless provided otherwise in the Articles, these Bylaws, or by law, every act or decision done or made by

a majority of the Directors present at a duly held meeting at which a quorum is present is the act of the Board. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of Directors, if any action taken is approved by at least a majority of the required quorum for the meeting or a greater number required by the articles, bylaws, or by law.

Adjournment of Meetings

Section 3.14. A majority of the Directors present, whether or not a quorum is present, may adjourn to another time and place. If the meeting is adjourned for more than 24 hours, notice of the adjournment shall be given prior to the time of the adjourned meeting to the Directors who were not present at the time of adjournment.

Action Without Meeting

Section 3.15. Any action required or permitted to be taken by the Board may be taken without a meeting, if all Directors individually or collectively consent in writing to the action. The consents shall be filed with the minutes of the proceedings of the board. Action by written consent has the same force and effect as a unanimous vote of the Directors.

Executive Committees

Section 3.16(a). The Board may create one or more committees to serve at its pleasure by resolution adopted by a majority of the number of Directors then in office when a quorum is present. Each committee shall consist of two or more Directors, appointed by a majority vote of the Directors then in office.

(b) Any executive committee, to the extent provided in the resolution of the Board, shall have all the authority of the Board, except with respect to the following actions:

(1) The approval of any action for which the approval of the members or a majority of all members is required by law;

(2) The filing of vacancies on the Board or in any committee that has the authority of the Board;

(3) The fixing of compensation of the Directors for serving on the Board or on any committee;

(4) The amendment or repeal of bylaws or the adoption of new bylaws;

(5) The amendment or repeal of any resolution of the Board which by its express terms is not amendable or repealable;

(6) The appointment of committees of the Board or their members;

(7) The expenditure of corporate funds to support a nominee for Director after there are more people nominated for Director than can be elected.

Resignation of Directors

Section 3.17. Any Director may resign effective upon written notice to the Chairman of the Board, the President, the

Secretary, or the Board of Directors, unless the notice specifies a later time for the effectiveness of the resignation. If a resignation is effective at a future time, a successor may be elected to take office when the resignation becomes effective.

Removal of Directors

Section 3.18. Any or all Directors may be removed without cause. If the Corporation has fewer than 50 members, the removal shall be approved by an affirmative vote or written ballot of a majority of the votes entitled to be cast. If the Corporation has 50 or more members, the removal shall be approved or ratified by the affirmative vote of a majority of the votes represented and voting at a duly held meeting at which a quorum is present or by written ballot, or by the affirmative vote or written ballot of any greater proportion of the votes as required in these Bylaws or by law.

Cause of Vacancies on Board

Section 3.19. Vacancies on the Board of Directors shall exist on the death, resignation, or removal of any Director; whenever the number of Directors is authorized; whenever the Board declares an office vacant pursuant to Section 3.20 of these Bylaws; and on the failure of the members to elect the full number of Directors authorized.

Declaration of Vacancies

Section 3.20. The Board may declare vacant the office of any Director whose eligibility for election has ceased, who has been declared of unsound mind by a final order of court, or who is convicted of a felony.

Filling Vacancies on Board

Section 3.21. Except for vacancies created by removal of a Director pursuant to Section 3.18 of these Bylaws, vacancies may be filled by approval of the board, or, if the number of directors then in office is less than a quorum, by (1) the unanimous written consent of the directors then in office, (2) the affirmative vote of a majority of the directors then in office at a meeting held pursuant to notice or waivers of notice in accordance with Section 3.11 of these Bylaws, or (3) the sole remaining director. Vacancies created by the removal of a Director may be approved only by approval of the members pursuant to *Section 12224 of the Corporations Code*. The members may elect a Director at any time to fill any vacancy not filled by the Directors.

ARTICLE IV. OFFICERS

Titles

Section 4.01. The officers of the Corporation shall be a _____[*specify* Chair of the Board *or* a President *or both*], a Secretary, a Treasurer or a Chief Financial Officer or both, and any other officer with the titles and duties as determined by the Board and as may be necessary to enable it to sign instruments. The President [*or, if none,* Chair of the Board] is the Chief Executive Officer of the Corporation. If there is no Chief Financial Officer, the treasurer is the chief financial officer of the corporation, unless otherwise provided for in the articles or bylaws. The same person may hold any number of offices. The Chair of the Board [*or* President] shall be elected from among the

Board members elected by the membership of the Corporation.

Appointment and Resignation

Section 4.02. The officers shall be chosen by the Board and serve at the pleasure of the Board, subject to the rights, if any, of an officer under any contract of employment. Any officer may resign at any time on written notice to the Corporation without prejudice to the rights, if any, of the Corporation under any contract to which the officer is a party.

ARTICLE V. CORPORATE RECORDS AND REPORTS

Required Records

Section 5.01. The Corporation shall keep adequate and correct books and records of account and minutes of the proceedings of its members, Board, and committees of the Board. It shall also keep a record of the members, including the names, addresses, class of membership, and number of membership units held by each. The minutes shall be kept in written form. Other books and records shall be kept either in written form or in any other form capable of being converted into written form.

Annual Report

Section 5.02.(a) For fiscal years in which the Corporation has, at any time, more than 25 members, the Corporation shall notify each member yearly of the member's right to receive an annual financial report. The Board shall promptly cause the most recent annual report to be sent to a member on written request. The annual report shall be prepared no later than 120 days after the close of the Corporation's fiscal year.

(b) The annual report shall contain in appropriate detail all of the following: (1) a balance sheet as of the end of the fiscal year, an income statement, and statement of changes in financial position for the fiscal year; (2) a statement of the place where the names and addresses of the current members are located; and (3) the statement required by Section 5.03 of these Bylaws.

(c) The annual report shall be accompanied by any pertinent report by independent accountants, or, if there is no such report, by the certificate of an authorized officer of the Corporation that the statements were prepared without audit from the books and records of the corporation.

Annual Statement of Transactions and Indemnifications

Section 5.03. In addition to the annual report described in Section 5.02, the Corporation shall furnish annually to its members and Directors a statement of the transactions and indemnifications to interested persons as required by law. If the Corporation does not issue an annual report pursuant to Section 5.02 of these Bylaws, the statement shall be mailed or delivered to members within 120 days after the close of the fiscal year.

ARTICLE VI. INSPECTION RIGHTS

Articles and Bylaws

Section 6.01. The Corporation shall keep at its principal office in California the original or a copy of its articles and bylaws as amended to date, which shall be open to inspection by the members at all reasonable times during office hours. If the Corporation has no office in California, it shall furnish on the written request of any member a copy of the articles or bylaws as amended to date.

Books and Records

Section 6.02. The accounting books and records and minutes of proceedings of the members, the Board, and committees of the Board shall be open to inspection on the written demand of any member at any reasonable time, for a purpose reasonably related to that person's interests as a member.

Every Director has the absolute right at any reasonable time to inspect and copy all books, records, and documents of every kind, and to inspect the physical properties of the Corporation.

Inspection of Membership List

Section 6.02(a). Subject to the Corporation's right to set aside a member's demand for inspection pursuant to *Section 12601 of the Corporations Code* and the power of the court to limit inspection rights pursuant to *Section 12602 of the Corporations Code*, and unless the Corporation provides a reasonable alternative pursuant to Section 6.02(c) of these Bylaws, a member may do either or both of the following:

(1) Inspect and copy the record of all the members' names, addresses, and voting rights, at reasonable times, on making a written demand five business days in advance which states the purpose for which the inspection rights are requested;

(2) Obtain from the Secretary, upon written demand and tender of a reasonable charge, a list of the names, addresses, and voting rights of those members entitled to vote for the election of Directors, as of the most recent record date for which it has been compiled, or as of a date specified by the member subsequent to the date of demand. The demand shall state the purpose for which the list is requested. The membership list shall be made available on or before the later of ten business days after the demand is received or after the date specified as the date as of which the list is to be compiled.

(b) Any member or members possessing 5 percent or more of the voting power may demand the list for a purpose reasonably related to the members' interests as members. The Corporation may deny access if it reasonably believes that the information shall be used for another purpose or if it provides a reasonable alternative pursuant to Section 6.02(c) of these Bylaws.

(c) The Corporation may, within ten days after receiving a demand, deliver a written offer of an alternative method of achieving the purpose identified in the demand without providing access to or a copy of the membership list. An alternative method which reasonably and in a timely manner accomplishes the proper purpose set forth in a demand made pursuant to Section 6.02(a) of these Bylaws shall be a reasonable alternative, unless the Corporation fails to do the things which it offered to do within a reasonable time after acceptance of the offer. Any rejection of the offer shall be in writing and indicate the reasons the proposed alternative does not meet the proper purpose of the demand.

ARTICLE VII. PATRONAGE DISTRIBUTIONS

Time and Manner of Distribution

Section 7.01. The Corporation may make "patronage distributions" to each person who _____ [purchases goods or services from the Corporation *or* whose products or services are marketed, processed, or handled by the Corporation]. The amount of any patronage distribution shall be computed with reference to the volume or value (or both) of each person's _____ [purchase of products from or use of the services of the Corporation *or* products or services provided to the Corporation for marketing], and with reference to the net earnings of the Corporation from business done with or for those persons. The time and manner of patronage distributions shall be determined on an annual basis by the Board of Directors.

Income Tax Consent

Section 7.02. Each person who obtains membership in the Corporation on the effective date of this Bylaw or who continues as a member after that date, consents, by that act alone, to take into account in the manner provided in *Section 1385(a) of the Internal Revenue Code* in the taxable year in which received from the Corporation:

(a) The amount of any distribution of patronage dividends made in a written notice of allocation, as defined in *Section 1388(b) of the Internal Revenue Code*; and

(b) The amount of any per-unit retain allocations made in per-unit retain certificates, as defined in *Section 1388(g) of the Internal Revenue Code*.

CERTIFICATE OF SECRETARY OF _____ [*name of co-op*]

I hereby certify that I am the duly elected and acting Secretary of this corporation and that the foregoing Bylaws constitute the Bylaws of this corporation, as duly adopted by the Board of Directors on _____[*date*].

Dated: _____

_____ [*signature*]
[*typed name*], Secretary



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART IV. FORMS
C. Bylaws

7-14 California Legal Forms--Transaction Guide §§ 14.241-14.259

[Reserved]

§§ 14.241[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14 CONSUMER COOPERATIVE CORPORATIONS
PART IV. FORMS
D. Other Corporate Documents

7-14 California Legal Forms--Transaction Guide § 14.260

§ 14.260 Disclosure Statement

[1] Comment

[a] Use of Form

This form contains the disclosure provisions that must be included in any membership certificates issued by a consumer co-op or disclosure documents issued to persons purchasing memberships for consideration. It contains alternative provisions allowing the co-op to either state verbatim all required disclosures or to provide the member with the source for obtaining the information. For a checklist of information required in the disclosure document and membership certificate, see *§ 14.160*, P 2.

[b] Issuance of Disclosure Document--In General

Prior to issuing a membership, the co-op must provide the purchaser with a disclosure document in the form of a prospectus, offering circular, brochure or similar document, a specimen copy of the membership certificate, or a receipt that the co-op proposes to issue [*Corp. Code § 12401(b)*]. Since the statutory requirement applies only to "purchasers," no disclosure document need be provided to persons who do not purchase a membership for consideration. The co-op need not provide a document to an existing member prior who purchases additional memberships if that member was previously provided with a disclosure document that is accurate and correct as of the date the additional memberships are purchased [*Corp. Code § 12401(e)*].

[i] Required Provisions

The disclosure document must contain a statement that the co-op is a cooperative corporation [*Corp. Code § 12401(b)(1)*]. It must state that that a copy of the articles and bylaws will be furnished free of charge to a member or prospective member upon written request, and include the address of the office of the co-op and the address to which a written request should be directed [*Corp. Code § 12401(b)(2)*]. The document must also state whether the membership is redeemable and the conditions under which the membership may be redeemed at the option of the co-op or the member [*Corp. Code § 12401(b)(6)*].

Other statements are required only as applicable. If the co-op imposes restrictions on transfer of the membership [*see § 14A.201, Section 2.05*], the document must contain a statement to that effect and state the restrictions imposed [*Corp. Code § 12401(b)(3)*]. If the co-op may levy dues, assessments, or membership or transfer fees, the document must include a statement to that effect and the conditions under which the co-op may make the levy [*Corp. Code § 12401(b)(4)*]. If the member is required to contribute services to the co-op, the document must contain a statement to that effect and include the amount and nature of the services to be contributed [*Corp. Code § 12401(b)(5)*]. Finally, if the voting power or the proprietary interests of the members is unequal [*see Corp. Code § 12314*], the document must include a statement to that effect and the rules by which the voting power and proprietary rights are to be determined [*Corp. Code § 12401(b)(7)*].

[ii] Alternative Statement

As an alternative to a verbatim description of any transfer restrictions, conditions of levy, amount and nature of services to be contributed, conditions under which memberships are redeemable, or the rules by which the voting power and proprietary rights of members are to be determined, the disclosure document may contain a statement that the specified information will be provided free of charge to a member or prospective member who requests it in writing. When the disclosure document contains this alternative statement, it must also set forth the address of the office of the co-op and the address to which the request is to be directed [*Corp. Code § 12401(b)(8)*].

[c] Disclosure in Membership Certificates

[i] Requirements

A consumer co-op may issue membership certificates, but is not required to do so. If certificates are issued, they must contain the same mandatory information regarding membership rights and restrictions that is required in disclosure documents [*see Corp. Code § 12401(a)*].

[ii] Issuance of New Certificates

If the articles or bylaws are amended so that the disclosure statement on outstanding membership certificates is no longer accurate, the board of directors may cancel the outstanding certificates and issue in their place new certificates conforming to the amended articles or bylaws [*Corp. Code § 12401(c)*]. When the new certificates are issued, the board may order holders of outstanding certificates to surrender and exchange them for new certificates within a reasonable time fixed by the board. The board may provide that, upon notice of the order, the membership rights of a certificate holder will be suspended until the certificate is surrendered. Those rights may only be suspended after notice of the order is given to the certificate holder and only until the certificate is surrendered. The board may enforce its surrender order by civil action [*Corp. Code § 12401(d)*].

A transferee of a membership certificate is entitled to a disclosure statement that is accurate and correct as of the date the transfer is registered. If the corporation has not issued new certificates correcting an inaccurate statement, and if the transferee has not already been provided with an accurate statement, the co-op must provide the transferee with an accurate statement upon registration of the transfer [*Corp. Code § 12401(f)*].

[2] FORM

Disclosure Statement

DISCLOSURE STATEMENT OF _____ [*name of corporation*]

1. The information contained in this disclosure statement is accurate and correct as of _____[*specify date*].

2. This Corporation is a cooperative corporation formed pursuant to Title I, Division 3, Part 2 of the Corporation Code.

3. A copy of the Corporation's articles of incorporation and bylaws will be furnished without charge to any member or prospective member upon written request. The address of the office of the Corporation is _____[*specify address*]. The address to which a written request should be directed is _____[*state address*].

[*If there are transfer restrictions imposed on memberships, add:*]

4. The Corporation has imposed restrictions upon the transfer of memberships. The transfer restrictions _____ [will be provided free of charge pursuant to Item 10 of this Statement *or* are as follows: _____ (*specify all restrictions*)].

[*If co-op may levy dues, assessments, or fees, add:*]

5. The Corporation is authorized to levy _____ [*specify type of levy, e.g.*, transfer fees]. The conditions under which the Corporation may make such a levy _____ [are as follows: _____ (*specify conditions*) *or* will be provided free of charge pursuant to Item 10 of this Statement].

[*If members are required to contribute services, add:*]

6. Each member is required to contribute services to the Corporation. The amount and nature of the services to be contributed _____ [are as follows: _____ (*specify amount and nature*) *or* will be provided free of charge pursuant to Item 10 of this Statement].

[*If membership is redeemable, add:*]

7. This membership is redeemable. The conditions under which the membership may be redeemed at the option of the Corporation or the member _____ [will be provided free of charge pursuant to Item 10 of this Statement *or* are as follows: _____ (*state conditions*)].

[*If voting power of members is unequal, add:*]

8. The voting power of members of this Corporation is unequal. The rules by which voting power will be determined _____ [are as follows: _____ (*state rules*) *or* will be provided free of charge pursuant to Item 10 of this Statement].

[*If proprietary interests of the members are unequal, add:*]

9. The proprietary interests of the members of this Corporation are unequal. The rules under which those interests will be determined _____ [are as follows: _____ (*state rules*) *or* will be provided free of charge pursuant to Item 10 of this Statement].

[*If members may request further information from the corporation regarding Items 4-9, add:*]

10. The address of the office of this Corporation is _____[*state address*]. Requests for information from the Corporation regarding any of the matters set forth in this Statement should be directed to _____[*specify address*].



60 of 103 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS

7-14A California Legal Forms--Transaction Guide 14A.syn

§ 14A.syn Synopsis to Chapter 14A: AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS

§ 14A.01 California Statutes

§ 14A.02 Federal Statutes

§ 14A.03 California Regulations

§ 14A.04 Federal Regulations

§ 14A.05 California Attorney General Opinions

§§ 14A.06-14A.19 [Reserved]

§ 14A.20 Law Reviews

§ 14A.21 Annotations

§ 14A.22 Text References

[1] Related Forms With Tax Analysis

[2] Related Forms

[3] Related California Forms

[4] Additional Text References

§§ 14A.23-14A.29 [Reserved]

§ 14A.30 Governing Law

§ 14A.31 Nature of Agricultural Co-Ops

[1] In General

[2] Stock or Nonstock Co-Ops

[3] Directors and Management

[4] Cooperative Bargaining Associations

§ 14A.32 Formation of Agricultural Co-Op

[1] Requirements

[2] Articles of Incorporation

[3] Bylaws

§ 14A.33 Exemptions From Antitrust Laws

§ 14A.34 Federal Income Taxation

[1] Classification as Exempt or Nonexempt

[2] Deduction of Patronage Dividends

[3] Netting of Patronage Gains and Losses

[4] Special Deductions for "Exempt" Associations

§ 14A.35 State Income Taxation

§ 14A.36 Winding Up and Dissolution

§§ 14A.37-14A.99 [Reserved]

§ 14A.100 Facts

Scope

§ 14A.101 Documents

Scope

§§ 14A.102-14A.119 [Reserved]

§ 14A.120 Financial Considerations

Scope

§ 14A.121 Management

Scope

§§ 14A.122-14A.139 [Reserved]

§ 14A.140 Selecting and Reserving Corporate Name

Scope

§ 14A.141 Drafting and Filing Articles of Incorporation

Scope

§ 14A.142 Holding First Meeting of Directors

Scope

§ 14A.143 Drafting Bylaws

Scope

§§ 14A.144-14A.159 [Reserved]

§ 14A.160 Miscellaneous Procedures

Scope

§ 14A.161 Correcting Errors or Defects in Filed Instruments

Scope

§ 14A.162 Federal Income Tax Procedures

Scope

§ 14A.163 California Income Tax Procedures

Scope

§ 14A.164 Modifying or Repealing Articles and Bylaws

Scope

§ 14A.165 Precluding Escheat of Member's Unclaimed Interest

Scope

§§ 14A.166-14A.199 [Reserved]

§ 14A.200 Articles of Incorporation of Agricultural Nonprofit Cooperative Association Organized Without Stock

[1] Comment

[a] Use of Form

[b] Required Provisions

[i] Signatories

[ii] Name of Co-Op

[iii] Purposes Clause

[iv] Principal Business Office

[v] Initial Agent for Service of Process

[vi] Board of Directors

[vii] Nonstock Membership Associations

[viii] Stock Associations

[c] Revolving Funds

[d] Statement of Corporate Powers

[e] Execution, Filing, and Amendment of Articles

[f] Amending Articles to Reorganize Corporation

[2] FORM

Articles of Incorporation of Agricultural Nonprofit Cooperative Association Organized Without Stock

§ 14A.201 Bylaws of Agricultural Nonprofit Cooperative Association Organized Without Stock

[1] Comment

[a] Use of Form

[b] Optional Provisions

[c] Membership

[i] In General

[ii] Qualification and Number of Members

[iii] Fees and Dividends

[iv] Valuation of Member's Interest

[v] Meetings of Members

[d] Directors and Officers

[i] In General

[ii] Number

[iii] Executive Committee

[iv] Election

[v] Meetings

[vi] Annual Report to Members

[vii] Vacancies

[viii] Removal

[e] Revolving Fund

[f] Income Tax Consent

[g] Amending and Repealing Bylaws

[h] Certificate of Secretary

[2] FORM

Bylaws of Agricultural Nonprofit Cooperative Association Organized Without Stock

§ 14A.202 Application for Membership in Agricultural Nonprofit Cooperative Association Organized Without Stock

[1] Comment

[a] Use of Form

[b] Marketing Contract

[c] Income Tax Consent

[2] FORM

Application for Membership in Agricultural Nonprofit Cooperative Association Organized Without Stock

§ 14A.203 Marketing Contract of Cooperative Association

[1] Comment

[a] Use of Form

[b] Statutory Authorization for Contract

[c] Resale of Products

[d] Pooling System

[e] Income Tax Consent

[f] Action on Contract

[i] Specific Performance and Injunction

[ii] Presumption of Producer's Ability to Deliver

[iii] Liquidated Damages

[iv] Association's Rights as Producer

[2] FORM

Marketing Contract of Cooperative Association

§ 14A.204 Marketing Contract of Agricultural Cooperative Bargaining Association

[1] Comment

[a] Use of Form

[b] Nature of Bargaining Association

[c] Unfair Trade Practices

[i] Acts of Processors

[ii] Acts of Processors or Associations

[iii] Enforcement and Penalties

[iv] Rights of Bargaining Association

[2] FORM

Marketing Contract of Agricultural Cooperative Bargaining Association

§ 14A.205 Application for Recognition of Income Tax Exemption of Agricultural Nonprofit Cooperative Association--I.R.S. Form 1028

[1] Comment

[a] Use of Form

[b] Definition of "Exempt" Associations

[c] Tax Benefits of "Exempt" Associations

[d] Procedure for Establishing Exempt Status

[2] FORM

Application for Recognition of Income Tax Exemption of Agricultural Nonprofit Cooperative Association--I.R.S. Form 1028



61 of 103 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS

7-14A California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter covers the formation of agricultural nonprofit cooperative associations ("agricultural co-ops") pursuant to Chapter 1, Division 20 of the Food and Agricultural Code [*Food & Agric. Code §§ 54001-54294*]. It includes coverage of cooperative bargaining associations [*Food & Agric. Code §§ 54401-54463*] but does not discuss fish marketing associations, a specific form of cooperative association [*see Corp. Code §§ 13200-13356*]. The Legal Background contains a discussion of the nature and formation of agricultural co-ops, including state and federal tax treatment. The Transaction Guide contains a checklist of procedures required for incorporation, and the Forms include the forms necessary for that process.

For a detailed discussion of nonprofit organizations, see Ch. 13A, *Nonprofit Unincorporated Associations* . The tax aspects of nonprofit organizations, and procedures for obtaining tax-exempt status, are covered in Ch. 13B, *Tax-Exempt Status for Nonprofit Entities* . Nonprofit corporations are discussed in Ch. 13, *Nonprofit Corporations* . Consumer cooperative corporations are covered in Ch. 14, *Consumer Cooperative Corporations* .



62 of 103 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

7-14A California Legal Forms--Transaction Guide § 14A.01

§ 14A.01 California Statutes

Corporations formed upon filing articles. *Corp. Code § 200*.

Consumer cooperative corporations generally. *Corp. Code § 12200 et seq.*

Fish marketing associations generally. *Corp. Code § 13200 et seq.*

Securities of agricultural association exempt from qualification. *Corp. Code § 25100(m)*; *Food & Agric. Code § 54201*.

Nonprofit cooperative agricultural associations. *Food & Agric. Code § 54001 et seq.*
Definitions. *Food & Agric. Code § 54001 et seq.*
General provisions. *Food & Agric. Code § 54031 et seq.*
Articles of incorporation. *Food & Agric. Code § 54081 et seq.*
Bylaws. *Food & Agric. Code § 54111 et seq.*
Directors and management. *Food & Agric. Code § 54141 et seq.*
Powers of association. *Food & Agric. Code § 54171 et seq.*
Financial provisions. *Food & Agric. Code § 54201 et seq.*
Members. *Food & Agric. Code § 54231 et seq.*
Marketing contracts. *Food & Agric. Code § 54261 et seq.*
Corporate reorganization as cooperative association. *Food & Agric. Code § 54291 et seq.*
Cooperative bargaining associations generally. *Food & Agric. Code § 54401 et seq.*

Nonprofit cooperative associations formed by gas producers. *Pub. Util. Code § 3001 et seq.*

Articles of incorporation. *Pub. Util. Code § 3061 et seq.*

Bylaws. *Pub. Util. Code § 3081 et seq.*

Management. *Pub. Util. Code § 3101 et seq.*

Members. *Pub. Util. Code § 3171 et seq.*

Tax deduction for income from nonprofit activities. *Rev. & Tax. Code § 24404*.

Tax deduction for patronage refunds from gas producers' cooperative association. *Rev. & Tax. Code § 24406.5*.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

7-14A California Legal Forms--Transaction Guide § 14A.02

§ 14A.02 Federal Statutes

Agricultural nonprofit cooperative associations authorized to engage in commerce. *7 U.S.C. § 291*.

Secretary of Agriculture authorized to restrain association from violating antitrust laws. *7 U.S.C. § 292*.

Farmers Cooperative Service created in Department of Agriculture to assist agricultural associations. *7 U.S.C. §§ 451-457*.

Agricultural associations exempt from antitrust laws. *15 U.S.C. § 17*.

Definition of "exempt" marketing and producing associations. *I.R.C. § 521(b)(1)*.

Exempt cooperatives subject to federal income tax. *I.R.C. § 1381(b)*.

Deduction for patronage dividends by exempt and nonexempt cooperatives. *I.R.C. § 1382(b)*.

Deductions for dividends on capital stock and nonpatronage income by exempt cooperatives. *I.R.C. § 1382(c)*.

Taxation of associations marketing products under pooling arrangements. *I.R.C. § 1382(e)-(g)*.

Tax treatment of cooperatives' patrons. *I.R.C. § 1385*.

Patronage dividends and per-unit retain allocations defined. *I.R.C. § 1388*.

Required filing of annual information return disclosing patronage dividends. *I.R.C. § 6044*.

Annual federal income tax return filing requirements. *I.R.C. § 6072(d)*.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

7-14A California Legal Forms--Transaction Guide § 14A.03

§ 14A.03 California Regulations

State tax deduction for agricultural associations. *18 Cal. Code Reg. §§ 24404-24405*.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

7-14A California Legal Forms--Transaction Guide § 14A.04

§ 14A.04 Federal Regulations

Filing of application required to obtain status as "exempt" association. *Treas. Reg. § 1.521-1(e).*

Definition of "patron." *Treas. Reg. § 1.1388-1(e).*

Federal income tax forms.

Annual tax return for nonexempt corporation. *Treas. Reg. § 1.6012-2(a)(3).*

Annual tax return for exempt corporation. *Treas. Reg. § 1.6012-2(f).*

Annual information return disclosing patronage dividends. *Treas. Reg. § 1.6044-2.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

7-14A California Legal Forms--Transaction Guide § 14A.05

§ 14A.05 California Attorney General Opinions

Marketing and agency forms of agreements authorized. *5 Ops. Cal. Atty. Gen. 247 (1945)* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART I. RESEARCH GUIDE
A. Primary Sources

7-14A California Legal Forms--Transaction Guide §§ 14A.06-14A.19

[Reserved]

§§ 14A.06[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

7-14A California Legal Forms--Transaction Guide § 14A.20

§ 14A.20 Law Reviews

Roberts, *Understanding Agricultural Cooperatives, 4 Cal. Law. 13 (Feb. 1984).*

Englebrecht, *Review and Analysis of the Tax Effects of Distributions Affecting Cooperatives and Their Patrons, 60 Taxes 558 (1982).*

Beaver, *Revenue Act of 1978 Creates New Tax Planning Environment for Farm Cooperatives, 50 J. Tax'n 138 (1979).*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

7-14A California Legal Forms--Transaction Guide § 14A.21

§ 14A.21 Annotations

Annot., Cooperative Associations: Rights in Equity Credits or Patronage Dividends, 50 A.L.R.3d 435 (1973).

Annot., Construction and Effects of Co-Operative Farm or Dairy Products Agreement With Respect to Association's Charges and Deductions for Gathering, Grading, Processing, Shipping, and Marketing the Products, 90 A.L.R.2d 1142 (1963).

Annot., Validity and Construction of Provision for Liquidated Damages in Contract With Co-Operative Marketing Association, 12 A.L.R.2d 130 (1950).

Annot., Income and Excess Profits Tax of Co-Operative Association and Its Patrons or Members, 8 A.L.R.2d 925 (1949).

Annot., Cooperative Marketing of Farm or Dairy Products by Producers' Association, 98 A.L.R. 1406 (1935) .

Annot., Cooperative Marketing of Farm Products by Producers' Association, 77 A.L.R. 405 (1932), 47 A.L.R. 936 (1927), 33 A.L.R. 247 (1924), 25 A.L.R. 1113 (1923) .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

7-14A California Legal Forms--Transaction Guide § 14A.22

§ 14A.22 Text References

[1] Related Forms With Tax Analysis

Rabkin & Johnson, Current Legal Forms With Tax Analysis (Matthew Bender)
Ch. 2A, *Joint Ventures, Business Trusts and Associations*, 2A.40- 2A.44 (formation of cooperatives).
Ch. 24, *Agricultural Transactions*, Form 24.10 (cooperative marketing agreement).

[2] Related Forms

Warren's Forms of Agreements, Ch. 13, *Miscellaneous*, § 79 (cooperative marketing agreements) (Matthew Bender).

[3] Related California Forms

California Legal Forms (Matthew Bender)
Ch. 3, *Articles of Incorporation*.
Ch. 4, *Bylaws*.
Ch. 5, *Directors' Meetings, Actions, and Resolutions*.
Ch. 7, *Corporate Records and Reports*.
Ch. 10, *Amendment of Articles*.
Ch. 12, *Winding Up and Dissolution*.
Ch. 13, *Nonprofit Corporations*.
Ch. 13A, *Nonprofit Unincorporated Associations*.
Ch. 13B, *Tax-Exempt Status for Nonprofit Entities*.
Ch. 48, *Agricultural Financing*.
Ch. 49, *Agricultural Contracts*.

[4] Additional Text References

Ballantine & Sterling, California Corporation Laws, Ch. 20, *Corporations for Specific Purposes* , § 429 (Matthew Bender).



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART I. RESEARCH GUIDE
B. Secondary Sources

7-14A California Legal Forms--Transaction Guide §§ 14A.23-14A.29

[Reserved]

§§ 14A.23[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART II. LEGAL BACKGROUND

7-14A California Legal Forms--Transaction Guide § 14A.30

§ 14A.30 Governing Law

Federal law authorizes persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, or nut or fruit growers to act together in associations to collectively process, handle, and market their products in interstate and foreign commerce, subject to certain restrictions [*see 7 U.S.C. § 291*; *see also § 14A.33*]. *Food & Agric. Code §§ 54001-54294* provide the corporate vehicle through which agricultural producers may form these associations.

The General Corporation Law [*Corp. Code §§ 100-2319*] applies to agricultural co-ops except when its provisions are inconsistent with the provisions of the Food and Agricultural Code [*Food & Agric. Code § 54040*]. Agricultural co-ops are specifically exempted from the qualification requirements of the Corporate Securities Law [*see Food & Agric. Code § 54201*; *Corp. Code § 25100(m)*; *see also Corp. Code §§ 25110, 25120, 25130*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART II. LEGAL BACKGROUND

7-14A California Legal Forms--Transaction Guide § 14A.31

§ 14A.31 Nature of Agricultural Co-Ops

[1] In General

An agricultural co-op is organized to make a profit only for its members as producers of agricultural products, not for itself as such or its members as such [*Food & Agric. Code § 54033*]. An agricultural "product" includes any horticultural, viticultural, aquacultural, forestry, dairy, livestock, poultry, bee, or farm product [*Food & Agric. Code § 54004*]. The co-op may engage in any activity connected with the production and marketing of its products, or with the purchase, use, or financing of supplies or equipment [*Food & Agric. Code § 54171*]. The co-op may make marketing contracts with its members that require members to sell all or part of their products exclusively to or through the association [*Food & Agric. Code § 54261*]. The association may establish reserves, commonly structured as "Revolving Funds" [*see § 14A.201[1][e]*], and invest the funds from the reserves [*see Food & Agric. Code § 54175*].

[2] Stock or Nonstock Co-Ops

An agricultural association may be organized with or without shares of stock [*Food & Agric. Code § 54081(e), (f)*]. Most agricultural co-ops are organized without stock so that the property interests of members will be tied solely to the members' contribution to production [*see* Kerner, *Securities and Capital Structures of Farmer Cooperatives in California, 19 Hastings L.J. 309 (1968)*; *see also* Note, *Farmworker Production Cooperatives: the Property Interests of Members, 11 U.C.D. L. Rev. 661 (1978)*]. The majority of agricultural co-ops with stock were organized under the General Corporation Law and later amended their articles to come within the purview of the Food and Agricultural Code [*see Food & Agric. Code § 54291*; *see also § 14A.200[1][f]*].

In an association organized without stock, the voting and property rights of members can be equal or unequal [*Food & Agr. Code § 54081(e)*]. Thus, unlike the rights of stockholders, which are definite and fixed, the voting rights of members can be made flexible and dependent on the amount of products grown and marketed through the association by each member during specified intervals of time. Although the association does not issue stock shares, its members are deemed to be "shareholders" for purposes of applying the General Corporation Law [*Food & Agric. Code § 54040*].

If an association is organized with stock, it may limit in its bylaws the amount of common stock that any member may own [*Food & Agric. Code § 54236*]. The association can not issue a stock certificate to a member until full payment has

been made [*Food & Agric. Code § 54235*].

[3] Directors and Management

The corporation's affairs are managed by a board of not less than three directors who are elected by the members [*Food & Agric. Code § 54141*]. The number of directors may be fixed or variable [*Food & Agric. Code § 54116(b)*]. Unlike a corporation organized under the General Corporations Law, in which the directors are ordinarily elected for one-year terms [*see Corp. Code § 301*], the directors of an agricultural co-op may serve for terms of varying length. The bylaws may provide for an executive committee with all the powers and functions of the board [*Food & Agric. Code § 54146*]. The board of directors must elect a president, one or more vice presidents, a secretary, a treasureer, and any other officers prescribed by the bylaws [*Food & Agric. Code § 54149*].

[4] Cooperative Bargaining Associations

A cooperative bargaining association is a particular type of co-op formed for the purpose of group bargaining between its producer members and the first handler or processor with respect to the sale of any agricultural commodity except milk, cotton, or cottonseed. It is organized and functions in the same manner as any other agricultural co-op [*Food & Agric. Code § 54001*; *see § 14A.204*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesManagement Duties & LiabilitiesBusiness & Corporate LawCooperativesMembers & Other Constituents



74 of 103 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART II. LEGAL BACKGROUND

7-14A California Legal Forms--Transaction Guide § 14A.32

§ 14A.32 Formation of Agricultural Co-Op

[1] Requirements

A minimum of three natural persons who are engaged in the production of any product [*see Food & Agric. Code § 54004*], the majority of whom are California residents, is necessary to form an agricultural co-op. The co-op may be formed for the purpose of engaging in any activity connected with any one or more of the following [*Food & Agric. Code § 54061*]:

- The marketing, or selling of its members' products.
- The harvesting, preserving, drying, processing, canning, packing, grading, storing, handling, shipping, or utilization of any product of its members, or the manufacturing or making of the byproducts of any product of its members.
- The manufacturing, selling, or supplying to its members of machinery, equipment, or supplies.
- The financing of any of the above activities.

The co-op is formed by signing, acknowledging, and filing articles of incorporation with the Secretary of State in the manner prescribed by the General Corporation Law [*Food & Agric. Code § 54082*; *see Corp. Code § 200(a)*]. For a discussion of those requirements, see *Ch. 3, Articles of Incorporation, § 3.10* et seq.

[2] Articles of Incorporation

The articles of incorporation of an agricultural co-op must show that its signatories are engaged in the production of agricultural products [*see Food & Agric. Code § 54004* (definition)] and that they propose to incorporate an association pursuant to *Food & Agric. Code §§ 54001-54294* [*Food & Agric. Code § 54081*]. The articles must also state the name of the co-op, the purpose for which it is formed, the county where its principal business office is located, the number of directors (which must be not less than three), and the names and addresses of the persons serving as the first directors, as well as their terms of office if those terms are of differing length [*Food & Agric. Code § 54081(a)-(d)*]. Additional

requirements concern the issuance of stock, or members' voting and property rights if the co-op is organized without stock [*see Food & Agric. Code § 54081(e), (f)*; *see also § 14A.141*, P 1(a)(9), (10)].

[3] Bylaws

An agricultural co-op must adopt a code of bylaws for its government and management within 30 days after incorporation. The vote or written assent of shareholders or members holding a majority of the voting power is required to adopt the bylaws [*Food & Agric. Code § 54111*]. For further discussion of the adoption of bylaws, see *§ 14A.201[1]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsGovernmentsAgriculture & FoodProcessing, Storage & Distribution



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART II. LEGAL BACKGROUND

7-14A California Legal Forms--Transaction Guide § 14A.33

§ 14A.33 Exemptions From Antitrust Laws

The Capper-Volstead Act [*7 U.S.C. §§ 291, 292*] and the Clayton Act [*15 U.S.C. § 17*] exempt agricultural co-ops from the federal antitrust laws. Persons collectively engaged in producing agricultural products may act together in associations to prepare and market those products, to have marketing agencies in common, and to make the necesary contracts, provided the associations are operated for the mutual benefit of the members as producers. However, no member of an exempt association may have more than one vote because of membership capital owned, the association cannot pay dividends on membership capital exceeding 8 percent, and the association may not deal in nonmembers' products in an amount greater in value than products handled by it for members [*see 7 U.S.C. § 291*].

California law specifically states that any association organized pursuant to the agricultural association chapter of the Food and Agricultural Code [*see Food & Agric. Code §§ 54001-54294*] is not a conspiracy, a combination in restraint of trade, an illegal monopoly, or an attempt to lessen competition, arbitrarily fix prices, or create an unlawful combination or pool [*Food & Agric. Code § 54038*]. In addition, state law provides that marketing contracts and agreements between that association and its members are not illegal, in restraint of trade, or contrary to any law against combinations or pooling [*Food & Agric. Code § 54039*]. Specific rules govern unfair trade practices by and against cooperative bargaining associations [*see Food & Agric. Code §§ 54431-54435*; *see also § 14A.204[1]*].

Despite these exemptions, agricultural co-ops are not completely immune from the antitrust laws. The Secretary of Agriculture is authorized to take action against an association that unlawfully monopolizes or acts in restraint of trade in violation of the Sherman Act [*7 U.S.C. § 292*; *see 15 U.S.C. §§ 1-7*] and the Federal Trade Commission also has jurisdiction to challenge allegedly monopolistic practices [*Sunkist Growers, Inc. v. Federal Trade Comm'n (C.D. Cal. 1979) 464 F. Supp. 302, 311]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Antitrust & Trade LawExemptions & ImmunitiesCollectives & CooperativesGeneral OverviewAntitrust & Trade LawExemptions & ImmunitiesCollectives & CooperativesCapper-Volstead ActBusiness & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate

LawCooperativesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART II. LEGAL BACKGROUND

7-14A California Legal Forms--Transaction Guide § 14A.34

§ 14A.34 Federal Income Taxation

[1] Classification as Exempt or Nonexempt

For federal income tax purposes, agricultural co-ops (termed "farmers' cooperatives" in the Internal Revenue Code) are divided into "exempt" and "nonexempt" categories, although under present law neither are exempt from income taxation [*see I.R.C. § 1381(b)*]. The taxation of exempt and nonexempt associations is identical except for two additional deductions allowed to exempt associations [*see § 14A.34[4]*].

The Internal Revenue Service defines exempt farmers' cooperatives as farmers', fruit growers', or like associations organized and operated on a cooperative basis for the purpose of either (1) marketing the products of members or other producers, and returning to them the proceeds of sales, less necessary marketing expenses, on the basis of the quantity or value of products furnished by them, or (2) purchasing supplies and equipment for the use of members or other persons, and returning those supplies and equipment to them at actual cost, plus necessary expenses [*I.R.C. § 521(b)(1)*]. A nonexempt association is any other corporation that operates on a cooperative basis and allocates amounts to patrons on the basis of the business done with or for those patrons [*see I.R.C. § 1381(a)*; *Treas. Reg. § 1.1381-1(a)*; *see also § 14A.34[2]*].

To establish its exempt status, an association must file an application for recognition of exemption [*Treas. Reg. § 1.521-1(e)*; *see § 14A.205*]. Exempt status will not be denied because the association has capital stock, as long as the dividend rate on that stock is fixed at an amount not exceeding the legal interest rate in the state of incorporation or 8 percent, whichever is higher [*I.R.C. § 521(b)(2)*; *see Food & Agric. Code § 54120*], and substantially all the stock is owned by producers who market their products or purchase their supplies and equipment through the association [*I.R.C. § 521(b)(2)*; *see Food & Agric. Code § 54231*]. To satisfy this "substantially all" ownership requirement, producers must own at least 85 percent of that stock [*Rev. Rul. 73-248, 1973-2 C.B. 295* ; *see West. Cent. Co-op v. United States (8th Cir. 1985) 758 F.2d 1269, 1271]* . For purposes of applying the 85 percent test, the relevant consideration is whether the right to vote has actually accrued or been terminated by the time of the annual shareholders' meeting following the close of the taxable year [*Farmers Coop. Co. v. Commissioner (8th Cir. 1987) 822 F.2d 774, 779]* .

The Internal Revenue Service will not deny exempt status because the association computes its net earnings for

purposes of determining amounts available for distribution to patrons by netting its patronage gains and losses pursuant to *I.R.C. § 1388(j)* [*I.R.C. § 521(b)(6)*; *see § 14A.34[3]*].

The Internal Revenue Service will not deny exempt status because the association has accumulated and maintained a reserve for any necessary purpose [*I.R.C. § 521(b)(3)*]. Exempt status will not be denied because the association conducts business with nonmembers, as long as the value of nonmember business does not exceed the value of business done with members, and the value of purchases made for nonmembers or nonproducers does not exceed 15 percent of all purchases [*I.R.C. § 521(b)(4)*; *see Food & Agric. Code § 54179*]. Business done for the United States or one of its agencies is disregarded in determining the amount of business done with nonmembers [*I.R.C. § 521(b)(5)*].

[2] Deduction of Patronage Dividends

Both exempt and nonexempt associations are entitled to deduct "patronage dividends" in computing taxable income [*see I.R.C. §§ 1382(b)(1), 1381(a)*; *see also Treas. Reg. § 1.1382-1(a)*]. For a detailed discussion of that deduction, see *Ch. 14, Consumer Cooperative Corporations, § 14.48[2]*.

[3] Netting of Patronage Gains and Losses

An agricultural co-op may opt to net its patronage gains and losses for purposes of determining its net earnings for any taxable year [*I.R.C. § 1388(j)*]. For further discussion of this option, see *Ch. 14, Consumer Cooperative Corporations, § 14.48[3]*.

[4] Special Deductions for "Exempt" Associations

Exempt associations are entitled to two deductions that are unavailable to nonexempt associations. First, an exempt association is allowed to deduct amounts paid during the taxable year as dividends on its capital stock [*I.R.C. § 1382(c)(1)*]. Capital stock includes any stock or any other form of capital represented by capital retain certificates, revolving fund certificates, letters of advice, or other evidence of a proprietary interest in a cooperative association.

In addition, an exempt association may deduct amounts paid during the payment period for the taxable year in money, qualified notices of allocation, or other property on a patronage basis to patrons with respect to its earnings during the taxable year which are derived from business done for the United States or from sources other than patronage [*I.R.C. § 1382(c)(2)*]. Nonpatronage sources are those not directly related to the marketing, purchasing, or service activities of the agricultural association [*Treas. Reg. § 1.1382-3(c)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral OverviewTax LawFederal Taxpayer GroupsExempt OrganizationsConditions & Restrictions (IRC secs. 501-505, 521, 526-530)Tax LawState & Local TaxesGeneral Overview



77 of 103 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART II. LEGAL BACKGROUND

7-14A California Legal Forms--Transaction Guide § 14A.35

§ 14A.35 State Income Taxation

All agricultural associations in California are subject to state income tax. However, farmers, fruit growers, and other similar associations organized and operated in whole or in part on a cooperative or mutual basis as marketing or purchasing cooperatives may deduct all income resulting from or arising out of business activities for or with their members carried on by them or their agents, or when done on a nonprofit basis for or with nonmembers [*Rev. & Tax. Code § 24404*]. "All income resulting from or arising out of" includes all amounts, whether or not derived from patronage, allocated to members during the taxable year. Amounts allocated include cash, merchandise, capital stock, revolving fund certificates, certificates of indebtedness, retain certificates, letters of advice, or written instruments that in some other manner disclose to each member the dollar amount allocated to that member. Allocations made after the close of the taxable year and on or before the fifteenth day of the ninth month following the close of that year will be considered as made on the last day of the taxable year to the extent they are attributable to income derived before the close of the year [*Rev. & Tax. Code § 24404*].

Nonprofit cooperative associations organized under the Food and Agricultural Code [*see Food & Agric. Code § 54001 et seq.*] that have been issued the certificate of the board of supervisors [*see Food & Agric. Code § 54042*] are exempt from the minimum franchise tax for five consecutive taxable years commencing with the first taxable year for which the certificate is issued [*Rev. & Tax. Code § 23153(a), (c)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsTax LawState & Local TaxesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART II. LEGAL BACKGROUND

7-14A California Legal Forms--Transaction Guide § 14A.36

§ 14A.36 Winding Up and Dissolution

The Food and Agricultural Code does not prescribe any procedures for dissolution of agricultural co-ops. Therefore, the provisions of the General Corporation Law govern dissolution [*Food & Agric. Code § 54040*; *see Corp. Code §§ 1800-2011*]. For a discussion of the procedures required under that law, see Ch. 12, *Winding Up and Dissolution* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART II. LEGAL BACKGROUND

7-14A California Legal Forms--Transaction Guide §§ 14A.37-14A.99

[Reserved]

§§ 14A.37[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

7-14A California Legal Forms--Transaction Guide § 14A.100

§ 14A.100 Facts

1. Identity of incorporators.

NOTE:
At least three persons are required to form an agricultural co-op [*Food & Agric. Code § 54061*].

a. Names.

b. Addresses.

c. Telephone numbers.

2. Address of principal office.

a. Street address.

b. City.

c. County.

NOTE:
The articles of incorporation must state the county where the principal office for the transaction of business of the co-op is to be located [*Food & Agric. Code § 54081(c)*].

3. Proposed name of co-op.

NOTE:
For an outline of requirements and prohibitions relating to proposed corporate names, see *§ 14A.140*.

4. Purpose of co-op.

5. Number of directors.

NOTE:
The co-op must have at least three directors [*Food & Agric. Code § 54141*].

6. Names and addresses of first directors.

7. Whether co-op will be stock or nonstock corporation.

8. Type of agricultural products to be handled.

NOTE:
A cooperative bargaining association cannot bargain with respect to milk, cotton, or cottonseed [***see*** *Food & Agric. Code § 54401*].

9. Geographical area to be served.

10. Estimated number of producers to become members.

11. Business and financial advisors.

a. Banks

b. Insurance agents.

c. Accountants.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

7-14A California Legal Forms--Transaction Guide § 14A.101

§ 14A.101 Documents

1. Any existing preincorporation documents:

    a. Subscription agreements.

    b. Membership applications.

2. If existing corporation is reorganizing as agricultural co-op, copy of:

NOTE:
Any corporation may reorganize as a nonprofit agricultural co-op by amending its articles to conform with the Food and Agricultural Code provisions governing agricultural co-ops [*Food & Agric. Code § 54291*].

a. Articles of incorporation.

b. Bylaws.

c. Financial and tax records.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporationsFormationPreincorporationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

7-14A California Legal Forms--Transaction Guide §§ 14A.102-14A.119

[Reserved]

§§ 14A.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

7-14A California Legal Forms--Transaction Guide § 14A.120

§ 14A.120 Financial Considerations

1. Determine period co-op will use as taxable year.

a. Calendar year.

b. Fiscal year.

2. Determine whether co-op should be organized with or without stock.

NOTE:
Most agricultural co-ops formed today are organized without stock. For a discussion of the choice of a stock or nonstock structure, see *§ 14A.31[2]*.

a. If co-op will have a stock structure, determine:
(1) Number of shares.

(2) Whether there should be limitation on number of shares per member.

NOTE:
The bylaws may limit the amount of common stock that any member may own [***see*** *Food & Agric. Code § 54236*].

(3) Whether shares will be classified.

(4) If shares are classified, what classes and what preferences, restrictions, and number in each class.

b. If co-op is structured without stock, determine:

(1) Whether voting power, property rights, and interests of members will be equal or unequal.

(2) If rights will be unequal, what rules will determine rights.

(3) Whether members will be charged any of following fees:

(a) Entrance, organization, or membership fees [*see Food & Agric. Code § 54118*].

(b) Annual fees and service charges [*see Food & Agric. Code § 54119*].

3. Determine whether co-op should use a revolving fund to supply capital.

NOTE:
A revolving fund is a reserve of money temporarily retained from the sale of members' products, used as the co-op's capital base. The proceeds from member's products are withheld and credited to them in lieu of immediate payment. For an explanation of this system, see *§ 14A.201[1][e]*.

a. Consider how much capital must be retained during first year to cover operating expenses.

b. Decide whether amount retained should be supplemented with membership fees or business or service changes.

NOTE:
The co-op may prescribe the amount of fees and charges in the bylaws [***see*** *Food & Agric. Code §§ 54118, 54119*].

c. Determine how long retained capital should be held in fund.

4. For marketing contracts with members, determine:

a. Whether contracts should be "purchase and sale" or "agency" agreements [*see Food & Agric. Code § 54261*; *see also § 14A.203[1][b]*].

b. Duration of members' marketing contracts.

NOTE:
Marketing contracts may be of any duration not exceeding 15 years [*Food & Agric. Code § 54261*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporationsFormationPreincorporationGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

7-14A California Legal Forms--Transaction Guide § 14A.121

§ 14A.121 Management

1. Determine whether terms of directors should be staggered, and, if so, term of each of first directors [*Food & Agric. Code § 54081(d)*].

2. Decide whether number of directors should be [*Food & Agric. Code § 54116(b)*]:

NOTE:
For an explanation of the required number of directors under either system, see discussion in *§ 14A.200[1][b][vi]*.

a. Fixed; or

b. Variable.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

7-14A California Legal Forms--Transaction Guide §§ 14A.122-14A.139

[Reserved]

§§ 14A.122[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Formation of Nonprofit Agricultural Cooperative Association

7-14A California Legal Forms--Transaction Guide § 14A.140

§ 14A.140 Selecting and Reserving Corporate Name

NOTE:
For a checklist of procedures for corporate name selection and reservation, see *Ch. 2, **Formation of Corporations**, § 2.132*.

1. Select name and several alternatives.

NOTE:
An agricultural co-op formed pursuant to *Food & Agric. Code §§ 54001-54294* may use the word "cooperative" in its name [*Food & Agric. Code § 54036*]. For a detailed discussion of limitations applicable to business names, see Ch. 2, ***Formation of Corporations*** .

a. Name must not include any of following words or related words [*Corp. Code § 201(a)*]:
(1) "Bank";

(2) "Trust";

(3) "Trustee."

NOTE:
The prohibition does not apply if a certificate of approval from the Commissioner of Financial Institutions is attached to the articles of incorporation [*Corp. Code § 201(a)*].

b. Name must not be likely to mislead public [*Corp. Code § 201(b)*].

c. Name must not be same as, or resemble so closely as to tend to deceive [*Corp. Code § 201(b)*]:

NOTE:
The co-op may adopt a name substantially similar to that of an existing corporation upon proof of consent by the existing corporation and a finding by the Secretary of State that under the circumstances the public is not likely to be misled [*Corp. Code § 201(b)*].

(1) Name of domestic corporation.

(2) Name of foreign corporation that:

(a) Is authorized to transact intrastate business; or

(b) Has registered its name with Secretary of State [*see Corp. Code § 2101*].

(3) Name that foreign corporation has assumed [*see Corp. Code § 2106(b)*].

(4) Name that will become record name of domestic or foreign corporation on effective date of filed corporate instrument [*see Corp. Code §§ 110(c), 5008(c)*].

(5) Name of corporation under reservation.

2. Check availability of name from Corporate Name Index Division of Secretary of State's Office.

3. Reserve corporate name by request to Secretary of State [*see Corp. Code § 201(c)*; *see also Gov. Code § 12186(a) (fee)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporate NamesRequirements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Formation of Nonprofit Agricultural Cooperative Association

7-14A California Legal Forms--Transaction Guide § 14A.141

§ 14A.141 Drafting and Filing Articles of Incorporation

1. Draft articles [*see § 14A.200*] and make copies for filing and future tax purposes.

a. Articles must include [*Food & Agric. Code § 54081*]:
(1) Statement that signatories are engaged in production of products.

NOTE:
"Product" includes any horticultural, viticultural, forestry, dairy, livestock, poultry, bee, or farm product [*Food & Agric. Code § 54004*].

(2) Statement that signatories propose to incorporate corporation pursuant to *Food & Agric. Code §§ 54001-54294*].

(3) Name of co-op.

(4) Purposes for which it is formed.

NOTE:
Food & Agric. Code § 54061 lists all of the permissible purposes for which an agricultural co-op may be formed. For a summary of those purposes, see *§ 14A.32[1]*.

(5) County in which principal business office will be located.

(6) Number of directors.

NOTE:
The co-op must have at least three directors [*Food & Agric. Code § 54141*]. The number of directors

may be fixed or variable [*Food & Agric. Code § 54116(b)*]. If the number is variable, the stated maximum must not be greater than two times the stated minimum minus one [*Food & Agric. Code § 54116(b)*; ***see*** *Food & Agric. Code § 54081(d)*].

(7) Names and addresses of first directors.

(8) Terms of office for each initial director, if of varying lengths.

NOTE:
If the terms of the first directors named in the articles are not specified, those terms will be one-year terms [***see*** *Food & Agric. Code § 54040*; *Corp. Code § 301(a)*].

(9) If co-op has stock structure:

NOTE:
No distinction other than those listed by statute may exist between classes of stock or stockholders [*Food & Agric. Code § 54081(f)*].

(a) Number of shares authorized.

(b) If shares have par value, par value of each share and aggregate par value of all shares.

(c) If shares have no par value, statement of that fact.

(d) If shares are classified, description of classes; statement of preferences, rights, privileges, and restrictions; and number of shares in each class.

(10) If co-op is formed without stock:

(a) Statement whether voting power, property rights, and interest of members are equal or unequal.

(b) If voting power, rights, and interest will be unequal, statement of general rule(s) by which voting power, rights, and interests will be determined.

b. Articles may include any restrictions on co-op's statutory powers summarized below [*Corp. Code § 204(a)(6)*; *see Food & Agric. Code § 54040*]:

(1) Power to engage in any activity connected with producing or marketing members' products [*see Food & Agric. Code § 54171*].

(2) Power to borrow and to advance money to members [*see Food & Agric. Code § 54172*].

(3) Power to act as agent of members in activities related to producing and marketing products or borrowing money [*see Food & Agric. Code § 54173*].

(4) Power to have interest in corporations engaged in related activities [*see Food & Agric. Code § 54180*].

(5) Power to acquire and own securities of associations engaged in related activities [*see Food & Agric.*

Code § 54174].

(6) Power to establish reserves and invest funds [*see Food & Agric. Code § 54175*].

(7) Power to own property [*see Food & Agric. Code § 54176*].

(8) Power to levy assessments [*see Food & Agric. Code § 54177*].

(9) Power to use facilities for any purpose so long as proceeds benefit members [*see Food & Agric. Code § 54179*].

(10) Power to enter contracts with other associations upon resolution of board [*see Food & Agric. Code § 54181*].

(11) Power to assert all rights of a producer, if acting for members as producer marketing or bargaining association in its dealings with processors or produce dealers in connection with any product produced by its members [*see Food & Agric. Code § 54182*].

(12) Power to do all acts necessary to accomplish corporate purposes [*see Food & Agric. Code § 54178*].

c. Articles must be signed and acknowledged by each director named in articles [*Corp. Code § 200(b)*].

NOTE:

Execution and acknowledgment must be in the manner prescribed by the General Corporation Law [*Food & Agric. Code § 54082*]. Acknowledgement may take either of two forms [*Corp. Code § 149*]: notarial acknowledgment [***see*** *Civ. Code §§ 1180-1207*] or written declaration [***see*** Ch. 3, ***Articles of Incorporation***].

2. Obtain check for filing fees.

NOTE:

For the current fee for filing articles of incorporation of a corporation without stock, see *Gov. Code § 12186(d)*. For the current fee for filing articles of incorporation of a corporation with stock, see *Gov. Code § 12186(c)*.

3. File articles with Secretary of State [*Corp. Code § 200*].

NOTE:

For a detailed checklist of procedures involved in filing the articles of incorporation, see Ch. 3, ***Articles of Incorporation*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Formation of Nonprofit Agricultural Cooperative Association

7-14A California Legal Forms--Transaction Guide § 14A.142

§ 14A.142 Holding First Meeting of Directors

NOTE:
For a detailed checklist of procedures to be followed at the first meeting, see Ch. 5, ***Directors' Meetings, Actions, and Resolutions*** .

1. Either:

a. Instruct initial board of directors to hold first meeting; or

b. Have board waive meeting and take initial actions by unanimous written consent [*see Corp. Code § 307(b)*].

2. If meeting is to be held:

a. Fix time and place of meeting.

b. Have any two directors call it [*Corp. Code § 307(a)(1)*].

c. Prepare notice of meeting [*Corp. Code § 307(a)(2)*] or waiver of notice to be signed by each director [*Corp. Code § 307(a)(3)*].

NOTE:
A notice of meeting or a waiver of notice need not specify the purpose of any meeting [*Corp. Code § 307(a)(2)*].

3. Distribute membership applications, if used [*see § 14A.202*].

4. Have directors adopt bylaws.

NOTE:
The directors must adopt bylaws within 30 days after incorporation [*Food & Agric. Code § 54111*]. For an outline of some of the considerations involved in drafting bylaws, see *§ 14A.143*.

5. Have directors choose following officers:

NOTE:
Any two or more offices, except those of president and secretary, may be held by the same person.

a. President.

b. One or more vice presidents.

c. Secretary.

d. Treasurer.

e. Any other officers prescribed by bylaws.

6. Have directors determine:

a. Location of co-op's principal office.

b. Financial structure of co-op, including:

(1) Use of revolving fund.

(2) Use of membership fees.

c. Form of membership certificate.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Formation of Nonprofit Agricultural Cooperative Association

7-14A California Legal Forms--Transaction Guide § 14A.143

§ 14A.143 Drafting Bylaws

1. Include required prohibition on transfer of membership certificates or common stock to any person not qualified to be member or shareholder [*Food & Agric. Code § 54237*; *see § 14A.201[2]*, Section 2.05 of Form].

2. Include any of following optional provisions:

NOTE:
The bylaws may contain any provision, not in conflict with law or the articles, for the management of the activities and for the conduct of the affairs of the co-op [*Corp. Code § 5151(c)*; ***see*** *Food & Agric. Code § 54040*]. *Food & Agric. Code §§ 54112-54122* set forth the specific optional provisions discussed below.

a. Membership provisions [*Food & Agric. Code § 54121*]:
(1) Number and qualification of members or stockholders, and conditions precedent to membership or ownership of common stock [*see § 14A.201[2]*, Section 2.01 of Form].

NOTE:
Only persons who produce products for handling by the co-op, or who use its services or facilities, are qualified to be members [***see*** *Food & Agric. Code § 54231*].

(2) Method, time, and manner of permitting members to withdraw or common stockholders to transfer stock [*see § 14A.201[2]*, Section 2.06 of Form].

(3) Manner of assignment and transfer of interest of members and common stock of shareholders [*see § 14A.201[2]*, Section 2.05 of Form].

(4) Conditions upon which, and time when, membership will cease [*see § 14A.201[2]*, Section 2.06 of Form].

(5) Automatic suspension of membership rights when eligibility ceases.

(6) Mode, manner, and effect of expulsion [*see § 14A.201[2]*, Section 2.07 of Form].

b. Membership fees [*Food & Agric. Code § 54118*; *see § 14A.201[2]*, Section 2.02 of Form]:

(1) Amount of entrance, organization, and membership fees, if any.

(2) Manner and method of collecting fees.

(3) Purposes for which fees may be used.

c. Service fees [*Food & Agric. Code § 54119*]:

(1) Amount required to pay to carry on business of co-op.

(2) Charge for services rendered by co-op.

(3) Time and manner of collection.

(4) Marketing contract between co-op and each member or stockholder.

d. Limitations on amount of common stock any member may own [*Food & Agric. Code § 54236*].

e. Dividends on stock or membership capital.

NOTE:
The dividends must be in the nature of interest and must not exceed 8 percent per year [*Food & Agric. Code § 54121*].

f. Provision for co-op to purchase member's interest or stock upon withdrawal, expulsion, death, disqualification, or forfeiture of membership [*Food & Agric. Code § 54122*; *see § 14A.201[2]*, Section 2.08 of Form].

g. Provisions regarding meetings, including [*Food & Agric. Code §§ 54112-54114*]:

(1) Time, place, and manner of calling and conducting meetings [*see § 14A.201[2]*, Sections 4.01 -4.10 of Form].

(2) Number of stockholders or members for quorum [*see § 14A.201[2]*, Section 4.06 of Form].

(3) Rights of members or stockholders to vote by proxy or to cumulate votes [*see § 14A.201[2]*, Sections 3.02, 3.03 of Form].

h. Following matters with respect to directors [*Food & Agric. Code § 54116*]:

(1) Number of directors [*see § 14A.201[2]*, Section 5.01 of Form].

NOTE:

The number of directors must be stated in the articles of incorporation, but may also be stated in the bylaws [*Food & Agric. Code § 54081(d)*]. In the event of an inconsistency between the articles and bylaw provisions, the provision more recently adopted or amended will prevail [*Food & Agric. Code § 54116(d)*].

(2) Qualifications [*see § 14A.201[2],* Section 5.03 of Form].

(3) Compensation [*see § 14A.201[2],* Section 5.14 of Form].

(4) Time of election [*see § 14A.201[2],* Section 5.02 of Form].

(5) Term of office of directors [*see § 14A.201[2],* Section 5.02 of Form].

(6) Duties [*see § 14A.201[2],* Section 5.15 of Form].

(7) Time, place, and manner of conducting meetings [*Food & Agric. Code § 54112*; *see § 14A.201[2],* Sections 5.06 -5.13 of Form].

(8) Number of directors that will constitute quorum [*Food & Agric. Code § 54115*; *see § 14A.201[2],* Section 5.11 of Form].

i. Following matters regarding election of directors [*Food & Agric. Code §§ 54142-54145*]:

(1) Provision for primary elections to nominate directors.

(2) Election by districts or by representatives from districts.

(3) Selection by other directors or by public official or commission.

j. Following matters regarding directors and officers [*Food & Agric. Code § 54116*]:

(1) Time of their election [*see § 14A.201[2],* Section 6.01 of Form].

(2) Qualifications [*see § 14A.201[2],* Section 6.01 of Form].

(3) Compensation [*see § 14A.201[2],* Section 6.03 of Form].

(4) Duties [*see § 14A.201[2],* Section 6.01 of Form].

(5) Term of office [*see § 14A.201[2],* Section 6.01 of Form].

k. Creation of executive committee [*Food & Agric. Code § 54146*; *see § 14A.201[2],* Section 5.16 of Form].

l. Remuneration of officers, directors, and members of executive committee [*Food & Agric. Code § 54147*; *see § 14A.201[2],* Sections 5.14, 6.03 of Form].

m. Penalties for violation of bylaws [*Food & Agric. Code § 54117*].

3. Include certificate of secretary.

NOTE:

The original or a copy of the bylaws, in writing or in any other form capable of being converted into clearly legible tangible form, certified to be a true copy by a person purporting to be the secretary or an assistant secretary of the co-op is prima facie evidence of the adoption of those bylaws and the matters stated therein [*Corp. Code § 314*; ***see*** *Food & Agric. Code § 54040*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
C. Procedural Guide to Formation of Nonprofit Agricultural Cooperative Association

7-14A California Legal Forms--Transaction Guide §§ 14A.144-14A.159

[Reserved]

§§ 14A.144[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14A California Legal Forms--Transaction Guide § 14A.160

§ 14A.160 Miscellaneous Procedures

1. Advise co-op that it must adopt a code of bylaws within 30 days after incorporation [*Food & Agric. Code § 54111*].

2. Accept or deny membership applications in timely manner [*see § 14A.202[2]*].

3. If membership certificates will be used:

a. Draft membership certificates.

NOTE:
Any restrictions on transfer of membership certificates of the co-op to any person who is not qualified to be a member must be printed on every certificate that is subject to those restrictions [*Food & Agric. Code § 54237*].

b. Issue membership certificates to members whose membership fees, if any, are paid in full.

NOTE:
A certificate must be issued to members of nonstock co-ops after full payment of any membership fee [***see*** *Food & Agric. Code § 54234*].

4. Prepare report of corporate operations [*Food & Agric. Code § 54204*].

a. Report must be prepared and sent:

(1) 120 days after close of fiscal or calendar year.

(2) At three, six, and nine month intervals if required in bylaws.

b. Report must:

(1) Include balance sheet as of closing date of fiscal or calendar year.

(2) Be in form either:
(a) Sanctioned by sound accounting practice for co-op; or

(b) Approved by certified public accountant or public accountant.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14A California Legal Forms--Transaction Guide § 14A.161

§ 14A.161 Correcting Errors or Defects in Filed Instruments

1. Draft certificate of correction to correct, in any filed instrument, any of following [*Corp. Code § 109(a)*; *see Food & Agric. Code § 54040*]:

a. Misstatement of fact.

b. Defect in execution.

c. Any other error or defect.

2. Use correct form of certificate [*Corp. Code § 109(b)*]:

a. If certificate corrects original articles of incorporation, use either:
(1) Officers' certificate [*see Corp. Code § 173* (definition)]; or

(2) Certificate signed and verified by all or majority of incorporators.

b. If certificate corrects agreement of merger or officers' certificate accompanying agreement of merger, use officers' certificate of surviving corporation.

c. If certificate corrects any other instrument, use either:

(1) Officers' certificate [*see Corp. Code § 173* (definition)]; or

(2) Certificate signed and verified as required for particular instrument being corrected.

3. Include all of following [*Corp. Code § 109(c)*; *see Food & Agric. Code § 54040*]:

NOTE:
For examples of certificates of correction, see Ch. 10, ***Amendment of Articles*** **.**

a. Following title: "Certificate of Correction of _____ [*title of instrument and name of co-op*]."

b. Name of co-op.

c. Date that instrument being corrected was filed.

d. Provision in instrument as corrected.

e. If execution was defective, reason for defect.

f. If applicable, that certificate does not alter wording of any resolution or written consent that was in fact adopted by board or shareholders.

4. If provision of any of following is being amended, identify provision in accordance with requirements for certificate of amendment of articles of incorporation [*see Corp. Code § 907(a)*]:

NOTE:
Corp. Code § 907(a) requires that a certificate of amendment must establish the wording of the amendment by stating that (1) the articles will be amended to read as set forth in full, (2) an identified provision will be stricken or amended to read as set forth in the certificate, and/or (3) the provisions set forth will be added to the articles [*Corp. Code § 907(a)*; ***see*** Ch. 10, ***Amendment of Articles***].

a. Articles of incorporation.

b. Amended articles.

c. Restated articles [*see Corp. Code § 910*].

d. Certificate of determination [*see Corp. Code § 156*].

5. Have certificate signed and verified or acknowledged according to requirements for instrument being corrected.

6. Pay filing fee when filing certificate with Secretary of State [*Gov. Code § 12186(p)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsBusiness & Corporate LawCorporationsGoverning Documents & ProceduresArticles of Incorporation & BylawsAmendments to Articles of Incorporation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14A California Legal Forms--Transaction Guide § 14A.162

§ 14A.162 Federal Income Tax Procedures

1. File application for recognition of "exempt" status on I.R.S. Form 1028 in internal revenue district where principal office or place of business is located [*Treas. Reg. § 1.521-1(e)*].

NOTE:

For an explanation of "exempt" status, see the discussion in *§ 14A.34[1]*.

The I.R.S. district director may issue a determination letter granting exempt status in advance of operations if the proposed operations are described in sufficient detail to permit the conclusion that the organization will clearly meet the requirements of the exemption [Rev. Proc. 80-25, 1980-1 C.B. 667].

2. File annual income tax return.

a. If co-op is exempt, file I.R.S. Form 990-C [*Treas. Reg. § 1.6012-2*] on or before [*I.R.C. § 6072(d)(1)*]:

(1) Fifteenth day of ninth month following close of fiscal year, if return is made on basis of fiscal year.

(2) Fifteenth day of September following close of taxable year, if return is made on basis of calendar year.

b. If co-op is nonexempt and if 50 percent or more of net earnings from business done for or with patrons was paid out in patronage dividends, file I.R.S. Form 1120 [*Treas. Reg. § 1.6012-2(a)(3)*] on or before [*I.R.C. § 6072(d)(2)*]:

(1) Fifteenth day of ninth month following close of fiscal year, if return is made on basis

of fiscal year.

(2) Fifteenth day of September following close of taxable year, if return is made on basis of calendar year.

c. If co-op is nonexempt and if less than 50 percent of net earnings from business done for or with patrons was paid out in patronage dividends, file I.R.S. Form 1120 [*Treas. Reg. § 1.6012-2(a)(3)*] on or before [*I.R.C. § 6072(b)*]:

(1) Fifteenth day of third month following close of taxable year, if return is made on basis of fiscal year.

(2) Fifteenth day of March following close of calendar year, if return is made on basis of calendar year.

3. File information return on IRS 1096 and 1099 if patronage or nonpatronage dividends aggregating $10 or more were paid to any patron within calendar year [*I.R.C. § 6044*; *Treas. Reg. § 1.6044-2(a)*].

4. Mail or personally deliver one of following to each person for whom co-op filed information return:

NOTE:
This information must be delivered before January 31 of the year following the calendar year for which the return is made [*I.R.C. § 6044(e)*]. If the information is mailed, it must be sent by first-class mail and the envelope must include adequate notice that the statement is enclosed [*I.R.C. § 6044(e)*].

a. Statement that includes:

(1) Name and address of co-op [*see I.R.C. § 6044(e)*].

(2) Aggregate amount of payments reported for that person [*see I.R.C. § 6044(e)*].

(3) Legend stating that amount shown was reported to the IRS [*Treas. Reg. § 1.6044-5(b)*].

b. IRS Form 1099 [*Treas. Reg. § 1.6044-5(b)*].

5. If co-op opts to net patronage gains and losses for any taxable year, provide patrons with notice of that fact [*I.R.C. § 1388(j)(3)(A)*].

a. Prepare written notice that states all of following:

NOTE:
Any detailed data regarding earnings and losses that could result in a competitive disadvantage to the co-op, or provide a competitive advantage to a competitor of the co-op, may be omitted [*I.R.C. § 1388(j)(3)(B)*]:

(1) That organization has offset earnings and losses from one or more allocation units, and that offset may affect amount distributed to its patrons;

(2) General identification of allocation units; and

(3) Any rights that patrons have to additional financial information of co-op under terms of its charter, articles, bylaws, or any provision of law.

b. Send copy of notice to all patrons on or before fifteenth day of ninth month following close of taxable year.

NOTE:

Failure to provide sufficient notice will not affect the tax treatment of the co-op [*I.R.C. § 1388(j)(3)(C)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other ConstituentsTax LawFederal Taxpayer GroupsExempt OrganizationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14A California Legal Forms--Transaction Guide § 14A.163

§ 14A.163 California Income Tax Procedures

1. File annual return on or before fifteenth day of ninth month following close of taxable year [*see Rev. & Tax. Code § 18601(b)*].

2. File information return if patronage dividends totaling $100 or more were paid to any patron within calendar year [*Rev. & Tax. Code § 18640(a)*].

3. If information return is required to be filed [*see* (2), *above*], provide written statement to each person whose name is required to be set forth in information return [*Rev. & Tax. Code § 18640(b)*].

NOTE:
The Franchise Tax Board may prescribe the form of the statement [*Rev. & Tax. Code § 18640(b)*].

a. Include both of following in statement [*Rev. & Tax. Code § 18640(b)*]:
(1) Name and address of co-op.

(2) Amount of allocations.

b. Provide statement [*Rev. & Tax. Code § 18640(c)*]:

(1) On or before January 31 of year following calendar year for which information return was made.

(2) In person or by first-class mail.

NOTE:

If the statement is provided in a separate mailing by first-class mail, it must contain adequate notice that the statement is enclosed [*Rev. & Tax. Code § 18640(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14A California Legal Forms--Transaction Guide § 14A.164

§ 14A.164 Modifying or Repealing Articles and Bylaws

1. To amend articles of incorporation, follow procedures required by General Corporation Law [*Food & Agric. Code § 54083*; *see Corp. Code §§ 900-911*].

NOTE:
For a list of the procedures to be followed, see Ch. 10, ***Amendment of Articles*** .

2. If amending, repealing, or adopting new bylaws, advise co-op that vote or written assent of members holding majority of voting power is required [*see Food & Agric. Code § 54111*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14A California Legal Forms--Transaction Guide § 14A.165

§ 14A.165 Precluding Escheat of Member's Unclaimed Interest

NOTE:

Normally, intangible personal property held or owed in the course of the holder's business that remains unclaimed by the owner for more than three years after it becomes payable or distributable escheats to the state [Corp. Code § 1520(a); ***see*** *Code Civ. Proc. §§ 1500-1582* (Unclaimed Property Law); ***but see*** *Code Civ. Proc. §§ 1511, 1513-1519, 1521* (exceptions)]. However, if the holder has records that contain the address of the apparent holder of property valued at least $50, notice procedures apply [***see*** Corp. Code § 1520(b); ***see also*** Corp. Code §§ 1513.5(a), 1516(d) (exceptions)]. For further discussion of the Unclaimed Property Law, see Ch. 102C, ***Lost and Unclaimed Property*** .

However, if an agricultural association takes the following actions, any proprietary interest in the association that would otherwise escheat to the state will instead become the property of the association [***see*** *Food & Agr. Code § 54041(a)*]. "Proprietary interest" includes any membership, membership certificate, membership share, share certificate, or equity or dividend certificate of any class representing a proprietary interest in, and issued by, the association. It includes all accrued and unpaid earnings, dividends, and patronage distributions relating to the interest [*Food & Agric. Code § 54041(d)*].

1. Give notice of proposed transfer of proprietary interest at least 60 days before date of proposed transfer [*Food & Agric. Code § 54041(c)(1)*]:

NOTE:

Notice given in this manner constitutes actual notice [*Food & Agric. Code § 54041(c)(1)*].

a. By first-class or certified mail to last address of affected member, as shown on association's records; and

b. By publication in newspaper of general circulation in county in which affected member last resided, as shown on association's records.

2. Verify that no written notice objecting to transfer has been received by association before date of proposed transfer, from [*Food & Agric. Code § 54041(c)(2)*]:

a. Affected member; or

b. If affected member is deceased:
(1) Member's heirs; or

(2) Executor or executrix of member's estate.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCooperativesGeneral OverviewBusiness & Corporate LawCooperativesFormationBusiness & Corporate LawCooperativesMembers & Other Constituents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-14A California Legal Forms--Transaction Guide §§ 14A.166-14A.199

[Reserved]

§§ 14A.166[Reserved]



98 of 103 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART IV. FORMS

7-14A California Legal Forms--Transaction Guide § 14A.200

§ 14A.200 Articles of Incorporation of Agricultural Nonprofit Cooperative Association Organized Without Stock

[1] Comment

[a] Use of Form

This form is a set of articles of incorporation for an agricultural nonprofit cooperative association organized without stock. Although agricultural co-ops may be formed with or without stock [*see* Food & Agric. Code § 5081(e), (f)], today most are formed without stock [*see § 14A.31[2]*].

An agricultural co-op is formed by signing, acknowledging, and filing these articles with the Secretary of State in the manner prescribed by the General Corporation Law [*see Food & Agric. Code § 54082*; *Corp. Code § 200(a)*]. However, the provisions required in the articles of an agricultural co-op differ in several respects from those required for a corporation formed under the General Corporation Law [*see* Ch. 3, *Articles of Incorporation*] or the Consumer Cooperative Corporation Law [*see § 14.200*].

[b] Required Provisions

[i] Signatories

A minimum of three persons, a majority of whom are California residents, are necessary to form an agricultural co-op [*Food & Agric. Code § 54061*]. The articles must show that the signatories of the articles are engaged in the production of horticultural, viticultural, aquacultural, forestry, dairy, livestock, poultry, bee, or farm products [*see Food & Agric. Code § 54004* (definition of "product")], and that they propose to incorporate a nonprofit agricultural cooperative association [*Food & Agric. Code § 54081*].

[ii] Name of Co-Op

The articles must set forth the name of the agricultural co-op [*Food & Agric. Code § 54081(a)*]. The word "cooperative" may be included in the name [*Food & Agric. Code § 54036*]. The steps involved in selecting and reserving a name are the same as those for reserving the name of any new corporation organized under the General Corporation Law [*see*

Corp. Code § 201; *Food & Agric. Code § 54040*; *see also § 14A.140*].

[iii] Purposes Clause

The articles must state the purposes for which the co-op was formed [*Food & Agric. Code § 54081(b)*]. However, the Food and Agricultural Code, unlike the General Corporation Law, does not require a specific statement of the corporate purpose [*see Corp. Code § 202(a)(1)*]. Consequently, this form reiterates all the permissible purposes for which an agricultural co-op may be formed [*see Food & Agric. Code § 54061*].

[iv] Principal Business Office

The articles must state the county where the principal office for the transaction of business of the co-op is to be located [*Food & Agric. Code § 54081(c)*].

[v] Initial Agent for Service of Process

Although the Food and Agricultural Code does not require the articles of incorporation to state the co-op's initial agent for service of process, the General Corporation Law applies except when its provisions are in conflict with or inconsistent with the express provisions of that chapter [*see Food & Agric. Code § 54040*]. Presumably, the absence of this standard provision does not constitute such a conflict or inconsistency and a provision should be set forth pursuant to the General Corporation Law [*see Corp. Code § 202(c)*].

The General Corporation Law requires that articles of incorporation set forth the name and address in California of a corporation's initial agent for service of process [*Corp. Code § 202(c)*]. The agent may be a natural person residing in California or a corporation which has filed a required certificate [*see Corp. Code § 1505*] and whose capacity to act as agent has not terminated. If a natural person is designated, the person's complete business or residence street address must be set forth. If a corporate agent is designated, no address for it must be set forth [*Corp. Code § 1502*; *see Corp. Code § 202(c)*].

[vi] Board of Directors

The corporation's affairs are managed by a board of not less than three directors who are elected by the members [*Food & Agric. Code § 54141*]. The articles must state the number of directors and the name and addresses of the people who will serve as the first directors [*Food & Agric. Code § 54081*]. The number of directors may be fixed or variable [*Food & Agric. Code § 54116(b)*]. If the number is fixed, the stated minimum must be not less than three. If the number is variable, the stated minimum must not be less than three and the stated maximum must not be greater than two times the stated minimum minus one [*Food & Agric. Code § 54116(b)*; *see Food & Agric. Code § 54081(d)*]. When a variable number is set forth in the articles, the exact number of directors must be fixed by approval of the board of directors or the shareholders [*see Corp. Code § 153*] in the manner set forth in the bylaws [*Food & Agric. Code § 54116(e)*].

Unlike a corporation organized under the General Corporations Law, in which the directors are ordinarily elected for one-year terms [*see Corp. Code § 301*], the directors of an agricultural co-op may serve for terms of varying length. If the first directors will serve for terms of different lengths, the articles must state the term for which each named person will serve [*Food & Agric. Code § 54081(d)*]. However, if the terms of the first directors named in the articles are not specified, those terms will be one-year terms [*Food & Agric. Code § 54040*; *see Corp. Code § 301(a)*].

[vii] Nonstock Membership Associations

If the co-op is organized without stock, the articles must state whether the voting power and the property rights and interests of each member are equal or unequal. When those rights are unequal, the articles must include the general rules that are applicable to all members by which the voting power and property rights and interests of each member are

determined and fixed [*Food & Agric. Code § 54081(e)*]. Although the co-op does not issue stock shares, its members are deemed to be "shareholders" for purposes of applying the General Corporation Law [*Food & Agric. Code § 54040*].

[viii] Stock Associations

If the co-op is organized with stock, the articles must specify the number of shares which may be issued, and if the shares have a par value, the par value of each share and the aggregate par value of all shares. If the shares have no par value, the articles must make a statement to that effect [*Food & Agric. Code § 54081(f)*].

If the shares are classified, the articles must include a description of the classes of shares, a statement of the number of shares of each kind or class, and a statement of the nature and extent of the preferences, rights, privileges, and restrictions that are granted to or imposed upon the holders of the respective classes of stock. No other distinction may exist between classes of stock or their stockholders [*Food & Agric. Code § 54081(f)*].

One class of stock must always be known as common stock, and voting power may be restricted to that class [*Food & Agric. Code § 54081(f)*]. Common stock may only be issued to members who produce any product that is to be handled by or through the co-op, or who use or employ any service or facility offered by the co-op on or in connection with land used for the production of any product [*Food & Agric. Code § 54231*].

[c] Revolving Funds

Agricultural co-ops may establish reserves and invest the funds of those reserves in bonds or other property authorized in the bylaws [*Food & Agric. Code § 54175*]. Many co-ops establish "revolving funds" with money retained from sale proceeds of members products, and issue their members credits for the withheld amounts in lieu of immediate payment [*see § 14A.201[1][e]*]. A provision for a revolving fund is provided in these articles, as well as in the co-op's bylaws [*see § 14A.201*, Article VI].

[d] Statement of Corporate Powers

The powers that an agricultural co-op may exercise are enumerated in *Food and Agric. Code §§ 54171-54182* [*see § 14A.141*, P 1(b)]. A statement of those corporate powers in the articles of incorporation is not required by statute. However, a statement of corporate powers or any restrictions on them is optional [*see Corp. Code § 204(a)(6)*; *Food & Agric. Code § 54040*]. The short summary statement of corporate powers included in this form may be deleted or augmented as desired.

[e] Execution, Filing, and Amendment of Articles

The articles of incorporation of an agricultural co-op must be signed, acknowledged, and filed with the Secretary of State in the manner prescribed by the General Corporation Law [*see Food & Agric. Code § 54082*; *Corp. Code § 200(a)*; *see also* Ch. 3, *Articles of Incorporation*]. They may be amended in the manner and for the purposes authorized by the General Corporation Law [*Food & Agric. Code § 54083*; *see Corp. Code §§ 900-911*].

[f] Amending Articles to Reorganize Corporation

Any corporation may reorganize as a cooperative corporation by amending its articles to conform with the applicable provisions of the Food and Agricultural Code [*Food & Agric. Code § 54291*]. Articles will be deemed to conform with the chapter if either (1) they provide or declare in substance that the corporation is organized and exists as a nonprofit cooperative corporation for one or more of the purposes provided in that chapter, or (2) it clearly appears from the articles of incorporation that the corporation desires to be subject to, and to be organized, exist, and function pursuant to that chapter [*Food & Agric. Code § 54292*]. A corporation that reorganizes in this manner is treated as if it had originally been organized as an agricultural co-op [*Food & Agric. Code § 54291*].

[2] FORM

Articles of Incorporation of Agricultural Nonprofit Cooperative Association Organized Without Stock

ARTICLES OF INCORPORATION
OF
_____ [*name of association*]

Preamble

We, the undersigned, a majority of whom are residents of the State of California, and each of whom is engaged in the production of an agricultural product as defined in *Section 54004 of the Food and Agricultural Code* of the State of California, have associated ourselves together and propose to incorporate a nonprofit cooperative association pursuant to the provisions of Chapter 1 of Division 20 of the Food and Agricultural Code of the State of California.

I. Name

The name of this Association shall be _____[*name*], hereinafter known as "the Association."

II. Purposes

The Association is formed for the purposes of engaging in any activity connected with any one or more of the following activities:

(1) The production, marketing, or selling of the products as defined in *Section 54004 of the Food and Agricultural Code* of its members.

(2) The harvesting, preserving, drying, processing, canning, packing, grading, storing, handling, shipping, or utilization of any product of its members, or the manufacturing or making of the by-products of any product of its members.

(3) The manufacturing, selling, or supplying to its members of machinery, equipment, or supplies.

(4) The financing of any of the above activities.

III. Principal Office

The county where the principal office for the transaction of business of the Association is to be located is _____ County, California.

IV. Initial Agent for Service of Process

The name of the Corporation's initial agent for service of process is _____[*name*]. [*If agent is a natural person, add:*] The agent's complete _____[business *or* residential] address is _____[*street, city, state, and zip code*].

V. Directors

[*EITHER*]

The Association shall have _____ [*number not less than three*] Directors, collectively known as the Board of Directors.

[*OR*]

The Association shall have not less than _____ [*number not less than three*] nor more than _____[*number not more than two times the stated minimum minus one*] Directors. The exact number of Directors shall be fixed by approval of the _____ [board *or* members] in the manner provided in the bylaws. The Directors shall be known collectively as the Board of Directors.

[*Continue with the following:*]

The name and addresses of the persons who are to serve as the first Directors of the Association are:

Names	Addresses
_____	___ ___ ___ ___ ___ ___ ___ _
_____	___ ___ ___ ___ ___ ___ ___ _
_____	___ ___ ___ ___ ___ ___ ___ _

[*If the terms of the Directors are to be staggered, add:*]

The first Directors shall serve for terms of different lengths as follows:

_____[*name of Director*] shall serve as a Director until the first annual meeting of members, to be

held on or about _____, 20 _____, and the election of a successor.

_____[*name of Director*] shall serve as a Director until the second annual meeting of members, to be held on or about _____, 20 _____, and the election of a successor.

_____[*name of Director*] shall serve as a Director until the third annual meeting of members, to be held on or about _____, 20 _____, and the election of a successor.

VI. Voting Rights

The Association is a membership association organized without shares of stock.

[*If rights are equal:*]

The voting rights of each member of the Association shall be equal and each member shall be entitled to one vote.

[*Or, if rights are unequal:*]

The voting rights of each member of the Association shall be unequal and shall be determined and fixed in accordance with the following general rule applicable to all members of this Association:

Each member shall have one vote for each _____ [*specify amount e.g.,* one hundred tons of pears] marketed by that member to or through the facilities of the Association during the fiscal [*or* calendar] year preceding the exercise of voting right as shown on the books and records of the Association. However, in no event shall any member have less than one vote [nor shall any member, at any time, be entitled to more than _____ (*number)* votes].

[*OPTIONAL*]

VII. Revolving Funds

To provide funds for effecting corporate purposes, the Association may collect or retain from members for its own use sums to be determined from time to time by the Board of Directors of the Association, in accordance with any applicable provisions contained in the bylaws. Pursuant to those provisions, retained funds shall be placed in one or more Association funds called "Revolving Funds" to the credit of the respective members from whom collected or retained, and each member shall be entitled to a credit, called "Revolving Fund Credit," for the amount collected or retained from that member. Revolving Fund Credits shall be repayable out of moneys in any Revolving Fund not required for the use of the Association at that time, with the priorities and on the conditions provided in the bylaws of the Association.

Revolving Fund Credits may also be set up on the books of the Association and admitted by the Association in payment for property purchased by the Association or as consideration for moneys loaned or advanced to the Association, the principal of which shall be payable solely and exclusively out of the moneys in the Revolving Fund to which credited in the same manner as Revolving Fund Credits for retained funds.

The matter of payment of interest (which in no event may exceed eight percent per annum) on Revolving Fund Credits shall be appropriately provided for in the bylaws.

VIII. Property Rights

[*If rights are equal:*]

The property rights and interests of each member shall be equal.

[*Or, if rights are unequal:*]

The property rights and interests of each member of the Association shall be unequal and shall be determined and fixed by the following general rule applicable to all members of the Association:

Each member's property rights and interests in the Association shall be measured by the unrefunded contribution of that member in money or property to the Association's Revolving Fund or Funds and shall be in the same proportion that that member's unrefunded contribution to that Revolving Fund bears to all unrefunded contributions made to the Revolving Fund by all the members of the Association.

[*OPTIONAL*]

IX. Powers

In order to carry out the purposes for which it was formed, the Association shall have and may exercise each and every power, privilege, right, and immunity now or hereafter authorized for a corporation organized and existing pursuant to Chapter 1 of Division 20 of the Food and Agricultural Code.

Signatures

IN WITNESS WHEREOF, we have hereunto set our hands this _____ day of _____.

_____ [*signature of director*]
[*typed name*]

_____ [*signature of director*]
[*typed name*]

_____ [*signature of director*]
[*typed name*]

ACKNOWLEDGMENT

[*Acknowledgments taken in California must be in the following form (Civ. Code § 1189(a)(1)):*]

)
State of California)
County of _____)
)

On _____[*date*], before me, _____[*name and title of officer taking acknowledgment*], personally appeared _____ [*name(s) of person(s) signing instrument*], who proved to me on the basis of satisfactory evidence to be the person[s] whose name[s] _____ [is *or* are] subscribed to the within instrument and acknowledged to me that _____[he *or* she *or* they] executed the same in _____[his *or* her *or* their] authorized _____[capacity *or* capacities], and that by _____[his *or* her *or* their] signature[s] on the instrument the person[s], or the entity upon behalf of which the person[s] acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct. WITNESS my hand and official seal.

Signature _____ [*Seal*]

[*OR*]

DECLARATION

The undersigned declare that they are the incorporators and the directors named therein who have executed these Articles of Incorporation and hereby declare that this instrument is the act and deed of the undersigned.

Executed _____[*date*]

_____ [*signature of director*]
[*typed name*]

_____ [*signature of director*]
[*typed name*]

_____ [*signature of director*]
[*typed name*]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART IV. FORMS

7-14A California Legal Forms--Transaction Guide § 14A.201

§ 14A.201 Bylaws of Agricultural Nonprofit Cooperative Association Organized Without Stock

[1] Comment

[a] Use of Form

This form is an illustrative set of bylaws for an agricultural co-op organized without stock. Although agricultural co-ops may be formed with or without stock, today most are organized without stock [*see § 14A.31[2]*].

Within 30 days after incorporation, the co-op must adopt bylaws for its government and management that are not inconsistent with the Food and Agricultural Code provisions governing cooperative associations [*see Food & Agric. Code §§ 54001-54294*]. The vote or written assent of shareholders or members holding a majority of the voting power is required to adopt the bylaws [*Food & Agric. Code § 54111*].

For a detailed discussion of corporate bylaws under the General Corporation Law, see Ch. 4, *Bylaws* .

[b] Optional Provisions

Corporate bylaws may contain any provision, not in conflict with law or the articles, for the management of the activities and for the conduct of the affairs of the corporation [*Corp. Code § 5151(c)*; *see Food & Agric. Code § 54040*]. *Food & Agric. Code §§ 54112-54122* contain various optional provisions which may be included in the co-op's bylaws. These provisions are discussed below.

[c] Membership

[i] In General

The bylaws may prescribe the rules concerning membership, including [*Food & Agric. Code § 54121*]:

- The number and qualification of members or stockholders of the co-op and the conditions precedent to membership.

- The method, time, and manner of permitting members to withdraw or common stockholders to transfer stock [*see* Section 2.06 of Form].

- The manner of assignment and transfer of the interest of members and common stock of shareholders [*see* Section 2.05 of Form].

- The conditions upon which, and time when, membership will cease [*see* Section 2.06 of Form].

- The automatic suspension of the rights of a member when his or her eligibility ceases.

- The mode, manner, and effect of the expulsion of a member [*see* Section 2.07 of Form].

The bylaws must prohibit the transfer of membership certificates or common stock to any person who is not qualified to be a member or shareholder [*Food & Agric. Code § 54237*; *see* Section 2.05 of Form]. The bylaws of a co-op issuing stock may place limitations on stock ownership [*see Food & Agric. Code §§ 54121, 54236*].

[ii] Qualification and Number of Members

A co-op may admit as members or issue common stock to only those persons who are engaged in the production of any product [*see Food & Agric. Code § 54004* (definition); *see also § 14A.31[1]*] handled by or through the co-op, or who use any service or facility offered by the co-op on or in connection with land used for the production of any product. Lessees and tenants of land used for the production of products, and lessors and landlords that receive as rent all or part of the crop raised on the leased premises, are qualified to become members [*Food & Agric. Code § 54231*]. If a member of a nonstock co-op is not a natural person, it may be represented by any individual, associate, officer, or manager or member who is duly authorized in writing [*Food & Agric. Code § 54232*]. An agricultural co-op may be a member of any other agricultural association [*Food & Agric. Code § 54233*]. This form does not limit the number of potential members, but permits the board of directors to admit or deny membership to applicants in its discretion [*see* Section 2.01 of Form]. It requires that prospective members submit an application form [*see § 14A.202*] to the Board for acceptance [*see* Section 2.01 of Form], and that the Board issue a membership certificate to accepted members [*see Food & Agric. Code § 54234*; *see* Section 2.03 of Form].

[iii] Fees and Dividends

The bylaws may set the amount of entrance, organization, and membership fees, if any; the manner and method of collecting those fees; and the purposes for which they may be used [*Food & Agric. Code § 54118*; *see* Section 2.02 of Form]. When a membership fee is charged, a member is not liable for the debts of the co-op to an amount exceeding the unpaid amount of the fee [*Food & Agric. Code § 54239*]. The bylaws may also state the amount each member or shareholder is required to pay to carry on the business of the co-op; any charge for services rendered to the member by the co-op, and the time and manner of collection; and the marketing contract between the co-op and each of its members and stockholders [*Food & Agric. Code § 54119*]. This form does not require members to pay any fees, but does provide that members may be required to contribute a specified amount to the Revolving Fund [*see* Section 2.02 of Form].

The amount of any dividends (not exceeding 8 percent per year) that may be declared on stock or membership capital may also be stated in the bylaws [*Food & Agric. Code § 54120*].

[iv] Valuation of Member's Interest

The bylaws may provide for the co-op to purchase a member's interest upon his or her withdrawal, expulsion, death, or forfeiture of membership, or at the option of the co-op, together with the manner of determining the value of the

interest. They may also prescribe the conditions and terms for the co-op's repurchase of stock from disqualified stockholders. This form provides that the Association will pay a terminated member his or her interest upon dissolution of the Association [*see* Section 2.08 of Form]. In the case of the expulsion of a member when the bylaws do not provide any procedure or penalty, the board of directors may equitably appraise that member's property, fix the amount of the interest in money, and pay it to the member within one year after expulsion [*Food & Agric. Code § 54122*; *see* Section 2.08 of Form].

[v] Meetings of Members

The bylaws may provide the time, place, and manner for calling and conducting meetings [*see* Sections 4.01 -4.05 of Form]. If no provision is made for the location of meetings, they will be held in the city where the principal place of business is located, at a place designated by the board of directors [*Food & Agric. Code § 54112*]. Notice of meetings at which members are permitted to take action must be given not more than 60 nor less than 10 days before the date of the meeting [*Corp. Code § 601(a)*; *see Food & Agric. Code § 54040*; *see also* Section 4.03 of Form]. The record date for determining the shareholders entitled to notice of a meeting may be fixed as a date not more than 60 nor less than 10 days prior to the date of the meeting [*Corp. Code § 701(a)*; *see Food & Agric. Code § 54040*; *see also* Section 4.05 of Form]. The notice must state the place, date, and hour of the meeting, any means of electronic transmission by and to the corporation [*see Corp. Code §§ 20, 21*] or electronic video screen communication by which shareholders may participate in the meeting, and the general nature of business to be transacted in a special meeting [*Corp. Code § 601(a)*; *see Food & Agric. Code § 54040*; *see also* Section 4.04 of Form].

The bylaws may prescribe the number of stockholders or members that constitute a quorum [*Food & Agric. Code § 54113*]. This form provides that members representing a majority of the voting power constitute a quorum [*see* Section 4.06 of Form]. The bylaws may also prescribe the rights of members or stockholders to vote, by proxy or mail or both, and the conditions, manner, form, and effects of those votes [*Food & Agric. Code § 54114*; *see* Section 3.03 of Form]. In addition, they may include the right of members or stockholders to cumulate votes or a prohibition against cumulative voting [*Food & Agric. Code § 54114*; *see* Section 3.02 of Form].

[d] Directors and Officers

[i] In General

The bylaws may prescribe the qualifications, compensation, duties, and term of office of directors and officers and the time of their election [*Food & Agric. Code § 54116*]. This form requires directors to be qualified members of the co-op [*see* Section 5.03 of Form], and officers to be members of the board of directors [*see* Section 6.01 of Form]. While the co-op may provide a fair remuneration for the time actually spent by the officers and directors in service of the co-op [*Food & Agric. Code § 54147*], only reimbursement for directors' and officers' actual expenses is provided in this form [*see* Sections 5.14, 6.03 of Form]. This form lists various standard duties of directors [*see* Section 5.15 of Form]. The specific duties of each officer are not listed. For a comprehensive statement of officers' duties, see Ch. 4, *Bylaws* .

[ii] Number

Although the number of directors must be stated in the articles of incorporation [*Food & Agric. Code § 54081(d)*], it may also be set forth in the bylaws [*see* Section 5.01 of Form] as a fixed or variable number [*Food & Agric. Code § 54116(c)*; *see § 14A.200[1][b][vi]*]. In the event of an inconsistency between an article provision and a bylaw provision concerning the number of directors, the provision more recently adopted or amended will prevail [*Food & Agric. Code § 54116(d)*]. If a variable number of directors is set forth in the articles or bylaws, the exact number must be fixed within the specified limits by approval of the board or of the members in the manner specified in the bylaws [*Food & Agric. Code § 54116(e)*].

[iii] Executive Committee

If the co-op plans to create an executive committee, the bylaws may provide for that committee and may allot to it all the functions and powers of the board of directors, subject to the general direction and control of the board [*Food & Agric. Code § 54146*; *see* Section 5.16 of Form]. The bylaws may also state an amount of fair remuneration for the time actually spent by the members of the executive committee in the co-op's service [*Food & Agric. Code § 54147*].

[iv] Election

The bylaws may provide for primary elections to nominate directors [*Food & Agric. Code § 54143*]. They may also require directors to be elected by districts [*Food & Agric. Code § 54142*], by representatives from members' districts [*see Food & Agric. Code § 54144*], or chosen by other directors or by public official or commission to represent the public interest [*see Food & Agric. Code § 54145*]. This form does not contain those provisions.

The directors must elect a president, one or more vice presidents, a secretary, a treasurer, and any other officers prescribed by the bylaws. Any two or more offices, except those of president and secretary, may be held by the same person. The treasurer may be a bank or depository [*Food & Agric. Code § 54149*].

[v] Meetings

The bylaws may determine the time, place, and manner of conducting meetings of the board of directors [*see* Sections 5.06 -5.13 of Form]. Those meetings may be held at any place in or out of state that is fixed by a quorum of the board of directors unless otherwise provided in the articles or bylaws [*Food & Agric. Code § 54112*]. Regular meetings may be held without notice if the time and place of the meetings are fixed by the bylaws or by the board. Special meetings must be held on four days' notice by mail or 48 hours' notice delivered personally or by telephone, including a voice messaging system or by electronic transmission by the corporation [*Corp. Code § 307(a)(2)*; *see Corp. Code § 20* ("electronic transmission by the corporation" defined)]. No notice of a meeting is required for any director who provides a waiver of notice or a written consent to holding the meeting, or a written approval of the minutes of the meeting, whether before or after the meeting, or who attends the meeting without protesting the lack of notice to that director either before or at the commencement of the meeting [*Corp. Code § 307(a)(3)*]. Notices of meetings or waivers of notice need not specify the purpose of any regular or special meeting [*Corp. Code § 307(a)(2)*]. All waivers, consents, and approvals must be filed with the corporate records or made a part of the minutes of the meeting [*Corp. Code § 307(a)(3)*; *see Food & Agric. Code § 54040*].

The bylaws may state the number of directors that constitutes a quorum [*Food & Agric. Code § 54115*]. These bylaws require a majority of the directors for a quorum [*see* Section 5.11 of Form].

[vi] Annual Report to Members

The board of directors must send an annual report of the operations of the co-op to the members no later than 120 days after the close of the fiscal or calendar year, unless the bylaws expressly dispense with this requirement. The report must include a balance sheet as of the closing date, prepared from, and in accordance with, the corporate books, pursuant to sound accounting practices. The bylaws may require interim reports for the three month, six month, or nine month periods of the current fiscal year [*Food & Agric. Code § 54204*]. This form does not require any interim reports.

[vii] Vacancies

If a vacancy on the board of directors occurs other than by expiration of term, the remaining members may fill the vacancy by majority vote. Special rules apply when the bylaws require election by district [*Food & Agric. Code § 54148*].

[viii] Removal

Any member may bring charges against an officer or director by filing them in writing with the secretary of the co-op, together with a petition signed by 5 percent of the members requesting the removal of the officer or director in question. The removal must be voted on at the next meeting of the co-op. If a majority of the members vote for removal, the co-op may replace the officer or director [*Food & Agric. Code § 54150*].

The director or officer against whom the charges are brought must be informed in writing of those charges prior to the meeting, and must have an opportunity at the meeting to be heard in person or by counsel and to present witnesses. The person bringing the charges will also have the opportunity to be heard and present witnesses. Special rules apply to directors elected by district [*Food & Agric. Code § 54150*].

[e] Revolving Fund

A co-op may establish reserves and invest the funds of the reserves in bonds or any other property provided in the bylaws [*Food & Agric. Code § 54175*]. Many co-ops supply capital reserves in the form of "revolving funds" by temporarily withholding as "capital retains" a certain portion of sale proceeds due to members and issuing revolving fund credits in lieu of money. The income tax structure allows the co-op to retain these funds without having to pay income tax on them [*see § 14A.34[2]*]. Interest payable on the withheld funds cannot exceed 8 percent per year [*Food & Agric. Code § 54120*]. This financial structure keeps capital investment closely related to the use of the co-op facilities. Revolving funds are used by both stock and nonstock co-ops [*see* Kerner, *Securities and Capital Structures of Farmer Cooperatives in California*, 19 Hastings L. Rev. 309 (1968)].

This form provides for the establishment of a revolving fund, from which the retained moneys will be paid out to members from time to time [*see* Article VII]. It also provides that nonpatronage income will be allocated to members and held together with the patronage amounts in the revolving fund [*see* Section 7.12 of Form].

[f] Income Tax Consent

In order for an exempt agricultural co-op to deduct amounts paid to patrons as patronage dividends, per-unit retain allocations, or nonpatronage income distributions [*see § 14A.34[2]*], payment must be made in money, property, or a "qualified" written notice of allocation or per-unit retain certificate by the fifteenth day of the ninth month following the close of the taxable year [*see I.R.C. § 1382(b)-(d)*].

A notice of allocation is any form of written notice that shows the amount allocated to that patron and any portion that constitutes a patronage dividend [*I.R.C. § 1388(b)*]. The notice is "qualified" if it is redeemable at face value within 90 days, or if the patron has consented to include the allocated amount in gross income for the year [*I.R.C. § 1388(c)*; *see I.R.C. § 1385(a)*]. "Consent" occurs when the patron either consents in writing, cashes a qualified check, or obtains or retains membership in a co-op after it has adopted a bylaw providing that membership constitutes such an agreement [*I.R.C. § 1388(c)(2)*; *see I.R.C. § 1385(a)*].

Similarly, a per-unit retain certificate is any written notice that discloses to the recipient the stated dollar amount of a per-unit retain allocation by the co-op [*I.R.C. § 1388(g)*; *see § 14A.34[2]*]. The certificate is "qualified" if the recipient either agrees in writing to include the allocated amount in gross income for the year, or if the recipient obtains or retains membership in an organization after it has adopted a bylaw providing that membership constitutes such an agreement [*I.R.C. § 1388(h)*; *see I.R.C. § 1385(a)*].

The income tax consent provision in Section 8.07 of this Form is included to ensure that any payments in the form of allocations will be qualified and thus deductible to the co-op. When consent is thus obtained through a bylaw provision, the member must receive written notification and copy of that bylaw [*see I.R.C. § 1388(c)(2)(B), (h)(2)(B)*]. For use of the income tax consent in marketing agreements, see *§ 14A.203[2]*, P 11 and § 14A.204[2], P 9. For use of the consent

statement in a membership application, see the discussion in *§ 14A.202[1][c]*.

[g] Amending and Repealing Bylaws

The vote or written assent of shareholders or members that hold at least a majority of the voting power is necessary to amend or repeal the bylaws, or to adopt additional bylaws. The power to amend, repeal, or adopt bylaws can be delegated to the board of directors, and likewise revoked [*Food & Agric. Code § 54111*].

[h] Certificate of Secretary

The original or a copy of the bylaws certified to be a true copy by a person purporting to be the secretary or an assistant secretary of the co-op is prima facie evidence of the adoption of those bylaws and the matters stated therein [*Corp. Code § 314*; *see Food and Agr. Code § 54040*]. This form includes a secretary's certificate. For other secretary's certificates, see *Ch. 4, Bylaws, §§ 4.01* and *4.02*.

[2] FORM

Bylaws of Agricultural Nonprofit Cooperative Association Organized Without Stock

BYLAWS OF
_____ [*name of association*]

ARTICLE I. GENERALLY

Purposes

Section 1.01. The purpose of the Association is to render, within the limitations of the Cooperative Marketing Law of California, service to its members at cost in connection with the production by its members of _____ [*type of product, e.g.*, pears].

Principal Office

Section 1.02. The principal office of the Association is in the City of _____ County, California, at a place to be determined from time to time by the Board of Directors.

Definitions

Section 1.03. As used in these Bylaws:

The term "Association" means the _____[*name of association*] (the "Association").

The term "Board" means the Board of Directors of that Association.

The term "Cooperative Marketing Law" means the provisions of Chapter 1 of Division 20 of the Food and Agricultural Code of the State of California.

The term "Articles of Incorporation" includes amendments and means the Articles of Incorporation of the Association as last amended.

The term "Products" means _____ [*type of products, e.g.,* pears].

ARTICLE II. MEMBERS

Admission to Membership

Section 2.01. Any person desiring membership in the Association shall submit a membership application on a form prescribed by the Board of Directors. The application shall contain an agreement to abide by the Bylaws, rules, and regulations of the Association. The Board shall admit or deny membership in its discretion. Acceptance of the application shall make the agreement immediately effective and binding on the member. The word person as used in this article includes individuals, firms, partnerships, corporations, associations, lessees and tenants of lands used for or in the production of products, and any lessor or landlord who receives as rent all or part of the products raised on leased premises. If the member is not a natural person, that member may be represented by any individual, associate, officer, or manager or member of it who is duly authorized in writing

Membership Fee

Section 2.02. No membership fee shall be charged. However, the Board of Directors may require a membership applicant to invest a prescribed amount in the Revolving Fund described in Article 6.01 of these Bylaws.

Membership Certificate

Section 2.03. Each member of the Association is entitled to a membership certificate, signed by the _____ [*specify officer(s), e.g.,* President and Secretary] of the Association.

Joint Owners

Section 2.04. When the right to dispose of any product is owned by more than one person, whether as cotenants, joint tenants, partners, an unincorporated association, or otherwise, all owners may be collectively admitted to membership as a single member entitled to one membership certificate. The membership certificate may be issued in the names of all owners or in any name that they have chosen as their collective name. All of them collectively shall be deemed a single member of the Association and will possess the rights of one member. The right to vote and assent shall be held by those persons as authorized in a written document filed with the Association. In the absence of an authorization, the right to vote and assent may be exercised by any one of those persons.

Transfer of Membership

Section 2.05. The transfer of membership certificates to any person who does not fall within one of the following categories is prohibited:

(a) Any person who is engaged in the production of any product which is handled by or through the Association.

(b) Any person who uses or employs any service or facility offered by the Association on, or in connection with, land which is used for the production of any product, including any person who is a lessor or landlord who receives as rent all or part of the crop which is raised on the leased premises.

The foregoing transfer restriction shall be printed on every membership certificate issued by the Association.

Termination of Membership

Section 2.06. A membership and all membership rights shall automatically terminate upon any of the following events:

(a) The loss of qualifications necessary for admission to membership.

(b) The voluntary resignation at any time of a member with written notice delivered to _____ [*specify officer or other person, e.g.,* the Secretary of the Corporation].

(c) The death of a member or the dissolution of a corporate member.

(d) The expulsion of a member pursuant to Section 2.07 of these Bylaws.

Expulsion

Section 2.07. A member who _____ [*specify grounds for expulsion, e.g.,* fails to comply with the Bylaws, rules or regulations of the corporation] shall be expelled from membership in the Association only after reasonable notice and an opportunity to be heard is given pursuant to this section. The corporation must provide written notice of the expulsion and the reasons for expulsion at least _____ [*specify number, e.g.,* 15] days prior to the effective date of the expulsion. The notice must be given personally or sent by first-class or registered mail to the last address of the member shown on the corporation's records. The opportunity to be heard shall be _____ [*set forth procedures for hearing, e.g.,* a hearing one week before the effective expulsion date before a committee appointed by the Board].

Effect of Termination

Section 2.08. All rights as a member of the Association shall cease upon termination of membership. Termination shall not relieve that member from any obligations to the Association. A terminated member shall be not be entitled to payment on account of any property interest in the Association except as follows:

(a) The terminated member shall be entitled to receive payment on account of any moneys received by the Association from the sale of Products produced by that person, and on account of any funds credited to that person in the Revolving Fund after termination.

(b) In the case of any member terminated other than by expulsion, the member shall be entitled to receive payment on account of any interest in the unallocated property and assets of the Association upon dissolution.

(c) In the case of an expelled member, the Board of Directors shall equitably and conclusively appraise that member's property interest in the Association and fix the amount in money. The fixed amount shall be paid to the expelled member within one year of expulsion.

ARTICLE III. VOTING AND PROPERTY RIGHTS

Voting Rights

[*EITHER*]

Section 3.01. The voting power of each member is equal and each member shall have one vote.

[*OR*]

Section 3.01. Each member shall have one vote for each _____ [*specify amount, e.g.*, one hundred tons of pears] marketed to or through the facilities of the Association during the fiscal [or calendar] year preceding the exercise of his or her voting right as shown on the books and records of the Association. However, in no event shall any member have less than one vote [nor shall any member, at any time, be entitled to more than _____ (*number*) votes].

At the conclusion of each fiscal [or calendar] year, the Board of Directors shall determine the voting rights of each member on the basis of the business done by that member with the Association during that year and send notice to that member of those voting rights. A determination of voting rights by the Board will be conclusive and binding on all members until the next determination at the end of the following year.

Cumulative Voting

[*EITHER*]

Section 3.02. No member shall be permitted to cumulate votes except when the right to exercise a cumulative voting privilege is specifically granted or reserved by law.

[*OR*]

Section 3.02. A member shall have the right to cumulate votes for the election of votes pursuant to *Section 708 of the Corporations Code*.

Voting by Proxy

[*EITHER*]

Section 3.03. Voting by proxy for any purpose shall not be permitted for any purpose.

[*OR*]

Section 3.03. Every member who is entitled to vote or execute consents shall have the right to do so either in person or by an agent authorized by written proxy executed by the member or by the duly authorized agent of that member, and filed with the Secretary of the Association.

Property Rights

[*EITHER*]

Section 3.04. The property rights of all members shall be equal.

[*OR*]

Section 3.04. The property rights and interests of each member shall be unequal and shall be determined and fixed by the following general rule applicable to all members of the Association:

Each member's property rights and interests in the Association shall be measured by the unrefunded contribution of that member in money or property to the Association's Revolving Fund and shall be in the same proportion that the member's unrefunded contribution bears to all unrefunded contributions made to the Revolving Fund by all the members of the Association.

Property Rights upon Dissolution

Section 3.05. Upon dissolution of the Association, all of the money, property, and assets shall be applied and distributed as follows:

(a) First, in payment of all debts, liabilities, and obligations of the Association other than those represented by Revolving Fund Credits or other credits issued to members or patrons.

(b) Second, in payment of all Revolving Fund Credits and other credits issued to members and patrons.

(c) Third, any residue remaining after payment in full of all indebtedness, including that evidenced by Revolving Fund Credits and other credits issued to members and patrons, shall be distributed to those members in good standing who held Revolving Fund Credits at the time of commencement of proceedings for liquidation or dissolution, in the proportion that the amount of Revolving Fund Credits held by each of them at that time bears to the total amount of credits outstanding at that time.

ARTICLE IV. MEETINGS OF MEMBERS

Annual Meeting

Section 4.01. There shall be one regular meeting of the members of the Association annually, which shall be held at the principal office of the corporation, located at _____ California, or at any other place in California that may be designated by the Board of Directors. The meeting shall be called on the date in the month of _____ of each year at an hour and place determined by the Board of Directors and stated in the notice of the annual.

Special Meetings

Section 4.02. Special meetings of the members of the Association shall be called by the Secretary of the Association on request of the President of the Association, the Board of Directors, or members holding not less than _____ [*e.g.*, one-fifth] of the voting power of the Association. The requests shall be in writing, shall be filed with the Secretary of the Association, and shall state the time, place, and purpose of the meetings.

Notice of Meetings

Section 4.03. Written notice of each meeting of members, whether annual or special, shall be given by the Secretary of the Association to each member entitled to notice, _____ [*number not more than 10 nor more than 60, e.g.*, 15], days before the meeting, either by personal delivery, by electronic transmission by the corporation, or by first class mail, postage prepaid, to the address of each member as listed in the books of the Association. If no address appears on the books of the Association for a member entitled to notice, the notice shall be addressed to the member in care of General Delivery in the city where the principal office of the Association is situated.

One method of service may be used as to some members and the other method as to other members.

Contents of Notice

Section 4.04. Notice of any membership meeting shall specify the place, day, and hour of the meeting. [*If members may participate in meeting electronically, add:* The notice shall also specify the means of electronic transmission by and to the corporation or electronic video screen communication by which members may participate in meetings.] In the case of special meetings, the general nature of the business to be transacted at the meeting shall be stated in the notice. In the case of the annual meeting, the nature of the business to be transacted at the meeting need not be stated. However, when a proposal to amend the Articles of Incorporation or these Bylaws is to be voted on at any meeting notice of that fact shall be given.

Members Entitled to Notice

Section 4.05. Notices of meetings shall be mailed on the same day and at the same time to each member who, on the record date for notice of the meeting, is entitled to vote. The record date for determination of members entitled to notice is 5:00 p.m. local time at the office of the Secretary of the Association on the day immediately preceding the day of mailing.

Quorum

Section 4.06. Members present in person or by proxy at any membership meeting and representing a majority of the voting power of the Association constitute a quorum for the transaction of all business that may legally come before that meeting.

Adjourned Meetings

Section 4.07. If a quorum is not present at any meeting of the members, those members present in person or by proxy shall have power to adjourn the meeting without notice other than oral announcement at the meeting until a quorum shall be present. At any adjourned meeting at which a quorum is present, any business which might have been transacted at the meeting as originally noticed, may be transacted.

Business to Be Transacted

Section 4.08. At the annual meeting of members, any business may be transacted with respect to which the members are

permitted to act, including, subject to the provisions for notice, the amendment, repeal, and adoption of bylaws and the approval and ratification of amendments to the articles of incorporation. At a special meeting of members, only the business specified in the notice of meeting, may be transacted.

Presiding Officers

Section 4.09. The President and the Secretary of the Association shall act as Chairman and Secretary, respectively, of each meeting of members.

Manner of Voting

Section 4.10. At meetings of members all questions, except as otherwise expressly provided by statute or by these Bylaws, shall be determined by a majority of the votes represented at the meeting. All voting shall be by voice vote, unless a majority of the members represented at the meeting demand a vote by written ballot.

ARTICLE V. DIRECTORS

Number

[*EITHER*]

Section 5.01. The Association shall have _____ [*number not less than three*] Directors, collectively known as the Board of Directors.

[*OR*]

Section 5.01. The Association shall have not less than _____ [*number not less than three*] nor more than _____[*number not more than two times the stated minimum minus one*] of Directors. The exact number of Directors shall be fixed, within the specified limits, by approval of the _____ [Board of Directors *or* members] at the _____ [organizational meeting *or* annual meeting]. The Directors shall be known collectively as the Board of Directors.

Term

[*EITHER*]

Section 5.02. The Directors shall be elected at each annual meeting and shall hold office until their successors have been elected and qualified for office.

[*OR*]

Section 5.02. The Directors shall be elected at the annual meeting to terms of office on a staggered basis, determined by the length of the terms of the initial Directors as specified in the articles of incorporation. The term of office shall begin immediately upon a Director's election and qualification. Each Director shall hold office for _____ [*number*] year(s) and

until a successor is elected and qualified, or until the Director resigns, becomes disqualified, or is removed from office.

Qualifications

Section 5.03. Each Director shall be a duly qualified member of the Association or an authorized representative of a member who is not a natural person.

Vacancies

Section 5.04. Vacancies on the Board of Directors arising other than by expiration of the term of office of a Director shall be filled by the majority vote of the remaining Directors then in office. The newly appointed Director shall hold office for the unexpired portion of the term of office of the Director he or she is appointed to replace, and until the election and qualification of a successor.

Removal of Director

Section 5.05. Any member may bring charges against a Director by filing them in writing with the Secretary of the Association, together with a petition signed by 5 percent of the members requesting the removal of the Director in question. The removal shall be voted on at the next meeting of the Association. If a majority of the members vote for removal, the Association may remove the Director and fill the vacancy pursuant to Section 5.04. The Director against whom the charges are brought shall be informed in writing of those charges prior to the meeting, and shall have an opportunity at the meeting to be heard in person or by counsel and to present witnesses. The person bringing the charges shall also have the opportunity to be heard and present witnesses.

Any Director who ceases to be a member of this Association or who violates any contract with this Association, after a majority of the Board finds that membership has ceased or a contract violation has occurred, shall cease to be a member of the Board of Directors.

Organizational Meeting

Section 5.06. A meeting of the Board of Directors, to be known as the "organizational meeting," shall be held immediately following adjournment of the annual meeting of members for the purpose of organizing, electing, and appointing officers of this Association. Any other business may also be transacted at the meeting. No notice of an organizational meeting need be given. If not held at the time appointed, or if the organizing, electing, and appointment of officers of this Association is not effected or completed at the meeting, the business or organizing, electing, and appointing officers of this Association shall be transacted or completed at the next regular or special meeting of the Board of Directors.

Regular Meetings

Section 5.07. Regular meetings of the Board of Directors shall be held _____ [*specify time, e.g.*, on the first Monday of each month] at the principal office of the corporation. No notice of regular meetings shall be required. However, if the time or place of the regular meeting is changed, written notice of that fact shall be given any Directors who were absent at the time the resolution effecting the change was adopted. In the event the day fixed for the regular meeting falls on a legal holiday, the meeting shall be held on the next succeeding business day without further notice.

Special Meetings

Section 5.08. A special meeting of the Board of Directors shall be called by the Secretary of the Association on request of the President of the Association, on request of any Vice President of the Association, or on the request of any _____ [*number, e.g.,* two] Directors. These requests shall be in writing, shall be filed with the Secretary of the Association, and shall state the time and place, of the meeting.

Notice of Special Meetings

Section 5.09. Written notice of a special meeting of the Board of Directors, specifying the time and place of the meeting, shall be given by the Secretary of the Association to each Director at least _____ [*specify time not more than four days, e.g.,* three] days if by mail, or 48 hours if personally delivered or by telephone or telegraph, before the meeting.

Waiver of Notice

Section 5.10. Unless otherwise prohibited by law, a Director may waive notice of a special meeting of the Board of Directors. Attendance at and participation in the proceedings of any special meeting shall be deemed such a waiver. The waiver of any Director not present or participating in any special meeting shall be in writing, signed by the Director, either before or after the holding of the meeting, and filed with the Secretary of the Association.

Quorum

Section 5.11. A majority of the authorized number of Directors shall be necessary to constitute a quorum for the transaction of business. Unless otherwise required by law or these bylaws, every act or decision done or made by a majority of the Directors present at a meeting duly held at which a quorum is present shall be regarded as the act of the Board of Directors.

Adjournment

Section 5.12. If a quorum is not be present at the time set for holding any meeting of the Board of Directors, the Directors present shall have the power to adjourn the meeting, without notice other than oral announcement at the meeting, until a quorum shall be present. Any business that might have been transacted at the meeting as originally noticed may be transacted at an adjourned meeting.

Business to Be Transacted

Section 5.13. Any and all business presented may be transacted at any regular meeting of the Board of Directors or at any adjournment thereof, or at any meeting held by written consent or for which a waiver of notice has been obtained.

Compensation of Directors

Section 5.14. The Directors of the Association shall receive no compensation for their services as Directors but shall be entitled to reimbursement for all traveling and other actual expenses reasonably incurred by them in connection with

attendance at any meetings of the Board of Directors, or any committee on presentation to the Treasurer of vouchers on a form prescribed by the Board of Directors.

Powers and Duties of Directors

Section 5.15. The Directors shall have the power and duty to manage the business and affairs of the corporation and to exercise all corporate powers, including the duty to:

(a) Prescribe the qualifications and requirements for membership.

(b) Accept or deny membership applications.

(c) Issue membership certificates.

(d) Make and enter into agreements with producers, processors, distributors, and others for the sale, marketing, and consignment of the products produced by members.

(e) Carry out the membership and marketing agreements of the Association to the members' benefit.

(f) Install an auditing system to keep a complete record of the property rights and interests of the members.

(g) Determine and fix any amounts to be charged and retained for services rendered to members.

(h) Establish grades, standards, and classification of products when necessary and to determine and fix the prices for those products.

(i) Determine, from time to time, which members are in good standing, and to terminate the membership of those members not in good standing.

(j) Send to each member, no later than 120 days after the close of the fiscal [*or* calendar] year, an annual report of the Association's operations, including a balance sheet, approved by a certified public accountant pursuant to *Food & Agric. Code § 54204*.

Executive Committee

Section 5.16. The Board of Directors may elect an Executive Committee by majority vote. The Executive Committee shall have any of the functions and powers of the Board of the Directors that the Board allocates to it, but shall be subject to the general supervision and control of the Board of Directors. The Executive Committee shall have _____ [*number*] members. Those members shall serve for a term of one year and until their successors are elected and qualified. Vacancies shall be filled by majority vote of the Board of Directors. The Board of Directors may fix an amount of fair remuneration for the time actually spent by the members of the Executive Committee in the Association's service.

ARTICLE VI. OFFICERS

Election and Term of Officers

Section 6.01. The officers of the Association shall be a President, one or more Vice Presidents, a Secretary, and a

Treasurer. All officers shall be members of the Board of Directors. Any two or more offices, except those of president and secretary, may be held by the same person. The Board of Directors shall elect officers _____ [*specify time, e.g.,* annually]. The officers shall hold office until the election and qualification of their successors or until they are removed by majority vote of the members pursuant to Section 6.05.

Appointive Officers

Section 6.02. The Board of Directors may appoint Assistant Secretaries, Assistant Treasurers, and any other officers it deems necessary serve at the pleasure of the Board of Directors and who shall perform the duties prescribed by the Board of Directors.

Compensation of Officers

Section 6.03. The Officers of the Association shall receive no compensation for their services as Officers, but shall be entitled to reimbursement for all traveling and other actual expenses reasonably incurred by them in connection with Association business upon presentation to the Treasurer of vouchers on a form prescribed by the Board of Directors.

Bank as Treasurer

Section 6.04. The Board of Directors, in its discretion, may appoint a bank or other depository as Treasurer of this Association, in which event the bank or depository shall not be considered as an officer of the Association but as performing a function of the Board of Directors. If the Board of Directors should name a bank or other depository as Treasurer of this Association, the usual accounting duties of the Treasurer, shall be performed by the Secretary of the Association, except that the funds of the Association shall be deposited only as and where authorized by the Board of Directors.

Removal of Officer

Section 6.05. Any member may bring charges against an officer by filing them in writing with the Secretary of the Association, together with a petition signed by 5 percent of the members requesting the removal of the officer in question. Removal shall be pursuant to the procedures set forth inSection 5.05.

ARTICLE VII. REVOLVING FUND

Retains

Section 7.01. Subject to the provisions of its membership or marketing agreements, to provide capital for its corporate purposes, the Association shall temporarily retain from the net returns of the sale of Products of its patrons, as set forth in Section 7.04, any amounts, called "retains," that may be determined by the Board of Directors. The aggregate of the amounts retained which have not subsequently been paid to members shall be known as the "Revolving Fund" of the Association. The patrons of the Association shall be credited on the books of the Association with the amounts retained from each of them respectively.These credits shall be known as "Revolving Fund Credits."

Amount of Retains

Section 7.02. The amount of the retains for any fiscal [calendar] year or season shall be fixed by the Board of Directors during or at the end of the fiscal [calendar] year and in no case later than _____ days after close of such fiscal [calendar] year.

Credits Represent Association Indebtedness

Section 7.03. Revolving Fund Credits shall be deemed to evidence an indebtedness of the Association to the respective person to whom credited, payable solely and exclusively on the conditions and at the time or times herein provided. No interest shall be payable on or in respect to said Revolving Fund Credits [unless otherwise provided by the Board of Directors, and in no case shall interest be payable on any such Revolving Fund Credits at a rate exceeding eight (8) percent per annum].

Revolving Fund Statements

Section 7.04. As soon after the end of each fiscal [*or* calendar] year as practicable, and in no event later than the fifteenth day of the ninth month following the close of the year, there shall be mailed or delivered to each patron a statement showing the amount retained or collected from and credited to that patron as a Revolving Fund Credit during that year. The statement shall be in the form and contain any other information as the Board of Directors prescribes.

Payment of Revolving Fund Credits

Section 7.05. From time to time the Board of Directors shall, by resolution, determine the amount of moneys not then needed and that will not be needed for the use of the Association and that is available for payment of Revolving Fund Credits. From the amount determined to be available, the oldest unpaid Revolving Fund Credits shall, as soon as practicable after that determination, be paid. In determining the oldest credits, all credits for the same fiscal [*or* calendar] year shall have the same priority. If there are not sufficient moneys available for the payment of all Revolving Fund Credits of a particular year, the same proportionate part of each credit for that year shall be paid.

Assignment of Revolving Fund Credits

Section 7.06. No assignment or transfer of any Revolving Fund Credit, whether voluntary or involuntary, shall be of any effect as against the Association or entitle the assignee or transferee to receive any moneys from the Association until evidence satisfactory to the Association of assignment or transfer is submitted.

No Assignment While Indebted to Association

Section 7.07. No assignment or transfer of any Revolving Fund Credit, whether voluntary or involuntary, by act of law or otherwise, can be made or be of any effect against the Association, as long as the party whose interest is to be assigned or transferred is indebted to the Association in any manner, whether that indebtedness is liquidated or unliquidated, due or not due. The Association may withhold consent to and refuse to recognize or be bound by any assignment or transfer, as long as any indebtedness or liability exists. The Association shall have and is hereby given a prior lien on and against the Revolving Fund Credits of any person to secure any indebtedness or liability owed to the Association by that person. The Association may, at any time, set off against any of the Revolving Fund Credits of any person an amount equal to any indebtedness of that person to the Association for which indebtedness the Association is given a lien. In such a case, indebtedness on both sides in the same amount shall be deemed canceled and satisfied.

Association Relies on Own Records

Section 7.08. In making payments of the indebtedness represented by any Revolving Fund Credits, the Association may rely absolutely on its own records, and shall not be liable to any person other than the person appearing by its records to be the owner or entitled to payment thereof.

Payment of Revolving Fund Credits on Dissolution

Section 7.09. In event of the dissolution or winding up of the affairs of the Association, all indebtedness represented by Revolving Fund Credits shall be deemed due, but shall not be paid in any part until all other indebtedness of the Association has been paid or its payment secured. Thereafter, the Revolving Fund Credits shall be paid from the remaining funds and assets of the Association without regard to the time or year in which they were incurred or to the priorities applicable in the case of revolution of the fund.

No Segregation of Funds Required

Section 7.10. The moneys retained for the Revolving Fund may be commingled with other moneys belonging or coming to the Association and may be used for any and all corporate purposes. Nothing contained in these Bylaws shall be deemed to require that any specific moneys or funds be physically segregated or designated, or marked or set apart or held for the Revolving Fund, nor shall the Revolving Fund be deemed a trust fund held for the owners of the Revolving Fund Credits. The liability represented by Revolving Fund Credits shall be junior and subordinate to all other obligations and indebtedness of the Association.

Revolving Fund Credits for Other Indebtedness

Section 7.11. Whenever the Association shall incur indebtedness in the purchase or acquisition of any property or for moneys borrowed or moneys advanced as capital contribution, the Board of Directors may provide for payment of that indebtedness out of the Revolving Fund. For such purpose, the creditor shall have Revolving Fund Credits in the amount and with the priority designated by the Board of Directors. In that event, the credits will have the same rights as though they had originally arisen on account of retains for the Revolving Fund made in the fiscal [*or* calendar] year designated by the Board of Directors.

Income Other Than From Retains

Section 7.12. In the event the Association should receive or realize income other than from retains as herein defined, whether or not that income is derived from patronage, the Board of Directors of the Association shall, in its discretion and subject to limitations of the laws of the State of California and the United States, employ those funds for expenses of the Association, for capital expenditures, and for the establishment of reasonable reserves for whatever purposes the Board of Directors deems to be in the best interests of the Association. Those amounts shall be credited to members on the basis of each member's pro rata share of the tonnage of Products handled by the Association, and shall be retained in the Association's Revolving Fund together with the proceeds from patrons' Products.

Compromising and Discounting Revolving Fund Credit

Section 7.13. Notwithstanding any other provision of these Bylaws, the Board of Directors of the Association shall have

power to pay off or obtain a release or satisfaction of any one or more Revolving Fund Credits for either of the following purposes:

(a) To compromise or settle a dispute in respect to the credit or a dispute with the holder thereof.

(b) To obtain for the Association a discount for advance payment that the Board of Directors, in its absolute discretion, deems substantial.

ARTICLE VIII. PROCESSING AND MARKETING

Marketing Agreement May Be Required

Section 8.01. The Board of Directors may require any member or nonmember patron of this Association to enter into any marketing, crop purchase, or other agreement with the Association that the Board of Directors may deem appropriate as a condition to membership in this Association, or as a condition to the handling by this Association of the Products produced by that member or patron.

Form and Contents of Marketing Agreement

Section 8.02. Any marketing, crop purchase, or other agreement executed by this Association with any member or patron shall be in the form prescribed by the Board of Directors and may contain any of the following provisions:

(a) Provisions concerning the harvesting, handling, packing, processing, selling, shipping, delivery to the Association, and transfer of title of any Products produced by the member or patron.

(b) Provisions granting the Association exclusive control of the handling of patrons' products after delivery; unqualified power to take title to those products; the right to process, sell, mortgage, or otherwise dispose of or transfer the products; and the right to sue on, enforce, and compromise any rights or claims arising from transactions involving products.

(c) Provisions allowing the Association to pool any products subject to the agreement.

(d) Provisions granting the Association a first lien on all of the products of the member or patron.

(e) Provisions allowing the Board of Directors to determine the standard of quality of any products subject to the agreement.

(f) Provisions for the Association to pay to the patron or member any net returns as defined in Section 8.04.

(g) Provisions for liquidated damages on breach of the agreement by the member or patron.

(h) Any other provisions that may be prescribed by the Board of Directors.

Nonprofit Operation of Association

Section 8.03. In rendering service to members, such as marketing, selling, otherwise handling products, or otherwise making facilities or services available to patrons within the limitations of the Cooperative Marketing Law, the Association shall at all times be operated on a nonprofit cooperative basis for the benefit of its patrons as producers of

Products. The Association is obligated to account for "net returns" as defined in Section 7.04, on a patronage basis to all of its patrons, members and nonmembers alike, for all amounts received on account of the sale of products.

Determination of Net Returns

Section 8.04. The Association shall determine the "net returns" received by it from the handling of Products delivered to it by patrons during each fiscal [*or* calendar] year (1) by deducting from the gross amount received for handling Products in the particular pool in which any Products are included the specific operating expenses, including the cost of receiving, packing, and shipping the Products in the pool, incurred by the Association in handling the Products in the pool; (2) by deducting from the gross amount received from the handling of all Products in all pools during the year the general operating costs and expenses of the Association, including depreciation, losses, wages, insurance, taxes, and interest on money owed by the Association.

Allocation of Net Returns

Section 8.05. Net returns received by the Association from the handling of Products in any particular pool shall be allocated to each patron who delivered Products to the pool in the same ratio as the amount of Products delivered by the patron to such pool bears to the total amount of Products delivered by all patrons to the pool.

Losses

Section 8.06. The Board of Directors may charge losses as current operating expenses or carry those losses forward to be charged against future proceeds, or it may charge the losses ratably against any reserves or funds of the Association as it may deem appropriate.

Income Tax Consent

Section 8.07. Each person who hereafter applies for and is accepted into membership in this Association, and each member of the Association on the effective date of these Bylaws [*or* this Bylaw] who continues as a member of the Association after that date, consents, by that act alone, that he or she shall take the following into account at the stated dollar amounts in the manner provided in *Section 1385(a) of the Internal Revenue Code* in the taxable year in which received:

(a) The amount of any distribution of patronage dividends as defined in *Section 1388(a) of the Internal Revenue Code*, when made in written notices of allocation as defined in *Section 1388(b) of the Internal Revenue Code* and received by that member from the Association.

(b) The amount of any distributions, referred to in *Section 1382(c)(2)(A) of the Internal Revenue Code*, of income derived by the Association from business done with the United States, its agencies, or from sources other than patronage, when made in written notices of allocation as defined in *Section 1388(b) of the Internal Revenue Code* and received by that member from the Association.

(c) The amount of any per-unit retain allocations, as defined in *Section 1388(f) of the Internal Revenue Code*, when made in per-unit retain certificates as defined in *Section 1388(g) of the Internal Revenue Code* and received by such member from the Association.

ARTICLE IX. MISCELLANEOUS

Notices

Section 9.01. Unless otherwise expressly provided in these Bylaws, any notices, statements, or other instruments required to be served on, given to, delivered to, or mailed to any patron, member, or director of the Association shall be deemed duly served, given, delivered, or mailed when deposited in the United States mail, postage prepaid, addressed to the patron, member, or director at the address appearing for that person on the books of the Association, or if no address appears on the books of the Association for that person, then addressed to him or her in care of General Delivery at _____[*city where principal office of association is located*], California.

Unclaimed Payments

Section 9.02. Whenever a member or patron is entitled to receive any payment or allocation from the Association, and the Association, after making reasonable efforts to do so, is unable to locate that person or a duly authorized representative of that person, the Association may, after the expiration of the applicable statute of limitations, discharge that liability on its books, whereupon the claim of that person to those moneys shall be extinguished, and the Association shall treat the amount of money so charged off as incidental income to the Association in the current tax year.

Association Member of Other Cooperative

Section 9.03. This Association shall be eligible to become a member of any other cooperative association organized under the provisions of the Cooperative Marketing Law of California, or under a similar law of any other state, and this Association is hereby authorized to invest in the capital fund of another cooperative any amounts as may be provided for in any contract between this Association and the other cooperative.

Amendment of Bylaws

Section 9.04. These Bylaws may be amended, repealed, and new Bylaws adopted by the vote or written assent of members holding a majority of the voting power of the Association, or by the Board of Directors of the Association when authorized to so do by the vote or written assent of members holding a majority of the voting power of the Association.

[*If association will use a fiscal year, add:*]

Fiscal Year

Section 9.05. The fiscal year of the Association shall begin on the _____ day of _____ [*month*] and end on the _____ day of _____ [*month*] of each year.

CERTIFICATE OF SECRETARY OF _____ [*name of corporation*]

I hereby certify that I am the duly elected and acting Secretary of this corporation and that the foregoing Bylaws constitute the Bylaws of this corporation, as duly adopted by the Board of Directors on _____, 20

_____.

Dated: _____

_____ [(*signature*)]
[*typed name*], Secretary



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART IV. FORMS

7-14A California Legal Forms--Transaction Guide § 14A.202

§ 14A.202 Application for Membership in Agricultural Nonprofit Cooperative Association Organized Without Stock

[1] Comment

[a] Use of Form

This form is an application for membership in an agricultural co-op organized without stock. Although not required by statute, it is designed for use by a co-op which requires, in its bylaws, that any person desiring membership file a written application for membership and an agreement to abide by the bylaws, rules, and regulations of the co-op [*see § 14A.201[2]*, Section 1.02 of Form]. For a discussion of subscription agreements for corporations organized with stock, see *Ch. 2, Formation of Corporations, § 2.32*.

[b] Marketing Contract

Although entrance and membership fees are authorized by statute [*see Food & Agric. Code §§ 54118, 54119*], this form does not require payment of any fees upon application or acceptance of a member. However, it does require that the prospective member execute a marketing contract that becomes effective upon acceptance of the application. § 14A.203 is a marketing contract which provides that capital will be raised by retaining specified amounts from the proceeds of a producer's products sold by the co-op [*see § 14A.203*, P 7].

[c] Income Tax Consent

This form contains a consent by the prospective member to include certain distributions in gross income, so that any payments in the form of allocations will be qualified and thus deductible to the co-op [*see I.R.C. § 1382(b)-(d)*]. For a detailed discussion of the need for the consent, see discussion in *§ 14A.201[1][f]*.

A statement of consent should be included in the membership application as well as in the bylaws. Consent required for a qualified allocation or per-unit retain certificate may be made in writing or by becoming a member of a co-op after it has adopted a bylaw making membership a statement of consent [*see I.R.C. § 1388(c)(2), (h)(2)*]. The statement of consent in this form will ensure the qualification of distributions made to any members who join the co-op before the

adoption of a bylaw provision constituting consent.

[2] FORM

Application for Membership in Agricultural Nonprofit Cooperative Association Organized Without Stock

APPLICATION FOR MEMBERSHIP
IN _____ [*name of association*]

The undersigned hereby applies for membership in the _____[*name of association*], a nonprofit cooperative association organized pursuant to the provisions of the Agricultural Code of California, herein called "Association," and agrees to observe and be bound by the articles of incorporation, bylaws, rules, and regulations of the Association now or hereafter in effect, and to deliver to the Association concurrently with this application for membership an executed marketing contract in the form prescribed by the Association to become effective on acceptance by the Association of this application for membership.

The undersigned hereby consents and agrees that he or she shall take into account, in the manner provided in *Section 1385 of the Internal Revenue Code*, all patronage dividends, or distributions made pursuant to *Section 1382(c)(2)(A) of the Internal Revenue Code*, when made in written notices of allocation, and the amount of any per-unit retain allocations when made in per-unit retain certificates.

The undersigned certifies that he or she has received a copy of the articles of incorporation and bylaws of the Association, and that he or she is a person, as defined in the bylaws, who is engaged in the production of _____ [*product handled by association, e.g.,* peas] as _____ [*e.g.*, owner, lessee, *etc.*] of the following described lands:

Location	Number of Acres
_____	_____
_____	_____
_____	_____

Dated: _____

_____ [*signature of applicant*]
[*typed name and address*]

Application accepted by
Board of Directors
_____, 20 _____.
_____[*signature*]
Secretary of Association



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART IV. FORMS

7-14A California Legal Forms--Transaction Guide § 14A.203

§ 14A.203 Marketing Contract of Cooperative Association

[1] Comment

[a] Use of Form

This form is a marketing contract between an agricultural co-op and a member-producer of that co-op. It is subject to the general rules regarding the formation and validity of contracts. Marketing contracts may take the form of "purchase and sale" or "agency" agreements [*see Food & Agric. Code § 54261*; *see also 5 Ops. Cal. Atty. Gen. 247, 249 (1945)]* . Inasmuch as most provisions in both types of contracts are identical, this form includes several alternative provisions allowing it to be used as either a sales agreement or an agency agreement.

[b] Statutory Authorization for Contract

Agricultural co-ops and their members may make marketing contracts that require the members to sell, for any period of time no longer than 15 years, all or any specified part of any product or specified commodity exclusively to or through the co-op, or any facilities which are created by the co-op. If the contract provides for a sale to the co-op, title to the product passes absolutely and unreservedly to the co-op (except for recorded liens) upon delivery or at any other specified time that is expressly and definitely agreed in the contract [*Food & Agric. Code § 54261*].

Marketing contracts and agreements between an agricultural co-op and its members are not illegal, in restraint of trade, or contrary to any statute enacted against pooling or combinations [*Food & Agric. Code § 54039*].

[c] Resale of Products

The contract may provide for the co-op to sell or resell any product delived by its members, with or without taking title to the product, and pay over to its members the resale price, after deducting all of the following: (1) necessary selling, overhead, and other costs and expenses, including interest on preferred stock, not exceeding 8 percent per annum, and reserves for retiring the stock, if any; (2) other proper reserves; and (3) interest not exceeding 8 percent per year on common stock [*Food & Agric. Code § 54262*].

[d] Pooling System

This form gives the co-op the right to "pool" products. Many California agricultural co-ops use pooling systems under which products delivered to the co-op from various producers are recorded separately and then mixed together into a pool. Sales are made out of the pool without regard to the original source of the products. When all products in the pool are sold, the pool is closed and the net proceeds received from the pool are distributed among the contributing producers on the basis of the amount contributed to the pool. This system has been successfully used because it permits all members to share in price fluctuations and permits risk minimization through a ratable sharing by members in returns from the pool [*see* Wiles, *Taxation of Farmers' Cooperatives and Their Patrons,* 18 S. Cal. Tax. Inst. 449, 457 (1966)].

For purposes of deducting patronage dividends [*see § 14A.34[2]*], patronage of products marketed under pooling arrangements is treated as occurring during the taxable year in which the pool closes, and marketing of products is treated as occurring during any of the taxable years in which the pool is open [*I.R.C. § 1382(e)*].

[e] Income Tax Consent

This form contains a consent by the member-producer to include certain allocations in gross income, so that any payments in the form of allocations will be qualified and thus deductible to the co-op [*see I.R.C. § 1382(b)-(d)*]. For a detailed discussion of the need for the consent see discussion in *§ 14A.201[1][f]*.

[f] Action on Contract

[i] Specific Performance and Injunction

A marketing contract that provides for the delivery of a product produced or acquired by a member to the co-op may be specifically enforced by the co-op to secure delivery of the product [*Food & Agric. Code § 54261*]. If there is a breach or threatened breach of the contract by a member, the co-op will be entitled to an injunction to prevent the further breach of the contract and to a decree of specific performance of the contract. The association will also be entitled to a temporary restraining order and preliminary injunction against the member pending adjudication of the injunction. To obtain temporary relief, the association must file both a verified complaint showing the breach or threatened breach and a bond [*Food & Agric. Code § 54265*].

[ii] Presumption of Producer's Ability to Deliver

In an action on a marketing contract, it will be conclusively presumed that a landowner, landlord, or lessor is able to control the delivery of any product that is produced on that member's land by tenants or others whose tenancy, possession, or work on the land, or the terms of whose tenancy, possession, or work were created or changed after the member's execution of the marketing contract [*Food & Agric. Code § 54266*].

[iii] Liquidated Damages

A marketing contract or the bylaws may fix as liquidated damages specific sums to be paid by the member to the co-op upon the breach of any provision of the contract regarding the sale, delivery, or withholding of any product. It may provide that the member will pay all costs, premiums for bonds, expenses, and fees if any action is brought on the contract by the co-op. These provisions are valid and enforceable and will not be regarded as penalties [*Food & Agric. Code § 54264*].

[iv] Association's Rights as Producer

Any agricultural association organized pursuant to Chapter 1, Division 20 of the Food and Agricultural Code [*Food & Agric. Code § 54001 et seq.*] that acts for its members as a producer marketing or bargaining association in its dealings

with a person licensed as a processor [*see Food & Agric. Code § 55401 et seq.*] or produce dealer [*see Food & Agric. Code § 56101 et seq.*] in connection with any product produced by its members may, either in its own name or in the name of its members, assert all the rights of a producer with respect to any of those products [*Food & Agric. Code § 54182*].

[2] FORM

Marketing Contract of Cooperative Association

MARKETING CONTRACT

Preamble

This contract is made between _____[*name of producer*], hereafter designated as "Producer," and the _____[*name of association*], a nonprofit cooperative association organized pursuant to the provisions of the Food and Agricultural Code, hereafter designated as the "association."

[*For a sales contract:*]

Purchase and Sale

1. The Association hereby purchases from Producer and Producer hereby sells to the Association all _____ [*type of products, e.g.*, nectarines], called "Products," produced by or for Producer, or acquired by or for Producer, as landlord, tenant, lessor, or lessee in the State of California during the duration of this contract. This contract is intended as a contract of purchase and sale and not as an agency contract.

[*Or, for an agency contract:*]

Agency

1. Producer hereby appoints and designates the Association as exclusive sales agent for, and agrees annually to market through the facilities of the Association, all _____ [*type of products, e.g.* pears], herein called "Products," produced by or for Producer or acquired by or for Producer as landlord, tenant, lessor, or lessee, in the State of California during the duration of this contract.

[*For a sales contract:*]

Producer to Pick and Deliver

2. Producer agrees to cultivate, care for, pick [*or* harvest], haul, and deliver the Products, at the Producer's own expense, to the Association at the warehouses, packing stations, or other places at the time and in the manner designated by the Association by written notice to the Producer.

[*Or, for an agency contract:*]

Producer to Deliver

2. Producer agrees to deliver the Products to the Association at the warehouses, packing stations, or other places at the time and in the manner designated by the Association in writing to Producer.

[*For a sales contract:*]

Title to Products

3. This contract is intended by the parties to pass to and vest in the Association present title and right of possession to all of the Products covered hereby. The Association shall at all times have the right to enter on any premises where the Products are located and remove them; but the right of the Association to enter and remove the Products shall not affect the obligation of the Producer to pick, haul, and deliver them as above provided and the risk of loss of the products prior to their delivery to the Association shall be borne by Producer. The Association may pay any liens which, in the opinion of the Association, have attached to the products prior to their delivery to the Association.

[*Or, for an agency contract:*]

Association's Right to Pick

3. Producer hereby irrevocably authorizes and empowers the Association to transfer title to the Products, and to take possession of them when they are mature for picking [harvesting] by entering on any premises where the products are located and removing them. However, the right of the Association to enter and remove the Products shall not affect the obligation of Producer to deliver the Products as above provided. In the event the Association elects to enter and remove the Products, the Association may deduct from any sums that are then or later become payable to Producer from the Association a sufficient amount to cover the Association's reasonable expenses in picking or otherwise removing and hauling the Products.

[*For a sales contract:*]

Obligation of Association to Resell Products

4. The Association agrees to resell the products delivered to it by Producer on the terms and in the form determined by the Association, and to pay to Producer as the purchase price of the products the net resale proceeds determined and paid in the form and manner provided in this contract and in the bylaws of the Association as now existing or hereafter amended.

[*Or, for an agency contract:*]

Obligation of Association to Market Products

4. The Association agrees to receive, [pack,] sell, and market the products delivered to it by Producer on the terms and in the form the Association may determine, and to pay to Producer the net proceeds of the sale, herein called "Net Resale Proceeds," determined as provided in this contract and in the bylaws of the Association as now existing or hereafter amended.

[*Continue with the following provisions for either a sales or an agency contract:*]

Rules, Regulations, and Standards

5. The Association shall make rules and regulations regarding the picking, harvesting, and delivery of Products covered by this agreement, and, if necessary, provide inspectors and graders to standardize, grade, and classify them. Producer agrees to observe and to conform to those rules and regulations and to accept the grading standards and classifications established by the Association. The Association may reject or refuse to accept delivery of any or all Products which in its judgement do not conform to the standards established by it. All Products shall be at the Producer's risk until delivered to the Association.

Right to Pool Products

6. The Association shall have the right to pool Products delivered to it by Producer pursuant to the rules and regulations the Board of Directors of the Association may from time to time prescribe with Products delivered to the Association by other growers, whether members or nonmembers of the Association. These pools will open and close at the times the Board of Directors of the Association may decide. The Board of Directors may, at any time, for reasons by it deemed sufficient, close any pool or extend the time for closing any pool. The Board of Directors may also exclude from any pool any Products because of difference in quality, damage by the elements, or for other reasons satisfactory to the Board of Directors. Each Producer whose Products are included in a pool shall share ratably in the net proceeds received from the sale of the pool according to the amount of Producer's Products included in such pool.

Determination of Net Proceeds Payable to Producer

7. The Association shall determine the net resale proceeds received by it from the sale of products covered by this contract and payable to Producer by deducting from the gross amount received by it from the resale of the Products, the following items:

(a) The specific expenses incurred by the Association in marketing the Products, such as the cost of receiving, grading, cleaning, packing, shipping, and selling the Products.

(b) A ratable portion of the general operating costs and expenses of the Association, including, among other things, depreciation on property, losses, salaries, wages, insurance, taxes, [interest not exceeding eight (8) percent per annum on its issued and outstanding preferred stock, reserves for retiring preferred stock, interest not exceeding eight (8) percent per annum on its issued and outstanding common stock,] and interest on moneys owing from the Association.

(c) To provide capital for its corporate purposes, the Association shall also deduct and temporarily retain from the net resale proceeds due Producer any amounts, called "retains," that the Board of Directors of the Association may determine annually in accordance with Article _____, Section _____ of the bylaws of the Association. The retains will be deposited in and credited to the account of Producer in the Revolving Fund [*or* Funds] of the Association as provided in the bylaws of the Association.

Articles of Incorporation and Bylaws Part of Contract

8. The articles of incorporation and bylaws of the Association constitute a part of this contract, and any amendment to the articles, made in the manner provided by law, or to the bylaws, made as therein provided, shall automatically modify this contract.

Liquidated Damages

9. In the event that Producer sells, markets, or disposes of any Product covered by this contract contrary to the provisions of this contract, or otherwise fails to deliver the Products to the Association in accordance with the obligations set forth herein, that act or omission will injure the Association in an amount that will be extremely difficult to determine and fix, and that is, therefore, fixed in an amount of $_____ [*set forth measure of liquidated damages, e.g.*, $_____ per ton *or* _____ percent of the market value] of all Products that are delivered, marketed, or disposed of contrary to the provisions of this contract, which amount Producer agrees to pay to the Association on demand, as liquidated damages.

Court Expenses

10. Should the Association bring any action to enforce any provision of this contract, or to secure specific performance, or to collect damages of any kind for any breach hereof, Producer shall pay to the Association all costs, premiums for bonds, expenses, and fees, including reasonable attorney's fees as determined by the court, expended or incurred by the Association in any such proceedings.

Income Tax Consent

11. Producer hereby consents and agrees that Producer shall take into account, at their stated dollar amounts, in the manner provided in *Section 1385(a) of the Internal Revenue Code* in the taxable year in which received by him:

(a) The amount of any distribution of patronage dividends as defined in *Section 1388(a) of the Internal Revenue Code* when made in qualified written notices of allocation as defined in *Section 1388(b) of the Internal Revenue Code* and received by Producer from the Association;

(b) The amount of any distributions referred to in *Section 1382(c)(2)(A) of the Internal Revenue Code* of income derived by the Association from business done with the United States, its agencies, or from sources other than patronage, when made in qualified written notices of allocation as defined in *Section 1388(b) of the Internal Revenue Code* and received by Producer from the Association;

(c) The amount of any per-unit retain allocations as defined in *Section 1388(f) of the Internal Revenue Code* when made in per-unit certificates as defined in *Section 1388(g) of the Internal Revenue Code* and received by Producer from the Association.

Acts Beyond the Control of the Parties

12. In the event the performance of this contract by either party is prevented or delayed by act of God, war, civil

insurrection, fire, flood, storm, strikes, lockouts, or by any law, regulation, or order of any federal, state, county, or municipal authority, or by any other cause beyond the control of a party, that party's performance to the extent it is so prevented or delayed shall be excused.

Assignment of Agreement

13. This agreement, and the rights and obligations hereunder, cannot be transferred or assigned without the Association's prior written consent. In the event that all or any part of the land now or hereafter owned by Producer and used for the production of Products covered by this contract is sold, leased, or otherwise transferred, this agreement shall nevertheless remain in full force and effect and the Producer shall remain obligated hereunder unless and until the written consent of the Association to a transfer or termination of this agreement has been obtained.

Agreement Binding on Heirs

14. This agreement shall be binding on the heirs, administrators, executors, successors, and assigns of the parties.

Notices

15. Except as otherwise expressly provided herein or by law, any notice, consent, or request required or permitted by this contract, by the bylaws of the Association, or by law, shall be in writing. Any notice, consent, request, or other instrument, required or permitted to be delivered to either party by this contract, by the bylaws of the Association, or by law, shall be deemed properly served or delivered when it is enclosed in an envelope, first class postage prepaid, and deposited in the United States mail addressed to the Association at _____[*address of principal office of Association*], California, or to Producer at the address set forth under Producer's signature at the bottom of this contract. Either party may change that party's address for the purpose of this paragraph by giving written notice of the change in the manner herein provided.

Term

16. The term of this agreement shall be _____ [*number*] years [*period not exceeding fifteen* (*15*) *years*] commencing _____, 20 _____. This agreement may, however, be terminated prior to the end of the term as follows: _____ [*set forth manner of termination, e.g.:*

(a) By Producer's giving written notice to the Association of his or her decision desire to terminate this contract between the _____ day of _____ [*month*] and the _____ day of _____ [*month*] of any year, in which case the contract will be terminated as of _____[*date*] of that year.

(b) By the Association giving written notice to Producer of its decision to terminate this contract between the _____ day of _____ [*month*] and the _____ day of _____ [*month*] of any year, in which case this contract will be terminated as of _____[*date*] of that year].

Entire Agreement

17. This contract constitutes the entire agreement between the parties hereto, supersedes all negotiations or stipulations covering its subject matter which preceded or accompanied its execution, and terminates and supersedes all prior

existing marketing contracts between Producer and the Association. Any promises, representations, statements, inducements, terms, or conditions made to either party by the other party are of no force or effect unless expressly set forth herein.

Waiver

18. The waiver of any breach of this contract shall not constitute a continuing waiver or a waiver of any subsequent breach, whether of the same or a different provision, of this contract.

Persons to Whom Proceeds Payable

19. All deliveries of Products under this Agreement are to be made in the name of Producer unless notice to the contrary is given in writing to the Association. All payments or advances under this Agreement are to be made to the person in whose name such deliveries are made or on order signed by that person and written notice thereof given to the Association; provided, however, that if at the time of any delivery there stands on record, or the Association has actual knowledge of, a crop mortgage covering the Products so delivered, the payments or advances shall, except as in this agreement otherwise provided, be made only as directed by written request delivered to the Association and signed by both mortgagor and mortgagee.

[*For an agency contract:*]

Power to Pledge Products

20. Producer agrees that the Association shall have full power to borrow money and pledge as security any and all Products delivered to it pursuant to this contract, or any warehouse receipts or other documents relating to the Products.

Signatures

IN WITNESS WHEREOF, the parties have executed this contract this _____ day of _____, 20 _____.

PRODUCER
_____ [*signature of producer*]
[*typed name*]
THE ASSOCIATION
_____ [*name of association*]
By _____ [*signature*]
[*typed name and title*]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART IV. FORMS

7-14A California Legal Forms--Transaction Guide § 14A.204

§ 14A.204 Marketing Contract of Agricultural Cooperative Bargaining Association

[1] Comment

[a] Use of Form

This form is a marketing contract between a member-producer and a cooperative bargaining co-op. Many of the provisions of this contract, including Paragraphs 6-16, parallel those of an agricultural co-op's sales or agency marketing contract. For a complete discussion of those provisions, see *§ 14A.203[1]*.

[b] Nature of Bargaining Association

A cooperative bargaining association is a farmer association that is organized and functioning as a cooperative association [*see Food & Agric. Code §§ 54001-54294*] for the purpose of group bargaining between its producer members and the first handler or processor with respect to the sale of any agricultural commodity except milk, cotton, or cottonseed [*Food & Agric. Code § 54401*]. It is the public policy of the state to establish and support the right of any farmer to join voluntarily, belong to, and freely participate in cooperative bargaining associations. Interference with this right is an unfair trade practice [*Food & Agric. Code § 54402*; *see § 14A.204[1][c]*].

[c] Unfair Trade Practices

[i] Acts of Processors

It is an unfair trade practice for any processor, handler, distributor, or their agents to (1) interfere with, restrain, coerce, or boycott producers in the exercise of their rights to join, belong to, or participate in cooperative bargaining associations [*Food & Agric. Code § 54431(a)*; *see Food & Agric. Code § 54402*]; (2) discriminate against any producer with respect to price or other terms of purchase of any raw agricultual commodity, because of the producer's membership in or contract with any cooperative bargaining association [*Food & Agric. Code § 54431(b)*]; or (3) pay or loan money or give another item of value to a producer as an inducement for refusing, ceasing to belong to, or breaching a membership agreement in, a cooperative bargaining association [*Food & Agric. Code § 54431(c)*].

[ii] Acts of Processors or Associations

It is unlawful for associations, as well as processors, to maliciously or knowingly give false reports about the finances, management, or activities of a cooperative bargaining association [*Food & Agric. Code § 54431(d)*]. It is unlawful for certain producers and associations to refuse to reasonably negotiate to reach agreement for price, terms of sale, compensation for commodities produced under contract, and other contract provisions [*Food & Agric. Code § 54431(e), (f)*; *see Food & Agric. Code §§ 54432-54435*]. Refusal by producers or cooperative bargaining associations to reasonably negotiate or bargain includes the refusal to comply with court-ordered conciliation procedures [*Food & Agric. Code § 54431(e)*; *see Food & Agric. Code § 54401 et seq.* (conciliation)].

[iii] Enforcement and Penalties

Producers or processors may file complaints against unfair trade practices relating to cooperative bargaining associations with the Secretary of Agriculture. The Secretary will then pursue investigations, and may take action through administrative hearings [*see Food & Agric. Code §§ 54404-54404.5*]. Willful violation of the provisions concerning unfair trade practices may result in substantial monetary penalties [*see Food & Agric. Code §§ 54461, 54462*], or injunction [*see Food & Agric. Code § 54463*]. Violation of the conciliation provisions [*see Food & Agric. Code § 54401 et seq.*] may also result in a substantial monetary penalty [*see Food & Agric. Code § 54458*].

[iv] Rights of Bargaining Association

For discussion of an association's rights as a bargaining association [*see Food & Agric. Code § 54182*], see *§ 14A.203[1][f][iv]*.

[2] FORM

Marketing Contract of Agricultural Cooperative Bargaining Association

MARKETING CONTRACT

Preamble

This contract is made between _____[*name of Producer*], hereinafter designated as "Producer," and the _____[*name of Association*], a nonprofit cooperative association organized pursuant to the provisions of the Food and Agricultural Code of the State of California, hereafter designated as the "Association."

Appointment of Association Exclusive Agent

1. Producer hereby appoints and designates the Association as exclusive sales agent for, and agrees to sell and deliver all _____ [*type of products, e.g.*, pears], herein called "Products," produced by or for Producer or acquired by or for Producer as landlord, tenant, lessor, or lessee in the State of California during the continuance of this contract only to those persons, firms, or corporations, and only on the terms and conditions, that are designated, fixed, established, and approved by the Association.

Obligations of Association

2. Each year during the term of this contract, the Association shall, for and on behalf of Producer and all other growers who have executed similar contracts with the Association, solicit and negotiate with the largest number of processors

practicable such terms, conditions, and prices for the sale of the Products produced during the year as the Association in its absolute discretion deems to the best advantage of the growers who have executed contracts with the Association. Upon completion of negotiations, and in no event later than the _____ day of _____ [*month*] of each year, the Association shall deliver by mail to Producer a form of "approved contract" for the sale of Producer's Products to any processor with whom the Association has conducted negotiations, which approved contract shall be in the form and contain the terms, conditions, and prices negotiated with those processors by the Association.

Producer to Sell Products Only on Contracts Approved by Association

3. During the term of this contract, Producer shall not sell any Products to any buyer except pursuant to purchase and sale agreements approved by the Association. After issuance of its form of approved contract each year, the Association shall approve, on written request of Producer, any and all purchase and sale agreements entered by Producer for the sale of Products for the year which are in the form of, and contain the same terms, conditions, and prices as are contained in, the approved contract form. Notice of approval by the Association of any purchase and sale agreement shall be given to Producer by United States mail, first-class postage prepaid, addressed to Producer at the post office address set forth under his or her signature at the bottom of this contract.

Payment for Products Sold

4. During the term of this contract, any buyer of Producer's Products shall, unless otherwise directed by the Association, pay directly to Producer the full purchase price of all Products sold by Producer to such buyer, less the amount, not to exceed _____ [*e.g.,* one (1)] percent of the gross purchase price of the Products as shall be determined, on or before _____ [*date, e.g.,* February 1] of the year in which sale occurs, by the Board of Directors of the Association; which amount the Producer hereby authorizes and directs the buyer to deduct from the gross purchase price of the Products and pay directly to the Association. The amounts deducted and paid to the Association shall be used by the Association to pay the operating costs and expenses of the Association, including, among other things, depreciation on property, losses, salaries, wages, insurance, taxes, [interest not exceeding eight percent per annum on its issued and outstanding preferred stock, reserves for retiring preferred stock, interest not exceeding eight percent per annum on its issued and outstanding common stock,] and interest on moneys owing from the Association. If, at the end of any fiscal year of the Association, the Board of Directors finds that the aggregate amount deducted during the fiscal year from the gross sales proceeds of Products sold during such year by all growers who have executed similar contracts with the Association exceeds the amount required in that year to pay operating costs and expenses, the excess amount of the deductions shall, in the absolute discretion of the Board of Directors, either be ratably credited to the account of each Producer in the Revolving Fund of the Association according to the amount of Products sold by that producer during the year, or distributed among the growers according to the amount of Products sold by each of them during such year. The determination by the Board of Directors of the amount required to pay operating costs and expenses in any year, the amount of deductions in excess of the required amount, and the ratable portion of the excess to be credited or paid to Producer shall be conclusive and binding on Producer.

Information to Be Furnished by Producer

5. On receiving written request from the Association, Producer agrees to promptly notify the Association in writing of the location of all crops of the Products covered by this agreement owned or controlled by the producer, the number of acres planted with those Products, the varieties of Products planted, and the amount of Products Producer expects to produce in any specified year.

Articles of Incorporation and Bylaws Part of Contract

6. The articles of incorporation and bylaws of the Association constitute a part of this contract, and any amendment to the articles, made in the manner provided by law, or to the bylaws, made as therein provided, shall automatically modify this contract.

Liquidated Damages

7. In the event that Producer sells, markets, or disposes of any Product covered by this contract contrary to the provisions of this contract, that act will injure the Association in an amount that will be extremely difficult to determine and fix, and that is therefore fixed in an amount of _____ [*set forth measure of liquidated damages, e.g.*, $_____ per ton *or* _____ percent of the gross sale proceeds] of all Products that are sold, marketed, or disposed of contrary to the provisions of this contract, which amount Producer agrees to pay to the Association on demand, as liquidated damages.

Court Expenses

8. Should the Association bring any action to enforce any provision of this contract, or to secure specific performance hereof, or to collect damages of any kind for any breach hereof, Producer shall pay to the Association all costs, premiums for bonds, expenses, and fees, including reasonable attorneys' fees, as determined by the court, expended or incurred by the Association in any such proceedings.

Income Tax Consent

9. Producer hereby consents and agrees that he or she shall take into account, at their stated dollar amounts, in the manner provided in *Section 1385(a) of the Internal Revenue Code* in the taxable year in which received by Producer:

(a) The amount of any distribution of patronage dividends as defined in *Section 1388(a) of the Internal Revenue Code* when made in qualified written notices of allocation as defined in *Section 1388(b) of the Internal Revenue Code* and received by Producer from the Association;

(b) The amount of any distributions referred to in *Section 1382(c)(2)(A) of the Internal Revenue Code* of income derived by the Association from business done with the United States, its agencies, or from sources other than patronage, when made in qualified written notices of allocation as defined in *Section 1388(b) of the Internal Revenue Code* and received by Producer from the Association;

(c) The amount of any per-unit retain allocations as defined in *Section 1388(f) of the Internal Revenue Code* when made in per-unit certificates as defined in *Section 1388(g) of the Internal Revenue Code* and received by Producer from the Association.

Act of God Clause

10. In the event the performance of this contract by either party is prevented or delayed by act of God, war, civil insurrection, fire, flood, storm, strikes, lockouts, or by any law, regulation, or order of any federal, state, county, or municipal authority, or by any other cause beyond the control of a party, that party's performance to the extent it is so prevented or delayed shall be excused.

Assignment of Agreement

11. This agreement, and the rights and obligations hereunder, shall not be transferred or assigned without the Association's prior written consent. In the event that all or any part of the land now or hereafter owned by Producer and used for the production of Products covered by this contract is sold, leased, or otherwise transferred, this contract shall nevertheless remain in full force and effect and Producer shall remain obligated unless and until the written consent of the Association to a transfer or termination of this contract has been obtained.

Agreement Binding on Heirs

12. This agreement shall be binding on the heirs, administrators, executors, successors, and assigns of the parties.

Notices

13. Except as otherwise expressly provided herein or by law, any notice, consent, or request required or permitted by this contract, by the bylaws of the Association, or by law, shall be in writing. Any such notice, consent, request, or other instrument, required or permitted to be delivered to either party by this contract, by the bylaws of the Association, or by law, shall be deemed properly served or delivered when it is enclosed in an envelope, first-class postage prepaid, and deposited in the United States mail addressed to the Association at _____[*address of principal office of Association*], California, or to Producer at the address set forth under Producer's signature at the bottom of this contract. Either party may change its address for the purposes of this paragraph by giving written notice of the change in the manner herein provided to the other party.

Term

14. The initial term of this contract shall be until _____ [*date, e.g.*, December 31, 2008] and that term shall be automatically renewed for successive terms of one calendar year each thereafter without any other actions being taken by either party for a period ending _____[*date*], but in no event for a period exceeding 15 years from the date of execution of this agreement. However, commencing with the year _____, either party may terminate this contract by serving written notice of termination on the other party.

Entire Agreement

15. This contract constitutes the entire agreement between the parties, supersedes all negotiations or stipulations covering its subject matter which preceded or accompanied its execution, terminates and supersedes all prior existing marketing contracts between Producer and the Association. Any promises, representations, statements, inducements, terms, or conditions, made to either party by the other party, are of no force or effect unless expressly set forth herein.

Waiver

16. The waiver of any breach of this contract shall not constitute a continuing waiver or a waiver of any subsequent breach, whether of the same or a different provision of this contract.

Signatures

IN WITNESS WHEREOF, the parties hereto have executed this contract in duplicate original this _____ day of _____, 20 _____.

PRODUCER
_____ [*signature of producer*]
[*typed name*]
THE ASSOCIATION
_____ [*name of association*]
By _____ [*signature*]
[*typed name and title*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 14A AGRICULTURAL NONPROFIT COOPERATIVE ASSOCIATIONS
PART IV. FORMS

7-14A California Legal Forms--Transaction Guide § 14A.205

§ 14A.205 Application for Recognition of Income Tax Exemption of Agricultural Nonprofit Cooperative Association--I.R.S. Form 1028

[1] Comment

[a] Use of Form

This form is the official application [I.R.S. Form 1028], for recognition of exempt status by the IRS, together with the accompanying IRS instructions. For federal income tax purposes, agricultural co-ops (termed "farmers' cooperatives" in the Internal Revenue Code) are divided into "exempt" and "nonexempt" categories. Although under present law neither type is exempt from income taxation [*see I.R.C. § 1381(b)*], exempt associations are entitled to two special deductions [*see I.R.C. § 1382(c)*] in addition to the deduction allowed for patronage dividends [*I.R.C. § 1382(b)*; *see* discussion in *§ 14A.34[2]*].

[b] Definition of "Exempt" Associations

The IRS defines "exempt" farmers' cooperatives as farmers', fruit growers', or like associations organized and operated on a cooperative basis for the purpose of either (1) marketing the products of members or other producers, and returning to them the proceeds of sales, less necessary marketing expenses, on the basis of the quantity or value of products furnished by them, or (2) purchasing supplies and equipment for the use of members or other persons, and returning those supplies and equipment to them at actual cost, plus necessary expenses [*I.R.C. § 521(b)(1)*].

The IRS will not deny exempt status because the association has capital stock, as long as the dividend rate on that stock is fixed at an amount not exceeding the legal interest rate in the state of incorporation or 8 percent, whichever is higher [*I.R.C. § 521(b)(2)*; *see Food & Agric. Code § 54120*], and substantially all the stock is owned by producers who market their products or purchase their supplies and equipment through the association [*I.R.C. § 521(b)(2)*; *see Food & Agric. Code § 54231*]. To satisfy this "substantially all" ownership requirement, producers must own at least 85 percent of that stock [*Rev. Rul. 73-248, 1973-2 C.B. 295* ; *see West. Cent. Co-op v. United States (8th Cir. 1985) 758 F.2d 1269, 1271]* . For purposes of applying the 85 percent test, the relevant consideration is whether the right to vote has actually accrued or been terminated by the time of the annual shareholders' meeting following the close of the taxable year [*Farmers Coop. Co. v. Commissioner (8th Cir. 1987) 822 F.2d 774, 779]* .

The IRS will not deny exempt status because the association computes its net earnings for purposes of determining amounts available for distribution to patrons by netting its patronage gains and losses pursuant to *I.R.C. § 1388(j)* [*I.R.C. § 521(b)(6)*; *see Ch. 14, Consumer Cooperative Corporations, § 14.48[3]*].

Exempt status will not be denied because the association has accumulated and maintained a reserve for any necessary purpose [*I.R.C. § 521(b)(3)*] or because the association conducts business with nonmembers, as long as the value of nonmember business does not exceed the value of business done with members and the value of purchases made for nonmembers or nonproducers does not exceed 15 percent of all purchases [*I.R.C. § 521(b)(4)*; *see Food & Agric. Code § 54179*]. Business done for the United States or one of its agencies is disregarded in determining the amount of business done with nonmembers [*I.R.C. § 521(b)(5)*].

[c] Tax Benefits of "Exempt" Associations

Exempt associations are entitled to two deductions that are unavailable to nonexempt associations [*see* discussion in *§ 14A.34[4]*]. First, an exempt association is allowed to deduct amounts paid during the taxable year as dividends on its capital stock [*I.R.C. § 1382(c)(1)*]. Capital stock includes any stock or any other form of capital represented by capital retain certificates, revolving fund certificates, letters of advice, or other evidence of a proprietary interest in a cooperative association. The deduction is allowable only for the year in which the dividend is actually or constructively paid [*Treas. Reg. § 1.1382-3(b)*].

In addition, an exempt association may deduct amounts paid during the payment period for the taxable year in money, qualified notices of allocation, or other property on a patronage basis to patrons with respect to its earnings during the taxable year which are derived from business done for the United States or from sources other than patronage [*I.R.C. § 1382(c)(2)*]. Nonpatronage sources are those not directly related to the marketing, purchasing, or service activities of the agricultural association [*Treas. Reg. § 1.1382-3(c)(2)*].

[d] Procedure for Establishing Exempt Status

To establish its status as an exempt association, a corporation must file an application for recognition of exemption, I.R.S. Form 1028, with the district director of the internal revenue district in which the principal place of business or principal office of the organization is located [*Treas. Reg. § 1.521-1(e)*]. The district director may issue a determination letter granting exempt status in advance of operations if the proposed operations are described in sufficient detail to permit the conclusion that the organization will clearly meet the requirements of the statutory exemption [Rev. Proc. 80-25, 1980-1 C.B. 667].

[2] FORM

Application for Recognition of Income Tax Exemption of Agricultural Nonprofit Cooperative Association--I.R.S. Form 1028

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1 of 184 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS

7-15 California Legal Forms--Transaction Guide 15.syn

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.syn Synopsis to Chapter 15: GENERAL PARTNERSHIPS

§ 15.01 California Sources

[1] Statutes

[2] Regulations

§ 15.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 15.03-15.04 [Reserved]

§ 15.05 Law Reviews and Periodicals

§ 15.06 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 15.07-15.08 [Reserved]

§ 15.09 Scope of Part; Governing Law

§ 15.10 Partnership Defined

[1] In General

[2] Distinguished From Other Profit Sharing Arrangements

[3] Joint Ventures

§ 15.11 Uniform Partnership Act of 1994

[1] Effective Dates and Purpose

[2] Summary of Changes From Former UPA

[a] Generally

[b] Entity Theory Adopted

[c] Fiduciary Duty

[d] Dissociation and Dissolution

[e] Joint and Several Liability

[f] Partnership Agreements

[g] Partnership Conversions

[h] Mergers

[i] Partnership Statements

[3] Correlation Table--Former UPA/UPA '94

§ 15.12 Partnership Statements Under UPA '94

[1] Generally

[2] Statement of Authority

[3] Statement of Denial

[4] Statement of Dissociation

[5] Statement of Dissolution

[6] Statement of Conversion

[7] Certificate of Conversion

[8] Statement of Merger

[9] Statement of Amendment of Cancellation

§ 15.13 Property Rights of Partnership

[1] In General

[2] How Acquired

[3] Presumptions

§ 15.14 Partners' Interest in Partnership

[1] No Interest in Partnership Property

[2] Effect of Transfer of Partner's Interest

[3] Charging Orders

§ 15.15 Relations of Partners to Persons Dealing With Partnership

[1] Partner as Agent of Partnership

[a] Ordinary Course of Business

[b] Not in the Ordinary Course of Business

[2] Transfers of Partnership Property

[a] Authorized Transfers

[b] Recovering Property From Unauthorized Transfers

[3] Statement of Partnership Authority

[a] Effect

[b] Transfers of Property Other Than Real Property

[c] Transfers of Real Property

[d] Statement of Denial

[4] Capacity to Sue

[a] Partnership and Third Parties

[b] Actions by Partners

[5] Judgments

§ 15.16 Liability of Partnership and Partners

[1] Partnership Liability for Partner Actions

[2] Partner Liability for Partnership Obligations

[3] Liability for Misrepresentation of Person as Partner

[4] Limits on Partnership Status Liability

§ 15.17 Relations of Partners to Each Other and the Partnership

[1] The Partnership Agreement

[2] What the Partnership Agreement Cannot Do

[3] Partner and Partnership Rights and Liabilities Under UPA '94

[a] When the Act Standards Apply

[b] Management

[c] Profits and Losses

[d] Partnership Accounts

[e] Payments and Advances

[f] Distributions in Kind

[4] Partner Fiduciary Duties Under UPA '94

[a] Duties and Obligations Owed

[b] Duty of Loyalty

[c] Duty of Care

[5] Continuation of Term Partnership

§ 15.18 Tax Consequences of Formation

[1] Partnership as Separate Entity

[2] Nonrecognition of Gain or Loss on Contribution of Property

[3] Basis

[a] Partner's Basis in Partnership

[b] Partnership Basis in Contributed Property

[4] Assumption of Liabilities

[5] Contributing Depreciable Property

§ 15.19 Taxation of Partnership Income

[1] Partnership Does Not Pay Tax

[2] Partnership Taxable Income

[3] Partners Are Responsible for Income Tax

[4] Allocating a Partner's Distributive Share

§ 15.20 Substantial Economic Effect

§ 15.21 Contributions of Property to Partnership

[1] Tax Problems

[2] Property With Built-In Gain or Loss

[a] Built-In Gain or Loss Treatment

[b] Effect of Distributing the Property

[c] Allocating Built-In Gain or Loss

[d] Traditional Method and Ceiling Rule

[e] Traditional Method With Curative Allocations

[f] Remedial Allocations

[g] Allocations on Property by Property Basis

[h] Small Disparities

[i] Anti-Abuse Rule

§ 15.22 Loss Allowance

[1] Loss Limited to Partner's Adjusted Basis

[2] At Risk Limitations

[3] Passive Activity Limitations

§ 15.23 Taxable Year of Partnership

[1] Consequences of Selecting the Partnership Taxable Year

[2] Majority Interest Taxable Year

[3] Business Purpose

[4] Electing Alternative Taxable Year

§ 15.24 Partnership Distributions

§§ 15.25-15.99 [Reserved]

§ 15.100 Facts

Scope

§ 15.101 Additional Facts for Professional Partnerships

Scope

§ 15.102 Documents

Scope

§§ 15.103-15.109 [Reserved]

§ 15.110 Formation of General Partnerships

Scope

§ 15.111 Additional Determinations for Professional Partnerships

Scope

§§ 15.112-15.119 [Reserved]

§ 15.120 General Procedures

Scope

§ 15.121 Statement of Partnership Authority

Scope

§§ 15.122-15.129 [Reserved]

§ 15.130 Standard Provisions

Scope

§ 15.131 Additional Provisions for Professional Partnerships

Scope

§ 15.132 Buy-Sell Agreement Provisions

Scope

§§ 15.133-15.139 [Reserved]

§ 15.140 Change in Partnership Taxable Year

Scope

§ 15.141 Federal and State Information Returns

Scope

§§ 15.142-15.199 [Reserved]

§ 15.200 Long Form for Commercial Partnership

[1] Comment

[a] Use of Form

[b] Partnership Agreement and UPA '94

[c] Partnership Term

[d] Capital Contributions

[e] Management

[f] Capital and Income Accounts

[g] Dissociation

[h] Partners' Personal Debts

[2] FORM

Long Form for Commercial Partnership

§ 15.201 Long Form for Investment Partnership

[1] Comment

[a] Use of Form

[b] Taxation of Investment Partnerships

[c] Net Profits

[d] Partnership Term

[e] Capital Contributions

[f] Interest on Capital Accounts

[g] Profits and Losses

[h] Accounting and Inspection of Books

[i] Salaries and Expenses

[j] Management of Partnership Business

[k] Voting Requirements

[l] Termination or Continuation of Partnership

[2] FORM

Long Form for Investment Partnership

§ 15.202 General Partnership Agreement Short Form

[1] Comment

[a] Use of Form

[b] Net Profits

[2] FORM

General Partnership Agreement Short Form

§§ 15.203-15.209 [Reserved]

§ 15.210 Term of Partnership Specified Period and Year to Year Continuation Upon Expiration

[1] Comment--Use of Form

[2] FORM

Term of Partnership Specified Period and Year to Year Continuation Upon Expiration

§ 15.211 Provision for Contribution of Personal Property and Cash to Initial Partnership Capital

[1] Comment

[a] Use of Form

[b] Contributed Property Tax Considerations

[2] FORM

Provision for Contribution of Personal Property and Cash to Initial Partnership Capital

§ 15.212 Provision for Contributions of Real Property to Initial Partnership Capital

[1] Comment--Use of Form

[2] FORM

Provision for Contributions of Real Property to Initial Partnership Capital

§ 15.213 Provision Granting Partnership Interest in Exchange for Partner's Services

[1] Comment

[a] Use of Form

[b] Noncontributing Partners

[2] FORM

Provision Granting Partnership Interest in Exchange for Partner's Services

§ 15.214 Provision for Distributing Profits and Losses Among Partners According to Their Respective Net Worths in the Partnership

[1] Comment--Use of Form

[2] FORM

Provision for Distributing Profits and Losses Among Partners According to Their Respective Net Worths in the Partnership

§ 15.215 Provision for Percentage of Net Profits to Be Added to Partnership Capital Each Accounting Period

[1] Comment--Use of Form

[2] FORM

Provision for Percentage of Net Profits to Be Added to Partnership Capital Each Accounting Period

§ 15.216 Provision for Maintenance of Separate Capital and Income Accounts for Each Partner

[1] Comment

[a] Use of Form

[b] Distinction Between Capital and Income

[c] Importance of Distinction for Nontax Purposes

[d] Importance of Distinction for Income Tax Purposes

[2] FORM

Provision for Maintenance of Separate Capital and Income Accounts for Each Partner

§ 15.217 Provision for Loan of Property to Partnership by Partner

[1] Comment

[a] Use of Form

[b] Reasons for Loaning Asset to Partnership

[2] FORM

Provision for Loan of Property to Partnership by Partner

§ 15.218 Provision for Payment of Interest on Capital Accounts of Partners

[1] Comment--Use of Form

[2] FORM

Provision for Payment of Interest on Capital Accounts of Partners

§ 15.219 Provision for Special Allocation for Property Contributed With Built-In Gain or Loss

[1] Comment--Use of Form

[2] FORM

Provision for Special Allocation for Property Contributed With Built-In Gain or Loss

§ 15.220 Provision Guaranteeing Partner Specified Amount Per Year From the Net Profits of the Partnership

[1] Comment

[a] Use of Form

[b] Distributions to Partners--Tax Consequences

[2] FORM

Provision Guaranteeing Partner Specified Amount Per Year From the Net Profits of the Partnership

§ 15.221 Provision Guaranteeing Payment of Specified Minimum Amount Each Year Regardless of Profits

[1] Comment

[a] Use of Form

[b] Deduction of Guaranteed Payments

[2] FORM

Provision Guaranteeing Payment of Specified Minimum Amount Each Year Regardless of Profits

§ 15.222 Provision Specifying Amount of Permanent Capital to Be Maintained by Partnership and Restricting Withdrawals Until Partnership Capital Equals Specified Amount

[1] Comment--Use of Form

[2] FORM

Provision Specifying Amount of Permanent Capital to Be Maintained by Partnership and Restricting Withdrawals Until Partnership Capital Equals Specified Amount

§ 15.223 Provision Establishing Monthly Expense Accounts for Partners

[1] Comment

[a] Use of Form

[b] Duty to Indemnify Partner for Partnership Expenses

[c] Expense Account Method of Indemnification

[2] FORM

Provision Establishing Monthly Expense Accounts for Partners

§ 15.224 Provision for Monthly Reimbursement of Partnership Expenditures Made by Each Partner

[1] Comment--Use of Form

[2] FORM

Provision for Monthly Reimbursement of Partnership Expenditures Made by Each Partner

§ 15.225 Provision Allowing Partner to Devote Less Than Full Time to the Partnership Business

[1] Comment--Use of Form

[2] FORM

Provision Allowing Partner to Devote Less Than Full Time to the Partnership Business

§ 15.226 Provision Requiring Arbitration of Disputes Arising Under Partnership Agreement

[1] Comment--Use of Form

[2] FORM

Provision Requiring Arbitration of Disputes Arising Under Partnership Agreement

§§ 15.227-15.239 [Reserved]

§ 15.240 Determining Value of Partnership Interest Using Annual Determination by Partners

[1] Comment

[a] Use of Form

[b] Determining Value of Deceased Partner's Partnership Interest--Federal Estate Tax Considerations

[2] FORM

Determining Value of Partnership Interest Using Annual Determination by Partners

§ 15.241 Schedule of Annual Determinations by Partners of Agreed Values to Be Paid for Partnership Interest

[1] Comment--Use of Form

[2] FORM

Schedule of Annual Determinations by Partners of Agreed Values to Be Paid for Partnership Interest

§ 15.242 Determining Value of Partnership Interest Using Net Book Value Plus or Minus Agreed Amount by Which Market Value Exceeds or Is Less Than Book Value

[1] Comment

[a] Use of Form

[b] Book Value Distinguished From Fair Market or Agreed Value

[2] FORM

Determining Value of Partnership Interest Using Net Book Value Plus or Minus Agreed Amount by Which Market Value Exceeds or Is Less Than Book Value

§ 15.243 Schedule of Agreed Amounts by Which Market Value Exceeds or Is Less Than Book Value of Partnership Assets

[1] Comment--Use of Form

[2] FORM

Schedule of Agreed Amounts by Which Market Value Exceeds or Is Less Than Book Value of Partnership Assets

§ 15.244 Determining Value of Partnership Interest Using Amount Equivalent to Partner's Capital and Income

Accounts on Date of Death, or Dissociation

[1] Comment--Use of Form

[2] FORM

Determining Value of Partnership Interest Using Amount Equivalent to Partner's Capital and Income Accounts on Date of Death, or Dissociation

§ 15.245 Determining Value of Partnership Interest Using Single Appraiser's Value or Balance in Partner's Capital and Income Accounts, Whichever Is Greater

[1] Comment--Use of Form

[2] FORM

Determining Value of Partnership Interest Using Single Appraiser's Value or Balance in Partner's Capital and Income Accounts, Whichever Is Greater

§ 15.246 Determining Value of Partnership Interest Using Inventory and Account to Be Taken as of Date of Death or Date Dissociation Notice Served on Remaining Partners

[1] Comment--Use of Form

[2] FORM

Determining Value of Partnership Interest Using Inventory and Account to Be Taken as of Date of Death or Date Dissociation Notice Served on Remaining Partners

§ 15.247 Determining Value of Partnership Interest Using Net Book Value of Interest Plus Capitalized Share of Past Average Net Profits

[1] Comment

[a] Use of Form

[b] Partnership Interests

[c] Book Value Defined

[d] Valuation of Goodwill

[2] FORM

Determining Value of Partnership Interest Using Net Book Value of Interest Plus Capitalized Share of Past Average Net Profits

§ 15.248 Determining Value of Partnership Interest Using Net Book Value of Interest Plus Capitalized Value of Income Attributable to Goodwill

[1] Comment--Use of Form

[2] FORM

Determining Value of Partnership Interest Using Net Book Value of Interest Plus Capitalized Value of Income Attributable to Goodwill

§ 15.249 Determining Value of Partnership Interest Using Partner's Capitalized Share of Past Average Ordinary Partnership Income

[1] Comment

[a] Use of Form

[b] Capitalization Method of Valuing Interests

[2] FORM

Determining Value of Partnership Interest Using Partner's Capitalized Share of Past Average Ordinary Partnership Income

§ 15.250 Provision Requiring Remaining Partners to Purchase Partnership Interest of Deceased or Dissociated Partner

[1] Comment

[a] Use of Form

[b] Modifications to Form

[c] Continuation of Term Partnership

[d] Practical Consequences

[e] Tax Consequences

[2] FORM

Provision Requiring Remaining Partners to Purchase Partnership Interest of Deceased or Dissociated Partner

§ 15.251 Provision Requiring Partnership to Purchase and Liquidate Interest of Deceased or Dissociated Partner

[1] Comment--Use of Form

[2] FORM

Provision Requiring Partnership to Purchase and Liquidate Interest of Deceased or Dissociated Partner

§ 15.252 Provision Allowing Deceased Partner's Spouse or Other Legatee to Continue Decedent's Partnership Interest and Become General Partner

[1] Comment--Use of Form

[2] FORM

Provision Allowing Deceased Partner's Spouse or Other Legatee to Continue Decedent's Partnership Interest and Become General Partner

§ 15.253 Provision for Payment of Distributive Share of Net Profits to Estate of Deceased Partner in Liquidation of Partnership Interest

[1] Comment--Use of Form

[2] FORM

Provision for Payment of Distributive Share of Net Profits to Estate of Deceased Partner in Liquidation of Partnership Interest

§ 15.254 Provision for Continuation of Partnership to End of Fiscal Year in Which Deceased Partner Died

[1] Comment

[a] Use of Form

[b] Partnership Termination and Close of Taxable Year--Tax Consequences

[2] FORM

Provision for Continuation of Partnership to End of Fiscal Year in Which Deceased Partner Died

§ 15.255 Provision Allowing Deceased Partner's Personal Representative to Continue Decedent's Partnership Interest During Administration of Estate

[1] Comment

[a] Use of Form

[b] Representative's Participation as Partner

[2] FORM

Provision Allowing Deceased Partner's Personal Representative to Continue Decedent's Partnership Interest During Administration of Estate

§ 15.256 Consent of Partners' Spouses to Accept Buy-Sell Provisions of Partnership Agreement in Lieu of All Other Interests in Partnership

[1] Comment

[a] Use of Form

[b] Partnership Interest as Community Property

[2] FORM

Consent of Partners' Spouses to Accept Buy-Sell Provisions of Partnership Agreement in Lieu of All Other Interests in Partnership

§§ 15.257-15.259 [Reserved]

§ 15.260 Agreement for Purchase and Sale of Partnership Interest Funded by Insurance--Cross-Purchase Plan Between Two Partners Without a Trustee

[1] Comment

[a] Use of Form

[b] Purpose of Insurance Agreements

[c] Federal Estate Tax Treatment of Life Insurance

[d] Federal Estate Tax Treatment of Insurance on Surviving Partner

[2] FORM

Agreement for Purchase and Sale of Partnership Interest Funded by Insurance--Cross-Purchase Plan Between Two Partners Without a Trustee

§ 15.261 Agreement for Purchase and Sale of Partnership Interest Funded by Insurance--Entity Purchase Plan--Insurance Policies Owned by the Partnership as an Entity

[1] Comment

[a] Use of Form

[b] "Entity Purchase" or "Partnership Owner" Plan Defined

[c] Inclusion of Insurance Policies in Deceased Partner's Estate

[d] Income Tax Basis of Surviving Partner's Partnership Interest

[e] Income Taxation of Purchase Price to Decedent's Estate

[f] Effect of Premium Payments on Taxable Partnership Income

[2] FORM

Agreement for Purchase and Sale of Partnership Interest Funded by Insurance--Entity Purchase Plan--Insurance Policies Owned by the Partnership as an Entity

§ 15.262 Agreement for Purchase and Sale of Partnership Interest Funded by Insurance--Trustee Plan--Cross-Insurance Between More Than Two Partners

[1] Comment

[a] Use of Form

[b] Reason for Trustee

[2] FORM

Agreement for Purchase and Sale of Partnership Interest Funded by Insurance--Trustee Plan--Cross-Insurance Between More Than Two Partners

§§ 15.263-15.269 [Reserved]

§ 15.270 Professional Partnerships--General Form of Agreement

[1] Comment

[a] Use of Form

[b] Nature of Professional Partnership

[c] Special Provisions Applicable to Professional Partnerships

[d] Taxable Year of Professional Partnership

[e] Licensing of Professional Partnerships

[f] Partner Dissociation

[2] FORM

Professional Partnerships--General Form of Agreement

§ 15.271 Professional Partnerships--Provision for Contribution of Existing Practices to Partnership

[1] Comment

[a] Use of Form

[b] Tax Consequences of Merger of Practices

[2] FORM

Professional Partnerships--Provision for Contribution of Existing Practices to Partnership

§ 15.272 Professional Partnerships--Provision for Sharing Profits and Losses According to Who Originated Client and Who Performed Services for Client

[1] Comment

[a] Use of Form

[b] Purpose of Form

[2] FORM

Professional Partnerships--Provision for Sharing Profits and Losses According to Who Originated Client and Who Performed Services for Client

§ 15.273 Professional Partnerships--Provision for Sharing Profits and Losses According to Units if Participation Assigned to Each Partner

[1] Comment

[a] Use of Form

[b] Units of Participation Formula

[2] FORM

Professional Partnerships--Provision for Sharing Profits and Losses According to Units if Participation Assigned to Each Partner

§ 15.274 Professional Partnerships--Provision for Payment of Portion of Fees to Named Partners Before Distribution of Net Profits

[1] Comment--Use of Form

[2] FORM

Professional Partnerships--Provision for Payment of Portion of Fees to Named Partners Before Distribution of Net Profits

§ 15.275 Professional Partnerships--Provision for Percentage of Net Profits to Be Credited to Bonus Reserve Account and Distributed Among Partnership Employees

[1] Comment--Use of Form

[2] FORM

Professional Partnerships--Provision for Percentage of Net Profits to Be Credited to Bonus Reserve Account and Distributed Among Partnership Employees

§ 15.276 Professional Partnerships--Provision for Management Committee

[1] Comment--Use of Form

[2] FORM

Professional Partnerships--Provision for Management Committee

§ 15.277 Professional Partnerships--Provisions for Calling and Conducting Partnership Meetings--Each Partner to Have One Vote

[1] Comment--Use of Form

[2] FORM

Professional Partnerships--Provisions for Calling and Conducting Partnership Meetings--Each Partner to Have One Vote

§ 15.278 Professional Partnerships--Provisions for Calling and Conducting Partnership Meetings--Each Partner's Voting Rights Measured by Units of Participation in Partnership Profits

[1] Comment--Use of Form

[2] FORM

Professional Partnerships--Provisions for Calling and Conducting Partnership Meetings--Each Partner's Voting Rights Measured by Units of Participation in Partnership Profits

§ 15.279 Professional Partnerships--Provision for Membership at Firm Expense in Professional or Civic Organizations

[1] Comment--Use of Form

[2] FORM

Professional Partnerships--Provision for Membership at Firm Expense in Professional or Civic Organizations

§ 15.280 Professional Partnerships--Provisions for Partner's Gradual Retirement

[1] Comment--Use of Form

[2] FORM

Professional Partnerships--Provisions for Partner's Gradual Retirement

§§ 15.281-15.284 [Reserved]

§ 15.285 Statement of Partnership Authority (GP-1)

[1] Comment

[a] Use of Form

[b] Contents and Execution

[c] Effect of Statement

[d] Avoiding Gap in Chain of Title of Partnership Property

[2] FORM

Statement of Partnership Authority (GP-1)

§ 15.286 Statement of Denial (GP-2)

[1] Comment--Use of Form

[2] FORM

Statement of Denial (GP-2)

§ 15.287 Statement of Amendment or Cancellation (GP-7)

[1] Use of Form

[2] FORM

Statement of Amendment or Cancellation (GP-7)

§§ 15.288-15.289 [Reserved]

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FOOTNOTES:

(n38)Footnote *. Robert Schindewolf and Dennis Zickerman are members of the California Bar and are principals in ProWrite, Inc., a provider of services to traditional and multimedia publishers of legal, tax, and continuing education products.

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2 of 184 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS

7-15 California Legal Forms--Transaction Guide Scope

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

Scope

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and Dennis F. Zickerman, J.D.n* John J. Camozzi, J.D., M.B.A.,n** Practice Consultant Scope

This chapter covers general partnerships. Part A covers the formation of general partnerships, Part B covers the dissolution of general partnerships, and Part C covers mergers of general partnerships. Limited partnerships are discussed in Chapters Ch. 16-16B. Limited liability partnerships are discussed in Ch. 16C, *Limited Liability Partnerships* .

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
PART I. RESEARCH GUIDE
A. Primary Sources

7-15 California Legal Forms--Transaction Guide § 15.01

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

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Contents of fictitious business name statement. *Bus. & Prof. Code § 17913*.

Fees for filing fictitious business name statements.*Bus. & Prof. Code § 17929*.

Ownership of property as tenants in partnership. *Civ. Code §§ 682(2), 684*.

Venue for actions based on partnership agreement. *Code Civ. Proc. § 395*.

Uniform Partnership Act of 1994. *Corp. Code §§ 16100-16962*.

General provisions. *Corp. Code §§ 16101-16114*.

Nature of partnership. *Corp. Code §§ 16201-16204*.

Relations of partners to persons dealing with partnership. *Corp. Code §§ 16301-16308*.

Relations of partners to each other and to partnership. *Corp. Code §§ 16401-16406*.

Transferees and creditors of partner. *Corp. Code §§ 16501-16504*.

Income taxation of partners and partnerships. *Rev. & Tax. Code §§ 17851-17931*.

[2] Regulations

Federal treasury regulations applicable to California income tax. 18 Cal. Code Reg. § 19523.



4 of 184 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
PART I. RESEARCH GUIDE
A. Primary Sources

7-15 California Legal Forms--Transaction Guide § 15.02

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.02 Federal Sources

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Method of electing adjustment to basis of partnership property. *I.R.C. § 754*.

Basis of property. *I.R.C. § 1012*.

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Requirement that partnership file information income tax return. *I.R.C. § 6031*.

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Continuation and termination of partnership. *Treas. Reg. § 1.708-1*.

Treatment of liquidating distributions. *Treas. Reg. § 1.731-1*.

Treatment of payments liquidating partner's interest in income. *Treas. Reg. § 1.736-1*.

Treatment of gain or loss from sale of partnership interest. *Treas. Reg. § 1.741-1*.

Treatment of payments for partner's interest in unrealized receivables or substantially appreciated property. *Treas. Reg. § 1.751-1*.

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Valuation of business interests subject to buy-sell agreement. *Treas. Reg. §§ 20.2031-3(c)*, 20.2031-2(h).



5 of 184 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
PART I. RESEARCH GUIDE
A. Primary Sources

7-15 California Legal Forms--Transaction Guide §§ 15.03-15.04

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

[Reserved]

§§ 15.03[Reserved]



6 of 184 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
PART I. RESEARCH GUIDE
B. Secondary Sources

7-15 California Legal Forms--Transaction Guide § 15.05

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
PART I. RESEARCH GUIDE
B. Secondary Sources

7-15 California Legal Forms--Transaction Guide § 15.06

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
PART I. RESEARCH GUIDE
B. Secondary Sources

7-15 California Legal Forms--Transaction Guide §§ 15.07-15.08

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

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§§ 15.07[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.09

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§ 15.09 Scope of Part; Governing Law

This part covers the formation of general partnerships under California's Uniform Partnership Act of 1994 (UPA '94), which became effective on January 1, 1997, for partnerships formed on or after that date [*Corp. Code § 16111(a)* (pre-1997 partnerships could elect earlier coverage of UPA '94)]. Effective January 1, 1999, all general partnerships are governed by UPA '94 [*Corp. Code § 16111(b)*].

Although the discussion and forms in this part apply to general partnerships irrespective of their size or purpose, some of the unique issues involved in forming professional partnerships are given special attention. Mining partnerships, formed when two or more persons acquire a mining claim and actually work it to extract minerals, are not covered in this part. Such partnerships, however, are general partnerships subject to UPA '94 to the extent consistent with the Public Resource Code's provisions for mining partnerships [*Pub. Res. Code § 3940*].

Dissociation from, and dissolution of partnerships are covered in Part B of this chapter. Conversion and merger of partnerships are the subject of Part C.

Fictitious business names are covered in Ch. 1A, *Role of Counsel in Starting a New Business* . The formation and taxation of real estate investment partnerships are discussed in Ch. 29A, *Joint Ventures* , and Ch. 29B, *Nonprofit Real Estate Syndicates* . Limited liability partnerships are covered in Ch. 16C, *Limited Liability Partnerships* . The formation and operation of limited partnerships are discussed in Ch. 15A, *Formation of Limited Partnerships* . The formation and operation of limited liability companies is covered in Ch. 12C, *Limited Liability Companies* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral

PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.10

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.10 Partnership Defined

[1] In General

A "partnership" is an association of two or more persons to carry on as co-owners a business for profit that is formed under *Corp. Code § 16202* (the Uniform Partnership Act of 1994), a predecessor law, or comparable law of another jurisdiction [*Corp. Code §§ 16101(9), 16202(a), (b)*; *see Holmes v. Lerner (1999) 74 Cal. App. 4th 442, 457, 88 Cal. Rptr. 2d 130* (determining that partnership had been formed under former *Corp. Code § 15006* (*now see Corp. Code § 16202*), notwithstanding absence of express agreement to share profits); *see also Persson v. Smart Inventions, Inc. (2005) 125 Cal. App. 4th 1141, 1157-1159, 23 Cal. Rptr. 3d 335* (partnership normally does not continue to exist after formation of corporation; thus shareholders do not owe fiduciary duties to each other despite referring to each other as partners)]. A partnership may be formed whether or not the persons intend to form one [*Corp. Code § 16202(a)*]. Thus, formation of a partnership is not dependent on a formal written agreement [*Cochran v. Board of Supervisors (1978) 85 Cal. App.3d 75, 81, 149 Cal. Rptr. 304]* . Partnerships may be created by parol agreement or inferred from the acts and declarations of the parties [*Cochran v. Board of Supervisors (1978) 85 Cal. App. 3d 75, 81, 149 Cal. Rptr. 304]* .

Ordinarily, partnerships are characterized by two features: (1) a community of interest in a particular business, and (2) a sharing of profits from the business [*see People v. Park (1978) 87 Cal. App. 3d 550, 564, 151 Cal. Rptr. 146* ; *see also Holmes v. Lerner (1999) 74 Cal. App. 4th 442, 457, 88 Cal. Rptr. 2d 130* (determining that partnership had been formed under former *Corp. Code § 15006*, notwithstanding absence of express agreement to share profits; under former *Corp. Code § 15007(4)* (*now see Corp. Code § 16202(c)*), profit sharing was prima facie evidence of being partner rather than required element)]. Community of interest contemplates joint participation in the management, control, profits, and losses of the business [*Constans v. Ross (1951) 106 Cal. App. 2d 381, 386, 235 P.2d 113]* .

[2] Distinguished From Other Profit Sharing Arrangements

To distinguish between partnerships and other associations or obligations that are not subject to its provisions, the

following rules apply in determining whether a partnership is formed [*Corp. Code § 16202(c)*]:

- Joint tenancy, tenancy in common, tenancy by the entireties, joint property, common property, or part ownership does not by itself establish a partnership, even if the co-owners share profits made by the use of the property.

- The sharing of gross returns does not by itself establish a partnership, even if the persons sharing them have a joint or common right or interest in property from which the returns are derived.

- A person who receives a share of the profits of a business is presumed to be a partner in the business, unless the profits were received for any of the following reasons:

    - In payment of a debt by installments or otherwise.

    - In payment for services as an independent contractor or of wages or other compensation to an employee.

    - In payment of rent.

    - In payment of an annuity or other retirement benefit to a beneficiary, representative, or designee of a deceased or retired partner.

    - In payment of interest or other charge on a loan, even if the amount of payment varies with the profits of the business, including a direct or indirect present or future ownership of the collateral, or rights to income, proceeds, or increase in value derived from the collateral.

    - In payment for the sale of the goodwill of a business or other property by installments or otherwise.

[3] Joint Ventures

A joint venture exists when co-owners of a business agree to share the profits, losses, and control of the business [*Connor v. Great Western (1968) 69 Cal. 2d 850, 863, 73 Cal. Rptr. 369, 447 P.2d 609* ; *see De Anza Enterprises v. Johnson (2002) 104 Cal. App. 4th 1307, 1314-1315, 128 Cal. Rptr. 2d 749* (litigation between joint venturers over buyout procedure set forth in written joint venture agreement)]. Joint ventures are characterized by three features [*Orosco v. Sun-Diamond Corp. (1997) 51 Cal. App. 4th 1659, 1666, 60 Cal. Rptr. 2d 179* ; *580 Folsom Associates v. Prometheus Development Co. (1990) 223 Cal. App. 3d 1, 15-16, 272 Cal. Rptr. 227]* :

- The members have joint control over the venture (even though they may delegate that control);

- The members share the profits of the undertaking; and

- Each member has an ownership interest in the enterprise.

It follows that the incidents of partnerships and joint ventures are the same [*see Stodd v. Goldberger (1977) 73 Cal. App. 3d 827, 141 Cal. Rptr. 67]* . For most purposes, joint ventures are considered a form of partnership and are governed by partnership principles, including the Uniform Partnership Act [*see Zeibak v. Nasser (1938) 12 Cal. 2d 1, 12, 82 P.2d 375]* .

Distinctions between joint ventures and partnerships, when made, have been based on concepts of the former involving a single transaction of limited duration and the latter involving an ongoing business enterprise [*see Nelson v. Abraham (1947) 29 Cal. 2d 745, 749, 177 P.2d 931]* . A partnership, however, may be formed for a single venture and for a limited time [*see Kaufman-Brown Potato Co. v. Long (9th Cir. 1950) 182 F.2d 594, 599* ; *see also Page v. Page (1961) 55 Cal. 2d 192, 196, 10 Cal. Rptr. 643, 359 P.2d 41]* , which UPA '94 indirectly recognizes by defining a "partnership at will" to include a partnership in which the partners have not agreed to remain partners until the expiration of a definite term or the completion of a particular project [*Corp. Code § 16101(11)*]. The distinction between partnerships and joint ventures, therefore, is in most cases rather indefinite and of little practical significance.

Mutual agency, which is characteristic of partnerships, has not been imposed on joint venturers when their undertaking is limited in scope and it would be inequitable to do so [*see Hayward's v. Nelson (1956) 299 P.2d 1013* ; *but see Smalley v. Baker (1968) 262 Cal. App. 2d 824, 69 Cal. Rptr. 521]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawJoint VenturesFormation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.11

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.11 Uniform Partnership Act of 1994

[1] Effective Dates and Purpose

Effective January 1, 1999, all general partnerships are governed by the Uniform Partnership Act of 1994 (UPA '94) [*Corp. Code § 16111(b)*]. Under former law, partnerships formed before January 1, 1997, and partnerships continuing the business of a dissolved partnership, were governed by the Uniform Partnership Act (former UPA) until January 1, 1999, unless they elected earlier coverage of UPA '94 [*Corp. Code § 16111(a)*]. The enactment of UPA '94 has no effect on proceedings commenced or rights accrued prior to January 1, 1997 [*Corp. Code § 16112*].

The purpose of enacting UPA '94 was to achieve uniformity among the states enacting it [*Corp. Code § 16108*], and partnerships governed by UPA '94 will be similarly governed by any repeals of or amendments to the Act [*Corp. Code § 16107*]. UPA '94's provisions regarding the rights and duties of surviving partners, the legal representatives of deceased partners, the creditors of either, and the creditors of the partnership all supersede any conflicting provisions in the Probate Code [*Corp. Code § 16109*].

For further discussion of California's 1996 enactment of UPA '94, see Ballantine & Sterling, California Corporation Laws, Ch. 24, *Partnerships* (Matthew Bender).

[2] Summary of Changes From Former UPA

[a] Generally

For those familiar with the law governing general partnerships prior to the effective date of UPA '94, a brief review of the changes made by UPA '94 will help guide planning for post-1997 partnership formation and the preparation of amendments to existing partnership agreements.

[b] Entity Theory Adopted

First, UPA '94 expressly recognizes a partnership as an entity distinct from its partners, thereby mooting the old debate over whether a partnership is legally an entity or merely an aggregate of individuals [*Corp. Code § 16201*]. Adoption of the entity approach means that each partner has separate legal interests and that the ownership of the partnership assets is in the entity, not as undivided interests of the partners. As a practical matter, for example, there is no longer the need to convey title from the old partnership to the new partnership every time there is change in partners. Another example is that property acquired by a partnership becomes property of the partnership as an entity and not of the partners individually [*Corp. Code § 16203*]. This prevents a partner from forcing an in kind distribution of the property upon leaving the partnership. Instead, the partner can only be paid the value of his or her partnership interest. Finally, dissolution of the partnership is another area in which selection of entity versus aggregate theory makes a major difference.

[c] Fiduciary Duty

The former UPA was very thin on the law of fiduciary duty, common law being the main source of judicial decisions. Although it is not yet clear whether UPA '94 will have a significant practical impact in this area of partnership law, UPA '94 does make the fiduciary duty of partners more explicit [*see Corp. Code § 16404*] by establishing a comprehensive, but not exhaustive, definition of partnership fiduciary duties. These duties include the duty of loyalty and the duty of care as they relate to appropriation of partnership opportunities, self-dealing, competing with the partnership, conduct that is negligent, reckless, or constitutes intentional misconduct or knowing violation of law, the obligation of good faith and fair dealing, and nonwaiver of the duties of loyalty, due care, and good faith and fair dealing in the partnership agreement, except when it would not be unreasonable to do so [*see Corp. Code § 16103*].

PRACTICE TIP:

UPA '94 allows the partners broad latitude to self-define the duty of loyalty [*Corp. Code § 16103(b)(3)*], the duty of care [*Corp. Code § 16103(b)(4)*], and the obligation of good faith and fair dealing [*Corp. Code § 16103(b)(5)*]. Depending on the nature of the parties' existing or anticipated relationships, the prospective partners may self-define these duties to avoid later conflict. *Commentary by John J. Camozzi.*

[d] Dissociation and Dissolution

UPA '94 ends the distinctions under the former UPA between partners who withdraw, those that retire, and those that die. "Dissociation," a term UPA '94 uses generically to describe any departure of a partner from the partnership, may be voluntary (e.g., retirement) or involuntary (e.g., death or expulsion), rightful or wrongful, but in no case does a partner's dissociation require the partnership to dissolve if the remaining partners want to continue.

UPA '94 changes the rule that any change in the membership of a partnership causes its dissolution. As originally enacted, the former UPA followed the theory that any change in the membership of the partnership causes dissolution. Later amendments liberalized the rule, but only to the extent of providing that a partnership could avoid dissolution if *all* the partners agreed *in advance* of the withdrawal or addition of a partner that the partnership would not dissolve [*see* former *Corp. Code § 15031(4), (7)*]. If the partnership continued after the withdrawal or addition of a partner, but not pursuant to a preexisting agreement not to dissolve, then a new partnership had to be formed or the business is treated as if it were operating as a dissolved but unliquidated enterprise [*see* former *Corp. Code § 15041*].

Under UPA '94, changes in the composition of the partnership do not necessarily dissolve the partnership, notwithstanding that there is no prior agreement not to dissolve. While it is true, for example, that in a partnership for a definite term or for a particular purpose, dissolution and winding up are required when a partner dissociates before the expiration of the term of the partnership, a majority in interest of the remaining partners may simply agree to continue

the partnership if they act within 90 days of the partner's dissociation [*Corp. Code § 16801*]. Similarly, in an at will partnership, the dissociation of a partner who has been expelled will not dissolve the partnership unless at least half of the partners decide to do so [*Corp. Code § 16801*]. Thus, the withdrawal of a partner, by itself, no longer constitutes an event of dissolution, and instead will trigger the buyout provisions of Article 7 of UPA '94. These buyout provisions are mandatory absent some other provision for buyout in the partnership agreement. The former UPA also required a buyout, but limited it to the interests of retiring or deceased partners. Moreover, UPA '94's buyout provisions are fairly detailed concerning the valuation of a dissociated partner's interest and the timing of payment, whereas the former UPA merely spoke of "the value of his interest at the date of dissolution."

[e] Joint and Several Liability

UPA '94 provides that a partnership may sue and be sued in the partnership name. This follows the entity approach and is declarative of California law under *Code Civ. Proc. § 369.5(a)*. A judgment against the partnership is not by itself a judgment against a partner [*Corp. Code § 16307(c)*], so a partner must be individually named in the suit and a judgment entered against the partner in order for his, her or its personal assets to be the subject of a levy against the partnership. However, in order for an extended statute of limitations for collection to apply to them, general partners need not be separately assessed for a partnership tax debt for which they are secondarily liable [*26 U.S.C. § 6502*]. In a case in which the IRS timely assessed unpaid employment taxes against a partnership which never satisfied the debt, the IRS filed a proof of claim for those taxes in the general partners' Chapter 13 petitions under the Bankruptcy Code. The partners argued that the assessment extended the statute of limitations only against the partnership; the IRS had not separately assessed the general partners within the limitations period. The U.S. Supreme Court held that because the only relevant taxpayer for purposes of the assessment and collection statutes was the partnership, proper assessment of the tax against the partnership sufficed to extend the statute of limitations for collection of the tax from the general partners, who were liable for the payment of the partnership's debts. The government's timely assessment against the partnership was sufficient to extend the statute of limitations to collect the tax in a judicial proceeding, whether from the partnership itself or from those liable for its debts [*United States v. Galletti (2004) 541 U.S. 114, 124 S. Ct. 1548, 158 L. Ed. 2d 279, 285]* .

Under UPA '94 [*Corp. Code § 16306(a)*], partners are jointly and severally liable for all partnership obligations, not just for tort-type liabilities as under the former UPA [*Corp. Code § 16306(a)*]. Generally, joint and several liability permits a creditor to proceed immediately against any of the joint and several judgment debtors. Under UPA '94, however, subject to certain exceptions, creditors are required to first exhaust the partnership assets before levying against a partner to satisfy a judgment based on a claim against the partnership [*Corp. Code § 16307(d)*]. For example, a judgment creditor may proceed directly against the assets of a partner who is liable independently as the primary tortfeasor, but must exhaust the partnership's assets before proceeding against the separate assets of the other partners who are liable only as partners.

[f] Partnership Agreements

UPA '94 creates an extensive set of rules to govern the relations among partners and between the partners and the partnership. Most of these rules, however, can be varied by express agreement of the parties [*see Corp. Code § 16103*]. Thus, UPA '94 has its greatest impact on partnerships that must rely on statutory rules because they do not have detailed written partnership agreements.

[g] Partnership Conversions

The former UPA authorized conversions of general partnerships into limited liability partnerships, but its provisions did not treat the conversion of general partnerships into other entities, such as domestic or foreign limited partnerships and limited liability companies. UPA '94 contains detailed provisions [*see Corp. Code §§ 16901-16909*] covering such conversions, including the drafting of conversion plans, the approvals required for conversion, the effect of conversion

on titles to real property and on the rights and liabilities of partners and the partnership, and the filing of statements of conversion. The UPA '94 conversion provisions are not exclusive, and general partnerships can be converted into other entities in any other manner provided by law [*Corp. Code § 16917*]. Conversion of partnerships is covered in Part C of this chapter.

[h] Mergers

While the former UPA authorized merger between partnerships, its provisions, added in 1992 and amended in 1995, were limited in scope and merely required that the partnership agreement sanction the merger and prescribed the vote required. The UPA '94 provisions [*see Corp. Code §§ 16910-16917*] are far more detailed, covering merger agreements, the law governing the surviving partnership, the effect of merger on title to real property, creditors rights and the liabilities of the members of the surviving entity, and, finally, the requirement of filing a statement of merger. Like the conversion provisions, the merger provisions of UPA '94 are not exclusive, and general partnerships can be merged into other entities in any other manner provided by law [*Corp. Code § 16917*]. Partnership merger is covered in Part C of this chapter.

[i] Partnership Statements

As discussed in more detail below, UPA '94 refines and expands the role of partnership statements. The former UPA also provided for partnership statements, but their only function was to create record title to real property [*see* former *Corp Code §§ 15010.5-15010.7*]. The former UPA also provided for public notice of a partnership dissolution in the form of newspaper publication [*see* former *Corp. Code § 15035.5*], but this was not a public record capable of giving constructive notice to third persons. The partnership statements provided for under UPA '94 combine the functions of creating record title and giving constructive notice of changes in the partnership. This is accomplished with a statement that is filed with the Secretary of State and, as necessary, recorded in the counties where the partnership owns real property [*see Corp. Code § 16105*].

[3] Correlation Table--Former UPA/UPA '94

This table compares and correlates the former Uniform Partnership Act [former *Corp. Code §§ 15001-15058*] with the Uniform Partnership Act of 1994 [*Corp. Code §§ 16100-16962*]. Using this table, readers can determine the sections of the former UPA that correspond to those in UPA '94, and vice versa. The table also indicates whether or not each section was revised and, if so, whether the revision was minor or major. Classification of revisions as "minor" or "major" obviously involves a degree of discretionary judgment by the authors of this table.

The left hand column gives the section number of the former UPA sections. The middle column indicates the corresponding section of the UPA '94, if any. The right hand column indicates whether or not any revision was made, as well as the extent of the revision.

Pre-1997 Act Section	UPA '94 Section	Effect
15001	16100	Minor revision
15002	16101	Minor revision
15003	16102	Major revision
	16103	New

15004, 15005	16104	Minor revision
15010.5	16105	Minor revision
	16106	New
	16107	New
15004(4)	16108	No revision
15045	16109	No revision
	16110	New
	16111	New
	16112	New
	16113	New
	16114	New
	16201	New
15006	16202	Minor revision
15006(2)		Not reenacted, but see Pub. Res. Code § 3940
15007	16202(c)	Minor revision
	16203	New
15008	16204	Minor revision
15009	16301	Minor revision

15010	16302	Minor revision
15010.5	16105, 16302(b), 16304	Minor revision
15010.6		Not reenacted
15010.7	16303	Minor revision
15011		Not reenacted, but see § 16301
15012		Not reenacted
	16304	New
15013	16305(a)	Minor revision
15014	16305(b)	Minor revision
15015	16306	Minor revision
	16307	New
15016	16308	Minor revision
15017	16306(b)	Major revision
15018	16401	Minor revision
	16402	New
15019	16403(a), (b)	Minor revision
15020	16403(c)	Minor revision
15021(1)	16404(b)	Minor revision
15021(2)	16404(g)	Minor revision

	16404(b)-(f)	New
15022	16405(b)	Minor revision
	16405(a)	New
	16405(c)	New
15023	16406	No revision
15024		Not reenacted, but see § 16502
	16501	New
15025		Not reenacted
15026	16502	Minor revision
15027	16503	Minor revision
15028	16504	Minor revision
	16601	New
	16602	New
	16603	New
	16701	New
	16701.5	New
	16702	New
	16703	New
	16704	New

	16705	New
15029		Not reenacted
15030	16802(a)	No revision
15031	16801	Major revision
	16802(b)	New
15032		Not reenacted
	16803(c)	New
15033		Not reenacted
15034		Not reenacted
15035	16804	Minor revision
15035.5	16805	Major revision
15036		Not reenacted
15037	16803(a), (b)	Minor revision
15038		Not reenacted
15039		Not reenacted
15040	16807	Major revision
	16806	New, but see § 15035
15041		Not reenacted
15042		Not reenacted

15043		Not reenacted
15044		Not reenacted
15045	16109	No revision
	16901	New
	16902	New
	16903	New
	16904	New
	16905	New
	16906	New
	16907	New
	16908	New
	16909	New
15046	16910	Major revision
	16911	New
	16912	New
	16913	New
	16914	New
	16915	New
	16916	New

	16917	New
15047	16951	No revision
15048(a)	16952	No revision
15048(b)-(e)		Not reenacted
15049	16953	No revision
15050	16954	No revision
15051	16955	No revision
	16955.5	New
15052	16956	No revision
15053	16957	No revision
15054	16958	No revision
15055	16959	No revision
15056	16960	No revision
15057	16961	No revision
15058	16962	No revision

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionPartnership Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.12

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.12 Partnership Statements Under UPA '94

[1] Generally

UPA '94 provides for various partnership statements that, once filed with the Secretary of State, and, if the partnership owns real property, recorded, are intended to place third parties on notice of the status of the partnership and the authority of the partners to act for the partnership. The principal effect of such filings will be to protect both the partners and third parties in transactions conducted in reliance on the filed and/or recorded statements. The UPA '94 partnership statements are much more particularized in content and effect than the omnibus "statement of partnership" filed under the former UPA. "Statement" is defined in UPA '94 as a statement of partnership authority, a statement of denial, a statement of dissolution, a statement or certificate of conversion, a statement of merger, or an amendment or cancellation of any of the foregoing [*Corp. Code § 16101(17)*].

PRACTICE TIP:

UPA '94 partnership statements are important documents in the formation, operation, and dissolution of partnerships, and all partners should become familiar with the statement forms and filing requirements. *Commentary by John J. Camozzi.*

[2] Statement of Authority

A statement of authority may, but is not required, to be filed by the partnership in order to supplement a partner's authority to enter into transactions on behalf of the partnership. It contains information about the partnership, including the names of partners (or an agent), the names of partners authorized to transfer partnership real property, and the names of partners with specific or limited authority to enter into other transactions on behalf of the partnership [*Corp. Code § 16303(a)*].

[3] Statement of Denial

A statement of denial may be filed by a partner or other person named as a partner in a statement of partnership authority, or in a list maintained by the partnership's agent, in order to deny status as a partner. It has the effect, when filed, of putting third parties on notice of limitations on the authority of persons with whom they are conducting partnership transactions [*Corp. Code § 16304*].

[4] Statement of Dissociation

This statement is filed by a dissociated partner or the partnership and has the same limiting effect on a dissociated partner's authority to transact partnership as a statement of denial [*Corp. Code § 16704*].

[5] Statement of Dissolution

A statement of dissolution has the purpose of putting third persons on notice that the partnership is in the process of winding up its affairs. It has the effect of cancelling previously a filed statement of partnership authority [*Corp. Code § 16805*].

[6] Statement of Conversion

If a partnership has filed a statement of partnership authority that is effective at the time of conversion, and the partnership is converting to a domestic limited partnership, limited liability company, or corporation, the certificate of limited partnership or articles of the converted entity must contain a statement of conversion on the prescribed form [*Corp. Code § 16906(a)*; *see Corp. Code § 16303*; *see also* [2], *above*]. The filing of this form is optional if the converting partnership does not have an effective statement of partnership authority on file. The statement of conversion must state the name and file number of the converting partnership, as well as a statement that the principal terms of the conversion were approved by the requisite voting interests [*Corp. Code § 16906(a)*]. The filing of this statement effectively cancels any previously filed statement of partnership authority by the converting partnership [*Corp. Code § 16906(c)*]. For additional discussion, see *§§ 15.602[5][c], [8][d]*, and *15.801[1]*.

[7] Certificate of Conversion

A partnership that is converting to a foreign other business entity and that has filed a statement of partnership authority that is effective at the time of conversion may file a certificate of conversion [*Corp. Code § 16906(b)*; *see Corp. Code § 16303*; *see also* [2], *above*]. The certificate of conversion must state the names of the converting and converted partnerships, the street address of the converted entity's chief executive office and of any California office, and the form of organization of the converted entity [*Corp. Code § 16906(b)*]. The filing of this statement effectively cancels any previously filed statement of partnership authority by the converting partnership [*Corp. Code § 16906(c)*]. For additional discussion, see *§§ 15.602[6][c]* and *15.802[1]*. The Secretary of State's official form for a certificate of conversion is reproduced in § 15.802[2].

[8] Statement of Merger

Filed by surviving partnerships, other business entities into which a partnership has merged, or constituent domestic partnerships, the statement of merger is intended to put third parties on notice of the reorganization and afford the opportunity to revise any statements of partnership authority that a surviving domestic partnership may have on file [*Corp. Code § 16915*].

[9] Statement of Amendment of Cancellation

Any person authorized by the UPA '94 to file a statement may amend or cancel the statement by filing an amendment or cancellation that names the partnership, identifies the statement, and states the substance of the amendment or

cancellation [*Corp. Code § 16105(d)*]. A statement of amendment of cancellation is made on the Secretary of State's Standard Form GP-7. For an illustration of Form GP-7, and comment, see *§ 15.287*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.13

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.13 Property Rights of Partnership

[1] In General

Property acquired by a partnership is property of the partnership and not of the partners individually [*Corp. Code § 16203*]. "Property" means all property, real, personal, or mixed, tangible or intangible, or any interest therein [*Corp. Code § 16101(15)*].

[2] How Acquired

Property is partnership property if acquired in the name of the partnership, or in the name of one or more partners with an indication in the instrument transferring title of the person's capacity as a partner or the existence of a partnership but without an indication of the name of the partnership [*Corp. Code § 16204(a)*]. Property is acquired in the name of the partnership by transfer to either (1) the partnership in its name, or (2) one or more partners in their capacity as partners if the name of the partnership is indicated in the instrument transferring title [*Corp. Code § 16204(b)*].

[3] Presumptions

Property is presumed to be partnership property if purchased with partnership assets, even if it is not acquired in the partnership name or in the name of one or more partners by an instrument indicating the person's capacity as a partner or the existence of a partnership [Corp. Code § 16204(c)]. Property acquired in the name of one or more of the partners, without an indication in the instrument of transfer of the partner's capacity as a partner or of the existence of a partnership, and without use of partnership assets, is presumed to be separate property even if used for partnership purposes [*Corp. Code § 16204(d)*]. For a discussion of transfers of partnership property, see *§ 15.15[2]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersPartnership Property



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.14

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.14 Partners' Interest in Partnership

[1] No Interest in Partnership Property

A partner is not a co-owner of partnership property and has no interest in it that can be transferred [*Corp. Code § 16501*]. Only the partner's personal property interest ("transferable interest") in his or her share of the partnership profits and losses and the right to receive distributions can be transferred [*Corp. Code § 16502*].

[2] Effect of Transfer of Partner's Interest

A partner can transfer his or her interest in the partnership, and such a transfer will cause neither the partner's dissociation from the partnership nor its dissolution. Other than his or her interest in partnership distributions, a transferring partner retains the rights and duties of a partner [*Corp. Code § 16503(d)*]. A transfer that violates a restriction on transfer in the partnership agreement is ineffective as to a person with notice of the restriction [*Corp. Code § 16503(f)*; *see Corp. Code § 16102* (defining "notice")].

A transferee is not entitled to participate in managing the partnership business and has no right to access to the partnership books and records [*Corp. Code § 16503(a)*]. A transferee of a partner's transferable interest gets only the right to receive the transferee's distributions, the net amount due the transferor on dissolution and winding up, and the right to seek a judicial determination that it would be equitable to wind up the business [*Corp. Code § 16503(b)*]. In a dissolution and winding up, a transferee is entitled to an account of transactions only from the date of the latest account agreed to by all the partners [*Corp. Code § 16503(c)*]. The partnership does not have to recognize the transferee's rights until it has notice of the transfer [*Corp. Code § 16503(e)*].

[3] Charging Orders

UPA '94 provides the exclusive remedy by which a judgment creditor of a partner or a partner's transferee may satisfy a

judgment out of the judgment debtor's transferable interest in the partnership [*Corp. Code § 16504(a)*]. Briefly, that remedy permits the judgment creditor to apply for a court order charging the transferable interest of the judgment debtor to satisfy the judgment, and gives the court the power to appoint a receiver of partnership distributions and to make all other orders, directions, accounts, and inquiries the judgment debtor might have made or that the circumstances of the case may require [*Corp. Code § 16504(a)*].

A charging order is a lien on the judgment debtor's transferable interest, and the court may order a foreclosure of an interest subject to a charging order at any time. The purchaser at the foreclosure sale has the rights of a transferee [*Corp. Code § 16504(b)*]. At any time before foreclosure, an interest charged may be redeemed by the judgment debtor, by other partners out of their separate property, or out of partnership property with the consent of all the partners whose interests are not charged [*Corp. Code § 16504(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersPartnership Property



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.15

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.15 Relations of Partners to Persons Dealing With Partnership

[1] Partner as Agent of Partnership

[a] Ordinary Course of Business

Each partner is an agent of the partnership for purpose of the partnership business. The acts of a partner in the ordinary course of business bind the partnership unless the partner had no authority to act in a particular matter and the person with whom the partner was dealing knew or received notification that the partner lacked authority [*Corp. Code § 16301(1)*]. A partner's authority may be limited by a statement of partnership authority [*see* [3], *below*].

[b] Not in the Ordinary Course of Business

A partner is not the agent of the partnership, and his or her acts do not bind the partnership, if the acts are not for carrying on the ordinary course of the partnership business or business of the kind carried on by the partnership. However, a partnership may be bound by acts of a partner outside the ordinary course of partnership business if the other partners authorize it [*Corp. Code § 16301(2)*]

[2] Transfers of Partnership Property

[a] Authorized Transfers

A partner may authorize a transfer of property if the partner is acting as an agent for the partnership or the partnership is otherwise bound by the acts of the partner [*see* [1], *above*]. The method of authorized transfer depends on the manner in which the property is held. Partnership property may be held in the name of the partnership, in the name of a partner with an indication of the partner's status as a partner or of the existence of the partnership, or solely in the name of the partner with no reference to the partner's status or the existence of the partnership. In the first instance, a partner may

transfer property by signing a transfer instrument in the partnership's name [*Corp. Code § 16302(a)(1)*]. In the second and third instances, a partner may transfer property by signing a transfer instrument in his or her own name [*Corp. Code § 16302(a)(2), (3)*].

If one person holds all of the partners' interest in the partnership, all of the partnership property vests in that person. That person may execute a document in the name of the partnership to evidence vesting of the property in that person and may file or record the document [*Corp. Code § 16302(d)*].

[b] Recovering Property From Unauthorized Transfers

A partnership may recover partnership property from a transferee only if it proves that the partner was not an agent of the partnership and that the partnership was not bound by the acts of the partner [*see* [1], *above; see also* [3][c], *below* (effect of partnership statement on authorized real property transfers)]. In addition, the partnership must prove either that a subsequent transferee for value knew or received notification that the person who signed the transfer instrument lacked authority to bind the partnership, or, as to a transferee for value, when the property was held solely in the name of the partner with no indication of the partner's status or the existence of the partnership, that the transferee knew or received notification that the property was partnership property and that the person who signed the transfer instrument lacked authority to bind the partnership [*Corp. Code § 16302(b)*].

A partnership may not recover partnership property from a subsequent transferee if the partnership could not meet the above rule to recover property from an earlier transferee [*Corp. Code § 16302(c)*].

[3] Statement of Partnership Authority

[a] Effect

A statement of partnership authority [*see § 15.12[2]*] may be used to specify the authority, or limitations on the authority of some or all of the partners to enter into other transactions on behalf of the partnership and any other matter [*Corp. Code § 16303(a)(2)*]. Its effect on dealings between third parties and the partnership and individual partners depends on the extent to which the third parties have notice and knowledge of the statement [*see Corp. Code § 16102* (knowledge and notice construed)]. Filing alone is not sufficient to deem that a third party, who is not a partner, knows of limitations on the authority of a partner to act [*Corp. Code § 16304(f)*].

[b] Transfers of Property Other Than Real Property

A third person dealing with a partner on behalf of a partnership may rely conclusively on a grant of authority in a filed statement of partnership authority for all transfers for value other than transfers of real estate. However, there are two situations in which a partnership may disavow the partner's authority to make the transfer [*Corp. Code § 16303(d)(1)*]:

- If there was a subsequent statement on file that limited the authority granted to the partner [filed cancellation of a limitation revives a previous grant of authority], or

- If the third party had knowledge that the partner was not authorized to take the actions prescribed in the statement.

[c] Transfers of Real Property

A statement of partnership authority filed in the office of recording transfers for partnership real property binds the partnership and third party for a real property transfer. The third party may rely conclusively on the authority of the partner to make the transfer [*Corp. Code § 16303(d)(2)*]. The third party also is deemed to know of any limitation on the authority of a partner to transfer real property [*Corp. Code § 16303(e)*].

[d] Statement of Denial

A partner or person named as a partner in a filed statement of partnership authority may file a statement of denial. The statement of denial should describe the fact being denied, including a person's authority or status as partner. The statement of denial acts as a limitation of authority. [*Corp. Code § 16304*].

[4] Capacity to Sue

[a] Partnership and Third Parties

A partnership may sue and be sued in the name of the partnership [*Corp. Code § 16307(a)*]. In addition to an action against the partnership, a third party may bring the same or a separate action against any or all of the partners, except for partners in a limited liability partnership [*Corp. Code § 16307(b)*; *see* Ch. 16C, *Limited Liability Partnerships*].

A partnership may bring an action against a partner for damage to the partnership from a breach of the partnership agreement or a violation of a duty to the partnership [*Corp. Code § 16405(a)*].

[b] Actions by Partners

A partner may bring an action against the partnership or another partner to do any of the following [*Corp. Code § 16405(b)*]:

- Enforce the partner's rights under the partnership agreement.
- Enforce the partner's rights under UPA '94.
- Enforce the rights and protect the interests of the partner, including those that arise independently of the partnership.

[5] Judgments

Because, under the UPA '94, a partnership is treated as a separate entity, a judgment against a partnership is not a judgment against a partner and the judgment may not be satisfied from a partner's assets without a judgment against the partner [*Corp. Code § 16307(b)*]. Similarly, a judgment creditor of a partner may not execute against the assets of the partner to satisfy a judgment based on a claim against the partnership unless [*Corp. Code § 16307(d)*]:

- A judgment based on the same claim has been obtained against the partnership and execution is returned unsatisfied in whole or in part;
- The partnership is in bankruptcy;
- The partner agrees that the creditor does not need to exhaust partnership assets;
- The court grants permission to levy against the partner after finding that partnership assets are clearly insufficient, the exhaustion of partnership assets is excessively burdensome, or that the court's permission is an appropriate exercise of its equity powers; or
- Liability is imposed on the partner by law or contract independent of the existence of the partnership.

These same rules apply to purported partners [*Corp. Code § 16307(e)*; *see § 15.16[3]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersAuthority to ActBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersPartnership PropertyBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersTransfers of Interests



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.16

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.16 Liability of Partnership and Partners

[1] Partnership Liability for Partner Actions

A partnership is liable for the wrongful act or omission, or other actionable conduct of a partner acting in the ordinary course of the partnership business or with the authority of the partnership [*Corp. Code § 16305(a)*]. Similarly, the partnership is liable for the misapplication of any money or property by a partner acting in the course of the partnership business or with authority of the partnership [*Corp. Code § 16305(b)*].

[2] Partner Liability for Partnership Obligations

Partners are jointly and severally liable for all partnership obligations unless otherwise agreed by the claimant or provided by law [*Corp. Code § 16306(a)*; *see, e.g., Great Western Bank v. Kong (2001) 90 Cal. App. 4th 28, 31-33, 108 Cal. Rptr. 2d 266* (although under *Corp. Code § 16306(a)* all partners were jointly and severally liable for bank loan on real property, after foreclosure and entry of deficiency judgment, assignment of judgment to partnership and 11 of 12 partners extinguished the debt; the 11 partners could not acquire bank's right to collect balance of judgment from 12th partner, their co-obligor)]. However, a partner is not personally liable for partnership obligations incurred before the partner's admission to the partnership [*Corp. Code § 16306(b)*].

However, in order for an extended statute of limitations for collection to apply to them, general partners need not be separately assessed for a partnership tax debt for which they are secondarily liable [*26 U.S.C. § 6502*]. In a case in which the IRS timely assessed unpaid employment taxes against a partnership which never satisfied the debt, the IRS filed a proof of claim for those taxes in the general partners' Chapter 13 petitions under the Bankruptcy Code. The partners argued that the assessment extended the statute of limitations only against the partnership; the IRS had not separately assessed the general partners within the limitations period. The U.S. Supreme Court held that because the only relevant taxpayer for purposes of the assessment and collection statutes was the partnership, proper assessment of the tax against the partnership sufficed to extend the statute of limitations for collection of the tax from the general

partners, who were liable for the payment of the partnership's debts. The government's timely assessment against the partnership was sufficient to extend the statute of limitations to collect the tax in a judicial proceeding, whether from the partnership itself or from those liable for its debts [*United States v. Galletti (2004) 541 U.S. 114, 124 S. Ct. 1548, 158 L. Ed. 2d 279, 285]* .

[3] Liability for Misrepresentation of Person as Partner

If a person who is not a partner claims partnership status, he or she will be liable to anyone who enters into a transaction with the partnership or purported partnership based on that representation. Misrepresentations that are made in a public manner may increase liability to include persons who rely on the misrepresentation, even if the purported partner did not know that the person relied on the misrepresentation [*Corp. Code § 16308(a)*].

The partnership may be liable to a third person who enters into a transaction with the partnership based on the misrepresentation if all the partners consent to the representation. If fewer than all of the partners consent to the representation, those partners become jointly and severally liable [*Corp. Code § 16308(b)*].

[4] Limits on Partnership Status Liability

A person is not liable as a partner merely because he or she is named as a partner in a statement of partnership authority [*Corp. Code § 16308(c)*]. Nor is a former partner liable after dissociation simply because the partnership statement of authority was not amended or a statement of dissociation was not filed [*Corp. Code § 16308(d)*]. Persons who are not partners are not liable as partners to other persons, except for misrepresentations of partnership status [*Corp. Code § 16308(e)*; *see Armato v. Baden (1999) 71 Cal. App. 4th 885, 897-899, 84 Cal. Rptr. 2d 294* (under former *Corp. Code § 15016*, independent contractor doctors for medical group were not jointly liable under ostensible partnership theory for treatment plaintiff received from group's physician assistant)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionNegligent Acts of PartnersBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionPartnership LiabilitiesBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.17

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.17 Relations of Partners to Each Other and the Partnership

[1] The Partnership Agreement

The partnership agreement governs relations among partners, and between partners and the partnership, except to the extent limited by law. Relations between the partnership and partners or among partners not covered by the partnership agreement are governed by UPA '94 [*Corp. Code § 16103(a)*].

[2] What the Partnership Agreement Cannot Do

A partnership agreement may not do any of the following [*Corp. Code § 16103(b)*]:

- Change the statutory rights and duties with respect to partnership statements available [*Corp. Code § 16105*], except to eliminate the duty to provide copies of partnership statements to all the partners.

- Make unreasonable restrictions on a partners' right to access books and records.

- Eliminate a partner's duty of loyalty, although it may establish types or categories of activities that do not violate the duty or allow, with full disclosure, for ratification of acts that would violate the duty.

- Reduce a partner's duty of care unreasonably.

- Eliminate a partner's obligation of good faith and fair dealing, although it may prescribe standards by which performance of that obligation may be measured.

- Change a partner's power to dissociate except to require notice in writing.

- Change the right of a court to expel a partner under the dissociation provisions.

- Change the requirements to wind up partnership business under court determinations [*see Corp. Code § 16801(4)-(6)*].

- Restrict the rights of third parties.

- Change the law applicable to registered limited liability partnerships.

PRACTICE TIP:

Note that UPA '94 expressly authorizes partners to reasonably self-define their fiduciary duties of loyalty, care, and good faith and fair dealing. Reduction or modification of these duties may be appropriate to avoid disputes over, for example, a potential conflict of interest resulting from a partner's involvement with another entity. On the other hand, counsel should be wary of reducing fiduciary duties when the prospective partners are less sophisticated and, in some cases, may need to have fiduciary duties spelled out in greater detail. During the client interview, counsel should carefully identify possible issues that would warrant modifying or particularizing the statutory fiduciary duties or that could create an actual conflict of interest in the representation of multiple parties during partnership formation. *Commentary by John J. Camozzi.*

[3] Partner and Partnership Rights and Liabilities Under UPA '94

[a] When the Act Standards Apply

The UPA '94 provisions setting forth the rights and liabilities of partners and partnerships as among themselves apply to the extent that a partnership agreement is silent and there is no contrary provision, with the exceptions noted in [2], *above* [*Corp. Code § 16103(a)*].

[b] Management

Each partner has equal rights in the management and conduct of the partnership business [*Corp. Code § 16401(f)*]. Decisions in the ordinary course of business may be made by a majority of partners. However, acts outside the ordinary course of business and amendment of the partnership agreement may be undertaken only with the consent of all partners [*Corp. Code § 16401(j)*].

[c] Profits and Losses

Each partner is entitled to an equal share of partnership profits, and is chargeable with a share of partnership losses in proportion to the partner's share of profits [*Corp. Code § 16401(b)*].

[d] Partnership Accounts

Each partner is deemed to have a partnership account that is credited with an amount equal to the money and the net value of property contributed to the partnership plus the partner's share of partnership profits. A partner's account is charged with an amount equal to the money plus the net value of any other property distributed to the partner and the partner's share of any partnership losses [*Corp. Code § 16402(a)(1), (2)*].

[e] Payments and Advances

A partner is entitled to be reimbursed for payments made and indemnified for liabilities incurred in the ordinary course of business or for the preservation of the partnership business or property [*Corp. Code § 16401(c)*]. Similarly, a partner

is entitled to be reimbursed for advances to the partnership in excess of the capital the partner agreed to contribute [*Corp. Code § 16401(d)*]. Payments or advances that become partnership obligations are loans that accrue interest from the date of the payment or advance [*Corp. Code § 16401(e)*].

[f] Distributions in Kind

A partner has no right to receive, and may not be required to accept, a distribution in kind [*Corp. Code § 16402*].

[4] Partner Fiduciary Duties Under UPA '94

[a] Duties and Obligations Owed

Under UPA '94, a partner owes a duty of loyalty and a duty of care to the partnership [*Corp. Code § 16404(a)*]. Further, a partner must discharge his or her duties under UPA '94 and the partnership agreement, and exercise any partner rights, consistent with the obligation of good faith and fair dealing [*Corp. Code § 16404(d)*].

The obligation of good faith and fair dealing may not be eliminated by the partnership agreement. However, the partnership agreement may prescribe standards to measure a partner's performance of the obligation [*Corp. Code § 16103(b)(5)*].

A partner does not violate a duty or obligation under UPA '94 or the partnership agreement simply because the partner's conduct furthers his or her own interest [*Corp. Code § 16404(e)*; *see, e.g., Jones v. Wagner (2001) 90 Cal. App. 4th 466, 473-474, 108 Cal. Rptr. 2d 669* (no breach of fiduciary duty for partner to bid on and purchase partnership real property at foreclosure sale that took place after other partners had failed to fulfill their obligation to make mortgage payments on property); *but see* Everest Investors 8 v. *McNeil Partners (2003) 114 Cal. App. 4th 411, 424, 429, 8 Cal. Rptr. 3d 31* (limited partner alleged that general partners breached fiduciary duties by engaging in wrongful actions related to merger transaction that benefitted themselves at expense of limited partners; claims held to be individual rather than derivative in nature)]. The apparent purpose of *Corp. Code § 16404(e)* is to excuse partners from accounting for incidental benefits obtained in the course of partnership activities, when there is no detriment to the partnership. The statute cannot be invoked to justify a partner's substantial use of partnership property at the expense of the partnership [*Enea v. Superior Court (2005) 132 Cal. App. 4th 1559, 1566, 34 Cal. Rptr. 3d 513]* .

[b] Duty of Loyalty

A partner's duty of loyalty includes all of the following [*Corp. Code § 16404(b)*]:

- To account for any property, profit, or benefit obtained in the conduct and winding up of partnership business, including the appropriation of a partnership opportunity;

- To refrain from dealing with the partnership on behalf of a party having an adverse interest to the partnership; and

- To refrain from competing with the partnership.

The list of loyalty-related obligations in *Corp. Code § 16404(b)* is not exclusive. The statute provides that "loyalty to the partnership and the other partners *includes* all of" the listed obligations (emphasis added). Thus, the statute leaves further articulation of the duty of loyalty to traditional common law processes [*Enea v. Superior Court (2005) 132 Cal. App. 4th 1559, 1565, 34 Cal. Rptr. 3d 513* (one partner could not occupy partnership's real property and pay below-market rent over objection of other partner)].

The duty of loyalty is imposed by law. It does not depend on any provision in the partnership agreement [*Enea v.*

Superior Court (2005) 132 Cal. App. 4th 1559, 1566-1567, 34 Cal. Rptr. 3d 513] , nor may it be eliminated by the partnership agreement. However, the partnership agreement may provide, if not manifestly unreasonable, for [*Corp. Code § 16103(b)(3)(A), (B)*]:

- Specific type or categories of activities that do not violate the duty of loyalty, or

- Ratification, after full disclosure of all material facts, of acts or transactions that would violate the duty of loyalty by all or some lesser number of partners.

[c] Duty of Care

A partner's duty of care means that the partner will avoid engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law, in conducting partnership business or winding up the partnership [*Corp. Code § 16404(c)*]. A partner's duty of care may not be unreasonably reduced by the partnership agreement [*Corp. Code § 16103(b)(4)*].

[5] Continuation of Term Partnership

A partnership that is created for a definite term or particular undertaking may be continued after the expiration of the term or completion of the undertaking. If the partnership is continued and there is no express agreement to do so, the rights and duties of the partners remain the same as they were at the expiration of the term or completion of the undertaking, consistent with a partnership at will [*Corp. Code § 16406(a)*]. Partners who acted in the partnership business and who continue the business without settlement or dissolution are presumed to have agreed that the partnership will continue [*Corp. Code § 16406(b)*].

PRACTICE TIP:

Term partnerships are akin to joint ventures. When working with less sophisticated clients, counsel may prefer to structure the relationship as a joint venture, rather than a term partnership, in order to reinforce the relationship's finite nature and seek to avoid the unintended creation of an at will partnership. *Commentary by John J. Camozzi*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.18

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.18 Tax Consequences of Formation

[1] Partnership as Separate Entity

For tax purposes, a partnership is an unincorporated organization by or through which a business, financial operation, or venture is carried on [*I.R.C. § 761(a)*]. Partnerships receive entity treatment for purposes of calculating taxable income and filing information returns [*see United States v. Basye (1973), 410 U.S. 441, 448 n.8, 93 S. Ct. 1080, 35 L. Ed. 2d 412]* . Partnerships serve as conduits through which the tax obligation passes to the individual partners [*United States v. Basye (1973) 410 U.S. 441, 448 n.8, 93 S. Ct. 1080, 35 L. Ed. 2d 412]* .

[2] Nonrecognition of Gain or Loss on Contribution of Property

In general, for both federal and California tax purposes, the contribution of property to a partnership in exchange for a partnership interest does not create recognizable gain or loss to either the partnership or the contributing partner [*I.R.C. § 721(a)*; *Rev. & Tax. Code § 17851*]. Under California law, the taxation of partnerships is generally determined in accordance with Subchapter K of the Internal Revenue Code [*Rev. & Tax. Code § 17851*; *see I.R.C. §§ 701-761* (Subchapter K); *but see Rev. & Tax. Code §§ 17851.5* (imposes tax on limited partnerships), 17853-17857 (modifications of federal provisions), 17935 (applicable to limited partnerships only); *see also § 15.20*].

[3] Basis

[a] Partner's Basis in Partnership

The basis of a partner's interest in a partnership equals the amount of money plus the adjusted basis at the time of contribution of any property contributed [*I.R.C. § 722*; *Rev. & Tax. Code § 17851*]. A partner's basis in the partnership is adjusted to account for partnership profits and losses, distributions to the partner, and other tax items such as tax-exempt income, depletion deductions, and the like [*I.R.C. § 705*].

[b] Partnership Basis in Contributed Property

A partnership's basis in the contributed property is the contributing partner's adjusted basis at the time of contribution [*I.R.C. § 723*; *Rev. & Tax. Code § 17851*]. However, the nonrecognition rule of *I.R.C. § 721(a)* does not apply to gain realized on a transfer of property to a partnership that would be treated as an investment company [*see I.R.C. § 351*] if the partnership were incorporated [*I.R.C. § 721(b)*; *Rev. & Tax. Code § 17851*]. Therefore, if a property transfer falls within the scope of *I.R.C. § 721(b)*, the contributing partner's basis in the partnership will be increased by the amount of gain recognized to the partner at the time of contribution [*I.R.C. § 722*; *Rev. & Tax. Code § 17851*], and the partnership's basis in the contributed property would be the partner's basis increased by the amount of the partner's gain [*I.R.C. § 723*; *Rev. & Tax. Code § 17851*].

[4] Assumption of Liabilities

If property is contributed to a partnership subject to liabilities, the partnership and partner generally are treated as if the partnership assumed the liabilities to the extent of the fair market value of the property [*see I.R.C. § 752(c)*; *Rev. & Tax. Code § 17851*]. To the extent there is an assumption of liability, the partner is treated as having received a distribution of money from the partnership [*I.R.C. § 752(b)*; *Rev. & Tax. Code § 17851*]. This constructive distribution reduces the basis of the contributor's partnership interest in an amount equal to the liability assumed by the partnership [*see I.R.C. § 733*; *Rev. & Tax. Code § 17851*]. If the constructive distribution exceeds the partner's tax basis in the partnership, the constructive distribution may produce taxable gain [*see I.R.C. § 731(a)*; *Rev. & Tax. Code § 17851*].

[5] Contributing Depreciable Property

Depreciation previously taken on contributed property is not recaptured when the property is contributed to a partnership [*see I.R.C. §§ 1245(b)(3), 1250(d)(3)*; *Rev. & Tax. Code § 17851*]. The partnership's holding period includes that of the contributing partner [*see I.R.C. § 1223(1)*; *Rev. & Tax. Code § 17851*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsContributions to Partnerships (IRC secs. 721-724)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsDistributions by Partnerships (IRC secs. 731-737)Character of Gains & LossesTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsTax Accounting (IRC secs. 701-703, 706)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsTransfers of Interest (IRC secs. 741-743)Basis



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.19

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.19 Taxation of Partnership Income

[1] Partnership Does Not Pay Tax

The basic premise of Subchapter K is that the partnership is only an accounting entity for determining items of income and loss that are to be allocated to the individual taxpayers (the partners) [*see I.R.C. § 701*; *see also I.R.C. §§ 701-761*]. Thus, partnerships file information returns but they do not, as entities, pay tax [*I.R.C. §§ 701, 6031*]. For California tax purposes, the taxation of partnerships generally conforms to federal law [*Rev. & Tax. Code § 17851*; *but see Rev. & Tax. Code §§ 17851.5* (application of tax for privilege of doing business to limited partnerships, limited liability companies, and limited liability partnerships), 17853-17857 (modifications of federal law), 17935 (tax on limited partnership)].

[2] Partnership Taxable Income

Partnership taxable income is computed in the same manner as individual taxable income, except that items of gains and loss must be stated separately [*I.R.C. § 703(a)(1)*; *see I.R.C. § 702(a)*], and the following deductions are not available to the partnership [*I.R.C. § 703(a)(2)*; *Treas. Reg. § 1.703-1(a)(2)*]:

- Personal exemptions [*see I.R.C. § 151*].
- Foreign taxes [*see I.R.C. §§ 164(a), 901*].
- Charitable contributions [*see I.R.C. § 170*].
- Net operating losses [*see I.R.C. § 172*].
- Specified individual itemized deductions [*see I.R.C. §§ 211-219*].

- Oil and gas depletion [*see I.R.C. § 611*].
- Standard deduction [*see I.R.C. § 63(c)*].
- Capital loss carryovers [*see I.R.C. § 1212*].

For California tax purposes, partnership taxable income is generally determined in accordance with Subchapter K of the Internal Revenue Code [*Rev. & Tax. Code § 17851*; *see I.R.C. §§ 701-761*; *but see Rev. & Tax. Code §§ 17853-17857* (modifications of federal provisions), 17851.5, 17935 (tax for privilege of doing business imposed on limited partnerships, limited liability companies, and limited liability partnerships)]. However, the deduction allowed by *I.R.C. § 164(a)* with respect to taxes paid to another state is not allowed to partnerships under California law [*Rev. & Tax. Code § 17853*].

[3] Partners Are Responsible for Income Tax

For both federal and California tax purposes, partners are responsible in their individual capacities for payment of income taxes on partnership income [*I.R.C. § 701*; *Rev. & Tax. Code § 17851*]. Liability for tax due on the distributive share attaches regardless of whether or not the share is actually distributed [*see I.R.C. §§ 701, 702*; *see also Rev. & Tax. Code § 17851*].

PRACTICE TIP:

When the partners intend to finance growth of their business with retained earnings, the partnership agreement can provide for an annual tax distribution in an amount that will satisfy the individual partners' tax liability on the retained earnings. *Commentary by John J. Camozzi*.

[4] Allocating a Partner's Distributive Share

Each item of taxable income or loss realized by the partnership is allocated between the partners, and the amount allocated to each partner is that partner's "distributive share," which is generally determined by the partnership agreement. Each partner must take into account separately the partner's distributive share of the following partnership items [*I.R.C. § 702(a)*]:

- Gains and losses from sales or exchanges of capital assets held for not more than one year.
- Gains and losses from sales or exchanges of capital assets held for more than one year.
- Gains and losses from sales or exchanges of property described in *I.R.C. § 1231* (relating to certain property used in a trade or business and involuntary conversions).
- Charitable contributions [*see I.R.C. § 170(c)*].
- Dividends that are subject to capital gains treatment [*see I.R.C. § 1(h)(11)*] or for which a corporate dividends-received deduction applies [*see I.R.C. §§ 241-249*].
- Taxes paid or accrued to foreign countries and United States possessions [*see I.R.C. § 901*].
- Other items of income, gain, loss, deduction, or credit to the extent provided by the regulations [*see Treas. Reg. § 1.702-1(a)(8)*].

- Taxable income or loss, exclusive of items requiring separate computation under the preceding paragraphs.

The purpose of these separate computations is to preserve the character of the items, such as charitable contributions, whose ultimate treatment depends on facts particular to each partner. Further, the tax character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share is determined at the partnership level as if the item was realized directly from the same source as that realized by the partnership, or incurred in the same manner as incurred by the partnership [*I.R.C. § 702(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partner Distributive Shares



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.20

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.20 Substantial Economic Effect

Generally, a partner's distributive share of income, gain, loss, deduction, or credit is determined by the partnership agreement [*see I.R.C. § 704(a)*]. If the partnership agreement provides for any special allocations of income, gain, loss, deduction, or credit, the IRS will not recognize the allocation if it does not have substantial economic effect [*see I.R.C. § 704(b)*].

To have substantial economic effect, a special allocation must affect the dollar amount of the partners' shares in total partnership income independent of tax consequences [*Treas. Reg. § 1.704-1(b)(2)(i),(iii)*]. For instance, a partnership agreement may allocate to a partner who lives in a foreign country a greater percentage of the profit derived from operations conducted by that partner within the country than the partner's distributive share of partnership income generally. An allocation of this type would have substantial economic effect and would be recognized absent other circumstances showing that its principal purpose was tax avoidance [*Treas. Reg. § 1.704-1(b)(2)*].

On the other hand, if a partnership agreement is amended to provide for a year in which the partnership incurs losses on the sale of depreciable property, by specially allocating those losses to one partner who has individual gains against which the losses could be used and an equal amount of partnership loss or deduction of a different character to other partners who could not use the losses, the special allocation would not withstand IRS scrutiny. Since the purpose and effect of this allocation would be solely to reduce the taxes of one partner without actually affecting any partner's share of partnership income, it would not have substantial economic effect and would not be recognized [*Treas. Reg. § 1.704-1(b)(2)*]. If a special allocation is not recognized, the distributive share to which it relates is determined in accord with the distributee partner's interest in the partnership (taking into account all facts and circumstances) [*I.R.C. § 704(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsAllocations of Basis (IRC secs. 704, 755)Tax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partner Income & Credits



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.21

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.21 Contributions of Property to Partnership

[1] Tax Problems

The partnership basis of property contributed by a partner is the adjusted basis of the property to the contributing partner at the time of the contribution [*I.R.C. § 723*; *Rev. & Tax. Code § 17851*]. Because the fair market value of contributed property may differ from the contributing partner's adjusted basis, potential tax problems surround contributions of property to partnerships.

Income, gain, loss, and deductions with respect to property contributed to the partnership by a partner must be shared among partners pursuant to Treasury Regulations so as to take account of the variation between the basis of the property and its fair market value at the time of contribution. Similar rules apply to contributions by a partner of accounts payable and other accrued but unpaid items [*I.R.C. § 704(c)(1)(A)*; *Rev. & Tax. Code § 17851*]. Special rules apply to (1) distributions of contributed property that occur within seven years of contribution [*see I.R.C. § 704(c)(1)(B)*; *see also I.R.C. § 704(c)(3)*]; (2) distributions of contributed property that would not result in gain or loss outside the partnership context [*see I.R.C. § 704(c)(2)*; *Rev. & Tax. Code § 17851*]; and (3) distributions of any contributed property that has a built-in loss at the time of contribution [*see I.R.C. § 704(c)(1)(C)*].

Contributing property that is subject to a liability may also have sales tax consequences. The transfer of property to a commencing partnership in which the partnership assumes the liability in whole or in part as consideration for the transfer may be a taxable sale under the California Sales and Use Tax Law [*Cal-Metal Corp. v. State Bd. of Equalization (1984) 161 Cal. App. 3d 759, 765, 207 Cal. Rptr. 783* ; *see Rev. & Tax. Code §§ 6001-7176*; *see also Ch. 17, Buying and Selling a Business or Professional Practice, § 17.12*]. If it is a sale, the contributing partner may owe sales tax on some portion of the liability assumed by the partnership [*see Cal-Metal Corp. v. State Bd. of Equalization (1984) 161 Cal. App. 3d 759, 768 769, 207 Cal. Rptr. 783]* .

[2] Property With Built-In Gain or Loss

[a] Built-In Gain or Loss Treatment

Built-in gain or loss on property contributed to a partnership is any unrecognized gain or loss on property contributed to the partnership. The built-in gain or loss is the difference between the property's fair market value at the time of contribution and the partner's adjusted basis in the property [*see Treas. Reg. § 1.704-3(a)(3)(ii)*]. This gain or loss is subject to special allocation rules designed to prevent the shifting of the tax consequences of the built-in gain or loss from the contributing partner to other partners. A partnership agreement does not have the required substantial economic effect if it does not account for built-in gain or loss as required under the Treasury Regulations [*see Treas. Reg. § 1.704-1(b)(2)(iv)(d)(3)*; for further discussion of substantial economic effect, *see § 15.20*].

[b] Effect of Distributing the Property

If built-in gain or loss property is distributed within seven years of being contributed to the partnership, the contributing partner must recognize any remaining built-in gain or loss. The character of the gain or loss is determined as if the property were sold to the distributee, and the partnership must make appropriate adjustments to reflect the partner's recognition of the gain or loss [*I.R.C. § 704(c)(1)(B)*].

[c] Allocating Built-In Gain or Loss

If the built-in gain or loss property is not distributed, the partnership must allocate the built-in gain or loss using a reasonable method to assure that the contributing partner receives the tax burdens and benefits of the built-in gain or loss. [*I.R.C. § 704(c)*; *Treas. Reg. § 1.704-3(a)(1)*]. The Treasury Regulations give three allocation methods that are deemed to meet the reasonable allocation standard [*Treas. Reg. § 1.704-3(a)(1)*]. They are the traditional method [*Treas. Reg. § 1.704-3(b)*], the traditional method with curative allocations [*Treas. Reg. § 1.704-3(c)*] and, under temporary regulations, the remedial allocation method [Temp. Treas. Reg. § 1.704-3T(d), (e)(3)]. Although there are three separate methods, in practice the traditional allocation method is used first, and if the ceiling rule under that method limits allocations, then curative or remedial allocations may be used [*Treas. Reg. § 1.704-3(c)(1)*; Temp. Treas. Reg. § 1.704-3T(d)].

[d] Traditional Method and Ceiling Rule

The traditional allocation method requires the allocation of built-in gain or loss to the contributing partner on the sale of the property, or a portion of the gain or loss if only a portion of the property is sold. The more complex requirement of the traditional method is the allocation of cost recovery deductions, depreciation, depletion, or amortization, among the partners to account for built-in gain or loss [*Treas. Reg. § 1.704-3(b)(1)*]. For example, assume that A and B form a partnership, AB, in which the partnership agreement provides that they are to share the profits equally. A contributes $10,000 in cash and B contributes machinery worth $10,000, but with an adjusted tax basis of $4,000. If, during the year, the partnership sells the machinery for $10,000, then under the traditional allocation method the $6,000 gain ($10,000 proceeds less $4,000 adjusted basis) is allocated to B, the contributing partner. However, if the machinery is kept for the year and depreciated on a straight-line basis over a 10 year period, then the partnership is entitled to $400 of tax depreciation (10 percent of adjusted basis of $4,000), although for book purposes the depreciation is $1,000 (10 percent of $10,000), divided equally between A and B for capital account purposes. Under the traditional allocation method, the tax depreciation is allocated entirely to A for the year. Thus, assuming the proceeds and operating expenses of AB are equal in that year, A will have a book value in the partnership of $9,500 ($10,000 less book deprecation of $500) and a tax basis of $9,600 ($10,000 less tax depreciation of $400). B will have also have a book value of $9,500, but B's tax basis will be $4,000. The built-in gain associated with the property will be reduced from $6,000 to $5,400 ($9,000 book value after book depreciation of $1,000, less $3,600 tax basis in property after depreciation of $400) [*Treas. Reg. § 1.704-3(b)(2)*].

In the above example, the ceiling rule operates to limit the allocation of depreciation to the noncontributing partner to

the actual tax depreciation allowed. Although allocations of deductions must take into account the built-in gain or loss, the total allocated to one partner in a taxable year may not exceed the allowable partnership deduction in the year [*Treas. Reg. § 1.704-3(b)(1)*].

[e] Traditional Method With Curative Allocations

If the ceiling rule limits allocations, a partnership may use the traditional method with curative allocations [*Treas. Reg. § 1.704-3(c)*]. Under this method the partnership may make curative allocations of partnership income, gain or loss, or tax deductions to cure disparities in the book and tax basis values of the cash partner caused by the operation of the ceiling rule noted above. Thus, in the above example, A, the cash contributing partner, had a tax basis of $9,600 and a book value basis of $9,500 at the end of the first year. If the partnership had earned income during the year and chose to use the traditional method with curative allocations, an extra $100 of income could have been allocated for tax purposes to B instead of A, thereby curing the disparity in tax and book capital accounts. The curative allocation would also have the effect of more quickly reducing B's built-in gain with respect to the contributed property [*Treas. Reg. § 1.704-3(c)(1)*].

Curative allocations may not exceed the amount necessary to offset the disparity caused by the ceiling rule [*Treas. Reg. § 1.704-3(c)(3)*] and must have the same effect on each partner's tax liability as the item limited by the ceiling rule. For example, an allocation of ordinary income can not be a curative allocation for capital gain [*Treas. Reg. § 1.704-3(c)(3)(iii)*].

[f] Remedial Allocations

Partnerships may use a remedial allocation method to eliminate ceiling rule disparities for noncontributing partners [Temp. Treas. Reg. § 1.704-3T(d)]. As with curative allocations, remedial allocations may only be made if the ceiling rule limits the allocation of income or deductions and causes a disparity in the noncontributing partner's tax and book basis. Remedial allocations are tax allocations of income or gain that are offset by tax allocations of loss or deduction. These tax allocations are created by the partnership and have no effect on the partnership's book capital accounts [Temp. Treas. Reg. § 1.704-3T(d)(1)].

The remedial allocation method requires that the partnership calculate the book value of the adjusted tax basis and the built-in gain of the contributed property separately. The adjusted tax basis of the property is recovered for book purposes in the same manner as other property, generally, over the property's remaining recovery period. However, the built-in gain--the amount by which the book basis exceeds the adjusted tax basis--is recovered using a recovery period and any applicable method that may be used for new property of a type that the partner contributed. Thus, if A contributes $10,000 in cash and B contributes property with a FMV of $10,000 and an adjusted basis of $4,000 with four years remaining in the cost recovery period partnership AB, the book value of the built-in gain and the adjusted tax basis of the property are recovered for book value purposes under different schedules. The adjusted tax basis is recovered over the remaining period; $4,000 over four years. The built-in gain of $6,000 is recovered, over a *new* recovery period of 10 years on a straight-line basis.

In this example, book depreciation is $1,600 per year divided equally between A and B, assuming the partnership agreement provides for equal division. The tax depreciation is allocated $800 to A and $200 to B. No remedial allocations are allowed during this period because there are no disparities between the noncontributing partner A's book depreciation and tax depreciation.

After four years when the property's tax depreciation basis is exhausted, A will still have book depreciation of $300 (of $600--$6,000 recovered over 10-year period) but no tax depreciation. Remedial allocations then may be made to correct the disparity between the noncontributing partner's book and tax depreciation.

Remedial allocations are tax allocations created by the partnership that have no effect on the partnership's book capital accounts. The allocations essentially are phantom transactions for tax purposes that assign remedial allocations of gain, loss or deduction to the noncontributing partner and simultaneous offsetting allocations to the contributing partner [Temp. Treas. Reg. § 1.704-3T(d)(1)]. Like curative allocations, remedial allocations must have the same effect on each partner's tax liability as the tax item limited by the ceiling rule [Temp. Treas. Reg. § 1.704-3T(d)(3)]. Thus, in the example above, the remedial allocations would be an allocation of tax depreciation of $300 per year to A and a corresponding and offsetting allocation of $300 of income to B. The income allocated to B must be of the same type of income as income from the property [Temp. Treas. Reg. § 1.704-3T(d)(5), Example 1(iii)(B)].

[g] Allocations on Property by Property Basis

Regardless of the allocation method used, built-in gain or loss must be accounted for on a property by property basis. Generally, gain or loss on different properties may not be aggregated [*Treas. Reg. § 1.704-3(a)(2)*]. However, aggregation of properties, other than real property, is allowed for (1) depreciable property that is in the same general asset account of both the partner and partnership, (2) zero-basis property, and (3) inventory, other than securities or similar investment interests, if the partnership does not use a specific identification method of accounting [*Treas. Reg. § 1.704-3(e)(2)*].

[h] Small Disparities

Small amounts of built-in gain or loss (small disparities) may be disregarded for special allocation purposes [*Treas. Reg. § 1.704-3(e)(1)(i)*]. Small disparities are differences of less than 15 percent between the partner's adjusted basis in the property and the book value for partnership purposes if the total disparity does not exceed $20,000. The fifteen percent and $20,000 figures are measured in the aggregate on all properties contributed by the partner [*Treas. Reg. § 1.704-3(e)(1)(ii)*].

[i] Anti-Abuse Rule

All methods of allocation are subject to an anti-abuse rule stated in the regulations. Under this rule, any allocation method or combination of methods that is used with a view to shifting the tax consequences of built-in gain or loss among the partners in a way that substantially reduces the present value of the partners' aggregate tax liability is not reasonable for purposes of qualifying under the regulation standards [*Treas. Reg. § 1.704-3(a)(10)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsBasis (IRC secs. 704, 705, 722-724, 731-735, 737, 742, 751, 754, 755)Optional AdjustmentsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsContributions to Partnerships (IRC secs. 721-724)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.22

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.22 Loss Allowance

[1] Loss Limited to Partner's Adjusted Basis

A partner's distributive share of partnership losses is allowed only to the extent of the partner's adjusted basis in the partnership at the end of the partnership taxable year in which the loss occurs [*I.R.C. § 704(d)*]. Any excess may be deducted at the end of the partnership year in which it is repaid to the partnership [*I.R.C. § 704(d)*]. A former partner cannot invoke the loss carryover provisions of *I.R.C. § 704(d)* in the tax year after he or she withdraws from the partnership [*Treas. Reg. § 1.704-1(d)*; *see Sennett v. C.I.R. (9th Cir. [T.C.] 1985) 752 F.2d 428 431]* .

[2] At Risk Limitations

Loss allowances are further limited for a partner who is any of the following: (1) an individual, (2) an S corporation, or (3) a closely held corporation in which five or fewer individuals own more than 50 percent of the stock [*see I.R.C. §§ 465(a)(1), 542(a)(2)*]. Such a partner may deduct losses from certain activities to the extent of the amounts the partner has at risk in the activity giving rise to the loss [*I.R.C. § 465(a)*]. Amounts at risk include: (1) the money and adjusted basis of other property contributed by the partner to the activity, and (2) amounts borrowed for use in the activity if the partner is personally liable for their repayment or has pledged property not used in the activity as security for the loan [*I.R.C. § 465(b)(1)*]. Amounts are not at risk if they are protected against loss through nonrecourse financing, guarantees, stop loss agreements, or other similar arrangements [*I.R.C. § 465(b)(4)*; *see Whitmire v. C.I.R. (9th Cir. 1999) 178 F.3d 1050, 1058* (limited partner held not at risk under *I.R.C. § 465* because he was protected from loss by *I.R.C. § 465(b)(4)*)]. However, amounts at risk also include the partner's share of any qualified nonrecourse financing that is secured by real property used in the activity of holding real property [*I.R.C. § 465(b)(6)(A)*; *I.R.C. § 465(b)(6)(E)* ("holding real property" defined)]. The "partner's share" will be determined on the basis of the partner's share of liabilities of that partnership incurred in connection with the financing [*I.R.C. § 465(b)(6)(C)*; *see I.R.C. § 752*]. "Qualified nonrecourse financing" means any financing (1) that is borrowed by a taxpayer with respect to the activity of holding real property [*see I.R.C. § 465(b)(6)(E)* (defined)]; (2) that is borrowed from a qualified person [*see I.R.C. §*

465(b)(6)(D)(i) (defined)] or from (or guaranteed by) any federal, state, or local government or instrumentality; (3) for which no person is personally liable for repayment; and (4) that is not convertible debt [*I.R.C. § 465(b)(6)(B)*].

[3] Passive Activity Limitations

The at-risk rule acts as a ceiling on the amount of loss that may be deducted for any activity. The passive activity rule then acts as a potential further limitation on the deductibility of losses that are otherwise allowable under the at-risk rule. An activity involving the conduct of a trade or business in which the taxpayer does not materially participate is denominated a "passive" activity for federal income tax purposes [*I.R.C. § 469(c)*]. Deductions and credit arising from passive activities may only be taken against income and tax liability attributable to all passive activities [*I.R.C. § 469(a)(1), (d)*]. Deductions and credits that are disallowed under the rule in any taxable year may be carried forward to the next taxable year but not back to any previous taxable year [*I.R.C. § 469(b)*].

For a detailed discussion of the passive activity rule, see Ch. 29A, *Joint Ventures* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsTax LawFederal Income Tax ComputationDeductions for LossesGeneral OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Loss Deduction Limitations (IRC sec. 704)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.23

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.23 Taxable Year of Partnership

[1] Consequences of Selecting the Partnership Taxable Year

Partners are taxed on their shares of partnership income for the taxable partnership year ending within the taxable year of the partner [*I.R.C. § 706(a)*; *Rev. & Tax. Code § 17851*]. Accordingly, if the principal partners are not all on the same taxable year, income from the partnership may be deferred for some or all of them through selection of the partnership taxable year.

Federal law allows three alternative methods of determining the taxable year of a partnership: the majority interest [*see* [2], *below]*, business purpose [*see* [3], *below*], and the alternative tax year election [*see* [4], *below*].

A partnership generally must select the same taxable year for California purposes as it selects for federal purposes except with approval of the Franchise Tax Board [*Rev. & Tax. Code § 17565(a)*].

[2] Majority Interest Taxable Year

The "majority interest" method determines the taxable year by reference to the partners. Specifically, it provides that the taxable year will be the "majority interest taxable year," if applicable [*I.R.C. § 706(b)(1)(B)(i)*; *Rev. & Tax. Code § 17851*]. That year is the taxable year of the partner or partners who, on specified "testing days," own an aggregate interest in the partnership's profits and capital of more than 50 percent [*I.R.C. § 706(b)(1)(B)(i), (4)(A)(i)*; *Rev. & Tax. Code § 17851*]. The "testing days" will be the first day of the partnership's existing taxable year (determined without regard to the above definition of majority interest taxable year), unless the Secretary prescribes different days [*I.R.C. § 706(b)(4)(A)(ii)*; *Rev. & Tax. Code § 17851*].

If a majority interest taxable year can not be determined, then the partnership taxable year will be the same as the taxable year of all of the principal partners [*I.R.C. § 706(b)(1)(B)(ii)*; *Rev. & Tax. Code § 17851*]. A "principal partner"

is a partner with a 5 percent or greater interest in partnership profits or capital [*I.R.C. § 706(b)(3)*; *Rev. & Tax. Code § 17851*]. If a taxable year cannot be determined on either basis, then the partnership's taxable year will be the calendar year unless another period is prescribed by IRS regulations [*I.R.C. § 706(b)(1)(B)(iii)*; *Rev. & Tax. Code § 17851*].

[3] Business Purpose

As an alternative to the majority interest taxable year, a partnership may select a taxable year that corresponds to its business. However, the partnership must establish to the satisfaction of the IRS that there is a business purpose for using that taxable year. Deferral of income to partners is not a business purpose in this regard [*I.R.C. § 706(b)(1)(C)*; *Rev. & Tax. Code § 17851*; *see Treas. Reg. § 1.706-1*].

[4] Electing Alternative Taxable Year

Under the alternative taxable year method, a partnership may elect to have a taxable year other than the required taxable year, majority interest, or business purpose [*I.R.C. § 444(a), (e)*; *Rev. & Tax. Code § 17551(a), (b)*]. This election may be made only if there is no more than a three-month period (known as the "deferral period" [*see I.R.C. § 444(b)(4)*]) between the beginning of the first taxable year under the election and the close of the first required taxable year (under *I.R.C. § 706(b)*) ending within that year [*I.R.C. § 444(b)*; *Rev. & Tax. Code § 17551(a), (b)*]. Thus, the partnership cannot elect a taxable year that has more than a three-month overlap with the taxable year that it would be required to use in the absence of such an election.

The election to use an alternative taxable year is made by filing IRS Form 8716 [*see* Ch. 2B, *Electing Subchapter S Status*]. If the partnership makes such an election, it must make the advance tax payments required by *I.R.C. § 7519* [*I.R.C. § 444(c)(1)*]. That section requires the partnership to pay the amount by which its "required payment" (the highest rate of tax under *I.R.C. § 1*, plus one percentage point applied to its net base year income, over the required payment for the preceding applicable election year) exceeds $500 [*I.R.C. § 7519(b)*].

An election of an alternative taxable year will remain in effect until the partnership changes its taxable year. A change to a required taxable year may be made without the consent of the Secretary [*I.R.C. § 444(d)(2)(A)*; *Rev. & Tax. Code § 17551(a), (b)*]. However, once the partnership terminates its election in this manner, it cannot elect another alternative year [*I.R.C. § 444(d)(2)(B)*; *Rev. & Tax. Code § 17551(a), (b)*].

I.R.C. § 444 is applicable to select a partnership taxable year for California taxation purposes [*Rev. & Tax. Code § 17551(a)*]. However, the advance payments under *I.R.C. § 7519* are not required for California [*Rev. & Tax. Code § 17551(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsTax LawFederal Income Tax ComputationTax AccountingTaxable Year (IRC secs. 441-444)Elections



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.24

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§ 15.24 Partnership Distributions

When a partnership transfers money or property to a partner in a transaction other than a loan, sale, or guaranteed payment, a distribution occurs [*Treas. Reg. § 1.731-1(c)(2), (3)*; *see Rev. & Tax. Code § 17024.5(d)*]. Any decrease in a partner's share of partnership liabilities and any assumption by the partnership of a partner's personal liabilities are treated as money distributions to the partner [*I.R.C. § 752(b)*; *Rev. & Tax. Code § 17851*]. Distributions are considered current for tax purposes if they do not result in a termination of the recipient partner's partnership interest [*Treas. Reg. §§ 1.731-1(a), 1.761-1(d); Rev. & Tax. Code § 17851*].

Gain on a current distribution is not recognized except to the extent that any money distributed exceeds the adjusted basis of the recipient partner's partnership interest immediately before the distribution [*I.R.C. § 731(a)(1)*; *Rev. & Tax. Code § 17851*]. No loss is recognized by a partner on a current distribution [*see I.R.C. § 731(a)(2)*; *Rev. & Tax. Code § 17851*].

Exceptions to the general rule of nonrecognition of gain or loss on current distributions are made in certain situations involving unrealized receivables and substantially appreciated property [*see I.R.C. § 751(b)(1)*; *Rev. & Tax. Code § 17851*]. The exception for distributions of unrealized receivables has particular application to professional partnerships in which a substantial portion of total assets are usually represented by open accounts.

The partnership has no gain or loss on distributions of property or money to a partner [*I.R.C. § 731(b)*; *Rev. & Tax. Code § 17851*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral

PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsDistributions by Partnerships (IRC secs. 731-737)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsDistributions by Partnerships (IRC secs. 731-737)Partner Retirement & DeathTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsDistributions by Partnerships (IRC secs. 731-737)Recognition of Gains & Losses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide §§ 15.25-15.99

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§§ 15.25[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
A. Client Interview Facts and Documents

7-15 California Legal Forms--Transaction Guide § 15.100

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.100 Facts

1. Names and addresses of all partners, including county in which each resides.

NOTE:
Each partner's county of residence is important since it will determine where suit for breach of the partnership agreement or violation of a duty to the partnership should be filed. Generally, proper venue for such actions is the county in which the defendant partner resides [***see*** *Code Civ. Proc. § 395*].

2. Names, addresses, and registered agents for service of process of every partner that is an entity rather than an individual.

NOTE:
When one of more of the prospective partners is an entity, it is good practice to obtain the names of the individual principals of the entity, determine if there are any potential conflicts of interest between them and the proposed partnership, and obtain waivers as necessary from the other partners.

3. Type and general characteristics of business to be conducted.

NOTE:
This information will be necessary to determine: (1) whether compliance with certain licensing requirements will be necessary; (2) what accounting method should be

employed; and (3) what, if any, special provisions should be included in a buy-sell agreement.

4. Proposed partnership name.

a. Which partners' names, if any, will be used.

b. If partners' names will not be used, what fictitious business name will be adopted [*see Bus. & Prof. Code §§ 17900-17930*].

c. Which partners' names will be retained after death, retirement, or other dissociation of a partner.

NOTE:
Continued use of a partnership name, or a dissociated partner's name as part of the partnership name, by partners continuing the business after a partner has dissociated, does not of itself make the dissociated partner liable for partnership obligations [*Corp. Code § 16705*].

5. Partnership address and principal place of business.

6. Term of partnership, including:

a. Date partnership will commence.

b. Length of time partnership is to continue, either:

(1) Specified period, or

(2) Until dissolved by agreement, or

(3) Until specified undertaking is completed, or

(4) Until dissolved by some specific act or event.

7. Initial capital.

a. Amount necessary to commence operations.

b. Initial capital contribution by each partner.

c. Property other than cash to be contributed by each partner, including;

(1) Detailed description of property.

(2) Value to be attributed to property on partnership books.

(3) Contributing partner's adjusted income tax basis for property.

NOTE:

This information will help to determine the following: (1) the contributing partner's initial tax basis for the partnership interest [***see*** *I.R.C. § 722*]; (2) the partnership's initial income tax basis for the contributed property [***see*** *I.R.C. § 723*]; and (3) whether the partnership agreement should provide for special allocations of gain, loss, depreciation, or income [***see*** *I.R.C. § 704*; ***see also*** discussion in *§ 15.21*].

8. Any arrangement for a partner to loan property or cash to the partnership.

9. Each partner's taxable year.

NOTE:
This information will help determine the partnership taxable year [***see*** *I.R.C. § 706*; ***see also*** discussion in *§ 15.23*].

10. Frequency with which partners require accountings of partnership affairs.

11. Each partner's distributive share of net partnership profits and losses; either:

NOTE:
Subject to contrary provision in the partnership agreement, partners share losses in the same proportion they share profits. If the partners' distributive shares of partnership profits are not specified in the partnership agreement, profits are shared equally [*Corp. Code § 16401(b)*].

a. Stated percentages to remain unchanged;

b. Stated percentages to vary with partnership taxable year;

c. Division based on units of participation in partnership business;

d. Division based on proportion of business brought in and amount of work performed by each partner; or

e. Partners' retention of percentage of income earned by them before net profits are computed and distributed.

12. Manner in which each partner's distributive share is to be paid.

a. Portion, if any, to be paid as regular salary or periodic draw.

NOTE:
Unless there are salary provisions in the partnership agreement, partners are not entitled to remuneration for services performed for the partnership [***see*** *Corp. Code § 16401(h)*].

(1) Basis for making salary determination (e.g., amount of time devoted to business).

(2) Whether salaries should be deducted before computing net profits or charged against partners' shares of net profits [*see I.R.C. § 707(c)*].

b. Information relevant to determination of what portion, if any, of distributive share is to be available as a draw:

(1) Amounts required by each partner for living expenses.

(2) Each partner's anticipated income taxes on partnership and non-partnership income.

(3) Anticipated income of partnership business.

(4) Anticipated income from sources other than partnership

(5) Growth potential of partnership business.

NOTE:
A business with good growth potential may require a large portion of partnership cash flow to be plowed back into the partnership operations in order to reach its full potential. Retained earnings financing requires consideration of how the partners will pay taxes on their undistributed income.

13. Amount of time each partner must devote to partnership business.

14. Partners' business experience and outside business activities, if any, and any restrictions to be placed on those activities.

NOTE:
The partner's duty of loyalty to the partnership includes, for example, the duty not to compete or engage in self-dealing [*Corp. Code § 16404(b)*]. The partnership agreement may, however, relax fiduciary duties by specifying types or categories of activities that do not violate the duty of loyalty, or may provide for partnership ratification, after full disclosure, of a specific act or transaction that would otherwise violate the duty of loyalty [*Corp. Code § 16103(b)*]. Partners who have manifold business interests may be unwittingly in violation of their duty of loyalty, so a provision in the partnership agreement for ratification is probably advisable in such cases. A gross disparity in the partners' business experience or the absence of a prior business relationship between the partners may justify heightened fiduciary duties.

15. Special duties, if any, each partner will perform.

a. Division of labor according to each partner's level of skill, training, or other factors.

b. Designate one partner as managing partner, or

c. Designate partners to serve on management committee.

NOTE:
Subject to contrary provision in the partnership agreement, all partners have equal rights in the management and conduct of the partnership business [*Corp. Code § 16401(f)*].

16. Limitation on ability of any partner to incur partnership liabilities.

NOTE:
Limitations on a partner's ability to bind the partnership generally will only be effective if also included

in the partnership statement of authority [***see*** *Corp. Code § 16303*].

17. Vote required for certain administrative and/or business matters, including:

a. Ordinary matters.

NOTE:

Subject to contrary provision in the partnership agreement, ordinary partnership matters may be decided by a majority of the partners. An act outside the ordinary course of partnership business, or an amendment to the partnership agreement, require the unanimous consent of the partners, unless the partnership agreement provides otherwise [*Corp. Code § 16401(j)*].

b. Expulsion of partners.

NOTE:

Absent an agreement to the contrary, expulsion of a partner will require the unanimous vote of the other partners when the grounds for expulsion are specified circumstances having to do with the partner's financial condition or capacity to engage business [***see*** *Corp. Code § 16601(4)*].

c. Admission of new partners.

NOTE:

Subject to contrary provision in the partnership agreement, no person can become a member of the partnership without unanimous consent of the partners [*Corp. Code § 16401(i)*].

18. Weight accorded each partner's vote.

NOTE:

Ordinarily, each partner's vote will count equally toward resolution of a partnership question [***see*** *Corp. Code § 16401(f)*]. The partners may wish to weight some votes more heavily than others and may do so in the partnership agreement (e.g., apportion voting power based on amounts of capital contributions). If one or more of several partners are actually to manage the partnership, counsel may want to consider at the outset whether an alternative entity, such as a limited liability company or limited liablity partnership, would be more appropriate.

19. Grounds for expulsion.

NOTE:

The bases on which partners may be expelled (involuntarily dissociated) may be spelled out in the partnership agreement. Subject to a contrary provision in the agreement, a partner can be expelled by the unanimous vote of the other partners for a variety of reasons (e.g., it is illegal to carry on the business with that partner, or the partner is a corporation that has dissolved) [*Corp. Code § 16601(2)-(4)*]. Other events, such as the bankruptcy, death, or incapacity of a partner are also statutory grounds for dissociating that partner [*Corp. Code § 16601(7)-(10)*].

20. Notice period required before dissociation will be effective.

NOTE:

The only condition the partnership agreement can place on a partner's ***power*** to dissociate from the partnership is a requirement that the notice of dissociation be in writing [*Corp. Code § 16103(b)(6)*]. There seems to be no statutory bar, however, to placing conditions on the ***right*** to dissociate, e.g., by requiring advance notice.

21. Disposition of outgoing partner's interest.

a. Sale to remaining partners.

b. Liquidation of interest.

c. Valuation method by which purchase price will be set.

NOTE:
Absent provisions in the agreement to the contrary, UPA '94 provisions for the buyout of a dissociated partner's interest will apply [see *Corp. Code § 16701*; ***see*** discussion in *§ 15.303[2]* in Part B of this chapter].

22. If cross purchase is to be funded by insurance, ascertain whether:

a. Arrangements for insurance have already been made; or

b. Each partner will carry insurance on all other partners; or

c. Partnership will carry insurance on all partners.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
A. Client Interview Facts and Documents

7-15 California Legal Forms--Transaction Guide § 15.101

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.101 Additional Facts for Professional Partnerships

NOTE:
In forming a professional partnership, obtain the following information, as well as the facts listed in § 15.100.

1. Each partner's experience, reputation, professional training, and age.

2. If existing solo practices are merging, manner in which work in progress will be valued.

3. License required for each partner.

   a. Effect that loss of a partner's license would have on partnership.

   b. Circumstances under which partner would be allowed to remain in a nonpracticing position.

4. Method for setting fees.

5. Method for distributing work in progress among partners upon dissolution.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationPartnership Agreements



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
A. Client Interview Facts and Documents

7-15 California Legal Forms--Transaction Guide § 15.102

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.102 Documents

1. If property other than cash is contributed to the partnership, obtain the following:

    a. Instrument (e.g., deed) conveying title to contributing partner.

    b. Documents of title to motor vehicles.

    c. Leases affecting contributed property.

    d. Licenses and permits, if any.

    e. Franchise agreements, if any.

    f. Financial statements for going businesses contributed.

    NOTE:
    Financial statements, while not determinative, will aid in computing both the adjusted tax basis and the fair market value of contributed businesses.

2. Insurance policies on all real and personal property contributed to the partnership.

3. Insurance policies, if already issued, to be used in funding cross purchase agreements.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionPartnership Liabilities



29 of 184 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
A. Client Interview Facts and Documents

7-15 California Legal Forms--Transaction Guide §§ 15.103-15.109

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

[Reserved]

§§ 15.103[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
B. Preliminary Determinations

7-15 California Legal Forms--Transaction Guide § 15.110

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.110 Formation of General Partnerships

1. Determine potential partners' objectives.

2. Determine name under which partnership will conduct business.

NOTE:
Ascertain necessity for filing a fictitious name certificate [***see*** *Bus. & Prof. Code §§ 17900-17930*].

PRACTICE TIP:
Name selection can be problematic because in addition to the ego and marketing issues, counsel must consider all prior uses of the name to avoid tradename or trademark infringement actions by established users. *Commentary by John J. Camozzi*.

3. Determine necessity for special licenses and/or permits.

4. Determine whether goodwill will be a major partnership asset.

NOTE:
Payments based on goodwill in the liquidation of an interest of a retiring or deceased partner will not be treated as payments in exchange for the partnership interest unless the partnership agreement provides so and the partnership is a service partnership (i.e., that capital is not a material income-producing factor) and the retiring or deceased partner is a

general partner in the partnership [***see*** *I.R.C. § 736(b)(2)(B), (3)*; ***see also*** *§ 15.24*].

5. Determine whether accounts receivable will be a major partnership asset.

NOTE:

Payments for unrealized receivables made in liquidation of a partnership interest are not treated as payments for partnership property unless the partnership agreement provides so and the partnership is a service partnership (i.e. capital is not a material income-producing factor) and the retiring or deceased partner is a general partner in the partnership [***see*** *I.R.C. § 736(b)(2)(A)*]. Unrealized receivables include services rendered or to be rendered [***see*** *I.R.C. § 751(c)(2)*].

6. Determine which accounting method will be used for partnership business.

a. Cash; or

NOTE:

A partnership that has a C corporation as a partner may not use the cash method of accounting, unless one of the following exceptions applies: (1) the partnership is a farming business; (2) the partnership's average gross receipts for the preceding three taxable years were $5,000,000 or less; (3) substantially all of the activities of the C corporation partner involve performing health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting services, and substantially all of the stock of the corporation is held by employees performing those services [*I.R.C. § 448*]; or (4) the taxpayer qualifies for and elects to use the special small business exception, under which the IRS allows certain taxpayers with annual gross receipts of $10 million or less to use the cash method of accounting [*Rev. Proc. 2002-28, 2002-1 C.B. 815*].

Furthermore, a "tax shelter" is prohibited from using the cash method of accounting under all circumstances [*I.R.C. § 448(a)(3)*]. A "tax shelter" is (1) an enterprise for which interests required to be registered with state or federal securities agencies have been sold; (2) a "syndicate," i.e., a partnership in which more than 35 percent of losses for the taxable year are allocable to limited partners or entrepreneurs [***see*** *I.R.C. § 1256(i)(3)(B)*]; or (3) a tax shelter [***see*** *I.R.C. § 6661(b)(2)(C)(ii)*] formed for the principal purpose of avoiding federal income tax [*I.R.C. § 448(d)(3)*; ***see*** *I.R.C. § 461(i)(3)*].

An S corporation will not be considered to be a tax shelter [***see*** *I.R.C. § 448(d)(3)* (definition)] merely because it is required to file a notice of exemption from registration with a state agency authorized to require such registration [***see*** *I.R.C. § 461(i)(3)(A)*] if there is a requirement applicable to all corporations offering securities for sale in the state that to be exempt from registration the corporation must file such a notice [*I.R.C. § 448(d)(3)*]. The California Department of Corporations requires all corporations issuing securities to either register the securities or file a notice of exemption [***see*** *Corp. Code §§ 25110, 25120, 25130* (registration requirements); *Corp. Code §§ 25100-25105* (exemption requirements); ***see also*** Ch. 6, ***Securities Regulation Issues***].

b. Accrual.

NOTE:

Partnerships likely to accumulate substantial accounts receivable (e.g., service or

professional partnerships) should not employ the accrual method since it will result in tax liability for amounts not necessarily realized [***see*** *I.R.C. § 446*].

PRACTICE TIP:

Parties utilizing the partnership entity usually anticipate flow through tax losses during the first few years of operation. The cash basis will generally provide a greater flow through tax loss than will the accrual basis. *Commentary by John J. Camozzi*.

7. Determine whether partners should maintain separate capital and income accounts [*see § 15.200[2]*], including:

a. Whether partner's income account balance will be transferred to capital account at close of partnership taxable year [*see § 15.200[2]*]; or

b. Whether partner's income account balance will be a loan to the partnership, including:

(1) What, if any, rate of interest loan will bear.

(2) The date from which interest will be due [*see Corp. Code § 16401(e)*].

NOTE:

Unless otherwise agreed, an advance made by a partner that exceeds the amount the partner agreed to contribute to partnership capital constitutes a loan to the partnership that accrues interest from the date of the payment or advance [*Corp. Code § 16401(e)*]. Unless another interest rate is specified, the rate will be that specified in *Civil Code § 3289*.

8. Determine partnership's taxable year [*see I.R.C. §§ 444, 706*; *see also* discussion in *§ 15.23*].

NOTE:

Unless the partnership elects a taxable year pursuant to *I.R.C. § 444* [***see*** (c), ***below***], its taxable year will be determined according the rules set forth in *I.R.C. § 706* [***see*** (a), (b), ***below***].

a. By reference to partners [*I.R.C. § 706(b)(1)(B)*]:

(1) Taxable year of one or more of partners who, on specified "testing days" [*see I.R.C. § 706(b)(4)(A)(ii)*; *see also § 15.23*] have greater than 50 percent aggregate interest in partnership profits and capital [*I.R.C. § 706(b)(1)(B)(i)*].

(2) If (1), above, does not apply, taxable year of all of principal partners [*I.R.C. § 706(b)(1)(B)(ii)*].

NOTE:

A "principal partner" is a partner with a 5 percent or greater interest in partnership profits or capital [*I.R.C. § 706(b)(3)*].

(3) If (1) and (2), above, do not apply, calendar year, unless other period is prescribed by regulations [*I.R.C. § 706(b)(1)(B)(iii)*].

b. Taxable year based on business purpose [*I.R.C. § 706(b)(1)(C)*].

NOTE:

In order to use such a taxable year, the partnership must establish, to the satisfaction of the Internal Revenue Service, that there is a business purpose for using that taxable year [*I.R.C. § 706(b)(1)(C)*; ***see*** *Treas. Reg. § 1.706-1*]. Deferral of income to partners is not a satisfactory business purpose in this regard [*I.R.C. § 706(b)(1)(C)*].

c. Any taxable year that partnership elects pursuant to *I.R.C. § 444*.

NOTE:

A partnership may elect to have a taxable year other than a taxable year determined by reference to the partners or established by its business purposes [*I.R.C. § 444(a), (e)*; ***see*** *I.R.C. § 706(b)(1)*]. Such an election may be made only if there is no more than a three-month period (known as the "deferral period" [***see*** *I.R.C. § 444(b)(4)*]) between the beginning of the first taxable year under the election and the close of the first required taxable year (under *I.R.C. § 706(b)*) ending within that year [*I.R.C. § 444(b)*]. This means a partnership may not elect a taxable year that has more than a three-month overlap with the taxable year that it would be required to use in the absence of such an election [*I.R.C. § 444(b)*]. If the partnership makes such an election, it becomes subject to the advance tax payments required by *I.R.C. § 7519* [*I.R.C. § 444(c)(1)*]. An election of an alternative taxable year will remain in effect until the partnership changes its taxable year. Once the partnership terminates its election in this manner, it cannot elect another alternative year [*I.R.C. § 444(d)(2)(B)*].

9. Determine what, if any, special allocations should be made.

NOTE:

Absent contrary agreement, the partners will share equally in profits and losses [***see*** *Corp. Code § 16401(b)*]. Equal distribution may be acceptable if the partners' capital contributions are roughly equal. In determining whether or not to make special allocations, consider (1) type of partnership involved; (2) the amount of each partner's capital contribution; (3) extent of any difference between the contributing partner's income tax basis and the fair market value of the contributed property; and (4) each partner's individual tax planning strategy.

10. Determine whether to elect out of partnership status for income tax purposes if [*I.R.C. § 761(a)*; *see Treas. Reg. § 1.761-2*]:

NOTE:

By avoiding partnership treatment under *Internal Revenue Code Section 761(a)*, the members of an investment partnership will be able to make inconsistent tax elections regarding income derived from the partnership. Normally, all elections regarding partnership income must be made at the partnership level and are reflected on the information return [***see*** discussion in *§ 15.19[4]*]. If, however, the partnership does not report income under the provisions of Internal Revenue Code Subchapter K, the partners may make elections on their individual returns regarding, for example, the methods under which they will take depreciation on partnership property and the manner in which they will report income from installment sales under *I.R.C. § 453*.

a. Partnership is formed for investment purposes only and not to conduct business; or

b. Partnership is formed for joint production, extraction, or use of property but not for sale of that property.

11. If a buy-sell agreement for purchase of a dissociating partner's interest is to be executed:

NOTE:

For more detailed coverage of buy-sell agreements, see Ch. 8D, ***Buy-Sell Agreements*** **.** The discussion in Ch. 8D is geared primarily to small, closely-held corporations, but a good deal of that discussion is applicable to partnerships as well.

a. Determine whether buy-sell provision should be included in partnership agreement or set out in a separate agreement incorporated by reference into partnership agreement.

b. Determine method of purchase:

(1) Sale of interest to remaining partners [*see I.R.C. § 741*].

(a) Remaining partners to have option to purchase or right of first refusal with liquidation by sale to partnership if right not exercised [*see § 15.200[2]*]; or

(b) Remaining partners required to purchase [*see § 15.250[2]*].

NOTE:

It may be impractical to require the remaining partners to purchase an outgoing partner's interest unless the means by which the purchase will be made (e.g., insurance proceeds) are provided for in the agreement [***see § 15.256[1], below***].

(2) Liquidation of interest by sale to partnership [*see I.R.C. § 736*].

c. Determine valuation method for purchase price [*see § 15.240*].

NOTE:

The value of a departing partner's interest in the partnership may be determined by any one or more of the following factors: (1) appraisal; (2) book value; (3) capitalized past average income; (4) capitalized goodwill; and (5) agreement of the partners. [For discussions of the various methods, their tax consequences, and the situations in which they should be employed, ***see*** *§§ 15.240-15.245, 15.303[2],* ***below*** ; ***see also*** *Neubauer v. Goldfarb (2003) 108 Cal. App. 4th 47, 54-57, 133 Cal. Rptr. 2d 218* , in which the court held that a waiver of corporate directors' and majority shareholders' fiduciary duties to minority shareholders in private close corporations is against public policy, and a contract provision in a buy-sell agreement purporting to waive any fiduciary duty with respect to fairness of overall consideration is void)].

PRACTICE TIP:

Depending on the nature of the partnership's business, limiting buy-sell provisions to only one valuation method may be contrary to the best interests of a dissociating partner and could be a breach of the attorney-client relationship. *Commentary by John J. Camozzi*.

d. Determine manner in which purchase price will be paid.

(1) Cash.

(2) Funded by proceeds of specific life insurance policy in the event of a partner's death.

(3) Property other than cash.

(4) Installment payments to withdrawing partner or deceased partner's estate, which may be evidenced by promissory notes and supported by security agreements.

(5) By paying portion of partnership income for specified period to partner or partner's estate.

NOTE:

Payments made in liquidation of a retiring or deceased partner's interest are considered distributive shares of partnership income if they are determined with regard to partnership income [*I.R.C. § 736(a)(1)*]. If payments are determined without regard to partnership income, they are guaranteed payments [***see** I.R.C. § 736(a)(2)*]. Since guaranteed payments are treated as ordinary income to the recipient, a retiring partner or deceased partner's estate will generally prefer to receive distributive shares. Even though the partnership may deduct guaranteed payments [***see** I.R.C. § 707(c)*; ***see also** I.R.C. § 162(a)*], the characterization of payments to a deceased or retiring partner will usually make little difference to the remaining partners because their distributive shares of partnership income will be proportionately reduced by any liquidation payments considered distributive shares.

e. If a deceased partner's interest is to be purchased with proceeds from a life insurance policy, determine which of the following plans to employ:

(1) Cross-purchase plan with each partner carrying policies on lives of all other partners; or

NOTE:

Cross-purchase plans are generally best suited for use by two-member partnerships in which the mechanics of maintaining the policies and collecting the proceeds are unlikely to be complex or time consuming [***see** § 15.256[1]*].

(2) Entity purchase plan with partnership carrying policies on all partners' lives, including:

NOTE:

Since entity purchase plans require the partnership to buy and maintain insurance policies on the partners' lives, they are particularly suitable for partnerships with many members (i.e., when it would be burdensome to require each partner to maintain policies on the lives of all others).

(a) How to share premium obligations.

(b) Whether policies will be held by escrow agent, in safe deposit box, or by trustee under an insurance trust.

f. Trustee plan with trustee named as beneficiary of policies issued under either cross purchase or entity purchase plans.

NOTE:

If partners are concerned about protecting their heirs or desire expert advice regarding the disposition of deceased partners' interests, a trustee, as an impartial fiduciary, should be employed [***see*** § 15.259].

g. Determine whether surviving or withdrawing partner should purchase policies issued on own life.

h. Determine which parties should execute buy-sell agreement.

(1) Partners.

(2) Partners' spouses.

(3) Trustee, if entity purchase plan is to be funded by insurance.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
B. Preliminary Determinations

7-15 California Legal Forms--Transaction Guide § 15.111

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.111 Additional Determinations for Professional Partnerships

1. Determine which, if not all, partners' names will appear in partnership name, including:

a. Whether to retain retired or deceased partners' names.

b. At what point, if any, dissociated partners' names will be deleted.

PRACTICE TIP:
The goodwill associated with a dissociated partner's name can have substantial value to the partnership, particularly when dissociation is caused by death or disability. An agreement to delete the dissociated partner's name may create a conflict of interest between the entity and the dissociated partner's estate. Name change provisions therefore should be carefully considered. *Commentary by John J. Camozzi.*

2. Determine which partners are likely to die or retire first, including:

a. Whether special early retirement provisions are necessary.

b. Whether retiree should continue association with partnership in any capacity other than partner (e.g., consultant).

NOTE:
Absent an express agreement to the contrary, retirement is not an event causing a partner

to be dissociated [***see*** *Corp. Code § 16601*].

3. If prior practices are merging, determine the following:

a. How existing accounts receivable should be treated [*see § 15.271[1]*].

(1) Transferred to new partnership; or

(2) Retained and collected by incoming partners in their individual capacities.

b. How work in progress should be treated.

(1) Completed by the partnership; or

(2) Completed by partner handling work prior to partnership formation.

c. How work in progress should be valued.

4. Determine whether or not to provide for gradual retirement.

5. Determine what should be done with partnership records pertaining to a dissociated partner.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
B. Preliminary Determinations

7-15 California Legal Forms--Transaction Guide §§ 15.112-15.119

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

[Reserved]

§§ 15.112[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
C. Procedural Guide

7-15 California Legal Forms--Transaction Guide § 15.120

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.120 General Procedures

1. Prepare fee agreement and conflicts of interest disclosures.

2. Prepare partnership agreement and have it executed by:

a. Partners.

b. Partners' spouses.

NOTE:
It is particularly important that the partners' spouses execute the agreement or a separate consent form if the agreement provides for purchase of a deceased partner's partnership interest [***see*** § 15.259].

3. Prepare certificate of fictitious name, if necessary [*see Bus. & Prof. Code §§ 17900-17930*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*].

4. Be sure appropriate licenses and permits are obtained prior to commencing partnership operations:

a. Accountants register partnership and obtain permit to practice in partnership name from State Board of Accountancy, 1021 O Street, Sacramento, CA 95814 [*see Bus. & Prof. Code §§ 5070, 5072*].

NOTE:

A partner in an accounting firm must submit an affidavit containing information required by the Board [***see*** *Bus. & Prof. Code § 5075*]. Until the accounting partnership has been registered, it should not use the designation C.P.A. or P.A. [*Bus. & Prof. Code §§ 5055, 5056, 5072(a)*].

b. [Reserved]

c. Civil engineers and licensed land surveyors within 30 days of partnership formation, register with State Board of Registration for Civil and Professional Engineers, 1021 O Street, Sacramento, CA 95814 [*see 16 Cal. Code Reg. § 463(b)*].

d. Collection agencies obtain license in partnership name from State Collection Agency Licensing Bureau, 1021 N Street, Sacramento, CA 95814 [*see Bus. & Prof. Code §§ 6875, 6877*].

e. Contractors obtain separate partnership license before submitting any joint bid for work [*see Bus. & Prof. Code § 7029*].

f. Private investigators and adjusters obtain license from State Bureau of Collection and Investigative Services, 1430 Howe Avenue, Sacramento, CA 95825 [*see Bus. & Prof. Code § 7525*; *see also 16 Cal. Code Reg. §§ 600-651*].

NOTE:

Each partner must file a separate application in the partnership name but only one need satisfy the examination and experience requirements for a partnership license [***see*** *16 Cal. Code Reg. § 651*].

g. Landscape architects notify State Board of Landscape Architects, 1021 O Street, Sacramento, CA 95814 if forming partnership with lay person.

NOTE:

The licensed landscape architect's signature and license number, and the date must appear on all service instruments [*Bus. & Prof. Code § 5642*]. Lay partners may not be identified as landscape architects [*Bus. & Prof. Code § 5642*].

h. Physicians, surgeons, and podiatrists apply for permit from Division of Licensing of the Board of Medical Quality Assurance, 1021 O Street, Sacramento, CA 95814, if engaging in practice under a fictitious name [*see Bus. & Prof. Code §§ 2393, 2429*].

NOTE:

It is a misdemeanor to practice medicine under a fictitious name unless the necessary permit is obtained [***see*** *Bus. & Prof. Code § 2429*].

i. If partnership business will involve sale of personal property on which sales tax must be charged, do the following [*see* Ch. 17, *Buying and Selling a Business or Professional Practice*]:

(1) Submit application for sales and use tax permit to State Board of Equalization [*see Rev. & Tax. Code § 6066(a)*].

NOTE:

Applications for tax permits must be authenticated in a form or pursuant to methods prescribed by the SBE [*Rev. & Tax. Code § 6066(a)*]. The application may be filed using

electronic media, as prescribed; electronic media includes but is not limited to computer modem, magnetic media, optical disk, facsimile machine, or telephone [*Rev. & Tax. Code § 6066(b), (c)*].

(2) Prepare to deposit security with the Board in an amount no greater than twice the partnership's average estimated quarterly sales tax liability [*see Rev. & Tax. Code § 6701*].

5. Establish partnership books and records, reflecting accounting method (cash or accrual) and taxable year (calendar or fiscal).

6. Obtain tax identification number for partnership by submitting I.R.S. Form SS-4.

7. If a principal partner will have a taxable year other than that of the partnership, secure Internal Revenue Service and Franchise Tax Board approval [*see Treas. Reg. § 1.442-1(b)(1)*; *see also Rev. & Tax. Code § 17552*].

8. If partner elects taxable year pursuant to *I.R.C. § 444*, submit IRS Form 8716 (election form) by earlier of [Temp. Treas. Reg. § 1.444-3T]:

NOTE:

Such an election may be made only if there is no more than a three-month period (known as the "deferral period" [***see** I.R.C. § 444(b)(4)*]) between the beginning of the first taxable year under the election and the close of the first required taxable year (under *I.R.C. § 706(b)*) ending within that year [*I.R.C. § 444(b)*]. This means, essentially, that the partnership cannot elect a taxable year that has more than a three-month overlap with the taxable year that it would be required to use in the absence of such an election. For further discussion, see *§ 15.23[4]*.

a. Fifteenth day of fifth month following month that includes first day for which election will be effective; or

b. Due date (without regard to extensions) of income tax return.

9. If partnership elects taxable year based on business purpose [*I.R.C. § 706(b)(1)(C)*; *see § 15.23[3]*], submit IRS Form 1128 on or before last day of month following close of taxable year to be adopted [*see Treas. Reg. § 1.442-1(b)*].

NOTE:

An existing partnership may only change its tax year by securing the Commissioner's approval [***see** I.R.C. § 442*] or by making an *I.R.C. § 444* election. However, approval is automatic for certain changes, such as a change to the required tax year pursuant to administrative procedures [*Treas. Reg. 1.706-1(b)(8)(i)(A)*].

To obtain approval, see *Treas. Reg. § 1.442-1(b)* [*Treas. Reg. 1.706-1(b)(10)*]. If not automatic, approval will be granted if the taxpayer establishes a "substantial business purpose." However, approval will not be granted unless the Commissioner and the taxpayer agree to terms, conditions, and adjustments under which the change will be effected [*Treas. Reg. § 1.442-1(b)*]. Deferral of income to partners is not a satisfactory business purpose [*I.R.C. § 706(b)(1)(C)*].

10. Establish bank accounts where partnership funds will be deposited.

a. Designate specific partner(s) as signatory for accounts.

b. Rent safe deposit box and designate partner(s) who will have access to it.

11. Obtain all necessary insurance coverage, including:

a. Casualty policies on partnership property.

b. Life coverage, if required to fund buy-sell agreement.

12. Negotiate and execute leases, if necessary, for partnership business premises and equipment.

PRACTICE TIP:

Counsel may also have to prepare personal guarantees of partners and their spouses if third parties demand them as a condition of doing business with an unseasoned partnership. *Commentary by John J. Camozzi*.

13. Make certain that partners' wills provide that all documents necessary to dispose of their partnership interests at death be executed and delivered in accord with:

a. Provisions of their buy-sell agreement, if any; or

b. Their wills.

PRACTICE TIP:

Extreme care should be taken when providing estate planning services to individual partners who are not counsel's named clients. Confidential disclosures can create ethical problems that may not be avoided by a conflicts disclosure and waiver. *Commentary by John J. Camozzi*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
C. Procedural Guide

7-15 California Legal Forms--Transaction Guide § 15.121

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.121 Statement of Partnership Authority

NOTE:

Filing a statement of partnership authority is not mandatory but is advisable if the partnership will hold title to real property or wishes to limit the authority of some or all the partners with respect to transactions with third parties [***see*** *Corp. Code § 16303*]. A common limitation on authority is the prohibition on any partner binding the partnership in a transaction exceeding a specified dollar amount without the co-signature of at least one other partner.

1. Prepare statement of partnership authority [*see Corp. Code § 16303(a)*; *see also § 15.285*], including:

a. Partnership name.

b. The street address of its chief executive office and of one office in California.

c. The names and mailing addresses of all partners or of an agent appointed and maintained by the partnership for the purpose of maintaining a list of the names and mailing addresses of all partners [*Corp. Code § 16303(b)*].

d. The names of the partners authorized to execute an instrument transferring real property held in the partnership's name.

e. The authority, or limitations on the authority, of some or all partners to enter into other

transactions on behalf of the partnership and any other matter.

2. Have statement of authority executed by at least two partners [*Corp. Code § 16105(c)*].

3. File statement of partnership authority with the Secretary of State and file copy certified by Secretary of State with recorder in each county where partnership holds real property [*Corp. Code § 16105(a), (b)*].

NOTE:

The Secretary of State's filing fee is $70 [*Corp. Code § 16112*]. The fee for recording documents is $10 for the first page and $3 for each additional page [***see*** *Gov. Code §§ 27361, 27364* (certification under seal fee determined by board of supervisors)]. A recorded statement that is not a copy certified by the Secretary of State will not have the effect given to such statements by UPA '94.

Generally speaking, the effect of filing and recording a statement of authority will be to protect bona fide transferees for value and to permit the partnership to recover partnership property the transfer of which was contrary to a limitation on authority [***see*** *Corp. Code §§ 16302, 16303*; ***see also*** *Federal Deposit Insurance Corp. v. Superior Court (1997) 54 Cal. App. 4th 337, 345-348, 62 Cal. Rptr. 2d 713* (interpreting former *Corp. Code § 15010.5*, predecessor statute under former UPA)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersAuthority to Act



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
C. Procedural Guide

7-15 California Legal Forms--Transaction Guide §§ 15.122-15.129

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

[Reserved]

§§ 15.122[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
D. Drafting Guide

7-15 California Legal Forms--Transaction Guide § 15.130

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.130 Standard Provisions

NOTE:
Unless otherwise indicated, all bracketed section references to text are to the Forms in this Part.

1. Names of all partners [*see § 15.200[2]*].

2. Type of business in which partnership will engage [*see §§ 15.200[2], 15.201[2]*], including:

a. Authority for partnership to engage in other types of businesses, if desired [*see § 15.200[2]*].

b. Number of partners necessary to approve partnership entry into new business [*see § 15.200[2]*].

3. Partnership name [*see § 15.200[2]*].

4. Partnership term:

a. Indefinite term (e.g., continuation until terminated or dissolved by mutual agreement) [*see § 15.201[2]*].

b. Fixed term [*see § 15.201[2]*].

(1) If desired, partnership continuation on notice or, in absence of notice, automatically.

NOTE:
When a fixed term partnership is continued without an express agreement, the partners' rights and duties remain the same as they were at the time the term expired, so far as is consistent with a partnership at will. Partners who continue a fixed term partnership without any settlement or liquidation of the partnership are presumed to have agreed that the partnership will continue [*Corp. Code § 16406*].

(2) If desired, imposition of liquidated damages on premature withdrawal of partner.

(3) If desired, partnership termination on death or incapacity of a partner.

5. Place(s) where partnership will conduct business, including [*see § 15.201[2]*]:

a. Addresses.

b. Name of each county.

6. Each partner's initial capital investment.

a. State amount of cash and/or agreed market value of property or services contributed [*see § 15.200[2]*].

b. Describe fully any property or services contributed.

c. If cash contributions are to be made, specify following:

(1) Amount each partner will contribute.

(2) Bank and account where deposit will be made.

(3) Date by which each partner must make required deposit.

7. Special allocations of following items as they relate to contributed property [*see § 15.219*]:

a. Depreciation.

b. Depletion.

c. Gains on sales.

d. Losses on sales.

NOTE:
Special allocations regarding contributed property are required to take into account any variation between the contributing partner's basis in the property and its fair market value at the time of contribution [***see** I.R.C. § 704(b), (c)(2); Treas. Reg. § 1.704-3(a)(1); **see also** § 15.21*].

8. If desired, a provision assuring that partners' capital investments remain in same proportion as their initial capital contributions [*see § 15.200[2]*] by:

a. Prohibiting contributions without unanimous consent of partners.

b. Prohibiting withdrawals without unanimous consent of partners [*see § 15.200[2]*].

c. Requiring pro rata contributions from partners [*see § 15.200[2]*].

9. Conditions under which additional contributions may be required, including [*see* 15.212]:

a. Guidelines for determining needed capital.

b. Method for determining amounts required from each partner.

c. Provision whereby partner who contributes portion greater than original share will receive:

(1) Correspondingly greater share of partnership earnings, and

(2) Increase in partnership interest to reflect contribution.

d. Provision for reduction in percentage of partnership interest for partner who:

(1) Makes no contribution, or

(2) Does not make additional contribution in proportion to original partnership interest.

10. Amounts, if any, of contributions to be treated as loans to partnership, including [*see § 15.200[2]*]:

a. Terms for repayment, including interest.

b. Any security interest created in connection with sums advanced, and any agreement to subordinate to subsequent third party secured creditors.

NOTE:
Subject to the partnership agreement, a partner who makes an advance to the partnership in excess of the amount agreed to be contributed entitled to interest from the date of contribution [*Corp. Code § 16401(e)*].

11. If separate capital and income accounts are maintained [*see §§ 15.200[2], 15.201[2]*]:

a. Provision establishing accounts.

b. Provision for disposition of unwithdrawn shares, if any, in partnership income.

(1) Automatic transfer to capital account at end of fiscal year [*see § 15.200[2]*], or

(2) Transfer into capital account only with partner's consent.

NOTE:
Subject to contrary agreement, each partner is entitled to have a partnership account that is credited with an amount equal to the partner's contribution (net of liabilities) and the partner's share of profits. The account is charged with an amount equal to the money or value of property distributed to the partner, plus the partnership losses [*Corp. Code § 16401(a)*].

12. Distribution of partnership profits and losses, including:

a. Salaries, if any, to be received by partners [*see § 15.202*].

(1) Basis for payment (e.g., partner's special skills for which a portion of salary is to be paid, amount of time each partner will devote to partnership business, etc.).

(2) Whether salaries will be:
(a) Deducted before computing net profits and distributive shares, or

(b) Charged against partners' shares of net profits.

NOTE:
To the extent that they are determined without regard to partnership income, payments made to a partner for services or use of capital are "guaranteed payments" [*I.R.C. § 707(c)*]. Guaranteed payments are gross income to the recipients and may generally be deducted by the partnership [***see** I.R.C. §§ 61(a), 162(a), 707(c)*; ***see also** I.R.C. § 263*].

(3) If partner(s) engaged in the management will receive additional salary, basis on which it will be determined.

NOTE:
Subject to contrary agreement, no partner is entitled to remuneration for conducting partnership business [*Corp. Code § 16401(h)*].

(4) Provision for salary adjustments, if desired.

b. Formula for computing partners' distributive shares in net profits and losses [*see § 15.201[2]*].

NOTE:
Subject to contrary agreement, partnership profits and losses are shared equally [*Corp. Code § 16401(b)*; ***see*** discussion in *§ 15.17[3]*].

(1) Percentages related to capital contributions that remain unchanged, or

(2) Percentages stated yearly for each partner, or

(3) Division of fees or charges between partners who secured income generating business and performed services, or

(4) Division based on units of participation in overall partnership business.

c. Time frame for distributions (e.g., monthly, quarterly).

d. If desired, distributions to be made pursuant to specified vote of partners.

13. Guidelines for partnership management.

NOTE:
Subject to contrary agreement, all partners have equal rights in the management and conduct of partnership business [*Corp. Code § 16401(f)*].

a. Managing partner [*see § 15.270[2]*], or

b. Management committee [*see § 15.276[2]*], or

c. Management by majority vote of all partners [*see § 15.201[2]*], or

d. Management by vote of all partners weighted in accord with their interests in net partnership profits [*see § 15.270[2]*].

14. Restrictions, if any, on authority of partners and managers [*see § 15.201[2]*].

15. Specify provisions governing partnership meetings, including [*see § 15.201[2]*]:

a. Regular meetings at particular time and place.

b. Special meetings at call of designated number or percentage in interest of the partners.

c. Notice and waiver of notice.

d. Attendance in person, by electronic media (e.g., telephone), or waiver of attendance through signed written consent.

e. Regular minutes to be placed in partnership book.

16. Specify partners' voting rights on partnership matters.

NOTE:
Subject to contrary agreement, differences arising in the ordinary course of business may be decided by majority vote of the partners, but an act outside the ordinary course of business and an amendment to the partnership agreement require unanimous consent [*Corp. Code § 16401(j)*].

a. Weighted voting [*see § 15.270[2]*].

b. Issues requiring voting margins other than a majority (e.g., unanimous or three-fourths approval).

PRACTICE TIP:
Weighted voting (e.g., a majority of the outstanding partnership interests) is often preferred over straight supermajority voting (e.g., three-fourths of the partners) when the partners have made unequal contributions to the partnership. *Commentary by John J.*

Camozzi.

17. Amount of time each partner is required to devote to partnership business.

a. Undivided time [*see § 15.200[2]*], or

b. Less than full time [*see § 15.225[2]*].

c. If desired, limit partner's right to engage in other business activities.

18. Limitations on partners' power to incur partnership liabilities [*see § 15.200[2]*].

a. Maximum amount of liability any partner may incur on behalf of the partnership.

b. Coordinate liability limits with provisions regarding partnership management (e.g., give managing partner exclusive authority to incur partnership liabilities).

c. Indemnification of partners by partnership for payments made and personal liabilities reasonably incurred [*see Corp. Code § 16401(c)*]:

(1) In the ordinary and proper conduct of partnership business.

(2) For the preservation of partnership business or property.

19. Manner in which accounts will be maintained, including [*see § 15.201[2]*]:

a. Requirement that proper partnership books be kept.

b. Provision for inspection of partnership books.

NOTE:
The partnership agreement cannot unreasonably restrict the partners' right of access to books and records or the right to be furnished with information concerning the partnership business [*Corp. Code § 16103(b)*].

c. Accounting method to be used.

d. Partnership taxable year.

e. Requirement for periodic accountings to partners (e.g., at close of taxable year, quarterly).

f. If desired, institutions at which partnership accounts and safe deposit boxes are established.

20. Partnership policies respecting the following:

a. Vacations.

b. Sick leave.

c. Extended absences.

d. Expense accounts.

21. Restrictions on transfer or assignment of a partner's transferable partnership interest [*see § 15.14[2]*].

NOTE:

The only interest a partner has to sell is that partner's "transferable interest," i.e., that partner's share of partnership profits and losses and the right to receive distributions [*Corp. Code § 16502*]. A partner who transfers that interest (other than as security) may, however, be expelled from the partnership, either because (1) the transfer violates the terms of the partnership agreement, (2) it is a self-executing event that causes dissociation, or (3) because the remaining partners unanimously vote to expel [***see** Corp. Code § 16601*].

22. Restrictions on transfer or assignment of partnership property.

NOTE:

Although partners generally have authority to act on behalf of the partnership [***see** Corp. Code § 16301*], the partnership agreement can limit a partner's authority to deal with partnership property or conduct business on behalf of the partnership [***see** Corp. Code §§ 16302, 16303*]. Any limitation of a partner's authority to act on behalf of the partnership should also be made explicit in the statement of partnership authority filed with the Secretary of State and with the recorder in a county in which the partnership owns real property, indicating the scope of a partner's authority to generally act on behalf of the partnership and specifically to convey real property [*Corp. Code § 16303(d)*].

23. Scope of fiduciary duties of partners.

NOTE:

Although the general rule is that the duties of care, loyalty, and good faith and fair dealing that a partner owes the partnership and other partners cannot be waived [***see** Corp. Code § 16103(b)*], if it would not be manifestly unreasonable to do so, the partnership agreement may tailor the scope of these duties to fit the needs of the partners and the partnership [*Corp. Code § 16103(b)*; ***see*** discussion in *§ 15.17[4]*].

a. Identify specific types or categories of activities that do not violate a partner's duty of loyalty.

b. Provide for a ratification by all or by specified number or percentage of other partners of acts that would otherwise violate duty of loyalty.

c. Provide standards by which the performance of an obligation is to be measured so that the obligation of good faith and fair dealing will not be violated.

24. Admission of new partners [*see § 15.201[2]*].

NOTE:

Subject to contrary agreement, no person can become a member of the partnership without the consent of all partners [*Corp. Code § 16401(i)*].

a. Manner of admission, including:

(1) Vote required.

(2) Selection process, if desired (e.g., committee of partners to screen potential members).

b. Method for allocating net profits and capital reserves to new partners.

NOTE:

Absent a contrary agreement, persons admitted into an existing partnership are not personally liable for any partnership obligation incurred before the person's admission [*Corp. Code § 16306(b)*].

25. Manner in which partnership agreement may be amended [*see § 15.270[2]*].

NOTE:

For federal tax purposes, a partnership agreement includes all modifications made prior to or at the time the partnership return is filed, so long as all partners agree to the modification or it is otherwise adopted in a manner specified by the partnership agreement [***see** I.R.C. § 761(c)*]. If the agreement or any modification is silent as to a specific matter, local law will govern for federal tax purposes [***see** Treas. Reg. § 1.761-1(c)*].

In California, although a written partnership agreement might require amendments to the agreement to be in writing, this type of provision may be waived. The partners may orally agree on a change of some kind--for instance, to modify the written agreement's formula for allocating profits to the partners--and the irregular amendment will be effective because the partners agreed to it, even though the prescribed method for amending the agreement was not followed [*Richard B. LeVine, Inc. v. Higashi (2005) 131 Cal. App. 4th 566, 587, 32 Cal. Rptr. 3d 244] .*

26. Partners' retirement.

a. Compulsory retirement at specified age, or

b. Voluntary retirement, or

c. Gradual retirement [*see § 15.280[2]*].

27. Expulsion of partners, including [*see § 15.200[2], Section 4.01*; *see also Corp. Code § 16601*]:

a. Bases for expulsion, e.g.:

(1) Violation of any term contained in partnership agreement.

(2) Failure to make required contributions.

(3) Loss of professional license or threat of disciplinary action [*see § 15.270[2]*].

(4) Bankruptcy [*see § 15.270[2]*].

(5) Assignment for benefit of creditors [*see § 15.270[2]*].

(6) Partner's involvement in litigation detrimental to partnership [*see § 15.270[2]*].

(7) Willful breach of partnership agreement [*see § 15.201[2]*].

(8) Disability extending beyond specified period.

(9) Transfer of partner's transferable interest in profits and losses.

b. Method in which expulsion will be accomplished.

(1) Require vote of specified portion of partners [*see § 15.270*].

(2) Set forth formal expulsion procedures (e.g., service of written notice signed by each partner on partner to be expelled) [*see § 15.201[2]*].

(3) Self-executing on violation of partnership agreement.

28. Notice required of dissociating partners.

NOTE:

A partner may voluntarily dissociate from the partnership upon giving notice or at later date specified by the partner [*Corp. Code § 16601(1)*]. The partnership agreement cannot limit a partner's power to dissociate, but it can require written notice be given by withdrawing partners [*Corp. Code § 16103(b)(6)*].

PRACTICE TIP:

Requiring that a dissociating partner give written notice of dissociation may be in the best interests of the partnership and the continuing partners, but may run counter to the best interests of the dissociating partner. When the attorney is representing the individual partners, requiring written notice may, at the very least, create a conflict of interest, and at worst, violate the attorney-client fiduciary duty. This issue becomes most problematic when a partner dissociates from the partnership in an emotionally charged state. In such situations, the dissociating partner may simply give oral notice of dissociation and walk away from the partnership in anger or disgust, though not in breach of the partnership agreement. The dissociating partner may reasonably believe that he/she is no longer a partner and that nothing further is required to terminate his/her partnership relationship. The dissociating partner's failure to submit written dissociation notice may make the dissociation ineffective, or if effective, may make the dissociation wrongful (because it would be in breach of the partnership agreement), and may expose the dissociated partner to continuing partnership liabilities or partner liabilities caused by the wrongful dissociation [*see Corp. Code § 16602(c)*]. This can be particularly troublesome when the partners are not sophisticated or the dissociating partner is reluctant or unable to retain dissociation counsel. Formation counsel should use care in requiring written notification of dissociation. *Commentary by John J. Camozzi*.

29. Valuation of dissociated partners' interests based on:

NOTE:

Unless the agreement provides otherwise, the partnership must buy out a dissociated partner's interest at a price determined by what the value of the interest would be on dissolution of the partnership, based on the greater of the liquidation value of the assets or the going concern value (without the dissociated partner) of the partnership, with interest paid from the date of dissociation until the date of payment [*Corp. Code § 16701(a), (b)*]. If no agreement for the buyout is reached within 120 days after the partner demands payment, the partnership is required to pay an estimated buyout price, less offsets [*Corp. Code § 16701(d)*]. Tender of a deferred payment is authorized in the event the partner wrongfully dissociated

before the end of the term of the partnership [*Corp. Code § 16701(h)*]. A dissociated partner may sue the partnership to have the buyout price determined by the court if the partner declines a tendered payment or payment is not made [*Corp. Code § 16701(i)*]. See the discussion in *§ 15.303[2]*.

a. Book value, whether partially or totally [*see § 15.242[2]*], or

b. Appraisal of partnership assets [*see §§ 15.201[2], 15.245[2]*], or

c. Stipulation regarding value of partnership property in excess of book value [*see § 15.243[2]*], or

NOTE:
Periodic updates and stipulations as to the fair market value of partnership assets will be an attractive method if those assets can be expected to substantially appreciate or decline in value. The book value will reflect decreases in asset value attributable to depreciation, but it will not necessarily represent fair market value of a partnership interest.

d. Require partners to annually set value on all partnership interests [*see §§ 15.240[2], 15.241[2]*], or

e. Require all parties to agree on value at the time of loss of partner subject to arbitration if they are unable to agree.

30. Terms on which a dissociating partner or partner's estate will be paid for interest.

a. Lump sum payment [*see § 15.202[2]*], or

b. Periodic payments [*see § 15.200[2]*].

NOTE:
Absent an agreement to the contrary, the partnership is required to pay interest on the buyout price from the date of dissociation until the date of payment [*Corp. Code § 16701(b)*].

31. If desired, continuing payments to retired partners or deceased partners' successors in interest, specifying allocation among the following bases:

NOTE:
The way in which the partnership agreement allocates liquidation payments will determine (1) whether or not the partnership will be able to deduct the payments, and (2) to what extent and in what manner the payments will be taxed to the recipient [***see** I.R.C. §§ 61(a), 707(c), 736(a), (b), 751(c)*].

a. Partnership income [*see I.R.C. § 736(a)(1)*].

b. Guaranteed payments [*see I.R.C. § 736(a)(2)*].

c. Unrealized receivables [*see I.R.C. § 736(b)(2)(A)*].

d. Goodwill [see *I.R.C. § 736(b)(2)(B)*].

32. Procedures to be followed on dissolution.

NOTE:

With some exceptions, the partners are free to agree on which events will cause the partnership to dissolve, the vote required to effect a dissolution, the circumstances under which the partners' right to have the business wound up may be waived and the partnership continued, and the persons who may participate in the winding up of the partnership [***see*** *Corp. Code §§ 16801-16803*].

a. Events causing dissolution, e.g., [*see Corp. Code § 16801*]:

(1) All or a specified percentage of the partners vote to dissolve for any reason.

(2) Dissociation of a key partner.

(3) Premature dissociation of a partner in a partnership for a definite term or particular purpose.

(4) An event makes it unlawful for the partnership business to be continued.

b. Termination and winding up of partnership affairs [*see Corp. Code §§ 16803-16807*; *see also § 15.302*].

(1) Persons authorized to wind up partnership business.

(2) Required filing of statement of dissolution.

(3) Order of distribution of partnership assets and settlement of partners' accounts.

33. If desired, a requirement that disputes among partners be subject to arbitration. [*see § 15.226[2]*].

34. If desired, partners' approvals required for a conversion or merger of partnership into another entity [*see Corp. Code §§ 16901-16917*; *see also* Part C of this chapter].

35. If desired, an applicable law provision [*see § 15.201[2]*].

36. Spousal consents [*see § 15.200[2]*].

NOTE:

Every partnership agreement should contain a clear expression of spousal consent.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersAuthority to ActBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersManagement & Voting



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
D. Drafting Guide

7-15 California Legal Forms--Transaction Guide § 15.131

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.131 Additional Provisions for Professional Partnerships

NOTE:
The following as well as the foregoing provisions should be included in professional partnership agreements.

1. Effect that partner's loss of professional license will have on partnership.

NOTE:
Some professionals are precluded from practicing with lay people or must notify state regulatory agencies if they intend to do so.

a. Automatic expulsion on loss of license, or

b. Continued association with partnership in nonpracticing capacity.

2. Manner of setting fees for services rendered.

a. Include specific formula, or

b. Set forth general policy.

3. If desired, a hold harmless or indemnity agreement for any liability based on professional negligence.

4. Additional bases for expulsion, including:

a. Conviction of crime involving moral turpitude and affecting partnership.

b. Misconduct of a nature that reflects adversely on partnership reputation.

NOTE:
A provision for expulsion based on misconduct will be particularly appropriate for a partnership that relies on reputation or community standing for business (e.g., law firms or medical clinics).

c. Resignation from professional organization under threat of disciplinary action.

5. Manner in which clients will be notified of a partner's withdrawal, including:

a. Contents of notice and provision for withdrawing partner's approval;

b. Whether withdrawing partner's clients will be assigned to remaining partners; or

c. Whether withdrawing partner will have the right to retain files relating to work in progress.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
D. Drafting Guide

7-15 California Legal Forms--Transaction Guide § 15.132

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.132 Buy-Sell Agreement Provisions

NOTE:
A buy-sell provision may be included in the partnership agreement or executed separately and incorporated into the partnership agreement by reference. For detailed coverage of buy-sell agreements, see Ch. 8D, ***Buy-Sell Agreements*** , which is geared primarily to small, closely-held corporations but is generally applicable to partnership buy-sell agreements as well.

1. Identity of purchaser of withdrawing partner's interest.

a. If remaining partners are to purchase:
(1) Whether or not purchase will be mandatory.

(2) Whether or not partnership business is to be continued after purchase.

b. If partnership is to purchase, whether the interest will be:

(1) Liquidated [*see § 15.251[2]*];

(2) Distributed among remaining partners [*see § 15.250[2]*]; or

(3) Resold to new partner.

2. Procedure for placing value on partner's interest.

NOTE:

This procedure should conform to that specified in the partnership agreement for evaluation of partnership assets and interests [***see*** *§ 15.270[2]*]. See also *Neubauer v. Goldfarb (2003) 108 Cal. App. 4th 47, 54-57, 133 Cal. Rptr. 2d 218* , in which the court held that a waiver of corporate directors' and majority shareholders' fiduciary duties to minority shareholders in private close corporations is against public policy, and a contract provision in a buy-sell agreement purporting to waive any fiduciary duty with respect to fairness of overall consideration is void.

3. If payment is to be in cash:

a. Lump sum payment [*see § 15.202[2]*];

b. Payment from future profits as a continued distributive share [*see § 15.253[2]*]; or

c. Payment from proceeds of life insurance policy on deceased partner [*see §§ 15.260-15.262*].

4. If provisions of agreement are triggered by partner's death, a requirement that [*see § 15.260[2]*]:

a. Each partner's will reflect the existence of the buy-sell agreement;

b. All conveyances and other documents necessary to performance under the buy-sell agreement be executed by the deceased's personal representative; and

c. Profits earned after partner's death will be allocated to remaining partners.

5. If agreement is to be funded by insurance proceeds, include the following:

a. Partner's agreement to purchase life insurance policies under:

(1) Cross-purchase arrangement [*see § 15.260[2]*]; or

(2) Buy-out arrangement [*see § 15.261[2]*].

b. Provision for ownership of the policies [*see § 15.262[2]*].

c. Provision regarding premium payments, including:

(1) Who will be responsible for payment.

(2) From what source funds for premium payments will be taken.

d. Include provision allowing partner to purchase policy on own life under the following circumstances [*see §§ 15.260-15.262*]:

(1) When cross-purchase arrangement was entered into and a sole surviving partner remains; or

(2) When a partner withdraws from the partnership; or

(3) On termination of the partnership.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersAuthority to ActBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersTransfers of InterestsContracts LawTypes of ContractsPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
D. Drafting Guide

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§§ 15.133[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

7-15 California Legal Forms--Transaction Guide § 15.140

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§ 15.140 Change in Partnership Taxable Year

NOTE:
The following procedures must be taken on or before the last day of the month in which the new taxable year begins.

1. Submit IRS Form 1128 to Commissioner of Internal Revenue, Washington, D.C. 20224 [*see Treas. Reg. § 1.442-1(b)*].

NOTE:
An existing partnership may only change its tax year by securing the Commissioner's approval [***see** I.R.C. § 442*] or by making an *I.R.C. § 444* election. However, approval is automatic for certain changes, such as a change to the required tax year pursuant to administrative procedures [*Treas. Reg. 1.706-1(b)(8)(i)(A)*].

To obtain approval, see *Treas. Reg. § 1.442-1(b)* [*Treas. Reg. 1.706-1(b)(10)*]. If not automatic, approval will be granted if the taxpayer establishes a "substantial business purpose." However, approval will not be granted unless the Commissioner and the taxpayer agree to terms, conditions, and adjustments under which the change will be effected [*Treas. Reg. § 1.442-1(b)*].

If all individual partners are changing to the same taxable year, their individual changes must be approved by the IRS and the FTB [***see** Treas. Reg. § 1.442-1(b)*].

2. Submit copy of IRS Form 1128 to California Franchise Tax Board.

NOTE:
Obtain formal approval before adjusting partnership books and records to reflect new taxable year.

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Income Tax ComputationTax AccountingTaxable Year (IRC secs. 441-444)General OverviewTax LawFederal Income Tax ComputationTax AccountingTaxable Year (IRC secs. 441-444)Changes in Accounting PeriodsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsTax Accounting (IRC secs. 701-703, 706)Taxable Year of Partnerships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

7-15 California Legal Forms--Transaction Guide § 15.141

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.141 Federal and State Information Returns

PRACTICE TIP:

Counsel, who will not be preparing the partnership tax returns, should consider referring the client to a tax professional and monitoring the latter's compliance with the matters listed below. Generally, the earlier the tax professional works with the partnership, the stronger the partnership's team of professional advisors and service providers will be. *Commentary by John J. Camozzi.*

1. Designate a partner to be "tax matters partner."

NOTE:

A partnership must have a "tax matters partner" (TMP) to act as a liaison between the partnership and the IRS on tax issues [***see*** *I.R.C. § 6231(a)(7)*; ***see also*** *Treas. Reg. § 301.6231(a)(7)-1*]. Among other responsibilities, the TMP gives notice to the other partners of tax proceedings, makes tax decisions that bind the other partners, and petitions the IRS for readjustments [***see*** *I.R.C. §§ 6223(g), 6224(c)(3), 6226(a)*]. The TMP of a partnership is either (1) the general partner designated as the TMP, or (2) if no such partner is designated, the general partner having the largest profits interest in the partnership at the close of the taxable year. If there is more than one such partner, the first such partner alphabetically is the TMP [*I.R.C. § 6231(a)(7)*]. If the partnership has not designated a tax matters partner and it is impracticable [***see*** *Treas. Reg. § 301.6231(a)(7)-1(o)* (determination of impracticability)] to apply the largest-profits-interest rule, the Commissioner will select a tax matters partner [*I.R.C. §*

6231(a)(7); *Treas. Reg. § 301.6231(a)(7)-1(n), (p)*; ***see*** Temp. Treas. Reg. § 301.6231(a)(7)-1T(p)(2)]. Within 30 days of that selection, the Secretary must notify all partners entitled to notice [***see*** *I.R.C. § 6223(a)*] of the name and address of the selected TMP [*I.R.C. § 6231(a)(7)*; ***see*** *Treas. Reg. § 301.6231(a)(7)-1(r)*; ***see also*** Temp. Treas. Reg. § 301.6231(a)(7)-1T(r)(1)]. The person designated as TMP must be, or have been, a general partner during the taxable period in question [*Treas. Reg. § 301.6231(a)(7)-1(b)(1)*].

2. File IRS Form 1065 [Treas. Reg. § 1.6031-1(a)]:

a. With District Director of Internal Revenue for district where partnership's principal place of business is located [*see* Treas. Reg. § 1.6031-1(e)(1)].

b. On or before [*I.R.C. § 6072(a)*]:
(1) April 15 if partnership is on calendar year.

(2) Fifteenth day of fourth month following close of taxable year if partnership is on fiscal year.

3. File Franchise Tax Board Form 565:

a. With Franchise Tax Board, 1025 P Street, Sacramento, CA 95814.

b. On or before 15th day of fourth month following close of partnership taxable year.

4. If partnership is reporting its income for first time, include the following with both federal and state returns [*see Treas. Reg. § 1.441-1(c)*, 1.706.1(b)(7)].

a. Copies of letters from Commissioner of Internal Revenue and Franchise Tax Board approving adoption of partnership taxable year other than that of all principal partners; or

b. Statement that partnership taxable year is same as that of all principal partners; or

c. Statement that all principal partners are concurrently changing to taxable year adopted by partnership; or

d. Statement that all principal partners are on different taxable years and partnership has adopted a calendar year.

5. If partnership changes taxable year, file separate return for period beginning on day after former taxable year closed and ending day before new taxable year [*see I.R.C. § 443(a)*; *Treas. Reg. § 1.443-1(a), 1.706-1(b)(8)(i)(B)]*.

a. Include copy of letter from IRS Commissioner approving adoption of new year.

NOTE:
An existing partnership may only change its tax year by securing the Commissioner's approval or by making an *I.R.C. § 444* election. However, approval is automatic for certain changes, such as a change to the required tax year pursuant to administrative procedures [*Treas. Reg. 1.706-1(b)(8)*].

b. By 15th day of fourth month after close of short period.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsPartnership Tax Returns (IRC sec. 6031)Information ReturnsTax LawState & Local TaxesGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

7-15 California Legal Forms--Transaction Guide §§ 15.142-15.199

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

[Reserved]

§§ 15.142[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
1. Complete Partnership Agreements

7-15 California Legal Forms--Transaction Guide § 15.200

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.200 Long Form for Commercial Partnership

[1] Comment

[a] Use of Form

This form is a detailed partnership agreement for partnerships that will engage in commercial operations and in which the partners will be personally active. It may be adapted for use in any partnership in which the partners will all actively participate in the partnership business. See *§ 15.201[2]* for a form to be used for an investment partnership, and § 15.202[2] for a short form partnership agreement.

The form provides for separate capital and income accounts, with the balance of the income accounts at the end of each fiscal year to be transferred to the capital accounts. It provides each partner with a drawing account, but does not pay the partners salaries for their efforts in the partnership business. See § 15.203[2] for a monthly salary provision.

[b] Partnership Agreement and UPA '94

The partnership agreement governs relations among partners and between partners and the partnership except to the extent limited by law. Relations between the partnership and partners or among partners that are not covered by the partnership agreement default to the UPA '94 provisions [*Corp. Code § 16103(a)*]. See *§ 15.17[2]* for a discussion of the partnership and partner relations that may not be changed by the partnership agreement.

[c] Partnership Term

Section 1.03 of this form establishes an at-will partnership. The at-will partnership continues until dissolved by the

agreement of the partners. This form provides specific authority for dissolving the partnership. A percentage of the partners or partnership interests can be authorized to dissolve the partnership. Under UPA '94, at least half of the partners must agree to dissolve the partnership [*Corp. Code § 16801(1)*]. See the *form in § 15.201[2]* for an example of a form used to create a term partnership. See the discussion at *§ 15.302[2]* for events that may cause the dissolution of an at-will partnership.

[d] Capital Contributions

Article 2 of the agreement requires equal contributions by the partners and forbids additional contributions, withdrawal of capital, or loans to the partnership, without consent of all partners. The agreement anticipates a working partnership with all partners devoting equal time and money to the partnership business. Article 2 may need modification if one or more partners are more active in, or contribute more capital to the partnership than other partners. If a partner will contribute property to the partnership that has a fair market value greater or less than the partner's adjusted basis, special allocation provisions should be included. See the discussion in *§ 15.21* and the form to use in *§ 15.219[2]*.

PRACTICE TIP:

If the partners are not devoting equal time and resources to the partnership, or it will be managed by less than all the partners, the passive or less active partners may prefer a different entity structure, such as a limited liability company or limited partnership. *Commentary by John J. Camozzi*.

[e] Management

This form gives equal rights in the management and conduct of partnership business. In this respect it follows the UPA '94 [*Corp. Code § 16401(f)*]. Note, however, that the language of the form gives each partner one vote. This is consistent with other provisions of the agreement that require equal contributions to the partnership capital and equal shares of the profit. This arrangement may, however, be altered to allow weighting the vote according to partnership interests held by partners when each partner does not contribute equally to the partnership.

[f] Capital and Income Accounts

Article 2 of the agreement requires separate capital and income accounts for each partner. This provisions allows for the possibility of future unequal contributions, and allows for easy computation of each partner's contributions to the partnership. See the more detailed discussion in *§ 15.216[1]* on separate capital and income accounts.

[g] Dissociation

This form contains provisions setting forth specific reasons for dissociation [*Corp. Code § 16601*; *see § 15.301[2]* for discussion of dissociation under UPA '94]. The form allows remaining partners to purchase a dissociating or deceased partner's interest for a price that is to be determined by appraisal. This buy-out arrangement is different from the UPA '94 buy-out provision under *Corp. Code § 16701*, but variation of the buy-out formula is permitted by partnership agreement. Other buy-out formulas for computing a deceased or dissociated partner's interest are found in the forms in *§§ 15.240* through *15.249*.

A individual partner's power to dissociate may not be modified by the partnership agreement. The partnership agreement may require, however, that a partner give written notice of his or her intent to dissociate [*Corp. Code § 16103(b)*]. This form does contain such a requirement. In addition, this form requires that the written notice be given in advance of dissociation. Although the agreement may not stop a partner from dissociating without advance notice, it appears that the failure to give advance notice as required by agreement would make a partner's dissociation wrongful, and subject the partner to any attendant liabilities for damages caused by dissociation without notice [*Corp. Code § 16602(c)*].

PRACTICE TIP:

Requiring dissociating partners to give written notice may be advantageous from the partnership's perspective, but not so from the point of view of the dissociating partner. Dissociations can be emotionally charged events, and when the partnership relation is failing and a partner dissociates by walking away in disgust, that partner, though not otherwise in breach of the partnership agreement, may believe he/she is no longer a partner but may not think to submit a formal written notice of dissociation. This can be particularly troublesome when the dissociating partner is not sophisticated and is reluctant or unable to retain dissociation counsel. Formation counsel should use care in requiring written notice of dissociation and avoiding conflicts of interest. *Commentary by John J. Camozzi*.

[h] Partners' Personal Debts

This form requires that all partners hold their co-partners harmless for personal debts. Upon application, a partner's judgment creditor may charge the amount of any unsatisfied judgment against the debtor's transferable partnership interest [*Corp. Code § 16504*]. Although specificpartnership property may not be reached by a partner's creditor, the other partners may have no alternative but to satisfy their co-partner's personal debt to avoid foreclosure sale of the partnership interest [*Corp. Code § 16504(b), (c)*].

[2] FORM

Long Form for Commercial Partnership

PARTNERSHIP AGREEMENT

This Partnership Agreement ("Agreement") is made on _____[*date*], by _____[*name*], _____[*name*], and _____[*name*], (whose names, addresses, taxpayer identification numbers, and partnership interests are listed on exhibit A, attached to and made part of this Agreement) hereinafter referred to as "Partners."

RECITALS

In consideration of the mutual covenants contained in this Agreement, the Partners agree to form a general partnership ("Partnership") for the purposes and under the terms, provisions, and conditions set forth below.

It is therefore agreed:

ARTICLE 1. NATURE OF PARTNERSHIP

Type of Business

Section 1.01. The Partnership shall engage in the general business of _____ [*e.g.*, the manufacture and wholesale distribution of wine racks] and shall have the power do perform any acts in furtherance of that business.

PRACTICE TIP

The partnership business should be narrowly defined in order to limit the scope of the partners' fiduciary duties with respect to other business activities [*see, e.g., Kelton v. Stravinski (2006) 138 Cal. App. 4th 941, 948, 41 Cal. Rptr. 3d 877* (because partnership agreement limited partnership business to one specific warehouse development project, provided that partners could participate independently in

competitive real estate activities and provided that partners had no obligation to refer any business opportunity to partnership, partner could engage independently in other warehouse development projects and had no duty to account for profits to either partnership or other partner)]. *Commentary by John J. Camozzi*.

Name of Partnership

1.02. The name of the Partnership shall be _____.

Term of Partnership

1.03. The Partnership shall commence on _____[*specify, e.g.*, the execution of this Agreement *or* _____ [*date*]], and shall continue until dissolved by agreement of the Partners.

Place of Business

1.04. The Partnership's principal place of business shall be at _____ Street, _____, California, or at any other place or places that may be agreed on by the [*or* a majority of the] Partners.

ARTICLE 2. FINANCIAL

Initial Capital

2.01. The initial capital of the Partnership shall be the sum of the amounts listed in Exhibit A as the initial capital contributions of the Partners.

Additional Contributions to Capital

2.02. No Partner shall be required to make additional contributions to the capital of this Partnership. No Partner shall be allowed to make a voluntary contribution to capital without the written consent of all other Partners.

Withdrawal of Capital

2.03. No portion of the Partnership capital may be withdrawn at any time without the express written consent of all Partners.

Interest on Capital

2.04. No Partner shall be entitled to interest on contributions to the capital of the Partnership. [*For an alternative provision providing for the payment of interest on the capital contributions of the partners, see § 15.218[2].*]

Loans to Partnership

2.05. No Partner may loan or advance money to the Partnership without the written consent of a majority of the other Partners. Any loan by a Partner to the Partnership shall be separately entered in the Partnership books as a loan to the Partnership, shall bear interest at a rate agreed on by the lending Partner and a majority of the remaining Partners, and shall be evidenced by a promissory note delivered to the lending Partner and executed in the name of the Partnership by a majority of the remaining Partners.

Books of Account

2.06. Complete and accurate accounts of all Partnership transactions shall be kept in proper books. Each partner shall enter in the Partnershipbooks an accurate account of all transactions carried out by such Partner on behalf of the Partnership.

Inspection of Books

2.07. The books of account and other Partnership records shall, at all times, be kept in the Partnership's principal place of business. Each Partner, or that Partner's attorney, accountant, or legal representative shall, at all reasonable times, have access to, and may inspect and copy, any Partnership books and records.

Method of Accounting

2.08. The Partnership books of account shall be kept on a cash [*or* accrual] basis.

Fiscal Year

2.09. The fiscal year of the Partnership shall end on the _____day of [*month*] of each year.

Accountings

2.10. As soon after the close of each fiscal year as is reasonable, a full and accurate inventory and accounting shall be made of the Partnership affairs as of the close of the fiscal year. In making the accounting, the net profit or net loss sustained by the Partnership during such fiscal year shall be ascertained and credited or debited, as the case may be, in the Partnership books of account, to the respective Partners in the proportions specified in Section 2.12 of this Agreement.

Definition of Profits and Losses

2.11. The terms "net profits" and "net losses" as used in this Agreement mean the net profits and net losses of the Partnership as determined by generally accepted accounting principles for each accounting period provided for in this Agreement.

Profits and Losses

2.12. The net profits or net losses of the Partnership shall be credited or charged, as the case may be, to the Partners in _____[equal proportions *or* the following proportions: _____(*specify proportions*,

e.g., _____ [*name*] 50 percent, _____[*name*] 30 percent, _____[*name*] 20 percent)].

Capital Accounts

2.13. A separate capital account shall be maintained for each Partner. Each Partner's capital account shall consist of the following:

(1) That Partner's initial contribution to the Partnership capital as set forth in Exhibit A of this Agreement;

(2) That Partner's additional contributions to Partnership capital under Section 2.02 of this Agreement; and

(3) Any amounts transferred from the income to the capital account of that Partner under Section 2.14 of this Agreement.

Income Accounts

2.14. A separate income account shall be maintained for each Partner. At the end of each fiscal year each Partner's share of the net profits or net losses of the Partnership shall be credited or debited to, and withdrawals during that fiscal year deducted from, that Partner's income account. After those amounts have been credited or debited to and deducted from a Partner's income account, any balance or deficit remaining in the account shall be transferred to or charged against that Partner's capital account. [*For alternative provisions for requiring separate income and capital accounts, and a discussion of the reasons for separate accounts, see § 15.216.*]

Bank Accounts

2.15. All Partnership funds shall be deposited in accounts in the name of the Partnership at any bank or banks in _____ County, California, that may from time to time be selected by a majority vote of all Partners. All withdrawals from any such account or accounts shall be made only by check or other written instrument signed by at least two Partners.

ARTICLE 3. RIGHTS AND DUTIES OF PARTNERS

Time Devoted to Partnership

3.01. Each Partner shall devote undivided time and attention to the Partnership business and shall not engage or invest in any other business, except the ownership of stock or bonds listed on a national securities exchange, without the consent of all other Partners. [*For an alternative provision not requiring one or more partners to devote their undivided time and attention to the partnership business, see § 15.225.*]

Salaries

3.02. No Partner shall be entitled to any salary or other compensation for services in the Partnership business. [*For an alternative provision specifying that each partner will be entitled to a specified salary deductible by the partnership before determination of net profits, see § 15.202[2].*]

Draws

3.03. Each Partner shall be entitled to withdraw from the Partnership funds the sum of $ _____ per month for personal use. Each withdrawal by a Partner shall be charged against that Partner's share of the Partnership net profits for the fiscal year in which made. If the total withdrawals by any Partner during any such fiscal year exceeds that Partner's share of the net profits for that year, the Partner shall be entitled to no further withdrawals until the deficiency has been repaid to the Partnership.

The limitation on the amount of withdrawals contained in this paragraph may be increased or decreased at any time by unanimous consent of the Partners.

Management

3.04. Each Partner shall have an equal voice in the management and conduct of the Partnership business. Any differences arising among the Partners as to ordinary matters connected with the Partnership business shall be decided by a majority vote of the Partners, each Partner having one vote. No act in contravention of this Agreement, however, may be done without the consent in writing of all the Partners.

Statement of Partnership

3.05. Concurrent with the execution of this Agreement, the Partners shall cause to be filed with the California Secretary of State a Statement of Partnership Authority pursuant to *California Corporations Code Section 16303* setting forth the Partners' rights to equal management and control of the Partnership and any limitations thereon as set forth in this Agreement. The Partnership shall cause the Statement of Partnership Authority be recorded in every county in which the Partnership owns, or contemplates owning, real property.

Power to Incur Liabilities

3.06. Each Partner shall have authority to bind the Partnership in making contracts and incurring obligations in the Partnership name and on its credit in the ordinary course of the Partnership business. No Partner, however, shall incur any obligation in the Partnership name or on its credit exceeding the sum of $ _____ without the consent of the other Partners. Any Partner who incurs any obligation in the name and on the credit of the Partnership in violation of this provision shall be individually liable to the other Partners for the entire amount of the obligation incurred. The $ _____ limitation on the amount of an obligation that may be incurred by a Partner may be increased or decreased at any time by agreement of all Partners.

Vacations

3.07. Each Partner shall be entitled to a vacation of one business day for each _____ days of full time service rendered by that Partner to the Partnership business during the preceding twelve month period. No more than _____ vacation days shall be taken by any Partner at one time without the consent of _____ percent in numbers [*or* all] of the remaining Partners. Each Partner shall be entitled to withdraw from the Partnership funds the amounts specified in Section _____ [*e.g.,* 3.03] of this Agreement during vacation periods.

Penalty for Extended Absence

3.08. The failure of any Partner not disabled, as provided in Section 4.02 of this Agreement, to devote undivided time and attention to the Partnership business for a period exceeding _____ weeks shall constitute an extended absence by that Partner. That Partner shall forfeit to the Partnership $ _____ per week for each week of absence. The amount forfeited will be charged to the absent Partner and distributed to the other Partners in the proportion that their respective shares of the Partnership net profits and net losses bear to one another.

Reimbursement of Expenses

3.09. The Partnership shall indemnify all Partners for payments made and personal liabilities reasonably incurred by them in the ordinary and proper conduct of the Partnership business or for the preservation of Partnership business or property.

Prohibited Acts

3.10. No Partner shall, without the consent of all other Partners:

(a) Loan any Partnership funds;

(b) Extend Partnership credit to any person a Partner has notified the Partnership not to trust;

(c) Incur any obligations in the name or on the credit of the Partnership except in the ordinary course of the Partnership business; and

(d) Become bail, surety, or indorser for any other person. Any loss sustained by the Partnership because of the breach of this paragraph by any Partner shall be deducted from that Partner's share of the Partnership net profits, or if the net profits for the fiscal year in which the breach occurred be insufficient, from that Partner's capital interest in the Partnership.

Personal Debts

3.11. All Partners shall discharge their separate obligations as they become due and protect the other Partners and the Partnership from all costs, claims, and demands in relation to those obligations.

Assignment of Interest

3.12. No Partner shall sell, assign, mortgage, hypothecate, or encumber an interest in the Partnership.

Inventions

3.13. Any inventions, whether patentable or not, developed or invented by any Partner during the term of this Partnership shall be Partnership property.

ARTICLE 4. PARTNER DISSOCIATION

Expulsion of a Partner

4.01. A Partner may be expelled from the Partnership for any of the following:

(1) Willful breach of any provision contained in this Agreement;

(2) Conduct adversely affecting the Partnership business;

(3) Conduct relating to Partnership matters that makes continuation of the Partnership unreasonable if that Partner remains a member.

A Partner shall be expelled upon unanimous vote of all other Partners. The other Partners shall serve the expelled Partner with a written notice stating the grounds for and effective date of the expulsion and bearing all such Partners' signatures. Within _____ days after the expulsion becomes effective, the expelled Partner shall be entitled to receive the value of that Partner's Partnership interest. The value of the expelled Partner's Partnership interest shall be determined by a complete inventory and accounting of Partnership affairs as of the close of business on the day the expulsion became effective, less the value of Partnership goodwill, and less any damages sustained by the other Partners because of the breach, if any, of this Agreement by the expelled Partner.

Disability of a Partner

4.02. If any Partner, in the opinion of any medical doctor duly licensed to practice in California, becomes unable because of any physical or mental disability to devote full time and attention to the Partnership business, that Partner shall, subject to the following terms and conditions, be excused from devoting any time or attention to the Partnership business during the continuance of the disability:

(a) During the first [*period, e.g.,* six months] of disability, the disabled Partner shall continue to be entitled to receive the full share of the Partnership net profits as specified in this Agreement and to withdraw from the Partnership funds each month the full amount specified in Section _____ [*e.g.,* 3.03] of this Agreement.

(b) At any time after the disabled Partner has been unable to devote full time and attention because of such disability to the Partnership business for a period of [*e.g.,* six months] or longer, the remaining Partners by majority vote may involuntarily dissociate the disabled Partner by serving on the disabled Partner written notice of dissociation, stating its effective date.

Bankruptcy, Insanity, or Charging Order

4.03. The remaining Partners may, by service of a written notice stating the effective date thereof on both the Partner and on the trustee in bankruptcy of that Partner, the guardian of that Partner, or the judgment creditor of that Partner who has obtained a charging order against that Partner's interest, involuntarily dissociate any Partner:

(a) Who has been adjudged a bankrupt pursuant to a petition in bankruptcy filed by or against that Partner under the Bankruptcy Act of the United States;

(b) For whom a conservator has been appointed pursuant to *Probate Code Sections 1800 through 1849.5*.

(c) Against whose interest in the Partnership a charging order has been issued under *Corporations Code Section 16504* and not removed within 30 days after it is issued.

Voluntary Dissociation of a Partner

4.04. Any Partner may voluntarily dissociate from the Partnership by giving all other Partners _____[*number, e.g.* 30] days advance written notice of intention to do so.

Option to Purchase Dissociated Interest

4.05. On the voluntary or involuntary dissociation of a Partner by reason of death, or by reason of any matters stated in Sections 4.02, 4.03, or 4.04 and 5.12 of this Agreement, the remaining Partners shall have an option to purchase the interest of the dissociated Partner's interest in the Partnership by paying to that Partner or the person legally entitled thereto the value of that Partner's interest, determined as provided in Section 4.06 of these Articles. The remaining Partners shall give notice of their exercise of that option in the following manner:

(a) If dissociation is caused by the death of a Partner, by serving written notice of their exercise of this option on the personal representative of the deceased Partner within [*number*] days after the appointment and qualification of the personal representative.

(b) If dissociation is caused by the voluntary withdrawal of a Partner or under Section 5.12, by serving written notice of the exercise of this option of the withdrawing Partner within [*number e.g.,* 30] days after service on the remaining Partners of the notice of withdrawal provided in Section 4.04 of this Agreement.

(c) If dissociation is caused by the disability of a Partner pursuant to Section 4.02 of this Agreement, by serving written notice of the exercise of the option on the disabled Partner at the same time the notice of involuntary dissociation is served on the disabled Partner.

(d) If dissociation is caused by any of the reasons specified in Section 4.03 of this Agreement, by serving written notice of the exercise of this option on both the dissociated Partner and that Partner's trustee in bankruptcy, guardian, or the judgment creditor who secured a charging order against the dissociated Partner's interest, at the same time the notice of dissociation of the Partner is served on those persons.

Purchase Price of Partnership Interest

4.06. On exercise of the option described in Section 4.05 of this Agreement to purchase a dissociated Partner's Partnership interest, the remaining Partners shall pay to the person legally entitled thereto, in the manner specified in Section 4.07 of this Agreement, the value of the dissociated Partner's interest, determined as follows:

(1) The remaining Partners, at the time they give notice in the manner specified in Section 4.05 of their exercise of the option to purchase, shall appoint an appraiser. Within [*number*] days after receiving that notice, the person legally entitled to receive the value of the Partnership interest being purchased shall appoint an appraiser. If the two appraisers so appointed are unable to agree on the value of the interest within _____[*number*] days, they shall appoint a third appraiser. The decision in writing of any two of the three appraisers so appointed shall be binding and conclusive on the parties to this Agreement and on any person legally entitled to receive the value of the dissociated Partner's interest. If a Partner is dissociated because of a charging order issued against the interest of the dissociated Partner, unless the remaining Partners guarantee in writing the payment to the judgment creditor who secured that charging order the full amount of the claim, including interests and costs, the appraiser to be appointed by the person legally entitled to receive the value of the dissociated Partner's interest shall be appointed by the court that issued the charging order. All fees and expenses of each appraiser shall be paid by _____ [the remaining Partners *or* the purchasing and selling

parties in equal proportions *or* the party on whose behalf that appraiser was appointed, and the fees and expenses of the third appraiser to be paid equally by the purchasing and selling parties].

PRACTICE TIP

The multi-appraiser approach illustrated by this form can be costly and time consuming, and when the parties are bearing their own appraisal costs, could lead to a deep pocket battle of experts. A better practice may be to agree on a neutral appraiser with the partnership to bear the cost. *Commentary by John J. Camozzi*.

(2) In determining the value of the Partnership interest to be purchased, the appraisers shall value:

(a) All items of inventory at their actual cost to the Partnership.

(b) All tangible assets of the Partnership, including lands, buildings, fixtures, machinery, automobiles, and equipment, at their fair cash market value;

(c) All accounts receivable due the Partnership that are not more than 90 calendar days old and not barred by the statute of limitations at one-half their face value;

(d) All accounts receivable due the Partnership that are less than 90 calendar days old at their full face value; and

(e) Goodwill and other intangible assets of the Partnership at their fair cash market value. [*For alternative provisions for determining the purchase price payable for the partnership interest of a dissociated partner, see §§ 15.202 and 15.240through 15.249.*]

Payment of Purchase Price

4.07. On exercise of the option to purchase the Partnership interest of a dissociated Partner, the remaining Partners shall pay to the person legally entitled thereto the value of the interest, determined as provided in Section 4.06 of this Agreement, in the following manner: _____ [*describe payment terms, e.g.,* One half in cash on receipt of the appraisers' report provided for in Section 4.06, and the balance in 12 equal monthly installments commencing not later than 30 days after receipt of that report. Each monthly installment shall be applied first to interest at the rate of _____ percent per annum on the then remaining unpaid principal balance of the purchase price from the date the appraisers' report was received by the remaining Partners and then to the reduction of principal.

Purchase by Less Than All Remaining Partners

4.08. If any remaining Partner is unable or unwilling to exercise the option contained in Section 4.05 of this Agreement to participate in the purchase of an outgoing Partner's interest, the option may be exercised and the interest purchased by the other remaining Partners. No remaining Partner shall be denied a right to participate in any such purchase if that Partner delivers to all other Partners a written declaration of intent to participate. This written declaration shall be delivered before the appraisers' report is delivered.

Assumption of Partnership Obligations

4.09. On any purchase and sale of a Partnership interest under this Agreement, the remaining Partners shall assume all Partnership obligations and shall protect, defend, and indemnify the dissociated Partner, the personal representative and estate of a deceased, insane, or incompetent Partner, and the property of any dissociated Partner from liability for any

such obligations.

Publication of Notice

4.10. On any purchase and sale of a Partnership interest under this Agreement, or on the expulsion of a Partner pursuant to Section 4.01 of this Agreement, the remaining Partners shall, at their own costs and expenses, as soon as reasonably practicable after giving notice of expulsion or of exercise of their option to purchase the dissociating Partner's interest, prepare, publish, file, and serve all notices as may be required by law to protect the dissociated Partner and the personal representative and estate of a deceased, insane, or incompetent Partner from liability for future obligations of the Partnership business.

ARTICLE 5. DISSOLUTION, MERGER OR CONVERSION

Merger

5.10. The Partnership may be merged with a limited liability company, limited partnership or other business entity under *Corporations Code Sections 16910 through 16916* on the written approval of _____[a majority of the Partners *or* those Partners collectively owning at least _____ (*e.g.*, 50) percent interest in the Partnership].

Conversion

5.11. The Partnership may be converted into a limited liability company, limited partnership or other business entity under *Corporations Code Sections 16902 through 16909* on the written approval of [a majority of the Partners *or* those Partners collectively owning at least _____ (*e.g.*, 50) percent interest in the Partnership].

Dissenter Rights

5.12. Any Partner who does not vote in favor of a partnership conversion or merger shall be notified of the approval of the conversion or merger and be given an opportunity to dissociate from the partnership in a voluntary dissociation under Article 4 of this Agreement as of the date the conversion or merger is effective.

Dissolution

5.13. The Partnership may be wound up and dissolved on the written approval of _____[a majority of the Partners *or* those Partners collectively owning at least _____ (*e.g.*, 50) percent interest in the Partnership]. On dissolution of the partnership, the Partnership affairs shall be wound up, the Partnership assets liquidated, and the Partnership's obligations to creditors, including, to the extent permitted by law, partners who are creditors, shall be paid. Any surplus shall be divided among the Partners according to their rights to distribution of their Partnership account.

ARTICLE 6. MISCELLANEOUS

Notices

6.01. All notices between the Partners shall be in writing and shall be deemed duly served when personally delivered to a Partner, or, in lieu of such personal service, when deposited in the United States mail, certified, first-class postage prepaid, addressed to the Partner at the Partner's address set forth in Exhibit A of this Agreement, or to such other place as may be specified in a notice given pursuant to this paragraph as the address for service of notice on the Partner.

Consents and Agreements

6.02. Any and all consents and agreements provided for or permitted by this Agreement shall be in writing. Signed copies of all such consents and agreements shall be filed and kept with the books of the Partnership.

Attorneys' Fees

6.03. If any litigation is commenced between the Partners or their personal representatives concerning any provision of this Agreement or the rights and duties of any person in relation thereto, the prevailing party or parties shall be entitled, in addition to such other relief as may be granted, to a reasonable sum for their attorneys' fees in that litigation. The amount of this sum shall be determined either by the court or in a separate action brought for that purpose.

Sole Agreement

6.04. This Agreement contains the sole agreement of the parties relating to their partnership and correctly sets forth the rights, duties, and obligations of each to the others as of its date. Any prior agreements, promises, negotiations, or representations not expressly set forth in this instrument are of no force and effect.

Executed at _____ County, California on _____[*date*].

_____ [*signature of partner*]
_____ [*typed name*]
_____ [*signature of partner*]
_____ [*typed name*]
_____ [*signature of partner*]
_____ [*typed name*]

Spousal Consent

The undersigned are the spouses of the above general partners who have signed above. We have read and understood the terms and conditions of the foregoing Agreement and agree to be bound by its terms. We agree that our respective spouses shall have the sole and exclusive power to manage the partnership interest created by the foregoing Agreement, regardless of whether that interest was acquired with community property, quasi-community property, or separate property assets, however so titled or characterized. We further acknowledge and agree that our respective spouses may, from time to time, or at any time, amend, restate, sell, transfer, assign or hypothecate their respective partnership interests in any manner whatsoever, with or without our further consent.

Executed at _____ County, California on _____[*date*].

_____ [*signature of spouse*]
_____ [*typed name*]

_____ [*signature of spouse*]
_____ [*typed name*]
_____ [*signature of spouse*]
_____ [*typed name*]

Exhibit A

Name and Address of Partner	Taxpayer Identification Number	Initial Capital Contribution	Percentage of Ownership
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____



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1. Complete Partnership Agreements

7-15 California Legal Forms--Transaction Guide § 15.201

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§ 15.201 Long Form for Investment Partnership

[1] Comment

[a] Use of Form

This form is a detailed partnership agreement that comprehensively defines the partners' rights and obligations. It is designed to be used when three or more persons form a general partnership for the purpose of pooling capital and making investments. While many of the provisions in this form may also be used in agreements among partners who will actively engage in a business enterprise (e.g., the manufacture and distribution of products), the *form in § 15.200[2]* is designed for use in such situations. See *§ 15.270[2]* for a partnership agreement to be used by professionals who wish to practice as partners.

[b] Taxation of Investment Partnerships

Investment partnerships may elect not to report income under the Internal Revenue Code provisions otherwise applicable to partnerships [*I.R.C. § 761(a)*]. All members of the partnership must join in making such an election [*see I.R.C. § 761(a)*]. The election is made by attaching a statement containing the following information to IRS Form 1065: all partners' names, addresses, and identification numbers; an assertion that the partnership qualifies to make the election; a statement that all partners assent to the election; and identification of where a copy of the partnership agreement is available [*see Treas. Reg. § 1.761-2(b)(2)*]. The IRS may allow the election if the partnership is for investment purposes only and the income of its members can be adequately determined without computing the partnership taxable income [*see I.R.C. § 761(a)*].

[c] Net Profits

Net profits are defined generally in this form by reference to accepted accounting principles. For a discussion of the reasons underlying use of this definition, see *§ 15.202[1]*.

[d] Partnership Term

General partnerships may be formed for (1) a specified period; (2) an indefinite period; or (3) whatever amount of time is necessary to accomplish an undertaking or series of undertakings. If the partnership agreement does not specify a particular term or undertaking, the partnership exists "at will" and may be dissolved, without breach of the agreement, by the express will of at least half of the partners [*Corp. Code § 16801(1)*]. See *§ 15.302[2]* for discussion of the differences in treatment of dissolution of at will and fixed term partnerships.

Article 3 of this form provides for continuation of the partnership from year to year following expiration of a fixed term upon the affirmative vote of a specified percentage in interest of the partners to continue. Unless the agreement provides otherwise, the partners' rights and obligations remain in effect if the partnership business is continued beyond the expiration of a fixed term or the completion of a specific undertaking [*see Corp. Code § 16406(a)*]. If partners who normally ran the partnership business during the partnership term continue the business after expiration of the term, they are presumed to have agreed that the partnership will continue [*Corp. Code § 16406(b)*].

[e] Capital Contributions

Article 4 of this form addresses initial and subsequent capital contributions. It requires that each partner make an initial capital contribution, and describes the method by which additional contributions may be compelled. Because this agreement allows the contribution of property to the partnership, a special allocation provision is included in case there is built-in gain or loss on the contributed property [*see Section 4.05* of form]. See the discussion at *§ 15.21* for discussion of why this special allocation provision is required.

This form does not allow for the contribution of services instead of cash or property. Some partnerships need to attract highly skilled partners by granting partnership interests for services. See the form in § *15.213[2]* for a provision allowing contribution of services rather than capital.

All property brought into the partnership or acquired on its account is partnership property, and not property of the partners individually [*Corp. Code §§ 16203, 16204*]. If a partner contributes community property to a partnership, that property is divested of its community nature [*Rosenthal v. Rosenthal (1966) 240 Cal. App. 2d 927, 931, 50 Cal. Rptr. 385]* . Although the contributing partner's spouse may lose a community interest in property transferred to the partnership, the spouse has a community property interest in the partner's transferable interest in the partnership to the extent it was acquired with community property or earnings since marriage [*see Kenworthy v. Hadden (1978) 87 Cal. App. 3d 696, 701, 151 Cal. Rptr. 169* ; *Corp. Code § 16502*].

[f] Interest on Capital Accounts

Section 4.02 of this form requires the partners to make interest bearing advances to the partnership as needed. Subject to contrary agreement, a partner who makes a payment or advance beyond the amount of capital that the partner originally agreed to contribute is entitled to interest from the date of the payment or advance [*see Corp. Code § 16401(e)*]. If capital contributions to the partnership are unequal and if capital plays an important role in production of partnership income (e.g., in an investment partnership), the agreement should ordinarily provide for interest to be paid on capital accounts.

[g] Profits and Losses

Section 5.02 of this form requires distribution of profits and losses among partners according to their respective

percentages of interest in the partnership. In the absence of an agreement to the contrary, the partners will share equally in the profits and surplus remaining after satisfaction of partnership liabilities [*see Corp. Code § 16401(b)*]. Losses will shared in the same proportion as for profits unless the partnership agreement provides otherwise [*see Corp. Code § 16401(b)*].

For tax purposes, the partners' distributive shares of partnership profits and losses are determined by the partnership agreement as long as the distributions have substantial economic effect [*I.R.C. § 704(a)*; *see § 15.20*]. This form provides for distributions according to the partners' ownership in the partnership and will meet the IRS test. Section 4.05 is a special allocation provision to account for any built-in gain or loss on property that may be contributed to the partnership [*see § 15.21* for discussion].

[h] Accounting and Inspection of Books

This form provides for the maintenance and regular review of partnership books of account. Unless the partners agree otherwise, the partnership books must be kept at the partnership's principal place of business and made accessible to every partner for inspection and copying [*Corp. Code § 16403(a), (b)*]. This form follows UPA '94 and satisfies the requirement that the partnership agreement may not unreasonably restrict the right of access to books and records or the right to be furnished information [*see Corp. Code § 16103(b)(2)*].

[i] Salaries and Expenses

A partner is not entitled to remuneration for acting in the partnership business [*Corp. Code § 16401(h)*]. Section 5.01 of this form follows UPA '94 by providing that no partner is to be compensated beyond the appropriate individual share in partnership net profits. The partners may agree to provide salaries and expense accounts for one or more of their number [*see Corp. Code § 16103(a)*]. See the *forms in §§ 15.202[2], 15.220[2],* and *15.221[2]* for alternative provisions. The *forms in §§ 15.223[2]* and *15.224[2]* provide clauses regarding partners' expenses.

[j] Management of Partnership Business

Section 8.01 of this form gives the partners equal rights in the management and conduct of partnership activities. In this respect, it follows the UPA '94. [*see Corp. Code § 16401(f)*]. However, this form also gives authority for the day-to-day operations of the Partnership to a Managing Partner, whose authority is specifically defined.

PRACTICE TIP

If the partners are not devoting equal time and resources to the partnership, or it will be managed by less than all the partners, the passive or less active partners may prefer a different entity structure, such as a limited partnership. *Commentary by John J. Camozzi*.

[k] Voting Requirements

This form includes voting requirements based on a specified percentage in interest of the partners [*see, e.g., Sections 5.01, 5.02,* and 8.01]. Making voting rights dependent on percentages of partnership interests is a particularly appropriate device for investment partnerships in which the partners' capital contributions often are unequal.

[l] Termination or Continuation of Partnership

Article 8 of this form includes a provision for termination of the partnership before expiration of the specified term upon a vote of a specified percentage in interest of the partners. It provides detailed instructions regarding the liquidation procedure, including a schedule for asset distribution.

Section 10.01 of this form specifies the events that constitute default under the partnership agreement. It provides a

procedure whereby a defaulting partner's interest may be purchased and the partnership business continued. Although at-will partnerships are not dissolved by the dissociation of a partner for death or other reason, those events can cause the dissolution of a term partnership such as this one [Corp. Code § 16801(1), (2)]. This form varies the provisions of the law and continues the partnership upon the death or other dissociation of a partner, except on an affirmative vote of a specified percentage in interest of the partners to dissolve. For a more detailed discussion of partnership dissolution and its consequences, see *§ 15.300*.

[2] FORM

Long Form for Investment Partnership

PARTNERSHIP AGREEMENT

This Partnership Agreement ("Agreement") is made on _____[*date*], by _____[*name*], _____[*name*], and _____[*name*], (whose names, addresses, tax identification numbers, and partnership interests are listed on exhibit A, attached to and made part of this agreement) hereinafter referred to as "Partners."

RECITALS

In consideration of the mutual covenants contained in this Agreement, the Partners agree to form a general partnership (hereinafter referred to as "Partnership") for the purposes and under the terms, provisions, and conditions set forth below.

It is therefore agreed:

ARTICLE 1. NAME AND PLACE OF BUSINESS

Name

1.01. The Partnership business and activities shall be conducted under the name _____[*name of partnership*] in California and under any variations of this name that may be necessary to comply with the laws of other states in which the Partnership transacts business or makes investments.

Place of Business

1.02. The Partnership's principal place of business shall be _____[*city*], [*county*], California. Additional places of business may be established at other locations agreed upon by the Partners.

Address

1.03. The Partnership's mailing address shall be _____[*street address*], _____[*city*], _____County, California [*zip code*].

ARTICLE 2. PARTNERSHIP PURPOSES

Primary Purpose

2.01. The Partnership's primary purpose shall be to invest in stocks, bonds, and securities. This purpose shall include, but shall not be limited to, purchasing, selling, and dealing in any of the following:

(1) Stocks, bonds, notes, options, and evidences of indebtedness of any domestic or foreign entity or association;

(2) Bonds and other obligations of any foreign or domestic government or political subdivision;

(3) Bills of exchange and other commercial paper;

(4) Securities of any nature or description;

(5) Commodities; and

(6) Precious metals.

The Partnership may engage in all usual and customary activities associated with investment in stocks, bonds, and securities.

Other Purposes

2.02. The Partnership's other purposes shall be to:

(1) Enter into other Partnership agreements in the capacity of a general Partner or limited Partner;

(2) Become a member of a joint venture or some other form of syndication for investment; and

(3) Buy, sell, lease, and deal in services, personal property, and real property.

PRACTICE TIP

Unless specific investments are identified at the time of formation, counsel may prefer not to include the broad authority to invest until the opportunity to make such investments is presented. In many cases the partners may not want to assume such broad investment risks with out a limited liability shield, which might, at that time, dictate conversion of the partnership to a limited liability partnership or limited partnership. *Commentary by John J. Camozzi*.

ARTICLE 3. PARTNERSHIP TERM

The Partnership shall begin on _____[*date*], and shall continue until _____[*date*]. Upon expiration of this term, the Partnership may continue from year to year on the affirmative vote of [*e.g.*, 75] percent in interest, not in numbers, of the Partners. [*See form in § 15.200[2] for provision to create an at-will partnership.*]

ARTICLE 4. CONTRIBUTIONS TO PARTNERSHIP

Initial Contributions

4.01. All Partners shall, upon demand, contribute to the Partnership the amount of cash or property of agreed fair market value set out opposite the name of each on exhibit a as their initial capital contributions.

Future Contributions

4.02. Each Partner shall be obligated to make the advances set forth in this section until such obligation is terminated by a vote of _____percent in interest, not in numbers, of the Partners. Upon written request of the Partnership Manager, each Partner shall advance to the Partnership a pro rata share (the ownership percentage set opposite each Partner's name on Exhibit A) of all costs, expenses, or charges respecting the Partnership operation and the ownership, operation, and maintenance of any Partnership property, including but not limited to ad valorem taxes, debt amortization (including interest payments), insurance premiums, repairs, costs of capital improvements made on approval of the Partners as provided in this agreement, management fees, salaries, advertising expenses, professional fees, and utility costs, to the extent these amounts exceed the income, if any, derived from the Partnership and the proceeds of any loans made to the Partnership.

The Partnership Manager may estimate the cash requirements of the Partnership for periods of up to one year in advance and request payment of each Partner's pro rata share of estimated cash requirements. Each Partner shall pay the requested amount within _____ days after receiving the Manager's written statement. At the end of each period covered by the estimate, the Partnership Manager shall provide each Partner with an accounting of the amounts actually advanced for costs, expenses, and charges. If the estimate paid by the Partners exceeded the actual cash expenditures, the Partnership Manager shall either refund the excess to the Partners or apply the excess against the estimated cash requirements for the succeeding period.

Contributions Secured

4.03. All Partners grant to the Partnership Manager liens on their interests in the Partnership to secure the payment of contributions and the performance of obligations required under this Agreement.

Withdrawal of Capital

4.04. No Partner shall withdraw any portion of the Partnership capital without the express written consent of all other Partners.

Allocation of Depreciation, Gain, or Loss

4.05. If a Partner contributes property to the Partnership that has an adjusted income tax basis that differs from the fair market value at which the Partnership accepts and credits the property to the Partner's capital account for the purpose of determining each Partner's distributive share of Partnership net profits and losses, then for income tax purposes, any depreciation, depletion, gain or loss with respect to the property must, pursuant to *Section 704(c) of the Internal Revenue Code* and *Treasury Regulation Section 1.704-3* be allocated according to the [*select one* traditional method *or* traditional method with curative allocations *or* traditional method with remedial allocations].

ARTICLE 5. PARTNERSHIP OPERATION

Partnership Interests

5.01. As among themselves, all Partners shall be entitled to share Partnership net profits and shall be obliged to bear Partnership liabilities in the percentages of ownership set opposite their names on Exhibit A. If a Partner defaults under

the terms of this agreement, that Partner shall indemnify the other Partners for any loss or liability caused by the default and exceeding the percentages set forth in Exhibit A. Unless otherwise provided in this agreement, no Partner shall have any right to compensation solely by reason of contribution to the Partnership, except to share in the Partnership net profits in the percentage set opposite each Partner's name on Exhibit A. Any Partner may, however, loan the Partnership any additional funds agreed upon by [*e.g.*, 75] percent in interest, not in numbers, of the Partners. The Partnership shall pay _____ percent per annum interest on such loans, and shall charge the interest payments as Partnership business expenses in the Partnership books.

Distributions

5.02. Distributions from the Partnership to the Partners shall be made at such times and in such amounts as determined by a vote of [*e.g.*, 75] percent in interest, not in numbers, of the Partners. Any distributions from the Partnership shall be made proportionately to all Partners in the percentages set opposite their names in Exhibit A.

PRACTICE TIP

It is often preferable to use distributions to first pay off partner loans before making pro rata equity returns. *Commentary by John J. Camozzi*.

Net Profits Defined

5.03. The term "net profits" as used in this agreement means the net profits of the Partnership as determined by generally accepted accounting principles for each accounting period provided for in this agreement.

ARTICLE 6. OWNERSHIP OF PARTNERSHIP PROPERTY

6.01. The Partnership shall own all real and personal property acquired by the Partnership, including improvements. Partners have no ownership rights in specific Partnership property, and may not transfer any interest in Partnership property either voluntarily or involuntarily.

ARTICLE 7. FISCAL MATTERS

Fiscal Year

7.01. The Partnership fiscal year shall be the calendar year.

Books and Records

7.02. Proper books and records shall be kept regarding all Partnership transactions, and each Partner, the Partner's attorney, accountant and legal representatives, shall, on reasonable notice, have access to those books and records during business hours. The books shall be kept in a manner of accounting agreed upon by the Partners and reflecting Partnership income. The books and records shall designate and identify any property in which the Partnership owns a beneficial interest. The records shall include, but not be limited to, the ownership of property (real, personal, and mixed) as well as any property in which the Partnership owns an interest and the title to which has been recorded or is maintained in the name of one or more designated Partners without Partnership designation. The books and records shall be reviewed annually at the Partners' expense by a certified public accountant selected by the Partners, who shall prepare and deliver to the Partnership, for filing, the appropriate federal Partnership income tax return.

Partnership Accounts

7.03. All funds of the Partnership shall be deposited in its name (or in the name of a nominee as provided in Section 8.02) in accounts maintained at a bank designated by the Partnership Manager or with an agent designated by the Partnership Manager. Checks shall be drawn upon the Partnership accounts only for Partnership purposes and shall be signed by the Partnership Manager or by an officer or authorized agent of the Partnership Manager.

Accountings

7.04. A complete accounting of Partnership affairs as of the close of business on [*e.g.*, the last days of March, June, September, and December of each year] shall be rendered to each Partner within _____ days after the close of each such month.

ARTICLE 8. MANAGEMENT OF PARTNERSHIP AFFAIRS

8.01. The Partners shall control the Partnership and all its affairs and shall have equal rights in the management and conduct of Partnership investments and activities. The Partners designate _____[*name*] as Partnership Manager to serve in that capacity until the Partners designate a new Manager by a vote of _____ percent in interest, not in numbers, of the Partners. The Partnership Manager shall not receive a salary or any other compensation for serving as Partnership Manager. The Partnership Manager shall be responsible for the day-to-day management and ministerial acts of the Partnership.

The Partnership Manager shall have the right and power to bind the Partnership subject to the conditions and limitations set forth in this Agreement. The general management and final determination of all questions relating to the usual daily business affairs and ministerial acts of the Partnership shall rest in the Partnership Manager. In this connection, and not by way of limitation, the Partnership Manager is authorized to do all things and to execute all documents, contracts, evidences of indebtedness, security agreements, financing statements, and other instruments necessary to carry out the purposes of the Partners as expressed in this Agreement. All business arrangements entered into shall be on terms and conditions generally acceptable to a person in similar circumstances exercising prudent business judgment. The Partnership Manager shall devote all reasonably necessary attention and business capacity to the Partnership affairs. The Partners acknowledge that the Partnership Manager manages and may continue to manage other Partnerships and may continue to engage in other distinct or related businesses.

Restrictions on Authority of Manager and Partners

8.02. The individual Partners and the Partnership Manager shall have no authority with respect to the Partnership and this agreement to:

(1) Do any act in contravention of this agreement;

(2) Do any act that would make it impossible to carry on the Partnership business;

(3) Possess Partnership property or assign the right of the Partnership or its Partners in specific Partnership property for other than a Partnership purpose;

(4) Make, execute, or deliver any general assignments for the benefit of creditors, or any bond, guaranty, indemnity bond, or surety bond;

(5) Assign, transfer, pledge, compromise, or release any Partnership claim except for full payment, or arbitrate or consent to the arbitration of any disputes or controversies;

(6) Make, execute, or deliver any deed, long term ground lease, contract to sell all or any part of Partnership property, or execute any new note or mortgage to renew and extend without increasing any existing note or mortgage, without first having obtained the consent, either by vote or writing, of _____ percent in interest, not in numbers, of the Partners; or

(7) Do any of the following without unanimous consent of the Partners:

(a) Confess a judgment;

(b) Make, execute, or deliver for the Partnership any bond, mortgage, deed of trust, guaranty, indemnity bond, surety bond, or accommodation paper or accommodation endorsement;

(c) Amend or otherwise change this agreement so as to modify the rights or obligations of the Partners as set forth; or

(d) Create any personal liability for any Partner other than liability to which that Partner may agree in writing.

Statement of Partnership

8.03. Concurrent with the execution of this Agreement, the Partners shall cause to be filed with the California Secretary of State a Statement of Partnership Authority pursuant to *California Corporations Code Section 16303* setting forth the Partners' rights to manage and control the Partnership's business, including any limitations on the authority of Partners to bind the Partnership as set forth in this Agreement. The Partnership shall cause the Statement of Partnership Authority be recorded in every county in which the Partnership owns, or contemplates owning, real property.

Meetings of Partners

8.04. The Partners shall hold regular [*e.g.*, quarterly] meetings at times and places to be selected by the Partners. In addition, [*e.g.*, 30] percent in interest, not in numbers, of the Partners may call special meetings to be held in _____ County at any time after giving [*e.g.*, three] days notice to all Partners. Any Partner may waive notice of or attendance at any meeting, or may attend by telephone or any other electronic communication device, or may execute a signed written consent. The Partners shall transact all business properly brought before them at their meetings.

The Partners shall keep regular minutes of all their proceedings. The minutes shall be placed in the Partnership minute book.

Action Without Meeting

8.05. Any action that may or is required to be taken at a meeting of the Partners may be taken without a meeting if written consent setting forth the action to be taken is signed by all Partners entitled to vote. This consent shall have the same force as a unanimous vote of the Partners. The consent, or a signed copy thereof, shall be placed in the Partnership minute book.

ARTICLE 9. RESTRICTION ON TRANSFER

Prohibition Against Transfer

9.01. Except as otherwise provided in this Agreement, no Partner may sell, assign, transfer, encumber, or otherwise dispose of any Partnership interest, Partnership property, or Partnership assets without prior written consent of _____ [*e.g.*, 75] percent in interest, not in numbers, of all other Partners, and shall not pass title to any Partnership interest or property in the absence of such consent. Any transfer prohibited under this section shall be void, and any attempt by a Partner to dispose of a Partnership interest in violation of this section shall constitute a material default under this Agreement.

Effect of Assignment

9.02. If a transfer of a Partner's interest is permitted under Section 9.01, the transferee or assignee to whom an interest has been transferred shall not have a right to participate in the management or conduct of the partnership business, to require access to information concerning partnership transactions, or to inspect or copy the partnership books or records. A transferee may receive distributions to which the transferring Partner may have otherwise been entitled and to receive, on the dissolution of the Partnership, the net amount otherwise distributable to the transferring Partner.

Death of Partner

9.03. On the death of a Partner, the decedent's estate shall sell and the _____[surviving Partners *or* Partnership] shall purchase the deceased Partner's interest in the Partnership. Valuation of the deceased Partner's interest shall be made by appraisal as provided in Article 12. The Partnership shall not be dissolved upon the death of a Partner under *Corporation Code 16801* except by affirmative vote of _____ [*e.g.*, 75] percent in interest, not in numbers, of the Partners. [*For alternative methods of valuation, and other provisions governing the purchase and sale of partnership interests, see forms in §§ 15.240-15.255.*]

ARTICLE 10. DEFAULT BY A PARTNER

10.01. The following events shall constitute default by a Partner:

(1) The failure to make, when due, any contribution or advance required under the terms of this agreement and the continuance of that failure for _____ [*e.g.*, 10] days after the Partnership Manager notifies the Partner of the failure in writing.

(2) Violation of any other provisions in this agreement and failure to remedy the violation within _____ [*e.g.*, 10] days after notice of the violation from the Partnership Manager or the other Partners.

(3) The assignment of Partnership property for the benefit of creditors, or the filing of a petition under any section or chapter of the federal bankruptcy code or under any similar law of the United States or any state.

(4) Adjudication of the Partner as a bankrupt or insolvent under any section or chapter of the federal bankruptcy code or under any similar law of the United States or any state.

(5) The appointment of a receiver for all or substantially all of a Partner's assets and the failure to have the receiver discharged within _____ [*e.g.*, 30] days after appointment.

(6) The commencement of any legal action by a creditor against a Partner resulting in litigation that, in the opinion of

the Partnership Manager or _____ [*e.g.*, 75] percent in interest, not in numbers, of the other Partners creates a real and substantial risk of involvement of Partnership property that will probably:

(a) Act to their financial detriment; or

(b) Result in the creditor or the creditor's assigns succeeding in or to all or part of the Partner's interest in the Partnership.

PRACTICE TIP

Commencement of creditor litigation against a partner that may involve partnership assets may, at the very least, create a conflict of interest, and at worst, violate the attorney-client fiduciary duty. High net worth partners may be reluctant to disclose their investment portfolio and unrelated business dealings to the partnership. This is particularly true when the individual partner has a greater net worth than the partnership. However, if the partnership has a greater net worth than the individual partner, the partnership may have an interest in knowing if any individual partner is exposing the partnership to risk. Generally, a partner has no fiduciary duty to disclose unrelated financial dealings to the partnership. Requiring a partner to disclose personal financial dealings may compromise the privacy rights of the disclosing partner and may raise issues of contract interpretation and good faith and fair dealing by allowing the other partners to examine the disclosing partner's financial disclosures and summarily declare the partnership agreement in default. *Commentary by John J. Camozzi*.

Effect of Default

10.02. Upon a Partner's default, _____ [*e.g.*, 75] percent in interest, not in numbers, of the other Partners shall have the right to elect to dissociate the defaulting Partner without dissolving the Partnership. The nondefaulting Partners may make this election at any time within _____ [*e.g.*, one year] from the date of default, upon _____ [*e.g.*, ten] days written notice of that election to the defaulting Partner provided that default is continuing on the date notice is given.

All nondefaulting Partners (hereinafter referred to as "Purchasing Partners") who voted to make the election to dissociate the defaulting Partner shall be required to purchase such interest, pro rata, in the proportion that their individual Partnership interests bear to the aggregate of all Partnership interests. The purchase price for the defaulting Partner's interest shall be paid in cash or, at the purchasing Partners' option, by execution and delivery of each purchasing Partner's note payable to the order of the defaulting Partner, in the amount of the purchase price. These notes shall bear interest at the rate of _____percent per annum and shall be payable in _____ [*number*] equal annual installments of principal and interest, the first payment to be made one year from the date of execution and delivery and with that note containing full prepayment privileges without penalty. The purchase price to be paid to a defaulting Partner shall be the _____ lower of:

(1) The fair market value; or

(2) The defaulting Partner's total cash investment in the Partnership, or the agreed value of contributed property, as of the date of default.

The purchase price shall be reduced by the aggregate amount of any outstanding debts to the Partnership and by any damages caused by the default of the defaulting Partner. Fair market value shall be determined as specified in Article 12 of this Agreement.

Upon receipt of the purchase price (cash or note), the defaulting Partner shall have no further interest in the Partnership, its business, or its assets, and shall execute and deliver any assignments and other instruments necessary to evidence and effectively transfer the interest of the defaulting Partner to the Purchasing Partners. If the necessary assignments and instruments are not delivered after notice by the Partnership Manager that the consideration is available to the defaulting Partner, the Partnership Manager may deliver such consideration to the defaulting Partner and execute such assignments and instruments as the defaulting Partner's irrevocable agent. All Partners agree, that the Partnership Manager shall not be individually liable for any actions so taken.

The assignment or transfer of a defaulting Partner's interest shall not relieve that Partner from any personal liability for outstanding obligations relating to the Partnership which may exist on the date of the assignment or transfer. A Partner's default shall not relieve any other Partner from liabilities and obligations under this agreement. A defaulting Partner's Partnership interest shall not be considered in any Partnership voting requirement.

Option to Assist Defaulting Partner

10.03. Any Partner may agree to assist a defaulting Partner. Such an agreement and any advance or payment made thereunder shall be secured by a lien upon the defaulting Partner's Partnership interest. The lien may be foreclosed, at the assisting Partner's option, by the Partnership Manager.

Option to Cure Defaults

10.04. Any Partner may cure another Partner's default after providing all Partners with written notice of intent to cure. If the option to cure is exercised, the defaulting Partner shall be obligated to the curing Partner for all reasonable expenses, amounts, and contractual liabilities incurred in the process. This obligation shall be secured by a lien on the defaulting Partner's Partnership interest which may be foreclosed, at the curing Partner's option, by the Partnership Manager. Exercise of the option to cure shall not constitute a waiver of any claim for breach of this Partnership agreement.

Foreclosure for Default

10.05. If a Partner is in default, the lien provided for in Section 4.03 of this agreement may, at the option of _____ [*e.g.*, 75 percent in interest, not in numbers, of the nondefaulting Partners, be foreclosed by the Partnership Manager].

Transfer by Attorney in Fact

10.06. Each Partner appoints the Partnership Manager as the Partner's attorney in fact in the event that the Partner becomes a defaulting Partner who is dissociated under the terms of this Agreement. Upon dissociation, the Partnership Manager may assign or transfer the defaulting Partner's Partnership interest. The Partnership Manager shall not be personally liable for any matter related to such an assignment or transfer.

Additional Effects of Default

10.07. Pursuit of remedies provided under this Agreement shall not preclude pursuit of other remedies available at law or equity. The Partners shall not be deemed to waive or forfeit, by pursuit of remedies provided under this agreement, any amounts due to them as a result of another Partner's breach of this Agreement. If nondefaulting Partners waive another Partner's specific breach, the waiver shall not be deemed to extend to any other breach of this Agreement. If the nondefaulting Partners refrain from enforcing any remedy available under this agreement against a defaulting Partner,

they shall not be deemed to have waived the default.

ARTICLE 11. AMENDMENT

Subject to the provisions of Article 8, this Agreement may be modified only by a written instrument executed by Partners collectively owning at least [*e.g.*, 75] percent in interest of the Partnership.

ARTICLE 12. PROCEDURE FOR APPRAISAL

Selection of Appraisers

12.01. Within _____ days after an appraisal is required under any provision of this agreement, two appraisers shall be selected, one by each opposing party. If either party fails to name an appraiser within the specified time, the other Partners may select the second appraiser.

PRACTICE TIP

The multi-appraiser approach illustrated by this form can be costly and time consuming, and when the parties are bearing their own appraisal costs, could lead to a deep pocket battle of experts. A better practice may be to agree on a neutral appraiser with the partnership to bear the cost. *Commentary by John J. Camozzi*.

Determination of Fair Market Value

12.02. The two appraisers selected under Section 12.01 shall determine the Partnership fair market value. They shall take into account any defaulting Partner's interest and equity in the Partnership as well as any outstanding obligations or encumbrances relating to Partnership property. The appraisers' determination of fair market value shall be final and binding on all parties. If the two appraisers selected are unable to agree on fair market value, they shall select a third appraiser whose determination of fair market value shall be averaged with those of the other appraisers. The average shall be conclusive as to the Partnership fair market value and shall be final and binding on all parties.

Fees and Expenses

12.03. Each opposing party shall pay the fees and expenses of its own appraiser and, if a third appraiser is selected, the fee of the third appraiser shall be paid equally by the two parties.

ARTICLE 13. PARTNERSHIP TERMINATION

Terminating Events

13.01. The following events shall terminate the Partnership:

(1) The affirmative vote of [*e.g.*, 75] percent in interest, not in numbers, of the Partners, or

(2) The expiration of the term provided for in Article 3 of this Agreement.

Distribution of Assets

13.02. Upon termination, the Partnership assets shall be applied toward any outstanding Partnership obligations to creditors, including, to the extent permitted by law, partners who are creditors. After all outstanding Partnership liabilities have been satisfied, the balance of the Partnership assets shall be distributed to the Partners in proportion to their Partnership interests as set forth in Exhibit A.

ARTICLE 14. MISCELLANEOUS PROVISIONS

Notices

14.01. Except as otherwise specifically provided, all notices required or permitted under this agreement shall be in writing and shall be deemed delivered when deposited in the United States mail, first-class postage prepaid, registered or certified mail, return receipt requested, addressed to the Partners at their respective addresses as set forth on Exhibit A or at other addresses specified by written notice delivered in accordance with this section.

California Law to Apply

14.02. This agreement shall be construed under and in accordance with the laws of the state of California. All obligations created under this agreement are performable in California.

Other Instruments

14.03. The parties agree that they will execute any additional instruments and documents necessary or convenient to carry out the Partnership created by this agreement.

Headings

14.04. The headings used in this agreement are for administrative purposes only and do not constitute substantive matter to be considered in construing the terms of this agreement.

Parties Bound

14.05. This agreement is binding on and shall inure to the benefit of the parties and their respective heirs, executors, administrators, legal representatives, successors, and assigns when permitted by this agreement.

Legal Construction

14.06. If one or more of the provisions contained in this agreement shall, for any reason, be held unenforceable in any respect, its unenforceability shall not affect any other provision and the agreement shall be construed as if the unenforceable provision had never been included.

Counterparts

14.07. This agreement may be executed in any number of counterparts and each counterpart shall be deemed an original

for all purposes.

Prior Agreements Superseded

14.08. This agreement supersedes any prior understandings and written or oral agreements among the parties regarding any matter relating to the Partnership.

Executed at _____[*city*], California on _____[*date*].

_____ [*signature*]
_____ [*typed name of partner*]
_____ [*signature*]
_____ [*typed name of partner*]
_____ [*signature*]
_____ [*typed name of partner*]

Spousal Consent

The undersigned are the spouses of the above general partners who have signed above. We have read and understood the terms and conditions of the foregoing Agreement and agree to be bound by its terms. We agree that our respective spouses shall have the sole and exclusive power to manage the partnership interest created by the foregoing Agreement, regardless of whether that interest was acquired with community property, quasi-community property, or separate property assets, however so titled or characterized. We further acknowledge and agree that our respective spouses may, from time to time, or at any time, amend, restate, sell, transfer, assign or hypothecate their respective partnership interests in any manner whatsoever, with or without our further consent.

Executed at _____ County, California on _____[*date*].

_____ [*signature of spouse*]
_____ [*typed name*]
_____ [*signature of spouse*]
_____ [*typed name*]
_____ [*signature of spouse*]
_____ [*typed name*]

Exhibit A

Name and Address of Partner	Taxpayer Identification Number	Initial Capital Contribution	Percentage of Ownership
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
1. Complete Partnership Agreements

7-15 California Legal Forms--Transaction Guide § 15.202

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.202 General Partnership Agreement Short Form

[1] Comment

[a] Use of Form

This form is a short-form partnership agreement that provides for equal rights and duties among the partners. It may be used in forming two-member or other small partnerships when the partners will work actively in the partnership business and will depend on it for at least a portion of their yearly income. Accordingly, this form contains provisions authorizing payment of specific salaries to the partners and requiring them to devote their full time and efforts to the partnership business. This form allows a remaining partner the option of purchasing the interest of the other partner on a co-partner's death or withdrawal. Because the form is designed to be used by smaller, less formal commercial partnerships it does not provide detailed definitions of fiscal matters or partners' rights and obligations. In this respect it relies on the provisions of UPA '94, which will fill in the gaps to govern relations between partners that are not covered by the partnership agreement [*Corp. Code § 16103(a)*].

[b] Net Profits

This form provides that "net profits" be defined in accordance with generally accepted accounting principles.Regarding how a court may be expected to deal with the reference to generally accepted accounting principles, see *Ch. 7,Corporate Records and Reports, § 7.31[5][a]*. "Net profits" could be more specifically defined either as the net profits shown on the partnership information tax return, or by listing the specific items that are deductible from partnership gross income. However, these more specific definitions may present problems for the partners once operation of the partnership business has commenced. The "net profit" or "taxable income" shown on the information tax return may not be the same as the net profit distributable to the partners. For example, the partnership may not deduct premiums paid

for policies on the partners' lives that will be used to fund an "entity" buy-sell agreement. See *§ 15.261[1]* for further discussion.

Listing deductible items in the partnership agreement presents practical difficulties. During the course of its existence, the partnership may incur deductible expenses that were not contemplated at the time the agreement was drafted. Accordingly, frequent amendment of the partnership agreement, resulting in administrative confusion, could result from defining net profits in this manner.

PRACTICE TIP

Small partnerships, particularly when the partnership goal is to create jobs for the partners, tend to rely more on their professional tax advisor/accountant for advice than their attorney. Counsel forming a small partnership should not anticipate regular contact with the partnership after formation, should keep the agreement terms simple, and should broadly draft all tax and accounting provisions to ensure flexibility for future operations. *Commentary by John J. Camozzi*.

[2] FORM

General Partnership Agreement Short Form

PARTNERSHIP AGREEMENT

Preamble

This Partnership Agreement ("Agreement") is made on _____[*date*], by and between the following, who shall be referred to in this Agreement as "Partners:"

_____[*name*] _____[*address*] [*taxpayer i.d.*]
_____[*name*] _____[*address*] [*taxpayer i.d.*]

Type of Business

1. The Partners shall associate to form a General Partnership for the purpose of [*describe business, e.g.*, manufacturing and distributing headphones], and shall have the power to do all acts in furtherance of the Partnership business.

Partnership Name

2. The Partnership name shall be _____.

Partnership Term

3. The Partnership shall commence on _____[*specify, e.g.*, the execution of this Agreement *or* _____ (*date*),] and shall continue until dissolved by agreement of the Partners or terminated under the provisions of this Agreement.

Place of Business

4. The Partnership's principal place of business shall be at _____[*street*], _____[*city*], [*county*], California. The Partnership shall maintain any other place or places of business agreed upon by the Partners.

Initial Capital

5. The Partnership's initial capital shall be $ _____. Each Partner shall contribute toward the initial capital by depositing the following amounts in the Partnership checking account at the _____ Office of the _____ Bank in _____[*city*], California, on or before _____[*date*]:

_____[*name*] shall contribute $ _____.

_____[*name*] shall contribute $ _____.

Capital Withdrawals

6. No Partner shall withdraw any portion of the Partnership capital without the other Partner's express written consent.

Profits and Losses

7. The Partners shall share equally in Partnership net profits and shall bear Partnership losses equally.

Books of Account

8. Partnership books of account shall be accurately kept and shall include records ofall Partnership income, expenses, assets, and liabilities. The Partnership books of account shall be maintained on [an accrual *or* a cash] basis. Each Partner shall have the right to inspect the Partnership books at any time.

Fiscal Year

9. The Partnership's fiscal year shall end on [*month*], [*day*] each year.

Accountings

10. Complete accountings of the Partnership affairs at the close of business on the last days of March, June, September, and December of each year shall be rendered to each Partner within _____ days after the close of each such month. At the time of each accounting, the net profits of the Partnership shall be distributed to the Partners as provided in this Agreement. Except as to errors brought to the Partners' attention within _____days after it is rendered, each accounting shall be final and conclusive.

Time Devoted to Partnership

11. Each Partner shall devote undivided time to and use utmost skill in the Partnership business. [*Or, for an alternative*

provision not requiring all partners to devote undivided time and attention to partnership business, see form in § 15.225[2] .]

Management and Authority

12. Each Partner shall have an equal right in the management of the Partnership. Each Partner shall have authority to bind the Partnership in making contracts and incurring obligations in the Partnership name or on its credit. No Partner, however, shall incur obligations in the Partnership name or on its credit exceeding $ _____ without the other Partner's express written consent. Any obligation incurred in violation of this provision shall be charged to and collected from the Partner who incurred the obligation.

Statement of Partnership

13. Concurrent with the execution of this Agreement, the Partners shall cause to be filed with the California Secretary of State a Statement of Partnership Authority pursuant to *California Corporations Code Section 16303* setting forth the Partners' rights to equal management and control of the Partnership and any limitations thereon as set forth in this Agreement. The Partnership shall cause the Statement of Partnership Authority be recorded in every county in which the Partnership owns, or contemplates owning, real property.

Partners' Salaries

14. As compensation for services in the Partnership business, each Partner shall be entitled to a salary of $ _____ per month. The Partnership shall deduct the Partners' salaries as ordinary business expenses prior to computing net profits. A Partner's salary may be increased or reduced at any time by mutual agreement of the Partners. [*See forms in §§ 15.200[2] and 15.201[2] for alternative provisions to allowing salaries.*]

Net Profits Defined

15. The term "net profits," as used in this Agreement, shall mean the Partnership net profits as determined by generally accepted accounting principles for each accounting period specified in this Agreement.

Withdrawal of Partner

16. Upon [*number, i.e* 30] days written notice of intent to the other Partner, either Partner may dissociate from the partnership by withdrawing as a Partner.

PRACTICE TIP

Requiring dissociating partners to give written notice may be advantageous from the partnership's perspective, but not from the point of view of the dissociating partner. If the attorney is representing the individual partners, requiring written notice may, at the very least, create a conflict of interest, and at worst, violate the attorney-client fiduciary duty. This issue becomes most problematic when a partner dissociates from the partnership in an emotionally charged state. In such situations, the dissociating partner may simply give oral notice of dissociation and walk away from the partnership in anger or disgust, though not in breach of the partnership agreement. The dissociating partner may reasonably believe that he/she is no longer a partner and that nothing further is required to terminate his/her

partnership relationship. The dissociating partner's failure to submit written dissociation notice may make the dissociation ineffective, or if effective, may make the dissociation wrongful (because it would be in breach of the partnership agreement), and may expose the dissociated partner to continuing partnership liabilities or partner liabilities caused by the wrongful dissociation [*see Corp. Code § 16602(c)*]. This can be particularly troublesome when the partners are not sophisticated or the dissociating partner is reluctant or unable to retain dissociation counsel. Formation counsel should use care in requiring written notification of dissociation. *Commentary by John J. Camozzi*

Option to Purchase Dissociated Interest

17. On dissociation of either Partner by the death, withdrawal, or other act, the remaining Partner may continue the Partnership business by purchasing the outgoing Partner's interest in the Partnership assets and goodwill. The remaining Partner shall have the option to purchase the dissociated Partner's interest by paying to the outgoing Partner or the appropriate personal representative the value of the dissociated Partner's interest as determined under Paragraph 17 of this Agreement. If the remaining Partner does not exercise this option, the Partnership shall be dissolved as provided under Paragraph 20 of this Agreement.

Purchase Price of Partnership Interest

18. On exercise of the option described in Paragraph 16 of this Agreement, the remaining Partner shall pay to the dissociated Partner or appropriate personal representative the value of the dissociated Partner's Partnership interest as determined by the last regular accounting preceding dissolution plus the full unwithdrawn portion of the dissociated Partner's share in net profits earned between the date of that accounting and the date of dissociation. [*For alternative provisions to determine thepurchase price for the interest of a dissociated Partner, see forms in §§ 15.200[2] and 15.240-15.249*.]

Liability of Deceased Partner's Estate

19. If on the death of one Partner, the surviving Partner exercises his or her option to purchase the deceased Partner's interest under Paragraphs 16 and 17, the liability of the deceased Partner's estate for Partnership obligations incurred during the period of continuation shall be limited to the amount that the deceased Partner had invested or involved with the Partnership at the time of death and that is includable in the deceased Partner's estate.

Duties of Purchasing Partner

20. On any purchase and sale made pursuant to Paragraphs 16, 17, or 18 of this Agreement, the remaining Partner shall assume all Partnership obligations. The remaining Partner shall hold and defend the withdrawing Partner or the deceased Partner's estate and personal representative, as well as any property belonging to either a withdrawing or deceased Partner, free and harmless from all liability for Partnership obligations. Immediately upon purchase of a withdrawing or deceased Partner's interest, the remaining Partner shall prepare, file, serve, and publish all notices required by law to protect the withdrawing Partner or the deceased Partner's estate and personal representative from liability for future Partnership obligations. All costs incident to the requirements of this Paragraph shall be borne by the remaining Partner.

Dissolution

21. When: (1) the Partnership is dissolved by agreement of the Partners; or (2) a remaining Partner declines to exercise the option to purchase a dissociated Partner's interest under Paragraph 16; or (3) it is otherwise required by law, the Partnership affairs shall be wound up, the Partnership assets liquidated, its obligations to creditors, including, to the extent permitted by law, Partners who are creditors, shall be paid, and the surplus divided among the Partners according to their rights of distribution of their Partnership accounts.

Notices

22. All notices between the Partners shall be in writing and shall be deemed served when personally delivered to a Partner, or when deposited in the United States mail, certified, first-class postage prepaid, addressed to a Partner at the Partner's address set forth in the Preamble to this Agreement or to such other place as may be specified in a notice given pursuant to this Paragraph as the address for service of notice on that Partner.

Consents and Agreements

23. All consents and agreements provided for or permitted by this Agreement shall be in writing. Signed copies of all consents and agreements pertaining to the Partnership shall be kept with the Partnership books.

Governing Law

24. This Agreement shall be governed by the California Uniform Partnership Act of 1994, as amended, and shall in all respects be a contract under California law.

Attorney Fees

25. As between the parties to this Agreement, the prevailing party in any dispute arising from or relating to this Agreement shall be awarded costs and attorney fees whether or not the matter is resolved by trial or appeal.

PRACTICE TIP

In a small partnership, the attorney fees provision is probably the most important dispute resolution cost control measure that can be included in the agreement. Small partnership disputes can be worse than divorces. Without a strong cost control mechanism, small partnership dissolutions can become financial wars of attrition between emotionally charged individuals who are without the ability to pay.
Commentary by John J. Camozzi.

Sole Agreement

24. This instrument contains the Partners' sole agreement relating to their Partnership. It correctly sets out the Partners' rights and obligations. Any prior agreements, promises, negotiations, or representations not expressly set forth in this instrument have no force or effect.

Executed _____[*date*], at _____County, California.

_____ [*signature of partner*]

_____ [*typed name*]
_____ [*signature of partner*]
_____ [*typed name*]

Spousal Consent

The undersigned are the spouses of the above general partners who have signed above. We have read and understood the terms and conditions of the foregoing Agreement and agree to be bound by its terms. We agree that our respective spouses shall have the sole and exclusive power to manage the partnership interest created by the foregoing Agreement, regardless of whether that interest was acquired with community property, quasi-community property, or separate property assets, however so titled or characterized. We further acknowledge and agree that our respective spouses may, from time to time, or at any time, amend, restate, sell, transfer, assign or hypothecate their respective partnership interests in any manner whatsoever, with or without our further consent.

Executed at _____ County, California on _____[*date*].

_____ [*signature of spouse*]
_____ [*typed name*]
_____ [*signature of spouse*]
_____ [*typed name*]
_____ [*signature of spouse*]
_____ [*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
1. Complete Partnership Agreements

7-15 California Legal Forms--Transaction Guide §§ 15.203-15.209

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

[Reserved]

§§ 15.203[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.210

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.210 Term of Partnership Specified Period and Year to Year Continuation Upon Expiration

[1] Comment--Use of Form

This form establishes a partnership that will last for a definite period and, upon expiration of that period, continue on a year to year basis. It is similar to Article 3 of the *form in § 15.201[2]* but provides for an automatic continuation on a year to year basis. Because of the automatic renewal feature of the form, it meets the UPA '94 definition of "partnership at will," a partnership in which the partners have not agreed to remain partners until the expiration of a *definite term* or the completion of a particular undertaking [*Corp. Code § 16101(11)*]. It may be substituted in either *form in §§ 15.200[2]* or *15.201[2]*. See the discussion at *§ 15.302[2]* for the consequences for dissolution purposes of forming an at will or term partnership.

[2] FORM

Term of Partnership Specified Period and Year to Year Continuation Upon Expiration

Term of Partnership

The Partnership shall _____[commence on _____(execution of this Agreement *or* _____[*date*]) *or* continue for a period of _____ years]. Thereafter the Partnership shall automatically be continued for additional consecutive periods of one year each unless, at least _____ days prior to the above expiration date or at least _____ days prior to the end of any subsequent one-year period, either [*or* any] Partner serves written notice on the other(s) of a desire to terminate the Partnership.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.211

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.211 Provision for Contribution of Personal Property and Cash to Initial Partnership Capital

[1] Comment

[a] Use of Form

This form provides for an initial partnership capital contribution consisting of both personal property and cash. It may be used when one or more partners contribute personal property, such as fixtures or equipment.

[b] Contributed Property Tax Considerations

Neither the contributing partner nor the partnership recognize gain or loss on property contributed toward the initial partnership capital [*I.R.C. § 721(a)*]. The basis of a partner's partnership interest is the amount of cash plus the adjusted tax basis of property contributed by the partner [*I.R.C. § 722*]. If a partner is relieved of any liability attached to contributed property, then the partner is treated as having received a distribution of money from the partnership [*I.R.C. § 752(b)*]. Such a constructive distribution will reduce the contributing partner's basis for the partnership interest by the amount of the liability assumed [*I.R.C. § 733(1)*].

The partnership assumes the contributing partner's adjusted basis at the time of contribution for any contributed property [*I.R.C. § 723*]. Because the fair market value of the contributed property may differ from its adjusted basis, contributions of property to partnerships may create tax problems. For the consequences of these tax problems, see *§ 15.21[2]*. This form should only be used in conjunction with the *form in § 15.219* to meet the Internal Revenue Code requirements that any built-in gain or loss on property contributed to a partnership be properly allocated under *I.R.C. § 704*.

[2] FORM

Provision for Contribution of Personal Property and Cash to Initial Partnership Capital

Initial Capital

The Partnership's initial capital shall consist of:

(1) All fixtures, equipment, machinery, and other items listed on Exhibit A to this Agreement and contributed by _____[*name*] at an agreed value of $_____;

(2) The sum of $_____ cash contributed by _____[*name*];

(3) The lease marked Exhibit B for the premises at _____Street, _____, California, contributed by _____[*name*] at an agreed value of $ _____;



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.212

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.212 Provision for Contributions of Real Property to Initial Partnership Capital

[1] Comment--Use of Form

This form may be substituted in any of the complete partnership agreements at §§ 15.200[2], 15.201[2], and 15.202[2] if one or more partners will contribute real property to the initial partnership capital. For a discussion of the tax considerations involved when property is contributed to a partnership, see *§§ 15.21* and *15.211[1][b]*. This form should not be used without a special allocation provision such the one at § 15.219[2].

[2] FORM

Provision for Contributions of Real Property to Initial Partnership Capital

Initial Capital

The initial capital of the Partnership shall be $ _____, contributed by the Partners as follows:

(1) _____[*name of partner*] shall contribute to the Partnership at an agreed value of $ _____ the real property, together with the apartment building thereon, in _____County, California, described as follows: [*set forth legal description*].

(2) _____[*name of partner*] shall contribute to the Partnership at an agreed value of $ _____ the real property, together with the office building thereon, in _____ County, California, described as follows: [*set forth legal description*].

(3) Each Partner shall also contribute in cash to the Partnership on or before _____[*date*], the sum of $ _____, respectively.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.213

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.213 Provision Granting Partnership Interest in Exchange for Partner's Services

[1] Comment

[a] Use of Form

This form should be used in when a partnership will grant a partnership interest to a partner who contributes only services and makes no initial capital contribution. It may be used in place of or in combination with the capital contribution provisions in the complete partnership agreements in §§ 15.200[2], 15.201[2] or 15.202[2].

If the noncontributing partner is limited in making withdrawals only until the contribution to the partnership equals a specified amount, Paragraph (c) of this form need not be used. If, however, the noncontributing partner is limited in making withdrawals until that partner's contributions equal those of each of the other partners, the partnership agreement should contain some provision similar to Paragraph (c) of this form limiting the amount of the share of the net profits of each of the other partners that may be left in the partnership each year. Otherwise, the implied promise to the noncontributing partner that the limitation on withdrawals will someday terminate may be illusory. As the noncontributing partner's capital contribution increases each year, so may the capital contributions of all other partners, with the result that the noncontributing partner's contribution will never equal those of the other partners.

[b] Noncontributing Partners

There is no legal requirement that each partner make a capital contribution to the partnership [*Bowen v. Velliquette, (1957) 153 Cal. App. 2d 847, 851, 315 P.2d 95]* . If one partner has a special skill, talent, knowledge, or other attribute, it may benefit the partnership to exchange a partnership interest for that partner's special quality in lieu of a capital contribution. In such instances, both the contributing and noncontributing partners may want the latter to acquire a

capital interest in the partnership.

PRACTICE TIP

Intangible capital contributions are very common in high-tech startups. Founders will often contribute technology or know-how when the partnership is in its infancy. After the ideas have incubated and a new technology or project is developed, the partners will then often look to add partners with different or additional skills, or convert the partnership into a limited liability company and try to attract venture capital. *Commentary by John J. Camozzi*.

Generally, a noncontributing partner is required to leave some share of partnership net profits each year until that partner's determinable capital contributions equal either a specific sum or the other partners' contributions. The noncontributing partner's withdrawals from partnership funds may be limited, with the remainder of that partner's share of net profits after withdrawals to be transferred to a capital account. The noncontributing partner's other income sources and requirements for living expenses will determine the extent of any withdrawal limitation.

If the contributing partners do not devote full time to the partnership business, they may wish to provide a salary for a noncontributing partner who does. See the *form in § 15.202[2]* for a monthly salary provision.

[2] FORM

Provision Granting Partnership Interest in Exchange for Partner's Services

Initial Capital

(a) The initial capital of the Partnership shall be $ _____ to be contributed by _____ and _____[*names of contributing partners*] in the following manner: _____[*set forth manner of making initial contributions, e.g.,* each Partner shall contribute the sum set forth opposite that Partner's name below by depositing that sum on or before _____ (*date*), in an account in the name of the Partnership at the _____ Office of _____ Bank, in _____, California].

(b) _____[*name of noncontributing partner*] shall make no cash contribution to the initial Partnership capital but shall contribute intangible capital in the form of [*specify, e.g.,* technological expertise in software development *or* the devotion of _____ (his/her) undivided time and attention to the Partnership business and shall be entitled to _____ [a _____ percent share *or* an equal share with the other Partners] of the Partnership net profits and losses.

(c) Until _____[*name of contributing partner*]'s contributions to the Partnership capital equal(s) _____[those of each of the other Partners *or* $ _____], _____[*name of noncontributing Partner*] shall make no withdrawals from the Partnership funds [in excess of $ _____ per month] and shall contribute [the remaining portion of] the annual distributive share of Partnership net profits to the Partnership capital.

(d) On each accounting provided for in this Agreement _____percent of each Partner's distributive share of Partnership net profits shall be retained in the Partnership and credited as a contribution by such Partner to the Partnership capital. Until all Partners' contributions to the capital of the Partnership are equal, this paragraph shall not apply to _____[*name of noncontributing partner*]'s distributive share of net profits, nor shall any other Partners be entitled to make further contributions to the Partnership capital except as provided in this paragraph without the consent of all the Partners.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.214

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.214 Provision for Distributing Profits and Losses Among Partners According to Their Respective Net Worths in the Partnership

[1] Comment--Use of Form

If the amount of capital and retained earnings is a major factor in determining what the partnership may earn in subsequent years (as in the case of a self-financed growth company), it may be important to offer an incentive to the partners to leave their distributive shares of net profits in the partnership. This form is designed to provide such an incentive by providing that net profits and net losses of the partnership must be divided among the partners according to their then respective "net worths" in the partnership. Increasing net worth by leaving partnership profits with the partnership may increase a partner's share of future partnership profits.

When both the amount of capital and retained earnings and the ability of one partner who devotes full time to the partnership business to manage that capital are the major elements which produce revenue for the partnership, this form may be combined with a guaranteed salary provision for a managing partner [*see* salary provision in the *form in § 15.202[2]*] to give the other partners an incentive for not withdrawing their shares of the partnership's profits and at the same time provide the managing partner with adequate compensation for services.

[2] FORM

Provision for Distributing Profits and Losses Among Partners According to Their Respective Net Worths in the Partnership

Profits and Losses

The net Partnership profits or losses for each accounting provided for in this Agreement shall be credited or charged to the Partners in the same proportions that their respective net worths in the Partnership bear to the total net worth of the Partnership before determination of net Partnership profits or losses for that accounting period.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.215

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.215 Provision for Percentage of Net Profits to Be Added to Partnership Capital Each Accounting Period

[1] Comment--Use of Form

If the partners anticipate that they will have to withdraw major portions of their distributive shares of net partnership profits for living expenses, or they want to keep their "net worths" or capital accounts equal, they may provide for the future growth of the partnership business by agreeing that a specified percentage of their distributive shares of the partnership net profits each accounting period will be retained in the business. In using this form, however, care should be taken not to make the percentage of net profits to be retained so high that an individual partner will be unable to pay income taxes on the partner's full share of the partnership net profits. The last sentence of the form prohibiting any other contributions to capital by any partner need be used only if the partners wish to keep their contributions equal.

[2] FORM

Provision for Percentage of Net Profits to Be Added to Partnership Capital Each Accounting Period

Percentage of Net Profits to Be Added to Capital

On each accounting provided for in this Agreement, _____percent of each Partner's distributive share of the net Partnership profits shall be retained in the Partnership and credited as a contribution by such Partner to the Partnership capital. [No Partner shall be entitled to make any other contributions to the Partnership capital without the written consent of the other Partners].



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.216

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.216 Provision for Maintenance of Separate Capital and Income Accounts for Each Partner

[1] Comment

[a] Use of Form

This form provides for the maintenance of separate capital and income accounts for each partner. Under this form, each partner's share of the net partnership profits is credited to the partner's income account, and any credit balance in a partner's income account--in other words, any unwithdrawn profits not already transferred to capital account--is declared to be a partnership liability to that partner and not part of the partner's interest in the partnership capital. Furthermore, this form requires definite, affirmative action by the partners to transfer any portion of unwithdrawn profits from the partners' income accounts to their capital accounts. It also provides that no such transfer may be made if the proportional interests of the partners in the capital of the partnership would be changed thereby. This insures that the proportional capital interests of the partners in the partnership will remain the same as established by their contributions to the initial capital of the partnership. This form may be inserted as Sections 2.14 and 2.15 of the *form in § 15.200[2]*.

[b] Distinction Between Capital and Income

Each partner's capital interest in a partnership is the amount that partner has set apart and invested in the partnership business. The increases, proceeds, or earnings of partnership capital, beyond expenditures incurred in its use, constitute the profits of the business [*Bailey v. Clark (1875) 88 U.S. 284, 22 L. Ed. 651, 652]* .

A partner may decide not to withdraw the full distributive share of the partnership profits each year. The question then arises as to whether the portion of profits the partner has allowed to "remain in the business" is a loan to the partnership or an additional contribution to the partnership capital. One California case has held that such unwithdrawn profits are,

in effect, a loan to the partnership [*Dugan v. Forster (1930) 104 Cal. App. 117, 121* P, 384]. However, the provisions of UPA '94, which apply absent a contrary partnership agreement, require that an account be maintained for each partner that includes the value of money and property contributed to the partnership together with a partner's share of partnership profits. In effect, this provision makes partnership profits left in the partnership additional capital contributions [Corp. Code § 16401(a)(1)]. Most accountants do not set up those unwithdrawn profits in their financial reports as loans to the partnership, but rather as part of the partner's "net worth" in the partnership business. "Net worth" is the partner's original investment plus any profit reinvested in the business [*see* Martin, Attorney's Handbook of Accounting, Auditing and Financial Reports (4th ed.), § 4.01(2) (Matthew Bender)].

PRACTICE TIP

Counsel should make sure that the partnership's accountant treats the partners' accounts as intended at formation and as provided by the partnership agreement. *Commentary by John J. Camozzi*.

This form eliminates any confusion by requiring that partnership profits left in the partnership be kept separate in an income account until a majority of the partners vote to charge the income account balances to their capital accounts. This is a permissible variation from UPA '94 by partnership agreement [*Corp. Code § 16103*].

[c] Importance of Distinction for Nontax Purposes

The determination of "net worth" in or capital contributions is important if the share of partnership profits and losses or voting rights are based on a partner's interest in a partnership. See the *form in § 15.201[2]*. This form keeps the respective interests of the partners the same as their initial contributions. Thus, in a partnership that divides partnership profits and losses according to the partners' capital contributions to the partnership, a partner who withdraws greater amounts of partnership profits during a year than other partners will not receive a reduced share of future partnership profits. The form limits credit transfers from the income account to capital account to those that do not change the proportionate interests of the partners.

[d] Importance of Distinction for Income Tax Purposes

The capital interests owned by a partner can make a difference in several different tax areas. Selection of a tax year for a partnership is generally limited based on the capital interests of partners [*see I.R.C. § 706*; *see also § 15.23*]. The capital interests of a partner in a partnership affect whether deductions will be allowed for losses from sales or exchanges of property directly or indirectly: (1) between a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or the profits interest, in the partnership [*I.R.C. § 707(b)(1)(A)*]; or (2) between two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profit interests [*I.R.C. § 707(b)(1)(B)*]. The characterization of gain on the sale of an asset used in trade or business and subject to depreciation as capital or ordinary is affected if the sale is between a partnership and a person owning more than 50 percent of the capital interest or profits interest in the partnership [*I.R.C. § 707(b)(2)*]. Finally, the determination of whether a partnership is terminated or continues after the sale or exchange of a partnership interest, the merger or consolidation of two or more partnerships, or the division of a partnership into two or more partnerships, depends on a comparison of the capital and profit interests of the partners in the partnership business before and after the sale, transfer, merger, consolidation, or division [*I.R.C. § 708*].

[2] FORM

Provision for Maintenance of Separate Capital and Income Accounts for Each Partner

Capital Accounts

Individual capital accounts shall be maintained for all Partners consisting of their contributions to the initial Partnership capital as:

(1) Increased by:

(a) Any additional contributions to Partnership capital made by them pursuant to this Agreement.

(b) Any amounts transferred from their income accounts to their capital account pursuant to this Agreement.

(2) Decreased by:

(a) Any distributions made to them in reduction of Partnership capital.

(b) Their shares of any Partnership losses charged to the capital accounts of the Partners pursuant to this Agreement.

Income Accounts

Individual income accounts shall be maintained for all Partners. Partners' shares of net Partnership profits shall be credited to their income accounts and all Partners' shares of any net loss suffered by the Partnership shall be charged to their income accounts unless the Partners agree [by majority vote] to charge that loss to their capital accounts. All withdrawals by Partners shall be charged to their income accounts. The Partners may at any time by majority vote [*or* agreement] transfer all or any portion of the credit balances in their respective income accounts to their capital accounts, provided the ratio each Partner's capital account bore to the total capital of the partnership, as reflected by the combined capital accounts of all the Partners, immediately prior to the transfer, is not changed by the transfer.

Balance in Partner's Income Account Not Capital

A credit balance in a Partner's income account shall constitute a Partnership liability to that Partner, payable without interest [on demand *or* at such time as may be determined by majority vote (*or* agreement) of the Partners], and shall not constitute a part of that Partner's interest in the Partnership capital. A debit balance in a Partner's income account, whether occasioned by withdrawals in excess of that Partner's share of Partnership net profits or the charging to an income account of any share in Partnership net losses, shall constitute an obligation of that Partner to the Partnership, payable without interest [on demand *or* from that Partner's share of the future net profits of the Partnership], and shall not reduce that Partner's interest in the Partnership capital.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.217

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.217 Provision for Loan of Property to Partnership by Partner

[1] Comment

[a] Use of Form

This form is a provision for the loan of property to the partnership by a partner. It may be used when a partner intends to loan rather than contribute assets to the partnership. It may be used in place of Paragraph 6 in the *form in § 15.202[2]* and added as Section 2.16 to the *form in § 15.200[2]* when appropriate.

[b] Reasons for Loaning Asset to Partnership

There are several reasons why a partner may wish to loan rather than contribute real or personal property to a partnership. First, on dissolution or insolvency, partnership assets are primarily liable for the partnership debts, while the individual partners and their separate properties are have only secondary liability [*Corp. Code § 16807*]. Second, the partnership agreement need not contain a provision for the allocation of depreciation deductions, capital gains, or losses relating to loaned property [*see § 15.21*]. If the property remains the partner's separate asset and is merely loaned to the partnership, the deductions, gains, or losses will automatically be allocated for income tax purposes to the partner. Finally, the partner lending property to the partnership will be entitled to its return in kind on termination of the partnership.

However, if property owned by one partner prior to organization of the partnership thereafter is used for partnership purposes without being mentioned in the partnership agreement, a court in subsequent litigation is required to determine whether the property became a partnership asset based on the intention of the partners as evidenced by their conduct and course of dealing during the partnership [*Perelli-Minetti v. Lawson (1928) 205 Cal. 642, 648, 272 P. 573]*

[2] FORM

Provision for Loan of Property to Partnership by Partner

Loan of Asset to Partnership

_____[*Name of partner*] agrees to loan to the Partnership during the continuance of the Partnership [the property described on Exhibit B *or* the following property: _____ (*describe property*)], and not to sell or dispose of that property during the continuance of the Partnership without the consent of the other Partners, on condition that:

(1) The property shall remain _____[*name*]'s separate property, shall not become part of the Partnership capital or assets, and shall be returned to _____[*name*] on termination of the Partnership in substantially the same condition, reasonably wear and tear excepted, as it is now in.

(2) The Partnership, at its own cost and expense, shall maintain the property in a safe, clean, and workable condition, shall carry insurance on the property in an amount equivalent to its replacement cost against loss or damage by fire, theft, or the elements, and shall pay all taxes levied or assessed against the property.

[*If distributive shares of profits and losses are determined according to the respective net worths of the Partners in the Partnership:* (3) For purposes of determining _____ (*name*)'s share of the net Partnership profits and losses, but not otherwise, the agreed value of the property, $ _____, shall be considered a contribution to the capital of the Partnership by _____ (him/her).]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.218

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.218 Provision for Payment of Interest on Capital Accounts of Partners

[1] Comment--Use of Form

When the partners' capital contributions are not equal and capital plays an important part in the production of partnership income, the partners may wish to receive interest on their contributions to the partnership. A partner is not entitled to interest on the capital contribution under UPA '94 except to the extent the contribution is greater than the amount a partner originally agreed to contribution [*Corp. Code § 16401(d), (e)*]. This form makes a permissible variation from UPA '94 by providing for the payment of interest at a specified rate on capital contributions to the partnership. This form may be inserted as Paragraph 7 of the *form in § 15.202[2]* or Section 2.16 to the *form in § 15.200[2]*.

PRACTICE TIP

This form allows interest to all partners regardless of the disparate amounts of the capital contributions. As an alternative, counsel may recommend that interest be paid only on the capital accounts that exceed a minimum average. This alternative rewards the greater contributors by treating all minimum (and lower) contributions as non-interest bearing. *Commentary by John J. Camozzi*.

[2] FORM

Provision for Payment of Interest on Capital Accounts of Partners

Interest

All Partners shall be entitled to interest at the rate of _____percent per annum on the average balance

in their capital accounts during the preceding fiscal year of the Partnership. Interest shall be paid from the Partnership gross profits at the close of each such fiscal year [*or* quarterly during the year], shall be cumulative so that any deficiency in one year may be paid from the gross profits for any succeeding year or years, and shall be deductible by the Partnership as an ordinary and necessary business expense before determination of net profits.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.219

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.219 Provision for Special Allocation for Property Contributed With Built-In Gain or Loss

[1] Comment--Use of Form

This provision should always be included if the partnership agreement allows a partner to contribute property to the partnership capitalization. This form is designed as a general form applying to all property that has already been contributed, or may be contributed in the future, at a value either greater or less than its adjusted income tax basis in the hands of the contributing partner [*see § 15.21* for a discussion of the tax problems associated with the contribution of property to a partnership]. It satisfies the IRS requirements for special allocations to account for built-in gain or loss on property that is contributed to a partnership [*I.R.C. § 704*; *Treas. Reg. §§ 1.704-1*, 1.704-3] This form may be inserted as Paragraph 7 of the *form in § 15.202[2]*, or added as Section 2.12 to the *form in § 15.200[2]*.

[2] FORM

Provision for Special Allocation for Property Contributed With Built-In Gain or Loss

Allocation of Depreciation, Gain, or Loss

If a Partner, on formation of the Partnership or at any time thereafter, contributes property with an adjusted income tax basis different from the agreed value or fair market value at which the property is accepted and credited to that Partner's capital account by the Partnership, then solely for income tax purposes and the determination of each Partner's distributive share of the net Partnership profits and losses, any depreciation, depletion, gain, or loss with respect to that property shall, pursuant to *Section 704(c) of the Internal Revenue Code of 1986*. and *Treasury Regulation Section 1.704-3* be allocated according to the [traditional method *or* traditional method with curative allocations *or* traditional method with remedial allocations].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.220

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.220 Provision Guaranteeing Partner Specified Amount Per Year From the Net Profits of the Partnership

[1] Comment

[a] Use of Form

This provision guarantees that one partner will receive a minimum specified amount from the net partnership profits each year. It redistributes the shares of net profit payable to each partner in years when the partnership has net profits insufficient to pay the guaranteed amount plus the full shares of all other partners. If, for example, each partner in a three-person partnership is to receive one third of the annual net profits, but one partner is guaranteed $10,000 of each year's net profits in a year when the partnership earned only $20,000 net profits, each of the other partners would receive only $5,000, or one fourth of the net profits.

This form differs from a provision guaranteeing one or more partners a salary "deductible as an ordinary and necessary expense of the partnership business before determination of net profits" [*see* Paragraph 13 of *form in § 15.202[2]*], a provision for the payment of interest on the amount of capital contributed by one or more partners [*see form in § 15.218*], or a provision simply guaranteeing payment of a specified amount to one or more partners each year regardless of net profits, in the following ways. First, in a year when the partnership earned no net profits, the amounts specified in such a salary, interest, or guaranteed payment provision would still be payable by the partnership and might result in a net loss to the partnership. In a year when the partnership had no net income, the amounts specified in this form would not be payable and could not result in a net loss to the partnership. Second, the amounts specified in such a salary, interest, or guaranteed payment provision must be paid before the net profits of the partnership can be determined. The amounts specified in this form cannot be paid or determined until after the net profits of the partnership have been computed.

[b] Distributions to Partners--Tax Consequences

Only the portion of any payment made under this form that exceeds the recipient partner's otherwise distributable share of partnership net profits is deductible from partnership income [*see Treas. Reg. § 1.707-1(c)*, Example (2)]. In this respect, the tax consequences of such distributions differ from those attending salary, interest, or guaranteed payments which are deductible as business expenses [*see I.R.C. §§ 162(a), 707(c)*].

Under California law, the taxation of partnerships is generally determined in accordance with the partnership provisions of the Internal Revenue Code [*Rev. & Tax. Code § 17851*; *see I.R.C. §§ 701-761*; *but see Rev. & Tax. Code §§ 17851-17932* (modifications to federal law)].

[2] FORM

Provision Guaranteeing Partner Specified Amount Per Year From the Net Profits of the Partnership

Guaranty of Profits

Notwithstanding any other provision of this Agreement, _____[*name of partner*] shall be entitled to receive from the net profits earned by the Partnership in each fiscal year either the share of those profits distributable to _____[*name*] under the provisions of Paragraph _____of this Agreement or the sum of $ _____, whichever is greater.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.221

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.221 Provision Guaranteeing Payment of Specified Minimum Amount Each Year Regardless of Profits

[1] Comment

[a] Use of Form

This form, like the *form in § 15.220*, redistributes the shares of the partnership's net profits that are payable to the partners in the years when the partnership had net profits insufficient to pay both the amount guaranteed and the full distributive shares of the other partners. This form, however, guarantees that such payments will be made without regard to partnership income. This form may be added to the *form in § 15.200[2]*, following Section 2.15, and numbered accordingly.

PRACTICE TIP

Guaranteed payment provisions create two classes of partners: those receiving payments and those funding them. Care should be taken to ensure that all partners understand the effect of such provisions before the agreement is presented for their signatures. *Commentary by John J. Camozzi*.

[b] Deduction of Guaranteed Payments

To the extent determined without regard to the partnership income, payments to a partner for services or the use of capital are considered made to one who is not a member of the partnership and are deductible as trade or business expenses on the partnership informational income tax return [*I.R.C. §§ 162(a), 707(c)*]. There are three types of provisions that can be inserted in a partnership agreement guaranteeing payments, deductible by the partnership, to one or more partners:

- A provision entitling one or more partners to a salary "deductible as an ordinary and necessary expense of the partnership business before determination of net profits" [*see* Paragraph 13 of *form in § 15.202[2]*];

- A provision entitling one or more partners to interest on their contributions to the partnership capital [*see form in § 15.218[2]*]; and

- A provision similar to this form, guaranteeing a partner a specified amount each year from the partnership.

Payments for a partner's services or use of capital may be deducted as guaranteed payments if they are determined without regard to partnership income and are ordinary and necessary business expenses within the meaning of *I.R.C. § 162(a)* [*see I.R.C. § 707(c)*]. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services [*Treas. Reg. § 1.162-7(a)*]. If a payment made to a partner and deducted by the partnership as a guaranteed payment is challenged by the IRS, the Tax Court will examine the nature of the services for which the compensation was paid to determine whether they were ordinary and necessary to the partnership business [*see J.E. Cagle, Jr. (1974) 63 T.C. 86]* .

Partnership syndication expenses (that is, costs paid or incurred in selling partnership interests) may not be deducted from partnership income [*I.R.C. § 709(a)*]. Syndication and organizational expenses must be capitalized and amortized over a period of not less than 60 months. Capital expenditures may not be deducted from partnership income as guaranteed payments [*I.R.C. § 707(c)*; *see I.R.C. §§ 162(a), 263*].

Under California law, the taxation of partnerships is generally determined in accordance with the partnership provisions of the Internal Revenue Code [*Rev. & Tax. Code § 17851*; *see I.R.C. §§ 701-761*; *but see Rev. & Tax. Code §§ 17851-17932* (modifications to federal law)].

[2] FORM

Provision Guaranteeing Payment of Specified Minimum Amount Each Year Regardless of Profits

Guaranteed Payment

During the continuance of this Partnership, the Partnership shall pay to _____[*name of partner*] a sum of not less than $ _____ each fiscal year. Should the share of the net Partnership profits distributable under Paragraph _____ of this Agreement to _____[*name of partner*] in any such year be less than $ _____, the remaining Partners shall contribute, from their capital accounts or otherwise, such amounts as may be necessary to enable the Partnership to pay _____[*name of partner*] the sum of $ _____. These contributions shall be made by the remaining partners in the same proportion as [they are entitled to share in the Partnership profits *or* their respective net worths in the Partnership bear to each other].



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.222

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.222 Provision Specifying Amount of Permanent Capital to Be Maintained by Partnership and Restricting Withdrawals Until Partnership Capital Equals Specified Amount

[1] Comment--Use of Form

This form is designed to provide a minimum level of capital in the partnership, and to restrict partner withdrawals of partnership profits so that the capitalization of the partnership does not fall below a predetermined level. It may be used with the complete partnership agreements in §§ 15.200[2] and 15.202[2] for working partnerships to assure capitalization levels for the partnerships.

[2] FORM

Provision Specifying Amount of Permanent Capital to Be Maintained by Partnership and Restricting Withdrawals Until Partnership Capital Equals Specified Amount

Permanent Capital: Restrictions on Withdrawals

[Except as provided in Section _____ of this Agreement], [N]o Partner shall withdraw without the written consent of the other Partners any portion of the net Partnership profits unless the total Partnership capital exceeds $ _____. Thereafter, the total permanent capital of the Partnership shall be maintained at the sum of $ _____[*restate amount specified in preceding sentence*]. Any Partner may withdraw any portion of that Partner's distributive share of the annual net Partnership profits not required to maintain the total capital of the Partnership equal to the sum of $ _____[*restate amount specified in preceding sentences*].



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.223

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.223 Provision Establishing Monthly Expense Accounts for Partners

[1] Comment

[a] Use of Form

This form should be used when the partners will incur monthly expenses relative to the partnership business and want to be reimbursed for those expenses. It is particularly appropriate to partnerships in which the partners will be traveling or entertaining on the partnership's behalf. This form may be used in any of the complete partnerships agreements in §§ 15.200[2], 15.201[2], or 15.202[2].

[b] Duty to Indemnify Partner for Partnership Expenses

Corp. Code § 16401(c) provides that the partnership must indemnify every partner for payments made and liabilities incurred in the ordinary course of its business or for the preservation of its business or property. If the partnership business requires the partners to travel, entertain customers, and incur other similar expenses away from the partnership's principal place of business, the partners may desire to spell out in their partnership agreement the manner in which they will be indemnified for these business expenses. They may also wish to limit in advance the amount of these expenses for which a partner can expect to be indemnified without the consent of all other partners. The *forms in §§ 15.200[2]* and *15.224[2]* provide alternative methods for handling partners' expenses.

[c] Expense Account Method of Indemnification

This form provides that the monthly travel, entertainment, and incidental business expenses of a partner will be paid in advance by the partnership through separate revolving monthly expense accounts for each partner. If not all of the

partners are likely to incur such expenses, this form may be modified to provide that expense accounts will be established only for the one or more partners.

Under this form an expense account in a stated amount is established at the beginning of the first month for each partner. During the month, the partners pay their incidental business expenses from the account, and on the last day of the month they file itemized accounts of expenses in the partnership books. The amount of these expenditures are then paid back into the partner's expense account, restoring the account to its original balance for the partner's use during the next month. If a partner exhausts the expense account in any month and incurs additional expenses connected with the partnership business, that partner will be reimbursed for the additional expenses only if all other partners consent to the reimbursement. This limitation on the amount of expenses a partner will be indemnified for in any month should be considered in conjunction with the other limitations on the amount of any obligation a partner may incur in the partnership name found in the *forms in §§ 15.200[2]* and *15.202[2]*.

[2] FORM

Provision Establishing Monthly Expense Accounts for Partners

Reimbursement of Expenses

Each Partner shall have an expense account not to exceed $ _____per month for the payment of actual, reasonable, and necessary expenses incurred in the ordinary course of Partnership business. Each Partner shall keep an itemized account of all expenses paid from that Partner's expense account and shall enter that account in the Partnership books on the last day of each calendar month. No Partner shall, without the consent of all other Partners, be reimbursed for any expenses in excess of that Partner's expense account.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.224

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.224 Provision for Monthly Reimbursement of Partnership Expenditures Made by Each Partner

[1] Comment--Use of Form

This form, like the *form in § 15.223[2]*, provides a method for partners to be reimbursed. Under this form each partner, on submission of an itemized account of such expenses, will be reimbursed monthly. It also limits the amount of a partner's expenses which will be reimbursed by the partnership. It may be used with any of the complete partnership agreements in §§ 15.200[2], 15.201[2], and 15.202[2]. It should not be added before considering the other limitations on obligations that a partner may incur on behalf of the partnership.

[2] FORM

Provision for Monthly Reimbursement of Partnership Expenditures Made by Each Partner

Reimbursement of Expenses

On submission of an itemized account to the Partnership [*or* to the accountant for the Partnership] each Partner shall be reimbursed monthly for all actual, necessary, and reasonable expenditures made by that Partner in the ordinary course of the Partnership business; provided, however, no Partner shall, without the consent of the other Partners, be reimbursed for any expenditures exceeding $ _____.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.225

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.225 Provision Allowing Partner to Devote Less Than Full Time to the Partnership Business

[1] Comment--Use of Form

This form is designed to be used when not all partners will devote full time to the partnership business. In such situations it should be substituted for Paragraph 11 of the *form in § 15.202[2]* or Section 3.01 of the *form in § 15.200[2]*.

This form does not prohibit the partners who have agreed to devote undivided time and attention to the partnership business from engaging or investing in any business. Unless such a prohibition is expressly included in the partnership agreement, any partner may engage in any other business that does not create an interest adverse to that of the partnership and that does not prevent that partner from devoting all necessary attention to the partnership business [*see Neilsen v. Holmes (1947) 82 Cal. App. 2d 315, 324, 186 P.2d 197]* .

PRACTICE TIP

It is important to narrowly define the partnership business in order to limit the partners' fiduciary duties under this provision and under the agreement in general. *Commentary by John J. Camozzi*.

[2] FORM

Provision Allowing Partner to Devote Less Than Full Time to the Partnership Business

Time Devoted to Partnership

_____ and _____[*names of partners*] shall devote their undivided time and attention

to the Partnership business. _____[*Name of other partner*] shall be required to devote only so much time and attention to the Partnership business as all Partners, including _____[*names*], shall deem reasonable or necessary for the furtherance of the partnership business.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide § 15.226

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.226 Provision Requiring Arbitration of Disputes Arising Under Partnership Agreement

[1] Comment--Use of Form

This form contains two alternative arbitration clauses that require the partners to attempt resolution of disputes either in lieu of or before resorting to formal litigation. The first alternative requires binding arbitration. The second alternative establishes informal arbitration guidelines and provides that any result of the proceeding will be nonbinding.

Partnerships are consensual arrangements in which amicable relations among the partners are generally essential to the efficient operation of the business. Including an arbitration clause in the partnership agreement may facilitate early settlement of differences and, ultimately, save the partnership from premature dissolution. Including such a clause may be more important now that partners may bring legal actions against each other and the partnership to enforce rights under the partnership agreement or rights under UPA '94 [*Corp. Code § 16405(b)*]. In *Larkin v. Williams, Woolley, Cogswell, Nakazawa & Russell* [*Larkin v. Williams, Woolley, Cogswell, Nakazawa & Russell (1999) 76 Cal. App. 4th 227, 90 Cal. Rptr. 2d 195]* , the arbitration clause in a partnership agreement stated: "Any controversy or claim arising out of or relating to any provision of this agreement or the breach thereof shall be settled by arbitration. ..." One of the partners filed a complaint for dissolution based on another partner's breach of the agreement, and the firm petitioned to compel arbitration. The court of appeal held that the language of the arbitration clause extended to plaintiff's action which arose out of or related to the partnership agreement [*Larkin v. Williams, Woolley, Cogswell, Nakazawa & Russell (1999) 76 Cal. App. 4th 227, 230-231, 90 Cal. Rptr. 2d 195* (reversing order denying petition to compel arbitration)].

PRACTICE TIP

Arbitrators have great latitude in making an award. The scope of the abritrator's authority should be limited to ensure predictability and encourage early informal resolution. It should also be remembered

that arbitration may be an ineffective forum for resolving equitable issues. It is not uncommon to carve out equity jursdiction from the arbitration clause and to preserve such equity jurisdiction in the appropriate state or federal court. *Commentary by John J. Camozzi*.

[2] FORM

Provision Requiring Arbitration of Disputes Arising Under Partnership Agreement

Arbitration of Disputes

[*EITHER*]

The Partners shall make a good-faith effort to settle any dispute or claim arising under the Partnership Agreement. If the Partners fail to resolve any such disputes or claims, they shall submit them to arbitration under the rules of the American Arbitration Association then in effect. The arbitration award shall be in writing, and shall comply with all provisions of this Agreement and governing law. Judgment on arbitration awards may be entered by any court with appropriate jurisdiction.

[*OR*]

Any controversy or claim arising under this Partnership Agreement shall be submitted for arbitration under the following rules:

(1) Each Partner shall select one arbitrator. The arbitrators selected by the Partners shall choose one additional arbitrator and these shall make up the arbitration panel.

PRACTICE TIP

Panel arbitrations are very expensive, but can be effective in complex matters in which arbitrator expertise is critical. For example, a partnership dispute requiring resolution of accounting, legal, and technical issues may call for an arbitration panel composed of an accountant, an attorney, and an engineer. *Commentary by John J. Camozzi*.

(2) The Partners shall agree on and stipulate to a statement of facts and issues presented, which shall be submitted to the arbitration panel.

(3) If desired, each Partner may submit a written statement of position to the arbitration panel. If a Partner chooses to submit a statement of position, copies of that statement must be served on all other Partners, who shall have the right to submit written rebuttals within _____ days from receipt. Copies of rebuttals shall be served on all Partners.

(4) The arbitration panel may request oral argument at which all Partners shall have the right to be present.

(5) If the arbitration panel desires, it may submit written questions to the Partners. The Partners shall respond to any such questions in writing. If a question is addressed to an individual or fewer than all Partners, copies of the question and the answer shall be served on the other Partners.

(6) Fees and expenses of the arbitration panel shall be paid by the Partnership as a business expense.

(7) The decision of and any award from the arbitration panel shall not be binding on the Partners and shall in no way

prejudice any rights they may have to pursue all available legal and equitable remedies.

PRACTICE TIP

Nonbinding arbitrations can be costly and often ineffective. The parties may want to consider mediation as a precursor to binding arbitration. *Commentary by John J. Camozzi*.



64 of 184 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
2. Alternative Provisions For Term, Capital, Profits, Taxes, and Attention to Business

7-15 California Legal Forms--Transaction Guide §§ 15.227-15.239

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

[Reserved]

§§ 15.227[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.240

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.240 Determining Value of Partnership Interest Using Annual Determination by Partners

[1] Comment

[a] Use of Form

This form is an alternative provision for determining the value of the partnership interest of a deceased or dissociated partner. It can be used as a substitute valuation provision in the buy and sell agreements in the *forms in §§ 15.200[2], 15.201[2],* and *15.202[2]*. This form establishes an arm's length valuation of any partnership interest by having the partners annually determine and set forth on an attached schedule the total value of the partnership and the resulting value of each partner's interest. It also provides that if the partners should, for any reason, fail to determine those values for two consecutive years, the value of a deceased or dissociated partner's interest will be set by appraisal.

PRACTICE TIP

Business valuation is a complex financial specialty that looks at many objective and subjective factors. Partner-agreed valuations are a simple approach to the problem, but can easily understate or overstate market value. This can be particularly problematic if the market value is closely related to goodwill tied to a dissociating partner, or if the dissociated partner's past breaches of fiduciary duty have contributed to unreasonably overstated agreed valuations. In many cases, a business valuation by an objective professional is the preferred method [*see § 15.245*]. *Commentary by John J. Camozzi.*

[b] Determining Value of Deceased Partner's Partnership Interest--Federal Estate Tax Considerations

For federal estate tax purposes, the fair market value of a partnership interest is the net amount a willing purchaser would pay to a willing seller for that interest, when neither party is under a compulsion to buy or sell, and both have

reasonable knowledge of the relevant facts [*Treas. Reg. § 20.2031-3*]. The net amount is determined on the basis of all relevant factors, including (1) a fair appraisal of all partnership assets including goodwill, whether tangible and intangible, as of the valuation date and (2) the demonstrated earning capacity of the partnership business [*Treas. Reg. § 20.2031-3(a)*]. Accordingly, any valuation procedures specified in a buy-sell agreement will bear on, but not necessarily determine, the value of a deceased partner's partnership interest for federal estate tax purposes [*see § 15.253* for discussion of valuing a partner's interest for estate tax purposes].

Special rules apply to (1) the valuation of gifts of partnership interests to family members [*see Treas. Reg. 25.2701-1-25.2701-8*]; (2) the effect of options, contracts to purchase, and other agreements on the value of partnership interests [*see Treas. Reg. §§ 25.2703-1, 25.2703-2*]; and (3) the characterization of lapses of voting and liquidation rights in family-controlled partnerships as transfers, the estate tax effect of such transfers, and the estate tax effect of restrictions on liquidation of interests in family partnerships [*see Treas. Reg. §§ 25.2704-1-25.2704-3*].

[2] FORM

Determining Value of Partnership Interest Using Annual Determination by Partners

Purchase Price of Partnership Interest

On exercise of the option described in [*section or paragraph number of Agreement that allows option to purchase dissociated or deceased partner's interest*] to purchase the Partnership interest of a deceased or dissociated Partner, the remaining Partners shall pay to the person legally entitled thereto [in the manner specified in _____ (*section or paragraph number that provides for special manner of payment, if applicable*)] as the full purchase price of the interest an amount equal to the Agreed Value, as herein defined, of the interest, together with the unwithdrawn portion of the deceased or dissociated Partner's distributive share of the Partnership net profits earned between the day the Agreed Value was determined and the day the option to purchase the Partnership interest is exercised. The Agreed Value of the Partner's interest in the Partnership shall be determined as follows:

(1) The Partners agree that the present fair market value of the Partnership's capital assets, including goodwill, is $ _____, that the fair market value of its unrealized receivables is $ _____, that the fair market value of its inventory is $ _____, and that the fair market value and Agreed Value of each Partner's interest in the Partnership is as follows:

Name of Partner	Value of Interest
_____	$ _____
_____	$ _____
_____	$ _____
_____	$ _____

(2) Within [*number*] days after the close of each Partnership fiscal [*or* calendar] year, the Partners shall determine the then fair market value of the Partnership's capital assets, including goodwill, the then fair market value of its unrealized receivables, the then fair market value of its inventory, and the resulting fair market and Agreed Value of their respective interests in the Partnership. The values so determined shall be entered on the schedule attached to this Agreement [*or* to this Agreement and marked "Schedule of Agreed Values"]. Each entry on the schedule shall be dated and shall be signed by each of the partners. Except as otherwise provided in this Agreement [*or* in this Agreement], the last determination of Agreed Values entered on that schedule shall be binding and conclusive on the parties hereto, their successors, assigns, and personal representatives.

(3) If no Agreed Value for the Partnership interest of a deceased or dissociated Partner has been entered on the schedule

within two years immediately preceding a Partner's death or dissociation, the person legally entitled to the value of that Partner's interest may demand that the last Agreed Value for that interest entered on the schedule be disregarded and that the Agreed Value of the interest be determined by independent appraisers in the following manner: The remaining Partners and the person legally entitled to the value of the interest being purchased shall each appoint one appraiser. If the two appraisers so appointed are unable to agree within [*number*] days after their appointment, they shall appoint a third appraiser. The decision in writing of any two of the three appraisers so appointed shall be binding and conclusive on both the remaining Partners and the person legally entitled to receive the value of the Partnership interest being purchased. The remaining Partners shall pay all costs and expenses incurred by the appraisers incident to the appraisal.

PRACTICE TIP

Multiple appraisers, like panel arbitration, can be costly, particularly when a disputed valuation will also involve attorneys. Valuation by a single valuator, agreed to by the partners and paid for by the partnership, is often a better alternative. When the parties are unable to agree on a single valuator, they may petition the court to appoint one. *Commentary by John J. Camozzi*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.241

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.241 Schedule of Annual Determinations by Partners of Agreed Values to Be Paid for Partnership Interest

[1] Comment--Use of Form

This form is a schedule of agreed values to be used with the *form in § 15.240*. It should be attached to the end of the partnership agreement. Although there are only three entries in this form, as many entries of agreed value may be placed in the schedule attached to the partnership agreement as desired.

[2] FORM

Schedule of Annual Determinations by Partners of Agreed Values to Be Paid for Partnership Interest

SCHEDULE OF AGREED VALUES

1. We agree that as of this date the fair market value of the Partnership's capital assets, including goodwill, is $ _____, the fair market value of its unrealized receivables is $ _____, the fair market value of its inventory is $ _____, and that therefore the fair market and Agreed Value of each Partner's interest in the Partnership is as follows:

Name of Partner	Value of Interest
_____	$ _____
_____	$ _____
_____	$ _____

Dated: _____.

_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]

2. We agree that as of this date the fair market value of the Partnership's capital assets, including goodwill, is $ _____, the fair market value of its unrealized receivables is $ _____, the fair market value of its inventory is $ _____, and that therefore the fair market and Agreed Value of each Partner's interest in the Partnership is as follows:

Name of Partner	Value of Interest
_____	$ _____
_____	$ _____
_____	$ _____

Dated: _____.

_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]

3. We agree that as of this date the fair market value of the Partnership's capital assets, including goodwill, is $ _____, the fair market value of its unrealized receivables is $ _____, the fair market value of its inventory is $ _____, and that therefore the fair market and Agreed Value of each Partner's interest in the Partnership is as follows:

Name of Partner	Value of Interest
_____	$ _____
_____	$ _____
_____	$ _____

Dated: _____.

_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.242

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.242 Determining Value of Partnership Interest Using Net Book Value Plus or Minus Agreed Amount by Which Market Value Exceeds or Is Less Than Book Value

[1] Comment

[a] Use of Form

This form provides another alternative valuation provision that may be used with the buy-out agreement provisions in the complete partnership agreements in §§ 15.200[2], 15.201[2], and 15.202[2]. It requires the partners to meet every year to determine the amount by which the market value exceeds or is less than the book value of their partnership interests. The amount agreed on will be added to or subtracted from the book value of a deceased or dissociated partner's interest to determine the purchase price for that interest.

[b] Book Value Distinguished From Fair Market or Agreed Value

Generally, a partnership's books will carry its fixed assets at a value equal to their cost less any depreciation deductions taken on them. In most instances, the book value of partnership interests will not reflect either the value of intangible assets (e.g., goodwill or easements) or the appreciated value of tangible assets. It follows that the net book value of a partner's partnership interest will not reflect either the partner's distributive share of any fluctuation in the market value of partnership assets or the value of partnership intangibles [*see Piedmont Publishing Co. v. Rogers (1961) 193 Cal. App. 2d 171, 14 Cal. Rptr. 133]* .

"Agreed value" (i.e., a value determined and agreed upon by the partners and attached, by schedule, to the partnership agreement) may not accurately reflect changes in all partners' capital investments. For example, a partner might withdraw a portion of that partner's capital account the day after an agreed value had been determined and entered on

the partnership books. The actual value of such a partner's partnership interest would not be reflected in the partnership books until agreed values are next determined.

This form resolves the difficulties of using book value or agreed value by combining them to determine the purchase price of a partnership interest. It provides that the price paid for an outgoing partner's interest will be its net book value plus or minus an amount that the partners agree will reflect the difference between the interest's market and book values. Net book value of a partner's interest should reflect withdrawals from and additions to partnership capital while the agreed value of the interest should reflect market fluctuations of partnership property values.

[2] FORM

Determining Value of Partnership Interest Using Net Book Value Plus or Minus Agreed Amount by Which Market Value Exceeds or Is Less Than Book Value

Purchase Price of Partnership Interest

On exercise of the option described in [*section or paragraph number of agreement that allows option to purchase dissociated or deceased partner's interest*] to purchase the Partnership interest of a deceased or dissociated, the remaining Partners shall pay to the person legally entitled thereto [in the manner specified in _____ (*section or paragraph number that provides for special manner of payment, if applicable*)] as the full purchase price of the interest an amount equal to:

(1) The net book value, excluding any value for Partnership goodwill, of the interest as shown on the books of the Partnership on the date of the Partner's death or dissociation.

(2) As an addition to or subtraction from that book value, the deceased or dissociated Partner's distributive share of the amount, herein called "excess value," by which the total fair market value of all Partnership assets, including goodwill, either exceeds or is less than the total book value of those assets. The partners agree that the excess value presently [exceeds *or* is less than] book value by the amount of $ _____. They further agree that within [*number*] days after the close of each Partnership [fiscal *or* calendar] year they shall meet, redetermine the excess value, determine whether it exceeds or is less than book value, and enter that information on the attached schedule marked "Schedule of Excess Values." Each entry on the schedule shall be dated and signed by each Partner. The last determination entered on the schedule shall be binding and conclusive on the Partners, their successors, assigns, and personal representatives. If no entries have been made on the schedule for either of the two [fiscal *or* calendar] years of the Partnership preceding the death or dissociation of a Partner, the person legally entitled to the value of that Partner's interest may demand that the last entry of excess value on the schedule be disregarded and that the excess value be determined by a single arbitrator agreed on by the person legally entitled to the value of the interest and the remaining Partners, or, if they are unable to agree on an arbitrator, that the excess value be determined by arbitration conducted under the rules of the American Arbitration Association.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.243

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.243 Schedule of Agreed Amounts by Which Market Value Exceeds or Is Less Than Book Value of Partnership Assets

[1] Comment--Use of Form

This form is a schedule of excess values for use with the *form in § 15.242*. This form should be attached to the end of the partnership agreement when the provisions of the *form in § 15.242* are used in the agreement.

[2] FORM

Schedule of Agreed Amounts by Which Market Value Exceeds or Is Less Than Book Value of Partnership Assets

SCHEDULE OF EXCESS VALUES

1. We, the Partners of _____[*name of partnership*] agree that "excess value" as defined in [*add paragraph or section number of agreement that contains valuation clause*] is $ [*specify agreed amount*] [in excess of *or* less than] the book value of the assets of the Partnership.
Dated: _____.

_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]

[*typed name*]

2. We, the Partners of _____[*name of partnership*], agree that "excess value" as defined in [*add paragraph or section number of agreement that contains valuation clause*] is $ [*specify agreed amount*] [in excess of *or* less than] the book value of the assets of the Partnership.
Dated: _____.

_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]

3. We, the Partners of _____[*name of partnership*], agree that "excess value" as defined in [*add paragraph or section number of agreement that contains valuation clause*] is $ [*specify agreed amount*] [in excess of *or* less than] the book value of the assets of the Partnership.
Dated: _____.

_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]

4. We, the Partners of _____[*name of partnership*], agree that "excess value" as defined in [*add paragraph or section number of agreement that contains valuation clause*] is $ [*specify agreed amount*] [in excess of *or* less than] the book value of the assets of the Partnership.
Dated: _____.

_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.244

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.244 Determining Value of Partnership Interest Using Amount Equivalent to Partner's Capital and Income Accounts on Date of Death, or Dissociation

[1] Comment--Use of Form

This form provides another alternative method of valuing a partnership interest that is to be purchased by the remaining partners on the death or dissociation of a partner. It may be used with the buy-out provisions in the complete partnership agreements in §§ 15.200[2], 15.201[2], and 15.202[2]. It provides that the purchase price for the partnership interest of a deceased or dissociated partner will be an amount equal to the partner's capital and income accounts on the partnership books as of the date of death or dissociation. Before using this form, the attorney should check the partnership agreement provisions that specify what will be entered in and how the individual capital and income accounts of each partner will be kept.

[2] FORM

Determining Value of Partnership Interest Using Amount Equivalent to Partner's Capital and Income Accounts on Date of Death, or Dissociation

Purchase Price of Partnership Interest

On exercise of the option described in [*section or paragraph number of agreement that allows option to purchase dissociated or deceased partner's interest*] to purchase the Partnership interest of a deceased or dissociated Partner, the remaining Partners shall pay to the person legally entitled thereto [, in the manner specified in _____ (*section or paragraph number that provides for special manner of payment, if applicable*)], as the full purchase price of the interest, an amount equal to that Partner's capital and income accounts as they appear on the Partnership books on

the date of death, or dissociation, and as adjusted to include the Partner's distributive share of any Partnership net profits or losses not previously credited to or charged against those income and capital accounts. In determining the amount payable under this paragraph, no value shall be attributed to the goodwill of the Partnership, and adequate provision shall be made for any existing contingent liabilities of the Partnership.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.245

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.245 Determining Value of Partnership Interest Using Single Appraiser's Value or Balance in Partner's Capital and Income Accounts, Whichever Is Greater

[1] Comment--Use of Form

This form provides another method for valuing a deceased or dissociated partner's interest in a partnership. It may be used with the buy-out agreement provisions in the complete partnership agreements in §§ 15.200[2], 15.201[2], and 15.202[2]. It provides that the purchase price for the partnership interest of a deceased or dissociated partner will be either an amount determined by a qualified appraiser appointed by the remaining partners, or the balance in the capital and income accounts of the deceased or dissociated partner as shown on the books of the partnership, whichever is greater. Any qualifications required of the appraiser (such as membership in the American Institute of Real Estate Appraisers) may be substituted for the words "competent member of the American Society of Appraisers" in Paragraph (a) of this form. If the payment for the deceased or dissociated partner's interest is a liquidation instead of a sale, the appraiser's report ordinarily will show the portion of the purchase price attributable to partnership property, goodwill, unrealized receivables, and inventory. The outgoing partner's capital and income accounts will not reflect such values [*see § 15.242[1][b]* for discussion of book value and agreed value].

[2] FORM

Determining Value of Partnership Interest Using Single Appraiser's Value or Balance in Partner's Capital and Income Accounts, Whichever Is Greater

Purchase Price of Partnership Interest

On exercise of the option described in [*section or paragraph number of agreement that allows option to purchase*

dissociated or deceased partner's interest] to purchase the Partnership interest of a deceased or dissociated Partner, the remaining Partners shall pay to the person legally entitled to the value of the interest [, in the manner specified in _____ (*section or paragraph number that provides for special manner of payment, if applicable*)] an amount equal to the greater of the following:

(1) The amount the deceased or dissociated Partner would have received had the Partnership been completely dissolved and liquidated on the day the option was exercised, as determined by a competent member of the American Society of Appraisers actively engaged in business in _____ County, California, selected by the remaining Partners; or

(2) The balance in the capital and income accounts of the deceased or dissociated Partner on the day the option was exercised as shown on the books of the Partnership.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.246

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.246 Determining Value of Partnership Interest Using Inventory and Account to Be Taken as of Date of Death or Date Dissociation Notice Served on Remaining Partners

[1] Comment--Use of Form

This form provides another alternative provision for determining the value of a partner's interest in a partnership. It may be used with the buy-out agreement provisions in the complete partnership agreements in §§ 15.200[2], 15.201[2], and 15.202[2]. This form provides that the purchase price and value of a deceased or dissociated partner's interest will be determined by a complete inventory and account of the partnership as of (1) the date of deceased partner's death; (2) the date notice of dissociation is served on an involuntarily dissociated partner; or (3) the date a withdrawing partner serves notice of intention to dissociate from the partnership on the remaining partners.

This form decreases the remaining partners' opportunities to influence the value of partnership assets after a partner's death or dissociation. It affords the remaining partners time in which to arrange financing for the purchase of the deceased or outgoing partner's interest. However, before expelling a partner, the remaining partners should estimate the value of the partner's interest and attempt to arrange financing.

This form specifies the values to be placed on different partnership assets in the inventory and accounting. This form attributes no value to the partnership goodwill. For definitions of "goodwill" and "book value" as used in this form, see *§ 15.247*. The effect of buy-sell agreements on valuation of partnership interests for federal estate tax purposes is discussed in *§ 15.240*.

[2] FORM

Determining Value of Partnership Interest Using Inventory and Account to Be Taken as of Date of Death or

Date Dissociation Notice Served on Remaining Partners

Purchase Price of Partnership Interest

On exercise of the option described in [*section or paragraph number of agreement that allows option to purchase dissociated or deceased partner's interest*] to purchase the Partnership interest of a deceased or dissociated Partner, the remaining Partners shall pay to the person legally entitled thereto [, in the manner specified in _____ (*section or paragraph number that provides for special manner of payment, if applicable*),] an amount equal to the value of the interest as determined by a complete inventory and accounting of the Partnership affairs as of the close of the Partnership business on the day of the deceased Partner's death, or for a dissociated Partner, the day the notice of dissociation is served. For purposes of this inventory and accounting:

(1) All items of Partnership inventory shall be valued at their actual cost to the Partnership or at their then market value, whichever is [lower *or* higher].

(2) All tangible assets of the Partnership, including lands, buildings, fixtures, machinery, automobiles, and equipment shall be valued at their book value then appearing on the Partnership books.

(3) All accounts receivable due the Partnership that are more than 90 calendar days old and not barred by the statute of limitations shall be valued at one-half their face value.

(4) All accounts receivable due the Partnership that are less than 90 calendar days old shall be valued at their full face value.

(5) No value shall be attributed to the goodwill, trade name, leasehold interests, or other intangible assets of the Partnership.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.247

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.247 Determining Value of Partnership Interest Using Net Book Value of Interest Plus Capitalized Share of Past Average Net Profits

[1] Comment

[a] Use of Form

This form provides another alternative method of valuing partnership interests. It may be used with the buy-out agreement provisions in the complete partnership agreements in §§ 15.200[2], 15.201[2], and 15.202[2]. This form requires the capitalization of the deceased or dissociated partner's interest in past partnership earnings. The form provides for the capitalized earnings to be added to the net book value of the partner's partnership interest to arrive at a purchase price for the interest. For an alternative provision requiring capitalization of all partnership income, see *§ 15.249[2]*.

[b] Partnership Interests

A partner's share in the partnership profits and surplus constitutes a partner's transferable partnership interest [*Corp. Code § 16502*]. For purposes of determining the partnership interest, "surplus" is the excess of partnership assets over partnership liabilities [*see Comstock v. Fiorella (1968) 260 Cal. App. 2d 262, 267, 67 Cal. Rptr. 104]* . Accordingly, the net book value of a partner's interest is the amount by which the partner's share of partnership assets (as valued on the books) exceeds the share of partnership liabilities (as shown on the books), plus any undistributed share in net profits. Since this form bases the purchase price of an outgoing or deceased partner's interest on its net book value, it is important to recognize how partnership assets are treated in the partnership books.

[c] Book Value Defined

The "book value" of any asset may be market value, cost less depreciation, or any other concept of value recognized by sound accounting practice and used by a particular business in recording its financial transactions [*Lassallette v. Parisian Baking Co. (1952) 110 Cal. App. 2d 375, 377, 242 P.2d 671]* . Ordinarily, current assets, such as inventory items, are entered on the books of a business at their cost to the business or their market value, whichever is lower, and fixed assets are carried on the books at their actual cost to the business less any depreciation deductions. In most instances, partnership books will not reflect the value of intangible assets or the appreciation in value of tangible assets [*Piedmont Publishing Co. v. Rogers (1961) 193 Cal. App. 2d 171, 190, 14 Cal. Rptr. 133]* . Because it has no clearly definable "cost," goodwill created by the business generally is not carried on the books of the business. Goodwill purchased by the business from another going concern does, of course, have a clearly defined "cost" to the business and, according to accepted accounting practices, is entered on the books of the business. Consequently, the net book value of a partner's interest in the partnership will ordinarily only reflect his or her share of the depreciated cost of the fixed assets in the partnership's inventory, valued at either cost or market value, whichever is lower. It will not include any value for the goodwill created by the partners' operation of the business. Goodwill, however, is a valuable asset. In one case involving a dispute over the term "total book value" in a buy-sell agreement, the court held that this term was intended to include the value of the goodwill created by a television broadcasting company and not purchased from another going concern [*Piedmont Publishing Co. v. Rogers (1971) 193 Cal. App. 2d 171, 191, 14 Cal. Rptr. 133]* . To avoid such confusion, Paragraph (a) of this form expressly provides that any value attributable to the goodwill of the partnership will be excluded in determining the "net book value" of a partner's interest in the partnership.

[d] Valuation of Goodwill

The patronage enjoyed by a partnership because of its reputation for excellence, and the expectation that this patronage will continue, constitute the partnership's "goodwill" [*Piedmont Publishing Co. v. Rogers (1961) 193 Cal. App. 2d 171, 186, 14 Cal. Rptr. 133* ; *see Bus. & Prof. Code § 14100*]. Goodwill is an intangible asset which, like other property interests, is transferable [*see Bus. & Prof. Code § 14102*]. It follows that the value of any partnership goodwill is closely related to the partnership's earning capacity.

The value of a partnership's goodwill is difficult to appraise. However, when it is necessary to value goodwill and there is no better basis for valuation, the Internal Revenue Service provides the following formula [*see Rev. Rul. 68-609, 1968-2 C.B. 327*]:

(1) Compute average earnings for a representative number of years preceding the valuation date;

(2) Compute average annual value of tangible assets used in partnership business for a representative number of years preceding the valuation date;

(3) Compute a fair percentage return on the value arrived at in step (2), above;

(4) Subtract the amount arrived at in step (3) from the amount arrived at in step (1) to arrive at this figure, which will represent the average partnership earnings attributable to goodwill;

(5) Capitalize the figure arrived at in step (4) by an appropriate figure. The Internal Revenue Service specifies that the goodwill of low-risk businesses should be capitalized at a lower rate (e.g., 15 percent to 17 percent) than high-risk businesses (e.g., 17 percent to 20 percent).

Paragraph (b) of this form allows the partners to determine the rate at which goodwill should be capitalized for purposes of the buy-sell agreement.

[2] FORM

Determining Value of Partnership Interest Using Net Book Value of Interest Plus Capitalized Share of Past Average Net Profits

Purchase Price of Partnership Interest

On exercise of the option described in [*section or paragraph number of agreement that allows option to purchase dissociated or deceased partner's interest*] to purchase the Partnership interest of a deceased or dissociated Partner, the remaining Partners shall pay to the person legally entitled thereto [, in the manner specified in _____ (*section or paragraph number that provides for special manner of payment, if applicable*)], as the full purchase price of the interest, an amount equal to:

(1) The net book value, excluding any value for Partnership goodwill, of the interest as shown on the last regular Partnership accounting preceding the death, withdrawal, or termination, as adjusted to reflect an annual depreciation and obsolescence charge of not over _____ percent against any tangible assets that have been depreciated on the Partnership books at a higher rate, plus;

(2) [*Number*] times the deceased or dissociated Partner's distributive share of the average annual net profits of the Partnership during its preceding five fiscal years.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.248

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§ 15.248 Determining Value of Partnership Interest Using Net Book Value of Interest Plus Capitalized Value of Income Attributable to Goodwill

[1] Comment--Use of Form

This form provides a method for valuation of partnership interests that takes into account the worth of partnership goodwill. It should be used by partnerships whose earnings will, to some extent, depend on their reputations in the community. It may be used with the buy-out agreement provisions in the complete partnership agreements in §§ 15.200[2], 15.201[2], and 15.202[2]. For a valuation clause requiring capitalization of all partnership income, see *§ 15.249*. For a discussion of goodwill valuation and related considerations, see *§ 15.247*.

[2] FORM

Determining Value of Partnership Interest Using Net Book Value of Interest Plus Capitalized Value of Income Attributable to Goodwill

Purchase Price of Partnership Interest

On exercise of the option described in [*section or paragraph number of agreement that allows option to purchase dissociated or deceased partner's interest*] to purchase the Partnership interest of a deceased or dissociated Partner, the remaining Partners shall pay to the person legally entitled thereto [in the manner specified in _____ (*section or paragraph number that provides for special manner of payment, if applicable*)], as the full purchase price of the interest, an amount equal to:

(1) The net book value, excluding any value for Partnership goodwill, of the interest as shown on the last regular

Partnership accounting preceding the death, withdrawal, or termination and adjusted to reflect an annual depreciation and obsolescence charge of not over _____ percent against any tangible assets that have been depreciated on the Partnership books at a higher rate, plus;

(2) The value of the Partner's interest in the goodwill of the Partnership business as determined by capitalizing [*fraction, e.g.*, one fifth] of the deceased or dissociated Partner's distributive share of the average annual net profits of the Partnership during its preceding [*number*] full taxable years at _____percent.



74 of 184 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.249

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.249 Determining Value of Partnership Interest Using Partner's Capitalized Share of Past Average Ordinary Partnership Income

[1] Comment

[a] Use of Form

This form should be used when the partners intend to base any valuation of an outgoing partner's interest exclusively on past partnership earnings. It may be used with the buy-out agreement provisions in the complete partnership agreements in §§ 15.200[2], 15.201[2], and 15.202[2]. This form may be modified to allow the deduction or addition of specific income items, such as reasonable wages for each partner devoting full time to the partnership business. For a provision requiring that partnership goodwill be capitalized, see *§ 15.248*.

In using this form, it is important to select carefully the number of partnership taxable years over which earnings will be averaged. The period selected should accurately reflect the income that the remaining partners can expect to receive from the partnership business in the future. Generally, partnerships should not employ a period of less than five years for capitalization purposes [*see Rev. Rul. 68-609, 1968-2 C.B. 327*].

All extraordinary income during the selected period, such as nonrecurring capital gains and losses, should be excluded when valuing the outgoing partner's interest. If the partnership agreement does not provide that each partner will receive a salary for service in the partnership business, a reasonable "wage" for each partner should be deducted from the net partnership profits before they are averaged and capitalized. This form provides for the deduction of amounts required to amortize and pay long-term partnership debts.

[b] Capitalization Method of Valuing Interests

Capitalization of income is a generally accepted method of valuing business interests [*see DeLuz Homes, Inc. v. County of San Diego (1955) 45 Cal. 2d 546, 564, 290 P.2d 544]* . This method is based on the assumption that a certain rate of return is received on each $100 of invested capital. For example, if the rate of return on each $100 of invested capital is 20 percent, and a partnership has net profits of $20,000 per year for five years, the total value of the partnership under the capitalization formula would be 20 times $20,000, or $400,000.

Under this form, the percentage rate at which the adjusted net partnership profits will be capitalized must be determined. The normal return on capital for the particular type of business in which the partnership is engaged will generally determine the rate of capitalization. The IRS indicates that an 8 to10 percent rate of return based on tangible assets is appropriate [*see Rev. Rul. 68-609, 1968-2 C.B. 327*]. Among the factors that will influence the rate selected are (1) the nature of the business; (2) the risk involved in the business; and (3) the stability or irregularity of earnings (e.g., a low-risk business with regular earnings will be capitalized at a lower rate than a high-risk business with erratic earnings) [*see Rev. Rul. 68-609, 1968-2 C.B. 327*]. For a discussion of the IRS formula applied to value goodwill, see *§ 15.247*.

PRACTICE TIP

Earnings valuation multipliers tend to be industry specific and are often discounted for identifiable risks. Care should be taken in selecting a multiplier value at the partnership's inception, which, if not later adjusted for risk, may over or under value the partnership interest. *Commentary by John J. Camozzi*.

[2] FORM

Determining Value of Partnership Interest Using Partner's Capitalized Share of Past Average Ordinary Partnership Income

Purchase Price of Partnership Interest

On exercise of the option described in [*section or paragraph number of agreement that allows option to purchase dissociated or deceased partner's interest*] to purchase the Partnership interest of a deceased or dissociated Partner, the remaining Partners shall pay to the person legally entitled thereto [, in the manner specified in _____ (*section or paragraph number that provides for special manner of payment, if applicable*)], as the full purchase price of the interest, an amount equal to the deceased or dissociated Partner's distributive share of the average "adjusted net profits" of the Partnership for the preceding [*e.g.*, five] full taxable years of the Partnership, [capitalized at the rate of *or* divided by] _____percent. The term "adjusted net profits" of the Partnership as used in the paragraph shall mean the total net Partnership profits for each of those [*e.g.*, five] preceding taxable years, as adjusted by:

(1) The deduction of:

(a) The amounts required to amortize and pay according to its contractual obligations any long-term Partnership debts.

(b) Any nonrecurring capital gains realized by the Partnership because of the sale of major Partnership assets.

(2) The addition of:

(a) Any nonrecurring capital losses suffered by the Partnership because of the sale of major Partnership assets.

(b) Any losses suffered by the Partnership from disaster to the extent not compensated for by insurance.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.250

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§ 15.250 Provision Requiring Remaining Partners to Purchase Partnership Interest of Deceased or Dissociated Partner

[1] Comment

[a] Use of Form

This form is a basic buy-sell provision that requires the remaining partners to purchase a deceased or dissociated partner's interest in the partnership. It is designed to be included in partnership agreements. For example, it may be substituted for Section 4.05 and 4.06 of the *form in § 15.200[2]*. If it is used in that form, then Section 4.08 should be omitted.

[b] Modifications to Form

This form may be modified by substituting any of the valuation provisions in §§ 15.240-15.249 for subparagraphs (1) and (2) in the second paragraph of this form. The form may also be modified to limit the buy-sell to a partner's death, rather than having it occur on death and any dissociation. The partners may prefer an option to purchase or a right of first refusal [*see form in § 15.260[2]*] on the dissociation of another partner, rather than making the buy-sell required in that situation.

[c] Continuation of Term Partnership

This form contain an optional clause that may be used to continue the partnership. It only applies if the partnership is for a definite term or particular undertaking. These types of partnerships dissolve within 90 days after the death or wrongful dissociation (express dissociation before completion of the term or task *Corp. Code § 16602(b)(2)*), unless a majority in

interest of the partners agree to continue the partnership [*Corp. Code § 16801(2)(A)*]. This clause is not needed for at will partnerships because they do not otherwise dissolve on the death or dissociation of a partner [*Corp. Code § 16801(1)*].

[d] Practical Consequences

Because this form imposes a contractual duty to purchase on the remaining partners, it presents practical difficulties. For example, if a partner withdraws from the partnership because it is undergoing financial problems, the remaining partners are then obligated to purchase an interest in an unsuccessful business. Problems also may arise if one or more of the remaining partners does not have the money necessary to make the required purchase. For this reason, caution must be exercised in the use of this form, and the practical difficulties should be considered and resolved by the partners.

[e] Tax Consequences

This form establishes that the remaining partners are purchasing the deceased or dissociated partner's interest in the partnership. Thus, it creates a sale of the partnership interest rather than a liquidation. Because there is a sale of the interest, the deceased or departing partner will recognize capital gain or loss on the sale, except to the extent the price is paid for unrealized receivables or inventory [*I.R.C. § 741*]. Furthermore, the remaining partners receive no deduction. This treatment should be compared with that of a liquidation of a partnership interest, in which case the deceased or dissociated partner has part ordinary income and part capital gain but the partnership and remaining partners may deduct all or at least a portion of the payments [*I.R.C. § 736(a), (b)*; *see I.R.C. § 731*]. See *§ 15.307* for more detailed discussion of the different tax consequences of a sale or liquidation of a partnership interest. See *§ 15.251[2]* for a form to require liquidation of a deceased or dissociated partner's interest.

[2] FORM

Provision Requiring Remaining Partners to Purchase Partnership Interest of Deceased or Dissociated Partner

[*Optional provision for partnerships for a term or particular undertaking; unnecessary for other partnerships:*]

Continuation of Partnership

The Partnership shall not dissolve on the death or wrongful dissociation of any Partner. On any Partner's death or wrongful dissociation, the remaining Partners agree to continue to conduct the Partnership business under the Partnership name.

[*For all partnerships:*]

Purchase of Partnership Interest

On any Partner's death or other dissociation, that Partner or that Partner's personal representative shall sell, and each remaining Partner shall buy, a portion of the deceased or dissociated Partner's Partnership interest. The portion of the interest that an individual remaining Partner shall be obligated to buy under this Agreement shall be that proportion which the remaining Partner's net worth in the Partnership bears to the total net worth in the Partnership of all remaining Partners. All remaining Partners shall pay to the person legally entitled thereto [, in the manner specified in _____ (*section or paragraph number that provides for special manner of payment, if applicable*)], as

the full price for the interest purchased under this Agreement, their proportional shares of an amount equal to:

(1) The net book value, excluding goodwill, of the deceased or dissociated Partner's interest as it appears on the Partnership books on the date of the selling Partner's death or notice of dissociation; plus

(2) [*number*] times the deceased or dissociated Partner's distributive share of the average net Partnership profits for the preceding [*e.g.*, five] Partnership fiscal years.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.251

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§ 15.251 Provision Requiring Partnership to Purchase and Liquidate Interest of Deceased or Dissociated Partner

[1] Comment--Use of Form

This form is a provision that requires the partnership as an entity, and not the remaining partners, to purchase and liquidate the interest of a deceased or dissociated partner. It provides for the liquidation and not the sale of the interest. See *§ 15.250[2]* for a form requiring purchase by the remaining partners. Any formulas set forth in the *forms in §§ 15.240through 15.249*, or in the complete agreements in §§ 15.200[2] or 15.202[2], may be substituted for Paragraphs (1) and (2) of this form.

For discussion of the difference in tax treatment of liquidation of partnership interests and purchase and sale, see *§§ 15.250[1][e]* and *15.307*.

[2] FORM

Provision Requiring Partnership to Purchase and Liquidate Interest of Deceased or Dissociated Partner

Liquidation of Interest

On any Partner's death or dissociation that Partner or that Partner's estate or successor shall sell, and the Partnership shall purchase and liquidate, that Partner's interest by paying to the person legally entitled thereto, in full satisfaction and discharge of the interest, the following amount:

(1) The net book value, excluding goodwill, of the interest as it appears on the Partnership books on the date of that Partner's death, withdrawal, or expulsion; and

(2) The sum of $ _____ for the Partner's interest in the goodwill of the Partnership business.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.252

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§ 15.252 Provision Allowing Deceased Partner's Spouse or Other Legatee to Continue Decedent's Partnership Interest and Become General Partner

[1] Comment--Use of Form

This form is a provision governing the disposition of a specific partner's partnership interest upon that partner's death. It allows a named legatee the option to continue as a partner in the partnership rather than selling or liquidating the partnership interest. This form may be made to generally apply to any deceased partner's partnership interest by substituting the words "any partner" for the name of the specific partner and omitting the specific legatee's name. It may be added as the last paragraph of Article 4 in the *form in § 15.200[2]* or inserted as Paragraph 19 in the *form in § 15.202[2]*.

PRACTICE TIP

Care should be taken in using this form. In most cases the partners will prefer liquidating the deceased partner's interest (*see § 15.253*) rather than admit an unknown legatee to the partnership's business and affairs. *Commentary by John J. Camozzi*.

[2] FORM

Provision Allowing Deceased Partner's Spouse or Other Legatee to Continue Decedent's Partnership Interest and Become General Partner

Legatee's Right to Become Partner

The remaining Partners' option to purchase a deceased Partner's interest shall, upon _____[*name of*

partner]'s death, be subject to _____[*name of spouse or other legatee*]'s right to assume the partnership interest and become a General Partner. _____[*name of spouse or other legatee*] may exercise that right provided:

(1) That, at the time of death, _____[*name of partner*]'s Partnership interest is designated to pass to _____[*name of spouse or other legatee*] by will, the laws of intestate succession, or otherwise;

(2) That _____[*name of partner*]'s estate is in such a condition that a sale of his or her Partnership interest is not required during probate administration;

(3) That within _____ days after the date of _____[*name of partner*]'s death, _____[*name of spouse or other legatee*] serves a declaration of intent to enter the Partnership and become a General Partner on the remaining Partners and the executors of _____[*name of partner*]'s estate.

Upon distribution of _____[*name of partner*]'s interest, _____[*name of spouse or other legatee*] shall be admitted to the Partnership as a General Partner with all the rights and obligations _____[*name of partner*] would have had. Neither the deceased Partner's estate nor its executors and administrators shall be liable for obligations incurred or losses suffered by the Partnership business during probate administration of the decedent's estate beyond the amount includable in that estate already invested or involved in the Partnership on the date of the deceased Partner's death.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.253

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.253 Provision for Payment of Distributive Share of Net Profits to Estate of Deceased Partner in Liquidation of Partnership Interest

[1] Comment--Use of Form

This form is a provision requiring the partnership to continue in business following a partner's death and to liquidate the deceased partner's interest by making periodic distributions to the decedent's estate. It may be substituted for the buy-sell provisions of Article 4 in the *form in § 15.200[2]*, or for Paragraphs 15 through 18 in the *form in § 15.202[2]*. This form requires liquidation payments based on the partnership income. Therefore, the payments to the partner's estate will be treated the same as distributions from the partnership [*I.R.C. § 736(a)*; *see IRC § 731*]. For a more detailed discussion of the tax consequences of periodic payments in liquidation of a partner's interest, see *§ 15.307[3]*.

PRACTICE TIP

An alternative structure would be for the partnership to purchase the deceased partner's interest through a promissory note rather than through periodic distribution. *Commentary by John J. Camozzi*.

[2] FORM

Provision for Payment of Distributive Share of Net Profits to Estate of Deceased Partner in Liquidation of Partnership Interest

Income Payments to Deceased Partner's Estate

Upon any Partner's death the Partnership shall pay to the decedent's estate, [*e.g.*, monthly *or* quarterly], the deceased Partner's share of Partnership net profits to the end of the calendar month in which that Partner died and for a period of

_____ months thereafter in complete liquidation of the deceased Partner's Partnership interest. If the Partnership is terminated during that _____ month period, before all payments are made to the deceased Partner's estate, a single payment shall be made from the Partnership assets in an amount equal to the average monthly net Partnership profits for the _____ month period preceding the deceased Partner's death, multiplied by the number of months remaining in the _____ month period following the close of the calendar month in which the death occurred. The Partnership shall not make any payments to a deceased Partner's estate for the deceased Partner's Partnership interest except those provided for under this Paragraph.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.254

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.254 Provision for Continuation of Partnership to End of Fiscal Year in Which Deceased Partner Died

[1] Comment

[a] Use of Form

This form may be used in a two-member partnership to avoid closure of the partnership for tax purposes. It provides that on a partner's death, the partnership will continue in business until the end of the calendar month or fiscal year and that the deceased partner's estate will share in the net partnership profits for that period. It may be substituted for Paragraph 18 of the *form in § 15.202[2]* or added to Article 4 of the *form in § 15.200[2]*. If used in that form, then Section 4.05(1) of that form should be changed to provide that the surviving partners will have a specified number of days after the close of the fiscal year (or the calendar month) in which the deceased partner's death occurs to exercise their option to purchase the deceased partner's interest in the partnership.

[b] Partnership Termination and Close of Taxable Year--Tax Consequences

Although the death of a partner in a two-member partnership does not require the dissolution of the partnership under California law [*Corp. Code § 16801(1)*], it could cause the close of the partnership's tax year for federal and California tax purposes [*I.R.C. § 708(b)(1)(B)*; *Rev. & Tax. Code § 17851*]. In such a case, the deceased partner's final income return could reflect a "bunching" of income because of the premature close of the partnership taxable year. This form avoids that result by providing that the estate or other successor to the deceased partner continues to share in the profits until the close of a month or the end of a fiscal year. The provision under the Treasury Regulation prevents the closure of the partnership's tax year [*Treas. Reg. § 1.708-1(b)(1)(i)*]. For further analysis of the tax consequences attending partnership termination, see *§ 15.307*.

[2] FORM

Provision for Continuation of Partnership to End of Fiscal Year in Which Deceased Partner Died

Death of Partner

On the death of a Partner, the Partnership business shall continue to the end of the [Partnership fiscal year *or* calendar month] in which the death occurs. The deceased Partner's _____[estate *or* successor in interest] shall share in the net profits and losses of the Partnership during the balance of that [fiscal year *or* month] in the same manner as the deceased Partner would have had the Partner survived to the end of that [fiscal year *or* month]. However, the _____[estate *or* successor in interest] of any deceased Partner shall not be liable for any obligations or losses incurred by the Partnership after the date of the deceased Partner's death, beyond the value of the deceased Partner's interest in the Partnership at the date of his or her death. At the end of the [fiscal year *or* calendar month] in which the Partner's death occurs, the surviving Partners shall either dissolve the Partnership or purchase the deceased Partner's partnership interest by paying to the decedent's estate a purchase price for the interest determined as of the date of the Partner's death pursuant to [*paragraph or section number of agreement that provides for purchase of deceased partner's interest*] of this Agreement.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.255

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.255 Provision Allowing Deceased Partner's Personal Representative to Continue Decedent's Partnership Interest During Administration of Estate

[1] Comment

[a] Use of Form

This form is an alternative provision allowing a deceased partner's personal representative (executor or administrator [*see Prob. Code § 58(a)*]) to become a new general partner and continue the decedent's interest in the partnership during administration of the estate. It allows the personal representative to participate as a partner, with all of the rights, powers, duties, and obligations of the deceased partner. Before using this provision, the attorney should make certain that it will not be inconsistent with any other provision in the partnership agreement (such as a buy-sell provision) relating to continuation or operation of the partnership following the death of a partner.

For a similar provision allowing a deceased partner's spouse or other legatee to continue the decedent's partnership interest and become a general partner, see the *form in § 15.252[2]*. For a provision that avoids admission of an unknown person as a general partner, see the *form in § 15.253[2]*.

[b] Representative's Participation as Partner

The personal representative of a deceased partner is required to take possession or control of the decedent's estate and collect all debts due the decedent or the estate [*see Prob. Code § 9650(a)(1)*]. However, in the absence of a provision in the partnership agreement or a court order [*see Prob. Code § 9762*], the personal representative has no right to participate as a partner; that is, to take possession of the specific partnership property [*see Corp. Code § 16501*] or to participate in the partnership business [*see Corp. Code § 16503*]. With respect to the partnership, the personal

representative merely has the right to commence and maintain any action against any surviving partner that the decedent could have commenced and maintained [*Prob. Code § 9763(a)*], and to examine books and records and receive an accounting [*Corp. Code § 16403(c)*]. A provision such as this form may be used to give the personal representative additional rights, up to the full extent of the rights of the deceased partner's rights, to participate in the winding up of the partnership business [*see Prob. Code § 9762(b)*].

PRACTICE TIP

Counsel should exercise care in recommending or including personal representative rights of partnership control. The personal representative may not understand the business, may be a stranger with no personal relationship to the other partners, and may not wish to assume the fiduciary duties of a partner. *Commentary by John J. Camozzi.*

[2] FORM

Provision Allowing Deceased Partner's Personal Representative to Continue Decedent's Partnership Interest During Administration of Estate

Personal Representative's Right to Become Partner

On the death of _____[any of the partners *or specify name(s) of a specific partner or partners*], _____[his *or* her *or* the deceased partner's] personal representative, at the option of the surviving partners and the personal representative, shall have the right to assume the decedent's partnership interest and continue as a Partner with all the rights, powers, duties, and obligations formerly held by the decedent [*or specify more limited powers*] for the purposes of winding up Partnership affairs during administration of the estate.

For purposes of this [section *or* paragraph], "personal representative" means executor, administrator, administrator with the will annexed, successor personal representative, or a person who performs substantially the same function under the law of another jurisdiction governing the person's status.

PRACTICE TIP

Often a dissolving partnership will appoint a single partner, or a partnership committee, as the liquidating partner with the sole authority to wind-up and terminate the partnership. The liquidating partner should be someone familiar with the partnership and partnership business. Including a deceased partner's personal representative in the selection of the liquidating partner, or making the personal representative the liquidating partner, may not be in the partnership's best interest. *Commentary by John J. Camozzi.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.256

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.256 Consent of Partners' Spouses to Accept Buy-Sell Provisions of Partnership Agreement in Lieu of All Other Interests in Partnership

[1] Comment

[a] Use of Form

This form is a document in which the partners' spouses acknowledge the terms of the buy-sell arrangement as binding on any community property claims to their spouse's partnership interests. This form may be used with the *forms in §§ 15.200[2]-15.202[2]* and *§§ 15.260[2]-15.262* if any of the partners executing those agreements are married. The waiver and consent provisions should be executed by all partners' spouses and attached to the partnership agreement if it contains a buy-sell provision, or to a separate buy-sell agreement.

[b] Partnership Interest as Community Property

Partnership interests are community property to the extent they are acquired with community property or earnings since marriage [*Kenworthy v. Hadden (1978) 87 Cal. App. 3d 595, 701, 151 Cal. Rptr. 169]* . They are also personal property subject to assignment or other transfer [*see Corp. Code § 16502*; *see also §§ 15.13, 15.14*].

[2] FORM

Consent of Partners' Spouses to Accept Buy-Sell Provisions of Partnership Agreement in Lieu of All Other Interests in Partnership

CONSENT OF SPOUSES

We certify that:

1. We are the spouses of _____[*partner's name*], _____[*partner's name*], and _____[*partner's name*] who are General Partners in _____[*partnership name*].

2. We have read and approve the provisions of [Paragraphs *or* Sections] _____through [*buy-sell provisions*] of the attached [Partnership Agreement *or* Articles of Partnership] regarding the purchase and sale of a deceased or dissociated Partner's interest.

3. We agree to accept the provisions of _____ Paragraphs *or* Sections] _____ through [*buy-sell provisions*] of [that Agreement *or* those Articles] in lieu of all other interests, community or otherwise, that any of us have in that Partnership.

Executed _____[*date*], at _____County, California.

_____ [*spouse's signature*]
[*typed name*]
_____ [*spouse's signature*]
[*typed name*]
_____ [*spouse's signature*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
3. Alternative Provisions Relating to Purchase and Sale of Partnership Interests

7-15 California Legal Forms--Transaction Guide §§ 15.257-15.259

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

[Reserved]

§§ 15.257[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
4. Purchase and Sale Agreements Funded With Insurance

7-15 California Legal Forms--Transaction Guide § 15.260

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.260 Agreement for Purchase and Sale of Partnership Interest Funded by Insurance--Cross-Purchase Plan Between Two Partners Without a Trustee

[1] Comment

[a] Use of Form

This form is a cross-purchase type of insurance-funded buy-sell agreement. It is designed to be used by a two-member partnership, but may be modified to accommodate the needs of a larger partnership. The cross-purchase plan contained in this form is best suited, however, to partnerships that do not have so many members that purchase and maintenance of policies on all their lives becomes a burden for the individual partners. Any valuation formulas in the *forms in §§ 15.240[2]-15.249[2]* may be modified and inserted in Section 3.02 of this form. If a provision those forms is modified for this form, all language before the words "an amount equal to" in the first paragraph of the form being modified should be deleted, and the unbracketed language in the first paragraph of Section 3.02 of this form should be substituted for the deleted language. See *Section 3.02* of the *form in § 15.261[2]* for an additional valuation method.

PRACTICE TIP

Partnership buy-sell agreements triggered by a partner's death are estate planning tools. Counsel may wish to review an intended buy-sell agreement with the partners' estate planning attorneys. If they do not have such attorneys, counsel may wish to make an appropriate referral and give the partners an opportunity to confer with estate planning counsel before making any buy-sell agreements. *Commentary by John J. Camozzi.*

[b] Purpose of Insurance Agreements

The partners are free to structure purchase terms of a buy-sell agreement in any manner they desire. However, if the agreement does not provide for a source of funds with which the purchase is to be made, the remaining partner or partners may encounter problems in making the purchase. For example, future partnership profits might be the only funds available to the remaining partner for purchasing a deceased partner's interest. If the partnership business is expanding or in its incipient stages, the remaining partner would be forced to use profits that should be reinvested in the business. Accordingly, the partnership's growth potential could be seriously curtailed.

Unless some method of financing a buy-sell agreement is arranged, the agreement may either fail or stifle the partnership business. One method of financing a buy-sell agreement is to provide for the purchase of business life insurance on each partner. By selecting the proper amount of insurance and making periodic adjustments to reflect changes in the partnership business, the purchase price specified in the buy-sell agreement can be totally or substantially funded at all times. The agreement should address the possibility that the insurance proceeds may be greater or less than the purchase price of the partnership interest. For example, to provide for insurance proceeds exceeding the purchase price, this form (as well as the *forms in §§ 15.261* and *15.262*) states that the purchase price may not be less than the life insurance proceeds [*see Section 3.02* of Form]. It also requires the execution of a promissory note for the balance of the purchase price if the insurance proceeds are insufficient to pay the entire purchase price [*see Section 3.03* of Form].

There are three common types of buy-sell agreements funded by insurance:

- The "cross-purchase" plan, under which each partner owns a policy insuring the life of the other partner(s) [this form];

- The "entity purchase" plan, under which the partnership as an entity owns and is the beneficiary of policies insuring the lives of all partners [*see § 15.261[2]*]; and

- The "trustee" plan, under which an independent trustee is the owner and beneficiary of policies insuring the lives of all partners [*see § 15.262[2]*].

For further discussion of buy-sell agreements and insurance funding, see Ch. 8D, *Buy-Sell Agreements* .

PRACTICE TIP

Buy-sell agreements backed by insurance are most common in small partnerships. They are also common in any partnership in which the partnership business may suffer by the loss of a key manager. In such cases the value of insurance proceeds should be sufficient to pay the deceased partner's estate and to fund the partnership with sufficient capital to hire a substitute manager and support partnership cash flow needs until the new hire can be placed. The more specialized or unique the deceased partner's contribution, the greater the insurance proceeds to the partnership should be. *Commentary by John J. Camozzi*.

[c] Federal Estate Tax Treatment of Life Insurance

Life insurance policy proceeds must be included in a decedent's gross estate for federal estate tax purposes only to the extent that they are payable to the estate or to other beneficiaries under policies to which the decedent possessed, at death, any incidents of ownership, exercisable either alone or in conjunction with another person [*I.R.C. § 2042*]. However, if within three years preceding his or her death, a partner transfers an interest in insurance proceeds that is includable in the partner's gross estate [*see I.R.C. § 2042*], or would have been includable had the partner retained an interest in the proceeds, then the value of the proceeds, to the extent of the deceased partner's interest in them at the time of the transfer, must be included in the gross estate, unless the transfer was a bona fide sale for an adequate and full consideration in money or money's worth [*see I.R.C. §§ 2035(a), (d)*].

In order to avoid the inclusion of life insurance proceeds in a deceased partner's gross estate, it is important to draft an insurance funded buy-sell agreement so that no proceeds are payable to the partner's estate and so that the partner will have no incidents of ownership over the insurance policy on his or her life. "Incidents of ownership" include the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke the assignment, to pledge the policy for a loan, and to obtain a loan against the value of the policy from the insurer [*Treas. Reg. § 20.2042-1(c)(2)*]. A reversionary interest constitutes an incident of ownership only if the value of the interest exceeds 5 percent of the value of the policy immediately before death [*I.R.C. § 2042(2)*].

[d] Federal Estate Tax Treatment of Insurance on Surviving Partner

Under the cross-purchase arrangement in this form, the proceeds of the insurance policy on a deceased partner's life will not be included in that partner's estate [*see I.R.C. § 2042*]. However, since the deceased partner's policy on the surviving partner's life is intangible personal property owned by the deceased partner at the time of death, it is includable in the deceased partner's estate for federal estate tax purposes [*see I.R.C. § 2033*]. The value of that policy is determined by taking the amount of the interpolated terminal reserve of the policy at the date of death and adding the proportionate part of the gross premium paid just before the date of death that covers a period extending beyond that date [*Treas. Reg. § 20.2031-8*].

Although the deceased partner's estate will be taxed on the value of the policy insuring the surviving partner's life, it will have no use for the policy. It is unlikely that the surviving partner will be able to purchase life insurance at as favorable a premium rate as that paid by the deceased partner. Accordingly, it is best to allow the surviving partner to purchase the policy on his or her life from the deceased partner's estate [*see Section 2.05* of Form]. As a matter of practice, the purchase price for the policy on the surviving partner's life is usually equal to the amount of tax imposed on the decedent's estate attributable to the policy.

[2] FORM

Agreement for Purchase and Sale of Partnership Interest Funded by Insurance--Cross-Purchase Plan Between Two Partners Without a Trustee

BUY AND SELL AGREEMENT

Preamble

_____[*name*] and _____[*name*], both of _____ County, California, agree that:

ARTICLE 1. PURPOSES

Identity of Partnership

Section 1.01. They are sole owners as General Partners of the partnership known as _____[*name of partnership*], located at _____Street in _____[*city*], [in the _____Judicial District of] _____ County, California.

Purposes of Agreement

Section 1.02. The purposes of this Agreement are (1) to provide for the continuance of the Partnership business on the death or retirement of a Partner; and (2) to ensure the purchase of the Partner's partnership interest by the surviving or remaining Partner.

ARTICLE 2. INSURANCE

Agreement to Insure

Section 2.01. Each Partner shall apply for and shall carry, throughout the term of the partnership, insurance in the amount of $ _____ on the life of the other partner. Each partner shall be named as beneficiary of the policy insuring the life of the other.

Ownership of Policies

Section 2.02. Each Partner shall own and hold full legal title to the policy insuring the life of the other Partner. Each Partner shall be exclusively entitled to exercise any rights, options, or privileges provided for in that policy or permitted by the insurance company issuing that policy in respect to such policy. Each Partner agrees, however, not to exercise any right, option, or privilege without giving the other Partner 30 days written notice of intent to do so.

Payment of Premiums

Section 2.03. Each Partner agrees to pay, as they become due, all premiums on the policy owned by the Partner and to give proof of the payment of each premium to the other insured Partner within 20 days after the premium is due. If any premium is not paid within 20 days after its due date, the insured Partner shall have the right to pay the premium and be reimbursed for that payment by the owner of the policy. The insurance company issuing any such policy is authorized and directed to give the insured Partner, upon written request, any information regarding the status of the policy insuring the Partner's life.

Ownership of Policy on Death

Section 2.04. On the death of either Partner, the ownership of any policy owned by the deceased Partner on the life of the other Partner shall pass, subject to the provisions of this Article, to the executors or administrators of the decedent's estate.

Survivor's Option to Purchase Policy

Section 2.05. On either Partner's death, the surviving Partner shall have the right to purchase from the decedent's estate, and the executors or administrators of the estate shall sell to the surviving Partner, any or all policies owned by the deceased Partner insuring the life of the surviving Partner. The purchase price for the policy shall be an amount equal to its interpolated terminal reserve as of the date of the deceased Partner's death, less any existing indebtedness charged against the policy, plus the proportionate part of the gross premium last paid on the policy before the date of the deceased Partner's death that covers the period extending beyond the date of death.

Termination of Survivor's Option

Section 2.06. If the surviving Partner fails to pay to the executors or administrators of the deceased Partner's estate, within [*number*] days after their appointment, the purchase price, determined as provided in Section 2.05 of this Agreement, for any policy insuring the Partner's life, his or her right to purchase that policy shall terminate and the executors or administrators of the deceased Partner's estate may take any action with respect to that policy as they desire and deem to be in the estate's best interests.

ARTICLE 3. SALE OF PARTNERSHIP INTEREST ON DEATH

Mandatory Purchase and Sale

Section 3.01. On either Partner's death, the surviving Partner shall purchase from the estate of the deceased Partner, and the executors or administrators of that estate shall sell to the surviving Partner, the entire Partnership interest of the deceased Partner at the price and on the terms and conditions specified in this Article.

Purchase Price of Partnership Interest

Section 3.02. On either Partner's death, the surviving Partner shall pay to the estate of the deceased Partner, in the manner specified in Section 3.03 of this Agreement, as the full purchase price for the deceased's Partnership interest, _____ [*set forth formula for determining purchase price, e.g.,* an amount determined as follows:

(1) The surviving Partner within _____ (*number*) days after the appointment and qualification of executors or administrators for the deceased Partner's estate shall appoint an appraiser and notify the executors or administrators in writing of the name and address of that appraiser. Within _____ (*number*) days after receiving notice, the executors or administrators shall appoint an appraiser and notify the surviving Partner in writing of the name and address of the appraiser. If the two appraisers so appointed are unable to agree on the purchase price to be paid for the deceased's Partnership interest within _____ (*number*) days after their appointment, they shall appoint a third appraiser. The decision in writing of any two of the three appraisers shall be binding and conclusive on the parties to this Agreement, their heirs, executors, administrators, and any person having a claim to the deceased's Partner's interest. All fees and expenses of each appraiser shall be paid by the _____(surviving Partner *or* surviving Partner and the estate of the deceased Partner in equal portions *or* party on whose behalf the appraiser was appointed, the fees and expenses of the third appraiser to be paid equally by the surviving Partner and the estate of the deceased Partner).

PRACTICE TIP

A single appraiser, mutually agreeable to the parties, with the cost borne by the partnership, can be a more economical and practical alternative. Unlike valuation on dissociation, valuation on death is usually not adversarial and is a more amicable procedure to establish a defensible valuation of a partnership interest. *Commentary by John J. Camozzi*.

(2) In determining the purchase price to be paid for the deceased's Partnership interest, the appraisers shall value:

(a) All inventory items at their actual cost to the Partnership.

(b) All tangible Partnership assets, including lands, buildings, fixtures, machinery, automobiles, and equipment, at their fair cash market value.

(c) All accounts receivable due the Partnership that are more than 90 calendar days old and not barred by the statute of limitations at one-half their face value.

(d) All accounts receivable due the Partnership that are less than 90 calendar days old at their full face value.

(e) Goodwill and other intangible assets of the Partnership at their fair market value.

In no event, however, shall the purchase price for the deceased Partner's Partnership interest be less than the amount of insurance owned by the surviving Partner on the deceased Partner's life, pursuant to Article II of this Agreement.].

Payment of Purchase Price

Section 3.03. On either Partner's death, the surviving Partner shall pay the proceeds of the insurance policies owned, pursuant to this Agreement, by the surviving Partner on the life of the deceased Partner, to the executors or administrators of the deceased Partner's estate. The payment of the insurance proceeds shall be applied toward payment of the purchase price for the deceased's Partnership determined under Section 3.02 of this Agreement. If the purchase price for the deceased Partner's interest as determined pursuant to Section 3.02 of this Agreement exceeds the proceeds of that life insurance, the surviving Partner shall execute a promissory note for the balance of the purchase price. The promissory note shall be made payable to the order of the executors or administrators of the deceased Partner's estate and shall contain:

(1) Provisions for the payment of the principal amount in not more than [*number*] equal consecutive [monthly *or* annual] installments, commencing _____[_____ (*number*) months *or* _____ (*number*) days *or* one year] after the date of the deceased Partner's death.

(2) Provisions for the payment with each principal installment of interest on the unpaid principal balance of that note at the rate of _____percent per annum from the date of the deceased Partner's death.

(3) Provisions allowing the surviving Partner to pay, without penalty, any or all installments provided for in that note before they become due.

(4) Such other provisions concerning acceleration of maturity, attorneys' fees, and other matters as are contained in the form of promissory note now being supplied by _____ Title Insurance Company for use in _____ County, California, attached hereto as Exhibit A.

Security for Note

[*EITHER*]

Section 3.04. Any promissory note executed pursuant to Section 3.03 of this Agreement shall be secured by a chattel mortgage on _____[all tangible Partnership assets *or* tangible Partnership assets having a value, as determined by the probate court administering the deceased Partner's estate, equal to three times the principal amount of that note].

[*OR*]

Section 3.04. Any promissory note executed pursuant to Section 3.03 of this Agreement shall be secured by a separate security agreement and recorded financing statements under the California Uniform Commercial Code.

[*Continue with the following:*]

Execution of Instruments

Section 3.05. When they receive an amount equal to the proceeds of the insurance policy owned by the surviving Partner on the deceased Partner's life and any note required to' be executed to their order as payees pursuant to Section 3.03 of this Agreement, or when they receive the proceeds and cash in lieu of the note, the executors or administrators of the deceased Partner's estate shall execute and deliver to the surviving Partner all instruments necessary to transfer complete title to the deceased Partner's interest in the Partnership to the surviving Partner and all additional instruments required by the surviving Partner to conveniently carry on the business of the Partnership.

Partnership Profits After Death

Section 3.06. All profits earned by the Partnership business after the date of the deceased Partner's death shall belong to the surviving Partner, and the deceased Partner's estate shall have no right or claim to those profits or interest on their amount.

Assumption of Partnership Obligations

Section 3.07. On any purchase and sale of a deceased Partner's interest under this Article, the surviving Partner shall assume all Partnership obligations and shall protect and indemnify the decedent's estate, the executors or administrators of that estate, and the property of that estate from liability on any such obligation.

Publication of Notice

Section 3.08. On any purchase and sale of a deceased Partner's interest under this Article, the surviving Partner, as soon after that sale as is practicable, shall prepare, publish, file, and serve all notices required by law to protect the deceased Partner's estate and the executors or administrators of that estate from liability for any future obligations of the Partnership business including, without limitation, a Statement of Dissociation pursuant to *California Corporations Code Section 16704*. All costs incident to performance under this Section shall be borne by the surviving Partner.

ARTICLE 4. SALE OF PARTNERSHIP INTEREST DURING LIFE

First Right of Refusal

Section 4.01. If, during any partner's lifetime, that Partner desires to dissociate from the Partnership, that Partner shall first offer in writing to sell his or her interest in the Partnership to the other Partner at a price determined pursuant to Section 3.02 of this Agreement but payable in full on the date of sale. If the offer is not accepted by the other Partner within [*number*] days after receipt of the written offer, and the Partnership is not dissolved and terminated, the Partner desiring to dissociate shall have the right to sell his or her Partnership interest to any other person on condition that [*number*] days prior to the sale the dissociating Partner offers to sell his or her interest to the other Partner at the price and on the terms offered by that other person. On transfer of the dissociating Partner's interest to a transferee who is not then a partner, the transferee thereupon shall have the full right, during the continuance of the Partnership, to participate in the management and control of the Partnership business and affairs.

PRACTICE TIP

The rights of a transferee of a partnership interest are spelled out in *Corp. Code § 16503*. *Commentary by John J. Camozzi*.

ARTICLE 5. MISCELLANEOUS PROVISIONS

Amendment

Section 5.01. This Agreement may be altered, amended, or terminated by a writing signed by both Partners.

Termination

Section 5.02. This Agreement shall terminate on the occurrence of any of the following events:

(1) Cessation of the Partnership business.

(2) Bankruptcy, receivership, or dissolution of the Partnership.

(3) Bankruptcy of either Partner.

(4) Death of both Partners simultaneously or within a period of [*number*] days.

(5) At either Partner's option, exercised by giving written notice to the other Partner, if the other Partner fails to pay the premiums within the grace period on the life insurance policy owned by that Partner for the purposes of this Agreement, or, without the written consent of the insured Partner, assigns, surrenders, borrows against, changes the beneficiary on, or alters the lump sum payment provisions of any such policy.

Purchase of Policies on Termination

Section 5.03. If this Agreement terminates before either Partner dies, each Partner shall be entitled to an assignment of any policy insuring that Partner's own life. An assignment shall be made under this Section when one Partner pays to the owner of that policy, within [*number*] days after termination, an amount equal to the interpolated terminal reserve of the policy as of the date of transfer, less any existing indebtedness charged against the policy, plus the proportionate part of the gross premium last paid before the date of transfer which covers the period extending beyond that date.

Notice to Partner

Section 5.04. Any and all notices, offers, or other matters required or permitted by this Agreement to be served on, given to, or delivered to a Partner shall be in writing and shall be deemed duly served, given, or delivered when personally delivered to that Partner, or, in lieu of personal service, when deposited in the United States mail, certified, first-class postage prepaid, addressed to that Partner at the address of the principal place of business of the Partnership.

Notice to Executors or Administrators

Section 5.05. Any and all notices, offers, or other matters required or permitted by this Agreement to be served on, given to, or delivered to the executors or administrators of a deceased Partner's estate shall be in writing and shall be

deemed duly served, given, or delivered when personally delivered to any one of those executors or administrators, or, in lieu of personal service, when deposited in the United States mail, certified, first-class postage prepaid, addressed to those executors or administrators in care of the clerk of the court which appointed them.

Binding on Heirs

Section 5.06. This Agreement shall be binding on the parties, their heirs, executors, administrators, successors, and assigns.

Inclusion in Wills

Section 5.07. Both Partners shall include in their respective wills any appropriate provisions that may be necessary to carry out this Agreement.

Performance by Insurance Company

Section 5.08. No insurance company whose policies shall be issued because of this Agreement shall have any liability except as set forth in its policies. No insurance company shall be bound to inquire into or take notice of any provisions of this Agreement relating to policies of insurance or to the application of the proceeds of those policies. The signature of the owner of any policy requesting or ordering any action whatsoever shall be sufficient authority for the insurance company to take or permit that action. Payment or other performance by an insurance company in accord with the terms of its policy shall completely discharge that company from all claims, suits, and demands of all persons whatsoever.

Attorneys' Fees

Section 5.09. In any dispute between the parties to this Agreement or their personal representatives concerning any matter arising from or relating to this Agreement, the party or parties prevailing in that dispute shall be entitled, in addition to such other relief as may be granted, to a reasonable sum for their attorneys' fees. This sum shall be determined by the arbitrator or judge in that dispute or in a separate action brought for that purpose.

Governing Law

Section 5.10. This Agreement shall be governed by the laws of the State of California.

Executed on _____[*date*], at _____County, California.

_____ [*signature of partner*]
[*typed name*]
_____ [*mailing address*]
_____ [*taxpayer identification number*]
_____ [*signature of partner*]
[*typed name*]
_____ [*mailing address*]
_____ [*taxpayer identification number*]

Spousal Consent

The undersigned are the spouses of the above general partners who have signed above. We have read and understood the terms and conditions of the foregoing Agreement and agree to be bound by its terms. We agree that our respective spouses shall have the sole and exclusive power to manage the partnership interest created by the foregoing Agreement, regardless of whether that interest was acquired with community property, quasi-community property, or separate property assets, however so titled or characterized. We further acknowledge and agree that our respective spouses may, from time to time, or at any time, amend, restate, sell, transfer, assign or hypothecate their respective partnership interests in any manner whatsoever, with or without our further consent.

Executed at _____ County, California on _____[*date*].

_____ [*signature of spouse*]
_____ [*typed name*]
_____ [*signature of spouse*]
_____ [*typed name*]
_____ [*signature of spouse*]
_____ [*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
4. Purchase and Sale Agreements Funded With Insurance

7-15 California Legal Forms--Transaction Guide § 15.261

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.261 Agreement for Purchase and Sale of Partnership Interest Funded by Insurance--Entity Purchase Plan--Insurance Policies Owned by the Partnership as an Entity

[1] Comment

[a] Use of Form

This form is a buy-sell agreement based on the entity or partnership owner plan. It is particularly useful to partnerships with many members or when the partnership is generating sufficient cash flow to regularly make premium payments. When a partnership has numerous members, individual cross purchases are likely to be unduly complicated.

In using this form, any of the formulas for determining the value of the partnership interest of a deceased, withdrawing, or terminated partner set forth in the *forms in §§ 15.240-15.249* may be modified and inserted in place of Section 3.02 of this form as the formula for determining the purchase price payable by the partnership for the partnership interest of the deceased partner. Care should be taken, however, to expressly provide in any valuation formula that the value of the deceased's interest in the partnership goodwill is being included in determining the purchase price. In modifying the provisions of any form for insertion as Section 3.02 of this form, all language appearing before the words "an amount equal to" in the first paragraph of the form being modified should be deleted and the unbracketed language appearing in the first paragraph of Section 3.02 of this form substituted in its place.

PRACTICE TIP

Business valuation is a complex financial specialty that looks at many objective and subjective factors. Partner-agreed valuations are a simple approach to the problem, but can easily understate or overstate market value. This can be particularly problematic if the market value is closely related to goodwill tied to a dissociating partner, or if the dissociated partner's past breaches of fiduciary duty have contributed to

unreasonably overstated agreed valuations. In many cases, a business valuation by an objective professional is the preferred method (*see § 15.245*). *Commentary by John J. Camozzi*.

[b] "Entity Purchase" or "Partnership Owner" Plan Defined

This form provides an "entity" or "partnership owner" type of insurance funded buy-sell agreement. Under this agreement, the partnership owns insurance policies on the partners' lives. The partnership pays the premiums on these policies. When a partner dies, the partnership purchases and liquidates the deceased partner's interest with the proceeds from the policy on his or her life. Since the partnership, rather than another partner [*see § 15.260[2]*] or a trustee [*see § 15.262*], is the purchaser, the liquidation provisions of the Internal Revenue Code apply to performance under the buy-sell agreement set forth in this form [*see I.R.C. § 736*]. For a discussion of the tax consequences attending liquidation, see *§ 15.308*. For additional discussion of buy-sell agreements in general, see Ch. 8D, *Buy-Sell Agreements* .

[c] Inclusion of Insurance Policies in Deceased Partner's Estate

Proceeds of an insurance policy on the life of a decedent payable to someone other than the decedent's estate are subject to federal estate taxes only if the decedent, at the time of death, possessed any "incidents of ownership" exercisable either alone or in conjunction with another person over the policy [*see I.R.C. § 2042*]. The incidents of ownership of the life insurance policies purchased under this form rest in the partnership as an entity rather than in the partners. Accordingly, the proceeds of these policies are not subject to federal taxes imposed on a deceased partner's estate [*see Knipp v. Commissioner (1955) 25 T.C. 153]* .

Insurance policies on partners' lives, if purchased by the partnership as provided in this form, are partnership assets [*see Miller v. Hall (1944) 65 Cal. App. 2d 200, 207, 150 P.2d 287]* . Therefore, their value will be taken into account in computing the value of the deceased's partnership interest. Section 2.06 of this form establishes a value for the policies based on their cash surrender value. However, by including these policies as partnership assets, the purchase price payable for the deceased partner's interest in the partnership will be increased, as will be the value of the partnership interest for federal estate tax purposes.

[d] Income Tax Basis of Surviving Partner's Partnership Interest

The adjusted income tax basis for a partner's interest in the partnership is increased by any tax-exempt income received by the partnership [*I.R.C. § 705(a)(1)(B)*]. Proceeds of an insurance policy on a deceased partner's life received by the partnership would be tax exempt to the partnership [*I.R.C. § 101(a)*; *see Treas. Reg. § 1.101-1(a)*]. Accordingly, if a three-member partnership whose profits are divided equally among the partners receives $30,000 in insurance proceeds on the partner's death under a policy carried on its books at its cash surrender value of $6,000, the two surviving partners' adjusted income tax bases for their partnership interests will be increased by $8,000 each. If a cross purchase plan [*see § 15.260[2]*] had been used instead, each surviving partner would have carried $15,000 in insurance on the deceased partner's life, would have received and paid $15,000 worth of premiums for one half of the deceased partner's interest, and would have thus increased each of their adjusted income tax bases in the partnership by $15,000 rather than $8,000. However, under the partnership owner plan, each partner pays only one third of the premiums on a $30,000 insurance policy instead of the full premium on a $15,000 policy.

California follows federal law in the taxation of partnerships [*Rev. & Tax. Code § 17851*; *see I.R.C. §§ 701-761*; *but see Rev. & Tax. Code §§ 17851-17932* (modifications to federal law)].

[e] Income Taxation of Purchase Price to Decedent's Estate

Payments made in liquidation of a deceased partner's interest in a partnership, to the extent they exceed the value of the deceased partner's interest in partnership property, are taxable to his or her estate as partnership distributions or

guaranteed payments [*see I.R.C. § 736(a), (b)*; *Rev. & Tax. Code § 17851*; *see § 15.308* for more detailed discussion of the different tax consequences for sale and liquidation of partnership interests].

[f] Effect of Premium Payments on Taxable Partnership Income

Premiums paid on insurance policies insuring the lives of partners are not deductible for income tax purposes. Section 2.05 of this form will reduce the share of partnership profits distributable to each partner but not the share of profits on which each partner must pay income tax. For example, in a two member partnership in which profits are to be distributed equally, if the partnership profit before payment of premiums is $1,000 and the premiums total $100, the share of profits distributable to each partner is $450, but the share of profits on which each partner must pay income tax is $500.

PRACTICE TIP

Although entity payment of premiums may have an adverse tax consequence for the partners, it can often be the surest way to ensure premium payments. Thus, the adverse tax consequence is often an acceptable trade-off to reduce the risk of premium default. *Commentary by John J. Camozzi*.

[2] FORM

Agreement for Purchase and Sale of Partnership Interest Funded by Insurance--Entity Purchase Plan--Insurance Policies Owned by the Partnership as an Entity

M BUY AND SELL AGREEMENT

Preamble

_____[*Name of partner*], and _____[*name of partner*], both of _____ County, California, _____[*name of partner*], of _____ County, California (the "Partners"), and _____[*name of partnership*] ("the Partnership"), agree that:

ARTICLE 1. PURPOSES

Identity of Partnership

Section 1.01. The Partners are the sole owners as General Partners of _____[*name of partnership*], which maintains its principal place of business at _____ Street in _____[*city*], [in the _____ Judicial District of] _____ County, California.

Purpose of Agreement

Section 1.02. The purpose of this Agreement is to provide for the continuance of the Partnership business on the death or retirement of a Partner and the purchase of his or her interest in the Partnership by the Partnership.

ARTICLE 2. INSURANCE

Identification of Policies

Section 2.01. The Partnership is the applicant, owner, and beneficiary of the following life insurance policies issued by the _____ Life Insurance Company:

Policy No. _____, insuring the life of _____[*name of partner*] in the amount of $ _____.

Policy No. _____, insuring the life of _____[*name of partner*] in the amount of $ _____.

Policy No. _____, insuring the life of _____[*name of partner*] in the amount of $ _____

Additional Policies

Section 2.02. The Partnership shall have the right, on majority vote of the Partners, to purchase additional insurance on the lives of any or all of the Partners. Any additional insurance shall be listed on a schedule attached to this Agreement and marked Schedule A.

Ownership of Policies

Section 2.03. The Partnership shall be the beneficiary and sole owner of each insurance policy purchased under this Agreement and shall hold full legal title to each policy. It is agreed, however, that no rights, options, or privileges provided for in that policy or permitted by the insurance company issuing that policy shall be exercised without the written consent of all the Partners.

Payment of Premiums

Section 2.04. The Partnership shall pay, as they become due, all premiums on the insurance policies purchased under this Agreement, and shall give proof to each Partner within [*e.g.*, 20] days after their due dates. If any premium on any policy is not paid by the Partnership within [*e.g.*, 20] days after its due date, any Partner shall have the right to pay the premium and be reimbursed for the payment by the Partnership. The insurance company issuing any policy under this Agreement is authorized and directed to furnish all Partners with any information they may request in writing pertaining to the status of any insurance policy.

Premiums as Partnership Expense

Section 2.05. The total amount of premiums payable each year by the Partnership on all insurance policies purchased under this Agreement shall be borne equally by the Partners. Although not deductible for federal or state income tax purposes, all premium payments shall be considered, as between the Partners, an ordinary and necessary expense of the Partnership business deductible before determination of the net profits of the Partnership.

Insurance Policies as Partnership Assets

Section 2.06. The cash surrender value of each insurance policy purchased under this Agreement shall be considered, for the purpose of determining the value of any Partner's interest in the Partnership, a Partnership asset.

ARTICLE 3. SALE OF PARTNERSHIP INTEREST ON DEATH

Purchase by Partnership

Section 3.01. On any Partner's death, the Partnership shall purchase from his or her estate, for the account of the surviving Partners, and the executors or administrators of the deceased Partner's estate shall sell to the Partnership for the account of the surviving Partners, the entire Partnership interest of the deceased Partner at the price and on the terms and conditions specified in this Article.

Purchase Price of Partnership Interest

Section 3.02. On any partner's death, the Partnership shall pay to his or her estate in the manner specified in Section 3.03 of this Agreement, as the full purchase price for the decedent's Partnership interest, _____[*set forth formula for determining purchase price, e.g.*, the value of that interest as shown on the last regular Partnership accounting preceding the deceased Partner's death plus the full unwithdrawn portion of the deceased Partner's distributive share of any net profits earned by the Partnership between the date of that accounting and the date of the deceased Partner's death, plus the sum of $ _____ for the deceased Partner's interest in the goodwill of the Partnership]. In no event, however, shall the purchase price for a deceased Partner's Partnership interest be less than the amount of insurance owned by the Partnership on the deceased Partner's life pursuant to Article 2 of this Agreement.

Payment of Purchase Price

Section 3.03. On any Partner's death, the proceeds of the insurance policies owned, pursuant to this Agreement, by the Partnership on his or her life shall be paid by the Partnership to the executors or administrators of the deceased Partner's estate and applied toward payment of the purchase price for the decedent's Partnership interest determined as provided in Section 3.02 of this Agreement. If the purchase price for the deceased Partner's interest, as determined pursuant to Section 3.02 of this Agreement, exceeds the proceeds of the life insurance, the balance of the purchase price shall be paid by the Partnership pursuant to the terms of a series of [*number*] negotiable promissory notes of equal amounts to be executed by the Partnership to the order of the executors or administrators of the decedent's estate. The first of these notes shall become due and payable [*number*] months after it is executed and the remaining notes shall become due and payable at intervals of [*number*] months thereafter. Each note shall bear interest at the rate of _____ percent per annum from its execution date payable at maturity; be guaranteed in writing by each of the surviving Partners; provide that in the event of default in payment of principal or interest, all unpaid notes of the same series shall immediately become due and payable; be subject to prepayment in whole or in part without penalty; and provide for the payment by its maker and guarantors of any attorneys' fees fixed by court if litigation is required to enforce payment.

Execution of Instruments

Section 3.04. On receipt of an amount equal to the proceeds of the insurance policies owned by the Partnership under this Agreement of the deceased Partner's life and any notes required to be executed to their order as payees pursuant to Section 3.03 of this Agreement, or on their receipt of the insurance proceeds and cash in lieu of the notes, the executors or administrators of the deceased Partner's estate shall execute and deliver to the Partnership all instruments necessary to transfer full title to the deceased Partner's interest in the Partnership to the Partnership, and all instruments required by the surviving Partners to conveniently carry on the Partnership business.

Distribution of Deceased's Interest

Section 3.05. The deceased Partner's interest in the Partnership purchased by the Partnership pursuant to this Article shall be divided among the surviving Partners in the same proportions as they were entitled to share in the Partnership profits immediately prior to the death of the deceased Partner.

Partnership Profits After Death

Section 3.06. All profits earned by the Partnership business after the date of the deceased Partner's death shall belong to the surviving Partners. The deceased Partner's estate shall have no right or claim to Partnership profits earned after death or to interest on those profits.

Assumption of Partnership Obligations

Section 3.07. On any purchase and sale of a deceased Partner's interest in the Partnership under this Article, the surviving Partners shall assume all Partnership obligations and shall protect and indemnify the decedent's estate, the executors or administrators of the estate, and the property of the estate, from liability on any such obligation.

Publication of Notice

Section 3.08. As soon as practicable after any purchase and sale of a deceased Partner's interest under this Article, the surviving Partners, at their own cost and expense, shall prepare, publish, file, and serve all notices required by law to protect the deceased Partner's estate and the executors or administrators of the estate from liability for any future obligations of the Partnership business, including, without limitation, a Statement of Dissociation pursuant to *California Corporations Code Section 16704*.

ARTICLE 4. SALE OF PARTNERSHIP INTEREST DURING LIFE

Prohibition of Sale

Section 4.01. No Partner shall assign, encumber, or dispose of an interest in the Partnership, or any portion of a Partnership interest, by sale or otherwise, without the written consent of the other Partners.

ARTICLE 5. MISCELLANEOUS PROVISIONS

Amendment

Section 5.01. This Agreement may be altered, amended, or terminated by a writing signed by a majority of the Partners.

Termination

Section 5.02. This Agreement shall terminate on the occurrence of any of the following events:

(1) Cessation of the Partnership business.

(2) Bankruptcy, receivership, or dissolution of the Partnership.

(3) Bankruptcy of any Partner.

Purchase of Policies on Termination

Section 5.03. If this Agreement terminates before the death of all but one Partner, each Partner shall be entitled to an assignment from the Partnership of the policy or policies insuring his or her life on the payment to the Partnership within [*number*] days after termination of an amount equal to the interpolated terminal reserve of the policies as of the date of transfer, less any existing indebtedness charged against the policies, plus the proportionate part of the gross premiums last paid on the policies before the date of transfer that cover a period extending beyond that date.

Purchase of Policies on Withdrawal

Section 5.04. Any Partner who is permitted to withdraw from the Partnership shall have the right to purchase the policy or policies owned by the Partnership insuring his or her life by paying to the Partnership within [*number*] days after withdrawal, an amount equal to the interpolated terminal reserve value of the policies as of the date of withdrawal, less any existing indebtedness charged against the policies, plus the proportionate part of the gross premiums last paid on the policies before the date of withdrawal that cover a period extending beyond that date.

Binding on Heirs

Section 5.05. This Agreement shall be binding on the parties, their heirs, executors, administrators, successors, and assigns.

Performance by Insurance Company

Section 5.06. No insurance company that issues policies under this Agreement shall have any liability except as set forth in its policies. No insurance company shall be bound to inquire into or take notice of any of the provisions of this Agreement relating to those insurance policies or to the application of the proceeds of those policies. Payment or other performance by the insurance company in accord with the terms of its policies shall completely discharge the company from all claims, suits, and demands of all persons whatsoever.

Attorneys' Fees

Section 5.07. If any litigation is commenced between the parties to this Agreement or their personal representatives concerning any matter relating to this Agreement, the party or parties prevailing in that litigation shall be entitled, in addition to any other relief granted, to a reasonable sum for their attorneys' fees. The amount to which the prevailing party is entitled shall be determined by the court in that litigation or in a separate action brought for that purpose.

Governing Law

Section 5.08. This Agreement shall be governed by the laws of the State of California.

Executed on _____[*date*], at _____County, California.

_____ [*signature of partner*]
[*typed name*]
_____ [*mailing address*]
_____ [*taxpayer identification number*]
_____ [*signature of partner*]
[*typed name*]
_____ [*mailing address*]
_____ [*taxpayer identification number*]
_____ [*signature of partner*]
[*typed name*]
_____ [*mailing address*]
_____ [*taxpayer identification number*]

SCHEDULE A

Schedule of Additional Life Insurance Policies

Policy No. _____ issued _____[*date*], by _____ Life Insurance Company, insuring _____[*name of partner*] in the amount of $ _____.

Policy No. _____ issued _____[*date*], by _____ Life Insurance Company, insuring _____[*name of partner*] in the amount of $ _____.

Policy No. _____ issued _____[*date*], by _____ Life Insurance Company, insuring _____[*name of partner*] in the amount of $ _____.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
4. Purchase and Sale Agreements Funded With Insurance

7-15 California Legal Forms--Transaction Guide § 15.262

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.262 Agreement for Purchase and Sale of Partnership Interest Funded by Insurance--Trustee Plan--Cross-Insurance Between More Than Two Partners

[1] Comment

[a] Use of Form

This form is an insurance funded cross-purchase plan to be carried out by a trustee. Before this form is used, the fiduciary that will be named as trustee should be consulted as to any provisions it may wish added to or altered in this form. For example, a particular trustee may wish a paragraph added to Article 5 limiting its liability for acts performed by it based on information furnished to it by the partners, or may be unwilling to accept the formula for determining its fees contained in Section 5.04 of this form.

In specifying the purchase price to be paid for the interest of a deceased partner, any of the formulas for determining the value of the partnership interest of a deceased, withdrawing, or terminated partner set forth in the *forms in §§ 15.240[2]-15.249[2]* may be modified and inserted in place of Section 3.02 of this form as the formula for determining the purchase price. In modifying the provisions of any such form for insertion into this agreement, all language appearing before the words "an amount equal to" in the first paragraph of any such form should be deleted and the unbracketed language appearing in the first paragraph of Section 3.02 of this form substituted in its place.

[b] Reason for Trustee

Although it is not required by law or otherwise, some attorneys feel it is desirable to name a disinterested third party, usually a corporate fiduciary, as a trustee or escrow holder in an insurance-funded buy-sell agreement between partners. The principal purpose of the trustee is to serve as an escrow agent on the partner's death. The trustee will file proofs of

death, collect the insurance proceeds on the life of the deceased partner, determine the purchase price payable by each surviving partner, and see that all instruments required to be executed by the various parties are in order before the transaction is closed. The fact that the trustee is an impartial party will tend to assure the surviving spouse and heirs that the transaction is being carried out in a fair and competent manner and that the purchase price was accurately computed in compliance with the buy-sell agreement.

The trustee will also serve as a central custodian of all the insurance policies and the master copy of the partnership buy-sell agreement. This is especially useful when there are several partners and a considerable number of insurance policies to be issued under the buy-sell agreement. An experienced trustee, such as a trust officer of a corporate fiduciary, may be able to make valuable suggestions regarding provisions that should be included in the partnership buy-sell agreement and the types of insurance that should be subject to it. Therefore, it is wise to consult with the proposed trustee before drafting the buy-sell agreement.

PRACTICE TIP

Institutional trustee services can be very expensive. Moreover, institutional trustees tend to be very conservative and may require substantial modification of this or any other agreement, or may only agree to use their own form of agreement. The use of an institutional trustee, therefore, should be more the exception than the rule. *Commentary by John J. Camozzi*.

[2] FORM

Agreement for Purchase and Sale of Partnership Interest Funded by Insurance--Trustee Plan--Cross-Insurance Between More Than Two Partners

PARTNERSHIP BUY AND SELL AND TRUST AGREEMENT

_____ and _____[*names of partners*], "Partners," and _____, "Trustee," a California corporation, agree that:

ARTICLE 1. PURPOSES

Identity of Partnership

Section 1.01. The above-named Partners are the sole owners as General Partners _____[*name of partnership*], which maintains its principal place of business at _____ Street in _____[*city*], [in the _____ Judicial District of] _____ County, California.

Purpose of Agreement

Section 1.02. The purpose of this Agreement is to Provided for the continuance of the Partnership business on the death or retirement of a Partner and the purchase of his or her interest in the partnership by the surviving or remaining Partners.

ARTICLE 2. INSURANCE

Agreement to Insure

Section 2.01. On execution of this Agreement, each Partner shall apply for and thereafter during the continuance of this Agreement carry insurance in the amount of $ _____ on the life of each of the other Partners.

Additional Insurance

Section 2.02. Each Partner, during the continuance of this Agreement, shall apply for and carry such additional insurance on the life of each of the other Partners as may be determined by majority vote of the Partners.

Trustee as Beneficiary and Custodian

Section 2.03. Each such policy shall be payable to the Trustee as beneficiary, shall be delivered to the Trustee for safekeeping, shall be subject to all the provisions of this Agreement, and shall be listed by the Trustee on a schedule attached to this Agreement and labeled Schedule A.

Ownership of Polices

Section 2.04. Each Partner shall own any insurance policies he or she applies for insuring the life of another Partner pursuant to this Agreement, shall hold full legal title to the insurance policy, and shall have the exclusive right to exercise any rights, options, or privileges provided for in the policy or permitted by the insurance company issuing the policy in respect. Each Partner agrees, however, not to exercise any right, option, or privilege without giving each of the other Partners [*number*] days notice in writing of the intention to do so. The Trustee, as custodian of the policies, shall release any policy to the owner on receiving proof satisfactory to it that such notice has been given or has been waived in writing by the other Partners.

Payment of Premiums

Section 2.05. During the continuance of this Agreement, each Partner shall pay, as they become due, all premiums on policies owned pursuant to this Agreement and shall give proof of each payment to the Trustee and to the Partner whose life is insured by the policy on which the premium became due within [*number*] days after the due date of the premium. If any premium is not paid within [*number*] days after its due date, the Partner whose life is insured by the policy on which the premium is due shall have the right to pay the premium and be reimbursed for the payment by the owner of the policy. The insurance company issuing any policy required by this Agreement is authorized and directed to furnish the insured Partner and the Trustee any information they, or either of them, may request in writing pertaining to the status of any insurance policy.

Ownership of Policies on Death

Section 2.06. On the death of any Partner, the ownership of any policies owned by the Partner on the other Partners' lives shall pass, subject to the provisions of this Article, to the executors or administrators of his or her estate.

Survivor's Option to Purchase Policies

Section 2.07. On any Partner's death, each surviving Partner shall have the right to purchase from the deceased Partner's estate and the executors or administrators of the estate shall sell to each surviving Partner, any or all policies owned by the deceased Partner insuring the life of that surviving Partner. The purchase price for the policy or policies shall be

equal to the interpolated terminal reserve of the policy or polices as of the date of the deceased Partner's death, less any existing indebtedness charged against the policies, plus the proportionate part of the gross premiums last paid thereon before the date of the deceased Partner's death that cover a period extending beyond that date.

Termination of Survivor's Option

Section 2.08. If any surviving Partner fails to pay to the executors or administrators of the deceased Partner's estate within [*number*] days after their appointment and qualification the purchase price, determined as provided in Section 2.07 of this Agreement, for any insurance policy insuring that Partner's life, the right to purchase that policy shall terminate and the executors or administrators of the deceased Partner's estate may take any action with respect to the policy as they desire.

ARTICLE 3. SALE OF PARTNERSHIP INTEREST ON DEATH

Mandatory Purchase and Sale

Section 3.01. On any Partner's death, each surviving Partner shall purchase from the deceased Partner's estate, and the executors or administrators of the decedent's estate shall sell to each surviving Partner, at the price and on the terms and conditions specified in this Article, the portion of the entire Partnership interest of the deceased Partner as the interest of each surviving Partner in the Partnership bears to the total interests of all surviving Partners in the Partnership. For the purposes of this Section, the interest of each surviving Partner and the total interests of all surviving Partners in the Partnership shall _____[mean their individual and aggregate net worths respectively in the Partnership as of the close of business on the date of the deceased Partner's death, as shown by the Partnership books *or* be determined according to the proportions they, immediately prior to the Partner's death, were entitled to share in the Partnership profits].

Purchase Price of Partnership Interest

Section 3.02. On any Partner's death, each surviving Partner shall pay to the deceased Partner's estate, in the manner specified in Section 3.03 of this Agreement, as the full purchase price for the portion of the deceased's Partnership interest being sold to the surviving Partner, that Partner's proportionate share, determined according to the percentage of the deceased's interest being sold, of _____[*set forth formula for determining entire purchase price, e.g.*, an amount equal to the value of the deceased Partner's interest in the Partnership as shown on the last regular Partnership accounting preceding the deceased Partner's death, plus the unwithdrawn portion of the deceased Partner's distributive share of any net profits earned by the Partnership between the date of the accounting and the date of the deceased Partner's death]. In no event, however, shall the purchase price for a surviving Partner's portion of the deceased Partner's Partnership interest be less than the amount of insurance owned by that surviving Partner on the deceased Partner's life pursuant to Article II of this Agreement.

Payment of Purchase Price

Section 3.03. Each Partner agrees that on the death of a Partner, the proceeds of any policies subject to this Agreement owned by any Partner on the deceased Partner's life shall be applied by the Trustee toward payment of the purchase price payable by him or her pursuant to Section 3.02 of this Agreement. If the purchase price payable by any surviving Partner exceeds the proceeds of the insurance policies subject to this Agreement owned by him or her on the life of the deceased Partner, the balance of the purchase price shall be paid by the surviving Partner in [*number*] consecutive equal monthly installments commencing [*number*] months after the date of the deceased Partner's death, and shall be

evidenced by a negotiable promissory note to be executed by that surviving Partner to the order of the executors or administrators of the estate of the deceased Partner as payees. The promissory note shall contain the following provisions:

(1) Provisions for each installment to be applied first to interest on the then remaining unpaid principal balance of the note at the rate of _____ percent per annum from the date of the deceased Partner's death and then to reduction of the principal balance of the note.

(2) Provisions allowing the surviving Partner to pay, without penalty, any or all installments provided for in the note before they become due.

(3) All other provisions concerning acceleration of maturity, attorneys' fees, and other matters as are contained in the form of promissory note attached to this Agreement and marked Exhibit B.

Security for Note

Section 3.04. Any promissory note executed pursuant to Section 3.03 of this Agreement in partial payment of the purchase price for any portion of a deceased's Partnership interest shall be secured by a chattel mortgage on the maker's tangible assets having a value, as determined by the Trustee, equal to three times the principal amount of such note.

Execution of Instruments

Section 3.05. On receipt by the Trustee of an amount equal to the proceeds of any insurance policies owned by a surviving Partner on the life of the deceased Partner and any note required to be executed by any surviving Partner pursuant to Section 3.03 of this Agreement, or on receipt by the Trustee of the insurance proceeds and cash in lieu of the note, the executors or administrators of the deceased Partner's estate shall execute and deliver to the Trustee any instruments necessary to transfer to the surviving Partner full title to the portion of the deceased Partner's interest in the Partnership purchased by him or her.

Partnership Profits After Death

Section 3.06. All profits earned by the Partnership business after the date of a deceased Partner's death shall belong to the Partnership. The deceased Partner's estate shall have no right or claim to profits or interest on profits earned after the deceased Partner's death.

PRACTICE TIP

This form assumes a partnership that is financially fairly complex and that may have been very dependent on the deceased partner. Proceeds in excess of estate benefits should go to the partnership, to allow for continued operations during the transition from dependence on the deceased partner to the surviving partners (or a new employee), while those continuing the business develop the skills and know-how lost on the death of their partner. *Commentary by John J. Camozzi*.

Assumption of Partnership Obligations

Section 3.07. On any purchase and sale of a deceased Partner's interest, the surviving Partners shall assume all Partnership obligations and shall, jointly and severally, protect and indemnify the decedent's estate, the executors or

administrators of that estate, and the property of that estate from liability on any Partnership obligation.

Publication of Notice

Section 3.08. As soon as practicable after any purchase and sale of a deceased Partner's interest under this Article, the Trustee shall, at the cost and expense of the surviving Partners, prepare, publish, file, and serve all notices required by law to protect the deceased Partner's estate and the executors or administrators of that estate from liability for any future obligations of the Partnership business, including, without limitation, a Statement of Dissociation pursuant to *California Corporations Code Section 16704*..

ARTICLE 4. SALE OF PARTNERSHIP INTEREST DURING LIFE

Section 4.01. If, during any Partner's lifetime, that Partner desires to dissociate from the Partnership, that Partner shall first offer in writing to sell his or her full interest in the Partnership to the other Partners at a price determined pursuant to Section 3.02 of this Agreement but payable in full on the date of sale. Each remaining Partner shall have the right to purchase a portion of that interest equal to the proportion that his or her net worth in the Partnership bears to the aggregate net worth of all remaining Partners as shown by the Partnership books on the date the withdrawal is served. However, the dissociating Partner may not be compelled to sell less than his or her full interest in the Partnership. If any remaining Partner fails to purchase the specified portion of the withdrawing Partner's interest, it may be purchased by the other remaining Partners jointly or separately. If the remaining Partners fail to accept the offer to purchase the full interest of the dissociating Partner in the Partnership within [*number*] days after they receive that offer, and the Partnership is not dissolved and terminated, the Partner desiring to dissociate from the Partnership shall have the right to sell his or her interest to any other person providing that at least [*number*] days prior to the sale, the dissociating Partner offers in a writing delivered to each remaining Partner to sell his or her interest to the remaining Partners at the same price and on the same terms offered by the other person. On transfer of the dissociating Partner's interest to a transferee who is not then a partner, the transferee thereupon shall have the full right, during the continuance of the Partnership, to participate in the management and control of the Partnership business and affairs.

PRACTICE TIP

The rights of a transferee of a partnership interest are spelled out in *Corp. Code § 16503*. *Commentary by John J. Camozzi*.

ARTICLE 5. RIGHTS AND DUTIES OF TRUSTEE

Duties During Lives of Partners

Section 5.01. During the continuance of this Agreement, the Trustee shall:

(1) Receive and safely hold all life insurance policies subject to this Agreement.

(2) Receive and safely maintain at its office in _____, California, subject to inspection by any Partner or any Partner's authorized agent at any time during its normal business hours, the master copy of this Agreement signed by all Partners.

(3) Enter together with the signature of its authorized agent or employee on a schedule attached to the master copy of this Agreement marked Schedule A the policy number, insurer's name, insured Partner's name, and the face amount of each policy subject to this Agreement.

(4) Receive and maintain at its office in _____, California, subject to inspection by any Partner or any

Partner's authorized agent at any time during its normal business hours, proof of payment of all premiums paid by the Partners pursuant to this Agreement.

(5) Receive and maintain a complete file of all notices and correspondence pertaining to this Agreement or to the policies subject to this Agreement.

(6) Release any policy subject to this Agreement to the owner of such policy on receipt of satisfactory proof that she notices required by Section 2.04 of this Agreement have either been given in the manner prescribed by this Agreement or have been waived in writing by the other Partners.

Duties on Death of a Partner

Section 5.02. On the death of a Partner, the Trustee shall:

(1) Make a claim for and collect the proceeds of all life insurance policies subject to this Agreement insuring the life of the deceased partner. The Trustee, however, shall be under no obligation to institute any legal action to recover the proceeds of any such policy or policies until it receives a written agreement signed by the surviving Partners to indemnify it for all costs, expenses, and attorneys' fees that may arise as a result of that legal action. Should the proceeds received by the trustee on any policy or policies exceed the purchase price payable by the owner of the policy or policies pursuant to Section 3.02 of this Agreement and all expenses and fees payable by the owner, the Trustee shall immediately pay the excess portion of the proceeds to the owner and apply the balance of the proceeds as provided in this paragraph.

(2) Demand and receive from the surviving Partners:

(a) All promissory notes and chattel mortgages required to be executed by any or all of the surviving Partners pursuant to Sections 3.03 and 3.04 of this Agreement, or, at the option of any surviving Partner, cash in lieu of any note and mortgage required of that surviving Partner.

(b) Proof satisfactory to it of the value of the property encumbered by each chattel required under Section 3.04 of this Agreement.

(c) An agreement in writing signed by all surviving Partners that they will jointly and severally protect and indemnify the deceased Partner's estate, the executors or administrators of that estate, and the property of that estate from liability on any and all existing Partnership obligations.

(d) A list of the names and addresses of all suppliers and other persons who had extended credit to the Partnership prior to the date of the deceased Partner's death.

(e) Amounts required to pay the costs and expenses to be incurred by the Trustee in preparing, publishing, filing, and serving the notices required under Section 3.08 of this Agreement.

(f) Their share of the compensation payable to the Trustee pursuant to Section 5.04 of this Agreement and any additional expenses that may be incurred by the Trustee in performing its duties under this paragraph.

(3) Demand and receive from the executors or administrators of the deceased Partner's estate:

(a) A certified copy of their letters testamentary or letters of administration.

(b) A certified copy of an order of the probate court administering the deceased Partner's estate, approving the sale of the decedent's interest in the Partnership pursuant to this Agreement and authorizing the executors or administrators of his or her estate to execute, acknowledge, and deliver to the Trustee any instruments that, in the trustee's judgment are required to be executed, acknowledged, or delivered by them under this Agreement.

(c) Instruments executed by the executors or administrators of the decedent's estate that are required, in the Trustee's judgment, to be executed and delivered to the Trustee under Section 3.05. of this Agreement.

(4) On its receipt of all instruments and moneys specified in Subsections (1), (2), and (3) of this Section 5.02, the Trustee shall:

(a) Deduct from the proceeds it receives from insurance policies subject to this Agreement the portion of the compensation payable to the Trustee pursuant to Section 5.04 of this Agreement by the executors or administrators of the deceased Partner's estate and the portion of any expenses incurred by it in performing its duties under this paragraph that is payable by those administrators or executors.

(b) Deliver to the executors or administrators of the deceased Partner's estate the balance of the proceeds it receives from insurance policies subject to this Agreement.

(c) Deliver to the executors and administrators of the estate any and all promissory notes received by it and executed by the surviving Partners pursuant to Section 3.03 of this Agreement.

(d) Deliver to the executors or administrators of the estate the written agreement signed by all surviving Partners that they will jointly and severally protect and indemnify the deceased Partner's estate, the executors or administrators of that estate, and the property of that estate from liability on any and all Partnership obligations.

(e) The insurance policies subject to this Agreement owned by the deceased Partner on the lives of the surviving Partners.

(f) Deliver to each of the surviving Partners the instrument or instruments executed by the executors or administrators of the deceased Partner's estate under Section 3.05 of this Agreement, transferring to each surviving Partner full and complete title to the portion of the deceased Partner's interest in the Partnership being purchased by the surviving Partner.

(g) Record in the proper counties all chattel mortgages received by it, executed by the surviving Partners under Section 3.04 of this Agreement, with instructions to the recording officials to return those mortgages directly to the executors or administrators of the deceased Partner's estate at such address as may be furnished to the Trustee by the executors or administrators, or in care of the clerk of the probate court administering the estate of the deceased Partner.

(h) Prepare, publish, file, and serve all notices required by law to protect the deceased Partner's estate and the executors or administrators of the estate from liability for any future obligations of the Partnership business.

(I) Reimburse itself for all expenses incurred by it in performing its duties under this paragraph and pay to itself the compensation payable to the Trustee under Section 5.04 of this Agreement.

Duties on Termination of Agreement

Section 5.03. If this Agreement is terminated other than by the death of the Partners, the Trustee shall:

(1) Demand of the Partners an amount equal to the compensation payable to the Trustee under Section 5.04 of this Agreement, and any amounts required to reimburse the Trustee for expenses or counsel fees it incurred in performing its duties under this Agreement.

(2) Deliver the insurance policies subject to this Agreement to their respective owner. However, the Trustee shall be under no duty to deliver the policies until it has received the amount demanded by it pursuant to Subsection (1) of this Section 5.03.

Fees of Trustee

Section 5.04. The Trustee shall be paid as compensation for its services under this Agreement a commission equal to _____ percent of all money received by it on the death of a Partner as proceeds of life insurance policies subject to this Agreement, or, should this Agreement be terminated other than by the death of the Partners, a fee of $ _____ for its services in terminating the trust. The Trustee shall also be reimbursed for all reasonable expenses and counsel fees it incurred in performing its duties under this Agreement. All compensation, expenses, and counsel fees that may become due to the Trustee under this Section shall, unless otherwise expressly provided in this Agreement, be paid equally by the Partners. For the purposes of this Section, the word "Partners" includes the executors or administrators of the deceased Partner's estate.

Resignation of Trustee

Section 5.05. The Trustee, on giving [*number*] days written notice, shall have the right to resign at any time. The Partners shall have the right to substitute another Trustee in place of the Trustee named in this Agreement at any time on payment to the Trustee named in this Agreement of a fee of $ _____.

ARTICLE 6. MISCELLANEOUS PROVISIONS

Amendment of Agreement

Section 6.01. This Agreement may be altered, amended, or terminated by a writing signed by all the Partners. However, this Agreement may not be amended in such a way as to affect the duties of the Trustee without the Trustee's written consent to such amendment.

Termination

Section 6.02. This Agreement shall terminate on the occurrence of any of the following events:

(1) Cessation of the Partnership business.

(2) Bankruptcy, receivership, or dissolution of the Partnership.

(3) Bankruptcy of any Partner.

(4) Death of [*number*] Partners simultaneously or within a period of [*number*] days.

(5) At any Partner's option if another Partner either fails to pay the premiums on or assigns, surrenders, borrows against, changes the beneficiary of, or alters the payment provisions of any life insurance policy which he or she owns subject to

this Agreement. Any Partner may terminate this Agreement under these conditions by giving written notice to the other Partners and the Trustee.

Purchase of Policies on Termination

Section 6.03. If this Agreement terminates before the death of all but one Partner, each Partner shall be entitled to an assignment of any policy insuring his or her own life. An assignment of a policy insuring a Partner's life shall be made when he or she pays to the owner of that policy within [*number*] days after termination an amount equal to the interpolated terminal reserve of that policy as of the date of transfer, less any existing indebtedness charged against the policy, plus the proportionate part of the gross premium last paid on the policy before the date of transfer which covers a period extending beyond that date.

Notices

Section 6.04. All notices, offers, or other matters required or permitted by this Agreement to be served on, given to, or delivered to any person or entity shall be in writing and shall be deemed duly served, given, or delivered when personally delivered to such person or to a managing agent of such entity, or, in lieu of personal service, when deposited in the United States mail, certified, first-class postage prepaid, addressed:

(1) If to a Partner, to that partner at the address set forth below that Partner's signature at the end of this Agreement.

(2) If to the executors or administrators of the estate of a deceased Partner, to them in care of the clerk of the court that appointed them.

(3) If to the Trustee, to it at _____ Street, _____, California, or any other place the Trustee may from time to time designate by notice in writing to the Partners given pursuant to this paragraph as its address for the purposes of this paragraph.

Binding on Heirs

Section 6.05. This Agreement shall be binding on the parties, their heirs, executors, administrators, successors, and assigns.

Performance by Insurance Companies

Section 6.06. No company that issues life insurance policies under this Agreement shall be bound to inquire into or take notice of any provisions in this Agreement relating to policies of insurance or to the application of the proceeds of those policies. The signature of the owner of any policy requesting or ordering any action whatsoever shall be sufficient authority for the insurance company to take or permit that action.

Attorneys' Fees

Section 6.07. In any dispute between the parties or their personal representatives concerning any matter relating to this Agreement, the party or parties prevailing in that dispute shall be entitled, in addition to any other relief that may be granted, to a reasonable sum for their attorneys' fees. The amount of attorneys' fees awarded under this Section shall be determined by the arbitrator or judge in that dispute or in a separate action brought for that purpose.

Governing Law

Section 6.08. This Agreement shall be governed by the laws of the State of California.

Executed on _____[*date*], at _____County, California.

PARTNERS
_____ [*signature of partner*]
[*typed name*]
_____ [*mailing address*]
_____ [*taxpayer identification number*]
_____ [*signature of partner*]
[*typed name*]
_____ [*mailing address*]
_____ [*taxpayer identification number*]
_____ [*signature of partner*]
[*typed name*]
_____ [*mailing address*]
_____ [*taxpayer identification number*]

TRUSTEE
_____ [*name of trustee*]
By _____ [*signature*]
[*typed name and title*]

SCHEDULE A

Schedule of Insurance Policies Subject to Agreement

Policy No. _____ issued _____[*date*], by _____ Life Insurance Company, on the life of _____[*name of partner*], in the amount of $ _____, owned by _____[*name of partner*] and received _____[*date*], on behalf of _____[*name of trustee*], by [*signature of trustee's agent*].

Policy No. _____ issued _____[*date*], by _____ Life Insurance Company, on the life of _____[*name of partner*], in the amount of $ _____, owned by _____[*name of partner*] and received _____[*date*], on behalf of _____[*name of trustee*], by [*signature of trustee's agent*].

Policy No. _____ issued _____[*date*], by _____ Life Insurance Company, on the life of _____[*name of partner*], in the amount of $ _____, owned by _____[*name of partner*] and received _____[*date*], on behalf of _____[*name of trustee*], by [*signature of trustee's agent*].



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
A. General Partnerships
4. Purchase and Sale Agreements Funded With Insurance

7-15 California Legal Forms--Transaction Guide §§ 15.263-15.269

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

[Reserved]

§§ 15.263[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
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B. Professional Partnerships

7-15 California Legal Forms--Transaction Guide § 15.270

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.270 Professional Partnerships--General Form of Agreement

[1] Comment

[a] Use of Form

This form is designed to be used by professional partnerships of three or more partners. It may be modified for smaller partnerships by eliminating such provisions as Paragraph 24, defining the Partners' voting rights. In using this form to draft a particular professional partnership agreement, the attorney should consider not only the various alternative provisions for professional partnerships contained in forms §§ 15.271[2] through 15.280[2], but also the alternative provisions contained in the general partnership agreements set forth in the *forms in §§ 15.200[2]*, *15.201[2]*, and *15.202[2]*.

[b] Nature of Professional Partnership

A professional partnership is not a special form of partnership. Aside from specific statutory provisions governing the practice of the particular profession it is engaged in, there are no special statutes regulating its affairs. It is an association of two or more persons as general partners for the purpose of practicing a profession or operating a personal service business. The chief characteristics that distinguish a professional partnership from any other general partnership is that it tends to have little capital, no inventory, and relatively large amounts of unrealized receivables. Its reputation depends on the skill, experience, and training of its individual members [*Lyon v. Lyon (1966) 246 Cal. App. 2d 519, 525, 54 Cal. Rptr. 829]* . It follows that professional partnership agreements require provisions not found in ordinary commercial partnership agreements.

Partnerships to provide legal and accounting services may be formed either as ordinary limited partnerships or as limited liability partnerships (LLPs). LLPs are special entities that are governed by a specific set of provisions of the

partnership statutes [*see Corp. Code §§ 16951-16962*] (LLP provisions of UPA '94). The formation of LLPs is a separate subject that is covered in Ch. 16C, *Limited Liability Partnerships* . Ch. 16C discusses the characteristics of LLPs and should be consulted in connection with the determination of whether to form a legal or accounting partnership as a general partnership or an LLP. Formation of a legal or accounting partnership as an LLP may be an attractive option and should be seriously considered. The remainder of this comment focusses solely on general partnerships, and this form is not suitable for a legal or accounting partnership that is being formed as an LLP. For LLP forms and comment, see Ch. 16C, *Limited Liability Partnerships* .

[c] Special Provisions Applicable to Professional Partnerships

Because a professional partnership's income is derived from the personal services of its members and its reputation is dependent on the reputation of its members, provisions governing their rights, duties, and conduct are more detailed in professional than in commercial partnership agreements. For example, the various partners' experience, reputation, skill, and ability to attract clients are not usually equal. Therefore, the provisions in the partnership agreement for division of the partnership profits require special consideration.

Further, because a professional partnership has little capital or inventory and is almost entirely dependent on the partners' earnings, different tax considerations may be involved in drafting provisions relating to the death or retirement of a partner than are involved in drafting similar provisions for an ordinary commercial partnership. For example, Section 4.05 of this form provides that the partnership interest of a deceased or retired partner will be "liquidated" by the partnership by payment of a specified amount each month, determined by the past income of the partnership. Although such payments will be taxable to the retired partner or the deceased partner's estate as ordinary income, either as a distributive share of partnership income or guaranteed payments [*see I.R.C. § 736(a)*; *see also § 15.307*], the "liquidation" provision was purposely included in this form. Ordinarily, after a partner's retirement, the continuing partners will be in a higher income tax bracket than the retired partner and will gain more by being able to deduct such payments on their income tax returns than the retired partner will lose by having to report the payments as ordinary income.

PRACTICE TIP

Not all professional partnerships will have little capital. Some professional partnerships will have dramatic fluctuations in their business cycles and will require substantial retained earnings to self-finance operations through down cycles. An accounting partnership, for example, may have substantial first and second quarter cash flow and minimal third quarter cash flow. *Commentary by John J. Camozzi*.

[d] Taxable Year of Professional Partnership

Section 2.14 of this form provides that the partnership will keep its books on a cash and calendar year basis. Consequently, this form anticipates that the partnership will file its informational income tax return on a cash and calendar year basis. The cash basis has been selected because of the large amount of accounts receivable usually carried by a professional partnership. Under the cash basis method of accounting, accounts receivable are not reported as income and the partners do not pay taxes on them until they have been paid to the partnership. The alternative is the accrual method of accounting, which requires that accounts receivable be reported as income and taxes paid on them when they become unconditional obligations owed to the partnership. For most professional partnerships, it will be preferable not to report an account receivable that may ultimately be uncollectible than to report it under the accrual method and later try to prove it is deductible as a bad debt.

The calendar year basis of accounting and reporting was specified in this form because the partners will usually have been on a calendar year basis, and in most instances the partnership taxable year must be based on the taxable year of the partners [*see I.R.C. § 706(b)(1)(B)*; *see also § 15.23*].

California generally follows federal law with respect to the selection of a tax year for partnerships [*Rev. & Tax. Code § 17851*; *see I.R.C. §§ 701-761*; *but see Rev. & Tax. Code §§ 17851-17932* (modifications to federal law)].

[e] Licensing of Professional Partnerships

In addition to the professional licenses held by the partners, some but not all professional partnerships are required to register and obtain a license in the partnership name. A law partnership is not required to obtain any kind of permit or license in the partnership name from the State Bar of California, though a professional law corporation is required to register [*see Bus. & Prof. Code § 6160*], and a legal services limited liability partnership must register with the State Bar [*see Corp. Code § 16306(f)*; *see also* State Bar LLP Rules and Regulations, Rule 1.0; Ch. 16C, *Limited Liability Partnerships*]. However, a partnership of accountants is required to obtain a permit from the Board of Accountancy [*see Bus. & Prof. Code §§ 5070, 5072, 5073*]. A medical partnership is required to obtain a permit from the Division of Licensing of the Board of Medical Quality Assurance only if it is using a fictitious name [*see Bus. & Prof. Code § 2415*]. A list of the most common types of professional partnerships that must obtain a professional license in the partnership name is contained in § 15.120.

[f] Partner Dissociation

Section 4.01 requires advance written notice of a partner's withdrawal from the partnership. The partnership agreement may not vary a partner's power to withdraw from the partnership other than to require written notice [*Corp. Code § 16103(b)(6)*], but it does make a withdrawal without notice a wrongful dissociation that may subject the partner to liability for any damages caused by the partner's failure to give notice [*see Corp. Code § 16602(b)(1), (c)*].

[2] FORM

Professional Partnerships--General Form of Agreement

PARTNERSHIP AGREEMENT

_____, _____, and _____[*names*], hereinafter referred to as "Partners," agree that

ARTICLE 1. NATURE OF PARTNERSHIP

Partnership Purpose

1.01. The Partners voluntarily associate themselves as General Partners for the purpose of engaging in the general practice of [*profession, e.g.,* law, medicine] and matters related and incidental to that practice under the laws of the State of California and the rules and regulations of _____[*professional association, e.g.*, The State Bar of California].

Name

1.02. The name of the Partnership, herein called "firm name," shall be _____[*partnership name*]; provided, however:

(1) If any Partner whose surname is included in the firm name permanently withdraws from the Partnership, that

Partner's name shall, on receipt of that Partner's written request or at the election of the remaining Partners, be deleted from the firm name.

(2) If a Partner whose surname is included in the firm name is expelled, the Partnership shall immediately delete that Partner's surname from the firm name, unless after the expulsion a person with the same surname continues to be a member of the Partnership.

(3) On the death of any Partner whose surname is included in the firm name, the Partnership may continue to use the deceased Partner's surname as part of the firm name, without compensation to the deceased Partner's estate or beneficiaries, for any period of time authorized by the laws of the State of California, the rules and regulations of any professional association of which the Partnership or the Partners are members, or the majority vote of the surviving Partners.

Term

1.03. The Partnership shall commence on _____[*date*], and shall continue until dissolved by mutual agreement of the parties or terminated as provided in this Agreement.

Location

1.04. The Partnership offices shall be located at _____[*street address and city*], California, or any other place or places in _____County, California, that may be designated by majority vote of the Partners.

ARTICLE 2. FINANCIAL

Capital

2.01. The initial capital of the Partnership shall consist of the capital contributions made by each of the Partners, as specified on a schedule attached to this Agreement marked Exhibit A.

Withdrawal of Capital

2.02. No portion of the Partnership capital may be withdrawn at any time without the express written consent of all the Partners.

Interest on Capital

2.03. No Partner shall be entitled to interest on contributions to the capital of the Partnership.

Additional Contributions to Capital

2.04. Any Partner whose capital account is less than $ _____shall, at the end of each calendar year in which Partner's share of Partnership net profits exceeds $ _____, contribute _____ percent of that Partner's share of Partnership net profits to the Partnership capital until that Partner's capital account

amounts to $ _____.

Profits and Losses

2.05. The net Partnership profits shall be divided and the net Partnership losses shall be borne by the Partners in the following proportions:

Name of Partner	Percentage of Profit and Loss
_____ [*partner's name*]	_____%
_____ [*partner's name*]	_____%
_____ [*partner's name*]	_____%

Profits of Deceased or Terminated Partner

2.06. On the death of a Partner or on the withdrawal, retirement, or expulsion of a Partner as provided in this Agreement, that Partner's distributive share of the future Partnership profits and losses shall be divided among the remaining Partners in accord with their percentage interests as specified in Section 2.05 of this Agreement.

Expenses

2.07. All rents, payments for office or professional supplies, professional dues, premiums for insurance, wages, salaries, and other expenses incidental to the Partnership business shall be paid out of the profits or capital of the Partnership and shall, for the purpose of this Agreement, be considered ordinary and necessary expenses of the Partnership business deductible before net profits are determined.

Salaries

2.08. No Partner shall receive any salary for services rendered to or in the Partnership business.

Draws

2.09. During each calendar year each Partner shall be entitled to withdraw from the Partnership funds in equal monthly installments an amount equal to but not in excess of [*fraction, e.g.,* four-fifths] of his or her distributive share of Partnership net profits for the preceding year. Each withdrawal by a Partner shall be charged against his or her distributive share of the net Partnership profits for the year in which made. Each Partner shall be entitled, at the end of any calendar year, to withdraw the balance of his or her distributive share of the Partnership net profits for the year after making the capital contribution, if any, required by Section 2.04 of this Agreement; provided, however, the withdrawals made by the Partners during the first calendar year of the Partnership shall not exceed the following amounts each month:

Name of Partner	Amount
_____	$ _____

_____ $ _____
_____ $ _____

Fees

2.10. The amount charged by each Partner for professional services rendered in connection with the Partnership business shall be determined by each Partner pursuant to a schedule of charges to be adopted by majority vote of the Partners. However, each Partner may render professional services for any member of his or her immediate family without charge and may, on approval of the Partners having a majority interest in the Partnership profits and losses, render professional services without charge or at less than regular charge to any professional, civic, educational, religious, or charitable organization or project.

Bank Accounts

2.11. All Partnership funds shall be deposited in bank accounts designated by majority vote of the Partners. The Partners shall also designate by majority vote three Partners, one of whom shall be the Managing Partner, who shall be authorized to sign checks and make withdrawals from such bank accounts. All checks and withdrawals on or from any such bank account shall require the signatures of two authorized Partners.

Books

2.12. Complete and accurate accounts of all Partnership transactions shall be kept in proper books, and each Partner shall enter in those books a full and accurate account of all transactions conducted by that Partner on behalf of the Partnership. The books of account and other Partnership records shall be kept in the Partnership place of business at all times, and each Partner shall have access to, and may inspect and copy, any of them at any time.

Method of Accounting

2.13. The Partnership books of account shall be kept on a cash and calendar year basis.

Accountings

2.14. As soon after December 31 in each year as is reasonably practicable, a complete and accurate accounting shall be made of all Partnership receipts and disbursements during the preceding calendar year. The net Partnership profits or losses during that year shall be ascertained and credited or debited, as the case may be, on the Partnership books, to the respective Partners in the proportions specified in Section 2.05 of this Agreement.

Capital Accounts

2.15. An individual capital account shall be maintained for each Partner. Each Partner's capital account shall consist of his or her contribution to the initial capital, any additional contributions to the Partnership capital made by that Partner pursuant to this Agreement, and any amounts transferred from his or her income account to Partnership capital pursuant to this Agreement.

Income Accounts

2.16. An individual income account shall be maintained for each Partner. At the end of each calendar year each Partner's share of the Partnership net profits or losses shall be credited or debited to, and his or her withdrawals during the year deducted from, that income account. Except as provided in Section 2.04 of this Agreement, amounts may be transferred from a Partner's income account to the Partnership only by majority vote of the Partners.

Amounts in Income Accounts

2.17. Any amount credited to a Partner's income account on any regular Partnership accounting provided for in this Agreement shall constitute a liability of the Partnership to that Partner payable without interest on demand.

ARTICLE 3. RIGHTS AND DUTIES OF PARTNERS

Vacations and Sick Leave

3.01. Each partner shall devote full time, knowledge, and skill to the Partnership business. Each Partner shall be entitled to vacations, sick leave, and absences from the Partnership business in the following manner:

(a) Each Partner shall be entitled to [*number*] weeks vacation in each calendar year to be taken at such times as may be most convenient to the Partnership. Any vacation not used in one year may be used in a future year only with the approval and to the extent agreed on by majority vote of the Partners.

(b) Each Partner shall be entitled to [*number*] weeks sick leave each calendar year without adjustment in earnings because of actual sickness or accident to the Partner or any member of the Partner's immediate family. Sick leave not used in one year may not be carried over to future years or used for additional vacation.

(c) In addition to sick leave, each Partner who becomes pregnant shall be entitled to [*number*] months maternity leave during any twelve month period without adjustment in earnings.

(d) Each Partner, in addition to the vacation and sick leave provided for in this Section shall be entitled to be absent from the Partnership business for [*number*] days each calendar year for the purpose of attending professional meetings or postgraduate courses.

(e) If any Partner's vacation or sick leave exceeds the limits specified in this Section for any year, that Partner's distributive share of the net Partnership profits for the year shall be reduced at the rate of _____ percent for each week the vacation or sick leave exceeds the limits specified in this Section without the consent of [a majority *or* all] of the remaining Partners. The amount by which any Partner's distributive share of Partnership net profits is reduced pursuant to this provision shall be credited to the other Partners according to their percentage interests in those profits as specified in Section 2.05 of this Agreement.

Management

3.02. In addition to other matters specified in this Agreement, the following matters shall be determined by majority vote of the Partners as *defined in Section 3.05* of this Agreement:

(a) Matters relating to general management, professional policy, and the purchase of furniture and equipment costing more than $ _____.

(b) The assignment of professional duties and responsibilities among the Partners.

(c) The selection of a Partner to serve as Managing Partner.

Statement of Partnership

3.03. Concurrent with the execution of this Agreement, the Partners shall cause to be filed with the California Secretary of State a Statement of Partnership Authority pursuant to *California Corporations Code Section 16303* setting forth the Partners' rights with respect to management and control of the Partnership and any limitations thereon as set forth in this Agreement. The Partnership shall cause the Statement of Partnership Authority be recorded in every county in which the Partnership owns, or contemplates owning, real property.

Managing Partner

3.04. The Managing Partner shall be selected at the beginning of each calendar year and shall serve in that capacity for the calendar year or until a successor is selected. The Managing Partner shall have the duty and authority to carry out and implement decisions relating to general management and professional policy, to purchase supplies, furniture, and equipment costing less than $ [*amount specified in Section 3.02(a*)], and to employ, discharge, and supervise the clerical, administrative, and other employees of the Partnership.

Votes

3.05. In any matter requiring a majority vote of the Partners, each Partner shall have one vote for each one percent of Partnership net profits distributable to the Partner under Section 2.05 of this Agreement during the year in which that vote is taken. "Majority vote of the Partners" as used in this Agreement shall mean 51 percent of the votes cast pursuant to this Section.

Prohibited Acts

3.06. No Partner shall, without the consent of all other Partners:

(a) Loan any Partnership funds;

(b) Tender any professional services to any person if requested by the Managing Partner not to do so;

(c) Incur any obligations in the name of or on the credit of the Partnership except in the ordinary course of the Partnership business; or

(d) Become bail, surety, or endorser for any other person.

The Partnership shall be indemnified for any losses it sustains because of the breach of this paragraph by the Partner committing the breach.

Personal Debts

3.07. Each Partner shall pay and discharge that Partner's own separate obligations as they become due, and shall protect the other Partners and the Partnership from all costs, claims, and demands relating to his or her personal obligations.

Malpractice

3.08. Each Partner shall indemnify the Partnership for all damages and expenses for which the Partnership may become liable as a result of any alleged act of negligence or professional malpractice on the part of that Partner to the extent that the damages and expenses are not paid or reimbursed under a policy of insurance carried by the Partnership.

Assignment of Interest

3.09. No Partner shall sell, assign, mortgage, hypothecate, or encumber any interest in the Partnership.

ARTICLE 4. PARTNER DISSOCIATION

Withdrawal of Partner

4.01. Any Partner may withdraw from the Partnership at the end of any calendar year by giving _____ months written notice to the other Partners. On service of that notice:

(a) The dissociation of the Partner from the Partnership will automatically become effective at the end of the calendar year in which given, unless within [*number*] days after receiving notice the remaining Partners, by written agreement signed by all of them, elect to dissolve the Partnership and serve written notice of their election on the dissociating Partner, in which event his or her notice shall be deemed an expression of the Partner's will to dissolve and wind up the Partnership business.

(b) If the remaining Partners do not elect to dissolve the Partnership, the Partnership books shall be closed at the end of the calendar year in the usual manner. The withdrawing Partner shall then be paid the balance shown in his or her capital and income accounts, increased by his or her share of Partnership net profits or decreased by his or her share of Partnership net losses during the year, and decreased further by his or her drawings against anticipated profits during the year. The net amount payable to the withdrawing Partner shall not include any share in uncollected charges received by the Partnership subsequent to the effective date of withdrawal and shall be payable without interest in [*number*] equal consecutive [*e.g.*, monthly *or* quarterly] installments commencing [*number*] month(s) after the effective date of dissociation.

(c) A Partner may withdraw from the Partnership without the written advance notice required under this Paragraph, but such a withdrawal shall be considered a wrongful dissociation under *Corp. Code § 16602(b)(1)* and the Partner will be liable for any damages caused by the wrongful dissociation under *Corp. Code § 16602(c)*.

Expulsion of a Partner

4.02. Any Partner may be expelled from the Partnership.

(a) Expulsion shall become effective on the adoption by majority vote of the remaining Partners, at a meeting held after five days written notice has been given to the expelled Partner, of a written resolution finding that the Partner has:

(1) Engaged in personal misconduct or a willful breach of this Agreement of such a serious nature as to render the Partner's continued presence in the Partnership personally or professionally obnoxious or detrimental to the other Partners or the Partnership;

(2) Been expelled, suspended, or otherwise disciplined by the final action of any professional organization or duly constituted authority;

(3) Resigned from any professional organization under threat of disciplinary action;

(4) Been convicted by final action of any court of any offense punishable as a felony or involving moral turpitude; or

(5) Made an assignment for the benefit of creditors or been declared a bankrupt.

(b) The expelled Partner shall be entitled to receive from the remaining Partners, as soon as practical after the effective date of the dissociation, the book value of the expelled Partner's Partnership interest as determined by a complete inventory and accounting of the Partnership affairs as of the close of business on the effective date of the dissociation, less any value attributable to the goodwill of the Partnership business and less any damages, if the expulsion was caused by willful breach of this Agreement, sustained by the remaining Partners or the Partnership because of the breach.

Retirement of Partner

4.03. Any Partner may voluntarily retire from the Partnership at any time after the age of _____ years by giving [*number*] months written notice of the intention to retire to the other Partners.

Disability of Partner

4.04. Any Partner who is disabled because of illness, accident, or other cause, and therefore unable to perform normal duties as a Partner for a continuous period of [*number*] months or longer may be retired from the Partnership by majority vote of the other Partners. [*For an alternative provision concerning termination of a disabled partner's interest in the Partnership, see Section 4.02 of form in § 15.200[2].*]

Payment for Partnership Interest

4.05. On the dissociation of a Partner due to death or retirement under Section 4.03, or because of disability under Section 4.04, the Partnership shall pay to the person legally entitled thereto, in full liquidation of that Partner's interest in the Partnership, the following amounts:

(a) An amount each month for [*number*] consecutive months following the retirement or death of the Partner that is equal to [*fraction or percentage, e.g.,* one third] of the Partner's average monthly earnings from the Partnership in the [*number*] years immediately preceding the Partner's retirement or death during which the Partner was a member of the partnership; plus

(b) The Partner's distributive share of the Partnership net profits for its current year to the date of retirement or death, less withdrawals made by the Partner against those profits, payable [*number*] days after the date of retirement or death; plus

(c) An amount equal to the balance in the Partner's capital and income accounts on the date of retirement or death,

payable without interest in [*number*] consecutive equal [*e.g.,* quarterly] installments beginning [*number*] months after the date of retirement or death.

Noncompetition Clause

4.06. Any retired Partner who engages in competition with the Partnership in any way during the period any amounts are payable to him or her under Subparagraph (a) of Paragraph 4.05 of this Agreement shall forfeit all right to any remaining payments due under that Subparagraph. "Competition with the partnership" shall mean engaging, directly or indirectly, (including, by way of example only, as a director, principal, partner, venturer, partner, or agent), or having any direct or indirect interest, in any business similar to or competitive with that then being carried on by the Partnership in the _____[, *specify geographical scope of noncompetition, e.g.,* City and County of Los Angeles].

Retired Partner's Right to Examine Books

4.07. Any person legally entitled to receive any payments pursuant to the provisions of Paragraph 4.05 of this Agreement shall have the right to examine the Partnership books and records at any time during normal business hours to the extent that the examination is necessary to determine the amount of any payments set forth in Paragraph 4.05 of this Agreement.

Limitation on Payments to Dissociated Partners

4.08. A dissociated Partner, including a deceased Partner's estate, shall not have any claim against the Partnership or the remaining Partners, except for payments expressly provided in this Agreement to be paid to them. If the Partnership is dissolved before the full amount of these payments has been paid, the unpaid balance shall be paid in full before any distribution of Partnership assets shall be made to the remaining Partners.

Dissolution

4.09. The Partnership may be dissolved on the affirmative vote of a [*specify, e.g.,* a majority in interest, *or* a majority in numbers, *or percentage greater than majority*] of the Partners. On dissolution of the Partnership, all Partnership assets, including any lease for office space occupied by the Partnership, but excluding any files or records pertaining to the affairs of its [clients *or* patients] shall be liquidated and the proceeds distributed in the manner specified in *California Corporations Code Section 16807*.

Files

4.10. On any dissolution of the Partnership, the Partner who has usually rendered professional services for a particular [client *or* patient] shall be entitled to the [client's *or* patient's] file unless the [client *or* patient] requests that a different disposition be made of that file. A Partner who withdraws from the Partnership shall be entitled only to the records or files of those [clients *or* patients] for whom he or she regularly performed professional services as a member of the Partnership and for whom he or she also rendered professional services before becoming a member of the Partnership. The estate of a deceased Partner shall not be entitled to any records or files of the Partnership except records and files relating to personal matters of the deceased Partner.

ARTICLE 5. MISCELLANEOUS

Additional Partners

5.01. The Partners may by [*specify, e.g.*, a majority in interest, *or* a majority in numbers, *or* unanimous vote], admit additional Partners and fix the capital contributions, if any, to be made and the participation percentage in profits and losses of any additional Partners. All Partners shall relinquish an equal proportion of their own participation percentage in Partnership profits and losses to any such additional Partners. However, before being admitted, each additional Partner must first agree in writing to be bound by the provisions of this Agreement.

Notices

5.02. Any notices permitted or required by law or by this Agreement shall be in writing and shall be deemed duly given when personally delivered to the Partner to whom they are addressed or, in lieu of personal delivery, when deposited in the United States mail, first-class postage prepaid, certified, addressed to that Partner at the address that appears below that Partner's signature at the end of this Agreement.

Amendments

5.03. No amendment to this Agreement shall be valid unless made in writing and signed by all of the Partners.

Executed on _____[*date*] at _____[*city*], _____ County, California.

_____ [*signature of partner*]
[*typed name*]
_____ [*mailing address*]
_____ [*taxpayer identification number*]
_____ [*signature of partner*]
[*typed name*]
_____ [*mailing address*]
_____ [*taxpayer identification number*]
_____ [*signature of partner*]
[*typed name*]
_____ [*mailing address*]
_____ [*taxpayer identification number*]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
B. Professional Partnerships

7-15 California Legal Forms--Transaction Guide § 15.271

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.271 Professional Partnerships--Provision for Contribution of Existing Practices to Partnership

[1] Comment

[a] Use of Form

This form provides for the merger of existing professional practices into the partnership being formed. It is designed to be substituted for Section 2.01 of the *form in § 15.270[2]*. Although it provides for the merger of two partnerships, a single or solo practitioner, and a person who contributes cash to the new partnership, it can be modified to eliminate one or more firms or persons or to add as many firms or persons as desired. If additional firms or practitioners are merged into the new partnerships, paragraphs describing them should be inserted after Subparagraph (d) of this form and the last two subparagraphs of this form renumbered accordingly. If the existing firms' accounts receivable are being transferred to the new partnership, the language excluding them in Subparagraph (a), (b), and (d) of this form, as well as all the language of Subparagraph (f) of this form should be omitted.

Frequently small firms will desire to "merge" or reorganize into a large partnership to conserve expenses, expand services, and perhaps enhance the reputation of their practice. This form provides for such a merger or reorganization. Each of the former small firms contributes its assets to the initial capital of the new partnership. For the purposes of clearly indicating the tax consequences of such a merger, this form also provides for the contribution of cash to the initial capital of the new partnership by one partner.

PRACTICE TIP

Not infrequently small firm mergers fail because the fiercely autonomous individual partners are unable to define or establish an entity culture or shared management practices. Counsel should consider the true motivations of a small firm merger and carefully review any post-merger management practices. Counsel should also keep in mind the risks of partnership dissolution and be certain that the attorney-client

relationship is clearly defined, making all appropriate conflict disclosures and maintaining all waivers in the file. *Commentary by John J. Camozzi*.

[b] Tax Consequences of Merger of Practices

Neither the partnership nor the contributing partner recognize gain or loss on contributions of cash or other property to the partnership [*I.R.C. § 721*; *see § 15.18[2]*]. Consequently, each existing firm can transfer all of its assets to the new partnership, and the partner who contributes cash to the partnership can do so without any income tax liability. However, the basis to the partnership of each item of property contributed to it is the adjusted basis the contributing partner had for the property immediately before the contribution to the partnership [*I.R.C. § 723*]. Because of the large amount of accounts receivable or "unrealized receivables" inherent in their businesses, most professionals report their income on a cash rather than an accrual basis [*see* discussion in *§ 15.271[1][d]*]. Accordingly, they pay taxes on their accounts receivable only as they receive payments on those accounts. Therefore, they will have no income tax basis for accounts receivable and the partnership will have no basis for them when they are contributed to the partnership capital. Further, because such accounts are not within the definition of "capital assets" [*see I.R.C. § 1221*], any income received from them after their transfer to the partnership would be taxed as ordinary income to the partnership. Thus a portion of the amount received on each contributed accounts receivable will be taxed to each partner in the new partnership, including the partner who contributed only cash to the partnership [*see* Grant & Paul, *Tax Problems of Professional Partnerships*, 1960 So. Cal. Tax Inst. 517, 518]. To avoid this result, this form provides that the accounts receivable of each existing firm remain the property of that firm, but will be billed and collected by the new partnership and paid to the existing firm to which they belong. In this manner the tax consequences of transferring such accounts to the new partnership are avoided, but the existing firm's clients are reminded each month that their former attorney or doctor is now part of the new partnership--a reminder that will be valuable to the goodwill of the new partnership.

Under California law, the taxation of partnerships generally is determined in accordance with the partnership provisions of the Internal Revenue Code [*Rev. & Tax. Code § 17851*; *see I.R.C. §§ 701-761*; *but see Rev. & Tax. Code §§ 17851-17932* (modifications to federal law)].

[2] FORM

Professional Partnerships--Provision for Contribution of Existing Practices to Partnership

Capital

2.01. The initial capital of the Partnership shall consist of:

(a) All the physical assets shown on a schedule attached to this Agreement marked Exhibit A, and the intangible assets, including client lists, accounts receivable and work in progress shown on Exhibit A, of the Partnership for the practice of [*profession*] previously conducted by _____ and _____[*names*] under the name of _____[*firm name*], which are contributed to this Partnership by those persons at an agreed value of $ _____.

(b) All the physical assets shown on a schedule attached to this Agreement marked Exhibit B, and the intangible assets, including client lists, accounts receivable and work in progress shown on Exhibit A, of the individual practice of [*profession*] previously conducted by _____[*name*], which are contributed to this Partnership by _____[*name of owner*] at an agreed value of $ _____.

(c) The sum of $ _____ in cash, contributed to this Partnership by _____[*name of partner*].

(d) All the physical assets shown on a schedule attached to this Agreement marked Exhibit C, and the intangible assets,

except accounts receivable and work in progress, of the Partnership for the practice of [*profession*] previously conducted by _____ and _____[*names*] under the name of _____[*firm name*], which are contributed to this Partnership by those persons at an agreed value of $ _____.

(e) The term "work in progress" as used in this section means matters, cases, or other activities requiring the rendition of professional services commenced prior to but not completed at the date of this Agreement by any of the former Partnerships or practices mentioned in this section, referred to in this Agreement as "existing" firms. Each such matter, case, or activity shall be completed by this Partnership. The charges for completion shall be billed and collected by this Partnership, and shall, on receipt, be allocated between the existing firm involved and this Partnership in a manner determined by majority vote of all Partners.

(f) Accounts receivable of the existing firms shall be billed and collected by this Partnership but at all times shall remain the property of the existing firms and their members. Any payments received on any accounts receivable shall be promptly paid to the existing firm whose property it remains. Any practices, other than normal billing and accounting procedures, required to collect any such accounts receivable shall be undertaken by the existing firm whose property it remains and not by this Partnership.

(g) "Client lists" as used herein shall mean all client information, billing records, accounts, work in progress related to those accounts, and all after-acquired information, records, accounts and client matters, contributed to the Partnership by the respective Partners. On dissolution of the Partnership or dissociation of any Partner, other than by death, disability, or expulsion, all such client lists shall be distributed in-kind to the Partner who contributed such client lists to the Partnership pursuant to this Agreement.

PRACTICE TIP

The disposition of unfinished partnership business on *dissolution* of a professional partnership can be controlled by agreement. This is particularly important when client services are rendered over time as in the legal profession. For example, in the absence of an agreement providing otherwise, attorneys' fees received for cases in progress on the dissolution of a law partnership are to be shared by the former partners according to their right to fees in the dissolved partnership, regardless of which partner provides the legal services in the case after dissolution. The fact that the client substitutes one of the former partners as attorney of record in place of the dissolved partnership does not affect this result [*Jewel v. Boxer (1984) 156 Cal. App. 3d 171, 174, 203 Cal. Rptr. 13]* . A partner has no right, however, to share in the proceeds from future business from the dissolved partnership's former clients who elected to retain the services of a new partnership formed by former copartners [*Fraser v. Bogucki (1988) 203 Cal. App. 3d 604, 611, 250 Cal. Rptr. 41]* . For further discussion of the rights of partners with respect to unfinished partnership business, see Ballantine & Sterling, California Corporation Laws, Ch. 24, pt. C (Matthew Bender). *Commentary by John J. Camozzi.*



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
B. Professional Partnerships

7-15 California Legal Forms--Transaction Guide § 15.272

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.272 Professional Partnerships--Provision for Sharing Profits and Losses According to Who Originated Client and Who Performed Services for Client

[1] Comment

[a] Use of Form

This form provides that the partner who secured the business of a client or customer, and the partner who performed the services for which the fee is charged, will receive stated percentages of all fees received from the customer or client. After the stated percentages are distributed to the partners, the partnership profits will be determined and distributed equally among all partners. If used, this form should be substituted for 2.05 of the *form in § 15.270[2]*. Other provisions of the *form in § 15.270[2]* referring to the percentage interests of the partners in the partnership profits, especially 3.01 and 3.02, should be omitted if this form is used.

[b] Purpose of Form

A number of factors affect the fairness of profit division in professional partnerships. Many partners prefer the "formula" approach provided in this form, which apportions each fee received among the partner originating the fee for the partnership, the partner who actually performed services for which the fee was paid, and other partners. This system requires the careful maintenance of reliable records of the work performed by each partner and accurate records of which clients were secured by each partner. It also requires a detailed breakdown of the general costs of maintaining the partnership and their allocation on an hourly or other basis to the services performed. For a detailed discussion of this "formula" approach and the objections to it, see Willis, *The Problems of Professional Partnership*, 26 N.Y.U. Tax. Inst. 167, 171 173 (1968).

[2] FORM

Professional Partnerships--Provision for Sharing Profits and Losses According to Who Originated Client and Who Performed Services for Client

Profits and Losses

2.05. Net Partnership profits and losses shall be shared in the following manner:

(a) Each Partner who has originated a particular client [*or* patient *or* customer] by having secured that [client's *or* patient's *or* customer's] business for the Partnership shall be allocated _____ percent of all fees received from that [client *or* patient *or* customer]. If more than one Partner is responsible for securing a [client's *or* patient's *or* customer's] business for the Partnership, the allocated percentage shall be apportioned equally among the responsible Partners. Each Partner who has performed or directed the performance of services on behalf of any client shall be allocated _____ percent of any fees received as a result of those services. The remaining fees shall be distributed equally among the Partners.

(b) All Partnership expenses in rendering professional services to any client, including allowances for the general office, insurance, rental, and other overhead expenses of the Partnership, determined pursuant to a formula to be adopted by majority vote of the Partners, shall be _____[*specify method in which overhead will be paid, e.g.,* charged to the Partners in the same proportion as the fees for those services are allocated among the Partners under this Section *or* paid before any fees are distributed to the Partners according to the method specified in this Section].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
B. Professional Partnerships

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AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.273 Professional Partnerships--Provision for Sharing Profits and Losses According to Units if Participation Assigned to Each Partner

[1] Comment

[a] Use of Form

This form provides for the allocation of partnership profits and losses on the basis of units of participation assigned to each partner. It is a substitute for Section 2.05 of the *form in § 15.270[2]*. If it is used, Section 3.01(d) should be modified to provide that a partner's share of the profits of the partnership will be reduced by a specified number of units of participation instead of percentage for each week that partner's vacation or sick leave exceeds the limits set in Section 3.01 of the *form in § 15.270[2]*.

[b] Units of Participation Formula

The most readily adjustable formula for determining each partner's distributive share of partnership profits and losses is the assignment of "units of participation" to each partner. Each partner is assigned a specified number of "units of participation." As the total number of "units of participation" outstanding among the partners increases or decreases, the partners' individual interests in partnership profits and losses also increase and decrease without any amendment of the partnership agreement being required.

The total number of units assigned to the partners need not total 100 or any other figure. Thus, if 10 units are outstanding, each unit is worth 10 percent of the profits, and if 20 units are outstanding, each unit is worth only 5 percent of the profits. Consequently, on the termination of a partner's interest in the partnership, no change in the number of units held by the remaining partners is required. Conversely, when a new partner is added or a junior partner's share of profits is increased, no change in the number of units of participation assigned to the other partners

need be made. However, if each partner was given a specified percentage interest in the profits and losses of the partnership, changes in the number of partnership units would be required. Although mathematically the results should be the same, senior partners may be more reluctant to increase the stated percentage of profits distributable to a junior partner when the stated percentage distributable to them must be reduced in the partnership agreement than they are to increase the number of participating units held by a junior partner when the number of units held by them remains the same.

PRACTICE TIP

Anti-dilution rights in profit-sharing agreements can be creatively structured to protect classes of partners. For example, a senior partner may have anti-dilution rights against junior partners, but not among themselves, and junior partners may have no anti-dilution rights. These types provisions should be carefully considered before including them in any agreement. *Commentary by John J. Camozzi*.

[2] FORM

Professional Partnerships--Provision for Sharing Profits and Losses According to Units if Participation Assigned to Each Partner

Profits and Losses

2.05. Net Partnership profits and losses shall be shared by the Partners on the basis of the units of participation held by each Partner.

(a) The units of participation that shall be held by each Partner are as follows:

Name of Partner	Units of Participation
_____	_____ [*e.g.*, 30] units
_____	_____ [*e.g.*, 20] units
_____	_____ [*e.g.*, 17] units

(b) After the net Partnership profit or loss for any calendar year has been calculated, the total number of units of participation held by the then members of the Partnership shall be divided into that calculated net profit or loss, thereby determining the amount of that profit or loss, therein called "unit value," that is attributable to each unit of participation then outstanding. Each Partner's distributive share of the net profit or loss shall then be determined by multiplying the unit value by the number of units of participation held by that Partner.

(c) On termination of any Partner's interest in the Partnership, the units of participation held by that Partner will also terminate. The number of units of participation assigned to a new Partner upon admission to the Partnership shall be determined by a majority vote of the remaining Partners. In either case no adjustment will be required with respect to the units of participation held by the other Partners. Except as otherwise expressly provided in this Agreement, the number of units of participation held by each Partner as specified in this section shall not be changed except by amendment to this Agreement.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
B. Professional Partnerships

7-15 California Legal Forms--Transaction Guide § 15.274

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.274 Professional Partnerships--Provision for Payment of Portion of Fees to Named Partners Before Distribution of Net Profits

[1] Comment--Use of Form

This form provides that specified partners will receive a stated portion of fees charged for their work prior to distribution of the remainder of the net partnership profits. If this form is used, any provision in the *forms in §§ 15.272[2]* or *15.273[2]* or Section 2.05 of the form in § 15.70[2] may be substituted in place of Paragraph (b) of this form. If used, this form should be substituted for Section 2.05 of the *form in § 15.270[2]*.

[2] FORM

Professional Partnerships--Provision for Payment of Portion of Fees to Named Partners Before Distribution of Net Profits

Profits and Losses

2.05. The Partnership profits and losses shall be shared in the following manner:

(a) The amount of fees received or collected by the Partnership for charges made for the time and services of each Partner shall be determined. Each Partner shall receive a percentage of fees received or collected by the Partnership for charges made for his or her time and services, determined as follows:

Name of Partner	Percentage
_____	_____percent

_

Name of Partner Percentage

_____ _____percent

_

Name of Partner Percentage

_____ _____percent

_

(b) After each Partner has received his or her percentage of fees under Subsection (a) of this Section, the Partnership's net profits or losses shall be determined and distributed to the Partners in the following proportions:

Name of Partner Percentage

_____ _____percent

_

Name of Partner Percentage

_____ _____percent

_

Name of Partner Percentage

_____ _____percent

_



92 of 184 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
B. Professional Partnerships

7-15 California Legal Forms--Transaction Guide § 15.275

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.275 Professional Partnerships--Provision for Percentage of Net Profits to Be Credited to Bonus Reserve Account and Distributed Among Partnership Employees

[1] Comment--Use of Form

Paragraph (a) of this form provides for a stated percentage of the annual net partnership profits to be credited to a "bonus reserve account" and distributed among the partners and employees of the partnership in a manner determined by a majority vote of the partners, such as incentive bonuses. Any of the formulas set forth in the *forms in §§ 15.272[2]through 15.274[2]* or in Section 2.05 of the *form in § 15.270[2]* may be modified and inserted as Paragraph (b) of this form to describe the manner in which the remainder of the annual net Partnership profits or losses will be distributed among the partners themselves. This form is designed to be substituted, when appropriate, for Section 2.05 of the *form in § 15.270[2]*.

[2] FORM

Professional Partnerships--Provision for Percentage of Net Profits to Be Credited to Bonus Reserve Account and Distributed Among Partnership Employees

Profits and Losses

Section 2.05. The net Partnership profits and losses shall be shared in the following manner:

(a) _____ percent of the annual net Partnership profits shall be allocated on each regular accounting provided for in this Agreement to a "bonus reserve account," and shall be distributed among the Partners and employees of the Partnership in a manner determined by majority vote of the Partners. However, by majority vote of the partners, all of the funds credited to the bonus reserve account on any accounting provided for in this Agreement may be used to

alleviate any current and temporary emergency needs of the Partnership for which no other funds are suitable or available.

(b) All the remaining net Partnership profits shall be distributed to and any net Partnership losses shall be borne by the Partners in the following manner:

_____ [*Set forth manner of sharing profits; see Section 2.05 of form in § 15.270[2] and forms in §§ 15.272[2]-15.74[2]*].



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
B. Professional Partnerships

7-15 California Legal Forms--Transaction Guide § 15.276

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.276 Professional Partnerships--Provision for Management Committee

[1] Comment--Use of Form

This form creates a management committee composed of the partners to manage the affairs of the partnership. Subject to any agreement between them, each partner has equal rights in the management and conduct of the partnership business [*Corp. Code § 16401(f)*]. This form is designed primarily for use by large professional partnerships in which it would be inconvenient to hold daily or weekly partnership meetings. This form is designed to be substituted for Section 3.02 of the *form in § 15.270[2]*. If it is used, Section 3.03 of that form should be omitted, the remaining paragraphs of that form renumbered accordingly, and all provisions that provide for decisions by the majority vote of the partners carefully reviewed. Further, if this form is used, consideration should be given to the use of either *form in §§ 15.277[2]* or *15.278[2]* relating to meetings of the partners. If this form is used, the remainder of the agreement should be reviewed to assure that it contains no inconsistent provisions with respect to voting rights, allocation of responsibilities among the partners, and authority of the partners.

[2] FORM

Professional Partnerships--Provision for Management Committee

Management Committee

Section 3.02. Except as otherwise expressly provided in this Agreement, the entire management of the Partnership shall be vested in a Management Committee consisting of three Partners, no one of whom may be retired (although a member of the Management Committee may be participating in steps toward gradual retirement as herein provided).

(a) Each Partner named to the Management Committee shall serve as a member until withdrawal from the Partnership,

retirement from the Partnership, expulsion from the Partnership, resignation as a member of the Management Committee, or removal from the Management Committee by majority vote of the Partners.

PRACTICE TIP

Professional partnerships often rotate management committee membership on an annual basis, as is done on a corporate board of directors. An appointment terminable by a majority in interest at the majority's will is not a true life appointment. If a lifetime appointment is intended, then it should only be terminable for cause, as defined in the agreement. Each partnership must structure its management committee to fit its needs and the relative strengths of the partners. *Commentary by John J. Camozzi*.

(b) Any member of the Management Committee may resign from the Committee at any time by giving written notice of resignation to the other members of the Management Committee.

(c) Any vacancies that may occur on the Management Committee shall be filled as soon as possible by vote of the Partners at a meeting of Partners called for that purpose.

(d) Action of the Management Committee shall be by majority vote of its members, but it shall not be necessary that any notice be given of its meetings or of the matters to be decided at any meeting. Any decision of the Committee may be reversed by subsequent action of the Committee.

(e) The Management Committee may delegate any part of its powers, rights, and authority to any subcommittee of one or more of its members either for the purpose of recommending to the full Management Committee what action should be taken or with power in the subcommittee to act. In the latter event, the act of the subcommittee shall be the act of the Management Committee. Any such delegation may be terminated by the Management Committee at any time without notice.

(f) The Management Committee may appoint any Partner or full-time employee of the Partnership, or any group of such Partners and full-time employees, to investigate any matter and recommend action by the Management Committee or by vote of the Partners.

(g) Though it has no obligation to do so, the Management Committee may refer any matter to a meeting of the Partners for decision.

(h) _____, _____, and _____[*names*] are hereby appointed members of the Management Committee.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
B. Professional Partnerships

7-15 California Legal Forms--Transaction Guide § 15.277

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.277 Professional Partnerships--Provisions for Calling and Conducting Partnership Meetings--Each Partner to Have One Vote

[1] Comment--Use of Form

This form is designed for use in place of Sections 3.03 and 3.04 of the *form in § 15.270[2]*. It provides the procedure for calling and conducting meetings of the partners in which each partner has one vote. For a form granting voting rights to the partners according to their percentage interests in the partnership profits and losses, see *Section 3.04* of the *form in § 15.270[2]*. For a provision concerning partnership meetings in which each partner has the same number of votes as "units of participation" in partnership profits and losses held by that partner, see the *form in § 15.278[2]*.

[2] FORM

Professional Partnerships--Provisions for Calling and Conducting Partnership Meetings--Each Partner to Have One Vote

Partnership Meetings--Notice

3.03. A meeting of the Partners may be held at the office of the Partnership at any time:

(a) On call of the [Management Committee *or* Managing Partner] and [*number*] hours notice [in writing *or* either in writing or oral] to each Partner specifying the time and purpose of the meeting.

(b) On [*number*] days notice in writing, specifying the time and purpose of the meeting, given to each Partner and signed by any [*number*] Partners.

Conduct of Partnership Meetings

3.04. At any meeting of Partners provided for in this Agreement:

(a) Each Partner shall have one vote on any matter properly brought before the meeting whether a vote of the Partners on that matter is required by this Agreement or the matter is voluntarily submitted to vote of the Partners by the Management Committee.

(b) The presence, either in person or by proxy, at any meeting of a majority in [number *or* interest] of all Partners shall, except as otherwise provided in this Agreement, constitute a quorum for the transaction of any business that may come before that meeting.

(c) Except as otherwise expressly provided in this Agreement, the decision by majority vote of all Partners present, either in person or by proxy, at any meeting at which a quorum is present shall be binding on the Partnership and each Partner.

(d) No Partner shall be entitled to vote on any matter coming before any meeting that affects that Partner's continuing status as a member of the Partnership, or on any matter involving ratification of that Partner's transactions with the Partnership whether individually or through an entity in which: (1) that partner owns at least a 51 percent interest; or (2) ownership resides in individuals related by kinship or marriage to that Partner. For the purpose of determining whether a quorum is present to act on such matters or whether such a matter has received the percentage of votes required for its passage, the number of units of participation outstanding shall be deemed reduced by the number held by the Partner so affected.

(e) Except as provided in Subsection (d) of this Section 3.04, the following matters must be adopted by the vote of the Partners as specified below, either in person or by proxy, at a meeting held after [*number*] days notice in writing has been given to each Partner specifying the time and purpose of the meeting:

Matter	Vote Required
Admission of a New Partner	_____[*e.g.*, majority in interest *or* in number]
Retirement of a Partner	_____[*e.g.*, majority in interest *or* in number]
Gradual Retirement of a Partner	_____ [*e.g.*, majority in interest *or* two-thirds in number]
Disability of a Partner	_____ [*e.g.*, majority in interest *or* two-thirds in number]
Expulsion of a Partner	_____ [*e.g.*, majority in interest *or* two-thirds in number]
Amendment of Partnership	_____[*e.g.*, majority in interest *or* two-thirds (in number]
Agreement	_____ [*e.g.*, majority in interest *or* two-thirds in number]
Dissolution of Partnership	_____[*e.g.*, majority in interest *or* two-thirds (in number]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
B. Professional Partnerships

7-15 California Legal Forms--Transaction Guide § 15.278

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.278 Professional Partnerships--Provisions for Calling and Conducting Partnership Meetings--Each Partner's Voting Rights Measured by Units of Participation in Partnership Profits

[1] Comment--Use of Form

This form is designed for use in place of Sections 3.03 and 3.04 of the *form in § 15.270[2]*. It provides that the voting rights of each partner at a partnership meeting will be equivalent to the number of "units of participation" in the partnership profits held by that partner. Accordingly, this form should be used only if the *form in § 15.273[2]*, providing for the sharing of profits and losses according to "units of participation" held by the partners, is also used. The nature and advisability of using "units of participation" as a method for distributing partnership profits and losses is discussed in *§ 15.273[1]*. For a provision concerning partnership meetings in which each partner has one vote, see the *form in § 15.277[2]*. For a provision granting voting rights to the partners according to their percentage interest in the partnership profits and losses, see *Section 3.04* of the *form in § 15.270[2]*.

[2] FORM

Professional Partnerships--Provisions for Calling and Conducting Partnership Meetings--Each Partner's Voting Rights Measured by Units of Participation in Partnership Profits

Partnership Meetings--**Notice**

3.03. A meeting of the partners may be held at the office of the Partnership at any time during regular business hours on the call, without notice, of the [Management Committee *or* Managing Partner], or on [*number*] days notice in writing to each Partner specifying the time and purpose of the meeting signed by any [*number*] Partners.

Conduct of Partnership Meetings

3.04. At any meeting of Partners provided for in this Agreement:

(a) Each Partner will have one vote for each unit of participation in the net profits and net losses of the Partnership held by that Partner pursuant to Paragraph 2.05 of this Agreement [whether the vote on a particular matter is required by this Agreement or the matter is voluntarily submitted to vote of the Partners by the Management Committee].

(b) The presence in person or by proxy at any meeting of Partners holding a majority of the total number of units of participation in the Partnership shall constitute a quorum for the transaction of any business that may come before the meeting, except as otherwise provided in this agreement.

(c) Except as otherwise expressly provided in this Agreement, the decision by majority vote of all units of participation represented, either in person or by proxy, at any such meeting at which a quorum is present, shall be binding on the Partnership and each Partner.

(d) No Partner shall be entitled to vote on any matter coming before any meeting that affects that Partner's continuing status as a member of the Partnership, or on any matter involving ratification of that Partner's transactions with the Partnership whether individually or through an entity in which: (a) that partner owns at least a 51 percent interest; or (b) ownership resides in individuals related by kinship or marriage to that Partner. For the purpose of determining whether a quorum is present to act on such matters or whether such a matter has received the percentage of votes required for its passage, the number of units of participation outstanding shall be deemed reduced by the number held by the Partner so affected.

PRACTICE TIP

This paragraph could, if appropriate, include further disqualifying conflicts of interest. *Commentary by John J. Camozzi*.

(e) Except as provided in Subparagraph (d) of this Paragraph 3.04, the following matters to be effective must be adopted by the vote specified below of all units of participation outstanding, cast either in person or by proxy, at a meeting held after [*number*] days notice in writing has been given to each Partner specifying the time and purpose of the meeting.

Matter	Vote Required
Admission of a New Partner	_____[*e.g.*, majority in interest *or* in number]
Retirement of a Partner	_____[*e.g.*, majority in interest *or* in number]
Gradual Retirement of a Partner	_____ [*e.g.*, majority in interest *or* two-thirds in number]
Disability of a Partner	_____ [*e.g.*, majority in interest *or* two-thirds in number]
Expulsion of a Partner	_____ [*e.g.*, majority in interest *or* two-thirds in number]
Amendment of Partnership	_____[*e.g.*, majority in interest *or* two-thirds (n number]
Agreement	_____ [*e.g.*, majority in interest *or* two-thirds in number]
Dissolution of Partnership	_____[*e.g.*, majority in in-

terest *or* two-thirds (in number]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
B. Professional Partnerships

7-15 California Legal Forms--Transaction Guide § 15.279

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.279 Professional Partnerships--Provision for Membership at Firm Expense in Professional or Civic Organizations

[1] Comment--Use of Form

To enhance its reputation and attract business in the community, professional partnerships often encourage their members to become active in professional and civic organizations such as a county bar association or the local chamber of commerce. This form provides that the partnership will become a member of any such organization at partnership expense, and requires or encourages each partner to belong to one or more such organizations. This form is designed to be inserted as Section 3.09 of the *form in § 15.270[2]*.

[2] FORM

Professional Partnerships--Provision for Membership at Firm Expense in Professional or Civic Organizations

Professional and Community Organizations

3.09. As an ordinary and necessary expense of its business, deductible before determination of net profits:

(a) The Partnership shall maintain membership in whatever professional and civic organizations are necessary or are determined by [majority vote of the Partners *or* the Management Committee] to be desirable for the practice of its profession.

(b) Each Partner [must *or* is encouraged to] belong to one or more professional associations or community organizations approved by [majority vote of the Partners *or* the Management Committee], such as: _____[*list types*

of organizations whose dues partnership will pay, e.g., Chamber of Commerce, Junior Chambers of Commerce, American Bar Association, _____ County Bar Association].

(c) As members of any such organizations, the Partnership and each Partner will act in accord with the rules and principles of those organizations at all times.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
B. Professional Partnerships

7-15 California Legal Forms--Transaction Guide § 15.280

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.280 Professional Partnerships--Provisions for Partner's Gradual Retirement

[1] Comment--Use of Form

The abrupt retirement or death of a partner can disrupt the operation of a professional or personal service partnership. First, the retiree is usually a senior partner not only in age, but also in the development of the firm, and the remaining partners may be unprepared financially to liquidate the retiree's interest [*see* Willis, *The Problems of the Professional Partnership*, 26 N.Y.U. Tax. Inst. 167, 180 (1968)]. Second, the goodwill of a professional partnership is dependent on the personal and confidential relationship existing between each partner and the clients or patients he or she serves [*Lyon v. Lyon (1966) 246 Cal. App. 2d 519, 524, 54 Cal. Rptr. 829]* . The client who is accustomed to having a particular partner handle work may not instantly trust whoever else is assigned to handle future matters. This form provides for the gradual retirement of a partner, thereby giving the remaining partners an opportunity to plan ahead for liquidation of the retiring partner's interest and gives the retiring partner a chance to gradually introduce clients to other members of the partnership.

PRACTICE TIP

While gradual retirement is the preferred method, often immediate retirement is dictated by poor health or other events. Care should be taken to ensure that an event of sudden retirement does not result in a breach of the partnership agreement. *Commentary by John J. Camozzi.*

This form may be inserted as Section 4.04 of the *form in § 15.270[2]*, and the subsequent sections of that form renumbered accordingly.

[2] FORM

Professional Partnerships--Provisions for Partner's Gradual Retirement

Gradual Retirement

4.04. Any Partner on attaining the age of [*number*] years, may, by giving [*number*] months written notice of intent to the other Partners, enter into a [*number of years*] -year plan, commencing on expiration of that notice period, for his or her gradual retirement from the Partnership.

(a) During the period of gradual retirement, the retiring Partner shall be listed on the Partnership letterhead and stationery as [*e.g.*, "of counsel"] and shall, except as otherwise expressly provided in this paragraph, retain all his or her rights, privileges, and interests in the Partnership.

(b) During the [*specify period, e.g.*, first year] of gradual retirement, the retiring Partner shall not be required to devote more than _____ hours per week to the Partnership business, nor to render professional services to any [client *or* patient] of the Partnership except those for whom he or she had customarily and habitually rendered such services in the past. During such period, that Partner's distributive share of net Partnership profits [and voting rights] before commencement of the period of gradual retirement shall be reduced by _____percent.

(c) During the [*specify period, e.g.*, second year] of gradual retirement, the retiring Partner shall not be required to devote more than [*lesser number than in Subsection (b)*] hours per week to the business and that Partner's distributive share of net Partnership profits [and voting rights] before commencement of the period of his or her gradual retirement shall be further reduced by _____ percent.

(d) During the [*specify period, e.g.*, third year] of gradual retirement, the retiring Partner shall not be required to devote more than _____ hours per week or more than _____ weeks per year to the business of the Partnership and that Partner's distributive share of net Partnership profits [and voting rights] before the commencement of the period of his or her gradual retirement shall be further reduced by _____ percent.

(e) During the [*specify period, e.g.*, fourth and fifth years] of gradual retirement, the retiring Partner shall not be required to devote any specified amount of time to the Partnership business, nor to render professional services to any [client *or* patient] of the Partnership, but shall be required to render on request consulting services to the other Partners. During the [*restate period, e.g.*, fourth and fifth years] of gradual retirement, the retiring Partner's distributive share of net Partnership profits [and voting rights] before the commencement of the period of his or her gradual retirement shall be further reduced by _____ percent.

(f) At the end of the [*specify period, e.g.*, fifth year] of the gradual retirement period, the retiring Partner will be retired from the Partnership, will have no further rights, duties, or privileges therein, and his or her Partnership interest shall be liquidated in the manner provided in Paragraph _____ of this Agreement.

(g) Any Partner who competes with the Partnership in any way during the period of his or her gradual retirement, shall forfeit all rights under this paragraph and shall be subject to expulsion from the Partnership in the manner provided by Paragraph 4.02 of this Agreement.



98 of 184 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
B. Professional Partnerships

7-15 California Legal Forms--Transaction Guide §§ 15.281-15.284

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

[Reserved]

§§ 15.281[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
C. Partnership Statements

7-15 California Legal Forms--Transaction Guide § 15.285

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.285 Statement of Partnership Authority (GP-1)

[1] Comment

[a] Use of Form

This form is official Form GP-1, Statement of Partnership Authority under *Corp. Code § 16303*. The form is available from any office of the California Secretary of State. The form should be filed with the General Partnership Unit of the Secretary of State, together with the filing fee of $70 [*Corp. Code § 16113(a)*].

Certified copies of the statement should be filed in all counties where title to real property is recorded in the partnership name [*see Corp. Code §§ 16105, 16303*].The fee for recording documents is $10 for the first page and $3 for each additional page [*see Gov. Code § 27361*; *see also Gov. Code § 27364* (certification under seal fee determined by board of supervisors)].

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 15.285. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Note that, when an existing limited liability company or limited partnership converts to a California general partnership,

that entity must use a different form, Form GP-1A, to file its statement of partnership authority [*see Corp. Code §§ 15677.6(a)(2)*, repealed January 1, 2010, 15911.06(a)(2) (conversion from limited partnership), 17540.6 (conversion from limited liability company)]. For discussion and a reproduction of Form GP-1A, see Pt. C, § 15.801.

[b] Contents and Execution

A statement of partnership authority must include the following [*Corp. Code § 16303(a)*]:

- Name of the partnership.
- Street address of its chief executive office.
- If the chief executive office is outside California, the street address of an office in California, if any.
- Names and mailing addresses of all partners or of an agent who maintains the list of names and mailing addresses of all partners and who will make it available on a showing of good cause.
- Names of all partners authorized to execute an instrument transferring real property held in the name of the partnership.

The partnership statement of authority may include statements that grant or limit the authority for some or all of the partners to enter into transactions on behalf of the partnership or any other matter [*Corp. Code § 16303(b)*].

A statement filed by a partnership must be signed by at least two of the partners who declare under penalty of perjury that the contents of the statement are accurate [*Corp. Code § 16105(c)*]. Copies should be sent to all nonfiling partners [*Corp. Code § 16105(e)*].

[c] Effect of Statement

A statement of partnership authority helps to protect the partnership and partners against liability from the unauthorized acts of partners by giving constructive notice of the authority of partners in the partnership. Third parties may rely on conclusively on a filed statement to the extent that they are uncontradicted by later-filed statements [*Corp. Code § 16303(d)(1)*; *see Federal Deposit Insurance Corp. v. Superior Court (1997) 54 Cal. App. 4th 337, 345-348, 62 Cal. Rptr. 2d 713* (interpreting *Corp. Code § 15010.5*, predecessor statute under former UPA)]. In addition, third parties who purchase partnership real property are deemed to know of any limitations on the authority of a partner to act if the statement of partnership authority is on record in the recording office [*Corp. Code § 16303(d)(1), (e)*]. Third parties otherwise are *not* deemed to know of a limitation on the authority of a partner because the limitation is contained in a filed statement [*Corp. Code § 16303(f)*]. For further discussion of the effect of a statement of partnership authority with respect to third persons and transfers of real property, see *§ 15.15[3]*.

[d] Avoiding Gap in Chain of Title of Partnership Property

Whenever real property recorded in the partnership name is conveyed, whether the conveyance is signed by one or all the partners, a "gap" will appear in the chain of title to the property and title insurance companies will be reluctant to insure the purchaser's title unless it can be established that the person signing the conveyance is a person authorized to convey real property recorded in the partnership name. Recording a certified copy of the statement of partnership authority in the office of the county recorder of any county remedies this problem. As noted above, third parties who purchase partnership real property are deemed to know of any limitations on the authority of a partner to act if the statement of partnership authority is on record in the recording office [*Corp. Code § 16303(d)(1), (e)*].

A provision in a recorded statement of partnership signed by all the partners granting the authority to one or more partners individually to transfer partnership property generally will serve as satisfactory evidence of that authority to title companies. These provisions will also be picked up by the title companies in their search of records and will obviate the necessity of bringing the partnership agreement to the title company office each time a piece of partnership real property is being conveyed.

[2] FORM

Statement of Partnership Authority (GP-1)

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100 of 184 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
C. Partnership Statements

7-15 California Legal Forms--Transaction Guide § 15.286

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.286 Statement of Denial (GP-2)

[1] Comment--Use of Form

This form is official Form GP-2, Statement of Denial [*see Corp. Code § 16304*]. It is available from any office of the California Secretary of State. The form should be filed with the General Partnership Unit of the Secretary of State, together with the filing fee of $30 [*see* Instructions to Form].

A statement of denial may be used to deny a person's partnership status, or limit a person's authority as a partner. It may be filed either by a partner in the partnership or by the person who is affected. A statement of denial is a limitation of authority that limits the extent to which third parties may rely on a filed and recorded partnership statement of authority [*Corp. Code § 16304*; *see Corp. Code § 16303(d), (e)*; *see also § 15.285[1], above*]. In order for a statement of denial to be effective for real estate transfers, a certified copy of the statement issued by the Secretary of State must be recorded with the county recorder's office for recording transfers of real property [*see* Instructions to Form].

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 15.286. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader 3.0 or better.

[2] FORM

Statement of Denial (GP-2)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
C. Partnership Statements

7-15 California Legal Forms--Transaction Guide § 15.287

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

§ 15.287 Statement of Amendment or Cancellation (GP-7)

[1] Use of Form

This form is official form GP-7, Statement of Amendment or Cancellation [*see Corp. Code § 16105(d)*]. It is available from any office of the California Secretary of State. The form should be filed with the General Partnership Unit of the Secretary of State, together with the filing fee of $30 [*see* Instructions to Form].

Form GP-7 is a multipurpose form that can be used to amend or cancel any of the statements authorized to be filed under UPA '94, including a statement of partnership authority [Form GP-1; *see § 15.285*], statement of denial [Form GP-2; *see § 15.286*], statement of dissociation [Form GP-3; *see § 15.530*], statement of dissolution [Form GP-4; *see § 15.531*], statement of conversion [Form GP-5; *see § 15.801*], statement of merger [Form GP-6; *see § 15.811*], or even another statement of amendment of cancellation.

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 15.287. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Any person authorized by the UPA'94 to file a statement may amend or cancel the statement by filing an amendment or cancellation that names the partnership, identifies the statement, and states the substance of the amendment or

cancellation [*Corp. Code § 16105(d)*]. Form GP-7 is used to make such a statement. The statement must be completed according to the attached instructions and mailed to the General Partnership Unit of the Secretary of State's office in Sacramento. A fee of $30 must accompany the form [*see* Instructions to Form].

[2] FORM

Statement of Amendment or Cancellation (GP-7)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART A. Formation of General Partnerships
IV. FORMS
C. Partnership Statements

7-15 California Legal Forms--Transaction Guide §§ 15.288-15.289

AUTHOR: by Robert D. Schindewolf, J.D., and Dennis F. Zickerman, J.D. John J. Camozzi, J.D., M.B.A., Practice Consultant

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§§ 15.288[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS

7-15 California Legal Forms--Transaction Guide 15.syn

§ 15.syn Synopsis to Chapter 15: GENERAL PARTNERSHIPS

§ 15.290 California Sources

[1] Statutes

[2] Regulations

§ 15.291 Federal Sources

[1] Statutes

[2] Regulations

§§ 15.292-15.294 [Reserved]

§ 15.295 Law Reviews and Periodicals

§ 15.296 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 15.297-15.298 [Reserved]

§ 15.299 Scope of Part

§ 15.300 Governing Law

§ 15.301 Distinction Between "Dissociation," "Dissolution," "Winding Up," and "Termination"

[1] In General

[2] Events Triggering a Partner's Dissociation

[a] Notice by Partner

[b] Provision in Partnership Agreement

[c] Unanimous Vote of Other Partners

[d] Judicial Determination

[e] Financial Problems

[f] Loss of Capacity

[3] Power of Partner to Dissociate

§ 15.302 Events Causing Dissolution and Winding Up

[1] Partnership at Will

[2] Partnership for a Definite Term

[3] By Judicial Decree

[a] Any Partnership

[b] Partnership for a Definite Term

[4] Agreed-on Event or Unlawfulness

§ 15.303 Rights of Partners on Dissociation or Dissolution

[1] In General

[2] Buyout of Dissociating Partners

[a] Terms of Buyout

[b] Failure to Reach Agreement; Payment or Tender of Buyout Price

[c] Court Action to Determine Buyout Price

[3] Rights and Duties of Dissociating Partner With Respect to Partnership

§ 15.304 Rights on Rescission of Partnership Agreement for Fraud or Misrepresentation

§ 15.305 Rights of Retiring Partner or Estate of Deceased Partner When Business Is Continued

§ 15.306 Liability of Partners and Partnership

[1] Liability of Dissociated Partners

[a] When Discharged

[b] Placing Third Persons on Notice of Dissociation

[2] Liability of Partnership and Partners

[a] For Acts of Dissociated Partner

[b] When There Is a Waiver of Dissolution

[c] Partnership's Liability for Post-Dissolution Acts

[d] Limitation on Partner's Authority to Bind Partnership

[e] Partners' Liability for Post-Dissolution Acts

§ 15.307 Winding Up Partnership Affairs

[1] Persons Authorized to Wind Up Business

[2] Scope of Authority of Person Winding Up Business

[3] Order of Distribution of Partnership Assets and Settlement of Accounts

[4] Costs of Winding Up and Allocation of Post-Dissolution Income

§ 15.308 Tax Consequences of Dissolution

[1] In General

[2] Sale of Partnership Interest

[a] Capital Gain or Loss

[b] Deceased Partner's Interest

[c] Taxable Year for Partner

[d] Partnership Basis Adjustment

[3] Liquidation of Partnership Interest

[a] Liquidation Payment Made by Partnership

[b] Special Treatment for Liquidating Payments

[c] Payments in Exchange for Partnership Property

[d] Other Payments

[e] Partnership Basis Adjustment

[4] Termination of Partnership

[a] State and Tax Law Causes for Termination

[b] Deemed Occurrences Under Tax Law When Partnership Business Continues

[c] Close of Partnership Tax Year

[d] Merger or Consolidation of Partnerships

§§ 15.309-15.399 [Reserved]

§ 15.400 Facts

[1] General Information

Scope

[2] Information About Dissociating Partners

Scope

[3] Information Concerning Status of Partnership Dissolution.

Scope

§ 15.401 Documents Relevant to Dissociation of Partner or Dissolution of Partnership

Scope

§§ 15.402-15.409 [Reserved]

§ 15.410 Dissociation of a Partner

Scope

§ 15.411 Dissolution

Scope

§ 15.412 Winding Up and Termination

Scope

§§ 15.413-15.419 [Reserved]

§ 15.420 Dissociation of Partner

Scope

§ 15.421 Dissolution of Partnership

Scope

§ 15.422 Winding Up and Termination

Scope

§§ 15.423-15.429 [Reserved]

§ 15.430 Election to Increase Tax Basis of Partnership Assets on Death of Partner or Sale or Exchange of Partnership Interest

Scope

§ 15.431 Election to Increase Basis of Undistributed Assets on Distribution to Any Partner

Scope

§§ 15.432-15.499 [Reserved]

§ 15.500 Agreement Dissolving Partnership--Sale of Assets--Liquidating Distribution of Net Proceeds to All Partners

[1] Comment

[a] Use of Form

[b] Termination of Partnership

[c] Tax Consequences of Liquidating Distributions

[2] FORM

Agreement Dissolving Partnership--Sale of Assets--Liquidating Distribution of Net Proceeds to All Partners

§§ 15.501-15.509 [Reserved]

§ 15.510 Agreement for Buyout of Dissociating Partner's Interest in Partnership

[1] Comment

[a] Use of Form

[b] Buyout Requirement

[c] Terms of Buyout

[d] No Buyout Within 90 Days of Dissolution

[e] Failure to Reach Agreement; Payment or Tender of Buyout Price

[f] Documents to Accompany Payment or Tender

[g] Court Action to Determine Buyout Price

[h] Rights and Duties of Dissociating Partner With Respect to Partnership

[i] Liability of Dissociated Partners

[i] When Discharged

[ii] Statement of Dissociation

[2] FORM

Agreement for Buyout of Dissociating Partner's Interest in Partnership

§ 15.511 Notice to Accompany Payment for Dissociating Partner's Interest

[1] Comment

[a] Use of Form

[b] Buyout Formula

[c] No Buyout Within 90 Days of Dissolution

[d] Tender to Wrongfully Dissociating Partners

[e] Contents of Notice

[f] Court Action to Determine Buyout Price

[2] FORM

Notice to Accompany Payment for Dissociating Partner's Interest

§§ 15.512-15.519 [Reserved]

§ 15.520 Agreement for Sale of Partnership Interest to Corporation

[1] Comment

[a] Use of Form

[b] Structure of Sale for Tax Purposes

[2] FORM

Agreement for Sale of Partnership Interest to Corporation

§§ 15.521-15.529 [Reserved]

§ 15.530 Statement of Dissociation (GP-3)

[1] Comment

[a] Use of Form

[b] Contents, Execution, and Filing

[c] Effect on Dissociating Partner's Authority

[d] Liability of Dissociated Partners

[e] Liability of Partnership and Partners for Later Acts of Dissociated Partner

[f] Statement of Fictitious Name

[2] FORM

Statement of Dissociation (GP-3)

§ 15.531 Statement of Partnership Dissolution (GP-4)

[1] Comment

[a] Use of Form

[b] Contents, Execution, and Filing

[c] Partnership's Liability for Post-Dissolution Acts

[d] Limitation on Partner's Authority to Bind Partnership

[e] Filing New Statement of Partnership Authority

[2] FORM

Statement of Partnership Dissolution (GP-4)

§§ 15.532-15.539 [Reserved]

§ 15.540 Letter to Creditors and Suppliers of Partnership Advising Them of Partner's Dissociation

[1] Comment

[a] Use of Form

[b] Protection of Partnership and Dissociating Partner

[2] FORM

Letter to Creditors and Suppliers of Partnership Advising Them of Partner's Dissociation

§ 15.541 Letter to Creditors and Suppliers of Partnership Advising Them of Partnership's Dissolution

[1] Comment

[a] Use of Form

[b] Protection of Partnership and Partners

[2] FORM

Letter to Creditors and Suppliers of Partnership Advising Them of Partnership's Dissolution

§§ 15.542-15.589 [Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
I. RESEARCH GUIDE
A. Primary Sources

7-15 California Legal Forms--Transaction Guide § 15.290

§ 15.290 California Sources

[1] Statutes

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Statement of withdrawal of partner. *Bus. & Prof. Code § 17923*.

Ownership of property as tenants in partnership. *Civ. Code §§ 682(2), 684*.

Right of a deceased partner's executor or administrator to an accounting from remaining partners. *Code Civ. Proc. § 339(1)*.

Venue for actions based on partnership agreement. *Code Civ. Proc. § 395*.

Uniform Partnership Act of 1994. *Corp. Code § 16100 et seq.*

General provisions. *Corp. Code §§ 16101-16114*.

Relations of partners to persons dealing with partnership. *Corp. Code §§ 16301-16308*.

Relations of partners to each other and to partnership. *Corp. Code §§ 16401-16406*.

Transferees and creditors of partner. *Corp. Code §§ 16501-16504*.

Partner's dissociation. *Corp. Code §§ 16601-16603*.

Partner's dissociation when business not wound up. *Corp. Code §§ 16701-16705*.

Winding up partnership business. *Corp. Code §§ 16801-16807*.

Surviving partner's right to possession of partnership and to settle partnership business. Prob. Code § 571.

Probate court order authorizing executor or administrator of deceased partner's estate to continue as partner. Prob. Code § 571.

Probate court order for executor or administrator of deceased partner's estate to complete contract of decedent by conveying or transferring property or partnership interests. *Prob. Code §§ 850-853*.

Income taxation of partners and partnerships. *Rev. & Tax. Code §§ 17851-17931*.

[2] Regulations

Federal treasury regulations applicable to California income tax. 18 Cal. Code Reg. § 19523.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
I. RESEARCH GUIDE
A. Primary Sources

7-15 California Legal Forms--Transaction Guide § 15.291

§ 15.291 Federal Sources

[1] Statutes

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Closing of taxable year. *I.R.C. § 706(c)*.

Guaranteed payments. *I.R.C. § 707(c)*.

Continuation or termination of partnerships. *I.R.C. § 708*.

Distributions by partnerships. *I.R.C. §§ 731-736*.

Transfers of partnership interests. *I.R.C. §§ 741-743*.

Treatment of unrealized receivables and inventory items. *I.R.C. § 751*.

Method of electing adjustment to basis of partnership property. *I.R.C. § 754*.

Basis of property. *I.R.C. § 1012*.

Basis of property acquired from decedent. *I.R.C. § 1014*.

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[2] Regulations

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Income of partners. *Treas. Reg. §§ 1.702-1, 1.702-2*.

Taxable year of partner and partnership. *Treas. Reg. § 1.706-1*.

Continuation and termination of partnership. *Treas. Reg. § 1.708-1*.

Treatment of liquidating distributions. *Treas. Reg. § 1.731-1*.

Treatment of payments liquidating partner's interest in income. *Treas. Reg. § 1.736-1*.

Treatment of gain or loss from sale of partnership interest. *Treas. Reg. § 1.741-1*.

Treatment of payments for partner's interest in unrealized receivables or substantially appreciated property. *Treas. Reg. § 1.751-1*.

Election to adjust basis of partnership property. *Treas. Reg. §§ 1.732-1, 1.732-2, 1.733-1, 1.734-1, 1.734-2, 1.743-1, 1.754-1*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
I. RESEARCH GUIDE
A. Primary Sources

7-15 California Legal Forms--Transaction Guide §§ 15.292-15.294

[Reserved]

§§ 15.292[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
I. RESEARCH GUIDE
B. Secondary Sources

7-15 California Legal Forms--Transaction Guide § 15.295

§ 15.295 Law Reviews and Periodicals

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
I. RESEARCH GUIDE
B. Secondary Sources

7-15 California Legal Forms--Transaction Guide § 15.296

§ 15.296 Text References

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[2] Additional Text References

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
I. RESEARCH GUIDE
B. Secondary Sources

7-15 California Legal Forms--Transaction Guide §§ 15.297-15.298

[Reserved]

§§ 15.297[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.299

§ 15.299 Scope of Part

This part covers the dissociation of partners and the dissolution and winding up of general partnerships under the Uniform Partnership Act of 1994, including the partners' rights and duties to the partnership and to the other partners, their duties and obligations to third parties, and their continuing liability for matters related to the partnership after dissociation from the partnership or the partnership's dissolution and winding up. Following this discussion is a summary of the tax consequences of liquidation of the partnership and of disposition of partnership interests. This part also describes the procedures to be followed to dissolve a partnership's business and either wind it up or continue it by agreement or pursuant to statute. Dissociation of a partner that does not result in a dissolution of the partnership is covered in connection with the continuation of a partnership and the sale of a departing partner's partnership interest.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionWithdrawalBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewTax LawState & Local TaxesIncome TaxPartnerships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.300

§ 15.300 Governing Law

The Uniform Partnership Act of 1994 (UPA '94) [*Corp. Code §§ 16100-16962*] governs all partnerships on and after January 1, 1999, including the dissolution of partnerships at any time thereafter [*Corp. Code § 16111(b)*].

The former Uniform Partnership Act, originally enacted in 1949 [former *Corp. Code §§ 15001-15045*], governed partnerships formed before January l, 1997 until the earlier of either (1) January 1, 1999, or (2) the effective date of a partnership's election to be governed by UPA '94 [*Corp. Code § 16111(a)*]. However, since January 1, 1999, all partnerships have been governed by UPA '94, regardless of the date on which they were originally formed [*Corp. Code § 16111(b)*]. The former UPA now affects only actions or proceedings commenced, or rights accrued, prior to the date the UPA'94 took effect [*Corp. Code § 16112*].

For a correlation table showing the relationship between sections of the former UPA and UPA '94, see *§ 15.11[3]* in Part A of this chapter.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.301

§ 15.301 Distinction Between "Dissociation," "Dissolution," "Winding Up," and "Termination"

[1] In General

Under UPA '94, a partnership is an entity distinct from its partners [*Corp. Code § 16201*]. This means, among other things, that changes in the composition of the partnership do not necessarily trigger dissolution. A partner's "dissociation" (a term introduced by UPA '94) from a partnership is treated separately from partnership dissolution, although the dissociation of a partner may be a predicate for dissolution in the case of a partnership for a definite term or particular purpose [*see Corp. Code § 16801*; *see also § 15.302[2]*]. Absent a judicial determination that a partnership must be dissolved and wound up for reasons that will be described [*see § 15.302[3]*], partnerships at will are not automatically dissolved by the rightful or wrongful dissociation of a partner. Again excepting a judicial determination that a partnership must be wound up, a partnership agreement can control when and if a partnership should dissolve [*see Corp. Code § 16103*].

The partnership continues after dissolution only for the purpose of winding up its affairs, and is terminated at the conclusion of the winding up [*Corp. Code § 16802(a)*]. "Termination" is the term used to denote the cessation of any business activity on the part of the dissolved partnership. For income tax purposes, termination is either the cessation of any business activity by the partners in partnership form, or the sale, within a 12-month period, of 50 percent or more of the total interest in partnership capital and profits [*see I.R.C. § 708*; Rev. & Tax. Code § 17867].

[2] Events Triggering a Partner's Dissociation

[a] Notice by Partner

A partner may dissociate from a partnership voluntarily at any time by giving notice to the partnership of the partner's express will to withdraw as a partner on that date or on a stated later date [*Corp. Code § 16601(1)*].

[b] Provision in Partnership Agreement

A partner is dissociated on the occurrence of an event that the agreement specifies will cause the partner's dissociation [

Corp. Code § 16601(2)]. For example, in a professional partnership, the agreement would commonly require dissociation if a partner's license to practice is revoked. A partner may also be expelled if the partnership agreement so provides, for example, if the partnership agreement provides the grounds for expulsion [*Corp. Code § 16601(3)*].

[c] Unanimous Vote of Other Partners

Absent an agreement to the contrary, a partner may be expelled by the unanimous vote of the other partners if any of the following apply [*Corp. Code § 16601(4)*]:

- There has been a transfer of all or substantially all of that partner's transferable interest in the partnership, other than a transfer for security purposes, or a court order charging the partner's interest, that has not been foreclosed.

- Within 90 days after the partnership notifies a corporate partner that it will be expelled because it has filed a certificate of dissolution or the equivalent, its charter has been revoked, or its right to conduct business has been suspended by the jurisdiction of its incorporation, and the certificate of dissolution has not been revoked or the corporation's charter or its right to conduct business has not been reinstated.

- A partnership, limited partnership, or limited liability company that is a partner has been dissolved and its business is being wound up.

[d] Judicial Determination

On application by the partnership or another partner, a court may order a partner's expulsion for any of the following reasons [*Corp. Code § 16601(5)*]:

- The partner engaged in wrongful conduct that adversely and materially affected the partnership business.

- The partner willfully or persistently committed a material breach of the partnership agreement or of a duty owed to the partnership or the other partners.

- The partner engaged in conduct relating to the partnership business that makes it not reasonably practicable to carry on the business in partnership with that partner.

[e] Financial Problems

If the partner acts or fails to act in any of the following instances, the partner is dissociated from the partnership unless the partnership agreement provides otherwise [*Corp. Code § 16601(6)*]:

- By becoming a debtor in bankruptcy.

- By executing an assignment for the benefit of creditors.

- By seeking, consenting to, or acquiescing in the appointment of a trustee, receiver, or liquidator of that partner or all or substantially all of that partner's property.

- By failing, within 90 days after the appointment, to have vacated or stayed the appointment of a trustee, receiver, or liquidator of the partner or of all or substantially all of the partner's property obtained without the partner's consent or acquiescence, or failing within 90 days after the expiration of a stay to

have the appointment vacated.

[f] Loss of Capacity

A partner who is an individual is dissociated from the partnership by death, the appointment of a guardian or general conservator of that partner, or a judicial determination that the partner has otherwise become incapable of performing the partner's duties under the partnership agreement [*Corp. Code § 16601(7)*].

A partner that is a trust or acting by virtue of being a trustee of a trust is dissociated upon the distribution of the trusts entire transferable interest in the partnership, but not merely by reason of the substitution of a successor trustee [*Corp. Code § 16601(8)*]. A partner that is an estate or acting as a partner by virtue of being a personal representative of an estate is dissociated when the estate's entire transferable interest in the partnership is distributed, but not upon the mere substitution of a successor personal representative [*Corp. Code § 16601(9)*]. Finally, termination of a partner who is not an individual, partnership, corporation, trust or estate will also result in that partner's dissociation [*Corp. Code § 16601(10)*].

[3] Power of Partner to Dissociate

A partner has the power to dissociate at any time, rightfully or wrongfully, by the partner's express will [*Corp. Code § 16602(a)*]. The partnership agreement can declare dissociation to be a violation of the agreement (which would make the dissociation "wrongful" [Corp. Code § 16662(b)(1)]), but the agreement cannot vary a partner's power to dissociate, except to require the dissociating partner to notify the partnership in writing [*Corp. Code § 16103(b)(5)*].

In any partnership, dissociation will be wrongful when it constitutes a breach of the partnership agreement. In partnerships for a definite term or particular purpose, subject to a contrary partnership agreement, dissociation is also wrongful in the following situations [*Corp. Code § 16602(b)(2)*]:

- The partner dissociates before the term of the partnership expires or the undertaking has been completed.
- The partner has been expelled by court order.
- The partner is dissociated by reason of becoming a debtor in bankruptcy.
- A partner that is not an individual, trust, or estate is dissociated because it willfully dissolves or terminates.

The UPA '94 distinguishes between rightful and wrongful dissociation for the purpose of allocating rights and liabilities. For example, a wrongfully dissociating partner will be liable to the partnership for whatever damages are caused by the dissociation [*Corp. Code § 16602(c)*], and a wrongfully dissociating partner is not permitted a voice in determining whether a partnership should waive dissolution and continue in business [*see Corp. Code § 16802(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionBreach of Agreement & ExpulsionBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpTerminationBusiness & Corporate LawGeneral

PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.302

§ 15.302 Events Causing Dissolution and Winding Up

[1] Partnership at Will

A partnership at will [*see Corp. Code § 16101(11)* (definition)] must be dissolved and wound up if it is the express will of at least half the partners [*Corp. Code § 16801(1)*]. Excluded from that half are wrongfully dissociating partners [*see Corp. Code § 16602(b)*; *see also § 15.301[2][c]*], but included in determining whether half the partners want to dissolve are those who have rightfully dissociated within the preceding 90 days and whose express purpose of dissociation is their willingness to dissolve and wind up the partnership business [*Corp. Code § 16801(1)*]. The partnership agreement, of course, may vary the statutory rule and specify a lower or higher voting requirement, and base it either on the number of partners or on the percentage of the partnership interests they own [*see Corp. Code § 16103(a)*].

[2] Partnership for a Definite Term

Absent an agreement to the contrary, a partnership for a definite term or particular purpose must be dissolved and wound up if all the partners expressly agree to do so, the partnership term has expired, or the undertaking has been completed [*Corp. Code § 16801(2)(B), (C)*].

Under UPA '94, these partnerships are treated somewhat differently than a partnership at will, because it is assumed that the composition of the partnership is essential to accomplishing its purpose, and that the dissociation of a partner should always give the other partners the opportunity to dissolve and wind up the partnership. Thus, absent a contrary provision in the partnership agreement, a partnership for a definite term or particular undertaking must dissolve and be wound up after 90 days have elapsed since a partner has wrongfully dissociated, or has dissociated for reasons of incapacity or financial problems [*Corp. Code § 16801(2)(A)*]. However, a majority in interest of the other partners can agree to continue the partnership. Included in the interests capable of approving a continuation of the partnership are those of partners who have withdrawn from the partnership within 90 days after a partner's dissociation that would trigger dissolution, i.e., wrongful dissociation or dissociation for reasons of incapacity or financial problems [*see Corp. Code § 16602(b)(2)(A)*]. For example, if a partner withdraws from the partnership within 90 days after one of the partners has died, that partner's withdrawal is not wrongful and that partner may still help form the majority in interest to continue

the partnership.

Incapacity occurs when any of the following events happens [*Corp. Code § 16601(7)-(10)*]:

- An individual partner dies, is placed under guardianship or general conservatorship, or is the subject of a judicial determination that he or she has otherwise become incapable of performing his or her duties under the partnership agreement.

- A partner is a trust or is acting as a partner by virtue of being a trustee, and the trust's entire transferable interest in the partnership is distributed.

- A partner is an estate or is acting as partner by virtue of being a personal representative of an estate, and the estate's entire transferable interest in the partnership is distributed.

- There is a termination of any partner who is not an individual, partnership, corporation, trust, or estate.

The financial problems specified by statute are the partner's act or failure to act in the following instances [*Corp. Code § 16601(6)*]:

- By becoming a debtor in bankruptcy;

- By executing an assignment for the benefit of creditors;

- By seeking, consenting to, or acquiescing in the appointment of a trustee, receiver, or liquidator of the partner or of all or substantially all of that partner's property.

- By failing, within 90 days after appointment, to have vacated or stayed the appointment of a trustee, receiver, or liquidator of all or substantially all of the partner's property obtained without the partner's consent or acquiescence, or failing within 90 days after the expiration of a stay to have the appointment vacated.

A partner wrongfully dissociates from a partnership for a definite term when any of the following occur [*Corp. Code § 16602(b)(2)*]:

- The dissociation violates the partnership agreement.

- The partner dissociates before the term of the partnership expires or the undertaking has been completed.

- The partner has been expelled by court order.

- The partner is dissociated by reason of becoming a debtor in bankruptcy.

- A partner that is not an individual, trust, or estate is dissociated because it willfully dissolves or terminates.

[3] By Judicial Decree

[a] Any Partnership

Regardless of anything in the partnership agreement to the contrary [*see Corp. Code § 16103(8)*], either a partnership at will or a partnership for a definite term must be dissolved and its business wound up if, on the application of a partner, a court determines one of the following applies [*Corp. Code § 16801(5)*; *see Corp. Code § 16405(b)* (partner's right to sue partnership to force dissolution)]:

- The economic purpose of the partnership is likely to be unreasonably frustrated.

- Another partner has engaged in conduct relating to the partnership business that makes it not reasonable practicable to carry on the business in partnership with that partner.

- It is not otherwise reasonably practicable to carry on the partnership business in conformity with the partnership agreement.

[b] Partnership for a Definite Term

Anything in the partnership agreement to the contrary notwithstanding [*see Corp. Code § 16103(8)*], a transferee of a partner's transferable interest (that is, the partner's interest in profits, losses, and distributions [Corp. Code § 16502]) in a partnership for a definite term or particular purpose, may apply for a judicial determination that it is equitable to wind up the partnership business at the expiration of the term or completion of the undertaking. The right of the transferee to seek winding up is dependent on the partnership's status at the time of the partner's transfer or the entry of a charging order against the partner's interest. Thus, if a partnership for a definite term or limited purpose is continued after the expiration of the term or completion of the undertaking, it is presumed to be a partnership at will, and a transfer at that time would not give the transferee the right to seek winding up [*Corp. Code § 16801(6)*; *see Corp. Code § 16406*].

[4] Agreed-on Event or Unlawfulness

Any partnership, whether at will or for a definite term, will be dissolved and wound up if there is a provision in the partnership agreement specifying an event requiring that result [*Corp. Code § 16801(3)*]. Since such a provision obviously is not self-executing, each partner has the right to enforce the partners' rights under the partnership agreement [*Corp. Code § 16405(b)(1)*].

Similarly, any partnership must be dissolved and wound up if an event makes it unlawful for all or substantially all of the partnership business to be continued. A cure of illegality within 90 days after notice to the partnership of the event is effective retroactively to the date of the event [*Corp. Code § 16801(4)*]. The partnership agreement cannot waive illegality as a basis for compelling the dissolution and winding up of the business [*Corp. Code § 16103(8)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpTerminationBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.303

§ 15.303 Rights of Partners on Dissociation or Dissolution

[1] In General

The dissociation of a partner does not necessarily result in the dissolution of the partnership. Therefore, it is necessary to distinguish between a dissociating partner's rights on dissociation, and the rights of partners generally when there is a dissolution and winding up. The following discussion deals with the former.

[2] Buyout of Dissociating Partners

[a] Terms of Buyout

Most partnerships should have an agreement covering the purchase of a dissociating partner's interest. If there is no such agreement, the provisions of UPA '94 will control. Under UPA '94, when a partner dissociates, whether rightfully or wrongfully, that partner's interest in the partnership must be bought out by the partnership [*Corp. Code § 16701(a)*]. The buyout price is the amount the partner would receive as surplus on dissolution and winding up, that is, after the creditors have been paid and the accounts settled [*see Corp. Code § 16807*], if, on the date of dissociation, the assets of the partnership were sold at a price equal to the greater of (1) the liquidation value or (2) the value based on the sale of the entire business as a going concern (without the dissociated partner), and the partnership was wound up as of that date. Interest must be paid from the date of dissociation to the date of payment [*Corp. Code § 16701(b)*]. Damages for wrongful dissociation and any other amounts owed the partnership by the dissociating partner must be offset against the buyout price, with interest from the date the amount owed is due until the date of payment [*Corp. Code § 16701(c)*].

These provisions for buyout do not apply to a partner who dissociates within 90 days before the partnership's dissolution. Instead, such a partner would be treated as any other partner, and would have to wait for the winding up of the partnership, with the amount distributable to that partner taking into account any amounts owed by the partner to the partnership, including damages for wrongful dissociation [*Corp. Code § 16701.5*].

[b] Failure to Reach Agreement; Payment or Tender of Buyout Price

Unless there is an agreement to the contrary, if no agreement for purchase of a dissociated partner's interest is reached within 120 days after a written demand for payment, the partnership must pay (or cause to be paid) to the dissociated partner the amount the partnership estimates to be the buyout price with accrued interest, less any offsets [*Corp. Code § 16701(e)*]. If the partner has wrongfully dissociated from a partnership for a definite term or particular purpose [*see Corp. Code § 16602(b)(2)*; *see also § 15.302[2], [3][b]*], the buyout of that partner will be deferred until the expiration of the term or completion of the undertaking, unless the partner establishes to the satisfaction of a court that earlier payment will not cause undue hardship to the business of the partnership. If the payment is deferred, it must be adequately secured and bear interest [*Corp. Code § 16701(h)*], and the partnership may tender a written offer to pay the estimated amount of the deferred buyout price, with interest but reduced by offsets, stating the time payment, type of security, and the other terms and conditions of the obligation [*Corp. Code § 16701(f)*].

Either payment or tender of the buyout price must be accompanied by all of the following [*Corp. Code § 16701(g)*]:

- A statement of partnership assets and liabilities as of the date of dissociation;
- The latest available partnership balance sheet and income statement, if any;
- An explanation of how the estimated amount of the payment was calculated; and
- Written notice that the payment is in full satisfaction of the obligation to purchase unless, within 120 days after the written notice, the dissociated partner commences an action to determine the buyout price and any offsets or other terms of the obligation to purchase.

[c] Court Action to Determine Buyout Price

Partners who have dissociated may maintain an action against the partnership to determine the buyout price of their interests, including any offsets or other terms of the obligation to purchase. The action must be commenced within 120 days after the partnership has tendered payment or an offer to pay, or within one year after written demand for payment if the partnership has not paid or tendered an offer of payment. The court must determine the buyout price, offsets, and accrued interest, and enter a judgment for any additional payment or refund. The court also must determine the security for payment and other terms of the obligation in the case of a deferred payment to a wrongfully dissociating partner [*Corp. Code § 16701(i)*].

The court may assess reasonable attorneys' fees and the fees and expenses of appraisers or experts against a party that the court finds acted arbitrarily, vexatiously, or not in good faith. That finding may be based on the partnership's failure to tender payment or an offer to pay or to furnish the statement [*see* [b], *above*] that must accompany an offer to pay or tender of payment [*Corp. Code § 16701(i)*].

[3] Rights and Duties of Dissociating Partner With Respect to Partnership

A dissociating partner's rights and duties with respect to the partnership and its property generally come to an end on dissociation. Thus, when a partner dissociates, either rightfully or wrongfully, the following rules apply [*Corp. Code § 16603*]:

- The partner's right to participate in the management and conduct of the business terminates.
- The partner's duty to refrain from competing with the partnership terminates [*see Corp. Code § 16404(b)(3)*].
- The partner's duties of loyalty and care as to the conduct or winding up of the partnership business

> are generally continued, but only with respect to matters arising and events occurring before the partner's dissociation. This means, for example, that a dissociated partner could not assist a person with a claim against the partnership that arose before the partner's dissociation, nor could a dissociated partner make any recklessly false accusation against a partnership with respect to a transaction occurring before dissociation [*see Corp. Code § 16404(b)* (duties of loyalty and care); *see also § 15.17[4]*].

When a partnership is incorporated, the partnership ceases to exist after formation of the corporation, even if the entity is operated in a manner similar to that which it was operated as a partnership [*Persson v. Smart Inventions, Inc. (2005) 125 Cal. App. 4th 1141, 1157, 23 Cal. Rptr. 3d 335* (rejecting trial court conclusion that a "de facto" partnership existed concurrently with the corporate enterprise); *Cavasso v. Downey (1920) 45 Cal.App. 780, 785, 188 P. 594]* . Thus, the obligations among partners that flow from a partnership, including fiduciary duties among partners, ordinarily no longer exist and therefore cannot be enforced against one another by the former partners turned shareholders, with the limited exception that courts will enforce pre-incorporation agreements among partners or joint venturers who have incorporated in order to carry out the agreement between or among the partners or joint venturers [*Persson v. Smart Inventions, Inc. (2005) 125 Cal. App. 4th 1141, 1157-1159, 23 Cal. Rptr. 3d 335]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpDistribution of AssetsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionPartnership LiabilitiesBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersAuthority to Act



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.304

§ 15.304 Rights on Rescission of Partnership Agreement for Fraud or Misrepresentation

UPA '94 contains no specific provision regarding the rights of partners on rescission of the partnership agreement for fraud or misrepresentation. Nevertheless, since partners are granted the right to compel a dissolution and winding up when another partner has engaged in conduct relating to the partnership that makes it not reasonably practicable to carry on the partnership business in partnership with that partner (almost certainly the case if there has been fraud or misrepresentation), UPA '94 essentially provides the same rights and remedy for partners seeking rescission of a partnership agreement as did the former UPA [*see Corp. Code § 16405(b)(2)(C)*]. For example, under the former UPA, a partner entitled to rescind might be entitled to a lien on, or to retain, surplus partnership property, and/or to be indemnified by the guilty partner [*see Corp. Code § 15039*]. Furthermore, a partner may maintain an action against a partner or the partnership to enforce the rights and otherwise protect the interest of the partner [*Corp. Code § 16405(b)(3)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersLosses & ProfitsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersPartnership Property



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.305

§ 15.305 Rights of Retiring Partner or Estate of Deceased Partner When Business Is Continued

UPA '94 makes no distinction between a retiring or deceased partner and any other partner who is dissociated from the partnership. A dissociated partner is entitled to receive payment for that partner's partnership interest [*see § 15.303[2]*] and, in the case of a retiring partner, is relieved of his or her duties to the partnership with respect to events occurring after the partner's dissociation [*see § 15.303[3]*]. Continued use of a partnership name, or a dissociated partner's name as part of the partnership name, by partners continuing the business, does not of itself make the dissociated partner liable for an obligation of the partners or the partnership that continues the business [*Corp. Code § 16705*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionContinuationBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.306

§ 15.306 Liability of Partners and Partnership

[1] Liability of Dissociated Partners

[a] When Discharged

A partner's dissociation does not of itself discharge that partner's liability for a partnership obligation incurred before dissociation [*Corp. Code § 16703(a)*]. It is common, however, for buyout agreements to indemnify a partner against past and future partnership liabilities. UPA '94 expressly requires, absent a contrary understanding among the partners, that a dissociating partner be indemnified against all partnership liabilities no matter when incurred, other than those liabilities incurred by the partnership as a result of the act of the dissociated partner within two years after dissociation [*see Corp. Code § 16701(d)* (buyout provisions); *see also Corp. Code § 16702* (partnership obligation incurred by dissociated partner)].

A dissociated partner ordinarily is not liable for a partnership obligation incurred *after* dissociation [*Corp. Code § 16703(a)*]. If all of the following are true, however, a dissociating partner will be liable to third parties for transactions entered into by the partnership within two years after the partner's dissociation [*Corp. Code § 16703(b)*]:

- The other party reasonably believes that the dissociated partner was a partner;
- The other party had no notice of the partner's dissociation; and
- The other party is not deemed to have knowledge or notice of the partner's dissociation [*see Corp. Code §§ 16303(e), 16704(c)*].

Avoiding a two-year overhang of liability is accomplished by notifying partnership creditors by letter, and by giving constructive notice by filing and, as appropriate, recording a statement of dissociation [*see* [b], *below*].

A dissociated partner is relieved from liability for a partnership obligation, regardless of when incurred, if the partnership's creditor, having notice of the partner's dissociation [*see Corp. Code § 16102* (definition of "notice")] but

without the partner's consent, agrees to a material alteration in the nature or time of payment of a partnership obligation [*Corp. Code § 16703(d)*].

[b] Placing Third Persons on Notice of Dissociation

A dissociating partner and/or the partnership can notify third parties of the dissociation by certified mail, and can give constructive notice to the world by filing and if appropriate, recording, a statement of dissociation.

The partner or the partnership may file a statement of dissociation with the Secretary of State. The statement of dissociation must state the name of the partnership, any identification number issued by the Secretary of State, and that the partner is dissociated [*Corp. Code § 16704(a)*]. The filed statement is a "limitation" on the dissociating partner's authority [*Corp. Code § 16704(b)*]. With respect to real property transactions, a filed and recorded statement of dissociation will give third persons immediate constructive knowledge of the limitation on authority pursuant to *Corp. Code § 16303(e)*. With respect to all other transactions, a filed statement will give constructive notice to third parties 90 days after the statement has been filed with the Secretary of State [*Corp. Code § 16704(c)*]. Depending on the circumstances of the partner's dissociation, among other considerations, a 90-day window of joint and several liability for non-real property transactions probably is undesirable from both the dissociating partner's and the partnership's point of view. Therefore, as noted above, in addition to the constructive notice given by the filing of a statement, actual notice should be given to partnership creditors at the earliest possible time.

[2] Liability of Partnership and Partners

[a] For Acts of Dissociated Partner

For two years after a partner dissociates, the partnership remains bound by the acts of that partner only if the same circumstances exist that would bind the dissociating partner with respect to post-dissociation partnership obligations, that is, the third party reasonably believed the dissociated partner was still a partner, had no notice of the dissociation, and did not have constructive knowledge of the dissociation [*Corp. Code § 16702(a)*; *see* [1][a], *above*]. The same rules regarding the effect of filing and, if appropriate, recording a statement of dissociation apply as well [*see Corp. Code § 16704(c)*; *see also* [1][b], *above*].

A buyout agreement under UPA '94 is not required to indemnify the dissociated partner for that partner's post-dissociation actions that bind the partnership [*see Corp. Code § 16701(d)*]. Furthermore, if the partnership is liable for an act of the dissociated partner within the two-year period, that partner is liable to the partnership for any damages arising out of the obligation the partner incurred [*Corp. Code § 16702(b)*].

[b] When There Is a Waiver of Dissolution

A partnership continues after dissolution only for the purpose of winding up its business, and is terminated only after the winding up is completed [*Corp. Code § 16802(a)*]. At any time after dissolution, but before winding up is completed, all of the partners, including any dissociating partner other than one who has wrongfully dissociated, can waive the right to have the business wound up and terminated, and resume carrying on business as if dissolution had never occurred. In that event, any liability incurred by the partnership or a partner after dissolution and before the waiver is determined as if dissolution never occurred. Furthermore, the partnership will be bound by a partner's acts that were appropriate to winding up the business, and the rights of a third party arising out of conduct in reliance on the dissolution before the third party knew or received notification of the waiver cannot be adversely affected [*Corp. Code § 16802(b)*]. This means, for example, that a third party is protected when it relies on its knowledge that the partnership is being dissolved and has no notice of a waiver of dissolution, even though the transaction would be inappropriate to a partnership that is continuing its business.

[c] Partnership's Liability for Post-Dissolution Acts

A partnership is bound by a partner's post-dissolution acts that either (1) are appropriate for the winding up of the business, or (2) would have bound the partnership before dissolution, that is, were in the ordinary course of doing business and the partner's authority to act in the matter was not limited by a filed statement of authority [*see Corp. Code § 16301(a)*], provided that the other party did not have notice of the dissolution [*Corp. Code § 16804*].

[d] Limitation on Partner's Authority to Bind Partnership

UPA '94 provides the means for placing third parties on notice of the dissolution by permitting any partner (other than a wrongfully dissociating partner) to file a statement of dissolution with the Secretary of State, stating, along with the identity of the partnership, the fact that it is being dissolved and wound up [*Corp. Code § 16805(a)*]. This statement has the important effect of canceling a filed statement of partnership authority, and constitutes a limitation on authority [*Corp. Code § 16805(b)*]. With respect non-real property transactions, however, third persons are not deemed to have notice of the dissolution or a limitation on a partner's authority until 90 days after the statement is filed [*Corp. Code § 16805(c)*]. Here again, immediate actual notice to partnership creditors is important. On the other hand, if the statement is also recorded in the county where the partnership holds real property, it will give immediate constructive notice of the limitation on the authority of a partner to transfer that property [*Corp. Code § 16805(b)*].

After filing and, if appropriate, recording the statement of dissolution, a dissolved partnership may file and record a new statement of partnership authority that will give one or more partners authority to act on behalf of the partnership in transactions with third parties [*Corp. Code § 16805(d)*]. If such a statement is filed and recorded, it will have the effect of immediately giving constructive notice of to third persons in transactions involving the partnership's real property, whether or not those transactions are appropriate to winding up the business [Corp. Code § 16895(d)].

[e] Partners' Liability for Post-Dissolution Acts

After dissolution, each partner is liable to the other partners for that partner's share of any partnership obligation that was appropriate for the winding up of the business or that would have bound the partnership had it been incurred before dissolution (i.e., was in the ordinary course of business) and the other party had no notice of the dissolution [*Corp. Code § 16806(a)*; *see Corp. Code § 16804*]. Partners who bind the partnership after dissolution by acts that are not appropriate to the winding up of the business are liable to the partnership for any damage to the partnership that arises from the partnership liability they incurred [*Corp. Code § 16806(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionPartnership LiabilitiesBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersAuthority to Act



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.307

§ 15.307 Winding Up Partnership Affairs

[1] Persons Authorized to Wind Up Business

Any partner who has not dissociated may participate in winding up the partnership's business, subject, of course to any limitation on that partner's authority in a statement of partnership authority filed and/or recorded after a statement of dissolution has been filed [*Corp. Code § 16803(a)*]. The legal representative of the last surviving partner may also wind up the partnership's business [*Corp. Code § 16803(b)*]. On the application of any partner, or a partner's legal representative, or a transferee, a court, for good cause shown, may order judicial supervision of the winding up [*Corp. Code § 16803(a)*].

[2] Scope of Authority of Person Winding Up Business

A person winding up a partnership's business may do the following [*Corp. Code § 16803(c)*]:

- Preserve the partnership business or property as a going concern for a reasonable time.
- Prosecute and defend actions and proceedings, whether civil, criminal, or administrative.
- Settle and close the partnership's business.
- Dispose of and transfer the partnership's property.
- Discharge the partnership's liabilities
- Distribute the assets of the partnership [*see* [3], *below*].
- Settle disputes by mediation or arbitration.
- Perform other necessary acts.

[3] Order of Distribution of Partnership Assets and Settlement of Accounts

The assets of the partnership, including the contributions the partners must make to satisfy an excess of charges over credits to their respective accounts, must be applied to discharge the partnership obligations to creditors, including partner-creditors to the extent permitted by law. Any surplus must be applied to pay in cash the net amount distributable to partners [*Corp. Code § 16807(a)*].

Each partner is entitled to a settlement of all partnership accounts on winding up, with the profits and losses that result from liquidation of partnership assets being credited and charged to the partners' accounts. The partnership must distribute an amount equal to any excess of the credits over the charges in each partner's account, but a partner must contribute to the partnership any excess of charges over credits in that partner's account [*Corp. Code § 16807(b)*; *see O'Flaherty v. Belgum (2004) 115 Cal. App. 4th 1044, 1047, 1056-1061, 9 Cal. Rptr. 3d 286* (arbitrator exceeded authority by declaring forfeiture of withdrawing partners' capital accounts; forfeiture was contrary to partnership law, partnership agreement, and decisional law)]. If such a contribution is not made, then the other partners (and the estate of a deceased partner) must contribute an amount proportional to their share of losses to cover their joint and several liability for partnership obligations. A partner, or a partner's personal representative, can recover from other partners any amount the partner contributed to the extent it exceeds that partner's share of the joint and several obligations of the partnership [*Corp. Code § 16807(c), (e)*].

After settlement of accounts, each partner (and the estate of a deceased partner) must contribute, proportionally to the partner's share of partnership losses, the amount necessary to satisfy joint and several partnership obligations unknown at the time accounts were settled [*Corp. Code § 16807(d), (e)*].

In all the instances discussed above, an assignee for the benefit of creditors of a partnership or a partner, or a court-appointed creditor representative of a partnership or a partner, may enforce a partner's obligation to contribute to the partnership [*Corp. Code § 16807(f)*].

[4] Costs of Winding Up and Allocation of Post-Dissolution Income

The costs of reasonable overhead expenses for winding up unfinished partnership business may be charged to the partnership by the partner generating post-dissolution income [*Jewel v. Boxer (1984) 203 Cal. Rptr. 13*]. Net post-dissolution is then allocated to the partners according to their respective partnership interests [*Fox v. Abrams (1985) 163 Cal. App. 3d 610, 614, 210 Cal. Rptr. 260]* . Subject to the partnership agreement, the partner winding up the business may not seek extra compensation (beyond the overhead expenses and his or her share of the post-dissolution partnership allocation) for winding up partnership affairs or completing unfinished partnership business [*Jewel v. Boxer (1984) 156 Cal. App. 3d 171, 176-177*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpDistribution of AssetsBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpDistribution of Estate PropertyBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersAuthority to Act



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.308

§ 15.308 Tax Consequences of Dissolution

[1] In General

The tax consequences of the dissolution of a partnership differ, depending on whether the transaction involves the sale or exchange ("sale") of a partnership interest [*see* [2], *below*] or the liquidation of a partnership interest [*see* [3], *below*].

The characterization of the transaction as a sale or liquidation is important to the buying partners as well as to the selling partner. If the transaction is a sale, the remaining partners are purchasing a capital asset in much the same manner, for income tax purposes, as they would purchase any other capital asset--with funds they have already earned or will earn in the future and on which they have paid or will pay in the future ordinary income tax. The purchase price they pay becomes their basis for the partnership interest purchased. In other words, the adjusted basis of each remaining partner's interest in the partnership is increased by the portion of the purchase price that partner pays for the selling partner's partnership interest [*I.R.C. §§ 742*, *1012*; *see Rev. & Tax. Code § 18031*].

If the transaction is a liquidation of the partnership interest, the remaining partners face different tax consequences. The partnership as an entity is distributing capital assets to the selling partner. For income tax purposes, the situation is the same as if the partnership gave the selling partner's share of partnership property to that partner, and that partner sold it at an appreciated market value. The basis of the remaining partners' interests in the partnership would be unaffected. To the extent, however, that the partnership gives the selling partner anything in excess of the fair market value of the selling partner's interest in partnership property, it is giving either a distributive share of its income or a guaranteed payment from its income, and that excess amount is taxed as ordinary income [*I.R.C. § 736(a)*]. If the excess payments are considered a distributive share of partnership income to the selling partner, they reduce the distributive shares going to the remaining partners on which they must pay taxes. If the excess payments are considered guaranteed payments to the selling partner, they are deductible by the partnership and again reduce the distributive shares going to the remaining partners on which they must pay taxes [*Treas. Reg. § 1.736-1(a)(4)*]. Thus, the major difference for the remaining partners in the two transactions is obtaining the partnership interest with after-tax or pre-tax dollars. This advantage for remaining partners has to be compared with the capital gains advantage to the deceased or dissociated partner on the purchase and sale of the partnership interest rather than liquidation.

In addition to the differing tax treatment accorded to sale or liquidation, there is a question as to who bears these tax consequences. Under a sale or liquidation of a partnership interest, the differing tax consequences are borne by the individual partners involved. If the transaction results in the termination of the partnership, all of the partners bear tax consequences [*see* [4], *below*].

California generally follows the federal tax law in this area of partnership taxation [*Rev. & Tax. Code § 17851*; *see I.R.C. §§ 701-761*; *but see Rev. & Tax. Code §§ 17851-17932* (modifications to federal law)].

PRACTICE TIP:

Dissolution counsel can be placed in a conflict of interest situation when advising on the tax consequences of dissolution. The competing interests are now the partnership itself, the remaining partners, and the withdrawing partner. Counsel should consider referring each adverse interest to separate tax counsel before finalizing the structure of the transaction. *Commentary by John J. Camozzi.*

[2] Sale of Partnership Interest

[a] Capital Gain or Loss

Generally, gain or loss resulting from the sale of a partnership interest is accorded capital asset treatment and is reported as a capital gain or loss by the transferor [*I.R.C. § 741*; *Treas. Reg. § 1.741-1(a)*]. However, payments made in exchange for a partner's interest in unrealized receivables or inventory are treated as ordinary income [*I.R.C. § 751(b)*; *Treas. Reg. § 1.751-1(a)*]. The transferor's distributive share of partnership income up to the date of the sale is ordinary income [*see I.R.C. §§ 702, 706(c)(2)*], and the transferor must include that distributive share on his or her individual income tax return for the taxable year [*see Treas. Reg. § 1.706-1(c)*; *see also Rev. & Tax. Code § 17024.5*].

[b] Deceased Partner's Interest

If a partner dies, the partner's estate receives a new income tax basis for the interest equal to the value placed on the interest for federal estate tax purposes [*I.R.C. § 1014*; *Treas. Reg. § 1.1014-3(a)*; for decedents dying after 2009, a modified carryover basis regime generally applies, so a step-up basis does not apply (*I.R.C. § 1022*)]. Payments for a partner's interest in the partnership assets generally represent the fair market value of the assets at the time of the outgoing partner's death or retirement [*see Treas. Reg. § 1.736-1(a)(2)*]. The Internal Revenue Service will usually accept the partners' valuation of a deceased partner's interest in partnership property if it is arrived at in an arm's length agreement. If, however, such a valuation reflects only the partner's net interest, it must be adjusted to take into account the partner's share of partnership obligations [*Treas. Reg. § 1.736-1(b)(1)*]. Thus, if the buy and sell provisions of a partnership agreement are sufficient to establish the value of a partnership interest for federal estate tax purposes, the basis of a deceased's partnership interest will be the same as the purchase price specified in the partnership agreement and the estate will have no taxable gain on the sale of the interest to the remaining partners.

[c] Taxable Year for Partner

The taxable year of a partnership closes with respect to a partner whose entire interest in the partnership terminates, whether by reason of death, liquidation, or otherwise, as of the date of the termination of the entire interest [*I.R.C. § 706(c)(2)(A)*]. The taxable year does not close (other than at the end of the partnership's regular tax year) with respect to a partner who sells or exchanges less than his or her entire partnership interest, or with respect to a partner whose interest is reduced, whether by entry of new partners, partial liquidation, gift, or otherwise [*I.R.C. § 706(c)(2)(B)*]. An early closing of the partnership year with respect to a selling partner can result in the bunching of income to the transferor and requires careful planning to avoid an excessive tax burden on the transferor.

[d] Partnership Basis Adjustment

The purchase of a partnership interest results in an increase in the tax basis of the partnership interest to the purchasing party [*see I.R.C. §§ 742, 1012*; *see also Rev. & Tax. Code § 18031*]. When that occurs, the partnership may elect to increase its basis in the remaining partnership properties [*see I.R.C. §§ 743(b), 754*]. The partnership may also elect to adjust basis when a distribution to a partner results in a substantial basis reduction in the contributed property [*see I.R.C. § 734(a), (b)*; *see also I.R.C. § 734(d)* ("substantial basis reduction" defined)].

[3] Liquidation of Partnership Interest

[a] Liquidation Payment Made by Partnership

The distinguishing characteristic of a liquidation of a partnership interest from the sale of a partnership interest is that the payments are made by the partnership rather than the remaining partners [*Treas. Reg. § 1.736-1(a)(1)(i)*]. In general, the payments received by a retiring partner or the estate of a deceased partner are liquidating distributions and will be treated as either ordinary income or capital gain, depending on the source to which the payment is allocated or attributed.

[b] Special Treatment for Liquidating Payments

The general rules of *I.R.C. § 731*, which apply to the tax treatment partnership distributions, specifically do not apply to payments made in liquidation of a partnership interest [*I.R.C. § 731(d)*]. The tax treatment of payments in liquidation of a partnership interest is determined under *I.R.C. § 736*. Under this section, payments made in liquidation of the interest of a retiring or deceased partner are allocated between payments for the value of the partner's interest in partnership assets and other payments [*Treas. Reg. § 1.736-1(a)(2)*].

[c] Payments in Exchange for Partnership Property

Liquidating payments made in exchange for the interest of the partner in partnership property, are treated as liquidating distributions to the extent that they do not include amounts paid for unrealized receivables or goodwill and are taxable under *I.R.C. § 731* [*I.R.C. § 736(b)*; *Treas. Reg. § 1.736-1(b)(1)*]. Under *I.R.C. § 731*, these payments are treated as capital gain or loss measured by the partner's basis in the partnership [*I.R.C. § 731(a)*].

The amounts paid for unrealized receivables of the partnership or partnership goodwill (except to the extent that the partnership agreement provides for payment therefor) are not included in payments for partnership property. Thus, such payments may not be accorded capital gain treatment [*see I.R.C. § 736(b)(2)*]. Goodwill, however, may be treated as partnership property for which capital gain treatment is available if (1) the partnership agreement provides for payments for goodwill; (2) capital is not a material income-producing factor for the partnership; and (3) the retiring or deceased partner was a general partner in the partnership [*I.R.C. § 736(b)(3)*].

[d] Other Payments

Payments made in liquidation of the interest of a retiring or deceased partner other than for partnership property are either treated as a distributive share of partnership income or as guaranteed payments [*see I.R.C. §§ 707(c), 736(a)*]. Both are reported as ordinary income by the recipient during the taxable year in which received [*see I.R.C. §§ 61(a), 707(c), 736(a)(2)*; *Treas. Reg. § 1.736-1(a)(4)*; *Rev. & Tax. Code § 17071*].

[e] Partnership Basis Adjustment

The partnership may elect to increase the basis of undistributed partnership property after a liquidating distribution [*see I.R.C. §§ 734(b), 754*]. The taxable year of the partnership closes as of the date of liquidation with respect to a partner whose entire interest is liquidated, except that the taxable year of a partnership with respect to a partner who dies will

not close before the end of the partnership's taxable year [*I.R.C. § 706(c)*]. This may result in the bunching of income to the recipient [*see* [4], *below*].

[4] Termination of Partnership

[a] State and Tax Law Causes for Termination

Although the loss of a partner or the admission of a new partner is not an automatic cause of dissolution, the partnership nevertheless may be dissolved and wound up because of the express will of a majority of the partners, or by court order or other reasons [*see Corp. Code § 16801*]. Further, a partnership may be terminated for tax purposes, even though it is not terminated for state law purposes, by the sale or exchange of 50 percent or more of the total interest in partnership capital and profits within a 12-month period [*I.R.C. § 708(b)*]. The disposition of a partnership interest by gift (including assignment to a successor in interest), bequest, or inheritance, or the liquidation of a partnership interest, however, is not a sale or exchange for this purpose [*Treas. Reg. § 1.708-1(b)(2)*].

[b] Deemed Occurrences Under Tax Law When Partnership Business Continues

On termination, if the partnership business will continue, the partnership is deemed to distribute its properties to the purchaser and the remaining partners, if any. Immediately thereafter, the purchaser and any remaining partners will be deemed to have contributed the properties to a new partnership, either for continuation of the business or for winding up [*see Treas. Reg. § 1.708-1(b)(4)*].

[c] Close of Partnership Tax Year

The partnership taxable year closes with respect to all partners on the date on which the partnership terminates, either the date the winding up is completed or the date of the sale or exchange of an interest together with all other interests transferred during the preceding 12 months transfers 50 percent or more in both partnership capital and profits [*Treas. Reg. § 1.708-1(b)(3)*; *Rev. & Tax. Code § 17024.5* (federal I.R.C. and regulations generally apply)].

If the partnership taxable year is not a calendar year, the closing of its taxable year upon termination can result in the bunching of income to the partners because the income of the partnership from the close of the regular taxable year to the date of termination, as well as income from the regular taxable year, must be shown on each partner's tax return for the calendar year in which the partnership is terminated.

For example, if the partnership's taxable year ends January 31 and the partners are calendar year taxpayers, they will show income from the 12-month period ending January 21 of that year on their returns. If the partnership is terminated on August 31, the partners will have to show on their income tax returns for that year not only the income from the partnership taxable year ending January 31, but also the income from February through August, for a total of 19 months of income on one year's tax return. This effect can be avoided by careful coordination of the termination date and the partnership taxable year [*see* Willis, Partnership Taxation, Ch. 31, *Terminating Partnership*, § 31.12 (McGraw-Hill 2d ed. 1976)].

[d] Merger or Consolidation of Partnerships

If two or more partnerships merge or consolidate, the resulting partnership will be considered the continuation of any merging or consolidating partnership whose members own an interest of more than 50 percent in the capital and profits of the resulting firm [*I.R.C. § 708(b)(2)(A)*]. If a partnership divides into two or more partnerships, the resulting partnerships (other than any resulting partnership the members of which had an interest of 50 percent or less in the capital and profits of the prior partnership) will be considered a continuation of the prior partnership [*see I.R.C. § 708(b)(2)(B)*]. For further discussion, see Part C of this chapter.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewTax LawFederal Income Tax ComputationValuationBusiness InterestsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsDistributions by Partnerships (IRC secs. 731-737)Character of Gains & LossesTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsDistributions by Partnerships (IRC secs. 731-737)Partner Retirement & DeathTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsFamily Partnerships (IRC sec. 704)Tax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsIncome (IRC secs. 701-703)Partner Distributive SharesTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsPartnership Tax Returns (IRC sec. 6031)Statutes of LimitationsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsTransactions Between Partner & Partnership (IRC sec. 707)Tax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsTransfers of Interest (IRC secs. 741-743)Exchanges & Sales of Partnership Interests



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide §§ 15.309-15.399

[Reserved]

§§ 15.309[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

7-15 California Legal Forms--Transaction Guide § 15.400

§ 15.400 Facts

NOTE:

If the partnership or one of the partners is already a client, most of the following information and documents may already be on file, including the partnership agreement. Nevertheless, the client interview checklist should be reviewed to make certain all pertinent facts and documents are available in order to make a complete analysis of steps to be taken if a partner is dissociating or the partnership is going to dissolve.

PRACTICE TIP:

The importance of identifying the client and establishing a clear attorney-client relationship cannot be overstated. Multiple representations of parties involved in a partnership dissolution can lead to conflict of interest problems. Even the most amicable dissolution can create irreconcilable conflicts and become adversarial. Dissolution is a time of individual partner reexamination of both the partnership relationship and personal life goals. Even with full conflict disclosure and consent, counsel may find it impossible to represent multiple interests. *Commentary by John J. Camozzi.*

[1] General Information

1. Establish type and basic terms of partnership agreement.

a. Name and address of partnership.

b. Business purpose.

c. Oral or written agreement.

d. Term or at will of partnership.

2. Partnership's offices and real property, including:

a. Address, including county.

b. For rented premises, date lease expires, current rental price, and liability for early cancellation.

c. For owned premises, details of outstanding loans.

3. Partners.

a. Identify client(s).

b. Make appropriate conflict disclosures and obtain appropriate consents and/or waivers.

c. Names, addresses, and telephone number (home and business).

d. Unless contained in an agreement, request all facts concerning each partner's share of profit and loss, capital contributions, and amount, if any, partnership owes each partner as a partnership creditor.

[2] Information About Dissociating Partners

1. Reasons why partner(s) want to voluntarily dissociate from partnership.

NOTE:

A partner may dissociate, rightfully or wrongfully, at any time [*Corp. Code § 16602(a)*]. In a partnership at will, unless it would violate the partnership agreement to do so, a dissociating partner's withdrawal is not wrongful [*Corp. Code § 16602(b)*]. In a partnership for a definite term or particular purpose, however, premature withdrawal, or withdrawal because of incapacity or financial difficulty such as bankruptcy, is generally wrongful [*Corp. Code § 16602(b)(2)*]. A partner who dissociates wrongfully is denied certain rights that the partner would have had were the dissociation rightful. See *§ 15.302[2]* for a discussion of dissociation from the partnership. The reasons for dissociation generally determine whether the dissociation or dissolution will be amicable (and therefore an apt subject for an agreement) or hostile (and therefore likely to entail litigation). At this point counsel can also identify possible conflict of interest issues.

2. Complete circumstances surrounding the partnership's desire that the partner dissociate from the partnership, e.g.:

a. An event specified in partnership agreement causes partner to be dissociated [*Corp. Code § 16601(2)*].

b. Partnership agreement provides grounds for expulsion for partner's acts or failure to act

[*Corp. Code § 16601(3)*].

c. There are grounds for seeking court-ordered dissociation of partner based on [*Corp. Code § 16601(5)*]:
(1) Wrongful conduct that adversely and materially affects partnership business;

(2) Persistent material breaches of partnership agreement or of a duty owed partnership or other partners; or

(3) Partners conduct makes it not reasonably practicable to carry on business with that partner.

d. Partnership has voted or will vote to dissociate partner.

NOTE:
Absent an agreement to the contrary, generally speaking a partner may be expelled by the unanimous vote of the other partners if it is unlawful to carry on the partnership business with that partner, if the partner's interest is transferred, or if the partner is a corporate or other business entity that is dissolving or has had its right to do business suspended or revoked [***see*** *Corp. Code § 16601(4)*; ***see also*** *§ 15.301[2]*].

3. Will dissociation require that partnership dissolve because:

a. The partnership agreement so provides, or

b. There is no agreement covering dissociation but UPA '94 requires dissolution in the event of dissociation.

NOTE:
Partnerships at will are not required to dissolve when a partner dissociates unless the partnership agreement requires it. On the other hand, when a partner prematurely dissociates from a partnership for a definite term or a particular purpose, the remaining partners are given 90 days to decide whether to either dissolve the partnership or vote to continue it with no intervening dissolution [*Corp. Code § 16801(2)*]. See the discussion in *§ 15.302[2]*.

4. Does partnership have a buyout agreement for dissociating partner's interest, or will the UPA '94 buyout provisions apply [*see Corp. Code § 16701*].

NOTE:
If dissolution follows within 90 days of the dissociation, the partner is not entitled to a buyout of his, her or its interest and must await winding up and settlement of accounts, at which time damages resulting from the wrongful dissociation can be charged against that partner's account [*Corp. Code § 16701.5*].

5. Method available for determining price partnership is to pay for purchase of partnership interest of dissociating partner:

a. Formula contained in partnership agreement or buy-sell agreement.

b. Appraisal or accounting by third party under method agreed on by all parties.

c. Negotiations between all parties.

d. Arbitration, either as provided in agreement or with mutual consent of parties.

6. If dissociating partner (or that partner's estate) is to be paid for, that partner's share of partnership goodwill:

a. Value of goodwill; or

b. Method to establish value of goodwill.

NOTE:
Goodwill may be treated as partnership property and receive capital gain treatment in a liquidation only if (1) the partnership agreement provides for payment, (2) capital is not a material income producing factor in the partnership, and (3) the retiring or deceased partner was a general partner in the partnership [*I.R.C. § 736(b)(2), (3)*].

7. Interest of dissociating partner in:

a. Unrealized receivables.

b. Substantially appreciated inventory assets.

8. Method of payment of purchase price for partnership interest being purchased, e.g.:

a. Lump-sum cash.

b. Installments, pursuant to agreement.

c. Installments under promissory note, either secured or unsecured.

d. Payments funded by insurance.

e. Payment of portion of partnership income for specified period.

f. Payment deferred until expiration of partnership term or completion of purpose if partner has prematurely dissociated [*see Corp. Code § 16701(h)*].

9. If dissociation of a partner has already occurred, have notice of dissociation and an amended statement of partnership authority been filed with the Secretary of State and, as appropriate, recorded in each county where partnership owns real property [*see Corp. Code § 16303* (statement of partnership authority); *Corp. Code § 16704* (statement of dissociation)]?

10. If dissociation is a result of a partner's death, bankruptcy, or adjudicated incompetence:

a. Name and address of attorney handling partner's estate or interests.

b. Name and address of partner's personal representative, guardian, conservator or trustee, as applicable.

c. Name of court and style and file number of probate or bankruptcy action.

11. If an entity such as corporation or trust is dissociating because it has dissolved or been otherwise terminated:

a. Jurisdiction of state of incorporation or organization.

b. Name of agent for service of process.

c. Names of trust beneficiaries.

[3] Information Concerning Status of Partnership Dissolution.

1. What event or events dictate that partnership be dissolved, e.g. [*see Corp. Code § 16801*]:

a. Election to do so by partners.

NOTE:
Absent a different requirement in the partnership agreement, a partnership at will must dissolve if it is the express will of at least half of the partners [*Corp. Code § 16801(1)*]. Unless there is another agreement, a partnership for a definite term or particular purpose is dissolved by a partners' vote only if all of them expressly agree [*Corp. Code § 16801(2)(B)*].

b. In a partnership for a definite term or particular purpose:

(1) Expiration of partnership term or completion of purpose.

(2) Ninety days have elapsed since a partner has wrongfully dissociated, or has dissociated for reasons of incapacity or financial problems [*Corp. Code § 16801(2)(A)*; *see § 15.302[2]*].

NOTE:
However, a majority in interest of the other partners can agree to continue the partnership. Included in the interests capable of approving a continuation of the partnership are those of partners who have withdrawn from the partnership within 90 days after a partner's dissociation that would trigger dissolution, i.e., wrongful dissociation or dissociation for reasons of incapacity or financial problems [*see Corp. Code § 16602(b)(2)(A)*].

c. Impracticable to carry on business.

NOTE:
Differences between the partners could lead to a lawsuit alleging one or more grounds for judicial dissolution, i.e., the economic purpose of the partnership is likely to be frustrated; one partner's conduct makes it not practicable to carry on the business; or it not otherwise reasonable to carry on the business in conformity with the partnership agreement [*Corp. Code § 16801(5)*].

d. Event stipulated in partnership agreement.

e. Event making it illegal to continue the business.

f. Transferee of partner's transferable partnership interest seeks court-ordered dissolution.

2. If a vote to dissolve has been held, names of partners who voted to dissolve and the percentage of partnership interests they hold.

3. Names of partners, if any, designated to carry out winding up and termination of partnership.

NOTE:

If the partnership has dissolved, it should file a statement of dissolution with the Secretary of State. This filing will cancel any existing partnership authority, although as to third parties it only gives constructive notice of the dissolution after it has been on file for 90 days [*Corp. Code § 16805(a), (b)*; ***see*** *§ 15.306[1][b]*]. If recorded, the statement gives immediate constructive notice to third parties with respect to the partnership's real property [*Corp. Code § 16805(b)*]. To place third parties on notice of which partners have authority to conduct transactions in the winding up of the business, the dissolved partnership should then file, and record if appropriate, a new statement of partnership authority specifying the authority of named partners to wind up the partnership business [*Corp. Code § 16805(d)*]. For the scope of the authority of a partner who is winding up the business, see *§ 15.307[2]*.

4. Identify partners responsible for completion of unfinished partnership business (work-in-progress), if any, and project costs for, and partnership income from, any such business.

5. Desired disposition of partnership assets.

a. Liquidation of all partnership assets and conversion to cash.

b. Sale of business as a going concern to third parties.

c. Return of capital and distribution of any balance, pro rata, to partners.

6. Name and address of attorney and/or accountant representing each partner.

7. Details relating to cash and invested partnership funds:

a. Name and address of bank or other deposit institution.

b. Account number or numbers.

c. Amount of deposit and applicable interest rate.

d. Name of brokerage.

e. Amount invested.

f. Degree of liquidity.

8. Identify and value tangible and intangible partnership assets.

a. Real property.

b. Capital equipment.

c. Intellectual property rights.

d. Receivables.

9. Information regarding any safe deposit box, including box number and persons with access.

10. Relevant tax information such as:

a. Adjusted basis of partners in partnership.

b. Taxable year of partners and partnership.

11. Printout or other list of all current creditors of partnership (including partners), including amounts owed and who have made loans to partnership, and:

a. Amount owed to each.

b. Amounts that are secured, with description of partnership assets used as security.

c. Amounts that are not secured.

d. Description of debts as fixed or contingent.

e. If debt is contingent, description of contingency.

12. Complete description of all partnership liabilities other than outstanding loans.

a. Contracts.

b. Accounts payable.

c. Other contingent liabilities.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionContinuationBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpValuation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

7-15 California Legal Forms--Transaction Guide § 15.401

§ 15.401 Documents Relevant to Dissociation of Partner or Dissolution of Partnership

1. Partnership agreement.

2. Any separate buy-sell agreement.

3. Any agreement to continue partnership despite event otherwise requiring dissolution.

4. Minutes of partnership meeting at which action was take to involuntarily dissociate any partner.

5. Letters of resignation or other documents pertaining to partner's dissociation.

6. In the case of an individual partner who has died or been declared incompetent to act as a partner:

    a. Copy of will if partner has died.

    b. Copy of documents filed in probate proceedings.

    c. Copy of documents relevant to appointment of guardian or conservator.

7. Partnership's fictitious name statement.

8. Statement of partnership authority.

9. Statement(s) of dissociation, if any.

10. List of partnership's assets.

11. Deeds, notes, deeds of trust or mortgages, and other documents relating to real property assets of partnership.

12. Documents of title for vehicles, mobile homes, aircraft, or vessels owned by partnership.

13. Contracts and leases entered into by partnership.

14. Licenses and permits held by partnership.

15. Financial statement for partnership's most recent tax year.

16. Insurance policies purchased to fund purchase and sale of partnership interests.

17. Partnership income tax information returns for past six years.

18. Copies of documents tending to prove that a partner is guilty of conduct that prejudicially affects carrying on of business.

19. Copies of documents tending to prove that a partner has willfully or persistently breached partnership agreement.

20. Copies of documents tending to prove that a partner has willfully or persistently conducted self in partnership business matters so that it is not reasonably practicable to carry on business in partnership with that partner.

21. Copies of documents, in addition to financial statements, tending to show that it is not reasonably practicable to carry on partnership business.

PRACTICE TIP:

Items 18-21, *above*, call for documents that may be used as evidence in an action for judicial dissolution. Such proceedings would probably be contested and would result in a judicial decree rather than an agreement to dissolve. *Commentary by John J. Camozzi.*

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpAccountingBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpDistribution of AssetsBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsTax LawState & Local TaxesIncome TaxPartnerships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

7-15 California Legal Forms--Transaction Guide §§ 15.402-15.409

[Reserved]

§§ 15.402[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
B. Preliminary Determinations

7-15 California Legal Forms--Transaction Guide § 15.410

§ 15.410 Dissociation of a Partner

1. Determine whether partner's dissociation requires that partnership dissolve [*see § 15.400[2]*].

NOTE:
In a partnership for a definite term or particular purpose, unless the partnership agreement requires dissolution, a majority in interest of the remaining partners are given the option to continue the partnership in the event of a partner's premature voluntary or involuntary dissociation [*Corp. Code § 16801(2)*].

2. If dissociation requires or permits dissolution, determine whether remaining partners will continue the business because:

a. Partnership agreement provides so provides.

b. Majority in interest will vote to continue.

3. Determine whether dissociation of partner was or will be wrongful [*see Corp. Code § 16602*; *see also § 15.301[3]*].

NOTE:
A wrongfully dissociating partner, in addition to being liable to the partnership for damages arising from the dissociation [*Corp. Code § 16602(c)*], is prohibited from further exercising his, her, or its rights as a partner.

4. Determine dissociating partner's right to have partnership interest bought out pursuant to partnership agreement or separate buyout agreement, e.g.:

NOTE:

If no buyout agreement exists, the default provisions of UPA '94 apply [***see*** *Corp. Code § 16701*; ***see also*** *§ 15.303[2]*].

a. Requirement that partners or partnership fund purchase or liquidation and, if so, governing details.

b. Method of determining buyout price.

NOTE:

Different methods for valuation of partnership interests are discussed and illustrated in the forms in *§§ 15.240[2]-15.249[2]* in Part A of this chapter. See *§ 15.303[2][a]* for a discussion of the valuation formula prescribed by the UPA '94 default provisions for buyout of a partner's interest.

c. Payment for partnership goodwill.

d. Payment for partnership's unrealized receivables.

e. Method of allocating each partner's distributive share of net profits and losses.

f. Insurance, if any, for funding purchase of dissociating partner's partnership interest, including:

(1) Whether policy is paid up and in effect.

(2) What proof of loss is required.

(3) Where proof of loss must be filed.

g. Offsets to be charged against dissociating partner's interest based on debt owed partnership or damages for wrongful dissociation.

h. Whether payment of buyout price can be deferred until expiration of partnership's term or completion of its purpose.

NOTE:

Absent a contrary agreement, a partner who wrongfully dissociates from a partnership for a definite term or particular purpose by leaving early ordinarily is not entitled to payment of the buyout price until the term expires or the purpose has been achieved [***see*** *Corp. Code § 16701(h)*; ***see also*** *§ 15.303[2][b]*].

5. If dissociation is result of partner's death and no agreement provides for disposition of that partner's partnership interest, determine whether deceased partner's will provides:

a. For disposition of partnership interest.

b. For that partner's executor, without court order or approval, to execute and deliver all documents required to complete disposition of partnership interest.

6. Determine whether any business or tax licenses or permits need to be changed.

7. Determine if partners want to change name of partnership.

NOTE:

Continued use the partnership's name, or a dissociated partner's name as part of the partnership name, will not of itself make the dissociated partner liable for an obligation of the partners or the partnership continuing the business [*Corp. Code § 16705*].

8. Determine whether partnership desires that dissociated partner enter noncompetition agreement as part of buyout.

NOTE:

Any partner, on or in anticipation of his or her dissociation from the partnership, may agree not to carry on a business similar to that carried on by the partnership within a specified geographic area where partnership business was transacted so long as any other member of the partnership (or any person deriving title to the business or its goodwill from any other member of the partnership) carries on a similar business in that area [*Bus. & Prof Code § 16602(a), (b)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpTermination



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
B. Preliminary Determinations

7-15 California Legal Forms--Transaction Guide § 15.411

§ 15.411 Dissolution

NOTE:

At any time before winding up and liquidation, the partners, including those that have not wrongfully dissociated, can waive the right to have the business wound up, and the business will be resumed as if dissolution had never occurred [*Corp. Code § 16802(b)*; ***see*** *§ 15.306[2][b]*].

1. Determine the date on which partners will meet to vote on dissolution.

2. Names of partners designated to carry out winding up and termination of partnership.

3. Determine whether partnership filed and, as appropriate, recorded statement of partnership authority [*see Corp. Code §§ 16105, 16303*].

4. Determine whether partnership filed statement of fictitious business name.

NOTE:

In most cases, a statement of fictitious business name must be filed in the county in which the partnership has its principal place of business [***see*** *Bus. & Prof. Code § 17915*].

5. Determine tax consequences of dissolution of partnership [*see § 15.308*].

6. Determine respective rights of partners under agreement for settlement of partners' accounts on dissolution [*see § 15.412*].

7. Determine whether partnership desires that one or more partners enter noncompetition agreement.

NOTE:

Any partner, on or in anticipation of partnership dissolution, may agree not to carry on a business similar to that carried on by the partnership within a specified geographic area where partnership business was transacted so long as any other member of the partnership (or any person deriving title to the business or its goodwill from any other member of the partnership) carries on a similar business in that area [*Bus. & Prof Code § 16602(a), (b)(1)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpTermination



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
B. Preliminary Determinations

7-15 California Legal Forms--Transaction Guide § 15.412

§ 15.412 Winding Up and Termination

1. Determine what limitations, if any, will apply to partners charged with winding up partnership affairs.

NOTE:
Any limitations on a partner's authority to wind up partnership affairs should be noted in a new statement of partnership authority filed after dissolution with the Secretary of State. The filing of a statement of dissolution will cancel the partnership's existing statement of authority [***see*** *Corp. Code § 16805*]. For the scope of the authority of a partner who is winding up the business, see *§ 15.307[2]*.

2. Determine most advantageous method for liquidation of partnership assets:

a. Sale of partnership business as "going business" to individual, corporation, or other partnership.

NOTE:
The sale of a partnership business as a going business may require compliance with the Bulk Transfer Division of the California Commercial Code [***see*** *Com. Code §§ 6101-6111*; ***see also*** Ch. 17, ***Buying and Selling a Business or Professional Practice***].

b. Assignment of contracts and accounts receivable.

c. Going out of business sale.

d. Public auction.

3. If going out of business sale is to be conducted, determine requirements for license or permit from local governmental entities.

4. Determine whether partnership will be terminated for federal income tax purposes, i.e., whether there will be sale or exchange of 50 percent or more of total interests in partnership capital and profits within 12-month period [*I.R.C. § 708(b)(1)*].

5. Determine who will act as custodian of records or files upon dissolution and termination.

PRACTICE TIP:

A deficiency tax assessment may be issued up to six years after final tax returns are filed [*Rev. & Tax. Code §§ 19057* (four years), 19508 (six years when more than 25 percent of stated gross income omitted)]. Moreover, if a fraudulent tax return is filed, a deficiency tax assessment may be filed at any time [*Rev. & Tax. Code § 19057*]. A records custodian should preserve partnership records for at least seven years from the termination date of the partnership. *Commentary by John J. Camozzi.*

6. If partnership is in business as retail seller of consumer goods, determine process by which any "dealer reserve accounts" established by lenders can be released to partners charged with winding up and termination.

NOTE:

A "dealer reserve account" is an account, opened by the lender, that finances conditional sales contracts for the purchase of goods by consumers. Generally, the lender requires that a portion of the purchase price paid by the lender for each contract be deposited in the dealer reserve account and maintained there until the contract is paid by the consumer.

7. Determine what assets or type of assets are available for application in paying partnership liabilities and settling accounts between partners after dissolution [*see Corp. Code § 16807*].

8. Determine liability of each partner and the estate of any deceased partner for partnership creditor obligations [*Corp. Code § 16807(c)*].

9. Make preliminary estimate of damages, if any, caused by wrongful dissociation of partner [*Corp. Code § 16602(c)*].

NOTE:

A partner who wrongfully dissociates is liable in damages to the partnership. If dissolution follows within 90 days of the dissociation, the partner is not entitled to a buyout of the partner's interest and must await winding up and settlement of accounts, at which time damages resulting from the wrongful dissociation can be charged against that partner's account [*Corp. Code § 16701.5*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpAccountingBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpTerminationBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpValuationBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
B. Preliminary Determinations

7-15 California Legal Forms--Transaction Guide §§ 15.413-15.419

[Reserved]

§§ 15.413[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
C. Procedural Guide

7-15 California Legal Forms--Transaction Guide § 15.420

§ 15.420 Dissociation of Partner

1. If death of partner is cause of dissociation and buyout agreement is funded by life insurance, file necessary proof of loss forms with and collect proceeds from insurers:

a. Obtain copy of death certificate for each policy.

b. Obtain proof of loss forms from each insurer.

c. Have proof of loss forms signed by all beneficiaries.

d. File proofs of loss with insurers.

2. Give preliminary notification to dissociating partner or partner's personal representative that buyout will be in accordance with terms of existing buyout agreement, and:

a. Arrange for services of accountants and/or business appraisers to calculate value of partner's interest.

b. Send buyout offer to dissociating partner or personal representative with supporting documents, including [*see Corp. Code § 16701(b)*]:
(1) Statement of partnership assets and liabilities as of date of dissociation.

(2) Latest available partnership balance sheet and income statement.

(3) Explanation of how the amount of partner's interest was calculated.

c. In cover letter to dissociating partner or personal representative state that:

(1) Payment of amount in offer will be in full satisfaction of partnership's obligation under buyout agreement, and,

(2) Dissociating partner or personal representative has number of days specified in agreement to either accept offer or commence arbitration or seek other remedies provided for in agreement.

NOTE:
After 120 days have passed since dissociation and the parties have been unsuccessful in reaching an agreement, the partnership must pay an amount it estimates to be the buyout price and notify the partner that the payment is in full satisfaction of the partner's obligation to buy out the dissociating partner unless that partner commences an action to determine the buyout price within 120 days [*Corp. Code § 16701(g)*].

3. If there is no existing buyout agreement, prepare recommended draft agreement for dissociating partner's counsel to review and arrange for subsequent execution by all parties [*see § 15.510*].

NOTE:
If there are no buyout provisions in the partnership agreement or a separate agreement, the default provisions of UPA '94 will apply and the partnership will have 120 days from the date of dissociation to reach agreement with the dissociated partner on the buyout price. If no agreement is reached, the partnership must pay the dissociated partner the estimated buyout price, plus accrued interest, reduced by any amounts the partner owes the partnership [***see*** *Corp. Code § 16701(f)* and discussion in *§ 15.303[2][b]*].

4. If there is no existing buyout agreement and negotiations for purchase have reached impasse, within 120 days after dissociation [*Corp. Code § 16701(e)*]:

a. Advise remaining partners that dissociating partner's interest must be purchased for cash payment.

b. Estimate amount due to dissociating partner buyout formula [*see* discussion of formula in § 15.303].

c. Draft and send dissociating partner notice that payment is in full satisfaction of obligation to purchase interest [*see § 15.511*].

5. Include indemnification agreement in any buyout agreement.

NOTE:
Buyout agreements must indemnify dissociating partners for past and future partnership obligations other than obligations that are the result of an act of the dissociated partner after that partner has dissociated [***see*** *Corp. Code § 16701(d)*].

6. If partner has wrongfully dissociated by withdrawing prematurely from partnership for definite term or particular purpose, prepare tender of deferred payment of buyout price [*see § 15.511[1][d]*].

NOTE:
A partner who wrongfully dissociates in this manner is not entitled to immediate payment of the buyout

price unless the partner can establish the satisfaction of a court that earlier payment will not work a hardship on the business of the partnership [***see*** *Corp. Code 16701(f), (h)*; ***see also*** *§ 15.303[2]*].

7. Prepare, file, and, as appropriate, record statement of dissociation [*see § 15.530*] with Secretary of State's office and a certified copy of the statement with the county recorder in each county in which the partnership owns real property [*Corp. Code § 16704(a)*].

NOTE:

The filing fee is $30 [*Corp. Code § 16113(b)*]. The fee for recording documents is $10 for the first page and $3 for each additional page [*Gov. Code § 27361*]; a separate fee for certifying the copy applies as well [***see*** *Gov. Code § 27364* (certification under seal fee determined by board of supervisors)]. A recorded statement that is not a copy certified by the Secretary of State will not have the effect given to such statements by UPA '94 [*Corp. Code § 16105(b)*].

8. Send copies of partnership statements to all nonfiling partners [*Corp. Code § 16105(e)*].

9. Arrange for denial of dissociated partner's access to partnership bank accounts, safe deposit boxes, and credit cards.

10. If necessary, obtain new signature cards for partnership accounts and safe deposit boxes if required by depositary.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionPartnership LiabilitiesBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersInspection of Books & Records



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
C. Procedural Guide

7-15 California Legal Forms--Transaction Guide § 15.421

§ 15.421 Dissolution of Partnership

1. Have partners designate partners who are designated to:

a. Wind up partnership business affairs.

b. Complete unfinished business (work-in-progress), if any.

2. Prepare, file, and, as appropriate, record statement of dissolution [*see § 15.531*] with Secretary of State's office and a certified copy of statement with the county recorder in each county in which the partnership owns real property [*Corp. Code § 16805*].

NOTE:

There is no filing fee if the purpose of the filing is to cancel the partnership's filed statement of authority [*Corp. Code § 16113(c)*]. The fee for recording documents is $10 for the first page and $3 for each additional page [*Gov. Code § 27361*]; a separate fee for certifying the copy applies as well [***see*** *Gov. Code § 27364* (certification under seal fee determined by board of supervisors)]. A recorded statement that is not a copy certified by the Secretary of State will not have the effect given to such statements by UPA '94 [*Corp. Code § 16105(b)*].

3. Have partnership file statement of partnership authority [*see § 15.285* in Part A of this chapter] with Secretary of State's office and a certified copy of the statement with the county recorder in each county in which the partnership owns real property [*Corp. Code §§ 16105, 16805(d)*].

NOTE:

The filing of a statement of dissolution will cancel any existing statement of partnership authority on file. A new statement of partnership authority should be filed to indicate those partners having authority

to wind up the business. For a discussion of the effect of filing a statement of authority on third parties, see *§ 15.306[2][d]*.

The filing fee is $70 [*Corp. Code § 16113(a)*]. The fee for recording documents is $10 for the first page and $3 for each additional page [*Gov. Code § 27361*]; a separate fee for certifying the copy applies as well [***see*** *Gov. Code § 27364* (certification under seal fee determined by board of supervisors)]. A recorded statement that is not a copy certified by the Secretary of State will not have the effect given to such statements by UPA '94 [*Corp. Code § 16105(b)*].

4. Send copies of above partnership statements to all nonfiling partners [*Corp. Code § 16105(e)*].

5. Send notice of dissolution to each creditor of partnership, by any means desired, including certified mail with return receipt requested.

6. Have accounting of partnership affairs, assets, and liabilities conducted and prepared:

a. As of close of business on date of dissolution.

b. By accountant servicing partnership or another accountant chosen by partners or partner charged with winding up.

7. Notify partnership's banks and other depositaries of dissolution of partnership and, if necessary, obtain new signature cards for partners who will be winding up partnership.

8. If called for by nature of partnership assets, have independent appraiser conduct appraisal of non-cash assets owned by partnership on dissolution date.

9. Arrange for and conduct inventory of safe deposit boxes rented by partnership.

10. Complete inventory of other partnership assets as of date of dissolution, including:

a. List of all tangible and intangible assets, indicating:
(1) Location.

(2) Condition.

(3) Original cost or basis.

(4) Estimated worth or book value.

b. List of all bank or other forms of deposit, including:

(1) Amounts on deposit or invested.

(2) Location.

(3) Account or other identification number.

c. List of all accounts receivable, including:

(1) Amount and time due.

(2) Persons from whom due and address.

d. List of contents of safe deposit box.

e. Customer lists.

f. Intellectual property rights.

11. Close partnership books as of date of dissolution.

12. Abandon partnership's fictitious business name statement.

NOTE:

A fictitious business name for a partnership is any name that does not include the surname of each general partner or that suggests the existence of additional owners *Bus. & Prof. Code § 17900(b)(2)*]. Partnerships that regularly transact business under a fictitious business name must file a fictitious business name statement [***see*** *Bus. & Prof. Code § 17910(a)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersGeneral OverviewBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersInspection of Books & Records



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
C. Procedural Guide

7-15 California Legal Forms--Transaction Guide § 15.422

§ 15.422 Winding Up and Termination

1. Follow all generally applicable dissolution procedures [*see § 15.421*]

2. Dispose of partnership assets by one or more of following:

    a. Public auction.

    b. Going out of business sale.

    c. Assignment of accounts receivable to factor or other financial institution.

    d. Assignment of contracts.

    e. Sale of partnership business as going business to corporation, other entity, or sole proprietor.

3. Apply proceeds from disposition of partnership assets as follows [*see Corp. Code § 16807*]:

    a. Pay liabilities owing to creditors other than partners.

    NOTE:
    These liabilities would include those for employment and sales taxes, for which a partner may be personally liable if they go unpaid. For example, on dissolution, any partner or other person having control or supervision, or who is charged with responsibility for the filing, of sales tax returns or the payment of tax, is personally liable for any unpaid sales taxes, plus any interest or penalties if the failure is willful [*Rev. & Tax. Code § 6829(a),*

(d) ("willful" defined as an intentional, conscious, and voluntary course of action); ***see*** *State Board of Equalization v. Wirick (2001) 93 Cal. App. 4th 411, 413, 419, 112 Cal. Rptr. 2d 919* (*Rev. & Tax. Code § 6829* applied to former chief financial officer of corporation, despite fact that he had resigned position over one year before corporation ceased business; because present tense in statute includes past tense, section covers former officers as well as those in charge when corporation ceases)]. The partner or other person is only liable for the taxes that became due during the period that he or she had the control, supervision, responsibility, or duty to act for the partnership [*Rev. & Tax. Code § 6829(b)*], and only if the State Board of Equalization can establish that the partnership (1) included or added tax reimbursement in to the selling price of tangible personal property sold in the conduct of partnership business or (2) consumed tangible personal property and failed to pay the tax to the seller or has included use tax on the billing and collected the use tax or issued a receipt for the use tax without reporting and paying use tax [*Rev. & Tax. Code § 6829(c)*; *see Rev. & Tax. Code § 6829(f)* (notice of deficiency determination)].

b. Pay liabilities owing to partners other than for capital and profits.

4. If disposition of partnership assets does not yield sufficient amount to pay partnership liabilities:

a. Require partners to contribute amounts necessary to satisfy them [*see Corp. Code § 16807*].

NOTE:

An assignee for the benefit of creditors or any person appointed by the court may enforce the obligation to make contributions [*Corp. Code § 16807(f)*]. Any partner or legal representative has the right to enforce contributions to the extent of the amount paid by the partner or estate in excess of that party's share of the liability [***see*** *Corp. Code § 16807(c)*].

b. If any partner is insolvent or is not subject to process and refuses to contribute, require other partners to contribute [*Corp. Code § 16807(c)*]:

(1) Their share of liabilities; and

(2) In relative proportions in which they share profits, any additional amount necessary to pay liabilities.

5. If payment of liabilities leaves sufficient amounts to make distributions to remaining partners, distribute surplus in cash either [*Corp. Code § 16807(b)*; *see O'Flaherty v. Belgum (2004) 115 Cal. App. 4th 1044, 1047, 1056-1061, 9 Cal. Rptr. 3d 286* (arbitrator exceeded authority by declaring forfeiture of withdrawing partners' capital accounts; forfeiture was contrary to partnership law, partnership agreement, and decisional law)]:

a. As provided in partnership agreement; or

b. In an amount equal to the excess of credits over charges in each partner's account after crediting and charging each account with profits and losses resulting from liquidation.

6. After all obligations of partnership have been paid:

a. Render complete accounting to each partner and each unpaid creditor, if any.

b. Have partners execute and file final federal and California income tax returns.

c. Have partners cancel any outstanding permits and licenses.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpAccountingBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpTerminationBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpValuationBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionPartnership LiabilitiesTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsContributions to Partnerships (IRC secs. 721-724)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
C. Procedural Guide

7-15 California Legal Forms--Transaction Guide §§ 15.423-15.429

[Reserved]

§§ 15.423[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-15 California Legal Forms--Transaction Guide § 15.430

§ 15.430 Election to Increase Tax Basis of Partnership Assets on Death of Partner or Sale or Exchange of Partnership Interest

NOTE:

The purchase of a partnership interest by another partner or a third party increases the tax basis of the partnership interest of the purchasing party to the amount of the purchase price [***see*** *I.R.C. §§ 742, 1012*; *Rev. & Tax. Code §§ 17851, 18031* (taxation of partnerships, and gain and loss on disposition of property, determined in accordance with Internal Revenue Code, unless otherwise provided)]. For decedents dying before 2010, the basis of property in the hands of a person who acquired the property from a decedent or to whom the property passed from a decedent is the fair market value of the property at the date of the decedent's death [***see*** *I.R.C. §§ 742, 1014*; *Rev. & Tax. Code §§ 17851, 18031* (taxation of partnerships, and gain and loss on disposition of property, determined in accordance with Internal Revenue Code, unless otherwise provided)]. For decedents dying after 2009, a modified carryover basis rule generally applies, so a step-up basis in the property does not apply [*I.R.C. § 1022*].

As a result of the increase in the tax basis of property passing by purchase or descent, the basis in the remaining assets of the partnership will in most cases be lower than the acquiring party's basis in the newly acquired partnership interest. In those circumstances, the remaining partners may have the partnership elect to increase the basis of the partnership assets in order to decrease their income tax liability on distribution when the partnership dissolves in the future [***see*** *I.R.C. §§ 743, 754*; *Rev. & Tax. Code § 17851* (taxation of partnerships determined in accordance with Internal Revenue Code, unless otherwise provided)].

The basis of partnership property may also be adjusted as the result of a distribution to a partner if there is a substantial basis reduction in the contributed property [***see*** *I.R.C. § 734(a), (b)*; ***see also*** *I.R.C. § 734(d)* ("substantial basis reduction" defined)]. See *§ 15.431*, P 1a(3).

PRACTICE TIP:

Counsel and the partners' and partnership's tax advisors may wish to collectively consider the tax effect a change in tax basis may have. When counsel does not have specialized tax knowledge, it may be prudent to directly involve a tax professional concerning these tax matters. *Commentary by John J. Camozzi.*

1. Advise partners of adjusted basis election following transfer of interest in partnership, either [*see I.R.C. §§ 743(a), 754*; *Rev. & Tax. Code § 17851*]:

a. By sale or exchange; or

b. On death of partner.

2. Advise partners of effect of election, i.e., that partnership must either [*I.R.C. § 743(b)*; *Rev. & Tax. Code § 17851*]:

a. Increase adjusted basis of partnership property by excess of basis to transferee partner over that partner's proportionate share of adjusted basis of partnership property; or

b. Decrease adjusted basis by excess of transferee's proportionate share of adjusted basis of partnership property over basis of that partner's interest in partnership.

3. After independent consideration by remaining partners and their affirmative vote, make election in written statement [*Treas. Reg. § 1.754-1(b)(1)*; *see I.R.C. § 754*; *Rev. & Tax. Code § 17851*]:

a. Setting forth name and address of partnership.

b. Declaring that partnership elects under *I.R.C. § 754* to apply provisions of *I.R.C. § 743(b).*

c. Executed by at least one partner.

4. Submit election statement to Internal Revenue Service and California Franchise Tax Board.

a. Attach written election statement to partnership income tax return for taxable year in which transfer, sale, or death occurs [*I.R.C. § 754*; *Treas. Reg. § 1.754-1(b)(1)*; *Rev. & Tax. Code §§ 17024.5(e), 17851*].

b. To ensure that election will be effective, file partnership tax return on or before due date [*see* Treas. Reg. § 1.6031-1(e)] or under "timely amendment" [*see Treas. Reg. § 1.754-1*; *Estate of Dupree v. United States (5th Cir. 1968) 391 F.2d 753, 758-759* ; *see also Rev. & Tax. Code §§ 17024.5(e), 17851*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpDissolutionDeath & IncapacityBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpDistribution of AssetsBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpWinding UpDistribution of Estate PropertyTax LawFederal

Taxpayer GroupsLimited Liability Companies & PartnershipsAllocations of Basis (IRC secs. 704, 755)Tax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsBasis (IRC secs. 704, 705, 722-724, 731-735, 737, 742, 751, 754, 755)Optional AdjustmentsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsBasis (IRC secs. 704, 705, 722-724, 731-735, 737, 742, 751, 754, 755)Partner InterestsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsContributions to Partnerships (IRC secs. 721-724)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-15 California Legal Forms--Transaction Guide § 15.431

§ 15.431 Election to Increase Basis of Undistributed Assets on Distribution to Any Partner

1. Advise partnership that basis of undistributed partnership property can be increased under following circumstances [*see I.R.C. §§ 734(b), 754*; *Rev. & Tax. Code § 17851*]:

a. If distribution is made to partner or partners of cash or property and that distribution results in:
(1) Gain to distributees;

(2) Increase in distributees' basis in partnership interest; or

(3) Substantial basis reduction in contributed property.

NOTE:
A partnership has a substantial built-in loss with respect to a transfer of an interest in a partnership if the partnership's adjusted basis in the partnership property exceeds the fair market value of the property by more than $250,000 [*I.R.C. § 734(d)(1)*]. However, an electing investment partnership may elect to avoid being treated as having a substantial built-in loss with respect to any transfer occurring during the pendency of the election [***see*** *I.R.C. § 743(e)(1)*; ***see also*** *I.R.C. § 743(e)(6)* (consent irrevocable unless Secretary consents)].

b. If election is made to increase basis of undistributed property.

2. If criteria listed in (1)(a), *above*, are met, and after independent consideration by remaining partners, if increase is desired have partnership make election to adjust basis of partnership in written statement [*Treas. Reg. § 1.754-1(b)(1)*; *see I.R.C. § 754*; *Rev. & Tax. Code §§ 17024.5(e), 17851*]:

NOTE:

The adjustment of basis may be desirable because the increased basis will result in lower income tax liability on distribution when the partnership dissolves.

a. Setting forth name and address of partnership.

b. Declaring that partnership elects under *I.R.C. § 754* to apply provisions of *I.R.C. § 734(b)*.

c. Executed by at least one partner.

3. Submit election statement to Internal Revenue Service and California Franchise Tax Board.

a. Attach written election statement to partnership income tax return for taxable year in which transfer, sale, or death occurs [*I.R.C. § 754*; *Treas. Reg. § 1.754-1(b)(1)*; *Rev. & Tax. Code §§ 17024.5(e), 17851*].

b. Instruct partnerships' tax professional to assure that election will be effective by filing partnership tax return:

(1) On or before due date for return [*see* Treas. Reg. § 1.6031-1(e); *Rev. & Tax. Code § 17024.5(e)*]; or

(2) Under "timely amendment" [*see Treas. Reg. § 1.754-1*; *Estate of Dupree v. United States (5th Cir. 1968) 391 F.2d 753, 758-759* ; *see also Rev. & Tax. Code §§ 17024.5(e), 17851*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Tax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsBasis (IRC secs. 704, 705, 722-724, 731-735, 737, 742, 751, 754, 755)General OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsBasis (IRC secs. 704, 705, 722-724, 731-735, 737, 742, 751, 754, 755)Optional AdjustmentsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsBasis (IRC secs. 704, 705, 722-724, 731-735, 737, 742, 751, 754, 755)Partner InterestsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsContributions to Partnerships (IRC secs. 721-724)Basis of PropertyTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsTransfers of Interest (IRC secs. 741-743)Basis



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-15 California Legal Forms--Transaction Guide §§ 15.432-15.499

[Reserved]

§§ 15.432[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
A. Liquidation of Partnerships or Partnership Interests

7-15 California Legal Forms--Transaction Guide § 15.500

§ 15.500 Agreement Dissolving Partnership--Sale of Assets--Liquidating Distribution of Net Proceeds to All Partners

[1] Comment

[a] Use of Form

This form is an agreement for the dissolution of a partnership with cessation of the partnership business and a liquidating distribution of the net proceeds to the partners. It is for use when the parties wish to dissolve the partnership, sell the firm's assets, pay its debts, and distribute the proceeds to the partners in a liquidating distribution. Under applicable law, the partners may agree to dissolve and wind up the partnership at any time [*see Corp. Code § 16801*; *see also § 15.302*].

The partnership agreement may not adequately provide for dissolution of the partnership because, apart from specifying the events that could require dissolution or the vote needed to dissolve the partnership, it is unlikely that the partnership agreement can cover all the aspects of dissolution in advance of that event. Consequently, a document like this form will reflect the understanding of the partners at the time the partnership is actually going to be dissolved.

This form contemplates a liquidating distribution to the partners, which is treated the same under federal and California tax law [*see I.R.C. § 736*; *Rev. & Tax. Code § 17851*; *I.R.C. §§ 701-761*; *see also Rev. & Tax. Code § 17024.5*; *but see Rev. & Tax. Code §§ 17852-17857* (modifications of federal provisions)].

This form includes an optional provision requiring the partner charged with winding up the affairs of the partnership to conduct a "going out of business" sale to convert the assets of the partnership to cash. Local ordinances may control such sales and should be reviewed and discussed with the partner who is winding up the business.

[b] Termination of Partnership

This form provides for the withdrawal of all of the partners in a three-member partnership. For income tax purposes,

such a withdrawal causes a termination of the partnership [*see I.R.C. § 708(b)(1)*; *see also § 15.308[4]*].

[c] Tax Consequences of Liquidating Distributions

Liquidating distributions are taxed under *I.R.C. § 736*. They are allocated between payments for partnership property, which receive capital gain or loss treatment and other payments, which are treated either as a partner's distributive share of partnership income or guaranteed payments both of which are ordinary income to the partner [*I.R.C. § 736(a), (b)*]. Because this form does not contemplate the continuation of the partnership business, and all payments are made by the partnership to the partners, there is no question that the payments are liquidating distributions. See *§ 15.308* for further discussion of the tax consequences of liquidating distributions. Consider also the advantages and disadvantages of a purchase and sale of partnership interests if some of the partners will continue the business [*see § 15.308*].

[2] FORM

Agreement Dissolving Partnership--Sale of Assets--Liquidating Distribution of Net Proceeds to All Partners

AGREEMENT DISSOLVING PARTNERSHIP

Between

_____ [*Name of first partner*],
_____ [***Name of second partner***],

and

_____ [*Name of third partner*],

Doing Business as

_____ [*Name of partnership*]

ARTICLE 1 RECITALS

Partnership

1.01. _____[*Name of first partner*], hereinafter referred to as First Partner, residing at _____[*street address, city, and state*], _____[*name of second partner*], hereinafter referred to as Second Partner, residing at _____[*street address, city, and state*], and _____[*name of third partner*], hereinafter referred to as Third Partner, residing at _____[*street address, city, and state*], have been and now are Partners doing business under the firm name of _____, with principal place of business at _____[*street address, city, county, and state*].

Partnership Agreement

1.02. The parties entered into this Partnership and have continued in Partnership under the provisions of [an oral *or* a written] agreement made on _____. [A copy of that agreement is attached as Exhibit _____].

Desire to Dissolve

1.03. The parties now desire to dissolve their Partnership and liquidate its affairs pursuant to a plan whereby the parties shall complete all unfinished business, sell their stock of goods, or so much of the stock as possible, [by holding a "going-out-of-business" sale, subject to obtaining all necessary governmental permits for such a sale,] convert all other partnership noncash assets, together with any stock of goods remaining unsold, to cash by sale or other disposition for the best price obtainable, and distribute to the Partners any proceeds remaining after the payment of all liabilities of the Partnership in liquidation of the interests of the Partners.

ARTICLE 2 DISSOLUTION

Effective Date

2.01. The parties dissolve their Partnership, effective at the close of business on _____[*date*], and shall thereafter promptly complete all unfinished business and liquidate the affairs of the Partnership.

Statement of Dissolution

2.02. The parties shall cause a statement of dissolution and an amended statement of partnership authority to be filed in the office of the California Secretary of State [*if appropriate, add:*, and certified copies of those statements to be recorded in each county in which the Partnership owns real property]. The amended statement of partnership authority shall name _____ as Partner(s) having sole authority to complete the unfinished business of the Partnership and to act on behalf of the partnership to wind up its business in accordance with the provisions of Paragraph 3.02 of this agreement.

Cessation of Business

2.03. Except for the purpose of completing unfinished business and carrying out the liquidation of the affairs of the Partnership, none of the parties shall do any further business or incur any further obligations on behalf of the Partnership after the effective date set forth in Paragraph 2.01.

Unfinished Business

2.04. For the purpose of this Agreement "unfinished business" shall mean the following [*specify, e.g.*, cases *or* contracts] that are the Partnership's work-in-progress as of the date of this Agreement and that are to be completed by the following Partners:

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The Completing Partner(s) shall have the sole and separate authority to complete unfinished business and, upon its completion, deposit any resulting income in the Partnership bank account as provided in Section 3.09 of this Agreement. The Completing Partner(s) shall not be entitled to receive any additional compensation for completing unfinished business, but shall be entitled to deduct reasonable overhead expenses incurred in completing unfinished business from the income resulting from that business. Upon completion of unfinished business, the Completing Partner(s) shall provide an account to the Partnership of all income and overhead expenses resulting from completion of that business and shall pay that income, net of reasonable overhead expenses, to the Partnership for use in settling the Partnership accounts and distributing the Partnership surplus according to provisions of this Agreement.

ARTICLE 3 LIQUIDATION

Sale of Noncash Assets

3.01. In liquidating the affairs of the Partnership, the parties shall sell their stock of goods, or so much of the stock as possible, [at a "going-out-of-business" sale, subject to obtaining all necessary governmental permits for such a sale], and shall convert all other Partnership noncash assets, together with any stock of goods remaining unsold, to cash by sale or other disposition for the best price obtainable.

Appointment of Partner to Wind Up

3.02. First Partner is appointed as the Partner to wind up and carry out the terms and conditions of this Agreement. First Partner shall have the right and obligation to sell all Partnership assets at such prices and on such terms and conditions as in First Partner's opinion may be in the best interests of both Partners, provided that no sale shall be made of any asset having an original cost to the Partnership in excess of $ _____ by First Partner without the written consent of Second Partner and Third Partner.

Accounting

3.03. Immediately following the dissolution of the Partnership and before commencing to conduct any sale of a sets, the parties shall cause an accounting to be made by _____[*name of accountants*] of the year-to-date net income and of all of the assets of the Partnership, and of the respective equities of the creditors and the Partners in the assets as of the effective date of the dissolution.

Take Inventory and Fix Sale Prices

3.04. In taking an accounting of the assets of the Partnership and the equities therein, the parties shall take a complete physical inventory of the stock of goods on hand and fix prices for the sale of the stock of goods at such level as will insure as complete a sale of the goods as is possible and at the same time obtain the highest price for the goods as may be possible, taking into consideration the necessity for ending the sale at an early date.

Purchase by a Party

3.05. Except for the purchase of the goodwill of the Partnership and the right to use the name of _____[*name of partnership*], any of the parties may purchase any of the stock of goods or other noncash assets, current or noncurrent, of the Partnership upon agreement with the other parties as to price and terms.

Sale of Goodwill and Right to Use Name

3.06. The parties, by a majority vote, may sell for such price and on such terms as they deem proper the goodwill of the Partnership and the sole right to use the name of _____[*name of partnership*] either to some of the parties or to other persons.

Settling Accounts

3.07. The parties shall first pay all of the liabilities of the Partnership, including those owing to the Partners other than for capital or profits. If the assets of the Partnership are not sufficient to pay all of the liabilities of the Partnership, the Partners shall contribute pro rata according to their respective Partnership interests as set forth in the Partnership Agreement, the amounts necessary to pay the Partnership liabilities. Any liabilities incurred in the ordinary course of the Partnership's business which are asserted after the Partnership's accounts have been settled shall be paid promptly by the Partners pro rata according to their respective Partnership interests.

Distribution of Surplus

3.08. All amounts remaining after payment of the above liabilities shall be distributed as follows: [*give details, e.g.,* to each Partner in the ratio that the Partner's Capital Account and Income Account combined bear to the combined Capital and Income Accounts of all Partners]. Except for the amount equal to the Partner's distributive share of the Partnership income for the Partnership taxable year up to the date of dissolution, such payments are intended by the Partners to be payments in liquidation of the interests of the Partners within the meaning of *Internal Revenue Code Section 736(b)*.

Continued Use of Partnership Bank Account

3.09. To liquidate more readily the affairs of the Partnership, the parties shall continue to maintain the bank account now maintained in the _____[*name of bank*] until all of the Partnership unfinished business is completed and the Partnership affairs are liquidated, and shall deposit in the account all moneys received by any of the parties for completion of unfinished business or on the sale of any of the assets of the Partnership, and shall make all payments of liabilities from the account by check signed as now required for the drawing of funds from the bank account by the Partnership.

Disclosure

3.10. Except as disclosed in the books and records of the Partnership, each of the parties represents and warrants that to the best of that party's knowledge that the party has not heretofore contracted any liability that can or may charge the Partnership or the other party, nor received or discharged any of the credits, moneys, or effects of the Partnership not reflected on the Partnership books and records.

Inspection of Books and Records

3.11. Each Partner shall have the right, directly or through a representative designated in writing, at all reasonable times, to examine the books of the Partnership, and records pertinent thereto, for the purpose of establishing and enforcing the Partner's rights under this Agreement.

Deciding Disputes

[*Select one of following alternatives:*]

3.12. In deciding any questions or disputes that may arise between the parties in the course of liquidating the affairs of the Partnership, the vote of a majority of the parties shall be binding upon all of the parties.

[*OR*]

3.12. The Partners shall make a good faith effort to settle any dispute or claim arising under this Agreement. If the Partners fail to resolve any such disputes or claims, they shall submit them to arbitration under the rules of the American Arbitration Association then in effect, subject to the requirement that the arbitrator shall issue a written opinion, supported by substantial evidence and in accordance with governing law. Judgment on arbitration awards may be entered by any court with appropriate jurisdiction.

[*OR*]

3.12. Any controversy or claim arising under this Agreement shall be submitted for arbitration under the following rules:

(a) Each Partner shall select one arbitrator. The arbitrators selected by the Partners shall choose one additional arbitrator and these shall make up the arbitration panel.

(b) The Partners shall agree on and stipulate to a statement of facts and issues presented which shall be submitted to the arbitration panel.

(c) If desired, each Partner may submit a written statement of position to the arbitration panel. If a Partner chooses to submit a statement of position, copies of such statement must be served on all other Partners who shall have the right to submit written rebuttals within _____ days from receipt. Copies of such rebuttals shall be served on all Partners.

(d) The arbitration panel may request oral argument at which all Partners shall have the right to be present.

(e) If the arbitration panel desires, it may submit written questions to the Partners. The Partners shall respond to such questions in writing. If a question is addressed to an individual or fewer than all Partners, copies of the question and the answer thereto shall be served on the other Partners.

(f) Fees and expenses of the arbitration panel shall be paid by the Partnership as a business expense.

(g) The decision of and any award from the arbitration panel shall not be binding on the Partners and shall in no way prejudice any rights they may have to pursue all available legal and equitable remedies.

[*CONTINUE*]

ARTICLE 4 EXECUTION AND ENFORCEMENT

Counterparts

4.01. This Agreement may be executed in any number of counterparts, and each such counterpart shall be deemed to be an original instrument.

Survival of Representations

4.02. The representations and agreements set forth herein shall be continuous and shall survive the taking of any accounting.

Successors and Assigns

4.03. This Agreement shall inure to the benefit of and bind the successors, assigns, heirs, executors, and administrators of the parties.

Applicable Law

4.04. This Agreement shall be construed under and in accordance with the laws of the State of California.

Other Instruments

4.05. The parties hereto covenant and agree that they will execute any other and further instruments and documents that are or may become necessary or convenient to effectuate and carry out this Agreement.

Headings

4.06. The headings used in this Agreement are used for administrative purposes only and do not constitute substantive matter to be considered in construing the terms of this Agreement.

No Strict Construction

4.07. This Agreement shall not be strictly construed against any party to the Agreement.

Severability

4.08. In case any one or more of the provisions contained in this Agreement shall for any reason be held to be invalid, illegal, or unenforceable in any respect, that invalidity, illegality, or unenforceability shall not affect any other provision and this Agreement shall be construed as if the invalid, illegal, or unenforceable provision had never been part of the Agreement.

Prior Agreements Superseded

4.09. This Agreement supersedes any prior understandings or written or oral agreements between the parties respecting the within subject matter, including the Partnership Agreement attached as Exhibit _____ to the extent

that it may conflict with any of the provisions contained in this Agreement.

Survival of Representations and Warranties

4.10. The representations and warranties set forth in this Agreement are continuous and survive the taking of any accounting, and the dissolution and winding up of the Partnership.

Executed on _____[*date*], at _____[*city and state*].

_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

[*Acknowledgments taken in California must be in the following form (Civ. Code § 1189(a)(1)):*]

State of California
County of _____

On _____[*date*], before me, _____[*name and title of officer taking acknowledgment*], personally appeared [*name(s) of person(s) signing instrument*], [who proved to me on the basis of satisfactory evidence] to be the person[s] whose name[s] [is *or* are] subscribed to the within instrument and acknowledged to me that _____[he *or* she *or* they] executed the same in _____[his *or* her *or* their] authorized _____[capacity *or* capacities], and that by _____[his *or* her *or* their] signature[s] on the instrument the person[s], or the entity upon behalf of which the person[s] acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature _____[*Seal*]

Spousal Consent

The undersigned are the spouses of the general partners who have signed above. We have read and understood the terms and conditions of the foregoing Agreement and agree to be bound by its terms. We agree that our respective spouses shall have the sole and exclusive power to manage the partnership interests that are the subject of the foregoing Agreement, regardless of whether these interest were acquired with community property, quasi-community property, or separate property assets, howeverso titled or characterized. We further acknowledge and agree that in furtherance of this Agreement our respective spouses may, from time to time, or at any time, sell, transfer, assign or hypothecate those partnership interests, or any tangible or intangible property represented by those interests, in any manner whatsoever, with or without our further consent.

Executed at _____ County, California on _____[*date*].

_____ [*signature of spouse*]
[*typed name*]
_____ [*signature of spouse*]
[*typed name*]
_____ [*signature of spouse*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
A. Liquidation of Partnerships or Partnership Interests

7-15 California Legal Forms--Transaction Guide §§ 15.501-15.509

[Reserved]

§§ 15.501[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
B. Sale of Partnership Interests
1. Sale of Interest to Continuing Partners

7-15 California Legal Forms--Transaction Guide § 15.510

§ 15.510 Agreement for Buyout of Dissociating Partner's Interest in Partnership

[1] Comment

[a] Use of Form

This form is an agreement for a partnership to purchase the interest of a dissociating partner. This form tracks the provisions of UPA '94 that require a dissociating partner's interest to be bought out by the partnership. This form assumes that the partnership either does not have a written agreement or that its agreement does not state the terms for a buyout of a dissociating partner's interest.

[b] Buyout Requirement

A dissociating partner is entitled to have that partner's interest bought out [*Corp. Code § 16701(a)*; for discussion of what constitutes dissociation, *see § 15.301[2]*]. The statute provides that the partnership "shall cause" the dissociated partner's interest to be purchased, leaving it up to the parties to arrange the method of buyout that makes the most economic sense for those continuing the business and the dissociating partner or that partner's personal representative. For example, life insurance is often used to fund the contingency of death of a partner, and installment payments to a retiring partner may be the best way to fund a buyout of that partner's interest. See the forms in *§§ 15.260[2]-15.262[2]* for examples of agreements funded with insurance.

[c] Terms of Buyout

The buyout price is the amount the partner would receive as surplus on dissolution and winding up, that is, after creditors have been paid and accounts settled [*see Corp. Code § 16807*], if, on the date of dissociation, the assets of the partnership were sold at a price equal to the greater of (1) the liquidation value or (2) the value based on the sale of the entire business as a going concern (without the dissociated partner), and the partnership was wound up as of that date. Interest must be paid from the date of dissociation to the date of payment [*Corp. Code § 16701(b)*]. The interest rate

under UPA '94 (unless the parties agree otherwise) is that specified in *Civ. Code § 3289* [*Corp. Code § 16104(b)*]. Damages for wrongful dissociation and any other amounts owed the partnership by the dissociating partner must be offset against the buyout price, with interest from the date the amount owed is due until the date of payment [*Corp. Code § 16701(c)*].

[d] No Buyout Within 90 Days of Dissolution

The foregoing buyout requirements do not apply to a partner who dissociates within 90 days before the partnership's dissolution. Instead, such a partner would be treated as any other partner and would have to wait for the winding up of the partnership, with the amount distributable to that partner taking into account any amounts owed by the partner to the partnership, including damages for wrongful dissociation [*Corp. Code § 16701.5*].

[e] Failure to Reach Agreement; Payment or Tender of Buyout Price

Unless there is an agreement to the contrary (e.g., one giving the partnership a longer time to reach agreement), if no agreement for purchase of a dissociated partner's interest is reached within 120 days after a written demand for payment, the partnership must pay (or cause to be paid to) the dissociated partner the amount the partnership estimates to be the buyout price with accrued interest, less any offsets [*Corp. Code § 16701(e)*; *see § 15.511[2]* (notice that accompanies the estimated payment]. If the partner has wrongfully dissociated from a partnership for a definite term or particular purpose [*see Corp. Code § 16602(b)(2)*; *see also § 15.302[2]*], the buyout of that partner will be deferred until the expiration of the term or completion of the undertaking unless the partner establishes to the satisfaction of a court that earlier payment will not cause undue hardship to the business of the partnership. If the payment is deferred it must be adequately secured and bear interest [*Corp. Code § 16701(h)*] and the partnership may tender a written offer to pay the estimated amount of the deferred buyout price, with interest but reduced by offsets, stating the time payment, type of security, and the other terms and conditions of the obligation [*Corp. Code § 16701(f)*]. In the event either a tender offer or an estimated payment of the buyout price is required under UPA '94, this form could be used to convey the terms of the offer to the dissociated partner. With some modification as to the date payment will be made, this form could also be used to tender a deferred payment to a wrongfully dissociating partner.

[f] Documents to Accompany Payment or Tender

This form assumes that the parties have concluded their bargain based on complete disclosure of the bases on which the buyout was agreed to. When, however, the parties have been unable to agree and the payment or tender requirements discussed in [e], *above*, are triggered, the partnership is required to include with either a payment or tender of the buyout price (1) a statement of partnership assets and liabilities as of the date of dissociation; (2) the latest available partnership balance sheet and income statement, if any; (3) an explanation of how the estimated amount of the payment was calculated; and (4) written notice that the payment is in full satisfaction of the obligation to purchase unless, within 120 days after the written notice, the dissociated partner commences an action to determine the buyout price and any offsets or other terms of the obligation to purchase [*Corp. Code § 16701(g)*]. This form provides that the partnership will furnish these documents at a date fixed by the parties, presumably enough in advance of the payment date that the dissociating partner and that partner's attorney and/or accountant can review the calculation used to arrive at the buyout price.

[g] Court Action to Determine Buyout Price

Partners who have dissociated may maintain an action against the partnership to determine the buyout price of their interests, including any offsets or other terms of the obligation to purchase. The action must be commenced within 120 days after the partnership has tendered payment or an offer to pay, or within one year after written demand for payment if the partnership has not paid or tendered an offer of payment. The court must determine the buyout price, offsets, and accrued interest and enter a judgment for any additional payment or refund. The court must also determine the security for payment and other terms of the obligation in the case of a deferred payment to a wrongfully dissociating partner [

Corp. Code § 16701(i)].

The court may assess reasonable attorneys' fees and the fees and expenses of appraisers or experts against a party that the court finds acted arbitrarily, vexatiously, or not in good faith. That finding may be based on the partnership's failure to tender payment or an offer to pay or to furnish the statement [*see* [*i*][ii], *below*] that must accompany an offer to pay or tender of payment [*Corp. Code § 16701(i)*].

[h] Rights and Duties of Dissociating Partner With Respect to Partnership

A dissociating partner's rights and duties with respect to the partnership and its property generally come to an end on dissociation. Thus, when a partner dissociates, either rightfully or wrongfully, the following apply [*Corp. Code § 16603*]:

- The partner's right to participate in the management and conduct of the business terminates.

- The partner's duty to refrain from competing with the partnership terminates [*see Corp. Code § 16404(b)(3)*].

- Only with respect to matters arising and events occurring before the partner's dissociation, the partner's duties of loyalty and care as to the conduct or winding up of the partnership business are generally continued. This means, for example, that a dissociated partner could not assist a person with a claim against the partnership that arose before the partner's dissociation; nor could a dissociated partner make any recklessly false accusation against a partnership with respect to a transaction occurring before dissociation [*see Corp. Code § 16404(b)* (duties of loyalty and care); *see also § 15.17[4]*].

[i] Liability of Dissociated Partners

[i] When Discharged

A partner's dissociation does not of itself discharge that partner's liability for a partnership obligation incurred before dissociation [*Corp. Code § 16703(a)*]. It is common, however, for buyout agreements to indemnify a partner against past and future partnership liabilities, as does the agreement in this form. UPA '94 expressly requires, absent a contrary understanding among the partners, that a dissociating partner be indemnified against all partnership liabilities no matter when incurred, other than those liabilities incurred by the partnership as a result of the *act of the dissociated partner* within two years after dissociation [*see Corp. Code § 16701(d)* (buyout provisions); *see also Corp. Code § 16702* (partnership obligation incurred by dissociated partner)]. Furthermore, if the partnership is liable for an act of the dissociated partner within the two-year period, that partner is liable to the partnership for any damages arising out of the obligation the partner incurred [*Corp. Code § 16702(b)*].

A dissociated partner ordinarily is not liable for a partnership obligation incurred after dissociation [*Corp. Code § 16703(a)*]. If all of the following are true, however, a dissociating partner will be liable to third parties for transactions entered into by the partnership within two years after the partner's dissociation [*Corp. Code § 16703(b)*]:

- The other party reasonably believes that the dissociated partner was a partner, and

- The other party had no notice of the partner's dissociation, and

- The other party is not deemed to have knowledge or notice of the partner's dissociation [*see Corp. Code §§ 16303(e), 16704(c)*].

[ii] Statement of Dissociation

Avoiding a two-year overhang of liability is accomplished by notifying partnership creditors by letter, and by giving constructive notice by filing and, as appropriate, recording a statement of dissociation. This form provides that the partnership will file, and if necessary, record the statement, and provide a copy--as it is required to do--to the dissociating partner [*Corp. Code §§ 16105(e), 16704*]. For a form for the statement of dissociation, see *§ 15.530*.

[2] FORM

Agreement for Buyout of Dissociating Partner's Interest in Partnership

BUYOUT AGREEMENT

Between

_____ [*Name of partnership*],

and

_____ [*Name of dissociating partner*]

_____[*Name of partnership*], and _____[*name of dissociating partner*] agree as follows:

ARTICLE 1 RECITALS

Partnership

1.01. _____[*Name of partnership*] (hereinafter "the Partnership") is a California general partnership having a principal place of at _____[*street address, city, and state*]. _____[*Name of dissociating partner*] is a partner in _____[*name of partnership*] and resides at _____[*street address, city, and state*].

Partnership Agreement

1.02. The parties entered into the Partnership and have continued in the Partnership under the provisions of [an oral *or* a written] agreement made on _____[*date*]. [A copy of that agreement is attached as Exhibit _____.]

Dissociation of Partner

[*Specify reason for dissociation, e.g.:*]

1.03. _____[*Name of dissociating partner*] has notified the Partnership that _____[he

or she *or* it] desires to retire and dissociate from the Partnership on _____[date]. The parties enter this Agreement for the purpose of the buyout of _____'s [*name of dissociating partner*] interest in the Partnership.

ARTICLE 2 DISSOCIATION

Effective Date

2.01. The parties agree that _____[*name of dissociating partner*] is dissociated from the Partnership effective at the close of business on _____[*date*] ("the dissociation date"), after which date _____[*name of dissociating partner*] shall:

(a) Have no authority to enter any obligation on behalf of the partnership.

(b) Have no right to participate in the management and conduct of the Partnership's business.

(c) Be relieved of the duty of loyalty and care to the Partnership and the partners therein with respect to any matter arising after _____ [his *or* her *or* its] dissociation.

Statement of Dissociation

2.02. The partnership shall prepare a statement of dissociation stating that _____[*name of dissociating partner*] is dissociated from the partnership on the dissociation date and shall file the statement in the office of the Secretary of State [*add if appropriate:* and record a certified copy of the statement in the county recorder's office in each county where the Partnership owns real property]. Immediately after filing, the partnership shall provide a copy of the statement of dissociation certified by the Secretary of State to _____[*name of dissociating partner*].

ARTICLE 3 TERMS OF BUYOUT

Price

3.01. Within _____ days of the date of dissociation, _____[*name of dissociating partner*] shall receive, in cash, the amount that would have been distributable to [him *or* her *or* it] in settlement of _____[his *or* her *or* its] interest in the Partnership if, on the date of dissociation, the assets of the Partnership were sold at price equal to the greater of either (1) the Partnership's liquidation value or (2) the value of the Partnership were its entire business sold as a going concern (without _____[*name of dissociating partner*] as a partner), and the Partnership wound up as of that date (hereinafter "the buyout price"). Interest shall be paid from the dissociation date [*either:* at the rate of _____percent *or* at the rate that is specified in *Civil Code Section 3289*]. Payment of the buyout price by or on behalf of the Partnership shall be in full satisfaction of the Partnership's obligation to purchase _____'s [*name of dissociating partner*] interest in the Partnership.

Offsets

3.02. Any amounts owed by _____[*name of dissociating partner*] to the Partnership shall be deducted from the buyout price determined in accordance with Paragraph 3.01.

Indemnification

3.03. The Partnership shall indemnify and hold harmless _____[*name of dissociating partner*] against all Partnership liabilities whether incurred before or after the dissociation date. Indemnification shall not extend, however, to any Partnership liability incurred after the dissociation date that results from _____[*name of dissociating partner*] entering a transaction with a third party under the circumstances specified in *Corporations Code Section 16702*.

[*Optional*]

Noncompetition Agreement

3.06. In consideration of the payment of the buyout price, _____[*name of dissociating partner*] agrees that after the dissociation date _____[he *or* she *or* it] shall not, either directly or indirectly, carry on or engage in, either as an owner, part-owner, manager, operator, employee, salesman, agent, or other participant, a business similar to that carried on by the Partnership in _____[*specify, e.g.,* _____County, California,] for so long as the Partnership, or any person deriving title to the goodwill of the business from the Partnership, carries on a like business in that county.

ARTICLE 4 DISCLOSURE

Access to Partnership Books and Records

4.01. Until payment of the buyout price in accordance with Paragraph 3.01 is made, and thereafter for so long as is reasonably necessary, the Partnership shall provide _____[*name of dissociating partner*], or _____[his *or* her *or* its] legal representative, access to books and records pertaining to the period during which _____[he *or* she *or* it] was a partner. This right of access shall include the opportunity to inspect and copy books and records during ordinary business hours. The Partnership may impose a reasonable charge covering the cost of labor and material for copies furnished.

Supporting Documents

4.02. The partnership shall furnish _____[*name of dissociating partner*] with the following documents within _____ days of the date of this Agreement:

(a) A statement of partnership assets and liabilities as of the date of dissociation;

(b) The latest available partnership balance sheet and income statement, if any; and

(c) An explanation of how the amount of the buyout price for _____'s [*name of dissociating partner*] interest was calculated.

ARTICLE 5 EXECUTION AND ENFORCEMENT

Counterparts

5.01. This Agreement may be executed in any number of counterparts, and each counterpart shall be deemed to be an original instrument.

Applicable Law

5.02. This Agreement shall be construed under and in accordance with the laws of the State of California.

Other Instruments

5.03. The parties covenant and agree that they will execute any other and further instruments and documents that are or may become necessary or convenient to effectuate and carry out this Agreement.

Headings

5.04. The headings used in this Agreement are used for administrative purposes only and do not constitute substantive matter to be considered in construing the terms of this Agreement.

Severability

5.05. In case any one or more of the provisions contained in this Agreement shall for any reason be held to be invalid, illegal, or unenforceable in any respect, that invalidity, illegality, or unenforceability shall not affect any other provision and this Agreement shall be construed as if the invalid, illegal, or unenforceable provision had never been part of the Agreement.

Prior Agreements Superseded

5.06. This Agreement supersedes any prior understandings or written or oral agreements between the parties respecting the within subject matter, including the Partnership Agreement attached as Exhibit _____ to the extent that it may conflict with any of the provisions contained in this Agreement.

Survival of Representations and Warranties

5.07. The representations and warranties set forth in this Agreement are continuous and survive the payment of the buyout price.

Successors and Assigns

5.08. This Agreement shall inure to the benefit of and bind the successors, assigns, heirs, executors, and administrators of the parties.

Executed on _____[*date*], at _____[*city*], California.

FOR THE PARTNERSHIP

_____ [*signature*], Partner
[*typed name*]
_____ [*signature*], Partner
[*typed name*]
DISSOCIATING PARTNER
_____ [*signature*]
[*typed name*]

[*For acknowledgment and spousal consent form, see § 15.500[2]*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
B. Sale of Partnership Interests
1. Sale of Interest to Continuing Partners

7-15 California Legal Forms--Transaction Guide § 15.511

§ 15.511 Notice to Accompany Payment for Dissociating Partner's Interest

[1] Comment

[a] Use of Form

This form is a notice that will accompany cash payment of the estimated amount due a dissociating partner for the partner's interest in the partnership. It will only be needed if there is no provision in the partnership agreement that covers purchase of a dissociating partner's interest, and 120 days of fruitless negotiations have passed since the partnership received a written demand for payment [*Corp. Code § 16701(e)*].

[b] Buyout Formula

The amount of cash payment that will accompany this notice is calculated under the UPA '94 buyout formula. It is the amount the partner would receive as surplus on dissolution and winding up, i.e., after creditors have been paid and accounts settled [*see Corp. Code § 16807*], if, on the date of dissociation, the assets of the partnership were sold at a price equal to the greater of (1) the liquidation value or (2) the value based on the sale of the entire business as a going concern (without the dissociated partner), and the partnership was wound up as of that date. Interest must be paid from the date of dissociation to the date of payment [*Corp. Code § 16701(b)*]. The interest rate under UPA '94 (unless the parties agree otherwise) is that specified in *Civ. Code § 3289* [*Corp. Code § 16104(b)*]. Damages for wrongful dissociation and any other amounts owed the partnership by the dissociating partner must be offset against the buyout price, with interest from the date the amount owed is due until the date of payment [*Corp. Code § 16701(c)*].

[c] No Buyout Within 90 Days of Dissolution

The buyout requirements do not apply to a partner who dissociates within 90 days before the partnership's dissolution. Instead, such a partner would be treated as any other partner and would have to wait for the winding up of the partnership, with the amount distributable to that partner taking into account any amounts owed by the partner to the

partnership, including damages for wrongful dissociation [*Corp. Code § 16701.5*].

[d] Tender to Wrongfully Dissociating Partners

If the partner has wrongfully dissociated from a partnership for a definite term or particular purpose [*see Corp. Code § 16602(b)(2)*; *see also § 15.302[2]*], the buyout of that partner will be deferred until the expiration of the term or completion of the undertaking unless the partner establishes to the satisfaction of a court that earlier payment will not cause undue hardship to the business of the partnership. If the payment is deferred, it must be adequately secured and bear interest [*Corp. Code § 16701(h)*], and the partnership may tender a written offer to pay the estimated amount of the deferred buyout price, with interest but reduced by offsets, stating the time payment, type of security, and the other terms and conditions of the obligation [*Corp. Code § 16701(f)*]. In the event a tender of the deferred buyout price is to made, this form can be modified with respect to the term of payment to reflect the fact that the dissociating partner is not entitled to cash until the partnership term expires and to specify the amount and type of security offered for that payment.

[e] Contents of Notice

The notice must contain all of the following [*Corp. Code § 16701(g)*]:

- A statement of partnership assets and liabilities as of the date of dissociation;
- The latest available partnership balance sheet and income statement, if any;
- An explanation of how the estimated amount of the payment was calculated; and
- Written notice that the payment is in full satisfaction of the obligation to purchase unless, within 120 days after the written notice, the dissociated partner commences an action to determine the buyout price and any offsets or other terms of the obligation to purchase.

[f] Court Action to Determine Buyout Price

Partners who have dissociated may maintain an action against the partnership to determine the buyout price of their interests, including any offsets or other terms of the obligation to purchase. The action must be commenced within 120 days after the partnership has tendered payment or an offer to pay, or within one year after written demand for payment if the partnership has not paid or tendered an offer of payment. The court must determine the buyout price, offsets, and accrued interest and enter a judgment for any additional payment or refund. The court must also determine the security for payment and other terms of the obligation in the case of a deferred payment to a wrongfully dissociating partner [*Corp. Code § 16701(i)*].

The court may assess reasonable attorneys' fees and the fees and expenses of appraisers or experts against a party that the court finds acted arbitrarily, vexatiously, or not in good faith. That finding may be based on the partnership's failure to tender payment or an offer to pay or to furnish the statement [*see* [e], *above*] that must accompany an offer to pay or tender of payment [*Corp. Code § 16701(i)*].

[2] FORM

Notice to Accompany Payment for Dissociating Partner's Interest

NOTICE OF BUYOUT AND ESTIMATED PAYMENT FOR PARTNERSHIP INTEREST

_____ [*Name and address of partner*]

This notice is pursuant to *Section 16701 of the California Corporations Code*.

Your written demand for payment for your interest in _____[*name of partnership*], a California partnership from which you dissociated on _____[*date*], was received on _____[*date*]. Since that date, no agreement has been reached between you and _____[*name of partnership*] concerning the partnership's purchase of your partnership interest.

The cash payment enclosed with this notice represents the partnership's estimate of the amount due to you for your partnership interest, plus accrued interest since the date of your dissociation, and less any offsets representing amounts that you owe the partnership.

Attached to and made a part of this notice are the following:

(1) A statement of the assets and liabilities of

_____ [*name of partnership*] as of the date of your dissociation.

(2) The latest available partnership balance sheet and income statement dated

_____ .

(3) An explanation of the calculation used to arrive at the amount of payment for your interest in the partnership.

The enclosed payment is in full satisfaction of _____'s [*name of partnership*] obligation to purchase your interest in the partnership under California law, unless, within 120 days of the date of this notice you have commenced legal action to determine the buyout price for your partnership interest.
Dated: _____.

_____ [*name of partnership*]
By:
_____ [*signature of partner*]
[*typed name*]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
B. Sale of Partnership Interests
1. Sale of Interest to Continuing Partners

7-15 California Legal Forms--Transaction Guide §§ 15.512-15.519

[Reserved]

§§ 15.512[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
B. Sale of Partnership Interests
2. Sale of Partnership to Third Party

7-15 California Legal Forms--Transaction Guide § 15.520

§ 15.520 Agreement for Sale of Partnership Interest to Corporation

[1] Comment

[a] Use of Form

This form is an agreement for sale of all the partners' partnership interests to a corporation. After the decision is made to dissolve a partnership, the partners often will desire to sell all of the partnership assets, pay the liabilities, and distribute any excess. However, they may find that the assets can be disposed of more readily and at a higher price if sold together as a business or going concern rather than separately.

PRACTICE TIP:

Often the value of the partnership as a going concern will depend on the continued involvement of one or more partners as employees or consultants with the acquiring entity. Care should be taken to ensure that the sale valuation and purchase price fairly reflect the business valuation. An unfair discount on the business valuation and unfair premium on an employment or consulting contract may result in a violation of the fiduciary duties the partners owe to one another. *Commentary by John J. Camozzi.*

This agreement is drafted with provisions that favor the purchaser. An attorney representing the seller should modify the agreement for the seller's benefit.

For further coverage of the applicable law and the procedures for the sale of a partnership business, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

[b] Structure of Sale for Tax Purposes

The sale of a partnership business can either be structured as the sale of partnership interests or as the sale of partnership assets. If the sale is of the partnership interests, then the transaction is treated as the sale of a capital asset, except for

unrealized receivables and inventory items which result in ordinary income [*I.R.C. §§ 741, 751*]. If the sale is of partnership assets, then the proceeds are taxable according to the character of the assets [*I.R.C. § 702*].

This form provides for the sale of the partnership interests. To avoid misunderstanding, the agreement should clearly state that the transaction is the sale of partnership interests, rather than assets, even though the courts will look at the substance of the transaction and not the form. An agreement speaking only of partnership assets may be held to be a sale of partnership interests if all of the partnership business is conveyed [*Barran v. Commissioner of Int. Rev. (5th Cir. 1964) 334 F.2d 58, 64-65*]. On the other hand, a transaction structured as a sale of partnership interests may be held to be a sale of the assets, if it is substantially a sale of the assets, especially when the partnership has substantially completed its business activities [*see Rev. Rul. 72-172, 1972-1 C.B. 265* ; *see also Haggard v. Wood (9th Cir. 1961) 298 F.2d 24, 27]* .

The tax treatment of the purchaser is not so dependent on whether the transaction is structured as a purchase of partnership interests or partnership assets. The purchaser may be treated as acquiring partnership assets directly by purchase even if the transaction is structured as the purchase of partnership interests [*see McCauslen v. Commissioner (1966) 45 T.C. 588, 589-590]* . Therefore, this form provides for the allocation of the purchase price among the assets of the partnership.

The allocation of the total purchase price among assets may require extensive negotiations. For instance, recapture on depreciation previously taken by the partnership on certain assets may be ordinary income to it at the time of the sale [*I.R.C. §§ 1245, 1250*], and the partners will attempt to allocate as small a portion of the sales price to these assets as possible. The buyer, however, will want as much of the purchase price as possible allocated to the depreciable property since its subsequent depreciation on these assets depends on its cost basis in these assets [*I.R.C. § 167*].

The partners will want a large portion of the purchase price allocated to goodwill since it will result in capital gain to the partnership [*see I.R.C. § 741*]. However, the buyer may want to avoid the allocation to goodwill because goodwill may only be amortized over a 15-year period [*I.R.C. § 197(a)*]. The partners will try to avoid allocation of the purchase price to inventories because gain on the sale of inventory is ordinary income to the partnership, but the buyer will want a large allocation to inventory because a large allocation will increase its basis in these assets and will lower the amount of ordinary income it receives on subsequent sales of such inventory [*I.R.C. § 751*].

The buyer will also want to allocate a portion of the purchase price to a covenant not to compete since it can be deducted over the period of the covenant; the sellers will want to avoid such an allocation since it will be ordinary income to them [*see Barran v. Commissioner of Int. Rev. (5th Cir. 1964) 334 F.2d 58, 61-64* ; *see* Ch. 17, *Buying and Selling a Business or Professional Practice* (covenants not to compete)].

If the allocation of purchase price is done on an "arm's length" basis with parties having adverse interests, it should stand up for tax purposes [*see Treas. Reg. § 1.736-1(b)(1)*]. Obviously, attempts should not be made to allocate unreasonably the purchase price among assets in a way which does not at all reflect the true relative values of those assets.

[2] FORM

Agreement for Sale of Partnership Interest to Corporation

AGREEMENT FOR SALE OF PARTNERSHIP ASSETS

Between

_____ [*Names of partners*],

and

_____ [*Name of buyer*]

_____[*Name of partner*], who resides at _____[*address*], and _____[*name of partner*], who resides at _____[*address*], hereinafter collectively called Sellers and individually called Seller, and [*purchasing corporation*], a _____[*state of incorporation*] corporation, with its principal place of business at _____[*address*], hereinafter called Buyer, agree as follows:

ARTICLE 1 PLAN OF SALE

Plan

1.01. On the closing date, and subject to the performance of all conditions precedent contained herein:

(a) Sellers shall assign to Buyer all of their interest in their Partnership, subject to all of the liabilities of the Partnership.

(b) Except for costs and expenses incurred by Sellers in carrying out the provisions of this Agreement, Buyer will assume all of the liabilities of the Partnership at the closing date.

[*EITHER*]

(c) Buyer shall transfer to Sellers [*number*] shares of common stock [*or specify other security as appropriate*], each of $ _____ par value, of Buyer.

[*OR*]

(c) For and in consideration of the transfer of the Partnership interests, Buyer agrees to pay and deliver to Sellers, at closing, a bank cashier's check in the amount of $ _____.

[*CONTINUE*]

(d) Sellers will dissolve their Partnership, liquidate the Partnership affairs, and distribute to themselves in proportion to their respective interests in the Partnership the stock of Buyer received in the transaction.

Closing Date

1.02. The closing under this Agreement shall take place at the hour of [*time*] on _____[*date*], at _____[*office, street address, city, and state*], or at such other time and place as Sellers and Buyer shall

fix by agreement in writing. The date and time of closing constitute the closing date referred to in this Agreement.

ARTICLE 2 COVENANTS, REPRESENTATIONS, AND WARRANTIES OF SELLERS

Existence of Partnership

2.01. [*first partner*], residing at _____[*street address, city, and state*], and [*second partner*], residing at _____[*street address, city, and state*], have been and now are Partners doing business under the firm name of _____, hereinafter referred to as "the Partnership," with principal place of business at _____[*street address, city, county, and state*]. Sellers entered into and have continued in the Partnership under the provisions of [an oral *or* a written] agreement made on _____. [A copy of that agreement is attached as Exhibit _____.] Sellers represent and warrant that no other person or entity has any interest or claim of right to a partnership interest in the partnership.

Financial Statements

2.02. (a) There _____[are attached as Exhibits _____ through _____ *or* have been delivered previously to Buyer] the [audited *or* unaudited] balance sheet of the Partnership as of _____[*date*], and the related statements of income for the [*e.g.,* five] years then ended. All such financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and present fairly the financial position of the Partnership on _____[*date*], and the results of operations for the period then ended [*add if statements are unaudited:* subject, however, to normal changes resulting from year-end audit of the financial statements].

(b) The book values of the assets shown on that balance sheet correspond substantially to the values of those assets for federal income tax purposes.

Schedules Furnished

2.03. Sellers have delivered to Buyer the schedules enumerated below. To the extent that any such schedule identifies any contract, agreement, or other instrument in general terms in lieu of specific descriptions, the schedule will be supplemented by setting forth any specific descriptions that Buyer may request. If after the date of this Agreement there shall be any change in the matters reflected in any such schedule, Sellers will deliver to Buyer before the closing date appropriate supplements to the schedule so affected, making all deletions, modifications, and additions that may be required in order that Buyer shall have received currently complete and correct information as to the matters to be reflected in each such schedule.

Restrictions on Transfer of Properties

(a) Schedule 1: This schedule lists any of the assets, the transfer of which as herein contemplated is subject to any restriction, or which requires the consent of any third party, pursuant to a preferential or other right of purchase or otherwise, and describes in detail each such restriction, consent requirement, or purchase right.

Certain Material Contracts

(b) Schedule 2: This schedule lists all agreements, contracts, and other instruments, to the extent not listed in any other

schedule, not cancelable by Sellers on [*e.g.*, 90 days'] notice without penalty, which involve a payment or payments to be made by or to Sellers, or a liability or liabilities of or to Sellers, in excess of $ _____ in any year.

Pending Litigation

(c) Schedule 3: This schedule lists all litigation and proceedings pending or threatened in courts and governmental commissions and bureaus affecting the assets or Sellers' right to convey them.

Insurance

(d) Schedule 4: This schedule lists all fire, liability, and other insurance now in effect with respect to any of the assets of Sellers.

Guarantees

(e) Schedule 5: This schedule lists all indebtedness or liabilities of any person, firm, or corporation that Sellers have guaranteed or otherwise become liable for, absolutely or contingently.

Employment and Deferred Compensation Contracts

(f) Schedule 6: This schedule lists all employment, deferred compensation, and similar contracts by which Sellers are bound.

Title to, Condition, and Location of Assets

2.04. (a) Except as follows, Sellers have, and on the closing date will have, good and marketable title to all of the assets reflected as being owned by them on the balance sheet as of _____[*date*], and to all assets thereafter acquired, free and clear of all mortgages, liens, pledges, charges, or encumbrances of any nature:

(1) The lien of current taxes not yet due and payable.

(2) Minor exceptions, not in the aggregate material.

(3) Imperfections of title or easements that do not materially detract from or interfere with the operations, value, or use of the assets subject thereto or affected thereby, or materially affect title thereto.

(4) Liens, charges, or encumbrances set forth in the balance sheet.

(b) All leases included among the assets or to which any of the assets are subject, are in good standing, valid, and effective and, to the best of Sellers' knowledge, information, and belief after reasonable investigation by Sellers, there is not, under any of those leases, any existing material default, event of default, or event which with notice or lapse of time or both would constitute a material default.

(c) The plant and equipment included among the assets are in good operating condition and repair, subject only to ordinary wear and tear.

(d) Except as set forth in Schedule 1, there exists no restriction on the right of Sellers to assign and transfer all of the assets and convey good title, as contemplated by this Agreement.

(e) All of the assets are in the possession of Sellers and are located at _____[*street address, city, and state*].

No Material Change

2.05. Since _____[*date*], except as previously disclosed to buyer in writing, Sellers have not

(a) Suffered any change in their financial condition or the operations of their business, materially and adversely affecting the assets, or the earning power thereof, nor suffered any damage, destruction, or loss, whether covered by insurance or not, materially and adversely affecting the assets or the earning power thereof.

(b) Sold, exchanged, or otherwise disposed of, or entered into any agreement or arrangement to sell, exchange, or otherwise dispose of any of the assets of any interest therein.

(c) Except to the extent reflected on the balance sheet as of _____[*date*], incurred or agreed to incur any contractual liability, absolute or contingent, with respect to the assets.

(d) Waived any right or claim having value relating to the assets.

(e) Mortgaged or pledged any of the assets, or except in the ordinary course of business, subjected any to a lien, charge, or other encumbrance.

(f) Entered into any transaction the effect of which, considered as a whole, would be to cause their net ownership in any of the assets to be materially less than it was at that date.

(g) Had any labor troubles, other than routine grievance matters none of which is material.

(h) Entered into any transaction other than in the ordinary course of business with respect to the assets.

Compliance With Laws and Regulations

2.06. Sellers have complied with all laws, regulations, and orders applicable to their business.

No Default

2.07. Sellers have not received any notice of default and to their knowledge they are not in default under

(a) Any order, writ, injunction, or decree of any court or of any commission or other administrative agency.

(b) Any agreement or obligation to which they are parties, by which they are bound, or to which they may be subject.

Agreement Not Violative of Law or Contract

2.08. The execution and carrying out of this Agreement and compliance with the provisions of this Agreement by

Sellers will not violate, with or without the giving of notice or passage of time, any provision of law applicable to Sellers, and will not conflict with, or result in the breach or termination of any provision of, or constitute a default under, or result in the creation of any lien, charge, or encumbrance upon any of the assets, pursuant to any indenture, mortgage, deed of trust, or other agreement or instrument to which Sellers are parties or by which Sellers or any of their assets are bound.

Compliance With Contracts and Commitments

2.09. Except as set forth in Schedule 2, Sellers have no contract or commitment, written or oral, that relates to any of the assets. Sellers have duly complied with all provisions of each contract or commitment set forth in Schedule 2, and are not in default with respect to any of them.

Litigation

2.10. Except for any claims fully covered by insurance and except as set forth in Schedule 3, there is no litigation, proceeding, or governmental investigation pending, or to the knowledge of Sellers threatened, affecting Sellers or any of the assets, or Sellers' right to enter into this Agreement or to perform their obligations hereunder, nor do Sellers know of any ground for any such litigation, proceeding, or investigation.

Insurance

2.11. Sellers now have in force fire, liability, and other insurance with respect to their assets as set forth in Schedule 4, and Sellers agree that pending the closing date, except in accordance with the written approval of the Buyer, they will not change, increase, or decrease any such insurance.

Comply With Terms and Conditions

2.12. Sellers shall comply with all applicable terms and conditions of this Agreement.

Furnish Information for Proxy or Listing

2.13. Sellers shall deliver to Buyer such information as shall be needed for use in any proxy statement or listing application that Buyer may require or deem desirable in order to consummate the transactions contemplated by this Agreement.

ARTICLE 3 COVENANTS, REPRESENTATIONS, AND WARRANTIES OF BUYER

Legal Status

3.01. Buyer is a corporation duly organized, validly existing, and in good standing under the laws of _____[the State of California *or specify other state as appropriate*], with corporate power to carry on its business as it is now being conducted.

Capitalization

3.02. Buyer has an authorized capitalization of $ _____, divided into _____ shares of common stock of _____[*either:* the par value of $ _____ per share *or* no par value]. As of the date of this Agreement, [*number*] shares of the common stock are validly issued and outstanding, fully paid, and nonassessable.

Financial Statements

3.03. (a) There _____[are attached as Exhibits _____through _____ *or* have been delivered previously to Sellers] the [audited *or* unaudited] balance sheet of Buyer as of _____[*date*], and the related statements of income and retained earnings for the [*e.g.*, five] years then ended. All such financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and present fairly the financial position of Sellers on _____[*date*], and the results of operations for the period then ended [*add if statements are unaudited:*, subject, however to normal changes from year-end audit of the financial statements].

(b) The book values of the assets shown on said balance sheet correspond substantially to the values of such assets for federal income tax purposes.

Title to Assets

3.04. (a) Except as follows, Buyer has, and on the closing date will have, good and marketable title to all of the assets reflected as being owned by it on its balance sheet as of _____[*date*], free and clear of all mortgages, liens, pledges, charges, or encumbrances of any nature:

(1) The lien of current taxes not yet due and payable.

(2) Minor exceptions, not in the aggregate material.

(3) Such imperfections of title or easements as do not materially detract from or interfere with the operations, value, or use of the assets subject thereto or affected thereby, or materially affect title thereto.

(b) All leases included among the assets or to which any of the assets are subject, are in good standing, valid and effective and, to the best of Buyer's knowledge, information, and belief after reasonable investigation by Buyer, there is not, under any of such leases, any existing material default, event of default, or event which with notice or lapse of time or both would constitute a material default.

No Material Change

3.05. Since _____[*date*], except as previously disclosed to Sellers in writing, Buyer has not

(a) Suffered any material adverse change in its financial condition or the operation of its business, nor suffered any damage, destruction or loss, whether covered by insurance or not, materially and adversely affecting its assets or the earning power thereof.

(b) Except in the ordinary course of business, sold, exchanged, or otherwise disposed of, or entered into any agreement or arrangement to sell, exchange, or otherwise dispose of any of its assets, or rights or interest therein.

Litigation

3.06. There is no action, proceeding, or governmental investigation pending, or, to the knowledge of Buyer, threatened against, by, or affecting Buyer in any court or before any governmental agency, domestic or foreign, which, if decided adversely to Buyer, would materially and adversely affect the condition or operations, financial or otherwise, of Buyer. Buyer, to its knowledge, is not in default with respect to any order, writ, injunction, or decree of any such court or agency.

Approval by Board

3.07. The Board of Directors of Buyer has duly approved the transactions contemplated hereby and has authorized the execution and delivery of this Agreement and the performance thereof of Buyer.

[*Use following section if payment is in shares of buyer's stock:*]

Status of Shares to be Delivered

3.08. The shares of common stock of Buyer deliverable pursuant to this Agreement, when issued and delivered as provided in this Agreement, will be validly issued and outstanding shares of common stock of Buyer, fully paid and nonassessable, and will be voting stock of Buyer.

ARTICLE 4 CONDUCT OF BUSINESS OF SELLERS PENDING CLOSING

Access to Information and Documents

4.01. From the date of this Agreement until the closing date, Sellers shall give to Buyer full access, during normal business hours, to all properties, books, records, contracts, and commitments of Sellers, and shall furnish to Buyer, within 10 days after demand, all such documents and copies of documents, schedules of assets and liabilities, and other information with reference to the affairs of Sellers as Buyer may from time to time reasonably request.

Carry on Business as Usual

4.02. Pending consummation of the sale, Sellers shall

(a) Carry on their business in substantially the same manner as before.

(b) Use their best efforts to maintain their business organization intact, to retain their present employees, and to maintain their relationships with suppliers and others having business relationships with them.

(c) Maintain in full force insurance coverage comparable in amount and scope of coverage to that now maintained by them and, to the extent requested by Buyer, cause all policies of insurance and bonds to be endorsed to include Buyer as a party insured or beneficiary thereunder as its interest may appear.

(d) Exercise due diligence in safeguarding and maintaining confidential reports and data on their business.

Satisfy Conditions Precedent

4.03. Sellers shall use their best efforts to cause the satisfaction of all conditions precedent contained in this Agreement.

Negative Covenants

4.04. From the date of this Agreement until the closing date, except with the prior written consent of Buyer, Sellers shall not

(a) Except in the ordinary course of business and consistent with prior practice, grant any general or uniform increase in rates of pay to employees, or any substantial increase in salary, employment, or retirement benefits to any officer, employee, or agent.

(b) Enter into any employment contracts, bonus arrangements, pension plan, profit-sharing plan, or any other incentive or deferred compensation contracts.

(c) Waive any of their rights or claims having material value.

(d) Enter into any transaction outside the ordinary course of business.

ARTICLE 5 CONDUCT OF BUSINESS OF BUYER PENDING CLOSING

Carry on Business as Usual

5.01. Pending consummation of the sale, buyer shall carry on its business in substantially the same manner as before.

Satisfy Conditions Precedent

5.02. Buyer shall use its best efforts to cause the satisfaction of all conditions precedent contained in this Agreement.

Negative Covenants

5.03. From the date of this Agreement until the closing date, except with the prior written consent of Sellers, Buyer shall not

(a) Amend its articles of incorporation.

(b) Issue, sell, or acquire for value any shares of its stock, or adopt any stock option plan.

(c) Declare or pay any dividend or declare or make any distribution to its shareholders.

ARTICLE 6 CONDITIONS PRECEDENT TO OBLIGATIONS OF PARTIES TO CLOSE

Conditions Precedent to Obligations of Sellers

6.01. The obligations of the Sellers under this Agreement are, at their option, subject to the conditions that, on or before the closing date,

Approval of Proceedings and Instruments

(a) All actions, proceedings, instruments, and documents required to carry out this Agreement or incidental thereto and all other related legal matters shall have been approved by _____[*name*], counsel to Sellers.

Opinion of Counsel to Buyer

(b) Sellers shall have received the opinion of _____[*name*], counsel to Buyer, dated on the closing date, in form satisfactory to Sellers and their counsel, to the effect that

(1) Buyer is a corporation duly organized, validly existing, and in good standing under the laws of the State of _____ [California *or specify other as appropriate*].

(2) All corporate acts and other proceedings required to be taken by or on the part of the Buyer to authorize it to carry out this Agreement and to deliver the shares of stock of Buyer deliverable as provided herein have been duly and properly taken, and this Agreement has been duly executed by Buyer and is the valid and binding obligation of Buyer enforceable in accordance with its terms.

(3) The shares of common stock of Buyer will, on delivery of the certificate representing those shares in accordance with the terms of this Agreement, be duly and validly issued, fully paid and nonassessable.

(4) There is no action, proceeding, or governmental investigation pending, or, to the knowledge of counsel, threatened against, by, or affecting Buyer in any court or before any governmental agency, domestic or foreign, which, if decided adversely to Buyer, would materially and adversely affect the condition or operations, financial or otherwise, of Buyer, and that Buyer, to the knowledge of counsel, is not in default with respect to any order, writ, injunction, or decree of any such court or agency.

(5) There is no provision of the articles of incorporation or bylaws of Buyer or of any indenture, mortgage, or other agreement, known to such counsel, on the basis of an appropriate certificate known to Buyer, which prevents the Buyer from issuing and delivering to Sellers good title to all of the shares of common stock of Buyer being delivered pursuant to the terms of this Agreement.

Compliance With Terms and Conditions

(c) Buyer shall have fully complied with all of the terms and conditions of this Agreement to be complied with by it on or before the closing date, and Buyer shall have delivered a certificate to Sellers to that effect.

Correctness of Representations and Warranties

(d) The representations and warranties made by Buyer shall be correct, as of the closing date, with the same force as though those representations and warranties had been made on the closing date, and Buyer shall have delivered a certificate signed by its chief executive officer to the Seller to that effect and as to any other matters that the Seller may reasonably request.

[*Use if payment is in shares of buyer's stock:*]

Listing of Stock

(e) The shares of common stock of Buyer to be delivered to Sellers pursuant to this Agreement shall have been listed on the _____[*name of stock exchange*], subject to official notice of issuance or distribution or other formal condition.

Conditions Precedent to Obligations of Buyer

6.02. The obligations of the Buyer hereunder are, at its option, subject to the conditions that, on or before the closing date,

Approval of Proceedings and Instruments

(a) All actions, proceedings, instruments, and documents required to carry out this Agreement or incidental thereto and all other related legal matters shall have been approved by _____, counsel to Buyer.

Opinion of Counsel to Sellers

(b) Buyer shall have received the opinion of _____, counsel to Sellers, dated the closing date, in form and substance satisfactory to the Buyer and its counsel, to the effect that

(1) Sellers are Partners doing business under the firm name of _____, with principal place of business at _____ [*street address, city, county, and state*], pursuant to the provisions of an agreement in writing dated _____ [*date*], a copy of which is attached to this Agreement as Exhibit _____.

(2) To the knowledge of counsel, Sellers have complied with all laws, regulations, and orders applicable to their business.

(3) To the knowledge of counsel, Sellers have not received any notice of default and are not in default under any order, writ, injunction, or decree of any court, commission, or other administrative agency, or under any agreement or obligation to which they are parties or by which they are bound or to which they may be subject.

(4) To the knowledge of counsel, except as set forth in Schedule 2, Sellers have no contract or commitment, written or oral, that relates to any of the assets, and Sellers have duly complied with all provisions of each such contract or commitment set forth in Schedule 2 and is not in default with respect to any of them.

(5) To the knowledge of counsel, there is no action, proceeding, or governmental investigation pending or threatened against, by, or affecting Sellers in any court or before any governmental agency, domestic or foreign, which, if decided adversely to Sellers, would materially and adversely affect the condition or operations, financial or otherwise, of Sellers.

(6) This Agreement has been duly executed by Sellers and is the valid and binding obligation of Sellers enforceable in accordance with its terms.

(7) There is no provision of any indenture, mortgage, or other agreement known to counsel, or on the basis of an appropriate certificate, known to Sellers, that prevents Sellers from transferring good title to the assets in the manner contemplated by this Agreement or has or will result in a breach of the Sellers' warranties contained in Section 2.08.

(8) Except as set forth in the balance sheet as of _____ [*date*], good and marketable title to all of the assets of Sellers to be transferred has been duly vested in Buyer, free of all claims, liens, and encumbrances.

Compliance With Terms and Conditions

(c) Sellers shall have complied with all of the terms and conditions of this Agreement to be complied with by them, and shall have delivered a certificate to Buyer to that effect.

Correctness of Representations and Warranties

(d) The representations and warranties made by Sellers shall be correct, as of the closing date, with the same force as if those representations and warranties had been made on the closing date, and Sellers shall have delivered a certificate to Buyer to that effect and as to any other matters that Buyer may reasonably request.

[*Add if payment is in shares of stock:*]

Listing of Stock

(e) The shares of common stock of Buyer to be delivered to Sellers pursuant hereto shall have been listed on the _____[*name of stock exchange*], subject to official notice of issuance or distribution or other formal condition.

ARTICLE 7 CONSUMMATION OF TRANSACTION

Consideration of Sellers

7.01. (a) On the closing date, except for cash in an amount, not exceeding $ _____, that Sellers deem necessary to pay all costs and expenses incurred by them in carrying out this Agreement, Sellers shall deliver to Buyer instruments of transfer, in the form satisfactory to counsel for Buyer, for all Sellers' assets, business, and goodwill of every kind and description, tangible or intangible, real, personal, or mixed.

(b) Sellers shall use the retained funds to pay only the costs and expenses incurred in carrying out this Agreement and shall pay over to Buyer at the expiration of a period of [*e.g.*, 120] days following the closing date any balance remaining.

(c) On the closing date, Sellers shall deliver to Buyer possession of the assets, business, and goodwill transferred to Buyer.

Consideration of Buyer

7.02. (a) On the closing date, Buyer shall deliver to Sellers a certificate or certificates representing

_____ shares of the common stock of Buyer, all of which shall be validly issued, fully paid, and nonassessable.

(b) On receipt of the assets of Sellers, except for costs and expenses of Sellers incurred in carrying out the terms and conditions of this Agreement, Buyer shall assume, pay, satisfy, perform, discharge, and indemnify and hold harmless Sellers against any loss, cost, claim, or demand of any kind arising out of or resulting from the debts, obligations, agreements, and liabilities of Sellers of every kind and description as the same exist on the closing date.

Cessation of Sellers' Business

7.03. After the closing date, except for such activities as may be incident to liquidation of the Partnership affairs, Sellers shall not carry on any further business activities as partners doing business as _____[*name of partnership*].

Noncompetition Agreement by Seller

7.04. In connection with the sale by Sellers to Buyer of the goodwill, Sellers agree that they shall not, either directly or indirectly, carry on or engage in, either as owners, part-owners, managers, operators, employees, salesmen, agents, or other participants, the business of _____[*specify type of business being sold*] in _____ County, California for so long as Buyer, or any person deriving title to the goodwill of the business from Buyer, carries on a like business in that county.

ARTICLE 8 EXECUTION AND ENFORCEMENT

Provide Additional Documents

8.01. Sellers shall provide Buyer with any additional consents, releases, authorizations, transfers, and other documents that may be reasonably required to carry out the provisions of the planned sale and to accomplish fully its purposes and intents.

Counterparts

8.02. This Agreement may be executed in any number of counterparts, and each such counterpart shall be deemed to be an original instrument.

Survival of Covenants, Representations, and Warranties

8.03. All covenants, representations, and warranties made under this Agreement and in any certificates delivered at the closing shall be deemed to be material and to have been relied upon by Sellers and Buyer, notwithstanding any investigation made by Sellers or Buyer or on their respective behalfs, and shall survive the closing.

Specific Performance

8.04. Sellers acknowledge that the assets to be transferred to Buyer pursuant to this Agreement are unique, and that Buyer will not have an adequate remedy at law if Sellers fail to perform any of their obligations hereunder. In that

event, Buyer shall have the right, in addition to all other rights and remedies, to specific performance of this Agreement.

Notices

8.05. Any notice, request, instruction, or other communication required or permitted hereunder shall be deemed to be properly given when deposited in the United States mails, postage prepaid, or when deposited with a public telegraph company for transmittal, charges prepaid, addressed as follows:

(a) In the case of Sellers, to _____[*name, street address, city, and state*].

(b) In the case of Buyer, to _____[*name, street address, city, and state*].

Nonassignability

8.06. Except with the written consent of the other, the rights and obligations under this Agreement shall not be assignable by any party. Nothing herein expressed or implied is intended to confer upon any person, other than the parties hereto or their respective successors, assigns, heirs, and legal representatives, any rights, remedies, obligations, or liabilities under or by reason of this Agreement.

Executed on _____[*date*], at _____[*city and state*].

SELLERS
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]
BUYER
[*typed name of corporation*]
By _____ [*signature*]
[*typed name and title*]
By _____ [*signature*]
[*typed name and title*]

[*For acknowledgment, see § 15.500[2]*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
B. Sale of Partnership Interests
2. Sale of Partnership to Third Party

7-15 California Legal Forms--Transaction Guide §§ 15.521-15.529

[Reserved]

§§ 15.521[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
C. Partnership Statements and Notices
1. Partnership Statements

7-15 California Legal Forms--Transaction Guide § 15.530

§ 15.530 Statement of Dissociation (GP-3)

[1] Comment

[a] Use of Form

This form is official Form GP-3, Statement of Dissociation [*see Corp. Code § 16704*]. It is available from any office of the California Secretary of State. The form may be filed and, if appropriate, recorded, by either a dissociating partner or the partnership when a partner has left the partnership for any reason. Its purpose is to protect the partnership and the dissociating partner against liability by giving constructive notice of the dissociation to third parties. At the same time, third parties can conclusively rely on filed statements to the extent that they are uncontradicted by later filed statements [*Corp. Code § 16303(d), (e)*]. However, the filing of a statement of dissociation requires the prior filing of a Statement of Partnership Authority [*see* Instructions to Form; *see also § 15.285*].

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 15.530. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Contents, Execution, and Filing

A statement of dissociation may be filed with the Secretary of State by the dissociating partner or the partnership, and must state the name of the partnership, any identification number issued by the Secretary of State, and that the partner is

dissociated [*Corp. Code § 16704(a)*].

A statement filed by a partnership must be executed by two partners who declare under penalty of perjury that the contents of the statement are accurate [*Corp. Code § 16105(c)*]. A statement filed by the dissociated partner must be executed with the original signature of the dissociated partner [*see* Instructions to Form]. Facsimiles and photocopies are not acceptable for filing.

A copy of the statement, certified by the Secretary of State, may then be recorded in the recorder's office in any county where the partnership owns real property [*Corp. Code § 16105(b)*]. A copy of the filed statement should promptly be sent to each nonfiling partner and any other person named as a partner in the statement, but failure to do so will not limit the effectiveness of the statement as to third parties [*Corp. Code § 16105(e)*].

The fee for filing a statement of dissociation is $30 [*Corp. Code § 16113(b)*]. The fee for recording documents is $10 for the first page and $3 for each additional page [*Gov. Code § 27361*]; a separate fee for certifying the copy applies as well [*see Gov. Code § 27364* (certification under seal fee determined by board of supervisors)]. A recorded statement of dissociation that is not a copy certified by the Secretary of State will not have the effect given to such statements by UPA '94 [*Corp. Code § 16105(b)*].

A statement of dissociation may be amended or canceled by filing a Statement of Amendment/Cancellation on official Form GP-7 [*Corp. Code § 16105(d)*; *see § 15.287[2]*]. Form GP-7 may be filed with the office of the Secretary of State and, if the partnership owns real property in California, it may also be recorded in the office of the county recorder. The filing fee is $30, and the statement may only be filed if there has been a prior filing of a Statement of Partnership Authority [*see § 15.285*].

[c] Effect on Dissociating Partner's Authority

The filed statement is a "limitation" on the dissociating partner's authority [*Corp. Code § 16704(b)*]. This means that with respect to real property transactions, a filed and recorded statement of dissociation will give third persons immediate constructive knowledge of the limitation on authority pursuant to *Corp. Code § 16303(e)*. With respect to all other transactions, a filed statement will give constructive notice of the limitation to third parties 90 days after the statement has been filed with the Secretary of State [*Corp. Code § 16704(c)*].

Depending on the circumstances of the partner's dissociation (among other considerations), a 90-day window of joint and several liability for non-real property transactions probably undesirable from both the dissociating partner's and the partnership's point of view. Therefore, in addition to the constructive notice given by the filing of a statement, actual notice should be given to partnership creditors at the earliest possible time. See *§ 15.540[2]* for a letter to creditors giving actual notice.

[d] Liability of Dissociated Partners

A partner's dissociation does not of itself discharge that partner's liability for a partnership obligation incurred before dissociation [*Corp. Code § 16703(a)*].

A dissociated partner ordinarily is not liable for a partnership obligation incurred after dissociation [*Corp. Code § 16703(a)*]. If all of the following are true, however, a dissociating partner will be liable to third parties for transactions entered into by the partnership within two years after the partner's dissociation [*Corp. Code § 16703(b)*]:

- The other party reasonably believes that the dissociated partner was a partner, and
- The other party had no notice of the partner's dissociation, and

- The other party is not deemed to have knowledge or notice of the partner's dissociation [*see Corp. Code §§ 16303(e), 16704(c)*].

Avoiding a two-year overhang of liability is accomplished by notifying partnership creditors by letter, and by giving constructive notice by filing and, as appropriate, recording a statement of dissociation [*see* [c], *above*].

A dissociated partner is relieved from liability for a partnership obligation, regardless of when incurred, if the partnership's creditor, having notice of the partner's dissociation [*see Corp. Code § 16102* (definition of "notice")] but without his, her or its consent, agrees to a material alteration in the nature or time of payment of a partnership obligation [*Corp. Code § 16703(d)*].

[e] Liability of Partnership and Partners for Later Acts of Dissociated Partner

For two years after a partner dissociates, the partnership remains bound by the acts of that partner, but only if the same circumstances exist that would bind the dissociating partner with respect to post-dissociation partnership obligations; that is, the third party reasonably believed the dissociated partner was still a partner, had no notice of the dissociation, and did not have constructive knowledge of the dissociation [*Corp. Code § 16702(a)*; *see* [c], *above*]. The same rules regarding the effect of filing and, if appropriate, recording a statement of dissociation, apply as well [*see Corp. Code § 16704(c)*; *see also* [b], *above*].

[f] Statement of Fictitious Name

When the partnership has previously filed a statement of fictitious business name, a withdrawing partner may file a statement of withdrawal [*see Bus. & Prof. Code § 17923(a)*; *see Bus. & Prof. Code § 17923(b)* (contents)]. The statement of withdrawal must be executed in the same manner as the fictitious business name statement and filed in the county where the partnership filed its fictitious business name statement [*Bus. & Prof. Code § 17923(a)*]. Further, the statement of withdrawal must be published in the same manner as the fictitious business name statement and an affidavit showing the publication must be filed with the county clerk after the completion of the publication [*Bus. & Prof. Code § 17923(c)*]. The fact that a statement of withdrawal is filed does not cause a previously filed statement of fictitious business name to expire [*see Bus. & Prof. Code § 17923(d)*]. The previous statutory authority for filing a statement of dissociation in lieu of satisfying the publication and affidavit requirements [*see Bus. & Prof. Code § 17923(c)*] has been deleted. For further discussion of these requirements, see Ch. 1A, *Role of Counsel in Starting a New Business* .

[2] FORM

Statement of Dissociation (GP-3)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
C. Partnership Statements and Notices
1. Partnership Statements

7-15 California Legal Forms--Transaction Guide § 15.531

§ 15.531 Statement of Partnership Dissolution (GP-4)

[1] Comment

[a] Use of Form

This form is official Form GP-4, Statement of Dissolution [*see Corp. Code § 16805*]. It is available from any office of the California Secretary of State. The form may be filed with the office of the Secretary of State and, if the partnership owns real property in California, it is also recorded in the office of the county recorder. The purpose of filing and recording a statement of dissolution is to protect the interests of the partnership and of third persons dealing with the partnership who rely on the public record in conducting business with the partnership. However, the filing of a statement of dissolution requires the prior filing of a Statement of Partnership Authority [*see* Instructions to Form; *see also § 15.285*].

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 15.531. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Contents, Execution, and Filing

A statement of dissolution may be filed with the Secretary of State after the partnership has dissolved. It can be filed by any partner who has not wrongfully dissociated. It must state the name of the partnership, any identification number

issued by the Secretary of State, and that the partnership has dissolved and is winding up its business [*Corp. Code § 16805(a)*].

Although the statement may be filed by one partner, UPA '94 requires that any statement filed "by a partnership" be executed by two partners [*Corp. Code § 16105(c)*], and the Form GP-4 does require two partners to sign the statement under penalty of perjury that the contents of the statement are accurate [*Corp. Code § 16105(c)*]. A copy of the statement, certified by the Secretary of State, may then be recorded in the recorder's office in any county where the partnership owns real property [*Corp. Code § 16105(b)*]. A copy of the filed statement should be promptly sent to each nonfiling partner and any other person named as a partner in the statement, but failure to do so will not limit the effectiveness of the statement as to third parties [*Corp. Code § 16105(e)*].

There is no fee for filing a statement of dissolution. The fee for recording documents is $10 for the first page and $3 for each additional page [*Gov. Code § 27361*]; a separate fee for certifying the copy applies as well [*see Gov. Code § 27364* (certification under seal fee determined by board of supervisors)]. A recorded statement of dissolution that is not a copy certified by the Secretary of State will not have the effect given to such statements by UPA '94 [*Corp. Code § 16105(b)*].

A statement of dissolution may be amended or canceled by filing a Statement of Amendment/Cancellation on official Form GP-7 [*Corp. Code § 16105(d)*; *see § 15.287[2]*]. Form GP-7 may be filed with the office of the Secretary of State and, if the partnership owns real property in California, it may also be recorded in the office of the county recorder. The filing fee is $30, and the statement may only be filed if there has been a prior filing of a Statement of Partnership Authority [*see § 15.285*].

[c] Partnership's Liability for Post-Dissolution Acts

A partnership is bound by a partner's post-dissolution acts that are either (1) appropriate for the winding up of the business or (2) would have bound the partnership before dissolution, that is, were in the ordinary course of doing business and the partner's authority to act in the matter was not limited by a filed statement of authority [*see Corp. Code § 16301(a)*], provided that the other party did not have "notice" of the dissolution [*Corp. Code § 16804*]. "Notice" in this context means that the party knows a fact, has received notice of it, or has reason to know it [*Corp. Code § 16102(b)*].

[d] Limitation on Partner's Authority to Bind Partnership

Although absent notification sent to a third party, that party does not have notice of a dissolution, a filed statement of dissolution will place third parties on notice, albeit delayed. A filed statement of dissolution has the important effect of canceling a filed statement of partnership authority, and it constitutes a "limitation" on authority [*Corp. Code § 16805(b)*]. Further, with respect to non-real property transactions, third persons are deemed to have notice of the dissolution and the limitation on a partner's authority after 90 days have elapsed since the filing of the statement [*Corp. Code § 16805(c)*]. Obviously, actual notice in the form of a return receipt requested letter to creditors affords more immediate protection for non-real property transactions than does the filing of the statement of dissolution [*see § 15.541*, for an appropriate notice]. On the other hand, if the statement is also recorded in the county where the partnership holds real property, it will give immediate constructive notice of the limitation on the authority of a partner to transfer that property [*Corp. Code § 16805(b)*].

[e] Filing New Statement of Partnership Authority

After filing and, if appropriate, recording the statement of dissolution, a dissolved partnership may file and record a new statement of partnership authority that will give one or more partners authority to act on behalf of the partnership in transactions with third parties [*Corp. Code § 16805(d)*]. If such a statement is filed and recorded, it will have the effect

of immediately giving constructive notice of to third persons in transactions involving the partnership's real property, whether or not those transactions are appropriate to winding up the business [Corp. Code § 16895(d)].

[2] FORM

Statement of Partnership Dissolution (GP-4)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
C. Partnership Statements and Notices
1. Partnership Statements

7-15 California Legal Forms--Transaction Guide §§ 15.532-15.539

[Reserved]

§§ 15.532[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
C. Partnership Statements and Notices
2. Letter Notices of Dissociation or Dissolution

7-15 California Legal Forms--Transaction Guide § 15.540

§ 15.540 Letter to Creditors and Suppliers of Partnership Advising Them of Partner's Dissociation

[1] Comment

[a] Use of Form

This form is a letter giving notice of the dissociation of a partner. This form treats the dissociation prospectively, and should be modified if the dissociation has already occurred.

In addition to being an opportunity to make contact with business customers and suppliers, this letter performs the important function of giving them actual notice of changes in the partnership. The letter should be sent by certified mail, return receipt requested.

[b] Protection of Partnership and Dissociating Partner

As discussed in *§ 15.530[1]*, when a partner dissociates it is essential that those dealing with the partnership receive notification of the fact that partner no longer has authority to act as agent for the partnership. It is also important to protect the dissociated partner from further partnership liability. This letter will suffice to give actual notice to past and existing creditors.

[2] FORM

Letter to Creditors and Suppliers of Partnership Advising Them of Partner's Dissociation

[*Letterhead*]

_____[*date*]

_____[*Name and address of creditor*]

Dear _____:

After [*e.g.,* five] years of being a partner in our firm, _____[*name of dissociating partner*] has decided to leave the firm with the mutual consent of the other partners.

_____'s [*name of dissociating partner*] last day with the firm will be _____[*date*]. After that date, _____[he *or* she] will cease to be associated with us and will no longer have authority to do business on behalf of the partnership.

We have enjoyed our business relationship with you in the past and hope that we can continue to maintain that relationship in the future.

Dated: _____.
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
C. Partnership Statements and Notices
2. Letter Notices of Dissociation or Dissolution

7-15 California Legal Forms--Transaction Guide § 15.541

§ 15.541 Letter to Creditors and Suppliers of Partnership Advising Them of Partnership's Dissolution

[1] Comment

[a] Use of Form

This form is a letter giving notice of the dissolution of a partnership. In addition to being an opportunity to make contact with and thank former business customers and suppliers, this letter performs the important function of giving them actual notice of the partnership's winding up and those entitled to conduct it. The letter should be sent by certified mail, return receipt requested.

[b] Protection of Partnership and Partners

As discussed in *§ 15.531[1]*, because of the 90-day delay in giving constructive notice by means of the statement of dissolution, it is important that creditors and suppliers of the partnership receive notification of the dissolution by mail. In addition to alerting third parties that business will not be conducted in a routine manner pursuant to a winding up, they can also be placed on notice as to which partners they can safely deal with if not all partners are authorized to conduct the winding up.

The partners themselves are liable for partnership liabilities incurred after dissolution, even if not incurred in a transaction appropriate to a winding, if the third party had no notice of the dissolution [*Corp. Code § 16804*].

[2] FORM

Letter to Creditors and Suppliers of Partnership Advising Them of Partnership's Dissolution

[*Letterhead*]

_____[*date*]

_____[*Name and address of creditor*]

Dear _____:

After [*e.g.*, 15] years of doing business under the firm name of _____[*name of partnership*], we decided to dissolve our partnership and wind up and liquidate the business.

The partnership dissolved on _____[*date*], and on an after that date ceased to exist except for the purpose of winding up and terminating its affairs.

_____[*name of partner*] has been appointed to carry out this winding up and liquidation and in that capacity has sole authority to act on behalf of the partnership. Please telephone or fax us at the above address if you have any questions concerning our account with you.

We have enjoyed our business relationship with you in the past and wish you continued success in the future.
_____ Dated:

_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]



147 of 184 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART B. Dissolution of General Partnerships
IV. FORMS
C. Partnership Statements and Notices
2. Letter Notices of Dissociation or Dissolution

7-15 California Legal Forms--Transaction Guide §§ 15.542-15.589

[Reserved]

§§ 15.542[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS

7-15 California Legal Forms--Transaction Guide 15.syn

§ 15.syn Synopsis to Chapter 15: GENERAL PARTNERSHIPS

§ 15.590 California Sources

[1] Statutes

[2] Regulations

§ 15.591 Federal Sources

[1] Statutes

[2] Regulations

§§ 15.592-15.594 [Reserved]

§ 15.595 Law Reviews and Periodicals

§ 15.596 Text References

[1] Matthew Bender Sources

[2] Additonal Text References

§§ 15.597-15.598 [Reserved]

§ 15.599 Scope of Part

§ 15.600 Governing Law

§ 15.601 Definition of Terms

§ 15.602 Conversions

[1] Entities Into Which Partnership May Convert; Carryover of Interests

[2] Requirement That Law of Jurisdiction Authorize Conversion

[3] Plan of Conversion

[a] Contents

[b] Approvals

[c] All Partners Deemed Parties to Plan

[d] Amendment of Plan

[e] Maintaining Plan of Conversion

[4] Abandoning Conversion

[5] Conversion Into Limited Partnership or Limited Liability Company

[a] Effective Date

[b] Evidence of Conversion

[c] Statement of Conversion

[6] Conversion Into Foreign Other Business Entity

[a] Effective Date

[b] Secretary of State as Agent for Service of Process

[c] Certificate of Conversion

[7] Title to Real Property of Converting Partnership

[a] Recording Requirements

[b] Presumption in Favor of Bona Fide Purchasers

[8] Conversion of Limited Partnership or Limited Liability or Other Company into Domestic Partnership

[a] When Permitted

[b] Approvals

[c] Effective Date

[d] Filing Requirements for Statement of Partnership Authority and Statement of Conversion

[9] Effect of Conversion on Rights and Liabilities of Converting Entity and on Partners

[a] Converting Entity Unchanged

[b] Rights and Liabilities of Partners

[c] Right of Dissenting Partner to Dissociate

§ 15.603 Merger

[1] Entities That May Merge

[a] Pursuant to Article 9 of UPA '94

[b] Merger Must Be Authorized by Law Under Which Entity Is Organized

[c] Law Governing Merger Proceedings

[2] Merger Agreement

[a] Approval

[b] Required Contents

[c] Scope of Agreement

[d] Amendment

[e] Abandonment

[f] Maintenance and Provision of Copies

[3] Statements, Agreements, and Certificates of Merger

[a] Generally

[b] Statement of Merger

[c] Certificate of Merger

[i] When and by Whom Filed

[ii] Contents

[d] Agreement of Merger

[e] Effect of Filing

[4] Effective Date of Merger

[a] When Certificate of Merger Is Required

[b] Merger Not Involving Domestic Other Business Entity

[5] Effect of Merger on Constituent Parties

[6] Effect of Merger on Rights of Creditors and Others

[a] Enforcement of Liens Against Survivor

[b] Pending Actions

[c] The Secretary of State as Agent for Service of Process

[7] Liabilities of Partners or Members of Surviving Entity

[a] Pre-Merger and Post-Merger Obligations of Constituent Parties

[b] When Pre-Merger Obligations Not Satisfied out of Survivor's Property

[8] Effect of Merger on Title to Real Property

[a] Recording Certificate or Statement of Merger

[b] Presumption in Favor of Bona Fide Purchasers

[9] Right of Dissenting Partner to Dissociate

§ 15.604 Tax Consequences of Conversion or Merger

[1] Conversions to Limited Partnerships and Limited Liability Companies

[2] Mergers With Other General or Limited Partnerships

[3] Mergers With Limited Liability Companies

[4] Property Taxation

§§ 15.605-15.719 [Reserved]

§ 15.720 Facts

[1] Information Relating to Partnership

Scope

[2] Facts Relating to Converted or Surviving Entity

Scope

§ 15.721 Documents

Scope

§§ 15.722-15.729 [Reserved]

§ 15.730 Approval of Conversion or Merger

Scope

§ 15.731 Operation of Converted or Surviving Entity

Scope

§§ 15.732-15.739 [Reserved]

§ 15.740 Conversion

Scope

§ 15.741 Merger

Scope

§§ 15.742-15.749 [Reserved]

§ 15.750 Conversion

Scope

§ 15.751 Merger

Scope

§§ 15.752-15.799 [Reserved]

§ 15.800 Plan of Conversion

[1] Comment

[a] Use of Form

[b] Contents

[2] FORM

Plan of Conversion

§ 15.801 General Partnership Statement of Partnership--Conversion (GP-1A)

[1] Comment

[a] Use of Form

[b] Requirement for Statement of Conversion

[2] FORM

General Partnership Statement of Partnership--Conversion (GP-1A)

§ 15.802 Certificate of Conversion (CONV-1A)

[1] Comment

[a] Use of Form

[b] Statutory Requirements for Certificate of Conversion--Conversion to Foreign Other Business Entity

[c] Statutory Requirements for Statement of Conversion--Conversion to Domestic Entities

[d] Effect of Filing Certificate of Conversion

[2] FORM

Certificate of Conversion (CONV-1A)

§ 15.803 Articles of Incorporation for Conversion of California General Partnership to Corporation

[1] Comment

[a] Use of Form

[b] Filing Conversion Articles

[2] FORM

Articles of Incorporation for Conversion of California General Partnership to Corporation

§ 15.804 Articles of Incorporation for Conversion of Foreign General Partnership to California Corporation

[1] Comment--Use of Form

[2] FORM

Articles of Incorporation for Conversion of Foreign General Partnership to California Corporation

§§ 15.805-15.809 [Reserved]

§ 15.810 Agreement to Merge

[1] Comment

[a] Use of Form

[b] Contents

[c] Scope of Agreement

[d] Effective Date of Merger

[2] FORM

Agreement to Merge

§ 15.811 Statement of Merger (GP-6)

[1] Comment

[a] Use of Form

[b] Certificate of Merger--Filing Requirements

[c] Certificate of Merger--Contents

[2] FORM

Statement of Merger (GP-6)

§§ 15.812-15.819 [Reserved]

§ 15.820 Notice of Approval to Dissenting Partners

[1] Comment

[a] Use of Form

[b] Statutory Buyout Procedure

[2] FORM

Notice of Approval to Dissenting Partners

§ 15.821 Demand Letter From Dissenting Partner

[1] Comment--Use of Form

[2] FORM

Demand Letter From Dissenting Partner



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
I. RESEARCH GUIDE
A. Primary Sources

7-15 California Legal Forms--Transaction Guide § 15.590

§ 15.590 California Sources

[1] Statutes

Contents of fictitious business name statement. *Bus. & Prof. Code § 17913*.

Abandonment of use of fictitious business name statement. *Bus. & Prof. Code § 17922*.

Fees for filing fictitious business name statements. *Bus. & Prof. Code § 17923*.

Ownership of property as tenants in partnership. *Civ. Code §§ 682(2), 684*.

Venue for actions based on partnership agreement. *Code Civ. Proc. § 395*.

Conversion of corporation into "other business entity" (including partnership) *Corp. Code § 1151*; *see Corp. Code § 1150 et seq.*

Conversion of "other business entity" (including partnership) into domestic corporation. *Corp. Code § 1157*.

Uniform Partnership Act of 1994. *Corp. Code § 16100 et seq.*

General provisions. *Corp. Code §§ 16101-16114*.

Nature of partnership. *Corp. Code §§ 16201-16204*.

Relations of partners to persons dealing with partnership. *Corp. Code §§ 16301-16308*.

Relations of partners to each other and to partnership. *Corp. Code §§ 16401-16406*.

Transferees and creditors of partner. *Corp. Code §§ 16501-16504.*

Conversions and mergers. *Corp. Code §§ 16901-16917.*

Income taxation of partners and partnerships. *Rev. & Tax. Code §§ 17851-17931.*

[2] Regulations

Federal treasury regulations applicable to California income tax. 18 Cal. Code Reg. § 19523.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
I. RESEARCH GUIDE
A. Primary Sources

7-15 California Legal Forms--Transaction Guide § 15.591

§ 15.591 Federal Sources

[1] Statutes

Income taxation of partners and partnerships. *I.R.C. §§ 701-771*.

Closing of taxable year. *I.R.C. § 706(c)*.

Guaranteed payments. *I.R.C. § 707(c)*.

Continuation or termination of partnerships. *I.R.C. § 708*.

Distributions by partnerships. *I.R.C. §§ 731-736*.

Transfers of partnership interests. *I.R.C. §§ 741-743*.

Treatment of unrealized receivables and inventory items. *I.R.C. § 751*.

Method of electing adjustment to basis of partnership property. *I.R.C. § 754*.

Basis of property. *I.R.C. § 1012*.

Requirement that partnership file information income tax return. *I.R.C. § 6031*.

Time for filing partnership return. *I.R.C. § 6072(a)*.

[2] Regulations

Income taxation of partners and partnerships. Treas. Reg. §§ 1.701-1.771.

Continuation and termination of partnership. *Treas. Reg. § 1.708-1*.

Treatment of liquidating distributions. *Treas. Reg. § 1.731-1*.

Treatment of payments liquidating partner's interest in income. *Treas. Reg. § 1.736-1*.

Treatment of gain or loss from sale of partnership interest. *Treas. Reg. § 1.741-1*.

Treatment of payments for partner's interest in unrealized receivables or substantially appreciated property. *Treas. Reg. § 1.751-1*.

Election to adjust basis of partnership property. *Treas. Reg. §§ 1.732-1, 1.732-2, 1.733-1, 1.734-1*, 1.734-2, 1.743-1, 1.754-1.

Filing of partnership information returns. Treas. Reg. § 1.6031-1.

Valuation of business interests subject to buy-sell agreement. *Treas. Reg. §§ 20.2031-3(c), 20.2031-2(h)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
I. RESEARCH GUIDE
A. Primary Sources

7-15 California Legal Forms--Transaction Guide §§ 15.592-15.594

[Reserved]

§§ 15.592[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
I. RESEARCH GUIDE
B. Secondary Sources

7-15 California Legal Forms--Transaction Guide § 15.595

§ 15.595 Law Reviews and Periodicals

Feldman, *Your Partner's Keeper: The Duty of Good Faith and Fair Dealing Under the Revised Uniform Partnership Act, 48 S.M.U. L. Rev. 1931 (1995).*

Harris, *Why Anti-Competitive Clauses Should Be Unenforceable in Law Partnerships: An Argument for Rejecting California's Approach, 8 Geo. J. Legal Ethics 669 (1995).*

Johnson, *Limit Liability for Lawyers: General Partners Need Not Apply, 51 Bus. Law. 85 (1995).*

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153 of 184 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
I. RESEARCH GUIDE
B. Secondary Sources

7-15 California Legal Forms--Transaction Guide § 15.596

§ 15.596 Text References

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Ballantine & Sterling, CALIFORNIA CORPORATION LAWS (Matthew Bender).

Ch. 24, *Partnerships*.

Ch. 26, *Taxation of Partnerships*.

Cavitch, BUSINESS ORGANIZATIONS, Chs. 5-42 (Matthew Bender).

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Rabkin & Johnson, CURRENT LEGAL FORMS WITH TAX ANALYSIS, Ch. 1, *Partnerships* , Forms 1.113 (agreement for division of partnership), 1.114-1.116 (agreements for sale of partnership interest), 1.117-1.123 (retirement of partner), 1.124-1.127 (liquidation of partnership) (Matthew Bender).

Rabkin & Johnson, FEDERAL INCOME, GIFT AND ESTATE TAXATION, Ch. 16, *Partnership* (Matthew Bender).

[2] Additonal Text References

Witkin, Summary of California Law, vol. 9, *Partnership* (10th ed. 2005).

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
I. RESEARCH GUIDE
B. Secondary Sources

7-15 California Legal Forms--Transaction Guide §§ 15.597-15.598

[Reserved]

§§ 15.597[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.599

§ 15.599 Scope of Part

This part describes the procedure for, and contains forms related to, the conversion and merger of general partnerships under Article 9 of the Uniform Partnership Act of 1994 (UPA '94). Under Article 9, a general partnership may convert into a domestic limited partnership, domestic corporation, or domestic limited liability company, or into a foreign "other business entity"; in other words, a foreign limited partnership, corporation, limited liability company, or unincorporated association. Conversion to a registered limited liability partnership is not permitted under Article 9. Such conversions are governed by Article 10 of UPA '94, and only a law or accounting partnership may convert into a registered limited liability partnership [*see* Ch. 16C, *Limited Liability Partnerships*].

Under Article 9 of UPA '94, general partnerships can merge with other general partnerships and with limited partnerships and limited liability companies. The merger of two or more limited partnerships is governed by ULPA '08 and is covered in Ch. 16B, *Conversions and Mergers of Limited Partnerships* .

This part also discusses the statutory authority governing the conversion of limited partnerships, limited liability companies, and corporations into California general partnerships [*see § 15.602[8]*; *see also Corp. Code § 16908*] and includes the statement of partnership authority (Form GP-1A) that must be filed by such converting entities [*see § 15.801*]. For more detailed coverage of the requirements for such conversions, see Ch. 11F, *Corporate Conversions* , Ch. 12C, *Limited Liability Companies* , and Ch. 16B, *Conversions and Mergers of Limited Partnerships*, respectively.

It is assumed in this part that the legal and tax consequences of a conversion or merger have been considered, and the decision made to proceed with the transaction. For a discussion summarizing the legal and tax incidents of doing business or practicing a profession in any of the various partnership forms or as a limited liability company, see the Legal Background in Ch. 12C, *Limited Liability Companies*. This part focuses on the legal considerations, from the partnership's point of view, that precede and are coincident with a plan or agreement to convert or to merge. It does not cover the procedures and forms relevant to formation of the converted or surviving entity. If that entity is a general partnership, then the materials in Part A of this chapter will apply. If the converted or surviving entity is a limited liability company, see Ch. 12C, *LimitedLiability Companies* , and if a limited partnership, see Ch. 16, *Formation of Limited Partnerships* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawLimited PartnershipsGeneral OverviewMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawMergersGeneral OverviewBusiness & Corporate LawUnincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.600

§ 15.600 Governing Law

Article 9 of UPA '94, provisions for conversion of general partnerships [*see Corp. Code §§ 16901-16917*], became operative on January 1, 1997, and applies to partnerships formed on and after that date. On and after January 1, 1999, all partnerships are governed by UPA '94 [*Corp. Code § 16111(a), (b)*].

With respect to both conversion and merger of partnerships, the UPA '94 provisions are not exclusive, and general partnerships may be converted or merged in any other manner provided by law.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.601

§ 15.601 Definition of Terms

The UPA '94 provisions for conversion and merger of partnerships contain the following definitions, which are crucial to understanding how the law applies [*Corp. Code § 16901*]:

- "Constituent other business entity" means any other business entity that is merged with or into one or more partnerships and includes a surviving other business entity.

- "Constituent partnership" means a partnership that is merged with or into one or more other partnerships or other business entities and includes a surviving partnership.

- "Disappearing other business entity" means a constituent other business entity that is not the surviving other business entity.

- "Disappearing partnership" means a constituent partnership that is not the surviving partnership.

- "Domestic" means organized under the laws of this state when used in relation to any partnership, other business entity, or person (other than an individual).

- "Foreign other business entity" means any other business entity formed under the laws of any state other than California or under the laws of the United States or of a foreign country.

- "Foreign partnership" means a partnership formed under the laws of any state other than this state or under the laws of a foreign country.

- "General partner" means a partner in a partnership and a general partner in a limited partnership.

- "Limited liability company" means a limited liability company created under Title 2.5 (commencing with *Corp. Code § 17000*), or comparable law of another jurisdiction.

- "Limited partner" means a limited partner in a limited partnership.

- "Limited partnership" means a limited partnership created under Chapter 3 (CRLPA, commencing with *Corp. Code § 15611*, repealed January 1, 2010) or Chapter 5.5 (ULPA '08, commencing with *Corp. Code § 15900*), predecessor law, or comparable law of another jurisdiction.

- "Other business entity" means a limited partnership, limited liability company, corporation, business trust, real estate investment trust, or an unincorporated association (other than a nonprofit association), but excluding a partnership.

- "Partner" includes both a general partner and a limited partner.

- "Surviving other business entity" means an other business entity into which one or more partnerships are merged.

- "Surviving partnership" means a partnership into which one or more other partnerships or other business entities are merged.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawAntitrustTransnational MergersMergers & Acquisitions LawMergersGeneral OverviewBusiness & Corporate LawUnincorporated Associations



158 of 184 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.602

§ 15.602 Conversions

[1] Entities Into Which Partnership May Convert; Carryover of Interests

A general partnership may be converted into a domestic other business entity or a foreign other business entity--that is, a domestic or foreign limited partnership, limited liability company, corporation, business trust, real estate investment trust, or unincorporated association (other than a nonprofit association), but excluding a partnership [*see Corp. Code § 16902(a)*; *see also Corp. Code § 16901(12)* ("other business entity" defined)]. Conversion into a domestic or foreign limited partnership or limited liability company may be effected only if each of the partners of the converting partnership will receive a percentage interest in the profits and capital of the converted other business entity equal to the partner's percentage interest in profits and capital of the converting partnership as of the effective time of the conversion [*Corp. Code § 16902(a)(1)*]. Conversion into any other business entity or foreign other business entity may be effected only if each of the partnership interests of the same class is treated equally with respect to any distribution of cash, property, rights, interests, or securities of the converted other business entity unless all partners of the same class consent [*Corp. Code § 16902(a)(2)*].

Note that separate provisions in Article 10 of UPA '94 [*see Corp. Code§§ 16951-16962*] permit the conversion of any domestic law or accounting general partnership into a limited liability partnership if partners holding the majority of interests in current profits approve the conversion, unless the partnership agreement specifies a different vote for conversion [*Corp. Code § 16955*].

[2] Requirement That Law of Jurisdiction Authorize Conversion

Corp. Code § 16902(b) states that conversion of a partnership to a domestic limited partnership or limited liability company or foreign other business entity may be effected only if (1) the law under which the converted entity will exist *expressly* permits the formation of that entity *pursuant to a conversion*; and (2) the partnership complies with any and all other requirements of that law as it applies to conversion of the other business entity.

[3] Plan of Conversion

[a] Contents

A general partnership that wants to convert to a domestic or a foreign other business entity must approve a plan of conversion that states the following [*Corp. Code § 16903(a)*; *see § 15.800*]:

- The terms and conditions of the conversion.
- The place of the organization of the converted entity and of the converting partnership and the name of the converted entity after conversion, if different from that of the converting partnership.
- The manner of converting the partnership interests of each of the partners into shares of, securities of, or interests in the converted entity.
- The provisions of the governing documents for the converted entity, such as a limited partnership agreement, limited liability company articles of organization and operating agreement, or articles or certificate of incorporation, to which the holders of interest in the converted entity are to be bound.
- Any other details or provisions as are required by laws under which the converted entity is organized.
- Any other details or provisions that are desired.

[b] Approvals

Unless the partnership agreement provides for a different vote for conversion, a plan of conversion must be approved by the number or percentage of partners required by the partnership agreement to approve an amendment to the partnership agreement. If, however, the conversion effects a change for which the partnership agreement requires a greater number or percentage of partners than is required to amend the partnership agreement, the plan of conversion must be approved by that greater number or percentage. If the partnership agreement fails to specify the vote required to amend the partnership agreement, the plan of conversion must be approved by all partners [*Corp. Code § 16903(b)*].

In addition to the foregoing approvals, if the partnership is converting into a limited partnership, then the plan of conversion must be approved by all partners who will become general partners of the converted limited partnership pursuant to the plan of conversion [*Corp. Code § 16903(c)*].

[c] All Partners Deemed Parties to Plan

All partners of the converting partnership, except those that dissociate upon effectiveness of the conversion [*see Corp. Code § 16909(e)*], are deemed parties to any partnership or operating or organic document for the converted entity adopted as part of the plan of conversion, regardless of whether that partner has executed any of those documents. Adoption of a new partnership, operating agreement, or other organic document is effective at the effective time or date of the conversion [*Corp. Code § 16903(d)*; *see* [5], *below*, for effective date of conversion].

[d] Amendment of Plan

A plan of conversion may be amended before the conversion takes effect if the amendment is approved by the partnership in the same manner, and by the same number or percentage of partners, that was required for approval of the original plan of conversion [*Corp. Code § 16903(e)*].

[e] Maintaining Plan of Conversion

The converted entity must keep the plan of conversion at (1) the principal place of business of the converted entity, if the converted entity is a foreign other business entity or a corporation; or (2) the office at which records are to be kept under either *Corp. Code § 15614* or 15901.14 (domestic limited partnerships) or *Corp. Code § 17057* (domestic limited liability companies). A partner of the converting partnership has an unwaivable right to request that the person authorized to act on behalf of the converted entity, at the entity's expense, promptly deliver to the partner or the holder of interests or other securities a copy of the plan of conversion [*Corp. Code § 16903(g)*].

[4] Abandoning Conversion

In their discretion, the partners of a converting partnership may abandon a conversion at any time before it is effective, without further approval by the partners, if abandonment is done in the same manner, and by the same number orpercentage of partners, that was required for approval of the original plan of conversion, subject to the contractual rights of third parties [*Corp. Code § 16903(f)*].

[5] Conversion Into Limited Partnership or Limited Liability Company

[a] Effective Date

If a partnership is converting into a domestic other business entity, the conversion is effective on the earliest date that all of the following have occurred [*Corp. Code § 16904(a)*]:

- The approval of the plan of conversion by the partners of the converting partnership [*see* [3][b], *above*].

- The filing of all documents required by law to create the converted other business entity, including, if required, a statement of conversion [*see* [c], *below*].

- The effective date, if set forth in the plan of conversion, has occurred.

[b] Evidence of Conversion

A copy of the certificate of limited partnership, articles of organization, or articles of incorporation (including any statement of conversion required), duly certified by the Secretary of State, is conclusive evidence of the conversion of the partnership [*Corp. Code § 16904(b)*; *see Corp. Code § 16906*].

[c] Statement of Conversion

Converting partnerships that have a currently effective statement of partnership authority [*see Corp. Code § 16303*; *see also § 15.15[3]* (statements of partnership authority)] on file must include a statement of conversion along with the charter documents of the domestic limited partnership, limited liability company, or corporation into which they are converting. If the converting partnership does not have a statement of authority in effect at the time of conversion, filing the statement of conversion is optional. The statement, which must in a form prescribed by the Secretary of State, includes basic information about the partnership's identity as well as a statement that the conversion received the approval of the requisite partnership interests [*Corp. Code § 16906(a)*]. If filed, a statement of conversion that is contained in the certificate of a limited partnership or articles of a limited liability company has the effect of canceling any statement of partnership authority on file [*Corp. Code § 16906(c)*].

The contents of the statement of conversion are specified by statute [*see Corp. Code § 16906(a)(1), (2)*] and are reflected in the forms promulgated by the Secretary of State. These forms are to be used as follows:

- A general partnership that is converting into a California limited partnership will file Form LP-1A,

Certificate of Limited Partnership--Conversion [*see Ch. 16B, Conversions and Mergers of Limited Partnerships, § 16B.411*]. This form includes the appropriate Statement of Conversion.

- A general partnership that is converting into a California limited liability company will file Form LLC-1A, Limited Liability Company Articles of Organization--Conversion [*see § 12C.200A*]. This form includes the appropriate Statement of Conversion.

- A general partnership that is converting into a California corporation will file articles of incorporation that include a statement of conversion. For a sample set of articles for a California general partnership that is converting into a California corporation, containing the required statement of conversion, see *§ 15.803*. For a sample set of articles for a foreign general partnership that is converting into a California corporation, see *§ 15.804*.

A general partnership that converts to a foreign other business entity does not file a statement of conversion, but rather a certificate of conversion [§ 15.802] as discussed in [6][c], *below*.

[6] Conversion Into Foreign Other Business Entity

[a] Effective Date

Conversion of a partnership to a foreign other business entity is generally governed by the laws of the foreign jurisdiction [*see Corp. Code § 16902*; *see also* [2], *above*], including the law determining the effective date of the conversion [*Corp. Code § 16905(b)*].

[b] Secretary of State as Agent for Service of Process

In general, the Secretary of State is the agent for service of process in an action or proceeding against a foreign other business to enforce an obligation of a converted partnership. Unless a statement of conversion has been filed to effect the conversion [*see* [c], *below*], the converted entity must promptly notify the Secretary of State of the mailing address of its agent for service of process, its chief executive office, and of any change of address.

To enforce an obligation of a partnership that has converted to a foreign other business entity, the Secretary of State is the only agent for service of process in an action against the converted foreign entity if the designated agent is (1) a natural person that cannot be found with due diligence, (2) a corporation and no person to whom delivery may be made may be located with due diligence, or (3) if no agent has been designated and if no officer, partner, manager, member, or agent of the converted foreign entity may be located after diligent search and thatfact is shown by affidavit to the satisfaction of the court. The court may then make an order that service may be effected by personal delivery to the Secretary (or assistant or deputy) of two copies of the process and two copies of the order, which must state the address to which the process must be sent by the Secretary. Service of process in this manner is deemed complete on the 10th day after delivery of the process to the Secretary [*Corp. Code § 16905(c)(1)*].

On receipt of process, order, and the applicable fee [*see Gov. Code § 12206*], the Secretary will notify the converted foreign entity at the specified address by forwarding a copy of the process and order by certified mail, return receipt requested [*Corp. Code § 16905(c)(2)*]. The Secretary of State will keep a record of all process served on the Secretary, recording the time of service and the Secretary's actions. The certificate of the Secretary, under official seal, certifying to receipt of process, the provision of notice to the converted entity, and the forwarding of process constitutes competent and prima facie evidence of the matters stated in the certificate [*Corp. Code § 16905(c)(3)*].

[c] Certificate of Conversion

Corp. Code § 16906(b) provides that a California general partnership that is converting into a foreign other business

entity--that is, a limited partnership, limited liability company, corporation, business trust, real estate investment trust, or unincorporated association other than a nonprofit association, but excluding a general partnership [*see Corp. Code § 16901(6), (12)*]--that has filed a statement of partnership authority under *Corp. Code § 16303* [*see § 15.285*] that is effective at the time of conversion *may* file a certificate of conversion with the Secretary of State [*Corp. Code § 16906(b)*]. Note that *Corp. Code § 16906(b)* uses the word "may," which would appear to mean that the filing of a certificate of conversion is optional in all cases involving conversion to a foreign entity. In contrast, the official instructions to the Secretary of State's form [*see § 15.802*] state that this form "shall" be filed with the Secretary of State, which would indicated that the Secretary of State's office regards such a filing as mandatory. Whether or not the filing of a certificate of conversion is mandatory under these circumstances, there are advantages to filing such a certificate, as discussed in [7], *below*.

The certificate of conversion must identify the partners and the entity into which the partnership is converting, including the street address of the converted entity's chief executive office and any office in California and its form of organization [*Corp. Code § 16906(b)*]. The Secretary of State's office has promulgated an official form that satisfies these requirements [*see § 15.802* (form)].

The filing of a certificate of conversion has the effect of canceling any statement of partnership authority on file [*Corp. Code § 16906(c)*].

[7] Title to Real Property of Converting Partnership

[a] Recording Requirements

The recording of (1) a certificate of conversion, or a certificate of limited partnership, articles of organization, or articles of incorporation, complying with *Corp. Code § 16906*, in the form prescribed by the Secretary of State, certified by the Secretary of State, or (2) a copy of a certificate of conversion or a certificate of limited partnership, articles of organization, articles or certificate of incorporation, or other certificate evidencing the creation of a foreign other business entity by conversion, containing a statement of conversion, certified by the Secretary of State or an authorized public official of the state or place pursuant to the laws of which the conversion is effected, in the county recorder's office in the county where the converting entity owns California real property, is evidence of record ownership of all interest in the property in the converted partnership or other entity [*Corp. Code § 16907(a)*]. This rule operates only when the law of the jurisdiction of the converted entity provides, as does UPA '94 [*see Corp. Code § 16909(b)*], that conversion vests in the converted partnership or other business entity all the real property of the converting partnership or other business entity [*Corp. Code § 16907(a)*].

A filed and, if appropriate, recorded certificate of conversion, or a certificate of limited partnership, articles of organization, or articles or certificate of incorporation containing a statement of conversion, or other certificate evidencing the creation of an other business entity by conversion, need not contain all the information required in a statement of conversion [*see Corp. Code § 16906*] to effect a change of record title [*Corp. Code § 16907(b)*]. It is enough if the certificate or other document is executed and declared to be accurate under penalty of perjury [*see Corp. Code § 16105(c)*] by two partners, and states the name of the converting partnership or converting other business entity that held title to the real property and the name of the converted entity [*Corp. Code § 16907(b)*].

[b] Presumption in Favor of Bona Fide Purchasers

If the certificate of conversion or other certificate evidencing the creation of another business entity by conversion is duly recorded, it creates a conclusive presumption in favor of bona fide purchasers for value that the conversion was validly completed [*Corp. Code § 16907(c)*].

[8] Conversion of Limited Partnership or Limited Liability or Other Company into Domestic Partnership

[a] When Permitted

Article 9 of UPA '94 authorizes a domestic limited partnership, limited liabilitycompany, or corporation, or a foreign other business entity, to be converted to a domestic general partnership. How often this is likely to occur is not certain. Nevertheless, the statute provides that such a conversion may be "pursuant to this article," but only if the converting entity is authorized by the laws under which it is organized [*Corp. Code § 16908(a)*]. Note that the statute appears to require a foreign other entity, e.g., a limited partnership, converting to a California general partnership do so pursuant to Article 9. This is probably a drafting error since it is not clear what interest California has in the method by which a foreign entity converts, as evidenced by the fact that according to Article 9, the effective date of such a conversion is governed by the law under which the converting entity is organized [*Corp. Code § 16908(d)*], not California law.

The statutes governing limited partnerships [*see Corp. Code § 15900 et seq.* (ULPA '08)] limited liability companies [*see Corp. Code § 17540.1 et seq.*], and corporations [*see Corp. Code § 1150 et seq.*] govern the procedures for conversion of those entities into other types of entities, including California general partnerships. For more detailed coverage of the requirements for such conversions, see Ch. 11C, *Mergers* , Ch. 12C, *Limited Liability Companies* , and Ch. 16B, *Conversions and Mergers of Limited Partnerships*, respectively.

[b] Approvals

An entity converting into a domestic partnership must approve a plan of conversion or whatever instrument is required to be approved pursuant to the laws under which the entity is organized [*Corp. Code § 16908(b)*]. The conversion of a domestic limited partnership, limited liability company, or corporation, or a foreign other business entity must be approved by the number or percentage of the partners, members, shareholders, or holders of interest of the converting entity as is required by the law under which the entity is organized, or a greater or lesser percentage (subject to applicable laws) as set forth in the limited partnership agreement, articles of organization, operating agreement, or articles or certificate of incorporation, or other governing document for the converting entity [*Corp. Code § 16908(c)*].

[c] Effective Date

The conversion by a domestic limited partnership, limited liability company, corporation, or a foreign other business entity into a partnership will be effective under UPA '94 at such time as the conversion is effective under the law under which the converting entity is organized [*Corp. Code § 16908(d)*].

[d] Filing Requirements for Statement of Partnership Authority and Statement of Conversion

A limited partnership or limited liability company that is converting into a California general partnership must complete a statement of conversion on its statement of partnership authority. If no statement of partnership authority is filed, then the converting entity must file a separate certificate of conversion [*Corp. Code § 15911.06(a)(2)* (limited partnership), 17540.6(a)(2) (limited liability companies); *see § 15.802* (standard certificate of conversion form)].

Converting limited liability companies or limited partnerships file the statement of partnership authority using Form GP-1A, which is a specialized form of partnership statement that is to be used when the partnership being formed is a preexisting business that is being converted from some other form of business entity, rather than a brand new entity. For general discussion of the effect of filing a statement of partnership authority, see *§ 15.285[1]* and discussion in Part A of this chapter. Form GP-1A includes the mandatory statement of conversion required by statute [*see Corp. Code § 15911.06(a)(2)* (conversion from limited partnership), 17540.6 (conversion from limited liability company)] and is reproduced in § 15.801.

The filing with the Secretary of State of a certificate of conversion (or a statement of partnership authority containing a statement of conversion) [*see Corp. Code § 16908(a)*] has the effect of the filing of a certificate of cancellation by the

converting foreign limited partnership or foreign limited liability company. Therefore, a converting foreign limited partnership or foreign limited liability company that has made this filing is not required to file a certificate of cancellation as a result of the conversion [*Corp. Code § 16908(e)*; *see Corp. Code § 15909.07*, *17455*]. If a converting other business entity is a foreign corporation qualified to transact business in California, the foreign corporation automatically surrenders its right to transact intrastate business in California by virtue of this filing [*Corp. Code § 16908(e)*].

[9] Effect of Conversion on Rights and Liabilities of Converting Entity and on Partners

[a] Converting Entity Unchanged

An entity that converts into another entity pursuant to UPA '94 is for all purposes the same entity that existed before the conversion, and when conversion takes effect, the following apply [*Corp. Code § 16909(a), (b)*]:

- All the rights and property, whether real, personal, or mixed, of the converting entity remain vested in the converted entity.

- All debts, liabilities, and obligations of the converting entity continue as debts, liabilities, and obligations of the converted entity.

- All rights of creditors and liens upon the property of the converting entity are preserved unimpaired and remain enforceable against the convertedentity to the same extent as against the converting entity as if the conversion had not occurred.

- Any action or proceeding pending by or against the converting entity may be continued against the converted entity as if the conversion had not occurred.

[b] Rights and Liabilities of Partners

A partner of a converting partnership is liable for the following [*Corp. Code § 16909(c)*]:

- All obligations of the converting partnership for which the partner was personally liable before the conversion.

- All obligations of the converted entity incurred after the conversion takes effect, but those obligations may be satisfied only out of property of the entity if (1) the converted other business entity is a limited partnership and the partner becomes a limited partner; (2) the converted other business entity is a limited liability company and the partner becomes a member, unless the articles of organization or the operating agreement of the limited liability company provide otherwise; or (3) the converted other business entity is a corporation and the partner becomes a shareholder.

A partner of a partnership that converted from an other business entity is liable for any and all obligations of the converting other business entity for which the partner was personally liable before the conversion, but only to the extent the partner was liable for the obligation of the converting entity prior to the conversion [*Corp. Code § 16909(d)*].

Case law outside the conversion context holds that when a partnership is incorporated, the partnership ceases to exist after formation of the corporation, even if the entity is operated in a manner similar to that which it was operated as a partnership [*Persson v. Smart Inventions, Inc. (2005) 125 Cal. App. 4th 1141, 1157, 23 Cal. Rptr. 3d 335* (rejecting trial court conclusion that a "de facto" partnership existed concurrently with the corporate enterprise); *Cavasso v. Downey (1920) 45 Cal.App. 780, 785, 188 P. 594]* . Thus, the obligations among partners that flow from a partnership,

including fiduciary duties among partners, ordinarily no longer exist and therefore cannot be enforced against one another by the former partners turned shareholders, with the limited exception that courts will enforce pre-incorporation agreements among partners or joint venturers who have incorporated in order to carry out the agreement between or among the partners or joint venturers [*Persson v. Smart Inventions, Inc. (2005) 125 Cal. App. 4th 1141, 1157-1159, 23 Cal. Rptr. 3d 335]* .

[c] Right of Dissenting Partner to Dissociate

A partner of a converting partnership who does not vote in favor of the conversion and does not agree to become a partner, member, shareholder, or holder of an interest in the converted other business entity may rightfully dissociate from the partnership as of the date the conversion takes effect [*Corp. Code § 16909(e)*].

Within 10 days after the partners approve conversion, the converting partnership must send notice of the approval to each partner that has not approved the conversion, accompanied by copies of *Corp. Code § 16701* (buyout provisions) and a brief description of the procedure to be followed under that section if the partner wishes to dissociate from the partnership. A partner that wants to dissociate must send written notice of dissociation within 30 days after the date of the notice of the approval of the conversion. The converting partnership must then cause the partner's interest in the entity to be purchased [*Corp. Code § 16909(e)*].

The converting partnership is bound under *Corp. Code § 16702* by an act of a dissociated general partner, and the partner is liable under *Corp. Code § 16703* for transactions entered into by the converted entity after the conversion takes effect [*Corp. Code § 16909(e)*]. To limit the scope of this liability, the partnership and/or the dissociating partner should file a statement of dissociation that has the effect of placing third persons on notice of the dissociation [*see Corp. Code § 16704*]. For a detailed discussion of dissociation, including the buyout of dissociated partners and the liabilities of the partnership on dissociation, refer to § 15.303[2] and § 15.306[2].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsGeneral OverviewMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawMergersGeneral OverviewBusiness & Corporate LawUnincorporated Associations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.603

§ 15.603 Merger

[1] Entities That May Merge

[a] Pursuant to Article 9 of UPA '94

The following entities may be merged pursuant to Article 9 of UPA '94 [*Corp. Code § 16910(a)*]:

- Two or more partnerships into one partnership.

- One or more partnerships and one or more other business entities into one of those other business entities.

- One or more partnerships, other than a limited liability partnership, and one or more other business entities into one partnership.

[b] Merger Must Be Authorized by Law Under Which Entity Is Organized

Any number of partnerships may merge with any number of other business entities only if the other business entities organized in California are authorized by law to merge. If a domestic partnership is the surviving partnership, any foreignother business entity that is a party to the merger must not be legally prohibited by the laws under which it is organized from merging. If a foreign partnership or foreign other business entity is the survivor of the merger, the laws of the jurisdiction under which the survivor is organized must authorize the merger [*Corp. Code § 16910(b)*].

[c] Law Governing Merger Proceedings

If the surviving entity is a domestic partnership or a domestic other business entity, the merger proceedings with respect to that partnership or other business entity and any domestic disappearing partnership must conform to the provisions of Article 9 of UPA '94 that govern the merger of domestic partnerships. If, however, the surviving entity is a foreign partnership or a foreign other business entity, the merger proceedings may be in accordance with the laws of the state or

place of organization of the surviving partnership or surviving other business entity [*Corp. Code § 16913(b)*].

[2] Merger Agreement

[a] Approval

Each partnership and other business entity that is merging must approve a merger agreement. In the case of a partnership, approval must be by the number or percentage of partners required to approve a merger by the partnership agreement of the constituent partnership. Absent a voting requirement for merger approval, the merger agreement must be approved by that number or percentage of partners specified by the partnership agreement to approve an amendment to the partnership agreement. If, however, the merger effects a change for which the partnership agreement requires a greater number or percentage of partners than that required to amend the partnership agreement, then the merger must be approved by that greater number or percentage. If the partnership agreement is silent on approval of both mergers and amendments, then the merger agreement must be approved by all the partners [*Corp. Code § 16911(a)*].

The agreement of merger must be approved on behalf of each constituent other business entity by those persons required to approve the merger by the laws under which it is organized. Other persons may be parties to the agreement of merger [*Corp. Code § 16911(a)*].

If the partnership is merging into a limited partnership, then in addition to the approval of the partners as described above, the agreement of merger must be approved by all partners who will become general partners of the surviving limited partnership when the merger takes effect [*Corp. Code § 16911(b)*].

[b] Required Contents

The agreement of merger must state the following [*Corp. Code § 16911(a)*]:

- The terms and conditions of the merger.

- The name and place of organization of the surviving partnership or surviving other business entity, and of each disappearing partnership and disappearing other business entity, and the agreement of merger may change the name of the surviving partnership, which new name may be the same as or similar to the name of a disappearing partnership.

- The manner of converting the partnership interests of each of the constituent partnerships into interests or other securities of the surviving partnership or surviving other business entity. If partnership interests of any of the constituent partnerships are not to be converted solely into interest or other securities of the surviving partnership or surviving other business entity, the merger agreement must specify the cash, property, rights, interests, or securities that the holders of the partnership interest are to receive in exchange for the partnership interests. The cash, property, rights, interests, or securities may be in addition to or in lieu of interests or other securities of the surviving partnership or surviving other business entity. If the partnership interests are canceled without consideration, that fact must be stated.

- Any other details or provisions required by the laws under which any constituent other business entity is organized.

- Any other details or provisions that are desired, including, without limitation, a provision for the treatment of fractional partnership interests.

[c] Scope of Agreement

A duly approved merger agreement, in addition to stating the terms of merger, may amend the partnership agreement of any domestic constituent partnership, or adopt an entirely new partnership agreement for a domestic constituent partnership, if it is the surviving partnership in the merger. Any amendment to a partnership agreement or adoption of a new partnership agreement will be effective as of the time or date the merger is effective [*Corp. Code § 16911(e)*].

[d] Amendment

After approval, a merger agreement may be amended before the merger takes effect if the amendment is approved by the partners of each constituent partnership in the same manner as required for approval of the original agreement of merger, and by each of the constituent other business entities [*Corp. Code § 16911(c)*].

[e] Abandonment

The partners of a constituent partnership may in their discretion, abandon a merger in the same manner that is required for approval of the original agreementof merger. However, abandonment is subject to the contractual rights, if any, of third parties, including other constituent partnerships and constituent other business entities [*Corp. Code § 16911(d)*].

[f] Maintenance and Provision of Copies

The surviving partnership or surviving other business entity must keep the merger agreement at the following locations [*Corp. Code § 16911(f)*]:

- The principal place of business of the surviving entity if the surviving entity is a partnership or a foreign other business entity.

- The office referred to in *Corp. Code § 1500* if the surviving entity is a domestic corporation.

- The office referred to in *Corp. Code § 15614(a)* or 15901.14, if the surviving entity is a domestic limited partnership, or at the office referred to in *Corp. Code § 17057*, if the surviving entity is a domestic limited liability company.

On the request of a partner of a constituent partnership or a holder of interests or other securities of a constituent other business entity, the authorized person on behalf of the partnership or the surviving other business entity must promptly deliver a copy of the merger agreement to the requesting party. The copy is provided at the partnership's or other entity's expense, and a waiver of the right to a copy of the merger agreement is unenforceable [*Corp. Code § 16911(f)*].

[3] Statements, Agreements, and Certificates of Merger

[a] Generally

UPA '94 provides for the filing of either a statement of merger or a certificate of merger, depending on who the parties to the merger are. The purpose of filing either document is the same: to place third parties on notice of the merger, fix its effective date, and establish record title to real property. The UPA '94 provisions permitting or requiring these fillings, and the interrelated provisions regarding effective dates of mergers, are not models of clarity.

[b] Statement of Merger

Filing a statement of merger is not mandatory. UPA '94 provides that it may be filed in the following circumstances [*Corp. Code § 16915(a)*]:

- In a merger involving a domestic partnership and another partnership in which no other domestic

other business entity is a party, e.g., two domestic partnerships or a domestic partnership and a foreign partnership.

- In a merger involving a domestic partnership and a foreign other business entity in which no other domestic other business entity is a party, e.g., a domestic partnership and a foreign limited partnership or limited liability company.

The statement of merger may be filed in the Secretary of State's office by either the surviving partnership or the surviving foreign other business entity. The statement declares that one or more partnerships have merged into the surviving partnership or surviving foreign other business entity, or that one or more partnerships or foreign other business entities have merged into the surviving domestic partnership, and contains the following [*Corp. Code § 16915(a)*]:

- The name of each partnership or foreign other business entity that is a party to the merger.

- The name of the surviving entity into which the other partnerships or foreign other business entities were merged.

- The street address of the surviving entity's chief executive office and of an office in California, if any.

- Whether the surviving entity is a partnership or a foreign other business entity, specifying the type of the entity.

[c] Certificate of Merger

[i] When and by Whom Filed

Filing a certificate of merger is mandatory in any merger involving a domestic partnership when a domestic other business entity is also a party [*Corp. Code § 16915(b)*]. This does not mean that either has to be the survivor, nor that the merger might not also involve, for example, a foreign partnership or other business entity.

After approval of the merger by the constituent parties, a certificate of merger must be filed in the office of the Secretary of State by both the constituent partnerships and the constituent other business entities. It must be filed on a form prescribed by the Secretary of State, and must be executed and acknowledged by each domestic constituent partnership by two partners (unless a lesser number is provided in the partnership agreement), by each foreign constituent partnership by one or more partners, and by each constituent other business entity by those persons required to execute the certificate of merger by the laws under which the constituent other business entity is organized [*Corp. Code § 16915(b)*].

Form GP-6, which formerly was used for both statements of merger and certificates of merger, is no longer used for a certificate of merger. Instead, Secretary of State Form OBE MERGER-1 is used when a certificate of merger is needed. For an illustration of the latter form, official instructions and comments, and discussion, see *Ch. 16B, Conversions and Mergers of Limited Partnerships, § 16B.421*.

[ii] Contents

The certificate of merger must set forth all of the following [*Corp. Code § 16915(b)*]:

- The names and the Secretary of State's file numbers, if any, of each of the constituent partnerships

and constituent other business entities, separately identifying the disappearing partnerships and disappearing other business entities and the surviving partnership or surviving other business entity.

- If a vote of the partners was required, a statement that the principal terms of the agreement of merger were approved by a vote of the partners, which equaled or exceeded the vote required.

- If the surviving entity is a domestic partnership and not an other business entity, any change to the information set forth in any filed statement of partnership authority of the surviving partnership resulting from the merger, including any change in the name of the surviving partnership resulting from the merger. The filing of a certificate of merger setting forth any changes to any filed statement of partnership authority of the surviving partnership has the effect of the filing of a certificate of amendment of the statement of partnership authority by the surviving partnership, and no other amendment need be filed [*see Corp. Code § 16105(d)* (amending statements of authority); *see also § 15.287[2]* (statement of amendment or cancellation)].

- The future effective date or time (which must be a date or time certain not more than 90 days subsequent to the date of filing) of the merger, if the merger is not to be effective upon the filing of the certificate of merger with the office of the Secretary of State.

- If the surviving entity is an other business entity or a foreign partnership, the full name, type of entity, legal jurisdiction in which the entity was organized and by whose laws its internal affairs are governed, and the address of the principal place of business of the entity.

- Any other information required to be stated in the certificate of merger by the laws under which each constituent other business entity is organized.

[d] Agreement of Merger

If the surviving entity is a domestic corporation or a foreign corporation in a merger involving a domestic corporation, the surviving corporation must file a copy of the agreement of merger and the requisite attachments [*Corp. Code § 16915(b)*; *see Corp. Code § 1113(g)(1)*]. For further discussion of mergers involving corporations, see Ch. 11, *Merger and Acquisition Issues* .

[e] Effect of Filing

A filed statement of merger or a certificate of merger has the effect of the filing of a cancellation for each disappearing partnership of any statement of partnership authority filed by it [*Corp. Code § 16915(c)*].

For all mergers in which a certificate of merger is required to be filed, a copy of the certificate of merger duly certified by the Secretary of State is conclusive evidence of the merger of [*Corp. Code § 16912(b)*]:

- The constituent partnerships (either by themselves or together with constituent other business entities) into the surviving other business entity; or

- The constituent partnerships or the constituent other business entities, or both, into the surviving partnership.

[4] Effective Date of Merger

[a] When Certificate of Merger Is Required

When a certificate of merger is required to be filed [*see* [3][c], *above*], the merger will be effective as of the date it is filed, unless a later effective date or time is specified in the certificate [*Corp. Code §§ 16912(a), 16913(c)*]. This means, for example, that in a merger between a domestic partnership and a domestic limited partnership, the merger will be effective as of the date the certificate of merger is filed unless the certificate specifies a later date. If, however, such a merger also involved a foreign partnership or other business entity, and that partnership or entity was the survivor, the merger becomes effective in accordance with the law of the survivor's jurisdiction [*Corp. Code § 16913(d)*].

[b] Merger Not Involving Domestic Other Business Entity

A merger in which no domestic other business entity is a party (e.g., between two general partnerships) to the merger is effective on the later of any of the following [*Corp. Code § 16912(b)*]:

- The approval of the agreement of merger by all parties to the merger [*see Corp. Code § 16911*];
- The filing of all documents required by law to be filed as a condition to the effectiveness of the merger; or
- Any effective date specified in the agreement of merger.

[5] Effect of Merger on Constituent Parties

When a merger takes effect, the separate existence of the disappearing partnerships and disappearing other business entities ceases, and the surviving partnership or surviving other business entity succeeds, without other transfer, act or deed, to all the rights and property whether real, personal, or mixed, of each of the disappearing parties. The survivor is subject to all the debts and liabilities ofeach in the same manner as if the surviving partnership or surviving other business entity had itself incurred them [*Corp. Code § 16914(a)*].

[6] Effect of Merger on Rights of Creditors and Others

[a] Enforcement of Liens Against Survivor

When a merger takes effect, all rights of creditors and all liens on the property of each of the constituent partnerships and constituent otherbusiness entities are preserved unimpaired, and may be enforced against the surviving partnership or the surviving other business entity to the same extent as if the debt, liability or duty which gave rise to that lien had been incurred or contracted by it. Liens on the property of a disappearing partnership or disappearing other business entity are limited, however, to the property affected thereby immediately prior to the time the merger is effective [*Corp. Code § 16914(a)*].

[b] Pending Actions

When a merger takes effect, any action or proceeding pending by or against any disappearing partnership or disappearing other business entity may be prosecuted to judgment, which will bind the surviving entity. In the alternative, the surviving entity may be proceeded against or be substituted in the disappearing party's place [*Corp. Code § 16914(a)*].

[c] The Secretary of State as Agent for Service of Process

Unless a certificate of merger has been filed to effect the merger, a surviving foreign entity must promptly notify the Secretary of State of the mailing address of its agent for service of process, its chief executive office, and of any change of address [*Corp. Code § 16914(b)(1)*]. To enforce an obligation of a partnership that has merged with a foreign partnership or foreign other business entity, the Secretary of State will only be the agent for service of process in a suit

against the surviving foreign partnership or foreign other business entity if any of the following conditions exists [*Corp. Code § 16914(b)(1)*]:

- The agent designated for the service of process for that entity is a natural person and cannot be located with due diligence.

- The agent is a corporation and no person to whom delivery may be made can be located with due diligence.

- No agent has been designated and no one of the officers, partners, managers, members, or agents of the entity can be located after diligent search, and it is so shown by affidavit to the satisfaction of the court.

The court will then make an order that service be made by personal delivery to the Secretary of State (or to an assistant or deputy Secretary of State) of two copies of the process together with two copies of the order; the order must also state an address to which the process will be sent by the Secretary of State. Service in this manner is deemed complete on the 10th day after delivery of the process to the Secretary of State [*Corp. Code § 16914(b)(1)*].

On receipt of the process and order and the applicable fee [*see Gov. Code § 12197(c)*], the Secretary of State will provide notice to the entity of the service of the process by forwarding by certified mail, return receipt requested, a copy of the process and order to the address specified in the order [*Corp. Code § 16914(b)(2)*]. The Secretary of State will keep a record of all process served on the Secretary and record the time of service and the Secretary's action with respect to the process. The Secretary's certificate, under official seal, certifying to the receipt of process, the provision of notice to the entity, and the forwarding of the process, constitutes competent and prima facie evidence of the matters stated [*Corp. Code § 16914(b)(3)*].

[7] Liabilities of Partners or Members of Surviving Entity

[a] Pre-Merger and Post-Merger Obligations of Constituent Parties

A partner of the surviving partnership or surviving limited partnership, a member of the surviving limited liability company, a shareholder of the surviving corporation, or a holder of equity securities in the surviving other business entity is liable for all of the following [*Corp. Code § 16914(c)*]:

- All obligations of a party to the merger for which that person was personally liable before the merger.

- All other obligations of the surviving entity incurred before the merger by a party to the merger, but those obligations may be satisfied only out of property of the entity.

- All obligations of the surviving entity incurred after the merger takes effect, but those obligations may be satisfied only out of property of the entity if that person is a limited partner, a shareholder in a corporation, or, unless expressly provided otherwise in the articles of organization or other governing documents, a member of a limited liability company or a holder of equity securities in a surviving other business entity.

[b] When Pre-Merger Obligations Not Satisfied out of Survivor's Property

If the pre-merger obligations of a partnership or limited partnership are not satisfied out of the property of the surviving entity, those who were general partners immediately before the effective date of the merger must contribute the amount

needed to satisfy that partnership's or limited partnership's obligations to the surviving entity. The contribution willmade as if the merged party had dissolved, i.e., be proportional to the partner's share in partnership losses [*see Corp. Code § 16807(c)* (partner's contribution on liquidation)]. In the case of a partner in a foreign limited partnership, the contribution will be determined by that jurisdiction's laws concerning the liability of general partners on dissolution [*Corp. Code § 16914(d)*].

[8] Effect of Merger on Title to Real Property

[a] Recording Certificate or Statement of Merger

The recording of a statement of merger, agreement of merger, or certificate of merger, certified by the Secretary of State or authorized official of the state or place under whose laws the merger is effected, in the county recorder's office in the county where the disappearing partnership or other business entity owns California real property, is evidence of record ownership of all interest in the property in the surviving partnership or other entity. This rule operates only when the law of the jurisdiction of the disappearing entity provides, as does UPA '94 [*see Corp. Code § 16914(a)*], that the effect of merger is to vest in the surviving partnership or other business entity all the real property of the disappearing partnership or other business entity [*Corp. Code § 16916(a)*].

A filed, and if appropriate, recorded certificate of merger need not contain all the information required in a statement of merger [*see Corp. Code § 16915(a)*] to effect a change of record title. It is enough if the statement is executed and declared to be accurate under penalty of perjury [*see Corp. Code § 16105(c)*] by two partners (or an authorized person if on behalf of an other business entity), and states (1) the names of the disappearing partnership or other business entity that held title to the real property, and (2) the name of the surviving entity [*Corp. Code § 16916(b)*].

[b] Presumption in Favor of Bona Fide Purchasers

If a certified copy of a certificate of merger is duly recorded it creates a conclusive presumption in favor of bona fide purchasers for value that the merger was validly completed [*Corp. Code § 16916(c)*]. Note that UPA '94 does not accord the same protection to bona fide purchasers when it is a certified *statement* of merger rather than a certificate of merger that is recorded. This is probably a drafting oversight.

[9] Right of Dissenting Partner to Dissociate

A partner of a domestic disappearing partnership who does not vote in favor of a merger and does not agree to become a partner, member, shareholder, or holder of interest or equity securities of the surviving partnership or surviving other business entity has the right to dissociate from the partnership as of the date the merger takes effect [*Corp. Code § 16914(e)*].

Within 10 days after the partners' approval of a merger, the partnership must send notice of the approval to each partner that has not approved the conversion, accompanied by copies of *Corp. Code § 16701* (buyout provisions) and a brief description of the procedure to be followed under that section if the partner wishes to dissociate from the partnership. A partner that wants to dissociate must send written notice of dissociation within 30 days after the date of the notice of the approval of the merger. The disappearing partnership must then cause the partner's interest in the entity to be purchased [*Corp. Code § 16914(e)*].

The surviving entity is bound under *Corp. Code § 16702* by an act of a dissociated general partner, and the partner is liable under *Corp. Code § 16703* for transactions entered into by the surviving entity after the merger takes effect [*Corp. Code § 16914(e)*]. To limit the scope of this liability, the partnership and/or the dissociating partner will want to file a statement of dissociation that has the effect of placing third persons on notice of the dissociation [*see Corp. Code § 16704*]. The dissociation of a partner in connection with a merger pursuant to these rules does not constitute a wrongful dissociation [*Corp. Code § 16914(e)*; *see Corp. Code § 16602*]. For a detailed discussion of dissociation,

including the buyout of dissociated partners and the liabilities of the partnership on dissociation, see the Legal Background to Part B of this chapter.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesGeneral OverviewMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawAntitrustTransnational MergersMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide § 15.604

§ 15.604 Tax Consequences of Conversion or Merger

[1] Conversions to Limited Partnerships and Limited Liability Companies

The tax consequences of conversion of a general partnership either to limited partnership or limited liability company taxed as a partnership are the same, according to IRS rulings [*Rev. Rul. 84-52, 1984-1 C.B. 157* (conversion to limited partnership); *Rev. Rul. 95-37, 1995-1 C.B. 130* (conversion to limited liability company)]. Thus, the tax consequences of a conversion are as follows:

- Partners do not recognize gain or loss on the conversion;
- The partnership is not terminated for tax purposes unless its business will not continue after the conversion;
- The adjusted basis of any partner's interest in the partnership is not changed if the partners' shares of partnership liabilities do not change;
- If the partners' shares of partnership liabilities change causing a deemed contribution of money to the partnership, the adjusted basis of the partner's interest is increased by the amount of the deemed contribution;
- If the partners' shares of partnership liabilities change causing a deemed distribution of money to a partner, then the basis of such a partner's interest will be reduced (but not below zero) by the amount of the deemed distribution, and gain must be recognized by the partner if the deemed distribution exceeds the partner's adjusted basis; and
- The partners' holding period for the partnership interest is not changed.

Additionally, the conversion does not cause the taxable year of the partnership to close with respect to all the partners or

with respect to any partner. Furthermore, because the conversion does not cause a termination, the new limited partnership or limited liability company does not need to obtain a new taxpayer identification number [*Rev. Rul. 95-37, 1995-1 C.B. 130*].

The IRS ruling on conversions to limited liability companies does not apply to any conversion to a limited liability company classified as a corporation [*Rev. Rul. 95-37, 1995-1 C.B. 130*].

California generally follows the federal tax law in the area of taxation of partnerships [*Rev. & Tax. Code § 17851*].

[2] Mergers With Other General or Limited Partnerships

When two or more partnerships merge or consolidate into one partnership, the IRS deems the resulting partnership to be a continuation of the merging or consolidating partnership whose partners own an interest of more than 50 percent in the capital and profits of the resulting partnership [*I.R.C. § 708(b)(2)(A)*; *Treas. Reg. § 1.708-1(c)(1)*]. If the resulting partnership can be considered a continuation of more than one of the merging or consolidating partnerships, the partnership will be considered the continuation of solely that partnership that is credited with the contribution of assets having the greatest fair market value (net of liabilities) to the resulting partnership unless the Commissioner permits otherwise [*Treas. Reg. § 1.708-1(c)(1)*]. The other merging partnerships are terminated [*Treas. Reg. § 1.708-1(c)(1)*]. If none of the partners of the merging partnerships hold an interest of more than 50 percent, then all the merging partnerships are considered terminated and the resulting partnership is a new partnership [*Treas. Reg. § 1.708-1(c)(1)*]. The IRS has ruled that the merger provisions of *I.R.C. § 708(b)(2)(A)* take precedence over the 50 percent termination rules of *I.R.C. § 708(b)(1)(B)* [*Ltr. Rul. 8619015 (Feb. 5, 1986)*].

Termination of the merging partnerships does not have tax consequences to the partners because the partnerships that terminate are treated as having contributed all of their respective assets and liabilities to the resulting partnership in exchange for a partnership interest. That partnership interest is then treated as having been transferred to the partners in liquidation of their partnership interests with their basis determined under *I.R.C. § 732(b)* [*Rev. Rul. 68-289, 1968-1 C.B. 314*]. Because there is no deemed distribution of cash, there is no recognition of gain to the partners [*see I.R.C. § 731*]. There is no termination of the continuing partnership under the rule requiring a termination when more than 50 percent of the partnership interests are sold or exchanged within a twelve month period even though more than 50 percent is distributed by the terminating partnerships [*Rev. Rul. 90-17, 1990-1 C.B. 119*].

This treatment for mergers differs from the treatment when there is a termination because of the sale or exchange of more than 50 percent of the total capital and profits interest of a partnership within a 12 month period [*see I.R.C. § 708(b)(1)(B)*]. In this situation, there is a deemed distribution of partnership properties to the partners based on their respective partnership interests, and a contribution by the continuing partners of those properties to the new partnership [*Treas. Reg. § 1.708-1(b)(4)*]. This can result in the recognition of gain or recapture of tax credits to partners depending on the cash position and partnership property held by the partnership.

[3] Mergers With Limited Liability Companies

The IRS has not ruled on the tax consequences of mergers of partnerships and limited liability companies as it has on the conversion of a partnership to a limited liability company [*Rev. Rul. 95-37, 1995-1 C.B. 130*]. Although it is likely that such mergers will be treated similar to partnership mergers, until there is a ruling practitioners should consider requesting a private letter ruling to assure that there are no unintended income tax consequences of the merger.

[4] Property Taxation

Increased property taxes on partnership or limited liability company property can be a side effect of mergers and even of conversions if enough partners choose not to become members of the new business entity. Ordinarily, the transfer or

purchase of interests in partnerships and limited liability companies is not a transfer of real property that will subject the property to reassessment [*Rev. & Tax. Code § 64(a)*]. But when there is a more than 50-percent change in ownership in a partnership or limited liability company, there is a transfer of the entity's real property that causes reassessment and potentially increased property taxes [*Rev. & Tax. Code § 64(c)*]. The purchase of minority partnership interests by a majority partner is exempted from this reassessment [*Rev. & Tax. Code § 64(c)(2)*]. Thus, practitioners must determine the change in ownership of partnership and limited liability interests in mergers and conversion to accurately predict whether there will be a deemed change of ownership of the entity's real estate causing a reassessment and potential property tax increases.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawMergersGeneral OverviewMergers & Acquisitions LawTax-Free AcquisitionsMergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsAcquiring an Interest (IRC secs. 709, 721)Tax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsTransfers of Interest (IRC secs. 741-743)Exchanges & Sales of Partnership Interests



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART II. LEGAL BACKGROUND

7-15 California Legal Forms--Transaction Guide §§ 15.605-15.719

[Reserved]

§§ 15.605[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

7-15 California Legal Forms--Transaction Guide § 15.720

§ 15.720 Facts

NOTE:

This transaction guide does not attempt to enumerate the steps necessary to form the entities into which a partnership can convert or with which it can merge. If the converted or surviving entity is a limited partnership or a limited liability company, the chapters containing the appropriate procedures and forms should be consulted [***see*** Ch. 12C, ***Limited Liability Companies*** , and Ch. 16, ***Formation of Limited Partnerships***]. If a general partnership is the survivor in a merger, then the procedures and forms in Part A of this chapter should be reviewed.

[1] Information Relating to Partnership

1. Reasons why partnership proposes to convert into or merge with another entity.

NOTE:

The business objectives driving a decision to convert or merge will often include the need to limit the partners' liability, although other considerations, such as synergy or the need to meet competition more effectively, may also play a role. It should be noted that if the partnership is a law, architecture, or accounting partnership seeking limited liability, it may convert only to a registered limited liability partnership [*Corp. Code § 16101(7), (8), (14)*; ***see*** Ch. 16C, ***Limited Liability Partnerships***], or form a professional corporation [***see*** Ch. 12C, ***Professional Corporations***].

2. Type and general characteristics of business.

NOTE:

The choice of the converted or surviving entity may be limited by the nature of the

partnership's business. For example, real estate, high technology, venture capital, oil and gas, and theatrical investments are enterprises regarded as well-suited to the limited liability company structure. On the other hand, limited liability companies currently cannot engage in professional practices, banking, insurance, or trust company business [*Corp. Code §§ 17002(a), 17375*; ***see*** *Corp. Code §§ 13401(a), 13401.3*; ***but see*** *Corp. Code § 17002(b)* (subsidiary LLC may operate as licensed health care service plan)].

3. Names and addresses of all partners.

4. Partnership mailing address and principal place of business.

5. Tax identification number of partnership.

6. Name and address of registered agent for service of process of every corporate partner.

7. Desired effective date of proposed conversion or merger.

NOTE:

For the effective date of conversion to a domestic limited partnership or limited liability company, see *§ 15.602[5]*. For the effective date of conversion to a foreign other business entity, see *§ 15.602[6]*. For the effective date of a merger, see *§ 15.603[4]*.

8. Each partner's distributive share of net partnership profits and losses.

9. Any provisions in existing partnership agreement regarding required approval for conversion or merger or to amend agreement.

NOTE:

For approvals required for a conversion, see *§ 15.602[3][b]*. For approvals required for a merger, see *§ 15.603[2]*.

10. Complete information concerning any pending litigation to which partnership is a party, including names of counsel.

11. Names of partners who are likely to dissent from conversion or merger.

NOTE:

Partners who do not approve a conversion and partners of a disappearing partnership who do not approve a merger may dissociate from the partnership and the partnership will be required to buy them out, either in accordance with an existing buyout agreement or pursuant to the buyout provisions of UPA '94 [***see*** *Corp. Code §§ 16909(e), 16914(e)*; ***see also*** the discussion in *§ 15.303[2]*].

12. Whether partners are aware of potential costs of conversion or merger.

a. Attorneys, accountants, and appraisers fees.

b. Property taxation of changes in ownership.

NOTE:

For a discussion of the property tax consequences of conversion or merger, see *§ 15.604*.

c. Franchise taxes and fees.

NOTE:

For example, a limited liability company must pay an annual minimum franchise tax of $800 [*Rev. & Tax. Code § 17941*], and must pay an additional fee based on total income over $250,000 [*Rev. & Tax. Code § 17942(a)*; ***see*** *Rev. & Tax. Code § 17942(b)(1)*, 24172 ("total income" defined)]. Filing fees include fees for filing articles and a statement of information [***see*** *Gov. Code § 12190(b), (k)*].

d. Potential income tax consequences.

NOTE:

There are no adverse income tax implications in a conversion to a limited partnership or limited liability company [*Rev. Rul. 84-52, 1984-1 C.B. 157* ; ***see*** *Rev. Rul. 95-37, 1995-1 C.B. 130*]. With respect to mergers, however, especially in mergers involving limited liability companies, the income tax consequences are less certain. See *§ 15.604* for further discussion of these issues.

[2] Facts Relating to Converted or Surviving Entity

1. Does law of jurisdiction of entity to be created by conversion expressly permit entity to be formed by conversion [*see Corp. Code § 16902(b)*]?

2. Are entities with which partnership will merge authorized by law to do so [*see Corp. Code § 16910(b)*]?

3. Extent to which existing partnership agreement will be blueprint for governance of converted or surviving entity.

4. Name of converted or surviving entity.

5. Length of time converted or surviving entity is to continue, either:

a. Specified period, or

b. Until dissolved by agreement, or

c. Until specified undertaking is completed, or

d. Until dissolved by some specific act or event.

6. How partnership interests are to be exchanged for interests in converted or surviving entity.

NOTE:

Conversion into a domestic or foreign limited partnership or limited liability company may be effected only if each of the partners of the converting partnership will receive a percentage interest in the profits and capital of the converted other business entity equal to the partner's percentage interest in profits and capital of the converting partnership as of the effective time of the conversion [*Corp. Code § 16902(a)(1)*

]. Conversion into any other business entity or foreign other business entity may be effected only if each of the partnership interests of the same class is treated equally with respect to any distribution of cash, property, rights, interests, or securities of the converted other business entity unless all partners of the same class consent [*Corp. Code § 16902(a)(2)*].

7. Person(s) who will be general partners if partnership converting to or merging with limited partnership.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesGeneral OverviewMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

7-15 California Legal Forms--Transaction Guide § 15.721

§ 15.721 Documents

1. Partnership agreement.

2. Any separate buyout agreements for partner's interest.

3. Current financial statements balance sheet.

4. All instruments evidencing title, e.g.,

    a. Deeds.

    b. Documents of title to motor vehicles.

    c. Leases.

5. Licenses and permits, if any.

6. Franchise agreements, if any.

7. Fictitious business name statement, if any.

8. Insurance policies on all real and personal property contributed to the partnership.

9. Insurance policies, if any, used to fund cross purchase agreements.

10. Any separate buyout agreements for the interests of dissociating partners.

11. Copy of statement of partnership authority on file with Secretary of State.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

7-15 California Legal Forms--Transaction Guide §§ 15.722-15.729

[Reserved]

§§ 15.722[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

7-15 California Legal Forms--Transaction Guide § 15.730

§ 15.730 Approval of Conversion or Merger

1. Can conversion or merger be approved by vote specified in partnership agreement?

NOTE:
Absent a specific provision for approval of a conversion or merger, the vote needed to approve an amendment to the partnership agreement will suffice to approve the conversion or merger. If the agreement is silent as to conversions, mergers and amendments, then all the partners must approve a conversion or merger [*Corp. Code §§ 16903(b), 16911(a)*].

2. Will proposed conversion or merger effect change requiring greater approval than is needed to amend agreement?

NOTE:
For example, if the number or percentage of partners required to ratify a self-dealing transaction is greater than that required to amend the partnership agreement, that higher number or percentage will have to approve the conversion or merger if the ratification approval requirements are changed (presumably by making them lower or eliminating them altogether) by the charter documents of the converted or surviving entity [***see*** *Corp. Code §§ 16903(b), 16911(a)*].

3. How will purchase of dissenting interests be funded?

a. Sale to remaining partners.

b. Liquidation of interest by partnership.

NOTE:

Absent provisions in the agreement to the contrary, UPA '94 provisions for the buyout of a dissociated partner's interest will apply [***see*** *Corp. Code § 16701*; ***see also*** *§ 15.303[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesRights of PartnersAuthority to ActMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

7-15 California Legal Forms--Transaction Guide § 15.731

§ 15.731 Operation of Converted or Surviving Entity

NOTE:

Many of the following organizational issues may be mooted in a partnership conversion if the converted entity will be operated in much the same way as the predecessor partnership. This is also true in a merger when the partners in a disappearing partnership become subject to the existing agreement of the surviving entity. If conversion or merger requires the drafting of entirely new articles of partnership or an entirely new organizational agreement, the following items are important and should be considered in conjunction with the determinations relevant to the formation of the converted or surviving entity; i.e., a general or limited partnership or a limited liability company [***see*** Part A of this chapter; Ch. 12C, ***Limited Liability Companies***; Ch. 16, ***Formation of Limited Partnerships***].

1. Special duties, if any, each general partner or member will perform in converted or surviving entity.

2. Designation of general partners or manager(s) of converted or surviving entity.

3. Vote to be required for administrative and/or business matters.

4. Grounds for expulsion of general partners or members of converted or surviving entity.

5. Terms for admission of new general partners or members.

6. Weight accorded each general partner's or member's vote.

7. Amount of time each general partner or member must devote to converted or surviving entity.

8. Restrictions, if any, to be placed on general partners' or members' outside business activities.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsGeneral OverviewMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

7-15 California Legal Forms--Transaction Guide §§ 15.732-15.739

[Reserved]

§§ 15.732[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART III. TRANSACTION GUIDE
C. Procedural Guide

7-15 California Legal Forms--Transaction Guide § 15.740

§ 15.740 Conversion

1. Draft plan of conversion containing [*Corp. Code § 16903(a) see § 15.800[2]* (form)]:

a. Terms and conditions of conversion.

b. Place of organization of converted entity and of converting partnership.

c. Name of converted entity after conversion, if different from that of converting partnership.

d. Manner of converting partnership interests of each partner into shares of, securities of, or interests in converted entity.

NOTE:
A general partnership may be converted into a domestic other business entity or a foreign other business entity [***see*** *Corp. Code § 16902(a)*]. Conversion into a domestic or foreign limited partnership or limited liability company may be effected only if each of the partners of the converting partnership will receive a percentage interest in the profits and capital of the converted other business entity equal to the partner's percentage interest in profits and capital of the converting partnership as of the effective time of the conversion [*Corp. Code § 16902(a)(1)*]. Conversion into any other business entity or foreign other business entity may be effected only if each of the partnership interests of the same class is treated equally with respect to any distribution of cash, property, rights, interests, or securities of the converted other business entity unless all partners of the same class consent [*Corp. Code § 16902(a)(2)*].

e. Provisions of governing documents for converted entity, such as limited partnership agreement including limited partnership agreement, limited liability company articles of organization and operating agreement, or articles or certificate of incorporation if converted entity is a corporation, to which holders of interest in converted entity will be bound.

NOTE:

Including provisions of the converted entity's governing document is normally accomplished by attaching it and incorporating it by reference.

f. Any other details or provisions required by laws under which converted entity is organized.

g. Any other details or provisions that are desired.

h. Effective date of conversion.

NOTE:

If a partnership is converting into a domestic other business entity, conversion is effective on the date when all of the following have occurred: (1) the approval of the conversion plan; (2) the filing of all documents required by law to create the converted entity, including, if required, a statement of conversion; and (3) the effective date set forth in the plan of conversion [*Corp. Code § 16904(a)*].

If the partnership is converting to a foreign other business entity, conversion is effective according to the law of the foreign jurisdiction [*Corp. Code § 16902(b)*].

2. Submit plan of conversion for approval of partners.

NOTE:

Absent a specific provision for approval of a conversion, the vote needed to approve an amendment to the partnership agreement will suffice to approve a conversion. However, if the conversion effects a change for which the partnership agreement requires a greater number or percentage of partners than is required to amend the agreement, the plan of conversion must be approved by that greater number or percentage [*Corp. Code § 16903(b)*]. If the agreement is silent as to conversions and amendments, then all the partners must approve a conversion [*Corp. Code §§ 16903(b), 16911(a)*]. In addition to the foregoing approvals, if the partnership is converting into a limited partnership, then the plan of conversion must be approved by all partners who will become general partners of the converted limited partnership pursuant to the plan of conversion [*Corp. Code § 16903(c)*].

3. Submit any amendments of plan of conversion to partners for approval by same vote as required for adoption of original plan [*Corp. Code § 16903(e)*].

4. If partners decide to abandon conversion, arrange for vote to abandon by same vote required to approve original plan [*Corp. Code § 16903(f)*].

NOTE:

The plan can be abandoned at any time before the conversion is effective, but abandonment cannot prejudice the rights of third parties [*Corp. Code § 16903(f)*].

5. File one of following, as appropriate [*Corp. Code § 16906(a)*]:

NOTE:

Converting partnerships that have filed a statement of partnership authority that is effective at the time

of conversion must file the certificate of limited partnership, articles of organization, or articles of incorporation containing a statement of conversion on conversion to a domestic limited partnership, limited liability company, or corporation [*Corp. Code § 16906(a)*; ***see*** *Corp. Code § 16303*; ***see also*** *§ 15.15[3]*]. If the converting partnership has no effective statement of partnership authority on file, the converted domestic entity may file the statement on its certificate of limited partnership, articles of organization, or articles of incorporation [*Corp. Code § 16906(a)*]. These optional filings are recommended. Once a certificate of limited partnership or articles of organization containing a statement of conversion, or a certificate of conversion is filed, the document has the effect of canceling any statement of partnership authority on file [*Corp. Code § 16906(c)*]. The applicable filing fee is set forth in *Corp. Code § 16113(b)*.

a. LP-1A, Certificate of Limited Partnership--Conversion [*see § 16B.411*] for general partnership that is converting into California limited partnership [*Corp. Code § 16906(a)*].

NOTE:

The form mentioned above contains the statement of conversion language prescribed by statute [***see*** *Corp. Code § 16906(a)*].

b. Form LLC-1A, Limited Liability Company Articles of Organization--Conversion [*see § 12C.200A*] for general partnership that is converting into California limited liability company [*Corp. Code § 16906(a)*].

NOTE:

The form mentioned above contains the statement of conversion language prescribed by statute [***see*** *Corp. Code § 16906(a)*].

c. Certificate of conversion (Form CONV-1A) [*see § 15.802*] for general partnership that is converting to foreign other business entity [*Corp. Code § 16906(b)*].

NOTE:

Corp. Code § 16906(b) provides that a California general partnership that is converting into a foreign other business entity--that is, a limited partnership, limited liability company, corporation, business trust, real estate investment trust, or unincorporated association other than a nonprofit association, but excluding a general partnership [***see*** *Corp. Code § 16901(6), (12)*]--that has filed a statement of partnership authority under *Corp. Code § 16303* [***see*** *§ 15.285*] that is effective at the time of conversion ***may*** file a certificate of conversion with the Secretary of State [*Corp. Code § 16906(b)*]. Note that *Corp. Code § 16906(b)* uses the word "may," which would appear to mean that the filing of a certificate of conversion is optional in all cases involving conversion to a foreign entity. In contrast, the official instructions to the Secretary of State's form [***see*** *§ 15.802*] state that this form "shall" be filed with the Secretary of State, which would indicate that the Secretary of State's office regards such a filing as mandatory.

Although the statute does not mandate that the official form be used for filing a certificate of conversion [*Corp. Code § 16906(b)*; ***cf.*** *Corp. Code § 16906(a)*, which does require that the official forms be used for ***statements*** of conversion], there is no reason to draft a non-standard form, nor is there any guarantee that such a form would be readily accepted by the Secretary of State's office in lieu of the official form.

d. For California general partnership that is converting into domestic corporation, prepare and file articles of incorporation as follows:

NOTE:

For an illustration of the Secretary of State's sample set of articles of incorporation for a California general partnership that is converting into a California stock corporation, see *§ 15.803*. The sample form includes suggested language for the required statement of conversion, containing the information specified below. For sample articles applicable to foreign limited partnerships that convert to California corporations, see *§ 15.804*.

(1) Include in articles of incorporation for converted entity a statement of conversion containing following information [*Corp. Code §§ 1157(e), 16906(a), (b)*]:

(a) Name, form, and jurisdiction of organization of converting entity [*Corp. Code §§ 1157(e), 16906(b)(1)*].

(b) Secretary of State's file number, if any, of converting partnership [*Corp. Code §§ 1157(e), 16906(b)(1)*].

(c) Statement that principal terms of plan of conversion were approved by vote of partners that equaled or exceeded vote required under *Corp. Code § 16303* [*Corp. Code § 16906(b)(2)*].

(g) If converting entity is a foreign general partnership, all of following [*Corp. Code § 1157(e)*]:

(i) Statement that converting entity is authorized to effect conversion by laws under which it is organized.

(ii) Statement that converting entity has approved plan of conversion or other instrument that is required to be approved to effect conversion under laws under which converting entity is organized.

(iii) Statement that conversion has been approved by number or percentage of partners, members, shareholders, or other holders of interest of converting entity that is required by laws under which that entity is organized, or a greater or lesser percentage that may be set forth in converting entity's partnership agreement, articles of organization, operating agreement, articles of incorporation, or other governing document in accordance with applicable laws.

(2) File articles of incorporation with Secretary of State as follows [*see § 15.803[2]* (official filing instructions)]:

(a) Include original and at least two copies with submission.

NOTE:

The Secretary of State will certify two copies of the filed document without charge, provided that the copies are submitted to the Secretary of State with the document to be filed. Any additional copies submitted will be certified on request and payment of an additional per-copy certification fee.

(b) Include appropriate filing fee.

(c) Include both of following in submission to facilitate return of documents [*see* Conversion of a California General Partnership Into a California Stock Corporation, Instructions, in § 15.803[2]]:

(i) Self-addressed envelope.

(ii) Letter referencing corporate name and sender's name, return address, and telephone number.

(d) Mail or hand deliver filing packet to Sacramento office of Secretary of State.

NOTE:

These documents must be mailed or hand delivered for over-the-counter processing to the Sacramento office. They cannot be processed using the preclearance, expedited, wait for, or rush letter service, and cannot be filed in the regional offices [***see*** Conversion of a California General Partnership Into a California Stock Corporation, Instructions, in § 15.803[2]].

6. Record certified original or copy of certified certificate of conversion or certificate of limited partnership, articles of organization, or articles of incorporation containing statement of conversion in each county in which converted entity owns real property [*Corp. Code § 16907(a)*; *see* discussion of effect of recording in § 15.602[7]].

NOTE:

The fee for recording documents is $10 for the first page and $3 for each additional page [*Gov. Code § 27361*]; a separate fee for certifying the copy applies as well [***see*** *Gov. Code § 27364* (certification under seal fee determined by board of supervisors)]. A recorded statement that is not a copy certified by the Secretary of State will not have the effect given to such statements by UPA '94 [*Corp. Code § 16105(b)*].

7. Within 10 days of approval of conversion, notify by certified mail all partners not voting in favor of conversion of their right to dissociate and be bought out [*see § 15.821[2]* (form for notice)], and include [*Corp. Code § 16909(e)*]:

a. Copy of *Corp. Code § 16701* (statutory buyout provisions).

b. Brief description of procedure to be followed under that section if partner wishes to dissociate from partnership.

NOTE:

A partner that wants to dissociate must send written notice of dissociation within 30 days after the date of the notice of the approval of the conversion. The converting partnership must then cause the partner's interest to be purchased [*Corp. Code § 16909(e)*]. For a discussion of the buyout procedure, refer to § 15.303[2].

8. As to any dissociating partner, file statement of dissociation in the office of the Secretary of State, and record a certified copy in each county in which partnership owns property [*see* § 15.560[2] (form)].

NOTE:

The converting partnership is bound under *Corp. Code § 16702* by an act of a dissociated general partner, and the partner is liable under *Corp. Code § 16703* for transactions entered into by the converted entity after the conversion takes effect [*Corp. Code § 16909(e)*]. For the effect that filing a statement of dissociation has on third parties, see the discussion in *§ 15.306[2]*.

The filing fee is $30 [*Corp. Code § 16113(b)*]. The fee for recording documents is $10 for the first page and $3 for each additional page [*Gov. Code § 27361*]; a separate fee for certifying the copy applies as well [***see*** *Gov. Code § 27364* (certification under seal fee determined by board of supervisors)]. A recorded statement that is not a copy certified by the Secretary of State will not have the effect given to such statements by UPA '94 [*Corp. Code § 16105(b)*].

9. Notify all creditors of partnership of effective date of conversion and of dissociation of any partner.

NOTE:

For a discussion of the rights and liabilities of partners and the converting partnership with respect to third parties, see *§ 15.602[9]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral OverviewBusiness & Corporate LawUnincorporated Associations



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART III. TRANSACTION GUIDE
C. Procedural Guide

7-15 California Legal Forms--Transaction Guide § 15.741

§ 15.741 Merger

1. Draft merger agreement containing [*Corp. Code § 16911(a)*; *see § 15.810[2]* (form)]:

a. Terms and conditions of merger.

b. Name (which may be changed by the agreement) and place of organization of surviving partnership or other business entity.

c. Name of each disappearing partnership and each disappearing other business entity.

d. Manner of converting partnership interests of each constituent partnership into interests or other securities of survivor.

e. If partnership interests of any of constituent partnerships are not to be converted solely into interests or other securities of survivor, specify either:
(1) Cash, property, rights, interests, or securities (which may be in lieu of or in addition to interests or other securities of the survivor) to be exchanged for partnership interests; or

(2) That partnership interests are canceled without consideration.

f. Any other details or provisions required by laws under which any constituent other business entity is organized.

g. Any other details or provisions that are desired, including, without limitation, provisions for treatment of fractional partnership interests.

h. Any amendment to partnership agreement of any domestic constituent partnership.

i. Any new partnership agreement for surviving domestic constituent partnership.

NOTE:
Any amendment to a partnership agreement or adoption of a new partnership agreement will be effective as of the time or date the merger is effective [*Corp. Code § 16911(e)*].

j. Effective date of merger.

(1) If merger involves a domestic partnership and domestic other entity is also a constituent party, either [*Corp. Code § 16913(c), (d)*]:
(a) As of date certificate of merger is filed; or

(b) As of date specified in certificate of merger; or

(c) If foreign partnership or other entity is surviving entity, then in accordance with law of foreign surviving entity.

(2) If merger involves only partnerships, domestic or foreign, or a domestic partnership and a foreign other entity, the later of any of the following [*Corp. Code § 16912(b)*]:

(a) Approval of merger agreement by all parties; or

(b) Filing of all documents required by law to be filed as condition of effective date of merger; or

(c) Any effective date specified in merger agreement.

2. Submit merger agreement for approval of partners, by [*Corp. Code § 16911(a), (b)*]:

a. One of following:

(1) Vote specified for approving merger in a constituent partnership's partnership agreement; or

(2) If no provision in partnership agreement for merger approval, then by vote specified in partnership agreement for approving amendment of that agreement; or

NOTE:
If, however, merger effects a change for which the partnership agreement requires a greater number or percentage of partners than that required to amend the partnership agreement, the merger must be approved by that greater number or percentage.

(3) All partners if no vote specified for approving merger or amendment of partnership agreement.

b. Those persons required to approve merger by law under which constituent other business entity is organized.

c. All partners who will become general partners if partnership is merging into a surviving limited partnership.

3. Submit any amendments of merger agreement to partners and members of constituent other business entities for approval by same vote as required for adoption of original plan [*Corp. Code § 16911(c)*].

4. If partners decide to abandon merger, arrange for vote to abandon by same vote required to approve original plan [*Corp. Code § 16911(d)*].

NOTE:

Abandonment cannot prejudice the rights of third parties [*Corp. Code § 16911(d)*].

5. Complete and file in Secretary of State's office a statement of merger (Form GP-6) if [*Corp. Code § 16915(a)*; *see § 15.811[2]* (form)]:

NOTE:

Filing a statement of merger is not mandatory, but is recommended in the following cases.

a. Merger involves only domestic partnership and another partnership in which no other domestic other business entity is a party; e.g., two domestic partnerships or a domestic partnership and a foreign partnership.

b. Merger involves domestic partnership and a foreign other business entity in which no other domestic other business entity is a party; e.g., a domestic partnership and a foreign limited partnership or limited liability company.

NOTE:

The filing fee is $30 [*Corp. Code § 16113(b)*]. The statement of merger may be filed in the Secretary of State's office by either the surviving partnership or the surviving foreign other business entity. The statement declares that one or more partnerships have merged into the surviving partnership or surviving other business entity [*Corp. Code § 16915(a)*].

6. Record certified copy of statement of merger in each county in which disappearing partnership or other entity owns real property [*Corp. Code § 16916*; *see* discussion of effect of recording in § 15.603[8]].

NOTE:

The fee for recording documents is $10 for the first page and $3 for each additional page [*Gov. Code § 27361*]; a separate fee for certifying the copy applies as well [***see*** *Gov. Code § 27364* (certification under seal fee determined by board of supervisors)]. A recorded statement that is not a copy certified by the Secretary of State will not have the effect given to such statements by UPA '94 [*Corp. Code § 16105(b)*].

7. Complete and file certificate of merger with Secretary of State on official form (Form OBE MERGER-1) when merger involves domestic partnership and a domestic other business entity is also a party to merger [*Corp. Code § 16915(b)*].

NOTE:

Form GP-6, which formerly was used for both statements of merger and certificates of merger, is no longer used for a certificate of merger. Instead, Secretary of State Form OBE MERGER-1 is used when a certificate of merger is needed. For an illustration of the latter form, official instructions and comments, and discussion, see *Ch. 16, **Conversions and Mergers of Limited Partnerships**, § 16B.421*.

The filing fee is $30 [*Corp. Code § 16113(b)*]. The certificate of merger must be executed and

acknowledged by each domestic constituent partnership by two partners (unless a lesser number is provided in the partnership agreement), by each foreign constituent partnership by one or more partners, and by each constituent other business entity by those persons required to execute the certificate of merger by the laws under which the constituent other business entity is organized [*Corp. Code § 16915(b)*].

8. Record certified certificate of merger with county recorder in each county where disappearing partnership or other business entity owns real property [*Corp. Code § 16916(a)*; *see* discussion of effect of recording in § 15.603[8]].

NOTE:

The fee for recording documents is $10 for the first page and $3 for each additional page [*Gov. Code § 27361*]; a separate fee for certifying the copy applies as well [***see*** *Gov. Code § 27364* (certification under seal fee determined by board of supervisors)]. A recorded statement that is not a copy certified by the Secretary of State will not have the effect given to such statements by UPA '94 [*Corp. Code § 16105(b)*].

9. File copy of agreement of merger and requisite attachments with Secretary of State when merger involves domestic corporation and surviving entity is domestic or foreign corporation [*Corp. Code § 16915(b)*; *see Corp. Code § 1113(g)(1)*].

NOTE:

For further discussion of mergers involving corporations, see Ch. 11, ***Merger and Acquisition Issues*** .

10. Within 10 days of approval of merger, notify by certified mail all partners not voting in favor of merger of their right to dissociate and be bought out [*see § 15.820[2]*], and include [*Corp. Code § 16914(e)*]:

a. Copy of *Corp. Code § 16701* (statutory buyout provisions).

b. Brief description of procedure to be followed under that section if partner wishes to dissociate from partnership.

NOTE:

A partner that wants to dissociate must send written notice of dissociation within 30 days after the date of the notice of the approval of the conversion. The converting partnership must then cause the partner's interest to be purchased [*Corp. Code § 16914(e)*]. For a discussion of the buyout procedure, see *§ 15.303[2]*.

11. As to any dissociating partner, file statement of dissociation in the office of the Secretary of State, and record a certified copy in each county in which partnership owns property [*see* § 15.560[2] (form)].

NOTE:

The surviving partnership is bound under *Corp. Code § 16702* by an act of a dissociated general partner, and the partner is liable under *Corp. Code § 16703* for transactions entered into by the converted entity after the conversion takes effect [*Corp. Code § 16909(e)*]. For the effect that filing a statement of dissociation has on third parties, see the discussion in *§ 15.306[2]*.

The filing fee is $30 [*Corp. Code § 16113(b)*]. The fee for recording documents is $10 for the first page and $3 for each additional page [*Gov. Code § 27361*]; a separate fee for certifying the copy applies as well [***see*** *Gov. Code § 27364* (certification under seal fee determined by board of supervisors)]. A recorded statement that is not a copy certified by the Secretary of State will not have the effect given to such statements by UPA '94 [*Corp. Code § 16105(b)*].

12. Notify all creditors of partnership of effective date of merger and of dissociation of any partner.

NOTE:

For a discussion of the rights and liabilities of partners and the surviving partnership or other entity with respect to third parties, see *§ 15.602[9]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawAntitrustPremerger NotificationsMergers & Acquisitions LawAntitrustTransnational MergersMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART III. TRANSACTION GUIDE
C. Procedural Guide

7-15 California Legal Forms--Transaction Guide §§ 15.742-15.749

[Reserved]

§§ 15.742[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-15 California Legal Forms--Transaction Guide § 15.750

§ 15.750 Conversion

NOTE:

The following actions relate specifically to the conversion of a partnership and not to the creation of the converted entity. For related and subsequent procedures appropriate to the converted entity, refer to the Procedural Guides in Ch. 12C, ***Limited Liability Companies*** and Ch. 16, ***Formation of Limited Partnerships***].

1. Arrange for plan of conversion to be maintained at [*Corp. Code § 16903(g)*]:

a. Principal place of business, of converted entity if converted entity is foreign other business entity or corporation.

b. Office at which records are to be kept under either *Corp. Code § 15614* or 15901.14 (domestic limited partnerships) or *Corp. Code § 17057* (domestic limited liability companies).

2. Arrange for buyout of dissenting partner(s) interest in partnership by means of:

a. Agreement of sale to remaining partners.

b. Agreement for liquidation of interest by partnership.

c. Notice and payment of estimated buyout price if no agreement reached within 120 days of partner's demand for payment [*Corp. Code § 16701(e)*].

NOTE:

Absent provisions in the agreement to the contrary, UPA '94 provisions for the buyout of a dissociated partner's interest will apply [***see*** *Corp. Code § 16701*; ***see also*** discussion in *§ 15.303[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsGeneral OverviewMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-15 California Legal Forms--Transaction Guide § 15.751

§ 15.751 Merger

NOTE:

The following actions relate specifically to the disappearing partnership in a merger, and not to the surviving entity. For related and subsequent procedures appropriate to the surviving entity, refer to the Procedural Guides in Ch. 12C, ***Limited Liability Companies***, Part A (***Formation of General Partnerships***) of this chapter, Ch. 16, ***Formation of Limited Partnerships,*** and Ch. 16B, ***Conversions and Mergers of Limited Partnerships***.

1. Arrange for merger agreement to be maintained at [*Corp. Code § 16911(f)*]:

a. Principal place of business if surviving entity is partnership or foreign other business entity.

b. Office at which records are to be kept under *Corp. Code § 1500* if surviving entity is domestic corporation.

c. Office at which records are to be kept under either *Corp. Code § 15614* or 15901.14 (domestic limited partnerships) or *Corp. Code § 17057* (domestic limited liability companies).

2. Arrange for buyout of dissenting partner(s) interest in partnership by means of:

a. Agreement of sale to remaining partners.

b. Agreement for liquidation of interest by partnership.

c. Notice and payment of estimated buyout price, if no agreement is reached within 120 days of partner's demand for payment [*Corp. Code § 16701(e)*].

NOTE:
Absent provisions in the agreement to the contrary, UPA '94 provisions for the buyout of a dissociated partner's interest will apply [***see*** *Corp. Code § 16701*; ***see also*** discussion in *§ 15.303[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited PartnershipsGeneral OverviewMergers & Acquisitions LawGeneral OverviewMergers & Acquisitions LawGeneral Business ConsiderationsGeneral OverviewMergers & Acquisitions LawMergersGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

7-15 California Legal Forms--Transaction Guide §§ 15.752-15.799

[Reserved]

§§ 15.752[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART IV. FORMS
A. Conversion

7-15 California Legal Forms--Transaction Guide § 15.800

§ 15.800 Plan of Conversion

[1] Comment

[a] Use of Form

This form is a plan of conversion to convert a domestic partnership to a domestic limited liability company [*see Corp. Code § 16903*]. It may be adapted for use in converting a general partnership into other domestic business entities and foreign other business entities [*see Corp. Code § 16903(a)*]. The plan must be approved by the number of partners required by the partnership agreement either for a conversion or an amendment to the partnership agreement or by all the partners if there is no provision in the agreement for approval of conversion or amendment of the agreements [*see Corp. Code § 16903(b)*]. With the approval of the plan and other specified requirements, a domestic general partnership may be converted to a domestic or foreign other business entity [*Corp. Code § 16902*; *see § 15.602*]. Under this form, the partnership interests will be exchanged for equal interests in the converted entity. This meets one of the additional requirements for conversion, that a partner's percentage ownership interests in profits and capital of the converting partnership must be carried over to the converted entity [*Corp. Code § 16902(a)*].

[b] Contents

A general partnership that wants to convert to a domestic limited partnership or limited liability company, or to a foreign other business entity must approve a plan of conversion that states the following [*Corp. Code § 16903(a)*]:

- The terms and conditions of the conversion.

- The place of the organization of the converted entity and of the converting partnership and the name of the converted entity after conversion, if different from that of the converting partnership.

- The manner of converting the partnership interests of each of the partners into securities of, shares of, or interests in the converted entity.

- The provisions of the governing documents for the converted entity, including a limited partnership agreement, limited liability company articles of organization and operating agreement, or articles or certificate of incorporation to which the holders of interest in the converted entity are to be bound.

- Any other details or provisions as are required by laws under which the converted entity is organized.

- Any other details or provisions that are desired.

[2] FORM

Plan of Conversion

PLAN OF CONVERSION

1. _____[*name of converting partnership*] has agreed to convert to a [*specify, e.g.*, Limited Liability Company *or* Limited Partnership *or* Corporation].

2. _____[*name of converting partnership*] is organized, validly existing, and in good standing under the laws of the State of California. The Secretary of State's file number for _____[*name of converting partnership*] is [*file number*].

3. The name of the converted [*specify, e.g.*, Limited Liability Company *or* Limited Partnership *or* Corporation] will be _____[*name of converted entity*]. It will be organized under the laws of the State of California.

4. The office of _____[*name of converted entity*] will be at _____[*address of chief executive office*].

5. The agent for service of process on _____[*name of converted entity*] will be _____[*name*], at _____[*address*].

6. The terms of this conversion are: _____[*specify terms, e.g.*, at the effective date of the conversion, each profits and capital interest of _____ (*name of converting partnership*) will be converted into an equal profits and capital interest in _____ (*name of converted entity*)].

7. All holders of interests in _____[*name of converted entity*] will be bound by its [*specify governing documents, e.g.*, articles of organization and operating agreement], a copy of which is attached as Appendix A and made a part of this plan.

8. The terms of this plan of conversion were approved by the percentage of vote required by partnership agreement and law.

[*Add if converting to limited partnership:*]

9. All general partners of _____[*name of converted limited partnership*] have approved the terms of the plan of conversion.

Executed on _____[*date*], at [*place*].

_____ [*name of converted partnership*]
By _____ [*signature*]
[*typed name and title*]
_____ [*name of surviving entity*]
By _____ [*signature*]
[*typed name and title*]

[*Attach copy of articles and operating agreement or limited partnership agreement of converted entity*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART IV. FORMS
A. Conversion

7-15 California Legal Forms--Transaction Guide § 15.801

§ 15.801 General Partnership Statement of Partnership--Conversion (GP-1A)

[1] Comment

[a] Use of Form

This form is the Secretary of State's official form for a statement of partnership by an entity that is converting *to* a California general partnership *from* some other form of entity. It includes the mandatory statement of conversion required by statute [*see Corp. Code §§ 1151* (conversion from corporation), 15911.06 (conversion from limited partnership), *17540.6* (conversion from limited liability company)]. The form is available from any office of the Secretary of State, or can be obtained on the Secretary of State's website as described below.

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 15.801. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

This form is a specialized form of partnership statement that is to be used when the partnership being formed is a preexisting business that is being converted from some other form of business entity, rather than a brand new entity. Newly formed partnerships file their statement of partnership using Form GP-1, which is illustrated as *§ 15.285*. For general discussion of the effect of filing a statement of partnership authority, see *§ 15.285[1]* and discussion in Part A of this chapter.

Entities that are converting *from* California general partnerships *to* other business entities do not file this form. Rather,

they file a certificate of conversion that is appropriate for the type of business entity into which they are converting. For discussion, see *§ 15.802[c]*.

[b] Requirement for Statement of Conversion

A limited partnership, limited liability company, or corporation that is converting into a California general partnership must complete a statement conversion on the statement of partnership authority (this form). If no statement of partnership authority is filed, then the converting entity must file a separate certificate of conversion [*Corp. Code §§ 1155(a)(2)* (corporation), 15911.06 (limited partnership), *17540.6(a)(2)* (limited liability companies); *see § 15.802* (standard certificate of conversion form)].

[2] FORM

General Partnership Statement of Partnership--Conversion (GP-1A)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART IV. FORMS
A. Conversion

7-15 California Legal Forms--Transaction Guide § 15.802

§ 15.802 Certificate of Conversion (CONV-1A)

[1] Comment

[a] Use of Form

This form is the Secretary of State's official form for a certificate of conversion, together with the accompanying official instructions. This form is filed with the Secretary of State in the following situations involving general partnership conversions:

- By a California general partnership that is converting into a foreign other business entity [*see Corp. Code § 16906(b)*; *see also* [b], *below*]. California general partnerships that are converting into California other business entities should file a statement of conversion using the form that is appropriate for the type of business entity into which they are converting [*Corp. Code § 16906(a)*; *see* [c], *below*].

- By a corporation, limited partnership, or limited liability company that is converting into a California general partnership *if no statement of partnership authority* [*see § 15.801*] *is filed* (a nonregistered general partnership) [*Corp. Code §§ 1155(a)(2)* (corporation), 15911.06(a)(4) (limited partnership), *17540.6(a)(2)* (limited liability company)].

- By a California limited partnership or limited liability company that is converting to a foreign general partnership [*see Corp. Code §§ 15911.06(a)(2)* (limited partnership), *17540.6(a)(4)* (limited liability company)]. For discussion, see Ch. 12C, *Limited Liability Companies* , and Ch. 16B, *Conversions and Mergers of Limited Partnerships*, respectively.43

This form is available from any office of the Secretary of State, or can be obtained on the Secretary of State's website as described below.

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 3405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 15.802. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Statutory Requirements for Certificate of Conversion--Conversion to Foreign Other Business Entity

Corp. Code § 16906(b) provides that a California general partnership that is converting into a foreign other business entity--that is, a limited partnership, limited liability company, corporation, business trust, real estate investment trust, or unincorporated association other than a nonprofit association, but excluding a general partnership [*see Corp. Code § 16901(6), (12)*]--that has filed a statement of partnership authority under *Corp. Code § 16303* [*see § 15.285*] that is effective at the time of conversion *may* file a certificate of conversion with the Secretary of State [*Corp. Code § 16906(b)*]. Note that *Corp. Code § 16906(b)* uses the word "may," which would appear to mean that the filing of a certificate of conversion is optional in all cases involving conversion to a foreign entity. In contrast, the official instructions to the Secretary of State's form (reproduced below) state that this form "shall" be filed with the Secretary of State, which would indicate that the Secretary of State's office regards such a filing as mandatory. Whether or not the filing of a certificate of conversion is mandatory under these circumstances, there are advantages to filing such a certificate, as discussed in [d], *below*.

The required contents of a certificate of conversion are specified by statute [*see Corp. Code § 16906(b)*] and incorporated into this form. While the statute does not mandate that the official form be used for filing a certificate of conversion [*Corp. Code § 16906(b)*; *cf. Corp. Code § 16906(a)*, which does require that the official forms be used for *statements* of conversion], there is no reason to draft a non-standard form, nor is there any guarantee that such a form would be readily accepted by the Secretary of State's office in lieu of the official form.

[c] Statutory Requirements for Statement of Conversion--Conversion to Domestic Entities

This form ordinarily is not appropriate for California general partnerships that are converting to other California business entities. In those cases, a *statement* of conversion, rather than a *certificate* of conversion, is filed as discussed below [*Corp. Code § 16906(a)*].

If a converting California general partnership has filed a statement of partnership authority under *Corp. Code § 16303* [*see § 15.285*] and that statement is effective at the time of conversion, then, on conversion to a California limited partnership, limited liability company, or corporation, the certificate of limited partnership, articles of organization, or articles of incorporation must contain a statement of conversion in a form prescribed by the Secretary of State [*Corp. Code § 16906(a)*]. If the converting partnership has not filed a statement of authority under *Corp. Code § 16303*, completion of the statement of conversion is optional [*Corp. Code § 16906(a)*].

The contents of the statement of conversion are specified by statute [*see Corp. Code § 16906(a)(1), (2)*] and are reflected in the forms promulgated by the Secretary of State. These forms are to be used as follows:

- A general partnership that is converting into a California limited partnership will file Form LP-1A, Certificate of Limited Partnership--Conversion [*see* § 15C.205]. This form includes the appropriate Statement of Conversion.

- A general partnership that is converting into a California limited liability company will file Form

LLC-1A, Limited Liability Company Articles of Organization--Conversion [*see § 12C.200A*]. This form includes the appropriate Statement of Conversion.

- A general partnership that is converting into a California general corporation will include a statement of conversion in the new entity's articles of incorporation. For an illustration of the Secretary of State's sample articles of incorporation for a converting California general partnership, containing statement of conversion language, see *§ 15.803[2]*. For an illustration of the Secretary of State's sample articles of incorporation for a foreign limited partnership, see *§ 15.804*.

[d] Effect of Filing Certificate of Conversion

The filing of a certificate of conversion with the Secretary of State has the same effect as the filing of a cancellation by the converting partnership of any statement of partnership authority that had been filed by the partnership [*Corp. Code § 16906(c)*].

Once the certificate of conversion has been filed, certified copies of the certificate may be recorded in the county recorder's office of counties where the partnership held real property. Recordation provides notice to third parties and also provides a title chain for the real property for title insurance purposes [*see Corp. Code § 16907(a)*]. Furthermore, recordation will create, in favor of bona fide purchasers or encumbrancers for value, a conclusive presumption that the conversion was validly completed [*Corp. Code § 16907(c)*].

[2] FORM

Certificate of Conversion (CONV-1A)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART IV. FORMS
A. Conversion

7-15 California Legal Forms--Transaction Guide § 15.803

§ 15.803 Articles of Incorporation for Conversion of California General Partnership to Corporation

[1] Comment

[a] Use of Form

This form is a reproduction of the sample articles of incorporation for a California general partnership that is converting to a California stock corporation. This form is drafted to meet the minimum statutory requirements for articles containing a statement of conversion for a general stock corporation [*see Corp. Code §§ 200, 1157(d), (e), 16901*, 16901.1]. The Secretary of State's office advises that this sample may be used as a guide in preparing articles. The Secretary of State's office further advises that modifications can be made to add permissive provisions and/or to meet the specific statutory requirements for a professional or close corporation. The Secretary of State's office does not provide a standardized form due to the many possible drafting variations. For general discussion of articles of incorporation, including the statutory requirements for articles of incorporation as well as mandatory and optional provisions for corporate articles, see Ch. 3, *Articles of Incorporation* .

PRACTICE TIP

ELECTRONIC FORMS NOTE: An electronic version of this form is available on the official website of the California Secretary of State, Business Programs Division, which is located at www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405. Bear in mind, however, that the form is illustrative only and that the Secretary of State's office does not provide a standardized form.

This sample should not be used if the converting entity is a foreign general partnership. The State's office has prepared a separate set of sample articles for foreign general partnerships that are converting to California corporations. These articles are illustrated in § 15.804.

[b] Filing Conversion Articles

Articles of incorporation containing a statement of conversion into a domestic stock corporation must be accompanied by the appropriate filing fees. These documents must be mailed or hand delivered for over-the-counter processing to the Sacramento office. They cannot be processed using the preclearance, expedite, wait for or rush letter service, and cannot be filed in the regional offices [*see* Conversion of a California General Partnership Into a California Stock Corporation, Instructions, in [2], *below*].

The original and at least two copies should be included with the submission. The Secretary of State will certify two copies of the filed document without charge, provided that the copies are submitted to the Secretary of State with the document to be filed. Any additional copies submitted will be certified on request and payment of an additional per copy certification fee.

To facilitate the processing of documents mailed to the Secretary of State, a self-addressed envelope and a letter referencing the corporate name as well as the sender's name, return address, and telephone number should be included with the submission [*see* Conversion of a California General Partnership Into a California Stock Corporation, Instructions, in [2], *below*].

[2] FORM

Articles of Incorporation for Conversion of California General Partnership to Corporation

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART IV. FORMS
A. Conversion

7-15 California Legal Forms--Transaction Guide § 15.804

§ 15.804 Articles of Incorporation for Conversion of Foreign General Partnership to California Corporation

[1] Comment--Use of Form

This form is a reproduction of the sample articles of incorporation for a foreign general partnership that is converting to a California stock corporation. A foreign other business entity, including a foreign general partnership [*see Corp. Code §§ 171.07, 174.5, 1159(g)*], may convert to a California Corporation if, and only if, the converting entity is authorized by the laws under which it is organized to effect the conversion [*Corp. Code § 1157(a)*].

This form is drafted to meet the minimum statutory requirements for articles containing a statement of conversion for a general stock corporation [*see Corp. Code §§ 200, 1157(d), (e)*]. The Secretary of State's office advises that this sample may be used as a guide in preparing articles. The Secretary of State's office further advises that modifications can be made to add permissive provisions and/or to meet the specific statutory requirements for a professional or close corporation. The Secretary of State's office does not provide a standardized form due to the many possible drafting variations. For general discussion of articles of incorporation, including the statutory requirements for articles of incorporation as well as mandatory and optional provisions for corporate articles, see Ch. 3, *Articles of Incorporation* .

PRACTICE TIP

ELECTRONIC FORMS NOTE: An electronic version of this form is available on the official website of the California Secretary of State, Business Programs Division, which is located at www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405. Bear in mind, however, that the form is illustrative only and that the Secretary of State's office does not provide a standardized form.

This sample should not be used if the converting entity is a California general partnership. The State's office has prepared a separate set of sample articles for California general partnerships that are converting to California corporations. These articles are illustrated in § 15.803.

For information on the applicable filing and submission requirements for these articles, see *§ 15.803[1][2]*.

[2] FORM

Articles of Incorporation for Conversion of Foreign General Partnership to California Corporation

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART IV. FORMS
A. Conversion

7-15 California Legal Forms--Transaction Guide §§ 15.805-15.809

[Reserved]

§§ 15.805[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART IV. FORMS
B. Merger

7-15 California Legal Forms--Transaction Guide § 15.810

§ 15.810 Agreement to Merge

[1] Comment

[a] Use of Form

This form illustrates an agreement of merger to be used for the merger of a domestic general partnership into a limited partnership, limited liability company, or other business entity. Under this form, the general partnership disappears after merging with the other business entity. However, alternative provisions are included if the partnership is to be the surviving entity. The form also may be modified to be used for the merger of two or more partnerships or a partnership or partnerships with one or more other business entities as permitted under UPA '94 [*Corp. Code § 16910(a)*]. This form includes all the information required by statute, and also includes a statement that the terms and conditions of the agreement have been approved by partners and members of the merging entities [*Corp. Code § 16911*; *see § 15.603[2][a]* (approval requirements)]. For further discussion of mergers, including what entities may merge, the effect of merger, and the rights of creditors and others against the surviving entity, see *§ 15.603*.

[b] Contents

An agreement of merger at a minimum must include the following [*Corp. Code § 16911(a)*]:

- The terms and conditions of the merger.

- The name and place of organization of the surviving partnership or surviving other business entity, and of each disappearing partnership and disappearing other business entity.

- The manner of converting the partnership interests of each of the constituent partnerships into interests or other securities of the surviving partnership or surviving other business entity. If partnership interests of any of the constituent partnerships are not to be converted solely into interest or other securities of the surviving partnership or surviving other business entity, the agreement must specify the

property or interests which the holders of the partnership interest will receive in exchange for the partnership interests or that the partnership interests are canceled without consideration.

- Any other details or provisions required by the laws under which any constituent other business entity is organized.

- Any other details or provisions that are desired. This may include a provision for the treatment of fractional partnership interests.

The agreement of merger must be kept by a surviving entity and disclosed to entitled parties under specified conditions [*Corp. Code § 16911(f)*; *see § 15.603[2][f]*].

[c] Scope of Agreement

The scope of a merger agreement may go beyond the details of the merger to include amending an existing partnership agreement or adopting a new partnership agreement of any participating domestic partnership. Any amendment to a partnership agreement or adoption of a new partnership agreement will be effective as of the time or date the merger is effective [*Corp. Code § 16911(e)*].

[d] Effective Date of Merger

This form provides that the merger will be effective on the date that the certificate of merger is filed with the Secretary of State. Because the form is predicated on the merger of a domestic partnership into a domestic other business entity, a certificate of merger must be filed and usually controls the effective date [*see Corp. Code §§ 16912, 16915(b)*; *see also § 15.603[4]*].

[2] FORM

Agreement to Merge

AGREEMENT OF MERGER

This is an Agreement of Merger between _____[*name of disappearing partnership or other business entity*] and _____[*name of merging limited partnership, liability company or partnership*]. Under this Agreement of Merger, _____[*name of disappearing partnership or other business entity*] will merge into _____[*name of surviving limited liability company or other business entity or partnership*] and cease its separate existence.

On completion of the merger, the name of the surviving Limited Liability Company will be _____[*name of surviving entity*]. Its place of organization will be California.

ARTICLE 1 RECITALS

[*EITHER:*]

Disappearing Partnership

1.01. _____[*Name of disappearing partnership*] is a partnership duly organized, validly existing, and in good standing under the laws of _____[the State of California *or specify other state*].

[*OR*]

Disappearing Other Business Entity

1.01. _____[*Name of disappearing other business entity*] is a [*specify nature of other business entity, e.g.,* limited partnership or limited liability company] duly organized, validly existing, and in good standing under the laws of _____[the State of California *or specify other state*].

[*Continue with one of the following:*]

Surviving Other Business Entity

1.02. _____[*Name of surviving other business entity*] is a [*specify type of other business entity, e.g.,* limited partnership, limited liability company] duly organized, validly existing, and in good standing under the laws of _____[the State of California *or specify other state*]. _____[*Name*] is to be the surviving other business entity, as that term is defined in the California Uniform Partnership Act of 1994, to the merger described in this agreement.

[*OR*]

Surviving Partnership

1.02. _____[*Name of surviving partnership*] is a partnership duly organized, validly existing, and in good standing under the laws of _____[the State of California *or specify other state*]. _____[*Name*] is to be the surviving partnership, as that term is defined in the California Uniform Partnership Act of 1994, to the merger described in this agreement.

[*Continue with the following:*]

ARTICLE 2 MERGER

Surviving _____ [Other Business Entity *or* Partnership]

2.01. _____[*Name of disappearing entity*] shall be merged with and into _____[*name of surviving entity*] under the laws of the State of California]. [*If applicable, add:* _____ (*name*), a _____ (*specify type of other business entity, e.g.,* limited liability company or limited partnership), is specifically authorized to merge _____[*specify, e.g.,* under the laws of _____ (*state of organization*)].

Certificate of Merger

2.02. _____[*Name of surviving entity*] shall file a certificate of merger with the Secretary of State, as required under *Corporations Code Section 16915*. The certificate shall be signed and acknowledged by the required

number of partners or members of all constituent entities. Certified copies of the certificate of merger shall be filed in the office of the recorder in all counties in which _____[*name of disappearing entity*] holds real property.

Effective Date of Merger

2.03. The merger shall be effective on the filing of the certificate of merger.

ARTICLE 3 TERMS AND CONDITIONS

Negative Covenants

3.01. Between the date of this agreement and the date on which the merger becomes effective, each constituent entity will not:

(a) _____ [*specify, e.g.,* Make any distributions to its partners].

(b) Except in the ordinary course of business and for adequate value, dispose of any of its assets.

(c) Enter into any contract or agreement obligating it for a period in excess of _____ [*specify, e.g.,* three months] or for an amount in excess of _____ [*specify, e.g.,* $10,000] except _____ [in the ordinary course of business *or specify*].

Further Assignments or Assurances

3.02. If at any time the surviving entity considers or is advised that any further assignments or assurances in law are necessary to vest or to perfect or to confirm of record in the surviving entity the title to any property or rights of [*disappearing entity*], or otherwise carry out the provisions of this agreement, _____[*specify, e.g.,* the general partners of _____ (*disappearing general partnership*) or the managers of _____ (*disappearing other business entity*)], as of the effective date of the merger, will execute and deliver all proper deeds, assignments, confirmations, and assurances in law, and do all acts that the surviving entity [*specify, e.g.,* reasonably determines *or* determines in its sole discretion] to be proper to vest, perfect, and confirm title to such property or rights in the surviving entity, and otherwise carry out the provisions of this agreement.

ARTICLE 4 BASIS OF CONVERTING INTERESTS

Assets of Constituent Entities

4.01. The _____[*specify, e.g.,* partners of _____ (*disappearing partnership*) *or* general partners of _____ (*disappearing limited partnership*) or managers of _____ (*disappearing other business entity*)] agree that [*summarize financial situation of disappearing entity before merger, e.g.:*]

(1) The present value of its assets, including goodwill is $

_____ ;

(2) The fair market value of its unrealized receivables is $

_____ ;

(3) The fair market value of its inventory is $

_____ ; and

(4) The estimated amount of its liabilities is $

_____ .

The [*specify, e.g.,* partners or managers] of [*surviving entity*] agree that [*summarize financial situation of surviving entity before merger, e.g.:*]

(1) The present value of its assets, including goodwill, is $

_____ ;

(2) The fair market value of its unrealized receivables is $

_____ ;

(3) The fair market value of its inventory is $

_____ ; and

(4) The estimated amount of its liabilities is $

_____ .

Conversion

4.02. (a) At the effective date of the merger, each interest of [each *or* the] disappearing entity will be converted into [*specify number or amount*] interest[s] of the surviving entity.

(b) No fractional interests of the surviving entity after merger will be issued to the holders of interests of the disappearing entity. However, holders who would otherwise be entitled to receive a fraction of an interest of the surviving entity on the basis of the conversion provided for in this article will instead receive a cash payment equal to the value of that fraction, based on the market value of an interest of the disappearing entity as of the effective date of the merger.

(c) Each interest of _____[*name of surviving entity*] will be converted into [*specify number or amount*] interest[s] of the surviving entity after merger.

(d) No fractional interests of the surviving entity before merger will be issued to the holders of interests of the surviving entity after merger. However, holders who would otherwise be entitled to receive a fraction of an interest of the

surviving entity on the basis of the conversion provided for in this article will instead receive a cash payment equal to the value of that fraction, based on the market value of an interest of the disappearing entity as of the effective date of the merger.

Exchange

4.03. If any interest of a disappearing entity being exchanged in connection with this merger is evidenced by a certificate, each holder of that interest must surrender the certificate or certificates, properly endorsed, to the surviving entity or its transfer agent, and will receive in exchange a certificate or certificates representing the number of interests of the surviving entity into which the interests of the disappearing entity have been converted.

ARTICLE 5 MANAGEMENT OF SURVIVING ENTITY

Management and Control

5.01. The [*specify, e.g.,* general partners *or* managers] of [*surviving entity*] have the sole and exclusive control of the business, subject to any limitations in the [*specify, e.g.,* partnership agreement *or* articles and operating agreement] of the surviving entity.

ARTICLE 6 INTERPRETATION AND ENFORCEMENT

Notices

6.01. Any notice, request, demand, or other communication required or permitted under this agreement may be delivered in person, delivered by certified mail, return receipt requested, or delivered by facsimile transmission. Deliveries by certified mail or by facsimile transmission will be sent to the following addresses:

(a) In the case of [*disappearing entity*] to _____[*entity name, name of appropriate general partner or director, street address, city, and state*] or to any other person or address specified in a written notice provided by [*disappearing entity*] to [*surviving entity*] in the manner required by this paragraph.

(b) In the case of [*surviving entity*] to _____[*entity name, name of appropriate general partner or director, street address, city, and state*] or to any other person or address specified in a written notice provided by [*surviving entity*] to [*disappearing entity*] in the manner required by this paragraph.

Counterpart Executions

6.02. This agreement may be executed in any number of counterparts, each of which shall be deemed an original.

Partial Invalidity

6.03. If any term of this agreement is held by a court of competent jurisdiction to be void and unenforceable, the remainder of the contract terms shall remain in full force and effect.

Controlling Law

6.04. The validity, interpretation, and performance of this agreement shall be controlled by and construed under the laws of the State of California.

Approvals

6.05. The partners and members of each constituent entity to this merger agreement have approved by the voting percentages required by partnership agreement, articles, operating agreement, and law the terms and conditions of this agreement.

Executed on _____, at _____[*city and state*].

_____ [*name of disappearing entity*]
By _____ [*signature*]
[*typed name and title*]
_____ [*name of surviving entity*]
By _____ [*signature*]
[*typed name and title*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART IV. FORMS
B. Merger

7-15 California Legal Forms--Transaction Guide § 15.811

§ 15.811 Statement of Merger (GP-6)

[1] Comment

[a] Use of Form

This form is the Secretary of State's official form (Form GP-6) for a statement of merger.

ELECTRONIC FORMS NOTE:
Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 15.811. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

A statement of merger *may* be filed with the Secretary of State to place third parties on notice of the merger, fix its effective date, and establish record title to real property. A statement of merger also has the effect of filing a cancellation of a statement of partnership authority for each disappearing partnership [*Corp. Code § 16915(a), (c)*; *see § 15.603[3]*]. Certified copies of the statement should be filed in the County Recorder's office in all counties in which a disappearing entity holds real property [*see Corp. Code § 16916*; *see also § 15.603[8]*].

A Statement of merger is used when a partnership merges only with other partnerships or when a domestic partnership merges with foreign other business entities. If a domestic partnership and a domestic other business entity are involved in the merger, then a certificate of merger, rather than a statement of merger, is required [*Corp. Code § 16915(a), (b)*; *see* discussion in [b], below].

[b] Certificate of Merger--Filing Requirements

A certificate of merger *must* be filed in any merger *involving* a domestic partnership when a domestic other business entity is also a party. This does not mean that either entity has to survive or that only domestic entities can be involved [*Corp. Code § 16915(b)*]. For example, the certificate must still be filed if the merger involves a foreign partnership or other business entity in addition to the domestic entities.

If the surviving entity is a domestic corporation or a foreign corporation in a merger involving a domestic corporation, the surviving corporation must also file a copy of the agreement of merger and the requisite attachments [*Corp. Code § 16915(b)*; *see Corp. Code § 1113(g)(1)*]. For further discussion of mergers involving corporations, see Ch. 11, *Mergers and Acquisitions* .

The certificate of merger is filed in the office of the Secretary of State by the constituent partnerships and other business entities after approval of the merger by the constituent parties. It must be executed and acknowledged by each domestic constituent partnership by two partners (unless a lesser number is provided in the partnership agreement), by each foreign constituent partnership by one or more partners, and by each constituent other business entity by those persons required to execute the certificate of merger by the laws under which the constituent other business entity is organized [*Corp. Code § 16915(b)*]:

For further discussion of a certificate of merger, including its effect, see *§ 15.603[3][c], [d]*. Form GP-6, which formerly was used for both statements of merger and certificates of merger, is no longer used for a certificate of merger. Instead, Secretary of State Form OBE MERGER-1 is used when a certificate of merger is needed. For an illustration of the latter form, official instructions and comments, and discussion, see Ch. 15C, *Conversions and Mergers of Limited Partnerships*, § 15C.201.

[c] Certificate of Merger--Contents

The certificate of merger must set forth all of the following [*Corp. Code § 16915(b)*]:

- The names and the Secretary of State's file numbers, if any, of each of the constituent partnerships and constituent other business entities, separately identifying the disappearing partnerships and disappearing other business entities and the surviving partnership or surviving other business entity.

- If a vote of the partners was required, a statement that the principal terms of the agreement of merger were approved by a vote of the partners, which equaled or exceeded the vote required.

- If the surviving entity is a domestic partnership and not an other business entity, any change to the information set forth in any filed statement of partnership authority of the surviving partnership resulting from the merger, including any change in the name of the surviving partnership resulting from the merger. The filing of a certificate of merger setting forth any changes to any filedstatement of partnership authority of the surviving partnership has the effect of the filing of a certificate of amendment of the statement of partnership authority by the surviving partnership, and no other amendment need be filed [*see Corp. Code § 16105(d)* (amending statements of authority); *see also § 15.287[2]* (statement of amendment or cancellation)].

- The future effective date or time (which must be a date or time certain not more than 90 days subsequent to the date of filing) of the merger, if the merger is not to be effective upon the filing of the certificate of merger with the office of the Secretary of State.

- If the surviving entity is an other business entity or a foreign partnership, the full name, type of

entity, legal jurisdiction in which the entity was organized and by whose laws its internal affairs are governed, and the address of the principal place of business of the entity.

- Any other information required to be stated in the certificate of merger by the laws under which each constituent other business entity is organized.

[2] FORM

Statement of Merger (GP-6)

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART IV. FORMS
B. Merger

7-15 California Legal Forms--Transaction Guide §§ 15.812-15.819

[Reserved]

§§ 15.812[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART IV. FORMS
C. Notice and Demand Letter

7-15 California Legal Forms--Transaction Guide § 15.820

§ 15.820 Notice of Approval to Dissenting Partners

[1] Comment

[a] Use of Form

This form may be used to satisfy the requirement that notice of approval of a conversion or merger be given to partners who do not vote in favor of the conversion or merger. Within 10 days after the approval of the conversion or merger, the partnership must send notice of the approval to each partner that did not approve the conversion or merger. The notice must include a copy of *Corp. Code § 16701* and a brief description of the procedure to be followed under that section if a partner wishes to dissociate [*Corp. Code §§ 16909(e), 16914(e)*]. If the partnership agreement adequately provides for the buyout of dissociating partners in all situations including conversion and merger, it will likely provide for notice to dissenting partners. If so, this form, modified to refer to the provisions of the partnership agreement under which the dissociating partner will be bought out, can be used [*see Corp. Code § 16103*].

[b] Statutory Buyout Procedure

After receiving the notice of approval, a dissenting partner has 30 days to notify the partnership of his, her or its decision to dissociate and demand payment [*see § 15.821*]. The partner has the right to dissociate as of the effective date of the merger or conversion. If the partner exercises that right, then absent a partnership agreement to the contrary, his, her or its interest will be valued and purchased in accordance with the statutory buyout procedures in *Corp. Code § 16701* [*Corp. Code §§ 16909(e), 16914(e)*]. Those procedures require that if the parties cannot agree on a buyout price within 120 days of the date of the dissociating partner's written demand for payment [*see § 15.821[2]* (form)], then the partnership must pay an estimated buyout price calculated according to the statutory formula. For a transmittal letter accompanying such a payment, see § 15.513.

[2] FORM

Notice of Approval to Dissenting Partners

NOTICE TO PARTNERS OF _____ [*name*],
A CALIFORNIA GENERAL PARTNERSHIP,
OF APPROVAL OF CONVERSION [*or* MERGER]

To: _____ [*name of partner*]
_____ [*address of partner*]_____

This is to give notice that the partnership interests of _____[*name*], a California general partnership, have approved by the requisite vote or consent the principal terms of a [*either:* plan of conversion *or* merger agreement] as permitted under *California Corporations Code Section 16902* [*or* 16910]. Under the [*either:* plan of conversion *or* merger agreement] _____[*name*] will be converted [*or* merged] into _____[*name of converted or merged entity*], a [*specify, e.g.,* Limited Partnership *or* Limited Liability Company].

You did not vote in favor of the adoption of the [*either:* plan of conversion *or* merger agreement]. Any member of this partnership who did not vote in favor of the conversion [*or* merger] and who does not agree to become a [*specify according to type of converted entity, e.g.* member] of _____[*name of converted or merged entity*] may dissociate from the partnership and demand payment under the provisions of *Corporations Code Section 16701*.

Under *California Corporations Code Section 16701*, you have 30 days from the date of this notice to notify us in writing of your desire to dissociate from _____[*name of partnership*] and to demand payment for your partnership interest. The partnership must then cause your interest to be purchased at a price determined by the amount that would have been payable to you if, on the date of [conversion *or* merger], the assets of the partnership were sold at a price equal to the greater of the liquidation value or the value based on the sale of the entire business as a going concern without you as a partner, and the partnership's assets were distributed on dissolution under *California Corporations Code Section 16807* after the discharge of obligations.

If we have not reached agreement regarding the purchase of your interest in the partnership within 120 days of your written demand for payment, the partnership will pay you in cash for your interest, the amount of that payment being calculated according to the statutory buyout formula described in the preceding paragraph. This payment will be in full satisfaction of the partnership's obligation to purchase your interest in the partnership unless, within 120 days after you receive the payment, you commence an action to determine the buyout price of your interest.
Dated: _____.

_____ [*name of partnership*]
By _____ [*signature*]
[*typed name and title*]

[*Attach copy of Corp. Code § 16701, as follows:*]

Text of *Corporations Code 16701*

Except as provided in Section 16701.5, all of the following shall apply:

(a) If a partner is dissociated from a partnership, the partnership shall cause the dissociated partner's interest in the partnership to be purchased for a buyout price determined pursuant to subdivision (b).

(b) The buyout price of a dissociated partner's interest is the amount that would have been distributable to the

dissociating partner under subdivision (b) of Section 16807 if, on the date of dissociation, the assets of the partnership were sold at a price equal to the greater of the liquidation value or the value based on a sale of the entire business as a going concern without the dissociated partner and the partnership was wound up as of that date. Interest shall be paid from the date of dissociation to the date of payment.

(c) Damages for wrongful dissociation under subdivision (b) of Section 16602, and all other amounts owing, whether or not presently due, from the dissociated partner to the partnership, shall be offset against the buyout price. Interest shall be paid from the date the amount owed becomes due to the date of payment.

(d) A partnership shall indemnify a dissociated partner whose interest is being purchased against all partnership liabilities, whether incurred before or after the dissociation, except liabilities incurred by an act of the dissociated partner under Section 16702.

(e) If no agreement for the purchase of a dissociated partner' s interest is reached within 120 days after a written demand for payment, the partnership shall pay, or cause to be paid, in cash to the dissociated partner the amount the partnership estimates to be the buyout price and accrued interest, reduced by any offsets and accrued interest under subdivision (c).

(f) If a deferred payment is authorized under subdivision (h), the partnership may tender a written offer to pay the amount it estimates to be the buyout price and accrued interest, reduced by any offsets under subdivision (c), stating the time of payment, the amount and type of security for payment, and the other terms and conditions of the obligation.

(g) The payment or tender required by subdivision (e) or (f) shall be accompanied by all of the following:

(1) A statement of partnership assets and liabilities as of the date of dissociation.

(2) The latest available partnership balance sheet and income statement, if any.

(3) An explanation of how the estimated amount of the payment was calculated.

(4) Written notice that the payment is in full satisfaction of the obligation to purchase unless, within 120 days after the written notice, the dissociated partner commences an action to determine the buyout price, any offsets under subdivision (c), or other terms of the obligation to purchase.

(h) A partner who wrongfully dissociates before the expiration of a definite term or the completion of a particular undertaking is not entitled to payment of any portion of the buyout price until the expiration of the term or completion of the undertaking, unless the partner establishes to the satisfaction of the court that earlier payment will not cause undue hardship to the business of the partnership. A deferred payment shall be adequately secured and bear interest.

(i) A dissociated partner may maintain an action against the partnership, pursuant to subparagraph (B) of paragraph (2) of subdivision (b) of Section 16405, to determine the buyout price of that partner's interest, any offsets under subdivision (c), or other terms of the obligation to purchase. The action shall be commenced within 120 days after the partnership has tendered payment or an offer to pay or within one year after written demand for payment if no payment or offer to pay is tendered. The court shall determine the buyout price of the dissociated partner's interest, any offset due under subdivision (c), and accrued interest, and enter judgment for any additional payment or refund. If deferred payment is authorized under subdivision (h), the court shall also determine the security for payment and other terms of the obligation to purchase. The court may assess reasonable attorney's fees and the fees and expenses of appraisers or other experts for a party to the action, in amounts the court finds equitable, against a party that the court finds acted arbitrarily, vexatiously, or not in good faith. The finding may be based on the partnership's failure to tender payment or an offer to pay or to comply with subdivision (g).



184 of 184 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 15 GENERAL PARTNERSHIPS
PART C. Conversions and Mergers of General Partnerships
PART IV. FORMS
C. Notice and Demand Letter

7-15 California Legal Forms--Transaction Guide § 15.821

§ 15.821 Demand Letter From Dissenting Partner

[1] Comment--Use of Form

This form is a letter used to notify a partnership of a partner's desire to dissociate from the partnership in the face of a conversion or merger that the partner has not voted in favor of. The letter must be sent within 30 days after the notice of approval of the conversion or merger [*Corp. Code §§ 16909(e), 16914(e)*]. This letter begins the statutory buyout procedure [*see Corp. Code § 16701*], that applies if the partnership does not otherwise provide for the purchase of a dissociated partner's interest.

[2] FORM

Demand Letter From Dissenting Partner

NOTICE OF DISSOCIATION AND
DEMAND FOR PURCHASE OF INTEREST

To: _____[*name of partnership*], a California general partnership
_____[*address of partnership*]

I am a partner in _____[*name of partnership*], a California general partnership, and hold [*number or amount*] interest in that partnership.

Under *California Corporations Code Section 16909(e)* [*or for merger* 16914(e)], I exercise my right to dissociate from _____[*name of partnership*] and demand that the partnership purchase my interest under the provisions of *California Corporations Code Section 16701* and pay to me in cash the buyout price established under

that provision as of _____[*date*], the effective date of the [conversion *or* merger] of this partnership.

_____ Dated:

_____ [*signature*]
[*typed name*]
[*address*]



1 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS

8-16 California Legal Forms--Transaction Guide 16.syn

§ 16.syn Synopsis to Chapter 16: FORMATION OF LIMITED PARTNERSHIPS

§ 16.01 California Statutes

§ 16.02 Federal Statutes

§ 16.03 Federal Regulations

§ 16.04 [Reserved]

§ 16.05 Law Reviews

§ 16.06 [Reserved]

§ 16.07 Text References

[1] Matthew Bender Sources

[2] Additional Text References

§§ 16.08-16.09 [Reserved]

§ 16.10 Operative Dates

§ 16.11 Preexisting Limited Partnerships

§ 16.12 Electing Limited Partnership--Liability of General Partners

§ 16.13 Application of Securities Laws

§ 16.14 Application of California Law

§§ 16.15-16.19 [Reserved]

§ 16.20 Nature of California Limited Partnerships

[1] Definition

[2] Permissible Business of Limited Partnerships

§ 16.21 Formation of Limited Partnerships

[1] Overview of Formal Requirements

[2] Certificate of Limited Partnership

[a] Contents of Certificate

[b] Execution and Filing of Certificate

[i] Execution

[ii] Filing Requirements

[iii] Filing Date

[iv] Execution and Filing by Person Other Than General Partner

[v] Resubmission of Returned Instruments

[c] Recordation of Certificate

[d] Liability for Misstatements

[3] Limited Partnership Name

[a] Name Requirements and Restrictions

[b] Reservation of Name

[c] Fictitious Business Names

[4] Partnership Agreement

[a] Use of Written Agreement

[b] Variation of ULPA '08 Provisions by Partnership Agreement

[c] Inconsistency With Filed Certificate

[d] Creation of Classes of Partners

[i] General Partners

[ii] Limited Partners

[e] Consent to Jurisdiction, Arbitration, and Service of Process

§ 16.22 Amending Certificate of Limited Partnership

[1] Certificate of Amendment

[a] In General

[b] When Required

[c] Execution and Filing of Certificate

[d] Failure to Sign or Deliver Record

[2] Restated Certificate

[3] Certificate of Correction

§ 16.23 Operating Requirements

[1] Office and Agent for Service of Process

[a] Office

[b] Agent for Service of Process

[c] Substituted Service on Secretary of State

[2] Required Records

§ 16.24 Partnership Meetings

§§ 16.25-16.29 [Reserved]

§ 16.30 Rights and Duties of Limited Partners

[1] Access to Partnership Records

[a] Information Required to Be Maintained By Partnership

[b] Information Regarding Activities and Financial Condition

[c] Confidential Information

[d] Restrictions on Use of Information

[e] Exercise of Partner's Rights by Others

[f] Charges For Costs

[2] Contributions and Distributions

[3] Permissible Actions

§ 16.31 Liability of Limited Partners

[1] Limited Liability

[2] Liability for Misstatements

[3] Liability for Improper Distributions and Contributions

[4] Liability of Investor in Partnership

§ 16.32 Admission, Powers, and Duties of Limited Partners

[1] Manner of Admission

[2] Powers and Duties

§ 16.33 Dissociation of Limited Partners

[1] Causes of Dissociation

[2] Effect of Dissociation

§ 16.34 Rights, Powers, Restrictions, and Liabilities of General Partners

[1] General Partner as Agent of Partnership

[2] Dual Capacity as General and Limited Partner Permitted

[3] Rights in Management and Conduct of Partnership's Activities

[4] Right to Information

[a] Current Partners

[b] Dissociated Partners

[5] Contributions and Distributions

[6] Liabilities

[a] Liability for False Information

[b] Liability for Improper Distributions

[c] Liability for Partnership Obligations

[d] Partnership's Liability for General Partner's Actions

§ 16.35 Duties of General Partners

[1] General Duties

[2] Fiduciary Duties

§ 16.36 Admission of General Partners

§ 16.37 Dissociation of General Partners

[1] Causes of Dissociation

[2] Power to Dissociate

[a] By Express Will

[b] Wrongful Dissociation

[c] Liability Upon Wrongful Dissociation

[3] Effect of Dissociation as General Partner

[a] Right to Participate in Management

[b] Duties of Loyalty and Care

[c] Certificate of Dissociation

[d] Transferable Interests

[e] No Discharge of Obligations

[4] Liability of Dissociated General Partner

[5] Liability of Partnership for Actions of Dissociated Partner

§ 16.38 Transfer of Partnership Interests

[1] Transferable Interest

[2] Effect of Transfer

[3] Rights and Obligations of Transferee

[4] Rights of Deceased Partner's Representative

§ 16.39 Contributions

[1] Nature of Contribution

[2] Obligation to Contribute

§ 16.40 Distributions

[1] Sharing of Distributions

[2] Allocation of Profits and Losses

[3] Form of Distributions

[4] Right to Receive Distribution

[5] Status as Creditor as to Distribution

[6] Limitations on Distributions

[7] Distributions Made in Violation of § 15905.08

§§ 16.41-16.49 [Reserved]

§ 16.50 In General

§ 16.51 Registration Requirements

[1] Application for Registration

[a] In General

[b] Transacting Intrastate Business Defined

[2] Name Requirements

[3] Issuance of Certificate

[4] Cancellation of Application or Certificate

[5] Service of Process

§ 16.52 Effect of Recording Application for Registration

§ 16.53 Consequences of Failure to Register

§ 16.54 Cancellation of Registration

§§ 16.55-16.69 [Reserved]

§ 16.70 Federal Entity Classification Rules

[1] In General

[2] Determining Whether Separate Entity Exists

[3] Classification of Separate Entities as Trusts or Business Entities

[4] Classification of Certain Business Entities as Corporations

[5] Eligible Entities May Choose Classification for Federal Tax Purposes

[6] Default Classification Rules

[7] How to Elect Entity Classification

[8] Time for Election; Effective Date

[9] Classification Rules for Partnership Terminations and Divisions

[10] Transition Rules

[11] Classification for California Income Tax Purposes

§ 16.71 Publicly Traded Partnerships Taxed as Corporations

§§ 16.72-16.99 [Reserved]

§ 16.100 Facts

Scope

§ 16.101 Documents

Scope

§§ 16.102-16.109 [Reserved]

§ 16.110 Preliminary Considerations

Scope

§ 16.111 Formation of Domestic Limited Partnerships

Scope

§ 16.112 Registration of Foreign Limited Partnerships

Scope

§§ 16.113-16.119 [Reserved]

§ 16.120 Provisions for Limited Partnership Agreement

[1] Formation and Organization

Scope

[2] Partnership Members and Transfers

Scope

[3] Partnership Finances

Scope

[4] Allocation and Distribution of Profits and Losses

Scope

[5] Management of Partnership Affairs

Scope

[6] Books, Records, and Accounts

Scope

[7] Rights, Powers, and Duties of, and Restrictions on, Partners

Scope

[8] Meetings of Partners

Scope

[9] Transfer of Partnership Interests

Scope

[10] Liabilities of Partners

Scope

[11] Prohibited Transactions

Scope

[12] Dissolution of Partnership

Scope

[13] Record Dates

Scope

[14] Miscellaneous Provisions

Scope

§ 16.121 Limited Partnership Certificates

[1] Certificate of Limited Partnership

Scope

[2] Certificate of Amendment to Certificate of Limited Partnership

Scope

[3] Restated Certificate of Limited Partnership

Scope

[4] Certificate of Correction

Scope

§§ 16.122-16.199 [Reserved]

§ 16.200 Limited Partnership Agreement--General Form

[1] Comment

[a] Use of Form

[b] Variation of the Effect of ULPA '08 Provisions

[c] Publicly Traded Partnerships Taxable as Corporations

[d] Formation of Limited Partnerships

[2] FORM

Limited Partnership Agreement--General Form

§§ 16.201-16.209 [Reserved]

§ 16.210 Certificate of Limited Partnership [Form LP-1]

[1] Comment

[a] Use of Form

[b] Filing the Certificate

[c] Contents of Certificate

[d] Liability for False Information

[e] Inconsistencies With Partnership Agreement

[2] FORM

Certificate of Limited Partnership

§ 16.211 Certificate of Amendment to Certificate of Limited Partnership

[1] Comment

[a] Use of Form

[b] Requirement for Amendment

[c] Liability for False Information

[d] Signature Requirements

[e] Restated Certificate of Limited Partnership

[2] FORM

Certificate of Amendment to Certificate of Limited Partnership

§ 16.212 Restated Certificate of Limited Partnership

[1] Comment--Use of Form

[2] FORM

Restated Certificate of Limited Partnership

§§ 16.213-16.219 [Reserved]

§ 16.220 Application for Registration as a Foreign Limited Partnership

[1] Comment

[a] Use of Form

[b] Contents of Form

[c] Payment of Filing Fee

[2] FORM

Application for Registration as a Foreign Limited Partnership

§ 16.221 Amendment to Application for Registration as a Foreign Limited Partnership

[1] Comment--Use of Form

[2] FORM

Amendment to Application for Registration as a Foreign Limited Partnership

§§ 16.222-16.229 [Reserved]

§ 16.230 Written Consent of Partner to Action Taken Without a Meeting of Partners

[1] Comment

[2] FORM

Written Consent of Partner to Action Taken Without a Meeting of Partners

§§ 16.231-16.239 [Reserved]

§ 16.240 Consent to Admission of Partner's Transfree as Limited Partner

[1] Comment--Use of Form

[2] FORM

Consent to Admission of Partner's Transferee as Limited Partner

§ 16.241 Consent to Admission of New General Partner

[1] Comment

[a] Use of Form

[b] Admission of New General Partner

[2] FORM

Consent to Admission of New General Partner

§ 16.242 Consent to Admission of Replacement for Sole General Partner and to Continue Activities of Limited Partnership

[1] Comment

[a] Use of Form

[b] Replacement for Sole General Partner

[2] FORM

Consent to Admission of Replacement for Sole General Partner and Election to Continue Business Partnership

§§ 16.243-16.249 [Reserved]

§ 16.250 Consent to Compromise of Partner's Obligation to Make Contribution or Return Distribution to Partnership

[1] Comment

[a] Use of Form

[b] Execution of Compromise

[c] Obligation of Partner's Transferee

[d] Creditors' Rights

[2] FORM

Consent to Compromise of Partner's Obligation to Make Contribution or Return Distribution to Partnership

§ 16.260 Request for Reservation of Limited Partnership Name--Official Form

[1] Comment--Use of Form

[2] FORM

Request for Reservation of Limited Partnership Name--Official Form

§ 16.261 Resignation of Agent for Service of Process [Form RA-100]

[1] Comment--Use of Form

[2] FORM

Resignation of Agent for Service of Process [Form LP-100]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS

8-16 California Legal Forms--Transaction Guide Scope

Scope

Scope

This chapter discusses the nature and formation of limited partnerships under the Uniform Limited Partnership Act of 2008 (ULPA '08) after its operative date, January 1, 2008. It also covers the application of the ULPA '08 to limited partnerships existing before that date ("preexisting limited partnerships"). The operation of preexisting limited partnerships under the provisions of former limited partnership acts is beyond the scope of this chapter; for coverage, see Ballantine & Sterling, Ch. 25, *Limited Partnerships Parts A, B.* This chapter also covers the registration requirements applicable to foreign limited partnerships under the ULPA '08.

The Legal Background discusses the formation of limited partnerships; the rights, status, and obligations of limited and general partners; and changes in partnership membership. Federal income tax classification of limited partnerships is also covered. The Transaction Guide includes procedures for forming a limited partnership, and drafting guides for limited partnership agreements and other partnership documents.

The forms include a complete limited partnership agreement, the official limited partnership certificates, and forms for use by partners in granting consent to various actions. For other limited partnership agreements, see Chs. 29A, *Joint Ventures* , 29B, *Nonpublic Real Estate Syndicates* , and *Ch. 29C, Public Real Estate Syndicates* .

The chapter contains an overview of limited partnership interests as securities; for an extensive discussion of securities law, see Ch. 6, *Securities Regulation Issues* . The securities law aspects of real estate syndicate interests are covered in Chapter 29B, *Nonpublic Real Estate Syndicates* , and Ch. 29C, *Public Real Estate Syndicates* .

The dissolution of limited partnerships is covered in Ch. 16A. The merger of limited partnerships with other limited partnerships, as well as with other business entities, is discussed in Chapter 16B.

The formation, operation, and dissolution of general partnerships are covered in Ch. 15, Part A, *Formation of General Partnerships* and Ch. 15, Part B, *Dissolution of General Partnerships* . Limited liability partnerships are discussed in Ch. 16C; limited liability companies are discussed in Ch. 12C.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

8-16 California Legal Forms--Transaction Guide § 16.01

§ 16.01 California Statutes

Ownership of property as tenants in partnership. *Civ. Code §§ 682(2), 684.*

Right of deceased partner's executor or administrator to accounting. *Code Civ. Proc. § 339(1).*

Venue of actions based on partnership agreement. *Code Civ. Proc. § 395.*

California Uniform Limited Partnership Act (ULPA). *Corp. Code §§ 15501-15533*, repealed January 1, 2010.

California Revised Limited Partnership Act (CRLPA). *Corp. Code § 15611 et seq.*, repealed January 1, 2010.

Uniform Limited Partnership Act of 2008. *Corp. Code § 15900 et seq.*
Definitions. *Corp. Code § 15901.02.*
Nature, purpose, and duration of limited partnership. *Corp. Code § 15901.04.*
Powers of limited partnership. *Corp. Code § 15901.05.*
Name of limited partnership. *Corp. Code § 15901.08.*
Reservation of name. *Corp. Code § 15901.09.*
Partnership agreement. *Corp. Code § 15901.10.*
Office and agent for service of process. *Corp. Code § 15901.14.*
Service of process. *Corp. Code § 15901.16.*
Formation of limited partnerships. *Corp. Code §§ 15902.01-15902.09.*
Certificate of limited partnership. *Corp. Code § 15902.01.*
Amendment of certificate. *Corp. Code § 15902.02.*
Filing requirements. *Corp. Code § 15902.06.*
Certificate of correction. *Corp. Code § 15902.07.*
Reviving cancelled certificate. *Corp. Code § 15902.09.*
Limited partners. *Corp. Code §§ 15903.01-15903.07.*

Becoming limited partner. *Corp. Code § 15903.01*.
No power to bind partnership. *Corp. Code § 15903.02*.
Liability of limited partner. *Corp. Code § 15903.03*.
Right to information. *Corp. Code § 15903.04*.
Fiduciary duties. *Corp. Code § 15903.05*.
Liability of investor in partnership. *Corp. Code § 15903.06*.
Creation of class of limited partners. *Corp. Code § 15903.07*.
General partners. *Corp. Code §§ 15904.01-15904.09*.
Becoming general partner. *Corp. Code § 15904.01*.
General partner as agent. *Corp. Code § 15904.02*.
Partnership's liability for general partner's actions. *Corp. Code § 15904.03*.
Liability of general partner. *Corp. Code § 15904.04*.
General partner's rights in management. *Corp. Code § 15904.06*.
General partner's right to information. *Corp. Code § 15904.07*.
Fiduciary duties of general partner. *Corp. Code § 15904.08*.
Creation of class of general partners. Corp. Code § 15903.09.
Contributions and distributions. *Corp. Code §§ 15905.01-15905.09*.
Partner's contribution. *Corp. Code § 15905.01*.
Sharing of distribution. *Corp. Code § 15905.03*.
Allocation of profits and losses. *Corp. Code § 15905.035*.
Distributions. *Corp. Code §§ 15905.04-15905.09*.
Dissociation as partner. *Corp. Code §§ 15906.01-15906.07*.
Transferable interests and rights. *Corp. Code § 15907.01 et seq.*
Dissolution. *Corp. Code §§ 15908.01-15908.09*
Foreign limited partnerships. *Corp. Code §§ 15909.01-15909.08*.
Conversion and merger. *Corp. Code §§ 15911.01-15911.19*.
Dissenting limited partners' rights. *Corp. Code §§ 15911.20-15911.33*.
Operative date of ULPA '08. *Corp. Code § 15912.04*.
Limited application of ULPA '08 to preexisting limited partnerships. *Corp. Code § 15912.06*.
Application of law to actions commenced, proceedings brought, or rights accrued before operative date. *Corp. Code § 15912.07*.
Mergers of limited partnerships and other business entities. *Corp. Code § 23006*.
Minimum franchise tax. *Rev. & Tax. Code §§ 17935-17937*.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

8-16 California Legal Forms--Transaction Guide § 16.02

§ 16.02 Federal Statutes

Limitation on losses and credits from passive activities. *I.R.C. § 469*.

Income taxation of partners and partnership. *I.R.C. §§ 701*-755.

Partnership information income tax return. *I.R.C. §§ 6031, 6072*.

Taxation of partnership as association taxable as corporation. *I.R.C. § 7701*.

Taxation of publicly traded partnerships as corporations. *I.R.C. § 7704*.



5 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

8-16 California Legal Forms--Transaction Guide § 16.03

§ 16.03 Federal Regulations

Income taxation of partners and partnerships. Treas. Reg. §§ 1.701-1.771.

Filing partnership information tax returns. Treas. Reg. § 1.6031-1.

Valuation of business interests subject to buy-sell agreements. *Treas. Reg. §§ 20.2031-2(h), 20.2031-3(c).*

Valuation of partnership interests for federal estate tax purposes. *Treas. Reg. § 20.2031-3*.

Valuation of gift of partnership interest to family member for estate tax purposes; treatment of unpaid qualified payments at death of transferor or applicable family member. *Treas. Reg. §§ 25.2701-1-25.2701-8*.

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

8-16 California Legal Forms--Transaction Guide § 16.04

[Reserved]

§ 16.04[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-16 California Legal Forms--Transaction Guide § 16.05

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-16 California Legal Forms--Transaction Guide § 16.06

[Reserved]

§ 16.06[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-16 California Legal Forms--Transaction Guide § 16.07

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Ch. 15, *General Partnerships*.
Ch. 16A, *Dissolution of Limited Partnerships*.
Ch. 16B, *Conversions and Mergers of Limited Partnerships*.
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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-16 California Legal Forms--Transaction Guide §§ 16.08-16.09

[Reserved]

§§ 16.08[Reserved]



11 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Governing Law

8-16 California Legal Forms--Transaction Guide § 16.10

§ 16.10 Operative Dates

The Uniform Limited Partnership Act of 2008 (ULPA '08), set forth in *Corp. Code §§ 15900-15912.07*, became operative on January 1, 2008 [*see Corp. Code § 15912.04*; Stats. 2006, ch. 495, § 20; *Corp. Code § 15900*].

Existing acts governing limited partnerships, *i.e.*, the Uniform Limited Partnership Act (ULPA) [*Corp. Code §§ 15501-15533*] and the California Revised Limited Partnership Act (CRLPA) [*Corp. Code §§ 15611-15723*], became inoperative and were repealed on January 1, 2010 [*see Corp. Code §§ 15534, 15724*]. Before that date, the new Act governed only [*see Corp. Code § 15912.06(a)*]:

- Limited partnerships formed on or after January 1, 2008; and

- Limited partnerships formed before January 1, 2008, which elected to be subject to the new Act, except as otherwise provided in *Corp. Code § 15912.06(c),(d)* [*see §§ 16.11, 16.12*].

Except as otherwise provided in *Corp. Code § 15912.06(c)* [*see § 16.11*], on and after January 1, 2010 the new Act governs *all* limited partnerships [*Corp. Code § 15912.06(b)*].

Corp. Code § 15912.06 refers to "limited partnerships," which are domestic limited partnerships by definition [*see Corp. Code § 15901.02(q)*]. Because the ULPA '08 contains no comparable phase-in provisions for foreign limited partnerships, once the 2008 Act became effective, it applied immediately to all foreign limited partnerships, whether formed before or after the 2008 Act's effective date [*see* Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* , § 724.03 (Matthew Bender)].

The ULPA '08 does not affect any action commenced, proceeding brought, or right accrued before its operative date [*see Corp. Code § 15912.07*].

For detailed discussion of the California partnership acts, see Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* (Matthew Bender). Part A of that chapter summarizes major similarities and differences

between the ULPA '08 and the CRLPA, Part B discusses the provisions of the CRLPA, and Part C covers the 2008 Act.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Governing Law

8-16 California Legal Forms--Transaction Guide § 16.11

§ 16.11 Preexisting Limited Partnerships

With respect to any limited partnership formed before January 1, 2008, the following rules apply except as the partners otherwise elect in the manner provided in the partnership agreement or by law for amending the partnership agreement [*Corp. Code § 15912.06(c)*]:

- *Corp. Code § 15901.04(c)* (providing that the limited partnership has perpetual duration) [*see § 16.20*] does not apply and the limited partnership has whatever duration it had under the law applicable immediately before January 1, 2008.

- *Corp. Code §§ 15906.01* and *15906.02* (dissociation of limited partner and effects of dissociation) [*see § 16.33*] do not apply and a limited partner has the same right and power to dissociate from the limited partnership, with the same consequences, as existed immediately before January 1, 2008.

- *Corp. Code § 15906.03(d)* (dissociation of general partner by expulsion) [*see § 16.37[1]*] does not apply.

- *Corp. Code § 15906.03(e)* (expulsion of general partner by judicial order) [*see § 16.37[1]*] does not apply and a court has the same power to expel a general partner as the court had immediately before January 1, 2008.

- *Corp. Code § 15908.01(c)* (nonjudicial dissolution of limited partnership after dissociation of general partner) [*see* Ch. 16A, *Dissolution of Limited Partnerships*] does not apply and the connection between a person's dissociation as a general partner and the dissolution of the limited partnership is the same as existed immediately before January 1, 2008.

These provisions will not apply to pre-existing partnerships without the election by the partners, because their ongoing relationship as established in the partnership agreement might have been based on a different agreement or on different assumptions that should not be automatically changed without the consent of all partners [*see* Ballantine & Sterling,

California Corporation Laws, Ch. 25, *Limited Partnerships* , § 724.04].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesContracts LawTypes of ContractsPartnership Agreements



13 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Governing Law

8-16 California Legal Forms--Transaction Guide § 16.12

§ 16.12 Electing Limited Partnership--Liability of General Partners

With respect to a limited partnership formed before January 1, 2008 that elects to be subject to the ULPA '08 [*see Corp. Code § 15912.06(a)(2)*; *see also* [1], *above*], after the election takes effect, the provisions of the ULPA '08 relating to the liability of the partnership's general partners to third parties apply [*Corp. Code § 15912.06(d)*]:

- Before January 1, 2010, to (1) a third party that had not done business with the limited partnership in the year before the election took effect; and (2) a third party that had done business with the limited partnership in the year before the election took effect only if the third party knows or has received a notification of the election.

- On and after January 1, 2010, to all third parties, but those provisions remain inapplicable to any obligation incurred while those provisions were inapplicable under clause (2) above.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & Liabilities



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Governing Law

8-16 California Legal Forms--Transaction Guide § 16.13

§ 16.13 Application of Securities Laws

Under the Corporate Securities Law of 1968, it is unlawful to offer or sell securities in California unless the securities are qualified for sale by the California Commissioner of Corporations, are exempted from qualification, or are not subject to qualification [*see Corp. Code §§ 25110, 25120, 25130*; *see, e.g., Corp. Code §§ 25100.1, 25101.1, 25102.1* (securities not subject to qualification)]. Limited partnership interests are considered to be securities subject to that law, despite the fact that they are not specifically included within the definition of "securities" [*see Corp. Code § 25019*]. They may be labeled as either profit-sharing agreements or investment contracts, which are both specifically included within the definition [*see Corp. Code § 25019*; *see also* Marsh & Volk, Practice Under the California Corporate Securities Laws, Ch. 5, *Problems Relating to Special Types of Issuers and Securities* (Matthew Bender)], although the exact characterization is not important since the list of items set forth in *Corp. Code § 25019* is illustrative rather than all-inclusive [*see People v. Syde (1951) 37 Cal. 2d 765, 768, 235 P.2d 601]* . Courts will look to the substance of an investment, rather than to its form, to determine whether it is a security [*see Silver Hills Country Club v. Sobieski (1961) 55 Cal. 2d 811, 814, 13 Cal. Rptr. 186, 361 P.2d 906]* .

In California, courts have generally used the "risk capital test" to determine whether an investment is a "security" within the meaning of *Corp. Code § 25019*. Under that test, a transaction comes within the regulatory purposes of the Corporate Securities Law if investors provide capital that will be risked in the promoter's venture or enterprise [*see Silver Hills Country Club v. Sobieski (1961) 55 Cal. 2d 811, 815, 13 Cal. Rptr. 186, 361 P.2d 906]* . A limited partnership interest is a security under that test, notwithstanding that investor participation is contemplated or required, as long as the investor is not involved in those essential managerial efforts that affect the failure or success of the enterprise [*People v. Graham (1985) 163 Cal. App. 3d 1159, 1168-1169, 210 Cal. Rptr. 318]* .

For purposes of the qualification requirements of the Corporate Securities Law, a "sale" of securities includes every contract of sale, contract to sell, or disposition of a security or interest in a security for value, as well as any exchange of securities or any change in the rights, preferences, privileges, or restrictions of or on outstanding securities [*Corp. Code § 25017(a)*]. "Offer" includes every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value [*Corp. Code § 25017(b)*].

There are numerous exemptions from the California qualification requirements. The limited offering exemption [*see Corp. Code § 25102(f)*; *see* Ch. 6B, *California Limited Offering Exemptions*] is generally used for limited partnership interests [*see* Marsh & Volk, Practice Under the California Corporate Securities Laws, Ch. 5, *Problems Relating to Special Types of Issuers and Securities* (Matthew Bender)]. Further, master limited partnership interests are exempt from qualification under *Corp. Code § 25100(o)* if they are listed, or approved for listing on notice of issuance, on a national securities exchange or on the National Market System of the NASDAQ Stock Market (or its successor) that has been certified by the Commissioner [*Corp. Code § 25100(o)*].

For a discussion of the corporate securities laws in general, see Ch. 6, *Securities Regulation Issues* . For a discussion of the securities law aspect of real estate syndicate interests, see Ch. 29B, *Nonpublic Real Estate Syndicates* , and Ch. 29C, *Public Real Estate Syndicates* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesReal Property LawSecurities RegulationPartnershipsSecurities LawGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Governing Law

8-16 California Legal Forms--Transaction Guide § 16.14

§ 16.14 Application of California Law

California law governs relations among the partners of a limited partnership and between the partners and the partnership. It also governs the liability of partners as partners for an obligation of the limited partnership [*Corp. Code § 15901.06*]. A partnership agreement may not vary the law applicable to a limited partnership under § 15901.06 [*Corp. Code § 15901.10(b)(2)*; *see § 15.21[4][b]*].

Unless displaced by particular provisions of the ULPA '08, the principles of law and equity supplement that act [*Corp. Code § 15901.06(a)*]. If an obligation to pay interest arises under the ULPA '08 and the rate is not specified, the rate is that set forth in *Civ. Code § 3289* [*Corp. Code § 15901.07(b)*].



16 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Governing Law

8-16 California Legal Forms--Transaction Guide §§ 16.15-16.19

[Reserved]

§§ 16.15[Reserved]



17 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Formation and Operation of Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.20

§ 16.20 Nature of California Limited Partnerships

[1] Definition

A limited partnership (or a domestic limited partnership) (except in the phrases "foreign limited partnership" and "foreign limited liability limited partnership") is an entity with one or more general partners and one or more limited partners, which is formed under the ULPA '08 by two or more persons, or which becomes subject to the ULPA '08 pursuant to conversion [*see Corp. Code § 15911.01 et seq.*; *see also* Ch. 16B, *Conversions and Mergers of Limited Partnerships*] or election or operation of law [*Corp. Code § 15901.02(q)*; *see Corp. Code §§ 15911.01, 15912.06(a),(b)*; *see also § 16.11*]. With respect to a limited partnership, a "general partner" is a person to whom either of the following applies: (1) becomes a general partner under *Corp. Code § 15904.01* [*see § 16.36*] the person or (2) the person was a general partner in a limited partnership when the limited partnership became subject to the ULPA '08 under *Corp. Code § 15912.06(a)* or *(b)* [*Corp. Code § 15901.02(m)*; *see § 16.21*]. A "limited partner" is a person to whom either of the following applies: (1) the person becomes a limited partner under *Corp. Code § 15903.01* [*see § 16.32*] or 15907.02(h) (transfer) or (2) the person was a limited partner in a limited partnership when the limited partnership became subject to the ULPA '08 under *Corp. Code § 15912.06(a)* or *(b)* [*Corp. Code § 15901.02(p)*; *see § 16.21*]. A "partner" means a limited partner or a general partner [*Corp. Code § 15901.02(w)*]. A "person" means an individual, partnership, limited partnership, trust, estate, association, corporation, limited liability company, or other entity, whether domestic or foreign [*Corp. Code § 15901.02(y)*].

The most important feature of a limited partnership, particularly from the point of view of a limited partner investor, is that a limited partner is granted limited liability as long as the limited partner does not participate in control of the partnership business [*see § 16.21[4][d][ii]*]. The affairs of the partnership are managed by the general partners [*see § 16.21[4][d][i]*; the liability of general partners is discussed in *§ 16.34[3]*.

A limited partnership has certain features formerly associated only with corporations. For example, a partnership name may be reserved in advance of formation [*see § 16.21[3][b]*] and formation is accomplished on the filing of a certificate of limited partnership with the Secretary of State [*see § 16.21[1]*]. Limited partners are accorded rights to inspect partnership records and obtain financial reports similar to those available to corporate shareholders [*see § 16.30[1]*],

voting rights, and the right to call partnership meetings [*see §§ 16.24[a], 16.30[3][b]*]. In addition, important litigation rights, including class and derivative actions that are similar to those of corporate shareholders, are granted to limited partners [*see Corp. Code §§ 15910.01 et seq.*].

The ULPA '08 states that a limited partnership is an entity distinct from its partners [*Corp. Code § 15901.04(a)*], which has a perpetual duration [*Corp. Code § 15901.04(c)*].

[2] Permissible Business of Limited Partnerships

A limited partnership may be organized for any lawful purpose. It may engage in any lawful business activity, whether or not for profit, except the banking business, the business of issuing policies of insurance and assuming insurance risks, or the trust company business [*Corp. Code § 15901.04(b)*].

A limited partnership has power to do all things necessary or convenient to carry on its activities, including power to sue, be sued, and defend in its own name and to maintain an action against a partner for harm caused to the partnership by a breach of the partnership agreement or violation of a duty to the partnership [*Corp. Code § 15901.05*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesContracts LawTypes of ContractsPartnership Agreements



18 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Formation and Operation of Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.21

§ 16.21 Formation of Limited Partnerships

[1] Overview of Formal Requirements

A limited partnership is formed by the filing of a certificate of limited partnership in the office of the Secretary of State [*see Corp. Code § 15902.01(a), (c)*], together with the payment of required filing fees [*see Corp. Code § 15902.01(f)*; *Gov. Code § 12188(b)*; *see also* [2], *below*]. At least one general partner and at least one limited partner are required to form a limited partnership [*see Corp. Code § 15901.02(q)*].

Before filing the certificate of limited partnership, the partnership may select and reserve a name [*see Corp. Code §§ 15901.08, 15901.09, 15902.01(a)*; *see also* [3], *below*]. Either before or after the filing of the certificate of limited partnership, the partners must enter into a partnership agreement [*Corp. Code § 15902.01(a)*]. The partnership agreement may be written or oral [*Corp. Code § 15901.02(x)*], but need not be filed in the office of the Secretary of State [*see* [4], *below*].

A limited partnership that is defectively formed due to its failure to file a certificate of limited partnership may be treated as a general partnership [*see American Alternative Energy v. Windridge, Inc. (1996) 42 Cal. App. 4th 551, 560-562, 49 Cal. Rptr. 2d 686* (noncompliance with certificate requirement under CRLPA rendered entity a general partnership with capacity to sue)].

[2] Certificate of Limited Partnership

[a] Contents of Certificate

The ULPA '08 specifies certain items that must be included in the certificate of limited partnership, and accords the general partners discretion to include other information. The certificate must state the following [*Corp. Code § 15902.01(a)*]:

- The name of the limited partnership [*see* [3], *below*];

- The address of the initial designated office [*see § 16.23[2]*];

- The name and address of the initial agent for service of process [*see Corp. Code § 15901.16(d)(1)*; *see also § 16.23[1]*]; and

- The name and address of each general partner.

A certificate of limited partnership may also contain any other matters, but may not vary or otherwise affect the provisions specified in *Corp. Code § 15901.10(b)* in a manner inconsistent with that section [*Corp. Code § 15902.01(b)*; *see § 16.21[4]*].

The desirability of including additional information in the certificate is unclear. If the general partners wish to keep the additional information private, the information should instead be included in the partnership agreement [*see* [4], *below*]. Further, if the limited partners want to be able to vote on an issue on which the partners have currently agreed, the issue should be included in the partnership agreement rather than the certificate; limited partners are permitted by statute to vote on amendments to the partnership agreement without being deemed to participate in the control of the business and jeopardizing their limited liability status [*Corp. Code § 15903.03(b)(4)*; *see § 16.30[3][a]*].

The certificate must be filed on a form prescribed by the Secretary of State (LP-1) and be accompanied by the payment of the required filing fees [*see Corp. Code § 15902.01(a),(f)*; *Gov. Code § 12188(b)*; *see also* [b], *below*].

[b] Execution and Filing of Certificate

[i] Execution

An initial certificate of limited partnership must be signed by all general partners listed in the certificate [*Corp. Code § 15902.04(a)(1)*]; *see § 16.210*]. A partner may execute the certificate either personally or by an attorney-in-fact [*Corp. Code § 15902.04*]. For discussion of the execution, and filing of a certificate of limited partnership by someone other than a general partner, see [iv], *below*.

[ii] Filing Requirements

The general partners must file the certificate of limited partnership, on the form prescribed by the Secretary of State (LP-1), in the office of the Secretary of State [*Corp. Code §§ 15902.01(a)*]. The certificate must be accompanied by the payment of the required filing fees [*Gov. Code § 12188(b)*; *see Corp. Code § 15902.01(f)*]. If the check or other remittance accepted in payment of the filing fee is not paid on presentation, the Secretary may cancel the filing of the certificate [*see Corp. Code § 15902.01(f)*]. After receiving notice of nonpayment, the Secretary will notify the agent for service of process (or the person submitting the certificate for filing) in writing of the application of this rule. If the amount is not then paid by cashier's check or the equivalent, the Secretary will issue a second written notice of cancellation, effective on issuance, at least 20 days after the first notice but within 90 days of the original filing [*see Corp. Code § 15902.01(f)*; *see also § 16.210[1][b]*].

[iii] Filing Date

Any record authorized or required to be delivered to the Secretary of State for filing under the ULPA '08 must be completed on a form prescribed by and in a medium permitted by the Secretary of State, and be delivered to the Secretary of State. Unless the Secretary of State determines that a record does not comply with the filing requirements of the ULPA '08, and if all requisite fees have been paid, the Secretary of State must file the record [*Corp. Code § 15902.06(a)*; *see Corp. Code § 15901.02(ac)* ("record" means information inscribed on tangible medium or stored in electronic or other medium, and is retrievable in perceivable form)].

Except as otherwise provided [*see Corp. Code §§ 15901.16* (service of process), 15902.01 (certificate of limited partnership), and 15902.07 (certificate of correction) [*see § 16.22[3]*], a record delivered to the Secretary of State for filing under the ULPA '08 may specify an effective time and delayed effective date [*Corp. Code § 15902.06(b)*]. Except as otherwise provided in ULPA '08, a record filed by the Secretary of State is effective [*Corp. Code § 15902.06(b)*]:

- If the record does not specify a delayed effective date, on the date the record is filed as evidenced by the Secretary of State's endorsement of the date on the record;

- If the record specifies a delayed effective date, on the earlier of the specified date or the 90th day after the record is filed.

If a delayed effective date is specified, the record may be prevented from becoming effective by a certificate stating that by appropriate action it has been revoked and is null and void. The certificate must be executed in the same manner as the original record and delivered to the Secretary of State for filing before the specified effective date [*Corp. Code § 15902.06(c)*].

[iv] Execution and Filing by Person Other Than General Partner

If a person required by the ULPA '08 to sign or deliver a record, *e.g.*, a certificate of limited partnership, to the Secretary of State for filing does not do so, any other person that is aggrieved may petition the superior court to order [*Corp. Code § 15902.05(a)*; *see Corp. Code § 15901.02(af)* ("sign" defined)]:

- The person to sign the record;

- The person to deliver the record to the Secretary of State for filing; or

- The Secretary of State to file the record unsigned.

If the person aggrieved as described *above* is not the limited partnership or foreign limited partnership to which the record pertains, the aggrieved person must make the limited partnership or foreign limited partnership a party to the action. A person aggrieved as described *above* may seek the remedies described *above* in the same action in combination or in the alternative. In any such action, if the court finds the failure of the person to comply with the requirement to sign a record or deliver a record to the Secretary of State for filing to have been without justification, the court may award an amount sufficient to reimburse the persons aggrieved bringing the action for the reasonable expenses incurred by those persons, including attorneys' fees, in connection with the action or proceeding [*Corp. Code § 15902.05(b)*].

A record filed unsigned pursuant to this provision is effective without being signed [*Corp. Code § 15902.05(c)*].

Any person, other than a general partner, delivering a record to the Secretary of State for filing must state the statutory authority for that action after the signature on the appropriate record [*Corp. Code § 15902.05(d)*].

Furthermore, if no certificate of limited partnership has been filed, a person that makes an investment in the enterprise and erroneously but in good faith believes that the person has become a limited partner in the enterprise may cause an appropriate certificate of limited partnership, amendment, or certificate of correction to be signed and delivered to the Secretary of State for filing [*Corp. Code § 15903.06(a)*; *see § 16.31[4]*].

[v] Resubmission of Returned Instruments

If the Secretary of State determines that a record delivered for filing does not conform to the law and returns it to the

person delivering it, the record may be resubmitted. It must be accompanied by a written opinion of the member of the State Bar of California delivering the record or representing the person delivering it, to the effect that the specific provisions of the record objected to by the Secretary of State do conform to law and stating the points and authorities on which the opinion is based. With respect to any disputed point of law, other than the application of *Corp. Code §§ 15901.08, 15901.09, 15909.02*, and *15909.05* (name requirements), the Secretary of State must rely on that written opinion in determining whether the record conforms to law. When filed by the Secretary of State upon resubmission, that record is effective retroactively as of the date that the original record was delivered to the Secretary of State for filing [*Corp. Code § 15902.06(d)*].

[c] Recordation of Certificate

A limited partnership may record in the office of the county recorder of any county in California a certified copy of the certificate of limited partnership that has been filed in the office of the Secretary of State. The recording creates a conclusive presumption in favor of any bona fide purchaser or encumbrancer for value of the partnership real property located in the county in which the certified copy has been recorded that (1) the persons named as general partners in the certificate are in fact the general partners, and (2) these persons are all of the general partners of the partnership [*Corp. Code § 15902.01(e)*].

[d] Liability for Misstatements

If any record that is delivered to the Secretary of State for filing under the ULPA '08 and filed by the Secretary contains false information, a person that suffers loss by reliance on the information may recover damages for the loss from [*Corp. Code § 15902.08(a)*]:

- A person that signed the record, or caused another to sign it on the person's behalf, and knew the information to be false at the time the record was signed; and

- A general partner that had notice that the information was false when the record was filed or had become false because of changed circumstances, if the general partner had notice for a reasonably sufficient time before the information is relied upon to enable the general partner to effect an amendment under *Corp. Code § 15902.02* (amendments or restatements of certificates of limited partnerships), file a petition pursuant to § 15902.05 (filings pursuant to judicial order) [*see* [2][b][iv], *above*], or deliver to the Secretary of State for filing a certificate of correction pursuant to *Corp. Code § 15902.07*.

Signing a record authorized or required to be filed under the 2008 Act constitutes an affirmation under the penalties of perjury that the facts stated in the record are true [*Corp. Code § 15902.08(b)*]. Liability for misstatements is discussed in *further detail in § 16.31[2]*.

[3] Limited Partnership Name

[a] Name Requirements and Restrictions

The name of a limited partnership, as set forth in its certificate of limited partnership, must end with the words "limited partnership" or the abbreviation "L.P." or "LP" [*Corp. Code § 15901.08(b)*]. The name may contain the name of any partner [*Corp. Code § 15901.08(a)*]; the name may not include the words "bank," "insurance," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." [*Corp. Code § 15901.08(g)*].

Unless authorized as described in the next paragraph, the name of a limited partnership must be distinguishable in the records of the Secretary of State from: (1) the name of any limited partnership that has previously filed a certificate of limited partnership pursuant to *Corp. Code § 15902.01* or any foreign limited partnership registered pursuant to *Corp. Code § 15909.01*; and (2) each name reserved under *Corp. Code § 15901.09* [*Corp. Code § 15901.08(d)*].

A limited partnership may apply to the Secretary of State for authorization to use a name that does not comply with the above requirements. The Secretary of State will authorize use of the name applied for if, as to each conflicting name [*Corp. Code § 15901.08(e)*]:

- The present user, registrant, or owner of the conflicting name consents in a signed record [*see* Corp. Code § 15901(ac) (definition)] to the use and submits an undertaking in a form satisfactory to the Secretary of State to change the conflicting name to a name that is distinguishable in the records of the Secretary of State from the name applied for;

- The applicant delivers to the Secretary of State a certified copy of the final judgment of a court of competent jurisdiction establishing the applicant's right to use in California the name applied for; or

- The applicant delivers to the Secretary of State proof satisfactory to the Secretary of State that the present user, registrant, or owner of the conflicting name (1) has merged into the applicant; (2) has been converted into the applicant; or (3) has transferred substantially all of its assets, including the conflicting name, to the applicant.

[b] Reservation of Name

A limited partnership name may be reserved in advance of formation in much the same manner as the advance reservation of corporate names [*see Corp. Code § 15901.09*].

The exclusive right to the use of a name that complies with the requirements described in *Corp. Code § 15901.08* [*see* [a], *above*], may be reserved by [*Corp. Code § 15901.09(a)*]:

(1) A person intending to organize a limited partnership under the ULPA '08 and to adopt the name;

(2) A limited partnership or a foreign limited partnership authorized to transact business in California intending to adopt the name;

(3) A foreign limited partnership intending to obtain a certificate of registration to transact business in California and adopt the name;

(4) A person intending to organize a foreign limited partnership and have it obtain a certificate of registration to transact business in California and adopt the name;

(5) A foreign limited partnership formed under the name; or

(6) A foreign limited partnership formed under a name that does not include the phrases "limited partnership," the abbreviation "L.P." or "LP" or "LLP" or "LLLP" or "L.L.P." The name reserved, however, may differ from the foreign limited partnership's name only to the extent necessary to comply with name requirements [*see Corp. Code § 15901.08(b), (c)*].

A person may apply to reserve a name by delivering to the Secretary of State an application that states the name to be reserved and the paragraph of *Corp. Code § 15901.08(a)* that applies. If the Secretary of State finds that the name is available for use by the applicant, the Secretary must issue a certificate of name reservation and thereby reserve the name for the exclusive use of the applicant for 60 days [*Corp. Code § 15901.09(b)*]. An applicant that has reserved a name may reserve the same name for an additional 60-day period. The Secretary of State will not issue a certificate reserving the same name for two or more consecutive 60-day periods to the same applicant or for the use or benefit of

the same person [*Corp. Code § 15901.09(c)*].

A person that has reserved a name may transfer it to another person, effective on delivery to the Secretary of State of a notice of transfer that states the reserved name, the name and address of the transferee, and the paragraph of *Corp. Code § 15901.08(a)* that applies to the transferee [*Corp. Code § 15901.09(d)*].

There are other means of protecting the partnership name, including trade or service mark protection [*see* Ch. 103B, *Trademarks*]. For coverage of name reservation and other methods of protecting the partnership name, see *§ 16.111*. For a reproduction of the Secretary of State's official form for requesting a limited partnership name, see *§ 16.260*.

[c] Fictitious Business Names

If the limited partnership will conduct business under a fictitious name, then the partnership must file a fictitious business name statement [*Bus. & Prof. Code § 17902*; *see Bus. & Prof. Code §§ 17900-17930*]. If the limited partnership regularly transacts business for profit under a fictitious name, it must file a fictitious business name certificate within 40 days after it commences business [*Bus. & Prof. Code § 17910(a)*].

For any limited partnership that has filed a certificate of limited partnership with the California Secretary of State [*see Corp. Code § 15902.01*; *see also §§ 16.111, 16.121*], or any foreign limited partnership that has filed an application to register with the Secretary of State [*see Corp. Code § 15909.02*; *see also § 16.51*], a business name is a "fictitious business name" if it is any name other than the name of the limited partnership on file with the Secretary of State[*Bus. & Prof. Code § 17900(b)(4)*]. For a limited partnership that has not filed its certificate, or a foreign limited partnership that has not filed its application, a name that does not include the surname of each general partner, or a name that suggests the existence of additional owners [*see Bus. & Prof. Code §§ 17900(c), 17901*] is a fictitious business name [*Bus. & Prof. Code § 17900(b)(2)*].

[4] Partnership Agreement

[a] Use of Written Agreement

A limited partnership agreement the partners' agreement, whether oral, implied, in a record, or in any combination, concerning the limited partnership. The term includes the agreement as amended [*Corp. Code § 15901.02(x)*].

Because the ULPA '08 contains many specific provisions that depend on the provisions of the partnership agreement, it is advisable to have a specific and detailed agreement in writing [*see Corp. Code § 15901.11(5)* (duty to maintain copy of agreement); *see also § 16.200[1][d]*]. Further, as a practical matter, federal and state tax law make a written agreement necessary [*see § 16.70*].

[b] Variation of ULPA '08 Provisions by Partnership Agreement

Except as otherwise described *below*, the partnership agreement governs relations among the partners and between the partners and the partnership. To the extent the partnership agreement does not otherwise provide, the ULPA '08 governs relations among the partners and between the partners and the partnership [*Corp. Code § 15901.10(a)*].

A partnership agreement *may not* [*Corp. Code § 15901.10(b)*]:

(1) Vary a limited partnership's power under *Corp. Code § 15901.05* to sue, be sued, and defend in its own name.

(2) Vary the law applicable to a limited partnership under *Corp. Code § 15901.06* [*see § 16.14*].

(3) Vary the requirements of *Corp. Code § 15902.04* (signature requirements for filed "records").

(4) Vary the information required by *Corp. Code § 15901.11* (information required to be retained at limited partnership's designated office) [*see § 16.23[2]*] or unreasonably restrict the right to information under *Corp. Code § 15903.04* (limited partners) [*see § 16.30[1]*] or *Corp. Code § 15904.07* (general partners) [*see § 16.34[4]*]. However, the partnership agreement may impose reasonable restrictions on the availability and use of information obtained under those sections and may define appropriate remedies, including liquidated damages, for a breach of any reasonable restriction on use.

(5) Eliminate the duty of loyalty under *Corp. Code § 15904.07* [*see § 16.35[2]*, but the partnership agreement may: (a) identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; and (b) specify the number or percentage of partners which may authorize or ratify, after full disclosure to all partners of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty.

(6) Unreasonably reduce the duty of care under *Corp. Code § 15904.08(a)* [*see § 16.35[2]*].

(7) Eliminate the obligation of good faith and fair dealing of limited partners under *Corp. Code § 15903.05(b)* [*see § 16.35[2]*] and of general partners under *Corp. Code § 15904.08(d)* [*see § 16.35[2]*], but the partnership agreement may prescribe the standards by which the performance of this obligation is to be measured, if the standards are not manifestly unreasonable.

(8) Vary the power of a person to dissociate as a general partner under *Corp. Code § 15906.04(a)* except to require that the notice under *Corp. Code § 15906.03(a)* be in a record [*see § 16.37*].

(9) Eliminate the power of a court to decree dissolution in the circumstances specified in *Corp. Code § 15908.02(a)* [*see* Ch. 16A, *Dissolution of Limited Partnerships*].

(10) Vary the requirement to wind up the partnership's business as specified in *Corp. Code § 15908.03* [*see* Ch. 16A, *Dissolution of Limited Partnerships*].

(11) Unreasonably restrict the right of a partner to maintain an action as provided in *Corp. Code § 15910.01 et seq.*

(12) Restrict the right of a partner to approve a conversion or merger [*see* Ch. 16B, *Conversion and Merger of Limited Partnerships*].

(13) Vary the provisions of Article 11.5 (regarding dissenting limited partners' rights to dissent in a conversion or merger), except to the extent expressly permitted by those provisions [*see* Ch. 16B, *Conversion and Merger of Limited Partnerships*].

(14) Restrict rights under the ULPA '08 of a person other than a partner or a transferee.

[c] Inconsistency With Filed Certificate

Subject to *Corp. Code § 15902.01(b)* [*see* § 16,21[2][a]], if any provision of a partnership agreement is inconsistent with the filed certificate of limited partnership or with a filed certificate of dissociation, cancellation, or amendment or filed certificate of conversion or merger [*Corp. Code § 15902.01(d)*]:

(1) The partnership agreement prevails as to partners and transferees; and

(2) The filed certificate of limited partnership, certificate of dissociation, cancellation, or amendment or filed certificate of conversion or merger prevails as to persons, other than partners and transferees, that reasonably rely on the filed record to their detriment.

[d] Creation of Classes of Partners

[i] General Partners

A partnership agreement may provide for the creation of classes of general partners. If so, the agreement must must define the rights, powers, and duties of those classes, including the rights, powers, and duties senior to other classes of general partners [*Corp. Code § 15904.09*]. The agreement may provide to all or specified classes of general partners the right to vote separately, or with all or any class of the general partners, on any matter [*Corp. Code § 15904.09*].

[ii] Limited Partners

A partnership agreement may provide for the creation of classes of limited partners. If so, the agreement must must define the rights, powers, and duties of those classes, including the rights, powers, and duties senior to other classes of limited partners [*Corp. Code § 15903.07*]. The agreement may provide to all or specified classes of limited partners the right to vote separately, or with all or any class of the limited partners, on any matter [*Corp. Code § 15903.07*].

[e] Consent to Jurisdiction, Arbitration, and Service of Process

A partner may consent, in a written partnership agreement or other writing, to be subject to the nonexclusive jurisidiction of the courts of a specified jurisdiction, or the exclusive jurisdiction of the California courts [*Corp. Code § 15901.17*].

If a partner wishes to use the arbitration process, that partner may consent, in a written partnership agreement or other writing, to be nonexclusively subject to arbitration in a specified state, or to be exclusively subject to arbitration in California [*Corp. Code § 15901.17*].

Along with the consent to jurisdiction or arbitration, a partner may consent to be served with legal process in the manner prescribed in the written partnership agreement or other writing [*Corp. Code § 15901.17*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesRegistration RequirementsBusiness & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Formation and Operation of Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.22

§ 16.22 Amending Certificate of Limited Partnership

[1] Certificate of Amendment

[a] In General

A certificate of limited partnership [*see § 16.21[2]*] may be amended by filing a certificate of amendment [*Corp. Code § 15902.02*]. Alternatively, the partnership may file a restated certificate [*Corp. Code § 15902.02*; *see* [2], *below*].

Because most items contained in a certificate of limited partnership are for identification purposes, some amendments (such as a change in address of a general partner) need not be the subject of agreement among the partners or governed by the partnership agreement. However, items such as a change in the name of the partnership or the designated agent for service of process may be substantive matters in the agreement itself. In this situation, the partnership agreement should be amended before the certificate is amended.

A certificate of amendment must state the following [*Corp. Code § 15902.02*]:

- The name of the limited partnership.
- The Secretary of State's file number of the limited partnership.
- The changes the amendment makes to the certificate as most recently amended or restated.

The amendment takes effect as of the filing of the certificate of amendment with the Secretary of State[*Corp. Code § 15902.02(f)*; *see also Corp. Code § 15902.06(c)* (delayed effective date); *see also* [c], *below*].

[b] When Required

Whenever any of the following events occurs, the general partners must promptly file a certificate of amendment promptly[*Corp. Code § 15902.02*; *see § 16.211[2]*]:

- The admission of a new general partner;

- The dissociation of a person as a general partner; or

- The appointment of a person to wind up the limited partnership's activities under *Corp. Code § 15908.03(c)* or *(d)*.

A general partner that knows that any information in a filed certificate of limited partnership was false when the certificate was filed or has become false due to changed circumstances must promptly cause the certificate to be amended, or if appropriate, deliver to the Secretary of State for filing an amendment or a certificate of correction pursuant to *Corp. Code § 15902.07* [*Corp. Code § 15902.02(c)*; *see § 16.22[3]*].

A certificate of limited partnership may be amended at any time for any other proper purpose as determined by the limited partnership [*Corp. Code § 15902.02(d)*].

[c] Execution and Filing of Certificate

A certificate of amendment delivered to the Secretary of State for filing pursuant to the ULPA '08 must be signed as follows [*Corp. Code § 15902.04(a)*]. An amendment designating as a general partner a person admitted under *Corp. Code § 15908.01(c)(2)* following the dissociation of a limited partnership's last general partner [*see § 16.36*] must be signed by that person admitted as a general partner [*Corp. Code § 15902.04(a)(2)*]. An amendment required by *Corp. Code § 15908.03(c)* following the appointment of a person to wind up the dissolved limited partnership's activities [*see* Ch. 16A, *Dissolution of Limited Partnerships*] must be signed by that person [*Corp. Code § 15902.04(a)(3)*]. Any other amendment must be signed by [*Corp. Code § 15902.04(a)(4)*]:

- At least one general partner listed in the certificate of limited partnership;

- Each other person designated in the amendment as a new general partner; and

- Each person that the amendment indicates has dissociated as a general partner, unless (1) the person is deceased or a guardian or general conservator has been appointed for the person and the amendment so states; or (2) the person has previously delivered a certificate of dissociation to the Secretary of State for filing.

Any person may execute the certificate either personally or by an attorney-in-fact [*Corp. Code § 15902.04*]. The certificate of amendment must then be filed, on the form prescribed by the Secretary of State, in the office of the Secretary of State [*Corp. Code § 15902.02*], accompanied by the payment of the required filing fees [*Gov. Code § 12188(d)*].

[d] Failure to Sign or Deliver Record

If a person required by the ULPA '08 to sign or deliver a record, *e.g.*, a certificate of amendment [*see § 16.22[1]*], to the Secretary of State for filing does not do so, any other person that is aggrieved may petition the superior court to order [*Corp. Code § 15902.05(a)*]:

- The person to sign the record;

- The person to deliver the record to the Secretary of State for filing; or

- The Secretary of State to file the record unsigned.

If the person aggrieved as described *above* is not the limited partnership or foreign limited partnership to which the record pertains, the aggrieved person must make the limited partnership or foreign limited partnership a party to the action. A person aggrieved as described *above* may seek the remedies described *above* in the same action in combination or in the alternative. In any such action, if the court finds the failure of the person to comply with the requirement to sign a record or deliver a record to the Secretary of State for filing to have been without justification, the court may award an amount sufficient to reimburse the persons aggrieved bringing the action for the reasonable expenses incurred by those persons, including attorneys' fees, in connection with the action or proceeding [*Corp. Code § 15902.05(b)*].

A record filed unsigned pursuant to this provision is effective without being signed [*Corp. Code § 15902.05(c)*].

Any person, other than a general partner, delivering a record to the Secretary of State for filing must state the statutory authority for that action after the signature on the appropriate record [*Corp. Code § 15902.05(d)*].

[2] Restated Certificate

In lieu of filing a certificate of amendment [*see* [1], *above*], the general partners may file a Restated Certificate of Limited Partnership [*Corp. Code § 15902.02*]. A restated certificate embodies, in a single certificate, all of the operative and effective provisions contained in the different certificates that have been filed with the Secretary of State [*Corp. Code § 15902.02*]. The restated certificate replaces the original certificate of limited partnership and all amendments previously filed with the Secretary of State [*Corp. Code § 15902.02*].

The restated certificate may include an amendment that has not been previously filed with the Secretary of State [*Corp. Code § 15902.02*]. However, any new amendment effected in a restated certificate is subject to the other provisions of the CRLPA that would apply if a separate certificate of amendment were filed to effect that amendment or change [*Corp. Code § 15902.02*; *see* [1], *above*].

A restated certificate of limited partnership must be signed by at least one general partner listed in the certificate, and to the extent the restated certificate effects a change under any other paragraph of *Corp. Code § 15902.04(a)*, the restated certificate must be signed in a manner that satisfies the requirements of that paragraph [*Corp. Code § 15902.04(a)(5)*].

[3] Certificate of Correction

A limited partnership or foreign limited partnership may deliver to and on a form prescribed by the Secretary of State for filing a certificate of correction to correct a record previously delivered by the limited partnership or foreign limited partnership to the Secretary and filed by the Secretary, if at the time of filing the record contained false or erroneous information or was defectively signed [*Corp. Code § 15902.07(a)*]. A certificate of correction may not state a delayed effective date, and must (1) describe the record to be corrected, including its filing date and file number, (2) specify the incorrect information and the reason it is incorrect or the manner in which the signing was defective, and (3) correct the incorrect information or defective signature [*Corp. Code § 15902.07(b)*].

When filed by the Secretary of State, a certificate of correction is effective retroactively as of the effective date of the record the certificate corrects, except that the certificate is effective when filed (1) for the purposes of *Corp. Code § 15901.03(c)* and *(d)* (notice) and (2) as to persons relying on the uncorrected record and adversely affected by the correction [*Corp. Code § 15902.07(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesContracts LawTypes of ContractsPartnership Agreements



20 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Formation and Operation of Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.23

§ 16.23 Operating Requirements

[1] Office and Agent for Service of Process

[a] Office

A limited partnership must continuously maintain an office in California (which need not be a place of its activity in the state), where specified partnership records are kept [*see Corp. Code §§ 15901.14(a)(1), 15901.11*; *see also* [2], *below*]. This office is its "designated office" [*see Corp. Code § 15901.02(e)*.

[b] Agent for Service of Process

In addition, each limited partnership must continuously maintain a California agent for service of process on the partnership [*see Corp. Code §§ 15901.14(a)(2)* (domestic limited partnerships), 15901.14(b) (foreign limited partnerships)]. The agent for service of process must be an individual who is a California resident, or a corporation that has complied with *Corp. Code § 1505* (certificate requirement) and whose capacity to act as an agent has not terminated [*Corp. Code § 15901.14(c)*]. The certificate of limited partnership must state (1) the name and address of the agent if the agent is an individual or (2) the name of the agent if the agent is a corporation [*Corp. Code §§ 15902.01(a)(3), 15901.16(d)(1)*; *see § 16.21[2][a]*].

Whenever the address of an individual agent for service of process is changed, or a new agent is designated, the partnership must file a certificate of amendment [*Corp. Code § 15902.02(b), (c)*; *see § 16.22*]. Similarly, the partnership must file a certificate of amendment if (1) an individual agent dies, resigns, or no longer resides in California or (2) a corporate agent resigns, dissolves, or withdraws from California, forfeits its right to transact intrastate business, has its rights, powers, and privileges suspended, or ceases to exist [*Corp. Code § 15901.16*; *see § 16.22*].

An agent designated for service of process may resign by filing a signed and acknowledged statement of resignation with the Secretary of State. The filing terminates the authority of the agent, and the Secretary of State will give written notice of the filing by mail to the partnership at its designated office [*Corp. Code § 15901.16*].

[c] Substituted Service on Secretary of State

Whenever an agent for service of process has resigned and not been replaced, or if the designated agent cannot be found with reasonable diligence at the address designated for personal delivery of process, and it is shown by affidavit to the court's satisfaction that process against a limited partnership cannot be served on the designated agent (or, if a foreign limited partnership, upon any general partner by hand as provided in *Code Civ. Proc. § 415.10, 415.20(a),* or *415.30(a)*) with reasonable diligence, the court will order service on the Secretary of State [*Corp. Code § 15901.16*]. However, because Chapter 4 of the Code of Civil Procedure permits service on the general partner or general manager in lieu of service on the designated agent [*see Code Civ. Proc. § 416.40*; *see also Code Civ. Proc. §§ 415.10-415.50* (procedure)], the exercise of reasonable diligence probably requires an attempt to serve a general partner or general manager before applying to the court for an order designating the Secretary of State for service of process.

Service is made by hand delivering one copy of the process for each defendant to be served, a copy of the court order authorizing service on the Secretary of State, and the prescribed fee [*see Gov. Code § 12197*] to the Secretary of State or to any assistant or deputy Secretary of State. Service is deemed complete on the tenth day after delivery of process to the Secretary of State [*Corp. Code § 15901.16*]. The Secretary of State will then give notice to the limited partnership by forwarding a copy of the process to the principal office by registered mail, return receipt requested [*Corp. Code § 15901.16*]. The Secretary of State keeps a record of all process served in this manner, and records the time of service and any action taken. A certificate under official seal certifying the Secretary of State's receipt of process and notice to the limited partnership constitutes prima facie evidence of the matters stated in the certificate [*Corp. Code § 15901.16*].

[2] Required Records

A limited partnership must keep the following records at its designated office [*Corp. Code § 15901.11*]:

- A current list of the full name and last known street and mailing address of each partner, in alphabetical order, separately identifying the general partners and the limited partners.

- A copy of the initial certificate of limited partnership, and all amendments to and restatement of the certificate, together with executed copies of any powers of attorney pursuant to which any certificate has been executed.

- A copy of any filed certificate of conversion or merger.

- Copies of the limited partnership's federal, state, and local income tax returns and reports for the six most recent taxable years.

- Copies of any limited partnership's partnership agreement made in a record and any amendments to the agreement.

- Financial statements of the limited partnership for the six most recent years.

- A copy of any record made by the limited partnership during the past three years of any consent given by or vote taken of any partner pursuant to the ULPA '08 or the partnership agreement.

- Unless contained in a partnership agreement made in a record, a record stating (a) the amount of cash, and a description and statement of the agreed value of the other benefits, contributed and agreed to be contributed by each partner; (b) the times at which, or events on the happening of which, any additional contributions agreed to be made by each partner are to be made; (c) for any person that is both a general partner and a limited partner, a specification of what transferable interest the person owns in

each capacity; and (d) any events upon the happening of which the limited partnership is to be dissolved and its activities wound up.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon AgentsContracts LawTypes of ContractsPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Formation and Operation of Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.24

§ 16.24 Partnership Meetings

Unlike prior law [*see, e.g., Corp. Code § 15637* (CRLPA, repealed January 1, 2010)], the ULPA '08 does not contain default provisions regarding partnership meetings. Therefore, the partnership agreement should set forth any desired provisions governing this topic [*see* Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* , § 732.01[2] (Matthew Bender)]. The ULPA '08 does provide that each general partner has equal rights in the management and conduct of the limited partnership's activities [*Corp. Code § 15904.06(a)*]. It also provides that action requiring the consent of partners may be taken without a meeting, and a partner may appoint a proxy to consent or otherwise act for the partner by signing an appointment record, either personally or by the partner's attorney in fact [*Corp. Code § 15901.15*; *see Corp. Code § 15901.02(ab)* ("proxy" defined)]. Whenever the ULPA '08 or a partnership agreement provides for a limited partner to give or withhold consent to a matter, the limited partnership must provide the limited partner without demand before that consent is given or withheld, with all information material to the limited partner's decision that the limited partnership knows [*Corp. Code § 15903.04(j)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Formation and Operation of Limited Partnerships

8-16 California Legal Forms--Transaction Guide §§ 16.25-16.29

[Reserved]

§§ 16.25[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Rights and Duties of Partners

8-16 California Legal Forms--Transaction Guide § 16.30

§ 16.30 Rights and Duties of Limited Partners

[1] Access to Partnership Records

[a] Information Required to Be Maintained By Partnership

A limited partner may, on 10 days' demand pursuant to a record received by the limited partnership, inspect and copy any information required to be maintained pursuant to *Corp. Code § 15901.11* [*see § 16.23[2]*] during regular business hours in the partnership's designated office. The limited partner need not have any particular purpose for seeking this information [*Corp. Code § 15903.04(a)*].

[b] Information Regarding Activities and Financial Condition

Subject to a partnership's right to keep certain information confidential [*see* [c], *below*], a limited partner may, during regular business hours and at a reasonable location specified by the partnership, obtain from the partnership and inspect and copy true and full information regarding the state of the activities and financial condition of the partnership and other information regarding its activities that is just and reasonable if [*Corp. Code § 15903.04(b)*; *see also Corp. Code § 15903.04(d)* (rights of dissociated limited partner)]:

- The limited partner seeks the information for a purpose reasonably related to the partner's interest as a limited partner;

- The limited partner makes a demand in a record received by the partnership, describing with reasonable particularity the information sought and the purpose for seeking the information; and

- The information sought is directly connected to the limited partner's purpose.

This information may be transmitted to the limited partner via electronic transmission [*Corp. Code § 15903.04(b)*; *see Corp. Code § 15901.02(h)* (definition)].

Within 10 days after receiving a demand, the partnership in a record must inform the limited partner that made the demand [*Corp. Code § 15903.04(c)*]:

- What information the limited partnership will provide in response to the demand;
- When and where the limited partnership will provide the information; and
- If the partnership declines to provide any demanded information, the partnership's reasons for declining.

[c] Confidential Information

The partnership has the right to keep confidential from limited partners for any period of time that the partnership deems reasonable, any information which it reasonably believes to be in the nature of trade secrets or other information the disclosure of which the partnership in good faith believes is not in its best interest or could damage it or its business or which it is required by law or by agreement with a third party to keep confidential [*Corp. Code § 15903.04(g)*].

[d] Restrictions on Use of Information

The partnership may impose reasonable restrictions on the use of information obtained. In a dispute concerning the reasonableness of such a restriction, the partnership has the burden of proving reasonableness [*Corp. Code § 15903.04(h)*].

[e] Exercise of Partner's Rights by Others

A limited partner or person dissociated as a limited partner may exercise the rights to information through an attorney or other agent. Any restriction imposed by law or the partnership agreement applies both to the attorney or other agent and to the limited partner or person dissociated as a limited partner [*Corp. Code § 15903.04(k)*]. The rights to information do not extend to a person as transferee, but may be exercised by the legal representative of an individual under legal disability who is a limited partner or person dissociated as a limited partner [*Corp. Code § 15903.04(l)*]. If a limited partner dies, the deceased partner's personal representative or other legal representative may exercise the rights of a current limited partner under *Corp. Code § 15903.04* [*Corp. Code § 15903.04(f)*; *see Corp. Code § 15907.04*; *see also § 16.30[1]*].

[f] Charges For Costs

A limited partnership may charge a person that makes a demand the reasonable costs of copying, limited to the costs of labor and material [*Corp. Code § 15903.04(i)*].

[2] Contributions and Distributions

The rules governing contributions and distributions are set forth in *Corp. Code §§ 15905.01-15905.09*. Those rules are discussed in *§§ 16.39* (contributions) and 16.40 (distributions).

[3] Permissible Actions

A limited partner is not liable for any obligation of a limited partnership unless named as a general partner in the certificate or, in addition to exercising the rights and powers of a limited partner, the limited partner participates in the control of the business [*Corp. Code § 15903.03(a)*; *see* § 16.41]. A limited partner does not participate in the control of the business within the meaning of § 15903.03(a) solely by doing, attempting to do, or having the right or power to do, one or more of the following [*Corp. Code § 15903.03(b)*]:

- Being:

  (1) An independent contractor for, an agent or employee of, or transacting business with, the partnership or a general partner of the partnership.

  (2) An officer, director, or shareholder of a corporate general partner of the partnership.

  (3) A member, manager, or officer of a limited liability company that is a general partner of the partnership.

  (4) A limited partner of a partnership that is a general partner of the partnership.

  (5) A trustee, administrator, executor, custodian, or other fiduciary or beneficiary of an estate or trust that is a general partner.

  (6) A trustee, officer, advisor, shareholder, or beneficiary of a business trust that is a general partner.

- Consulting with and advising a general partner with respect to the business of the partnership.

- Acting as surety for the partnership or for a general partner, guaranteeing one or more specific debts of the partnership, providing collateral for the partnership or general partner, borrowing money from the partnership or a general partner, or lending money to the partnership or a general partner.

- Approving or disapproving an amendment to the partnership agreement.

- Voting on, proposing, or calling a meeting of the partners.

- Winding up the partnership pursuant to *Corp. Code § 15908.03*.

- Executing and filing a certificate pursuant to *Corp. Code § 15902.05*, a certificate of withdrawal pursuant to *Corp. Code § 15902.04(a)(4)*, or a certificate of cancellation of the certificate of limited partnership pursuant to *Corp. Code § 15902.04(a)(6)*.

- Serving on an audit committee or committee performing the functions of an audit committee.

- Serving on a committee of the partnership or the limited partners for the purpose of approving actions of the general partner.

- Calling, requesting, attending, or participating at any meeting of the partners or the partners.

- Taking any action required or permitted by law to bring, pursue, settle, or terminate a derivative action on behalf of the partnership.

- Serving on the board of directors or a committee of, consulting with or advising, being or acting as an officer, director, stockholder, partner, member, manager, agent, or employee of, or being or acting as a fiduciary for, any person in which the partnership has an interest.

- Exercising any right or power permitted to limited partners under the 2008 Act and not specifically

enumerated above.

The enumeration above does not mean that any other conduct or the possession or exercise of any other power by a limited partner constitutes participation by the limited partner in the control of the business of the limited partnership [*Corp. Code § 15903.03(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Rights and Duties of Partners

8-16 California Legal Forms--Transaction Guide § 16.31

§ 16.31 Liability of Limited Partners

[1] Limited Liability

In the operation of a limited partnership, the general rule is that a limited partner is not liable for any obligation of a limited partnership unless that partner is named as a general partner in the limited partnership certificate, or, in addition to the exercise of the rights and powers of a limited partner [*see § 16.30 [3]*], that partner participates in the control of the partnership business [*Corp. Code § 15903.03*; *see, e.g., Gruendl v. Oewel Partnership (1997) 55 Cal. App. 4th 654, 659, 64 Cal. Rptr. 2d 217* (under prior law, limited partner not deemed to have participated in control merely because he acted as surety, lent money to limited partnership, or exercised duties as president of corporate general partner)]. Even if a limited partner participates in the control of the business without being named as a general partner, that partner may be held liable as a general partner only to those persons who transact business with the limited partnership with (1) actual knowledge of that partner's participation in control and (2) a reasonable belief, based on the limited partner's conduct, that the partner is a general partner at the time of the transaction [*Corp. Code § 15903.03*]. However, nothing in the ULPA '08 will be construed to affect the liability of a limited partner to third parties for the limited partner's participation in tortious conduct [*Corp. Code § 15903.03*].

[2] Liability for Misstatements

If a record delivered to the Secretary of State for filing under the ULPA '08 and filed by the Secretary contains false information, a person that suffers loss by reliance on the information may recover damages for the loss from a person, which includes a limited partner [*see Corp. Code § 15901.02(y)*], that signed the record, or caused another to sign it on the person's behalf, and knew the information to be false at the time the record was signed [*Corp. Code § 15902.08(a)(1)*].

[3] Liability for Improper Distributions and Contributions

A partner or transferee that received a distribution knowing that the distribution to that partner or transferee was made in violation of *Corp. Code § 15905.08* [*see § 16.40[6]*] is personally liable to the limited partnership. However, liability is only to the extent that the distribution received by the partner or transferee exceeded the amount that could have been

properly paid under *Corp. Code § 15905.08* [*Corp. Code § 15905.09(b)*; *see § 16.40[6]*].

[4] Liability of Investor in Partnership

Except as otherwise described below, a person that makes an investment in a business enterprise and erroneously but in good faith believes that the person has become a limited partner in the enterprise is not liable for the enterprise's obligations by reason of making the investment, receiving distributions from the enterprise, or exercising any rights of or appropriate to a limited partner, if, on ascertaining the mistake, the person [*Corp. Code § 15903.06(a)*]:

- Causes an appropriate certificate of limited partnership, amendment, or certificate of correction to be signed and delivered to the Secretary of State for filing; or

- Withdraws from future participation as an owner in the enterprise by signing and delivering to and on a form prescribed by the Secretary of State for filing a certificate of withdrawal under § 15903.06.

A person that makes such an investment is liable to the same extent as a general partner to any third party that enters into a transaction with the enterprise, believing in good faith that the person is a general partner, before the Secretary of State files a certificate of withdrawal, certificate of limited partnership, amendment, or certificate of correction to show that the person is not a general partner [*Corp. Code § 15903.06(b)*].

If a person makes a diligent effort in good faith to comply but is unable to cause the appropriate certificate of limited partnership, amendment, or certificate of correction to be signed and delivered to the Secretary of State for filing, the person has the right to withdraw from the enterprise as described above, even if the withdrawal would otherwise breach an agreement with others that are or have agreed to become co-owners of the enterprise [*Corp. Code § 15903.06(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesTortsBusiness TortsGeneral OverviewTortsVicarious LiabilityPartnersLimited Partners



25 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Rights and Duties of Partners

8-16 California Legal Forms--Transaction Guide § 16.32

§ 16.32 Admission, Powers, and Duties of Limited Partners

[1] Manner of Admission

A person becomes a limited partner in one of the following ways [*Corp. Code § 15903.01(a)*]:

- As provided in the partnership agreement;
- As the result of a conversion or merger under *Corp. Code § 15911.01 et seq.* [*see* Ch. 16B, *Conversion and Mergers of Limited Partnerships*]; or
- With the consent of all the partners.

[2] Powers and Duties

A limited partner does not have the right or the power as a limited partner to act for or bind the limited partnership [*Corp. Code § 15903.02*].

A limited partner does not have any fiduciary duty to the limited partnership or to any other partner solely by reason of being a limited partner [*Corp. Code § 15903.05(a)*]. Further, a limited partner must discharge the duties to the partnership and the other partners under the ULPA '08 or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing [*Corp. Code § 15903.05(b)*]. Finally, a limited partner does not violate a duty or obligation under the ULPA '08 or under the partnership agreement merely because the limited partner's conduct furthers that partner's own interest [*Corp. Code § 15903.05(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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LawTypes of ContractsPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Rights and Duties of Partners

8-16 California Legal Forms--Transaction Guide § 16.33

§ 16.33 Dissociation of Limited Partners

[1] Causes of Dissociation

A person does not have a right to dissociate as a limited partner before the termination of the partnership [*Corp. Code § 15906.01(a).*]

However, a person is dissociated from a limited partnership as a limited partner upon the occurrence of any of the following 10 events [*Corp. Code § 15906.01(b)*]:

(1) The partnership's having notice of the person's express will to withdraw as a limited partner or on a later date specified by the person. (This circumstance of dissociation seems inconsistent with the nonexistence of a right to dissociate set forth in § 15906.01(a); *see* Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* , § 746.01 (Matthew Bender) for further discussion).

(2) An event agreed to in the partnership agreement as causing the person's dissociation as a limited partner.

(3) The person's expulsion as a limited partner pursuant to the partnership agreement.

(4) The person's expulsion as a limited partner by the unanimous consent of the other partners if:

- It is unlawful to carry on the partnership's activities with the person as a limited partner.

- There has been a transfer of all of the person's transferable interest [*see Corp. Code § 15901.02(ak)*; *see also § 16.38*] in the partnership, other than a transfer for security purposes, or a court order charging the person's interest, which has not been foreclosed.

- The person is a corporation and, within 90 days after the partnership notifies the person that it will be expelled as a limited partner because it has filed a certificate of dissolution or the equivalent, its charter has been revoked, or its right to conduct business has been suspended by the jurisdiction of its incorporation, there is no revocation of the certificate of dissolution or no reinstatement of its charter or its right to conduct business.

- The person is a limited liability company or partnership that has been dissolved and whose business is being wound up.

(5) On application by the partnership, the person's expulsion as a limited partner by judicial order because: (a) the person engaged in wrongful conduct that adversely and materially affected the partnership's activities; (b) the person willfully or persistently committed a material breach of the partnership agreement or of the obligation of good faith and fair dealing under *Corp. Code § 15903.05(b)* [*see § 16.32[2]*] or (c) the person engaged in conduct relating to the partnership's activities which makes it not reasonably practicable to carry on the activities with the person as limited partner.

(6) In the case of a person who is an individual, the person's death.

(7) In the case of a person that is a trust or is acting as a limited partner by virtue of being a trustee of a trust, distribution of the trust's entire transferable interest in the partnership, but not merely by reason of the substitution of a successor trustee.

(8) In the case of a person that is an estate or is acting as a limited partner by virtue of being a personal representative of an estate, distribution of the estate's entire transferable interest in the partnership, but not merely by reason of the substitution of a successor personal representative.

(9) Termination of a limited partner that is not an individual, partnership, limited liability company, corporation, trust, or estate.

(10) The partnership's participation in a conversion or merger under *Corp. Code § 15911.01 et seq.* [*see* Ch. 16B, *Conversions and Mergers of Limited Partnerships*] if the partnership (a) is not the converted or surviving entity; or (b) is the converted or surviving entity but, as a result of the conversion or merger, the person ceases to be a limited partner.

[2] Effect of Dissociation

Upon a person's dissociation as a limited partner, subject to *Corp. Code § 15907.04* (rights of deceased partner's representative), the person does not have further rights as a limited partner [*Corp. Code § 15906.02(a)(1)*]. The effect of this provision is that a dissociated limited partner's status becomes that of a mere transferee, except as to a deceased dissociated limited partner or one dissociated in connection with a conversion or merger [*see* Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* , § 746.02 (Matthew Bender)]. Furthermore, upon dissociation, the person's obligation of good faith and fair dealing as a limited partner under *Corp. Code § 15903.05(b)* [*see § 16.32[2]*] continues only as to matters arising and events occurring before the dissociation [*Corp. Code § 15906.02(a)(2)*]. Finally, subject to *Corp. Code § 15907.04* (rights of deceased partner's representative) and *Corp. Code § 15911.01 et seq.* (conversion and merger) [*see* Ch. 16A, *Conversion and Merger of Limited Partnerships*], any transferable interest owned by the person in the person's capacity as a limited partner immediately before dissociation is owned by the person as a mere transferee [*Corp. Code § 15906.02(a)(3)*; *see Corp. Code § 15901.02(ak)* (definition of transferable interest, (al) (definition of transferee)].

A person's dissociation as a limited partner does not of itself discharge the person from any obligation to the partnership

or the other partners which the person incurred while a limited partner [*Corp. Code § 15906.02(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsDissolution & Winding UpBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Rights and Duties of Partners

8-16 California Legal Forms--Transaction Guide § 16.34

§ 16.34 Rights, Powers, Restrictions, and Liabilities of General Partners

[1] General Partner as Agent of Partnership

Each general partner is an agent of the limited partnership for the purposes of its activities. An act of a general partner, including the signing of a record in the partnership's name, for apparently carrying on in the ordinary course the limited partnership's activities or activities of the kind carried on by the limited partnership binds the limited partnership, unless the general partner did not have authority to act for the limited partnership in the particular matter and the person with which the general partner was dealing knew, had received a notification, or had notice under *Corp. Code § 15901.03(d)* that the general partner lacked authority [*Corp. Code § 15904.02(a)*].

An act of a general partner which is not apparently for carrying on in the ordinary course the limited partnership's activities or activities of the kind carried on by the limited partnership binds the limited partnership only if the act was actually authorized by all the other partners [*Corp. Code § 15904.02(b)*].

[2] Dual Capacity as General and Limited Partner Permitted

A person may be both a general partner and a limited partner. A person that is both a general and a limited partner has the rights, powers, duties, and obligations provided by the ULPA '08 and the partnership agreement in each capacity. When the person acts as a general partner, the person is subject to the obligations, duties, and restrictions under the ULPA '08 and the partnership agreement for general partners. When the person acts as a limited partner, the person is subject to the obligations, duties, and restrictions under the ULPA '08 and the partnership agreement for limited partners [*Corp. Code § 15901.13*].

[3] Rights in Management and Conduct of Partnership's Activities

Each general partner has equal rights in the management and conduct of the limited partnership's activities. Except as expressly provided in the ULPA '08, any matter relating to the activities of the limited partnership may be exclusively decided by the general partner or, if there is more than one general partner, by a majority of the general partners [*Corp. Code § 15904.06(a)*].

The consent of each partner is necessary to (1) amend the partnership agreement; and (2) sell, lease, exchange, or otherwise dispose of all or substantially all of the limited partnership's property, with or without the goodwill, other than in the usual and regular course of the limited partnership's activities [*Corp. Code § 15904.06(b)*].

A limited partnership must reimburse a general partner for payments made and indemnify a general partner for liabilities incurred by the partner in the ordinary course of the activities of the partnership or for preservation of its activities or property [*Corp. Code § 15904.06(c)*]. A limited partnership must also reimburse a general partner for an advance to the partnership beyond the amount of capital the partner agreed to contribute [*Corp. Code § 15904.06(d)*]. A payment or advance made by a general partner which gives rise to an obligation of the limited partnership as described above constitutes a loan to the limited partnership which accrues interest from the date of the payment or advance [*Corp. Code § 15904.06(e)*].

A general partner is not entitled to remuneration for services performed for the partnership [*Corp. Code § 15904.06(f)*].

[4] Right to Information

[a] Current Partners

A general partner, without having any particular purpose for seeking the information, may inspect and copy during regular business hours in the limited partnership's designated office, required information [*Corp. Code § 15904.07(a)(1)*; *see Corp. Code § 15901.02(ad)* (required information is that which partnership must maintain under *Corp. Code § 15901.11*)]. Similarly, the partner may inspect and copy, at a reasonable location specified by the limited partnership, any other records maintained by the limited partnership regarding the limited partnership's activities and financial condition [*Corp. Code § 15904.07(a)(2)*].

Each general partner and the limited partnership must furnish to a general partner the following information, which may be transmitted via electronic transmission [*Corp. Code § 15904.07(b)*; *see Corp. Code § 15901.02(h)* (definition)]:

> (1) Without demand, any information concerning the limited partnership's activities and activities reasonably required for the proper exercise of the general partner's rights and duties under the partnership agreement or the ULPA '08; and
>
> (2) On demand, any other information concerning the limited partnership's activities, except to the extent the demand or the information demanded is unreasonable or otherwise improper under the circumstances.

[b] Dissociated Partners

Except as to deceased general partners [*see Corp. Code §§ 15904.07(e)*, *15907.04*], on 10 days' demand made in a record received by the limited partnership, a person dissociated as a general partner may have access to the information and records described in *Corp. Code § 15904.07(a)* [*see* [a], *above*], at the location there specified if (1) the information or record pertains to the period during which the person was a general partner; (2) the person seeks the information or record in good faith; and (3) the person satisfies the requirements imposed on a limited partner by *Corp. Code § 15903.04(b)* [*Corp. Code § 15904.07(c)*; *see § 16.30*]. The limited partnership must respond to such a demand in the same manner as provided in *Corp. Code § 15903.04(c)* [*Corp. Code § 15904.07(b)*; *see § 16.30*].

The partnership may impose reasonable restrictions on the use of information. In any dispute concerning the reasonableness of such a restriction, the partnership has the burden of proving reasonableness [*Corp. Code § 15904.07(f)*].

The partnership may charge a person dissociated as a general partner that makes such a demand reasonable costs of copying, limited to the costs of labor and material [*Corp. Code § 15904.07(g)*]. A general partner or person dissociated as a general partner may exercise the rights under this section through an attorney or other agent. Any restriction imposed by the partnership or by the partnership agreement applies both to the attorney or other agent and to the general partner or person dissociated as a general partner [*Corp. Code § 15904.07(h)*].

The rights described above do not extend to a person as transferee, but the rights of a person dissociated as a general partner may be exercised by the legal representative of an individual who dissociated as a general partner under *Corp. Code § 15906.03(g)(2)* or *(3)* [*Corp. Code § 15904.07(i)*; *see § 16.37*].

[5] Contributions and Distributions

The rules governing contributions and distributions are set forth in *Corp. Code §§ 15905.01-15905.09*. Those rules are discussed in *§§ 16.39* (contributions) and 16.40 (distributions).

[6] Liabilities

[a] Liability for False Information

If a record delivered to the Secretary of State for filing under the ULPA '08 and filed by the Secretary contains false information, a person that suffers loss by reliance on the information may recover damages for the loss from [*Corp. Code § 15902.08(a)*]:

- A person that signed the record, or caused another to sign it on the person's behalf, and knew the information to be false at the time the record was signed; and

- A general partner that had notice that the information was false when the record was filed or had become false because of changed circumstances, if the general partner had notice for a reasonably sufficient time before the information is relied upon to enable the general partner to effect an amendment under *Corp. Code § 15902.02* (amendments or restatements of certificates of limited partnerships), file a petition pursuant to § 15902.05 (filings pursuant to judicial order), or deliver to the Secretary of State for filing a certificate of correction pursuant to *Corp. Code § 15902.07*.

Signing a record authorized or required to be filed under the 2008 Act constitutes an affirmation under the penalties of perjury that the facts stated in the record are true [*Corp. Code § 15902.08(b)*].

[b] Liability for Improper Distributions

A general partner that consents to a distribution made in violation of *Corp. Code § 15905.08* [*see § 16.40[6]*] is personally liable to the limited partnership for the amount of the distribution that exceeds the amount that could have been distributed without the violation if it is established that in consenting to the distribution the general partner failed to comply with that section [*Corp. Code § 15905.09(a)*]. Establishing the liability, however, may be quite difficult [*see* Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* , § 745.08].

A partner or transferee that received a distribution knowing that the distribution to that partner or transferee was made in violation of § 15905.08 is personally liable to the limited partnership but only to the extent that the distribution received by the partner or transferee exceeded the amount that could have been properly paid under *Corp. Code § 15905.08* [*Corp. Code § 15905.09(b)*].

A general partner against which an action is commenced as described above may implead in the action (1) any other

person that is liable under § 15905.09(a) and compel contribution from the person; and (2) any person that received a distribution in violation of § 15905.09(b) and compel contribution from the person in the amount the person received in that violation [*Corp. Code § 15905.09(c)*].

An action under *Corp. Code § 15905.09* is barred if it is not commenced within four years after the distribution [*Corp. Code § 15905.09(d)*].

[c] Liability for Partnership Obligations

All general partners are liable jointly and severally for all obligations of the limited partnership unless otherwise agreed by the claimant or provided by law [*Corp. Code § 15904.04(a)*]. However, a person that becomes a general partner of an existing limited partnership is not personally liable for an obligation of a limited partnership incurred before the person became a general partner [*Corp. Code § 15904.04(b)*].

[d] Partnership's Liability for General Partner's Actions

A limited partnership is liable for loss or injury caused to a person, or for a penalty incurred, as a result of a wrongful act or omission, or other actionable conduct, of a general partner acting in the ordinary course of activities of the limited partnership or with authority of the limited partnership [*Corp. Code § 15904.03(a)*].

If, in the course of the partnership's activities or while acting with authority of the partnership, a general partner receives or causes the limited partnership to receive money or property of a person not a partner, and the money or property is misapplied by a general partner, the limited partnership is liable for the loss [*Corp. Code § 15904.03(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesContracts LawTypes of ContractsPartnership AgreementsTortsIntentional TortsBreach of Fiduciary DutyGeneral Overview



28 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Rights and Duties of Partners

8-16 California Legal Forms--Transaction Guide § 16.35

§ 16.35 Duties of General Partners

[1] General Duties

The general partners in a limited partnership are required to maintain an office and an agent for service of process within California [*see Corp. Code § 15901.14*; *see also § 16.23[1]*] and maintain certain specific types of records in that office [*see Corp. Code § 15901.11*; *see also § 16.23[2]*]. They are required to prepare a partnership agreement [*see § 16.21[4]*], to prepare and execute the original and any amended certificate of limited partnership [*see* Corp. Code §§ 15012.01-15902.09; *see also §§ 16.21[2]*, *16.22*] and give limited partners access to partnership records [*see Corp. Code § 15903.04*; *see also § 16.30*].

[2] Fiduciary Duties

The fiduciary duties that a general partner owes to the partnership and the other partners are the duties of loyalty and care [*Corp. Code § 15904.08(a)*].

A general partner's duty of loyalty to the partnership and the other partners is limited to the following [*Corp. Code § 15904.08(b)*]:

- To account to the partnership and hold as trustee for it any property, profit, or benefit derived by the general partner in the conduct and winding up of the partnership's activities or derived from a use by the general partner of partnership property, including appropriating a partnership opportunity;

- To refrain from dealing with the partnership in the conduct or winding up of activities as or on behalf of a party having an interest adverse to the partnership; and

- To refrain from competing with the partnership in the conduct or winding up of its activities.

A general partner's duty of care to the partnership and the other partners in the conduct and winding up of the limited partnership's activities is limited to refraining from engaging in grossly negligent or reckless conduct, intentional

misconduct, or a knowing violation of law [*Corp. Code § 15904.08(c)*].

A general partner must discharge the duties to the partnership and the other partners under the ULPA '08 or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing [*Corp. Code § 15904.08(d)*]. A general partner does not violate a duty or obligation under the ULPA '08 or under the partnership agreement merely because the general partner's conduct furthers the general partner's own interest [*Corp. Code § 15904.08(e)*].

This list of duties is similar to that set forth in the Uniform Partnership Act of 1994 [*see Corp. Code § 16404*], and was included in the ULPA '08 to make it more of a stand-alone statute [*see* Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* , § 743.08 (Matthew Bender)].

Legal Topics:

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Rights and Duties of Partners

8-16 California Legal Forms--Transaction Guide § 16.36

§ 16.36 Admission of General Partners

A person becomes a general partner [*Corp. Code § 15904.01*]:

- As provided in the partnership agreement.
- Under *Corp. Code § 15908.01(c)(2)* following the dissociation of a limited partnership's last general partner [*see § 16.120[2]*].
- As the result of a conversion or merger [*see Corp. Code § 15911.01 et seq.*; *see also* Ch. 16B, *Conversion and Merger of Limited Partnerships*].
- With the consent of all the partners.

Legal Topics:

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Rights and Duties of Partners

8-16 California Legal Forms--Transaction Guide § 16.37

§ 16.37 Dissociation of General Partners

[1] Causes of Dissociation

The ULPA '08 provides that a person is dissociated from a partnership as a general partner upon the occurrence of any of the following 11 events [*Corp. Code § 15906.03*]:

(1) The partnership's having notice of the person's express will to withdraw as a general partner or on a later date specified by the person.

(2) An event agreed to in the partnership agreement as causing the person's dissociation as a general partner.

(3) The person's expulsion as a general partner pursuant to the partnership agreement.

(4) The person's expulsion as a general partner by the unanimous consent of the other partners if:

(a) it is unlawful to carry on the partnership's activities with the person as a general partner;

(b) there has been a transfer of all or substantially all of the person's transferable interest in the partnership, other than a transfer for security purposes, or a court order charging the person's interest, which has not been foreclosed;

(c) the person is a corporation and, within 90 days after the partnership notifies the person that it will be expelled as a general partner because it has filed a certificate of dissolution or the equivalent, its charter has been revoked, or its right to conduct business has been suspended by the jurisdiction of its incorporation, there is no revocation of the certificate of dissolution or no reinstatement of its charter or its right to conduct business;

or

(d) the person is a limited liability company or partnership that has been dissolved and whose business is being wound up.

(5) On application by the partnership, the person's expulsion as a general partner by judicial order because:

(a) the person engaged in wrongful conduct that adversely and materially affected the limited partnership activities;

(b) the person willfully or persistently committed a material breach of the partnership agreement or of a duty owed to the partnership or the other partners under *Corp. Code § 15904.08* [*see § 16.35*]; or

(c) the person engaged in conduct relating to the partnership's activities which makes it not reasonably practicable to carry on the activities of the partnership with the person as a general partner.

(6) The person's:

(a) becoming a debtor in bankruptcy;

(b) execution of an assignment for the benefit of creditors;

(c) seeking, consenting to or acquiescing in the appointment of a trustee, receiver, or liquidator of the person or of all or substantially all of the person's property; or

(d) failure, within 90 days after the appointment, to have vacated or stayed the appointment of a trustee, receiver, or liquidator of the general partner or of all or substantially all of the person's property obtained without the person's consent or acquiescence, or failing within 90 days after the expiration of a stay to have the appointment vacated.

(7) In the case of a person who is an individual: the person's death, the appointment of a guardian or general conservator for the person, or a judicial determination that the person has otherwise become incapable of performing the person's duties as a general partner under the partnership agreement.

(8) In the case of a person that is a trust or is acting as a general partner by virtue of being a trustee of a trust, distribution of the trust's entire transferable interest in the partnership, but not merely by reason of the substitution of a successor trustee.

(9) In the case of a person that is an estate or is acting as a general partner by virtue of being a personal representative of an estate, distribution of the estate's entire transferable interest in the partnership, but not merely by reason of the substitution of a successor personal representative.

(10) Termination of a general partner that is not an individual, partnership, limited liability company, corporation, trust, or estate.

(11) The partnership's participation in a conversion or merger under *Corp. Code § 15911.01 et seq.* [*see*

Ch. 16B, *Conversions and Mergers of Limited Partnerships*], if the limited partnership is not the converted or surviving entity, or is the converted or surviving entity but as a result of the conversion or merger the person ceases to be a general partner.

[2] Power to Dissociate

[a] By Express Will

A person has the power to dissociate as a general partner at any time, rightfully or wrongfully, by express will pursuant to *Corp. Code § 15906.03(a)* [*Corp. Code § 15906.04(a)*].

[b] Wrongful Dissociation

A person's dissociation as a general partner is wrongful only if [*Corp. Code § 15906.04(b)*]:

(1) It is in breach of an express provision of the partnership agreement; or

(2) It occurs before the termination of the limited partnership, and:

- The person withdraws as a general partner by express will;
- The person is expelled as a general partner by judicial determination [*see Corp. Code § 15906.03(e)*];
- The person is dissociated as a general partner by becoming a debtor in bankruptcy; or
- In the case of a person that is not an individual, trust (other than a business trust) or estate, the person is expelled or otherwise dissociated as a general partner because it willfully dissolved or terminated.

[c] Liability Upon Wrongful Dissociation

A person that wrongfully dissociates as a general partner is liable to the limited partnership and, subject to *Corp. Code § 15910.01* (direct action by partner), to the other partners for damages caused by the dissociation. This liability is in addition to any other obligation of the general partner to the limited partnership or to the other partners [*Corp. Code § 15906.04(c)*].

[3] Effect of Dissociation as General Partner

[a] Right to Participate in Management

Upon a person's dissociation as a general partner, the person's right to participate as a general partner in the management and conduct of the partnership's activities terminates [*Corp. Code § 15906.05(a)(1)*].

[b] Duties of Loyalty and Care

Upon dissociation, the person's duty of loyalty as a general partner under *Corp. Code § 15904.08(b)(3)* terminates. The person's duty of loyalty as a general partner under *Corp. Code § 15904.08(b)(1)* and *(2)* and duty of care under *Corp. Code § 15904.08(c)* [*see § 16.35*] continue only with regard to matters arising and events occurring before the person's dissociation as a general partner [*Corp. Code § 15906.05(a)(2),(3)*].

[c] Certificate of Dissociation

The person may sign and deliver to the Secretary of State for filing, on a form prescribed by the Secretary of State, a certificate of dissociation pertaining to the person. At the request of the partnership, the person must sign an amendment to the certificate of limited partnership which states that the person has dissociated [*Corp. Code § 15906.05(a)(4)*].

[d] Transferable Interests

Subject to *Corp. Code § 15907.04* (deceased dissociated general partner) and *Corp. Code § 15911.01 et seq.* (conversions and mergers) [*see* Ch. 16B, *Conversions and Mergers of Limited Partnerships*], any transferable interest [*see Corp. Code § 15901.02(ak)* (definition of transferable interest)] owned by the person immediately before dissociation in the person's capacity as a general partner is owned by the person as a mere transferee [*Corp. Code § 15906.05(a)(5)*; *see Corp. Code § 15901.02(al)* (definition of transferee)].

[e] No Discharge of Obligations

A person's dissociation as a general partner does not of itself discharge the person from any obligation to the partnership or the other partners which the person incurred while a general partner [*Corp. Code § 15906.05(b)*].

[4] Liability of Dissociated General Partner

A person's dissociation as a general partner does not of itself discharge the person's liability as a general partner for an obligation of the partnership incurred before dissociation. Except as otherwise described in *Corp. Code § 15906.07(b),(c)* [*see below*], however, the person is not liable for a partnership's obligation incurred after dissociation [*Corp. Code § 15906.07(a)*]. A person whose dissociation as a general partner resulted in a dissolution and winding up of the partnership's activities is liable to the same extent as a general partner under *Corp. Code § 15904.04* [*see § 16.34[6]*] on an obligation incurred by the partnership under *Corp. Code § 15908.04* (actions following dissolution) [*Corp. Code § 15906.07(b)*]. A person that has dissociated as a general partner but whose dissociation did not result in dissolution and winding up of the partnership's activities is liable on a transaction entered into by the partnership after the dissociation only if (1) a general partner would be liable on the transaction, and (2) at the time the other party enters into the transaction less than two years have passed since the dissociation and the other party does not have notice of the dissociation and reasonably believes that the person is a general partner [*Corp. Code § 15906.07(c)*].

By agreement with a creditor of a partnership and the partnership, a person dissociated as a general partner may be released from liability to the creditor for an obligation of the partnership [*Corp. Code § 15906.07(d)*]. A person dissociated as a general partner is also released from liability for an obligation of the partnership if the partnership's creditor, with notice of the person's dissociation as a general partner but without the person's consent, agrees to a material alteration in the nature or time of payment of the obligation [*Corp. Code § 15906.07(e)*].

[5] Liability of Partnership for Actions of Dissociated Partner

After a person is dissociated as a general partner and before the limited partnership is dissolved, converted, or merged out of existence [*see Corp. Code § 15911.01 et seq.*], the partnership is bound by an act of the person only if the act would have bound the partnership under *Corp. Code § 15904.02* [*see § 16.34[1]*] before the dissociation, and at the time the other party enters into the transaction (1) less than two years have passed since the dissociation and (2) the other party does not have notice of the dissociation and reasonably believes that the person is a general partner [Corp. Code § 15906(a)].

If a limited partnership is bound under these circumstances, the person dissociated as a general partner which caused the partnership to be bound is liable (1) to the partnership for any damage caused to the limited partnership arising from the obligation incurred under § 15906(a), and (2) if a general partner or another person dissociated as a general partner is

liable for the obligation, to the general partner or other person for any damage caused to the general partner or other person arising from the liability [*Corp. Code § 15906.06(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Rights and Duties of Partners

8-16 California Legal Forms--Transaction Guide § 16.38

§ 16.38 Transfer of Partnership Interests

[1] Transferable Interest

The only interest of a partner which is transferable is the partner's transferable interest. A transferable interest is personal property [*Corp. Code § 15907.01*]. "Transferable interest" is defined as a partner's right to receive distributions [*Corp. Code § 15901.02(ak)*].

[2] Effect of Transfer

A transfer, in whole or in part, of a partner's transferable interest [*Corp. Code § 15907.02(a)*]:

- Is permissible;
- Does not by itself cause the partner's dissociation or a dissolution and winding up of the limited partnership's activities; and
- Does not, as against the other partners or the partnership, entitle the transferee to participate in the management or conduct of the partnership's activities, to require access to information concerning the partnership's transactions except as otherwise provided in *Corp. Code § 15907.02(c)* [*see* [3], *below*], or to inspect or copy the required information or the partnership's other records or to exercise any other rights or powers of a partner.

"Transfer" includes an assignment, conveyance, deed, bill of sale, lease, mortgage, creation of a security interest or encumbrance, gift, and transfer by operation of law [*Corp. Code § 15901.02(aj)*].

[3] Rights and Obligations of Transferee

A transferee has a right to receive, in accordance with the transfer, distributions to which the transferor would otherwise be entitled [*Corp. Code § 15907.02(b)*; *see Corp. Code § 15901.02(al)* ("transferee" defined as person to which all or

part of transferable interest has been transferred, whether or not transferor is a partner)]. A transferee is entitled to an account of the partnership's transactions only upon the dissolution and winding up of the partnership [*Corp. Code § 15907.02(c)*]. Upon transfer, the transferor retains the rights of a partner other than the interest in distributions transferred and retains all duties and obligations of a partner [*Corp. Code § 15907.02(d)*]. A limited partnership need not give effect to a transferee's rights until the partnership has notice of the transfer [*Corp. Code § 15907.02(e)*]. A transfer of a partner's transferable interest in the partnership in violation of a restriction on transfer contained in the partnership agreement is ineffective as to a person having notice of the restriction at the time of transfer [*Corp. Code § 15907.02(f)*]. A transferee that becomes a partner with respect to a transferable interest is liable for the transferor's obligations under *Corp. Code §§ 15905.02* and *15905.09* (regarding contributions and distributions) [*see § 16.39*]. However, the transferee is not obligated for liabilities unknown to the transferee at the time the transferee became a partner [*Corp. Code § 15907.02(g)*].

A transferee of a partnership interest, including a transferee of a general partner, may become a limited partner if and to the extent that the partnership agreement so provides or all general partners and a majority in interest of the limited partners consent [*Corp. Code § 15907.02(h)*; *see Corp. Code § 15901.02(t)* (definition)].

[4] Rights of Deceased Partner's Representative

If a partner dies, the deceased partner's personal representative or other legal representative may exercise the rights of a transferee as provided in *Corp. Code § 15907.02* [*see* [3], *above*]. For the purposes of settling the estate, the representative may exercise the rights of a current limited partner under *Corp. Code § 15903.04* [*Corp. Code § 15907.04*; *see § 16.30[1]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Rights and Duties of Partners

8-16 California Legal Forms--Transaction Guide § 16.39

§ 16.39 Contributions

[1] Nature of Contribution

A partner's contribution may consist of tangible or intangible property or other benefit to the limited partnership, including money, services performed, promissory notes, other agreements to contribute cash or property, and contracts for services to be performed [*Corp. Code § 15905.01*]. "Contribution" is defined as any benefit provided by a person to a limited partnership in order to become a partner, or in the person's capacity as a partner [*see Corp. Code § 15901.02(c)*].

[2] Obligation to Contribute

A partner's obligation to make a contribution to a limited partnership is not excused by the partner's death, disability, or other inability to perform personally [*Corp. Code § 15905.02(a)*]. If a partner does not make a promised nonmonetary contribution, the partner is obligated at the option of the limited partnership to contribute money equal to the value of that portion, as stated in the required information, of the stated contribution which has not been made [*Corp. Code § 15902.02(b)*].

The obligation of a partner to make a contribution or return money or other property paid or distributed in violation of the ULPA '08 may be compromised only by consent of all partners. A creditor of a limited partnership which extends credit or otherwise acts in reliance on an obligation of a partner to make a contribution, without notice of any compromise of that obligation, may enforce the original obligation [*Corp. Code § 15905.02(c)*].

A partnership agreement may provide that the interest of a partner who fails to make any contribution or other payment that the partner is required to make will be subject to specific remedies for, or specific consequences of, the failure. A provision will be enforceable in accordance with its terms unless the partner seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the agreement was made. The specific remedies or consequences may include loss of voting, approval, or other rights, loss of the partner's ability to actively participate in the management and operations of the partnership, liquidated damages, or a reduction of the defaulting partner's economic rights [*Corp. Code § 15905.02(d)*]. The reduction of the defaulting partner's economic

rights may include one or more of the following provisions [*Corp. Code § 15905.02(d)(1)-(6)*]:

- Diluting, reducing, or eliminating the defaulting partner's proportionate interest in the partnership.
- Subordinating the defaulting partner's interest in the partnership to that of non-defaulting partners.
- Permitting a forced sale of the partnership interest.
- Permitting the lending or contribution by other partners of the amount necessary to meet the defaulting partner's commitment.
- Adjusting the interest rates or other rates of return, preferred, priority, or otherwise, with respect to contributions by or capital accounts of the other partners.
- Fixing the value of the defaulting partner's interest in the partnership by appraisal, formula and redemption, or sale of the defaulting partner's interest in the partnership at a percentage of that value.

These provisions are not to be construed to affect the rights of third-party creditors of the partnership to seek equitable remedies nor any rights existing under the Uniform Fraudulent Transfer Act [*Corp. Code § 15905.02(d)(7)*; *see Civ. Code § 3439 et seq.*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Rights and Duties of Partners

8-16 California Legal Forms--Transaction Guide § 16.40

§ 16.40 Distributions

[1] Sharing of Distributions

A distribution by a limited partnership must be shared among the partners on the basis of the value, as stated in the required records when the limited partnership decides to make the distribution, of the contributions the limited partnership has received from each partner [*Corp. Code § 15905.03*]. "Distribution" is defined as a transfer of money or other property from a limited partnership to a partner in the partner's capacity as a partner, or to a transferee on account of a transferable interest owned by the transferee [*Corp. Code § 15901.02(f)*].

[2] Allocation of Profits and Losses

The profits and losses of a limited partnership must be allocated among the partners in the manner provided in the partnership agreement. If the partnership agreement does not otherwise provide, profits and losses are allocated in the same manner as the partners share distributions [*Corp. Code § 15905.035*].

[3] Form of Distributions

A partner does not have a right to demand or receive any distribution from a limited partnership in any form other than cash. Subject to, a limited partnership may distribute an asset in kind to the extent each partner receives a percentage of the asset equal to the partner's share of distributions [*Corp. Code § 15905.06*].

[4] Right to Receive Distribution

A partner does not have a right to any distribution before the dissolution and winding up of the limited partnership unless the partnership decides to make an interim distribution [*Corp. Code § 15905.04*].

Furthermore, a person does not have a right to receive a distribution on account of dissociation [*Corp. Code § 15905.05*].

[5] Status as Creditor as to Distribution

When a partner or transferee becomes entitled to receive a distribution, the partner or transferee has the status of, and is entitled to all remedies available to, a creditor of the limited partnership with respect to the distribution. However, the partnership's obligation to make a distribution is subject to offset for any amount owed to the limited partnership by the partner or dissociated partner on whose account the distribution is made [*Corp. Code § 15905.07*].

[6] Limitations on Distributions

A limited partnership may not make a distribution in violation of the partnership agreement [*Corp. Code § 15905.08(a)*].

Furthermore, a partnership may not make a distribution if, after the distribution: (1) the partnership would not be able to pay its debts as they become due in the ordinary course of its activities; or (2) the partnership's total assets would be less than the sum of its total liabilities plus the amount that would be needed, if it were to be dissolved, wound up, and terminated at the time of the distribution, to satisfy the preferential rights upon dissolution, winding up, and termination of partners whose preferential rights are superior to those of persons receiving the distribution [*Corp. Code § 15905.08(b)*]. The limited partnership may base a determination that a distribution is not prohibited under § 15905.08(b) on financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances or on a fair valuation or other method that is reasonable in the circumstances [*Corp. Code § 15908.08(c)*].

Except for distributions in the form of indebtedness (*see below*), the effect of a distribution under § 15905.08(b) is measured in the case of distribution by purchase, redemption, or other acquisition of a transferable interest in the partnership, as of the date money or other property is transferred or debt is incurred by the partnership [*Corp. Code § 15905.08(d)(1)*]. In all other cases, the effect of a distribution is measured as of the date the distribution is authorized, if the payment occurs within 120 days after that date; or as of the date the payment is made, if payment occurs more than l20 days after the distribution is authorized [*Corp. Code § 15905.08(d)(2)*]. If indebtedness is issued as a distribution, each payment of principal or interest on the indebtedness is treated as a distribution, the effect of which is measured on the date the payment is made [*Corp. Code § 15905.08(g)*].

A limited partnership's indebtedness to a partner incurred by reason of a distribution made in accordance with *Corp. Code § 15905.08* is at parity with the limited partnership's indebtedness to its general unsecured creditors [*Corp. Code § 15905.08(e)*]. A limited partnership's indebtedness, including indebtedness issued in connection with or as part of a distribution, is not considered a liability for purposes § 15905.08(b), if the terms of the indebtedness provide that payment of principal and interest are made only to the extent that a distribution could then be made to partners under this section [*Corp. Code § 15905.08(f)*].

The Uniform Law Comments state that reasonable compensation to partners for services or contributions to various retirement, pension or other benefit plans should not be treated as distributions and that a determination that a distribution is not prohibited seems to require exercise of the standard of ordinary care imposed upon partners.

[7] Distributions Made in Violation of § 15905.08

A general partner that consents to a distribution made in violation of *Corp. Code § 15905.08* [*see* [6], *above*] is personally liable to the limited partnership for the amount of the distribution that exceeds the amount that could have been distributed without the violation if it is established that in consenting to the distribution the general partner failed to comply with § 15904.08 [*Corp. Code § 15905.09(a)*; *see Corp. Code § 15905.09(c),(d)* (actions under this section)].

A partner or transferee that received a distribution knowing that the distribution to that partner or transferee was made in

violation of *Corp. Code § 15905.08* [*see* [6], *above*] is personally liable to the limited partnership, but only to the extent that the distribution received by the partner or transferee exceeded the amount that could have been properly paid under *Corp. Code § 15905.08* [*Corp. Code § 15905.09(b)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Rights and Duties of Partners

8-16 California Legal Forms--Transaction Guide §§ 16.41-16.49

[Reserved]

§§ 16.41[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Foreign Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.50

§ 16.50 In General

A "foreign limited partnership" is a partnership formed under the laws of any jurisdiction other than California and required by those laws to have one or more general partners and one or more limited partners [*Corp. Code § 15901.02(k)* (term includes a foreign limited liability limited partnership, defined in *Corp. Code § 15901.02(j)*)]. With respect to a foreign limited partnership, a general partner means a person that has rights, powers, and obligations similar to those of a general partner in a domestic limited partnership [*Corp. Code § 15901.02(m)(2)*].

The laws of the state or jurisdiction under which the foreign limited partnership is organized govern relations among the partners of the foreign limited partnership and the liability of partners as partners for an obligation of the foreign limited partnership, except as to foreign limited liability partnerships, which will be treated as if they were foreign limited partnerships [*Corp. Code § 15909.01(a)*]. A foreign limited partnership cannot be denied California registration by reason of any difference between those laws and California law [*Corp. Code § 15909.01(b)*]. A certificate of registration, however, does not authorize a foreign limited partnership to engage in any business or exercise any power that a limited partnership may not engage in or exercise in California [*Corp. Code § 15909.01(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Foreign Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.51

§ 16.51 Registration Requirements

[1] Application for Registration

[a] In General

A foreign limited partnership may apply for a certificate of registration to transact business in California [*see Corp. Code § 15909.02*]. Activities of a foreign limited partnership that do not constitute transacting business in California for registration purposes described *below* include the activities set forth in *Corp. Code § 15901.02(ai)* [*Corp. Code § 15909.03(a)*; *see* [b], *below*]. For purposes of required registration as a foreign limited partnership, ownership in California of income-producing real property or tangible personal property, other than as described above, constitutes transacting business in California [*Corp. Code § 15909.03(b)*]. *Corp. Code § 15909.03* does not apply in determining the contacts or activities that may subject a foreign limited partnership to service of process, taxation, jurisdiction, or regulation under any other law of California [*Corp. Code § 15909.03(c)*].

To register, a foreign limited partnership must submit an application for registration as a foreign limited partnership, on a form prescribed by the Secretary of State, signed and acknowledged by a general partner [*Corp. Code § 15909.02(a)*; *see § 16.220* (LP-5); *see also Gov. Code § 12188(c)* (filing fee)]. The application must include the name and address of an agent for service of process, the name of the partnership, the jurisdiction under which it is organized, the address of its designated office [*see Corp. Code § 15901.02(e)* (defined as its principal office); *see also Corp. Code § 15901.02(aa)* (office where principal executive office is located, whether or not in California)], the name and address of each general partner, and whether the foreign limited partnership is a foreign limited liability partnership [*Corp. Code § 15909.02(a)*]. The partnership must also deliver a certificate of existence signed by the official having custody of its publicly filed records in the jurisdiction where the partnership is organized [*Corp. Code § 15909.02(b)*].

In addition, a foreign limited partnership must file an amendment to the application for registration, on a form prescribed by the Secretary of State, if the original application for registration contains false information or any statements made in the application have become erroneous. The amendment must be signed and acknowledged by a general partner [*Corp. Code § 15909.06*].

For a guide to the procedures for registration, see *§ 16.112*.

[b] Transacting Intrastate Business Defined

The term "transacting intrastate business" means for purposes of registration entering into repeated and successive transactions of business in California other than interstate or foreign commerce [*Corp. Code § 15901.02(ai)*]. A person is not deemed to be transacting intrastate business in California merely because of the person's status as a limited partner of a domestic limited partnership or a foreign limited partnership registered to transact intrastate business in California [*Corp. Code § 15901.02(ai)*].

A foreign limited partnership is not considered to be transacting intrastate business merely because of its status as one or more of the following [*Corp. Code § 15901.02(ai)*]:

- A shareholder of a foreign corporation transacting intrastate business.
- A shareholder of a domestic corporation.
- A limited partner of a foreign limited partnership transacting intrastate business.
- A limited partner of a domestic limited partnership.
- A member or manager of a foreign limited liability company transacting intrastate business.
- A member or manager of a domestic limited liability company.

Further, a foreign limited partnership is not considered to be transacting intrastate business solely on the basis that the partnership conducts one or more of the following activities in California [*Corp. Code § 15901.02(ai)*]:

- Maintaining or defending any action or suit or any administrative or arbitration proceeding, or effecting the settlement thereof or the settlement of claims and disputes.
- Holding meetings of its partners, or carrying on other activities concerning its internal affairs.
- Maintaining bank accounts.
- Maintaining offices or agencies for the transfer, exchange, and registration of its securities or depositaries with relation to its securities.
- Effecting sales through independent contractors.
- Soliciting or procuring orders, whether by mail or through employees, agents, or otherwise, when the orders require acceptance outside California before becoming binding contracts.
- Creating or acquiring evidences of debt or mortgages, liens, or security interests on real or personal property.
- Securing or collecting debts or enforcing mortgages and security interests in property securing the debts.
- Conducting an isolated transaction completed within a 180-day period that is not the course of a

number of repeated transactions of a similar nature.

- Transacting business in interstate commerce.

This list is not exclusive; other activities may not constitute transacting intrastate business in California [*Corp. Code § 15901.02(ai)*].

[2] Name Requirements

A foreign limited partnership must comply with the name requirements applicable to domestic limited partnerships set forth in *Corp. Code § 15901.08* [*Corp. Code § 15909.05(a)*; *see § 16.21[3]*]. If a foreign limited partnership authorized to transact business in California changes its name to one that does not so comply, it may not thereafter transact business in California until it complies and obtains an amended certificate of registration [*Corp. Code § 15909.05(b)*].

[3] Issuance of Certificate

If the Secretary of State determines that the application for registration conforms to law and that all requisite fees have been paid, the Secretary of State will issue a certificate of registration to transact intrastate business in California. However, registration is subject to any licensing requirements otherwise imposed by California law [*Corp. Code § 15909.04*].

[4] Cancellation of Application or Certificate

The application for registration must be accompanied by the payment of the required filing fees [*Gov. Code § 12188(c)*; *see Corp. Code § 15909.05(c)*]. If the check or other remittance accepted in payment of the filing fee is not paid on presentation, the Secretary of State may cancel the application and certificate of registration [*Corp. Code § 15909.05(c)*]. After receiving notice of nonpayment, the Secretary of State will notify the agent for service of process (or the person submitting the instrument for filing) in writing of the application of this rule. If the amount is not then paid, by cashier's check or the equivalent, the Secretary of State will issue a second written notice of cancellation, effective on issuance, at least 20 days after the first notice but within 90 days of the original filing [*see Corp. Code § 15909.05(c)*].

[5] Service of Process

A foreign limited partnership is served by delivering process to the designated agent, in accordance with the provisions set forth in *Corp. Code § 15901.16* [*see Corp. Code § 15901.16(a)* (application of section to foreign limited partnerships]. For further discussion, see *§ 16.23[1]*.

Legal Topics:

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Foreign Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.52

§ 16.52 Effect of Recording Application for Registration

A foreign limited partnership may record a certified copy of the application for registration (and any previously filed amendment to the application), together with the certificate of registration, in the office of the county recorder of any county in California [*Corp. Code § 15902.01(e)*]. The recording creates a conclusive presumption in favor of any bona fide purchaser or encumbrancer for value of the partnership real property located in the county in which the certified copy has been recorded that (1) the persons named as general partners in the certificate are in fact the general partners, and (2) these persons are all of the general partners of the partnership [*Corp. Code § 15902.01(e)*].

Legal Topics:

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38 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Foreign Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.53

§ 16.53 Consequences of Failure to Register

A foreign limited partnership transacting intrastate business in California that has failed to register may not maintain any action or proceeding in California courts [*Corp. Code § 15909.07(b)*]. The transaction of intrastate business in California without registration constitutes the appointment of the Secretary of State as the partnership's agent for service of process in cases arising out of that business [*Corp. Code § 15909.07(f)*]. However, the failure to register does not impair any of its contracts or invalidate its acts, or prevent the partnership from defending any action or proceeding in California [*Corp. Code § 15909.07(d)*]. Further, a limited partner of a foreign limited partnership is not liable for the obligations of the foreign limited partnership solely because the partnership transacted intrastate business in California without registration [*Corp. Code § 15909.07(e)*].

An unregistered foreign limited partnership that transacts intrastate business in California without registration is subject to a penalty of $20 for each day that unauthorized business is transacted. The maximum liability is $10,000 [*Corp. Code § 15909.07(d)*]. An action to recover the penalty may be brought by the Attorney General or district attorney [*Corp. Code § 15909.07(d)*; *see Corp. Code § 2258* (sanctions on foreign corporations for failure to qualify)]. In addition, the Attorney General may also bring an action to restrain a foreign limited partnership from transacting intrastate business in California in violation of California law [*Corp. Code § 15909.08*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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39 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Foreign Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.54

§ 16.54 Cancellation of Registration

A foreign limited partnership may cancel its registration by filing a certificate of cancellation, on a form prescribed by the Secretary of State, with the Secretary. The certificate of cancellation must be signed and acknowledged by a general partner. The registration is cancelled when the certificate becomes effective under *Corp. Code § 15902.06* [*Corp. Code § 15909.07(a)*; *see § 16.21[2][b]*].

Legal Topics:

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Foreign Limited Partnerships

8-16 California Legal Forms--Transaction Guide §§ 16.55-16.69

[Reserved]

§§ 16.55[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
E. Tax Classification

8-16 California Legal Forms--Transaction Guide § 16.70

§ 16.70 Federal Entity Classification Rules

[1] In General

Final federal entity classification regulations [*see Treas. Reg. §§ 301.7701-1*-301.7701-6], allow eligible entities to elect their tax classification for federal tax purposes as an association taxable as a corporation or as a partnership. Entities with only a single owner may elect to be classified as a corporation or to be disregarded as an entity separate from their owner [*Treas. Reg. § 301.7701-3(a)*]. These "elective classification" regulations replace former regulations that classified business organizations as associations or partnerships, based on the presence or absence of the four corporate characteristics of continuity of life, centralization of management, limited liability for debts of the enterprise, and free transferability of interests [*see* former *Treas. Reg. 301.7701-2(a)*-(e)].

The elective classification regulations were generally effective January 1, 1997 [*Treas. Reg. § 301.7701-3(f)(1)*]. All prior revenue rulings and procedures are obsolete to the extent that they use the prior classification regulations and their focus on corporate characteristics to differentitate between partnerships and corporations. [*1997-1 C.B. 348, Notice 97-1*].

[2] Determining Whether Separate Entity Exists

The first step in the federal entity classification process is to determine whether there is an entity separate from its owners. This determination is a matter of federal law, not local law, and generally focuses on whether the participants carry on a trade, business, financial operation, or venture and divide any resulting profits [*Treas. Reg. § 301.7701-1(a)(1)*]. For example, a separate entity exists for federal tax purposes if co-owners of an apartment building lease space and in addition provide services to the occupants directly or through an agent [*Treas. Reg. § 301.7701-1(a)(2)*]. Mere co-ownership of property that is maintained, kept in repair, or rented or leased, however, does not constitute a separate entity for federal tax purposes. For example, if an individual owner, or tenants in common, of farm property lease it to a farmer for cash rental or a share of the crops, they do not necessarily create a separate entity for tax purposes [*Treas. Reg. § 301.7701-1(a)(2)*]. Similarly, a joint undertaking merely to share expenses does not create a separate entity for federal tax purposes [*Treas. Reg. § 301.7701-1(a)(2)*]. Certain joint undertakings that are not entities under local law may be entities for federal tax purposes. Conversely, not all entities formed under local law will

be recognized as separate entities for federal tax purposes. For example, if an LLC with a single individual owner is disregarded as an entity separate from its owner under *Treas. Reg. § 301.7701-3*, its individual owner is subject to federal tax as if the LLC's business were operated as a sole proprietorship [*Treas. Reg. § 301.7701-1(a)(3)*].

[3] Classification of Separate Entities as Trusts or Business Entities

An organization that is recognized as a separate entity for federal tax purposes is classified as either a trust [*Treas. Reg. § 301.7701-4*] or a business entity [*Treas. Reg. § 301.7701-2*], unless a separate provision of the Internal Revenue Code provides for special treatment [*Treas. Reg. § 301.7701-1(b)*]. An organization generally is classified as a trust if it does not have associates or an objective to carry on a business for profit [*Treas. Reg. § 301.7701-4*].

[4] Classification of Certain Business Entities as Corporations

Certain business entities are automatically classified as corporations for federal tax purposes. These include corporations denominated as such under applicable law, associations, joint-stock companies, insurance companies, organizations that conduct certain banking activities, organizations wholly owned by a state or political subdivision, organizations that are taxable as corporations under a provision of the Internal Revenue Code other than *I.R.C. § 7701(a)(3)*, and certain organizations formed under the laws of specified foreign jurisdictions (including a US possession, territory, or commonwealth) [*Treas. Reg. § 301.7701-2(b)*]. A special grandfathering rule applies for specific listed foreign entities. Under the rule, a foreign entity described in the list of foreign entities treated as per se corporations [*Treas. Reg. § 301.7701-2(b)*] will nevertheless be classified as other than a corporation if certain conditions are met. The grandfathering rule also lists certain situations in which a grandfathered foreign business entity will lose its grandfathered status [*Treas. Reg. § 301.7701-2(d)*].

[5] Eligible Entities May Choose Classification for Federal Tax Purposes

Any business entity that is not required to be treated as a corporation for federal tax purposes [*see* [4], *above*] is an "eligible entity" [*Treas. Reg. § 301.7701-3(a)*]. An eligible entity may choose its entity classification under rules set forth in the regulations. An eligible entity with at least two members may choose to be classified as either a partnership or an association (taxable as a corporation). An eligible entity with a single member may choose to be classified as an association (taxable as a corporation) or may choose to be disregarded as an entity separate from its owner [*Treas. Reg. § 301.7701-3(a)*]. However, if the single owner of a business entity is a bank [*I.R.C. § 581*] or a foreign bank [*I.R.C. § 585(a)(2)(B)*] then the special rules applicable to banks continue to apply to the single owner as if the wholly-owned entity is a separate entity except with regard to *I.R.C. §§ 864(c)*, *§ 882(c)*, and *884* [*Treas. Reg. § 301.7701-2(c)(2)(ii)*].

[6] Default Classification Rules

To provide most eligible entities with the classification they would choose without requiring them to file an election, default classification rules are provided that aim to match taxpayers' expectations (and thus reduce the number of elections that will be needed) [*Treas. Reg. § 301.7701-3(b)*]. The default classification for an existing entity is the classification that the entity claimed immediately prior to January 1, 1997. An entity's default classification continues until the entity elects to change its classification by means of an affirmative election [*Treas. Reg. § 301.7701-3(b)(3)*].

For domestic entities, a newly formed eligible entity will be classified as a partnership under the default rules if it has at least two members, or will be disregarded as an entity separate from its owner if it has a single owner [*Treas. Reg. § 301.7701-3(b)(1)*]. For foreign entities, the default classification is based on whether the members have limited liability. Thus, a foreign eligible entity will be classified as an association (and taxable as a corporation) if all members have limited liability. A foreign eligible entity will be classified as a partnership if it has two or more members and at least one member does not have limited liability; the entity will be disregarded as an entity separate from its owner if it has a single owner and that owner does not have limited liability [*Treas. Reg. § 301.7701-3(b)(2)(i)*].

A member is not treated as having limited liability for purposes of this rule if the member, by virtue of membership in the foreign entity, has personal liability for all or any portion of the debts of the entity [*Treas. Reg. § 301.7701-4(b)(2)(ii)*].

[7] How to Elect Entity Classification

An eligible entity [*see* [5], *above*] may affirmatively elect its classification (or may change its classification) on Form 8832, Entity Classification Election [*Treas. Reg. § 301.7701-3(c)(1)(i)*]. The election must be signed by each member of the entity, or by any officer, manager, or member of the entity who is authorized to make the election and who represents to having that authorization under penalties of perjury. The determination of whether a person is authorized to make an election is based on local law [*Treas. Reg. § 301.7701-3(c)(2)(i)*]. If the election is made by all of the members, each person who is an owner at the time the election is made must consent to the election. If an election is to be effective for any period before the date the election is made, however, each person who was an owner between the date the election is to be effective and the date the election is filed and who is not an owner on the date the election is filed must also consent to the election [*Treas. Reg. § 301.7701-3(c)(2)(ii)*; *see § 16.30 [3]*]. An election will not be accepted unless it includes all of the required information, including the entity's taxpayer identifying number (TIN) [*Treas. Reg. § 301.7701-3(c)(1)(i)*].

Taxpayers (including indirect owners of an entity) are required to attach a copy of the classification election to their tax returns, but failure to do so will not invalidate an otherwise valid election. All members of an entity are required to file tax returns that are consistent with the entity's election. Therefore, failure to attach the election form to a federal tax or information return may give rise to penalties against the non-filing party. Other penalties may be imposed against parties who file federal tax or information returns inconsistent with the entity's election [*Treas. Reg. § 301.7701-3(c)(1)(ii)*].

[8] Time for Election; Effective Date

An entity classification election must be made at the beginning of the taxpayer's taxable year. Taxpayers may specify the date on which an election will be effective, but an election cannot be effective more than 75 days before, or more than 12 months after, the date on which the election is filed. If no effective date is specified in the election, the effective date is the date of filing. No election, whenever filed, is effective before January 1, 1997 [*Treas. Reg. § 301.7701-3(c)(1)(iii)*].

Not more than one election to change an entity's classification may be made during any 60-month period. The Commissioner may waive this rule by letter ruling, but only if there has been more than a 50-percent ownership change in the entity. The 60-month limitation applies only to a change in classification by election. It does not apply if the organization's business is actually transferred to another entity [*Treas. Reg. § 301.7701-3(c)(1)(iv)*].

[9] Classification Rules for Partnership Terminations and Divisions

A partnership is considered terminated if within a 12-month period there is a sale or exchange of at least 50 percent of the total interests in partnership capital and profits [*I.R.C. § 708(b)(1)(B)*]. When a partnership is divided into two or more partnerships, the resulting partnerships (other than any resulting partnership the members of which had an interest of 50 percent or less in the capital and profits interest of the prior partnership) are considered a continuation of the prior partnership [*I.R.C. § 708(b)(2)(B)*]. For purposes of the entity classification rules, a partnership resulting from one of the above terminations or divisions is a partnership [*Treas. Reg. § 301.7701-3(e)*]. This rule does not apply for certain foreign entities whose entity status was grandfathered under special rules [*Treas. Reg. § 301.7701-3(e)*; *see Treas. Reg. § 301.7701-2(d)(3)*].

[10] Transition Rules

A special transition rule applies for entities that were in existence on January 1, 1997. The IRS will not challenge the prior classification of an existing eligible entity or an existing foreign entity described on the per se list [*see Treas. Reg. § 301.7701-2(b)(8)*] for periods before 1997 if the following requirements are met [*Treas. Reg. § 301.7701-3(f)(2)*]:

- The entity had a reasonable basis (within the meaning of *I.R.C. § 6662*) for its claimed classification;

- The entity and all members of the entity recognized the federal tax consequences of any change in the entity's classification within the 60 months before January 1, 1997; and

- Neither the entity nor any member had been notified in writing on or before May 8, 1996 that the classification of the entity was under examination.

[11] Classification for California Income Tax Purposes

California generally conforms to the federal entity classification rules under *Treas. Reg. § 301.7701-2* [*see Rev. & Tax. Code § 23038*; *see also* FTB *Notice 92-5*]. The classification of a business entity as an association taxable as a corporation is determined under FTB regulations, which must be consistent with the federal regulations in effect on January 1, 1997, that classify a business entity as a partnership or an association taxable as a corporation, or disregard the separate existence of the business entity [*Rev. & Tax. Code § 23038(b)(2)(B)(i)*]. The classification of an eligible business entity as a partnership or an association taxable as a corporation is the same as the classification of the entity for federal tax purposes [*Rev. & Tax. Code § 23038(b)(2)(B)(ii)*]. However, if an eligible business entity was properly classified as an association taxable as a corporation for any income year beginning with the 60-month period preceding January 1, 1997, the entity continues to be an association taxable as a corporation until it elects to be classified the same as the entity is classified for federal purposes. This rule does not apply to any entity that was not doing business in California, did not derive income from California, and had no California resident owner during the 60-month period preceding January 1, 1997 [*Rev. & Tax. Code § 23038(b)(2)(C)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsDefinitionsPartners & Partnerships



42 of 175 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
E. Tax Classification

8-16 California Legal Forms--Transaction Guide § 16.71

§ 16.71 Publicly Traded Partnerships Taxed as Corporations

A limited partnership may be classified as a corporation for tax purposes if it is "publicly traded" [*I.R.C. § 7704*]. A partnership is "publicly traded" if its interests are either traded on an established securities market (including any national securities exchange registered under the Securities Exchange Act of 1934 [*see 15 U.S.C. §§ 78a-78kk*]), or readily tradable on a secondary market or its substantial equivalent [*I.R.C. § 7704(b)*; *see* Conf. Rep. No. 100-495, Pub. L. No. 100-495, p. 948 ("readily tradable" means interest is regularly quoted by brokers or dealers who make a market in the interest; "secondary market" is indicated by existence of a person standing ready to make a market in the interest)]. If a partnership's interests are not traded on an established securities market [*I.R.C. § 7704(b)(1)*], however, those interests will be classified as readily tradable on a secondary market (or its substantial equivalent) [*I.R.C. § 7704(b)(2)*] only if all of the interests were issued (1) in a transaction that was registered under the Securities Act of 1933 [*see 15 U.S.C. §§ 77a-77aa*], or (2) in a transaction that was not registered under the Securities Act of 1933 and the partnership either (a) has more than 500 partners, or (b) offers each unit of partnership interest for less than $20,000, [*1988-2 C.B. 386, Notice 88-75* ("safe harbor" provisions); *see* Ballantine & Sterling, California Corporation Laws, Ch. 26, *Income Taxation of Partnerships* (Matthew Bender)].

A partnership that is classified as "publicly traded" under these rules will be deemed to have transferred all of its assets to a newly formed corporation in exchange for the stock of the corporation, and distributed the stock to its partners in liquidation of their interests in the partnership [*I.R.C. § 7704(f)*; *see* Conf. Rep. No. 100-495 (Pub. L. No. 100-495) p. 945]. Numerous "safe harbors," however, are available to allow partnerships to escape taxation as corporations under *I.R.C. § 7704* [*see 1988-2 C.B. 386, Notice 88-75*]. Furthermore, even if a partnership (excluding regulated investment companies [*see I.R.C. § 851(a)*] meets the definition of a "publicly traded partnership," it will not be subject to corporate tax treatment if 90 percent or more of its gross income for the taxable year, and for each preceding taxable year beginning after December 31, 1987, in which it was in existence, consists of interest, dividends, or other specified passive-type income [*I.R.C. § 7704(c), (d)*]. Thus, *I.R.C. § 7704* is inapplicable to the vast majority of limited partnerships.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesTax LawFederal Taxpayer GroupsC CorporationsPublicly Traded Partnerships (IRC secs. 469, 7704)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
E. Tax Classification

8-16 California Legal Forms--Transaction Guide §§ 16.72-16.99

[Reserved]

§§ 16.72[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-16 California Legal Forms--Transaction Guide § 16.100

§ 16.100 Facts

1. Names, addresses, and telephone numbers of all general partners and all known limited partners.

NOTE:
The full name and last known street and mailing address of each partner must be included in the partnership's records [*Corp. Code § 15901.11(1)*; ***see*** *§ 16.23[2]*]. The names and addresses of the general partners must be included in the certificate of limited partnership [*Corp. Code § 15902.01(a)(4)*; ***see*** *§§ 16.21[2][a], 16.210*].

2. Each partner's taxable year.

NOTE:
This information may be helpful in selecting a proper taxable year for the partnership.

3. Name and address of agent for service of process on:

a. Partnership.

NOTE:
This information must be included in the certificate of limited partnership, except that if the agent is a corporation, only its name need be included [*Corp. Code §§ 15901.16(d)(1), 15902.01(a)(3)*; ***see*** *§§ 16.21[2][a], 16.23[1][b], 16.210*].

b. Any corporations or partnerships that are members of partnership.

4. Type and general characteristics of business to be conducted.

5. Name proposed for partnership, such as:

NOTE:
The partnership's name must be included in its certificate of limited partnership [*Corp. Code § 15902.01(a)(1)*; ***see*** *§§ 16.21[2][a], 16.210*]. Name restrictions are discussed in *§ 16.21[3]*.

a. Names of all general partners; or

b. Fictitious business name (i.e., any name other than name of limited partnership as filed with Secretary of State) [*see Bus. & Prof. Code §§ 17900-17930*; *see also § 16.21[3][c]*; Ch. 1A, *Role of Counsel in Starting a New Business*].

6. If partnership name is to include surnames of general partners, which names are to be retained after death or retirement?

7. Partnership addresses (including county):

a. Address of its initial designated office.

NOTE:
This information must be included in the certificate of limited partnership [*Corp. Code § 15902.01(a)(2)*; ***see*** *§§ 16.21[2][a], 16.210*].

b. Other business addresses.

c. Address of office in California where partnership records are to be kept [*see Corp. Code § 15901.11*; *see also § 16.23*].

8. Term of partnership, including:

a. Date partnership is to commence operations.

NOTE:
The length of "lead time" required before the partnership can commence business will be determined in part by the estimated time it will take to sell the limited partnership interests.

b. Length of time partnership is to continue.

NOTE:
The ULPA '08 provides that a limited partnership has a perpetual duration [*Corp. Code § 15901.04(b)*; ***see*** *§ 16.20*]. This provision is a "default" provision; it may be changed in a partnership agreement to specify some other duration [***see*** *Corp. Code § 15901.10(b)*]. Even if the default rule is not changed in the agreement, a limited partnership can be terminated by winding up and dissolution and by other events [***see*** Ballantine & Sterling, California Corporation Laws, Ch. 25, ***Limited Partnerships*** , § 727 (Matthew Bender)].

(1) Specified period.

(2) Specified period or until sooner dissolved and wound up in accordance with partnership agreement.

(3) Until dissolved by agreement.

(4) Until specified undertaking is completed.

(5) Until dissolved following occurrence of specific act or event.

(6) Any combination of these.

9. Partnership capital necessary to commence operations.

10. Initial capital contributions by general and limited partners.

NOTE:
This information must be included in the records to be kept by the partnership [***see*** *Corp. Code § 15901.11(8)*; *see also § 16.23*].

a. Cash.

b. Property, including:

(1) Description and valuation.

(2) Contributing partner's adjusted income tax basis.

c. Services rendered, including description and valuation.

d. Promissory note, including amount.

NOTE:
A partner's contribution to the partnership may consist of a promissory note or other agreement to contribute money or property [*Corp. Code § 15905.01*]. The obligation of any partner to make a contribution may be compromised only by the written consent of all of the partners [*Corp. Code § 15905.02(c)*]. A creditor of a limited partnership which extends credit or otherwise acts in reliance on an obligation of a partner to make a contribution, without notice of any compromise of that obligation, may enforce the original obligation [*Corp. Code § 15905.02(c)*]. Nothing in *Corp. Code § 15905.02* will be construed to affect the rights of third-party creditors of the partnership to seek equitable remedies or any rights existing under the Uniform Fraudulent Transfer Act [*Corp. Code § 15905.02(d)(7)*; *see Civ. Code §§ 3439 et seq.*].

e. Other obligation to contribute money or property or to render services, including description and valuation.

11. Details of any arrangements made among prospective partners for future contributions of capital.

NOTE:
Ordinarily, no such arrangements will exist at the formation stage. However, in the case of a small limited partnership when all members are prior acquaintances, discussions may have occurred regarding

whether the partnership will be permitted to "call" for additional contributions. Unless contained in a partnership agreement made in a record, a limited partnership must keep at its designated office a record stating the times at which, or events on the happening of which, any additional contributions agreed to be made by each partner are to be made [*see Corp. Code § 15901.11(8)*].

12. Whether any general partner intends to make contribution and share in profit and loss as limited partner [*see Corp. Code § 15644*].

NOTE:

A person may be both a general partner and a limited partner. A person that is both has the rights, powers, duties, and obligations provided by the ULPA '08 and the partnership agreement in each capacity. When the person acts as a general partner, the person is subject to the obligations, duties, and restrictions under the ULPA '08 and the partnership agreement for general partners. When the person acts as a limited partner, the person is subject to the obligations, duties, and restrictions under the ULPA '08 and the partnership agreement for limited partners [*Corp. Code § 15901.13*; *see §§ 16.30-16.35*].

13. Whether obligation of any partner to make contributions may be compromised and, if so, whether consent of all partners should be required.

NOTE:

Unless otherwise provided in the partnership agreement, the obligation of a partner to make a contribution may be compromised only with the written consent of all of the partners [*Corp. Code § 15905.02(c)*; *see* paragraph 11, *above*].

14. Details of arrangements for any partner to:

NOTE:

A partner may lend money to and transact other business with the partnership unless otherwise provided in the partnership agreement [*Corp. Code § 15901.12*]. However, if the limited partnership is subject to regulation by the Commissioner of Corporations, there are generally restrictions on transactions between the partnership and a general partner [***see, e.g.,*** *10 Cal. Code Reg. §§ 260.140.1-260.140.114.10* (real estate syndicates)]. Further, these transactions involve conflicts of interest that will have to be carefully spelled out in any offering memorandum or prospectus [***see, e.g.,*** *10 Cal. Code Reg. §§ 260.140.114.5(c)(2), 260.140.117.3*; ***see, e.g.,*** Ch. 29C, ***Public Real Estate Syndicates***].

a. Transact business with partnership.

b. Loan property or cash to partnership.

c. Lease property to partnership, including terms of lease.

15. Share of each partner in profits and losses.

16. Amount of time each general partner will be required to devote to partnership business, and:

a. Whether partner has or may have outside business activities.

b. If partner has or may have outside business activities, restrictions, if any, to be placed on those activities.

17. Special duties, if any, each general partner will perform:

a. Division of labor according to each partner's level of skill, training, or other factors.

b. Designation of managing partners:

(1) Designation of managing partner; or

(2) Designation of partners to serve on management committee.

18. Any limitations to be imposed on amount or types of partnership liabilities that any general partner may incur.

19. Weight accorded each partner's vote:

a. General partners.

b. Limited partners.

20. Vote required for approval or disapproval by general partners of administrative and/or business matters occurring in ordinary course of partnership business.

21. Voting rights of limited partners

a. Matters on which limited partners may be allowed to vote, for example:

NOTE:
The ULPA '08 does not set forth extensive provisions on voting, in contrast to prior law [*see, e.g., Corp. Code § 15636(f)* (CRLPA)]. It does provide that a limited partner does not participate in the control of the business solely by voting on, proposing, or calling a meeting of the partners [*Corp. Code § 15903.04(b)(5)*]. The partnership agreement may set forth any provisions other than those prohibited by the ULPA '08 in *Corp. Code § 15901.10(b)* [*see § 16.21[4][b]*].

(1) Dissolution and winding up [*see Corp. Code § 15908.01(b),(c)*; *see also* Ch. 16A, *Dissolution of Limited Partnerships*].

(2) Merger of limited partnership [*see Corp. Code §§ 15678.1-15911.01 et seq.*; *see also* Ch. 16B, *Mergers of Limited Partnerships*].

(3) Sale, exchange, lease, mortgage, pledge, or other transfer of, or granting of security interest in, all or substantial part of partnership assets other than in ordinary course of business.

(4) Incurrence of debt other than in ordinary course of business.

(5) Change in nature of business.

(6) Transactions in which general partners have actual or potential conflict of interest

with limited partners or the partnership.

(7) Election to continue business of partnership when general partner ceases to be such and at least one general partner remains.

(8) Admission of new general partner when at least one general partner remains.

(9) Other matters related to business of limited partnership that partnership agreement makes subject to approval or disapproval of limited partners.

(10) Any action required or permitted by law to bring, pursue, settle, or terminate derivative action on behalf of partnership.

b. Margin to be required for limited partners' approval or disapproval of partnership actions on which partnership agreement may permit them to vote.

22. Voting rights of limited partners applicable to expulsion of general partner [*see, e.g., Corp. Code § 15906.03(d)* (unanimous consent of other partners)].

23. Voting requirements of limited partners applicable to admission of new general partner and election to continue business after general partner ceases to be partner and there is no remaining or surviving general partner [*see Corp. Code § 15908.01(c)*; *see also* Ch. 16A, *Dissolution of Limited Partnerships*].

24. Amount of salary or other remuneration to be paid to any partner, if any.

NOTE:
A limited partner ordinarily would not be paid a salary unless he or she independently contracts with the partnership. A partner may lend money to and transact other business with the limited partnership and has the same rights and obligations with respect to the transaction as a person that is not a partner [*Corp. Code § 15901.12*].

a. Basis for making salary determination (e.g., amount of time devoted to business).

b. Whether salaries paid should be deducted before computing net profits, or charged against partners' shares of net profits [*see I.R.C. § 707(c)*; *see also* Ch. 15, Part A, *Formation of General Partnerships*].

25. Rights of partners to distributions during operation of partnership.

NOTE:
A "distribution" is a transfer of money or property by a partnership to its partners without consideration [*Corp. Code § 15901.02(f)*]. Unless otherwise provided in the partnership agreement, distributions must be shared among the partners on the basis of the value, as stated in the required records when the limited partnership decides to make the distribution, of the contributions the limited partnership has received from each partner [*Corp. Code § 15905.035*].

a. Frequency of distributions to be specified in partnership agreement.

b. Extent of each distribution to be specified in partnership agreement.

c. Details of any arrangement by which any limited partner will have priority over other limited partners.

d. Whether limited partners will be given right to receive property other than money in any distribution.

NOTE:
Unless otherwise provided in the partnership agreement, no limited partner has the right to demand or receive any distribution from a limited partnership in any form other than cash [*Corp. Code § 15905.06*].

e. Whether any partner may be compelled to accept distribution of assets in kind in lieu of proportionate cash distribution being made to other partners.

NOTE:
Subject to *Corp. Code § 15908.09(b)*(applications of assets in dissolution), a limited partnership may distribute an asset in kind to the extent each partner receives a percentage of the asset equal to the partner's share of distributions [*Corp. Code § 15905.06*].

26. Frequency with which accountings of partnership affairs will be required.

NOTE:
The ULPA '08 requires only that the partnership maintain records, including financial statements, for the six most recent fiscal years [*Corp. Code § 15901.11(4),(6)*]. The limited partners have access to these records [***see*** *Corp. Code § 15903.04(a)*].

27. When financial statement should be distributed to all partners.

28. When copies of the partnership's tax returns should be:

a. Prepared by the partnership (i.e., whether partnership should be required to prepare them in advance of date on which partners' returns are due to IRS).

b. Distributed to all partners.

29. Extent to which limited partnership interests may be transferred [*see Corp. Code § 15907.02(a)*].

NOTE:
A partnership may be taxed as a corporation if its interests are assignable to the extent they are "publicly traded" [*I.R.C. § 7704*]. "Publicly traded" means its interest are (1) traded on an established securities market [*I.R.C. § 7704(b)(1)*], or (2) readily tradable on a secondary market [*I.R.C. § 7704(b)(2)*; ***see*** Conf. Rep. No. 100-495, Pub. L. No. 100-203, p. 948 (definitions)]. A partnership's interests, however, will be treated as publicly traded on a secondary market only if they were issued in a transaction that was registered under the Securities Act of 1933 [***see*** *15 U.S.C. §§ 77a-77aa*], or in a transaction that was not so registered when the partnership either (1) has more than 500 partners, or (2) offers each unit of partnership interest for less than $20,000 [***see*** *1988-2 C.B. 386, Notice 88-75*]. For further discussion, see *§§ 16.13, 16.71*.

30. Criteria for admission of additional limited partners:

a. When partnership interest is to be acquired directly from partnership:

(1) Contributions and other financial requirements.

(2) Consent required.

NOTE:
The partnership agreement usually provides for the acquisition of a partnership interest directly from the partnership. If the agreement does not provide for this, then the written consent of the partners is required [*Corp. Code § 15903.01*]. The partnership agreement may provide for a consent of a specified number of partnership interests, or simply permit the general partners to admit additional limited partners on compliance with the agreement.

b. When partnership interest will be acquired from transferor, whether partnership agreement should admit transferee as limited partner.

NOTE:
A transferee may become a limited partner if and to the extent that the partnership agreement provides or all general partners and a majority in interest of the limited partners consent [*Corp. Code § 15907.02(h)*].

31. Rules desired for partnership meetings.

NOTE:
Unlike prior law [***see, e.g.,*** *Corp. Code § 15637* (CRLPA, repealed January 1, 2010)], the ULPA '08 does not contain default provisions regarding partnership meetings. Therefore, the partnership agreement should set forth any desired provisions governing this topic [***see*** Ballantine & Sterling, California Corporation Laws, Ch. 25, ***Limited Partnerships*** , § 732.01[2] (Matthew Bender)].

a. Place where meetings are to be held [*see Corp. Code § 15637(a)*].

b. Time and manner of giving notice of meeting.

c. Proportion of limited partnership interests required to constitute quorum at partnership meetings.

d. Whether partnership agreement should permit or limit action to be taken without meeting on written consent.

NOTE:
The ULPA '08 provides that action requiring the consent of partners may be taken without a meeting, and a partner may appoint a proxy to consent or otherwise act for the partner by signing an appointment record, either personally or by the partner's attorney in fact [*Corp. Code § 15901.15*].

e. Whether notice of adjourned meeting need be given [*see Corp. Code § 15637(d)*].

32. Whether general partners may be expelled for specified reasons [*see Corp. Code § 15906.03*; *see also § 16.37[2]*].

NOTE:
A person is dissociated from a limited partnership as a general partner upon the occurrence of an event agreed to in the partnership agreement as causing the person's dissociation as a general partner, or upon

the person's expulsion as a general partner pursuant to the partnership agreement [***see*** *Corp. Code § 15906.03(b),(c)*].

33. Whether partnership agreement should provide for specific consequences to general partner for breach of partnership agreement [*see, e.g., Corp. Code § 15906.04(b)* (wrongful dissociation)].

34. Rules desired to govern withdrawal of general partner.

NOTE:

Unless the partnership agreement provides otherwise, upon dissociation as a general partner a person's right to participate as a general partner in the management and conduct of the partnership's activities terminates, among other things [***see*** *Corp. Code § 15906.05(a)*]. Further, the person's dissociation as a general partner does not of itself discharge the person from any obligation to the limited partnership or other partners which the person incurred while a general partner [*Corp. Code § 15906.05(b)*; ***see*** *§§ 16.34-16.35*].

35. Rules restricting or preventing general partner from assigning or encumbering partnership interest [*see Corp. Code § 15907.01, 15907.02*; *see also § 16.38*].

36. Rules regarding liability of dissociated general partner.

NOTE:

Unless the partnership agreement provides otherwise, liability is as set forth in *Corp. Code § 15906.07* [***see*** *§ 16.37[4]*].

37. Rules desired to govern withdrawal of limited partner:

NOTE:

A person does not have a right to dissociate as a limited partner before the termination of the limited partnership [*Corp. Code § 15906.01(a)*]. However, this is one of the provisions that may be modified in a partnership agreement [***see*** *Corp. Code § 15901.10*].

In a given partnership, if limited partners are considered as simply investors with transferable interests, the partnership agreement may provide for their dissociation on transfer and admission of the transferee as a limited partner (as in a corporation when a stockholder sells stock to another person who becomes the stockholder). However, in an enterprise that amounts to a family limited partnership with relationships among the original partners, the partnership agreement may provide that the original partners remain as such during the term of the partnership, even if some or all of their transferable interests become owned by others. ***See*** Ballantine & Sterling, California Corporation Laws, Ch. 25, ***Limited Partnerships*** , § 746.01 (Matthew Bender).

38. Whether partnership agreement should provide for specific consequences to limited partner for breach of partnership agreement.

39. Whether partnership desires to restrict limited partners' right to information.

NOTE:

A partnership agreement may not unreasonably restrict the right to information under *Corp. Code § 15903.04* [***see*** *§ 16.30[1]*], but it may impose reasonable restrictions on the availability and use of information obtained under that section and may define appropriate remedies, including liquidated damages, for a breach of any reasonable restriction on use [*Corp. Code § 15901.10(b)(4)*; ***see*** *§*

16.21[4][b]].

40. Any specific provisions specifying consequences of partner's failure to make required contribution, such as [*Corp. Code § 15905.02(d)*]:

NOTE:
A partnership agreement may provide that the interest of a partner who fails to make any contribution or other payment that the partner is required to make will be subject to specific remedies for, or specific consequences of, the failure. A provision will be enforceable in accordance with its terms unless the partner seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the agreement was made [*Corp. Code § 15905.02(d)*].

a. Loss of voting, approval, or other rights.

b. Loss of partner's ability to actively participate in management and operations of partnership.

c. Liquidated damages.

d. Reduction of defaulting partner's economic rights.

41. Rules desired to specify when partnership should be dissolved and wound up [*see Corp. Code § 15908.01 et seq.*]:

NOTE:
The procedures involved in the dissolution and winding up of limited partnerships are discussed in Ch. 16A.

a. Time to be specified for, or event that will precipitate, dissolution and winding up.

b. Number of general and limited partners needed for written consent to dissolution and winding up.

c. Whether dissolution and winding up will be required if general partner ceases to be such and at least one other general partner remains.

d. Whether new general partner may be admitted if sole general partner ceases to be such.

42. Rules desired to govern winding up on dissolution [*see Corp. Code § 15908.03*]:

a. Which partners should be required by partnership agreement to wind up partnership business.

NOTE:
Unless otherwise provided in the partnership agreement if a dissolved limited partnership does not have a general partner, a person to wind up the dissolved limited partnership's activities may be appointed by the consent of limited partners owning a majority of the rights to receive distributions as limited partners at the time the consent is to be effective [*Corp. Code § 15908.03(c)*].

b. If limited partners wind up partnership affairs, whether they should be allowed reasonable compensation [*see Corp. Code § 15908.03(e)*].

43. Rules desired for distribution of assets on dissolution and after satisfaction of liabilities to creditors; either [*see Corp. Code § 15908.09(a),(b)*:

a. To partners as they share in distributions; or

b. As otherwise provided by partnership agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesContracts LawTypes of ContractsPartnership AgreementsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-16 California Legal Forms--Transaction Guide § 16.101

§ 16.101 Documents

1. Instruments evidencing prospective partners' legal or equitable title to real or personal property that they intend to convey to partnership.

2. Any instruments that will be used to convey title to real or personal property to partnership.

3. Leases on property to be acquired.

4. Leases under which partnership will occupy property as subtenant of one or more partners.

5. Licenses and permits issued to partners or their existing businesses.

6. Contracts and/or franchise agreements to be assigned to partnership.

7. Financial statements for any going business to be acquired.

8. Insurance policies on any real or personal property to be acquired.

9. Licenses or other documents securing:

    a. Copyrights.

    b. Patent rights.

    c. Trade names, trademarks, and/or service marks.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesContracts LawTypes of ContractsLease AgreementsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-16 California Legal Forms--Transaction Guide §§ 16.102-16.109

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§§ 16.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Procedural Guide

8-16 California Legal Forms--Transaction Guide § 16.110

§ 16.110 Preliminary Considerations

1. Must partnership file certificate of fictitious name [*see Bus. & Prof. Code §§ 17900-17930*; *see also § 16.21[3][c]*]?

NOTE:
A "fictitious business name" is any name other than the name of the limited partnership on file with the Secretary of State *Bus. & Prof. Code § 17900(b)(4)*. For further discussion, see Ch. 1A, ***Role of Counsel in Starting a New Business*** .

2. What type of licenses or permits will be required before partnership can conduct its business?

NOTE:
For discussion of various license and permit requirements, see Chs. 1B through 1F.

3. Will goodwill be major asset of partnership's business [*see* Ch. 15, Part A, *Formation of General Partnerships*]?

NOTE:
The partnership agreement should require payments based on goodwill in provisions governing the liquidation of any partnership interest when goodwill is a substantial asset. Unless expressly provided for, payments for goodwill are not treated as payments in exchange for an interest in partnership property and, accordingly, are taxed as ordinary income to the partner who receives them [***see*** *I.R.C. § 736(b)(2)(B)*; ***see also*** Ch. 15, Part A, ***Formation of General Partnerships***]. This rule only applies if capital is not a material income-producing factor for the partnership and the retiring or deceased partner was a general partner [*I.R.C. § 736(b)(3)*].

4. Will accounts receivable be major asset of partnership's business [*see* Ch. 15, Part A, *Formation of General Partnerships*]?

NOTE:
Counsel should advise clients who intend to form a limited partnership that will operate a business involving accounts receivable that payments for unrealized receivables made in liquidation of a partnership interest are not considered payments for partnership property [***see** I.R.C. § 736(b)(2)(A)*]. This rule only applies if capital is not a material income-producing factor for the partnership and the retiring or deceased partner was a general partner [*I.R.C. § 736(b)(3)*].

5. What accounting method (cash or accrual) should be used [*see I.R.C. § 446*]?

NOTE:
Partnerships organized to operate retail or wholesale commercial enterprises are likely to accumulate substantial accounts receivable and should not employ the accrual method, since it will result in tax liability for amounts not necessarily realized [***see** I.R.C. § 446*].

However, a partnership that has a C corporation as a partner may not use the cash method of accounting unless it is a farming business, a qualified personal service corporation, or a small business with less than $5,000,000 in gross receipts [*I.R.C. § 448(a)(2), (b)*], or unless it qualifies under a special small business exception, under which the IRS allows certain taxpayers with average annual gross receipts of $10 million or less to use the cash method of accounting [*Rev. Proc. 2002-28, 2002-1 C.B. 815*]. A partnership that qualifies as a "tax shelter" [***see** I.R.C. § 461(i)(3)*] is prohibited from using the cash method of accounting under all circumstances [*I.R.C. § 448(a)(3)*]. For further discussion of these restrictions, see Ch. 15, Part A, ***Formation of General Partnerships*** .

6. If separate capital and income accounts are to be maintained for each partner, should each partner's annual net balance:

a. Automatically be transferred to capital accounts at close of each partnership taxable year; or

b. Be treated as loan to partnership and, if so [*see Corp. Code § 15901.12*]:
(1) What, if any, rate of interest will loan bear?

(2) From what date will interest be due?

7. What taxable year should be adopted by partnership [*see I.R.C. §§ 444, 706*; *see also* Ch. 15, Part A, *Formation of General Partnerships*]?

NOTE:
Unless the partnership elects a taxable year pursuant to *I.R.C. § 444*, its taxable year will be determined according to the rules set forth in *I.R.C. § 706* [***see*** Ch. 15, Part A, ***Formation of General Partnerships***]. For purposes of California taxation, the taxable year of a taxpayer may not be different from the taxable year used for federal purposes, unless initiated or approved by the Franchise Tax Board [*Rev. & Tax. Code § 17565(a)*].

8. Could partnership be classified as corporation for income tax purposes, due to "public trading" of partnership

interests [*I.R.C. § 7704*]?

NOTE:
A publicly traded partnership is classified as a corporation for tax purposes [*I.R.C. § 7704*; ***see*** *I.R.C. § 7704(b)* (definition); ***see also*** P b, ***below***]. For further discussion of *I.R.C. § 7704*, see *§ 16.70*.

a. Are partnership interests traded as follows [*I.R.C. § 7704(b)*]?

NOTE:
Partnership interests are considered "publicly traded" only when transfer occurs under the following circumstances [*I.R.C. § 7704(b)*].

(1) Traded on established securities market [*see* Conf. Rep. No. 100-495, Pub. L. No. 100-495, p. 947 ("established securities market" defined)]; or

(2) Readily tradable on secondary market or its substantial equivalent [*see* Conf. Rep. No. 100-495, Pub. L. No. 100-495, p. 948 (definitions of "readily tradable" and "secondary market")].

b. Does partnership meet either of following criteria [*1988-2 C.B. 386, Notice 88-75*]?

NOTE:
A partnership that does not meet either of these criteria is exempt from application of *I.R.C. § 7704*. In addition, the IRS has specified numerous other exemptions from application of that section [***see*** *Notice 88-75, 1988-2 C.B. 386*].

(1) All of partnership interests were issued in transaction that was registered under Securities Act of 1933 [*see 15 U.S.C. §§ 77a-77aa*]; or

(2) All of partnership interests were issued in transaction that was not registered under Securities Act of 1933, but partnership either:
(a) Has more than 500 partners; or

(b) Offers each unit of partnership interest for less than $20,000.

c. Is partnership electing 1987 partnership [*I.R.C. § 7704(g)*]?

NOTE:
A partnership that qualifies as an electing 1987 partnership [***see*** *I.R.C. § 7704(g)(2)*] is exempt from the application of *I.R.C. § 7704*, but may be subject to additional tax [*I.R.C. § 7704(g)(1), (3)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesFictitious NamesGeneral OverviewBusiness & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsDissolution & Winding UpBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & LiabilitiesContracts LawTypes of ContractsPartnership AgreementsTax LawFederal Taxpayer GroupsLimited Liability

Companies & PartnershipsTax Accounting (IRC secs. 701-703, 706)General Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Procedural Guide

8-16 California Legal Forms--Transaction Guide § 16.111

§ 16.111 Formation of Domestic Limited Partnerships

NOTE:
A "domestic limited partnership" is a limited partnership formed in California [*Corp. Code § 15901.02(q)*]. A "foreign limited partnership" is a limited partnership formed under the laws of a jurisdiction other than California [*Corp. Code § 15901.02(k)*].

1. Select partnership name that meets all statutory criteria.

a. Choose name that is distinguishable in records of Secretary of State from [*Corp. Code § 15901.08(d)*; *see § 16.21[3]*]:

NOTE:
The fact that a partnership name has been reserved or is already in use in California can be ascertained from the office of the Secretary of State by telephone or written inquiry [***see*** paragraph 2, ***below***]. A limited partnership may apply to the Secretary of State for authorization to use a name that does not comply with the above requirements [***see*** *Corp. Code § 15901.08(e)*; ***see also*** *§ 16.21[3]*].

(1) Name of any limited partnership that has previously filed certificate of limited partnership pursuant to *Corp. Code § 15902.01*, or any foreign limited partnership registered pursuant to *Corp. Code § 15909.01*; and

(2) Each name reserved under *Corp. Code § 15901.09*.

b. If desired, include name of any partner [*Corp. Code § 15901.08(a)*].

c. Add either of following to end of name [*Corp. Code § 15901.08(b)*]:

(1) "Limited Partnership"; or

(2) The abbreviation "L.P." or "LP."

d. Do not use words "bank," "insurance," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." [*Corp. Code § 15901.08(g)*].

e. Do not use language prohibited by federal law [*see Ch. 2, Formation of Corporations, § 2.13*].

2. Protect name by obtaining certificate of reservation of that name from Secretary of State [*see Corp. Code § 15901.09*; *see also § 16.210*]:

a. Determine availability of name from office of Secretary of State by:

(1) Telephone: (916) 653-3365; or

(2) Letter, addressed to Secretary of State, Limited Partnership Unit, P.O. Box 944225, Sacramento, CA 94244-2250.

b. Send written request for reservation of name to office of Secretary of State [*see* P a(2), *above*] with required fee [*see Gov. Code § 12188(a)*; *see § 16.260* (official name reservation form)].

c. Do not attempt to reserve name for two or more consecutive 60-day periods.

NOTE:

The Secretary of State will not issue certificates reserving the same name for two or more consecutive 60-day periods to the same applicant or for the use or benefit of the same person [***see*** *Corp. Code § 15901.09(c)*]. If the formation of a limited partnership is not completed within the initial 60-day period, it would appear that another reservation could be made on the sixty-second day, provided the name had not been reserved by someone else on the sixty-first day.

3. Advise partnership to protect its name by one or more of following:

a. Local filing of statement of fictitious business name [*see Bus. & Prof. Code §§ 17900-17930*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*].

b. Registration of trademark or service mark [*see* Ch. 103B, *Trademarks*].

4. Draft, and have all original general and limited partners execute, limited partnership agreement [*Corp. Code § 15902.01*].

NOTE:

Although the ULPA '08 requires a limited partnership to have an agreement, it does not prescribe specific language. It does not even require the partnership agreement to be written [*Corp. Code § 15902.01*; ***see*** *Corp. Code § 15901.02(x)* ("partnership agreement" defined)]. Rather, with certain limited exceptions [*see Corp. Code § 15901.10*; *see also § 16.21[4]*], the ULPA '08 merely states the rules that will apply absent a contrary provision in the agreement. The Client Interview portion of this Transaction

Guide [***see** § 16.100*] indicates what choices are available to the drafter of the agreement. Suggestions for the drafting of a limited partnership agreement are *set forth in § 16.120*; for a limited partnership agreement, see *§ 16.200*.

5. Select agent for service of process to be named in certificate of limited partnership and maintained within California by the partnership [*see Corp. Code §§ 15901.14, 15902.01(a)(3), 15621(a)(4)*; *see also § 16.23[1]*].

NOTE:

After its formation, the limited partnership must continuously maintain, within California, an agent for the service of process [*Corp. Code § 15901.14(a)*]. The name and address of individuals or the name of the corporation designated as the agent for service of process must be included in the certificate of limited partnership [*Corp. Code §§ 15902.01(a)(3), 15901.16(d)*]. If a corporation is designated as agent for service of process, it must file a certificate disclosing the places it can be served with process and the name of each person authorized to accept service of process, among other matters [***see** Corp. Code § 15901.16(d)*; ***see also** Corp. Code § 1505*].

6. Draft and file certificate of limited partnership [*see § 16.210*].

NOTE:

For a detailed guide to drafting and filing a limited partnership certificate, see *§ 16.121*.

7. Pay minimum franchise tax to Franchise Tax Board [*Rev. & Tax. Code § 17935*].

NOTE:

Limited partnerships must pay the minimum franchise tax if they are doing business in California [*Rev. & Tax. Code § 17935(a)*]. Before January 1, 2011, "Doing business" is defined as actively engaging in any transaction for the purpose of financial or pecuniary gain or profit [*Rev. & Tax. Code § 23101(a)*]. For taxable years beginning on or after January 1, 2011, a taxpayer is doing business in California if certain conditions relating to organization, sales, property value, or compensation paid are met [*see Rev. & Tax Code § 23101(b)*; *see also Ch. 12B, Foreign Corporations and Associations, § 12B.31*].

In addition, limited partnerships that have executed, acknowledged, and filed a certificate of limited partnership [***see** Corp. Code § 15902.01*] must pay the minimum franchise tax [*Rev. & Tax. Code § 17935(b)(1)*]. This tax is payable for each taxable year or portion of taxable year, until a certificate of cancellation is filed [*Rev. & Tax. Code § 17935(b)(1)*; ***see** Corp. Code § 15902.03*; ***see also*** Ch. 16A, ***Dissolution of Limited Partnerships***].

The Secretary of State will include with the instructional materials, provided in conjunction with the form for filing a certificate of limited partnership, a notice stating that the filing of a certificate of limited partnership obligates the partnership to pay an annual tax for that taxable year [*Corp. Code § 15902.01(g)*; ***see** Rev. & Tax. Code § 17935*]. The notice will be updated annually to specify the dollar amount of the annual tax [*Corp. Code § 15902.01(g)*].

8. Advise partnership that on receipt of certificate of limited partnership from Secretary of State, it should record certified copy of certificate in office of county recorder of any county in which partnership owns real property [*see Corp. Code § 15902.01(e)*].

NOTE:

The recording creates a conclusive presumption in favor of any bona fide purchaser or encumbrancer for value of the partnership real property that the persons named as general partners are all the general partners, among other matters [*Corp. Code § 15902.01(e)*].

9. Advise partnership to establish (and continuously maintain) within California an office at which partnership records [*see* P 10, *below*] are to be kept [*Corp. Code § 15901.11*].

10. Advise partnership to maintain the following information at its designated office [*Corp. Code § 15901.11*]:

a. Current list, in alphabetical order by name of partners, of each partner's full name and last known street and mailing address.

NOTE:
The list must separately identify the general partners, in alphabetical order, and the limited partners, in alphabetical order [*Corp. Code § 15901.11(1)*].

b. Copy of certificate of limited partnership and:

(1) All amendments to and restatements of certificate.

(2) Executed copies of any powers of attorney pursuant to which any certificate, amendment, or restatement has been executed.

c. Copies of partnership's federal, state, and local income tax returns and reports, if any, for prior six years.

d. Copies of original partnership agreement and all amendments.

e. Partnership financial statements for prior six years.

f. Copy of any filed certificate of conversion or merger.

g. Copy of any record made by partnership during past three years of any consent given by, or vote taken of, any partner.

h. Unless contained in partnership agreement made in record:

(1) Amount of cash, and description and statement of agreed value of other benefits, contributed and agreed to be contributed by each partner;

(2) Times at which or events upon which additional contributions agreed to be made by each partner are to be made;

(3) For person that is both general and limited partner, specification of what transferable interest person owns in each capacity; and

(4) Any events upon which limited partnership will be dissolved and activities wound up.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited

PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & Liabilities



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Procedural Guide

8-16 California Legal Forms--Transaction Guide § 16.112

§ 16.112 Registration of Foreign Limited Partnerships

NOTE:

The laws of the jurisdiction in which the firm was organized govern its organization and affairs and the liability of its limited partners. A foreign limited partnership may not be denied registration in California by reason of any difference between those laws and the law of California [*Corp. Code § 15909.01*].

1. Advise foreign limited partnership that before transacting intrastate business in California, it must register with Secretary of State [*see Corp. Code § 15909.02*].

NOTE:

The term "transacting intrastate business" means entering into repeated and successive transactions of business in California, other than interstate or foreign commerce [*Corp. Code § 15901.02(ai)(1)*; ***see*** *Corp. Code § 15901.02(ai)(2)-(4)*; *see also § 16.51[1][b]*]. The Attorney General may sue to restrain an unregistered foreign limited partnership from transacting intrastate business in California [*Corp. Code § 15909.08*].

2. Advise foreign limited partnership that if its name does not comply with *Corp. Code § 15901.08* [*see § 16.21[3]*], for purposes of transacting business in California it must adopt an alternate name that does comply [*Corp. Code §§ 15909.02(a)(1), 15909.05(a)*].

NOTE:

If a foreign corporation authorized to transact business in California changes its name to one that does not comply with *Corp. Code § 15901.08*, it may not transact business in California until it complies with the above name requirements and obtains an amended certificate of registration [*Corp. Code § 15909.05(b)*].

3. Complete, and have signed and acknowledged by general partner, registration application on form prescribed by Secretary of State [*see § 16.220*], setting forth [*Corp. Code § 15909.02(a)*]:

NOTE:
The partnership must also deliver with the completed application a certificate of existence signed by the official having custody of its publicly filed records in the jurisdiction where the partnership is organized [*Corp. Code § 15909.02(b)*].

a. Name of firm and, if different, name under which it proposes to register and do business in California.

b. Jurisdiction and date of formation.

c. Name and address of agent for service of process [*see Corp. Code § 15909.02(a)(4)*; *see also Corp. Code § 15901.16(d)(1)*].

NOTE:
If the agent for service of process is a corporation, only the corporation's name need be designated. The corporation must file a certificate disclosing the address of each office where service can be made and the name of each person authorized to accept service, among other matters [***see*** *Corp. Code § 15901.16*; ***see also*** *Corp. Code § 1505*].

If a partnership is domiciled outside of California and has no regular place of business within California, it should file a statement of unincorporated association [***see*** *Corp. Code §§ 15800(a), 16309*] designating an agent for service of process (either a natural person or corporation that has filed the certificate required of corporate agents [***see*** *Corp. Code § 1505*]) with the Secretary of State [***see*** *Corp. Code § 18200*].

The Secretary of State will include with the instructional materials, provided in conjunction with the form for filing a certificate of limited partnership, a notice stating that the filing of a certificate of limited partnership obligates the partnership to pay an annual tax for that taxable year [*Corp. Code § 15692(h)*; ***see*** *Rev. & Tax. Code § 17935*]. The notice will be updated annually to specify the dollar amount of the annual tax [*Corp. Code § 15692(h)*].

d. Address of designated office of firm and its principal office in California, if any.

e. Names and business or residence addresses of general partners.

f. Whether foreign limited partnership is foreign limited liability limited partnership.

4. Submit following to Secretary of State, Limited Partnership Unit, P.O. Box 944225, Sacramento, CA 94244-2250:

a. Original application and copies.

NOTE:
The Secretary of State will compare and certify two copies of the certificate without charge [***see*** *Gov. Code § 12185*].

b. Filing fee [*Gov. Code § 12188(c)*].

NOTE:

The Secretary of State may cancel the partnership's application and certificate of registration if the partnership's check or other remittance submitted to pay the filing fee is not honored. On receiving written notification that the check was not honored for payment, the Secretary must give written notice to the partnership's agent for service of process, or to the person who submitted the check, that the application and certificate will be cancelled if payment is not received. If the partnership does not then pay the amount due with a cashier's check or its equivalent, the Secretary must give a second written notice of cancellation, effective on issuance. The second notice must be given at least 20 days after the first notice and no later than 90 days after the original filing [*Corp. Code § 15909.05(c)*].

5. Pay minimum franchise tax to Franchise Tax Board [*Rev. & Tax. Code § 17935*].

NOTE:

Foreign limited partnerships that are doing business or that have registered in California must pay the minimum franchise tax [*Rev. & Tax. Code § 17935(a), (b)(1)*]. Before January 1, 2011, "Doing business" is defined as actively engaging in any transaction for the purpose of financial or pecuniary gain or profit [*Rev. & Tax. Code § 23101(a)*]. For taxable years beginning on or after January 1, 2011, a taxpayer is doing business in California if certain conditions relating to organization, sales, property value, or compensation paid are met [*see Rev. & Tax Code § 23101(b)*; *see also Ch. 12B, Foreign Corporations and Associations, § 12B.31*]. This tax must be paid for each taxable year (or portion of taxable year) until a certificate of cancellation [LP-7] is filed [*Rev. & Tax. Code § 17935(b)(1)*; ***see*** *Corp. Code § 15909.07*; ***see also*** Ch. 16A, ***Dissolution of Limited Partnerships***].

6. Advise partnership that on receipt of certificate of registration from Secretary of State [*see Corp. Code § 15909.04*], it should record certified copy of application for registration and certificate of registration in office of county recorder of any county in which partnership owns real property [*see Corp. Code § 15902.01(e)*].

NOTE:

The recording creates a conclusive presumption in favor of any bona fide purchaser or encumbrancer for value of the partnership real property that the persons named as general partners are all the general partners, among other matters [***see*** *Corp. Code § 15902.01(e)*].

7. Advise partnership that it must file amendment to application for registration, signed and acknowledged by a general partner, in office of Secretary of State [*Corp. Code § 15909.06*; *see § 16.221*]:

a. When any statement made in prior application for registration has become erroneous.

b. If any statement in application for registration was false when made.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsDissolution & Winding UpBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & Liabilities



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Procedural Guide

8-16 California Legal Forms--Transaction Guide §§ 16.113-16.119

[Reserved]

§§ 16.113[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Drafting Guide

8-16 California Legal Forms--Transaction Guide § 16.120

§ 16.120 Provisions for Limited Partnership Agreement

NOTE:

The ULPA '08 grants a considerable latitude to the drafter of a limited partnership agreement. Except as specifically prohibited by the ULPA '08, the partnership agreement governs relations among the partners and between the partners and the partnership. To the extent the agreement does not otherwise provide, the ULPA '08 governs relations among the partners and between the partners and the partnership [*Corp. Code § 15901.10*; *see § 16.21[4][b]* (prohibited provisions); ***see also*** Ballantine & Sterling, California Corporation Laws, Ch. 25, ***Limited Partnerships*** (Matthew Bender)]. For partnerships formed before January 1, 2008, certain provisions of the ULPA '08 will not apply except as the partners otherwise elect in the manner provided in the partnership agreement or by law for amending the partnership agreement [*see Corp. Code § 15912.06(b),(c)*; *see also § 16.11*].

No attempt has been made to incorporate the real estate syndicate rules or any other rules of the California Corporations Commissioner that may require specific provisions to appear in the partnership agreement regardless of the options offered by the CRLPA. For coverage of the real estate syndicate rules, see Chs. 29A, *Joint Ventures* , 29B, *Nonpublic Real Estate Syndicates* , and 29C, *Public Real Estate Syndicates*].

[1] Formation and Organization

1. Begin agreement with preamble setting forth [*see § 16.200[2]*, Preamble]:

a. Names of initial general partners and designation of those persons as general partners.

b. Names of initial limited partners and designation of those persons as limited partners.

c. Assent of those persons to terms set forth in balance of agreement.

2. Set forth agreement of parties to form limited partnership, designated as "the Partnership," pursuant to the Uniform Limited Partnership Act of 2008 [*see § 16.200[2],* P 1.01].

3. State name of partnership [*see § 16.200[2],* P 1.02].

NOTE:
The name of the partnership may include the name of any limited partner [*Corp. Code § 15901.08(a)*].

a. Use name that is distinguishable in records of Secretary of State from [*Corp. Code § 15901.08(d)*]:

NOTE:
A limited partnership may apply to the Secretary of State for authorization to use a name that does not comply with the above [*Corp. Code § 15901.08(e)*; ***see*** *§ 16.21[3]*].

(1) Name of any limited partnership that has previously filed a certificate [*see Corp. Code § 15902.01*] or any registered foreign limited partnership [*see Corp. Code § 15909.01*]; and

(2) Each name reserved under *Corp. Code § 15901.09*.

NOTE:
The name of the partnership may include the name of a partner [*Corp. Code § 15901.08(a)*].

b. Do not use words "bank," "insurance," "trust," "trustee," "incorporated," "inc.," "corporation," or "corp." [*Corp. Code § 15901.08(g)*].

c. Add either of following to end of name [*Corp. Code § 15901.08(b)*]:

(1) "Limited Partnership"; or

(2) The abbreviation "L.P." or LP.

4. Specify type of business partnership will conduct, adding or including related or incidental activities [*see § 16.200[2],* P 1.03].

NOTE:
A California limited partnership may engage in any lawful business activity, whether or not for profit, except the banking business, the business of issuing policies of insurance and assuming insurance risks, or the trust company business [*Corp. Code § 15901.04(b)*].

5. Consider providing that partnership will engage in no other business [*see § 16.200[2],* P 1.03].

6. Specify address of partnership's designated office within California [*see § 16.200[2],* P 1.04]:

a. Include county.

b. State that address may change, as determined from time to time by general partners.

c. Provide for limited partners to be notified of any change of address of designated office.

7. If desired, include term of partnership's existence [*see § 16.200[2]*, P 1.05]:

NOTE:
The ULPA '08 provides that a limited partnership has perpetual duration [***see** Corp. Code § 15901.04(c)*]. This default provision, however, may be changed by the partnership agreement [***see** Corp. Code § 15901.10*]. However, the default provision does not apply to a partnership formed before January 1, 2008 unless the partners otherwise elect [*Corp. Code § 15912.06(c)*; ***see** § 16.20*].

a. Specify that term will commence on specified date or upon filing of certificate of limited partnership.

b. State term, either:

(1) For fixed period of time, sufficiently long to accomplish contemplated project; or

(2) Unlimited or indefinite period, *e.g.*, until dissolution.

8. Include agreement of general partners to execute and file certificate of limited partnership [*see § 16.200[2]*, P 1.06].

9. Include glossary of terms used in agreement [*see § 16.200[2]*, P 1.07].

[2] Partnership Members and Transfers

1. Provide that additional general partners may be admitted after original certificate of limited partnership has been filed, on [*Corp. Code § 15904.01*; *see Corp. Code § 15636(f)*; *see also § 16.200[2]*, P 2.03]:

a. On consent of all partners;

b. As result of conversion or merger;

c. After dissociation of limited partnership's last general partner [*see Corp. Code § 15908.01(c)(2)*; or

d. As otherwise desired.

NOTE:
Corp. Code § 15904.01(a) provides that a person becomes a general partner as provided in the partnership agreement.

For a consent to the admission of an additional general partner and relevant discussion, see *§ 16.241*.

2. Provide for admission of replacement for sole or sole remaining general partner:

NOTE:
A partnership is dissolved 90 days after the dissociation of a person as a general partner if the partnership does not have a remaining general partner, unless before the end of that period consent to continue its

activities and admit at least one general partner is given by limited partners owning a majority of rights to receive distributions as limited partners at the time the consent is to be effective, and at least one person is admitted as a general partner in accordance with the consent [*Corp. Code § 15908.01(c)(2)*].

3. Provide for admission of additional limited partners [*see Corp. Code § 15903.01*; *see also § 16.200[2]*, P 2.05].

NOTE:

A person becomes a limited partner as provided in the partnership agreement, as the result of a conversion or merger, or with the consent of all the partners [*Corp. Code § 15903.01*].

4. Provide for admission of transferees of partnership interests as substituted limited partners, subject to [*Corp. Code §§ 15907.02(h), 15674(a)*; *see § 16.200[2]*, P 2.06, Article 9]:

NOTE:

The transferee of a general partner's or a limited partner's interest in a limited partnership may become a limited partner when (1) the partnership agreement so provides, or (2) all general partners and a majority in interest of the limited partners consent [*Corp. Code § 15907.02(h)*; *see § 16.200[2]*, paragraph 9.03].

a. Other provisions of partnership agreement; or

b. Consent of existing partners.

5. Require general partners to add name, address and contribution for any new partner to records maintained by partnership [*see Corp. Code §§ 15901.11, 15631(b)*; *see also § 16.200[2]*, P 2.07].

6. Provide that any new partner must execute a written agreement to be bound by partnership agreement prior to admission to partnership [*see § 16.200[2]*, P 2.08].

7. If desired, provide for creation of classes of limited partners [*Corp. Code § 15903.07*]:

a. Define rights, powers, and duties of those classes, including rights, powers and duties senior to other classes of limited powers.

b. If desired, provide to all or certain specified classes the right to vote separately or with all or any class or the general partners on any matter.

8. If desired, provide for creation of classes of general partners [*Corp. Code § 15904.09*]:

a. Define rights, powers, and duties of those classes, including rights, powers and duties senior to other classes of general powers.

b. If desired, provide to all or certain specified classes the right to vote separately or with all or any class or the general partners on any matter.

[3] Partnership Finances

1. Set forth initial capitalization of partnership [*see § 16.200[2]*, P 3.01].

NOTE:

In a small limited partnership in which all of the initial general and limited partners are known, the capitalization can be stated simply in terms of dollar amounts [***see*** *§ 16.200[2],* P 3.01]. In more complex partnerships, capitalization is often expressed in terms of partnership units to be sold in return for initial capital contributions by partners [***see*** Chs. 29A, *Joint Ventures* , 29B, *Nonpublic Real Estate Syndicates* , and 29C, *Public Real Estate Syndicates*].

Often, an affiliate, such as the president, of the general partner makes a small contribution (in the more complex partnerships, this will generally be the cost of one limited partnership unit), thereby becoming the original or initial limited partner. He or she then receives that contribution back upon the admission of the first additional limited partner. The general partner may also purchase another class of limited partnership interests or make a contribution giving it a percentage interest in the distributions, income, and losses. In any event, these separate contributions should be indicated either in the agreement or in an attachment to the agreement.

2. Set forth each original partner's initial contribution to partnership of either [*see Corp. Code § 15905.01*; *see also § 16.200[2]*, PP 3.02, 3.03]:

NOTE:

"Contribution," except in the phrase "right of contribution," means any benefit provided by a person to a limited partnership in order to become a partner or in the person's capacity as a partner [*Corp. Code § 15901.02(c)*].

A person admitted to a limited partnership as a partner is not required to make any contribution. However, subject to any provision in the partnership agreement, a partner is not excused from any obligation to contribute money or other property or other benefit to, or to person services for, a limited partnership by reason of the partner's death, disability, or other inability to perform personally [*Corp. Code § 15905.03(a)*].

If an advance ruling from the IRS on the tax status of the partnership is desired [***see*** § 16.113], the general partner or partners must have a 1 percent interest in each material item of partnership income, gain, loss, deduction, or credit. Limited partnership interests owned by a general partner are not counted [*Rev. Proc. 74-17, 1974-1 C.B. 438*].

Special requirements exist for syndicates required to qualify under the Corporate Securities Law of 1968. For coverage of these requirements, see Chs. 29A, *Joint Ventures* , 29B, *Nonpublic Real Estate Syndicates* , and 29C, *Public Real Estate Syndicates* .

a. Money.

b. Property, describing property and indicating agreed upon value.

NOTE:

Property is rarely contributed to a partnership. In most cases, property will be acquired out of partnership assets and loans or will be leased.

c. Services rendered, describing services and indicating agreed upon value.

NOTE:

Services are rarely contributed. In most cases, a separate agreement provides for services in return for stated fees.

d. Promissory note or other obligation to contribute money or property, describing property and indicating agreed upon value.

e. Obligation to render services, describing services and indicating agreed upon value.

3. Consider including provision permitting general partner to make contributions, and share in profits, losses, and distributions, as limited partner [*see Corp. Code § 15901.13*].

NOTE:

If the agreement permits the general partner to participate as a limited partner, that partner's interest as a limited partner must be separately designated in the partnership agreement. One who is both a general and a limited partner has the rights, powers, duties, and obligations provided by the ULPA '08 and the partnership agreement in each capacity. When the person acts as a general partner, the person is subject to the obligations, duties, and restrictions under the ULPA '08 and the partnership agreement for general partners. When the person acts as a limited partner, the person is subject to the obligations, duties, and restrictions under the ULPA '08 and the partnership agreement for limited partners [*Corp. Code § 15901.13*].

The limited partnership interest held by a general partner could be limited by, for example, denying the general partner the right to vote its limited partnership interests on matters such as removing a general partner, particularly if unanimity is required by the agreement. One way of doing this is by creating two classes of limited partnership interests.

4. Include provision for initial capital contribution by future limited partners [*see § 16.200[2],* P 3.04].

5. Consider including provision governing additional contributions by partners, e.g., provision permitting additional voluntary contributions by any limited partner, with or without provision that additional contributions are subject to approval by general partners.

6. Consider provision prohibiting interest on contributions [*see § 16.200[2]*, P 3.05].

NOTE:

If partnership interests are being sold over a period of time and the partnership will not be commenced unless adequate start up capital is contributed, an interest-bearing impound account in which contributions are held would be a standard feature of the partnership agreement. For illustrative provisions, see Chs. 29A, *Joint Ventures* , 29B, *Nonpublic Real Estate Syndicates* , and 29C, *Public Real Estate Syndicates* .

7. Consider including provisions protecting partnership against default of limited partner's promise to make or complete contribution, either:

a. Provision for sale of defaulting limited partner's interest to either another limited partner or general partner; or

b. Provision that obligation of partner to make any contribution may be compromised upon notice of compromise to all existing creditors of partnership, either [*see Corp. Code § 15905.02(c)*; *see also §*

16.250]:

NOTE:

Subject to contrary provisions in the partnership agreement, the obligation of a partner to make a contribution or return money or property distributed in violation of the CRLPA may be compromised only by the written consent of all the partners [*Corp. Code § 15905.02(c)*].

Notwithstanding the compromise of any obligation to contribute to the partnership, a creditor of the partnership which extends credit or otherwise acts in reliance on an obligation described in *Corp. Code § 15905.03(a)* without any notice of any compromise may enforce the original obligation [*Corp. Code § 15905.03(a)*; ***see*** *§ 16.250*].

(1) By written consent of all partners; or

(2) Under specified conditions.

8. If desired, provide that interest of partner who fails to make any contribution or other required payment will be subject to specific remedies for, or specific consequences of, failure [*Corp. Code § 15905.02(d)*; *see § 16.200[2]*, paragraph 3.06]:

NOTE:

A provision will be enforceable in accordance with its terms unless the partner seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the agreement was made rights [*Corp. Code § 15905.02(d)*].

a. Loss of voting, approval, or other rights.

b. Loss of partner's ability to actively participate in management and operations of partnership.

c. Liquidated damages.

d. Reduction of defaulting partner's economic rights, which may include one or more of following [*Corp. Code § 15905.02(d)(1)-(6)*]:

NOTE:

These provisions are not to be construed to affect the rights of third-party creditors of the partnership to seek equitable remedies nor any rights existing under the Uniform Fraudulent Transfer Act [*Corp. Code § 15905.02(d)(7)*; ***see*** *Civ. Code § 3439 et seq.*].

(1) Diluting, reducing, or eliminating defaulting partner's proportionate interest in partnership.

(2) Subordinating defaulting partner's interest in partnership to that of non-defaulting partners.

(3) Permitting forced sale of partnership interest.

(4) Permitting lending or contribution by other partners of amount necessary to meet defaulting partner's commitment.

(5) Adjusting interest rates or other rates of return, preferred, priority, or otherwise, with respect to contributions by or capital accounts of the other partners.

(6) Fixing value of defaulting partner's interest in partnership by appraisal, formula and redemption, or sale of defaulting partner's interest in partnership at percentage of that value.

[4] Allocation and Distribution of Profits and Losses

1. Provide for allocation of partnership profits and losses, either [*see Corp. Code § 15905.035*; *see also § 16.200[2]*, P 4.01]:

NOTE:
The profits and losses must be allocated among the partners in the manner provided in the partnership agreement. If the agreement does not otherwise provide, profits and losses must be allocated in the same manner as the partners share distributions [*Corp. Code § 15905.04*].

a. In the same manner as the partners share distributions; or

b. On any other basis acceptable to parties.

2. Include definition of "net income" and "net loss" [*see § 16.200[2]*, P 1.07(i)].

3. Provide for distribution of partnership profits in terms of cash available for distribution [*see § 16.200[2]*, paragraph 4.02].

NOTE:
A distribution must be shared among the partners on the basis of the value, as stated in the required records when the partnership decides to make the distribution, of the contributions the partnership has received from each partner.

4. Include provision that partners do not have right to receive property other than money upon any distribution [*Corp. Code § 15905.06*; *see § 16.200[2]*, P 4.03].

[5] Management of Partnership Affairs

1. Provide for exercise by general partners only of powers of control and management of partnership affairs [*see § 16.200[2]*, P 5.01].

2. Designate general partners responsible for management, either:

NOTE:

Each general partner has equal rights in the management and conduct of the limited partnership's activities. Except as otherwise provided in the ULPA '08, any matter relating to the activities of the partnership may be exclusively decided by the general partner, or if there is more than one general partner, by a majority of the general partners [*Corp. Code § 15904.06(a)*].

a. Equal responsibility among all general partners [*see § 16.200[2]*, P 5.01];

b. Managing partner;

c. Management committee; or

d. Specific class of general partners, if any.

3. Set forth any desired restrictions on authority of managing partners.

4. Describe power and authority of managing general partners generally, and specifically with regard to [*see § 16.200[2]*, P 5.01]:

a. Acquisition of property for partnership in ordinary course of partnership business.

b. Disposition of partnership property in ordinary course of partnership business.

c. Financing of partnership activities.

d. Employment of agents to facilitate conduct of partnership affairs.

e. Any other action permitted by law and customary in, or reasonably related to, conduct of partnership business or affairs.

5. Include prohibition against exercise of control or management functions by limited partners [*see § 16.200[2]*, P 5.02].

6. Provide for fiduciary duties of general partners [*see § 16.200[2]*, P 5.03].

7. Consider inclusion of provision permitting general partners to act on behalf of partnership in own names or in name of nominee [*see § 16.200[2]*, P 5.04].

8. Consider inclusion of provisions governing dissociation of general partners [*see § 16.200[2]*, P 5.05].

NOTE:

After dissociation, among other things the person's transferable interest is owned by the person as a mere transferee [*Corp. Code § 15906.05(a)(5)*; *see § 16.37[3]*].

9. Consider inclusion of provisions governing dissociation of limited partners [*see § 16.200[2]*, paragraph 5.06].

[6] Books, Records, and Accounts

1. Provide for use of cash or accrual method of accounting [*see § 16.200[2]*, P 6.01(a)].

2. Specify partnership's taxable year [*see I.R.C. §§ 444*, *706*; *see also* Ch. 15, Part A, *Formation of General Partnerships* , § 16.200[2], P 6.01(b)].

NOTE:
Unless the partnership elects a taxable year pursuant to *Internal Revenue Code Section 444*, its taxable year will be determined according to the rules set forth in *Internal Revenue Code Section 706* [***see*** Ch. 15, Part A, ***Formation of General Partnerships***].

3. Include provision requiring general partners to maintain true and proper books, accounts, records, and reports [*see § 16.200[2]*, P 6.02].

4. Include requirement that partnership keep and maintain records required by statute [*see Corp. Code § 15901.11*] in its designated office in California [*see § 16.200[2]*, P 6.03].

NOTE:
For discussion of the types of records a partnership is required by law to keep at an office within California, see *Section 16.23[2]*.

5. Provide that, on 10 days' demand made in record received by limited partnership, limited partner may inspect and copy any of following during regular business hours in partnership's designated office [*Corp. Code § 15903.04(a)*; *see Corp. Code § 15901.11*; *see also § 16.200[2]*, paragraph 6.04]:

NOTE:
The limited partner need not have any particular purpose for seeking this information [*Corp. Code § 15903.04(a)*].

The partnership agreement may not unreasonably restrict the right to information set forth in *Corp. Code § 15903.04*. However, it may impose reasonable restrictions on the availability and use of information obtained, and may define appropriate remedies including liquidated damages for a breach of any reasonable restriction on use [***see*** *Corp. Code § 15901.10(b)(4)*].

a. Current list of partners' names and addresses.

b. Copy of initial certificate of limited partnership and all amendments and restatements, and any powers of attorney pursuant to which any certificate was executed.

c. Copy of partnership agreement and all amendments.

d. Copy of any filed certificate of conversion or merger.

e. Copy of limited partnership's federal, state, and local income tax returns and reports, if any, for six most recent years.

f. Copy of any financial statement of limited partnership for six most recent years.

g. Copy of any record made by partnership during past three years of consent given by or vote taken of any partner pursuant to ULPA '08 or partnership agreement.

h. Unless contained in partnership agreement made in record:
(1) Amount of cash, and description and statement of agreed value of other benefits, contributed and agreed to be contributed by each partner;

(2) Times at which or events upon which additional contributions agreed to be made by each partner are to be made;

(3) For person that is both general and limited partner, specification of what transferable interest person owns in each capacity; and

(4) Any events upon which limited partnership will be dissolved and activities wound up.

6. Set forth right of each limited partner to obtain from partnership true and full information regarding state of activities and financial condition of partnership, and other information regarding its activities as is just and reasonable, under following circumstances [*Corp. Code § 15903.04(b)*; *see § 16.200[2],* P 6.05]:

a. Information must be obtained during regular business hours.

b. Information must be obtained at reasonable location specified by partnership.

c. Information may be transmitted via electronic transmission.

d. Limited partner must seek information for purpose reasonably related to interest as limited partner.

e. Demand must be in record received by partnership, describing with reasonable particularity:

(1) Information sought; and

(2) Purpose for seeking information.

f. Information sought must be directly connected to limited partner's purpose.

7. Require partnership, within 10 days after receiving demand under paragraph 6, above, to inform partner who made demand [*Corp. Code § 15903.04(c)*; *see § 16.200[2],* paragraph 6.06]:

a. What information partnership will provide in response.

b. When and where partnership will provide information.

c. Reasons for declining to provide any demanded information.

8. Provide that general partner may inspect and copy during regular business hours [*Corp. Code § 15904.07(a)*; *see § 16.200[2]*, paragraph 6.07]:

NOTE:

The partner need not have any particular purpose for seeking this information [*Corp. Code § 15904.07(a)*].

The partnership agreement may not unreasonably restrict the right to information set forth in *Corp. Code § 15904.07*. However, it may impose reasonable restrictions on the availability and use of information obtained, and may define appropriate remedies including liquidated damages for a breach of any reasonable restriction on use [***see*** *Corp. Code § 15901.10(b)(4)*].

a. Required information, in limited partnership's designated office.

b. Any other records maintained by partnership regarding its activities and financial conditions, at reasonable locations specified by partnership.

9. Provide that limited partnership must furnish to general partner [*Corp. Code § 15904.07(b)*); *see § 16.200[2]*, paragraph 6.08]:

NOTE:
This information may be transmitted via electronic transmission [*Corp. Code § 15904.07(b)*; ***see*** *Corp. Code § 15901.02(h), (i)* (definition)].

a. Without demand, any information concerning partnership's activities reasonably required for proper exercise of general partner's rights and duties under partnership agreement or ULPA '08.

b. On demand, any other information concerning partnership's activities, unless demand or information demanded is unreasonable or improper under circumstances.

10. Consider requiring partnership to send each partner copy of partnership's federal, state, and local income tax or information return for taxable year [*see § 16.200[2]*, paragraph 6.09].

11. Define and provide for establishment of capital accounts for each partner [*see Corp. Code § 15611(b)*; *see also § 16.200[2]*, P 6.10].

12. Provide for establishment of income accounts for each partner [*see § 16.200[2]*, P 6.11].

13. Provide for establishment of partnership bank accounts [*see § 16.200[2]*, P 6.12].

[7] Rights, Powers, and Duties of, and Restrictions on, Partners

1. Grant general partners full and exclusive charge and control of management, conduct, and operation of partnership [*see § 16.200[2]*, P 7.01].

2. Cover obligation of general partners to devote time and attention to affairs of partnership, either [*see § 16.200[2]*, P 7.02]:

a. Undivided time and attention, without engaging in any other business; or

b. All time needed to conduct affairs of partnership efficiently with right of general partner to manage other businesses.

3. Provide for voting rights of general partners [*see § 16.200[2],* P 7.03].

4. Consider providing that general partners have all rights and powers of and are subject to all restrictions imposed on general partners under ULPA '08 [*see § 16.200[2],* P 7.04].

5. Provide for salaries to general partners and deductibility of those salaries as ordinary and necessary business expenses [*see § 16.200[2],* P 7.05].

6. Provide for voting rights of limited partners [*see § 16.200[2],* P 7.06].

7. Consider including provisions governing right of any partner to [*Corp. Code § 15901.12*]:

NOTE:
a partner has the same rights and obligations with respect to the loan or other transaction as a person that is not a partner [*Corp. Code § 15901.12*].

a. Lend money to partnership [*see § 16.200[2],* P 7.07].

b. Transact other business with partnership [*see § 16.200[2],* P 7.08].

8. Include provision governing right of any partner to engage in other business [*see § 16.200[2],* P 7.09].

9. Consider including provisions governing rights, powers, and duties of partners in event of merger [*see* Ch. 16B, *Mergers of Limited Partnerships*].

10. Consider including provisions specifying dissenting rights of limited partners pursuant to merger [*see* Ch. 16B, *Mergers of Limited Partnerships*].

[8] Meetings of Partners

NOTE:
Unlike prior limited partnership law [***see, e.g.,*** *Corp. Code § 15637* (CRLPA, repealed January 1, 2010)], the ULPA '08 does not require or set forth default provisions regarding partnership meetings. It does provide that action requiring the consent of partners under it may be taken without a meeting, and that a partner may appoint a proxy to consent or otherwise act for the partner by signing an appointment record, either personally or by the partner's attorney-in-fact [*Corp. Code § 15901.15*]. Limited partnerships with some size or complexity may want to provide for meetings and voting to efficiently conduct their business [***see*** Ballantine & Sterling, California Corporation Laws, Ch. 25, ***Limited Partnerships*** , § 732.01[2] (Matthew Bender)]. For those partnerships, the provisions below are suggestions regarding possible topics to include.

1. Include provision for call of meeting by and at written request of general partner or limited partners holding more than 10 percent of limited partnership interests [*see Corp. Code § 15637(b), (c)(3)*; *see also § 16.200[2],* P 8.01].

2. Specify method of setting record date for determining partners entitled to notices of meetings and right to vote, or right to take any other lawful action as of record date [*see § 16.200[2]*, PP 13.01, 13.03].

3. Include provision requiring general partners to send all partners notice of meeting setting forth [*see § 16.200[2]*, P 8.02]:

a. Description of matters to be covered at meeting.

b. Place, date, and hour of meeting.

c. Means by which notice is to be given.

4. Specify what constitutes a quorum and consequences of withdrawal of sufficient partners to leave less than quorum [*see* § 16.200[2], P 8.03].

5. Include provisions for adjournment of meeting [*see Corp. Code § 15637(d), (h)(3)*; *see also § 16.200[2]*, P 8.04].

6. Include provisions regularizing meeting not duly called, noticed, or held by providing for waiver of notice or consent to holding of meeting if quorum is present [*see § 16.200[2]*, P 8.05].

7. Set forth rules governing waiver of notice [*see § 16.200[2]*, P 8.06].

8. Consider including provision for actions by partners by written consent without meeting [*see Corp. Code § 15901.15*; *see also § 16.200[2]*, P 8.07].

9. Provide for use of proxies [*see Corp. Code § 15637(j)*; *see also § 16.200[2]*, P 8.08].

[9] Transfer of Partnership Interests

NOTE:
Provisions for the admission of new partners are included in Form 16.200[2], Article 2, "Members of Partnership" [***see** § 16.120[2]*].

1. Consider including provision prohibiting transfer of limited partnership interests, except [*see Corp. Code § 15907.02*]:

NOTE:
Unless otherwise provided [***see** Corp. Code § 15901.10*; § 16.21[4]], transfer of a partner's transferable interest [***see** Corp. Code §§ 15901.02(ak), 15907.01* (definition)] in whole or part is permissible, and does not by itself cause the partner's dissociation or a dissolution and winding up of the limited partnership's activities [*Corp. Code § 15907.02(a)(1),(2)*]. Such a transfer does not, as against the other partners or the limited partnership, entitle the transferee to participate in the management or conduct of the limited partnership's activities, to require access to information concerning the limited partnership's transactions except as provided in *Corp. Code § 15907.02(c)* (accounting upon dissolution and winding up) [***see** § 16.38*], or to inspect or copy the required information or the

limited partnership's other records or to exercise any other rights or powers of a partner [*Corp. Code § 15907.02(a)(3)*]. A transferee has a right to receive, in accordance with the transfer, distributions to which the transferor would otherwise be entitled [*Corp. Code § 15907.02(b)*]. Upon transfer, the transferor retains the rights of a partner other than the interest in distributions transferred, and retains all duties and obligations of a partner [*Corp. Code § 15907.02(d)*]. A limited partnership need not give effect to a transferee's rights until the limited partnership has notice of the transfer [*Corp. Code § 15907.02(e)*]. A transfer of a transferable interest in violation of a restriction on transfer in the partnership agreement is ineffective as to a person having notice of the restriction at the time of transfer [*Corp. Code § 15907.02(f)*].

If the partnership is subject to the jurisdiction of the Commissioner of Corporations with regard to its offering of limited partnership interests, restrictions on assignment of those interests will not be allowed. Moreover, restrictions on the substitution of a limited partner are generally disfavored and will be allowed only to the extent necessary to preserve the tax status of the partnership and any restriction must be supported by opinion of counsel [***see** 10 Cal. Code Reg. § 260.140.116.7*].

a. As provided elsewhere in partnership agreement [*see § 16.200[2],* P 9.01; *see also § 16.200[2],* P 9.02 for permitted transfers]; or

b. Upon consent of all general partners and majority in interest of limited partners.

NOTE:
A transferee of a partnership interest, including a transferee of a general partner, may become a limited partner if and to the extent that the partnership agreement provides, or all general partners and a majority in interest of the limited partners consent [*Corp. Code § 15907.02(h)*].

2. If agreement includes provisions governing transfer of partnership interest [*see Corp. Code § 15907.02*; *see also § 16.200[2],* P 9.02]:

a. Consider advance notice to general partners of receipt of offer for purchase of partner's interest and opportunity for them to purchase.

b. Consider providing opportunity for other partners to purchase, in event general partners fail to exercise option to purchase.

c. Include provision outlining rights and obligations of transferor and transferee of interest.

3. Include provisions for conditions under which transferee of limited partnership interest may become a partner [*see Corp. Code § 15907.02(g),(h)*; *see also § 16.200[2],* paragraph 9.03].

4. Include provisions regarding exercise of rights by deceased partner's representative [*see Corp. Code § 15907.04*; *see also § 16.200[2],* paragraph 9.04].

NOTE:
Under these circumstances, absent provision to the contrary in the partnership agreement, the partner's personal representative or other legal representative may exercise the rights of a transferee [*see Corp.*

Code § 15907.02; *see also § 16.38[3]*], and for the purposes of settling the estate may exercise the rights of a current limited partner under *Corp. Code § 15903.04* [*Corp. Code § 15907.04*; *see § 16.38[4]*].

[10] Liabilities of Partners

1. Provide for joint and several liability of all general partners for all obligations of limited partnership [*see § 16.200[2]*, P 10.01].

NOTE:
This liability exists by default under the ULPA '08 unless otherwise agreed by the claimant or provided by law [*Corp. Code § 15904.04(a)*]. A person who becomes a general partner of an existing limited partnership is not personally liable for an obligation of a limited partnership incurred before the person became a general partner [*Corp. Code § 15904.04(b)*].

2. Limit liability of limited partners to partnership to amount of capital contributions and any loans [*see § 16.200[2]*, P 10.02].

3. Provide for partnership's liability for following actions of general partners [*see* Form 16.200[2], paragraph 10.03]:

a. For loss or injury caused to person, or penalty incurred, as result of wrongful act or omission or other actionable conduct of general partner acting in ordinary course of activities of partnership, or with authority of partnership [*Corp. Code § 15904.03(a)*].

b. For loss if, in course of partnership's activities or while acting with authority of partnership, general partner receives or causes partnership to receive money or property of person not a partner and misapplies it [*Corp. Code § 15904.03(b)*].

[11] Prohibited Transactions

1. Include provisions prohibiting any partner from doing any of following acts and stating promise of each partner not to do any such acts [*see § 16.200[2]*, P 11.01]:

a. Using partnership name or substantially similar name, or any trademark or trade name adopted by partnership, except in ordinary course of partnership business.

b. Disclosing to nonpartners any partnership business practice, trade secrets, or other information not generally known.

c. Acting with intent to harm partnership business operations.

d. Doing any act contrary to partnership agreement, without prior express written approval of all partners.

e. Doing any act that would make it impossible to carry on partnership business.

f. Confessing judgment against partnership.

g. Abandoning, wrongfully transferring, or disposing of partnership property.

2. Set forth prohibition against use by general partners of partnership assets for any purpose other than conducting partnership business and include promise of general partners not to do so [*see § 16.200[2],* P 11.02].

[12] Dissolution of Partnership

1. Set forth time when, or events on which, partnership will be dissolved and its affairs wound up, e.g.:

NOTE:
The ULPA '08 provides that a limited partnership has a perpetual duration [*Corp. Code § 15901.04(b)*; ***see*** *§ 16.20[1]*]. This provision is a "default" provision; it may be changed in a partnership agreement to specify some other duration [***see*** *Corp. Code § 15901.10(b)*]. Even if the default rule is not changed in the agreement, a limited partnership can be terminated by winding up and dissolution and by other events [***see*** Ballantine & Sterling, California Corporation Laws, Ch. 25, ***Limited Partnerships*** , § 727 (Matthew Bender)].

a. On expiration of term set forth in agreement for existence of partnership [*see Corp. Code § 15908.01(a)*; *see also § 16.200[2],* P 12.01].

b. Upon written consent of any specified percentage of general and limited partners [*see Corp. Code § 15908.01*; *see also § 16.200[2],* P 12.02].

c. After dissociation of person as general partner, if [*Corp. Code § 15908.01(c)*; *see § 16.200[2],* paragraph 12.03]:
(1) Partnership has at least one remaining general partner, and consent to dissolve is given within 90 days after dissociation by partners owning majority of rights to receive distributions as partners at time consent is to be effective; or

(2) If partnership does not have remaining general partner, passage of 90 days after dissociation, unless before end of period:
(a) Consent to continue activities of partnership and admit at least one general partner is given by limited partners owning majority of rights to receive distributions as limited partners at time consent is to be effective; and

(b) At least one person is admitted as general partner in accordance with consent.

d. Passage of 90 days after dissociation of partnership's last limited partner, unless before end of period limited partnership admits at least one limited partner [*Corp. Code § 15908.01(d)*; *see § 16.200[2],* paragraph 12.03].

e. Upon happening of event specified in agreement [*Corp. Code § 15908.01(a)*; *see § 16.200[2],* paragraph 12.04]

f. When court orders partnership dissolved [*Corp. Code § 15908.02*; *see § 16.200[2],* paragraph 12.05; *see also* Ch. 16A, *Dissolution of Limited Partnerships*].

NOTE:
The partnership agreement may not eliminate the power of a court to decree dissolution in these circumstances [*Corp. Code § 15901.10(b)(9)*].

2. Designate partner responsible for winding up affairs of dissolved partnership [*see Corp. Code § 15908.03(c)*; *see also § 16.200[2]*, P 12.06].

3. Prescribe procedure for liquidation of partnership assets, winding up partnership affairs, and distributions [*see Corp. Code § 15908.09*; *see also § 16.200[2]*, P 12.07].

4. Consider including provision prohibiting dissolution in event:

a. Limited partner withdraws from partnership [*see Corp. Code § 15906.01*].

b. Any partner seeks payment of debts owing by partnership.

5. Consider including provisions for filing of certificate of cancellation of certificate of limited partnership [*Corp. Code § 15902.03*; *see § 16.200[2]*, P 12.09].

6. Consider including provision for reasonable compensation to be paid to limited partners winding up partnership affairs [*Corp. Code § 15908.03(e)*; *see § 16.200[2]*, Paragraph 12.09].

[13] Record Dates

1. Specify method by which partners may set record date for purpose of partnership meetings (if meetings are permitted by partnership agreement) [*see § 16.200[2]*, P 13.01].

2. Specify method by which partners may set record date for distributions [*see § 16.200[2]*, P 13.02].

3. Provide method for determining record dates in absence of action by partners setting any record dates [*see § 16.200[2]*, P 13.02].

[14] Miscellaneous Provisions

1. Specify that partnership agreement contains entire agreement of parties [*see § 16.200[2]*, P 14.01].

2. Specify method of amending agreement [*see § 16.200[2]*, P 14.02].

NOTE:
The consent of each partner is necessary to amend the partnership agreement [*Corp. Code § 15904.06(b)*].

3. Provide for attorneys' fees in actions for declaratory or injunctive relief or for interpretation of agreement [*see § 16.200[2]*, P 14.03].

4. Specify that California law governs [*see § 16.200[2]*, P 14.04].

NOTE:

A partnership agreement may not vary the law applicable to a limited partnership under Corp. Code § 15901.01 [*Corp. Code § 15901.10(b)(2)*]. A general partner may, in a written partnership agreement or other writing, consent to be subject to the nonexclusive jurisdiction of the courts of a specified jurisdiction, or the exclusive jurisdiction of the California courts [*Corp. Code § 15901.17*]. A partner may consent to be served with legal process in the manner prescribed in the agreement or other writing [*Corp. Code § 15901.17*].

5. Provide for arbitration, if desired.

NOTE:

A general partner desiring to use the arbitration process may, in a written partnership agreement or other writing, consent to be nonexclusively subject to arbitration in a specified state, or exclusively subject to arbitration in California [*Corp. Code § 15901.17*].

6. Provide for written notice and delivery by regular mail to partners at addresses shown in partnership records [*see § 16.200[2],* P 14.05].

7. Provide that agreement is binding on partners and their successors [*see § 16.200[2],* P 14.06].

8. Provide for severability of invalid provisions [*see § 16.200[2],* P 14.07].

9. Provide for consent of spouses [*see § 16.200[2],* P 14.08].

10. Include provision under which general partners may elect to adjust basis of partnership property in event of transfer of interests of limited partners [*see I.R.C. § 754*; *see also § 16.200[2],* P 14.09].

11. Permit use of counterparts [*see § 16.200[2],* P 14.10].

12. Exclude headings from terms of agreement [*see § 16.200[2],* P 14.11].

13. Include covenant of cooperation in execution of necessary documents [*see § 16.200[2],* P 14.12].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesRequirementsBusiness & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsDissolution & Winding UpBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & Liabilities



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Drafting Guide

8-16 California Legal Forms--Transaction Guide § 16.121

§ 16.121 Limited Partnership Certificates

[1] Certificate of Limited Partnership

1. Include all of following mandatory information on form prescribed by Secretary of State [*Corp. Code § 15902.01(a)(1)-(4)*; *see § 16.210[2]*, PP 1-8]:

a. Name of limited partnership.

b. Address of partnership's initial designated office office.

c. Names and addresses of all general partners.

d. Agent for service of process, either:
(1) Name and address of individual agent for service of process; or

(2) Name of corporate agent for service of process.

e. If partnership was formed under ULPA, date, location, and file number of recorded certificate.

2. State number of general partners whose acknowledgment is required for filing certificates of amendment etc. [*see Corp. Code § 15902.04*; *see also § 16.210[2]*, P 8].

NOTE:
Although this information is not required by statute, it is required by the Secretary of State's mandatory form.

3. Set forth any other information that the person filing the certificate determines to include [*Corp. Code § 15902.01(b)*;

see § 16.210[2], P 9].

NOTE:

Although the certificate may contain matters not mentioned in the statute, even nonessential information, once included, will require an amendment of the certificate if that information becomes obsolete [*see Corp. Code § 15902.02*].

4. Have certificate of limited partnership

NOTE:

If a person required to sign or deliver a record to the Secretary of State for filing does not do so, any other person that is aggrieved may petition the superior court to order the person to sign or deliver the record, or for the Secretary to file the record unsigned [*Corp. Code § 15902.05(a)*].

a. Signed by all general partners listed in the certificate [*Corp. Code § 15902.04(a)(1)*];

b. Caused to be signed by purported limited partner [*see Corp. Code § 15903.06(a)(1)*].

NOTE:

A person believing erroneously but in good faith that he or she has become a limited partner after making an investment in a business enterprise may cause an appropriate certificate to be signed and delivered to the Secretary of State [*Corp. Code § 15903.06(a)(1)*].

c. Signed by attorney-in-fact of any person required or permitted to execute a certificate [*Corp. Code § 15902.04*]; or

5. Mail certificate to Secretary of State, Limited Partnership Unit, P.O. Box 944225, Sacramento, CA 94244-2250 [*Corp. Code § 15902.01*].

NOTE:

A limited partnership is formed at the time the certificate is filed in the office of the Secretary of State [*Corp. Code § 15902.01(c)*].

A limited partnership that is defectively formed due to its failure to file a certificate of limited partnership may be treated as a general partnership [***see*** *American Alternative Energy v. Windridge, Inc. (1996) 42 Cal. App. 4th 551, 560-562, 49 Cal. Rptr. 2d 686* (noncompliance with certificate requirement rendered entity a general partnership with capacity to sue)].

a. File original and at least two copies.

NOTE:

The Secretary of State will compare and certify two copies of the certificate without charge [***see*** *Gov. Code § 12185*].

b. Accompany certificate with filing fee [*see Gov. Code § 12188(b)*].

NOTE:

The Secretary of State may cancel the filing of the certificate if the partnership's check or

other remittance submitted to pay the filing fee is not honored. On receiving written notification that the check was not honored for payment, the Secretary must give written notice to the partnership's agent for service of process, or to the person who submitted the check, that the filing will be canceled if payment is not received. If the partnership does not then pay the amount due with a cashier's check or its equivalent, the Secretary must give a second written notice of cancellation, effective immediately. The second notice must be given at least 20 days after the first notice and no later than 90 days after the original filing [*Corp. Code § 15902.01(f)*].

6. If date of filing other than date of receipt by Secretary of State is desired, specify effective date [*Corp. Code § 15902.06(b)*].

NOTE:

Except as otherwise provided [***see*** *Corp. Code §§ 15901.16*, *15902.01*, and *15902.07*], a record delivered to the Secretary of State for filing under the ULPA '08 may specify an effective time and delayed effective date. Such a record is effective on the earlier of the specified date or the 90th day after the record is filed [*Corp. Code § 15902.06(b)*; ***see*** *§ 16.21[2][b][iii]*].

7. Record certified copy of certificate of limited partnership in office of county recorder of any county in which partnership has real property [*see Corp. Code § 15902.01(e)*].

NOTE:

Recording is not mandatory. However, recording creates a conclusive presumption in favor of any bona fide purchaser or encumbrancer for value of partnership real property in the county where the certificate is recorded that the persons named as general partners in the certificate are all of the general partners, among other matters [***see*** *Corp. Code §§ 15902.01(e)*].

[2] Certificate of Amendment to Certificate of Limited Partnership

NOTE:

The general partners may file a restated certificate of limited partnership that embodies in a single certificate all of the operative and effective provisions contained in various certificates of amendment that have been filed with the Secretary of State [*Corp. Code § 15902.02(e)(1)*]. The restated certificate may also include an amendment that has not been filed, and replaces the initial certificate and all previously filed amendments [*Corp. Code § 15902.02(e)(2), (3)*; ***see*** *Corp. Code § 15902.02(e)(4)*; ***see also*** *Corp. Code § 15902.04(a)(5)* (execution requirements)]. For further discussion, see [3], ***below***.

1. Include all information indicated on form prescribed by Secretary of State [*Corp. Code § 15902.02(a)*; *see § 16.211*]:

a. File number assigned to limited partnership by Secretary of State [*Corp. Code § 15902.02(a)(1)*].

b. Name of limited partnership [*Corp. Code § 15902.02(a)(1)*].

c. Changes the amendment makes to the certificate as most recently amended or restated [*Corp. Code § 15902.02(a)(2)*].

2. Have certificate of amendment signed as follows [*Corp. Code § 15902.04(a)*]:

a. Amendment designating as general partner person admitted under *Corp. Code § 15908.01(c)(2)* following dissociation of limited partnership's last general partner [*see § 16.36*] must be signed by that person admitted as general partner [*Corp. Code § 15902.04(a)(2)*].

b. Amendment required by *Corp. Code § 15908.03(c)* following appointment of person to wind up dissolved limited partnership's activities [*see* Ch. 16A, *Dissolution of Limited Partnerships*] must be signed by that person [*Corp. Code § 15902.04(a)(3)*].

c. Any other amendment must be signed by:
(1) At least one general partner listed in certificate of limited partnership;

(2) Each other person designated in amendment as new general partner; and

(3) Each person that the amendment indicates has dissociated as general partner, unless (1) the person is deceased or a guardian or general conservator has been appointed for the person and the amendment so states; or (2) the person has previously delivered a certificate of dissociation to the Secretary of State for filing.

d. Any person may sign by attorney in fact [*Corp. Code § 15902.04(b)*]

3. Instruct general partners to file certificate of amendment promptly, to reflect [*Corp. Code § 15902.02(b)*]:

a. Admission of new general partner.

b. Dissociation of person as general partner.

c. Appointment of person to wind up limited partnership's activities under *Corp. Code § 15908.03(c),(d)* [*see* Ch. 16A, *Dissolution of Limited Partnerships*].

NOTE:
As a precautionary measure, any time anything in the certificate becomes inaccurate, the certificate should be amended.

4. File certificate of amendment:

a. In office of Secretary of State Limited Partnership Division, P.O. Box 944225, Sacramento, CA 94244-2250 [*Corp. Code § 15902.02(a)*].

b. In original and at least two copies.

NOTE:
The Secretary of State will compare and certify up to two copies without additional charge [***see*** *Gov. Code § 12185*].

c. Accompanied by filing fee [*see Gov. Code § 12188(d)*].

5. If desired, specify delayed effective date [*Corp. Code § 15902.06(b)*].

NOTE:

Except as otherwise provided [***see*** *Corp. Code §§ 15901.16, 15902.01,* and *15902.07*], a record delivered to the Secretary of State for filing under the ULPA '08 may specify an effective time and delayed effective date. Such a record is effective on the earlier of the specified date or the 90th day after the record is filed [*Corp. Code § 15902.06(b)*; ***see*** *§ 16.21[2][b][iii]*].

6. Record certificate of amendment in office of county recorder of any county in which partnership has real property [*see Corp. Code § 15902.01(e)*].

NOTE:

Although recordation is not required [***see*** *Corp. Code § 15902.01(e)*] it is recommended as a method of protecting title to real property.

7. File following in partnership office in California where its records are maintained [*Corp. Code § 15901.11(2)*]:

a. Copy of certificate of amendment.

b. Executed copy of each power of attorney pursuant to which any certificate was executed.

[3] Restated Certificate of Limited Partnership

NOTE:

In lieu of filing a certificate of amendment [***see*** [2], ***above***], a restated certificate of limited partnership may be filed. The restated certificate embodies in a single certificate all of the operative and effective provisions contained in the various certificates that have been filed with the Secretary of State [*Corp. Code § 15902.02(e)(1)*]. The restated certificate may also include an amendment that has not been filed; it replaces the initial certificate and all previously filed amendments [*Corp. Code § 15902.02(e)(2)*; ***see*** *Corp. Code § 15902.02(e)(4)*; ***see also*** Corp. Code § 1502.04(a)(5) (execution requirements)].

1. Include all information indicated on form prescribed by Secretary of State [*Corp. Code §§ 15902.02(e)(1)*; *see § 16.212*].

2. Include text of any new amendment [*see Corp. Code § 15902.02(e)(2)*; *see also § 16.212[2]*].

3. Have restated certificate of limited partnership signed [*Corp. Code § 15902.04(a)(5)*]:

a. By at least one general partner.

b. To extent certificate effects change requiring another signature [*see Corp. Code § 15902.04(a)*], in manner satisfying requirements for that change.

4. File restated certificate:

a. In office of Secretary of State Limited Partnership Division, P.O. Box 944225, Sacramento, CA 94244-2250 [*Corp. Code §§ 15902.02(e), 15902.06(a)*].

b. In original and at least two copies.

NOTE:
The Secretary of State will compare and certify up to two copies without additional charge [***see*** *Gov. Code § 12185*].

c. Accompanied by filing fee [*see Gov. Code § 12188(e)*].

5. If desired, specify delayed effective date [*Corp. Code § 15902.06(b)*].

NOTE:
Except as otherwise provided [***see*** *Corp. Code §§ 15901.16, 15902.01,* and *15902.07*], a record delivered to the Secretary of State for filing under the ULPA '08 may specify an effective time and delayed effective date. Such a record is effective on the earlier of the specified date or the 90th day after the record is filed [*Corp. Code § 15902.06(b)*; ***see*** *§ 16.21[2][b][iii]*].

6. Record restated certificate in office of county recorder of any county in which partnership has real property [*see Corp. Code § 15902.01(e)*].

NOTE:
Although recordation is not required [***see*** *Corp. Code § 15902.01(e)*] it is recommended as a method of protecting title to real property.

7. File following in partnership office in California where its records are maintained [*Corp. Code § 15901.11(2)*]:

a. Copy of restated certificate.

b. Executed copy of each power of attorney pursuant to which any certificate was executed.

[4] Certificate of Correction

NOTE:
A limited partnership or foreign limited partnership may deliver to and on a form prescribed by the Secretary of State for filing a certificate of correction to correct a record previously delivered by the limited partnership or foreign limited partnership to the Secretary and filed by the Secretary, if at the time of filing the record contained false or erroneous information or was defectively signed [*Corp. Code § 15902.07(a)*; ***see*** *§ 16.22[3]*].

1. Include following information [*Corp. Code § 15902.07(b)*]:

a. Describe record to be corrected, including its filing date and file number.

b. Specify incorrect information and reason it is incorrect or the manner in which signing was defective.

c. Correct incorrect information or defective signature.

2. Do not state delayed effective date [*Corp. Code § 15902.07(b)*].

3. Upon filing, certificate is effective [*Corp. Code § 15902.07(c)*]:

a. Retroactively as of effective date of record that certificate corrects.

b. When filed:
(1) For purposes of *Corp. Code § 15901.03(c)* and *(d)* (notice of facts) and;

(2) As to persons relying on uncorrected record and adversely affected by correction [*Corp. Code § 15902.07(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawLimited PartnershipsDissolution & Winding UpBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Drafting Guide

8-16 California Legal Forms--Transaction Guide §§ 16.122-16.199

[Reserved]

§§ 16.122[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
A. Limited Partnership Agreements

8-16 California Legal Forms--Transaction Guide § 16.200

§ 16.200 Limited Partnership Agreement--General Form

[1] Comment

[a] Use of Form

This form is a partnership agreement governing a relatively small, privately owned limited partnership to be formed under ULPA '08 [*Corp. Code §§ 15900-15912.07*]. It is designed for use by persons who have already decided to become partners and do not currently contemplate the addition of new limited partners to obtain additional capital.

Although the ULPA '08 requires that the partners enter into a limited partnership agreement [*Corp. Code § 15902.01(a)*; *see* [d], *below*], the agreement need not be as long or as complex as this form since the ULPA '08 provides numerous rules that will apply unless the partnership agreement provides to the contrary. However, even when the drafter of the partnership agreement wishes to follow the statutory requirements, it is good practice to include them in the agreement in any case, both as an easy reference and because the law may be amended in a manner not anticipated by the partners or their counsel.

For a detailed guide to the statutory provisions that apply in the absence of provisions in the agreement to the contrary and alternate suggestions for the drafting of a limited partnership agreement, see *§ 16.120*.

For additional limited partnership agreements for use by limited partnerships that intend to make public or private offerings conforming to federal and California securities laws, see Chs. 29B, *Nonpublic Real Estate Syndicates* , and 29C, *Public Real Estate Syndicates* .

[b] Variation of the Effect of ULPA '08 Provisions

Except as provided below, the partnership agreement governs relations among the partners and between the partners and the partnership. To the extent the partnership agreement does not otherwise provide, the ULPA '08 governs relations among the partners and between the partners and the partnership [*Corp. Code § 15901.10(a)*].

A partnership agreement may not do any of the following [*Corp. Code § 15901.10(b)*]:

- Vary a limited partnership's power under *Corp. Code § 15901.05* to sue, be sued, and defend in its own name.

- Vary the law applicable to a limited partnership under *Corp. Code § 15901.06* [*see § 16.14*].

- Vary the requirements of *Corp. Code § 15902.04* (signature requirements for filed "records").

- Vary the information required by *Corp. Code § 15901.11* (information required to be retained at limited partnership's designated office) [*see § 16.23[2]*] or unreasonably restrict the right to information under *Corp. Code § 15903.04* (limited partners) [*see § 16.30[1]* or *Corp. Code § 15904.07* (general partners) [*see § 16.34[4]*]. However, the partnership agreement may impose reasonable restrictions on the availability and use of information obtained under those sections and may define appropriate remedies, including liquidated damages, for a breach of any reasonable restriction on use.

- Eliminate the duty of loyalty under *Corp. Code § 15904.07* [*see § 16.35[2]*], but the partnership agreement may: (a) identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; and (b) specify the number or percentage of partners which may authorize or ratify, after full disclosure to all partners of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty.

- Unreasonably reduce the duty of care under *Corp. Code § 15904.08(a)* [*see § 16.35[2]*].

- Eliminate the obligation of good faith and fair dealing of limited partners under *Corp. Code § 15903.05(b)* [*see § 16.32[2]*] and of general partners under *Corp. Code § 15904.08(d)* [*see § 16.35[2]*]. However, the partnership agreement may prescribe the standards by which the performance of this obligation is to be measured, if the standards are not manifestly unreasonable.

- Vary the power of a person to dissociate as a general partner under *Corp. Code § 15906.04(a)* [*see § 16.37[2]*], except to require that the notice under *Corp. Code § 15906.03(a)* be in a record.

- Eliminate the power of a court to decree dissolution in the circumstances specified in *Corp. Code § 15908.02(a)* [*see* Ch. 16A, *Dissolution of Limited Partnerships*].

- Vary the requirement to wind up the partnership's business as specified in *Corp. Code § 15908.03* [*see* Ch. 16A, *Dissolution of Limited Partnerships*].

- Unreasonably restrict the right of a partner to maintain an action as provided in *Corp. Code § 15910.01 et seq.*

- Restrict the right of a partner to approve a conversion or merger [*see* Ch. 16B, *Conversions and Mergers of Limited Partnerships*].

- Vary the provisions of Article 11.5 (regarding dissenting limited partners' rights to dissent in a conversion or merger), except to the extent expressly permitted by those provisions [*see* Ch. 16B, *Conversions and Mergers of Limited Partnerships*].

- Restrict rights under the ULPA '08 of a person other than a partner or a transferee.

[c] Publicly Traded Partnerships Taxable as Corporations

A partnership that is "publicly traded" may be classified as a corporation for tax purposes [*I.R.C. § 7704*; *see § 16.71*]. If a partnership's interests are not traded on an established securities market [*see I.R.C. § 7704(b)(1)*], however, the partnership will be treated as a corporation pursuant to this rule only if all of its interests were issued (1) in a transaction that was registered under the Securities Act of 1933 [*see 15 U.S.C. §§ 77a-77aa*], or (2) in a transaction that was not registered under the Securities Act of 1933 if the partnership either (a) has more than 500 partners, or (b) offers each unit of partnership interest for less than $20,000, [*1988-2 C.B. 386, Notice 88-75* ("safe harbor" provisions)]. Other "safe harbor" exceptions may apply even to partnerships that do not meet these criteria. For further discussion, see *§ 16.71*.

This agreement is designed for a small privately owned limited partnership whose shares will not be traded on an established securities market or secondary market. Such a partnership would fall within one of the "safe harbors" that the Internal Revenue Service has set forth in advance of issuing regulations [*see 1988-2 C.B. 386, Notice 88-75* ; *see also § 16.71*]. In the event that this agreement is adapted or otherwise used as a model for an agreement for a large partnership, however, the possible adverse effects of *I.R.C. § 7704* must be considered.

[d] Formation of Limited Partnerships

To form a limited partnership, the partners must enter into a partnership agreement and the general partners must file a certificate of limited partnership with the Secretary of State [*Corp. Code § 15902.01(a)*; *see § 16.21*]. The partnership agreement is not required to be written [*see Corp. Code § 15902.01(a)*; *see also Corp. Code § 15901.02(x)* ("partnership agreement" defined)]; however, it is advisable to memorialize an oral agreement in a written form, to prevent subsequent disagreements over the agreement's terms [*see § 16.21 [4]*]. A limited partnership is formed when the certificate is filed [*Corp. Code § 15902.01(c)*]. There is no requirement that any partner have a preexisting relationship with any other partner in order to form a limited partnership [*Corp. Code § 15902.01(c)*].

For discussion of the formation of a limited partnership, including these requirements as well as name requirements and the need to maintain certain records and an office and agent for service of process in California, see *§§ 16.21* and *16.23*. A guide to the procedures involved in forming a California limited partnership is *set forth in § 16.111*.

[2] FORM

Limited Partnership Agreement--General Form

LIMITED PARTNERSHIP AGREEMENT

Preamble

AGREEMENT of Limited Partnership made _____ [*date*], by and between _____ [*name of general partner*], _____ [*name of general partner*], and _____ [*name of general partner*] (General Partners), and _____ [*name of limited partner*], and _____ [*name of limited partner*] (Limited Partners).

IT IS HEREBY AGREED:

ARTICLE 1. THE PARTNERSHIP

Formation of Limited Partnership

1.01. The General Partners and the Limited Partners agree to form a limited partnership (the Partnership), pursuant to the provisions of the Uniform Limited Partnership Act of 2008.

Name of Partnership

1.02. The name of the Partnership is "_____ [*name of partnership*], a Limited Partnership." The business of the Partnership shall be conducted under that name. [*Add, if desired:* The name of the Partnership may be changed by the General Partners by giving written notice of the change to the Limited Partners and by filing a certificate of amendment or restated certificate with the Secretary of State.]

Purpose of Partnership

1.03. The Partnership is organized for the following purpose _____ [*specify any lawful purpose, and, if desired, its business activity*].

Designated Office

1.04. The designated office of the Partnership is at _____[*address*], _____ County, California, or at any other place within _____ County, California, as may be determined from time to time by the General Partners. If the General Partners change the principal designated office of the Partnership, they must give written notice of the change of address to each Limited Partner at least _____ [*number*] days before that change.

Term of Partnership

1.05. The term of the Partnership commences on _____ [the date on which the Partnership's Certificate of Limited Partnership is filed by the Secretary of State of California in the manner required by the Uniform Limited Partnership Act of 2008 *or* _____ (*date not more than 90 days after date certificate is received by Secretary of State*)] [*add, if desired:* and continues until _____ (*specify date or event*)].

Certificate of Limited Partnership

1.06. The General Partners will immediately execute a Certificate of Limited Partnership and cause that Certificate to be filed in the office of the Secretary of State of California. Thereafter, _____ [all *or* not less than one] of the General Partners will execute and cause to be filed certificates of amendment of the Certificate of Limited Partnership (or Restated Certificates of Limited Partnership) whenever required by the Uniform Limited Partnership Act of 2008 or this Agreement. The General Partners will execute and cause to be filed original or amended certificates evidencing the formation and operation of the Partnership whenever required under the laws of any other states in which the Partnership determines to do business. The General Partners will also record a certified copy of the Certificate and any amendment in the office of the county recorder in every county in which the Partnership owns real property.

Definitions

1.07. Except as otherwise stated in this Agreement or as the context of this Agreement requires, the terms defined in this

Section, for the purposes of this Agreement, have the meanings specified in this Section.

(1) "Agreement" means this Limited Partnership agreement, as amended.

(2) "Cash available for distribution" means total cash income from operations during any given accounting period plus the cash proceeds, if any, from the sale or other disposition, refinancing, or liquidation of Partnership property, less cash expenses as well as any allowances or reserves for contingencies or for repair to and maintenance of properties, and anticipated obligations the General Partners shall in their discretion deem necessary during the same accounting period.

(3) "Distribution" means a transfer of money or other property from the limited partnership to a partner in the partner's capacity as a partner or to a transferee on account of a transferable interest owned by the transferee.

(4) "General Partners" refers to _____ [*names of general partners*], or any successor.

(5) "Limited Partner" refers to any person who becomes a limited partner under *Corporations Code § 15903.01* or 15907.02(h), or was a limited partner in a limited partnership when it became subject to the Uniform Limited Partnership Act of 2008 under *Corporations Code § 15912.06(a)* or *(b)*.

(6) "Majority in interest of the limited partners" means more than _____ [*specify, e.g.*, 50] percent of the interest of all partners.

(7) "Net income" and "net loss" means the net income or net loss of the Partnership as determined for the purposes of computing federal income taxes pursuant to the Internal Revenue Code in accordance with generally accepted accounting principles.

(8) "Partners" or "the Partners" refers collectively to the General Partners and the Limited Partners. Reference to "Partner" is a reference to any one of the Partners.

(9) "Partnership" refers to the Limited Partnership created under this Agreement and the Certificate of Limited Partnership to be filed with the Office of the Secretary of State pursuant to the Uniform Limited Partnership Act of 2008.

(10) "Transferee" means a person to which all or part of a transferable interest has been transferred, whether or not the transferor is a partner.

(11) "Transferor" means a partner which has transferred the partner's transferable interest in the limited partnership.

(12) "Vote" includes written consent.

ARTICLE 2. MEMBERS OF PARTNERSHIP

Original General Partners

2.01. The name of each original General Partner is as follows: _____[*name*], _____[*name*], and _____[*name*].

Original Limited Partners

2.02. The name of each original Limited Partner is as follows: _____[*name*], _____[*name*], and _____[*name*].

Admission of Additional General Partners

2.03. Subject to any other provision of this Agreement, a person may be admitted as a General Partner after the Certificate of Limited Partnership is filed only with the written consent of _____ [all of the partners *or specify other consent requirement*].

Replacement of Sole Remaining General Partner

2.04. Upon the dissociation of a General Partner when there is no remaining General Partner, one or more new General Partners may be admitted to the Partnership on the written consent of the limited partners owning a majority of the rights to receive distributions as limited partners at the time the consent is to be effective *or* _____ (*specify*)]; provided that the Limited Partners agree in writing to continue the business of the Partnership pursuant to Paragraph 12.03 of this Agreement.

Admission of Additional Limited Partners

2.05. Subject to the provisions of Article 9 of this Agreement, governing transfers of partnership interests, a person may acquire an interest in the Partnership directly from the Partnership and be admitted as an additional Limited Partner_____ [with the consent of all of the partners *or* _____ (*specify other consent requirement*)].

Admission of Substituted Limited Partner

2.06. The transferee of a partnership interest may be admitted as a substituted Limited Partner with the vote or written consent of _____ [all general partners and a majority in interest of the limited partners *or* _____ (*specify other consent requirement*)].

Amendment of Partnership Records

2.07. On admission of a General Partner or Limited Partner, the General Partners shall add the name, address and contribution to the list of Partners kept in the designated office of the Partnership.

Additional Partners Bound by Agreement

2.08. Before any person is admitted to the Partnership as a General or Limited Partner, that person shall agree in writing to be bound by all of the provisions of this Agreement.

[*Continue with the following:*]

ARTICLE 3. FINANCING

Capitalization

3.01. The Partnership shall have an initial capitalization of _____ [*specify total sum, e.g.,* $1,000,000], of which _____ [*specify lesser sum, e.g.,* $970,000] shall be contributed by the Limited Partners, as further described in Paragraph 3.03 of this Agreement.

General Partner Capital Contribution

3.02. (a) Each of the original General Partners named in this Agreement shall contribute to the capital of the Partnership in cash the sum of _____ [*specify amount, e.g.,* $10,000].

(b) Each new General Partner admitted after the execution of this Agreement shall contribute, before admission to the Partnership, a sum that shall be determined by the General Partners. These provisions are subject, however, to any requirements for approval by the Limited Partners specified elsewhere in this Agreement. If there are no remaining General Partners, the contribution and interest of a new General Partner shall be determined by the Limited Partners in accordance with Paragraph 2.04 of this Agreement.

Limited Partner Capital Contribution

3.03. Each of the Limited Partners shall contribute to the capital of the Partnership cash in the amount of _____ [*specify dollar amount*].

[*OR*]

3.03. The Limited Partners shall contribute to the capital of the Partnership cash as follows: _____[*name of limited partner*], $_____ [*specify amount*], _____[*name of limited partner*], $_____ [*specify amount*], and _____[*name of limited partner*], $_____ [*specify amount*].

[*OR*]

3.03. The property or services contributed to the initial capital of the Partnership by each Limited Partner is as follows:

Name	Type of Contribution	Agreed Valuation
_____	_____	_____
_____	_____	_____
_____	_____	_____

[*Continue as follows:*]

Initial Capital Contributions From New Limited Partners

3.04. Each new Limited Partner admitted to the Partnership shall contribute to the capital of the Partnership _____ [an amount determined by the General Partners *or* the sum of $_____ in cash *or describe*].

[*Optional*:]

Interest on Contributions

3.05. No interest shall be paid on the initial contributions to the Partnership capital.

Consequences of Failure to Make Contribution

3.06. The interest of a Partner who fails to make any required contribution or other payment shall be subject to the following specific consequences: _____ [*specify, e.g.*, loss of the Partner's ability to actively participate in the management and operations of the Limited Partnership.

[*Continue with the following:*]

ARTICLE 4. ALLOCATION AND DISTRIBUTION OF PROFITS AND LOSSES

Allocation of Profits and Losses

4.01. The net profits of the Partnership are allocated to, and any net losses suffered by the Partnership will be borne by, the Partners _____ [in the same manner as the partners share distributions *or* in the following proportions:

GENERAL PARTNERS

_____ (*name of partner*) _____ (*percent*)

_____ (*name of partner*) _____ (*percent*)

_____ (*name of partner*) _____ (*percent*)

LIMITED PARTNERS

_____ (*name of partner*) _____ (*percent*)

_____ (*name of partner*) _____ (*percent*)

_____ (*name of partner*) _____ (*percent*)].

Distribution of Cash Available for Distribution

4.02. A distribution shall be shared among the Partners on the basis of the value, as stated in the required records when the Partnership decides to make the distribution, of the contributions the Partnership has received from each Partner.

Distributions Other Than Cash

4.03. A partner does not have a right to demand or receive any distribution from the Limited Partnership in any form other than cash.

ARTICLE 5. MANAGEMENT OF PARTNERSHIP AFFAIRS

Control and Management

5.01. (a) The General Partners have the sole and exclusive control of the Limited Partnership. Subject to any limitations expressly set forth in this Agreement, the General Partners have the power and authority to take any action from time to time as they may deem to be necessary, appropriate, or convenient in connection with the management and conduct of the business and affairs of the Partnership, including without limitation, the power to do the following:

(1) Acquire property, including real or personal property, for the use of the Partnership on the terms and conditions as the General Partners may, from time to time, determine to be advantageous to the Partnership;

(2) Dispose of Partnership property, either in the ordinary course of the business of the Partnership or, from time to time, when the General Partners deem the disposition to be in the best interests of the Partnership;

(3) Finance the Partnership's activities by borrowing money from third parties on the terms and under the conditions as the General Partners deem appropriate. When money is borrowed for Partnership purposes, the General Partners are authorized to pledge, mortgage, encumber, or grant a security interest in Partnership properties as security for the repayment of those loans;

(4) Employ, retain, or otherwise secure the services of any personnel or firms deemed necessary by the General Partners for or to facilitate the conduct of Partnership business affairs, all on the terms and for the consideration as the General Partners deem advisable; and

(5) Take any and all other action permitted by law that is customary in or reasonably related to the conduct of the Partnership business or affairs.

(b) Each general partner has equal rights in the management and conduct of the limited partnership's activities. Except as otherwise provided in the Uniform Limited Partnership Act of 2008, any matter relating to the activities of the Partnership may be exclusively decided by the General Partner, or if there is more than one General Partner, by a majority of the General Partners.

Restrictions on Limited Partners

5.02. The Limited Partners do not have either the obligation or the right to take part, directly or indirectly, in the active management or control of the business of the Partnership, except as otherwise permitted in this Agreement or by the Uniform Limited Partnership Act of 2008.

Fiduciary Duties of General Partners

5.03. The fiduciary duties that a General Partner owes to the Partnership and the other Partners are the duties of loyalty and care. A General Partner's duty of loyalty to the Partnership and the other Partners is limited to the following:

(1) To account to the Partnership and hold as trustee for it any property, profit, or benefit derived by the general partner in the conduct and winding up of the Partnership's activities or derived from a use by the General Partner of partnership property, including appropriating a partnership opportunity;

(2) To refrain from dealing with the Partnership in the conduct or winding up of activities as or on behalf of a party having an interest adverse to the Partnership; and

(3) To refrain from competing with the Partnership in the conduct or winding up of its activities.

A General Partner's duty of care to the Partnership and the other Partners in the conduct and winding up of the Limited Partnership's activities is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.

A General Partner must discharge the duties to the Partnership and the other Partners under the Uniform Limited Partnership Act of 2008 or under the Partnership Agreement and exercise any rights consistently with the obligation of good faith and fair dealing. A General Partner does not violate a duty or obligation under the Uniform Limited Partnership Act of 2008 or under the Partnership Agreement merely because the General Partner's conduct furthers the General Partner's own interest.

Authority for Use of Nominees

5.04. All Partners recognize that practical difficulties exist in doing business as a Limited Partnership, occasioned by third parties seeking to determine the capacity of the General Partners to act for and on behalf of the Partnership, or for other reasons. Therefore, the Limited Partners specifically authorize the General Partners to acquire all real and personal property, arrange all financing, enter contracts, and complete all other arrangements needed to effectuate the purpose of this Partnership, either in their own names or in the name of a nominee, without having to disclose the existence of this Partnership. If the General Partners decide to transact the Partnership business in their own names or in the name of a nominee, they shall place a written declaration of trust in the Partnership books and records that acknowledges the capacity in which the nominee acts and the name of the Partnership as the true or equitable owner.

Dissociation of General Partners

5.05. A person is dissociated from the Partnership as a General Partner upon the occurrence of any of the following events:

(a) The Partnership's having notice of the person's express will to withdraw as a General Partner or on a later date specified by the person.

(b) The following event(s): _____ [*specify*].

(c) The person's expulsion as a General Partner pursuant to this Agreement.

(d) The person's expulsion as a General Partner by the unanimous consent of the other Partners if:

(1) it is unlawful to carry on the Partnership's activities with the person as a General Partner;

(2) there has been a transfer of all or substantially all of the person's transferable interest in the Partnership, other than a transfer for security purposes, or a court order charging the person's interest, which has not been foreclosed;

(3) the person is a corporation and, within 90 days after the Partnership notifies the person that it will be expelled as a General Partner because it has filed a certificate of dissolution or the equivalent, its charter has been revoked, or its right to conduct business has been suspended by the jurisdiction of its incorporation, there is no revocation of the certificate of dissolution or no reinstatement of its charter or its right to conduct business; or

(4) the person is a limited liability company or Partnership that has been dissolved and whose business is being wound up.

(e) On application by the Partnership, the person's expulsion as a General Partner by judicial order because:

(1) the person engaged in wrongful conduct that adversely and materially affected the Partnership activities;

(2) the person willfully or persistently committed a material breach of the Agreement or of a duty owed to the Partnership or the other Partners under *Corp. Code § 15904.08*; or

(3) the person engaged in conduct relating to the Partnership's activities which makes it not reasonably practicable to carry on the activities of the Partnership with the person as a General Partner.

(f) The person's:

(1) becoming a debtor in bankruptcy;

(2) execution of an assignment for the benefit of creditors;

(3) seeking, consenting to or acquiescing in the appointment of a trustee, receiver, or liquidator of the person or of all or substantially all of the person's property; or

(4) failure, within 90 days after the appointment, to have vacated or stayed the appointment of a trustee, receiver, or liquidator of the general partner or of all or substantially all of the person's property obtained without the person's consent or acquiescence, or failing within 90 days after the expiration of a stay to have the appointment vacated.

(g) In the case of a person who is an individual: the person's death, the appointment of a guardian or general conservator for the person, or a judicial determination that the person has otherwise become incapable of performing the person's duties as a General Partner under this Agreement.

(h) In the case of a person that is a trust or is acting as a General Partner by virtue of being a trustee of a trust, distribution of the trust's entire transferable interest in the Partnership, but not merely by reason of the substitution of a successor trustee.

(i) In the case of a person that is an estate or is acting as a General Partner by virtue of being a personal representative of an estate, distribution of the estate's entire transferable interest in the Partnership, but not merely by reason of the substitution of a successor personal representative.

(j) Termination of a General Partner that is not an individual, partnership, limited liability company, corporation, trust, or estate.

(k) The Partnership's participation in a conversion or merger under *Corp. Code § 15911.01 et seq.*, if the Partnership is not the converted or surviving entity, or is the converted or surviving entity but as a result of the conversion or merger the person ceases to be a General Partner.

Dissociation of Limited Partners

5.06. A person does not have a right to dissociate as a Limited Partner before the termination of the Partnership.

However, a person is dissociated from the Partnership as a Limited Partner upon the occurrence of any of the following events:

(a) The Partnership's having notice of the person's express will to withdraw as a Limited Partner or on a later date specified by the person.

(b) The following event(s): _____ [*specify*].

(c) The person's expulsion as a Limited Partner pursuant to this Agreement.

(d) The person's expulsion as a Limited Partner by the unanimous consent of the other Partners if:

(1) It is unlawful to carry on the Partnership's activities with the person as a Limited Partner.

(2) There has been a transfer of all of the person's transferable interest in the Partnership, other than a transfer for security purposes, or a court order charging the person's interest, which has not been foreclosed.

(3) The person is a corporation and, within 90 days after the Partnership notifies the person that it will be expelled as a limited partner because it has filed a certificate of dissolution or the equivalent, its charter has been revoked, or its right to conduct business has been suspended by the jurisdiction of its incorporation, there is no revocation of the certificate of dissolution or no reinstatement of its charter or its right to conduct business.

(4) The person is a limited liability company or partnership that has been dissolved and whose business is being wound up.

(e) On application by the Partnership, the person's expulsion as a Limited Partner by judicial order because: the person engaged in wrongful conduct that adversely and materially affected the Partnership's activities; the person willfully or persistently committed a material breach of the Agreement or of the obligation of good faith and fair dealing under *Corp. Code § 15903.05(b)*; or the person engaged in conduct relating to the Partnership's activities which makes it not reasonably practicable to carry on the activities with the person as Limited Partner.

(f) In the case of a person who is an individual, the person's death.

(g) In the case of a person that is a trust or is acting as a Limited Partner by virtue of being a trustee of a trust, distribution of the trust's entire transferable interest in the partnership, but not merely by reason of the substitution of a successor trustee.

(h) In the case of a person that is an estate or is acting as a Limited Partner by virtue of being a personal representative of an estate, distribution of the estate's entire transferable interest in the Partnership, but not merely by reason of the substitution of a successor personal representative.

(i) Termination of a Limited Partner that is not an individual, partnership, limited liability company, corporation, trust, or estate.

(j) The Partnership's participation in a conversion or merger under *Corp. Code § 15911.01 et seq.* if the Partnership (a) is not the converted or surviving entity; or (b) is the converted or surviving entity but, as a result of the conversion or merger, the person ceases to be a Limited Partner.

ARTICLE 6. BOOKS, RECORDS, AND ACCOUNTS

Partnership Accounting Practices

6.01. (a) The Partnership books shall be kept on a _____ [cash *or* accrual] basis. The Partnership books shall be closed and balanced and audited by an independent certified public accountant at the end of each fiscal year of the Partnership.

(b) The fiscal year of the Partnership _____ [is the calendar year *or* ends on the last day of _____ (month) of each calendar year *or* will be determined by the General Partners *or specify other year*].

Maintenance of Records and Accounts

6.02. At all times, the General Partners must maintain or cause to be maintained true and proper books, records, reports, and accounts in which shall be entered fully and accurately all transactions of the Partnership.

Required Records

6.03. The General Partners must maintain at the designated office of the Partnership within California all of the following records:

(1) A current list of the full name and last known street and mailing address of each Partner, separately identifying the general partners in alphabetical order, and the limited partners, in alphabetical order.

(2) A copy of the initial certificate of limited partnership and all amendments to and restatements of the certificate, together with signed copies of any powers of attorney pursuant to which any certificate has been executed.

(3) A copy of any filed certificate of conversion or merger.

(4) Copies of the Partnership's federal, state, and local income tax or information returns and reports, if any, for the six most recent years.

(5) A copy of any partnership agreement made in a record and any amendment made in a record to any partnership agreement.

(6) A copy of any financial statement of the Limited Partnership for the six most recent years.

(7) A copy of any record made by the Partnership during the past three years of consent given by or vote taken of any Partner pursuant to the Uniform Limited Partnership Act of 2008 or the Partnership Agreement.

(8) Unless contained in a partnership agreement made in a record:

(1) The amount of cash, and description and statement of agreed value of other benefits, contributed and agreed to be contributed by each Partner;

(2) The times at which or events upon which additional contributions agreed to be made by each Partner are to be made;

(3) For a person that is both a general and limited partner, a specification of what transferable interest person owns in each capacity; and

(4) Any events upon which the Partnership will be dissolved and its activities wound up.

Limited Partners Right to Information

6.04. On 10 days' demand made in a record received by the Partnership, a Limited Partner may inspect and copy any information required to be maintained by the Limited Partnership pursuant to paragraph 6.03 during regular business hours in the Partnership's designated office. The Limited Partner need not have any particular purpose for seeking the information.

Access to Other Records by Limited Partners

6.05. Each Limited Partner and/or each Limited Partner's duly authorized representative, attorney, or attorney-in-fact may obtain from the Partnership (and may obtain via electronic transmission) and inspect and copy true and full information regarding the state of the activities and financial condition of the Partnership and other information regarding the activities of the Partnership as is just and reasonable if:

(1) The Limited Partner seeks the information for a purpose reasonably related to the Partner's interest as

a Limited Partner.

(2) The demand is made in a record received by the Partnership, describing with reasonable particularity the information sought and the purpose for seeking the information.

(3) The information sought is directly connected to the Limited Partner's purpose.

Partnership's Response to Demand

6.06. Within 10 days after receiving a demand under paragraph 6.05, the Limited Partnership in a record shall inform the Limited Partner who made the demand:

(1) What information the Partnership will provide in response.

(2) When and where the Partnership will provide the information.

(3) The reasons for declining to provide any demanded information.

General Partners' Right to Required Information

6.07. A General Partner, without having any particular purpose for seeking the information, may inspect and copy during regular business hours:

(1) Required information, as specified in paragraph 6.03, in the Limited Partnership's designated office.

(2) Any other records maintained by the Partnership regarding its activities and financial conditions, at a reasonable location specified by the Partnership.

General Partners' Access to Other Information

6.08. Each General Partner and the Limited Partnership shall furnish to a General Partner (and may transmit via electronic transmission):

(1) Without demand, any information concerning the Partnership's activities reasonably required for proper exercise of the General Partner's rights and duties under the Agreement or the Uniform Limited Partnership Act of 2008.

(2) On demand, any other information concerning the Partnership's activities, unless the demand or the information demanded is unreasonable or improper under circumstances.

[*Optional*:]

Partnership Tax Returns

6.09. The General Partners shall send to each Partner within _____ [*specify time*] after the end of each taxable year a copy of the Partnership's tax returns.

[*Continue with the following*:]

Capital Accounts

6.10. An individual capital account must be maintained for each General Partner and Limited Partner. A capital account consists of a Partner's contribution to the initial capital of the Partnership, any additional contributions to the Partnership capital made by the Partner pursuant to this Agreement, and any amounts transferred to the capital account from that Partner's income account pursuant to this Agreement.

Income Accounts

6.11. An individual income account will be maintained for each Partner. At the close of each _____ [*specify accounting period, e.g.*, fiscal year], each Partner's share of the net profits or net losses of the Partnership will be credited or debited to, and that Partner's distributions received during each fiscal year will be deducted from, that Partner's income account and any resulting balance or deficit shall be transferred to or charged against that Partner's capital account.

Banking

6.12. The General Partners will open and maintain a separate bank account in the name of the Partnership with _____[*name of bank*], in which there shall be deposited all of the funds of the Partnership. No other funds may be deposited in the account. The funds in that account must be used solely for the business of the Partnership, and all withdrawals from that account are to be made only on checks signed by _____ [any of the General Partners *or* all of the General Partners *or* such other person or persons as the General Partners may from time to time designate].

ARTICLE 7. RIGHTS, POWERS, DUTIES, AND RESTRICTIONS OF PARTNERS

General Partners' Exclusive Right to Manage

7.01. The General Partners have full and exclusive charge and control of the management, conduct, and operation of the Partnership in all matters and respects.

Devotion of Time by General Partners

7.02. The General Partners must devote _____[their entire care, attention, and business capacity to the affairs of the Partnership *or* such care, attention, and business capacity to the affairs of the Partnership as may be reasonably necessary]. [*Consider adding the following sentence if the second alternative in the previous sentence is used:* In this connection, the Partners acknowledge that any General Partner may be the Manager or General Partner of other partnerships and may continue to manage other partnerships, and may continue to engage in other _____ (*specify types of businesses, e.g.*, distinct *or* related) businesses (, whether or not competitive

with the business of the Partnership)].

Voting Rights of General Partners

7.03. All General Partners have equal rights in the management and conduct of the Partnership business. Any difference arising with regard to the ordinary course of the Partnership business will be decided by a majority of the General Partners.

Restrictions on General Partners

7.04. Except as otherwise expressly provided in this Agreement, each General Partner is subject to all the restrictions imposed on general partners by the the Uniform Limited Partnership Act of 2008 and has all the rights and powers granted general partners under that act.

Salaries of General Partners

7.05. As compensation for their services to the Partnership in the conduct of its business, each General Partner is entitled to a salary of $_____ per month. The aggregate of those salaries will be deducted by the Partnership as an ordinary and necessary expense of the Partnership business before determination of net profits or cash available for distribution.

Voting Rights of Limited Partners

7.06. A Limited Partner does not participate in the control of the Partnership's business solely by voting on, proposing, or calling a meeting of the partners, or by calling, requesting, attending, or participating at any meeting of the partners or the Limited Partners. [*Optional:* The Limited Partners have the right to vote on the following matters: _____ (*specify*)].

Loans to the Partnership

7.07. Nothing in this Agreement prevents a Partner from lending money to the Partnership on a promissory note or similar evidence of indebtedness for a reasonable rate of interest. Any Partner lending money to the Partnership has the same rights and risks regarding the loan as would any person or entity making the loan who was not a member of the Partnership.

Transaction of Business With Partnership

7.08. Except as otherwise provided in this Agreement, a Partner _____ [_____ (may *or* may not) transact other business with the Partnership *or* may transact only the following types of business with the Partnership: _____ (*specify*)]. If any Partner transacts business with the Partnership, that Partner has the same rights and obligations with regard to the Partnership as a person who is not a Partner.

[*Use the following if 7.02, above, does not prohibit general partners from engaging in other businesses:*]

Partners Engaging in Other Business

7.09. Except as otherwise provided in Paragraph 7.02 of this Agreement, any of the Partners may engage in or possess an interest in other business ventures of every nature and description independently or with others, including but not limited to [*specify types of business*]. Neither the Partnership nor the Partners have any right by virtue of this Agreement in and to any such independent ventures or to the income or profits derived from them.

[*Optional: (ULPA '08 does not require or set forth default provisions regarding partnership meetings)*]

ARTICLE 8. PARTNERSHIP MEETINGS

Call and Place of Meetings

8.01. (a) Meetings of the Partners will be held at _____ [*specify*]. [*Add provisions regarding call of meetings, if desired*.]

Notice of Meeting

8.02. Notice of a meeting must be given _____ [*specify time and manner of giving notice*].

Quorum

8.03. At any duly held or called meeting of Partners, _____ [*Specify what constitutes quorum and consequences when quorum is not present.*]

Adjournment of Meetings

8.04. _____ [*Specify provisions for adjournment of meeting*.]

Meetings Not Duly Called, Noticed, or Held

8.05. _____ [*Specify provisions regarding meetings not dully called, noticed, or held*.]

Waiver of Notice

8.06. _____ [*Set forth rules regarding waiver of notice*.]

Consent to Action Without Meeting

8.07. Any action requiring the consent of Partners under the Uniform Limited Partnership Act of 2008 may be taken without a meeting. [*Add additional provisions as desired*.]

Proxies

8.08. A Partner may appoint a proxy to consent or otherwise act for that Partner by signing an appointment record, either personally or by the Partner's attorney-in-fact. [*Add additional provisions as desired*.]

[*Continue with the following*:]

ARTICLE 9. TRANSFER OF PARTNERSHIP INTERESTS

Conditions for Transfer

9.01. A Partner may transfer an interest in the Partnership subject to the provisions of this Article 9. The only interest of a Partner that is transferable is the Partner's transferable interest, which is personal property. A "transferable interest" means a partner's right to receive distributions.

Permitted Transfers

9.02. (a) The transfer of a Partnership interest is permissible if made in the following manner: _____ [*specify*].

(b) A transfer, in whole or part, of a Partner's transferable interest, does not by itself cause the Partner's dissociation or a dissolution and winding up of the Partnership's activities. Such a transfer does not, as against the other Partners or Partnership, entitle the transferee to participate in the management or conduct of the Partnership's activities, to require access to information concerning the Partnership's transactions except as provided in *Corp. Code § 15907.02(c)* (accounting upon dissolution and winding up), or to inspect or copy the required information or the Partnership's other records or to exercise any other rights or powers of a Partner.

(c) A transferee has a right to receive, in accordance with the transfer, distributions to which the transferor would otherwise be entitled.

(d) Upon transfer, the transferor retains the rights of a Partner other than the interest in distributions transferred, and retains all duties and obligations of a Partner.

(e) The Partnership need not give effect to a transferee's rights until the Partnership has notice of the transfer.

(f) A transfer of a transferable interest in violation of a restriction on transfer in this Agreement is ineffective as to a person having notice of the restriction at the time of transfer.

Transferee as Limited Partner

9.03. A transferee of a Partnership interest, including a transferee of a General Partner, may become a Limited Partner if all General Partners and a majority in interest of the Limited Partners consent [*or specify other provisions*]. A transferee that becomes a Partner with respect to a transferable interest is liable for the transferor's obligations under *Corporations Code §§ 15905.02* and *15905.09*. However, the transferee is not obligated for liabilities unknown to the transferee at the time the transferee becomes a partner.

Death of Partner

9.04. If any Partner dies, the deceased Partner's personal representative or other legal representative may exercise the rights of a transferee pursuant to *Corporations Code § 15907.02*. For the purposes of settling the estate, the representative may exercise the rights of a current Limited Partner pursuant to *Corporations Code § 15903.04*

ARTICLE 10. LIABILITIES OF PARTNERS

Liability of General Partners

10.01. Except as otherwise provided below, all General Partners are liable jointly and severally for all obligations of the Limited Partnership unless otherwise agreed by the claimant or provided by law. A person that becomes a General Partner of the existing Limited Partnership is not personally liable for an obligation of the Limited Partnership incurred before the person became a General Partner.

Liability of Limited Partners

10.02. The liability of the Limited Partners is restricted and limited to the amount of the actual capital contributions that each Limited Partner makes or agrees to make to the Partnership.

Liability of Partnership for Actions of General Partner

10.03. (a) The Partnership is liable for loss or injury caused to a person, or for a penalty incurred, as a result of a wrongful act or omission or other actionable conduct of a General Partner acting in the ordinary course of activities of the Partnership, or with authority of the Partnership.

(b) If, in the course of the Partnership's activities or while acting with authority of the Partnership, a General Partner receives or causes the Partnership to receive money or property of person not a partner, and the money or property is misapplied by a General Partner, the Limited Partnership is liable for the loss.

ARTICLE 11. PROHIBITED TRANSACTIONS

Specified Acts

11.01. During the time of the organization or continuance of this Partnership, neither the General nor Limited Partners may take, and the Partners specifically promise not to do, any of the following actions:

(1) Use the name of the Partnership (or any substantially similar name) or any trademark or trade name adopted by the Partnership, except in the ordinary course of the Partnership business.

(2) Disclose to any nonpartner any of the Partnership business practices, trade secrets, or any other information not generally known to the business community.

(3) Do any other act or deed with the intention of harming the business operations of the Partnership.

(4) Do any act contrary to this Agreement, except with the prior express written approval of all Partners.

(5) Do any act that would make it impossible to carry on the intended or ordinary business of the Partnership.

(6) Confess a judgment against the Partnership.

(7) Abandon or transfer or dispose of Partnership property, real or personal.

[*Optional:*]

(8) Admit another person or entity as a General or Limited Partner.

[*Continue with the following:*]

Use of Partnership Assets

11.02. The General Partners may not use, and specifically promise not to use, directly or indirectly, the assets of this Partnership for any purpose other than conducting the business of the Partnership, for the full and exclusive benefit of all its Partners.

ARTICLE 12. DISSOLUTION OF THE PARTNERSHIP

Dissolution and Winding Up

12.01. The Partnership will be dissolved, and its affairs will be wound up on the expiration of the term provided for the existence of the Partnership in Paragraph 1.05 or on the occurrence of any of the events specified in Paragraphs 12.02 through 12.05, whichever is the first to occur.

Dissolution Upon Consent

12.02. The Partnership will be dissolved on any date specified in a consent to dissolution signed by all of the General Partners and by all the Limited Partners owning a majority of the rights to receive distributions as Limited Partners at the time the consent is to be effective.

Dissolution After Dissociation of a General Partner

12.03. (a) The Partnership will dissolve and its affairs will be wound up after dissociation of person as general partner, if the Partnership has at least one remaining General Partner, and a consent to dissolve the Partnership is given within 90 days after dissociation by partners owning a majority of the rights to receive distributions as Partners at the time the consent is to be effective.

(b) The Partnership will dissolve and its affairs must be wound up after dissociation of a person as a general partner if the partnership does not have a remaining General Partner, upon the passage of 90 days after dissociation, unless before the end of the period:

(1) Consent to continue the activities of the Partnership and admit at least one General Partner is given by Limited Partners owning a majority of the rights to receive distributions as Limited Partners at the

time the consent is to be effective; and

(2) At least one person is admitted as a General Partner in accordance with the consent.

(c) The Partnership is dissolved and its activities must be wound up after the passage of 90 days after the dissociation of the Partnership's last Limited Partner, unless before the end of the period the Partnership admits at least one Limited Partner.

Dissolution Upon Specific Event

12.04. The Partnership is dissolved and its activities must be wound up after _____ [*specify happening of specific event*].

Dissolution Upon Judicial Decree

12.05. The Partnership will be dissolved and its affairs wound up when required by a decree of judicial dissolution entered under *Corporations Code § 15908.02(a)*.

Responsibility for Winding Up

12.06. (a) In winding up its activities, the Limited Partnership must discharge its liabilities, settle and close its activities, and marshal and distribute its assets.

(b) If the Partnership does not have a General Partner, a person to wind up the Partnership's activities may be appointed by the consent of Limited Partners owning a majority of the rights to receive distributions as Limited Partners at the time the consent is to be effective.

Liquidation and Distribution

12.07. (a) The person or persons responsible for winding up the affairs of the Partnership pursuant to Paragragh 12.06 may amend its Certificate of Limited Partnership to state that the Limited Partnership is dissolved; preserve the Limited Partnership business or property as a going concern for a reasonable time; prosecute and defend actions and proceedings, whether civil, criminal, or administrative; transfer the Limited Partnership's property; settle disputes by mediation or arbitration; file a certificate of cancellation; and perform other necessary acts.

(b) In winding up, the Partnership's assets must be applied to satisfy the Partnership's obligations to creditors, including partners that are creditors. Any surplus remaining after the Partnership complies must be returned to the Partners as they share in distributions.

Reasonable Compensation

12.08. Unless otherwise provided in this Agreement, any Limited Partners winding up the affairs of the Partnership will be entitled to reasonable compensation.

Cancellation of Certificate of Limited Partnership

12.09. On completion of the winding up of the Partnership's affairs the Partnership must file in the office of the Secretary of State a certificate of cancellation of the Certificate of Limited Partnership. If the Partnership does not have a General Partner, the person appointed to wind up activities must file the certificate.

ARTICLE 13. RECORD DATES

Setting Record Date for Meetings

13.01. The record date for determining the Partners entitled to notice of meetings, the right to vote at any meeting, or the right to take any other lawful action with regard to a meeting or the conduct of a vote by the Partners will be_____ [*specify*].

Setting Record Date for Distributions

13.02. The record date for determining the Partners entitled to any distribution or the right to take any other lawful action will be _____ [*specify*].

Automatic Record Date

13.03. In the absence of any action setting a record date the record date will be determined as follows _____ [*specify*].

ARTICLE 14. MISCELLANEOUS PROVISIONS

Entire Agreement

14.01. This Agreement contains the entire understanding among the Partners and supersedes any prior written or oral agreements between them regarding the subject matter contained in this Agreement. There are no representations, agreements, arrangements, or understandings, oral or written, between and among the Partners relating to the subject matter of this Agreement that are not fully expressed in this Agreement.

Amendments

14.02. (a) Subject to Subparagraph (b) of this Paragraph 14.02, the consent of each Partner is necessary to amend the Partnership Agreement. Any amendment of this Agreement must be in writing, dated, and executed by all Partners. If any conflict arises between the provisions of any amendment and the original Agreement as previously amended, the most recent provisions control.

(b) The provisions of this Agreement may not be amended to contravene the restrictions set forth in *Corporations Code § 15901.10*.

Attorneys' Fees

14.03. If any action at law or in equity, including an action for declaratory or injunctive relief, is brought to enforce or

interpret the provisions of this Agreement, the prevailing party is entitled to reasonable attorneys' fees.

Governing Law

14.04. All questions with regard to the construction of this Agreement and the rights and liabilities of the parties will be governed by the laws of the State of California.

Notices

14.05. All notices must be in writing and sent by first class United States mail. All notices to the Partners must be sent to them at the addresses shown for them in the records of the Partnership. All notices to the Partnership must be sent to it at its designated office in California. Notices will be deemed to have been delivered when deposited in the United States mails.

Successors

14.06. Subject to the restrictions against assignment of limited partnership interests contained in this Agreement, this Agreement inures to the benefit of and is binding on the assigns, successors in interest, personal representatives, estates, heirs, and legatees of each of the parties.

Severability

14.07. If any provisions of this Agreement are declared by a court of competent jurisdiction to be invalid, void, or unenforceable, the remaining provisions continue in full force and effect.

Execution by Spouses

14.08. This Agreement is executed by the Partners and by the spouses of Partners when those spouses are not themselves Partners. The signature of a spouse who is not a Partner may not be construed as making that spouse a Partner or as imposing on that spouse any responsibility for any Partnership obligation but merely as recording that spouse's consent to the execution by his or her spouse of this Agreement and to all of its terms and conditions to the extent that community property interests, if any, may be involved.

Election of Adjusted Basis

14.09. In the event of a transfer of all or part of the interest of a Limited Partner, the General Partners may elect, on behalf of the Partnership, to adjust the basis of the Partnership property pursuant to *Section 754 of the Internal Revenue Code*. All other elections required or permitted to be made by the Partnership under the Internal Revenue Code must be made by the General Partners in such manner as will, in their opinion, be most advantageous to a majority in interest of the Limited Partners.

Counterparts

14.10. This Agreement may be executed in several counterparts and all counterparts so executed constitute one

agreement that is binding on all of the parties, notwithstanding that all of the parties are not signatory to the original or the same counterpart.

Headings

14.11. The headings preceeding the paragraphs of this Agreement are for convenience of reference only, are not a part of this Agreement, and are to be disregarded in the interpretation of any portion of this Agreement.

Other Instruments

14.12. The parties to this Agreement covenant and agree that they shall execute all other instruments and documents that are or may become necessary or convenient to effectuate and carry out the Partnership created by this Agreement.

Executed on_____[*date*], at_____[*city*], California.

GENERAL PARTNERS
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

LIMITED PARTNERS
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

SPOUSES
_____ [*signature*]
[*typed name*]
_____ [*signature*]
[*typed name*]

EXHIBIT A

_____ [*name*], a California Limited Partnership

List of Partners General Partners

Name of Partner	Address	Total Initial Contribution
_____	_____	$_____
_____	_____	$_____

_____	_____	$_____
_____	_____	$_____
_____	_____	$_____

Limited Partners

Name of Partner	Address	Total Initial Contribution
_____	_____	$_____
_____	_____	$_____
_____	_____	$_____
_____	_____	$_____
_____	_____	$_____



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
A. Limited Partnership Agreements

8-16 California Legal Forms--Transaction Guide §§ 16.201-16.209

[Reserved]

§§ 16.201[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
B. Limited Partnership Certificates
1. Domestic Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.210

§ 16.210 Certificate of Limited Partnership [Form LP-1]

[1] Comment

[a] Use of Form

This form is a reproduction of the certificate of limited partnership prescribed by the Secretary of State. This official form, and no other certificate, must be completed and filed as part of the process of forming a California limited partnership. In order to form a partnership, the general partners must sign and file a certificate of limited partnership [*Corp. Code § 15902.01(a)*; *see § 16.21*]. Either before or after the filing of the certificate, the partners must enter into a partnership agreement [*Corp. Code § 15902.01(a)*; *see § 16.200*].

For a discussion of the formation of a California limited partnership, see *§ 16.21*. The procedures for forming a domestic California limited partnership are *set forth in § 16.111*. A guide to the contents of a limited partnership certificate and the procedures for executing, acknowledging, and filing the certificate of limited partnership is contained in § 16.121[1].

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 16.210. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Filing the Certificate

A limited partnership is formed at the time its certificate is filed in the office of the Secretary of State [*Corp. Code § 15902.01(c)*]. It has been held under former law that a limited partnership that is defectively formed due to its failure to file a certificate of limited partnership may be treated as a general partnership [*see American Alternative Energy v. Windridge, Inc. (1996) 42 Cal. App. 4th 551, 560-562, 49 Cal. Rptr. 2d 686* (noncompliance with certificate requirement rendered entity a general partnership with capacity to sue)].

The general partners ordinarily must be the ones who file the certificate [*see Corp. Code § 15902.01(a)*], but under limited circumstances when they fail to do so, a purported limited partner may cause the certificate to be signed and delivered to the Secretary of State [*Corp. Code § 15903.06(a)*]; *see § 16.21[2][b][iv]*]. Furthermore, if a person required by the ULPA '08 to sign or deliver the certificate does not do so, any other person that is aggrieved may petition the superior court to order the person to sign or deliver the record, or for the Secretary of State to file the record unsigned [*Corp. Code § 15902.05(a)*].

Any person, other than a general partner, who files a certificate of limited partnership must state the statutory authority for filing after the signature on the certificate [*Corp. Code § 15902.05(d)*].

The original and one copy of the certificate, together with the filing fee [*see Gov. Code § 12188(b)*], should be mailed to the California Secretary of State, Limited Partnership Unit, P.O. Box 944225, Sacramento, CA 94244-2250.

The Secretary of State may cancel the filing of the certificate if the partnership's check or other remittance submitted to pay the filing fee is not honored. On receiving written notification that the check was not honored for payment, the Secretary must give written notice to the partnership's agent for service of process, or to the person who submitted the check, that the filing will be canceled if payment is not received. If the partnership does not then pay the amount due with a cashier's check or its equivalent, the Secretary must give a second written notice of cancellation that is immediately effective. The second notice must be given at least 20 days after the first notice and no later than 90 days after the original filing [*Corp. Code § 15902.01(f)*].

[c] Contents of Certificate

The certificate of limited partnership must contain all of the following information [*Corp. Code § 15902.01(a)*]:

- The name of the limited partnership;
- The address of the initial designated office;
- The names and addresses of the general partners; and
- The name and address of the initial agent for service of process [*see Corp. Code § 15901.16(d)(1)*], or, if a corporate agent is designated, only the name of that agent.

The certificate may also contain any other matters that the person filing the certificate desires to include, but may not vary or otherwise affect the provisions specified in *Corp. Code § 15901.10(b)* [*see § 16.21[4][b]*] [*Corp. Code § 15901.10(b)*; *see* [2], P 9, *below*].

[d] Liability for False Information

If a record delivered to the Secretary of State for filing under the ULPA '08 and filed by the Secretary contains false information, a person that suffers loss by reliance on the information may recover damages for the loss from [*Corp. Code § 15902.08(a)*]:

- A person that signed the record, or caused another to sign it on the person behalf, and knew the information to be false at the time the record was signed; and

- A general partner that had notice that the information was false when the record was filed or had become false because of changed circumstances, if the general partner had notice for a reasonably sufficient time before the information is relied upon to enable the general partner to effect an amendment under *Corp. Code § 15902.02* (amendments or restatements of certificates of limited partnerships), file a petition pursuant to § 15902.05 (filings pursuant to judicial order), or deliver to the Secretary of State for filing a certificate of correction pursuant to *Corp. Code § 15902.07*.

Signing a record authorized or required to be filed under the 2008 Act constitutes an affirmation under the penalties of perjury that the facts stated in the record are true [*Corp. Code § 15902.08(b)*].

[e] Inconsistencies With Partnership Agreement

Subject to *Corp. Code § 15902.01(b)* [*see § 16.21[2][a]*], if any provision of a partnership agreement is inconsistent with the filed certificate of limited partnership [*Corp. Code § 15902.01(d)*]:

(1) The partnership agreement prevails as to partners and transferees; and

(2) The filed certificate of limited partnership prevails as to persons, other than partners and transferees, that reasonably rely on the filed record to their detriment.

[2] FORM

Certificate of Limited Partnership

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
B. Limited Partnership Certificates
1. Domestic Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.211

§ 16.211 Certificate of Amendment to Certificate of Limited Partnership

[1] Comment

[a] Use of Form

This form is the Secretary of State's official form for a certificate of amendment (LP-2). It may be used to amend a certificate of limited partnership [*see Corp. Code § 15902.02(a)*; *see § 16.22[1]*]. Alternatively, a limited partnership may filed a restated certificate of limited partnership, which replaces the original certificate and incorporates all amendments [*see Corp. Code § 15902.02(e)*; *see also* [e], *below*; *§§ 16.22[2], 16.212*].

The original and one copy of the certificate, together with the filing fee [*see Gov. Code § 12188(d)*], should be mailed to the Secretary of State, Limited Partnership Division, P.O. Box 944225, Sacramento, CA 94244-2250 [*see Corp. Code § 15902.02*].

For a guide to the procedures involved in amending the certificate, including the procedures for executing, acknowledging, and filing the certificate, see *§ 16.121[2]*.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 16.211. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Requirement for Amendment

A limited partnership must promptly deliver to the Secretary of State for filing an amendment to a certificate of limited partnership to reflect [*Corp. Code § 15902.02(b)*]:

- The admission of a new general partner;
- The dissociation of a person as a general partner; or
- The appointment of a person to wind up the limited partnership's activities under *Corp. Code § 15908.03(c)* or *(d)*.

A certificate of limited partnership may be amended at any time for any other proper purpose as determined by the limited partnership [*Corp. Code § 15902.02(d)*].

[c] Liability for False Information

A general partner that knows that any information in a filed certificate of limited partnership was false when the certificate was filed or has become false due to changed circumstances must promptly cause the certificate to be amended, or if appropriate, deliver to the Secretary of State for filing an amendment or a certificate of correction pursuant to *Corp. Code § 15902.07* [*Corp. Code § 15902.02(c)*; *see § 16.22[1][b]*].

[d] Signature Requirements

A certificate of amendment delivered to the Secretary of State for filing pursuant to the ULPA '08 must be signed as follows [*Corp. Code § 15902.04(a)*]. An amendment designating as a general partner a person admitted under *Corp. Code § 15908.01(c)(2)* following the dissociation of a limited partnership's last general partner must be signed by that person admitted as a general partner [*Corp. Code § 15902.04(a)(2)*]. An amendment required by *Corp. Code § 15908.03(c)* following the appointment of a person to wind up the dissolved limited partnership's activities [*see* Ch. 16A, *Dissolution of Limited Partnerships*] must be signed by that person [*Corp. Code § 15902.04(a)(3)*]. Any other amendment must be signed by [*Corp. Code § 15902.04(a)(4)*]:

- At least one general partner listed in the certificate of limited partnership;
- Each other person designated in the amendment as a new general partner; and
- Each person that the amendment indicates has dissociated as a general partner, unless (1) the person is deceased or a guardian or general conservator has been appointed for the person and the amendment so states; or (2) the person has previously delivered a certificate of dissociation to the Secretary of State for filing.

If a person required by the ULPA '08 to sign or deliver a record, *e.g.*, a certificate of amendment, to the Secretary of State for filing does not do so, any other person that is aggrieved may petition the superior court to order [*Corp. Code § 15902.05(a)*]:

- The person to sign the record;
- The person to deliver the record to the Secretary of State for filing; or
- The Secretary of State to file the record unsigned.

A record filed unsigned in this manner is effective without being signed [*Corp. Code § 15902.05(c)*].

Anyone other than a general partner who files the certificate must include the statutory authority after his or her signature [*Corp. Code § 15902.05(d)*]. Any person permitted or required to execute the certificate of amendment may do so by an attorney-in-fact [*Corp. Code § 15902.04(b)*].

[e] Restated Certificate of Limited Partnership

When a number of certificates of amendment have been filed or many additional amendments are necessary, the general partners may alternatively file a restated certificate of limited partnership that embodies in a single certificate all of the operative and effective provisions contained in the various certificates of amendment that have been filed with the Secretary of State [*Corp. Code § 15902.02(e)(1)*; *see § 16.212*]. The restated certificate may also include an amendment that has not been filed [*Corp. Code § 15902.02(e)(2)*]. The restated certificate replaces the initial certificate and all previously filed amendments [*Corp. Code § 15902.02(e)(3)*; *see Corp. Code § 15902.02(e)(4)*; *see also Corp. Code § 15902.04(a)(5)(a)(8)* (execution requirements)].

[2] FORM

Certificate of Amendment to Certificate of Limited Partnership

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
B. Limited Partnership Certificates
1. Domestic Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.212

§ 16.212 Restated Certificate of Limited Partnership

[1] Comment--Use of Form

This form is a reproduction of the restated certificate of limited partnership, LP-10, prescribed by the Secretary of State. A restated certificate embodies, in a single certificate, all of the operative and effective provisions contained in the different certificates that have been filed with the Secretary of State [*Corp. Code § 15902.02(e)(1)*]. The restated certificate replaces the original certificate of limited partnership and all amendments previously filed with the Secretary of State [*Corp. Code § 15902.02(e)(3)*]. A restated certificate [*Corp. Code § 15902.02(e)*] may be filed in lieu of filing a certificate of amendment [*see § 16.211*]. This approach is commonly taken when the original certificate has been amended several times, in order to eliminate any confusion.

The restated certificate may include an amendment that has not been previously filed with the Secretary of State [*Corp. Code § 15902.02(e)(2)*]. However, any new amendment effected in a restated certificate is subject to the other provisions of the ULPA '08 that would apply if a separate certificate of amendment were filed to effect that amendment or change [*Corp. Code § 15902.02(e)(4)*].

A restated certificate of limited partnership must be signed by at least one general partner listed in the certificate, and to the extent the restated certificate effects a change under any other paragraph of *Corp. Code § 15902.04(a)*, the restated certificate must be signed in a manner that satisfies the requirements of that paragraph [*Corp. Code § 15902.04(a)(5)*]; *see also § 16.211[1][d]*].

[2] FORM

Restated Certificate of Limited Partnership

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
B. Limited Partnership Certificates
1. Domestic Limited Partnerships

8-16 California Legal Forms--Transaction Guide §§ 16.213-16.219

[Reserved]

§§ 16.213[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
B. Limited Partnership Certificates
2. Foreign Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.220

§ 16.220 Application for Registration as a Foreign Limited Partnership

[1] Comment

[a] Use of Form

This form is the Secretary of State's official application for registration of a foreign limited partnership, LP-5. A foreign limited partnership must register, using this application form, before it transacts intrastate business in California [*Corp. Code § 15909.02*]. In general, the term "transact intrastate business" means entering into repeated and successive business transactions in California, other than interstate or foreign commerce [*Corp. Code § 15901.02(ai)*; *see § 16.51[1][b]*].

The original and one copy of the application, together with the filing fee [*see Gov. Code § 12188(c)*], must be mailed to the office of the Secretary of State, Limited Partnership Unit, P.O. Box 944225, Sacramento, CA 94244-2250. If the Secretary of State finds that the application conforms to the law and that all requisite fees have been paid, the Secretary of State's office will issue a certificate of registration to transact intrastate business in California, subject to any licensing requirements otherwise imposed by the laws of California [*Corp. Code § 15909.04*].

For a guide to the procedures involved in registering a foreign limited partnership, and the procedures for executing and filing the certificate, see *§ 16.112*. For discussion of the ULPA '08 requirements imposed on foreign limited partnerships, including the sanctions against an unregistered foreign limited partnership under *Corp. Code § 15909.07*, see *§§ 16.50*-16.55. For the form used to amend the application for registration, see *§ 16.221*.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 16.220. Please be sure to

include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Contents of Form

The application for registration as a foreign limited partnership must be signed and acknowledged by a general partner, and must set forth all of the following [*Corp. Code § 15909.02(a)*]:

- The name of the foreign limited partnership and, if its name does not comply with *Corp. Code § 15901.08* [*see § 16.21[3]*], for purposes of transacting business in California it must adopt an alternate name that does comply [*Corp. Code §§ 15909.02(a)(1), 15909.05(a)*];
- The state or jurisdiction under whose law the partnership is organized;
- The name and address of a partnership's initial agent for service of process [*see* Corp. Code §];
- The street address of the designated office of the foreign limited partnership and, if laws of jurisdiction under which partnership is organized require it to maintain office there, address of that office; and
- The names and addresses of the general partners.
- Whether foreign limited partnership is foreign limited liability partnership.

The partnership must also deliver a certificate of existence signed by the official having custody of its publicly filed records in the jurisdiction where the partnership is organized [*Corp. Code § 15909.02(b)*].

A foreign limited partnership whose name does not comply with *Corp. Code § 15901.08* [*see § 16.21[3]*], may not obtain a certificate of registration until it adopts, for purposes of transacting business in California, an alternate name that does comply [*Corp. Code § 15909.05(a)*].

[c] Payment of Filing Fee

The fee for filing the application for registration as a foreign limited partnership must accompany the application [*Gov. Code § 12188(c)*]. The Secretary of State may cancel the partnership's application and certificate of registration if the partnership's check or other remittance submitted to pay the filing fee is not honored. On receiving written notification that the check was not honored for payment, the Secretary must give written notice to the partnership's agent for service of process or to the person who submitted the check that the application and certificate will be cancelled if payment is not received. If the partnership does not then pay the amount due with a cashier's check or its equivalent, the Secretary will issue a second written notice of cancellation, effective immediately. The second notice must be given at least 20 days after the first notice and no later than 90 days after the original filing [*Corp. Code § 15909.05(c)*].

[2] FORM

Application for Registration as a Foreign Limited Partnership

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
B. Limited Partnership Certificates
2. Foreign Limited Partnerships

8-16 California Legal Forms--Transaction Guide § 16.221

§ 16.221 Amendment to Application for Registration as a Foreign Limited Partnership

[1] Comment--Use of Form

This form is the Secretary of State's official form for amendment of a foreign limited partnership's application for registration, LP-6. A foreign limited partnership must file this form if any statement in its application for registration was false when made or has become erroneous. The amendment must be signed and acknowledged by a general partner. The original and one copy of the amendment must be filed promptly in the office of the Secretary of State, Limited Partnership Unit, P.O. Box 944225, Sacramento, CA 94244-2250 [*Corp. Code § 15909.06*]. A filing fee must accompany the form [*see Gov. Code § 12188(e)*].

For a discussion of the registration and amendment requirements for foreign limited partnerships, see *§§ 16.50* through 16.55. For a guide to the procedures involved in registering and amending the registration of a foreign limited partnership, see *§ 16.112*.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 16.221. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[2] FORM

Amendment to Application for Registration as a Foreign Limited Partnership

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
B. Limited Partnership Certificates
2. Foreign Limited Partnerships

8-16 California Legal Forms--Transaction Guide §§ 16.222-16.229

[Reserved]

§§ 16.222[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
C. Consents
1. Partnership Meetings

8-16 California Legal Forms--Transaction Guide § 16.230

§ 16.230 Written Consent of Partner to Action Taken Without a Meeting of Partners

[1] Comment

This form is a written consent by a limited partner to actions that would ordinarily be voted on at a meeting. Unlike prior law [*see, e.g., Corp. Code § 15637* (CRLPA, repealed January 1, 2010)], the ULPA '08 does not contain default provisions regarding partnership meetings [*see* Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* , § 732.01[2] (Matthew Bender)]. It does specify, however, that any action requiring the consent of partners under the ULPA '08 may be taken without a meeting [*Corp. Code § 15901.15*]. A partner may appoint a proxy to consent or otherwise act for the partner by signing an appointment record, either personally or by the partner's attorney in fact [*Corp. Code § 15901.15*; *see Corp. Code § 15902.04* (any record may be signed by attorney in fact)].

It is probably not good practice to permit all actions on which the limited partners have a right to vote (such as the expulsion of a general partner) to be consummated by written consent. However, many partnership actions can be approved in this manner. If there are certain actions that will not be subject to the general written consent provision in this form, it should be modified to indicate what the excluded actions are.

[2] FORM

Written Consent of Partner to Action Taken Without a Meeting of Partners

CONSENT TO ACTION TAKEN WITHOUT MEETING

The undersigned, _____ [*name*], a _____ [General *or* Limited] Partner in _____ [*name of partnership*], who represents _____ [*specify*] percent of the interests of the Partners in the Partnership, consents to the following actions being taken without meeting of the Partners.

_____ [*describe action(s)*].

[*Add, if desired:*]

APPOINTMENT OF PROXY

I hereby appoint _____ [*name*] to consent or otherwise act for me with respect to the above-stated action(s).
Dated: _____.

_____ [*signature of partner, personally or by partner's attorney in fact*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
C. Consents
1. Partnership Meetings

8-16 California Legal Forms--Transaction Guide §§ 16.231-16.239

[Reserved]

§§ 16.231[Reserved]



65 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
C. Consents
2. Admission of Partners

8-16 California Legal Forms--Transaction Guide § 16.240

§ 16.240 Consent to Admission of Partner's Transfree as Limited Partner

[1] Comment--Use of Form

This form is a consent to the admission of a limited or general partner's transferee to a limited partnership. It is for use when the partnership agreement requires the consent of all or a stated number or percent of the partners or if it is silent on the subject.

An transferee of a general or limited partner's interest in a limited partnership may become a limited partner if and to the extent that the partnership agreement provides or all the general partners and a majority in interest of the limited partners consent [*Corp. Code § 15907.01(h)*; *see Corp. Code § 15901.02(t)* ("majority in interest of the limited partners" defined)]. The assignee becomes a limited partner at the time provided in, or on compliance with, the partnership agreement.

For additional discussion of the admission of limited partners, see *§ 16.32*.

[2] FORM

Consent to Admission of Partner's Transferee as Limited Partner

CONSENT TO ADMISSION OF TRANSFEREE AS LIMITED PARTNER

The undersigned, _____ [*name*], a _____ [General *or* Limited] Partner in _____ [*name of partnership*] (Partnership), [*add following if partnership agreement requires consent by specified voting margin:* who represents _____ (*specify*) percent of the interests of the Partners in the Partnership,] consents to the admission of _____ [*name*], of _____ [*address*], as a Limited Partner in the Partnership and as the holder of a _____ [*specify*] percent interest in the Partnership.
Dated: _____.

_____ [*signature of partner*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
C. Consents
2. Admission of Partners

8-16 California Legal Forms--Transaction Guide § 16.241

§ 16.241 Consent to Admission of New General Partner

[1] Comment

[a] Use of Form

This form is a consent by the partners of a limited partnership to the admission of a new general partner. It includes space for the signatures of all the partners. All consents to admission of a general partner should be filed in the partnership records.

For general discussion of the admission of general partners, see *§ 16.36*. For a consent by the limited partners to the admission of a replacement for a sole general partner who has ceased to be a general partner (by any means), and relevant discussion, see *Section 16.242*.

[b] Admission of New General Partner

A person becomes a general partner [*Corp. Code § 15904.01*]:

- As provided in the partnership agreement.
- Under *Corp. Code § 15908.01(c)(2)* following the dissociation of a limited partnership's last general partner, in order to continue the activities of the limited partnership [*see § 16.242*].
- As the result of a conversion or merger [*see Corp. Code § 15911.01 et seq.*; *see also* Ch. 16B, *Conversions and Mergers of Limited Partnerships*].
- With the consent of all the partners.

Upon the admission of a new general partner, the limited partnership must promptly deliver to the Secretary of State for

filing an amendment to the certificate of limited partnership to reflect that fact [*see Corp. Code § 15902.02(b)(1)*].

[2] FORM

Consent to Admission of New General Partner

CONSENT TO ADMISSION OF GENERAL PARTNER

The undersigned Partners of _____[*name of partnership*] (Partnership) consent to the admission of _____[*name*], of_____[*address*], as a General Partner in the Partnership and as the holder of a _____ [*specify*] percent interest in the Partnership.
Dated: _____.

PARTNERS
_____ [*signature of partner*]
[*typed name*]

_____ [*signature of partner*]
[*typed name*]

_____ [*signature of partner*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
C. Consents
2. Admission of Partners

8-16 California Legal Forms--Transaction Guide § 16.242

§ 16.242 Consent to Admission of Replacement for Sole General Partner and to Continue Activities of Limited Partnership

[1] Comment

[a] Use of Form

This form is a consent by the limited partners to the admission of a replacement for a sole remaining general partner and to continue the activities of the partnership. It includes space for the signatures of all the limited partners, although a separate consent form may be executed by each limited partner whose consent is required. This form may be used when the only general partner ceases to be a general partner [*see Corp. Code § 15908.01(c)(2)*; *see also* [b], *below*]. All consents to the admission of a general partner should be filed in the partnership records.

For general discussion of the admission of general partners, see *§ 16.36*.

[b] Replacement for Sole General Partner

Ordinarily, a limited partnership is dissolved, and its activities must be wound up upon the passage of 90 days after dissociation of the last general partner, unless before the end of that period [*Corp. Code § 15908.01(c)(2)*]:

- Consent to continue the activities of the limited partnership and admit at least one general partner is given by limited partners owning a majority of the rights to receive distributions as limited partners at the time the consent is to be effective; and

- At least one person is admitted as a general partner in accordance with the consent.

The limited partners may vote on the admission of a general partner and an election to continue the business of the partnership without being deemed to participate in the control of the business [*see Corp. Code § 15903.03(b)(5)*].

[2] FORM

Consent to Admission of Replacement for Sole General Partner and Election to Continue Business Partnership

CONSENT TO REPLACEMENT OF GENERAL PARTNER

[*Select one of the following:*]

[*If name of replacement general partner is known, use:*]

The undersigned Limited Partners of _____[*name of limited partnership*] (Partnership), who own a majority of the rights to receive distributions as limited partners as of the time this consent is to be effective, consent to continue the activities of the Partnership and consent to the admission of _____[*name*], of _____[*address*], as a General Partner in the Partnership and as the holder of a _____ [*specify*] percent interest in the Partnership.

[*Continue with the following:*]

LIMITED PARTNERS
_____ [*signature of partner*]
[*typed name*]
_____ [*date*]

_____ [*signature of partner*]
[*typed name*]
_____ [*date*]

_____ [*signature of partner*]
[*typed name*]
_____ [*date*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
C. Consents
2. Admission of Partners

8-16 California Legal Forms--Transaction Guide §§ 16.243-16.249

[Reserved]

§§ 16.243[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
C. Consents
3. Compromise of Partner's Obligations

8-16 California Legal Forms--Transaction Guide § 16.250

§ 16.250 Consent to Compromise of Partner's Obligation to Make Contribution or Return Distribution to Partnership

[1] Comment

[a] Use of Form

This form is a consent by a partner to the compromise of another partner's obligation to make a contribution of capital or to return money or property distributed in violation of law. It is for use only if the partnership agreement does not prohibit any such compromise and, if not prohibited it should be used when, for any reason, a partner finds it necessary to obtain such a compromise.

With respect to the compromise of an obligation to make a contribution, the more common practice in installments in the partnership agreement for default procedures that will result in the general or limited partners buying out the defaulting partner rather than compromising the claim for contributions.

[b] Execution of Compromise

Unless the partnership agreement provides to the contrary, a partner's obligation to make a contribution to the partnership (or return money or other property paid or distributed in violation of the ULPA '08) may be compromised only by the consent of all the partners [*Corp. Code § 15905.02(c)*]. Therefore, if the partnership agreement does not provide for the execution of a compromise by less than all of the partners, each partner must execute a copy of this form [*see Corp. Code § 15905.02(c)*; *see also* [d], *below*].

[c] Obligation of Partner's Transferee

An transferee who becomes a partner with respect to a transferable interest [*see Corp. Code § 15901.02(ak)* (right to receive distributions)] is liable for the obligations of the transferor to make contributions to the partnership. [*Corp. Code § 15907.02(g)*; *see Corp. Code § 15905.02*; *see also § 16.38*]. Furthermore, a transferee that becomes a partner with

respect to a transferable interest is liable for the transferor's obligations under *Corp. Code § 15905.09* [*Corp. Code § 15907.02(g)*]. Under that section, a partner or transferee that received a distribution knowing that the distribution to that partner or transferee was made in violation of *Corp. Code § 15905.08* [*see § 16.40*] is personally liable to the limited partnership, but only to the extent that the distribution received by the partner or transferee exceeded the amount that could have been properly paid under *Corp. Code § 15905.08* [*Corp. Code § 15907.02(g)*]. However, the transferee is not obligated for liabilities that are unknown to the transferee at the time that the transferee becomes a partner [*Corp. Code § 15907.02(g)*].

[d] Creditors' Rights

A creditor of a limited partnership which extends credit or otherwise acts in reliance on an partner's obligation to contribute [*see Corp. Code § 15905.02(a)*], without notice of any compromise, may enforce the original obligation [*Corp. Code § 15905.02(c)*]. Nothing in *Corp. Code § 15905.02* will be construed to affect the rights of third-party creditors of the partnership to seek equitable remedies nor any rights existing under the Uniform Fraudulent Transfer Act [*Corp. Code § 15905.02(c)(7)*; *see* Civ. Code § 2429 et seq.].

For further discussion, see *§§ 16.31[3]*, *16.34[3][b]*.

[2] FORM

Consent to Compromise of Partner's Obligation to Make Contribution or Return Distribution to Partnership

COMPROMISE OF PARTNER'S OBLIGATION

The undersigned, _____[*name*], a _____ [General *or* Limited] Partner in _____[*name of partnership*] (Partnership), who represents _____ [*specify*] percent of the interests of the Partners in the Partnership, consents to the compromise of the obligation of _____[*name*], a _____ [General Partner *or* Limited Partner] in the Partnership to

[*Use following to compromise obligation to make or complete an agreed contribution:*]

_____ [make *or* complete] the contribution of capital _____ [*describe obligation, e.g.,* in the amount of $_____ *or* in the form of _____ (*describe property*)] to the Partnership.

[*OR*]

[*Use following to compromise obligation to return distribution made to a partner:*]

return money or property distributed to that Partner in violation of the Uniform Limited Partnership Act of 2008.

[*Continue with following:*]

The undersigned agrees that the effect of this compromise is _____ [as described in that certain instrument of compromise dated _____ (*date*) *or* to eliminate any previous obligation of that Partner to _____ (make *or* complete a contribution of capital to the Partnership *or* return any money or

property distributed to that Partner in violation of the Uniform Limited Partnership Act of 2008) *or otherwise describe effect*].
Dated: _____

_____ [*signature of partner*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
D. Other Limited Partnership Forms

8-16 California Legal Forms--Transaction Guide § 16.260

§ 16.260 Request for Reservation of Limited Partnership Name--Official Form

[1] Comment--Use of Form

This form is the official name reservation form used by the California Secretary of State's office. The form may be used to request the reservation of a corporate, limited partnership, or limited liability company name.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 16.260. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Under the ULPA '08, a person may apply to reserve a name by delivering to the Secretary of State an application that states the name to be reserved and the paragraph of *Corp. Code § 15901.08(a)* (regarding person making application) that applies [*see § 16.21[3]*]. If the Secretary of State finds that the name is available for use by the applicant, the Secretary will issue a certificate of name reservation and thereby reserve the name for the exclusive use of the applicant for 60 days [*Corp. Code § 15901.09(b)*]. Only one reservation will be made per request form. The name reservation request must be accompanied by a check, payable to the Secretary of State, covering the applicable fee of $10. The applicable fee does not depend on the number of names included in the request [*see* "Limited Partnership Name Availability," Secretary of State's website located at http://www.ss.ca.gov/business/lp/lp_naav2.htm#resv].

The request may be submitted by mail, along with a self-addressed envelope, to the Sacramento office at [*see instructions to Form*]:

Secretary of State

Name Availability Unit
1500 11th Street, 3d Floor
Sacramento, CA 95814

The request may be submitted in person at the Secretary of State's Sacramento office. A special handling fee applies to each name reserved in person. This fee must be remitted by separate check, payable to the Secretary of State; the fee will be retained regardless of whether the reservation of the proposed name is accepted or denied. Currently, email and/or online requests for name reservations are not accepted [*see* "Limited Partnership Name Availability," Secretary of State's website located at http://www.ss.ca.gov/business/lp/lp_naav2.htm#resv].

For discussion of name reservation for limited partnerships, see *§ 16.21[3]*. For a procedural guide to assist in choosing a limited partnership name, see *§ 16.111*.

[2] FORM

Request for Reservation of Limited Partnership Name--Official Form

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16 FORMATION OF LIMITED PARTNERSHIPS
PART IV. FORMS
D. Other Limited Partnership Forms

8-16 California Legal Forms--Transaction Guide § 16.261

§ 16.261 Resignation of Agent for Service of Process [Form RA-100]

[1] Comment--Use of Form

This form is the Secretary of State's official Form RA-100, "Resignation of Agent Upon Whom Process May Be Served." This form is for use by a resigning agent for service of process to notify the Secretary of State of the resignation [*see Corp. Code § 15901.16(d)(2)*]. Use of this form is not mandatory. It is provided for the convenience of the resigning agent. The resigning agent alternatively may notify the Secretary of State of his or her resignation with a letter of resignation. When notified of the resignation, the Secretary of State will provide written notice of the resignation to the LLP [*Corp. Code § 15901.16(d)(2)*].

An agent designated for service of process may file a signed and acknowledged statement of resignation as agent, which will terminate the agent's authority to act in that capacity. The Secretary of State will mail written notice of the resignation to the limited partnership or foreign limited partnership at its designated office [*Corp. Code § 15901.16(d)(2)*]. If the agent for service of process resigns, a domestic limited partnership must promptly file an amendment to the certificate of limited partnership [Corp. Code § *Corp. Code § 15901.16(d)(3)*; *see Corp. Code § 15902.02(b)(3)*] and appoint another agent for service of process. on receipt of the notice. Similarly, on the resignation of the agent for service of process of a foreign limited partnership, the partnership must promptly file an amendment to its application for registration [Corp. Code § *Corp. Code § 15901.16(d)(3)*; *see Corp. Code § 15909.06*] and appoint another agent.

This form may be obtained from any office of the Secretary of State.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 16.261. Please be sure to include your email address along with your request and we will provide the form via return email. To

view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[2] FORM

Resignation of Agent for Service of Process [Form LP-100]

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72 of 175 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS

8-16A California Legal Forms--Transaction Guide 16A.syn

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.syn Synopsis to Chapter 16A: DISSOLUTION OF LIMITED PARTNERSHIPS

§ 16A.301 California Statutes

§ 16A.302 Federal Sources

[1] Statutes

[2] Regulations

§§ 16A.303-16A.304 [Reserved]

§ 16A.305 Law Reviews [Reserved]

§ 16A.306 Text References

[1] Matthew Bender Sources

[2] Additional Text References [Reserved]

§§ 16A.307-16A.309 [Reserved]

§ 16A.310 Dissolution of Limited Partnerships Under the ULPA '08

§ 16A.311 Process of Dissolution, Winding Up, and Cancellation

§ 16A.312 Causes of Dissolution Under ULPA '08

[1] Nonjudicial Dissolution

[2] Judicial Dissolution

§ 16A.313 Winding Up Partnership Activities

[1] Continuation of Partnership for Purpose of Winding Up

[2] Appointment of Person to Wind Up Activities

[3] Judicial Supervision of Winding Up

[4] Limited Partners' Entitlement to Reasonable Compensation

§ 16A.314 Certificate of Cancellation

§ 16A.315 Reviving Canceled Certificate

[1] Requirements

[2] Contents of Certificate of Revival

[3] Certificate Deemed To Be Amendment

[4] Effect of Filing Certificate

§ 16A.316 Acts of Partner Binding Partnership After Dissolution

[1] General Partner

[2] Dissociated General Partner

§ 16A.317 Liability of General Partner After Dissolution

§ 16A.318 Disposing of Claims Against Partnership

§ 16A.319 Notice of Dissolution

[1] Nature and Contents of Notice

[2] Claims That Are Barred

[3] Enforcement of Claims That Are Not Barred

[4] Tax Liabilities

§ 16A.320 Application of Assets to Satisfy Obligations to Creditors

[1] Obligations to Creditors

[2] Remaining Surplus

[3] Assets Insufficient to Satisfy Obligations

§§ 16A.321-16A.399 [Reserved]

§ 16A.400 Information Required for Dissolution and Winding Up

[1] Facts

Scope

[2] Documents

Scope

§§ 16A.401-16A.409 [Reserved]

§ 16A.410 Circumstances Causing Dissolution

Scope

§ 16A.411 Determining Partnership's Liability for Acts of Partners Following Dissolution

Scope

§§ 16A.412-16A.419 [Reserved]

§ 16A.420 Dissolving Limited Partnership

Scope

§ 16A.421 Winding Up Partnership Activities

Scope

§ 16A.422 Disposing of Claims Against Dissolved Partnership

Scope

§ 16A.423 Publishing Notice of Dissolution

Scope

§ 16A.424 Applying Assets to Satisfy Obligations

Scope

§§ 16A.425-16A.429 [Reserved]

§ 16A.430 Reviving Canceled Certificate

Scope

§ 16A.431 Applying for Judicial Dissolution

Scope

§§ 16A.432-16A.439 [Reserved]

§ 16A.440 Agreement to Dissolve Limited Partnership

[1] Comment

[2] FORM

A Agreement to Dissolve Limited Partnership

§ 16A.441 Agreement to Dissolve Limited Partnership After Dissociation of General Partner

[1] Comment

[2] FORM

Agreement to Dissolve Limited Partnership After Dissociation of General Partner

§ 16A.442 Agreement to Continue Activities of Limited Partnership After Dissociation of Sole General Partner

[1] Comment

[a] Use of Form

[b] Avoiding Dissolution on Dissociation of Sole General Partner

[c] Requirement That Certificate of Limited Partnership Be Amended

[2] FORM

Agreement to Continue Activities of Limited Partnership After Dissociation of Sole General Partner

§§ 16A.443-16A.449 [Reserved]

§ 16A.450 Certificate of Cancellation

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[c] Signature Requirements

[d] Recording Certificate

[2] FORM

§ 16A.451 Certificate of Revival

[1] Comment

[a] Use of Form

[b] Deemed Amendment to Certificate of Limited Partnership

[c] Confirmation of Tax Payments

[d] Contents of Certificate

[e] Signature Requirements

[f] Effect of Filing Certificate

[2] FORM

Reviewed by W. Rod Stern, J.D., LL.M.,
Groh, Carroll & Sternn*

FOOTNOTES:

(n43)Footnote *. The law firm of Groh, Carroll & Stern (Irvine, California) concentrates in the specialty areas of business, corporate, and tax law for transactional matters, and handles business, corporate, tax, and real estate litigation and arbitration matters. Mr. Stern received an LL.M. in Taxation from New York University School of Law in 1989, and a J.D. from Hastings College of the Law, University of California, in 1983. His personal practice emphasizes business and tax planning advice for individuals and small and medium-size businesses, as well as tax litigation and dispute resolution, probate, and conservatorship matters.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS

8-16A California Legal Forms--Transaction Guide Scope

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

Scope

Reviewed by W. Rod Stern, J.D., LL.M.,
Groh, Carroll & Sternn* Scope

This chapter covers the dissolution of limited partnerships under the Uniform Limited Partnership Act of 2008 (ULPA '08) [*Corp. Code § 15900-15912.07*]. As of January 1, 2010, this act governs all limited partnerships, except as otherwise provided in *Corp. Code § 15912.06(c)* [*Corp. Code § 15912.06(b)*; *see Ch. 16, Formation of Limited Partnerships, § 16.11*]. The Legal Background discusses the causes of nonjudicial dissolution and issues related to winding up and termination of a limited partnership. The Transaction Guide covers the procedural steps required to dissolve and wind up a limited partnership. The Forms section of this chapter includes several agreements among partners relating to dissolution or continuation of a limited partnership. It also includes official forms required to be filed with the Secretary of State.

For the requirements and procedure for forming a limited partnership under the ULPA '08, see Chapter 16, *Formation of Limited Partnerships* . The merger of limited partnerships is covered in Chapter 16B, *Conversions and Mergers of Limited Partnerships* . The tax consequences of dissolving a partnership are discussed in Chapter 15, Part B, *Dissolution of General Partnerships* .

For detailed discussion of all the California partnership acts, see Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* (Matthew Bender). That chapter summarizes major similarities and differences between the ULPA '08 and the prior law, the California Revised Limited Partnership Act (CRLPA) [former *Corp. Code § 15611 et seq.*, repealed Jan. 1, 2010], and provides detailed coverage of the ULPA '08.

FOOTNOTES:
(n44)Footnote *. The law firm of Groh, Carroll & Stern (Irvine, California) concentrates in the specialty areas of business, corporate, and tax law for transactional matters, and handles business, corporate, tax, and real estate litigation and arbitration matters. Mr. Stern received an LL.M. in Taxation from New York University School of Law in 1989, and a J.D. from Hastings College of the Law, University of California, in 1983. His personal practice emphasizes business and tax planning advice for individuals and small and medium-size businesses, as well as tax litigation and dispute resolution, probate, and conservatorship matters.



74 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

8-16A California Legal Forms--Transaction Guide § 16A.301

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.301 California Statutes

Dissolution under Uniform Limited Partnership Act of 2008.
Amendment of certificate of limited partnership upon appointment of person to wind up. *Corp. Code § 15902.02*.
Certificate of cancellation. *Corp. Code § 15902.03*.
Signature requirements on filed records. *Corp. Code § 15902.04*.
Causes of dissolution. *Corp. Code § 15908.01*.
Application for dissolution. *Corp. Code § 15908.02*.
Winding up activities after dissolution. *Corp. Code § 15908.03*.
Liability for general partner's acts after dissolution. *Corp. Code § 15908.04*.
Liability for obligations incurred after dissolution. *Corp. Code § 15908.05*.
Disposing of claims against dissolved partnership. *Corp. Code § 15908.06*.
Notice of dissolution. *Corp. Code § 15908.07*.
Barred claims. *Corp. Code § 15908.08*.
Application of assets to obligations. *Corp. Code § 15908.09*.
Application and construction of ULPA '08. *Corp. Code § 15912.01*.
Severability of provisions. *Corp. Code § 15912.02*
Operative date of ULPA '08. *Corp. Code § 15912.04*.
Limitations on application before Jan. 1, 2010. *Corp. Code § 15912.06*.
Application of provisions before operative date. *Corp. Code § 15912.07*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

8-16A California Legal Forms--Transaction Guide § 16A.302

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.302 Federal Sources

[1] Statutes

Income of partners. *I.R.C. § 702*.

Taxable year of partner and partnership. *I.R.C. § 706*

Liquidating distribution. *I.R.C. § 731*.

Optional adjustment to basis of partnership property. *I.R.C. §§ 732-734, 743, 754*.

Gain on unrealized receivables and inventory items. *I.R.C. §§ 735-751*.

Sale or exchange. *I.R.C. § 741*.

[2] Regulations

Income of partners. *Treas. Reg. §§ 1.702-1, 1.702-2*.

Taxable year of partner and partnership. *Treas. Reg. § 1.706-1*.

Liquidating distribution. *Treas. Reg. §§ 1.731-1, 1.736-1*.

Optional adjustment to basis of partnership property. *Treas. Reg. §§ 1.732-1, 1.732-1, 1.733-1, 1.734-1, 1.734-2, 1.743-1, 1.734-1*.

Gain on unrealized receivables and inventory items. *Treas. Reg. §§ 1.735-1, 1.751-1*.

Sale or exchange. *Treas. Reg. § 1.741-1*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

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[Reserved]

§§ 16A.303[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-16A California Legal Forms--Transaction Guide § 16A.305

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

Law Reviews [Reserved]

§ 16A.305Law Reviews [Reserved]



78 of 175 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-16A California Legal Forms--Transaction Guide § 16A.306

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.306 Text References

[1] Matthew Bender Sources

Ballantine & Sterling, California Corporation Laws (Matthew Bender)
Ch. 25, *Limited Partnerships*.
Ch. 26, *Income Taxation of Partnerships*.

California Legal Forms (Matthew Bender)
Ch. 16, *Formation of Limited Partnerships*
Ch. 16B, *Conversion and Merger of Limited Partnerships*

California Forms of Pleading and Practice (Matthew Bender)
Ch. 400, *Partnerships: Governing Statutes*.
Ch. 404, *Partnerships: Actions Between Limited Partners and Partnership*.
Ch. 405, *Partnerships: Actions Between Limited Partners or Partnerships and Third Parties*.
Ch. 406, *Partnerships: Dissolution*.

[2] Additional Text References [Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

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AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

[Reserved]

§§ 16A.307[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND

8-16A California Legal Forms--Transaction Guide § 16A.310

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.310 Dissolution of Limited Partnerships Under the ULPA '08

As of January 1, 2010, the ULPA '08 governs *all* limited partnerships, except as otherwise provided in *Corp. Code § 15912.06(c)* [*Corp. Code § 15912.06(b) ; see Ch. 16, Formation of Limited Partnerships, § 16.11*; *see also 16A.312[1], below*].

The ULPA '08 does not affect an action commenced, proceeding brought, or right accrued before the chapter became operative (January 1, 2008) [*Corp. Code § 15912.07*].

For detailed discussion of California partnership law, including the California Revised Limited Partnership Act (CRLPA) [former *Corp. Code § 15611 et seq.*, repealed Jan. 1, 2010], see Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND

8-16A California Legal Forms--Transaction Guide § 16A.311

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.311 Process of Dissolution, Winding Up, and Cancellation

Dissolution of a limited partnership is a process that consists of winding up of partnership affairs, liquidation of its assets, and cancellation of its certificate of limited partnership. "Winding up" partnership activities may involve amending the certificate of limited partnership to state that the partnership is dissolved, prosecuting and defending actions and proceedings, transferring partnership property, settling disputes, discharging the partnership's liabilities, and distributing partnership assets [*see Corp. Code § 15908.03*; *see also § 16A.313*]. A partnership may publish notice of its dissolution requesting persons with claims against it to present them [*see Corp. Code § 15908.07*; *see also § 16A.319*], and may dispose of known claims by following specified procedures [*see Corp. Code § 15908.06*; *see also § 16A.318*]. Upon completion of winding up, a dissolved limited partnership must file a certificate of cancellation [*see Corp. Code § 15902.03*; *see also § 16A.450*].



82 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND

8-16A California Legal Forms--Transaction Guide § 16A.312

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.312 Causes of Dissolution Under ULPA '08

[1] Nonjudicial Dissolution

Except as provided in *Corp. Code § 15908.02* (judicial dissolution) [*see* [2], *below*], a limited partnership is dissolved and its activities must be wound up only upon the occurrence of any of the following [*Corp. Code § 15908.01*]:

- The happening of an event specified in the partnership agreement [*Corp. Code § 15908.01(a)*].

- The consent of all general partners and of limited partners owning a majority of the rights to receive distributions as limited partners at the time the consent is to be effective [*Corp. Code § 15908.01(b)*; *see Corp. Code § 15901.02(f)* ("distribution" defined)].

- After the dissociation of a person as a general partner [*Corp. Code § 15908.01(c)*]:

  (1) If the limited partnership has at least one remaining general partner, and a consent to dissolve the partnership is given within 90 days after the dissociation by partners owning a majority of the rights to receive distributions as partners at the time the consent is to be effective; or

  (2) If the limited partnership does not have a remaining general partner, the passage of 90 days after the dissociation, unless before the end of that period (a) consent to continue the activities of the limited partnership and admit at least one general partner is given by limited partners owning a majority of the rights to receive distributions a limited partners at the time the consent is to be effective, and (b) at least one person is admitted as a general partner in accordance with the consent.

- The passage of 90 days after the dissociation of the limited partnership's last limited partner, unless

before the end of the period the limited partnership admits at least one limited partner.

With respect to a limited partnership formed before January 1, 2008, except as the partners otherwise elect in the manner provided in the partnership agreement or by law for amending the partnership agreement, *Corp. Code § 15908.01(c)* does not apply. The connection between a person's dissociation as a general partner and the dissolution of the limited partnership is the same as existed immediately before January 1, 2008 [*Corp. Code § 15912.06(c)(5)*; *see Ch. 16, Formation of Limited Partnerships, § 16.11*].

[2] Judicial Dissolution

On application by a partner, a court of competent jurisdiction may order dissolution of a limited partnership if it is not reasonably practicable to carry on the activities of the limited partnership in conformity with the partnership agreement [*Corp. Code § 15908.02(a)*]. The other partners, however, may avoid dissolution by purchasing for cash the partnership interests owned by the partners initiating the proceedings at their fair market value [*Corp. Code § 15908.02(a)*]. A partnership agreement may not eliminate the power of a court to decree dissolution in the circumstances specified in *Corp. Code § 15908.02(b)(9)* [*Corp. Code § 15901.10*; *see Ch. 16, Formation of Limited Partnerships, § 16.21[4][b]*].

For further coverage of judicial dissolution, see California Forms of Pleading and Practice, Ch. 406, *Partnerships: Dissolution* (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND

8-16A California Legal Forms--Transaction Guide § 16A.313

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.313 Winding Up Partnership Activities

[1] Continuation of Partnership for Purpose of Winding Up

A limited partnership continues after dissolution only for the purpose of winding up its activities [*Corp. Code § 15908.03(a)*]. A partnership agreement may not vary the requirement to wind up the partnership's business as specified in *Corp. Code § 15908.03* [*Corp. Code § 15901.10*; *see Ch. 16, Formation of Limited Partnerships, § 16.21[4][b]*].

In winding up, a partnership must discharge the limited partnership's liabilities, settle and close the limited partnership's activities, and marshal and distribute the assets of the partnership [*Corp. Code § 15908.03(b)(2)*]. The partnership may (1) amend its certificate of limited partnership to state that the partnership is dissolved, (2) preserve the limited partnership business or property as a going concern for a reasonable time, (3) prosecute and defend actions and proceedings, whether civil, criminal, or administrative, (4) transfer the limited partnership's property, (5) settle disputes by mediation or arbitration, (6) file a certificate of cancellation [*see Corp. Code § 15902.03*; *see also § 16A.314*], and (7) perform other necessary acts [*Corp. Code § 15908.03(b)(1)*].

[2] Appointment of Person to Wind Up Activities

If a dissolved limited partnership does not have a general partner, a person to wind up the limited partnership's activities may be appointed by the consent of limited partners owning a majority of the rights to receive distributions as limited partners at the time the consent is to be effective [*Corp. Code § 15908.03(c)*]. A person so appointed has the powers of a general partner under *Corp. Code § 15908.04* [*see § 16A.316*]. That person must promptly amend the certificate of limited partnership to state that the limited partnership does not have a general partner, and the name of the address of the person appointed to wind up the limited partnership [*Corp. Code § 15908.03(c)*].

[3] Judicial Supervision of Winding Up

On the application of any partner, the appropriate court may order judicial supervision of the winding up, including the appointment of a person to wind up the dissolved limited partnership's activities, if (1) the limited partnership does not

have a general partner and within a reasonable time following the dissolution no person has been appointed pursuant to *Corp. Code § 15908.03(c)* [*see* [2], *above*], or (2) the applicant establishes other good cause [*Corp. Code § 15908.03(d)*].

[4] Limited Partners' Entitlement to Reasonable Compensation

Unless otherwise provided in the partnership agreement, the limited partners winding up the affairs of the partnership pursuant to *Corp. Code § 15908.03* are entitled to reasonable compensation [*Corp. Code § 15908.03(e)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND

8-16A California Legal Forms--Transaction Guide § 16A.314

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.314 Certificate of Cancellation

A dissolved limited partnership that has completed winding up must deliver to Secretary of State, on a form prescribed by the Secretary for filing, a certificate of cancellation that states [*Corp. Code § 15902.03*]:

- The name of the limited partnership and the Secretary of State's file number.
- The date of filing its initial certificate of limited partnership.
- Any other information as determined by the general partners filing the certificate, or by a person appointed pursuant to *Corp. Code § 15908.03(c)* or *(d)* [*see § 16A.313[2], [3]*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND

8-16A California Legal Forms--Transaction Guide § 16A.315

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.315 Reviving Canceled Certificate

[1] Requirements

A domestic limited partnership [*see Corp. Code § 15901.02(g)*] whose certificate of limited partnership has been canceled pursuant to *Corp. Code § 15902.03* [*see § 16A.314, above*] may be revived by filing a certificate of revival with the Secretary of State, on a form prescribed by the Secretary. That form must be accompanied by written confirmation by the Franchise Tax Board (FTB) that all of the following have occurred [*Corp. Code 15902.09(a)*; *see Corp. Code 15902.09(e)*]:

- All of the following have been paid to the Franchise Tax Board [*Corp. Code 15902.09(a)(1)*]:

  (1) The annual tax due under *Rev. & Tax. Code § 17935*.

  (2) All fees, penalties, and interest for each year for which the domestic limited partnership failed to pay the annual tax, including each year between the cancellation of its certificate of limited partnership and its revival.

- All required tax returns have been filed, including returns for each taxable year between the cancellation of its certificate of limited partnership and its revival [*Corp. Code 15902.09(a)(2)*].

[2] Contents of Certificate of Revival

A certificate of revival must set forth all of the following [*Corp. Code § 15902.09(b)*]:

- The name of the limited partnership at the time its certificate of limited partnership was canceled. If the name is not available at the time of revival, the name under which the limited partnership is to be revived.

- The date of filing of the original certificate of limited partnership.

- The address of the limited partnership's designated office [*see Corp. Code § 15901.02(e)* ("designated office" defined)].

- The name and address of the initial agent for service of process in accordance with *Corp. Code § 15901.16(d)(1)* [*see Ch. 16, Formation of Limited Partnerships, § 16.23[1]*].

- A statement that the certificate of revival is filed by one or more general partners of the limited partnership authorized to execute and file the certificate of revival to revive the limited partnership.

- The Secretary of State's file number for the original limited partnership.

- The name and address of each general partner.

- Any other matters the general partner or partners executing the certificate of revival determine to include therein.

[3] Certificate Deemed To Be Amendment

The certificate of revival should be deemed to be an amendment to the certificate of limited partnership. The limited partnership will not be required to take any further action to amend its certificate of limited partnership pursuant to *Corp. Code § 15902.02* [*see Ch. 16, Formation of Limited Partnerships, § 16.22*] with respect to the matters set forth in the certificate of revival [*Corp. Code § 15902.09(c)*].

[4] Effect of Filing Certificate

Upon filing the certificate of revival, the limited partnership will be revived with the same force and effect as if the certificate of limited partnership had not been canceled pursuant to *Corp. Code § 15902.03* [*see § 16A.314*]. The revival will validate all contracts, acts, matters, and things made, done, and performed by the limited partnership, its partners, employees, and agents following the time its certificate of limited partnership was canceled pursuant to *Corp. Code § 15902.03* with the same force and effect and all intents and purposes, as if the certificate of limited partnership had remained in full force and effect [*Corp. Code § 15902.09(d)*]. This provision applies provided that third parties are relying on the acts of the partnership, its partners, employees, and agents [*Corp. Code § 15902.09(d)*].

All real and personal property, and all rights and interests, that belong to a limited partnership at the time its certificate of limited partnership was canceled pursuant to *Corp. Code § 15902.03* [*see § 16A.314*] or that were acquired by the limited partnership following the cancellation of the certificate of limited partnership, that were not disposed of prior to the time of its revival, will be vested in the limited partnership after its revival as fully as if they were held by the limited partnership at, and during the time after, as the case may be, the time the certificate of limited partnership was canceled. After its revival, the limited partnership and its partners will have all of the same liability for contracts, acts, matters, and things made, done, or performed in the limited partnership's name and on behalf of its partners, employees, and agents, as the limited partnership and its partners would have had if the limited partnership's certificate of limited partnership had at all times remained in full force and effect [*Corp. Code § 15902.09(d)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND

8-16A California Legal Forms--Transaction Guide § 16A.316

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.316 Acts of Partner Binding Partnership After Dissolution

[1] General Partner

A limited partnership is bound by a general partner's act after dissolution which [*Corp. Code § 15908.04(a)*]:

- Is appropriate for winding up the limited partnership's activities; or

- Would have bound the limited partnership under *Corp. Code § 15904.02* (general partner as agent of partnership) [*see Ch. 16, Formation of Limited Partnerships, § 16.34*] before dissolution, if at the time the other party enters into the transaction, the other party does not have notice of the dissolution.

[2] Dissociated General Partner

A person dissociated as a general partner binds a limited partnership through an act occurring after dissolution if [*Corp. Code § 15908.04(b)*]:

- At the time the other party enters into the transaction, less than two years have passed since the dissociation, and the other party does not have notice of the dissociation and reasonably believes that the person is a general partner; and

- The act is appropriate for winding up the limited partnership's activities; or the act would have bound the limited partnership under *Corp. Code § 15904.02* (general partner as agent of partnership) [*see Ch. 16, Formation of Limited Partnerships, § 16.34*] before dissolution and at the time the other party enters into the transaction that party does not have notice of the dissolution [*Corp. Code § 15908.04(b)(2)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND

8-16A California Legal Forms--Transaction Guide § 16A.317

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.317 Liability of General Partner After Dissolution

If a general partner having knowledge of the dissolution causes a limited partnership to incur an obligation under *Corp. Code § 15908.04(a)* [*see § 16A.314[1]*] by an act that is not appropriate for winding up the partnership activities, the general partner is liable to the limited partnership for any damage caused to the limited partnership arising from the obligation. If another general partner or a person dissociated as a general partner is liable for the obligation, the general partner is liable to that other general partner or person for any damage caused to that other general partner or other person arising from the liability [*Corp. Code § 15908.05(a)*].

If a person dissociated as a general partner causes a limited partnership to incur an obligation under *Corp. Code § 15908.04(b)* [*see § 16A.314*[2]], the person is liable (1) to the limited partnership for any damage caused to the partnership arising from the obligation, and (2) if a general partner or another person dissociated as a general partner is liable for the obligation, to the general partner or other person for any damage caused to the general partner or other person arising from the liability [*Corp. Code § 15908.05(b)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND

8-16A California Legal Forms--Transaction Guide § 16A.318

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.318 Disposing of Claims Against Partnership

A dissolved limited partnership may dispose of the known claims against it by following the procedures described *below* [*Corp. Code § 15908.06(a)*]]. A dissolved limited partnership may notify its known claimants of the dissolution in a record [*see Corp. Code § 15901.02(ac)* (definition)]. The notice must [*Corp. Code § 15908.06(b)*]:

- Specify the information required to be included in a claim;
- Provide a mailing address to which the claim is to be sent;
- State the deadline for receipt of the claim, which may not be less than 120 days after the date the notice is received by the claimant; and
- State that the claim will be barred if not received by the deadline.

A claim against a dissolved limited partnership is barred if the requirements of § 15908.06(b) are not met, and either the claim is not received by the specified deadline, or in the case of a claim that is timely received but rejected in writing by the dissolved limited partnership, the claimant does not commence an action to enforce the claim against the limited partnership within 90 days after the receipt of a written notice of the rejection [*Corp. Code § 15908.06(c)*]. *Corp. Code § 15908.06* does not apply to a claim based on an event occurring after the effective date of dissolution or a liability that is contingent on that date [*Corp. Code § 15908.06(d)*].

If a claim against a dissolved limited partnership is barred under *Corp. Code § 15908.06*, any corresponding claim under *Corp. Code § 15904.04* (liability of general partner) is also barred [*Corp. Code § 15908.08*].



89 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND

8-16A California Legal Forms--Transaction Guide § 16A.319

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.319 Notice of Dissolution

[1] Nature and Contents of Notice

A dissolved limited partnership may publish notice of its dissolution and request persons having claims against the limited partnership to present them in accordance with the notice [*Corp. Code § 15908.07(a)*]. The notice must be published at least once in a newspaper of general circulation in the county in which the dissolved limited partnership's principal office is located [*see Corp. Code § 15901.02(aa)* ("principal office" defined)], or if it has none in this state, in the county in which the limited partnership's designated office is or was last located [*Corp. Code § 15908.07(b)(1)*; *see Corp. Code § 15901.02(e)* ("designated office" defined)]. It must describe the information required to be contained in a claim, and provide a mailing address to which the claim is to be sent [*Corp. Code § 15908.07(b)(2)*]. Further, it must state that a claim against the limited partnership is barred unless an action to enforce the claim is commenced within four years after publication of the notice [*Corp. Code § 15908.07(b)(3)*].

[2] Claims That Are Barred

If a dissolved limited partnership publishes a notice in accordance with *Corp. Code § 15908.07(b)* [*see* [1], *above*], the claim of each of the following claimants is barred unless the claimant commences an action to enforce the claim against the dissolved limited partnership within four years after the publication date of the notice [*Corp. Code § 15908.07(c)*]:

- A claimant that did not receive notice in a record [*see Corp. Code § 15901.02(ac)* (definition)] under *Corp. Code § 15908.06* [*see § 16A.316*].

- A claimant whose claim was timely sent to the dissolved limited partnership but not acted on.

- A claimant whose claim is contingent or based on an event occurring after the effective date of dissolution.

If a claim against a dissolved limited partnership is barred under *Corp. Code § 15908.07*, any corresponding claim

under *Corp. Code § 15904.04* (liability of general partner) is also barred [*Corp. Code § 15908.08*].

[3] Enforcement of Claims That Are Not Barred

A claim that is not barred under *Corp. Code § 15908.07* may be enforced (1) against the dissolved limited partnership, to the extent of its undistributed assets; (2) if the assets have been distributed in liquidation, against a partner or transferee to the extent of that person's proportionate share of the claim or the partnership's assets distributed to the partner or transferee in liquidation, whichever is less (and a person's total liability for all claims under *Corp. Code § 15908.07(d)* does not exceed the total amount of assets distributed to the person as a part of the winding up of the dissolved limited partnership; or (3) against any person liable on the claim under *Corp. Code § 15904.04* (liability of general partners) [*Corp. Code § 15908.07(d)*].

[4] Tax Liabilities

Publication of a notice of dissolution of a limited partnership pursuant to *Corp. Code § 15908.07* does not bar the collection of any tax, interest, penalty, or addition to tax under *Rev. & Tax. Code §§ 17001 et seq.*, *18401 et seq.*, or *23001* set seq. [*Corp. Code § 15908.07(e)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND

8-16A California Legal Forms--Transaction Guide § 16A.320

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.320 Application of Assets to Satisfy Obligations to Creditors

[1] Obligations to Creditors

In winding up a limited partnership's activities, the assets of the limited partnership, including the contributions required as described herein, must be applied to satisfy the limited partnership's obligations to creditors, including to the extent permitted by law, partners that are creditors [*Corp. Code § 15908.09(a)*].

[2] Remaining Surplus

Any surplus remaining after the limited partnership complies with *Corp. Code § 15908.09(a)* [*see* [1], *above*] must be returned to the partners as they share in distributions [*Corp. Code § 15908.09(b)*; *see Corp. Code § 15901.02(f)* ("distribution" defined)].

[3] Assets Insufficient to Satisfy Obligations

If a limited partnership's assets are insufficient to satisfy all of its obligations under *Corp. Code § 15908.09(a)* [*see* [1], *above*], the following rules will apply. Each person that was a general partner when the obligation was incurred and that has not been released from the obligation under *Corp. Code § 15906.07* [*see Ch. 16, Formation of Limited Partnerships, § 16.37*] must contribute to the limited partnership for the purpose of enabling the limited partnership to satisfy the obligation. The contribution due from each of those persons is in proportion to the right to receive distributions in the capacity of general partner in effect for each of those persons when the obligation was incurred [*Corp. Code § 15908.09(c)(1)*; *see Corp. Code § 15901.02(c)* ("contribution" defined); *see also Corp. Code § 15901.02(f)* ("distribution" defined)].

If a person does not contribute the full amount required under *Corp. Code § 15908.09(c)(1)*, discussed *above*, with respect to an unsatisfied obligation of the limited partnership, the other persons required to contributed by paragraph (1) on account of the obligation must contribute the additional amount necessary to discharge the obligation. The additional contribution due from each of those other persons is in proportion to the right to receive distributions in the capacity of

general partner in effect for each of those other persons when the obligation was incurred [*Corp. Code § 15908.09(c)(2)*].

If a person does not make the additional contribution under *Corp. Code § 15908.09(c)(2)*, described *above*, further additional contributions are determined and due in the same manner as provided in that paragraph [*Corp. Code § 15908.09(c)(3)*].

A person that makes an additional contribution under *Corp. Code § 15908.09(c)(2)* or *(3)* may recover from any person whose failure to contribute under *Corp. Code § 15908.09(c)(1)* or *(2)* necessitated the additional contribution. A person may not recover more than the amount additionally contributed. A person's liability may not exceed the amount the person failed to contribute [*Corp. Code § 15908.09(d)*].

The estate of a deceased individual is liable for the person's obligations under *Corp. Code § 15908.09* [*Corp. Code § 15908.09(e)*]. Furthermore, an assignee for the benefit of creditors of a limited partnership or a partner, or a person appointed by a court to represent creditors of a limited partnership or a partner, may enforce a person's obligation to contribute under *Corp. Code § 15908.09(c)* [*Corp. Code § 15908.09(f)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND

8-16A California Legal Forms--Transaction Guide §§ 16A.321-16A.399

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

[Reserved]

§§ 16A.321[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-16A California Legal Forms--Transaction Guide § 16A.400

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.400 Information Required for Dissolution and Winding Up

[1] Facts

1. Basic information about partnership:

a. Name of partnership.

b. Date of formation.

c. Whether formed in California or other jurisdiction.

d. Date certificate of limited partnership was filed with Secretary of State.

e. Secretary of State's file number.

f. Date any amendment to certificate, restated certificate, or certificate of correction was filed with Secretary of State.

g. If certified copy of certificate was recorded with county recorder of any county:
(1) Name of each county.

(2) Date of recording.

2. Basic information for each of partnership's offices or sites:

a. Address.

b. Phone number.

b. If premises are rented:

(1) Date lease expires.

(2) Current rental amount.

(3) Any liability for early cancellation.

c. If premises are owned, details of outstanding loans.

3. Basic information for each partner:

a. Name and address of each partner and spouse.

b. Status as either general or limited partner.

c. Amount and proportion of capital contribution.

d. Manner in which each shares in distributions [*Corp. Code § 15905.03*; *see Corp. Code § 15901.02(f)* ("distribution" defined)].

e. Allocation of profits and losses [*see Corp. Code § 15905.035*].

f. Percentage interest in partnership.

4. Cause of dissolution.

5. Date on which event causing dissolution occurred or will occur.

6. Name and address of attorneys and accountants for partnership and each partner.

7. Basic information about partnership financial accounts:

a. Name and address of financial institutions.

b. Account numbers.

c. Amounts held and liquidity of funds held by each institution.

8. Partnership assets, including:

a. Location.

b. Adjusted tax basis.

c. Details of any loans.

9. Name and address of each creditor, including partners who are creditors, and:

a. Amount owed to each.

b. Amount that is secured, and facts of security.

c. Amounts that are not secured.

d. Whether debt is fixed or contingent, and facts of contingency.

10. Description of obligations other than loans, including:

a. Contracts, including real property or equipment leases.

b. Accounts payable.

11. Any amounts owed to following for interim distributions:

NOTE:

When a partner or transferee becomes entitled to receive a distribution [***see*** *Corp. Code § 15901.02(f)* ("distribution" defined)], the partner or transferee has the status of, and is entitled to all remedies available to, a creditor of the limited partnership with respect to the distribution. However, the limited partnership's obligation to make a distribution is offset for any amount owed to the limited partnership by the partner or dissociated partner on whose account the distribution is made [*Corp. Code § 15905.07*].

a. Partners [*Corp. Code § 15905.04*; *see Ch. 16, Formation of Limited Partnerships, § 16.40*]

b. Transferees for distributions [*Corp. Code § 15907.02*; *see Ch. 16, Formation of Limited Partnerships, § 16.38*].

12. Any assets other than money to be distributed.

NOTE:

A partner does not have a right to demand or receive any distribution from a limited partnership in any form other than cash [*Corp. Code § 15905.06*; ***see*** *Ch. 16,* ***Formation of Limited Partnerships****, § 16.40*].

13. Any provisions in partnership agreement relevant to dissolution and winding up, *e.g.*, provisions for compensation.

NOTE:

Unless otherwise provided in the partnership agreement, limited partners winding up the affairs of the partnership pursuant to *Corp. Code § 15908.03* [***see*** *§ 16A.313*] are entitled to reasonable compensation [*Corp. Code § 15908.03(e)*].

[2] Documents

1. Copy of limited partnership agreement.

2. Copy of following, if applicable:

a. Initial certificate of limited partnership filed with Secretary of State.

b. Certificate of amendment.

c. Restated certificate.

d. Certificate of correction.

e. Certificate of cancellation.

f. Certificate of revival.

g. Certificate of merger.

h. Power of attorney under which any certificate was signed.

3. Partnership's fictitious business name statement.

4. List of partnership assets.

5. Documents relating to partnership real property:

a. Deeds.

b. Leases.

c. Notes.

d. Deeds of trust or mortgages.

e. Title insurance.

6. Documents of title for partnership's personal property.

7. Contracts entered into by partnership, including equipment leases.

8. Licenses and permits held by partnership.

9. Trademark, service mark, or trade name registrations.

10. Patent and copyright registrations.

11. Partnership's current list of partners, showing each partner's [*see Corp. Code § 15901.11(2)*]:

a. Full name.

b. Last known street and mailing address.

12. Copies of partnership's federal, state, and local income tax returns and reports, if any, for six most recent years [*see Corp. Code § 15901.11(4)*].

13. Partnership financial statements for six most recent years [*see Corp. Code § 15901.11(6)*].

14. Partnership books and records for past three years [*see Corp. Code § 15901.11(7)*]

15. Unless contained in partnership agreement made in a record, a record stating each of following [*see Corp. Code § 15901.11(8)*; *see also Corp. Code § 15901.02(ac)* ("record" defined)]:

a. Amount of cash, and description and statement of agreed value of other benefits, contributed and agreed to be contributed by each partner.

b. Times at which, or events on the happening of which, additional contributions agreed to be made by each partner are to be made.

c. For any person that is both a general and limited partner, specification of what transferable interest person owns in each capacity.

d. Any events upon the happening of which limited partnership is to be dissolved and its activities wound up.

16. If judicial dissolution will be requested [*see § 16A.431*], copies of any documents or financial statements that substantiate that it is not reasonably practicable to carry on partnership business in conformity with partnership agreement [*see Corp. Code § 15908.02(a)*].



93 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-16A California Legal Forms--Transaction Guide §§ 16A.401-16A.409

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

[Reserved]

§§ 16A.401[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-16A California Legal Forms--Transaction Guide § 16A.410

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.410 Circumstances Causing Dissolution

1. Determine whether event has occurred (or whether one is imminent) that causes non-judicial dissolution:

NOTE:
A partnership is dissolved and its activities must be wound up only upon the occurrence of any of the following [*Corp. Code § 15908.01*].

a. Event specified in partnership agreement [*Corp. Code § 15908.01(a)*].

b. Consent of [*Corp. Code § 15908.01(b)*]:
(1) All general partners; and

(2) Limited partners owning majority of rights to receive distributions as limited partners at time consent is to be effective.

c. Dissociation of person as general partner, when either [*Corp. Code § 15908.01(c)*]:

NOTE:
With respect to a limited partnership formed before January 1, 2008, except as the partners otherwise elect in the manner provided in the partnership agreement or by law for amending the partnership agreement, *Corp. Code § 15908.01(c)* does not apply. The connection between a person's dissociation as a general partner and the dissolution of the limited partnership is the same as existed immediately before January 1, 2008 [*Corp.*

Code § 15912.06(c)(5); ***see*** *Ch. 16,* ***Formation of Limited Partnerships****, § 16.11*].

(1) Limited partnership has at least one remaining general partner, and consent to dissolve partnership is given within 90 days after dissociation by partners owning majority of rights to receive distributions as partners at time the consent is to be effective; or

(2) Limited partnership does not have a remaining general partner, and 90 days have passed since dissociation.

NOTE:
Dissolution will not take place if before the end of that 90-day period (a) consent to continue the activities of the limited partnership and admit at least one general partner is given by limited partners owning a majority of the rights to receive distributions a limited partners at the time the consent is to be effective, and (b) at least one person is admitted as a general partner in accordance with the consent [*Corp. Code § 15908.01(c)(2)*].

d. 90 days have passed after dissociation of last limited partner.

NOTE:
Dissolution will not take place if before the end of the 90-day period the limited partnership admits at least one limited partner [*Corp. Code § 15908.01(d)*].

2. Do grounds exist for obtaining judicial dissolution, *i.e.*, it is not reasonably practicable to carry on activities of limited partnership in conformity with partnership agreement [*see Corp. Code § 15908.02*; *see also § 16A.431*]?

NOTE:
Judicial dissolution is not covered in detail in this chapter. For discussion, see California Forms of Pleading and Practice, Ch. 406, ***Partnerships: Dissolution*** .



95 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-16A California Legal Forms--Transaction Guide § 16A.411

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.411 Determining Partnership's Liability for Acts of Partners Following Dissolution

1. With respect to general partner, determine whether partnership is bound by partner's act after dissolution because that act [*Corp. Code § 15908.04(a)*]:

a. Is appropriate for winding up limited partnership's activities; or

NOTE:
If a general partner having knowledge of the dissolution causes a limited partnership to incur an obligation under *Corp. § Code § 15909.04(a)* by an act that is ***not*** appropriate for winding up the partnership's activities, the general partner is liable (1) to the limited partnership for any damage caused to the limited partnership arising from the obligation; and (2) if another general partner or person dissociated as a general partner is liable for the obligation, to that other general partner or person for any damage caused to that other general partner or person arising from the liability [*Corp. Code § 15908.05(a)*].

b. Would have bound partnership under *Corp. Code § 15908.04* [*see § 16A.316[2]*] before dissolution if, at time other party enters into transaction, other party does not have notice of dissolution.

2. With respect to person dissociated as general partner, determine whether person binds limited partnership through act occurring after dissolution because both [*Corp. Code § 15908.04(b)*]:

NOTE:
If person dissociated as general partner causes limited partnership to incur obligation under *Corp. Code § 15908.04(b)*, person is liable (1) to limited partnership for any damage caused to partnership arising from obligation; and (2) if general partner or another person dissociated as a general partner is liable for the

obligation, to the general partner or other person for any damage caused to the general partner or other person arising from the liability [*Corp. Code § 15908.05(b)*].

a. At time other party enters into transaction:

(1) Less than two years have passed since dissociation; and

(2) Other party does not have notice of dissociation and reasonably believes that person is general partner.

b. That act:

(1) Is appropriate for winding up limited partnership's activities; or

(2) Would have bound limited partnership under *Corp. Code § 15904.02* [*see Ch. 16, Formation of Limited Partnerships, § 16.34*] before dissolution and at time other party enters into transaction other party does not have notice of dissolution.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-16A California Legal Forms--Transaction Guide §§ 16A.412-16A.419

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

[Reserved]

§§ 16A.412[Reserved]



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CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16A California Legal Forms--Transaction Guide § 16A.420

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.420 Dissolving Limited Partnership

1. If dissolution is occurring by consent of partners, procure requisite consents [*see Corp. Code § 15908.01(b)*; *see also § 16A.440* (form)]]:

a. Consent of all general partners; and

b. Consent of limited partners owning majority of rights to receive distributions as limited partners at time consent is to be effective.

2. If dissolution is occurring after dissociation of general partner, confirm following [*see Corp. Code § 15908.01(c)*]:

NOTE:
With respect to a limited partnership formed before January 1, 2008, except as the partners otherwise elect in the manner provided in the partnership agreement or by law for amending the partnership agreement, *Corp. Code § 15908.01(c)* does not apply. The connection between a person's dissociation as a general partner and the dissolution of the limited partnership is the same as existed immediately before January 1, 2008 [*Corp. Code § 15912.06(c)(5)*; ***see*** *Ch. 16,* ***Formation of Limited Partnerships****, § 16.11*].

a. If partnership has at least one remaining general partner, consent to dissolve is given within 90 days after dissociation by partners owning majority of rights to receive distributions as partners at time the consent is to be effective [*see Corp. Code § 15908.01(c)(1)*; *see § 16A.441* (form)]; or

b. If partnership does not have remaining general partner:
(1) 90 days have passed since dissociation;

(2) No consent to continue activities and admit new limited partner has been given by limited partners owning majority of rights to receive distributions as limited partners when consent is to be effective; and

NOTE:
For a form in which the partners consent to continue the limited partnership activities in these circumstances [***see*** *Corp. Code § 15908.01(c)(2)*], see *§ 16A.442*].

(3) No person has been admitted as general partner.

3. If dissolution is occurring after dissociation of last limited partner, confirm following [*see Corp. Code § 15908.01(d)*; *see also § 16A.312[1]*]:

a. 90 days have passed since dissociation.

b. Limited partnership has not admitted any additional limited partner.



98 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16A California Legal Forms--Transaction Guide § 16A.421

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.421 Winding Up Partnership Activities

1. Ensure that persons responsible for winding up [*see* paragraph 3, *below*] do following [*Corp. Code § 15908.03(b)(2)*]:

NOTE:
In winding up, the limited partnership must take these actions [*Corp. Code § 15908.03(b)(2)*].

a. Discharge limited partnership's liabilities.

b. Settle and close limited partnership's activities.

c. Marshal and distribute assets of partnership.

2. Advise persons responsible for winding up [*see* paragraph 3, *below*] to handle following matters, as applicable:

NOTE:
In winding up its activities, the limited partnership may take the following actions, and may perform other necessary acts [*Corp. Code § 15908.03(b)*].

a. Amend certificate of limited partnership to state that partnership is dissolved [*see Ch. 16, Formation of Limited Partnerships, § 16.211*].

b. Preserve limited partnership business or property as going concern for a reasonable time.

c. Prosecute and defend actions and proceedings, whether civil, criminal, or administrative.

d. Transfer limited partnership's property.

e. Settle disputes by mediation or arbitration.

f. File certificate of cancellation that states [*see Corp. Code § 15902.03*; *see also § 16A.450* (form)]:

NOTE:
There is no fee for filing the certificate of cancellation [***see*** *Gov. Code § 12188(n)*].

(1) Name of limited partnership and Secretary of State's file number.

(2) Date of filing initial certificate of limited partnership.

(3) Any other information determined by general partners filing certificate person appointed pursuant to *Corp. Code § 15908.03(c)* or *(d)* [*see* paragraph 3, *below*].

NOTE:
A certificate of cancellation must be signed by all general partners listed in the certificate of limited partnership, or, if the certificate of a dissolved limited partnership lists no general partners, by the person appointed pursuant to *Corp. Code § 15908.03(c)* or *(d)* [***see*** paragraph 3***, below***] to wind up the dissolved limited partnership's activities [*Corp. Code § 15902.04(a)(6)*].

g. Perform other necessary acts.

3. If partnership does not have general partner [*Corp. Code § 15908.03(c)*]:

NOTE:
If a limited partnership does not have a general partner and within a reasonable time following dissolution no person has been appointed pursuant to *Corp. Code § 15908.03(c)* or for other good cause, on application of any partner the appropriate court may order judicial supervision of the winding up, including appointment of a person to wind up the dissolved limited partnership's activities [*Corp. Code § 15908.03(d)*].

a. Ensure that person to wind up activities is appointed by consent of limited partners owning majority of rights to receive distributions as limited partners at time consent is to be effected.

NOTE:
The person appointed has the powers of a general partner under *Corp. Code § 15908.04* [***see*** *§ 16A.316*].

b. Ensure that appointed person promptly amends certificate of limited partnership to state [*Corp. Code § 15908.03(d)*]:

(1) That limited partnership does not have general partner.

(2) Name of person appointed to wind up limited partnership.

4. Cancel any outstanding permits or licenses held by partnership.

5. Arrange for filing of partnership's final federal and state income tax returns.

NOTE:

Limited partnerships must pay the minimum franchise tax if they are doing business in California [*Rev. & Tax. Code § 17935(a)*]. In addition, limited partnerships that have executed, acknowledged, and filed a certificate of limited partnership [***see*** *Corp. Code § 15902.01*] and every foreign limited partnership that has registered in California [***see*** *Corp. Code § 15909.01*] must pay the minimum franchise tax for each taxable year (or portion thereof) until a certificate of cancellation is filed [*Rev. & Tax. Code § 17935(b)(1)*; ***see*** *Corp. Code §§ 15902.03, 15909.07*]. When the taxpayer files a return with the FTB that is designated as its final return, the board will notify the taxpayer that the franchise tax is due annually until a certificate of cancellation is filed [*Rev. & Tax. Code § 17935(b)(2)*; ***see*** *Corp. Code §§ 15902.03, 15909.07*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16A California Legal Forms--Transaction Guide § 16A.422

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.422 Disposing of Claims Against Dissolved Partnership

NOTE:

A dissolved limited partnership may dispose of the known claims against it by following the procedures outlined below [*Corp. Code § 15908.06(a)*]. These provisions do not apply to a claim based on an event occurring after the effective date of dissolution, or a liability that is contingent on that date [*Corp. Code § 15908.06(d)*].

1. Notify partnership's known claimants of dissolution in a record [*see Corp. Code § 15901.02(ac)* (definition)], stating [*Corp. Code § 15908.06(b)*]:

a. Information required to be included in a claim;

b. Mailing address to which the claim is to be sent;

c. Deadline for receipt of claim, which may not be less than 120 days after date notice is received by claimant; and

d. That claim will be barred if not received by deadline.

2. Ascertain that claim received is barred when [*Corp. Code § 15908.06(c)*]:

a. Provisions of paragraph 1, *above*, are met; and

b. Either:

(1) Claim is not received by specified deadline; or

(2) In case of claim that is timely received but rejected in writing by partnership, claimant does not commence action to enforce claim within 90 days after receipt of written notice of rejection.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16A California Legal Forms--Transaction Guide § 16A.423

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.423 Publishing Notice of Dissolution

NOTE:

A dissolved limited partnership may publish notice of its dissolution and request persons having claims against the limited partnership to present them in accordance with the notice [*Corp. Code § 15908.07(a)*]. The claims of certain claimants are barred unless the claimant commences an action to enforce the claim within four years after the notice's publication date [*Corp. Code § 15908.07(c)*; ***see*** *§ 16A.319*]. However, publication of a notice of dissolution of a limited partnership pursuant to *Corp. Code § 15908.07* does not bar the collection of any tax, interest, penalty, or addition to tax under *Rev. & Tax. Code §§ 17001 et seq., 18401 et seq.*, or *23001 et seq.* [*Corp. Code § 15908.07(e)*].

1. Publish notice at least once in newspaper of general circulation in county [*Corp. Code § 15908.07(b)(1)*]:

a. Where dissolved limited partnership's principal office is located [*see Corp. Code § 15901.02(aa)* ("principal office" defined)]; or

b. If partnership does not have principal office in California, where limited partnership's designated office is or was last located [*see Corp. Code § 15901.02(e)* ("designated office" defined)].

2. Describe information required to be contained in claim, and provide mailing address to which claim is to be sent [*Corp. Code § 15908.07(b)(2)*].

3. State that claim against limited partnership is barred unless action to enforce claim is commenced

within four years after publication of notice [*Corp. Code § 15908.07(b)(3)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16A California Legal Forms--Transaction Guide § 16A.424

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.424 Applying Assets to Satisfy Obligations

1. Ensure that partnership assets are applied to satisfy partnership's obligations to creditors (including partners) [*Corp. Code § 15908.09(a)*].

NOTE:
In winding up a limited partnership's activities, the assets of the limited partnership, including required contributions discussed below in this section, must be applied to satisfy the limited partnership's obligations to creditors, including to the extent permitted by law, partners that are creditors [*Corp. Code § 15908.09(a)*].

2. Ensure that any surplus remaining after limited partnership complies with *Corp. Code § 15908.09(a)* [*see* paragraph 1, *above*] is returned to partners as they share in distributions [*Corp. Code § 15908.09(b)*; *see Corp. Code § 15901.02(f)* ("distribution" defined)].

3. If limited partnership's assets are insufficient to satisfy all of its obligations under *Corp. Code § 15908.09(a)* [*see* paragraph 1], *above*], apply following rules [*Corp. Code § 15908.09(c)*]:

NOTE:
The estate of a deceased individual is liable for the person's obligations under *Corp. Code § 15908.09*.

a. Each person that was general partner when obligation was incurred and that has not been released from obligation under *Corp. Code § 15906.07* [*see Ch. 16, Formation of Limited Partnerships, § 16.37*] must contribute to partnership to enable it to satisfy

obligation [*Corp. Code § 15908.09(c)(1)*].

NOTE:

The contribution due from each of those persons is in proportion to the right to receive distributions in the capacity of general partner in effect for each of those persons when the obligation was incurred [*Corp. Code § 15908.09(c)(1)*; ***see*** *Corp. Code § 15901.02(f)* ("distribution" defined)]. An assignee for the benefit of creditors of a limited partnership or a partner, or a person appointed by a court to represent creditors of a limited partnership or a partner, may enforce a person's obligation to contribute under *Corp. Code § 15908.09(c)* [*Corp. Code § 15908.09(f)*].

b. If person does not contribute full amount required under *Corp. Code § 15908.09(c)(1)*, [*see* paragraph a, *above*], with respect to partnership's unsatisfied obligation, other persons required to contributed by paragraph (1) on account of obligation must contribute additional amount necessary to discharge obligation [*Corp. Code § 15908.09(c)(2)*].

NOTE:

The additional contribution due from each of those other persons is in proportion to the right to receive distributions in the capacity of general partner in effect for each of those other persons when the obligation was incurred [*Corp. Code § 15908.09(c)(2)*].

A person that makes an additional contribution under *Corp. Code § 15908.09(c)(2)* or *(3)* may recover from any person whose failure to contribute under *Corp. Code § 15908.09(c)(1)* or *(2)* necessitated the additional contribution. A person may not recover more than the amount additionally contributed. A person's liability may not exceed the amount the person failed to contribute [*Corp. Code § 15908.09(d)*].

c. If a person does not make the additional contribution under *Corp. Code § 15908.09(c)(2)* [*see* paragraph b, *above*], further additional contributions are determined and due in the same manner as provided in that paragraph [*Corp. Code § 15908.09(c)(3)*].

NOTE:

A person that makes an additional contribution under *Corp. Code § 15908.09(c)(2)* or *(3)* may recover from any person whose failure to contribute under *Corp. Code § 15908.09(c)(1)* or *(2)* necessitated the additional contribution. A person may not recover more than the amount additionally contributed. A person's liability may not exceed the amount the person failed to contribute [*Corp. Code § 15908.09(d)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16A California Legal Forms--Transaction Guide §§ 16A.425-16A.429

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

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§§ 16A.425[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

8-16A California Legal Forms--Transaction Guide § 16A.430

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.430 Reviving Canceled Certificate

NOTE:

Upon filing a certificate of revival, a limited partnership will be revived with the same force and effect as if the certificate of limited partnership had not been canceled pursuant to *Corp. Code § 15902.03* [*Corp. Code § 15902.09(d)*; ***see*** *§ 16A.450*].

1. If desired, revive partnership after cancellation of certificate of limited partnership by [*Corp. Code § 15902.09(a)*]:

NOTE:

A domestic limited partnership whose certificate of limited partnership has been canceled pursuant to *Corp. Code § 15902.03* [***see*** *§ 16A.314*, ***above***] may be revived by filing a certificate of revival with the Secretary of State, on a form prescribed by the Secretary [*Corp. Code § 15902.09(a)*; ***see*** *§ 16A.451* (form)]. The certificate of revival should be deemed to be an amendment to the certificate of limited partnership. The limited partnership will not be required to take any further action to amend its certificate of limited partnership pursuant to *Corp. Code § 15902.02* [***see*** *Ch. 16,* ***Formation of Limited Partnerships****, § 16.211*] with respect to the matter set forth in the certificate of revival [*Corp. Code § 15902.09(c)*].

a. Filing certificate of revival with Secretary of State on prescribed form [*see* paragraph 2, *below*; *see also § 16A.451* (form)].

b. Accompany certificate by written confirmation by Franchise Tax Board (FTB) that all of following have occurred [*Corp. Code 15902.09(a)*; *see Corp. Code 15902.09(e)*]:

(1) All of following have been paid to Franchise Tax Board [*Corp. Code 15902.09(a)(1)*]:

(a) Annual tax due under *Rev. & Tax. Code § 17935*.

(b) All fees, penalties, and interest for each year for which domestic limited partnership failed to pay annual tax, including each year between cancellation of its certificate of limited partnership and its revival.

(2) All required tax returns have been filed, including returns for each taxable year between cancellation of its certificate of limited partnership and its revival [*Corp. Code 15902.09(a)(2)*].

2. Set forth all of following in certificate [*Corp. Code § 15902.09(b)*]:

a. Either:

(1) Name of limited partnership at time its certificate of limited partnership was canceled; or

(2) If name is not available at time of revival, name under which limited partnership is to be revived.

b. Date of filing of original certificate of limited partnership.

c. Address of limited partnership's designated office [*see Corp. Code § 15901.02(e)* ("designated office" defined)].

d. Name and address of initial agent for service of process in accordance with *Corp. Code § 15901.16(d)(1)* [*see Ch. 16, Formation of Limited Partnerships, § 16.23*].

e. Statement that certificate of revival is filed by one or more general partners of limited partnership authorized to execute and file certificate of revival to revive limited partnership.

f. Secretary of State's file number for original limited partnership.

g. Name and address of each general partner.

h. Any other matters that general partner or partners executing certificate of revival determine to include.

3. Pay $30 filing fee $30 [see *Gov. Code § 12188(h)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

8-16A California Legal Forms--Transaction Guide § 16A.431

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.431 Applying for Judicial Dissolution

NOTE:

On application by a partner, a court of competent jurisdiction may order dissolution of a limited partnership if it is not reasonably practicable to carry on the activities of the limited partnership in conformity with partnership agreement [***see*** *Corp. Code § 15908.02*]. Judicial dissolution is not covered in detail in this chapter. For discussion, see California Forms of Pleading and Practice, Ch. 406, ***Partnerships: Dissolution*** .

1. If it is not reasonably practicable to carry on activities of limited partnership in conformity with partnership agreement, file application by partner for order of dissolution [*see Corp. Code § 15908.02(a)*].

2. If other partners desire to prevent winding up and dissolution, arrange for them (purchasing parties) to purchase for cash partnership interests owned by partners initiating proceedings (moving parties) [*see Corp. Code § 15908.02(b)*].

NOTE:

If the purchasing parties electing to purchase these partnership interests are unable to agree with the moving parties on the fair market value of the interests, upon application the court will stay the winding up and dissolution proceedings to ascertain and fix the fair market value [***see*** *Corp. Code § 15908.02(c)-(f)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

8-16A California Legal Forms--Transaction Guide §§ 16A.432-16A.439

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

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§§ 16A.432[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART IV. FORMS
A. Agreements Among Partners

8-16A California Legal Forms--Transaction Guide § 16A.440

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.440 Agreement to Dissolve Limited Partnership

[1] Comment

This form is an agreement by the general partners and the required percentage of limited partners to signify their written consent to dissolve a limited partnership governed by the Uniform Limited Partnership Act of 2008 (ULPA '08). Unless the partnership agreement provides otherwise [*see Corp. Code § 15901.10*; *see also* Ch. 16, *Formation of Limited Partnerships* , § 14.2[4][b]], a limited partnership is dissolved upon the consent of all of its general partners and of limited partners owning a majority of the rights to receive distributions as limited partners at the time the consent is to be effective [*Corp. Code § 15908.01(b)*].

After winding up the partnership's affairs has been completed, a certificate of cancellation must be filed with the Secretary of State on the prescribed form [*see Corp. Code § 15902.03*]. That form is *set forth in § 16A.450*.

Other events that cause dissolution of a limited partnership are discussed in *§ 16A.312[1]*]. For a procedural guide to dissolution and winding up, see *§§ 16A.420-16A.424*.

[2] FORM

A Agreement to Dissolve Limited Partnership

AGREEMENT TO DISSOLVE LIMITED PARTNERSHIP

THIS AGREEMENT is effective _____ [*date*], by and between _____ [*name of general partner*(s)] (General Partner(s)), and _____ [*names of limited partners*] (Limited Partners) of _____ [*name of limited partnership*], a California limited partnership (Limited Partnership).

Formation of Limited Partnership

1. The Limited Partnership was formed pursuant to a Limited Partnership Agreement (Limited Partnership Agreement) dated _____ [*date*] and its certificate of limited partnership was filed with the Secretary of State on _____ [*date*].

[*Choose one of the following:*]

[*If limited partnership agreement sets forth procedure for dissolution by written consent of partners:*]

Authority for Dissolution

2. The Limited Partnership Agreement provides that the Limited Partnership may be dissolved by the written consent of _____ [*insert specific requirements of limited partnership agreement*].

[*If limited partnership agreement does not cover procedure for dissolution by consent of partners:*]

Authority for Dissolution

2. Pursuant to *Corporations Code Section 15908.01(b)*, a limited partnership is dissolved upon the consent of all of its general partners and of limited partners owning a majority of the rights to receive distributions as limited partners at the time the consent is to be effective. The Limited Partnership Agreement for this Limited Partnership does not contain any different requirements for the dissolution of the Limited Partnership by the written consent of its partners.

[*Continue with the following:*]

Consent of General Partners

3. The following General Partners, which constitute [all of the General Partners *or* the number of General Partners required by the Limited Partnership Agreement for an agreement to dissolve the Limited Partnership] consent to the dissolution and winding up of the Limited Partnership:

[*Choose one of the following:*]

[*If names and ownership interests of limited partners will be set forth in body of this agreement*:]

Consent of Limited Partners

4. The following Limited Partners, representing _____ [a majority *or set forth other percentage required by limited partnership agreement*] of the rights to receive distributions as limited partners at the time this consent is to be effective, consent to the dissolution and winding up of the Limited Partnership:

Name of Partner	Interest
_____	_____ percent
_____	_____ percent
_____	_____ percent
_____	_____ percent

[*Or, if names and ownership interests of limited partners will be incorporated by reference in this agreement by means of an exhibit, such as when the list of limited partners is lengthy:*]

Consent of Limited Partners

4. Each of those Limited Partners listed in Exhibit A, attached to and incorporated by reference in this agreement, which represent _____ [a majority *or set forth other percentage required by limited partnership agreement*] of the rights to receive distributions as limited partners at the time this consent is to be effective, consent to the dissolution and winding up of the Limited Partnership.

[*Continue with the following:*]

Winding Up Activities After Dissolution

5. The Partnership shall wind up its activities pursuant to the provisions of the Limited Partnership Agreement and of applicable California law.

Covenant of Cooperation

6. Each of the Partners agrees to do all things necessary, and to promptly sign all required documents, to effect the dissolution, winding up, and termination of the Limited Partnership.

GENERAL PARTNERS
_____ [*signature*]
[*typed name*]
_____ [*date*]
_____ [*signature*]
[*typed name*]
_____ [*date*]
_____ [*signature*]
[*typed name*]
_____ [*date*]

LIMITED PARTNERS

_____ [*signature*]
[*typed name*]
_____ [*date*]
_____ [*signature*]
[*typed name*]
_____ [*date*]
_____ [*signature*]
[*typed name*]
_____ [*date*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART IV. FORMS
A. Agreements Among Partners

8-16A California Legal Forms--Transaction Guide § 16A.441

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.441 Agreement to Dissolve Limited Partnership After Dissociation of General Partner

[1] Comment

This form is an agreement by the remaining general partner(s) and the required percentage of limited partners to signify their written consent to dissolve a limited partnership governed by the Uniform Limited Partnership Act of 2008 (ULPA '08) after the dissociation of a person as a general partner. Unless the partnership agreement provides otherwise [*see Corp. Code § 15901.10*; *see also* Ch. 16, *Formation of Limited Partnerships* , § 14.2[4][b]], after the dissociation of a person as a general partner when the partnership has at least one remaining general partner, the partnership is dissolved and if a consent to dissolve is given within 90 days after the dissociation by partners owning a majority of the rights to receive distributions as partners at the time the consent is to be effective [*Corp. Code § 15908.01(c)(1)*].

With respect to a limited partnership formed before January 1, 2008, except as the partners otherwise elect in the manner provided in the partnership agreement or by law for amending the partnership agreement, *Corp. Code § 15908.01(c)* does not apply. The connection between a person's dissociation as a general partner and the dissolution of the limited partnership is the same as existed immediately before January 1, 2008 [*Corp. Code § 15912.06(c)(5)*; *see Ch. 16, Formation of Limited Partnerships, § 16.11*].

After winding up the partnership's affairs has been completed, a certificate of cancellation must be filed with the Secretary of State on the prescribed form [*see Corp. Code § 15902.03*]. That form is *set forth in § 16A.450*.

Other events that cause dissolution of a limited partnership are discussed in *§ 16A.312[1]*. For a procedural guide to dissolution and winding up, see *§§ 16A.420-16A.424*.

[2] FORM

Agreement to Dissolve Limited Partnership After Dissociation of General Partner

AGREEMENT TO DISSOLVE LIMITED PARTNERSHIP
AFTER DISSOCIATION OF GENERAL PARTNER

THIS AGREEMENT is effective _____ [*date*], by and between _____ [*name of general partner*(s)] (General Partner(s)), and _____ [*names of limited partners*] (Limited Partners) of _____ [*name of limited partnership*], a California limited partnership (Limited Partnership).

Formation of Limited Partnership

1. The Limited Partnership was formed pursuant to a Limited Partnership Agreement (Limited Partnership Agreement) dated _____ [*date*] and its certificate of limited partnership was filed with the Secretary of State on _____ [*date*].

Authority for Dissolution

[*Either, if partnership agreement does not vary statutory provisions:*]

2. Pursuant to *Corporations Code Section 15908.01(c)(1)*, a limited partnership is dissolved and its activities must be wound up after the dissociation of a person as a general partner if the limited partnership has at least one remaining general partner and a consent to dissolve is given within 90 days after dissociation by partners owning a majority of the rights to receive distributions as partners at the time the consent is to be effective. The Limited Partnership Agreement for this Limited Partnership does not contain any different requirements for the dissolution of the Limited Partnership by the written consent of its partners.

[*Or, if partnership agreement provides for other procedure*:]

2. The Limited Partnership Agreement provides that the Limited Partnership may be dissolved after dissociation of a person as a general partner _____ [*insert specific requirements of limited partnership agreement*].

[*Continue with the following:*]

Dissociation of General Partner

3. _____ [*Name of general partner*] was dissociated as a general partner _____ [*specify event, e.g.,* by giving notice of the express will to withdraw as a general partner] on _____ [*date*], which was less than 90 days before the date of this Agreement.

Consent of Partners

[*Either:*]

4. The following Partners, which constitute [_____ a majority *or set forth other percentage required*

by limited partnership agreement] of the rights to receive distributions as partners at the time this consent is to be effective, consent to the dissolution and winding up of the Limited Partnership:

Name of Partner	Interest
_____	_____ percent
_____	_____ percent
_____	_____ percent
_____	_____ percent

[*Or, if names and ownership interests of limited partners will be incorporated by reference in this agreement by means of an exhibit, such as when the list of limited partners is lengthy:*]

Consent of Partners

4. Each of the Partners listed in Exhibit A, attached to and incorporated by reference in this agreement, which represent _____ [a majority *or set forth other percentage required by limited partnership agreement*] of the rights to receive distributions as partners at the time this consent is to be effective, consent to the dissolution and winding up of the Limited Partnership.

[*Continue with the following:*]

Winding Up Activities After Dissolution

5. The Partnership shall wind up its activities of pursuant to the provisions of the Limited Partnership Agreement and of applicable California law.

Covenant of Cooperation

6. Each of the Partners agrees to do all things necessary, and to promptly sign all required documents, to effect the dissolution, winding up, and termination of the Limited Partnership.

GENERAL PARTNERS
_____ [*signature*]
[*typed name*]
_____ [*date*]
_____ [*signature*]
[*typed name*]
_____ [*date*]

LIMITED PARTNERS
_____ [*signature*]
[*typed name*]
_____ [*date*]
_____ [*signature*]

[*typed name*]
_____ [*date*]
_____ [*signature*]
[*typed name*]
_____ [*date*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART IV. FORMS
A. Agreements Among Partners

8-16A California Legal Forms--Transaction Guide § 16A.442

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.442 Agreement to Continue Activities of Limited Partnership After Dissociation of Sole General Partner

[1] Comment

[a] Use of Form

This form is an agreement by the limited partners to signify their written consent to continue the activities of the limited partnership governed by the Uniform Limited Partnership Act of 2008 (ULPA '08) after the dissociation of the partnership's sole general partner. It also includes provisions to admit at least one general partner [*see Corp. Code § 15908.01(c)(2)*].

With respect to a limited partnership formed before January 1, 2008, except as the partners otherwise elect in the manner provided in the partnership agreement or by law for amending the partnership agreement, *Corp. Code § 15908.01(c)* does not apply. The connection between a person's dissociation as a general partner and the dissolution of the limited partnership is the same as existed immediately before January 1, 2008 [*Corp. Code § 15912.06(c)(5)*; *see Ch. 16, Formation of Limited Partnerships, § 16.11*].

[b] Avoiding Dissolution on Dissociation of Sole General Partner

Unless the partnership agreement provides otherwise [*see Corp. Code § 15901.10*; *see also* Ch. 16, *Formation of Limited Partnerships* , § 16.21[4][b]], after the dissociation of a person as a general partner when the partnership does not have a remaining general partner, the partnership is dissolved upon the passage of 90 days after the dissociation, unless before the end of that period consent to continue the activities of the limited partnership and admit at least one general partner is given by limited partners owning a majority of the rights to receive distributions as limited partners at the time the consent is to be effective; and at least one person is admitted as a general partner in accordance with the consent [*Corp. Code § 15908.01(c)(2)*].

[c] Requirement That Certificate of Limited Partnership Be Amended

Both the dissociation of a person as a general partner and the admission of a new general partner are events that require the limited partnership to promptly deliver to the Secretary of State for filing an amendment to a certificate of limited partnership [*Corp. Code § 15902.02(b)*]. The amendment of a certificate of limited partnership is *covered in Ch. 16, Formation of Limited Partnerships, § 16.211*.

[2] FORM

Agreement to Continue Activities of Limited Partnership After Dissociation of Sole General Partner

AGREEMENT TO CONTINUE PARTNERSHIP BUSINESS

This agreement is effective _____ [*date*] by the undersigned limited partners of _____ [*name of limited partnership*], a California limited partnership (the Limited Partnership), which constitute [_____ a majority *or set forth other percentage required by limited partnership agreement*] of the rights to receive distributions as partners at the time this consent is to be effective.

Dissociation of Sole General Partner

1. _____ [*Name of general partner*], the only remaining general partner, was dissociated as a general partner _____ [*specify event, e.g.*, by giving notice of the express will to withdraw as a general partner] on _____ [*date*], which was less than 90 days before the date of this Agreement.

Agreement to Continue Limited Partnership Business

2. The undersigned Limited Partners consent to continue the activities of the Limited Partnership as a California limited partnership under the name _____ [*name of limited partnership*] in accordance with the provisions of the Limited Partnership Agreement.

Agreement to Admission of General Partner

3. The undersigned Limited Partners consent to the admission of _____ [*name of at least one new general partner*] to the Limited Partnership as a General Partner.

_____ [*signature*]
[*typed name*]
_____ [*date*]
_____ [*signature*]
[*typed name*]
_____ [*date*]
_____ [*signature*]
[*typed name*]
_____ [*date*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART IV. FORMS
A. Agreements Among Partners

8-16A California Legal Forms--Transaction Guide §§ 16A.443-16A.449

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

[Reserved]

§§ 16A.443[Reserved]



110 of 175 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART IV. FORMS
B. Official Certificates

8-16A California Legal Forms--Transaction Guide § 16A.450

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.450 Certificate of Cancellation

[1] Comment

[a] Use of Form

This form is the official certificate of cancellation for a limited partnership governed by the ULPA '08, LP-4/7. It is prescribed by the Secretary of State and may be obtained online at www.ss.ca.gov. The filing of this certificate cancels (1) a certificate of limited partnership, and (2) the registration of a foreign limited partnership to do business in California. The form must be filed by a limited partnership that has completed winding up, or by a foreign limited partnership in order to cancel its certificate of registration [*see Corp. Code §§ 15902.03, 15909.07*]. There is no filing fee [*Gov. Code § 12188(n)*].

[b] Contents of Certificate

The certificate of cancellation must state [*Corp. Code § 15902.03*]:

- The name of the limited partnership and the Secretary of State's file number.
- The date of filing its initial certificate of limited partnership.
- Any other information as determined by the general partners filing the certificate, or by a person appointed pursuant to *Corp. Code § 15908.03(c)* or *(d)* [*see § 16A.313[2], [3]*].

[c] Signature Requirements

A certificate of cancellation must be signed by all general partners listed in the certificate of limited partnership, or if the certificate of limited partnership of a dissolved limited partnership lists no general partners, by the person appointed

pursuant to *Corp. Code § 15908.03(c)* or *(d)* to wind up the dissolved limited partnership's activities [*Corp. Code § 15902.04(a)(6)*; *see § 16A.313[2], [3]*].

For a foreign limited partnership, the certificate must be signed and acknowledged by a general partner of the foreign limited partnership [*Corp. Code § 15909.07(a)*; *see Corp. Code § 15901.02(a)* ("acknowledged" defined)]. If a foreign limited partnership cancels its certificate of registration, it appoints the Secretary of State as its agent for service of process for rights of action arising out of the transaction of business in California [*Corp. Code § 15909.07(f)*].

[d] Recording Certificate

If a certified copy of the certificate of limited partnership has been previously recorded in any county in California [*see Corp. Code § 15902.01(e)*], it is recommended that a certified copy of the certificate of cancellation also be recorded in the same county or counties [*see Corp. Code § 15902.01(e)*].

[2] FORM

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16A DISSOLUTION OF LIMITED PARTNERSHIPS
PART IV. FORMS
B. Official Certificates

8-16A California Legal Forms--Transaction Guide § 16A.451

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16A.451 Certificate of Revival

[1] Comment

[a] Use of Form

This form is a certificate of revival prescribed by the Secretary of State, LP-7. It is prescribed by the Secretary of State and may be obtained from office, or online at www.ss.ca.gov. A domestic limited partnership whose certificate of limited partnership has been canceled pursuant to *Corp. Code § 15902.03* [*see § 16A.450, above*] may be revived by filing a certificate of revival with the Secretary of State, on a form prescribed by the Secretary [*Corp. Code § 15902.09(a)*]. The filing fee is $30 [*Gov. Code § 12188(h)*].

[b] Deemed Amendment to Certificate of Limited Partnership

The certificate of revival should be deemed to be an amendment to the certificate of limited partnership. The limited partnership will not be required to take any further action to amend its certificate of limited partnership pursuant to *Corp. Code § 15902.02* [*see Ch. 16, Formation of Limited Partnerships, § 16.211*] with respect to the matter set forth in the certificate of revival [*Corp. Code § 15902.09(c)*].

[c] Confirmation of Tax Payments

The certificate of revival must be accompanied by written confirmation by Franchise Tax Board (FTB) that all of the following have occurred [*Corp. Code 15902.09(a)*; *see Corp. Code 15902.09(e)*]:

- All of the following have been paid to the Franchise Tax Board [*Corp. Code 15902.09(a)(1)*]:

  (1) The annual tax due under *Rev. & Tax. Code § 17935*.

(2) All fees, penalties, and interest for each year for which the domestic limited partnership failed to pay the annual tax, including each year between the cancellation of its certificate of limited partnership and its revival.

- All required tax returns have been filed, including returns for each taxable year between the cancellation of its certificate of limited partnership and its revival [*Corp. Code 15902.09(a)(2)*].

[d] Contents of Certificate

The certificate must set forth all of the following [*Corp. Code § 15902.09(b)*]:

- The name of the limited partnership at the time its certificate of limited partnership was canceled. If the name is not available at the time of revival, the name under which the limited partnership is to be revived.

- The date of filing of the original certificate of limited partnership.

- The address of the limited partnership's designated office [*see Corp. Code § 15901.02(e)* ("designated office" defined)].

- The name and address of the initial agent for service of process in accordance with *Corp. Code § 15901.16(d)(1)* [*see Ch. 16, Formation of Limited Partnerships, § 16.23*].

- A statement that the certificate of revival is filed by one or more general partners of the limited partnership authorized to execute and file the certificate of revival to revive the limited partnership.

- The Secretary of State's file number for the original limited partnership.

- The name and address of each general partner.

- Any other matters the general partner or partners executing the certificate of revival determine to include.

[e] Signature Requirements

The certificate must be signed by at least one general partner listed in the certificate of limited partnership [*see Corp. Code § 15902.04(a)(9)*]. A certificate filed by a foreign limited partnership must be signed by at least one general partner of the foreign limited partnership [*see Corp. Code § 15902.04(a)(9)*].

[f] Effect of Filing Certificate

Upon filing the certificate of revival, the limited partnership will be revived with the same force and effect as if the certificate of limited partnership had not been canceled pursuant to *Corp. Code § 15902.03* [*see § 16A.450*]. The revival will validate all contracts, acts, matters, and things made, done, and performed by the limited partnership, its partners, employees, and agents following the time its certificate of limited partnership was canceled pursuant to *Corp. Code § 15902.03* with the same force and effect and all intents and purposes, as if the certificate of limited partnership had remained in full force and effect [*Corp. Code § 15902.09(d)*]. This provision applies provided that third parties are relying on the acts of the partnership, its partners, employees, and agents [*Corp. Code § 15902.09(d)*].

All real and personal property, and all rights and interests, that belong to a limited partnership at the time its certificate

of limited partnership was canceled pursuant to *Corp. Code § 15902.03* [*see § 16A.450*] or that were acquired by the limited partnership following the cancellation of the certificate of limited partnership, that were not disposed of prior to the time of its revival, will be vested in the limited partnership after its revival as fully as if they were held by the limited partnership at, and during the time after, as the case may be, the time the certificate of limited partnership was canceled. After its revival, the limited partnership and its partners will have all of the same liability for contracts, acts, matters, and things made, done, or performed in the limited partnership's name and on behalf of its partners, employees, and agents, as the limited partnership and its partners would have had if the limited partnership's certificate of limited partnership had at all times remained in full force and effect [*Corp. Code § 15902.09(d)*].

[2] FORM

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS

8-16B California Legal Forms--Transaction Guide 16B.syn

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.syn Synopsis to Chapter 16B: CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS

§ 16B.301 California Statutes

§ 16B.302 Federal Sources

[1] Statutes

[2] Regulations

§§ 16B.303-16B.304 [Reserved]

§ 16B.305 Law Reviews [Reserved]

§ 16B.306 Text References

[1] Matthew Bender Sources

[2] Additional Text References [Reserved]

§§ 16B.307-16B.309 [Reserved]

§ 16B.310 Law Applicable to Conversions

§ 16B.311 Definitions Applicable to Conversions

[1] In General

[2] "Converted Entity"

[3] "Converted Limited Partnership"

[4] "Converting Limited Partnership"

[5] "Converting Entity"

[6] "Foreign Other Business Entity"

[7] "Other Business Entity"

§ 16B.312 Conditions Allowing Conversion

[1] Entities Into Which Limited Partnerships May Be Converted

[2] Applicable Law Must Permit Conversion

§ 16B.313 Plan of Conversion

[1] Required Provisions

[2] Approval Requirements

[3] All Non-Dissenting Partners Deemed Parties to Plan

[4] Maintaining Plan of Conversion

[5] Amending Plan of Conversion

[6] Abandoning Conversion

§ 16B.314 Effective Date of Conversion

§ 16B.315 Compliance With Other Laws

§ 16B.316 Service Of Process

§ 16B.317 Certificate or Statement of Conversion

[1] Type of Document Required

[2] Contents of Certificate or Statement of Conversion

§ 16B.318 Record Ownership of Real Property

§ 16B.319 Conversion of Other Business Entity to a Domestic Limited Partnership

§ 16B.320 Effect of Conversion

[1] No Deemed Transfer of Property

[2] Rights and Liabilities Continue

[3] Partner's Liability

§§ 16B.321-16B.329 [Reserved]

§ 16B.330 Law Applicable to Mergers

§ 16B.331 Definitions Applicable to Mergers

[1] In General

[2] "Constituent Corporation"

[3] "Constituent Limited Partnership"

[4] "Constituent Other Business Entity"

[5] "Disappearing Limited Partnership"

[6] "Disappearing Other Business Entity"

[7] "Foreign Other Business Entity"

[8] "Other Business Entity"

[9] "Surviving Limited Partnership"

[10] "Surviving Other Business Entity"

§ 16B.332 Entities Allowed to Merge

§ 16B.333 Agreement of Merger

[1] Approval

[2] Contents

[3] Rules for Partnerships With Over 35 Limited Partners

[4] Amendment of Agreement of Merger

[5] Amendment or Adoption of New Partnership Agreement

[6] Location and Inspection of Agreement of Merger

[7] Abandonment of Merger

§ 16B.334 Certificate of Merger

[1] When Required

[2] Contents

[3] Effect on Disappearing Limited Partnerships

[4] Filing Requirement for Surviving Corporations

[5] Filing Requirement for Disappearing Foreign Corporations

§ 16B.335 Effective Date of Merger

§ 16B.336 Succession to Rights and Liabilities of Disappearing Entities

§ 16B.337 Merger with Foreign Limited Partnerships or Foreign Other Business Entities

§ 16B.338 Record Ownership of Real Property

§§ 16B.339-16B.349 [Reserved]

§ 16B.350 Law Governing Dissenting Limited Partners' Rights

[1] Article 11.5 of ULPA '08

[2] Application of Article 11.5

§ 16B.351 Definitions Applicable to Dissenting Limited Partners' Rights

[1] In General

[2] "Reorganization"

[3] "Control"

[4] "Dissenting Interest"

[5] "Dissenting Limited Partner"

§ 16B.352 Nature of Dissenting Rights

[1] Right to Require Purchase of Interest

[2] Limitation on Right to Attack Reorganization

§ 16B.353 Procedures to Enforce Dissenting Rights

[1] Notice of Approval of Reorganization

[2] Demand for Payment

[3] Submission of Certificate or Written Statement

[4] Subsequent Procedure When Parties Agree on Nature of Interest and Price

[5] Subsequent Procedure When Parties Disagree on Nature of Interest or Fair Market Value

[a] Court Action

[b] Court-Appointed Appraisers

[c] Judgment

[d] Costs

[6] Dissenting Limited Partners as Creditors

[7] Rights of Dissenting Limited Partners Continue Until Payment

[8] Loss of Status as Dissenting Interest

[9] Litigation as to Adequacy of Vote or Consent

§§ 16B.354-16B.359 [Reserved]

§ 16B.360 Conversion

[1] Facts

Scope

[2] Documents

Scope

§ 16B.361 Merger

[1] Facts

Scope

[2] Documents

Scope

§§ 16B.362-16B.369 [Reserved]

§ 16B.370 Conversion of Limited Partnership Into Another Type of Business Entity

Scope

§ 16B.371 Mergers

Scope

§ 16B.372 Foreign Entities

Scope

§ 16B.373 Manner of Converting Interests in Merged Limited Partnerships

Scope

§§ 16B.374-16B.379 [Reserved]

§ 16B.380 Procedures for Conversion of Limited Partnerships

Scope

§ 16B.381 Procedures for Conversion of Other Business Entity to Domestic Limited Partnership

Scope

§ 16B.382 Drafting and Approving Agreement of Merger

Scope

§ 16B.383 Filing Certificate of Merger

Scope

§ 16B.384 Mailing Notice of Approval of Reorganization

Scope

§ 16B.385 Evaluating Dissenting Limited Partner Status

Scope

§ 16B.386 Exercising Dissenting Limited Partner Status

Scope

§ 16B.387 Bringing Action to Enforce Payment

Scope

§§ 16B.388-16B.399 [Reserved]

§ 16B.400 Subsequent Procedures Regarding Conversion of Limited Partnership

Scope

§ 16B.401 Amending Merger Agreement

Scope

§ 16B.402 Filing With County Recorder

Scope

§§ 16B.403-16B.409 [Reserved]

§ 16B.410 Certificate of Conversion to Foreign Other Business Entity

[1] Comment

[a] Use of Form

[b] Statutory Requirements for Certificate of Conversion--Conversion to Foreign Limited Partnership or Foreign Other Business Entity

[c] Statutory Requirements for Certificate of Conversion--Conversion to Domestic Entity

[d] Effect of Filing Certificate of Conversion

[2] FORM

§ 16B.411 Certificate of Limited Partnership--Conversion to Limited Partnership

[1] Comment

[a] Use of Form

[b] Required Statement of Conversion

[2] FORM

§§ 16B.412-16B.419 [Reserved]

§ 16B.420 Agreement of Merger

[1] Comment

[a] Use of Form

[b] Approval of Merger

[c] Contents of Agreement of Merger

[d] Rules for Partnerships With 35+ Limited Partners

[e] Location and Inspection of Agreement of Merger

[2] FORM

Agreement of Merger

§ 16B.421 Certificate of Merger

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[c] Executing, Acknowledging, and Filing Certificate

[d] Effect of Filing Certificate

[e] Effect of Recording Certificate

[2] FORM

§§ 16B.422-16B.429 [Reserved]

§ 16B.430 Notice to Limited Partners of Approval of Reorganization

[1] Comment

[a] Use of Form

[b] Rights of Dissenting Limited Partners

[i] In General

[ii] Limited Partnerships That Must Purchase Dissenting Interests

[2] FORM

Notice to Limited Partners of Approval of Reorganization

§ 16B.431 Written Demand by Limited Partner for Purchase of Dissenting Interests

[1] Comment--Use of Form

[2] FORM

Written Demand by Limited Partner for Purchase of Dissenting Interests

Reviewed by W. Rod Stern, J.D., LL.M.,
Groh, Carroll & Sternn*

FOOTNOTES:

(n46)Footnote *. The law firm of Groh, Carroll & Stern (Irvine, California) concentrates in the specialty areas of business, corporate, and tax law for transactional matters, and handles business, corporate, tax, and real estate litigation and arbitration matters. Mr. Stern received a LL.M. in Taxation from New York University School of Law in 1989, and a J.D. from Hastings College of the Law, University of California, in 1983. His personal practice emphasizes business and tax planning advice for individuals and small and medium-size businesses, as well as tax lit igation and dispute resolution, probate, and conservatorship matters.



113 of 175 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS

8-16B California Legal Forms--Transaction Guide Scope

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

Scope

Reviewed by W. Rod Stern, J.D., LL.M.,
Groh, Carroll & Sternn* Scope

This chapter covers the conversion and merger of limited partnerships under the Uniform Limited Partnership Act of 2008 (ULPA '08) [*Corp. Code §§ 15900-15912.07* (operative January 1, 2008)]. As of January 1, 2010, this act governs all limited partnerships, except as otherwise provided in *Corp. Code § 15912.06(c)* [*Corp. Code § 15912.06(b)*; *see Ch. 16, Formation of Limited Partnerships, § 16.11*]. The Legal Background discusses conversion and merger requirements and partners' dissenting rights. The Transaction Guide covers the procedural steps required to merge limited partnerships and other business entities, convert to another business entity, and exercise dissenting partners' rights. This chapter also includes forms applicable to mergers and conversions, and to the exercise of the rights of dissenting limited partners.

The nature and formation of limited partnerships are discussed in Ch. 16, *Formation of Limited Partnerships* . The dissolution of limited partnerships is discussed in Ch. 16A, *Dissolution of Limited Partnerships* .

For detailed discussion of California partnership law, including the California Revised Limited Partnership Act (CRLPA) [former *Corp. Code § 15611 et seq.*, repealed Jan. 1, 2010], *see* Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* (Matthew Bender). The merger of California corporations with domestic and foreign limited partnerships is covered in Ch. 11C, *Mergers* . The conversion of California corporations into other business entities, including limited partnerships, and the conversion of other business entities into corporations, is discussed in Ch. 11F, *Corporate Conversions* .

FOOTNOTES:
(n47)Footnote *. The law firm of Groh, Carroll & Stern (Irvine, California) concentrates in the specialty areas of business, corporate, and tax law for transactional matters, and handles business, corporate, tax, and real estate litigation and arbitration matters. Mr. Stern received a LL.M. in Taxation from New York University School of Law in 1989, and a J.D. from Hastings College of the Law, University of California, in 1983. His personal practice emphasizes business and tax planning advice for individuals and small and medium-size businesses, as well as tax lit igation and dispute resolution, probate, and conservatorship matters.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

8-16B California Legal Forms--Transaction Guide § 16B.301

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.301 California Statutes

Corporations and other business entities merging with limited partnerships. *Corp. Code §§ 161, 161.5, 161.7, 165.5, 167.3, 167.5, 167.7, 167.8, 171.03, 171.05, 171.07, 171.3, 171.5, 174.5, 190, 190.5, 190.7, 1101.1, 1109, 1113, 1201.*

Conversion of corporation into "other business entity" (including limited partnerships). *Corp. Code § 1151*; *see Corp. Code § 1150 et seq.*

Conversion of "other business entity" (including limited partnership) into domestic corporation. *Corp. Code § 1150 et seq.*

Conversion and merger under Uniform Limited Partnership Act of 2008 (ULPA '08). *Corp. Code § 15911.01 et seq.*
Definitions. *Corp. Code § 15911.01.*
"Converted entity." *Corp. Code § 15911.01(a).*
"Converted limited partnership." *Corp. Code § 15911.01(b).*
"Converting limited partnership. "*Corp. Code § 15911.01(c).*
"Converting entity." *Corp. Code § 15911.01(d).*
"Constituent corporation." *Corp. Code § 15911.01(e).*
"Constituent limited partnership." *Corp. Code § 15911.01(f).*
"Constituent other business entity." *Corp. Code § 15911.01(g).*
"Disappearing limited partnership." *Corp. Code § 15911.01(h).*
"Disappearing other business entity." *Corp. Code § 15911.01(i).*
"Foreign other business entity." *Corp. Code § 15911.01(j).*
"Other business entity." *Corp. Code § 15911.01(k).*
"Surviving limited partnership." *Corp. Code § 15911.01(l).*
"Surviving other business entity." *Corp. Code § 15911.01(m).*

Conversions.
Conditions allowing conversion of limited partnership into other business entity. *Corp. Code § 15911.02*.
Requirements for plan of conversion. *Corp. Code § 15911.03*.
Determining effective date of conversion. *Corp. Code § 15911.04*.
Compliance with law. *Corp. Code § 15911.05*.
Required documents. *Corp. Code § 15911.06*.
Filing of record of conversion. *Corp. Code § 15911.07*.
Conversion of other business entity to domestic limited partnership. *Corp. Code § 15911.08*.
Effect of conversion. *Corp. Code § 15911.09*.

Mergers.
Law governing merger. *Corp. Code § 15911.10*.
Entities allowed to merge. *Corp. Code § 15911.11*.
Approval of agreement of merger. *Corp. Code §§ 15911.12, 15911.13*.
Filing and execution of certificate of merger. *Corp. Code § 15911.14*.
Effective date of merger. *Corp. Code § 15911.15*.
Succession; creditors' rights. *Corp. Code § 15911.16*.
Effect of filing on surviving entities. *Corp. Code § 15911.17*.
Interests of disappearing partnership or other business entity. *Corp. Code § 15911.18*.
Presumption of validity of merger. *Corp. Code § 15911.19*.

Dissenting limited partners' rights.
Definition of "reorganization," "control." *Corp. Code § 15911.20*.
Definition of "dissenting interest," "dissenting limited partner"; right to require purchase of interest. *Corp. Code § 15911.21*.
Notice of approval of reorganization. *Corp. Code § 15911.22*.
Submitting certificate of interest. *Corp. Code § 15911.23*.
Determining value of dissenting interest. *Corp. Code § 15911.24*.
Action to determine whether interest is dissenting interest. *Corp. Code § 15911.25*.
Court-appointed appraisers. *Corp. Code § 15911.26*.
Dissenting limited partners as creditors. *Corp. Code § 15911.27*.
Cash distributions before payment credited against total to be paid. *Corp. Code § 15911.28*.
Limited partners' rights until payment. *Corp. Code § 15911.29*.
Loss of status as dissenting interest. *Corp. Code § 15911.30*.
Proceedings suspended during litigation. *Corp. Code § 15911.31*.
Application of dissenting rights article. *Corp. Code § 15911.32*.
Right to attack validity of reorganization. *Corp. Code § 15911.33*.

Application and construction of ULPA '08. *Corp. Code § 15912.01*.

Severability of provisions. *Corp. Code § 15912.02*.

Operative date of ULPA '08. *Corp. Code § 15912.04*.

Limitations on application before January 1, 2010. *Corp. Code § 15912.06*.

Application of provisions before operative date. *Corp. Code § 15912.07*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

8-16B California Legal Forms--Transaction Guide § 16B.302

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.302 Federal Sources

[1] Statutes

Income of partners. *I.R.C. § 702*.

Tax year of terminating partnerships. *I.R.C. § 706(c)(1)*.

Termination of partnerships. *I.R.C. § 708(b)(1)*.

Continuation of partnerships after merger. *I.R.C. § 708(b)(2)(A)*.

Carry over basis of contributed property. *I.R.C. § 723*.

Recognition of gain incident to merger; decrease in share of partnership liabilities. *I.R.C. §§ 731, 752*.

[2] Regulations

Income of partners. *Treas. Reg. §§ 1.702-1, 1.702-2*.

Taxable year of partnerships. *Treas. Reg. § 1.706-1*.

Tax year of terminated partnership closes on effective date of merger. *Treas. Reg. § 1.708-1(b)(3), (c)*.

Continuing partnership retains tax year. *Treas. Reg. § 1.708-1(c)*.



116 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

8-16B California Legal Forms--Transaction Guide §§ 16B.303-16B.304

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[Reserved]

§§ 16B.303[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

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Law Reviews [Reserved]

§ 16B.305Law Reviews [Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-16B California Legal Forms--Transaction Guide § 16B.306

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.306 Text References

[1] Matthew Bender Sources

Ballantine & Sterling, California Corporation Laws (Matthew Bender).
Ch. 12, *Corporate Acquisitions, Mergers, and Reorganizations*.
Ch. 25, *Limited Partnerships*.
Ch. 26, *Income Taxation of Partnerships*.

California Forms of Pleading and Practice (Matthew Bender).
Ch. 400, *Partnerships: Governing Statutes*.
Ch. 404, *Partnerships: Actions Between Limited Partners and Partnership*.
Ch. 405, *Partnerships: Actions Between Limited Partners or Partnerships and Third Parties*.
Ch. 406, *Partnerships: Dissolution*.

California Legal Forms (Matthew Bender).
Ch. 11F, *Corporate Conversions*.
Ch. 12C, *Limited Liability Companies*.
Ch. 15, *General Partnerships*, Part C.
Ch. 16, *Formation of Limited Partnerships*.
Ch. 16A, *Dissolution of Limited Partnerships*.
Ch. 29A, *Joint Ventures*.
Ch. 29B, *Nonpublic Real Estate Syndicates*.
Ch. 29C, *Public Real Estate Syndicates*.

California Real Estate Law and Practice, Ch. 24, *Drafting and Analyzing Agreements and Certificates of Limited Partnership* (Matthew Bender).

[2] Additional Text References [Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-16B California Legal Forms--Transaction Guide §§ 16B.307-16B.309

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[Reserved]

§§ 16B.307[Reserved]



120 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Conversions of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.310

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.310 Law Applicable to Conversions

As of January 1, 2010, the ULPA '08 governs *all* limited partnerships, except as otherwise provided in *Corp. Code § 15912.06(c)* [*Corp. Code § 15912.06(b) ; see Ch. 16, Formation of Limited Partnerships, § 16.11*].

The ULPA '08 does not affect an action commenced, proceeding brought, or right accrued before the chapter became operative (January 1, 2008) [*Corp. Code § 15912.07*].

For detailed discussion of California partnership law, including the California Revised Limited Partnership Act (CRLPA) [former *Corp. Code § 15611 et seq.*, repealed Jan. 1, 2010], see Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Conversions of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.311

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.311 Definitions Applicable to Conversions

[1] In General

The ULPA '08 sets forth definitions specifically applicable to conversions of limited partnerships [*see Corp. Code § 15911.01*]. These definitions are in addition to those generally applicable throughout the ULPA '08 [*see Corp. Code § 15901.02*; *see also* Ch. 16, *Formation of Limited Partnerships*].

[2] "Converted Entity"

"Converted entity" means the other business entity or foreign other business entity or foreign limited partnership that results from a conversion of a domestic limited partnership under the ULPA '08 [*Corp. Code § 15911.01(a)*].

[3] "Converted Limited Partnership"

"Converted limited partnership" means a domestic limited partnership that results from a conversion of an other business entity or a foreign other business entity or a foreign limited partnership pursuant to *Corp. Code § 15911.08* [*Corp. Code § 15911.01(b)*; *see § 16B.319*].

[4] "Converting Limited Partnership"

"Converting limited partnership" means a domestic limited partnership that converts to an other business entity or a foreign other business entity or a foreign limited partnership pursuant to the ULPA '08 [*Corp. Code § 15911.01(c)*].

[5] "Converting Entity"

"Converting entity" means an other business entity or a foreign other business entity or a foreign limited partnership that converts to a domestic limited partnership pursuant to the ULPA '08 [*Corp. Code § 15911.01(d)*].

[6] "Foreign Other Business Entity"

"Foreign other business entity" means an other business entity formed under the laws of any state other than California or under the laws of a foreign country [*Corp. Code § 15911.01(j)*].

[7] "Other Business Entity"

"Other business entity" means a corporation, general partnership, limited liability company, business trust, real estate investment trust, or unincorporated association (other than a nonprofit association), but excludes a limited partnership [*Corp. Code § 15911.01(k)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Conversions of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.312

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.312 Conditions Allowing Conversion

[1] Entities Into Which Limited Partnerships May Be Converted

A limited partnership may be converted into any of the following [*Corp. Code § 15911.02(a)*]:

- An other business entity.
- A foreign other business entity.
- A foreign limited partnership.

Conversion under the ULPA '08 is permitted only under the following conditions [*Corp. Code § 15911.02(a)*]. For a conversion into a domestic or foreign partnership or limited liability company or into a foreign limited partnership, each of the partners of the converting partnership must receive a percentage interest in the profits and capital of the converted entity equal to that partner's percentage interest in profits and capital of the converting limited partnership as of the effective time of the conversion consent [*Corp. Code § 15911.02(a)(1)*]. For a conversion into an other business entity or foreign other business entity not specified *above*, both of the following must occur [*Corp. Code § 15911.02(a)(2)*]:

- Each limited partnership interest of the same class must be treated equally with respect to any distribution of cash, property, rights, interests, or securities of the converted entity, unless all limited partners of the class consent; and
- The nonredeemable limited partnership interests of the converting limited partnership must be converted only into nonredeemable interests or securities of the converted entity, unless all holders of the unredeemable interests consent.

[2] Applicable Law Must Permit Conversion

The conversion of a limited partnership to an other business entity, a foreign other business entity, or a foreign limited partnership may be effected only if both the law under which the converted entity will exist expressly permits the formation of that entity pursuant to a conversion, and the limited partnership complies with all other requirements of any other law that applies to conversion to the converted entity [*Corp. Code § 15911.02(b)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Conversions of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.313

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.313 Plan of Conversion

[1] Required Provisions

A limited partnership that desires to convert to an other business entity, a foreign other business entity, or a foreign limited partnership must approve a plan of conversion. That plan must state all of the following [*Corp. Code § 15911.03(a)*]:

- The terms and conditions of the conversion.
- The place of organization of the converted entity and of the converting limited partnership and the name of the converted entity after conversion.
- The manner of converting the limited and general partnership interests of each of the partners into shares of, securities of, or interests in, the converted entity.
- The provisions of the governing documents for the converted entity, including the partnership agreement, limited liability company articles of organization and operating agreement, or articles or certificate of incorporation if the converted entity is a corporation, to which the holders of interests in the converted entity are to be bound.
- Any other details or provisions that are required by the laws under which the converted entity is organized, or that are desired by the parties.

[2] Approval Requirements

The plan of conversion must be approved by all general partners of the converting limited partnership and by a majority in interest of each class of limited partners of the converting limited partnership, unless a greater or lesser approval is

required by the partnership agreement of the converting limited partnership [*Corp. Code § 15911.03(b)*; *see Corp. Code § 15901.10(b)(12)* (partnership agreement may not restrict right of partner to approve conversion)]. However, if the limited partners of the limited partnership would become personally liable for any obligations of the converted entity as a result of the conversion, the plan of conversion must be approved by all of the limited partners of the converting limited partnership, unless the plan of conversion provides that all limited partners will have dissenters' rights as provided in *Corp. Code §§ 15911.20-15911.33* [*Corp. Code § 15911.03(b)*; *see § 16B.350* et seq.].

[3] All Non-Dissenting Partners Deemed Parties to Plan

Upon the effectiveness of the conversion, all partners of the converting limited partnership, except those that exercise dissenters' rights [*Corp. Code §§ 15911.20-15911.33*; *see § 16B.350* et seq.] are deemed parties to any governing documents for the converted entity adopted as part of the plan of conversion, whether or not the partner has executed the plan or the governing documents for the converted entity. Any adoption of governing documents made pursuant thereto is effective at the effective time or date of the conversion [*Corp. Code § 15911.03(c)*].

[4] Maintaining Plan of Conversion

The converted entity must keep the plan of conversion at the following location [*Corp. Code § 15911.03(f)*]:

- The principal place of business of the converted entity, if the converted entity is a domestic partnership or foreign other business entity;

- The principal executive office of, or registrar or transfer agent of, the converted entity, if the converted entity is a domestic corporation; or

- The office at which records are to be kept under *Corp. Code § 17057*, if the converted entity is a domestic limited liability company [*see* Ch. 12C, *Limited Liability Companies*].

Upon the request of a partner of a converting limited partnership, the authorized person on behalf of the converted entity must promptly deliver to the partner or the holder of shares, interests, or other securities, at the expense of the converted entity, a copy of the plan of conversion. A waiver by a partner of these rights is unenforceable [*Corp. Code § 15911.03(f)*].

[5] Amending Plan of Conversion

Notwithstanding its prior approval, a plan of conversion may be amended before the conversion takes effect if the amendment is approved by all general partners of the converting limited partnership. If the amendment changes any of the principal terms of the plan, the plan must also be approved by the limited partners of the converting limited partnership in the same manner and to the same extent as required for the approval of the original plan [*Corp. Code § 15911.03(d)*].

[6] Abandoning Conversion

The general partners of a converting limited partnership in their discretion may abandon a conversion by unanimous approval at any time before the conversion is effective, without further approval by the limited partners, subject to the contractual rights of third parties other than limited partners [*Corp. Code § 15911.03(e)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Conversions of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.314

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.314 Effective Date of Conversion

A conversion into an other business entity, a foreign other business entity, or a foreign limited partnership becomes effective upon the earliest date that all of the following occur [*Corp. Code § 15911.04(a)*]:

- The plan of conversion is approved by the partners of the converting limited partnership, as provided in *Corp. Code § 15911.03* [*see § 16B.313[2]*];

- All documents required by law to create the converted entity are filed and contain a statement of conversion if required under *Corp. Code § 15911.06* [*see § 16B.317*]; and

- The effective date, if set forth in the plan of conversion, occurs.

A copy of the statement of partnership authority or articles of organization complying with *Corp. Code § 15911.06* [*see § 16B.317*], if applicable, duly certified by the Secretary of State, is conclusive evidence of the conversion of the limited partnership [*Corp. Code § 15911.04(b)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Conversions of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.315

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.315 Compliance With Other Laws

The conversion of a limited partnership into a foreign limited partnership or foreign other business entity must comply with *Corp. Code § 15911.02 et seq.* [*Corp. Code § 15911.05(a)*; *see § 16B.312*]. If the limited partnership is converting into a foreign limited partnership or foreign other business entity, those conversion proceedings must be in accordance with the laws of the state or place of organization of the foreign limited partnership or foreign other business entity and the conversion will become effective in accordance with that law [*Corp. Code § 15911.05(b)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Conversions of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.316

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.316 Service Of Process

To enforce an obligation of a limited partnership that has converted to a foreign limited partnership or foreign other business entity, the Secretary of State will only be the agent for service of process in an action or proceeding against that converted foreign entity, if (1) the agent designated for the service of process for that entity is a natural person and cannot be found with due diligence; (2) if the agent is a corporation and no person, to whom delivery may be made, may be located with due diligence; or (3) if no agent has been designated and if no one of the officers, partners, managers, members, or agents of that entity may be located after diligent search; and in each case it is so shown by affidavit to the satisfaction of the court. The court then may make an order that service be made by personal delivery to the Secretary of State or to an assistant or deputy Secretary of State of two copies of the process together with two copies of the order. The order must set forth an address to which the process will be sent by the Secretary of State. Service in this manner is deemed complete on the 10th day after delivery of the process to the Secretary of State [*Corp. Code § 15911.05(c)(1)*].

Upon receipt of the process and order and the fee set forth in *Gov. Code § 12206*, the Secretary of State must provide notice to that entity of the service of the process by forwarding by certified mail, return receipt requested, a copy of the process and order to the address specified in the order [*Corp. Code § 15911.05(c)(2)*].

The Secretary of State must keep a record of all process served upon the Secretary and record in it the time of service and the Secretary's action with respect thereto. The certificate of the Secretary of State, under the Secretary's official seal, certifying to the receipt of process, the providing of notice to that entity, and the forwarding of the process is competent and prima facie evidence of the matters stated in it [*Corp. Code § 15911.05(c)(3)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Conversions of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.317

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.317 Certificate or Statement of Conversion

[1] Type of Document Required

Upon conversion of a limited partnership, one of the following applies [*Corp. Code § 15911.06(a)*]:

- If the limited partnership is converting into a domestic limited liability company, a statement of conversion must be completed on the articles of organization for the converted entity and filed with the Secretary of State.

- If the limited partnership is converting into a domestic partnership, a statement of conversion must be completed on the statement of partnership authority for the converted entity. If no statement of partnership authority is filed, a certificate of conversion must be filed separately with the Secretary of State.

- If the limited partnership is converting into a domestic corporation, a statement of conversion must be completed on the articles of incorporation for the converted entity and must be filed with the Secretary of State.

- If the limited partnership is converting into a foreign limited partnership or foreign other business entity, a certificate of conversion must be filed with the Secretary of State.

[2] Contents of Certificate or Statement of Conversion

Any certificate or statement of conversion must be executed and acknowledged [*see Corp. Code § 15901.02(a)* (definition)] by all general partners, unless a lesser number is provided in the certificate of limited partnership. The certificate or statement must set forth all of the following [*Corp. Code § 15911.06(b)*]:

- The name and the Secretary of State's file number of the converting limited partnership.

- A statement that the principal terms of the plan of conversion were approved by a vote of the partners that equaled or exceeded the vote required under *Corp. Code § 15911.03* [*see § 16B.313*] specifying each class entitled to vote and the percentage vote required of each class.

- The form of organization of the converted entity.

- The mailing address of the converted entity's agent for service of process and the chief executive office of the converted entity.

The filing with the Secretary of State of a certificate of conversion or a statement of partnership authority, articles of organization, or articles of incorporation containing a statement of conversion as set forth *above* has the effect of the filing of a certificate of cancellation by the converting limited partnership, and no converting limited partnership that has made the filing is required to file a certificate of cancellation under *Corp. Code § 15902.03* as a result of that conversion [*Corp. Code § 15911.06(c)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Conversions of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.318

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.318 Record Ownership of Real Property

Whenever a limited partnership or other business entity having any real property in California converts into a limited partnership or an other business entity pursuant to laws of California or of the state or place in which the limited partnership or other business entity was organized, and the laws of the state or place of organization, including California of the converting limited partnership or other converting entity provide substantially that the conversion vests in the converted limited partnership or other converted entity all the real property of the converting limited partnership or other converting entity, the filing for record in the office of the county recorder of any county in California in which any of the real property of the converting limited partnership or other converting entity is located either of the documents listed *below* evidences record ownership in the converted limited partnership or other converted entity of all interest of the converting limited partnership or other converting entity in and to the real property located in that county [*Corp. Code § 15911.07(a)*]:

- A certificate of conversion or statement of partnership authority, a certificate of limited partnership, articles of incorporation, or articles of organization complying with *Corp. Code § 15911.06* [*see § 16B.317*] in the form prescribed and certified by the Secretary of State.

- A copy of a certificate of conversion or a statement of partnership authority, certificate of limited partnership, articles of organization, articles of incorporation, or other certificate or document evidencing the creation of a foreign other business entity or foreign limited partnership by conversion, containing a statement of conversion, certified by the Secretary of State or an authorized public official of the state or place pursuant to the laws of which the conversion is effected.

A filed and, if appropriate, recorded certificate of conversion or a statement of partnership authority, certificate of limited partnership, articles of organization, articles or certificate of incorporation, or other certificate evidencing the creation of a foreign other business entity or foreign limited partnership by conversion, containing a statement of conversion, filed pursuant to *Corp. Code § 15911.06* [*see § 16B.317*] stating the name of the converting limited

partnership or other converting entity in whose name property was held before the conversion and the name of the converted entity or converted limited partnership, but not containing all of the other information required by *Corp. Code § 15911.06*, operates with respect to the entities named to the extent provided in *Corp. Code § 15911.07(a)* [*Corp. Code § 15911.07(b)*].

Recording of a certificate of conversion, or a statement of partnership authority, certificate of limited partnership, articles of organization, articles of incorporation, or other certificate evidencing the creation of another business entity or a limited partnership by conversion, containing a statement of conversion, as described *above*, will create in favor of bona fide purchasers or encumbrances for value, a conclusive presumption that the conversion was validly completed [*Corp. Code § 15911.07(c)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Conversions of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.319

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.319 Conversion of Other Business Entity to a Domestic Limited Partnership

An other business entity or a foreign other business entity or a foreign limited partnership may be converted to a domestic limited partnership pursuant to the conversion provisions of the ULPA '08 only if the converting entity is authorized by the laws under which it is organized to effect the conversion [*Corp. Code § 15911.08(a)*].

An other business entity or a foreign other business entity or a foreign limited partnership that desires to convert into a domestic limited partnership must approve a plan of conversion or another instrument required to be approved to effect the conversion pursuant to the laws under which that entity is organized [*Corp. Code § 15911.08(b)*].

The conversion of an other business entity or a foreign other business entity or a foreign limited partnership into a domestic limited partnership must be approved by the number or percentage of the partners, members, shareholders, or holders of interest of the converting entity as is required by the laws under which that entity is organized, or a greater or lesser percentage, subject to applicable laws, as set forth in the converting entity's partnership agreement, articles of organization, operating agreement, articles or certificate of incorporation, or other governing document [*Corp. Code § 15911.08(c)*].

The conversion by an other business entity or a foreign other business entity or a foreign limited partnership into a domestic limited partnership is effective under the ULPA '08's provisions at the time the conversion is effective under the laws under which the converting entity is organized, as long as a certificate of limited partnership containing a statement of conversion has been filed with the Secretary of State. If the converting entity's governing law is silent as to the effectiveness of the conversion, it becomes effective upon the completion of all acts required under Title 2 of the Corporations Code [*see Corp. Code § 15501 et seq.* (partnerships)] to form a limited partnership [*Corp. Code § 15911.08(d)*].

Filing with the Secretary of State of a certificate of conversion or a certificate of limited partnership containing a statement of conversion pursuant to subdivision (a) of *Corp. Code § 15911.08* has the effect of filing a certificate of

cancellation by the converting foreign limited partnership or foreign limited liability company and no converting foreign limited partnership or foreign limited liability company that has made the filing is required to file a certificate of cancellation under *Corp. Code § 15902.03* or *17455* (applicable to limited partnerships governed by the ULPA '08 and limited liability companies governed by the Beverly-Killea Limited Liability Company Act) as a result of that conversion. If a converting other business entity is a foreign corporation qualified to transact business in California, the foreign corporation, by virtue of the filing, automatically surrenders its right to transact intrastate business [*Corp. Code § 15911.08(e)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Conversions of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.320

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.320 Effect of Conversion

[1] No Deemed Transfer of Property

An entity that converts into another entity pursuant to the ULPA 08's conversion provisions is, for all purposes other than for the purposes of *Rev. & Tax. Code §§ 17001 et seq.*, *18401 et seq.*, and *23001 et seq.*, the same entity that existed before the conversion, and the conversion will not be deemed a transfer of property [Corp. Code. § 15911.09(a)].

[2] Rights and Liabilities Continue

Upon a conversion taking effect, all of the following apply [*Corp. Code § 15911.09(b)*]:

- All rights and property, whether real, personal, or mixed, of the converting entity or converting limited partnership are vested in the converted entity or converted limited partnership.

- All debts, liabilities, and obligations of the converting entity or converting limited partnership continue as debts, liabilities, and obligations of the converted entity or converted limited partnership.

- All rights of creditors and liens upon the property of the converting entity or converting limited partnership are preserved unimpaired and remain enforceable against the converted entity or converted limited partnership to the same extent as against the converting entity or converting limited partnership as if the conversion had not occurred.

- Any action or proceeding pending by or against the converting entity or converting limited partnership may be continued against the converted entity or converted limited partnership as if the conversion had not occurred.

[3] Partner's Liability

A partner of a converting limited partnership is liable for the following [*Corp. Code § 15911.09(c)*]:

- All obligations of the converting limited partnership for which the partner was personally liable before the conversion.

- All obligations of the converted entity incurred after the conversion takes effect, but those obligations may be satisfied only out of property of the entity if that partner is a limited partner or a shareholder in a corporation, or unless expressly provided otherwise in the articles of organization or other governing documents, a member of a limited liability company, or a holder of equity securities in another converted entity if the holders of equity securities in that entity are not personally liable for the obligations of that entity under the law under which the entity is organized or its governing documents.

A partner of a converted limited partnership remains liable for any and all obligations of the converting entity for which the partner was personally liable before the conversion, but only to the extent that the partner was liable for the obligations of the converting entity prior to the conversion [*Corp. Code § 15911.09(d)*].

If the other party to a transaction with the limited partnership reasonably believes when entering the transaction that the limited partner is a general partner, the limited partner is liable for an obligation incurred by the limited partnership within 90 days after the conversion takes effect. The limited partner's liability for all other obligations of the limited partnership incurred after the conversion takes effect is that of a limited partner [*Corp. Code § 15911.09(e)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. Conversions of Limited Partnerships

8-16B California Legal Forms--Transaction Guide §§ 16B.321-16B.329

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

[Reserved]

§§ 16B.321[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Mergers of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.330

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.330 Law Applicable to Mergers

Under the ULPA '08 [*Corp. Code §§ 15900-15912.07*], mergers of limited partnerships are governed by *Corp. Code §§ 15911.10-15911.19* [*Corp. Code § 15911.10*]. Before January 1, 2010, the ULPA '08 governs only the following [*see Corp. Code § 15912.06(a)*]:

- Limited partnerships formed on or after January 1, 2008; and

- Limited partnerships formed before January 1, 2008, which elect to be subject to the new Act, except as otherwise provided in *Corp. Code § 15912.06(c), (d)* [*see Ch. 16, Formation of Limited Partnerships, §§ 16.11, 16.12*].

On and after January 1, 2010, the ULPA '08 will govern *all* limited partnerships, except as otherwise provided in *Corp. Code § 15912.06(c)* [*Corp. Code § 15912.06(b) ; see* discussion in *§ 16B.310*].

The merger of limited partnerships governed by prior law is discussed in Part A of this chapter. The merger provisions of the ULPA '08 are substantively very similar to those of the CRLPA [*see* Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* , § 753.01 (Matthew Bender)]. For detailed discussion of all the California partnership acts, see Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Mergers of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.331

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.331 Definitions Applicable to Mergers

[1] In General

The ULPA '08 sets forth definitions specifically applicable to mergers of limited partnerships [*see Corp. Code § 15911.01*]. These definitions are in addition to those generally applicable throughout the ULPA '08 [*see Corp. Code § 15901.02*; *see also* Ch. 16, *Formation of Limited Partnerships*].

[2] "Constituent Corporation"

"Constituent corporation" means a corporation that is merged with or into one or more limited partnerships or other business entities and includes a surviving corporation [*Corp. Code § 15911.01(e)*].

[3] "Constituent Limited Partnership"

"Constituent limited partnership" means a limited partnership that is merged with or into one or more limited partnerships or other business entities and includes a surviving limited partnership [*Corp. Code § 15911.01(f)*].

[4] "Constituent Other Business Entity"

"Constituent other business entity" means an other business entity that is merged with or into one or more limited partnerships and includes a surviving other business entity [*Corp. Code § 15911.01(g)*].

[5] "Disappearing Limited Partnership"

"Disappearing limited partnership" means a constituent limited partnership that is not the surviving limited partnership [*Corp. Code § 15911.01(h)*].

[6] "Disappearing Other Business Entity"

"Disappearing other business entity" means a constituent other business entity that is not the surviving other business entity [*Corp. Code § 15911.01(i)*].

[7] "Foreign Other Business Entity"

"Foreign other business entity" means an other business entity formed under the laws of any state other than California or under the laws of a foreign country [*Corp. Code § 15911.01(j)*].

[8] "Other Business Entity"

"Other business entity" means a corporation, general partnership, limited liability company, business trust, real estate investment trust or unincorporated association, other than a nonprofit corporation, but excludes a limited partnership [*Corp. Code § 15911.01(k)*].

[9] "Surviving Limited Partnership"

"Surviving limited partnership" means a limited partnership into which one or more other limited partnerships or other business entities are merged [*Corp. Code § 15911.01(l)*].

[10] "Surviving Other Business Entity"

"Surviving other business entity" means another business entity into which one or more limited partnerships are merged [*Corp. Code § 15911.01(m)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Mergers of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.332

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.332 Entities Allowed to Merge

The following entities may be merged pursuant to the ULPA '08 [*Corp. Code § 15911.11*]:

- Two or more limited partnerships into one limited partnership [*Corp. Code § 15911.11(a)*].

- One or more limited partnerships and one or more other business entities into one of those other business entities [*Corp. Code § 15911.11(b)*].

- One or more limited partnerships and one or more other business entities into one limited partnership [*Corp. Code § 15911.11(c)*].

The merger of any number of limited partnerships with any number of other business entities may be effected only if the other business entities that are organized in California are authorized by the laws under which they are organized to effect the merger, and (1) if a limited partnership is the surviving limited partnership, the foreign other business entities are not prohibited by the laws under which they are organized from effecting that merger, and (2) if a foreign limited partnership or foreign other business entity is the survivor of the merger, the laws of the jurisdiction under which the survivor is organized authorize that merger [*Corp. Code § 15911.11*].

If one or more domestic corporations is also a party to a merger of one or more limited partnerships and one or more other business entities into one limited partnership, the merger may be effected only if, with respect to any foreign other business entity that is a corporation, the foreign corporation is authorized by the laws under which it is organized to effect that merger [*Corp. Code § 15911.11(c)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Mergers of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.333

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.333 Agreement of Merger

[1] Approval

Each limited partnership and other business entity that desires to merge must approve an agreement of merger. The agreement must be approved by all general partners of each constituent limited partnership and the principal terms of the merger must be approved by a majority in interest of each class of limited partners of each constituent limited partnership, unless a greater approval is required by the partnership agreement of the constituent limited partnership [*Corp. Code § 15911.12(a)*; *see Corp. Code § 15901.10(b)(12)* (partnership agreement may not restrict right of partner to approve conversion); *see also Ch. 16, Formation of Limited Partnerships, § 16.21[4][b]*]. However, if the limited partners of any constituent limited partnership would become personally liable for any obligations of a constituent limited partnership or constituent other business entity as a result of the merger, the principal terms of the agreement of merger must be approved by all of the limited partners of the constituent limited partnership, unless the agreement of merger provides that all limited partners will have dissenters' rights [*see § 16B.350* et seq.]. The agreement of merger must be approved on behalf of each constituent other business entity by those persons required to approve the merger by the laws under which it is organized. Other persons, including a parent [*see Corp. Code § 15901.02(v)* (definition)] of a constituent limited partnership, may be parties to the agreement of merger [*Corp. Code § 15911.12(a)*].

[2] Contents

The agreement of merger must state [*Corp. Code § 15911.12(a)*]:

- The terms and conditions of the merger.

- The name and place of organization of the surviving limited partnership or surviving other business entity, and of each disappearing limited partnership and disappearing other business entity. The agreement of merger may change the name of the surviving limited partnership; the new name may be the same as or similar to the name of a disappearing domestic or foreign limited partnership, subject to

Corp. Code § 15901.08 (name requirements) [*see Ch. 16, Formation of Limited Partnerships, § 16.21[3]*].

- The manner of converting the partnership interests of each of the constituent limited partnerships into interests, shares, or other securities of the surviving limited partnership or surviving other business entity.

- If partnership interests of any of the constituent limited partnerships are not to be converted solely into interests, shares, or other securities of the surviving limited partnership or surviving other business entity, the cash, property, rights, interests, or securities that the holders of the partnership interests are to receive in exchange for the partnership interests. The cash, property, rights, interests, or securities may be in addition to or in lieu of interests, shares, or other securities of the surviving limited partnership or surviving other business entity.

- If applicable, that the partnership interests are canceled without consideration.

- Any other details or provisions that are required by the laws under which any constituent other business entity is organized, including, if a domestic corporation is a party to the merger, *Corp. Code § 1113(b).*

- Any other details or provisions that are desired, including, without limitation, a provision for the treatment of fractional partnership interests.

[3] Rules for Partnerships With Over 35 Limited Partners

With respect to constituent limited partnerships with over 35 limited partners [*see Corp. Code § 15911.12(b)*], each limited partnership interest of the same class of any constituent limited partnership, other than a limited partnership interest in another constituent limited partnership that is being canceled and that is held by a constituent limited partnership or its parent [*see Corp. Code § 15901.02(v)* (definition)] or a limited partnership of which the constituent limited partnership is a parent must, unless all limited partners of the class consent, be treated equally with respect to any distribution of cash, property, rights, interests, or securities. However, except in a merger of a limited partnership with a limited partnership in which it controls at least 90 percent of the limited partnership interests entitled to vote with respect to the merger, the unredeemable limited partnership interests of a constituent limited partnership may be converted only into unredeemable interests or securities of the surviving limited partnership or other business entity or a parent if a constituent limited partnership or a constituent other business entity or its parent owns, directly or indirectly, prior to the merger, limited partnership interests of another constituent limited partnership or interests or securities of a constituent other business entity representing more than 50 percent of the interests or securities entitled to vote with respect to the merger of the other constituent limited partnership or constituent other business entity or more than 50 percent of the voting power, as defined in *Corp. Code § 194.5*, of a constituent other business entity that is a domestic corporation, unless all of the limited partners of the class consent [*Corp. Code § 15911.12(b)*].

The provisions described *above* do not apply to any transaction if the California Commissioner of Corporations has approved the terms and conditions of the transaction and the fairness of those terms and conditions pursuant to *Corp. Code § 25142* [*Corp. Code § 15911.13*].

[4] Amendment of Agreement of Merger

Notwithstanding its prior approval, an agreement of merger may be amended before the filing of the certificate of merger or the agreement of merger as provided in *Corp. Code § 15911.14* [*see § 16B.334*] if (1) the amendment is approved by the general partners of each constituent limited partnership in the same manner as required for approval of

the original agreement of merger and (2) if the amendment changes any of the principal terms of the agreement of merger, the amendment is approved by the limited partners of each constituent limited partnership in the same manner and to the same extent as required for the approval of the original agreement of merger, and by each of the constituent other business entities [*Corp. Code § 15911.12(c)*].

[5] Amendment or Adoption of New Partnership Agreement

An agreement of merger approved as described in [1], *above*, may amend the partnership agreement of any constituent limited partnership. The agreement may adopt a new partnership agreement for a constituent limited partnership if it is the surviving limited partnership in the merger. Any amendment to a partnership agreement or adoption of a new partnership agreement made as described above is effective at the effective time or date of the merger. However, if a greater number of limited partners is required to approve an amendment to the partnership agreement of a constituent limited partnership than is required to approve the agreement of merger and the number of limited partners that approve the agreement of merger is less than the number of limited partners required to approve an amendment to the partnership agreement of the constituent limited partnership, any amendment to the partnership agreement or adoption of a new partnership agreement of that constituent limited partnership made in a merger agreement is effective only if the agreement of merger provides that all of the limited partners will have dissenters' rights [*Corp. Code § 15911.12(e)*; *see § 16B.350* et seq.].

[6] Location and Inspection of Agreement of Merger

The surviving limited partnership or surviving other business entity must keep the agreement of merger at its designated office or at the business address specified in *Corp. Code § 15911.14(a)(5)*, as applicable. Upon the request of a limited partner of a constituent limited partnership or a holder of shares, interests, or other securities of a constituent other business entity, the general partners of the surviving limited partnership or the authorized person of the surviving other business entity must promptly deliver to the limited partner or the holder of shares, interests, or other securities, at the expense of the surviving limited partnership or surviving other business entity, a copy of the agreement of merger. A waiver by a partner or holder of shares, interests, or other securities of the rights described *above* is unenforceable [*Corp. Code § 15911.12(f)*].

[7] Abandonment of Merger

The general partners of a constituent limited partnership may, in their discretion, abandon a merger, subject to the contractual rights, if any, of third parties, including other constituent limited partnerships and constituent other business entities, without further approval by the limited partnership interests, at any time before the merger is effective [*Corp. Code § 15911.12(d)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Mergers of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.334

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.334 Certificate of Merger

[1] When Required

If the surviving entity is a limited partnership or an other business entity, other than a corporation in a merger in which a domestic corporation is a constituent party, after approval of a merger by the constituent limited partnerships and any constituent other business entities, the constituent limited partnerships and constituent other business entities must file a certificate of merger in the office of, and on a form prescribed by, the Secretary of State. The certificate of merger must be executed and acknowledged by each domestic constituent limited partnership by all general partners, unless a lesser number is provided in the certificate of limited partnership of the domestic constituent limited partnership, and by each foreign constituent limited partnership by one or more general partners, and by each constituent other business entity by those persons required to execute the certificate of merger by the laws under which the constituent other business entity is organized [*Corp. Code § 15911.14(a)*].

[2] Contents

The certificate of merger must set forth all of the following [*Corp. Code § 15911.14(a)*]:

- The names and the Secretary of State's file numbers, if any, of each of the constituent limited partnerships and constituent other business entities, separately identifying the disappearing limited partnerships and disappearing other business entities and the surviving limited partnership or surviving other business entity.

- If a vote of the limited partners was required under *Corp. Code § 15911.12* [*see § 16B.333*], a statement setting forth the total number of outstanding interests of each class entitled to vote on the merger and that the principal terms of the agreement of merger were approved by a vote of the number of interests of each class which equaled or exceeded the vote required, specifying each class entitled to vote and the percentage vote required of each class.

- If the surviving entity is a limited partnership and not an other business entity, any change required to the information set forth in the certificate of limited partnership of the surviving limited partnership resulting from the merger, including any change in the name of the surviving limited partnership resulting from the merger. The filing of a certificate of merger setting forth any such changes to the certificate of limited partnership of the surviving limited partnership has the effect of filing a certificate of amendment by the surviving limited partnership, and the surviving limited partnership need not file a certificate of amendment under *Corp. Code § 15902.02* to reflect those changes.

- The future effective date or time, which must be a date or time certain not more than 90 days subsequent to the date of filing of the merger, if the merger is not to be effective upon the filing of the certificate of merger with the office of the Secretary of State.

- If the surviving entity is an other business entity or a foreign limited partnership, the full name of the entity, type of entity, legal jurisdiction in which the entity was organized and by whose laws its internal affairs are governed, and the address of the principal place of business of the entity.

- Any other information required to be stated in the certificate of merger by the laws under which each constituent other business entity is organized, including, if a domestic corporation is a party to the merger, *Corp. Code § 1113(g)(2)*. If the surviving entity is a foreign limited partnership in a merger in which a domestic corporation is a disappearing other business entity, a copy of the agreement of merger and attachments as required under *Corp. Code § 1113(g)(1)* must be filed at the same time as the filing of the certificate of merger.

[3] Effect on Disappearing Limited Partnerships

A certificate of merger or the agreement of merger, as applicable, has the effect of the filing of a certificate of cancellation for each disappearing limited partnership, and no disappearing limited partnership need file a certificate of cancellation under *Corp. Code § 15902.03* as a result of the merger [*Corp. Code § 15911.14(c)*].

[4] Filing Requirement for Surviving Corporations

If the surviving entity is a domestic corporation or a foreign corporation in a merger in which a domestic corporation is a constituent party, after approval of the merger by the constituent limited partnerships and constituent other business entities, the surviving corporation must file in the office of the Secretary of State a copy of the agreement of merger and attachments required under *Corp. Code § 1113(g)(1)*. The certificate of merger must be executed and acknowledged by each domestic constituent limited partnership by all general partners, unless a lesser number is provided in the certificate of limited partnership of the domestic constituent limited partnership [*Corp. Code § 15911.14(b)*].

[5] Filing Requirement for Disappearing Foreign Corporations

If the organization disappearing into the other business entity is a foreign corporation qualified to transact intrastate business in California, a certificate of satisfaction of the Franchise Tax Board as required by *Rev. and Tax. Code § 23334* must be filed with the certificate of merger or agreement of merger, as applicable. By the filing of the certificate of merger or agreement of merger, as applicable, the foreign corporation automatically surrenders its right to transact intrastate business [*Corp. Code § 15911.14(d)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Mergers of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.335

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.335 Effective Date of Merger

Unless a future effective date or time is provided in a certificate of merger or the agreement of merger, if an agreement of merger is required to be filed under *Corp. Code § 15911.14* [*see § 16B.334*], in which event the merger will be effective at that future effective date or time, a merger is effective upon the filing of the certificate of merger or the agreement of merger, as is applicable, in the office of the Secretary of State [*Corp. Code § 15911.15(a)*].

For all purposes, a copy of the certificate of merger duly certified by the Secretary of State is conclusive evidence of the merger of (1) the constituent limited partnerships, either by themselves or together with constituent other business entities, into the surviving other business entity, or (2) the constituent limited partnerships or the constituent other business entities, or both, into the surviving limited partnership [*Corp. Code § 15911.15(b)(1)*].

In a merger in which the surviving entity is a corporation in which a domestic corporation and a domestic limited partnership are parties to the merger, a copy of an agreement of merger certified on or after the effective date by an official having custody of it has the same force in evidence as the original and, except as against the state, is conclusive evidence of the performance of all conditions precedent to the merger, the existence on the effective date of the surviving corporation, and the performance of the conditions necessary to the adoption of any amendment to the articles of incorporation of the surviving corporation, if applicable, contained in the agreement of merger [*Corp. Code § 15911.15(b)(2)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Mergers of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.336

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.336 Succession to Rights and Liabilities of Disappearing Entities

Upon a merger of limited partnerships or limited partnerships and other business entities pursuant to the ULPA '08, the separate existence of the disappearing limited partnerships and other business entities ceases and the surviving limited partnership or other business entity succeeds, without other transfer, act, or deed, to all rights and property, real, personal, or mixed, of each disappearing party, and is subject to all debts and liabilities of each as if the surviving party had itself incurred them [*Corp. Code § 15911.16(a)*].

All rights of creditors and all liens on the property of each constituent party are preserved unimpaired and may be enforced against the surviving party to the same extent as if the debt, liability, or duty which gave rise to that lien had been incurred or contracted by the surviving party, provided that the liens on the property of a disappearing party are limited to the property affected thereby immediately before the time the merger is effective [*Corp. Code § 15911.16(b)*].

Any action or proceeding pending by or against any disappearing party may be prosecuted to judgment, which will bind the surviving party, or the surviving party may be proceeded against or be substituted in the place of the disappearing party [*Corp. Code § 15911.16(c)*].

Nothing in the ULPA '08's provisions as to mergers is intended to affect the liability a general partner of a disappearing limited partnership may have in connection with the debts and liabilities of that partnership existing before the merger is effective [*Corp. Code § 15911.16(d)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Mergers of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.337

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.337 Merger with Foreign Limited Partnerships or Foreign Other Business Entities

The merger of any number of domestic limited partnerships with any number of foreign limited partnerships or foreign other business entities must comply with the merger provisions described *below* [*Corp. Code § 15911.17(a)*].

If the surviving entity is a domestic limited partnership or a domestic other business entity, the merger proceedings with respect to that entity and any domestic disappearing limited partnership must conform to the provisions of the ULPA '08 governing the merger of domestic limited partnerships. However, if the surviving entity is a foreign limited partnership or a foreign other business entity, then the merger proceedings may be in accordance with the laws of the state or place of organization of the surviving entity subject to the following [*Corp. Code § 15911.17(b)*]:

- The merger becomes effective in accordance with the laws of the jurisdiction in which the surviving limited partnership or entity is organized, but is effective as to any domestic disappearing limited partnership as of the time of effectiveness in that jurisdiction upon the filing in California of a certificate of merger or agreement of merger as provided in *Corp. Code § 15911.14* [*Corp. Code § 15911.17(d)*; *see § 16B.334*].

- The provisions of *Corp. Code §§ 15911.20-15911.33*, regarding dissenters' rights apply [*see § 16B.350* et seq.].

- With respect to any domestic constituent corporation, *Corp. Code §§ 1113* (mergers of corporations with other types of entities), 1200 et seq. (reorganizations), and 1300 et seq. (dissenting rights in mergers) apply.

If the surviving entity is a domestic limited partnership or domestic other business entity, other than a domestic corporation, the certificate of merger must be filed as provided in *Corp. Code § 15911.14(a)* [*see § 16B.334*] and thereupon, subject to *Corp. Code § 15911.15(a)* [*see § 16B.335*] the merger is effective as to each domestic constituent

entity. If the surviving entity is a domestic corporation, the agreement of merger with attachments must be filed as provided in *Corp. Code § 15911.14(b)* [*see § 16B.334*] and thereupon subject to *Corp. Code § 15911.15(a)* [*see § 16B.335*] the merger is effective as to each domestic constituent entity unless another effective date is provided in the merger provisions of *Corp. Code § 1100 et seq.* with respect to any constituent corporation or constituent limited partnership [*Corp. Code § 15911.17(c)*].

If a merger described in *Corp. Code § 15911.17(c)* or *(d)* also includes a foreign disappearing limited partnership previously registered for the transaction of intrastate business in California pursuant to *Corp. Code § 15909.02*, the filing of the certificate of merger or agreement of merger, as is applicable under *Corp. Code § 15911.14* [*see § 16B.334*] automatically has the effect of a cancellation of registration for that foreign limited partnership pursuant to *Corp. Code § 15909.06* without the necessity of the filing of a certificate of cancellation [*Corp. Code § 15911.17(e)*].

The provisions of *Corp. Code § 15911.12(b)* [*see § 16B.333[3]*] and the provisions regarding dissenters' rights in the ULPA '08 [*see § 16B.350* et seq.] apply to the rights of the limited partners of any of the constituent limited partnerships that are domestic limited partnerships and of any domestic limited partnership that is a parent of any foreign constituent limited partnership [*Corp. Code § 15911.17(f)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Mergers of Limited Partnerships

8-16B California Legal Forms--Transaction Guide § 16B.338

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.338 Record Ownership of Real Property

Whenever a domestic or foreign limited partnership or other business entity having any real property in California merges with another limited partnership or other business entity pursuant to the laws of California or of the state or place in which any constituent entity was organized, and the laws of the state or place of organization, including California of any disappearing entity provide substantially that the making and filing of the agreement of merger or certificate of merger vests in the surviving entity all the real property of any disappearing entity, the filing for record in the office of the county recorder of any county in California in which any of the real property of the disappearing entity is located of either of the following evidences record ownership in the surviving entity of all interest of that disappearing entity in and to the real property located in that county: (1) a certificate of merger certified by the Secretary of State, or other certificate prescribed by the Secretary of State, or (2) a copy of the agreement of merger or certificate of merger, certified by the Secretary of State or an authorized public official of the state or place pursuant to the laws of which the merger is effected [*Corp. Code § 15911.18*].

Recording of the certificate of merger in accordance with *Corp. Code § 15911.18* creates, in favor of bona fide purchasers or encumbrancers for value, a conclusive presumption that the merger was validly completed [*Corp. Code § 15911.19*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. Mergers of Limited Partnerships

8-16B California Legal Forms--Transaction Guide §§ 16B.339-16B.349

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

[Reserved]

§§ 16B.339[Reserved]



142 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Dissenting Limited Partners' Rights

8-16B California Legal Forms--Transaction Guide § 16B.350

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.350 Law Governing Dissenting Limited Partners' Rights

[1] Article 11.5 of ULPA '08

Under the ULPA '08 [*Corp. Code §§ 15900-15912.07*], rights of dissenting limited partners are set forth in Article 11.5 [*Corp. Code §§ 15911.20-15911.33*]. Before January 1, 2010, the ULPA '08 governs only the following [*see Corp. Code § 15912.06(a)*]:

- Limited partnerships formed on or after January 1, 2008; and

- Limited partnerships formed before January 1, 2008, which elect to be subject to the new Act, except as otherwise provided in *Corp. Code § 15912.06(c), (d)* [*see Ch. 16, Formation of Limited Partnerships, §§ 16.11, 16.12*].

On and after January 1, 2010, the ULPA '08 will govern *all* limited partnerships, except as otherwise provided in *Corp. Code § 15912.06(c)* [*Corp. Code § 15912.06(b) ; see* discussion in *§ 16B.310*].

The rights of dissenting limited partners governed by prior law is discussed in Part A of this chapter. The provisions of the ULPA '08 on dissenting rights are substantively very similar to those of the CRLPA [*see* Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* , § 754 (Matthew Bender)]. For detailed discussion of all the California partnership acts, see Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* (Matthew Bender).

[2] Application of Article 11.5

The provisions of the ULPA '08 respecting dissenters' rights apply to [*Corp. Code § 15911.32(a)*]:

- A domestic limited partnership formed on or after January 1, 1991.

- A foreign limited partnership if (1) the foreign limited partnership was formed on or after January 1, 1991 or filed an application to qualify to do business on or after January 1, 1991, and (2) limited partners holding more than 50 percent of the voting power held by all limited partners of the foreign limited partnership reside in California.

- A limited partnership if the partnership agreement so provides or if all general partners and a majority in interest of the limited partners determine that those provisions will apply.

The dissenter's rights provisions of the ULPA '08 do not apply to limited partnership interests governed by limited partnership agreements whose terms and provisions specifically set forth the amount to be paid in respect of such interests in the event of a reorganization of the limited partnership, or to limited partnerships with 35 or fewer limited partners, unless the partnership agreement provides that these provisions will apply or unless all general partners and a majority in interest of the limited partners agree that these provisions will apply [*Corp. Code § 15911.32(b)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Dissenting Limited Partners' Rights

8-16B California Legal Forms--Transaction Guide § 16B.351

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.351 Definitions Applicable to Dissenting Limited Partners' Rights

[1] In General

The ULPA '08 sets forth definitions specifically applicable to dissenters' rights [*see Corp. Code §§ 15911.20, 15911.21*]. These definitions are in addition to those generally applicable throughout the ULPA '08 [*see Corp. Code § 15901.02*; *see also* Ch. 16, *Formation of Limited Partnerships*].

[2] "Reorganization"

"Reorganization" refers to any of the following [*Corp. Code § 15911.20(a)*]:

- A conversion pursuant to *Corp. Code § 15911.01* [*see § 16B.310* et seq.].

- A merger pursuant to *Corp. Code § 15911.10* [*see § 16B.330* et seq.].

- The acquisition by one limited partnership in exchange, in whole or in part, for its partnership interests (or the partnership interests or equity securities of a partnership or other business entity that is in control of the acquiring limited partnership) of partnership interests or equity securities of another limited partnership or other business entity if, immediately after the acquisition, the acquiring limited partnership has control of the other limited partnership or other business entity.

- The acquisition by one limited partnership in exchange in whole or in part for its partnership interests (or the partnership interests or equity securities of a partnership or other business entity which is in control of the acquiring limited partnership) or for its debt securities (or debt securities of a limited partnership or other business entity which is in control of the acquiring limited partnership) which are not adequately secured and which have a maturity date in excess of five years after the consummation of the acquisition, or both, of all or substantially all of the assets of another limited partnership or other

business entity.

[3] "Control"

"Control" means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a limited partnership or other business entity [*Corp. Code § 15911.20(b)*].

[4] "Dissenting Interest"

"Dissenting interest" means the interest of a limited partner that satisfies all of the following conditions [*Corp. Code § 15911.21(b)*]:

(1) Either:

(A) Was not, immediately before the reorganization, either (i) listed on any national securities exchange certified by the Commissioner of Corporations under *Corp. Code § 25100(o)*, or *(ii)* listed on the list of OTC margin stocks issued by the Board of Governors of the Federal Reserve System, provided that in either instance the limited partnership whose outstanding interests are so listed provides, in its notice to limited partners requesting their approval of the proposed reorganization, a summary of the provisions of *Corp. Code §§ 15911.21, 15911.22, 15911.23, 15911.24* and *15911.25*; or

(B) If the interest is of a class of interests listed as described in clause (i) or (ii) of subparagraph (A) *above*, demands for payment are filed with respect to five percent or more of the outstanding interests of that class.

(2) Was outstanding on the date for the determination of limited partners entitled to vote on the reorganization.

(3) (A) Was not voted in favor of the reorganization, or (B) if the interest is described in clause (i) or (ii) of subparagraph (A) of paragraph (1) *above*, was voted against the reorganization; provided, however, that clause (A) rather than this clause (B) of this sub-paragraph applies in any event where the approval for the proposed reorganization is sought by written consent rather than at a meeting.

(4) The limited partner has demanded that the interest be purchased by the limited partnership at its fair market value in accordance with *Corp. Code § 15911.22*.

(5) The limited partner has submitted the interest for endorsement, if applicable, in accordance with *Corp. Code § 15911.23*.

[5] "Dissenting Limited Partner"

"Dissenting limited partner" means the recordholder of a dissenting interest, and includes an assignee of record of such an interest [*Corp. Code § 15911.21(c)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Dissenting Limited Partners' Rights

8-16B California Legal Forms--Transaction Guide § 16B.352

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.352 Nature of Dissenting Rights

[1] Right to Require Purchase of Interest

If the approval of outstanding limited partnership interests is required for a limited partnership to participate in a reorganization, pursuant to the limited partnership agreement of the partnership, or otherwise, then each limited partner of the limited partnership holding those interests may, by complying with the provisions on dissenting rights, require the limited partnership to purchase for cash, at its fair market value, the interest owned by the limited partner in the limited partnership, if the interest is a dissenting interest [*see § 16B.351[4]*]. The fair market value is determined as of the day before the first announcement of the terms of the proposed reorganization, excluding any appreciation or depreciation in consequence of the proposed reorganization [*Corp. Code § 15911.21(a)*].

[2] Limitation on Right to Attack Reorganization

No limited partner of a limited partnership who has a right under Article 11.5 [*see Corp. Code §§ 15911.20-15911.33*] to demand payment of cash for the interest owned by that limited partner in a limited partnership has any right at law or in equity to attack the validity of the reorganization, or to have the reorganization set aside or rescinded, except in an action to test whether the vote or consent of limited partners required to authorize or approve the reorganization has been obtained in accordance with the procedures established therefor by the partnership agreement of the limited partnership [*Corp. Code § 15911.33(a)*].

If one of the parties to a reorganization is directly or indirectly controlled by, or under common control with, another party to the reorganization, the paragraph *above* does not apply to any limited partner of that controlled party who has not demanded payment of cash for that limited partner's interest pursuant to dissenters' rights. However, if that limited partner institutes any action to attack the validity of the reorganization or to have the reorganization set aside or rescinded, the limited partner will not thereafter have any dissenter's right to demand payment of cash for that limited partner's interest [*Corp. Code § 15911.33(b)*].

If one of the parties to a reorganization is directly or indirectly controlled by, or under common control with, another party to the reorganization, then in any action to attack the validity of the reorganization or to have the reorganization set aside or rescinded, (1) a party to a reorganization which controls another party to a reorganization has the burden of proving that the transaction is just and reasonable as to the limited partners of the controlled party, and (2) a person who controls two or more parties to a reorganization has the burden of proving that the transaction is just and reasonable as to the limited partners of any party so controlled [*Corp. Code § 15911.33(c)*].

Corp. Code § 15911.32(b) and *(c)* do not apply if a majority in interest of the limited partners other than limited partners who are directly or indirectly controlled by, or under common control with, another party to the reorganization approve or consent to the reorganization [*Corp. Code § 15911.33(d)*]. *Corp. Code § 15911.32* does not prevent a partner of a limited partnership that is a party to a reorganization from bringing an action against a general partner of the limited partnership, the limited partnership, or any person controlling a general partner at law or in equity as to any matters (including, without limitation, an action for breach of fiduciary obligation or fraud) other than to attack the validity of the reorganization or to have the reorganization set aside or rescinded [*Corp. Code § 15911.33(e)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Dissenting Limited Partners' Rights

8-16B California Legal Forms--Transaction Guide § 16B.353

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.353 Procedures to Enforce Dissenting Rights

[1] Notice of Approval of Reorganization

If limited partners have the right described in *§ 16B.352, above* , subject to compliance with paragraphs (4) and (5) of the definition of "dissenting interest" [*see § 16B.351[4]*], to require the limited partnership to purchase their partnership interests for cash, the partnership must mail to each such partner a notice of approval of the reorganization by the requisite vote or consent of limited partners, within 10 days after the date of that approval, accompanied by (1) a copy of *Corp. Code §§ 15911.21 through 15911.25, (2)* a statement of the price determined by the partnership to represent the fair market value of its outstanding interests, and (3) a brief description of the procedure to be followed if the partner desires to exercise the partner's rights under those sections. The statement of price constitutes an offer by the partnership to purchase at the price stated any dissenting interests (as defined), unless they lose their status as dissenting interests under *Corp. Code § 15911.30* [*Corp. Code § 15911.22(a)*].

[2] Demand for Payment

Any limited partner who has a right to require the limited partnership to purchase the partner's interest for cash under *Corp. Code § 15911.21* [*see § 16B.351[2]*], subject to compliance with *Corp. Code § 15911.21(b)(4), (5)*, and who desires the partnership to purchase that interest, must make written demand upon the partnership to purchase that interest and for payment to the partner in cash of its fair market value. The demand is not effective for any purpose unless it is received by the partnership or any transfer agent thereof in the case of interests described in *Corp. Code § 15911.21(b)(1)(A)(i)* or *(ii)* [*see § 16B.351[4]*] not later than the date of the limited partners' meeting to vote upon the reorganization, or (2) in any other case, within 30 days after the date on which notice of the approval of the reorganization by the requisite vote or consent of the limited partners is mailed by the limited partnership to the limited partners [*Corp. Code § 15911.22(b)*].

The demand must state the number or amount of the limited partner's interest in the limited partnership and must contain a statement of what that partner claims to be the fair market value of that interest on the day before the

announcement of the proposed reorganization. The statement of fair market value constitutes an offer by the partner to sell the interest at that price [*Corp. Code § 15911.22(c)*].

[3] Submission of Certificate or Written Statement

Within 30 days after the date on which notice of the approval of the outstanding interests of the limited partnership is mailed to the limited partner pursuant to *Corp. Code § 15911.22(a)* [*see* [1], *above*], the limited partner must submit to the partnership at its principal office or at the office of any transfer agent thereof, one of the following [*Corp. Code § 15911.23*]:

- If the interest is evidenced by a certificate, the limited partner's certificate representing the interest which the partner demands that the partnership purchase, to be stamped or endorsed with a statement that the interest is a dissenting interest or to be exchanged for certificates of appropriate denominations so stamped or endorsed; or

- If the interest is not evidenced by a certificate, written notice of the number or amount of interest which the partner demands that the partnership purchase.

Upon subsequent transfers of the dissenting interest on the books of the partnership, the new certificates or other written statement issued therefor must bear a similar statement, together with the name of the original holder of the dissenting interest [*Corp. Code § 15911.23*].

[4] Subsequent Procedure When Parties Agree on Nature of Interest and Price

If the limited partnership and the dissenting limited partner agree that the partner's interest is a dissenting interest and agree upon the price to be paid for it, the dissenting partner is entitled to the agreed price with interest thereon at the legal rate on judgments from the date of consummation of the reorganization. All agreements fixing the fair market value of any partner's interest as between the partnership and that partner must be in writing and filed in the records of the partnership [*Corp. Code § 15911.24(a)*].

Subject to the provisions of *Corp. Code § 15911.27* [see [6], *below*], payment of the fair market value for a dissenting interest must be made within 30 days after its amount has been agreed to or within 30 days after any statutory or contractual conditions to the reorganization are satisfied, whichever is later, and in the case of dissenting interests evidenced by certificates of interest, subject to surrender of such certificates of interest, unless provided otherwise by agreement [*Corp. Code § 15911.24(b)*].

[5] Subsequent Procedure When Parties Disagree on Nature of Interest or Fair Market Value

[a] Court Action

If the limited partnership denies that a limited partnership interest is a dissenting interest, or the partnership and a dissenting limited partner fail to agree upon the fair market value of a dissenting interest, then that partner or any interested limited partnership, within six months after the date on which notice of the approval of the reorganization by the requisite vote or consent of the limited partners was mailed to the limited partner, but not thereafter, may file a complaint in the superior court of the proper county praying the court to determine whether the interest is a dissenting interest, or the fair market value of the dissenting interest, or both, or may intervene in any action pending on such a complaint [*Corp. Code § 15911.25(a)*]. Two or more dissenting limited partners may join as plaintiffs or be joined as defendants in any such action and two or more such actions may be consolidated [*Corp. Code § 15911.25(b)*].

On the trial of the action, the court must determine the issues. If the status of the limited partnership interest as a dissenting interest is in issue, the court must first determine that issue. If the fair market value of the dissenting interest

is in issue, the court must determine, or must appoint one or more impartial appraisers to determine, the fair market value of the dissenting interest [*Corp. Code § 15911.25(c)*].

[b] Court-Appointed Appraisers

If the court appoints an appraiser or appraisers, they must proceed forthwith to determine the fair market value per interest of the outstanding limited partnership interests of the limited partnership, by class if necessary. Within the time fixed by the court, the appraisers, or a majority of them, must make and file a report in the office of the clerk of the court. Thereupon, on the motion of any party, the report must be submitted to the court and considered on such additional evidence as the court considers relevant. If the court finds the report reasonable, the court may confirm it [*Corp. Code § 15911.26(a)*].

If a majority of the appraisers appointed fails to make and file a report within 30 days from the date of their appointment, or within any further time allowed by the court, or the report is not confirmed by the court, the court must determine the fair market value per interest of the outstanding limited partnership interests of the limited partnership, by class if necessary [*Corp. Code § 15911.26(b)*].

[c] Judgment

Subject to *Corp. Code § 15911.27* [*see* [6], *below*], judgment must be rendered against the limited partnership for payment of an amount equal to the fair market value, as determined by the court, of each dissenting interest which any dissenting limited partner who is a party, or has intervened, is entitled to require the partnership to purchase, with interest thereon at the legal rate on judgments from the date of consummation of the reorganization [*Corp. Code § 15911.26(c)*].

Any such judgment is payable forthwith but, with respect to limited partnership interests evidenced by transferable certificates of interest, only on the endorsement and delivery to the limited partnership of those certificates representing the interests described in the judgment. Any party may appeal from the judgment [*Corp. Code § 15911.26(d)*].

[d] Costs

The costs of the action, including reasonable compensation for the appraisers, to be fixed by the court, are assessed or apportioned as the court considers equitable, but, if the appraisal exceeds the price offered by the limited partnership, the partnership must pay the costs (including, in the discretion of the court, if the value awarded by the court for the dissenting interest is more than 125 percent of the price offered by the limited partnership under *Corp. Code § 15911.22(a)*, attorneys' fees and fees of expert witnesses) [*Corp. Code § 15911.26(e)*; *see* Ballantine & Sterling, California Corporation Laws, Ch. 25, *Limited Partnerships* , § 754.04].

[6] Dissenting Limited Partners as Creditors

To the extent that payment to dissenting limited partners for their dissenting interests would require the limited partners to return that payment or a portion of it by reason of *Corp. Code § 15905.09* (circumstances in which certain distributions must be returned as improper) or the Uniform Fraudulent Transfer Act [*see Civ. Code § 3439 et seq.*] then that payment or portion thereof must not be made. The dissenting partners become creditors of the limited partnership for the amount not paid, together with interest thereon at the legal rate on judgments until the date of payment. The claims of dissenting limited partners are subordinate to all other creditors in any proceeding relating to the winding up and dissolution of the limited partnership, with such debt to be payable when permissible [*Corp. Code § 15911.27*].

Any cash distributions made by a limited partnership to a dissenting limited partner after the date of consummation of the reorganization, but before any payment by the partnership for that dissenting partner's interest, is to be credited against the total amount to be paid by the partnership for that dissenting interest [*Corp. Code § 15911.28*].

[7] Rights of Dissenting Limited Partners Continue Until Payment

Except as expressly limited by the ULPA '08's provisions on dissenting rights, dissenting limited partners continue to have all the rights and privileges incident to their interests immediately before the reorganization, including limited liability, until payment by the limited partnership for their dissenting interests. A dissenting limited partner may not withdraw a demand for payment unless the limited partnership consents thereto [*Corp. Code § 15911.29*].

[8] Loss of Status as Dissenting Interest

A dissenting interest loses its status as such and its holder ceases to be a dissenting limited partner and ceases to be entitled to require purchase of the interest upon the happening of any of the following [*Corp. Code § 15911.30*]:

- The limited partnership abandons the reorganization. Upon abandonment, the partnership must pay, on demand, to any dissenting limited partner who has initiated dissenting proceedings in good faith, all reasonable expenses incurred in those proceedings and reasonable attorneys' fees.

- The interest is transferred before its submission for endorsement in accordance with *Corp. Code § 15911.23* [*see* [3], *above*].

- The dissenting limited partner and the limited partnership do not agree on the status of the interest as a dissenting interest or on its purchase price, and neither files a complaint nor intervenes in a pending action, as provided in *Corp. Code § 15911.25* [*see* [5], *above*] within six months after the date on which notice of the approval of the reorganization by the requisite vote or consent of limited partners was mailed to the limited partner.

- The dissenting limited partner, with the consent of the limited partnership, withdraws the limited partner's demand for purchase of the dissenting interest.

[9] Litigation as to Adequacy of Vote or Consent

If litigation is instituted to test the sufficiency or regularity of the vote or consent of the limited partners in authorizing a reorganization, any proceedings under *Corp. Code §§ 15911.25* and *15911.26* [*see* [5], *above*] will be suspended until final determination of that litigation [*Corp. Code § 15911.31*].



146 of 175 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Dissenting Limited Partners' Rights

8-16B California Legal Forms--Transaction Guide §§ 16B.354-16B.359

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

[Reserved]

§§ 16B.354[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-16B California Legal Forms--Transaction Guide § 16B.360

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.360 Conversion

[1] Facts

NOTE:

The facts and documents listed below concern conversions of limited partnerships into other types of entities. When a limited partnership is converted into an other business entity, such as a limited liability company or a general partnership, the chapters concerning those entities should also be reviewed [***see, e.g.,*** Ch. 12C, ***Limited Liability Companies*** ; Ch. 15, Part C, ***Conversions and Mergers of General Partnerships***]. When an other business entity or foreign limited partnership is converted ***into*** a domestic limited partnership, Ch. 16, ***Formation of Limited Partnerships***, should also be consulted.

1. Reasons that limited partnership wishes to convert into other business entity or foreign limited partnership.

NOTE:

The business objectives driving a decision to convert often include the need to limit the partners' liability, although other considerations such as synergy, capital needs, or the need to meet competition more effectively, may play a role. If an existing partnership is a law, architecture, or accounting partnership seeking limited liability, it may only convert to a registered limited liability partnership [*Corp. Code § 16101(7), (8), (14)*; ***see*** Ch. 16C, ***Limited Liability Partnerships***] or form a professional corporation [***see*** Ch. 12A, ***Professional Corporations***].

2. Type and general characteristics of business.

NOTE:

The choice of the converted entity may be limited by the nature of the partnership's business. For example, real estate, high technology, venture capital, oil and gas, and theatrical investments are enterprises regarded as well-suited to the limited liability company structure. On the other hand, limited liability companies currently cannot render professional services, or engage in the banking business, the business of issuing policies of insurance and assuming insurance risks, or the trust company business [***see*** *Corp. Code §§ 17002, 17375*]. "Professional services" means any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, the Osteopathic Act, or the Yacht and Ship Brokers Act [*Corp. Code § 13401(a), 13401.3*].

3. Names and addresses of all general and limited partners.

4. Following information about existing entity:

a. Mailing address, telephone and fax number of principal place of business.

b. Tax identification number of business.

c. Name and address of registered agent for service of process.

5. Desired effective date of proposed conversion.

6. Allocation of partnership profits and losses.

7. Any provisions in existing partnership agreement regarding required approval for conversion or to amend agreement.

8. Complete information concerning any pending litigation to which partnership is a party, including names of counsel.

9. Names of partners who are likely to dissent from conversion.

10. Whether partners are aware of potential costs of conversion.

a. Attorneys, accountants, and appraisers' fees.

b. Property taxation of changes in ownership.

c. Franchise taxes and fees.

NOTE:

For example, a limited liability company must pay an annual minimum franchise tax of $800 [*Rev. & Tax. Code § 17941*] and must pay an additional fee if total income from all sources derived from or attributable to California is $250,000 or more [*Rev. & Tax. Code § 17942(a)*; ***see*** *Rev. & Tax. Code §§ 17942(b)(1), 24271* ("total income" defined)]. Filing fees include fees for filing articles and a statement of information [***see*** *Gov. Code § 12190(b), (k)*].

d. Potential income tax consequences.

NOTE:

There are no adverse federal income tax implications in a conversion to a foreign limited partnership or limited liability company [*Rev. Rul. 84-52, 1984-1 C.B. 157* ; ***see*** *Rev. Rul. 95-37, 1995-1 C.B. 130*].

11. Does law of jurisdiction of entity to be created by conversion expressly permit entity to be formed by conversion?

NOTE:

A domestic limited partnership may be converted into an other business entity, a foreign other business entity, or a foreign limited partnership only if (1) the law under which the converted entity will exist expressly permits the formation of that entity pursuant to a conversion, and (2) the limited partnership complies with all other requirements of any law that applies to conversion of the converted entity [*Corp. Code § 15911.02(b)*]. California permits domestic and foreign other business entities and foreign limited partnerships to convert into a domestic limited partnership [***see*** *Corp. Code § 15911.08*].

12. Facts about converted entity:

a. Extent to which existing partnership or operating agreement will be blueprint for governance of converted entity.

b. Name of converted entity.

c. Length of time converted entity is to continue, either:

(1) Specified period;

(2) Until dissolved by agreement;

(3) Until specified undertaking is completed;

(4) Until dissolved by some specific act or event.

13. How existing partnership interests are to be exchanged for interests in converted entity.

NOTE:

A limited partnership may be converted into a domestic or foreign partnership or LLC or into a foreign limited partnership only if each of the partners of the converting limited partnership will receive a percentage interest in the profits and capital of the converted entity equal to the partner's percentage interest in profits and capital of the converting limited partnership as of the effective time of the conversion [*Corp. Code § 15911.02(a)(1)*].

For conversion into an other business entity or foreign other business entity not specified ***above***, both of the following must occur: (1) each limited partnership interest of the same class must be treated equally with respect to any distribution of cash, property, rights, interests, or securities of the converted entity, unless all limited partners of the class consent; and (2) the nonredeemable limited partnership interests of the converting limited partnership must be converted only into nonredeemable interests or securities of the converted entity, unless all holders of the unredeemable interests consent [*Corp. Code § 15911.02(a)(2)*].

14. Person(s) who will be general partners, managers, members, directors, or officers in converted entity.

[2] Documents

1. Initial partnership agreement of each converting limited partnership, including all amendments.

2. Initial certificate of limited partnership of each converting limited partnership, including all amendments and restatements.

3. Articles of incorporation, trust, or other charter documents of each converting business entity, including all amendments.

4. Copies of certificates and statements of general partnership on file.

5. Copies of any powers of attorney under which charter documents or agreements were executed.

6. Any separate buyout agreements for partner's interest.

7. Current financial statements and/or balance sheet.

8. Most recent tax returns of each converting entity.

9. Lists of each converting entity's assets.

10. All instruments evidencing title, *e.g.*:

a. Deeds.

b. Documents of title to motor vehicles.

c. Leases.

d. Liens, deeds of trust, or mortgages.

11. Licenses, permits, and patents if any.

12. Franchise agreements, if any.

13. Fictitious business name statement, if any.

14. Insurance policies on all real and personal property contributed to converting entity, and any policies on property contributed to converted limited partnership as part of conversion process.

15. Insurance policies, if any, used to fund cross purchase agreements.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-16B California Legal Forms--Transaction Guide § 16B.361

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.361 Merger

[1] Facts

1. Basic information about each constituent limited partnership.

a. Facts regarding partnership entity.
(1) Name.

(2) Date of formation.

(3) Address and telephone number of designated office.

(4) Name, address, and telephone number of any transfer agents.

(5) Whether partnership is California or foreign limited partnership.

(6) Number of limited partners.

b. Name, address, and telephone number of each general partner.

c. Basic information about limited partners.

(1) Name and address of each limited partner and each partner's spouse.

(2) Amount and proportion of capital contribution.

(3) Allocation of profits and losses.

(4) Percentage interest in partnership.

2. Basic information about each constituent other business entity.

NOTE:
The term "other business entity" means a corporation, general partnership, limited liability company, business trust, real estate investment trust or unincorporated association, other than a nonprofit corporation, but excludes a limited partnership [*Corp. Code § 15911.01(k)*; ***see*** *Corp. Code § 15911.01(g)*].

a. Facts regarding entity.

(1) Business name.

(2) Type of entity.

(3) Date of formation.

(4) Address and telephone number of principal business office.

(5) Name, address, and telephone number of any transfer agents.

(6) Whether entity is organized under laws of California or foreign jurisdiction.

(7) If entity is organized under foreign jurisdiction, specifics about laws governing its internal affairs.

b. Basic information about persons responsible for management and control of entity, such as general partner, director, or trustee.

(1) Name, address, and telephone number.

(2) Following information, as applicable:
(a) Amount and proportion of capital contribution.

(b) Proportion of share in profits and losses.

(c) Percentage interest in entity.

(d) Number of shares owned.

3. Purpose of proposed merger.

4. Basic information about proposed surviving limited partnership or other business entity.

NOTE:

If significant changes are made to the surviving entity's structure, other than the change of the survivor's name, the surviving entity may need to amend partnership agreement, articles of incorporation, trust, or other charter documents.

a. Whether name of surviving entity will be changed.

b. Amount of contributions of assets and liabilities of each constituent entity.

c. Proposed management and control structure.

d. Proposed distributions of profits and losses.

[2] Documents

1. Partnership agreements of each general or limited partnership, including all amendments.

2. Articles of incorporation, trust, or other charter documents of each constituent business entity, including all amendments.

3. Certificates of each limited partnership, including all amendments or restatements and all powers of attorney under which certificate or amendment was executed.

4. Each constituent business entity's fictitious business statements.

5. Lists of each constituent business entity's assets.

6. Licenses, franchise agreements, and patents.

7. Documents related to property owned by entity, including deeds and other documents of title, leases, liens, deeds of trust, or mortgages, and insurance policies.

8. Loan agreements and other financial documents.

9. Contracts and leases entered into by constituent business entities.

10. Copies of orders, judgments, or decrees affecting each constituent business entity.

11. Most recent tax returns, financial statements, and balance sheets.



149 of 175 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-16B California Legal Forms--Transaction Guide §§ 16B.362-16B.369

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

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§§ 16B.362[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-16B California Legal Forms--Transaction Guide § 16B.370

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.370 Conversion of Limited Partnership Into Another Type of Business Entity

1. Can conversion be approved by vote specified in partnership agreement?

NOTE:

Unless otherwise provided in the partnership agreement, the plan of conversion must be approved by all general partners of the converting limited partnership and by a majority in interest of each class of limited partners of the converting limited partnership [*Corp. Code § 15911.03(b)*; ***see*** *Corp. Code § 15901.10(b)(12)* (partnership agreement may not restrict right of partner to approve conversion)]. However, if the limited partners of the limited partnership would become personally liable for any obligations of the converted entity as a result of the conversion, the plan of conversion must be approved by all of the limited partners of the converting limited partnership, unless the plan of conversion provides that all limited partners will have dissenters' rights as provided in *Corp. Code §§ 15911.20-15911.33* [*Corp. Code § 15911.03(b)*; ***see*** *§ 16B.350* et seq.].

2. How will purchase of any dissenting interests be funded?

NOTE:

Unless otherwise provided in the agreement, statutory provisions for the buyout of a dissenting partner's interest will apply [***see*** *Corp. Code § 15911.20 et seq.*; ***see also*** *§ 16B.350* et seq.].

3. Operation of converted entity.

NOTE:

This determination is relevant only if the converted entity will not operate in the same manner as the predecessor entity.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-16B California Legal Forms--Transaction Guide § 16B.371

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.371 Mergers

1. Determine whether following advantages of merger of limited partnerships and other business entities indicate that merger is best method to achieve purpose.

a. Simplicity.

NOTE:
A merger is perfected by approving an agreement of merger and filing a certificate of merger or an agreement of merger [***see*** *Corp. Code §§ 15911.12*, *15911.14*]. As of the effective date of the merger, the surviving entity succeeds without further transfer to all the rights and property of each disappearing entity [***see*** *Corp. Code § 15911.16(a)*].

(1) Means to combine or increase capital.

(2) Means to acquire assets.

(3) Means to further centralize management.

b. Dissenting limited partners' only method of objecting to merger is to require surviving entity to purchase their interests [*see Corp. Code § 15911.33*; *see also* § 16.352[2]].

NOTE:
Litigation can be instituted to test the sufficiency and regularity of the vote or consent of the limited partners in authorizing the reorganization [***see*** *Corp. Code § 15911.14*].

c. Effective date of merger can be controlled [*see Corp. Code § 15911.15*].

2. Determine whether following disadvantages of merger of limited partnerships outweigh benefits.

a. Surviving entity automatically becomes subject to all debts and liabilities of each disappearing entity [*see Corp. Code § 15911.16(a)*].

b. General partner of disappearing limited partnership remains liable for partnership debts and liabilities that existed before effective date of merger [*see Corp. Code § 15911.16(d)*].

c. All rights of creditors and all liens on property of each constituent entity are preserved against surviving entity [*see Corp. Code § 15911.16(b)*].

NOTE:
However, any liens against the property of a disappearing entity are limited to the property affected by the lien immediately before the effective date of the merger [***see*** *Corp. Code § 15911.16(b)*].

d. Agreement of merger must be approved by each constituent limited partnership.

NOTE:
The agreement of merger must be approved by all general partners of each constituent limited partnership. The principal terms of the merger must be approved by a majority in interest of each class of limited partners of each constituent limited partnership, unless a greater approval is required by the constituent limited partnership agreement. However, if the limited partners of any constituent limited partnership become personally liable for any obligations of a constituent entity as a result of the merger, the principal terms of the agreement of merger must be approved by all of the limited partners of the constituent limited partnership unless the agreement provides that all limited partners have dissenters rights [*Corp. Code § 15911.12(a)*].

e. Agreement of merger must be approved on behalf of each constituent other business entity by those persons required to approve merger by laws under which they are organized [*Corp. Code § 15911.12(a)*].

f. Dissenting limited partners may require that limited partnership purchase their interest at fair market value on day preceding first announcement of terms of proposed reorganization [*see Corp. Code § 15911.21(a)*].

g. Disappearing limited partnership will lose name and identity in merger unless surviving limited partnership changes name [*see Corp. Code § 15911.12(a)(2)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-16B California Legal Forms--Transaction Guide § 16B.372

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.372 Foreign Entities

1. Determine whether proposed merger involves foreign limited partnership or foreign other business entity.

NOTE:

A "foreign limited partnership" is a partnership formed under the laws of a jurisdiction other than California and required by those laws to have one or more general partners and one or more limited partners. The term includes a foreign limited liability limited partnership [*Corp. Code § 15901.02(k)*]. A foreign other business entity" means a corporation, general partnership, limited liability company, business trust, real estate investment trust, or unincorporated association, other than a nonprofit association, excluding a limited partnership, formed under the laws of any state other than California, or under the laws of a foreign country [*Corp. Code § 15911.01(j), (k)*].

2. Determine whether laws under which foreign limited partnership or foreign other business entity is organized permit merger.

NOTE:

Any number of domestic limited partnerships may merge with any number of foreign limited partnerships or foreign other business entities if the foreign entities are authorized by the laws under which they are organized to effect such a merger, and the merger complies with *Corporations Code § 15911.10* [*Corp. Code § 15911.17(a)*].

3. If foreign limited partnership or foreign other business entity will be survivor, determine whether merger will be conducted under foreign law.

NOTE:

If the surviving entity is a foreign limited partnership or a foreign other business entity, then the merger proceedings may be in accordance with the laws of the state or place of organization of the surviving entity. However, the following requirements apply: (1) the merger becomes effective in accordance with the laws of the jurisdiction in which the surviving limited partnership or entity is organized, but is effective as to any domestic disappearing limited partnership as of the time of effectiveness in that jurisdiction upon the filing in California of a certificate of merger or agreement of merger as provided in *Corp. Code § 15911.14* [*Corp. Code § 15911.17(d)*]; (2) the provisions of *Corp. Code §§ 15911.20-15911.33*, regarding dissenters' rights apply [***see** § 16B.350* et seq.]; and (3) with respect to any domestic constituent corporation, *Corp. Code §§ 1113* (mergers of corporations with other types of entities), 1200 et seq. (reorganizations), and 1300 et seq. (dissenting rights in mergers) apply [*Corp. Code § 15911.17(b)*]. However, a domestic disappearing limited partnership must still file a certificate of merger or an agreement of merger as provided in *Corp. Code § 15911.14* [*Corp. Code § 15911.17(d)*].

a. Determine when merger becomes effective in accordance with law of foreign jurisdiction.

NOTE:

The merger is effective as to any domestic disappearing limited partnership as of the time of effectiveness in the foreign jurisdiction on the filing in California of a certificate of merger or agreement of merger [*Corp. Code § 15911.17(d)*].

b. Evaluate merger laws of foreign jurisdiction, and ascertain whether foreign law provides for dissenting limited partners' rights.

4. If any disappearing entity is foreign, determine:

NOTE:

If the surviving entity is domestic, the merger proceedings as to that entity and any domestic disappearing entities must conform to the merger provisions of the ULPA '08 [*Corp. Code § 15911.17(b)*].

a. Whether foreign limited entity is authorized to transact intrastate business in California [*see Corp. Code § 15909.02*].

NOTE:

If a merger includes a foreign disappearing limited partnership previously registered for the transaction of intrastate business in California pursuant to *Corp. Code § 15909.02*, the filing of the certificate of merger or agreement of merger, as is applicable under *Corp. Code § 15911.14* [***see** § 16B.334*] automatically has the effect of a cancellation of registration for that foreign limited partnership pursuant to *Corp. Code § 15909.06* without the necessity of the filing of a certificate of cancellation [*Corp. Code § 15911.17(e)*].

b. With respect to any real property owned by foreign entity:

(1) Whether any real property is in California.

(2) Whether foreign laws provide that perfection of merger vests all real property in surviving entity.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-16B California Legal Forms--Transaction Guide § 16B.373

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.373 Manner of Converting Interests in Merged Limited Partnerships

NOTE:

The agreement of merger must state the manner of converting the partnership interests of each of the constituent limited partnerships into interests, shares, or other securities of the surviving limited partnership or surviving other business entity, or that the partnership interests are cancelled without consideration [*Corp. Code § 15911.12(a)(3)*].

1. Determine whether interests of disappearing limited partnership will be converted into [*Corp. Code § 15911.12(a)(3)*]:

NOTE:

If partnership interests of any of the constituent limited partnerships are not to be converted solely into interests, shares, or other securities of the surviving limited partnership or surviving other business entity, the cash, property, rights, interests, or securities that the holders of the partnership interests are to receive in exchange for the partnership interests must be stated in the agreement of merger. The cash, property, rights, interests, or securities may be in addition to or in lieu of interests, shares, or other securities of the surviving limited partnership or surviving other business entity [*Corp. Code § 15911.12(a)(3)*].

a. Interests, shares, or other securities of the surviving limited partnership or surviving other business entity.

b. Cash, property, rights, interests, or securities that the holders of the partnership interests are to receive in exchange for the partnership interests.

NOTE:
Unless all limited partners of a class consent to the contrary, each limited partnership interest of the same class of any constituent limited partnership having more than 35 limited partners, must be treated equally with respect to any distribution of cash, property, rights, interest, or securities [*Corp. Code § 15911.12(b)*]. This rule does not apply to a limited partnership interest in another constituent limited partnership that is being canceled and that is held by a constituent limited partnership or its parent or a limited partnership of which the constituent limited partnership is a parent [*Corp. Code § 15911.12(b)*]. Further, it does not apply to any transaction if the Commissioner of Corporations has not approved the terms and conditions of the transaction and the fairness of those terms and conditions pursuant to *Corp. Code § 25142* [*Corp. Code § 15911.13*].

2. If interests of disappearing limited partnership will be converted solely into interests of surviving limited partnership or its parent, determine exchange ratio for conversion.

3. Determine whether constituent limited partnership or other business entity or parent owns (directly or indirectly) limited partnership interests of another constituent limited partnership or securities of constituent other business entity, representing (1) more than 50 percent of limited partnership interests or securities of other constituent business entity entitled to vote with respect to merger prior to merger, or (2) more than 50 percent of voting power [*see Corp. Code § 194.5*] of constituent other business entity that is domestic corporation [*see Corp. Code § 15911.12(b)*].

NOTE:
If a constituent limited partnership has more than 35 limited partners under these circumstances (other than in a merger of a limited partnership with a limited partnership in which it controls at least 90 percent of the limited partnership interests entitled to vote with respect to the merger), the unredeemable limited partnership interests of a constituent limited partnership may be converted only into unredeemable interests or securities of the surviving limited partnership or other business entity or a parent, unless all of the limited partners of the class consent [*Corp. Code § 15911.12(b)*]. These provisions do not apply to any transaction if the California Commissioner of Corporations has approved the terms and conditions of the transaction and the fairness of those terms and conditions pursuant to *Corp. Code § 25142* [*Corp. Code § 15911.13*].

4. Determine whether any other details or provisions regarding conversion are desired in agreement of merger.

NOTE:
Because the agreement of merger may be recorded with a California county recorder to evidence transfer of title to real estate to the surviving entity [***see*** *Corp. Code § 15911.18*], optional provisions that the parties prefer to keep private should be set forth in a side agreement rather than in the agreement of merger.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-16B California Legal Forms--Transaction Guide §§ 16B.374-16B.379

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

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§§ 16B.374[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16B California Legal Forms--Transaction Guide § 16B.380

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.380 Procedures for Conversion of Limited Partnerships

NOTE:
These procedures apply to a limited partnership converting into an other business entity, foreign other business entity, or foreign limited partnership. For procedures applicable to the conversion of another entity into a domestic limited partnership, see *§ 16B.381*.

1. Draft plan of conversion, stating all of following [*Corp. Code § 15911.03(a)*; *see § 16B.313[1]*]:

a. Terms and conditions of conversion.

b. Place of organization of converted entity and of converting limited partnership.

c. Name of converted entity after conversion.

d. Manner of converting limited and general partnership interests of each of partners into shares of, securities of, or interests in, converted entity.

NOTE:
A limited partnership may be converted into a domestic or foreign partnership or LLC or into a foreign limited partnership only if each of the partners of the converting limited partnership will receive a percentage interest in the profits and capital of the converted entity equal to the partner's percentage interest in profits and capital of the converting limited partnership as of the effective time of the conversion [*Corp. Code § 15911.02(a)(1)*].

For conversion into an other business entity or foreign other business entity not specified ***above***, both of the following must occur: (1) each limited partnership interest of the same class must be treated equally with respect to any distribution of cash, property, rights, interests, or securities of the converted entity, unless all limited partners of the class consent; and (2) the nonredeemable limited partnership interests of the converting limited partnership must be converted only into nonredeemable interests or securities of the converted entity, unless all holders of the unredeemable interests consent [*Corp. Code § 15911.02(a)(2)*].

e. Provisions of governing documents for converted entity, including partnership agreement, limited liability company articles of organization and operating agreement, or articles or certificate of incorporation if converted entity is corporation, to which holders of interests in converted entity are to be bound.

f. Any other details or provisions that are required by the laws under which the converted entity is organized.

g. Any other details or provisions that are desired by parties.

h. Effective date of conversion [*see § 16B.314*].

NOTE:

A conversion into an other business entity, a foreign other business entity, or a foreign limited partnership becomes effective upon the earliest date that all of the following occur [*Corp. Code § 15911.04(a)*]:

- The plan of conversion is approved by the partners of the converting limited partnership, as provided in *Corp. Code § 15911.03*;
- All documents required by law to create the converted entity are filed and contain a statement of conversion if required under *Corp. Code § 15911.06*; and
- The effective date, if set forth in the plan of conversion, occurs.

2. Submit plan of conversion for approval of partners.

NOTE:

Unless otherwise provided in the partnership agreement, the plan of conversion must be approved by all general partners of the converting limited partnership and by a majority in interest of each class of limited partners of the converting limited partnership [*Corp. Code § 15911.03(b)*; ***see*** *Corp. Code § 15901.10(b)(12)* (partnership agreement may not restrict right of partner to approve conversion)]. However, if the limited partners of the limited partnership would become personally liable for any obligations of the converted entity as a result of the conversion, the plan of conversion must be approved by all of the limited partners of the converting limited partnership, unless the plan of conversion provides that all limited partners will have dissenters' rights as provided in *Corp. Code §§ 15911.20-15911.33* [*Corp. Code § 15911.03(b)*; ***see*** *§ 16B.350* et seq.].

3. Submit any amendments to plan of conversion to partners for approval by same vote as required for adoption of

original plan.

NOTE:

Notwithstanding its prior approval, a plan of conversion may be amended before the conversion takes effect if the amendment is approved by all general partners of the converting limited partnership. If the amendment changes any of the principal terms of the plan, the plan must also be approved by the limited partners of the converting limited partnership in the same manner and to the same extent as required for the approval of the original plan [*Corp. Code § 15911.03(d)*].

4. Complete and file one of following, as appropriate, with Secretary of State [*Corp. Code § 15911.06*]:

NOTE:

Any certificate or statement of conversion must be executed and acknowledged [***see*** *Corp. Code § 15901.02(a)*] by all general partners, unless a lesser number is provided in the certificate of limited partnership. The certificate or statement must set forth the name and the Secretary of State's file number of the converting limited partnership; a statement that the principal terms of the plan of conversion were approved by a vote of the partners that equaled or exceeded the vote required under *Corp. Code § 15911.03*, specifying each class entitled to vote and the percentage vote required of each class; the form of organization of the converted entity; and the mailing address of the converted entity's agent for service of process and the chief executive office of the converted entity [*Corp. Code § 15911.06(b)*].

a. If limited partnership is converting into domestic limited liability company, statement of conversion on articles of organization for converted entity [*Corp. Code § 15911.06(a)(1)*; *see § 16B.317*].

b. If limited partnership is converting into domestic partnership [*Corp. Code § 15911.06(a)(2)*; *see § 16B.317*]:

(1) Statement of conversion on statement of partnership authority for converted entity.

(2) If no statement of partnership authority is filed, separate certificate of conversion [*see § 16B.410*].

c. If limited partnership is converting into domestic corporation, statement of conversion on articles of incorporation for converted entity [*Corp. Code § 15911.06(a)(3)*].

d. If limited partnership is converting into foreign limited partnership or foreign other business entity, certificate of conversion [*Corp. Code § 15911.06(a)(4)*; *see § 16B.410*].

5. Record applicable certificate of conversion, statement of partnership authority, or certificate of limited partnership, articles of incorporation, articles of organization, or other certificate evidencing the creation of another business entity or limited partnership by conversion [*see* paragraph 5, *above*] in each county in which converted entity owns real property [*Corp. Code § 15911.07*].

NOTE:

Recordation creates a conclusive presumption in favor of bona fide purchasers or encumbrancers for value that the conversion was validly completed [*Corp. Code § 15911.07(c)*].

6. Notify all creditors of limited partnership of effective date of conversion and any exercise of dissenters' rights by limited partners.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16B California Legal Forms--Transaction Guide § 16B.381

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.381 Procedures for Conversion of Other Business Entity to Domestic Limited Partnership

NOTE:

An other business entity or a foreign other business entity or a foreign limited partnership may be converted to a domestic limited partnership pursuant to the conversion provisions of the ULPA '08 only if the converting entity is authorized by the laws under which it is organized to effect the conversion [*Corp. Code § 15911.08(a)*].

1. Advise client that entity must approve plan of conversion or instrument required to be approved to effect conversion pursuant to laws under which entity is organized [*Corp. Code § 15911.08(b)*].

2. Ensure approval by number or percentage of partners, members, shareholders, or holders of interest of converting entity required by laws under which that entity is organized, or a greater or lesser percentage (subject to applicable laws), set forth in converting entity's governing document [*Corp. Code § 15911.08(c)*].

3. Complete statement of conversion on certificate of limited partnership and file with Secretary of State [*Corp. Code § 15911.08(d)*; *see § 16B.411*].

4. Advise client that conversion is effective under ULPA '08 when conversion is effective under laws under which converting entity is organized, if certificate of limited partnership containing a statement of conversion has been filed with Secretary of State [*Corp. Code § 15911.08(d)*].

NOTE:

If the converting entity's governing law is silent as to the effectiveness of the conversion,

it becomes effective upon the completion of all acts required under Title 2 of the Corporations Code [***see*** *Corp. Code § 15501 et seq.* (partnerships)] to form a limited partnership [*Corp. Code § 15911.08(d)*].

5. Notify client that converting foreign limited partnership or foreign limited liability company that has made required filing [*see* paragraph 4, *above*] is not required to file certificate of cancellation [*Corp. Code § 15911.08(e)*].

NOTE:

Filing with the Secretary of State of a certificate of conversion or a certificate of limited partnership containing a statement of conversion pursuant to *Corp. Code § 15911.08* has the effect of filing a certificate of cancellation by a converting foreign limited partnership or foreign limited liability company and no converting foreign limited partnership or foreign limited liability company that has made the filing is required to file a certificate of cancellation under *Corp. Code § 15902.03* or *17455* as a result of that conversion.

If a converting other business entity is a foreign corporation qualified to transact business in California, the foreign corporation, by virtue of the filing, automatically surrenders its right to transact intrastate business [*Corp. Code § 15911.08(e)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16B California Legal Forms--Transaction Guide § 16B.382

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.382 Drafting and Approving Agreement of Merger

1. Draft agreement of merger, including all of following [*Corp. Code § 15911.12(a)*; *see § 16B.420*]:

a. Terms and conditions of merger.

b. Name and place of organization of surviving limited partnership [*see Corp. Code § 15911.01(l)*] or surviving other business entity [*see Corp. Code § 15911.01(m)*], and of each disappearing limited partnership [*see Corp. Code § 15911.01(h)*] and disappearing other business entity [*see Corp. Code § 15911.01(i)*].

NOTE:
The agreement of merger may change the name of the surviving limited partnership. The new name may be the same as or similar to the name of a disappearing domestic or foreign limited partnership, subject to *Corp. Code § 15901.08*, which sets forth the requirements for a limited partnership's name [*Corp. Code § 15911.12(a)(2)*; ***see*** Ch. 16, ***Formation of Limited Partnerships***].

c. Manner of converting partnership interests of each of constituent limited partnerships into interests, shares, or other securities of surviving limited partnership or surviving other business entity.

d. If partnership interests of any of constituent limited partnerships are not to be converted solely into interests, shares, or other securities of surviving limited partnership or surviving other business entity, cash, property, rights, interests, or securities that holders of partnership interests are to receive in exchange for the partnership interests.

e. If applicable, that partnership interests are canceled without consideration.

f. Any other details or provisions that are required by laws under which any constituent other business entity is organized, including, if domestic corporation is party to merger, *Corp. Code § 1113(b)*.

g. Any other details or provisions that are desired, including provision for treatment of fractional partnership interests.

2. Submit agreement of merger to partners for approval as follows, unless partnership agreement provides otherwise [*Corp. Code § 15911.12(a)*]:

NOTE:
Each limited partnership and other business entity that desires to merge must approve an agreement of merger [*Corp. Code § 15911.12(a)*].

a. Agreement must be approved by all general partners of each constituent limited partnership.

b. Principal terms of merger must be approved by majority in interest of each class of limited partners of each constituent limited partnership, unless greater approval is required by constituent limited partnership agreement.

c. If limited partners of any constituent limited partnership become personally liable for any obligations of constituent entity as result of merger, principal terms of agreement of merger must be approved by all limited partners of constituent limited partnership unless agreement provides that all limited partners have dissenters rights [*see Corp. Code § 15911.20 et seq.*].

3. If merger involves other business entities, submit agreement of merger to persons required to approve merger by laws under which constituent other business entities are organized [*Corp. Code § 15911.12(a)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16B California Legal Forms--Transaction Guide § 16B.383

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.383 Filing Certificate of Merger

1. Complete Secretary of State's official form for certificate of merger [*see Corp. Code § 15911.14* (statutory requirements); *see also § 16B.421*].

NOTE:
The form is available online at the California Secretary of State's website, www.ss.ca.gov/business.

2. Submit certificate of merger to each constituent entity for execution and acknowledgment by [*see Corp. Code § 15911.14*]:

a. All general partners of each domestic constituent limited partnership, unless lesser number is provided in certificate of limited partnership of domestic constituent limited partnership.

b. One or more general partners of each foreign constituent limited partnership.

c. Those persons in each constituent other business entity required to execute certificate of merger by laws under which constituent other business entity is organized.

3. File certificate of merger [*see § 16B.421*] in office of Secretary of State.

NOTE:
By filing the certificate of merger (or an agreement of merger, as applicable), a foreign corporation automatically surrenders its right to transact intrastate business [*Corp. Code §*

15911.14(d)].

The filing of a certificate of merger (or an agreement of merger, as applicable), has the effect of the filing of a certificate of cancellation for each disappearing limited partnership, and no disappearing limited partnership need file a certificate of cancellation under *Corp. Code § 15902.03* as a result of the merger [*Corp. Code § 15911.14(c)*]. A copy of the certificate of merger duly certified by the Secretary of State is conclusive evidence of the merger of (1) the constituent limited partnerships, either by themselves or together with constituent other business entities, into the surviving other business entity, or (2) the constituent limited partnerships or the constituent other business entities, or both, into the surviving limited partnership [*Corp. Code § 15911.15(b)(1)*].

Recording of the certificate of merger [***see*** *Corp. Code § 15911.18*; ***see also*** *§ 16B.338*] creates, in favor of bona fide purchasers or encumbrancers for value, a conclusive presumption that the merger was validly completed [*Corp. Code § 15911.19*].

4. File agreement of merger (and any required attachments, under following circumstances [*Corp. Code § 15911.14(a)(6), (b)*]:

a. If surviving entity is foreign limited partnership in merger in which domestic corporation is disappearing other business entity.

b. If surviving entity is domestic corporation or foreign corporation in merger in which domestic corporation is constituent party [*see Corp. Code § 1113(g)(1)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16B California Legal Forms--Transaction Guide § 16B.384

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.384 Mailing Notice of Approval of Reorganization

NOTE:
If the limited partners have a right to require the limited partnership to purchase their dissenting interests [***see*** *Corp. Code § 15911.21*; ***see*** *§ 16B.352*], the limited partnership must mail notice of the approval of the reorganization by the requisite vote or consent of the limited partners to each of its limited partners [*Corp. Code § 15911.22(a)*; ***see*** *Corp. Code § 15911.21(b)(4), (5)*].

1. Draft notice of approval that satisfies each of the following requirements [*Corp. Code § 15911.22(a)*; *see § 16B.430*]:

a. States that proposed reorganization has been approved by requisite vote or consent of limited partners.

b. States price determined by partnership to represent fair market value of its outstanding interests.

NOTE:
The statement of price constitutes an offer by the partnership to purchase at the price stated any dissenting interests [***see*** *Corp. Code § 15911.21*], unless they lose their status as dissenting interests under *Corp. Code § 15911.30* [*Corp. Code § 15911.22(a)*].

c. Briefly describes procedure for dissenting limited partners to follow in order to exercise dissenting rights.

2. Include copy of *Corp. Code §§ 15911.21-15911.25* to accompany notice of approval [*Corp. Code § 15911.22(a)*];

3. Mail notice to each limited partner entitled to require limited partnership to purchase dissenting interests within 10 days after date of approval by requisite vote or consent [*Corp. Code § 15911.22(a)*].

4. For each limited partner that complies with procedures to exercise dissenting rights [*see § 16B.386*], instruct partnership to either:

a. Purchase dissenting interests at fair market value, plus interest thereon at legal rate on judgments from date of consummation of reorganization [*see Corp. Code § 15911.24*]:

NOTE:

All agreements fixing the fair market value of any dissenting limited partner's interest as between the limited partnership and that limited partner must be in writing and filed in the records of the limited partnership [***see*** *Corp. Code § 15911.24(a)*].

The payment requirement is subject to the provisions of *Corp. Code § 15911.27*, which provides that to the extent a payment to dissenting limited partners for dissenting interests would require the limited partners to return that payment or a portion of it as an improper distribution [***see*** *Corp. Code § 15905.09*] or because of the application of the Uniform Fraudulent Transfer Act [***see*** *Civ. Code § 3439 et seq.*], then that payment or portion thereof is not to be made. The dissenting partners become creditors of the limited partnership for the amount not paid, together with interest at the legal rate on judgments until the date of payment. The claims of dissenting limited partners are subordinate to all other creditors in any proceeding relating to the winding up and dissolution of the limited partnership, with the debt to be payable when permissible [*Corp. Code § 15911.27*].

(1) Within later of following dates:

(a) Thirty days after amount of fair market value has been agreed to; or

(b) Thirty days after any statutory or contractual conditions to reorganization are satisfied.

(2) If dissenting interests are evidenced by certificates of interest, by surrender of certificates.

b. Refuse to purchase interests, based on [*see Corp. Code § 15911.25*; *see also § 16B.382*]:

(1) Denial by limited partnership of dissenting interest status; or

(2) Failure of limited partnership and limited partner to agree on fair market value of dissenting interests.

5. If limited partnership refused to purchase dissenting interests [*see* paragraph 4b, *above*], advise partnership that it may:

a. File complaint in superior court to determine disputed issues, within six months after date on which notice of approval of reorganization was mailed to limited partner [*see Corp. Code § 15911.25(a)*].

b. Intervene in any action pending on such a complaint [*see Corp. Code § 15911.25(a)*].

c. Take no action, and force limited partner to attempt to enforce payment.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16B California Legal Forms--Transaction Guide § 16B.385

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.385 Evaluating Dissenting Limited Partner Status

NOTE:

These procedures apply to those limited partners who wish to sell their interests back to the limited partnership. If the approval of outstanding limited partnership interests is required for a limited partnership to participate in a reorganization, pursuant to the limited partnership agreement or otherwise, each limited partner of the limited partnership holding those interests may, by complying with the provisions on dissenting rights, require the limited partnership to purchase those interests for cash at fair market value, if the interest is a dissenting interest [*Corp. Code § 15911.21(a)*; ***see*** *Corp. Code § 15911.21(b), (c)* ("dissenting interest" and "dissenting limited partner" defined)]. If a limited partner has the right to demand cash payment for dissenting interest, this procedure is the limited partner's exclusive remedy, other than an action to test whether the vote or consent of the limited partners was obtained in accordance with the procedures established by the partnership agreement [*Corp. Code § 15911.33(a)*].

1. Determine whether dissenting rights statutes are applicable to limited partnership, as follows [*Corp. Code § 15911.32*; *see § 16B.350[2]*]:

NOTE:

Article 11.5 of the ULPA '08 [***see*** *Corp. Code §§ 15911.20-15911.33*] provides rights for dissenting limited partners in certain limited partnerships involved in reorganizations [***see*** *§ 16B.350*; ***see also*** *Corp. Code § 15911.20* ("reorganization" defined)].

a. Domestic limited partnership formed on or after January 1, 1991 [*Corp. Code § 15911.32(a)*].

b. Foreign limited partnership if [*Corp. Code § 15911.32(a)*]:

(1) Foreign limited partnership was formed on or after January 1, 1991 or filed an application to qualify to do business on or after January 1, 1991, and

(2) Limited partners holding more than 50 percent of voting power held by all limited partners of foreign limited partnership reside in California.

c. Limited partnership, if [*Corp. Code § 15911.32(a)*]:

(1) Partnership agreement provides for application of Article 11.5; or

(2) All general partners and majority in interest of limited partners determine that those provisions will apply.

d. Limited partnership interest is *not* governed by limited partnership agreement whose terms and provisions specifically set forth amount to be paid in respect of those interests in event of reorganization of limited partnership [*Corp. Code § 15911.32(b)*].

e. Limited partnership with 36 or more limited partners [*Corp. Code § 15911.32(b)*].

f. Limited partnership with 35 or fewer limited partners, if [*Corp. Code § 15911.32(b)*]:

(1) Partnership agreement provides that Article 11.5 will apply; or

(2) All general partners and majority in interest of limited partners agree that these provisions will apply.

2. Ascertain whether approval of outstanding limited partnership interests is required for limited partnership to participate in proposed reorganization [*see Corp. Code §§ 15911.12, 15911.21*].

NOTE:

Each merging limited partnership must approve an agreement of merger. The agreement of merger must be approved by all general partners of each constituent limited partnership. The principal terms of the merger must be approved by a majority in interest of each class of limited partners of each constituent limited partnership, unless a greater approval is required by the partnership agreement of the constituent limited partnership. However, if the limited partners of any constituent limited partnership become personally liable for any obligations of a constituent limited partnership or other business entity as a result of the merger, the principal terms of the agreement of merger must be approved by all of the limited partners unless the agreement of merger provides that all limited partners have dissenters' rights [*Corp. Code § 15911.12(a)*].

3. Confirm that limited partnership interest in question satisfies all requirements for classification as "dissenting interest" [*Corp. Code § 15911.21(b)*]:

a. Either [*Corp. Code § 15911.21(b)(1)*]:

(1) Immediately before reorganization:

(a) Interest was not listed on any national securities exchange certified by the Commissioner of Corporations [*see Corp. Code § 25100(o)*], or list of OTC margin stocks

issued by Board of Governors of Federal Reserve System; or

(b) Interest was listed [*see* paragraph 1a, *above*] and notice to limited partners requesting approval of proposed reorganization summarizes provisions of *Corp. Code §§ 15911.21-15911.25*; or

(2) Demands for payment are filed with respect to 5 percent or more of outstanding interests of class of listed interests.

b. Interest was outstanding on date for determination of limited partners entitled to vote on reorganization [*Corp. Code § 15911.21(b)(2)*], and either [*Corp. Code § 15911.21(b)(3)*]:

(1) Interest was not voted in favor of reorganization; or

(2) If interest is listed on certified national securities exchange or on list of OTC margin stocks issued by Board of Governors of Federal Reserve System, it was voted against reorganization.

NOTE:
If approval for the proposed reorganization is sought by written consent rather than at a meeting, it is sufficient to establish dissenting status if the interest was not voted in favor of the reorganization [***see*** *Corp. Code § 15911.21(b)(3)*].

4. Advise client that dissenting interest terminates if any of following occur [*Corp. Code § 15911.30*]:

a. Limited partnership abandons reorganization.

NOTE:
Upon abandonment, the partnership must pay, on demand, to any dissenting limited partner who has initiated dissenting proceedings in good faith, all reasonable expenses incurred in those proceedings and reasonable attorneys' fees [*Corp. Code § 15911.30*].

b. Interest is transferred before its submission for endorsement [*see Corp. Code § 15911.23*].

c. Dissenting limited partner and limited partnership do not agree on status of interest as dissenting interest or on its purchase price, and neither files a complaint nor intervenes in a pending action [*see Corp. Code § 15911.25*; *see also § 16B.353[5]*] within six months after date on which notice of approval of reorganization was mailed to limited partner.

d. Dissenting limited partner, with consent of limited partnership, withdraws demand for purchase of dissenting interest.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16B California Legal Forms--Transaction Guide § 16B.386

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.386 Exercising Dissenting Limited Partner Status

NOTE:
If limited partners have a right to require limited partnership to purchase their limited partnership interests for cash [***see*** *Corp. Code § 15911.21*], the limited partnership must mail to each such limited partner a notice of the approval of the reorganization by the requisite vote or consent within 10 days after approval [*Corp. Code § 15911.22(a)*].

1. Have limited partner make written demand on partnership that complies with following [*Corp. Code 15911.22(b)*]:

a. Demands both [*Corp. Code 15911.22(b)*]:
(1) Purchase of dissenting interest.

(2) Payment in cash of fair market value of dissenting interest.

b. States following [*Corp. Code 15911.22(c)*]:

(1) Number or amount of the limited partner's interest.

(2) Statement of what partner claims to be fair market value of interest on day before announcement of the proposed reorganization.

NOTE:
The statement of fair market value constitutes an offer by the partner to sell the interest at

that price [*Corp. Code § 15911.22(c)*].

c. Is received by partnership or transfer agent [*Corp. Code 15911.22(b)*]:

(1) If interests are listed on national securities exchange certified by Commissioner of Corporations, or list of OTC margin stocks issued by Board of Governors of Federal Reserve System [*see Corp. Code §§ 15911.21(b)(1), 25100(o)*], no later than date of limited partners' meeting to vote on reorganization; or

(2) In any other case, within 30 days after date on which notice of approval of reorganization was mailed to limited partners.

2. Instruct dissenting partner to submit following to partnership at principal office (or office of any transfer agent of partnership) for endorsement within 30 days after date on which notice of approval of reorganization was mailed to partner [*Corp. Code § 15911.23*]:

NOTE:
On subsequent transfers of dissenting interest on the books of the limited partnership, the new certificates or other written statement issued therefore must bear a statement that the interests are dissenting interests, and the name of the original holder of the dissenting interest [*Corp. Code § 15911.23*].

a. If interest is evidenced by certificate, limited partner's certificate representing interest that partner demands that limited partnership purchase.

b. If interest is not evidenced by certificate, written notice of the number or amount of interest that limited partner demands that limited partnership purchase.

3. If partner and partnership agree that partner's interest is dissenting, and agree on purchase of shares, instruct partner to submit written agreement to partnership [*Corp. Code § 15911.24(a)*].

NOTE:
All agreements fixing the fair market value of any dissenting limited partner's interest as between the limited partnership and that limited partner must be in writing and filed in the records of the limited partnership. The dissenting limited partner is entitled to the agreed price with interest thereon at the legal rate on judgments from the date of consummation of the reorganization [*Corp. Code § 15911.24(a)*].

4. Regarding payment for dissenting interest, advise partner that [*Corp. Code § 15911.24(b)*]:

NOTE:
These procedures apply when the partnership agreement does not provide otherwise, and the limited partnership and the limited partner agree that the interest is a dissenting interest and agree on the fair market value of the interest [***see*** *Corp. Code § 15911.24*].

a. If partnership is able to make payment, it must pay fair market value for interests:

NOTE:
The payment provision is subject to the provisions of *Corporations Code § 15911.27*, which provides that to the extent a payment to dissenting limited partners for dissenting interests would require the limited partners to return that payment or a portion of it as an

improper distribution [***see*** *Corp. Code § 15905.09*] or because of the application of the Uniform Fraudulent Transfer Act [***see*** *Civ. Code § 3439 et seq.*], then that payment or portion thereof is not to be made. The dissenting partners become creditors of the limited partnership for the amount not paid, together with interest at the legal rate on judgments until the date of payment. The claims of dissenting limited partners are subordinate to all other creditors in any proceeding relating to the winding up and dissolution of the limited partnership, with the debt to be payable when permissible [*Corp. Code § 15911.27*].

(1) Within the later of the following:
(a) Thirty days after amount of fair market value has been agreed upon; or

(b) Thirty days after any statutory or contractual conditions to reorganization are satisfied.

(2) After partner surrenders certificates, if dissenting shares are evidenced by certificates of interest.

b. If partnership is not able to make payment, dissenting partner becomes creditor of partnership [*Corp. Code § 15911.27*]:

(1) For amount not paid, together with interest thereon at legal rate on judgments until date of payment.

(2) Subordinate to all other creditors in any proceeding relating to winding up and dissolution of limited partnership, with the debt to be payable when permissible.

c. Any cash distributions made by limited partnership to dissenting limited partner after date of consummation of reorganization, but before any payment by partnership for that dissenting partner's interest, must be credited against total amount to be paid by partnership for that dissenting interest [*Corp. Code § 15911.28*].

d. Dissenting limited partners generally continue to have all rights and privileges incident to their interests immediately before reorganization, including limited liability, until payment by for dissenting interests [*Corp. Code § 15911.29*].

NOTE:
A dissenting limited partner may not withdraw a demand for payment unless the limited partnership consents to withdrawal [*Corp. Code § 15911.29*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16B California Legal Forms--Transaction Guide § 16B.387

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.387 Bringing Action to Enforce Payment

NOTE:

These procedures apply only when the dissenting limited partnership denies that a limited partnership is a dissenting interest, or if the limited partnership and a limited partner fail to agree on the fair market value of the dissenting interest [*Corp. Code § 15911.25*].

1. File complaint in superior court of proper county, within six months after date on which notice of approval of reorganization was mailed to limited partner, to determine [*Corp. Code § 15911.25(a)*]:

NOTE:

Two or more dissenting limited partners may join as plaintiffs, or be joined as defendants in that action. Two or more such actions may be consolidated [*Corp. Code § 15911.25(b)*].

a. Whether interest is dissenting interest.

b. Fair market value of dissenting interest.

c. Both of above issues.

2. If action on complaint to enforce payment of dissenting shares is already pending, file intervention petition on behalf of dissenting limited partner [*see Corp. Code § 15911.26(b)*].

NOTE:

For discussion and forms for intervention generally, see California Forms of Pleading and Practice, Ch. 395, ***Parties*** (Matthew Bender).

3. Advise dissenting limited partner that amount of judgment will be for payment of amount equal to fair market value, as determined by court, of each dissenting interest, with interest thereon at legal rate on judgments from date of consummation of reorganization [*Corp. Code § 15911.26(c)*].

NOTE:

The payment requirement is subject to *Corp. Code § 15911.27*, which provides that to the extent a payment to dissenting limited partners for dissenting interests would require the limited partners to return that payment or a portion of it as an improper distribution [***see*** *Corp. Code § 15905.09*] or because of the application of the Uniform Fraudulent Transfer Act [***see*** *Civ. Code § 3439 et seq.*], then that payment or portion thereof is not to be made. The dissenting partners become creditors of the limited partnership for the amount not paid, together with interest at the legal rate on judgments until the date of payment. The claims of dissenting limited partners are subordinate to all other creditors in any proceeding relating to the winding up and dissolution of the limited partnership, with the debt to be payable when permissible [*Corp. Code § 15911.27*].

4. Advise dissenting limited partner that court may equitably assess or apportion costs, including reasonable compensation for any appraisers appointed by the court [*Corp. Code § 15911.26(e)*].

NOTE:

If the appraisal exceeds the price offered by the limited partnership, the limited partnership must pay the costs, including, in the discretion of the court, if the value awarded by the court for the dissenting interest is more than 125 percent of the price offered by the limited partnership under *Corp. Code § 15912.03(a)*, attorneys' fees and fees of expert witnesses [*Corp. Code § 15911.26(e)*; ***see*** Ballantine & Sterling, California Corporation Laws, Ch. 25, ***Limited Partnerships*** , § 754.04 (although statute refers to *Corp. Code § 15902.03*, that cite seems erroneous and correct reference appears to be *Corp. Code § 15911.22(a)*)].

5. If dissenting interest is evidenced by transferable certificate of interest, have dissenting partner endorse certificates and deliver certificates to partnership.

NOTE:

With respect to limited partnership interests evidenced by transferable certificates of interest, any judgment requiring payment for dissenting interests is payable only on the endorsement and delivery to the limited partnership of those certificates representing the interests described in the judgment [*Corp. Code § 15911.26(d)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16B California Legal Forms--Transaction Guide §§ 16B.388-16B.399

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

[Reserved]

§§ 16B.388[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

8-16B California Legal Forms--Transaction Guide § 16B.400

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.400 Subsequent Procedures Regarding Conversion of Limited Partnership

NOTE:

The following actions relate specifically to the conversion of a limited partnership into another entity, and not to the creation of the converted entity. For procedures appropriate to the converted entity, see the applicable chapter for the new entity, ***e.g.***, Ch. 15, ***General Partnerships***, Ch. 12C, ***Limited Liability Companies***.

1. Arrange for plan of conversion to be maintained at [*Corp. Code § 15911.03(f)*]:

NOTE:

On the request of a partner of a converting limited partnership, the authorized person on behalf of the converted entity must promptly deliver to the partner or the holder of shares, interests, or other securities, at the expense of the converted entity, a copy of the plan of conversion. A waiver by a partner of these rights is unenforceable [*Corp. Code § 15911.03(f)*].

a. Principal place of business of converted entity if converted entity is domestic partnership or foreign other business entity.

b. Principal executive office of, or registrar or transfer agent of, converted entity, if converted entity is domestic corporation.

c. Office at which records are to be kept under *Corp. Code § 17057* if converted entity is

domestic limited liability company [*see* Ch. 12C, *Limited Liability Companies*].

2. If general partners decide to abandon conversion, have all general partners approve abandonment of conversion.

NOTE:

The general partners of a converting limited partnership may, by unanimous approval at any time before conversion is effective, in their discretion abandon a conversion without further approval by the limited partners, subject to the contractual rights of third parties other than limited partners [*Corp. Code § 15911.03(e)*; ***see*** *§ 16B.313[6]*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

8-16B California Legal Forms--Transaction Guide § 16B.401

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.401 Amending Merger Agreement

NOTE:

Notwithstanding its prior approval, an agreement of merger may be amended before the filing of the certificate of merger or the agreement of merger as provided in *Corp. Code § 15911.14* [*Corp. Code § 15911.12(c)*].

1. Obtain approval of amendment by general partners of each constituent limited partnership, in same manner as required for approval of original agreement of merger [*Corp. Code § 15911.12(c)*].

2. Obtain approval of each of constituent other business entities.

3. If amendment changes any of principal terms of agreement of merger, obtain approval by limited partners of each constituent limited partnership, in same manner and to same extent as required for approval of the original agreement of merger [*Corp. Code § 15911.12(c)*].



166 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

8-16B California Legal Forms--Transaction Guide § 16B.402

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.402 Filing With County Recorder

1. After merger, file in county recorder's office in county where real property is located [*Corp. Code § 15911.18*]:

NOTE:

The procedures in this section apply only to disappearing domestic or foreign limited partnerships or other business entities if (1) the partnership or entity owns real property in California, and (2) the laws of the state or place of organization of any disappearing entity provide substantially that the filing of an agreement of merger or certificate of merger vests all of the real property of any disappearing entity in the surviving entity [*Corp. Code § 15911.18*].

Recording of the certificate of merger in accordance with *Corp. Code § 15911.18* creates, in favor of bona fide purchasers or encumbrancers for value, a conclusive presumption that the merger was validly completed [*Corp. Code § 15911.19*].

a. Certificate of merger certified by Secretary of State, or other certificate prescribed by the Secretary of State; or

b. Copy of following, certified by Secretary of State or authorized public official of state or place pursuant to laws of which merger is effected:
(1) Agreement of merger.

(2) Certificate of merger.

2. After conversion, file in county recorder's office in county where real property is located [*Corp. Code § 15911.07*]:

NOTE:

The procedures in this section apply only when (1) a limited partnership or other business entity having any real property in California converts into a limited partnership or an other business entity pursuant to laws of California or of the state or place in which the limited partnership or other business entity was organized, and (2) the laws of the state or place of organization of the converting limited partnership or other converting entity provide substantially that the conversion vests in the converted limited partnership or other converted entity all the real property of the converting limited partnership or other converting entity [*Corp. Code § 15911.07(a)*].

The filing for record evidences record ownership in the converted limited partnership or other converted entity of all interest of the converting limited partnership or other converting entity in and to the real property located in that county [*Corp. Code § 15911.07(a)*].

Recording of a certificate of conversion, or a statement of partnership authority, certificate of limited partnership, articles of organization, articles of incorporation, or other certificate evidencing the creation of another business entity or a limited partnership by conversion, containing a statement of conversion, will create in favor of bona fide purchasers or encumbrances for value, a conclusive presumption that the conversion was validly completed [*Corp. Code § 15911.07(c)*].

a. Certificate of conversion or statement of partnership authority, certificate of limited partnership, articles of incorporation, or articles of organization complying with *Corp. Code § 15911.06* [*see § 16B.317*] in form prescribed and certified by Secretary of State.

b. Copy of certificate of conversion or statement of partnership authority, certificate of limited partnership, articles of organization, articles of incorporation, or other certificate or document evidencing creation of foreign other business entity or foreign limited partnership by conversion, containing statement of conversion, certified by the Secretary of State or authorized public official of state or place pursuant to laws of which conversion is effected.

3. Pay recording fees [*see Gov. Code § 27361*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART III. TRANSACTION GUIDE
D. Related and Subsequent Procedures

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[Reserved]

§§ 16B.403[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART IV. FORMS
A. Conversion Forms

8-16B California Legal Forms--Transaction Guide § 16B.410

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.410 Certificate of Conversion to Foreign Other Business Entity

[1] Comment

[a] Use of Form

This form is the Secretary of State's official form for a certificate of conversion, CONV-1A, together with the accompanying official instructions. It should be filed with the Secretary of State in the following situations involving limited partnership conversions:

- By a California limited partnership that is converting into a foreign limited partnership or foreign other business entity [*see Corp. Code § 15911.06(a)(4)*; *see* [b], *below*].

- By a California limited partnership that is converting into a California general partnership *if no statement of partnership authority is filed* [*see Corp. Code § 15911.06(a)(2)*; *see* [b], *below*; *see also* Ch. 15, *General Partnerships*].

- By a California general partnership or LLC that is converting into a foreign limited partnership [*see Corp. Code § 16906(b)* (general partnership), 17540.6(a)(4) (LLC)]; *see also* Chs. 12C, *Limited Liability Companies* , Ch. 15, *General Partnerships*].

This form is available from any office of the Secretary of State, or from the Secretary's website at www.ss.ca.gov/business/business.htm.

[b] Statutory Requirements for Certificate of Conversion--Conversion to Foreign Limited Partnership or Foreign Other Business Entity

Corp. Code § 15911.06(a)(4) provides that a California limited partnership that is converting into a foreign limited

partnership or foreign other business entity, *i.e.*, any other business entity formed under the laws of any state other than California or under the laws of a foreign country [*see Corp. Code §§ 15901.02(k), (l), (u), 15911.01(j), (k)*], must file a certificate of conversion with the Secretary of State [*Corp. Code § 15911.06(a)(4)*].

The required contents of a certificate of conversion are specified by statute [*see Corp. Code § 15911.06(b)*; *see also § 16B.317[2]*] and incorporated into this form.

[c] Statutory Requirements for Certificate of Conversion--Conversion to Domestic Entity

In most cases, this form is not appropriate for California limited partnerships that are converting to other California business entities. When a California limited partnership converts to another type of California entity, a *statement* of conversion rather than a *certificate* of conversion is filed, as discussed *below* [*see Corp. Code § 15911.06(a)(1)-(3)*].

If the limited partnership is converting to a California LLC, the statement of conversion must be completed on the articles of organization for the converted entity and filed with the Secretary of State [*see Corp. Code § 15911.06(a)(1)*]. If the limited partnership is converting into a California partnership, the statement of conversion must be completed on the statement of partnership authority for the converted entity. However, if no statement of partnership authority is filed, a certificate of conversion (this form) must be filed separately with the Secretary of State [*see Corp. Code § 15911.06(a)(2)*]. If the limited partnership is converting into a California corporation, the statement of conversion must be completed on the articles of incorporation for the converted entity and filed with the Secretary of State [*see Corp. Code § 15911.06(a)(3)*].

The required contents of a certificate of conversion are specified by statute [*see Corp. Code § 15911.06(b)*; *see also § 16B.317[2]*] and are reflected in the forms promulgated by the Secretary of State. These forms are to be filed as follows:

- A limited partnership that is converting into a California LLC will file Form LLC-1A, Limited Liability Company Articles of Organization--Conversion [*see Ch. 12C, Limited Liability Companies, § 12C.200A*]. That form includes the appropriate statement of conversion.

- A limited partnership that is converting into a California general partnership will file Form GP-1A, General Partnership Statement of Partnership--Conversion [*see* Ch. 15, *General Partnerships* , Pt. C., § 15.801]. That form includes the appropriate statement of conversion. (If no partnership statement is filed, then this form § 16B.400 must be filed separately).

- A limited partnership that is converting into a California corporation will include a statement of conversion in the new entity's articles of incorporation.

[d] Effect of Filing Certificate of Conversion

The filing with the Secretary of State of a certificate of conversion or a statement of partnership authority, articles of organization, or articles of incorporation containing a statement of conversion as set forth *above* has the effect of the filing of a certificate of cancellation by the converting limited partnership. No converting limited partnership that has made the filing is required to file a certificate of cancellation under *Corp. Code § 15902.03* as a result of that conversion [*Corp. Code § 15911.06(c)*].

Once the statement of conversion has been filed, certified copies of the statement may be recorded in the county recorder's office of any county where the partnership held real property. Recordation evidences record ownership in and to the real property located in that county, and also creates, in favor of bona fide purchasers or encumbrancers for value, a conclusive presumption that the conversion was validly completed [*Corp. Code § 15911.07(a), (c)*].

[2] FORM

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169 of 175 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART IV. FORMS
A. Conversion Forms

8-16B California Legal Forms--Transaction Guide § 16B.411

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.411 Certificate of Limited Partnership--Conversion to Limited Partnership

[1] Comment

[a] Use of Form

This form is the Secretary of State's official form, LP-1A, for a certificate of limited partnership that must be filed by an entity that is converting *from* some other form of entity *to* a California limited partnership. It includes the mandatory statement of conversion required by statute [*see Corp. Code §§ 1155(a)(1)* (conversion from corporation), 16906(a) (conversion from general partnership), 17540.6(a)(1) (conversion from limited liability company)]. The form is available from any office of the Secretary of State, or from the Secretary's website at www.ss.ca.gov/business/business.htm.

This form is basically a specialized form of limited partnership certificate to be used when the limited partnership being formed is a preexisting business that is being converted from some other form of business entity, rather than a brand new entity. For general discussion of the effect of filing a certificate of limited partnership, see *Ch. 16, Formation of Limited Partnerships, § 16.21[2]*.

Entities that are converting *from* California limited partnerships *to* other business entities do not file this form. Rather, they file a statement or certificate of conversion that is appropriate for the type of business entity into which they are converting. For discussion, see *§ 16B.410*.

[b] Required Statement of Conversion

A corporation or limited liability company that is converting into a California limited partnership must complete a statement of conversion on the certificate of limited partnership for the converted entity [*see Corp. Code §§ 1155(a)(1)* (conversion from corporation), 17540.6(a)(1) (conversion from LLC)].

A California general partnership that is converting into a California limited partnership must complete a statement of conversion on the certificate of limited partnership for the converted entity if the converting partnership had filed a statement of partnership authority under *Corp. Code § 16303* and that statement is effective at the time of conversion. If a converting partnership has not filed a statement of partnership authority under *Corp. Code § 16303* that is effective at the time of conversion, then the filing of a statement of conversion on its certificate of limited partnership is optional [*Corp. Code § 16906(a)*].

This form contains the statement of conversion information.

[2] FORM

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART IV. FORMS
A. Conversion Forms

8-16B California Legal Forms--Transaction Guide §§ 16B.412-16B.419

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

[Reserved]

§§ 16B.412[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART IV. FORMS
B. Merger Forms

8-16B California Legal Forms--Transaction Guide § 16B.420

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.420 Agreement of Merger

[1] Comment

[a] Use of Form

This form is a general agreement for the merger of a limited partnership with another limited partnership or other business entity pursuant to the merger provisions of the ULPA '08. It can be adapted for use when more than two limited partnerships or other business entities are merging.

For discussion of the amendment of an agreement of merger or the abandonment of a merger before it becomes effective, see *§ 16B.333[5], [7]*.

[b] Approval of Merger

The first step required by the ULPA '08 to effectuate a merger of two or more limited partnerships or other business entities is for limited partnership and other business entity to approve an agreement of merger [*Corp. Code § 15911.12(a)*]. The agreement of merger must be approved by all general partners of each constituent limited partnership [*see Corp. Code § 15911.01(f)*], and the principal terms of the merger must be approved by a majority in interest of each class of limited partners of each constituent limited partnership, unless a greater approval is required by the partnership agreement of the constituent limited partnership [*Corp. Code § 15911.12(a)*]. However, if the limited partners of any constituent limited partnership become personally liable for any obligations of a constituent limited partnership or constituent other business entity [*see Corp. Code § 15911.01(g)*] as a result of the merger, the principal terms of the agreement must be approved by all of the limited partners of the constituent limited partnership unless the agreement provides that all limited partners will have dissenter's rights [*Corp. Code § 15911.12(a)*; *see Corp. Code § 15911.20 et seq.*].

The agreement must be approved on behalf of each constituent other business entity by those persons required to

approve the merger by the laws under which it is organized. Other persons, including a parent of a constituent limited partnership, may be parties to the agreement of merger [*Corp. Code § 15911.12(a)*].

[c] Contents of Agreement of Merger

An agreement of merger must state [*Corp. Code § 15911.12(a)*]:

- The terms and conditions of the merger.

- The name and place of organization of the surviving limited partnership [*see Corp. Code § 15911.01(l)*] or surviving other business entity [*see Corp. Code § 15911.01(m)*], and of each disappearing limited partnership [*see Corp. Code § 15911.01(h)*] and disappearing other business entity [*see Corp. Code § 15911.01(i)*].

- The manner of converting the partnership interests of each of the constituent limited partnerships into interests, shares, or other securities of the surviving limited partnership or surviving other business entity.

- If partnership interests of any of the constituent limited partnerships are not to be converted solely into interests, shares, or other securities of the surviving limited partnership or surviving other business entity, the cash, property, rights, interests, or securities that the holders of the partnership interests are to receive in exchange for the partnership interests. The cash, property, rights, interests, or securities may be in addition to or in lieu of interests, shares, or other securities of the surviving limited partnership or surviving other business entity.

- If applicable, that the partnership interests are canceled without consideration.

- Any other details or provisions that are required by the laws under which any constituent other business entity is organized, including, if a domestic corporation is a party to the merger, *Corp. Code § 1113(b)*.

- Any other details or provisions that are desired, including, without limitation, a provision for the treatment of fractional partnership interests.

In addition, the agreement of merger may change the name of the surviving limited partnership. The new name may be the same as or similar to the name of a disappearing domestic or foreign limited partnership, subject to *Corp. Code § 15901.08*, which sets forth the requirements for a limited partnership's name [*Corp. Code § 15911.12(a)(2)*; *see Ch. 16, Formation of Limited Partnerships, § 16.21[3]*].

[d] Rules for Partnerships With 35+ Limited Partners

With respect to constituent limited partnerships with over 35 limited partners [*Corp. Code § 15911.12(b)*], each limited partnership interest of the same class of any constituent limited partnership, other than a limited partnership interest in another constituent limited partnership that is being canceled and that is held by a constituent limited partnership or its parent [*see Corp. Code § 15901.02(v)* (definition)] or a limited partnership of which the constituent limited partnership is a parent must, unless all limited partners of the class consent, be treated equally with respect to any distribution of cash, property, rights, interests, or securities. However, except in a merger of a limited partnership with a limited partnership in which it controls at least 90 percent of the limited partnership interests entitled to vote with respect to the merger, the unredeemable limited partnership interests of a constituent limited partnership may be converted only into unredeemable interests or securities of the surviving limited partnership or other business entity or a parent if a

constituent limited partnership or a constituent other business entity or its parent owns, directly or indirectly, prior to the merger, limited partnership interests of another constituent limited partnership or interests or securities of a constituent other business entity representing more than 50 percent of the interests or securities entitled to vote with respect to the merger of the other constituent limited partnership or constituent other business entity or more than 50 percent of the voting power, as defined in *Corp. Code § 194.5*, of a constituent other business entity that is a domestic corporation, unless all of the limited partners of the class consent [*Corp. Code § 15911.12(b)*].

The provisions described *above* do not apply to any transaction if the California Commissioner of Corporations has approved the terms and conditions of the transaction and the fairness of those terms and conditions pursuant to *Corp. Code § 25142* [*Corp. Code § 15911.13*].

[e] Location and Inspection of Agreement of Merger

The surviving limited partnership or surviving other business entity must keep the agreement of merger at its designated office or at the business address specified in *Corp. Code § 15911.14(a)(5)*, as applicable. Upon the request of a limited partner of a constituent limited partnership or a holder of shares, interests, or other securities of a constituent other business entity, the general partners of the surviving limited partnership or the authorized person of the surviving other business entity must promptly deliver to the limited partner or the holder of shares, interests, or other securities, at the expense of the surviving limited partnership or surviving other business entity, a copy of the agreement of merger. A waiver by a partner or holder of shares, interests, or other securities of the rights described *above* is unenforceable [*Corp. Code § 15911.12(f)*].

[2] FORM

Agreement of Merger

AGREEMENT TO MERGE

_____ [*Name of disappearing limited partnership or other business entity*]

With and Into

_____ [*Name of surviving limited partnership or other business entity*]

Under the Name of

"_____" [*Premerger or new name of surviving entity*]

_____ [*Name of constituent limited partnership or other business entity*] and _____ [*name of constituent limited partnership or other business entity*] agree as follows:

ARTICLE 1. RECITALS OF CONSTITUENT ENTITIES

[*Select one of the following:*]

Disappearing Limited Partnership

1.01. _____ [*Full name of disappearing limited partnership*] is a limited partnership duly organized, validly existing, and in good standing under the laws of _____ [the State of California *or specify*].

[*Or*]

Disappearing Other Business Entity

1.01. _____ [*Full name of disappearing other business entity*] is a _____ [*specify nature of other business entity, e.g.,* "general partnership"] duly organized, validly existing, and in good standing under the laws of _____ [the State of California *or specify*].

[*Continue with one of the following:*]

Surviving Limited Partnership

1.02. _____ [*Full name of surviving limited partnership*] is a limited partnership duly organized, validly existing, and in good standing under the laws of _____ [the State of California *or specify*]. _____ [*Name*] is to be the surviving limited partnership, as that term is defined in the Uniform Limited Partnership Act of 2008, to the merger described in this agreement.

[*Or*]

Surviving Other Business Entity

1.02. _____ [*Full name of surviving other business entity*] is a _____ [*specify nature of other business entity, e.g.,* "general partnership"] duly organized, validly existing, and in good standing under the laws of _____ [the State of California *or specify*]. _____ [*Name*] is to be the surviving other business entity, as that term is defined in the Uniform Limited Partnership Act of 2008, to the merger described in this agreement.

[*Continue with the following:*]

ARTICLE 2. MERGER

Surviving _____ [Limited Partnership *or* Other Business Entity]

2.01. _____ [*Disappearing entity*] shall be merged with and into _____ [*full name of surviving entity*] under the laws of _____ [the State of California *or specify other state*]. [*If applicable, add:* _____(*Name*), a _____ (*specify nature of other business entity, e.g.,* "general partnership"), is specifically authorized to merge _____[*specify, e.g.,* "under the laws of

_____"].

ARTICLE 3. TERMS AND CONDITIONS

Negative Covenants

3.01. Between the date of this agreement and the date on which the merger becomes effective, each constituent entity will not:

(a) _____ [*Specify, e.g.*, "Make any distributions to its limited partners" *or* "Pay any dividends to its shareholders"].

(b) Except in the ordinary course of business and for adequate value, dispose of any of its assets.

(c) Enter into any contract or agreement obligating it for a period in excess of _____ [*specify, e.g.*, "three months"] or for an amount in excess of _____ [*specify, e.g.*, "$10,000"] except _____ ["in the ordinary course of business" *or specify*].

Further Assignments or Assurances

3.02. If at any time the surviving entity considers or is advised that any further assignments or assurances in law are necessary to vest or to perfect or to confirm of record in the surviving entity the title to any property or rights of _____ [*disappearing entity*], or otherwise carry out the provisions of this agreement, _____ [*specify, e.g.*, "the general partner(s) of _____ (*disappearing limited partnership*)" *or* "the general partners of _____ (*disappearing general partnership*)" *or* "the directors of _____ (*disappearing other business entity*)"], as of the effective date of the merger, will execute and deliver all proper deeds, assignments, confirmations, and assurances in law, and do all acts that the surviving entity _____ [*specify, e.g.*, "reasonably determines" *or* "determines in its sole discretion"] to be proper to vest, perfect, and confirm title to such property or rights in the surviving entity, and otherwise carry out the provisions of this agreement.

ARTICLE 4. MANNER OF CONVERTING INTERESTS

Assets of Constituent Entities

4.01. The _____ [*specify, e.g.*, "partners of _____ (*disappearing limited partnership*)" *or* "general partners of _____ (*disappearing general partnership*)" *or* "directors of _____ (*disappearing other business entity*)"] agree that _____ [*summarize financial situation of disappearing entity before merger, e.g.*,

"(1) The present value of its assets, including goodwill is $_____;

(2) The fair market value of its unrealized receivables is $_____;

(3) The fair market value of its inventory is $_____; and

(4) The estimated amount of its liabilities is $_____"].

The _____ [*specify, e.g.,* "partners" *or* "directors"] of _____ [*surviving entity*] agree that _____ [*summarize financial situation of surviving entity before merger, e.g.,*

"(1) The present value of its assets, including goodwill is $_____;

(2) The fair market value of its unrealized receivables is $_____;

(3) The fair market value of its inventory is $_____; and

(4) The estimated amount of its liabilities is $_____"].

Conversion

[*Select one of the following:*]

4.02. (a) At the effective date of the merger, each interest of _____ [each *or* the] disappearing entity will be converted into _____ [*specify number or amount*] interests of the surviving entity.

(b) No fractional interests of the surviving entity will be issued to the holders of interests of the disappearing entity. However, holders who would otherwise be entitled to receive a fraction of an interest of the surviving entity on the basis of the conversion provided for in this article will instead receive a cash payment equal to the value of that fraction, based on the market value of an interest of the disappearing entity as of the effective date of the merger.

[*OR*]

4.02. The limited partnership interests of _____ [*specify entity*] are cancelled without consideration.

[*Continue with the following:*]

Exchange

4.03. If any interest of a disappearing entity being exchanged in connection with this merger is evidenced by a certificate, each holder of that interest must surrender the certificate or certificates, properly endorsed, to the surviving entity or its transfer agent, and will receive in exchange a certificate or certificates representing the number of interests of the surviving entity into which the interests of the disappearing entity have been converted.

Interests of Surviving Entity

4.04. (a) The presently outstanding _____ [*number*] interest(s) of _____ [*specify class of interest*] of _____ [*disappearing entity*] shall be converted into _____ [*specify class of interest*] of the surviving entity.

(b) The presently outstanding _____ [*number*] interest(s) of _____ [*specify class of interest*] of _____ [*surviving entity*] shall be converted into _____ [*specify class of*

interest] of the surviving entity.

ARTICLE 5. MANAGEMENT OF SURVIVING ENTITY

Management and Control

5.01. The _____ [*specify, e.g.,* "general partners" *or* "directors"] of _____ [*surviving entity*] have the sole and exclusive control of the business, subject to any limitations in the _____ [*specify, e.g.,* "partnership agreement" *or* "articles of incorporation and bylaws"] of the surviving entity.

ARTICLE 6. INTERPRETATION AND ENFORCEMENT

Notices

6.01. Any notice, request, demand, or other communication required or permitted under this agreement may be delivered in person, delivered by certified mail, return receipt requested, or delivered by facsimile transmission. Deliveries by certified mail or by facsimile transmission will be sent to the following addresses:

(a) In the case of _____ [*disappearing entity*] to: _____ [*entity name, name of appropriate general partner or director, street address, city, and state*] or to any other person or address specified in a written notice provided by _____ [*disappearing entity*] to _____ [*surviving entity*] in the manner required by this paragraph.

(b) In the case of _____ [*surviving entity*] to: _____ [*entity name, name of appropriate general partner or director, street address, city, and state*] or to any other person or address specified in a written notice provided by _____ [*surviving entity*] to _____ [*disappearing entity*] in the manner required by this paragraph.

Counterpart Executions

6.02. This agreement may be executed in any number of counterparts, each of which shall be deemed an original.

Partial Invalidity

6.03. If any term of this agreement is held by a court of competent jurisdiction to be void and unenforceable, the remainder of the contract terms shall remain in full force and effect.

Controlling Law

6.04. The validity, interpretation, and performance of this agreement shall be controlled by and construed under the laws of _____ [*specify, e.g.,* "the State of California" *or other state*], the state in which this agreement is being executed.

Executed on _____, at _____ [*city and state*].

_____ [*name of disappearing entity*]

By _____[*signature*]
[*typed name and title*]

_____ [*name of surviving entity*]
By _____[*signature*]
[*typed name and title*]



172 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART IV. FORMS
B. Merger Forms

8-16B California Legal Forms--Transaction Guide § 16B.421

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.421 Certificate of Merger

[1] Comment

[a] Use of Form

This form is the official certificate of merger, OBE MERGER-1. If the surviving entity is a limited partnership or an other business entity, other than a corporation in a merger in which a domestic corporation is a constituent party, after approval of a merger by the constituent limited partnerships and any constituent other business entities, the constituent limited partnerships and constituent other business entities must file a certificate of merger in the office of, and on a form prescribed by, the Secretary of State [*Corp. Code § 15911.14(a)*].

The filing of this certificate effectuates the merger. The filing fee varies depending on the type of merger involved [*see Gov. Code § 12188(i), (j)*].

[b] Contents of Certificate

The certificate of merger must set forth all of the following [*Corp. Code § 15911.14(a)*]:

- The names and the Secretary of State's file numbers, if any, of each of the constituent limited partnerships and constituent other business entities, separately identifying the disappearing limited partnerships and disappearing other business entities and the surviving limited partnership or surviving other business entity.

- If a vote of the limited partners was required under *Corp. Code § 15911.12* [*see § 16B.333*], a statement setting forth the total number of outstanding interests of each class entitled to vote on the merger and that the principal terms of the agreement of merger were approved by a vote of the number of interests of each class which equaled or exceeded the vote required, specifying each class entitled to vote

and the percentage vote required of each class.

- If the surviving entity is a limited partnership and not an other business entity, any change required to the information set forth in the certificate of limited partnership of the surviving limited partnership resulting from the merger, including any change in the name of the surviving limited partnership resulting from the merger.

- The future effective date or time, which must be a date or time certain not more than 90 days subsequent to the date of filing of the merger, if the merger is not to be effective upon the filing of the certificate of merger with the office of the Secretary of State.

- If the surviving entity is an other business entity or a foreign limited partnership, the full name of the entity, type of entity, legal jurisdiction in which the entity was organized and by whose laws its internal affairs are governed, and the address of the principal place of business of the entity.

- Any other information required to be stated in the certificate of merger by the laws under which each constituent other business entity is organized, including, if a domestic corporation is a party to the merger, *Corp. Code § 1113(g)(2)*.

[c] Executing, Acknowledging, and Filing Certificate

The certificate of merger must be executed and acknowledged by each domestic constituent limited partnership by all general partners, unless a lesser number is provided in the certificate of limited partnership of the domestic constituent limited partnership [*Corp. Code § 15911.14(a)*]. In addition, the certificate must be executed and acknowledged by each foreign constituent limited partnership by one or more general partners, and by each constituent other business entity by those persons required to execute the certificate of merger by the laws under which the constituent other business entity is organized [*Corp. Code § 15911.14(a)*].

If the surviving entity is a foreign limited partnership in a merger in which a domestic corporation is a disappearing other business entity, a copy of the agreement of merger and attachments as required under *Corp. Code § 1113(g)(1)* must be filed at the same time as the filing of the certificate of merger [*Corp. Code § 15911.14(a)(6)*].

If the surviving entity is a domestic corporation or a foreign corporation in a merger in which a domestic corporation is a constituent party, after approval of the merger by the constituent limited partnerships and constituent other business entities, the surviving corporation must file in the office of the Secretary of State a copy of the *agreement* of merger and attachments required under *Corp. Code § 1113(g)(1)* [*Corp. Code § 15911.14(b)*].

The certificate of merger must be executed and acknowledged by each domestic constituent limited partnership by all general partners, unless a lesser number is provided in the certificate of limited partnership of the domestic constituent limited partnership [*Corp. Code § 15911.14(b)*].

[d] Effect of Filing Certificate

A certificate of merger (or an agreement of merger, as applicable), has the effect of the filing of a certificate of cancellation for each disappearing limited partnership, and no disappearing limited partnership need file a certificate of cancellation under *Corp. Code § 15902.03* as a result of the merger [*Corp. Code § 15911.14(c)*].

A copy of the certificate of merger duly certified by the Secretary of State is conclusive evidence of the merger of (1) the constituent limited partnerships, either by themselves or together with constituent other business entities, into the surviving other business entity, or (2) the constituent limited partnerships or the constituent other business entities, or

both, into the surviving limited partnership [*Corp. Code § 15911.15(b)(1)*].

In a merger in which the surviving entity is a corporation in which a domestic corporation and a domestic limited partnership are parties to the merger, a copy of an agreement of merger certified on or after the effective date by an official having custody of it has the same force in evidence as the original and, except as against the state, is conclusive evidence of the performance of all conditions precedent to the merger, the existence on the effective date of the surviving corporation, and the performance of the conditions necessary to the adoption of any amendment to the articles of incorporation of the surviving corporation, if applicable, contained in the agreement of merger [*Corp. Code § 15911.15(b)(2)*].

[e] Effect of Recording Certificate

Recording of the certificate of merger [*see Corp. Code § 15911.18*] creates, in favor of bona fide purchasers or encumbrancers for value, a conclusive presumption that the merger was validly completed [*Corp. Code § 15911.19*]. If a copy of a certificate of limited partnership was recorded with the county recorder when the partnership was formed, or when the partnership acquired real property, a copy of the certificate of merger should be recorded wherever the certificate of limited partnership was recorded.

[2] FORM

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173 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART IV. FORMS
B. Merger Forms

8-16B California Legal Forms--Transaction Guide §§ 16B.422-16B.429

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

[Reserved]

§§ 16B.422[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART IV. FORMS
C. Rights of Dissenting Partners

8-16B California Legal Forms--Transaction Guide § 16B.430

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.430 Notice to Limited Partners of Approval of Reorganization

[1] Comment

[a] Use of Form

This form is a notice of approval of a reorganization of a limited partnership. One of the critical aspects of a reorganization of limited partnerships is the right of dissenting limited partners to force the limited partnership to purchase their dissenting interests for cash. To initiate this process, the ULPA '08 requires the limited partnership to mail notice of the approval of the reorganization by the requisite vote or consent of the limited partners to each of its limited partners, if its limited partners have a right to require purchase [*Corp. Code § 15911.22(a)*; *see Corp. Code § 15911.21(b)(4), (5)*; *see* [b], *below*]. The notice must be sent to each limited partner within 10 days after the date of approval by the requisite vote or consent.

The notice must be accompanied by [*Corp. Code § 15911.22(a)*]:

- A copy of *Corp. Code §§ 15911.21 through 15911.25*;
- A statement of the price determined by the partnership to represent the fair market value of its outstanding interests; and
- A brief description of the procedure to be followed if the partner desires to exercise the partner's rights under those sections.

The statement of price constitutes an offer by the partnership to purchase at the price stated any dissenting interests [*see Corp. Code § 15911.21(b)*; *see also § 16B.351[4]*], unless they lose their status as dissenting interests under *Corp. Code § 15911.30* [*Corp. Code § 15911.22(a)*; *see § 16B.353[8]*].

[b] Rights of Dissenting Limited Partners

[i] In General

If the approval of outstanding limited partnership interests is required for a limited partnership to participate in a reorganization, pursuant to the limited partnership agreement of the partnership, or otherwise, then each limited partner of the limited partnership holding those interests may, by complying with the provisions on dissenting rights, require the limited partnership to purchase for cash, at its fair market value, the interest owned by the limited partner in the limited partnership, if the interest is a dissenting interest [*see § 16B.351[4]*]. The fair market value is determined as of the day before the first announcement of the terms of the proposed reorganization, excluding any appreciation or depreciation in consequence of the proposed reorganization [*Corp. Code § 15911.21(a)*].

In order to require purchase, the limited partner's interest must be a dissenting interest [*see Corp. Code § 15911.21(b)*; *see also § 16B.351[4]*]. The limited partner must make a written demand on the partnership for the purchase of the dissenting interest [*see Corp. Code §§ 15911.21(b)(4), 15911.22(b), (c)*; *see also § 16B.353[2]*]. Further, if the interest is evidenced by a certificate, the limited partner must submit to the limited partnership (or its transfer agent) the certificate representing the interest which the partner demands that the partnership purchase, to be stamped or endorsed with a statement that the interest is a dissenting interest or to be exchanged for certificates of appropriate denominations so stamped or endorsed. If the interest is not evidenced by a certificate, the limited partner must submit a written notice of the number or amount of interest which the partner demands that the partnership purchase [*Corp. Code § 15911.23*].

If the limited partnership and the dissenting limited partner agree that the partner's interest is a dissenting interest and agree on the price to be paid for it, the dissenting partner is entitled to the agreed price with interest thereon at the legal rate on judgments from the date of consummation of the reorganization [*Corp. Code § 15911.24(a)*]. If the limited partnership denies that a limited partnership interest is a dissenting interest, or the partnership and a dissenting limited partner fail to agree on the fair market value of a dissenting interest, then that partner or any interested limited partnership, within six months after the date on which notice of the approval of the reorganization by the requisite vote or consent of the limited partners was mailed to the limited partner, but not thereafter, may file a complaint in the superior court of the proper county praying the court to determine whether the interest is a dissenting interest, or the fair market value of the dissenting interest, or both, or may intervene in any action pending on such a complaint [*Corp. Code § 15911.25(a)*; *see § 16B.353[5]*].

[ii] Limited Partnerships That Must Purchase Dissenting Interests

The provisions of Article 11.5 of the ULPA '08 respecting dissenters' rights apply to [*Corp. Code § 15911.32(a)*]:

- A domestic limited partnership formed on or after January 1, 1991.

- A foreign limited partnership if (1) the foreign limited partnership was formed on or after January 1, 1991 or filed an application to qualify to do business on or after January 1, 1991, and (2) limited partners holding more than 50 percent of the voting power held by all limited partners of the foreign limited partnership reside in California.

- A limited partnership if the partnership agreement so provides or if all general partners and a majority in interest of the limited partners determine that those provisions will apply.

However, Article 11.5 does not apply to limited partnership interests governed by limited partnership agreements whose terms and provisions specifically set forth the amount to be paid in respect of such interests in the event of a reorganization of the limited partnership, or to limited partnerships with 35 or fewer limited partners, unless the partnership agreement provides that Article 11.5 will apply or unless all general partners and a majority in interest of the

limited partners agree that it will apply [*Corp. Code § 15911.32(b)*].

[2] FORM

Notice to Limited Partners of Approval of Reorganization

NOTICE OF LIMITED PARTNERS'
APPROVAL OF REORGANIZATION TO LIMITED
PARTNERS OF _____ [*name of limited partnership*]:

NOTICE IS HEREBY GIVEN that the outstanding interests of each class of this limited partnership have approved, by the requisite vote or consent, the principal terms of a reorganization, as defined in the Uniform Limited Partnership Act of 2008, whereby _____ [*specify, e.g.,* "this limited partnership will be merged into _____ (*name of surviving limited partnership*) pursuant to the terms of a Merger Agreement between the two limited partnerships dated _____"].

NOTICE IS FURTHER GIVEN that any limited partner of this limited partnership may require the limited partnership to purchase for cash at their fair market value on the day before the first announcement of the reorganization described in this notice any interests owned by the limited partner that come within the definition of "dissenting interests" contained in *Corporations Code Section 15911.21(b)*. To be dissenting interests within the definition contained in Section 15911.21(b), the interests must have been held of record, that is, outstanding, on the date for determination of the limited partners who were entitled to vote on the reorganization described in this notice and must not have been voted in favor of the reorganization.

NOTICE IS FURTHER GIVEN that for a limited partner to enforce his or her right to require this limited partnership to purchase any dissenting interests owned by him or her, the limited partner must take two actions:

[*If the interest is listed on any certified national securities exchange or on the list of OTC margin stocks, use the following:*]

1. Before the date of the limited partners' meeting to vote on the reorganization, the limited partner must have served a written demand for this limited partnership to purchase his or her dissenting interests and pay the limited partner the fair market value, in cash, of those interests on the limited partnership or on a transfer agent of the limited partnership. The demand must have stated the number and class of interests held by the limited partner that the limited partner demanded the limited partnership purchase as dissenting interests, and the price that the limited partner claimed to be the fair market value of those interests as of the day before the first announcement of the proposed reorganization described in this notice.

[*If the interest is not listed on any certified national securities exchange or on the list of OTC margin stocks, use the following:*]

1. Within 30 days after the date of the mailing of this notice to the limited partner, the limited partner must serve on the limited partnership (or on a transfer agent of the limited partnership) a written demand for this limited partnership to purchase his or her dissenting interests and to pay the limited partner the fair market value, in cash, of those interests. The demand must state the number and class of interests held by the limited partner that the limited partner demands the limited partnership purchase as dissenting interests, and the price the limited partner claims to be the fair market value of those interests as of the day before the first announcement of the proposed reorganization described in this notice.

[*Continue with the following:*]

2. Within 30 days after the date of the mailing of this notice to the limited partner, the limited partner must, in addition to making the demand described above, _____ [*specify, e.g.,* "submit the certificate for the interests he or she claims to be dissenting interests to the limited partnership or its transfer agent so that there may be stamped or endorsed on the certificate a statement that the interests represented by it are dissenting interests" *or, if the interest is not evidenced by a certificate:* "written notice of the number or amount of interest that the limited partner demands that the limited partnership purchase"]. The _____ [certificate *or* written notice] should be submitted to the limited partnership at its principal office at _____ [*address*], California or to its transfer agent, _____ [*name*], at its office at_____ [*address*], California.

Thereafter, should the limited partnership fail to agree to purchase the limited partner's dissenting interests at an agreed price, or deny they are dissenting interests, the limited partner may file a complaint against the limited partnership to force it to purchase the interests. The complaint must be filed in the Superior Court of the State of California for the County of _____, the county in which the principal executive office of this limited partnership is located. The complaint must be filed by the limited partner within six months after the date on which this notice was mailed to the limited partner. A copy of *California Corporations Code Sections 15911.21-15911.25*, which govern the procedure a limited partner must follow to require this limited partnership to purchase dissenting interests owned by the limited partner, is enclosed with this notice.

[*Select one of the following alternatives:*]

[*If the limited partnership has only one class of interests outstanding, use:*]

NOTICE IS FURTHER GIVEN that this limited partnership has determined that the price of $_____ per interest represents the fair market value of dissenting interests of this limited partnership as of the day before the first announcement of the terms of the reorganization described in this notice.

[*If the limited partnership has more than one class of interests outstanding, use:*]

NOTICE IS FURTHER GIVEN that this limited partnership has determined that the following prices represent the fair market value of dissenting interests of this limited partnership as of the day before the first announcement of the terms of the reorganization described in this notice: _____ [*specify, e.g.,*

"$_____ per interest for _____(*specify class of interest*);

$_____ per interest for _____ (*specify class of interest*); and

$_____ per interest for _____ (*specify class of interest*)"].

[*Continue with the following:*]

Dated: _____ [*typed name and title*]



175 of 175 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16B CONVERSIONS AND MERGERS OF LIMITED PARTNERSHIPS
PART IV. FORMS
C. Rights of Dissenting Partners

8-16B California Legal Forms--Transaction Guide § 16B.431

AUTHOR: Reviewed by W. Rod Stern, J.D., LL.M., Groh, Carroll & Stern

§ 16B.431 Written Demand by Limited Partner for Purchase of Dissenting Interests

[1] Comment--Use of Form

This form is the written demand that must be served on a limited partnership that is a party to a reorganization [*see Corp. Code § 15911.20*] by a limited partner desiring to have the limited partnership purchase his or her dissenting interests. The nature of a limited partner's right to require a limited partnership to purchase dissenting interests, limited partnerships that must purchase dissenting interests, interests that are dissenting interests, and the procedure to be followed to enforce a dissenting limited partner's rights to require the purchase are discussed in *§§ 16B.350-16B.353*. A procedural guide for enforcing the rights of a dissenting limited partner, up to filing an action to enforce those rights, is *set forth in §§ 16B.384-16B.387*.

The demand contained in this form must be served on a limited partnership within 30 days after the partnership has mailed a notice to the limited partner of approval of a proposed reorganization by the requisite vote or consent of the limited partners [*Corp. Code § 15911.22(b)*]. However, if the dissenting interests covered by this demand are listed on a certified national securities exchange or on the list of OTC margin stocks of the Federal Reserve System, the demand should be served on the limited partnership on or before the date set for the limited partners' meeting to vote on the proposed reorganization [*Corp. Code § 15911.22(b)*].

[2] FORM

Written Demand by Limited Partner for Purchase of Dissenting Interests

DEMAND FOR PURCHASE OF INTERESTS

TO: _____ [*name of limited partnership*], a California limited partnership:

I am the holder of record of _____ [*number or amount*] of _____ ["limited partnership interest(s)" *or specify class of interests*] issued by you _____ [*add, if applicable,* as evidenced by Certificate No. _____ issued by you].

Pursuant to *Corporations Code Section 15911.22*, I hereby demand that you purchase these interests and pay to me in cash their fair market value as of _____ [*specify the day before the first announcement of the terms of the proposed reorganization*] whereby _____ [*specify, e.g.*, "you will be merged into _____ (*name of surviving limited partnership*)" *or* _____ "(*name of disappearing limited partnership*) will be merged into you"].

I hereby state, pursuant to *Corporations Code Section 15911.22*, that I claim $_____ per interest to be the fair market value of my interests as of the day before the announcement of the terms of the proposed reorganization described above.

[*If dissenting interests are represented by certificate(s), add:*]

I herewith submit to you, pursuant to *Corporations Code Section 15911.23*, the certificate(s) representing the interests in respect to which this demand is made in order that _____ [it *or* they] may be stamped or endorsed with a statement that these interests are dissenting interests.

Dated: _____

_____ [*signature*]
[*typed name*]
[*street address*]
_____, California
_____ [*signature*]
[*typed name*]
[*street address*]
_____, California



1 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS

8-16C California Legal Forms--Transaction Guide 16C.syn

AUTHOR: by Kristin M. Schwaighart

§ 16C.syn Synopsis to Chapter 16C: LIMITED LIABILITY PARTNERSHIPS

§ 16C.01 California Sources

[1] Statutes

[2] State Bar Rules

§ 16C.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 16C.03-16C.04 [Reserved]

§ 16C.05 Law Reviews and Periodicals

§ 16C.06 Text References

§§ 16C.07-16C.09 [Reserved]

§ 16C.10 Effective Date of Enabling Legislation

§ 16C.11 Effect of Uniform Partnership Act of 1994

§ 16C.12 General Characteristics

§ 16C.13 Status as Person and Partnership

§ 16C.14 Legislative Perspective

§ 16C.15 Role of Limited Liability Partnerships in California

§§ 16C.16-16C.19 [Reserved]

§ 16C.20 Definition

§ 16C.21 Becoming a Registered LLP

[1] General Requirements

[2] Registration With Regulatory Body

[a] Law Partnerships

[b] Accounting Partnerships

[c] Architectural Services Partnerships

[3] Name Requirements

[4] Registration With Secretary of State as LLP

[a] Filing Requirements

[b] Contents of Registration

[c] Effect of Registration

[d] Security Requirements

[i] Practice of Public Accountancy

[ii] Practice of Law

[iii] Practice of Architecture

[iv] Transmittal Form Evidencing Compliance With Alternative Security Requirements

[v] Adequacy of Security for Malpractice Claims

[vi] Compliance During Insolvency

[vii] Compliance During Dissolution

[viii] Inadmissibility of Evidence of Security Compliance

[e] Amended Registration

§ 16C.22 Operating Matters

[1] Governing Legislation

[2] Limitations on Distributions

[3] Agent for Service of Process

[4] Alteration of Partnership Agreement

[a] Need for Changes

[b] General Considerations

[c] Provisions to Change

[i] Provision for Sharing in Partnership Profits and Losses

[ii] Provision Concerning Maintenance of Capital Account

[iii] Provision Concerning Maintenance of Income Accounts

[iv] Provision Governing Replenishment of Drawing Accounts

[v] Provision Regarding Contribution on Liquidation

[vi] Additional Considerations

[d] Provisions to Add to Agreement

[i] Statement of LLP Status

[ii] Summary of Partners' Nonliability

[5] California LLPs as Foreign LLPs Outside of California

§ 16C.23 Liability of Partners of General Partnerships and Registered LLPs

[1] General Partnerships

[2] Registered LLPs

[a] Limited Liability

[b] Agreement Extending Liability

§ 16C.24 Cessation of LLP Status

§§ 16C.25-16C.29 [Reserved]

§ 16C.30 Definition

§ 16C.31 Governing Law

§ 16C.32 Requirements for Transacting Intrastate Business in California

[1] General Requirements

[2] Name Requirements

[3] Registration

[a] Filing Requirements

[b] Contents of Registration

[c] Effect of Registration

[d] Effect of Failure to Register

[i] Penalties

[ii] "Transacting Intrastate Business" Defined

[e] Security Requirements

[f] Amended Registration

[4] Agent for Service of Process

§ 16C.33 Cessation of LLP Status; Withdrawal

§§ 16C.34-16C.39 [Reserved]

§ 16C.40 Overview

§ 16C.41 General Corporations

[1] Formation and Operation

[2] Limited Liability

[3] Income Tax Treatment

§ 16C.42 Professional Corporations

§ 16C.43 S Corporations

[1] Definition

[2] Structural Restrictions Applicable to S Corporations

[3] Tax Treatment

§ 16C.44 Limited Partnerships

[1] Formation and Operation

[2] Limited Liability

[3] Tax Treatment

§ 16C.45 General Partnerships

[1] Formation and Operation

[2] Liability

[3] Tax Treatment

§ 16C.46 Limited Liability Companies

§ 16C.47 Conversion Costs

[1] Introduction

[2] Dissolution of Existing Entity

[3] Property Taxation of Changes in Ownership

§§ 16C.48-16C.59 [Reserved]

§ 16C.60 Income Taxation of LLPs

[1] General Rule

[2] Classification of LLP as Association or Partnership

[a] Election of Entity Classification

[b] Default Classification if No Election Made

[c] Transition Rule for Pre-1977 Periods for LLPs in Existence on January 1, 1997

[d] LLP's Entity Status for California Tax Purposes

§ 16C.61 Minimum California Franchise Tax

§ 16C.62 Liability for Sales Taxes on Termination

§§ 16C.63-16C.99 [Reserved]

§ 16C.100 Facts

Scope

§ 16C.101 Documents

Scope

§§ 16C.102-16C.109 [Reserved]

§ 16C.110 Reformulating Partnership as Legal Services LLP

Scope

§ 16C.111 Reformulating Partnership as Public Accountancy LLP

Scope

§ 16C.112 Reformulating Partnership as Architectural Services LLP

Scope

§§ 16C.113-16C.119 [Reserved]

§ 16C.120 Registration of Partnership as Legal Services LLP

[1] Domestic LLP

Scope

[2] Foreign LLP

Scope

§ 16C.121 Registration of Partnership as Public Accountancy LLP

[1] Domestic LLP

Scope

[2] Foreign LLP

Scope

§ 16C.122 Registration of Partnership as Architectural Services LLP

[1] Domestic LLP

Scope

[2] Foreign LLP

Scope

§§ 16C.123-16C.129 [Reserved]

§ 16C.130 Legal Services, Architecture, or Public Accountancy LLP Agreement

Scope

§§ 16C.131-16C.139 [Reserved]

§ 16C.140 Amending Filing Documents

[1] Domestic LLPs

Scope

[2] Foreign LLPs

Scope

§ 16C.141 Withdrawal or Cessation of LLP

Scope

§§ 16C.142-16C.199 [Reserved]

§ 16C.200 Registration [Form LLP-1]

[1] Comment

[a] Use of Form

[b] Contents of Registration

[c] When Transmittal Form Evidencing Compliance With Alternative Security Provision Required

[d] Registration With State Bar

[2] FORM

Registration [Form LLP-1]

§ 16C.201 Amendment of Registration [LLP-2]

[1] Comment

[a] Use of Form

[b] Contents of Certificate

[2] FORM

Amendment of Registration [LLP-2]

§ 16C.202 Limited Liability Partnership Alternative Security Provision [LLP-3]

[1] Comment

[a] Use of Form

[b] Contents of Form

[2] FORM

Limited Liability Partnership Alternative Security Provision [LLP-3]

§ 16C.203 Limited Liability Partnership Notice of Change of Status [LLP-4]

[1] Comment--Use of Form

[2] FORM

Limited Liability Partnership Notice of Change of Status [LLP-4]

§§ 16C.204-16C.229 [Reserved]

§ 16C.230 Application for Issuance of Certificate of Registration as LLP [LLP 101]

[1] Comment

[a] Use of Form

[b] Information Regarding Persons Practicing Law

[c] Registration Requirements

[d] Effective Date of Registration

[e] Acknowledgment of Receipt of Application

[f] Change of Address

[2] FORM

Application for Issuance of Certificate of Registration as LLP [LLP 101]

§ 16C.231 State Bar Rules and Regulations for LLPs

[1] Comment--Use of Form

[2] FORM

Scope

§§ 16C.232-16C.239 [Reserved]

§ 16C.240 California Limited Liability Partnership Agreement--Practice of Law

[1] Comment

[a] Use of Form

[b] Nature of Legal Services LLP

[c] Special Provisions Applicable to Professional Partnerships

[d] Taxable Year

[e] Security Compliance

[2] FORM

California Limited Liability Partnership Agreement--Practice of Law

§ 16C.241 California Limited Liability Partnership Agreement--Practice of Public Accountancy

[1] Comment

[a] Use of Form

[b] Nature of Public Accountancy LLP

[c] Special Provisions Applicable to Professional Partnerships

[d] Taxable Year

[e] Security Compliance

[2] FORM

California Limited Liability Partnership Agreement--Practice of Public Accountancy

§ 16C.242 California Limited Liability Partnership Agreement--Practice of Architecture

[1] Comment

[a] Use of Form

[b] Nature of Architectural Services LLP

[c] Special Provisions Applicable to Professional Partnerships

[d] Taxable Year; Tax Matters Partner

[e] Security Compliance

[2] FORM

California Limited Liability Partnership Agreement--Practice of Architecture

§§ 16C.243-16C.249 [Reserved]

§ 16C.250 Statement That Specific Provision Does Not Extend Liability

[1] Comment--Use of Form

[2] FORM

Statement That Specific Provision Does Not Extend Liability

§ 16C.251 Provision That Nothing in Agreement Extends Liability

[1] Comment--Use of Form

[2] FORM

Provision That Nothing in Agreement Extends Liability

§§ 16C.252-16C.269 [Reserved]

§ 16C.270 Cover Letter for LLP's Certificate or Application for Registration

[1] Comment--Use of Form

[2] FORM

Cover Letter for LLP's Certificate or Application for Registration

§ 16C.271 Legal LLP Name Change

[1] Comment--Use of Form

[2] FORM

Legal LLP Name Change

by Kristin M. Schwaighartn*

FOOTNOTES:

(n49)Footnote *. Ms. Schwaighart is an attorney specializing in business entities and business taxation.



2 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS

8-16C California Legal Forms--Transaction Guide Scope

AUTHOR: by Kristin M. Schwaighart

Scope

by Kristin M. Schwaighartn* Scope

This chapter discusses the nature and formation of legal services, architecture, and public accountancy limited liability partnerships (LLPs) in California. The Legal Background covers the registration of domestic and foreign LLPs. The Transaction Guide provides checklists of information and documents to be covered in client interviews. Additional guides cover the registration of LLPs, the amendment of registration documents, and ongoing reporting requirements. The Forms part contains all of the Secretary of State's mandatory LLP forms, the official LLP rules, regulations, and forms of the California State Bar, complete limited liability partnership agreements, and related forms.

This chapter is designed for use by existing general partnerships that desire to take advantage of the liability protection offered by the LLP organizational form. Although the chapter contains complete limited liability partnership agreement forms, it is not designed to cover all of the issues surrounding the formation of a general partnership. For detailed coverage of the formation, operation, and dissolution of general partnerships, see Ch. 15, *General Partnerships* .

This chapter covers formation and operating requirements under the Uniform Partnership Act of 1994 (UPA '94). Effective January 1, 1999, all registered LLPs are governed by the UPA '94, regardless of their formation date [*Corp. Code § 16955.5(d)*; *see Corp. Code § 16111(a), (b)*; *see also § 16C.11*].

FOOTNOTES:
(n50)Footnote *. Ms. Schwaighart is an attorney specializing in business entities and business taxation.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

8-16C California Legal Forms--Transaction Guide § 16C.01

AUTHOR: by Kristin M. Schwaighart

§ 16C.01 California Sources

[1] Statutes

Public accountancy.

Permit required. *Bus. & Prof. Code § 5051.*

Acts constituting practice of public accountancy. *Bus. & Prof. Code § 5051.*

Exemptions. *Bus. & Prof. Code § 5052.*

Certified public accountant defined. *Bus. & Prof. Code § 5055.*

Public accountant defined. *Bus. & Prof. Code § 5056.*

Name restrictions. *Bus. & Prof. Code §§ 5058-5060.*

Registration. *Bus. & Prof. Code § 5070.*

Expiration and renewal of suspended or revoked permits. *Bus. & Prof. Code § 5070.8.*

Practice as partnership requires registration. *Bus. & Prof. Code §§ 5071-5076.*

Practice of architecture under Architects Practice Act. *Bus. & Prof. Code § 5500 et seq.*
"Architect" defined. *Bus. & Prof. Code § 5500.*
"Engaging in practice of architecture" defined. *Bus. & Prof. Code § 5500.1.*

"Person" includes any individual, firm,partnership, general corporation,professional corporation, or limited liability partnership, as authorized by Corporations Code *Bus. & Prof. Code § 5535*.
Formation of business entity or collaboration with non-architects. *Bus. & Prof. Code § 5535.2*.
"Business entity" and "collaboration" defined. *Bus. & Prof. Code § 5535.25*. Licensee required. *Bus. & Prof. Code § 5536*.
Written contract required. *Bus. & Prof. Code § 5536.22*.
Liability of architect signing plans or other documents; duty to supervise. *Bus. & Prof. Code § 5536.25*.
Persons exempt from registration. *Bus. & Prof. Code §§ 5537.6, 5644*.
Qualifications, application, fees, and licensure. *Bus. & Prof. Code §§ 5550-5552*.
Duration of license. *Bus. & Prof. Code § 5555*.
Enforcement, procedure, and penalties. *Bus. & Prof. Code §§ 5565-5566.2*.
Grounds for discipline. *Bus. & Prof. Code §§ 5577-5586*.

Limited liability partnerships under Uniform Partnership Act of 1994. *Corp. Code § 16951 et seq.*

"Professional limited liability partnership services" defined. *Corp. Code § 16101(14)*.

"Registered limited liability partnership" defined. *Corp. Code § 16101(8)*.

"Foreign limited liability partnership" defined. *Corp. Code § 16101(6)*.

Liability of general partner. *Corp. Code § 16306*.

Partners' rights and duties. *Corp. Code § 16401*.

Name of LLP. *Corp. Code § 16952*.

LLP registration. *Corp. Code § 16953*.

Amendment of registration; notice of cessation. *Corp. Code § 16954*.

Effect of conversion of general partnership to LLP. *Corp. Code § 16955*.

Security requirements. *Corp. Code § 16956*.

Limitations on LLP distributions. *Corp. Code § 16957*.

Foreign LLP governed by laws of jurisdiction of organization; name requirements. *Corp. Code § 16958*.

Registration of foreign LLPs. *Corp. Code § 16959*.

Amendment of registration; notice of cessation. *Corp. Code § 16960*.

Domestic or foreign LLP registration replaces Business and Profession Code filing requirements. *Corp. Code § 16961*.

Designation of agent for service of process. *Corp. Code § 16962*.

Registered LLP treated as partnership for tax purposes. *Rev. & Tax. Code § 28.5*.

"Doing business in California" defined. *Rev. & Tax. Code § 23101*.

Minimum franchise tax on registered LLPs. *Rev. & Tax. Code §§ 17948-17948.3*.

[2] State Bar Rules

Certificate of registration for registered LLP providing legal services. State Bar LLP Rules and Regulations, Rule 1 et seq.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

8-16C California Legal Forms--Transaction Guide § 16C.02

AUTHOR: by Kristin M. Schwaighart

§ 16C.02 Federal Sources

[1] Statutes

Income taxation of partners and partnerships. *I.R.C. §§ 701*-761.

Partnership information income tax returns. *I.R.C. §§ 6031, 6072.*

[2] Regulations

Income taxation of partners and partnerships. Treas. Reg. § 1.701-1.771.

Filing partnership information returns. Treas. Reg. § 1.6031-1.

Valuation of business interests subject to buy-sell agreements. *Treas. Reg. §§ 20.2031-2(h), 20.2031-3(c).*

Valuation of partnership interests for federal estate tax purposes. *Treas. Reg. § 20.2031-3.*

Election of entity classification for tax purposes. *Treas. Reg. § 301.7701-3.*



5 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART I. RESEARCH GUIDE
A. Primary Sources

8-16C California Legal Forms--Transaction Guide §§ 16C.03-16C.04

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.03[Reserved]



6 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-16C California Legal Forms--Transaction Guide § 16C.05

AUTHOR: by Kristin M. Schwaighart

§ 16C.05 Law Reviews and Periodicals

Rosenstein, *Ten Obstacles to a Negotiated Agreement and How to Overcome Them*, 44(7) Prac. Law. 47 (1998).

Bishop, *The Limited Liability Partnerships Amendments to the Uniform Partnership Act (1994), 53 Bus. Law. 101 (1997).*

Stong, *A User's Guide to Alternative Dispute Resolution in Business Cases*, 43(4) Prac. Law. 15 (1997).

Cardozo, *Incorporate or Not? 34 Prac. Law. 63 (January 1988).*

Frankel, *Choice of Entity Decisions After the Tax Reform Act of 1986, 46 N.Y.U. Inst. on Fed. Tax'n 45*.1 (1988).

Bowers, *Choice of Entity: A Primer*, 1 Prac. Tax. L. 79 (Fall 1986).



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CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-16C California Legal Forms--Transaction Guide § 16C.06

AUTHOR: by Kristin M. Schwaighart

§ 16C.06 Text References

Ballantine & Sterling, California Corporation Laws (Matthew Bender).
Ch. 2, *Choice of Form of Doing Business*.
Ch. 22, *Corporate Franchise and Income Taxes in California*.
Ch. 26, *Income Taxation of Partnerships*.

California Legal Forms (Matthew Bender).
Ch. 1A, *Role of Counsel in Starting a New Business*.
Ch. 1B, *Selecting Form of Business Entity*.
Ch. 2, *Formation of Corporations*.
Ch. 12A, *Professional Corporations*.
Ch. 12C, *Limited Liability Companies*.
Ch. 15, *General Partnerships*.
Ch. 86, *Agreements for Professional Services*.

Cavitch, Business Organizations with Tax Planning (Matthew Bender).
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-16C California Legal Forms--Transaction Guide §§ 16C.07-16C.09

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.07[Reserved]



9 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. 1995 Limited Liability Partnership Legislation

8-16C California Legal Forms--Transaction Guide § 16C.10

AUTHOR: by Kristin M. Schwaighart

§ 16C.10 Effective Date of Enabling Legislation

On October 8, 1995, Governor Wilson signed legislation permitting the registration of domestic and foreign limited liability partnerships (LLPs) in California [Stats. 1995, ch. 679 (S.B. 513); *see Corp. Code §§ 16306(c)- (h), 16951-16962* (UPA '94); *see also § 16C.11*]. As urgency legislation [Stats. 1995, ch. 679, § 20], the legislation became effective when chaptered on October 10, 1995.

This legislation allows a domestic or foreign general partnership practicing law, public accountancy, or (until 2012) architecture [*Corp. Code § 16101(6)(A), (8)(A), (19)*], to register as a limited liability partnership (LLP). Assuming compliance with all statutory requirements, the legislation permits partners of an LLP to limit their personal liability for the obligations of the partnership, such as the acts, errors or omissions arising out of the practice of law, accountancy, or architecture, including liability for malpractice of their partners, but not including liability for their own tortious conduct.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawLimited Liability Partnerships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. 1995 Limited Liability Partnership Legislation

8-16C California Legal Forms--Transaction Guide § 16C.11

AUTHOR: by Kristin M. Schwaighart

§ 16C.11 Effect of Uniform Partnership Act of 1994

LLPs are a species of general partnership [*see Corp. Code § 16101(8), (9)*] and, as such, are governed by the general provisions of the Uniform Partnership Act of 1994 (UPA '94) [*Corp. Code § 16100 et seq.*], as well as by the special provisions specifically applicable to LLPs. The statutes governing LLPs are subdivisions of the UPA '94, which applies to all general partnerships.

The UPA '94 took effect on January 1, 1997 [*Corp. Code § 16111*; *see Corp. Code § 16101 et seq.*]. Since January 1, 1999, all partnerships have been governed by the UPA '94, regardless of when they were formed [*Corp. Code § 16111*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. 1995 Limited Liability Partnership Legislation

8-16C California Legal Forms--Transaction Guide § 16C.12

AUTHOR: by Kristin M. Schwaighart

§ 16C.12 General Characteristics

An LLP is a general partnership that can provide its partners with limitations on their personal liability without changing most other attributes of a general partnership. Thus, an LLP can combine the income tax transparency of partnerships on both the federal and California levels [*but see § 16C.60*], the management flexibility of general partnerships and, with some significant limitations, limited liability for general partners akin to that of shareholders of business corporations.

As described in more detail in *§ 16C.23*, the LLP format can protect the personal assets of partners of law, architecture, and public accounting firms from liability for partnership debts and obligations, and most particularly from liability for obligations arising from acts, errors, or omissions arising out of practice of law, architecture, or public accounting ("malpractice") [*Corp. Code § 16306(c)*], but not including a partner's liability to third parties for his or her own malpractice [*Corp. Code § 16306(e)*; *see § 16C.23*]. For LLP partners to obtain limited liability for malpractice, their LLP must comply with requirements for "security" subject to a maximum annual total coverage [*see Corp. Code § 16956*; *see also § 16C.21[4][d]*]. The minimum for all LLPs is $1 million *see § 16C.21[4][d][iii]*). The maximum for a legal services LLP is $7,500,000 and for a public accounting or architecture LLP is $5,000,000 [*Corp. Code § 16956(a)(1)(A)*, (2)(A), (3)(A); *see § 16C.21[4][d]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawGeneral PartnershipsGeneral OverviewBusiness & Corporate LawLimited Liability Partnerships



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. 1995 Limited Liability Partnership Legislation

8-16C California Legal Forms--Transaction Guide § 16C.13

AUTHOR: by Kristin M. Schwaighart

§ 16C.13 Status as Person and Partnership

A registered LLP is a "person" [*Corp. Code § 16101(13)*; *Rev. & Tax. Code § 19*] and a "partnership". To the extent a general partnership is an "entity" (which it is for some purposes), an LLP retains that status. A registered LLP can own property, and can sue and be sued, just as can a non-LLP general partnership [*see Corp. Code §§ 16955(b), 16959(h), (k)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. 1995 Limited Liability Partnership Legislation

8-16C California Legal Forms--Transaction Guide § 16C.14

AUTHOR: by Kristin M. Schwaighart

§ 16C.14 Legislative Perspective

In 1994, California passed the Beverly-Killea Limited Liability Company Act [*see Corp. Code § 17000 et seq.*] creating limited liability companies (LLCs) under California law. In addition to establishing a new form of business organization in California, that law contains detailed requirements for LLCs including formation, operation, limitation of members' and managers' liability, and dissolution. Properly structured LLCs can provide income tax transparency and limited liability to their members and managers [*see* Ch. 12C, *Limited Liability Companies*].

The prospect of professional LLCs created substantial opposition during the legislative process. While Chapter 9 of the LLC Act was reserved for the future enactment of professional LLC legislation, the Act specifically prohibited the formation of domestic professional LLCs and the registration in California of foreign LLCs providing professional services required to be licensed under the California Business & Professions Code. [Stats. 1994, ch. 1200, § 93].

Firms intending to practice or practicing law, public accountancy, or (until 2012) architecture can, however, form or convert to LLPs. The 1995 LLP legislation authorizes a professional partnership format that can be income tax transparent [*see § 16C.60*] and can afford its partners limited liability [*see § 16C.23[2]*]. The legislation was enacted as urgency legislation because it was recognized to be necessary for the following reasons [Stats. 1995, ch. 679, § 20]:

- To provide an attractive business environment;
- To stem the flow of business and jobs from California;
- To avoid disadvantages for California professionals in competing with professionals in other jurisdictions;
- To avoid causing California businesses to incur costs in excess of those charged for similar services elsewhere; and

- To protect the rights of Californians dealing with LLPs.

To ensure passage of this legislation, financial responsibility provisions were included [*Corp. Code § 16956*; *see § 16C.21[4][d]*].

The 1995 LLP legislation is much more limited than the LLC legislation, both in its level of detail and in its scope. The details of the law governing LLPs are provided by the law already applicable to general partnerships, which is now modified respecting LLPs.

The only firms that can take advantage of the LLP form in California are partnerships, other than limited partnerships, that are law and public accountancy partnerships registered in California as California LLPs, or foreign LLPs, registered and operating as LLPs in other jurisdictions, that have registered in California. From January 1, 1999 until January 1, 2012, domestic and foreign general partnerships engaged in the practice of architecture also may register as professional limited liability partnerships (LLPs) [*Corp. Code § 16101(6)(A), (8)(A), (19)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. 1995 Limited Liability Partnership Legislation

8-16C California Legal Forms--Transaction Guide § 16C.15

AUTHOR: by Kristin M. Schwaighart

§ 16C.15 Role of Limited Liability Partnerships in California

The role that LLPs will play in California's legal, architecture, and accounting fields is not yet clear. California joins at least 30 other states that permit LLPs to do business as such within their borders, and the majority of these other states do not restrict use of this business structure to law, architecture, and public accounting firms. However, because these professions are not permitted to organize as LLCs in California, the impact of LLPs is likely to be significant, at least and especially with regard to firms currently organized as general partnerships in California or as general partnerships or LLPs in other jurisdictions and desiring LLP status in California.

Penalties are imposed on foreign LLPs doing intrastate business in California without proper California registration [*see Corp. Code § 16959(i)*; *see also § 16C.32[3][d][i]*]. Avoidance of those penalties provides one reason for prompt registration as a foreign LLP, even though registration does not seem to be required for its partners to obtain limited liability (other than for malpractice) under California law [*see Corp. Code § 16959(j)*]. For a partner of a foreign LLP to obtain limited liability for malpractice other than the partner's own, the foreign LLP must register and comply with statutory security requirements [*see § 16C.21[4][d]*]. Foreign public accounting LLPs and foreign legal services LLPs must be registered with, respectively, the California State Board of Accountancy and the California State Bar to practice their professions in California.

An existing firm organized as a professional corporation would face significant tax and other costs if it were to convert to an LLP [*see § 16C.42*]. Use of the LLP format by those corporations depends on their perception of the advantage of converting and the tax and other costs of doing so [*see §§ 16C.42, 16C.47*]. Existing professional corporations can, of course, be partners in an LLP and enjoy whatever advantages may flow from the LLP protections not enjoyed by those corporations.

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral OverviewTax LawState & Local TaxesIncome TaxPartnerships



15 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
A. 1995 Limited Liability Partnership Legislation

8-16C California Legal Forms--Transaction Guide §§ 16C.16-16C.19

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[Reserved]

§§ 16C.16[Reserved]



16 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. California Limited Liability Partnerships

8-16C California Legal Forms--Transaction Guide § 16C.20

AUTHOR: by Kristin M. Schwaighart

§ 16C.20 Definition

A "registered limited liability partnership" (a "registered LLP") is an association of two or more persons to carry on as co-owners a business for profit, other than a limited partnership, formed pursuant to an agreement governed by the UPA '94 [*Corp. Code § 16951 et seq.*] that is registered under *Corp. Code § 16953* and satisfies one of the following requirements [*Corp. Code § 16101(8)(A)*]:

- Each of its partners is either a "licensed person" (that is, a person duly licensed, authorized, or registered under the Business and Professions Code to practice architecture, public accountancy, or law, or lawfully able to render these services in California [*Corp. Code § 16101(7), (14)*], or a person who is licensed or authorized to engage in the practice of architecture, public accounting, or law in a jurisdiction(s) other than California [*Corp. Code § 16101(8)(A)(i)*].

- The partnership is licensed under the laws of California to engage in the practice of architecture, public accountancy, or law [*Corp. Code § 16101(8)(A)(ii)*. The California Board of Accountancy licenses all accounting partnerships; the California State Bar requires registration only of law LLPs; *see § 16C.23[2][a][ii]*].

- The partnership (1) is "related" to a registered LLP that practices public accountancy or, to the extent permitted by the California State Bar, practices law or is related to a foreign LLP; and (2) provides services related or complementary to the public accountancy or legal services provided by (or provides services or facilities to) that registered LLP or foreign LLP [*Corp. Code § 16101(8)(A)(iii)*].

A partnership is "related" to a registered LLP or foreign LLP if the following conditions are satisfied [*Corp. Code § 16101(8)(B)*:

- At least a majority of the partners in one partnership are also partners in the other partnership, or

- Holders of at least a majority in interest in each partnership, hold interests in or are members of another person, other than an individual, and each partnership renders services pursuant to an agreement with that other person, or

- One partnership, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, the other partnership.

The provision recognizing related partnerships was primarily intended to afford LLP status to consulting or other subpartnerships or affiliated partnerships of public accounting firms. Applicability of this provision to partnerships related to registered legal services LLPs is less clear, but could apply to controlled related partnerships owning premises leased to a legal services LLP, or those providing services other than the practice of law.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsGovernmentsState & Territorial GovernmentsLicenses



17 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. California Limited Liability Partnerships

8-16C California Legal Forms--Transaction Guide § 16C.21

AUTHOR: by Kristin M. Schwaighart

§ 16C.21 Becoming a Registered LLP

[1] General Requirements

A domestic partnership meeting the requirements described in § 16C.20 may become a registered LLP by the vote of partners holding a majority of the interests of the partners in the current profits of the partnership, or by any different vote required by its partnership agreement [*Corp. Code § 16955(a)*].

Becoming a registered LLP is simple: the partnership must file a registration with the Secretary of State and pay the applicable fee [*see Corp. Code § 16953(a), (b)*; *see also* [4][a], *below*]. The partnership becomes a registered LLP when that registration is filed, or at any later date or time specified in the registration. The partnership continues as a registered LLP until dissolved and finally wound up or until it files a notice that it is no longer an LLP [*Corp. Code § 16953(e)*; *see § 16C.24*].

An LLP providing professional services in California must comply with all statutory and administrative registration or filing requirements of the state bodies that prescribe the rules and regulations governing the profession in which that partnership proposes to engage. No such body may disclose, unless compelled by a subpoena or other order of a court of competent jurisdiction, any information received in the course of evaluating the compliance of an LLP with applicable statutory and administrative registration or filing requirements. However, this restriction on disclosure does not prevent a state body from disclosing the manner in which the LLP has complied with the security requirements [*see Corp. Code § 16956*; *see also* [4][d], *below*] or whether the LLP has or has not complied with any other requirements of that body [*Corp. Code § 16953(h)*].

[2] Registration With Regulatory Body

[a] Law Partnerships

A registered LLP providing legal services must have a currently effective certificate of registration issued by the

California State Bar if the liability of its partners is to be limited for professional malpractice claims against their firm or other partners [*Corp. Code § 16306(f)*]. The State Bar promulgated Limited Liability Partnership Rules and Regulations, effective January 1, 1996 [*see § 16C.231*]. The application for registration requires that it be accompanied by a nonrefundable fee of $50 per partner, up to a maximum fee of $2,500 [*see § 16C.230*]. Among other things, eligibility for certification requires that the applicant must certify that each partner is an active member of the State Bar or is licensed and entitled to practice law in another jurisdiction and that the applicant have and maintain for the period of certification the requisite security for claims [State Bar LLP Rules and Regulations, Rules 3.2, 3.4, 5.1; *see* [4], *below*].

The LLP legislation does not appear to require registration with the State Bar to obtain limited liability against claims other than malpractice claims. The State Bar's LLP Rules, however, seem to require registration under those Rules for an attorney to practice law in California through an LLP [*see § 16C.231* (State Bar LLP Rules and Regulations, Rule 1.0)]. The Rules also provide for annual renewal and for termination of LLP status if the LLP fails to renew in a timely manner [*see § 16C.231* (State Bar LLP Rules and Regulations, Rule 10.0)]. Further, the Rules provide for the involuntary termination of the registration certificate if the LLP has only one partner or the State Bar is notified that the LLP has been suspended by the Secretary of State or the Franchise Tax Board [State Bar LLP Rules and Regulations, Rules 8.1-8.3].

[b] Accounting Partnerships

Only certificate holders may secure a permit to engage in the practice public accountancy [*Bus. & Prof. Code § 5070*]. Permits are effective for two years, and may be renewed [*Bus. & Prof. Code § 5070.5*; *see Bus. & Prof. Code § 5070.6* (renewal of expired permits)].

Persons [*Bus. & Prof. Code § 5535* ("person" defined)] who wish to engage in the practice of accountancy as a partnership must register with the Board [*Bus. & Prof. Code § 5071*; *see Bus. & Prof. Code §§ 5072-5076*].

[c] Architectural Services Partnerships

Persons, including individuals, firms,partnerships, general corporations,professional corporations, and limited liability partnerships performing architectural services must be licensed [*see Bus. & Prof. Code §§ 5535, 5536*]. However, the State Board of Architecture advises that there are no current registration requirements for limited liability partnerships engaged in the practice of architecture.

[3] Name Requirements

Corp. Code § 16952 sets forth specific requirements for the name of an LLP. The last words or letters of its name must be "Registered Limited Liability Partnership" or "Limited Liability Partnership" or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" [*Corp. Code § 16952*].

The LLP legislation does not state that an LLP must do business under its official name. Nevertheless, a conservatively-run LLP would almost certainly use its legal name when doing business in California or some name indicating the limited liability of its partners. The Rules of the California State Bar also require that an applicant for Bar certification must agree that the only name under which it will practice is the name filed with the State Bar [*see § 16C.231* (State Bar LLP Rules and Regulations, Rule 3.3)].

[4] Registration With Secretary of State as LLP

[a] Filing Requirements

To become a registered LLP, a partnership must file a registration with the Secretary of State on official Form LLP-1 [

Corp. Code § 16953(a); *see § 16C.200*]. The registration must be executed by one or more partners who are authorized to do so [*Corp. Code § 16953(a)*], and must be accompanied by the applicable fee [*see Corp. Code § 16953(b)*]. The Secretary must register as a registered LLP any partnership that submits a completed registration with the requisite fee [*Corp. Code § 16953(c)*; *see Corp. Code § 16953(d)* (cancellation of registration if remittance of fee not paid)].

[b] Contents of Registration

The registration must set forth all of the following [*see Corp. Code § 16953(a)*; Form LLP-1; *see § 16C.200*]:

- The name of the registered LLP.
- Whether or not the LLP is domestic or foreign.
- The address of its principal office.
- The name and address of its agent for service of process on the LLP in California [*see § 16C.22[3]*].
- A brief statement describing the business in which the partnership engages.
- A statement that the partnership is registering as a registered LLP.
- Any delayed effective date of registration.
- Any other matters that the partnership determines to include.

If an architecture or accounting services LLP relies on the third alternative security provision, confirming $10 million net worth [*Corp. Code § 16956(a)(1)(D), (3)(D)*], or if a legal services LLP relies on the third alternative security provision, confirming $15 million net worth [*Corp. Code § 16956(a)(2)(D)*], the registration must be accompanied by a transmittal form (Form LLP-3) [*Corp. Code § 16956(b)*; for discussion of the statutory security requirements, *see* [d], *below*; *see also § 16C.202*].

Because the registration form is a public document and can only be changed by an amendment filed with the Secretary of State [*see Corp. Code § 16954*; *see also* [e], *below*], it may be prudent to include only the information required by statute in that form.

Copies of the Secretary of State's registration form [Form LLP-1] may be obtained from the Secretary's office [*see Corp. Code § 16953(g)*; *see also § 16C.200*].

[c] Effect of Registration

A partnership effectively becomes a registered LLP when the initial registration is filed and the fee paid, or at any later date or time specified in the registration [*Corp. Code § 16953(e)*]. The Secretary of State may cancel the filing of a registration if the remittance accepted for the fee is not honored for payment, after giving at least 20 days written notice to the person submitting the instrument or to the agent for service of process [*Corp. Code § 16953(d)*]. Otherwise, the partnership continues as a registered LLP until it has been dissolved and finally wound up or it files a notice that it is no longer a registered LLP [*Corp. Code § 16953(e)*; *see Corp. Code § 16954(b)*].

The status of a partnership as a registered LLP is not adversely affected by errors or subsequent changes in the information stated in its registration, an amended registration [*see Corp. Code § 16954(a)*; *see also* [e], *below*] or a notice terminating its LLP status [*Corp. Code § 16953(e)*; *see Corp. Code § 16954(b)*; *see also § 16C.24*]. However,

achieving limited liability for partners depends on satisfaction of the requirements described in [1], *above*, not just on filing the registration form. The California State Bar's Rules require annual renewal of an LLP's certificate of registration with the State Bar [*see § 16C.231* (State Bar LLP Rules and Regulations, Rule 10.0)]. Accountancy partnership registrations with the State Board of Accountancy must also be renewed every two years [*see Bus. & Prof. Code § 5070.5* (permits expire at end of month of licensee's birthday during second of two-year term unless renewed)]. The State Board of Architecture advises that there are no current registration requirements for limited liability partnerships engaged in the practice of architecture.

When a domestic partnership effectively converts to a registered LLP, all of the following apply [*Corp. Code § 16955(b)*]:

- All real and personal property, tangible and intangible, of the converting partnership remains vested in the converted registered LLP.

- All debts, obligations, liabilities, and penalties of the converting partnership continue as debts, obligations, liabilities, and penalties of the converted registered LLP.

- All civil or criminal actions, suits, or proceedings pending by or against the converting partnership may be continued as if the conversion had not occurred.

- To the extent provided in the conversion agreement and by statute, the partners of a partnership continue as partners in the converted registered LLP.

- A partnership that has been converted to a registered LLP is the same person that existed before the conversion.

The filing of a registration with the Secretary of State replaces and makes it unnecessary for all purposes for the registered LLP to make any of the filings referred to in Chapter 5 of the Business and Professions Code related to fictitious business names [*Corp. Code § 16961*; *see Bus. & Prof. Code § 17900 et seq.*].

An LLP registration (or an amended registration) on file with the Secretary of State constitutes notice that the partnership is a registered LLP and notice of the facts stated in the registration that are required to be stated in the registration [*Corp. Code § 16953(f)*].

[d] Security Requirements

[i] Practice of Public Accountancy

When a public accountancy partnership registers as an LLP [*see* [a], *above*], and at all times during which it transacts intrastate business in California, it must provide security for claims against it based on acts, errors, or omissions arising out of its practice of public accountancy. The security must comply with one, or some combination [*see Corp. Code § 16956(b)*], of the following [*Corp. Code § 16956(a)(1)*]:

- Maintaining a policy or policies of insurance against liability imposed on or against it by law for damages arising out of claims The total aggregate limit of liability under the policy or policies of insurance for LLPs with five or fewer licensed persons may not be less than $1 million; and for partnerships with more than five licensees rendering professional services on behalf of the partnership, an additional $100,000 insurance for each additional licensee. The maximum amount of insurance, however, need not exceed $5 million in any one designated period, less amounts paid in defending, settling, or discharging those claims. A "licensed person" is a person duly licensed, authorized or

registered under the Business and Professions Code to render LLP services or who is lawfully able to do so in California [*Corp. Code § 16101(7)*]. Because strict compliance with the "security" requirements seems critical to limiting malpractice liability, the count of licensed persons should be carefully made and constantly monitored, and the amount of security kept current if maintained below the maximum. In making the count, an LLP should bear in mind that the term "licensed persons" is not limited to persons practicing in California but includes persons licensed, authorized, registered, or lawfully able to practice in California.

- Maintaining in trust or bank escrow, cash, bank certificates of deposit, United States Treasury obligations, bank letters of credit, or bonds of insurance or surety companies as security for payment of liabilities imposed by law for damages arising out of the claims The amount of security for partnerships with five or fewer licensed persons must not be less than $1 million; and for partnerships with more than five licensees rendering professional services on behalf of the partnership, an additional $100,000 of security must be obtained for each additional licensee. The maximum amount of security, however, need not exceed $5 million.

- Confirming [*see Corp. Code § 16956(a)(1)(D), (c)*] that, as of the last day of its most recently completed fiscal year, the LLP had a net worth equal to or exceeding $10 million. The statute does not indicate the consequence of an incorrect confirmation.

Unless the LLP uses the net worth method in the third alternative listed above, each partner of the LLP, by virtue of that person's status as a partner, automatically guarantees payment of the difference between the maximum amount of security required for LLPs providing accounting services and the security otherwise provided in accordance with the first two alternatives listed above. The aggregate amount paid by all partners under these guarantees will not exceed that difference. Nothing in this rule affects or impairs the rights or obligations of the partners among themselves or the LLP, including, but not limited to, rights of contribution, subrogation, or indemnification [*Corp. Code § 16956(a)(1)(C)*; *see* [viii], *below*].

For purposes of satisfying these security requirements, a registered LLP may aggregate the security it provides pursuant to the security provisions described above [*Corp. Code § 16956(b)*].

When using the malpractice insurance policy option, the policies may be issued on a claims-made or occurrence basis. A claims-made policy must cover claims initially asserted in the designated period, while an occurrence policy must cover occurrences during the designated period. "Designated period" means a policy year or any other period specified in the policy that does not exceed 12 months. The impairment or exhaustion of the aggregate limit of liability by amounts paid under the policy in connection with the settlement, discharge, or defense of claims applicable to a designated period does not require the LLP to acquire additional insurance coverage for that designated period. The policies may be in any form reasonably available in the commercial insurance market, and may be subject to the terms, conditions, exclusions, and endorsements that are typically contained in those policies. Specifically, policies may be subject to a deductible or self-insured retention [*Corp. Code § 16956(a)(1)(A)*; *see* [vii], *below*].

When using the second alternative, the LLP remains in compliance during any calendar year notwithstanding amounts paid out in defending, settling, or discharging claims, provided that the LLP met the requisite amount as of the first business day of that calendar year. Notwithstanding the pendency of other claims against the LLP, the LLP will be deemed in compliance as to a claim if within 30 days after the time that the claim is initially asserted through service of a summons, complaint, or comparable pleading in a judicial or administrative proceeding, the LLP provides the requisite amount of security by designating and segregating funds pursuant to this security alternative [*Corp. Code § 16956(a)(1)(B)*].

To use the net worth alternative method of meeting the security requirements, a registered accounting LLP must file

official Form LLP-3 with the Secretary of State's office establishing compliance with security requirements [*see Corp. Code § 16956(b), (c)*; *see also* [iv], *below*; *§ 16C.202*]. In addition, an LLP using this alternative must file an annual confirmation with the Secretary of State's office on Form LLP-3 [*see Corp. Code § 16956(c)*; *see also* [iv], *below*; *§ 16C.202*]. To be current in a given year, the form for confirming compliance with this alternative method must be on file within four months of the completion of the prior fiscal year. Timely filing constitutes full compliance with the financial security requirements as of the beginning of the fiscal year. A confirmation filed during any particular fiscal year continues to be effective for the first four months of the next succeeding fiscal year [*Corp. Code § 16956(c)*].

The statute does not address directly whether an LLP registering after the first four months (and before the end) of a fiscal year can use the net worth alternative during that year by filing the required confirmation with its registration; clarification seems in order. To avoid uncertainty in securing limited liability for its partners, an accounting LLP may wish to use the first two alternatives for any partial year.

Additional considerations involved in satisfying the four alternatives described above are discussed in [v]-[vii], *below*.

[ii] Practice of Law

When a law partnership registers as an LLP [*see* [a], *above*], and at all times during which it transacts intrastate business in California, it must provide security for claims against it based on acts, errors, or omissions arising out of the practice of law. The security must comply with one, or some combination [*see Corp. Code § 16956(b)*], of the following [*Corp. Code § 16956(a)(2)*]:

- Maintaining a policy or policies of insurance against liability imposed on or against it by law for damages arising out of claims rendering. The total aggregate limit of liability under the policy or policies of insurance for LLPs with five or fewer licensed persons may not be less than $1 million; and for partnerships with more than five licensees rendering professional services on behalf of the partnership, an additional $100,000 insurance must be obtained for each additional licensee. The maximum amount of insurance, however, need not exceed $7.5 million in any one designated period, less amounts paid in defending, settling, or discharging those claims. A "licensed person" is a person duly licensed, authorized or registered under the Business and Professions Code to render LLP services or who is lawfully able to do so in California [*Corp. Code § 16101(7)*]. Because strict compliance with the "security" requirements seems critical to limiting malpractice liability, the count of licensed persons should be carefully made and constantly monitored, and the amount of security kept current if maintained below the maximum. In making the count an LLP should bear in mind that the term "licensed persons" is not limited to persons practicing in California, but means the persons licensed, authorized, registered, or lawfully able to practice in California. The California State Bar's Limited Liability Partnership Rules and Regulations should also be consulted in determining what persons to count [*see* [1], *above*; *see also § 16C.231* (State Bar LLP Rules and Regulations, Rule 5.3)].

- Maintaining in trust or bank escrow, cash, bank certificates of deposit, United States Treasury obligations, bank letters of credit, or bonds of insurance companies as security for payment of liabilities imposed by law for damages arising out of claims The maximum amount of security for partnerships with five or fewer licensed persons must not be less than $1 million; and for partnerships with more than five licensees rendering professional services on behalf of the partnership, an additional $100,000 of security must be obtained for each additional licensee. The maximum amount of security, however, need not exceed $7.5 million.

- Confirming [*Corp. Code § 16956(a)(2)(D), (c)*] that, as of the last day of its most recently completed fiscal year, the LLP had a net worth equal to or exceeding $15 million. The statute does not indicate the consequences of an incorrect confirmation.

Unless the LLP uses the net worth method in the third alternative listed above, each partner of the LLP, by virtue of that person's status as a partner, automatically guarantees payment of the difference between the maximum amount of security required for LLPs providing legal services and the security otherwise provided in accordance with the two preceding paragraphs. The aggregate amount paid by all partners under these guarantees will not exceed that difference. Nothing in this rule affects or impairs the rights or obligations of the partners among themselves or the LLP, including, but not limited to, rights of contribution, subrogation, or indemnification [*Corp. Code § 16956(a)(2)(C)*; *see* [viii], *below*].

A registered LLP may satisfy these security requirements by aggregating the security it provides pursuant to the security provisions described above [*Corp. Code § 16956(b)*].

When using the malpractice insurance policy option, the policies may be issued on a claims-made or occurrence basis. A claims-made policy must cover claims initially asserted in the designated period, while an occurrence policy must cover occurrences during the designated period. "Designated period" means a policy year or any other period specified in the policy that does not exceed 12 months. The impairment or exhaustion of the aggregate limit of liability by amounts paid under the policy in connection with the settlement, discharge, or defense of claims applicable to a designated period does not require the LLP to acquire additional insurance coverage for that designated period. The policies may be in any form reasonably available in the commercial insurance market, and may be subject to the terms, conditions, exclusions, and endorsements that are typically contained in those policies. Specifically, policies may be subject to a deductible or self-insured retention [*Corp. Code § 16956(a)(2)(A)*; *see* [vi], *below*].

When using the second alternative, the LLP remains in compliance during any calendar year notwithstanding amounts paid out in defending, settling, or discharging claims, provided that the LLP met the requisite amount as of the first business day of that calendar year. Notwithstanding the pendency of other claims against the LLP, the LLP will be deemed in compliance as to a claim if within 30 days after the time that the claim is initially asserted through service of a summons, complaint, or comparable pleading in a judicial or administrative proceeding, the LLP provides the requisite amount of security by designating and segregating funds pursuant to this security alternative [*Corp. Code § 16956(a)(2)(B)*].

The California State Bar's LLP Rules and Regulations provide that a registered legal services LLP must maintain the required security [*see* [1], *above*] for claims against it for acts, errors, and omissions from the time of the application through the entire period of certification [State Bar LLP Rules and Regulations, Rules 3.4, 5.1; *see also § 16C.231* (Rules)].

Additional considerations involved in satisfying the alternatives described above are discussed in [v]-[vii], *below*.

[iii] Practice of Architecture

When an architecture partnership registers as an LLP [*see* [a], *above*], and at all times during which it transacts intrastate business in California, it must provide security for claims against it based on acts, errors, or omissions arising out of its practice of architecture. The security must comply with one, or some combination [*see Corp. Code § 16956(b)*], of the following [*Corp. Code § 16956(a)(3)*]:

- Maintaining a policy or policies of insurance against liability imposed on or against it by law for damages arising out of those claims in an amount for each claim of at least $100,000 multiplied by the number of licensed persons rendering professional services on behalf of the LLP. (On and after January 1, 2008, the total aggregate limit of liability under the policies of insurance for LLPs with five or fewer licensees may not be less than $1 million. For all other LLPs, an additional $100,000 of liability coverage must be obtained for each additional licensee, but the total aggregate limit of liability under the

policies is not required to exceed $5 million.) A "licensed person" is a person duly licensed, authorized or registered under the Business and Professions Code to render LLP services or who is lawfully able to do so in California [*Corp. Code § 16101(7)*]. Because strict compliance with the "security" requirements is critical to limiting malpractice liability, the count of licensed persons should be carefully made and constantly monitored, and the amount of security kept current if maintained below the maximum. In making the count, an LLP should bear in mind that the term "licensed persons" is not limited to persons practicing in California but includes persons licensed, authorized, registered, or lawfully able to practice in California.

- Maintaining in trust or bank escrow, cash, bank certificates of deposit, United States Treasury obligations, bank letters of credit, or bonds of insurance or surety companies as security for payment of liabilities imposed by law for damages arising out of the claims in the same amount set forth above.

- Confirming [*see Corp. Code § 16956(a)(3)(D), (c)*] that, as of the last day of its most recently completed fiscal year, the LLP had a net worth equal to or exceeding $10 million. The statute does not indicate the consequence of an incorrect confirmation.

Unless the LLP uses the net worth method in the third alternative listed above, each partner of the LLP, by virtue of that person's status as a partner, automatically guarantees payment of the difference between the maximum amount of security required for LLPs providing architectural services and the security otherwise provided in accordance with the first two alternatives listed above. The aggregate amount paid by all partners under these guarantees will not exceed that difference. Nothing in this rule affects or impairs the rights or obligations of the partners among themselves or the LLP, including, but not limited to, rights of contribution, subrogation, or indemnification [*Corp. Code § 16956(a)(3)(C)*; *see* [vii], *below*].

A registered LLP may aggregate the security it provides pursuant to the security provisions described above [*Corp. Code § 16956(b)*].

When using the malpractice insurance policy option, the policies may be issued on a claims-made or occurrence basis: a claims-made policy must cover claims initially asserted in the designated period, and an occurrence policy must cover occurrences during the designated period. "Designated period" means a policy year or any other period specified in the policy that does not exceed 12 months. The impairment or exhaustion of the aggregate limit of liability by amounts paid under the policy in connection with the settlement, discharge, or defense of claims applicable to a designated period does not require the LLP to acquire additional insurance coverage for that designated period. The policies may be in any form reasonably available in the commercial insurance market, and may be subject to the terms, conditions, exclusions, and endorsements that are typically contained in those policies. Specifically, policies may be subject to a deductible or self-insured retention [*Corp. Code § 16956(a)(3)(A)*; *see* [vii], *below*].

When using the second alternative, the LLP remains in compliance during any calendar year notwithstanding amounts paid out in defending, settling, or discharging claims, provided that the LLP met the requisite amount as of the first business day of that calendar year. Notwithstanding the pendency of other claims against the LLP, the LLP will be deemed in compliance as to a claim if within 30 days after the time that the claim is initially asserted through service of a summons, complaint, or comparable pleading in a judicial or administrative proceeding, the LLP provides the requisite amount of security by designating and segregating funds pursuant to this security alternative [*Corp. Code § 16956(a)(3)(B)*].

To use the net worth alternative method of meeting the security requirements, a registered architecture LLP must file official Form LLP-3 with the Secretary of State's office establishing compliance with security requirements [*see Corp. Code § 16956(b), (c)*; *see also* [iv], *below*; *§ 16C.202*]. In addition, an LLP using this alternative must file an annual confirmation with the Secretary of State's office on Form LLP-3 [*see Corp. Code § 16956(c)*; *see also* [iv], *below*; *§*

16C.202]. To be current in a given year, the form for confirming compliance with this alternative method must be on file within four months of the completion of the prior fiscal year. Timely filing constitutes full compliance with the financial security requirements as of the beginning of the fiscal year. A confirmation filed during any particular fiscal year continues to be effective for the first four months of the next succeeding fiscal year [*Corp. Code § 16956(c)*].

The statute does not address directly whether an LLP registering after the first four months (and before the end) of a fiscal year can use the net worth alternative during that year by filing the required confirmation with its registration; clarification seems in order. To avoid uncertainty in securing limited liability for its partners, an architecture LLP may wish to use the first two alternatives for any partial year.

Additional considerations involved in satisfying the four alternatives described above are discussed in [v]-[vii], *below*.

[iv] Transmittal Form Evidencing Compliance With Alternative Security Requirements

For LLPs to use the third (net worth) alternative for meeting the security requirements [*see* [i]-[iii], *above*], the LLP must file a transmittal form with the Secretary of State using Form LLP-3 [*Corp. Code § 16956(b)*; *see Corp. Code § 16956(a)(1)(D)* (accounting), *(2)(D)* (law), *(3)(D),(b)* (architecture)].

Whenever any information set forth in the transmittal form becomes inaccurate or insufficient, the LLP must file a certificate of amendment on Form LLP-2 [*Corp. Code § 16954(a)*; *see* [e], *below*; *see also § 16C.201*].

Each year, LLPs must file Form LLP-3 to confirm compliance with the net worth alternative security requirement [*Corp. Code § 16956(c)*; *see* § 16C.220].

[v] Adequacy of Security for Malpractice Claims

The limitation of liability [*see Corp. Code § 16306(c)*] ordinarily applies to any registered LLP, as soon as the LLP is registered, as to claims arising while the partnership is a registered LLP. This general rule is subject to a crucial qualification with respect to acts, errors, or omissions arising out of the rendering of accounting, architecture, or legal services by the registered LLP. As to these claims, limitation of liability seems to be contingent on compliance with statutory security requirements [*see Corp. Code § 16956(a)*; *see also* [i]-[iii], *above*], although the LLP legislation does not specify that consequence. Accordingly, it is extremely important that the requirements of those statutory provisions be observed.

There are several issues to be considered in that connection, the first relating to insurance [*see Corp. Code § 16956(a)(1)(A)* (accounting), *(2)(A)* (law), *(3)(A)* (architecture)]. The first issue, relating to insurance, appears to have been resolved by 1997 legislation. When the LLP security requirements were first passed, an issue existed as to whether a policy containing a deductible, requiring retention by the insured of a portion of the loss above a deductible, or deducting from the total coverage amounts paid in defending or settling claims, would satisfy the statutory requirements. The security requirements were modified by 1997 legislation [Stats. 1197 ch. 387] that resolves this issue. It qualifies the maximum amounts by providing that they are reduced by amounts paid in defending, settling, or discharging claims. The impairment or exhaustion of the aggregate limit of liability by amounts paid under the policy in connection with the settlement, discharge, or defense of claims applicable to a designated period does not require the LLP to acquire additional insurance for that period. The 1997 legislation also provides that the policies may be in a form reasonably available in the commercial insurance market and may be subject to terms, conditions, exclusions, and endorsements typically continued in those policies. Policies that are subject to a deductible or self-insured retention are now specifically permitted [*Corp. Code § 16956(a)(1)(A), (2)(A), (3)(A)*].

A second issue relates to the amount of security required when the number of licensed persons increases. A legal, architecture, or accounting registered LLP or registered foreign LLP is required to have an amount of security based on

the number of professionals, up to the respective maximum amounts [*see Corp. Code § 16956(a)(1)- (3)*]. If an amount of security provided below the maximum becomes too low on the hiring of an additional professional, the security requirements would not be sufficient and, at least for claims arising in the period between the increase and provision of the required increased security, liability for malpractice claims would not be limited. Issues of this type suggest that a law firm may wish to employ the written agreement procedure as a fall back. Similarly, an architecture or accounting LLP that is not using the net worth alternative may wish to have extra insurance or cash security so as to provide a margin of error in using the other alternatives.

[vi] Compliance During Insolvency

If a registered LLP or foreign LLP is otherwise in compliance with the security requirements when a bankruptcy or other insolvency proceeding is commenced with respect to it, the LLP will be deemed to be in compliance throughout the pendency of the proceeding [*Corp. Code § 16956(e)*]. However, if an LLP conducts business after the insolvency proceeding ends, it must comply with the security requirements [*Corp. Code § 16956(a)(1), (2)*] to secure the limitations on liability available to partners of LLPs under *Corp. Code § 16306(c)* [*Corp. Code § 16956(e); see § 16C.23*].

[vii] Compliance During Dissolution

On the dissolution and winding up of the partnership, the partnership must, with respect to any insurance policies maintained pursuant to its security obligations, maintain or obtain an extended reporting period endorsement or equivalent provision in the maximum requisite total aggregate limit of liability for a minimum of three years if reasonably available from the insurer [*Corp. Code § 16956(a)(1)(A), (2)(A), (3)(A)*].

With regard to the automatic guarantee security requirement discussed in [i], [ii], and [iii], *above*, neither the withdrawal of a partner nor the dissolution and winding up of the LLP affects the rights or obligations of a partner arising before withdrawal or dissolution and winding up. This guarantee applies only to conduct that occurred before the withdrawal or dissolution and winding up [*Corp. Code § 16956(a)(1)(C), (2)(C), (3)(C)*].

[viii] Inadmissibility of Evidence of Security Compliance

Neither the existence of the security requirements [*Corp. Code § 16956(a)*] nor the extent of a registered or foreign LLP's compliance with the alternative requirements is admissible in court, or may in any manner be made known to a jury or other trier of fact in determining an issue of liability for, or to the extent of, the damages in question [*Corp. Code § 16956(d)*].

[e] Amended Registration

A registered LLP may amend its registration by filing a certificate of amendment, official Form LLP-2, with the Secretary of State. Use of LLP-2 is mandatory [*see Corp. Code § 16954(d)*]; copies may be obtained from the Secretary of State's office. An LLP must file an amended registration within a reasonable time after any information set forth in the initial registration [*see § 16C.200*], the alternative security provision [*see § 16C.202*], or any previously filed certificate of amendment [*see § 16C.201*] becomes inaccurate or to add information to the registration or previously filed certificate of amendment [*Corp. Code § 16954(a)*]. The certificate of amendment must be executed by one or more partners authorized to do so [*Corp. Code § 16954(a)*], and accompanied by the applicable filing fee [*Corp. Code § 16954(c)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsContracts

LawTypes of ContractsPartnership Agreements



18 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. California Limited Liability Partnerships

8-16C California Legal Forms--Transaction Guide § 16C.22

AUTHOR: by Kristin M. Schwaighart

§ 16C.22 Operating Matters

[1] Governing Legislation

Except as described below as to limitations on distributions and appointment of an agent for service of process, the LLP legislation does not impose operating requirements on LLPs or requirements as to the content of a registered LLP's partnership agreement. For the most part, those requirements are supplied by legislation governing partnerships in general [*see* Ch. 15, Part A, *Formation of General Partnerships*]. However, as discussed in [4], *below*, some provisions of an LLP agreement must be tailored to the consequences of LLP status.

[2] Limitations on Distributions

A registered LLP may not make any distribution if, after giving effect to the distribution, either of the following is true [*Corp. Code § 16957(a)*]:

- The LLP would not be able to pay its debts as they become due in the usual course of business.

- The LLP's total assets would be less than the sum of its liabilities, plus the amount that would be needed to satisfy the preferential rights of other partners on dissolution that are superior to the rights of the partners receiving the distribution if the registered LLP were to be dissolved at the time of the distribution.

For this purpose, a "distribution" is a transfer of money or property by a registered LLP to its partners without consideration [*Corp. Code § 16957(c)*].

This prohibition on distributions appears modeled closely after a similar prohibition applicable to limited liability companies [*see Corp. Code § 17254*] and bears resemblance to *Corp. Code §§ 500* and *501* as to dividends payable by business corporations. The prohibition as to LLCs is accompanied by provisions on which an LLC can rely to determine

whether a distribution is permitted. The LLP statute provides no such guidance and, unlike the General Corporation Law, does not make conformance to generally accepted accounting principles a protection against challenge.

A cause of action with respect to an obligation to return a distribution is extinguished unless the action is brought within four years after the distribution is made [*Corp. Code § 16957(b)*]. The LLP statute does not specify who may bring an action alleging an improper distribution or articulate what obligation a partner has to return an improper distribution [*compare Corp. Code § 17254(e)*, which requires an LLC member to return an improper distribution only if the member had actual knowledge of facts indicating the impropriety of the distribution].

[3] Agent for Service of Process

Each registered LLP whose principal office is not located in California (and each registered foreign LLP) must designate an agent for service of process. The agent may be any natural person or a domestic or foreign corporation entitled to be designated as agent for the service of process [*Corp. Code § 16962(a)* (no California residency requirement); (permitting a domestic or foreign corporation to be designated as agent for service of process if it files a required certificate with the Secretary of State setting forth its address, names of employees to whom process may be delivered, and certain other matters)]. In addition to other appropriate forms of service [*see Code Civ. Proc. § 416.40*], delivery by hand of a copy of any process against a registered LLP (or registered foreign LLP) constitutes valid service if delivered to (1) any natural person designated by it as agent or (2) if a corporate agent has been designated, any person named in that agent's most recent certificate at the office of that agent [*Corp. Code § 16962(b)*].

If the designated agent for service of process has resigned and has not been replaced, or if the designated agent cannot with reasonable diligence be found at the address designated for personally delivering the process, or if no agent has been designated, and it is shown by affidavit to the satisfaction of the court that process against a registered LLP (or foreign LLP required to be registered in California) cannot be served with reasonable diligence on the designated agent by hand in the manner provided in Code Civ. Proc. § 415.10, Corp. Code § 16962 provides for alternative methods of service through the Secretary of State.

[4] Alteration of Partnership Agreement

[a] Need for Changes

The conversion of an existing professional partnership to an LLP almost inevitably requires a considerable number of changes to its partnership agreement. Similarly, the creation of a new partnership that will be an LLP requires the drafting of provisions not usually found in a general partnership agreement.

The following summary is designed to alert partners of prospective LLPs and those drafting LLP partnership agreements to the need for changes. These changes should not simply be drafted into the agreement as somehow necessitated by the use of the LLP format. They must be carefully analyzed and understood and agreed to by the partners.

Important as the following matters are among partners, careful changes may be even more important in preventing third parties (including bankruptcy trustees) from reaching the personal assets of a "nonliable" partner through sharing obligations of partners and obligations of partners to their partnership. Partners should carefully examine their partnership agreement to see what other provisions could provide an indirect or "back door" access to the personal assets of nonliable partners. The agreement among the partners as to the treatment of liable and nonliable partners should be applied to each provision that might conceivably lead to the nonliable partners' assets.

[b] General Considerations

The following are general issues that should be considered when drafting or amending a partnership agreement for an

LLP. Because partnerships vary drastically, depending on the business needs and arrangements of partners, and range from relatively simple two-person partnerships to partnerships with dozens or hundreds of partners with perhaps several classes of partners, this summary is necessarily only illustrative, not exhaustive.

- All partnership assets and capital, including the capital provided by nonliable partners, and all insurance proceeds, may be insufficient to meet partnership obligations. Limited liability to third persons is likely to be of importance to a particular partner's personal assets other than his or her partnership interest only under this circumstance.

- The existence of obligations beyond the partnership's capacity to pay creates the risk that it will cease to be a going concern, and that partners will be extremely adversely affected even if their personal assets are not exhausted.

- The partnership may wish to deal differently with malpractice, or other extraordinary obligations, than with ordinary obligations such as salaries, occupancy costs, and the other operating expenses. Accordingly, counsel should consider how costs other than those related to malpractice should be charged in the partnership's accounts and ultimately to partners' capital or other accounts if that becomes necessary.

- Consideration should be given to the extent to which partners not liable for a malpractice obligation are to indemnify partners who are liable, or to assist them in meeting any personal obligation to pay malpractice claims. How should malpractice claims that are paid be charged internally if paid out of partnership assets (that is, charged only to the liable partner's accounts or more broadly)? To what extent should a liable partner be required to replenish that partner's capital and other accounts or those of others that might be reduced in paying a malpractice claim?

[c] Provisions to Change

[i] Provision for Sharing in Partnership Profits and Losses

A typical partnership agreement provides for sharing of partnership profits and losses in accordance with partnership interests. However, if a claim in excess of all resources of the partnership is viewed as a loss for loss sharing purposes, will loss sharing result in an obligation of partners, not otherwise liable, to pay to the partnership or other partners amounts necessary to settle that claim? As to malpractice obligations, the loss sharing provision may need to be changed so that nonliable partners share in losses caused by partners liable for malpractice, if at all, only to the extent set forth in the agreement. It should also be noted that malpractice obligations may arise through activities of others than partners, and the issue of how to deal with the partners sharing malpractice losses not occasioned by the tortious conduct of a partner must be resolved.

The drafting of this provision becomes more complex if the partnership elects to treat malpractice or other extraordinary liabilities differently from the ordinary liabilities of the partnership. *Corp Code § 16401*, which may be changed by agreement, prescribing rights and duties of partners to their partnership, including contributions by partners to partnership losses, should be carefully examined.

[ii] Provision Concerning Maintenance of Capital Account

Partnership agreements typically provide that a capital account with a deficit balance must be replenished either out of future income or by contribution. Several issues arise in this connection. One is the extent to which the capital account (or other accounts) of a partner liable for malpractice will be charged, and the extent to which that partner must replenish the account. Another is the extent to which other partners' capital accounts can be charged for partnership

obligations for which they are not intended to be liable [*see* [b], *above* (possible difference in treatment of malpractice and ordinary obligations)].

Another issue is the extent to which a liable partner may be required to replenish another, nonliable partner's capital account or reimburse that partner for charges to it if the nonliable partner's capital account is diminished by losses for which that partner is not liable. As noted above, a replenishment obligation might be treated as an asset of the partnership against which the holder of an obligation in excess of the partnership's resources could levy, thereby reaching personal assets of partners that they thought were exempt as a result of being partners of an LLP.

[iii] Provision Concerning Maintenance of Income Accounts

A typical partnership agreement provides for an income account for each partner to which is credited that partner's share of net profits and to which is debited that partner's share of any net loss. If a partner's income account can be charged for, or additions to it reduced by, a share of an obligation of the partnership for which the partner is not intended to be liable, that is an indirect but potent erosion of that partner's limited liability. To the extent that partner is required to reimburse the partnership for a deficit in the partner's income account, there could be a total loss of the limited liability.

[iv] Provision Governing Replenishment of Drawing Accounts

Many partnership agreements provide for partner drawing accounts and, like income accounts, require replenishment by a partner if the account is overdrawn either through drawings or charges to the account for partnership losses. Similar consideration must be given to a drawing account as to an income account [*see* [iii], *above*].

[v] Provision Regarding Contribution on Liquidation

Partnership agreements typically provide, in the event of liquidation of the partnership, for contributions by partners in proportion to their interests if the assets of the partnership are insufficient to satisfy partnership obligations. Since the nonliability provisions of the LLP legislation may be most important when partnership assets are exhausted by obligations and the partnership is insolvent or liquidated, failure to appropriately alter an obligation to contribute to the partnership to cover any deficiency in its ability to meet its obligations in liquidation could erode or eradicate partners' intended limited liability.

[vi] Additional Considerations

In addition to the kinds of changes discussed above, a variety of other matters should be considered for the partnership agreement. These changes include the following:

- Addition of provisions to ensure the existence of security and the taking of other steps to ensure continuing limited liability.

- Alteration of provisions regarding compensation or shares to account for differences in risks, or other factors, among partners.

- Amendment of provisions regarding distributions, both to keep partnership assets as low as possible given capital needs of the firm, and to avoid violation of restrictions on distributions or fraudulent conveyance laws.

[d] Provisions to Add to Agreement

[i] Statement of LLP Status

Counsel should consider adding a provision to the partnership agreement clearly stating that the partnership is a limited liability partnership under the provisions of California law. It may also be advisable to go on in the agreement to indicate briefly the consequences of that status, giving effect to the partners' decisions about treatment of limited liability as mentioned in [b] and [c], *above*. Thus, for example, to the extent that a partner who has statutory liability for the partner's own tortious conduct must pay that obligation out of his or her own pocket without indemnification or contribution by other partners, this point may need to be stated. Further, if a liable partner will be required to reimburse the partnership for losses occasioned by the partner's tortious conduct, the agreement should clearly state this rule.

[ii] Summary of Partners' Nonliability

Another possible addition to the partnership agreement is a general provision summarizing the overall agreements as to nonliability of partners and the absence of any obligation to participate in or contribute toward any losses for which they are not intended to be liable. This provision should also state that it overrides any other provision of the agreement inconsistent with the general principle stated, as a way to attempt to override any other provision, not specifically tailored, that could unintentionally erode the agreed limitations on liability.

[5] California LLPs as Foreign LLPs Outside of California

California's LLP legislation provides that the laws of the jurisdiction under which a foreign LLP is organized govern its organization and internal affairs, as well as the liability and authority of its partners, subject to compliance with applicable California security requirements [*Corp. Code § 16958(a)*; *see § 16C.31*]. This rule may or may not have an analogue under the laws of other jurisdictions in which a California LLP might do business or be subject to legal process. Even if the other jurisdiction has LLP legislation, that legislation may not include provisions comparable to the California provisions as to foreign LLPs. Even if those jurisdictions do look to the organizational jurisdiction of a foreign LLP to determine the liability of its partners, the recognition of limited liability may be tailored or limited to that provided under the jurisdiction's own LLP legislation.

The extent to which one state of the United States must defer to the laws of another state as to the status and characteristics of an organization formed under the laws of the other state is somewhat uncertain. Corporations formed under the laws of one state are universally recognized as such under the laws of other states of the United States, but doubts have been raised as to whether organizations like limited partnerships or limited liability companies are accorded the characteristics granted by their organizing state in other states unless the other state legislatively agrees. The full faith and credit clause of the United States Constitution may require recognition between states, but the matter is somewhat unclear.

The limitation of liability provided in many, if not most, of the other jurisdictions having LLP legislation is less plenary than California's. In some cases, the limitation relates only to liability for acts, errors, and omissions in the practice of the particular profession or business undertaken, that is, as to professional organizations, "professional malpractice," and not to other types of obligations such as contractual obligations of the partnership or other kinds of tortious conduct. Other jurisdictions provide that a particular partner remains liable not only for personal tortious conduct but also for the professional malpractice or wrongful acts or misconduct of any person under that partner's direct supervision and control. Depending on the language of the other jurisdiction recognizing California law, the deferral to California law might be abridged to the extent California law provides greater immunity from liability than that of the other jurisdiction.

Accordingly, before knowingly subjecting a California LLP to the jurisdiction of the courts of another jurisdiction, it seems prudent to investigate the laws of that other jurisdiction to be certain what its laws offer. On the other hand, if the firm in question is a general partnership that has LLP status in its jurisdiction of organization and is operating or would operate as a general partnership in the other jurisdictions if it were a non-LLP partnership, it certainly would be no worse off with either no protection as an LLP or more limited protection as an LLP in that jurisdiction than afforded to

it in California. Given that principle, the importance of knowing the differences between California LLP legislation and that of the other jurisdictions may be chiefly informational, enabling the partners to understand their risks of doing business outside California. The information is nevertheless important because it should be considered when drafting the LLP partnership agreement.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon AgentsContracts LawTypes of ContractsPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
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B. California Limited Liability Partnerships

8-16C California Legal Forms--Transaction Guide § 16C.23

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§ 16C.23 Liability of Partners of General Partnerships and Registered LLPs

[1] General Partnerships

In general, all assets of all partners are exposed to claims arising from obligations of their general partnership [*Corp. Code §§ 16305, 16306*]. General partners are jointly and severally liable to non partners for the wrongful acts and omissions of any partner acting in the ordinary course of partnership business [*Corp. Code §§ 16305, 16306(a)*] and for the misapplication of funds or property of third persons by other partners [*Corp. Code § 16305(b)*]. Further, general partners are jointly liable for the all other debts and obligations of the partnership [*Corp. Code § 16306(a)*]. This extensive exposure to liability, and the recourse to each partner's personal assets, is a fundamental disadvantage of general partnerships.

[2] Registered LLPs

[a] Limited Liability

In contrast to the virtually unlimited exposure to liability that characterizes partners of general partnerships [*see* [1], *above*], a partner of a registered LLP is not directly or indirectly liable or accountable, by way of indemnification, contribution, assessment, or otherwise, for the debts, obligations, or liabilities of or chargeable to the partnership, or another partner in the partnership, whether arising in tort, contract, or otherwise, that are incurred, created, or assumed by the partnership while the partnership is a registered LLP, by reason of being a partner or acting in the conduct of partnership business or activities [*Corp. Code § 16306(c)*]. This limited liability may only be secured (1) by registering as an LLP [*Corp. Code § 16953*; *see § 16C.21[4][a], [c]*]; (2) as to liability for malpractice [*see § 16C.21[4][v]*], by complying with rather substantial security requirements [*Corp. Code § 16956*; *see § 16C.21[4][d]*]; and (3) as to a legal services LLP, obtaining a certificate of registration from the California State Bar [*Corp. Code § 16306(f)*; *see § 16C.21[1]*].

This limitation of liability does not affect the liability of a partner of a registered LLP to third parties for that partner's

tortious conduct [*Corp. Code § 16306(e)*].

The rule of limited liability does not affect or impair the ability of a partner to act as a guarantor or surety for, provide collateral for, or otherwise be liable for, the debts, obligations, or liabilities of a registered LLP [*Corp. Code § 16306(h)*; *see* [b], *below*]. A partner in a registered LLP is not a proper party to a proceeding by or against a registered LLP in which personal liability for partnership debts, obligations, or liabilities is asserted against the partner, unless that partner is personally liable for tortious conduct [*Corp. Code § 16306(e)*], or that partner has agreed to be liable [*Corp. Code § 16306(g)*; *see Corp. Code § 16306(d)*; *see also* [b], *below*].

[b] Agreement Extending Liability

Notwithstanding the rule of limited liability [*Corp. Code § 16306(c)*; *see* [a], *above*], all or certain specified partners of a registered LLP, if those specified partners agree, may be liable in their capacity as partners for all or specified LLP debts, obligations, or liabilities if the partners possessing a majority of the interests of the partners in the current profits of the partnership (or any different vote required by the partnership agreement) specifically agreed in writing to the specified debts, obligations, or liabilities in writing before those debts, obligations, or liabilities were incurred [*Corp. Code § 16306(d)*]. This provision seems to require a specification of particular items rather than a general agreement as to, for example, "all liabilities."

That specific agreement may be modified or revoked if the partners possessing a majority of the interests of the partners in the current profits of the partnership, or any different vote required by the partnership agreement, agree to the modification or revocation in writing. However, the modification or revocation does not affect the liability of a specific agreeing partner for any debts, obligations, or liabilities that were incurred, created, or assumed by the registered LLP before the modification or revocation [*Corp. Code § 16306(d)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsContracts LawTypes of ContractsPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. California Limited Liability Partnerships

8-16C California Legal Forms--Transaction Guide § 16C.24

AUTHOR: by Kristin M. Schwaighart

§ 16C.24 Cessation of LLP Status

If a registered LLP ceases to be a registered LLP, it must file a notice (Form LLP-4) with the Secretary of State stating that it is no longer a registered LLP [*Corp. Code § 16954(b), (d)*; *see* § 16C.203]. The notice must be executed by one or more partners authorized to do so [*Corp. Code § 16954(b)*], and must be accompanied by the applicable fee [*see Corp. Code § 16954(c)*; *Gov. Code § 12189(c)*]. The notice must state that a final annual tax return [*see* Rev. & Tax. Code § 17948.3] has been or will be filed with the Franchise Tax Board [Corp. Code § 16954(b)]. The Secretary of State will notify the Franchise Tax Board of the cessation [Corp. Code § 16954(e)].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
B. California Limited Liability Partnerships

8-16C California Legal Forms--Transaction Guide §§ 16C.25-16C.29

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.25[Reserved]



22 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Foreign Limited Liability Partnerships

8-16C California Legal Forms--Transaction Guide § 16C.30

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§ 16C.30 Definition

A "foreign limited liability partnership" is a partnership, other than a limited partnership, formed pursuant to an agreement governed by the laws of another jurisdiction and denominated or registered as an LLP or registered LLP under the laws of that jurisdiction and that satisfies one of the following requirements [*Corp. Code §§ 16101(6), 16202(a)*; *see Bus. & Prof. Code § 17900(b)(2)*]:

- Each partner is a licensed person [*see Corp. Code § 16101(7)* ("licensed person" defined); *see also § 16C.20*] or a person licensed or authorized to provide professional LLP services in a jurisdiction or jurisdictions other than California.

- The partnership is licensed under the laws of California to engage in the practice of architecture, public accountancy, or law. The California State Bar requires registration of foreign legal services LLPs as well as domestic legal services LLPs [State Bar LLP Rules and Regulations, Rule 3.1; *see § 16C.231*; *see also § 16C.21[1]*].

- The partnership is "related" to a registered LLP that practices public accountancy or, to the extent permitted by the California State Bar, practices law or is related to a foreign LLP and provides services related or complementary to the public accountancy or legal services provided by (or provides services or facilities to) that registered LLP or foreign LLP.

A partnership is "related" to a foreign LLP [*see Corp. Code § 16101(6)(A)*] if (1) at least a majority of the partners in one partnership are also partners in the other partnership, or (2) at least a majority in interest in each partnership hold interests or are members in another person other than an individual, and each renders services pursuant to an agreement with that other person, or (3) one partnership, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, the other partnership [*Corp. Code § 16101(6)(B)*]. This provision was primarily intended to permit LLP status to consulting or other such partnerships or affiliated partnerships of public

accounting firms. Applicability of this provision to partnerships related to registered legal services LLPs is less clear but could apply to controlled related partnerships owning premises leased to the legal services LLP or providing services other than the practice of law.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawLimited Liability PartnershipsGovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Foreign Limited Liability Partnerships

8-16C California Legal Forms--Transaction Guide § 16C.31

AUTHOR: by Kristin M. Schwaighart

§ 16C.31 Governing Law

Corp. Code § 16958(a) provide that the laws of the jurisdiction under which a foreign LLP is organized govern its organization and internal affairs, as well as the liability and authority of its partners, subject to compliance with the applicable California security requirements [*see Corp. Code § 16956*; *see also § 16C.21[4][d]*]. A foreign LLP may not be denied registration by reason of any difference between those laws and the laws of California [*Corp. Code § 16958(a)(2)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Foreign Limited Liability Partnerships

8-16C California Legal Forms--Transaction Guide § 16C.32

AUTHOR: by Kristin M. Schwaighart

§ 16C.32 Requirements for Transacting Intrastate Business in California

[1] General Requirements

Before transacting intrastate business in California [*see* [3][d][ii], *below* (definition)], a foreign LLP must comply with all statutory and administrative registration or filing requirements of the California governmental bodies that prescribe the rules and regulations governing the particular profession in which the partnership proposes to engage in California [*Corp. Code § 16959(a)(1)*; *see Corp. Code § 16959(q)*]. Further, a foreign LLP transacting intrastate business in California must file a registration with the Secretary of State, together with the applicable fee [*see Corp. Code § 16959(a)(1), (b)*; *see also* [3], *below*], and must comply with statutory security requirements [*Corp. Code § 16956(a)*; *see § 16C.21[4][d]*]. The Secretary of State is required to register as a foreign LLP any partnership that submits a completed application with the required fee [*Corp. Code § 16959(c)*; *see Corp. Code § 16959(d)* (cancellation of registration if remittance of fee not paid)].

The Limited Liability Partnership Rules and Regulations of the California State Bar would seem to require a foreign LLP to secure the certificate of the State Bar referred to in *§ 16C.21[1]* [*see § 16C.231* (State Bar LLP Rules and Regulations, Rules 1.0, 3.0)]. An accounting partnership must register with the California Board of Accountancy [*Bus. & Prof. Code § 5071*].

[2] Name Requirements

The name of a foreign LLP transacting business in California must satisfy statutory requirements. The last words or letters of the name of a foreign LLP must be "Registered Limited Liability Partnership" or "Limited Liability Partnership," one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" as the last words or letters of its name, or similar words or abbreviations as required or authorized by the jurisdiction of formation of the foreign LLP [*Corp. Code § 16958(b)*].

The statute does not specify that the foreign LLP must do business in California under that name. Nevertheless, a

conservatively-run LLP would almost certainly use its legal name when doing business in California or some name indicating the limited liability of its partners. The Rules of the California State Bar referred to in [1], *above*, also require that an applicant for Bar certification must agree that it will only practice under the name filed with the State Bar [*see § 16C.231* (State Bar LLP Rules and Regulations, Rule 3.3)].

[3] Registration

[a] Filing Requirements

A foreign LLP transacting intrastate business in California must register with the Secretary of State within 30 days after the date on which the foreign LLP first transacts intrastate business in California [*Corp. Code § 16959(a)(1)*]. To register, a foreign LLP must file a registration on Form LLP-1 [*see § 16C.200*] with the Secretary of State, signed by a person authorized to do so by the laws of the jurisdiction of the LLP's formation [*Corp. Code § 16959(a)(1)*]. The Secretary of State is required to register as a foreign LLP any partnership that submits a completed application and the required fee [*Corp. Code § 16959(c)*].

The registration must be accompanied by the applicable fee [*see Corp. Code § 16959(b)*]. In addition, the applicant must attach a certificate from an authorized public official of the foreign LLP's jurisdiction of organization to the effect that the foreign LLP is in good standing in that jurisdiction, if that jurisdiction permits the issuance of these certificates, or, in the alternative, a statement by the foreign LLP that the laws of its jurisdiction of organization do not permit the issuance of certificates of good standing [*Corp. Code § 16959(a)(2)*].

If an accounting or architectural services foreign LLP relies on the third alternative security provision, confirming $10 million net worth [*Corp. Code § 16956(a)(1)(D), (3)(D)*], or if a legal services foreign LLP relies on the third alternative security provision, confirming $15 million net worth [*Corp. Code § 16956(a)(2)(D)*], the registration must be accompanied by a transmittal form [Form LLP-3] confirming compliance with that security alternative [*see Corp. Code § 16958(g)*; *see also § 16C.202*].

[b] Contents of Registration

The registration form must state the following [*Corp. Code § 16959(a)(1), (g)*; *see* § 16C.210 (Form LLP-5)]:

- The name of the foreign LLP.
- Whether or not the LLP is domestic or foreign, and its jurisdiction.
- The address of its principal office.
- The name and address of its agent for service of process in California.
- A brief statement of the business in which it engages.
- Any delayed effective date of registration.
- Any other matters that the partnership determines to include.

Caution should always be exercised when determining whether or not to include optional matters in the registration form. The registration form is a public document, and changes may require formal amendment [*see Corp. Code § 16960(a)*; *see also* [f], *below*].

[c] Effect of Registration

A partnership effectively becomes registered as a foreign LLP when the initial registration is filed and the fee paid, or at any later date or time specified in the registration. The partnership continues as a registered foreign LLP until it has been dissolved and finally wound up, or until it files a notice that the partnership is no longer an LLP [*Corp. Code § 16959(e)*; *see Corp. Code § 16960(b)*; *see also § 16C.33*]. The status of a partnership registered as a foreign LLP, and the liability of a partner of that foreign LLP, is not adversely affected by errors or subsequent changes in the information stated in its registration, an amended registration [*see Corp. Code § 16960(a)*; *see also* [e], *below*], or a notice terminating the LLP status [*Corp. Code § 16959(e)*; *see Corp. Code § 16960(b)*; *see also § 16C.33*].

The California State Bar's Limited Liability Partnership Rules and Regulations require annual renewal of an LLPs certificate of registration with the State Bar [*see § 16C.231* (State Bar LLP Rules and Regulations, Rule 10.0); *see also § 16C.21[1]*].

The filing of a registration with the Secretary of State replaces and makes it unnecessary for all purposes for a registered foreign LLP to make any of the filings referred to in Chapter 5 of the Business & Professions Code related to fictitious business names [*Corp. Code § 16961*; *see Bus. & Prof. Code § 17900 et seq.*].

The LLP registration (or an amended registration) on file with the Secretary of State constitutes notice that the partnership is a foreign LLP and notice of those facts stated in the registration that are required to be stated in the registration [*Corp. Code § 16959(f)*].

[d] Effect of Failure to Register

[i] Penalties

Failure to register with the Secretary of State in a timely manner [*see* [a], *above*] subjects a foreign LLP to penalties that are essentially the same as those applicable to unregistered foreign corporations [*Corp. Code § 16959(h), (i)*; *see Corp. Code §§ 2203, 2259*].

Penalties include inability to maintain court proceedings in California [*Corp. Code § 16959(h)*] and monetary penalties [*Corp. Code § 16959(i)*]. The monetary penalties are $20 for each day that an unregistered foreign LLP transacts intrastate business in California up to a maximum of $10,000 [*Corp. Code § 16959(i)*].

A partner of a foreign LLP is not liable for the debts or obligations of the foreign LLP solely by reason of its having transacted business in California without registration [*Corp. Code § 16959(j)*]. A foreign LLP transacting business in California without registration appoints the Secretary of State as its agent for service of process with respect to causes of action arising out of the transaction of business in California [*Corp. Code § 16959(k)*; *but see* [e], *below* (requirement that foreign LLP comply with California's "security" requirements if it does intrastate business in California)].

The California Attorney General may bring an action to restrain a foreign LLP from transacting intrastate business without first satisfying the registration requirements [*Corp. Code § 16959(p)*].

[ii] "Transacting Intrastate Business" Defined

The definition of "transacting intrastate business" applicable to foreign LLPs is essentially the same as the definitions used for foreign corporations and foreign LLCs [*Corp. Code § 16959(l)*; *see Corp. Code §§ 191, 17001(ap)*]. "Transact intrastate business" means to repeatedly and successively provide professional LLP services in California, other than in interstate or foreign commerce [*Corp. Code § 16959(l)*]. A person will not be deemed to be transacting intrastate business in California merely because of that person's status as a partner of a registered LLP or a foreign LLC, whether or not registered to transact intrastate business in California [*Corp. Code § 16959(o)*].

Without excluding other activities that may not be considered transacting intrastate business, a foreign LLP will not be considered to be transacting intrastate business merely because its subsidiary or affiliate transacts intrastate business, or merely because of its status as any one or more of the following [*Corp. Code § 16959(m)*]:

- A shareholder of a domestic corporation.
- A shareholder of a foreign corporation transacting intrastate business.
- A limited partner of a foreign limited partnership transacting intrastate business.
- A limited partner of a domestic limited partnership.
- A member or manager of a foreign LLC transacting intrastate business.
- A member or manager of a domestic LLC.

Further, without excluding other activities that may not be considered transacting intrastate business, a foreign LLP will not be considered to be transacting intrastate business solely by reason of carrying on any one or more of the following activities in California [*Corp. Code § 16959(n)*]:

- Maintaining or defending any action or suit or any administrative or arbitration proceeding, or effecting its settlement or the settlement of claims or disputes.
- Holding meetings of its partners or carrying on any other activities concerning its internal affairs.
- Maintaining bank accounts or offices or agencies for the transfer, exchange, and registration of the foreign LLP's securities or maintaining trustees or depositories with respect to those securities.
- Effecting sales through independent contractors.
- Soliciting or procuring orders, whether by mail or through employees, agents, or otherwise, when those orders require acceptance outside California before becoming binding contracts.
- Creating or acquiring evidences of debt or mortgages, liens, or security interests in real or personal property.
- Securing or collecting debts or enforcing mortgages and security interests in property securing the debts.
- Conducting an isolated transaction that is completed within 180 days and not in the course of a number of repeated transactions of a like nature.

[e] Security Requirements

At the time of registration, and at all times during which a foreign LLP transacts intrastate business in California, it must provide "security" for claims against it based on acts, errors or omissions arising out of its practice of public accountancy, architecture, or law by complying with detailed security requirements [*Corp. Code § 16956(a)*; *see § 16C.21[4][d]*]. This requirement applies to all foreign LLPs transacting intrastate business, not just those that register [*see Corp. Code § 16956(a)*].

[f] Amended Registration

A registered foreign LLP may amend its registration by filing a certificate of amendment, official Form LLP-2, with the Secretary of State. Use of LLP-6 is mandatory [*see Corp. Code § 16960(d)*]; copies may be obtained from the Secretary of State's office [*Corp. Code § 16960(a)*; *see § 16C.201*].

A foreign LLP must file an amended registration within a reasonable time after any information set forth in the initial registration [*see § 16C.200*], the alternative security provision [*see § 16C.202*], or any previously filed certificate of amendment [*see § 16C.201*] becomes inaccurate. In addition, a foreign LLP must file an amended registration to add information to the registration or previously filed certificate of amendment, or to withdraw its registration as a foreign LLP [*Corp. Code § 16960(a)*]. However, to withdraw its registration, or to cease its status as an LLP, a foreign LLP must file official Form LLP-4 [*see Corp. Code § 16960(b), (c)*; *see also § 16C.203[2]*, Instructions to Form].

The certificate of amendment must be executed with the original signature of one or more partners authorized to do so [*Corp. Code § 16960(a)*], and must be accompanied by the applicable filing fee [*Corp. Code § 16960(e)*].

[4] Agent for Service of Process

Each registered foreign LLP must designate as its agent for service of process a natural person (who does not seem to be required to have an address or to reside in California) or a domestic or foreign corporation entitled to be designated as agent for the service of process under *Corp. Code § 1505* [*Corp. Code § 16962(a)*; *see § 16C.22[3]*]. In addition to other appropriate forms of service [*see Code Civ. Proc. § 416.40*], delivery by hand of a copy of any process against a registered foreign LLP constitutes valid service if delivered to (1) any natural person designated by it as agent or (2) if a corporate agent has been designated, any person named in that agent's most recent certificate [*see Corp. Code § 1505*] at the office of that corporate agent [*Corp. Code § 16962(b)*].

Service of process when an agent has resigned and not been replaced or cannot be found by exercising reasonable diligence is discussed in *§ 16C.22[3]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesGeneral OverviewBusiness & Corporate LawForeign BusinessesGeneral OverviewBusiness & Corporate LawForeign BusinessesQualificationsBusiness & Corporate LawLimited Liability PartnershipsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon AgentsContracts LawTypes of ContractsPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Foreign Limited Liability Partnerships

8-16C California Legal Forms--Transaction Guide § 16C.33

AUTHOR: by Kristin M. Schwaighart

§ 16C.33 Cessation of LLP Status; Withdrawal

If a registered foreign LLP ceases to be an LLP, it must file a notice with the Secretary of State [*Corp. Code § 16960(b)*]. The notice, official Form LLP-4, must state that the registered foreign LLP is no longer a foreign LLP. The notice must be executed by one or more partners authorized to do so [*Corp. Code § 16960(b)*], and must be accompanied by the applicable fee [*see Corp. Code § 16960(e)*; *see Gov. Code § 12189(d)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
C. Foreign Limited Liability Partnerships

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§§ 16C.34[Reserved]



27 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Comparison of LLPs With Other Business Entities

8-16C California Legal Forms--Transaction Guide § 16C.40

AUTHOR: by Kristin M. Schwaighart

§ 16C.40 Overview

This portion of the Legal Background briefly compares California partnerships registered as LLPs with corporations, including general corporations [§ 16C.41], professional corporations [§ 16C.42], and S corporations [§ 16C.43]; with limited partnerships [§ 16C.44]; with non-LLP general partnerships [§ 16C.45]; and with limited liability companies [§ 16C.46]. Section 16C.47 discusses some cost and other considerations not otherwise mentioned in this summary that may be involved in converting an existing business entity into another structure. This material is included to assist in evaluation of current and potential organizational alternatives.

Conversion from a California law, architecture, or public accountancy general partnership to a registered LLP is not a reorganization into a new type of legal format. Rather, the converted partnership continues to be a general partnership while allowing its partners to achieve limited liability (except for their own tortious conduct) in exchange for registering as an LLP, paying a minimum annual franchise tax and, as to malpractice liability, satisfying security requirements and (if a legal services LLP) registering with the California State Bar and paying the registration fee [*see §§ 16C.21, 16C.32*].

Conversion of a professional corporation to a registered LLP is a change to a new entity, and involves substantial cost and other consequences [*see § 16C.42*].

A disadvantage in using an LLP in California is that California has no case law on which to rely for guidance in interpreting the limited liability intended to be afforded by the LLP legislation. In contrast, well-developed and instructive bodies of law exist concerning corporations and limited partnerships.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability

PartnershipsBusiness & Corporate LawLimited PartnershipsGeneral OverviewBusiness & Corporate LawProfessional Associations & Corporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Comparison of LLPs With Other Business Entities

8-16C California Legal Forms--Transaction Guide § 16C.41

AUTHOR: by Kristin M. Schwaighart

§ 16C.41 General Corporations

[1] Formation and Operation

Public filing requirements applicable to forming an LLP are about as simple as those required to form a corporation under the California General Corporation Law. Corporations must file articles of incorporation and LLPs must file a registration, in each case with the Secretary of State [*Corp. Code §§ 200-204, 16953, 16959*]. Each of these instruments can occupy as little as one page. No further formation documents are required to be filed by either type of entity although corporate articles can be very long and an LLP may need to file some attachments to its registration. A legal services LLP and a professional law corporation will need to register with the State Bar, and a corporation will normally make some filing under the Corporate Securities Law as to its securities.

The partners in a proposed LLP frequently will have an existing partnership agreement describing the conduct of partnership business and the relationships between the partners [*see Corp. Code §§ 16101, 16951*] in whatever detail the partners feel is necessary. Although an LLP is not required to have a formal oral, written, or express agreement, as a general partnership it must have some partnership agreement and the agreement should probably be in writing. The agreement may or may not be complex, depending on the LLP's needs. It almost certainly will need modification to deal with partner limited liability [*see § 16C.22[4]*]. In contrast, a corporation must have written bylaws by which it is operated and managed [*Corp. Code § 211-213*]; these bylaws need to include at least certain minimum provisions to fill gaps left for them by the General Corporation Law, and usually contain detailed other provisions concerning the corporation's internal affairs.

Registered LLPs may engage only in the practice of law, architecture, or public accountancy [*Corp. Code § 16101(6), (8), (14)*]. Corporations, of course, other than corporations subject to the Banking Law or professional corporations, may pursue any lawful business activity but can only be used to practice law, architecture, or public accountancy if they are professional corporations. Professional corporations may engage in professional activities permitted under their respective governing statutes [*Corp. Code § 206*; *see Corp. Code §§ 13400-13410*].

As is true of ordinary general partnerships, any number of partners of an LLP may actively participate in the conduct of partnership business, distributing work, and sharing risks and rewards. In contrast to a corporate structure where shareholders elect a board of directors, each director has a single vote and the board manages the corporation through officers and employees, an LLP's partnership agreement may create nearly any management structure and may allocate management voting rights based on ownership or other factors. A corporation with 35 or fewer shareholders may, however, be formed as a close corporation under the General Corporation Law and as such may operate without a board of directors and pursuant to a shareholders agreement, which may be structured much like a partnership agreement [*see Corp. Code § 158*].

[2] Limited Liability

An LLP partner is not liable for the debts and obligations of the LLP if the LLP is registered as an LLP, it has a certificate of registration from the California State Bar if it is a legal services LLP and, as to liability for malpractice by the partnership or another partner in the partnership, if the security requirements are satisfied [*Corp. Code § 16306(c), 16956*; *see § 16C.21*]. Nevertheless, both partners in LLPs and corporate shareholders may be personally liable under certain circumstances for their own acts [*see People v. Clauson (1964) 231 Cal. App. 2d 374, 41 Cal. Rptr. 691* ; *Cooperman v. Unemployment Ins. Appeals Bd. (1975) 49 Cal. App. 3d 1, 122 Cal. Rptr. 127]* . In particular, a partner of an LLP is liable for personal tortious misconduct [*Corp. Code § 16306(e)*]. A shareholder in other than a close corporation would not normally be active enough to commit tortious acts in conduct of its business. See also the comparison of LLCs and professional corporations in § 16C.42.

[3] Income Tax Treatment

The principal advantage of an LLP over a business corporation that is not an S corporation, referred to as a "C corporation," is the different tax treatment that can be afforded an LLP. A properly registered LLP retains its partnership status and can be essentially income tax transparent [*see § 16C.60*]. The following brief discussion relates to an LLP that is classified as a partnership for income tax purposes.

The most immediate advantage of partnership income tax status is the pass-through aspect of profit and loss to its partners. This treatment avoids the double taxation applicable to C corporations, once on earnings at the corporate level [*I.R.C. § 11*; *Rev. & Tax. Code §§ 23038, 23151*] and again on dividend and appreciated property distributions at the shareholder level [*I.R.C. §§ 1(h)(11)* (taxation of dividends at capital gains rates), *61(a)(7), 301(a),* (c), *316*]. LLPs have an additional advantage over C corporations in that LLPs can specially allocate items of income, gain, loss, deduction, and distributions pursuant to the partnership agreement, within the restrictions of *I.R.C. § 704(b)*. Further, LLPs are not subject to accumulated earnings taxes [*I.R.C. § 531 et seq.*] and personal holding company taxes [*I.R.C. § 541 et seq.*] that may be imposed on C corporations.

Whether tax transparency to partners is beneficial depends on the applicable tax rates and the amount of income involved. Pass-through (and therefore, selection of an LLP over a C corporation) may be beneficial if an individual partner's tax rate is less than the federal corporate tax rate. The maximum individual tax rate after 2002 is 35 percent [*I.R.C. § 1(a)- (d), (i)(2)*]. In contrast, the maximum federal corporate tax for taxable income between $75,000 and $10 million is 34 percent. For taxable income over $10 million, the maximum corporate tax rate is 35 percent [*I.R.C. § 11(b)(1)*]. An additional 5 percent tax is imposed on corporate taxable income exceeding $100,000, with an $11,750 cap on additional tax liability. This causes an effective tax rate of 39 percent on taxable income between $100,000 and $335,000. A 3 percent additional tax is imposed on corporate taxable income exceeding $15 million, with a $100,000 cap on additional tax liability. This causes an effective tax rate of 38 percent on corporate taxable income between $15 million and $18,333,333. Corporate taxable income over $18,333,333 is subject to a tax rate of 35 percent [*I.R.C. § 11(b)(1)*].

Thus, the pass-through of income may not be beneficial, especially if the business needs to retain its earnings and does not plan significant cash distributions to its owners. However, because LLP income taxation is at the partner level if it is taxed as a partnership, partners who are not C corporations may benefit from the maximum 15 percent capital gain income tax rate [*I.R.C. § 1(h)(1)(C)*, effective generally for tax years ending on or after 5/16/03 and before 2009; *see* Pub. Law No. 108-27, §§ 301, 303]. Most legal services or public accountancy LLPs will probably distribute most of their net income to their partners and will probably not regularly have capital gains, so these detriments to transparency may not be important.

One advantage of a corporation available to holders of "small business stock" is that half the gain from sale of the stock may be excluded under certain circumstances [*I.R.C. § 1202*]. In addition, shareholders of a "small business corporation" in some circumstances may deduct as an ordinary loss losses from the sale, exchange or worthlessness of their stock in the business which ordinarily would be capital losses [*I.R.C. § 1244*]. These provisions are not available to partners of LLPs but ordinarily would not be of major import to shareholders of a professional corporation.

An important tax difference between corporations and LLPs may arise if an appreciated asset is to be contributed to the entity's capital in exchange for an ownership interest. Unless the transferors are in "control" of the corporation immediately after the exchange, they will recognize gain in the amount of the fair market value of the acquired interest in the corporation over the tax basis of the property transferred [*I.R.C. § 351(a)*]; no such control requirement applies to contributions to an LLP by its partners [*I.R.C. § 721(a)*].

There is also an important difference between the basis of a shareholder in a C corporation in the corporation's stock and of an LLP partner in an LLP interest. The stock basis of the C corporation shareholder is not affected by the gains or losses realized by the C corporation while the bases of LLP partners (and S corporation shareholders) in their ownership interests are increased by allocations to them of gains and profits earned by their company and decreased by allocations to them of losses incurred by the company [*I.R.C. §§ 705(a), 1367(a)*]. Losses of C corporations therefore are retained at the corporate level; losses of LLPs and S corporations that flow through to the owners may be used by them to offset other income, subject to extremely complex rules involving primarily the owner's basis and the application of passive loss limitations.

Typically, an LLP partner suffers no adverse tax consequences on liquidation [*I.R.C. § 731(b)*; *see § 16C.60*]; an LLP partner will not recognize gain unless the distribution exceeds the partner's adjusted basis in the LLP immediately before the distribution [*I.R.C. § 731(a)*]. However, shareholders of C corporations are subject to potential double taxation on liquidation [*I.R.C. §§ 331, 336*].

In addition to federal taxes, both LLPs and C corporations must pay state taxes and fees to do business in California. For example, LLPs must pay a minimum franchise tax [*Rev. & Tax. Code §§ 17948-17948.2*; *see Rev. & Tax. Code §§ 23151, 23153(d)(1)*; *see also § 16C.61*]. C corporations must pay either a state franchise tax or an income tax [*see Rev. & Tax. Code §§ 23101 et seq., 23501 et seq.*], and may be subject to other fees.

There are a number of other tax rules that differ as between C corporations and the other entities considered here. They include differences as to methods of accounting that may be used, taxable years that may be elected, and others.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsBasis (IRC secs. 704, 705, 722-724, 731-735, 737, 742, 751, 754, 755)General OverviewTax LawFederal Taxpayer GroupsS CorporationsGeneral Overview



29 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Comparison of LLPs With Other Business Entities

8-16C California Legal Forms--Transaction Guide § 16C.42

AUTHOR: by Kristin M. Schwaighart

§ 16C.42 Professional Corporations

The corporate practice of law, architecture, and public accounting is permitted in California [*see Corp. Code § 13400 et seq.*; *see also Bus. & Prof. Code §§ 5150 et seq., 6160 et seq.*]. However, the former tax incentives that once might have outweighed the double taxation that affects a C corporation [*see § 16C.41[3]*] but not an LLP, such as increased pension contributions, increased insurance benefits, and tax deferrals through the selection of a tax year, have been largely eroded.

Under the LLP legislation and the present rules for professional corporations, those corporations may have some cost advantage over LLPs. Compare State Board of Accountancy Rule 75.8 with the description of an accountancy LLP's security requirements in § 16C.21[4][d][i], and compare Law Corporation Rule IV.B with § 16C.21[4][d][ii].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawProfessional Associations & CorporationsTax LawState & Local TaxesIncome TaxCorporations & Unincorporated AssociationsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Comparison of LLPs With Other Business Entities

8-16C California Legal Forms--Transaction Guide § 16C.43

AUTHOR: by Kristin M. Schwaighart

§ 16C.43 S Corporations

[1] Definition

S corporation status is primarily a creature of federal and state tax law [*see I.R.C. § 1361* et seq.; *Rev. & Tax. Code § 23800 et seq.*]. While retaining the corporate characteristic of limited liability [*see § 16C.42* (professional corporations)], a corporation can generally secure pass-through tax status by filing an S election on Form 2553 with the Internal Revenue Service and Form 100S with the Franchise Tax Board [*see I.R.C. § 1362*; *see also Rev. & Tax. Code § 23801*]. However, S corporations are subject to structural [*see* [2], *below*] and tax restrictions [*see* [3], *below*] not applicable to LLPs.

[2] Structural Restrictions Applicable to S Corporations

S corporation shareholder status is subject to several restrictions. An S corporation may not have (1) more than 100 shareholders; (2) shareholders who are not individuals other than estates [*see I.R.C. § 1361(b)(1)(A), (B), (c)(3)*], certain enumerated types of trusts [*see I.R.C. § 1361(b)(1)(B), (c)(2), (d), (e)*], qualified subchapter S subsidiaries [*see I.R.C. § 1361(b)(3)*], and certain exempt organizations [*I.R.C. § 1361(b)(1)(B)*; *see I.R.C. § 1361(c)(6)*]; or (3) shareholders who are nonresident aliens [*I.R.C. § 1361(b)(1)(C)*]. LLPs may have an unlimited number of partners (provided that they are licensed attorneys or accountants) and may have a variety of classes of members and classes of interests. In contrast, S corporations may not have more than one class of stock [*I.R.C. § 1361(b)(1)(D), (c)(4)*].

A corporation that has a valid election under *I.R.C. § 1362(a)* in effect for federal purposes will be an S corporation under California tax law [*Rev. & Tax. Code § 23801(a)*], and its shareholders will be shareholders of an S corporation without regard to whether the corporation is qualified to do business or is incorporated in California [*Rev. & Tax. Code § 23801(b)*].

[3] Tax Treatment

LLPs classified as partnerships for income tax purposes and S corporations are not subject to federal income taxation at the LLP/corporate level. Most items of S corporation income and loss (and their tax attributes) pass through to the shareholders [*I.R.C. §§ 1361*-1379]. The profits and losses of an LLP classified as a partnership can be allocated among partners and classes of partners, within IRS restrictions, by its partnership agreement, provided that the allocation relates to the partner's interest in the partnership or has substantial effect [*see I.R.C. § 704(a), (b)*]. Each S corporation shareholder, however, recognizes and reports a pro rata share, based on share holdings, of the corporation's income, loss, deductions, and credits; S corporations are not permitted to specially allocate these items [*I.R.C. §§ 1366, 1377(a)*]. An S corporation shareholder does not have a basis in the corporation's debts (except debt to that shareholder) to use as passed through losses [*I.R.C. § 1366(d)*]. Partners of such an LLP are entitled to basis for its debts [*I.R.C. §§ 701-704, 752*], even though the debts are nonrecourse as to the partners.

S corporations may be subject to penalty taxes for certain built-in gains [*I.R.C. § 1374*] and on excessive passive income [*I.R.C. § 1375*; *see Rev. & Tax. Code § 23811*]. LLPs classified as partnerships are not subject to these penalties.

The death of an S corporation shareholder and changes in the number and identity of shareholders may result in the termination of the S election [*I.R.C. § 1362(d)(2)*] and unexpected and unwelcome loss of the corporation's tax status, but does not affect the basis of the assets of the corporation [*I.R.C. § 1014(a)*]. In contrast, an LLP faced with the death or withdrawal of a partner or admission of new partners may encounter a timing and recognition problem regarding the closing of the LLP taxable years of either the continuing LLP or the deceased member [*see I.R.C. §§ 706, 708*; *see also Treas. Reg. § 1.706-1(c)*] and, if not continued by the remaining partners, could face dissolution and winding up.

At the California level, LLPs are not subject to income taxation at the entity level if classified as a partnership for federal purposes, but are subject to the annual minimum franchise tax [*Rev. & Tax. Code §§ 17948-17948.2*; *see Rev. & Tax. Code §§ 23151, 23153(d)(1)*; *see also § 16C.61*].

California generally conforms to the federal tax treatment of S corporations. However, S corporations are subject to an annual minimum franchise tax [*Rev. & Tax. Code §§ 23151, 23153(d)(1), 23802(c)*], as well as a 1.5 percent income tax at the corporate level [*Rev. & Tax. Code 23802(b)(1)*; *see Rev. & Tax. Code 23802(b)(2)* (applicable rate for financial corporations)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability PartnershipsContracts LawTypes of ContractsPartnership AgreementsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsLiabilities (IRC sec. 752)Tax LawFederal Taxpayer GroupsS CorporationsGeneral OverviewTax LawFederal Taxpayer GroupsS CorporationsShareholders (IRC secs. 1361, 1362, 1366, 1377)Determination of Tax Liability



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Comparison of LLPs With Other Business Entities

8-16C California Legal Forms--Transaction Guide § 16C.44

AUTHOR: by Kristin M. Schwaighart

§ 16C.44 Limited Partnerships

[1] Formation and Operation

Since law, architecture, and accounting firms do not organize as limited partnerships, this discussion is largely academic except for possible reference if the right to operate as an LLP in California is expanded beyond those fields.

LLPs and limited partnerships essentially involve the association of two or more persons to form and carry on a business; a limited partnership requires one or more general partners and one or more limited partners [*Corp. Code §§ 15901.02(q), 16101, 16202(a)*]. Formal formation requirements are minimal: LLPs must file a simple registration with the Secretary of State and must have an oral or written partnership agreement; LLPs converting from general partnerships generally have pre-existing partnership agreements [*see Corp. Code §§ 16101(6), 16202(a)*]. Similarly, limited partnerships must file a simple certificate of limited partnership (Form LLP-1) with the Secretary of State and must have an oral or written partnership agreement [*Corp. Code §§ 15901.02(x), 15902.01*].

[2] Limited Liability

Partners of registered LLPs that meet the requirement for that status and provide the required security [*see § 16C.21[4][d]*] and limited partners of properly structured and operated limited partnerships are ordinarily shielded from personal liability for partnership obligations [*Corp. Code §§ 15903.03, 16306(c)*]. Nevertheless, both LLP partners and limited partners may be liable beyond the amount of their capital contributions under certain circumstances [*see § 16C.23*; *see also Corp. Code §§ 16306(c), (d), (e),* 15903.03]. Personal liability attaches to a partner of a limited partnership executing a Form LP-1 knowing it to be false. Because the person executing this form is usually the general partner, and general partners have unlimited liability for the limited partnership's obligations [*Corp. Code § 15904.04*], this limitation rarely affects the status of the limited partners. However, a limited partner who participates in the control of the limited partnership's business is treated as a general partner and loses the protection of limited liability [*Corp. Code § 15903.03*)]. LLPs are not required to have a partner who is personally liable for the debts of the LLP, even if they participate in management, but one or more LLP partners may agree to assume additional liability [*see Corp. Code*

§ 16306(c), (d)].

[3] Tax Treatment

LLPs and limited partnerships, if both qualify for partnership tax treatment, provide income tax transparency to the LLP partners and limited and general partners: partners are subject to tax [*I.R.C. § 701*]. This treatment avoids for both the double-level taxation imposed on corporations. LLPs, like limited partnerships, may elect their tax status for federal purposes under the federal entity classification rules [*Treas. Reg. § 301.7701-3*; *see also § 16C.60*].

Both LLPs and limited partnerships must pay the minimum franchise tax annually if they do business in California, and remain liable for this tax until dissolution documents [*see Corp. Code §§ 15623, 15696*, 15902.03, 15909.07], are filed [*Rev. & Tax. Code §§ 17935, 17948-17948.2, 23151, 23153(d)(1)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawLimited PartnershipsFormationBusiness & Corporate LawLimited PartnershipsManagement Duties & Liabilities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Comparison of LLPs With Other Business Entities

8-16C California Legal Forms--Transaction Guide § 16C.45

AUTHOR: by Kristin M. Schwaighart

§ 16C.45 General Partnerships

[1] Formation and Operation

General partnerships and LLPs (which generally retain their general partnership nature) essentially involve the association of two or more persons to associate to form and carry on as co-owners a business for profit [*Corp. Code §§ 16101(6), (8), 16202(a)*]. Formal formation requirements are minimal: LLPs must file a registration with the Secretary of State [*Corp. Code § 16953*] and, if a legal services LLP, must obtain a certificate of registration from the California State Bar [*see* State Bar LLP Rules and Regulations, Rule 3.1 (§ 16C.231)]. General partnerships have no formal filing requirements, and need not have a formal oral, written, or express partnership agreement [*see Cochran v. Board of Supervisors (1978) 85 Cal. App. 3d 75, 81, 149 Cal. Rptr. 304* ; *see also Leff v. Gunter (1983) 33 Cal. 3d 508, 514-518, 189 Cal. Rptr. 377, 658 P.2d 740]* . However, most general partnerships have some form of written agreement to handle the formal or informal business arrangements that the partners participate in, and that, subject to proof as to the specifics of the agreement and the rules of the Uniform Partnership Act of 1994, define the partners' relationships with each other. An LLP converting from non-LLP general partnerships typically would have a pre-existing partnership agreement [*see Corp. Code §§ 16101(6), (8), 16202(a)*], which should be carefully examined to determine changes that may be required or desirable to take advantage of LLP status [*see § 16C.22[4]*].

Both general partnerships and LLPs allow for the participation of any number of principals in the conduct of the business, distributing work, and sharing risks and rewards [*Corp. Code §§ 16301, 16401*]. Each partner is an agent of a general partnership for the purpose of its business and the act of a partner for apparently carrying on in the usual way the partnership business binds the partnership [*Corp. Code § 16301*]. Each LLP partner is a similar agent of the LLP with similar powers [*Corp. Code § 16301*].

[2] Liability

A major difference between LLPs and general partnerships is that LLP partners can limit their liability by registering as an LLP and satisfying the security requirements [*Corp. Code §§ 16306, 16953, 16956, 16959*]. With certain exceptions,

such as for personal tortious conduct, LLP partners are not personally liable for the LLP's obligations [*Corp. Code § 16306(c), (e)*] unless they agree to be liable [*Corp. Code § 16306(d)*] or guarantee its obligations [*Corp. Code § 16306(h)*]. Limitations on liability are discussed in *§ 16C.23* and security requirements are discussed in *§ 16C.21[4][d]*.

In contrast, all the assets of general partners are exposed to claims arising from obligations of the general partnership [*Corp. Code §§ 16305, 16306*]. General partners are jointly and severally liable for wrongful acts and omissions of any partner acting in the ordinary course of partnership business [*Corp. Code §§ 16305(a), 16306(a)*] and for the misapplication of funds or property by other partners [*Corp. Code § 16305(b)*]. Further, partners are jointly for the obligations of the partnership and severally liable [*see Corp. Code § 16306(a)*; *see also Corp. Code § 16100 et seq.*]. This extensive liability of general partners and the recourse to each partner's personal assets constitutes a fundamental disadvantage of a general partnership compared to an LLP, and is the primary motivating factor behind a partnership's determination to convert to a registered LLP.

[3] Tax Treatment

LLPs that elect partnership tax treatment, and general partnerships provide income tax transparency to the LLP partners and general partners: partners are subject to tax [*I.R.C. § 701*]. This treatment avoids for both the double-level taxation imposed on corporations. However, LLPs, because they must have two partners, may choose to be classified for federal tax purposes as either a partnership or an association (taxable as a corporation) [*Treas. Reg. § 301.7701-3(a)*; *see § 16C.60*].

LLPs, unlike general partnerships, must pay the minimum franchise tax annually if they do business in California, and remain liable for this tax until dissolution documents, including a tax clearance certificate, are filed [*Rev. & Tax. Code §§ 17851.5, 17948-17948.2, 23151, 23153(d)(1)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawGeneral PartnershipsManagement Duties & LiabilitiesCauses of ActionPartnership LiabilitiesBusiness & Corporate LawLimited Liability Partnerships



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Comparison of LLPs With Other Business Entities

8-16C California Legal Forms--Transaction Guide § 16C.46

AUTHOR: by Kristin M. Schwaighart

§ 16C.46 Limited Liability Companies

The following discussion is extremely brief because (1) the LLP form may be used only by attorneys, architects, or public accountants to practice law, architecture, or public accountancy, and (2) professionals (including attorneys, architects, and public accountants) cannot practice through an LLC, or as a registered foreign LLC, in California [*Corp. Code § 17375*]. With this caveat, many consider that an LLC has very favorable attributes compared to other business entities, principally because it limits its members' liability for its obligations, it is very flexible, it can have a structure as simple or as complex as desired, and its members can achieve pass-through income tax treatment, even if active in management, without affecting their limited liability. For more detailed discussion of LLCs, see Ch. 12C, *Limited Liability Companies* .

LLCs, like LLPs, are extremely simple to organize: LLCs must file simple articles of organization (Form LLC-1) with the Secretary of State and must have an oral or written operating agreement [*Corp. Code § 17050(a)*]; LLPs must file a simple registration with the Secretary of State [*Corp. Code § 16953*] or register with the relevant state regulatory body, and typically already have pre-existing partnership agreements [*see Corp. Code §§ 16101(6), (8), 16202(a)*], which they may modify to deal with partners' limited liability. Legal services LLPs must apply to the California State Bar for a certificate of registration and renew it annually [*see § 16C.21[1]*].

Partners of LLPs and members and managers of properly structured LLCs are shielded from personal liability from company obligations [*Corp. Code §§ 16306(c), 17101(a), 17158*]. Nevertheless, both LLP partners and LLC members and managers may be liable in amounts exceeding their capital contributions, for example, in the case of personal tortious conduct or pursuant to the terms of a written guarantee or other contractual obligation entered into by the member outside the operating agreement [*Corp. Code §§ 16306(d), 17101(c), 17158*].

Properly structured LLCs, like LLPs, if both qualify for partnership tax treatment, provide income tax transparency to their members and partners [*I.R.C. § 701*]. Both LLCs and LLPs must pay the minimum franchise tax annually if they do business in California, and remain liable for this tax until dissolution documents, including a tax clearance

certificate, are filed [*Rev. & Tax. Code §§ 17941, 17948, 17948.2, 23151, 23153(d)(1)*; *see § 16C.61*]. However, LLCs but not LLPs must also pay a graduated fee on income over $250,000 [*Rev. & Tax. Code § 17942(a)*; *see Rev. & Tax. Code § 17942(d)* (penalty for underpayment)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability CompaniesGeneral OverviewBusiness & Corporate LawLimited Liability CompaniesFormationBusiness & Corporate LawLimited Liability CompaniesManagement Duties & LiabilitiesBusiness & Corporate LawLimited Liability Partnerships



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Comparison of LLPs With Other Business Entities

8-16C California Legal Forms--Transaction Guide § 16C.47

AUTHOR: by Kristin M. Schwaighart

§ 16C.47 Conversion Costs

[1] Introduction

Discussion in the preceding sections compares and contrasts the LLP format with other business formats (C corporations, professional corporations, S corporations, limited partnerships, general partnerships, and LLCs) from the perspective of two or more persons considering forming or converting to a California registered LLP to provide law or public accounting and determining which type of available entity best suits their needs. This section focuses on two key factors that should be evaluated in that context. These are (1) the additional costs of dissolving an existing entity [*see* [2], *below*], and (2) converting an entity into an LLP and the tax consequences, if any, of a change in ownership of business real property [*see* [3], *below*].

Many of the other costs involved in creating an LLP or converting to that form are likely to be much the same for an LLP as for any other format available in California to persons engaged in the practice of law or public accountancy: professional fees (such as attorneys, accountants, and appraisers), which tend to fluctuate with the complexity of the proposed business structure; filing fees (State Bar application fees are $200 for a law professional corporation and $50 a partner up to a $2,500 maximum for a legal services LLP); and other normal formation costs.

[2] Dissolution of Existing Entity

A professional corporation organized under the General Corporation Law may not at present be merged into a general partnership, so that its conversion to an LLP would require its dissolution and its net assets to be contributed to the new LLP. Such a dissolution and redeployment of some or all of its assets in an LLP can be costly, involving, by way of example, the following:

- Obtaining consent of shareholders [*see, e.g., Corp. Code § 1900*]. Usually this cost would be nominal.

- Preparing and mailing notices to creditors and claimants and document filings and recordings [*see, e.g., Corp. Code §§ 1901, 1903, 1905, 15621, 15623*, 15902.03, 15908.07].

- Paying or assuming outstanding debts and liabilities [*see, e.g., Corp. Code §§ 2001-2009, 15683*, 15908.09, *16807*]. This could involve significant negotiations with creditors who will be expected to continue to do business with the successor registered LLP and with clients, who will need to be educated as to the difference in their rights as to the LLP and its partners. Both could be apprehensive about the new format.

- Paying or assuming tax liabilities [*see, e.g., Corp. Code §§ 2001, 16807*]. This could be time consuming but ordinarily not difficult.

- Valuing, liquidating, and distributing business assets [*see, e.g., Corp. Code §§ 2004-2007, 16401, 16807, 15684*; *see also Com. Code §§ 6101-6111* (bulk sales)].

- Terminating existing professional licenses and registrations, and obtaining new ones.

- Arranging for assignments to the LLP of ongoing agreements, licenses, etc. and (more problematic) consents to those assignments.

The dissolution of a professional corporation and its reincarnation as a registered LLP would not be a tax-free reorganization so the income tax cost of such a transaction should be carefully reviewed with tax counsel.

The conversion of a general partnership into a registered LLP does not constitute a termination of the partnership, at least if the individual partnership interests remain the same [*see Rev. Rul. 95-55, 1995-2 C.B. 313* ; *see § 16C.60*], and is generally tax neutral. Since the partnership would continue in existence, presumably its existing agreements, licenses, etc. would remain in effect. To satisfy ethical obligations, clients should be informed. To avoid creditor apprehension as to future credit worthiness of the LLP, discussion and explanations may be advisable.

[3] Property Taxation of Changes in Ownership

Ordinarily, transfers of any interest in real property between a corporation and a partnership, and a shareholder, partner, or any other person, and between entities, constitute changes in ownership [*Rev. & Tax. Code §§ 61(j), 62*; *see 18 Cal. Code Reg. § 462*] that may result in the reassessment of the value of the real property and a resulting change in real property taxes [*see* Cal. Const. art. XIIIA, § 2]. However, no change in ownership occurs if the transfer between entities (or by individuals to an entity) preserves the previous owners' proportionate interests in the property and the transfer is only a change in the method of holding title to the property [*Rev. & Tax. Code § 62(a)*; *see Rev. & Tax. Code § 64(b)* (exemption for affiliated group transfers)]. Because the conversion of a general partnership into an LLP retains the partnership status, the reorganization should not cause a reassessment, at least in the absence of changes in partnership interests. Similarly conversion of a professional corporation (by dissolution and reformation) into a registered LLP, if the shareholders/partners reclaim the same proportionate interests should not trigger reassessment.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability PartnershipsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsContinuations & Terminations of Partnerships (IRC sec. 708)Tax LawState & Local TaxesIncome TaxPartnerships



35 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
D. Comparison of LLPs With Other Business Entities

8-16C California Legal Forms--Transaction Guide §§ 16C.48-16C.59

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.48[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
E. Taxation of LLPs

8-16C California Legal Forms--Transaction Guide § 16C.60

AUTHOR: by Kristin M. Schwaighart

§ 16C.60 Income Taxation of LLPs

[1] General Rule

Under California law, a registered LLP remains a partnership for tax purposes [*Rev. & Tax. Code § 28.5*]. Registered LLPs can be pass-through tax entities in the same manner as general partnerships. The key question is whether an LLP will be classified for federal tax purposes as a partnership or as an association [*Treas. Reg. § 301.7701-3(a)*; *see* [2], *below*].

[2] Classification of LLP as Association or Partnership

[a] Election of Entity Classification

After 1996, an LLP may elect its tax status for federal purposes under the federal entity classification rules [*see Treas. Reg. § 301.7701-3*]. Because an LLP must have two partners, it may choose to be classified for federal tax purposes as either a partnership or an association taxable as a corporation [*Treas. Reg. § 301.7701-3(a)*]. This election is available when an LLP is initially formed and wishes to elect an initial classification that differs from the default classification [*Treas. Reg. § 301.7701-3(a)*; *see* [b], *below*]. Subject to the limitation that an entity ordinarily may change its entity classification only once every 60 months [*Treas. Reg. § 301.7701-3(c)(4)*], the election is also available for an existing LLP that wishes to change its classification [*Treas. Reg. § 301.7701-3(a)*].

PRACTICE TIP:

Before 1997, an LLP's classification for federal tax purposes depended on the presence or absence of corporate characteristics as set forth in prior regulations. The IRS issued a revenue ruling, the so-called "New York ruling," in which it analyzed those corporate characteristics in classifying a New York LLP [*Rev. Rul. 95-55, 1995-2 C.B. 313*]. Because of the elective classification rules set forth in the regulations, the classifications rules in *Revenue Ruling 95-55* are now obsolete [*see 1997-1 C.B. 348, Notice 97-1*].

[b] Default Classification if No Election Made

The entity classification of an LLP that does not make an affirmative entity classification election [*see* [a], *above*] is determined under a default classification. The default classification for an LLP that was in existence on January 1, 1997, is the classification that it claimed immediately before January 1, 1997. For an LLP that successfully met the guidelines of *Rev. Rul. 95-55, 1995-2 C.B. 313, Rev. Rul. 95-55*], the default classification would be a partnership.

A newly formed domestic LLP will be classified as a partnership under the default rules if it has at least two members. Since California law requires at least two members, a new LLP's default entity status is a partnership [*Treas. Reg. § 301.7701-3(b)(1)*]. An LLP's default classification continues until the LLP elects to change its classification be means of an affirmative election [*Treas. Reg. § 301.7701-3(b)(3)*].

Because the default provisions provide the tax classification--as a partnership--that LLPs will almost always choose, the only LLPs that need to file an election are those that were treated as associations taxable as corporations before 1997 under *Rev. Rul. 95-55* [*see Rev. Rul. 95-55, 1995-2 C.B. 313*].

[c] Transition Rule for Pre-1977 Periods for LLPs in Existence on January 1, 1997

A special transition rule applies for LLPs (and other entities) that were in existence on January 1, 1997. The IRS will not challenge the prior classification of an LLP in existence on that date for periods before 1997 if the following requirements are met [*Treas. Reg. § 301.7701-3(f)(2)*]:

- The LLP had a reasonable basis (within the meaning of *Internal Revenue Code § 6662*) for its claimed classification;

- The LLP and all its members recognized the federal tax consequences of any change in the LLP's classification within the 60 months before January 1, 1997; and

- Neither the LLP nor any member had been notified in writing on or before May 8, 1996, that the classification of the LLP was under examination.

[d] LLP's Entity Status for California Tax Purposes

Under California partnership and corporation law, a registered LLP remains a partnership for tax purposes [*Corp. Code § 16101(8)(A), (9)*; *Rev. & Tax. Code § 28.5*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability PartnershipsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral OverviewTax LawState & Local TaxesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
E. Taxation of LLPs

8-16C California Legal Forms--Transaction Guide § 16C.61

AUTHOR: by Kristin M. Schwaighart

§ 16C.61 Minimum California Franchise Tax

Every LLP doing business in California [*see Rev. & Tax. Code § 23101* (definition of "doing business in California" for tax purposes)] and required to file an informational return [*see Rev. & Tax. Code § 18633*] must pay an annual minimum franchise tax for the privilege of doing business in California [*Rev. & Tax. Code §§ 17948-17948.2, 23151, 23153(d)(1)*]. In addition, every registered LLP and every registered foreign LLP not covered by the preceding sentence that has registered with the Secretary of State must pay this tax annually [*Rev. & Tax. Code § 17948(b)*; *see Rev. & Tax. Code § 17948.2* (no liability if LLP did no business in California and taxable year was not more than 15 days)].

The tax must be paid annually until a notice of cessation is filed with the Secretary of State [*see Corp. Code §§ 16954, 16960*; *see also § 16C.24*], or a foreign LLP withdraws its registration [*see Corp. Code § 16960*; *see also § 16C.33*], or the registered or foreign LLP has been dissolved and finally wound up [*Rev. & Tax. Code § 17948(b)*]. A registered LLP will not be subject to the tax for a taxable year if it (1) files a timely final annual return [*see* Rev. & Tax. Code § 17948.3(b)(definition)] with the Franchise Tax Board for the preceding taxable year, (2) does not do business in California after the end of the taxable year for which the final return was filed, and (3) files a notice of cessation [*see* Corp. Code §§ 16954(b), 16960(b)] with the Secretary of State before the end of the 12-month period beginning with the date the final tax return was filed [Rev. & Tax. Code § 17948.3(a)].

PRACTICE TIP:

The Secretary of State includes a notice, in its instructional materials provided in conjunction with the registration form, that filing the LLP registration obligates the LLP to pay the annual minimum tax for that taxable year [*Corp. Code §§ 16953(g), 16959(g)*; *see Rev. & Tax. Code § 17948*]. The notice will be updated annually to specify the dollar amount of that tax [*Corp. Code § 16953(g)*]. If an LLP files a return that is designated as its final return, the Franchise Tax Board will notify the LLP that the annual tax is due annually until a certificate of cancellation is filed [*Rev. & Tax. Code § 17948(d)*; *see Corp. Code §§ 16954, 16960*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
E. Taxation of LLPs

8-16C California Legal Forms--Transaction Guide § 16C.62

AUTHOR: by Kristin M. Schwaighart

§ 16C.62 Liability for Sales Taxes on Termination

On the termination, dissolution, or abandonment of a registered or foreign (whether or not registered) LLP, any partner or other person having control or supervision, or who is charged with responsibility for the filing, of sales tax returns or the payment of tax, is personally liable for any unpaid sales taxes, plus any interest or penalties if the failure is willful [*Rev. & Tax. Code § 6829(a), (d)* ("willful" defined as an intentional, conscious, and voluntary course of action); *see State Board of Equalization v. Wirick (2001) 93 Cal. App. 4th 411, 413, 419, 112 Cal. Rptr. 2d 919* (*Rev. & Tax. Code § 6829* applied to former chief financial officer of corporation, despite fact that he had resigned position over one year before corporation ceased business; because present tense in statute includes past tense, section covers former officers as well as those in charge when corporation ceases)]. The partner or other person is only liable for the taxes that became due during the period that he or she had the control, supervision, responsibility, or duty to act for the LLP [*Rev. & Tax. Code § 6829(b)*], and only if the State Board of Equalization can establish that the LLP (1) included or added tax reimbursement in to the selling price of tangible personal property sold in the conduct of partnership business or (2) consumed tangible personal property and failed to pay the tax to the seller or has included use tax on the billing and collected the use tax or issued a receipt for the use tax without reporting and paying use tax [*Rev. & Tax. Code § 6829(c)*; *see Rev. & Tax. Code § 6829(f)* (notice of deficiency determination)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability PartnershipsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsGeneral OverviewTax LawState & Local TaxesSales TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART II. LEGAL BACKGROUND
E. Taxation of LLPs

8-16C California Legal Forms--Transaction Guide §§ 16C.63-16C.99

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.63[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-16C California Legal Forms--Transaction Guide § 16C.100

AUTHOR: by Kristin M. Schwaighart

§ 16C.100 Facts

NOTE:

This Transaction Guide is designed for use by general partnerships converting to legal services LLPs, architecture LLPs, or public accountancy LLPs. For a more general approach to forming and operating a general partnership and preparing a partnership agreement, see Ch. 15, Part A, ***Formation of General Partnerships*** .

The following list of facts and documents is drafted for use in the context of a general partnership converting to an LLP. Therefore, many of these facts may be ascertainable from an existing partnership agreement. For more specific facts and documents needed to form and operate an LLP and to prepare a partnership agreement, see Ch. 15, Part A, ***Formation of General Partnerships*** .

1. Information regarding partners.

a. Name.

b. Resident address, including county, and telephone number.

c. Business address and telephone number.

d. Citizenship, e.g., United States citizen, resident alien, or citizen of country other than United States.

e. Social security number.

f. Taxable year.

g. Marital status.

h. Age.

i. Estimated net worth.

j. Projected annual income.

k. Capital account information.

l. Professional experience, reputation, ongoing education, and license information.

2. Information regarding partnership.

a. Name.

b. Date of organization.

c. Jurisdiction of organization.

d. Type of business conducted.
(1) Legal services.

(2) Public accountancy services.

(3) Services related to practice of law or public accountancy.

(4) Architectural services.

e. Term of partnership.

f. Tax identification number.

g. Location of principal office and mailing addresses of all partnership offices.

h. Financial data about partnership, including net worth of partnership assets.

3. Information regarding any additional partners to be added or expelled, or any partners resigning, at time of conversion [*see* P 1, *above*].

NOTE:
The addition, expulsion, or resignation of partners at the time of conversion may have Proposition 13 consequences. [*Rev. & Tax. Code §§ 62(a), 64(b)*; ***see*** *§ 16C.47[3]*].

4. Information concerning existing insurance policies, including general liability and professional malpractice policies.

5. Past history of claims against existing professional liability insurance policies.

6. Desired effective date of conversion to LLP status.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawLimited Liability PartnershipsContracts LawTypes of ContractsPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-16C California Legal Forms--Transaction Guide § 16C.101

AUTHOR: by Kristin M. Schwaighart

§ 16C.101 Documents

1. Current copy of existing partnership agreement, including any amendments.

2. Any separate agreements to make contributions to partnership.

3. Any agreements by partner(s) guaranteeing any partnership debt or obligation.

4. Documents evidencing ownership of real or personal property, including deeds or other instruments.

5. Existing contracts, such as leases or employment agreements that will be transferred to LLP.

6. Any existing fictitious business name certificate.

NOTE:
On registration of an LLP, no new fictitious business name statement is required under *Bus. & Prof. Code § 17900 et seq.* [*Corp. Code § 16961*].

7. Insurance policies:

a. Policies on all real and personal property.

b. Any policies used to fund any cross purchase agreements.

c. Professional liability policies.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawLimited Liability PartnershipsContracts LawTypes of ContractsPartnership Agreements



42 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-16C California Legal Forms--Transaction Guide §§ 16C.102-16C.109

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.102[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-16C California Legal Forms--Transaction Guide § 16C.110

AUTHOR: by Kristin M. Schwaighart

§ 16C.110 Reformulating Partnership as Legal Services LLP

NOTE:

The following list is drafted for use in the context of a general partnership converting to an LLP. For more basic determinations necessary to form and operate a partnership or LLP and to prepare a partnership agreement, see Ch. 15, Part A, ***Formation of General Partnerships*** .

1. Determine identity of client, and whether or not potential conflict of interest exists as to [*see* Cal. Rules *Prof. Cond.*, *Rules 3-310*, *3-600*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*]:

a. All partners and partnership.

b. Partnership.

c. One or more partners.

2. Determine current policy limits of existing professional liability policies held by partnership.

a. Ascertain total coverage per licensed person.

b. Ascertain policy limits of any umbrella policy.

3. Evaluate whether partnership can afford to provide security for claims against it based on acts, errors, or omissions out of its practice of law satisfying combination of following requirements [*see Corp. Code § 16956(a)(2), (b)*]:

NOTE:

In addition to the financial burden of satisfying statutory security requirements in order to limit liability, legal services LLPs must file registration documents with the Secretary of State [***see*** *Corp. Code § 16953*] and the State Bar [***see*** *§ 16C.231* (State Bar LLP Rules and Regulations, Rule 4.0); ***see also*** *§ 16C.21[2][a]*]. Filing fees should also be considered in the cost benefit analysis to determine whether or not to reformulate as an LLP [***see*** *Gov. Code § 12189*].

Unless using net worth method discussed in (c), below, each partner automatically guarantees payment of difference between maximum amount of security required and amount provided under (a) and/or (b), ***below***.

a. Maintaining insurance against liability imposed on or against it by law for damages arising out of claims subject to $7.5 million maximum.

NOTE:

The amount of security for legal services LLPs with five or fewer licensed persons may not be less than $1 million. For partnerships with more than five licensees rendering professional services on behalf of the partnership, an additional $100,000 insurance must be obtained for each additional licensee [Corp. Code § 16596(a)(2)(A); ***see*** *§ 16C.21[d]*].

b. Maintaining security in form of cash, bank certificates of deposit, U.S. treasury obligations, letters of credit, and similar assets [*see § 16C.21[4][d][ii]*] subject to $7.5 million maximum.

NOTE:

The minimum amount of security for legal services LLPs with five or fewer licensed persons may not be less than $1 million. For partnerships with more than five licensees rendering professional services on behalf of the partnership, an additional $100,000 of security must be obtained for each additional licensee. [Corp. Code § 16596(a)(2)(B); ***see*** *§ 16C.21[d]*].

c. Confirming that, as of last day of its most recently completed fiscal year, its net worth was $15,000,000.

4. If significant amounts of additional capital are needed to increase professional liability policy limits (or other acceptable forms of security) evaluate history of partnership to determine whether protections of LLP form outweigh additional expense.

5. Determine whether partnership is willing to increase its reporting obligations.

NOTE:

In addition to satisfying statutory security requirements in order to limit liability [***see*** P 3, ***above***], LLPs must file registration documents with the Secretary of State [***see*** *Corp. Code § 16953*]. Further, if facts set forth in filed documents change, such as a change in address or LLP name, additional filings are required [***see*** *Corp. Code § 16954*]. If the LLP uses the net worth security alternative [***see*** *Corp. Code § 16956(a)(2)(D)*], the LLP must file an additional form and update it annually [***see*** *Corp. Code §§ 16953(a), 16956(a)*; ***see also*** *§ 16C.202* (Form LLP-3)]. Finally, a legal services LLP must file with the State Bar [***see*** *§§ 16C.21[2][a], 16C.23[2][a][ii]*].

6. Determine whether or not to amend partnership agreement.

NOTE:

The conversion of an existing professional partnership to an LLP almost inevitably requires significant

amendments to its partnership agreement [***see*** *§ 16C.130*]. Similarly, the creation of a new partnership that will be an LLP requires the drafting of provisions not usually found in a general partnership agreement. These amendments should not simply be grafted onto an existing agreement, but must be carefully analyzed and evaluated in the context of the complete partnership agreement; these amendments must be understood and agreed to by the partners. For example, provisions relating to the sharing of profits and losses among the partners must be carefully analyzed to determine whether the provisions would permit third parties, including bankruptcy trustees, to reach the personal assets of a "nonliable" partner through sharing obligations of partners and obligations of partners to their partnership. The agreement among the partners as to the treatment of liable and nonliable partners should be applied to each provision that might conceivably lead to the nonliable partners' assets [***see*** *§ 16C.22[4]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsFormationGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsBusiness & Corporate LawLimited Liability PartnershipsContracts LawTypes of ContractsPartnership AgreementsGovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-16C California Legal Forms--Transaction Guide § 16C.111

AUTHOR: by Kristin M. Schwaighart

§ 16C.111 Reformulating Partnership as Public Accountancy LLP

1. Determine identity of client, and whether or not potential conflict of interest exists as to [*see* Cal. Rules *Prof. Cond., Rules 3-310, 3-600*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*]:

a. All partners and partnership.

b. Partnership.

c. One or more partners.

2. Determine current policy limits of existing professional liability policies held by partnership.

a. Ascertain total coverage per licensed person.

b. Ascertain policy limits of any umbrella policy.

3. Evaluate whether partnership can afford to provide security for claims against it based on acts, errors, or omissions out of its practice of public accountancy satisfying combinations of following requirements [*see Corp. Code § 16956(a)(1), (b)*]:

NOTE:
In addition to the financial burden in satisfying statutory security requirements in order to limit liability, public accountancy LLPs must file registration documents with the Secretary of State [***see*** *Corp. Code § 16953*]. Filing fees should also be considered in the cost benefit analysis to determine whether or not to reformulate as an LLP [***see*** *Gov. Code § 12189*].

Unless using net worth method discussed in (c), below, each partner automatically guarantees payment of the difference between maximum amount of security required and amount provided under (a) and/or (b), ***below***.

a. Maintaining insurance against liability imposed on or against it by law for damages arising out of claims subject to $5 million maximum.

NOTE:
The total aggregate limited of liability under the policy for accounting services LLPs with five or fewer licensed persons may not be less than $1 million. For partnerships with more than five licensees rendering professional services on behalf of the partnership, an additional $100,000 of insurance must be obtained for each additional licensee. [Corp. Code § 16596(a)(1)(A); ***see*** *§ 16C.21[d]*].

b. Maintaining security in form of cash, bank certificates of deposit, U.S. treasury obligations, letters of credit, and similar assets [*see § 16C.21[4][d][i]*] subject to $5 million maximum.

NOTE:
The minimum amount of security for accounting services LLPs with five or fewer licensed persons may not be less than $1 million. For partnerships with more than five licensees rendering professional services on behalf of the partnership, an additional $100,000 of security must be obtained for each additional licensee. [Corp. Code § 16596(a)(1)(B); ***see*** *§ 16C.21[d]*].

c. Confirming that, as of last day of its most recently completed fiscal year, its net worth was at least $10,000,000.

4. If significant amounts of additional capital are needed to increase professional liability policy limits (or other acceptable forms of security) evaluatehistory of partnership to determine whether protections of LLP form outweigh additional expense.

5. Determine whether partnership is willing to increase its reporting obligations.

NOTE:
In addition to satisfying statutory security requirements in order to limit liability [***see*** P 3, ***above***], LLPs must file registration documents with the Secretary of State [***see*** *Corp. Code § 16953*]. If the LLP uses the net worth security alternative [***see*** *Corp. Code § 16956(a)(1)(D)*], the LLP must file an additional form [***see*** *Corp. Code §§ 16953(a), 16956(a)*; ***see also*** *§ 16C.202* (Form LLP-3)], and update that form annually [***see*** *Corp. Code § 16956(c)*]. Further, if facts set forth in filed documents change, such as a change in address or LLP name, additional filings are required [***see*** *Corp. Code § 16954*].

6. Determine whether or not to amend partnership agreement.

NOTE:
The conversion of an existing professional partnership to an LLP almost inevitably requires significant amendments to its partnership agreement [***see*** *§ 16C.130*]. Similarly, the creation of a new partnership that will be an LLP requires the drafting of provisions not usually found in a general partnership agreement. These amendments should not simply be grafted onto an existing agreement, but must be carefully analyzed and evaluated in the context of the complete partnership agreement; these amendments must be understood and agreed to by the partners. For example, provisions relating to the sharing of profits and losses among the partners must be carefully analyzed to determine whether the provisions would permit third parties, including bankruptcy trustees, to reach the personal assets of a

"nonliable" partner through sharing obligations of partners and obligations of partners to their partnership. The agreement among the partners as to the treatment of liable and nonliable partners should be applied to each provision that might conceivably lead to the nonliable partners' assets [***see § 16C.22[4]***].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawProfessional Associations & CorporationsContracts LawTypes of ContractsPartnership AgreementsGovernmentsState & Territorial GovernmentsLicensesInsurance LawGeneral Liability InsuranceConflicts of Interest



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-16C California Legal Forms--Transaction Guide § 16C.112

AUTHOR: by Kristin M. Schwaighart

§ 16C.112 Reformulating Partnership as Architectural Services LLP

1. Determine identity of client, and whether or not potential conflict of interest exists as to [*see* Cal. Rules *Prof. Cond., Rules 3-310, 3-600*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*]:

a. All partners and partnership.

b. Partnership.

c. One or more partners.

2. Determine current policy limits of existing professional liability policies held by partnership.

a. Ascertain total coverage per licensed person.

b. Ascertain policy limits of any umbrella policy.

3. Evaluate whether partnership can afford to provide security for claims against it based on acts, errors, or omissions out of its practice of architecture satisfying combinations of following requirements [*see Corp. Code § 16956(a)(3), (b)*]:

NOTE:

In addition to the financial burden in satisfying statutory security requirements in order to limit liability, architecture LLPs must file registration documents with the Secretary of State [***see*** *Corp. Code § 16953*]. Filing fees should also be considered in the cost benefit analysis to determine whether or not to reformulate as an LLP [***see*** *Gov. Code § 12189*].

Unless using net worth method discussed in (c), ***below***, each partner automatically guarantees payment of the difference between maximum amount of security required and amount provided under (a) and/or (b), ***below***.

a. Maintaining insurance of at least $100,000 per claim, per person licensed, authorized, registered, or otherwise lawfully able to render public accounting services in California, subject to $5 million maximum.

NOTE:
The minimum amount of security for architecture LLPs with less than five licensed persons may not be less than $500,000 (increased to $1 million on and after January 1, 2008) [Corp. Code § 16596(a)(3)(A); ***see*** *§ 16C.21[d]*].

b. Maintaining security in form of cash, bank certificates of deposit, U.S. treasury obligations, letters of credit, and similar assets [*see § 16C.21[4][d][i]*] of at least $100,000 per claim, per person licensed, authorized, registered, or otherwise lawfully able to render architectural services in California, subject to $5 million maximum.

NOTE:
The minimum amount of security for architecture LLPs with less than five licensed persons may not be less than $500,000 (increased to $1 million on and after January 1, 2008) [Corp. Code § 16596(a)(3)(A); ***see*** *§ 16C.21[d]*].

c. Confirming that, as of last day of its most recently completed fiscal year, its net worth was at least $10 million.

4. If significant amounts of additional capital are needed to increase professional liability policy limits (or other acceptable forms of security) evaluate history of partnership to determine whether protections of LLP form outweigh additional expense.

5. Determine whether partnership is willing to increase its reporting obligations.

NOTE:
In addition to satisfying statutory security requirements in order to limit liability [***see*** P 3, ***above***], LLPs must file registration documents with the Secretary of State [***see*** *Corp. Code § 16953*]. If the LLP uses the net worth security alternative [***see*** *Corp. Code § 16956(a)(3)(D)*], the LLP must file anadditional form [***see*** *Corp. Code § 16953(a), 16956(a)*; ***see also*** *§ 16C.202* (Form LLP-3)], and update that form annually [***see*** *Corp. Code § 16956(c)*]. Further, if facts set forth in filed documents change, such as a change in address or LLP name, additional filings are required [***see*** *Corp. Code § 16954*].

6. Determine whether or not to amend partnership agreement.

NOTE:
The conversion of an existing professional partnership to an LLP almost inevitably requires significant amendments to the partnership agreement [***see*** *§ 16C.130*]. Similarly, the creation of a new partnership that will be an LLP requires the drafting of provisions not usually found in a general partnership agreement. These amendments should not simply be grafted onto an existing agreement, but must be carefully analyzed and evaluated in the context of the complete partnership agreement; these amendments must be understood and agreed to by the partners. For example, provisions relating to the sharing of profits and losses among the partners must be carefully analyzed to determine whether the provisions would permit third parties, including bankruptcy trustees, to reach the personal assets of a

"nonliable" partner through sharing obligations of partners and obligations of partners to their partnership. The agreement among the partners as to the treatment of liable and nonliable partners should be applied to each provision that might conceivably lead to the nonliable partners' assets [***see § 16C.22[4]***].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawProfessional Associations & CorporationsContracts LawTypes of ContractsPartnership AgreementsGovernmentsState & Territorial GovernmentsLicensesInsurance LawGeneral Liability InsuranceConflicts of InterestInsurance LawMalpractice InsuranceArchitects & Engineers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-16C California Legal Forms--Transaction Guide §§ 16C.113-16C.119

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.113[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16C California Legal Forms--Transaction Guide § 16C.120

AUTHOR: by Kristin M. Schwaighart

§ 16C.120 Registration of Partnership as Legal Services LLP

NOTE:
The following guides are drafted for use in the context of an existing law or public accounting general partnership converting to an LLP. For more basic steps to form and operate a partnership or LLP and to prepare a partnership agreement, see Ch. 15, ***General Partnerships*** .

[1] Domestic LLP

1. If potential conflict of interest exists (e.g., if some partners oppose reformulation as LLP) [*see* Cal. Rules *Prof. Cond., Rules 3-310, 3-600*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*]:

a. Send conflict of interest disclosure letter.

b. If representing all partners, seek informed written consent from all partners to representation.

c. If representing one or more but not all partners, send written disclaimer to other partners identifying parties being represented, and nature of that representation.

2. Secure consents of partners to formation as LLP.

3. Select name of proposed LLP [*see Corp. Code § 16952*; *see also §§ 16C.21[3][a], 16C.270*].

NOTE:
The last words or letters of the name of an LLP must be "Registered Limited Liability Partnership" or

"Limited Liability Partnership" or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" [*Corp. Code § 16952*].

The LLP legislation does not state that an LLP must do business under its official name. Nevertheless, a conservatively-run LLP would almost certainly use its legal name when doing business in California or some name indicating the limited liability of its partners. The LLP Rules of the California State Bar require that an applicant for Bar certification must agree to practice only under the name filed with the State Bar [***see** § 16C.231* (State Bar LLP Rules and Regulations, Rule 3.3)].

4. Complete registration on official Form LLP-1 [*see §§ 16C.21[4][c]*, *16C.200*], setting forth all of following [*Corp. Code § 16953(a)*; *see § 16C.200*]:

a. Name of registered LLP.

b. Whether LLP is domestic or foreign.

c. Address of its principal office.

d. Name and address of LLP's agent for service of process on LLP in California.

e. Brief statement describing business in which partnership engages.

f. Statement that partnership is registering as registered LLP.

g. Any delayed effective date of registration.

h. Any other matters that LLP determines to include.

NOTE:
Because the certificate of registration is a public document and can only be changed by an amendment filed with the Secretary of State [***see** Corp. Code § 16954*; ***see also** §§ 16C.21[4][e]*, *16C.201*], it may be prudent to include in that form only the information actually required by statute.

5. If net worth security alternative is selected, prepare official Form LLP-3 [*see* Corp. Code § 16596(a)(2)(D); *see also §§ 16C.21[4][d]*, *16C.202*].

6. Ensure that all documents to be filed are properly executed.

NOTE:
Official forms filed with the Secretary of State must be executed and filed with the original signature of one or more authorized partners.

7. Prepare cover letter [*see § 16C.271* (o)].

8. File completed certificate of registration (and alternative security provision form if applicable [*see § 16C.202*]), cover letter [*see § 16C.270*], and filing fee with LLP Unit of Sacramento office of Secretary of State's office.

9. Complete and file State Bar certificate of registration.

10. File copies of consents and all other documents with partnership records.

11. Amend partnership agreement as necessary for conversion to LLP [*see §§ 16C.22[4], 16C.130*].

[2] Foreign LLP

1. If potential conflict of interest exists (e.g., if some partners oppose reformulation as LLP) [*see* Cal. Rules *Prof. Cond., Rules 3-310, 3-600*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*]:

a. Send conflict of interest disclosure letter.

b. If representing all partners, seek informed written consent from all partners to representation.

c. If representing one or more but not all partners, send written disclaimer to other partners identifying parties being represented, and nature of that representation.

2. Verify that foreign LLP is organized and currently registered and in good standing with state of organization [*see* P 9, *below*].

NOTE:

The laws of the jurisdiction under which a foreign LLP is organized govern its organization and internal affairs, as well as the liability and authority of its partners, subject to compliance with the applicable California security requirements [***see*** *Corp. Code § 16956, 16958(a)*; ***see also*** *§ 16C.31*]. A foreign LLP may not be denied registration by reason of any difference between those laws and the laws of California [*Corp. Code § 16958(a)(2)*].

3. Secure consents of partners to formation as LLP.

4. Verify that LLP name is acceptable [*see Corp. Code § 16958(b)*; *see also §§ 16C.32[2], 16C.270*].

NOTE:

The last words or letters of the name of an LLP must be "Registered Limited Liability Partnership" or "Limited Liability Partnership" or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" [*Corp. Code § 16958(b)*], or similar ending as authorized by the jurisdiction of formation [***see*** § 16C.210[2], Instructions to Form, item 1].

The LLP legislation does not state that an LLP must do business under its official name. Nevertheless, a conservatively-run LLP would almost certainly use its legal name when doing business in California or some name indicating the limited liability of its partners. The LLP Rules and Regulations of the California State Bar require that an applicant for Bar certification agree to practice only under the name filed with the State Bar [***see*** *§ 16C.231* (State Bar LLP Rules and Regulations, Rule 3.3)].

5. Complete registration on official Form LLP-1 [*see §§ 16C.32[3], 16C.200*], setting forth all of following [*Corp. Code § 16959(a)*; Form LLP-1; *see § 16C.200*]:

a. Name of foreign LLP.

b. Whether LLP is domestic or foreign and its jurisdiction.

c. Address of its principal office.

d. Name and address of agent for service of process in California [*see § 16C.32[4]*].

e. Brief statement describing business in which partnership engages.

f. Any delayed effective date of registration.

g. Any other matters that LLP determines to include.

NOTE:
Because the certificate of registration is a public document and can only be changed by an amendment filed with the Secretary of State [***see*** *Corp. Code § 16954*; ***see also*** *§§ 16C.32[3][f], 16C.201*], it may be prudent to include in that form only the information required by statute.

6. If net worth security alternative is selected, prepare official Form LLP-3 [*see* Corp. Code § 16596(a)(2)(D); *see also §§ 16C.21[4][d], 16C.202*].

7. Ensure that all documents to be filed are properly executed.

NOTE:
Official forms filed with the Secretary of State must be executed and filed with the original signature of one or more authorized partners.

8. Secure certificate of good standing from authorized public official in jurisdiction of formation or, if this certificate is not permissible in that jurisdiction, prepare statement that jurisdiction of formation does not permit issuance of certificates of good standing [*see Corp. Code § 16959(a)(2)*].

9. Prepare cover letter [*see § 16C.270*].

10. File completed application for registration (and alternative security provision form if applicable) with attached certificate of good standing or statement [*see* P 6, *above*], cover letter, and filing fee with LLP Unit of Sacramento office of Secretary of State's office.

11. Complete and file State Bar certificate of registration.

12. File copies of consents and all other documents with partnership records.

13. Amend partnership agreement if necessary for registering as LLP in California [*see §§ 16C.22[4], 16C.130*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawProfessional Associations & CorporationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon Agents



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16C California Legal Forms--Transaction Guide § 16C.121

AUTHOR: by Kristin M. Schwaighart

§ 16C.121 Registration of Partnership as Public Accountancy LLP

[1] Domestic LLP

1. If potential conflict of interest exists (e.g., if some partners oppose reformulation as LLP) [*see* Cal. Rules *Prof. Cond., Rules 3-310, 3-600*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*]:

a. Send conflict of interest disclosure letter.

b. If representing all partners, seek informed written consent from all partners to representation.

c. If representing one or more but not all partners, send written disclaimer to other partners identifying parties being represented, and nature of that representation.

2. Secure consents of partners to formation as LLP.

3. Select name of proposed LLP [*see Corp. Code § 16952*; *see also §§ 16C.21[3][a], 16C.270*].

NOTE:
The last words or letters of the name of an LLP must be "Registered Limited Liability Partnership" or "Limited Liability Partnership" or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" [*Corp. Code § 16952*].

The LLP legislation does not state that an LLP must do business under its official name. Nevertheless, a conservatively-run LLP would almost certainly use its legal name when doing business in California or

some name indicating the limited liability of its partners.

4. Complete registration on official Form LLP-1 [*see § 16C.21[4][b]*], setting forth all of following [*Corp. Code § 16953(a)*; *see § 16C.200*]:

a. Name of registered LLP.

b. Whether LLP is domestic or foreign.

c. Address of its principal office.

d. Name and address of LLP's agent for service of process on LLP in California.

e. Brief statement describing business in which partnership engages.

f. Statement that partnership is registering as registered LLP.

g. Any delayed effective date of registration.

h. Any other matters that LLP determines to include.

NOTE:
Because the certificate of registration is a public document and can only be changed by an amendment filed with the Secretary of State [***see*** *Corp. Code § 16954*; ***see also*** *§§ 16C.21[4][e], 16C.201*], it may be prudent to include in that form only the information required by statute.

5. If net worth security alternative is selected, prepare official Form LLP-3 [*see Corp. Code § 16956(a)(1)(D)*; *see also §§ 16C.21[4][d][i], 16C.202* (Form LLP-3)].

6. Ensure that all documents to be filed are properly executed.

NOTE:
Official forms filed with the Secretary of State must be executed and filed with the original signature of one or more authorized partners.

7. Prepare cover letter [*see § 16C.270*].

8. Verify that LLP is registered under *Bus. and Prof. Code § 5070 et seq.*

9. File completed certificate of registration (and alternative security provision form if applicable), cover letter, and filing fee with LLP Unit of Sacramento office of Secretary of State's office.

10. File copies of consents and all other documents with partnership records.

11. Amend partnership agreement as necessary for conversion to LLP [*see §§ 16C.22[4], 16C.130*].

12. File change of name with State Board of Accountancy, with applicable fee [*see* St. Bd. of Accountancy Rule 11A-36].

[2] Foreign LLP

1. If potential conflict of interest exists (e.g., if some partners oppose reformulation as LLP) [*see* Cal. Rules *Prof. Cond., Rules 3-310, 3-600*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*]:

a. Send conflict of interest disclosure letter.

b. If representing all partners, seek informed written consent from all partners to representation.

c. If representing one or more but not all partners, send written disclaimer to other partners identifying parties being represented, and nature of that representation.

2. Verify that foreign LLP is organized and currently registered and in good standing with state of organization [*see* P 9, *below*].

NOTE:

The laws of the jurisdiction under which a foreign LLP is organized govern its organization and internal affairs, as well as the liability and authority of its partners, subject to compliance with the applicable California security requirements [***see*** *Corp. Code § 16956, 16958(a)*; ***see also*** *§ 16C.31*]. A foreign LLP may not be denied registration by reason of any difference between those laws and the laws of California [*Corp. Code § 16958(a)(2)*].

3. Secure consents of partners to formation as LLP.

4. Verify that LLP name is acceptable [*see Corp. Code § 16958(b)*; *see also §§ 16C.32[2], 16C.270*].

NOTE:

The last words or letters of the name of an LLP must be "Registered Limited Liability Partnership" or "Limited Liability Partnership" or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" [*Corp. Code § 16958(b)*], or similar ending as authorized by the jurisdiction of formation [***see*** § 16C.210[2], Instructions to Form, item 1].

The LLP legislation does not state that an LLP must do business under its official name. Nevertheless, a conservatively-run LLP would almost certainly use its legal name when doing business in California or some name indicating the limited liability of its partners.

5. Complete registration on official Form LLP-1 [*see § 16C.32[3]*], setting forth all of following [*Corp. Code § 16959(a)*; *see § 16C.200*]:

a. Name of foreign LLP.

b. Whether LLP is domestic or foreign, and its jurisdiction.

c. Address of its principal office.

d. Name and address of agent for service of process in California [*see § 16C.32[4]*].

e. Brief statement describing business in which partnership engages.

f. Any delayed effective date of registration.

g. Any other matters that LLP determines to include.

NOTE:
Because the certificate of registration is a public document and can only be changed by an amendment filed with the Secretary of State [***see*** *Corp. Code § 16954*; ***see also*** *§§ 16C.32[3][f], 16C.201*], it may be prudent to include in that form only the information required by statute.

6. If net worth security alternative is selected, prepare official Form LLP-3 [*see Corp. Code § 16956(a)(1)(D)*; *see also §§ 16C.21[4][d][i], 16C.32[3][e], 16C.202* (Form LLP-3)].

7. Ensure that all documents to be filed are properly executed.

NOTE:
Official forms filed with the Secretary of State must be executed and filed with the original signature of one or more authorized partners.

8. Secure certificate of good standing from authorized public official in jurisdiction of formation or, if this certificate is not permissible in that jurisdiction, prepare statement that jurisdiction of formation does not permit issuance of certificates of good standing [*see Corp. Code § 16959(a)(2)*].

9. Prepare cover letter [*see § 16C.270*].

10. Verify that LLP is registered under *Bus. and Prof. Code § 5070 et seq.*

11. File completed application for registration (and alternative security provision form if applicable) with attached certificate of good standing or statement [*see* P 9, *above*], cover letter, and filing fee with LLP Unit of Sacramento office of Secretary of State's office.

12. File copies of consents and all other documents with partnership records.

13. Amend partnership agreement if necessary for registering as LLP in California [*see §§ 16C.22[4], 16C.130*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawProfessional Associations & CorporationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon AgentsContracts LawTypes of ContractsPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16C California Legal Forms--Transaction Guide § 16C.122

AUTHOR: by Kristin M. Schwaighart

§ 16C.122 Registration of Partnership as Architectural Services LLP

[1] Domestic LLP

1. If potential conflict of interest exists (e.g., if some partners oppose reformulation as LLP) [*see* Cal. Rules *Prof. Cond., Rules 3-310, 3-600*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*]:

a. Send conflict of interest disclosure letter.

b. If representing all partners, seek informed written consent from all partners to representation.

c. If representing one or more but not all partners, send written disclaimer to other partners identifying parties being represented, and nature of that representation.

2. Secure consents of partners to formation as LLP.

3. Select name of proposed LLP [*see Corp. Code § 16952*; *see also §§ 16C.21[3][a], 16C.270*].

NOTE:
The last words or letters of the name of an LLP must be "Registered Limited Liability Partnership" or "Limited Liability Partnership" or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" [*Corp. Code § 16952*].

4. Complete registration on official Form LLP-1 [*see § 16C.21[4][c]*], setting forth all of following [*Corp. Code § 16953(a)*; *see § 16C.200*]:

a. Name of registered LLP.

b. Whether LLP is domestic or foreign.

c. Address of its principal office.

d. Name and address of LLP's agent for service of process on LLP in California.

e. Brief statement describing business in which partnership engages.

f. Statement that partnership is registering as registered LLP.

g. Any delayed effective date of registration.

h. Any other matters that LLP determines to include.

NOTE:
Because the certificate of registration is a public document and can only be changed by an amendment filed with the Secretary of State [***see*** *Corp. Code § 16954*; ***see also*** *§§ 16C.21[4][e], 16C.201*], it may be prudent to include in that form only the information required by statute.

5. If net worth security alternative is selected, prepare official Form LLP-3 [*see Corp. Code § 16956(a)(3)(D)*; *see also §§ 16C.21[4][d][iii], 16C.202* 20 (Form LLP-3)].

6. Ensure that all documents to be filed are properly executed.

NOTE:
Official forms filed with the Secretary of State must be executed and filed with the original signature of one or more authorized partners.

7. Prepare cover letter [*see § 16C.270*].

8. File completed certificate of registration (and alternative security provision form if applicable), cover letter, and filing fee with LLP Unit of Sacramento office of Secretary of State's office.

9. File copies of consents and all other documents with partnership records.

10. Amend partnership agreement as necessary for conversion to LLP [*see §§ 16C.22[4], 16C.130*].

[2] Foreign LLP

1. If potential conflict of interest exists (e.g., if some partners oppose reformulation as LLP) [*see* Cal. Rules *Prof. Cond., Rules 3-310, 3-600*; *see also* Ch. 1A, *Role of Counsel in Starting a New Business*]:

a. Send conflict of interest disclosure letter.

b. If representing all partners, seek informed written consent from all partners to representation.

c. If representing one or more but not all partners, send written disclaimer to other partners identifying parties being represented, and nature of that representation.

2. Verify that foreign LLP is organized and currently registered and in good standing with state of organization [*see* P 9, *below*].

NOTE:

The laws of the jurisdiction under which a foreign LLP is organized govern its organization and internal affairs, as well as the liability and authority of its partners, subject to compliance with the applicable California security requirements [***see*** *Corp. Code §§ 16956, 16958(a)*; ***see also*** *§ 16C.31*]. A foreign LLP may not be denied registration by reason of any difference between those laws and the laws of California [*Corp. Code § 16958(a)(2)*].

3. Secure consents of partners to formation as LLP.

4. Verify that LLP name is acceptable [*see Corp. Code § 16958(b)*; *see also §§ 16C.32[2], 16C.270*].

NOTE:

The last words or letters of the name of an LLP must be "Registered Limited Liability Partnership" or "Limited Liability Partnership" or one of the abbreviations "L.L.P.," "LLP," "R.L.L.P.," or "RLLP" [*Corp. Code § 16958(b)*], or similar ending as authorized by the jurisdiction of formation [***see*** § 16C.210[2], Instructions to Form, item 1].

5. Complete registration on official Form LLP-1 [*see § 16C.32[3]*], setting forth all of following [*Corp. Code § 16959(a)*; *see § 16C.200*]:

a. Name of foreign LLP.

b. Whether LLP is domestic or foreign, and its jurisdiction.

c. Address of its principal office.

d. Name and address of agent for service of process in California [*see § 16C.32[4]*].

e. Brief statement describing business in which partnership engages.

f. Any delayed effective date of registration.

g. Any other matters that LLP determines to include.

NOTE:

Because the certificate of registration is a public document and can only be changed by an amendment filed with the Secretary of State [***see*** *Corp. Code § 16954*; ***see also*** *§§ 16C.32[3][f], 16C.201*], it may be prudent to include in that form only the information required by statute.

6. If net worth security alternative is selected, prepare official Form LLP-3 [see *Corp. Code § 16956(a)(3)(D)*; *see also §§ 16C.21[4][d][i], 16C.32[3][e], 16C.202* (Form LLP-3)].

7. Ensure that all documents to be filed are properly executed.

NOTE:

Official forms filed with the Secretary of State must be executed and filed with the original signature of one or more authorized partners.

8. Secure certificate of good standing from authorized public official in jurisdiction of formation or, if this certificate is not permissible in that jurisdiction, prepare statement that jurisdiction of formation does not permit issuance of certificates of good standing [*see Corp. Code § 16959(a)(2)*].

9. Prepare cover letter [*see § 16C.270*].

10. File completed application for registration (and alternative security provision form if applicable) with attached certificate of good standing or statement [*see* P 8, *above*], cover letter, and filing fee with LLP Unit of Sacramento office of Secretary of State's office.

12. File copies of consents and all other documents with partnership records.

13. Amend partnership agreement if necessary for registering as LLP in California [*see §§ 16C.22[4], 16C.130*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawProfessional Associations & CorporationsCivil ProcedurePleading & PracticeService of ProcessMethodsService Upon AgentsContracts LawTypes of ContractsPartnership Agreements



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-16C California Legal Forms--Transaction Guide §§ 16C.123-16C.129

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.123[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
D. Drafting Guide

8-16C California Legal Forms--Transaction Guide § 16C.130

AUTHOR: by Kristin M. Schwaighart

§ 16C.130 Legal Services, Architecture, or Public Accountancy LLP Agreement

NOTE:

The following guide is drafted for use in the context of an existing legal services, architecture, or public accounting general partnership converting to an LLP. For more basic steps to form and operate a partnership or LLP and to prepare a partnership agreement, see Ch. 15, Part A, ***Formation of General Partnerships*** .

1. State partnership name [*see §§ 16C.240[2],* P 1.01, *16C.241[2],* P 1.01].

2. Identify partnership as limited liability partnership [*see §§ 16C.240[2],* P 1.02, *16C.241[2],* P 1.02, *16C.242[2],* P 1.02].

3. Specify type of business in which partnership will engage:

a. Legal services [*see § 16C.240[2],* P 1.03].

b. Public accountancy services [*see § 16C.241[2],* P 1.03].

c. Services related to practice of law or public accountancy.

d. Architectural services [*see § 16C.242[2],* P 1.02].

4. Specify partnership term [*see §§ 16C.240[2],* P 1.04, *16C.241[2],* P 1.04].

a. Indefinite term, until terminated or dissolved by mutual agreement.
(1) Include provisions prescribing method for dissolution.

(2) Specify that bankruptcy of a partner or separation of partner (by withdrawal, death, incapacity, disability, retirement, termination, or expulsion) does not terminate the partnership.

b. Indefinite until occurrence of dissolution event.

5. Specify place(s) where partnership will conduct business, including [*see §§ 16C.240[2]*, P 1.05, *16C.241[2]*, P 1.05, *16C.242[2]*, P 1.05].

a. Addresses.

b. Name of each county.

6. Describe each partner's initial capital investment [*see §§ 16C.240[2]*, P 3.01, *16C.241[2]*, P 3.01, *16C.242[2]*].

a. State amount of cash and/or agreed fair market value of property or services contributed.

b. Describe fully any property or services contributed.

c. If cash contributions are made, specify following:

(1) Amount each partner will contribute.

(2) Bank and account where deposit will be made.

(3) Date by which each partner must make required deposit.

7. If desired, provide for special allocations of following items as they relate to contributed property:

a. Depreciation.

b. Depletion.

c. Gains on sales.

d. Losses on sales.

NOTE:
Special allocations regarding contributed property allow the partnership to take into account any variation between the contributing partner's basis in the property and its fair market value at the time of contribution [***see*** *I.R.C. § 704(b), (c)(2)*; *Treas. Reg. § 1.704-1(c)(2)*].

8. If desired, include provision ensuring that partners' capital investments remain in same proportion as their initial capital contributions by:

a. Prohibiting contributions without unanimous consent of partners.

b. Prohibiting withdrawals without unanimous consent of partners.

c. Requiring pro rata contributions from partners.

9. Specify conditions under which additional contributions may be required, including [*see §§ 16C.241[2],* P 3.05,, P 3.01, *16C.242[2],* P 3.05].

a. Guidelines for determining needed capital.

b. Method for determining amounts required from each partner.

c. Provision that partner who contributes portion greater than original share receives:

(1) Correspondingly greater share of partnership earnings, and

(2) Increase in partnership interest to reflect contribution.

d. Provision for reduction in percentage of partnership interest for partner who makes no contribution, or makes no additional contribution in proportion to original partnership interest.

10. Specify amounts, if any, of contributions to be treated as loans to partnership, including:

a. Terms for repayment, including interest.

b. Any security interest created in connection with sums advanced.

NOTE:
Subject to the partnership agreement, a partner who contributes capital in excess of the agreed amount is entitled to interest from the date of contribution [*Corp. Code § 16401(e)*].

11. If separate capital and income accounts are maintained, add [*see §§ 16C.240[2],* P 3.15, *16C.241[2],* P 3.13, *16C.242[2],* P 3.13].

a. Provision establishing accounts.

b. Provision for disposition of any unwithdrawn shares in partnership income.

(1) Automatic transfer to capital account at end of fiscal year.

(2) Transfer into capital account only with partner's consent.

12. Specify fiscal year [*see §§ 16C.240 [2],* P 3.13, *16C.241[2],* P 3.09, *16C.242[2],* P 3.09].

13. Specify method of accounting [*see §§ 16C.240 [2],* P 3.13, *16C.241[2],* P 3.08, *16C.242[2],* P 3.08].

14. Provide for distribution of partnership profits and losses, including:

NOTE:

Subject to contrary agreement, each partner is entitled to share equally in partnership profits, losses, and surplus [*Corp. Code § 16401(b)*]. Provisions should be added to ensure that the personal liability of the partners is not extended beyond *Corp. Code § 16401(c)* [***see*** *§§ 16C.240[2]*, P 6.04, *16C.241[2]*, PP 3.05, 3.12, 6.05, *16C.242[2]*, PP 3.05, 3.12, 6.05].

a. Salaries, if any, to be received by partners.

(1) Basis for payment (e.g., partner's special skills for which a portion of salary is to be paid, amount of time each partner will devote to partnership business, etc.).

(2) Whether salaries will be deducted before computing net profits and distributive shares, or charged against partners' shares of net profits.

NOTE:
To the extent that they are determined without regard to partnership income, payments made to a partner for services or use of capital are "guaranteed payments" [*I.R.C. § 707(c)*]. Guaranteed payments are gross income to the recipients and may generally be deducted by the partnership [***see*** *I.R.C. §§ 61(a), 162(a), 263, 707(c)*].

(3) If partner(s) engaged in management will receive additional salary, specify basis on which compensation will be determined.

NOTE:
Subject to contrary agreement, no partner is entitled to remuneration for conducting partnership business [*Corp. Code § 16401(h)*].

(4) Include provision for salary adjustments, if desired.

b. Include formula for computing partners' distributive shares in net profits and losses.

NOTE:
Subject to contrary agreement, each partner is entitled to share equally in partnership profits, losses, and surplus [*Corp. Code § 16401(b)*]. Provisions should be added to ensure that the personal liability of the partners is not extended beyond *Corp. Code § 16401(c)* [***see*** *§§ 16C.240[2]*, P 6.04, *16C.241[2]*, PP 3.05, 3.12, 6.05, *16C.242[2]*, PP 3.05, 3.12, 6.05].

c. Set forth time frame for distributions, such as monthly or quarterly.

d. If desired, provide for distributions to be made pursuant to specified vote of partners.

15. Include guidelines for partnership management.

a. Managing partner.

b. Management committee.

c. Management by majority vote of all partners.

d. Management by vote of all partners weighted according to their interests in net partnership profits.

16. Specify restrictions, if any, on authority of partners and managers.

17. Specify provisions governing partnership meetings, including:

a. Regular meetings at particular time and place.

b. Special meetings at call of designated number or percentage in interest of the partners.

c. Notice and waiver of notice.

d. Attendance in person, by electronic media, or waiver of attendance through signed written consent.

e. Regular minutes to be placed in partnership book.

18. Specify partners' voting rights on partnership matters.

NOTE:
Subject to contrary agreement, questions regarding partnership business may be decided by majority vote of the partners, but no act in contravention of the agreement may be done without unanimous consent [*Corp. Code § 16401(j)*].

a. Accord varying weight to partners' votes, if desired.

b. Specify any issues requiring voting margins other than a majority.

19. Set forth amount of time each partner is required to devote to partnership business [*see §§ 16C.240[2]*, P 4.01, *16C.241[2]*, P 4.01, *16C.242[2]*, P 4.01].

a. Undivided time.

b. Less than full time.

c. If desired, limit partner's right to engage in other business activities.

20. Include provisions limiting partners' power to incur partnership liabilities [*see §§ 16C.241[2]*, P 4.05, *16C.242[2]*, P 4.05].

a. Maximum amount of liability any partner may incur on behalf of the partnership.

b. Coordinate liability limits with provisions regarding partnership management (e.g., give managing partner exclusive authority to incur partnership liabilities).

c. Include provision for indemnification of partners by partnership for payments made and personal liabilities reasonably incurred [*Corp. Code § 16401(c)*]:

(1) In ordinary and proper conduct of partnership business.

(2) For the preservation of partnership business or property.

21. Specify manner in which accounts will be maintained, including [*see §§ 16C.241[2],* P 3.06, *16C.242[2],* P 3.06].

a. Requirement that proper partnership books be kept.

b. Provision for inspection of partnership books.

c. Accounting method to be used.

d. Partnership taxable year.

e. Requirement for periodic accountings to partners (e.g., at close of taxable year, quarterly).

f. If desired, specify institutions at which partnership accounts and safe-deposit boxes are established.

22. Specify partnership policies respecting the following [*see §§ 16C.240[2],* P 4.01, *16C.241[2],* PP 4.06, 4.07, *16C.242[2],* PP 4.06, 4.07].

a. Vacations.

b. Sick leave.

c. Extended absences.

d. Expense accounts.

23. Include any desired restrictions on transfer or assignment of partnership interests.

a. Prohibit transfer or encumbrance of partnership interest without consent of all or specified portion of partners.

b. Require that deceased partner's interest be liquidated or sold to remaining partners.

24. Provide for admission of new partners.

NOTE:
Subject to contrary agreement, no person can become a member of the partnership without the consent of all partners [*Corp. Code § 16401(i)*]. The admission of a new partner may require additional security partners [*Corp. Code § 16956(a)*; ***see*** *§§ 16C.240[2],* PP 4.07, 4.08, 6.04, *16C.241[2],* P 4.12, *16C.242[2],* P 4.12].

a. Specify required vote and selection process, such as hiring committee.

b. Specify method for allocating net profits and capital reserves to new partners.

25. Provide for partners' retirement [*see § 16C.240[2],* P 5.03].

a. Compulsory retirement at specified age, or

b. Voluntary retirement, or

c. Gradual retirement.

26. Provide for expulsion of partners [*see §§ 16C.240[2]*, P 5.02, *16C.241[2]*, P 5.01, *16C.242[2]*, P 5.01].

a. Bases for expulsion.

(1) Violation of any term contained in partnership agreement.

(2) Failure to make required contributions.

(3) Loss of professional license, threat of disciplinary action, or resignation from regulatory professional association.

(4) Bankruptcy.

(5) Assignment for benefit of creditors.

(6) Partner's involvement in litigation detrimental to partnership.

(7) Willful breach of partnership agreement.

(8) Disability extending beyond specified period.

(9) Partner's conviction of crime involving moral turpitude that affects partnership.

(10) Misconduct that reflects negatively on partnership.

b. Method in which expulsion will be accomplished.

(1) Require acquiescence of specified portion of partners.

(2) Set forth formal expulsion procedures (e.g., service of written notice signed by each partner on partner to be expelled).

27. Provide for disability of partner [*see §§ 16C.240[2]*, P 5.04, *16C.241[2]*, P 5.02, *16C.242[2]*, P 5.02].

28. Provide for retirement of partner [*see § 16C.240[2]*, P 5.03].

29. Provide for withdrawal of partner [*see §§ 16C.240[2]*, P 5.01, *16C.241[2]*, P 5.04].

30. Provide for death of partner [*see* § 166C.241[2], P 5.09, *16C.242[2]*, P 5.09].

31. Include method for valuation and purchase of expelled, retiring, withdrawing, or deceased partners' interests [*see §§ 16C.240[2]*, P 5.05, *16C.241[2]*, PP 5.06-5.08, *16C.242[2]*, PP 5.06-5.08].

a. Specify whether valuation will be partially or totally based on book value.

b. Provide for appraisal of partnership assets.

c. Include stipulation regarding value of partnership property in excess of book value.

NOTE:
Periodic updates and stipulations as to the fair market value of partnership assets will be an attractive method if such assets can be expected to substantially appreciate or decline in value. The book value will reflect decreases in asset value attributable to depreciation, but it will not necessarily represent fair market value of a partnership interest.

d. Include provision requiring partners to annually set value on all partnership interests.

e. Require all parties to agree on value at the time of loss of partner subject to arbitration if they are unable to agree.

32. Set forth terms under which an outgoing partner or his or her estate will be paid the balance in capital or other accounts.

a. Lump sum payment.

b. Periodic payments.

33. If desired, include provision for continuing payments to retired partners or deceased partners' successors in interest, specifying allocation among following bases:

NOTE:
The way in which the partnership agreement allocates liquidation payments will determine (1) whether or not the partnership will be able to deduct the payments, and (2) to what extent and in what manner the payments will be taxed to the recipient [*I.R.C. §§ 61(a), 707(c), 736(a), (b), 751(c)*].

a. Partnership income [*I.R.C. § 736(a)(1)*].

b. Guaranteed payments [*I.R.C. § 736(a)(2)*].

c. Unrealized receivables [*I.R.C. § 736(b)(2)(A)*].

d. Goodwill [*see I.R.C. § 736(b)(2)(A)*].

34. Specify procedures to be followed on dissolution [*see §§ 16C.240[2]*, P 5.09, *16C.241[2]*, Art. 5, *16C.242[2]*, Art. 5].

a. Continuation of partnership business by remaining partners

b. Termination and winding up of partnership affairs

35. If desired, include provision requiring arbitration of disputes among partners.

36. Specify manner in which partnership agreement may be amended.

37. Manner of handling clients.

a. Client of partnership rather than individual practitioner.

b. Effect of withdrawal of partner.

(1) Manner of notifying clients.

(2) Custody of files.

38. Provide for malpractice coverage and security compliance [*see §§ 16C.240[2]*, PP 4.07, 4.08, *16C.241[2]*, P 4.12, *16C.242[2]*, P 4.12].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawLimited Liability PartnershipsBusiness & Corporate LawProfessional Associations & CorporationsCivil ProcedureAlternative Dispute ResolutionGeneral OverviewContracts LawTypes of ContractsPartnership AgreementsTax LawFederal Income Tax ComputationValuationBusiness InterestsTax LawFederal Taxpayer GroupsLimited Liability Companies & PartnershipsTransactions Between Partner & Partnership (IRC sec. 707)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
D. Drafting Guide

8-16C California Legal Forms--Transaction Guide §§ 16C.131-16C.139

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.131[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

8-16C California Legal Forms--Transaction Guide § 16C.140

AUTHOR: by Kristin M. Schwaighart

§ 16C.140 Amending Filing Documents

[1] Domestic LLPs

NOTE:
The requisite accompanying filing fee is set forth in *Gov. Code § 12189* [*Corp. Code § 16954(c)*].

1. If any information set forth in registration (Form LLP-1) becomes inaccurate, or to add new information, file certificate of amendment (Form LLP-2) within reasonable time of occurrence of event causing discrepancy [*Corp. Code § 16954(a)*; *see § 16C.201*].

2. If any information set forth in the alternative security provision (Form LLP-3) becomes inaccurate, file certificate of amendment (Form LLP-2) within reasonable time of occurrence of event causing discrepancy [*Corp. Code § 16954(a)*; *see § 16C.201*].

3. If any information set forth in previously filed certificate of amendment becomes inaccurate, or to add new information, file certificate of amendment (Form LLP-2) within reasonable time of occurrence of event causing discrepancy [*Corp. Code § 16954(a)*; *see § 16C.201*].

[2] Foreign LLPs

NOTE:
The requisite accompanying filing fee is set forth in *Gov. Code § 12189* [*Corp. Code §*

16960(e)].

1. If any information set forth in certificate of registration (Form LLP-1) becomes inaccurate, or to add new information, file certificate of amendment (Form LLP-2) within reasonable time of occurrence of event causing discrepancy [*Corp. Code § 16960(a)*; *see § 16C.201*].

2. If any information set forth in the alternative security provision (Form LLP-3) becomes inaccurate, file certificate of amendment (Form LLP-2) within reasonable time of occurrence of event causing discrepancy [*Corp. Code § 16960(a)*; *see § 16C.201*].

3. If any information set forth in previously filed certificate of amendment becomes inaccurate, or to add new information, file certificate of amendment (Form LLP-2) within reasonable time of occurrence of event causing discrepancy [*Corp. Code § 16960(a)*; *see § 16C.201*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

8-16C California Legal Forms--Transaction Guide § 16C.141

AUTHOR: by Kristin M. Schwaighart

§ 16C.141 Withdrawal or Cessation of LLP

1. If foreign LLP retains its LLP status but is no longer required to be registered in California, LLP may withdraw its registration by filing notice of change of status (Form LLP-4) [*Corp. Code § 16960(c)*; *see Gov. Code § 12189(d)*; *see also § 16C.203*].

2. If domestic or foreign LLP ceases to be an LLP, file notice of change of status (Form LLP-4) [*Corp. Code §§ 16954(b), 16960(b)*; *see § 16C.203*] accompanied by applicable filing fee [*Corp. Code §§ 16954(c), 16960(e)*; *see Gov. Code § 12189(c), (d)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

8-16C California Legal Forms--Transaction Guide §§ 16C.142-16C.199

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.142[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
A. Official Forms of the Secretary of State

8-16C California Legal Forms--Transaction Guide § 16C.200

AUTHOR: by Kristin M. Schwaighart

§ 16C.200 Registration [Form LLP-1]

[1] Comment

[a] Use of Form

This form is official Form LLP-1, Registered Limited Liability Partnership Registration, used to register a domestic or foreign LLP with the Secretary of State. To secure the benefits of limited liability, an LLP must register with the Secretary of State [*Corp. Code §§ 16953(a), 16959(a)(1)*]. Only firms engaged in the practice of architecture, the practice of public accountancy, the practice of law, or practices related or complementary to the practice of public accountancy or law may register as an LLP [*Corp. Code § 16101(8)*]. A foreign LLP transacting intrastate business in California must register with the Secretary of State within 30 days after the date on which the foreign LLP first transacts intrastate business in California [*Corp. Code § 16959(a)(1)*]. The use of this form is mandatory, and copies may be obtained from the office of the Secretary of State [*see Corp. Code §§ 16953(g), 16959(g)*].

The registration must be executed with the original signature of one or more authorized partners [*Corp. Code §§ 16953(a), 16959(a)(1)*]. Neither facsimiles nor photocopies of the executed certificate will be accepted for filing [*see* Instructions to Form, item 11].

The executed registration must be filed, together with the filing fee [*Corp. Code §§ 16953(b), 16959(b)*; *see Gov. Code § 12189*], with the Limited Liability Partnership Unit in the Sacramento office of the Secretary of State [*see* Instructions to Form]. For a cover letter to submit with the registration, see *§ 16C.270*.

In addition, a foreign LLP registering in California must attach to the registration a certificate from an authorized public official of the foreign LLP's jurisdiction of organization to the effect that the foreign LLP is in good standing in that jurisdiction. If the jurisdiction of organization does not permit the issuance of a certificate of good standing, the foreign LLP must attach a statement that the laws of its jurisdiction of organization do not permit the issuance of certificates of good standing [*Corp. Code § 16959(a)(2)*].

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 16C.200. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Contents of Registration

The registration must set forth all of the following [*Corp. Code § 16953(a)*; *see* [2], *below*]:

- The name of the registered LLP.
- Whether the LLP is domestic or foreign, and its jurisdiction.
- The address of its principal office.
- The name and address of its agent for service of process in California [*see § 16C.22[3]*].
- A brief statement describing the business in which the partnership engages.
- A statement that the partnership is registering as a registered LLP.
- Any delayed effective date.
- The name and address of the individual or firm to whom acknowledgment of the filing should be sent.

In addition, the registration may include any other matters that the LLP determines to include [Corp. Code §§ 16593(a), *16959(a)(1)*]. However, because the registration form is a public document and can only be changed by an amendment filed with the Secretary of State [*see Corp. Code §§ 16954, 16960(a)*], it may be prudent to include in this form only the information required by statute.

[c] When Transmittal Form Evidencing Compliance With Alternative Security Provision Required

If an LLP selects the third alternative security provision (that is, the net worth requirement), the registration must be accompanied by a transmittal form (Form LLP-3) confirming compliance with that requirement [*see Corp. Code § 16956*]. For further discussion, see *§ 16C.21[4][d]* and *§ 16C.202*.

[d] Registration With State Bar

The Office of Certification of the State Bar has adopted rules and regulations governing registration of California attorneys to practice law in the LLP form [*see §§ 16C.230* (application for registration), *16C.231* (rules and regulations)]. For further discussion, see *§§ 16C.21[2][a]* and *16C.23[2][a][ii]*.

[2] FORM

Registration [Form LLP-1]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
A. Official Forms of the Secretary of State

8-16C California Legal Forms--Transaction Guide § 16C.201

AUTHOR: by Kristin M. Schwaighart

§ 16C.201 Amendment of Registration [LLP-2]

[1] Comment

[a] Use of Form

This form is official Form LLP-2, Limited Liability Partnership Amendment of Registration. Use of this form is mandatory [*see Corp. Code §§ 16954(d), 16960(d)*]. Copies of LLP-2 may be obtained from any Secretary of State's office.

Domestic and foreign LLPs must file an amendment to the registration within a reasonable time after any information set forth in the initial registration [*see § 16C.200*], the alternative security provision [*see § 16C.202*], or any previously filed certificate of amendment becomes inaccurate, or to add information to the registration or previously filed certificate of amendment [*Corp. Code §§ 16954(a), 16960(a)*].

The amendment must be executed with the original signature of one or more authorized partners [*Corp. Code §§ 16954(a), 16960(a)*]. Neither facsimiles nor photocopies of the executed certificate will be accepted for filing [*see* Instructions to Form, item 4].

The executed certificate must be filed, together with the filing fee [*Corp. Code §§ 16954(c), 16960(e)*; *see Gov. Code § 12189*], with the Limited Liability Partnership Unit in the Sacramento office of the Secretary of State [*see* Instructions to Form].

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at

cal.custquest@bender.com and requesting an electronic copy of CLF Form 16C.201. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

[b] Contents of Certificate

The certificate of amendment must contain the following information:

- The LLP's name, as registered with the Secretary of State.
- The Secretary of State's file number.
- The text of the amendment [*see* Instructions to Form, item 3].
- The name and address of the individual or firm to whom acknowledgment of the filing should be sent.

[2] FORM

Amendment of Registration [LLP-2]

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58 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
A. Official Forms of the Secretary of State

8-16C California Legal Forms--Transaction Guide § 16C.202

AUTHOR: by Kristin M. Schwaighart

§ 16C.202 Limited Liability Partnership Alternative Security Provision [LLP-3]

[1] Comment

[a] Use of Form

This form is official Form LLP-3, Limited Liability Partnership Alternative Security Provision. Use of this form is mandatory [*see Corp. Code §§ 16953(a), 16959(a), 16956(a), (c)*]. Copies of LLP-3 may be obtained from any Secretary of State's office.

PRACTICE TIP

ELECTRONIC FORMS NOTE: Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 16C.202. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Form LLP-3 must be filed in two situations:

- When a domestic or foreign LLP relies on the net worth security alternative when initially filing its registration [see *§ 16C.200*], the LLP must file Form LLP-3 with the registration [*Corp. Code §§ 16953(a), 16956(a)(1)(D), (2)(D), (b), 16959(a)*].

- When a domestic or foreign LLP relies on the net worth security alternative, the LLP must annually confirm compliance by filing Form LLP-3 [*Corp. Code § 16956(c)*].

In both situations, there is no filing fee that must accompany LLP-3 [*see* Instructions to Form].

Form LLP-3 must be executed with the original signature of one or more authorized partners. Neither facsimiles nor photocopies of the executed certificate will be accepted for filing [*see* Instructions to Form, item 7]. The executed Form LLP-3 must be filed with the Limited Liability Partnership Unit in the Sacramento office of the Secretary of State.

CAUTION:

At the time of publication, Form LLP-3, reproduced below, had not yet been updated by the Secretary of State's office to reflect 1998 legislative changes authorizing architectural services LLPs.

[b] Contents of Form

The alternative security provision (Form LLP-3) must contain the following information:

- The nature of the filing [*see* [a], *above*].
- The name of the registered LLP or the foreign LLP.
- The Secretary of State's file number.
- The jurisdiction of organization.
- The address of the principal office.
- Statement identifying the nature of the LLP services and confirming the requisite net worth.
- The name and address of the individual or firm to whom acknowledgment of the filing should be sent.

[2] FORM

Limited Liability Partnership Alternative Security Provision [LLP-3]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
A. Official Forms of the Secretary of State

8-16C California Legal Forms--Transaction Guide § 16C.203

AUTHOR: by Kristin M. Schwaighart

§ 16C.203 Limited Liability Partnership Notice of Change of Status [LLP-4]

[1] Comment--Use of Form

This form is official Form LLP-4, Limited Liability Partnership Notice of Change of Status. Use of this form is mandatory [*see Corp. Code §§ 16954(d), 16960(d)*]. Copies of LLP-4 may be obtained from any Secretary of State's office.

ELECTRONIC FORMS NOTE:

Electronic copies of this form that may be printed out and filled in for filing can be obtained at the official website of the California Secretary of State, Business Programs Division, which is located at http://www.ss.ca.gov/business/business.htm. You may also obtain a copy of this form via email by contacting Matthew Bender & Co. at (800) 424-0651, ext. 405, or emailing us at cal.custquest@bender.com and requesting an electronic copy of CLF Form 16C.203. Please be sure to include your email address along with your request and we will provide the form via return email. To view and print these forms, your computer system will need Adobe Acrobat Reader version 3.0 or higher.

Whenever a registered domestic or foreign LLP ceases to be a registered LLP, it must file this notice with the Secretary of State stating that it is no longer a registered domestic or foreign LLP [*Corp. Code §§ 16954(b), 16960(b)*]. Similarly, if a foreign LLP remains an LLP, but is no longer required to be registered in California [*see Corp. Code § 16959(a)*], the foreign LLP may withdraw its registration by filing Form LLP-4 [*Corp. Code § 16960(c)*].

Form LLP-4 must be executed with the original signature of one or more authorized partners. Neither facsimiles nor photocopies of the executed certificate will be accepted for filing [*see* Instructions to Form, item 5]. The executed Form LLP-4 must be filed with the Limited Liability Partnership Unit in the Sacramento office of the Secretary of State [*see* Instructions to Form], together with the applicable filing fee [*see Corp. Code § 16954(c), 16960(e); see also Gov. Code § 12189(c), (d)*]. The notice must state that a final annual tax return [*see* Rev. & Tax. Code § 17948.3] has been or will

be filed with the Franchise Tax Board [Corp. Code § 16954(b)]. The Secretary of State will notify the Franchise Tax Board of the cessation [Corp. Code § 16954(e)].

[2] FORM

Limited Liability Partnership Notice of Change of Status [LLP-4]

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60 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
A. Official Forms of the Secretary of State

8-16C California Legal Forms--Transaction Guide §§ 16C.204-16C.229

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.204[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
B. Official Forms of the State Bar of California

8-16C California Legal Forms--Transaction Guide § 16C.230

AUTHOR: by Kristin M. Schwaighart

§ 16C.230 Application for Issuance of Certificate of Registration as LLP [LLP 101]

[1] Comment

[a] Use of Form

This form is the official Application for Issuance of Certificate of Registration as a Limited Liability Partnership with the State Bar of California. The form, available from the State Bar web site at http://www.calbar.org/2cer/llp/llpapply.htm, consists of the following parts:

- Instructions for completing the application.
- Application form.
- Attachment 1: List of all attorneys and/or law corporation partners in the LLP.
- Attachment 2: List of all non-partners, including employees and all other persons and/or law corporations practicing in the LLP, association, and/or "of counsel" with the LLP in a continuous relationship.
- Attachment 3: Declaration of compliance with *Rule 1-400, Rules of Professional Conduct.*

The application form and attachments 1 through 3 must be completed and returned to the State Bar. The application must be accompanied by an original certified copy (including the cover with the red date stamp) of the Secretary of State's Certificate of Registration (LLP-1), or by an original certified copy of the Secretary of State's Foreign LLP Application for Registration (LLP-5), as appropriate, and by the required non-refundable application fee (currently $50 per partner, to a maximum of $2500).

For detailed instructions, see the first page of this form. For a copy of the State Bar's LLP Rules and Regulations, see *§ 16C.231*. For answers to questions that arise while completing the form, call the State Bar at (415) 241-2100.

[b] Information Regarding Persons Practicing Law

Attachment 1 requires the names of all attorney and/or law corporation partners in the LLP. Attorney license/member number need only be provided for attorneys licensed to practice in California [*see* form instructions].

Attachment 2 requires the names of all non-partners, including employees and all other persons and/or law corporations practicing in the LLP, association, and/or "of counsel" with the LLP in a continuous relationship. "Continuous relationship" means co-counsel, contract attorneys, persons sharing office space, and/or any person practicing "of counsel" to the LLP [*see* form instructions].

[c] Registration Requirements

An LLP providing legal services must have a currently effective certificate of registration issued by the California State Bar if the liability of its partners is to be limited for professional malpractice claims against the partnership or other partners [*Corp. Code § 16306(f)*]. All partnerships providing accounting services must register with the State Board of Accountancy [*see Bus. & Prof. Code § 5070 et seq.*]; there is no separate registration requirement for accountancy LLPs.

In addition, all LLPs must register with the Secretary of State, using a separate form (Form LLP-1) [*Corp. Code § 16953(a)*; *see § 16C.200*].

[d] Effective Date of Registration

For LLPs that register with the Secretary of State [*see § 16C.21[4]*] after January 1, 1996, and apply to the State Bar after that registration, the effective date of State Bar registration is the date the complete application is received by the State Bar, unless a later effective date is requested and granted before the certificate is issued [State Bar LLP Rules and Regulations, Rule 7.1; *see § 16C.231*]. Once the application is received, complete and correct, accompanied by the appropriate fee, the State Bar will mail a certificate of registration to the LLP.

[e] Acknowledgment of Receipt of Application

With each application packet, the State Bar includes an Acknowledgment of Receipt in the form of a postcard. To receive a record of the date on which the application is received by the State Bar, that postcard must be completed, stamped, and included with the completed application. The State Bar will return completed, stamped postcards to the LLP with a date stamp indicating receipt of the application.

[f] Change of Address

The official address of record of an LLP is maintained by the State Bar's Office of Certification. To change the LLP's address of record, that office must be notified in writing.

Change of an individual bar member's official State Bar address must be sent separately to the Membership Records Office of the State Bar. Changing an address with one office does not change that address with the other office [*see* the instructions page to this form, Instruction 2].

[2] FORM

Application for Issuance of Certificate of Registration as LLP [LLP 101]

Specific Instructions

A $50 per partner (not to exceed $2,500) non-refundable fee must accompany this application.

(Numbers Correspond to Questions on the Application Form.)

1. Fill in the complete name of the limited liability partnership (LLP). This name must be the same name set forth on the Secretary of State's Registered Limited Liability Partnership Registration (LLP-1).

2. Fill in the address of record for the LLP. Please note that the "official LLP address of record" is maintained by the Office of Certification. To change the address of record of the LLP or to file any special reports other than the Annual Report, notification must be forwarded in writing to The Office of Certification, LLP, The State Bar of California, 180 Howard Street, San Francisco, CA 94105. Note that change of an individual's bar member's official State Bar address must be sent to the Membership Records Office of the State Bar. Changing your address with one office does not change it with the other office.

3. Fill in the name and the direct dial telephone number, if available, of the person the State Bar will contact should issues arise. If the mailing address of the contact person is different than where the LLP practices, answer all questions in this box.

4. Fill in the name of the partner or partners authorized to act on behalf of the LLP for State Bar purposes. If the authorized partner is a law corporation, set forth the complete name of the corporation. A shareholder of the law corporation may sign on behalf of the corporation wherever the signature of the authorized partner is required. Please specify that you are signing on behalf of the corporation.

5. Complete and submit the following:

A. Attachment 1. List the names of all attorney and/or law corporation partners in the LLP. Attorney License/Member Number need only be provided for attorneys licensed to practice in California. For Jurisdiction(s) in which Admitted to Practice, list only states and/or countries. If your LLP includes a partner or partners who are licensed only in a non-U.S. jurisdiction, see State Bar LLP Rule 4.3. If a partner is licensed in more than one jurisdiction, list the primary jurisdiction first. (A partner licensed to practice law in California will be entered as a California partner unless you specify otherwise.) You may attach additional pages if necessary.

NOTE:
If you list the name of a law corporation partner on Attachment 1, do not list the shareholder(s) as an individual attorney partner(s), unless the shareholder(s) and the law corporation are separate partners in the LLP.

B. Attachment 2. List the names of all non-partners, including employees and all other persons and/or law corporations practicing in partnership, association and/or "of counsel" with the LLP in a continuous relationship. "Continuous relationship" means co-counsel, contract attorneys, any person sharing office space, and/or any person practicing "of counsel" to the LLP. You may attach additional pages if necessary.

NOTE:
Attorney License/Member Number need only be provided for attorneys licensed to practice in

California. For Jurisdiction(s) in which Admitted to Practice, list only states and/or countries.

C. Attachment 3. See State Bar LLP Rule 3.3 and *California Rule of Professional Conduct 1-400*.

D. Secretary of State Certification. Attach an original certified copy (including the cover with the red date stamp) of the Secretary of State's Registered Limited Liability Partnership Registration (LLP-1). The form is available from the office of The Secretary of State.

NOTE:

Certification cannot be issued and the application will not be processed until all attachments are received in our office.

6. The declaration must be signed by a partner authorized to act on behalf of the LLP. If the authorized partner is a law corporation, set forth the complete name of the corporation. A shareholder of the law corporation may sign on behalf of the corporation. Please specify that you are signing on behalf of the corporation. The application is not complete unless it has an original signature. No copies of signature, please. Without the original signed declaration by a partner authorized to act on behalf of the LLP, certification cannot be issued and the application will not be processed until we receive a declaration with the original signature of an authorized partner.

SPECIAL NOTE If you will be forwarding a separate list of partners, or separate lists of partners who practice in different offices or jurisdictions, as an addendum to Attachment 1, please use the following format:

Last Name, First Name, Middle Initial in alphabetical order; Jurisdiction(s) Where Licensed to Practice (list the primary jurisdiction first); California State Bar Attorney License Member Number (if applicable).

Do not list partners and non-partners together on one list. If a "mixed list" is submitted, certification cannot be issued and the application will not be processed until you submit separate lists of partners and non-partners.

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62 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
B. Official Forms of the State Bar of California

8-16C California Legal Forms--Transaction Guide § 16C.231

AUTHOR: by Kristin M. Schwaighart

§ 16C.231 State Bar Rules and Regulations for LLPs

[1] Comment--Use of Form

This form is a copy of the Limited Liability Partnership Rules and Regulations adopted by the California State Bar. These rules and regulations govern the registration of California attorneys to practice law in the LLP form.

The Application for Certification referred to in this form is *set forth in § 16C.230*.

[2] FORM

State Bar Rules and Regulations for LLPs

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63 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
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8-16C California Legal Forms--Transaction Guide §§ 16C.232-16C.239

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.232[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
C. Limited Liability Partnership Agreements
1. Complete Agreements

8-16C California Legal Forms--Transaction Guide § 16C.240

AUTHOR: by Kristin M. Schwaighart

§ 16C.240 California Limited Liability Partnership Agreement--Practice of Law

[1] Comment

[a] Use of Form

This form is designed for use by a California limited liability partnership that provides legal services. It may be adapted for use by an LLP that provides services related to the practice of law. This form is a simple agreement for a three to five partner firm. It may be adapted as needed for partnerships of greater size. Alternative provisions may be found in Ch. 15, Part A, *Formation of General Partnerships* .

[b] Nature of Legal Services LLP

A legal services LLP is not a special form of partnership. Aside from specific statutory and regulatory provisions governing the practice of law, there are no special statutes regulating its affairs. An LLP is an association of two or more persons as partners for the purpose of practicing of law that has filed a certificate of registration (Form LLP-1) [*see § 16C.200*]. Typically, a professional partnership differs from other general partnerships in that it tends to have little capital, no inventory, and relatively large amounts of unrealized receivables. Its reputation depends on the skill, experience, and training of its individual members [*Lyon v. Lyon (1966) 246 Cal. App. 2d 519, 525, 54 Cal. Rptr. 829]* .

[c] Special Provisions Applicable to Professional Partnerships

Because a professional partnership's income is derived from the personal services of its members and its reputation is dependent on the reputation of its members, provisions governing their rights, duties, and conduct are more detailed in professional partnership agreements. For example, the various partners' experience, reputation, skill, and ability to attract clients are not usually equal. Therefore, the provisions in the partnership agreement for division of the

partnership profits require special consideration.

Further, because a professional partnership has little capital or inventory and is almost entirely dependent on the partners' earnings, different tax considerations may be involved in drafting provisions relating to the death or retirement of a partner than are involved in drafting similar provisions for an ordinary commercial partnership. For example, Paragraph 5.05 provides that the partnership interest of a deceased or retired partner will be liquidated by the partnership by payment of a specified amount each month, determined by the past income of the partnership. These payments are taxable to the retired partner or the deceased partner's estate as ordinary income [*see I.R.C. § 736(a)*]. Ordinarily, after a partner's retirement, the continuing partners are in a higher income tax bracket than the retired partner and gain more by being able to deduct the payments on their income tax returns than the retired partner will lose by having to report the payments as ordinary income.

[d] Taxable Year

Paragraph 3.14 provides that the partnership will keep its books on a cash and calendar year basis. Consequently, this form anticipates that the partnership will file its informational income tax return on a cash and calendar year basis. The cash basis is useful when significant amounts of accounts receivable are carried by the partnership. Under the cash basis method of accounting, accounts receivable are not reported as income and the partners do not pay taxes on them until they have been paid to the partnership. Further, the calendar year basis of accounting and reporting was specified in this form because the partners are usually on a calendar year basis, and in most instances the partnership taxable year must be based on the taxable year of the partners [*see I.R.C. § 706(b)*].

[e] Security Compliance

Paragraph 4.07 provides that each partner agrees to indemnify the partnership for all damages and expenses for which the partnership may become liable as a result of any alleged act of negligence or professional malpractice on the part of that partner to the extent that the damages and expenses are not paid or reimbursed under a policy of insurance carried by the Partnership.

Paragraph 4.08 requires that the partnership satisfy the security requirements necessary to secure limited liability status [*see Corp. Code § 16956*].

Paragraph 6.04 is designed as a summary of the limited liability of partners in an LLP. The provision states that the partnership has fulfilled all requirements necessary to secure its status as a limited liability partnership, and that nothing in the agreement is intended to extend the liability of partners to cover obligations for which they are not personally liable under *Corp. Code § 16306(c)*. Inclusion of this type of paragraph is advisable to prevent, for example, a "sharing in partnership profits and losses" provision to expand liability. For further discussion, see *§ 16C.22[4]*.

[2] FORM

California Limited Liability Partnership Agreement--Practice of Law

PARTNERSHIP AGREEMENT OF _____ [***Full name of limited liability partnership***], A CALIFORNIA LIMITED LIABILITY PARTNERSHIP

ARTICLE 1 NATURE OF PARTNERSHIP

Parties

1.01. _____[*Name*] of _____ County, California, _____[*name*], _____[*name*], _____[*name*], and _____[*name*], all of _____ County, California, voluntarily associate themselves together as partners engaged in the practice of law under the name _____[*name*], a limited liability partnership registered under the laws of the state of California, on the terms and conditions set forth in this Partnership Agreement.

Name of Partnership

1.02. The name of this Partnership is _____. For all purposes, this name belongs to the Partnership. However,

(1) If any Partner whose surname is included in the firm name permanently withdraws from the Partnership, that Partner's name shall, on receipt of that Partner's written request or at the election of the remaining Partners, be deleted from the firm name.

(2) If a Partner whose surname is included in the firm name is expelled, the Partnership shall immediately delete that Partner's surname from the firm name unless after the expulsion a person with the same surname continues to be a member of the Partnership.

(3) On the death of any Partner whose surname is included in the firm name, the Partnership may continue to use the deceased Partner's surname as part of the firm name without compensation to the deceased Partner's estate or beneficiaries for any period of time authorized by the laws of the State of California, the rules and regulations of the California State Bar [*optional:* or any other state bar associations of which the Partners are members], or the majority vote of the surviving Partners.

Business of Partnership

1.03. The Partnership is formed for the purpose of engaging in the general practice of law and matters related and incidental to that practice under the laws of the State of California and the rules and regulations of the State Bar of California.

Term of Partnership

1.04. The Partnership commences on _____[*date*], and continues until dissolved by mutual agreement of the parties or terminated as provided in this Agreement. The Partnership does not automatically dissolve if or when the Partnership changes its status from a limited liability partnership to a [*identify other potential business forms, e.g.,* general partnership *or* professional corporation].

Location of Partnership

1.05. The Partnership offices shall be located at _____[*address(es)*], or at any other place or places in _____ County, California as may be designated by majority vote of the Partners.

The Partnership's principal place of business is _____[*address*].

ARTICLE 2 DEFINITIONS

Partners

2.01. A "Partner" is a party to this agreement who has not been separated from the Partnership by death, retirement, withdrawal, a determination of incapacity or disability, and has not been terminated or expelled.

Partnership

2.02. The "Partnership" is _____, a registered limited liability partnership.

The "Act"

2.03 The "Act" is the Uniform Partnership Act of 1994, and specifically *Corporations Code Sections 16951 through 16962*, which govern limited liability partnerships. It is the intention of the Partnership that its internal affairs be governed by, and this Agreement construed to effectuate, that Act.

ARTICLE 3 FINANCIAL MATTERS

Capital

3.01. The initial capital of the Partnership shall consist of the capital contributions made by each of the Partners as specified on a schedule attached to this Agreement marked Exhibit A.

Withdrawal of Capital

3.02. No portion of the Partnership capital may be withdrawn at any time without the express written consent of all the Partners.

Interest on Capital

3.03. No Partner shall be entitled to interest on contributions to the capital of the Partnership.

Additional Contributions to Capital

3.04. Any Partner whose capital account is less than $ _____must, at the end of each calendar year in which Partner's share of Partnership net profits exceeds $ _____, contribute _____ percent of that Partner's share of Partnership net profits to the Partnership capital until that Partner's capital account amounts to $ _____.

Profits and Losses

3.05. For the calendar years _____ through _____ and thereafter, the net Partnership profits will be divided and the net Partnership losses will be borne by the Partners in the following proportions:

Name of Partner

_____

Share of Profits and Losses _____

___

Name of Partner

_____

Share of Profits and Losses _____

___

Name of Partner _____

___

Share of Profits and Losses _____

___

Name of Partner _____

___

Share of Profits and Losses _____

___

Profits of Deceased or Terminated Partner

3.06. On the death of a Partner or on the withdrawal, retirement, or expulsion of a Partner as provided in this Agreement, that Partner's distributive share of the future Partnership profits and losses will be divided among the remaining Partners in accordance with their percentage interests as specified in Paragraph 3.05 of this Agreement.

Expenses

3.07. All rents, payments for office or professional supplies, professional dues, premiums for insurance, wages, salaries, and other expenses incidental to the Partnership business will be paid out of the profits or capital of the Partnership and, for the purpose of this Agreement, are considered ordinary and necessary expenses of the Partnership business deductible before net profits are determined.

Salaries

3.08. No Partner will receive any salary for services rendered to or in the Partnership business.

Draws

3.09. During each calendar year each Partner is entitled to withdraw from the Partnership funds in equal monthly installments an amount equal to but not in excess of [*fraction, e.g.,* four-fifths] of his or her distributive share of Partnership net profits for the preceding year. Each withdrawal by a Partner will be charged against his or her distributive share of the net Partnership profits for the year in which made. Each Partner is entitled, at the end of any calendar year, to withdraw the balance of his or her distributive share of the Partnership net profits for the year after making the capital contribution, if any, required by Paragraph 3.04 of this Agreement. However, the withdrawals made

by the Partners during the first calendar year of the Partnership may not exceed the following amounts each month:

An error occurred in the processing of a table at this point in the document. Please refer to the table in the online document.

Fees

3.10. The amount charged by each Partner for professional services rendered in connection with the Partnership business must be determined by each Partner pursuant to a schedule of charges to be adopted by majority vote of the Partners. However, each Partner may render professional services for any member of his or her immediate family without charge and may, on approval of the Partners having a majority interest in the Partnership profits and losses, render professional services without charge or at less than regular charge to any professional, civic, educational, religious, or charitable organization or project.

Bank Accounts

3.11. All Partnership funds will be deposited in bank accounts designated by majority vote of the Partners. The Partners will also designate by majority vote [*specify, e.g.,* three] Partners, one of whom shall be the Managing Partner, who are authorized to sign checks and make withdrawals from the Partnership's bank accounts. All checks and withdrawals on or from any Partnership bank account requires the signatures of two authorized Partners.

Books

3.12. Complete and accurate accounts of all Partnership transactions will be kept in proper books and each Partner must enter in those books a full and accurate account of all transactions conducted by that Partner on behalf of the Partnership. The books of account and other Partnership records must, at all times, be kept in the Partnership place of business and each Partner, at all times, has access to, and may inspect and copy, any of them.

Method of Accounting

3.13. The Partnership books of account will be kept on a cash and calendar year basis.

Accountings

3.14. As soon after December 31 in each year as is reasonably practicable, a complete and accurate accounting will be made of all Partnership receipts and disbursements during the preceding calendar year. The net Partnership profits or losses during that year will be ascertained and credited or debited, as the case may be, on the Partnership books, to the respective Partners in the proportions specified in this Agreement.

Capital Accounts

3.15. An individual capital account will be maintained for each Partner. Each Partner's capital account consists of his or her contribution to the initial capital, any additional contributions to the Partnership capital made by that Partner pursuant to this Agreement, and any amounts transferred from his or her income account to Partnership capital pursuant

to this Agreement.

Income Accounts

3.16. An individual income account will be maintained for each Partner. At the end of each calendar year each Partner's share of the Partnership net profits or losses will be credited or debited to, and his or her withdrawals during the year deducted from, that income account. Except as provided in Paragraph 3.04 of this Agreement, amounts may be transferred from a Partner's income account to the Partnership only by majority vote of the Partners.

Amounts in Income Accounts

3.17. Any amount credited to a Partner's income account on any regular Partnership accounting provided for in this Agreement constitutes a liability of the Partnership to that Partner payable without interest on demand.

ARTICLE 4 RIGHTS AND DUTIES OF PARTNERS

Vacations and Sick Leave

4.01. Each partner must devote full time, knowledge, and skill to the Partnership business. Each Partner is entitled to vacations, sick leave, and absences from the Partnership business in the following manner:

(1) Each Partner is entitled to

_____ [*number*] weeks vacation in each calendar year to be taken at such times as may be most convenient to the Partnership. Any vacation not used in one year may be used in a future year only with the approval and to the extent agreed on by majority vote of the Partners.

(2) Each Partner is entitled to

_____ [*number*] weeks sick leave each calendar year without adjustment in earnings because of actual sickness or accident to the Partner or any member of the Partner's immediate family. Sick leave not used in one year may not be carried over to future years or used for additional vacation.

(3) In addition to sick leave, each Partner who becomes pregnant is entitled to

_____ [*number*] months maternity leave without adjustment in earnings.

(4) Each Partner, in addition to the vacation and sick leave provided for in this Paragraph is entitled to be absent from the Partnership business for

_____ [*number*] days each calendar year for the purpose of attending professional meetings or postgraduate courses.

(5) If any Partner's vacation or sick leave exceeds the limits specified in this Paragraph for any year, that Partner's distributive share of the net Partnership profits for the year will be reduced at the rate of

_____ percent for each week the vacation or sick leave exceeds the limits specified in this Paragraph without the consent of

_____ [a majority *or* all] of the remaining Partners. The amount by which any Partner's distributive share of Partnership net profits is reduced pursuant to this provision will be credited to the other Partners according to their percentage interests in profits as specified in Paragraph 3.05 of this Agreement.

Management

4.02. In addition to other matters specified in this Agreement, the following matters will be determined by majority vote of the Partners as defined in Paragraph 4.04 of this Agreement:

(1) Matters relating to general management, professional policy, and the purchase of furniture and equipment costing more than $

_____ .

(2) The assignment of professional duties and responsibilities among the Partners.

(3) The selection of a Partner to serve as Managing Partner.

Managing Partner

4.03. The Managing Partner will be selected at the beginning of each calendar year and serves in that capacity for the calendar year or until a successor is selected. The Managing Partner has the duty and authority to carry out and implement decisions relating to general management and professional policy, to purchase supplies, furniture, and equipment costing less than $ [*amount specified in Paragraph 4.02(1)*], and to employ, discharge, and supervise the clerical, administrative, and other employees of the Partnership.

Votes

4.04. In any matter requiring a majority vote of the Partners, each Partner has one vote for each one percent of Partnership net profits distributable to the Partner under Paragraph 3.05 of this Agreement during the year in which the vote is taken. "Majority vote of the Partners" as used in this Agreement means 51 percent of the votes cast pursuant to this Paragraph.

Prohibited Acts

4.05. No Partner may, without the consent of all other Partners,

(1) Loan any Partnership funds.

(2) Tender any professional services to any person if requested by the Managing Partner not to do so;

(3) Incur any obligations in the name of or on the credit of the Partnership except in the ordinary course of the Partnership business; or

(4) Become bail, surety, or endorser for any person other than the Partnership, and only with the consent of all the partners.

The Partnership will be indemnified for any losses sustained because of a breach of this Paragraph by the Partner committing the breach.

Personal Debts

4.06. Each Partner must pay and discharge his or her own separate obligations as they become due and will protect the other Partners and the Partnership from all costs, claims, and demands relating to his or her personal obligations.

Malpractice Coverage

4.07. Each Partner agrees to indemnify the Partnership for all damages and expenses for which the Partnership may become liable as a result of any alleged act of negligence or professional malpractice on the part of that Partner to the extent that the damages and expenses are not paid or reimbursed under a policy of insurance carried by the Partnership.

Compliance With Security Requirements

4.08. The Partnership will satisfy the statutory security requirements of *Corporations Code Section 16956* in the following manner: [*specify*].

[*Select one of the following:*]

[*If the insurance or financial asset method (see Corp. Code § 16956(a)(2)(A), (B)) is selected, add:*]

Whenever a new Partner is added to the Partnership, the Partnership will ensure that the Partnership is still in compliance with the statutory security requirements.

[*OR, if the net worth method (see Corp. Code § 16956(a)(2)(D)) is selected, add:*]

The Partnership will file a statement (on official Form LLP-3) with the California Secretary of State to establish that the Partnership has a net worth of at least $15,000,000 in its most recently completed fiscal year. The Partnership will file this statement annually for as long as this statement is true and the Partnership remains a limited liability partnership. If the Partnership's net worth becomes less than $15,000,000 for any fiscal year, and the Partnership wishes to remain a limited liability partnership, the Partnership will satisfy the security requirements by another method.

[*CONTINUE*]

Each Partner, by virtue of that Partner's status as a partner, automatically guarantees payment of any difference between the maximum amount of security required by statute and the security otherwise provided by the Partnership. The aggregate amount paid by all Partners under these guarantees may not exceed that difference. The withdrawal of a

Partner does not affect the rights and obligations of the Partner arising before withdrawal.

Assignment of Interest

4.09. No Partner may sell, assign, mortgage, hypothecate, or encumber any interest in the Partnership.

ARTICLE 5 TERMINATION OF PARTNERSHIP

Withdrawal of Partner

5.01. Any Partner may withdraw from the Partnership at the end of any calendar year by giving _____ months written notice to the other Partners. On service of this notice:

(1) The withdrawal automatically becomes effective at the end of the calendar year in which given, unless within

_____ [*number*] days after receiving notice the remaining Partners, by written agreement signed by all of them, elect to dissolve the Partnership and serve written notice of their election on the withdrawing Partner, in which event his or her notice of withdrawal is of no force or effect.

(2) If the remaining Partners do not elect to dissolve the Partnership, the Partnership books will be closed at the end of the calendar year in the usual manner. The withdrawing Partner must then be paid the balance shown in his or her capital and income accounts, increased by his or her share of Partnership net profits or decreased by his or her share of Partnership net losses during the year, and decreased further by his or her drawings against anticipated profits during the year. The net amount payable to the withdrawing Partner will not include any share in uncollected charges received by the Partnership after the effective date of withdrawal and is payable without interest in

_____ [*number*] equal consecutive

_____ [*e.g.*, monthly, quarterly] installments commencing

_____ [*number*] month(s) after the effective date of withdrawal.

Expulsion of a Partner

5.02. Any Partner may be expelled from the Partnership.

(1) Expulsion becomes effective on the adoption by majority vote of the remaining Partners, at a meeting held after five days written notice has been given to the expelled Partner, of a written resolution finding that the Partner has:

(a) Engaged in personal misconduct or a willful breach of this Agreement of such a serious nature as to render the Partner's continued presence in the Partnership personally or professionally obnoxious or detrimental to the other Partners or the Partnership;

(b) Been expelled, suspended, or otherwise disciplined by the final action of the California State Bar or other duly constituted authority;

(c) Resigned from any professional organization under threat of disciplinary action;

(d) Been convicted by final action of any court of any offense punishable as a felony or involving moral turpitude;

(e) Made an assignment for the benefit of creditors or been declared a bankrupt.

(2) The expelled Partner is entitled to receive from the remaining Partners as soon as practical after the effective date of the expulsion, the book value of the expelled Partner's Partnership interest as determined by a complete inventory and accounting of the Partnership affairs as of the close of business on the effective date of the expulsion, less any value attributable to the goodwill of the Partnership business and less any damages, if the expulsion was caused by willful breach of this Agreement, sustained by the remaining Partners or the Partnership because of the breach.

Retirement of Partner

5.03. Any Partner may voluntarily retire from the Partnership at any time by giving [*number*] months' written notice of the intention to retire to the other Partners.

Disability of Partner

5.04. Any Partner who is disabled because of illness, accident, or other cause, and therefore unable to perform normal duties as a Partner for a continuous period of [*number*] months or longer may be retired from the Partnership by majority vote of the other Partners.

Payment for Partnership Interest

5.05. On the retirement, either voluntary or because of disability, or death, of a Partner the Partnership will pay to the person legally entitled to that sum in full liquidation of that Partner's interest in the Partnership the following amounts:

(1) An amount each month for

_____ [*number*] consecutive months following the retirement or death of the Partner that is equal to

_____ [*fraction or percentage, e.g.,* one third (1/3)] of the Partner's average monthly earnings from the Partnership in the

_____ [*number*] years, or shorter period as during which the Partner was a member of the Partnership, immediately preceding retirement or death; plus

(2) The Partner's distributive share of the Partnership net profits for its current year to the date of retirement or death less withdrawals made by the Partner against those profits, payable

_____ [*number*] days after the date of retirement or death; plus

(3) An amount equal to the balance in the Partner's capital and income accounts on the date of retirement or death, payable without interest in

_____ [*number*] consecutive equal

_____ [*e.g.*, quarterly] installments beginning

_____ [*number*] months after the date of retirement or death.

Noncompetition Clause

5.06. Any retired Partner who competes with the Partnership in any way during the period any amounts are payable to him or her under Paragraph 4.05(1) of this Agreement forfeits all right to any remaining payments due under that Subparagraph.

Retired Partner's Right to Examine Books

5.07. Any person legally entitled to receive any payments pursuant to the provisions of Paragraph 5.05 of this Agreement has the right to examine the Partnership books and records at any time during normal business hours to the extent that the examination is necessary to determine the amount of any payments set forth in Paragraph 5.05 of this Agreement.

Continuation of Partnership

5.08. The withdrawal, retirement, expulsion, or death of any Partner does not dissolve the Partnership and does not affect the continuance of the Partnership business, except as expressly provided in this Agreement. Neither a withdrawing, retired, or expelled Partner, nor a deceased Partner's estate has any claim against the Partnership or the remaining Partners except for payments expressly provided in this Agreement to be paid to them. If the Partnership is dissolved before the full amount of these payments has been paid, the unpaid balance must be paid in full before any distribution of Partnership assets may be made to the remaining Partners.

Dissolution

5.09. On dissolution of the Partnership other than by reason of the withdrawal, expulsion, retirement, or death of a Partner, all Partnership assets including any lease for office space occupied by the Partnership but excluding any files or records pertaining to the affairs of the Partnership's clients will be liquidated and the proceeds distributed in the manner specified in *Corporations Code Section 16807*.

Files

5.10. On any dissolution of the Partnership, the Partner who has usually rendered professional services for a particular client is entitled to that client's file unless the client requests that a different disposition be made of that file. A Partner who withdraws from the Partnership is entitled only to the records or files of those clients for whom he or she regularly

performed professional services as a member of the Partnership and for whom he or she also rendered professional services before becoming a member of the Partnership. The estate of a deceased Partner is not entitled to any records or files of the Partnership except records and files relating to personal matters of the deceased Partner.

ARTICLE 6 MISCELLANEOUS

Additional Partners

6.01. The Partners may by [*specify, e.g.*, a majority in interest, *or* a majority in numbers, *or* unanimous vote], admit additional Partners and fix the capital contributions, if any, to be made and the participation percentage in profits and losses of any additional Partners. All Partners must relinquish an equal proportion of their own participation percentage in Partnership profits and losses to any additional Partners. However, before being admitted, each additional Partner must first agree in writing to be bound by the provisions of this Agreement.

Notices

6.02. Any notices permitted or required by law or by this Agreement must be in writing and will be deemed duly given when personally delivered to the Partner to whom they are addressed or, in lieu of personal delivery, when deposited in the United States mail, first-class postage prepaid, certified, addressed to the Partner at the office of the Partnership.

Amendments

6.03. No amendment to this Agreement is valid unless made in writing and signed by all of the Partners.

Summary of Limited Liability

6.04. This partnership has fulfilled all requirements necessary to secure its status as a limited liability partnership. Nothing in this Agreement is intended to render the Partners liable for Partnership obligations for which they are not personally liable under *Corporations Code Section 16306(c)*. This Paragraph overrides any other provision in this Agreement that is or might be interpreted as inconsistent with this principle.

Executed on _____[*date*], at _____[*city*], _____ County, California.

_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
C. Limited Liability Partnership Agreements
1. Complete Agreements

8-16C California Legal Forms--Transaction Guide § 16C.241

AUTHOR: by Kristin M. Schwaighart

§ 16C.241 California Limited Liability Partnership Agreement--Practice of Public Accountancy

[1] Comment

[a] Use of Form

This form is designed for use by a California limited liability partnership that provides public accountancy services. It may be adapted for use by an LLP that provides services related to the practice of public accountancy. This form is a simple agreement for a three to five partner firm. It may be adapted as needed for partnerships of greater size. Alternative provisions may be found in Ch. 15, Part A, *Formation of General Partnerships* , Part A.

[b] Nature of Public Accountancy LLP

A public accountancy LLP is not a special form of partnership. Aside from specific statutory and regulatory provisions governing the practice public accountancy [*see § 16C.21[2][b]*], there are no special statutes regulating its affairs. An LLP is an association of two or more persons as partners for the purpose of practicing of law that has filed a certificate of registration (Form LLP-1) [*see § 16C.200*]. Typically, a professional partnership differs from other general partnerships in that it tends to have little capital, no inventory, and relatively large amounts of unrealized receivables. Its reputation depends on the skill, experience, and training of its individual members [*see Lyon v. Lyon (1966) 246 Cal. App. 2d 519, 525, 54 Cal. Rptr. 829]* .

[c] Special Provisions Applicable to Professional Partnerships

Because a professional partnership's income is derived from the personal services of its members and its reputation is dependent on the reputation of its members, provisions governing their rights, duties, and conduct are more detailed in professional partnership agreements. For example, the various partners' experience, reputation, skill, and ability to attract clients are not usually equal. Therefore, the provisions in the partnership agreement for division of the

partnership profits require special consideration.

[d] Taxable Year

Paragraph 3.08 provides that the partnership will keep its books on a cash basis. The cash basis is useful when significant amounts of accounts receivable are carried by the partnership. Under the cash basis method of accounting, accounts receivable are not reported as income and the partners do not pay taxes on them until they have been paid to the partnership.

Paragraph 3.09 permits the partnership to specify its fiscal year. Informational income tax return must be filed in accordance with these provisions. The calendar year basis of accounting and reporting is most common because the partners are usually on a calendar year basis, and in most instances the partnership taxable year must be based on the taxable year of the partners [*see I.R.C. § 706(b)*].

[e] Security Compliance

Paragraph 4.12 provides that the LLP will satisfy the statutory security requirements of *Corp. Code § 16956*. If the net worth security alternative is selected, the form requires that the LLP will comply with the annual filing requirement [*Corp. Code § 16956(c)*].

Paragraph 3.12, which deals with the allocation of profits and losses, contains a statement that nothing in the paragraph is intended to require any action on the part of the partners or the partnership that would render the partners liable for partnership obligations for which they are not personally liable under *Corp. Code § 16306(b)*.

Paragraph 6.05 is designed as a summary of the limited liability of partners in an LLP. The provision states that the partnership has fulfilled all requirements necessary to secure its status as a limited liability partnership, and that nothing in the agreement is intended to extend the liability of partners to cover obligations for which they are not personally liable under *Corp. Code § 16306(c)*. Inclusion of this type of paragraph is advisable to prevent, for example, a "sharing in partnership profits and losses" provision to expand liability. For further discussion, see *§ 16C.22[4]*.

[2] FORM

California Limited Liability Partnership Agreement--Practice of Public Accountancy

PARTNERSHIP AGREEMENT OF

_____ [*Full name of limited liability partnership*],

A CALIFORNIA LIMITED LIABILITY PARTNERSHIP

ARTICLE 1 NATURE OF PARTNERSHIP

Parties

1.01. _____[*Name*], of _____ County, California, _____[*name*], _____[*name*], _____[*name*], and _____[*name*], all of _____ County, California, voluntarily associate themselves together as partners engaged in the practice of public accounting under the name _____[*name*], a limited liability partnership registered

under the laws of the state of California, on the terms and conditions set forth in this Partnership Agreement.

Name of Partnership

1.02. The name of this Partnership is _____. For all purposes, this name belongs to the Partnership.

Business of Partnership

1.03. The Partnership is engaged in the business of public accounting.

Term of Partnership

1.04. The Partnership commences on _____[*date*] and continues until the Partnership is dissolved pursuant to this Agreement. The bankruptcy or separation, whether by reason of termination, expulsion, withdrawal, retirement, incapacity, disability, or death, of a Partner does not terminate or dissolve the Partnership. The Partnership does not terminate or dissolve if or when the Partnership changes its status from a limited liability partnership to a general partnership.

Place of Business

1.05. The Partnership's principal place of business is _____[*address*], or at any other place or places as may be agreed on by [the unanimous consent of the *or* the consent of a majority of the] Partners.

ARTICLE 2 DEFINITIONS

Partners

2.01. A "Partner" is a party to this agreement who has not been separated from the Partnership by death, retirement, withdrawal, a determination of incapacity or disability, and has not been terminated or expelled.

Partnership

2.02. The "Partnership" is _____, a registered limited liability partnership.

The "Act"

2.03 The "Act" is the Uniform Partnership Act of 1994, and specifically *Corporations Code Sections 16951 through 16962*, which govern limited liability partnerships. It is the intention of the Partnership that its internal affairs be governed by, and this Agreement construed to effectuate, that Act.

ARTICLE 3 FINANCIAL MATTERS

Initial Capital

3.01. The initial capital of the Partnership is the sum of $ _____, contributed equally by the Partners.

Additional Contributions to Capital

3.02. No Partner may be required to make additional contributions to the capital of this Partnership, except as provided in Paragraph 3.05. No Partner is permitted to make a voluntary contribution to capital without the written consent of all other Partners.

Withdrawal of Capital

3.03. No portion of the Partnership capital may be withdrawn at any time without the express written consent of all Partners.

Interest on Capital

3.04. No Partner is entitled to interest on contributions to the capital of the Partnership.

Loans to Partnership

3.05. In addition to making the required initial capital contribution, Partners may be required periodically by a vote of a majority of the Partners to loan the additional capital to the Partnership on a pro rata basis in proportion to their interests in the partnership. No Partner may otherwise loan or advance money to the Partnership without the written consent of a majority of the other Partners.

Any loan by a Partner to the Partnership must be separately entered in the Partnership books as a loan to the Partnership. The loan bears interest at a rate determined by a majority of the Partners; the interest on the loans will be treated as an expense of the Partnership. These loans must be evidenced by a promissory note delivered to the lending Partner and executed in the name of the Partnership by the Partnership. These loans may be repaid in full at any time at the discretion of the Partnership.

If a Partner is unable to otherwise secure outside financing to fulfill the Partner's capital contribution or capital loan obligation, the Partnership may assist as deemed appropriate under the circumstances.

Nothing in this Paragraph is intended to require any action of the Partnership that would render the Partners liable for Partnership obligations for which they are not personally liable under *Corporations Code Section 16306*.

Books of Account

3.06. Complete and accurate accounts of all Partnership transactions must be kept in proper books. Each partner shall enter in the Partnership books an accurate account of all transactions carried out by such Partner on behalf of the Partnership.

Inspection of Books

3.07. The books of account and other Partnership records will, at all times, be kept in the Partnership's principal place of

business. At all times, each Partner has access to, and may inspect and copy, any Partnership books and records.

Method of Accounting

3.08. The Partnership books of account will be kept on a cash basis.

Fiscal Year

3.09. The fiscal year of the Partnership ends on the _____[*date*], of each year.

Accountings

3.10. As soon after the close of each fiscal year as is reasonable, a full and accurate inventory and accounting shall be made of the Partnership affairs as of the close of the fiscal year. In making the accounting, the net profit or net loss sustained by the Partnership during such fiscal year shall be ascertained and credited or debited, as the case may be, in the Partnership books of account, to the respective Partners in the proportions specified in Paragraph 3.12 of this Agreement.

Definition of Profits and Losses

3.11. The terms "net profits" and "net losses" as used in this Agreement mean the net profits and net losses of the Partnership as determined by generally accepted accounting principles for each accounting period provided for in this Agreement.

Profits and Losses

3.12. The net profits or net losses of the Partnership will be credited or charged, as the case may be, to the Partners [in equal proportions *or* in the following proportions: _____ (*specify proportions, e.g.*, _____ (*name*) 50 percent, _____ (*name*) 30 percent, _____ (*name*) 20 percent]. Nothing in this Paragraph relating to allocation of losses is intended to require any action on the part of the Partners or the Partnership that would render the Partners liable for Partnership obligations for which they are not personally liable under *Corporations Code Section 16306*.

Capital Accounts

3.13. Each Partner must maintain a separate capital account. An individual Partner's capital account consists of the following:

(1) That Partner's initial contribution to the Partnership capital under Paragraph 3.01 of this Agreement;

(2) That Partner's additional contributions to Partnership capital under Paragraph 3.02 of this Agreement; and

(3) Any amounts transferred from the income to the capital account of that Partner under Paragraph 3.14 of this Agreement.

Income Accounts

3.14. A separate income account will be maintained for each Partner. At the end of each fiscal year each Partner's share of the net profits or net losses of the Partnership shall be credited or debited to, and withdrawals during that fiscal year deducted from, that Partner's income account. After those amounts have been credited or debited to and deducted from a Partner's income account, any balance or deficit remaining in the account shall be transferred to or charged against that Partner's capital account.

Bank Accounts

3.15. All Partnership funds will be deposited in accounts in the name of the Partnership at any bank or banks in _____ County, California, as may from time to time be selected by a majority vote of all Partners. All withdrawals from these accounts will be made only by check or other written instrument signed by at least two Partners.

ARTICLE 4 RIGHTS AND DUTIES OF PARTNERS

Time Devoted to Partnership

4.01. Each Partner must devote undivided working time and professional skill and attention to the Partnership business. A Partner may not provide professional services to any business enterprise that is not a client. A Partner may not engage or invest in any other business, except the ownership of stock or bonds listed on a national securities exchange, without the consent of all other Partners.

Salaries

4.02. No Partner is entitled to any salary or other compensation for services in the Partnership business.

Draws

4.03. Each Partner is entitled to withdraw from the Partnership funds the sum of $ _____ per month for personal use. Each withdrawal by a Partner will be charged against that Partner's share of the Partnership net profits for the fiscal year in which made. If the total withdrawals by any Partner during any fiscal year exceeds that Partner's share of the net profits for that year, the Partner will not be entitled to further withdrawals until the deficiency has been repaid to the Partnership.

The limitation on the amount of withdrawals contained in this paragraph may be increased or decreased at any time by unanimous consent of the Partners.

Management

4.04. Each Partner has an equal voice in the management and conduct of the Partnership business. Any differences arising among the Partners as to ordinary matters connected with the Partnership business shall be decided by a majority vote of the Partners, each Partner having one vote. No act in contravention of this Agreement, however, may be done without the consent in writing of all the Partners.

Power to Incur Liabilities

4.05. Each Partner has authority to bind the Partnership in making contracts and incurring obligations in the Partnership name and on its credit in the ordinary course of the Partnership business. However, no Partner may incur any obligation in the Partnership name or on its credit exceeding the sum of $ _____ without the consent of the other Partners. Any Partner who incurs any obligation in the name and on the credit of the Partnership in violation of this provision shall be individually liable to the other Partners for the entire amount of the obligation incurred. This dollar limitation on the amount of an obligation that may be incurred by a Partner may be increased or decreased at any time by agreement of all Partners.

Vacations

4.06. Each Partner is entitled to a vacation of one business day for each _____days of full time service rendered by that Partner to the Partnership business during the preceding twelve month period. No more than _____ vacation days may be taken by any Partner at one time without the consent of [*specify percentage in numbers or* all] of the remaining Partners. Each Partner is entitled to withdraw from the Partnership funds the amounts specified in Paragraph [*e.g.,* 4.03] of this Agreement during vacation periods.

Penalty for Extended Absence

4.07. The failure of any Partner not disabled, as provided in Paragraph 5.02 of this Agreement, to devote undivided time and attention to the Partnership business for a period exceeding _____ weeks constitutes an extended absence by that Partner. That Partner will forfeit to the Partnership $ _____ per week for each week of absence unrelated to disability. The amount forfeited will be charged to the absent Partner and distributed to the other Partners in the proportion that their respective shares of the Partnership net profits and net losses bear to one another.

Reimbursement of Expenses

4.08. The Partnership will indemnify all Partners for payments made and personal liabilities reasonably incurred by them in the ordinary and proper conduct of the Partnership business or for the preservation of Partnership business or property.

Prohibited Acts

4.09. No Partner may, without the consent of all other Partners,

(1) Loan any Partnership funds;

(2) Extend Partnership credit to any person a Partner has notified the Partnership not to trust;

(3) Incur any obligations in the name or on the credit of the Partnership except in the ordinary course of the Partnership business; and

(4) Become bail, surety, or indorser for any other person.

Any loss sustained by the Partnership because of the breach of this Paragraph by any Partner shall be deducted from such Partner's share of the Partnership net profits, or if the net profits for the fiscal year in which the breach occurred be insufficient, from that Partner's capital interest in the Partnership.

Personal Debts

4.10. All Partners must discharge their separate obligations as they become due and protect the other Partners and the Partnership from all costs, claims, and demands in relation to those obligations.

Assignment of Interest

4.11. No Partner may sell, assign, mortgage, hypothecate, or encumber an interest in the Partnership.

Malpractice Coverage

4.12. The Partnership will satisfy the statutory security requirements of *Corporations Code Section 16956* in the following manner: [*specify*].

[*Select one of the following:*]

[*If the insurance or financial asset method (see Corp. Code § 16956(a)(1)(A), (B)) is selected, add:*]

Whenever a new Partner is added to the Partnership, the Partnership will ensure that the Partnership is still in compliance with the statutory security requirements.

[*OR, if the net worth method (see Corp. Code § 16956(a)(1)(D)) is selected, add:*]

The Partnership will file a statement (on official Form LLP-3) with the California Secretary of State to establish that the Partnership has a net worth of at least $10 million in its most recently completed fiscal year. The Partnership will file this statement annually for as long as this statement is true and the Partnership remains a limited liability partnership. If the Partnership's net worth becomes less than $10 million for any fiscal year, and the Partnership wishes to remain a limited liability partnership, the Partnership will satisfy the security requirements by another method.

[*CONTINUE*]

Each Partner, by virtue of that Partner's status as a partner, automatically guarantees payment of any difference between the maximum amount of security required by statute and the security otherwise provided by the Partnership. The aggregate amount paid by all Partners under these guarantees may not exceed that difference. The withdrawal of a Partner does not affect the rights and obligations of the Partner arising before withdrawal.

ARTICLE 5 TERMINATION OF PARTNERS AND PARTNERSHIP

Expulsion of a Partner

5.01. A Partner may be expelled from the Partnership for any of the following:

(1) Willful breach of any provision contained in this Agreement;

(2) Conduct adversely affecting the Partnership business or reputation;

(3) Conduct relating to Partnership matters that makes continuation of the Partnership unreasonable if that Partner remains a member.

(4) Loss of professional license, threat of disciplinary action by or resignation from regulatory professional association, or failure to satisfy continuing education requirements.

(5) Bankruptcy.

(6) Assignment for benefit of creditors.

(7) Conviction of crime involving moral turpitude that affects the Partnership or its reputation.

A Partner will be expelled on the unanimous vote of all other Partners. The other Partners must serve the expelled Partner with a written notice stating the grounds for and effective date of the expulsion and bearing all the other Partners' signatures. Within _____ days after the expulsion becomes effective, the expelled Partner is entitled to receive the value of that Partner's Partnership interest. The value of the expelled Partner's Partnership interest will be determined by a complete inventory and accounting of Partnership affairs as of the close of business on the day the expulsion became effective, less the value of Partnership goodwill, and less any damages sustained by the other Partners because of the breach, if any, of this Agreement by the expelled Partner.

The expulsion of one or more Partners does not terminate the Partnership.

Disability of a Partner

5.02. If any Partner, in the opinion of any medical doctor duly licensed to practice in California, becomes unable because of any physical or mental disability to devote full time and attention to the Partnership business, that Partner will, subject to the following terms and conditions, be excused from devoting any time or attention to the Partnership business during the continuance of that disability:

(1) During the first

_____ [*period, e.g.*, six months] of disability, the disabled Partner shall continue to be entitled to receive the full share of the Partnership net profits as specified in this Agreement and to withdraw from the Partnership funds each month the full amount specified in Paragraph

_____ [*e.g.*, 4.03] of this Agreement.

(2) At any time after the disabled Partner has been unable to devote full time and attention because of that disability to the Partnership business for a period of

_____ [*e.g.*, six months] or longer, the remaining Partners by majority vote may

terminate the disabled Partner's Partnership interest by serving on the disabled Partner written notice of termination, stating its effective date.

The disability of one or more Partners does not terminate the Partnership.

Bankruptcy, Insanity, or Charging Order

5.03. The remaining Partners, by service of a written notice stating the effective date on both the Partner and on the trustee in bankruptcy of that Partner, the guardian of that Partner, or the judgment creditor of that Partner who has obtained a charging order against that Partner's interest, may terminate the interest in the Partnership of any Partner

(1) Who has been adjudged a bankrupt pursuant to a petition in bankruptcy filed by or against that Partner under the Bankruptcy Act of the United States;

(2) For whom a conservator has been appointed pursuant to *Probate Code Sections 1800 through 1849.5*.

(3) Against whose interest in the Partnership a charging order has been issued under *Corporations Code Section 16504* and not removed within 30 days after it is issued.

The bankruptcy or insanity of one or more Partners does not terminate the Partnership.

Withdrawal of a Partner

5.04. Any Partner may voluntarily withdraw from the Partnership by giving all other Partners at least [*number e.g.*, 90] days written notice of the Partner's intention to withdraw. The withdrawal of one or more Partners does not terminate the Partnership.

Retirement of a Partner

5.05. Any Partner may retire or be retired by the Partnership as follows:

(1) A partner must retire at the end of the Partnership's fiscal year following the Partner's 65th birthday, unless a majority of the other Partners consent to extend the retirement date for a limited period.

(2) A Partner may retire at the end of the Partnership's fiscal year following the Partner's

_____ [*number e.g.*, 60th] birthday, with full benefits, if the Partner notifies the Partnership in writing of the Partner's intended retirement at least one year before the desired retirement date.

The retirement of one or more Partners does not terminate the Partnership.

Option to Purchase Terminated Interest

5.06. On dissolution of a Partnership interest by reason of a Partner's death, or by reason of any matters stated in Paragraphs 5.02, 5.03, or 5.04 of this Agreement, the remaining Partners have an option to purchase the interest of the deceased, terminated, or withdrawing Partner in the assets and goodwill of the Partnership business by paying to that Partner (or the person legally entitled to compensation) the value of that Partner's interest, determined as provided in Paragraph 5.07. The remaining Partners must give notice of their exercise of that option in the following manner:

(1) If the Partnership is dissolved by the death of a Partner, by serving written notice of their exercise of this option on the personal representative of the deceased Partner within

_____ [*number*] days after the appointment and qualification of the personal representative.

(2) If the Partnership is dissolved by the voluntary withdrawal of a Partner, by serving written notice of the exercise of this option of the withdrawing Partner within

_____ [*number e.g.,* 30] days after service on the remaining Partners of the notice of withdrawal provided in Paragraph 5.04 of this Agreement.

(3) If the Partnership is dissolved because of the disability of a Partner pursuant to Paragraph 5.02 of this Agreement, by serving written notice of the exercise of the option on the disabled Partner at the same time the notice of termination of his or her Partnership interest is served on the disabled Partner.

(4) If the Partnership is dissolved for any of the reasons specified in Paragraph 5.03 of this Agreement, by serving written notice of the exercise of this option on both the terminated Partner and that Partner's trustee in bankruptcy, guardian, or the judgment creditor who secured a charging order against the terminated Partner's interest, at the same time the notice of termination of the terminated Partner's partnership interest is served on those persons.

Purchase Price of Partnership Interest

5.07. On exercise of the option described in Paragraph 5.06 of this Agreement to purchase an outgoing Partner's Partnership interest, the remaining Partners must pay to the person legally entitled thereto, in the manner specified in Paragraph 5.08, the value of the outgoing Partner's interest, determined as follows:

(1) The remaining Partners, at the time they give notice in the manner specified in Paragraph 5.06 of their exercise of the option to purchase, must appoint an appraiser. Within

_____ [*number*] days after receiving that notice, the person legally entitled to receive the value of the Partnership interest being purchased must appoint an appraiser. If the two appraisers so appointed are unable to agree on the value of the interest within

_____ [*number*] days, they shall appoint a third appraiser. The decision in writing of any two of the three appraisers so appointed shall be binding and conclusive on the parties hereto and on any person legally entitled to receive the value of such deceased, withdrawing, or terminated Partner's interest. If the Partnership is terminated because of a charging order issued against the interest of the terminated Partner, unless the remaining Partners guarantee in writing the payment to the judgment creditor who secured such charging order the full amount of the claim, including interests and costs, the

appraiser to be appointed by the person legally entitled to receive the value of such terminated Partner's interest shall be appointed by the court which issued such charging order. All fees and expenses of each appraiser shall be paid by

_____ [the remaining Partners *or* the purchasing and selling parties in equal proportions *or* the party on whose behalf such appraiser was appointed, and the fees and expenses of the third appraiser to be paid equally by the purchasing and selling parties].

(2) In determining the value of the Partnership interest to be purchased, the appraisers shall value

(a) All items of inventory at their actual cost to the Partnership.

(b) All tangible assets of the Partnership, including lands, buildings, fixtures, machinery, automobiles, and equipment, at their fair cash market value;

(c) All accounts receivable due the Partnership that are not more than 90 calendar days old and not barred by the statute of limitations at one-half their face value;

(d) All accounts receivable due the Partnership that are less than 90 calendar days old at their full face value; and

(e) Goodwill and other intangible assets of the Partnership at their fair cash market value.

Payment of Purchase Price

5.08. On exercise of the option to purchase the Partnership interest of a deceased, withdrawing, or terminated Partner, the remaining Partners shall pay, to the person legally entitled to payment, the value of the interest, determined as provided in Paragraph 5.07 of this Agreement, in the following manner:

One half in cash on receipt of the appraisers' report provided for in Paragraph 5.07, and the balance in 12 equal monthly installments commencing not later than 30 days after receipt of that report. Each monthly installment will be applied first to interest at the rate of _____ percent per annum on the then remaining unpaid principal balance of the purchase price from the date the appraisers' report was received by the remaining Partners and then to the reduction of principal.

Purchase by Less Than All Remaining Partners

5.09. If any remaining Partner is unable or unwilling to exercise the option contained in Paragraph 5.06 of this Agreement to participate in the purchase of an outgoing Partner's interest, the option may be exercised and the interest purchased by the other remaining Partners. No remaining Partner shall be denied a right to participate in any such purchase if that Partner delivers to all other Partners a written declaration of intent to participate. This written declaration must be delivered before the appraisers' report is delivered.

Death of a Partner

5.10. The death of one or more Partners does not terminate the Partnership. After the death of a Partner, the remaining

Partners may continue the business of the Partnership. The effective date of separation from the Partnership is the last day of the month in which death occurred. Neither the personal representative nor the estate of the deceased Partner will be liable for any obligations of the Partnership incurred after the separation date.

Assumption of Partnership Obligations

5.11. On any purchase and sale of a Partnership interest under this Agreement, the remaining Partners must assume all Partnership obligations and must protect and indemnify the separating Partner, the personal representative and estate of a deceased, insane, or incompetent Partner, and the property of any separating, deceased, insane, or incompetent Partner from liability for any Partnership obligations.

Publication of Notice

5.12. On any purchase and sale of a Partnership interest under this Agreement, or on the expulsion of a Partner pursuant to Paragraph 5.01 of this Agreement, the remaining Partners shall, at their own costs and expenses, as soon as reasonably practicable after giving notice of expulsion or of exercise of their option to purchase the departing Partner's interest, prepare, publish, file, and serve all notices required by law to protect the expelled, withdrawing, or terminated Partner and the personal representative and estate of a deceased, insane, or incompetent Partner from liability for future obligations of the Partnership business.

Dissolution Without Sale

5.13. On dissolution of the Partnership other than as provided in Paragraphs 5.01 through 5.12 of this Agreement, the affairs of the Partnership must be wound up, the assets liquidated, the debts paid, and the remaining funds divided among the Partners according to their then net worths in the Partnership business.

ARTICLE 6 MISCELLANEOUS

Notices

6.01. All notices between the Partners must be in writing and will be deemed duly served when personally delivered to a Partner, or, in lieu of personal service, when deposited in the United States mail, certified, first-class postage prepaid, addressed to the Partner at the address of the principal place of business of the Partnership [*or* to any other place as may be specified in a notice given pursuant to this Paragraph as the address for service of notice on the Partner].

Consents and Agreements

6.02. Any and all consents and agreements provided for or permitted by this Agreement shall be in writing. Signed copies of all consents and agreements must be filed and kept with the books of the Partnership.

Attorneys' Fees

6.03. If any litigation is commenced between the Partners or their personal representatives concerning any provision of this Agreement or the rights and duties of any person in relation to this Agreement, the prevailing party or parties will be entitled, in addition to any other relief as may be granted, to a reasonable sum for their attorneys' fees in that

litigation. The amount of this sum will be determined either by the court or in a separate action brought for that purpose.

Sole Agreement

6.04. This instrument contains the sole agreement of the parties relating to their Partnership and correctly sets forth the rights, duties, and obligations of each to the others as of its date. Any previous agreements, promises, negotiations, or representations not expressly set forth in this Agreement are of no force and effect.

Summary of Limited Liability

6.05. This partnership has fulfilled all requirements necessary to secure its status as a limited liability partnership. Nothing in this Agreement is intended to render the Partners liable for Partnership obligations for which they are not personally liable under *Corporations Code Section 16306(c)*. This Paragraph overrides any other provision in this Agreement that is or might be interpreted as inconsistent with this principle.

Executed at _____ County, California on _____[*date*].

_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
C. Limited Liability Partnership Agreements
1. Complete Agreements

8-16C California Legal Forms--Transaction Guide § 16C.242

AUTHOR: by Kristin M. Schwaighart

§ 16C.242 California Limited Liability Partnership Agreement--Practice of Architecture

[1] Comment

[a] Use of Form

This form is designed for use by a California limited liability partnership that provides architectural services. This form is a simple agreement for a three to five partner firm. It may be adapted as needed for partnerships of greater size. Alternative provisions may be found in Ch. 15, Part A, *Formation of General Partnerships* , Part A.

[b] Nature of Architectural Services LLP

An Architectural Services LLP is not a special form of partnership. Aside from specific statutory and regulatory provisions requiring that architects be licensed [*see § 16C.21[2][c]*], there are no special statutes regulating its affairs. An LLP is an association of two or more persons as partners for the purpose of practicing of law that has filed a certificate of registration (Form LLP-1) [*see § 16C.200*]. Typically, a professional partnership differs from other general partnerships in that it tends to have little capital, no inventory, and relatively large amounts of unrealized receivables. Its reputation depends on the skill, experience, and training of its individual members [*Lyon v. Lyon (1966) 246 Cal. App. 2d 519, 525, 54 Cal. Rptr. 829* ; *see* [c], *below*].

[c] Special Provisions Applicable to Professional Partnerships

Because a professional partnership's income is derived from the personal services of its members and its reputation is dependent on the reputation of its members, provisions governing their rights, duties, and conduct are more detailed in professional partnership agreements. For example, the various partners' experience, reputation, skill, and ability to attract clients are not usually equal. Therefore, the provisions in the partnership agreement for division of the partnership profits require special consideration.

Further, because professional partnerships tend to have limited capital or inventory and are almost entirely dependent on the partners' earnings, different tax considerations may be involved in drafting provisions relating to the death or retirement of a partner than are involved in drafting similar provisions for an ordinary commercial partnership. For example, Paragraph 5.06 provides that the remaining partners have the option to purchase a partnership interest on its dissolution, and Paragraphs 5.07 and 5.09 prescribe the manner of purchases. These payments will be taxable to the retired partner or the deceased partner's estate as ordinary income, either as a distributive share of partnership income or guaranteed payments [*see I.R.C. § 736(a)*]. However, because the continuing partners are ordinarily in a higher income tax bracket than the retired partner, they will gain more by being able to deduct the payments on their income tax returns than the retired partner will lose by having to report the payments as ordinary income.

[d] Taxable Year; Tax Matters Partner

Paragraph 3.08 provides that the partnership will keep its books on a cash basis. The cash basis is useful when significant amounts of accounts receivable are carried by the partnership. Under the cash basis method of accounting, accounts receivable are not reported as income and the partners do not pay taxes on them until they have been paid to the partnership.

Paragraph 3.09 permits the partnership to specify its fiscal year. Informational income tax return must be filed in accordance with these provisions. The calendar year basis of accounting and reporting is most common because the partners are usually on a calendar year basis, and in most instances the partnership taxable year must be based on the taxable year of the partners [*see I.R.C. § 706(b)(1)*]. California generally follows federal law with respect to the selection of a tax year for partnerships [*Rev. & Tax. Code § 17851*; *but see Rev. & Tax. Code §§ 17851-17932* (modifications to federal law)].

Paragraph 3.16 designates a tax matters partner. Partnerships must have a "tax matters partner" (TMP) to represent the partnership and act as a liaison between the partnership and the IRS on tax issues [*see I.R.C. § 6231(a)*; *see also Treas. Reg. § 301.6231(a)(7)-1*]. Among other responsibilities, the TMP has notification responsibilities to the partners and the IRS, and the actions of the TMP may bind the partnership and certain partners [*I.R.C. § 6231(a)*; *see I.R.C. §§ 6223(g), 6224(c), 6226(a)*]. If the partnership fails to designate a TMP, the Internal Revenue Code provides rules to determine that status. Ordinarily, the general partner with the largest interest in partnership profits at the close of the taxable year automatically becomes the TMP; if the partnership has more than one such partner, the first such partner alphabetically is designated the TMP [*I.R.C. § 6231(a)(7)*; *Treas. Reg. § 301.6231(a)(7)-1(m)(2)*].

[e] Security Compliance

Paragraph 4.12 provides that the LLP will satisfy the statutory security requirements of *Corp. Code § 16956*. If the net worth security alternative is selected, the form requires that the LLP will comply with the annual filing requirement [*Corp. Code § 16956(c)*; *see § 16C.202*].

Paragraph 3.12, which deals with the allocation of profits and losses, contains a statement that nothing in the paragraph is intended to require any action on the part of the partners or the partnership that would render the partners liable for partnership obligations for which they are not personally liable under *Corp. Code § 16306(b)*.

Paragraph 6.05 is designed as a summary of the limited liability of partners in an LLP. The provision states that the partnership has fulfilled all requirements necessary to secure its status as a limited liability partnership, and that nothing in the agreement is intended to extend the liability of partners to cover obligations for which they are not personally liable under *Corp. Code § 16306(c)*. Inclusion of this type of paragraph is advisable to prevent, for example, a "sharing in partnership profits and losses" provision to expand liability. For further discussion, see *§ 16C.22[4]*.

[2] FORM

California Limited Liability Partnership Agreement--Practice of Architecture

PARTNERSHIP AGREEMENT OF _____ [***full name of limited liability partnership***], A CALIFORNIA LIMITED LIABILITY PARTNERSHIP

ARTICLE 1 NATURE OF PARTNERSHIP

Parties

1.01. _____[*Name*] of _____ County, California, _____[*name*], _____[*name*], _____[*name*], and _____[*name*], all of _____ County, California, voluntarily associate themselves together as partners engaged in the practice of architecture under the name _____[*name*], a limited liability partnership registered under the laws of the state of California, on the terms and conditions set forth in this Partnership Agreement.

Name of Partnership

1.02. The name of this Partnership is _____. For all purposes, this name belongs to the Partnership. However,

(1) If any Partner whose surname is included in the firm name permanently withdraws from the Partnership, that Partner's name shall, on receipt of that Partner's written request or at the election of the remaining Partners, be deleted from the partnership name.

(2) If a Partner whose surname is included in the firm name is expelled, the Partnership shall immediately delete that Partner's surname from the firm name unless after the expulsion a person with the same surname continues to be a member of the Partnership.

(3) On the death of any Partner whose surname is included in the firm name, the Partnership may continue to use the deceased Partner's surname as part of the firm name without compensation to the deceased Partner's estate or beneficiaries.

Business of Partnership

1.03. The Partnership is engaged in the business of providing architectural services.

Term of Partnership

1.04. The Partnership commences on _____[*date*] and continues until the Partnership is dissolved pursuant to this Agreement. The bankruptcy or separation, whether by reason of termination, expulsion, withdrawal, dissociation, retirement, incapacity, disability, or death, of a Partner does not terminate or dissolve the Partnership. The Partnership does not terminate or dissolve if or when the Partnership changes its status from a limited liability partnership to a general partnership.

Location of Partnership

1.05. The Partnership is located at _____[*address*], or at any other place or places as may be agreed on by [the unanimous consent of the *or* the consent of a majority of the] Partners.

The Partnership's principal place of business is _____[*address*].

ARTICLE 2 DEFINITIONS

Partners

2.01. A "Partner" is a party to this agreement who has not been separated from the Partnership by death, retirement, withdrawal, dissociation, a determination of incapacity or disability, and has not been terminated or expelled.

Partnership

2.02. The "Partnership" is _____[*name*], a registered limited liability partnership.

The "Act"

2.03. The "Act" is the Uniform Partnership Act of 1994, and specifically *Corporations Code Sections 16951 through 16962*, which govern limited liability partnerships. It is the intention of the Partnership that its internal affairs be governed by, and this Agreement construed to effectuate, that Act.

ARTICLE 3 FINANCIAL MATTERS

Initial Capital

3.01. The initial capital of the Partnership is the sum of $ _____, contributed equally by the Partners.

Additional Contributions to Capital

3.02. No Partner may be required to make additional contributions to the capital of this Partnership, except as provided in Paragraph 3.05. No Partner is permitted to make a voluntary contribution to capital without the written consent of all other Partners.

Withdrawal of Capital

3.03. No portion of the Partnership capital may be withdrawn at any time without the express written consent of all Partners.

Interest on Capital

3.04. No Partner is entitled to interest on contributions to the capital of the Partnership.

Loans to Partnership

3.05. In addition to making the required initial capital contribution, Partners may be required periodically by a vote of a majority of the Partners to loan the additional capital to the Partnership on a pro rata basis in proportion to their interests in the partnership. No Partner may otherwise loan or advance money to the Partnership without the written consent of a majority of the other Partners.

Any loan by a Partner to the Partnership must be separately entered in the Partnership books as a loan to the Partnership. The loan bears interest at a rate determined by a majority of the Partners; the interest on the loans will be treated as an expense of the Partnership. These loans must be evidenced by a promissory note delivered to the lending Partner and executed in the name of the Partnership by the Partnership. These loans may be repaid in full at any time at the discretion of the Partnership.

If a Partner is unable to otherwise secure outside financing to fulfill the Partner's capital contribution or capital loan obligation, the Partnership may assist as deemed appropriate under the circumstances.

Nothing in this Paragraph is intended to require any action of the Partnership that would render the Partners liable for Partnership obligations for which they are not personally liable under *Corporations Code Section 16306*.

Books of Account

3.06. Complete and accurate accounts of all Partnership transactions must be kept in proper books. Each partner shall enter in the Partnership books an accurate account of all transactions carried out by such Partner on behalf of the Partnership.

Inspection of Books

3.07. The books of account and other Partnership records will, at all times, be kept in the Partnership's principal place of business. At all times, each Partner has access to, and may inspect and copy, any Partnership books and records.

Method of Accounting

3.08. The Partnership books of account will be kept on a cash basis.

Fiscal Year

3.09. The fiscal year of the Partnership ends on the _____[*date*] of each year.

Accountings

3.10. As soon after the close of each fiscal year as is reasonable, a full and accurate inventory and accounting shall be made of the Partnership affairs as of the close of the fiscal year. In making the accounting, the net profit or net loss sustained by the Partnership during such fiscal year shall be ascertained and credited or debited, as the case may be, in the Partnership books of account, to the respective Partners in the proportions specified in Paragraph 3.12 of this

Agreement.

Definition of Profits and Losses

3.11. The terms "net profits" and "net losses" as used in this Agreement mean the net profits and net losses of the Partnership as determined by generally accepted accounting principles for each accounting period provided for in this Agreement.

Profits and Losses

3.12. The net profits or net losses of the Partnership will be credited or charged, as the case may be, to the Partners [in equal proportions *or in the following proportions:* _____ (*specify proportions, e.g.,* _____ (*name*) 50 percent, _____ (*name*) 30 percent, _____ (*name*) 20 percent]. Nothing in this Paragraph relating to allocation of losses is intended to require any action on the part of the Partners or the Partnership that would render the Partners liable for Partnership obligations for which they are not personally liable under *Corporations Code Section 16306*.

Capital Accounts

3.13. Each Partner must maintain a separate capital account. An individual Partner's capital account consists of the following:

(1) That Partner's initial contribution to the Partnership capital under Paragraph 3.01 of this Agreement;

(2) That Partner's additional contributions to Partnership capital under Paragraph 3.02 of this Agreement; and

(3) Any amounts transferred from the income to the capital account of that Partner under Paragraph 3.14 of this Agreement.

Income Accounts

3.14. A separate income account will be maintained for each Partner. At the end of each fiscal year each Partner's share of the net profits or net losses of the Partnership shall be credited or debited to, and withdrawals during that fiscal year deducted from, that Partner's income account. After those amounts have been credited or debited to and deducted from a Partner's income account, any balance or deficit remaining in the account shall be transferred to or charged against that Partner's capital account.

Bank Accounts

3.15. All Partnership funds will be deposited in accounts in the name of the Partnership at any bank or banks in _____ County, California, as may from time to time be selected by a majority vote of all Partners. All withdrawals from these accounts will be made only by check or other written instrument signed by at least two Partners.

Tax Matters Partner

3.16. The Partnership designates _____[*name*] as the Tax Matters Partner.

ARTICLE 4 RIGHTS AND DUTIES OF PARTNERS

Time Devoted to Partnership

4.01. Each Partner must devote undivided working time and professional skill and attention to the Partnership business. A Partner may not provide professional services to any business enterprise that is not a client. A Partner may not [engage *or* engage or invest] in any other business, except the ownership of stock or bonds listed on a national securities exchange, without the consent of all other Partners.

Salaries

4.02. No Partner is entitled to any salary or other compensation for services in the Partnership business.

Draws

4.03. Each Partner is entitled to withdraw from the Partnership funds the sum of $ _____ per month for personal use. Each withdrawal by a Partner will be charged against that Partner's share of the Partnership net profits for the fiscal year in which made. If the total withdrawals by any Partner during any fiscal year exceeds that Partner's share of the net profits for that year, the Partner will not be entitled to further withdrawals until the deficiency has been repaid to the Partnership.

The limitation on the amount of withdrawals contained in this paragraph may be increased or decreased at any time by unanimous consent of the Partners.

Management

4.04. Each Partner has an equal voice in the management and conduct of the Partnership business. Any differences arising among the Partners as to ordinary matters connected with the Partnership business shall be decided by a majority vote of the Partners, each Partner having one vote. No act in contravention of this Agreement, however, may be done without the consent in writing of all the Partners.

Power to Incur Liabilities

4.05. Each Partner has authority to bind the Partnership in making contracts and incurring obligations in the Partnership name and on its credit in the ordinary course of the Partnership business. However, no Partner may incur any obligation in the Partnership name or on its credit exceeding the sum of $ _____ without the consent of the other Partners. Any Partner who incurs any obligation in the name and on the credit of the Partnership in violation of this provision shall be individually liable to the other Partners for the entire amount of the obligation incurred. This dollar limitation on the amount of an obligation that may be incurred by a Partner may be increased or decreased at any time by agreement of all Partners.

Vacations and Sick Leave

4.06. Each Partner is entitled to a vacation of one business day for each _____days of full time service rendered by that Partner to the Partnership business during the preceding twelve month period. No more than _____ vacation days may be taken by any Partner at one time without the consent of [*specify percentage in numbers or* all] of the remaining Partners. Each Partner is entitled to withdraw from the Partnership funds the amounts specified in Paragraph [*e.g.*, 4.03] of this Agreement during vacation periods.

Each Partner is entitled to [*number*] weeks sick leave each calendar year without adjustment in earnings because of actual sickness or accident to the Partner or any member of the Partner's immediate family. Sick leave not used in one year may not be carried over to future years or used for additional vacation.

In addition to sick leave, each Partner who becomes pregnant is entitled to [*number*] months maternity leave without adjustment in earnings.

Each Partner, in addition to the vacation and sick leave provided for in this Paragraph, is entitled to be absent from the Partnership business for [*number*] days each calendar year for the purpose of attending professional meetings or courses.

Penalty for Extended Absence

4.07. The failure of any Partner not disabled, as provided in Paragraph 5.02 of this Agreement, to devote undivided time and attention to the Partnership business for a period exceeding _____ weeks constitutes an extended absence by that Partner. That Partner will forfeit to the Partnership $ _____ per week for each week of absence unrelated to disability. The amount forfeited will be charged to the absent Partner and distributed to the other Partners in the proportion that their respective shares of the Partnership net profits and net losses bear to one another.

Reimbursement of Expenses

4.08. The Partnership will indemnify all Partners for payments made and personal liabilities reasonably incurred by them in the ordinary and proper conduct of the Partnership business or for the preservation of Partnership business or property.

Prohibited Acts

4.09. No Partner may, without the consent of all other Partners,

(1) Loan any Partnership funds;

(2) Extend Partnership credit to any person a Partner has notified the Partnership not to trust;

(3) Incur any obligations in the name or on the credit of the Partnership except in the ordinary course of the Partnership business; and

(4) Become bail, surety, or indorser for any other person.

Any loss sustained by the Partnership because of the breach of this Paragraph by any Partner will be deducted from that Partner's share of the Partnership net profits, or if the net profits for the fiscal year in which the breach occurred be

insufficient, from that Partner's capital interest in the Partnership.

Personal Debts

4.10. All Partners must discharge their separate obligations as they become due and protect the other Partners and the Partnership from all costs, claims, and demands in relation to those obligations.

Assignment of Interest

4.11. No Partner may sell, assign, mortgage, hypothecate, or encumber an interest in the Partnership.

Malpractice Coverage; Compliance With Security Requirements

4.12. Each Partner agrees to indemnify the Partnership for all damages and expenses for which the Partnership may become liable as a result of any alleged act of negligence or professional malpractice on the part of that Partner to the extent that the damages and expenses are not paid or reimbursed under a policy of insurance carried by the Partnership.

The Partnership will satisfy the statutory security requirements of *Corporations Code Section 16956* in the following manner: [*specify*].

[*Select one of the following:*]

[*If the insurance or financial asset method (see Corp. Code § 16956(a)(3)(A), (B)) is selected, add:*]

Whenever a new Partner is added to the Partnership, the Partnership will ensure that the Partnership is still in compliance with the statutory security requirements.

[*OR, if the net worth method (see Corp. Code § 16956(a)(3)(D)) is selected, add:*]

The Partnership will file a statement (on official Form LLP-3) with the California Secretary of State to establish that the Partnership has a net worth of at least $10 million in its most recently completed fiscal year. The Partnership will file this statement annually for as long as this statement is true and the Partnership remains a limited liability partnership. If the Partnership's net worth becomes less than $10 million for any fiscal year, and the Partnership wishes to remain a limited liability partnership, the Partnership will satisfy the security requirements by another method.

[*CONTINUE*]

Each Partner, by virtue of that Partner's status as a partner, automatically guarantees payment of any difference between the maximum amount of security required by statute and the security otherwise provided by the Partnership. The aggregate amount paid by all Partners under these guarantees may not exceed that difference. The withdrawal of a Partner does not affect the rights and obligations of the Partner arising before withdrawal.

ARTICLE 5 TERMINATION OF PARTNERS AND PARTNERSHIP

Expulsion of a Partner

5.01. A Partner may be expelled from the Partnership for any of the following:

(1) Willful breach of any provision contained in this Agreement;

(2) Conduct adversely affecting the Partnership business or reputation;

(3) Conduct relating to Partnership matters that makes continuation of the Partnership unreasonable if that Partner remains a member.

(4) Loss of professional license, threat of disciplinary action by or resignation from regulatory professional association, or failure to satisfy continuing education requirements.

(5) Bankruptcy.

(6) Assignment for benefit of creditors.

(7) Conviction of crime involving moral turpitude that affects the Partnership or its reputation.

A Partner will be expelled on the unanimous vote of all other Partners. The other Partners must serve the expelled Partner with a written notice stating the grounds for and effective date of the expulsion and bearing all the other Partners' signatures. Within _____[_____days *or* a reasonable time] after the expulsion becomes effective, the expelled Partner is entitled to receive the value of that Partner's Partnership interest. The value of the expelled Partner's Partnership interest will be determined by a complete inventory and accounting of Partnership affairs as of the close of business on the day the expulsion became effective, less the value of Partnership goodwill, and less any damages sustained by the other Partners because of the breach, if any, of this Agreement by the expelled Partner.

The expulsion of one or more Partners does not terminate the Partnership.

Disability of a Partner

5.02. If any Partner, in the opinion of any medical doctor duly licensed to practice in California, becomes unable because of any physical or mental disability to devote full time and attention to the Partnership business, that Partner will, subject to the following terms and conditions, be excused from devoting any time or attention to the Partnership business during the continuance of that disability:

(1) During the first

_____ [*period, e.g.,* six months] of disability, the disabled Partner shall continue to be entitled to receive the full share of the Partnership net profits as specified in this Agreement and to withdraw from the Partnership funds each month the full amount specified in Paragraph

_____ [*e.g.,* 4.03] of this Agreement.

(2) At any time after the disabled Partner has been unable to devote full time and attention because of

that disability to the Partnership business for a period of

_____ [*e.g.*, six months] or longer, the remaining Partners by majority vote may terminate the disabled Partner's Partnership interest by serving on the disabled Partner written notice of termination, stating its effective date.

The disability of one or more Partners does not terminate the Partnership.

Bankruptcy, Insanity, or Charging Order

5.03. The remaining Partners, by service of a written notice stating the effective date on both the Partner and on the trustee in bankruptcy of that Partner, the guardian of that Partner, or the judgment creditor of that Partner who has obtained a charging order against that Partner's interest, may terminate the interest in the Partnership of any Partner

(1) Who has been adjudged a bankrupt pursuant to a petition in bankruptcy filed by or against that Partner under the Bankruptcy Act of the United States;

(2) For whom a conservator has been appointed pursuant to *Probate Code Sections 1800 through 1849.5*.

(3) Against whose interest in the Partnership a charging order has been issued under *Corporations Code Section 16504* and not removed within 30 days after its issuance.

The bankruptcy or insanity of one or more Partners does not terminate the Partnership.

Withdrawal of a Partner

5.04. Any Partner may voluntarily withdraw from the Partnership by giving all other Partners at least [*number e.g.*, 90] days written notice of the Partner's intention to withdraw.

The withdrawal of one or more Partners does not terminate the Partnership.

Retirement of a Partner

5.05. Any Partner may retire or be retired by the Partnership as follows:

(1) A partner must retire at the end of the Partnership's fiscal year following the Partner's 65th birthday, unless a majority of the other Partners consent to extend the retirement date for a limited period.

(2) A Partner may retire at the end of the Partnership's fiscal year following the Partner's

_____ [*number e.g.*, 60th] birthday, with full benefits, if the Partner notifies the Partnership in writing of the Partner's intended retirement at least one year before the desired retirement date.

The retirement of one or more Partners does not terminate the Partnership.

Option to Purchase Terminated Interest

5.06. On dissolution of a Partnership interest by reason of a Partner's death, or by reason of any matters stated in Paragraph 5.02, 5.03, or 5.04 of this Agreement, the remaining Partners have an option to purchase the interest of the deceased, terminated, or withdrawing Partner in the assets and goodwill of the Partnership business by paying to that Partner (or the person legally entitled to compensation) the value of that Partner's interest, determined as provided in Paragraph 5.07. The remaining Partners must give notice of their exercise of that option in the following manner:

(1) If the Partnership is dissolved by the death of a Partner, by serving written notice of their exercise of this option on the personal representative of the deceased Partner within

_____ [*number*] days after the appointment and qualification of the personal representative.

(2) If the Partnership is dissolved by the voluntary withdrawal of a Partner, by serving written notice of the exercise of this option of the withdrawing Partner within

_____ [*number e.g.,* 30] days after service on the remaining Partners of the notice of withdrawal provided in Paragraph 5.04 of this Agreement.

(3) If the Partnership is dissolved because of the disability of a Partner pursuant to Paragraph 5.02 of this Agreement, by serving written notice of the exercise of the option on the disabled Partner at the same time the notice of termination of his or her Partnership interest is served on the disabled Partner.

(4) If the Partnership is dissolved for any of the reasons specified in Paragraph 5.03 of this Agreement, by serving written notice of the exercise of this option on both the terminated Partner and that Partner's trustee in bankruptcy, guardian, or the judgment creditor who secured a charging order against the terminated Partner's interest, at the same time the notice of termination of the terminated Partner's partnership interest is served on those persons.

Purchase Price of Partnership Interest

5.07. On exercise of the option described in Paragraph 5.06 of this Agreement to purchase an outgoing Partner's Partnership interest, the remaining Partners must pay to the person legally entitled thereto, in the manner specified in Paragraph 5.08, the value of the outgoing Partner's interest, determined as follows:

(1) The remaining Partners, at the time they give notice in the manner specified in Paragraph 5.06 of their exercise of the option to purchase, must appoint an appraiser. Within

_____ [*number*] days after receiving that notice, the person legally entitled to receive the value of the Partnership interest being purchased must appoint an appraiser. If the two appraisers so appointed are unable to agree on the value of the interest within

_____ [*number*] days, they will appoint a third appraiser. The decision in writing of any two of the three appraisers is binding and conclusive on the parties to this Agreement and on any

person legally entitled to receive the value of that deceased, withdrawing, or terminated Partner's interest. If the Partnership is terminated because of a charging order issued against the interest of the terminated Partner, unless the remaining Partners guarantee in writing the payment to the judgment creditor who secured that charging order the full amount of the claim, including interests and costs, the appraiser to be appointed by the person legally entitled to receive the value of that terminated Partner's interest will be appointed by the court that issued the charging order. All fees and expenses of each appraiser shall be paid by

_____ [the remaining Partners *or* the purchasing and selling parties in equal proportions *or* the party on whose behalf the appraiser was appointed, and the fees and expenses of the third appraiser to be paid equally by the purchasing and selling parties].

(2) In determining the value of the Partnership interest to be purchased, the appraisers shall value

(a) All items of inventory at their actual cost to the Partnership.

(b) All tangible assets of the Partnership, including lands, buildings, fixtures, machinery, automobiles, and equipment, at their fair cash market value;

(c) All accounts receivable due the Partnership that are not more than 90 calendar days old and not barred by the statute of limitations at one-half their face value;

(d) All accounts receivable due the Partnership that are less than 90 calendar days old at their full face value; and

(e) Goodwill and other intangible assets of the Partnership at their fair cash market value.

Payment of Purchase Price

5.08. On exercise of the option to purchase the Partnership interest of a deceased, withdrawing, or terminated Partner, the remaining Partners must pay, to the person legally entitled to payment, the value of the interest, determined as provided in Paragraph 5.07 of this Agreement as follows:

(1) One half in cash on receipt of the appraisers' report provided for in Paragraph 5.07; plus

(2) The balance in 12 equal monthly installments commencing not later than 30 days after receipt of that report.

Each monthly installment will be applied first to interest at the rate of _____ percent per annum on the then remaining unpaid principal balance of the purchase price from the date the appraisers' report was received by the remaining Partners and then to the reduction of principal.

Purchase by Less Than All Remaining Partners

5.09. If any remaining Partner is unable or unwilling to exercise the option contained in Paragraph 5.06 of this Agreement to participate in the purchase of an outgoing Partner's interest, the option may be exercised and the interest

purchased by the other remaining Partners. No remaining Partner may be denied a right to participate in such a purchase if that Partner delivers to all other Partners a written declaration of intent to participate. This written declaration must be delivered before the appraisers' report is delivered.

Death of a Partner

5.10. The death of one or more Partners does not terminate the Partnership. After the death of a Partner, the remaining Partners may continue the business of the Partnership. The effective date of separation from the Partnership is the last day of the month in which death occurred. Neither the personal representative nor the estate of the deceased Partner will be liable for any obligations of the Partnership incurred after the separation date.

Assumption of Partnership Obligations

5.11. On any purchase and sale of a Partnership interest under this Agreement, the remaining Partners must assume all Partnership obligations and must protect and indemnify the separating Partner, the personal representative, and the estate of a deceased, insane, or incompetent Partner, and the property of any separating, deceased, insane, or incompetent Partner from liability for any Partnership obligations.

Publication of Notice

5.12. On any purchase and sale of a Partnership interest under this Agreement, or on the expulsion of a Partner pursuant to Paragraph 5.01 of this Agreement, the remaining Partners must, at their own costs and expenses, as soon as reasonably practicable after giving notice of expulsion or of exercise of their option to purchase the departing Partner's interest, prepare, publish, file, and serve all notices required by law to protect the expelled, withdrawing, or terminated Partner and the personal representative and estate of a deceased, insane, or incompetent Partner from liability for future obligations of the Partnership business.

Dissolution Without Sale

5.13. On dissolution of the Partnership other than as provided in Paragraphs 5.01 through 5.12 of this Agreement, the affairs of the Partnership must be wound up, the assets liquidated, the debts paid, and the remaining funds divided among the Partners according to their then net worths in the Partnership business.

ARTICLE 6 MISCELLANEOUS

Notices

6.01. All notices between the Partners must be in writing and will be deemed duly served when personally delivered to a Partner, or, in lieu of personal service, when deposited in the United States mail, certified, first-class postage prepaid, addressed to the Partner at the address of the principal place of business of the Partnership [or to any other place as may be specified in a notice given pursuant to this Paragraph as the address for service of notice on the Partner].

Consents and Agreements

6.02. Any and all consents and agreements provided for or permitted by this Agreement shall be in writing. Signed

copies of all consents and agreements must be filed and kept with the books of the Partnership.

Attorneys' Fees

6.03. If any litigation is commenced between the Partners or their personal representatives concerning any provision of this Agreement or the rights and duties of any person in relation to this Agreement, the prevailing party or parties will be entitled, in addition to any other relief as may be granted, to a reasonable sum for their attorneys' fees in that litigation. The amount of this sum will be determined either by the court or in a separate action brought for that purpose.

Amendments

6.04. No amendment to this Agreement is valid unless made in writing and signed by all of the Partners.

Sole Agreement

6.05. This instrument constitutes the sole agreement of the parties relating to their Partnership and correctly sets forth the rights, duties, and obligations of each to the others as of its date. Any previous agreements, promises, negotiations, or representations not expressly set forth in this Agreement are of no force and effect.

Summary of Limited Liability

6.06. This partnership has fulfilled all requirements necessary to secure its status as a limited liability partnership. Nothing in this Agreement is intended to render the Partners liable for Partnership obligations for which they are not personally liable under *Corporations Code Section 16306(c)*. This Paragraph overrides any other provision in this Agreement that is or might be interpreted as inconsistent with this principle.

Executed on _____[*date*], at _____ City, _____ County, California.

_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]
_____ [*signature of partner*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
C. Limited Liability Partnership Agreements
1. Complete Agreements

8-16C California Legal Forms--Transaction Guide §§ 16C.243-16C.249

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.243[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
C. Limited Liability Partnership Agreements
2. Provisions Protecting Limited Liability

8-16C California Legal Forms--Transaction Guide § 16C.250

AUTHOR: by Kristin M. Schwaighart

§ 16C.250 Statement That Specific Provision Does Not Extend Liability

[1] Comment--Use of Form

This form is a statement that nothing in a particular paragraph of an LLP agreement may be interpreted to require any action by the management committee on behalf of the partners, the partnership, or any management committee that would extend the liability of partners beyond the provisions of *Corp. Code § 16306(c)*. The form may be added to articles and/or individual paragraphs that might otherwise raise the issue of expanded liability [*see § 16C.22[4]*]. In particular, this form should be included in provisions dealing with the allocation of partnership losses.

[2] FORM

Statement That Specific Provision Does Not Extend Liability

_____. Nothing in this Paragraph is intended to require any action of the Management Committee that would render the Partners liable for Partnership obligations for which they are not personally liable under *Corporations Code Section 16306(c)*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
C. Limited Liability Partnership Agreements
2. Provisions Protecting Limited Liability

8-16C California Legal Forms--Transaction Guide § 16C.251

AUTHOR: by Kristin M. Schwaighart

§ 16C.251 Provision That Nothing in Agreement Extends Liability

[1] Comment--Use of Form

This form is a general provision summarizing that nothing in the partnership agreement may be interpreted to render any partners liable for any obligations of the partnership for which they would not be liable under the provisions of *Corp. Code § 16306(c)*. It further states that it overrides any other inconsistent provision in the agreement. This form may be added to any LLP agreement, presumably at or near the end of the agreement [*see § 16C.22[4]*].

[2] FORM

Provision That Nothing in Agreement Extends Liability

Summary of Limited Liability

_____. This partnership has fulfilled all requirements necessary to secure its status as a limited liability partnership. Nothing in this Agreement is intended to render the Partners liable for Partnership obligations for which they are not personally liable under *Corporations Code Section 16306(c)*. This Paragraph overrides any other provision in this Agreement that is or might be interpreted as inconsistent with this principle.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
C. Limited Liability Partnership Agreements
2. Provisions Protecting Limited Liability

8-16C California Legal Forms--Transaction Guide §§ 16C.252-16C.269

AUTHOR: by Kristin M. Schwaighart

[Reserved]

§§ 16C.252[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
D. Related Forms

8-16C California Legal Forms--Transaction Guide § 16C.270

AUTHOR: by Kristin M. Schwaighart

§ 16C.270 Cover Letter for LLP's Certificate or Application for Registration

[1] Comment--Use of Form

This form is a cover letter to accompany a domestic certificate of registration (Form LLP-1) [*see § 16C.200*] or foreign application for registration (Form LLP-5) [*see* § 16C.210]. LLP forms must be filed with the LLP Unit in the Sacramento office of the Secretary of State. The letter should explain that the certificate or application is submitted for filing, state any delayed effective date, and state that the requisite fee is enclosed [*see Corp. Code §§ 16953(b), 16959(b)*; *see also Gov. Code § 12189(a), (b)*].

[2] FORM

Cover Letter for LLP's Certificate or Application for Registration

_____[*date*]

Office of the Secretary
Limited Liability Partnership Unit
P.O. Box 944228
Sacramento, CA 94244-2280

Re: [Certificate of *or* Application for] Registration as a Limited Liability Partnership

Dear Sir or Madam:

Enclosed for filing is the executed original [certificate of *or* application for] registration of _____[

name of LLP] as a limited liability partnership. Please immediately file the [certificate of *or* application for] registration, certify and endorse the file date, and return a certified copy to the undersigned.

[*Optional:*]

The [certificate of *or* application for] registration specifies a delayed effective date of [*specify*].

[*CONTINUE*]

A check for $ [*specify statutory filing fee (see Corp. Code §§ 16953(b), 16959(b); see also Gov. Code § 12189(a), (b))*] is enclosed to cover the filing fee for the [certificate *or* application]. A self-addressed, stamped envelope is also enclosed for your convenience.

Thank you for your attention to this matter.

Very truly yours, _____ [*signature*]
[*typed name*]
_____ [*name of LLP*]
_____ [*address*]



72 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 16C LIMITED LIABILITY PARTNERSHIPS
PART IV. FORMS
D. Related Forms

8-16C California Legal Forms--Transaction Guide § 16C.271

AUTHOR: by Kristin M. Schwaighart

§ 16C.271 Legal LLP Name Change

[1] Comment--Use of Form

This form is used to report a name change to the California State Bar. Rule 11.0 of the Limited Liability Partnership Rules and Regulations of the State Bar [*see § 16C.231[2]* (State Bar LLP Rules and Regulations, Rule 11)] requires legal LLPs to report any name change to the State Bar within 45 days of the change. To effect a name change, the following items must be forwarded to the State Bar [*see* instructions on State Bar of California website, http://www.calbar.org/2cer/llp/name.htm]:

- An original certified copy of Form LLP-2 [*see § 16C.201[2]*], including the cover page with the red date stamp. These forms may be obtained online or by contacting the Secretary of State's LLP filing unit at (916) 653-3795.

- A Declaration of Compliance with *Rule 1-400 of the Rules of Professional Conduct* of the State Bar of California setting forth the new LLP name. This declaration must be signed by a partner authorized to act on behalf of the LLP.

On receipt of these items, the LLP's file will be further reviewed. On completion of the processing procedure, a Certificate of Registration will be issued to the LLP in its new name. There is no fee to request a name change from the State Bar [*see* instructions on State Bar of California website, http://www.calbar.org/2cer/llp/name.htm].

[2] FORM

Legal LLP Name Change

_____[*date*]

Office of the Secretary
Limited Liability Partnership Unit
P.O. Box 944228
Sacramento, CA 94244-2280

Re: _____ Request for Name Change for _____[*name of existing limited liability partnership*]
Dear Sir or Madam:

This letter reports a name change for _____[*name of existing limited liability partnership*]. The new name of the LLP is _____.

The undersigned partner declares that _____[he *or* she] is authorized to act on behalf of the LLP. _____[*New name*] is in compliance with *Rule 1-400 of the Rules of Professional Conduct* of the State Bar relating to communications and solicitations.

Enclosed is an original certified copy of the Secretary of State's Amendment to Registration (LLP-2), which was filed on _____[*date*].

Please process this request as soon as practicable and issue a new Certificate of Registration in the name of _____.

Thank you for your attention to this matter.

Very truly yours,
_____ [*signature*]
[typed name, Partner]
_____ [*name of LLP*]
_____ [*address*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE

8-17 California Legal Forms--Transaction Guide 17.syn

AUTHOR: Marilyn E. Minger Revision Author

§ 17.syn Synopsis to Chapter 17: BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE

§ 17.01 California Sources

[1] Constitution

[2] Statutes

[3] Regulations

[4] Rules of Professional Conduct

§ 17.02 Federal Sources

[1] Statutes

[2] Regulations

§§ 17.03-17.04 [Reserved]

§ 17.05 Law Reviews and Periodicals

§ 17.06 Annotations

§ 17.07 Text References

§§ 17.08-17.09 [Reserved]

§ 17.10 Legal Considerations in the Purchase and Sale of a Business

§ 17.11 Evaluating Income Tax Consequences of Sale

[1] Identifying Basic Income Tax Issues

[2] Determining Amount of Gain or Loss

[3] Determining Character of Gain or Loss

[4] Allocating Purchase Price to Each Asset

[a] Burden on Parties to Purchase and Sale

[b] Applicable Asset Acquisition

[c] Treatment of Applicable Asset Acquisition

[d] Allocation Inconsistent With Allocation in Parties' Written Agreement

[5] Reporting Requirements for Additional Information

§ 17.12 Evaluating Sales Tax Consequences of Selling a Business

[1] Applicability of Sales Tax

[a] Transactions Subject to State and Local Sales Taxes

[b] Types of Assets Typically Subject to Sales Tax on Sale of Business

[2] Determining Whether "Occasional Sales" Exemption Is Applicable to Sale

[3] Evaluating Businesses Making Taxable and Nontaxable Sales

§ 17.13 Evaluating Property Tax Consequences of Sale

[1] Transferring Real Property in Sale of Business

[2] Determining Amount of Property Tax

§ 17.14 Evaluating Effect of Successor Liability Statutes

[1] Withholding Sufficient Portion of Purchase Price to Pay State Taxes

[2] Withholding Sufficient Portion of Purchase Price to Pay Sales and Use Taxes

[a] Withholding Obligation

[b] Buyer's Failure to Withhold Sufficient Funds

[c] Tax Clearance Certificate

[3] Withholding Sufficient Portion of Purchase Price to Pay Employment Taxes

[4] Withholding Sufficient Portion of Purchase Price to Pay California Income Tax Withholding

§ 17.15 Assignment of Trademarks or Service Marks

[1] "Trademarks" and "Service Marks" Defined

[2] Transferring Trademarks and Service Marks

§ 17.16 Complying With Hazaradous Materials Regulations

[1] Hazardous Materials Defined

[2] Governing Laws

[3] Evaluating Compliance and Potential Liability

§ 17.17 Letter of Intent for Anticipated Sale

[1] Purpose of Letter of Intent

[2] Binding Nature of Letter of Intent

§ 17.18 Conducting Due Diligence

[1] Purpose of Due Diligence

[2] Obtaining Relevant Information About the Business

[3] Timing of Due Diligence

[4] Assuring Confidentiality of Business Information

§ 17.19 Use of Noncompetition Clauses in the Purchase and Sale of a Business

[1] Restricting Regional Competition by Seller

[2] In Sale of Law Practice

[3] Using Liquidated Damages Clause to Remedy Breach of Noncompetition Agreement

§ 17.20 Business Transfers Governed by Bulk Sales Division of Commercial Code

[1] Protecting Creditors From Seller Fraud

[2] "Bulk Sales" Defined

[a] Sales Subject to Bulk Sales Division

[b] Sales Exempt From Bulk Sales Division

[3] Determining if Business Is Subject to Bulk Sales Division

[4] Failure to Comply With Bulk Sales Division

[a] Buyer's Liability

[b] Exception When Buyer Has Made Good Faith Effort to Comply

[c] Limitations on Buyer's Liability

[d] Time for Commencement of Action

[5] Complying With Notice Requirements Under Bulk Sales Division

[a] Notice of Sale

[b] Recording, Publishing, and Delivering Notice

[6] Paying Creditor Claims

[a] Transactions Subject to Requirements

[b] Obligations of Buyer

[c] Submission of Claims to Seller; Disputed Claims

[d] Payment of Undisputed Claims

[7] Paying Creditors When Claims Exceed Cash Deposit

[a] Deposit of Purchase Price With Escrow Agent

[b] Delay of Closing and Written Notice to Creditors

[c] Distribution to Creditors in Order of Priority

[d] Allocation of Principal and Interest on Buyer's Future Payment Obligations

[e] Payment for Commissions and Related Expenses

[8] Considering Special Rules for Bulk Sale Auctions and Liquidations

§ 17.21 Evaluating Transaction Under Laws Governing Fraudulent Transfers

[1] Uniform Fraudulent Transfer Act

[2] Civil Code Provisions Applicable to Transfers of Personal Property Without Delivery

§ 17.22 Special Considerations for Purchase and Sale of Professional Practices

[1] Professional Practices Defined

[2] Sale of Business Goodwill

[3] Transferring Work in Progress

[4] Determining Applicability of Tax Laws in Transfer of Professional Practice

[5] Sale of Law Practice

[a] Sale to Another Bar Member of Law Firm

[b] Conditions of Sale

[c] Agreement Not to Practice Law Generally Unenforceable

[d] Providing Notice to Client

[e] Contents of Notice to Clients

[f] Obtaining Client's Consent

[g] Obtaining Client's Consent for Division of Fees After Transfer of Practice

§ 17.23 Purchase and Sale of Franchise

[1] "Franchise" Defined

[2] Restrictions on Franchise Sale

§§ 17.24-17.99 [Reserved]

§ 17.100 Attorney's Representation of Parties

Scope

§ 17.101 Basic Facts About Buyer

Scope

§ 17.102 Basic Facts About Seller

Scope

§ 17.103 Basic Facts About Business

Scope

§ 17.104 Documents

Scope

§§ 17.105-17.109 [Reserved]

§ 17.110 Basic Terms of Sale

Scope

§ 17.111 Applicability of Bulk Sales Division

Scope

§ 17.112 Applicability of Sales and Use Tax

Scope

§ 17.113 Other Pre-Sale Determinations

Scope

§§ 17.114-17.119 [Reserved]

§ 17.120 Drafting Letter of Intent

Scope

§ 17.121 Due Diligence Checklist

Scope

§ 17.122 Preparing Sales Documents

Scope

§ 17.123 Giving Notice Required by Bulk Sales Division

Scope

§ 17.124 Handling Creditor Claims Under Bulk Sales Division

Scope

§ 17.125 Closing the Sale

Scope

§ 17.126 Satisfying Seller's Tax Obligations

Scope

§ 17.127 Distributing Proceeds When Com. Code §§ 6106.2 and 6106.4 Are Inapplicable

Scope

§ 17.128 Distributing Proceeds When Com. Code §§ 6106.2 and 6106.4 Apply

Scope

§ 17.129 Reporting Statutory Change in Ownership of Real Property

Scope

§ 17.130 Reporting Income Tax Consequences of Sale

Scope

§§ 17.131-17.199 [Reserved]

§ 17.200 Contract for Sale of Business

[1] Comment

[a] Use of Form

[b] Mandatory Terms of Sales Contract

[c] Description of Property Being Sold

[d] Amount of Purchase Price

[e] Allocation of Purchase Price

[f] Payment of Purchase Price

[g] Seller's Warranties Regarding Business

[h] Assumption of Liabilities

[i] Closing of Sale

[j] Bills of Sale

[k] Conduct of Business

[l] Risk of Loss

[m] Proration of Expenses

[n] Inventory

[o] Insurance Policies

[p] Indemnification

[q] Attorneys' Fees

[r] Arbitration

[s] Standard Contractual Provisions

[t] Additional Provisions

[u] Attached Exhibits

[2] FORM

Contract for Sale of Business

§ 17.201 Contract of the Sale of Business and Real Property

[1] Comment

[a] Use of Form

[b] Combined Sale of Business and Real Property

[c] Sale of Business

[d] Issuance of License

[e] Sale of Real Property

[f] Payment of Purchase Price

[g] Risk of Loss

[h] Liquidated Damages

[i] Time of the Essence

[j] Standard Contractual Provisions

[k] Optional Contract Provisions

[2] FORM

Contract of the Sale of Business and Real Property

§§ 17.202-17.209 [Reserved]

§ 17.210 Bulk Sales Provisions

[1] Comment

[a] Use of Form

[b] Compliance With Bulk Sales Law

[2] FORM

Bulk Sales Provisions

§ 17.211 Provisions for Sale of Professional Practice

[1] Comment

[a] Use of Form

[b] Sale of Law Practice

[c] Seller's Warranties

[d] Buyer's Warranties

[e] Protection of Goodwill.

[f] Malpractice Insurance

[g] Assumption of Obligations

[2] FORM

Provisions for Sale of Professional Practice

§ 17.212 Limitations on and Procedures for Indemnification

[1] Comment--Use of Form

[2] FORM

Limitations on and Procedures for Indemnification

§ 17.213 Noncompetition Provision

[1] Comment

[a] Use of Form

[b] Severability Provision

[c] Professional Practices

[d] Liquidated Damages

[2] FORM

Noncompetition Provision

§ 17.214 Warranty by Seller Regarding Hazardous Materials

[1] Comment--Use of Form

[2] FORM

Warranty by Seller Regarding Hazardous Materials

§ 17.215 Seller's Conduct of Business Pending Closing

[1] Comment--Use of Form

[2] FORM

Seller's Conduct of Business Pending Closing

§ 17.216 Seller's Association With Business After Sale

[1] Comment--Use of Form

[2] FORM

Seller's Association With Business After Sale

§ 17.217 Buyer's Use of Current Business Name or Seller's Name Prohibited

[1] Comment

[a] Use of Form

[b] Relationship Between Business Name and Goodwill

[c] Limitations on Use of Transferred Name

[2] FORM

Buyer's Use of Current Business Name or Seller's Name Prohibited

§ 17.218 Sale Conditioned on Creditors' Acceptance of Purchase Price for Debts

[1] Comment

[a] Use of Form

[b] Payment to Creditors

[2] FORM

Sale Conditioned on Creditors' Acceptance of Purchase Price for Debts

§ 17.219 Delaying Closing to Obtain Business License

[1] Comment--Use of Form

[2] FORM

Delaying Closing to Obtain Business License

§ 17.220 Provision Assigning Registered Trademark or Service Mark

[1] Comment--Use of Form

[2] FORM

Provision Assigning Registered Trademark or Service Mark

§§ 17.221-17.249 [Reserved]

§ 17.250 Escrow Instructions for Sale of Business--Subject to Bulk Sales Division

[1] Comment

[a] Use of Form

[b] Use of Escrow

[c] Escrow Instructions

[d] Duties of Escrow Agent

[e] Joint or Separate Instructions

[f] Request for Information (Form UCC-11)

[g] Standard Escrow Instructions--Recitals

[h] Obligations to Escrow Holder

[i] Deposits Into Escrow

[j] Inventory

[k] Transfer of Documents

[l] Proration of Expenses

[2] FORM

Escrow Instructions for Sale of Business--Subject to Bulk Sales Division

§§ 17.251-17.259 [Reserved]

§ 17.260 Agreement to Find Purchaser for Business ("Finder's Agreement")

[1] Comment

[a] Use of Form

[b] Finder's Duties

[c] Finder's Fee

[d] Seller's Obligations

[e] Term and Exclusivity

[f] Expenses

[2] FORM

Agreement to Find Purchaser for Business ("Finder's Agreement")

§ 17.261 Letter of Intent

[1] Comment

[a] Use of Form

[b] Binding Nature of Letter of Intent

[2] FORM

Letter of Intent

§ 17.262 Nondisclosure Agreement

[1] Comment

[a] Use of Form

[b] Features of Form

[2] FORM

Nondisclosure Agreement

§ 17.263 Assignment of Service Contracts, Warranties, Guaranties, and Other Intangible Property

[1] Comment--Use of Form

[2] FORM

Assignment of Service Contracts, Warranties, Guaranties, and Other Intangible Property

§§ 17.264-17.269 [Reserved]

§ 17.270 Notice of Intended Bulk Sale

[1] Comment

[a] Use of Form

[b] Contents of Required Notice

[c] Recording, Publishing, and Delivering the Notice

[d] Filing Fees

[2] FORM

Notice of Intended Bulk Sale

§ 17.271 Notice to Creditors Regarding Insufficient Funds

[1] Comment

[a] Use of Form

[b] Delay of Closing and Distribution

[c] Contents of Notice

[d] If Escrow Is Not Used

[2] FORM

Notice to Creditors Regarding Insufficient Funds

§ 17.272 Notice of Sale of Law Practice

[1] Comment

[a] Use of Form

[b] Notice Requirements and Time for Giving Notice

[2] FORM

Notice of Sale of Law Practice

§§ 17.273-17.279 [Reserved]

§ 17.280 Consent of Franchisor

[1] Comment--Use of Form

[2] FORM

Consent of Franchisor

§ 17.281 Consent of Franchisor Subject to Specified Conditions

[1] Comment--Use of Form

[2] FORM

Consent of Franchisor Subject to Specified Conditions

§§ 17.282-17.289 [Reserved]

§ 17.290 Bill of Sale for Business--Basic Form

[1] Comment

[a] Use of Form

[b] Bills of Sale in General

[c] Contents of Form

[2] FORM

Bill of Sale for Business--Basic Form

§ 17.291 Bill of Sale for Business--Including Accounts Receivable and Power of Attorney for Collection

[1] Comment

[a] Use of Form

[b] Power of Attorney to Collect Accounts Receivable

[c] Effect of Transferring Receivables

[2] FORM

Bill of Sale for Business--Including Accounts Receivable and Power of Attorney for Collection

§ 17.292 Bill of Sale for Business--Including Assumption of Obligations and Indemnity Agreement

[1] Comment

[a] Use of Form

[b] Assumption of Liabilities

[2] FORM

Bill of Sale for Business--Including Assumption of Obligations and Indemnity Agreement

§ 17.293 Bill of Sale for Professional Practice

[1] Comment

[a] Use of Form

[b] Work in Progress

[2] FORM

Bill of Sale for Professional Practice

§§ 17.294-17.299 [Reserved]

§ 17.300 Request for Tax Clearance From Board of Equalization

[1] Comment

[a] Use of Form

[b] Purchaser's Withholding Obligations

[c] Addresses of SBE Offices

[2] FORM

Request for Tax Clearance From Board of Equalization

§ 17.301 Request for Tax Clearance From Employment Development Department

[1] Comment

[a] Use of Form

[b] Buyer's Withholding Requirement

[c] Effect of Tax Clearance Certificate

[d] Addresses of Board Offices

[2] FORM

Request for Tax Clearance From Employment Development Department

§ 17.302 Request for Tax Clearance From State of California, Franchise Tax Board

[1] Comment

[a] Use of Form

[b] Buyer's Withholding Requirement

[c] Effect of Tax Certificate or Statement

[d] Address of Franchise Tax Board

[2] FORM

Request for Tax Clearance From State of California, Franchise Tax Board

Marilyn E. Mingern*
Revision Author

FOOTNOTES:

(n52)Footnote *. Marilyn E. Minger is a solo practitioner in Oakland, California, specializing in business law, personal injury, bankruptcy, and probate. Ms. Minger formerly worked for Heller, Ehrman, White & McAuliffe and Pettit & Martin in San Francisco, where she practiced corporate law.



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE

8-17 California Legal Forms--Transaction Guide Scope

AUTHOR: Marilyn E. Minger Revision Author

Scope

Marilyn E. Mingern*
Revision Author Scope

This chapter covers the sale of small, unincorporated businesses and professional practices. Although the topics examined here may also be relevant to the sale of a corporation or partnership, procedures relating specifically to a corporate merger and acquisition or sale of a partnership are not covered in this chapter. For a discussion of the sale of incorporated businesses pursuant to a cash purchase of assets or shares, a merger, or an acquisition of shares for shares or assets for shares, see Ch. 11, *Merger and Acquisition Issues* . For information about the dissolution and sale or merger of a general partnership, see Ch. 15, Part B, *Dissolution of General Partnerships* and Ch. 15, Part C, *Conversions and Mergers of General Partnerships* .

FOOTNOTES:
(n53)Footnote *. Marilyn E. Minger is a solo practitioner in Oakland, California, specializing in business law, personal injury, bankruptcy, and probate. Ms. Minger formerly worked for Heller, Ehrman, White & McAuliffe and Pettit & Martin in San Francisco, where she practiced corporate law.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART I. RESEARCH GUIDE
A. Primary Sources

8-17 California Legal Forms--Transaction Guide § 17.01

AUTHOR: Marilyn E. Minger Revision Author

§ 17.01 California Sources

[1] Constitution

Basis for property taxation. Cal. Const., art. XIII.

Limitations on property taxation. Cal. Const., art. XIIIA.

[2] Statutes

Goodwill.

Defined. *Bus. & Prof. Code § 14100*.

Transfer of goodwill does not include right to use seller's name. *Bus. & Prof. Code § 14101*.

Nature of goodwill as transferable property. *Bus. & Prof. Code § 14102*.

Seller may transfer business name along with goodwill. *Bus. & Prof. Code § 14103*.

Model State Trademark Law. *Bus. & Prof. Code § 14200 et seq.*

Noncompetition agreements.

Contract provision restricting person from engaging in lawful profession, trade, or business is generally void. *Bus. & Prof. Code § 16600*.

Noncompetition agreement is valid when made with sale of business goodwill. *Bus. & Prof. Code § 16601*.

Bills of sale.

Defined as transfer in writing equivalent to grant or conveyance. *Civ. Code § 1053*.

Effective on delivery. *Civ. Code § 1054*.

Conditional delivery to transferee not allowed. *Civ. Code § 1056*.

Conditional delivery to third person called "escrow." *Civ. Code § 1057*.

Transfer of obligations.

Burden of obligation not transferable without consent of beneficiary or creditor. *Civ. Code § 1457*.

Right arising from another's obligation is transferable. *Civ. Code § 1458*.

Contracts generally.

Nature of contracts. *Civ. Code §§ 1549-1615*.

Formation of contracts. *Civ. Code §§ 1619-1632*.

Interpretation of contracts. *Civ. Code §§ 1635-1662*.

Unlawful contracts. *Civ. Code §§ 1667-1670.5*.

Liquidated damages provisions. *Civ. Code § 1671*.

Grounds for rescission of contract. *Civ. Code § 1689*.

Modification of written contract. *Civ. Code § 1698*.

Effect of contractual provision for attorneys' fees and costs. *Civ. Code § 1717*.

Uniform Fraudulent Transfer Act. *Civ. Code §§ 3439-3439.12*.

Conveyance without delivery. *Civ. Code §§ 3440-3440.9*.

Interpleader actions. *Code Civ. Proc. §§ 386-386.6*.

Attorneys' fees provision. *Code Civ. Proc. § 1021*.

Bulk sales.
Title of division. *Com. Code § 6101*.
Definition of bulk sale. *Com. Code § 6102(a)(3)*.
Application of division. *Com. Code § 6103(a)*.
Exempt transfers. *Com. Code § 6103(c)*.

Required notice to creditors. *Com. Code § 6105*.
Transfers for cash consideration. *Com. Code § 6106.2*.
Escrow agent's duties when cash deposited or agreed to be deposited in escrow is insufficient to pay all creditor claims filed with escrow agent. *Com. Code § 6106.4*.
Extent of liability. *Com. Code § 6107*.
Sales by auctioneers and liquidators. *Com. Code § 6108*.
Limitations on creditor's actions against buyers, auctioneers, and liquidators in bulk sales. *Com. Code § 6110*.
Transitional rules. *Com. Code § 6111*.

Secured transactions. *Com. Code § 9101 et seq.*

Escrow Law. *Fin. Code § 17000 et seq.*

Environmental laws.
Duty of inquiry for development projects. *Gov. Code § 65962.5(f)*.
"Hazardous waste" defined. *Health & Safety Code § 25117*.
California Safe Drinking Water and Toxic Enforcement Act (Proposition 65). *Health & Safety Code §§ 25249.5-25249.11*.
Regulation of underground storage tanks. *Health & Safety Code §§ 25280-25299.7*.
Asbestos notification requirements and related requirements. *Health & Safety Code §§ 25915-25919.4*; *Lab. Code §§ 6501.5-6510*.
California Environmental Quality Act of 1970 (CEQA). *Pub. Res. Code § 21000 et seq.*
California Coastal Act of 1976. *Pub. Res. Code § 30000 et seq.*

Sales and Use Tax Law. *Rev. & Tax. Code § 6001 et seq.*
"Retail sale" defined. *Rev. & Tax. Code §§ 6006* ("sale"), 6007 ("retail sale").
"Occasional sale" defined. *Rev. & Tax. Code § 6006.5*.
"Sales price" defined. *Rev. & Tax. Code § 6011*.
"Gross receipts" defined. *Rev. & Tax. Code § 6012*.
"Retailer" defined. *Rev. & Tax. Code § 6015*.
"Tangible personal property" defined. *Rev. & Tax. Code § 6016*.
Sales tax imposed on gross receipts of retailer from sale of tangible personal property sold at retail. *Rev. & Tax. Code § 6051*.
Gross receipts from occasional sales exempt from sales tax. *Rev. & Tax. Code § 6367*.
Successor liable for sales tax owed by business seller. *Rev. & Tax. Code §§ 6811, 6812*.
Requirement for filing sales tax returns. *Rev. & Tax. Code § 6452*.

Personal Income Tax Law. *Rev. & Tax. Code § 17001 et. seq.*

Unemployment and disability compensation insurance contributions.
Duty to withhold purchase price until receipt of certificate of tax clearance. *Unemp. Ins. Code § 1731*.
Request for certificate of tax liability or clearance. *Unemp. Ins. Code § 1732*.
Successor liability for contributions, interest, and penalty owed by seller upon failure to withhold purchase price. *Unemp. Ins. Code § 1733*.
Duty to withhold applicable to state income taxes as well. *Unemp. Ins. Code § 13002(i)*.

[3] Regulations

Activities requiring seller's permit. *18 Cal. Code Reg. § 1595(a)*.

Applicability of sales tax to sale of business. *18 Cal. Code Reg. § 1595(b)*.

Applicability of sales tax to property fixed to land being sold. *18 Cal. Code Reg. § 1596*.

Resale certificates. *18 Cal. Code Reg. § 1668*.

Successor's liability for sales tax. *18 Cal. Code Reg. § 1702*.

[4] Rules of Professional Conduct

Restrictions on payment of fee to nonattorney broker for purchase or sale of law practice. *Cal. Rules Prof. Conduct, Rule 1-320*.

Restrictions on attorney's communications to former, present, or prospective clients. *Cal. Rules Prof. Conduct, Rule 1-400(D)*.

Restrictions on agreements not to practice law. *Cal. Rules Prof. Conduct, Rule 1-500*.

Restrictions on division of fees for legal services between attorneys not associated in practice. *Cal. Rules Prof. Conduct, Rule 2-200*.

Conditions on sale or purchase of law practice. *Cal. Rules Prof. Conduct, Rule 2-300*.

Attorney's obligation to avoid adverse interests. *Cal. Rules Prof. Conduct, Rule 3-300*.

Attorney's obligation to avoid representation of adverse interests. *Cal. Rules Prof. Conduct, Rule 3-310*.

Attorney's obligation to client upon termination of employment. *Cal. Rules Prof. Conduct, Rule 3-700*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART I. RESEARCH GUIDE
A. Primary Sources

8-17 California Legal Forms--Transaction Guide § 17.02

AUTHOR: Marilyn E. Minger Revision Author

§ 17.02 Federal Sources

[1] Statutes

Trademarks and service marks.

Defined. *15 U.S.C. § 1127*.

Assignable when goodwill of business is transferred. *15 U.S.C. § 1060*.

Income tax statutes.

Depreciation deductions allowed for trade or business property. *I.R.C. §§ 167, 168*.

Determination of gain or loss on sale of business. *I.R.C. §§ 1001(a), (b), 1011*.

Rules governing allocation of purchase price in asset acquisitions. *I.R.C. § 1060*.

Capital asset defined. *I.R.C. § 1221*.

Treatment of property used in trade or business. *I.R.C. § 1231*.

[2] Regulations

Rules governing allocation of purchase price in asset acquisitions. Temp. Treas. Reg. §§ 1.338(b)-2T, 1.1060-1T.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART I. RESEARCH GUIDE
A. Primary Sources

8-17 California Legal Forms--Transaction Guide §§ 17.03-17.04

AUTHOR: Marilyn E. Minger Revision Author

[Reserved]

§§ 17.03[Reserved]



78 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART I. RESEARCH GUIDE
B. Secondary Sources

8-17 California Legal Forms--Transaction Guide § 17.05

AUTHOR: Marilyn E. Minger Revision Author

§ 17.05 Law Reviews and Periodicals

Nichols & Bradford, *Corporate Acquisitions and Successor Liability (With Forms)*, 44(5) Prac. Law. 21 (1998).

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART I. RESEARCH GUIDE
B. Secondary Sources

8-17 California Legal Forms--Transaction Guide § 17.06

AUTHOR: Marilyn E. Minger Revision Author

§ 17.06 Annotations

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART I. RESEARCH GUIDE
B. Secondary Sources

8-17 California Legal Forms--Transaction Guide § 17.07

AUTHOR: Marilyn E. Minger Revision Author

§ 17.07 Text References

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Ch. 1C, *Regulation of Employers*.

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Ch. 1E, *Taxation of Businesses*.

Ch. 1F, *Insurance Considerations in Business Formation*.

Ch. 2A, *Incorporating a Going Business*.

Ch. 11, *Merger and Acquisition Issues*.

Ch. 12, *Winding Up and Dissolution*.

Ch. 12A, *Professional Corporations*.

Ch. 15, *General Partnerships*.

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Part B, *Dissolution of General Partnerships.*

Part C, *Conversions and Mergers of General Partnerships.*

Ch. 15B, *Dissolution of Limited Partnerships*.

Ch. 26, *Real Property Escrows*.

Ch. 34C, *Retail, Industrial, and Office Leases*.

Ch. 42, *Secured Transactions*.

Ch. 51, *Franchise Agreements*.

Ch. 75, *Formation of Contracts and Standard Contractual Provisions*.

Ch. 76, *Assignment of Rights and Obligations*.

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART I. RESEARCH GUIDE
B. Secondary Sources

8-17 California Legal Forms--Transaction Guide §§ 17.08-17.09

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[Reserved]

§§ 17.08[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.10

AUTHOR: Marilyn E. Minger Revision Author

§ 17.10 Legal Considerations in the Purchase and Sale of a Business

Parties to the purchase and sale of a business must contemplate a variety of legal issues including, but not limited to, the following:

- Tax consequences of the transfer and the applicability of income taxes, sales and use taxes, and property taxes [*see §§ 17.11-17.13*].
- Assignment of trademarks and service marks [*see § 17.15*].
- Compliance with hazardous waste regulations [*see § 17.16*].
- Use of letter of intent for the purchase of the business [*see § 17.17*].
- Pre-sale investigation and due diligence of the business [*see § 17.18*].
- Use of noncompetition clauses in the sale of a business [*see § 17.19*].
- Compliance with bulk sales division of Commercial Code [*see § 17.20*].
- Fraudulent transfers and creditors' rights [*see § 17.21*].
- Special requirements for purchase and sale of professional practices [*see § 17.22*].
- Issues relating to the purchase and sale of a franchise [*see § 17.23*].

If the transaction includes a transfer of employees, then labor and employment issues might arise. However, there should be no issue concerning the statutory duty to warn the employees and various government officials about a mass

layoff [*see generally Lab. Code § 1400 et seq.* (Worker Adjustment and Retraining Notification Act, or WARN Act); *see also 29 U.S.C. § 2101 et seq.* (equivalent federal law applicable to larger employers)], even if the threshold number of 50 employees were transferred, because there would be no mass layoff under the statute. The WARN Act defines a mass layoff in terms of employees losing their positions with the employer [*Lab. Code § 1400(c), (d)*], whereas in the case of a business transfer that includes existing employees, the employees would merely be exchanging the former employer for a new employer. There would be no duty under the WARN Act even if not all of the existing employees were transferred, as long as fewer than 50 were laid off in the process [*MacIsaac v. Waste Management Collection & Recycling, Inc. (2005) 134 Cal. App. 4th 1076, 1086-1087, 36 Cal. Rptr. 3d 650]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawPurchase & SaleFraudulent TransfersTax LawState & Local TaxesReal Property TaxGeneral OverviewTax LawState & Local TaxesSales TaxGeneral OverviewTax LawState & Local TaxesUse TaxGeneral OverviewTrademark LawConveyancesAssignmentsTrademark LawProtection of RightsGeneral OverviewTrademark LawSpecial MarksService MarksEstablishment



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.11

AUTHOR: Marilyn E. Minger Revision Author

§ 17.11 Evaluating Income Tax Consequences of Sale

[1] Identifying Basic Income Tax Issues

The two income tax issues arising under federal and California law from the sale of a business are (1) the amount of gain or loss realized and recognized [*see* [2], *below*], and (2) the character of the gain or loss as ordinary or capital income [*see* [3], *below*].

The sale of a business is not considered to be the sale of a single unit or interest. Instead, it is treated as the sale of the separate assets that, taken together, constitute the business [*Williams v. McGowan (2d Cir. 1945) 152 F.2d 570, 572]* . Therefore, the purchase price must be allocated to the separate assets being sold [*Rev. Rul. 55-79, 1955-1 C.B. 370*].

For further discussion of the income tax consequences of the sale of real property generally, see Ch. 23, *Real Property Sales Agreements* , Legal Background, "Gain or Loss on Sale of Real Property--In General," et seq. For further coverage of the capital gain treatment of specific assets, see Rabkin & Johnson, Federal Income, Gift and Estate Taxation, Ch. 34, *Capital Transactions* (Matthew Bender).

[2] Determining Amount of Gain or Loss

For purposes of federal and state income taxation, the amount of gain or loss recognized by a seller on the sale of any property is the difference between the amount realized from the purchase price (including the fair market value of any note received, or any mortgages or deeds of trust the buyer assumed) that is allocated to the asset, and the seller's adjusted income tax basis for the asset [*I.R.C. §§ 1001(a), (b)* (computation of gain or loss), 1011 (determination of adjusted basis); *Rev. & Tax. Code §§ 18031* (gain or loss determined in accordance with federal law), 24901(b) (amount realized includes fair market value of other property received)].

[3] Determining Character of Gain or Loss

Determining the character of gain or loss on the sale of a business should reflect the tax interests of the buyer and seller,

even though those interests may conflict under certain circumstances. For example, the characterization of gain from the sale of a business as capital rather than ordinary is advantageous for high income noncorporate taxpayers. For these taxpayers capital gains are taxed at lower rates than those applicable to ordinary income [*compare I.R.C. § 1(a)-(e), (i)(2) with I.R.C. § 1(h)*]. No similar advantage, however, is available to corporate taxpayers selling a business. For corporate taxpayers, the tax rate for capital gains is the same as those for ordinary income [*compare I.R.C. § 11(b) with I.R.C. § 1201*]. Some advantage may be available to the corporate taxpayer if it has capital losses than may be offset only against capital gain [*I.R.C. § 1211(a)*].

To characterize gain from the sale of a business as capital gain, a seller would allocate as much of the purchase price as possible to goodwill or other intangibles such as trademarks or trade names, going concern value, or covenants not to compete, which are usually treated as capital assets [*see I.R.C. § 1221*; *but see I.R.C. §§ 197(f)(7), 1221(a)(2)* (goodwill and other intangibles eligible for amortization are depreciable business assets and not capital assets)].

A buyer, however, is likely to want to allocate the bulk of the purchase price to inventory or depreciable fixtures machinery, or equipment. This allocation provides higher immediate deductions either because of an increased cost of goods sold [*see Treas. Reg. § 1.61-3(a)*] or increased depreciation deductions [*I.R.C. §§ 167, 168*]. This type of allocation, however increases the ordinary income to the seller [*see I.R.C. § 1221(a)(1), (2)* (stock in trade, inventory and depreciable business property are not capital assets)]. Even though a buyer who acquires goodwill in a business may be eligible to amortize the cost, the 15 year amortization period makes the amortization deduction less attractive than depreciation or cost of goods sold deductions [*compare I.R.C. § 197 with I.R.C. §§ 167, 168*].

[4] Allocating Purchase Price to Each Asset

[a] Burden on Parties to Purchase and Sale

Ordinarily, the parties in a purchase and sale have the burden of establishing the amount of the purchase price allocated to each of the assets being sold, including intangible assets such as goodwill. The amount that they allocate to each asset should bear a reasonable relation to the asset's fair market value [*see* Rabkin & Johnson, *Federal Income, Gift, and Estate Taxation, Ch. 34, Capital Transactions, § 34.03* (Matthew Bender)].

[b] Applicable Asset Acquisition

A special method of allocating value among various assets in the sale of a business must be used if there is an applicable asset acquisition [*I.R.C. 1060*]. An "applicable asset acquisition" is any direct or indirect transfer of assets in which (1) the assets constitute a trade or business, and (2) the buyer's basis in the assets is determined wholly by reference to the consideration paid for the assets [*I.R.C. § 1060(c)*; *see Rev. & Tax. Code § 18031* (gain or loss on disposition of property determined in accordance with federal law)]. A group of assets constitutes a trade or business if use of the assets would constitute an active business for purposes of *I.R.C. § 355* (regarding distribution of stock of a controlled corporation)], or if goodwill or going concern value could attach to those assets [*Treas. Reg. § 1.1060-1(b)(2)(i)*]. A transaction that is part purchase of assets and part like-kind exchange [*see I.R.C. § 1031*; *see also* Ch. 24, *Exchanges of Real Property*] is also subject to these restrictions [*I.R.C. § 1060(c)*].

[c] Treatment of Applicable Asset Acquisition

In the case of an applicable asset acquisition, for purposes of determining the buyer's basis in the assets and the seller's gain or loss, the consideration received for the assets must be allocated among the assets in accordance with *I.R.C. § 338(b)(5)* (relating to stock purchases treated as asset acquisitions) [*I.R.C. § 1060(a)*]. Under *I.R.C. § 338(b)(5),* allocation is made by the "residual allocation method," generally in accordance with regulations under *I.R.C. § 338*. The seller substitutes "consideration" for ADSP (aggregate deemed sale price) in making the allocation under the regulations, and the buyer substitutes "consideration" for AGUB (adjusted grossed-up basis) [*Treas. Reg. §§ 1.338-6*, 1.338-7, 1.1060-1(c)(2)].

Allocation--both to each class and among the assets within each class--is done according to the gross fair market value of the assets [*Treas. Reg. §§ 1.338-6(a)(2),* 1.1060-1(c)(2)]. To make the allocation, assets are first divided into the following seven classes [*Treas. Reg. §§ 1.338-6(a)(2),* 1.1060-1(c)(2)]:

- Class I Assets. Cash and general deposit accounts, including savings and checking accounts [*Treas. Reg. §§ 1.338-6(b)(1),* 1.1060-1(c)(2)].

- Class II Assets. Actively traded personal property [*see I.R.C. § 1092(d)(1)*; *Treas. Reg. § 1.1092(d)-1*, but without regard to *I.R.C. § 1092(d)(3)*] and certificates of deposit and foreign currency, even if they are not actively traded personal property. Assets in Class II include US government securities and publicly traded stock. Class II assets do not include stock of target affiliates, whether or not of a class that is actively traded, other than actively traded stock described in *I.R.C. § 1504(a)(4)* (certain preferred stock). This restriction excludes target affiliate stock from Class II when the target holds and 80 percent or greater interest in the target affiliate but a minority interest in target affiliate stock of the same class is actively traded [*Treas. Reg. §§ 1.338-6(b)(2)(ii),* 1.1060-1(c)(2)].

- Class III Assets. Assets that the taxpayer marks to market at least annually for Federal income tax purposes and debt instruments. These assets include accounts receivable, mortgages, and credit card receivables from customers that arise in the ordinary course of business *Treas. Reg. §§ 1.338-6(b)(2)(iii),* 1.1060-1(c)(2)]. Class III assets do not include debt instruments issued by persons related to the target at the beginning of the day following the acquisition date, certain contingent debt instruments [*see Treas. Reg. §§ 1.1275-4,* 1.483-4; *I.R.C. § 988*], (but not those subject to the non-contingent bond method [*see Treas. Reg. §§ 1.1275-4(b),* 1.483-4] or which involve single nonfunctional currencies [*see Treas. Reg. § 1.988-2(b)(2)(I)(B)(2)*]), or debt instruments convertible into the stock of the issuer of other property [*Treas. Reg. §§ 1.338-6(b)(2)(iii),* 1.1060-1(c)(2)].

- Class IV Assets. Stock in trade of the taxpayer or other property of a kind that would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business [*Treas. Reg. §§ 1.338-6(b)(2)(iv),* 1.1060-1(c)(2)].

- Class V Assets. All assets that do not fall in any of the other six classes [*Treas. Reg. §§ 1.338-6(b)(2)(v),* 1.1060-1(c)(2)].

- Class VI Assets. All Section 197 intangibles [*see I.R.C. § 197*] except goodwill and going concern value [*Treas. Reg. §§ 1.338-6(b)(2)(vi),* 1.1060-1(c)(2)].

- Class VII Assets. Goodwill and going concern value (whether or not the goodwill or going concern value qualifies as a Section 197 intangible) [*Treas. Reg. §§ 1.338-6(b)(2)(vii),* 1.1060-1(c)(2)].

The consideration is first reduced by the amount of the Class I assets. Any amount remaining after the reduction is then allocated to the remaining assets [*Treas. Reg. §§ 1.338-6(b)(1), (2),* 1.1060-1(c)(2)]. The remaining consideration is allocated to Class II assets in proportion to the fair market value of each Class II asset, then among Class III assets in proportion to the fair market value of each Class III asset, then among Class IV assets in proportion to the fair market value of each Class IV asset, then among Class V assets in proportion to the fair market value of each Class V asset, then among Class VI assets in proportion to the fair market value of each Class VI asset, and finally to Class VII assets [*Treas. Reg. §§ 1.338-6(b)(2)(i),* 1.1060-1(c)(2)].

In making the above allocations, the seller and purchaser must each adjust the amount allocated to an individual asset to

take into account specific identifiable costs incurred in transferring that asset in connection with the applicable asset acquisition (such as real estate transfer costs or security interest perfection costs). Those costs increase (or decrease, as appropriate) the total consideration that is allocated under the residual method. No adjustment is made to amounts allocated to an individual asset for general costs associated with the overall asset acquisition or with groups of assets (such as non-specific appraisal fees or accounting fees). These costs are taken into account only indirectly through their effect on the total consideration to be allocated [*Treas. Reg. § 1.1060-1(c)(3)*; *see* Temp. Treas. Reg. § 1.1060-1T(c)(3)].

PRACTICE TIP:

The allocation of consideration is based on the gross fair market value of the assets [*Treas. Reg. §§ 1.338-6(a)(2)*, 1.1060-1(c)(2)]. To substantiate proper valuation, and to reduce the chance of a successful challenge by the IRS upon a later audit, an independent, expert appraisal of the assets should be obtained near the time of the transaction. An appraisal is especially important when the parties do not have a binding allocation agreement.

Both the buyer and the seller must file IRS Form 8594, Asset Acquisition Statement, with the IRS with the following information about the asset acquisition [*I.R.C. § 1060(b)*]:

- The amount of consideration to be allocated to *I.R.C. § 197* intangibles.
- Any modification of the amount to be allocated to *I.R.C. § 197* intangibles.
- Any other information about any other assets transferred that the IRS deems necessary. Regulations require information concerning the amount of consideration in the transaction and its allocation among all assets transferred, and information concerning subsequent adjustments to consideration [*Treas. Reg. § 1.1060-1(e)(1)(i)*].

Form 8594 must be filed with income tax returns for the taxable year that included the first date assets are sold pursuant to the applicable asset acquisition [*Treas. Reg. §§ 1.1060-1(e)(1)(ii)(A)*, effective for asset acquisitions occurring on or after March 15, 2001]. When an increase or decrease in consideration is taken into account in a later taxable year, the seller and the purchaser each must file a supplemental asset acquisition statement on Form 8594 with the income tax return for the taxable year in which the increase or decrease is properly taken into account [*Treas. Reg. § 1.1060-1(e)(1)(ii)(B)*]. An information return must also be filed in certain entity transfers, as discussed in [5], *below*.

[d] Allocation Inconsistent With Allocation in Parties' Written Agreement

Any agreement between the parties as to the allocation of any amount of consideration to, or as to the fair market value of, any of the assets generally is binding on them [*I.R.C. § 1060(a)*], unless they would be permitted under existing legal authority [*see Commr. v. Danielson (3d Cir.) 378 F.2d 771 , cert. denied, (1967) 389 U.S. 858]* to refute the valuation or allocation, as because of mistake, undue influence, fraud, duress, or similar reason. The IRS, however, may challenge any valuations or allocations if it determines them to be inappropriate [*I.R.C. § 1060(a)*; *Treas. Reg. § 1.1060-1(c)(4)*].

[5] Reporting Requirements for Additional Information

When a seller who is a 10-percent owner with respect to any business transfers an interest in that business and the seller (or a related person) enters into an employment contract, a covenant not to compete, a royalty or lease agreement, or other agreement with the buyer in connection with the transfer, the seller and the buyer must furnish any required information to the Secretary [*I.R.C. § 1060(e)(1)*; *see I.R.C. § 1060(e)(3)* ("related person" defined); *see also I.R.C. §§ 267(b), 707(b)(1)*]. A "10-percent owner" is any person who holds 10 or more percent, by value, of the interests in the business immediately before the transfer [*I.R.C. § 1060(e)(2)(A)*; *see I.R.C. § 1060(e)(2)(B)* (constructive ownership

rules); *see also I.R.C. § 318*]. This reporting requirement applies regardless of whether or not the transaction is an applicable asset acquisition that must be reported under *I.R.C. § 1060* [*see* [4][c], [d], *above*], and, in the case of a stock purchase, whether or not an election is made under *I.R.C. § 338* to treat the stock purchase as an asset purchase [House Conf. Rep., Pub. L. No. 101-508, § 11323].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewReal Property LawPurchase & SaleContracts of SaleGeneral OverviewTax LawFederal Income Tax ComputationSales & ExchangesGeneral OverviewTax LawFederal Income Tax ComputationSales & ExchangesCapital Gains & Losses (IRC secs. 1201-1202, 1211-1212, 1221-1223, 1231-1260, 1271-1278, 1281-1288, 1291-1298)Treatment of GainsTax LawFederal Income Tax ComputationValuationBusiness Interests



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.12

AUTHOR: Marilyn E. Minger Revision Author

§ 17.12 Evaluating Sales Tax Consequences of Selling a Business

[1] Applicability of Sales Tax

[a] Transactions Subject to State and Local Sales Taxes

The sale of a business may be subject to state sales tax. The Sales and Use Tax Law [*Rev. & Tax. Code § 6001 et seq.*] imposes a tax on the gross receipts of a retailer from the sale of tangible personal property sold at retail in California [*Rev. & Tax. Code §§ 6051-6051.5*]. In addition, similar local and transit taxes may be imposed on the gross receipts of a retailer from the sale of tangible personal property sold at retail within authorized counties and transit districts [*see Rev. & Tax. Code § 7200 et seq.* (Bradley-Burns Uniform Local Sales and Use Tax Law), *Rev. & Tax Code § 7251 et seq.* (Transactions and Use Tax Law)].

A "retailer" is defined as a seller who makes any retail sale of tangible personal property [*Rev. & Tax. Code § 6015(a)*]. A "retail sale" is a transfer of title or possession of tangible personal property for consideration, for any purpose other than resale in the regular course of business [*Rev. & Tax. Code §§ 6006(a), 6007*]. A one-time sale of assets may qualify as a retail sale subject to the imposition of sales tax, even if the seller has never sold personal property at retail before the asset sale [*see Santa Fe Energy Co. v. California State Bd. of Equalization (1984) 160 Cal. App. 3d 176, 182, 206 Cal. Rptr. 499* (oil company subject to sales tax on sale of assets although it never had sold personal property at retail prior to sale)].

"Tangible personal property" is personal property that may be seen, weighed, measured, felt, or touched, or that is perceptible to the senses in any other manner [*Rev. & Tax. Code § 6016*]. "Gross receipts" are defined as the total amount of the sales prices received from sales, leases, or rentals of tangible personal property sold at retail [*Rev. & Tax. Code § 6012(a)*]. "Sales price" is defined as the total amount for which tangible personal property is sold [*Rev. & Tax. Code § 6011(a)*]. The total amount includes (1) any services that are a part of the sale, (2) all receipts, cash, credits, and property of any kind, and (3) any amount for which credit is allowed by the seller to the buyer [*Rev. & Tax. Code §§ 6011(b), 6012(b)*].

[b] Types of Assets Typically Subject to Sales Tax on Sale of Business

When a business is sold, the seller typically transfers two types of tangible personal property to the buyer: (1) equipment and furniture, and (2) stock in trade and merchandise. Because the stock in trade and merchandise of the business is usually sold to the buyer for purposes of resale in the regular course of business, the sale of that type of property is not taxable as a retail sale [*see Rev. & Tax. Code §§ 6007, 6051*]. However, the State Board of Equalization may presume that all gross receipts are subject to sales tax. The seller has the burden of proving that a sale of tangible personal property is not a retail sale, unless he or she obtains a resale certificate from the buyer [*Rev. & Tax. Code §§ 6091, 6092*]. Because the other business assets, such as furniture and equipment, are not generally sold for resale, the gross receipts from their sale are subject to taxation [*see Rev. & Tax. Code §§ 6051-6051.4*] unless they are "intangible" or otherwise exempt [*see Rev. & Tax. Code §§ 6351 et seq.* (exemptions from sales and use tax law)]. The seller must report any taxable proceeds on his or her final sales tax return [*see Rev. & Tax. Code § 6452*].

[2] Determining Whether "Occasional Sales" Exemption Is Applicable to Sale

All persons actively engaged in the business of selling tangible personal property at retail must obtain a sales tax permit (often referred to as a "seller's permit" or "resale number") from the State Board of Equalization before making sales in California [*see Rev. & Tax. Code §§ 6066, 6071*; *18 Cal. Code Reg. § 1699*]. For discussion of the permit, see *Ch. 1E, Taxation of Businesses, § 1E.65*.

The gross receipts from "occasional sales" of tangible personal property are exempt from the sales and use tax [*Rev. & Tax. Code § 6367*]. Two different types of sales qualify as "occasional" sales. First, a sale of all or substantially all of the property held or used in activities requiring a sales tax permit qualifies as an occasional sale if the ultimate ownership of that property is substantially the same after the transfer as it was before the sale [*Rev. & Tax. Code § 6006.5(b)*]. An example of a sale in which the ultimate ownership is the same both before and after the transfer is the incorporation of a going business. "Substantially all of the property" means 80 percent or more of all the tangible personal property held or used in the course of activities, including tangible personal property located outside California [*18 Cal. Code Reg. § 1595(b)(2)*].

Second, a sale of property that is not held or used by a seller in the course of activities for which a sales tax permit is required qualifies as an occasional sale if the sale is not one of a series of sales that are sufficient in number, scope, and character to constitute an activity requiring a sales tax permit [*see Rev. & Tax. Code § 6006.5(a)*]. Any taxpayer whose business does not involve retail sales, but who makes three or more sales of tangible personal property used in the business for substantial amounts in a 12-month period (or who makes a substantial number of sales for a relatively small amount during that period) will be considered to be a "retailer" subject to the sales tax permit requirement [*Rev. & Tax. Code § 6019*; *18 Cal. Code Reg. § 1595(a)*]. The determination of whether the seller has made sales of "substantial amounts" or has made a "substantial number" of sales is based on sale frequency and dollar value [*see 18 Cal. Code Reg. § 1595(a)(4)(B)*]. Therefore, a sale of business furniture and equipment used in a business that does not involve retail sales that is the seller's first or second sale of business property in a year will be exempt from sales tax as an occasional sale [*see Rev. & Tax. Code §§ 6006.5(a), 6367*].

[3] Evaluating Businesses Making Taxable and Nontaxable Sales

Many businesses require a sales tax permit for only part of their activities [*see generally Ch. 1E, Taxation of Businesses, §§ 1E.60-1E.66*]. For example, a service business may also sell some tangible personal property, or a retailer may sell both taxable and exempt property. The State Board of Equalization has prescribed rules regarding the taxation of the sale of the business that differentiate between service and nonservice enterprises [*18 Cal. Code Reg. § 1595(a)*].

When operators of service enterprises (such as hospitals, hotels, theaters, schools, laundromats, car washes, transportation companies, and trucking companies) that make some sales incidental to their primary service business

(such as the sale of popcorn in a theater or soap in a laundromat) sell that service business, only the gross receipts from the tangible personal property used in the selling activity are subject to sales tax [*18 Cal. Code Reg. § 1595(a)(5)(A)(1)*]. However, if in any 12-month period, the operator of a service enterprise makes more than two sales for substantial amounts [*see 18 Cal. Code Reg. § 1595(a)(4)(B)* (determining scope of sale)] of the tangible personal property used in the service enterprise, the gross receipts from those sales are subject to taxation. If one of those multiple sales is a sale of the business, sales tax will apply to the gross receipts from the sale of the tangible personal property used in the service enterprise [*18 Cal. Code Reg. § 1595(a)(5)(A)(2)*].

For all other businesses that are not essentially service enterprises, sales tax applies to the sale of all business assets. For example, sales tax applies to sales of grocery and liquor stores that sell both exempt food products and taxable items, and pharmacies that sell exempt medicine and taxable items such as bandages [*18 Cal. Code Reg. § 1595(a)(5)(B)(1)*].

If a service enterprise and a sales business are operated together so as to constitute one business, tax will apply to the sale of all assets of the business. Thus, if a car wash and gas station are operated at the same premises, and the car wash is available only to persons who buy gas, or the price of a car wash is reduced with the sale of gas, sales tax will apply to the sale of the car wash [*18 Cal. Code Reg. § 1595(a)(5)(B)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawSales of AssetsGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewTax LawFederal Income Tax ComputationSales & ExchangesBusiness Property (IRC secs. 1031, 1221, 1231)Property Used in Trade or BusinessTax LawState & Local TaxesSales TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.13

AUTHOR: Marilyn E. Minger Revision Author

§ 17.13 Evaluating Property Tax Consequences of Sale

[1] Transferring Real Property in Sale of Business

If the sale of the business includes the real property on which the business is conducted, the buyer faces property tax consequences. All property in California is subject to property taxation at its full value on an annual basis, unless exempt under federal or California law [*Cal. Const., art. XIII, § 1*; *Rev. & Tax. Code §§ 201, 401*].

Real property subject to local property taxation is reassessed when a change in ownership occurs [*see* Cal. Const. arts. XIII, XIIIA; *see also* California Real Estate Law and Practice, Ch. 401, *Real Property Valuation and Assessment* (Matthew Bender)]. A "change in ownership" is a transfer of a present interest in real property (including beneficial use of the property), the value of which is substantially equal to the value of the fee interest [*Rev. & Tax. Code § 60*]. That change requires the buyer to file a change in ownership statement [*Rev. & Tax. Code §§ 480-480.2*; *see § 17.129* of the Transaction Guide]. If the change in ownership takes place after March 1 (the assessment date), and the property has appreciated, the buyer will be liable for a supplemental assessment that reflects the difference between the property's taxable value on the current assessment roll, and the new assessed value on the date of the change in ownership. The supplemental assessment will be prorated for the portion of the tax year remaining after the reappraisal [*see Rev. & Tax. Code §§ 75.41, 75.51*].

[2] Determining Amount of Property Tax

Property is taxable to the owner based on its fair market value as of the lien date (January 1) preceding the fiscal year for which the taxes are levied [*Rev. & Tax. Code §§ 405(a), 2192*]. Local tax authorities generally assess and collect the property tax [*see Rev. & Tax. Code §§ 121, 128, 404*].

The property tax consequences of the sale of a business depend on whether the property being sold is on the "secured" or "unsecured" tax rolls. Taxes on real property and personal property that is affixed to real property are secured by a lien on the real property [*Rev. & Tax. Code § 109*]. Personal property that is not affixed to real property is generally on the unsecured roll [*Rev. & Tax. Code §§ 109, 134*]. Therefore, a buyer who purchases property on the secured roll after

January 1 takes the property subject to any tax lien [*see Rev. & Tax. Code § 109*]. He or she needs to investigate whether or not the seller has already paid the taxes, and to negotiate the sales price to reflect the hidden cost of any such lien. However, if the buyer purchases property on the unsecured roll after January 1, he or she will take it free of any tax lien [*see Rev. & Tax. Code §§ 109, 134*]. Therefore, a seller of property on the unsecured roll should ensure that the sales price reflects the tax liability, whether already paid or owing by the seller.

For further discussion of the property tax implications of a sale of real property, see "Property Tax--In General" and subsequent headings in Ch. 23, *Real Property Sales Agreements*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Real Property LawProperty ValuationTax LawFederal Income Tax ComputationDeductions for Business ExpensesGeneral OverviewTax LawState & Local TaxesReal Property TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.14

AUTHOR: Marilyn E. Minger Revision Author

§ 17.14 Evaluating Effect of Successor Liability Statutes

[1] Withholding Sufficient Portion of Purchase Price to Pay State Taxes

"Successor liability statutes" protect the state of California against business owners who sell their businesses without paying the taxes owed to the state. Successor liability statutes require that any person who purchases a business must withhold enough of the purchase price to cover all amounts that the seller owes for specific state taxes. These statutes are set forth in California's Sales and Use Tax Law [*Rev. & Tax. Code §§ 6811, 6812*], Unemployment Insurance Code [*Unemp. Ins. Code §§ 1731-1736*], and Personal Income Tax Law [*Rev. & Tax. Code § 18669 et seq.*].

[2] Withholding Sufficient Portion of Purchase Price to Pay Sales and Use Taxes

[a] Withholding Obligation

When a person liable for sales or use taxes sells his or her business or stock of goods, the buyer must withhold a sufficient portion of the purchase price to pay any sales or use taxes that the seller owes to the California State Board of Equalization (SBE) [*Rev. & Tax. Code § 6811*; *see Schnyder v. State Board of Equalization (2002) 101 Cal. App. 4th 538, 546-547, 124 Cal. Rptr. 2d 571* (purchasers of business did not "withhold" purchase funds as required by statute by initially depositing them with escrow agent and then interpleading them)]. Generally, the buyer should withhold the entire purchase price, rather than just the amount shown as owing on the seller's final sales tax return [*see People v. Buckles (1943) 57 Cal. App. 2d 76, 79, 134 P.2d 8]* , since the SBE has the power to examine and audit the books, papers, records, equipment, and business of the seller to determine the amount required to be paid [*Rev. & Tax. Code § 7054*]. A buyer of the business or stock of goods of any one location of a business establishment that has various locations is considered to be a buyer subject to these withholding rules [*18 Cal. Code Reg. § 1702(e)*].

[b] Buyer's Failure to Withhold Sufficient Funds

If the buyer fails to withhold sufficient funds from the purchase price, he or she becomes personally liable for the taxes owed, up to the amount of the purchase price of the business or stock of goods [*Rev. & Tax. Code § 6812(a)*; *see*

Schnyder v. State Board of Equalization (2002) 101 Cal. App. 4th 538, 542, 124 Cal. Rptr. 2d 571 (purchasers of business held personally liable for sales and use taxes as successors under *Rev. & Tax. Code § 6812*)]. The buyer's liability extends to all amounts incurred in the operation of the business by the seller, including the following [*18 Cal. Code Reg. § 1702(b)*]:

- Taxes incurred with respect to the operation of the business by the predecessor or any former owner, including the sale of the business [*see § 17.12, above*], even though not then determined against the predecessor.

- Interest on the predecessor's taxes to the date of payment.

- Penalties for nonpayment of taxes.

- Penalties for negligence or intentional disregard of the Sales and Use Tax Law or authorized rules and regulations.

- Penalties for fraud or an intent to evade the tax determined and unpaid at the time of sale.

However, if the SBE finds that a buyer's failure to withhold a sufficient amount of the purchase price to cover the amount owed by the former owner is due to reasonable cause and circumstances beyond the buyer's control, and occurred notwithstanding the exercise of ordinary care and in the absence of willful neglect, the SBE may relieve the buyer of any penalty included in the notice of successor liability [*Rev. & Tax. Code § 6814(b)(1)*; *18 Cal. Code Reg. § 1702(d)*].

[c] Tax Clearance Certificate

The buyer is released from the withholding obligations when the seller produces a receipt from the SBE showing that any outstanding taxes have been paid, or the SBE issues a certificate of tax clearance stating that no amount is due [*Rev. & Tax. Code § 6811*; *18 Cal. Code Reg. § 1702(c)*]. The SBE may issue the certificate after all amounts have either been paid or secured to the satisfaction of the SBE [*Rev. & Tax. Code § 6813*]. The SBE is required either to issue a certificate of tax clearance, or mail notice to the buyer of the amount of tax, interest, and penalties that must be paid as a condition of issuing that certificate, within 60 days after the latest of the following [*Rev. & Tax. Code § 6812(b)*; *18 Cal. Code Reg. § 1702(c)*]:

- The date the SBE receives a written request from the buyer for a certificate [*see § 17.300*].

- The date of the sale of the business or stock of goods.

- The date the former owner's records are made available for audit.

If the SBE mails a notice of successor liability, the buyer may petition for reconsideration within 30 days of the receipt of this notice [*Rev. & Tax. Code § 6814(a)*; *see Rev. & Tax. Code §§ 6562-6594* (reconsideration procedure)].

The failure of the SBE to mail either a certificate of clearance or a notice of successor liability to the buyer, after written request by the buyer, releases the buyer from any further obligation to withhold the purchase price [*Rev. & Tax. Code § 6812(c)*; *18 Cal. Code Reg. § 1702(c)*]. In addition, the buyer is released from any further successor liability for sales and use taxes after three years from the date that the SBE is notified of the purchase of the business or stock of goods [*Rev. & Tax. Code § 6812(c)*; *see Rev. & Tax. Code § 6814(a)*; *18 Cal. Code Reg. § 1702(d)*].

[3] Withholding Sufficient Portion of Purchase Price to Pay Employment Taxes

Unemp. Ins. Code § 1731 provides that the buyer of a business that employs individuals in the business must withhold in trust money or other property sufficient to pay any contributions, interest, and penalties due or unpaid by the seller for unemployment compensation insurance contributions or disability compensation insurance contributions. The withholding must continue until the seller produces a certificate from the Employment Development Department (EDD) stating that no contributions, interest, or penalties are due [*Unemp. Ins. Code § 1731*].

If the buyer fails to withhold sufficient funds, he or she becomes personally liable for the contributions, interest, or penalties owed, up to the amount of the purchase price [*Unemp. Ins. Code § 1733*]. If the seller does not produce the certificate, the buyer must pay the amount due at the time of the purchase [*Unemp. Ins. Code § 1731*].

Within 30 days of a request from either the seller or buyer [*see § 17.301*], the EDD must issue a certificate of tax clearance or a statement showing the amount due. Failure to issue a certificate or statement within that time will be deemed equivalent to issuance of a tax clearance certificate [*Unemp. Ins. Code § 1732(a)*]. Issuance of a certificate stating that no contributions, interest, or penalties are due (or the failure to issue such a certificate within 30 days of a request) will not release the seller from liability on account of any contributions, interest, or penalties then or thereafter determined to be due from the seller. It will, however, release the buyer from any further liability on account of any such contributions, interest, or penalties [*Unemp. Ins. Code § 1732(b)*]. For a list of requirements that the seller must satisfy in order for the EDD to issue a certificate of tax clearance, see *§ 17.126*, Paragraph 2.

[4] Withholding Sufficient Portion of Purchase Price to Pay California Income Tax Withholding

The buyer of a business must withhold in trust either money or other property sufficient to pay any state income taxes, interest, and penalties that the seller was required to deduct and withhold from the wages of its employees, but did not remit to the state [*Rev. & Tax. Code 18669*]. The buyer must continue to withhold the money or property in trust until the Franchise Tax Board (FTB) issues a certificate stating that no taxes, interest, or penalties are due or unpaid from the seller [*Rev. & Tax. Code § 18669(a)*]. If the buyer fails to withhold sufficient funds, he or she becomes personally liable for the taxes, interest, or penalties owed, up to the amount of the fair market value of the business acquired [*Rev. & Tax. Code § 18669(d)*]. If a the buyer does not request a certificate, the buyer must pay the amount of tax, interest, or penalties due or unpaid by the seller to the FTB on the day the business is acquired [*Rev. & Tax. Code § 18669(b)*].

The FTB must issue a certificate or statement showing the amount of tax, interest, and penalties due from the seller within 60 days after the buyer requests the certificate [*Rev. & Tax. Code § 18669(b)*]. Failure to issue a certificate or statement within that time is deemed equivalent to the issuance of a certificate stating that no tax, interest, or penalties are due [*Rev. & Tax. Code § 18669(b)*]. Issuance of a certificate stating that no taxes, interest, or penalties are due (or the failure to issue a certificate within 60 days of a request) does not release the seller from liability on account of any taxes, interest, or penalties then or thereafter determined to be due from the seller [*Rev. & Tax. Code § 18669(c)*]. It does, however, release the buyer from any liability on account of any such taxes, interest, or penalties [*Rev. & Tax. Code § 18669(c)*].

If the FTB issues a statement showing that taxes, interest, and penalties are claimed to be due from the seller, the buyer must pay the amount stated (not in excess of the fair market value of the business acquired) to the FTB on or before the later of the following [*Rev. & Tax. Code § 18669(b)*]:

- Thirty days after the statement is mailed or delivered to the buyer; or
- The day the business is acquired.

Payment by the buyer does not release the seller from liability to the FTB except to the extent of the amount paid by the buyer [*Rev. & Tax. Code § 18669(c)*]. Late payment by the buyer will result in a penalty of 10 percent of the amount

payable [*Rev. & Tax. Code § 18669(b)*].

For additional discussion and a form for requesting a FTB tax clearance, see *§ 17.302*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Mergers & Acquisitions LawLiabilities & Rights of SuccessorsSuccessor Liability DoctrineMergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewTax LawState & Local TaxesAdministration & ProceedingsFailure to Pay TaxTax LawState & Local TaxesIncome TaxIndividuals, Estates & TrustsFailure to Pay Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.15

AUTHOR: Marilyn E. Minger Revision Author

§ 17.15 Assignment of Trademarks or Service Marks

[1] "Trademarks" and "Service Marks" Defined

A "trademark" is any word, name, symbol, device, or any combination that (1) is used by a person or (2) is the subject of an application to register on the principal register by a person who has a bona fide intention to use it in commerce, in order to identify and distinguish his or her goods (including a unique product) from those manufactured or sold by others and to indicate the source of the goods, even if that source is unknown [*15 U.S.C. § 1127*].

A "service mark" is any word, name, symbol, device, or any combination that (1) is used by a person or (2) is the subject of an application to register on the principal register by a person who has a bona fide intention to use it in commerce, in order to identify and distinguish the services of one person (including a unique service) from the services of others and to indicate the source of the services, even if that source is unknown. Titles, character names, and other distinctive features of radio or television programs may be registered as service marks notwithstanding the fact that they, or the programs, may advertise the goods of the sponsor [*15 U.S.C. § 1127*].

[2] Transferring Trademarks and Service Marks

If a trademark or service mark is used in connection with the business being sold, the seller should assign the mark to the buyer. A federally registered trademark or service mark, or one for which application to register has been filed, is assignable with the goodwill of the business in which the mark is used, or with that part of the goodwill connected with the use of and symbolized by the mark [*15 U.S.C. § 1060(a)*; *see 15 U.S.C. § 1060(b)* (foreign assignees)]. However, no application to register a mark under *15 U.S.C. § 1051(b)* is assignable before the filing of any amendment to conform the application [*see 15 U.S.C. § 1051(a), (c)*] or the filing of the verified statement of use [*see 15 U.S.C. § 1051(d)*], except to a successor to the applicant's business, or portion of the business, to which the mark pertains, if that business is ongoing and existing [*15 U.S.C. § 1060(a)(1)*]. It is not necessary to include the good will of the business connected with the use of and symbolized by any other mark used in the business, or by the name or style under which the business is conducted [*15 U.S.C. § 1060(a)(2)*].

Assignment is made by executing and recording a written instrument in the Patent and Trademark Office. Acknowledgment constitutes prima facie evidence of the execution of an assignment; when the prescribed information reporting the assignment is recorded, the record constitutes prima facie evidence of execution [*15 U.S.C. § 1060(a)(3)*]. However, an assignment is void against any subsequent purchaser for valuable consideration without notice, unless the prescribed information reporting the assignment is recorded within 3 months after the date of the assignment or before the subsequent purchase [*15 U.S.C. § 1060(a)(4)*]. A trademark or service mark registered in California is assignable with the goodwill of the business in which the mark is used, or with that part of the goodwill connected with the use of and symbolized by the mark. Assignment is made by executing, acknowledging, and filing a written instrument with the California Secretary of State, together with the applicable filing fee [*Bus. & Prof. Code § 14260*].

An assignment is void as against any subsequent purchaser for valuable consideration without notice, unless the assignment is filed within three months after the date of the assignment or before the subsequent purchase [*15 U.S.C. § 1060*; *Bus. & Prof. Code § 14220*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Trademark LawConveyancesAssignmentsTrademark LawProtection of RightsGeneral OverviewTrademark LawSpecial MarksService MarksEstablishment



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.16

AUTHOR: Marilyn E. Minger Revision Author

§ 17.16 Complying With Hazaradous Materials Regulations

[1] Hazardous Materials Defined

A buyer of a business should always be alert to the use and presence of hazardous materials in the business and on the property where the business operates or has operated. In California, "hazardous waste" is defined as waste that because of its quantity, concentration, or physical, chemical, or infectious characteristics may cause or significantly contribute to an increase in mortality or an increase in serious, irreversible, or incapacitating reversible illness or pose a substantial present or potential hazard to human health or the environment, due to factors including but not limited to carcinogenicity, acute toxicity, chronic toxicity, bioaccumulative properties, or persistence in the environment, when improperly treated, stored, transported, or disposed of or otherwise managed [*Health & Safety Code §§ 25117(a), 25141(b)*]. "Hazardous waste" also includes RCRA hazardous waste [*Health & Safety Code § 25117(b)*] and, unless expressly provided to the contrary, extremely hazardous waste and acutely hazardous waste [*Health & Safety Code § 25117(c)*].

[2] Governing Laws

Businesses generating, treating, storing, transporting, or disposing of a wide variety of hazardous wastes may be subject to regulation under the following state and federal laws, including the following:

- The National Environmental Policy Act of 1969 (NEPA) [*42 U.S.C. § 4321 et seq.*; *40 C.F.R. § 6.100 et seq.*; *see* "National Environmental Policy Act of 1969 (NEPA)" in the Legal Background to Ch. 30B, *Zoning, Building, and Environmental Permits*].

- The California Environmental Quality Act of 1970 (CEQA) [*Pub. Res. Code § 21000 et seq.*; *14 Cal. Code Reg. § 15000 et seq.*; *see* Ch. 30B, *Zoning, Building, and Environmental Permits* , Legal Background, "California Environmental Quality Act of 1970 (CEQA)--General Requirements," et seq.].

- The California Coastal Act of 1976 [*Pub. Res. Code § 30000 et seq.*; *14 Cal. Code Reg. § 13001 et*

seq.; *see* Ch. 30B, *Zoning, Building, and Environmental Permits* , Legal Background, "California Coastal Act--Area Covered," et seq.].

In addition, other regulations and restrictions may apply to property located in specific regions [*see* Ch. 30B, *Zoning, Building, and Environmental Permits* , Legal Background, "Overview of Environmental Regulations"], or to particular uses on property, such as operation of underground storage tanks [*see Health & Safety Code § 25280 et seq.*; *see also Health & Safety Code § 25284* (buyer of business using underground storage tanks must either obtain new operating permit or have seller transfer original permit)].

[3] Evaluating Compliance and Potential Liability

Liability for past improprieties is a hallmark of much environmental regulation. Violations of environmental laws can subject a company to civil penalties or criminal sanctions. Therefore, compliance with environmental laws should be evaluated by a competent environmental consultant and should consist of the following:

- A review of the seller's compliance with environmental laws to determine the likelihood of civil and criminal penalties and fines;

- A determination of the likelihood that the company could be liable for the cleanup of contaminated properties; and

- An evaluation of the expenses associated with compliance.

Coverage of the environmental regulation of real property is beyond the scope of this chapter. For more detailed discussion, see Ch. 33, *Contamination Considerations in Real Property Transactions* . For in-depth coverage of environmental law generally, see California Environmental Law and Land Use Practice (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Environmental LawHazardous Wastes & Toxic SubstancesResource Conservation & Recovery ActEnforcementCivil PenaltiesEnvironmental LawHazardous Wastes & Toxic SubstancesResource Conservation & Recovery ActPermitsReal Property LawEnvironmental RegulationGeneral OverviewReal Property LawZoning & Land UseOrdinances



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.17

AUTHOR: Marilyn E. Minger Revision Author

§ 17.17 Letter of Intent for Anticipated Sale

[1] Purpose of Letter of Intent

A letter of intent is used to set forth the principal terms of the anticipated contract for the sale of the business. Although letters of intent are most widely used in the sale of publicly traded corporations, they are also helpful when negotiations are expected to be lengthy or when the nature of the business is complex and requires investigation. A letter of intent may not be necessary or appropriate for all business sales. With some sales, especially those of small businesses, it may be more efficient to bypass the letter of intent and proceed directly to the contract of sale. For a sample letter of intent, see the *form in § 17.261*.

[2] Binding Nature of Letter of Intent

Parties to a sale generally will prefer that a letter of intent not be binding. Contract law determines the enforceability of a letter of intent. Therefore, if parties do not want the letter to be binding, the letter should include a clause that expressly states that the letter is not a binding or enforceable contract. For a sample nonbinding clause, see the *form in § 17.261*, Paragraph 30.

The parties should exercise caution should be exercised in signing a letter of intent because it may constitute a binding contract if there is not express language stating otherwise [*see Levin v. Knight (9th Cir. 1986) 780 F.2d 786, 787* (writing between parties that includes price and subject matter may be binding even if other significant terms are not included)].

Parties to a transaction may expressly provide that only certain provisions of the letter of intent are to be binding. Binding provisions may include the buyer's covenant not to disclose proprietary and confidential information and the seller's covenant to negotiate exclusively with the buyer [*see § 17.261[1][b]*].

Once the terms and conditions of the sale have been finalized, parties to a transaction typically enter into a binding sales contract.

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawTypes of ContractsPersonal PropertyReal Property LawPurchase & SaleContracts of SaleGeneral OverviewReal Property LawPurchase & SaleContracts of SaleFormalities



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.18

AUTHOR: Marilyn E. Minger Revision Author

§ 17.18 Conducting Due Diligence

[1] Purpose of Due Diligence

A business transaction often takes several months or more to complete. During that time, the buyer needs to conduct a diligent investigation to evaluate the operations of the business and to identify any legal or contractual impediments to the anticipated sale. This "due diligence" allows a buyer to determine the risk of any undisclosed liabilities and helps protect a buyer from post-sale litigation. Due diligence is critical in understanding a business and evaluating its worth.

[2] Obtaining Relevant Information About the Business

Due diligence is undertaken by directing inquiries for information directly to the subject business and by investigating and reviewing public records and documents in the custody of third parties. Although due diligence is generally the task of buyer's counsel, seller's counsel may have a responsibility to verify the seller's warranties or legal opinions about the operations of the business. Investigation responsibilities are often allocated to a variety of professionals with expertise in specific areas of business acquisitions. Professionals consulted for purposes of investigation may include, but are not limited to, the following:

- Tax lawyers or accountants.
- Environmental consultants.
- Patent or trademark attorneys.
- Lawyers or experts specializing in employee benefits.
- Investment bankers.
- Real estate appraisers.

- Actuaries.
- Industry specialists.

The division of responsibility for undertaking due diligence should be committed to writing to assure proper and thorough investigation of the business.

[3] Timing of Due Diligence

A buyer should be cautious about entering into a binding sales agreement without first conducting due diligence. In lieu of a binding sales agreement, the seller may require the buyer to enter into a confidentiality agreement or a letter of intent to purchase before allowing a prospective buyer access to key documents and information. This is especially important if the potential buyer is also a potential competitor of the seller. A confidentiality agreement typically will provide that the buyer will hold in confidence all business information acquired during negotiation and investigation.

[4] Assuring Confidentiality of Business Information

Parties to a sale of a business may enter into a confidentiality agreement with respect to particular information exchanged and uncovered during due diligence. This agreement may be included in a letter of intent and should be expressly binding, even if the sale does not proceed to closing. Confidentiality agreements should specify the nature of the information to be kept in confidence, any exceptions to information deemed confidential, and the ongoing obligation to maintain confidentiality even if the sale is not completed. Although confidentiality agreements may be included in a letter of intent [*see, e.g., § 17.261[2]*, Paragraph 19], parties also may execute a separate confidentiality or nondisclosure agreement [*see § 17.262*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral OverviewReal Property LawEnvironmental RegulationLiabilities & RisksGeneral OverviewReal Property LawPurchase & SaleGeneral OverviewTrademark LawConveyancesGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.19

AUTHOR: Marilyn E. Minger Revision Author

§ 17.19 Use of Noncompetition Clauses in the Purchase and Sale of a Business

[1] Restricting Regional Competition by Seller

Noncompetition clauses are commonly used to protect the buyer of a business from competition by the seller [*see Monogram Industries, Inc. v. Sar Industries, Inc. (1976) 64 Cal. App. 3d 692, 698, 134 Cal. Rptr. 714]* . Any person who sells the goodwill of a business, any owner of a business entity who sells or otherwise disposes of all of his or her ownership interest in the business entity, and any owner of a business entity that sells (1) all or substantially all of the business' operating assets together with the business' goodwill, (2) all or substantially all of the operating assets of a division or subsidiary together with that division's or subsidiary's goodwill, or (3) all of the ownership interest of any subsidiary may agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the sold business, division, or subsidiary conducted business provided that the buyer (or any person deriving title to the goodwill or ownership interest from the buyer) carries on a similar business in that geographic area [*Bus. & Prof. Code § 16601*]. Similar provisions apply to a partner on or in anticipation of the partnership's dissolution or that partner's dissociation [*see Bus. & Prof. Code § 16602*], and any member on or in anticipation of dissoulution of, or the termination of that member's interest in, a limited liability company (including a series of a limited liability company formed under the laws of a jurisdiction that recognizes such a series [*see Bus. & Prof. Code § 16602.5*; *see also Hill Medical Corporation v. Wycoff (2000) 86 Cal. App. 4th 895, 897, 906-908, 103 Cal. Rptr. 2d 779* (holding that noncompetition provision in radiologist's stock redemption agreement was void under *Bus & Prof. Code § 16600* and did not fall within exception of *Bus & Prof. Code § 16601*, when business goodwill was not a factor in corporation's repurchase of his shares); Ch. 11A, *Cash Purchase of Shares*; Ch. 15, Part B, *Dissolution of General Partnerships*, § 15.501[1][f]; Ballantine & Sterling, California Corporation Laws, Ch. 4, *Close Corporations* ; Ch. 24, *Partnerships* (Matthew Bender)].

At common law, a covenant against competition was valid to the extent it was reasonably necessary for the protection of the goodwill purchased by the covenantee [*Swenson v. File (1970) 3 Cal. 3d 389, 396, 90 Cal. Rptr. 580, 475 P.2d 852] . Bus. & Prof. Code § 16601* is a codification of this rule of reasonableness [*Monogram Industries, Inc. v. Sar Industries, Inc. (1976) 64 Cal. App. 3d 692, 698, 134 Cal. Rptr. 714]* . Accordingly, courts have broadly interpreted the

territorial restrictions of that section by holding that the areas in which a business is "carried on" embrace more than merely the county or city where the physical plant or office of the business is located [*Swenson v. File (1970) 3 Cal. 3d 389, 396, 90 Cal. Rptr. 580, 475 P.2d 852]* . For example, in *Monogram Industries, Inc. v. Sar Industries, Inc.*, the territorial limits of a noncompetition agreement were held to be coextensive with the entire area in which a seller conducted all phases of the business, including production, promotional, and marketing activities as well as sales. In that case, in which the seller solicited sales and advertised a product throughout the United States and Canada, a noncompetition agreement covering both of those countries, Puerto Rico, and the Virgin Islands was held to be reasonable, even though the seller did not have actual sales in all those places [*Monogram Industries, Inc. v. Sar Industries, Inc. (1976) 64 Cal. App. 3d 692, 702, 134 Cal. Rptr. 714]* . A seller's agreement to refrain from carrying on competitive business in all 58 counties in California was enforceable (to support a preliminary injunction in the buyer's action against the seller for violating the agreement) because substantial evidence established that the plaintiff in fact carried on business in all of the counties [*Alliant Ins. Servs., Inc. v. Gaddy (2008) 159 Cal. App. 4th 1292, 1303-1306, 72 Cal. Rptr. 3d 259* (citing *Monogram Industries, Inc. v. Sar Industries, Inc.*)]. Similarly, a court found that a business that before its sale had substantial sales in 30 different California counties, but had physical plants and offices only in San Francisco and Los Angeles, "carried on" business in all 30 counties. The seller's covenant not to carry on a similar business in California therefore was held enforceable in all 30 counties where the business had substantial sales [*Kaplan v. Nalpak Corp. (1958) 158 Cal. App. 2d 197, 203, 322 P.2d 226]* .

The seller of a business may be in violation of an agreement to refrain from carrying on a similar business in a specified city if he or she opens a similar business just outside the city [*Roberts v. Pfefer (1970) 13 Cal. App. 3d 93, 98, 91 Cal. Rptr. 308]* . However, a seller did not violate a noncompetition agreement, even though his office was located in an adjoining area, when he had only isolated, occasional transactions not substantially affecting the competitive position of the sold business in the area or with residents of the area in which the sold business had been carried on [*Swenson v. File (1970) 3 Cal. 3d 389, 397, 90 Cal. Rptr. 580, 475 P.2d 852]* .

For a discussion of covenants not to compete in the context of an employment relationship, see Ch. 85, *Employment Agreements* .

[2] In Sale of Law Practice

An attorney may not enter into a noncompetition agreement in connection with the sale of his or her law practice unless he or she intends to permanently retire from the practice of law [*see Cal. Rules Prof. Conduct, Rule 1-500(B)*]. For discussion, see *§ 17.22[5][c]*.

[3] Using Liquidated Damages Clause to Remedy Breach of Noncompetition Agreement

The parties should consider fixing damages in the event a noncompetition agreement is breached. A liquidated damages provision is valid unless the party seeking to invalidate it can establish that it was unreasonable under the circumstances existing at the time the contract was made [*Civ. Code § 1671*; *see Weber, Lipshie & Co. v. Christian (1997) 52 Cal. App. 4th 645, 656-657, 60 Cal. Rptr. 2d 677* (partnership agreement's liquidated damages provision, which provided that damages to accounting firm for loss of fees from breach of covenant would be measured by doubling firm's time charges for clients lost due to breach for 12 months immediately preceding their loss, was enforceable under *Civ. Code § 1671*)]. For discussion of liquidated damages provisions in contracts generally, see *Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.251*. For an example and discussion of a liquidated damages provision for a noncompetition agreement in an employment contract, see Ch. 85, *Employment Agreements* . For discussion of the special requirements applicable to a liquidated damages provision in a contract for the sale of real property, see *§ 17.201[1][h]*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewContracts LawRemediesLiquidated DamagesContracts LawTypes of ContractsPartnership AgreementsLabor & Employment LawEmployment RelationshipsEmployment ContractsConditions & TermsTrade Secrets & Unfair CompetitionNoncompetition & Nondisclosure AgreementsReal Property LawPurchase & SaleRemediesDamagesGeneral Overview



92 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.20

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§ 17.20 Business Transfers Governed by Bulk Sales Division of Commercial Code

[1] Protecting Creditors From Seller Fraud

The Uniform Commercial Code--Bulk Transfers Division of the California Commercial Code [*see* former *Com. Code §§ 6101-6111*] was adopted to ensure that the owner of a business does not defraud creditors by either (1) selling the business for less than the market price and paying creditors less than the amount owed or (2) simply selling the business to a good faith purchaser and disappearing with the proceeds [*see* California Code Comment to former *Com. Code § 6101* (adopting without change Comment to U.C.C. § 6-601)]. The bulk transfer provisions were substantially revised and recodified as the Uniform Commercial Code--Bulk Sales Division ("Bulk Sales Division") [*see Com. Code §§ 6101-6111*], generally applicable to bulk sales if date of the bulk sale is on or after January 1, 1991 [*Com. Code § 6111(a)*; *see Com. Code § 6102(a)(7)* ("date of bulk sale" defined); *but see Com. Code § 6111(b)* (transitional rules when date of bulk sale is on or after January 1, 1991, but date of bulk sale agreement is before that date)].

To protect creditors, the Bulk Sales Division requires a buyer to record and publish advance notice of the sale [*see Com. Code §§ 6104(b), 6105*]. Further, in a small cash sale of not more than $2,000,000, the buyer or escrow agent is authorized to impound and control the distribution of the proceeds, and must apply the sale proceeds to the seller's debts before paying the seller [*see Com. Code §§ 6106.2, 6106.4*]. A seller's "creditors" are "claimants" or other persons holding specified types of claims incurred in the seller's business [*see Com. Code § 6102(a)(5), (6)*].

[2] "Bulk Sales" Defined

[a] Sales Subject to Bulk Sales Division

A "bulk sale" is any sale *outside* the ordinary course of the seller's business of more than one half of seller's inventory and equipment, as measured by the fair market value on the date of the bulk sale agreement [*Com. Code § 6102(a), (8), (15)*; *see Com. Code §§ 6102(b)(2), (3), 9102(a)(33)* ("equipment" defined), 9102(a)(48) ("inventory" defined)]. A sale is "in the ordinary course of the seller's business" if the sale comports with usual or customary practices in the kinds of business in which the seller is engaged or with the seller's own usual or customary practices [*Com. Code § 6102(a)(13)*].

The term "bulk sale" also encompasses such a sale when conducted by auction, and a sale or series of sales conducted by a liquidator on the seller's behalf [*Com. Code § 6102(a)(3)(i)*].

[b] Sales Exempt From Bulk Sales Division

The following categories of sales are exempt from the requirements of the Bulk Sales Division:

- A transfer made to secure payment or performance of an obligation [*Com. Code § 6103(c)(1)*].
- A transfer of collateral to a secured party pursuant to *Com. Code § 9609* [*Com. Code § 6103(c)(2)*].
- A disposition of collateral pursuant to *Com. Code § 9610* [*Com. Code § 6103(c)(3)*].
- The acceptance of collateral pursuant to *Com. Code § 9620* [*Com. Code § 6103(c)(4)*].
- A sale of an asset encumbered by a security interest or lien if (1) all the sale proceeds are applied in partial or total satisfaction of the debt secured by the security interest or lien or (2) the security interest or lien is enforceable against the asset after the asset has been sold to the buyer and the net contract price is zero [*Com. Code § 6103(c)(5)*].
- A general assignment for the benefit of creditors or a subsequent transfer by the assignee [*Com. Code § 6103(c)(6)*].
- A sale by an executor, administrator, receiver, trustee in bankruptcy, debtor in possession, or any public officer under judicial process [*Com. Code § 6103(c)(7)*].
- A sale made in the course of judicial or administrative proceedings for the dissolution or reorganization of an organization [*Com. Code § 6103(c)(8)*].
- A sale to a buyer whose principal place of business is in the United States [*see Com. Code § 6102(a)(14)*] if the buyer assumes all debts owed to claimants of whom the buyer has knowledge on the date that the buyer receives the seller's list of creditors or completes reasonable inquiry, records and publishes notice of the assumption, and is not insolvent after the assumption [*Com. Code § 6103(c)(9)*; *see Com. Code §§ 6103(d)* (contents of notice), 6105].
- A sale to a buyer whose principal place of business is in the United States [*see Com. Code § 6102(a)(14)*] if the buyer assumes all debts incurred in the seller's business before the date of the bulk sale [*see Com. Code § 6102(a)(7)*], is not insolvent after the assumption, and records and publishes notice of the assumption not later than 30 days after the date of the bulk sale [*Com. Code § 6103(c)(10)*; *see Com. Code §§ 6103(e)* (contents of notice), 6105].
- A sale to a new organization that is organized to take over and continue the seller's business and that has its principal place of business in the United States [*see Com. Code § 6102(a)(14)*] if the buyer assumes all debts incurred in the seller's business before the date of the bulk sale [*see Com. Code § 6102(a)(7)*], the seller receives nothing from the sale except an interest in the new organization that is subordinate to any claims against the organization arising from the assumption, and the buyer records and publishes notice of the assumption not later than 30 days after the date of the bulk sale [*Com. Code § 6103(c)(11)*; *see Com. Code §§ 6103(e)* (contents of notice), 6105].
- A sale of assets having either (a) a value, net of liens and security interests, of less than $10,000 or

(b) a value of more than $5 million on the date of the bulk sale agreement [*Com. Code § 6103(c)(12)*; *see Com. Code § 6103(f)* (valuation); *see also Com. Code § 6102(a)(8)* (date of agreement)].

- A sale required by and made pursuant to statute [*Com. Code § 6103(c)(13)*].

- A transfer of personal property in connection with a sale/leaseback if the transfer is exempt under *Civ. Code § 3440.1(k)* (transfers without delivery) [*Com. Code § 6103(c)(14)*; *see Com. Code § 10308*].

- A transfer of personal property in connection with a sale/leaseback if there has been compliance with *Civ. Code § 3440.1(h)*, requiring the filing of a financing statement [*see Com. Code §§ 9501 et seq.*] with the Secretary of State and the publication of notice of the intended transfer [*Com. Code § 6103(c)(14)*].

- A transfer that is subject to and complies with the license transfer requirements [*see Bus. & Prof. Code §§ 24070-24082*], such as the transfer of a retail alcoholic beverage license, if the transferee records and publishes the requisite notice of transfer at least 12 business days before the transfer is consummated [*Com. Code § 6103(c)(15)*; *see Com. Code § 6105(a)(1)-(4)*; *see also* Ch. 18, *Buying and Selling a Retail Alcoholic Beverage License and Business*].

- A transfer of goods in a warehouse when a warehouseman has issued a warehouse receipt [*see Com. Code § 7102*; *see also § 54A.200* in Ch. 54A, *Storage of Goods*], and a copy of the receipt is kept at the warehouseman's principal place of business and at the warehouse where the goods are stored [*Com. Code § 6103(c)(16)*].

[3] Determining if Business Is Subject to Bulk Sales Division

The Bulk Sales Division applies to a bulk sale if both of the following conditions exist:

- The seller's principal business is the sale of inventory from stock, including those who manufacture what they sell, or is that of restaurant owner [*Com. Code § 6103(a)(1)*]; and

- The seller is located in California, or is located in jurisdiction outside the United States but has its major American executive office in California, on the date of the bulk sale agreement [*Com. Code § 6103(a)(2)*].

A seller is deemed to be located at its place of business or, if the seller has more than one place of business, at its chief executive office [*Com. Code § 6103(b)*].

The "date of bulk sale agreement" means either of the following [*Com. Code § 6102(a)(8)*]:

- In the case of a sale by auction or conducted by a liquidator on the seller's behalf, the date on which the seller engages the auctioneer or liquidator; or

- In all other cases, the date on which the bulk sale agreement becomes enforceable between the buyer and the seller.

The "date of bulk sale" means either of the following [*Com. Code § 6102(a)(7)(i)*]:

- In the case of a sale by auction or conducted by a liquidator on the seller's behalf, the date on which more than 10 percent of the net proceeds is paid to or for the benefit of the seller; or

- In all other cases, the later of the date on which more than 10 percent of the net contract price is paid to or for the benefit of the seller, or the date on which more than 10 percent of the assets, as measured by value, are transferred to the buyer.

If the contract price is deposited in an escrow, the contract price is "paid to or for the benefit of the seller" as of the earlier of the dates when (1) the seller acquires the unconditional right to receive the deposit or (2) the date when the deposit is delivered to or for the benefit of the seller [*Com. Code § 6102(a)(7)(ii)(B)*].

[4] Failure to Comply With Bulk Sales Division

[a] Buyer's Liability

In general, if a buyer fails to comply with the bulk sale notice requirements with respect to one or more claimants, the buyer is liable for damages in the amount of any claims against the seller, less any amount that the claimant would not have realized if the buyer had complied with the notice requirements [*Com. Code § 6107(a)*]. The claimant has the burden of establishing the validity and amount of the claim, and the buyer has the burden of establishing the amount that the claimant would not have realized if the buyer had complied [*Com. Code § 6107(b)*]. If the buyer pays a claim to a creditor based on the buyer's failure to comply with the notice requirements, that payment discharges pro tanto the seller's debt to the creditor [*Com. Code § 6107(i)*]. Further, unless the buyer and seller agree to the contrary, the buyer has an immediate right of reimbursement from the seller for any amount paid to a creditor in partial or total satisfaction of the buyer's liability under *Com. Code § 6107(a)* [*Com. Code § 6107(j)*].

[b] Exception When Buyer Has Made Good Faith Effort to Comply

Despite the general rule of liability for failure to comply with the bulk sale notice requirements, a buyer who makes a good faith and commercially reasonable effort to comply with the bulk sale notice requirements, or to exclude the sale from the application of the bulk sale requirements, is not liable to creditors for failure to comply with the notice requirements [*Com. Code § 6107(c)*]. The buyer has the burden of establishing the good faith and commercial reasonableness of the effort [*Com. Code § 6107(c)*].

[c] Limitations on Buyer's Liability

The amount of cumulative liability of the buyer in a single bulk sale for failure to comply with the bulk sale notice requirements is subject to certain limitations [*see Com. Code § 6107(d)-(f)*], and no action may be brought by or on behalf of a claimant whose claim is unliquidated or contingent [*Com. Code § 6107(g)*]. A buyer's failure to comply with the bulk sale notice requirements [*see Com. Code § 6104*] does not impair the buyer's rights in or title to the assets; render the sale ineffective, void, or voidable; entitle a creditor to more than a single satisfaction of its claim; or create liability other than that provided in the Bulk Sales Division [*Com. Code § 6107(h)*].

[d] Time for Commencement of Action

An action under the Bulk Sales Division against a buyer, auctioneer, or liquidator must ordinarily be commenced within one year after the date of the bulk sale [*Com. Code § 6110(a)*]. However, if the buyer, auctioneer, or liquidator conceals the fact that the bulk sale has occurred, the statute of limitations is tolled, and an action may be commenced within the earlier of (1) one year after the person bringing the action discovers that the sale has occurred or (2) one year after the person bringing the action should have discovered that the sale has occurred, but no later than two years after the date of the bulk sale. Complete noncompliance with the Bulk Sales Division does not in and of itself establish concealment [*Com. Code § 6110(b)*].

[5] Complying With Notice Requirements Under Bulk Sales Division

[a] Notice of Sale

In any bulk sale subject to the Bulk Sales Division, the buyer must do all of the following [*Com. Code § 6104*; *see Com. Code § 6106.2*]:

- Obtain from the seller a list of all business names and addresses used by the seller within three years before the date that the list is sent or delivered to the buyer;
- Give notice of the bulk sale; and
- Comply with the distribution requirements applicable to small cash bulk sales.

The notice referred to above must state all of the following [*Com. Code § 6105*; *see § 17.270*]:

- That a bulk sale is about to be made.
- The names and business addresses of the buyer and seller. The buyer must include all other business names and addresses used by the seller within the past three years, to the extent known.
- The location and general description of the property to be transferred.
- The place and the anticipated date of the bulk sale [*see* [1], [3], *above*].
- Whether or not the bulk sale is subject to *Com. Code § 6106.2*, which governs creditor claims in sales for which the consideration is (a) $2 million or less, and (b) substantially all cash, an obligation to pay cash in the future, or a combination of the two [*Com. Code § 6106.2(a)*].

In a small cash sale [*Com. Code § 6106.2(a)*; *see* the fifth bulleted item, *above*], the notice must also state the name and address of the person with whom claims may be filed and the last date (which must be the business day before the noticed sale date) for filing claims [*Com. Code §§ 6105(a)(5), 6106.2(f)*].

In a bulk sale by auction or liquidation, the notice must be accompanied by a statement that the sale will be by auction or liquidation. The statement must include the name of the auctioneer or liquidator, and the time and place of the auction or the time and place on or after which the liquidator will begin to sell assets on the seller's behalf [*Com. Code § 6108(a)(3)*].

[b] Recording, Publishing, and Delivering Notice

At least 12 business days before the date of the bulk sale, the buyer must take three actions with respect to the notice of bulk sale [*Com. Code § 6105(b)*]. A "business day" is any day other than a Saturday, Sunday, or day observed as a holiday by the California state government [*Com. Code § 6105(b)*].

First, the buyer must record the notice in the office of the county recorder of the county or counties in California in which the tangible assets are located and, if different, in the county in which the seller is located at least 12 business days before the date of the bulk sale [*Com. Code § 6105(b)(1)*; *see Com. Code § 6103(a)(2)*; *see also Com. Code § 6102(a)(7)* ("date of bulk sale" defined)].

Second, the buyer must publish the bulk sale notice at least 12 business days before the date of the bulk sale [*Com. Code § 6105(b)(2)*; *see Com. Code § 6102(a)(7)*]. The notice must be published at least once in a newspaper of general circulation published in the judicial district in which the tangible assets are located and, if different, in the judicial

district in which the seller is located [*Com. Code § 6105(b)(2)*; *see Com. Code § 6103(a)(2)*] If no such newspaper exists, the notice must be published in a newspaper of general circulation in the county in which the judicial district is located [*Com. Code § 6105(b)(2)*]. If the tangible assets are located in more than one judicial district, the notice must be published in the judicial district in which a greater portion of the assets are located and, if different, the judicial district in which the seller is located [*Com. Code § 6105(b)*; *see Com. Code § 6103(b)*].

Third, the buyer must deliver the notice or send the notice by registered or certified mail to the county tax collector in the California county or counties in which the tangible assets are located at least 12 business days before the date of the bulk sale [*Com. Code § 6105(b)(3)*]. In addition, if the notice is delivered or sent during the period from January 1 to May 7, inclusive, it must be accompanied by a completed business property statement with respect to the property involved in the bulk sale [*Com. Code § 6105(b)(3)*; *see Rev. & Tax. Code § 441* (procedure for filing property statements)].

One court, reading *Com. Code § 6105* in light of the legislative intent, has held that the notice must be published and recorded at least 12 business days before the anticipated sale date *as specified in the notice* (as opposed to the *actual* sale date). Otherwise, creditors do not have sufficient time to file a timely claim [*Gifford v. J&A Holdings (1997) 54 Cal. App. 4th 996, 999, 63 Cal. Rptr. 2d 253* (postponing actual date of sale until 12 business days after recordation did not comply with literal terms of statute; postponement without notice did not constitute good faith effort at compliance under *Com. Code § 6107(c)*)].

[6] Paying Creditor Claims

[a] Transactions Subject to Requirements

The Bulk Sales Division imposes additional requirements on the payment of creditor claims when the consideration for the bulk sale is $2 million or less and is either substantially all cash, an obligation of the buyer to pay cash in the future to the seller, or a combination of the two [*see Com. Code § 6106.2(a), (b)*; *see also Com. Code § 6106.4*]. Bulk sales fitting this description are commonly referred to as "small cash sales."

[b] Obligations of Buyer

In a small cash sale, the buyer (or an escrow agent if the transaction is handled through an escrow) has a duty to apply the consideration in accordance with statutory distribution requirements [*see Com. Code § 6106.2(a), (b)*; *see Com. Code § 6106.4* (escrow duties and distribution)]. This duty extends so far as is necessary to pay those debts of the seller for which claims are both (1) due and payable on or before the date of the bulk sale and (2) filed in writing on or before the date specified as the last date to file claims with the person designated in the notice to receive claims [*Com. Code § 6106.2(b)*; *see Com. Code §§ 6105(b), 6106.2(f)*]. The buyer or escrow agent owes this duty to each creditor who files a timely claim [*Com. Code § 6106.2(b)*]. However, this duty does not apply to sales made at auction, or sales or series of sales conducted by a liquidator on the seller's behalf [*Com. Code § 6106.2(b)*].

These requirements were designed to ensure that the sales proceeds will not be dissipated before the creditors have a chance to collect on their claims. Because of the added burden on the buyer, no particular method of withholding the funds is imposed. The buyer may withhold and pay out the funds, use a separate account for that purpose, or use an escrow agent [*see* Bender' S Uniform Commercial Code Service--Sales and Bulk Transfers, Ch. 15, *Bulk Transfers--Article 6* (Matthew Bender)].

[c] Submission of Claims to Seller; Disputed Claims

The buyer or escrow agent should submit all creditor claims to the seller for approval or rejection. If the seller disputes whether a claim is due and payable on the noticed sale date, or disputes the amount of any claim, the buyer or escrow agent must withhold from distribution an amount specified by statute (or the pro rata amount determined when the cash

available in escrow for distribution is insufficient to pay all claims in full [*see Com. Code § 6106.4(b)*; *see also* [7], *below*]) and give written notice to the claimant within two business days after distribution that the amount will be paid to the seller (or to the other claimants, if necessary, when the cash available for distribution is insufficient) unless attached by the claimant within 25 days from the mailing of the notice [*Com. Code § 6106.2(c)*]. The buyer or escrow agent must pay to the seller (or to the other claimants, when necessary) any portion of the amount withheld that is not attached within that time.

An attachment is limited in its effect to the amount withheld for the attaching claimant, and will give that claimant no greater priority or rights with respect to the claim than the claimant would have had if the claim had not been disputed [*Com. Code § 6106.2(c)*]. A claimant may obtain the issuance of an attachment for a claim that is less than $500 and that otherwise meets the requirements of, or that is a secured claim or lien of the type described in, *Code Civ. Proc. § 483.010*. This remedy is in addition to any other remedies that the claimant may have, including any right to attach the property intended to be transferred or any other property [*Com. Code § 6106.2(c)*; *see Code Civ. Proc. § 481.010 et seq.* (Attachment Law)].

[d] Payment of Undisputed Claims

With respect to timely claims that the seller does not dispute, the buyer or escrow agent, within 45 days after closing (that is, passing of legal title), must either (1) pay the claims to the extent of the cash consideration, or (2) institute an interpleader action [*see Code Civ. Proc. § 386(b)* (action requires various creditors to interplead and litigate their claims against one debtor); *see also* California Forms of Pleading and Practice, Ch. 314, *Interpleader* (Matthew Bender)] in the appropriate court for the county where the seller had its principal place of business, and deposit the sale consideration with the clerk of that court [*Com. Code § 6106.2(e)*].

If the cash consideration payable is insufficient to pay all of the claims received in full, and no escrow has been established [*see Com. Code § 6106.4*], the buyer must follow escrow procedures specified by statute [*Com. Code § 6106.2(d)*; *see* [7], *below*].

[7] Paying Creditors When Claims Exceed Cash Deposit

[a] Deposit of Purchase Price With Escrow Agent

Whenever the notice of a bulk sale with consideration of $2 million or less payable in cash [*see Com. Code § 6106.2(a)*] states that claims may be filed with an escrow agent, the intended buyer must deposit the full amount of the purchase price or consideration with the escrow agent. If at the time the bulk sale is otherwise ready to be consummated (that is, the seller is otherwise ready to pass title to the buyer), the amount of cash deposited or agreed to be deposited at or before the consummation is insufficient to pay in full all of the claims filed with the escrow agent, the escrow agent must follow the special procedures set forth in [b]-[e], *below* [*Com. Code § 6106.4*]. If no escrow has been established, the buyer must follow these procedures [*Com. Code § 6106.2(d)*].

[b] Delay of Closing and Written Notice to Creditors

First, the escrow agent or buyer must delay the passing of legal title and distribution of the consideration for not less than 25 nor more than 30 days from the date of mailing a notice of the delayed closing to creditors [*Com. Code § 6106.4(a)(1)*]. Within five business days after the time the transfer would otherwise have closed, the escrow agent or buyer must send a written notice of the delayed closing and insufficiency to each creditor who has filed a claim, stating the following [*Com. Code § 6106.4(a)(2), (c)*]:

- The total consideration deposited or agreed to be deposited in the escrow.
- The name of each claimant who filed a claim against the escrow and the amount of each claim.

- The amount proposed to be paid to each claimant.

- The new date scheduled for the closing (that is, passing of legal title).

- The date on or before which distribution will be made to claimants, which must not be more than five days after the new date specified for the passing of legal title.

- If an obligation to pay cash in the future is part of the consideration, the amount, terms, and due dates of the obligation and the portion of the claims expected to be paid from it [*see Com. Code § 6106.4(c)*].

If the escrow agent or buyer receives no written objection to the distribution described in this notice before the new date specified for the passing of legal title, the escrow agent or buyer will not be liable to any person to whom the notice was sent for any good faith error that may have been committed in allocating and distributing the consideration as stated in the notice [*Com. Code § 6106.4(a)(3)*].

[c] Distribution to Creditors in Order of Priority

Next, the escrow agent or buyer must distribute, on the new closing date specified in the notice to creditors, the consideration to the following claims in the following order of priority [*Com. Code § 6106.4(b)*]:

- All obligations owing to the United States, to the extent given priority by federal law.

- Secured claims, including statutory and judicial liens, to the extent of the consideration fairly attributable to the value of the properties securing the claims and in accordance with the priorities provided by law [*see Civ. Code §§ 2897-2899* (priority of liens); *see also* California Forms of Pleading and Practice, Ch. 342, *Liens and Wage Preferences* (Matthew Bender)]. However, a secured creditor will participate in the distribution only after depositing a release of lien conditioned on receiving an amount equal to that distribution [*Com. Code § 6106.4(b)*].

- Escrow and professional charges and broker's fees attributable directly to the sale.

- Unpaid employee wage claims earned within 90 days prior to the sale, transfer, or opening of the escrow [*Com. Code § 6106.4(b)(4)*; *see Code Civ. Proc. § 1205*].

- All other tax claims.

- All other unsecured claims pro rata, including any deficiency claims of partially secured creditors.

[d] Allocation of Principal and Interest on Buyer's Future Payment Obligations

Finally, to the extent that an obligation of the buyer to pay cash in the future is a part of the consideration, and the cash consideration is not sufficient to pay all claims filed in full, the escrow agent or buyer must apply all principal and interest received on the obligation to the payment of claims in the order of priority listed above until they are paid in full, before making any payment to the seller [*Com. Code § 6106.4(c)*].

[e] Payment for Commissions and Related Expenses

No funds may be drawn from the escrow, before the completion and closing of the escrow, for the payment, in whole or

in part, of any commission, fee, or other consideration as compensation for a service that is contingent on the performance of any act, condition, or instruction set forth in the escrow [*Com. Code § 6106.4(c)*].

[8] Considering Special Rules for Bulk Sale Auctions and Liquidations

The buyer's duties under the Bulk Sales Division [*see Com. Code § 6104*], the notice requirements [*see Com. Code § 6105*], and the liability provisions [*see Com. Code § 6107*] generally apply to bulk sales by auction and to bulk sales conducted by liquidators on the sellers' behalf [*Com. Code § 6108(a)*]. However, certain modifications must be made [*see, e.g., Com. Code § 6108(a)(3)* (additional notice requirement)]. For example, when the sale is by auctioneers or liquidators, the term "buyer" refers to the auctioneer or liquidator [*Com. Code § 6108(a)(1)*]. Thus a person who buys at a bulk sale by auction or conducted by a liquidator is not the "buyer" for purposes of the Bulk Sales Division, need not comply with the buyer notice duties, and is not liable for the failure of an auctioneer or liquidator to comply with his or her duties under the Bulk Sales Division [*Com. Code § 6108(c)*].

In a single bulk sale, the cumulative liability of the auctioneer or liquidator for failure to comply with his or her duties [*see Com. Code § 6108*] may not exceed the amount of the net proceeds of the sale allocable to inventory and equipment sold, less the amount of the portion of any part of the net proceeds paid to or applied for the benefit of a creditor that is allocable to inventory and equipment [*Com. Code § 6108(a)(4)*]. The term "net contract price" refers to the net proceeds of the auction or the liquidation sale or series of sales [*Com. Code § 6108(a)(2)*]. A payment made by the auctioneer or liquidator to a person to whom the auctioneer or liquidator is, or believes himself or herself to be, liable reduces pro tanto the auctioneer's or liquidator's cumulative liability [*Com. Code § 6108(b)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Bulk Sales (Article 6)General OverviewCommercial Law (UCC)Bulk Sales (Article 6)NoncomplianceContracts LawTypes of ContractsBona Fide Purchasers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.21

AUTHOR: Marilyn E. Minger Revision Author

§ 17.21 Evaluating Transaction Under Laws Governing Fraudulent Transfers

[1] Uniform Fraudulent Transfer Act

The Uniform Fraudulent Transfer Act [*Civ. Code §§ 3439-3439.12*] provides that a transfer made by a debtor is fraudulent as to any creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer either (1) with actual intent to hinder, delay, or defraud the creditor, or (2) without receiving a reasonably equivalent value in exchange for the transfer, when the debtor was engaged or about to engage in a business or transaction for which the remaining assets were unreasonably small, or when the debtor intended to incur debts beyond his or her ability to pay them as they became due [*see Civ. Code § 3439.04*; *see also Sanwa Bank California v. Chang (2001) 87 Cal. App. 4th 1314, 1317-1318, 105 Cal. Rptr. 2d 330* (creditor brought action against wife after husband transferred family residence to her and then failed to include it in his bankruptcy estate)]. With respect to a creditor whose claim arose before the transfer, the transfer is also considered to be fraudulent if the debtor (1) did not receive a reasonably equivalent value for the transfer, and (2) the debtor was insolvent at that time or became insolvent as a result of the transfer [*Civ. Code § 3439.05*; *see* Ch. 9, *Dividends, Reacquisitions of Shares, and Assessments*]. A showing of good faith and reasonably equivalent value is sufficient to defeat a creditor's action pursuant to *Civ. Code §§ 3439.04(a), (b), 3439.05* [*Civ. Code § 3439.08*; *see, e.g., Annod Corporation v. Hamilton & Samuels (2002) 100 Cal. App. 4th 1286, 1294-1295, 123 Cal. Rptr. 2d 924* (affirming summary judgment for defendants in fraudulent conveyance action brought by landlord against partners who took partnership draws rather than paying rent)].

This Act is designed to prevent debtors from placing property beyond the reach of their creditors when the property legitimately should be made available to satisfy the creditors' demands [*see Chichester v. Mason (1941) 43 Cal. App. 2d 577, 584, 111 P.2d 362* (decided under former *Civ. Code §§ 3439*, 3442)]. A transfer made to defraud creditors, however, may be attacked only by one who is injured by the transfer [*see, e.g., Mehrtash v. Mehrtash (2001) 93 Cal. App. 4th 75, 80-81, 112 Cal. Rptr. 2d 802* (plaintiff failed to show she was injured by transfer of heavily mortgaged property when she produced no evidence that value of property could support any net recovery for her in event conveyance were set aside)]. The parties may avoid application of the Act to the sale of a business by ensuring that they

obtain a professional evaluation of the fair market value of the business. The manner in which a business should be evaluated or priced by a prospective buyer is beyond the scope of this chapter. For further discussion of the Uniform Fraudulent Transfer Act, see *California Forms of Pleading and Practice, Ch. 270, Fraudulent Conveyances, § 270.30 et seq.* (Matthew Bender).

[2] Civil Code Provisions Applicable to Transfers of Personal Property Without Delivery

The Civil Code also contains provisions rendering fraudulent certain transfers of personal property without delivery [*see Civ. Code §§ 3440-3440.9*]. A transfer of personal property by a person with possession is void against the creditors of the debtor and subsequent good faith purchasers if the transfer is not accompanied by an immediate delivery and an actual and continued change of possession [*see Civ. Code § 3440*]. Various types of property, however, are exempted [*see Civ. Code § 3440.1*]. These provisions are intended to prevent the deception of creditors arising out of the ostensible ownership of the property by a debtor who has made a secret transfer of the property [*see* Dersch v. Thomas (1934) 138 Cal. App. (Supp.) 785, 789, *30 P.2d 630]* . For further discussion, see *California Forms of Pleading and Practice, Ch. 270, Fraudulent Conveyances, § 270.70 et seq.* (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewMergers & Acquisitions LawSales of AssetsGeneral OverviewReal Property LawPurchase & SaleGeneral OverviewReal Property LawPurchase & SaleFraudulent Transfers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.22

AUTHOR: Marilyn E. Minger Revision Author

§ 17.22 Special Considerations for Purchase and Sale of Professional Practices

[1] Professional Practices Defined

A "professional practice" is a business for the performance of specialized services by a person who has qualified, by reason of education or training, to perform those services. The Professional Corporation Act [*Corp. Code §§ 13400-13410*] defines professional services as those services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Osteopathic Act, the Chiropractic Act, or the Yacht and Ship Brokers Act [*Corp. Code §§ 13401(a), 13401.3*; *see* Ch. 12A, *Professional Corporations*]. Medical, dental, accounting, and legal practices are typical professional practices.

[2] Sale of Business Goodwill

Goodwill is one of the most valuable assets of a professional practice. "Goodwill" is defined as the expectation of continued patronage [*Bus. & Prof. Code § 14100*]. Continued patronage by the business's clients depends on the personal skill of the professional and the confidence those clients have in him or her [*see Lyon v. Lyon (1966) 246 Cal. App. 2d 519, 524-525, 54 Cal. Rptr. 829]* .

The goodwill of a business is transferable property [*Bus. & Prof. Code § 14102*]. A person transferring the goodwill of a business may transfer with it the right to use the name under which the business is conducted [*Bus. & Prof. Code § 14103*]. The goodwill of a business, however, does not otherwise include a right to use the name of any person from whom the business was acquired [*Bus. & Prof. Code § 14101*]. For further discussion, see *§ 17.217[1][b]*.

Any person who sells the goodwill of a business, any owner of a business who sells or otherwise disposes of all of his or her ownership interest in the business entity, and any owner of a business entity that sells (1) all or substantially all of the business' operating assets together with the business' goodwill, (2) all or substantially all of the operating assets of a division or subsidiary together with that division's or subsidiary's goodwill, or (3) all of the ownership interest of any subsidiary may agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the sold business, division, or subsidiary conducted business provided that the buyer (or any person deriving title

to the goodwill or ownership interest from the buyer) carries on a similar business in that geographic area [*Bus. & Prof. Code § 16601*; *see Hill Medical Corporation v. Wycoff (2000) 86 Cal. App. 4th 895, 897, 906-908, 103 Cal. Rptr. 2d 779* (holding that noncompetition provision in radiologist's stock redemption agreement was void under *Bus. & Prof. Code § 16600* and did not fall within exception of *Bus. & Prof. Code § 16601*, when business goodwill was not a factor in corporation's repurchase of his shares)]. Use of a noncompetition agreement will help ensure that the buyer, rather than the seller, receives the patronage of the practice's existing clients. For an example and discussion of a noncompetition provision, see *§ 17.213*. Special restrictions apply to noncompetition agreements regarding the practice of law [*see* [5][c], *below*].

[3] Transferring Work in Progress

The burden of an obligation (that is, the required performance or duty) may not be transferred unless the party entitled to its benefit consents to the transfer [*Civ. Code § 1457*]. Therefore, in order for the seller to transfer work in progress to the buyer, the seller must first obtain the consent of the client or patient for whom the work was begun.

"Personal service" contracts, which call for the skill or other personal quality of the promisor, are not assignable. Performance by an assignee would be essentially different from that for which the promisee contracted [*Coykendall v. Jackson (1936) 17 Cal. App. 2d 729, 731, 62 P.2d 746]* . Even a formal recital of assignability in a contract is not binding if the parties intended a purely personal obligation [*Davis v. Basalt Rock Co. (1951) 107 Cal. App. 2d 436, 444-445, 237 P.2d 338]* . However, if the services required may be performed by another as satisfactorily as by the promisor, or if the contract by its terms shows that performance by others was contemplated, the obligation may be assigned despite its apparently "personal nature" [*Estate of Burke (1926) 198 Cal. 163, 167-168, 244 P. 340* ; *see Didier v. American Gas Co. (1968) 261 Cal. App. 2d 742, 750, 68 Cal. Rptr. 217]* . For further discussion, see Ch. 92, *Service Contracts* .

Additional restrictions are imposed on the transfer of legal work [*see* [5], *below*].

[4] Determining Applicability of Tax Laws in Transfer of Professional Practice

Generally, a professional practice will not have a seller's permit issued by the Board of Equalization (SBE) because the business sells services, rather than tangible personal property [*see Rev. & Tax. Code § 6051*; *18 Cal. Code Reg. § 1501*]. The sale of the practice will be exempt from sales tax as an "occasional sale," unless it is the seller's third sale of tangible personal property used in the practice during the past 12 months [*see Rev. & Tax. Code § 6006.5*; *18 Cal. Code Reg. 1595*; *see also § 17.12[2]*]. The contract for the sale of any professional practice that has employees must provide for withholding of the purchase price until receipt of a tax clearance certificate from the Employment Development Department [*see Unemp. Ins. Code §§ 1731, 1733*].

[5] Sale of Law Practice

[a] Sale to Another Bar Member of Law Firm

Cal. Rules Prof. Conduct, Rule 2-300 provides that, subject to the rules discussed in [b], *below*, all or substantially all of a living or deceased California Bar member's law practice, including goodwill, may be sold to another bar member or law firm. Admission to or retirement from a law partnership or corporation, retirement plan, or similar arrangement, or sale of the tangible assets of a law practice, is not deemed to be a sale or purchase for purposes of Rule 2-300 [*Cal. Rules Prof. Conduct, Rule 2-300(F)*].

[b] Conditions of Sale

When a law practice is sold, the fees charged to clients must not be increased solely by reason of the sale [*Cal. Rules Prof. Conduct, Rule 2-300(A)*]. In addition, if the rules of the court or other tribunal in which a matter is pending require

a substitution of attorney, the parties must take all steps necessary for the substitution [*Cal. Rules Prof. Conduct, Rule 2-300(C)*; *see Cal. Rules Prof. Conduct, Rule 3-700* (attorney must obtain permission to withdraw from proceeding in tribunal, when required by tribunal's rules)]. Furthermore, all the activities of a buyer or potential buyer must comply with *Cal. Rules Prof. Conduct, Rules 3-300* (avoidance of adverse interests) and 3-310 (avoidance of representing adverse interests) [*Cal. Rules Prof. Conduct, Rule 2-300(D)*]. Neither party may disclose confidential information to a nonmember of the California Bar in connection with the sale [*Cal. Rules Prof. Conduct, Rule 2-300(E)*]. Finally, if the sale contemplates the transfer of responsibility for work not yet completed, or responsibility for client files or information that the attorney is required to keep confidential [*see Bus. & Prof. Code § 6068(e)* (attorney has duty to preserve secrets of his or her clients)], each client must receive written notice prior to the transfer, and consent in writing to the transfer [*Cal. Rules Prof. Conduct, Rule 2-300(B)*]. For an example of that notice and consent, and discussion of applicable requirements, see § 17.273.

[c] Agreement Not to Practice Law Generally Unenforceable

Although restricting the right of its former owner to compete with the business would be an effective way of protecting the goodwill of a business [*see* [2], *above; see also* § 17.273], *Cal. Rules Prof. Conduct, Rule 1-500*, limits the use of noncompetition agreements applicable to attorneys. That rule provides that a member of the California Bar must not be a party to, or participate in offering or making an agreement, whether in connection with the settlement of a lawsuit or otherwise, if the agreement restricts the right of a member to practice law [*Cal. Rules Prof. Conduct, Rule 1-500(A)*]. However, that limitation will not be construed to prohibit a noncompetition agreement that either (1) is a part of an employment, shareholders', or partnership agreement among members, so long as the restrictive agreement does not survive the termination of the employment, shareholder, or partnership relationship; or (2) requires payments to a member upon his or her retirement from the practice of law [*Cal. Rules Prof. Conduct, Rule 1-500(A)*]. Thus it appears that an attorney may not enter into a noncompetition agreement in connection with the sale of his or her law practice unless he or she intends to permanently retire from the practice of law [*see Cal. Rules Prof. Conduct, Rule 1-500(A)*]. A member must not be a party to or participate in offering or making an agreement that precludes the reporting of a violation of that rule [*Cal. Rules Prof. Conduct, Rule 1-500(B)*].

[d] Providing Notice to Client

When the sale of a law practice contemplates the transfer of responsibility for work not yet completed, or responsibility for client files or information that the attorney is required to keep confidential [*see Bus. & Prof. Code § 6068(e)* (attorney has duty to preserve secrets of his or her clients)], the seller must send written notice to each client whose uncompleted case or confidential files will be transferred, not less than 90 days prior to the transfer [*Cal. Rules Prof. Conduct, Rule 2-300(B)(2)*; *see* § 17.273]. If the seller is deceased or has a conservator or other person acting in a representative capacity, the buyer must send the notice prior to the sale [*Cal. Rules Prof. Conduct, Rule 2-300(B)(1)* (no time limitation imposed)].

[e] Contents of Notice to Clients

The notice to clients must state all of the following [*Cal. Rules Prof. Conduct, Rule 2-300(B)(1)(a), (2)(a)*; *see* § 17.273]:

- That the interest in the law practice is being transferred to the buyer.
- That the client has the right to retain other counsel.
- That the client may take possession of any client papers and property, including correspondence, pleadings, deposition transcripts, exhibits, physical evidence, expert's reports, and other items reasonably necessary to the client's representation, whether the client has paid for them or not [*see Cal. Rules Prof.*

Conduct, Rule 3-700(D)(1)]. The client has the right to a prompt refund of any part of a fee paid in advance that has not been earned, but not to a refund of a true retainer fee that is paid solely for the purpose of ensuring the availability of the attorney for that matter or case [*see Cal. Rules Prof. Conduct, Rule 3-700(D)(2)*].

- That the buyer may act on behalf of the client unless otherwise notified by the client, if (1) no response is received to the notice within 90 days after it was sent, or (2) when the seller is deceased or represented by a conservator, the client's rights would be prejudiced by a failure to act during that time.

The notice must also comply with the rules governing attorney-client fee arrangements [*see Cal. Rules Prof. Conduct, Rules 4-100-4-400* (financial relationship between attorney and client)], and must comply with the requirements imposed by Rule 1-400(D) [*Cal. Rules Prof. Conduct, Rule 2-300(B)(1)(a), (2)(a)*]. That rule prohibits a communication from being false or misleading, from being transmitted in a manner involving duress, or from stating that a bar member is a certified specialist unless he or she holds a current specialist certificate issued by the California Board of Legal Specialization [*see Cal. Rules Prof. Conduct, Rule 1-400(D)*].

[f] Obtaining Client's Consent

In addition to sending written notice of transfer, the seller must obtain the client's written consent to the transfer not less than 90 days prior to the transfer [*Cal. Rules Prof. Conduct, Rule 2-300(B)(2)(b)*]. If the seller is deceased or has a conservator or other person acting in a representative capacity, the buyer must obtain consent prior to the sale [*Cal. Rules Prof. Conduct, Rule 2-300(B)(1)(b)* (no time limitation imposed)]. However, if the client does not respond to the notice within 90 days from the date that it was sent to the client's last address as shown on the seller's records, consent will be presumed unless (1) the client otherwise gives notification or (2) when the seller is deceased or represented by a conservator, the client's rights would be prejudiced by a failure to act during that time [*Cal. Rules Prof. Conduct, Rule 2-300(B)(1)(b), (2)(b)*].

[g] Obtaining Client's Consent for Division of Fees After Transfer of Practice

If the buyer and seller will divide the fees for a case or file transferred in the sale, they must obtain the client's written consent to that division, after a full disclosure of the terms of the fee division [*Cal. Rules Prof. Conduct, Rule 2-200(A)(1)*; *see Margolin v. Shemaria (2000) 85 Cal. App. 4th 891, 903, 102 Cal. Rptr. 2d 502* (attorney had no viable contract for fee sharing after making case referral to another attorney when contract did not comply with Rule 2-200)]. Further, the total fee charged by both attorneys must not be increased solely due to the division of fees pursuant to the sale, and must not be unconscionable [*Cal. Rules Prof. Conduct, Rule 2-200(A)(2)*; *see Cal. Rules Prof. Conduct, Rule 4-200(B)* (factors used to determine conscionability)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawProfessional Associations & CorporationsReal Property LawPurchase & SaleGeneral Overview



95 of 156 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide § 17.23

AUTHOR: Marilyn E. Minger Revision Author

§ 17.23 Purchase and Sale of Franchise

[1] "Franchise" Defined

Franchising is essentially a method of doing business by licensing others to sell the franchisor's product or service using the franchisor's trademark [Glickman, Franchising, Ch. 2, *Nature of Franchise Relationship*, § 2.01 (Matthew Bender); *see Ch. 51, Franchise Agreements, § 51.20*]. For purposes of the California Franchise Investment Law [*Corp. Code § 31000 et seq.*], which requires registration of franchise offerings with the Commissioner of Corporations, a franchise is defined as a contract or agreement that stipulates the following [*Corp. Code § 31005*; *see Ch. 51A, Franchise Registration, § 51A.10*]:

- A franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor;

- The operation of the franchisee's business pursuant to the plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate; and

- The franchisee is required to pay, directly or indirectly, a franchise fee.

[2] Restrictions on Franchise Sale

Virtually all franchise agreements require the consent of the franchisor before the franchise may be assigned. This type of restriction assures the personal responsibility of the franchisee, and prevents the transfer of the franchise to an unqualified person [*see* Glickman, Franchising, Ch. 9, *Considerations in Developing the Agreement*, § 9.03[16]; Ch. 10, *Provisions of the Franchise Agreement*, § 10.15 (Matthew Bender)]. Many franchise agreements give the franchisor the first right to purchase the franchise [*see* Glickman, Franchising, Ch. 10, *Provisions of the Franchise Agreement*, § 10.15 (Matthew Bender)]. Some franchise agreements simply require the franchisor's written consent before the franchised business is sold to a third party. Many franchise agreements also specify the qualifications that a buyer of the franchised

business must have before the franchisor will consent to the sale [*see* Glickman, Franchising, Ch. 10, *Provisions of the Franchise Agreement*, § 10.15 (Matthew Bender)]. For examples of these types of assignment provisions in a franchise agreement, see *Ch. 51, Franchise Agreements, § 51.210*.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawDistributorships & FranchisesAssignments & TransfersTrademark LawConveyancesFranchisesTrademark LawProtection of RightsGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART II. LEGAL BACKGROUND

8-17 California Legal Forms--Transaction Guide §§ 17.24-17.99

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[Reserved]

§§ 17.24[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-17 California Legal Forms--Transaction Guide § 17.100

AUTHOR: Marilyn E. Minger Revision Author

§ 17.100 Attorney's Representation of Parties

1. If requested to represent both the buyer and the seller, recommend that one party obtain separate counsel.

2. If parties do not withdraw request and do not appear to have conflicting or potentially conflicting interests [*see Cal. Rules Prof. Conduct, Rule 3-310*]:

a. Make full disclosure to each party of nature of representation of other party; and

b. Obtain written consent of both buyer and seller to arrangement before accepting employment.

NOTE:
For additional coverage of this issue, see Ch. 1A, ***Role of Counsel in Starting a New Business*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsLegal EthicsClient RelationsEffective Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-17 California Legal Forms--Transaction Guide § 17.101

AUTHOR: Marilyn E. Minger Revision Author

§ 17.101 Basic Facts About Buyer

1. Name, address, and telephone number of buyer.

2. Legal status of buyer:

    a. Individual.

    b. Partnership.

    c. Corporation.

    d. Husband and wife.

3. Whether buyer will continue seller's business or practice.

4. Resources available for transaction.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporations



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-17 California Legal Forms--Transaction Guide § 17.102

AUTHOR: Marilyn E. Minger Revision Author

§ 17.102 Basic Facts About Seller

1. Name, address, and telephone number of seller.

2. All business names and addresses used by seller during preceding three years [*see Com. Code §§ 6104(a), 6105(a)(2)*].

3. Legal status of seller:

a. Individual.

b. Partnership.

c. Corporation.

d. Husband and wife.

4. Sales tax permit number, if seller has sales tax permit for business [*see Rev. & Tax. Code § 6071*; *see also* Ch. 1E, *Taxation of Businesses*].

5. Employer number issued by Employment Development Department, if applicable.

NOTE:

For general coverage of requirements imposed on employers under California law, see Employer's Guide (Cal. Employment Dev. Dep't Pub. DE-4525) [***see*** Ch. 1C, ***Regulation of Employers***].

6. Federal employer identification number, if applicable.

NOTE:

For general coverage of requirements imposed on employers under federal law, see Ch. 1C, ***Regulation of Employers*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewReal Property LawPurchase & SaleGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-17 California Legal Forms--Transaction Guide § 17.103

AUTHOR: Marilyn E. Minger Revision Author

§ 17.103 Basic Facts About Business

1. Name and address of business being sold.

2. Any fictitious name under which business was conducted, and dates on which fictitious business name statement was filed or published.

NOTE:

For coverage of fictitious business name statements [***see*** *Bus. & Prof. Code §§ 17900-17930*], see Ch. 1A, ***Role of Counsel in Starting a New Business*** .

3. Every county and city in which business is conducted.

NOTE:

Any required bulk transfer notice must be published in the judicial district where the business assets are located [***see*** *Com. Code § 6105(b)(2)*; ***see also*** *§ 17.123*].

4. Any other states and countries in which business was conducted.

NOTE:

Although taxation of multinational businesses is a specialized topic beyond the scope of this chapter, this fact is necessary to accurately determine the tax consequences of the sale.

5. Nature of business being sold.

6. Whether business manufactured or sold products that might be subject to potential products liabilities actions.

NOTE:
For coverage of products liability actions, see California Forms of Pleading and Practice, Ch. 460, ***Products Liability*** (Matthew Bender).

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesGeneral OverviewBusiness & Corporate LawCorporate NamesFictitious NamesGeneral OverviewBusiness & Corporate LawCorporate NamesFictitious NamesRegistration RequirementsCommercial Law (UCC)Bulk Sales (Article 6)Notice to Claimants



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-17 California Legal Forms--Transaction Guide § 17.104

AUTHOR: Marilyn E. Minger Revision Author

§ 17.104 Documents

1. Copy of franchise agreement, if any, under which business is operated.

2. Any leases to be assigned to buyer.

3. Any of following instruments to be assigned to buyer:

    a. Contracts.

    b. Notes.

    c. Deeds.

4. Inventory of business assets being sold.

5. Any installment purchase contracts or other instruments executed by seller granting third party security interest in any of business assets.

6. Instruments, such as deeds or title policies, that show legal description of any real property to be transferred.

7. Instruments, such as certificate of ownership of motor vehicle, evidencing ownership of any personal property to be transferred.

8. All insurance policies held by business or owners for business purposes.

9. All licenses or permits issued to business or owners.

10. If buyer is partnership, copy of partnership agreement.

11. If buyer is corporation, copy of board and shareholder resolutions authorizing purchase.

12. List of employees of business, including:

a. Names.

b. Social security numbers.

c. Positions.

d. Salaries.

13. Collective bargaining agreement, if any.

14. Tax returns for preceding several years.

15. Any fictitious business name statement filed.

16. Any environmental permits held by business.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporate NamesGeneral OverviewBusiness & Corporate LawDistributorships & FranchisesFranchise RelationshipsFranchise AgreementsBusiness & Corporate LawGeneral PartnershipsDissolution & Winding UpGeneral OverviewBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsContracts LawNegotiable InstrumentsTransfersContracts LawSecured TransactionsInstallment ContractsAssignmentsContracts LawTypes of ContractsPartnership AgreementsReal Property LawPurchase & SaleGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-17 California Legal Forms--Transaction Guide §§ 17.105-17.109

AUTHOR: Marilyn E. Minger Revision Author

[Reserved]

§§ 17.105[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-17 California Legal Forms--Transaction Guide § 17.110

AUTHOR: Marilyn E. Minger Revision Author

§ 17.110 Basic Terms of Sale

1. Determine whether retail alcoholic beverage license will be transferred with business.

NOTE:
If a retail alcoholic beverage license is part of the sale, counsel should follow the procedures set forth in Ch. 18, ***Buying and Selling a Retail Alcoholic Beverage License and Business*** , rather than those set forth in this Transaction Guide.

2. Evaluate total purchase price for sale of business.

NOTE:
This Transaction Guide does not cover the manner in which a business should be evaluated or priced by a prospective buyer. It assumes that the parties have consulted a financial advisor regarding the fair market value of the business being sold.

3. Determine manner in which purchase price will be paid:

a. Cash on execution of sale contract.

b. Cash on close of escrow.

c. Installments according to terms of promissory note.

d. Combination of cash, cash on close of escrow, or installments.

4. If portion of purchase price will be paid in installments or on deferral basis, determine any security to be given for payment of purchase price:

NOTE:
For further discussion of secured transactions, see Ch. 42, ***Secured Transactions*** .

a. Security interest in fixtures, equipment, and inventory.

b. Security interest in accounts receivable.

c. Deed of trust on business real property or other real property.

d. Security interest in personal property owned by buyer and not connected with business.

e. If buyer is corporation, personal liability of one or more of corporate officers or owners.

f. Other security.

5. Determine whether any assets will be excluded from sale:

a. Accounts receivable.

b. Real property to be retained by seller and leased to buyer.

c. Work in progress.

NOTE:
When a professional practice, such as a law practice, is being sold, it may be impossible or illegal to attempt to transfer work in progress to the buyer without the consent of the client [***see*** *§ 17.22[5][f]*].

d. Other assets of business.

6. Determine whether buyer will assume any obligations of business:

a. Installment sales contracts for particular items of furniture and fixtures.

b. Products liability claims arising later but based on seller's operations.

c. Contracts for services or goods used in business.

NOTE:
For example, a buyer may wish to assume the law book contracts of a law practice.

7. Evaluate manner in which buyer and seller will pay or share following sale costs:

a. Escrow and attorneys' fees.

b. Recording and publication costs.

c. Inventory costs.

d. Other costs.

8. Determine items to be prorated in escrow between buyer and seller, for example:

a. Rent of premises occupied by business.

b. Utilities.

c. Personal property taxes levied on fixtures and equipment of business.

d. Employee salaries.

e. Union welfare contributions and other employee benefits.

f. Insurance policies for business.

g. Equipment leases.

h. Other business expenses.

9. Determine whether real property as well as personal property will be transferred.

NOTE:
Various special requirements apply to the sale of real property. For discussion, see Ch. 23, ***Real Property Sales Agreements*** .

10. Determine how parties should allocate purchase price among assets being sold.

NOTE:
This information is needed for federal and state income tax purposes as well as state sales and use tax purposes.

In an "applicable asset acquisition," [***see*** (a), ***below***], the parties must allocate the purchase price pursuant to the "residual method" for purposes of determining (1) the seller's gain or loss on the sale, and (2) the buyer's basis in the assets purchased [*I.R.C. § 1060(a)*; ***see*** *Rev. & Tax. Code § 18031*]. That method requires fair market value to be allocated to all assets other than goodwill and going concern value in the order required by regulation, with any residual amount allocated to those two assets [Temp. Treas. Reg. §§ 1.338(b)-2T(b), 1.1060-1T(d); ***see*** b, ***below***]. Both parties to the agreement must file information returns specifying, among other items, amounts that have been allocated to goodwill and going concern value [*I.R.C. § 1060(b)*]. In an applicable asset acquisition [***see*** a, ***below***], the parties are bound for tax purposes by the terms of the written agreement as to the allocation of any consideration, or as to the fair market value of any of the assets unless the IRS determines that the allocation (or fair market value) is not appropriate [*I.R.C. § 1060(a)*]. For further discussion, see *§ 17.11[4]*].

a. Determine whether both of following apply [*I.R.C. § 1060(a), (c)*]:

NOTE:

The restrictions set forth in *I.R.C. § 1060* apply only to "applicable assets acquisitions," that is, sales that meet the following two requirements [*I.R.C. § 1060(a), (c)*].

(1) Sale is direct or indirect transfer of assets constituting trade or business; and

NOTE:

A group of assets constitutes a trade or business if use of the assets would constitute an active business for purposes of *I.R.C. § 355* (regarding distribution of stock of a controlled corporation)], or if goodwill or going concern value could attach to those assets [Temp. Treas. Reg. § 1.1060-1T(b)(2)].

(2) Transferee's basis in assets is determined wholly by reference to consideration paid for assets [*I.R.C. § 1060(c)*].

b. If sale is "applicable asset acquisition" under a, *above*, determine classification of all assets being sold under following categories [Temp. Treas. Reg. §§ 1.338(b)-2T(b), 1.1060-1T(d)].

(1) Class I assets.

NOTE:

Class I assets are cash and demand deposits and similar accounts in banks, savings and loan associations, and other depository institutions [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(1), 1.1060-1T(d)(1)].

(2) Class II assets.

NOTE:

Class II assets are certificates of deposit, U.S. government securities, and foreign currency [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(ii), 1.1060-1T(d)(2)(ii)].

(3) Class III assets.

NOTE:

All assets, other than Class I, II, IV, and V assets, are Class III assets [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(iii), 1.1060-1T(d)(2)(iii)].

(4) Class IV assets.

NOTE:

Class IV assets are intangible assets [***see*** *I.R.C. § 197*], except those in the nature of goodwill and going concern value [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(iv), 1.1060-1T(d)(2)(iv)].

(5) Class V assets.

NOTE:

Class V assets are intangible assets in the nature of goodwill and going concern value [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(iv), 1.1060-1T(d)(2)(iv)].

11. Determine how ongoing business costs and expenses should be prorated between buyer and seller.

NOTE:

Normally, the parties prorate these costs as of the closing date, based on a 30-day month [***see § 17.200[m]***].

12. Determine whether buyer will complete any work in progress.

NOTE:

If the buyer will assume responsibility for work in progress, the customer or client must generally consent [***see*** *Civ. Code § 1457* (burden of obligation cannot be transferred without consent of party entitled to benefit)]. Furthermore, if legal work in progress is to be transferred, the seller must send written notice to each client and obtain his or her consent [*Cal. Rules Prof. Conduct, Rule 2-300(B)*; ***see*** § 17.273[2]].

13. Determine whether contract of sale should include noncompetition clause [*see Bus. & Prof. Code § 16601*].

a. Ascertain whether operation of same or similar business by seller in same area would diminish value of business being sold [*see Monogram Industries, Inc. v. Sar Industries, Inc. (1976) 64 Cal. App. 3d 692, 698 134 Cal. Rptr. 714]* .

b. Determine geographic areas in which business being sold has been carried on.

NOTE:

A noncompetition clause will be enforceable only with respect to the geographic area in which the business (or business entity, division, or subsidiary) being sold was carried on before the sale and only so long as the buyer (or other person deriving title to the goodwill or ownership interest from the buyer) carries on a similar business in that geographic area [*Bus. & Prof. Code § 16601*].

14. Determine whether parties should allocate risk of potential products liability actions.

NOTE:

Liability for defective products may be imposed on the successor to a manufacturer or other distributor of a product in the "stream of commerce" if (1) the plaintiff's remedies against the predecessor company were virtually destroyed by the successor's acquisition of the business, (2) the successor had the ability to estimate the risk of product liability claims arising from the predecessor, and (3) it was fair and equitable to require the successor to assume responsibility for defective products, in view of the successor's use of the predecessor's goodwill in the continued operation of the business [*Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 31, 136 Cal. Rptr. 574, 560 P.2d 3* ; ***see*** *Kaminski v. Western MacArthur Co. (1985) 175 Cal. App. 3d 445, 456-458, 220 Cal. Rptr. 895* (***Alad*** successor liability rule applies to all distributors of product into stream of commerce)].

15. Determine whether contract should provide for association of seller with business after sale.

NOTE:

This type of provision is useful when the buyer wants the seller to train him or her in the operation of the business, or when effective transfer of the business goodwill depends on continuing patronage of the current business clients. However, the drafting attorney should evaluate the parties' relationship before including such a requirement as a condition of sale [***see*** *§ 17.216*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewMergers & Acquisitions LawTaxable AcquisitionsGeneral OverviewContracts LawNegotiable InstrumentsTransfersInsurance LawProperty InsuranceCoverageReal PropertyGeneral OverviewReal Property LawFixtures & ImprovementsSecurity InterestsReal Property LawPurchase & SaleGeneral OverviewTax LawFederal Income Tax ComputationValuationGeneral OverviewTax LawFederal Income Tax ComputationValuationBusiness Interests



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-17 California Legal Forms--Transaction Guide § 17.111

AUTHOR: Marilyn E. Minger Revision Author

§ 17.111 Applicability of Bulk Sales Division

1. Determine whether business is type that is subject to Bulk Sales Division of Commercial Code [*Com. Code § 6103(a)*; *see Com. Code §§ 6101-6111*]:

NOTE:
If the Uniform Commercial Code--Bulk Sales Division applies, the buyer must give public notice of the bulk sale, essentially to provide notice to the seller's creditors [***see*** *Com. Code §§ 6104, 6105*]. Careful attorneys usually determine, before setting the date of sale, the name, address, publication dates, and deadline dates of any newspapers of general circulation published in judicial districts (or counties) in which the notice will need to be published. Similarly, careful attorneys usually record the notice at least 13 or 14 business days before the date of the bulk sale.

a. Is seller's principal business sale of inventory from stock, including those who manufacture what they sell, or is business that of restaurant owner [*Com. Code § 6103(a)(1)*; *see Com. Code § 6103(c)* (exceptions)]?

b. On date of bulk sale agreement, is seller located in California, or located in jurisdiction outside United States but has its major American executive office in California [*Com. Code § 6103(a)(2)*; *see Com. Code § 6103(b)*]?

2. If business is subject to Bulk Sales Division of Commercial Code [*see* (1), *above*], determine whether proposed sale is "bulk sale" subject to Bulk Sales Division [*Com. Code § 6102(a)(3)*]:

a. Is sale of assets not in ordinary course of seller's business; and

b. Do assets being sold constitute more than half of seller's inventory and equipment?

NOTE:
In determining the percentage of the seller's inventory and equipment being transferred, the assets are valued at their fair market value as of the date of the bulk sale agreement [*Com. Code § 6102(a)(3), (8), (15)*; ***see*** *Com. Code §§ 6102(b)(2), (3), 9102(a)(33)* ("equipment" defined), 9102(a)(48) ("inventory" defined)].

3. Determine whether sale is one of following transactions that is exempt from Bulk Sales Division [*Com. Code § 6103(c)*]:

a. Is transfer made to secure payment or performance of obligation [*Com. Code § 6103(c)(1)*]?

b. Does sale involve a transfer of collateral to a secured party pursuant to *Com. Code § 9609* [*Com. Code § 6103(c)(2)*]?

c. Does sale involve a disposition of collateral pursuant to *Com. Code § 9610* [*Com. Code § 6103(c)(3)*]?

d. Will there be an acceptance of collateral pursuant to *Com. Code § 9620* [*Com. Code § 6103(c)(4)*]?

e. Is sale a sale of asset encumbered by security interest or lien in which either [*Com. Code § 6103(c)(5)*]:

(1) All sale proceeds are applied in partial or total satisfaction of debt secured by security interest or lien; or

(2) Security interest or lien is enforceable against asset after sale to buyer and net contract price is zero?

f. Will there be a general assignment for benefit of creditors, or subsequent transfer by assignee [*Com. Code § 6103(c)(6)*]?

g. Will there be a sale by executor, administrator, receiver, trustee in bankruptcy, debtor in possession, or any public officer under judicial process [*Com. Code § 6103(c)(7)*]?

h. Will sale be made in course of judicial or administrative proceedings for dissolution or reorganization [*Com. Code § 6103(c)(8)*]?

i. Will there be a sale to buyer whose principal place of business is in United States [*see Com. Code § 6102(a)(14)*] and in which [*Com. Code § 6103(c)(9)*]:

(1) Buyer assumes all debts owed to claimants of whom buyer has knowledge on date that buyer receives the seller's list of creditors or completes reasonable inquiry;

NOTE:
The buyer must obtain a verified and dated list of claimants from the seller or conduct reasonable inquiry to discover the claimants no earlier than 21 days before the date of the

bulk sale [*Com. Code § 6103(c)(9)(i)*].

(2) Buyer is not insolvent after assumption; and

(3) Buyer records and publishes notice of assumption [*see Com. Code §§ 6103(d)* (contents of notice), 6105]?

j. Is sale to buyer whose principal place of business is in United States [*see Com. Code § 6102(a)(14)*] and [*Com. Code § 6103(c)(10)*]:

(1) Buyer assumes all debts incurred in the seller's business before the date of the bulk sale [*see Com. Code § 6102(a)(7)*];

(2) Buyer is not insolvent after assumption; and

(3) Buyer records and publishes notice of assumption not later than 30 days after date of the bulk sale [*see Com. Code §§ 6103(e)* (contents of notice), 6105]?

k. Is sale to new organization that is organized to take over and continue seller's business and that has its principal place of business in United States [*see Com. Code § 6102(a)(14)*], and do all of following conditions apply [*Com. Code § 6103(c)(11)*]?

(1) Buyer assumes all debts incurred in seller's business before date of bulk sale [*see Com. Code § 6102(a)(7)*];

(2) Seller receives nothing from sale except interest in new organization that is subordinate to any claims against organization arising from assumption; and

(3) Buyer records and publishes notice of assumption not later than 30 days after date of bulk sale [*see Com. Code §§ 6103(e)* (contents of notice), 6105].

l. Is sale one of assets having value, on date of sale agreement, of either [*Com. Code § 6103(c)(12)*; *see Com. Code § 6103(f)* (valuation); *see also Com. Code § 6102(a)(8)* (date of agreement)]:

(1) Less that $10,000, net of liens and security interests, or

(2) More than $5 million?

m. Is sale required by and made pursuant to statute [*Com. Code § 6103(c)(13)*]?

n. Is sale a transfer of personal property in connection with sale/leaseback and either [*Com. Code § 6103(c)(14)*]:

(1) Transfer is exempt under *Civ. Code § 3440.1(k)* (transfers without delivery) [*see Com. Code § 10308*]; or

(2) Transfer complies with *Civ. Code § 3440.1(h)*, requiring filing of financing statement [*see Com. Code §§ 9501 et seq.*] with Secretary of State and notice of intended transfer is published.

o. Is transfer subject to and in compliance with license transfer requirements [*see Bus. & Prof. Code §§ 24070-24082*], such as the transfer of a retail alcoholic beverage license, provided transferee records and publishes requisite notice of

transfer at least 12 business days before transfer is consummated [*Com. Code § 6103(c)(15)*; *see Com. Code § 6105(a)(1)-(4)*; *see also* Ch. 18, *Buying and Selling a Retail Alcoholic Beverage License and Business*]?

p. Is transfer one of goods in warehouse and [*Com. Code § 6103(c)(16)*]:

(1) Warehouse operator has issued warehouse receipt [*see Com. Code § 7102*; *see also Ch. 54A, Storage of Goods, § 54A.200*]; and

(2) Copy of receipt is kept at warehouse operator's principal place of business and at warehouse where goods are stored?

4. If proposed sale is subject to Bulk Sales Division, determine[*see Com. Code § 6105*]:

a. Address of office of county recorder in county or counties in which seller is located and tangible assets of seller are located.

b. Address of county tax collector in county or counties in which tangible assets of seller are located.

c. Judicial districts in which seller is located and seller's assets are located.

d. Name and address of newspaper of general circulation in judicial districts in which seller is located and seller's assets are located.

NOTE:
The notice of intended transfer [***see** § 17.270*] must be published in a newspaper of general circulation that is published in the judicial district where the property is located and, if different, in judicial district where seller is located [***see** Com. Code § 6105(b)(2)*].

(1) Publication dates of newspaper; and

(2) Newspaper's deadlines for accepting legal notices.

e. Whether consideration for sale of assets meets following criteria:

NOTE:
When the sale consideration is $2,000,000 or less and is substantially all in cash and/or an obligation of the buyer to pay cash in the future, the buyer or escrow agent is subject to additional requirements regarding payment of creditor claims [***see** Com. Code §§ 6106.2, 6106.4*; ***see also** § 17.20[6], [7]*].

(1) Consideration is $2 million or less; and

(2) Consideration is all cash, obligation to pay cash in future, or combination of two.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Bulk Sales (Article 6)Notice to ClaimantsContracts LawNegotiable InstrumentsTransfersReal

Property LawLandlord & TenantLease AgreementsCommercial LeasesSale-Leaseback Transactions



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-17 California Legal Forms--Transaction Guide § 17.112

AUTHOR: Marilyn E. Minger Revision Author

§ 17.112 Applicability of Sales and Use Tax

NOTE:

The Sales and Use Tax Law imposes a tax on the gross receipts of a retailer from the sale of tangible personal property sold at retail in California [*Rev. & Tax. Code § 6051*].

1. Determine whether each item of personal property being sold is "tangible" or "intangible" [*see Rev. & Tax. Code §§ 6016, 6051*].

NOTE:

The sales tax is imposed only on the sale of tangible personal property [*Rev. & Tax. Code § 6051*]. "Tangible personal property" is personal property that may be seen, weighed, measured, felt, or touched, or that is perceptible to the senses in any other manner [*Rev. & Tax. Code § 6016*].

2. Determine whether any tangible personal property will be sold at retail.

NOTE:

When a business is sold, the seller typically transfers two types of tangible personal property to the buyer: (1) equipment and furniture, and (2) stock in trade and merchandise. Because the stock in trade and merchandise of the business is usually sold to the buyer for purposes of resale in the regular course of business, the sale of that type of property is not taxable as a retail sale [***see*** *Rev. & Tax. Code §§ 6007, 6051*]. However, the furniture and equipment are generally subject to sales tax, unless exempt [***see*** *Rev. & Tax. Code § 6051*; ***see also*** *§ 17.12*].

3. If personal property is tangible, determine whether "occasional sale" exemption applies [*Rev. & Tax. Code §§ 6006.5, 6367*]:

NOTE:
This exemption covers two types of sales: the sale of property held in activities requiring a sales tax permit [***see*** (a), ***below***] when ownership is the same before and after the sale [***see*** (b), *below*], and the sale of property used in activities not requiring a sales tax permit [***see*** (a), ***below***] when the seller is not deemed to be a retailer [*Rev. & Tax. Code § 6006.5*; ***see*** (c), ***below***].

a. Is property is of a type that requires sales tax permit from Board of Equalization [*see Rev. & Tax. Code §§ 6066, 6071*]?

NOTE:
All persons actively engaged in the business of selling tangible personal property at retail must obtain a sales tax permit (or "seller's permit") from the State Board of Equalization prior to making sales in California [***see*** *Rev. & Tax. Code §§ 6066, 6071*; *18 Cal. Code Reg. § 1699*].

b. If sales tax permit is required, will ultimate ownership of property be substantially the same after transfer as before transfer?

NOTE:
The ultimate ownership is substantially similar to that which existed before a transfer if 80 percent or more of that ownership is unchanged after the transfer [*18 Cal. Code Reg. § 1595(b)(2)*]. This type of transfer occurs, for example, when a going business is incorporated [***see*** Ch. 2A, ***Incorporating a Going Business***].

c. If sales tax permit is not otherwise required, what is number and size of retail sales made in last year?

NOTE:
Any taxpayer whose business does not involve retail sales, but who makes three or more sales of tangible personal property used in the business for substantial amounts in a 12-month period (or who makes a substantial number of sales for a relatively small amount during that period) will be considered to be a "retailer" subject to the sales tax permit requirement [*Rev. & Tax. Code § 6019*; *18 Cal. Code Reg. § 1595(a)*]. The determination of whether the seller has made sales of "substantial amounts" or has made a "substantial number" of sales is based on sale frequency and dollar value [***see*** *18 Cal. Code Reg. § 1595(a)(4)(B)*].

4. Determine whether business involves both services and sales of tangible personal property.

NOTE:
Generally, only the gross receipts from sales activities, rather than the service activities, are subject to tax [***see*** *18 Cal. Code Reg. § 1595*; ***see also*** *§ 17.12[3]*].

5. Determine whether business involves sales of both exempt and taxable personal property.

NOTE:

Generally, sales tax applies to all business assets of a business that sells exempt and nonexempt products [***see*** *18 Cal. Code Reg. § 1595*; ***see also*** *§ 17.12[3]*].

6. Ascertain whether local or transit taxes are also imposed on sale [*see Rev. & Tax. Code §§ 7200-7212* (Bradley-Burns Uniform Local Sales and Use Tax Law), 7251-7274 (Transactions and Use Tax Law)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewReal Property LawPurchase & SaleGeneral OverviewTax LawFederal Income Tax ComputationSales & ExchangesBusiness Property (IRC secs. 1031, 1221, 1231)Property Used in Trade or BusinessTax LawState & Local TaxesSales TaxGeneral OverviewTax LawState & Local TaxesUse TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-17 California Legal Forms--Transaction Guide § 17.113

AUTHOR: Marilyn E. Minger Revision Author

§ 17.113 Other Pre-Sale Determinations

1. Determine if buyer will be subject to state or local licensing requirement to operate business.

NOTE:

Most local governments require local businesses to maintain business licenses, renewable annually. Local government should be contacted to determine the applicable requirements. State licenses are required for businesses engaging in various categories of activity. Applicable license requirements may be determined by contacting the state agency charged with regulation of the particular business or profession.

2. Ascertain if property being sold is subject to following federal, state, or local environmental laws and regulations:

NOTE:

For discussion and an example of a seller's warranty regarding hazardous materials, see *§ 17.214*. Compliance with environmental regulation of real property is beyond the scope of this chapter. For discussion, see Ch. 30B, ***Zoning, Building, and Environmental Permits*** ; ***see also*** Ch. 33, ***Contamination Considerations in Real Property Transactions*** . For detailed coverage of environmental law generally, see California Environmental Law and Land Use Practice(Matthew Bender).

a. National Environmental Policy Act of 1969 (NEPA) [*42 U.S.C. § 4321 et seq.*; *40 C.F.R. § 6.100 et seq.*; *see* Ch. 30B, *Zoning, Building, and Environmental Permits* , Legal Background, "National Environmental Policy Act of 1969 (NEPA)"].

b. California Environmental Quality Act of 1970 (CEQA) [*Pub. Res. Code § 21000 et seq.*; *14 Cal. Code Reg. § 15000 et seq.*; *see* Ch. 30B, *Zoning, Building, and Environmental Permits* , Legal Background, "California Environmental Quality Act of 1970 (CEQA)--General Requirements," et seq.].

c. California Coastal Act of 1976 [*Pub. Res. Code § 30000 et seq.*; *14 Cal. Code Reg. § 13001 et seq.*; *see* Ch. 30B, *Zoning, Building, and Environmental Permits* , Legal Background, "California Coastal Act--Area Covered," et seq.].

d. Other regulations and restrictions applicable to:
(1) Property located in specific regions [*see* Ch. 30B, *Zoning, Building, and Environmental Permits* , Legal Background, "Overview of Environmental Regulations"].

(2) Particular uses on property [*see, e.g., Health & Safety Code § 25280 et seq.* (regulation of operation of underground storage tanks)].

3. If business is operated under franchise agreement, determine [*see §§ 17.280, 17.281*]:

NOTE:
The assignability of a franchise is generally covered in the franchise agreement. For further discussion, see Ch. 51, ***Franchise Agreements*** .

a. Whether franchisor has first right and option to purchase business.

b. Whether sale to third party is subject to franchisor's consent.

c. Conditions precedent, if any, to which franchisor's consent is subject.

4. If business being sold is law practice, determine whether either of following conditions applies [*see Cal. Rules Prof. Conduct, Rule 2-300(B)*]:

NOTE:
Under these circumstances, the seller is required to send notice to, and obtain the consent of, each affected client [*Cal. Rules Prof. Conduct, Rule 2-300(B)*].

a. Contract of sale contemplates transfer of work not yet completed.

b. Contract of sale contemplates transfer of responsibility for client files or information that attorney is required to keep confidential [*see Bus. & Prof. Code § 6068(e)* (attorney has duty to preserve secrets of his or her clients)].

5. Determine buyer's possible obligations under any collective bargaining agreements between seller and union.

NOTE:
The buyer may be bound by such an agreement (or similar legal obligation) if some or all of the following factors are present: an express or implied assumption of the agreement; a substantial continuity of identity in the business enterprise, particularly in the work force, before and after the change in

ownership; and the complete disappearance of the initial employer [***see*** *Howard Johnson Co. v. Detroit Local Joint Executive Board (1974) 417 U.S. 249, 94 S. Ct. 2236, 41 L. Ed. 2d 46]* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawDistributorships & FranchisesAssignments & TransfersBusiness & Corporate LawDistributorships & FranchisesFranchise RelationshipsFranchise AgreementsGovernmentsState & Territorial GovernmentsLicensesReal Property LawEnvironmental RegulationGeneral OverviewReal Property LawZoning & Land UseOrdinances



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-17 California Legal Forms--Transaction Guide §§ 17.114-17.119

AUTHOR: Marilyn E. Minger Revision Author

[Reserved]

§§ 17.114[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-17 California Legal Forms--Transaction Guide § 17.120

AUTHOR: Marilyn E. Minger Revision Author

§ 17.120 Drafting Letter of Intent

NOTE:

Letters of intent are helpful when negotiations are expected to be lengthy or when the nature of the business is complex and requires investigation. A letter of intent may not be necessary or appropriate for all business sales. With some sales, especially those of small businesses, it may be more efficient to proceed directly to the contract of sale. The following provisions should be considered when drafting a letter of intent. For a letter of intent, see *§ 17.261*.

1. Include opening clause describing form of transaction.

NOTE:

This clause should include the identities of the parties to the transaction, the structure of the transaction,the anticipated purchase price and allocation of assets.

2. Include clause stating the status and disposition of liabilities and debts, as well as repayment terms on any outstanding loans of business.

3. Include provision allocating sales taxes and closing expenses.

NOTE:

A statement regarding the anticipated tax consequences of the proposed transaction may be stated in the letter to formalize the parties' intentions.

4. Provision warranting veracity of information provided by seller upon which buyer will rely to evaluate

business.

5. Clause specifying changes or restrictions on seller's business conduct during the negotiation period, including any protective or restrictive provisions such as noncompetition covenants.

6. Clause stating the anticipated closing date.

7. Provision describing scope of buyer's investigation and due diligence of business.

NOTE:
Due diligence often includes investigation of financial records and warranties, the status of ongoing business deals and pending contracts, compliance with laws and regulations, as well as other aspects of the subject business. The letter of intent generally will set forth the scope of the investigation and the expected duration of due diligence. For additional information on conducting due diligence, see *§ 17.121*.

8. Clause stating any warranty by seller that seller is not negotiating with any other party for sale of business, and any agreement made by seller to terminate negotiations with other prospective buyers during a specified period of negotiation and investigation.

9. Provision stating non-binding force of letter of intent.

NOTE:
Certain provisions in the letter of intent relating to negotiations may be expressly binding even if the letter itself does not constitue a contract of sale. For instance, the letter may state that confidentiality provisions in the letter are binding even though the rest of the letter of intent is not binding on the parties [***see*** *§ 17.17[2]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewContracts LawContract Conditions & ProvisionsGeneral OverviewReal Property LawPurchase & SaleGeneral OverviewTax LawState & Local TaxesSales TaxGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-17 California Legal Forms--Transaction Guide § 17.121

AUTHOR: Marilyn E. Minger Revision Author

§ 17.121 Due Diligence Checklist

NOTE:

Even if the buyer is not conducting formal due diligence, the following list of issues to be investigated should be considered. Due diligence is undertaken by directing inquiries for information directly to the subject business, and by investigating and reviewing records with public agencies or third parties. Although due diligence is generally the task of buyer's counsel and other professional advisers, seller's counsel may have a responsibility to verify the seller's warranties or legal opinions about the operations of the business.

The following checklist may be used as a due diligence checklist for the buyer or may form the basis of a document request of the seller by the buyer.

1. Obtain and review copies of all contracts and other documents regarding customer commitments to purchase products of the business.

2. Obtain and review documents relating to any partnership or joint venture affiliations or any other investments of the business.

3. Obtain and review materials related to employees of business.

a. Employment and consulting contracts.

b. Noncompetition agreements.

c. bonus and other incentive or compensation plans.

d. Other contracts respecting employees.

e. Company policies, manuals and memoranda respecting vacations, sick leave, termination pay, hiring, promotion, etc.

f. Summaries of unwritten employee policies and practices.

g. Documents and correspondence relating to any equal employment charges, claims, investigations or complaints before federal, state or local agencies, and any affirmative action, government set aside or similar plans.

h. Copies of any OSHA complaints, reports and files on any investigations.

4. Obtain and review any labor-related documents.

a. Collective bargaining contracts and documents regarding any union representation proceedings or pending or threatened labor disputes.

b. Copies of any and all unfair labor practice charges, grievances, arbitration awards, side letters, and records of contract negotiations.

c. Union pension and insurance plans.

5. Obtain and review employee benefit plans.

a. Profit sharing, employee thrift, pension, health, insurance, welfare and other employee benefit plans, as well as any related trusts, ERISA determination letters or government correspondence and the like.

b. Actuarial reports and calculation of liabilities and plan assets.

6. Obtain and review documents related to any real property owned or used by the business, including:

a. Leases, subleases, subordination and non-disturbance agreements, deeds and options.

b. Title reports and all insurance policies.

7. Material equipment leases and subleases.

NOTE:

Inquiries should be conducted with respect to any liens on vehicles or other equipment. Lenders or suppliers who have taken a security interest in the business may have filed a U.C.C. priority lien.

Counsel should advise the buyer to mail Form UCC-11, "Request for Information or Copies," and the applicable filing fee, to the Secretary of State's office [***see*** *Com. Code §§ 9523, 9528*; ***see also*** Ch. 42, ***Secured Transactions***]. Form UCC-11 is used to request a certificate showing whether any presently effective financing statement is on file with respect to the seller's business [***see*** *Com. Code § 9523*]. Often, the escrow instructions instruct the escrow holder to mail this certificate. On the request of any

person and payment of the statutory fee, the Secretary of State must issue a combined certificate showing financing statement information [***see*** *Com. Code § 9528*], state tax lien data [***see*** *Gov. Code § 7226*], attachment lien information [***see*** *Code Civ. Proc. §§ 488.375, 488.405*], judgment lien information [***see*** *Code Civ. Proc. § 697.580*], and federal lien information [*Com. Code § 9528*; ***see*** *Code Civ. Proc. § 2103*].

8. Obtain and review any loan agreements, industrial revenue bond documentation, promissory notes, indentures, agreements for lines of credit and other financing or other agreements respecting money borrowed or loaned, list of bank accounts and authorized signatories, security agreements and financing statements, U.C.C. searches, credit reports, deeds of trust, suretyships, indemnities, waivers, guarantees and loans to insiders.

9. Obtain and review any product warranties, marketing literature and samples of all forms of purchase orders, invoices, and similar materials. Correspondence, internal reports or other documents relating to customer complaints or account claims.

NOTE:
All warranties and guarantees should be evaluated to determine potential liabilities connected to business activities.

10. Obtain and review any marketing agreements, including distributorship agreements, wholesaler agreements, sales representative and commission agreements and agreements with raw materials, packaging and equipment suppliers.

11. Obtain and review any membership agreements or other documents relating to exchange, trade association or self-regulatory organization memberships.

12. Obtain and review any litigation and arbitration files, files regarding claims or threatened litigation and arbitration, and any judgments, injunctions, consent decrees, other court orders and the like.

13. Obtain and review any copies of recent attorney letters to auditors.

14. Obtain and review any documents relating to any audits, inquiries or investigations by, or proceedings or threatened proceedings with, any governmental authorities or self-regulatory bodies.

15. Obtain and review any licenses, permits and authorizations from governmental or self-regulatory bodies, including any environmental or operating permits, copies of applications for such permits and authorizations, and related correspondence including notices to and from, and correspondence with, environmental regulatory authorities.

16. Obtain and review any environmental audit, consultant and inspection reports and related correspondence, spill reports, manifests and other documents relating to hazardous waste management (including storage, transport and disposal), monitoring reports and feasibility studies.

17. Obtain and review any patent, trademark, tradename, copyright, service mark and service name registrations and applications, and any correspondence relating to claims or threatened claims of infringement.

18. Obtain and review any technology and other licensing agreements.

19. Obtain and review any confidentiality agreements.

20. Obtain and review any powers of attorney.

21. Obtain and review any broker, finder or investment banker agreements or correspondence relating to sale of business.

22. Obtain and review financial information of business.

a. Financial statements and management letters from auditors for past five years.

b. Most recent unaudited statements.

c. Projections for last five years.

23. Obtain and review any instruments or agreements not identified above of a material nature, including all items:

a. Calling for the payment or receipt of more than a threshhold amount; or

NOTE:
The minimum amount above which an expense should be deemed "material" obviously depends on the size of the business. For smaller businesses, amounts in excess of $2000 or $5000 might conceivably be classified as "material." For larger businesses, the threshhold amount might be in the neighborhood of $20,000.

b. Extending over a period longer than one year.

24. Obtain and review tax documents.

a. Federal, state and local tax returns for latest closed and all open years.

b. Copies of any correspondence and documents relating to penalties, fines, deficiencies or other claims for additional taxes.

c. Settlements or agreements waiving statutes of limitations or extending time.

25. Obtain and review list and age of accounts receivable.

26. Obtain and review list of accounts payable.

27. Obtain and review organizational chart of business.

28. Obtain and review list of employees and their compensation.

29. Obtain and review all insurance contracts and policies and documents relating to workers compensation compliance.

30. Obtain and review any amendments, modifications, or terminations relating to any items referred to above.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewBusiness & Corporate LawDistributorships & FranchisesFranchise RelationshipsFranchise AgreementsBusiness & Corporate LawGeneral PartnershipsFormationPartnership AgreementsReal Property LawOwnership & TransferBusiness & Corporate EntitiesReal Property LawPurchase &

SaleGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-17 California Legal Forms--Transaction Guide § 17.122

AUTHOR: Marilyn E. Minger Revision Author

§ 17.122 Preparing Sales Documents

1. Draft contract for sale of business [*see §§ 17.200, 17.201*], and have parties:

NOTE:

For a basic contract of sale, see *§ 17.200*. For closing instructions for a bulk sale, see *§ 17.210*. For a contract of combined sale of a business and real property, see *§ 17.201*. For contract provisions for the sale of a professional practice, see *§ 17.211*.

For a general guide to drafting contracts, see Ch. 75, ***Formation of Contracts and Standard Contractual Provisions*** , Transaction Guide.

a. Read contract.

b. Execute contract.

NOTE:

Note that under the California Statute of Frauds, an agreement for the sale of real property must be subscribed by the parties to be charged or by their agents [*Civ. Code § 1624*]. Both spouses, either personally or by duly authorized agent, must execute any instrument by which community real property is sold or otherwise conveyed [*Fam. Code § 1102(a)*].

c. State date and place of execution.

2. If sale will be handled through an escrow [*see, e.g., Com. Code §§ 6101-6111* (sales subject to Bulk Sales Division)], draft escrow instructions if printed instructions will not be used [*see §§ 17.250* (separate escrow instructions), 17.210 (escrow instructions included in body of contract of sale)].

NOTE:
For a guide to drafting escrow instructions for the sale of real property, see Ch. 26, ***Real Property Escrows*** .

3. If required for sale of law practice [*Cal. Rules Prof. Conduct, Rule 2-300(B)*], draft notice of sale and consent of client [*see* § 17.273].

4. Prepare all of following documents for transfer of business:

a. Deeds or other instruments required to transfer real property.

NOTE:
For discussion and forms for deeds, see Ch. 27, ***Deeds and Recording*** .

b. Assignment of any leases or contracts to be transferred to buyer.

NOTE:
For discussion and forms for assignments, see Ch. 35A, ***Assignment and Sublease of Leasehold Interests*** . If the lease is for a term in excess of 35 years, a change of ownership also must be filed [***see*** *Rev. & Tax. Code § 61(c), 480*].

c. Vehicle registration transfer documents, if applicable.

NOTE:
For discussion and examples of transfer documents, see Ch. 102D, ***Registration and Transfer of Vehicles, Vessels, and Aircraft*** .

d. Bill of sale for tangible and intangible personal property, including [*see §§ 17.290-17.293*]:

NOTE:
A transfer of property may be made without a written instrument, if a writing is not required by statute [*Civ. Code § 1052*]. However, contracts of sale and escrow instructions often specify that the seller deliver a bill of sale for the personal property assets of the business to the buyer.

(1) Names of parties.

(2) Description of property.

(3) Description of consideration.

(4) Power of attorney to collect receivables [*see § 17.291*].

(5) Assumption of obligations and indemnity agreement [*see § 17.292*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewContracts LawStatutes of FraudsGeneral OverviewContracts LawTypes of ContractsPersonal PropertyReal Property LawDeedsGeneral OverviewReal Property LawOwnership & TransferBusiness & Corporate EntitiesReal Property LawPurchase & SaleGeneral OverviewReal Property LawPurchase & SaleContracts of SaleGeneral Overview



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-17 California Legal Forms--Transaction Guide § 17.123

AUTHOR: Marilyn E. Minger Revision Author

§ 17.123 Giving Notice Required by Bulk Sales Division

NOTE:

These procedures apply only to those sales that are subject to the Bulk Sales Division of the Commercial Code ("Bulk Sales Division") [***see*** *Com. Code §§ 6101-6111*]. The escrow instructions generally instruct the escrow agent to comply with these requirements.

1. Draft notice of intended sale, stating all of following [*Com. Code § 6105(a)*; *see § 17.270*]:

NOTE:

It is the responsibility of the buyer, or the auctioneer or liquidator, to give the notice [*Com. Code §§ 6104(b), 6105(a)*].

a. That bulk sale is about to be made.

b. Names and business addresses of buyer and seller.

c. All other business names and addresses used by seller within past three years.

d. Location and general description of property to be transferred.

e. Place and anticipated date of bulk sale [*see § 17.20[5][a]*].

f. Whether or not bulk sale is subject to *Com. Code § 6106.2*, requiring payment of

purchase price to creditors who file timely claims and, if so [*Com. Code §§ 6105(a)(5), 6106.2(f)*]:

NOTE:
Com. Code § 6106.2 applies to bulk sales for which the consideration is (a) $2 million or less and (b) substantially all cash, an obligation to pay cash in the future, or a combination of the two [*Com. Code § 6106.2(a)*; ***see*** 17.20[2]].

(1) Name and address of person with whom claims may be filed; and

(2) Last date (which must be business day before noticed sale date) for filing claims.

NOTE:
A "business day" is any day other than Saturday, Sunday, or a day observed as a holiday by the California state government [*Com. Code § 6105(b)*].

2. If bulk sale will be conducted by auctioneer or liquidator, draft statement to accompany notice of intended transfer, including all of following [*Com. Code § 6108(a)(3)*]:

a. Statement that sale will be by auction or liquidation.

b. Name of auctioneer or liquidator.

c. Time and place of auction, or time and place on or after which liquidator will begin to sell assets on seller's behalf.

3. Within 12 business days before date of bulk sale, have buyer (or auctioneer or liquidator) take all of following actions [*Com. Code § 6105(b)*; *see Com. Code § 6108(a)(1)*; *see also Gifford v. J&A Holdings (1997) 54 Cal. App. 4th 996, 1003-1005, 63 Cal. Rptr. 2d 253* (notice must be published and recorded at least 12 business days before the anticipated sale date *as specified in the notice*)]:

a. Record notice in office of county recorder in county or counties where property to be transferred is located and, if different, where seller is located [*Com. Code § 6105(b)(1)*].

NOTE:
Current recording fees are set forth in *Gov. Code § 27361*.

b. Publish notice in newspaper of general circulation [*Com. Code § 6105(b)(2)*]:

(1) In judicial district where property to be transferred is located; and, if different:

NOTE:
If the property to be transferred is located in more than one judicial district, the notice must be published in the judicial district where a greater portion of the property is located on the date the notice is published [*Com. Code § 6105(b)*]. If no newspaper of general circulation exists in the judicial district where the greater portion of the property is located, or where the seller is located [***see*** (2), ***below***], the notice must be published in a newspaper of general circulation in the county in which the judicial district is located [*Com. Code § 6105(b)*].

(2) In either:

(a) Judicial district where seller is located;

NOTE:
A seller is deemed to be located at its place of business. If a seller has more than one place of business, the seller is located at its chief executive office [*Com. Code § 6103(b)*].

(b) If seller is not located in United States, judicial district where seller's major executive office in California is located [*see Com. Code § 6103(a)(2)*]; or

(c) If there is no newspaper of general circulation published in required judicial district, county embracing that judicial district.

c. Deliver notice or send by registered or certified mail to county tax collector of county or counties where property to be transferred is located [*Com. Code § 6105(b)(3)*].

NOTE:
If the notice is delivered or sent during the period from January 1 to May 7, inclusive, the notice must be accompanied by a completed business property statement with respect to the property involved in the bulk sale [*Com. Code § 6105(b)(3)*; ***see*** *Rev. & Tax. Code § 441* (procedure for filing property statements)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Bulk Sales (Article 6)NoncomplianceCommercial Law (UCC)Bulk Sales (Article 6)Notice to ClaimantsContracts LawNegotiable InstrumentsTransfers



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-17 California Legal Forms--Transaction Guide § 17.124

AUTHOR: Marilyn E. Minger Revision Author

§ 17.124 Handling Creditor Claims Under Bulk Sales Division

NOTE:

These procedures apply only to those sales that are subject to the Bulk Sales Division of the Commercial Code [***see*** *Com. Code §§ 6101-6111*] and involve substantially all cash consideration (or an obligation of the buyer to pay cash in the future) of $2 million or less [*Com. Code §§ 6106.2, 6106.4*]. The buyer (or escrow agent) in this type of sale must apply the cash consideration to any debts of the seller for which claims are due and payable on or before the date of the bulk sale and are received in writing on or before the date specified as the last date to file claims with person designated by the notice [*Com. Code §§ 6106.2(b), 6106.4*].

1. If creditor claims will be handled through escrow, have buyer deposit full amount of purchase price with escrow agent [*Com. Code § 6106.4*].

2. Instruct buyer (or escrow agent) to submit all creditor claims as they are received to seller for approval or rejection [*see Com. Code §§ 6106.2, 6106.4*].

NOTE:

Disputed claims are subject to special rules [*Com. Code § 6106.2(c)*].

3. When sale is otherwise ready to be closed, if amount of consideration is insufficient to pay all claims timely filed, have buyer (or escrow agent) [*Com. Code §§ 6106.2(d), 6106.4(a)-(c)*]:

NOTE:

Claims will be deemed timely filed only if actually received by the person designated in

the notice to receive claims before the close of business on the day specified in the notice as the last date for filing claims [*Com. Code § 6106.2(f)*].

a. Delay distribution of consideration and passing of legal title for not less than 25 nor more than 30 days from date that notice of insufficiency is mailed [*Com. Code § 6106.4(a)(1)*].

b. Within five business days after date bulk sale would otherwise be closed, send written notice of insufficiency to each creditor who has filed claim, stating [*Com. Code § 6106.4(a)(2)*]:

NOTE:
If the buyer or escrow agent receives no written objection to the distribution described in the notice prior to the new date specified for the passing of legal title, the buyer or escrow agent will not be liable to any person to whom the notice was sent for any good faith error that may have been committed in allocating and distributing the consideration as stated in the notice [*Com. Code §§ 6106.2(d), 6106.4(a)(3)*].

(1) Total consideration deposited or agreed to be deposited in escrow.

(2) Name of each claimant who filed claim against escrow and amount of each claim.

(3) Amount proposed to be paid to each claimant.

(4) New date scheduled for passing of legal title.

(5) Date on or before which distribution will be made to claimants.

NOTE:
This date must not be more than five days after the new date specified for the passing of legal title [*Com. Code § 6106.4(a)(2)*].

(6) If part of sale consideration is future payment of cash [*Com. Code § 6106.4(c)*]:

(a) Amount, terms, and due date of obligation; and,

(b) Portion of claims expected to be paid by that obligation.

Legal Topics:

For related research and practice materials, see the following legal topics:
Commercial Law (UCC)Bulk Sales (Article 6)General OverviewCommercial Law (UCC)Bulk Sales (Article 6)Notice to Claimants



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-17 California Legal Forms--Transaction Guide § 17.125

AUTHOR: Marilyn E. Minger Revision Author

§ 17.125 Closing the Sale

NOTE:

As used in this chapter, "closing" means the time when legal title to the business passes from the seller to the buyer. The closing may take place on any one of several dates. It may be the date specified in the contract of sale or notice of intended bulk sale [***see*** *Com. Code § 6105(a)(4)*], the date to which closing was delayed due to insufficient funds [***see*** *Com. Code § 6106.4*], or the date when a specified condition occurs, such as the closing of a coordinated escrow for real property [***see*** *§ 17.200[1][i]*]. When escrow instructions are used, the escrow agent is instructed to follow the procedures listed below. When an escrow is not used, the attorney handling the sale (or "trustee") may follow those procedures.

1. Have seller execute and acknowledge before notary public if document will be recorded [*see Civ. Code §§ 1188-1190*; Ch. 27, *Deeds and Recording*] all instruments required to transfer business property from seller to buyer.

2. If applicable, have buyer deposit in escrow or with trustee that portion of purchase price payable on closing of sale.

3. Have buyer execute, acknowledge, and deposit with escrow agent or trustee any instruments evidencing or securing payment of any deferred part of purchase price.

4. Have seller assign any trade or service mark held by former business to buyer.

NOTE:

For the applicable procedures, see Ch. 103B, ***Trademarks*** .

5. Have seller assign copyrights and patents to buyer.

NOTE:
For discussion of copyrights, see Ch. 103A, ***Copyrights*** .

6. Distribute executed instruments of transfer to buyer.

7. Forward any assignment of lease and consent to assignment, together with filing fees, to county recorder of county where leased premises are located.

NOTE:
The fees chargeable for recording the assignment of lease and consent to assignment are the same as the fees chargeable for recording any other document [***see*** *Gov. Code § 27361*].

8. Forward any executed certificates of ownership for motor vehicles being transferred to Department of Motor Vehicles.

NOTE:
For the current transfer fee, see *Veh. Code § 9255*.

9. Forward any financing statements representing security given for payment of any deferred portion of purchase price to Secretary of State for filing [*Com. Code § 9510(a)(2)*].

NOTE:
For the current filing fee, see *Com. Code § 9525*; *Gov. Code § 12194(a)-(c)*.

10. Forward any fixture filing to appropriate filing office [*see Com. Code § 9501(a)(1)(B), (2)*; *Com. Code § 9334* (priority of security interest in fixtures)].

NOTE:
There are two ways in which a secured party may file a financing statement to perfect a security interest in goods that are or will become fixtures. A secured party may file in the Division 9 records, as with most other goods [***see*** *Com. Code § 9501(a)(2)*; *Com. Code § 9501* (UCC Comment P 4); ***see also*** Ch. 42, ***Secured Transactions***]. In these circumstances, the secured party files in the office of the Secretary of State [***see*** *Com. Code § 9501(a)(2)*]. Alternatively, a secured party may file the financing statement as a "fixture filing" [***see*** *Com. Code § 9501(a)(1)(B)*]. A fixture filing is the filing of a financing statement covering goods that are or will become fixtures and satisfying *Com. Code § 9502(a), (b)* [*Com. Code § 9102(a)(40)*; ***see*** *Com. Code § 9102(a)(41)* ("fixtures" defined)]. Filing is in the office where the record of a mortgage on the related real estate would be filed [***see*** *Com. Code § 9501(a)(1)(B)*].

A financing statement that is filed as a fixture filing must satisfy conditions in addition to those required of a standard financing statement [***see*** *Com. Code § 9502(b)*; ***see also*** *Com. Code § 9334* (priority of security interests in fixtures)]. For further discussion of these issues, see Ch. 42, ***Secured Transactions*** .

11. Advise seller that escrow holder or trustee will retain purchase price until receipt of certificates of tax clearance from Board of Equalization (SBE), Employment Development Department (EDD), and

Franchise Tax Board (FTB).

NOTE:

If the buyer (or escrow agent) distributes the purchase price before the seller has satisfied any amounts owed to the SBE, the EDD, or the FTB, the buyer will be personally liable, up to the amount of the purchase price (or, with respect to state income tax withholding, up to the fair market value of the business), for those liabilities [***see*** *Rev. & Tax. Code §§ 6812, 18669*; *Unemp. Ins. Code § 1733*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewCommercial Law (UCC)Bulk Sales (Article 6)Notice to ClaimantsReal Property LawOwnership & TransferBusiness & Corporate EntitiesReal Property LawPurchase & SaleGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-17 California Legal Forms--Transaction Guide § 17.126

AUTHOR: Marilyn E. Minger Revision Author

§ 17.126 Satisfying Seller's Tax Obligations

NOTE:

The seller must satisfy sales tax and employer tax withholding liabilities of the business immediately after the sale of the business, in order for the State Board of Equalization, Employment Development Department, and Franchise Tax Board to issue tax clearance certificates. In contrast, the seller is required to satisfy any income tax obligations only at the time that he or she files an income tax return for the taxable year in which the sale occurred.

1. With respect to sales tax obligations, have seller:

NOTE:

For a discussion of a seller's sales tax obligations from the business, including the sale of the business, see *§ 17.12*.

a. Prepare final sales tax return [SBE Form BT 401-A] for seller's operation of business, clearly marked "FINAL RETURN" [*see Rev. & Tax. Code § 6452*].

b. Visit SBE office for district in which business is located, in order to:
(1) Surrender sales tax permit for business, if applicable.

(2) File final sales tax return.

(3) Pay full amount shown as owing on final sales tax return either by cash, certified

check, cashier's check, or money order payable to Board of Equalization.

NOTE:
Usually the district office of the Board of Equalization will issue a certificate of tax clearance upon payment of the amount due, unless its audit department feels seller's sales tax account should be audited. The seller should not pay any amount due by personal check. The State Board of Equalization requires evidence that the personal check has been honored by the seller's bank before it will issue a tax clearance certificate or return a security deposit. For additional information, see SBE Pamphlet 74, "Closing Out Your Seller's Permit," which is available from the Board of Equalization or online at the State Board of Equalization website, which is located at www.boe.ca.gov.

If the audit department of the district office decides to audit the seller's sales tax account, it will normally inform the seller of that fact at the time he or she files the final return. In that event, it will not issue a certificate of tax clearance until it has completed the audit and the seller has paid the amount found due.

2. With respect to unemployment contribution, ensure that within 10 days after "quitting business" [*Unemp. Ins. Code § 1116(a)(1)*], seller brings all of following to nearest Employment Tax Customer Service Office of Employment Development Department, or mails these materials to appropriate EDD processing office [*see* Requirements for Obtaining Certificate of Release of Buyer (Cal. Employment Dev't Department Pub. 3409A)]:

NOTE:
"Quitting business" does not include any change in the form or membership of the employer if, before and after the change, 50 percent or more of the control of management is held by the same individual, or is held by an individual before death and after death by his or her estate or heirs [*Unemp. Ins. Code § 1116(a)(4)*]. For coverage of required EDD procedures, see California Employer's Guide (Cal. Employment Dev. Dep't Pub. DE-44 1999 ed.); see also Requirements for Obtaining Certificate of Release of Buyer (Cal. Employment Dev. Dep't Pub. 3409A).

All payments to the Employment Development Department must be made by cashier's check, certified check, escrow check, currency, or money order [California Employer's Guide, (Cal. Employment Dev. Dep't Pub. DE-44 1999 ed.)]. The EDD prefers that the materials listed below be mailed to the appropriate EDD office for processing these requests. Requests are not processed at local EDD offices, but instead are referred to one of the four EDD offices that handle such claims; these offices are located in Downey, Laguna Hills, Sacramento, and San Jose. For the mailing addresses of these offices, see *§ 17.301[1]*.

The EDD will issue a certificate of tax clearance [EDD Form DE 2220] on filing of all required documents and payment of all amounts owed.

a. Completed Release of Buyer Request Form (Form DE 2220R) [*see § 17.301* (form)].

b. Signed Semi-Weekly/Monthly/Quarterly Report of Contributions (DE 88 and/or DE88ALL) for current quarter, along with payment in certified funds (cash, cashier's check, money order, or check from escrow company).

c. Copies of all DE 88 and/or DE88ALL deposits remitted eight weeks prior to date of sale, along with

proof of payment.

d. Signed Quarterly Wage Report (DE 6) or other EDD forms required for current quarter.

NOTE:
For an example and discussion of this form, see Ch. 12, ***Winding Up and Dissolution***, § 12.281.

e. Signed Annual Reconciliation Form (DE7) for current year.

NOTE:
For an example and discussion of this form, see Ch. 12, ***Winding Up and Dissolution***, § 12.282.

f. Prior annual reconciliation forms (DE 7 or DE 43) with accompanying documents, if not previously filed with EDD, along with payment of penalty, if applicable.

g. Copy of instructions from escrow agent.

3. Have seller deliver to buyer (or escrow agent) certificates of tax clearance from Board of Equalization and Employment Development Department, as soon as received.

NOTE:
To avoid successor liability for the seller's tax obligations, the purchase price should not be distributed until receipt of these certificates [***see*** *Rev. & Tax. Code § 6812*; *Unemp. Ins. Code § 1733*; § 17.14].

The buyer must also obtain certificate of tax clearance from Franchise Tax Board, but the buyer should obtain this certificate directly from the Board.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewReal Property LawOwnership & TransferBusiness & Corporate EntitiesReal Property LawPurchase & SaleGeneral OverviewTax LawState & Local TaxesSales TaxGeneral Overview



115 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-17 California Legal Forms--Transaction Guide § 17.127

AUTHOR: Marilyn E. Minger Revision Author

§ 17.127 Distributing Proceeds When Com. Code §§ 6106.2 and 6106.4 Are Inapplicable

NOTE:

Com. Code §§ 6106.2 and *6106.4* apply to bulk sales for which the consideration is (1) $2 million or less and (2) substantially all cash, an obligation to pay cash in the future, or a combination of the two impose special payment requirements.

1. If statements received from Board of Equalization, Employment Development Department, and/or Franchise Tax Board show any amounts owing from seller on account of business, pay to extent of purchase price (or, with respect to state income tax withholding, pay to extent of fair market value of business) [*see Rev. & Tax. Code §§ 6812, 18669*; *Unemp. Ins. Code § 1733*].

2. Pay sales proceeds to seller upon receipt of tax clearance certificates from Employment Development Department, Board of Equalization, and Franchise Tax Board.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewCommercial Law (UCC)Bulk Sales (Article 6)General OverviewReal Property LawOwnership & TransferBusiness & Corporate EntitiesReal Property LawPurchase & SaleGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-17 California Legal Forms--Transaction Guide § 17.128

AUTHOR: Marilyn E. Minger Revision Author

§ 17.128 Distributing Proceeds When Com. Code §§ 6106.2 and 6106.4 Apply

1. If statements received from Board of Equalization, Employment Development Department, and/or Franchise Tax Board show any amounts owing from seller on account of business, pay to extent of purchase price (or, with respect to state income tax withholding, pay to the extent of fair market value of business [*see Rev. & Tax. Code §§ 6812, 18669*; *Unemp. Ins. Code § 1733*].

2. If tax clearance statements are received from Employment Development Department and Board of Equalization within 45 days after closing [*see Com. Code § 6106.2(e)*]:

NOTE:
The buyer (or escrow agent) must either distribute the consideration or institute an action in interpleader [***see*** *Code Civ. Proc. § 386*] within 45 days after closing (that is, the date on which the buyer takes legal title to any of the goods) [*Com. Code § 6106.2(e)*].

a. With respect to disputed claims, have buyer (or escrow agent) withhold from distribution amount of claim (or, if consideration is insufficient, pro rata amount determined in accordance with (b)(2), *below*) [*Com. Code § 6106.2(c)*].

b. With respect to undisputed claims, have buyer (or escrow agent) distribute consideration as follows [*Com. Code § 6106.2(e)*]:
(1) If amount of consideration is sufficient to pay in full all timely creditor claims, pay all claims within 45 days after closing (that is, transfer of title), and distribute balance to seller [*Com. Code § 6106.2(e)*].

(2) If amount of consideration is insufficient to pay in full all timely claims, distribute consideration in following order of priority, within five days after new date for closing (that is, transfer of title) [*Com. Code §§ 6106.2(d), 6106.4(b)*]:

(a) All obligations owing to United States, to extent given priority by federal law.

(b) Secured claims, including statutory and judicial liens, to extent of consideration fairly attributable to value of properties provided by law.

NOTE:

A secured creditor, however, will participate in the distribution only after depositing a release of lien conditioned on receiving an amount equal to that distribution [*Com. Code § 6106.4(b)(2)*].

(c) Escrow and professional charges and broker's fees attributable directly to sale.

(d) Unpaid employee wage claims earned within 90 days before sale, transfer, or opening of escrow [*Com. Code § 6106.4(b)(4)*; *see Code Civ. Proc. § 1205*].

(e) All other tax claims.

(f) All other unsecured claims pro rata, including any deficiency claims of partially secured creditors.

c. If consideration consists partially of obligation to pay cash in future:

(1) If consideration was insufficient, first apply principal and interest received on that obligation to unpaid debts, in accordance with (b)(2), *above*, until claims are paid in full [*Com. Code § 6106.4(c)*].

NOTE:

Every distribution should be made pro rata to creditors having equal priority. A new determination must be made with respect to allocation after each payment received from the buyer, because some of the original high-priority creditors may have been paid in full after the preceding payment.

(2) When all creditor claims have been paid, distribute balance of amounts received to seller.

3. Within two business days after distribution, have buyer (or escrow agent) give written notice to claimant of disputed claim that withheld amount will be paid to seller (or, if consideration is insufficient, to claimants with priority unless claimant attaches that amount within 25 days from mailing of notice) [*Com. Code § 6106.2(c)*].

NOTE:

A claimant may obtain an attachment for a claim that is less than $500 and based on a contract, or is a secured claim or lien [*Com. Code § 6106.2(c)*; ***see*** *Code Civ. Proc. § 483.010*]. Such an attachment is limited in its effect to the amount withheld for that claimant, and will give that claimant no greater priority or rights with respect to the claim than he or she would have had if the claim had not been disputed [*Com. Code § 6106.2(c)*].

4. Retain amount of disputed claims for 25 days from date of mailing of notice to creditors.

a. If writ of attachment is levied during 25-day period, pay amount retained on claim to levying officer

and give garnishee's memorandum if requested [*Com. Code § 6106.2(c)*; *see Code Civ. Proc. §§ 483.010, 488.610*].

NOTE:

The courts may issue a writ of attachment ex parte when a bulk sale notice has been recorded and published [***see*** *Code Civ. Proc. § 485.010(b)(3)*]. Therefore, it is fairly easy for a creditor to obtain a writ of attachment. The writ, however, will be limited to the property covered by the bulk sale notice or the proceeds of the sale of the property [*see Code Civ. Proc. § 485.010(c)*]. For further discussion, see California Forms of Pleading and Practice, Ch. 62, ***Attachment*** (Matthew Bender).

b. If no writ is levied during 25-day period, pay disputed amount to seller (or, if consideration is insufficient, to claimants with priority [*Com. Code § 6106.2(c)*].

5. If Board of Equalization and/or Franchise Tax Board have not issued tax clearance within 45 days after transfer of title [*see Rev. & Tax. Code §§ 6811, 18669*], take either of following actions:

a. If only a few creditors have filed timely claims, attempt to obtain extension of time for payment of claims.

NOTE:

The Bulk Sales Division requires payment of timely creditor claims or filing of an interpleader action within 45 days after the buyer takes title to any of the business assets being transferred [*Com. Code § 6106.2(e)*]. However, the Board of Equalization has 60 days in which to issue a tax clearance certificate after the latest of the sale, a request, or audit [*Rev. & Tax. Code § 6812(b)*], and the Franchise Tax Board has 60 days in which to issue a tax clearance certificate after written request by the buyer [*Rev. & Tax. Code § 18669(b)*]. The buyer must not allow distribution until receipt of that certificate, or he or she will be liable for any taxes owed, up to the amount of the purchase price (or, with respect to state income tax withholding, up to the fair market value of the business) [***see*** *Rev. & Tax. Code §§ 6812, 18669*]. The creditors may be willing to extend the time for payment to avoid the filing of an interpleader action [***see*** (b), ***below***]. Note that because the Employment Development Department's failure to issue a tax clearance certificate within 30 days of a request is deemed the equivalent of a tax clearance, no similar conflict with the Bulk Sales Division should arise [***see*** *Unemp. Ins. Code § 1732*].

b. If creditors refuse to grant extension, have buyer (or escrow agent) file action in interpleader against [*Com. Code § 6106.2(e)*; *Code Civ. Proc. § 386*]:

NOTE:

The action must be brought in the appropriate court for the county where the seller had its principal place of business. At the time of filing, the buyer (or escrow agent) must deposit the sales consideration with the clerk of the court [*Com. Code § 6106.2(e)*]. For examples and further discussion of the interpleader action, see California Forms of Pleading and Practice, Ch. 314, ***Interpleader*** (Matthew Bender)].

(1) Buyer and seller;

(2) Board of Equalization and/or Franchise Tax Board; and

(3) All creditors who have filed timely claims.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewCommercial Law (UCC)Bulk Sales (Article 6)General OverviewCommercial Law (UCC)Bulk Sales (Article 6)Application of ProceedsReal Property LawOwnership & TransferBusiness & Corporate EntitiesReal Property LawPurchase & SaleGeneral OverviewTax LawFederal Tax Administration & ProcedureTax Credits & LiabilitiesLiens (IRC secs. 6320-6327)Federal Tax Lien Priority



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-17 California Legal Forms--Transaction Guide § 17.129

AUTHOR: Marilyn E. Minger Revision Author

§ 17.129 Reporting Statutory Change in Ownership of Real Property

NOTE:

Real property subject to local property taxation is reassessed when a change in ownership occurs [***see*** Cal. Const. arts. XIII, XIIIA; ***see also*** California Real Estate Law and Practice, Ch. 401, ***Real Property Valuation and Assessment*** (Matthew Bender)]. A "change in ownership" is a transfer of a present interest in real property (including beneficial use of the property), the value of which is substantially equal to the value of the fee interest [*Rev. & Tax. Code § 60*]. Such a change requires the acquiring individual or entity to file a change in ownership statement [*Rev. & Tax. Code §§ 480-480.2*]. For further discussion, see *Ch. 23,* ***Real Property Sales Agreements****, § 23.306*.

1. Determine whether real property of business has undergone statutory change in ownership, pursuant to any of following:

NOTE:

Except as provided in (b) or (c), ***below***, the purchase or transfer of ownership interests in legal entities (such as corporate stock or partnership interests) will not be deemed to constitute a transfer of the real property of the legal entity [*Rev. & Tax. Code § 64*]. For further discussion of what constitutes a change in ownership, see *Ch. 23,* ***Real Property Sales Agreements****, § 23.153*.

a. Real property of business that is subject to local property taxation is sold [*see Rev. & Tax. Code §§ 60, 480*].

b. Change in control of any corporation, partnership, limited liability company, or other legal entity occurs [*Rev. & Tax. Code §§ 64(c), 480.1*].

c. Interests representing cumulatively more than 50 percent of total interests in business entity are transferred by any of "original co-owners" in one or more transactions [*Rev. & Tax. Code §§ 64(d), 480.2*; *see Rev. & Tax. Code § 62(a)(2)*].

NOTE:
"Original co-owners" are those persons holding ownership interests in a legal entity immediately following a transaction excluded from the definition of "change in ownership" by *Revenue and Taxation Code § 62(a)(2)*. This section excludes any transfer between an individual or individuals and a legal entity or between legal entities (such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy) (1) that results solely in a change in the method of holding title to the real property and (2) in which the proportional interests of the sellers and buyers remain the same after the transfer [*Rev. & Tax. Code § 62(a)(2)*].

2. Have buyer or transferee prepare and file change in ownership statement as follows [*Rev. & Tax. Code §§ 480-480.2*]:

a. Complete official form:

NOTE:
A form may be obtained from the district office of the State Board of Equalization for the area in which the acquired business's real property is located. For further detailed discussion of change in ownership procedures, see *Ch. 23,* ***Real Property Sales Agreements****, § 23.306*).

(1) Preliminary change of ownership report [*see Ch. 23, Real Property Sales Agreements, § 23.306*], if change of ownership will be effected by recordation of deed or other document [*Rev. & Tax. Code §§ 480.3, 480.4*].

(2) Change in ownership statement [*see Ch. 23, Real Property Sales Agreements, § 23.306*], if preliminary change of ownership report is not filed [*see* (1), *above*], or if county assessor finds that filed preliminary report is inadequate [*Rev. & Tax. Code §§ 480-480.4*].

NOTE:
For a discussion of the change in ownership requirements for corporations, partnerships, limited liability companies, or other legal entities [*Rev. & Tax. Code § 480.2*], see Ch. 11C, ***Mergers*** , § 11C.161.

b. File report at time of recordation of transfer document [*Rev. & Tax. Code § 480.3(a)*] or file statement within 45 days from date of change in ownership of business, with county assessor of county in which property is located [*Rev. & Tax. Code §§ 480(c), (e)*; *see Rev. & Tax Code §§ 480.1(b), 480.2(b)*].

NOTE:
If the change of ownership occurs as the result of death, the statement must be filed (1) within 150 days after the date of death, or (2) when the inventory and appraisal is filed if the estate is probated [*Rev. & Tax. Code § 480(e)*]. A change in ownership statement must also be filed whenever the Board of

Equalization makes a written request for that statement [***see*** *Rev. & Tax. Code §§ 480.1(b), 480.2(b)*].

3. Advise buyer that Board of Equalization will impose monetary penalty for [*Rev. & Tax. Code § 482(b)*]:

a. Failure to file statement within 45 days from earlier of either:

(1) Date of change in control or change in ownership of corporation, partnership, LLC, or other legal entity; or

(2) Date of written request by State Board of Equalization.

b. Failure to file missing information after filing incomplete statement and receiving second request for information.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewCommercial Law (UCC)Bulk Sales (Article 6)General OverviewReal Property LawOwnership & TransferBusiness & Corporate EntitiesReal Property LawPurchase & SaleGeneral OverviewReal Property LawPurchase & SaleContracts of SaleGeneral Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-17 California Legal Forms--Transaction Guide § 17.130

AUTHOR: Marilyn E. Minger Revision Author

§ 17.130 Reporting Income Tax Consequences of Sale

NOTE:

The parties to the sale of a business must report any personal income tax consequences at the usual time for filing the tax return for the year in which the sale took place. In contrast, sales tax and unemployment tax procedures must be followed immediately after the sale [***see*** *§§ 17.126, 17.130*].

1. Advise buyer and seller to report any income tax consequences from sale of business on federal and state returns for year in which sale occurred [*see, e.g., I.R.C. § 1001*; *Rev. & Tax. Code § 18031* (determining seller's gain or loss on sale)].

NOTE:

For a discussion of the income tax consequences of the purchase and sale of property generally, see Ch. 23, ***Real Property Sales Agreements***, § 23.30.

2. Instruct buyer and seller to attach IRS Form 8594 to federal income tax form for year in which sale of business occurred [*see I.R.C. § 1060(b)*; Temp. Treas. Reg. § 1.1060-1T(h)(1)].

NOTE:

Both parties to an "applicable asset acquisition" must allocate the consideration received for the acquired assets using the residual allocation method [*I.R.C. § 1060(a)*; ***see*** *I.R.C. § 338(b)(5)*; ***see also*** Temp. Treas. Reg. §§ 1.338(b)-2T(b), 1.1060-1T(d)] and report the allocation to the IRS [Temp. Treas. Reg. § 1.1060-1T(h)(1)]. Form 8594 requires the names and addresses of each party, the date of the sale, the total sales price, and the fair market value and amount of sales price allocated to each class of asset transferred.

In an applicable asset acquisition, both parties are bound for tax purposes by the terms of the written agreement as to the allocation of any consideration, or as to the fair market value of any of the assets unless the IRS determines that the allocation (or fair market value) is not appropriate [*I.R.C. § 1060(a)*].

3. Advise parties that if amount allocated to any asset increases or decreases after Form 8594 is filed, they must attach new Form 8594 to federal income tax return for year in which increase or decrease is taken into account [Temp. Treas. Reg. § 1.1060-1T(h)(2)].

NOTE:
To report a change, only Parts I and IV of Form 8594 must be completed. Part IV requires a statement of the allocation as previously reported, the amount of increase or decrease, the redetermined allocation of the sales price, and the reason for the change.

4. Warn parties that failure to file an initial or updated Form 8594, when required, is punishable by fine [*I.R.C. § 1060(f)*; *see I.R.C. § 6721* (amount of fine)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawGeneral OverviewCommercial Law (UCC)Bulk Sales (Article 6)General OverviewReal Property LawOwnership & TransferBusiness & Corporate EntitiesReal Property LawPurchase & SaleGeneral OverviewTax LawFederal Income Tax ComputationSales & ExchangesBusiness Property (IRC secs. 1031, 1221, 1231)General Overview



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-17 California Legal Forms--Transaction Guide §§ 17.131-17.199

AUTHOR: Marilyn E. Minger Revision Author

[Reserved]

§§ 17.131[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
A. Complete Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.200

AUTHOR: Marilyn E. Minger Revision Author

§ 17.200 Contract for Sale of Business

[1] Comment

[a] Use of Form

This form is a basic contract for the sale of a business. With the exception of optional language in Section 6.01 of the form, this form is not designed to comply with the Bulk Sales Division. For provisions that may be added to this form if the sale is subject to the Bulk Sales Division of the Commercial Code ("Bulk Sales Division") [*Com. Code §§ 6101-6111*] see the *form in § 17.210[2]*. For provisions that may be used with this contract for the an example of a contract for the sale of a professional practice, see the *form in § 17.211*. For additional provisions that may be incorporated into this contract for sale, see the *forms in §§ 17.212-17.220*.

[b] Mandatory Terms of Sales Contract

Like all other contracts, contracts for the sale of a business must include the following:

- The consent of parties capable of contracting [*see Civ. Code §§ 1556-1559* (parties), 1565-1590 (consent)].
- A lawful objective [*see Civ. Code §§ 1595-1599*].
- Sufficient consideration [*Civ. Code § 1550*; *see Civ. Code §§ 1605-1615*].

For a discussion of these essential elements, see the discussion under "Parties--Capacity" and subsequent headings in the Legal Background to Ch. 75, *Formation of Contracts and Standard Contractual Provisions*.

[c] Description of Property Being Sold

The sales contract should enumerate all of the business property that the seller will transfer to the buyer and specifically describe any items of property that are not subject to the sale [*see* [2], Section 1.01, *below*]. Transfer of a leasehold interest [*see* [2], Section 1.01(5), *below*] should be accomplished by a written assignment signed by the assignor [*see Civ. Code §§ 1091, 1624*; *Code Civ. Proc. § 1971* (required for transfers of term exceeding one year); *see also* Ch. 35A, *Assignment and Sublease of Leasehold Interests*]. The seller may also state the condition of the tangible property being transferred [*see* [2], Section 7.01(f), *below*].

The parties should specifically identify any business assets that are *not* being sold.

[d] Amount of Purchase Price

The contract should state the total purchase price [*see* [2], Section 2.01, *below*].

Determination of the purchase price of a business is beyond the scope of this chapter, and is not covered in this form or comment. Generally, the parties will employ a financial expert to determine the fair market value of the business and of each individual asset. The investigation underlying the valuation determination may, however, overlap with the due diligence investigation undertaken to understand the business's rights and liabilities. For a discussion of due diligence, see *§ 17.18*. For a detailed checklist of the documents to be reviewed and information to be obtained during due diligence, see *§ 17.121*.

[e] Allocation of Purchase Price

For tax purposes, the parties must allocate the purchase price among the assets being sold. This allows the seller to determine any gain or loss on the sale and the buyer to determine his or her basis in the assets being acquired [*see § 17.11[4]*]. Furthermore, an allocation is required to determine sales tax on the sale [*see § 17.12*].

Restrictions on allocation of the purchase price apply to any applicable asset acquisition; that is, any direct or indirect transfer of assets in which (1) the assets constitute a trade or business, and (2) the buyer's basis in the assets is determined wholly by reference to the consideration paid for the assets [*see I.R.C. § 1060(a), (c)*]. For purposes of determining the buyer's basis in the assets and the seller's gain or loss in such a transaction, the consideration received for the assets must be allocated among the assets under the "residual method" [*I.R.C. § 1060(a)*; Temp. Treas. Reg. §§ 1.338(b)-2T(b), *1.1060-1T(d)]*. Under that method, the purchase price is reduced as follows [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2), *1.1060-1T(d)(2)*]:

- First, by the amount of "Class I assets." Class I assets consist of cash, demand deposits and similar accounts in banks, savings and loan associations (or other similar depositary institutions), and other items designated by the IRS in the Internal Revenue Bulletin [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(1), *1.1060-1T(d)(1)*].

- Second, by the amount of "Class II assets." Class II assets are certificates of stock, U.S. Government securities, readily marketable stock or securities [*see Treas. Reg. § 1.351-1(c)(3)*], foreign currency, and other items designated by the IRS in the Internal Revenue Bulletin [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(ii), *1.1060-1T(d)(2)(ii)*].

- Third, by the amount of "Class III assets." Class III assets are all assets that do not fall within any of the other asset categories specified in this list [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(iii), *1.1060-1T(d)(2)(iii)*].

- Fourth, by the amount of "Class IV assets." Class IV assets are all intangibles [*I.R.C. § 197*], except

those in the nature of goodwill and going concern value [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(iv), *1.1060-1T(d)(2)(iv)]*.

- Fifth, by the amount of "Class V assets." Class V assets are intangibles in the nature of goodwill and going concern value [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(v), *1.1060-1T(d)(2)(v)*].

When drafting the sales contract in an applicable asset acquisition, it is important to be aware that both parties will be bound for tax purposes by the terms of the written agreement as to the allocation of any consideration, or as to the fair market value of any of the assets, unless the IRS determines that the allocation (or fair market value) is not appropriate [*I.R.C. § 1060(a)*].

This form allocates the purchase price among the assets in the order indicated above generally referred to as the residual allocation method. Specifically, the allocations are made as follows [*see* [2], Section 3.01, *below*]:

- First, to cash and demand deposits and similar accounts in banks, savings and loan associations, and other depository institutions ("Class I assets") [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(1), *1.1060-1T(d)(1)*].

- Second, to fair market value of certificates of deposit, U.S. government securities, and foreign currency ("Class II assets") [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(ii), *1.1060-1T(d)(2)(i)*].

- Third, to fair market value of all other assets other than goodwill and going concern value ("Class III assets") [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(iii), *1.1060-1T(d)(2)(ii)*].

- Fourth, to intangibles except those in the nature of goodwill and going concern value [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(iv), *1.1060-1T(d)(2)(iv)*].

- Fifth, to goodwill and going concern value [Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(v), *1.1060-1T(d)(2)(v)*].

This form also contains the following [*see* [2], Section 3.02, *below* ; *see also* Temp. Treas. Reg. § 1.1060-1T(h) (seller and purchaser must report allocation); *Ann. 88-107, Announcement 88-107, 1988-32 I.R.B. 60* (parties must use IRS Form 8594 to report allocation); Dugoni, *Drafting and Agreement for the Purchase and Sale of a Medical or Dental Practice*, 4 C.E.B. Cal. Bus. Law Prac. 25 (Winter 1989)]:

- The acknowledgment of each party that the amount allocated to each individual asset represents its fair market value determined pursuant to arm's-length negotiation;

- A statement that each party has had the tax consequences of the allocations explained to him or her by a tax attorney or other advisor; and

- The agreement by each party to report the allocations as set forth in the contract of sale to the IRS. For further discussion of the reporting requirements, see *§ 17.11[4]*.

[f] Payment of Purchase Price

This form provides for payment of the sales price in either cash or installments [*see* [2], Section 4.01, *below*]. The installment sale alternative provides for execution of a promissory note and security agreement giving the seller a security interest in the property being sold. This type of transaction (excluding the sale of accounts receivable as part of the sale of the business from which they arose [*see Com. Code § 9109(d)(4)*]) is governed by Division 9 of the

California Commercial Code [*Com. Code § 9109(a)(1)*; *see Com. Code § 9101 et seq.*]. The seller may "perfect" his or her security interest by filing a financing statement [*see Com. Code §§ 9317, 9502*]. Coverage of secured transactions is beyond the scope of this chapter. For extensive discussion of secured transactions under Division 9, see Ch. 42, *Secured Transactions* .

[g] Seller's Warranties Regarding Business

This form contains the seller's warranties regarding ownership of the business, marketable title, the accuracy of the business books and accounts, outstanding debts, and pending litigation or proceedings [*see* [2], Section 7.01, *below*]. A warranty is a contractual term concerning any aspect of the sale, such as title or quality. The parties to the sale may negotiate for any express warranties to be included in the contract of sale. Although the buyer will want the contract to contain broad warranties regarding the business, the seller should limit his or her representations in order to avoid any possible liability for fraud or deceit [*see Civ. Code §§ 1571-1574* (fraud), *1709-1710* (deceit)]. For additional discussion of warranties under the California Commercial Code, and forms, see Ch. 52, *Sales of Goods Under the Uniform Commercial Code*, §§ 52.90-52.97.

[h] Assumption of Liabilities

A voluntary acceptance of the benefit of a transaction generally is equivalent to a consent to all the obligations arising from it, so far as the facts are known or ought to be known to the person accepting [*Civ. Code § 1589*]. Accordingly, this form provides that the buyer will assume all obligations appearing on the books of the business on the date of the sales contract [*see* [2], Section 5.01, *below*]. If the buyer is aware of the existing liabilities, he or she will be able to negotiate a purchase price reflecting the outstanding obligations. The seller should indemnify the buyer for all other claims and liabilities arising from operation of the business before the closing [*see* [2], Section 13.01, *below*], and the buyer should indemnify the seller for claims and liabilities arising after the closing [*see* [2], Section 13.02, *below*].

The law of products liability, however, has created uncertainty regarding unmatured liabilities. An action for injuries caused by a defective product may arise years after sale of the product. Liability may extend to a manufacturer, wholesaler, retailer, lessor, and even a licensor or franchisor, if the firm supplied the product in its normal course of business and contributed to the placing of the product on the market [*see Kasel v. Remington Arms Co. (1972) 24 Cal. App. 3d 711, 725-726, 101 Cal. Rptr. 314* (licensor); *Price v. Shell Oil Co. (1970) 2 Cal. 3d 245, 253, 85 Cal. Rptr. 178, 466 P.2d 722* (lessor of personal property); *Canifax v. Hercules Powder Co. (1965) 237 Cal. App. 2d 44, 52, 46 Cal. Rptr. 552* (wholesaler); *Vandermark v. Ford Motor Co. (1964) 61 Cal. 2d 256, 262-263, 37 Cal. Rptr. 896, 391 P.2d 168* (manufacturer and retailer)]. Furthermore, if the original manufacturer or distributor lacks sufficient assets to satisfy the claim or has dissolved the corporate entity, liability may be imposed on the successor to the business [*Rawlings v. D.M. Oliver, Inc. (1979) 97 Cal. App. 3d 890, 900, 159 Cal. Rptr. 119* (individual seller with insufficient assets); *Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 34, 136 Cal. Rptr. 574, 560 P.2d 3* (corporate seller dissolved)].

Under the landmark decision in *Ray v. Alad* [*Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 136 Cal. Rptr. 574, 560 P.2d 3]* , liability will be imposed on a successor only if (1) the plaintiff's remedies against the predecessor were virtually destroyed by the successor's acquisition of the business, (2) the successor had the ability to estimate the risk of product liability claims arising from the predecessor, and (3) it was fair and equitable to require the successor to assume responsibility for defective products, in view of the successor's use of the predecessor's goodwill in the continued operation of the business [*Ray v. Alad Corp. (1977) 19 Cal. 3d 22, 31, 136 Cal. Rptr. 574, 560 P.2d 3* ; *see Lundell v. Sidney Machine Tool Co. (1987) 190 Cal. App. 3d 1546, 1550-1557, 236 Cal. Rptr. 70* (defendant who merely purchased part of original manufacturer's assets not liable as successor because *Ray v. Alad* factors not present)]. Because this successor liability rule applies to all distributors in the "stream of commerce," not just to manufacturers [*Kaminski v. Western MacArthur Co. (1985) 175 Cal. App. 3d 445, 456-458, 220 Cal. Rptr. 895]* , the purchaser of a business needs to evaluate the risk of potential products liability.

[i] Closing of Sale

The contract should specify the date and place of closing, that is, transfer of title [*see* [2], Section 6.01, *below*]. Closing may be simultaneous with the execution of the contract for the sale of the business or the contract may be executed prior to a specified or target closing date. If the execution and closing occur separately, the contract should include provisions regarding each party's obligations between execution and close, including any limitations placed on seller's interim operation of the business and risk of loss provisions.

If a party is expected to deliver particular documents at the closing, those documents should be enumerated in the sales contract [*see* [2], Sections 6.02, 6.03, *below*]. The delivery of those documents should be identified as conditions precedent to the close. If they are not going to be delivered at the close, either the close can be postponed or provision can be made, such as a holdback, to protect the aggrieved party.

[j] Bills of Sale

A seller is not required to use a bill of sale to transfer title to specific personal property to the buyer, but contracts of sale and escrow instructions often specify that the seller deliver a bill of sale for personal property assets of the business to the buyer [*see* [2], Section 6.02(1), *below*].

[k] Conduct of Business

This contract requires the seller to continue operating the business in the same manner until the closing [*see* [2], Section 8.01, *below*]. For an alternative provision that lists specific requirements, see the form in *§ 17.215*.

[l] Risk of Loss

This form provides that the seller will bear the risk of damage to or loss of the assets of the business prior to closing, and the buyer will bear the risk of loss thereafter [*see* [2], Section 8.02, *below*]. However, *Civ. Code § 1511(2)* provides that performance of an obligation is excused when it is prevented or delayed by an irresistible superhuman cause, unless the parties have expressly agreed to the contrary. For a discussion and example of a "force majeure" clause, see *Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.235*.

[m] Proration of Expenses

The buyer and seller generally agree to prorate, as of the closing, the expenses incident to conducting the business. This form provides that the parties will prorate all personal property taxes, insurance policies, employee salaries and benefits, and rent when applicable [*see* [2], Section 11.01, *below*].

[n] Inventory

The contract should specify the date and method of taking inventory of the property being sold. This event may take place at the close of business hours on the day preceding the closing [*see* [2], Section 12.01, *below*].

[o] Insurance Policies

A provision may be included to require seller to provide a list of insurance policies insuring the business or assets to be transferred and to require the buyer to indicate in writing which policies, if any, he or she desires the seller to transfer to the buyer [*see* [2], Section 15.01, *below*]. Generally, an insured may sell or assign an insurance policy. However, in order to prevent an increase of risk to the insurer due to a change of ownership before a loss occurs, the insurer must consent to the assignment [*see University of Judaism v. Transamerica Ins. Co. (1976) 61 Cal. App. 3d 937, 941, 132 Cal. Rptr. 907* ,] whether or not the policy requires consent [*see Bergson v. Builders' Ins. Co. (1869) 38 Cal. 541, 544*

]. For further coverage of the law governing assignment of insurance policies, see *California Insurance Law and Practice, Ch. 8, The Insurance Contract, § 8.11* (Matthew Bender).

[p] Indemnification

One party may indemnify the other for potential products liability losses [*see Rossmoor Sanitation, Inc. v. Pylon, Inc. (1975) 13 Cal. 3d 622* (parties may bargain for one to make good the other's future losses)]. The question of who should undertake responsibility is a business decision to be made in negotiations between the seller and the buyer. The answer may affect the price of the business and may depend on whether the seller will continue to be in a position to insure or self-insure against products liability loss. Insurance companies typically sell discontinued operations or discontinued products liability insurance for the seller, as well as products liability insurance with coverage for products sold by the insured's predecessor in the business. This form contains an optional provision that the buyer will insure against products liability claims arising from seller's activities before the sale [*see* [2], Section 3.02, *below*]. For further discussion of products liability with respect to successors in interest, see *California Products Liability Actions, Ch. 2, Liability for Defective Products, § 2.14[5]* (Matthew Bender).

For provisions regarding the implementation of an indemnification that may either form the basis of an independent indemnification agreement or be incorporated into a master agreement, see the form in *§ 17.212*.

[q] Attorneys' Fees

This form specifically provides that attorneys' fees will be awarded to the prevailing party in any arbitration or litigation [*see* [2], Section 16.02, *below*]. A litigant is not entitled to attorneys' fees unless they are agreed to by the parties or specifically provided for by statute [*Code Civ. Proc. § 1021*]. In any action on a contract, if the contract provides that attorneys' fees and costs incurred to enforce the contract are to be awarded either to one of the parties or to the prevailing party, the party who is determined to be the party prevailing on the contract, regardless of whether he or she is the party named in the contract, is entitled to reasonable attorneys' fees in addition to other costs [*Civ. Code § 1717(a)*]. For further discussion and other examples of attorneys' fees provisions, see *Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.252*.

[r] Arbitration

This form provides that any dispute regarding the contract will be settled by arbitration [*see* [2], Section 16.01, *below*]. Some attorneys consider arbitration clauses to be more or less part of the "boilerplate" of an agreement; that is to say, provisions included fairly automatically. Inclusion and content of an arbitration clause, however, should be carefully considered because arbitration can limit an aggrieved party's rights. Unlike disputes resolved in the courts, with arbitration there may be no recourse to appeal a clearly erroneous decision.

Arbitration provisions commonly incorporate the rules of the American Arbitration Association or the California Arbitration Act [*see Code Civ. Proc. § 1280 et seq.*]. For additional examples and discussion of arbitration clauses, see *Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.250*. For an example and discussion of the statutory arbitration notice that must appear in any contract to convey real property [*Code Civ. Proc. § 1298*], see *Ch. 23, Real Property Sales Agreements, § 23.253*.

[s] Standard Contractual Provisions

Most written agreements include certain standard provisions. This form contains an "entire agreement" provision [*see* [2], Section 16.04, *below* ; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.270*], a clause governing amendment and modification [*see* [2], Section 16.05, *below* ; *see also* Ch. 77, *Discharge of Obligations*, §§ 77.320-77.323], a provision for the manner of giving notice [*see* [2], Section 16.06, *below* ; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.294*], and assignability provisions [*see* [2],

Section 16.07, *below* ; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, §§ 75.280-75.282*]. This form also contains a "choice of law" provision [*see* [2], Section 16.09, *below*], which may be useful if the sales transaction involves contacts with states other than California [*see Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.273*]. For other standard provisions, see Ch. 75, *Formation of Contracts and Standard Contractual Provisions* .

[t] Additional Provisions

Depending on the nature of the business being sold, other provisions may be added to or substituted for the provisions in this contract. For provisions governing the parties' conduct before and after the sale, see *§§ 17.215, 17.216*. If the business being sold is subject to a franchise agreement, see the forms in *§§ 17.280, 17.281*. For other miscellaneous provisions, see the forms in §§ 17.210-17.220.

[u] Attached Exhibits

The parties to a contract have the power to incorporate other documents by reference, whether or not those documents are attached [*King v. Larsen Realty, Inc. (1981) 121 Cal. App. 3d 349, 357, 175 Cal. Rptr. 226* ; *see Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.290*]. This contract incorporates various attached exhibits, including an inventory of fixtures and equipment [*see* [2], Section 1.01(2), *below*], a list of accounts receivable [*see* [2], Section 1.01(4), *below*], a promissory note and security agreement for use when the purchase price is financed [*see* [2], Section 4.01(b), second alternative provisions, *below*], a schedule of parties with an interest in or claim to business assets [*see* [2], Sections 5.01, 7.01(a), *below*], a list of all business obligations owed by the seller [*see* [2], Section 7.01(b), *below*], a list of all business employees and their salaries [*see* [2], Section 11.01(c), (d), *below*], and an inventory of stock in trade [*see* [2], Section 12.01, *below*].

[2] FORM

Contract for Sale of Business

CONTRACT FOR SALE OF BUSINESS

THIS AGREEMENT ("Agreement") is made on _____[*date*], between _____[*name of seller(s) and capacity, e.g.*, John and Jane Doe, husband and wife] (collectively, "Seller") and _____[*name of buyer(s) and capacity*] ("Buyer").

Recitals

Seller is the owner of a _____[*describe type of business, e.g.*, retail appliance sales and service] business known as "_____" [*name of business*] (the "Business"), located at _____[*address*], _____[*city*], [*add when noncompetition agreement (see § 17.213[2]) will be used:* in _____ County], California. Seller desires to sell the business to Buyer, and Buyer desires to purchase the business from Seller.

Therefore, Buyer and Seller agree as follows:

Article 1 PURCHASE AND SALE OF BUSINESS

Section 1.01. Purchase and Sale of Business. Seller shall transfer, assign, convey and deliver to Buyer, and Buyer shall purchase from Seller, on the terms and conditions set forth in this Agreement, the following property of the

Business (collectively, the "Assets"):

(1) The Inventory, as *defined in Section 12.01*;

(2) All the furniture, fixtures, equipment, and other tangible assets shown on the attached inventory marked "Exhibit _____" [*add if desired:*, with the following exceptions: _____ (*describe any exceptions*)];

(3) All the trade, goodwill, and other intangible assets;

(4) All of the accounts receivable shown on the attached schedule marked "Exhibit _____"; and

(5) The leasehold interest owned by Seller under the lease with _____ [*name of lessor*] dated _____, [*date*], for premises on which the business is located, pursuant to a valid assignment of lease.

Article 2 PURCHASE PRICE

Section 2.01. Purchase Price. In consideration of the transfer, assignment, conveyance and delivery of the Assets by Seller, on the terms and conditions of this Agreement, Buyer shall make a payment to Seller in the amount of $_____ (the "Purchase Price"), plus the assumption of the Liabilities by Buyer pursuant to Section 5.01.

Article 3 ALLOCATION OF PURCHASE PRICE

Section 3.01. Allocation. The Purchase Price shall be allocated as follows:

[*List assets by class (see Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2), 1.1060-1T(d)(2),) e.g.:*]

(1) _____ [*specify any cash, or checking or savings accounts of business (identified by institution and account number*)]: $_____.

(2) _____ [*describe any certificates of deposit, U.S. government securities, and readily marketable stock or securities*]: $_____.

(3) Inventory: $_____.

(4) Furniture, fixtures, and equipment: $_____.

(5) Accounts receivable: $_____.

(6) Leasehold interest: $_____.

[*Add, if seller will execute covenant not to compete (see the form in § 17.213):*]

(7) Covenant not to compete: $_____.

[*CONTINUE*]

(8) _____[Other] [i]ntangibles, other than goodwill and going concern value: $_____.

(9) Goodwill and going concern value: $_____.

Section 3.02. Fair Market Value. Buyer and Seller each acknowledge that the amount of Purchase Price allocated to the Assets in Section 3.01 represents the fair market value of the Assets, determined pursuant to arm's-length negotiation. [Buyer and Seller further acknowledge that a tax attorney or other qualified advisor has explained the tax consequences of those allocations to them.] Buyer and Seller each agree to report the sale of the business for income tax purposes according to the allocations *set forth in Section 3.01*.

Article 4 TERMS OF PAYMENT

Section 4.01. Terms of Payment. The Purchase Price shall be payable as follows:

[*If payment will be entirely in cash:*]

The Purchase Price shall be paid at the Closing by delivery of a wire transfer of immediately available funds or a certified, cashier's or other check acceptable to Seller in the amount of $_____.

[*OR, if payment will be made in installments:*]

(a) At the Closing, Buyer shall deliver $_____ _____ by wire transfer of immediately available funds or a certified, cashier's or other check acceptable to Seller.

(b) Buyer shall pay the balance of the Purchase Price according to the terms of a promissory note executed by Buyer, substantially in the form of the note attached as "Exhibit _____," which note is secured pursuant to the terms of a security agreement in the form of the attached document marked "Exhibit _____" to be executed by Buyer and Seller, granting to Seller a security interest in the Assets.

(c) Buyer shall execute any financing statements prepared by Seller to perfect the security interests granted by the security agreement.

Article 5 ASSUMPTION OF LIABILITIES

Section 5.01. Assumption of Liabilities. Buyer shall assume and discharge all of Seller's liabilities or obligations appearing on the attached document marked "Exhibit _____" (the "Liabilities"). The value of the Liabilities is as stated on Exhibit _____.

Article 6 CLOSING

Section 6.01. Time and Place of Closing. The sale and purchase shall be closed on _____[*date*] (the "Closing Date"), at _____[*time*], at _____[*location*] (or at such other time, date or place as may be mutually agreed on by the parties hereto), pursuant to Sections 6.02 and 6.03, below (the "Closing"). [*Add, if sale is subject to Bulk Sales Division, consideration is $2 million or less, and is substantially all cash, an obligation to pay cash in the future, or a combination of the two (Com. Code § 6106.2); use in combination with*

provisions in form in § 17.210[2]: However, if the amount of consideration deposited with the _____ (Buyer *or* Escrow Agent) is insufficient to pay in full all claims timely filed with Escrow Agent, closing may be delayed for a period not less than 25 days nor more than 30 days after a notice to creditors is sent, in accordance with *Commercial Code Section 6106.4*.]

Section 6.02. Delivery by Seller. At the Closing, Seller shall deliver to Buyer all of the following:

(1) A bill of sale executed by Seller, conveying to Buyer the Assets.

(2) Any other instruments required to transfer to Buyer the ownership of any of the Assets.

(3) _____ [*Other documentation particular to the business or negotiated as part of the transaction, including assignments, consents, etc.*]

(4) A tax clearance certificate from the Employment Development Department showing that no amounts are due from Seller on account of the Business for unemployment compensation insurance contributions, disability compensation insurance contributions, or state income taxes withheld from employee wages.

[*Add, if business involves any retail sales:*]

(5) A tax clearance certificate from the Board of Equalization showing no amounts are due from Seller for sales tax obligations resulting from operation or sale of the Business.

Section 6.03. Delivery by Buyer. At the Closing, Buyer shall deliver to Seller all of the following:

(1) A wire transfer of immediately available funds or certified or cashier's check in the amount of $_____.

(2) Instruments required to transfer to Buyer the Liabilities.

(3) _____ [*Other documentation particular to the business or negotiated as part of the transaction, including assignments, consents, etc.*]

Article 7 WARRANTIES OF SELLER

Section 7.01. Seller's Warranties. Seller hereby warrants and represents the following to Buyer:

(a) Seller is the sole owner of the Business, and no other person has any claim, right, or title to, or interest in, the Business or the Assets [*add, if applicable:*, except as shown on the attached schedule marked "Exhibit _____"].

(b) Seller has no undischarged obligations affecting the Business or Assets other than obligations arising in the usual and regular course of business listed in the attached document marked "Exhibit _____."

(c) Seller has paid, or shall pay, all taxes owed by Seller on account of the Business.

(d) The books of account for the Business constitute a complete record of the financial affairs of the Business and accurately set forth all liabilities, assets, and other matters regarding the financial condition of the Business. Buyer acknowledges that _____[he *or* she] inspected the books of account on _____[*date*],

at the office of _____[*specify, e.g.,* _____ (*name*), C.P.A.].

(e) To the best of Seller's knowledge, the purchase and sale will not conflict with or violate any agreement or law to which Seller or the Business is subject, and there are no pending or threatened lawsuits, other judicial proceedings, or administrative proceedings involving Seller or the Business.

(f) The tangible Assets shown on the attached inventory marked "Exhibit _____" are in good condition and repair, excluding reasonable wear and tear.

(g) _____[*Other warranties regarding the condition, existence, or accuracy of, or title to, other significant items, such as intellectual property, hazardous materials, customer or vendor lists, sales contracts and bids, inventories, purchase orders, accounts receivable and payable, financial statements*].

Article 8 COVENANTS OF SELLER

Section 8.01. Conduct of Business. Until the Closing, Seller will continue to conduct the business in the ordinary course and will not, without the prior written consent of Buyer, incur any liability other than in the ordinary course of business, encumber or permit to be encumbered any of the Assets, dispose of any of the Assets except in the regular and ordinary course of business, or pay or commit to pay any bonus or special remuneration to any employee.

Section 8.02. Risk of Loss. Until the Closing, all risk of loss to the Assets and loss, damage or destruction to the Assets shall be borne by Seller and the Purchase Price shall, in case of any such loss, damage or destruction, be reduced by the value of the damaged or destroyed Assets in accordance with the value set forth on Exhibit _____ (the Inventory).

Section 8.03. Confidentiality. Seller shall not divulge, communicate, use to the detriment of Buyer or for the benefit of any other person or persons, or misuse in any way, any of Buyer's confidential information discovered by or disclosed to the Seller as a result of the delivery, execution or performance of this Agreement.

Section 8.04. _____[*Other negotiated covenants, regarding such issues as access to information, regulatory approvals, assignments, possession*].

Section 8.05. Further Assurances. Seller agrees to cooperate fully with Buyer and to execute such further instruments, documents and agreements and to give such further written assurances, as may be reasonably requested by Buyer, to better evidence and consummate the transactions described herein and contemplated hereby, and to carry into effect the intents and purposes of this Agreement.

Article 9 COVENANTS OF BUYER

Section 9.01. Confidentiality. Buyer shall not divulge, communicate, use to the detriment of Seller or for the benefit of any other person or persons, or misuse in any way, any of Seller's confidential information discovered by or disclosed to Buyer as a result of the delivery, execution or performance of this Agreement.

Section 9.02. _____[*Other negotiated covenants*].

Section 9.03. Further Assurances. Buyer agrees to cooperate fully with Seller and to execute such further instruments, documents and agreements and to give such further written assurances, as may be reasonably requested by Seller, to better evidence and consummate the transactions described herein and contemplated hereby, and to carry into effect the intents and purposes of this Agreement.

Article 10 CONDITIONS PRECEDENT

Section 10.01. Conditions Precedent to Obligations of Buyer. Closing of the purchase and sale of the Assets and Buyer's obligation to purchase the Assets are expressly conditioned on _____[*list conditions that must be satisfied by Seller before Buyer is obligated to perform under the Agreement; conditions such as obtaining licenses, obtaining insurance, no litigation threatened or pending, the accuracy of the warranties, performance of all covenants, compliance with bulk sales requirements, deliverance of all documents*].

Section 10.02. Conditions Precedent to Obligations of Seller. Closing of the purchase and sale of the Assets and Buyer's obligations to purchase the Assets are expressly condition on: _____ _____[*list conditions that must be satisfied by Buyer before Seller is obligated to perform under the Agreement; conditions such as no litigation threatened or pending, the accuracy of the warranties, delivery of purchase price and documents*].

Article 11 PRORATION

Section 11.01. Prorations. Buyer and Seller shall prorate all of the following, on the basis of 30-day months, as of 12:01 A.M. Pacific time on the date specified in paragraph 6 for the closing:

(a) All personal property taxes levied or assessed against any of the business assets subject to this Agreement for the current tax year, based on the amount shown on the latest tax bill.

(b) All premiums on insurance policies insuring the business or the assets to be transferred to Buyer, that have been approved by and are being transferred to Buyer pursuant to Section 15.01.

(c) Salaries of the employees shown on the attached schedule marked "Exhibit _____."

(d) All social security taxes, and contributions to union, pension, Christmas bonus, or vacation funds accruing during the pendency of the purchase and sale for the business employees shown on the attached schedule marked "Exhibit _____."

(e) The rent of the premises occupied by the business pursuant to the lease between Seller and _____[*name of lessor*] dated _____.

(f) Charges accruing on any service contracts shown on the attached schedule marked "Exhibit _____."

(g) The rent of the equipment leased by the business, listed on the attached schedule marked "Exhibit _____."

(h) _____[*Describe any other costs or expenses that will be prorated*].

Article 12 INVENTORY

Section 12.01. Inventory. Attached as Exhibit _____ is a complete inventory as of _____[*date*], of the stock in trade and merchandise, raw materials, work in progress and finished goods to be sold and purchased under this Agreement (the "Inventory").

Section 12.02. Items Included. All items on the premises occupied by the Business when the inventory was taken that are of a quality usable in the ordinary course of the Business or saleable to customers under existing contracts or otherwise in the ordinary course of business are included in the Inventory and only items that are of a quality usable in the ordinary course of the Business or saleable to customers under existing contracts or otherwise in the ordinary course of business are included in the Inventory.

Section 12.03. Valuation. All items in the Inventory shall be valued according to the _____[*specify valuation method*] method of valuation.

Article 13 INDEMNIFICATION

Section 13.01. Buyer's Indemnification. Buyer shall indemnify and hold Seller harmless from any and all liabilities and obligations arising from Buyer's operation of the business after the Closing.

Section 13.02. Seller's Indemnification. Seller shall indemnify and hold Buyer harmless from any and all liabilities and obligations arising from Seller's operation of the business prior to the Closing, except for the Liabilities. [*Add, if buyer will insure or self-insure against products liability arising from seller's sales:* Seller, however, has no duty to indemnify Buyer when both of the following conditions are true: (1) the liability is for injury or damage caused by a defect in the design or manufacture of a product sold by Seller in the course of Seller's operation of the business, and (2) Seller has no actual knowledge of the liability or potential liability at the closing. Under these conditions, Buyer agrees to indemnify and hold Seller harmless from liability.]

Article 14 PAYMENTS OF COSTS AND EXPENSES

Section 14.01. Costs and Expenses. Except as expressly provided to the contrary in this Agreement, each party shall pay all of its own costs and expenses incurred with respect to the negotiation, execution and delivery of this Agreement and the exhibits hereto.

Article 15 INSURANCE

Section 15.01. Insurance Policies. Within _____[*specify time period, e.g.*, 10 days after execution of this contract], Seller shall provide buyer with a list of all insurance policies insuring the business or the assets of the business listed in Section 1.01 of this Agreement. This list shall include (1) the number of each policy; (2) the name and address of the insurance company and agent that issued each policy; (3) the premium payable on each policy; and (4) the beginning and expiration dates of each policy. Buyer shall determine which, if any, of those policies Buyer wishes to assume, and shall approve or reject in writing each insurance policy so listed, within _____[*specify time period, e.g.*, 10 days after receipt]. Buyer shall obtain the consent of the insurers to the transfer of those policies that Buyer wishes to assume, and shall provide Seller copies of the consents together with Buyer's written approvals of the policies to be assumed. Failure to notify Seller regarding assumption of insurance policies, or to obtain any insurer's consent, shall be deemed an election not to assume.

Article 16 MISCELLANEOUS PROVISIONS

Section 16.01. Arbitration. Any dispute arising under this Agreement, shall be settled by arbitration in accordance with _____[*specify method of arbitration or refer to specific rules, e.g.,* the Commercial Arbitration Rules of the American Arbitration Association], and judgment on the award rendered by the Arbitrator may be entered in any court having jurisdiction.

Section 16.02. Attorneys' Fees. If Buyer or Seller brings any legal action or seeks arbitration regarding any provision of this agreement, the prevailing party in the litigation or arbitration shall be entitled to recover reasonable attorneys' fees from the other party, in addition to any other relief that may be granted. This provision applies to _____[*specify, e.g.*, the entire agreement]. Buyer and Seller were each represented by an attorney in the negotiation and execution of the agreement.

Section 16.03. Survival of Agreements. Subject to the express limitations contained in this Agreement, all covenants, agreements, representations and warranties made in this Agreement shall survive the execution and delivery of this

Agreement and the consummation of the transactions contemplated by this Agreement.

Section 16.04. Entire Agreement. This Agreement constitutes the entire agreement between Buyer and Seller concerning their rights and obligations with respect to the sale and purchase of the business. Any agreements or representations respecting the business or its sale to Buyer not expressly set forth in this Agreement shall have no effect, except for a subsequent written modification signed by the party to be charged.

Section 16.05. Amendment of Agreement. This Agreement may be amended or modified at any time with respect to any provision by a written instrument executed by Buyer and Seller.

Section 16.06. Notices. Any notice required or permitted to be given under this Agreement shall be written, and may be given by personal delivery or by registered or certified mail, first-class postage prepaid, return receipt requested. Notice shall be deemed given upon actual receipt in the case of personal delivery, or upon mailing. Mailed notices shall be addressed as follows, but each party may change address by written notice in accordance with this paragraph:

To Buyer: _____ [*street address*],
_____ [*city*], California.

To Seller: _____ [*street address*],
_____ [*city*], California.

Section 16.07. Assignment. Neither Buyer nor Seller shall assign any right or interest arising under this Agreement without the prior written consent of the other.

Section 16.08. Effect on Heirs and Assigns. This Agreement shall be binding on and shall inure to the benefit of the heirs, executors, administrators, successors, and assigns of Buyer and Seller.

Section 16.09. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of California.

Executed on _____[*date*], at _____, California.

SELLER
_____ [*signature of seller*]
[*typed name*]
BUYER
_____ [*signature of buyer*]
[*typed name*]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
A. Complete Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.201

AUTHOR: Marilyn E. Minger Revision Author

§ 17.201 Contract of the Sale of Business and Real Property

[1] Comment

[a] Use of Form

This form is a contract for a bifurcated sale of a business and the real property on which the business is operated. It is designed for a sale that is not subject to the Bulk Sales Division of the Commercial Code ("Bulk Sales Division") [*see Com. Code §§ 6101-6111*]. For discussion of the Bulk Sales Division and an example of a contract for the sale of a business subject to its requirements, see the form in *§ 17.210*. Separate escrow instructions for such a sale are set forth in the form in *§ 17.250*. For an example of a contract for the sale of a professional practice, see the form in *§ 17.211*.

[b] Combined Sale of Business and Real Property

This contract contemplates two different but interdependent sales. The sale of the real property on which the business is conducted requires different procedures than the sale of the business, and is often handled by a different agency or person than the one handling the sale of the business. This form assumes that a title insurance company will handle the sale of the real property through an escrow [*see* [2], Section 3.05, *below*], and that an attorney will handle the sale of the business and personal property [*see* [2], Section 2.04, *below*]. Even if a commercial escrow company were to handle both parts of the sale, it would use separate escrows for each type of transaction. This contract is structured so that closing the sale of the business is conditioned on closing the real property sale, and vice versa [*see* [2], Sections 2.07, 3.07, *below*].

[c] Sale of Business

Because this form contemplates the sale of a business that is not subject to the Bulk Sales Division [*see Com. Code §§ 6101-6111*; *see also § 17.20*], it does not require use of the escrow typically established for a sale subject to those provisions [*see § 17.210*]. If the parties wish to use an escrow, however, the form may be modified accordingly. This

form requires the buyer to deposit the purchase price for the business with the attorney handling the sale for withholding until he or she receives a certificate of tax clearance for the business from the Employment Development Department [*see Unemp. Ins. Code §§ 1732, 1733*; *see also* [2], Section 2.06, *below* ; *§ 17.14[3]*]. It also contains an optional provision requiring a certificate of tax clearance from the Board of Equalization when applicable [*see Rev. & Tax. Code §§ 6811, 6812*; *see also* [2], Section 2.06, *below*]. For example, a business that is not subject to the Bulk Sales Division because its principal business is not the sale of merchandise (for example, a hair salon that sells shampoo) [*see Com. Code § 6102(a)(3)*] might nonetheless sell a limited amount of merchandise requiring a sales permit and tax clearance [*see § 17.14[2]*].

This comment discusses only those provisions unique to this form. For discussion of the various form provisions generally applicable to the sale of a business, see the discussion in *§ 17.200[1]*.

[d] Issuance of License

This form requires the buyer to obtain a state license for operation of the business, as well as any necessary county or city licenses or permits, as a condition of closing [*see* [2], Section 2.09, *below*]. The issuance of a state license to the buyer may require examination of the business premises, as well as examination of the buyer's qualifications. For example, the sale of a nursing facility requires issuance of a new license, which will not be issued without a safety, zoning, and building clearance [*see 22 Cal. Code Reg. §§ 72201, 72205*].

[e] Sale of Real Property

This form contains a basic contract of sale for the real property on which the business is operated. It provides for the sales transaction to be handled pursuant to an escrow. For discussion of escrow and escrow instructions, see *§ 17.250*; also see *§ 17.210[2]*.

Subsections [f] through [i], *below*, summarize the legal requirements applicable to real property sales agreements. For a basic contract for the sale of real property and extensive discussion of its provisions, see *Ch. 23, Real Property Sales Agreements, § 23.200*.

[f] Payment of Purchase Price

A real property sales agreement must provide for sufficient consideration [*see Civ. Code § 1550(4)*], which usually consists of the payment of a specified purchase price in exchange for transfer of title. The agreement must also adequately describe the terms and manner of payment [*Dennis v. Overholtzer (1960) 178 Cal. App. 2d 766, 774, 3 Cal. Rptr. 193* (disapproved on other grounds in *Ellis v. Mihelis (1963) 60 Cal. 2d 206, 221, 32 Cal. Rptr. 415, 384 P.2d 7*)]. This form provides for a down payment, and payment of the balance of the purchase price at close of escrow [*see* [2], Sections 3.02, 3.03, *below*]. For examples of alternative payment and financing provisions, see Ch. 23, *Real Property Sales Agreements* .

[g] Risk of Loss

Any contract made in California for the purchase and sale of real property will be interpreted as including an agreement that the parties will be bound by the Uniform Vendor and Purchaser Risk Act, unless the contract expressly provides otherwise [*Civ. Code § 1662*]. Under the Act, if all or a material part of the property is destroyed without fault of the buyer or taken by eminent domain, the seller cannot enforce the contract, and the purchaser is entitled to recover any portion of the purchase price that he or she has already paid [*Civ. Code § 1662(a)*]. After the legal title or possession has transferred to the buyer, the buyer bears the loss from destruction or eminent domain. The buyer is not relieved from a duty to pay the price, nor entitled to recover any portion already paid [*Civ. Code § 1662(b)*; *see Section 3.12* of form].

[h] Liquidated Damages

This form contains a liquidated damages provision that governs the seller's remedies in the case of a default by the buyer [*see* [2], Section 3.17, *below*]. Such a provision is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made [*Civ. Code §§ 1671(b), 1676*; *see Weber, Lipshie & Co. v. Christian (1997) 52 Cal. App. 4th 645, 656-657, 60 Cal. Rptr. 2d 677* (partnership agreement's liquidated damages provision, which provided that damages to accounting firm for loss of fees from breach of covenant would be measured by doubling firm's time charges for clients lost due to breach for 12 months immediately preceding their loss, was enforceable under *Civ. Code § 1671*)]. Further, the provision is valid only if (1) it is separately signed or initialed by each party to the contract, and (2) if included in a printed contract, it is set out either in at least 10-point bold type or in contrasting red print in at least 8-point bold type [*Civ. Code § 1677*].

[i] Time of the Essence

Most real property sales agreements provide that time is of the essence [*see* [2], Section 3.18, *below*]. This permits a party to insist on performance by the date specified for the close of escrow. Without it, later performance may have to be tolerated if it is tendered within a "reasonable time." However, a party may waive such a provision by conduct or express waiver. For example, a party waives the requirement by performing after the date [*see Lifton v. Harshman (1947) 80 Cal. App. 2d 422, 433, 182 P.2d 222 , disapproved on other grounds, Lee v. Gregoriou (1958) 50 Cal. 2d 502, 506, 326 P.2d 135]* , or by accepting performance after the date [*see Chin Ott Wong v. Title Ins. & Trust Co. (1948) 89 Cal. App. 2d 183, 186-188, 200 P.2d 541]* .

[j] Standard Contractual Provisions

Most written agreements include certain standard provisions regarding topics such as governing law, notice, and amendment of the contract [*see* [2], Article 4, *below*]. For discussion of attorneys' fees, see *§ 17.200[1][q]*. For a discussion of arbitration provisions, see *§ 17.200[1][r]*.

[k] Optional Contract Provisions

Depending on the nature of the business being sold, other provisions may be added to or substituted for the provisions in this contract. For provisions governing the parties' conduct before and after the sale, see *§§ 17.215[2], 17.216[2]*. If the business being sold is subject to a franchise agreement, see *§§ 17.280[2]* and *17.281[2]*. For other miscellaneous provisions, see *§§ 17.210[2]-17.220[2]*.

[2] FORM

Contract of the Sale of Business and Real Property

CONTRACT OF SALE OF BUSINESS AND REAL PROPERTY

This agreement is made on _____[*date*], between _____[*name of seller(s) and capacity, e.g.*, John and Jane Smith, husband and wife], Seller[s], and _____[*name of buyer(s) and capacity*], Buyer[s].

Recitals

Seller is the owner of a _____[*describe type of business, e.g.*, travel agency] business known as "_____" [*name of business*] ("the business"), located at _____[*address*], _____[*city*], [*add, if noncompetition agreement will be used (see § 17.213):* in _____ County], California. Seller also owns the real property on which the business is operated. Seller desires to sell the

business and real property to Buyer, and Buyer desires to purchase the business and real property from Seller. The business, assets of the business, and real property on which the business is located are hereafter collectively referred to as "the Property."

Therefore, Buyer and Seller agree as follows:

ARTICLE 1 PURCHASE AND SALE

Section 1.01. Sale of Real Property. Seller shall sell to Buyer and Buyer shall purchase from Seller the following, on the terms and conditions and in the manner set forth in Article III of this contract, the following property (hereafter collectively referred to as the "Real Property"):

(a) The real property on which the business is located, in _____[the City of _____, *or* an unincorporated area of] _____ County, California, and more particularly described _____[as follows: _____ (*set forth legal description*) *or* in the document attached as "Exhibit _____"].

(b) All improvements and fixtures located on the real property described in subparagraph (a) [*describe, if desired, e.g.*,, including the office building known as _____ (*describe*), at _____ (*address*), and those fixtures shown on the attached inventory marked "Exhibit _____"] (hereafter referred to as the "improvements and fixtures").

Section 1.02. Sale of Business Assets. Seller shall sell to Buyer, and Buyer shall purchase from Seller, on the terms and conditions and in the manner set forth in Article II of this contract, the following personal property assets of the business (hereafter called "the Business Assets"):

(a) All the furniture, equipment, and other tangible assets, other than any improvements and fixtures described in Section 1.01(b) shown on the attached inventory marked "Exhibit _____" [*add if desired:*, with the following exceptions: _____ (*describe any exceptions*)];

(b) All the trade, goodwill, and other intangible assets; and

(c) All of the accounts receivable shown on the attached schedule marked "Exhibit _____."

Section 1.03. Additional Provisions. The sales and purchases of the Business Assets and Real Property described in Sections 1.01 and 1.02 and in Articles 2 and 3 of this contract shall, in addition to the matters specified in those articles, be subject to all the terms, conditions, and provisions set forth in Article 4 of this contract. Article 4 shall apply to all portions of this contract.

ARTICLE 2 SALE OF BUSINESS ASSETS

Section 2.01. Purchase Price. The purchase price for the Business Assets shall be $_____, allocated in accordance with Section 4.01.

Section 2.02. Payment of Purchase Price. The purchase price *set forth in Section 2.01* shall be payable as follows:

(a) The sum of $_____, on execution of this contract.

(b) The remainder of the purchase price on or before closing.

[*OR, if the purchase price will be payable in installments. See § 17.200[2], Section 4.01.*]

Section 2.03. Warranties by Seller. Seller hereby warrants and represents to Buyer that:

(a) Seller is the sole owner of the business, and no other person has any claim, right, title to, or interest in, the Business Assets [*add, if applicable:*, except as shown on the attached schedule marked "Exhibit _____"].

(b) Seller has no undischarged obligations affecting the Business Assets being sold pursuant to this contract, other than obligations arising in the usual and regular course of business listed in the attached document marked "Exhibit _____."

(c) Seller has paid, or shall pay, all taxes owed by Seller on account of the business.

(d) The books of account for the business constitute a complete record of the financial affairs of the business and accurately set forth all liabilities, assets, and other matters regarding the financial condition of the business. Buyer acknowledges that _____[he *or* she] inspected the books of account on _____[*date*], at the office of _____[*specify, e.g.*, _____ (*name*), C.P.A.].

(e) To the best of Seller's knowledge, the purchase and sale will not conflict with or violate any agreement or law to which Seller or the business is subject, and there are no pending or threatened lawsuits, other judicial proceedings, or administrative proceedings involving Seller or the Business.

(f) If any state, county, or city governmental authorities require any repairs or alterations to the premises as a condition to issuing to Buyer an initial license or permit required to operate the business, _____[Buyer *or* Seller] shall cause the repairs, alterations, or work to be performed to the satisfaction of the licensing or inspecting authorities at _____[Buyer's *or* Seller's] own cost and expense, within _____[*number*] days after notification from Buyer of the need for the repairs or alterations.

Section 2.04. Time and Place of Closing. The sale and purchase of the Business Assets shall be closed at _____[*time*] on _____[*date*], or the third business day after the conditions specified in Section 2.07 of this contract have all been met, whichever shall occur last, at the office of _____[*name*], Attorney at Law, _____[*address*]. As used in this contract, "closing" means the passing of title to the Business Assets listed in Section 1.02, from Seller to Buyer.

Section 2.05. Delivery of Instruments. At the time and place specified in Section 2.04 for closing, on Buyer's payment of the purchase price described in Section 2.02, Seller shall deliver the following to Buyer:

(a) A bill of sale executed by Seller, conveying to Buyer all the Business Assets of the business described in Section 1.02 of this contract.

(b) Any other instruments required to transfer to Buyer the ownership of any of the Business Assets described in Section 1.02 of this contract.

(c) A statement or certificate from the Employment Development Department showing that no amounts are due from Seller on account of the business for unemployment compensation insurance contributions, disability compensation insurance contributions, or state income taxes withheld from employee wages.

[*Add, if business involves any retail sales:*]

(d) A certificate from the Board of Equalization showing no amounts are due from the Seller for sales tax obligations resulting from operation or sale of the business.

[*CONTINUE*]

Section 2.06. Withholding of Purchase Price. If Seller is unable to deliver to Buyer at closing the certificate[s] from the Employment Development Department [*add if applicable:* and the Board of Equalization] specified in Section 2.05 of this Contract, Buyer shall deposit the portion of the purchase price payable to Seller pursuant to Section 2.01 of this contract to _____[*repeat name of attorney set forth in Section 2.04*] (hereafter referred to as "the trustee"), to be held in trust pursuant to the terms and conditions specified in this section.

If the trustee receives any funds pursuant to this section, the trustee shall

(a) Deposit the money received pursuant to this section in a trust account reserved for client's funds;

(b) Request on behalf and in the name of Buyer, unless received from Seller within 24 hours after the closing, a statement of amount due or certificate of tax clearance from the Employment Development Department [*add if applicable:* and from the Board of Equalization].

(c) Within 24 hours after receiving the statement(s) or certificate(s) described in subparagraph (b)

(1) Pay to the Employment Development Department from the money deposited by Buyer any amount shown to be due from Seller on the statement received from the Employment Development Department.

[*Add, if applicable:*]

(2) Pay to the Board of Equalization from the money deposited by Buyer any amount shown to be due from Seller on the statement received from the Board of Equalization.

[*CONTINUE*]

(3) Pay any remaining balance to the Seller.

Section 2.07. Conditions Precedent to Sale. Closing of the purchase and sale of the Business Assets described in Section 1.02 of this contract, and Buyer's obligation to purchase the Business Assets described in that section, are expressly conditioned on the following:

(a) Issuance to Buyer [*prior to* _____ (*date*)] by _____[*specify licensing state agency, e.g.,* the Department of Consumer Affairs] of a license to operate the business on the premises on which it is presently located;

(b) Issuance to Buyer [*prior to* _____ (*date*)] by the _____[City *or* County] of _____ of a _____[*describe required license or permit, e.g.,* business license] for Buyer's operation of the business on the premises on which it is presently located;

(c) Closing of the Real Property escrow described in Article III of this contract, and conveyance to Buyer of good and marketable title to the Real Property described in Section 1.01 of this contract, in the manner prescribed in Article III of this contract.

Section 2.08. Failure of Conditions. If any of the conditions *set forth in Section 2.07* of this contract fails to occur, Buyer shall have the power, exercisable by written notice to Seller in the manner prescribed in this contract, to terminate this contract, cancel the purchase and sale described in it, and recover any money paid to Seller or

_____[*name of attorney acting as trustee*] as trustee on account of the purchase price described in Section 2.01 of this contract.

Section 2.09. License Applications by Buyer. Buyer shall, at Buyer's own expense, within _____[*specify time, e.g.,* 48 hours] after executing this contract, apply for the licenses and permits specified in Section 2.07 of this contract, and thereafter take any other actions required to obtain those licenses and permits.

Section 2.10. Conduct of Business. Until the closing, Seller shall continue to operate the business in the same manner as Seller has operated it in the past.

Section 2.11. Risk of Loss. Until the closing, Seller shall bear all risk of loss, damage, or destruction to the Business Assets. If any loss, injury, damage, or destruction substantially impairs the value of the Business Assets prior to the closing, Buyer may either terminate this contract, or proceed to closing and receive an assignment of applicable insurance proceeds. If any such loss, injury, damage, or destruction interrupts conduct of the business prior to the closing for a period of _____[*specify time, e.g.,* 30 days], Buyer may terminate this contract. The Buyer shall bear the risk of loss after the closing.

Section 2.12. Proration of Taxes. Buyer and Seller shall prorate all of the following, on the basis of 30-day months, as of 12:01 A.M. Pacific time on the date specified in Section 2.04 for the closing: _____[*list all items to be prorated (see, e.g., 17.200[2], Section 11.01)*].

Section 2.13. Costs and Expenses. All costs and expenses incurred in conducting the purchase and sale described in Section 1.01 of this contract in the manner prescribed by this Article shall be borne by Buyer and Seller in the following manner: _____[*specify, e.g.:*]

(a) The cost of drafting all instruments necessary to convey the Business Assets described in Section 1.02 of this contract to Buyer shall be paid by Seller;

(b) The cost of drafting all instruments evidencing or securing the payment to Seller of the purchase price specified in Section 2.01 of this contract shall be paid by Buyer;

(c) The cost of recording or perfecting all instruments evidencing or securing the payment to Seller of the purchase price specified in Section 2.01 of this contract shall be paid by Seller;

(d) The cost and expense of obtaining any license or permit required by Section 2.07 of this contract or required by law for the operation of the business by Buyer shall, except as provided in Section 2.03 of this contract, be paid by Buyer;

(e) All sales taxes arising because of the sale pursuant to this contract of the business to Buyer shall be paid by Seller;

(f) All other costs and expenses arising from the performance of the terms and conditions of this Article or the purchase and sale described in Section 1.02 of this contract shall be borne equally by Buyer and Seller.

ARTICLE 3 SALE OF REAL PROPERTY

Section 3.01. Warranties of Seller. Seller warrants the following:

(a) Seller owns the Real Property described in Section 1.01 free and clear of all liens, licenses, claims, encumbrances, easements, encroachments on the Real Property from adjacent properties, encroachments by

improvements on the Real Property onto adjacent properties, and rights of way of any nature, not disclosed by the public record, other than: _____[*specify exceptions, including any off-record items such as unrecorded leases*].

(b) Seller has no knowledge of any pending litigation involving the Real Property.

(c) Seller has no knowledge of any violations of, or notices concerning defects or noncompliance with, any applicable building code or other code, statute, regulation, ordinance, judicial order, or judicial holding pertaining to the Real Property.

(d) Seller is not in default under any contract, note, or encumbrance relating to the Real Property.

(e) Seller has no knowledge of any material defects in the real property and the improvements and fixtures on the real property other than those listed in the schedule attached as "Exhibit _____," and, except for those defects, the improvements and fixtures are in good condition, reasonable wear and tear excepted.

Section 3.02. Amount of Purchase Price. The total purchase price of the Real Property is $_____, allocated as follows:

(a) The sum of $_____ for the land described in Section 1.01(a).

(b) The sum of $_____, apportioned as specified in the attached schedule marked "Exhibit _____," for the improvements and fixtures described in Section 1.01(b).

Section 3.03. Payment of Purchase Price. The total purchase price specified in Section 3.02 of this contract shall be payable by Buyer to Seller as follows:

(a) The sum of $_____ on execution of this contract, as a deposit to be applied to the purchase price at the close of escrow. This amount shall be payable _____[*specify, e.g.*, by certified or cashier's check drawn to the order of _____ (*name of escrow agent*)]; and

(b) The balance of the purchase price at the close of escrow, payable _____[*specify, e.g.*, in cash *or* by certified or cashier's check drawn to the order of Seller].

[*For alternative payment provisions, see Ch. 23, Real Property Sales Agreements.*]

Section 3.04. Termination of Contract. If Buyer defaults in the performance of this Contract, the deposit described in Section 2.02 shall be forfeited as provided in Section 3.17. If this Contract is terminated for any other reason, the deposit shall be refunded to Buyer pursuant to Section 3.08.

Section 3.05. Opening of Escrow. An escrow shall be opened for the sale of the Real Property according to the terms of this Contract at the office of _____[*name and title of escrow agent*] ("Escrow Agent") at _____[*address*], within _____ days after the execution of this contract. Written escrow instructions shall be prepared by _____[*specify, e.g.*, the Escrow Agent *or* Buyer and Seller jointly *or* each party].

Section 3.06. Closing of Escrow. The escrow shall be closed on the date the deed is recorded. [The escrow shall be considered to be in a condition to close when the Escrow Agent is authorized under the escrow instructions, and when the Escrow Agent is otherwise able, to record the grant deed]. The escrow must be _____[in a condition to close *or* closed] no later than _____[*date*], unless the closing date is extended pursuant to the terms of this Contract. However, in no event shall the escrow be closed prior to 10 A.M. on _____[

date specified in Section 2.04 of the contract for earliest possible closing of purchase and sale of business].

Section 3.07. Conditions of Escrow. The close of the escrow described in Section 3.06 of this contract and Buyer's obligation to purchase the Real Property are subject to the satisfaction of the following conditions:

(a) The conveyance to Buyer of good and marketable title to the Real Property, as evidenced by a standard form California Land Title Association title insurance policy issued by _____ Title Company in the full amount of the purchase price specified in Section 3.02 of this contract insuring that title to the Real Property is vested in Buyer free and clear of all title defects, liens, encumbrances, conditions, covenants, restrictions, and other adverse interest of record or known to Seller, and subject only to those exceptions approved by Buyer in writing, any exceptions shown on the preliminary title report described in Section 3.16 of this contract that are not disapproved by Buyer pursuant to that section, and _____[*list any additional exceptions*].

(b) The delivery of possession of the Property (with all keys to locks) to Buyer immediately on the close of escrow free and clear of all uses and occupancies except those approved in writing by Buyer.

(c) The occurrence of all the matters, except the closing of this escrow and the conveyance to Buyer of good and marketable title to the Real Property, specified in Section 2.07 of this contract.

(d) The ability of Buyer and Seller to close the purchase and sale described in Section 1.01 of this contract, within _____[*specify time, e.g.,* three days] after the close of this escrow.

Section 3.08. Failure of Conditions. If any of the conditions specified in Section 3.07 of this contract fails to occur, Buyer shall have the power, exercisable by giving written notice to the escrow holder and to Seller, to cancel the escrow, terminate this contract, and recover any amounts paid to Seller or to the escrow holder on account of the purchase price described in Section 3.02 of this contract. The exercise of this power by Buyer shall not constitute a waiver of any other rights Buyer may have against Seller for breach of this contract. Seller shall instruct the Escrow Agent in the escrow instructions to immediately refund to Buyer all money and instruments deposited in the escrow by Buyer pursuant to this Contract upon any failure of a condition and receipt of notice from Buyer.

Section 3.09. Proration. All of the following shall be prorated between Buyer and Seller, on the basis of 30-day months, as of 12.01 A.M. Pacific Time on the date of the close of the escrow described in Section 3.06 of this contract:

(a) The real property taxes levied or assessed against the Real Property for the current tax year based on the latest available tax bills;

(b) Interest on any obligations secured by encumbrances to which the Real Property will remain subject after close of escrow.

[(c) _____ (*List any other items to be prorated*)].

Section 3.10. Bonds. Any bonds or improvement assessments that are a lien on the Real Property shall, on close of escrow, be _____[paid by Seller *or* assumed by Buyer].

Section 3.11. Closing Costs. All costs and expenses incurred in the escrow described in this Article shall be borne by Buyer and Seller in the following manner: _____[*specify, e.g.:*]

(a) Seller shall pay the full cost of securing the title insurance policy described in Section 3.07(a) of this contract;

(b) Seller shall pay the cost of preparing, executing, and acknowledging all instruments required to convey good and marketable title to the Real Property to Buyer;

(c) Seller shall pay any tax imposed on the conveyance of title to the Real Property to Buyer;

(d) Buyer shall pay the cost of preparing, executing, and acknowledging all instruments evidencing or securing the payment to Seller of the purchase price specified in Section 3.02 of this contract;

(e) Buyer shall pay the cost of recording all instruments required to convey good and marketable title to the Real Property to Buyer;

(f) Buyer shall pay the cost of recording any instruments securing payment to Seller of the purchase price described in Section 3.02 of this contract;

(g) Buyer and Seller shall pay any and all other costs and expenses arising from the performance of the terms and conditions of this Article, including any escrow fee charged by the escrow holder in addition to the cost of the title insurance policy required by this contract, in equal proportions.

Section 3.12. Loss and Condemnation. (a) If the improvements and fixtures on the Real Property are destroyed or substantially damaged prior to the close of escrow without fault of Buyer, or if the Real Property is taken by eminent domain by any governmental entity, Buyer shall have the power, exercisable by the giving of written notice to Seller and to the escrow holder within _____[*specify, e.g.,* 48 hours after the destruction, damage, or taking], to cancel the escrow, terminate this contract, and recover any and all amounts paid to Seller or to the escrow holder on account of the purchase price specified in Section 3.01 of this contract. For these purposes, improvements and fixtures on the Real Property shall be deemed substantially damaged if the cost of restoring them to their condition as of the date of execution of this Contract was _____ percent of the total purchase price.

(b) If the improvements and fixtures on the Real Property are damaged prior to the close of escrow without fault of Buyer, and the loss is not covered under Subparagraph (a) of this Section, _____[*describe allocation of risk, e.g.,* Buyer shall not have the power to cancel the escrow and terminate this contract, but shall be entitled to offset the cost of repair or replacement against the purchase price of the Real Property].

(c) If the improvements and fixtures on the Real Property are destroyed or substantially damaged after the close of escrow, or if the Real Property is taken by eminent domain by any governmental entity, Buyer is not relieved from Buyer's obligation to pay the full price for the Real Property, nor to recover any portion of the price that Buyer has paid.

Section 3.13. Insurance. Seller shall cancel all policies of insurance on the Real Property as of the close of escrow. Buyer shall be responsible for obtaining insurance on the Real Property as of the close of escrow.

Section 3.14. Vesting of Title. Buyer shall advise the Escrow Agent prior to the close of escrow of the manner in which title shall vest.

Section 3.15. Brokers' Commissions. Seller shall pay any and all commissions due to real estate or other brokers as a result of the purchase and sale described in this contract.

Section 3.16. Preliminary Title Report. Within _____ days after execution of this Contract, Seller shall furnish Buyer with a preliminary California Land Title Association report of the title to the Real Property and each document shown as an exception or encumbrance in the report. This shall be done at the expense of _____[Buyer *or* Seller]. Within _____ days after the delivery of the report and related documents to Buyer, Buyer shall notify Seller in writing of any objection to any exceptions in the report. If Buyer makes a timely objection to any exception and the exception is not eliminated within _____ days of the Seller's receipt of the objection, this Contract shall be terminated. Buyer's failure to object in this manner to any exception shall be an approval by Buyer of that exception.

[*If contract is printed, set out following provision in at least 10-point bold type or in contrasting red print in at least 8-point bold type (Civ. Code §§ 1676, 1677(b)):*]

Section 3.17. Liquidated Damages. If Buyer defaults in the performance of this Contract, the parties agree that Seller shall be released from any obligation to sell the Real Property to Buyer and may retain, as liquidated damages, the deposit paid by Buyer on execution of this Contract pursuant to Section 2.02. Seller shall refund to Buyer the remainder of the deposit, if any. The parties further agree that the amount of liquidated damages established by this provision is a reasonable estimate, under the circumstances existing on the date of execution of this Contract, of what Seller's damages would be in the event of a default by Buyer.

Initialed by Buyer: _____.

Initialed by Seller: _____.

Section 3.18. Time of the Essence. Time is of the essence in this Contract.

ARTICLE 4 GENERAL PROVISIONS

Section 4.01. Allocation of Purchase Price. (a) The total purchase price for the Property shall be allocated as follows:

[*List property by class (see Temp. Treas. Reg. §§ 1.338(b)-2T(b)(2)(i), 1.1060-1T(d)(2)), e.g.:*]

(1) _____ [*Specify any cash, or checking or savings accounts of business (identified by institution and account number*)]: $_____.

(2) _____ [*Describe any certificates of deposit, U.S. Government securities, and readily marketable stock or securities*]: $_____.

(3) All property not included in other categories: $_____.

(4) All intangible property, except property in the nature of goodwill and going concern value: $_____.

(5) Goodwill and going concern value: $_____.

(b) Buyer and Seller acknowledge that the amount allocated to each item of Property represents its fair market value determined pursuant to an arm's-length negotiation. They further acknowledge that a tax attorney or other qualified advisor has explained the tax consequences of the allocations to them. Buyer and Seller each agree to report the sale of the Property for federal income tax purposes in accordance with the allocations set forth in this paragraph.

Section 4.02. Arbitration. Any dispute arising under this Agreement, shall be settled by arbitration in accordance with _____[*specify method of arbitration or refer to specific rules, e.g.,* the Commercial Arbitration Rules of the American Arbitration Association], and judgment on the award rendered by the Arbitrator may be entered in any court having jurisdiction.

Section 4.03. Attorneys' Fees. If Buyer or Seller brings any legal action or seeks arbitration regarding any provision of this agreement, the prevailing party in the litigation or arbitration shall be entitled to recover reasonable attorneys' fees from the other party, in addition to any other relief that may be granted. This provision applies to _____[*specify, e.g.,* the entire agreement]. Buyer and Seller were each represented by an attorney in

the negotiation and execution of the agreement.

Section 4.04. Survival of Agreements. Subject to the express limitations contained in this Agreement, all covenants, agreements, representations and warranties made in this Agreement shall survive the execution and delivery of this Agreement and the consummation of the transactions contemplated by this Agreement.

Section 4.05. Entire Agreement. This Agreement constitutes the entire agreement between Buyer and Seller concerning their rights and obligations with respect to the sale and purchase of the business. Any agreements or representations respecting the business or its sale to Buyer not expressly set forth in this Agreement shall have no effect, except for a subsequent written modification signed by the party to be charged.

Section 4.06. Amendment of Agreement. This Agreement may be amended or modified at any time with respect to any provision by a written instrument executed by Buyer and Seller.

Section 4.07. Notices. Any notice required or permitted to be given under this Agreement shall be written, and may be given by personal delivery or by registered or certified mail, first-class postage prepaid, return receipt requested. Notice shall be deemed given upon actual receipt in the case of personal delivery, or upon mailing. Mailed notices shall be addressed as follows, but each party may change address by written notice in accordance with this paragraph:

To Buyer: _____ [*street address*],
_____ [*city*], California.

To Seller: _____ [*street address*],
_____ [*city*], California.

Section 4.08. Assignment. Neither Buyer nor Seller shall assign any right or interest arising under this Agreement without the prior written consent of the other.

Section 4.09. Effect on Heirs and Assigns. This Agreement shall be binding on and shall inure to the benefit of the heirs, executors, administrators, successors, and assigns of Buyer and Seller.

Section 4.10. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of California.

Executed on _____[*date*], at _____[*place*].

SELLER
_____ [*signature of seller*]
[*typed name*]
BUYER
_____ [*signature of buyer*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
A. Complete Sales Contracts

8-17 California Legal Forms--Transaction Guide §§ 17.202-17.209

AUTHOR: Marilyn E. Minger Revision Author

[Reserved]

§§ 17.202[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
B. Additional and Alternative Provisions for Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.210

AUTHOR: Marilyn E. Minger Revision Author

§ 17.210 Bulk Sales Provisions

[1] Comment

[a] Use of Form

This form contains provisions that may be used to modify the contract for the sale of a business in § 17.200 when the sale is subject to the Bulk Sales Division. In a sale subject to the Bulk Sales Division, either the buyer or an escrow agent must be authorized to impound and control the distribution of the proceeds of the sale, and must apply the proceeds to the seller's debts before paying the seller. For discussion of the Bulk Sales Division, see *§ 17.20*.

If the buyer is going to distribute the proceeds, the contract for sale may be modified to include escrow instructions. This form contains a set of escrow instructions, that may be modified to suit the details of the particular transaction. However, if an escrow agent is going to be used, it may be preferable to use a separate escrow agreement so that the escrow agent does not become a party to the contract for sale. For a separate escrow agreement, see *§ 17.250*. If a separate escrow agreement is used, the escrow provisions in this form then become redundant and should be deleted.

[b] Compliance With Bulk Sales Law

A "bulk sale" is any sale outside the ordinary course of the seller's business of more than one half of seller's inventory and equipment, as measured by the fair market value on the date of the sale [*Com. Code § 6102(a)(3), (8), (15)*; *see Com. Code §§ 6102(b)(2), (3), 9102(a)(33)* ("equipment" defined), 9102(a)(48) ("inventory" defined)].

The Bulk Sales Division [*see Com. Code §§ 6101-6111*] applies to a bulk sale if (1) the seller's principal business is the sale of inventory from stock, including those who manufacture what they sell, or is that of restaurant owner [*Com. Code § 6103(a)(1)*]; and (2) the seller is located in California, or is located in a jurisdiction outside United States but has its major American executive office in California, on the date of the sale [*Com. Code § 6103(a)(2)*; *see Com. Code § 6103(c)* (exceptions)]. For further discussion, see *§§ 17.20[3], 17.111*.

[2] FORM

Bulk Sales Provisions

Article _____
Compliance With Bulk Sales Division

Section _____.01. Bulk Sales. The purchase and sale of the Assets shall be conducted in full compliance with the requirements of the Bulk Sales Division of the California Commercial Code.

Section _____.02. Appointment of Escrow Agent. _____[*name of escrow agent*], _____[*describe status of escrow agent, e.g.,* Buyer's attorney], whose offices are located at _____[*street address*], _____[*city*], California, is hereby appointed escrow agent ("Escrow Agent") to oversee compliance with the Bulk Sales Division.

Section _____.03. Parties' Obligations to Escrow Agent. (a) Buyer and Seller agree to be jointly and severally liable to indemnify Escrow Agent and hold Escrow Agent and his/her property free and harmless from any and all claims, loss, damage, or liability to either or both Buyer and Seller or to any other person arising as a result of this escrow because of the following:

(1) The failure of any condition or conditions of this escrow.

(2) Escrow Agent's failure to ascertain or comply with the terms of any document, other than these Instructions, unless that document is filed in this escrow and Escrow Agent is expressly instructed by these Instructions to comply with a specified paragraph or provision of that document.

(3) Forgeries or false impersonations.

(4) Exercise of Escrow Agent's discretion in any particular manner in any situation in which Escrow Agent is authorized by these Instructions to exercise his/her discretion.

(5) Any reason other than Escrow Agent's gross negligence or willful misconduct in following these Instructions and acting as escrow agent of this escrow.

(b) Buyer and Seller further agree to be jointly and severally liable to reimburse Escrow Agent for all costs and expenses incurred by Escrow Agent in fulfilling these Instructions and performing the duties as escrow agent of this escrow if they are not otherwise paid in the manner provided in these Instructions.

(c) Buyer and Seller further agree to be jointly and severally liable to pay Escrow Agent a reasonable fee for services in acting as escrow agent of this escrow and fulfilling these Instructions.

Section _____.04. Escrow Agent's Acceptance. I hereby accept the appointment and instructions to me as Escrow Agent set forth in this Agreement.
_____ Dated:

ESCROW AGENT
_____ [*signature of escrow agent*]
[*typed name*]

Section _____.05. Escrow Instructions. Buyer and Seller hereby instruct the Escrow Agent as

follows:

Instruction 1: Notice of Bulk Sale. Prepare a notice of bulk sale and obtain Buyer's signature on the notice in accordance with *Com. Code Section 6105*. At least 12 business days before Closing, (a) record the notice in the office of the county recorder of _____ County, (b) publish the notice, and (c) deliver or mail the notice to the county tax collector in the manner required by *Commercial Code Section 6105(b)*.

Instruction 2: Seller's Deposit Into Escrow. On or before _____[*closing date*], Seller shall deposit into escrow all of the following:

(a) A bill of sale executed by Seller conveying to Buyer:

(1) All the stock in trade and merchandise of the business as shown on a complete inventory and accounting of that stock in trade and merchandise to be taken on _____ [*date*], by _____ [*name of person or firm that will take inventory*] in accordance with Paragraph 9 of these Instructions.

(2) All the furniture, fixtures, equipment, and other tangible assets of the business as shown on the attached inventory marked "Exhibit _____" [*add if desired:*, with the following exceptions: _____ (*describe any exceptions*)].

(3) All the trade, business name, goodwill, and other intangible assets of the business.

(b) A valid assignment of lease executed and acknowledged before a notary public by Seller assigning to Buyer all Seller's interest under the lease dated _____ between Seller as Lessee and _____[*name of lessor*] as Lessor for the premises occupied by the business.

(c) A consent to Seller's assignment of the above lease, executed and acknowledged before a notary public by _____[*name of lessor*].

(d) The certificate of ownership issued by the California State Department of Motor Vehicles for each motor vehicle included in the fixtures and equipment of the business as shown on the attached inventory marked "Exhibit _____," executed by Seller in the manner required to transfer registered ownership of each vehicle to Buyer.

(e) Any other instruments, executed by Seller, that in your opinion are reasonably necessary or convenient to transfer, assign, or register ownership of any of the tangible or intangible assets of the business to and in the name of Buyer.

(f) A copy of the inventory of the stock in trade and merchandise of the business taken in accordance with subparagraph (a)(1) and approved with Seller's signature.

(g) The latest tax bills received by Seller from the County of _____ and other taxing authorities showing the amount or amounts of personal property taxes levied or assessed, either for the current tax year or the preceding tax year, on any of the fixtures and equipment of the business shown on the attached inventory marked "Exhibit _____."

(h) A list of all persons employed by Seller in connection with the business showing the following:

(1) Their names, social security numbers, positions, and salaries;

(2) The dates on which they are paid each month; and

(3) The amount of contributions accruing each pay period to union welfare and pension funds, Christmas bonus funds, and vacation funds for each employee.

(i) A list of all insurance policies insuring the business or the assets of the business and showing the following:

(1) The number of each policy;

(2) The insurance company and agent that issued each policy;

(3) The premium payable on each policy; and

(4) The beginning and expiration dates of each policy.

(j) Seller's written approval or rejection, within 24 hours after receipt, of all claims against the business received by you prior to _____[*specify, e.g.*, 10 o'clock A.M.] on _____[*date set for closing*], and submitted to Seller pursuant to Paragraph 11.

(k) The amount required to pay Seller's share of any prorations described in Paragraph 12 of these instructions.

(l) The amount required to pay the escrow fees and costs in accordance with Paragraph 20 of these instructions, including the following: _____[*list costs and expenses to be paid by Seller, e.g.:*]

(1) One half of the cost of publishing and recording all notices and other instruments required by the Bulk Transfers Division of the California Commercial Code to be published or recorded in connection with this escrow.

(2) One half of all costs, expenses, and charges incurred by you or by Buyer and Seller in taking inventory of the stock in trade and merchandise on _____ [*date*].

(3) The costs of recording all instruments reasonably necessary or convenient to effect the transfer to Buyer of the business and assets.

(4) One half of all other costs and expenses incurred by you or Buyer and Seller as a result of this escrow, other than (i) any sales taxes arising from the sale, and (ii) the costs of drafting and recording or perfecting any instruments described in these instructions that evidence or secure the payment of money by Buyer to Seller.

Instruction 3: Buyer's Deposit Into Escrow. On or before _____[*closing date*], Buyer shall deposit into escrow all of the following:

(a) The sum of $_____, immediately on receipt by you of these Escrow Instructions.

(b) The additional sum of $_____, on or before _____[*specify time, e.g.*, 10 o'clock A.M.] on _____[*date*], the time and date set for closing.

[*If purchase price will be paid in installments (see § 17.200[2], Section 4.01), add:*]

(c) A promissory note executed by Buyer, substantially in the form of the note attached as "Exhibit _____," that is secured in the manner set forth in Paragraph (d), below, and that sets forth provisions for the payment to Seller of the following:

(1) The principal balance of the note in monthly installments of $_____, commencing one month

after close of escrow; and

(2) Interest on the unpaid principal balance of the note from the close of escrow at the rate of _____ percent per year, payable monthly commencing one month after the close of escrow.

(d) A security agreement in the form of the attached document marked "Exhibit _____" to be executed by Buyer and Seller, granting to Seller a security interest in all of the property described in Paragraph 1 of this contract.

(e) Any financing statements prepared by Seller to perfect the security interests granted by the security agreement.

[*CONTINUE*]

(f) Approval or rejection of each insurance policy on the list of policies demanded and received by you from Seller pursuant to Paragraph 7.

(g) A copy of the inventory of the stock in trade and merchandise of the business taken as described in Paragraph 9 of this contract and approved with Buyer's signature.

(h) The amount required to pay Buyer's share of any prorations described in Paragraph 12 of these instructions.

(i) The amount required to pay the escrow fees and costs pursuant to Paragraph 20, including the following: _____[*list costs and expenses to be paid by Buyer, e.g.:*]

(1) One half of the cost of publishing and recording all notices and other instruments required by the Bulk Transfers Division of the California Commercial Code to be published or recorded in connection with this escrow;

(2) One half of all costs, expenses, and charges incurred by you or by Buyer and Seller in taking inventory of the stock in trade and merchandise on _____ [*date*], in accordance with Paragraph 9 of these Instructions;

(3) The costs of recording all instruments reasonably necessary or convenient to effect the transfer to Buyer of the business and assets; and

(4) One half of all other costs and expenses incurred by you or Buyer and Seller as a result of this escrow, other than (a) any sales taxes arising from the sale, and (b) the costs of drafting and recording or perfecting any instruments described in these instructions that evidence or secure the payment of money by Buyer to Seller.

Instruction 4: Handling Creditor Claims. On the receipt of each creditor claim against the business, determine whether claim was due and payable on or before the noticed sale date, and filed prior to the last date for filing claims specified in the Notice. Promptly submit all timely claims to Seller for approval or rejection.

Instruction 5: Sufficiency of Deposit. On the Closing Date, determine whether the amount deposited by Buyer into escrow is sufficient to pay in full all timely creditor claims filed with you.

Instruction 6: Distribution of Sufficient Proceeds. If the amount deposited by Buyer is sufficient, take the following actions:

(a) If you have received a statement of any amount owed to the Board of Equalization or Employment Development Department on account of Seller's business, that amount should be paid in full within _____ [*specify time for payment, e.g.*, 48 hours after receipt], then proceed pursuant to subparagraph (b).

(b) When you have received certificates of tax clearance from both the Board of Equalization and the Employment Development Department, distribute the Purchase Price within 45 days of Closing as follows:

(1) First, pay all claims against the Business received by you and approved by Seller.

(2) Second, set aside and retain in escrow the amount of any claim against the Business disputed by Seller pursuant to Instruction 3, above. Within two business days after distribution of undisputed claims, send written notice to the creditor stating that the claim has been disputed, that the amount otherwise payable on the claim is being retained in escrow, and that the amount otherwise payable will be paid to Seller unless attached within 25 days of the date of mailing of the notice.

(3) Third, if a writ of attachment is levied on the amount retained by you on account of any claim disputed by Seller within 25 days from the date of mailing notice, pay the amount to the officer levying the writ of attachment and obtain a receipt.

(4) Fourth, within 25 days after mailing the notice, pay to Seller the amount of all unattached claims.

(5) Fifth, pay any funds remaining on deposit with you to Seller.

Instruction 7: Distribution of Insufficient Proceeds. If the amount deposited is insufficient, take the following actions:

(a) If you have received a statement of any amount owed to the Board of Equalization or Employment Development Department on account of the Business, pay that amount in full, then proceed pursuant to subparagraph (b).

(b) After receiving tax clearance certificates from both the State Board of Equalization and the Employment Development Department, set aside and retain in escrow the pro rata amount of any claim against the Business disputed by Seller in accordance with Instruction 3. Within two business days after distribution of undisputed claims pursuant to subparagraph (c) of this instruction, send written notice to the creditor stating that the claim has been disputed, that the amount otherwise payable on the claim is being retained in escrow, and that the amount otherwise payable will be paid to the Seller or to other claimants if not already paid in full, unless attached within 25 days of the date of mailing of the notice.

(c) Within five days after the date to which closing was postponed pursuant to paragraph _____ of this Agreement, pay the claims approved by Seller in the following order of priority:

(1) First, to all obligations owing to the United States, to the extent given priority by federal law.

(2) Second, to secured claims (including statutory and judicial liens) to the extent of the consideration fairly attributable to the value of the properties provided by law, after the creditor deposits a release of lien for the amount of distribution.

(3) Third, to escrow and professional charges and brokers' fees attributable directly to the sale.

(4) Fourth, to unpaid employee wage claims earned within 90 days prior to the sale, transfer, or opening of the escrow, pursuant to *Code of Civil Procedure Section 1205*.

(5) Fifth, to all other tax claims.

(6) Sixth, to all other unsecured claims pro rata, including any deficiency claims of partially secured creditors.

(d) If no writ of attachment is levied on the amount retained by Escrow Agent on account of any disputed claim against the business within 25 days after mailing the notice, pay the amount retained for that claim in the manner set forth in subparagraph of this Instruction, until the claims are paid in full. Thereafter, pay any remaining amounts of principal and interest to Seller.

Instruction 8: Escrow Fees and Costs. From the funds deposited with you by Buyer and Seller for escrow fees and costs pursuant to Instructions 2 and 3, pay to yourself all amounts incurred or earned by you in handling this escrow. Deliver a receipt of those fees and costs to Buyer and Seller.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
B. Additional and Alternative Provisions for Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.211

AUTHOR: Marilyn E. Minger Revision Author

§ 17.211 Provisions for Sale of Professional Practice

[1] Comment

[a] Use of Form

This form consists of provisions to be used with a general contract for the sale of a business when the business in question is an unincorporated professional practice. These provisions may be added to the complete agreement in § 17.200[2].

This comment discusses only those aspects of the sale of a professional practice that differ from the sale of any other type of business. For discussion of provisions applicable to the sale of businesses generally, see *§ 17.200[1]*.

For coverage of professional corporations, see Ch. 12A, *Professional Corporations* . For discussion of corporate dissolution, applicable to the sale of an incorporated business [*see Corp. Code § 13403* (General Corporations Law applies to professional corporations)], see Ch. 12, *Winding Up and Dissolution* .

[b] Sale of Law Practice

Special considerations apply to the sale of a law practice [*see § 17.22[5]*]. This form may be used for the sale of a law practice. It is designed primarily for use by a sole practitioner who has not incorporated the practice or entered into a partnership arrangement with other attorneys. For a discussion of the sale of an incorporated law practice, see Ch. 12, *Winding Up and Dissolution* .

[c] Seller's Warranties

Because the Bulk Transfers Division [*see Com. Code §§ 6101-6111*] does not apply to professional practices [*see § 17.20[2][b]*], its provisions requiring notice to creditors and payment of claims will not protect the buyer of a

professional practice. The buyer is forced to rely on the seller's representations regarding the existence of debts and obligations [*see* [2], Section _____.01, *below*]. Therefore, in addition to the usual seller's warranties, Buyer should require the seller to warrant without qualification that the list of obligations and all other financial data is complete and accurate [*see* [2], Section _____.01(e), *below*]. Furthermore, the seller should warrant that he or she is a licensee or member of the applicable professional agency or organization, and is not subject to investigation or discipline by that agency or organization [*see* [2], Section _____.01(f), *below*].

[d] Buyer's Warranties

The buyer of a professional practice should make various representations designed to protect the seller [*see* [2], Section _____.02, *below*]. This form requires the buyer to state the following:

- That he or she is licensed by the applicable professional agency or organization and is not subject to investigation or discipline by that agency or organization.

- That he or she understands that the seller does not guarantee the success of the buyer's continuation of the practice.

- That if the seller is providing financing for the sale, the buyer has sufficient resources to comply with the payment terms.

The contract may require the buyer to provide the seller with access to patrons' files if, for example, in a medical or dental practice, the seller might need to answer questions about prior treatment.

[e] Protection of Goodwill.

To preserve the value of the goodwill, the seller should agree to help the buyer establish contact with the existing patrons (for example, clients or patients) of the practice. This form requires the seller to allow the buyer on the business premises prior to the sale, and to introduce the buyer as his or her successor to clients and other business associates [*see* [2], Sections _____.04, _____.05, *below*]. It also requires the seller to send a letter to each client, at his or her own expense, announcing his or her sale of the practice to the buyer. Finally, it requires the seller to encourage his or her clients or patients, in every manner consistent with the ethics of the profession, to treat the buyer as the successor to the business. However, the buyer should acknowledge that the seller cannot guarantee the success of the buyer's practice [*see* [2], Sections _____.02(b), *below*].

[f] Malpractice Insurance

The contract may require both parties to maintain malpractice insurance for as long as they continue to practice the profession [*see* [2], Section _____.09, *below*]. This type of provision will protect one party from claims arising with respect to actions taken by the other. In particular, the seller may want such a provision to be included if he or she agrees to let the buyer continue using the original name of the practice.

[g] Assumption of Obligations

In addition to typical obligations like real property leases, many professional practices (particularly law practices) have ongoing obligations for the purchase of new and updated books, electronic research tools, and library services. This form provides that the buyer will assume all library and associated obligations [*see* [2], Section _____.07(a), *below*].

Many professional practices, particularly medical and dental practices, lease a variety of equipment. This form provides that the buyer will assume those equipment leases [*see* [2], Section _____.07(b), *below*].

[2] FORM

Provisions for Sale of Professional Practice

Article _____
Professional and Client Matters

Section _____.01. Seller's Warranties. Seller hereby warrants and represents the following to Buyer:

(a) Seller is _____[*specify profession, e.g.,* an attorney] licensed by _____[*specify applicable professional agency or organization, e.g.,* the State Bar of California], is a member in good standing, and is not subject to any actual or threatened investigation or discipline by _____[*specify agency or organization, e.g.,* the State Bar].

(b) Seller is the sole owner of the practice, and no other person has any claim, right, title to, or interest in, the practice [*add, if applicable:*, except as shown on the attached schedule marked "Exhibit _____"].

(c) Seller has no undischarged obligations affecting the practice or assets being sold pursuant to this contract, other than obligations arising in the usual and regular course of business listed in the attached document marked "Exhibit _____."

(d) Seller has paid, or shall pay, all taxes owed by Seller on account of the practice.

(e) The books of account for the practice constitute a complete record of the financial affairs of the business and accurately set forth all liabilities, assets, and other matters regarding the financial condition of the practice.

(f) To the best of Seller's knowledge, the purchase and sale will not conflict with or violate any agreement or law to which Seller or the practice is subject, and there are no pending or threatened lawsuits, other judicial proceedings, or administrative proceedings involving Seller or the practice.

Section _____.02. Buyer's Warranties. Buyer hereby warrants and represents the following to Seller:

(a) Buyer is _____[*specify profession, e.g.,* an attorney] licensed by _____[*specify applicable professional agency or organization, e.g.,* the State Bar of California], is a member in good standing, and is not subject to any actual or threatened investigation or discipline by _____[*specify agency or organization, e.g.,* the State Bar].

(b) Buyer understands that although Seller will use Seller's best efforts to encourage existing _____[clients *or* patients] to patronize the practice after the sale pursuant to Sections _____.04 and _____.05 of this contract, Seller does not guarantee the success of Buyer's continuation of the practice.

(c) Buyer inspected the books of account on _____[*date*], at the office of _____[*specify, e.g.,* _____ (*name*), C.P.A.].

(d) Buyer has the right to inspect all property subject to the sale, and to the extent that Buyer does not require Seller to repair any defects, Buyer must accept the property as is upon closing.

(e) Buyer shall keep all of Seller's _____[client *or* patient] files as long as Buyer continues to operate the practice. Buyer shall not destroy or otherwise remove the files of Seller's former _____[clients *or* patients] from Buyer's office without Seller's written consent. Buyer shall keep these files confidential and _____[*specify conditions under which files may be released, e.g.,* shall release

the files only on written consent of the _____ (client *or* patient)]. [*Add, if seller will have access to client or patient files after sale:* If necessary for Seller's former _____ (clients *or* patients) to receive adequate professional care (*or specify other circumstances*), Buyer shall allow Seller access to those files.]

[*Add, if seller is providing financing to buyer:*]

(f) Buyer has sufficient resources, combined with reasonable expectation of profits from the practice, to meet all financial obligations to Seller pursuant to this contract.

Section _____.03. Indemnity Agreements. (a) Except as otherwise expressly provided in this contract, Seller shall indemnify and hold Buyer and Buyer's property, including the property described in this contract, harmless from any and all claims, losses, damages, injuries, and liabilities arising from or on account of Seller's operation of Seller's practice or ownership of any of the property described in this contract.

(b) Buyer shall indemnify and hold Seller and Seller's property, including any interest given Seller as security for payment of any portion of the purchase price specified in this contract, harmless from any and all claims, losses, damages, injuries, and liabilities arising from or in connection with the operation of Seller's practice or the ownership, control, or management of any of the assets or property described in this contract after the closing of the purchase and sale of the practice.

Section _____.04. Introduction to _____[Clients ***or*** Patients.] Pending the closing, Buyer shall have the right, during normal business hours, to frequent the office where Seller conducts Seller's practice. Seller shall use Seller's best efforts to introduce Buyer to Seller's _____[*specify, e.g.,* clients *or* patients] and other persons with whom Seller does business in connection with the practice, as Seller's successor to the practice.

Section _____.05. Retention of Clients. Seller shall, in every manner consistent with the ethics of the profession, encourage Seller's present and former _____[*specify, e.g.,* clients *or* patients] to retain Buyer as their _____[*specify profession, e.g.,* accountant]. Seller shall send to each _____[client *or* patient], at Seller's own expense, a letter announcing Seller's sale of the practice to Buyer, and the continuation of Seller's practice by Buyer.

Section _____.06. Work in Progress. (a) Except as otherwise provided in this contract, Seller shall retain complete responsibility for and ownership of all work in progress of Seller's practice, and shall complete all such work. For purposes of this contract, "work in progress" means work on any matter, case, or other activity requiring the rendering of professional services, that Seller began prior to the date of this contract but did not complete by the closing date of this purchase and sale.

(b) With the consent of the particular _____[client *or* patient], Seller may assign any work in progress undertaken on behalf of that _____[client or patient] to Buyer for completion. [*Add, for work assigned by an attorney (see Cal. Rules Prof. Conduct, Rule 2-300(B)(2)):* Seller shall send written notice of the sale to the client not less than 90 days prior to the transfer.] On assignment, Buyer shall relieve Seller of all responsibility for the work's satisfactory completion. Buyer and Seller shall agree on the division of the fee or charge made to the _____[client *or* patient] upon completion of the work. If a _____[client *or* patient] refuses to consent to an assignment to Buyer, Seller may either assign the work in progress undertaken on behalf of that _____[client or patient] to any other _____[*describe professional, e.g.,* attorney *or* dentist] acceptable to that _____[client *or* patient], with his or her consent, or complete it _____[himself *or* herself].

[*Add only if seller is nonattorney or attorney who is retiring from the practice of law (see Cal. Rules Prof. Conduct, Rule 1-500):*]

(c) Seller shall undertake any matter, case, or other activity requiring the rendition of professional services as part of Seller's practice between the date of this contract and the closing date only with the consent of Buyer, and with the written consent of the _____[client *or* patient] to Buyer's completion of the matter if Seller does not complete it by the closing date.

Section _____.07. Assumption of Obligations. (a) Buyer shall assume and pay as they come due the obligations and accounts, listed in the attached document marked "Exhibit _____," that were incurred by Seller in establishing and maintaining the _____[*describe, e.g.,* law] library for the office. Buyer shall execute and deliver to each publishing company or other creditor to whom an obligation or account described in this paragraph is owed, any instruments that the creditor may require for the assumption of the obligation or account.

(b) Buyer shall assume the leases for the pieces of equipment listed in the attached document marked as "Exhibit _____." Buyer shall execute and deliver to each equipment lessor any instruments that the lessor may require for the assignment of the lease.

Section _____.08. Bills of Sale. Seller shall execute and deliver to Buyer a bill of sale evidencing the transfer of the personal property assets of the practice to Buyer.

Section _____.09. Malpractice Insurance. Buyer shall maintain malpractice insurance [*add if desired:* of at least $_____ (*specify amount*)] for as long as Buyer continues to operate the practice. [*Add if seller will continue to practice the same profession:* Seller shall maintain malpractice insurance [*add if desired:* of at least _____ (*specify amount*)] for as long as Seller continues to _____ (*describe, e.g.,* work as a CPA)].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
B. Additional and Alternative Provisions for Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.212

AUTHOR: Marilyn E. Minger Revision Author

§ 17.212 Limitations on and Procedures for Indemnification

[1] Comment--Use of Form

This form consists of provisions that may be added to a contract of sale such as Article 13 of the *form in § 17.200[2]*, or incorporated into a stand-alone indemnity agreement. Many contracts provide that one party or the other will indemnify the other for certain specified acts and stop there. This form provide a limitation on indemnification and procedures by which to invoke and utilize the conferred indemnity.

For a discussion of indemnification, see *§ 17.200[1][p]*.

[2] FORM

Limitations on and Procedures for Indemnification

Section _____.01. Limitation on Seller's Indemnity Obligations. The indemnity obligations of Seller shall be limited as follows:

(a) The indemnity obligation of Seller shall apply only to claims and losses in excess of the aggregate sum of $_____, and the first claims and losses up to that amount shall not be compensable by Seller; provided that claims and losses resulting from a breach of the representation in Section _____ (regarding taxes), or from fraud or intentional misrepresentation, shall be entirely compensable by Seller and shall not be subject to the limitation specified in this subsection (a).

(b) Seller's aggregate liability under the indemnities set forth in this Agreement shall be limited to the amount of the Purchase Price.

Section _____.02. Survival of Obligations. Seller's indemnity obligations shall survive the Closing and shall remain in

effect for a period of _____ months after the date of the Closing, except for the following:

(a) The indemnity obligation set forth in Section _____.01(a) with respect to fraud and intentional misrepresentations or intentional breaches shall remain in effect for the earlier of six years or two years from the date of discovery of each such fraud or intentional misrepresentation or breach; and

(b) The indemnity obligation with respect to payment of all taxes as set forth in Section _____.01(a) and the indemnity obligation with respect to any claim by any party for products liability shall continue until the expiration of the statute of limitations applicable to that claim.

Section _____.03. Notice of Claim. The party with a right to indemnification under this Agreement (the "Indemnified Party") shall be reimbursed by the other party ("Indemnifying Party") for any damage that is subject to indemnification under this Agreement. An Indemnified Party making any claim against an Indemnifying Party for indemnification shall make that claim in writing, setting forth in general terms the facts upon which the Indemnified Party bases the claim. If any third party asserts any claim or demand against any Indemnified Party by a third party for which that Party may claim indemnification under this Agreement, the Indemnified Party shall give the Indemnifying Party written notice within 30 days after receipt of the claim or demand, and shall indicate whether the Indemnified Party intends to assume the defense of that claim or demand.

Section _____.04. Defense. (a) The Indemnifying Party shall have the right to elect to participate, at that Party's own expense, in the defense of any claim that may be subject to the indemnification under this Agreement, and may exercise that election only by written notice given to the Indemnified Party within 15 days from the date of the Indemnified Party's notice of the claim or demand.

(b) If the Indemnified Party assumes the defense and the Indemnifying Party does not participate, the Indemnified Party shall have the right to completely control and to settle or litigate the proceedings.

(c) If the Indemnifying Party elects to participate in the defense and does not dispute liability for indemnification of all damages arising out of the claim or demand, the Indemnifying Party may elect to control the proceeding but may not settle the claim without the consent of the Indemnified Party; provided that the consent of the Indemnified Party shall not be unreasonably withheld.

(d) If the Indemnifying Party elects to participate in the defense but not to control the proceeding, the Indemnified Party shall control the proceeding but shall not settle the claim without the consent of the Indemnifying Party; provided that the consent of the Indemnifying Party shall not be unreasonably withheld.

(e) If the Indemnified Party elects not to assume the defense, the Indemnifying Party shall have the right to do so and to control the proceeding, but the Indemnified Party shall nonetheless have the right to participate in the proceeding, and the Indemnifying Party shall not settle the claim without the consent of the Indemnified Party; provided that the consent of the Indemnified Party shall not be unreasonably withheld.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
B. Additional and Alternative Provisions for Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.213

AUTHOR: Marilyn E. Minger Revision Author

§ 17.213 Noncompetition Provision

[1] Comment

[a] Use of Form

This form consists of noncompetition provisions or a "covenant not to compete" that prohibits the seller from carrying on the same type of business as the buyer in the same county or city. It may be added to the contract for sale of a business *set forth in § 17.200[2]*.

If this provision is added to the contract, then it might be advisable to add as well the provision in § 17.216[2].

Any person who sells the goodwill of a business, any owner of a business entity who sells or otherwise disposes of all of his or her ownership interest in the business entity, and any owner of a business entity that sells (1) all or substantially all of the business' operating assets together with the business' goodwill, (2) all or substantially all of the operating assets of a division or subsidiary together with that division's or subsidiary's goodwill, or (3) all of the ownership interest of any subsidiary may agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the sold business, division, or subsidiary conducted business provided that the buyer (or any person deriving title to the goodwill or ownership interest from the buyer) carries on a similar business in that geographic area [*Bus. & Prof. Code § 16601*]. For this purpose, "business entity" is defined to include any partnership (including a limited partnership or limited liability partnership), limited liability company (including a series of a limited liability company formed under the laws of a jurisdiction that recognizes such a series), or corporation. An "owner of a business entity" is defined as a partner (partnership), member (limited liability company) or any owner of capital stock (corporation). An "ownership interest" is defined as a partnership interest, a membership interest, or a capital stockholder. "Subsidiary" is defined as a business entity over which the selling business entity has voting control, or from which the selling business has a right to receive a majority share of distributions on dissolution or other liquidation of the business entity, or both [*Bus. & Prof. Code § 16601*].

A noncompetition agreement may not be used in connection with the sale of a law practice unless the selling attorney intends to permanently retire from the practice of law [*see Cal. Rules Prof. Conduct, Rule 1-500*; *see also § 17.22[5][c]*].

For additional discussion of noncompetition provisions, and for examples of those provisions in employment agreements, see *Ch. 85, Employment Agreements, §§ 85.470-85.473*.

[b] Severability Provision

The drafting attorney may wish to add a severability and partial invalidity provision to the noncompetition clause, stating that the covenant not to compete will be construed as a separate covenant for each city, county, or part of those cities and counties. Thus, if a court were to find that the covenant was invalid with respect to certain specified areas because the business was not "carried on" in those areas, the covenant could still be enforced with respect to the other specified areas [*see Bus. & Prof. Code § 16601*; *see also Hill Medical Corporation v. Wycoff (2000) 86 Cal. App. 4th 895, 897, 906-908, 103 Cal. Rptr. 2d 779* (holding that noncompetition provision in radiologist's stock redemption agreement was void under *Bus & Prof. Code § 16600* and did not fall within exception of *Bus & Prof. Code § 16601*, when business goodwill was not a factor in corporation's repurchase of his shares)]. A contract is severable if performance by each party is divided into two or more parts, and performance of each part by one party is the agreed exchange for a corresponding part by the other party [*Lowy v. United Pacific Ins. Co. (1967) 67 Cal. 2d 87, 91-92, 60 Cal. Rptr 225, 429 P.2d 577]* . If a contract has several distinct objects, then any of those objects that is lawful is valid, and any that is unlawful is invalid [*Civ. Code § 1599*]. For further discussion of severability, see *Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.271*.

[c] Professional Practices

When the business being sold is a professional practice, such as a doctor's or accountant's practice [*see §§ 17.22, 17.211*], it may be desirable to include an additional provision regarding referrals. This form prohibits the seller from referring a client or patient to any member of the profession, other than the buyer, within the same geographic area.

Note, however, that an attorney may not enter into a noncompetition agreement in connection with the sale of his or her law practice unless he or she intends to permanently retire from the practice of law [*see Cal. Rules Prof. Conduct, Rule 1-500(B)*]. For discussion, see *§ 17.22[5]*.

[d] Liquidated Damages

This form contains an optional liquidated damages provision, which may be included if the parties desire to fix the amount to be paid by the seller in the event of a breach of the noncompetition provision. A liquidated damages provision is valid unless the party seeking to invalidate it can establish that it was unreasonable under the circumstances existing at the time the contract was made [*Civ. Code § 1671*]. In *Weber, Lipshie & Co. v. Christian (1997) 52 Cal. App. 4th 645, 656-657, 60 Cal. Rptr. 2d 677* , the court found reasonable a liquidated damages provision that provided that damages to accounting firm for loss of fees from breach of covenant not to compete would be measured by doubling firm's time charges for clients lost due to breach for 12 months immediately preceding their loss. For discussion of liquidated damages provisions in contracts generally, see *Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.251*. For an example and discussion of a liquidated damages provision for a noncompetition agreement in an employment contract, see *Ch. 85, Employment Agreements, § 85.473*. For an example and discussion of the special requirements applicable to a liquidated damages provision in a contract for the sale of real property, see *§ 17.201[1][h]*.

[2] FORM

Noncompetition Provision

Section _____. Noncompetition Agreement by Seller. (a) In connection with the sale to Buyer of the goodwill of the _____[business *or* practice] described in Section _____ of this Agreement, Seller shall not, directly or indirectly, carry on or engage in, as an owner, manager, operator, employee, salesman, agent, consultant, or other participant, the business of _____[*specify type of business being sold, e.g.*, selling, servicing, and repairing household appliances] or any similar business in _____[*specify geographic region, e.g.*, Orange County and Los Angeles County], California, for as long as Buyer, or any person deriving title to the goodwill of the business from Buyer, carries on a like business in _____[*restate area(s), e.g.*, those counties]. [*Add, if additional limitation is desired:* This restriction shall terminate _____ year(s) from the date of execution of this contract.]

[*Add, if business being sold is a professional practice (but see Cal. Rules Prof. Conduct, Rule 1-500 regarding law practices):*]

(b) Furthermore, Seller shall not, within the time limitations set forth above, directly or indirectly refer any _____[patient *or* client] to any other _____[*type of professional, e.g.,* dentist] within _____[*geographic region, e.g.*, Orange County and Los Angeles County], if Buyer can provide the type of services needed by that _____[patient *or* client].

[*Add, if parties wish to provide for severability and partial invalidity:*]

(c) This covenant not to compete is intended as a separate covenant with respect to each _____[*state applicable area(s), e.g.*, city, county, or part thereof] set forth above. If any one of the covenants is declared invalid for any reason, this ruling shall not affect the validity of the remainder of the covenants. The other covenants in the noncompetition provision shall remain in effect as if the provision had been executed without the invalid covenants. The parties hereby declare that they intend that the remaining covenants of the provision continue to be effective without any covenants that have been declared invalid.

[*Add, if parties wish to include liquidated damages provision for breach of noncompetition agreement:*]

(d) If Seller breaches the obligation not to compete as set forth in this Section, Seller shall pay to Buyer as liquidated damages the sum of _____[*specify amount and payment schedule, e.g.,* $5,000 per month] for the period in which Seller continues to breach the obligation not to compete. Seller and Buyer agree that the amount stated as liquidated damages is reasonable under the circumstances existing at the time that this agreement was executed.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
B. Additional and Alternative Provisions for Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.214

AUTHOR: Marilyn E. Minger Revision Author

§ 17.214 Warranty by Seller Regarding Hazardous Materials

[1] Comment--Use of Form

This form is a warranty by the seller that the property being transferred to the buyer does not contain hazardous materials. It may be added to any contract of sale when the buyer is concerned about the presence of hazardous materials in the property being transferred. Use of such a provision is particularly important when the seller is transferring real property for a business that used chemicals or other potentially hazardous materials in its operation. If the buyer has particular concerns about the presence of hazardous materials, however, the parties should consult an environmental expert prior to the sale.

For an example and discussion of the real estate transfer disclosure statement, which requires disclosure of known environmental hazards on residential property [*see Civ. Code § 1102.6*], see *Ch. 23, Real Property Sales Agreements, § 23.300*. For additional discusion, see Ch. 33, *Contamination Considerations in Real Property Transactions* .

[2] FORM

Warranty by Seller Regarding Hazardous Materials

Section _____. Seller's Warranty Regarding Hazardous Materials. To the best of Seller's knowledge, the property being sold does not contain any hazardous substances subject to state or federal regulation. [*Add, if any type of personal property being transferred is often associated with particular hazardous material:* The _____ (*describe, e.g.,* furnace and other fixtures do not contain traceable levels of asbestos, and the light fixtures do not contain traceable levels of PCBs).]

[*Add, if real property is being transferred:*]

The Real Property does not contain any underground storage tanks regulated by *Health and Safety Code Sections 25280 through 25299.7*, and the building (and its fixtures) do(es) not contain any _____[*specify any particular chemicals or other hazardous materials*]. Seller has never been cited for violating any federal, state, or local environmental law or regulation with respect to operation of the business on the Real Property.

[*CONTINUE*]

All reports, test results, and other documents relating to the presence or absence of hazardous materials in the property [*add when real property is also being transferred:* or on the Real Property] being transferred are attached as "Exhibit _____."



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
B. Additional and Alternative Provisions for Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.215

AUTHOR: Marilyn E. Minger Revision Author

§ 17.215 Seller's Conduct of Business Pending Closing

[1] Comment--Use of Form

This form is an alternative contract provision governing the conduct of the business or professional practice pending its sale to the buyer. It should be used when the buyer wants specific assurances regarding the seller's operation of the business or practice during that interim period. The provision set forth in this form contains obligations as well as prohibitions of certain actions without written consent of the buyer.

[2] FORM

Seller's Conduct of Business Pending Closing

Section _____. Conduct of _____[Business ***or*** Practice] **Pending Closing.** (a) Pending the closing date specified in Paragraph _____ of this contract, Seller agrees to continue operating the _____[business *or* practice] in substantially the same manner as Seller has operated it in the past.

(b) Seller specifically agrees to do all of the following:

(1) Use Seller's best efforts to retain all present employees and to encourage them to continue their employment after the sale to Buyer.

(2) Use Seller's best efforts to maintain businesslike and courteous relationships with all suppliers, customers, employees, and other persons who come into contact with the _____ [business *or* practice].

(3) Maintain in full force and effect, at Seller's own cost and expense, insurance policies insuring for their full insurable value the tangible assets of the _____ [business *or* practice] against loss or destruction by fire, the

elements, theft, or civil disorder.

(4) Exercise due diligence in safeguarding and maintaining the confidentiality of all books, reports, and data pertaining to the _____ [business *or* practice].

(5) Keep and deliver to Buyer an accurate record of all money received as payment or part payment of any of the accounts receivable listed on the attached schedule marked "Exhibit _____."

(6) _____ [*specify any other duties*].

(c) Seller further agrees not to do any of the following without the written consent of Buyer:

(1) Increase or decrease the amount of employee compensation; or establish, discontinue, or change any related benefits of any employees or agents.

(2) Enter into any contracts or transactions, except in the ordinary course of business, on account of the _____ [business *or* practice].

(3) Incur any obligations [*optional:* exceeding $_____], or purchase or order any merchandise for or on account of the _____ [business *or* practice] [*optional:*, except as needed in the ordinary course of business].

(4) Waive any rights or claims arising out of or because of the _____ [business *or* practice].

(5) _____ (*Specify any other restrictions*).]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
B. Additional and Alternative Provisions for Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.216

AUTHOR: Marilyn E. Minger Revision Author

§ 17.216 Seller's Association With Business After Sale

[1] Comment--Use of Form

This form is an alternative contract provision specifying that the seller will work in the business or professional practice in a designated capacity for a specified period after its sale to the buyer. It should be added to a contract for the sale of a business or professional practice when the buyer wants the seller to train the buyer in the operation of the business, or when effective transfer of the goodwill depends on continuing patronage of the current clients. For example, the buyer of a small fast-food business typically will want the seller to continue working in the business for a period of several weeks after the sale, in order to train the buyer regarding the practical aspects of business operations.

In a sales or marketing business operated primarily by the seller or in a professional practice, the goodwill resulting from the personal skill, talent, experience, or reputation of the seller is often the most valuable asset [*see Smith v. Bull (1958) 50 Cal. 2d 294, 302, 325 P.2d 463* ; *see also § 17.22[2]*]. To protect the value of that asset, the buyer often will want to associate the seller with the business or practice until the customers or clients become acquainted and comfortable with the buyer. The seller's compensation for this association may be included as part of the sale, or may involve a separate consideration [*see* [2], *below*].

This provision also could be used to complement and reinforce a noncompetition provision of the kind discussed and illustrated in § 17.213 [see *Huong Que, Inc. v. Luu (2007) 150 Cal. App. 4th 400, 410-416, 58 Cal. Rptr. 3d 527* (business-sale agreement included buyer's hiring of sellers as "managing agents" of business for limited period, thus creating agency relationship in which sellers were bound, under law of agency, to act with loyalty to new owner; agency provision was not incompatible with, and was not superseded by, agreement's noncompetition provision; sellers could be liable, as disloyal agents, for damages arising from use of customer list for their own future business purposes)].

Before including this provision, the drafting attorney should consider the feasibility of the buyer and seller working together. If the parties have had an adversarial relationship throughout the sale negotiations, required association after

the sale may hinder, rather than facilitate, the successful transfer of the business or practice from one party to the other.

[2] FORM

Seller's Association With Business After Sale

Section _____. Seller's Association With _____[Business ***or*** Practice] **After Sale.** Seller shall continue to work in the _____[business *or* practice] as _____[*specify occupation, e.g.,* a consultant] for a period of _____[*specify, e.g.,* 30 days] after the closing of the purchase and sale described in this contract. [*Add, if seller will receive separate consideration:* Seller's compensation for the work specified in this Section shall consist of _____ (*specify, e.g.,* 20 percent of all gross sales *or* $_____), payable by Buyer to Seller _____ (*specify time for payment, e.g.,* on a weekly basis).] Seller shall use Seller's own automobile for the performance of services relating to the _____[business *or* practice], and shall maintain at Seller's own cost and expense an automobile liability insurance policy on the automobile insuring Buyer and Seller as named insureds against liability (1) in an amount not less than $_____ for bodily injury to or death of one person in any one accident; (2) in an amount not less than $_____ for bodily injury to or death of more than one person in any one accident; and (3) in an amount not less than $_____ for property damages resulting from any one accident. Buyer shall pay Seller the reasonable expenses [not exceeding $_____] incurred by Seller for the operation of Seller's automobile in the course of performing services for the _____[business *or* practice].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
B. Additional and Alternative Provisions for Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.217

AUTHOR: Marilyn E. Minger Revision Author

§ 17.217 Buyer's Use of Current Business Name or Seller's Name Prohibited

[1] Comment

[a] Use of Form

This form is an alternative contract provision prohibiting the buyer from using the trade name of the business being sold or the seller's name in connection with the operation of the business. It should be added when the seller wants to disconnect the name from the business. For example, the seller might want to use the existing name in connection with another business, or the business being sold might have been only one of several businesses operated under the same name.

[b] Relationship Between Business Name and Goodwill

The goodwill of a business is transferable property [*Bus. & Prof. Code § 14102*; *see § 17.22[2]*]. A person transferring the goodwill of a business may transfer with it the right to use the name under which the business is conducted [*Bus. & Prof. Code § 14103*].

The goodwill of a business, however, does not include a right to use the name of any person from whom the business was acquired [*Bus. & Prof. Code § 14101*]. Thus, if a contract for the sale of a business (and business goodwill) does not specifically permit use of the seller's personal name in continuing the business, the buyer cannot use that name [*Mahlstedt v. Fugit (1947) 79 Cal. App. 2d 562, 567-568, 180 P.2d 777* ; *but see Reid v. St. John (1924) 68 Cal. App. 348, 357, 229 P. 863* (express mention was not required when name had become trade name, and circumstances indicated seller's intent to transfer name)].

[c] Limitations on Use of Transferred Name

A valid transfer of the prior name may be limited in time or use. For example, when a seller transferred his business for

a consideration payable in installments and the bill of sale granted the buyer "[t]he use of the name 'Sam's Fishing Fleet' for a period of ten years or until said amount due and owing is paid," the court held that the buyer lost the use of the name when he paid the amount due and owing prematurely at the end of five years [*see Balesteri v. Holler (1978) 87 Cal. App. 3d 717, 719-723, 151 Cal. Rptr. 229]* . A seller might allow the buyer to use the former name, designated as such, solely to notify the public of the change in ownership [*see* [2], *below*].

[2] FORM

Buyer's Use of Current Business Name or Seller's Name Prohibited

Section _____. Use of Name Prohibited. Notwithstanding any other provision of this contract, the sale of the business shall not convey to Buyer any right to use the name "_____[*specify current name*]" or to use Seller's name in connection with the operation or promotion of the business. Within _____[*e.g.*, 30] days after the closing of the sale, Seller, at Seller's own costs and expense, shall cause the name[s] to be deleted from all signs and advertising pertaining to the business. However, for a period of [*specify, e.g.*, 30 days] following the closing of the sale, Buyer may advertise the fact that the business was "formerly known as '_____[*former name*],' " has been purchased by Buyer and will be known by a new name. [*Add, if applicable:* Buyer may also sell any existing inventory bearing the name "_____ (*specify current name*)," but shall not manufacture any additional inventory bearing that name.]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
B. Additional and Alternative Provisions for Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.218

AUTHOR: Marilyn E. Minger Revision Author

§ 17.218 Sale Conditioned on Creditors' Acceptance of Purchase Price for Debts

[1] Comment

[a] Use of Form

This form is an alternative contract provision conditioning sale of the business or professional practice on the creditors' acceptance of pro rata shares of the purchase price in full satisfaction of the seller's debts. It may be used when the sale is not subject to the creditor payment provisions of the Bulk Sales Division [*see Com. Code §§ 6106.2* and *6106.4*], and the seller is insolvent.

[b] Payment to Creditors

Under the Bulk Sales Division of the Commercial Code [*Com. Code §§ 6101-6111*], when the consideration for a sale is (1) $2 milllion or less and (2) substantially all cash, an obligation to pay cash in the future, or a combination of the two, the buyer or escrow agent must first apply the sale proceeds toward the payment of claims that the seller's creditors have filed in a timely manner [*see Com. Code §§ 6106.2(a), (b), 6106.4*; *see also § 17.20[6]*]. However, if these provisions of the Bulk Sales Division do not apply to the sale, an insolvent seller's creditors have no assurance that they will receive payment of their claims prior to the sale. If they attach the business assets, they may prevent closing of the sale and force the seller into bankruptcy. Generally, a bankruptcy sale of used fixtures and equipment will result in a lower sales price than if those same fixtures and equipment were sold as part of a going business in which the business goodwill is also transferred. Therefore, if (1) the sale proceeds are more than the seller could obtain from a forced sale and (2) the seller has no other assets from which the creditors can receive payment of their claims, those creditors may agree to accept the proceeds of the sale as a going business in full payment of their claims. This form conditions the sale of the business on such an agreement by the creditors.

[2] FORM

Sale Conditioned on Creditors' Acceptance of Purchase Price for Debts

Section _____. Sale Conditioned on Acceptance by Creditors. Buyer and Seller agree that as a condition precedent to closing of the purchase and sale set forth in this Agreement, each creditor of Seller shall agree in writing to accept a pro rata share of the purchase price in full satisfaction of that creditor's claim. If any creditor listed in the document attached as "Exhibit _____" fails to agree in writing by the closing date, this contact shall be void. In the event that this Agreement is invalidated by reason of this section, Buyer and Seller shall each be released from all liability for further performance, and neither shall be liable for any expenses incurred by the other in attempted performance of this contract.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
B. Additional and Alternative Provisions for Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.219

AUTHOR: Marilyn E. Minger Revision Author

§ 17.219 Delaying Closing to Obtain Business License

[1] Comment--Use of Form

This provision permits the parties to delay the closing if the buyer is unable to obtain a license or permit required to operate the business. When the buyer must obtain a new license or permit requiring agency inspection or approval of the business premises, additional time may be required for necessary corrections or repairs. For a discussion and an example of a provision conditioning the sale on issuance of a business license, see *§ 17.201[1][d], [2],* Sections 2.07(a), 2.09.

[2] FORM

Delaying Closing to Obtain Business License

Section _____. Business License. The closing may be postponed to a date not later than _____[*specify time*, e.g., 30 days] after the date specified in Section _____[*section of agreement specifying closing date of sale*] of this Agreement if Buyer is unable to obtain a business license or other required permit for the operation of the business. If any repairs or alterations to the business are required as a condition to the issuance of the license or permit, _____[Seller *or* Buyer] shall cause the repairs or alterations to be performed to the satisfaction of the licensing or inspecting authorities at _____[Seller's *or* Buyer's] own cost and expense. When the closing is postponed under to this paragraph, the inventory of the stock in trade and merchandise of the business described in Paragraph 14 of this contract shall also be postponed to the close of business on the day immediately preceding the postponed closing.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
B. Additional and Alternative Provisions for Sales Contracts

8-17 California Legal Forms--Transaction Guide § 17.220

AUTHOR: Marilyn E. Minger Revision Author

§ 17.220 Provision Assigning Registered Trademark or Service Mark

[1] Comment--Use of Form

This form is a provision obligating the seller to transfer and assign to the buyer a registered trademark or service mark used in connection with the business being sold. It should be added to a contract of sale [*see, e.g., § 17.200[2]*] only if the contract provides for transfer of the goodwill of the business to the buyer [*see 15 U.S.C. § 1060*; *Bus. & Prof. Code § 14220*; *see also § 17.15*].

This provision is not an instrument of transfer, but rather an agreement to execute an instrument of transfer. For the official form used to assign a trademark or service mark registered in California, see Ch. 103B, *Trademarks* .

[2] FORM

Provision Assigning Registered Trademark or Service Mark

Section _____. Assignment of Trademark. Seller, as part of and in connection with the sale and assignment of the goodwill of the business to Buyer [*or* that part of the goodwill connected with the use of and symbolized by the following mark], shall execute, acknowledge, and deliver to Buyer any written instruments that are required by law to assign to Buyer that _____[trademark *or* service mark], owned by Seller, that is registered in the _____[United States Patent and Trademark Office *or* Office of the Secretary of State of California] as Registration No. _____, dated _____.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
B. Additional and Alternative Provisions for Sales Contracts

8-17 California Legal Forms--Transaction Guide §§ 17.221-17.249

AUTHOR: Marilyn E. Minger Revision Author

[Reserved]

§§ 17.221[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
C. Escrow Instructions

8-17 California Legal Forms--Transaction Guide § 17.250

AUTHOR: Marilyn E. Minger Revision Author

§ 17.250 Escrow Instructions for Sale of Business--Subject to Bulk Sales Division

[1] Comment

[a] Use of Form

This form is a complete set of escrow instructions for the sale of a business subject to the Bulk Sales Division of the Commercial Code [*Com. Code §§ 6101-6111*]. Although an escrow is not required for the sale of a business, the parties to a sale subject to the Bulk Sales Division generally use an escrow to facilitate payment of creditor claims in compliance with that Division [*see § 17.20* for discussion of the Bulk Sales division].

As an alternative to using a separate set of escrow instructions, the parties may include some or all of the instructions in the contract of sale itself if they wish to combine all documents for the sale into one document [*see § 17.210*]. The advantage of using separate escrow instructions, however, is that they may be longer and more detailed, and the escrow agent need not be a party to the contract of sale. Furthermore, when in a separate agreement, escrow instructions may be drafted at a later date, to include additional instructions concerning matters that arise after execution of the sales contract. For discussion of the various provisions in the escrow instructions for the sale of a business, see *§ 17.210[1]*.

If a commercial escrow or title company handles the escrow, it will normally require the parties to use its own printed escrow instructions.

[b] Use of Escrow

An escrow is a procedural device for effectuating a sales transaction that requires a concurrent exchange of money and documents for the transfer of title to property after the parties have satisfied all conditions precedent. To insure that the separate interests of each party are protected, a disinterested party called the escrow agent handles the details of the transaction [*see Civ. Code § 1057* (escrow agent must be third party)].

The parties to the sale of a business generally use an escrow to ensure compliance with the provisions of the Bulk Sales Division [*Com. Code §§ 6101-6111*; *see § 17.20*] and the successor liability statutes in the Sales and Use Tax Law [*Rev. & Tax. Code §§ 6811, 6812*] and the Unemployment Insurance Code [*Unemp. Ins. Code §§ 1731-1733*; *see § 17.14*]. An escrow is a transaction in which instruments and funds are deposited with a neutral third party for delivery on the occurrence of specified conditions [*see Lee v. Title Ins. & Trust Co. (1968) 264 Cal. App. 2d 160, 162, 70 Cal. Rptr. 378* ; *see also § 17.210*]. The contract for sale itself may set forth escrow instructions, or it may refer to instructions set forth in a separate agreement [*see § 17.210*].

[c] Escrow Instructions

Escrow instructions are used to authorize and direct the escrow agent to act as the agent of the parties to the agreement, and to take the specific steps necessary to carry out the agreement. They define and limit the authority and the obligations of the escrow agent [*see Axley v. Transamerica Title Ins. Co. (1978) 88 Cal. App. 3d 1, 8-9, 151 Cal. Rptr. 570]* . For further coverage of escrow generally, and for examples of escrow instructions applicable to the sale of real property, see Ch. 26, *Real Property Escrows* .

[d] Duties of Escrow Agent

The escrow agent has a duty to comply strictly with the instructions of the principals, and to exercise reasonable skill and ordinary diligence [*Diaz v. United California Bank (1977) 71 Cal. App. 3d 161, 166, 139 Cal. Rptr. 314]* . If the written escrow instructions constitute the signed agreement of two principals with the escrow agent, neither party can unilaterally change the instructions [*Diaz v. United California Bank (1977) 71 Cal. App. 3d 161, 166, 139 Cal. Rptr. 314]* . However, if one party notifies the escrow agent of alleged material error in the jointly executed instructions, the escrow agent cannot ignore that notice and close the escrow. The duty to exercise reasonable skill and ordinary diligence requires the escrow agent to at least delay closure of the escrow until the matter can be clarified [*Diaz v. United California Bank (1977) 71 Cal. App. 3d 161, 171, 139 Cal. Rptr. 314* (escrow agent disregarded seller's notice that escrow instructions incorrectly stated amount of note due from buyer)].

[e] Joint or Separate Instructions

The buyer and seller may use either joint or separate escrow instructions to direct the escrow agent. The choice is often determined by the area of California in which the transaction takes place, or by the complexity of the sale. As a matter of custom, escrow procedures differ in northern and southern California. Joint or "bilateral" instructions are customarily used in southern California, at least in smaller transactions. Separate or "unilateral" instructions, separately executed by each party, are customarily used in northern California. This form contains joint instructions.

The process of drafting joint instructions usually requires the parties' attorneys to confront and resolve inconsistencies and other potential problems at the outset. The escrow agent can then handle the escrow pursuant to a single set of instructions in which potential conflicts have been eliminated. However, because the process of drafting joint instructions may require resolution of conflicts that prove to be immaterial and potential problems that never materialize, it can be a lengthy, time-consuming process that produces an unnecessarily complex set of instructions. For further discussion of these and other aspects of escrow procedure in the context of real property escrows, see Ch. 26, *Real Property Escrows* , Legal Background.

[f] Request for Information (Form UCC-11)

This form requires the escrow holder to mail Form UCC-11, "Request for Information or Copies," and the applicable filing fee to the Secretary of State's office [*see Com. Code § 9525*; *see also Com. Code §§ 9523, 9528*; [2], Paragraph 6, *below*]. A UCC-11 is used to request a certificate showing whether any presently effective financing statement is on file with respect to the seller's business [*see Com. Code § 9523*; *see also* Ch. 42, *Secured Transactions*]. On the request of any person and payment of the statutory fee [*see* Gov. Code § 9525], the Secretary of State must issue a combined

certificate showing financing statement information [*see Com. Code § 9523*], state tax lien data [*see Gov. Code § 7226*], attachment lien information [*see Code Civ. Proc. §§ 488.375, 488.405*], judgment lien information [*see Code Civ. Proc. § 697.580*], and federal lien information [*Com. Code § 9528*; *see Code Civ. Proc. § 2103*]. For coverage of applicable procedures, see *§ 17.121,* P 7 Note. For an illustration of Form UCC-11, see *Ch. 42, Secured Transactions, § 42.216.* Copies of Form UCC-11 are also available online at http://www.ss.ca.gov/business/ucc/ucc.htm and from office supply stores.

[g] Standard Escrow Instructions--Recitals

In addition to the specific instructions required by the Bulk Transfers Division and successor liability statutes, discussed *above*, the parties should include standard instructions regarding handling of the escrow [*see* Ch. 26, *Real Property Escrows*]. The first provision should sets forth the parties, the purpose of the escrow, and the closing date [*see* [2], Paragraph 1, *below*].

[h] Obligations to Escrow Holder

The parties should agree to indemnify the escrow agent from liability for his or her actions taken pursuant to the instructions. The parties should also agree to reimburse the escrow agent for costs incurred in following the instructions. Further, they should agree to pay the applicable escrow fee [*see* [2], Paragraph 2, *below*].

[i] Deposits Into Escrow

The instructions should list the documents and other property that each party is required to deposit into escrow [*see* [2], Paragraphs 7, 8, *below*]. The items should be separately listed, so that the escrow agent can confirm when he or she has all the items necessary to close the escrow.

[j] Inventory

The instructions should require the escrow agent to obtain an inventory of the property being sold from the person or firm taking the inventory [*see* [2], Paragraph 9, *below*]. For further discussion of inventory, see *§ 17.200[1][n]*.

[k] Transfer of Documents

The parties should instruct the escrow agent to arrange for the transfer of any insurance policies to be assigned to the buyer [*see* [2], Paragraph 10, *below*; *§ 17.200[o]*]. The instructions should also require the escrow agent to obtain the appropriate papers for the transfer of any other assets, such as motor vehicles, to the buyer [*see* [2], Paragraph 14, *below*]. For discussion and examples of transfer documents, see Ch. 102D, *Registration and Transfer of Vehicles, Vessels, and Aircraft* .

[l] Proration of Expenses

The instructions should list the expenses that the parties will prorate, and the manner of proration [*see* [2], Paragraph 12, *below*]. For discussion of the items that buyer and seller generally prorate, see *§ 17.200[m]*.

[2] FORM

Escrow Instructions for Sale of Business--Subject to Bulk Sales Division

JOINT ESCROW INSTRUCTIONS OF BUYER AND SELLER

TO: _____[*name of escrow agent*]
_____[*address*]

_____[*city, state, zip*]

_____[*name of seller*], "Seller," and _____[*name of buyer*], "Buyer," deposit with you the following joint escrow instructions ("Instructions"):

Preliminary Recitals

1. Seller has entered into a contract ("the contract"), which is attached and marked "Exhibit _____," to sell a business ("the business") to Buyer. The contract appoints you as escrow agent for the sale. Subject to the terms and conditions set forth below, Seller and Buyer hereby authorize and instruct you to open an escrow for the purpose of completing the sale of the business, and to complete the sale in accordance with the following directions. The date set for closing is _____[*time*] on _____[*date*].

Parties' Obligations to Escrow Agent

2. (a) Buyer and Seller agree to be jointly and severally liable to indemnify you and hold you and your property free and harmless from any and all claims, loss, damage, or liability to either or both Buyer and Seller or to any other person arising as a result of this escrow because of the following:

(1) The failure of any condition or conditions of this escrow.

(2) Your failure to ascertain or comply with the terms of any document, other than these Instructions, unless that document is filed in this escrow and you are expressly instructed by these Instructions to comply with a specified paragraph or provision of that document.

(3) Forgeries or false impersonations.

(4) Exercise of your discretion in any particular manner in any situation in which you are authorized by these Instructions to exercise your discretion.

(5) Any reason other than your gross negligence or willful misconduct in following these Instructions and acting as escrow agent of this escrow.

(b) We further agree to be jointly and severally liable to reimburse you for all costs and expenses that you incur in fulfilling these Instructions and performing your duties as escrow agent of this escrow, if those costs and expenses are not otherwise paid to you in the manner provided in these Instructions.

(c) Buyer and Seller further agree to be jointly and severally liable to pay you a reasonable fee for your services in acting as escrow agent of this escrow and fulfilling these Instructions.

Notice of Bulk Sale

3. As soon as possible after opening escrow, prepare a notice of bulk sale and obtain Buyer's signature on the notice in accordance with *Com. Code § 6105*. At least 12 business days before closing, (a) record the notice in the office of the county recorder; (b) publish the notice; and (c) deliver or mail the notice to the county tax collector in the manner required by *Com. Code Section 6105(b)*.

[*Include, if seller holds sales tax permit for business:*]

Sales Tax Clearance

4. As soon as possible after opening escrow, request from the Board of Equalization, on behalf of and in the name of Buyer, a statement showing the amount due or a certificate stating that no amount is due from Seller on account of the sales tax permit issued to Seller for the operation of the business.

[*CONTINUE*]

Unemployment Insurance Clearance

5. As soon as possible after opening escrow, request from the Employment Development Department, on behalf of and in the name of Buyer, a statement showing the amounts due or a certificate stating that no amount is due from Seller under the Unemployment Insurance Code on account of the business. If the Employment Development Department does not issue the certificate or statement within 30 days from your request, you may assume that no amount is claimed by that Department.

Financing Statements

6. Prepare, and forward to the Secretary of State, Form UCC-3, "Request for Information or Copies," requesting a certificate showing any presently effective financing statements on file naming Seller as debtor. On receipt of the certificate, either

(a) Obtain Buyer's written acknowledgment and acceptance of any items stated on the certificate; or

(b) Inform Seller of the reasons that Buyer will not accept the items stated on the certificate, and have Seller either pay the items or make arrangements satisfactory to Buyer for their adjustment.

Seller's Deposit in Escrow

7. On or before _____[*closing date*], Seller shall deposit into escrow all of the following:

(a) A bill of sale executed by Seller conveying to Buyer:

(1) All the stock in trade and merchandise of the business as shown on a complete inventory and accounting of that stock in trade and merchandise to be taken on _____ [*date*], by _____ [*name of person or firm that will take inventory*] in accordance with Paragraph 9 of these Instructions.

(2) All the furniture, fixtures, equipment, and other tangible assets of the business as shown on the attached inventory marked "Exhibit _____" [*add if desired:*, with the following exceptions: _____ (*describe any exceptions*)].

(3) All the trade, business name, goodwill, and other intangible assets of the business.

(b) A valid assignment of lease executed and acknowledged before a notary public by Seller assigning to Buyer all Seller's interest under the lease dated _____ between Seller as Lessee and _____[*name of lessor*] as Lessor for the premises occupied by the business.

(c) A consent to Seller's assignment of the above lease, executed and acknowledged before a notary public by _____[*name of lessor*].

(d) The certificate of ownership issued by the California State Department of Motor Vehicles for each motor vehicle included in the fixtures and equipment of the business as shown on the attached inventory marked "Exhibit _____," executed by Seller in the manner required to transfer registered ownership of each vehicle to

Buyer.

(e) Any other instruments, executed by Seller, that in your opinion are reasonably necessary or convenient to transfer, assign, or register ownership of any of the tangible or intangible assets of the business to and in the name of Buyer.

(f) A copy of the inventory of the stock in trade and merchandise of the business taken in accordance with subparagraph (a)(1) and approved with Seller's signature.

(g) The latest tax bills received by Seller from the County of _____ and other taxing authorities showing the amount or amounts of personal property taxes levied or assessed, either for the current tax year or the preceding tax year, on any of the fixtures and equipment of the business shown on the attached inventory marked "Exhibit _____."

(h) A list of all persons employed by Seller in connection with the business showing the following:

(1) Their names, social security numbers, positions, and salaries;

(2) The dates on which they are paid each month; and

(3) The amount of contributions accruing each pay period to union welfare and pension funds, Christmas bonus funds, and vacation funds for each employee.

(i) A list of all insurance policies insuring the business or the assets of the business and showing the following:

(1) The number of each policy;

(2) Tthe insurance company and agent that issued each policy;

(3) The premium payable on each policy; and

(4) Tthe beginning and expiration dates of each policy.

(j) Seller's written approval or rejection, within 24 hours after receipt, of all claims against the business received by you prior to _____[*specify, e.g.,* 10 o'clock A.M.] on _____[*date set for closing*], and submitted to Seller pursuant to Paragraph 11.

(k) The amount required to pay Seller's share of any prorations described in Paragraph 12 of these instructions.

(l) The amount required to pay the escrow fees and costs in accordance with Paragraph 20 of these instructions, including the following: _____[*list costs and expenses to be paid by Seller, e.g.:*]

(1) One half of the cost of publishing and recording all notices and other instruments required by the Bulk Transfers Division of the California Commercial Code to be published or recorded in connection with this escrow.

(2) One half of all costs, expenses, and charges incurred by you or by Buyer and Seller in taking inventory of the stock in trade and merchandise on _____ [*date*].

(3) The costs of recording all instruments reasonably necessary or convenient to effect the transfer to Buyer of the business and assets.

(4) One half of all other costs and expenses incurred by you or Buyer and Seller as a result of this escrow, other than (i) any sales taxes arising from the sale, and (ii) the costs of drafting and recording or perfecting any instruments described in these instructions that evidence or secure the payment of money by Buyer to Seller.

Buyer's Deposits Into Escrow

8. Buyer shall deposit into escrow all of the following:

(a) The sum of $_____, immediately on receipt by you of these Escrow Instructions.

(b) The additional sum of $_____, on or before _____[*specify time, e.g.,* 10 o'clock A.M.] on _____[*date*], the time and date set for closing.

[*If purchase price will be paid in installments (see § 17.200[2], Section 4.01) add:*]

(c) A promissory note executed by Buyer, substantially in the form of the note attached as "Exhibit _____," that is secured in the manner set forth in Paragraph (d), below, and that sets forth provisions for the payment to Seller of the following:

(1) The principal balance of the note in monthly installments of $_____, commencing one month after close of escrow; and

(2) Interest on the unpaid principal balance of the note from the close of escrow at the rate of _____ percent per year, payable monthly commencing one month after the close of escrow.

(d) A security agreement in the form of the attached document marked "Exhibit _____" to be executed by Buyer and Seller, granting to Seller a security interest in all of the property described in Paragraph 1 of this contract.

(e) Any financing statements prepared by Seller to perfect the security interests granted by the security agreement.

[*CONTINUE*]

(f) Approval or rejection of each insurance policy on the list of policies demanded and received by you from Seller pursuant to Paragraph 7.

(g) A copy of the inventory of the stock in trade and merchandise of the business taken as described in Paragraph 9 of this contract and approved with Buyer's signature.

(h) The amount required to pay Buyer's share of any prorations described in Paragraph 12 of these instructions.

(i) The amount required to pay the escrow fees and costs pursuant to Paragraph 20, including the following: _____[*list costs and expenses to be paid by Buyer, e.g.:*]

(1) One half of the cost of publishing and recording all notices and other instruments required by the Bulk Transfers Division of the California Commercial Code to be published or recorded in connection with this escrow;

(2) One half of all costs, expenses, and charges incurred by you or by Buyer and Seller in taking inventory of the stock in trade and merchandise on _____ [*date*], in accordance with Paragraph 9 of these Instructions;

(3) The costs of recording all instruments reasonably necessary or convenient to effect the transfer to Buyer of the business and assets; and

(4) One half of all other costs and expenses incurred by you or Buyer and Seller as a result of this escrow, other than (a) any sales taxes arising from the sale, and (b) the costs of drafting and recording or perfecting any instruments described in these instructions that evidence or secure the payment of money by Buyer to Seller.

Inventory

9. On or before the closing, obtain the following from _____[*name of person or firm that will take inventory of the stock in trade and merchandise of the business*]:

(a) The total value, determined as provided in Paragraph _____ of the contract of sale, of the stock in trade and merchandise of the business;

(b) The amount of all costs, expenses, and charges incurred for taking and computing the inventory of the stock in trade and merchandise of the business; and

(c) A complete copy of the inventory and accounting.

Insurance Policies

10. Contact the agent or company issuing each insurance policy for the business to be transferred to Buyer, and obtain all instruments required to transfer to Buyer each insurance policy that has been approved by Buyer.

Handling Creditor Claims

11. Upon the receipt of each creditor claim against the business, determine whether it was due and payable on or before the noticed sale date, and filed prior to the last date for filing claims specified in the notice described in Paragraph 3 of these Instructions. Promptly submit all timely claims to Seller for approval or rejection.

Proration of Expenses

12. Prorate the following items between Buyer and Seller on the basis of a 30-day month, as of 12:01 A.M. Pacific time on the date set for closing: [*list, e.g.:*]

(a) All personal property taxes levied or assessed for the current tax year against any of the fixtures and equipment of the business shown on the attached inventory marked "Exhibit _____," as determined from the latest available tax bill.

(b) All premiums on insurance policies insuring the business or assets of the business to be transferred to Buyer that have been approved in writing by Buyer.

(c) The rent payable for the premises occupied by the business.

(d) The salaries of the employees of the business shown on the list deposited by Seller pursuant to Paragraph 7 of these Instructions.

(e) All social security taxes and all contributions to union welfare, pension, Christmas bonus, or vacation funds accruing due to the employment of the employees shown on the list deposited by Seller pursuant to Paragraph 7 of these Instructions.

[*Add, if purchase price will be paid in installments:*]

Security Agreement

13. Obtain Seller's signature on the security agreement deposited by Buyer pursuant to Paragraph 8 of these instructions.

[*CONTINUE*]

Vehicle Registration

14. Obtain Buyer's signature on the certificates of vehicle ownership issued by the Department of Motor Vehicles and deposited by Seller pursuant to Paragraph 7 of these instructions.

Determination of Closing Date

15. (a) On the date set for closing pursuant to Paragraph 1 of this contract, determine whether the amount deposited by Buyer into escrow is sufficient to pay in full all timely creditor claims filed with you.

(b) If the amount deposited is sufficient, close the sale on the date specified in Paragraph 1 of these Instructions in accordance with the procedures specified in Paragraph 16, and distribute the amount deposited in the manner specified in Paragraph 18.

(c) If the amount deposited is insufficient, take the following actions:

(1) Determine the pro rata amount payable on each claim in accordance with the order of priorities specified in Paragraph 19.

(2) Within five business days from the original closing date specified in Paragraph 1, send written notice to each creditor of the Seller who has filed a timely claim with you, stating (i) the total consideration deposited or agreed to be deposited in escrow, (ii) the name of each creditor who filed a timely claim with you and the amount of each claim, (iii) the pro rata amount proposed to be paid each creditor who filed a timely claim, (iv) the new date scheduled for the passing of legal title to the business assets to buyer, and (v) the date, not more than five days after the new date specified for passing legal title to the business assets to buyer, on or before which distribution will be made to creditors who have filed timely claims with you.

(3) Delay the closing for a period of not less than 25 days nor more than 30 days from the date you mail the above-described notices, then proceed to closing in accordance with Paragraph 16, and distribution in accordance with Paragraph 19 of these Instructions.

Closing

16. Hold all instruments deposited by Seller pursuant to these instructions until the date set for closing in Paragraph 1, or until the date to which closing is postponed pursuant to 15(c) of these Instructions. At that time, if Buyer has delivered to you all the money and other items required by Paragraph 8 of these Instructions:

(a) Deliver to Buyer the bill of sale deposited by Seller pursuant to Paragraph 7 of these Instructions.

(b) Deliver to Buyer all other instruments deposited by Seller pursuant to Paragraph 7 of these Instructions as reasonably necessary or convenient to transfer, assign, or register ownership of any of the tangible or intangible assets of the business.

(c) Forward the assignment of lease and consent to assignment of lease executed and acknowledged by Seller and _____[*name of lessor*] deposited by Seller pursuant to Paragraph 7 of these Instructions, together with the required recording fees, to the County Recorder of _____ County, California, for recording.

(d) Have the assignment of lease and consent to assignment returned to Buyer at _____[*address*].

(e) Forward all Department of Motor Vehicles (DMV) certificates of ownership deposited by Seller pursuant to Paragraph 7 of these instructions, together with your check for any required fees, to the DMV for registration and transfer of the vehicles to Buyer.

(f) As soon as you receive the inventory of the stock in trade and merchandise of the business taken on _____[*date*], by _____[*name of person or firm that will take inventory*], make photocopies of the inventory and deliver them to Buyer and Seller.

[*Add, if purchase price will be paid in installments (see Paragraph 8):*]

(g) Forward the financing statements deposited by Buyer pursuant to Paragraph 8 of these Instructions, together with your check for the required filing fee, to the Secretary of State.

[*CONTINUE*]

Interpleader Action

17. Notwithstanding any other provision of these Instructions, if you fail to receive from the Board of Equalization the certificate of tax clearance described in Paragraph 4 of these Instructions within 45 days after closing (whether it occurred on the original date or a postponed date pursuant to Paragraph 15(c)), you shall commence an action in interpleader in the _____[*state appropriate court*] against Buyer and Seller, all creditors of Seller who have filed claims with you, and the Board of Equalization, and deposit the sales price received from Buyer with the clerk of that court. In that action you shall ask for attorneys' fees and costs expended and earned by you in bringing the action. Upon bringing that action, you shall disregard Paragraphs 18 and 19 of these Instructions with respect to payment of creditor claims.

Distribution of Sufficient Sales Proceeds

18. If, pursuant to Paragraph 15, you have determined that the purchase price deposited by Buyer in this escrow is sufficient to pay in full all of the claims filed with you

(a) If you have received a statement of any amount owed to the Board of Equalization or Employment Development Department on account of Seller's business, pay that amount in full within _____[*specify time for payment, e.g.*, 48 hours after receipt], then proceed pursuant to subparagraph (b).

(b) When you have received certificates of tax clearance from both the Board of Equalization and the Employment Development Department, distribute the purchase price within 45 days of closing as follows:

(1) First, pay all claims against the business received by you and approved by Seller.

(2) Second, set aside and retain in escrow the amount of any claim against the business disputed by Seller pursuant to Paragraph 11 of these Instructions. Within two business days after distribution of undisputed claims, send written notice to the creditor stating that the claim has been disputed, that the amount otherwise payable on the claim is being retained in escrow, and that the amount otherwise payable will be paid to the Seller unless attached within 25 days of the date of mailing of the notice.

(3) Third, if a writ of attachment is levied on the amount retained by you on account of any claim disputed by Seller within 25 days from the date of mailing notice, pay the amount to the officer levying the writ of attachment and obtain a receipt.

(4) Fourth, within 25 days after mailing the notice, pay to seller the amount of all unattached claims.

(5) Fifth, pay any funds remaining on deposit with you to Seller.

Distribution of Insufficient Sales Proceeds

19. If, in accordance with Paragraph 15 of these Instructions, you have determined that the amount deposited by Buyer in this escrow is insufficient to pay in full all of the claims filed with you, take the following actions:

(a) If you have received a statement of any amount owed to the Board of Equalization or Employment Development Department on account of Seller's business, pay that amount in full, then proceed pursuant to subparagraph (b).

(b) When you have received certificates of tax clearance from both the Board of Equalization and Employment Development Department, set aside and retain in escrow the pro rata amount of any claim against the business disputed by Seller in accordance with Paragraph 11. Within two business days after distribution of undisputed claims pursuant to subparagraph (c), send written notice to the creditor stating that the claim has been disputed, that the amount otherwise payable on the claim is being retained in escrow, and that the amount otherwise payable will be paid to the Seller or to other claimants if not already paid in full, unless attached within 25 days of the date of mailing of the notice.

(c) Within five days after the date to which closing was postponed pursuant to Paragraph 15(c) of these Instructions, pay the claims approved by Seller in the following order of priority:

(1) First, to all obligations owing to the United States, to the extent given priority by federal law.

(2) Second, to secured claims (including statutory and judicial liens) to the extent of the consideration fairly attributable to the value of the properties provided by law, after the creditor deposits a release of lien for the amount of distribution.

(3) Third, to escrow and professional charges and brokers' fees attributable directly to the sale.

(4) Fourth, to unpaid employee wage claims earned within 90 days prior to the sale, transfer, or opening of the escrow, pursuant to *Code of Civil Procedure Section 1205*.

(5) Fifth, to all other tax claims.

(6) Sixth, to all other unsecured claims pro rata, including any deficiency claims of partially secured creditors.

(d) If no writ of attachment is levied on the amount retained by you on account of any disputed claim against the business within 25 days after mailing the notice, pay the amount retained for that claim in the manner set forth in subparagraph (c), until the claims are paid in full. Thereafter, pay any remaining amounts of principal and interest to Seller.

[*Add, if purchase price will be paid in installments:*]

(e) Retain in escrow the promissory note described in Paragraph 7 of these instructions, and instruct Buyer to make all payments thereafter becoming due on the note to you as escrow agent. Apply all payments of principal and interest

received by you on the promissory note to claims in accordance with subparagraph (b), until they are paid in full. Thereafter, pay any remaining amounts of principal and interest to Seller.

[*CONTINUE*]

Escrow Fees and Costs

20. From the funds deposited with you by Buyer and Seller for escrow fees and costs under Paragraphs 7 and 8, pay to yourself all amounts incurred or earned by you in handling this escrow. Deliver a receipt of those fees and costs to Buyer and Seller.

Executed on _____[*date*], at _____[*place*], California.

SELLER
_____ [*signature of seller*]
[*typed name*]
BUYER
_____ [*signature of buyer*]
[*typed name*]

Accepted and approved _____[*date*].

ESCROW AGENT
_____ [*signature of escrow agent*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
C. Escrow Instructions

8-17 California Legal Forms--Transaction Guide §§ 17.251-17.259

AUTHOR: Marilyn E. Minger Revision Author

[Reserved]

§§ 17.251[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
D. Ancillary Agreements

8-17 California Legal Forms--Transaction Guide § 17.260

AUTHOR: Marilyn E. Minger Revision Author

§ 17.260 Agreement to Find Purchaser for Business ("Finder's Agreement")

[1] Comment

[a] Use of Form

This form is an agreement between the owner of a business and an third party who will attempt to find a buyer for the business in return for a fee. Such a person is known as a "finder" and this type of agreement is typically referred to as a "finder's agreement." This type of arrangement is commonly used in business transactions when a seller wishes to compensate an inidividual who has "connections" in a particular business and is willing to use those connections to find a purchaser for the business.

Under this form, the finder will receive a percentage of the sale price if the finder is able to locate a suitable buyer and the sale of the business is ultimately consummated. If no sale is completed, the finder receives nothing.

For a finder's agreement between a prospective *buyer* and finder, see Warren' S Forms of Agreements, Ch. 8, *Sale of a Going Business*, § 8.9, Form 8.9.02 (Matthew Bender).

[b] Finder's Duties

Under this agreement, the finder's duties are solely to locate prospective buyers and give those buyers information about the seller's business [*see* [2], Paragraph 1(a), *below*]. The information itself is prepared by the seller. The finder is not authorized to make further representations on behalf of the seller, to bind the seller in any way, to conduct negotiations on the seller's behalf, or to function as the seller's agent [*see* [2], Paragraph 1(b), *below*]. These limitations are included to limit the seller's potential liability for the finder's acts and representations, as well as to assure that the seller will retain complete control over the transactions. The finder may not assign his or her duties under the agreement, but may engage employees, agents, and advisers to assist him or her in discharging those duties [*see* [2], Paragraph 8, *below*]. The finder agrees to indemnify the seller for any liabilities the seller incurs based on any representations made by

persons alleging a relationship to the finder [*see* Paragraph 11 of form].

To preclude conflicts of interest, the finder is also prohibited from acting on behalf of any prospective buyer [*see* [2], Paragraph 1(c), *below*].

[c] Finder's Fee

The finder's compensation is determined as a percentage of the sale price of the business, as defined in the agreement [*see* [2], Paragraph 2(a), *below*]. Percentage agreements are commonly used, though other arrangements are such as flat rate or hourly fees are also possible. The compensation is payable in full either upon closing of the sale or within a specified time thereafter [*see* [2], Paragraph 2(b), *below*].

This form contains optional language requiring payment of the finder's fee directly from escrow upon closing, if an escrow is used [*see* [2], Paragraph 2(b), *below*]. This language is designed to protect the finder by providing greater assurance that the finder will actually receive his or her fee on closing. Another optional provision provides similar protection in a non-escrow situation by requiring the seller to have the buyer pay a portion of the purchase price equal to the finder's fee directly to the finder at closing [*see* [2], Paragraph 2(c), *below*].

Under this agreement, the seller is not required to pay any portion of the finder's fee, or any related expenses, prior to the closing. If the seller does elect to make any advances, the seller has a right to deduct the amount of those advances from any finder's fee ultimately due [*see* [2], Paragraph 2(e), *below*]. If no sale occurs, the finder receives no fee, and the form gives the drafter the option of determining whether or not any advances by the seller in that situation have to be reimbursed [*see* [2], Paragraph 2(g), *below*].

Some contracts of sale provide for an adjustment of the purchase price after closing, based upon various factors [*see, e.g., § 17.261[2]*, Paragraphs 21, 22 (letter of intent)]. Optional language in this form provides for an upward or downward adjustment of the finder's fee to account for any such adjustment, with an additional payment to the finder, or a refund of a portion of the finder's fee, as appropriate [*see* [2], Paragraph 2(f), *below*].

Under the terms of this agreement, the finder is generally prohibited from accepting any fee from the seller.

[d] Seller's Obligations

The seller is not required to sell the business to any prospective purchaser referred by the finder. The seller may refuse to sell to any prospective purchaser for any reason whatsoever, and no commission will be due [*see* [2], Paragraphs 2(g), 4, *below*].

[e] Term and Exclusivity

The agreement is for a specified term, such as one year [*see* [2], Paragraph 5, *below*]. The agreement may be made either exclusive or non-exclusive during that term [*see* [2], Paragraph 6, *below*]. The finder's fee is required to be paid as long as the sale is to a buyer referred by the finder occurs within a specified time (such as one year) after the referral, even if the finder's agreement itself has expired prior to the sale [*see* [2], Paragraphs 2(a), 5, *below*].

[f] Expenses

This agreement provides that expenses incurred by the finder are non-reimbursable [*see* [2], Paragraph 9, *below*; *see also* discussion of voluntary advancements in [c], *above*]. The seller is also required to bear his or her own expenses [*see* [2], Paragraph 10, *below*].

[2] FORM

Agreement to Find Purchaser for Business ("Finder's Agreement")

FINDER'S AGREEMENT

THIS FINDER'S AGREEMENT is made between _____[*name of seller*] (Seller) and _____[*name of finder, broker, or agent*] (Finder), collectively referred to as the "Parties."

RECITALS

A. Seller is seeking to locate a buyer for Seller's business (Business).

B. Finder will try to find a suitable buyer in return for a fee.

[C. _____ (*list any special qualifications or licenses that finder holds, such as real estate broker*).]

In reliance on the foregoing recitals, and in consideration of the representations, warranties, and covenants contained in this Agreement, the parties hereby agree as follows:

AGREEMENT

1. **Duties of Finder.** (a) Finder shall submit to Seller profiles of prospective buyers who have expressed an interest in purchasing the Business ("Prospective Buyers"). A profile shall consist of information regarding the Prospective Buyer's financial ability to purchase the Business and the Prospective Buyer's qualifications to run the Business ("Profile").

(b) Finder is authorized to deliver to Prospective Buyers a profile of the Business prepared by Seller describing the Business and summarizing its financial condition ("Business Profile"). Finder shall make no representations regarding the Business other than those contained in the Business Profile, or in any other way act or represent that he or she is authorized to act in a manner which would bind Seller in any way whatsoever.

(c) Finder shall not act on behalf of any Prospective Buyer and shall not negotiate on behalf of Seller or any Prospective Buyer. Finder's duties under this Agreement shall be limited solely and exclusively to locating Prospective Buyers and introducing them to Seller.

2. **Finder's Fee.** (a) If a Prospective Buyer ("Buyer") purchases the Business within _____[*e.g.*, one year] from the date Finder submits the Profile of that Prospective Buyer to Seller, Finder shall receive a Finder's fee equal to _____ percent of the total purchase price of the Business. For purposes of determining the amount of the Finder's fee due under this paragraph, the "total purchase price of the Business" means the total cash consideration actually paid by Buyer to Seller for the Business, including any contingent payments, plus the fair market value, as of the closing date of the sale, of any non-cash assets actually received by Buyer from Seller or any other person or entity as consideration for Buyer's sale of the Business. The value of any of Seller's liabilities assumed by Buyer shall be treated as part of the "total purchase price of the Business" for purposes of determining Finder's fee.

(b) The fee specified in (a), above, shall be payable to Finder in cash _____[immediately on *or* within _____ days after] the closing of the sale of the Business. [*Optional if finder's fee is due on closing of escrow:* If the closing is conducted through an escrow, Seller agrees that Finder's fee shall be paid to Finder directly from escrow upon the close of escrow. Seller agrees that an instruction requiring payment of Finder's fee in the manner specified in the preceding sentence will be included in any escrow instructions submitted to the escrow holder by Seller in connection with the sale.]

[*Optional:* (c) If the closing is not conducted through an escrow, Seller agrees to authorize and require the Buyer to pay

directly to Finder, at the closing, that portion of the sale price of the Business equal to the amount owed by Seller to Finder for Finder's fee, as determined under Paragraph 2(a), above. Seller agrees to include in the agreement between Buyer and Seller for sale of the Business a written provision requiring Buyer to make such a payment to Finder. Buyer's failure to comply with any such term in the contract of sale shall not relieve Seller from the obligation to pay Finder's fee as set forth in this Paragraph 2.]

(d) [Except as expressly provided in this agreement,] Finder shall not be paid a fee by Buyer or any Prospective Buyer without the prior written consent of Seller.

(e) Seller shall be under no obligation to pay Finder any compensation or other fee prior to the closing. If Seller, in Seller's sole discretion, elects to pay prior to the closing any portion of Finder's fee or any other expense incurred by Finder, Seller shall have the right to deduct any amounts so advanced from the fee due Finder under Paragraph 2(a), above.

[*Optional:* (f) Finder's fee as determined under Paragraph 2a, above, _____ (shall *or* shall not) be adjusted to reflect any post-closing adjustment in the purchase price of the Business that occurs pursuant to the terms of the contract of sale between Buyer and Seller, or by written agreement between Buyer and Seller (that is made within _____ days after the closing). *(If adjustment is permitted, add:* Any additional amounts owed by Seller to Finder under this Paragraph 2(f) shall be paid in cash to Finder within _____ days after Seller receives the additional funds from Buyer. Any reimbursement owed by Finder to Buyer under this Paragraph 2(f) shall be paid in cash to Buyer within _____ after the amount of the reimbursement is determined.)]

(g) If for any reason, or no reason, including the negligence or wilful refusal of Seller, no sale of the Business occurs, Finder shall receive no Finder's Fee or other consideration for any services performed under this Agreement. In the event that no sale occurs, Finder _____[shall *or* shall not] be required to reimburse Seller for all amounts advanced to Finder by Seller under Paragraph 2(e) of this Agreement

3. **Warranties of Finder.** Finder hereby represents and warrants to Seller that Finder's performance under this Agreement and the receipt of fees for that performance does not violate (1) any contractual obligation he or she may have, (2) any duty he or she may have to his or her present employer or (3) any federal or state laws or regulations applicable to Finder or his or her actions taken in furtherance of this Agreement.

4. **Obligations of Seller.** Seller shall be under no obligation to sell the Business to any Prospective Buyer introduced to Seller by Finder. Seller may, in Seller's sole and absolute discretion, contact, negotiate with, and enter into any agreement with any Prospective Buyer introduced by Finder.

5. **Term of Agreement.** This Agreement shall terminate automatically _____[*time, e.g.,* 12 months] months from the date this Agreement is executed by the Parties, unless extended by the Parties in a writing signed by both Parties. [*Optional:* Seller may terminate this Agreement at any time on delivery of written notice to Finder.] On termination of this Agreement, Finder shall deliver no additional Profiles to Seller, shall make no additional introductions to Seller, and shall cease to act as a Finder of Prospective Buyers; provided, however, that Finder shall be entitled to all fees due under Paragraph 2, above, after the effective date of termination.

6. _____[Exclusivity *or* Non-Exclusivity]. During the term of this agreement, Seller _____[shall not *or* may] engage any other firm or individual to act as a broker or finder with respect to the sale of all or any part of Seller's Business.

7. **Disclosure of Finder's Duties to Third Parties.** Finder agrees that Seller may notify any party Seller deems necessary or appropriate that Finder is acting as a Finder for Seller and will be receiving a finder's fee as described in Paragraph 2 of this Agreement.

8. **Nonassignability of Finder's Duties.** Finder shall not assign any portion of Finder's duties under this

Agreement to any other person or entity without Seller's prior written consent. However, Finder may, at Finder's own expense, employ persons, entities, or agents to assist Finder in discharging Finder's duties under this Agreement.

9. **Finder's Expenses.** Any expenses incurred by Finder in connection with the discharge of Finder's duties under this agreement, including but not limited to transportation, meals, lodging, entertainment, fees to other persons, agents, or advisers, document drafting fees, attorneys' fees, or any other expenses whatsoever, shall be paid by Finder and Seller shall have no obligation to reimburse Finder for any such expenss unless Seller specifically agrees otherwise in writing.

10. **Seller's Expenses.** Any expenses incurred by Seller in connection with the sale of Seller's Business shall be borne solely by Seller.

11. **Indemnification of Seller.** Finder agrees to indemnify and hold Seller harmless against all liabilities, claims, and expenses caused by any person claiming a commission, fee, or other expense in connection with the transaction who alleges a relationship with Finder.

12. **Governing Law.** The laws of the State of California, (irrespective of its choice of law principles) shall govern the validity of this Agreement, the construction of its terms, and the interpretation and enforcement of the rights and duties of the Parties to this Agreement.

13. **Effect on Successors and Assigns.** Subject to and unless otherwise provided in this Agreement, this Agreement shall be binding upon, and inure to the benefit of, the successors, executors, heirs, representatives, administrators, and assigns of the Parties.

14. **Entire Agreement.** This Agreement constitutes the entire understanding and agreement of the parties with respect to the subject matter of this Agreement, and supersedes all prior and contemporaneous agreements or understandings, inducements or conditions, express or implied, written or oral, between the Parties with respect to the subject matter of this Agreement. The express terms of this Agreement control and supersede any course of performance or usage of the trade inconsistent with any of the terms of this Agreement.

15. **Amendment.** Any term or provision of this Agreement may be amended, and the observance of any term of this Agreement may be waived (either generally or in a particular instance and either retroactively or prospectively) only by a writing signed by the party to be bound thereby.

16. **No Waiver.** The failure of any party to enforce any provision or provisions of this Agreement shall not be construed as a waiver of the right of that party thereafter to enforce any provisions of this Agreement.

17. **Attorneys' Fees.** Should suit or arbitration be brought to enforce or interpret any part of this Agreement, the prevailing party shall be entitled to recover, as an element of the costs of suit or arbitration and not as damages, reasonable attorneys' fees to be fixed by the court (including without limitation, costs, expenses and fees on any appeal).

18. **No Joint Venture.** Nothing in this Agreement shall be deemed or construed as creating a joint venture or partnership between the Parties. Neither party, by virtue of this Agreement, is authorized to be an agent, employee or legal representative of the other Party. Neither Party shall have the power to control the activities and operations of any other and their status is, and at all times will continue to be, that of independent contractors with respect to each other. Neither Party shall have any power or authority to bind or commit any other. Neither Party shall hold itself out as having any authority or relationship in contravention of this Paragraph.

Executed on _____[*date*], at _____[*place*], California.

SELLER

_____ [*signature of seller*]

[*typed name*]

FINDER

_____ [*signature of finder*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
D. Ancillary Agreements

8-17 California Legal Forms--Transaction Guide § 17.261

AUTHOR: Marilyn E. Minger Revision Author

§ 17.261 Letter of Intent

[1] Comment

[a] Use of Form

This form is a letter of intent between the prospective buyer and seller of a business. The purpose of a letter of intent is to set forth the principal terms of the anticipated contract for the sale of the business. Letters of intent are helpful when negotiations are expected to be lengthy or when the nature of the business is complex and requires investigation. A letter of intent may not be necessary or appropriate for all business sales. With some sales, especially those of small businesses, it may be more efficient to bypass the letter of intent and proceed directly to the contract of sale.

This form, probably more comprehensive than required for most transactions, may be modified to conform to particular transactions.

[b] Binding Nature of Letter of Intent

Parties to a sale generally will prefer that a letter of intent *not* be binding. Contract law determines the enforceability of a letter of intent. Therefore, if parties do not want the letter to be binding, the letter should include a clause that expressly states that the letter does not constitute a binding or enforceable contract [*see* [2], Paragraph 30, *below*].

In the alternative, only selected provisions of the letter of intent may be made binding. Binding provisions typically include the buyer's covenant not to disclose proprietary and confidential information, and the seller's covenant to negotiate exclusively with the buyer. Optional language in paragraph 30 of this form allows the drafter to specify that selected provisions of the form will be legally binding on the parties.

[2] FORM

Letter of Intent

Letter of Intent
[*Buyer's Letterhead*]
_____[*date*]
_____[*seller's name*]
_____[*seller's address*]

Re: Letter of Intent With Respect to Proposed Purchase of _____ [*name or description of business*]
Dear _____ [*name of seller*] :

_____[*name of buyer*] (Buyer) is prepared to purchase the assets of _____[*name or description of business*]. The purpose of this letter of intent is to summarize the basic terms and conditions upon which Buyer plans to commit to a binding agreement.

1. Assets. Buyer will purchase from _____[*name of seller*] (Seller) all of Seller's business assets including, without limitation, cash, name, patents, intangibles, equipment, inventory, fixtures, leasehold improvements, goods, receivables, instruments, choses in action, and chattel paper (referred to in this agreement collectively as the "Assets"). The Assets shall be transferred to Buyer free of all liens and encumbrances except as assumed by Seller pursuant to Paragraphs 4 and 5. Seller shall assign to Buyer all trade names used by Seller.

2. Purchase Price. Buyer shall pay to Seller a purchase price for all the Assets and the Noncompetition Agreement described in Paragraph _____, below, of $_____, plus the assumption of certain liabilities as set forth in Paragraph 9, below.

3. Allocation of Purchase Price. The parties shall agree upon an allocation of the purchase price.

4. Terms of Payment. The purchase price shall be paid at the Closing in the following manner:

(a) Delivery of a certified, cashier's or other check acceptable to Seller in the amount of $_____;

(b) The assumption of the liabilities as set forth in Paragraph 9, below; and

(c) Delivery of a Promissory Note ("Note") in the principal amount of $_____, bearing interest at the rate of _____ percent per annum. The Note shall be payable _____[*describe payment terms*].

5. Security for Promissory Note. The Note shall be secured by the assets of Buyer. The payment of the Note and security interest shall be junior and subordinate, and subject in right of payment, to the prior payment of all indebtedness for money borrowed by Buyer from institutional lenders, provided that the amount of institutional indebtedness shall not exceed $_____ in fiscal year _____; $_____ in fiscal year _____; $_____ in fiscal year _____; and $_____ in fiscal year _____. Seller agrees to execute and deliver from time to time subordination agreements in connection with such senior borrowings by Buyer.

6. Set-Off. Buyer shall be entitled to set-off against the Note any amounts payable by Seller to Buyer.

7. Bulk Sales Law. All amounts payable to Seller shall be subject to compliance with Division 6 of the California Uniform Commercial Code, and any and all amounts payable by Buyer to Seller shall be made in accordance with Division 6. [*If purchase price is less than $2 million, add:* The check referred to in Paragraph 4(a) above shall be held in

escrow by _____ (*name of escrow agent*) until Buyer and Seller shall instruct that agent to release the check in accordance with escrow instructions to be negotiated by the parties.]

8. Title. Title to the Assets shall be conveyed by bill of sale free and clear of all encumbrances, except as approved by Buyer in writing during the Due Diligence Period described below.

9. Assumption of Liabilities. Buyer shall assume all of Seller's noncontingent liabilities (except as set forth in Paragraph _____ relating to expenses of sale) as set forth on Seller's balance sheet as delivered at the date of the Closing (the "Liabilities"). Buyer shall assume no liabilities except as expressly set forth in this letter.

10. Other Agreements. Seller shall assign and Buyer shall assume the rights and obligations under Seller's lease of the premises at _____ and all open purchase orders, distribution contracts, service and maintenance agreements and similar agreements.

11. Due Diligence Period. On execution of a purchase agreement Buyer shall have a period of _____ days (the "Due Diligence Period") within which to inspect and investigate the assets and liabilities of the business. At the commencement of the Due Diligence Period, Seller shall provide Buyer and his or her agents, contractors, consultants or advisors ("Buyer's Agents") with reasonable access to all of the books and records of the business. If Buyer determines that the Assets and Liabilities are not satisfactory and as expected, Buyer shall have the right, at Buyer's election, to terminate the purchase agreement by written notice to Seller given on or prior to the expiration of the Due Diligence Period. In the event of such a termination, neither Seller nor Buyer shall have any further obligations under the purchase agreement.

12. Representations and Warranties. The documentation relating to the purchase of the Assets by Buyer shall contain customary representations and warranties of Seller including but not limited to the following:

(a) Seller has good and marketable title to the Assets including to all of the trademarks, licenses, patents and copyrights necessary for the conduct of the business and has the right to transfer the same to Buyer as part of the Assets.

(b) There is no pending litigation against Seller.

(c) Seller has prepared and filed all federal, state and local income, withholding, sales, real property, personal property and other tax returns and has paid all required taxes.

(d) Seller is in compliance with applicable laws the violation of which would have a material adverse affect on the Seller's operations or financial condition. Without limitation on the foregoing, Seller has complied with all laws regulating the discharge and disposal of hazardous waste.

(e) Seller's real property included in the Assets and all leased premises the lease of which is being assumed by Buyer are adequate for the present operations of the Seller and, as presently used by the Seller complies with all zoning and land use laws and does not contain any hazardous wastes below the ground surface.

(f) Seller has and is in compliance with all governmental licenses and permits necessary for the operation of its business, the absence of which or the noncompliance with which would have a material adverse affect on the operations or financial condition of the Seller.

(g) Seller maintains and will assign to Buyer at the Closing appropriate insurance policies relating to the Assets and the conduct of its business at the premises subject to the lease described in Paragraph 5.

(h) Seller's financial statements as delivered to Buyer are true and correct and there has been no adverse change in the business of Seller since the date of such financial statements to the Closing.

(i) Seller's inventory shown on Seller's financial statements delivered to Buyer consist of items of a quality and quantity usable and saleable in the ordinary course of business by Seller. All items included in the inventory are the property of the Seller, except for sales made in the ordinary course of business since _____[*date*]. For each such sale, either the purchaser has made full payment or the purchaser's liability to make payment is reflected on the books of Seller. No items included in the inventory have been pledged as collateral or are held by Seller on consignment from others. The inventory shown on the balance sheet is based on quantities determined by physical count or a measurement taken within the preceding 12 months and is valued at the lower of cost (determined on a first in, first out basis) or market value and on a basis consistent with that of prior years. The inventory being purchased by Buyer is sufficient to satisfy open orders pending with Seller.

(j) Seller's products and all components thereof are of a commercial quality and are sufficient to satisfy open orders pending with Seller and being assigned to Buyer.

(k) Seller's reserve for warranty repair as shown on financial statements is adequate to cover future warranty repairs.

(l) Seller shall deliver to Buyer and warrant as true and correct a customer list.

(m) Seller shall deliver and warrant as true and correct an aged accounts receivable and aged schedule of all liabilities being assumed by Buyer and a list of all sales contracts and bids presently pending with Seller.

(n) Seller's accounts receivable arose from valid sales in the ordinary course of business and, subject to a reasonable bad debt allowance, are collectible without extraordinary efforts.

(o) All items described in Seller's catalogs, advertising literature or other sales materials are presently manufactured by Seller or available to Seller on commercially reasonable terms in sufficient quantities and within sufficient time to satisfy reasonably anticipated demand for such items.

(p) At the Closing, Seller shall deliver to Buyer and warrant as true and correct a schedule of all bank accounts of Seller and shall deliver resignations of all signatories on those bank accounts and authorizations appointing Buyer's designees as signators on such bank accounts.

(q) Seller shall deliver to Buyer at the Closing and warrant as true and correct a schedule of all Seller's employees, their present compensation levels, their scheduled salary review date, their accrued and unpaid sick leave and vacation and all other items of compensation due or to come due Seller's employees.

(r) None of the documents delivered to Buyer (taken together) by Seller contain any untrue statement of a material fact or omit a statement of any material fact necessary in order to make the statements contained therein not misleading in light of the circumstances under which the statements were made.

13. Buyer's Representations and Warranties. The documentation relating to the purchase of the Assets by Buyer shall contain customary representations and warranties of Buyer including, but not limited to, Buyer's warranties of the following:

(a) Buyer has the power, authorization, and capacity to enter the transaction.

(b) There is no pending litigation against Buyer.

(c) Consummation of the sale of Assets by Buyer will not violate any contract or agreement to which Buyer is a party.

14. Noncompetition Agreement. At the Closing, Buyer shall receive from Seller an Agreement not to compete in the

business presently conducted by Seller for a period of the longer of _____ years from the Closing. $_____ of the purchase price of the Assets will be allocated to the Noncompetition Agreement.

15. Closing Date. The Closing Date shall occur no later than _____[*date*]. In the event the Closing Date has not occurred by _____[*date*], Seller shall have the right to terminate the purchase agreement.

16. Conduct of Business Until Closing. Until the Closing, Seller will continue to conduct the business and maintain business relationships in the ordinary and usual course, and will not encumber or dispose of the Assets except in the regular and ordinary course of business. During that period, Seller also shall not incur additional long term lease or other contracts, or pay any special bonuses or compensation to employees. Until the Closing, all risk of loss, damage or destruction of the Assets shall be borne by the Seller.

17. Access to Information. Until the Closing, Seller shall allow Buyer and Buyer's agents free access to Seller's files, books and offices, including any and all information relating to taxes, commitments, contracts, leases, licenses, and personal property and Seller's financial condition. Buyer will keep all such information in confidence, and in the event the sale of the Assets is not consummated shall return all copies of that information to Seller immediately on demand.

18. Purchase Agreement. The obligations of Seller to sell and of Buyer to buy the Assets are contingent upon the execution of a purchase agreement consistent with this Letter of Intent and otherwise in a form mutually acceptable to both parties. The purchase agreement shall be executed by both parties as expeditiously as possible after Seller returns to Buyer a fully executed copy of this Letter of Intent, but in no event later than _____[*date*].

19. Confidentiality. Seller and Buyer agree to hold in confidence all terms and conditions of this Letter of Intent, except that the parties may disclose documents, materials or information to parties who are required to know that information for the proper performance of their duties in effectuating the purchase and sale of the Assets; provided, however, that the disclosing party notifies all parties to whom information is disclosed that the information must be kept confidential in accordance with the terms of this Paragraph. Neither Seller nor Buyer shall issue any press release or general public announcement concerning the terms or fact of this Letter of Intent without first obtaining the consent of the other party, except as may be required by law. [It is agreed that an appropriate public announcement shall be made not later than _____ (*date*).]

20. Taxes. Immediately after the Closing, Seller shall request a tax clearance from the California State Board of Equalization with respect to Seller's sales taxes and a certificate from the California State Employment Development Department that Seller has paid all contributions, interest or penalties due under the Unemployment and Insurance Code and state income taxes withheld from employee wages. Seller shall indemnify and hold Buyer harmless against all sales taxes, amounts due under the Unemployment and Insurance Code and state income taxes withheld by Seller from employee wages. All sales taxes due on the sale of the Assets to Buyer shall be paid by Seller. Real and personal property taxes relating to the Assets shall be pro rated as of the Closing. Buyer shall not be responsible for any business, occupation, withholding, or similar tax, or any taxes of any kind related to any period before the Closing.

21. Audit. Buyer shall conduct an audit of the Assets purchased and liabilities assumed as soon as practicable after the Closing. In the event that audit shows that the net value of the Assets less liabilities is less than that set forth on the Seller's audited balance sheet for the period ended _____[*date*], an adjustment to purchase price will be made through the escrow described below.

22. Inventory. [Immediately after the Closing,] [I]n connection with the audit described in Paragraph 21, Buyer and Seller shall conduct a physical inventory of Seller's inventory and shall confirm that it satisfies the requirements of the purchase and sale agreement to be negotiated by the parties. In the event that the inventory has less value according to generally accepted accounting principles than the value set forth in the Seller's audited balance sheet dated _____, a reduction in the purchase price will be made through the escrow described below.

23. Seller's Liabilities. Seller shall indemnify and hold Buyer and the property of Buyer including the Assets purchased by Buyer, free and harmless from any and all claims and losses arising from Seller's operation of the business before the sale of the Assets which claims and losses are not assumed by Buyer on or before the Closing including without limitation claims for unpaid taxes of any kind or nature.

24. Accounts Receivable. Seller shall indemnify Buyer against the non-collectibility of receivables in excess of the allowance for bad debts set forth on Seller's financial statements delivered at the Closing.

25. Breach of Warranties. Seller shall indemnify Buyer against any loss, cost or liability incurred by Buyer as a result of the breach of any representation or warranty by Seller contained in the purchase documentation.

26. Indemnity. Seller shall indemnify and hold Buyer and the property of Buyer, including the Assets purchased by Buyer, free and harmless from any and all claims and losses arising from Seller's operation of its business before the sale of the Assets which claims and losses are not disclosed to Buyer.

27. Escrow. _____ percent of the cash purchase price payable for the Assets shall be placed in an interest bearing escrow account to satisfy any claim by Buyer pursuant to Paragraphs _____, _____, and _____, above. One half of the escrowed amount, less claims paid to Buyer, shall be paid to Seller 15 days after the completion of both the physical inventory set forth in Paragraph _____, above, and audit set forth in Paragraph _____, above, and the balance shall be paid to Seller _____ months after the date of Closing. Nothing in this Paragraph shall be construed as limiting the liability of Seller to the amount placed in escrow, nor shall that amount be considered as liquidated damages for any breach.

28. Expenses. Buyer and Seller shall each bear all of their expenses, including attorneys' fees, in connection with the negotiation of the documentation of the sale of Assets by Seller to Buyer. Seller shall be responsible for all Seller's attorneys' fees incurred from and after the date of this letter and all accounting fees incurred in connection with the audit of Seller's financial statements. Any party engaging a broker or finder shall be solely responsible for that broker's or finder's fee.

29. Negotiation Stand-Still. For a period of _____ days commencing with the date of execution of this letter of intent, Seller agrees that Seller will not enter a binding agreement with any other party relating to the sale of the Assets. For a period of _____ days commencing with the date of execution of this letter of intent, Seller agrees that Seller will not enter negotiations or discussions with any other party concerning the sale of the Assets [or Seller's capital stock].

30. Letter of Intent Nonbinding [Except as Otherwise Specified]. This letter of intent is intended as an outline of material business terms to serve as a basis for the preparation of a purchase agreement for review and approval by Buyer and Seller. [Except as expressly stated in this Paragraph 30], [T]his Letter of Intent shall not constitute a formal binding agreement and neither party is obligated to execute the purchase agreement. It is intended that all legal rights or obligations between the parties who are executing this Letter of Intent shall come into existence only when a definitive agreement is executed and delivered by those parties. [*If specified provisions of letter of intent are to be made binding, add the following:* Notwithstanding the preceding provisions of this Paragraph 30, however, _____ (*list portions of agreement that are to be made binding, e.g.*, Paragraph 19 of this Agreement, relating to confidentiality of information, and Paragraph 29, restricting Seller's right to enter into any agreements or conduct negotiations with other parties), shall be legally binding and enforceable by the Parties.]

If the terms of this letter of intent are acceptable to Seller, please execute the enclosed counterpart of this Letter of Intent, without addition or deletion, and deliver same to Buyer on or before _____[*date*]. Failure to

deliver the fully executed Letter of Intent by that date will render the provisions of this Letter of Intent inoperative and of no further force and effect.

Sincerely, _____ [*signature of buyer*]
[*typed name*]

APPROVED on _____[*date*]:

_____ [*signature of seller*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
D. Ancillary Agreements

8-17 California Legal Forms--Transaction Guide § 17.262

AUTHOR: Marilyn E. Minger Revision Author

§ 17.262 Nondisclosure Agreement

[1] Comment

[a] Use of Form

This form is a nondisclosure or confidentiality agreement between the prospective buyer and the prospective seller of a business. This type of agreement may be used to protect confidential information that may be disclosed during the due diligence period prior to the closing of the sale. In the event the sale does not close as planned, the parties, particularly the seller, may find it important to protect such confidential information from subsequent disclosure by the other party or that party's agents.

An alternative approach to nondisclosure is to include nondisclosure or confidentiality provisions in a letter of intent [*see, e.g., § 17.261*, Paragraph 19] or in the sales agreement itself. The advantage of a separate agreement is that it permits the inclusion of more detailed agreements regarding nondisclosure without unduly lengthening the sales agreement.

Although the seller is usually the principal party at risk with respect to the disclosure of information, this agreement protects both the buyer and the seller. Under some circumstances, the buyer as well as the seller may be required to disclose confidential information. For example, if the seller is carrying a note, information about the buyer's financial condition may be required. Similarly, if the seller is concerned about preservation of goodwill, taking care of long standing customers, and so on, the seller may require buyer to disclose relevant confidential information. Therefore the attached agreement works both ways.

[b] Features of Form

This form addresses the following issues related to confidential information:

- Defines what information is to be classified as confidential for purposes of the agreement [*see* [2], Paragraph 2, *below*].

- Restricts the disclosure of confidential information [*see*[2], Paragraph 3, *below*].

- Clarifies that confidential information remains the property of the disclosing party [*see*[2], Paragraph 4, *below*].

- States the term of the agreement and provides for nondisclosure of confidential information for an additional period after the expiration of that term [*see* [2], Paragraph 5, *below*]

- Provides for injunctive relief to prohibit unauthorized disclosures [*see* [2], Paragraph 6, *below*].

- Provides for return of confidential documents and information in the event that the the sale of the business falls through for any reason [*see* [2], Paragraph 7, *below*].

[2] FORM

Nondisclosure Agreement

NONDISCLOSURE AGREEMENT

THIS NONDISCLOSURE AGREEMENT is entered into by and between _____ ("Seller") and _____ ("Buyer"), colletively referred to as the "Parties."

Recitals

A. Buyer and Seller are involved in negotiations for Buyer to purchase _____[*describe business*] ("Business").

B. Seller will need to disclose certain information to Buyer, and Buyer may need to disclose certain information to Seller, in connection with the negotiations and the purchase.

C. This Agreement is being entered into to set forth the terms under which any such information is disclosed.

Buyer and Seller agree as follows:

AGREEMENT

1. Definition of "Receiving Party" and "Disclosing Party." When either party discloses Confidential Information (as defined in Paragraph 2, below) to the other, the party disclosing the Confidential Information shall be the "Disclosing Party" with respect to that Confidential Information and the other party shall be the "Receiving Party" with respect to that Confidential Information.

2. Definition of "Confidential Information." For purposes of this Agreement, "Confidential Information" shall mean information disclosed by a Disclosing Party to a Receiving Party that relates to product plans, designs, costs, prices, suppliers, finances, marketing plans, business opportunities, research, development, know-how, or personnel, or any other disclosed information that the Disclosing Party labels "Confidential" or otherwise notifies Receiving Party in writing that the information is confidential. Confidential Information shall not include information that (a) is now or subsequently becomes generally available to the public through no fault or breach on the part of Receiving Party; (b)

Receiving Party can demonstrate to have had rightfully in Receiving Party's possession prior to disclosure to Receiving Party by Disclosing Party; (c) is independently developed by Receiving Party without the use of any Confidential Information; or (d) Receiving Party rightfully obtained from a third party who has the right to transfer or disclose that information.

3. Nondisclosure and Nonuse of Confidential Information. Receiving Party shall not, without the prior written approval of Disclosing Party in each instance, or unless otherwise expressly permitted in this Agreement, use for its own benefit, publish or otherwise disclose to others, or permit the use by others for their benefit or to the detriment of Disclosing Party, any Confidential Information. Receiving Party shall carefully restrict access to the Confidential Information to those of Receiving Party's professional advisors who clearly need such access in order to participate on behalf of Receiving Party in the analysis and negotiation of a business relationship or any contract or agreement, or the advisability thereof, with Disclosing Party. Receiving Party may disclose Confidential Information if required by any judicial or governmental request, requirement or order; provided that Receiving Party will take reasonable steps to give Disclosing Party sufficient prior notice of that request for Disclosing Party to contest that request, requirement or order.

4. Ownership of Confidential Information. All Confidential Information and all intellectual property rights therein remain the property of Disclosing Party, and no license or other right to Confidential Information is granted or implied hereby.

5. Term. The term of this Agreement is _____[*e.g.*, two years], provided that Receiving Party's duty to protect Disclosing Party's Confidential Information shall survive expiration or termination of this Agreement and shall expire _____[*e.g.*, five years] from the date of disclosure.

6. Injunctive Relief. Receiving Party understands and acknowledges that any disclosure or misappropriation of any of the Confidential Information in violation of this Agreement may cause Disclosing Party irreparable harm, the amount of which may be difficult to ascertain and, therefore, agrees that Disclosing Party shall have the right to apply to a court of competent jurisdiction for an order restraining any further disclosure or misappropriation, and for such other relief as Disclosing Party shall deem appropriate. This right of Disclosing Party shall be in addition to the remedies otherwise available to Disclosing Party at law or in equity.

7. Return of Confidential Information. Receiving Party shall immediately return to Disclosing Party all written Confidential Information of Disclosing Party and any and all records, notes and other written, printed or tangible materials pertaining to that Confidential Information upon receipt of a written request from Disclosing Party.

8. Binding on Successors. This Agreement and Receiving Party's obligations hereunder shall be binding upon the representatives, assigns and successors of Receiving Party and shall inure to the benefit of the assigns and successors of Disclosing Party.

9. Governing Law. This Agreement shall be governed by and construed in accordance with California law.

10. Entire Agreement. This Agreement constitutes the sole understanding of the parties with respect to the subject matter of the Agreement, and may not be amended or modified except in writing signed by both of the Parties.

Executed on _____[*date*], at _____[*place*], California.

BUYER
_____ [*signature of buyer*]
[*typed name*]
SELLER
_____ [*signature of seller*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
D. Ancillary Agreements

8-17 California Legal Forms--Transaction Guide § 17.263

AUTHOR: Marilyn E. Minger Revision Author

§ 17.263 Assignment of Service Contracts, Warranties, Guaranties, and Other Intangible Property

[1] Comment--Use of Form

This form may be used when an express assignment and assumption of contracts, warranties, guaranties or other intangible property is required.

[2] FORM

Assignment of Service Contracts, Warranties, Guaranties, and Other Intangible Property

THIS ASSIGNMENT is made and entered by and between _____ (Assignor) and _____ (Assignee).

1. Assignment and Assumption. Assignor hereby assigns and transfers to Assignee, and Assignee assumes and accepts, all of Assignor's right, title, claim, obligation and interest in and under the following:

(a) All warranties and guaranties set forth in Schedule 1 attached to this Agreement, made by or received from any third party with respect to any building, building component, structure, fixture, machinery, equipment or material situated on, contained in any building or other improvement situated on, or comprising a part of any building or other improvement situated on, any part of the real property described in the attached Exhibit "A" (the "Real Property");

(b) All of the contracts and agreements listed in Schedule 2 attached to this Agreement; and

(c) Any intangible property now or hereafter owned by Assignor in connection with the buildings or improvements on the Real Property or personal property located therein, including, without limitation, the right to use any trade name now used in connection with said buildings and improvements and any governmental permits or licenses, agreements, utility contracts or other rights relating to the Ownership, use or operation of those buildings and improvements.

2. Covenants of Assignor. Assignor covenants that the warranties and guaranties described in Schedule 1 and the contracts and agreements described in Schedule 2 are in full force, and that to the best of Assignor's actual knowledge there exist no material defaults on the part of any party under those covenants and agreements, nor any acts or events which with the passage of time or the giving of notice, or both could become material defaults.

3. Assumption by Assignee. Without limiting Assignee's obligation pursuant to Paragraph 1, Assignee hereby assumes all of Assignor's obligations under the contracts and agreements described in Schedule 2.

4. Indemnity. Assignor hereby agrees to defend and indemnify Assignee against and hold Assignee harmless from any and all cost, liability, loss, damage, claim and expense, including, without limitation, reasonable attorneys' fees, court costs, fees of expert witnesses and costs originating prior to the date of execution of this Agreement and arising out of Assignor's obligations under the contracts and agreements described in Schedule 2. Assignee hereby agrees to defend and indemnify Assignor against, and hold Assignor harmless from any and all cost, liability, loss, damage, claim and expense, including, without limitation, reasonable attorneys' fees, court costs, fees of expert witnesses and costs originating subsequent to the date of execution of this Agreement and arising out of Assignee's obligations under the contracts and agreements described in Schedule 2.

5. Attorneys' Fees. In the event of any litigation between Assignor and Assignee arising out of the obligations of either party under this Assignment or concerning the meaning or interpretation of any provision contained herein, the losing party shall pay the prevailing party's costs and expenses of that litigation, including, without limitation, reasonable attorneys' fees, court costs, and fees of expert witnesses.

6. Successors and Assigns. This Assignment shall be binding on and inure to the benefit of the parties, their heirs, executors, administrators, successors in interest, and assigns.

7. Counterparts. This Assignment may be executed in counterparts with all such counterparts together constituting one original of this Assignment.

Executed on _____[*date*], at _____[*place*], California.

ASSIGNOR
_____ [*signature of assignor*]
[*typed name*]
ASSIGNEE
_____ [*signature of assignee*]
[*typed name*]

Exhibit A

[*Attach legal description of all real property*]

Schedule 1

[*Attach list of warranties and guaranties*]

Schedule 2

[*Attach list of contracts and agreements*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
D. Ancillary Agreements

8-17 California Legal Forms--Transaction Guide §§ 17.264-17.269

AUTHOR: Marilyn E. Minger Revision Author

[Reserved]

§§ 17.264[Reserved]



142 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
E. Notices

8-17 California Legal Forms--Transaction Guide § 17.270

AUTHOR: Marilyn E. Minger Revision Author

§ 17.270 Notice of Intended Bulk Sale

[1] Comment

[a] Use of Form

This form is a notice of intended bulk sale of a business. The Bulk Sales Division of the Commercial Code [*Com. Code §§ 6101-6111*] requires that the buyer (or escrow agent, auctioneer, or liquidator) give notice of the intended sale in the manner and within the time required by statute [*Com. Code §§ 6104(b), 6105*]. If the buyer fails to comply with the notice requirements with respect to one or more claimants, the buyer is liable for damages in the amount of any claims against the seller, less any amount that the claimant would not have realized if the buyer had complied with the notice requirements [*see Com. Code § 6107(a)*; *see also Com. Code § 6107(c)* (good faith effort at compliance), (d)(limitation of liability)].

For discussion of bulk sales, and the requirements imposed on them by the Commercial Code, see *§ 17.20*. For a notice of intended sale for use when a going business is incorporated, see *§ 2A.203* in Ch. 2A, *Incorporating a Going Business.* For a form and discussion of the notice used when the sale is by auction, see *California Forms of Pleading and Practice, Ch. 270, Fraudulent Conveyances, § 270.241* (Matthew Bender).

[b] Contents of Required Notice

The notice to creditors of the intended transfer must state all of the following [*Com. Code § 6105(a)*]:

- That a bulk sale is about to be made.
- The names and business addresses of the seller and the buyer.
- All other business names and addresses used by the seller within the past three years, to the extent

known to the buyer [*see Com. Code § 6104(a)*].

- The location and general description of the property to be transferred.

- The place and date on (or after which) the bulk sale will be closed.

- Whether or not the bulk sale is subject to *Com. Code § 6106.2*, which applies when the consideration for the sale, other than a sale at auction or by a liquidator, is $2 million or less and is substantially all cash, an obligation of the buyer to pay cash in the future to the seller, or a combination [*Com. Code § 6106.2(a), (b)*]. If this statute applies, the notice must also include the name and address of the person with whom claims may be filed, and the last date (which must be the business day before the noticed sale date) for filing claims [*Com. Code § 6106.2(f)*].

Preprinted forms setting forth these requirements are also available from commercial form publishers.

[c] Recording, Publishing, and Delivering the Notice

The bulk sale notice of intended transfer must be recorded in the office of the county recorder of the county or counties in California in which the tangible assets are located and, if different, in the county in which the seller is located at least 12 business days before the date of the bulk sale [*Com. Code § 6105(b)(1)*; *see Com. Code § 6103(a)(2)*; *see also Com. Code § 6102(a)(7)* ("date of bulk sale" defined)]. A "business day" is any day other than a Saturday, Sunday, or day observed as a holiday by the California state government [*Com. Code § 6105(b)*].

The notice must also be published at least 12 business days before the date of the bulk sale [*Com. Code § 6105(b)(2)*; *see Com. Code § 6102(a)(7)* ("date of bulk sale" defined)]. The notice must be published at least once in a newspaper of general circulation published in the judicial district in which the tangible assets are located and, if different, in the judicial district in which the seller is located [*Com. Code § 6105(b)(2)*; *see Com. Code § 6103(a)(2)*] If no such newspaper exists, notice must be published in a newspaper of general circulation in the county in which the judicial district is located [*Com. Code § 6105(b)(2)*]. If the tangible assets are located in more than one judicial district, the notice must be published in the judicial district in which a greater portion of the assets are located and, if different, in the judicial district in which the seller is located [*Com. Code § 6105(b)*; *see Com. Code § 6103(a)(2)*].

The notice also must be delivered, or sent by registered or certified mail, to the county tax collector in the California county or counties in which the tangible assets are located at least 12 business days before the date of the bulk sale [*Com. Code § 6105(b)(3)*]. If the notice is delivered or sent during the period from January 1 to May 7, inclusive, the notice must be accompanied by a completed business property statement with respect to the property involved in the bulk sale [*Com. Code § 6105(b)(3)*; *see Rev. & Tax. Code § 441* (procedure for filing property statements)].

One court, reading *Com. Code § 6105* in light of the legislative intent, has held that the notice must be published and recorded at least 12 business days before the anticipated sale date *as specified in the notice* (as opposed to the *actual* sale date). Otherwise, creditors do not have sufficient time to file a timely claim [*Gifford v. J&A Holdings (1997) 54 Cal. App. 4th 996, 999, 63 Cal. Rptr. 2d 253* (postponing actual date of sale until 12 business days after recordation did not comply with literal terms of statute; postponement without notice did not constitute good faith effort at compliance under *Com. Code § 6107(c)*)].

[d] Filing Fees

The office of the county recorder charges a filing fee for recording this notice. For the current fees, see *Gov. Code § 27361*.

[2] FORM

Notice of Intended Bulk Sale

Notice of Intended Bulk Sale

NOTICE IS HEREBY GIVEN that _____[*name of seller*], whose business address is _____, intends to make a bulk sale to _____[*name of buyer*], whose business address is _____, of the following property now located at _____: _____[*give general description of property, e.g.,* All the stock in trade, merchandise, fixtures, equipment, goodwill, and trade of the business known as "_____" (*name of business*)].

To the knowledge of the undersigned buyer, within the past three years, _____[*name of seller*] has used the following additional business names and addresses: _____[*list, e.g.,* the name "_____" at _____ (*address*); the name "_____" at _____ (*address*); and the name "_____" at _____ (*address*)].

The transfer of the property _____[is *or* is not] subject to *Commercial Code Section 6106.2,* which applies to transfers for which the consideration is $2 million or less and is substantially all cash, an obligation to pay cash in the future, or a combination of these. [*If transfer is subject to Com. Code § 6106.2, add:* Claims for debts may be filed with _____ (*name and address*). The last date for filing claims is _____ (*business day before the date on which the bulk sale will be closed*).]

The intended sale will be closed on or after _____[*date*], at _____[*address*], California.

_____ Dated:

_____ [*signature of buyer*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
E. Notices

8-17 California Legal Forms--Transaction Guide § 17.271

AUTHOR: Marilyn E. Minger Revision Author

§ 17.271 Notice to Creditors Regarding Insufficient Funds

[1] Comment

[a] Use of Form

This form is a notice to creditors that the amount of cash deposited by the buyer in escrow is insufficient to pay in full all of the claims timely filed with the escrow agent. It is only required to be given for a bulk sale in which the consideration is $2 million or less and is substantially all cash, an obligation to pay cash in the future, or a combination of the two [*see Com. Code §§ 6106.2, 6106.4*].

This form is designed for use when an escrow agent will be handling the distribution of the consideration, but can be adapted for use when the buyer will be distributing the assets.

[b] Delay of Closing and Distribution

If a bulk sale subject to *Com. Code § 6106.2* is otherwise ready to be consummated and the amount of consideration is insufficient to pay in full all of the claims timely filed with the buyer or the escrow agent, the buyer or escrow agent must delay distribution of the consideration and passing of legal title for not less than 25 nor more than 30 days from the date of giving the notice of insufficient funds [*Com. Code §§ 6106.2(d), 6106.4(a)(1)*]. Within five business days after the date the sale would otherwise be closed, the escrow agent must send this notice to each creditor who has filed a timely claim [*Com. Code §§ 6106.2(d), 6106.4(a)(2)*]. Claims will be deemed timely filed only if they are actually received by the person designated in the notice to receive claims before the close of business on the day specified in the notice as the last date for filing claims [*Com. Code § 6106.2(f)*]. If the buyer or escrow agent receives no written objection to the distribution described in the notice prior to the new date specified for the passing of legal title, the escrow agent will not be liable to any person to whom the notice was sent for any good-faith error that may have been committed in allocating and distributing the consideration as stated in the notice [*Com. Code §§ 6106.2(d), 6106.4(a)(3)*].

[c] Contents of Notice

The notice must state all of the following [*Com. Code §§ 6106.2(d), 6106.4(a)(2)*]:

- The total consideration deposited or agreed to be deposited in escrow or with the buyer.
- The name of each claimant who filed a timely claim, and the amount of each claim.
- The amount proposed to be paid to each claimant.
- The new date scheduled for passing of legal title.
- The date on or before which distribution will be made to claimants. This date must not be more than five days after the new date specified for the passing of legal title [*Com. Code §§ 6106.2(d), 6106.4(a)(2)*].
- If part of the sale consideration is future payment of cash,
  - The amount, terms, and due date of the obligation, and
  - The portion of claims expected to be paid by that obligation [*Com. Code § 6106.4(c)*].

[d] If Escrow Is Not Used

If a bulk transfer subject to the requirements set forth above will not be handled through an escrow, the buyer rather than the escrow agent must take all of the actions described above [*see Com. Code § 6106.2(d)*].

[2] FORM

Notice to Creditors Regarding Insufficient Funds

Notice to Creditors Regarding Insufficient Funds

NOTICE IS HEREBY GIVEN pursuant to *Commercial Code Section 6106.4* that the bulk sale from _____[*name of seller*] to _____[*name of buyer*], scheduled to be closed on _____[*date*], at the office of _____[*address*], Escrow Agent, as set forth in the Notice of Intended Bulk Sale dated _____, has been delayed.

1. The total consideration deposited or agreed to be deposited in escrow is $_____.

2. The following creditors have filed timely claims for the following amounts:

(a) _____[*name of creditor*]: $_____.

(b) _____[*name of creditor*]: $_____.

(c) _____[*name of creditor*]: $_____.

(d) _____[*name of creditor*]: $_____.

3. The new date scheduled for passing of legal title is _____[*date not less than 25 days or more*

than 30 days from date notice is mailed].

4. The new date on or before which distribution will be made to claimants is _____[*date not more than five days after new date specified for passing of legal title*].

[*Add, if part of sales price will be paid in future in cash:*]

5. The buyer's obligation to pay part of the sales price in the future in cash is as follows: _____[*state amount, terms, and due date of the obligation*]. The portion of claims expected to be paid by that obligation is _____[*describe*].

[*CONTINUE*]

If no written objection to the distribution described in this notice is received prior to the new date specified for the passing of legal title, the Escrow Agent will not be liable to any person to whom the notice was sent for any good-faith error that may have been committed in allocating and distributing the consideration as stated in the notice.
_____ Dated:

ESCROW AGENT
_____ [*signature of escrow agent*]
[*typed name*]



144 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
E. Notices

8-17 California Legal Forms--Transaction Guide § 17.272

AUTHOR: Marilyn E. Minger Revision Author

§ 17.272 Notice of Sale of Law Practice

[1] Comment

[a] Use of Form

This form is a notice to the client of a law practice that the practice is being transferred. It also contains a provision for the client's consent to the transfer. Notice and consent are required only when the sale contemplates the transfer of responsibility for work not yet completed, or responsibility for confidential client files or information [*Cal. Rules Prof. Conduct, Rule 2-300(B)*].

The form assumes that the seller is living, and is not represented by a conservator or other person. However, if a conservator or person other than the seller is making the sale, the form should be modified to reflect that fact.

For contract provisions for a contract of sale of a professional practice, see *§ 17.211*. For discussion of the requirements specifically applicable to the sale of a law practice, see *§ 17.22[5]*.

[b] Notice Requirements and Time for Giving Notice

When the sale of a law practice contemplates the transfer of responsibility for work not yet completed, or responsibility for client files or information that the attorney is required to keep confidential [*see Bus. & Prof. Code § 6068(e)* (attorney has duty to preserve secrets of his or her clients)], the seller must send written notice to each client whose uncompleted case or confidential files will be transferred, not less than 90 days prior to the transfer [*Cal. Rules Prof. Conduct, Rule 2-300(B)(2)*]. If the seller is deceased or has a conservator or other person acting in a representative capacity, the buyer must send the notice prior to the sale [*Cal. Rules Prof. Conduct, Rule 2-300(B)(1)* (no time limitation imposed)].

[2] FORM

Notice of Sale of Law Practice

_____[*date*]
_____[*name of client*]
_____[*client's address*]
_____[*city, state, zip*]

Re: _____ [*name or number of case or file*]
Dear _____ [*name of client*] :

This letter is to inform you that I am transferring my law practice to _____[*name of buyer*], effective _____[*date*].

As a result of this transfer, you have two alternatives regarding future handling of your _____[case *or* file]. First, you may consent to transfer your _____[case *or* file] to _____[*name of buyer*], who will thereafter handle it. If you choose this option, please sign the consent form below and return it to my office within 90 days from the date of this letter. Note, however, that if I do not receive this consent form within 90 days, and you do not otherwise instruct me regarding your _____[case *or* file], you will be presumed to have consented to its transfer to _____[*name of buyer*]. [*Add, if buyer and seller will divide fees on client's case or file:* _____ (*name of buyer*) and I will divide the fees for the legal services rendered on your _____ (case *or* file) in the following manner: _____ (*fully disclose terms of fee division*).]

Alternatively, you have the right to retain other counsel. You may take possession of any of your papers and property that I have in my office, including correspondence, pleadings, deposition transcripts, exhibits, physical evidence, expert's reports, and other items necessary to your representation, whether or not you have paid for them. If you wish to take possession of your papers and property, or have them transferred to an attorney other than _____[*name of buyer*], please contact my office as soon as possible.

You are also entitled to the refund of any part of a fee paid in advance that has not been earned, other than a true retainer fee that was paid solely for the purpose of ensuring my availability on your _____[case *or* file]. My records show that _____[*describe status of client's fees*]. If you have any questions regarding the status of your fees, please contact _____[*specify accountant or appropriate person*] as soon as possible.

Please feel free to contact me with any questions you may have regarding future handling of your _____[case *or* file].

Sincerely,
_____ [*signature of attorney*]
[*typed name*]

CONSENT TO TRANSFER OF _____ [CASE *or* FILE] TO _____ [*name of buyer*]

I, _____[*name of client*], consent to have _____[*name of seller*], Attorney at Law, transfer my _____[case *or* file] to _____[*name of buyer*], Attorney at Law, for future handling. If the court in which the matter is pending requires a substitution of attorney form, I agree to sign the required

form. [*Add if buyer and seller will divide fees on client's case or file:* I understand that _____ (*name of buyer and name of seller*) will divide the fees for legal services rendered on my _____ (case *or* file) in the manner set forth above, and I consent to that division.]

_____ Dated:

_____ [*signature of client*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
E. Notices

8-17 California Legal Forms--Transaction Guide §§ 17.273-17.279

AUTHOR: Marilyn E. Minger Revision Author

[Reserved]

§§ 17.273[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
F. Franchisor Consents

8-17 California Legal Forms--Transaction Guide § 17.280

AUTHOR: Marilyn E. Minger Revision Author

§ 17.280 Consent of Franchisor

[1] Comment--Use of Form

This form is a provision conditioning the purchase and sale of a business on the franchisor's consent to the sale of a franchised business. It should be included in a contract of sale when the business being sold is operated pursuant to a franchise agreement that (1) requires the franchisor's written consent, and (2) does not specify any conditions that must be performed as a prerequisite to consent. For an example of such a franchise agreement, see *Ch. 51, Franchise Agreements, § 51.211* (restaurant/fast food franchise).

For a provision to be used with a franchise agreement that gives the franchisor the first right to buy the business, requires the franchisor's written consent for any other transfer, and specifies the conditions precedent for transfer, see *§ 17.281*. For a general discussion of franchise agreements and their relationship to the agreement for the sale of a franchised business, see the comment to that form. For examples and extensive coverage of franchise agreements, see Ch. 51, *Franchise Agreements* .

[2] FORM

Consent of Franchisor

Section _____. Franchisor's Consent Required. (a) Seller is operating the business under a franchise ("the franchise"), granted to Seller by _____[*name of franchisor*], Franchisor, pursuant to a franchise agreement dated _____.

(b) Under Paragraph _____ of the franchise agreement, the written consent of Franchisor is a condition precedent to the closing of the sale and purchase described in this contract.

(c) Buyer and Seller shall promptly contact Franchisor to obtain Franchisor's written consent to the purchase and

sale described in this contract.

(d) Buyer and Seller shall promptly take all actions reasonably required to obtain Franchisor's written consent to the purchase and sale described in this contract.

(e) The time and date specified in this contract for closing of the purchase and sale described in this contract shall be extended for a period not exceeding _____[*specify, e.g.,* 10 days] from the date of this contract until the Franchisor's written consent to the purchase and sale has been received by the escrow agent named in this contract.

(f) If the escrow agent does not receive Franchisor's written consent within the period specified in Paragraph (e), above:

(1) This contract shall become null and void.

(2) Both Buyer and Seller shall be released from all liability for further performance of the terms and conditions of this contract.

(3) Neither Buyer nor Seller shall be liable for any expenses incurred or expended by the other in partial or attempted partial performance of this contract.

(4) Buyer shall be entitled to the immediate return of all funds paid to Seller or deposited in escrow on account of the purchase of the business.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
F. Franchisor Consents

8-17 California Legal Forms--Transaction Guide § 17.281

AUTHOR: Marilyn E. Minger Revision Author

§ 17.281 Consent of Franchisor Subject to Specified Conditions

[1] Comment--Use of Form

This form is a provision conditioning the purchase and sale of a business on the franchisor's consent to the sale of a franchised business and upon satisfaction of related conditions. It is for use only when the business being sold is subject to a franchise agreement that (1) gives the franchisor the first right to buy the business, (2) requires the franchisor's written consent for any other sale of the business, and (3) specifies the conditions required for that consent. For an example of a provision for use when the franchise agreement requires consent but does not specify any conditions, see *§ 17.280*.

For examples and discussion of franchise agreements, see Ch. 51, *Franchise Agreements* .

[2] FORM

Consent of Franchisor Subject to Specified Conditions

Section _____. Franchisor's Consent Required. (a) Seller is operating the business under a franchise ("the franchise"), granted to Seller by _____[*name of franchisor*], Franchisor, pursuant to a franchise agreement dated _____.

(b) Under Paragraph _____ of the franchise agreement, Franchisor has the first right and option to purchase the business and the franchise from Seller on the terms and conditions specified in this contract for the purchase of the business by Buyer within _____[*number specified in franchise agreement*] days after receipt by Franchisor of written notice and a copy of this contract, thereby invalidating this contract.

(c) Under Paragraph _____ of the franchise agreement, if Franchisor does not exercise its option to purchase the business and the franchise within the specified period, Seller cannot sell, assign, transfer, or convey

Seller's interest in the franchise without the prior written consent of Franchisor.

(d) Under Paragraph _____ of the franchise agreement, Franchisor's consent to the purchase of the business and the franchise by Buyer is subject to the following conditions:

[*Set forth all conditions specified in franchise agreement (see Ch. 51, Franchise Agreements, § 51.200[2], Section 7.04), e.g.:*]

(1) Buyer must be approved by Franchisor; therefore, Buyer agrees to make available any information reasonably required for that approval.

(2) Buyer must participate in the training course required by Franchisor of new franchisees; Buyer therefore agrees to so participate.

(3) Seller must not be in default under any provision of the franchise agreement; therefore, Seller agrees to pay in full all amounts owed to Franchisor, prior to assignment of the franchise to Buyer, through the escrow described in this Agreement.

(4) Buyer must assume all obligations of Seller; Buyer therefore expressly assumes those obligations.

(5) Buyer must be bound by all terms and provisions of the franchise agreement; Buyer therefore expressly agrees to be bound in the same manner and to the same extent as Seller.

(6) Buyer must execute and deliver to Franchisor its standard forms of personal guaranty and subordination agreement; Buyer therefore agrees to do so.

(7) Seller must execute and deliver to Franchisor a general release of all claims and causes of action against Franchisor and its affiliates and agents; Seller therefore agrees to do so.

(8) _____ [*specify any other conditions set forth in franchise agreement*].

(e) Pending the closing of the sale described in this contract, Seller shall continue to operate the business in the same manner as Seller has operated it in the past, in full compliance with the terms of the franchise agreement.

(f) Buyer shall pay to Franchisor, on behalf of Seller, the sum of $_____ for costs incurred by Franchisor for reasonable legal and accounting fees, credit and investigation charges, and retraining expenses incurred as a consequence of this contract.

(g) If Franchisor exercises its option to purchase the business and the franchise from Seller, as described in Subparagrapn (b), above, or if Franchisor for any reason not attributable to Buyer or Seller fails or refuses to consent in writing to the sale to Buyer within _____[*number set forth in franchise agreement*] days after the date of this contract,

(1) This contract shall become null and void.

(2) Both Buyer and Seller shall be released from all liability for further performance of the terms and conditions of this contract.

(3) Neither Buyer nor Seller shall be liable for any expenses incurred or expended by the other in partial or attempted partial performance of this contract.

(4) Buyer shall be entitled to the immediate return of all funds paid to Seller or deposited in escrow on account of the purchase of the business.

[*Add when one attorney drafts sale contract on behalf of both parties:*]

(5) Buyer and Seller shall be jointly and severally liable for the payment of all reasonable fees and charges made for the preparation of this contract, as well as for the payment of any reasonable fees or charges made for establishing and cancelling the escrow described in the contract.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
F. Franchisor Consents

8-17 California Legal Forms--Transaction Guide §§ 17.282-17.289

AUTHOR: Marilyn E. Minger Revision Author

[Reserved]

§§ 17.282[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
G. Bills of Sale

8-17 California Legal Forms--Transaction Guide § 17.290

AUTHOR: Marilyn E. Minger Revision Author

§ 17.290 Bill of Sale for Business--Basic Form

[1] Comment

[a] Use of Form

This form is a basic bill of sale that a seller may use to convey to a buyer all of the personal property assets of a named business, other than the accounts receivable. For an example of a bill of sale that transfers accounts receivable and includes a power of attorney to collect them, see *§ 17.291*. For a bill of sale that contains assumption of liability and indemnity agreements, see *§ 17.292*. For a bill of sale for a professional practice, see *§ 17.293*. For a bill of sale transferring a going business to a corporation, see *Ch. 2A, Incorporating a Going Business, § 2A.204[2]*. For a bill of sale applicable solely to goods subject to the Uniform Commercial Code, see Ch. 52, *Sales of Goods Under the Uniform Commercial Code* , Form 52.04.

[b] Bills of Sale in General

A bill of sale is a written instrument equivalent to a grant or conveyance [*Civ. Code § 1053*], used to evidence the transfer of title to personal property from a seller to a buyer [*see Hull v. Ray (1926) 80 Cal. App. 284, 289, 251 P. 810]* . A seller is not required to use a bill of sale to transfer title to specific personal property to the buyer. A transfer of property may be made without a writing, if a writing is not required by statute [*Civ. Code § 1052*]. However, contracts of sale and escrow instructions often specify that the seller deliver a bill of sale for the personal property assets of the business to the buyer.

A bill of sale takes effect upon delivery by the seller [*Civ. Code § 1054*]. Delivery to the buyer or the buyer's agent is absolute, and cannot be conditional [*Civ. Code § 1056*]. However, the grantor may deposit a bill of sale with a third person (that is, put it into escrow), to be delivered upon performance of a condition [*Civ. Code § 1057*]. Upon delivery by the depositary (that is, the escrow agent), the transfer will take effect [*Civ. Code § 1057*]. Delivery discharges any conditions on which the delivery was made [*Civ. Code § 1056*].

[c] Contents of Form

A bill of sale of business assets should set forth the basic facts of the sales transaction, including the parties to the sale, the type of property being transferred, and the consideration paid. The seller generally transfers any leasehold interest for the premises occupied by the business to the buyer on closing of the sale by an assignment of lease executed by the seller, and a consent to the assignment executed by the lessor. For examples and discussion of these forms, see Ch. 35A, *Assignment and Sublease of Leasehold Interests* .

[2] FORM

Bill of Sale for Business--Basic Form

BILL OF SALE OF BUSINESS

In consideration of _____[*state consideration*], the receipt of which is acknowledged, _____[*name of seller*], Seller, hereby transfers to _____[*name of buyer*], Buyer, the following assets of the business known as "_____[*name of business*]" located at _____[*address*], _____[*city*], California ("Business"):

1. All stock in trade and merchandise of the business, as shown on an inventory taken on _____ [*date*], by _____ [*name of person or firm that took inventory*], which is marked "Exhibit _____" and attached to this Bill of Sale[, except _____ (*specify any exceptions*)];

2. All furniture, fixtures, equipment, and other tangible assets of the business, as shown on an inventory taken on _____ [*date*], by _____ [*name of person or firm that took inventory*], which is marked "Exhibit B" and attached to this Bill of Sale[, except _____ (*specify any exceptions*)]; and

3. All trade, goodwill, business name, and other intangible assets of the business, not including the accounts receivable of the business.

Executed on _____[*date*], at _____[*place*].

_____ [*signature of seller*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
G. Bills of Sale

8-17 California Legal Forms--Transaction Guide § 17.291

AUTHOR: Marilyn E. Minger Revision Author

§ 17.291 Bill of Sale for Business--Including Accounts Receivable and Power of Attorney for Collection

[1] Comment

[a] Use of Form

This form is a bill of sale that transfers the business's accounts receivable as well as the other business assets, and provides a power of attorney to the buyer to collect the receivables. It includes initial recitals regarding the parties and business, and separate bill of sale and power of attorney sections. For a basic bill of sale, see *§ 17.290*. For a bill of sale containing assumption of obligations and indemnity agreements, see *§ 17.292*. For a bill of sale for a professional practice, see *§ 17.293*.

This comment discusses only those provisions unique to this form. For a discussion of bills of sale generally, see *§ 17.290[1]*.

[b] Power of Attorney to Collect Accounts Receivable

This form appoints the buyer as the seller's attorney in fact to demand, receive, and collect all the accounts receivable of the business. A power of attorney allows the buyer to issue receipts for payments received, to compromise any disputed accounts, and, if necessary, to assign the accounts to a collection agency for collection and suit. A collection agency generally requires an account to be assigned to it, rather than merely listed for collection, in order to sue on the account in its own name as a real party in interest [*see Code Civ. Proc. § 367* (actions must be prosecuted in name of real party in interest)].

For a general discussion of powers of attorney, see Ch. 98, *Powers of Attorney* ; for a specific form for the power to collect debts and compromise claims, see *§ 98.220*. For a provision regarding the power of attorney to collect debts in a bill of sale transferring a going business to a corporation, see *Ch. 2A, Incorporating a Going Business, § 2A.204[2]*.

[c] Effect of Transferring Receivables

A transfer (other than one intended to create a security interest [*see Com. Code § 9109(a)(1), (3)*]) of any right to payment and any transfer of accounts or chattel paper excluded from the coverage of Division 9 of the Commercial Code [*see Com. Code § 9101 et seq.* (secured transactions)] will be deemed perfected as against third persons on the delivery to the buyer of a written and executed assignment of the account, contract right, or right to payment [*see Civ. Code § 955.1(a)*].

[2] FORM

Bill of Sale for Business--Including Accounts Receivable and Power of Attorney for Collection

BILL OF SALE

Recitals

_____[*name of seller*], Seller, is the owner of the business known as "_____" [*name of business*], located at _____[*address*], California (hereafter referred to as "the business").

On _____[*date*], Seller entered into a contract (hereafter referred to as "the contract") to sell the business to _____[*name of buyer*], Buyer;

Bill of Sale

1. In consideration of _____[*state consideration*], the receipt of which is acknowledged, Seller hereby transfers to Buyer the following assets of the business:

(a) All of the stock in trade and merchandise of the business, as shown on an inventory taken on _____[*date*], by _____[*name of person or firm that took inventory*], which is marked "Exhibit _____" and attached to this Bill of Sale[, except _____ (*specify any exceptions*)];

(b) All of the furniture, fixtures, equipment, and other tangible assets of the business, as shown on an inventory taken on _____[*date*], by _____[*name of person or firm that took inventory*], which is marked "Exhibit _____" and attached to this Bill of Sale[, except _____ (*specify any exceptions*)]; and

(c) All of the trade, goodwill, business name, and other intangible assets of the business, including all accounts receivable.

Power of Attorney to Collect Debts

2. Seller hereby appoints Buyer as Seller's attorney in fact to demand, receive, and collect for Buyer's own use and benefit all debts, obligations, and accounts receivable now owing to the business. Seller authorizes Buyer to take all legally permissible actions that are required, or deemed by Buyer to be required, to recover and collect those debts, obligations, and accounts receivable. Seller further authorizes Buyer to use Seller's name in any manner that Buyer deems necessary for the collection and recovery of those debts, obligations, and accounts receivable but without cost, expense, or damage to Seller.

Executed on _____[*date*], at _____[*place*].

_____ [*signature of seller*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
G. Bills of Sale

8-17 California Legal Forms--Transaction Guide § 17.292

AUTHOR: Marilyn E. Minger Revision Author

§ 17.292 Bill of Sale for Business--Including Assumption of Obligations and Indemnity Agreement

[1] Comment

[a] Use of Form

This form is a two-party bill of sale in which the buyer agrees to assume all existing obligations of the business, and the seller agrees to indemnify the buyer against all obligations not shown on the books of the business. For a basic bill of sale, see *§ 17.290*. For a bill of sale that transfers accounts receivable and includes a power of attorney to collect them, see *§ 17.291*. For a bill of sale for a professional practice, see *§ 17.293*. For a bill of sale transferring a going business to a corporation, see *Ch. 2A, Incorporating a Going Business, § 2A.204[2]*.

This comment discusses only those provisions unique to this form. For a discussion of bills of sale generally, see *§ 17.290[1]*.

[b] Assumption of Liabilities

This form contains an assumption by the buyer of all of the obligations that appear on the books of the business on the date of sale [*see* [2], Paragraph 2, *below*]. That provision is designed for use with a contract of sale that requires assumption by the buyer. For discussion of contractual assumption of obligations, and coverage of products liability, see *§ 17.200[1][h]*; see also California Forms of Pleading and Practice, Ch. 460, *Products Liability* (Matthew Bender). In connection with the assumption of obligations, this form requires the buyer to give notice to suppliers of the business, such as wholesalers, that the seller will no longer be liable for obligations thereafter incurred by the business [*see* [2], Paragraph 4, *below*].

For an example of an assumption of liability and indemnity provision in a bill of sale transferring a going business to a corporation, see *Ch. 2A, Incorporating a Going Business, § 2A.204[2]*.

[2] FORM

Bill of Sale for Business--Including Assumption of Obligations and Indemnity Agreement

BILL OF SALE AND AGREEMENT

This agreement is made between _____[*name of seller*], Seller, and _____[*name of buyer*], Buyer, for the sale of the business known as "_____" [*name of business*], located at _____[*address*], California (hereafter referred to as "the business").

Bill of Sale

1. In consideration of _____[*state consideration*], the receipt of which is acknowledged, Seller hereby transfers to Buyer the following assets of the business:

(a) All of the stock in trade and merchandise of the business, as shown on an inventory taken on _____[*date*], by _____[*name of person or firm that took inventory*], which is marked "Exhibit _____" and attached to this Bill of Sale[, except _____ (*specify any exceptions*)];

(b) All of the furniture, fixtures, equipment, and other tangible assets of the business, as shown on an inventory taken on _____[*date*], by _____[*name of person or firm that took inventory*], which is marked "Exhibit _____" and attached to this Bill of Sale[, except _____ (*specify any exceptions*)]; and

(c) All of the trade, goodwill, business name, and other intangible assets of the business, including all accounts receivable.

Assumption of Obligations

2. In consideration of the transfer of the property described in Paragraph 1, Buyer hereby agrees to assume, pay, and discharge all debts, duties, and obligations that appear on the date of this instrument on the books of the business as owed by Seller on account of the business to any person or persons. Buyer further agrees to indemnify and hold the Seller and the Seller's property free and harmless from any such debt, duty, or obligation, and from any suits, actions, or legal proceedings brought to collect or enforce any such debt, duty, or obligation.

Indemnity by Seller

3. Seller agrees to indemnify and hold Buyer and the property of Buyer, including the business, free and harmless from all liability for any debts, obligations, or claims arising from or connected with the operation of the business by Seller and not shown on the books of the business as of the date of this instrument.

[*Add, if Buyer will insure or self-insure against products liability arising out of past sales by Seller:*]

Notwithstanding the preceding sentence, however, Seller has no duty to indemnify Buyer if both of the following conditions are satisfied: (1) the liability is for injury or damage caused by a defect in the design or manufacture of a product sold by Seller in the course of Seller's operation of the business, and (2) Seller had no actual knowledge of the liability or potential liability at the time the sale of the business was closed. Under these conditions, Buyer agrees to indemnify and hold Seller and the property of Seller free and harmless from liability.

[*CONTINUE*]

Notice of Sale

4. Buyer agrees, at Buyer's own cost and expense, to promptly notify all suppliers of the business of this sale, and of the fact that Seller shall no longer be liable for any obligations incurred in the operation or name of the business.

Power of Attorney to Collect Debts

5. Seller hereby appoints Buyer as Seller's attorney in fact to demand, receive, and collect for Buyer's own use and benefit all debts, obligations, and accounts receivable now owing to the business. Seller authorizes Buyer to take all legally permissible actions that are required, or deemed by Buyer to be required, to recover and collect those debts, obligations, and accounts receivable. Seller further authorizes Buyer to use Seller's name in any manner that Buyer deems necessary for the collection and recovery of those debts, obligations, and accounts receivable but without cost, expense, or damage to Seller.

Executed on _____[*date*], at _____[*place*].

SELLER
_____ [*signature of seller*]
[*typed name*]
BUYER
_____ [*signature of buyer*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
G. Bills of Sale

8-17 California Legal Forms--Transaction Guide § 17.293

AUTHOR: Marilyn E. Minger Revision Author

§ 17.293 Bill of Sale for Professional Practice

[1] Comment

[a] Use of Form

This form is a bill of sale designed for use in connection with the sale of a professional practice. For a basic bill of sale,see *§ 17.290*. For a bill of sale that transfers accounts receivable and contains a power of attorney to collect them, see *§ 17.291*. For a bill of sale containing assumption and indemnity agreements, see *§ 17.292*. For a bill of sale transferring a going business to a corporation, see *Ch. 2A, Incorporating a Going Business, § 2A.204[2]*.

This comment discusses only those provisions unique to this form. For a discussion of bills of sale generally, see *§ 17.290[1]*.

[b] Work in Progress

This form specifically states that all work in progress, other than that specifically assigned to the buyer, will remain the property and responsibility of the seller. The work in progress of a professional practice cannot be assigned without the consent of the professional's client or patient [*see Civ. Code § 1457*; see also discussion in *§ 17.22[3]*]. When the sale of a law practice contemplates the transfer of responsibility for work not yet completed, or responsibility for client files or information that the attorney is required to keep confidential [*see Bus. & Prof. Code § 6068(e)* (attorney has duty to preserve secrets of his or her clients)], each client must receive written notice prior to the transfer, and consent in writing to the transfer [*Cal. Rules Prof. Conduct, Rule 2-300(B)*]. For an example of that notice and consent, and discussion of applicable requirements, see § 17.273.

[2] FORM

Bill of Sale for Professional Practice

BILL OF SALE OF BUSINESS

Recitals

_____[*name of seller*] (Seller) has an established _____[*specify type of practice, e.g.,* accounting] practice known as "_____" [*name of practice*], located at _____[*address*], California (hereafter referred to as "the practice").

On _____[*date*], Seller entered into a contract to sell the practice to _____[*name of buyer*] (Buyer).

Buyer and Seller agree as follows:

Sale

1. In consideration of _____[*state consideration*], the receipt of which is acknowledged, _____[*name of seller*], Seller, hereby transfers to _____[*name of buyer*], Buyer, the following assets of the practice:

(a) All of the furniture, fixtures, equipment, and library of the practice, [except _____ (*specify any exceptions*),] as shown on the attached inventory taken on _____[*date*], by _____[*name of person or firm that took inventory*], marked "Exhibit _____."

(b) All of the files, books, records, work papers, and other tangible assets of or pertaining to the practice, including the accounts receivable listed on the attached inventory taken on _____[*date*], by _____[*name of person or firm that took inventory*], marked "Exhibit _____," but excluding any files, books, or records specifically relating to any work in progress as defined in Paragraph 2 of this Bill of Sale.

(c) All of the trade, goodwill, and other intangible assets of the practice.

Work in Progress

2. Any work in progress, together with all files and records specifically relating to the work in progress, remains the property and responsibility of Seller, unless specifically assigned to Buyer by a separate instrument in writing executed by both Seller and _____[*describe type of patron, e.g.,* the client]. [*Add, for work assigned by an attorney (Cal. Rules Prof. Conduct, Rule 2-300(B)(2)):* Seller shall send written notice to the client not less than 90 days prior to the transfer, in accordance with *Cal. Rules Prof. Conduct, Rule 2-300*. If the client does not respond within 90 days of the notice, the client's consent to the transfer shall be assumed.] On assignment, Buyer shall relieve Seller of all responsibility for the work's satisfactory completion. Buyer and Seller shall agree on the division of the fee or charge made to the client upon completion of the work. "Work in progress" means work on any matter, case, or other activity requiring the rendering of professional services, that Seller began prior to the date of this contract but did not complete by the closing date of this purchase and sale.

Power of Attorney to Collect Debts

3. Seller hereby appoints Buyer as Seller's attorney in fact to demand, receive, and collect for Buyer's own use and benefit all debts, obligations, and accounts receivable now owing to the business. Seller authorizes Buyer to take all legally permissible actions that are required, or deemed by Buyer to be required, to recover and collect those debts, obligations, and accounts receivable. Seller further authorizes Buyer to use Seller's name in any manner that Buyer

deems necessary for the collection and recovery of those debts, obligations, and accounts receivable but without cost, expense, or damage to Seller.

Executed on _____[*date*], at _____[*place*].

_____ [*signature of seller*]
[*typed name*]



153 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
G. Bills of Sale

8-17 California Legal Forms--Transaction Guide §§ 17.294-17.299

AUTHOR: Marilyn E. Minger Revision Author

[Reserved]

§§ 17.294[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
H. Requests for Tax Clearance

8-17 California Legal Forms--Transaction Guide § 17.300

AUTHOR: Marilyn E. Minger Revision Author

§ 17.300 Request for Tax Clearance From Board of Equalization

[1] Comment

[a] Use of Form

This form is a request from the buyer of a business that engaged in retail sales to the State Board of Equalization (SBE) requesting a certificate of tax clearance. For equivalent forms used to request certificates of tax clearance from the Employment Development Department and the Franchise Tax Board, see *§§ 17.301* and *17.302*, respetively. This form was drafted by the publisher; as of the date this material was published, the SBE did not have an official form for requesting a tax clearance.

[b] Purchaser's Withholding Obligations

When a person liable for sales or use taxes sells his or her business or stock of goods, the buyer must withhold a sufficient portion of the purchase price to pay any sales or use taxes owed by the seller [*Rev. & Tax. Code § 6811*]. If the buyer fails to withhold sufficient funds, the buyer becomes personally liable for the taxes owed, up to the amount of the purchase price of the business or stock of goods [*Rev. & Tax. Code § 6812*; *see Schnyder v. State Board of Equalization (2002) 101 Cal. App. 4th 538, 542, 124 Cal. Rptr. 2d 571* (purchasers of business held personally liable for sales and use taxes as successors under *Rev. & Tax. Code § 6812*)]. The buyer is released from these withholding obligations when the seller produces a receipt from the State Board of Equalization (SBE) showing that any outstanding taxes have been paid, or the Board issues a certificate of tax clearance stating that no taxes, interest, or penalties are due [*Rev. & Tax. Code § 6811*; *18 Cal. Code Reg. § 1702(c)*]. The SBE may issue the certificate after all amounts have either been paid or secured to the satisfaction of the Board [*Rev. & Tax. Code § 6813*; *see § 17.126* for applicable procedures].

The SBE must either issue a certificate of tax clearance, or mail notice to the buyer of the amount that must be paid as a condition of issuing that certificate, within 60 days after the latest of the following [*Rev. & Tax. Code § 6812(b)*; *18*

Cal. Code Reg. § 1702(c); *see Rev. & Tax. Code § 6814* (service of notice)]:

- The date the SBE receives a written request from the buyer for a certificate (this form).
- The date of the sale of the business or stock of goods.
- The date the former owner's records are made available for audit.

Failure of the Board to mail the notice will release the buyer from any further obligation to withhold the purchase price [*Rev. & Tax. Code § 6812(c)*].

If the SBE finds that a buyer's failure to withhold a sufficient amount of the purchase price to cover the amount owed by the former owner is due to reasonable cause and circumstances beyond the buyer's control, and occurred notwithstanding the exercise of ordinary care, and in the absence of willful neglect, it may relieve the buyer of any penalty includable in the notice of successor liability [*Rev. & Tax. Code § 6814(b)*]. The last day on which the buyer's obligation as successor must be enforced is three years after the date that the SBE is notified of the purchase of the business or stock of goods [*Rev. & Tax. Code § 6812(c)*; *see Rev. & Tax. Code § 6814(a)*].

If an escrow is used for the sale, the escrow instructions often require the escrow agent to request the certificate on behalf of the buyer [*see, e.g., § 17.250[2]*, Paragraphs 18, 19]. This form is designed for use by either the buyer or escrow agent.

For further discussion, see *§ 17.12*. See also SBE Pamphlet 74, "Closing Out Your Seller's Permit," which is available from the SBE or online at the SBE website located at www.boe.ca.gov.

If the audit department of the district office decides to audit the seller's sales tax account, it will normally inform the seller of that fact at the time he or she files the final return. In that event, it will not issue a certificate of tax clearance until it

[c] Addresses of SBE Offices

The request for a certificate of tax clearance should be addressed to the local office of the SBE for the area in which the business being transferred is located. The local office is listed in the phone book for each area, and a complete list of the SBE offices may be found on the SBE website located at www.boe.ca.gov. If the business is located outside of California, the request should be sent to the California State Board of Equalization at Sacramento, New York, Chicago, or Houston offices. The current addresses of these offices are listed in the SBE website listed above, or may be obtained from the SBE customer service line at (800) 400-7115.

[2] FORM

Request for Tax Clearance From Board of Equalization

Request for Tax Clearance Certificate

Department of Business Taxes
California State Board of Equalization
_____[*address of local department*]
_____[*city, state, zip*]

Re: _____ [*name of seller*]

Retail Sales Permit No. _____
To whom it may concern:

This letter is a request for a certificate of tax clearance made pursuant to *Revenue and Taxation Code Section 6812*.

_____[*Name of buyer*], the buyer, has entered into a contract to purchase the business known as _____[*name of business*] located at _____[*address*], _____[*city*], California. _____[*Name of seller*], the seller, holds Retail Sales Permit No. _____, issued by the Board of Equalization for that business. The sale of the business will take place on or after _____[*date*], for a total purchase price of $_____.

I hereby request [*add, if request is made by escrow agent:* on behalf of _____ (*name of buyer*), the proposed buyer of the business,] that you issue a certificate stating that no amount is due from the seller of that business on account of the retail sales permit issued for the business, or in the alternative, a notice of the amount that must be paid as a condition of issuing the certificate. The business records of the seller will be available for audit on or after _____[*date*], at _____[*specify accountant's office or other location*].

Sincerely, _____ [*signature*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
H. Requests for Tax Clearance

8-17 California Legal Forms--Transaction Guide § 17.301

AUTHOR: Marilyn E. Minger Revision Author

§ 17.301 Request for Tax Clearance From Employment Development Department

[1] Comment

[a] Use of Form

This form is a request from the buyer of a business to the Employment Development Department (EDD) requesting a certificate of tax clearance. For equivalent forms used to request certificates of tax clearance from the Board of Equalization and the Franchise Tax Board, see *§§ 17.300*, *17.302*, respectively. This is the official form [DE 2220R] used by the Department to handle such requests.

In order to obtain the certificate, the seller or seller's representative must submit various materials to the EDD. For a list of these materials, see *§ 17.126*, Paragraph 2 [*see also* Requirements for Obtaining Certificate of Release of Buyer (Cal. Employment Dev't Department Pub. 3409A). For additional information, see the EDD California Employer's Guide (Cal. Employment Dev. Dep't Pub. DE-44), published annually. The current version of this guide may be downloaded from the EDD website, which is located at www.edd.cahwnet.gov.

[b] Buyer's Withholding Requirement

The buyer of a business that employs individuals in the business must withhold in trust either money or other property sufficient to pay any contributions, interest, and penalties due or unpaid by the seller for unemployment compensation insurance contributions, or disability compensation insurance contributions [*Unemp. Ins. Code § 1731*]. The withholding must continue until the seller produces a certificate from the Employment Development Department (EDD) stating that no contributions, interest, or penalties are due [*Unemp. Ins. Code § 1731*; *see* EDD Form DE 2220]. If the buyer fails to withhold sufficient funds, he or she becomes personally liable for the contributions, interest, or penalties owed, up to the amount of the purchase price [*Unemp. Ins. Code § 1733*]. If the seller does not produce the certificate, the buyer must pay the amount due at the time of the purchase [*Unemp. Ins. Code § 1731*].

Within 30 days of a request from either the seller or buyer, the Department must issue a certificate of tax clearance or a statement showing the amount due. Failure to issue a certificate or statement within that time will be deemed equivalent to issuance of a tax clearance certificate [*Unemp. Ins. Code § 1732(a)*]. When an escrow is used for the sale, the escrow instructions often require the escrow agent to request the certificate on behalf of the buyer [*see, e.g., § 17.250[2]*, Paragraphs 18, 19]. This form is designed for use by either the buyer, seller, or escrow agent. For further discussion, see *§ 17.14[3]*.

[c] Effect of Tax Clearance Certificate

The issuance of a certificate showing that no contributions, interest, or penalties are due (or the failure to issue that certificate within 30 days after a request) will not release the seller from liability on account of any contributions, interest, or penalties then or thereafter determined to be due. It will, however, release the buyer from any further liability on account of any such contributions, interest, or penalties [*Unemp. Ins. Code § 1732*].

[d] Addresses of Board Offices

The completed form should be submitted to the appropriate EDD office, as itemized on page 3 of the official form [*see* [2], *below*].

[2] FORM

Request for Tax Clearance From Employment Development Department

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156 of 156 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 17 BUYING AND SELLING A BUSINESS OR PROFESSIONAL PRACTICE
PART IV. FORMS
H. Requests for Tax Clearance

8-17 California Legal Forms--Transaction Guide § 17.302

AUTHOR: Marilyn E. Minger Revision Author

§ 17.302 Request for Tax Clearance From State of California, Franchise Tax Board

[1] Comment

[a] Use of Form

This form is a request from the buyer of a business to the Franchise Tax Board (FTB) requesting a certificate or statement showing the amount of tax, interest, and penalties that the seller was required to deduct and withhold from the wages of its employees, but did not remit to the state. For equivalent forms used to request certificates of tax clearance from the Employment Development Department and the Board of Equalization, *see §§ 17.301[2]* and *17.302[2]*, respectively. This form was drafted by the publisher; as of the date this material was published, the FTB did not have an official form for requesting a tax clearance.

[b] Buyer's Withholding Requirement

The buyer of a business must withhold in trust either money or other property sufficient to pay any state income taxes, interest, and penalties that the seller was required to deduct and withhold from the wages of its employees, but did not remit to the state [*Rev. & Tax. Code § 18669*]. The buyer must continue to withhold the money or property in trust until the FTB issues a certificate stating that no taxes, interest, or penalties are due or unpaid from the seller [*Rev. & Tax. Code § 18669(a)*]. If the buyer fails to withhold sufficient funds, he or she becomes personally liable for the taxes, interest, or penalties owed, up to the amount of the fair market value of the business acquired [*Rev. & Tax. Code § 18669(d)*]. If the buyer does not request a certificate, the amount of tax, interest, or penalties due or unpaid by the seller must be paid by the buyer to the FTB on the day the business is acquired [*Rev. & Tax. Code § 18669(b)*].

Within 60 days after a written request from the buyer, the FTB must issue a certificate or statement showing the amount of tax, interest, and penalties due from the seller [*Rev. & Tax. Code § 18669(b)*]. Failure to issue a certificate or statement within that time is deemed equivalent to the issuance of a certificate stating that no tax, interest, or penalties are due [*Rev. & Tax. Code § 18669(b)*]. When an escrow is used for the sale, the escrow instructions often require the

escrow agent to request the certificate on behalf of the buyer [*see, e.g., § 17.250[2],* Paragraphs 18, 19]. For further discussion, *see § 17.14[4]*.

[c] Effect of Tax Certificate or Statement

Issuance of a certificate stating that no taxes, interest, or penalties are due (or the failure to issue a certificate within 60 days of a request) does not release the seller from liability on account of any taxes, interest, or penalties then or thereafter determined to be due from the seller [*Rev. & Tax. Code § 18669(c)*]. It does, however, release the buyer from any liability on account of any such taxes, interest, or penalties [*Rev. & Tax. Code § 18669(c)*].

If the FTB issues a statement showing that taxes, interest, and penalties are claimed to be due from the seller, the buyer must pay the FTB the amount stated (not in excess of the fair market value of the business acquired) on or before the later of (1) 30 days after the statement is mailed or delivered to the buyer, or (2) the day the business is acquired [*Rev. & Tax. Code § 18669(b)*]. Payment by the buyer does not release the seller from liability to the FTB, except to the extent of the amount paid by the buyer [*Rev. & Tax. Code § 18669(c)*]. Late payment by the buyer will result in a penalty of 10 percent of the amount payable [*Rev. & Tax. Code § 18669(b)*].

[d] Address of Franchise Tax Board

The request for a certificate or statement showing the amount of tax, interest, and penalties due from the seller should be addressed to the State of California, Franchise Tax Board, Correspondence Unit, P.O. Box 942840, Sacramento, CA 94240-0040, or to any local office of the Franchise Tax Board (records are computerized and can be accessed from any Franchise Tax Board office). For a complete list of the addresses of the FTB field offices, see the FTB website which is located at www.ftb.ca.gov.

[2] FORM

Request for Tax Clearance From State of California, Franchise Tax Board

Request for Certificate or Statement of Taxes Owing

_____[*date*]
State of California
Franchise Tax Board
Correspondence Unit
P.O. Box 942840
Sacramento, CA 94240-0040
[*OR, address of local Franchise Tax Board office*]

Re: _____ [*name of seller*]
Account No. _____
To whom it may concern:

This letter is a request for a certificate or statement of taxes, interest, and penalties owing, and is made pursuant to *Revenue and Taxation Code Section 18669.*

_____[*Name of buyer*] has entered into a contract to purchase the business known as _____[*name of business*], located at _____[*street address*], _____[*city*], California. _____[*Name of seller*], the seller, was assigned account no. _____ by the Franchise Tax Board. The sale of the business will take place on or after

_____[*date*].

I hereby request [*add, if escrow agent makes request:* on behalf of _____ (*name of buyer*), the proposed buyer of the business,] that you issue a certificate or statement showing the amount, if any, of any state income taxes, interest, and penalties which the seller was required to deduct and withhold form the wages of its employees, but did not remit to the State.

Sincerely, _____ [*signature*]
[*typed name*]



1 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS

8-18 California Legal Forms--Transaction Guide 18.syn

AUTHOR: Lynne Carmichael

§ 18.syn Synopsis to Chapter 18: BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS

Scope

§ 18.01 California Sources

[1] California Constitution

[2] California Statutes

[3] California Regulations

§ 18.02 Federal Sources

[1] United States Constitution

[2] Federal Statutes

[3] Federal Regulations

§§ 18.03-18.04 [Reserved]

§ 18.05 Law Reviews and Annotations

§ 18.06 Text References

§ 18.07 Pamphlets and Other Materials

§§ 18.08-18.09 [Reserved]

§ 18.10 Governing Law

[1] Federal and State Constitutions

[2] Alcoholic Beverage Control Act

[3] Uniform Commercial Code, Bulk Sales Division

[4] Federal Laws

[5] Other Laws

§ 18.11 Regulations

§§ 18.12-18.19 [Reserved]

§ 18.20 Types of Alcoholic Beverage Licenses

[1] Retail Licenses

[2] Nonretail Licenses

§ 18.21 Retail On-Sale Licenses

[1] Basic Categories of On-Sale Licenses

[a] Retailer's On-Sale License

[b] Special On-Sale General License

[c] Restricted Service Lodging Establishments

[d] Brewpub-Restaurant License

[2] Premises for Which Licenses Are Issued

[3] Issuance and Renewal of On-Sale Licenses

[4] Permits

§ 18.22 Retail Off-Sale Licenses

[1] In General

[2] Issuance and Renewal of Off-Sale Licenses

§§ 18.23-18.29 [Reserved]

§ 18.30 Restrictions Imposed on General Licenses

[1] Original Issuance

[2] Inter-County Transfer

[3] Prohibition on Transfer for Two Years After Issuance

[4] Purchase Price on Transfer

§ 18.31 Restrictions Imposed on Off-Sale Beer and Wine Licenses

§ 18.32 Conditional Licenses

[1] Existing Conditions

[2] Conditions Imposed at Time of Transfer

§ 18.33 Tied-House Restrictions

§§ 18.34-18.39 [Reserved]

§ 18.40 Authorized Transfers of Retail Licenses

[1] In General

[2] Exchanges of On-Sale Licenses

[3] Between Particular Persons

§ 18.41 Requirements for Transfer of Retail License

[1] In General

[2] Notice of Intended Transfer

[3] Bulk Sale Notice

[4] Establishing an Escrow

[5] Parties'Agreement Regarding Distribution of Consideration

[6] Filing Application

[7] Required Documents

[8] Transfer Fees

[9] Investigation Period

[10] Required Notices

§§ 18.42-18.49 [Reserved]

§ 18.50 Temporary Permit--Issuance

[1] Issuance

[2] Operation of Business Under Permit

§ 18.51 Escrow Requirements

[1] Payment of Tax Holds

[2] Distribution of Consideration

§ 18.52 Impediments to Transfer

[1] Denial of Application

[2] Protests

[3] Conditional Licenses

Scope

§§ 18.53-18.99 [Reserved]

§ 18.100 Facts Regarding Parties to Sale

Scope

§ 18.101 Facts Regarding Alcoholic Beverage License

Scope

§ 18.102 Facts Regarding Business

Scope

§ 18.103 Facts Regarding Sale

Scope

§ 18.104 Documents

Scope

§§ 18.105-18.109 [Reserved]

§ 18.110 General Determinations

Scope

§ 18.111 Applicability of Transfer Restrictions on General Licenses

Scope

§ 18.112 Applicability of Bulk Sales Division

Scope

§ 18.113 Applicability of Sales and Use Tax Law

Scope

§ 18.114 Structuring Sale of License and Business

Scope

§§ 18.115-18.119 [Reserved]

§ 18.120 Representing Parties

Scope

§ 18.121 Investigating Liabilities of Business

Scope

§ 18.122 Drafting Contract of Sale and Related Documents

Scope

§ 18.123 Giving Notice of Intended Transfer of License

Scope

§ 18.124 Giving Notice of Intended Bulk Sale

Scope

§ 18.125 Opening Escrow

Scope

§ 18.126 Applying for License Transfer

Scope

§ 18.127 Giving Notice of Application

Scope

§ 18.128 Handling Creditor Claims

Scope

§ 18.129 Satisfying Seller's Tax Obligations

Scope

§ 18.130 Closing the Sale

Scope

§ 18.131 Distributing Sales Proceeds

Scope

§ 18.132 Procedures on Denial of License Transfer

Scope

Scope

§§ 18.133-18.149 [Reserved]

§ 18.150 Contract for Sale of License and Business

Scope

§ 18.151 Escrow Instructions

Scope

§ 18.152 Contract for Sale of License Only

Scope

§§ 18.153-18.159 [Reserved]

§ 18.160 Financing Sale

Scope

§ 18.161 Reporting Statutory Change in Ownership of Real Property

Scope

§ 18.162 Reporting Income Tax Consequences of Sale

Scope

§ 18.163 Advising Buyer Regarding New Business

Scope

§ 18.164 Advising Seller Regarding Abandonment of Fictitious Business Name

Scope

§ 18.165 Advising Buyer Regarding License Renewal

Scope

§ 18.166 Paying Federal Occupational Tax

Scope

§§ 18.167-18.199 [Reserved]

§ 18.200 Contract for Sale of Retail Alcoholic Beverage License and Business

[1] Comment

[a] Use of Form

[b] Basic Contract Provisions

[c] Description of Property Being Sold

[d] Amount of Purchase Price

[e] Allocation of Purchase Price

[f] Payment of Purchase Price

[g] Inventory

[h] Insurance Policies

[i] Compliance With Bulk Sales Division

[j] Time and Place of Sale

[k] Application for License Transfer

[l] Conduct of Business

[m] Risk of Loss

[n] Application for Temporary Permit

[o] Prorations

[p] Escrow Holder and Instructions

[q] Costs and Expenses

[r] Denial of Transfer Application

[s] Seller's Warranties

[t] Buyer's Warranties

[u] Indemnification

[v] Reliance on Representations

[w] Attorneys' Fees

[x] Arbitration

[y] Standard Contractual Provisions

[z] Optional Provisions

[aa] Attached Exhibits

[2] FORM

Contract for Sale of Retail Alcoholic Beverage License and Business

§ 18.201 Escrow Instructions for Sale of Retail Alcoholic Beverage License and Business

[1] Comment

[a] Use of Form

[b] Escrow Instructions In General

[c] Mandatory Nature of Escrow

[d] Appointment of Escrow Holder

[e] Specific Escrow Instructions

[i] Notice of Intended Bulk Sale

[ii] Information Request

[iii] Deposit of Total Purchase Price

[iv] Acknowledgment of Creditor Claims

[v] Notice to Creditors of Disputed Claims

[vi] Prohibition on Exchange of Funds

[vii] Time for Payment

[viii] Payment of Tax Holds

[ix] Notice to Creditors Regarding Distribution

[x] Payment of Other Creditor Claims

[f] Standard Escrow Instructions

[i] Recitals

[ii] Obligations to Escrow Holder

[iii] Deposits into Escrow

[iv] Inventory

[v] Transfer of Documents

[vi] Proration of Expenses

[2] FORM

Escrow Instructions for Sale of Retail Alcoholic Beverage License and Business

§ 18.202 Contract for Sale of Retail Alcoholic Beverage License Only

[1] Comment

[a] Use of Form

[b] Transfer of License to New Premises

[i] In General

[ii] Premises Under Construction

[c] Contract Provisions

[i] Purchase Price

[ii] Time and Place of Sale

[iii] Application for License Transfer

[iv] Escrow Holder and Instructions

[v] Denial of Transfer Application

[vi] Warranties

[vii] Attorneys' Fees

[viii] Arbitration

[ix] Standard Contractual Provisions

[2] FORM

Contract for Sale of Retail Alcoholic Beverage License Only

§§ 18.203-18.209 [Reserved]

§ 18.210 Notice of Intended Transfer of Retail Alcoholic Beverage License [ABC-227]

[1] Comment

[a] Use of Form

[b] Recordation Requirement

[c] Contents of Form

[d] Filing Requirement

[e] Relationship to Notice of Bulk Sale

[2] FORM

Notice of Intended Transfer of Retail Alcoholic Beverage License [ABC-227]

§ 18.211 Notice of Intended Bulk Sale

[1] Comment

[a] Use of Form

[b] Application of Bulk Sales Division

[c] Contents of Notice

[d] Recordation and Publication Requirements

[e] Relationship to Notice of Intended Transfer

[2] FORM

Notice of Intended Bulk Sale

§ 18.212 Combined Notice of Intended Sale of Retail Alcoholic Beverage License and Notice of Intended Bulk Sale

[1] Comment

[a] Use of Form

[b] Recordation and Publication Requirements

[c] Number of Copies Required

[2] FORM

Combined Notice of Intended Sale of Retail Alcoholic Beverage License and Notice of Intended Bulk Sale

§§ 18.213-18.219 [Reserved]

§ 18.220 License Transfer Request ("Sign Off") [ABC-211-A]

[1] Comment

[a] Use of Form

[b] Issuance of Temporary Permit

[c] Seller Signatures

[2] FORM

License Transfer Request ("Sign Off") [ABC-211-A]

§ 18.221 Application Questionnaire [Form ABC-217]

[1] Comment

[a] Use of Form

[b] General Requirements

[c] Applicant and Premises Information

[d] Investment Information

[e] Investment Details

[f] Bank Accounts

[g] Notarization

[h] Filing Fees

[i] Temporary Permit

[j] Processing Application

[2] FORM

Application Questionnaire [Form ABC-217]

§ 18.222 Application Signature Sheet ("Sign On") [ABC-211-SIG]

[1] Comment

[a] Use of Form

[b] General Information

[c] Signatures

[2] FORM

Application Signature Sheet ("Sign On") [ABC-211-SIG]

§ 18.223 Declaration Regarding Temporary Permit [Form ABC-282]

[1] Comment

[a] Use of Form

[b] Cash-Only Purchases of Alcoholic Beverages

[2] FORM

Declaration Regarding Temporary Permit [Form ABC-282]

§ 18.224 Individual Personal Affidavit [Form ABC-208A]

[1] Comment

[a] Use of Form

[b] Interests in Other Alcoholic Beverage Licenses

[c] Criminal History

[d] Financial Contributions

[2] FORM

Individual Personal Affidavit [Form ABC-208A]

§ 18.225 Individual Financial Affidavit [Form ABC-208B]

[1] Comment

[a] Use of Form

[b] Scope of Disclosure

[2] FORM

Individual Financial Affidavit [Form ABC-208B]

§ 18.226 Corporate Questionnaire [Form ABC-243]

[1] Comment

[a] Use of Form

[b] Stock Certificates

[c] Other Qualification Materials

[2] FORM

Corporate Questionnaire [Form ABC-243]

§ 18.227 Limited Partnership Questionnaire [Form ABC-256]

[1] Comment

[a] Use of Form

[b] Other Qualification Materials

[2] FORM

Limited Partnership Questionnaire [Form ABC-256]

§ 18.228 Limited Liability Company Questionnaire [Form ABC-256-LLC]

[1] Comment

[a] Use of Form

[b] Other Qualification Materials

[2] FORM

Limited Liability Company Questionnaire [Form ABC-256-LLC]

§§ 18.229-18.239 [Reserved]

§ 18.240 Notice of Application for Change In Ownership of Alcoholic Beverage License [ABC-207-D]

[1] Comment

[a] Use of Form

[b] Publishing Notice of Application-On-Sale Licenses

[c] Areas Having "Undue Concentration of Licenses"

[2] FORM

Notice of Application for Change In Ownership of Alcoholic Beverage License [ABC-207-D]

§ 18.241 Affidavit of Posting Notice of Application [ABC-293]

[1] Comment

[a] Use of Form

[b] Posting Requirement

[c] Affidavit Requirement

[2] FORM

Affidavit of Posting Notice of Application [ABC-293]

§ 18.242 Statement Regarding Consideration Deposited in Escrow [ABC-226]

[1] Comment

[a] Use of Form

[b] Filing Requirement

[c] Exception to Filing Requirement

[2] FORM

Statement Regarding Consideration Deposited in Escrow [ABC-226]

§ 18.243 Notice to Creditors Regarding Distribution

[1] Comment

[a] Use of Form

[b] Required Contents

[2] FORM

Notice to Creditors Regarding Distribution

§§ 18.244-18.249 [Reserved]

§ 18.250 Application Withdrawal [ABC-209]

[1] Comment

[a] Use of Form

[b] Protests

[2] FORM

Application Withdrawal [ABC-209]

§ 18.251 License Action Request [ABC-231]

[1] Comment

[a] Use of Form

[b] License Reinstatement

[c] License Revocation

[2] FORM

License Action Request [ABC-231]

Lynne Carmichael n*

FOOTNOTES:

(n55)Footnote *. Lynne Carmichael is a partner in the San Francisco law firm of Hinman & Carmichael LLP. The firm's practice is exclusively alcoholic beverage law, including licensing, defending administrative disciplinary actions brought by federal and state alcoholic beverage control regulators, and counseling clients on regulatory and corporate strategies related to production, importation and marketing of alcoholic beverages. Ms. Carmichael has written several articles about alcoholic beverage licensing and regulation and participates in many industry groups. She is a past president of Women for WineSense and a former Board member of the San Francisco Chapter of the American Institute of Wine & Food. Prior to her association with Hinman & Carmichael, Ms. Carmichael was a partner at Brobeck, Phleger & Harrison. She is a 1978 graduate of U.C. Berkeley's Boalt Hall School of Law and a 1965 graduate of Occidental College.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS

8-18 California Legal Forms--Transaction Guide Scope

AUTHOR: Lynne Carmichael

Scope

Lynne Carmichael n* Scope

This chapter covers the sale of a retail alcoholic beverage license and business. The Legal Background examines the different types of retail licenses and discusses the laws governing the sale of a retail license and the business for which it was issued.

The Transaction Guide provides checklists of information and documents needed to draft an agreement for the sale of a license and business, determinations that the attorney should make before drafting or approving such an agreement, and procedures used to transfer a license. The Forms include contracts of sale, escrow instructions, transfer applications, and statutory notices regarding the sale.

This chapter is designed to be used in conjunction with Ch. 17, *Buying and Selling a Business or Professional Practice*. Because the sale of an alcoholic beverage license and business is subject to many of the same laws as the sale of any other business, portions of Ch. 17 are applicable to this chapter as well. To avoid unnecessary repetition, this chapter contains numerous cross-references to coverage in that chapter.

FOOTNOTES:
(n56)Footnote *. Lynne Carmichael is a partner in the San Francisco law firm of Hinman & Carmichael LLP. The firm's practice is exclusively alcoholic beverage law, including licensing, defending administrative disciplinary actions brought by federal and state alcoholic beverage control regulators, and counseling clients on regulatory and corporate strategies related to production, importation and marketing of alcoholic beverages. Ms. Carmichael has written several articles about alcoholic beverage licensing and regulation and participates in many industry groups. She is a past president of Women for WineSense and a former Board member of the San Francisco Chapter of the American Institute of Wine & Food. Prior to her association with Hinman & Carmichael, Ms. Carmichael was a partner at Brobeck, Phleger & Harrison. She is a 1978 graduate of U.C. Berkeley's Boalt Hall School of Law and a 1965 graduate of Occidental College.



3 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART I. RESEARCH GUIDE
A. Primary Sources

8-18 California Legal Forms--Transaction Guide

AUTHOR: Lynne Carmichael

NOTE:

This Research Guide contains authorities and sources specifically relevant to the transfer of a retail alcoholic beverage license and business. For additional research materials applicable to the sale of businesses generally, see *Ch. 17,* ***Buying and Selling a Business****, §§ 17.01-17.07.*



4 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART I. RESEARCH GUIDE
A. Primary Sources

8-18 California Legal Forms--Transaction Guide § 18.01

AUTHOR: Lynne Carmichael

§ 18.01 California Sources

[1] California Constitution

Department of Alcoholic Beverage Control has exclusive power to license manufacture, importation, and sale of alcoholic beverages in California; Legislature authorized to provide for on-sale alcoholic beverage licenses. *Cal. Const., art. XX, § 22*.

[2] California Statutes

Alcoholic Beverage Control Act. *Bus. & Prof. Code § 23000 et seq.*

General provisions and definitions. *Bus. & Prof. Code §§ 23000-23047*.

Administration. *Bus. & Prof. Code §§ 23049-23098*.

Authorized unlicensed transactions and exemptions. *Bus. & Prof. Code §§ 23100-23113*.

Licenses and fees. *Bus. & Prof. Code §§ 23300-23455*.

Imports. *Bus. & Prof. Code §§ 23660-23673*.

Restrictions on issuance of licenses. *Bus. & Prof. Code §§ 23770-23827*.

Applications for licenses. *Bus. & Prof. Code §§ 23950-23962*.

Notices and protests. *Bus. & Prof. Code §§ 23985-23987*.

Denial. *Bus. & Prof. Code §§ 24010-24016*.

Issuance and renewal of licenses. *Bus. & Prof. Code §§ 24040-24052*.

Transfer of licenses. *Bus. & Prof. Code §§ 24070-24082*.

Suspension and revocation of licenses. *Bus. & Prof. Code §§ 24200-24211*.

Hearings. *Bus. & Prof. Code §§ 24300-24310*.

Tied-house restrictions. *Bus. & Prof Code §§ 25500-25512*.

Regulatory provisions. *Bus. & Prof. Code §§ 25600-25667*.

Administration of Department of Alcoholic Beverage Control Board. *Bus. & Prof. Code §§ 25750-25762*.

Penal provisions.

Sale of alcoholic beverages near certain colleges is misdemeanor. *Penal Code § 172 et seq.*

Abatement of unlawful liquor sales. *Penal Code §§ 11200-11207*.

Alcoholic Beverage Tax Law. *Rev. & Tax. Code § 32001 et seq.*

[3] California Regulations

Regulations of Department of Alcoholic Beverage Control. *4 Cal. Code Reg. § 1 et seq.*

Fingerprinting of licensees and transferees required. *4 Cal. Code Reg. § 57*.

Names of married persons in which license will be issued. *4 Cal. Code Reg. § 58*.

Transfer of licenses. *4 Cal. Code Reg. § 60*.

Transfer of license for premises under construction. *4 Cal. Code Reg. § 64*.

Diagram of premises to be licensed required before transfer of license. *4 Cal. Code Reg. § 64.2*.

Surrender of license required on closing of business. *4 Cal. Code Reg. § 65*.

ABC refusal to transfer license when transferor is delinquent in tax payments. *4 Cal. Code Reg. § 68.2*.

Rules when corporate licensee has change in board membership. *4 Cal. Code Reg. § 68.5*.

Regulations regarding Alcoholic Beverage Control Appeals Board. *4 Cal. Code Reg. § 175 et seq.*

Regulations regarding alcoholic beverage tax. *18 Cal. Code Reg. § 2500 et seq.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART I. RESEARCH GUIDE
A. Primary Sources

8-18 California Legal Forms--Transaction Guide § 18.02

AUTHOR: Lynne Carmichael

§ 18.02 Federal Sources

[1] United States Constitution

Each state authorized to regulate transportation or importation of intoxicating liquor into state. *U.S. Const., Amend. XXI, § 2*.

[2] Federal Statutes

Unlawful liquor traffic. *18 U.S.C. §§ 1261-1265*.

Seizure and forfeiture of liquor involved in unlawful liquor traffic. *18 U.S.C. § 3615*.

Federal occupational taxes on alcoholic beverages. *I.R.C. § 5001* et seq.

Imposition of tax on retail dealers in liquor and beer. *I.R.C. § 5121*.

Definitions of retail dealers in liquor, retail dealers in beer, and limited retail dealers. *I.R.C. § 5122*.

Dealers exempt from tax. *I.R.C. § 5123*.

Records required to be kept by retail dealers. *I.R.C. § 5124*.

Registration requirement for persons subject to special federal tax. *I.R.C. § 7011(a)*.

Intoxicating liquors transported into state or territory subject to laws of that state or territory. *27 U.S.C. § 121*.

Interstate transportation of intoxicating liquor for possession, use, or sale in violation of state law prohibited. *27 U.S.C. § 122*.

Federal Alcohol Administration Act. *27 U.S.C. §§ 201-219a*.

[3] Federal Regulations

Regulations applicable to liquor dealers. 27 C.F.R. § 194.1 et seq.

Basis of tax. 27 C.F.R. § 194.21.

Retail dealer in liquors defined. 27 C.F.R. § 194.23.

Retail dealer in beer defined. 27 C.F.R. § 194.25.

Rules regarding partnerships. 27 C.F.R. §§ 194.91-194.94.

Payment of tax. 27 C.F.R. §§ 194.101-194.111.

Due date of tax. 27 C.F.R. § 194.102.

Issuance of stamps for payment of tax. 27 C.F.R. §§ 194.121-194.127.

Rules regarding change in proprietorship or control. 27 C.F.R. §§ 194.161-194.170.



6 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART I. RESEARCH GUIDE
A. Primary Sources

8-18 California Legal Forms--Transaction Guide §§ 18.03-18.04

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.03[Reserved]



7 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-18 California Legal Forms--Transaction Guide § 18.05

AUTHOR: Lynne Carmichael

§ 18.05 Law Reviews and Annotations

Carmichael, *Transferring Retail Liquor Licenses in California*, Cal. Bus. Law Practitioner (CEB), Vol. XV, No. 3 (Summer 2000).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-18 California Legal Forms--Transaction Guide § 18.06

AUTHOR: Lynne Carmichael

§ 18.06 Text References

California Legal Forms (Matthew Bender).

Ch. 17, *Buying and Selling a Business or Professional Practice*.

Ch. 85, *Employment Agreements*.

California Forms of Pleading and Practice, Ch. 18, *Alcoholic Beverage Licenses* (Matthew Bender).

California Points and Authorities, Ch. 15, *Alcoholic Beverage Licensing* (Matthew Bender).



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-18 California Legal Forms--Transaction Guide § 18.07

AUTHOR: Lynne Carmichael

§ 18.07 Pamphlets and Other Materials

"Questions and Answers concerning the Alcoholic Beverage Control Act and Related Constitutional Provisions," (ABC 2002).



10 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART I. RESEARCH GUIDE
B. Secondary Sources

8-18 California Legal Forms--Transaction Guide §§ 18.08-18.09

AUTHOR: Lynne Carmichael

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§§ 18.08[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
A. Statutes and Regulations

8-18 California Legal Forms--Transaction Guide § 18.10

AUTHOR: Lynne Carmichael

§ 18.10 Governing Law

[1] Federal and State Constitutions

The United States Constitution authorizes each state to regulate the transportation or importation of intoxicating liquor for delivery or use into its borders [*U.S. Const., amend. XXI, § 2*]. The California Constitution provides that the State of California has the exclusive right and power to license and regulate the manufacture, sale, purchase, possession, and transportation of alcoholic beverages within the state, subject to federal internal revenue laws [*Cal. Const., art. XX, § 22*]. It also authorizes the legislature to provide for the licensing of premises where alcoholic beverages are sold and delegates the power to issue licenses to the Department of Alcoholic Beverage Control ("ABC") [*Cal. Const., art. XX, § 22*].

[2] Alcoholic Beverage Control Act

The California legislature has exercised its power to regulate alcoholic beverages by enacting the Alcoholic Beverage Control Act ("Act") [*Bus. & Prof. Code § 23000 et seq.*]. The Act is designed to protect the welfare of the people of California by eliminating the unlicensed and unlawful manufacture and sale of alcoholic beverages [*Bus. & Prof. Code § 23001*]. The term "alcoholic beverages" means alcohol, spirits, liquor, wine, and beer, and every liquid or solid containing alcohol, spirits, wine, or beer, that (1) contains 1/2 of one percent or more of alcohol by volume, and (2) is fit for beverage purposes either alone or when diluted, mixed, or combined with other substances [*Bus. & Prof. Code § 23004*].

The Act governs issuance of alcoholic beverage licenses and regulates all other phases of the alcoholic beverage industry in California, including manufacturing, importation, and wholesale and retail distribution. The power to control the licensing of alcoholic beverage sales in California reasonably extends to the transfer of alcoholic beverage licenses. Otherwise, the power to control their original issuance would be meaningless [*Pac. Firestone Escrow Co. v. Food Giant Markets, Inc. (1962) 202 Cal. App. 2d 155, 158, 20 Cal. Rptr. 570]* . The Act's comprehensive provisions give an unmistakable indication of the legislature's determination to exercise its power to control every phase of a transfer [*see*

Grover Escrow Corp. v. Gole (1969) 71 Cal. 2d 61, 64-65, 77 Cal. Rptr. 21, 453 P.2d 461] .

Chapter 6 of the Act governs the issuance and transfer of alcoholic beverage licenses [*see Bus. & Prof. Code § 23950 et seq.*]. Articles 1-4 of that chapter concern the issuance and denial of licenses [*see Bus. & Prof. Code § 23950 et seq.*], and Article 5 governs transfers of licenses [*see Bus. & Prof. Code § 24070 et seq.*].

[3] Uniform Commercial Code, Bulk Sales Division

The Uniform Commercial Code-Bulk Sales Division [*Com. Code § 6101 et seq.*] protects the creditors of certain types of businesses when the owner makes a bulk sale. The Bulk Sales Division requires a buyer to record and publish advance notice of the sale [*see Com. Code §§ 6104(b), 6105*] and, in small cash sales of not more than $2,000,000, to impound and control the distribution of the proceeds [*see Com. Code §§ 6106.2, 6106.4*; *see also Ch. 17, Buying and Selling a Business or Professional Practice, §§ 17.20, 17.210*].

A "bulk sale" is any sale outside the ordinary course of the seller's business of more than one half of the seller's inventory and equipment, as measured by the fair market value on the date of the bulk sale agreement [*Com. Code § 6102(a)(3), (8), (15)*; *see Com. Code §§ 6102(b)(2), (3), 9102(a)(33)* ("equipment" defined), *9102(a)(48)* ("inventory" defined)]. A sale is "in the ordinary course of the seller's business" if the sale comports with usual or customary practices in the kinds of business in which the seller is engaged or with the seller's own usual or customary practices [*Com. Code § 6102(a)(13)*]. The term "bulk sale" also encompasses such a sale that is *not* "in the ordinary course of the seller's business" when conducted by auction, and a sale or series of sales conducted by a liquidator on the seller's behalf [*Com. Code § 6102(a)(3)(i)*].

The Bulk Sales Division applies to a bulk sale if [*Com. Code § 6103(a)(2)*; *see Com. Code § 6103(c)* (exceptions)]:

- The seller's principal business is the sale of inventory from stock, including those who manufacture what they sell, or is that of restaurant owner [*Com. Code § 6103(a)(1)*]; and

- The seller is located in California, or is located in jurisdiction outside the United States but has its major American executive office in California, on the date of the bulk sale agreement.

The Bulk Sales Division has only limited application to the sale of an alcoholic beverage license and business. A transfer that is subject to and complies with the transfer provisions of the Alcoholic Beverage Control Act [*Bus. & Prof. Code § 24070 et seq.*] is exempt from most Bulk Sales Division provisions [*Com. Code § 6103(c)(15)*; *see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.20[2]*]. Because the requirements regarding escrow and payment of creditor claims [*Com. Code §§ 6106.2, 6106.4*; *see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.20[6], [7]*] are inconsistent with the payment requirements set forth in the transfer division of the Alcoholic Beverage Control Act [*see Bus. & Prof. Code § 24074*; *see also § 18.51[2]*], both could not be applied to the same transaction. The transfer of an alcoholic beverage and license, however, is subject to the Bulk Sales Division's notice requirements [*Com. Code § 6103(c)(15)*; *see Com. Code § 6105(a)(1)-(4), (b)*]. Therefore, if the Bulk Sales Division applies and the buyer fails to comply with its notice requirements, the buyer is liable for the claims of the seller's creditors [*see Com. Code § 6107*; Ch. 17, *Buying and Selling a Business or Professional Practice*, § *17.20[4], [5]*; *see also § 18.112*].

[4] Federal Laws

Until passage of the Homeland Security Act of 2002 [Pub. L. 107-296, 116 Stat. 2135], federal governmental oversight of the alcoholic beverage industry was carried out by the Bureau of Alcohol, Tobacco and Firearms. With passage of the Homeland Security Act of 2002, the responsibilities for criminal and regulatory violations of federal firearms, explosives, arson, alcohol, and tobacco smuggling laws were transferred to the Bureau of Alcohol, Tobacco, Firearms

and Explosives ("ATF"), within the Department of Justice under the general oversight of the Director of Homeland Security [Homeland Security Act of 2002, Pub. L. 107-296, § 1111(c)(1), 116 Stat. 2135].

Administration and enforcement of Chapters 51 and 52 of the Internal Revenue Code of 1986 [*I.R.C. §§ 5001 et seq., 5701 et seq*], *I.R.C. §§ 4181* and *4182*, and Title 27 of the Federal Alcohol Administration Act [*27 U.S.C. § 201 et seq.*] and all functions of the former Bureau of Alcohol, Tobacco and Firearms not transferred to ATF were retained under the Department of Treasury in a newly named Alcohol and Tobacco Tax and Trade Bureau ("TTB") [Homeland Security Act of 2002, Pub. L. 107-296, § 1111(c)(2), (d), 116 Stat. 2135]. The TTB is responsible for licensing, labeling, formula approval, and tax collections related to the alcoholic beverage industry.

The principal federal impact on California retail licensed businesses is the imposition and collection of the federal Special Occupational Tax on retail sellers of alcoholic beverages imposed by the Internal Revenue Code [*26 U.S.C. § 5121*]. This tax of $250 a year for each retail outlet is payable annually (July 1 to June 30) by every retail seller of alcoholic beverages.

[5] Other Laws

In addition to the laws specifically applicable to the sale of alcoholic beverage licenses, described above, other laws govern all sales of businesses. For a discussion of the statutes that operate to protect the creditors of a business that is being sold, and the state and federal statutes that impose income, sales and use, and property tax on the sale of the business, see the Legal Background to Ch. 17, *Buying and Selling a Business or Professional Practice*. For discussion of statutes that govern the sale of a specific type of property (for example, goodwill, trademarks, or real property), or govern a specific type of sale (for example, sale of a franchised business or professional practice), see the comments to the applicable forms in Ch. 17.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
A. Statutes and Regulations

8-18 California Legal Forms--Transaction Guide § 18.11

AUTHOR: Lynne Carmichael

§ 18.11 Regulations

The administrative regulations of the ABC implementing the Act are set forth in Title 4, Division 1 of the California Code of Regulations [*see 4 Cal. Code Reg. § 1 et seq.*]. Article 11, Rules 55 through 68.5, address applications for and transfer of licenses [*see 4 Cal. Code Reg. §§ 55-68.5*].

The administrative regulations of the Alcohol and Tobacco Tax and Trade Bureau implementing the occupational taxes applicable to retail sellers of alcoholic beverages are set forth in 27 C.F.R. Part 194.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
A. Statutes and Regulations

8-18 California Legal Forms--Transaction Guide §§ 18.12-18.19

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.12[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
B. Retail Licenses

8-18 California Legal Forms--Transaction Guide § 18.20

AUTHOR: Lynne Carmichael

§ 18.20 Types of Alcoholic Beverage Licenses

[1] Retail Licenses

The transfer provisions of the Alcoholic Beverage Control Act are applicable to all licenses, but because the cost of nonretail licenses is relatively low [*see Bus. & Prof. Code § 23954.5*], and because the Act restricts the number of retail licenses that can be issued by the ABC [*see Bus. & Prof. Code §§ 23816, 23817, 23817.5, 23958*], the transfer provisions of the Act are used primarily to transfer "retail licenses" [*see Bus. & Prof. Code §§ 24070-24082*]. Therefore, the discussion in this chapter is limited to the transfer of retail licenses under those provisions. However, the Act also authorizes the ABC to issue various other types of alcoholic beverage licenses [*see Bus. & Prof. Code § 23320*].

The Act uses, but does not define, the general term "retail license." A retail license authorizes the licensee to sell alcoholic beverages for consumption, rather than resale [*see Bus. & Prof. Code §§ 23393, 23394, 23396*]. The Act provides for two specific types of retail licenses: on-sale and off-sale. The most common types of retail licenses are:

- On-sale general, which authorizes the sale of all types of alcoholic beverages: namely, beer, wine, and distilled spirits, for consumption on the premises, and the sale of beer and wine for consumption off the premises [*see Bus. & Prof. Code §§ 23396, 23401*].

- Off-sale general, which authorizes the sale of all types of alcoholic beverages for consumption off the premises in original, sealed containers [*see Bus. & Prof. Code § 23394*].

- On-sale beer and wine, which authorizes the sale of all types of wine and malt beverages (e.g., beer, porter, ale, stout, and malt liquor) for consumption on and off the premises [*see Bus. & Prof. Code §§ 23396, 23401*].

- Off-sale beer and wine, which authorizes the sale of all types of wine and malt beverages for

consumption off the premises in original, sealed containers [*see Bus. & Prof. Code § 23393*].

- On-sale beer, which authorizes the sale of malt beverages for consumption on and off the premises [*see Bus. & Prof. Code §§ 23396, 23401*].

[2] Nonretail Licenses

In addition to retail licenses, the ABC may issue a variety of other licenses [*see Bus. & Prof. Code § 23320* (schedule of licenses and renewal fees)]. For example, a manufacturer's or winegrower's license authorizes the licensee to manufacture, produce, package, and sell the authorized beverage [*Bus. & Prof. Code §§ 23356, 23356.1*; *see also Bus. & Prof. Code § 23356.5* (wine blender's license)]. An importer's license authorizes the licensee to import and export alcoholic beverages and to transfer the beverages to himself or herself under another license [*Bus. & Prof. Code § 23374*]. A wholesaler's license authorizes the sale of the alcoholic beverages specified in the license only to other licensees authorized to sell the same alcoholic beverages [*Bus. & Prof. Code § 23378*].

The "tied-house" laws in California generally prohibit cross-ownership or control between retail and nonretail licensees [*see Bus. & Prof. Code §§ 25500, 25502, 25503*; *see also § 18.33*]. However, there are a number of exceptions to the tied-house laws that allow holders of some nonretail licenses, particularly winegrower's licenses, also to hold retail licenses [*see Bus. & Prof. Code §§ 25503.15, 25503.30, 23362*]. Under a further statutory tied-house exception, California wine-importing businesses often hold a beer and wine importer's license, a beer and wine wholesaler's license as well as a retail package off-sale beer and wine license under which wine only may be sold to consumers [*Bus. & Prof. Code § 23378.2*]. Some businesses that operate under California nonretail licenses, including any businesses that manufacture, import, or wholesale alcoholic beverages, also require issuance of one or more federal basic permits [*27 U.S.C. § 203*]. If any nonretail license is the subject of a transfer, the attorney handling the sale should consult the nearest district office of the Department of Alcoholic Beverage Control and the National Revenue Center of the Federal Alcohol and Tobacco Tax and Trade Bureau ("TTB") in Cincinnati, Ohio for applicable requirements and procedures.



15 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
B. Retail Licenses

8-18 California Legal Forms--Transaction Guide § 18.21

AUTHOR: Lynne Carmichael

§ 18.21 Retail On-Sale Licenses

[1] Basic Categories of On-Sale Licenses

[a] Retailer's On-Sale License

A "retailer's on-sale license" authorizes the sale of the alcoholic beverages specified in the license for consumption on the premises where sold [*see Bus. & Prof. Code §§ 23024, 23396*]. In addition, every on-sale general license with respect to beer and wine, and any other on-sale license with respect to the particular beverage or beverages mentioned in the license, also authorizes the exercise of the off-sale privileges granted by an off-sale beer and wine license [*Bus. & Prof. Code § 23401*]. The on-sale licenses most commonly the subject of transfers are (1) on-sale beer and wine licenses, and (2) on-sale general licenses [*see Bus. & Prof. Code § 23024*]. In addition, several other types of on-sale licenses may be involved in connection with the sale of a business.

[b] Special On-Sale General License

A special on-sale general license ("special" because a club is not open to the general public) may be issued to a club [*see Bus. & Prof. Code §§ 23320.1, 23399.2, 24078*]. A club is defined as a corporation or association that meets all the following criteria [*Bus. & Prof. Code § 23037*]:

- Operates an establishment solely for a social or athletic purpose but not for pecuniary gain;
- Has a bona fide membership list;
- Receives dues from a majority of its members at least once a year;
- Has property owned by members; and

- Sells alcoholic beverages only to its members and bona fide guests.

A special on-sale general license may be issued to an association meeting these requirements even if it is operated for pecuniary gain, or its property is not owned by its members, or both [*Bus. & Prof. Code § 23399.2*].

[c] Restricted Service Lodging Establishments

An on-sale license for restricted service lodging establishments may be issued to a hotel or motel that [*see Bus. & Prof. Code § 23396.1(b)*]:

- Does not operate a bona fide eating place or other public premises;

- Has at least 10 guestrooms; and

- Does not derive more than 5 percent of its total gross annual revenues from sales of alcoholic beverages.

This license allows the hotel or motel to sell or furnish alcoholic beverages for consumption on the premises to its transient guests and their invitees by means of controlled access alcoholic beverage cabinets ("minibars") [*see Bus. & Prof. Code § 23355.2*], or in circumstances where the cost of the alcoholic beverages is included in the price of the overnight transient occupancy accommodation.

[d] Brewpub-Restaurant License

A brewpub-restaurant license in an on-sale retail license that may be issued to a bona fide public eating place as long as the licensed premises has at least a seven-barrel brewing capacity and produces not less than 100 barrels nor more than 5,000 barrels of beer annually on the licensed premises. This license authorizes the sale of beer, wine, and distilled spirits for consumption on the premises and the sale of beer produced by the licensee to licensed beer and wine wholesalers [*see Bus. & Prof. Code § 23396.3*].

This license also requires that the licensee submit a federal brewer's notice to TTB [*26 U.S.C. § 5401(a)*; *27 C.F.R. § 25.25*]. The attorney handling the sale should contact TTB for applicable requirements and procedures.

[2] Premises for Which Licenses Are Issued

The legislature, under a constitutional grant of authority [*see Cal. Const., art. XX, § 22*], has authorized issuance of on-sale licenses for the following types of premises:

- Bona fide public eating places [*see Bus. & Prof. Code § 23038*].

- Public premises where food is not sold or served to the extent sold or served in a bona fide public eating place [*see* discussion, *below*], but where food products may be sold or served incidentally to the sale and service of alcoholic beverages [*see Bus. & Prof. Code § 23039(a)(1)*].

- Public premises for the sale and service of beer only [*see Bus. & Prof. Code § 23039(a)(2)*].

- Railroad dining or club cars [*see Bus. & Prof. Code § 23321*], passenger ships [*see Bus. & Prof. Code §§ 23321.6, 23321.7, 24043*], common carriers by air [*see Bus. & Prof. Code § 23321*], and bona fide clubs after they have been lawfully operated for at least a year [*see Bus. & Prof. Code §§ 23037, 23431*].

A "bona fide public eating place" is a place that is regularly used for the serving of meals to guests for compensation and that has suitable kitchen facilities connected to it. It does not include an establishment that serves only sandwiches or salads [*Bus. & Prof. Code § 23038*]. It also includes a convention center, exhibit hall, or auditorium that is owned by or leased to the State of California, or to any incorporated city, county, city and county, or public corporation [*Bus. & Prof. Code § 23038.1*]. For purposes of on-sale beer and wine licenses, it also includes a ball park, stadium, or coliseum featuring professional sporting events that maintains kitchen facilities for preparing food for patrons [*Bus. & Prof. Code § 23038.2*].

"Public premises," with respect to an on-sale beer license, means premises on which no food whatsoever is sold or served to the public [*Bus. & Prof. Code § 23039(a)(2)*]. With respect to other on-sale licenses, "public premises" means premises on which food is not sold or served to the public as in a bona fide public eating place, but on which food products may be sold or served incidentally to the sale or service of alcoholic beverages [*Bus. & Prof. Code § 23039(a)(1)*].

No one under 21 years of age may enter or be present in a public premises at any time. The premises must be posted with signs stating that no one under 21 is allowed [*Bus. & Prof. Code § 25665*; *4 Cal. Code Reg. § 107*].

[3] Issuance and Renewal of On-Sale Licenses

The Act limits the number of on-sale general licenses that the ABC may issue [*see Bus. & Prof. Code § 23816*; *see also § 18.30*]. However, it does not impose a corresponding limitation on the number of on-sale beer and wine licenses or on-sale beer licenses that the ABC may issue.

All retail on-sale licenses, other than on-sale general licenses for seasonal business [*see 4 Cal. Code Reg. § 56*], daily on-sale general licenses [*see Bus. & Prof. Code § 24045.1*], and special licenses for the sale of beer and wine issued on a temporary basis [*see Bus. & Prof. Code § 24045(a)*], are issued on an annual basis [*Bus. & Prof. Code § 24045(a)*]. However, a license transferred, for example, to a spouse, living trust, fiduciary, or partner, or to a corporation, limited partnership, or limited liability company with new owners [*see Bus. & Prof. Code §§ 24071, 24071.1, 24071.2*] will only be issued for the unexpired term remaining on the transferor's license [*Bus. & Prof. Code § 24045(b)*]. Further, the ABC may assign or reassign dates for the expiration of licenses, and may establish a registration year for any licenses consisting of any period from six months to 18 months, with prorated fees for licenses with a registration year of other than 12 months [*Bus. & Prof. Code § 24045(c)*].

Every license, other than a temporary license or a daily on-sale general license [*see Bus. & Prof. Code §§ 24045(a), 24045.1*], is renewable unless the license was revoked, provided that the renewal application is made and the applicable fee paid [*Bus. & Prof. Code § 24048*; *see Bus. & Prof. Code § 23320* (schedule of fees)]. The licensee must renew the license annually [*Bus. & Prof. Code § 24045(c)*; *see § 18.165*].

[4] Permits

A number of different permits may be issued to holders of retail on-sale licenses. These permits are transferable as part of the retail on-sale license [*see Bus. & Prof Code § 23399(e)*]:

- A caterer's permit may be issued to any licensee under an on-sale general license; a caterer's permit authorizes the sale of beer, wine, and distilled spirits at social gathering and events held off the licensed premises [*Bus. & Prof Code § 23399(a)*].

- An event permit may be issued to any licensee under an on-sale general license or an on-sale beer and wine license. An event permit authorizes the sale of beer, wine, and distilled spirits under an on-sale

general license, and beer and wine only under an on-sale beer and wine license at events held no more frequently than four days in any single calendar year on property adjacent to and owned by or under the control of the licensee [*see Bus. & Prof Code § 23399(b)*].

- A controlled access alcoholic beverage cabinet is a closed container, access to the interior of which is restricted by means of a locking device or controlled at all times by the licensee. A hotel or motel with an on-sale license may be issued a controlled access alcoholic beverage cabinet permit and may sell alcoholic beverages to its registered guests from these cabinets located in the guestrooms of the hotel or motel [*see Bus. & Prof Code § 23355.2*].

On-sale general licenses can be issued to a multi-room premises, but the Department of Alcoholic Beverage Control ("ABC") may require duplicate or portable bar licenses if spirits are served in rooms other than the location of the principal licensed area. If there is more than one location from which distilled spirits are sold to the public, a duplicate license (for rooms such as a separate barroom in a hotel) or portable bar license (because bars are rolled into banquet rooms or to outside areas) will be required [*see Bus. & Prof Code §§ 24042, 24042.5*].

PRACTICE TIP:

The ABC web page [www.abc.ca.gov] provides information about permits issued to the license holder. If the buyer intends to continue the business as conducted by the seller, the buyer should apply to transfer the permits as part of the transfer of the retail on-sale license. *Commentary by Lynne Carmichael.*



16 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
B. Retail Licenses

8-18 California Legal Forms--Transaction Guide § 18.22

AUTHOR: Lynne Carmichael

§ 18.22 Retail Off-Sale Licenses

[1] In General

An off-sale license authorizes the sale of packaged alcoholic beverages of the type specified in the license for consumption off the premises where they are sold [*see Bus. & Prof. Code §§ 23393, 23394*]. Off-sale licenses are customarily held by liquor stores, wine shops, drug stores, and grocery stores.

The Act authorizes, and the ABC issues, two types of retail off-sale licenses:

- A retail package off-sale beer and wine license authorizes the sale of beer in containers and wine in packages, to consumers only and not for resale, for consumption off the premises where sold [*Bus. & Prof. Code § 23393*]. The wine sold under this type of license must be sold in quantities of 52 gallons or less per sale [*Bus. & Prof. Code § 23393*].

- An off-sale general license authorizes the sale of distilled spirits to consumers for consumption off the premises [*Bus. & Prof. Code § 23394*]. This type of license also authorizes the sale of distilled spirits for resale purposes to holders of daily on-sale general licenses [*Bus. & Prof. Code § 23394*; *see Bus. & Prof. Code § 24045.1*]. In addition, the holder of an off-sale general license may sell beer and wine for consumption off the premises in the same manner as the holder of a retail package off-sale beer and wine license [*Bus. & Prof. Code § 23394*].

[2] Issuance and Renewal of Off-Sale Licenses

The Act limits the number of off-sale general licenses that the ABC may issue [*see Bus. & Prof. Code § 23816*; *see also § 18.30*]. It also limits the number of off-sale beer and wine licenses that can be issued in certain parts of the state [*see Bus. & Prof. Code § 23817.5*].

All retail off-sale licenses are issued on an annual basis [*Bus. & Prof. Code § 24045(a)*]. However, a license transferred, for example, to a spouse, living trust, fiduciary, or partner, or to a corporation, limited partnership, or limited liability company with new owners [*see Bus. & Prof. Code §§ 24071*, *24071.1*, *24071.2*] will only be issued for the unexpired term remaining on the transferor's license [*Bus. & Prof. Code § 24045(b)*]. Further, the ABC may assign or reassign dates for the expiration of licenses, and may establish a registration year for any licenses consisting of any period from six months to 18 months, with prorated fees for licenses with a registration year of other than 12 months [*Bus. & Prof. Code § 24045(c)*].

Every retail off-sale license is renewable unless the license was revoked, provided that the renewal application is made and the applicable fee paid [*Bus. & Prof. Code § 24048*; *see Bus. & Prof. Code § 23320* (schedule of fees)]. The licensee must renew the license annually [*Bus. & Prof. Code § 24045(c)*; *see § 18.165*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
B. Retail Licenses

8-18 California Legal Forms--Transaction Guide §§ 18.23-18.29

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.23[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
C. Restrictions on License Transfer

8-18 California Legal Forms--Transaction Guide § 18.30

AUTHOR: Lynne Carmichael

§ 18.30 Restrictions Imposed on General Licenses

[1] Original Issuance

The legislature has declared that the public welfare and morals require a limitation on the number of premises licensed for the sale of distilled spirits [*see Bus. & Prof. Code § 23815*]. Thus, the Department of Alcoholic Beverage Control ("ABC") must issue on-sale and off-sale general licenses on the basis of each county's population [*see Bus. & Prof. Code §§ 23816, 23817*]. For purposes of these limitations, population is determined by the most recent United States decennial or special census or a subsequent census validated by the Population Research Unit of the California Department of Finance [*Bus. & Prof. Code § 23818*].

The number of premises for which the ABC may issue an on-sale general license (including a special (private club) on-sale general license [*Bus. & Prof. Code § 23816*; *see Bus. & Prof. Code § 23320.1*]) is limited to one for each 2,000, or fraction of 2,000, inhabitants of the county where the premises are situated [*Bus. & Prof. Code § 23816*; *see Bus. & Prof. Code § 23824* (exceptions for premises located on land owned by and leased from, or for premises owned by, state or governmental entities)]. No additional on-sale general license, other than a renewal or transfer due to an increase in population [*see Bus. & Prof. Code § 23821*], may be issued in any county where the number of premises for which on-sale general licenses are issued is more than one for each 2,000, or fraction of 2,000, inhabitants of the county. The ABC cannot issue an on-sale general license in lieu of, or upon the cancellation or surrender of, an on-sale beer and wine license [*Bus. & Prof. Code § 23816*]. These restrictions, however, do not prohibit the exchange of an on-sale general license for a special on-sale license, or the exchange of a special on-sale general license for an on-sale general license [*Bus. & Prof. Code § 23825*].

The number of premises for which the ABC may issue an off-sale general license is limited to one for each 2,500, or fraction of 2,500, inhabitants of the county where the premises are situated [*Bus. & Prof. Code § 23817*]. No additional off-sale general license, other than a renewal or transfer due to an increase in population [*see Bus. & Prof. Code § 23821*], will be issued in any county where the number of premises for which off-sale general licenses are issued is

more than one for each 2,500, or fraction of 2,500, inhabitants of the county [*Bus. & Prof. Code § 23817*].

[2] Inter-County Transfer

All on-sale and off-sale general licenses may be transferred from one county to another, subject to the following limitations [*see Bus. & Prof. Code § 24070(a)*]. The number of on-sale or off-sale general licenses in any county on June 1 of any year may not be increased during the following 12-month period by issuance of whichever is less: (1) more than 25 new original on-sale or off-sale general licenses, or (2) new original on-sale or off-sale general licenses that increase by more than 10 percent the number of those licenses in existence in the county at the beginning of the 12-month period [*Bus. & Prof. Code § 24070(a)(1), (b)(1)*].

After the ABC determines the number of new original on-sale and off-sale licenses that may be issued in any county during any 12-month period under these rules, it may permit transfer of on-sale or off-sale general licenses into the county if it has concluded that the foregoing rules permit additional general licenses in the county [*Bus. & Prof. Code § 24070(a)(2), (b)(2)*]. In no event, however, may the combined total number of new original on-sale or off-sale general licenses that may be issued in the county during any 12-month period, and the number of on-sale or off-sale general licenses that may be transferred into the county during that period, exceed one for each 2,000 (for on-sale licenses) or 2,500 (for off-sale licenses) inhabitants [*Bus. & Prof. Code § 24070(a)(3), (b)(3)*; *see Bus. & Prof. Code §§ 23816, 23817*].

[3] Prohibition on Transfer for Two Years After Issuance

As a result of the limitations on the number of on-sale general and off-sale general licenses, and the fact that the licenses are transferable from person to person, general licenses have become property of substantial value [*see Golden v. State (1955) 133 Cal. App. 2d 640, 643, 285 P.2d 49]* . In order to prohibit speculation in general licenses, the legislature has provided that no general license is transferable from the licensee to another person for a period of two years from the date of issuance, except (1) to a spouse, partner, or fiduciary [*see Bus. & Prof. Code § 24071*; *see also § 18.40[3]*], or (2) if the ABC determines that the transfer is necessary to prevent undue hardship [*Bus. & Prof. Code § 24070(c)*)]. If the licensee is a corporation, a controlling interest in the stock ownership of the licensee may not be directly or indirectly sold, transferred, or hypothecated unless the licensee is a corporation whose stock is listed on a California or New York stock exchange, or unless it is required by law to file periodic reports with the SEC [*Bus. & Prof. Code § 24070(c)*].

[4] Purchase Price on Transfer

The purchase price or consideration that may be paid by a transferee or received by a transferor of an on-sale general license or an off-sale general license is $6,000; however, after a period of five years from the date of the original issuance of the license, there are no restrictions as to the purchase price or consideration [*Bus. & Prof. Code § 24079(a)*]. A violation of this limitation on the purchase price is a crime [*People v. Anderson (1991) 1 Cal. App. 4th 1084, 1089-1090, 3 Cal. Rptr. 2d 247]* . Further, this purchase price limitation cannot be avoided by paying the statutory price to a corporate licensee and a finder's fee to an individual who is one of a few shareholders of the licensee corporation [*People v. Anderson (1991) 1 Cal. App. 4th 1084, 1091-1092, 3 Cal. Rptr. 2d 247]* . Notwithstanding this rule, however, any original on-sale or off-sale general license for which an original fee of $12,000 was paid may not be transferred for a purchase price in excess of $12,000 for two years following its initial issuance and is thereafter free from monetary limitations on the purchase price [*Bus. & Prof. Code § 24079(c)*]

Furthermore, during the five years after an inter-county transfer of an on-sale or off-sale general license, the purchase price or consideration that a buyer may pay or a seller may receive for the license must not exceed $6,000 [*Bus. & Prof. Code § 24070(d), (e)*; *see Bus. & Prof. Code § 24079*]. The ABC advises that if the proposed transfer falls within one of these categories, the parties should contact the local district office for detailed instructions [*see* Form ABC-521,

Issuance of Original and Intercounty Transfer of On-Sale General and Off-Sale General Licenses, pp. 4-5 (7/02)].

For a discussion of purchase price allocation for purposes of determining basis and gain or loss on the sale pursuant to federal tax law [*I.R.C. § 1060*; Temp. Treas. Reg. § 1.1060-1T], *see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.11[4]*.



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
C. Restrictions on License Transfer

8-18 California Legal Forms--Transaction Guide § 18.31

AUTHOR: Lynne Carmichael

§ 18.31 Restrictions Imposed on Off-Sale Beer and Wine Licenses

The number of premises for which an off-sale beer and wine license is issued is limited to one for each 2,500 inhabitants (or fraction of that number) of the city or county in which the premises is situated. No additional off-sale beer and wine license, other than a renewal or transfer, may be issued in any city or county in which the number of premises for which all off-sale beer and wine licenses are issued is more than one for each 2,500 inhabitants of the city or county. No additional off-sale beer and wine license, other than a renewal or transfer, may be issued in a city and county, if the number of off-sale beer and wine licenses, in combination with the number of off-sale general licenses issued in the city and county, exceeds 1 per 1,250 inhabitants. [*Bus. & Prof Code § 23817.5*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
C. Restrictions on License Transfer

8-18 California Legal Forms--Transaction Guide § 18.32

AUTHOR: Lynne Carmichael

§ 18.32 Conditional Licenses

[1] Existing Conditions

The ABC may impose operating conditions on a retail license in any of the following situations:

- If grounds exist to deny an application for a license or if a protest against issuance of a license is filed, and the ABC finds that the grounds for the denial or the basis for the protest may be removed by imposing conditions [*Bus. & Prof. Code § 23800(a)*].

- If the ABC makes findings that would justify license suspension or revocation, and the imposition of a condition is reasonably related to those findings [*Bus. & Prof. Code § 23800(b)*].

- If the ABC issues an order suspending or revoking only some of the license privileges [*Bus. & Prof. Code § 23800(c)*].

- If the ABC makes findings that the licensee has failed to correct objectionable conditions within a reasonable time after receipt of a written notice to correct conditions under *Bus. & Prof. Code § 24200(e)* (conditions constituting a nuisance on the licensed premises) or § 24200.1(a) and (b) (conditions constituting a nuisance on the licensed premises or an adjacent area, or a public sidewalk abutting the licensed premises) [*Bus. & Prof. Code § 23800(d)*].

Operating conditions may restrict or deny any privileges of the license, such as hours of sales, exercise of off-sale privileges at an on-sale premises, size and placement of signs, types and strengths of alcoholic beverages, container sizes, single-container sales, and other restrictions to "protect the public welfare and morals" [*Bus. & Prof. Code § 23801*]. In the case of a transfer [*see Bus. & Prof. Code § 23800(f)*], the ABC may impose restrictions on the presence of the license transferor on the premises [*Bus. & Prof. Code § 23801(g)*; *see* [2], *below*].

The fact that conditions have been imposed on a license is noted on the front of the license, and a copy of the conditions must be kept with the license in the licensed premises, available for examination by any peace officer. Conditions are binding on any person to whom the license is transferred [*Bus. & Prof. Code § 23802*]. Failure to comply with the conditions is grounds for suspension or revocation of the license [*Bus. & Prof. Code § 23804*]. When conditions are imposed, the ABC recites the grounds for imposition in the document imposing the conditions.

A licensee or an applicant for transfer may petition to have conditions removed or modified, arguing that the grounds for the imposition of the conditions no longer exist. The cost is $100. If the ABC believes the grounds that caused the imposition no longer exist, it must order removal or modification. First, however, the ABC must notify the "local governing body," (the city council, board of supervisors or an agency or department designated by the governing body). If the local governing body objects, the ABC cannot modify or remove the conditions without a hearing [*Bus. & Prof. Code § 23803*].

[2] Conditions Imposed at Time of Transfer

When the ABC receives an application to transfer a retail license, it mails a copy of the application to the sheriff, chief of police, and district attorney of the locality in which the premises are situated, to the city or county planning director with jurisdiction over the premises, and to the board of supervisors if the premises are in an unincorporated area or the city council or other governing body if the premises are in an incorporated area. The license cannot transfer for at least 30 days after the mailing, and the period can be extended for an additional 20 days if the ABC receives written notice from the police or sheriff representative that he or she is preparing a protest to the transfer of the license or proposed conditions to be imposed [*Bus. & Prof. Code § 23987*]. In certain areas where there is an "undue concentration" of retail licenses [*Bus. & Prof. Code § 23958.4*], the local governing body or its designee has 40 days to respond, which can be extended by an additional 20 days upon written request [*Bus. & Prof. Code § 23800(e)(2)*].

The ABC and the local governing body can use the occasion of the transfer to impose new conditions on the transferred license [*Bus. & Prof. Code §§ 23987, 23800(e)*, (f)]. The ABC may prescribe conditions that it determines are reasonable pursuant to its investigation or that are requested by the local governing body (or its designated subordinate officer or agency) in whose jurisdiction the license is located, if the request is supported by substantial evidence that specified problems on the premises or in the immediate vicinity of the premises will be mitigated by the conditions [*Bus. & Prof. Code § 23800(e)(1)*].

Upon receipt of the request, as long as it is received within the time authorized in the statutes, the ABC may either adopt the conditions requested or notify the local governing body, in writing, that it has determined that there is no substantial evidence that the problems exist or that the conditions would not mitigate the problems identified [*Bus. & Prof. Code § 23800(e)(1)*]. If the ABC denies a licensee's or applicant's petition for removal of conditions or adopts conditions requested by the local governing body, it must give written notice of its decision to the licensee or applicant [*Bus. & Prof. Code § 23800(e)(1)*]. The licensee or applicant, within 10 days after the mailing of the denial, may submit a written request for a hearing, conducted and appealable as provided in *Bus. & Prof. Code § 24300* [*Bus. & Prof. Code § 23805*].

In the case of a transfer [*see Bus. & Prof. Code § 23800(f)*], if the license transferor has violated the Alcoholic Beverage Control Act multiple times while in possession of the license, the ABC may impose restrictions on the presence of the transferor on the licensed premises without lawful business. For these purposes, "lawful business" specifically excludes (without limitation) working or volunteering at the premises, consulting with the licensee regarding the operation of the premises, and loitering [*Bus. & Prof. Code § 23801(g)*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
C. Restrictions on License Transfer

8-18 California Legal Forms--Transaction Guide § 18.33

AUTHOR: Lynne Carmichael

§ 18.33 Tied-House Restrictions

The Alcoholic Beverage Control Act contains a series of "tied-house" provisions that restrict the relationships between alcoholic beverage manufacturers, wholesalers, and retail licensees [*see Bus. & Prof. Code §§ 25500-25512*]. For example, no manufacturer, winegrower, rectifier, distiller, bottler, importer, or wholesaler may directly or indirectly own any interest in an on-sale or off-sale license [*Bus. & Prof. Code §§ 25500(a)(1), 25502(a)(1)*], make loans or other payments to a retail licensee [*Bus. & Prof. Code §§ 25500(a)(2), 25502(a)(2)*; *see, e.g., Dep't of Alcoholic Beverage Control v. Alcoholic Beverage Control Appeals Bd. (2002) 100 Cal. App. 4th 1066, 1074-1080, 123 Cal. Rptr. 2d 278* (suspension of wine grower/supplier's license because payment for advertising in exclusive sales catalog of individual retail licensee violated *Bus. & Prof. Code § 25502(a)(2)*)], or own any interest in the business, furniture, or fixtures of a business operated under a retail license [*Bus. & Prof. Code §§ 25500(a)(3), 25502(a)(3)*]. However, under specified conditions, these restrictions do not prohibit the transfer of a retail on-sale or off-sale license to any person (including a manufacturer or wholesaler) with respect to premises that are an integral part of the operations of a hotel, motel, or marine park [*see Bus. & Prof. Code § 25503.16*], chef's school [*see Bus. & Prof. Code §§ 25503.17, 25503.18*], passenger cruise ship [*see Bus. & Prof. Code § 25503.19*], or restaurant [*see Bus. & Prof. Code §§ 25503.15, 25503.30*], notwithstanding the fact that the transfer would otherwise violate the tied-house restrictions [*see Bus. & Prof. Code §§ 25503.11-25503.22*. 25503.28-25503.30, 25503.37].



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
C. Restrictions on License Transfer

8-18 California Legal Forms--Transaction Guide §§ 18.34-18.39

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.34[Reserved]



23 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
D. Filing the Application To Transfer

8-18 California Legal Forms--Transaction Guide § 18.40

AUTHOR: Lynne Carmichael

§ 18.40 Authorized Transfers of Retail Licenses

[1] In General

The Act expressly states that each alcoholic beverage license issued under the Act is separate, distinct, and transferable upon approval by the ABC (1) from the licensee to another person, and (2) from one premises to another premises [*Bus. & Prof. Code § 24070*]. Generally premises-to-premises transfers must be within a county. However, in August of each year, based on population growth, the ABC allows the issuance of new licenses and the transfer of licenses county-to-county. The number of licenses available for transfer into a county is limited to one for every additional 2,500 persons in the county, up to a maximum of 25 in any one year. However, notwithstanding any other provision of law, no license may be transferred into any county having a population of 35,000 or less [*Bus. & Prof. Code § 24077*].

[2] Exchanges of On-Sale Licenses

The typical transfer of on-sale licenses does not involve any change in privileges. However, the holder of an on-sale license or the proposed transferee of the license may exchange a public premises license for a bona fide public eating place or a bona fide public eating place license for a public premises license [*Bus. & Prof. Code § 24070.1*]. In any exchange, the licensee must comply with the requirements for public premises operations or bona fide public eating place operations [*see Bus. & Prof. Code §§ 23038, 23039*].

[3] Between Particular Persons

Licenses may be transferred person-to-person upon payment of transfer and annual fees appropriate to the type of license transferred [*see Bus. & Prof. §§ 23320, 24072*]. The Act also allows for reduced-fee transfers for the following types of transfers [*Bus. & Prof. Code § 24071*]:

- From one spouse to the other prior to entry of a final decree of divorce (dissolution).

- By or to the surviving partners of a deceased licensee.

- By or to the executor, administrator, conservator, or guardian of a minor ward, incompetent person, conservatee, debtor in a bankruptcy case, person for whose estate a receiver is appointed, or assignor for the benefit of creditors.

- By or to the surviving spouse of a deceased licensee if the licensee leaves no estate for administration.

- By or to the trustee of a licensee's bankrupt estate, a receiver of a licensee's estate, or an assignee for the benefit of creditors of a licensee with the consent of the assignor.

- By or to a receiver appointed for a judgment debtor [*see Code Civ. Proc. § 708.630*].

- By a licensee to a revocable living trust when the licensee is also the trustee.

- Between partners where no new partner is being licensed.

- Between corporations whose outstanding shares of stock are owned by the same natural persons.

- From a licensee to a corporation or limited liability company whose entire ownership interests are held by the licensee or his or her spouse.

- From a corporation to a person who owns or whose spouse owns the entire stock of the corporation.

The Act also requires license transfers when the general partner of a limited partnership changes and when 50 percent or more of the ownership interests of a corporation, limited partnership or limited liability company is acquired by a person or persons who did not hold 50 percent when the license was issued to the entity [*Bus. & Prof. Code §§ 24071.1, 24071.2*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
D. Filing the Application To Transfer

8-18 California Legal Forms--Transaction Guide § 18.41

AUTHOR: Lynne Carmichael

§ 18.41 Requirements for Transfer of Retail License

[1] In General

When a licensee (the "seller") proposes to transfer a retail alcoholic beverage license to another person (the "buyer"), the buyer must apply to the ABC for a license of the type to be transferred [*4 Cal. Code Reg. § 60(b)*; *Bus. & Prof. Code §§ 24073*, *24074*]. Before filing the transfer application, the buyer and seller of most retail licenses will be required to record a notice of the intended transfer [*Bus. & Prof. Code § 24073*; *see § 18.41[2]*] and open an escrow for payment of timely creditor claims [*Bus. & Prof. Code § 24074*; *§ 18.41[4]*]. These notice and escrow requirements, however, do not apply to the following types of transfers [*Bus. & Prof. Code § 24075*]:

- The transfer of a license made by an executor, administrator, guardian, conservator, trustee, receiver (other than a receiver appointed for a judgment debtor [*see Code Civ. Proc. § 708.630*]), or other person acting in the legal or proper discharge of official duty or in the discharge of any trust imposed by law.

- Any transfer or assignment made for the benefit of creditors.

- A transfer to a surviving spouse or fiduciary or other person within the meaning of *Bus. & Prof. Code § 24071* [*see § 18.40[3], above*].

[2] Notice of Intended Transfer

Before filing a transfer application with the ABC, the buyer and seller must record a notice of intended transfer in the county recorder's office for the county where the licensed premises are located, if the license is (1) an off-sale or on-sale general license restricted in number [*see Bus. & Prof Code §§ 23816*, *23817*]; (2) an off-sale or on-sale beer and wine license; (3) an on-sale beer license; or (4) an on-sale general license for seasonal business [*Bus. & Prof. Code § 24073*; *see Bus. & Prof. Code § 24075* (exceptions to requirement); *see also § 18.41[1]*]. The buyer and seller must file a copy of that notice, certified by the county recorder, with the transfer application [*Bus. & Prof. Code § 24073*; *see § 18.123*].

The notice of intended transfer must state all of the following [*Bus. & Prof. Code § 24073*; *see § 18.210* (Form ABC-227)]:

- The name and address of the seller.
- The name and address of the buyer.
- The kind of license intended to be transferred.
- The address of the premises to which the license is issued.
- An agreement between the buyer and seller that the consideration for the transfer of the business and license will be paid only after the ABC has approved the transfer.
- The place where the purchase price or consideration for the business and license will be paid; the amount of the purchase price or consideration; and a description of the entire consideration, including a designation of cash, checks, promissory notes, and tangible and intangible property, and the amount of each. If no present consideration is involved in the transfer of the license, the notice should state that no consideration is involved.
- The name and address of the escrow holder (also known as the "escrow agent") [*see Bus. & Prof. Code § 24074*] or corporate guarantor [*see Bus. & Prof. Code § 24074.4*; ABC-227 INSTR *Instructions and General Information,* p1-2; § 18.41[4]], as appropriate.

[3] Bulk Sale Notice

The notice required by the Act as a prerequisite to the transfer of an alcoholic beverage license differs in several material ways from the notice required by the Bulk Sales Division of the Commercial Code (the "Bulk Sales Division," Division 6) [*see Com. Code §§ 6101-6111*; *see also Bus. & Prof. Code § 24073*; *Com. Code § 6105*; *§ 18.211* (notice of bulk sales)]. For example, the notice required by the Act must state the amount of the purchase price and a description of the instruments constituting the purchase price [*see Bus. & Prof. Code § 24073(f)*; *see also § 18.210*]. The Bulk Sales Division does not impose that requirement. The notice required by the Bulk Sales Division requires a list of all other business names and addresses used by the seller within the preceding three years [*see Com. Code § 6105(a)(2)*], but the Act does not impose that requirement. The notice required by the Act must be recorded, but need not be published [*Bus. & Prof. Code § 24073*]. A notice of intended bulk sale, in contrast, must be both recorded and published [*Com. Code § 6105(b)*].

Bus. & Prof. Code § 24073 is not intended to relieve a seller from compliance with the Bulk Sales Division requirements, when applicable. Therefore, if the seller of a retail alcoholic beverage license will also sell the going business for which the license is issued to the buyer, it appears that two notices must be given. Before an application for transfer of the alcoholic beverage license can be filed with the ABC, the buyer or seller must record the notice required by the Act (discussed *above*) [*Bus. & Prof. Code § 24073*]. To avoid liability to creditors of the seller [*see Com. Code § 6107*], the buyer must record and publish the notice required by the Bulk Sales Division [*Com. Code §§ 6103(c)(15), 6105*]. The ABC does not provide guidance regarding any combination of these two notices, stating only that recording an ABC-227 Notice of Intended Transfer "does not eliminate the need to comply with Division 6 of the Commercial Code, which relates to the business, stock in trade, fixtures, etc. of a merchant. ABC does not give advice on what will meet the Commercial Code requirements" [*see* Form ABC-227 INSTR, *Instructions and General Information,* p. 1 (9/99)]. Some commercial escrow companies have attempted to combine the two required notices into one instrument [*see, e.g., § 18.212*]. However, the resulting form will be lengthy and therefore expensive to publish, as newspapers

charge by the column inch for publishing the notice. It may be better practice to record two separate notices [*see §§ 18.210, 18.211*], and then to publish only the notice required by the Bulk Sales Division [*see Com. Code § 6105*].

[4] Establishing an Escrow

If the intended transfer of the alcoholic beverage license and business involves a purchase price or consideration, the buyer and seller generally must also establish an escrow before filing a transfer application with the ABC [*Bus. & Prof. Code § 24074*; *see Bus. & Prof. Code § 24075* (exceptions to requirement); § 18.41[1]]. Because an essential element of an escrow is the deposit of money or other consideration with the escrow holder, there is no requirement that an escrow be established when no consideration is involved in the transaction. Furthermore, no escrow is required if, for a transfer of an off-sale beer and wine license only, (1) a corporation with a net worth on a consolidated basis of at least $5,000,000 according to its most recent audited financial statement files a guaranty of full payment of all creditor claims, and (2) the guaranty is acceptable to the creditors [*Bus. & Prof. Code § 24074.4*; *see § 18.125*].

The escrow holder must be some person, corporation, or association not a party to the transfer [*Bus. & Prof. Code § 24074*], and must meet the requirements of Chapter 1 of the Escrow Law [*Bus. & Prof. Code § 24074.1*; *see Fin. Code §§ 17000-17010* (applicability of escrow law to particular persons)]. However, because the attorney handling the sale may act as escrow holder, it should be noted that a California-licensed attorney who has a bona fide client relationship with a principal in a real estate or personal property transaction and who is not actively engaged the business of an escrow agent is exempt from the requirements of the Escrow Law [*Fin. Code § 17006(a)(2)*].

The buyer must deposit the full amount of the purchase price or consideration with the escrow holder before filing a transfer application [*Bus. & Prof. Code § 24074*]. In practice, because an application to transfer is often filed before the parties' official transaction closing, the buyer may actually deposit the consideration into the escrow after the application is filed [*see Bus. & Prof. Code § 24074.3(a)* (requiring buyer to provide a statement that the consideration has been deposited within 30 days after the filing)]. The purchase price or consideration need not be entirely in the form of cash, draft, or check, but may consist in whole or in part of promissory notes. Liability on those notes, however, should be conditioned on approval of the transfer by the ABC. The amount deposited may be either (1) the total consideration for the property, business, and the liquor business, (2) the separate reasonable consideration for the licensed business and license, or (3) the consideration for the license only when it is the only asset being transferred [*see* Form ABC-227 INSTR, *Instructions and General Information*, p. 1 (9/99)]. The buyer and seller must also deposit an agreement regarding distribution of that consideration with the escrow holder [*Bus. & Prof. Code § 24074*; *see* 18.41[5]].

[5] Parties'Agreement Regarding Distribution of Consideration

The buyer and seller must enter into an agreement setting forth various specific directions regarding distribution of the consideration held in escrow, and deposit that agreement with the escrow holder. First, the agreement must direct the escrow holder to notify any claimant who has filed a claim against the seller with the escrow holder, if the seller disputes his or her claim [*see § 18.131* for coverage of claims process]; to retain the amount or pro rata amount of the disputed claim for 25 days; and to pay the amount or pro rata amount to the seller if not attached during that period [*Bus. & Prof. Code § 24074*]. Second, it must direct the escrow holder, after the tax prerequisites for transfer [*see Bus. & Prof. Code § 24049*; *see also § 18.51[1]*] have been satisfied, to pay out of the purchase price or consideration (whether it takes the form of cash, checks, promissory notes, or tangible or intangible property) the claims of bona fide creditors of the seller who file their claims with the escrow holder before the ABC notifies the escrow holder of its approval of the license transfer [*Bus. & Prof. Code § 24074*]. Third, it must direct the escrow holder to distribute the purchase price or consideration in the statutory order if it is not sufficient to pay all timely claims in full [*Bus. & Prof. Code § 24074*; *see § 18.51[2]*]. Finally, it must direct the escrow holder to make the distribution within a reasonable time after the completion of the transfer of the license [*Bus. & Prof. Code § 24074*].

[6] Filing Application

When a licensee proposes to transfer a retail alcoholic beverage license to another person, the buyer must apply to the ABC for a license of the type to be transferred, and must meet all of the qualifications required of an original applicant for that type of license [*4 Cal. Code Reg. § 60(b)*; *see Bus. & Prof. Code §§ 23958, 24073, 24074*]. The seller must join in the application [*4 Cal. Code Reg. § 60(b)*; *see § 18.220*]. While the ABC prefers that the application be made in person, so that any corrections in the required information can be made at the time of application, Form ABC-211-SIG "*Application Signature Sheet (Sign On)"* (9/01) is designed to be used as the signature page for buyers' applications not signed in the ABC office [*see § 18.222*]. Furthermore, Form ABC-211-A "*License Transfer Request ("Sign Off")* (9/01) can also be completed by seller without appearing in the ABC office [*see § 18.220*]. Signatures on both these forms must be notarized if they are not signed in the ABC office. Most frequently, the seller signs the forms in advance, and the buyer or the buyer's representative then personally comes in to the ABC and files the application in person. The ABC occasionally will accept applications by mail when personal appearance is impractical, but will return the paperwork by mail if any corrections are necessary, thereby delaying processing of the application.

PRACTICE TIP:

In many district offices of the ABC, the wait for an appointment to file an application to transfer can be several weeks, if not months. As soon as a transfer of an alcoholic beverage license appears likely, or even possible, the buyer or buyer's representative should call the appropriate ABC district office to make an appointment to file. It can always be canceled if the transaction does not proceed. *Commentary by Lynne Carmichael.*

[7] Required Documents

The application for transfer must include the following documents:

- A license transfer request (Form ABC-211-A) [*see § 18.220*] signed by seller and indicating seller's intention to transfer.

- Evidence of ownership or tenancy of the premises, such as deed or lease (not necessarily required at time of application, but will be required prior to approval of transfer application).

- Any franchise agreement, if applicable (not necessarily required at time of application, but will be required prior to approval of transfer application).

- A certified copy of the notice of intended transfer [*see Bus. & Prof. Code § 24073*; *see also* [2], *above*].

- An application questionnaire (Form ABC-217) [*see § 18.221*] signed by the buyer, giving financial and investment information about the transaction, including information about the total consideration to be paid, and the consideration to be paid for each asset [*Bus. & Prof. Code § 24080*]. For a discussion of limitations on these amounts, see *§ 18.30[4]*.

- An application signature sheet (Form ABC-211 SIG) [*see § 18.222*] if the buyer's representative(s) will not file the application in person.

- A complete detailed diagram of the proposed premises where the buyer will exercise the license privileges [*see 4 Cal. Code Reg. § 64.2*].

- Fiduciaries' proof of status (that is, death certificate or letters testamentary).

- Court order authorizing transfer if the seller has filed for protection under bankruptcy laws.
- Organizational documents of parties that are business entities [*see §§ 18.226-18.228*].

[8] Transfer Fees

The buyer must pay a transfer fee when filing the application [*Bus. & Prof. Code § 24072*; *4 Cal. Code Reg. § 60(c)*; *see § 18.221*].

[9] Investigation Period

Immediately after the buyer has filed the application for transfer and accompanying documents, and paid the applicable transfer fee, the ABC must send a copy of the application (1) to the sheriff, chief of police, and district attorney of the locality in which the premises are located; and (2) to the board of supervisors of the county if the premises are in unincorporated territory, or to the city council or other governing body of the city if the premises are within an incorporated area [*Bus. & Prof. Code § 23987*]. The ABC cannot transfer the license for at least 30 days after mailing those notices [*Bus. & Prof. Code § 23987*], and generally requires an even longer period, for purposes of investigation [*Bus. & Prof. Code §§ 23987*].

Upon receipt of the application, the ABC assigns an investigator (1) to determine whether the applicant and premises qualify for a license, and whether the parties have complied with all provisions of the Act, and (2) to investigate all matters connected with the license that may affect the public welfare and morals [*Bus. & Prof. Code § 23958*]. The average waiting period for a license is 55-65 days [*see* Instructions and General Information to Form ABC-211-A, reproduced in § 18.220]. For this reason, applicants should be cautious with respect to extensive financial commitments, plans for a grand opening, and so on, during this period. Missing or incomplete documents can also cause delays. The investigator ultimately prepares a report recommending approval or denial of the license, which the ABC reviews at various levels.

[10] Required Notices

After filing a transfer application with the ABC, the buyer must give various notices regarding the application. First, the buyer must post a notice of intention to engage in the sale of alcoholic beverages in a conspicuous place at the entrance to the licensed premises for at least 30 consecutive days [*Bus. & Prof. Code § 23985*]. Because the ABC will not issue a license for the premises unless this requirement is satisfied, the buyer must notify the ABC of the date the notice is first posted by filing an affidavit of posting [*Bus. & Prof. Code § 23985*; *4 Cal. Code Reg. § 109*]. A similar requirement applies when the buyer has filed an application for premises that are to be constructed, or are in the process of construction [*Bus. & Prof. Code § 23985*; *see Bus. & Prof. Code § 24044*]. For further discussion, see *§ 18.241*.

In addition, if the license to be transferred is an on-sale license [*see § 18.21*], the buyer must publish a notice of the application in a newspaper of general circulation (other than a legal or professional trade publication) that is published in the city where the licensed premises are located, or in the nearest such newspaper of general circulation if the licensed premises are not within a city [*Bus. & Prof. Code § 23986(a)*; *see § 18.240* (Form ABC-207-D)]. The notice must be published once in the newspaper within 10 days after filing the transfer application [*see Bus. & Prof. Code § 23986(a)*; *see also Gov. Code § 6061*]. The buyer must file an affidavit of publication with the ABC before the license will be issued [*Bus. & Prof. Code § 23986(a)*]. An ABC employee will prepare the affidavit of publication if the buyer comes to the district office with proof that the notice has been published as required [*see § 18.240*].

Furthermore, if the premises are located in a census tract that has an undue concentration of licenses as defined by ABC rules or regulations [*see 4 Cal. Code Reg. § 61.3*], the buyer of an on-sale or off-sale license must publish a notice of the

application once a week for three successive weeks in a newspaper of general circulation (other than a legal or professional trade publication) that is published in the city where the licensed premises are located, or in the nearest such newspaper of general circulation if the licensed premises are not within a city [*Bus. & Prof. Code § 23986(b)*; *see Gov. Code § 6063*]. He or she must then file an affidavit of publication with the ABC before the license will be issued [*Bus. & Prof. Code § 23986(b)*].

If the parties have applied for transfer of a retail license that requires a recorded notice of intended transfer [*see Bus. & Prof. Code § 24073*; § 18.210 (ABC-227)], and if there is consideration for the transfer requiring an escrow, within 30 days after filing the application the buyer must also file a statement under penalty of perjury that the purchase price set forth in the escrow agreement [*see Bus. & Prof. Code § 24074*] has been deposited with the escrow holder [*Bus. & Prof. Code § 24074.3(a)*; *see § 18.242* (ABC-226)]. Although the ABC may extend the 30-day period for good cause, it will not transfer the license until it has received the statement [*Bus. & Prof. Code § 24074.3(a)*]

Finally, if the premises are not currently licensed, or are licensed under a different type of license than the one sought by the application, the buyer must mail notification of the application to every resident of real property within a 500-foot radius of the premises for which the license is to be issued, and submit proof of compliance to the ABC prior to license approval [*Bus. & Prof. Code § 23985.5(a)*]. The buyer must also notify owners of real property within a 500-foot radius if the local jurisdiction where the license is to be issued provides a list of the names and addresses of the owners to the buyer free of charge [*Bus. & Prof. Code § 23985.5(a), (b)*].

PRACTICE TIP:

If the buyer intends to remodel the premises prior to opening the business under the transferred license, and if that remodel involves moving the entrance or enlarging the premises, the ABC may require the buyer to mail a notice to residents within 500 feet, even though the license type is not changing. Moving or changing the entrance may require a premises-to-premises transfer, which expands the allowable grounds for protests of the license transfer. *Commentary by Lynne Carmichael.*



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
D. Filing the Application To Transfer

8-18 California Legal Forms--Transaction Guide §§ 18.42-18.49

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.42[Reserved]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
E. Post-Application Considerations

8-18 California Legal Forms--Transaction Guide § 18.50

AUTHOR: Lynne Carmichael

§ 18.50 Temporary Permit--Issuance

[1] Issuance

When a seller is transferring a retail alcoholic beverage license with the licensed business, the ABC has the discretion to issue the buyer a "temporary permit" to operate the business on the same premises during the application process. A temporary permit is a conditional permit, authorizing the holder to sell any alcoholic beverages that would be permitted to be sold under the privileges of the license for which the transfer application has been filed [*Bus. & Prof. Code § 24045.5*].

The ABC will issue a temporary permit only when all of the following conditions exist [*Bus. & Prof. Code § 24045.5*]:

- The buyer has filed an application with the ABC for transfer of the license at the premises to himself or herself.
- The buyer has submitted an application for a temporary permit, together with the temporary permit fee.
- The seller has surrendered the license for the premises, in accordance with ABC rules [*see 4 Cal. Code Reg. § 65*; § 18.220].
- The premises have been operated under a license within 30 days of the date the buyer filed the application for a temporary permit.

When issued, a temporary permit is valid for a period not to exceed four calendar months. The ABC has the discretion to extend the permit for an additional four calendar month period upon payment of an additional fee and compliance with all of the preceding conditions [*Bus. & Prof. Code § 24045.5*]. However, the ABC may summarily cancel or

suspend a temporary permit at any time if it determines that good cause for the cancellation or suspension exists [*Bus. & Prof. Code § 24045.5*].

If the ABC refuses to issue or extend a temporary permit, the buyer will not be entitled to petition for the permit [*see Bus. & Prof. Code § 24011*], or to receive a hearing [*Bus. & Prof. Code § 24045.5*; *see Bus. & Prof. Code § 24012*].

[2] Operation of Business Under Permit

During operation of the business under a temporary permit, the buyer must pay for all alcoholic beverage purchases in currency or by business check at or before the time of their delivery [*Bus. & Prof. Code § 24045.5*]. This requirement, however, does not apply to a buyer who is operating under a retail license held in exactly the same ownership, in addition to the temporary permit, and who is not delinquent in payment for any alcoholic beverages as to any retail license under which he or she is operating [*Bus. & Prof. Code § 24045.5*; *see Bus. & Prof. Code § 25509*]. Before the ABC will approve the transfer of the license for which the buyer has applied, the buyer must file a statement under penalty of perjury that all current obligations incurred under the temporary permit have been discharged, and that all outstanding checks issued by him or her in payment for alcoholic beverages will be honored on presentation [*Bus. & Prof. Code § 24045.5*; § 18.223].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
E. Post-Application Considerations

8-18 California Legal Forms--Transaction Guide § 18.51

AUTHOR: Lynne Carmichael

§ 18.51 Escrow Requirements

[1] Payment of Tax Holds

The ABC may refuse to transfer any license when the seller is delinquent in the payment of any taxes due under any of the following laws ("tax holds"), if the tax liability arises partially or completely from the exercise of the privileges of the alcoholic beverage license [*Bus. & Prof. Code § 24049*; *4 Cal. Code Reg. § 68.2*]:

- The Alcoholic Beverage Tax Law [*Rev. & Tax. Code §§ 32001-32557* (excise tax imposed on manufacture or importation of alcohol)].
- The Sales and Use Tax Law [*Rev. & Tax. Code § 6001 et seq.*].
- The Personal Income Tax Law [*Rev. & Tax. Code § 17001 et seq.*].
- The Bank and Corporation Tax Law [*Rev. & Tax. Code § 23001 et seq.*].
- *Rev. & Tax. Code §§ 134, 405(a)*, regarding county tax on unsecured property.

Similarly, the ABC may refuse to transfer a license if the seller is delinquent in the payment of any amount due under the Unemployment Insurance Code when the liability arises from the conduct of a business licensed by the ABC [*Bus. & Prof. Code § 24049*; *4 Cal. Code Reg. § 68.2*].

The release of tax holds is a condition precedent to the transfer of an alcoholic beverage license [*see Golden v. State (1955) 133 Cal. App. 2d 640, 646, 285 P.2d 49* ; *United States v. California (9th Cir. [Cal.] 1960) 281 F.2d 726, 727-728*]. Accordingly, the Act requires the parties to instruct the escrow holder to pay creditor claims out of the purchase price deposited in escrow only after the tax holds have been released [*Bus. & Prof. Code § 24074*; *see*

discussion under § 18.51[1]].

In practice, the agencies administering the tax laws give notice to the ABC of any tax delinquencies for ABC licensees. Upon receipt of a delinquency notice, the ABC attaches the notice to the licensee's file and notes the tax hold in the ABC database. If the licensee files an application to transfer the license to another person, the ABC returns a duplicate of the application to the taxing agency [*4 Cal. Code Reg. § 68.2(1)*]. The taxing agency must demand the delinquent amount from the licensee within 30 days after receiving notice of the application to transfer the license, and must give notice of the demand to the escrow holder and buyer. If the agency fails to make a demand within this time, the ABC may proceed to transfer the license [*4 Cal. Code Reg. § 68.2(2)*]. The ABC sends a notice [Form ABC-202-A] to the escrow holder when there is nothing preventing approval of a license transfer except delinquent taxes. After the escrow holder has paid the tax delinquency from the escrow funds, the taxing agency must send notice of the tax delinquency release in duplicate to the escrow holder, who then sends the original copy to the ABC [*see 4 Cal. Code Reg. § 68.2(3)*]. Upon receipt of the release, the ABC will approve transfer of the license and notify the escrow holder [Form ABC-226, Part III] of its approval. At that point, the escrow holder must distribute the sale proceeds deposited in escrow [*see* discussion in [2], *below*].

PRACTICE TIP:

If the funds in the escrow are insufficient to pay the tax holds in full, the taxing agency or agencies will negotiate with the seller and among themselves to determine how the funds from the escrow will be applied to their claims. In some instances, even though all the consideration in the escrow is applied to the tax holds, and the tax holds are released so that the license can be transferred, the seller's obligations to the taxing agency or agencies may not be fully satisfied. *Commentary by Lynne Carmichael.*

[2] Distribution of Consideration

After the escrow holder has paid the tax obligations set forth in *Bus. & Prof. Code § 24049* ("tax holds") [*see* [1], *above*] and the tax holds are released, the escrow holder must distribute any remaining consideration held in escrow to creditors who filed their claims with the escrow holder before he or she received notice of the ABC's approval of the transfer [*Bus. & Prof. Code § 24074*]. If the purchase price or consideration is not sufficient to pay the claims in full, the escrow holder must distribute the consideration in the following order, as instructed by the parties and required by the statute [*Bus. & Prof. Code § 24074*]:

- First, to the United States for claims based on income or withholding taxes, then for other tax claims not specified in *Bus. & Prof. Code § 24049*.

- Second, to the payment of claims for wages and other compensation earned by employees of the seller prior to the sale, transfer, or opening of escrow.

- Third, to the payment of claims of secured creditors, to the extent of the proceeds that arise from the sale of the security.

- Fourth, to the payment of claims on mechanics' liens.

- Fifth, to the payment of escrow fees and claims for brokerage and attorneys' fees.

- Sixth, to the payment of claims for goods sold and delivered to the seller for resale at the licensed premises; to the payment of claims for services rendered, performed, or supplied in connection with the operation of the licensed business; and to the payment of the claims of a landlord to the extent of proceeds on past due rent.

- Seventh, to the payment of other claims that have been reduced to court-ordered judgments, including claims for court-ordered support of a minor child.

- Eighth, to the payment of all other claims. If sufficient assets are not available for payment of each claim in full, payment must be made pro rata.

This distribution scheme is a mandatory and exclusive system of priorities that cannot be defeated by the levy of a writ of attachment on the escrow account by one creditor [*Grover Escrow Corp. v. Gole (1969) 71 Cal. 2d 61, 65-66, 77 Cal. Rptr. 21, 453 P.2d 461]* . However, unlike the requirements of *Bus. & Prof. Code § 24049*, its provisions are not conditions precedent to the transfer of the alcoholic beverage license, but merely a designated method of distributing the sale proceeds [*see Golden v. State of California (1955) 133 Cal. App. 2d 640, 646, 285 P.2d 49]* .

If, at the time a creditor files a lien against the seller, the escrow holder has already paid the *Bus. & Prof. Code § 24049* taxes, there may be no property of the seller to which the lien can attach. If the seller does not exercise the right to dispute any timely creditor's claim [*Bus. & Prof. Code § 24074*], and the assets are insufficient to pay all claims in full, the seller loses all power to establish a claim to any portion of the proceeds. The matter of distribution then becomes one wholly between the creditors and the escrow holder. Therefore, a United States tax lien that was established after the payment of *Bus. & Prof. Code § 24049* taxes, but when the proceeds still remained in escrow, could not attach to those proceeds because the seller had no property rights in them [*Business Title Corp. v. United States (1978) 21 Cal. 3d 710, 721-722, 147 Cal. Rptr. 622, 581 P.2d 627]* .



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART II. LEGAL BACKGROUND
E. Post-Application Considerations

8-18 California Legal Forms--Transaction Guide § 18.52

AUTHOR: Lynne Carmichael

§ 18.52 Impediments to Transfer

[1] Denial of Application

The ABC may deny an application for transfer of a license if [*Bus. & Prof. Code § 23958*]:

- Either the applicant or the premises do not qualify for a license;
- Issuance would tend to create a law enforcement problem; or
- Issuance would result in or add to an undue concentration of licenses, and the applicant fails to show that public convenience or necessity would be served by issuance.

A discussion of the administrative and judicial remedies used to contest such a denial is beyond the scope of this chapter. For general discussion of administrative and judicial proceedings relating to alcoholic beverage licenses, see California Forms of Pleading and Practice, Ch. 18, *Alcoholic Beverage Licenses* (Matthew Bender). Denial and protest proceedings under Article 3 of the ABC Act are conducted in accordance with the administrative adjudication provisions of the Administrative Procedure Act [*Bus. & Prof. Code § 24016*; *see Gov. Code § 11500 et seq.* (APA hearing procedures)]. For detailed discussion of the administrative adjudication process, see California Forms of Pleading and Practice, Ch. 473, *Public Agency Adjudication* (Matthew Bender), and subsequent chapters of that publication.

In practice, denial of a license transfer that is only person-to-person (as opposed to premises-to-premises) is rare.

[2] Protests

In a person-to-person transfer of an alcoholic beverage license and business, with no change in the already-licensed premises and no change in the type of license, the buyer does not mail a notice of the transfer to residents within 500

feet of the premises [*see Bus. & Prof Code § 23985.5*]. Anyone can protest the transfer of the license, as long as the protest is filed at any office of the ABC within 30 days after the notice of transfer is posted at the premises, within 30 days of the mailing of a notification pursuant to *Bus. & Prof. Code § 23985.5*, or within 30 days of the mailing of a notice by the ABC to law enforcement officers pursuant to *Bus. & Prof. Code § 23987*, whichever is later. The time within which a local law enforcement agent may file a protest will be extended pursuant to a request made under § 23987 [*Bus. & Prof Code § 24013(a)*]. The ABC may reject protests, except protests made by a public agency or official, or made by the governing body of the city or county, if it determines the protests are false, vexatious, frivolous or without reasonable or probable cause. If a protest is rejected and the ABC proceeds to issuance, the protestant whose protest has been rejected may file an accusation against the license with the department within 10 days after the license is issued, alleging the grounds of the protest as grounds for revocation of the license [*Bus. & Prof Code § 24013(b)*].

If a protest is not denied by the ABC, the ABC will proceed with its investigation and determine whether to recommend issuance. If the ABC is recommending issuance in spite of a protest by a public agency, a public official, or the governing body of a city or county, the ABC must notify the protesting agency, public official, or governing body in writing of the determination to recommend issuance and the reasons for that recommendation. At the same time, the ABC must give the public agency, public official, or governing body written notice of hearing as required by *Gov. Code § 11509* [*Bus. & Prof Code § 24013(b)*; *see § 18.41[10], [3], below*].

If the buyer is operating under a temporary permit, the temporary permit continues to be valid in spite of protests against the transfer. If the premises were not eligible for a temporary permit and the ABC is recommending issuance, the ABC may issue an interim permit for use at the premises until the protest hearing can be scheduled. An interim permit is issued for 120 days and can be renewed if necessary [*see Bus. & Prof Code § 24044.5*]. It can take many months for a protest hearing to be scheduled.

PRACTICE TIP:

The ABC has limited the valid grounds for protest by citizens in a person-to-person transfer that does not include any change in premises or operations. If the premises are already licensed with the same type of license, valid protests can only address a disqualifying factor in the transferee. Otherwise the ABC will reject the protests. However, as discussed in [3], *below*, protests and demands for conditions from the governing body or public officials are another matter. *Commentary by Lynne Carmichael.*

[3] Conditional Licenses

Even if a license transfer is a person-to-person transfer with no change in premises or operations, the ABC mails a copy of the transfer application to the sheriff, chief of police, and district attorney of the locality in which the transferred license is located, to the city or county planning director, whichever has jurisdiction, and to the board of supervisors if the premises are in the unincorporated part of a county, or city council or other appropriate governing body if the premises are in an incorporated city ("local officials") [*Bus. & Prof Code § 23987*; *see § 18.32*]. The local officials can protest the transfer of the license [*Bus. & Prof Code § 23987*]. If there is substantial evidence that adoptions of conditions would address problems at the premises or in the immediate location of the premises, local officials can request that conditions be imposed on the operation of the business [*see Bus. & Prof Code § 23800(e)*; *see § 18.32*].



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-18 California Legal Forms--Transaction Guide

AUTHOR: Lynne Carmichael

NOTE:

This Transaction Guide sets forth procedures specifically applicable to the transfer of a retail alcoholic beverage license and business. Because the sale of a business with such a license is also subject to many of the same laws and procedures as the sale of any other business, portions of the Transaction Guide for Ch. 17, *Buying and Selling a Business or Professional Practice*, are also applicable. To avoid unnecessary duplication, this Transaction Guide contains cross references to relevant material in that chapter.



30 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-18 California Legal Forms--Transaction Guide §§ 18.53-18.99

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.53[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-18 California Legal Forms--Transaction Guide § 18.100

AUTHOR: Lynne Carmichael

§ 18.100 Facts Regarding Parties to Sale

1. Name, address, and telephone number of each party.

2. All business names and addresses used by seller during preceding three years [*see Com. Code § 6105(a)(2)*].

3. Legal status of each party:

a. Individual.

NOTE:
If an individual is the sole licensee on an alcoholic beverage license, that individual will need to provide evidence of his or her legal status as a citizen or resident alien. Form ABC-69, which is available on the ABC website [www.abc.ca.gov], is used for this purpose. The evidence is only required if one natural person is to be the licensee.

b. Husband and wife.

NOTE:
If the business is the community property of the buyers, the alcoholic beverage license usually must be issued in the name of both husband and wife [*see* 4 Cal. Code Reg. § 58(a)].

c. Partnership.

d. Corporation.

e. Limited liability company.

4. Seller's permit number, if seller has sales tax permit (or "seller's permit") for business [*see Rev. & Tax. Code §§ 6066-6077*; *see also* Ch. 1E, *Taxation of Businesses*].

5. Employer number issued by Employment Development Department, if applicable [*see Unemp. Ins. Code §§ 13020, 13056*].

NOTE:

For general coverage of requirements imposed on employers under California law, see Ch. 1C, *Regulation of Employers* .

6. Federal employer identification number, if applicable.

NOTE:

For general coverage of requirements imposed on employers under federal law, see Ch. 1C, *Regulation of Employers* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-18 California Legal Forms--Transaction Guide § 18.101

AUTHOR: Lynne Carmichael

§ 18.101 Facts Regarding Alcoholic Beverage License

1. Type of license being transferred.

NOTE:

For coverage of the various types of retail licenses, see *§ 18.20[1]*. This Transaction Guide covers the transfer of retail licenses only. However, for a brief discussion of other types of alcoholic beverage licenses [*see* *Bus. & Prof. Code § 23320*], see *§ 18.20[2]*. If one of these other licenses is the subject of a transfer, the attorney handling the sale should consult the nearest district office of the Department of Alcoholic Beverage Control for applicable procedures.

2. Address of premises for which license was issued.

3. Exact name(s) of all license holder(s).

4. Date on which license was originally issued.

NOTE:

For general licenses transferred within two years after issuance, this fact is used to determine the amount of consideration that may be paid for the license [*see* *Bus. & Prof. Code § 24079*; *see also* *§ 18.111*].

PRACTICE TIP:

The License Query System link from the ABC web page www.abc.ca.gov provides reliable information about license type, premises address, actual license holder name(s),

date of issuance, date on which renewal fees are due, and any past or current disciplinary actions against the license. If a license is subject to restrictions on transfer or conditions on operations, they will be noted on the web page. Names of authorized signers (officers, general partners, managers) are usually shown and can help determine who must "sign off" on the transfer of the license. The information in the License Query System can be accessed by license number, licensee name, business address or business name. *Commentary by Lynne Carmichael.*

5. Whether license will be transferred alone or with seller's business.

Legal Topics:

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California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-18 California Legal Forms--Transaction Guide § 18.102

AUTHOR: Lynne Carmichael

§ 18.102 Facts Regarding Business

NOTE:

This section is applicable only when the transaction involves the sale of both the license and business for which the alcoholic beverage license was issued [*see* Ch. 17, *Buying and Selling a Business or Professional Practice* , for further coverage].

1. Name and address of business being sold.

2. Any fictitious name under which business was conducted, and dates on which fictitious business name statement was filed or published.

NOTE:

For coverage of fictitious business name statements [*see* *Bus. & Prof. Code §§ 17900-17930*], see Ch. 1A, *Role of Counsel in Starting a New Business* .

3. Every county and city in which business is conducted.

NOTE:

Any required bulk transfer notice must be published in the judicial district where the business assets are located [*see* *Com. Code § 6105(b)*; *see also* *§ 18.211*].

4. Any other states and countries in which business is conducted.

NOTE:

Although taxation of multinational businesses is a specialized topic beyond the scope of this chapter, this fact is necessary to accurately determine the tax consequences of the sale.

5. Nature of business being sold.

6. Whether business manufactured or sold products that might be subject to potential products liabilities actions.

NOTE:
For further coverage, see California Forms of Pleading and Practice, Ch. 460, *Products Liability* (Matthew Bender).

7. Whether business is operated under franchise agreement.

8. List of business assets, including accounts receivable, listing:

a. Value of each asset.

b. Manner in which value was determined.

c. Lessor and lease information for leased equipment.

9. List of business liabilities, including accounts payable, listing:

a. Names of creditors.

b. Purposes of obligations.

c. Terms of obligations.

10. Nature of interest in real property occupied by business:

a. Fee interest.

b. Lease of premises.

c. Sublease of premises.

11. Name and address of seller's lessor, if lease will be assigned to buyer.

12. Names of customers or clients, if applicable.

13. Names and addresses of any insurance agents or brokers serving the business.

14. Details of any pending litigation.

15. Location and account numbers of all existing bank or investment accounts for business.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-18 California Legal Forms--Transaction Guide § 18.103

AUTHOR: Lynne Carmichael

§ 18.103 Facts Regarding Sale

1. Name, address, and phone number of person who will serve as escrow holder.

NOTE:

Every transfer of an alcoholic beverage license that involves a purchase price or consideration must be conducted through an escrow, established before the parties file an application for transfer of the license [*see* *Bus. & Prof. Code § 24074*; ***see also* *§ 18.41[4]*].

2. Total purchase price for sale.

NOTE:

This Transaction Guide does not cover the manner in which the license and business should be evaluated or priced by a prospective buyer. It assumes that the parties have consulted a financial advisor regarding fair market value.

For general licenses, the total purchase price may be limited [*see* *Bus. & Prof. Code §§ 24070(d), (e), 24079*; ***see also* *§ 18.30[4]*]. For applicable determinations, see *§ 18.111*.

PRACTICE TIP:

The consideration to be placed into the escrow may be the total consideration, the separately stated reasonable consideration for the liquor-licensed business or the consideration for only the liquor license if that is the sole asset to be purchased from the seller [Form ABC-227 INSTR (NEW 9/99), p. 1]. When the business is a hotel, golf

course, supermarket or other business for which the liquor-licensed business is a small part, seller may want to establish a separate, reasonable value for the liquor-licensed business, which would include, at a minimum, the value of the alcoholic beverage license, the alcoholic beverage inventory and any furniture, fixtures and equipment used exclusively in the licensed business. *Commentary by Lynne Carmichael.*

3. Manner in which purchase price will be paid:

PRACTICE TIP:

While the law states that the buyer must deposit the total purchase price (or the separately stated reasonable value of the liquor-licensed business) with the escrow holder before the parties file the application for transfer of the license, the application for transfer is often lodged at the ABC well before the parties' transaction closing. Since the purchase price may consist of cash, checks, promissory notes, and tangible or intangible property, the buyer often places a demand note into the escrow, to be replaced with cash when the transaction closing occurs [*Bus. & Prof. Code § 24074*; *see § 18.200[1][d]*]. *Commentary by Lynne Carmichael.*

a. Cash on execution of sales contract.

b. Installments according to terms of promissory note.

c. Other.

4. If portion of purchase price will be paid in installments or on deferral basis, any security to be given for payment of purchase price.

NOTE:

For an in-depth discussion of secured transactions, see Ch. 42, *Secured Transactions*. A security interest cannot be created or reserved in an alcoholic beverage license [*Bus. & Prof. Code § 24076*].

5. Manner in which buyer and seller will pay or share costs of sale, for example:

a. Escrow fees.

b. Attorneys' fees.

c. Recording and publication costs.

d. Inventory costs.

e. Broker fees.

6. Whether buyer intends to use license on new premises, and if so:

a. Address of new premises.

b. Whether new premises are in a different city or census tract.

c. Whether new premises are in a different county.

NOTE:
Cities with an over-concentration of licenses of a particular type restrict the transfer of new licenses into their jurisdiction, even if the licenses are being transferred from other locations within the same county. Restrictions are imposed on the transfer of general licenses into other counties [*see* *Bus. & Prof. Code § 24070*; *see also* *§ 18.30[2]*].

7. Whether buyer will use license on premises under construction or to be constructed and, if so:

a. Name of owner.

b. Name of general contractor.

c. Anticipated completion date [*see 4 Cal. Code Reg. § 64(c)*].

8. If business will be transferred with license:

NOTE:
For more detailed coverage, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

a. Any assets to be excluded from sale.

b. Whether buyer will assume any obligations of business.

c. Items to be prorated in escrow between buyer and seller, for example:

(1) Rent.

(2) Utilities.

(3) Employee salaries.

(4) Insurance premiums.

(5) Equipment leases.

d. Whether buyer will apply for temporary retail permit to operate business pending approval of transfer [*see Bus. & Prof. Code § 24045.5*; *see also § 18.220[1]*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-18 California Legal Forms--Transaction Guide § 18.104

AUTHOR: Lynne Carmichael

§ 18.104 Documents

1. License to be transferred.

2. If business will be transferred together with license:

a. Copy of franchise agreement, if any, under which business is operated.

b. Any leases to be assigned to buyer.

c. Any of following instruments to be assigned to buyer:
(1) Contracts.

(2) Notes.

(3) Deeds.

d. Inventory of business assets being sold.

e. Any installment purchase contracts or other instruments executed by seller granting third party security interest in any of business assets.

f. Instruments, such as deeds or title policies, that show legal description of any real property to be transferred.

g. Instruments, such as certificate of ownership of motor vehicle, evidencing ownership of any personal property to be transferred.

h. All insurance policies held by business or owners for business purposes.

i. All licenses or permits issued to business or owners.

j. If buyer is partnership, copy of partnership agreement.

k. If seller or buyer is corporation, copy of board and shareholder resolutions authorizing sale or purchase.

NOTE:

For discussion, see Ch. 5, *Directors' Meetings, Actions, and Resolutions* , and Ch. 8A, ***Shareholders' Meetings, Voting, and Agreements*** .

l. List of all employees of business, including:

(1) Names.

(2) Social security numbers.

(3) Positions.

(4) Salaries.

(5) Accrued vacation, comp time and other benefits.

m. Collective bargaining agreement, if any.

n. Tax returns for preceding several years.

o. Any fictitious business name statement filed.

NOTE:

The buyer may have to file a new fictitious business name statement, and the seller may have to file a statement of abandonment of fictitious business name [*see* Ch. 17, ***Buying and Selling a Business or Professional Practice***].

p. Any environmental permits held by business.

3. If license will be transferred to premises under construction:

a. Copy of building permit issued for new premises.

b. Copy of contract for construction of new premises or letter from contractor.

c. Copy of building plans or sketch of floor plan.

d. Copy of lease or other instrument giving buyer a right to occupy new premises when installed in

business.

NOTE:

Information about lease terms must be included on the application. The ABC may also request that a copy of the lease be included in the transfer application file [*see § 18.221*].

e. Copy of conditional use permit if required at new location.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsBusiness & Corporate LawDistributorships & FranchisesBusiness OpportunitiesGovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
A. Client Interview--Facts and Documents

8-18 California Legal Forms--Transaction Guide §§ 18.105-18.109

AUTHOR: Lynne Carmichael

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§§ 18.105[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-18 California Legal Forms--Transaction Guide § 18.110

AUTHOR: Lynne Carmichael

§ 18.110 General Determinations

1. If requested to represent both parties to transaction, determine whether or not potential for conflict exists [*see Cal. Rules Prof. Conduct, Rule 3-310*].

NOTE:
For applicable procedures regarding representation of both parties, see *§ 18.120*.

2. Determine whether buyer meets all requirements imposed on original applicant for license of type to be transferred [*see 4 Cal. Code Reg. § 60(b)*].

NOTE:
For a discussion of the various types of retail licenses, see *§ 18.20[1]*. The requirements for the issuance of licenses are set forth in *Bus. & Prof. Code §§ 23950-24051*.

3. Determine parties who must sign documents relating to sale [*see Bus. & Prof. Code § 23953*]:

a. If either party is general partnership, each general partner [*Bus. & Prof. Code § 23953(b)*].

NOTE:
In the case of a general partnership, the partners are deemed to be the applicants for any alcoholic beverage license, and the licensees under any license actually issued [*Bus. & Prof. Code § 23953(b)*].

b. If either party is limited partnership, each general partner [*Bus. & Prof. Code § 23953(c)*].

c. If either party is a limited liability company that has elected to be managed by its members, each member or any officer authorized by articles or operating agreement to bind company [*Bus. & Prof. Code § 23953(d)*].

d. If either party is a limited liability company that has elected to be managed by manager(s), the manager(s) or any officer authorized by articles or operating agreement to bind company [*Bus. & Prof. Code § 23953(d)*].

e. If either party is corporation, two corporate officers, one from each of following categories [*Bus. & Prof. Code § 23953(e)*]:

(1) Chairperson of board, president, or vice president.

(2) Secretary, assistant secretary, chief financial officer, or assistant treasurer.

f. If business to be sold is or will be community property, husband and wife [*see 4 Cal. Code Reg. § 58*].

NOTE:
For further discussion of the rules regarding ownership of an alcoholic beverage license by a husband and wife [*see* *4 Cal. Code Reg. § 58*], see *§ 18.126*.

4. Determine whether following conditions exist, obviating need for escrow and related filings [*Bus. & Prof. Code §§ 24074.3(b), 24074.4*; *see § 18.125* (filing statement of deposit with escrow holder as prerequisite to transfer)].

a. Transfer involves off-sale beer and wine license.

b. Corporation with net worth on consolidated basis of at least $5 million (according to most recent audited financial statement) has filed guaranty of full payment of all creditor claims.

PRACTICE TIP:
While the statute requires that the guaranty be "acceptable to the creditors," in practice, the Department of Alcoholic Beverage Control ("ABC") does not require evidence that it is acceptable, relying instead on the post-filing requirement that all creditors' claims have been paid in a manner "acceptable to the creditors," and the guarantor's statement under penalty of perjury that all conditions of the transfer, including the payment of creditors, have been satisfied [*Bus. & Prof. Code § 24074.4(a)*].

Because an essential element of an escrow is the deposit of money or other consideration with the escrow holder, there is no requirement that an escrow be established when no consideration is involved in the transaction [*see* Form ABC-227 INSTR at 1, (NEW 9/99); § 18.210]. Furthermore, if certain fiduciary transfers are involved, no escrow is required [*see* Form ABC-227 INSTR at 2, (NEW 9/99); § 18.210]. *Commentary by Lynne Carmichael.*

5. Determine what, if any, instruments must be prepared for deposit into escrow upon execution of contract of sale.

NOTE:
Unless an escrow is not required [*see* P 4, ***above*], the full amount of the purchase price must be**

deposited into escrow before the parties may file an application for transfer of the license [*Bus. & Prof. Code § 24074*]. The purchase price may consist of cash, checks, promissory notes, or tangible or intangible property [*Bus. & Prof. Code § 24074*]. If the purchase price consists of notes [***see** § 18.103*], the attorney handling the sale must prepare the notes and instruments securing them prior to filing the transfer application. Furthermore, if the seller is transferring the business, documents of transfer for the business assets should be prepared and deposited into escrow [***see** § 18.122*].

6. Determine approximate date of sale.

NOTE:

For detailed information regarding the length of time the ABC requires to process and investigate an application prior to approval, see *§ 18.126[5]*].

7. If business will be transferred with license, determine:

NOTE:

For more detailed coverage of the following issues, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

a. Whether property being sold is subject to any federal, state, or local environmental laws or regulations.

b. Whether business is operated under franchise agreement.

c. Whether buyer may have obligations under any collective bargaining agreements between seller and union.

8. If license will be transferred alone, determine:

a. Whether type of license to be transferred is proper license for business that buyer intends to conduct [*see §§ 18.20*].

b. Whether zoning permits buyer's intended use and whether conditional use permit will be required by governing body [*see Bus. & Prof. Code § 23790*].

NOTE:

An initial application for a conditional use permit to sell alcohol for on-site consumption does not involve a fundamental vested right. Therefore, if the application were denied, a court reviewing that denial would not use its independent judgment to weigh the evidence but would apply the substantial-evidence test [*SP Star Enters., Inc. v. City of Los Angeles (2009) 173 Cal. App. 4th 459, 470-471, 93 Cal. Rptr. 3d 152* (substantial evidence supported denial of permit)].

c. Whether ABC is likely to approve premises to which buyer wishes to transfer license.

NOTE:

For example, the ABC will not approve a premises-to-premises transfer if the premises or parking lot for the premises is located within 100 feet of a residence unless (1) the buyer can prove that operation of the business would not interfere with the residents'quiet enjoyment, or (2) the premises have been operated under the

same type of license within 90 days of the application [*see* *4 Cal. Code Reg. § 61.4*]. Furthermore, the property must be properly zoned for the intended business [*see*** *Bus. & Prof. Code § 23790*; Ch. 30B, ***Zoning, Building, and Environmental Entitlements and Permits***].

Moreover, the ABC may deny a license if the applicant is unqualified, or if issuance would create a law enforcement problem or an undue concentration of licenses [*Bus. & Prof. Code § 23958*; *see* *§ 18.52[1]*].

d. Whether buyer has lease, deed, or other right to possession of premises.

NOTE:

The ABC will not approve a transfer unless the buyer can prove a right to possession and control of the premises on which he or she intends to use the license [*see* *4 Cal. Code Reg. § 60(m)*].

e. If license will be transferred to premises under construction, whether adequate financing and building permit have been obtained.

NOTE:

For extensive coverage of this topic, see Ch. 30A, *Construction Financing* .

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-18 California Legal Forms--Transaction Guide § 18.111

AUTHOR: Lynne Carmichael

§ 18.111 Applicability of Transfer Restrictions on General Licenses

NOTE:
The restrictions set forth in this section apply only to transfers of on-sale general or off-sale general licenses [*see § 18.30*; *see also § 18.21[1]*].

1. Determine whether proposed transfer to buyer is prohibited, because proposed transfer would take place within two years from date of issuance or inter-county transfer [*Bus. & Prof. Code § 24070(c)*].

NOTE:
No license meeting these criteria is transferable from the licensee to another person for a period of two years from the date of issuance, unless it meets one of the exceptions set forth in P 2, *below* [*Bus. & Prof. Code § 24070(c)*; ***see** § 18.30[3]*].

2. If transfer is otherwise prohibited pursuant to P 1, *above*, determine whether ABC may nonetheless approve transfer for either of following reasons [*Bus. & Prof. Code § 24070(c)*]:

a. Transfer is necessary to prevent undue hardship.

b. Transfer is one of following [*Bus. & Prof. Code §§ 24070(c), 24071*]:
(1) Transfer from one spouse to other spouse, and no final decree of dissolution has been entered prior to filing of transfer application.

(2) Transfer of license of decedent, minor ward, incompetent person, conservatee, debtor in a bankruptcy case, person for whose estate receiver is appointed, or assignor for benefit

of creditors by or to:

(a) Surviving partners of deceased licensee;

(b) Executor, administrator, conservator, or guardian of estate of licensee;

(c) Surviving spouse of deceased licensee if deceased leaves no estate to be administered;

(d) Trustee of bankrupt estate of licensee;

(e) Receiver of licensee's estate; or

(f) Assignee for benefit of licensee's creditors with consent of assignor.

(3) Transfer by or to receiver appointed for judgment debtor [*see Code Civ. Proc. § 708.630*].

(4) Transfer to revocable living trust when licensee is also trustee.

(5) Transfer between partners when no new partner is being licensed.

(6) Transfer between corporations whose outstanding shares are owned by same natural persons.

(7) Transfer of license, with proper notice [*see Bus. & Prof. Code § 24073*; § 18.210] to corporation whose entire stock is owned by licensee or licensee's spouse.

(8) Transfer between licensee and LLC whose entire membership consists of licensee or his or her spouse.

(9) Transfer from corporation to person who owns, or whose spouse owns, entire stock of that corporation.

3. Determine whether consideration for transfer is limited to $12,000, because transfer would take place within two years from date of issuance [*Bus. & Prof. Code §§ 24070(d), (e), 24079*].

NOTE:

Any original on-sale or off-sale general license for which an original fee of $12,000 was paid may not be transferred for a purchase price in excess of $12,000 for two years following its issuance. After two years, the license may be transferred without restriction as to purchase price or consideration that may be paid by a transferee or received by a transferor [*Bus. & Prof. Code § 24079(c)*]. For further discussion, see *§ 18.30*.

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-18 California Legal Forms--Transaction Guide § 18.112

AUTHOR: Lynne Carmichael

§ 18.112 Applicability of Bulk Sales Division

NOTE:

This section applies only when the licensee is transferring the business for which the license was issued together with the license. A transfer otherwise subject to the Bulk Sales Division that also is subject to and complies with the provisions of the Alcoholic Beverage Control Act [*Bus. & Prof. Code § 23000 et seq.*] is subject only to the notice requirements [*see Com. Code § 6105*; *see also § 18.124*] prescribed by the Bulk Sales Division [*Com. Code § 6103(c)(15)*; *see § 18.10[3]*].

1. Determine whether business is type that is subject to Bulk Sales Division of Commercial Code [*Com. Code § 6103(a)*; *see Com. Code §§ 6101 et seq.*]:

a. Seller's principal business is sale of inventory from stock, including those who manufacture what they sell, or is that of restaurant owner [*Com. Code § 6103(a)(1)*; *see Com. Code § 6103(c)* (exceptions)]; and

b. On date of bulk sale agreement, seller is located in California, or is located in jurisdiction outside United States but has its major American executive office in California [*Com. Code § 6103(a)(2)*; *see Com. Code § 6103(b)*].

2. If business is subject to Bulk Sales Division [*see* P 1, *above*], determine whether proposed sale is "bulk sale" subject to Bulk Sales Division [*Com. Code § 6102(a)(3)*]:

a. Sale of assets is not in ordinary course of seller's business; and

b. Assets being sold constitute more than half of seller's inventory and equipment.

NOTE:
In determining the percentage of the seller's inventory and equipment being transferred, the assets are valued at their fair market value as of the date of the bulk sale agreement [*Com. Code § 6102(a)(3), (8), (15)*; *see* *Com. Code §§ 6102(b)(2), 9102(a)(33)* ("equipment" defined), 6102(b)(3), 9102(a)(48) ("inventory" defined)].

3. If proposed sale is subject to Bulk Sales Division, determine following [*see Com. Code § 6105*]:

a. Address of office of county recorder in county or counties in which seller and seller's tangible assets are located.

b. Judicial districts in which seller is located and seller's assets are located.

c. Name and address of newspaper of general circulation in judicial districts in which seller is located and seller's assets are located:

NOTE:
The notice of intended transfer [*see § 18.211*] must be published in a newspaper of general circulation that is published in the judicial district where the property is located and, if different, if judicial district where the seller is located [*Com. Code § 6105(b)(2)*; ***see*** *§ 18.124*].

(1) Publication dates of newspaper; and

(2) Newspaper's deadlines for accepting legal notices.

d. Date on or after which sale is to be closed.

NOTE:
This date is used to determine the recordation and publication dates [*Com. Code § 6105(b)(1), (2)*; ***see* *§ 18.124*].**

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsCommercial Law (UCC)Bulk Sales (Article 6)GovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-18 California Legal Forms--Transaction Guide § 18.113

AUTHOR: Lynne Carmichael

§ 18.113 Applicability of Sales and Use Tax Law

NOTE:

The Sales and Use Tax Law [*Rev. & Tax. Code § 6001 et seq.*] imposes a tax on the gross receipts of a retailer from the sale of tangible personal property sold at retail in California [*Rev. & Tax. Code § 6051 et seq.*]. Sales taxes will be payable based on the allocation of consideration to the tangible personal property (furniture, fixtures and equipment) of the transferred business. Sales taxes are not payable on the consideration allocated to the alcoholic beverage license. For discussion, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsTax LawState & Local TaxesAlcohol & Tobacco Products TaxAlcohol TaxImposition of TaxTax LawState & Local TaxesSales TaxImposition of TaxTax LawState & Local TaxesUse TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-18 California Legal Forms--Transaction Guide § 18.114

AUTHOR: Lynne Carmichael

§ 18.114 Structuring Sale of License and Business

NOTE:

When the licensee is transferring the business for which the license was issued together with the license, the attorney handling the sale must make various determinations regarding the transfer of the business property. For example, he or she must consider issues regarding allocation of the purchase price to the various assets for purposes of determining gain or loss and basis under federal tax law [*see I.R.C. § 1060*; *Treas. Reg. § 1.1060-1*; *see also* *Ch. 17, **Buying and Selling a Business or Professional Practice, § 17.11[4]*], division of business costs and expenses, and the possibility of future products liability litigation when structuring the sale. For applicable determinations, see Ch. 17, ***Buying and Selling a Business or Professional Practice*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGovernmentsState & Territorial GovernmentsLicenses



42 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
B. Preliminary Determinations

8-18 California Legal Forms--Transaction Guide §§ 18.115-18.119

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.115[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.120

AUTHOR: Lynne Carmichael

§ 18.120 Representing Parties

1. If requested to represent both parties to transaction, recommend that one party obtain separate counsel.

2. If parties do not withdraw request and do not appear to have conflicting or potentially conflicting interests [*see Cal. Rules of Prof. Conduct, Rule 3-310*]:

a. Make full disclosure to each party of nature of representation of other party; and

b. Obtain written consent of both parties to arrangement before accepting employment.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGovernmentsState & Territorial GovernmentsLicensesLegal EthicsClient RelationsEffective Representation



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.121

AUTHOR: Lynne Carmichael

§ 18.121 Investigating Liabilities of Business

NOTE:

If the transaction involves the sale of the business as well as the alcoholic beverage license, the buyer should ascertain whether any pending litigation, judgments, or tax liens affect the value of the business. For applicable procedures, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.122

AUTHOR: Lynne Carmichael

§ 18.122 Drafting Contract of Sale and Related Documents

1. Draft contract of sale [*see § 18.150, 18.152*], and have parties:

a. Read contract.

b. Execute contract.

NOTE:
For examples and discussion of execution requirements, see *Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.295*. Note that under the California Statute of Frauds, an agreement for the sale of real property must be subscribed by the parties to be charged or by their agents [*Civ. Code § 1624*]. Both spouses, either personally or by duly authorized agent, must execute any instrument by which community real property is sold or otherwise conveyed [*Fam. Code § 1102(a)*].

c. State date and place of execution.

2. If necessary, draft escrow instructions [*see § 18.151*] when printed instructions will not be used.

NOTE:
If the seller is transferring the license alone and the escrow procedures will be relatively simple, the contract of sale may contain the instructions to the escrow holder [*see § 18.152*]. For a guide to drafting escrow instructions for the sale of real property, see Ch. 23, ***Real Property Sales Agreements*** .

3. Prepare all of the following documents for transfer of business:

a. Deeds or other instruments required to transfer real property.

NOTE:

For discussion and forms for deeds, see Ch. 27, *Deeds and Recording* .

b. Assignment of leases or contracts to be transferred to buyer.

NOTE:

For discussion and forms of assignments, see Ch. 35A, *Assignment and Sublease of Leasehold Interests* . If the lease is for a term in excess of 35 years, a change of ownership must also be filed [***see** Rev. & Tax. Code §§ 62(c)(1), 480*].

c. Vehicle registration transfer documents, if applicable.

NOTE:

For discussion and examples of transfer documents, see Ch. 102A, *Personal Property Liens* .

d. Bill of sale for tangible and intangible personal property [*see* Ch. 17, *Buying and Selling a Business or Professional Practice*].

NOTE:

A transfer of property may be made without a written instrument if a writing is not required by statute [*Civ. Code § 1052*]. However, contracts of sale and escrow instructions often specify that the seller deliver a bill of sale for the personal property assets of the business to the buyer.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsContracts LawTypes of ContractsGovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.123

AUTHOR: Lynne Carmichael

§ 18.123 Giving Notice of Intended Transfer of License

NOTE:

The Department of Alcoholic Beverage Control ("ABC") will not transfer a retail on-sale or off-sale beer and wine license, on-sale beer and wine public premises license, on-sale beer license, on-sale beer public premises license, or on-sale general license for seasonal business unless, prior to filing the transfer application, the buyer or seller has recorded a notice of intended transfer in the office of the county recorder of the county or counties where the licensed premises are situated [*Bus. & Prof. Code § 24073*]. Certain transfers by fiduciaries, however, are exempt from this notice requirement [*Bus. & Prof. Code § 24075*; *see § 18.210*].

1. Prepare notice of intended transfer [*Bus. & Prof. Code §§ 24073, 24074*; *see § 18.210* (ABC-227)].

NOTE:

When the transfer of an alcoholic beverage license is accompanied by the sale of a licensed business subject to the notice requirement of the Bulk Sales Division [*Com. Code §§ 6103(c)(15), 6105(b)(1), (2)*; *see § 18.102*, the two notices may be combined into one form [***see** § 18.212*]. Due to the fact that publication of that longer, combined form is more expensive, it may be simpler and cheaper to record separate notices under the Act [***see** § 18.210*] and under the Bulk Sales Division [***see** § 18.211*].

2. Record original in office of county recorder of county or counties where premises to which license was issued are located [*Bus. & Prof. Code § 24073*].

NOTE:

For current filing fees, see *Gov. Code § 27361*.

3. Obtain certified copy of notice, to be filed with application for license transfer [*see Bus. & Prof. Code § 24073*; *see also § 18.126*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsContracts LawPerformanceAssignmentContracts LawTypes of ContractsGovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.124

AUTHOR: Lynne Carmichael

§ 18.124 Giving Notice of Intended Bulk Sale

NOTE:

The Bulk Sales Division [*Com. Code §§ 6101-6111*] applies only to a "bulk sale" by an enterprise subject to the Division [*see Com. Code § 6103(a), (c)*], that is a sale not in the ordinary course of the seller's business of more than half of the seller's inventory and equipment [*Com. Code § 6102(a)(3)*; ***see*** *§ 18.112*]. Therefore, the requirements set forth in this section do not apply to the transfer of an alcoholic beverage license alone. They specifically apply, however, when the sale of the business and retail alcoholic beverage license of a subject enterprise constitutes a bulk sale [***see*** *Com. Code § 6103(c)(15)* (transfer exempt from all but notice requirements); ***see also*** *§ 18.10[3]*].

1. Draft notice of intended sale, stating all of following [*Com. Code §§ 6103(c)(15), 6105(a)(1)-(4)*; *see § 18.211*]:

NOTE:

A notice combining these requirements and those imposed by the Alcoholic Beverage Control Act may be used in lieu of separate notices [*see § 18.212*].

a. That bulk sale is about to be made.

b. Names and business addresses of seller and buyer.

c. All other business names and addresses used by seller within past three years, to extent known by buyer.

d. Location and general description of property to be transferred.

e. Place and anticipated date of bulk sale, that is, the place and date on (or after which) bulk transfer will be closed.

2. Obtain buyer's signature [*see Com. Code § 6105*].

NOTE:

Although it is the buyer's responsibility to give the notice [*see* *Com. Code § 6104(b)*], both parties frequently sign the notice.

3. At least 12 business days before bulk sale is to be closed, have buyer (or escrow holder) take all of following actions [*Com. Code §§ 6103(c)(15), 6105(b)*]:

NOTE:

A "business day" is any day other than Saturday, Sunday, or a day observed as a holiday by the California state government [*Com. Code § 6105(b)*].

a. Record notice in office of recorder in county or counties where property to be transferred is located and, if different, where seller is located [*Com. Code § 6105(b)(1)*].

NOTE:

Current recording fees are set forth in *Gov. Code § 27361*.

b. Publish notice in newspaper of general circulation in judicial district where property to be transferred is located and, if different, in either [*Com. Code § 6105(b)(2)*]:

NOTE:

If there is no newspaper of general circulation published in required judicial district, publish notice in the county embracing that judicial district [*Com. Code § 6105(b)*].

If the property to be transferred is located in more than one judicial district, the notice must be published in the judicial district where a greater portion of the property is located on the date of publication [*Com. Code § 6105(b)*].

(1) Judicial district where seller is located;

NOTE:

A seller is deemed to be located at its place of business. If a seller has more than one place of business, the seller is located at its chief executive office [*Com. Code § 6103(b)*].

(2) If seller is not located in United States, judicial district where seller's major executive American office in California is located [*see Com. Code § 6103(a)(2)*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsCommercial Law (UCC)Bulk Sales (Article 6)



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.125

AUTHOR: Lynne Carmichael

§ 18.125 Opening Escrow

NOTE:

If the transfer involves a purchase price or consideration [*see* *Bus. & Prof. Code § 24074.4*; ***see also* *§ 18.103[3]*], and no corporate guarantor will handle creditor claims [***see*** *§ 18.110[4]*], the parties must take the actions listed in this section prior to filing an application for transfer of the alcoholic beverage license [***see*** *Bus. & Prof. Code § 24074*; ***see also*** *§ 18.126*].

1. Ensure that parties establish escrow with person, corporation, or association that [*see Bus. & Prof. Code § 24074*]:

NOTE:

The parties may appoint the escrow holder in the contract of sale [*see, e.g., § 18.200,* P 15].

a. Is not party to transfer.

b. Meets requirements of Chapter 1 of Escrow Law [*Bus. & Prof. Code § 24074.1*; *see Fin. Code §§ 17000-17010* (application of Escrow Law to particular persons); *see also* Ch. 26, *Real Property Escrows*].

NOTE:

A California-licensed attorney who has a bona fide client relationship with a principal in a real estate or personal property transaction and who is not actively

engaged the business of an escrow agent is exempt from the requirements of the Escrow Law [*Fin. Code § 17006(a)(2)*].

2. Ensure that buyer deposits full amount of purchase price or consideration into escrow before parties file application for transfer [*Bus. & Prof. Code § 24074*; *see § 18.103[3]* (permissible types of consideration)].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawAgency RelationshipsTypesAttorney & ClientBusiness & Corporate LawCorporationsReal Property LawPurchase & SaleEscrow



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.126

AUTHOR: Lynne Carmichael

§ 18.126 Applying for License Transfer

1. Instruct buyer to make appointment with Department of Alcoholic Beverage Control ("ABC") to file application for transfer of license.

NOTE:

The ABC prefers, and recommends, that the application be made in person, so that any corrections in the required information can be made at the time of application. Most frequently, the seller signs the forms in advance, and the buyer then personally comes in to the ABC and signs the application in the presence of the ABC personnel. Sometimes both buyer and seller will personally appear to sign the application. The ABC will accept applications by mail when personal appearance is impractical, but will return the paperwork by mail if any corrections are necessary, thereby delaying processing of the application. If buyer is unable to appear in person, a special "sign-on" form is required [*see* *§ 18.222*]. Any signatures not signed in the presence of the ABC must be notarized [***see*** *§§ 18.220, 18.222*].

If the seller is transferring the licensed business as well as the alcoholic beverage license, at the time of filing the transfer application the buyer may also apply for a temporary permit [*see* P 7 *below*] to operate the business during pendency of the application for license transfer [***see*** *Bus. & Prof. Code § 24045.5* (temporary permit)]. For further discussion, see *§ 18.41[6]*.

2. Ensure that following persons participate in application process:

a. All persons presently named as licensees on license (that is, seller(s)) [*see Bus. & Prof.*

Code § 23953; *4 Cal. Code Reg. § 60(b)*].

PRACTICE TIP:
To ensure that all necessary persons sign off on behalf of the seller, check the ABC webpage [www.abc.ca.gov] for information about persons named as licensees on the license. It is also usually a good idea to ask the appropriate ABC district office to check the file and specify the persons qualified to sign for the seller(s). *Commentary by Lynne Carmichael.*

b. If buyer is general partnership, each general partner [*Bus. & Prof. Code § 23953(b)*].

NOTE:
In the case of a general partnership, the partners are deemed to be the applicant for any license, and the licensees under any license actually issued [*Bus. & Prof. Code § 23953(b)*].

c. If buyer is limited partnership, each general partner [*Bus. & Prof. Code § 23953(c)*].

d. If buyer is LLC that has elected to be managed by its members, each member or any officer authorized by articles or operating agreement to bind company [*Bus. & Prof. Code § 23953(d)*].

e. If buyer is LLC that has elected to be managed by manager(s), manager(s) or any officer authorized by articles or operating agreement to bind company [*Bus. & Prof. Code § 23953(d)*].

f. If buyer is corporation, two corporate officers, one from each of following categories [*Bus. & Prof. Code § 23953(e)*].

(1) Chairperson of board, president, or vice president.

(2) Secretary, assistant secretary, chief financial officer, or assistant treasurer.

g. If business is purchased as community property, husband and wife [*see 4 Cal. Code Reg. § 58*].

NOTE:
If the business is community property, the license must be issued in the name of both husband and wife, unless one spouse can satisfactorily demonstrate that he or she is qualified as a license holder but cannot participate in the operation of the business [*4 Cal. Code Reg. § 58(a)*]. If the business is separate property, the license may be issued to one spouse only [*4 Cal. Code Reg. § 58(b)*]. However, the unlicensed spouse must also meet the qualifications of a license holder, unless the spouses live apart [*4 Cal. Code Reg. § 58(c)*].

3. Advise buyer and seller that they must present all of following documents on filing transfer application (or at later time and place agreed on between applicants and ABC representative):

a. Application signed by all necessary parties [*see § 18.220* (ABC-211A); *see also* P 2, *above*, for signature requirements].

NOTE:
Any signatures not signed in the presence of the ABC must be notarized on Form ABC-211 SIG [*see § 18.222*].

(1) For a general partnership, each partner must sign.

(2) For a limited partnership, each general partner must sign.

NOTE:
Limited partners do not need to sign the application.

(3) For a corporation, one person from each of following categories must sign:

NOTE:
If only one corporate officer exists, that officer must sign twice, once in each category.

(a) Chair of board, president, or a vice president; and

(b) Secretary, assistant secretary, chief financial officer, or assistant treasurer.

(4) For a limited liability company [*see* Ch. 12C, *Limited Liability Companies* , for information on the operation of LLCs)].:

(a) For a member-managed LLC, application must be signed by each member or by an officer authorized by articles of organization or operating agreement to bind LLC.

(b) For a manager-managed LLC, application must be signed by each manager or by an officer authorized by articles of organization or operating agreement to bind LLC.

NOTE:
If a managing member of the LLC is to sign the application on behalf of all parties, that person or organization must be listed in the agreement.

b. If applicant is a corporation [*see* ABC Form 279 (pre-application checklist)]:

(1) Form ABC-243 [*see § 18.226*].

(2) Copy of articles of incorporation.

(3) Copy of minutes reflecting election of current officers and directors.

(4) Copy of exemption letter or notification of issuance of stock, stamped by the Department of Corporations.

(5) Copy of stock register or stock certificates that are issued.

(6) For foreign corporations, copy of certificate to do business in California.

(7) A personal affidavit (Form ABC-208A) [*see § 18.224*] and personal financial affidavit (Form ABC-208B) [*see § 18.225*] for each of the following:

NOTE:

Each of these persons will be asked to submit fingerprints to the ABC after the application has been filed. Out-of-state spouses who take no part in the management of the business may receive waivers of this requirement [*see* *4 Cal. Code Reg. § 57*].

(a) President, secretary, and chief financial officer.

(b) Any officer particularly involved in alcoholic beverage operations.

(c) Any officer signing the application.

(d) A majority of the persons on the board of directors.

(e) Any shareholders holding 10 percent or more of the voting stock of the corporation, and spouses of those shareholders.

NOTE:

If any of the 10 percent or more owners is an entity, it must submit forms required of that entity, and each entity in the chain of title until reaching ownership by actual persons or by a publicly traded entity.

c. If applicant is a limited partnership [*see* ABC Form 279 (pre-application checklist)]:

(1) Form ABC-256 [*see § 18.227*].

(2) For California limited partnerships, copy of Certificate of Limited Partnership (Form LP-1) from Secretary of State's office [*see* Ch. 15A, *Formation of Limited Partnerships*, § 15A.210].

(3) For foreign limited partnerships, copy of Certificate of Limited Partnership (Form LP-5) from Secretary of State's office [*see* Ch. 15A, *Formation of Limited Partnerships*, § 15A.220].

(4) Copy of partnership agreement and any amendments to agreement.

(5) A personal affidavit (Form ABC-208A) [*see § 18.224*] and personal financial affidavit (Form ABC-208B) [*see § 18.225*] for each general partner and any limited partner owning 10 percent or more of the capital and profits of the partnership and the spouse of each partner required to submit a personal affidavit.

NOTE:

If any of these persons is an entity, it must submit forms required of that entity, and each entity in the chain of title until reaching ownership by actual persons or by a publicly traded entity.

Natural persons who are general partners; officers, directors, or 10% or more owners of general partners and spouses of owners; limited partners; officers, directors, or 10% or more owners of limited partners and spouses of limited partners will be asked to submit fingerprints to the ABC after the application has been filed [*see* *4 Cal. Code Reg. § 57*]. Out-of-state spouses who take no part in the

management of the business may receive waivers of this requirement.

d. If applicant is a limited liability company [*see* ABC Form 279 (pre-application checklist)]:

(1) Form ABC-256-LLC [*see § 18.228*].

(2) Copy of articles filed with Secretary of State [*see Ch. 12C, Limited Liability Companies, §§ 12C.200, 12C.200A*].

(3) For foreign LLC's, copy of certificate to do business in California [*see Ch. 12C, Limited Liability Companies, § 12C.204* (application for registration in California)].

(4) Copy of operating agreement [*see Ch. 12C, Limited Liability Companies, § 12C.220* et seq].

(5) A personal affidavit (Form ABC-208A) [*see § 18.224*] and personal financial affidavit (Form ABC-208B) [*see § 18.225*] for each member or, if the company is managed by a manager or managers, for each manager and any member holding 10 percent or more of the voting power of the company and the spouse of each member required to submit the personal affidavits.

NOTE:

If any of the above persons is an entity, it must submit forms required of that entity, and each entity in the chain of title until reaching ownership by actual persons or by a publicly traded entity.

Persons who must submit a personal affidavit will be asked to submit fingerprints to the ABC after the application has been filed. Out-of-state spouses who take no part in the management of the business may receive waivers of this requirement [*see 4 Cal. Code Reg. § 57*].

e. If applicant is a general partnership, copy of partnership agreement [*see* Ch. 15, Part A, *Formation of General Partnerships*].

f. Evidence of ownership or tenancy by buyer of premises to which license will be transferred.

NOTE:

The ABC will not transfer a license to any person unless that person (1) owns or otherwise has possession or control (or a right to possession or control) of the premises for which he or she is applying for a license, and (2) can produce an instrument in writing (or other clear and convincing proof) showing possession or control [*4 Cal. Code Reg. § 60(m)*]. The ABC has indicated that this information will not necessarily be required at the time of application, but will be required prior to approval of a transfer application.

g. If buyer is purchasing franchised business, copy of franchise agreement.

NOTE:

The ABC has indicated that this information will not necessarily be required at the time of application, but will be required prior to approval of a transfer application.

h. Certified copy of recorded notice of intended transfer [*see Bus. & Prof. Code § 24073*; § 18.210 (ABC-227); *see also § 18.123*].

NOTE:

The ABC requires an extra copy of the notice to be submitted with the certified copy [*see* *§ 18.210* (ABC-227)].

i. Application Questionnaire (ABC-217).

j. Form ABC-257, the diagram of premises showing exact location of clearly identifiable tangible boundaries of area in which alcoholic beverages will be sold, served, or consumed pursuant to license [*see 4 Cal. Code Reg. § 64.2*] and hours of operation and other details of buyer's business plan on the back.

k. If buyer or seller is fiduciary, proof of status (for example, death certificate or letters testamentary).

l. If the license will be transferred to premises under construction [*see Bus. & Prof. Code § 24044*]:

(1) Copy of building plans or sketch of floor plan.

(2) Copy of construction contract or letter from contractor.

4. Calculate amount of transfer fee to be paid upon filing transfer application [*see Bus. & Prof. Code § 24072*].

NOTE:

The transfer fee for transfer of a retail alcoholic beverage license from one person to another person in the same county is 50 percent of the original fee for the license, not to exceed $1,250. If there is no original fee for the type of license being transferred, the fee is $100 [*Bus. & Prof. Code § 24072(b)*; *see* *Bus. & Prof. Code § 23320* (schedule of fees)]. The ABC imposes a separate fee for transfer of a license from one premises to another [*see* *Bus. & Prof. Code § 24072(c)*] and for transfer of an off-sale general license from one county to another [*see* *Bus. & Prof. Code § 24072(d)*].

The fee for transfer of an on-sale or off-sale retail license from the licensee to the licensee and his or her mother, father, son, or daughter, when no consideration is given for the transfer, is half of the regular fee for transfer of a license from a licensee to another person [*Bus. & Prof. Code § 24072(e)*].

If the license being transferred is an off-sale general license, the ABC also charges the buyer a pro rata portion of the annual business practices fee to cover the cost of investigating unfair business practices by retail and wholesale alcoholic beverage dealers [*see* *Bus. & Prof. Code § 23053.5*].

5. Advise parties regarding time required for ABC decision on transfer:

NOTE:

On receipt of the application, the ABC assigns an investigator to determine whether the license should be issued [*Bus. & Prof. Code § 23958*]. Because of the delay between filing and a final decision, applicants should exercise caution with respect to extensive financial commitments or plans for a grand opening of the business.

a. ABC cannot transfer license for at least 30 days after mailing notice of application to local law enforcement agencies [*see Bus. & Prof. Code § 23987*; *see also § 18.41[9]*].

b. Most investigations take approximately 55-65 days.

c. If valid protest is filed during 30-day posting period [*see Bus. & Prof. Code § 23985*; *see also § 18.127*], ABC decision may take 95 days or longer.

6. Advise buyer to take following actions within 30 days after filing transfer application for retail license limited in numbers [*see Bus. & Prof. Code §§ 23815-23827* (limitation on number of licensed premises); *see also § 18.30*], off-sale or on-sale beer and wine license, on-sale beer public premises license, or on-sale general license for seasonal business [*Bus. & Prof. Code § 24074.3*]:

a. File completed Form ABC-226, "Statement Re Consideration Deposited in Escrow" [*Bus. & Prof. Code § 24074.3*; *see § 18.242*].

NOTE:

This form is an affidavit in which the applicant states under penalty of perjury that the purchase price or consideration set forth in the escrow agreement and contract of sale has been deposited with the escrow holder [*Bus. & Prof. Code § 24074.3*]. The escrow agent also signs it to indicate receipt of the consideration and forwards it to the ABC. Although the ABC may extend the 30-day period for good cause, it will not transfer the license until it has received the affidavit [*Bus. & Prof. Code § 24074.3*].

b. Submit copies of statement to seller and escrow holder [*Bus. & Prof. Code § 24074.3*].

7. If seller is transferring license and business, and buyer wishes to obtain temporary permit [*see Bus. & Prof. Code § 24045.5*]:

NOTE:

The permit allows the buyer to operate the premises while the transfer application is pending [*see Bus. & Prof. Code § 24045.5*]. In addition, it allows the seller to close the business and file the final sales and unemployment insurance returns prior to the time the ABC approves transfer of the license [***see § 18.129***].

a. Have seller sign License Transfer Request (Form ABC-211-A) in section indicating approval of issuance of temporary permit [*see § 18.220*].

NOTE:

In order for the ABC to issue the permit, the premises must have been operated under a license within 30 days of the date the buyer files his or her application for the temporary permit [*Bus. & Prof. Code § 24045.5(a)*].

b. Have buyer submit with application:

(1) Temporary permit fee [*Bus. & Prof. Code § 24045.5(d)*].

(2) Seller's request for surrender of license [*see § 18.220*].

(3) Proof of buyer's right of occupancy of premises during pendency of transfer application [*4 Cal. Code Reg. § 60(m)*].

(4) Buyer's statement under penalty of perjury that he or she has discharged all current obligations and that all outstanding checks issued in payment for alcoholic beverages will be honored on presentation [*Bus. & Prof. Code § 24045.5*; *see § 18.223*].

c. Inform buyer that issuance of temporary permit authorizes buyer to sell alcoholic beverage to same extent as under license for which he or she has applied [*Bus. & Prof. Code § 24045.5*].

d. On issuance of temporary retail permit:

(1) Have buyer obtain, before commencing business:
(a) Sales tax permit from State Board of Equalization.

(b) Employer's identification number from Employment Development Department.

(c) Federal employer's number from Internal Revenue Service.

(2) Have buyer comply with special federal occupational tax requirements [*I.R.C. § 5142*; 27 C.F.R. § 194.102].

NOTE:
For coverage of these requirements, see *§ 18.166*.

(3) Have buyer and seller take inventory of stock in trade and merchandise immediately before buyer commences business operations under temporary permit.

NOTE:
If the ABC subsequently denies the application for transfer, the parties will need to take inventory again before the seller takes back operation of the business [*see § 18.132[2][b]*].

(4) Advise buyer that while operating under temporary permit, he or she must pay in cash or check for all alcoholic beverages before or at the time of their delivery [*Bus. & Prof. Code § 24045.5*].

NOTE:
A temporary retail permit holder who also holds one or more retail licenses and is operating under the retail license or licenses in addition to the temporary permit, and who is not delinquent on any payments for alcoholic beverages [*see Bus. & Prof. Code § 25509*], may buy alcoholic beverages on credit under the temporary permit [*Bus. & Prof. Code § 24045.5*].

(5) Have seller deliver operation and possession of the business to buyer.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.127

AUTHOR: Lynne Carmichael

§ 18.127 Giving Notice of Application

NOTE:

The buyer must give the notices set forth in this section after filing the transfer application [*see* *Bus. & Prof. Code §§ 23985, 23985.5, 23986*]. However, this notice requirement does not apply to an exchange of an on-sale general license for a special on-sale general license [*Bus. & Prof. Code § 24072.5*]. The ABC is responsible for giving notice of the application to law enforcement authorities in the area where the premises are located [*Bus. & Prof. Code § 23987*].

1. Obtain Form ABC-207-B, "Public Notice of Application for Ownership Change," and take following actions [*Bus. & Prof. Code § 23985*; *4 Cal. Code Reg. § 109*]:

NOTE:

The ABC provides the notice, which is two feet long and 14 inches wide, at the time that the buyer files the transfer application [*see* *4 Cal. Code Reg. § 109*].

a. Date and post notice [*4 Cal. Code Reg. § 109*]:

PRACTICE TIP:

The ABC suggests that the buyer post the notice and file an affidavit of posting [*see § 18.241*] within five days from the application date [*see § 18.241* (ABC-293)]. However, this is only a recommendation; the buyer may wait longer than five days to post. *Commentary by Lynne Carmichael.*

(1) If premises are already constructed, post in conspicuous place that can be readily observed by ordinary passersby at or near entrance to premises.

(2) If premises consist of vacant lot:
(a) Mount notice on heavy cardboard or wood backing.

(b) Affix notice to post or stake of permanent material.

(c) Post notice at midpoint of largest boundary of lot fronting on public thoroughfare, not more than 10 feet from sidewalk (or roadway if there is no sidewalk), so that it is readily visible from sidewalk (or roadway).

b. Ensure that notice remains posted for at least 30 consecutive days [*Bus. & Prof. Code § 23985*; *4 Cal. Code Reg. § 109*].

c. File affidavit of posting with ABC [*see § 18.241*].

NOTE:

Because the ABC does not pursue its investigation and will not issue a license for the premises unless the applicant has complied with the posting requirement, the buyer must notify the ABC of the date the notice is first posted [*Bus. & Prof. Code § 23985*]. If the buyer delays in posting and returning the posting affidavit, the ABC's investigation will be delayed.

2. Mail notice of application to every *resident* of real property within 500-foot radius of premises, and submit proof of compliance to ABC [*Bus. & Prof. Code § 23985.5*].

NOTE:

The requirement that a buyer mail notice of application and submit proof of compliance only applies to premises that are not currently licensed, or that are currently licensed under a different type of license than is the subject of the application [*Bus. & Prof. Code § 23985.5*].

3. If local jurisdiction provides list of property owners, mail notice of application to every *owner* of real property within a 500-foot radius of premises and submit proof of compliance to ABC [*Bus. & Prof. Code § 23985.5(a)*].

NOTE:

This requirement only applies if the local jurisdiction where the license is to be issued provides a list of the names and addresses of the real property owners to the buyer free of charge [*Bus. & Prof. Code § 23985.5(b)*].

4. If license being transferred is on-sale license [*Bus. & Prof. Code § 23986(a)*]:

NOTE:

An on-sale license for premises in an area with an undue concentration of licenses is subject to additional requirements [*see* *Bus. & Prof. Code § 23986(b)*; ***see also* P 5, ***below***].

a. Obtain and complete Form ABC-207-D [*see § 18.240*], "Notice of Application for Change in Ownership of Alcoholic Beverage License."

b. Within 10 days after buyer files transfer application, publish notice once in newspaper of general circulation (other than legal or professional trade publication) [*see Gov. Code § 6061*]:

(1) In city where premises are located; or

(2) In city nearest premises where business will be conducted, if premises are not in a city.

c. File affidavit of publication with district office of ABC at which buyer filed application.

NOTE:

Newspapers typically send an affidavit of publication directly to the district office. An ABC employee will prepare the affidavit if the buyer brings in proof that the notice has been published as required. The ABC will not issue the license until this affidavit is filed [*Bus. & Prof. Code § 23986*].

5. If license being transferred is on-sale or off-sale license for premises located in census tract that has undue concentration of licenses [*Bus. & Prof. Code § 23986(b)*]:

NOTE:

An undue concentration of licenses, in the case of on-sale retail license applications, exists when the ratio of on-sale retail licenses to population in the census tract or census division in which the applicant premises are located exceeds the ratio of on-sale retail licenses to population in the county in which the applicant premises are located [*Bus. & Prof. Code § 23958.4(a)(2)*; *4 Cal. Code Reg. § 61.3(a)(1)*]. In the case of off-sale retail license applications, an undue concentration exists when the ratio of off-sale retail licenses to population in the census tract or census division in which the applicant premises are located exceeds the ratio of off-sale retail licenses to population in the county in which the applicant premises are located [*Bus. & Prof. Code § 23958.4(a)(3)*; *4 Cal. Code Reg. § 61.3(a)(2)*].

Although the ABC may deny an application if issuance (original issuance, upgrade of licensed privileges at a previously licensed premises or transfer to a previously unlicensed premises) would result in an undue concentration of licenses [*see* *Bus. & Prof. Code § 23958*; ***see also* *§ 18.52[1]*], it will nonetheless issue a license despite undue concentration under these criteria if the applicant is able to show that public convenience or necessity would be served by issuance [*4 Cal. Code Reg. § 61.3(a)*].

a. Publish notice of application once a week for three consecutive weeks in newspaper of general circulation (other than a legal or trade publication) [*see Gov. Code § 6063*]:

(1) In city where premises are located; or

(2) In city nearest premises where business will be conducted, if premises are not in a city.

b. File affidavit of publication with ABC.

Legal Topics:

For related research and practice materials, see the following legal topics:

Business & Corporate LawCorporationsGovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.128

AUTHOR: Lynne Carmichael

§ 18.128 Handling Creditor Claims

NOTE:

The procedures in this section apply when the parties use an escrow to effectuate the transfer [*see* *§ 18.110[4]*]. The parties should set forth these procedures in the instructions to the escrow holder [***see*** *§§ 18.151*, *18.201*].

1. Ensure that escrow holder sends written acknowledgment to creditor within 10 days after receiving claim [*see Bus. & Prof. Code § 24074.1*].

NOTE:

The notice of intended transfer [*Bus. & Prof. Code § 24073*; *see* *§§ 18.123*, *18.210*] is designed to alert creditors that the seller is planning to transfer the license (and business), and to permit them to take whatever steps may be necessary to protect their interests [***see*** Form ABC-227 INSTR p. 1 (NEW 9/99); § 18.210]. They may submit a claim to the escrow holder identified in the notice for amounts owed by the seller. Every claim filed by a bona fide creditor before the ABC has notified the escrow holder that the transfer is approved is entitled to full or pro rata payment from the buyer's deposited purchase price [***see*** *Bus. & Prof. Code § 24074*; ***see also*** *§ 18.131*].

2. Have escrow holder submit each creditor claim to seller for approval or rejection [*see Bus. & Prof. Code § 24074*].

3. Ensure that escrow holder notifies claimant of each claim that seller disputes [*Bus. & Prof. Code § 24074*; *see § 18.131[5]*]:

a. That seller has disputed claim.

b. That amount otherwise payable will be retained for 25 days after transfer.

c. That if not attached, amount will be paid to seller.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGovernmentsState & Territorial GovernmentsLicensesReal Property LawPurchase & SaleEscrow



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.129

AUTHOR: Lynne Carmichael

§ 18.129 Satisfying Seller's Tax Obligations

NOTE:

The ABC will not transfer an alcoholic beverage license when the seller is delinquent in the payment of taxes imposed by state law, if the tax liability arises partially or completely from the exercise of the privileges of the license [*Bus. & Prof. Code § 24049*; *4 Cal. Code Reg. § 68.2*; *see § 18.51[1]*].

1. Prepare requests for tax clearances from Board of Equalization (BOE) and Employment Development Department (EDD), as applicable.

NOTE:

For the procedures used to request a tax clearance certificate from the BOE with respect to sales taxes [*Rev. & Tax. Code §§ 6811, 6812*], and from the EDD with respect to employment taxes [*Unemp. Ins. Code § 1732(a)*], see Ch. 17, *Buying and Selling a Business or Professional Practice* .

2. After seller transfers operation of business to buyer, or discontinues operation of business if transferring license only, have seller satisfy any outstanding tax obligations.

NOTE:

For applicable procedures regarding sales and employment taxes, see Ch. 17, *Buying and Selling a Business or Professional Practice* . Note, however, that unlike the sale of other types of businesses, the seller normally will not pay any sales tax on personal property (furniture, fixtures and equipment) due as a result of the sale at this time. Instead,

the buyer will deposit the sales tax on the sale of the business personal property in the escrow along with the rest of the consideration for the business and license. The escrow agent will notify the BOE of the pending sale and request a tax clearance certificate to protect the buyer from successor liability for the seller's tax obligations. Because the seller has filed its final sales tax return for the business, but has not paid the sales tax due, the BOE will give the escrow holder a notice of any amounts due from the seller, which will include the sales tax due on the sale of the business. The notice provides for a "conditional release" of the buyer if the stated amount is paid to the BOE from the escrow. If the transfer is not approved by the ABC, this procedure allows the seller simply to file an amended final sales tax return deleting the amount of tax shown to be due from the sale.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGovernmentsState & Territorial GovernmentsLicensesTax LawState & Local TaxesUse TaxImposition of Tax



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.130

AUTHOR: Lynne Carmichael

§ 18.130 Closing the Sale

NOTE:

These procedures apply when the parties use an escrow to effectuate the transfer [*see* *§ 18.110[4]*]. The parties should set forth these procedures in the escrow instructions [***see* *§ 18.151***; ***see also* *§ 18.201***].

1. Ensure that parties make the following deposits into escrow:

a. Have seller deposit any instruments required to transfer business property from seller to buyer [*see § 18.122[3]*].

b. Have buyer deposit any instruments evidencing or securing payment of purchase price [*see § 18.103[4]*].

2. Have escrow holder keep escrow open until notification from ABC that nothing prevents transfer except delinquencies for taxes under any of following laws [*see Bus. & Prof. Code §§ 24049, 24074*]:

NOTE:

The escrow must remain open until the ABC approves the qualifications of the buyer and premises [*see* Form ABC-227 INSTR at 2, (NEW 9/99); § 18.210]. The taxing agencies give notice to the ABC of any tax delinquencies for licensees. Upon receipt of a delinquency notice, the ABC attaches the original notice to the licensee's file. When the licensee files an application to transfer the license to another person, the ABC returns a duplicate to the taxing agency [*4 Cal. Code Reg. § 68.2(1)*]. The taxing agency must then demand the delinquent amount from the licensee within 30 days after receiving

notice of the transfer application, and must give notice of the demand to the escrow holder and the buyer. If the agency fails to make a demand within this time, the ABC may proceed to transfer the license [*4 Cal. Code Reg. § 68.2(2)*]. The ABC sends a notice (Form ABC-202-A) to the escrow holder when nothing prevents approval of a license transfer except delinquent taxes [***see** § 18.51[1]*].

a. Alcoholic Beverage Tax Law [*Rev. & Tax. Code § 32001 et seq.*].

b. Sales and Use Tax Law [*Rev. & Tax. Code § 6001 et seq.*].

c. Personal Income Tax Law [*Rev. & Tax. Code § 17001 et seq.*].

d. Corporation Tax Law [*Rev. & Tax. Code § 23001 et seq.*].

e. *Rev. & Tax. Code §§ 134, 405(b)*, regarding tax on unsecured property.

f. Unemployment Insurance Code.

3. Ensure that escrow holder, upon receipt of tax delinquency notices, takes all of following actions [*4 Cal. Code Reg. § 68.2*]:

a. Demands payment of any demand promissory notes from buyer [*see § 18.201*].

b. Pays from escrow funds amount demanded from taxing agencies for any tax delinquencies.

NOTE:
Payment of state tax delinquencies is a prerequisite to transfer of the license [*see *Bus. & Prof. Code §§ 24049, 24074*; ***see also** § 18.51[1]*].

c. Sends notice of payment to ABC main office in Sacramento.

NOTE:
When a taxing agency demands payment from a licensee [*see (b), ***above***], it must also include a form (in duplicate) to be completed by the person paying the tax delinquency. After that person (usually the escrow holder) has paid the amount owed to the agency, he or she sends the original of that form, which states that the delinquency has been cleared, to the main ABC office, and keeps the duplicate copy [***see** 4 Cal. Code Reg. § 68.2(3)*].

4. When escrow holder receives notice from ABC that it has transferred license, ensure that escrow holder does the following:

NOTE:
The ABC will send Form ABC-226 [*see § 18.242*, § III of the Form] to the escrow holder as confirmation that it has transferred the license.

a. Delivers any instruments evidencing transfer of business assets to buyer.

NOTE:
For further coverage, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

b. Forwards any financing statements representing security given for payment of any promissory notes to Secretary of State [*see Com. Code § 9501(a)(2)*].

c. Records any instruments conveying real property or occupancy of real property, in recorder's office for county where premises are located.

d. Forwards any fixture filing to appropriate filing office [*see Com. Code § 9501(a)(1)(B), (2)*; *Com. Code § 9334* (priority of security interest in fixtures)].

NOTE:

There are two ways in which a secured party may file a financing statement to perfect a security interest in goods that are or will become fixtures. A secured party may file in the Division 9 records, as with most other goods [*see* *Com. Code § 9501(a)(2)*; *Com. Code § 9501* (UCC Comment P 4); ***see also* Ch. 42, ***Secured Transactions***]. In these circumstances, the secured party files in the office of the Secretary of State [***see*** *Com. Code § 9501(a)(2)*]. Alternatively, a secured party may file the financing statement as a "fixture filing" [***see*** *Com. Code § 9501(a)(1)(B)*]. A fixture filing is the filing of a financing statement covering goods that are or will become fixtures and satisfying *Com. Code § 9502(a), (b)* [*Com. Code § 9102(a)(40)*; ***see*** *Com. Code § 9102(a)(41)* ("fixtures" defined)]. Filing is in the office in which the record of a mortgage on the related real estate would be filed [***see*** *Com. Code § 9501(a)(1)(B)*].

A financing statement that is filed as a fixture filing must satisfy conditions in addition to those required of a standard financing statement [*see* *Com. Code § 9502(b)*; ***see also* *Com. Code § 9334* (priority of security interests in fixtures)]. For further discussion of these issues, see Ch. 42, ***Secured Transactions*** .**

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsReal Property LawPurchase & SaleEscrow



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.131

AUTHOR: Lynne Carmichael

§ 18.131 Distributing Sales Proceeds

NOTE:

These procedures apply when the parties use an escrow to effectuate the transfer [*see § 18.110[4]*]. The parties should set forth these procedures in the instructions to the escrow holder [***see § 18.151***; ***see also § 18.201***].

1. Ensure that escrow holder, within 10 days after transfer of license [*Bus. & Prof. Code § 24074.1*]:

a. Determines whether consideration remaining in escrow is sufficient to pay in full all timely creditor claims.

NOTE:

To be eligible for payment, a creditor must file his or her claim with the escrow holder before the escrow holder receives notice that the transfer is approved [*Bus. & Prof. Code § 24074*].

b. If funds are insufficient to pay all creditor claims in full, determines pro rata amount payable on each claim, in accordance with order of priorities specified in P 4, *below*.

c. Gives notice, to each creditor who has filed timely claim, regarding the following [*see § 18.243*]:

(1) Whether there are sufficient assets in the escrow to pay all creditors in full.

(2) Date on or before which claims will be paid, if assets remaining in escrow are

sufficient to pay all creditors in full.

(3) All of following, if assets remaining in escrow are insufficient to pay all creditors in full:

(a) Total assets placed in escrow and nature of each asset;

(b) Name of each creditor who filed claim, and amount of each claim;

(c) Amounts proposed to be paid or set aside for each creditor; and

(d) Date on or before which assets will be distributed to creditors.

2. Have escrow holder set aside and retain for 25 days after transfer amount otherwise payable on claims disputed by seller [*Bus. & Prof. Code § 24074*; *see § 18.128* (handling creditor claims)].

3. If consideration in escrow is sufficient, ensure that escrow holder pays in full, within reasonable time after transfer of license, all timely claims that seller has approved or failed to dispute in writing [*Bus. & Prof. Code § 24074*].

4. If consideration in escrow is insufficient, ensure that escrow holder distributes funds, within reasonable time after transfer of license, in following order [*Bus. & Prof. Code § 24074*]:

a. First, to United States for claims based on income or withholding taxes; and thereafter for claims based on any other taxes not specified in *Bus. & Prof. Code § 24049* [*see § 18.130[2]*].

NOTE:

The California Supreme Court has held that any United States tax lien for taxes owed by the seller is a lien on the sale proceeds that has priority over, and must be paid before payment of, the claims of any other ordinary creditors of the seller. The only claims against the seller to which the United States tax lien is not superior is the claim of the State of California for the delinquent taxes described in *Bus. & Prof. Code § 24049* [*Business Title Corp. v. Division of Labor Law Enforcement (1976) 17 Cal. 3d 878, 887-889, 132 Cal. Rptr. 454, 553 P.2d 614]* .

b. Second, to payment of claims for wages, salaries, or fringe benefits of employees of seller earned or accruing prior to sale, transfer, or opening of escrow.

c. Third, to payment of claims of secured creditors, to extent of proceeds arising from sale of security.

d. Fourth, to payment of claims on mechanics' liens.

e. Fifth, to payment of escrow fees and payment of claims for prevailing brokerage fees for services rendered and claims for reasonable attorneys' fees for services rendered.

f. Sixth, to payment of following:

(1) Claims for goods sold and delivered to seller for resale at his or her licensed premises.

(2) Claims for services rendered, performed, or supplied in connection with operation of

licensed business.

(3) Claims of landlord, to extent of proceeds on past due rent.

g. Seventh, to payment of other claims that have been reduced to court-ordered judgments, including claims for court-ordered support of minor child.

h. Eighth, to payment of all other claims.

5. With respect to disputed claims, ensure that escrow holder takes following actions [*Bus. & Prof. Code § 24074*]:

a. If creditor serves writ of attachment for retained amount during 25-day period, answers writ of attachment in manner required by law and retains that amount until final settlement and discharge of writ.

b. If creditor does not serve writ of attachment during the 25-day period, pays the retained amount to seller.

6. Have escrow holder pay any remaining consideration to seller.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsReal Property LawPurchase & SaleEscrow



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
C. Procedural Guide

8-18 California Legal Forms--Transaction Guide § 18.132

AUTHOR: Lynne Carmichael

§ 18.132 Procedures on Denial of License Transfer

1. Pursue all applicable administrative remedies to contest denial.

NOTE:
For examples of applicable forms, see California Forms of Pleading and Practice, Ch. 18, *Alcoholic Beverage Licenses* (Matthew Bender).

2. If transfer is ultimately denied:

a . Have parties pay costs and expenses incurred in attempted performance of contract of sale.

b. If buyer was operating business under temporary permit [*Bus. & Prof. Code § 24045.5*; *see § 18.126[7]*], take inventory of stock in trade and merchandise remaining on premises.

c. Ensure that buyer receives money deposited into escrow, less any required payments to seller or escrow holder.

d. Instruct escrow holder to return all instruments deposited by either party into escrow.

Legal Topics:

For related research and practice materials, see the following legal topics:
GovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
D. Drafting Guide to Sales Contracts and Related Forms

8-18 California Legal Forms--Transaction Guide

AUTHOR: Lynne Carmichael

NOTE:

Section 18.150 is a drafting guide to a contract for the sale of a retail alcoholic beverage license and business that is subject to both the Alcoholic Beverage Control Act [*Bus. & Prof. Code § 23000 et seq.*] and the Bulk Sales Division of the Commercial Code [*Com. Code §§ 6101-6111*]. Section 18.151 is a drafting guide to escrow instructions for such a sale. Section 18.152 is a drafting guide to a contract for the sale of a retail alcoholic beverage license only.

For a general guide to drafting contracts, see the Transaction Guide in Ch. 75, *Formation of Contracts and Standard Contractual Provisions*.



57 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
D. Drafting Guide to Sales Contracts and Related Forms

8-18 California Legal Forms--Transaction Guide §§ 18.133-18.149

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.133[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
D. Drafting Guide to Sales Contracts and Related Forms

8-18 California Legal Forms--Transaction Guide § 18.150

AUTHOR: Lynne Carmichael

§ 18.150 Contract for Sale of License and Business

NOTE:
For an example and discussion of this type of contract, see *§ 18.200*.

1. Include following provisions regarding purchase and sale of business:

a. Name of each party to agreement and his or her capacity [*see § 18.200,* Recitals].

NOTE:
All contracts must contain the consent of parties capable of contracting [*Civ. Code § 1550*; *see* *Civ. Code §§ 1565-1590*]. If one of the parties is an entity, the contract should also include its form of organization and principal place of business.

b. Description of property to be sold [*see § 18.200,* P 1].

NOTE:
The parties should also specifically identify any business assets that are not being sold.

c. Condition of tangible property [*see § 18.200,* P 2].

d. Amount of purchase price [*see § 18.200,* P 3].

NOTE:
For a discussion of statutory restrictions on the total purchase price imposed on certain transfers

of general retail licenses [*see* *Bus. & Prof. Code §§ 24070(d), (e), 24079*], see *§ 18.30[4]*.

e. Allocation of purchase price in following manner [*I.R.C. § 1060(a)*; *Treas. Reg. §§ 1.338-6, 1.338-7*, 1.1060-1(c)(2); *see § 18.200*, P 4]:

NOTE:

These special allocation rules apply to a transfer in which (1) the assets constitute a trade or business, and (2) the buyer's basis in the assets is determined wholly by reference to the consideration paid for the assets [*I.R.C. § 1060(c)*; *see* Ch. 17, *Buying and Selling a Business or Professional Practice*]. The parties must also report the allocations on IRS Form 8594 when filing their income tax returns for the year in which the sale occurred [***see** I.R.C. § 1060(b)*; Treas. Reg. § 1.1060(e); ***see also** § 18.162*]. To the extent that the parties agree in writing as to the allocation of any consideration, or as to the fair market value of any of the transferred assets, the parties are bound by the terms of the agreement unless the IRS determines that the allocation (or fair market value) is not appropriate [*I.R.C. § 1060(a)*].

(1) First, to cash and general deposit accounts, including savings and checking accounts ("Class I Assets") [*Treas. Reg. §§ 1.338-6(b)(1), 1.1060-1(c)(2)]*.

(2) Second, to actively traded personal property [*see I.R.C. § 1092(d)(1)*; *Treas. Reg. § 1.1092(d)-1*, but without regard to *I.R.C. § 1092(d)(3)*] and certificates of deposit and foreign currency, even if they are not actively traded personal property, and to U.S. Government securities and publicly traded stock, other than certain stock of target affiliates ("Class II Assets") [*Treas. Reg. §§ 1.338-6(b)(2)(ii), 1.1060-1(c)(2)*].

(3) Third, to assets that are marked to market at least annually for Federal income tax purposes and debt instruments, including accounts receivable, mortgages, and credit card receivables from customers that arise in the ordinary course of business ("Class III Assets") [*Treas. Reg. §§ 1.338-6(b)(2)(iii), 1.1060-1(c)(2)*].

NOTE:

Note that Class III assets do not include debt instruments issued by persons related to the target at the beginning of the day following the acquisition date, certain contingent debt instruments [*see* *Treas. Reg. §§ 1.1275-4*, 1.483-4; *I.R.C. § 988*] (but not those subject to the non-contingent bond method [***see** Treas. Reg. § 1.1275-4(b)*, 1.483-4], or which involve single nonfunctional currencies [***see** Treas. Reg. § 1.988-2(b)(2)(i)(B)(2)*]), or debt instruments convertible into the stock of the issuer or other property [*Treas. Reg. §§ 1.338-6(b)(2)(iii)*, 1.1060-1(c)(2)].

(4) Fourth, to stock in trade, inventory, and merchandise ("Class IV Assets") [*Treas. Reg. §§ 1.338-6(b)(2)(iv), 1.1060-1(c)(2)*].

(5) Fifth, to all assets that do not fall in any of the other six classes ("Class V Assets") [*Treas. Reg. §§ 1.338-6(b)(2)(v), 1.1060-1(c)(2)*].

(6) Sixth, to all *I.R.C. § 197* intangibles except goodwill and going concern value ("Class VI Assets") [*Treas. Reg. §§ 1.338-6(b)(2)(vi), 1.1060-1(c)(2); see I.R.C. § 197*], more specifically [*see I.R.C. § 197(d)*]:

(a) Workforce in place, including its composition and terms and conditions (contractual or otherwise) of its employment.

(b) Business books and records, operating systems, or any other information base (including lists or other information with respect to current or prospective customers).

(c) Any patent, copyright, formula, process, design, pattern, know-how, format, or other similar item.

(d) Any customer-based intangible [*see I.R.C. § 197(d)(2)*].

NOTE:

For purposes of this chapter, "customer-based intangible" includes market composition, market share, and any other value resulting from future provision of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with customers [*see* *I.R.C. § 197(d)(2)*].

(e) Any supplier-based intangible [*see I.R.C. § 197(d)(3)*].

NOTE:

"Supplier-based intangible" means any value resulting from future acquisitions of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with suppliers of goods or services to be used or sold by the taxpayer [*see* *I.R.C. § 197(d)(3)*].

(f) Any item similar to those listed in PP (a)-(e), *above*.

(g) Any license, permit, or other right granted by a governmental unit or agency.

(h) Any covenant not to compete, or other arrangement that has substantially the same effect as a covenant not to compete, entered into in connection with a direct or indirect acquisition of an interest in all or a substantial portion of a trade or business.

(i) Any franchise, trademark, or trade name.

(7) Seventh, to goodwill and going concern value (whether or not the goodwill or going concern value qualifies as a Section 197 intangible) ("Class VII Assets") [*Treas. Reg. §§ 1.338-6(b)(2)(vii), 1.1060-1(c)(2)*].

NOTE:

For a discussion of the amount of the purchase price that the ABC will treat as allocated to goodwill for certain transfers of general retail licenses [*see* *Bus. & Prof. Code § 24079*], see *§ 18.30[4]*.

f. With respect to allocation of purchase price [*see* Treas. Reg. § 1.1060(e); (seller and purchaser must report allocation to IRS); *see also* P e, *above*; *§ 18.200*, P 4]:

(1) Acknowledgment of both parties that value allocated to each asset represents fair market value determined in arm's-length negotiation.

(2) Statement that each party has had tax consequences of allocations explained to him or her by tax attorney or other advisor.

(3) Agreement by each party to report allocations as set forth in contract of sale to IRS [*see § 18.162*].

g. Manner of payment [*see § 18.103[3]*; *see also § 18.200,* P 5].

NOTE:

The contract of sale in § 18.200 provides alternatives for payment in cash, or partial payment in cash and execution of a promissory note and security agreement.

h. Security for any notes given [*see § 18.200,* P 6].

i. Time and manner of taking inventory of all stock in trade, merchandise, and other tangible assets [*see § 18.200,* P 7].

j. If applicable [*see § 18.112*], statement that sale must be conducted in accordance with Bulk Sales Division of Commercial Code, to extent applicable [*see Com. Code §§ 6101-6111*; § 18.200, P 9].

NOTE:

For a discussion of the extent to which the Bulk Sales Division applies to the sale of a retail alcoholic beverage license and business, see *§ 18.10[3]*. For detailed discussion of the Bulk Sales Division, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

k. Time and place of sale [*see § 18.200,* P 10].

l. Requirement that parties file transfer application [*see § 18.200*] and take all actions required to facilitate transfer [*see § 18.200,* P 11].

m. Conduct of business prior to sale [*see § 18.200,* P 12].

n. Manner in which parties will bear risk of loss [*see § 18.200,* P 13].

o. Filing of application for temporary permit [*see § 18.200,* P 14].

NOTE:

This permit allows the buyer to conduct the business pending approval of the transfer application [*see* *Bus. & Prof. Code § 24045.5*; *discussion under § 18.50*].

p. Proration of business costs and expenses [*see § 18.200,* P 15].

NOTE:

Typical prorated expenses include property taxes, insurance premiums, salaries and related costs, and rent.

q. Requirement that parties open escrow prior to filing transfer application, and appoint escrow holder [*see Bus. & Prof. Code § 24074*; *see also § 18.200,* P 16].

r. Requirement that buyer deposit total purchase price into escrow prior to filing transfer application [*see Bus. & Prof. Code § 24074*; *see also § 18.200,* P 17].

NOTE:

The Alcoholic Beverage Control Act [*Bus. & Prof. Code §§ 23000 et seq.*] requires the buyer to deposit the full amount of the purchase price or consideration being paid for the license and business into escrow before filing an application for the transfer of the alcoholic beverage license [*Bus. & Prof. Code § 24074*]. Thus, unlike a contract for the sale of any other type of property, a contract for the sale of a retail alcoholic beverage license cannot provide that the buyer will pay a

portion of the purchase price on close of escrow.

s. Agreement to include statutory provisions regarding distribution of purchase price to creditors in escrow instructions to be drafted [*see Bus. & Prof. Code § 24074*; *see also § 18.200*, P 18].

t. Enumeration of costs and expenses of sale to be paid by each party [*see § 18.200*, P 19].

NOTE:

Typical costs and expenses of a sale include drafting and recording costs, sales taxes, and escrow, transfer, and recording fees.

u. Effect of denial of application for transfer of alcoholic beverage license [*see § 18.200*, P 20].

v. Seller's warranties [*see § 18.200*, P 21].

NOTE:

Typical representations cover ownership, marketable title, outstanding obligations, accuracy of books and records, and existence of pending litigation, as well as a representation regarding compliance with the Act.

w. Buyer's warranties [*see § 18.200*, P 22].

NOTE:

These representations should cover the buyer's eligibility for issuance of a license [*see* *Bus. & Prof. Code § 23952*].

x. Buyer's waiver of claims for damages based on representations other than those set forth in contract [*see § 18.200*, P 24].

y. Indemnity agreement of buyer and seller [*see § 18.200*, PP 23, 25].

NOTE:

Generally, the seller indemnifies the buyer for liabilities arising on account of the business prior to closing, and the buyer indemnifies the seller for liabilities arising thereafter.

2. Add following alternative contract provisions, as applicable:

NOTE:

These alternative provisions are set forth in Ch. 17, *Buying and Selling a Business or Professional Practice* .

a. Provision detailing seller's conduct of business pending closing [*see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.215*].

b. Provision for association of seller with business after sale [*see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.216*].

NOTE:

This type of provision should be added to a contract for the sale of a business or

professional practice when the buyer wants the seller to train him or her in the operation of the business, or when effective transfer of the business goodwill depends on continuing patronage of the current business clients.

c. Provision prohibiting the buyer's use of current business name or seller's name [*see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.217*].

NOTE:

The sale of the goodwill of a business does not include the right to use the name of any person from whom the business was acquired or the name under which the business is currently conducted, unless the seller specifically transfers the right to use that name [*see Bus. & Prof. Code §§ 14101, 14103*].

d. Noncompetition clause prohibiting seller from carrying on same or similar business in specified area or for specified time [*see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.213*].

NOTE:

Generally, a contract that restrains a person from engaging in a lawful profession, trade, or business of any kind is, to that extent, void in California [*Bus. & Prof. Code § 16600; see, e.g., Application Group, Inc. v. Hunter Group, Inc. (1998) 61 Cal. App. 4th 881, 900-902, 72 Cal. Rptr. 2d 73* (California law governed enforceability of noncompetition agreement in employment contract providing that Maryland law would govern contractual disputes)]. However, any person who sells the goodwill of a business, or any owner of a business entity selling or otherwise disposing of all of his or her ownership interest in the business entity, or any owner of a business entity that sells (1) all or substantially all of its operating assets together with the goodwill of the business entity; (2) all or substantially all of the operating assets of a division or a subsidiary of the business entity together with the goodwill of that division or subsidiary; or (3) all of the ownership interest of any subsidiary, may agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the business so sold, or that of the business entity, division, or subsidiary has been carried on, so long as the buyer, or any person deriving title to the goodwill or ownership interest from the buyer, carries on a like business within that area [*Bus. & Prof. Code § 16601*]. For additional discussion, see *Ch. 17, **Buying and Selling a Business or Professional Practice**, §§ 17.19, 17.213*.

e. If business being sold is subject to franchise agreement, any of following provisions that are appropriate:

(1) Statement that franchisor has first right and option to purchase business.

(2) Statement that sale to third party is subject to franchisor's consent.

(3) List of any conditions precedent to which franchisor's consent is subject.

f. Provision requiring seller to transfer and assign trademark or service mark to buyer [*see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.220*].

NOTE:

A federally registered trademark or service mark, or one for which an application to register has been filed, is assignable with the goodwill of the business in which the

mark is used, or with that part of the goodwill connected with the use of and symbolized by the mark [*15 U.S.C. § 1060*]. No application to register a mark under *15 U.S.C. § 1051(b)* is assignable prior to filing of a verified statement of use [*see* *15 U.S.C. § 1051(d)*], except to the applicant's business (or a portion of the business) to which the mark pertains, if that business is ongoing and existing [*15 U.S.C. § 1060*].

A trademark or service mark registered in California is assignable with the goodwill of the business in which the mark is used, or with that part of the goodwill connected with the use of and symbolized by the mark *Bus. & Prof. Code § 14220*].

g. Seller's warranty regarding absence of hazardous material in property being sold [*see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.214*].

3. Include following standard contractual provisions, as appropriate:

a. Statement that contract contains entire agreement of parties [*see § 18.200,* P 26; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.270*].

b. Right to modify and amend contract [*see § 18.200,* P 27].

NOTE:

Modification is usually only permitted with the written consent of both parties.

c. Provision for attorneys' fees and costs [*see § 18.200,* P 28]; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.252*].

NOTE:

Most written contracts contain a provision for attorneys' fees [*see* *Civ. Code § 1717* (prevailing party entitled to fees); *Code Civ. Proc. § 1021* (attorneys' fees awarded only when provided by contract or statute); ***see also* *Ch. 75,* ***Formation of Contracts and Standard Contractual Provisions****, § 75.252*].

d. Provision for arbitration of matters in controversy [*see § 18.200,* P 29; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.250*].

NOTE:

Arbitration is the submission for determination of a disputed matter to private unofficial persons selected in the manner provided by law or by the agreement of the parties [*Stockwell v. Equitable F. & M. Ins. Co. (1933) 134 Cal. App. 534, 540, 25 P.2d 873]* . For examples and discussion of arbitration clauses generally, see *Ch. 75, Formation of Contracts and Standard Contractual Provisions*, *§ 75.250*].

e. Manner of giving notice [*see § 18.200,* P 30; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.294*].

f. Assignment provisions [*see Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.280* et seq.; *see also* Ch. 76, *Assignments of Rights and Obligations*].

g. Statement that California law will govern agreement [*see § 18.200,* P 33; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.273*].

h. Incorporation by reference provision [*see § 18.200*, P 1 (incorporation of inventory of tangible business assets)].

NOTE:

The parties to a contract have the power to incorporate other documents by reference, and those documents need not be physically attached to the contract [***King v. Larsen Realty, Inc. (1981) 121 Cal. App. 3d 349, 357, 175 Cal. Rptr. 226]*** **.**

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsContracts LawSales of GoodsContracts LawTypes of ContractsGovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
D. Drafting Guide to Sales Contracts and Related Forms

8-18 California Legal Forms--Transaction Guide § 18.151

AUTHOR: Lynne Carmichael

§ 18.151 Escrow Instructions

NOTE:

For an example and discussion of escrow instructions, see *§ 18.201*. That form is intended for use with the contract of sale *set forth in § 18.200* [*see § 18.150*]. The party who handles the escrow is called the "escrow holder" or "escrow agent." If a commercial escrow or title company handles the escrow, however, it will normally require the parties to use its own printed escrow instructions.

1. Address instructions to escrow holder, if known, at escrow holder's business address [*see § 18.201*].

2. Include all of following provisions:

a. Preliminary recitals setting forth [*see § 18.201,* P 1]:
(1) Names of buyer and seller.

(2) Purpose of contract of sale.

(3) Proposed closing date.

b. Agreements by parties to indemnify, reimburse, and pay escrow holder [*see § 18.201,* P 2].

c. Addresses to which escrow holder should send notices to buyer and seller [*see § 18.201,* P 3].

d. Instruction to prepare, record, and publish notice required by Bulk Sales Division [*see Com. Code §§ 6103(c)(15), 6105(b); see also § 18.124; § 18.201,* P 4].

e. Instruction to prepare and record notice of intended transfer [*Bus. & Prof. Code § 24073*; *see § 18.123*; *see also § 18.201*, P 5].

NOTE:

For an example and discussion of this notice, see *§ 18.211*. For an example of this notice combined with the notice required by the Bulk Sales Division, and discussion, see *§ 18.212*.

f. Instruction to request sales tax clearance [*see Rev. & Tax. Code § 6812*; § 18.201, P 6].

NOTE:

For an example and discussion of the request form, see *Ch. 17, Buying and Selling a Business or Professional Practice*, *§ 17.300*.

g. Instruction to request unemployment insurance clearance [*see Unemp. Ins. Code § 1732*; § 18.201, P 7].

NOTE:

For an example and discussion of the request form, see *Ch. 17, Buying and Selling a Business or Professional Practice*, *§ 17.301*.

h. Instruction to send form UCC-11 to Secretary of State for certificate showing any financing statements naming seller as debtor [*see § 18.201*, § 8].

NOTE:

For an example and discussion of that form, see *Ch. 42, Secured Transactions*, *§ 42.216*.

i. Instruction regarding money and instruments to be received from buyer [*see § 18.201*, P 9].

j. Instruction regarding documents to be received from seller [*see § 18.201*, P 10].

k. Instruction to obtain inventory of stock in trade from persons taking inventory [*see § 18.201*, P 11].

l. Instruction to arrange for insurance policies and other transfer documents to be transferred to buyer [*see § 18.201*, P 12].

m. Instruction to send written acknowledgment to creditor within 10 days of receiving claim [*see Bus. & Prof. Code § 24074.1*; *§ 18.201*, P 13].

n. Instruction regarding submission of creditor claims to seller for approval or rejection [*see § 18.201*, P 13; § *18.128*].

o Instruction to notify claimant of each claim that seller disputes that [*Bus. & Prof. Code § 24074*; *§ 18.201*, P 13]:

(1) Seller has disputed claim.

(2) Amount otherwise payable will be retained for 25 days after transfer.

(3) If not attached, amount will be paid to seller.

p. Instruction to pay taxes specified in *Bus. & Prof. Code § 24049* [*see Bus. & Prof. Code § 24074*; *§ 18.201*, P 14].

NOTE:

The Department of Alcoholic Beverage Control may refuse to transfer any license if the seller is delinquent in the payment of any of those taxes, and the tax liability arises partially or completely from the exercise of the privileges of the license [*Bus. & Prof. Code § 24049*; *4 Cal. Code Reg. § 68.2*; *see § 18.51[1]*].

q. Instruction regarding determination of sale date as latest of [*see § 18.201*, P 15]:

(1) Date specified in notice of bulk transfer; or

(2) Date that ABC sends written notice that license transfer is approved.

r. Instruction regarding determination of amount of assets available for distribution to creditors [*see Bus. & Prof. Code § 24074*; *§ 18.201*, P 16].

s. Instruction to notify, within 10 days after transfer of license, each creditor who has filed a timely claim whether there are sufficient assets in escrow to pay all creditors in full, and [*Bus. & Prof. Code § 24074.1*; *§ 18.201*, P 17]:

NOTE:

Creditor claims are considered timely if they are filed before the ABC has notified the escrow holder that the license transfer is approved [*see Bus. & Prof. Code § 24074*].

(1) If so, date for distribution.

(2) If not:

(a) Total assets placed in escrow and nature of each asset;

(b) Name of each creditor who filed claim and amount of each claim;

(c) Amounts proposed to pay or set aside for each creditor; and

(d) Date for distribution to creditors.

t. Instruction regarding delivery of documents upon closing [*see § 18.201*, P 18].

u. Instruction regarding distribution of purchase price when proceeds are sufficient to pay all creditors in full [*see § 18.201*, P 19].

v. Instruction regarding distribution of purchase price when proceeds are insufficient to pay all creditors in full [*see § 18.201*, P 20].

NOTE:

The parties must instruct the escrow holder to distribute the funds in the order specified by statute [*Bus. & Prof. Code § 24074*; *see § 18.201[1][e][9]*].

w. Instruction regarding procedure when transfer application is denied [*see § 18.201*, P 21].

x. Prohibition on release of escrow funds in exchange for promissory note or consideration of less value [*see Bus. & Prof. Code § 24076*; *§ 18.201*, P 22].

y. Instructions regarding payment of escrow fees and costs [*see § 18.201*, P 23].

3. Include signature lines for buyer and seller.

4. Include signature line for escrow holder's acceptance and approval.

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsContracts LawTypes of ContractsReal Property LawPurchase & SaleEscrow



60 of 95 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
D. Drafting Guide to Sales Contracts and Related Forms

8-18 California Legal Forms--Transaction Guide § 18.152

AUTHOR: Lynne Carmichael

§ 18.152 Contract for Sale of License Only

NOTE:
For an example and discussion of this type of contract, see *§ 18.202[1]*.

1. Include following provisions regarding purchase and sale of license:

a. Name of each party to agreement and his or her capacity [*see § 18.202*, Recitals].

b. Description of license to be transferred [*see § 18.202*, P 1].

c. Total purchase price [*see § 18.202*, P 2].

NOTE:
For a discussion of statutory restrictions on the total purchase price imposed on certain transfers of general retail licenses [*see* *Bus. & Prof. Code §§ 24070(d), (e), 24079*], see *§ 18.30[4]*.

d. Manner of payment [*see § 18.202*, P 2].

NOTE:
The Alcoholic Beverage Control Act requires the buyer to deposit the full amount of the purchase price or consideration being paid for the license and business into escrow before filing an application for the transfer of the alcoholic beverage license [*Bus. & Prof. Code § 24074*; *see* *§ 18.202*, P 2]. Thus, unlike the contract for the sale of any other type of property, a contract for the sale of

a retail alcoholic beverage license cannot provide that the buyer will pay a portion of the purchase price on close of escrow. The contract in § 18.202 provides for payment in cash. For alternatives, see *§ 18.200*, P 5.

e. Time and place of sale, and appointment of escrow holder [*see Bus. & Prof. Code § 24074*; § 18.202, P 3].

f. Requirement that parties file transfer application [*see § 18.220-18.222*] and take all actions required to facilitate transfer [*see § 18.202*, P 4].

g. Requirement that parties deposit copy of contract into escrow [*see § 18.202*, P 5].

NOTE:

The parties'agreement on statutorily required order of distribution to creditors [*see § 18.131*] must be deposited into escrow [*Bus. & Prof. Code § 24074*].

h. Escrow instructions setting forth statutory requirements for distribution of sales proceeds and notices to creditors [*see Bus. & Prof. Code § 24074*; *§ 18.202*, P 6].

NOTE:

Escrow instructions can be incorporated into the underlying agreement so that the agreement itself serves as the instructions for the escrow that will be opened to implement it. For further discussion, see *§ 18.202[1][c][4]*. For general discussion of escrow instructions, see Ch. 26, *Real Property Escrows* .

i. Enumeration of costs and expenses of sale to be paid by each party [*see § 18.202*, P 7].

j. Effect of denial of application for transfer of alcoholic beverage license [*see § 18.202*, P 8].

k. Seller's and buyer's warranties [*see § 18.202*, PP 9, 10].

NOTE:

These warranties should contain representations that each party has not violated the Act [*see generally* Bus. & Prof. Code § 23000 et seq.], and that the buyer is eligible for issuance of a license [***see*** *Bus. & Prof. Code § 23952*].

2. Include standard contractual provisions, as appropriate [*see § 18.150[3]*].

3. Include signature lines for buyer and seller.

4. Include signature line for escrow holder's acceptance and approval of contract and escrow instructions.

Legal Topics:

For related research and practice materials, see the following legal topics:
Contracts LawTypes of ContractsGovernmentsState & Territorial GovernmentsLicenses



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CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
D. Drafting Guide to Sales Contracts and Related Forms

8-18 California Legal Forms--Transaction Guide §§ 18.153-18.159

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.153[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

8-18 California Legal Forms--Transaction Guide § 18.160

AUTHOR: Lynne Carmichael

§ 18.160 Financing Sale

NOTE:

For coverage of personal property secured transactions, see Ch. 42, *Secured Transactions* . For a detailed discussion of financing real property sales transactions, see Ch. 25, ***Real Estate Loans*** , and Ch. 25A, ***Security Instruments for Real Estate Financing*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGovernmentsState & Territorial GovernmentsLicenses



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

8-18 California Legal Forms--Transaction Guide § 18.161

AUTHOR: Lynne Carmichael

§ 18.161 Reporting Statutory Change in Ownership of Real Property

NOTE:

Real property subject to local property taxation is reassessed when a change in ownership occurs [*see* Cal. Const. art. XIII, XIIIA; ***see also* Hagman & Maxwell, California Real Estate Law & Practice, Ch. 401, ***Real Property Valuation and Assessment***]. A "change in ownership" is a transfer of a present interest in real property (including beneficial use of the property), the value of which is substantially equal to the value of the fee interest [*Rev. & Tax. Code § 60*]. That change requires the acquiring individual or entity to file a change in ownership statement [*Rev. & Tax. Code §§ 480-480.2*]. For further coverage, see *Ch. 17*, ***Buying and Selling a Business or Professional Practice***, *§ 17.129*.

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

8-18 California Legal Forms--Transaction Guide § 18.162

AUTHOR: Lynne Carmichael

§ 18.162 Reporting Income Tax Consequences of Sale

NOTE:

The parties to the sale of a license, or license and business, must report any personal income tax consequences of the sale at the usual time for filing the tax return for the year in which the sale took place. **For further coverage, see *Ch. 17, Buying and Selling a Business or Professional Practice*, *§ 17.130*.**

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

8-18 California Legal Forms--Transaction Guide § 18.163

AUTHOR: Lynne Carmichael

§ 18.163 Advising Buyer Regarding New Business

NOTE:

The buyer of a business must comply with all of the tax, license, permit, and other requirements applicable to any new business. For a general discussion of these requirements, see Ch. 1C, *Regulation of Employers* , and Ch. 1E, ***Taxation of Businesses*** .

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsLegal EthicsClient RelationsEffective Representation



66 of 95 DOCUMENTS

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

8-18 California Legal Forms--Transaction Guide § 18.164

AUTHOR: Lynne Carmichael

§ 18.164 Advising Seller Regarding Abandonment of Fictitious Business Name

NOTE:

A person who has previously filed a fictitious business name statement [*see* *Bus. & Prof. Code § 17910*] may file a statement of abandonment of that name when he or she ceases to transact business under that name [*Bus. & Prof. Code § 17922*]. For an example of the statement, see *Ch. 1A,* ***Role of Counsel in Starting a New Business,* *§ 1A.205*. For a list of applicable procedures, see *Ch. 1A,* ***Role of Counsel in Starting a New Business,*** *§ 1A.130*.

Legal Topics:

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CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

8-18 California Legal Forms--Transaction Guide § 18.165

AUTHOR: Lynne Carmichael

§ 18.165 Advising Buyer Regarding License Renewal

1. Advise buyer to file application for renewal of license before license expires [*Bus. & Prof. Code § 24048(b)*].

NOTE:

All licenses expire at midnight on the last day of the month posted on the license [*Bus. & Prof. Code § 24048*; *see §§ 18.21[3], 18.22[3]*]. On or before the first day of the month preceding the month posted on the license, the ABC will mail to each licensee at the licensed premises, or at any other designated address, an application to renew the license [*Bus. & Prof. Code § 24048(a)*]. The failure to mail this notice does not continue the right to a license [*Bus. & Prof. Code § 24048(e)*].

A renewal application is deemed to be filed on (1) the date that the document is actually delivered to, and the required renewal fee [*see* P 2, *below*] is paid at, any ABC office during office hours, or (2) the date that appears on the postmark, when the document and fee are mailed to the ABC [*Bus. & Prof. Code § 24048(g)*; ***see*** *Gov. Code § 11003* (filings by mail)].

2. Instruct buyer to pay renewal fees upon filing application.

NOTE:

For a current schedule of fees, see *Bus. & Prof. Code § 23320(a)*.

3. If license expires, advise buyer that he or she must take the following actions to reinstate license [*Bus. & Prof. Code § 24048(c)*]:

NOTE:

All licenses expire at midnight on the last day of the month posted on the license [*Bus. & Prof. Code § 24048*].

a. File renewal application within 60 days after license expires.

b. Pay annual renewal fee [*see Bus. & Prof. Code §§ 23320, 23358.3, 23399*].

c. Pay penalty fee, which is 50 percent of annual fee [*see Bus. & Prof. Code §§ 23320, 23358.3, 23399*].

4. If license is cancelled, advise buyer that he or she must take following actions within 30 days of cancellation to reinstate license [*Bus. & Prof. Code § 24048(f)*].

NOTE:

**Unless otherwise terminated or renewed [*see* *Bus. & Prof. Code § 24048(b), (c)*; *see also* PP 1-3, *above*], a license that is in effect on the month posted on the license continues in effect through 2 A.M. of the 60th day following the month posted on the license, at which time the license is automatically cancelled [*Bus. & Prof. Code § 24048(d)*]. On or before the 10th day preceding the cancellation of a license, the ABC will mail a notice of cancellation to each licensee who has not filed an application to renew, or notified the ABC of his or her intent not to renew, the license. The failure to mail this notice does not continue the right to a license [*Bus. & Prof. Code § 24048(e)*].

Once a license is cancelled in this manner and not reinstated within 30 days of cancellation, it is automatically revoked on the 31st day after cancellation [*Bus. & Prof. Code § 24048(f)*].

a. File renewal application.

b. Pay annual renewal fee by cashier's check or money order [*see Bus. & Prof. Code §§ 23320, 23358.3, 23399*].

c. Pay penalty fee by cashier's check or money order, which is 100 percent of annual fee [*see Bus. & Prof. Code §§ 23320, 23358.3, 23399*].

Legal Topics:

For related research and practice materials, see the following legal topics:
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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

8-18 California Legal Forms--Transaction Guide § 18.166

AUTHOR: Lynne Carmichael

§ 18.166 Paying Federal Occupational Tax

NOTE:

**Most retail dealers in alcoholic beverages [*see* *I.R.C. § 5122* (definition)] must pay a special occupational tax [*I.R.C. § 5121*] before engaging in business, and annually thereafter [*I.R.C. § 5142*; 27 C.F.R. § 194.102].

1. Advise buyer to contact National Revenue Center of the Alcohol and Tobacco Tax and Trade Bureau (TTB) regarding tax obligations before opening business.

NOTE:

Buyers required to comply with the federal occupational tax requirements [*see* PP 2-6, ***below*], should file with the TTB under the same name and for the same address that is on the application for transfer of the alcoholic beverage license.

2. If buyer is subject to occupational tax obligations [*see* P 1, *above*], instruct buyer to file TTB Form 5630.5 on or before commencing business [*I.R.C. § 5142*; 27 C.F.R. § 194.104].

NOTE:

Form 5630.5 is available on the TTB web page [www.ttb.gov] or from the National Revenue Center of TTB. The taxpayer is required to provide information relating to his or her name, trade name, employer identification number, business address, and type of alcoholic beverage business [***see*** 27 C.F.R. §§ 194.106 (form contents), 194.107 (execution requirements)]. **A penalty will be imposed for failure to file a timely return** [**27 C.F.R. § 194.109(a)**]. **Note, however, that certain related persons (such as a**

husband or wife or remaining partners) may continue the business at the same location without paying the special tax [***see*** 27 C.F.R. § 194.169].

3. Instruct buyer to pay tax upon filing form [27 C.F.R. § 194.105]:

NOTE:

A current schedule of taxes is shown on the form. A penalty will be imposed if the taxpayer does not pay the total amount due [27 C.F.R. § 194.109(b)], or if the check or money order is not honored [27 C.F.R. § 194.105]. The taxpayer will receive a stamp denoting payment of the tax [*see* *I.R.C. § 5142(c)(2)*; 27 C.F.R. § 194.121].

a. In cash; or

b. By check or money order made payable to Bureau of Alcohol, Tobacco, and Firearms.

4. Advise buyer that he or she must file new form and pay tax on or before July 1 of each new tax year [*I.R.C. § 5142(b)*; 27 C.F.R. § 194.104].

5. Instruct buyer to register with IRS district director for district in which business is located [*I.R.C. § 7011*].

NOTE:

Every person engaged in any trade or business on which a special tax is imposed by law must register his or her name, residence, business, and business address [*I.R.C. § 7011(a)*]. Registration is made by filing Alcohol and Tobacco Trade Bureau (TTB; formerly Bureau of Alcohol, Tobacco, and Firearms) Form 5630.5, which is available on the TTB website loated at www.ttb.gov.

6. Inform buyer that he or she must keep records on business premises of all distilled spirits, wines, and beer received [*see I.R.C. § 5124(a)*; 27 C.F.R. § 194.234; *see also Bus. & Prof. Code §§ 25752, 23334* (records must be kept for three years)].

NOTE:

The taxpayer must make these records available for inspection by any internal revenue officer during business hours [*see* *I.R.C. § 5146*].

Legal Topics:

For related research and practice materials, see the following legal topics:
Business & Corporate LawCorporationsGovernmentsState & Territorial GovernmentsLicensesTax LawExcise TaxesAlcohol, Tobacco & Related ItemsAlcohol



69 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART III. TRANSACTION GUIDE
E. Related and Subsequent Procedures

8-18 California Legal Forms--Transaction Guide §§ 18.167-18.199

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.167[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
A. Sales Contract and Escrow Agreement

8-18 California Legal Forms--Transaction Guide § 18.200

AUTHOR: Lynne Carmichael

§ 18.200 Contract for Sale of Retail Alcoholic Beverage License and Business

[1] Comment

[a] Use of Form

This form is a contract for the sale of a going retail business together with the alcoholic beverage license issued for that business. It assumes that the sale is subject to both the Alcoholic Beverage Control Act [*Bus. & Prof. Code § 23000 et seq.*] and the Bulk Sales Division of the Commercial Code [*Com. Code § 6101 et seq.*; *see § 18.10[3]*]. It may be used for the sale of a business with either a retail on-sale license (for example, a restaurant or bar) or off-sale license (for example, a liquor store or grocery store) [*see § 18.20* et seq.].

For a set of escrow instructions designed for use with this contract, see *§ 18.202*. For an example of a contract for the sale of a retail alcoholic beverage license only, see *§ 18.202*.

Determination of the purchase price of the business and license is beyond the scope of this chapter, and is not covered in this form or comment. Generally, the parties will employ a financial expert to determine the fair market value of the business and of each individual asset.

[b] Basic Contract Provisions

Like all other types of contracts, contracts for the sale of a business must include (1) the consent of parties capable of contracting [*see Civ. Code §§ 1556-1559* (parties), *1565-1590* (consent)], (2) a lawful object [*see Civ. Code §§ 1595-1599*], and (3) sufficient cause or consideration [*Civ. Code § 1550*; *see Civ. Code §§ 1605-1615*; Recitals in Form]. For coverage of these essential elements, see the discussion in *Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.11*.

[c] Description of Property Being Sold

The sales contract should enumerate all of the business property that the seller will transfer to the buyer, and specifically describe any items of property that are not subject to the sale [*see* P 1 of Form]. It should require transfer of any leasehold interest [*see* P 1(d) of Form] to be accomplished by a written assignment signed by the assignor [*see Civ. Code §§ 1091, 1624(c)*; *Code Civ. Proc. § 1971* (required for transfers of term exceeding one year); *see also* Ch. 35A, *Assignment and Sublease of Leasehold Interests*]. The seller may also state the condition of the tangible property being transferred [*see* P 2 of Form].

[d] Amount of Purchase Price

The contract should state the total purchase price. For certain transfers of general retail licenses, that amount is limited by statute [*see Bus. & Prof. Code §§ 24070(d), (e), 24079*; *see also § 18.30[4]*]. This form sets forth a specified sum, plus the value of the stock in trade and merchandise to be determined pursuant to an inventory [*see* P 3 of Form]. When the contract states the purchase price in this manner, it is impossible to state the exact amount allocated to the inventory in the notice of intended transfer [*see Bus. & Prof. Code P 24073(f)*; *§ 18.210*]. Therefore, the ABC will allow the parties to state the amount of the inventory as either an estimated amount or as an amount not to exceed a stated amount in that notice [*see § 18.210*].

[e] Allocation of Purchase Price

The parties should allocate the purchase price among the assets being sold [*see* P 4 of Form] in order for the seller to determine any gain or loss on the sale, and the buyer to determine his or her basis in the assets being acquired. In addition, an allocation is required to determine sales tax on the sale [*see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.11*].

The application must state the total purchase price or consideration to be paid, and the amount being paid for each asset [*Bus. & Prof. Code § 24080*; *see § 18.221*]. The total purchase price is limited by statute for certain transfers [*see Bus. & Prof. Code §§ 24070(d), (e), 24079*; *see also* discussion in *§ 18.20*].

Special rules regarding allocation of the purchase price govern any direct or indirect transfer of assets in which (1) the assets constitute a trade or business and (2) the buyer's basis in the assets is determined wholly by reference to the consideration paid for the assets [*see I.R.C. § 1060(a), (c)*]. For purposes of determining the buyer's basis in the assets and the seller's gain or loss in such a transaction, the consideration received for the assets must be allocated among the assets pursuant to the "residual method" [*I.R.C. § 1060(a)*; *Treas. Reg. §§ 1.338-6*, 1.338-7, 1.1060-1(a)(1), (c)(2)]. Under the residual method, assets are first divided into the following seven classes [*Treas. Reg. §§ 1.338-6(a)(2), 1.1060-1(c)(2)*]:

- Class I Assets: Cash and general deposit accounts, including savings and checking accounts [*Treas. Reg. §§ 1.338-6(b)(1), 1.1060-1(c)(2)]*.

- Class II Assets: Actively traded personal property, [*see I.R.C. § 1092(d)(1)*; *Treas. Reg. § 1.1092(d)-1*, but without regard to *I.R.C. § 1092(d)(3)*] and certificates of deposit and foreign currency, even if they are not actively traded personal property. Assets in Class II include U.S. government securities and publicly traded stock. Class II assets do not include stock of target affiliates, whether or not of a class that is actively traded, other than actively traded stock described in *I.R.C. § 1504(a)(4)* (certain preferred stock). This restriction excludes target affiliate stock from Class II when the target holds an 80 percent or greater interest in the target affiliate but a minority interest in target affiliate stock of the same class is actively traded [*Treas. Reg. §§ 1.338-6(b)(2)(ii), 1.1060-1(c)(2)*].

- Class III Assets: Assets that the taxpayer marks to market at least annually for federal income tax

purposes and debt instruments. These assets include accounts receivable, mortgages, and credit card receivables from customers that arise in the ordinary course of business [*Treas. Reg. §§ 1.338-6(b)(2)(iii), 1.1060-1(c)(2)*]. Class III assets do not include debt instruments issued by persons related to the target at the beginning of the day following the acquisition date, certain contingent debt instruments [*see Treas. Reg. §§ 1.1275-4, 1.483-4*; *I.R.C. § 988*] (but not those subject to the non-contingent bond method [*see Treas. Reg. § 1.1275-4(b)*, 1.483-4], or that involve single nonfunctional currencies [*see Treas. Reg. § 1.988-2(b)(2)(i)(B)(2)*]), or debt instruments convertible into the stock of the issuer or other property [*Treas. Reg. §§ 1.338-6(b)(2)(iii), 1.1060-1(c)(2)*].

- Class IV Assets: Stock in trade of the taxpayer or other property of a kind that would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business [*Treas. Reg. §§ 1.338-6(b)(2)(iv), 1.1060-1(c)(2)*].

- Class V Assets: All assets that do not fall in any of the other six classes [*Treas. Reg. §§ 1.338-6(b)(2)(v), 1.1060-1(c)(2)*].

- Class VI Assets: All Section 197 intangibles except goodwill and going concern value [*Treas. Reg. §§ 1.338-6(b)(2)(vi), 1.1060-1(c)(2); see I.R.C. § 197*].

- Class VII Assets: Goodwill and going concern value (whether or not the goodwill or going concern value qualifies as a Section 197 intangible) [*Treas. Reg. §§ 1.338-6(b)(2)(vii), 1.1060-1(c)(2)*].

The consideration is first reduced by the amount of the Class I assets. Any amount remaining after the reduction is then allocated to the remaining assets [*Treas. Reg. §§ 1.338-6(b)(1), (2)*, 1.1060-1(c)(2)]. The remaining consideration is allocated to Class II assets in proportion to the fair market value of each Class II asset, then among Class III assets in proportion to the fair market value of each Class III asset, then among Class IV assets in proportion to the fair market value of each Class IV asset, then among Class V assets in proportion to the fair market value of each Class V asset, then among Class VI assets in proportion to the fair market value of each Class VI asset, and finally to Class VII assets [*Treas. Reg. §§ 1.338-6(b)(2)(i), 1.1060-1(c)(2)*].

In making the above allocations, the seller and purchaser each must adjust the amount allocated to an individual asset to take into account specific identifiable costs incurred in transferring that asset in connection with the applicable asset acquisition (such as real estate transfer costs or security interest perfection costs). Those costs increase (or decrease, as appropriate) the total consideration that is allocated under the residual method. No adjustment is made to amounts allocated to an individual asset for general costs associated with the overall asset acquisition or with groups of assets (such as non-specific appraisal fees or accounting fees). These costs are taken into account only indirectly through their effect on the total consideration to be allocated [*Treas. Reg. § 1.1060-1(c)(3)*; *see* Temp. Treas. Reg. § 1.1060-1T(c)(3)].

For further discussion, see *Ch. 17, Buying and Selling a Business or Professional Practice, § 17.11[4]*. To the extent that the parties agree in writing as to the allocation of any consideration, or as to the fair market value of any of the transferred assets, the parties are bound by the terms of the agreement unless the IRS determines that the allocation (or fair market value) is inappropriate [*I.R.C. § 1060(a)*]. However, this rule does not apply if the parties are able to refute the allocation or valuation under the standards set forth in *Commissioner v. Danielson* [*Commissioner v. Danielson 378 F.2d 771 (3d Cir. 1967) , cert. denied, 389 U.S. 858 (1967)]* . Under this case, a party challenging the tax consequences of an agreement as construed by the Commissioner must offer proof that, in a suit between the parties, it would be admissible to alter that construction or show its unenforceability because of mistake, fraud, duress, and the like [*Treas. Reg. § 1.1060-1(c)(4)*].

This form allocates the purchase price among the assets in the order required by statute [*see* P 4 of Form]. In addition, it contains (1) the acknowledgment of each party that the amount allocated to each individual asset represents its fair market value determined pursuant to arm's length negotiation; (2) a statement that each party has had the tax consequences of the allocations explained to him or her by a tax attorney or other advisor; and (3) the agreement by each party to report the allocations as set forth in the contract of sale to the IRS [Treas. Reg. § 1.1060(e) (seller and purchase must report asset acquisition statements on IRS Form 8594, "Asset Allocation Statement")].

[f] Payment of Purchase Price

The Alcoholic Beverage Control Act [*Bus. & Prof. Code §§ 23000-25762*] ("Act") provides that before an application for the transfer of an alcoholic beverage license may be filed, the buyer must deposit the full amount of the purchase price or consideration being paid for the license and business into escrow [*Bus. & Prof. Code § 24074*; *see* P 5 of Form; § 18.41[4]]. Thus, unlike the contract for the sale of any other type of property, a contract for the sale of a retail alcoholic beverage license (either with or without the licensed business) cannot provide that the buyer will pay a portion of the purchase price on close of escrow. The buyer need not pay the purchase price or consideration entirely in cash, however. The consideration may also consist of checks, promissory notes, and tangible or intangible property [*see Bus. & Prof. Code §§ 24073, 24074*], as long as they are deposited prior to filing the application [*see* P 5 of Form]. Liability on promissory notes should be conditioned upon approval of the transfer by the ABC.

Despite the foregoing rule regarding time for deposit, however, use of a demand promissory note payable to the escrow holder on or before the close of escrow may effectively allow the buyer to pay a portion of the purchase price on close of escrow. This device allows the buyer to use and earn interest on that money during the pendency of the escrow [*see* P 5 of Form (note does not bear interest)]. It should be used only when the buyer is solvent and will be able to pay the demand note on or before the close of escrow. When used, the contract of sale and escrow instructions [*see § 18.201*] must identify the demand promissory note as such. A demand note to be replaced with cash on the close of escrow is treated as cash for purposes of the notice of intended transfer [*see §§ 18.210-18.212*].

This form also provides for execution of a promissory note and security agreement giving the seller a security interest in the property being sold [*see* P 6 of Form]. Note, however, that the alcoholic beverage license cannot serve as the security [*see Bus. & Prof. Code § 24076*]. This type of transaction (excluding the sale of accounts receivable as part of the sale of the business from which they arose [*see Com. Code § 9109(d)(4)*]) is governed by Division 9 of the California Commercial Code [*Com. Code § 9109(a)(1)*; *see Com. Code § 9101 et seq.*]. The seller may "perfect" his or her security interest by filing a financing statement [*see Com. Code §§ 9317, 9502*]. Coverage of secured transactions is beyond the scope of this chapter. For an extensive discussion of secured transactions under Division 9, see Ch. 42, *Secured Transactions* .

[g] Inventory

The contract should specify the date and method of taking inventory of the property being sold. This event generally takes place at the close of business hours on the day preceding the sale [*see* P 7 of Form]. However, if the ABC issues a temporary permit to the buyer to operate the business pending approval of the transfer application [*see Bus. & Prof. Code § 24045.5*; *see also § 18.50*], inventory should be taken on the day preceding the effective date of the temporary permit [*see* P 7 of Form]. For a discussion of the methods of valuing inventory, see Ch. 7, *Corporate Records and Reports* .

[h] Insurance Policies

This contract requires the seller to provide a list of insurance policies insuring the business or assets to be transferred to the seller. It also requires the buyer to indicate in writing which, if any, of those policies he or she desires the seller to transfer to the buyer [*see* P 8 of Form]. Generally, an insured may sell or assign an insurance policy. However, in order

to prevent an increase of risk to the insurer due to a change of ownership before a loss occurs, the insurer must consent to the assignment [*see University of Judaism v. Transamerica Ins. Co. (1976) 61 Cal. App. 3d 937, 941, 132 Cal. Rptr. 907]* , whether or not the policy requires consent [*see Bergson v. Builders' Ins. Co. (1869) 38 Cal. 541, 543]* . For further coverage, see California Insurance Law and Practice, Ch. 8, *The Insurance Contract* (Matthew Bender); for a general discussion of business issues, see Ch. 1F, *Insurance Considerations in Business Formation* .

[i] Compliance With Bulk Sales Division

The Bulk Sales Division of the Commercial Code [*see Com. Code §§ 6101-6111*] applies to a bulk sale only if (1) the seller's principal business is the sale of inventory from stock, including those who manufacture what they sell, or is that of restaurant owner [*Com. Code § 6103(a)(1)*]; and (2) the seller is located in California, or is located in a jurisdiction outside the United States but has its major American executive office in California, on the date of the bulk sale agreement [*Com. Code § 6103(a)(2)*; *see Com. Code § 6103(c)* (exceptions)]. A "bulk sale" is any sale outside the ordinary course of the seller's business of more than one half of the seller's inventory and equipment, as measured by the fair market value on the date of the bulk sale agreement [*Com. Code § 6102(a)(3), (8), (15)*; *see Com. Code §§ 6102(b)(2), 9102(a)(33)* ("equipment" defined), *6102(b)(3), 9102(a)(48)* ("inventory" defined); *see also § 18.10[3]*].

A transfer that is subject to and complies with the license transfer provisions of the Alcoholic Beverage Control Act [*Bus. & Prof. Code §§ 24070-24082*], however, is subject only to the Bulk Sales Division's notice requirements [*Com. Code § 6103(c)(15)*; *see Com. Code § 6105(a)(1)-(4), (b)*]. This form assumes that the seller is subject to the Bulk Sales Division, and requires compliance with applicable provisions [*see* P 9 of Form].

[j] Time and Place of Sale

The contract should specify the date and place of the sale. It should also provide that the sale will not take place on the scheduled date unless the Department of Alcoholic Beverage Control has approved the transfer [*see Bus. & Prof. Code § 24073*; *see also* P 10 of Form].

[k] Application for License Transfer

The parties should agree to file an application for transfer within 90 days after execution of the contract [*see* P 10 of Form]. The ABC will not transfer a license if the transfer is made to fulfill an agreement entered into more than 90 days preceding the date on which the transfer application is filed [*Bus. & Prof. Code § 24076*]. The parties should also agree to take all actions required to facilitate the transfer [*see* P 11 of Form].

[l] Conduct of Business

This contract requires the seller to continue operating the business in the usual manner until the sale [*see* P 12 of Form]. For an alternative provision that lists specific requirements, see *Ch. 17, Buying and Selling a Business or Professional Practice, § 17.215*.

[m] Risk of Loss

This form provides that the seller will bear the risk of damage to or loss of the assets of the business prior to closing, and the buyer will bear the risk of loss thereafter [*see* P 13 of Form]. Note, however, that *Civ. Code § 1511(2)* provides that performance of an obligation is excused when it is prevented or delayed by an irresistible superhuman cause, unless the parties have expressly agreed to the contrary. For a discussion and example of a "force majeure" clause, see *Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.235*.

[n] Application for Temporary Permit

The parties should specify whether the buyer may apply for a temporary permit to operate the business pending approval of the transfer application [*see Bus. & Prof. Code § 24045.5*; *see also § 18.50*]. This form describes the buyer's manner of management and status as sublessor upon obtaining a temporary permit, and provides for the return of assets and control upon ultimate denial of the transfer application [*see* P 14 of Form].

[o] Prorations

The buyer and seller generally agree to prorate, as of the closing, the expenses incident to conducting the business. This form provides that the parties will prorate all personal property taxes, insurance policies, employee salaries and benefits, and rent [*see* P 15 of Form].

[p] Escrow Holder and Instructions

When the intended transfer of the alcoholic beverage license or business involves a purchase price or consideration, the licensee and buyer must establish an escrow before filing a transfer application with the ABC [*Bus. & Prof. Code § 24074*; *see* P 16 of Form]. However, no escrow is required for a transfer of an off-sale beer and wine license if [*Bus. & Prof. Code § 24074.4*; *see § 18.110[4]*]:

- A corporation with a net worth on a consolidated basis of at least $5 million according to its most recent audited financial statement files a guaranty of full payment of all creditor claims; and

- The guaranty is acceptable to the creditors of the seller.

When an escrow is required, the parties must appoint an escrow holder who is not a party to the transfer [*Bus. & Prof. Code § 24074*], and who meets the requirements of Chapter 1 of the Escrow Law (unless he or she is a licensed attorney who is not actively engaged in conducting an escrow agency) [*Bus. & Prof. Code § 24074.1*; *see Fin. Code §§ 17000-17010*; *see also* P 16 of Form]. For further discussion, see *§ 18.41[4]*. The parties should also agree to direct the escrow holder, pursuant to escrow instructions, to distribute the consideration deposited by the buyer in accordance with *Bus. & Prof. Code § 24074* [*see Bus. & Prof. Code § 24074*; *see also* P 18 of Form]. For discussion of *Bus. & Prof. Code § 24074*, see *§ 18.51[2]*.

[q] Costs and Expenses

This form contains a provision allocating certain costs of the sale to the buyer or seller. It also requires the parties to bear some expenses equally [*see* P 19 of Form].

[r] Denial of Transfer Application

This contract of sale provides that it will become null and void upon final denial of the application for transfer of the retail alcoholic beverage license. In addition, it provides that each party will be restored, to the extent possible, to his or her position prior to execution of the contract. It also specifies that either party may bring an action to recover damages when the other party's actions resulted in denial of the transfer [*see* P 20 of Form].

[s] Seller's Warranties

This form contains the seller's warranties regarding ownership of the business, the accuracy of the business books and accounts, outstanding debts, and pending litigation or proceedings. It also sets forth a warranty that the seller is not in violation of the Alcoholic Beverage Control Act, and knows of no reason that the ABC might deny transfer of his or her license [*see* P 21 of Form]. For further discussion of the warranties made by the parties to the sale of a business, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

[t] Buyer's Warranties

The buyer should warrant that he or she has never been convicted of a felony or violation of the Alcoholic Beverage Control Act [*see Bus. & Prof. Code § 23952* (eligibility requirements for retail alcoholic beverage license)]. The buyer should also warrant that he or she knows of no reason that the ABC might deny transfer of the license to him or her [*see* P 22 of Form].

[u] Indemnification

The seller should indemnify the buyer for all claims and liabilities arising from operation of the business before the closing, and the buyer should indemnify the seller for claims and liabilities arising after the closing [*see* PP 23, 25 of Form]. For a form provision and discussion of the issue of products liability, see Ch. 17, *Buying and Selling a Business or Professional Practice* .

[v] Reliance on Representations

The buyer may state that he or she is purchasing the business based on his or her own inspection of the assets and accounts. This form also contains an express waiver of any claims based on representations other than those set forth in the contract [*see* P 24 of Form].

[w] Attorneys' Fees

This form specifically provides for attorneys' fees to be awarded to the prevailing party in litigation or arbitration [*see* P 28 of Form]. A litigant is not entitled to attorneys' fees unless they are agreed upon by the parties or specifically provided for by statute [*Code Civ. Proc. § 1021*]. In any action on a contract, if the contract provides that attorneys' fees and costs incurred to enforce the contract are to be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, regardless of whether he or she is the party named in the contract, is entitled to reasonable attorneys' fees in addition to other costs [*Civ. Code § 1717(a)*]. For further discussion and examples of attorneys' fees provisions, see *Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.252*.

[x] Arbitration

This form provides that any dispute regarding the contract will be settled by arbitration [*see* P 29 of Form]. Arbitration is the submission for determination of a disputed matter to private unofficial persons selected in the manner provided by law or by the agreement of the parties [*Stockwell v. Equitable F. & M. Ins. Co. (1933) 134 Cal. App. 534, 540, 25 P.2d 873]* . Arbitration provisions commonly incorporate the rules of the American Arbitration Association or the California Arbitration Act [*see Code Civ. Proc. § 1280 et seq.*]. For additional examples and discussion of arbitration clauses, see *Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.250*. For an example and discussion of the statutory arbitration notice that must appear in any contract to convey real property that contains a binding arbitration provision [*Code Civ. Proc. § 1298*], see Ch. 23, *Real Property Sales Agreements* .

[y] Standard Contractual Provisions

Most written agreements include certain standard provisions. This form contains an "entire agreement" provision [*see* P 26 of Form; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, §§ 75.270, 75.271*], a clause governing amendment and modification [*see* P 27 of Form; *see also* Ch. 77, *Discharge of Obligations*], a provision for the manner of giving notice [*see* P 30 of Form; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.294*], and assignability provisions [*see* PP 31, 32 of Form; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, §§ 75.280-75.282*; Ch. 76, *Assignment of Rights and Obligations*]. It also contains a "choice of law" provision [*see* P 33 of Form *see also Ch. 75, Formation of Contracts and Standard Contractual*

Provisions, § 75.273], which may be useful if the sales transaction involves contacts with states other than California. For other standard provisions, see Ch. 75, *Formation of Contracts and Standard Contractual Provisions* .

[z] Optional Provisions

Depending on the nature of the business being sold, the alternative form provisions set forth in Ch. 17, *Buying and Selling a Business or Professional Practice* , may be added to or substituted for the provisions in this contract.

[aa] Attached Exhibits

The parties to a contract have the power to incorporate other documents by reference, whether or not those documents are attached [*King v. Larsen Realty, Inc. (1981) 121 Cal. App. 3d 349, 357, 175 Cal. Rptr. 226* ; *see* Ch. 75, *Formation of Contracts and Standard Contractual Provisions*]. This contract incorporates attached exhibits such as an inventory of tangible business assets [*see* P 1 of Form], and other exhibits may be incorporated as necessary.

[2] FORM

Contract for Sale of Retail Alcoholic Beverage License and Business

CONTRACT FOR SALE OF BUSINESS AND ALCOHOLIC BEVERAGE LICENSE

This agreement is made on _____[*date*], between [*name of seller(s) and capacity, e.g.*, John and Jane Doe, husband and wife], Seller, and _____[*name of buyer(s) and capacity*], Buyer.

Recitals

Seller is the owner of [*describe business, e.g.*, a restaurant and cocktail lounge] known as "_____" [*name of business*] ("the business") located at _____[*address*], _____[*city*]. Seller is also the holder of _____[*specify type and number of license, e.g.*, an on-sale beer and wine alcoholic beverage license, No. _____ (*license number*)], issued by the Department of Alcoholic Beverage Control for the premises on which the business is located ("the alcoholic beverage license"). Seller desires to sell the business and the alcoholic beverage license to Buyer, and Buyer desires to purchase the business and the alcoholic beverage license from Seller.

Therefore, Buyer and Seller agree as follows:

Purchase and Sale

1. Seller shall sell to Buyer, and Buyer shall purchase from Seller, on the terms and conditions set forth in this contract, the following property:

(a) All the stock in trade and merchandise of the business, as determined by a complete inventory and accounting to be taken as provided in Paragraph 7 of this contract.

(b) All the furniture, fixtures, equipment, and other tangible assets of the business, shown on the attached inventory marked Exhibit [*add if desired:*, with the following exceptions: _____ (*describe any exceptions*)].

(c) The alcoholic beverage license.

(d) The leasehold interest owned by Seller under the lease with _____[*name of lessor*] dated _____, for premises on which the business is located, pursuant to a valid assignment of lease to be deposited into escrow.

(e) All of the accounts receivable of the business.

(f) All the trade, goodwill, and other intangible assets of the business.

Condition of Tangible Assets

[*If seller will warrant condition of assets:*]

2. Seller represents that all of the fixtures, furniture, equipment, and other tangible assets shown on the attached inventory marked Exhibit _____ that are being sold to Buyer are in good condition and repair, excluding reasonable wear and tear.

[*Or, if buyer will accept assets in "as is" condition:*]

2. Buyer agrees to inspect all of the fixtures, furniture, equipment, and other tangible assets shown on the attached inventory marked Exhibit _____ that are being sold to Buyer, and to accept them in an "as is" condition.

[*Continue with the following:*]

Total Purchase Price

3. The total purchase price ("the purchase price") to be paid by Buyer to Seller for all of the property described in Paragraph 1 of this contract is $_____, plus the value of the stock in trade and merchandise shown on the inventory described in Paragraph 7.

Allocation of Purchase Price

4.(a) The purchase price shall be allocated as follows:

[*List assets by the following classes as specified in Treas. Reg. §§ 1.338-6(a)(2), (b) 1.1060-1(c)(2) (see § 18.200[1][e]:*]

(1) _____ [*specify any cash and general deposit accounts, including savings and checking accounts, of the business (identified by institution and account number); see Treas. Reg. §§ 1.338-6(b)(1), 1.1060-1(c)(2)*]: $ _____.

(2) _____ [*describe any actively traded personal property, (see I.R.C. § 1092(d)(1); Treas. Reg. § 1.1092(d)-1, but without regard to I.R.C. § 1092(d)(3)) and certificates of deposit and*

foreign currency, even if they are not actively traded personal property, including U.S. Government securities and publicly traded stock, but do not include stock of target affiliates, whether or not of a class that is actively traded, other than actively traded stock described in I.R.C. § 1504(a)(4) (certain preferred stock)]: $_____.

(3) _____ [*describe assets that are marked to market at least annually for Federal income tax purposes and debt instruments, including accounts receivable, mortgages, and credit card receivables from customers that arise in the ordinary course of business, but do not include debt instruments issued by persons related to the target at the beginning of the day following the acquisition date, certain contingent debt instruments (see Treas. Reg. §§ 1.1275-4, 1.483-4; I.R.C. § 988), but not those subject to the non-contingent bond method (see Treas. Reg. § 1.1275-4(b), 1.483-4), or which involve single nonfunctional currencies (see Treas. Reg. § 1.988-2(b)(2)(i)(B)(2))], or debt instruments convertible into the stock of the issuer or other property (Treas. Reg. §§ 1.338-6(b)(2)(iii), 1.1060-1(c)(2))*]: $_____.

(4) Stock in trade, inventory, and merchandise [*list items covered in Treas. Reg. §§ 1.338-6(b)(2)(iv), 1.1060-1(c)(2)*]: $_____.

(5) All assets that do not fall in any of the other classes listed in this section [*include items such as furniture, fixtures, equipment, and the alcoholic beverage license (see Treas. Reg. §§ 1.338-6(b)(2)(v), 1.1060-1(c)(2)*]: $_____.

[*Add if seller will execute covenant not to compete (see Ch. 17, Buying and Selling a Business, § 17.213):*]

(6) Covenant not to compete (and other *Internal Revenue Code Section 197* intangibles except goodwill and going concern value): $_____.

[*Continue with the following:*]

(7) Goodwill and going concern value: $_____.

(b) Buyer and Seller each acknowledge that the amount of purchase price allocated to the assets in subparagraph (a) represents the fair market value of those assets, determined pursuant to arm's length negotiation. They further acknowledge that a tax attorney or other qualified advisor has explained the tax consequences of those allocations to them. Buyer and Seller each agree to report the sale of the business and the alcoholic beverage license for income tax purposes according to the allocations set forth in subparagraph (a).

Payment of Purchase Price

[*If payment will be entirely in cash:*]

5. Upon execution of this contract, Buyer shall deposit the purchase price specified in Paragraph 3 into the escrow described in Paragraph 15 of this contract.

[*Or, if payment will be a combination of cash and other consideration:*]

5. The purchase price specified in Paragraph 3 shall be payable as follows:

(a) On execution of this contract, Buyer shall deposit the sum of $_____ into the escrow described in Paragraph 15 of this contract.

(b) The additional sum of $_____ shall be evidenced by a demand promissory note, executed by Buyer, that:

(1) Is substantially in the form of the note attached as Exhibit _____.

(2) Is payable without interest to the Escrow Holder named in Paragraph 16 of this contract on demand prior to the close of escrow.

(3) Is deposited by Buyer into escrow on execution of this contract.

(c) The balance of the purchase price, $_____, shall be payable according to the terms of a promissory note, executed by Buyer, that:

(1) Is substantially in the form of the note attached as "Exhibit _____."

(2) Provides for payment of the principal balance of the note in monthly installments of $_____, commencing one month after close of escrow.

(3) Provides for interest on the unpaid principal balance of the note from the close of escrow at the rate of _____ percent per year, payable monthly commencing one month after the close of escrow.

(4) Is deposited by Buyer into escrow on execution of this contract.

[*Continue with the following:*]

Security for Purchase Price

6.(a) Any promissory note described in Paragraph 5 of this contract shall be secured by a security agreement in the form of the attached document marked Exhibit _____, to be executed by Buyer and Seller, granting to Seller a security interest in all of the property described in Paragraph 1 of this contract. However, no security interest shall be reserved or granted to Seller or to any other person in the alcoholic beverage license now or hereafter issued for the premises occupied by the business.

(b) Buyer shall execute any financing statements prepared by Seller to perfect the security interests granted by the security agreement.

Inventory

7. A complete inventory of the stock in trade and merchandise of the business shall be taken by _____[

name of person or company that will take inventory] at the close of business on [*day preceding sale and transfer of business and license*], or, if the Department of Alcoholic Beverage Control issues a temporary permit for the premises occupied by the business to Buyer in accordance with Paragraph 14 of this contract, on the day preceding the effective date of the temporary permit, in the following manner:

(a) Operation of the business will be suspended immediately prior to the taking of the inventory and will remain suspended until after the transfer of the business and alcoholic beverage license.

(b) All items on the premises occupied by the business at the time the inventory is taken that could constitute part of the stock in trade and merchandise of the business shall be conclusively presumed to be part of that stock in trade and merchandise, and shall be included in the inventory.

(c) All items shall be valued according to the [*specify valuation method*] method of valuation.

(d) No item listed on the inventory shall be sold to any person other than Buyer or removed from the premises until after the transfer of the business and alcoholic beverage license to Buyer.

Insurance Policies

8. Seller shall provide Buyer with a list of all insurance policies insuring the business or the assets of the business listed in Paragraph 1, which shall include (1) the number of each policy, (2) the insurance company and agent that issued each policy, (3) the premium payable on each policy, and (4) the beginning and expiration dates of each policy. Buyer shall determine which, if any, of those policies Buyer wishes to assume, and shall approve or reject in writing each insurance policy so listed.

Compliance With Bulk Sales Law

9. The purchase and sale of the business shall be conducted in full compliance with the applicable requirements of the Bulk Sales Division of the California Commercial Code.

Time and Place of Sale

10. The purchase and sale described in this contract and the transfer of the alcoholic beverage license from Seller to Buyer shall take place at the office of the Escrow Holder as specified in Paragraph 16 on _____[*date*], or within [*specify time period, e.g.,* 5 days] after _____ [the Department of Alcoholic Beverage Control approves transfer of the alcoholic beverage license *or, if business is subject to franchise agreement:* both of the following conditions have been satisfied:

(a) The Department of Alcoholic Beverage Control has approved transfer of the alcoholic beverage license.

(b) _____ (*name of franchisor*), (Franchisor), has given written consent to the purchase and sale].

The consideration for the purchase and sale of the business and transfer of the alcoholic beverage license shall be paid only after the Department of Alcoholic Beverage Control gives its approval of the transfer.

Application for License Transfer

11. Both Buyer and Seller shall take all actions reasonably required to facilitate the transfer of the alcoholic beverage license from Seller to Buyer. Promptly after execution of this contract, and in no event later than 90 days after its execution, Buyer and Seller shall execute and file with the Department of Alcoholic Beverage Control an application for transfer of the license from Seller to Buyer. Buyer shall pay all fees required to effectuate transfer of the license.

Conduct of Business

12. Until the closing, Seller shall continue to operate the business in the same manner as Seller has operated it in the past.

Risk of Loss

13. Until the closing, Seller shall bear all risk of loss, injury, damage, or destruction of the assets of the business. If any loss, injury, damage, or destruction substantially impairs the value of the business prior to the closing, Buyer may either terminate this contract, or proceed to closing and receive an assignment of applicable insurance proceeds or proportionate reduction in the purchase price. If any such loss, injury, damage, or destruction interrupts conduct of the business prior to the closing for a period of [*specify time, e.g.,* 30 days] or more, Buyer may terminate this contract. After the closing, Buyer shall bear all risk of loss.

Application for Temporary Permit

14.(a) After the parties have filed the application for transfer of the alcoholic beverage license in accordance with Paragraph 10 of this contract, Buyer [shall *or* may] file an application for a temporary permit allowing Buyer to operate the business while the transfer application is pending. At the time that Buyer files such an application, Seller shall surrender the alcoholic beverage license to the Department of Alcoholic Beverage Control in accordance with its rules.

(b) If Buyer's application for a temporary permit is granted:

(1) On the day before the temporary permit becomes effective, Buyer and Seller shall take inventory in accordance with Paragraph 7 of this contract. Buyer shall immediately become the owner of all the stock in trade and merchandise shown on that inventory, and shall thereby become indebted to Seller for the value of that stock in trade and merchandise.

(2) On the day the temporary permit becomes effective, Buyer shall assume full management and control of the business and operate it during the period covered by the temporary permit, or any extension of the permit, in full compliance with the terms of the permit and *Business and Professions Code Section 24045.5*.

(3) While Buyer has management and control of the business under the temporary permit, Buyer shall be considered to be a sublessee of Seller of the business premises. The parties therefore shall obtain the consent of Seller's lessor to the sublease, and Buyer shall pay $_____ per month to Seller as rent for the use of the business premises.

(4) If the transfer application is thereafter denied or withdrawn, Buyer shall return all of the business assets to Seller. Buyer and Seller shall promptly take inventory of all the stock in trade and merchandise of the business then on the premises, and Seller shall reimburse Buyer for the actual cost to Buyer of that

stock in trade and merchandise.

(5) If the temporary permit expires before approval of the transfer application, Buyer may attempt to obtain an extension. If the permit expires and no extension has been granted, Buyer shall comply with the procedures set forth in Subparagraph (b)(4).

Prorations

15. Buyer and Seller shall prorate all of the following, on the basis of 30-day months, as of 12:01 A.M. Pacific time on the date specified in Paragraph 10 for the closing:

(a) All personal property taxes levied or assessed against any of the business assets subject to this contract for the current tax year, based on the amount shown on the latest tax bill.

(b) All premiums on insurance policies insuring the business or the assets subject to this contract, that have been approved by and are being transferred to Buyer pursuant to Paragraph 8.

(c) Salaries of the employees shown on the attached schedule marked Exhibit _____.

(d) All social security taxes and contributions to union, pension, Christmas bonus, or vacation funds accruing during the pendency of the purchase and sale for the business employees shown on the attached schedule marked Exhibit _____.

(e) The rent of the premises occupied by the business pursuant to the lease between Seller and _____[*name of lessor*] dated _____.

[*If any additional costs or expenses will be prorated:*]

(f) _____ (*describe*)].

Appointment of Escrow Holder

16. Buyer and Seller shall open an escrow for the purchase and sale described in this contract within [*specify time period, e.g.,* 10 days] after execution of this contract, and before filing a transfer application with the Department of Alcoholic Beverage Control. _____[*name*], [*describe status of escrow holder, e.g.*, an attorney], whose offices are located at _____[*street address*], _____, [*city*] , California, is hereby appointed escrow holder ("Escrow Holder") to conduct the purchase and sale of the business and transfer of the alcoholic beverage license.

Deposits Into Escrow

17. Buyer and Seller agree that, prior to filing a transfer application with the ABC, they shall make the following deposits into the escrow described in Paragraph 16:

(a) [Buyer *or* Seller] shall deposit a copy of this contract with the Escrow Holder.

(b) Buyer shall deposit the total purchase price for the purchase, sale, and transfer into escrow, in the manner set forth in Paragraph 5 of this contract.

(c) Seller shall deposit all documents required to transfer the business assets to Buyer, including [*specify, e.g.,* a bill of sale for all furniture and fixtures, and the DMV registration for any business vehicles].

Required Escrow Instructions

18. Pursuant to escrow instructions to be drafted, the parties shall direct the Escrow Holder identified in Paragraph 16 to distribute the deposited purchase price in the manner required by *Business and Professions Code Section 24074.*

Costs and Expenses

19.(a) Seller shall bear the following costs and expenses:

(1) The cost of drafting and recording all instruments necessary to convey the business, other than the alcoholic beverage license, to Buyer.

(2) All sales taxes arising from the sale of the furniture, fixtures, and equipment of the business to Buyer.

(b) Buyer shall bear the following costs and expenses:

(1) The cost of drafting and recording or perfecting all instruments evidencing or securing the payment to Seller of the total purchase price specified in Paragraph 1 of this contract.

(2) Except as otherwise expressly provided in this paragraph, all costs, fees, and other expenses involved in securing the approval of the Department of Alcoholic Beverage Control to the transfer of the license to Buyer, including the cost of recording or publishing any notices required as a condition precedent to that approval.

(3) All governmental fees, taxes, and licenses not otherwise expressly specified in this paragraph, including the federal Special Occupational Tax, required to be paid as a condition precedent to the operation of the business by or the transfer of the license to Buyer.

(c) Buyer and Seller shall bear the following costs and expenses in equal proportions:

(1) The fee of the Escrow Holder identified in Paragraph 15 of this contract.

(2) The cost of recording and publishing the notice required by the Bulk Sales Division.

(3) Any and all other costs and expenses required for the performance of this contract or for completion of the sale, purchase, and transfer described in it.

Denial of License Transfer

20. If, after Buyer and Seller have exhausted all appropriate administrative remedies, the application for transfer of the alcoholic beverage license is finally denied for any reason, this contract shall be null and void except for the provisions

of Paragraph 14. The parties shall pay the costs and expenses incurred in the attempted performance of this contract in the proportions set forth in Paragraph 19, and each party shall be restored, to the extent possible, to his or her position prior to execution of this contract. However, this paragraph shall not prevent or bar either Buyer or Seller from maintaining an action against the other to recover damages for the breach of any warranty or other provision contained in this contract, when the breach was the cause for denial of the transfer.

Seller's Warranties

21. Seller hereby warrants and represents to Buyer that:

(a) Seller is the sole owner of the business, and no other person has any claim, right, or title to, or interest in, the business [*add, if applicable:*, except as shown on the attached schedule marked Exhibit _____].

(b) Seller has no undischarged obligations affecting the business or assets being sold pursuant to this contract, other than obligations arising in the usual and regular course of business listed in the attached document marked Exhibit _____.

(c) Seller has paid, or shall pay, all taxes owed by Seller on account of the Business.

(d) The books of account for the business constitute a complete record of the financial affairs of the business and accurately set forth all liabilities, assets, and other matters regarding the financial condition of the business.

(e) To the best of Seller's knowledge, the purchase and sale will not conflict with or violate any agreement or law to which Seller or the business is subject, and there are no pending or threatened lawsuits, other judicial proceedings, or administrative proceedings involving Seller or the Business.

(f) Seller is not in violation of the Alcoholic Beverage Control Act, and is not aware of any reason why the Department of Alcoholic Beverage Control should deny the application for transfer of the alcoholic beverage license from Seller to Buyer.

Buyer's Warranties

22. Buyer hereby warrants and represents to Seller that:

(a) No governmental tribunal has convicted or accused Buyer of violating the Alcoholic Beverage Control Act.

(b) Buyer has never been convicted of a felony.

(c) Buyer is not aware of any reason why the Department of Alcoholic Beverage Control should deny the application for transfer of the alcoholic beverage license from Seller to Buyer.

Indemnity Agreement by Seller

23. Except as otherwise expressly provided in this contract, Seller shall indemnify and hold Buyer and Buyer's property free and harmless from any and all claims, losses, damages, injuries, and liabilities arising from Seller's operation of the business or Seller's ownership of any of the assets of the business, including the alcoholic beverage license, prior to the sale and transfer to Buyer.

No Representations

24. Buyer represents to Seller that Buyer has inspected the assets and the books of account of the business, and that Buyer is purchasing the business as a result of that inspection and not as a result of any representations made by Seller or by any agent of Seller that are not incorporated into this contract. Buyer hereby expressly waives any and all claims for damages or for rescission or cancellation of this contract due to any representations made by Seller or any agent of Seller other than the representations contained in this contract.

Indemnity Agreement by Buyer

25. Buyer shall indemnify and hold Seller and Seller's property, including any interest given Seller, as security for payment of any portion of the total purchase price specified in Paragraph 3 of this contract, free and harmless from any and all claims, losses, damages, injuries, and liabilities arising from the operation of the business after the sale and transfer described in this contract, or during the period Buyer operates the business under any temporary permit issued to Buyer pending the purchase, sale, and transfer described in this contract.

Entire Agreement

26. This contract constitutes the entire agreement between Buyer and Seller concerning their rights and obligations with respect to the sale and purchase of the business, and transfer of the alcoholic beverage license. Any agreements or representations respecting the business, its sale to Buyer, or transfer of the alcoholic beverage license to Buyer, that are not expressly set forth in this contract shall have no effect, except for a subsequent written modification signed by the party to be charged.

Amendment of Contract

27. This contract may be amended or modified at any time with respect to any provision by a written instrument executed by Buyer and Seller.

Attorneys' Fees

28. If Buyer or Seller brings any legal action or seeks arbitration regarding any provision of this agreement, the prevailing party in the litigation or arbitration shall be entitled to recover reasonable attorneys' fees from the other party, in addition to any other relief that may be granted. This provision applies to this entire agreement. Buyer and Seller were each represented by an attorney in the negotiation and execution of the agreement.

Arbitration

29. Any dispute arising under this contract shall be settled by arbitration in accordance with [*specify method of arbitration or refer to specific rules, e.g.,* the Commercial Arbitration Rules of the American Arbitration Association], and judgment on the award rendered by the Arbitrator may be entered in any court having jurisdiction.

Notices

30. Any notice required or permitted to be given under this contract shall be written, and may be given by personal delivery or by registered or certified mail, first-class postage prepaid, return receipt requested. Notice shall be deemed given upon actual receipt in the case of personal delivery, or upon mailing. Mailed notices shall be addressed as follows, but each party may change address by written notice in accordance with this paragraph:

To Buyer at: _____[*address*].

To Seller at: _____[*address*].

Assignment

31. Neither Buyer nor Seller shall assign any right or interest arising under this contract without the prior written consent of the other. [*Add if buyer gave note for purchase price:* Nothing contained in this Paragraph, however, shall prevent Seller, after sale of the business and transfer of the alcoholic beverage license, from negotiating, assigning, or transferring any promissory note or other evidence of indebtedness given to Seller as part of the purchase price pursuant to Paragraph 5 of this contract.]

Binding on Heirs

32. This contract shall be binding on and shall inure to the benefit of the heirs, executors, administrators, successors, and assigns of Buyer and Seller.

Governing Law

33. This contract shall be governed by and construed in accordance with the laws of California.

Executed on _____[*date*], at _____, California.

SELLER
_____ [*signature of seller*]
[*typed name*]
BUYER
_____ [*signature of buyer*]
[*typed name*]

Escrow Holder's Acceptance

I hereby accept the appointment as Escrow Holder set forth in this sales contract.
_____ Dated:

ESCROW HOLDER
_____ [*signature of escrow holder*]
[*typed name*]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
A. Sales Contract and Escrow Agreement

8-18 California Legal Forms--Transaction Guide § 18.201

AUTHOR: Lynne Carmichael

§ 18.201 Escrow Instructions for Sale of Retail Alcoholic Beverage License and Business

[1] Comment

[a] Use of Form

This form is a complete set of escrow instructions for the sale of a retail alcoholic beverage license and business subject to both the Alcoholic Beverage Control Act [*Bus. & Prof. Code § 23000 et seq.*] and applicable provisions of the Bulk Sales Division of the Commercial Code [*Com. Code §§ 6101-6111*]. It is designed for use with the contract of sale *set forth in § 18.200.*

[b] Escrow Instructions In General

An escrow is a procedural device for effectuating a sales transaction that requires a concurrent exchange of money and documents for the transfer of title to property after all conditions precedent have been satisfied. To ensure that the separate interests of each party are protected, a disinterested party called the "escrow holder" or "escrow agent" handles the details of the transaction [*see Civ. Code § 1057* (escrow holder must be third party)]. Escrow instructions are used to authorize and direct the escrow holder to act as the agent of the parties to the agreement, and to take the specific steps necessary to carry out the agreement. They define and limit the authority and the obligations of the escrow holder [*see Axley v. Transamerica Title Ins. Co. (1978) 88 Cal. App. 3d 1, 8-9, 151 Cal. Rptr. 570]* . The buyer and seller may use joint or separate escrow instructions to direct the escrow holder. This form consists of joint instructions.

For further discussion of escrow instructions for the sale of a business, see Ch. 17, *Buying and Selling a Business or Professional Practice* . For coverage of escrow generally, and for examples of escrow instructions applicable to the sale of real property, see Ch. 26, *Real Property Escrows* .

[c] Mandatory Nature of Escrow

In contrast to the sale of other businesses [*see* Ch. 17, *Buying and Selling a Business or Professional Practice*], the transfer of a retail alcoholic beverage license and business that involves a purchase price or consideration must be handled pursuant to an escrow [*Bus. & Prof. Code § 24074*]. Before the parties may file a transfer application for such a transaction with the Department of Alcoholic Beverage Control ("ABC"), they must establish an escrow with some person, corporation, or association that meets statutory requirements [*Bus. & Prof. Code § 24074*; *see* [d], *below*], and the buyer must deposit the total purchase price with the escrow holder [*Bus. & Prof. Code § 24074*; *see § 18.41[4]*]. After the ABC approves the transfer, the escrow holder must distribute the deposited money to the seller's creditors [*Bus. & Prof. Code § 24074*; *see § 18.51[2]*].

The transfer of an off-sale beer and wine license [*see § 18.22[1]*] is exempted from the escrow requirement when a corporation with a net worth on a consolidated basis of not less than $5 million (according to its most recent audited financial statement) files a guaranty that (1) assures full, prompt, and faithful payment of all claims of bona fide creditors of the seller, and (2) is acceptable to the creditors [*Bus. & Prof. Code § 24074.4*]. All other transfers involving consideration must be handled pursuant to an escrow [*see Bus. & Prof. Code §§ 24074, 24074.1*].

[d] Appointment of Escrow Holder

The parties must appoint a person, corporation, or association that is not a party to the transfer to act as escrow holder [*Bus. & Prof. Code § 24074*]. The escrow holder must meet the requirements of Chapter 1 of the Escrow Law [*Bus. & Prof. Code § 24074.1*; *see Fin. Code §§ 17000-17010* (application of Escrow Law)]. For a discussion of that law [*Fin. Code § 17000 et seq.*], see Ch. 26, *Real Property Escrows* . Because the attorney handling the sale may act as escrow holder, it should be noted that a California-licensed attorney who has a bona fide client relationship with a principal in a real estate or personal property transaction and who is not actively engaged the business of an escrow agent is exempt from the requirements of that law [*Fin. Code § 17006(a)(2)*].

[e] Specific Escrow Instructions

[i] Notice of Intended Bulk Sale

The Bulk Sales Division [*see Com. Code § 6101 et seq.*] requires a buyer to record and publish advance notice of the proposed sale [*see Com. Code §§ 6104(b), 6105*]. If a buyer fails to comply with the bulk sale notice requirements [*see Com. Code § 6104*] with respect to one or more claimants, the buyer is liable for damages in the amount of any claims against the seller, less any amount that the claimant would not have realized if the buyer had complied with the notice requirements [*Com. Code § 6107(a)*; *but see Com. Code § 6107(c)* (good faith attempt at compliance), (d)-(f) (limitation of liability)]. This form instructs the escrow holder to prepare that notice, obtain the buyer's signature, and to record, publish, and deliver it on behalf of the buyer [*see* P 4 of Form]. For an example and discussion of the notice of intended bulk transfer, see *§ 18.211*.

[ii] Information Request

These instructions require the escrow holder to mail Form UCC-11, "Request for Information or Copies," and the applicable filing fee to the Secretary of State's office [*see Com. Code §§ 9523, 9528*; *see also* P 8 of Form]. Form UCC-11 is used to request a certificate showing whether any presently effective financing statement is on file with respect to the seller's business [*see Com. Code § 9523*; *see also* Ch. 42, *Secured Transactions*]. On the request of any person and payment of the statutory fee, the Secretary of State must issue a combined certificate showing financing statement information [*see Com. Code § 9523*], state tax lien data [*see Gov. Code § 7226*], attachment lien information [*see Code Civ. Proc. §§ 488.375, 488.405*], judgment lien information [*see Code Civ. Proc. § 697.580*], and federal lien information [*Com. Code § 9528(a)*; *see Code Civ. Proc. § 2103*]. For an illustration of Form UCC-11, see *Ch. 42, Secured Transactions, § 42.216*. Copies of Form UCC-11 are also available online from the Secretary of State's office at www.ss.ca.gov/business/ucc/ucc.htm and from office supply stores.

[iii] Deposit of Total Purchase Price

Before filing an application for transfer [*see § 18.221* (ABC-217)] with the ABC, the buyer must deposit the full amount of the purchase price or consideration with the escrow holder [*Bus. & Prof. Code § 24074*; *see* § 9 of Form]. The purchase price or consideration need not be entirely in the form of cash, draft, or check, but may in whole or part consist of promissory notes. The amount deposited may be either (1) the total consideration for the property, business, and the liquor business, (2) the separate reasonable consideration for the licensed business and license, if there is one in the contract, or (3) the consideration for the license only when it is the only asset being transferred person to person to another location [*see* Form ABC-227 INSTR**,** p. 2 (9/99)].

[iv] Acknowledgment of Creditor Claims

The instructions should require the escrow holder to acknowledge each creditor's claim [*see § 18.128*] within 10 days of receipt [*see Bus. & Prof. Code § 24074.1*], and to submit each claim to the seller for approval or dispute [*see* P 13 of Form; *see also Bus. & Prof. Code § 24074*].

[v] Notice to Creditors of Disputed Claims

The instructions should also require the escrow holder to notify each claimant whose claim has been disputed by the seller that: (1) the seller disputes the claim, (2) the amount otherwise payable on the claim will be retained in escrow for 25 days, and (3) the escrow holder will pay that amount to the seller unless the claimant attaches it during the 25-day period [*Bus. & Prof. Code § 24074*; *see* P 13 of Form]. For additional coverage of these procedures, see *§ 18.128*.

[vi] Prohibition on Exchange of Funds

The escrow holder must not release any funds deposited into escrow in exchange for a promissory note or in exchange for any other consideration of less value to the creditors than the funds exchanged [*Bus. & Prof. Code § 24074.2*; *see* P 22 of Form].

[vii] Time for Payment

The parties must instruct the escrow holder to pay or distribute the amount deposited by buyer within a reasonable time after the transfer of the license [*Bus. & Prof. Code § 24074*; *see* PP 19, 20 of Form].

[viii] Payment of Tax Holds

The ABC may refuse to transfer any license when the seller is delinquent in the payment of any taxes due under any of the following laws, if the tax liability arises partially or completely from the exercise of the privileges of the alcoholic beverage license [*Bus. & Prof. Code § 24049*; *4 Cal. Code Reg. § 68.2*]:

- The Alcoholic Beverage Tax Law [*Rev. & Tax. Code § 32001 et seq.*].
- The Sales and Use Tax Law [*Rev. & Tax. Code § 6001 et seq.*].
- The Personal Income Tax Law [*Rev. & Tax. Code § 17001 et seq.*].
- The Corporation Tax Law [*Rev. & Tax. Code § 23001 et seq.*].
- *Rev. & Tax. Code §§ 134* and *405(a)* regarding tax on unsecured property.

Similarly, the ABC may refuse to transfer a license if the seller is delinquent in the payment of any amount due under

the Unemployment Insurance Code when the liability arises from the conduct of a business licensed by the ABC [*Bus. & Prof. Code § 24049*; *4 Cal. Code Reg. § 68.2*; *see § 18.51[1]*]. Furthermore, the buyer will be liable as a successor for any unpaid taxes owed by the seller to the Board of Equalization [*see Rev. & Tax. Code § 6812* (sales tax); *Unemp. Ins. Code §§ 1733*, 13002(i) (employment and income taxes); *see also* Ch. 17, *Buying and Selling a Business or Professional Practice*]. The parties must therefore instruct the escrow holder to first pay the tax obligations set forth in Rev. & Tax. Code § 24049 [*see Bus. & Prof. Code § 24074*; P 14 of Form].

[ix] Notice to Creditors Regarding Distribution

Not more than 10 days after the retail alcoholic beverage license has been transferred, and prior to distribution of the assets deposited by the buyer into escrow, the escrow holder must advise each creditor who has filed a timely claim whether or not there are sufficient assets in the escrow to pay all creditors in full [*Bus. & Prof. Code § 24074.1*; *see* P 17 of Form]. If the assets in escrow are sufficient to pay all creditors in full, the notice must specify the date on or before which payment will be made. If the assets are insufficient to pay all creditors in full, the notice must state all of the following [Bus. & Prof. Code P 24074; *see* P 17 of Form]:

- The total assets deposited into escrow and the nature of each asset.
- The name of each creditor who filed a claim against the escrow and the amount of each claim.
- The amounts the escrow holder proposes to pay or set aside for each creditor.
- The date on or before which the escrow holder will distribute the assets to creditors.

For an example and discussion of this notice, see *§ 18.243*.

[x] Payment of Other Creditor Claims

The parties must direct the escrow holder to pay out of the purchase price or consideration, after any tax holds have been removed, the claims of the bona fide creditors of the licensee who filed their claims with the escrow holder before he or she was notified by the ABC of the license transfer [*Bus. & Prof. Code § 24074*; *see* P 19 of Form]. They must further direct the escrow holder to distribute the assets in escrow as follows, if the purchase price or consideration is not sufficient to pay those claims in full [*Bus. & Prof. Code § 24074*; *see § 18.51[2]*; P 20 of Form]:

- First, to the United States for claims based on income or withholding taxes, then for other tax claims not specified in *Bus. & Prof. Code § 24049*.
- Second, to the payment of claims for wages and other compensation earned by employees of the seller prior to the sale, transfer, or opening of escrow.
- Third, to the payment of claims of secured creditors, to the extent of the proceeds that arise from the sale of the security.
- Fourth, to the payment of claims on mechanics' liens.
- Fifth, to the payment of escrow fees and claims for brokerage and attorneys' fees.
- Sixth, to the payment of claims for goods sold and delivered to the seller for resale at the licensed premises; to the payment of claims for services rendered, performed, or supplied in connection with the operation of the licensed business; and to the payment of the claims of a landlord to the extent of

proceeds on past due rent.

- Seventh, to the payment of other claims that have been reduced to court-ordered judgments, including claims for court-ordered support of a minor child.

- Eighth, to the payment of all other claims. If sufficient assets are not available for payment of each claim in full, payment must be made pro rata.

[f] Standard Escrow Instructions

[i] Recitals

In addition to the specific instructions required by the Bulk Sales Division, the Alcoholic Beverage Control Act, and successor liability statutes, discussed above, the parties should include standard instructions regarding handling of the escrow [*see* Ch. 26, *Real Property Escrows* , for coverage]. The first provision should set forth the parties, the purpose of the escrow, and the closing date [*see* P 1 of Form].

[ii] Obligations to Escrow Holder

The parties should agree to indemnify the escrow holder for liability for actions taken by the escrow holder pursuant to the instructions, and agree to reimburse the escrow holder for costs incurred in following the instructions. Further, they should agree to pay the applicable escrow fees [*see* P 2 of Form].

[iii] Deposits into Escrow

The instructions should list the documents and other property that each party is required to deposit into escrow [*see* PP 9, 10 of Form]. The items should be separately listed, so that the escrow holder can confirm when he or she has all the items necessary to close the escrow.

[iv] Inventory

The instructions should require the escrow holder to obtain an inventory of the property being sold from the person or company taking the inventory [*see* P 11 of Form]. For further discussion of inventory, see *§ 18.210[1]*.

[v] Transfer of Documents

The parties should instruct the escrow holder to arrange for the transfer of any insurance policies to be assigned to the buyer [*see* P 12 of Form]. The instructions should also require the escrow holder to obtain the appropriate papers for the transfer of any other assets, such as motor vehicles, to the buyer [*see* P 12 of Form]. For discussion and examples of transfer documents, see Ch. 102D, *Registration and Transfer of Vehicles, Vessels, and Aircraft* .

[vi] Proration of Expenses

The instructions should list the expenses that the parties will prorate, and the manner of proration [*see* P 18 of Form].

[2] FORM

Escrow Instructions for Sale of Retail Alcoholic Beverage License and Business

JOINT ESCROW INSTRUCTIONS OF BUYER AND SELLER

TO: _____[*name of escrow holder*]

_____[*address*]
_____[*city, state, zip code*]

_____[*name of seller*], "Seller," and _____[*name of buyer*], "Buyer," deposit with you the following joint escrow instructions ("Instructions"):

Preliminary Recitals

1. Seller has entered into a contract ("the contract"), which is attached and marked "Exhibit _____," to sell to Buyer [*describe business, e.g.,* a restaurant and cocktail lounge] known as "_____" [*name of business*] ("the business"), and _____[*specify type and number of license, e.g.,* an on-sale beer and wine alcoholic beverage license, No. _____ (*license number*)] ("the alcoholic beverage license"), issued by the Department of Alcoholic Beverage Control for the premises on which the business is located. The contract appoints you as escrow holder for the sale. Subject to the terms and conditions set forth below, Seller and Buyer hereby authorize and instruct you to open an escrow for the purpose of completing the sale of the business, and to complete the sale in accordance with the following instructions. The date set for closing, subject to prior approval by the Department of Alcoholic Beverage Control [*add if business is subject to franchise agreement:* and written consent from the franchisor] is _____[*specify date and time*].

Parties'Obligations to Escrow Holder

2.(a) Buyer and Seller agree to be jointly and severally liable to indemnify you and hold you and your property free and harmless from any and all claims, loss, damage, or liability to either or both Buyer and Seller or to any other person arising as a result of this escrow due to:

(1) The failure of any condition or conditions of this escrow.

(2) Your failure to ascertain or comply with the terms of any document, other than these Instructions, unless that document is filed in this escrow and you are expressly instructed by these Instructions to comply with a specified paragraph or provision of that document.

(3) Forgeries or false impersonations.

(4) Exercise of your discretion in any particular manner in any situation in which you are authorized by these Instructions to exercise your discretion.

(5) Any reason other than your gross negligence or willful misconduct in following these Instructions and acting as escrow holder of this escrow.

(b) Buyer and Seller further agree to be jointly and severally liable to reimburse you for all costs and expenses incurred by you in fulfilling these Instructions and performing your duties as escrow holder of this escrow, if they are not otherwise paid to you in the manner provided in these Instructions.

(c) Buyer and Seller further agree to be jointly and severally liable to pay you a reasonable fee for your services in acting as escrow holder of this escrow and fulfilling these Instructions.

Notices to Buyer and Seller

3. Any notice required or permitted to be given by you to Buyer or Seller pursuant to the contract, these Instructions, or law, shall be in writing. Notice shall be deemed given upon personal delivery, or upon deposit in the United States mail, first-class postage prepaid, addressed as follows:

To Buyer: _____[*address*].

To Seller: _____[*address*].

Either party may change his or her address by giving notice to you in accordance with this paragraph.

Notice of Bulk Sale

4.(a) As soon as possible after opening escrow, prepare a notice of bulk sale stating all of the following, in accordance with *Commercial Code §§ 6103(c)(15)* and *6105*:

(1) That a bulk sale is about to be made.

(2) The names and business addresses of Buyer and Seller, and all other business names and addresses used by Seller within the past three years, to the extent known.

(3) The location and general description of the business property to be transferred.

(4) The place and date on or after which the sale will be made.

(b) At least 12 business days before closing, take all of the following actions:

(1) Have Buyer and Seller execute the notice.

(2) Record the notice in the office of the county recorder for _____ [*specify county or counties where seller and tangible assets of business are located*].

(3) Publish the notice at least once in a newspaper of general circulation in the judicial district where the business property is located. If the business property is located in more than one county, publish the notice in the judicial district where the greater portion of the business property is located. In addition, publish the notice in a newspaper of general circulation in the judicial district, if different, where (i) the seller's place of business is located, (ii) the seller's chief executive office in California is located, or (iii) the seller's major executive office in California is located (if the seller is outside the United States). If there is no such newspaper, publish the notice in a newspaper of general circulation in the county embracing that judicial district.

Notice of Intended Transfer

5.(a) As soon as possible after opening escrow, prepare a notice of intended transfer stating all of the following, in accordance with *Bus. & Prof. Code § 24073*:

(1) The Seller's name and address.

(2) The Buyer's name and address.

(3) The type of license to be transferred.

(4) The address of the premises to which the license was issued.

(5) An agreement between the Buyer and Seller that the consideration for the transfer of the business and license will be paid only after the Department of Alcoholic Beverage Control has approved the transfer.

(6) The place where the purchase price for the business and license will be paid; the amount of the purchase price; and a description of the entire consideration, including a designation of cash, checks, promissory notes, and tangible and intangible property, and the amount of each.

(7) Your name and business address.

(b) Record the notice in the office of the county recorder for _____ [*county where business is located*] County.

Sales Tax Clearance

6. As soon as possible after opening escrow, request from the Board of Equalization, on behalf of and in the name of Buyer, a statement showing the amount due or a certificate stating that no amount is due from Seller on account of the seller's permit issued to Seller for the operation of the business.

Unemployment Insurance Clearance

7. As soon as possible after opening escrow, request from the Employment Development Department, on behalf of and in the name of Buyer, a statement showing the amounts due or a certificate stating that no amount is due from Seller under the Unemployment Insurance Code on account of the business. If the Employment Development Department does not issue the certificate or statement within 30 days from your request, you may assume that no amount is claimed by that Department.

Financing Statements

8. Prepare and forward to the Secretary of State, Form UCC-11, "Request for Information," requesting a certificate showing any presently effective financing statements on file naming Seller as debtor. Upon receipt of the certificate, either:

(a) Obtain Buyer's written acknowledgment and acceptance of any items stated on the certificate; or

(b) Inform Seller of the reasons that Buyer will not accept the items stated on the certificate, and have Seller either pay the items or make arrangements satisfactory to Buyer for their adjustment.

Buyer's Deposits Into Escrow

9. Upon execution of these Instructions, Buyer shall deposit into escrow all of the following:

[*If buyer will pay purchase price in cash:*]

(a) The sum of $_____.

[*Or, if payment will be a combination of cash and other consideration:*]

(a) The sum of $_____, and each of the following:

(1) A promissory note in the amount of $_____, executed by Buyer, that is substantially in the form of the note attached to the contract as Exhibit _____, and that is payable without interest to you on demand prior to the close of escrow.

(2) A promissory note in an amount to be stated by you (which shall be the sum of $_____ plus the value of the stock in trade and merchandise as shown on the inventory taken in accordance with Paragraph _____ of the contract), that (i) is executed by Buyer; (ii) is substantially in the form of the note attached to the contract as Exhibit _____; (iii) provides for payment of the principal balance of the note in monthly installments of $_____ beginning one month after close of escrow; and (iv) provides for interest on the unpaid principal balance of the note from the close of escrow at the rate of _____ percent per year, payable monthly commencing one month after the close of escrow.

(3) A security agreement in the form of the document attached to the contract marked Exhibit _____, granting to Seller a security interest in all of the property described in Paragraph _____ of the contract.

(4) Any financing statements prepared by Seller to perfect the security interests granted by the security agreement.

[*Continue with the following:*]

(b) Approval or rejection of each insurance policy on the list of policies deposited by Seller pursuant to Paragraph 10 of these Instructions.

(c) A copy of the inventory of the stock in trade and merchandise of the business taken as described in Paragraph _____ of the contract and approved with Buyer's signature.

(d) The amount required to pay Buyer's share of any prorations described in Paragraph 18 of these instructions.

(e) The amount required to pay Buyer's share of estimated escrow fees and costs pursuant to Paragraph 23.

(f) The amount required to pay Buyer's share of the following costs and expenses: _____ [*list costs and expenses to be paid by Buyer, e.g.:*

(1) One-half the cost of publishing and recording all notices and other instruments required by the Bulk

Sales Division of the California Commercial Code to be published or recorded in connection with this escrow;

(2) One-half of all costs, expenses, and charges incurred by you or by Buyer and Seller in taking inventory of the stock in trade and merchandise on _____ [*date*] in accordance with Paragraph 11 of these Instructions;

(3) The costs of recording all instruments reasonably necessary or convenient to effect the transfer to Buyer of the business and assets; and

(4) One-half of all other costs and expenses incurred by you or Buyer and Seller as a result of this escrow, other than (i) any sales taxes arising from the sale, and (ii) the costs of drafting and recording or perfecting any instruments described in these instructions that evidence or secure the payment of money by Buyer to Seller.]

Seller's Deposit in Escrow

10. On or before _____[*closing date*], Seller shall deposit into escrow all of the following:

(a) A bill of sale executed by Seller conveying to Buyer:

(1) All the stock in trade and merchandise of the business as shown on a complete inventory and accounting of that stock in trade and merchandise to be taken pursuant to Paragraph _____ of the contract of sale.

(2) All the furniture, fixtures, equipment, and other tangible assets of the business, shown on the inventory marked "Exhibit _____ attached to the contract [*add if desired:*, with the following exceptions: _____ (*describe any exceptions*)].

(3) All the trade, goodwill, and other intangible assets of the business.

(b) A valid assignment of lease executed and acknowledged before a notary public by Seller assigning to Buyer all Seller's interest under the lease dated _____ between Seller as Lessee and _____[*name of lessor*] as Lessor for the premises occupied by the business.

(c) A consent to Seller's assignment of the above lease, executed and acknowledged before a notary public by _____[*name of lessor*].

(d) The certificate of ownership issued by the California State Department of Motor Vehicles for each motor vehicle included in the fixtures and equipment of the business as shown on the attached inventory marked Exhibit _____, executed by Seller in the manner required to transfer registered ownership of each vehicle to Buyer.

(e) Any other instruments, executed by Seller, that in your opinion are reasonably necessary or convenient to transfer, assign, or register ownership of any of the tangible or intangible assets of the business to and in the name of Buyer.

(f) The latest tax bills received by Seller from the County of _____ and other taxing authorities showing the amount or amounts of personal property taxes levied or assessed, either for the current tax year or the preceding tax year, on any of the fixtures and equipment of the business shown on the inventory marked Exhibit

_____ attached to the contract.

(g) A list of all persons employed by Seller in connection with the business showing (i) their names, social security numbers, positions, and salaries; (ii) the dates on which they are paid each month; and (iii) the amount of contributions accruing each pay period to union welfare and pension funds, Christmas bonus funds, and vacation funds for each employee.

(h) A list of all insurance policies insuring the business or the assets of the business and showing (i) the number of each policy; (ii) the insurance company and agent that issued each policy; (iii) the premium payable on each policy; and (iv) the beginning and expiration dates of each policy.

(i) Seller's written approval or rejection, within 24 hours after receipt, of all claims against the business received by you prior to [*specify, e.g.,* 10 A.M.] on _____[*date set for closing*], and submitted to Seller pursuant to 13 of these Instructions.

(j) The amount required to pay Seller's share of any prorations described in Paragraph 18 of these Instructions.

(k) The amount required to pay Seller's share of estimated escrow fees and costs pursuant to Paragraph 23 of these Instructions.

(l) The amount required to pay Seller's share of the following costs and expenses: [*list costs and expenses to be paid by Seller*].

Inventory

11. On or before the closing, obtain from _____[*name of person or firm that will take inventory of the stock in trade and merchandise of the business*]:

(a) The total value, determined as provided in Paragraph _____ of the contract of sale, of the stock in trade and merchandise of the business;

(b) The amount of all costs, expenses, and charges incurred for taking and computing the inventory of the stock in trade and merchandise of the business; and

(c) A complete copy of the inventory and accounting.

Insurance Policies and Transfer Documents

12. Contact the agent or company issuing each insurance policy for the business to be transferred to Buyer, and obtain all instruments required to transfer to Buyer each insurance policy that has been approved by Buyer. Obtain Buyer's signature on the certificates of vehicle ownership issued by the Department of Motor Vehicles and all other transfer documents deposited by Seller pursuant to Paragraph 10 of these Instructions.

Acknowledgment of Creditor Claims

13.(a) In accordance with *Business and Professions Code Section 24074.1*, send written acknowledgement to each creditor within 10 days of receiving that creditor's claim.

(b) Promptly submit all claims to Seller for approval or rejection, and inform Seller that you will treat a claim as approved if Seller does not dispute it in writing within [*number*] of days after receipt.

(c) For each claim that the Seller disputes, notify the claimant, in accordance with *Business and Professions Code Section 24074*:

(1) That the Seller has disputed the claim;

(2) That you will retain the amount otherwise payable on the claim for a period of 25 days after transfer of the license and business; and

(3) That if the creditor does not attach the amount otherwise payable on the claim within the 25-day period, you will pay that amount to the Seller.

Payment of Taxes

14.(a) The Department of Alcoholic Beverage Control may refuse to transfer the Seller's license if the Seller owes taxes under any of the following laws, when the tax liability arises partially or completely from the alcoholic beverage license or business:

(1) The Alcoholic Beverage Tax Law.

(2) The Sales and Use Tax Law.

(3) The Personal Income Tax Law.

(4) The Corporation Tax Law.

(5) *Revenue and Taxation Code Sections 134, 405(a)*, regarding tax on unsecured property.

(6) The Unemployment Insurance Code.

(b) If you receive notice that any amounts are due from Seller for any of the taxes listed in subparagraph (a), immediately verify with Seller that the amount of taxes claimed is correct, and that the tax arose in full or in part from the business or license.

(c) Hold all instruments and money received by you from Buyer or Seller pursuant to Paragraphs 9 or 10 of these Instructions until you receive notice from the Department of Alcoholic Beverage Control that nothing is preventing approval of the transfer except the tax delinquencies; at that time, if Seller and Buyer have performed all other conditions of this escrow:

[*Include if buyer will give note for purchase price:*]

(1) Demand that Buyer pay the promissory note described in Paragraph 9(a)(1) of these Instructions.

[*Continue with the following:*]

(2) Demand from Seller any amounts in excess of the cash deposited [*add if applicable:* and demand promissory note described in Paragraph 9(a)(1) of these Instructions] necessary to pay the taxes claimed pursuant to subparagraph (b) of these Instructions.

(3) Pay the taxes claimed pursuant to subparagraph (b) and obtain a release from the taxing authority.

(4) Send the tax releases to the Department of Alcoholic Beverage Control.

Determination of Closing Date

15. Except as provided in Paragraph 14 of these Instructions, hold all money and instruments demanded and received by you from Buyer or Seller pursuant to these Instructions until the date specified in Paragraph 1, or until _____[you receive written notice from the Department of Alcoholic Beverage Control approving the transfer *or, if business is subject to franchise agreement:* the Department of Alcoholic Beverage Control has approved transfer of the alcoholic beverage license, and _____ (*name of franchisor*), Franchisor, has given written consent to the purchase and sale], whichever date last occurs. Treat the latest of those dates as the date on which this escrow will close. At that time, if Buyer and Seller have satisfied all other conditions of these Instructions:

(a) Unless you have already done so pursuant to Paragraph 14, demand that Buyer pay the promissory note described in Paragraph 9(a)(1) of these Instructions.

(b) Have Seller execute the security agreement deposited by Buyer pursuant to Paragraph 9(a)(3).

(c) Complete the promissory note described in Paragraph 9(a)(2) of these Instructions by inserting the applicable amounts.

Determination of Assets Available for Distribution

16. After you have received written notice from the Department of Alcoholic Beverage Control approving the transfer:

(a) Determine the total amount of all creditor claims that were filed before you received notification of the approval, and therefore constitute timely claims.

(b) Determine whether the funds remaining in escrow after payment of taxes pursuant to Paragraph 14 of these Instructions are sufficient to pay in full all of the timely creditor claims, whether approved or disputed by Seller. If the funds are insufficient, determine the pro rata amount payable on each claim, in accordance with the order of priorities specified in Paragraph 20.

Notice to Creditors Regarding Distribution

17.(a) Within 10 days after transfer of the license, notify each creditor who has filed a timely claim whether there are sufficient assets in the escrow to pay all creditors in full.

(b) If the assets remaining in escrow are sufficient to pay all creditors in full, state the date on or before which you will pay their claims.

(c) If the assets remaining in escrow are insufficient to pay all creditors in full, state:

(1) The total assets placed in escrow with you and the nature of each asset;

(2) The name of each creditor who filed a claim against the escrow, and the amount of each claim;

(3) The amounts you propose to pay or set aside for each creditor; and

(4) The date on or before which you will distribute the assets to creditors.

Closing

18.(a) Deliver to Buyer the bill of sale deposited by Seller pursuant to Paragraph 10 of these Instructions.

(b) Deliver to Buyer all other instruments deposited by Seller pursuant to Paragraph 10 of these Instructions as reasonably necessary or convenient to transfer, assign, or register ownership of any of the tangible or intangible assets of the business.

(c) Forward the assignment of lease and consent to assignment of lease executed and acknowledged by Seller and _____[*name of lessor*] deposited by Seller pursuant to Paragraph 10 of these Instructions, together with the required recording fees, to the County Recorder of _____ County, California, for recording.

(d) Have the assignment of lease and consent to assignment returned to Buyer at _____[*address*].

(e) Forward all Department of Motor Vehicles ("DMV") certificates of ownership deposited by Seller pursuant to Paragraph 10 of these Instructions, together with your check for any required fees, to the DMV for registration and transfer of the vehicles to Buyer.

(f) As soon as you receive the inventory of the stock in trade and merchandise of the business pursuant to Paragraph 11, make photocopies of the inventory and deliver them to Buyer and Seller.

[*Add, if purchase price will be paid in installments (see P 9):*]

(g) Forward the financing statements deposited by Buyer pursuant to Paragraph 9 of these Instructions, together with your check for the required filing fee, to the California Secretary of State.

[*Continue with the following:*]

(h) Prorate all of the costs and expenses listed in Paragraph _____ of the contract, on the basis of 30-day months, as of 12:01 A.M. Pacific time on the closing date determined in accordance with Paragraph 15.

Distribution of Sufficient Sales Proceeds

19. If, pursuant to Paragraph 16 of these Instructions, you have determined that the amount remaining on deposit in escrow after payment of taxes pursuant to Paragraph 14, whether in the form of cash, checks, promissory notes, or tangible or intangible property, is sufficient to pay in full all of the timely creditor claims filed with you, distribute the

purchase price within a reasonable time after the transfer in the following manner:

(a) First, pay in full all claims that Seller has approved or failed to dispute in writing in accordance with Paragraph 13.

(b) Second, set aside and retain for 25 days after the transfer the full amount of any claim expressly disputed by Seller pursuant to Paragraph 13; and

(i) If the creditor of a disputed claim serves you with a writ of attachment for the retained amount during the 25-day period, answer the writ of attachment in the manner required by law and retain that amount until final settlement and discharge of the writ; or

(ii) If the creditor of a disputed claim does not serve you with a writ of attachment for the retained amount during the 25-day period, pay the retained amount to Seller within _____ [*specify time period, e.g.*, five days after expiration of the 25-day period].

[*Add, if buyer paid purchase price with note:*]

(c) Third, unless it has been attached or liquidated to pay creditor claims, deliver to Seller the promissory note and security agreement demanded and received by you from Buyer pursuant to Paragraph 9 of these Instructions and the security agreement demanded and received by you from Buyer.

[*Continue with the following:*]

(d) Finally, pay any funds remaining on deposit with you to Seller.

Distribution of Insufficient Sales Proceeds

20. If, pursuant to Paragraph 16 of these Instructions, you have determined that the amount remaining on deposit in escrow after payment of taxes pursuant to Paragraph 14, whether in the form of cash, checks, promissory notes, or tangible or intangible property, remaining on deposit in this escrow is not sufficient to pay in full all of the timely creditor claims filed with you, distribute the remaining amount within a reasonable time after the transfer in the following manner:

(a) Pay all claims in the following order of priority:

(1) First, to the United States for claims based on income or withholding taxes, and thereafter for claims based on any tax other than the taxes specified in Paragraph 14 of these Instructions.

(2) Second, to the payment of claims for wages, salaries, or fringe benefits that Seller's employees earned or accrued prior to the sale and transfer of the business and license or the opening of this escrow.

(3) Third, to the payment of claims of secured creditors to the extent of the proceeds that arise from the sale of their security.

(4) Fourth, to the payment of claims on mechanics' liens.

(5) Fifth, to the payment of escrow fees, the payment of claims for prevailing brokerage fees for services rendered, and claims for reasonable attorneys' fees for services rendered.

(6) Sixth, to the payment of claims for goods sold and delivered to Seller for resale at the premises for which the license was issued; to the payment of claims for services rendered, performed, or supplied in connection with the operation of the licensed business; and to the payment of claims of a landlord, to the extent of proceeds on past due rent.

(7) Seventh, to the payment of other claims that have been reduced to court ordered judgments, including claims for court ordered support of a minor child.

(8) Eighth, to the payment of all other claims, which may be made pro rata if sufficient assets are not available for payment in full.

(b) Set aside and retain for 25 days after the transfer the pro rata amount of any claim expressly disputed by Seller pursuant to Paragraph 13; and

(1) If the creditor of a disputed claim serves you with a writ of attachment for the retained amount during the 25-day period, answer the writ of attachment in the manner required by law and retain that amount until final settlement and discharge of the writ; or

(2) If the creditor of a disputed claim does not serve you with a writ of attachment for the retained amount during the 25-day period, pay the retained amount to Seller.

Denial of Transfer Application

21. If, after exhaustion of all appropriate administrative remedies, the application for transfer of the license from Seller to Buyer is finally denied, you shall:

(a) Adjust between Buyer and Seller any amounts due from one to the other under Paragraph _____ of the contract based on Buyer's operation of the business under a temporary retail permit.

(b) Reimburse yourself from the funds then remaining on deposit in this escrow for all costs and expenses incurred by you in performing these Instructions prior to the date you received notice of the denial of the transfer.

(c) Pay to yourself from the remaining funds on deposit in this escrow a reasonable fee for your services as escrow holder, not to exceed $_____.

(d) Return to Buyer and Seller all instruments, documents, and money deposited by each into escrow pursuant to these Instructions.

Prohibition on Exchange of Funds

22. You shall not release any funds deposited into escrow by Buyer or Seller in exchange for a promissory note or in exchange for any other consideration of less value to the creditors than the funds exchanged.

Escrow Fees and Costs

23. From the funds deposited with you by Buyer and Seller for escrow fees and costs pursuant to Paragraphs 9 and 10 of these Instructions, pay to yourself all amounts incurred or earned by you in handling this escrow. Deliver a receipt of those fees and costs to Buyer and Seller.

Executed on _____[*date*], at _____[*place*], California.

SELLER
_____ [*signature of seller*]
[*typed name*]
BUYER
_____ [*signature of buyer*]
[*typed name*]

Accepted and approved on _____[*date*].

ESCROW HOLDER
_____ [*signature of escrow holder*]
[*typed name*]



California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
A. Sales Contract and Escrow Agreement

8-18 California Legal Forms--Transaction Guide § 18.202

AUTHOR: Lynne Carmichael

§ 18.202 Contract for Sale of Retail Alcoholic Beverage License Only

[1] Comment

[a] Use of Form

This form is a contract for the sale of a retail alcoholic beverage license which is not accompanied by a sale of the going business for which the license was issued. It is intended for use when the buyer will transfer the license to new premises. The sale contemplated by this contract must comply with the Alcoholic Beverage Control Act [*see Bus. & Prof. Code § 23000 et seq.*; § 18.10[2]]. However, because the contract involves only the sale of a retail alcoholic beverage license and not more than half of the seller's inventory and equipment, the transfer is not subject to the Bulk Sales Division of the Commercial Code ("Bulk Sales Division") [*see Com. Code § 6102(a)(3)*; § 18.10[3]]. For discussion of the Bulk Sales Division and an example of a contract for the sale of both a license and business subject to its requirements, see *§ 18.200*. For a set of escrow instructions for use with such a contract, see *§ 18.201*.

This comment discusses only those contract provisions that are unique to this form. For discussion of the various provisions generally used in a contract for the transfer of a retail alcoholic beverage license, see *§ 18.200[1]*.

[b] Transfer of License to New Premises

[i] In General

Every retail alcoholic beverage license is separate and distinct, and is transferable upon approval by the Department of Alcoholic Beverage Control ("ABC") from the licensee to another person, and from one premises to another premises [*Bus. & Prof. Code § 24070*; *see § 18.40[1]*]. Subject to the rules limiting the number of licenses that may be issued in any county [*see § 18.30*], licenses may be transferred within the same county pursuant to a single transfer application [*4 Cal. Code Reg. § 60(a)*; *see § 18.220* (transfer application)].

[ii] Premises Under Construction

Although authorized by statute to do so [*see Bus. & Prof. Code § 24044*], the ABC ordinarily will not issue a new or original license for the retail sale of alcoholic beverages for premises that are under construction until the premises are substantially complete and ready for operation [*see 4 Cal. Code Reg. § 64(a)*]. However, the ABC may approve a license transfer from a licensee to a person who has premises under construction or to be constructed [*Bus. & Prof. Code § 24044*; *4 Cal. Code Reg. § 64(a)*]. For such a transfer, the ABC will hold the license until construction of the premises is complete and the premises are ready for operation [*4 Cal. Code Reg. § 64(b)*]. The escrow for the transfer need not remain open until the premises are completed. Rather, the escrow will close as usual, and the ABC will simply hold the license certificate pending completion, in order to prevent any sales under it [*4 Cal. Code Reg. § 64(b)*]. This procedure for the transfer of a license to premises under construction constitutes an exception to the general rule that requires a license issued for a specific location to be placed in use at that location within 30 days after issuance [*see Bus. & Prof. Code §§ 24040, 24044*]. However, no license transferred pursuant to this procedure may be retransferred prior to being placed into operation at the premises for which it was issued, except for undue hardship arising from causes beyond the buyer's control [*4 Cal. Code Reg. § 64(b)*]. The buyer may not sell any alcoholic beverages pursuant to the license until the premises have been completed [*Bus. & Prof. Code § 24044*].

PRACTICE TIP:

The ABC, in certain circumstances, will issue the license to the buyer so that the buyer can purchase alcoholic beverages and stock premises that are nearly ready for use. *Commentary by Lynne Carmichael.*

Every application for issuance or transfer of an alcoholic beverage license must be accompanied by a complete diagram, on a form furnished by the ABC, containing an exact description of clearly identifiable, tangible boundaries within which alcoholic beverages will be sold, served, or consumed pursuant to the license [*see 4 Cal. Code Reg. § 64.2(a)*]. When a license is being transferred to premises under construction, the application also must include a copy of the building plans or a sketch of the floor plan and the expected completion date [*see 4 Cal. Code Reg. § 64.1(c)*].

When the ABC holds a license pending completion of construction [*see Bus. & Prof. Code § 24044*; *4 Cal. Code Reg. § 64(b)*], the approved expected completion date may not be extended for more than six months unless the ABC determines that the delay in construction is beyond the control of the applicant or licensee [*4 Cal. Code Reg. § 64(c)*]. The ABC will deny the transfer application or cancel the license if already issued, if good cause for the delay does not exist [*4 Cal. Code Reg. § 64(c)*].

[c] Contract Provisions

[i] Purchase Price

The contract should state the total purchase price [*see* P 2 of Form]. For certain transfers of general retail licenses, that amount is limited by statute [*see Bus. & Prof. Code §§ 24070(d), (e), 24079*; *see also § 18.30[4]*]. Unlike the combined sale of a license and business, the parties need not allocate the purchase price among various assets [*see § 18.200[1][e]*].

Before an application for the transfer of an alcoholic beverage license may be filed, the buyer must deposit the full amount of the purchase price or consideration being paid for the license into escrow [*Bus. & Prof. Code § 24074*; *see* P 2 of Form]. Thus, unlike the contract for the sale of any other type of property, a contract for the sale of a retail alcoholic beverage license cannot provide that the buyer will pay a portion of the purchase price on close of escrow. This form provides for payment of the entire purchase price in cash [*see* P 2 of Form]. For an example and discussion of a provision for deferred payment, see *§ 18.200*.

[ii] Time and Place of Sale

The contract should specify the time and place for the sale. It should also provide that the sale will not take place on the scheduled date unless the ABC has approved the transfer [*see Bus. & Prof. Code § 24073*; *see also* P 3 of Form].

[iii] Application for License Transfer

The parties should agree to file an application for transfer within 90 days after execution of the contract [*see* P 4 of Form]. No license will be transferred if the transfer is to fulfill an agreement entered into more than 90 days preceding the date on which the transfer application is filed [*Bus. & Prof. Code § 24076*]. They should also agree to take all actions required to facilitate the transfer [*see Bus. & Prof. Code §§ 24073, 24074*; *see also* P 4 of Form].

[iv] Escrow Holder and Instructions

When the intended transfer of the alcoholic beverage license involves a purchase price or consideration, the buyer and seller must establish an escrow before filing a transfer application with the ABC [*Bus. & Prof. Code § 24074*; *see* P 5 of Form]. They must appoint an escrow holder who is not a party to the transfer [*Bus. & Prof. Code § 24074*], and who meets the requirements of Chapter 1 of the Escrow Law (other than a licensed attorney who is not actively engaged in conducting an escrow agency) [*Bus. & Prof. Code § 24074.1*; *see Fin. Code §§ 17000-17010*; P 5 of Form]. However, no escrow is required if, for a transfer of an off-sale beer and wine license: (1) a corporation with a net worth on a consolidated basis of at least $5 million according to its most recent audited financial statement files a guaranty of full payment of all creditor claims; and (2) the guaranty is acceptable to the creditors of the seller [*Bus. & Prof. Code § 24074.4*; *see § 18.125*]. For further discussion, see *§ 18.41[4]*.

Escrow instructions can be incorporated into the underlying agreement, so that the agreement itself serves as the instructions for the escrow that will be opened to implement it [*see* discussion in Ch. 26, *Real Property Escrows*]. This form sets forth the language of *Bus. & Prof. Code § 24074*, regarding the order in which the seller's creditors must receive payment from the deposited purchase price when the purchase price is insufficient to pay all claims in full [*see Bus. & Prof. Code § 24074*; P 6 of Form]. It should be noted, however, that every provision set forth in that section may not be applicable to the sale of the license without an accompanying sale of the business. For example, the requirement that the consideration be distributed in payment of the claims of secured creditors to the extent of the proceeds that arise from the sale of the security [*see Bus. & Prof. Code § 24074*] appears to be inapplicable, because an alcoholic beverage license cannot be used as security for an obligation [*see Bus. & Prof. Code § 24076*]. For further discussion of these payment provisions, see *§ 18.51[2]*. For a discussion of separate escrow instructions used for the sale of a license and business, and examples of additional escrow provisions that may be incorporated into this form, see *§ 18.201*.

[v] Denial of Transfer Application

This contract of sale provides that it will become null and void upon final denial of the application for transfer of the retail alcoholic beverage license. In addition, it requires the parties to be restored, to the extent possible, to their positions prior to execution of the contract. It also specifies that either party may bring an action to recover damages when the other party's actions resulted in denial of the transfer [*see* P 8 of Form].

[vi] Warranties

This form sets forth a warranty that the seller is not in violation of the Alcoholic Beverage Control Act, and knows of no reason that the ABC might deny transfer of his or her license [*see* P 9 of Form]. It also contains a warranty that the buyer has never been convicted of a felony or violation of the Alcoholic Beverage Control Act [*see Bus. & Prof. Code § 23952* (eligibility requirements for retail alcoholic beverage license)], and knows of no reason that the ABC might deny transfer of the license to the buyer [*see* P 10 of Form]. For general discussion of the warranties made by the parties to a sale, Ch. 17, *Buying and Selling a Business*.

[vii] Attorneys' Fees

This form provides for attorneys' fees to be awarded to the prevailing party in litigation or arbitration [*see* P 13 of Form]. A litigant is not entitled to attorneys' fees unless they are agreed upon by the parties or specifically provided for by statute [*Code Civ. Proc. § 1021*; *see Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.252*].

[viii] Arbitration

This form provides that any dispute regarding the contract will be settled by arbitration [*see* P 14 of Form]. Arbitration provisions commonly incorporate the rules of the American Arbitration Association or the California Arbitration Act [*see Code Civ. Proc. §§ 1280-1294.2*; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.250*].

[ix] Standard Contractual Provisions

Most written agreements include certain standard provisions. This form contains an "entire agreement" provision [*see* P 11 of Form; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.270*], a clause governing amendment and modification [*see* P 12 of Form; *see also Ch. 77, Discharge of Obligations, §§ 77.320-77.323*], a provision for the manner of giving notice [*see* P 15 of Form; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.294*], and assignability provisions [*see* PP 16, 17 of Form; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, §§ 75.280-75.282*]. It also contains a choice of law provision [*see* P 18 of Form; *see also Ch. 75, Formation of Contracts and Standard Contractual Provisions, § 75.273*]. For a list of these types of provisions, see *§ 18.150[3]*. For other standard provisions, see Ch. 75, *Formation of Contracts and Standard Contractual Provisions* .

[2] FORM

Contract for Sale of Retail Alcoholic Beverage License Only

CONTRACT FOR SALE OF RETAIL ALCOHOLIC BEVERAGE LICENSE

This agreement is made on _____[*date*] between [*name of seller(s) and capacity, e.g.,* John and Jane Doe, husband and wife], Seller, and _____[*name of buyer(s) and capacity*], Buyer.

Recitals

Seller is the holder of [*specify type of license, e.g.,* an on-sale beer and wine alcoholic beverage license], License No. _____, issued by the Department of Alcoholic Beverage Control for premises at _____[*address*]. Seller desires to sell that license to Buyer, and Buyer desires to become the holder of the license and transfer it to premises [owned *or* leased *or* being constructed] by Buyer at _____[*address*].

Therefore, Buyer and Seller agree as follows:

Purchase and Sale

1. Seller shall sell to Buyer, and Buyer shall purchase from Seller, on the terms and conditions set forth in this contract, the above license for the premises at _____[*address*], California.

Purchase Price

2. The total purchase price ("the purchase price") to be paid by Buyer to Seller for the transfer of the license is $_____, which Buyer shall deposit into the escrow described in Paragraph 3 of this contract immediately upon execution of this contract.

Time and Place of Sale

3. The sale, purchase, and transfer described in this contract shall take place at the office of _____[*name of escrow holder*], _____[*address of escrow holder*], through an escrow to be established immediately on execution of this contract by Buyer and Seller. Buyer and Seller hereby appoint _____[*name of escrow holder*] as Escrow Holder for the escrow.

Application for License Transfer

4. Both Buyer and Seller shall take all actions reasonably required to facilitate the transfer of the license from Seller to Buyer. Promptly after execution of this contract, and in no event later than 90 days after its execution, Buyer and Seller shall execute and file with the Department of Alcoholic Beverage Control an application for transfer of the license from Seller to Buyer. Buyer shall pay all fees required to effectuate transfer of the license.

Deposit of Contract Into Escrow

5. [Buyer *or* Seller] shall deposit a copy of this contract with the Escrow Holder named in Paragraph 3 of this contract immediately upon execution of this contract.

[*Add, if escrow instructions are incorporated into contract (see § 18.201 for additional instructions that may be added, or, if separate escrow instructions will be used, see § 18.200, P 17):*]

Escrow Instructions

6. Buyer and Seller hereby direct the Escrow Holder to take the following actions regarding the deposited purchase price, as required by *Business and Professions Code Section 24074*:

(a) Hold all money and instruments deposited into escrow until you receive written notice from the Department of Alcoholic Beverage Control approving the transfer.

(b) First, if you receive notice that any amounts are due from Seller under any of the following laws specified in *Business and Professions Code Section 24049*, and the tax liability arises partially or completely from the use of the license, pay the amount claimed and obtain a release from the taxing authority:

(1) The Alcoholic Beverage Tax Law.

(2) The Sales and Use Tax Law.

(3) The Personal Income Tax Law.

(4) The Corporation Tax Law.

(5) *Revenue and Taxation Code Sections 134, 405(a)*, regarding tax on unsecured property.

(6) The Unemployment Insurance Code, to the extent that liability arises from the conduct of a business licensed by the Department of Alcoholic Beverage Control.

(c) If the deposited purchase price is sufficient to pay all creditor claims in full, pay the claims of bona fide creditors of Seller who have filed their claims with the Escrow Holder before the Department of Alcoholic Beverage Control gives notification that the transfer application is approved.

(d) If the deposited purchase price is insufficient to pay all creditor claims in full, distribute that money in the following order:

(1) First, to the United States for claims based on income or withholding taxes, then for other tax claims not specified in *Business and Professions Code Section 24049*.

(2) Second, to the payment of claims for wages and other compensation earned by employees of the Seller prior to the sale, transfer, or opening of escrow.

(3) Third, to the payment of claims of secured creditors, to the extent of the proceeds that arise from the sale of the security.

(4) Fourth, to the payment of claims on mechanics' liens.

(5) Fifth, to the payment of escrow fees and claims for brokerage and attorneys' fees.

(6) Sixth, to the payment of claims for goods sold and delivered to the Seller for resale at the licensed premises; to the payment of claims for services rendered, performed, or supplied in connection with the operation of the licensed business; and to the payment of the claims of a landlord to the extent of proceeds on past due rent.

(7) Seventh, to the payment of other claims that have been reduced to court-ordered judgments, including claims for court-ordered support of a minor child.

(8) Eighth, to the payment of all other claims. If sufficient assets are not available for payment of each claim in full, payment must be made pro rata.

(e) If Seller disputes any claim filed with the Escrow Holder before he or she receives notification from the Department of Alcoholic Beverage Control of its approval of the transfer application, notify the claimant of the dispute; retain the amount otherwise payable on the claim for 25 days from the time payment would otherwise be made; and if the creditor does not attach that amount, pay it to Seller.

(f) Make all payments and distributions described in this paragraph within a reasonable time after transfer of the alcoholic beverage license from Seller to Buyer.

[*Continue with the following:*]

Costs and Expenses

7. Buyer and Seller shall bear the costs and expenses incurred in the purchase, sale, and transfer described in this contract in the following manner:

(a) Buyer shall bear all costs, fees, and other expenses involved in securing the approval of the Department of Alcoholic Beverage Control to the transfer of the license to Buyer, including the cost of recording or publishing any notices required as a condition precedent to that approval.

(b) Buyer and Seller shall bear the following costs and expenses in equal proportions:

(1) The fee of the Escrow Holder.

(2) Any and all other costs and expenses required for the performance of this contract or for completion of the sale, purchase, and transfer described in this contract.

Denial of License Transfer

8. If, after Buyer and Seller have exhausted all appropriate administrative remedies, the application for transfer of the alcoholic beverage license is finally denied for any reason, this contract shall be null and void and each party shall be restored, to the extent possible, to his or her position prior to execution of this contract. The parties shall pay the costs and expenses incurred in the attempted performance of this contract in the proportions set forth in Paragraph 7. However, this Paragraph shall not prevent or bar either Buyer or Seller from maintaining an action against the other to recover damages for the breach of any warranty or other provision contained in this contract, when the breach was the cause for denial of the transfer.

Seller's Warranty

9. Seller hereby warrants and represents to Buyer that Seller is not in violation of the Alcoholic Beverage Control Act, and is not aware of any reason why the Department of Alcoholic Beverage Control should deny the application for transfer of the alcoholic beverage license from Seller to Buyer.

Buyer's Warranty

10. Buyer hereby warrants and represents to Seller that:

(a) No governmental tribunal has convicted or accused Buyer of violating the Alcoholic Beverage Control Act.

(b) Buyer has never been convicted of a felony.

(c) Buyer is not aware of any reason why the Department of Alcoholic Beverage Control should deny the application for transfer of the alcoholic beverage license from Seller to Buyer.

Entire Agreement

11. This contract constitutes the entire agreement between Buyer and Seller concerning their rights and obligations with respect to the transfer of the alcoholic beverage license. Any agreements or representations respecting the transfer of the alcoholic beverage license to Buyer that are not expressly set forth in this contract shall have no effect, except for a subsequent written modification signed by the party to be charged.

Amendment of Contract

12. This contract may be amended or modified at any time with respect to any provision by a written instrument executed by Buyer and Seller.

Attorneys' Fees

13. If Buyer or Seller brings any legal action or seeks arbitration regarding any provision of this agreement, the prevailing party in the litigation or arbitration shall be entitled to recover reasonable attorneys' fees from the other party, in addition to any other relief that may be granted. This provision applies to the entire agreement. Buyer and Seller were each represented by an attorney in the negotiation and execution of the agreement.

Arbitration

14. Any dispute arising under this contract shall be settled by arbitration in accordance with [*specify method of arbitration or refer to specific rules, e.g.,* the Commercial Arbitration Rules of the American Arbitration Association], and judgment on the award rendered by the Arbitrator may be entered in any court having jurisdiction.

Notices

15. Any notice required or permitted to be given under this contract shall be written, and may be given by personal delivery or by registered or certified mail, first-class postage prepaid, return receipt requested. Notice shall be deemed given upon actual receipt in the case of personal delivery, or upon mailing. Mailed notices shall be addressed as follows, but each party may change address by written notice in accordance with this paragraph:

To Buyer: _____[*address*].

To Seller: _____[*address*].

Assignment

16. Neither Buyer nor Seller shall assign any right or interest arising under this contract without the prior written consent of the other.

Binding on Heirs

17. This contract shall be binding on and shall inure to the benefit of the heirs, executors, administrators, successors, and assigns of Buyer and Seller.

Governing Law

18. This contract shall be governed by and construed in accordance with the laws of California.

Executed on _____[*date*], at _____, California.

SELLER
_____ [*signature of seller*]
[*typed name*]
BUYER
_____ [*signature of buyer*]
[*typed name*]

Escrow Holder's Acceptance

I hereby accept the appointment and instructions to me as escrow holder set forth in this contract.
_____ Dated:

ESCROW HOLDER
_____ [*signature of escrow holder*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
A. Sales Contract and Escrow Agreement

8-18 California Legal Forms--Transaction Guide §§ 18.203-18.209

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.203[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
B. Notices

8-18 California Legal Forms--Transaction Guide § 18.210

AUTHOR: Lynne Carmichael

§ 18.210 Notice of Intended Transfer of Retail Alcoholic Beverage License [ABC-227]

[1] Comment

[a] Use of Form

This form is the official notice of intended transfer of an alcoholic beverage license. It is available from any district office of the Department of Alcoholic Beverage Control ("ABC") and on the ABC's web page [www.abc.ca.gov]. Recordation of this form is a prerequisite to filing most transfer applications. For an example and discussion of principal application form, see *§ 18.221*.

[b] Recordation Requirement

The ABC will not transfer an off-sale or on-sale general license, off-sale or on-sale beer and wine license, on-sale beer and wine public premises license, on-sale beer license, on-sale beer public premises license, or on-sale general license for seasonal business, unless the buyer or seller records this notice in the office of the county recorder of the county or counties in which the licensed premises are situated prior to filing the transfer application [*Bus. & Prof. Code § 24073*; *see Gov. Code § 27361* (recordation fees)]. The following types of transfers, however, are exempt from this requirement [*Bus. & Prof. Code § 24075*; *see § 18.41[2]*]:

- The transfer of a license made by an executor, administrator, guardian, conservator, trustee, receiver (other than a receiver appointed for a judgment debtor [*see Code Civ. Proc. § 708.630*]), or other person acting in the legal or proper discharge of official duty or discharge of any trust imposed by law.

- Any transfer or assignment made for the benefit of creditors.

- The transfer to a surviving spouse of a deceased licensee (when the deceased leaves no estate to be administered); to the surviving partners of a deceased licensee; to the executor, administrator,

conservator, or guardian of the estate of a licensee; to the trustee of a bankrupt estate of a licensee; to a receiver of the estate of a licensee; or to the properly appointed statutory or common law assignee for the benefit of creditors of a licensee [*see Bus. & Prof. Code § 24071*; Form ABC-227 INSTR, p. 2 (3/07)].

[c] Contents of Form

The notice of intended transfer must state all of the following [*Bus. & Prof. Code § 24073*]:

- The name and address of the licensee (seller) [*see* PP 1, 3 of Form].
- The name and address of the buyer [*see* PP 4, 6 of Form].
- The kind of license intended to be transferred, including the name and number [*see* P 7 of Form].
- The address of the premises to which the license was issued [*see* P 2 of Form]. pauls

PRACTICE TIP:
The "License Query System" link on the ABC web page [www.abc.ca.gov] is the best source of accurate license holder and premises address information for preparing Form ABC-227. If information about persons qualified to sign for the transferring licensee(s) is not available on the ABC web page, ask the appropriate ABC district office (also shown in the License Query System) to provide the information. *Commentary by Lynne Carmichael.*

- An agreement between the buyer and seller that the consideration for the transfer of the business and license will be paid only after the ABC has approved the transfer [*see* statement below P 10 of Form].
- The place where the purchase price or consideration for the business and license will be paid; the amount of the purchase price or consideration; and a description of the entire consideration, including a designation of cash, checks, promissory notes, and tangible and intangible property, and the amount of each [*see* P 10 of Form]. If the parties have agreed that the total purchase price will be a stated sum plus the value of the stock in trade and merchandise determined pursuant to an inventory [*see § 18.200*, P 3], the ABC allows the parties to state the amount of the inventory as either an estimated amount or as an amount not to exceed a stated amount [*see* Form ABC-227 INSTR (3/07)]. If no present consideration is involved in the transfer of the license, the notice should state that no consideration is involved [*see* Form ABC-227 INSTR, (3/07)].

PRACTICE TIP:
The ABC has issued a bulletin reminding parties that no licensee can enter into an agreement wherein the transfer of the license acts as security for a loan or as security for the fulfillment of any agreement [*see Bus. & Prof. Code § 24076*]. If the consideration for the transfer of the license consists of a note, the parties should be sure not to characterize it as a note "secured by a security agreement" or similar language that might violate *Bus. & Prof. Code § 24076* [*see* Department of Alcoholic Beverage Control Industry Bulletin "Notice of Intended Transfer--Form ABC 227" (01/03/02)]. *Commentary by Lynne Carmichael.*

- The name and address of the escrow holder [*see Bus. & Prof. Code § 24074*] or guarantor [*see Bus. & Prof. Code § 24074.4* and discussion in *§ 18.41[4]*], as appropriate [*see* P 8, 9 of Form].

[d] Filing Requirement

The buyer must file a copy of this notice, certified by the county recorder in the county where the licensed premises are located, with the application for the transfer of the license. One additional copy of this notice must also accompany the application [*see* Form].

[e] Relationship to Notice of Bulk Sale

Bus. & Prof. Code § 24073 is not intended to exempt the parties from complying with the Bulk Sales Division of the Commercial Code ("Bulk Sales Division") [*Com. Code § 6101 et seq.*], when they are otherwise required to do so [*see* Form ABC-227 INSTR (3/07)]. Therefore, the parties must comply with both the notice requirement of the Alcoholic Beverage Control Act [*Bus. & Prof Code § 24073*], and the notice requirement of the Bulk Sales Division [*see § 18.211*]. Although the two notices may be combined into one instrument [*see § 18.212*], it is better practice to record separate notices to ensure full compliance with the respective requirements of each notice provision. For further discussion see *§ 18.41[2]*.

[2] FORM

Notice of Intended Transfer of Retail Alcoholic Beverage License [ABC-227]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
B. Notices

8-18 California Legal Forms--Transaction Guide § 18.211

AUTHOR: Lynne Carmichael

§ 18.211 Notice of Intended Bulk Sale

[1] Comment

[a] Use of Form

This form is the notice to creditors of an intended bulk sale required by the Bulk Sales Division of the Commercial Code ("Bulk Sales Division") [*Com. Code § 6101 et seq.*]. For a basic notice of intended bulk sale and a discussion of its requirements, see *Ch. 17, Buying and Selling a Business or Professional Practice, § 17.270*. This notice is designed for use when an alcoholic beverage license is included in the transfer. This comment discusses only those topics specifically applicable to a transfer made under the Alcoholic Beverage Control Act [*Bus. & Prof. Code § 23000 et seq.*].

[b] Application of Bulk Sales Division

The Bulk Sales Division of the Commercial Code [*see Com. Code § 6101 et seq.*] applies to a bulk sale only if (1) the seller's principal business is the sale of inventory from stock, including those who manufacture what they sell, or is that of restaurant owner [*Com. Code § 6103(a)(1)*]; and (2) the seller is located in California, or is located in a jurisdiction outside the United States but has its major American executive office in California, on the date of the bulk sale agreement [*Com. Code § 6103(a)(2)*; *see Com. Code § 6103(c)* (exceptions)]. A "bulk sale" is any sale outside the ordinary course of the seller's business of more than one half of the seller's inventory and equipment, as measured by the fair market value on the date of the bulk sale agreement [*Com. Code § 6102(a)(3), (8), (15)*; *see Com. Code §§ 6102(b)(2), 9102(a)(33)* ("equipment" defined), *6102(b)(3), 9102(a)(48)* ("inventory" defined); *see § 18.10[3]*].

The Bulk Sales Division has only limited application to the sale of an alcoholic beverage license and business. A transfer that is subject to and complies with the license transfer provisions of the Alcoholic Beverage Control Act ("Act") [*Bus. & Prof. Code §§ 24070-24082*] is exempt from most provisions of the Bulk Sales Division [*Com. Code § 6103(c)(15)*; *see Ch. 17, Buying and Selling a Business or Professional Practice, § 17.20[2]*]. Such a transfer, however,

is subject to the Bulk Sales Division's notice requirements [*Com. Code § 6103(c)(15)*; *see Com. Code § 6105(a)(1)-(4), (b)*]. Thus, if the buyer fails to give notice of the sale (this form) in the prescribed time and within the prescribed time, the buyer is liable to the seller's creditors who file claims in a timely manner [*Com. Code §§ 6105, 6107*].

[c] Contents of Notice

The notice to creditors of the seller must state all of the following [*Com. Code §§ 6103(c)(15), 6105(a)(1)-(4)*; *see* Form]:

- That a bulk sale is about to be made.
- The names and business addresses of the seller and the buyer.
- All other business names and addresses used by the seller within the past three years, to the extent known to the buyer.
- The location and general description of the property to be transferred.
- The place and date on (or after which) the bulk sale will be consummated.

[d] Recordation and Publication Requirements

The buyer must record this notice in the office of the county recorder in the county or counties where the property to be transferred is located and, if different, where seller is located at least 12 business days before the transfer is to be consummated [*Com. Code §§ 6103(c)(15), 6105(b)(1)*; *see Gov. Code § 27361*]. The buyer must also publish the notice at least 12 business days before the transfer is to be consummated [*Com. Code §§ 6103(c)(15), 6105(b)(2)*]. The notice must be published at least once in a newspaper of general circulation published in the judicial district in which the tangible assets are located and, if different, in the judicial district in which the seller is located [*Com. Code § 6105(b)(2)*; *see Com. Code § 6103(a)(2)*]. If the tangible assets are located in more than one judicial district, the notice must be published in the judicial district in which a greater portion of the assets are located and, if different, the judicial district in which the seller is located [*Com. Code § 6105(b)*; *see Com. Code § 6103(a)(3)*]. If no newspaper of general circulation exists in the judicial district, notice must be published in a newspaper of general circulation in the county in which the judicial district is located [*Com. Code § 6105(b)(2)*]. For further discussion of these requirements, see *Ch. 17, Buying and Selling a Business or Professional Practice, § 17.270[1][c]*.

[e] Relationship to Notice of Intended Transfer

When the seller of a retail alcoholic beverage license and business is required to comply with both the notice requirement of the Alcoholic Beverage Control Act [*see § 18.200[2]* (ABC-227)] and the Bulk Sales Division [this form], the two notices may be combined into one instrument [*see § 18.212*]. However, it is better practice to record separate notices to ensure full compliance with the respective requirements of each notice provision. For further discussion, see *§ 18.41[3]*.

[2] FORM

Notice of Intended Bulk Sale

NOTICE OF INTENDED BULK SALE

NOTICE IS HEREBY GIVEN that _____[*name of seller*], whose business address is _____, intends to make a bulk sale to _____[*name of buyer*], whose business address

is _____, of the following property now located at _____:
_____[*give general description of property, e.g.,* all the stock in trade, merchandise, fixtures, equipment, alcoholic beverage license, goodwill, and trade of the business known as "_____ (*name of business*)"].

To the knowledge of the undersigned buyer, within the past three years, _____[*name of seller*] has _____[used the following additional business names and addresses: _____ (*list, e.g.,* the name "_____" at _____ [*address*]; the name "_____" at [*address*] ; and the name "_____" at _____[*address*]) *or* not used any other business names or addresses].

The intended transfer will take place on or after _____[*date*], at _____[*address*], California. [*Add if desired:* Claims for debts of the seller may be filed with _____ (*name*), Escrow Holder, at _____ (*address*). Pursuant to *Business and Professions Code Section 24074*, claims may be filed at any time before the Escrow Holder receives notice of approval of the alcoholic beverage license transfer from the Department of Alcoholic Beverage Control.]
_____ Dated:

_____ [*signature of buyer*]
[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
B. Notices

8-18 California Legal Forms--Transaction Guide § 18.212

AUTHOR: Lynne Carmichael

§ 18.212 Combined Notice of Intended Sale of Retail Alcoholic Beverage License and Notice of Intended Bulk Sale

[1] Comment

[a] Use of Form

This form is a notice of intended transfer of a retail alcoholic beverage license, combined with a notice of intended bulk sale. For an example and discussion of the notice of intended transfer pursuant to the Alcoholic Beverage Control Act ("Act") [*Bus. & Prof. Code § 23000 et seq.*], see *§ 18.210*. For an example and discussion of a notice of intended bulk transfer pursuant to the Bulk Sales Division of the Commercial Code ("Bulk Sales Division") [*Com. Code § 6101 et seq.*], see *§ 18.211*.

The Department of Alcoholic Beverage Control ("ABC") does not provide guidance regarding the combination of these two notices, stating only that the ABC does not give advice on what will meet the Commercial Code requirements [*see* Form ABC-227 INSTR, p. 1 (9/99), reproduced in § 18.210[2]]. This form meets the content requirements for both types of forms [*see Bus. & Prof. Code § 24073*; *Com. Code §§ 6103(c)(15), 6105(a)(1)-(4)*; *see also §§ 18.210[1], 18.211[1]*]. As discussed below, however, it may be simpler and cheaper to use two separate notices.

[b] Recordation and Publication Requirements

A notice of intended transfer pursuant to the Act must be recorded in the office of the county recorder in the county where the licensed premises are located [*Bus. & Prof. Code § 24073*; *see § 18.210[1]*]. A notice of intended bulk sale must be recorded in the office of the county recorder in the county or counties where the property to be transferred is located and, if different, where the seller is located [*see Com. Code §§ 6103(c)(15), 6105(b)(1)*; *§ 18.211[1]*]. Therefore, a combined form simplifies the recording process. However, the notice of bulk sale must also be published in a newspaper of general circulation in the judicial district where the tangible assets being transferred are located or where the greater portion of those assets are located and, if different, in the judicial district where the seller is located [*Com.*

Code §§ 6103(c)(15), 6105(b)]. If no newspaper of general circulation exists in the judicial district, notice must be published in a newspaper of general circulation in the county in which the judicial district is located [*Com. Code § 6105(b)(2)*; *see § 18.211[1]*]. When the information required for a notice of intended transfer under the Act is added to the information required to be published under the Bulk Sales Division, the resulting form becomes much longer. Because newspapers charge by the column inch, publishing the notice also becomes much more expensive. Therefore, it may be simpler and cheaper to record separate notices under the Act and under the Bulk Sales Division [*see §§ 18.210, 18.211*], and then to publish only the notice of intended bulk sale [*see Com. Code § 6105(b)* (publication requirements); *Gov. Code § 27361* (filing fees)].

[c] Number of Copies Required

When this form is used, the drafting attorney must prepare at least five copies. If the original will be recorded in two counties, the attorney should confirm that the first recorder will return the original to the buyer [*see Gov. Code § 27290*]. A certified copy must be filed with the ABC at the time of filing the transfer application [*Bus. & Prof. Code § 24073*]. A copy of the notice must be submitted to the appropriate newspaper for publication according to the rules set forth in the Bulk Sales Division [*see Com. Code § 6105(b)*; *§ 18.211[1]*].

[2] FORM

Combined Notice of Intended Sale of Retail Alcoholic Beverage License and Notice of Intended Bulk Sale

NOTICE OF INTENDED TRANSFER OF ALCOHOLIC BEVERAGE LICENSE AND INTENDED BULK SALE

NOTICE IS HEREBY GIVEN that _____[*name of seller*], whose business address is _____, intends to make a bulk sale and to transfer a retail alcoholic beverage license to _____[*name of buyer*], whose business address is _____. The property intended to be transferred is now located at _____[*address*], and consists of: _____[*give general description of property, e.g.*, all the stock in trade, merchandise, fixtures, equipment, alcoholic beverage license, goodwill, and trade of the business known as "_____ (*name of business*)"]. The alcoholic beverage license to be transferred is [*specify type and number*], now issued to _____[*name of seller*] for the premises located at _____[*address*].

To the knowledge of the undersigned buyer, within the past three years, _____[*name of seller*] has _____[used the following additional business names and addresses: _____ (*list, e.g.*, the name "_____" at _____ [*address*]; the name "_____" at [*address*] ; and the name "_____" at _____[*address*]) *or* not used any other business names or addresses].

The intended transfer will take place on or after _____[*date*], at the office of _____[*name*], the escrow holder for the transfer, located at _____[*address*]. [*Add if desired:* Claims for debts of the seller may be filed with the escrow holder, at _____ (*address*). Pursuant to *Business and Professions Code Section 24074*, claims may be filed at any time before the escrow holder receives notice of approval of the alcoholic beverage license transfer from the Department of Alcoholic Beverage Control.]

The total consideration for the transfer of the business and license described in this notice (including inventory, whether actual cost, estimated cost, or a not-to-exceed amount), is $_____, consisting of:

(1) Cash in the amount of $_____;

(2) Checks in the amount of $_____;

(3) Promissory notes in the amount of $_____; and

(4) Tangible and/or intangible property in the amount of $_____.

The parties agree that the consideration for the transfer of the business and license described in this notice will be paid only after the Department of Alcoholic Beverage Control has approved the proposed transfer. The parties also agree and direct the above escrow holder to make payment or distribution within a reasonable time after the completion of the transfer of the license, as provided in *Business and Professions Code Section 24074*.

_____ Dated:

SELLER

_____ [*signature of seller*]

[*typed name*]

BUYER

_____ [*signature of buyer*]

[*typed name*]



77 of 95 DOCUMENTS

California Legal Forms--Transaction Guide

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
B. Notices

8-18 California Legal Forms--Transaction Guide §§ 18.213-18.219

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.213[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
C. Basic Application Forms

8-18 California Legal Forms--Transaction Guide § 18.220

AUTHOR: Lynne Carmichael

§ 18.220 License Transfer Request ("Sign Off") [ABC-211-A]

[1] Comment

[a] Use of Form

This form is ABC Form 211-A, which is completed by the seller in a license transfer, authorizing the transfer to the buyer and also authorizing the buyer to obtain a temporary permit pending ABC approval of the transfer. The form and the instructions are available from any district office of the ABC and also on the ABC's web page (www.abc.ca.gov).

If this form is not signed by the seller at the ABC district office, signatures on the form must be notarized. The seller's mailing address and telephone number must be included so that notices of renewal or other notices related to the license can be sent to the seller while the ABC completes the investigation for transfer of the license.

[b] Issuance of Temporary Permit

If a seller is selling the business for which the license was issued together with the retail alcoholic beverage license and the parties have agreed that the buyer will operate under a temporary permit, the seller must sign this form twice (PP 9, 15 of the form). If the seller grants permission for a temporary permit by signing in paragraph 9 of this form, the buyer may apply for a temporary permit simultaneously with the filing of the transfer application [*Bus. & Prof. Code § 24045.5*; *see § 18.221* (application questionnaire)]. The temporary permit allows the buyer to operate the business pending approval of the transfer application [*Bus. & Prof. Code § 24045.5*]. In addition, it allows the seller to close the business and file the final sales and unemployment insurance returns prior to the time the ABC approves transfer of the license [*see § 18.129*].

When the buyer files the application for transfer, an ABC employee will provide and complete a form for the temporary permit. If the buyer is not present at the ABC to sign the temporary permit, the buyer must execute Form ABC-282, Declaration re Temporary Permit [*see § 18.223*] and submit it with the application. The ABC will issue a temporary

permit only if all of the following conditions have been satisfied [*Bus. & Prof. Code § 24045.5*]:

- The buyer has filed an application with the ABC for transfer of the license at the premises to himself or herself;

- The buyer has submitted an application for a temporary permit, together with a temporary permit fee; and

- The premises have been operated under a license within 30 days of the date the application for the temporary permit was filed.

As a condition to issuance of the temporary permit, the seller must surrender the license for the premises in accordance with the ABC's rules [*Bus. & Prof. Code § 24045.5(b)*]. Those rules require the seller to surrender the license within 15 days after closing, surrendering, quitting, or abandoning the licensed premises [*see 4 Cal. Code Reg. § 65(a)*]. The seller's signature approving issuance of a temporary permit to buyer also accomplishes the surrender of the license [*see* Form].

If the ABC approves transfer of the license to the buyer, it will automatically cancel the surrendered license [*see* Form ABC-211-A INSTR p. 1 (3/00)]. If the ABC does not approve transfer of the license to the buyer, or if the parties withdraw the application to transfer, the seller may reactivate the license at the premises [*see § 18.251* (reactivation of surrendered license)].

For further discussion of the temporary permit, see *§ 18.50[1]*.

[c] Seller Signatures

The form must be signed by the following [Form ABC-211-A INSTR, p. 1 (3/00)]:

- All general partners if the seller is a general partnership.

- Each general partner if the seller is a limited partnership.

- The chairperson, president or a vice president and the secretary or chief financial officer or assistant secretary or assistant treasurer if the seller is a corporation. If only one corporate officer exists, he or she must sign twice.

- All members of a limited liability company managed by its members, or by an officer authorized by the articles of organization or the operating agreement to bind the company; a manager or managers or an officer authorized by the articles of organization or the operating agreement to bind the company; or, for a limited liability company managed by a manager or managers, the form must be signed by the manager or managers or by an officer authorized by the articles of organization or the operating agreement to bind the company.

If any of the above persons is unavailable, administrators, executors, guardians, surviving partners, trustees, and receivers may sign the form on behalf of a deceased seller. Additional documents may be required [Form ABC-211-A INSTR, p. 2 (3/00)].

If a general partner has abandoned his or her interest in the licensed business, that partner's signature will not be required. A general partner may abandon by making an oral or written declaration to that effect [Form ABC-211-A INSTR, p. 2 (3/00)]. Otherwise, all the following conditions must exist [*4 Cal. Code Reg. § 60(l)*; Form ABC-211-A

INSTR, p. 2 (3/00)]:

- The general partner cannot be found or located
- The general partner has taken no active part in the operation or management of the licensed business;
- The general partner has not received any income directly or indirectly from the licensed business.

PRACTICE TIP:

If there is any question about whose signatures the ABC will require, the parties should contact the district office of the ABC responsible for the license. *Commentary by Lynne Carmichael.*

[2] FORM

License Transfer Request ("Sign Off") [ABC-211-A]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
C. Basic Application Forms

8-18 California Legal Forms--Transaction Guide § 18.221

AUTHOR: Lynne Carmichael

§ 18.221 Application Questionnaire [Form ABC-217]

[1] Comment

[a] Use of Form

This form provides basic information to the Department of Alcoholic Beverage Control ("ABC") about the buyer and the buyer's purchase transaction for the license and business. The ABC recommends that the application be made in person, so that any corrections in the required information can be made at the time of application. Most frequently, the seller signs the forms in advance, and the buyer then personally comes in to the ABC and signs the application in the presence of the ABC personnel. However, the ABC will accept applications filed by an attorney or other representative of the buyer.

The ABC will also accept applications by mail when personal appearance is impractical and when it is relatively certain that the papers have been completed accurately. However, the ABC will return the paperwork by mail if any corrections are necessary, thereby delaying processing of the application. If persons who sign for the buyer do not appear personally at the ABC office, the signatures must be notarized, and Form ABC 211 SIG [*see § 18.222*] must be submitted with the application.

[b] General Requirements

In order to transfer a retail alcoholic beverage license from one person to another, the intended buyer must apply to the ABC for a license of the type to be transferred, and must meet all of the qualifications required of an original applicant for that type of license. The seller must join the buyer in making the application [*4 Cal. Code Reg. § 60(b)*; *see Bus. & Prof. Code §§ 24073, 24074*; *see also 4 Cal. Code Reg. §§ 60(f)-(l)* (special requirements for transfers by fiduciaries and partnerships)].

[c] Applicant and Premises Information

The applicant must supply all information requested by the form. The information is provided to law enforcement agencies and may be provided to other governmental agencies [*see Civ. Code § 1798.24 (f), (o)* and *(p)*; *see also* ABC-217 INSTR]

- Applicant: If the license will be issued to individuals or legal entities other than a general partnership, complete with individual and entity names. For general partnerships, complete with partners' names [*see* Item 1].

- License Type: Indicate all licenses that will be transferred. If license type is not shown, indicate Other and write in license type [*see* Item 2]

- Transaction Type: If the transfer involves a surviving spouse or fiduciary, check the box opposite Section 24071 [*see Bus. & Prof. Code § 24071*; *see also § 18.40[3]*, ABC-217 INSTR], in addition to the box for person-to-person transfer [*see* Item 3]. If the license is being moved to a new location, or if the currently licensed premises will be enlarged or remodeled so that the entrance is in a new location, also check the box opposite premises-to-premises transfer [*see § 18.40[10]*].

- Applicant Mailing Address: If applicant is not occupying the licensed premises but would like ABC correspondence to go to the premises address when the transfer is completed, provide a mailing address and check the box next to Temporary [*see* Items 9 and 10].

- ABC License Cost: This amount [Item 11] must be transferred from Item 32a on the reverse of the form. Information about the fair market value of licenses in the county of the license to be transferred can be obtained from alcoholic beverage license brokers or from the local office of the ABC. In certain circumstances, the consideration that can be paid for the license is limited [*see Bus. & Prof. Code § 24079*; *see also § 18.30[4]*]

- Subtotal: This amount [Item 12] must match the total amount paid for the license, furniture/fixtures, goodwill/non-compete covenant, and leasehold improvements, as indicated in Item 32f on the reverse of the form.

- Felony Convictions and ABC Act Violations: These questions are only answered for persons named as licensee in Item 1 [Items 13 and 14]. Officers, partners, managers, etc. of the licensees named in Item 1 answer a similar question on Form 208A, Individual Personal Affidavit [*see § 18.224*].

[d] Investment Information

Every application for the transfer of an on-sale or off-sale general license must indicate whether the consideration, if any, to be paid to the transferor includes payment for any or all of the following and must include the actual amount paid for [*Bus. & Prof. Code § 24080*]:

- Inventory.

- Fixtures.

- Transfer of the license.

The consideration shown may be the entire consideration paid for real property and the licensed business or the consideration for the "business and ABC license" [*see* ABC-227 INSTR 1 (9/99); *see also § 18.41[2]*].

In addition, Item 32 of the Form requires information about any consideration paid for goodwill or a non-compete covenant or for leasehold improvements [Item 32d and e]. The amounts in Item 32a-e representing the subtotal in Item 32f should equal the amount shown on the ABC-227 Notice of Intended Transfer [*see § 18.210*] and the amount transferred to Item 12. The total purchase price or consideration for certain on-sale and off-sale general licenses is limited by statute [*see Bus. & Prof. Code § 24070(d), (e), 24079*]. For discussion of the statutory limitations on the purchase price of on-sale and off-sale general licenses, see *§ 18.30[4]*.

[e] Investment Details

The form requires disclosure of the amount of cash invested (including loans and lines of credit) and the source of the cash, as well as non-cash consideration for the transfer of the license and the business [Item 33]. These disclosures must match the Notice of Intended Transfer [ABC-227; *see § 18.210*] as well as the Individual Financial Affidavit information [ABC-208-B; *see § 18.224*] provided by individual licensees and investors.

[f] Bank Accounts

If bank account information is not known at the time of completing the application paperwork, the applicant may provide this information in a separate letter to the ABC investigator when it is available [Item 34].

[g] Notarization

Only one applicant signature is required on this form. It must be notarized unless the form is signed at the ABC office [Item 35].

[h] Filing Fees

The buyer must pay a transfer fee when filing the application [*Bus. & Prof. Code § 24072*; *4 Cal. Code Reg. § 60(c)*]. The fee for transfer of a retail license from a licensee to another person is 50 percent of the annual fee for the license, but will not exceed $1,250. The fee for transfer of a retail license from or to the persons set forth in *Bus. & Prof. Code § 24071* is $50 [*Bus. & Prof Code § 24071*; *see § 18.41[8]*]. If no original fee is set by law, the fee is $100 [*Bus. & Prof. Code § 24072(b)*; *see Bus. & Prof. Code § 23320* (schedule of fees)]. The fee for transfer of a license from one premises to another is $100 [*Bus. & Prof. Code § 24072(c)*; *see Bus. & Prof. Code § 24082* (exception for premises destroyed by fire or act of God)]. The fee for transfer of an on-sale or off-sale retail license from the licensee, to the licensee and his or her mother, father, son, or daughter when no consideration is given for the transfer, is half of the regular fee for transfer of a license from a licensee to another person [*Bus. & Prof. Code § 24072(e)*].

[i] Temporary Permit

If the business for which the license was issued is being transferred in the same transaction, the buyer may apply for a temporary permit simultaneously with the filing of the transfer application [*Bus. & Prof. Code § 24045.5*]. The ABC will provide a form for the temporary permit. By securing a temporary permit, the buyer will be able to carry on the licensed business pending the processing of the transfer application [*see § 18.50*]. For further discussion, see *§§ 18.220* and *18.223*.

[j] Processing Application

After the buyer has filed the application for transfer, provided the accompanying documents, and paid the transfer fee, the ABC must send a copy of the application (1) to the sheriff, chief of police, and district attorney of the locality in which the premises are located; and (2) to the board of supervisors of the county if the premises are within an unincorporated area, or to the city council or other governing body of the city if the premises are within an incorporated

area [*Bus. & Prof. Code § 23987*]. The ABC cannot transfer the license for at least 30 days after mailing those notices [*Bus. & Prof. Code § 23987*], and the usual waiting period is 55-65 days.

[2] FORM

Application Questionnaire [Form ABC-217]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
C. Basic Application Forms

8-18 California Legal Forms--Transaction Guide § 18.222

AUTHOR: Lynne Carmichael

§ 18.222 Application Signature Sheet ("Sign On") [ABC-211-SIG]

[1] Comment

[a] Use of Form

This form is used as the buyer's signature page for transfer applications when the application is not signed by the buyer in the District Office. The instructions on the face of the form indicate that it must be notarized in accordance with the law of the state where signed.

[b] General Information

The buyer must indicate the type of ownership of the applicant(s). Check all boxes that apply [Item 1], and list all applicant(s) names [Item 5]. The ABC does not assign a file number until after the application has been accepted; leave Item 2 blank. Indicate the license type, by number, in Item 3 [*see Bus. & Prof Code § 23320*; *§ 18.20[1]*].

The transaction type [Item 4] will be person to person transfer in all cases, but the buyer should check all boxes that apply:

- Premises to premises if the buyer will move the license to a new premises or if the buyer intends substantial enlargement of the premises or movement of the main entrance [*see § 18.40[1]*];

- Exchange if the buyer is exchanging an on-sale general license for a special on-sale license or vice versa [*see Bus. & Prof Code § 24072.5*] or on-sale general public premises license for an on-sale eating place license or vice versa [*see Bus. & Prof Code § 24072.2*]. For a discussion of license exchanges, see *§ 18.40[2]*.

[c] Signatures

The form must be signed by the following persons [Form ABC-211-A, p. 2 (02/09)]:

- A sole owner if the buyer is one individual.
- All partners if the seller is a general partnership.
- All general partners if the seller is a limited partnership.
- The chairperson of the board, president or a vice president *and* the secretary or chief financial officer or assistant secretary or assistant treasurer if the seller is a corporation. If only one corporate officer exists, he or she must sign twice.
- If a limited liability company is member-managed, all members must sign, or if an officer has been authorized by the articles of organization or the operating agreement to bind the company, that officer may sign alone. If a limited liability company is managed by a manager or managers, all managers must sign, or if an officer has been authorized by the articles of organization or the operating agreement to bind the company, that officer may sign.

If there is not enough space on the face of the form for all partners or members to sign, Item 14 on the back should be used. All signatures must be notarized.

[2] FORM

Application Signature Sheet ("Sign On") [ABC-211-SIG]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
C. Basic Application Forms

8-18 California Legal Forms--Transaction Guide § 18.223

AUTHOR: Lynne Carmichael

§ 18.223 Declaration Regarding Temporary Permit [Form ABC-282]

[1] Comment

[a] Use of Form

If the parties have agreed that a temporary permit will be available to buyer during the time that the ABC is processing the application, and if they have agreed upon the effective date of the temporary permit, the ABC will issue the temporary permit at the time it accepts the application for transfer. This form, ABC Form 282, is completed by the buyer before the filing and submitted with the application package if the buyer is not available at the filing appointment to sign the actual temporary permit.

[b] Cash-Only Purchases of Alcoholic Beverages

Holders of temporary permits who have no other licenses in California must pay for alcoholic beverages before or upon delivery by cash or business check. [*Bus. & Prof Code § 24045.5*].

[2] FORM

Declaration Regarding Temporary Permit [Form ABC-282]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
C. Basic Application Forms

8-18 California Legal Forms--Transaction Guide § 18.224

AUTHOR: Lynne Carmichael

§ 18.224 Individual Personal Affidavit [Form ABC-208A]

[1] Comment

[a] Use of Form

This form, Form ABC-208A, is used to provide the ABC with personal information about the following persons:

- Sole owner licensees.
- Officers, a majority of the directors, and persons who hold 10 percent or more of the capital or stock of a corporation.
- General partners of general partnerships.
- General partners and persons who hold 10 percent or more of the ownership interests of limited partnerships.
- All members of member-managed limited liability companies.
- All managers and 10 percent or more non-managing members of manager-managed limited liability companies.
- Trustees of trusts.
- Spouses of sole owner licensees, limited liability company members, and managers and 10 percent or more owners of any entity.

The ABC investigates the persons who complete this form to confirm their qualifications to hold an interest in an alcoholic beverage license. Disqualifying factors for retail license applicants include impermissible interests in manufacturers or wholesalers of alcoholic beverages [*see Bus. & Prof Code §§ 25500-25512*] and recent prosecutions or convictions for criminal offenses. The ABC may grant a license to a convicted felon who is rehabilitated [ABC-217 INSTR, p. 2 (2/03)].

[b] Interests in Other Alcoholic Beverage Licenses

In the individual completing the form has any current interest, direct or indirect, in any alcoholic beverage licensed business, or has ever been a licensee or officer or director of a corporate license, inside or outside California, this information must be disclosed. If the space is insufficient, provide the information on an attachment [Item 19].

Persons completing this form must also provide information about any interests in alcoholic beverage licenses that have been denied, suspended, revoked or had an offer in compromise accepted or rejected. This information also may be included on an attachment to the form [Item 20].

[c] Criminal History

The persons completing this form must disclose forfeited bail, convictions, fines, periods of probation and active prosecutions for criminal offenses. All incidents except minor traffic offenses must be disclosed. Even actions that were the subject of subsequent expungement must be disclosed, unless an order sealing records under *Pen. Code § 1203.45* has been issued. The ABC may grant a license to a convicted felon who is rehabilitated [ABC-217 INSTR, p.2 (2/03)].

[d] Financial Contributions

The persons completing this form must disclose whether they are making any financial contribution to the business. Investors in the buyer who hold 10 percent or more of the ownership interests are required to disclose the source of their investment. Persons making a financial contribution must check Box B in Item 23 and complete a Personal Financial Affidavit (ABC-208B) [§ 18.225]. Spouses of persons completing a Personal Financial Affidavit may check Box D in Item 23 and are not required to complete a Personal Financial Affidavit.

[2] FORM

Individual Personal Affidavit [Form ABC-208A]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
C. Basic Application Forms

8-18 California Legal Forms--Transaction Guide § 18.225

AUTHOR: Lynne Carmichael

§ 18.225 Individual Financial Affidavit [Form ABC-208B]

[1] Comment

[a] Use of Form

This form, Form ABC-208-B, is used by the ABC to investigate the source of the funds for acquisition of a alcoholic beverage licensed business and to ensure that all applicant ownership interests of 10 percent ore more are disclosed. By signing the form, the applicant authorizes the ABC to examine and secure copies of financial records to verify the source and control of the source of the funds [*see* ABC-208-B (4/03)].

[b] Scope of Disclosure

Persons completing this form must provide information about the source of the funds invested in the business. The ABC requires copies of bank or brokerage statements, loan agreements or other evidence of funds at least equal to the investment. The applicant must disclose the source of the funds, such as savings, inheritance, gifts, refinancing or lines of credit.

[2] FORM

Individual Financial Affidavit [Form ABC-208B]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
C. Basic Application Forms

8-18 California Legal Forms--Transaction Guide § 18.226

AUTHOR: Lynne Carmichael

§ 18.226 Corporate Questionnaire [Form ABC-243]

[1] Comment

[a] Use of Form

This form, Form ABC-243, is used by the ABC to collect information about corporate applicants and corporate holders of 10 percent or more of the capital or ownership interests of an applicant. This information, in turn, is used to identify the persons who must complete personal and financial affidavits. Only one signature is required on the form.

[b] Stock Certificates

While the form provides space on the front and back to list all issued, canceled and outstanding stock certificates of the corporation, the applicant may attach a copy of the stock register of the corporation, as long as all required information is presented (holder, pledgee if any, certificate number, number of shares, percentage of outstanding shares, date issued, and date canceled, if applicable). If the stock is publicly held, only stock exchange information need be provided.

[c] Other Qualification Materials

In addition to the Corporate Questionnaire, a corporation required to qualify must submit a file-stamped copy of its articles of incorporation, minutes showing the election of directors and the appointment of officers and, if the corporation is the applicant and is not a California corporation, a file-stamped copy of its qualification to do business in California.

[2] FORM

Corporate Questionnaire [Form ABC-243]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
C. Basic Application Forms

8-18 California Legal Forms--Transaction Guide § 18.227

AUTHOR: Lynne Carmichael

§ 18.227 Limited Partnership Questionnaire [Form ABC-256]

[1] Comment

[a] Use of Form

This form, Form ABC-256, is used by the ABC to collect information about limited partnership applicants and ownership interests of an applicant. This information, in turn, is used to identify the persons who must complete personal and financial affidavits. The signature of a general partner is required on the form.

[b] Other Qualification Materials

In addition to the limited partnership questionnaire, a limited partnership required to qualify must submit a file-stamped copy of its certificate of limited partnership, a copy of its limited partnership agreement and all amendments, including a list of all partners and their percentages of ownership, and, if the limited partnership is the applicant and is not a California entity, a file-stamped copy of its qualification to do business in California.

[2] FORM

Limited Partnership Questionnaire [Form ABC-256]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
C. Basic Application Forms

8-18 California Legal Forms--Transaction Guide § 18.228

AUTHOR: Lynne Carmichael

§ 18.228 Limited Liability Company Questionnaire [Form ABC-256-LLC]

[1] Comment

[a] Use of Form

This form is used by the ABC to collect information about limited liability company applicants and ownership interests of an applicant. This information, in turn, is used to identify the persons who must complete personal and financial affidavits. The signature of a managing member or a person designated by the members to sign on behalf of the limited liability company is required on the form.

[b] Other Qualification Materials

In addition to the limited liability company questionnaire, a limited liability company required to qualify must submit a file-stamped copy of its articles of organization, a copy of its operating agreement and all amendments, including a list of all members and their percentages of ownership, and, if the limited liability company is the applicant and is not a California entity, a file-stamped copy of its qualification to do business in California.

[2] FORM

Limited Liability Company Questionnaire [Form ABC-256-LLC]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
C. Basic Application Forms

8-18 California Legal Forms--Transaction Guide §§ 18.229-18.239

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.229[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
D. Post-Filing Forms

8-18 California Legal Forms--Transaction Guide § 18.240

AUTHOR: Lynne Carmichael

§ 18.240 Notice of Application for Change In Ownership of Alcoholic Beverage License [ABC-207-D]

[1] Comment

[a] Use of Form

This form, Form ABC-207-D, is the official notice of application to sell alcoholic beverages, for use by applicants for on-sale licenses only. It is available at any district office of the Department of Alcoholic Beverage Control ("ABC") and is prepared by the ABC at the time of filing.

Form ABC-207-D is used when there is a change in ownership of an on-sale license. When an on-sale license is originally issued to (i.e., to its first owner), Form ABC-207-A, Notice of Application to Sell Alcoholic Beverages, is used. The latter form, which is not reproduced in this chapter, is identical to form ABC-207-D, other than the caption.

[b] Publishing Notice of Application-On-Sale Licenses

Any applicant for the transfer of an on-sale retail license must publish the notice set forth in this form in a newspaper of general circulation (other than a legal or professional trade publication) that is published in the city where the licensed premises are located, or in the nearest such newspaper of general circulation if the licensed premises are not within a city [*Bus. & Prof. Code § 23986(a)*]. The notice must be published once in the newspaper within 10 days after the applicant has filed the transfer application [*see Gov. Code § 6061*].

The applicant must also file an affidavit of publication with the district office of the ABC at which he or she filed the application [*Bus. & Prof. Code § 23986(a)*]. The newspaper generally files an affidavit directly with the ABC after publication. An ABC employee will prepare the affidavit if the buyer brings in proof that the notice has been published as required.

[c] Areas Having "Undue Concentration of Licenses"

If the license being transferred is an on-sale or off-sale license for premises located in a census tract that the ABC determines has an undue concentration of licenses [*see Bus. & Prof. Code § 23958* (ABC may deny license if it would result in undue concentration)], this notice must also be published once a week for three consecutive weeks in a newspaper of general circulation (other than a legal or trade publication) in the city where the premises are located, or in the nearest such newspaper if the licensed premises are not within a city [*Bus. & Prof. Code § 23986(b)*; *see Gov. Code § 6063*]. An undue concentration of licenses, in the case of on-sale retail license applications, exists when the ratio of on-sale retail licenses to population in the census tract or census division in which the applicant premises are located exceeds the ratio of on-sale retail licenses to population in the county in which the applicant premises are located [*Bus. & Prof. Code § 23958.4(a)(2)*; *4 Cal. Code Reg. § 61.3(a)*]. Although the ABC may deny an application if issuance would result in undue concentration of licenses [*see Bus. & Prof. Code § 23958*; *see also § 18.127*], it will nonetheless issue a license despite undue concentration under these criteria if the applicant is able to show that public convenience or necessity would be served by issuance [*4 Cal. Code Reg. § 61.3(a)*].

[2] FORM

Notice of Application for Change In Ownership of Alcoholic Beverage License [ABC-207-D]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
D. Post-Filing Forms

8-18 California Legal Forms--Transaction Guide § 18.241

AUTHOR: Lynne Carmichael

§ 18.241 Affidavit of Posting Notice of Application [ABC-293]

[1] Comment

[a] Use of Form

This form, Form ABC-293, is used by the applicant to verify the date on which the posting notice was posted. It is supplied to the applicant, along with the posting notice, upon acceptance of the application to transfer at the district office of the Department of Alcoholic Beverages ("ABC").

[b] Posting Requirement

After filing an application to engage in the sale of alcoholic beverages at any premises [*see 4 Cal. Code Reg. § 60(b)*; *see also § 18.221* (ABC-217)], the buyer must post on those premises Form ABC-207-B, "Public Notice of Application for Ownership Change" [*Bus. & Prof. Code § 23985*; *4 Cal. Code Reg. § 109*]. This requirement also applies to a buyer who has filed an application for premises that are to be constructed, or are in the process of construction [*Bus. & Prof. Code § 23985*; *see Bus. & Prof. Code § 24044* (license for premises under construction)]. The ABC provides the notice, which is two feet long and 14 inches wide, at the time the buyer files the transfer application [*see 4 Cal. Code Reg. § 109*].

The buyer must post the notice in a conspicuous place which can be readily observed by ordinary passersby at or near the entrance to the premises [*4 Cal. Code Reg. § 109*]. If the premises are a vacant lot, the buyer first must mount the notice on heavy cardboard or wood backing, and affix it to a post or stake of permanent material. The buyer then must place it at the midpoint of the largest boundary of the lot fronting on a public thoroughfare, not more than 10 feet from the sidewalk (or roadway if there is no sidewalk), so that it is readily visible from the sidewalk (or roadway) [*4 Cal. Code Reg. § 109*].

[c] Affidavit Requirement

Because the ABC cannot pursue its investigation and will not issue a license for the premises unless the buyer has complied with the posting requirement, he or she must notify the ABC of the date the notice is first posted [*Bus. & Prof. Code § 23985*]. Posting should be accomplished within 5 days from the application date, but the parties may wait longer to post. Any delay in posting will delay the ABC's investigation [*see* Form].

[2] FORM

Affidavit of Posting Notice of Application [ABC-293]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
D. Post-Filing Forms

8-18 California Legal Forms--Transaction Guide § 18.242

AUTHOR: Lynne Carmichael

§ 18.242 Statement Regarding Consideration Deposited in Escrow [ABC-226]

[1] Comment

[a] Use of Form

This form is a statement by the applicant for a retail license transfer (the buyer) that the consideration for the transfer has been deposited into escrow. It is prepared by district office of the Department of Alcoholic Beverage Control ("ABC") at the time of filing the application.

[b] Filing Requirement

If the buyer has applied for transfer of a retail license limited in numbers [*see Bus. & Prof. Code §§ 23815-23827* (limitation on number of licensed premises); § 18.30], off-sale beer and wine license, on-sale beer and wine license, on-sale beer public premises license, or on-sale general license for seasonal business [*see Bus. & Prof. Code § 24073*], he or she must also file a statement under penalty of perjury that the purchase price set forth in the escrow agreement [*see Bus. & Prof. Code § 24074*] has been deposited with the escrow holder [*Bus. & Prof. Code § 24074.3(a)*; *see* Section I of Form]. The escrow holder must confirm the information, and certify that disbursement of the consideration will not establish a preference for any creditor of the seller except as provided by law [*see* Section II of Form].

The buyer must transmit the statement to the ABC within 30 days after the transfer application was filed [*see Bus. & Prof. Code § 24074.3*]. Although the ABC may extend the 30-day period for good cause, it will not transfer the license until it has received the statement [*Bus. & Prof. Code § 24074.3*]. Upon filing this statement, the buyer must also give copies to the seller and escrow holder [*Bus. & Prof. Code § 24074.3(a)*]. The ABC will return the form to the escrow holder on the day the license is transferred [*see* Section III of Form].

[c] Exception to Filing Requirement

A buyer is not required to open an escrow and file this form if (1) the transfer involves an off-sale beer and wine license, and (2) a corporation files a guaranty of full, prompt, and faithful payment of all claims of bona fide creditors of the seller that is acceptable to the creditors [*Bus. & Prof. Code §§ 24074.3(b), 24074.4*]. The guarantor corporation must have a net worth on a consolidated basis of not less than $5 million according to its most recent audited financial statement [Bus. & Prof. Code § 24074.4(b)]. The ABC will not transfer the license until the guarantor has paid all creditors' claims in full in cash or by certified check in a manner acceptable to the creditors, and has filed a statement under penalty of perjury that all conditions of the transfer have been satisfied [*Bus. & Prof. Code § 24074.4(a)*].

[2] FORM

Statement Regarding Consideration Deposited in Escrow [ABC-226]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
D. Post-Filing Forms

8-18 California Legal Forms--Transaction Guide § 18.243

AUTHOR: Lynne Carmichael

§ 18.243 Notice to Creditors Regarding Distribution

[1] Comment

[a] Use of Form

This form is a notice to creditors that the amount of cash deposited by the buyer in escrow is insufficient to pay in full all of the claims timely filed with the escrow holder. For an example of a similar form used for the sale of a business that does not include a retail alcoholic beverage license, see *Ch. 17, Buying and Selling a Business or Professional Practice, § 17.271*.

[b] Required Contents

Not more than 10 days after the retail alcoholic beverage license has been transferred, and prior to distribution of the assets deposited by the buyer into escrow, the escrow holder must advise each creditor who has filed a timely claim whether or not there are sufficient assets in the escrow to pay all creditors in full [*Bus. & Prof. Code § 24074.1*]. If the assets in escrow are sufficient to pay all creditors in full, the notice must specify the date on or before which payment will be made. If the assets are insufficient to pay all creditors in full, the notice must state all of the following [*Bus. & Prof. Code § 24074.1*]:

- The total assets deposited into escrow and the nature of each asset.
- The name of each creditor who filed a claim against the escrow, and the amount of each claim.
- The amounts the escrow holder proposes to pay or set aside for each creditor.
- The date on or before which the escrow holder will distribute the assets to creditors.

For a discussion of the order of priority for payment of the available funds [*Bus. & Prof. Code § 24074*], see *§ 18.51[2]*.

[2] FORM

Notice to Creditors Regarding Distribution

NOTICE TO CREDITORS REGARDING DISTRIBUTION

NOTICE IS HEREBY GIVEN pursuant to *Business and Professions Code Section 24074.1* that on _____[*date*], _____[*name of seller*] transferred to _____[*name of buyer*] retail alcoholic beverage license No. _____ and the business known as "_____" [*name of business*], and that there [are *or* there are not] sufficient assets in escrow to pay all creditors in full.

[*If there are sufficient assets:*]

Payment to all creditors who have filed timely claims will be made on _____[*date*].

[*Or, if there are insufficient assets, insert 1-3, below:*]

1. The assets deposited into escrow have a total value of $_____, and are as follows:

(a) [*describe asset*].

(b) [*describe asset*].

(c) [*describe asset*].

2. The following creditors have filed timely claims for the following amounts:

(a) _____[*name of creditor*]: $_____.

(b) _____[*name of creditor*]: $_____.

(c) _____[*name of creditor*]: $_____.

(d) _____[*name of creditor*]: $_____.

3. Payment to all creditors who have filed timely claims will be made on or before _____[*date*], in the following amounts:

(a) _____[*name of creditor*]: $[*amount proposed to be paid*].

(b) _____[*name of creditor*]: $[*amount proposed to be paid*].

(c) _____[*name of creditor*]: $[*amount proposed to be paid*].

(d) _____[*name of creditor*]: $[*amount proposed to be paid*].

[*Continue with the following:*]

_____ Dated:

ESCROW HOLDER

_____ [*signature of escrow holder*]

[*typed name*]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
D. Post-Filing Forms

8-18 California Legal Forms--Transaction Guide §§ 18.244-18.249

AUTHOR: Lynne Carmichael

[Reserved]

§§ 18.244[Reserved]



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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
E. Withdrawal or Denial of License Transfer Application

8-18 California Legal Forms--Transaction Guide § 18.250

AUTHOR: Lynne Carmichael

§ 18.250 Application Withdrawal [ABC-209]

[1] Comment

[a] Use of Form

This form is used by the buyer or the seller, or both jointly, to withdraw a pending application for transfer prior to the ABC's approval of the transfer. If only one party files to withdraw the application, the ABC will notify the other party and wait 10 days before processing the withdrawal [ABC Instructions, Interpretations and Procedures, Vol. I, p. L 159 (6/2/82)]]. This form also authorizes payment of the refund of application fees to the person designated in the form. One fourth of the license fee paid (up to a maximum of $100) is not returned to the applicant [*Bus. & Prof Code § 23959*].

[b] Protests

If the parties withdraw the application because of a protest or protests, the applicant may not refile an application for the same premises for one year from the date of withdrawal [*Bus. & Prof Code § 24013.1*].

[2] FORM

Application Withdrawal [ABC-209]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
CHAPTER 18 BUYING AND SELLING A RETAIL ALCOHOLIC BEVERAGE LICENSE AND BUSINESS
PART IV. FORMS
E. Withdrawal or Denial of License Transfer Application

8-18 California Legal Forms--Transaction Guide § 18.251

AUTHOR: Lynne Carmichael

§ 18.251 License Action Request [ABC-231]

[1] Comment

[a] Use of Form

This form, Form ABC-231, is used, among other uses, to reinstate a license surrendered so that a temporary permit could be issued to a potential buyer. If the buyer or seller, or both, withdraw the application to transfer and the seller wishes to resume operation of the business, the seller must submit this form.

[b] License Reinstatement

If the parties withdraw the application or the ABC denies the application for license transfer [*see § 18.52[1]*], the licensee must request the return of his or her license to avoid revocation. The ABC may reinstate a surrendered license pursuant to a request by the licensee made at least 10 days prior to the date of reinstatement [*4 Cal. Code Reg. § 65(c)*]. As a condition of reinstatement, the licensee must certify that (1) no change of ownership of the licensed business has occurred; and (2) the premises possess the same qualifications required for the original issuance of the license [*4 Cal. Code Reg. § 65(c)*].

[c] License Revocation

A surrendered license may be revoked if it is not transferred to another person or premises, or redelivered pursuant to a license action request with resumption of licensed activity, within one year of the surrender date [*4 Cal. Code Reg. § 65(d)*]. If the license was surrendered so that a temporary permit could be issued to an intended buyer, the surrender date will be the date of denial of the application for license transfer [*see* Form]. The ABC, however, may extend the one-year period for good cause if [*see 4 Cal. Code Reg. § 65(d)*]:

- An application for transfer of the surrendered license is pending;

- Litigation other than that involving disciplinary action by the ABC is pending;

- The premises for which the license was issued and for which the license is sought to be redelivered were destroyed due to circumstances beyond the control of the licensee by fire, flood, or other natural catastrophe, or as part of an urban renewal program, and the licensee makes an affirmative showing of good faith efforts to obtain reconstruction; or

- The Director of the ABC finds a case of undue hardship warranting an extension.

[2] FORM

License Action Request [ABC-231]

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DIVISION I: BUSINESS AND NONPROFIT ORGANIZATIONS
Chapters 19 [Reserved]

8-19 California Legal Forms--Transaction Guide Chapters 19

[Reserved]

Chapters 19[Reserved]